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QuickTake
NEWS IN CONTEXT








November 2016

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NORMAL INTEREST RATES

BY CLIVE CROOK

When central bankers started cutting interest rates to near zero after the 2008 stock market crash, they saw it as an emergency measure and thought things would gradually get back to normal. Now they're wondering what normal means. Eight years later, the shadow of the Great Recession is keeping rates super-low, but even when it has passed, they're unlikely to come all the way back. The reason is that the so-called normal or neutral rate of interest — which neither stimulates the economy nor cools it down — has fallen, perhaps permanently. If so, the implications for savers, investors and economic-policy makers will be far-reaching.

Photo: Alexander A. Cherednichenko/ Getty Images

THE SITUATION

Average interest rates in 20 developed nations fell from about 5 percent in 1990 to near zero in 2015, a Bank of England study found. These low rates leave central banks little or no room to cut again if more stimulus is required. Some are already having problems. The U.S., Europe and Japan have tried a variety of tools to jumpstart economic growth, from quantitative easing (buying government bonds in exchange for new money on deposit at the central bank) to pushing interest rates below zero (negative rates). But these policies haven't been as effective as central banks hoped. And the new fear is that this isn't just a temporary problem. Why? The world has settled into a pattern of saving more and investing less. Instead of borrowing for expansion or new ventures, corporations are hoarding cash. This falling demand for capital has driven down the neutral rate of interest. And lower interest rates mean tiny returns, hurting investors saving for college and under-funded public and private pension systems struggling to keep up with payments to the swelling ranks of retirees.

THE BACKGROUND

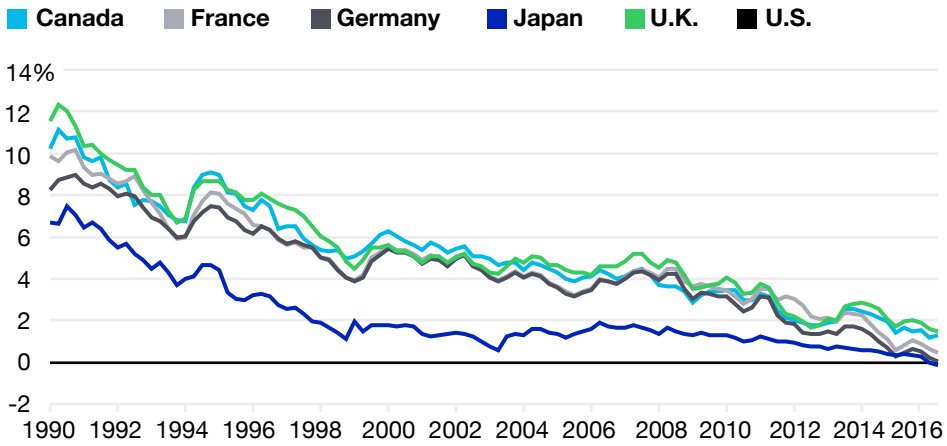
Nations' normal interest rates have historically tracked economic growth, which in turn is largely determined by productivity. In the U.S., the main index of productivity rose by almost 2 percent a year in the 50 years leading up to 1970; it's grown by less than 1 percent a year since then. Many other countries have seen a similar slowdown. A narrowing gap between rich and poor countries (crimping opportunities for "catch-up" growth), smaller increases in the number of people getting a secondary education and fewer transformational inventions like air conditioning or computers add to the problem. Meanwhile, the increasing concentration of wealth within countries and the rising global ratio of workers to dependents (thanks to declining birth rates) have been pushing up savings. Rich people are big savers, and workers save more than dependents. And the falling price of machines and other capital goods has kept spending on investment low.

THE ARGUMENT

If productivity growth recovers, downward pressure on the neutral interest rate will ease. That's possible. Some economists, like Erik Brynjolfsson and Andrew McAfee, argue that the full benefits of technologies such as artificial intelligence haven't yet appeared. Others, like Tyler Cowen, insist that persistently slow growth, also called secular stagnation, is the new normal. But this slow growth and the lower normal rate of interest that goes with it don't necessarily tie central banks' hands. U.S. Federal Reserve Chair Janet Yellen has argued that there are tools that work, including quantitative easing and forward guidance (giving a clear direction to the markets, such as a promise to keep interest rates low for longer than investors expected). She says these levers can be used to support demand and keep unemployment low. Others disagree, arguing that more radical kinds of monetary innovation will be needed to encourage growth. These could include so-called helicopter money or deeply negative interest rates (which in turn might require the abolition of paper money to prevent hoarding). Almost all agree that fiscal policy — government spending or tax changes — ought to carry more of the burden of stabilizing economies.

