

GLEANINGS II - 796
Thursday February 7th, 2019

Canadian housing market starting to ‘tank’? The Bank of Canada reported that in December the banks’ mortgage portfolios had grown to \$1.55TR (*roughly 91% of GDP*), up just 1.3% YoY, the slowest YoY rate of growth since May 2001. ¹ In Vancouver the number of unit sales in January was down 39.3% YoY & 36.3% off the ten-year average. Detached house prices were down 9.1% YoY to \$1,453,000², attached houses/duplexes 0.3% to \$800,600 & condos 1.7% YoY to \$658,600. Meanwhile in Edmonton the volume of detached houses sold was down 14.34%, & their price down 6.04% to \$404,275, while the declines for condos were 18.56% & 4.90% & for duplexes & rowhouses 1.02% and 7.51% respectively. This came after the CREA (Canadian Real Estate Association), that represents Canada’s 125,000 real estate agents, in mid-December had forecast that in 2019 national unit sales would be down just 0.5% to a nine-year low 456,200 units (& the average price up 1.7% to \$496,800) which would be a vast improvement over last year’s 11.2% unit decline to 458,200. Ottawa’s ‘mortgage stress tests’ introduced last year (that require mortgage applicants to have the ability to afford their mortgage even if rates were 200 bps over those currently quoted) have been criticized for making it harder for Canadians to buy a home; so it’s not surprising that at a February 5th lunchtime speech to the Canadian Economic Club in Toronto, Carolyn Rogers, the Assistant Superintendent of Financial Institutions in Ottawa, sought to rebut such criticism by telling her audience “It’s simply prudent. It’s prudent for the banks and ... for the borrower.” ³

Crown Prince Mohammed’s ‘goose cooked’? - The NYT reported this week that in January 2017, i.e. 18 months before the event, the CIA had intercepted a phone call in which he told someone Khashoggi had to be lured, or forced, back home and, if impossible, a bullet would do - *This may prove problematic for the White House that has ignored the CIA assessment Mohammed had ordered Khashoggi’s killing & maintaining he hadn’t been involved - the delay in reporting this may be due to the fact that the intelligence agencies amass such huge volumes of data that they must “warehouse” much of it until the need arises to search for a specific item.*

Last year’s G-7 Summit in Canada - This two-day June 8th- 9th event cost Ottawa \$600MM, incl. \$12.7MM for car rentals (plus another 4.7MM for car rentals by the Department of Foreign Affairs). Of the total \$222MM was spent by the RCMP, incl. \$23MM for the purchase of 631 cars (of which it resold 509 within months, through a government surplus website, for \$17.5MM, a *claimed 90% cost recovery of their original cost*).

Terrorists in Suits - On February 3rd the Israeli Ministry of Strategic Affairs and Public Diplomacy, seeking to “remove the mask” of NGOs promoting *the anti-Israel* BDS (Boycott, Divestment and Sanctions) movement, made public a report with that title to show the true nature thereof by revealing over 100 links between Hamas & the Popular Front for the

¹ Partly due to the fact that the mortgage stress tests the banks must now apply are driving some (*less creditworthy*) mortgage seekers into the arms of non-bank lenders (which could have drastic consequences down the road, since history has taught that mortgages contracted in the late stage of an economic boom, tend to have the highest failure rate.

² In part due to the fact that Chinese interest in ‘trophy’ houses in Vancouver to get their money out of China has all but entirely dried up.

³ Might one simple way to make the stress tests unnecessary, & reduce the cost of mortgage lending, be to simply outlaw floating rate mortgages?

Liberation of Palestine (PFLP), both of them “internationally recognized terrorist organizations” (although not by all Western nations, while some Asian ones even deem the former to be the legitimate government of the Gaza Strip), and 13 anti-Israel BDS-promoting/supporting NGOs - The entire report can be googled.

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US BANKS CUT STAFF, LOANED LESS AFTER TAX WINDFALL (Bloomberg, Ben Foldy)

- Based on a review of *last year's* financial results of the 23 banks the Fed deems most important to the economy, the Republican 2017 tax overhaul enabled them to save US\$21BN on their taxes (more than twice the FBI-, & almost twice the IRS-, budgets & more than NASA's budget request for this year), as their effective tax rate dropped to below 19% from 2016's 28% (while the six largest banks' aggregate profit for the first time ever exceeded US\$120BN, i.e. roughly 0.6% of GDP). While they had vowed to reward employees, help needed communities & support small businesses, they boosted dividend payouts & share buybacks by 23% but cut thousands of jobs⁴ (& plan to cut more) & in 2018 had their loan portfolios grow just 2.3%, well down from 3.6% YoY.

