

**Quote of the week** : “use banks, not tanks” - **Garry Kasparov**, a Russian citizen of Croatian descent who in 1986, at age 22, he became World Chess Champion & today is Chairman of the New York-based Human Rights Foundation (“To ensure freedom is both preserved and promoted”) – founded in 2005 by film maker Thor Halvorssen Mendoza, a Venezuelan by birth - and who in the past decade one of the highest profile Putin opponents in Russia. He also writes for Forbes & the Huffington Post and often in the op-ed pages of various newspapers.

We hear much about Europe’s ‘dependence on Russian natural gas. But the degree of that dependence varies widely, as noted below :

- 80-100% : Belaurus, Bulgaria, Czech Republic, Finland, Latvia, Lithuania, Moldova, Poland, Serbia & Slovakia;
- 60-80% : Austria, Estonia & Greece;
- 40-60% : Germany, Hungary, Turkey & Ukraine;
- 20-40% : France & Italy; and
- 0-20% : Belgium, Netherlands, Romania, Switzerland & UK.

But this is a ‘Mexican standoff’. For while Europe needs Russian gas, 70% of total Russian gas exports go to Europe & Moscow **needs** the foreign currency this generates. And longer term, Russia may have shot itself in the foot by proving itself to be an unreliable supplier; for all over Europe, first & foremost in the countries with a high degree of dependence on Russian gas & deepwater access, incl. the Baltic states & Ukraine, governments are planning and/or building, LNG regasification plants (in fact, a floating LNG regasification plant for Estonia was recently christened in South Korea). In a similar vein, oil prices may be put under pressure during the foreseeable future, since that would be another way to hit Putin ‘in the pocket book’.

The Washington, D.C.-based National Geographic Society<sup>1</sup> announced on March 18<sup>th</sup> it will redraw its maps to show Crimea as part of Russia, explaining its maps show the world “as it is, not as people would like it to be ... sometimes our maps are not received in a positive light by some people who want to see the world in a different light.” - *realistic though this may be, from a US foreign policy perspective it was not helpful & makes one wonder whose side the Society is on, announcing this change so precipitously. But for the Obama Administration kicking up a fuss over it now would be a matter of ‘locking the stable door after the horse has bolted.’*

The financial system’s reaction to the Fed’s tapering has so far defied yesteryear’s common wisdom. Depending on who one talked to, the expectation had been that it would hit the US stock market and/or the price of gold. But so far neither has happened (although some other markets have been hit). While the runup in the gold price YTD may be due to evidence of a developing shortage of physical gold, one must wonder why anyone but the most ardent subscriber to the ‘greater fool theory of investment’ would, for instance buy Facebook at 114x trailing-, & 47x expected-, earnings, and 21x Sales & 10.7x Book Value, paying no dividend while its treasury bulges with cash, & underwhelming earnings in the most recent quarter.

In all the fuss over the Crimean referendum, it has all but gone unnoticed that this week the Italian city of Venice is having one of its own online, ending today, March 21<sup>st</sup>, on whether to secede from Italy. Apart from its history, some of its 2+MM people are unhappy that, while they

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<sup>1</sup> Whose commercial & highly successful house organ, the National Geographic Magazine, is unusual in that it has had only three Editors-in-Chief in its 126 year history.

account for 3.3% of the country's population, 9% of its GDP, & close to 20% of its tax revenues, they get only 70¢ on the Euro of the taxes they pay back in the form of government services.

