

Quote of the week - "In the 1960's people took acid to make the world look weird. Now the world is weird and people take Prozac to make it look normal." - Source unknown.

An interesting observation from one of you : "While in politically correct Canada we are so careful about wishing christmas, here in ostensibly unsecular Bahrain we've christmas trees with decorations all over the place, and many hotels and clubs actually had a tree lighting ceremony."

In the world of central banking this was an unusual week. For two central banks had emergency meetings of their monetary policy making bodies just one week after their regular meetings, albeit for different-, though inter-related-, reasons. In Russia the central bank, after raising its key interest rate by 100 basis points at its regular meeting last week, overnight Monday, in attempt to keep the ruble from spiraling out of control on the down side, raised it by another 650 basis points to a bone-crushing 17% *that portends further downward pressure on GDP growth in 2015*. And then on Thursday, for the very opposite reason, i.e. to keep the Swiss Franc from rising in an untrammled fashion , the Swiss National Bank, for the first time in almost half a century, introduced a negative deposit rate (*after being hit by massive inflows of Russian money*).

On December 16th the ruble not only failed to respond to the overnight, seemingly panic-driven 650 bps. hike in the Russian central bank's key interest rate but weakened by 15+%, from 60-, to 77-, to the dollar (vs. 34 six months ago). So the next day Moscow took three stabs at trying to stabilize it. First, at 7:00 a.m. GMT the central bank announced it would support the ruble in the FX market to the tune of US\$7BN (*which wasn't such a big deal since it has been doing so for months at a US\$350MM average daily rate*); this prompted a brief raise to 62. Then at 11:00 a.m Prime Minister Dmitry Medvedev made a statement saying Russia had adequate reserves to ride out the crisis¹ which caused a recovery to 65 from the high 60's to which the ruble had declined after the initial impact of the early morning central bank announcement had worn off. Finally, at 2:00 p.m. the central bank announced a series of measures to prop up the banking system which caused the ruble to pop to 60. Since then it has since sort of stabilized around 62, up 12% from Tuesday morning, but still down 10% from 56 just a week ago² - *And polling results by the Moscow-based & supposedly still reasonably independent Levant Centre polling firm showed that Putin's popularity, while still high, may be starting to soften around the edges, even before the recent weaker ruble-driven higher food costs & shortages prompted him to advocate earlier this month a need for controls over food, medicine & "other basic goods markets", which in his view could be introduced "without any problem ... and it must be done", reminding the older Russians, his core support base, of the days of the Soviet Union.*

The lower oil prices are engendering much optimism about the effect thereof on US consumer spending. But a word of caution may be in order. First, the impact may be more psychological than real; for gasoline accounts for just 5% of the Consumer Price Index; so even a halving of gasoline prices may have a more muted effect on the **real** potential increase in consumers' discretionary spending power than the 'talking heads' insinuate. And secondly, & more

¹ Which more likely is bluff, rather than reality, given Russia's desperate need to import foodstuffs, the evidence of growing shortages of food stuffs & medicine, the continued money outflows & the volume of foreign debt due in 2015 & 2016.

² Rather ironically (& deservedly?) the Russian ruble has now weakened more since Putin messing with Ukraine than the currency of his victim, the Ukrainian hryvnia.

importantly, as much as 90% of the 10MM new jobs created since 2009 are said to have been directly or indirectly energy-related, many of them high-paying ones that fostered more discretionary spending & many others low-paying ones for workers with a high propensity to consume (i.e. a need to spend money on the necessities of life).

In the almost six years since Netanyahu returned to office the Jewish settler population in the West Bank has grown 23% to 335,993³, while Israel's overall population grew by just 9.6% to 8+MM⁴. Still, this was a slower rate of growth than the 31% racked up during the preceding five-year period under Prime Ministers Sharon & Olmert; this prompted Defense Minister Moshe Yaalon⁵ to note recently "We are very, very careful not to push the envelope too much ... This US Administration won't be around forever and I hope it is temporary."