Lower and Lower

Yield on 10-year government bonds each quarter



Source: Organisation for Economic Co-Operation and Development

DEUTSCHE BANK'S PROBLEM

BY JAN-HENRIK FÖRSTER

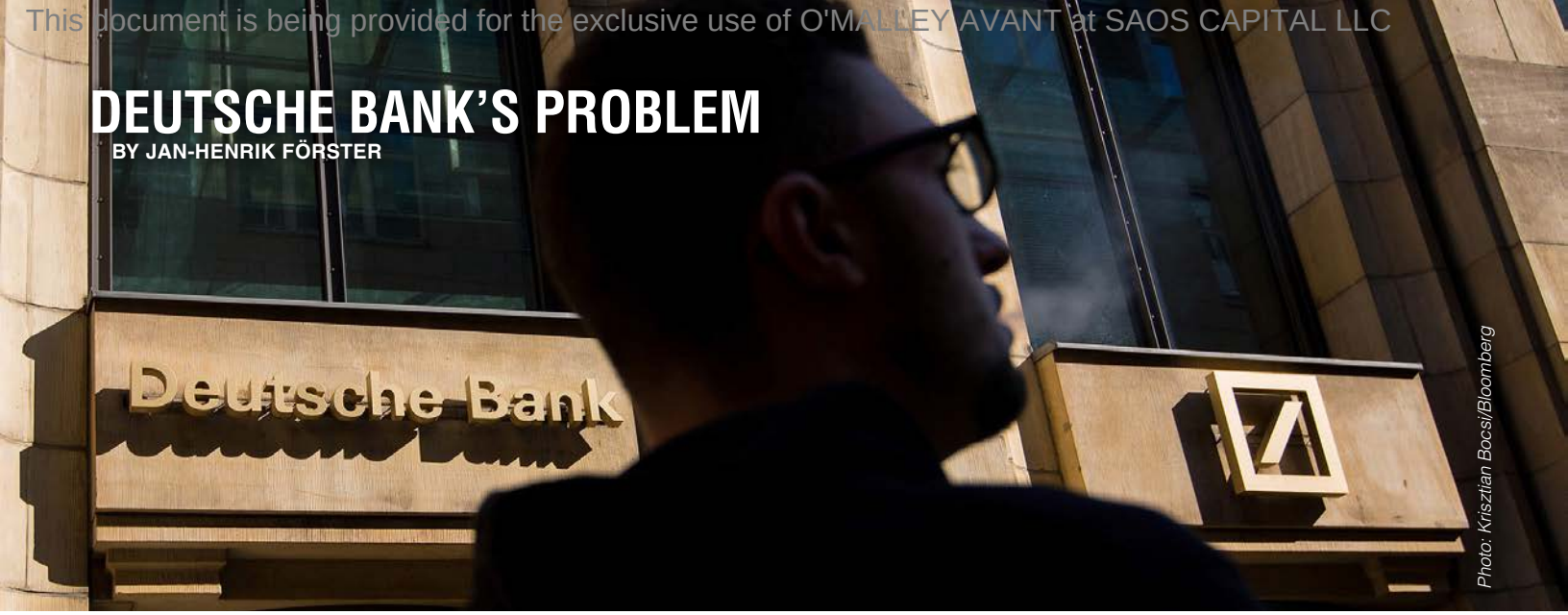


Photo: Krisztian Bocsi/Bloomberg

One of the world's most important financial institutions faces dwindling investor confidence amid concern it may need more capital or even government help. This story, ripped from the headlines of 2008, is happening today to Deutsche Bank AG. In mid-September, the U.S. Department of Justice told Germany's largest bank it would have to pay $14 billion to settle a case over how it sold and packaged residential mortgage-backed securities a decade ago. Though history suggests that figure is subject to negotiation, it was large enough to spook investors. Now Deutsche Bank may need help — but what kind, and from whom?

WHY DOES THIS MATTER OUTSIDE DEUTSCHE BANK?

Deutsche Bank, with about 1.8 trillion euros ($2 trillion) in assets, is more than half the size of the German economy and operates Europe's largest investment bank. More importantly, its connections to other lenders may make it the single biggest contributor to systemic risk among global banks, the International Monetary Fund said in June. It has gross notional exposure of 46 trillion euros to derivatives — contracts with other financial institutions tied to the value of an asset. Some of Deutsche Bank's most complex deals are "an accident waiting to happen," Jacques-Henri Gaulard, a Kepler Cheuvreux analyst, wrote on Sept. 29. Stuart Lewis, the bank's chief risk officer, told Welt am Sonntag that the real net risk of those products is actually much lower than that of several competitors.

SO IS DEUTSCHE BANK THE NEXT LEHMAN BROTHERS?

News that some hedge fund clients had reduced their exposure to Deutsche Bank carried ominous overtones of 2008, when the collapse of Lehman Brothers deepened the global financial crisis. Yet Deutsche Bank's situation appears less precarious. It's better capitalized, has 215 billion euros of liquid assets at hand and has access to cheap funding from the European Central Bank. It could seek to tap investors for fresh capital or sell off assets. What's more, few observers expect the German government would stand aside and let Deutsche Bank fail, not least because the world is still recovering from the U.S. decision to let Lehman go down.

HOW BIG A FINE IS DEUTSCHE BANK LIKELY TO PAY?

Deutsche Bank insists it has no intention of paying anywhere near the $14 billion requested by the Department of Justice. In past cases, the DOJ walked back somewhat from its initial requests: Bank of America ended up paying $16.7 billion after an original DOJ demand of $20 billion; Citigroup settled for $7 billion, down from $10 billion. Deutsche Bank's total litigation reserves stood at 5.5 billion euros at the end of June, and an agreement to pay more than $4 billion "would put questions around capital positions with the need to potentially build additional litigation reserves," JPMorgan analysts wrote.

WHAT CAN THE BANK DO?

Chief Executive Officer John Cryan, in charge since last year, is firing thousands of workers, dumping unprofitable clients and exiting businesses. Now he might have to consider additional asset sales to pay for legal bills and bolster capital; a partial IPO of the bank's asset management business could be an option. The lender has informally spoken to potential anchor investors, including new and existing shareholders, to back a possible capital increase. Qatar's royal family were said to be considering increasing their stake to as much as 25 percent from about 10 percent. Even some of Germany's biggest listed companies could be considering a capital injection into the troubled lender, which is considered vital to their interests abroad.

WHAT ARE THE MARKETS SAYING?

Deutsche Bank shares touched a record low of 9.90 euros on Sept. 30, before bouncing back on a report that the Justice Department fine will be smaller than feared.

WOULD THE GERMAN GOVERNMENT COME TO THE RESCUE?

The prospect of bailing out Deutsche Bank is politically noxious for German Chancellor Angela Merkel, who's deciding whether to seek a fourth term next year and has championed European Union rules aimed at keeping taxpayers off the hook in a crisis. Merkel's spokesman has said the government sees "no grounds" for talk of state funding for the bank. Cryan, for his part, told the Bild newspaper that accepting government support is "out of the question for us." That hasn't quelled speculation. Lawmakers from Merkel's governing coalition said they expect the government to step in if Deutsche Bank were at risk of collapse due to a capital shortfall.

FANNIE MAE AND FREDDIE MAC

BY JOE LIGHT

Photo: David Paul Morris/Bloomberg

For decades, the mortgage giants Fannie Mae and Freddie Mac were the fat and happy foundation of the U.S. housing market. By buying and packaging home loans into bonds and absorbing much of the risk, they made it easier for homebuyers to get mortgages, and to get them on easier terms than are available in most countries. Created by the government and then spun off as shareholder-owned corporations, Fannie and Freddie churned out steady profits, as investors treated their debt as virtually risk-free. It was the best of both worlds — until the housing market melted down in 2008. The government's bailout of Fannie and Freddie cost $187.5 billion. Lawmakers said the system needed to change. But changing it has been easier said than done — Fannie and Freddie have recently been more profitable, and the housing market more dependent on them, than ever.

THE SITUATION

Fannie and Freddie have been pouring money into the U.S. Treasury — more than $240 billion since 2012. That's prompted lawsuits by a number of investors who are challenging a change in the terms of the bailout that reserved all profits for the government. A judge dismissed a major case against the government in 2014, but that decision is under appeal and other cases are ongoing. In Congress, a bipartisan Senate bill called for winding down Fannie and Freddie and replacing them with a federal agency that would insure a smaller share of the mortgage market. A Republican-sponsored bill in the House of Representatives would have encouraged private investment in the mortgage market by loosening rules put in place after the 2008 housing crisis, and restricted the government's role even further.

