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Russia

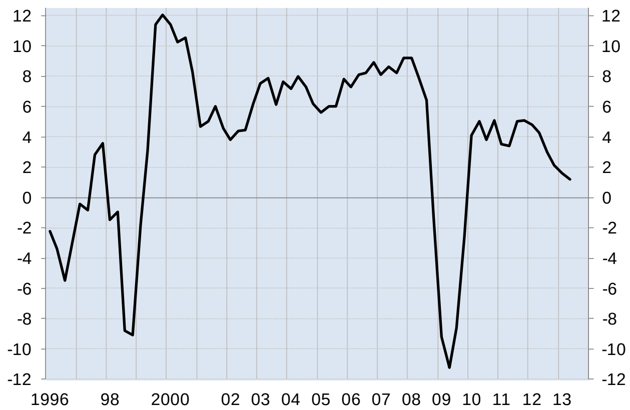
Russian economy ministry sees growth picking up in the second half of the year. Due to weakness in Russian economic activity in the first half, the economy ministry this week reduced its overall GDP growth forecast for 2013 from 2.4 % to 1.8 %. Growth, however, is expected to pick up in the second half. The earlier estimate of industrial output for the current year was revised down to around 0.5 %, while the estimate for investment growth was lowered to 2 %. Growth in retail sales should continue to rise this year at a pace above 4 %.

GDP growth in 2014 is currently forecast to reach about 3 %. Retail sales growth will continue at about 4 %, while investment growth is expected to climb to 4–5 %.

The forecast assumes an average price for Ural-grade crude of $106 a barrel this year and around $100 in subsequent years. Russian export earnings are expected to decline slightly this year and then plateau in 2014.

The economy ministry also lowered its forecast for imports. The value of goods imports is expected to increase about 2 % this year and 3–4 % next year. The ruble should weaken slightly against the dollar this year and a few per cent next year.

Russian GDP, percentage change from four quarters previous

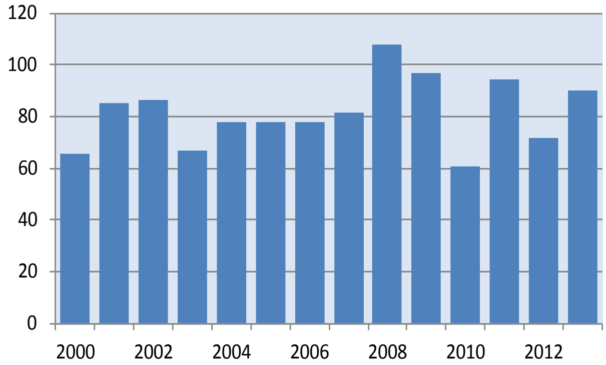


Source: Rosstat

Better-than-average Russian grain harvest ahead. Russian officials predict that this year's grain harvest will reach around 90 million metric tons, which is about 25 % higher than last year's poor harvest. Russian grain harvests averaged 82 million tons from 2000 to 2012. Wheat accounts for over half of Russia's total grain output.

Russia's grain exports this year are expected to increase to about 19 million tons. Grain exports in 2012 were 16 million tons, while in 2011 they were as much as 27 million tons. That year Russia was world's fourth largest grain exporter after the United States, Argentina and Australia.

Russian grain production (millions of metric tons)



Source: Rosstat

New law bans Russian officials and representatives from keeping their money outside the country. Under a law passed in April, people with jobs that involve setting policy affecting Russia's sovereignty or national security are forbidden from keeping their wealth abroad in foreign banks or holding foreign securities. The ban extends to e.g. members of representative bodies at all levels of government from parliament to local administrations, government officials, prosecutors, judges, members of the central bank board of directors, as well as all employees of state-owned corporations. The ban further applies to the spouses and minor children of the above-listed individuals.

The law gave those under the ban three months to repatriate their offshored wealth or resign their posts by August 17. Only a few members of Russia's upper-house Federation Council and a single deputy minister resigned their posts. Such notables as first deputy prime minister Igor Shuvalov and the chairman of technology fund Rosnano Anatoli Chubais said that they had repatriated their offshore holdings.

The state-owned bank VTB 24, which mainly serves private individuals, reports that its deposits rose 20 % in the first half of the year, or about the same amount as for all of 2012. Much of the growth is due to large one-time deposits. The bank's "VIP" client base increased about 25 % in the first half.

While the law does not forbid ownership of real property abroad, it requires the owner to declare annually his or her foreign real estate holdings and the sources of finance for their acquisition.