In Europe, years of a toxic brew of limited, if any, economic growth, government austerity & high unemployment has prompted a growing backlash of anger against the Brussels bureaucracy & the mainline national political parties, as well as rising tension between the 'have' & 'have-not' countries as to who is responsible for the economic mess & what should be done to get more economic growth - *part of the problem is that the hoi polloi in some of the most seriously affected countries still refuse to accept that living beyond their means is no longer an option; thus Italy, the fourth-largest economy in the Eurozone, that has had 10 quarters of negative-, & two of zero-, economic growth, by mid-November had seen 42 days this year in which there was at least one strike in the transportation sector by workers seeking to protect their 'rice bowl'.*

Greece is trying to elect a new President. The official candidate is the former EU Environmental Commissioner Stavros Dimas. Parliament, in which the ruling two-party coalition holds 155 of the 300 seats (the New Democratic Party 127⁶ & Pasok 28) is the electoral college. It is a three round affair, the first on December 17th & the other two on December 23rd & 29th, and failure to do so by the latter date would bring on an election, which the polls suggest would result in the radical left-of-centre & anti-EU Syriza Party heading the next government. In the first round Mr. Dimas received 160 votes. While interpreted as a victory for Syriza, it may well turn sour in its mouth; for, while in the first two rounds it will take 200 votes to elect, on December 29th just 180 will do the job. And with Syriza having only 71 seats, and the remaining 74 spread among seven independents & six parties, none of whom have over 17 seats & one of which, with 14 seats, is unabashedly pro-EU, and elections involving work & risk, and a possible loss of status for sitting politicians, it should not be beyond the realm of the possible for the government to entice another twenty MPs to do the sensible thing & support its candidate.

³ Over & above the 200,000+ Jews living in East Jerusalem; i.e. 10+% of Israel's Jewish population is of the settler variety.

⁴ Numbers which may be distorted somewhat by the fact that the fertility rates of both Palestinians & settlers is considerably higher than that of the rest of the Israeli population.

⁵ Among the more hawkish members of Likud.

⁶ Fifty of them, however, are "bonus seats" that accrued to it because it got the most votes in the last election (a rule put in place in an attempt to introduce a greater degree of stability in coalition governments (which seats, of course, would go to Syriza in any election in the near future, given the fact that at last report it was leading the New Democratic Party by 5% in the polls.

On December 16th in Serbia, at the 'Third Leaders Meeting' of China & the leaders of the 16 CEE (Central & Eastern Europe) countries, China Premier Li Keqiang announced the creation of a US\$3BN fund to facilitate (*export?*) financing for their cash-strapped countries. This came two years after Beijing set up a US\$10BN special credit facility to support cooperative projects in their countries. And the next day Li met separately with the leaders of Greece, Hungary & Serbia to agree on the building of a land-sea bridge to a Greek port to expedite the movement of goods from China to Europe - *here, as elsewhere around the world, Beijing is using its unwanted dollars to buy power & influence; this ought to make one wonder what its planned end game is once it has run down the US dollar portion of its FX reserves to a level with which it is comfortable; for the way the Chinese operate, this has to be part of a longer range plan.*

On December 17th there was a massive demonstration in Managua, the capital of Nicaragua, protesting against the December 22nd start of the Beijing promoted-, & funded-, US\$50BN, five-year project to build a canal across the country from the Pacific to the Atlantic that will compete, & dwarf, the Panama Canal. But, according to the protesters, some of whom carried signs saying "China, get out!", it will damage the environment & put the country's fresh water resources at risk (since it will incorporate the country's largest fresh water lake into the canal system).

One potential collateral benefit of the lower oil prices is that it should create an opportunity, if they so desired, for countries like India, Indonesia & Morocco that have budget-draining energy subsidy programs that disproportionately benefit the rich who drive gas guzzlers, to cut them back.

The bond market is currently pricing in a 93% probability that Venezuela will default within the next five years; but its bonds now trade at such deep discounts that some bargain hunters are becoming interested in accumulating them on the ground that at these prices they provide a potential upside over any haircut that might ensue when it does.

