

**Quote of the week :** “We have tried spending money. We are spending more than we have ever before and it does not work. ... I say after eight years of this administration we have just as much unemployment as when we started ... And an enormous debt to boot” - Secretary Henry Morgenthau ... in 1937. *There are two interesting aspects to this. While the official unemployment rate has gone from 9.9% in November 2009 to, at last report, 5.5%, if the participation rate today were the same as it was then, the needle on the unemployment rate would barely have budged (never mind the fact that the average ‘quality’ of US jobs today is not what it was then). And secondly, & rather ironically, the architect of the situation in the US today was none other than one Ben Bernanke who in 2004, two years before becoming Fed Chairman, authored a book entitled Essays on the Great Depression which prompted Roger Lowenstein in his NYT review thereof to call him “the academic expert on how to prevent financial crises from spinning out of control.” (too bad that academic expertise often fails to produce real world results, as Greece’s Prime Minister & his Finance Minister, whose academic forte is gaming theory, are learning the hard way).*

The EU is about to require Israel to label all products made in the West Bank settlements as such. This is only the latest outward token of the world’s frustration with Israel’s building of settlements on ‘occupied lands’ as *forbidden under the Fourth Geneva Convention* & the ‘dead in the water’ peace effort. Israel says this would encourage Mahmoud Abbas not to return to the negotiation table & Netanyahu told the Herzliya Conference, the annual Israeli political & security elite clambake, last week “Why should he talk? He can get by without talking ... with an international community that blames Israel for not talking.” - *He may well be right; for why should Abbas waste his time on someone who during the recent election campaign vowed in Hebrew (so that any translation into English could be disavowed?) that, if re-elected, ‘a Palestinian state will not happen during my tenure’, and when, as Netanyahu rightly points out, he has a global public opinion tail wind. Nevertheless, such a move ought to be a concern to all pragmatic Israelis; for it illustrates how the rest of the world has become increasingly ‘tone-deaf’ where Israel is concerned.*

An internal IDF investigation, launched after a public outcry over an Israeli Air Force attack last July 16<sup>th</sup> on the port of Gaza that killed four boys aged nine to eleven playing there (& wounded four more, three of them children) cleared all those involved of any wrongdoing, with the Military Advocate General opining “the attack process ... accorded with Israeli domestic law and international law requirements.” - *While the Israeli finding was based on the ‘fact’ the area where the boys were killed had “long been known as a compound belonging to Hamas’ Naval Police and Naval Force (including naval commandos) ... utilized exclusively by militants”, the ‘facts’ according to the locals are that the port was used more by fishermen than Hamas & that it had been closed that day since the Israelis wouldn’t let the fisherman go to sea to ply their trade*

**GLEANINGS II - 619**  
**Thursday June 18<sup>th</sup>, 2015**

**MEMO TO THE FED : LET THE ECONOMY OVERHEAT (WSJ, Greg Ip)**

- On Wednesday the Fed signaled it remains on track to hike interest rates later this year. But while the unemployment rate is now at a level that in ordinary times would have justified doing so to keep the economy from overheating, these are not ordinary times. Millions of Americans that want full-time jobs have part-time ones, many unemployed aren’t counted since they’re not looking for work, & workers’ scope for getting big wage gains has been compromised; all this suggests a need for a below-5% unemployment rate for a long period of time to generate significant wage gains & get inflation higher.