The Alberta Conservative Party, that has been in power for 43 years, has done it again. A few years ago it forced an unwilling Premier Ralph Klein from office (which, with the benefit of hindsight was the right thing to do since, like President Reagan in the US, he was subsequently proven to have been in the early stages of dementia). His successor Ed Stelmach, was forced after five years, a year or so after a party convention had given him 77% support, & a standing ovation about. And this week it was the turn of Premier Alison Redford, his surprise successor, who many people had hoped would be the new broom that swept clean. She had become her own worst enemy by first alienating her colleagues by her imperial ways, and then made the fatal mistake of alienating the rank & file party membership, and Mr. & Mrs. Joe & Jill Average Voter, first by spending unnecessarily much taxpayer money going to Mandela's funeral (she had reason to go since she had worked for him earlier in her career, but going never was the real issue, the unnecessary costs she incurred in doing so were) & then was found out to have taken her 11 year-old daughter, & her daughter's friend, on joy rides on government airplanes, only to whine, when caught out, how hard it was to be both a mother & a politician (an excuse that not only didn't cut it with the hoi polloi, but actually infuriated them even more. So, two days after having been given a standing ovation by her party's members in the legislature, she walked the plank last Wednesday before she would be pushed - *there are two interesting aspects to this, one specific, the other general. The first is that politicians cannot get away with doing things Mr. & Mrs. Average Voter can understand (talking about billions of dollars makes their eyes glaze over, while they can really relate to mundane matters, like traveling First Class & taking freebies for your family). The second, however, more important aspect is the growing voter sense that something is seriously amiss with a political system in which politicians (& bureaucrats) seem to have forgotten that their role in the system is to advance the public, rather than their self-, interest, & and their growing willingness to quit tolerating those who do.*

It's a sign of consumer optimism in the EU that in February new car sales were up for the sixth month in a row, by 7.6% YoY. And more noteworthy was their growth, albeit from low levels in PIGS countries like Portugal (up 40.2% YoY), Ireland (up 20.6%) & Spain (up 17.8%).

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**RUSSIA EXAMINES ITS OPTIONS (Stratfor, George Friedman)**

- The fall of the Yanukovich regime is a major defeat for Russia. While, after the collapse of the Soviet Union, Moscow had accepted that its former Eastern European vassals would be absorbed in the West's economic & political system, it took comfort from the fact Belarus & Ukraine would remain a buffer zone (Russia has always depended on depth as its primary defense against outside adventurers (*the effectiveness of which Napoleon & Hitler can attest to*). But the loss of Ukraine risks bringing Western influence to within 480 kilometres from Moscow &, with it the risk of "contagion", of undesirable Western influences spilling over into Russia proper & undermining its regime.
- *After a decade of drift*, under Putin Russia went on the offensive. He has used energy exports, the weakness of Europe & the US preoccupation with the Middle East to foster a perception, *at home & abroad*, of growing Russian geopolitical power. He ensured that Belarus & Ukraine had regimes that, while having significant domestic autonomy, could be depended on to follow the Russian foreign policy line. He sought to project power in the Middle East, especially in Iran & Syria, to make the US look weak & vacillating. But

events in Ukraine have now raised questions within Russia as to how all-powerful he really is. Unable to tolerate this, the only question for him now is how to respond. Crimea was a *low-hanging fruit*, a low-risk, low-cost undertaking that, while it makes him look like a bully in the West made him look strong at home. Going forward, he can :

- **do nothing** - the forces that threw out Yanukovich are quite disparate & covert activities can help ensure they will remain so. But that may take more time than he can afford & meanwhile weaken the power of the pro-Russian forces in Ukraine;
  - **invade Ukraine** - this would give Russia a common border with the EU & NATO (& *saddle it him with the cost of keeping Eastern Ukraine afloat*);
  - **act along the periphery** - large Russian minorities in the Caucasus, Moldova & the Baltic states may need 'protecting' (if necessary, after creating unrest there to 'justify' intervention). This would make Russia look strong & Europe weak, and underline the fact America is far away;
  - **seek to win favour with Eastern European countries by 'commercial imperialism'** – this would be facilitated by the fact most of them are not Eurozone members & hence not *directly* affected by its problems;
  - **create problems for the US elsewhere** - first & foremost in Iran where Moscow has just offered to build two new nuclear reactors or, for instance, by doing things like propping up the faltering Maduro regime in Venezuela.
- Moscow will *opportunistically* do all of the above.
  - Sanctions have their limitations since the Russian economy is now so entangled with the West that Moscow can retaliate tit for tat by moving against Western interests in Russia. Thus it can cut oil & gas shipments even though this would hurt it financially; and, while *in time* the US oil boom & European shale gas may make this a less powerful weapon, this is still well into the future. Short-term the two question marks are Germany & the US. Unless the former can convince the countries further East it will back them to the hilt against, say, Russian action in the Baltic states, they will hedge their bets; worse still, Europe is not united : the more distant from Russia, the less governments, *with problems of their own*, care about the situation in Eastern Europe. And with the US unable to exercise its military might, it must practice commercial imperialism of its own by providing Eastern Europe with the technology & materiel needed to discourage Russian adventurism abroad for the sake of promoting national pride at home, which in the present political environment in Washington may be easier said than done. The paradox in all this is that, while the sphere of Western influence has moved East, unless the US plays its hand cleverly, the East-West demarkation line will actually move West.