THE BACKGROUND

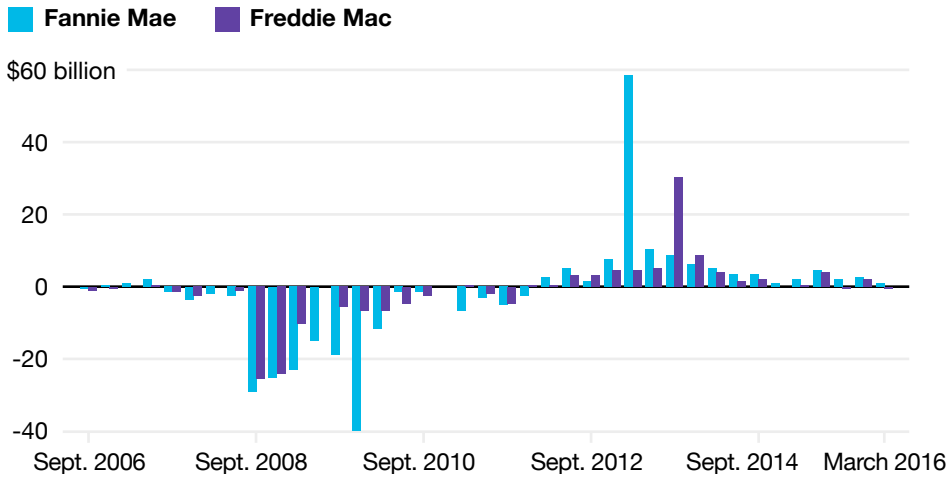
Congress created the Federal National Mortgage Association in 1938 as a government agency with a mission of reviving the mortgage market after its collapse in the Great Depression. Traditionally, banks that made mortgages held on to them. By buying mortgages from lenders, Fannie Mae, as it became known, freed up money that the banks could use to make more loans. After World War II, that process helped fuel a housing boom and made 30-year fixed-rate mortgages the American norm. (In most other countries mortgages have shorter terms or adjustable rates.) In 1968, Congress converted Fannie into a for-profit, shareholder-owned company, in part to ease a debt burden fueled by spending on the Vietnam War. Freddie Mac, the Federal Home Loan Mortgage Corporation, was created as a federally chartered corporation in 1970 to give Fannie Mae some competition. It was turned into a publicly traded company in 1989. The companies helped the market for mortgage-backed securities grow by guaranteeing the payments of bonds — bonds that many investors treated as nearly as safe as those of the U.S. Treasury, because of what was seen as an implicit government guarantee. That meant the companies could borrow more cheaply than other lenders. Some conservative economists say their collapse was caused by congressional requirements to back lending in poor areas. But most studies have pointed to their expanded investments in loans packaged by Wall Street during the housing boom, including subprime bonds.

THE ARGUMENT

The 2016 Republican presidential platform criticizes the companies for what it calls a "corrupt business model" that "lets shareholders and executives reap huge profits while the taxpayers cover all losses." Most plans in Congress involve shrinking the amount of mortgage-credit risk backstopped by the government, but opponents worry that such a move could make loans more expensive for consumers. The stalemate is leading some affordable housing groups, small lenders and investors — including hedge funds that bought shares in Fannie and Freddie for pennies on the dollar after the government put them in conservatorship — to argue that a more strongly regulated Fannie Mae and Freddie Mac should be allowed to retain profits to build capital reserves. That could allow them to leave governmental control. That "recap and release" plan would mean big profits for some shareholders.

Meltdown and Rebound

Quarterly profits and losses for Fannie and Freddie



Sources: Fannie Mae and Freddie Mac

Photo: Chris Ratcliffe/Bloomberg

"HARD" BREXIT

BY SIMON KENNEDY

Just when you finally grasped the meaning of "Brexit," the subject grows more complicated. In London and the capitals of continental Europe, political leaders are preparing to discuss the terms and conditions of the U.K.'s coming separation from the European Union. Two broad options are being shorthanded as "hard Brexit" and "soft Brexit," with the U.K.'s prime minister, Theresa May, thought to lean toward the "hard Brexit" camp.

WHAT'S A 'HARD BREXIT'?

It's a shorthand reference to one possible outcome of negotiations between the U.K. and the EU — the U.K. giving up its membership in Europe's single market for goods and services in return for gaining full control over its own budget, its own law-making and, most importantly, its own immigration policies. If that happens, British leaders will be under pressure to quickly land a new trade pact or individual industry-by-industry deals with the EU. Otherwise, companies will be subjected to standard World Trade Organization rules, which would impose tariffs on them. Banks would lose the easy access they now enjoy to the bloc.

HOW WOULD THAT DIFFER FROM A SOFTER BREXIT?

A softer form would see the U.K. maintain some tariff-free access to the single market of some 450 million consumers. The U.K. would likely still have to contribute to the EU budget, allow some freedom of labor movement and follow some EU rules. That's what Norway does, as a member of the European Economic Area but not of the EU.

WHY DOES IT MATTER?

Investors worried about a "hard Brexit" sent the pound to a three-decade low after May and colleagues in her Conservative Party gave hints that their preference is a clean break. The fear is that the economy would suffer as trade with the U.K.'s biggest commercial partner fades, leading to weaker growth, lower investment, faster inflation and a harder time plugging Britain's record current-account deficit. The Confederation of British Industry and British Retail Consortium are among business groups warning against a severing of ties with the EU's trading zone. Banks are particularly nervous. Leaving the single market could cost them so-called passporting rights, which allow them to offer services in the EU but have bases in London.

WHAT HAS MAY SAID?

Describing the exit deal she wants, May said on Oct. 2, "I want it to give British companies the maximum freedom to trade with and operate in the single market, and let European businesses do the same here. But let me be clear: We are not leaving the European Union only to give up control of immigration again." That and other comments by May have been taken as signaling that curbing immigration, rather than guaranteeing free trade, will be her top priority in Brexit negotiations.

DOES PARLIAMENT AGREE?

By bowing to pressure to let Parliament debate and probably vote on her Brexit plan, May signaled she's aware that even her fellow Conservatives remained worried about the consequences. Several of them spoke out in favor of parliamentary scrutiny. Bottom line: The center ground in Parliament is probably around a softer Brexit than the one May is apparently pursuing with her emphasis on border controls. What May is still refusing to allow is a parliamentary vote on whether to trigger the exit. A court is reviewing whether she has the prerogative to do that alone.

WHY ARE THE U.K. AND EUROPE NEGOTIATING THEIR BREAKUP?

On trade, customs, defense and the global flow of capital, the EU and its cross-channel neighbor are destined to continue doing business, post-Brexit. But since no country has left the EU before, there's no clear model to follow, and lots to pick and choose from. May says she wants a "bespoke" deal designed especially for Britain. Quitting the single market would mean negotiating industry-by-industry trade deals, with some sectors, such as finance, already calling for transitional arrangements to be put in place to bridge the gap between leaving and a new permanent relationship.