*'Letting her rip' seems like a 'doubling down' on what increasingly looks to have been a failed economic/financial policy approach. The contrary view is that of Michael Arone, Chief Investment Strategist at Boston-based State Street Global Advisers (that, with AUM North of US\$2.5TR is one of the world's largest money managers), who in a note to clients Why the Federal Reserve Needs to Bury the Ghost of 1937 (when the Fed is believed to have choked off an incipient recovery by tightening too soon) argued there is more risk in starting tightening too late than in doing so too early (Ip is a Carleton U. alum. In 1996 joined the Journal as a reporter, in 2004 moved to The Economist & last January rejoined the Journal as its chief economic commentator); while appreciating the two approach the issue from diametrically opposing perspectives, Arone from a right-of-centre market-, & Ip from a left-of-centre social-, one, the odds tend to favour those who must live by his wits over salaried scribes.*

### **TOP CHINESE GENERAL TELLS U.S. SEA DISPUTE SHOULDN'T HINDER TIES** **(Bloomberg, David Tweed)**

- General Fan Changlong is second to President Xi Jinping on China's Central Military Commission. After visiting military bases in California & Texas, and the aircraft carrier USS Ronald Reagan (that is to be deployed to Japan & *must have made China's first carrier look like a scow*), he met Defense Secretary Ashton Carter in Washington on June 11<sup>th</sup> (*at his invitation*) & was to meet with White House National Security Adviser Susan Rice the next day. When Carter stressed the US desire for China to end its land-reclamation activities in the South China Sea, Gen. Fan in return urged him to reduce the US' "maritime and airspace activities<sup>1</sup>" in the area, described the South China Sea situation as "just one episode in Sino-US relations", & waxed eloquent in saying "China and the US should climb high and gaze far ... If you look from afar, big waves appear small. If you look from high, the ocean seems peaceful".

*He reminds one a bit of the Japanese Ambassador in Washington who in 1941 kept prattling about peace, while full well knowing that the attack on Pearl Harbour was 'on', Having said that his visit was also in preparation for Xi Jinping's first official visit to the US/Washington in September (his get-together with Obama in California two years ago now having been relegated to the status of "an informal summit").*

### **CLINTON CAMPAIGN SAID TO BE 'DISCONNECTED' (G&M, Rachele Younglai)**

- Her campaign is tightly controlled. She has held just one news conference since she announced her bid in a Web video & engaged only in choreographed chats with voters, causing one major Democratic fundraiser to observe "It feels like a campaign ... disconnected with voters and activists." This is supposedly the doing of her campaign manager, 35 year-old Robert Mook, whose claim to fame is getting an unpopular Democrat elected governor of Virginia, & personal style is low key, disciplined & frugal.
- But the Clinton Foundation has become (& *will remain?*) an issue for accepting donations from governments she dealt with as Secretary of State & businesses that could benefit from the Clintons contacts around the world. And so has, & will, her wealth

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<sup>1</sup> Beijing was mightily upset last month after a US Navy P8-A Poseidon surveillance aircraft, with a CNN camera crew aboard, entered the airspace near its land reclamation project on the Spratly Islands' Fiery Cross Reef (that is 740 miles from the nearest Chinese landfall). When the locals sent a message to the aircraft in English, & *in the clear*, "this is the Chinese navy ... Please go away ... to avoid a misunderstanding" (*i.e. risk being shot down*), the aircraft responded to this, & seven other similar messages, by telling them 'it was flying in international airspace'.

- Bill & she in the past year 'earned' US\$30MM from making speeches, overshadowing her *claims of* modest beginnings & her message she will champion average Americans.
- While she has embraced one top liberal cause, providing a path to citizenship for millions of illegal immigrants, she has been silent on union demands to reject the TPP, and on Wall Street reform & the Keystone pipeline. And while in 2008 she sought to show she was as good as any man, she now plays up being a grandmother & tweets on women's issues. But, says Larry Sabato, Director of the University of Virginia's Center for Politics, if you want to win elections "You cannot isolate yourself from the press and ... from real voters who have not been vetted and handpicked".

