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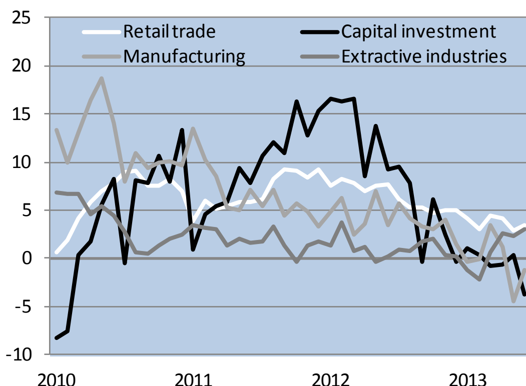
Russia

As Russian economic growth falters, government moves ahead with stimulus measures. Russia's economic growth slowed rather abruptly in the first half of the year. While GDP growth for all of 2012 was near 3.5 %, growth this year fell to just 1.6 % y-o-y in the first quarter and, according to the economy ministry's preliminary figure, about 2 % in the second quarter.

The industrial situation has weakened significantly, with industrial output essentially showing no growth from a year earlier. Growth in manufacturing has evaporated, even if part of the drop can be attributed to short workweeks. The sharpest drop was registered in machinery & equipment production, even if defence industry production has risen substantially. Resource extraction industries did slightly better in the second quarter, mainly due to higher production of crude oil.

Consumer demand is increasingly the main demand driver of the Russian economy, even if growth in consumer demand has also slowed slightly. Retail sales volumes were up 3.5 % y-o-y in the second quarter. Food sales volume continued to show a modest increase (2 %), while sales of non-foods were up over 4.5 %. Anaemic first-quarter investment declined further in the second quarter with fixed capital investment slightly below the 2Q2012 level. Development of exports has also been weak.

12-month change in Russian domestic demand and industrial output, %



Source: Rosstat

Lower economic growth has revived the stimulus discussion led especially by president Putin. Over the summer, the debate has resulted to decisions that include e.g. borrowing assets from the National Welfare Fund and pension funds to pay for transportation projects. Other stimulus measures include the Central Bank of Russia's recent decision to auction12-month loans secured by non-marketable assets from end of this month. The finance ministry has increased its bank deposits and deputy finance minister Moiseyev says that more is coming in early autumn. Putin recently issued a written instruction limiting administratively set rate hikes (on e.g. gas and electricity) over the next five years to no more than the inflation rate, a far lower level of rate hikes than originally planned.

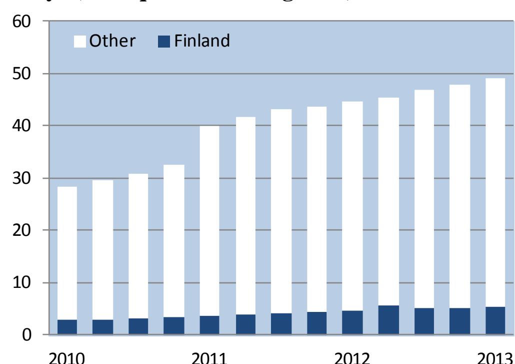
Nearly 10 % of Russians plan to travel abroad in their summer vacation. Despite the slowdown in the Russian economy, Russian holiday plans seem to be similar to last year. The share of Russians wanting to travel abroad for a vacation (especially a beach vacation) is actually three times larger than those planning to travel, but in most cases the price of such trips is prohibitive. Hence, according to recent surveys by the VTsIOM, Levada and FOM institutes, most Russians plan to spend their summer vacation at home or at their *dacha*.

Most Russian travellers save up for their holiday. Only a few per cent of those surveyed planned to borrow money to fund their trip. Russians plan to spend slightly more money on their trip abroad this year than last year. The average planned is just under 28,000 rubles (€700) per family member. The average monthly wage nationally in June was 31,200 rubles. A fifth of Moscow residents, about 2 million Muscovites, plans to travel abroad during their summer holidays this year, and plan to spend about €1,000 per family member.

The surveys show that Russians have begun to plan ahead more for their summer holidays than earlier. Russians continue to prefer to arrange their travel and activities themselves; less than a fifth of tourists reported that they had purchased package vacation deals for their most recent vacation abroad.

During the 2012 summer vacation season (July-September), Turkey was by far the top tourist destination among the non-CIS countries, accounting for 10 % of all Russian leisure travel. In terms of numbers of journeys, Russia's number-2 summer vacation destination was Finland with a 3.5 % share.

