**Quote of the Week :** “Short term disciplining till we reverse the present trend will give us long term benefits.” - India’s new Finance Minister Arun Jaitley[1], who for the time being also holds the Defense portfolio (making him the most powerful member of Prime Minister Modi’s government).

**Quote of the Week No. 2 :** “After last week’s ECB policy initiatives Mario Draghi should consider changing his name to Mario Drughy, or better still, Mario Druggie, being the latest person to have put a needle in the market’s arm.” - a market practitioner who preferred to stay anonymous.

These quotes present an interesting juxtaposition between a politician accepting the need for ‘short-term pain for long gain’ & a central banker, a supposed bulwark of financial & fiscal rectitude, having to abandon his perch because of politicians who won’t.

India now has the world’s likely most impressive Minister of Finance-Central Bank combo at a watershed moment in its history, when it needs to raise its GDP growth rate from the recent 5% to something closer to the 9% of five years ago :

- **Minister of Finance Arun Jaitley (age 61)** became one of its foremost corporate lawyers, who had both Coca Cola & Pepsi as clients, after his family came from Pakistan to India upon partition in 1947. Active in the BJP since university (he was jailed in one of the Congress Party’s periodic BJP clamp-downs), he has long been a leading party strategist & close to Modi (despite the differences in their family backgrounds & castes) whom he backed last year in the kerfuffle in the party when he became its standard bearer in this spring’s election. As Minister of Commerce in the last BJP government a decade ago he was instrumental in queering the developed countries’ pitch in the Doha Round to gain greater access to developing countries’ markets without cutting their own farm subsidy programs. In the last Parliament he was the Leader of the Opposition in the Upper House and, while his appointment as Finance Minister had been expected, that as Defense Minister pro tem was a total surprise. The only blemish on his escutcheon is that in the election he was unsuccessful in his run for a Punjabi seat in the Lower House; and
- **RBI Governor Raghuram Rajan (age 51)** has an equally, if not more, though vastly different, CV. He has a degree in Electrical Engineering from a local university & a Ph.D. in Management from MIT, for years taught at the University of Chicago’s School of Business (from which he is officially still on a leave of absence) & was the IMF’s Chief Economist from 2003 to 2007[2]. In 2008 the previous Prime Minister named him an Honorary Economic Adviser & in 2010 he got the Financial Times-Goldman Sachs Award for his book <u>Fault Lines : How Hidden Fractures Still Threaten The World Economy</u> being the Best Business Book of the Year. And he served as the Ministry of Finance’s Chief Economic Adviser for twenty months prior to being named to his present post last September (after which he introduced three

[1] Who had earlier told the press that his predecessor. P. Chidambaram had “inherited 8.5% growth and is going to leave behind 4.6% growth rate.”

[2] Midway through which he roiled many feathers when he questioned the then common wisdom, shared among others by then Fed Chairman Alan Greenspan, that credit defaults swaps & the like were making the financial system safer by spreading risk (a belief subsequently proven disastrously wrong by the Great Recession).

rate increases in quick succession in an effort to stifle inflation that so far seems to have had a measure of success, even though it is still above of his near-term target). And most importantly at this juncture, he is a member of the Group of Thirty economic & financial prominenti focused on 'the consequences of economic & financial decisions in the public-, & private-, sectors', the membership of which includes Paul Volcker, Jean-Claude Trichet, the former-, & Mario Draghi, the current-, ECB Presidents, Mark Carney & his predecessor Sir Mervyn king, Jaime Caruana, the General manager of the BIS & former Governor of Spain's central bank, Timothy Geithner, the New York Fed's William Dudley, Haruhiko Kuroda & Zhou Xiaochuan, the Governors of the Japanese & Chinese central banks respectively, as well as Goldman's Gerald Corrigan (a former Special Assistant to Paul Volcker at the US Treasury, and President of the Minneapolis Fed, while still in his 30's, & subsequently of the New York Fed), Roger W. Ferguson, the CEO of TIAA-CREF (*whom I wished Obama had named to succeed Bernanke*), Axel Webber (a German economist who also taught at the University of Chicago & now is Chairman of UBS), and Kenneth Rogoff, Larry Summers & Paul Krugman.

