With YTD single digit *YoY* growth in its exports despite a somewhat stronger global economy, & real estate construction weak, China's two main engines of demand seem to be sputtering; so Bloomberg economist Tom Orlik expected Second Quarter GDP growth on July 15th to come in at 6.8% annualized, down from 7.0% in the First Quarter & 7.5% in the year earlier period - *in the event, the numbers were stronger than expected across the board, with GDP growth, at 7.0% YoY, up from the 6.8% consensus, industrial output up 6.8%, vs. the 6.0% consensus & May's 6.1%, retail sales up 10.6% (vs 10.2% & May's 10.1%), and fixed investment up 11.4% (vs. 11.2% & 11.4% respectively). The downside of this was, however, that the stock market fell in the belief these numbers will cause Beijing to ease its foot on the fiscal stimulus gas pedal.*

While China's Second Quarter numbers were thus, *quite conveniently*, much better than expected, events sub rosa give credence to one serious China watcher's belief that GDP growth for all of 2015 will be in the 4-5% range (*implying a slowdown in growth in the Second Half of epic proportions*). Thus developers' land purchases were down 33.8% in the First Half, suggesting continued weakness in new construction, despite several cuts in RRRs (Reserve Requirement Rates) money is "tight", large sectors of industry are "under water", and June car sales were down 3.4%, continuing the declining trend seen in April & May when the growth in car sales had slowed from 3.7% in April to 1.2% in May [and car sales growth in July is expected to be (*a great deal?*) weaker still, due to the 'reverse wealth effect' of the stock market crash[1], with the sharp drop in visits to sales rooms deemed a harbinger thereof].

In another China-related event with potentially significant geopolitical implications Beijing is said to be about to enter, or may already have entered, into a deal with Djibouti for the development of a naval base, & possibly an airport, in that country (thereby increasing, at a time the Iran nuclear deal is seen as facilitating a possible US disengagement from the region, its capacity for pro-active involvement in the affairs of the strategic Gulf of Aden/Western Indian Ocean region) - *Djibouti is a tiny (with an area of 9,000 sq. mi., it is half again the size of Delaware, the US second-smallest state), relatively poor (US$1,600 per capita) coastal country in the Horn of Africa at the confluence of the Red Sea & Gulf of Aden that shares borders to its North with Eritrea, its West with Ethiopia & its South with Somalia. And it has since 2001 been home to the US Navy-run* Camp Lebronnier, *the only US military base (naval cum airforce) on the African continent, that is also the centerpiece of a network of six US drone-, & aerial surveillance bases in the region.*

Following the Iran nuclear deal, the NYT & Reuters had different views as to its effect on the short-term global oil supply situation. The former parroted the IEA line that years of investment neglect means Iran cannot quickly ramp production, while the latter reported NIOC (the National Iranian Oil Company) plans to do just that, quickly hike oil production to its pre-sanctions 4+MM bbld level (up from the current 3.3MM bbld.) 'if there is sufficient market demand'. Reuters may well be proven right; for Iran needs the money[2] [3], the malaise in the global oil service industry

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1 Moreover, the Chinese car market seems to be maturing, with the rate of YoY growth having declined from 19% in 2010 to 12% last year. This is due in part because of congestion-, & pollution-, driven restrictions on usage, and in part to the used car market having come into its own; for, while new car sales increased from 5MM in 2006 to 20+MM last year, used car sales went from zero to 9MM (& the number of cars scrapped from zero in 2010 to 4MM) last year.

2 And given that Iran's domestic oil consumption is about 2MM bbld, increasing output by 25% would result in a 50% increase in Iran's foreign exchange earnings from crude oil sales.

3 Although as part of the deal with the P5+1, Iran will gain access to as much as US$150BN of currently "frozen" assets abroad.

means it will be all over the Iranians to give them some work, & China may see this as an opportunity to lock up a captive source of supply. And any pressure on oil prices from more Iranian oil coming to the market will put pressure on natural gas prices, with negative consequences for LNG development & for Moscow's fiscal situation, & positive ones in the US for the use of gas in in power generation (last year, for the first time ever, natural gas generated more electricity in the US than coal).

