

Russia

Banking operations recovered last year. After slumping in previous years, growth of household deposits accelerated rapidly throughout 2010. Deposits increased 31 % in nominal terms, almost resuming their pre-crisis growth path. Foreign currency deposits as a share of total household deposits contracted from 26 % to 19 %, suggesting that Russian households had greater confidence in both the economy and the ruble.

Lending to households saw a nominal increase of 14 % in 2010, while loans to firms increased 12 %. (The stock of loans to households in 2009 contracted 11 % and the stock of corporate loans was unchanged). Last year's development reflects improving economic conditions and lower interest rates. The average rate on short-term corporate loans of less than a year fell to just 9.2 % at the end of 2010. 12-month inflation is expected to be around 8 % this year.

The economic crisis has driven banks to sharply increase investment in securities, particularly bonds. As of end-December, securities constituted 17 % of total banking sector assets (up from 8 % in January 2009). Banks prefer to support firms by purchasing their bonds as banks can use bonds as collateral in their own borrowing.

At the end of last year, Russia had 1,012 credit institutions, 955 of which were banks. The number of banks declined by 52 over the course of 2010. The Central Bank of Russia pulled the licenses of 27 banks for regulatory infringements. Other banks were swallowed up in mergers, a growing phenomenon in Russia. A few tiny banks lost their licenses simply because they could not meet the minimum capital requirement. These banks continued to operate under a limited license that e.g. does not include the right to take in household deposits.

The number of banks is expected to continue to shrink. One reason is a further increase in the minimum capital requirement. The minimum capital requirement for banks operating in Russia will rise in January 2012 from the current 90 million rubles (€2.3 million) to 180 million rubles.

Russia's five largest banks are all state-owned and together control 48 % of total banking sector assets. The banks owners are the central bank, the state, state enterprises or municipalities. The share of total assets held by banks owned by public-sector entities increased from less than 40 % in 2007 to over 50 % in 2010.

Moreover, Russia's large public-sector banks continue to increase their market position. The country's largest bank, Sberbank, is currently in negotiations to buy the private investment bank Troika Dialog. State-owned VTB is acquiring a stake in Transkreditbank (which is majority-

owned by Russian Railways), as well as a stake in Bank Moskvyy (majority-owned by the City of Moscow).

State divests a 10 % stake in VTB. The VTB offering held last week was the biggest privatisation sale since the government last year approved its plan to divest important state assets. The state majority-owned VTB has expanded rapidly over the past few years and is now the second largest bank in Russia.

The share offering took place on February 7. With a sales price close to the previous day's average price on the Moscow and London stock exchanges, the sale raised just under 96 billion rubles (about €2.4 billion) for the state. After the sale, the Russian state holds a 75.5 % stake in VTB.

According to press reports, the largest individual investor was Russian billionaire Suleiman Kerimov. Most investors were non-Russians, led by the Italian Generali finance group and the American investor group TPG Capital. Other institutional investors included the Harvard Endowment and China Investment Corporation (CIC). CIC is the first Chinese institutional investor to make significant investments in the Russian economy. Foreign investors already holding VTB shares also increased their holdings.

After the deal, VTB's owners will consist of the Russian state and 5–10 major investors, each with stakes of about 1 %. The sale increased the free float of VTB shares to about a quarter.

Russia's machine-building industry stares into the abyss. Russia's ministry of industry and trade reports that the domestic machine-building industry has over the past years lost market share both domestically and internationally. As Russia's economy grew briskly during the 2000s, an increasing part of new machinery and equipment was bought from abroad. Companies building machinery for the oil and gas, mining and metal refining and fabrication industries have been some of the hardest hit among domestic producers.

The average capacity utilisation of machine-building businesses has fallen to around 30 %, and over a quarter of all companies in the branch are currently operating in the red. The ministry of industry and trade says antiquated production technology and broken-down facilities have rendered most production facilities uncompetitive.