GLEANINGS II - 593
Thursday December 18th, 2014

US STOCKS ENJOY BEST DAY THIS YEAR ON DOVISH FED REMARKS
(MarketWatch, Anora Mahmudova)

- Stocks were solidly higher ahead of the FOMC meeting as currency-, & commodity-, markets had calmed after two unusually volatile sessions. Then on Wednesday, the market shrugged off falling oil prices & global deflationary concerns, and the indices chalked up their best one-day gains of the year, when the Fed *was seen as having* conveyed a more dovish posture at the conclusion of the two day FOMC meeting on Tuesday & Wednesday.

*"Beauty is in the eye of the beholder" & the market often sees what it wants to see; hence a headline reading Rate Hikes and Volatility not Expected to Kill Bull Market in 2015. But looking dispassionately at what came out of the latest FOMC meeting, it is hard to detect much of a really dovish nature in a post-meeting statement that replaced the pledge that interest rates would be kept low for "a considerable time" with one that the Committee **could** be "patient **in beginning** to tighten monetary policy" (bolding mine), or in Fed Chair Janet Yellen's observation in the post-meeting press conference that "There certainly was no decision on the part of the committee to move to a measured pace ... We'd probably not like to repeat a sequence (of rate*

increases) in which there was there was a measured pace and 25-basis point moves at every meeting” [thereby seemingly suggesting that, when the Fed finally does move, it may (have to?) do so in periodic, market-unsettling jumps rather ‘greasing them in’ in a series of regular 25 basis point baby steps]. And in this context it may also be worth noting the deletion from the statement issued after the FOMC’s October meeting of the sentence “there remains significant underutilization of labor resources” (a consideration known to be a major driver of Janet Yellen’s hitherto dovish bias).

THE MOST CORRUPTING CAMPAIGN-FUNDING PROVISIONS EVER ENACTED **(The Atlantic, Russell Berman)**

- Last August former House Republican Majority Leader Eric Cantor, after his surprise defeat in New Jersey’s Republican primary, cited the Gabriella Miller Kids First Research Act, that redirected federal dollars earmarked for the funding of political conventions to pediatric research, as “one of my proudest moments”. But the recent US\$1.013TR “omnibus” spending bill that will keep the US government afloat until the September 30th, the end of its fiscal year, *that went through the House by a vote of 219-202 & had to get Presidential approval by midnight Thursday December 18th to avoid a government shutdown*, had at the last moment an item inserted into it, on page 1599 of the 1,601 page document, that will fill the resultant void in political financing by dramatically increasing, from US\$97,200 to US\$776,000, the amount any person can contribute to various Democratic & Republican Party committees. This highlights the power of incoming Senate Majority Leader Mitch McConnell (R.-Ky), a champion of limitless political donations on First Amendment grounds.

To avoid another shutdown the White House agreed to, & pressured right wing Democratic lawmakers to support, the bill despite it also gutting the Dodd-Frank provision that would have relieved taxpayers from having to underwrite Wall Street losses on its most speculative activities, slashed environmental spending & the IRS budget, limited funding of the Department of Homeland Security, that is to implement Obama’s Immigration Executive Order (so as to be able to revisit it next year when the GOP will control both House & Senate) & reversed a Department of Transportation ruling that, to reduce truck drivers’ sleep deprivation-prompted accidents, had cut the maximum hours they can spend behind the wheel from 82 to 70 hours a week.

HERZOG SLAMS NETANYAHU AFTER ECONOMIC REPORT DECRIES HARDSHIPS OF ISRAELI HOUSEHOLDS (Jerusalem Post)

- On December 17th the Taub Center for Social Policy released its annual State of the Nation report. It said Israeli households across the board are having trouble making ends meet, largely due to the high cost of housing (among others because building a home takes an average 13 years, eleven to work through what it calls “the complex bureaucracy of the construction process” & then two years to build it). This prompted Labor Party Leader Isaac Herzog to accuse Netanyahu of having economic policies that have “turned the lives of most Israelis into a day-to-day survival race”. Also according to the report on average Non-Orthodox Jews have monthly expenditures NIS864 (US\$225)-, Muslims NIS1,919 (US\$499)-, & Haredi (ultra-Orthodox) Jews⁷ NIS3,209 (US\$834)-, greater than their reported incomes (*with average gross incomes in the*

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Who average NIS3,206 (US\$834) in social benefits vs. NIS2,000 (US\$520) for all other groups).

