

Russia

Bank of Russia cuts key rate again. Last Friday (Dec. 13), the Central Bank of Russia board of directors decided to cut the CBR key rate by 25 basis points to 6.25 %. The CBR said the cut was appropriate, largely due to a sharper-than-expected slowdown in inflation. The rate cut was the fifth this year. The CBR mentioned that the key rate could be lowered further in the first half of 2020.

The on-year rise in consumer prices slowed in November to just 3.5 %. The slowdown in inflation reflects factors such as the ruble's appreciation since the start of this year, weak economic growth and a good harvest. The central bank's updated inflation forecast now sees on-year inflation in the range of 2.9–3.2 % at the end of this year (down from 3.2–3.7 % earlier). The CBR expects the inflation to rise to a range of 3.5–4.0 % by the end of 2020 and thereafter remain near the official 4 % inflation target.

The average market rate on ruble-denominated corporate loans over one year was 9.3 % in October. The average rate on household ruble loans over one year was 12.7 % in October.

Recovery in Russian fixed investment remains slow. The real volume of fixed investment in the third quarter of this year was up only 0.8 % y-o-y. Growth in the first half was even a little lower, just 0.6 %. After a sharp drop in fixed investment in 2015, it recovered rather well in 2017–2018. However, this year's slow recovery means that fixed investment for the entire year will still remain a couple of per cent below the 2012–2013 level.

Fixed investment of large and mid-sized firms, as well as fixed investment by the state, which statistical reporting covers in the course of a year, appears to have developed more weakly than total fixed investment again this year. In fact, in the first nine months of 2019, fixed investment in these categories as a whole declined by over 2 % y-o-y. In other words, the Rosstat figures suggest that fixed investment in other categories (small firms, households and the grey economy) have been estimated to have continued their rapid growth further this year. These categories together account for about a quarter of total fixed investment.

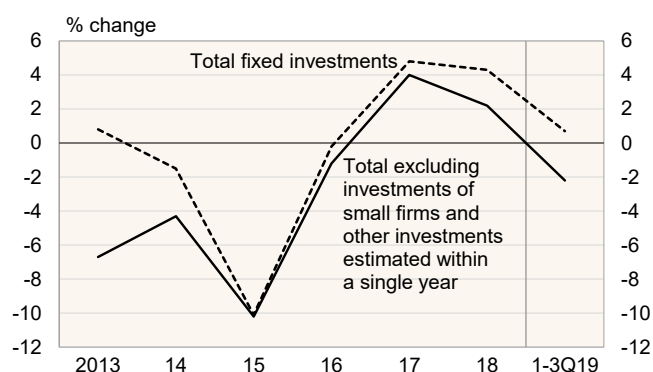
As in previous years, behind the average number of change in fixed investment there are large disparities in investment developments at the sectoral level. For those sectors where the investment of large and mid-sized firms is sizeable and thereby has a significant impact on the general track of fixed investment, three branches emerge as the biggest areas of growth this year. First, investment growth in natural gas production this year has well surpassed even last year's sharp increase. Second, after a substantial decline last year, investment in oil refining has risen fast. Third, following strong growth in 2018, the pace of investment in telecommunications has only accelerated this year.

On the other hand, after fairly tame growth in recent years, investment in the electricity sector has dropped steeply

this year. After two stronger years of investment, a similar sharp decline in pipeline investment has also occurred.

This year has not been promising from the standpoint of diversification of Russia's production base. After recovering nicely in 2017–2018 from a very sharp drop in 2015–2016, fixed investment in manufacturing other than oil refining has grown just very slightly this year.

Changes in real fixed investment in Russia, 2013–2019



Source: Rosstat.

Survey paints dreary picture of Russian business conditions. This autumn, the consulting firm PWC conducted a [survey](#) based on interviews with corporate representatives to get some notion of how Russia's business environment has changed since the early 1990s. The "fathers and sons" survey comprises the views of 1,000 representatives of various-sized firms across Russia. The study specifically looked at the generational differences between younger respondents (born 1980–1991) and older respondents (born 1957–1963).

About half of respondents said doing business in Russia had become harder than three decades ago. Business was complicated by factors such as administrative and regulatory barriers. Government control and inspection, as well as corruption, are also viewed to limit growth opportunities in the corporate sector. Nearly 70 % of respondents (and 80 % of "fathers") reported that corruption has worsened or remained about the same in recent decades. Most acknowledged improvements in such areas as competition, ease of starting a business and access to credit.

The survey also found that the risks facing entrepreneurs have changed in recent decades. In the early 1990s, most respondents said that the core business risks were getting murdered, physically assaulted or threats to family. The biggest fears today are damage to business reputation, imprisonment or forced emigration.

Only about half of all respondents believe that Russia's corporate sector will develop in a positive direction over the next 30 years. The younger generation, however, was slightly more optimistic. The most favourable outlooks were for the IT sector, energy production and trade. Sundowner branches included agriculture, healthcare and scientific research.