On July 6th S&P cut Ontario's credit rating from AA-(negative) to A+ (positive), the same as *tiny and economically-, & demographically-, challenged* New Brunswick[4], on the grounds it is "a sustained and projected underperformer on its budgetary performance and debt burden versus domestic and international peers ... slow to fully roll out the spending controls and revenue measures needed to eliminate its structural operating deficit, which has caused its tax-supported debt level to approximately double since fiscal 2008" - *while its Debt-to-GDP ratio is still a relatively low 40+%, this is on the high side for a non-sovereign government issuer & an all-time high for the Province (and 2x that of the most indebted US state, Rhode Island, 4x that of fiscally-challenged Illinois, & 5x that of California (a state often portrayed as a fiscal accident waiting to happen). And in the past nine years its debt has grown at an 8% compound annual rate although, due to the super-low interest rate environment, its interest payments have grown just 27%.*

It's not hard to see why Greece's pensions have been a prime target for its creditors. For in 2012 pension payouts accounted for 17% of its GDP[5]. Pensioners used to get 96% of their working days' earnings (as much as twice the norm in other OECD countries), the 600+ classes of "at risk" workers, incl. steam-bath attendants, hairdressers, musicians playing wind instruments & TV presenters, could retire at full pension at 55 (men) & 50 (women) & the 1MM government workers (one-fifths of the work force) got bonuses of up to 100,000 Euros when they retired (after having received 14 months of pay annually during their career). Other cases of fiscal mismanagement that made the creditors see red included the 1,700 workers at an institute 'for the protection' of a lake that has been dry since 1930, official cars having as many as 50 drivers, losses of 410MM Euros by the Athens Metro & 600MM by the national railway, the average Greek family having to lay out 3,000 Euros a year in bribes & the fact that, while only 300 Athens home owners were paying the luxury tax on their swimming pools, an aerial survey counted closer to 20,000 of them (*the question of course arises as to why they did not know, or chose to ignore, all this when they lent it money)*.

Several aspects of the Greek situation have not received the media attention they deserve :

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4 So it now rates the three Westernmost provinces AAA, Manitoba AA & all the other provinces A+.

5 Up, according to the OECD, from 13% in 2009, then the fourth highest among its members [after Austria (13.5%), France (13.7%) & Italy (15.4%)], 66% in excess of the 7.8% OECD average, and well in excess of that in Germany (11.3%), the US (6.8%) & Canada (4.5%)

- Much of the chatter about Greece getting tens of billions in bailout money is loose talk. For much, if not all, of the money involved will go to service and/or repay already existing debt, i.e. will serve to bail out the lenders, not the borrowers, with far less, if any, impact on Greece's net debt position;
- In the IMF's view Greece's debt load is "unsustainable" (& it has presented the other creditors with a study proving its point). In the upcoming negotiations between the creditors & Greece, this could give rise to a serious squabble between the IMF & the other creditors when they turn to the issue of "debt restructuring". For the IMF wants to see a measure of debt forgiveness to bring the debt down to what it deems a "sustainable" level, while the others are dead set against this (because this would come 'out of their hide") & will argue that in NPV terms it makes no difference whether debt relief is provided by write-offs or by rejigging repayment terms. In a worst case scenario from a systemic risk point of view, the IMF could make good its warning on July 14th that in the absence of a write-off it may not be able to participate in the next bailout round;
- A key part of the conditionality of the bailout package will involve the transfer of 50BN Euros-worth of government-owned assets (incl. banks, airports, ports, utilities & real estate) into a free-standing entity tasked with selling them and/or managing them to profitability (*& then selling them?*)[6], with any proceeds to be split three ways : half to recapitalize the Greek banks, one quarter to pay down debt & the balance to be "reinvested in the Greek economy"). This could in time prove to be the most positive aspect of the whole deal; first because featherbedding, overstaffing & a lack of productivity have hallmarked many of these assets and will be addressed as a matter of priority, if not by the management management group, then by the new owners and secondly because any combination of GDP growth & paydown of debt could have a dramatic impact on Greece's National Debt to GDP fraction; and
- the required cut in military spending is quite appropriate since Greece spends more, as a part of its GDP, on its military than just about every other EU country, but won't go over well with the country's military (with a population one-seventh the size of Germany's, Greece's military manpower is one-third that of Germany (although there are quality differences; for Greece still has conscription & Germany doesn't, and the above comparison includes the nearly 40% reservist component of the German military).

