Weekly Review
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BOFIT

Russia

Russia and OPEC agree on new production limits. Russia, OPEC and a few other oil-producing countries announced last Friday (Dec. 7) that they were cutting back crude oil production by a total of 1.2 million barrels a day from the start of 2019. OPEC members will reduce their production by a total of 800,000 barrels a day, while non-OPEC countries commit to cutting back by a total of 400,000 barrels a day. Soon after the agreement was announced, the price of a barrel of Brent crude rose by about 5 % to over 63 dollars. This week it slid back to a level of around 61 dollars.

The agreement of production cuts will stay in place for six months, and according to the agreement producer countries reduce their production by over 2 % from the October 2018 level. Russian energy minister Alexander Novak said that Russia plans to reduce its daily output gradually over the next few months for an overall reduction of 228,000 barrels a day. Novak further noted that production cuts in January 2019 would be at least 50,000–60,000 barrels a day. In addition to the production cut deal, Russia, OPEC and a few other oil-producing countries are now preparing a separate cooperation agreement to be signed in the first quarter of 2019.

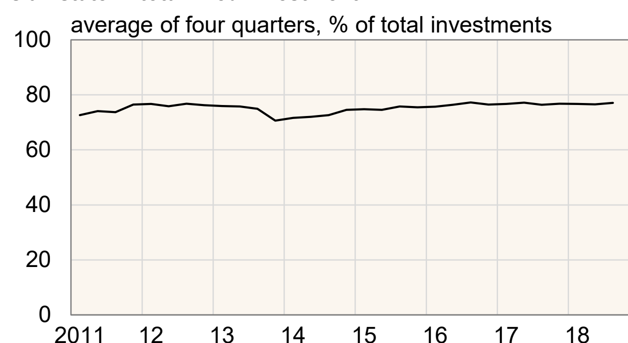
In late 2016, OPEC and Russia announced they had voluntarily agreed to a cut of nearly 1.8 million barrels a day. Russia's cut amounted to 300,000 barrels a day, a reduction it gradually implemented in the first half of 2017. The agreement on production cuts was extended twice in 2017. In June this year, OPEC and Russia announced that they were abandoning the production cuts. During last months, Russian oil output has been at an all-time high for the post-Soviet period. Russia's energy ministry reports that output in September-November averaged 11.4 million barrels a day, i.e. over 400,000 barrels a day above the previously agreed production ceiling, and over 4 % higher than in the same period in 2017.

Fixed investment growth in Russia accelerated in the third quarter. Fixed investment was up by over 5 % y-o-y in the third quarter of this year. In the first six months, on-year growth exceeded 3 %. For the entire January-September period, growth was slightly over 4 %.

Fixed investment by large and mid-sized firms, as well as the state, rose in the first nine months of the year by 1.4 % y-o-y. Rosstat estimates that other fixed investment, including investment by small firms, was up by well over 10 %, almost the same increase as in the first half of the year.

After two years of growth, fixed investment by large and mid-sized firms in crude oil production declined by a couple of per cent in January-September. In contrast, fixed investment in natural gas production increased by nearly 50 %, even if investment growth in the branch was already brisk in the previous two years. Last year's notable recovery in natural gas pipeline investments has continued this year. Large and mid-sized manufacturing firms markedly increased their investment, although the level of investment was still low in light of a steep three-year slump.

Share of investment of large firms, mid-sized firms and the Russian state in total fixed investment



Source: Rosstat.

The third unit of the natural gas liquefaction plant in Yamal went into operation in November. The plant is located on the coast of the Arctic Ocean. It brought its first unit, or train, on stream a year ago, and the fourth and final unit is to be commissioned next year. However, the fourth unit is significantly smaller than the first three. Somewhat unusually, the project is about a year ahead of its original schedule.

Russia's total natural gas liquefaction capacity now exceeds 25 million tons a year, which is equal to about 6 % of global capacity. Liquefaction, shipping and regasification are an alternative way to deliver gas to customers beyond the reach of pipelines. The largest demand is in Asia, which lacks a sufficient number of gas pipelines from production areas.

There are two large liquefaction plants in Russia. The other is on Sakhalin Island on the coast of the Pacific Ocean. From there, gas is shipped directly to Asian markets. In contrast, most of the Yamal gas is shipped towards the Atlantic due to difficult ice conditions. Even though the gas is transported by a fleet of icebreaker cargo ships, shipments towards the Pacific Ocean are possible only in summer. Most often these special ships are used to transport the gas to ice-free waters, where it is then transferred to other vessels. Such transfers are made, for example, in the Norwegian Sea or in Western European ports. The gas then continues its journey with market prices determining the final destination. Some of it goes to Asia.

The Yamal facility is majority-owned by the Russian gas company Novatek. The minority stakes are owned by the French Total, China National Petroleum Corporation and China's Silk Road Fund. Novatek has been in talks with French, Chinese, Japanese, Korean and Saudi entities about building yet another plant near the Yamal plant. Decisions are due next year. In addition, Novatek has announced its ambition to build yet more large facilities during the next decade.

