Weekly Review
5 • 1.2.2019

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Russia

United States Treasury lifts sanctions on Russian aluminium giant Rusal. On Sunday (Jan. 27) the Treasury lifted sanctions on the energy company EN+, the aluminium producer Rusal and the energy producer EuroSibEnergo. EN+ owns large stakes in Rusal and EuroSibEnergo.

The companies were added to the sanctions regime against Russia in April because sanctioned business magnate Oleg Deripaska, who has close ties with the Kremlin, directly or indirectly held substantial stakes in all three companies. The sanctions were lifted after Deripaska's holdings in the companies were transferred to the Russian VTB Bank and other entities in order to reduce his overall holdings below 50 %. The sanctions on Deripaska himself remain in place.

Because the divestment has little effect on the Russian government's ties to these companies, some factions in the US Congress sought to oppose the lifting of sanctions. However, they were not able to gather enough support to block it.

Russian industrial output grew at a moderate pace last year. Industrial output in 2018 was up 2.9 % from the previous year. However, seasonally-adjusted time series have shown little indication of growth since last spring.

Output of extraction industries grew faster last year than other industries, increasing by 4.1 % from the previous year. Oil production grew strongly towards the end of the year after the Organization of the Petroleum Exporting Countries (OPEC), Russia and several other countries agreed on a looser interpretation of their production quotas. Production should decline this year, however, with the introduction of lower production ceilings.

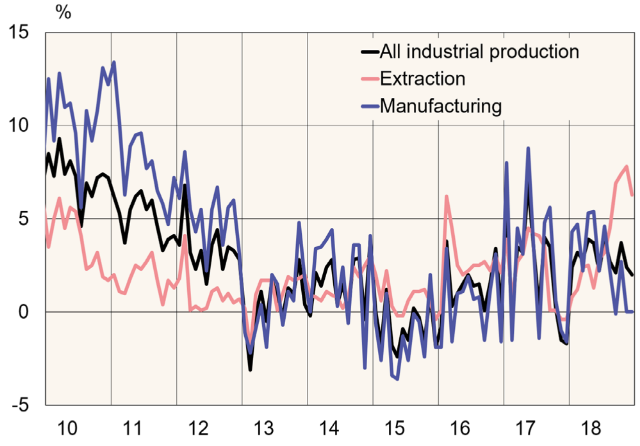
Manufacturing growth slowed towards the end of last year. Last year, production grew 2.6 % from the previous year, but in December, it was at the same level as in previous December. Different manufacturing branches have grown quite evenly. However, pharmaceutical and forest industries have grown somewhat faster, while metals and auto industries somewhat slower.

Construction activity statistics have been revised by the Russian Statistics Service to an exceptional degree. December figures showed that construction activity last year was roughly on the same level as the previous year. Revised figures released in January show construction had grown by 5.3 %. Especially the figures for northern regions involved in oil and gas production were revised sharply upwards. Explanations for the revision have been mostly general in nature.

The volume of goods transport last year was 2.9 % larger than in previous year. Almost half of transports go through pipelines and almost half on rail. Transit freight is not significant enough to much affect the growth figures. The Power of Siberia natural gas pipeline will not increase the overall pipeline transmission volumes until next year.

Agricultural output was down 0.8 % from 2017. Grain harvests were 16.7 % lower than in 2017, but still at a level well above the average of the past decade. Wheat accounts for two-thirds of the grain harvest. Because Russia exports quite a lot of wheat, the smaller crop is likely to affect global wheat prices. For many countries in the Middle East, the fertile southern steppes of Russia are a major wheat source. It was still unclear last autumn whether Russia would limit grain exports to hold down domestic prices. It now seems that idea is off the table for now.

Annual growth in Russian industrial output



Sources: Rosstat, Macrobond.

Central Bank of Russia resumes forex-buying mandated by fiscal rule. On January 15, the Central Bank restarted its foreign currency buying tied to the government's fiscal rule after a five month hiatus (for more, see BOFIT Weekly 2018/35 and 2018/38). Last Friday (Jan. 25), the CBR announced it would today (Feb. 1) commence its foreign currency purchases under the fiscal rule that were postponed in last fall.

Since the beginning of 2017, the CBR has purchased under the fiscal rule daily a pre-announced amount of foreign exchange on behalf of the finance ministry. During the period from January 15 to February 6 this year, the finance ministry is using, on average, 15.6 billion rubles (240 million dollars) a day for the forex buys, which in total corresponds to about 265 billion rubles (4 billion dollars). The finance ministry has yet to announce the schedule for the next forex buy.

The CBR will make up for its postponed foreign currency purchases under the fiscal rule gradually over the 36 months. These purchases will increase daily forex purchases under the fiscal rule by 2.8 billion rubles. The CBR may temporarily halt the purchase programme as needed.

Market observers note that the currency-buying in line with the fiscal rule could cause a slight depreciation of the ruble. Large impacts are not expected, however, as the daily forex-buying under the fiscal rule accounts for a small fraction of the forex market's daily turnover. Since the resumption of forex buying, the ruble's exchange rate against the dollar and euro has appreciated just over 1 % (as of February 1, USD 1= RUB 65.5; EUR 1= RUB 75.0).

