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Russia

CBR makes first small rate adjustments since September. The Central Bank of Russia raised its fixed deposit rate on December 11 by a quarter of a percentage point to 4.5 %. As a background for its decision, the CBR noted that persistent high inflation (currently 6.5 %) could sustain inflation expectations but also that economic growth slowed in the third quarter and in October. GDP grew 2.9 % y-o-y in the third quarter. The CBR, however, said that the confidence of economic actors has remained generally positive, and that healthy employment and good development of bank credit should support domestic demand.

Gazprom breaks ground on construction of South Stream gas pipeline in Russia. The final go-ahead on the project was reached in November when the final transit country, Bulgaria, agreed to construction of the pipeline on its soil. Turkey last year granted Gazprom permission to run the pipeline under the Black Sea in its territorial waters. The South Stream pipeline will go from the Russian city of Anapa along the seabed of the Black Sea to the Bulgarian coast, and from there on to Serbia, Hungary, Slovenia and Italy. A planned second branch of the pipeline would serve Croatia and Bosnia-Herzegovina. Gazprom holds a 50 % stake in the project. Other participants include the Italian ENI (20 % stake), the French EDF (15 %) and the German Wintershall (15 %).

The 1,500-kilometre South Stream pipeline is estimated to cost about $16 billion and it should be completed in 2015. When it reaches full capacity in 2018, it will be able to carry 63 billion cubic metres of gas annually. The construction work has yet to begin outside Russia. The required environmental impact studies have yet to be performed and the technical specification is still incomplete.

Gazprom sees the South Stream pipeline as providing an alternative transmission route to European markets that bypasses Ukraine. At the moment, about 80 % of Russian gas exports to Europe pass through Ukraine with current pipeline capacity of just over 140 billion m^3. Gazprom would continue to use its other European pipeline, which runs through Belarus and has a capacity of 35 billion m^3. The new Nord Stream gas pipeline to Northern Europe was commissioned a year ago. Its annual transmission capacity was boosted to 55 billion m^3 in October, although the pipeline only operates at a third of capacity at the moment.

Gazprom caves on gas prices in reaction to global market trends. Gazprom has lost market share in Europe as European energy companies have shifted to buying other gas on spot markets, where prices are well below what they pay on long-term supply contracts with Gazprom.

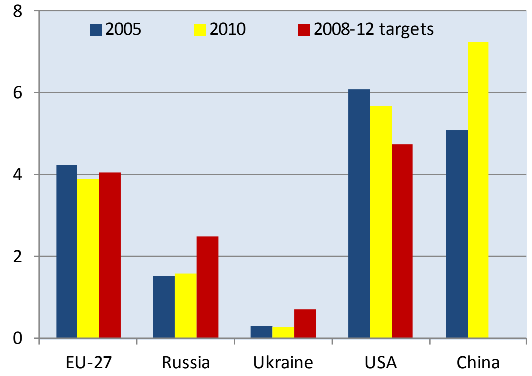
As buyers have moved away from dependence on Gazprom, several big European gas importers in the last couple of years have managed to negotiate discounts with Gazprom on existing contracts. Gazprom has also been taken to court for overly strict supply contract terms requiring buyers pay for a certain amount of gas even if the buyer does not take the full amount of gas under the contract.

In November, Poland won 16 % discount from Gazprom while Bulgaria got a 20 % cut. As part of the deal, Poland withdrew its claims against Gazprom filed with the Stockholm Arbitration Tribunal over Gazprom pricing policies.

No new commitments from Russia on carbon emissions at Doha climate summit. The Doha UN Climate Change Conference wound up on December 8 after agreeing on the next phase of the Kyoto Protocol that will run from 2013 to 2020. While e.g. the EU and Ukraine agreed to a new round of emission reductions, Russia will stay with its commitments under the first phase of the treaty whereby Russia only promises not to exceed its 1990 levels of greenhouse gas emissions. The commitment demands very little from Russia as it has consistently been clearly below 1990 levels in the post- Soviet era. The situation has created opportunities for Russia to sell carbon credits to other countries. Changes in the Kyoto treaty at the Doha round, however, limited Russia's possibility to sell carbon credits. In any case, Russia has benefited less than officials expected from emissions trading due to the low demand for carbon credits.

The Kyoto Protocol, created in 1997, had a first target phase spanning 2008–2012, during which the treaty imposed binding annual greenhouse gas emission targets for nearly 40 countries. China, the world's biggest greenhouse gas emitter, has refused to be bound under the Kyoto process, and like other developing nations, its efforts to cut emissions are voluntary. The Doha round agreed on drafting a new global climate treaty by 2015 that would come into force in 2020 when the Kyoto treaty expires. The new treaty would also bind developing nations to emission targets. The US, the biggest greenhouse gas producer in the industrialised world, has never ratified the Kyoto Protocol.

