Rundt's World Business Intelligence

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JORDAN **Page 11**
The Kingdom is undoubtedly in the cross-hairs of ISIS, but the jihadist group would probably find Jordan a tough nut to crack. It may want to bide its time at least until it has consolidated its newly gained position in Iraq. Economically Jordan is grappling with strong headwinds, but it is, for now, in a position to hold its own.

POLAND **Page 13**
Prime Minister Tusk won a parliamentary vote of confidence, which should allow the political storm to die down that arose over a sinister bugging affair leading to one of the worst scandals of the reborn Polish state. At that, he and the politicians most directly affected have much fence-mending to do, and the matter is far from over.

TURKEY **Page 15**
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International interest rates, spot and forward exchange rates, Euro, SDR, gold.

Trends You Should Know About

ARGENTINA

Since the US Supreme Court has shot down Argentina's appeal of US District Court Judge Griesa's ruling on its decade-old default case (see last week's Briefs) the government of President Cristina Fernandez de Kirchner has gone through all kinds of twists and turns to find a way out. First, the President vowed to defy the order to pay USD 1.5 billion to owners of un-restructured debt, particularly the billionaire hedge fund manager Paul Singer, a stance that her Economy Minister Axel Kicillof backed by promising to find a plan that would skirt the ruling. Then, Pres. Fernandez' lawyer in Manhattan reversed course, saying that the government was willing to negotiate with the "vulture" creditors. But the newly conciliatory position did not last long. A few days later, Cabinet chief Jorge Capitanich let it be known that the regime had changed its mind again and that "there is no Argentine mission or committee going to New York."

The erratic nature of Argentina's response reveals the crux of the problem for Ms. Fernandez. Obeying Judge Griesa's court order, she needs to settle with holdout creditors from the 2001 default to avoid triggering another debt default that would block the country's return to the international credit markets, something her regime would very much like to accomplish, judging from the recent arrangement with the Paris Club of creditor nations and the settlement with Repsol over the YPF sequestration. But she does not have the money to do this and she fears a massive loss of face if she yields on this issue.

Where the money is concerned, Argentina would have to pay the litigants about USD 1.5 billion at the same time it is due to pay interest of nearly USD 1 billion to holders of restructured bonds on June 30 (or a few days later, since there is a 30-day grace period). But more of problem is that paying the holdouts would trigger claims from others of as much as USD 15 billion, which is more than half the country's official international monetary reserves. The government has indicated that it may be preparing a swap of foreign-law debt to local legislation so that it can get around Judge Griesa's ruling, but this would be technically difficult and legally close to impossible.

On the other hand, Cristina Fernandez has sworn never to succumb to the "extortion" by holdouts and feels it is politically essential for her to be seen as following through on the pledge. So, there are no really good options for her. Meanwhile, holdouts are continuing to look for Argentine assets they can seize. The government has so far countered about 900 embargo attempts by creditors. These have ranged from a seized naval vessel docked in Ghana to attempts at grabbing the presidential jet. Pres. Fernandez last year rented a plane to fly to Vietnam to avoid seizure of her jet. There has been talk that the creditors may have designs on the state-owned energy producer YPF, but this might be difficult since – according to the enterprise – "YPF is an independent company and run as such, in accordance with the law… its assets do not belong to the Argentine Republic and therefore cannot be embargoed for debt taken on by the sovereign."

COLOMBIA

The economy grew in the first quarter of this year at the fastest pace in two years as real GDP was up 6.4% from a year earlier, following a 4.9% advance in the preceding three months. This was at least in part due to a surge in government spending ahead of the presidential elections, but there were other, more durable reasons as well. Outlays on public works jumped by 24.8% in January-March from a year earlier. Coffee production was up 14.9%. The global slump in metals prices, which hurt countries such as Chile and Peru, had much less of an effect in Colombia, where oil accounts for half of all the export revenue, and petroleum prices have risen 7% so far this year.

The national unemployment rate dropped to 9.2% of the workforce in April from 10.7% 12 months before. Annual inflation accelerated to 2.93% in May, after touching a six-decade low in November. With this, all signs point to further interest rate hikes. The local bond markets are convinced of this, and the country's shorter-term benchmark peso bonds have fallen to a three-year low.

VENEZUELA

New regulations that were published in the Official Gazette of June 17 require that all hotels and travel agencies in Venezuela must require foreign tourists to produce a receipt showing that any bolivars they spend were obtained on a legal exchange rather than in the black market. Since March, tourists have been able to get bolivars legally under the Sicad 2 exchange system for rough-

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ly VEB 50:USD 1.00, rather than the VEB 6.30:USD 1 the authorities use for "essential" imports. President Nicolas Maduro has been complaining that this market is not working as well as intended because – surprise, surprise – not enough dollars are flowing into it.

The new rule for tourists is intended to increase the flow. For one thing, though, there are not that many tourists coming to Venezuela these days, a country that has acquired a progressively worse reputation for crime. And for another, while Caracas is one of the most expensive cities in the world at the 6.3:1 exchange rate and is decidedly cheaper at 50:1, it becomes truly cheap at the black-market rate of currently about 75:1. When tourists use foreign credit cards instead of cash, the government uses an undisclosed exchange rate set by the Central Bank.

Canada

The economy's performance is not bad, although the news continues to be rather mixed. The two main weaknesses are a somewhat risky housing market and Canada's continued dependence on the US as a market for its goods & services. Pipeline projects seeking to diversify customers for oil exports are being pushed with vigor, however, and the Bank of Canada has been keeping the CAD's exchange rate low to promote sales abroad.

The Canadian economy, relatively speaking, has been doing fairly well so far this year, the impact of an unusually severe winter fully acknowledged. Wholesale sales rose in April more than twice as fast as the analysts had forecast, setting a record on gains in building materials and machinery and climbing, overall, by 1.2%, according to Statistics Canada. This suggests that economic growth may have been gaining momentum in the second quarter, as rising inventories suggest that wholesalers are confident stronger demand will be sustained in the months ahead.

Positive Signs

Canadian realtors registered their biggest sales gain in almost four years in May, as home sales jumped 5.9% from April and the average price of a home sold was up 7.1% year-on-year. The advance was the fourth consecutive monthly increment following four straight declines. "Had it not been for such a brutal winter," the Real Estate Association said, "the improvement in new listings and sales would likely have been more spread out over the past few months." The figures are still mixed, however, and suggest that the fairly tapped-out consumer remains the main driver of growth, as a long-predicted recovery of business investment and exports has yet to appear.

Consumers are being pinched by increases in the costs of gasoline, food and electricity this year. Their confidence index has been slipping of late, as optimism about personal finances has been waning. The national unemployment rate unexpectedly rose in May to 7.0% from 6.9%, the first increase so far in 2014, as full-time employment declined for a second month in a row while part-time positions increased. Average hourly wages of permanent employees rose a modest 1.6% in May from a year earlier, failing to keep pace with the consumer price index, which was up 2.3%.

Caveats

In a recent press conference and a revamped report, the Bank of Canada's new governor Stephen Poloz said that there are still "elevated" risks of a sharp correction in Canadian home prices due to "stretched valuations and some signs of overbuilding." The government has repeatedly amended mortgage rules to put the brakes on the housing market. Inter alia, it made sure that the Canada Mortgage and Housing Corporation, which provides government-backed insurance, no longer underwrites mortgages on second homes and that the self-employed no longer get insurance unless their income is verified.

This squeeze has not been without effect. It slowed the rise of household debt and home sales. But house prices remain at record levels nation-wide, especially in cities such as Toronto and Vancouver, where some analysts claim homes are still 75% overpriced. Still, the Bank of Canada seems to think that a soft landing is the most likely outcome and that the risk of a crash is quite limited. It says that the main scenario for a housing crash would be based on a shock that drives up unemployment and makes it harder for families to repay debts. Besides, Canada has held the title of having the world's soundest banks for six straight years, as this status is being defined by the World Economic Forum.

A relatively greater risk is Canada's continued export dependence on the United States, still the destination of roughly two-thirds of all shipments abroad. When

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the US economy drops by 2.9%, as it did in the first quarter of the year, this is clearly not without repercussions North of the 49th Parallel. So, Ottawa has been working hard on a variety of international trade pacts, reaching agreement in principle with the European Union on a Transatlantic trade deal, signing another accord with South Korea, and gaining admission to the group of 12 nations that are negotiating the Trans-Pacific Partnership.