The Fed's QE policies have had a destabilizing effect on the emerging market economies, first by prompting a wave of yield-hungry 'hot money' flooding into them, hiking inflationary pressures, but accelerating their economic growth & then, when Bernanke started talking a year ago about "tapering", & then acted thereon, causing the equivalent of a 'great big sucking sound' when that money left as fast as, if not faster than, it had come, with negative consequences for their economic growth. This prompted Rajan to make the headlines last January 29th when he told Bloomberg in an interview that "international monetary cooperation had broken down." And during the IMF Spring Meetings in Washington last April, he expanded on this theme in a panel discussion when he said the Fed hadn't been sufficiently concerned about the effect of its policies on the emerging market economies[3] & that, while his counterparts at the Fed would assure him in private they were 'sensitive' to this issue, they had never mentioned it in their post-FOMC meeting publicity. Furthermore that speeches by various Regional Fed Presidents hadn't helped, given their emphasis that the Fed's mandate from Congress was to help the US economy (a mantra reiterated by Chicago Fed President Charles Evans at that same panel session) & that, while New York Fed President William Dudley a few weeks earlier had said the Fed "has a special responsibility to manage policy in a way that helps promote global financial stability", in the next breath he had added that there are limits to what the Fed can do in this respect. On the other hand, in the same session Bank of Mexico Governor Augustin Carstens, once the developing countries' candidate for the IMF Managing Director's job that in the end went, as the tradition has been (something the developing country governments are becoming increasingly resentful off) to a European, France's then Finance Minister, Christine Lagarde, said "We have to be pragmatic ... our working assumption has long been that the Fed will do what it has to", & that all that mattered now was that the Fed should get its exit from its low interest rate policy regime "right" - *by stressing its overriding domestic priority so much, the Fed is likely hastening the erosion of the US dollar's key role in the global monetary system (& may be implicitly promoting isolationism).*

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3 When he repeated this claim in a speech at the Brookings Institution, Bernanke, who was in the audience, rose to protest, saying he had 'consulted emerging market central bankers formally 8x a year at international meetings' & that his criticism "just reflects the fact that you are very skeptical about unconventional monetary policy" (with Rajan's view being that Bernanke's idea of consulting is little more than "information sharing").

Mohamed El-Erian (age 58) was born in New York, spent his pre-teen years in Egypt, is a Cambridge & Oxford alum with a Ph.D. in economics from the latter, & for four years running (2009-2013) was included in Foreign Policy's list of Top 100 Global Thinkers (& last year in that of its 500 Most Powerful People in the World). His 2008 book When Markets Collide won the FT/GS Best Business Book of the Year Award & was named Best Book of the Year by the Economist. He spent most of career at the IMF & at California-based PIMCO, manager of the world's largest bond fund. He resigned as Co-CEO of the latter in January after falling out with its founder, Bill Gross, only to be immediately retained as Chief Economic Adviser by Munich-based Allianz, the world's largest insurance company & most influential financial services group in Germany (& hence Europe), **and** PIMCO's parent. On June 6th he told Bloomberg the ECB move to cut its rates, & start charging banks 0.10% for keeping money on deposit with it, was 'not enough to solve Europe's economic problems', & on CNBC called it the "firing a lot of small bullets", saying "They're trying a package approach hoping that somehow they are going to get to critical mass"[4] [5]. And, as the media haven't, he also noted that ECB President Mario Draghi had said he felt he had no choice but to make a move since European policy makers had failed to do the things that "really matter", like moving to improve the Eurozone's productivity & (*global*) competitivess[6]. This led El Erian to conclude "the risk right now ... (*is that*) at the end of the day, we may find ourselves in a rather unpleasant situation ... There are very few spare tires left in this car and this car is navigating a bumpy road." Also following the ECB move, the German think tank ZEW (with 180 employees & a 16MM Euro budget not only one of best-known-, but also largest-, best-funded-, & most highly regarded German think tanks) expressed a 'growing concern of dangerous bubbles' with its President, Clemens Fuest[7], saying "We have all the ingredients of a bubble; the prices of real estate and stock markets continue to rise ... and bond yields are falling despite the high risks." & calling for action by governments[8], instead of leaving it all up to the ECB - *For optimum results monetary & fiscal policy must work hand in glove. But the developed country policy decision makers have been hoping a good outcome will emerge 'virgin birth-like' on its own, & that in a worst case scenario it will be someone else's job to face the music when the biomass hits the fan*.

