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Russia

Russia one step closer to WTO membership. On November 10, the WTO working group on Russia's membership gave the go-ahead to the final conditions of the country's accession. Based on the working group's recommendation, the WTO Ministerial Conference in mid-December is expected to approve Russia's membership.

Only some membership conditions have so far been released. Information from the WTO and Russia's economy ministry give an idea of Russia's commitments to lowering import duties; the average import duty should fall from about 10 % at present to less than 8 %. About a third of the tariff reductions enter into force immediately upon accession, with the remaining reductions phased in over various transition periods. The most common transition periods are 2–3 years, but some of the most sensitive products (e.g. passenger cars) have been granted transition periods as long as seven years.

Lower duties will apply to a number of product groups in the technology category. For example, import duties on computers will be phased out completely after a three-year transition period. Import duties on passenger cars will be reduced incrementally over a seven-year period from their current level of 30–35 % to 15–20 %. Domestic content rules imposed on car assembly plants in Russia will remain in force until summer 2018. Average import duties on agricultural products will fall from over 13 % to under 11 %.

The WTO agreement also covers services. According to Russia's accession rules, foreign insurance companies will be able to establish branch offices in Russia after a nine-year transition period. Foreign banks, on the other hand, won't be able to establish branches in Russia even after WTO accession, and must instead operate as Russian subsidiaries.

From the EU's standpoint, a significant improvement is Russia's commitment to give advance notice of changes in export duties. Russia promised to consult the EU on planned change in export duties at least two months in advance. The shift affects about 600 raw materials not covered under Russia's WTO deal, but of which Russia is a significant exporter.

Russia has until June 15, 2012 to ratify its WTO agreement. Membership would become effective one month after ratification.

Diversity in economic performance and 2012 forecasts. Rosstat figures show GDP increased by 4.8 % y-o-y in the third quarter, and that GDP growth in the first half of the year was well under 4 %. The high third-quarter figure reflects the low comparison point of 3Q2010. The down-and-up development this year and last year has been considerably influenced by the agricultural output, which rebounded from its steep drop in 3Q2010.

Seasonally adjusted GDP growth revived in the third quarter after distinctly weak second-quarter performance, supported by the construction and retail sales segments. Manufacturing has fluctuated in recent months; after a weak September, output growth returned in October.

Most observers expect economic growth to slow at the end of this year due to flagging exports. After notable consensus earlier, forecasts for 2012 have diverged in recent months. One group of analysts still sees growth of around 4 % or even higher next year if the oil price does not sink below $100 a barrel. Another group has lowered their projections to below 4 % next year due to the weak outlook for the global economy. Some top forecasters put growth next year at 3 %, or even 2.5 %, if the oil price drops to the range of $80–90 a barrel.

Banking sector liquidity expected to improve by year's end. The substantial tightening of liquidity for Russian banks in recent months has been reflected in a sharp increase in demand for liquidity facilities provided by the central bank and the finance ministry. Interbank lending rates have also increased substantially from late summer: for example, the one-day Mosprime lending rate in August was below 4 %, but by mid-November had climbed to over 5.5 %.

The tight liquidity has been caused in part by an outflow of capital that accelerated in September as the outlook for the global economy began to weaken. As the capital outflows increased, the Central Bank of Russia made its largest currency selling interventions at the end of September in domestic currency markets. The CBR estimates that net capital exports in October-December will remain at about the same level as in July-September, i.e. $20 billion. For the year as a whole, the CBR expects the net outflow of capital to be around $70 billion, up from $34 billion last year.

A second major cause of the tightened liquidity situation is the budget. Unlike last year, the current budget is in surplus with spending financed from tax collections rather than tapping into the reserve fund. The finance ministry has sought to ease the situation through increasing the amounts offered at its auctions providing cash to banks in the form of temporary deposits.

Budget spending in Russia is traditionally weighted towards the end of the year, so budget spending tends to increase liquidity especially in December. Preliminary finance ministry data suggest that only slightly over 70 % of budgeted spending for 2011 had occurred in the January-October period, which means that in the remaining two months of this year the public sector should spend over 3 trillion roubles (about €72 billion) in budgeted funds.