*This is still early days, timing is everything & if Mook is as disciplined as claimed, this is part of a plan. But at some point her age will become an issue; for at election time she will be 69. And the latest polls suggest she is only modestly outdrawing all Republican Presidential hopefuls, which makes one wonder if she is preordained to always be a bridesmaid, never the bride.*

### **CALIFORNIA FARMERS ORDERED TO SAVE WATER (AP, Fenit Nirappil)**

- The drought has forced the State Water Resources Control Board to order farmers & others with some of the strongest 'water rights' to stop pumping from Sacramento-, San Joaquin-, & Delta-, watersheds. This applies to 114 entities & individuals whose water rights date back to 1903 & follows earlier water curtailments for municipalities & farmers with less iron-clad rights, and will boost the number of those forced to tap ground water (*from ever greater depths at an ever greater cost at ever-more long-term consequences*), buy increasingly costly water, use stored water, or go dry.
- Not since 1977 (*when the state had 22MM, not 39MM, people*) has the Board made senior water rights holders stop pumping & these the most extreme cuts ever imposed on them. And the regulators warn there may still more cuts to come, & Caren Trgovcich, the Board's Chief Deputy Director that "We are now at the point where demand in our system is outstripping supply for even the most senior water rights holders."

*California's water rights law was originally based on the Common Law 'riparian rights' concept, i.e. anyone with water flowing through, or by, his land can use/divert some of it for his own use, which is not 21<sup>st</sup> century-compatible & even then was better suited to rainy England with flowing water everywhere than to semi-arid California. Then in 1914 the State created the State Water Resources Control Board to register all new water rights claims on a first come, first served basis, but grandfathering all previous water rights as far back as the 1849 Gold Rush (that in some cases had been established by just nailing a note to a tree), & made this official by a clause in the Board's charter stating its jurisdiction extended only to permits issued by it (although other statutes have since expanded this somewhat). So now some holders of older water rights are talking of suing the Board to enforce the first come, first served principle.*

### **RICH CALIFORNIANS BALK AT LIMITS : 'WE'RE NOT ALL EQUAL WHEN IT COMES TO WATER (Chicago Tribune)**

- Rancho Santa Fe is a 3,100 inhabitant, *seven square mile*, ultra-wealthy (US\$189,000 median income) enclave of ranchettes, gated communities & country clubs in Southern California's San Diego County. In April, after Gov. Jerry Brown called for 25% less water consumption, it was the only community in the region where it actually increased (by 9%). But, as of July 1<sup>st</sup>, it faces water rationing : each household will have one allotment for basic indoor needs & another for outdoor use (at 50% of its past use). Those who exceed their allotments will see their already sky-high water bills triple &, those who

undeterred by that may have 'flow restrictors' installed (that make it difficult, for instance, to simultaneously have a shower & do laundry), and the real hard core cases could have their water cut off altogether.

- Steve Yuhas is a disabled Marine veteran & conservative talk show host who says "we didn't plan on getting a place that looks like ... an African Savannah" and "if you can pay for it, you should get all the water you want". And he fumed on social media that people "should not be forced to live on property with brown lawns, to golf on brown courses or to have to apologize for ... their gardens being beautiful ... we're not all equal when it comes to water."

*Many Californians don't agree with him, even in Rancho Santa Fe. But what may disturb people like him most is that, with green landscaping now a liability, real estate values have plummeted.*

### **IRAN POWER STRUGGLE COULD DERAIL NUCLEAR DEAL (DT, Con Coughlin)**

- The Iranian media say the Supreme Leader, 75 year-old Ayatollah Ali Khameni, has terminal prostate cancer & only months to live, and last March the 84 year-old Ayatollah Mohammed Yazdi, a hardline Khameni ally, became Head of the Assembly of Experts (that will name his successor). According to Western diplomats this has led to a succession tussle in which 54 year-old Sadeq Larijani, the Head of Iran's judicial system & younger brother of 57 year-old Ali Larijani, the Parliament's Chairman & formerly Iran's Chief Nuclear Negotiator, is positioning himself to get the job by conducting a purge of moderate ayatollahs, first & foremost Ayatollah Hashemi Shahroudi, an ally of former President Ali Akbar Hashemi Rafsanjani. And they fear that "the hardliners will be tempted to prove their revolutionary credentials by vetoing any deal with the US."

