

Those who bought the line that the Israeli election was, as CBC put it, “a resounding victory” for Likud & Netanyahu, were being manipulated. For ‘the devil is in the detail’ & it tells a different story. Likud has four ‘natural’ right wing partners, Jewish Home (led by Naftali Bennett), Yisrael Beiteinu (the Russian immigrant-based party of Foreign Minister Avigdor Lieberman that after the 2013 election accounted for 11 of the 31 seats won by its ‘joint list’ with Likud, the United Torah Party (of the Haredi Jews) & Shas (of the Sephardic Jews). And, while Likud with 30 seats in the new Knesset will have 10 **more** than before, the group as a whole will have four **fewer**, 57 rather than the 61 in the 120 seat Knesset; for the others between them lost 14 seats.

There are three parties with 42 seats between them that are likely all but 100% ‘bullet proof’ to any & all blandishments to join a Netanyahu-led coalition (Zionist Union 24, Meretz<sup>1</sup> 5 & the Arab List with 13<sup>2</sup>) & one, Yair Lapid’s Yesh Atid party that will likely be so (it is philosophically centrist, Lapid’s experience as Netanyahu’s Finance Minister was not a happy one, Netanyahu hasn’t called him since the election & the party has been dropping hints it will ‘likely join the opposition’). But in politics anything is possible, perhaps nowhere more so than in Israel.

Former Communications Minister Moshe Kahlon, & his not-yet-three-months-old Kulanu Party, with their 10 seats, are the **real** winners, not Netanyahu & Likud. For, unless the Zionist Union were to agree to join a ‘government of national union’, or unless Yair Lapid were willing to take more abuse by joining another Netanyahu-led coalition (neither likely nor impossible), Kahlon is firmly in the driver’s seat & the pivotal point of a political teeter-totter. This may prompt him to gravitate left rather than right; for there he will have greater leverage & greater scope to influence events, and its greater focus on bread & butter issues fits his own. Furthermore, he left Likud *before he was pushed to the sidelines* since, in the eyes of Netanyahu & other Likud insiders, his personal “brand” was getting so strong as to threaten their position - *and if it was deemed “strong” then, imagine how strong it would be seen to be today*. He has long wanted to be Finance Minister &, while Netanyahu last weekend announced that he wanted Kahlon to be his Finance Minister, Kahlon is aware that for Yair Lapid being Netanyahu’s Finance Minister had been frustrating & a political ‘kiss of death’, & he may *rightly* feel that as the star of a centrist coalition he will have greater opportunities to advance the causes dear to him than as a Netanyahu vassal. And he may have tipped his hand when on election night he told a throng of cheering supporters that “We need practical solutions (*to bread & butter issues?*) ... Now is the time to do what’s best for all of us. This evening is all about organizing the good.” (*a more pragmatic approach to politics than Netanyahu’s zealous one in which “what’s best for all of us” is very narrowly defined*). And whatever Kahlon’s feelings towards Netanyahu, they cannot have been improved by Likud in the dying days of the campaign, & on the day of the election, using a recording from the 2013 election campaign (when Kahlon was still in Likud), in which he urged voters to support Likud [for which Israel’s Central Elections Committee, made up of an (*Israeli-Arab*) Supreme Court judge as Chairman & MKs as members, has since fined Likud 30,000 shekels (US\$5,000) the day after the election].

But the key figure in this drama will be President Reuven Rivlin. For, while under the Israeli Constitution his office is largely ‘ceremonial’, it has one substantive, & in this instance potentially critical, task. That is to decide after each election whom to ask to form the next government.

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<sup>1</sup> The left-of-centre party that, as the Labor Party dominated Israeli politics from 1948-1977.

