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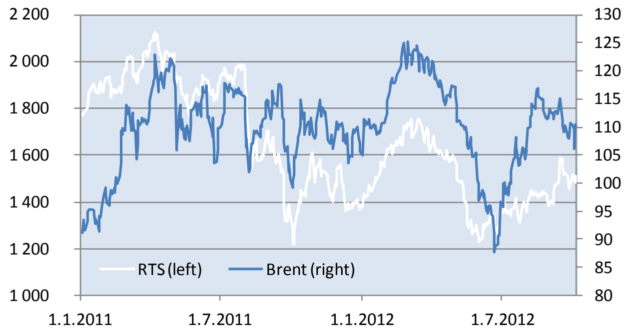
41 • 12.10.2012

Russia

Despite high volatility, Russian stock prices post steady gains over past three months. The RTS index for Moscow's newly merged MICEX-RTS securities exchange has been on an ascending trend since June, closely tracking a rise in crude oil prices. This trend is hardly surprising given the dominant weighting of energy companies in the RTS index. The RTS reached its high point this year in March after a spike in crude oil prices. Its low point in June came at the end of a months-long decline in oil prices. The RTS index is currently up 8 % from the start of the year.

RTS index and Brent oil price (US$/bbl)



Source: Bloomberg

Insider trading remains a problem in Russian securities markets. Factors such as the thinness of Russian securities markets make them vulnerable to price manipulation. Although Russia has had a law on insider trading since January 2011, the concept of trading on insider information is still unfamiliar to many market participants. Even Russia's securities markets overseer, the Federal Financial Markets Service (FSFR), has called for further specification of the legal terminology. The law's strict limitations often make it impossible for authorities to tackle what would be obvious infringements elsewhere. Insider trading cases demand a high level of expertise that has yet to be developed by Russian authorities. Since the insider trading law has been in force, the FSFR has exposed 16 cases of insider trading.

Russia has long had a debate over the possibility of concentrating general supervision of the financial sector into a single entity. This discussion again flared recently, based on the need to enhance the supervision of capital markets and the financial sector in general. At the moment, the Central Bank of Russia handles bank supervision and the FSFR supervises capital markets and the insurance industry.

The integration strategies currently being studied include ending the SFSR and moving all supervision duties to the CBR or putting the FSFR as is under the CBR.

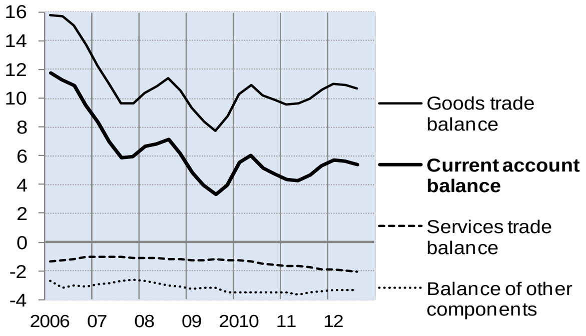
Although the current account surplus contracted, it remains substantial. Preliminary balance-of-payments figures from the Central Bank of Russia show that the current account surplus for the first three quarters of 2012 was somewhat smaller than in the same period in earlier years. Even so, the current account surplus in January-September still corresponded to over 5 % of GDP. In its recent draft of the 2013–2015 monetary policy programme, the CBR sees the current account surplus gradually evaporating away by 2015 if the price of crude oil stays slightly above $100 a barrel.

The small decline in the current account surplus this year reflects trends in trade in both goods and services. The goods trade surplus shrank, but still corresponded to more than 10 % of GDP in January-September. The services trade deficit has increased gradually in recent years and continued this year. For January-September, the services trade deficit was 2 % of GDP. Other components of the current account balance consist mainly of payments of interest and dividends, the deficit of which this year contracted slightly after growing in previous years.

Earnings from exports of goods and services increased rapidly after the 2009 recession, but growth slowed in the second and third quarters of this year to below 10 % y-o-y. Growth in export earnings from oil, petroleum products and natural gas slowed to below 5 % on a drop in export prices of oil and gas, as well as a poor performance of the volume of exports. Oil, petroleum products and gas still accounted for 66 % of Russia's total goods exports, and account for 18 % of GDP. Growth in other export earnings slowed, although earnings from exports of services continued to increase rapidly, driven mainly by strong growth in transport and logistics services.

Growth in imports of goods and services slowed in both the second and third quarters, even if the increase was more than 10 % from a year earlier. Goods imports grew over 10 % in January-September, while imports of services were up nearly 20 %. Spending by Russian tourists abroad increased 25 %. Spending on services grew to nearly a quarter of total spending on imported goods and services.

