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# BOFIT Weekly

27 • 8.7.2011

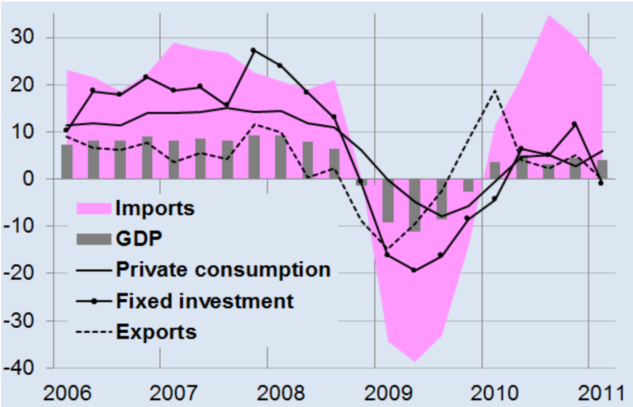
# Russia

**Rosstat releases first-quarter GDP figures.** Rosstat reports GDP grew well over 4 % y-o-y in the first three months of 2011. Private consumption rose substantially; up 5.7 % y-o-y. For the second quarter in a row, there was no on-year change in public consumption. The volume of exports was the same as in the first quarter of 2010. Fixed investments continued to contract slightly on year. Increased inventories were again a large contributor to GDP growth.

The trend of pre- and post-recession dynamics, where growth in demand has lead to more rapid growth in imports than in GDP seems to have remained, with imports climbing 23 % y-o-y in 1Q11.

Preliminary figures show that in late spring growth in private consumption was fairly strong, exports and investments revived and import growth remained high.

**GDP, imports and major demand components, change from the corresponding quarter of the previous year (%)**




*Source: Rosstat*

**MICEX and RTS bourses sign merger agreement.** After long negotiations, Russia's two largest securities exchanges moved ahead with a June 29 framework agreement to merge trading. The practical aspects of the merger should be completed at the beginning of 2012. The initial public offering of the merged exchange is expected in 2013.

The agreement still requires approvals from the Federal Antimonopoly Service and an extraordinary general meeting of the exchange shareholders that is set currently for August.

RTS is valued at 34.5 billion rubles (about €860 billion) and 103.5 billion rubles (about €2.6) for the MICEX. MICEX accounts for about 70 % of stock trading in Russia. The RTS is focused largely on derivatives trading.

According to MICEX and RTS agreement on merging the top Russian bourses represents a step towards creation of a major global financial centre. The goal of the new exchange is to become one of the world's top ten exchanges within five years.

New securities markets regulations were signed last week; President Dmitri Medvedev issued an order that the act on the single central depositary will be approved by early September. The act on the central depositary was approved by the Duma a few years ago. Officials have yet to reach agreement as to who will operate the central depository. So far, the RTS and MICEX have maintained their own depositories. A single central depository would greatly increase trading efficiency.

Medvedev also ordered to abolish limits on international IPOs by Russian firms. Previously, Russian companies holding IPOs on international markets were limited to offering no more than 25 % of the company's total stock. The limit was meant to encourage development of domestic stock markets. However, many companies skirted the restriction by simply listing their subsidiaries on foreign exchanges.

**Bank Moskvy restructures.** The current efforts to save struggling Bank Moskvy represent one of the largest bailout operations in Russian history. In May, Bank Moskvy was Russia's sixth largest bank when measured in terms of total capital.

The CBR has agreed with the Ministry of Finance and the Deposit Insurance Agency (DIA) on a plan to bailout the bank, whereby the DIA grants Bank Moskvy a 10-year loan of 295 billion rubles (about €7 billion) at an interest rate of 0.51 % p.a., i.e. well below current market rates. The remaining 100 billion rubles (about €2.5 billion) is to be raised from the bank's largest shareholder, VTB. The bailout package is only about 20 % smaller than the total capital of VTB, Russia's second largest bank.

One condition for receiving bailout assistance is that VTB commits to increasing its share of bank ownership from the current 46 % to 75 %. VTB, which is largely state-owned, purchased Bank Moskvy's voting share majority at the start of this year from the City of Moscow.

There have been several estimates as to the true size of Bank Moskvy's bad loan portfolio. Finance Minister Alexei Kudrin estimates the value of non-performing loans at around 250 billion rubles (over €6 billion), which represents about a third of the bank's total loan stock. As of end-May 2011, Bank Moskvy's total loan stock stood at about 740 billion rubles.