HOW DID 'HARD BREXIT' GET COINED?

Distinguishing between "hard" and "soft" Brexit began even before the June 23 referendum. In one early reference, John Wraith, head of U.K. rates strategy for UBS, told Bloomberg Radio in February that "a softer Brexit" would be "fairly friendly" and mean "rapid reestablishment of trading agreements," while a "hard Brexit" would mean "some tough negotiating and the establishment of trade barriers."

SO WHICH WILL IT BE — HARD OR SOFT?

In an Oct. 10 note, Morgan Stanley economists put the chance of a "hard Brexit" at 70 percent, up from 55 percent in their prior analysis. At Algebris Investments, strategist Alberto Gallo sees a 60 percent chance of a "hard Brexit" and warns that would lead to a recession and wipe 140 billion pounds off the economy, the equivalent of 7.5 percent of gross domestic product. Stewart Jackson, an aide to Brexit Secretary David Davis, has said the government won't compromise on budget payments, immigration, lawmaking and freedom from the jurisdiction of European judges. European governments, on the other hand, are united in saying there can be no single market membership without free labor movement.

IS THERE A MIDDLE GROUND?

Ultimately there will be a long negotiation with compromises likely on both sides. A middle ground would see the U.K. concede on immigration curbs with the EU granting some specialized link to the single market in return. Banks, for example, would get a bespoke deal based on having similar regulations to rivals in the bloc.

COOL WAR

BY MARC CHAMPION

On Christmas Day 1991, Mikhail Gorbachev resigned as the last leader of the Soviet Union, ending 44 years of ideological conflict, nuclear brinksmanship and military combat-by-proxy with the U.S. Forever. Or so it seemed. Now, Russia and the U.S. have squared off on either side of conflicts in Ukraine and Syria. Turkey, a North Atlantic Treaty Organization member, shot down a Russian fighter jet. A Russian leader is proposing an economic and political alternative to Western-style democracy. Is the Cold War back? The veteran U.S. statesman Henry Kissinger has said it's possible. Russian Prime Minister Dmitry Medvedev said it's happening.

THE SITUATION

In Ukraine, Russian troops have been fighting alongside and arming pro-Russian separatists since 2014. The U.S. Congress voted to supply more lethal weapons to the Ukrainian army, but for now a cease-fire is in place. In Syria, the U.S. has come under growing pressure from allies to arm Sunni rebels with anti-aircraft weapons, so they can defend themselves against Russian airstrikes. That would put U.S. weapons in position to kill Russian soldiers — just as American arms did in Afghanistan in the 1980s, and as Soviet arms killed U.S. troops in Vietnam. In October, Russia's Defense Ministry warned that it will shoot down planes from the U.S.-led coalition bombing Islamic State if they attack Syrian government troops. The U.S. and European nations have imposed sanctions against Russia to discourage further aggression in Ukraine. Sanctions were also a feature of the Cold War. Russian jets have been buzzing NATO airspace and naval vessels at a rate not seen since the days of the Soviet Union. Political oratory has also developed a Cold War tone, with President Vladimir Putin accusing the U.S. and the European Union of trying to humiliate Russia and a warning by an American general serving as NATO commander that Russia poses an "existential threat" to the West. The alliance is strengthening its presence along Russia's borders in response. American intelligence officials have said that Russia's government has directed the hacking of American political groups in the U.S. in order to interfere with the country's Nov. 8 election.

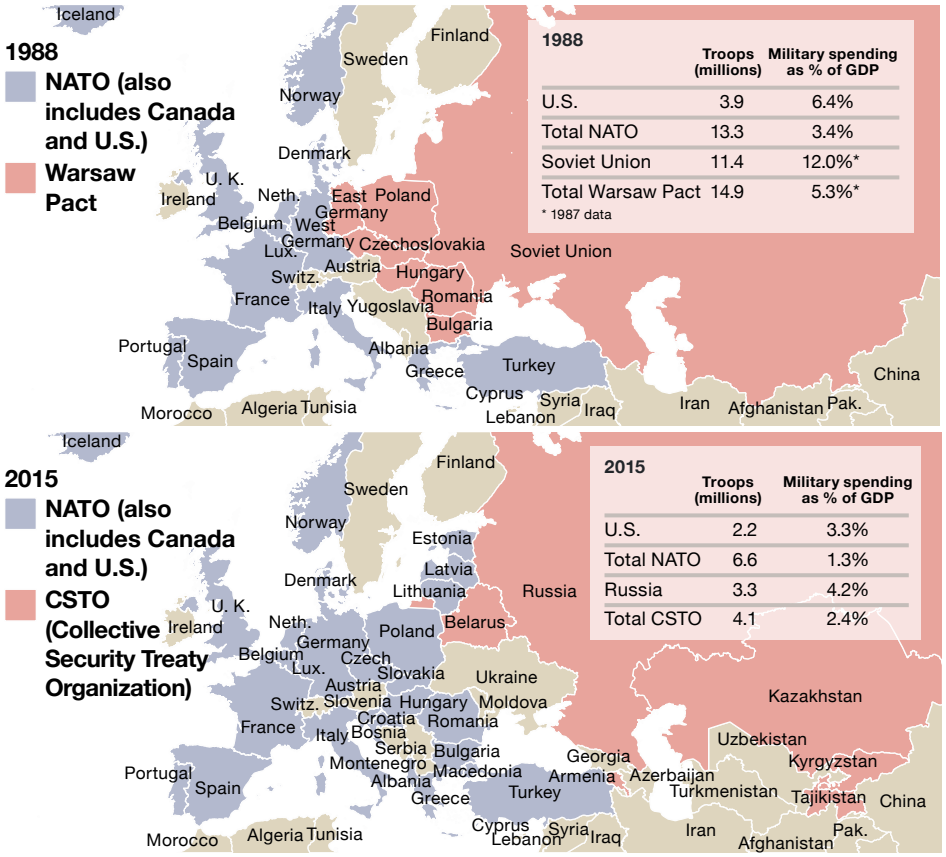
THE BACKGROUND

The Cold War began in 1947, when U.S. President Harry Truman asked Congress for $400 million (about $4.2 billion in today's dollars) to help defeat the communists in Greece's civil war and stop the Soviet Union from projecting power in the Mediterranean and Middle East. In his speech, he set out what came to be called the Truman doctrine, under which the U.S. would contain Soviet expansion by supporting "free peoples who are resisting subjugation by armed minorities or by outside pressures." Soviet diplomats saw this policy as imperial aggression from an American elite claiming the right to lead the world. The ensuing struggle included Soviet efforts in 1948 and 1961 to drive the Allies out of Berlin; a nuclear arms race; the Korean and Vietnam wars; the creation of opposing military blocs in Europe; and the Cuban missile crisis. It wasn't until 1969 that the two sides sought a kind of truce, with arms control treaties, hotlines and other measures to reduce the chance of war.

