Ukrainian economic woes and Eurozone fears could lead to negotiated solution with Russia

The economy in Ukraine is collapsing and inflation has reached 17%. Its currency, the Hryvnia, has suffered the worst performance of the year, losing 48% against the US Dollar, in the world and, unless foreign aid arrives promptly, a default is expected. Ukraine's civil has had tragic effects on the economy and expectations of GDP having fallen 7.5% in 2014 are optimistic, while the central Bank expects even worse performance in 2015. In order to avoid a sovereign default, the European Union estimates that Kiev would need a USD$ 15 billion injection and Prime Minister Arseniy Yatsenyuk has already found it very difficult to obtain even a fraction of that as he considers the holding of a donors' conference. In this scenario, the International Monetary Fund has already allocated a USD$ 17 billion rescue package. What is especially troubling is that, despite the desperate financial condition, the government has forecast an increase in military spending of 5.2% and a cut in social spending to ease the burden on the state budget, while the imports "non-essential" duties will be doubled to 10%. Ukraine's dire economic situation plays into a complex geopolitical scenario that contains the seeds of a thaw in relations between itself and Russia and Russia with the West.

In recent weeks it has also learned that Ukraine has almost completely dried up its gold reserves from March to today, demonstrating the seriousness of the financial and currency crisis. Gold reserves in Ukraine are at the lowest levels since August of 2005, a decrease of 45% in 8 months. In contrast, while Ukraine has almost wiped out its gold reserves, Russia has continued to buy back, coming to 1,187.5 tons in November. Since 2005, Moscow has tripled its gold reserves, bringing them to the highest levels since 1993, suggesting that central banks, beyond Western Europe and North America, still have appetite for the shiny metal. Therefore, as hard as the situation may be for Russia, facing international sanctions and de-facto isolation from the West, Ukraine's financial situation is far worse. Indeed, the new government, which replaced the one led by former President Yanukovich a year ago in a US and European Union supported coup, Ukraine has proven unable to control and stabilize the internal political and economic situation, while becoming a virtual tool of foreign geopolitical interests and machinations. The good news is that, given its precarious financial condition, Ukraine will be forced to reach some kind of negotiated settlement with Russia in 2015 rather than risking default and the spreading of the conflict. Russia shares this interest because, the pursuit of a more intense military option is out of the question – apart from the cost, it would risk inviting additional encroachment from NATO powers. Surely, Russia will be in recession, but it should be able to avoid a default despite a predicted 4% drop in GDP for 2015.

President Putin said that Russia's economy will adjust gradually to the new level of oil prices. Therefore, while Russians can continue to expect bad economic conditions in 2015, a recovery should start in 2016; neither Ukraine or Russia stand to gain militarily or politically from a perpetuation of the war while the European Union will be overly preoccupied with 'Euro' exits to continue sustaining Ukraine. European investors – and voters – are weary of the volatility and increased risk resulting from a very possible Greek exit from the Eurozone: a 'Grexit' as some have called it. Doubtless, Greece represents a very small part of the Eurozone economy but even the departure of a small economy from the Euro would generate several problems from the ‘mathematical’ standpoint in the short term. The prospect of a Greek exit is a kind of ‘black hole’ of risk, because no one has ever come out from the Euro, and no one has ever suggested the release of the Eurozone economy. This uncertainty creates market volatility, a self-feeding mechanism that will inevitably force the European Central Bank to intervene to calm the markets. This possibility will reduce the appetite for foreign adventurism in the EU, leaving Ukraine more isolated. Russia, in turn, will fare better later in 2015 because the low oil prices that have so fiercely targeted its resource economy are unsustainable in the long term, despite recent Saudi rhetoric.

The price of oil is too low for OPEC, which will surely cut production in order to cause prices to rebound to at least USD$ 70-80 per barrel – it seems to be a fairly realistic number in the medium term. Therefore, Russia will be in a stronger position than Ukraine, which will be left with the ultimate responsibility to find a solution, even if it means leaving a part of itself to Russia. The conditions point to such a solution to emerge before the end of 2015 but, in geopolitics, there are many uncertainties and it could take longer. The more optimistic timeline for a solution is backed by the fact that France has already stated that it would stop sanctions against Russia in view of a continued diplomatic effort aimed at easing dialogue between Kiev and Moscow. Last December 6, France’s President Hollande held a surprise meeting with Putin in Moscow upon returning to Paris from a trip to Kazakhstan. Many other EU powers are eager to lift sanctions as well and it will not be difficult to convince the EU as a whole to suspend or ease sanctions in order not to cripple Russia in return for the intensification of negotiations with Kiev. On January 15, there will be a big test in this direction as the French, Russian and Ukrainian will shake hands to create a compromise to restore peace. That solution, which should be satisfactory to the White House (if not a Republican interventionist Congress), will likely see a deal whereby Russia will stop supporting pro-Russian Ukrainian separatists in exchange for full recognition of Russia’s ownership of the Crimean peninsula plus any eventual reparations (in the form of gas supplies?). And then the ice between Russia and the West will break.