After graduating from Dartmouth Stephanie Pomboy joined Cyrus J. Lawrence, at the time (the 80's) a classy Wall Street merchant bank boutique. After its demise, she joined its former Chief Economist, Ed Hyman, when he set up the ISI Group in 1991, and in 2002 hung out her shingle as MacroMavens, a purveyor of macro-economic research services to institutional investors. By her own admission she is a "perma-bear". Be that as it may, in a recent presentation she made a number of seemingly valid points, incl. :

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4 Commonly known as 'damning with faint praise'.

5 Aka as "Throw enough biomass at the wall to make some of it stick."

6 Just as he believes that in the US the Fed's monetary policy has had to carry an undue share of the load because the politicians havebeen sitting on their hands.

7 Fuest is in his mid-forties. He taught economics at the University of Cologne & taxation at Oxford before becoming ZEW President last year. He is a sought-after economic adviser to politicians & compares himself to a medieval court jester, whose job it was to tell his King unpleasant truths, rather than what he wanted to hear, and was used to hearing.

8 The absence of which Mario Draghi intimated had forced his hand.

- Alan Greenspan created the last bubble & Bernanke the current one - all the mistakes that were made in the previous cycle have been repeated in spades in the present one;
- the unprecedented run-up in corporate profits was due to three factors, cuts in labour costs, low interest rates & banks reducing their provisions for losses - all three have run their course and are about to, or will soon, go in reverse; and
- 90% of the growth in consumer spending since 2008 was accounted for by inflation, & the non-discretionary share thereof increased - the implication being that there had been little volume growth (*& none or less on a per capita basis*), and that less of is now on "want" rather than "need" goods (*indicative of a lowering in the standard of living*).

On June 10th there was an the equivalent of an earthquake in the GOP when Rep. Eric Cantor (R.-Va), as its House Majority Leader the No. 2 in its House caucus, was unexpectedly trounced 55-45 by the little-known David Brat, a Tea Party-aligned economics professor at a tiny, obscure college with, among others, a Master's degree from a theological college, who ran on wanting to be Cantor's "tem limit" & to address the nation's ballooning deficit[9]

The White House decision to spend valuable & scarce political capital to repatriate the Pfc, & while captive promoted to Sgt., Bowe Bergdahl in exchange for five al-Qaeda 'heavies' in Guantanamo, is puzzling. For his five year absence hadn't been much of an issue, except for his family & friends. More importantly, according to his former platoon mates, those not constrained by non-disclosure agreements (*an interesting aspect of this matter the media haven't focused on*), he was a 'deserter' who, while on guard duty at his relatively small & isolated post, had "shed his weapons and walked away with only a knife, a compass, water & a diary." According to the late Michael Hastings, in 2012 in Rolling Stone Magazine, Bergdahl had told others he no longer supported the US effort in Afghanistan & written his parents "The future is too good to waste on lies ... The horror that is America is disgusting." Former Staff Sgt. Joseph Corder, one of those in the 1st Battalion, 501st Infantry Regiment, 4th Brigade Combat Team, 25th Infantry Division who knew him best, thinks he may have wanted to "see Afghanistan for himself, without the Army stopping him or having to tell him what to do." After he disappeared, soldiers looking from him supposedly had come across children who had seen an American "crawling on his belly through the weeds" & villagers who said an American soldier had been in the area looking for someone who spoke English. On Sunday June 1st, Defense Secretary Chuck Hagel, didn't help matters when, asked point blank by a reporter if Bergdahl had deserted, he waffled "Our first priority is assuring his well-being and his health, and getting him reunited with his family" - *all this suggests that, rather than being the (involuntary) prisoner of war the media have portrayed him to be, he had been a naive 21 year-old American who had made a bad decision with disastrous consequences (in which case getting him back would have still been the right thing to do, but not necessarily at the price paid; for anyone who believes for even a moment that, after more than a decade at Guantanamo, the five men released won't return to their lives' mission with even greater zeal, if not vengeance, is even more naive' than Bergdahl (who at least had the excuse of youth & inexperience) had been. A complicating factor may be that if Bergdahl had indeed deserted, the Army would have egg all over its face for having promoted him while in Taliban custody.*

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9 Washington still has a deficit, but it is no longer "ballooning". At US$500BN & 2.8% of GDP it is still nothing to sneeze at but respectable by global standards & down two-thirds off its peak. So he was either misleading voters or showing he didn't know the difference between a deficit (a "flow") & debt (a "stock") - and would be scary indeed for an economics professor.