THE ARGUMENT

Some analysts of Russia and Eastern Europe have argued that the Cold War cannot repeat itself because Russia has no ideology as alluring as communism, because its military is weaker, its allies fewer and its economy more integrated with the rest of the world's. The counter-argument, from the likes of Columbia University's Robert Legvold, is that while today's might be a different Cold War, it should be treated similarly. That's because Russia retains a vast nuclear arsenal, as well as the will and military means to be a regional superpower. A doctrine that claims the right to intervene militarily wherever ethnic Russians live makes the risk of escalation high. And while Putin's Russia may not have communism to offer the world, he has found takers for a concept of "managed democracy" and conservative values that compete with democratic and liberal ones. So containment and agreements to reduce the risk of unintended wars may be needed again.

Lines Redrawn



1988

	Troops (millions)	Military spending as % of GDP
U.S.	3.9	6.4%
Total NATO	13.3	3.4%
Soviet Union	11.4	12.0%*
Total Warsaw Pact	14.9	5.3%*

* 1987 data

2015

	Troops (millions)	Military spending as % of GDP
U.S.	2.2	3.3%
Total NATO	6.6	1.3%
Russia	3.3	4.2%
Total CSTO	4.1	2.4%

Source: IISS Military Balance, Bloomberg

COLOMBIA'S LIMBO

BY MATTHEW BRISTOW

In Colombia, only the old can remember the country when it was last at peace. The Revolutionary Armed Forces of Colombia, or FARC, have been fighting since 1964 for a Marxist revolution, leading wealthy Colombians to form vigilante groups that outdid the rebels in their savagery. Fueled by cocaine money, both sides helped make Colombia one of the most violent countries in the world. After four years of negotiations, the government and the FARC reached a peace deal under which the 6,000 or so guerrillas would disarm in exchange for seats in Congress, reduced punishment for crimes and a program to redistribute land to small farmers who were forced to flee the tumult. But voters rejected the agreement in an Oct. 2 plebiscite, putting the Andean nation of 49 million people at risk of returning to all-out conflict.

Photo: Nicolo Filippo Rosso/Bloomberg

THE SITUATION

The government of President Juan Manuel Santos, who won the 2016 Nobel Peace Prize for his efforts, was blindsided by the referendum result: 50.2 percent to 49.8. Santos is trying to salvage the peace process by holding talks with former President Alvaro Uribe, who led the opposition to the accord, saying it was too lenient on a group that kidnapped and murdered Colombians. Uribe wants changes including tougher penalties for FARC leaders guilty of serious crimes and their exclusion from Congress. The government is also talking with the FARC, to see which of Uribe's demands the group might swallow. A gulf remains between the two sides. The government had bet that the accord would boost tourism, agriculture and oil production, giving the nation a peace dividend after nearly three years of slowing economic growth.

THE BACKGROUND

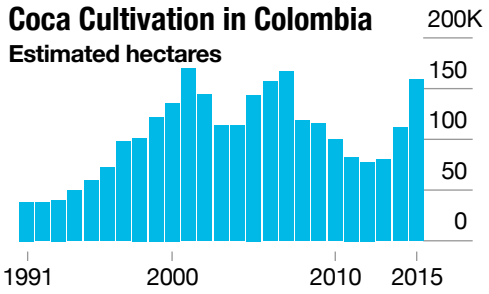
Other Marxist insurgencies in the Americas fizzled out after the Soviet Union collapsed in the 1990s, but Colombia's intensified as guerrillas tapped into a massive new source of funding: cocaine. Output of coca, the raw material, tripled in the 1990s in Colombia. Much of the production gravitated to FARC areas, where the state's presence was weak, giving the group's finances a big boost from the "taxes " it collected from farmers and traffickers. At its peak around the turn of the century, the FARC had a presence in 70 percent of the country. But it never captured a major town. More than 200,000 people died in the fighting, with millions driven from their homes, often to live in shantytowns in the main cities. Many of the worst atrocities were carried out not by the FARC, but by so-called "self-defense" groups set up by landowners and cocaine cartels to combat it. Still, FARC bomb attacks and the kidnapping of civilians earned it the hatred of many Colombians, who in 2002 elected the hard-line anti-FARC Uribe, whose father had been murdered by the group. Under Uribe, government forces cleared FARC roadblocks from the main highways, and the air force became increasingly effective at targeting the group's commanders. But the army was never able to eradicate the guerrillas, who used Colombia's dense forests to evade pursuit and planted land mines to protect their positions. Santos, Uribe's former defense minister, was elected president in 2010 and, with neither side close to victory, began making peace overtures.

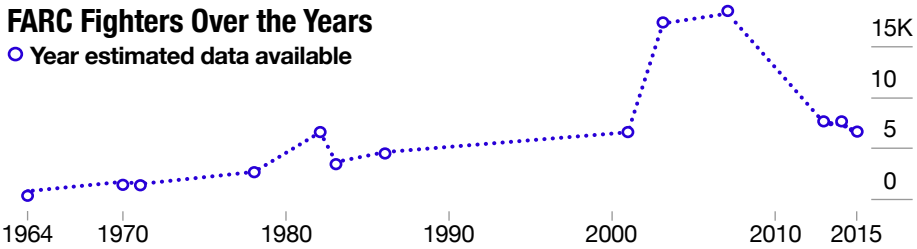
THE ARGUMENT

Uribe says he wants deep and not merely "cosmetic" changes to a 297-page document. The government and the FARC are warning that if too much time passes, everything achieved so far is at risk; a bilateral cease-fire cemented in August could break down and FARC leaders could lose control over their fighters. The deal was supposed to cut cocaine production, with the guerrillas helping with programs to substitute legal crops for coca. Cocaine output has been rising, after the government in 2015 suspended aerial spraying with herbicides said to be carcinogenic. A paralyzed peace process heightens the risk that the private armies of drug cartels will move into former FARC areas, increasing the flow of drugs to the U.S. and Europe.

Drugs and Revolution

After the Revolutionary Armed Forces of Colombia (FARC) began "taxing" the drug trade in the 1980s in exchange for protection, both the business and the group expanded. In the early 2000s, the government began scoring successes against the rebels. Still, coca production soared in 2015, after officials stopped aerial spraying of crops with a herbicide said to be carcinogenic.