GLEANINGS II - 623
Monday July 16th, 2015

FED HIKE MAY COME AS EARLY AS SEPTEMBER (Reuters, Jonathan Spicer)

- In a phone interview on July 10th Boston Fed President Eric Rosengren said September may be the right time to raise interest rates *for the first time since 2004*, if the US economy continues to improve & set a high hurdle to delay doing so until next year, saying : "If we do continue to get improvement in labor markets ... as early as September." He expects GDP growth to rebound in the Second Half to 2.75% & PCE (Personal Consumer Expenditure, a measure of inflation the Fed likes better than the CPI) to rise from 1.2% now to 1.3% by yearend & 1.6% by the end of 2016.

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6 Here is where Tsipras gained a small victory; for the distrust of the Greeks generally, because of their failure to fulfill previous privatization commitments, ran so deep that there was talk at one time of physically removing the management function for this entity from Greek soil, whereas, the way things stand now, it will be managed by Greek nationals on Greek soil, albeit under the supervision of the "relevant European institutions".

What is interesting about this is that he is, with the New York Fed's William Dudley, one of two outright 'doves' on the US monetary policy-setting FOMC (although this year not a voting member), & on June 1st had gone on record as saying "The conditions for beginning the tightening of monetary policy have not yet been met." Four days later Kansas Fed President Esther George, a 'hawkish' FOMC member, told her bank's 2015 Agricultural Symposium 'it was time to begin raising rates', warning that failing to do so risked the Fed repeating the mistake of 2004 when it waited too long & thereby helped inflate the 2006-2007 'bubble. And in her semi-annual testimony to the two Houses of Congress on Thursday & Friday of this week, the dovish Fed Chairman Janet Yellen is expected to tell lawmakers that the first interest rate hike since 2004 will happen this year[7]. And last but not least, on July 15th, after a speech to Mesa, Arizona Chamber of Commerce, San Francisco Fed President John Williams (who succeeded Yellen in that post & who is deemed a 'centrist' Fed Governor) told reporters that "September would be a very plausible to start lift-off." While it is true that First Quarter GDP growth was negative & the consensus is for it to have been less than stellar in the Second, the Atlanta Fed's GDPNow 'real time' GDP growth tracker on July 14th produced a 2.4% GDP forecast (after briefly hitting 2.6% during the week), there have been two months of back-to-back relatively strong job growth (254K in May & 223K in June), according to the WSJ "Much of the recent run-up in service inflation stems from the jump in rents. But service prices outside rents also are increasing. This upward trend might signal the domestic economy has less access capacity and labor market slack than is commonly assumed", home owners' equity in their homes has nearly doubled since 2011 to almost US$12TR & the annual rate of change in wages & salaries has gone from 1.6% in early 2014 to 2.5% at last report - meanwhile, the market still only seems to have 'priced in' a rate hike in, at the earliest, December.

<u>BIG OIL WORTH US$100B TO SOLAR FIRMS</u> (Bloomberg, Alex Longley)

- Traditionally oil companies have used fossil fuel-fed boilers to make the steam they must inject into oil-bearing rock formations to boost the recovery rate of the *heavy* oil there. But on July 8th Fremont, Cal.-based, GlassPoint Solar Inc. won a contract to supply one gigawatt of solar power to Royal Dutch Shell to help produce the steam it needs to produce heavy oil in Oman's Amal field[8]. It will do so by installing parabolic mirrors that will use the sun's energy to produce steam, building agricultural greenhouses over the fragile mirrors to protect them from sandstorms. According to CEO Rod MacGregor "the value of this contract is "way over US$100 billion[9], but that's just a snapshot, and it's growing very quickly ... A lot of solar companies have viewed oil and gas as an evil empire. What's going to bring the two together is fundamental economics".

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7 Perhaps the most significant sentence in her testimony before the House Financial Services Committee on July 15th came when she said "We now think the economy can not only tolerate but needs higher rates." But the greatest fireworks during the Q&A period occurred when she was attacked by Committee Chair Jeb Hensarling (R.-Texas) & other Republican members of the Committee, for having failed to comply, on the grounds the event is still under investigation by the Department of Justice & the Fed's Inspector General, with his subpoena to provide documents related to a leak from a 2012 FOMC meeting that his Committee too wants to investigate.

8 The word help is appropriate; for if the methodology used in the Company's *much smaller* plant in Kern County, Cal. is to be used here, solar power will be used to heat the water to as much as 190°F after which it will be turned into steam using a more conventional heat source.