Putin will not budge to the West’s demands

It should come as no surprise to anyone that Russia has formally entered a recession for the first time after 2009; this time, though, the prospects of recovery are bleaker. Russian President Vladimir Putin appears to be worried, while the average Russian is feeling anguished by Deputy Economy Minister Alexei Vedev’s unpleasant announcement that GDP growth for 2015 might be -0.8%, worse still than 2014, which is predicted to close at 0.5%.

Sanctions, the collapse of oil and the depreciation of the ruble have combined to give Russia and Putin the biggest blow since the start of the Ukrainian pro-Western European, ‘Euromaidan’ revolt in December 2013. Putin has retaliated, declaring the closure of the South Stream gas pipeline, which had a major European partner in Saipem with his back to the wall. The gas pipeline, could be re-directed to run via Turkey rather than Bulgaria and Poland and it stands as a symbol of the growing diplomatic distance between Moscow and the European Union (EU): the 23.5 billion dollar worth ‘Pipeline of Discord’. A few months ago, the oil giant Rosneft had to give up prospecting in the Arctic with its Texas-based partner Exxon, and now it is Gazprom’s turn to ‘feel the heat’.

The Government’s admission pf recession has come at a very difficult time, when the collapse of the ruble seems unstoppable and consumer prices are growing by the day. The causes of the disaster are obviously attributable mainly to the Western sanctions and Russia’s predictable annexation of the Crimea region. The drop in oil prices, last week, has merely served to highlight Russia’s worsening international relations. For years, Putin had urged experts and oligarchs to diversify the economy; manufacturing and agriculture in particular. The latter was negated and even regressed compared to the Soviet era, forcing Russia to become dependent on imported goods, which now cost much more as Russia relies. Until last summer, a Euro was worth 40 Rubles; yesterday, the currency price shifted to 67 Rubles, a new record low. The government needs top tale some control over worsening the situation even as the spiral of the crisis seems to have just begun.

Yesterday morning Putin had signed a decree suspending pay increases for all public officials. All Russians to have to prepare for tough times. The associations of travel agents, to cite one example, have indicated that the number of Russian tourists abroad next year will be less than half. Meanwhile, the closure of the South Stream pipeline may serve as a way to further alienate the EU. If Putin wants to close the South Stream pipeline, Europe has a lesson to learn, said the Vice-President of the European Commission pointing out that the EU imports acco8nt for more than 30% of its gas needs from Russia. The South Stream project was supposed to bring Russian gas to Europe through a pipeline under the Black Sea that would arrive in Bulgaria and then in the Balkans, bypassing Ukraine. Yet, Putin’s government shows no signs of gasping, nor has it indicated any halting of its ongoing involvement in neighboring Ukraine, largely because such policies have proven wildly popular with the Russian public. Until that changes, the Russian government will likely maintain its course despite growing economic pressures.

Nevertheless, the rhetoric of not bowing to foreign pressure contrasts with requests for negotiations to end the conflict, which means that at some level Putin is worried.

Putin remains popular with Russians, receiving approval ratings of 85% last week (it was 88% last September). Russia has appealed to the Western powers to abandon the sanctions policy in the interests of the world economy – requests that have resonated with many European citizens and officials, who worry that more sanctions would only add to their economic woes. That said, Putin will not budge because to abide by the Western demands is implausible in Putin's personal leadership 'vocabulary'. The 80% plus approval ratings are a reflection of his 'defiance' against those who have 'ganged up' against Russia. Only if he were he to give up the nationalist principles that have guided his actions vis-à-vis Ukraine, would he then incur the people's wrath. To ensure popularity remains high, Putin will likely continue to shore up support for Ukrainian rebels rather than abandon his ambitions.