Current account balance, % of GDP, four-quarter average



Sources: CBR, IMF

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China

IMF cuts again its economic growth forecast for China. The IMF's latest World Economic Outlook sees the global economy growth prospects weakening further, with growth moderating to 3.3 % this year and 3.6 % in 2013. World GDP grew 3.8 % in 2011. Noting the ongoing debt struggles in the euro area, the IMF warned that the risk of even poorer performance than forecasted has increased significantly. Growth in the volume of global trade should slow from 5.8 % in 2011 to 3.2 % this year, but then recover to 4.5 % in 2013.

The problems in Europe, the US and Japan were the main reason for the IMF's decision to lower its China forecast by nearly a half percentage point from April. China's GDP, however, is still expected to grow 7.8 % this year, and growth should pick up again to 8.2 % in 2013 as the effects of policy easing start to be felt. The IMF said that a large part of the recent slowdown was due to lower export demand, a situation similar to that seen in 2009.

The IMF expects Chinese inflation to remain at about 3 % this year and in 2013, as commodity prices decline and measures taken last year to tighten economic policy remove pressure to raise prices. The IMF expects China's current account surplus to contract from 2.8 % of GDP in 2011 to 2.3 % of GDP this year. The current account surplus is expected to grow slightly in 2013.

The growing wealth of the Chinese and the interlinkage of Asian economies have raised the importance of China for the rest of Asia in recent years. Exports to China now account for 16 % of Malaysian GDP, 13 % for South Korea, 9 % for Thailand and 8 % for Vietnam. The increased integration and China's lower economic growth was also noted by the IMF as a reason for lowering its growth outlooks for other Asian economies.

Rapid growth in Chinese tourism abroad. A third of the Chinese population journeyed somewhere during the recent week-long National Day holidays. Although most stayed in the country, the popularity of foreign travel with the Chinese is exploding. According to Chinese sources, the number of people taking trips abroad in the National Day holidays this year was up 50 % from the same holiday week a year earlier. In 2010–2011, foreign travel also increased at about 20 % a year. The tourism boom reflects the growing wealth and disposable incomes of Chinese.

China's National Tourism Administration reports that the most popular foreign travel destinations for Chinese are neighbouring areas. In addition to Hong Kong and Macao, Japan, Korea and Taiwan topped the list. Next are countries in Southeast Asia and the United States. The top European destinations are France, Germany, Italy and the UK. The total number of Chinese tourists for these four European countries is about the same as the number of Chinese visiting the US.

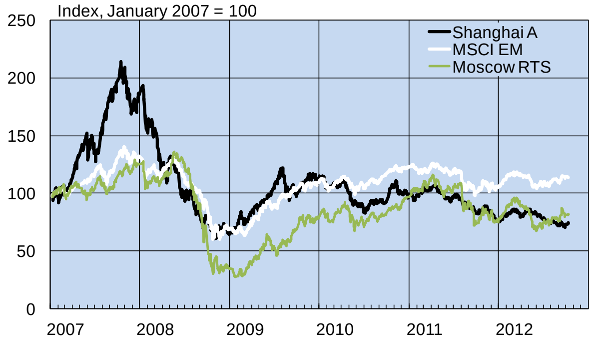
Chinese tourists are also flocking to Finland. Statistics Finland reports that in January-July, the number of overnight hotel stays by Chinese tourists increased 14 % y-o-y and that the number of Chinese tourists arriving in Finland surpassed those of tourists from e.g. Spain or Denmark.

Share prices in the doldrums. Although the general indices for China's Shanghai and Shenzhen stock markets rose slightly this week, the increase is likely to be short-lived. Share prices continue to be clobbered by lower macroeconomic growth domestically and abroad and the consequent lowering of corporate profit projections. The decline in share prices has now gone on for nearly two years, and has been accompanied with a decline in trading volumes.

Officials have sought to support stock prices through such measures as increasing the possibilities for foreign investors to buy shares. The qualified foreign institutional investor (QFII) programme launched in 2003 gave international investors access to China's stock and bond markets. The permitting process for new QFII participants has been accelerated this year. In addition, the investment quota has been raised and conditions for investor participation have been eased. As of mid-September, QFII permits had been granted to 157 foreign institutional investors with granted investment quota of $31 billion in total.

At the end of 2011, a parallel programme to the QFII, the RQFII was launched to allow investors in Hong Kong to use yuan in buying shares traded on mainland China exchanges. Due to the opening up of the financial markets, the significance of B-series shares, initially intended for foreign investors, has diminished. In August, China International Marine Containers became the first listed company to announce that it will get rid of B-shares altogether and convert them to Hong Kong exchange-listed H-shares.

Shanghai A index, Moscow RTS index and Morgan Stanley Capital International Emerging Markets (MSCI EM) index



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