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Russia

Final construction permit issued for Nord Stream 2 pipeline. The Danish Energy Agency last week granted a construction permit for Gazprom's Nord Stream 2 gas pipeline. If the permit goes uncontested, Gazprom can begin laying pipe next month in the waters of Denmark's exclusive economic zone. About 150 kilometres of the 1,230-km pipeline runs through the Danish exclusive economic zone. The pipeline has already been laid in the Russian, Finnish and Swedish zones, and work continues in the southern Baltic Sea. Under the original schedule, the pipeline was to have been completed by the end of 2019. The capacity of Nord Stream 2 of 55 billion cubic meters a year is identical to the capacity of its twin, the Nord Stream 1 pipeline, which was commissioned in 2012.

Great uncertainty still surrounds commissioning of the pipeline. Under the EU's internal gas market rules, individual gas suppliers are limited to using no more than 50 % of the capacity of trunk pipelines. The Nord Stream pipelines come ashore in Greifswald, Germany, from where gas is transmitted southward via the OPAL trunk pipeline. A 2016 decree gave Gazprom the right to use the full capacity of the OPAL pipeline if no other suppliers needed to use it. At the beginning of September, and EU court ruled that Gazprom's exemption on trunk pipeline use was invalid. If the ruling goes uncontested, Gazprom has to supply about 12 billion cubic metres of natural gas to its customers by alternative means. According to Poland, which had sought the ruling, Gazprom will have to import that gas into the EU via Ukraine. Ukraine, the EU and Russia last held talks on gas transiting Ukraine at the end of October, but adjourned without reaching an agreement. The current transit agreement expires at the end of December.

In April 2019, the Council of the EU approved changes in the EU gas market directive. At the start of next year, the EU internal gas market rules shall apply to gas transmission lines between a member state and a third country, up to the member state's territorial borders. It is still unclear how the rules will be interpreted with regard to the Nord Stream 2 pipeline.

CBR issues monetary policy guidelines for 2020–2022. Maintaining price stability will remain the top monetary policy priority for the Central Bank of Russia in coming years. This means, in practice, the active pursuit of an inflation target of around 4 % p.a. The main monetary steering instrument remains the CBR key rate (7-day repo rate).

The basic mechanism for implementing monetary policy also remains the same. The CBR will try to keep overnight lending rates on the interbank market close to the CBR's key rate. Money market rates will be guided by absorbing or injecting liquidity into the banking system. In recent years, the CBR has dealt with excess liquidity largely through deposit auctions and the issuance of Bank of Russia bonds. The CBR plans to retain this approach.

Overnight standing facilities that banks can use on a daily basis are used to restrict fluctuations in money market rates. The rates of the overnight standing facilities for absorbing and providing liquidity define the interest rate corridor of the CBR (it has been key rate ±1 % for the key rate's entire existence). This steering mechanism has remained in place since end-2013. The CBR notes that steering mechanisms do not require quantitative targets for monetary aggregates.

Based on the CBR's forecast, banks in coming years are likely to experience an increase in their structural liquidity surplus that will boost their deposits in the CBR considerably. Some of this increase will be due to the CBR's daily forex purchases on the domestic forex market. These purchases are fulfilment of forex orders from the finance ministry. According to the government's fiscal rule, it needs to convert the excess earnings from oil taxes into foreign currencies that then go into the reserve fund.

At the same time, the CBR expects its foreign currency and gold reserves to increase quite substantially. In addition to forex buying, the CBR plans to purchase to the reserves more gold, which already makes up about a fifth of its reserves.

The CBR noted that besides monetary policy also other factors can occasionally cause price fluctuations. These factors include changes in food prices, the ruble's exchange rate and official decisions concerning administratively regulated utility rates.

Russia hosts African leaders at first Russia-Africa summit. On October 23–24, Russia hosted the Africa-Russia Economic Forum in the Black Sea coastal city of Sochi. Egypt, the current chairman of the African Union acted as co-host. In addition to forum discussions, bilateral meetings between countries took place.

At the forum, experts discussed the possibility for Russia-Africa economic cooperation and Russian officials and corporations showcased Russian expertise, products and services. While Russia does not have large amounts of capital to invest, it has some interesting goods and services to offer to African states. These mainly involve arms, energy production, raw material extraction and food production.

Russia-Africa trade is quite modest, but Russia is not starting from zero. The forum is part of an effort to revive relationships that were formed during the Soviet era.

Egypt is Russia's top trading partner on the African continent. Russian customs reports that last year Egypt accounted for 1.6 % of Russian goods exports and 0.2 % of goods imports. Other African nations accounted for considerably less. In earlier years, Egypt was a major beach vacation destination for Russian tourists. As part of Egypt's plans to develop the Suez Canal area, it is establishing a special industrial zone for Russian firms. China is also involved in developing the same area.