While Russia is vulnerable, Putin will encourage Russian businesses to diversify, resume industrialization while continuing to develop its resource sector even as it invests in replacing imports from the West with local goods. Shifting the import focus away from Europe to China; in doing so, however, Russia must avoid the temptation to base that relationship on the familiar pattern of 'oil and gas in exchange for finished products' that has been a signature of the recent past. Moreover, Putin will challenge the rentier capitalists that have dubiously earned billions of dollars in the past two decades. The so-called, 'oligarchs', will be targeted such that their assets, privatized at ridiculously low prices in the roaring 1990's of the Boris Yeltsin era, will be re-nationalized. This will include banks, the foreign trade and strategic industries. In the anti-Russia rhetoric that has characterized the coverage of the former 'superpower', the media and western leaders have often failed to recognized that after the humiliation of the immediate post-Soviet era, Putin has raised Russia from the abyss and has instilled in Russians dignity and self-worth, which is why he is so popular and why the ‘oligarchs’ seen as pariahs. President Putin has the support of the vast majority of the Russian people; has allies in China and among the BRICS (Brazil, Russia, India, China, South Africa) and has the will and the power to “do the right thing. It remains to be seen if he can fulfill this historic challenge. Of course, in its campaign to consider their responsibilities towards the country, the Kremlin will have aroused the oligarchs’ anger, generating what is, for the time being, an unspoken fear of a coup sponsored by the new wealthy elites.

President Putin has urged his government to adopt new legislation to prevent the use of offshore tax havens making Russian citizens subject to taxes at home no matter where they come from their income. The measures are targeted towards the very wealthy Russians, who systematically try to move their goods and families abroad, fueling capital flight, one of the problems that Putin is no longer willing to tolerate especially when, for both factors cyclical and structural, the Russian economy started to slow down for the first time since he became president 14 years ago. Estimates suggest that capital flight from Russia reached over USD$ 100 billion pounds. It is indeed a measure that meets the favor of the most popular classes, as well as the middle class Russians whose welfare unlike the oligarchs is the fruit of labor and the economic growth of the past few years.

Sanctions against Russia ignore the real politik of the markets

The crisis in Ukraine, which started around last November, has intensified and exacerbated tensions between Russia and NATO to a degree unknown since the pre-Gorbachev Soviet Union.On September 30, The European Union decided to renew and add new sanctions against Russia, claiming that the peace plan in Ukraine has not yet been respected. Brussels had hinted that it would consider revoking the sanctions had there been progress by September 30 toward a ceasefire. The EU will continue to “closely monitor developments on the ground,” but failed to issue another deadline. Should the EU consider the ‘situation on the ground’ to have stabilized, it will consider amending or revoking the sanctions, in whole or in part. The EU, in effect, is looking for any possible excuse to scrap the sanctions as even the most critical EU member states were reluctant to enforce sanctions while others continue to demand a softer approach toward Moscow.

Russia, meanwhile, has taken the first steps to comply with the EU demands, agreeing to a ceasefire with Ukraine, even as it has enforced its own, ongoing, retaliatory embargo against a number of European agriculture-food sector products. The ceasefire is holding tenuously but there is great uncertainty and fear because Ukraine aspires to join NATO and the European Union within the next six years. There is very little chance Russia would allow this to happen without its own retaliation, especially about the issue of NATO membership. The Russian Foreign Ministry has been controversially referring to Ukraine’s ‘restive east’ as Novorossiya, the territory that once consisted of what in today’s terms would be Odessa, Mykolaiv, Kirovograd, Dnepropetrovsk, Kherson, Zaporizhya, Donetsk, and Luhansk.

The EU’s sanctions Russia concern companies operating in the energy, finance and defense sectors, including the oil giant Rosneft and the weapons manufacturer Kalashnikov. The EU has also imposed assets freeze and a ban on granting visas to travel to a number of officials and business personalities considered to have close ties to President Vladimir Putin and pro-Russian rebels in eastern Ukraine and in Crimea, annexed to Russia. NATO military command said that while the first phase of the ceasefire saw a significant withdrawal of Russian forces in Ukraine, there are still hundreds of troops, including special forces, in Ukraine. The conflict between pro-Russia rebels and Kiev’s own troops has now claimed more than 3,000 lives.

The crisis worsened last July 18, when (still unconfirmed) pro-Russia rebels accidentally shot down a Malaysian Airlines Boeing 777 airliner, (Flight MH-17) sparking a slew of allegations against Russia and its reckless arming of the rebels. Evidence suggesting that the rebels had Russian ‘Buk’ surface to air missiles, which were deployed against Ukrainian fighter jets and helicopters, amounted to a “massive escalation” of the crisis said Jonathan Eyal, director of the UK’s Royal United Services Institute. It should be noted that while Flight MH-17 served as the premise to bolster Western resolve against Putin, the Ukrainian government holds the actual technical fault because it failed to shut down its airspace at a time of aerial warfare. In fact, the families of that flight’s German victims plan to sue the government of Ukraine, rather than Russia’s, in accordance with that failure.

