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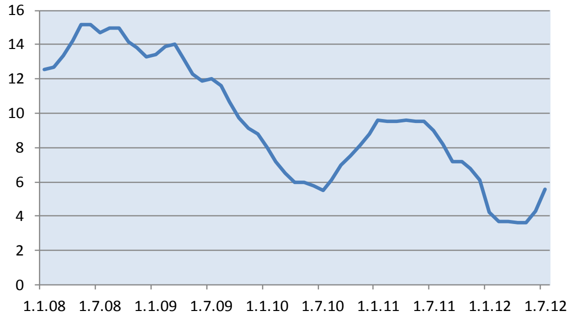
Russia

Inflation accelerates in July as expected. Consumer prices rose during July by 1.2 % m-o-m, the highest monthly inflation rate registered in over a year. The jump reflected hikes in administratively set rates for municipal services to households. Regulated rates are traditionally adjusted at the start of the year, but the adjustment was postponed due to presidential elections this year. Since the hikes, gas rates are up 13 %, electricity and water 6 %, and heating 5 %.

On-year consumer price inflation was 5.6 % in July. The government's target for end-year inflation is 5–6 %, but observers expect a slightly higher rate. At the end of 2011, on-year inflation was 6.1 %.

Consumer price inflation, 12-month percentage change



Source: Rosstat

Cabinet considers less exclusive rules on development of offshore hydrocarbon deposits. A 2008 law limited access to offshore oil & gas projects to Russian state-majority-owned energy companies with at least five years of experience in continental shelf operations. The definition effectively limited the pool of eligible firms to two companies: Gazprom and Rosneft. The law also let the government bypass competitive bidding competition by allocating exploration and production rights directly. Other companies (including foreign firms) are eligible to participate in continental shelf projects only in partnership with a Russian state-owned company as minority partners.

Responding to the law, Russia's large private oil companies Lukoil, Surgutneftegaz, Bashneft and TNK-BP last spring petitioned president Putin for the opportunity to develop deposits independently. Russia's Federal Anti-trust Service has also proposed that the government end practices that discriminate against qualified private firms. The cabinet is currently considering relaxing the restrictions for domestic firms, but it is expected that the participation of foreign firms will remain restricted also in the future.

At a government meeting at the start of this month it was noted that development of the arctic continental shelf cannot succeed without the participation of private capital. The natural resources ministry reports that the Russian continental shelf area is largely unexplored compared to e.g. the Norwegian and UK continental shelf areas. A strong push to explore for hydrocarbon deposits is needed to secure adequate levels of oil and gas production in the future.

Gazprom and Rosneft are unable to take care of mapping deposits or getting offshore production going on their own. Their exploration efforts in tracts where they hold licenses on the continental shelf have been very slow. Domestic oil companies have shown little enthusiasm for the current arrangement that allows minority participation of other companies in joint projects. To overcome this problem, the natural resources ministry has suggested that private domestic firms be allowed to implement projects independently.

US-based Exxon Mobil, the Italian ENI and the Norwegian Statoil signed in April cooperation agreements on oil & gas exploration with Rosneft for Russian continental shelf areas after Russia granted substantial tax breaks. In return, the Western oil companies will not only provide the projects with financing but also give Rosneft access to special exploration and drilling technologies for use in Arctic regions which Russia still lacks.

At the beginning of August, prime minister Dmitri Medvedev assembled a working group to formulate a proposal on how to proceed with exploration and exploitation of hydrocarbon deposits on the continental shelf. The working group will be led by Arkady Dvorkovich, deputy prime minister with portfolio for energy policy.

Russia ratifies agreement with US on bilateral easing of visa rules. On July 28, president Putin signed a visa agreement with the US. The executive treaty does require ratification by the US Congress and enters into force 30 days after both sides indicate that they are technically ready to handle the rule changes. US officials expect the new visa regime to enter into force by mid-September. Although the countries agreed on an easing of visa rules last November, it took ten months for Russia to ratify the deal.

Under the agreement, business and tourist visas will be granted typically as three-year multi-entry visas that allow a visitor to stay in the country up to six months per visit. Previously, three-year multi-entry visas were issued in principle only after an applicant had received several shorter visas. The visa allowed a maximum stay of 90 days during every 180 day period. The EU-Russia visa agreement of 2007 follows the same principles.

The changes in visa rules will have a greater impact on US travellers than their Russian counterparts as the US has already shifted to granting visas to many Russian citizens in the form of two-year multi-entry visas.