It has also been trying to pave the way – more specifically, create the transportation infrastructure – for diversifying its energy trade. For the time being, almost all the oil exports head South, which goes a long way in explaining Canada's frustration with the US Government's regulatory and legal hurdles which have prevented the construction of the Keystone XL pipeline. Enbridge Inc. has been trying hard to win all the needed approvals for its proposed Northern Gateway pipeline that would carry diluted bitumen from Alberta's oil sands across British Columbia and was first proposed a decade ago.

Pipeline Plans

It is quite clear that US dithering on the Keystone XL has given a strong impetus to Canada's resolve to get to the global markets with existing and planned conduits that could allow for oil sands production to increase by 25% or more in the next decade, even if the Keystone pipeline is never built. But there are still considerable hurdles to be overcome in Canada itself, especially in British Columbia, which is the natural route to the fast-growing Asian markets. The critical Northern Gateway pipeline has been running into strong opposition from Native Canadian groups. Enbridge has also encountered resistance from Kitimat, the town intended to be the port terminal for the Northern Gateway, which recently voted against the project in a non-binding referendum.

Meanwhile, there is a strong focus on expanding the capacity of existing conduits, such as the Alberta Clipper, which already transports 450,000 bpd to the United States, as well as the Trans Mountain pipeline from Alberta to Vancouver and a half dozen other projects. Canadian oil executives say they will need most, if not all, of these projects implemented if they are to meet their oil production target for 2025, which calls for an increase from the current 3.5 million barrels a day to 6 million bpd, including a doubling of oil sands production.

Promoting Non-Commodity Exports

Even if these ambitious plans can be realized, however, this does not change the trend that Toronto-Dominion Bank CEO Ed Clark highlighted earlier this year, when he warned that Canada is losing its competitive edge in exports beyond commodities, as fewer small companies look outside their home market for sales outlets. "Our market share of US non-commodity imports has dropped by about 30% over the past ten years," he told his listeners, saying that less than 10% of Canada's small and medium-sized companies are involved in exporting goods and services. About 50 companies generate roundly half of all exports.

There are numerous ways in which Canada's commercial banks and the government can help to change this trend, but the most important thing that has been done so far on this front has been a Central Bank policy geared to keeping the Canadian dollar relatively soft in the foreign exchange markets. Since taking over at the Bank of Canada last June, Governor Poloz in his statements has shifted from cautioning about the need for interest rate increases to a neutral view that leaves at least the possibility of a cut open. The Governor's occasional public references to the importance of a weaker currency to support exports and repeated warnings about the threat of low inflation have helped to maintain the downward pressures on the loonie. The CAD is currently trading about 1.5% lower than at the outset of this year, and while some market specialists suggest that the unit is now poised to test technical levels marking the boundary between bullish and bearish outlooks, a bullish breakout by the Canadian dollar at this point would probably not be sustained.

The Role of the CAD

Mr. Poloz took over the helm of the Bank of Canada after a stint leading the country's Export Development Corporation, so it is not surprising that he is quite familiar with the damage the CAD's earlier strength had wrought on manufacturers. While industries such as textiles, clothing and automotive parts have been besieged by so much international competition that they are not likely to see much of a gain from the now lower dollar, other industries have been benefitting and will continue to do so.

Interesting in this context is that an explosive, world-wide growth of CB reserves over the past decade, especially among emerging-market Central Banks, has led to a marked increase in CB holdings of securities denominated in Canadian dollars. Buyers, from the monetary authorities of Chile and the Czech Republic to those of Russia, have acquired upwards of CAD 200 billion in such assets, looking for diversification into "non-traditional" reserves. But any unwinding of these positions, should it occur because of relatively low Canadian interest rates

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and the decline of the Canadian dollar, is likely to be gradual and non-disruptive. (6/26/14)

France

The Cabinet has approved a string of new spending cuts to meet this year's fiscal deficit target. It may still undershoot its goal as its economic growth assumptions, modest as they are, could be too optimistic. Also, what France urgently needs are structural reforms, since the labor force lags behind its counterparts elsewhere in the region in terms of competitiveness.

When President Francois Hollande picked as his new Prime Minister Manuel Valls, a reformer who says he is committed to stamping out inefficiencies in the public sector, he drew a line under the traditional Leftist manifesto promising extensive tax-and-spend policies. Realizing that these have made economic problems worse rather than better and have helped to push his presidency into a ditch, he now seems to be recognizing that he must bring in a number of supply-side changes if the economy is to be prevented from sliding back into recession.

Supplementary Budget

It is with this in mind that the Cabinet recently approved EUR 4-billion worth of spending cuts in a supplementary budget for the current year, on top of spending reductions of EUR 14 billion already programmed, in the hope that this will suffice to meet the 2014 target of a fiscal deficit no greater than 3.8% of GDP. In doing so, the government reiterated its commitment to paring the shortfall further to 3.0% of GDP next year, as demanded by Brussels. The fresh cuts are to include EUR 1.6 billion in state spending and EUR 1.1 billion in benefits, with the remaining EUR 1.3 billion in additional savings to be derived from lower outlays on investment and reduced expenditures on unemployment and family benefits.

The mini-budget also sets out EUR 1.1 billion in income tax cuts for the nation's lowest earners and includes previously announced reductions in payroll taxes and corporate levies that will cost the government a total of EUR 5.5 billion. It is intended as the first stage of implementation of M. Hollande's "responsibility pact," a plan to revitalize the economy that he outlined last January. This scheme calls for more than EUR 40 billion in tax reductions, mainly for business, and EUR 30 billion in public spending cuts, to be introduced during the remaining three years of the President's term in office.

Tax Cuts For Business

Among more specific measures in this plan are EUR 6.5 billion in tax cuts for business in the next two years and EUR 3.6 billion to be pared from individual taxes in a step that according to the government will benefit roughly 3.7 million households (probably not coincidentally the number that were newly caught by the tax net after the financial crisis). The administration has so far stuck to its plan despite vociferous protests by 100 Socialist MPs, who have been harshly criticizing the EU's deficit reduction demands and have called for a major portion of the tax cuts directed at business to be refocused to support private and public demand.

M. Hollande has supported his change of tune with a shakeup at the Elysee Palace, bringing in a senior Bank of America Merrill Lynch economist, Laurence Boone, as his top economic adviser. He is still likely to find that his program will fall short of achieving the intended deficit shrinkage, though, since the government's expectation of 1% real GDP growth this year seems too optimistic and this could spell a shortfall in tax revenues. The French economy has fared worse than that of the euro area for the past three quarters and there is still little sign of any turnaround.

Lagging Economy

The purchasing power of households has improved, but too modestly to generate any real acceleration in spending. Companies are not inclined to invest and French exports will not benefit fully from anticipated improvements in world trade. Banque de France's index of manufacturing sentiment declined to 97 in June from 98 in May, while the Purchasing Managers' Index for services and industries compiled by Markit Economics slipped to 47.8 this month from 49.6, with 50 denoting the threshold between expansion and contraction.

The National Statistics Office predicts that unemployment will continue to climb in the second semester, reaching 10.2% of the workforce by the end of this year. Reflecting the added tax burden that is weighing on households, consumer spending unexpectedly dropped in April by 0.3%, after a 0.5% fall in the first quarter. The

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economy literally stalled in January-March, with real GDP remaining unchanged, following a revised 0.2% gain in the preceding three months. All this shows just how difficult it has become for the government to overhaul the economy, revive growth, rein in record-high unemployment and still keep Socialist backbenchers and voters in the electorate from revolting.

Structural Reforms Needed

The latter have been feeling the brunt of M. Hollande's deficit reduction plan in the form of higher taxes, which increased by about EUR 70 billion in the past three years. Government levies now amount to more than 46% of gross domestic product, the highest ratio in the Eurozone. The full weight of the increases has been felt by voters recently, as they prepared their tax filings for 2013, for which the first deadline was May 20. Little wonder that the President's popular approval ratings are now below 20%. And on present trends the economy will grow this year by at most 0.7%, markedly less than the 1.0% the government is hoping for. This could made additions spending cuts necessary.

An Acid Test Passed

Withal, though, what France most urgently needs are structural economic reforms, and these are the most difficult to push through, as the just-ended rail strike proved. At issue was a restructuring of the French rail system by combining the S.C.N.F. (the national rail operator responsible for transit) with the R.F.F. (the state administration that oversees the rail network infrastructure, such as track) under the umbrella of a single, newly formed state rail parent company. This led two major unions to go on strike to block the merger, meant to prepare for future competition with private and foreign train services, in keeping with EU directives.