The international response was to boost sanctions against Russia that had been rather tepid until that point. However, the US State Department, and the neo-conservatives that still have influence there, primarily one Ms. Victoria Nuland, the US Assistant Secretary of State in charge of Europe and Eurasian Affairs, played a rather important role in fomenting the crisis. Nuland was secretly filmed as she addressed Ukrainian business and political leaders at a Washington meeting that the United States had spent “USD$ 5 billion to develop Ukrainian Democratic Institutions”. Nuland was evidently rather involved, then also in the successful coup (and it was a coup, regardless of one’s feelings about the previous Ukrainian leadership) against the democratically elected, but pro-Russian President Viktor Yanukovych. Indeed, the situation in Ukraine is not at all as clear as the Western media and diplomacy hawks have presented it; that is, one where Russia is bullying a ‘democratic’ neighbor, trying to improve its fortune by looking toward alliances with the ‘West’ rather than staying ‘East’. Many commentators have ignored the huge role played by the United States and its allies in prompting the Ukrainian crisis in the first place, ignoring, in the process, the very real risk of it escalating into a more wide reaching war.

The crisis has actually been rather less about Russian aggression in Ukraine than a Western attempt to lure Ukraine into NATO and the European Union, while weakening the political future of Russia’s President Putin. Victoria Nuland’s previously mentioned meeting proves that Washington invested many US tax payers’ dollars to finance Kiev’s Maidan public protests and the coup against President Yanukovych, who had been democratically elected. Russia sees NATO’s creeping into Eastern Europe as a challenge to Russia, which had been assured of its continued influence – free of NATO troops – in a formal agreement signed by Presidents Mikhail Gorbachev and the George H. Bush at the time of German reunification in 1990. NATO, meanwhile, has announced it will build five new bases in Eastern Europe last August. This cannot but deepen tensions between the Kremlin and the West. Meanwhile, Ukraine has gained nothing since its new ‘democracy’ started. Kiev needed, says the IMF, some USD$ 35 billion in aid last May; the IMF has revised that amount to USD$ 55 billion, while economist Desmond Lachman says it now needs “closer to USD$

100 billion”. Moscow has not done so, but it could shut off supplies of its gas to Ukraine as winter approaches. The fact is that the most democratic solution would be to allow a referendum in the pro-Russian Ukrainian provinces to vote whether to stay in Ukraine or join Russia.

Many of the opinions heard so far, enforced by sanctions and materialized through the deceptive use of campaigns costing billions of dollars, have come from people living far beyond the borders of Russia or Ukraine. Meanwhile the sanctions continue; are they effective? The last package of sanctions Treasury USA and the EU takes aim at Russian banks, the energy industry and the military. Sberbank, the largest bank in Russia, will not have to Western long-term capital (that is any loan lasting over 30 days). The USA and the EU want to cease the development of exploration projects in Siberia and the Russian Arctic, preventing the West’s oil majors from selling equipment and technology for deepwater shale gas projects. Exxon and Shell, therefore, can no longer do business – building pipelines for instance – with such energy sector giants as Gazprom, Gazprom Neft, Lukoil, Rosneft and Surgutneftegaz.

The United States Secretary of the Treasury, David Cohen, has insisted that the sanctions package “isolate” Russia further from the global financial system. Interestingly, nationalist Russian shareholders have seen to it that the shares of the companies on the list of sanctions go up rather than down while the shares of the oil majors in the United States have gone down! Oh, and because Russia has been isolated from Western capital, Russia will simply not be importing goods and services both from the USA and the EU – finding alternatives through its BRICS (Brazil Russia, India, China, South Africa) partners and beyond. Moscow is simply dealing in local currencies with its other business partners and this could hurt the West and its currencies in the long term, because other developing countries might start to do the same.

Russia may sell its energy resource in any currency except USD and EUR while importing clothes, technology, hi-tech electronics, computers, agricultural goods and raw materials it needs from Asia and South America. There are serious doubts, moreover, as to how long the EU member states, in absence of a shared energy policy, will last without Russian gas even if they manage to secure alternative supplies from other countries (Azerbaijan, Qatar, Libya?). The West is still banned by another set of, rather counterproductive, sanctions against Iran, which means that it cannot import oil or gas from there to meet the Russian shortfall. The markets are less ‘irrational’ than they are motivated by profit and profit is based in reality. The current intentional politics practiced by the West against Russia express very little ‘reality ‘and much ideology. Russia has a huge surplus of foreign capital – and can protect itself from the economic storm. The EU is still in austerity mode and failing to recover; even Germany, the Union’s strongest economy, is hurting with recent growth rates noted at -0.2%. Markets respond to realpolitik and the economic wars launched by Washington and Brussels against Moscow will hurt the markets of the former rather than the latter.