And he is not bound to ask the leader of the largest party<sup>3</sup> (thus in 2009, then President Shimon Peres asked Netanyahu to do so, despite his Likud Party having one less seat than Tsipi Livni's Kadima Party, in the belief that he was more likely to succeed in putting together a viable coalition government than she. And in deciding who to pick following are some considerations that will drive Rivlin's decision :

- the right wing group now represents less than 50% of those who voted;
- the Arab List will have the third-largest bloc of seats in the new Knesset (*and while nobody expects it to become formally part of any coalition, there is no way in Hell that it will support any Netanyahu-led one*);
- there is significant-, & growing-, evidence that many Israelis want their government to spend more time on 'bread-and-butter' issues in which Netanyahu has shown little interest & on which Kahlon (& the opposition generally) campaigned almost exclusively);
- for some time now, polls have shown a clear majority of Israelis wants Netanyahu gone'; in fact in this election 75% of those who voted, voted for someone else;
- while a lifelong Likud party supporter, Rivlin has also long been a strong advocate of a two-state solution & of minority rights (especially Israeli-Arab minority rights); so the anti-Arab rants by Netanyahu & Lieberman-, and the former's explicit rejection of a two-state solution-, late in the campaign (*which had been his **real** position for nearly two decades; for in September 1996, three months after he became Prime Minister for the first time, he told a Likud Part audience that "there is not, and there never will be, a Palestinian state"; so he has just been stringing the rest of us along*) cannot help but give him cause for reflection;
- looking at the future for Israel as a Jewish homeland, he may come to the same conclusion as Thomas Friedman in a post-election NYT column, namely that Netanyahu "by declaring that he will never permit a two state solution ... will be the father of the one-state solution. And the one-state solution means that Israel will become, in time, either a non-Jewish democracy or a Jewish non-democracy" (*the latter being the direction in which some legislation tabled in the last Knesset was clearly pointing*);
- looking at Israel's situation in a broad geopolitical context, the President may be concerned for the short term, i.e. the first half of the next government's term in office, about the state of the critical Israeli-US relationship & longer-term that a right wing government would further erode Israel's status in the world (& in a worst case scenario give it a global pariah status like South Africa's during its late Apartheid years<sup>4</sup>;
- last but not least there will be a personal element in Rivlin's ultimate decision. Within Likud was always a rival to Netanyahu. While in many respects well to the right of him, he has nevertheless long been a strong advocate of minority right, especially Israeli Arab minority rights & as an MK (from 1988 - 1992, & again from 1996 - 2014) he put his money where his mouth was by routinely voting against all bills he deemed anti-democratic and/or harmful to Israeli Arabs, regardless of the party line. And Netanyahu may live to regret that after the 2013 election he did not re-appoint Rivlin to the Knesset Speaker's post he had held from 2003 - 2006 & again from 2009 - 2013, and then last

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<sup>3</sup> And according to some sources, obviously not from the Netanyahu camp, he has already indicated he won't feel bound to do so in this instance as well.

<sup>4</sup> With there being a fundamental difference between the two situations in that a peaceful outcome in South Africa may have been helped by both parties to the conflict basically having a New Testament 'turn-the-other-cheek' philosophical basis, while both parties to the Israeli-Palestinian conflict are more Old Testament 'an eye for an eye, a tooth for a tooth'-grounded (although that might be helpful in arriving at a two-state solution in addressing the "right to return" issue.

year unsuccessfully fought hard to keep him from becoming President (which he did with support from, among others, **both** the Arab MK's & Netanyahu's ally, Naftali Bennet.

*The above is not a prognostication as to what **will** happen but rather what **should** happen &, as a long shot, **could** happen (and while it would represent an earthquake of unprecedented proportions in Israeli politics, Rivlin may not be deterred by that). On Wednesday evening March 18<sup>th</sup> his office sent out invitations to the leaders of all ten parties that will have seats in the new Knesset for face-to-face meetings. While Netanyahu likely will spend his time with Rivlin trying to convince him that he is **entitled** to form the next government, Rivlin may well be more interested in what some of the others (first & foremost Moshe Kahlon, and any potential 'swing' leaders) may have to say. And while the President earlier mooted the idea of a 'national unity coalition' headed by Likud & the Zionist Union, he may find this to be a pipe dream since Netanyahu would see this as the beginning of an (ignominious) end to his political career & because it would become apparent that in such a coalition the participating parties may spend more time & energy fighting each other & positioning themselves for the next election (& within Likud brawling as to whom should succeed Netanyahu) than attending to the nation's business, & that a centrist coalition may have more reason to work together in a constructive manner for the good of the country than right wing one. In any case in the end it will likely be a matter of 'as goeth Kahlon, so goeth the nation', with only two moderately safe predictions, namely that the longer Rivlin takes to come to a decision, the slimmer Bibi's chances are likely to head the next government & that the more time he takes to do so the shriller the voices emanating from Likud will become that he is entitled to form the next government because he "won the election".*