Many Canadians believe their governments spend less time prying into their personal affairs than does Washington; so it must have come as a surprise to them when Rogers Communications, one of Canada's three oligopolistic cell phone service providers, reported that last year it had received almost 175,000 'requests for customer information' from government-, & police-, agencies.

France's Total SA was once deemed on track to become a major player in the Alberta oilsands. When in September 2010 it received approval to build a 300,000 bbld bitumen upgrader[10] near Edmonton, one observer burbled "Over the next 10 years, Total Canada will make a $15-billion to $20-billion capital investment into Alberta's economy relating to the upgrader". But only three months later, it abandoned the project to buy a 40% interest in Suncor's Voyageur upgrader project in the Fort McMurray region (plans for which the two companies cancelled last year, prompting a $1.65BN write-off for Total & the $500MM sale of its interest to Suncor) while Suncor acquired a similar-sized interest in Total's Joslyn oil sands mining project, North of Fort McMurray (which they, & their two other partners, two weeks ago put on hold as 'too costly to develop'). Meanwhile work is still proceeding, *for the time being at least*, on the their Fort Hills oilsands mining project a bit further North (*that Total had bought into in the same 2010 transaction mentioned above*), with the first oil still expected to start flowing three years hence - *this only serves to confirm my concerns, that few Albertans seem willing to share, that ever-increasing costs & the looming lack of pipeline capacity*[11] *to get its oil to market is putting yet another Alberta oil "boom" at risk (altough the CAPP, the Canadian Association of Petroleum Producers may have begun sharing the same concern since it just shaded its forecast of future Alberta oil production down a bit*)...

A Hongkong-based businessman earlier this spring bought US$100MM of gold in Ghana that he had transported home by a chartered aircraft while all through the piece having it guarded & supervised by a trusted employee. Imagine his horror when he found, upon its arrival in Hongkong that the 40 boxes contained metal bars all right, but not gold ones. At last report his employee was nowhere to be found.

Youth unemployment is potentially socially destabilizing & long-time deleterious to young people's career prospects . So it's ominous that, according to EuroStat, the overall under-25 unemployment rate in both the EA-18 & the EU-28, while down marginally YoY, remains in the 23% to 24% range. But there are big differences between countries : the outliers on the upside

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10 The problem with upgraders is that decisions to build, or not build them, are being made at the 'mcro', i.e. individual company level. But a couple years ago the CIBC calculated that in 2011 the double discount on Western Canada Select crude had cost the industry $16BN'; since the Alberta government's "take" is in the 30% range, that implies it lost $5BN - $6BN in revenues which could have subsidized a great deal of upgrader subsidization, never mind that upgrading the stuff locally would create more economic activity, & hence tax revenues, **plus** the fact that there would no longer be any need for import diluents **plus** the fact the outgoing product pipeline would be 25%-33% more efficient if the bitumen didn't have to be diluted so as to make it pipelineable **plus** the fact that it would weaken the environmentalists' black tarsands goop argument.

11 While I agreeing rail transport has a role to play in getting Alberta's oil to market, I believe that its greatest value-added potential lies in its ability to provide flexibility, i.e. to allow rapid responses to shifts in the demand for crude within North America, rather than to provide 'base load' capacity in competition with pipelines (which, after all, once in place, can more the product to market far more cheaply & safely).

are Greece (58% in March 2013 & 51% one year later), Spain (55% & 54%), Croatia (52% & 50%) & Italy (40% & 43%), and on the downside Germany (7% & 7%), Austria (7% & 8%) & Holland (10% & 11%) - *while that of France, now seemingly a growing threat to the Eurozone's survival, was at the average, & even down two points YoY, it may be the most dangerous because of it's concentration in the ghettoized, even if often second-, or third-, generation, Muslim immigrant community.*

Jean-Claude Juncker (age 59) was a Luxemburg politician for a quarter century & its Prime-, & Finance-, Minister for 19 years until dumped last year following a relatively minor scandal dating back years ago. For eight years too he was Chairman of the Eurogroup, the group of Eurozone country finance ministers, that (*mis*)managed the fallout from the post-2007 meltdown. He (a "left-leaning Christian Democrat") is now the candidate for the position of President of the European Commission, i.e. the EU's top bureaucrat, for what is still the biggest party in the European Parliament (although it did not fare well in the recent election), the right-of-centre EPP (European People's Party), affiliated in Germany with Angela Merkel's Christian Democratic Party. But Britain's Prime Minister David Cameron, who earlier distanced himself from the EPP, with the wholehearted support of **both** the Liberal Democrats **and** Labour, is now on a campaign to try & head this off on the grounds that, whereas the latest European Parliament elections demonstrated the need for a reform of the EU structure (*to bring it closer to the people*), with Juncker, a strong proponent of more & more, and faster & faster, integration, in the top bureaucrat spot reform would be "harder".