Signs of US recovery while Ukrainian crisis puts pressure on Europe’s economy

The financial crisis of 2008 led to a ‘Great Recession’ and a sovereign debt crisis in Europe, the consequences of which continue to be felt thanks, also, to the geopolitical fallout from Ukraine, Gaza and the Middle East – not to mention the tensions in East Asia between China and most of its neighbors. The West and NATO are pondering the adoption of tougher sanctions against Russia amid plans to run intensive military exercises that have clearly been announced with President Putin in mind. Most EU countries would rather avoid enforcing sanctions against Russia, which supplies much of the Union's energy along with several billion dollars of capital to its banks while serving as a key market for western luxury, agriculture and technology goods. As the summer of 2014 comes to a close, the European economy has yet to find respite while the United States, China and Japan have shown signs of health. Tensions abound and they come from all directions, generating a fog that makes it difficult to understand exactly what role the various individual factors, whether structural, political, economic, financial or military are having on the much awaited and often prematurely announced recovery.

The American economy improved in the second quarter, with GDP rising up 4.2% according to the Department of Commerce. The growth contrasts with the slowdown in the first quarter when the economy had contracted by 2.1%. The growth rate in the second quarter may temporarily lift fears of a slowdown or a recession in the American economy after the slowdown of the first quarter, which was such that the average growth rate for the first half of the year is actually lackluster at 1.05%. The confidence of European, and other, observers cannot be very high, considering look that the United States is still the biggest economy in the world and – despite the fact that China is catching up quickly – still the beacon that sets the direction of the international cycle. The USA is still the largest market in the world, absorbing exports from all over the world. There is also a psychological factor such that the world looks to 'America' for hope or perhaps at least some comfort that 'things will improve'. Indeed, this faith in America is not all misplaced.

The United States was surely hit by a hard recession sparked by debt and unscrupulous banking practices. The solution was to cut debt by promoting more savings, leading to lower consumption, which had the effect of slowing down the economy, given that the ‘austerity’ measures were practiced on a wide scale. Now, economists have suggested that American household budgets have improved and that their debt levels are more manageable even as housing values are recovering. In other words all the elements exist to warrant a healthy growth rate fueled by increased consumption and confidence. If the growth rate average for 2014 fails to inspire, despite some bursts of enthusiasm such as has occurred for the second quarter, it is because the improvements so far have mainly been registered at the individual family level. The extent of the 2008 crisis was such that it forced the State to intervene more directly in the American economy; public sector spending for the past six years has been unprecedented to compensate for the vastly reduced private sector spending. The public sector’s coffers were stretched to the limit, hampering its continued ability to compensate for the absentee private sector.

Now, there is actual room for optimism. Household accounts, including public accounts in the United States have improved and even the federal deficit stands at 2.9% of gross domestic product while it had been as high as 10.8 percent at the peak of the crisis in 2009. So, the United States continue to be alive, and all the more so because technical progress never left; innovation at all levels of industry continued and even capital at the corporate level flowed much more freely than in many parts of Europe. This is the kind of optimism reflected by the record highs of the NY stock exchange, which have kept commodities low, even managing to absorb the heavy geopolitical risk that was supposed to have driven gold prices to new records. Indeed, China, whose slowdown from an average GDP growth rate of around 10% to one closer to 7% was supposed to have had dire consequences, has failed to materialize into a crisis. China certainly has some risks, but these are far more related to the population’s rising demand for civil liberties, of which the right to a cleaner environment is essential. Then, there is Japan, whose economic situation is similar to that in much of the European Union, the much acclaimed ‘abenomics’ (a package of fiscal reforms and stimulus measures) reforms launched by Prime Minister Shinzo Abe to promote growth have started to choke after an initial sense of success in 2013.

The Tokyo stock exchange has been growing as has GDP but the improvements have come largely as the result of monetary policies favoring inflation (printing more money) and cash stimulus. Structural reform remains an elusive target. Only structural reform can achieve the desired effect of long term growth. Europe continues to loiter in recessionary territory, albeit there is great discrepancy among individual members. The explanation is more geopolitical than economic as any indicators of confidence are waning even in the economic powerhouse of Germany, which stands to lose or gain the most from its proximity to Ukraine. If Germany sneezes, the rest of Europe catches a cold and its economy is suffering the repercussions of tensions even though the actual growth factors remain intact. The policy of military encirclement against Russia, backed by Washington and blindly accepted – if not convincingly absorbed – by European governments, have led to a crisis of trade relations with Moscow, for which Europe’s productive apparatus has paid a great price, especially Germany, which is in turn the EU’s economic locomotive. NATO is planning to increase the effectiveness and visibility of its forces in Eastern Europe in a Cold War like scenario to scare Moscow into reducing its involvement in the Ukrainian civil war.