Sources: U.S. State Department, Office of National Drug Control Policy (coca); fighters data compiled by Stanford University's Mapping Militants Project and Bloomberg (2015)

YEMEN'S FAULT LINES

BY GLEN CAREY

Yemen was once held up by U.S. President Barack Obama as a model partner in the battle against Islamic militants. Today, it's engulfed in civil war and bombarded by a U.S.-supported coalition of Arab states. The journey between those points is the story of a country riven by internal divisions and torn by the interests of external parties. Benefitting from the instability are the jihadists who were once under pressure in Yemen, including the most potent branch of al-Qaeda.

Photo: AFP via Getty Images

THE SITUATION

Since March 2015 a Saudi-led coalition of Persian Gulf countries has been fighting rebels who had taken over the capital, Sana'a, and other cities. In its first direct military involvement in the war, the U.S. launched strikes against targets under rebel control in October after it said a U.S. Navy ship was targeted in two failed missile attacks. Days before, the U.S. had said it was reviewing its support of the coalition fighting the rebels after the bombing of a funeral hall in Sana'a killed more than 140 people. Human rights groups have documented repeated cases of coalition bombings of civilian targets, including schools and hospitals. The intervention has reduced the territory under the rebels' control but has failed to dislodge them from the capital and other parts of northern Yemen. The conflict has its roots in complaints by the rebels of marginalization of their community, followers of the prominent Houthi family. Houthis are members of the Zaidi branch of Shiite Islam to which 42 percent of Yemen's population belongs. Yemen had no tradition of Shiite-Sunni sectarianism, but outside powers have chosen sides along those lines, with Sunni-majority Saudi Arabia supporting uprooted President Abdurabuh Mansur Hadi, a Sunni. Saudi Arabia's rival, Shiite-majority Iran, has championed and aided the Houthis. Since the Gulf-state intervention, Al-Qaeda in the Arabian Peninsula has increased its strongholds in Yemen. It's been estimated that at least 10,000 civilians have been killed in the fighting in Yemen. About 2 million people, out of a population of 28 million, have been displaced from their homes. Yemen was already the poorest country in the Middle East.

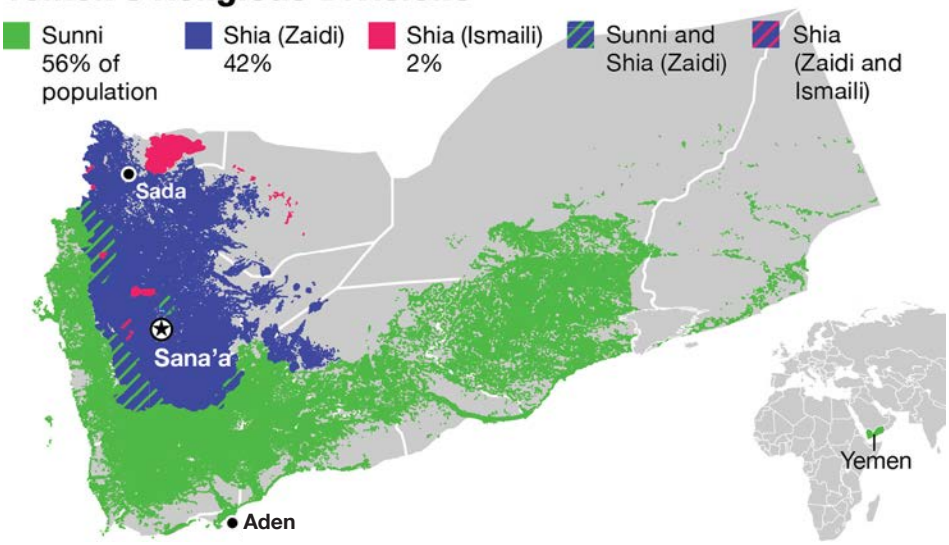
THE BACKGROUND

In 1904, the Ottoman and British empires established a frontier separating their spheres of influence in Yemen's north and south, respectively. The north gained independence in 1918 with Zaidi imams, long the local rulers, serving as kings until a republican revolution in 1962. South Yemen became a state in 1967. The country was unified in 1990. The Houthis fought unsuccessful rebellions from 2004 to 2010. An Arab Spring revolt forced President Ali Abdullah Saleh to step down in 2012. Under a U.S.- and Saudi-backed transition accord, Hadi replaced him, and talks supported by the United Nations set the stage for a constitutional convention and new elections. The Houthis, however, rejected a federation plan that arose from those discussions because their northern strongholds were included in a district with limited resources and no access to the sea. Yemen isn't a major oil producer but its location at the Bab el-Mandeb, a chokepoint in international shipping, makes it important for global energy trade.

THE ARGUMENT

The Saudi-led coalition said its intervention was aimed at compelling the Houthis to return to the political discussions they earlier abandoned. It hasn't worked yet. The Houthis rule out restoring Hadi to power, as the Saudis wish. They are allied with supporters of his predecessor, Saleh. The Saudis also justify military action as a response to aggression by Iran, which they paint as the Houthis' master. Independent observers say that's an exaggeration — that the Houthis receive aid from Iran but don't dance to its tune. In any case, if the Arab intervention was meant to bring stability to Yemen in the long-term, it's having the opposite effect in the short run. Cases of indiscriminate bombing have provoked calls in the U.S. and Europe to suspend arms sales to Saudi Arabia.

Yemen's Religious Divisions



Source: Dr. M. Izady, Gulf/2000 Project

PHILIPPINES' FIREBRAND

BY NORMAN P. AQUINO

Photo: Roslan Rahman/AFP via Getty Images

Take 7,100 islands, add 100 million people, throw in a twist of corruption, an unhealthy slug of poverty and a dab of dynastic politics, and what do you get? A recipe for disaster, you might think. And yet the Philippines has been simmering nicely as a developing democracy since overthrowing the dictator Ferdinand Marcos in 1986. Recent years have been marked by relative stability and economic growth that outpaced most of Southeast Asia. But the Philippines may be veering onto another course after voters turned to a fiery new president, one who is set to face serious challenges, and perhaps create a few.

THE SITUATION

Rodrigo Duterte, nicknamed The Punisher for his vigilante-style approach toward criminals, vowed to stamp out crime within a year of becoming president. Three months into his term, some 3,000 suspected drug dealers and users had been killed as part of his war on drugs, drawing protests from human rights groups, the U.S. and the United Nations. The outspoken Duterte threatened to withdraw the Philippines from the UN and unleashed an expletive-laden warning against U.S. interference that prompted President Barack Obama to snub a meeting. Other targets of his fiery tongue included the Pope and the European Union. On foreign policy, Duterte has engineered a shift toward China and Russia and away from the U.S., the Philippines' major military ally since signing a defense treaty in 1951. While a September poll showed the former mayor of Davao City enjoyed the trust of 86 percent of Filipinos, financial markets were less forgiving: The nation's currency and bonds tumbled in his first three months in office. The 71-year-old Duterte secured a landslide in the May 9 presidential election following an anti-establishment campaign that tapped into middle-class frustrations over corruption, public services and crime.