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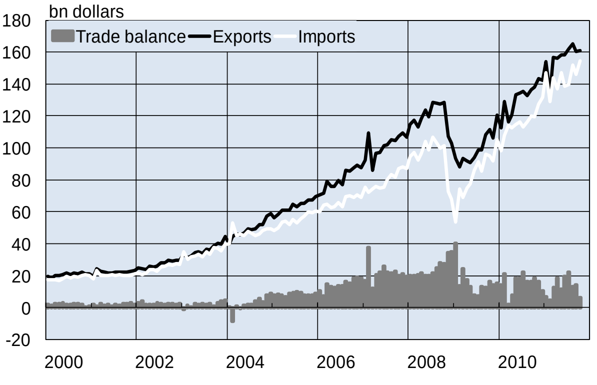
China

Economic slowdown yet to be reflected in a drop-off in metal imports to China. China customs figures show the value of imports continued to climb rapidly in October. China has reinforced its position as the world's largest consumer of raw materials, with continued strong growth registered for such commodities as pulp and copper. Imports of iron ore continue to rise, even with a build-up in ore stockpiles at Chinese ports. The ore stockpiling evidences both the cooling of the building boom and uncertainty caused by negotiations between the Chinese and international iron ore producers on adjustments to the pricing mechanism. China's construction sector is the world's largest steel consumer, and the lion's share of iron ore consumed by China goes to steel production.

After nearly ten years of steady growth, crude oil imports have stabilised; import volumes have held this year at a level of about 20 million metric tons a month. China does not publish comprehensive figures on its national oil stores, but by some estimates refiners have depleted their own stockpiles in an effort to keep up with rising domestic fuel consumption. Natural gas imports have increased rapidly as new liquefied natural gas (LNG) receiving terminals have been pressed into service.

Despite the increase in China's raw material imports, the struggles of developed economies have restrained global commodity prices. The lack of demand in developed economies is apparent in China's export figures, which showed marked declines in September-October relative to July-August. Nearly all of the decline can be attributed to plunging exports to the EU, China's largest export market. Weaker exports and higher imports have eroded China's trade surplus in recent months. One factor in export weakness and import strength has been appreciation of the yuan's exchange rate.

China's foreign trade (seasonally adjusted)



Sources: China customs and BOFIT

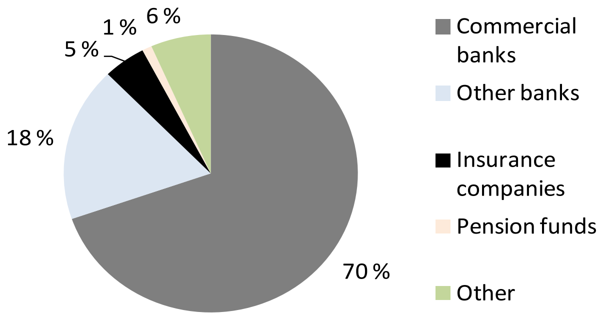
IMF points to vulnerabilities of China's financial sector from inefficiency and risk exposure. The IMF's views are based on the Financial Sector Assessment Program (FSAP), which was carried out a year ago, but the report was only released this week. The report states China's financial sector, while generally robust, faces a build-up in vulnerabilities from regulatory distortions. The over-involvement of officials in guiding bank policy means that banks fail to pay adequate attention to credit risk and assuring adequate returns on their investments. Excessive regulation prevents development of financial markets, including broader access to credit and more diverse savings strategies.

The IMF would like to see Chinese officials embark on a fundamental modernisation of the financial sector. Regulation of interest rates should be phased out and officials should extricate themselves from involvement in bank lending decisions. Banking operations need to be based on commercial objectives rather than broad government policy goals. The report further calls for greater focus on financial supervision and crisis management, as well as putting a reliable deposit insurance scheme in place.

Despite these deficiencies, China's financial institutions weathered the global economic crisis in fairly good condition. Bank profitability remained good and solvency increased. The largest risks facing banks relate to the explosive growth in lending, off-balance-sheet activity, a real estate bubble and unbalanced economic development. Stress testing showed that the largest banks would be fairly resilient to isolated shocks. However, risk rises if banks have to deal with multiple shocks such as a deterioration of economic growth combined with a collapse in real estate prices.

Commercial banks represent over two-thirds of the total net assets held by China's finance sector, with the biggest commercial banks still state-majority owned. While the number of foreign banks now exceeds 200, their operations remain quite narrow. The other major banking cluster is made up of nearly 3,000 cooperative financial institutions. There are also nearly 800 other financial entities in China, including insurance companies, pension funds and companies providing asset management services.

Structure of China's financial sector in 2010



Source: IMF

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