This does not mean that The United States, Germany and other allies, have plans to increase the number of its troops in the region, which would vastly increase tensions with Moscow. They merely intend to show “unity and readiness” to respond to events in Ukraine. For now, NATO merely wants to make it clear to Moscow that it is ready to send more troops in its bases in Eastern Europe if necessary through a “rapid deployment force”, through the enhancement of existing bases, logistics, supplies and infrastructure. It is doubtful that President Putin will feel any urge to reverse his strategy in Ukraine. However, Britain and six other states have announced they intention to create a multilateral force with at least 10,000 troops to respond to Russia in Ukraine according to the Financial Times. The official announcement is expected to be issued later this week at the NATO summit. The countries currently involved in the force, which will include naval units and ground troops, are Denmark, Latvia, Estonia, Lithuania, Norway and the Netherlands. Meanwhile, the Kremlin continues to deny any involvement, even though rumors abound that Russian speaking separatists in Ukraine are preparing to attack two key areas of Maryupol and Volnovakha in order to open a corridor between Donetsk until the Crimea. Should this be the case, NATO has stacked the deck too high in order to back down from taking more significant punitive actions with Moscow. This will only raise tensions in Europe, putting pressure on growth.

Western agricultural and potash sectors suffers more from anti-Russia sanctions than Russia itself

Russia has delivered a textbook response to the growing list of sanctions that the West and NATO countries have adopted, with more or less conviction, over its inevitable interventions in the Ukrainian civil war. Russia has banned food imports from several Western countries including Italy, Germany and Canada. It has also banned Western investment projects in the Russian agro-food sector just as Russian food tastes and consumption habits have been expanding to include a wide variety of products. From the Western perspective that Russia should modernize politically, the sanctions will have adverse effects, delaying that very process of modernization, forcing a resumption of cultural and political insularity. Russia will put planned projects on hold or cancel them outright, hurting Western companies in the process.

Western companies – especially German and Italian – have been providing the modern technologies and know-how to modernize the Russian agriculture and processing industry. Germany alone has invested over a billion Euros in Russian agribusiness, which have enabled Russia to vastly improve plant production, resuming its role as a primary exporter of wheat along with the USA, the EU and Argentina. The increase in the production of wheat and other crops has also allowed for improvements in poultry and pig production, which has raised demand for such minerals as potash and phosphate. Meanwhile, as late as 2013, several European small and medium enterprises in the agricultural sector had asked their EU representatives to significantly expand their corresponding commitments in Russia, facilitating ties further. The crisis and the Western (especially from the EU) promise to include Ukraine in NATO or even the EU have contributed greatly to the crisis. Not surprisingly, trade relations and problem-resolution mechanisms must be in place to build trust in trading partnerships and now both are in short supply. It will be difficult, but the EU must pursue a more diplomatic line with Russia in order to avoid completely cutting political level discussions and opportunities to continue working in favor of Russia's agricultural and food industry modernization, which benefit western companies directly.

The Russian government has chosen to ban imports of several food products from the EU and the USA not only as a means of political pressure, but also to highlight their positive impact on the development of Russian agriculture and food industry. It is therefore in the mutual interest of all powers concerned that the Ukraine conflict does not escalate further.

The effects of the embargo imposed by Russia have already been felt. Entire containers of EU food products have been blocked and sent ‘back to sender’, while Russian importers are advised have been terminated several contracts for the shipment of fruit and vegetables. The list of banned products covers the entire range of diets and tastes including beef, pork, chicken, fish, seafood, milk and dairy products, fruits and vegetables from the EU, USA, Norway, Australia and Canada, with the exception of alcohol and children’s products. It is a sharp brake on the increasing demand for EU products on the dinner tables of all countries that made up the former Soviet empire that had begun to appreciate such gastronomic delights as Parmigiano Reggiano and prosciutto, not to mention all manner of oranges, grapes and legumes. In the first quarter of 2014, Russian imports of EU food products had actually risen in the first quarter of 2014. Countries such as Italy, which are relying on exports to lead the path out of the economic crisis, consider agriculture as a very important economic sector. It is estimated that Italy alone will lose over 200 million Euros in lost agri-business with Russia alone. Now we are facing a worrying escalation of the conflict with a trade war, which confirms the strategic importance of food especially during periods of economic recession. Russian leaders are master chess players and they have not chosen to target food imports casually; they are very aware that agriculture is a primary pillar of growth for the European Union at a time of economic stagnation. Indeed, worldwide agricultural exports from Italy alone grew by 5 percent in 2013, reaching a record high value of 34 billion Euros, even as other sectors suffered.