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China

China's key policy meeting offered no answers to the country's economic challenges. The Communist Party of China's 19th Central Committee concluded its fourth plenary session at the end of October. In addition to discussing the work report submitted by president Xi, the session focused on modernisation of the current system and improving capacity for governance. The final communique from the meeting, however, consisted largely of antiquated party hype and failed to offer concrete plans for tackling the country's wide-ranging economic issues.

The communique, which otherwise barely mentioned current problems, addressed the unrest in Hong Kong by stressing the importance of the "one country, two system" principle, as well the need to guarantee national security in special administrative regions. Possible changes in the law or other measures contemplated by the party elite for Hong Kong were not clarified.

The plenary session, which plays an important role in the party's decision-making, was postponed for one year without any explanation. The lack of proper information from the session and the empty content of the communique contradict the meeting theme of modernizing the current system.

Profitability and solidity of China's largest banks stable even as credit risk grows. A third-quarter reviews of China's biggest banks show that profits at each of the country's four giant banks grew by 5–6 % from 3Q 2018. While the return on equity (ROE) in the banking industry declined slightly overall, annualised returns held steady at just over 10 % at the big banks. The ROE of the banking sector overall in 2015 still exceeded 20 %.

Over half of earnings at the big banks was generated by interest margins, i.e. differences between rates on deposits and lending. Other earnings mostly came from fees. The revenues from securities and forex-related businesses were still a relatively small for banks operating in China.

The total assets of the four biggest banks grew by 5–10 % y-o-y (about the same pace as the nominal GDP). In terms of assets and liabilities, the largest of the four big banks was Industrial and Commercial Bank of China, with total assets about 30.4 trillion yuan (3.9 trillion euros) at the end of September. The other big banks had total asset of just over 20 trillion yuan.

China's big banks appear to be quite solvent. At the end of September, the Common Equity Tier 1 (CET1) readings for all big banks were unchanged from a year earlier. (CET1 is the highest quality of regulatory capital, such as common shares and retained earnings). Readings ranged from 11.2 % to 14.0 %. The international standard Basel III regulatory framework requires a level of 4.5 % at minimum, if other capital requirements are not included.

Bank profits have been dragged down by the growth in non-performing loans (NPLs), which now total 2.2 trillion yuan for the sector. The situation is the worst in 15 years. International observers claim that the amount of NPLs is actually much larger. The future of the NPL situation is highly dependent on macroeconomic trends in China.

Despite China's implementation of a deposit insurance scheme in 2015, bank runs have been seen in some smaller banks this year, with depositors emptying their accounts at banks they no longer trust. The latest runs hit the Yichuan Rural Commercial Bank and Yingkou Coastal Bank.

Hong Kong enters recession. Preliminary figures indicate that Hong Kong's seasonally adjusted GDP fell in July-September by 3.2 % from the previous quarter. As second-quarter growth was also negative (down 0.5 % q-o-q), Hong Kong is now technically in recession. Third-quarter GDP was down by 2.9 % y-o-y. Last year, the special administrative region (SAR) still experienced growth of 3 % y-o-y.

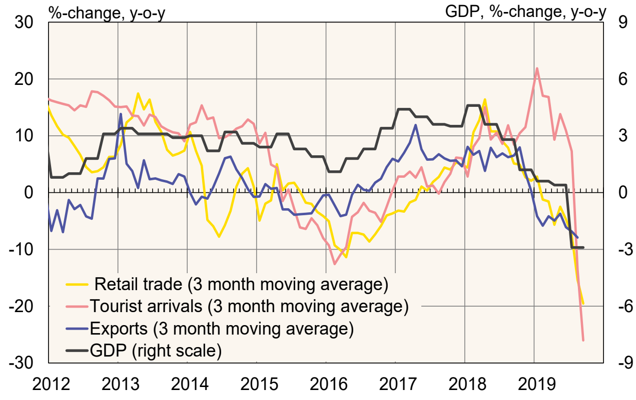
Hong Kong's economy is quite sensitive to shifts in tourism, trade and finance. Indeed, 55 % of the SAR's economy comes from just four branches: financial services, trade & logistics, tourism and professional services. Pro-democracy demonstrations have strongly impacted tourism, of which about 80 % comes from mainland China. Tourism flows began to decline in July and collapsed in August and September. The number of tourists arriving from mainland China fell by about 40 % y-o-y in August-September and the number of tourists coming from elsewhere fell by nearly 30 %. The lack of tourists has hurt retail sales.

The slowing Chinese economy also affects Hong Kong as roughly half of goods trade is conducted with mainland China. The volume of Hong Kong imports in August-September fell by about 10 % y-o-y, while exports were off 7 %.

The provision of financial services for foreign firms operating in China, as well as Chinese firms engaged in international expansion, are critical industries for the Hong Kong economy. Moreover, mainland Chinese have invested heavily in the local real estate market. However, there are currently no signs of major capital flight from Hong Kong.

The Markit purchasing manager index plunged from a slightly negative reading of 48 in June to 39 in October.

Key economic indicators for Hong Kong



Source: Macrobond.