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China

Corporate bond issues in China up again last year. People's Bank of China figures show that at the end of 2018, the stock of bonds on issue in the country totalled 86 trillion yuan (12.5 trillion dollars, equivalent to 96 % of GDP). The stock of bonds on issue increased last year by 16 % y-o-y. Bond issues were up 7 % y-o-y. New corporate bond issues increased last year by nearly 40 %, after contracting more than 30 % in 2017.

Banks account for 38 % of the bonds on issue (including policy banks), non-bank corporations 24 %, local governments 21 % and the central government 17 %. The stock of bonds issued by foreign institutions in mainland China grew by over 50 % last year, but was still just 155 billion yuan (23 billion dollars). At the end of September 2018, mainland China bonds held by foreign investors amounted to 1.75 trillion yuan. The volume rose by 58 % y-o-y, but was still just 2 % of China's bond market overall.

China has started to allow bond defaults in recent years, though the authorities still try to use various arrangements to avoid open defaults of troubled firms. The credit rating company Fitch reports that the number of bond payment defaults in mainland China rose from 25 in 2017 to 117 last year. The total value of payment defaults of 45 firms last year was 111 billion yuan (16 billion dollars). The amount includes four state-owned enterprises. The payment defaults have shed light on China's complex financing arrangements and brazen misrepresentation of company finances.

According to Fitch, rising risk pushed investors last year to prefer government bonds or bonds of firms with high-quality credit ratings. This was also seen in the widening interest rate gap between the bonds of firms with poor and good credit ratings. On Tuesday (Jan. 29), the interest rate on the one-year government bond was 2.4 %, the yield on the highest rated corporate bond (AAA+) was 3.2 % and the lowest high-quality corporate bond (AA-) 5.7 %.

China's markets open up to international credit ratings agencies. At the end of January, the People's Bank of China granted American credit rating agency S&P Global a licence to begin rating the creditworthiness of bonds traded on China's interbank markets. The ratings agencies Moody's and Fitch are likely to follow.

The government hopes that the presence of international ratings agencies will encourage competition, bring credibility to the credit assessments of Chinese firms and create a new wave of foreign investors in China. Local credit assessment agencies are currently seen as handing out excessively high credit scores to their clientele. Some of the pressure to let the major players onto the Chinese market also comes from the current trade war and China's growing need to finally deliver on its commitments to open its markets to the world.

The Chinese operating environment is difficult for credit ratings agencies. In recent months, for example, there have been several situations where companies that appeared solvent on paper could not service even minor debts.

Venezuela causes headaches for China and Russia. Amidst Venezuela's catastrophic economic crisis and political impasse, opposition leader Juan Guaidó declared himself interim president on January 23. The move occurred just weeks after president Nicolas Maduro was inaugurated to his second term. The United States and several Latin American countries immediately recognised Guaidó, while China and Russia said they backed the Maduro administration. Venezuela offers both China and Russia a strategic foothold in the Western Hemisphere, an opportunity both countries have pursued through lavish financing to Venezuela.

Several sources report that since 2008 China has lent Venezuela roughly 60–70 billion dollars to fund infrastructure and oil projects. Repayment of these loans is tied largely to oil supply contracts. Just last September, China granted Venezuela a 5-billion-dollar loan. Venezuela is currently thought to owe China something the range of 20–25 billion dollars. Venezuela earlier was China's seventh largest oil supplier, accounting for about 5 % of China's oil imports. China's imports from Venezuela declined by nearly a quarter last year, lowering Venezuela's share of Chinese oil imports to just 3.6 %.

While China's financing to Venezuela dwarfs the Russian input, the Russian government and the state-owned oil company Rosneft have granted credit to Venezuela since 2006 amounting to at least 17 billion dollars in total. Most of this credit is likely tied to oil supplies. Last November, the government continued to provide financing to Venezuela by agreeing to reschedule a loan for more the 3 billion dollars. So, this is the minimum outstanding amount Venezuela currently owes to Russia. By its own reports last autumn, Rosneft's claims on the Venezuelan government exceeded 3 billion dollars. Russia and China also hold stakes in the Venezuelan oil industry.

Figures from the Stockholm International Peace Research Institute (SIPRI) show Russia and China began exporting arms to Venezuela in 2006. During 2006–2016, Russia accounted for 74 % of arms sales to Venezuela. China, with an 11 % share, was the second largest supplier of arms to the country. Venezuela's arms imports appear, however, to have collapsed around 2015.

Venezuela's actual debt situation is very confused and the country no longer has the ability to service its debts. Reuters puts Venezuela's foreign debt at about 140 billion dollars, of which 60 billion dollars are government sovereign bonds or bonds issued by the state-owned oil company PDVSA. The remainders are credits granted by foreign governments and international institutions. Even if the country has the largest oil reserves in the world, its situation has deteriorated with the decline of oil prices in dollars, decreased production and the collapse of the bolivar. The situation also complicates debt repayment to China and Russia. The US sanctions imposed on Venezuela's oil industry and oil exports on Monday (Jan. 28) will only aggravate debt crisis of the Maduro administration.

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