Weekly Review
48 • 29.11.2019

BOFIT

# Russia

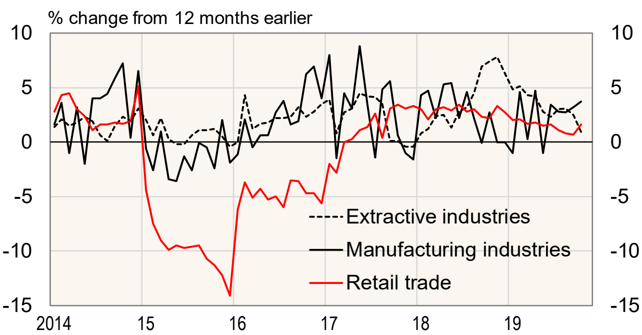
**Russian economic growth remained moderate in October.** Russian manufacturing growth in October accelerated to above 3.5 % y-o-y (growth averaged just over 2 % in the first nine months of this year). The higher growth in October largely reflected a jump in oil refining output, a branch that experienced fairly weak growth in the previous six months. Growth in extractive industries, however, fell to an unusually low level of less than 1 % with simultaneous contractions in oil and gas production, a situation not seen in two years.

Agricultural production continued to show robust growth, and the nearly 4 % growth in January-October points to similar figures for the whole year. Construction activity rose in October by 1 % y-o-y, which was somewhat better than the below 0.5 % pace of January-October. Like in the third quarter, the volume of goods transported fell slightly in October, but still diverged sharply from the strong growth seen in previous years and in the first half of this year.

Growth in fixed investment improved slightly in the third quarter, but was still below 1 % y-o-y. Growth was just 0.7 % y-o-y in the first nine months of 2019.

Retail sales growth recovered from its slow pace late this summer to over 1.5 % y-o-y in October, the pace for the January-October period. Growth in real household incomes strengthened in the third quarter. Consumer credit continued to support the recovery in consumption, even if that credit support impulse has been lower than in 2018. The growth of consumer borrowing flow has been lower this year than in previous years, even if it still outpaced inflation.

**Real growth in Russian industrial output and retail sales**




*Source: Rosstat.*

**Russian gas giant Gazprom share package to unknown buyer.** Gazprom, one of Russia's largest listed companies, sold 3.6 % of its shares via the Moscow Exchange last week. The offered shares had been held by a Gazprom subsidiary, and the offering was valued at around 190 billion rubles (2.7 billion euros) as the shares sold at an 11 % discount to the closing price preceding the placement.

A similar type of sale took place last July, when Gazprom subsidiaries sold a 2.9 % stake in parent-company shares. The offering at that time was valued at around 140 billion rubles (2 billion euros) and the shares were also sold at a small discount. In both rounds, all offered shares were purchased by a single unidentified investor.

Even with the offerings, the majority of Gazprom shares continue to be held by the Russian government. Gazprom estimates that its free float has now risen to 49.6 % of the share capital. Gazprom has a 15 % free-float weighting in the Moscow Exchange's RTS index, which is calculated in dollars.

**Global energy market trends not expected to cause big changes for Russia in near term.** The base scenario used in this year's [World Energy Outlook]() from the International Energy Agency (IEA) foresees slow growth in global demand for oil & gas in the years ahead, with the oil price climbing gradually to around 80 dollars a barrel by 2025. The emphasis in demand growth should shift increasingly to Asia.

In the IEA's base scenario, global oil demand grows at 1 % a year until 2025, with most demand growth coming from Asia, particularly China and India. EU oil consumption is expected to fall by just over 1 % a year. Growth in oil production should come mainly from the US. Russian oil production will remain close to current levels as it is restrained by a voluntary production ceiling agreement with OPEC and the depletion of current fields under production. High costs and Western sanctions complicate Russian efforts to bring new oil fields on stream.

The IEA expects growth in global demand for natural gas to average slightly less than 2 % a year until 2025. Again, most growth in demand will come from Asia, mainly China. No growth is expected in EU gas demand. The IEA estimates that Russian natural gas output will rise at just under 2 % a year on average until 2025.

While the IEA's base scenario "Stated Policies" takes into account the energy policies announced by various countries, the report also offers two alternative scenarios. In the first alternative scenario, current policies continue and oil & gas demand rise slightly faster than in the base scenario. The Sustainable Development scenario is aligned with the Paris climate accord. Global oil demand begins to decline in the near future, while gas demand up to 2025 grows at only about half the rate of the base scenario.

Crude oil, oil products and natural gas remain major export products for Russia. Their aggregate export value last year amounted to 260 billion dollars (16 % of GDP), accounting for 45 % of Russia's total exports of goods and services. While the EU is Russia's largest export market for oil & gas, its share of exports will likely decline in coming years as the focus of demand growth continues to shift to Asia. China accounted for over 25 % of Russian oil exports last year, while its share in gas exports was small. China is set to become a more important export market for Russia also in gas, however, with the launch of LNG production on the Yamal peninsula and the commissioning of the Power of Siberia pipeline.

Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160, FI-00101 Helsinki
Phone: +358 9 183 2268 • Web: www.bofit.fi/en

Editor-in-Chief Jouko Rautava• Email: Jouko.Rautava@bof.fi

Weekly Review
48 • 29.11.2019
BOFIT

# China

**Increased risks to financial system worry China's central bank.** The *Financial Stability Report* released by the People's Bank of China this week warns of considerable risks accumulating in the financial sector due to the ongoing slowdown in economic growth and structural economic problems it exposes. The report notes, however, that risks related to key actors have no more increased.

The PBoC performed stress tests on 30 large and mid-sized banks. The tests revealed that the quality of loan portfolios held by the sampled banks would rapidly degrade in the event of an economic slowdown. Even in the rather benign scenario, where real GDP growth falls to 5.3 % p.a., the stock of non-performing loans rises from 1.5 % to 5.4 % of all loans, while capital adequacy ratios fall from 14.5 % to 13.5 %, a level the PBoC still considers satisfactory.

Based on its risk assessment, the central bank divides into ten categories the various financial sector entities subject to banking supervision (e.g. all banks, corporate financial institutions, car finance companies, consumer finance companies and finance leasing companies). Risk is small for most large banks, but some carry mid-level risk level. In contrast, 586 actors out of 4,355 small and mid-sized financial institutions fall into the high-risk category. The PBoC says private and foreign financial companies typically receive good scores, while many rural banks belong in the high-risk category.

Indeed, the government has had to bail out some small and mid-sized domestic banks this year. At the end of May, officials took over Baoshang Bank. In July and August, public funds were expended on recapitalising the Jinzhou and Hengfeng banks. In November, the government bought out the stakes of six private shareholders in Harbin Bank. October and November also brought runs on the small Yingkou and Yichuan banks. The runs occurred despite the fact that Chinese deposit insurance fully covers deposits up to 500,000 yuan (nearly 65,000 euros). Increased uncertainty has driven up financing costs for small banks, forcing them to raise their deposit rates to attract new depositors and retain long-term depositors.

**China's central bank plans to issue its own digital currency in the future; details still sketchy**. The People's Bank of China hopes to implement an electronic form of yuan to complement, rather than compete with, traditional yuan notes. The innovation is unlikely to have an immediate impact on bank deposits. As planned, households and small firms would be able to store and use the new electronic money in common types of payment transactions.

None of the technical solutions employed or the launch dates for this new kind of money have yet been announced. Rumours on these details circulating in the media seem often to be baseless speculation.

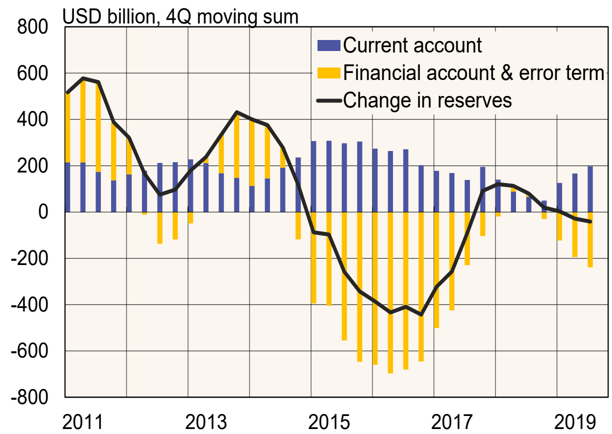
**PBoC tightens control of bitcoin and other cryptoasset services.** Activities involving cryptoassets in China are strictly regulated or banned. When initial coin offerings (ICOs) were forbidden in 2017, the government also cracked down on trading in cryptoassets, forcing crypto exchanges out of business. Banks are not allowed to get involved in any form of cryptoasset services. Even a ban on the "mining" of cryptoassets was briefly considered.

Despite the bans, interest in cryptoassets flourishes. Last week, the Shanghai division of the PBoC shut down several illegal cryptoasset operations. Inspections in Shenzhen also turned up similar illegal activities. As a lot of Chinese evidently still use virtual assets, stricter policies may affect prices of virtual currencies such as bitcoin.

**Capital outflows from China continued in the third quarter.** Preliminary balance-of-payments figures show a current account surplus of 59 billion dollars in the July-September period. The 12-month current account surplus has increased to about 1.4 % of GDP. Much of the increase was caused by lower value of goods import and a reduction in the services trade deficit. The change in currency reserves this year has been small. Overall, this translates into an increase in net capital outflows, which is measured as the sum of the financial account and the "net errors and omissions" term in the balance-of-payments accounting.

Later revisions of balance-of-payments data could alter the view on how much capital actually flowed out of the country. Revisions for the first two quarters of 2019 have produced reductions in the current account surplus by nearly 30 % from preliminary estimates. Using the new estimates, the amount of the net capital outflows diminished slightly. In the first half of this year, the outflow of capital was in fact "unclassified" and showed up in the net errors and omissions term which was clearly negative. The combined recorded figures for the capital and financial accounts indicated a small surplus.

**Trends in China's balance-of-payments, 2011–2019**




*Sources: Macrobond, SAFE and BOFIT.*