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Russia

Russia bans travel to Turkey and restricts imports. In reaction to Turkey's shooting down of a Russian military jet on November 24, Russia's foreign minister immediately declared a terrorist threat in Turkey and called on all Russians to avoid travel there. Russia's state tourism agency recommended that Russian travel agencies stop arranging trips to Turkey and promised sanctions if companies continue to offer trips. Thereafter, President Putin and the cabinet issued orders affirming a ban on arranging tours and an immediate cessation of charter flights to Turkey. The explicit purpose is to protect national security and Russian citizens from criminal and other illegal activity. Increased security inspections were ordered for schedule airline flights. Russia suspended part of its bilateral agreement as regards visa-free travel of Turkish citizens to Russia from 1 January 2016.

Turkey is a top destination for Russian tourists. In 2014, Russians logged some 4.4 million private trips to Turkey, while CBR figures show they spent €5 billion (13–14 % of total Russian spending on tourism abroad) in Turkey on goods and services. Due to the Russian recession, the figures for the first half of 2015 were clearly down from 1H14, but still amounted to 1.4 million trips and purchases in Turkey for €1.7 billion. About 36 million foreign tourists visited Turkey in 2014. Russian government circles indicated that compensation to travel agencies was unlikely.

Measures aimed at goods imports were also tightened before Russia laid down the afore-mentioned orders. Russia's consumer protection agency and the agricultural inspection agency announced that they were stepping up inspections of Turkish products. Several importers also reported there were intensified customs inspections and Turkish lorries were backed up at Russian borders. The president's ban on imports of Turkish imports from 1 January 2016 mainly applies to some poultry products, and selected fruits and vegetables. Overall, Russia imported over €1 billion worth of fruits and vegetables from Turkey in 2014 and over €500 million in the first half of this year as Turkey has made up for part of the produce lost by Russia under its countersanctions against EU food and farm imports.

Based on the experiences with the countersanctions launched in late summer 2014, the government ordered certain ministries to track prices of the newly banned products in the domestic market. Some economists, however, estimate the import ban will raise consumer prices 2–3 %.

Next week, the cabinet will take up application of the president's order to ban imports of Turkish services, i.e. which services and firms will be affected, as well as delivery and labour contracts. The impact of the final decision could be large as Turkish construction companies are quite active in Russia. The CBR reports that Turkey received about €2 billion last year from construction services in Russia, and this year at least 60,000 Turks were working at construction sites in Russia. Further on the services front, the president ordered authorities to intensify security inspections of Turkish ships in Russian harbours and Turkish lorries. The cabinet decided to cut sharply the quota of permits granted to Turkish road freight firms next year.

For the time being, money markets have remained rather calm about Russia-Turkey tensions.

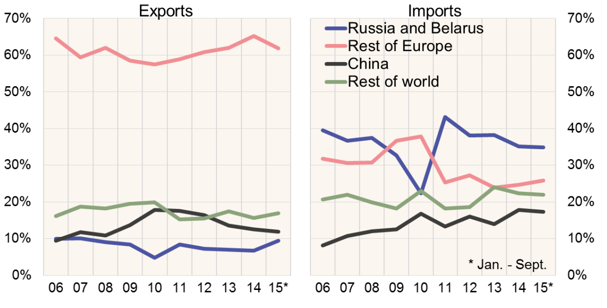
Impacts of Eurasian Customs and Economic Unions on the Kazakhstan market become clear. Even before Russia, Belarus and Kazakhstan established the Eurasian Customs Union (EACU) and unified their import duties in 2010, tariffs were all but eliminated between CIS countries under free-trade agreements. Thus, the establishment of the EACU affected to a large extent only import duties on goods from non-CIS countries. The weighted average of duties fell slightly in Russia and Belarus, while Kazakhstan's average rose from just over 5 % to nearly 10 %.

Russia's WTO accession in 2012 bound it to reducing its import tariffs by 2019. Since then, the EACU states have lowered the external duties according to Russia's WTO commitments. In Kazakhstan's case, it remains to be seen what happens. Its WTO agreement came into force this week with even lower tariff bindings than Russia's.

When the Customs Union became the Eurasian Economic Union (EAEU) at the start of this year, some barriers to market entry were lifted. In Kazakhstan, for example, European emissions standards no longer apply to cars produced within the EAEU. Russia's share of Kazakhstan's passenger car imports has increased from less than 10 % in 2010 to over 70 % in the first nine months of this year. Imports of e.g. Russian industrial machinery, televisions and chocolate, as well as Belarus tractors, lorries, meat, and dairy products have increased significantly. At the same time, imports of these products from developed economies have decreased.

Russia's and Belarus's share of Kazakhstan's total imports has not grown, however, because the flow of Chinese products such as clothing, footwear and machinery into Kazakhstan continues to rise. Russia accounted for 33 % of Kazakhstan's imports in the first nine months of this year ($7.8 billion) and Belarus 1.6 % ($360 million).

