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Russia

State banks moving aggressively to gain share in the finance sector. Sberbank, Russia's largest bank and majority-owned by the Central Bank of Russia, has agreed to acquire Russia's oldest investment bank, privately held Troika Dialog. The deal diversifies Sberbank operations, giving it a prominent role in Russian investment banking. The deal should be finalised by the end of this year and the merger completed by 2013.

Russia's second largest bank, state-owned VTB, is also focusing intensely on investment banking. VTB24, the VTB Group's retail bank, has grown rapidly through, among other things, bank acquisitions. At the start of 2011, VTB purchased Russia's fifth largest bank, Bank Moskvy, from the City of Moscow. A privately held bank, Alfa, was also interested in acquiring Bank Moskvy.

Some experts are concerned about the consolidation of state banks' position in the finance sector. According to Oleg Vyugin, CEO of the private MDM Bank and former head of the Federal Financial Markets Service, state banks are preventing the growth of private banks. They e.g. benefit from access to considerably cheaper credit than private banks.

At year's end, 25 % of Russian banking sector capital was of foreign origin. In addition to the 80 fully-foreign-owned banks operating in Russia, another 31 banks are majority-owned by foreign investors. Of course, the "foreign" owners in some cases are likely Russian as investment is made via registered firms from abroad.

Among the wholly-foreign-owned banks, the biggest in terms of capital are the Austrian Raiffeisenbank, the Italian Unicredit Bank, the French Société Genérálé Vostok and its subsidiary Rusfinans Bank, and the Italian Bank Intesa. All of these banks have operated a long time in Russia. Russia does not allow foreign banks to set up branches; under Russian law, foreign banks are expected to operate as independent subsidiaries.

The recession was tougher for foreign banks that have only operated on the Russian market for a few years than for foreign banks that had established themselves in the early 2000s during the period of rapid economic growth. Latecomer banks were hit hardest by the recession as they failed to sufficiently increase market share to weather the crisis. Some banks have already closed their doors or are planning on pulling out of Russia. In some cases, retreat was due to trouble with the parent bank that forced to close less important foreign operations. Last year, for example, the Spanish Santander divested its Russian operations, and the Swedish Swedbank began to take steps to pull out of retail banking. UK-based Barclays announced in February plans to sell its retail banking operations in Russia.

Russia and Ukraine emerge with little to show from customs union and gas supply talks. At the meeting of Russian prime minister Vladimir Putin and Ukrainian prime minister Mikola Azarov last week in Kiev, Ukraine requested that Russia lower the price of natural gas that it supplies to Ukraine. The terms on gas deliveries were agreed in 2009 by Putin and Ukraine's then-prime minister Julia Tymoshenko. Ukraine's current government sees that the country at that time agreed to pay a premium for Russian gas. Ukraine also asked Russia to lower barriers to imports of products critical to Ukraine's export sector.

In response, prime minister Putin invited Ukraine to join the Russia-Belarus-Kazakhstan customs union. He said that Ukraine would benefit annually from membership between $6 billion to $9.5 billion from easier market access. The amount apparently largely comes from the removal of export tariffs on Russian natural gas exports to Ukraine. Ukraine's economy, particular the important iron and steel branches of the export sector, are highly dependent on Russian energy imports.

Ukraine is currently negotiating a free-trade agreement with the EU. The free-trade agreement is part of an EU-Ukraine association agreement (AA) under preparation. The parties aim at concluding their free-trade agreement talks by the end of this year. Commenting on EU-Ukraine talks, Putin said he was worried that if the free-trade agreement lowers tariffs significantly, it would increase the flow of imported goods to the Ukrainian market harming the competitiveness of Ukraine's own products. As a result, Ukrainian goods could flow to Russia, Belarus and Kazakhstan. In this end, Putin said, retaliatory measures would be invoked against Ukrainian exports.

Ahead of the prime ministers' meeting, Ukraine's president Viktor Yanukovich said that his country was uninterested in customs union membership. Yanukovich instead proposed a free-trade agreement between Ukraine and the customs union. Igor Shuvalov, Russia's first deputy prime minister, said Ukraine may find it difficult to reconcile membership in two free-trade areas.

During his visit to Ukraine at the start of the week, France's prime minister François Fillon said that Ukraine's association agreement with the EU and membership in the Russia-Belarus-Kazakhstan customs union were not per se in conflict. Fillon noted, however, that moving forward with the AA could get difficult if Ukraine pushed for both at the same time.

Kyrgyzstan government to launch negotiations with Russia-Belarus-Kazakhstan customs union. Some 45 % of Kyrgyzstan's foreign trade is with Russia, Belarus and Kazakhstan. Kyrgyz merchants make considerable money buying goods in China and reselling them in Kazakhstan. Kyrgyzstan seeks to preserve this reselling business through customs union membership.