*Many locals were surprised when the Supreme Leader in August 2009 named Larijani to head the judicial system, deeming him a religious non-entity & "too inexperienced" in legal matters. And he is on the EU sanctions list for endorsing harsh punishment for those sentenced on trumped-up charges, and in 1998, when just 37, wrote "We support a society ... in which people will not demand rights from God but are conscious of their obligations to God."*

### **DESPERATE SYRIANS SURGE ACROSS TURKISH BORDER (AP, Lefteris Pitarakis)**

- On June 14<sup>th</sup>, as Syrian Kurdish fighters, supported by coalition air power, closed in on the ISIL-held strategic border town of Tal Abyad, thousands of Syrians streamed into Turkey through holes they cut in the border fence. Taken by surprise, the Turkish border troops were overwhelmed & called for reinforcements who quickly rounded up the refugees & prevented most of them from going further into Turkey. And Deputy Prime Minister Numan Kurtulmus claimed that they weren't fleeing the fighting but the coalition bombing, that his country had already taken in 2+MM refugees since 2011 & had been providing humanitarian aid to the internally displaced Syrians on their side of the border, and that "Our priority is for them to remain within their border".

*Tal Abyad is on the border and key to the flow of people & materiel from Turkey into Syria. The next day the Kurdish fighters, without much effort, drove ISIL out of the town &, their confidence boosted, headed for the ISIL stronghold of Raqqa (the capital of its caliphate), 50 miles South on the Euphrates River, which straddles cut the main transportation corridor for ISIL in Syria with their soul mates in Iraq. (which had already been compromised by the capture by Iraqi forces in late May of the border town of Husayba, further downstream on the Euphrates). Sunni rebel groups are accusing the Kurds (who may be Sunni as well but driven more by their*

*non-Arab ethnicity than by their common faith & who deem every Sunni Arab an ISIL sympathizer) of all sorts of dastardly deeds, none of the locals support the coalition bombings, & the Turkish government fears success for the Kurdish forces will increase the pressure for a Kurdish state that would include much of current Southeast Turkey (a fear reinforced by the Kurds' recent success at the ballot box?).*

### **CHINA'S UNSETTLING STOCK MARKET BOOM (NYT, Editorial)**

- China's economy may be slowing but its stock market is 'on wheels' as retail investors stampede it. What is particularly worrisome is the five-fold YoY increase in margin lending (to US\$358BN on June 15<sup>th</sup>, up 11% from May 27<sup>th</sup>). The biggest gains have been in the smaller, hitech stocks on the Shenzhen Exchange's ChiNext board (up 147% YoY) where, while the average P/E ratio for larger companies on the Shanghai Exchange is a *not unreasonable* 25x, the average P/E is 143x (with the shares of one, Leshi TV, an Internet video service, up almost 250% YoY & trading at 358x earnings).
- While government is moving to slow margin lending, it is still far too easy to borrow to buy stocks (& the new limits on how much margin lending securities firms can do still leave room for it to increase it by almost 50%<sup>2</sup>) & Beijing's moves to help the economy by lowering rates & encouraging more bank lending, could further inflate stock market prices. And while still mainly a concern for Beijing, the global risk is growing as it is made easier for foreigners to invest in Chinese stocks, to which big Western firms like Vanguard are responding by planning to add more Chinese stocks to their portfolios.
- After the last big rally in Chinese stocks, almost a decade ago, they cratered 70% in the 12 months following their October 2007 peak. And while this wiped out many small investors, it did little damage to the financial system since margin lending had been tightly restricted. But this time the risks are *potentially* bigger & broader-based.