Bank Moskvy claims that it was saddled by the problem loans through the reckless lending activities of earlier management. The investigating committee at the Ministry of the Interior is currently looking into the role of former CEO Andrei Borodin in the case.

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# China

**China continues to hike rates.** Starting Thursday (July 7), the People's Bank of China increased its core rates 25 basis points. The hike means that the one-year deposit rate now stands at 3.5 % and the credit rate at 6.56 %. It was the third rate hike this year. As part of monetary tightening, the PBoC has also raised bank reserve requirements six times this year. Market rates have been sharply higher at the start of July than at the start of June.

The rate hike was long expected as Chinese 12-month inflation appeared to accelerate last month from the 5.5 % reported in May. Market participants are split as to how long the monetary tightening will continue. Those expecting further tightening note that real deposit rates remain negative and there is no hard evidence that inflation is subsiding. Others expect that the cooling economy will reduce pressures to raise prices and see China's decision-makers as reluctant to sacrifice growth potential by continuing measures to tighten the monetary stance.

The latest readings of the official indexes of purchasing manager sentiment suggest that growth in industrial and services output slowed in June from previous months. The lower growth was expected and desirable in order to gradually redress economic imbalances. The spectre of local administrations defaulting on their massive borrowing of recent years combined with lower growth, however, has increased worries about China's economy during the last month.

**Strong growth in Chinese FDI outflows abroad; modest slowing in FDI inflow growth.** China's foreign direct investment abroad was greater in the first five months of this year than in the first six months of 2010. For January-May, China FDI outflows reached $20 billion, compared to $18 billion in January-June 2010. Financial sector investments are not included in this figure. Sector-specific figures are only released once a year. China's largest receivers of investment last year included the service sector, mining, manufacturing and retail. Access to raw materials and acquisition of technology remained the top drivers of Chinese foreign investment.

Country-level figures are not yet available for 2010, but the 2009 statistics show that about 75 % of Chinese investment went to the Asia/Pacific region, 13 % to Latin America and 6 % to Europe. North America and Africa each received about 3 %.

Hong Kong was by far the biggest source of FDI for China, account for about 55 % of total FDI inflows. Asia's dominance in FDI was further backed by the contributions of Singapore (5 %), Japan (3 %), Korea (3 %) and Taiwan (2 %). The EU's share was about 6 % and the United States 3 %.

January-May FDI inflows to China amounted to $48 billion, an increase of 23 % y-o-y. Despite this, the flow of investment to China seems to have slowed since March. The value of US FDI declined nearly 30 % in January-May, possibly reflecting the US economy's tepid recovery. Europe's debt crisis appears to have had only minimal effect on China FDI provided by large EU countries. Moreover, even with the impacts of Japan's natural and nuclear disasters, Japanese investment in China rose 56 %.

In terms of value, FDI inflows to China in January-May were led by investments in industrial production (share 40 %) and real estate (20 %). Although they account for 5 % of FDI, highest growth was registered in mining (up 145 % y-o-y), transport, storage and postal services (86 %), and banking and insurance (54 %).

**China's Communist Party turns 90.** Thousands of party leaders and members gathered in Beijing on July 1 to celebrate the party's 90$^{th}$ anniversary. In his keynote address, president Hu Jintao warned that corruption is a serious problem inside the party that corroded the people's confidence in the party. The PBoC recently estimated that thousands of government officials had embezzled or stolen over $120 billion between 1995 and 2008.

With 80 million members, China's Communist Party is the world's largest political party. Party membership is more than an ideological statement; members enjoy enhanced opportunities for career advancement and access to China's ruling elite. The party reports that last year 31 % of members worked in state offices or state enterprises. The average party member is quite elderly − only a quarter of party members are under 35 years old. The prestige of party membership can be seen in the number of applicants. Of the 21 million who applied to join the party last year, only 10 % were accepted. To be eligible, applicants must demonstrate good standing in the community and loyalty to the party by submitting recommendations from current party members and their companies or work unit leaders. Applicants must also write an essay supporting the party.

China's single-party system clashes with the needs of a functioning market economy. In addition to opportunities for corruption, economic reform has meant a gradual transfer of power away from the central administration to local and provincial governments. Demand for political reforms has increased, and within the party there is an ideological struggle over the party's future direction. In the view of the party's more liberal members, increased social problems indicate a need for political reform. Members at the grassroots level are calling for greater democracy within the party. China witnessed a minor political crackdown as the 90-year anniversary approached. For example, over 100 activists were arrested and the Chongqing's Communist Party leader Bo Xilai has made headlines with his revival of Maoist propaganda.

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