Britain's Lloyd's Banking Group in 2008 got a £20.5BN tax payer bailout, with the government getting a 43% interest in the bank (since reduced to 25%) & the EU stipulating it had to sell off part of its branch network by 2013 (later extended to 2015) as a sine qua non. It just made a start on the latter is with an IPO of 25% of its TSB subsidiary. What had some people puzzled, however, was that, while the Lloyds own shares trade at a 40% premium over their Book Value, the TSB IPO was priced at a discount thereof (*albeit at the low end of its expected 10% to 30% range*).

## GLEANINGS II - 566
## Thursday, June 12th, 2014

### ***EUROPEAN*** RATES TO DIVERGE FROM U.S., U.K. FOR YEARS (Reuters, James Regan)

- *Two days after the ECB rates cuts last week,* Benoit Coeure, a Board member since 2011[12], told France Inter/Radio on June 7th they would remain around that level for a long time, even as the Fed & the BoE would at some point start raising rates[13]. For "Clearly ... we wanted to indicate on Thursday ... that monetary conditions will diverge between the Eurozone on the one hand and the United States and the United Kingdom on the other, for a long period, which will be several years" (*so as to weaken the Euro which is so strong as to threaten Europe's & more specifically France's, economic recovery & importing deflation*).

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12 A French economist, he taught at France's über-prestigious L'ecole polytechnique, the training ground for the country's up & coming, public-, & private-, sector managerial class & subsequently was head of the French Finance Ministry's debt management operation.

13 Starting, it's generally expected, a year from now.

*This is the next shot in the global currency war President Hollande has long been urging the ECB to fire (to help France gain a short-term global competitive advantage without him having to introduce longer-term more effective & beneficial-, but short-term painful & unpopular-, domestic reforms). The PIIGS countries now constitute less-, & France more-, of a threat to the Eurozone's survival; for, while the former have made some, & sometimes serious-, genuflexes at the altar of domestic reform, Hollande was reluctant to do so even before his public approval rating sank lower than knee high to a grass hopper & his (Socialist) party was trashed by the far-right Front Nationale in the European parliamentary elections. Coeure must have gotten the word from Paris; for last September in a joint interview with a (German) fellow ECB Board member on German TV, he urged Eurozone politicians not to be complacent since "with our decisions (of low rates) we gave them time. It is important they use this time ... (to) become more resilient."*

**SOARING MARKETS MEAN CASH IS KING AT U.S. VALUE FUND (G&M, David Berman)**

- Memphis, Tenn.-based Southeastern Asset Management manages the mid-, & large-, cap US company-focused Long Leaf Partners Fund that far outperformed the S&P 500 over the past five-, 15-, and 20-year periods (over the past five by 16-, & over the past 15 by 185-, percent) by having a disciplined commitment to only buying stocks trading at deep discounts from their intrinsic value, as they calculate it. But now the 14 stocks in in its portfolio trade at over 70% of their intrinsic value, twice that at the start of the bull market in 2009. So in the First Quarter its managers sold two stocks & did't make one acquisition, after which the US$8.2BN fund is now 27% in cash, up from 17% YoY & 1.6% in 2009 (& the average fund's 5%), which has caused it to lag the S&P 500 over the past year.

*Amazon's current trailing P/E ratio of 560 & 2014 estimate of 270 make any value investor cringe (even though the former was a mere shadow of the 3,000x at the start of 2013), as would the corresponding numbers for Netflix (200 & 103) & Facebook (110 & 56).*

**NOW IS THE TIME TO PREPARE FOR THE NEXT CRISIS (CNBC, Matt Clinch)**

- Bad weather in the US, the crisis in Ukraine, rebalancing in China & the anticipated rise in interest rates have prompted the World Bank to downgrade its global GDP growth forecast for 2014 to 2.8% (from 3.2% last January)[14] While part of this was due to it scaling down its US forecast from 2.8% to 2.1% (largely due to the impact of its severe winter weather conditions-driven 1% negative GDP growth rate in the First Quarter[15]), it also reflected a downsizing of its developing country GDP growth forecast from 5.3% to 4.8%. In a press release its Chief Economist noted "We are not totally out of the woods yet ... A gradual tightening of fiscal policy and structural reforms is desirable to restore fiscal space depleted by the 2008 financial crisis. In brief, now is the time to prepare for the next crisis."

