

## Russia

**GDP contracted in first half of 2014.** Rosstat's preliminary estimate for GDP growth in the second quarter of this year is 0.8 % y-o-y. Comparable growth in the first quarter was 0.9 %. Nevertheless, development has weakened from last year, with seasonally adjusted GDP now estimated to have been slightly lower in the first half of this year than at the end of 2013.

Output of the five core sectors of the Russian economy (industry, agriculture, construction, retail sales and transport) in the first and second quarters increased just 0.3–0.4 % y-o-y. GDP growth has thus largely been driven by other sectors such as services, real estate and certain public sector branches.

**Change in the volume of GDP and output of five core sectors, % y-o-y**



Source: Rosstat

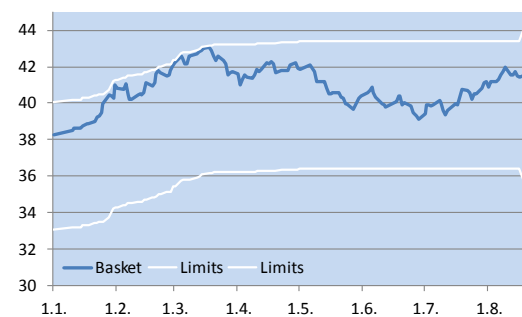
**Free-floating ruble almost a reality.** The Central Bank of Russia further relaxed its ruble exchange rate steering mechanism on Monday (Aug. 18). Steering is based on reacting to fluctuations in the exchange rate relative to a dollar-euro currency basket. The first change is that the fluctuation band limits governing the CBR response has been widened from two to nine rubles. Second, as long as the currency basket rate is within the allowed fluctuation range, the CBR will now abstain entirely from market operations to affect the ruble rate. (The central bank earlier also intervened to some extent within the fluctuation band). Third, less appreciation or depreciation pressure on the ruble will now be sufficient to move the entire band up or down. The measures will further increase the ruble's freedom of movement.

The changes are in line with the CBR policy of past couple of years to shift incrementally to floating ruble. The CBR confirmed it will cease steering the ruble's exchange rate by the end of this year, which will enable it to focus on achieving its inflation target. A floating exchange rate also allows the central bank better possibilities to influence financial market liquidity through interest-rate policy.

While the markets have doubted the CBR's commitment to free-float of the ruble amidst the current political and economic turbulence, the latest changes have largely erased this scepticism. The CBR has stated, however, that it still may support the ruble in exceptional circumstances.

When the Crimean crisis flared in March, the CBR intervened extensively in the currency markets, selling more than \$26 billion of its currency reserves in a month to prop up the ruble. Although the currency reserves have declined this year, they remain substantial. They stood at \$479 billion at the end of July, down from \$510 billion at the start of the year. The CBR has stayed out of the market entirely since late June, i.e. the ruble has *de facto* floated freely for the past eight weeks.

**Ruble/currency-basket rate and fluctuation band limits, Jan. 1–Aug. 21, 2014 (rising trend indicates weaker ruble)**



Source: Central Bank of Russia

**Russian imports down in first half.** The value of goods imports in the first half fell to \$153 billion, a drop of about 5 % y-o-y. Imports contracted in nearly all product groups on sluggish demand, ruble weakness and tighter credit markets. About half of Russia's imports consisted of machinery, equipment and transport vehicles, with the volume of imports from non-CIS countries contracting by 10 % y-o-y and even more sharply from the CIS countries mainly due to the Ukraine conflict. Metal imports also plummeted. The value of Russia's food imports in January-June was unchanged from 1H2013. Considerably less pork meat was imported than a year ago from both CIS and non-CIS countries. Imports of milk and dairy products rose substantially.

The value of Russian good exports increased just over 1 % y-o-y to \$256 billion. The bulk of export growth came from major increases in exports of petroleum products such as gasoline. Crude oil exports declined from a year earlier.

The EU accounted for half of Russian goods trade, APEC countries about a quarter and the CIS countries 13 %. The biggest drop in Russian trade volume was registered with the CIS countries.

