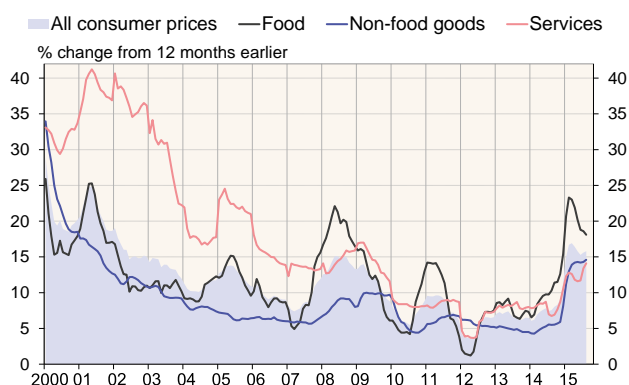


Russia

Russian inflation continues to pick up steam. Consumer prices showed in July-August their fastest on-month rise for years. In August consumer price inflation was nearly 16 % y-o-y and food prices were up over 18 %.

Following a price spike late last autumn and winter, food prices fell slightly in the summer in line with normal seasonal fluctuations. However, the rise in prices of non-food goods accelerated in July-August in a manner similar to (but milder than) what happened last winter and spring. An underlying factor was a sharp drop and increased volatility in the ruble exchange rate. Prices of services also rose faster than in many years, mostly due to unusually large rate hikes in July for household energy and water supply.

Consumer price inflation



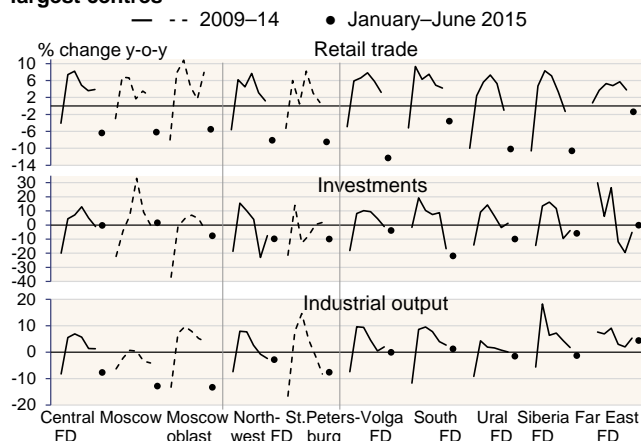
Source: Rosstat

Recession hits Russian regions. Private consumption has fallen considerably. The volume of retail sales in the first half was down 6–12 % y-o-y in most of the eight Federal Districts. The decline in the three most northwestern Federal Districts was distinctly worse than during the 2009 recession. In 22 of Russia's 83 administrative regions, the on-year contraction was 10 % or more.

Fixed capital investment, which began to fall in almost every Federal District already in 2014, has continued to slide this year. In the first half, investment nationwide was down more than 5 % y-o-y. Variations at the regional level were huge, however. Some 33 regions showed investment declines of at least 10 % y-o-y, while 19 regions saw investment slide at least 20 %. At the same time, investment increased by more than 5 % y-o-y in 23 regions.

Industrial output has been falling especially in the Central Federal District due to notable contraction in the production of several sectors in the City of Moscow and surrounding Moscow region. In the first half of the year, industrial output in 15 regions fell by more than 5 %, while output was up over 5 % in 24 regions.

Real economic growth in Russia's seven Federal Districts and largest centres



Source: Rosstat

Putin issues decree to speed up construction of Power of Siberia pipeline. It was hoped that president Putin's state visit to Beijing last week would give a boost to China-Russia economic relations, but the meeting produced little of substance. There was no progress in talks on construction of the Altai pipeline to bring gas into Western China and the new initiative on building a one more pipeline from the Far East received little attention.

Construction of the Power of Siberia natural gas pipeline has proceeded slowly since it began a year ago. Gas transmission is scheduled to begin in 2019, which requires that construction of the massive transmission pipeline grid be completed and two new gas fields brought on stream. Gazprom expects the Chayandinskoye field (Yakutia) to be producing in 2017 and the Kovykta field (Irkutsk) in 2022.

The Power of Siberia project is a key part of Russia's efforts to diversify gas export routes. The country's leaders have repeatedly described the project as a good example of intensified cooperation with China. At the end of August, Putin signed a decree to speed up implementation of the project and the cabinet moved ahead with enabling rules. The machinery and equipment needed for the construction of the Power of Siberia pipeline and new production areas will be exempt from import tariffs (if comparable domestic products are unavailable) and value-added tax. Moreover, numerous government agencies and state firms have been encouraged to support the project in many ways. For example, the state railways and other transport businesses have been encouraged to give priority to project shipments, while power grid operator Rosset has been asked to give priority to projects related to the Power of Siberia pipeline.