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[14] And the growing strength of ISIS in Northeastern Syria & Northwestern Iraq, if not checked, could at some points start having a serious effect on oil prices that would create a further drag on the global economy.

[15] In view of which other forecasters' optimism for the year's rate seems overdone.

*The longer such reforms are delayed, & the political will to bring them in still seems absent, the more unpleasant the eventual outcome will be (& the greater the cost of recovering from it).*

**EMERGING MARKETS FACE HUGE INFRASTRUCTURE NEEDS (EJ, Briefs)**

- At this week's 20th Conference of Montreal, organized by the International Economic Forum of the Americas with the theme The Foundation of the Next Era of Growth, World Bank CFO Bertrand Badré[16] (age 46) made his audience gasp when he said the emerging nations face a "shocking bill" of up to US$1.5TR **annually** (2% of current global GDP[17]) for infrastructure investment, in part since in the developing world **each month** 5MM more people move into urban areas & in part since sub-Sahara Africa will have to provide for its rapidly growing population. This will create a need for more private investment.

*Rather ironically, the cash-rich groups of investors most interested in investing in infrastructure projects generating long-life, highly predictable cash flows are the government-owned wealth funds of the non-renewable resource-rich-, & the public pension funds of the developed-,countries.*

**STEADY AS SHE GOES : JOB CREATION KEEPS UP PACE (MSNBC, Jeff Cox)**

- In May non-farm payrolls grew in line with recent trends, up 217,000 (almost exactly as expected) & the unemployment rate remained 6.3% while the broader gauge of joblessness (incl. those working part-time & those who have quit looking for work), at 12.2%, was at a year-long low. But *(unfortunately?)* most of the job gains were in lower wage-paying industries & wage growth maintained its annual 2.1% growth rate of the past year.

*So on an after-tax basis total wage gains lagged the official inflation rate, & by a street length the for consumers the most meaningful rate of inflation, i.e. the cost of food, energy & shelter*[18].

**MARKET CAUTIOUS AFTER CHINA'S QINGDAO PORT HALTS ALUMINUM SHIPMENTS (Platts.com, Wendy Wells)**

- Chinese traders & analysts reacted cautiously on June 3rd to the previous day's report that the port of Qingdao, the world's seventh-largest, had halted copper & aluminum movements from its warehouses after state officials launched an investigation into allegations that receipts for metals stored there had been used as security for multiple loans.

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16 A French citizen who prior to being named to his present position had been Lazard's Managing Partner in Paris & subsequently CFO of the French Bank Crédit Agricole.

17 The cost of which for the up-&-coming generation will be accreditive to the debt service burden bestowed on them by the Baby Boomers & the deferred cost of climate change remediation dumped on them by today's climate change sceptics/deniers.

18 That the proponents of "core CPI" in official circles factor out of the equation.

*Everyone quickly has become less sanguine since. It may not just have been a matter of the same metal being used as security for multiple loans (some of which may be 'underwater') but that some of the metal never existed in the first place. Metal prices have since come under pressure out of concern this will lead to metal being dumped as lenders run for cover. Several banks, incl. Citigroup & Standard Chartered, launched investigations of their own and/or quit lending against metal in Chinese warehouses (which has been big business & helped fuel the real estate boom). Word is that 20,000 tonnes of copper & 100,000 tonnes of aluminum (& twice as much alumina, intermediate stage aluminum) may be involved; while not much relative to China's total metal, for lenders this is small consolation (who also worry 'where there's is smoke, there's fire). At last report there were rumours of similar problems at another port, and CITIC, China's biggest & oldest state-owned financial conglomerate, let it be known it may have money at risk in this.*

**<u>CHINA PLANS ARTIFICIAL ISLAND IN DISPUTED SPRATLEYS</u> (SCMP, Kristine Kwok)**

- Beijing plans to turn its biggest installation on the Fiery Cross Reef in the disputed Spratley Islands into an artificial island, complete with an airstrip & sea port. This could be a prelude declaring the entire South China Sea an ADIZ (Air Defense Identification Zone), as it did last year with much of the East China Sea, a move US Secretary of State John Kerry, on June 9th warned Beijing against during a visit to Manila (that is seen as an attempt to show America isn't just a 'fair weather friend' & to act as a "catalyst for change").