9 This may be an exaggeration; third party sources put it at US$60BN; still it's very, very significant.

More evidence of solar power's growing importance & competitive positioning. The Company was founded in 2009, is privately-owned, employs less than 100 people & to date has raised US$87MM in three tranches, with Royal Dutch having participated in the last two. Since 2011 it has successfully operated a smaller scale commercial plant of this type in a 100 year-old field in Kern County, Cal. & since 2013 a pilot project in Oman that is said to have performed well.

<u>THE MORE THINGS CHANGE...</u> (JP, Yossi Melman)

- In 2007, a senior Israeli Cabinet Minister told senior military officers proposing Israel should do everything in its power to keep Iran from getting the bomb, that if a country wants nuclear weapons nothing will stop it, saying "I know at least one country that did it" (*referring to Israel itself?*). He told them it would be better to focus on delaying such a program to the maximum extent possible, expecting to be handsomely compensated by the US for doing so. Eight years later, when it appears only a miracle will prevent a nuclear deal *with Iran*, it's fair to say that through diplomacy, sabotage & assassinations attributed to Mossad, and demands to have sanctions imposed, Israel has managed to prevent Iran from getting the bomb, although it had lots of help in doing so.
- Another Israeli government could then have looked upon the nuclear agreement as its victory, with Iran brought to its knees and forced to sit down, negotiate & compromise on its nuclear program (as it had refused to do prior to 2013). While, when the talks started Iran may have been two-to-three months from a bomb, now the number of its centrifuges will be cut, it won't be allowed to enrich uranium beyond 3.16%, its uranium stockpile will be cut from 10 tons to 300 kg (*i.e. by 96+%*) & its *new* Arak nuclear facility will be reconfigured so as to make it unable to produce plutonium, & international inspections, while not sufficiently thorough, will be higher than before. And if Iran honours the deal, the chances of a nuclear arms race developing in the Middle East will be reduced (*thereby leaving Israel the cock of the region's nuclear walk*)[10]
- But the Netanyahu-led government has decided to take a different path. It's opposed to the agreement, any agreement. Netanyahu treid to drive a wedge between President Obama & Congress, and failed. He exaggerated the Iranian threat massivelyand he said on Monday night that Iran that Iran does not just want to achieve hegemony in the region but to control the world. He would have preferred sanctions to stay in place forever. But Israel is not the centre of the world, the others have interests of their own and sometimes don't listen to Israel, just as Israel often doesn't listen to them. The nuclear deal is far from perfect but the skies are not going to fall because of that. Israel remains the strongest & technically most advanced country in the Middle East with, according to foreign reports, an impressive nuclear arsenal *of its own*. An dthere won't be a shift in Iran's push for regional hegemony. It cannot its grip over Hezbollah & its efforts to destabilize other countries sinvce both are already in full gear.
- Only two things are sure. The military/security establishment will ask for bigger budgets, & Israel will ask the US to pay for this (just as the Minister suggested eight years ago).

*Netanyahu decried the deal & vowed Israel won't be bound by what he called "a stunning historic mistake" (while the **real** stunning historic mistake may well have been made by the Isrealis who put him, & have kept him, in the Prime Minister's chair (the writer came to Israel*

[10] This may be delusionary if, as seems to be happening, the Iran deal is going to be taken as a green light for the US, now basking in its shale oil-driven greater energy independence, to accelerate its disengagement from the Middle East; for that would really toss the cat among the pigeons where a regional conventional & nuclear arms race is concerned.

from Poland in 1957 as a six year-old boy, is a journalist focused on intelligence & strategic issues, and considers himself 'left-wing' who, while believing that Israel should get out of the '"occupied territories", feels that the "right-of-return" is inconsistent with a two-state solution.

MARKET CRASH SIGNALS CRISIS OF FAITH IN AUTHORITARIAN SYSTEM
(G&M, Nathan VanderKlippe)