THE BACKGROUND

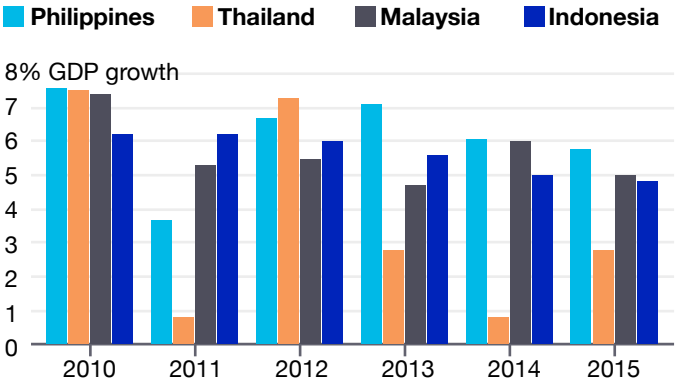
After centuries of Spanish and U.S. rule, the Philippines finally got to determine its own fate as the conclusion of World War II ended Japanese occupation. What emerged has developed into a splintered democracy of multiple parties that's fostered a political climate focused on personality over policy and dominated by powerful dynasties. Benigno Aquino, Duterte's predecessor, is the son of former President Corazon Aquino, whose People Power Revolution ended Marcos's 21-year rule. The Marcos era was marked by brutality — an estimated 3,000 people were killed and 35,000 tortured — and by extravagance epitomized by his wife Imelda's shoe collection. Marcos's reign left a legacy of widespread corruption and prompted a one-term limit on presidents. By boosting spending on agriculture, infrastructure and education, Aquino landed big punches with the economy. Soaring growth that's averaged 6.2 percent over the past six years led the World Bank to praise the country as Asia's "rising tiger." The Philippines earned its first-ever investment-grade credit rating and Aquino proclaimed an end to its "sick man of Asia" tag. Yet a quarter of the population remains in poverty, partly because of regular natural disasters including the devastating Typhoon Haiyan in 2013. Duterte vowed to continue Aquino's economic policies.

THE ARGUMENT

Duterte's critics see him as possibly the biggest menace since Ferdinand Marcos, and a threat even to democracy itself. On the international stage, Duterte has upended his country's strategic alliance with the U.S., saying it was "time to say goodbye" to America and that foreign policy now "veers towards" China. He even agreed to hold talks with China over territorial claims in the South China Sea — an approach that contrasts with Aquino's move to take the case to an international tribunal. After the Philippines won that case in July, Duterte called for "restraint and sobriety." He has also courted the military after opponents warned of discontent in an army with deep-rooted links to the U.S. Other challenges for the president include Manila's gridlocked traffic, underemployment that puts one-fifth of workers with advanced degrees in low-skill jobs and the migration of educated Filipinos overseas. Philippine watchers say winning the election may prove easier for Duterte than the task of dealing with entrenched political elites and bringing substance to his promises.

Rising Tiger Roars

Growth eclipses major Southeast Asia rivals



Source: Malaysia's Department of Statistics, Thailand's National Economic and Social Development Board, Statistics Indonesia, Philippine Statistics Authority

FRACKING IN EUROPE

BY KELLY GILBLOM

There are compelling reasons why Europe should replicate the U.S. shale boom. It would bring lower energy prices, for one. The continent's awkward dependence on Russia — which provides about a third of Europe's gas — is another. From the United Kingdom to Poland, companies have tried and failed to replicate the success of fracking in the U.S. In part, their efforts have been stymied by aggressive political opposition. Europeans are refusing to sign up for the shale revolution because they fear it will sully their scenery, contaminate their drinking water and clog their country lanes. But shale holds the promise of cheaper gas that can boost the economy and weaken Russia's grip on Europe's energy. So which set of imperatives will win — or could they coexist?

Photo: Gareth Fuller/PA Wire/Press Association Images

THE SITUATION

Europe's got more recoverable shale gas than the U.S., according to estimates, yet there's been little exploration. Germany, France, the Netherlands, Scotland and Bulgaria all effectively ban fracking. The only major activity is in the U.K., where the government is promoting the technology to help replace plunging domestic output from the North Sea. In October, Cuadrilla Resources won permission to frack four wells in the U.K., ending a two-and-a-half year battle with local authorities. In 2011, tremors caused by an exploratory Cuadrilla rig in northwestern England led to a one-year moratorium on fracking. In 2013, hundreds of protesters camped in a tiny village south of London until the company abandoned its well there. People in Zurawlow, a town in eastern Poland, successfully blockaded a fracking site in 2012, and Greenpeace activists have occupied a shale gas rig in Denmark. The fury — along with regulatory delays, tax concerns and poor output from a handful of test wells — has driven away investors. Chevron, Exxon Mobil and Total abandoned projects in Poland after exploration proved disappointing. Meager gas flows also halted progress in Denmark, with Total ditching shale gas drilling there.

THE BACKGROUND

Some of the conditions that ignited the U.S. shale boom don't exist in Europe. In most countries, private landowners don't own the mineral rights to oil and gas in the ground: the state does. That means fracking won't yield big financial rewards for local landowners. (In the U.S., the owner's cut can be an eighth of production revenue.) The British government and some companies have proposed direct payments to those affected by fracking. Environmental groups have called such pledges a bribe. Opponents include political organizations like the Greens, which hold seats in legislatures and have galvanized local opposition. People are more than three times as densely packed on the land in Europe than in the U.S., fueling not-in-my-backyard protests. Some rural projects have been rejected because they would bring trucks and equipment used for fracking — the nickname for hydraulic fracturing, which uses water, sand and chemicals to release oil and gas from shale rock — onto picturesque roads dating to Roman times. Alexander Medvedev, the chief executive officer of Russian oil giant Gazprom, said in a 2013 interview that the difficulty in finding unpopulated land and enough water to exploit shale wells in Europe could help Russian gas stay competitive. Russia can produce gas for about a sixth of the breakeven cost for U.K. shale.