*According to Jin Canrong, a professor of international relations at Beijing's Renmin University plans are for an island twice the size of the 44 sq. km. of Diego Garcia, the island 1,000 miles South of the Southern tip of India the US has leased from Britain since 1973 (after its 2,000 inhabitants were 'relocated' to Mauritius & the Seychelles), & uses as a huge military base. The Spratlys are located off the Northern tip of Borneo (South across the South China Sea from the Paracel Islands where Beijing launched its drilling ship initiative initiated six weeks ago). China, Taiwan & Vietnam claim all of them, while Philippines, Malaysia & Brunei, all of whom are much closer to them, claim only parts of them. And Beijing was mightily annoyed, & called it a "clumsy farce", when on June 9th Philippine soldiers visited their counterparts on the Vietnamese-held South Cay Island in the Spratlys for a friendly soccer match, to demonstrate, according to Philippine officials, 'it was possible to have harmony despite overlapping territorial claims' (but which some take as evidence of a emerging web of anti-Chinese networks among nations in the region).*

**<u>BEIJING TAKES SOUTH CHINA SEA OIL RIG DISPUTE WITH VIETNAM TO UN</u> (SCMP)**

- On June 9th Wang Min, China's Deputy Ambassador to the UN, sent a "position paper" on its oil rig operation in the South China Sea to UN Secretary-General Ban Ki-moon, asking him to circulate it among its 193 member governments. It claims CNOOC has conducted seismic operations & well site surveys *in the contested Paracel Islands region* for over a decade, and that its drilling operation is a "continuation of the routine process of explorations, & falls within China sovereignty & jurisdiction." It accuses Vietnam of infringing on its sovereignty, illegally interrupting its drilling operations, & violating international laws, incl. the UN Convention of the Law of the Sea (*which may be a real stretch).*

*Two weeks ago the The Hague-based UN Permanent Court of Arbitration gave China until December 15th to respond to the complaint filed with it on March 30th by the Philippines* *requesting it to uphold its right to exploit the waters within its 200 mile exclusive economic zone (which includes much of the Spratlys), in response to which China's Foreign Ministry spokesman Hong Lei issued a statement on June 3rd saying "China's position that it will not accept, or participate in, the tribunal case involving the Philippines hasn't changed." While this looks like the next step in Beijing's strategy to gain control over almost the entire South China Sea, it's hard to fathom what it thinks it stands to gain by taking it to the UN as a whole.*

**INDIA FINANCE MINISTER SAYS BALANCING GROWTH & INFLATION A PRIORITY (Reuters)**

- He said on June 3rd that balancing the two was the new government's top priority & that "food inflation would be tackled through supply side measures", and that the central bank had been following a calibrated approach in this respect.

*In an article Kick-starting India in its May 17th issue, the Economist concluded "India can go in one of two directions ... watch its position in the world decline as its infrastructure lags further behind and its army of underemployed people grows. Or ... stabilise its finances and build a productive private sector that creates the jobs its young people need and turn it into a serious global power." Given Modi's track record in Gujarat State, and the conciliatory noises by the new Minister of Finance & Central Bank Governor (under the previous government fiscal & monetary policies had worked at cross purposes), the odds favour the latter. And better policy coordination is a sine qua non if Modi is to make good his election promise to get the economy on a better track than the recent high inflation/deep fiscal deficits/slowing economic growth one, & if jobs are to be created for the 10+MM new entrants to the work force **each year** (the same number as China's with its 10% greater population, where, in addition, the number is starting to wane, while India's is still waxing). The weather vane in the short run will be whether Prime Minister Modi will be able to free up money for more infrastructure spending by taking steps, no matter how tiny in the first instance, to cut the subsidies of food, fuel & fertilizer subsidies that eat up for half of the Budget; for if he can, the international financial community is likely to cut him some slack.*

**MODI GOVERNMENT OUTLINES POLICY PLANS (WSJ, Niharika Mandhana)**

- Prime Minister Modi has committed himself to easing infrastructure bottlenecks & pursue more business-friendly policies. On June 9th he expanded somewhat on this theme in the address to the Lok Sabha, the Lower House of India's Parliament, by President Pranab Mukherjee. For after noting that "We are passing through an extremely difficult phase ... Putting the economy back on track is paramount", the President outlined an ambitious plan to remedy the country's persistent shortcomings in basic infrastructure, such as water & electricity, said the government would seek to boost foreign investment, offer incentives to promote labour-intensive manufacturing & simplify tax laws, and create a universally affordable healthcare system, put toilets in every home & connect every school to the Internet (without, however, providing details as to how all this would be funded or executed, given that in the year ended last March 31st, the budget deficit was equal to 4.5% of GDP).