US officials report that each year about 10 % of Russian visa applications are rejected. The rejection rate for Russian visa applications to the EU is less than 2 %.

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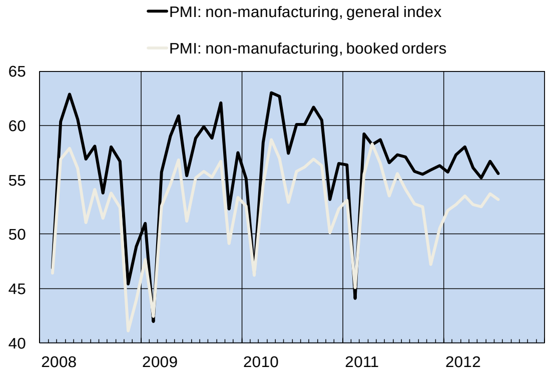
China

China's service and construction sectors post stable growth. China's official non-manufacturing purchasing manager index (PMI) was 55.6 points in July, a level well above the critical 50-point threshold between positive and negative outlooks. The number was down slightly from June. HBSC's Markit services PMI, which is widely watched internationally, registered a slight uptick in sentiment for China's service sector in August.

Figures released this week show growth in the volume of retail sales remained 11 % y-o-y, i.e. unchanged from previous months. In addition to the PMI numbers, this provides further evidence of continued strong growth in the service sector.

NBS/CFLP non-manufacturing PMI



Source: CEIC

Despite the slight drop in PMI sub-index on expectations, the overall outlook for services and construction remains optimistic. This is welcome news for China's decision-makers as Europe's debt crisis has clouded the outlook for China's export industries. Services and construction together generate nearly half of China's GDP, and their importance is expected to grow in the future as the emphasis of economic policy shifts from export- and investment-driven growth to growth led by domestic consumption.

China experiences balance-of-payments deficit for the first time in 14 years. The combined financial and capital account deficit was $71 billion in the second quarter. Although there was a first-quarter surplus as capital inflows exceeded outflows, the second quarter deficit reduced the overall first half deficit to $20 billion. The slight decline of direct investment into China and the rapid growth in Chinese investment abroad contributed in part to the financial account deficit. Data for other balance-of-payments categories will come later.

The $60 billion second-quarter current account surplus was up from $24 billion in the first quarter. Growth of the current account surplus slowed, however; the first-half surplus was 5 % smaller than in the 1H2011.

The combined current and financial account showed a slight deficit for the second quarter. The last time the combined quarterly balance was in the red was in 1998 in the wake of the Asian financial crisis.

China's foreign currency reserves swelled by $59 billion the first six months of this year to $3.24 trillion, despite the fact that the reserves declined in the second quarter.

China promises African countries $20 billion in low-interest loans. The latest China-Africa forum on economic cooperation, which has been held every three years since 2000, took place in Beijing in late July. In addition to announcing the next three years' credit line for the continent, China committed to increasing its development assistance, gradual elimination of import duties on products from the least developed countries and granting more favourable financing to Chinese companies that invest in Africa.

At the 2009 ministerial forum, China granted African countries $10 billion in low-interest loans. The loans have been mainly dedicated to construction of infrastructure such as roads, power plants, oil and gas pipelines, upgrades to telecommunications networks and improved water supplies. Foreign observers have, however, criticised China's use of development loans since they depart from standard practice of other donor nations that couple loans to good governance practices and environmental protection.

Cooperation with African states increased dramatically during the 2000s, even though Africa's overall share in Chinese foreign trade remains relatively small. In 2011, China's exports to Africa were valued at $73 billion (4 % of China's total exports) and consisted largely of manufactured goods. Imports from African countries were mostly raw materials and had a value of $93 billion (5 % of China's total imports).

Direct investments by Chinese firms in Africa have increased rapidly in recent years, reaching $13 billion in 2010. While the official share of investments in Africa is still just 4 % of China's total investment, the figures do not fully reflect the situation as it is likely that considerable investment flows through Hong Kong and tax havens.

Chinese investment in Africa is driven in part with securing access to natural resources. Indeed, Chinese state-owned enterprises have made large investments in backward states like Niger and Democratic Republic of Congo just to secure energy and raw materials. On the other hand, the dynamism of Africa is hard for investors anywhere to resist − six of the world's ten fastest growing economies are in Africa. In this respect Chinese investment is like any other investment and the interest of Chinese firms in Africa is essentially market-driven.

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