The work stoppage stranded thousands and exasperated millions more. It was seen as an acid test of Pres. Hollande's willingness and ability to hang tough in the face of sharp criticism from his base on the Left. Fortunately for him, there was not a great deal of public support for the walkout, particularly not in light of the generous labor safeguards and welfare benefits that rail workers receive. These include full retirement pensions for drivers as young as 50 and for conductors and other workers at 55. In the end, the government got the law passed this week by 355 votes to 168 with 27 abstentions.

But much more remains to be done on the labor front to make French workers competitive with their confreres elsewhere in the Eurozone. For instance, while governments over the last ten years have tried to water down the provisions of the 35-hour workweek, they have succeeded only partially. Full-time employees in France worked just 1,661 hours in 2013, or 239 fewer than their counterparts in the United Kingdom and 186 less than in Germany. Within the 28-member European Union, only the Finns worked even fewer hours.

Under the current system, blue-collar workers in France put in 35 hours a week, while white-collar employees are compensated with additional time off for working more than that. So, the French, on average, worked 39.2 hours a week in 2013, compared with 40.6 hours in Germany. The report, by the research group Coe-Rexecode in Paris, has reinforced business concerns that France will continue to lag behind the region's other major nations in terms of competitiveness. (6/26/14)

Germany

Berlin has joined Paris in nudging the Eurozone toward an easing of its fiscal requirements, but the ECB's latest package of stimulatory measures is being broadly condemned in the Federal Republic. The economy still powers ahead as those of neighbors struggle, yet the government sees no leeway for tax cuts. Interesting in the political arena is the headway made by the AfD party in the European parliament, which is already allowing it to become a thorn in Chancellor Merkel's side.

The weaker members of the Eurozone have been trying to get the stronger ones to acknowledge that for them to try and work themselves out of the mire with austerity programs alone is not tolerable in the longer run, since this sort of belt-tightening cuts into economic growth which, in turn, reduces government revenues and makes balancing the books that much harder. Germany has been one of the leading opponents against loosened deficit rules, but this appears to be changing.

The government of Chancellor Angela Merkel is supporting France, according to Economy Minister Gabriel, in seeking to persuade the European Commission to allow countries such as France and Italy to subtract the cost of economic reforms from the budget deficit.

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The initiative does not provide for the extra time Paris had asked to be allowed to meet deficit-cutting requirements. France is still committed to reducing the budget gap to 3.8% of gross domestic product this year and to 3.0% by 2018. Instead, Mr. Gabriel conceded that "countries that are embarking on reforms must have more time to cut their deficits, but it has to be binding – a binding chance to reform in return for more time." This is a change for Merkel's administration, which had been in the forefront of those responding to Europe's sovereign debt crisis by demanding government austerity in return for bailouts.

No Love For the ECB's Loose Monetary Policy

On the other hand, even though Germany's annual inflation rate almost halved in May, to 0.6% from 1.1% in April, heightening concern in some quarters that the Eurozone is facing a prolonged stretch of "excessively low consumer-price growth," the German media, reflecting a widespread public opinion, responded furiously to the European Central Bank's recent decision to introduce a negative interest rated for commercial banks parking cash with it and to come up with a liquidity injection boosting lending to companies. This unprecedented bid to get credit flowing reopened a rift between Chancellor Merkel and German economists and lawmakers who see the ECB's move as "a desperate attempt to divert capital flows to Southern Europe with ever-cheaper money and punishing interest rates on deposits in order to stimulate the economy there."

The bill, it is rightly pointed out, is being footed by all those who are investing money for the long term, the savers and holders of life insurance policies. Germany is a country in which traditionally saving has been looked at as a virtue and borrowing as something at least akin to a vice. German households save about 10% of their disposable income, so it is hardly surprising that the ECB's negative deposit rate is being referred to as a "Strafzins" or penalty interest rate with which the European Central Bank is "causing nightmares among many savers." The question is being raised to what extent this will lead to "old-age poverty."

Continued Economic Recovery

Of course, in contrast to conditions in, say, Italy, France, Portugal or even Finland the German economy is still powering ahead, having achieved a gain of 0.8% in January-March after a 0.4% advance in October-December. The Eurozone economy as a whole managed to inch ahead by just 0.2% in the first quarter, after a rise by the same magnitude in the final three months of 2013. Industrial output in Germany gained 0.2% in April from the preceding month, marking a return to expansion from a contraction in March. Services activity slowed more than analysts had predicted, but manufacturing strengthened, since the Purchasing Managers' Index for services slipped to 54.8 in June from 56.0 in May, while the factory gauge rose to 52.4 from 52.3. All these numbers, mind you, are well above the 50.0 threshold that marks the line between expansion and contraction. A composite index for German manufacturing and services growth, while it declined to 54.2 in June from 55.6 in May, was above 50.0 for the 14th month in a row.

In short, the economic recovery remains broad-based by sector and the strong performance in the private sector has persisted, so far in 2014 to near the end of the first semester. Unemployment unexpectedly increased in May by a seasonally adjusted 23,937 to 2.9056 million (while the seasonally adjusted jobless rate was unchanged, at 6.7%), but this was mainly a reflection of the mild Winter that had flattered economic data a bit during the year's opening months. The Frankfurt-based Deutsche Bundesbank has just raised its economic growth forecast for all of 2014 to 1.9% from 1.7%.

No Prospect For Tax Cuts

This upgrading of the forecast added to hopes in some quarters that government revenues would run up sufficiently to permit tax cuts. Indeed, the Finance Ministry recently released projections suggesting that tax revenues over the five years from 2014 to 2018 could be EUR 19.2 billion higher than in the last prediction, made in November. But not by as much as EUR 40 billion, as some analysts had been prognosticating.

This came as a disappointment to Olli Rehn, the EU Commissioner For Economic and Monetary Affairs, who had been calling for tax cuts to boost German domestic demand and reduce the country's external surpluses. It was disappointing also for Wolfgang Schaeuble, the normally cautious Finance Minister, who had indicated that tax cuts might be possible if the budget provided any leeway. The official consensus now is that policy makers are not left with enough room for maneuver.

An Interesting New Political Party

Noteworthy in the political arena is the headway the young Alternative fuer Deutschland (Alternative for Germany or AfD) party, formed only last year by a group of renegade academics, has been able to make toward be-

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coming influential. Its main supporters are not rabid xenophobes, as Germany's mainstream parties have tried to suggest, but church-going conservatives who believe in traditional family values, are worried about the loose monetary policies the ECB has been pursuing, and think that Germany should concentrate on its own weaknesses rather than pulling other Eurozone members out of the mire. Initially, the party had only one issue, which was a plea to see the old Deutsche Mark returned in place of the euro. But it quickly broadened its perspective, including education, domestic security and support for small businesses.

It now says it is not opposed to the European Union, but believes that smaller, weaker members should leave the Eurozone. It also opposes the planned free trade agreement between the EU and the US. In the German Federal elections last September, it failed to overcome the 5% threshold to become part of the Bundestag (the Lower House of parliament). But then, in the European elections, it scored 7% and the ECR (European Conservatives and Reformists), a bloc founded by British Prime Minister David Cameron in the European Parliament, voted narrowly to let the AfD in.

It Could Become a Challenge For the CDU

The decision by the ECR, on the basis of a secret ballot, embarrassed Mr. Cameron, who has been at pains explaining to German Chancellor Merkel and others that he, personally, did not support AfD's membership (although the group has also taken in the far-Right, anti-immigrant Danish People's Party and the Finns, a nationalist Finnish party). But in Germany, ECR membership has helped the AfD to be seen by a growing number of voters as a legitimate, democratic party to the Right of Merkel's CDU/CSU.

There are now three regional elections approaching in Eastern Germany, which may well lift the AfD into state assemblies for the first time, and this is bound to be unsettling to members of the CDU/CSU, with some now suggesting that, perhaps, their party should work with the AfD rather than against it.

This could become a challenge to Merkel, who has taken "her" party noticeably to the Left, to where it has been embracing a minimum wage, renewable energy, female quotas in board rooms and caps on rents. These policy shifts, along with the Chancellor's support for euro bailouts and accommodative ECB policies, have alienated a core group of CDU traditionalists who may swing to the AfD. (6/26/14)

Israel

The country's leadership is troubled by the acceptance in the West of the Palestinian unity government, but the response, stepping up Jewish settlements on the West Bank, is not likely to benefit Israel. This is especially true as the fate of three missing Israeli teenagers is currently raising tensions on several fronts and Israel is deeply concerned about any US-Iran cooperation in Iraq. On the economic front, the government has announced a new funding scheme for start-up tech companies and contracts are being worked on to turn Egypt and Jordan into long-term customers for Israeli natural gas.