This is a long way from President Trump's claim in his State of the Nation address that his administration had achieved a “massive tax cut for working families”. But the slowdown in loan growth may not be entirely the banks' fault; for there have been reports of loan demand being ‘anemic’, despite the still relatively low interest rate levels & the “buoyant” economy.

EXPERIENCING AN UNSUSTAINABLE BUBBLE (Forbes, Jesse Colombo)

- Since the dark days of the Great Recession America has experienced one of the most powerful household wealth booms in history, it having grown by US\$46TR (83%) to an all-time high US\$100.8TR (i.e. close to 5x GDP). According to BEA/Fed, during the dot.com bubble in the late 1990s on an inflation-adjusted basis household wealth grew by 75% in five years, in the housing bubble of the first decade of this century in six years by 56% & in the current, what the writer calls, the “Everything” bubble, by 86% in ten years. So in the first household Net Worth peaked at 429% of GDP & the second at 473%, while at the time of writing, last May, household Net Worth was 505% of GDP. This led the writer to conclude that “the coming reversion or bust is going to be even worse than the last two, unfortunately.”

In light of this it's ironic that a Fed survey of 12,000 people nationwide conducted in November & December, 2017 found that 40% didn't have the financial wherewithal to meet a US\$400 emergency without having to sell something or to borrow - The writer is 33 years of age, his daytime job is that of an analyst with Houston-based Clarity Financial LLC, an investment management firm with AUM of US\$275MM from some 800 high net worth individuals, and has a large following on his website & in the social media (in part because 11 years ago he had foreseen the US housing market collapse).

US ECONOMY CREATED 304,000 JOBS IN JANUARY (Politico, Ian Kullgren)

⁴ Thus Bank of America announced US\$1,000 bonuses for its 145,000 employees & Wells Fargo boosted its minimum wage to US\$15, only to promptly cut their staff by 4,900 & 4,000 respectively.

- Economic growth is *said to be* “strikingly robust” despite the China trade war & the 35 day government shutdown (suggesting to some the latter didn’t much slow down economic growth). Job growth was up from a revised estimate of 222,000 in December. And average hourly earnings were up 3.2% YoY, although the unemployment rate was, marginally, up by 0.1%, to 4.0%. This prompted Labor Secretary Alexander Acosta to tweet “January’s #JobsReport demonstrated the strength of the American economy ... as private sector job creation continued to surge despite the partial government shutdown”.

Are Acosta (& White House Economic Adviser Larry Kudlow) looking at the economy through rose-coloured glasses? For, while the Fed is said to have turned more ‘dovish’, it may have done so for the wrong (political) reasons, i.e. to avoid being publicly pilloried by President Trump. According to the BLS “core” inflation rate last March pierced the Fed’s 2% target by hitting 2.2%, peaked at 2.4% in July & ended the year in December back at 2.2%, while according to the St. Louis Fed “core” PCE, in the year ended last November had been up 4.7% YoY. The 222,000 December job creation number quoted above was well down from the initially reported 312,000. On February 1st the Atlanta Fed cut its concurrent 2019 GDPNow reading to 2.5%, from 2.8% in mid-January & 3.0% a month before (although on the 5th it upped it again to 2.7%). And the 3.2% growth in average hourly earnings cannot help but in due course give rise to ‘cost-push’ inflation, unless companies were prepared to “eat” some of their resultant higher staff costs (resulting in slower earnings growth & less market euphoria?). Finally, if the US dollar were, as is generally expected, to weaken over the next couple of years, this would also give rise to more upward inflationary ‘push’ from higher import costs although it could help prop up US stock prices (because these days a significant share of US corporate profits is generated abroad). Last but not least, while the inflationary effect of the Fed’s balance sheet expansion was muted by a decline in the velocity of money, that trend has been reversed, albeit so far only marginally (although Newton’s first law of motion says that “a body in motion stays in motion”, unless an external force comes into effect, which in this case does not seem likely).

NO RATE HIKES IN 2019 AS FED BECOMES MORE DOVISH (Yahoo Finance)

- At its first meeting this year, on January 29th-30th, the FOMC voted unanimously to maintain its 2.25-2.50% target range. And it drastically changed the language of its post-meeting statement from that after its December 18th-19th meeting by a) replacing its language re. future rate hikes from “being consistent with its goals” to “viewing an accomplishment of its goals as the most likely current outcome”, b) adding the word “patient” to future rate hikes & removing language related to the risk outlook remaining “roughly balanced” and c) adding that it would be willing to “adjust the run-off of its balance sheet⁵ ... in response to changing conditions & that its appropriate size likely would be larger than the just under US\$1TR of 2007.”