*This analysis misses a critical point, namely that, at the end of one of the warmest winters on record in Europe, it is in a better position, at least in the short run, to withstand energy blackmail than Russia will be in coping with any drop in its FX earnings.*

### **BANK ROSSIYA, KREMLIN'S FAVORITE BANK, TO BE 'FROZEN OUT OF THE DOLLAR'** (The Guardian, Simon Bowers)

- On March 20<sup>th</sup> President Obama signed an Executive Order for a new wave of sanctions against Russian institutions & individuals (that American banks & corporations are prohibited from dealing with). Most prominent among them is the St. Petersburg<sup>2</sup>-based Bank Rossiya. The significance of this is less its size (with assets of US\$10BN, it is only the 17<sup>th</sup>-largest bank in Russia) than the fact it has long been deemed the personal bank

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<sup>2</sup> Known as Leningrad in the Soviet Union days.

of many senior Russian government officials, incl. Putin himself. The bank is controlled by billionaire oligarch Yuri Kovalchuk, whose ties to Putin go back more than two decades to the days when the latter was Deputy Mayor of St. Petersburg & who to this day owns a dacha near Putin's on Lake Komsomolskoye outside the city. According to Obama "This is not our preferred outcome. These sanctions would not only have a significant impact of the Russian economy, but could also be disruptive to the global economy." Meanwhile S&P issued a report that said, among others, that "There is a material risk that the conflict between Russia and Ukraine could extend beyond Crimea and that violence between pro- and anti-Russian protesters could spread to other cities in Eastern Ukraine ... (*and that*) heightened geopolitical risk and the prospect of US and EU economic sanctions following Russia's incorporation of Crimea could reduce the flow of potential investment, trigger capital outflows, and further weaken Russia's already deteriorating economic performance."

*S&P is behind the eight ball : the reduction in capital inflows & increase in capital outflows has already been happening, and Putin seems to have called off, at least for the time being, his 'agents provocateurs' in Eastern Ukraine who instigated violence during demonstrations; at least the recent demonstrations have been small & peaceful & the demonstrators mostly limited to older people who in their younger, Soviet Union, days had migrated there from Russia to work in the coal mines. And Moscow's initial response to the Executive Order was pathetic : within minutes of Obama signing it, it issued a travel ban to, & within, Russia on nine American politicians & White House officials, incl. Sen. John McCain & House Speaker John Boehner (none of whom had given any indication of a wish to visit Russia). This, however, is unlikely its last word on the matter; for, if he wants to remain credible, Putin simply cannot afford not to make a counter move that could escalate the conflict to a more dangerous level.*

### **WHAT DOES THE US KNOW ABOUT PUTIN'S OIL WEALTH (Reuters)**

- One of the people included in the March 20<sup>th</sup> Executive Order on further sanctions was Gennady Timchenko, a close friend of Putin *who in 2007 founded the Volga Group, a private equity fund, has triple citizenship (Russian, Finnish & Armenian) & has for years lived in Geneva, and who until this week had been a co-owner of Geneva-based Gunvor*<sup>3 4</sup>, the No.4 oil trader in the world with a 4% market share (*the basis of which is that, according to the Economist, it markets 30-40% of the oil produced by LSE-listed but 69.5% Russian government-owned Rosneft*). In announcing the new sanctions the US Treasury included a *curious* sentence that said "Timchenko's activities in the energy sector have been directly linked to Putin. Putin has investments in Gunvor and may have access to Gunvor funds" (while refusing to go into detail). Not surprisingly, Gunvor called this "outrageous" & "blatantly false", and denied "Vladimir Putin has or ever has had any ownership or that he is a beneficiary of our business directly or indirectly". Putin's spokesman, Dmitry Peskov, called the sanctions "unacceptable" & said the Kremlin 'was studying' the inclusion of Tymchenko on the list. Then later in the day a Gunvor spokesman said Tymchenko's inclusion wouldn't affect the Company since he owned less than 50% of it, then, in his next breath, announced that he had sold his interest in the Company to CEO Tornqvist so that the latter now owned 87% of it, & finally that the