China

Preliminary deal in US-China trade talks avoids tariff hikes. Last Friday (Dec. 13), United States trade negotiators announced they had agreed with China on “phase one” trade treaty. While the text of the agreement was not released, the US trade representative’s office said the agreement covers intellectual property, technology transfers, agriculture, financial services, exchange rates, commitments to increased trade and dispute resolution. The agreement must still be finalised. No signing date has been announced and there are many uncertainties associated with the arrangement.

US negotiators said that China committed to purchasing US goods and services (industrial, agricultural, foodstuff and energy products) over the next two years in a total amount that exceeds China’s annual level of imports for those goods and services in 2017 by no less than \$200 billion. China confirmed that the parties had reached an agreement, but had no comment on details nor on the additional purchases.

The immediate effect of the announcement was to head off more tariff hikes and further escalation in the trade war. The US had threatened another round of 15 % tariff hikes on December 15 that would apply to nearly all Chinese imports still not subject to punitive tariffs. China also refrained from implementing its earlier-announced punitive tariffs.

The US further declared that, on the basis of the agreement, it was reducing from 15 % to 7.5 % the punitive tariffs on Chinese goods imposed on September 1. The tariffs affect about a fifth (110 billion dollars) in US imports from China. If the agreement is signed immediately in January, the lower tariff rates could be in force at the earliest in February. Other punitive tariffs on Chinese goods and services, however, would remain in place at their current levels. Punitive tariffs will still apply to nearly 70 % of US imports from China. This share has been stable since September 1. With the possible tariff cuts in February, the US-based Peterson Institute for International Economics (PIIE) estimates that the average US tariff rate on Chinese goods will be 19 %, down from the current 21 %. Prior to the trade war, the average tariff was 3 %.

About 60 % of China’s US imports are subject to punitive tariffs. PIIE figures that China’s average import tariff on US goods is 21 %, up from 8 % before the trade war.

China’s Central Economic Work Conference wraps up with little to show. The three-day Central Economic Work Conference of China’s top leadership took place last week in Beijing to set out next year’s economic policy framework and goals. The final statements from what is typically one of the year’s most important economic policy meetings was unusually vague: economic development should continue on the same fronts in the same manner as in previous years and stability is the central focus of economic policy.

Although China has yet to affirm an official GDP growth target for next year, some sources report that meeting participants settled on a target of around 6 % for 2020. If that target

is realised, China would hit its major policy target, set forth in 2012, of doubling real 2010 GDP by 2020.

In addition to the economic work conference, the meeting of the Central Committee in late October also had little to say about the economy. Given that China’s decision-makers are well aware of the need to reform the economy and better times for reforms cannot be expected due to worsening economic situation, the lack of guidance from party leadership is confusing. In light of China’s tightly closed decision-making system, one can only speculate as to whether this lack of direction reflects colliding differences among the leadership or that leaders are at a loss as to how to proceed due to the complexity of the challenges they face.

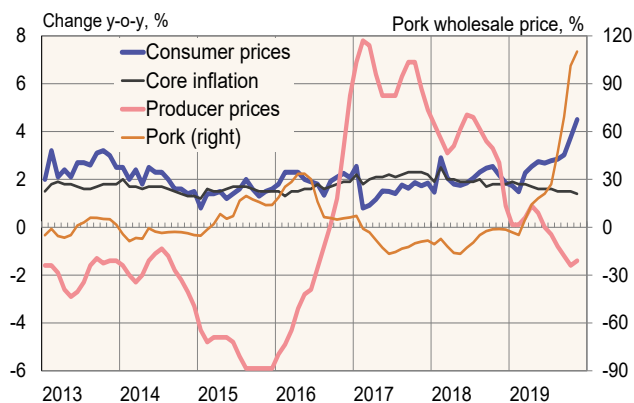
More mixed messages about the Chinese economy.

China’s National Bureau of Statistics reports industrial output growth rose from 4.7 % y-o-y in October to 6.2 % in November. The improved readings in the manufacturing purchasing manager indices affirmed the recovery. Passenger car production was slightly positive for the first time since June 2018. The readings of the services purchasing manager indices also suggested that conditions in November had improved from the previous month. The demand-side indicators, however, showed no corresponding strengthening in November.

While the purchasing manager indices suggest improvement in the service sector, there has been no sign of stronger growth in retail sales. Real growth in retail sales was 4.9 % in November (unchanged from October). Passenger car sales were down by more than 5 % y-o-y. November investment demand was unchanged from October. Estimates based on official figures show real on-year fixed investment growth in January–November was 2–3 %. Growth in electricity production and consumption has been below 5 % in recent months.

Accelerating inflation, which erodes household purchasing power, was a big contributor to the slowdown in retail sales. November consumer price inflation picked up from 3.8 % in October to 4.5 % in November as reduced pork supplies caused meat prices to soar. Producer prices, on the other hand, have been declining for five months.

Price trends in China



Sources: Macrobond and CEIC.