The purpose of the law is to "assure national security, improve transparency of lobbying activity, increase domestic investment and make anti-corruption measures more effective." Observers note it is rather easy to circumvent the ban, however. An affected person could e.g. hold their accounts under the names of third parties and keep shares in a managed securities register. Furthermore, it is rather difficult for officials to determine the existence of offshore accounts.

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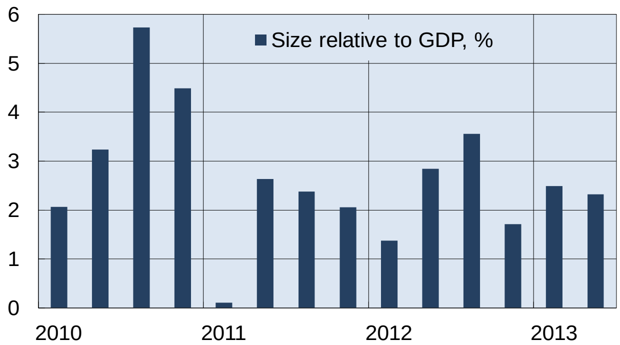
China

China's current account surplus remained stable in first half – while there was a large shift in capital flows. China's current account surplus for the first half of this year was $96 billion, an increase of about $18 billion from 1H2012. The size of the surplus relative to the economy also grew a bit. The 1H2013 surplus was about 2.4 % of GDP compared to 2.1 % in 1H2012. The size of the current account surplus during the first six months of this year was rather stable; shifts in first-quarter and second-quarter current account balances in previous years have been more visible.

Quarterly current account surpluses



Source: Macrobond

While the full balance-of-payments data for 2Q2013 becomes available at later date, preliminary figures released by China's State Administration of Foreign Exchange (SAFE) show the combined capital and financial account balance was about $1.6 billion in the red for the second quarter. The direction of net money flows apparently shifted sharply during the second quarter as the financial account balance showed a $90 billion surplus in the first quarter.

The commerce ministry reports that foreign direct investment inflows into the country picked up during the second quarter. Some $62 billion in FDI had flowed into China this year as of end-June, or 5 % more than in 1H2012. The factors boosting the pace of investment could be a more optimistic outlook than earlier for China's structural adaptation and stronger financial positions of foreign firms allowing them to increase their investments in China. In July, FDI inflows into China were up 24 % y-o-y.

The swift growth in Chinese foreign investment continued. Direct investment abroad by Chinese firms in the first half totalled around $46 billion, an increase of nearly 30 % from a year earlier. The rapid growth in Chinese investment abroad seems to partly explain the shift in the financial account balance although net FDI inflows into China are still larger than FDI outflows from China.

China's foreign currency reserves grew by about $130 billion in the first quarter, but growth slowed in the second to just $50 billion. The lower growth in China's foreign currency reserves reflects the shift in the direction of net capital flows and the resulting abatement of appreciation pressures on the yuan. The yuan appreciated against the dollar in the spring but the exchange rate remained fairly stable during the summer. The US Federal Reserve announced its plans at the end of May to cut back on its bond-buying programme (QE) sometime this year. The policy shift seems to have impacted China's capital flows along with other developing economies.

China hopes to liberalise its capital account and permit exchange rates to be set increasingly based on supply and demand. The shift, however, will be gradual in order to prevent sudden shifts in the current account and capital movements. An IMF report released in July claims that the yuan is moderately undervalued relative to a basket of currencies. This would imply that the Chinese currency should continue to appreciate as yuan convertibility becomes easier and thereby cause China's current account surpluses to shrink.

Housing prices in China continue to climb. The rise in housing prices continued throughout the first seven months of the year. The housing price index published by the National Bureau of Statistics showed that prices of newly built apartments in 70 large and mid-sized cities were up over 6 % y-o-y in July. The increase in apartment prices in large cities was well above the average rise. In Guangzhou and Shenzhen, for example, prices were up 17 % y-o-y. In smaller cities like Nanjing and Tianjin, the rise in housing prices was around 7–9 %. Prices of older housing posted rises similar to new housing in July.

The rise in prices is driven by several factors, including the availability of housing loans. Growth in the stock of housing loans accelerated sharply in the first half of 2013. People's Bank of China figures indicate the loan stock increased about 20 % y-o-y or about 10 percentage points more than in 1H2012. Growth in the volume of borrowing by real estate developers also accelerated slightly in the first half. Real-estate-related construction investment picked up in the first half by around 20 % y-o-y, suggesting that developers expect prices to climb further.

The rise in housing prices over the long term is also affected by the ceiling on bank deposit rates and regulation of financial markets. Investments in housing have offered better returns than most other investments in recent years, which is why excessive amounts of capital are channelled to the real estate sector. Prices have been on the increase this year despite official measures to limit excessive real estate investments.

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