US\$2,500 range), housing prices increased 53% faster than other prices in the decade ended in July 2013, the percentage of young people **not** owning a home had increased from 43% to 54% during the period, & 60% of Israeli Arabs lived below the poverty line, vs 18% of the immigrants from the former Soviet Union & 11% of 'veteran Jewish Israelis' (those born in Israel or having moved there prior to 1990, *when an influx of Soviet Jewry commenced*⁸).

He is angling to head a 'bloc' with a social justice-focused platform in next March's elections in what he calls Israel's "coalition game" politics, hoping Israeli voters by March will have become focused on bread-and-butter-, not the peace & security, & Jewish identity-, issues that are Netanyahu's forte.

ISRAEL'S RIGHTWARD LURCH WON'T HELP NETANYAHU KEEP HIS JOB **(The New Republic, Yishai Schwartz)**

- Early polls show Likud, & Naftali Bennett's *even more hawkish, religious, nationalist, & right wing* Bayit Yehudi Party gaining ground, in part at the expense of the Yisrael Beitenu Party of Netanyahu's former closest ally Avigdor Lieberman & in part at that of Yair Lapid's centrist Yesh Atid Party (for while the latter in the 2012 election came out of nowhere on a platform of economic & social reform to gain 19 seats in the Knesset, second only Likud's 20, it has lost support since Lapid as Finance Minister was prevented from making good his promises). As a result, they show them going from 43 to 48 seats which, together with the 10 seats the polls say the brand new Kulana Party of the popular former Communications Minister Moshe Kahlon will get, could give them a near majority in the *120 seat* Knesset.
- But while Israelis may be exasperated with the world & lurching to the right, and Netanyahu has credibility on security issues, his free market policy bias has led to a growing 'wealth gap', to a rising cost of living, & to the middle class feeling squeezed; so on balance he is increasingly looked upon as not having made the people better-off & as inspiring loathing. And if the people dislike him, the political class does even more so; for over the years, in a parliamentary system in which relationships needed to build coalitions are the be-all & end-all, he has over the years alienated many Israeli politicians.
- This could result in someone else being named to form the next government⁹, especially since the left & the centre have grown much closer, and have opened the door to a *possible* coalition with the deeply pragmatic & opportunistic Orthodox parties (*that typically control fifteen, or so, seats*) while Lieberman, long Netanyahu's most natural ally, is now believed to be thinking of dumping him, & Kahlon, *who some believe would be more comfortable in a coalition to his left, rather than his right*, will be the wild card.

⁸ Between 1989 & 2006 almost a million Jews emigrated from Russia to Israel; to put this number in perspective, it is worth noting that the **total** Jewish population of Israel today is about 6MM.

⁹ In fact the latest (Haaretz) poll suggest that only 34% of Israelis want him to remain Prime Minister and, more importantly, that his support has fallen off in the past three weeks to the point where if the election were held today Likud would get only 21 seats in the Knesset, down from 24 three weeks ago, the same number as the now combined Labor-Hatnua party list (the latter headed by Tsipi Livni, the latter of whom was Justice Minister (& the minister responsible for negotiations with the Palestinians) in the last Netanyahu coalition government.

The math in the first paragraph is flawed; for the 43 seats it says Netanyahu & Bennett control now, include the 11 seats Lieberman contributed when Yisrael Beitenu ran a joint list with Likud in the 2012 election. Two things will decide the composition of the post-election government. Whether peace & security (and Jewish identity) -, or bread-and-butter & economic/social-, issues will be foremost in independent voters' minds when they enter the voting booths in March. And which way Lieberman & Kahlon will decide to jump.

CHINA'S GEELY SHARES DOWN MOST IN 12 YEARS AFTER PROFIT WARNING (Reuters)

- Its First Half profits were down 20% YoY due to weakening domestic sales (that account for 80% of its total sales) in the face of growing competition from foreign car makers, incl. GM & Volkswagen¹⁰. Then on December 16th it announced it expects profit for the entire year to be down 50% YoY. This prompted a 22% drop in its share price, the most in 12 years.

