Weekly Report

Macroeconomic Analysis

Putin's Stubborn Desperation

By Martin Kabrt

On Tuesday, Vladimir Putin delivered a fiercely patriotic 'state of the nation' speech, accusing the West of attempts to dismember Russia and of casting an Iron Curtain around the country. Putin's further remarks included that Crimea is to stay with Russia "forever" and that the West supports "lawlessness" in southeast Ukraine. While Russian deputy foreign minister called on 29th November on the EU to lift the sanctions and promised to waive the Russian food import embargo in return, Putin's rhetoric is likely to only consolidate the US and EU resolve to keep the sanctions in place. This realisation is reflected even by Moscow, with their latest economic forecast "assuming that sanctions will remain in place throughout the whole of 2015".

With Russian Economy minister Siluanov estimating last week the sanctions cost Russia $40bn annually, steps towards peace in Ukraine and re-approachment with the West can save the country from sliding into recession. In contrast, Putin's steps to end Russia's economic woes, as outlined in his speech, are highly unsatisfactory. Putin pledged to use the National Wealth Fund to recapitalise domestic banks, which suffer from capital flight and struggle to pay foreign debts. He further promised not to raise taxes for the next four years and announced legal amnesty for capital repatriation to the country from offshore. Such modest measures, however, will hardly suffice to stop the capital outflow and reverse the economic decline.

Putin's most severe frustration is with the rouble, taking a double hit both from the conflict in Ukraine and from falling oil prices, and declining this year already by 38% against the dollar, marking the biggest annual drop since Russia's 1998 default. In an attempt to save the currency, the Bank of Russia have already sold over $74bn of foreign exchange reserves, announcing this Wednesday a further $1.9bn intervention. Recognising that foreign exchange interventions may not suffice to stabilise the situation, analysts expect the central bank on its 11th Dec policy meeting to further raise the interest rate by several hundred basis points in an attempt to make the currency more attractive. The roubles plunge led Putin even to desperate measures; in his 4th December speech, he pledged to punish those speculating against the currency. Yields on 10-year government rouble bonds are already at a 5-year-high and yet still no signs of a rouble recovery.

Russian economic woes are widespread. As the rouble falls, expensive imports drive inflation above expectations. With a stagnating economy and soaring inflation, Moscow expects a 2.8% fall in real incomes in 2015. This prediction came together with the Tuesday statement of Russian Economy ministry, changing in response to low oil prices and Western sanctions their forecast of 1.2% GDP growth in 2015 to a 0.5% fall, which would mark the country's first recession since 2009. The prospect of a recession and the drop in oil prices also cast considerable uncertainty about Russia's budget. On Friday, Putin already announced a plan to cut spending by 5% in 2015-2017.

While Putin is succeeding in portraying himself to his domestic audience as a safeguard of Russian freedom and sovereignty threatened by the deceitful West – his approval rating now stands at 85 percent, according to the nonprofit Levada Center in Moscow – this personal success will come at the cost of the nation's economic prosperity in the near future.

Russia –heading for a recession?

By Arnold Krutilins

With the crude oil Brent price at $69, the rouble at RUB 53 to the dollar on Friday evening and an end to economic sanctions nowhere to be seen, how much longer can Russia avoid a recession? Based on preliminary GDP growth estimates, capital outflows continuing, the price of oil and rubble plummeting, it is all but certain next year.

From an earlier estimate of 1.2% growth, Russia's economic development ministry predicted on Tuesday that the GDP may contract by 0.5% in 2015. Rising inflation in the country, up from 8.3% in October to 9.1% in November, is not doing consumers any favours either, as prices for consumer goods have been increasing. This has been increasingly reflected in food prices with the price of fruit and vegetables increasing by 8.7% in November alone. However, with unemployment remaining low at 5% and Putin urging the population to stay strong against the economic blockade of the West, the population seems unified in supporting Putin's policies at home and abroad, despite 80% of the population being reportedly worried about the country's economic problems. Known for their patriotic spirits, the population's resilience can also be explained by the fact that real wages grew by 2.2% between January and October. Furthermore, with the falling price of the rouble, some companies have seen a healthy increase in sales, particularly in the metal industry with the manufacturing index growing by 1.7%.

However, it is crucial to remember that Russia's energy exports make up half of its budget. With the rouble sinking 38% this year and Brent hovering below $70 a barrel after OPECOPEC decided not to cut its production targets, Russia's economic outlook is anything but stable. With a breakeven Brent price of approximately $117.8 for the Russian budget, the pressure on its two sovereign wealth funds to prop up the economy and a range of state-owned companies will continue, draining Russia's foreign currency and 'rainy day' reserves. This is particularly important since Western sanctions prevent a range of banks raising capital in US, EU and other markets.