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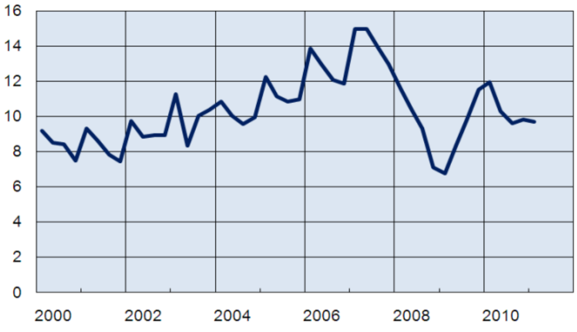
China

New quarterly statistical data suggest slowing economic growth. The latest figures from China's National Bureau of Statistics (NBS) show real GDP increased 9.7 % in the first quarter of 2011, a tiny drop from the 9.8 % y-o-y GDP growth in 4Q10. In 2010 – no matter whether one looks at the entire year or the first quarter – growth was driven by investment rather than consumption. In the first quarter of 2011, however, the contribution of consumption to growth was greater than that of investment. The contribution of net exports to growth in 1Q11 was slightly negative.

Although China's economic growth remains strong, the first quarter-on-quarter data ever released by the NBS suggest that growth is slowing. NBS figures show China's GDP grew 2.4 % q-o-q in the last quarter of 2010, which translates to an annual rate of 10 % y-o-y. In the first quarter of 2011, the 2.1 % q-o-q growth annualises to a rate of 8.7 %. Although for the time being the NBS has only published the growth figures for 4Q10 and 1Q11 and has given no indication as to how quarterly GDP growth is calculated, the new practice indicates increased sophistication in China's statistical systems and makes monitoring of the country's economic trends substantially easier.

Industrial output climbed nearly 15 % y-o-y in March and retail sales 12 %. Real disposable incomes of city-dwellers increased about 7 % in the first quarter, while first-quarter real growth in monetary incomes (the earnings measure used in this case) of rural residents was up 14 % y-o-y.

China's real GDP growth, y-o-y change (%)



Sources: NBSC, BOFIT

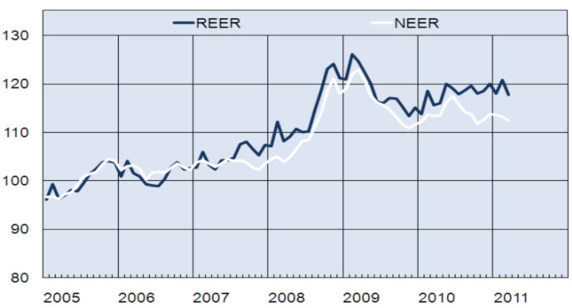
As inflation accelerates, China's central bank further tightens monetary policy. Following the release of the March economic figures, the People's Bank of China raised bank reserve requirements a half percentage point effective today (Thursday, April 21). After the increase, the reserve requirement ratio for the largest banks is 20.5 % of deposits. China's government began to tighten monetary policy in January 2010 and since then the reserve requirement has been gradually increased by a total of five percentage points. Starting last autumn, the PBoC has also incrementally raised reference credit and deposit rates a total of one percentage point and encouraged banks to restrain lending.

Central bank governor Zhou Xiaochuan said monetary tightening must continue to get inflation under control. 12-month inflation accelerated to 5.4 % in March. Food prices were up 11.7 % y-o-y, housing 6.6 % and pharmaceuticals and healthcare 3.2 %. While the rise in prices has been modest in many product groups, inflation as a whole has accelerated in non-food categories. This increases the risk of rising inflation expectations despite the fact that the bulk of the acceleration in the inflation rate still reflects high prices on the world market for raw materials and food.

Ballooning foreign currency reserves add to yuan appreciation pressures; no real yuan strengthening in the past 12 months. Central bank deputy governor Hu Xiaolian said that the flexibility of the yuan's exchange rate could be increased to deal with external price pressures. There is huge pressure at the moment for yuan appreciation, despite the fact that China's trade showed virtually no surplus in the first quarter. China's foreign currency reserves climbed by $197 billion in January-March to $3,045 billion. That growth nearly matched the record rate of growth at the end of 2010. Foreign direct investment inflows to China accounted for $30 billion of the growth in currency reserves during the first quarter.

Since the beginning of this year, the yuan's exchange rate has appreciated less than 1 % against the US dollar and lost over 5 % of its value against the euro. Using the real effective (trade-weighted) exchange rate, or REER, the measure preferred in assessing competitiveness and exchange rate trends, the yuan's exchange rate has remained unchanged for a year now. The nominal effective exchange rate (NEER) actually weakened a bit over the last 12 months.

Yuan effective exchange rates (REER and NEER), 2005=100



Source: BIS

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