Ever since al-Fatah, the party of Palestinian Authority President Mahmoud Abbas, and Hamas, which has run the Gaza Strip since seizing the territory from al Fatah in a brief civil war in 2007, declared their reconciliation and intention to form a unity government, Israel's leadership has sought to persuade the rest of the world that nothing good could come of this rapprochement between one Palestinian faction that – on and off – appeared willing to negotiate a two-country solution, and another one sworn to the Jewish state's destruction.

Troubled By Acceptance

To no avail. The Palestinians did form their unity government, an administration of technocrats headed by Prime Minister Rami Hamdallah, and the UN was quick to welcome its formation, with the Secretary Ban Ki-moon "taking note of the renewed assurances… by President Abbas that the government will continue to abide by those commitments of recognition of Israel, non-violence and adherence to previous agreements." Even though Israeli Prime Minister Benjamin Netanyahu took pains to remind all & sundry that Hamas is a brutal terrorist organization that cannot be trusted, the EU followed suit, saying it welcomed the opportunity to work with the new government on the condition that it sticks to the principle of peace with Israel based on a two-state solution.

So did the United States, albeit with the caveat that Washington "does not recognize a government with respect to Palestine, because that would recognize a state, and there is no state." This does not, however, change the fact that the US has been supporting the Palestinian Au-

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thority to the tune of more than USD 400 million a year, and that if this support is kept up, as must be expected, some of it will now go to a State-Department-designated foreign terrorist organization. This, although US law prohibits shelling out taxpayer funds to any Palestinian entity over which Hamas exercises "undue influence."

Palestinian Plans

The Palestinians have made no secret out of where they hope their plans will lead them. They want to have elections six months after the formation of the unity government and then pursue international recognition outside the framework of peace talks. They say they will come back to the negotiating table only if Israel makes good on its promise to release prisoners, freezes the construction of settlements, and is prepared to discuss borders immediately. PM Netanyahu repeated his position that he had no intention to rule over Palestinians in a binational state (although, in Reuven Rivlin, the Knesset has just elected for the first time a President espousing a one-state solution), but it does not appear that he has a good Plan B. Instead, Israel has been threatening financial and possibly military consequences for a reconstituted Palestinian leadership that includes Hamas.

Israeli Response

The Israeli authorities have threatened to withhold from the Palestinian Authority some of the taxes that they collect on the PA's behalf. More drastically, they said they are moving ahead with the planning and construction of hundreds of Jewish settlement homes as retaliation against the formation of the new government. Housing Minister Uri Ariel published bids for the construction of nearly 1,500 housing units in the West Bank and East Jerusalem, calling them "an appropriate Zionist response to the establishment of the Palestinian terror government." The authorities also revived plans for 1,800 more units.

Yet, by presenting the new building activity as a punishment for the new Hamas-backed Palestinian government Israel is distancing itself further from the international consensus, which still favors a two-state solution. The move, therefore, has drawn open criticism from the United Kingdom, France and the United States. A spokesman for President Abbas has indicated that the PA will "respond in an unprecedented way" without saying what this way will be. But the whole problem is made worse by the fact that Israel has just unleashed its most intense West Bank crack-down in the effort to find three Israeli teenagers kidnapped there.

Worries About a Possible Third Intifadah

President Abbas has come under fierce attack from fellow Palestinians for cooperating with Israel's search for the boys. The Israelis, accusing Hamas of orchestrating the kidnapping, have had the army conduct house-to-house searches, round-ups of suspects, and arrests of more than 340 people, two thirds of them Hamas politicians or operatives, in an operation called Brother's Keeper. In the process, they have found safe houses and tunnels where explosive devices were manufactured and stored. But Abbas, who has roundly condemned the kidnappers and promised to hold to account those responsible, has been denounced by Hamas and other factions as "traitor" and worse.

It is, at this point, still difficult to predict where the latest confrontation will end. But Hamas has strongholds on the West Bank in the cities of Hebron, Jenin, Qalqilia, Tulkarm and Nablus, and while these do not make for much of a military might, there have been whispers to the effect that the Palestinian Authority may unravel and a third intifadah (uprising) in the West Bank and the Gaza Strip may erupt.

The Threat That Is Iran

Israel is also deeply concerned at the prospect of the US Government cooperating with what it considers its deadliest foe, Iran, to prevent a sectarian breakup of Iraq. Teheran is already well on its way to extend its sway in that country, in support of Prime Minister Nuri al-Maliki and his Shiite government.

While Washington has no appetite for sending large numbers of troops back into the country from which it has just withdrawn, Teheran has no similar qualms about dispatching its revolutionary guards, not just to train and advise the Iraqi army or allied militias, but to fight with them and then take part in the spoils of war.

PM Netanyahu has not been mincing words when he said last weekend that the US should try to weaken both Iran and the ISIS jihadists driving toward Baghdad, rather than work with Tehran trying to stabilize Iraq. Both these camps, he said, "are enemies of the United States, and when your enemies are fighting each other, don't strengthen either one of them. Weaken both." In his view, "by far the worst outcome that could come out of this is that one of these factions, Iran, would emerge with a nuclear weapons capability… That would be a tragic mistake… It would make everything else pale in comparison.

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Help For High-Tech Startups

On the economic front, the Israeli government at the second annual Haredi High-Tech Conference in Jerusalem in May announced a new policy to provide preferential funding to technology startups that are founded by ultra-orthodox Jews (Haredim) and Arab Israelis, two groups that are not usually tied into the kinds of networks that could be helpful to them. Young companies that pass the strict application process will qualify for 85% in matching funding, up to 2 million shekels, instead of the 50% offered by other government programs. They will also enjoy a 75% subsidy on access to business mentors and enjoy other guidance.

Gas Deals

The companies investing in the huge deep-water natural-gas field Leviathan, meanwhile, led by US-based Noble Energy and Israel's Delek, are busy negotiating major supply deals that could soon lead to substantial exports by pipeline to Egypt and Jordan. The field off Haifa is said to contain 19 trillion cubic feet of discovered gas and could start exporting from late 2017. Egypt, which until recently exported gas to Israel, has seen production at the LNG facilities stall because the authorities diverted gas to local consumers.

Now that Abdel Fattalh al-Sisi has been confirmed as President, Cairo has become distinctly less hostile to Israel than it was under Islamist rule. As for Jordan, Noble already in February announced a USD 500-million contract to supply gas over 15 years to the Kingdom's potash and bromine factories. The Leviathan partners are now talking to Jordanian officials about a much bigger and longer-term export agreement under which Israel could supply the Kingdom with 3-4 billion cubic meters of gas per year. (6/26/14)

Japan

Japanese stocks hit a nearly five-month high this week in a positive reaction to further details of the "third arrow" of PM Abe's three-pronged effort to inject more dash into the economy. Even though crucial details of the program are still missing, there is optimism that it will do more than chip around the edges of Japan's economic foundations. Almost everything will depend on the implementation of the package, however, which – for now – leaves many questions open. And there is no sign yet that Abenomics is shaking companies' addiction to cash.

Continuing the gradual roll-out of the "third arrow" of its economic revival program, the government this week put more flesh on the bones of its previously unveiled framework. In contrast to earlier such announcements, however, and although the government has already disclosed most of the scheme in draft form over the past few weeks, global investors showed themselves to be encouraged by the Prime Minister's steps to create a corporate-friendly environment. We say "global investors" because foreigners have tended to drive movements in the Tokyo stock exchange since they have a large presence and are more-frequent traders.

As of end-March this year, foreign ownership of Japanese equities on the nation's four exchanges stood at a combined 30.8% of the shares listed in terms of value, an all-time high and up from 28% a year earlier. The Nikkei's so far more than 5% gain in June is in stark contrast to a year ago, when PM Abe's administration unveiled the initial version of its growth policy. Then, the plan struck most global investors as too vague. Now, there is evidently more confidence that the package has a chance of accomplishing what the Prime Minister promises it will do.

Positive Comments

The corporate tax cut from above 35% to "below 30%" over the next few years has been attracting positive comments, although the authorities have yet to specify the new rate they will be aiming for and how long it will take to get there, or what offsetting tax hikes will be included to contain the nation's bloated debt. There has been a positive reaction also to plans to knock down long-standing limits on companies' hiring and firing and the pay agreements they may make with their workers. Regulatory obstacles are also to be lowered in agriculture and health care.