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<sup>3</sup> Until this week he was said to own 23% of the Company, CEO Torbjorn Tornqvist 64% and other staff 13%, all of which, according to former Duma Chairman Ivan Rybkin is smoke & mirrors since behind the scenes Putin controls 50% of the Company.

<sup>4</sup> Gunvor is an old Norse word meaning "careful in fighting".

Company's ownership structure had been confirmed during the due diligence for a US\$500MM bond issue *in May of last year* that had been co-led by Goldman Sachs<sup>5</sup>.

*Of all the parties involved the US Treasury may have the most credibility. If indeed it has moved to hit Putin where it really hurts, it could shatter his Teflon image & prompt an overreaction.*

### **VLADIMIR PUTIN AND THE LESSONS OF 1938 (Politico, Garry Kasparov)**

- Over the past nine years I have dedicated my life to opposing Putin's campaign to destroy democracy & civil liberties in Russia, explaining time & again that he isn't a democratically-elected leader but a bad guy persecuting dissidents, putting the media under state control & subordinating the Russian economy to the Kremlin & his circle of cronies. In his "Rule like Stalin, Live like Trump" approach his main advantage over his Soviet predecessors has been that he had open access to international markets & institutions (although even I never imagined he would abuse them so easily, with help of the West). But all I got for my efforts was the West dismissing me as a trouble maker not in sync with its belief that Putin would bring about reform & liberalization.
- When I tweeted about the possibility of a "Ukrainian Anschluss" on February 20<sup>th</sup> the Sochi Games were still underway. I noted that Putin's invasion of Georgia had taken place during 2008 Olympics in Beijing & wondered what, with Russian troops still in South Ossetia & Abkazia, might dissuade him from similar action in Ukraine especially since, just a few months after Georgia, the EU had restarted talks with Russian on a formal partnership & cooperation agreement : in dealing with Putin the only thing that turning the other cheek achieves is getting slapped again.
- It's one thing for academics & pundits to sympathize with Putin and his "vital interests" & "sphere of influence" claims. But it is something else again when the likes of Obama, Cameron & Merkel fret about "instability" & the "high costs" of sanctions against Russia, and in so doing so are aided & abetted by a morally corrupt global banking system that cares about nothing but staying on the good side of the Russian money. Thus when Mikhail Khodorkovsky was jailed, and his Yukos oil company dismembered & sold to Putin's friends at Rosneft, the guarantees & the IPO were all underwritten & coordinated by big Western banks that, in so doing, provided Putin & his clique with the legitimacy & hard cash to stay in power. But the fact is that through the banks the West has all the leverage in the world it needs *to cut Putin down to size & alienate him from the oligarchs who keep him in power*; all it requires is the political will to use that muscle

*'Political will' is not the long suit of democratically elected politicians!*

### **RUSSIA PROPOSES INTERNATIONAL "SUPPORT GROUP" FOR UKRAINE (Reuters)**

- On March 17<sup>th</sup> the Russian Foreign Ministry proposed creating an international "support group" to mediate in the Ukrainian crisis, but on terms Kiev said were 'absolutely unacceptable' & the West was unlikely to welcome. For it suggested such a group should

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<sup>5</sup> Goldman's co-lead for the bond issue had been Credit Suisse, both of which firms have been known to be less than independent in their due diligence & transparent in the prospectuses they produce. In this case the latter statement only adds to the confusion about the Company's ownership. For the prospectus stated that Tymchenko & Tornqvist each owned 50% of its voting shares & employees 12.3% of its non-voting ones (which raises an interesting question as to how 50 + 50 can add up to 87.

push Ukraine to recognize the outcome of the Crimean referendum & implement the February 21<sup>st</sup> peace deal signed by Yanukovich & his opponents that *Moscow had refused to sign (presumably to enable him to return to Ukraine to run its government)*. While the Ministry's statement wasn't clear who might be in such a group, it did say it should urge Ukraine to adopt broad new powers for the country's regions (as the interim government has already agreed to in principle), and require it to uphold military & political neutrality.