As for Canada, while Prime Minister Harper engages in smug tirades against Russia, the sanctions and growing trade ‘Cold War’ may have consequences for the potash sector. Russia is part of the block of BRICS (Brazil, Russia, India, China and South Africa) countries, all of which have high potash and phosphate demand driven by their respective agriculture and food sectors. As western borders close in response to decisions in Bruxelles, Ottawa or Washington doors open to Russia’s East and South. In potash terms, the world’s largest potash producer Uralkali expects to be able to implement price increases by as much as 10% in the 2015 supply contracts with China. Uralkali is considered the clock for the fertilizer industry, which also includes Canada’s Potash Corp of course.

The People’s Republic of China is the world’s largest consumer of potash and now pays Uralkali USD$ 305/ton. Technically, this should be good news for Potash Corp and its CANPOTEX partners (Mosaic, Agrium), but China may well decide to increase its share of supply from Russia in solidarity over Western sanctions. In turn, Russia will replace Western imports with meat and dairy products from Brazil, Argentina, Ecuador, Chile and Uruguay, which are more than willing to step up to the opportunity. China has also indicated that it can increase the supply of fruits and vegetables to Russia. Uralkali also has close ties to India and if it should see it advantageous, it could slash potash prices below contract rates, revamping the ‘quantity’ model by increasing production and undercutting CANPOTEX. Moreover, Russia may decide to trade in local currency when dealing with other BRICS members, further damaging the potash market.

Global economic consequences of the Malaysian MH17 crash still to come

The crash of Malaysian Airlines MH 17 in Ukraine, beyond the all too human tragedy, has also raised market risks worldwide especially as far as the energy and banking sectors are concerned. Stocks dropped some 2-3% in worldwide trading on the day of the crash, July 17, only to recover – somewhat cynically – on the next day; however, as might have been expected, the Russian markets reacted differently. The Ruble dropped 5% and stocks some 2%. Meanwhile, the conditions for improvement do not exist. The crash of MH 17, regardless of who is ultimately found responsible, has only served to increase tensions. Even if the crash may offer Russian President Vladimir Putin reasons to reduce Russian support for the separatist rebels, the crash has only served to emphasize the deep differences that exist between the pro and anti Russian populations in Ukraine. This means the war in Ukraine has become even more intense. The crash has done nothing to resolve the underlying reasons for the conflict, adding only more motives to deepen them. Russian companies and Western ones that have business with them will have some difficult days ahead. Gazprom is the largest Russian company and the biggest extractor of natural gas in the world and Chinese demand may not be enough to protect it from potential new sanctions.

The US announced more sanctions against Russia on the very day of the MH 17 crash. Those will certainly deepen if it turns out that the missile that hit MH17 was, in fact, launched by pro-Russian separatists using Russian supplied weapons (even if the government forces have the same equipment). In that case, the U.S. and Europe would be forced to expand sanctions against Moscow, affecting such companies as the oil giant

Rosneft, which owns sizeable portions of important European companies like the tire maker Pirelli. Gazprom, Gazprombank, the principal shareholder of the South Stream pipeline would also be blacklisted. For its part, in the event of additional sanctions, and given that Russia has more than a 'few dogs in the Ukraine fight', Putin will not hesitate to retaliate with no less harsh measures. For the time being, the Kremlin has advised the White House that "the door remains open to negotiations to get out of this situation. But if our partners will continue with sanctions, measures will be taken against persons and foreign companies."

Moscow has an agreement with Beijing to supply gas worth up to USD$ 300 billion over the next 30 years; however, the Russian economy, over the past two decades – and ironically especially in the 15 years of Putin's leadership, Russia has become well integrated in the Western economic system, more than Washington, Berlin or Moscow would care to admit. Russians have invested heavily in the West, as much as USD$ 230 billion in foreign investments. Some companies rely on Western financial institutions and because of US sanctions, such companies will not be able to re-negotiate refinancing or other mechanisms, meaning that they will incur more interest on their loans, damaging the entire Russian economy. One of the first to suffer will be Rosneft itself. Then there is the issue of oil and interdependence with Europe.

Russia addresses half of European oil demand using about a third of its production (10.51 million barrels), collecting some USD$ 160 billion a year at current prices. Even if it switches some of this oil in China's direction, facing more sanctions, it would not be able to secure the same prices. Moreover, Russia relies on Western companies to obtain most of the oil and gas industry hardware. Then again, many European companies are not eager to see more sanctions pouring on Russia. Western European companies deliver goods and services to Russia in the tens of billions. Some companies like United

Technologies, FIAT Autos, GM or even BMW have joint ventures in Russia not to mention energy sector companies like ENI – a South Stream partner. Italy and Germany would be among the greatest ‘losers’ in this situation. Former German chancellor Gerhard Schröder is at the head of the supervisory board of the North Stream gas pipeline. Without Russian gas, the industrial region of the Rhine valley may well come to a stop. The Ukraine crisis presents diplomatic challenges on both sides of the former ‘Iron Curtain’, are the leaders prepares to manage it?