Breakdown of Kazakhstan's goods trade



Sources: Kazakhstan Customs, Eurasian Economic Commission

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China

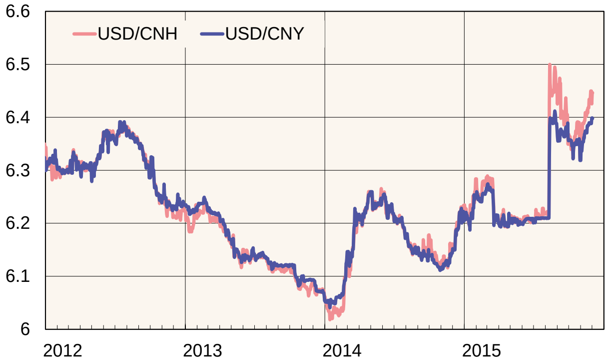
Yuan will join IMF's SDR basket. On Monday (Nov. 30), the IMF executive board voted to add the yuan as its fifth currency in its Special Drawing Rights (SDR) valuation basket. The incorporation of the yuan will officially take place on October 1, 2016. The yuan's weighting in the updated basket will be 11 %, with the US dollar maintaining it weighting of 42 %, and smaller weightings for the euro (from 37 % to 31 %), Japanese yen (9 % to 8 %) and the British pound (11 % to 8 %).

The IMF's decision, above all, is a symbolic acknowledgement of China's recent economic policies and the country's opening to the world. The People's Bank of China has promised to continue with reforms. SDR status does not directly influence the international attractiveness of yuan-based investments or use of the yuan in foreign trade. Rather how the yuan is perceived as a store of value is affected by China's economic development and how well China creates a balanced, predictable market environment.

The SDR is an international reserve asset available to help IMF member countries boost liquidity, so part of each member states' reserves is denominated in SDRs. At the end of November, a total of 204 billion SDR units (about $280 billion) had been allocated to IMF member states. The introduction of the yuan will impact IMF rate of lending and the rate paid on SDR deposits (weighted average of SDR basket to the national short-term interest rate).

The decision was expected. Markets barely reacted to the board's Monday announcement as IMF managing director Christine Lagarde had earlier declared her support for adding the yuan in the SDR basket. Since China's exchange rate reforms this summer, the yuan has faced depreciation pressure with the offshore yuan persistently trading in Hong Kong at a discount to the mainland rate. Many market participants expect the PBoC to let the yuan depreciate further after the SDR decision. The PBoC, however, has given assurances that it will hold the exchange rate steady and only intervene in the markets to mitigate exceptionally large shifts in capital flows.

Mainland yuan-dollar (CNY) and Hong Kong offshore (CNH) exchange rates



Source: Macrobond

Reforms reach China's military. The *South China Morning Post* (SCMP) reports president Xi Jinping announced on November 24 to China's top military officers that long-planned military reforms were finally underway. The goal is to reshape the military from Soviet-era structures to a Western-style organisation and operational capabilities, including larger roles for the navy and air force. Ground force command will be centralised from its current four branches and the number of military regions will be cut from seven to four. The reform gives more power to the central military committee led by president Xi, as well as the defence ministry's role in oversight relative to military leadership.

SCMP estimated in September that the army's size would shrink by 500,000 people to around one million. Additionally, the armed police force will form a national guard with about one million people. China wants to complete most of its biggest military shakeup in decades by 2020.

China's nuclear power industry making strides at home and abroad. In recent years, China has increased its efforts at developing a national nuclear power industry. Currently, China has 30 operating reactors, 21 reactors under construction and several projects waiting to break ground. About a third of active construction projects globally are located in China. The government wants 100 new reactors brought on line over the next ten years. The push for nuclear power plants is mainly a response to the country's air pollution problems, which can only be solved by moving to energy production that does not rely on fossil fuels, particularly coal.

China has actively utilised the world's leading nuclear power technology in joint projects, developing its own expertise and reactor technology. Many nuclear power plants to be soon completed in China are based on domestic "third-generation" reactor technology. The logical next step for China is to export its latest nuclear technology. China's government has established a goal of exporting eight reactors based on Chinese technology by 2020. Chinese banks participating in project financing help to meet the export target.

China's nuclear reactor exports have boomed this year, with state nuclear power companies CGN, CNNC and SNPTC joining in a number of international projects. Two projects underway in Pakistan use reactors based on Chinese technology. Projects in the UK were agreed this autumn, two of which are led by the French EDF with Chinese partners. The construction work of the first plant is getting underway. The second two-reactor plant, still under negotiation, would be the first nuclear power plant built in the West based on Chinese technology. CGN will begin construction in 2017 in Romania of a plant that uses Canadian technology. CNNC will begin construction of two nuclear power plants in Argentina in 2016 and 2017, which will be 85 % financed by Chinese banks. The second reactor will use Chinese technology. SNPTC is in negotiations with Turkey and South Africa.

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