*The following day in his March 18<sup>th</sup> speech to the Duma Putin said Russia didn't want to move into other regions (of Ukraine) and more specifically that "We don't want a division of Ukraine." In this he may well be sincere; for while Crimean gas will be a boon to the Russian treasury, the Eastern Ukrainian coal mines would be a monthly US\$500MM drain on it; so it would be much better for him if they were on the Ukrainian treasury's tab. Furthermore, within a united Ukraine, with a little behind the scenes support from Moscow the Russian-speaking East would become a burr under any future Ukrainian government's saddle that would keep it from becoming unduly Westernized and keep it, no matter how loosely, within Moscow's sphere of influence. So he's trying a "why buy the cow if you can get the milk through the fence" ploy.*

### **CRIMEAN TATARS ASKED TO VACATE LAND (RIA Novsti/Moscow Times)**

- On March 18<sup>th</sup> Crimea's Deputy Prime Minister, Rustam Temirgaliyev, announced his government wants to regularize the land unofficially taken over by Tatar squatters since Soviet Union days, saying "it is required for social needs ... But we are ready to allocate and legalize ... other plots of land to ensure a normal life for the Crimean Tatars."
- Deported en masse to Central Asia by Stalin seventy years ago, many Tatars returned to Crimea in the early 90's and, unable to reclaim their ancestral properties, took over other lands on which to build houses & mosques, and develop farms, with the Ukrainian authorities unable (*or, more likely unwilling?*) to settle the resultant land disputes.

*During WW II most Tatars involved in the war effort did so in the Soviet Army fighting against the Germans while relatively few (< 10,000 out of perhaps 50,000 military age males) served in Hitler's Tatar (auxiliary SS) Legions. But this didn't stop Stalin in 1944 from 'relocating' every Tatar man, woman & child to faraway Uzbekistan (where over 300,000 of them still live<sup>6</sup>, & many more in diaspora in other countries<sup>7</sup> incl. the US) with local & newly-arrived Russian speakers moving into their (fully-furnished) homes<sup>8</sup> & laying claim to their other assets. The 'Russification' of Crimea is illustrated by the following :*

- *in the 1939 Soviet Census of the 24 or so census districts in Crimea, five were >50% Tatar & another seven 25-50% so. But in the 2001 Ukrainian Census there were none with that high a ratio of Tatars (& only four with a 25-50% ratio, vs. seven in 1939); and*

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<sup>6</sup> As part of a broader-based program to secure the Soviet Union's borders by relocating the native populations in border regions, incl. the Baltic states, inland & 'restocking' the countries involved with politically more reliable Russians.

<sup>7</sup> Incl. supposedly as many as 4MM in Turkey (not all of whom, however, may be Crimean Tatars).

<sup>8</sup> Just as happened in the Occupied Countries during WW II with homes vacated by Jews shipped off to the extermination camps. Anyone who did see the movie *Schindler's List* way back when may remember the scene early on in the movie where he did just that, moving into a fully furnished flat 'vacated' by its Jewish owners.