As a nod in the direction of demands that Japan ease its unusually tight restrictions on immigration, Mr. Abe has been proposing a slight increase in the number of sectors that can bring in a few thousand foreign guest workers and an extension of their stay to five years from three. In one effort to address the problem of a shrinking working-age population the scheme will seek to encourage women to enter the labor force. Many economists and

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analysts also see merit in the plan that requires companies to adhere to a corporate governance code and better reward shareholders, which could help push up Japan's low return on equity. The program calls on Japanese companies to raise their ROE to global levels through a Tokyo Stock Exchange corporate governance code, with listed companies failing to follow these guidelines being asked to justify their decisions.

Nebulous SEZs

At that, much is apparently expected from the establishment of special economic zones where reduced regulations are to be in effect, yet, while government officials say these zones will be up and running by Autumn, the latest package still does not give a clear picture of what they will look like, in large part because discussion about them have only just begun. There are questions also concerning many "fringe" measures, such as the study of casinos as a way of attracting record numbers of tourists. This is the second attempt by Mr. Abe to convince domestic and foreign investors that he has the vision, the will and the political clout to carry out changes – conceivably some painful ones – so that Japan can meet global competition and cope with demographic challenges.

This means that in coming months investors will watch carefully for signals of whether Mr. Abe is following through on his long to-do list, or whether implementation of the promised reforms will fall short of what is being pledged. Premier Abe says that "we will break through whatever barriers there are to unlock the potential that the Japanese economy has." For now, investors seem to think that the latest package of growth-promoting measures has exceeded expectations and they believe that it will be implemented. There is, thus, at least in the near term still upside room for the stock market.

It'll Be a Long Wait-&-See

In the longer run, though, the lack of a fast-track implementation and the omission of bolder ideas, such as allowing large-scale immigration to counter Japan's population drop, or nation-wide labor deregulation, is likely to undermine confidence, unless the economy is seen as picking up momentum. Whether and to what extent this will happen is still difficult to foretell, since the performance so far this year has been highly erratic. As we pointed out in last week's Briefs, much of the 6.7% surge in real GDP in January-March may be attributed to consumers rushing to beat the deadline bringing a marked increase in the sales tax, but the widely reported forecasts of a 4.4% contraction in the second quarter are still "iffy."

Generally, while the government's goal of 2% annual GDP gains over the decade through 2022 is ambitious, it is not impossible to meet. The weaker yen will help, even though to date it has done more to amplify exporters' profit margins than to boost the volume of sales abroad. But wages are still lagging behind inflation, which is not particularly promising for consumer spending, and Prime Minister Abe's goal of having women in 30% of management positions will be difficult to achieve over the objections of a male-dominated business leadership.

Too Much Cash In Corporate Coffers

Perhaps part of the solution may rest with Mr. Abe's desire to reduce limits imposed on Japan's military by a constitution legislated under US pressure after World War II. Pushed by an ever more assertive China and urged on by the wish for strengthened ties with the United States, Mr. Abe has called for reinterpreting the pacifist charter and spending more on bolstering the defense forces. This would not only lead to stepped-up government outlays, but there is also evidence that patriotism lifts a nation's "animal spirits" which, in turn, helps to pump up economic activity.

Most importantly, though, the government needs to find a way to wean Japanese companies off their addiction to cash. At present, the holdings by non-financial companies of cash and deposits stand at JPY 232 trillion (about USD 2.3 trillion, as of end-March), and corporate borrowing from private banks has been increasing at the slowest pace since the final quarter of 2012. The reluctance of firms to sink cash into projects at home suggests that they do not really trust the effectiveness of Mr. Abe's third arrow and continue to see more potential abroad. The flow of direct investment overseas was JPY 1.25 trillion in the first quarter, raising the balance to a record JPY 66 trillion. (6/26/14)

Jordan

Many analysts believe that the Kingdom is in the cross-hairs of ISIS, the jihadist group that has seized a huge swathe of territory in Syria and Iraq for the caliphate it hopes to build. It would probably find Jordan a tougher nut to crack and may want to bide its time at least until it has consolidated its newly

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gained position. Economically Jordan, not surprisingly, is grappling with strong headwinds, but it is, for now, in a position to hold its own.

The brutal jihadist group that calls itself The Islamic State of Iraq and Syria/Levant (ISIS) has extended its Blitzkrieg Westward, taking over crucial towns such as Anah and Hadithah (which is near a critical Euphrates dam of which the destruction could seriously damage Iraq's electricity grid and cause disastrous floods) as well as Rutbah on the main highway to Jordan. These chokepoints now allow it to control the main border crossings into Syria and Jordan, which have also been taken by ISIS, including al-Qaim and al-Walid into Syria and Trebil into Jordan. These conquests help with the shuttling of fighters from Syria to Iraq and back, and with the delivery of (largely US-supplied) weapons and armor seized from the Iraqi army to ISIS jihadists battling Assad's forces in Syria. They also raise the threat by ISIS to the Hashemite Kingdom, with few doubting that Jordan is "a target of interest" for the jihadist movement.

The Maliki regime in Baghdad has withdrawn its forces from Western towns close to the 110-mile border between Iraq and Jordan and this has, obviously, left Amman feeling vulnerable. As it seeks to keep expanding the territory it controls as part of its plans to create a regional (for now) caliphate, ISIS is confronted in the North by Kurds who have Turkey's support, and in the South by Shiites with Iranian backing. Any effort to move Southwest into Lebanon would be fiercely resisted by Assad's military. But with the territory it now holds in Syria and Iraq ISIS can push into Jordan from two directions. Except that doing so would confront the group with considerable challenges.

One is that the Jordanian government is far more stable than those of Assad in Syria and Maliki in Iraq have proven to be. The Jordanian armed forces and the country's security apparatus are quite effective, and Jordan, if attacked, would receive strong backing from the United States as well as from Saudi Arabia, both of which are in a position to provide valuable financial, intelligence and military assistance to the Kingdom. Jordan, admittedly, has long had a significant Salafist and jihadist presence. It is, in fact, the native country of Abu Musab al-Zarqawi, the late founder of the organization that developed into ISIS.

The jihadists currently in Jordan, however, are dominated by forces that are strictly opposed to ISIS and have openly criticized the group and its viciousness – its mass killings of Shia non-combatants (including women and children), its insistence on imposing barbaric Islamist laws in areas over which it gains control, actions that risk alienating locals and which al-Qaeda leader Ayman al-Zawahiri specifically addressed in guidelines he issued for conducting the war against the infidels, but which were ignored by ISIS.

No Pushover

The state has adopted a policy that essentially says "if you want to join the fight in Syria, go ahead, but don't come back." Jihadis returning from combat with rebels in Syria are seized at the border and wind up at military trials with minimal legal safeguards, where they are accused of having "committed acts not authorized by the state, that sour relations with legitimate Syrian authorities." They face jail terms of two to five years and their treatment attests to official Amman's continued, pragmatic recognition of Pres. Assad's rule in the neighboring country. The clamp-down is not without risks. It carries the danger of generating deeper radicalization among disaffected Salafis, who view Jordan as part of what they call Bilad al-Sham, or Greater Syria. But Jordan's Monarchy continues to be torn by conflicting interests over Syria. As long as it can it will try to continue to steer a middle course between that of Gulf Arab allies, who want to see Assad ousted at almost any cost, and its own concerns, revolving around the notion that a radical Islamist victory in Syria would conjure up a worse threat.

In any event, ISIS would not find Jordan to be a pushover. It also has to consider the extent to which it owes its successes in Iraq – specifically its ability to hold on to territory gained while pushing on toward new conquests – to the support of local Sunni militias and organizations. For the better part of a decade, members of Saddam Hussein's Baathist party, including many of his top generals, have been forced to hide in the shadows, persecuted by the government in Baghdad and preparing and plotting for the chance to reclaim "their" country. Their objectives, right now, converge with those of the bloodthirsty ISIS, although most are more moderate in their aspirations.

Similar Objectives

The goal is getting rid of Maliki's sectarian government, decimating his "corrupt army," and renegotiating the formation of a Sunni region. The marriage of convenience is similar to the one ISIS concluded in Syria with the Free Syrian Army, focused on toppling Assad's

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regime. But the alliance in Syria has already imploded. The patriots fighting to liberate Syria eventually became disgusted by the violence of the ISIS jihadists seeking to establish an extreme fundamentalist state. They are now at war, and the odds are better than even that eventually something similar is going to happen in Iraq.