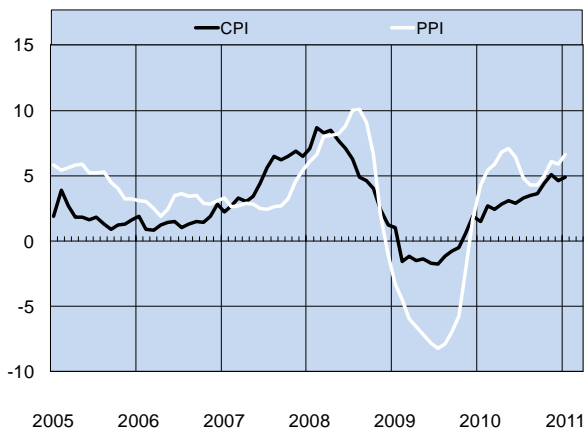
The ministry of industry and trade has drafted a policy paper on revitalising the machine-building sector over the next decade. State support would be used to stem the decline and modernise companies in the branch. The ministry has suggested support such as interest subsidies for investment loans, direct budget funding for innovation and more favourable customs treatment. The ministry has also proposed establishing joint ventures with top international firms.

China

Inflation picks up; housing's share of consumer shopping basket increased. China's consumer price index was up 4.9 % y-o-y in January (4.6 % in December), slightly below consensus expectations. Producer price inflation was 6.6 % y-o-y (5.9 %). The main factors fuelling inflation also in the coming months are soaring food and commodity prices driven by revived global demand and supply disruptions due to extreme weather events. The recent flooding in eastern Australia, for example, hit China's supplies of coal and iron ore, while drought in northern China has threatened the winter wheat crop in some of the country's main wheat-growing areas.

Lending was lower than expected in January and money supply growth (M2) slowed to about 17 % y-o-y (down from nearly 20 % in December). While the People's Bank of China is believed to continue monetary tightening, the fact that it has not published its target for credit growth for this year is an indication of ongoing small changes in the current monetary policy framework. Also reserve requirements policy focusing on bank deposits will be adjusted to better take into consideration the specific characteristics of individual banks.

China's inflation, 12-month percentage change

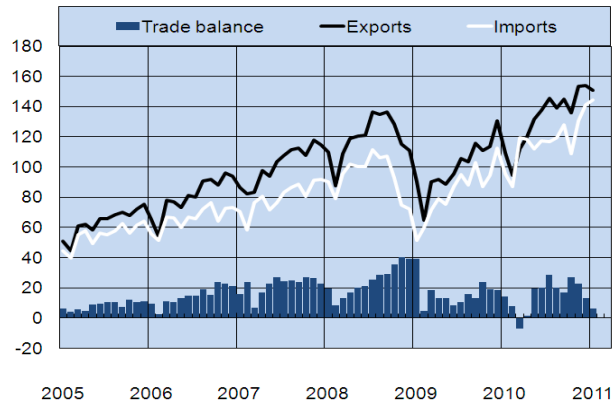


China's National Bureau of Statistics has slightly adjusted the structure of the basket of goods and services used in calculating consumer price inflation. The weighting of spending on food was lowered two percentage points to about 30 % of the basket. The share of spending on housing, long seen as understated, was increased four percentage points to 17–18 %. Weightings for other items were reduced slightly. The change had only a marginal impact on the January inflation figure.

China's foreign trade surplus shrank to \$6.5 billion in January. Exports in January hit \$150 billion (annual growth 37 %), and imports climbed to a record \$144 billion (51 %). As a result, China's trade surplus shrank more than \$6 billion from December and was substantially lower than a year ago.

The robust import growth reflects rising domestic demand and higher world commodity prices. China, the world's largest iron ore purchaser, saw the volume of iron ore imports increase nearly 50 % y-o-y in January, but the value of iron ore imports was up 150 %. Similarly, the volume of oil imports rose 25 %, but the value of oil imports was 50 % higher than in January 2010.

China's monthly foreign trade figures, USD billion



United States files complaint with WTO on China's domestic electronic payments. The US complaint says China restricts yuan-based card payments exclusively to cards issued by the Chinese UnionPay. After bilateral talks launched last autumn failed to resolve the dispute, the matter moved to WTO committee (which could take up to two years to decide the matter).

During its ten-year WTO membership, 21 complaints on 13 matters have been filed against China. The complaints include equal treatment of domestic and foreign firms, pirate production and supply of financial information. Nine of these cases were resolved with Chinese promises to make regulatory changes. Besides payment cards, disputes over corporate subsidies, raw material exports and metal product imports remain unresolved.

China has filed seven complaints with the WTO; five against the US and two against the EU. All China's claims concern anti-dumping measures, and it has won on half of its complaints. Last autumn China won its challenge to the EU's imposition of a five-year anti-dumping duty on Chinese steel fasteners. The WTO is currently hearing a Chinese complaint on EU anti-dumping duties on Chinese footwear.