*According to Bloomberg the capitalization of the Chinese stock market is now US\$10.TR (up 56.7% YoY), vs. US\$5TR for its Japanese-, & US\$25TR for its US-, counterparts<sup>3</sup>. One reason for this is that, with the real estate market cooling, speculators have switched venues. But the canary in the coal mine may be that corporate insider selling in May tripled MoM & that so-called 'cornerstone investors' have also started to cash in (thus even Central Huijin Investment Ltd., Beijing's vehicle for investing in the shares of the Shanghai-listed-, but still government-controlled-, 'Big Four' banks has been lightening up on its investment in the CCB (China Construction Bank) & ICBC (Commercial Bank of China)], and that between June 1<sup>st</sup> & 3<sup>rd</sup> Jia Yueting, the Founder, Chairman & CEO of aforementioned Leshi TV, acted on his May 25<sup>th</sup> announced plans to sell 148MM shares in his company (8% of the total outstanding) over the next few months to bring his holdings down to a still-controlling 36.85%, by selling 35MM shares, netting him a cool 2.5BN yuan (US\$403MM), the proceeds of which a company spokesman said he will lend back interest-free to the company (presumably on a fully-secured basis, which would be a neat-, seldom if ever before seen-, trick).*

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<sup>2</sup> Which will be further boosted by the recent US\$4.8BN IPO by Guotai Junan Securities Co., China's largest securities firm by revenue.

<sup>3</sup> So the exchanges' margin debt is 3.5% of their market cap, vs. 2.5% for the NYSE. But this number may understate reality to the extent that speculators are believed to have also begged, borrowed or stolen to the max from their families, or other non-securities firm-, sources.

## **BANK OF CHINA BECOMES FIRST ASIAN BANK TO HELP SET LONDON'S GOLD PRICE** **(The Telegraph)**

- The Bank of China will become the first Asian bank in history to join a group of Western institutions that, twice daily, sets the London benchmark price of gold under the aegis of the LBMA (London Bullion Market Association) although, according to Yu Sun, the manager of the Bank's London branch, it had "joined LBMA as an initial member in 1987, and has been actively participating in the gold trading business in London for over 40 years", adding that the inclusion of his bank should allow the gold price to better reflect supply & demand in the People's Republic, a major market for the precious metal. In so doing it brought the number of participants to eight : four of the original five, Bank of Nova Scotia, Barclays, HSBC & Société Générale (Deutsche Bank withdrew last year) & three newcomers Goldman Sachs, JPMorganChase London & UBS.
- Under the old system, introduced in 1919, the price was determined during a twice daily conference call (*but only since 2004; prior to that it had been done by representatives of the five institutions meeting in a room on the Rothschild premises*), but in the wake of the Libor rigging scandal, & allegations of hanky-panky in the gold fixing as well (in fact in May of last year Barclay's was fined £26MM by the Financial Conduct Authority for failings that had a trader attempt to manipulate the gold fix), it was decided to move to a more transparent, electronic system (that went 'live last March 20<sup>th</sup>).

*This may well be 'the camel's nose in the tent'; for Beijing has made no bones about its ambition to create its own gold price benchmarking system to compete with London's. And there are good reasons for this, apart from the demand for gold in its domestic market; for the global gold market is said to have an annual turnover of US\$18TR (i.e. about 1½ x newly mined output), while the London market last April averaged US\$20.2BN a day.*

## **OUT OF OPTIONS AND OUT OF TIME, TSIPRAS FACES GREECE'S MOMENT OF TRUTH** **(Bloomberg, Ben Sills)**

- The collapse of the Brussels talks on Sunday night (*after 45 minutes*) made the June 18<sup>th</sup> meeting of the Euro Finance Ministers the next deadline in this six year-long saga.