*Hopefully some of these promises were window dressing, especially that to 'press ahead' with futuristic investments in high-speed rail & smart cities; for if not, Modi is DOA at the start line.*

**<u>CAN RAJAN AND MODI DO WHAT ALAN GREENSPAN AND BILL CLINTON DID FOR *US* ECONOMIC GROWTH</u>?[19] (The Economic Times)**

- Only time will tell if India's new Prime Minister will be able to scale up his fabled "Gujarat Model" to revitalize Asia's No. 3 economy. But there are signs that RBI (Reserve Bank of India) Governor Rajan is extending an olive branch to the new leader (which should cheer global markets); for he seems willing to take Modi's pledge to bring down inflation at face value by holding the bank's benchmark repurchase rate at 8%, hinting he would even ease monetary policy if inflation pressures (which are largely a function of widespread inefficiency & rampant corruption, as well as a lack of infrastructure, were to wane *further*.

*They would have to follow a different path than the Geithner/Bernanke combo that did a better job creating wealth for the few than benefits for the masses.*

**<u>RUSSIAN COMPANIES PREPARE FOR TRADE IN RENMINBI</u> (CNBC, Jack Farrchy)**

- According to Pavel Teplukin, Deutsche Bank's No. 1 in Russia "Over the last few weeks there has been a significant interest in the market from large Russian companies to start using ..., and to set up accounts in, Asian currencies." And Andrei Kostin, CEO of the state-owned VTB Bank *purportedly* told Putin in a briefing that developing a system for trade settlement in roubles & yuan/*renminbi* is 'a priority on our agenda'.

*Meanwhile Andrei Belousov, a Putin economic adviser, opined "As long as Russia is not subject to systemic sanctions, ... I don't think Russia will ... bring about artificial de-dollarization."*

**<u>VENEZUELA SACRIFICES DRINKING WATER TO PAY BOND HOLDERS</u>**
**(BB, Corine Ross)**

- The country must import virtually all its consumer goods & is US$25BN in hock to its importers (about one-fifths of its estimated total indebtedness), causing people to have to stand in line for hours for drinking water & to go abroad to buy medicine. But it has been keeping up with its debt service payment obligations to its foreign bondholders (that this year are expected to amount to US$10BN, almost half its total FX reserves). So according to JPMorgan its dollar-denominated bonds, with their 10+% premium yield over UST, YTD provided holders with a 13.2% return, vs. the 8% of its benchmark portfolio). Nevertheless, the 50 year-old Economy Vice President (& *President of the state-owned oil monopoly PDVSA as well as Minister of Energy & Petroleum*) Rafael Ramirez on May 30th said "Venezuela doesn't have debt with anyone ... What we have are pending foreign-exchange liquidations, which we are reviewing."

*Venezuela is a "one-trick pony" on death row, or perhaps better, in the holding pen at the slaughterhouse. Almost all of its FX earnings, & most of its government revenues, come from oil, and the post-Chavez Maduro government is now caught in a 'vicious circle' of stable oil prices, declining oil output, rampant domestic inflation & Chavez having pre-sold a significant portion of the country's future oil production to China for cash upfront, using the money to sustain the support among the hoi polloi power base for his regime before dying. This doesn't bode well for Venezuelans but, far more importantly, poses a real risk for the system; for when*

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19 When Clinton & his then Treasury Secretary Robert Rubin got serious about balancing the Budget in return for which Greenspan went easy on interest rate hikes.

*Venezuela's house of cards collapses, the now risk-blind, short term yield-hungry holders of its bonds*[20] *will suddenly become 100% risk-averse & blindly fearful, and head for the exits, losses be damned; historically this has often been contagious & led to a more general crisis of confidence.*

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20 Ignoring the First Principle of successful investing, namely that Priority No. 1 is security **of** capital, rather than return **on** capital.