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Russia

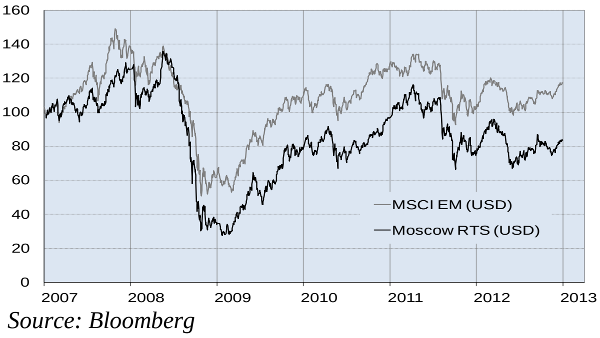
Russian stocks unperformed in 2012. Russia's main stock indexes last year trended with emerging markets elsewhere. The Moscow Stock Exchange's dollar-denominated RTS ended 2012 slightly up from the start of the year. Share prices overall, however, were still well below their 2007–2008 pre-crisis levels. Trading volume in 2012 was not just below pre-crisis levels but also lower than in 2010 and 2011.

Russia's stock indexes represent a narrow swath of firms. The RTS index comprises just 50 firms, with a third of the index weighted to oil companies, a fifth to gas companies and 18 % to banks. The individual companies with the greatest weightings are Gazprom, Lukoil and Sberbank, each representing 14–15 % of the RTS.

Share prices of Gazprom and metal producers fell partly due to lower export prices and ended the year well below 2011 levels. Russia's main oil companies, the largest privately held gas producer Novatek and Sberbank fared better through the year.

Although the merger of Moscow's MICEX and RTS exchanges was officially announced at the end of 2011, last year was spent working out many practical aspects of integration of the new Moscow Stock Exchange (MSE). The MSE continues to use the two standard indexes, the RTS and the ruble-denominated MICEX.

Moscow RTS Index and Morgan Stanley Capital International Emerging Markets Index, January 2007=100



Source: Bloomberg

Cabinet prepares measures to crack down on offshoring. In his wide-ranging policy speech on social and economic issues last month, president Vladimir Putin criticised the practice of offshoring Russian firms, whereby companies move assets out of Russia and use foreign law to govern contract disputes. Putin tasked the cabinet with coming up with measures to deal with the situation by next autumn.

Putin wants Russian law to govern in most company contracts, but today more than half of Russia's big firms (including state-owned enterprises) use almost solely foreign contract law in important contracts. This applies not just to contracts between Russian firms and foreign parties, but domestic parties as well.

As a result, the number of cases involving Russian firms in civil courts outside Russia is significant. In 2009, for example, 12 % of the cases heard by the London Court of International Arbitration involved Russian firms. Duma chairman Sergei Naryshkin claims that national sovereignty may even be jeopardised with issues affecting the Russian economy being decided abroad.

Russian reliance on foreign contract law reflects the general distrust of Russian courts. Putin said that the judicial system needs a complete overhaul so firms do not feel a need to resort to foreign law or dispute resolution abroad. In addition to e.g. improving the protection of property rights, Russia needs an attitudinal shift away from a common presumption in litigation that firms are presumed guilty and have to show innocence. While several calls for remedying the situation have been made over the past years, little progress has been achieved.

Concern rose abroad last summer, when the Russian Supreme Court of Arbitration (SAC) voided a clause in a contract between a Russian firm and a foreign firm stating that in a dispute both parties may seek a judgement in an arbitration court, but only the non-Russian party can take the dispute to court (in practice outside Russia). Hence, the Russian firm was able to take the dispute to a Russian court. This kind of clause is standard in some international contracts, and the ruling may suggest a crack-down on the use of foreign law in resolving contract disputes with Russian firms.

In his speech, Putin also mentioned the need to increase monitoring of capital outflows from Russia. Putin said the civilised answer was to make bilateral treaties with individual tax havens on exchanges of tax and company information concerning Russian firms in a manner similar to what has been done by the US and many European countries.

Putin encourages firms to conduct IPOs on domestic exchanges. In his December policy speech, president Putin tasked the cabinet with making sure domestic stock exchanges get involved with IPOs of companies where the state holds a stake of at least 50 %. The goal is to advance development of domestic financial markets.

While such IPOs have taken place in Russian exchanges in recent years, the share of sales inside Russia have been modest. For example, when the CBR sold its stake in Sberbank last September only 3 % of the issue was sold through the MSE; 97 % were sold in London.

Observers say that the Moscow exchange can well accommodate a $300–400 million IPO, but IPOs of over $1 billion should combine sales on the MSE with sales on at least one major international exchange. More IPOs could be arranged on the MSE if it had the better technical infrastructure and more sophisticated practices.