*Meanwhile, Hertzog on Thursday March 19<sup>th</sup> told Israel Army Radio in a interview that on election night he had gone to bed after midnight believing his Zionist Union was in a tie with Likud, only to be woken up early the next morning by a phone call from Tsipi Livni telling him that Likud was ahead by several seats, & that "The votes for Netanyahu rose late in the day in response to the warnings about Arab voters heading for the polls".<sup>5 6</sup> And then he followed this up rather strangely (& cryptically), and seemed to muddy the water, by saying that while he still "wanted to be Prime Minister one day ... I don't want to clean up after him (i.e. Netanyahu) ... if the people want a far right government for a limited time, then we will challenge it."*

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Last week two official agencies published their assessments of the global crude oil situation :

- the Paris-based **IEA** (International Energy Agency) reported that in February OPEC output had been up 90,000 bbl/d MoM to 30.22MM bbl/d as *political unrest-driven* losses in Libya & Iraq were outweighed by gains in Saudi Arabia, Iran & Angola; so global supply averaged 94MM bbl/d., up 1.3MM bbl/d YoY (1.4MM bbl/d from OPEC & some from the US, and lower output from non-OPEC/non-US producers). And it raised its output growth forecast for 2015 75,000 bbl/d. to 1MM bbl/d (to 95MM bbl/d) & demand growth to 93.5MM bbl/d; and

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<sup>5</sup> Such a clear voter-influencing move on Election Day in most, if not all, democratic systems would at best have been deemed not to be politically kosher.

<sup>6</sup> While the voter turnout this time was 71.8%, vs. 67.8% in 2013, that of Arab voters went from 61% in 2013, **below** the overall rate, to 77% this time, well **above** the overall rate.

- the Washington-based **EIA** (Energy Information Agency) said it expects global oil production to continue to outstrip demand, & the global inventory build-up to continue, through to the end of 2016 (under the global GDP growth assumptions noted below) :

	2013	2014	2015	2016
	-----MM bbl-----			
• Total world production	90.91	93.01	94.01*	94.40*
• consumption	91.24	92.15	93.13*	94.17*
• GDP growth	2.7%	2.7%	2.6%*	3.1%*
* estimates				

It also forecast that the average gasoline price in the US (that declined from US\$3.69 in June 2014 to US\$2.12 in January 2015) will increase to US\$2.42 by June 2015 & US\$2.90 a year later (& then tail off to US\$2.56 by yearend 2016).

Elsewhere a **Bloomberg** article entitled Record U.S. Oil Glut May Fill Storage noted the cutback in the number of active drilling rigs has so far failed to slow US output. So crude oil has started to fill the nation's storage facilities, with the largest of them, at Cushing, Okla., now at 72% of capacity, up from 48% YoY. And it warned "stocks may soon test storage capacity limits ... That could inevitably lead to renewed price weakness, which in turn could trigger the supply cuts that have so far remained illusive ... While the US supply response might take longer to kick in than expected, it might also prove more abrupt" *when it finally arrives*. Furthermore that Chinese demand "remains in a cooling mode" & that the ban on US oil exports should be lifted (which apparently could be done by Executive Order) *which may actually weaken the oil price situation further by pushing more product on an already saturated global market*. And an article in Forbes says the horizontal portion of 3,000 wells in the US has been completed & waiting to be fracked, which it estimates could generate as much as an additional 3MM bbl of new production (*on a gross-, not a net-, basis since in the meantime older wells will quit producing?*). Furthermore that the Bakken US\$8MM to US\$12MM-, & the Eagleford US\$6MM to US\$8MM-, cost of bringing a 16,000 foot fracked well (10,000 vertical & 8,000 horizontal) into production is split fairly evenly between drilling & fracking (*implying, that with the horizontal drilling cost now of a "sunk" nature, oil can be produced from them at a fraction of their notional all-in cost especially now that oil servicing costs are weakening?*).