Net capital outflows have surged to $125bn in 2014, with a prediction of a further $90bn leaving the country in 2015. A large portion of fleeing capital has been from foreign investors, rather than Russians looking to relocate their money abroad. To counter the significant capital outflows, Putin has announced an amnesty for "capital [from abroad] returning to Russia". Such tax amnesty programs, designed to return capital on which tax might not have been paid, have seen mixed success in recent years. In 2009, Italy saw €80bn returning to the country with Australia gaining additional A$302 million. The bigger question, however, is whether Russia's high-net-worth individuals are prepared to trust Putin to keep his word and not reverse the policy? Furthermore, with an end to Western sanctions not in sight, wider doubts in relation to Russia's investment opportunities might be present.

In conclusion, it seems that whilst domestic support for Putin remains at a record high and an amnesty for Russian capital abroad has been announced, low oil prices and a plunging rouble are far from helping the country to escape a likely economic recession next year. China and other Asian economies might be the only hope for Russia's exports and future economic growth, but substituting Russia's reliance on Europe and US might take months, if not years.

The Internet of Things the driver for growth in the current decade

By Ludger Pahler

The internet of things (IoT) is the vision of the world being interconnected by a network of intelligent devices that can exchange information. Over the past few years it has evolved from wireless networks, micro-electro-mechanical system and the internet converging and allowing the devices to communicate with each other. This is called machine 2 machine (M2M) communication and is most widely used in production facilities. But in recent times there has been a significant trend to go beyond M2M.

Chipmakers such as Intel see the biggest potential in the IoT in data-analytics which enables businesses to analyse their data and then improve their operations going forward. With more and more industries using those capabilities the IoT becomes a game changer. As the amount of data grows more and more big-data stores are needed. Gartner suggest that by 2020, 35ZB in data will generate $2 trillion in value. While this is a great future, prospect companies looking to implement those technologies still face major challenges. Those include the connecting to the cloud, the analysing of the data and making sure that this happens within a secure network. While Goldman Sachs sees the first devices such as fitness trackers and thermostats becoming more and more accepted by the general public it identifies disruptive technologies as the main area to concentrate on. But it also agrees with Intel that security remains a major concern. The areas in which the IoT is already making an impact are building and home automation, manufacturing and resources. The resources area is already under transformation with many western countries decentralising their electricity-grids.

The two industries enabling the IoT are the communications technology industry and the semiconductor industry. While communications technology is making sure that all devices are included in the network (cellular connections) and the development of infrastructure that enables businesses to store data nearer to the source leading to lower latencies and less noise within the data. Semiconductors on the other hand have to deliver sensors, provide connectivity and offer microcontrollers and low-cost microprocessors.

The software-industry is split into two sub-parts with the enterprise software on the one side and the consumer software on the other side. Enterprise solutions are focused on the handling of big data-streams and the ananlsis of these, with specialized companies dominating their market-segment. Within consumer software the current industry-leaders seem to maintain their competitive advantage given the accelerating pace of innovation. Within the foreseeable future the platform-providers and providers of “smarter” software to power and analyze “less smart” software are deemed for growth.

All those opportunities combined leave many exciting opportunities across many industries for the next few upcoming years with the biggest growth forecasted for the information technology sector.

Eurozone QE: A balancing act between members

By Austė Vyšniauskaitė

After this week’s Draghi dovish announcement, it is probable that the ECB will participate in sovereign quantitative easing (QE) (or even all domestic assets except gold purchases) by the end of Q1 2015 (next ECB meeting on 22nd January.) Although it is not clear how the programme will work, the consensus is that it is not going to be as large as the 2013 Bank of England’s (BoE) programme that purchased 25% of government debt (the total amount of the Eurozone’s government debt is about €9tn.)

The effect on yields matters a lot to the economy and the equity markets. It could determine whether Eurozone QE is perceived as a success or failure. In addition to this, government bonds are used to price assets across financial markets and unanticipated moves can create higher volatility. Naturally, the purchase of sovereign debt could lead to tighter periphery spreads, low front-end yields and steeper curves in the Euro area. However, if this effect is going to happen and how this effect will be spread over time is the most important question.

Economic theory suggests that asset purchasing programmes should lead to lower yields. However, rising expectations of a QE programme have already sent Eurozone bond yields down sharply (e.g., German 10-year Bund yields have fallen to historic lows below 0.7% over the past week). Contrary to classical economics, the experience of the US shows that bond yields may rise once the QE is announced. This might be because markets are forward looking and expect stronger economic growth and inflation.

In contrast to this, once the Bank of Japan (BoJ) announced QE, bond yields firstly dropped but then suddenly started increasing even though the BoJ announced QE expansion. This might be because the markets did not believe that the policy is going to be effective. Hence if the consensus is that ECB QE will not work, yields would logically fall (BoJ case) – the yields direction will show how markets judge the QE effectiveness.

On the other hand, there are a few questions about the ECB's decision making procedure and the extent to which opposition from the Bundesbank (or others) could prevent QE from occurring as Draghi appears to be struggling to build the overwhelming majority that he needs to deliver on this front. Against this backdrop, there is nothing formal in the voting process (which is going to change in January as Lithuania joins the Euro and Governing Council reaches it's size threshold) that stops the ECB doing QE even if German or other members of the GC are opposed to it, provided a majority of support can be secured.