Kyrgyzstan to compensate Stans Energy to the tune of $118.2 million

At the end of last April, Stans Energy Corp. (‘Stans’, TSXV: HRE | OTCQX: HREEF), won its international arbitration case in the matter between itself and the Government of the Republic of Kyrgyzstan at the Arbitration Court of the Moscow Chamber of Commerce and Industry. This week, the Court asked the State of Kyrgyzstan to compensate Stans to the tune of USD$118.2 million. Stans gained more than 50% in Toronto trading, topping CAD$ 0.20 per share even if the likelihood that the Government of Kyrgyzstan will abide by the Court’s ruling is very slim. After all, the Kyrgyz government was given numerous opportunities to demonstrate their willingness to honor international business standards, and allowed the issue to move to the Courts. Nevertheless, Stans still has options and ways to apply pressure on the authorities in Bishkek. One of them involves Centerra, which operates the Kumtor gold mine in Kyrgyzstan, a frequent, which various factions within the Kyrgyz government have often used as ‘punching bag’ in their internal disputes.

Stans has the legal right to pursue any of the Kyrgyz State’s foreign assets including its 32.7% stake, worth about some USD$ 500 million, in Centerra. Stans has not announced any measures yet – after all it will give the Kyrgyz Government a chance to abide by the ruling – but, clearly, Centerra appears to be likeliest option. With a gross domestic product (GDP) of about USD$ 5.7 billion (2012) and annual per capita income USD 1,137 (2012), over 37% of Kyrgyzstan population lives below the poverty line: Kyrgyzstan a poor country. Kyrgyzstan relies for its survival on foreign investment in its most important asset, which remains the Kumtor gold mine, which alone accounts for 5.5% of GDP. Gold exports serve as Kyrgyzstan’s main source of foreign currency. Yet Kyrgyzstan is considered to be one of the most democratic states in Central Asia. Its parliamentary democracy works reasonably well, compared to a region dominated by despots. This gives hope that some form of legal solution will be found such that Stans might be compensated.

Kyrgyzstan’s growing relationship with Russia may also be useful, given that the Arbitration Court that has ruled in favor of Stans is in Moscow. Russia’s President Vladimir Putin has to sponsor – to the tune of a billion dollars – the development of hydroelectric power stations, which is Kyrgyzstan’s second largest source of wealth after its mineral assets. Russia’s Gazprom, moreover, looking for ways to put pressure on the West in response to the Ukrainian crisis, will be more inclined to offer hydrocarbon resources, perhaps even taking over the ailing Kyrgyz gas network. The fact that the United States has left the Manas airport, which it used since 2001 in the ‘War on Terror’ (no less than the most important US aviation hub for the war in Afghanistan) has facilitated a gradual foreign relations policy aimed at closer ties to Moscow than Washington. As fragile as it is, Kyrgyzstan’s economy cannot deal with more problems, which has made it even further bound to Russia after recently accepting USD$1.2 billion in aid from Moscow.

Therefore, while Stans's possible pursuit of Centerra shares – for which there is a precedent: a Turkish company, Sistem, took 10% of the Kyrgyz government's Centerra shares – will embroil it in more political/judicial issues with Bishkek, Moscow's legal pressure could be brought to bear. Indeed, Stans now has the authority to seize Kyrgyzstan's foreign assets as well as any capital transfers beyond its borders, including shipments of minerals such as…gold. In other words, Stans has sufficient means of applying pressure on Bishkek that it has a good chance of resolving the situation through negotiations. Centerra Gold, for its part, has always been able to keep the Kumtor mine up and running, no matter how difficult the political situation in Kyrgyzstan, even managing to received the Government's approval of its mine plan for 2014 – notwithstanding the five and a half months delay. Centerra had even threatened to close the Kumtor mine if it did not get the approval, after 17 years of activity, but it was able to exercise pressure because the Kyrgyz government needs the Canadian gold company's expertise to operate Kumtor and that a closure would have had serious economic and social consequences.

The Kutessay-2 field during Soviet times delivered up to 80% of the USSR's rare earth supply. Kutessay-2 contains up to 15 rare-earth elements, as well as lead, zinc, silver, bismuth, molybdenum, thorium, tin, and copper. In addition, it contains niobium, tantalum and hafnium. The only obstacle standing between Stans moving to full operation has been the Government's obstruction, which has now been dealt by the arbitration process.