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China

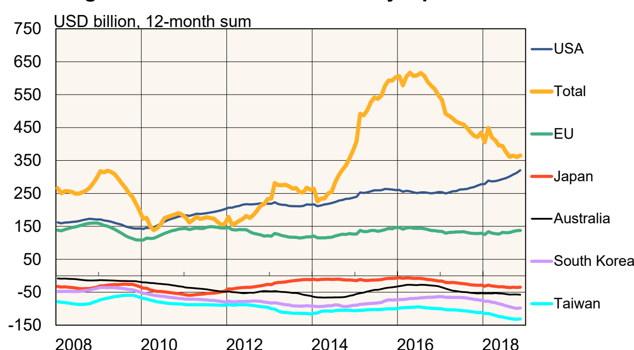
Growth of China's foreign trade slowed sharply in November; trade talks confront new problems. China customs reports that the value of goods exports in November rose by 5 % y-o-y, while the value of imports was up by just 3 %. For the January-October period, exports climbed by more than 10 % and imports by over 20 %. The rapid slowdown in import growth was not due only to declining commodity prices on the global market, but rather from the evaporation of growth in imports of machinery, equipment and related components.

Growth of Chinese goods exports to the US in November remained strong. In contrast, goods imports from the US declined by 25 % y-o-y. As a result, China's trade surplus with the US sored in November. Exports to the US were driven by strong economic growth in the US and anticipatory stocking-up on fears of impending tariff increases. United States customs figures show that goods imports from China already declined for those goods affected by the first round of additional tariffs in July and August.

China and the United States are still trying to negotiate a solution to their differences and end the trade war. China promised to buy even more American products and get rid of the additional tariffs imposed on American cars in July. Moreover, media reports claim China is even planning changes to its "Made in China 2025" industrial policy programme. It is hard to imagine, however, any quick fix to the situation as most of the reforms required take a while to implement even with the political will needed.

Already struggling trade negotiations were not helped last week by the US-ordered arrest of Huawei CFO Meng Wanzhou in Canada. The US accuses Meng of misleading banks about prohibited trade with Iran in violation of US sanctions. Meng was freed on bail in Vancouver, British Columbia, to await possible extradition to the US. China considers the arrest a political stunt, condemning it in the strongest terms. The Chinese government this week arrested two Canadians "on suspicion of engaging in activities that harm China's state security."

China's goods trade balances with major partners



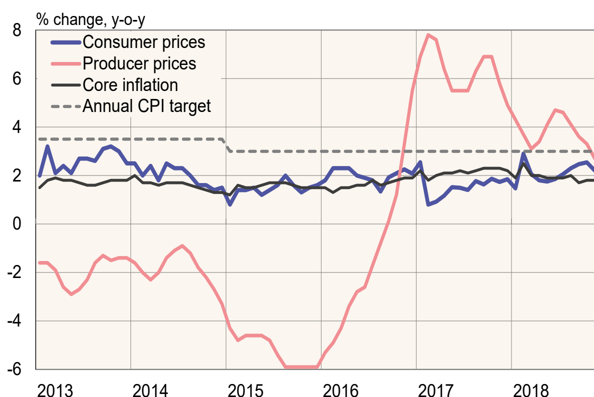
Sources: Macrobond and BOFIT.

Rise in Chinese prices remains modest. According to China's National Bureau of Statistics, consumer price inflation has remained modest and remarkably stable for years. 12-month consumer price inflation slowed to 2.2 % in November. Core inflation (food and energy prices excluded) has long remained at around the 2 % level.

The pace of producer price growth continued to slow in November. Producer prices were up 2.7 % y-o-y, but were down slightly from October due to drops in energy and commodity prices.

China's methodology for calculating consumer price inflation has been suspected for years to underestimate particularly housing costs. Even with the massive rent hikes recently in many cities, the consumer price index has only risen 2–3 %, even in China's tier-one cities.

Price trends in China



Sources: Macrobond and BOFIT.

Even with slowing growth, Hong Kong economy continues doing well. On-year GDP growth in the special administrative region slowed from 3.5 % in the second quarter to 2.9 % in the third quarter. In the first nine months of the year, GDP grew by 3.7 % y-o-y. The average on-year growth in Hong Kong since 2000 has been just under 3.9 %.

Hong Kong's economic growth this year has been broad based. Retail sales have provided an important engine of growth. Thanks to a strong first half, retail sales were up by over 10 % this year. Industrial output, exports and tourism earnings all made positive gains. Thanks to a strong economy, the unemployment rate fell from 3.0 % at the end of 2017 to 2.8 % in October. In recent months, Hong Kong's inflation rate has climbed to 2.7 %.

Business confidence indicators released by the NBS suggest that economic growth will continue to slow in the coming quarter. The growth outlook is clouded over the near and medium term by the slowdown in growth in mainland China, the US-China trade war and rising interest rates in the US. Shifts in American monetary policy impact Hong Kong instantly as the value of the Hong Kong dollar is pegged to the US dollar.

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