Russian trips abroad, Finland and other destinations, millions of journeys (four-quarter moving total)



Source: Rosturizm

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China

China ends regulation of lending rates allowing banks less restrictive loan pricing. The People's Bank of China announced last Friday (July 19) interest-rate policy reforms designed to further liberalise China's heavily regulated financial markets. The main reform eliminates the minimum lending rate for commercial banks. The rate floor was previously set at 70 % of the PBoC benchmark lending rate. The reform allows banks to compete by offering lower loan rates. This is considered a step towards market-based interest-rate setting.

An important exception to the reform concerns interest rates on mortgages. They remain regulated as officials seek to prevent overheating of the housing market due to excessively low rates. Housing prices have increased sharply this year.

The immediate impact of eliminating the interest-rate floor should be minor. PBoC figures show that only about 11 % of housing loans are priced below the 6 % benchmark rate. If financial market conditions change, however, and competition among banks intensifies, companies with low credit risk could gain access to cheaper loans. In this respect, the reform could hurt bank profits by narrowing the margin between credit and deposit rates.

The PBoC reports that China is not yet ready to deregulate deposit rates and will continue to place a ceiling on them. Banks can now offer 12-month deposit rates up to 3.3 %. A maximum deposit rate reduces competition and provides banks access to cheap money, which is aimed to assure bank profitability and banking sector stability.

IMF encourages China to address growing financial market risks. In its annual Article IV consultation released last week, the IMF said it generally expects Chinese economic growth to remain relatively strong, while being concerned over risks facing its financial markets. Hence the IMF called for China to rein in rapid credit growth and increase regulatory presence in informal banking activity. This year's report continues to stress the importance of financial market reforms for the development of Chinese economy. Financial market liberalisation combined with better regulatory oversight would reduce further build up of risk and help channel investment to more profitable projects.

The IMF is also pushing for a faster transition from investment-driven to consumption-driven growth. Potential fiscal stimulus should support this goal, but stimulus measures should only be considered if economic growth would fall well below the current official target. More important for achieving balanced economic growth, however, are structural reforms such as reducing income inequality and overhauling the tax system.

The IMF still expects Chinese GDP growth to approach 8 % this year as the economy is expected to pick up slightly in the second half of this year. There are no signs, however, of a pick-up in the economy at the moment. For example, the preliminary number for the July HSBC purchasing manager index released this week fell to its lowest level in eleven months on weak numbers for manufacturing output and new orders.

Rich OECD countries lead in innovation, but China outranks many EU countries. The UN's World Intellectual Property Organization (WIPO) this month released its Global Innovation Index 2013, which provides a snapshot of innovation activity in 142 countries. The index uses 84 measures of innovation both from input and output side. Innovation inputs include education spending, quality of top universities, graduate student populations, national justice systems, infrastructure, and spending on research and product development. Innovation output is measured by e.g. patents awarded, scientific publications, the share of royalties and licensing fees in services exports, and web presence.

As expected, rich OECD countries rank high in the survey, but also many emerging economies make relatively impressive showings. The Top Ten is dominated by small OECD countries traditionally active in e.g. ICT technology and pharmaceuticals. Somewhat surprisingly, neither Germany nor Japan made it into the Top Ten. Their rankings were dampened by e.g. their points on educational systems and internet use.

The highest-ranked non-OECD country outside the EU was Malaysia at 32nd place. China ranked 35th. A number of EU countries ranked lower than China, with Greece taking the cellar at 55th place. China's ranking was boosted especially by its high activity in patent applications but also R&D spending. Both China and Russia have significantly increased spending on innovation activity from 2012.

Selected countries on WIPO's 2013 Global innovation index

Ranking 2013 (2012)	Country	Innovation inputs	Innovation outputs
1 (1)	Switzerland	7 (4)	1 (1)
2 (2)	Sweden	5 (3)	3 (2)
3 (5)	UK	4 (5)	4 (6)
4 (6)	Netherlands	10 (15)	2 (3)
5 (10)	US	3 (9)	12 (16)
6 (4)	Finland	6 (6)	8 (5)
35 (34)	China	46 (55)	25 (19)
62 (51)	Russia	52 (60)	72 (49)
64 (58)	Brazil	67 (69)	68 (52)
66 (64)	India	87 (96)	42 (40)

Source: WIPO

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