

Russia

Stock market down after public protests over Duma elections. Following a rash of demonstrations in cities across Russia last weekend over Duma elections, share prices on Russia's main stock exchanges plummeted for two days (Dec. 12-13). State treasuries also shed value. Some of the drop reflected the general weakness of global stock markets.

Since Wednesday (Dec. 14), share prices have plateaued at a level above this year's low point in early October. Given the traditionally very volatile share prices in Russia, the current drop does not seem exceptionally large.

RTS index Jan. 1, 2010–Dec. 15, 2011



Source: RTS

The ruble's exchange rate weakened dramatically following the announcement of results of Duma elections. This week, however, the exchange rate rebounded somewhat, partly on euro weakness. Observers say the Central Bank of Russia seems to have been intervening in the currency market to prop up the value of the ruble.

Probably due to worries on high capital outflows, the CBR last week limited its liquidity credits available to banks. As a result, interbank lending rates have risen sharply and now stand at levels not seen for over two years.

Finance sector struggles with tight liquidity. The tightening liquidity situation has forced banks to rely increasingly on the central bank credit. As of end-November, CBR financing represented nearly 3 % of the banking sector's total liabilities while after the 2008–2009 financial crisis the share has typically been around 1 %. During the crisis, the share of CBR credit exceeded 12 %.

Average deposit and lending rates have also been on the rise since October. Especially the ten largest banks by deposit volume have hiked their rates significantly and started the hikes already in July. Rising interest rates and falling

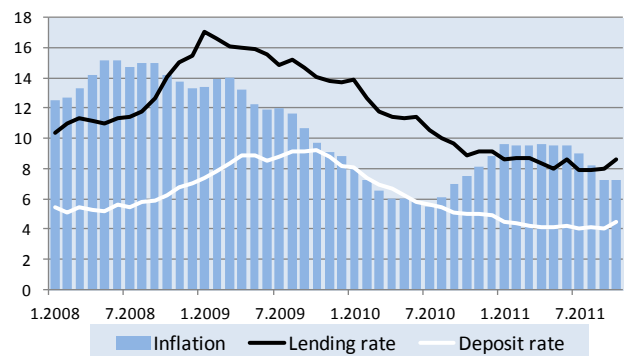
inflation have pushed average real lending rates back into positive territory.

In November, the finance ministry submitted a legislative proposal to the cabinet giving the CBR authority to limit deposit interest rates in situations where a bank is attempting to offer interest rates well above prevailing market rates to attract money during unstable economic conditions. The proposal would also set minimum rates for deposits; e.g. the minimum rate for ruble-denominated deposits would be 2/3 of the CBR refinancing rate (currently 8.25 %). The CBR was given similar authority during the 2008 financial crisis, but the enabling legislation expired in 2010. At the moment, the central bank merely provides guidance on appropriate interest rates. Rates on household deposits should not exceed by more than 1.5 percentage points the average of the deposit rates of the ten largest banks by deposit volume.

A 2008 law on bank restructuring set to expire in December has been extended through 2014. The shaky global recovery forced the extension. The law gives the central bank and the deposit insurance agency that deals with bank restructurings the right to intervene in troubled banks early on to help avert bankruptcy.

Under a new law passed this month, the minimum capital requirement for banks will rise from the current 90 million rubles (€2.1 million) to 300 million rubles (€7.2 million). The change applies to all new banks established after 1 January 2012, while the minimum capital requirement for existing banks increases to 180 million rubles next year and to 300 million rubles in 2015. The decision on hikes was made a couple of years ago, and after that smaller banks have gradually increased their capital or merged with other banks to keep their doors open. At present there are some 990 banks operating in Russia. Of those, 69 banks still had capital below 180 million rubles as of end-November. That was down from 103 at the end of October.

Average rates for household deposits, corporate credit and 12-month inflation, 2008–2011, % p.a.