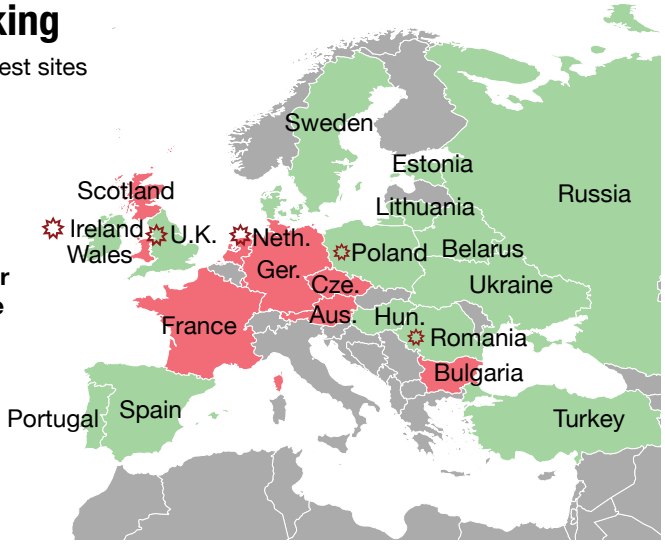
THE ARGUMENT

Even after a decade of fracking in the U.S., many Europeans still view the geology as untested and would rather not take the environmental risks. But backing away from shale may rob Europe of a key source of secure energy. Its dependence on Russia amid the conflicts in Ukraine and Syria adds urgency to the debate. With renewables still developing and Germany shunning nuclear power, Europe is burning more coal, putting its goals for cutting carbon emissions at risk. Energy-intensive industries — such as steel and petrochemicals — are also in peril as lower gas costs in the U.S. drive global producers to shift investments there. In September, the U.K. imported its first cargo of American shale gas as chemical makers look to cheaper U.S. supplies to keep their plants running.

Mad About Fracking

Fracking policies and protest sites

- **Active licenses**
- **Fracking banned or licensing suspended**
- **No fracking activity**
- **Countries where major fracking protests have occurred**



Source: Bloomberg Intelligence

DRIVERLESS CARS

BY KEITH NAUGHTON

Photo: Google

The auto industry seems to be hurtling headlong into an era when cars drive themselves. It may sound futuristic, but parts of it are already here. The robots are easing us out of the driver's seat bit by bit. Cars on the road today can brake for you or steer you back into your lane, while others coming in the next two years will change lanes automatically and allow you to drive hands-free — or mostly. That makes plenty of people nervous, and there's no end to the ethical and legal questions yet to be settled. But there's little doubt that the robot driver's day will come. Carmakers see a future in which autonomous "transport pods," often provided by ridesharing services like Uber or Lyft, supplant the tradition of two owner-operated cars in every garage.

THE SITUATION

The U.S. in January proposed spending $4 billion over 10 years on research and infrastructure to promote driverless cars and in September laid out a regulatory path for automakers to win approval for putting them on the road. Many more billions are being spent not only by car companies but by a range of technology companies on developing autonomous vehicles that use sensors, cameras and high-speed computing power to read and react to traffic, pedestrians, stoplights and infrastructure. Luxury lines have taken the lead in adding features like hands-free highway driving or self-parking cars. These so-called semiautonomous vehicles came under scrutiny after a fatal accident involving a Tesla sedan driving on autopilot. Google and Fiat Chrysler Automobiles are teaming up to develop about 100 self-driving Chrysler minivans, while BMW is collaborating with Intel and Mobileye, an Israeli maker of components for autonomous systems. General Motors is investing in Lyft and is developing a fleet of robot taxis. Ford promises to put 100,000 robot taxis on the road by 2021 and says it is developing driverless technology that will be affordable for the masses.

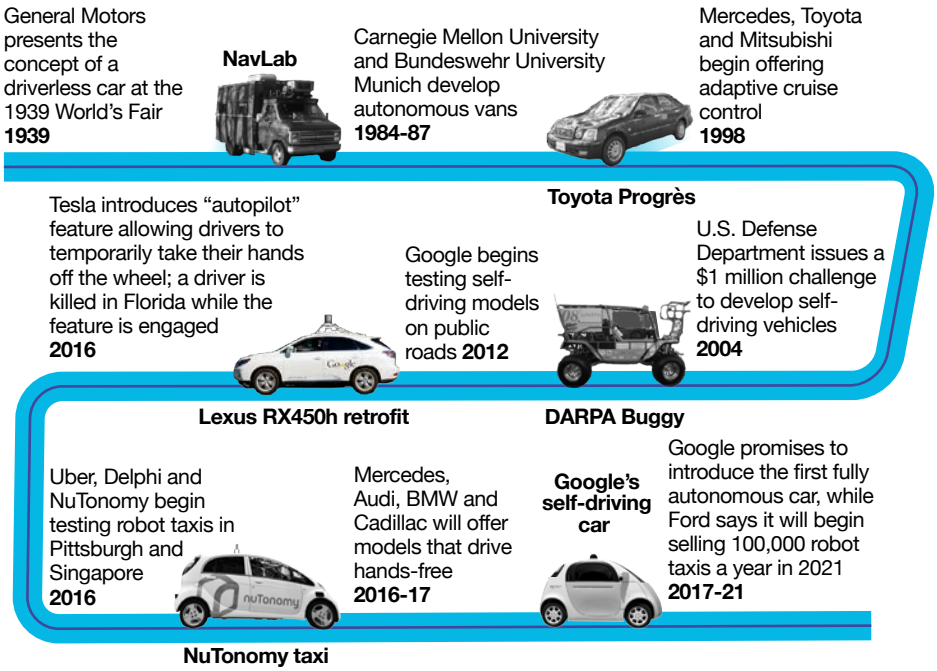
THE BACKGROUND

The dream of a self-driving car appeared in the pages of science fiction and then in the General Motors Futurama display at the 1939 New York World's Fair. Computing power didn't catch up with our imaginations until the 1980s, when Carnegie Mellon University came up with a robot Chevy van and Bundeswehr University Munich developed an autonomous Mercedes van. Consumers got their first taste of autopilot in the 1990s when Toyota, Mitsubishi and Mercedes began offering adaptive cruise control, which uses radar to automatically adjust vehicle speed to keep a set distance from cars ahead. As the cost and size of the sensors and chips have plunged, autonomous features have proliferated and can now be found in everyday Hondas and Fords. Google accelerated the pace of development by logging more than 2 million miles testing its driverless cars on Silicon Valley roads. In initial road tests, driverless cars actually have had an accident rate twice as high as human-driven models — though researchers say it's the humans in other cars who are generally to blame.

THE ARGUMENT

The accelerated pace of invention is outstripping governments' ability to regulate self-driving cars. There are few laws on the books requiring drivers to keep their hands on the wheel because no one imagined that would be an issue. More broadly, there's the ethical dilemma of turning over decision-making power to a robot in a life-or-death situation. The question of liability also remains unanswered, and automakers have yet to design a connected car that cannot be hacked, raising security concerns and dystopian scenarios of robot cars run amok. Yet driverless cars could save thousands of lives, since driver error is blamed in 94 percent of crashes. The benefit could be even higher in developing nations, where accident rates are high, and the cars could be a boon for the disabled or the elderly. The millions of truck drivers and others who could be put out of work by robot cars might not like the change as much, however.

Look, No Hands



Source: Bloomberg

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