There, ISIS fighters would hardly have been as successful as they turned out to be, had it not been for the Baathists. Three of Saddam's former generals led the assault on Mosul. Eight of the top ten generals in the ISIS army are believed to be Baathists. They were able to offer ISIS not only their military training, but also strong tribal ties in the region. Fighting alone, ISIS would never have been able to hang on to the vast territory it conquered. But the Baathists and their followers helped to keep these areas in ISIS hands while the army of terrorists, swollen with foreign jihadists battle-hardened in Syria, Chechnya, Afghanistan and other places and with the soldiers freed from local jails, was able to keep moving forward toward the grand prize, to wit, Baghdad and the holy Shia cities of Karbala and Najaf.

It was only with the help of the Baathists (united under the banner of the Naqshbandi army) that ISIS managed to keep the momentum going. It cannot count on this support forever, though, and above all it could not rely on it for any move into Jordan. The Sunni tribes that have been backing ISIS in Iraq receive substantial support and guidance from sponsors in the Gulf, including Saudi royals in Riyadh. There is no love lost between these backers and ISIS, the less so as the Saudis, who have branded the Islamic State a terrorist organization, have uncovered cells of the group on Saudi soil plotting against the Kingdom. So, chances are that Jordan is probably safe for now, at the very least until ISIS has ended its campaigns and consolidated its position in Syria and Iraq.

Economically, Jordan – to hardly anyone's surprise – is buffeted by strong headwinds. The economy has been gradually recovering from the sharp drop it suffered in 2010, largely as a result of the global downturn. Real gross domestic product gained by about 3.3% in 2013 and has, this year, a good chance to accelerate its growth to 3.5% or so. The recovery has been held back by the conflict in Syria and by the losses of the public electricity company NEPCO, as well as by a contraction in mining (following strikes in 2012 and difficulties in negotiating new contracts following the breakup of the fertilizer cartel in mid-2013), but these difficulties have been overcome.

Still, employment increased by just a little more than 1% between 2011 and 2013, while the working-age population grew by 6%. While the unemployment rate remained fairly stable at under 3% of the workforce, this was only because labor force participation continued to drop. Gender disparities have persisted, with 54% of men but only 10% of women of working age being formally employed in 2013. Demand pressures from a growing population contributed to a gradual increase in core inflation to over 4% year-on-year, but headline inflation, after temporarily spiking to 7% in early 2013 due to rising food prices and the liberalization of fuel prices in November 2012, is back down again to the low single digits.

Much-Improved Reserves

The current-account BoP deficit peaked in 2012 due to a number of factors ranging from higher energy prices, lower grants and a poorer export performance (stemming from lower potash prices and strikes) to rising numbers of Syrian refugees. Including grants it is estimated to have dipped just below 20% of GDP last year and current forecasts have it in this neighborhood also in 2014. Excluding grants, the respective ratios would be 16.5% and 14.2%. But official international monetary reserves have been increasing more impressively, most recently reported by the IMF at USD 13,796 million at the end of March, which was up from a low of USD 5.3 billion at the end of 2012, thanks to a reduction in dollarization, a large influx of grants from the Gulf Cooperation Council and the issuance of dollar-denominated domestic bonds as well as US-guaranteed Eurobonds.

This said, the risks for the economy remain high. Jordan is struggling to host the Syrian refugees that have already crossed the border, and will have a difficult time with additional arrivals. There also appears to be no end to the uncertainty surrounding the delivery of natural gas from Egypt, which has time and again been disrupted by sabotage of the pipeline and may make substantial additional financing necessary. While growth has picked up, it is still insufficient to make a meaningful dent in persistently high unemployment and poverty. But at least Jordan can count on continued financial support from the United States and the GCC. (6/26/14)

Poland

Prime Minister Donald Tusk won a parliamentary vote of confidence this week which should al-

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low the political storm to die down that arose over a sinister bugging affair leading to one of the worst scandals of the reborn Polish state. Mr. Tusk and the politicians in the direct focus of it have had much fence-mending and explaining to do, and the matter is far from over as the government is still trying to pin down the perpetrators of the illegal tape recordings and their agenda. Still, the administration, tough undeniable weakened, should now be able to hang on until the next scheduled election.

There are altogether four leading personages with previously first-class reputations who got caught up in the bugging scandal that, under different circumstances, could have cost the government its life and toppled the longest-lasting Prime Minister in Poland's post-Soviet history. It could even have seriously marred the long-standing relations between Poland and the US. As it turned out, none of a variety of potentially disastrous scenarios materialized. Mr. Tusk asked lawmakers for a vote of confidence to steady his rattled government, which his ruling Center-Right coalition of the Civic Platform and the Peasants Party won with ease, gaining the backing of 237 legislators in the 460-member Lower House. There will, now, be no need to call early elections.

Taped CB Governor

The mess began when a secretly made tape was provided to – and partly published by – the Wprost magazine containing a private conversation between Central Bank Governor Marek Belka and Interior Minister Bartlomiej Sienkiewicz. In this conversation, which took place in July 2013, Sienkiewicz is heard asking whether the Central Bank would be able to help the government support the economy before next year's election if weak growth and budgetary difficulties coincided with a surge in support for the opposition Law and Justice Party. Belka is heard replying that he would be ready to "play ball" with the rate-setting Monetary Policy Council, provided Finance Minister Jacek Rostowski, with whom he had had several run-ins, were replaced by a "technical and apolitical" figure.

On the tape, Belka also uses some choice words to describe the 10-member Monetary Policy Council (MPC), which sets interest rates and has some oversight over the Central Bank's accounts. Then, as if on cue, in November last year, Mr. Rostowski was removed as part of a Cabinet shuffle and was replaced by Mateusz Szczurek, an economist at ING Groep NV with no political experience. Belka protested that he never broke the law and that the recording was "manipulated" to suggest "an instance of the Central Bank Governor exceeding his powers, which never took place." He said he regretted the salty language used in the conversation, but rejected the notion that he should step down.

Foreign Minister Next In Line

He was promptly and strongly supported by Prime Minister Tusk, on the grounds that there is no evidence Rostowski's departure was in any way connected to the exchange with Sienkiewicz and that the Central Bank, while independent of the government, is required to cooperate with it on economic policy so long as it does not compromise its constitutional duty to protect the currency. Tusk told reporters that he shared the opinion of the CB Governor that "no matter how hideous the comments were, they were talking about ways to help Poland." Confidence in Belka as an independent policy maker has been shaken, to be sure, and it will be interesting to see whether, and if so, how he manages to smooth relations with the MPC, but it does seem that no laws were broken.

Problems flared up anew, however, as a second tape appeared, in which Foreign Minister Radoslaw Sikorski tells his former government colleague Jacek Rostowski in at times rather vulgar language that in his view the "Polish-American alliance is not worth anything," that it is, in fact, "detrimental because it creates a false sense of security for Poland." Warsaw had for years sought a bigger US military presence on Polish soil as protection against Russia, but even the ominous confrontation between the Kremlin and Ukraine has so far given rise to only symbolic gestures from Washington, such as joint exercises and modest rotational troop deployments.

Poland feels it should have benefitted more from its (continuing) support for various US-led missions around the world, from the war in Iraq to the NATO engagement in Afghanistan. Warsaw also bought 48 F-16 fighter jets from Lockheed Martin for about USD 3.5 billion and has been seeking closer ties with European allies within the North Atlantic Treaty Organization, particularly with neighboring Germany, without much success. Withal, Sikorski's disgruntlement is understandable, even if he overstates the case and the language he uses is hardly acceptable.

No Laws Were Broken

One needs to keep in mind, though, that not one of these officials actually broke the law, while the tape re-

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cordings made – in the last-mentioned case over dinner in a Warsaw restaurant – were illegal. By now, officials of all stripes have hustled to contain the potential damage. Comments were taken out of context, one hears, and Defense Minister Tomasz Siemoniak has been calling Poland's cooperation with the US "intensive and very good." In Washington, State Department spokeswoman Marie Harf has insisted that "the United States and Poland have an incredibly strong relationship… that's based on shared values."

Tusk and Sikorski have both said that the Polish government is under attack from an "organized criminal group" responsible for making and leaking the tapes. They have not said who they think is represented by this criminal group, but there has been speculation that Moscow may be behind the effort to destabilize the government (not impossible but unlikely because of both, the method of operation and the timing) or (more plausibly) domestic political rivals.