Source: Central Bank of Russia

China

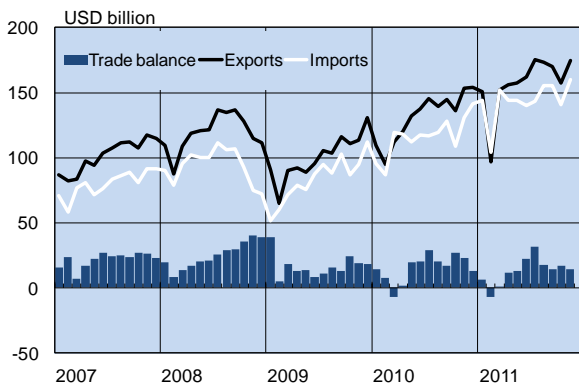
China export growth continues to slow. China's goods exports in November reached \$174 billion, a 14 % increase from a year earlier. Although 12-month growth remained brisk, it has shown signs of steady slowing since August. Seasonally adjusted figures indicate exports have held at the same level since late summer. The slowdown in exports largely reflects problems in the Eurozone; exports to Germany and France were flat and exports to Italy were down considerably. Export growth to Japan in recent months has fallen to 18 % y-o-y. Exports to the United States, in contrast, recovered to 13 % y-o-y growth in November. Although Chinese exports to emerging economies are still climbing rapidly, that growth, too, seems set to fade. Growth in emerging economies and, hence their imports are slowing, and their currencies have already declined against the yuan in recent months.

The value of Chinese imports climbed to \$160 billion in November, up 23 % y-o-y. Although growth in the value of imports has slowed this autumn, there is no indication of a dramatic slowdown in Chinese economy. The trend in import volumes of core commodities suggests demand remains strong.

China's goods trade surplus in November was about \$15 billion, which puts the trade surplus for all of 2011 on track to hit \$150 billion. In 2010, China's trade surplus was \$185 billion.

China's foreign trade provides a valuable snapshot of the overall condition and direction of global trade. During the global financial crisis in 2009, China surpassed Germany and the United States as the world's largest exporter. China currently accounts for about 11 % of world exports, while Germany and the United States each account for about 8 %. China's share of global imports is currently 10 %, while the US share exceeds 12 %.

Trends in China's foreign trade



Source: China customs

Inflation drops sharply in November. China's National Bureau of Statistics reports inflation slowed in November to 4.2 % y-o-y, down from over 6 % in September. The rise in prices of consumer goods, particularly food, slowed as the ample autumn grain crop made its way to market. Food prices have a large impact on Chinese inflation as food represents about a third of the CPI. November non-food inflation was 2.2 %.

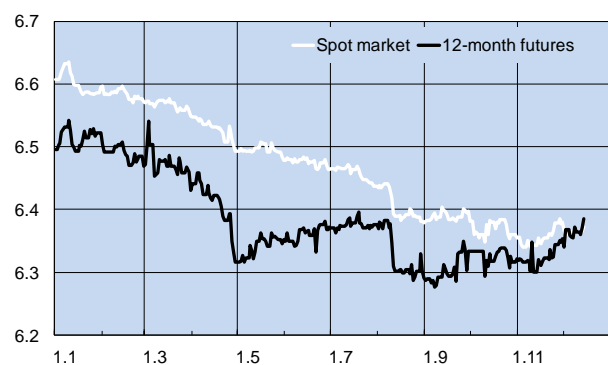
China's massive stimulus in 2009 and 2010 helped fuel inflation, and People's Bank of China reacted by tightening monetary stance during 2010 and 2011. The monetary measures have begun to bite, as inflation has fallen and growth in the broad money supply (M2) has slowed. M2 growth was 12.7 % y-o-y in November, the lowest growth in over ten years.

China began to relax its monetary stance this month by reducing the reserve requirement ratios for commercial banks. The loosening is expected to continue in the first half of 2012, as inflation is forecasted to decline.

Expectations of ongoing yuan appreciation begin to fade. The yuan-dollar exchange rate has remained around 6.36 in recent weeks, essentially unchanged from late October. Expectations about exchange rate trends are reflected in the price of yuan futures contracts, which currently anticipate modest yuan depreciation. The last time such a situation was seen was in the midst of the 2009 international financial meltdown. As at that time, yuan relative weakness appears to be due to repatriation of foreign investments in China to struggling developed countries.

The shift in exchange-rate expectations can also be seen in cooling of the Hong Kong's unregulated offshore yuan market. After massive growth that was still occurring three months ago, yuan-denominated deposits declined slightly in October. At the annual working conference on economic issues, China's senior leadership said that the yuan's exchange rate would be held basically stable in 2012. The message does not indicate a change in exchange rate policy as similar wording has also been used in the past.

Yuan spot and futures rates vs. US dollar in 2011



Source: Bloomberg