But there is a big debate about whether, in practice, Draghi can press ahead despite German objections. This is in regards to the fact that the Bundesbank, German politicians, or German public opinion might cause problems for the effectiveness of QE or other Eurozone policies. At the same time, however, the Bundesbank is not proposing any alternatives to sovereign QE (which promises an undesired higher inflation rate for Germany as well.)

Draghi's push toward more stimuli comes just as the Fed and BoE consider when to tighten their monetary policies. At the same time, the Bank of Japan is expanding its stimulus programs and the People's Bank of China last month cut interest rates for the first time in two years.

Still an Oily business?

By Anthony Avedissian

After OPEC's decision not to reduce production in defence of higher prices, various forecasters predicted oversupply would peak in 2015, and oil prices fell to five year lows this week.

Persistent supply from the US and OPEC, which has exceeded expectations and coincided with weaker demand from China and Europe, has sent the price of oil dramatically lower. OPEC's response to this fall in price has been particularly notable. At last month's OPEC meeting, Saudi Arabia, the cartel's leader and biggest producer, and its Gulf allies resisted calls to cut production despite the fall in prices, in order to balance the market. The decision to maintain their output target of 30m barrels per day sent the price of oil spiralling lower and it is more than 40% below its mid-June level of $115 a barrel. Kuwait, another OPEC member, said that, unless OPEC cut output, oil prices are likely to remain at around $65 a barrel until the middle of next year.

Morgan Stanley predicted that Brent would average $70 a barrel in 2015, down $28 from a previous forecast. The investment bank also said that oil prices could fall as low as $43 a barrel next year. Analysts claim that markets risk becoming unbalanced, with peak oversupply likely in the second quarter of 2015, unless the OPEC producers' cartel decides to intervene. JBC Energy forecasts that; world oil demand will fall by another 1m barrels per day in the first quarter of next year, and stagnate in the second, even as non-OPEC supply continues to grow.

Russia, Nigeria and Venezuela are set to suffer most from the further fall in oil prices. The rouble lost 2.2% against the dollar and 1.8% against the euro on Monday afternoon trading. Last week, the Russian government warned that the economy would fall into recession next year. Nigeria has had to devaluate their currency and Venezuela is likely to default on its debt soon. However, countries such as Turkey, Indonesia and India are said to be profiting from the weak oil price environment. The Head of Turkish equities at BNP Paribas claims that "every $10 drop in the oil price improves the Turkish current account deficit by $4.5 billion." Low oil prices are one of the main reasons that Turkey's current account deficit is expected to improve from 8% in 2014 to 5% in 2015, according to Citi Global Research.

Microeconomic Analysis

Sony's Hack

By Nick Bulloch

Hacking companies is becoming somewhat of a craze. Apply, Public Broadcasting Service, third party apps for Snapchat, and now Sony (again) has been hacked. Three years ago Sony Pictures was robbed of over 1,000,000 users' personal information (from passwords to home addresses) through a very simple SQL injection that allowed the hackers see everything; especially as the passwords were unencrypted. Before that, their PlayStation Network (PSN) was hacked and lost many of their customers' details (including card details) to people all around the world. Last week Sony was hacked again. This is reported to be the biggest hack in history with 100 TB (terabytes) stolen. At the moment only some 40 gigabytes have been looked through: finding unreleased movies; scripts; medical records; criminal records; 3,800 Social Security Numbers, and more. Fusion's Kevin Roose published the details of 26 archives from the attack and found over 6,000 Sony Pictures Employee details and HR-related information, such as how much it costs to fire employees as well as division by division salary numbers.

In the short-term a large part of Sony Pictures has been shut down, as they try and fix their computer systems. Meetings have been cancelled and lots of employees have been told to stay at home. This is going to have a big impact on Sony. Moreover, the films stolen are big blockbusters: such as their anticipated remake of "Annie" that is coming out on the 19th December, and their huge Brad Pitt blockbuster "Fury". Other films leaked include: "Still Alice", "Mr. Turner", and "To Write Love On Her Arms". Luckily at the moment "Annie" has only been downloaded 200,000 times, while "Fury" has been downloaded 1.2m times which isn't that bad as they already made more than $170m from its release.

At the moment it has been suggested by some in Sony that North Korea was behind this massive attack due to the film "The Interview". This film stars Seth Rogan and James Franco and they poke fun at North Korea and their dictator, which was received by them as an act of war. However, I think this is Sony trying to get a silver lining out of the event by creating publicity for the film. The FBI is handling this situation and Sony has not yet given a public statement on the hack.

At the moment the Sony stock price is yet to react as it is close to its 52-week high at $22.16 and hasn't dipped very much. However, it's still early days and we won't know the full extent of the hack for some time.

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