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**Thursday March, 19<sup>th</sup>, 2015**

**DOLLAR DROPS AFTER FED LOWERS YEAREND RATE FORECASTS**  
**(Market Watch, Joseph Adolfini)**

- The statement issued after the March 17<sup>th</sup>-18<sup>th</sup> FOMC meeting dropped the word "patient" (as expected)<sup>1</sup> & *replaced it with the words "reasonably confident" (that inflation will move back to its 2 percent objective over the medium term)* and also lowered the FOMC members' year end Fed Fund rate expectations from 1.125% to 0.625% which

<sup>1</sup> In the subsequent press conference Fed Chair Janet Yellen said, among others, that lower export growth had weakened the rate forecasts, that participants are now seeing more slack in the economy than they did previously, & that removing the word "patient ... doesn't mean we are going to be impatient."

was not (expected), which Fed Chair Janet Yellen attributed to the rapid rise in the dollar, and to declining exports & inflation. This caused the US dollar to drop against all major currencies.

*This was generally deemed 'dovish' & deferring any rate hike from the expected June date to at least September, if not later (prompting one comment that 'the Fed doesn't really want to raise the rate' (& will use any excuse not to do so?). According to former Fed Chairman Alan Greenspan the Fed is betting unemployment can drop as low as 5% without stoking inflation.*

### **CLINTON NEEDS A DEMOCRATIC OPPONENT (WP, Richard Cohen)**

- At the moment the media are her chief opponent & she needs someone else in her party's nomination race to divert their attention although, while they are obsessing about her emails (*or rather her use of personal email servers while Secretary of State*), for most Republicans it wouldn't matter if she had used two tin cans connected by a string to communicate.<sup>2</sup> But Elizabeth Warren says she is not running (*& would be unelectable in any case since she is too far to the left of her party to appeal to the independent voters needed to win, just as Sens. Cruz & Rubio would be too far to the right to do so*). And, while Joe Biden has been making noises about running, his chances of winning would be slim. But former Maryland Governor Martin O'Malley who is expected to try for the nomination, would fill the bill *perfectly*, experienced enough to be credible but with enough flies on him to keep the media busy until the Democratic convention scheduled for late July 2016.

*Since leaving the Governor's office last January after serving the State Constitution-constrained two four-year terms, O'Malley has been criss-crossing the country criticizing the Republican message that Social Security is driving the deficit, saying it is a "myth that's what wrong with the country is rising Social Security entitlements", and delivering a populist message of bringing back Glass-Steagall<sup>3</sup>, hiking the capital gains tax, raising the minimum wage & strengthening collective bargaining rights, in line with Elizabeth Warren's notion that America needs to "strengthen the middle class" (all of which will not just make the Koch brothers with their US\$900MM 'war chest' see red). But he may be just as unelectable as Elizabeth Warren & Sens. Cruz & Rubio, if only because his successor in Maryland Governor' was a Republican, only the seventh among the 67 Governors the state has had since Independence, & only the second in the past 46 years (the other one, Robert Ehrlich, whom O'Malley beat & succeeded, served only four years, from 2003-2007). But Hilary, if anything, is nor stupid. By the time the election rolls around, she will be 69, she knows the job is a 'killer', she is now a grandmother & she may be reluctant to risk besmirching her escutcheon and/or becoming a sacrificial lamb by running in a losing cause. And she must know she is now well past her "best before" date, just like Walter Mondale in 1984, Hubert Humphrey in 1968, and Adlai Stevenson in 1952 & 1956 before her, while she might actually add to her legacy in Democratic Party lore by endorsing some sacrificial lamb & help her party rebuild during the four years the Republicans will have, & likely will use, to self-destruct.*

### **THE IRAN DEAL IS WAY BIGGER THAN THE NUKES (AP, Adam Schreck)**

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<sup>2</sup> He is showing his age; for it's doubtful anyone under age 60 understands this imagery.