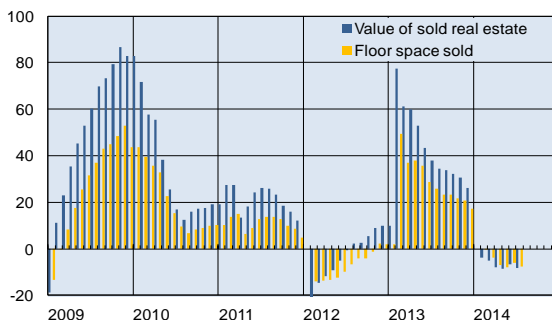
The Russian government informed on Wednesday (Aug. 20) on products taken off the banned import list. Following to proposals brought up last week, e.g. non-lactose dairy products and seed potatoes were removed from the list.

## China

**Weaker outlook for China's real estate sector.** China's property markets have cooled significantly in recent months. The National Bureau of Statistics reports the real estate sector posted 14 % y-o-y growth in the first six months of the year, down from over 20 % growth in 2013. The number of new real estate ventures has fallen sharply on market sluggishness. The volume of new housing starts measured in terms of floorspace was down 13 % y-o-y in January-July.

Uncertainty over housing price trends has driven investors to the sidelines. The NBS index shows prices of new and existing apartments fell on average about 1 % m-o-m in July. Many local governments have rushed to deal with the price drop e.g. by relaxing restrictions on apartment ownership to bolster housing demand and construction activity. With both builders and buyers gripped with uncertainty, the number of finalised apartment sales dropped throughout the first seven months of this year.

### 12-month change in real estate sales, %



Source: Macrobond

The regional differences in real estate trends are substantial. Real estate sales in western and central provinces are largely unchanged from last year in terms of floorspace sold. In the eastern parts of the country, real estate sales have plunged (down 15 % y-o-y in July). The goal of China's urbanisation strategy to channel the influx of population from the countryside to smaller cities further shapes regional trends in the future.

A recent Standard Chartered Bank survey found that real estate developers' confidence towards future housing demand has deteriorated. Moreover, the majority of firms responding to the survey reported that their financing costs have risen and that they now have greater difficulty in acquiring loans.

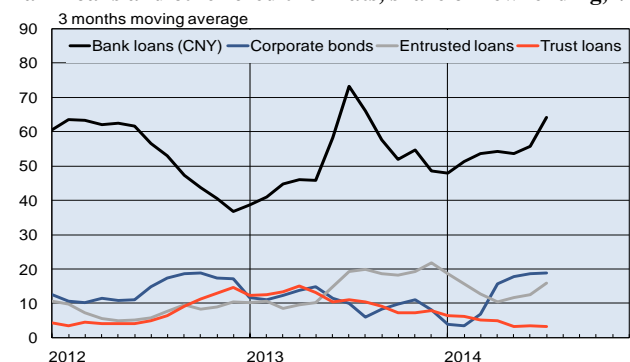
With many property holding companies carrying great amounts of debt, falling housing prices and higher credit costs could deliver great stress to the entire sector.

Small firms, in particular, lack access to cheap credit, so even a modest dip in cash flow may create large problems. Such a situation was seen earlier this year when the construction firm Zhejiang Xingrun defaulted on its scheduled bank loan payments.

**China's financial markets see increased popularity of bonds as a means of financing.** People's Bank of China figures show bond financing gained share in China's financial markets over the current year. Bonds now account for nearly 20 % of new credit issues, up from about 10 % a year ago. The share of bank loans has again started to rise since the beginning of the year, with the current ratio standing at about 60 % of new loans to corporations and households.

Official figures suggest that the role of China's shadow banking (off-balance-sheet financing activity and financing outside the formal banking sector) has shrunk over the past year. The share of new lending originated from trust companies has halved this year to slightly over 3 %. Trust loans are funded by collecting funds from firms and private individuals via commercial banks. Last spring, the China Banking Regulatory Commission (CBRC) tightened its rules for trust company asset management products. The move was designed to reduce risks arising from such off-balance-sheet lending. Problems in China's real estate sector may also explain some of the drop in demand for trust loans. Some real estate developers report that their access to trust loans has become more difficult recently.

### Bank loans and other credit formats, share of new lending, %



Source: Macrobond

Regulation will play a central role in development of China's financial markets. Officials this year have given the go-ahead on issuance of various types of debt securities, which may explain some of the increased popularity of bonds among investors. The trend follows a familiar pattern seen in previous years, i.e. new, less regulated financing modalities take off as officials attempt to limit the growth in traditional bank lending. Put simply, regulation in one sphere channels demand to alternative forms of finance.