While one analyst attributed this to weak sales in Russia, a major export market for all Chinese car makers, the firm would appear to have deeper-seated problems; for over the first eleven months of this year its total sales were down 27% & it is unlikely that a 50% drop in profit could be solely attributable to lower sales in a market that accounts for only a fraction of the 20% of its car production it exports every year.

CHINA LAUNCHES MAJOR CRACKDOWN ON FLOW OF ILLICIT FUNDS TO MACAU (SMCP)

- On December 16th the city's banks received instructions from its monetary authority that will turn up the heat on the promoters of the controversial Chinese VIP gambling junkets that in the past have generated the bulk of Macau's gambling revenues. This is the latest step, & *perhaps one of the more significant steps*, in President Xi's & the CCDI (*anti-corruption*) czar Wang Quishan's "Tigers and flies" anti-corruption campaign. Meanwhile, in Guanzhu, Zhang Xinhua, the former General Manager of Baiyun Nonggong Shang United Co. Ltd, was given a death sentence after being found guilty of embezzling 72MM yuan (US\$11.5MM) in state-owned assets, taking 100MM yuan in bribes & causing a loss of 248MM yuan in state-owned assets. And in Shanxi, 320 kms South of Beijing, a *middle-aged business woman* Ding Yuxin, a former ally of the *disgraced* former China Rail head *Liu Zhijun*, got 20 years in jail, was fined 2.5BN yuan (US\$400MM) & forfeited 20MM yuan in personal property *for having conspired with Liu to help companies get contracts worth 180BN yuan (US\$29BN) that supposedly had generated 2BN (US\$325MM) in 'middleman's fees' for her.*

This will have a devastating effect on the Macau economy. A year ago, the Standard Chartered analyst covering the gambling industry forecast 14% higher revenues for its casinos this year whereas now they are expected to be down 1% YoY. And it will get worse, if only because in November they were down 20% YoY. But for Beijing this will be a useful collateral benefit from its anti-corruption campaign; for under the terms of its transfer from Portugal to China in 1999, Macau, like Hongkong, is a 'Special Administrative Region, a status that is a thorn in Beijing's side & that it would like to see end (a development that serious economic pain may help expedite).

¹⁰ While overall sales growth has slowed down, it is still growing at a near double-digit YoY rate.

PUTIN'S SECRET GAMBLE ON RESERVES BACKFIRES INTO CURRENCY CRISIS **(BBB, Evgenia Pismennaya et. al.)**

- When Putin came to power in 2000, *in the wake of Russia's 1998 currency crisis*, the country, with US\$13BN in FX reserves & US\$130BN in foreign debt, was essentially broke. *But over the next eight years burgeoning oil prices helped to skyrocket its reserves 40+x to US\$583BN.* According to Alexei Kudrin, *Russia's Finance Minister from May 2000 until September 2011*, "For Putin, the reserves that Russia has accumulated over the past 14 years equal political power" (& *more importantly, economic might?*). So last February, as the Sochi Winter Olympic Games were underway, *when he was contemplating making the then Ukrainian President Viktor Yanukovich an offer he couldn't refuse to wean him off his dalliance with the EU*, his officials told him that Russia's FX reserves would be more than adequate to withstand the repercussions of any sanctions the West might impose in response. But they miscalculated; for since then Russia has spent at least US\$87BN¹¹ (17%) of its reserves in a vain attempt to prevent a collapse of the ruble & to keep it from spiraling into a panic¹². So far nothing has worked.

One year ago the exchange rate was 33 rubles to the dollar while at last report it was about 60, after having hit a high of 77 in intra-day trading on December 16th.

¹¹ This is actually a lowball figure, as of November 30th they were down 21% YoY, from US\$475BN to US\$ 374BN.

¹² And unless capital outflows from Russia cease & inflows of capital from abroad resume [other than the (rapidly diminishing) proceeds from oil & gas sales (that are desperately needed to import food stuffs other than grain)], neither of which seems very likely over the next 12 to 24 months, Russia is liable to lose another US\$120BN of its FX reserves next year (and a not dissimilar amount in 2016) to enable the its banks & corporations to pay back their foreign debt due in those years).