<sup>3</sup> That, enacted in 1933 during the Depression, was repealed in 1999 under Clinton (a move that is now, with the benefit of hindsight, seen as having laid the groundwork for the Great Recession).

- The big question is if any deal reached (by March 23<sup>rd</sup>) might be the onset of greater acceptance of Iran by the community of nations. On the surface, the answer is a resounding NO. The P5+1 negotiations have focused solely on the nuclear issue. Diplomatic relations between Washington & Tehran remain as they have been since 1979, in limbo. Iran still is one of only four countries deemed by the US to be a state sponsor of terrorism. *Successive* rounds of sanctions have left its economy hobbled, with few trading partners. And the Western-allied, oil-rich *Sunni* Gulf states *will continue* to distrust non-Arab Shiite Iran & may decide, in the wake of a deal, they'd better get a nuclear program of their own, *thereby adding a new dimension to the accelerating arms' race already underway in the region.*
- On the other hand, a deal couldn't help but lead to calls for greater involvement by Iran in world affairs (with consequences for its domestic policies). And, while for many in the West it would remain a global menace, a regional meddler & an oppressor of its people, others see it as an opportunity to normalize business relations with a country that, after decades of relative isolation, could become a huge potential market, ripe for foreign investment; or as Dubai-based geopolitical analyst Theodore Karasik puts it "Many people are already making plans for Iran's (re-)integration into the ... world economy ... Because the country's infrastructure is literally 30 years behind the times, every sector or commodity is open ... Iran is already preparing for this."
- And, while Iran has sponsored rebel movements in the Middle East, incl. *Sunni* Hamas in Gaza, Hezbollah in Lebanon (*that, while Shiite, has attracted a modicum of local Sunni support*) & now the *Shiite* Houthi rebels in Yemen, it has also *opportunistically* cooperated with the West, in 2001 to fight the Taliban in Afghanistan<sup>4</sup> & now by helping the Shiite Iraqi government troops fight ISIS. And while a deal with the P5+1 group will allow the clerics to tell the Iranian people that its nuclear efforts forced its enemies (incl. the US, the "Great Satan") to deal with it, thereby hoping to strengthen the extremist cause, opening up Iran's economy to the outside world may actually strengthen the hand of the more 'moderate' elements of Iranian society.

*Clearly the proponents of a deal think that in ten years a lot can happen & count on Iran's relative young, well-educated & potentially hedonistic population to result in a less hardline policy environment in years to come<sup>5</sup>. Perhaps they subscribe to the idea that "The Chinese use two brush strokes to write the word "crisis", one brush stroke stands for danger; the other for opportunity. In a crisis, be aware of the danger - but recognize the opportunity"<sup>6</sup> or that it's best*

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<sup>4</sup> That same year it was also among the first countries in the world to assistance to President Bush after 9/11, despite the fact that only weeks earlier he had included it in his "axis of evil"..

<sup>5</sup> 42+% of Iranians are under the age of 25. 85% of those over age 15 can read & write (up to 97% in the 15-24 year age cohort, vs. a regional average of 62%) with zero sex discrimination. World Bank data show Iran's tertiary enrollment (% of those in the five year age cohort after high school graduation enrolled in post-secondary educational institutions) is 55%: while less than the US & Finland (94%), Australia (86%) & Denmark (80%), this compares to Israel's 66%, Germany's 62%, Japan's 61%, France's 58% & Switzerland's 56%, and is ahead of Saudi Arabia's 51%, the Palestinians' 49%, Jordan's 47%, Lebanon's 46%, Tunisia's 35%, Egypt's & China's 30%, Oman's 28%, India's 23%, and Pakistan's & Yemen's 10% [& with an unusually high proportion of them in 'technical' courses of study, like medicine & engineering, where the Islamization of all education decreed by the Supreme Leader may be effective than in, say, the social sciences.

<sup>6</sup> John F. Kennedy.