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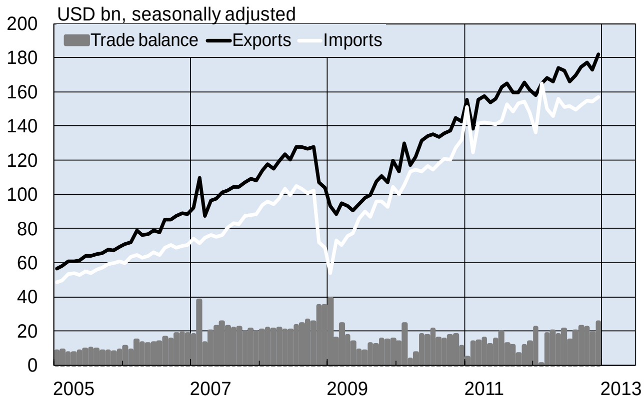
China

Chinese exports and imports picked up in December. On-year growth in the value of goods exports accelerated in December to 14 %; imports were up 6 % y-o-y. Growth in exports to the US and the UK picked up, and the contraction in exports to the largest euro area countries slowed sharply. Political differences between China and Japan were reflected in a continuing slide in the value of exports to Japan. China's trade performance overall last month fuelled cautious optimism that recovery in the global economy is underway.

The value of Chinese exports rose 8 % in 2012 as a whole to $2.05 trillion; imports were up 4 % to nearly $1.82 trillion. The resulting trade surplus exceeded $230 billion, up from a 2011 trade surplus of $160 billion. Growth in China's trade surplus reflects higher export prices and a slight decline in prices of imports. Based on figures for January-November, export and import volumes both rose 5–6 % last year.

Value of China's monthly goods trade, USD billion



Sources: China customs and BOFIT

Google's experience highlights opportunities and challenges for foreign companies in China. Google is best known in the West for its search engine, but in China, much of Google's success rests on its Android operating system for smartphones. The Android platform has enjoyed soaring popularity in China in recent years. By some estimates, Android is found on 90 % of late model smartphones in China. Google is increasing its push in development of phone and tablet applications for the Chinese user base.

Google introduced its search engine business to China in 2005, only to find its ability to offer services stymied by censorship guidelines. The company ultimately pulled out of the censored search business in 2010, claiming ethical reasons. It redirected users in mainland China to its Hong Kong servers, which were not subject to Chinese censorship. Accessing and using the Hong Kong site, however, quickly became difficult as mainland officials filtered content with the "Great Firewall." To improve the functionality of its Hong Kong site, Google initially provided a list of terms flagged by censors for users to avoid when performing searches. The company abandoned this approach when users began to report access to the site had been blocked entirely. Google has also had severe cybersecurity issues in China, as hackers attempt access to Google software and user data.

With the handover of power to a new administration underway, limits of Chinese censorship have been tested several times. So far there are no signs of an easing of censorship restrictions. International attention recently focused on Chinese responses to a censor rewrite of a New Year's editorial in the *Southern Weekly* newspaper. The 30-year commemorative piece had called for a society based on the rule of law. The propaganda clampdown led to a national backlash on twitter and other social media. At the censor's behest, China's major papers all published editorials explaining that China was not yet ready for a free press.

Income disparity in China continues to widen. The Survey and Research Centre for China Household Finance released a report in December suggesting that China has now joined the group of countries with the greatest inequality in income distribution. Using the Gini coefficient as a measure of income disparity, the study found that China's Gini value reached an eye-popping 0.61 in 2010. The figure was arrived at after surveying nearly 10,000 households around China. On the Gini scale, a reading of 0.0 would indicate a situation of uniform income distribution, while 1.0 would signify that a single individual earned every penny. As a rule of thumb, a value of 0.40 is considered a threshold after which social unrest emerges.

China has been reluctant to publish official estimates on income disparity. The most recent official figure is for 2000, when China's Gini coefficient was put at 0.41. Officials explain that they have held back on releasing estimates because it is nearly impossible to get reliable information on high earners. Even if releasing a Gini number is hard, officials do not dispute China's growing income disparity in recent years. A number of unofficial estimates of Gini values have been released. The World Bank came up with a value of 0.43 in 2005 and the Chinese Academy of Social Sciences (CASS) got a reading of 0.54 in 2008.

The widest income disparity in the world is found in South Africa, which has a Gini coefficient of 0.63. Income disparities above 0.60 are rare, however, and found mainly in a few African countries and small island nations. The lowest income disparities are found in the Nordic countries, where Gini coefficients are around 0.25.

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