CO_2 emissions of select countries in 2005 and 2010, as well as 2008–2012 targets under Kyoto treaty, billion tons



Sources: UNFCC, IEA.

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China

Capital investment and private consumption doing more to support Chinese economic growth, export industries struggle. After a modest pick-up in September and October, growth in Chinese exports fell to 3 % y-o-y in November on an accelerating decline in exports to Europe and as a new feature a contraction in exports to the US and Japan. The value of imports was unchanged from a year earlier, due in part to lower global commodity prices.

Domestic demand increasingly supports Chinese economic growth. Capital investment was up in January-November by about 20 % from the same period in 2011. Real growth in retail sales of 13 % y-o-y signalled that the robust growth in private demand continues. While higher food prices pushed 12-month inflation up to 2 %, inflation still presents little threat to the rise in real consumer purchasing power.

Growth in industrial output accelerated in November to 10 % y-o-y. Production of electricity and passenger cars was up 8 % y-o-y, while metal production clearly exceeded the average 10 % growth rate. In addition to strong retail sales, the services purchasing manager index indicated that growth in the service sector remains robust.

China and South Korea build on yuan-won swap arrangement to boost bilateral trade. South Korea and China agreed at the start of this month on increasing the use of their national currencies in bilateral trade. Already earlier, the central banks of China and South Korea established a nearly $60 billion currency swap arrangement, and now this facility will be used to promote the use of national currencies in trade between the two countries. Over the next two weeks, South Korea's central bank will begin to give Korean banks access to yuan-denominated loans to use in financing imports from China. Correspondingly, the People's Bank of China will grant won-denominated loans to Chinese companies to help finance their activities in South Korea.

Despite substantial bilateral trade between China and South Korea, virtually all earlier trade has been paid for in currencies other than won or yuan. The move will not only help companies reduce exposure to currency risk, currency conversion costs and vulnerability to financial shocks, it will also promote international acceptance of both currencies. South Korea went into the swap arrangement originally to support liquidity in its financial system during the global financial crisis. China has used the swap arrangement to strengthen the yuan's position and support Chinese exports.

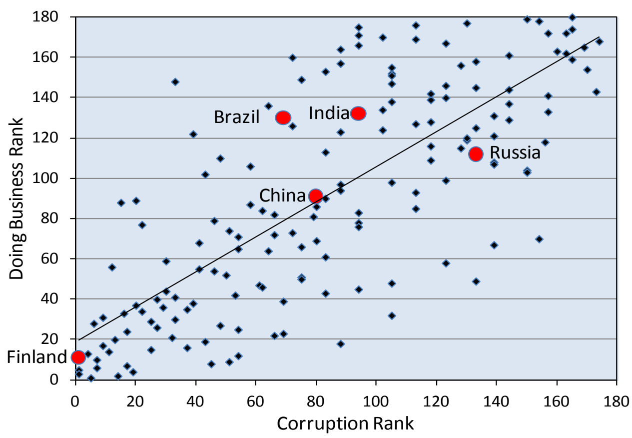
China drops in corruption perception index. At the beginning of December, Transparency International (TI) released its annual Corruption Perception Index (CPI) ranking. The 2012 CPI covers 176 countries, and scores public sector corruption from 0 (absolutely corrupt) to 100 (very clean). This year, about two-thirds of the countries surveyed had CPI scores below 50, suggesting serious corruption problems are fairly ubiquitous. The least corrupt countries included the Nordic countries and New Zealand, while the most corrupt countries were led by Afghanistan, North Korea and Somalia.

China's CPI score of 39 lowered it five places from 2011 to 80th place. Even with a drop in the rankings, China's public sector corruption was still less of a problem than in India or Russia. India's rank in 94th place was unchanged from last year, while Russian climbed ten notches to 133rd place.

TI has revised its index calculation methods, making comparison with earlier years difficult. Nevertheless, it is clear that the Chinese have become more concerned about corruption in recent years. In October, a Pew Research Center released a China survey as part of its Global Attitudes Project that found half of its Chinese interviewees consider corruption a "very big problem." Four years ago, the same survey found that only 39 % of Chinese saw corruption as a major problem. Revelations and public discussion of financial abuses by public officials and politicians in the last six months have brought the issue of corruption to centre stage.

Corruption thrives in environments with vague or complex administrative practices that impede business operations. In the scatter chart below, the x-axis indicates the country's ranking in TI's Corruption Perception Index and the y-axis shows each country's ranking in the IFC and World Bank's Doing Business 2013 survey. The data reflect 2012 reporting.

2012 corruption and business environment rankings



Sources: Doing Business 2013, Transparency International and BOFIT