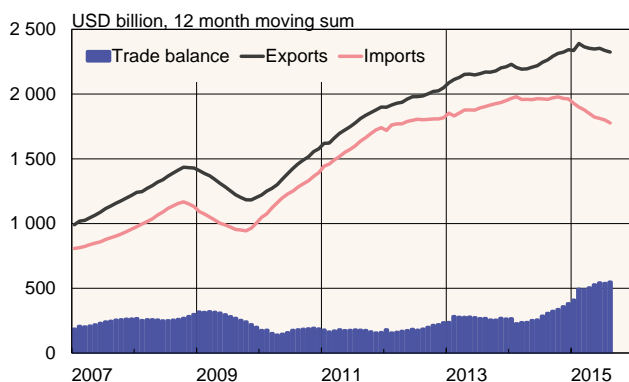
Construction of a 2.2-kilometre rail bridge across the Amur River commenced last year has not proceeded as anticipated either. The Chinese partner says it should complete its 1.9-kilometre stretch of the bridge by the end of October. The Russian partner has yet to start construction work.

China

Chinese foreign trade down again in August. Exports continued to contract in August, falling 6 % y-o-y. For the first eight months of the year, the value of goods exports was down 1 % y-o-y. Growth in the volume of exports remains sluggish.

The value of imports fell 14 % y-o-y in August, continuing a trend seen all this year. The main reason for falling import values is the collapse in prices of energy and other basic commodities. After several consecutive months of decline this spring, import volumes in June-July began to rise. The cumulative trade surplus for January-August climbed to \$366 billion.

Value of China's foreign trade



Source: Bloomberg

New figures on Chinese local government debt. Chinese officials report that the total amount of local government debt at the end of 2014 amounted to 15.4 trillion yuan (€2.3 trillion), or about 25 % of GDP. The new number is slightly lower than the official estimate released this spring. A full set of figures on local government indebtedness was last released in June 2013, when the overall debt figure was estimated to be around 10.9 trillion yuan.

The debt stock has risen 40 % over the past 18 months. Part of the increase reflects a reclassification of loans guaranteed by a local government as direct local government debt. In addition local governments are indirectly liable for loans they have guaranteed. The value of loan guarantees was put at 8.6 trillion yuan (€1.3 trillion), or 23 % more than in July 2013. Loans and guarantee obligations totalled around 25 trillion yuan (€3.5 trillion).

The government has turned to the bond markets for solutions to the debt problems of local governments. Under the latest guidelines, local governments are allowed this year to issue bonds worth up to 3.2 trillion yuan to refinance their existing credit obligations. Local governments have also been given the option of issuing new debt in the amount of 600 billion yuan. The ceiling on local government debt was raised this year to 16 trillion yuan.

Local governments have so far this year issued 1.4 trillion

yuan in their own bonds. These issues have largely been met with low investor enthusiasm due to their modest yields. Regulatory officials are again allowing local governments to borrow via external off-budget financial vehicles for certain types of financing. Policy banks have also begun to assist local governments in financing their infrastructure projects through directed bond issues.

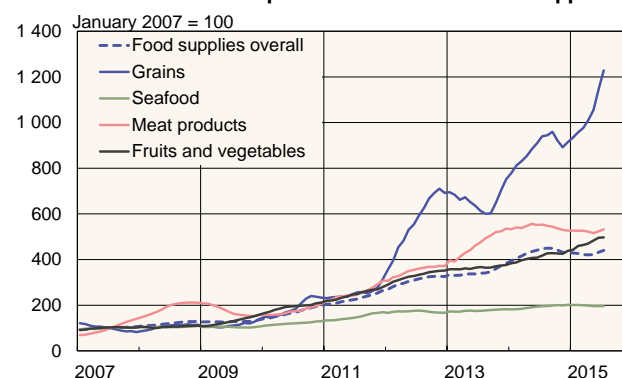
Chinese food imports up. Growth in domestic food production has failed to keep up with growing consumer demand and shifting consumer habits, even if China seeks to achieve self-sufficiency in many basic agricultural products. Agriculture now accounts for about 9 % of GDP, down from 15 % at the start of the 2000s. In the meantime, food imports have risen 18 % a year on average.

Despite low productivity, China remains the world's largest agricultural producer. Chinese farms are typically quite small and poorly suited to modern mechanised farming techniques. Further, the total area of available farmland continues to decline as a result of increasing environmental degradation and the loss of natural services. Agriculture has been hurt particularly by the lack of clean irrigation water and soil pollution. An official report released in 2014 found that nearly 20 % of China's farmland is toxified due to pollution and excessive use of fertilisers and pesticides.

Urbanisation reduces the rural labour force and the amount of available farmland, but it also increases average consumer incomes and reshapes consumption habits. China's environmental problems and scandals in the food industry have increased demand for foreign products, which are seen as safer than the local option in many cases. Strong growth has been seen in imports of grains, meat, vegetables and fruits.

Data compiled by China Global Investment Tracker show how China has invested \$43 billion over the past ten years in agricultural projects around the world. Chinese firms have partnered with foreign agricultural producers in order to learn how to enhance their productivity with the latest production methods and to import foreign produce to China. China has also entered into bilateral trade agreements with numerous countries to ease food imports.

Value of Chinese food imports and of various food supplies



Source: Macrobond