The Likely Course of Things

Fact is that, as matters look now, early elections would not benefit any of the political parties and that the Democratic Left Alliance last week dismissed the idea of putting forward a joint candidate for Prime Minister with the Law and Justice Party. This is quite aside from the fact that in order for lawmakers to dissolve the legislature and force early elections a two-thirds majority would be required, i.e., at least 307 votes, which the opposition cannot muster. So, the ruling coalition has rallied around Tusk with a show of unity based on the knowledge that there is no real alternative for the governing coalition in the current parliament.

This is not to say that the opposition Law and Justice Party will now bury the hatchet. It is initiating a legislative procedure seeking to remove CB Governor Belka with a motion to drag him before the State Tribunal. It has also filed a motion for what is known as a "constructive vote of no confidence." Its trouble is, though, is that Tusk's coalition controls an absolute majority of 235 votes in the legislature (32 of these belong to the Polish Peasants Party) and that an absolute majority would be needed for the opposition motions to pass.

Whatever the search for the wire-tapping culprits turns up, the incumbents have suffered a harsh blow to their reputations. But on current trends they should be able to hang on until the scheduled general elections late next year, hoping to contain the scandals and seeking to rebuild their position with the electorate. And the financial markets have been taking encouragement from this, judging from the performance of the zloty and of interest rates. (6/26/14)

Turkey

Under Erdogan, the presidency will become decidedly more powerful than it currently is, and the nation will become more polarized. Interesting will be its relationship with the Kurds, who will likely help Erdogan take the presidency, but may then push hard to join their brethren in Iraq in the formation of an independent state. The current-account BoP narrowed substantially in April, but in a trend that may not be sustained. If not, the CB's aggressive interest rate cutting may turn out to have been a mistake.

Prime Minister Recep Tayyip Erdogan has not yet officially announced whether he will seek the presidency in next week's elections, but there are few who doubt that he will emerge next week as the official candidate of the ruling AKP (Justice and Development Party), since he has made it quite clear in private that this is his ambition, now that he cannot run for a fourth term as PM. The opposition Republican People's Party (CHP) and the Nationalist Movement Party (MHP) have named Ekmeleddin Ihsanoglu as their joint candidate, hoping that their appeal for a peaceful and united rather than divided Turkey will give them the upper hand. The way the polls have been running, though, it appears that Erdogan may have little trouble winning outright, in the first round of voting, on August 10.

Vying For Votes

He will do what he can to put the voters in a good mood. This includes plans for a tax amnesty that could see billions of lira worth of unpaid taxes pardoned in the runup to the voting. He has also put enough political pressure on the supposedly independent Central Bank to "persuade" it to cut its benchmark repo interest rate by three-quarters of a percent to 8.75%, even though inflation is running at nearly double the official 5% target. This makes for negative interest rates in real terms and prompted Ali Babacan, Turkey's Deputy Prime Minister with responsibility for the economy, to reiterate warnings

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that political influence on the economy is strengthening to the point where "damage control" is becoming increasingly important.

Deepening the Polarization

Once Erdogan is President, if, as we expect, he runs and wins, the man, with his autocratic tendencies, will move swiftly to use every lever he can find to turn this so far largely ceremonial position into one of much-increased powers. Since this will have been the first time the Turks have ever voted directly for a President, he will claim a strong mandate for such an endeavor. That he will, in all likelihood, do so successfully has been evident from his callous responses to the recent mining disaster at Soma, where 301 died because of appallingly unsafe conditions, corrupt government inspectors and a politically connected operator. It is significant that in this case the victims were not urban "white Turks" as in the case of the Istanbul park demonstrations, or minority Kurds, but the very conservative Sunnis populating Anatolia whom his AKP has been championing.

Internationally, he is likely to keep up his efforts to work more closely with Iran, following his trip in January to Tehran and this month's return visit to Ankara by Iranian President Hasan Rouhani. While there are glaring political differences (for instance, Shiite Tehran has strongly backed President al-Assad in Syria since the start of the uprising against him, whereas predominantly Sunni Turkey has supported his opponents and has given refuge to rebel fighters) economically the two countries are paragons for a symbiotic relationship, with Turkey being hungry for Iran's oil and gas and eager to see its construction and other firms expand in Iran.

The Kurdish Conundrum

Ankara may have more difficulty with its Kurdish population, which it currently coddles to gain its support in the elections. Developments in Iraq make it ever more likely that no one will be able to put that country back together again and Iraqi Kurds have already come a long way in forming an independent entity with its own resource support in the form of oil. The Turks have been helping them as, earlier this month, for instance, under the protestations of the central government in Baghdad, a second shipment of Iraqi Kurdish crude delivered to the Turkish port of Ceyhan sailed into the Mediterranean, which is to say 2 million barrels of crude are now at sea and may wind up as Kurdish exports.

If the Kurds in Northern Iraq succeed in forming an independent state, as they well may, this will create an almost irresistible pull on those in Eastern Turkey, Northern Syria and Western Iran to join in. This is certainly not what any Erdogan administration in Turkey wants, but official Israeli sources, for instance, maintain that Kurdish independence in Iraq is already "a foregone conclusion," adding that Israel would be quick to recognize a Kurdish state, should it emerge. For its part, Turkey's government has just sent a bill to parliament setting out a legal framework for peace talks with Kurdish militants, but progress with these may now increasingly depend on developments in Iraq.

Trade Repercussions

On the positive side for Turkey, Ankara's energy bill should decline once cheap Iraqi Kurdish oil comes on stream. This is important even though the country's current-account BoP deficit narrowed by more than 40% in April from a year earlier, as the depreciated lira is helping to boost exports. The red-ink spill, long viewed by international economists as the Achilles heel of the country, contracted by one-third in the year's first four months. But this is a trend that may not be sustained. There is a distinct risk that the violence in Iraq will have a negative effect on the balance down the road.

Turkey should benefit from a stronger European economy, moderate domestic demand, the already mentioned weaker lira, and reduced gold imports. But Iraq has become Turkey's second biggest export market after Germany, worth USD 12 billion in 2013, and while the bulk of this trade is with the autonomous Kurdish enclave and has, therefore, not been seriously affected as ISIS in Iraq has largely refrained from confronting the Kurds, this is not something the Turks can count on in the longer run. (6/26/14)

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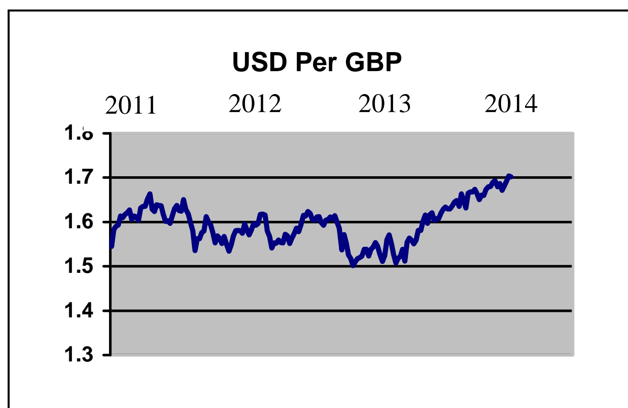
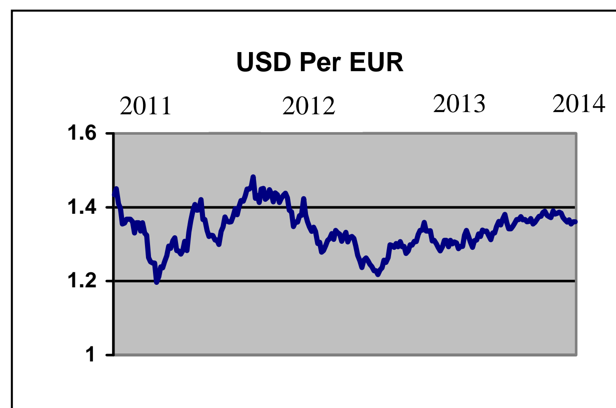
Exchange Market Trends





Short-Range Outlook

US DOLLAR, GENERAL: The dollar is currently being undermined by weak economic data, but it should soon regain its posture.

BRITISH POUND: The pound is approaching its highest in more than five years against the dollar on positive economic expectations. No early reversal is likely.

CHINESE YUAN: The latest upswing is fading again, but no big moves need to be expected.

EURO: The unit's trend versus the USD will continue to be soft, given the European Central Bank's loose monetary policies.