- China has lifted more people faster out of poverty than ever before. While this didn't compare with the thrills in China's stock market in the past year that had investors counting their weekly profit in the number of new Audis it would buy, when in the past month US$3TR of market value vanished, investors blamed the government, creating a crisis of trust. According to Willy Lam, a Senior Fellow at the Washington-based Jamestown Foundation[11], this has created the most serious crisis Xi Jinping has faced yet; for he says that the plummeting share prices are a sign "the economy cannot move forward without commensurate ... institutional reforms, if not political reforms".
- While the state media have blamed, among others, rumour mongers, overly excitable investors & short-selling foreign firms, Prof. Wang Fuzhong of China's Central University of Finance and Economics scoffs at this, calling it the same kind of thinking that has North Korea blaming "all of its disasters, natural or man-made, on the US." And while The Global Times, the Party mouthpiece, editorialized last week "All we need is confidence to overcome the hurdle, and only a cheerleading government can give us that", it was the government that played a leading role in creating this crisis by luring in hordes of new investors (few of whom had a clue what they were doing; a recent study found that two-thirds of them were high school drop-outs & 6% illiterate), beckoned into the market by the state media & policies that unleashed a terrific flow of new money, unaware of the fact the 2009 crash had been so deep that share prices were still below their previous highs. But Beijing was not alone in this. Thus Morgan Stanley's Jonathan Garner said late last year that the Shanghai Composite Index could go as high at 16,785 in 12 months (*i.e. increase five-fold while it recently peaked at 5,166*) & the CEO of the Hongkong Stock Exchange in May 'promised' "The party is ... here to stay."
- The key question now is what the leadership will learn from this mess. It has a vested interest in stoking the stock market; for the resultant financial gains will bail out its debt-ridden SOEs (& a national social security system that is estimated to be anywhere between US$2.6TR & US$4.0TR underfunded). Andrew Wood, an analyst with BMI Research is not optimistic, if only since Beijing's recent meddling in markets ran counter to its declaration at the Third Plenary Session *of the Party's Central Committee last November* to "would allow market forces to play a more decisive role in the economy."

But Xi is haunted by the ghost of (still alive) Gorbachev who, by seeking to loosen Party control in Russia three decades ago set a chain of events in motion that a few years later led to the Communist Party totally losing control (by the way, despite the recent collapse of Chinese stock market valuations, YTD the Shanghai Composite Index is still up 20+%).

SYRIZA SPLIT BEST OUTCOME FOR GREECE (Reuters, Hugh Dixon)

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[11] Founded in 1984 to promote the work of two prominent Soviet Bloc defectors that has since morphed into an organization that seeks to 'educate policy makers about events in societies strategically of tactically important to the US' (i.e. China, Russia, Eurasia & terrorism).

- On July 12th Prime Minister Tsipras secured parliamentary support from 251 of the 300 MPs for his U-turn on austerity & reform. But his own radical left party splintered in the process; for 15 of the 24 MP's who voted against it were members of his caucus (*& more have since threatened to quit following his lead*), And while he repeated this feat on July15, support was marginally smaller (& three of his minister failed to support him).
- Going forward, there are three options :
  - **A technocrat government** supported by the more moderate of Syriza's *current 149* MPs & those of three pro-Europe parties (*and, so far, the government's junior coalition partner*), i.e. the main opposition one , New Democracy (with 76 MPs), Potami (17MPs) & Pasok[12] (13 MPs). *Led by someone other than Tsipras it may have more credibility in the eyes of Europe's leaders but would have little, if any, legitimacy (although this could be solved by another referendum*);
  - **Another government headed by Tsipras with the same four party support**, *& pro tem the same solid majority in Parliament* but with few, if any, technocrats in it *& ministers from all four parties* - *while it would not lack legitimacy, it might be unduly depend for its survival on all MPs' desire to avoid another election & on all parties' current state of disarray (incl. the New Democracy party whose leader, Tsipras' predecessor Antonis Samaras, resigned on the night of the referendum, whose absence will make its easier for Tsipras to bend it to his will, but whose presence would have given it more credibility in the creditors' eyes; and*
  - **Another election**. The drawback of this is that it would require more life support for Greece's banks until after the elections could be held & a government be formed - *None of the MPs want an election & neither do the European leaders, in part out of concern that Tsipras would once again come out on top, since he remains personally popular (although the three pro-European parties have been talking about having a joint list in such an election that could give him a run for his money, having won 106 seats between them in the January election vs. Syriza's 99; the fact that he ended up with 149 seats, only two short of a majority, was due to the fact that as the party with the biggest share of the popular vote Syriza got 50 "bonus seats" in the 300-member Parliament).*

For the moment, option No.2, a crypto government of national unity looks like the way forward.

[12] A left-of-centre party that has been blamed for much of Greece's troubles today by a) founding the welfare state during its first term in office (1981-1985), b) cooking its books to qualify for Eurozone membership during its second (1993-2004) & c) mismanaging the early years of the global financial during its third (2009-2011).