*“to keep your friends close, but your enemies closer”<sup>7</sup>. Or maybe that any opening up of the Iranian economy will lead to a loosening of the Revolutionary Guards’ grip over it<sup>8 9</sup>, or that, with the economy having started to grow again after eight quarters of negative-, sometimes seriously, negative-, growth ending a year ago, but with inflation stubbornly remaining well in the double digit range, the aging Supreme Leader feels a deal is needed to forestall the popular unrest that accompanied the last two Presidential elections. Or perhaps, there is a realization by the leaders on our side that once the genie is out of the bottle it’s futile to try & put back it back in (an expression that, incidentally, is of Middle Eastern origin) & it’s wise to make the best of a bad situation. Or any combination or all of the above.*

### **IRAN DEAL MAY OPEN OIL TAPS IN MONTHS, NOT WEEKS (Reuters, Yeganeh Torbati)**

- At a time oil prices are weak, the market is expecting, & *not relishing the prospect of*, a deal dumping as much as 1MM bbl of Iranian crude on an already glutted market. But, while it is Iran’s declared intention to claw back market share lost as a result of the sanctions, US officials & Western diplomats say the sanctions would only be lifted in stages & even a partial return if Iranian crude exports will be deferred until at least 2016.

*The latter is likely unrealistic; for without a modicum of immediate relief from the restrictions on oil exports, much of the incentive to do a deal will be removed for the Iranians, if only because its would make the Supreme Leader look weak. Experts expect that at most 500,000-800,000 bbl will hit the supply stream within six months of the sanctions being lifted. Be that as it may, Iranian exports will be in full flight in 2016, just when, according the EIA forecast noted earlier, the oversupply from other sources should start to abate.*

### **RIKSBANK CUTS RATES DEEPER INTO NEGATIVE, EXPANDS QE PROGRAM (BB, Johan Carlstrom)**

- On March 18<sup>th</sup> Sweden’s central bank took the market by surprise when it cut its policy repo rate 15 bps to -0.25%, announced plans to add SEK30BN to the SEK10BN of government bonds it has already purchased & that it expects the rate to stay at this level until “at least the Second Half of next year, and said “today’s action was made necessary by the ECB’s unprecedented stimulus measures to drive down the Euro”. And Bank Governor Stefan Ingves told the subsequent press conference “This is a way of buying insurance against too low inflation in a insecure world ... What we have said many times in the past month and a half is , that if more is required, we will do more.” Earlier policy makers had pledged to jolt the country’s economy, the largest in Northern Europe, out of disinflation & the bank has long been criticized for failing to provide price

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<sup>7</sup> At various times attributed to Sun Tse or Macchiavelli, it can only reliably traced back to Godfather Part II.

<sup>8</sup> Which may delight President Rouhani, if not the Supreme Leader himself, for on Army Day last April 18<sup>th</sup> the former (a ‘moderate who won the 2013 election over seven less moderate/more conservative candidates) praised the Army for protecting the nation against external threats “without requesting its share from the nation and its elected government”, a dig at the Revolutionary Guards presumably sanctioned by the the Supreme Leader himself.

<sup>9</sup> Described by Mohsen Sazegara, a co-founder of the Revolutionary Guards in his mid-twenties & Deputy Prime from his late-20s to his mid-30s & for the past decade an exile living in the US & a dissident, as “something like the Communist Party, the KGB, a business complex and the Mafia.”

stability (on the downside; the CPI has been in negative territory for much of the past two plus years).

*In the aftermath of this announcement the krona plunged & the yield on the benchmark 10-year government bond declined slightly while the Swedish stock market strengthened (stock markets like QE, the more the better). Part of the surprise was that due to the fact this decision was taken at a board-, rather than a policy committee-, meeting. This move is part of a seemingly accelerating 'race to the bottom', 'beggar thy neighbour' currency war. And it was seen as a signal the bank won't tolerate any SEK appreciation and a move the bank sought to justify in the opening sentence of the statement accompanying the announcement that read "There are signs that inflation has bottomed out and is beginning to rise, but the recent appreciation of the krona risks breaking this trend" [(the CPI has been in negative-, & the unemployment rate in eight percent-, territory, for the past nearly three years as the economy grew at modest rates (although lately it has "ticked up" to a nearly 3% annual rate)].*