*In the event, the meeting did little other than to touch upon ECB concerns the Greek banks may not open on Monday - which was immediately & vehemently denied by Greece's Finance Minister -, with ECB Executive Board member Benoit Coeure, when asked for his view, answering "Tomorrow, yes, Monday I don't know" & to call for an emergency summit on Monday June 22<sup>nd</sup>, with EC Chairman, & former Polish Prime Minister, Donald Tusk saying "It is time to urgently discuss the situation in Greece at the highest political level". Meanwhile, in May government revenues were 900MM Euros (24%) below their target, in part because companies & individuals didn't file their tax returns & in part because the government in its efforts to meet its foreign debt servicing obligations has fallen behind on its domestic bills (incl. some wages & pensions), the Dutch Finance Minister cum Head of the Euro Finance Ministers' group in the post-meeting press conference called the Greek proposals too little to be credible, IMF Managing Director Christine Lagarde, after earlier having commented "we need adults in the room", said that Greece's proposals "cannot be smoke and mirrors", and Tsipras, after earlier insisting his government will never cut pensions further (a key issue for the hoi polloi in Germany) because "One can only read political motives in the creditors' insistence on new cuts to pensions after five years of plundering them", seemed to up the ante when he said "we need a mid-term solution ... to the end of 2016. A short-term solution might be the worst of all. What we don't want (is for) the economy to remain depressed ... (where) people don't have a shift in*

*expectations.” (while this may be a common sense thing to say, the loss of his government’s credibility with its creditors over the past five months has been such as to have none of them taking anything he says seriously.*

### **EL BRONCO WINS MEXICAN GOVERNOR’S RACE (NYT, Randal C. Archibold)**

- On June 7<sup>th</sup> Mexico had its midterm elections. The ruling PRI party lost some seats in Parliament’s lower house but retained a narrow majority. It also won five of the nine state governors’ races at stake, albeit two by the skin of its teeth. The higher than usual voter turnout was seen as reflecting voter frustration with the PRI, after months of scandals & sensational violence in parts of the country, and both main left-, & right-, of centre opposition parties for their inability to capitalize on its woes (with all three seen as ineffectual & corrupt). So, as Andrew Selee, a Mexico scholar at the Washington-based Woodrow Wilson Center, put it, “This election is hardly a repudiation of *President Nieto’s* government, but ... certainly not a ringing endorsement either.”
- But in Northern Mexico’s *richest & commercial/industrial powerhouse* state Nuevo Leon (*that shares a nine mile-long common border with Texas*) an independent candidate, 57 year-old Jaime Rodríguez Calderón (aka El Bronco)<sup>1</sup>, a rancher affecting cowboy boots & profane language, a 30-year PRI member until eight months ago, & the former mayor of the *Garcia* farming suburb of the state capital Monterrey, whupped his PRI opponent 49-25 in what had been expected to be a close race, despite lacking much of a platform. His success (& that of small party candidates over their major party rivals in the mayoralty races in two large cities, Cuernavaca & Guadalajara), prompted Enrique Krauze, a well-regarded political historian in Mexico to observe on Twitter “The triumph of El Bronco is a warning to the parties, renovate or die, and the presage of a citizen *presidential* candidate in 2018”, and *Federico Berrueto, Director-General of the polling firm GCE* that “*The mood in Mexico at the moment is favouring candidates or parties that are basically against everything.*”

*Voters are in a sour mood everywhere. While there had been concern how Rodrigues, if elected, could be an effective governor without party support, that was allayed by an outcome that gave the PRI 29% of the seats in the State Congress & the left-of-centre PAN 21%, with the other half spread among a host of smaller parties, four of whom with over 6% voter support.*

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<sup>1</sup> Whose anti-drug gang activities as mayor prompted two unsuccessful attempts to assassinate him by the utterly nasty Los Zetas drug cartel, supposedly Mexico’s largest (during one of which his bulletproof SUV was said to have been hit by 2,800 bullets), the abduction of his two year-old daughter, who was returned safely, & the death of his 22 year-old son in a car accident that he attributes to a failed kidnapping. Hence his campaign slogan : “One dead son, one kidnapped two-year-old daughter and 2,800 bullet holes in my truck.”.