AUSTRALIAN DOLLAR: The aussie will continue the strong rebound from its worst plunge since 1985.

BRAZILIAN REAL: While it may seem strange that the real is as weak as it is, considering the ongoing soccer World Cup, there are convincing economic reasons.

Medium-Term FX Forecast – Asia-Pacific

Currency	6/25/14	End-Jun 2014	End-Sep 2014	End-Dec 2014	End-Mar 2015	End-Jun 2015
Japanese yen	101.69	101.50	105.00	107.00	107.00	105.00
Australian $	0.9410	0.9460	0.9600	0.9700	0.9500	0.9300
N. Zealand $	0.8774	0.8790	0.8850	0.8800	0.8700	0.8800
Korean won	1016.4	1047.0	1060.0	1100.0	1100.0	1200.0
Pakrupee	98.768	98.750	99.000	103.00	105.00	107.00
Philip. Peso	43.865	43.900	45.000	45.000	47.000	47.000
Indon. Rupiah	12,099	11,999	12,000	12,150	12,300	12,800
Hong Kong $	7.7519	7.7590	7.7500	7.7600	7.7650	7.7650
Taiwan $	29.947	30.200	30.250	31.300	31.400	32.600

World Currency Tables

Foreign Units Per US$

Country	Unit	6/26/14	12/19/13	%	Country	Unit	6/26/14	12/13/12	%
Algeria	DZD	79.3835	78.895	-0.62	Kenya	KES	87.750	86.560	-1.36
Angola	AOR	97.6586	97.5550	-0.11	S. Korea	KRW	1016.350	1062.55	4.55
Argentina	ARS	8.1315	6.3975	-21.32	Kuwait	KWD	0.2822	0.2828	0.21
Australia	AUD	1.0627	1.1283	6.17	Lebanon	LBP	1508.63	1507.50	-0.07
Bangladesh	BDT	77.596	77.6679	0.09	Malaysia	MYR	3.2189	3.2844	2.03
Bolivia	BOB	6.9100	6.9100	0.00	Mexico	MXN	13.0145	12.9710	-0.33
Brazil	BRL	2.1977	2.3568	7.24	Morocco	MAD	8.2498	8.2089	-0.50
Brunei	BND	1.2493	1.2666	1.38	N. Zealand	NZD	1.1397	1.1289	-0.95
Bulgaria	BGL	1.4373	1.4251	-0.85	Nicaragua	NIQ	25.984	25.279	-2.71
Burma	MMK	976.305	978.00	0.17	Nigeria	NGN	163.756	158.955	-2.93
Canada	CAD	1.0693	1.0673	-0.19	Norway	NOK	6.1351	5.9412	-3.16
CFA-Franc	CAF	483.056	477.757	-1.10	Pakistan	PKR	98.768	107.275	8.61
Chile	CLP	549.96	531.016	-3.44	Paraguay	PYG	4390.50	4544.66	3.51
China	CNY	6.2249	6.0717	-2.46	Peru	PEN	2.8038	2.7608	-1.53
Colombia	COP	1883.97	1938.15	2.88	Philippines	PHP	43.865	44.443	1.32
Costa Rica	CRC	545.575	498.795	-8.57	Poland	PLN	3.0510	3.0455	-0.18
Czech Rep.	CZK	20.1786	20.2585	0.40	Romania	ROL	3.2249	3.2849	1.86
Denmark	DKK	5.4798	5.4645	-0.28	Russia	RUR	33.7168	32.9706	-2.21
Dom. Repub.	DOP	43.275	42.516	-1.75	Saudi Arabia	SAR	3.7508	3.7506	-0.01
Ecuador	ECS.	25000.0	25000.0	0.00	Singapore	SGD	1.2493	1.2666	1.38
Egypt	EGP	7.1516	6.8969	-3.56	Slovakia	SKK	0.7349	0.7323	-0.35
El Salvador	SVC	8.7470	8.7475	0.01	South Africa	ZAR	10.6364	10.3938	-2.28
Europ. Union	EUR	0.7349	0.7323	-0.35	Sweden	SEK	6.7404	6.5876	-2.27
Fiji	FJD	1.8305	1.8922	3.37	Switzerland	CHF	0.8934	0.8986	0.58
Guatemala	GTQ	7.7865	7.8745	1.13	Taiwan	TWD	29.947	28.829	-3.73
Honduras	HNL	20.961	20.455	-2.41	Thailand	THB	32.476	32.490	0.04
Hong Kong	HKD	7.7519	7.7537	0.02	Trin.Tobago	TTD	6.4345	6.4100	-0.38
Hungary	HUF	226.670	219.505	-3.16	Tunisia	TND	1.6846	1.6728	-0.70
India	INR	60.146	62.119	3.28	Turkey	TRL	2.1253	2.0735	-2.44
Indonesia	IDR	12099.0	12209.50	0.91	U.A.E.	AED	3.6729	3.6730	0.00
Iran	IRR	25480.5	12388.0	-51.38	Ukraine	UAH	11.8889	8.2700	-30.44
Israel	ILS	3.4235	3.75132	9.58	Uruguay	UYU	22.8005	21.2855	-6.64
Jamaica	JMD	111.715	102.730	-8.04	Venezuela	VEB	6.2921	6.2921	0.00
Japan	JAP	101.169	104.270	3.07	Vietnam	VND	21330.5	21108.5	-1.04
Jordan	JOD	0.7088	0.7083	-0.07	Zimbabwe	ZWD	378.000	378.000	0.00

Selected International Interest Rates

As of 6/26/14

	USD	GBP	CAD	EUR	CHF	JPY
CB Rate	0.75		1.25			0.50
Prime Rate	3.25	0.50	3.00	0.25	0.50	1.48

Euro-Currency Deposit Offered Rates

	USD	GBP	CAD	EUR	CHF	JPY
1 Month	0.23	0.50	1.14	0.16	0.02	0.23
3 Months	0.34	0.64	1.25	0.22	0.09	0.34
6 Months	0.45	0.87	1.37	0.33	0.18	0.45
1 Year	0.61	1.20	1.61	0.52	0.33	0.61

NEW YORK

Federal Funds	0.10
Commercial Paper	
30-59 Days	0.05
60-89 Days	0.08
90-179 Days	0.11
Bankers Accept.	
60-89 Days	0.23
150-179 Days	0.38
Treasury Bills	
1 Month	0.01
3 Months	0.03
6 Months	0.06
1 Year	0.12
5 Years	1.70
10 Years	2.59

LONDON

Sterling Libor	
1 Month	0.49
3 Months	0.55
6 Months	0.70
1 Year	1.03
Sterling CD's	
1 Month	0.45
3 Months	0.59
6 Months	0.77
1 Year	1.15
London-Interbank	
1 Month	0.15
3 Months	0.23
6 Months	0.33
1 Year	0.55

TORONTO

Treasury Bills	
1 Month	0.91
3 Months	0.94
6 Months	0.96
1 Year	0.99
Corporate Paper	
1 Month	1.13
2 Months	1.15
3 Months	1.17
Banker Accept.	
1 Month	1.19
3 Months	1.20

FRANKFURT

EURIBOR	
1 Month	0.10
3 Months	0.21
6 Months	0.31
1 Year	0.49

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Exchange Cross Rates

6/26/14	USD	CAD	JPY 100	GBP	SEK	CHF	AUD	EURO
USD		1.0693	1.0169	0.5876	6.7404	0.8938	1.0627	0.7349
CAD	0.9352		0.9510	0.5495	6.3036	1.0025	0.9938	0.6873
JPY 100	0.9834	1.0515		0.5778	6.6285	0.8790	1.0451	0.7227
GBP	1.7018	1.8197	1.7306		11.471	1.5211	1.8085	1.2507
SEK	0.1484	0.1587	0.1509	0.0872		0.1326	0.1577	0.1091
CHF	1.1188	1.1963	1.1377	0.6574	7.5412		1.1889	0.8222
AUD	0.9410	1.0062	0.9569	0.5529	6.3427	0.8411		0.6915
EURO	1.3607	1.4550	1.3837	0.7995	9.1717	1.2162	1.4460	

LdnGold	$1316.80	Silver		21.13	SDR	1.54394

6/26/14	CAD	JPY	GBP	SEK	CHF	AUD	EUR
2014Hi	1.0668	101.50	1.7039	6.3668	0.8733	1.0611	0.7195
2014 Lo	1.1238	104.83	1.6319	6.7404	0.9068	1.1416	0.7380