- *while in 1897 the Crimean population was pretty evenly split between Tatars, Russians & others (mostly Ukrainians), by 1939 this had changed to 19% Tatars, 50% Russians & 15% Ukrainians, 20 years later to 0%, 72% & 22%, & by 2001 to 12%, 59% & 23%.*

### **UKRAINE CRISIS SEES RUSSIAN ATTITUDES TO WEST WORSEN** (Moscow Times, Anna Dolgov)

- According to a survey by the Leveda Center, a Moscow-based independent pollster, the number of Russians whose attitude to the US is "bad" or "very bad" is now 56%, up from 39% YoY, & those who look negatively upon the EU 41%, up from 25% a year ago. Furthermore, 12% now see their country's relationship with the US as "hostile", up from 4% three months ago, & another 35% refer to it as "tense", vs. 13% in January (while the percentage that thinks the relationship with the EU is "hostile" has gone from 1% to 5%, & as "tense" from 9% to 27%). And far fewer than two months ago now believe their country should cooperate in foreign policy with the US, the EU & Japan, while far more now think China & India make good foreign policy partners.

*This would be music to Putin's ears although he may have hoped for more than 56%. As far as the Leveda Center's independence goes, while it may not be up to Western standards, it has in the past shown more independence than one might have expected possible in Putin's Russia.*

### **AS INVESTORS FLEE, RUSSIA INC. IS FEELING THE PAIN** (BW, Carol Matlack)

- Although the US & Europe have so far refrained from imposing all-out economic sanctions, Russian companies are suffering. Canceled IPOs, suspended loan negotiations & plummeting share prices have all been part of what is, according to economist Neal Shearing, of Capital Economics in London, a US\$50BN loss of private investment in Russia YTD. According to Dmitry Dudkin of Moscow-based UralSib Capital, "until the situation stabilizes, there will be fewer international banks willing to lend to Russia." And Alexander Lebedev, owner of the Moscow-based investment group National Reserve, says businessmen are "very scared" but keep quiet since the Kremlin in recent years has tightened government control of the economy.
- Despite Russia's resource wealth it has long suffered from a dearth of private investment and, while Putin's crowd in the Kremlin thinks this can be remedied by more government investment, Bernie Sucher, an American entrepreneur who has worked in Moscow for 20 years, believes that *over the longer term* it will backfire; for the more the government has become involved in the economy, the less competitive it has become.

*The lack of private investment may well be a function of oligarchs taking their money abroad.*

### **FOUR UNCOMFORTABLE TRUTHS ABOUT UKRAINE** (BW, Carol Matlack)

- The West is about to hand over billions in aid to Ukraine's new leadership which has promised to pursue "real reforms to stabilize the Ukrainian economy ... and strengthen its ties with the country's European neighbours." The question now is whether they can deliver, given the following four unpleasant truths :
  - **many of the key figures in the new leadership were part of the post-Orange Revolution Yushchenko/Tymoshenko regime** that failed to curb corruption & tackle economic inefficiency, and introduced crowd-pleasing social spending that made Ukraine, despite its strong agricultural-, & industrial base, Europe's second worst economic basket case (ahead only of Moldova);

- **since 1991 the country has squandered a staggering amount of foreign aid** - US\$19BN in grants & loans from the EU, another US\$11BN from the IMF & other governments, incl. the US, and US\$200-300BN in natural gas subsidies from Russia. And while any new IMF & EU help will be conditional upon implementation of a reform program, it is worth noting that a previous IMF bailout cratered because Ukraine failed to reform as it had undertaken to do;
- **the new government is a fragile coalition** that includes some scary elements (*while Putin exaggerates when he talks darkly about right wing extremists having taken over, there is some truth in his claim*). Thus Svoboda, a party with ugly neofascist tendencies (& there are others in the government even more extreme), occupies two prize posts in the government, Deputy Prime Minister & of Chief of National Security. Moreover, it is likely to bail if any economic sacrifice is demanded in the hope of riding the resultant wave of social unrest, particularly in the Eastern regions of the country. So, as Lilit Gevorgyan of London-based IHS puts it, "The Russians can just sit on the side and watch as it unravels";
- **Ukraine needs Russia** - not just as its primary source of energy but also as the market for US\$15BN of exports (that the EU could not readily absorb), and because of the deep historical & cultural ties between their two peoples.

*The most sensible thing that the West could do would be to go on a global treasure hunt in search for the ill-begotten gains stashed abroad by Yanukovych & the Ukrainian oligarchs so as to limit their need to dump their own money in what could prove a black hole - but unfortunately common sense is a scarce commodity in Western politics these days.*