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Russia

Russian WTO memberships in the final stretch – again. Since Russia entered into WTO membership talks 18 years ago on June 16, 1993, discussions have restarted and halted on numerous occasions. One factor in the on-again-off-again nature of the talks has been Russia's own insecurity over whether it actually wants to join the WTO and to which extent it is willing to accept commitments that accompany membership. As the Russian economy has experienced ups and downs over the lengthy negotiation process, interest in WTO membership has waxed and waned accordingly.

Russia's attitudes towards WTO membership again grew positive last year. Russia has been in a far more compromising mood in its membership discussions this time around. Both the US and the EU reached agreements in principle with Russia on outstanding bilateral issues. Russia quickly adopted a law governing intellectual property rights, which was a key issue for the US. With the EU Russia agreed it would cut export duties on round timber after WTO accession.

In recent months, however, there has been less progress on the few outstanding issues, including Russia's approaches to veterinary and phytosanitary inspections of imports, which differ from international practice. From the perspective of Russia's trading partners, Russia uses health and food safety inspections as a way to restrict imports. Another open issue is Russia's non-conforming demands on foreign firms investing in certain fields. For example, foreign car manufacturers with assembly plants in Russia have committed to certain levels of investment and annual production and certain degrees of domestic content to be allowed to bring in needed components at low duty rates.

Last week at the EU-Russia summit in Nizhni Novgorod, president Dmitri Medvedev presented his hope that the outstanding issues could be resolved within a month. EU representatives said Russian accession could take place this year, but for that negotiations should be extremely active. Medvedev is seen as a proponent for Russia's WTO membership, and it seems that both parties aim at accession to take place before Russia's presidential elections next March.

Russian firms shift gradually to internationally accounting practices. Finance minister Alexei Kudrin announced to a cabinet meeting on June 14 that, starting next year, corporate conglomerates would be required to prepare their financial statements in accordance with International Financial Reporting Standards (IFRS). The purpose of the reform is to increase transparency and make such firms more attractive to outside investors. Other companies will make the shift to international standards later.

The change is not totally new for Russia; some of Russia's largest corporations have used IFRS for years as it is necessary when a company seeks to raise money on international markets.

Banks have been required to prepare IFRS-compliant financial statements for some years, but have yet to be relieved of the requirement that they also prepare their accounts in accordance with Russian accounting standards as a basis for determining their tax liabilities. This dual accounting requirement imposes a substantial burden on banks.

IMF: Russian economic policy needs to leverage current commodity boom to shift direction. The fresh report to the IMF board on Article IV consultations with Russian officials at the start of the month finds that, without significant reforms, GDP growth in the medium-term is likely to remain below 4 % a year. As long as the Russian economy remains dependent on energy earnings, there remains a risk of a new recession in the event of a sharp decline in oil prices. If the government chooses to promote reforms, it is possible to achieve annual GDP growth as high as 6 % over the medium term.

The current high commodity prices on world markets are providing Russia with a window of opportunity to make needed reforms, including tightening fiscal and monetary policies, shoring up of the financial sector and implementing structural reforms.

According to the IMF the efforts of the Russian government to tighten fiscal policy are too cautious. Russia faces a risk that if economic growth accelerates budgetary policy may become procyclical and speed up inflation. The IMF recommends that Russia more quickly phases out corporate subsidies introduced during the recession and improves the targeting of social spending. Effective social spending, in turn, calls for fundamental reforms in pensions, social security and healthcare systems.

The IMF encourages Russia to continue tightening its monetary stance to get inflation under control and welcomes the CBR's current exchange rate policy, which allows for larger swings in the ruble's external value. The IMF recommends that Russia allow the ruble to appreciate if the inflow of foreign capital into the country swells again.

While the Russian financial sector is stable, the Fund notes that bank balance sheets may disguise serious shortcomings. The IMF encourages Russia to step up banking sector supervision to international levels.

The IMF expects Russian GDP to grow 4.8 % this year and 4.5 % next year. It also sees inflation falling to 8 % at the end of this year and further to around 7 % at the end of 2012.

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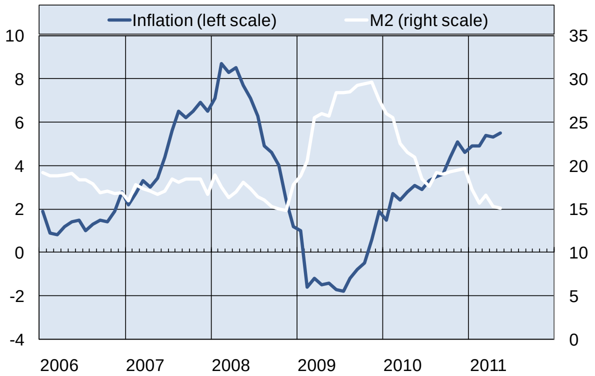
China

China posts strong May economic figures despite tighter monetary policy. On-year industrial output growth in May showed little change from the previous month's 13.3 % growth. Industrial output was up in all industrial branches; most notably machine-building and the metals industries, which were both up nearly 20 %. Investment in fixed assets and real estate continued to soar in May. Inflation accelerated slightly last month, with consumer prices up 5.5 % y-o-y.

While tightening of monetary policy has yet to bring inflation under control, it has significantly cut into rates of growth for both bank lending and the broader measure of the money supply (M2). Although the loan stock and money supply were still up 15 % y-o-y in May, they were down from rates close to 20 % y-o-y at the start of this year. Official financial market figures should be viewed with some scepticism, however, as stricter bank lending policies have meant that banks have shifted some of their lending activity off their balance sheets and channelled money into the grey market.

Inflation and M2 money supply, %-change, y-o-y



Source: China's National Bureau of Statistics

The International Monetary Fund IMF gave China generally high marks in its concluding report to the IMF board in its latest Article IV consultation. The IMF sees a positive economic outlook for China: growth of the Chinese economy is expected to remain strong this year and next year (on-year growth of 9.5 % in 2011 and 2012), while 12-month inflation is expected to decline to around 4 % by the end of this year.

The IMF considers measures taken by the Chinese officials to tighten monetary policy and to limit credit growth as appropriate. The risk in a pick-up in inflation, however, will persist if world commodity prices continue to rise, and risk of real estate bubble exists. The IMF supports policies geared to liberalisation of the financial markets, the ending of currency controls, and allowing the yuan to appreciate. As part of its Article IV consultation, China participated for the first time in the IMF-World Bank's Financial Sector Assessment Program.

Growth in household demand continues to slow; car sales down. Retail sales of consumer goods grew in May 16.9 % y-o-y in nominal terms, 0.2 percentage points below April and 1.8 percentage points lower than in May 2010. Due to higher inflation, growth in retail sales of consumer goods was up 11.4 % y-o-y in real terms in May, or nearly the same as the 11.8 % rate posted in April.

Growth in retail sales was supported in January-May by a 40 % y-o-y nominal increase in sales from petroleum and related products. The higher sales of petroleum and related products are due to both higher consumption and price growth. Sales of cosmetics and communications devices were also much higher in the first five months of 2011 compared to the same period last year. While the nominal growth in both groups was well over 20 %, they represent only a few per cent of the total value of retail sales. The Chinese New Year celebrations traditionally boost sales of gold and silver jewellery; in January-May, jewellery sales were up an average of 50 % in nominal terms. Jewellery sales accounted for 3 % of total retail sales last year.

Car sales are a big part of Chinese retail sales, accounting for nearly 30 % of total retail sales in 2010. Car sales increased 13 % y-o-y in nominal terms in January-May. However, the growth rate has decreased, dragging down the overall retail sales figure. Tax incentives to car buyers introduced during 2009 were phased out at the end of 2010, which might suggest that the growth in car sales returns to the long-term trend. The decline in car sales was partly due to the natural disasters in Japan, which resulted in a breakdown of the car part supply chain. This has impacted car production in China. Higher fuel prices and housing costs might also have dampened car demand.

Trade surplus up in May. The value of imports to China in May was about $144 billion, unchanged from the previous month. The 28 % y-o-y rise in import value was driven largely by high world commodity prices.

China's exports in May were up 19 % y-o-y to a level of $157 billion. The growth rate for exports was lower than in March and April reflecting seasonal fluctuations and e.g. the debt problems of the eurozone and the feeble economic recovery in the US. The US and EU are China's top export markets.

With May imports remaining unchanged from April and exports growing slower than average, the trade surplus was lower than expected. While the monthly surplus in May increased by a couple billion dollars from April to $13 billion, it was still a third smaller than in May 2010.