Under Bernanke & Yellen⁶ the Fed ‘painted itself into a corner’. For between 2009 & 2017 QE caused the size of its balance sheet to quintuple from US\$900BN to US\$4.5TR, i.e. from 6.3%-, to 24.9%-, of GDP, the inflationary effect whereof was muted by the velocity of money declining. And in the past year, the Fed reduced its balance sheet size by just US\$500BN (i.e. from 24.9%-, to 19.3% of GDP).

⁵ Now down to just over US\$4TR, from roughly US\$4.5TR.

⁶ Whom one Wall Streeter once referred to as an “extreme Keynesian on steroids”

ALMOST HALF THE VOTERS ARE DEAD SET AGAINST VOTING FOR TRUMP
(FiveThirtyEight, Geoffrey Skelley)

- When, in a WP/ABC News survey, roughly 600 days before the next presidential election, respondents were asked if, *next time around*, they would definitely vote-, consider voting-, or definitely not vote-, for Trump, 56% chose the latter option. Morning Consult posed a similar question to a different group of people with a similar result : 8% percent said they would “probably”-, & 47% that they would “definitely”-, vote for someone else. While this outcome was not all that different from what voters had said about Obama in 2012 when 51% said they would “probably” not vote for him (& he got still re-elected), in Trump’s case the percentage of those who said that would “definitely” not vote for him is much higher than Obama’s was in 2012.

In other recent polls only 31% said they would “strongly” or “somewhat” support another government shutdown, 64% disagreed with Trump’s idea there is a “national emergency on the Mexico border & 63% disapproved of his handling of the country’s foreign policy. And his approval rating has slipped from 43% to 39%, and in Michigan, where in 2016 he beat Hillary by just 0.2% of the popular vote (i.e. by 47.50-47.27), he is trailing all four of the more likely Democrats he might face 21 months hence : Joe Biden 40-53, Kamala Harris 42-47, Bernie Sanders 41-52 and Elizabeth Warren 43-46. And what may be more important is that signs are growing that more Republican ‘prominenti” have had it “up to here” with him & have begun to worry about his impact on their party’s 2020 election prospects.

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Trump’s State of the Union Speech - To give credit where credit is due, it was well written⁷ & delivered (with him seemingly sticking mostly to his Teleprompter text), and beautifully choreographed, with Trump doing a great job of using his twenty or so human ‘props’ (incl. the D-day-, & Dachau-, survivors & liberator, & the 12 year-old girl brain cancer survivor) whose life stories had been well researched. But the whole atmosphere was more that of a campaign rally, complete with almost endless standing ovations & some mindless braying of “USA, USA”, than of an august affair of state. ‘Talking the talk’ is always the easy-, & ‘walking the walk’ the hard-, part, and there is nothing in Trump’s Presidential track record (except as regards ‘The Wall’) to suggest he would meet the “walking” challenge. And what was interesting was that only four Supreme Court Justices (all of them ‘conservative’) attended, who, while sitting in the front row directly in front of him, seldom, if ever, joined the most blue-suited male attendees in their standing ovations, and that the Armed Forces brass in the front row to Trump’s right mostly sat there like a bunch of wooden cigar shop Indians, even when Trump bragged about how much better the Armed Forces were now funded. And what was most fascinating was that Senate Majority Leader Mitch McConnell, half a dozen rows up on the aisle straight in front of Trump, only perfunctorily participated in the applauding, with the same, if not more so, applicable to his wife, Transportation Secretary Elaine Lan Chao (in the front row to Trump’s left). Among the more interesting parts of his speech, apart from the observation by a commentator that five of the Cabinet members are so on an “acting” basis only (i.e. have not been confirmed by the Senate) because that way they are “more beholden to him?”, were the following :

- “I am willing to work with you to achieve a ‘historic breakthrough’ ... we are not two parties, but one nation ... our agenda is of the American people ... put Americans’

⁷ And seemed to validate rumours earlier in the day he had not found it aggressively enough anti-Democratic.

- interest first ... victory is winning for our country ... tonight I ask you to choose greatness”, *all of them totally out of character*;
- “Five million Americans lifted off food stamps”⁸ - *while Breitbart wasted no time seeking to verify this number, his “5MM” was due to a favourable timing choice; for the statistics of the Department of Agriculture, that administers the SNAP program, show that in September 2017 42,489,337 Americans were in receipt of food stamps while in October 2017 that jumped to 45,628,213, only to drop again to 41,577,017 in November & then gradually decline to 38,577,141 in September 2018, the last month of record) - this appears due to the fact that, while from February to September 2017 the number of households in receipt of food stamps was steady in the 20-21MM range, in October 2017 it jumped to 22+MM, only to subside again the very next month to 20MM (since when steadily been in the 19+MM range);*
 - He bragged that during his tenure the rate of GDP growth had :nearly doubled. While this was correct in a way since it had been 1.8% in both 4Q/16 & 1Q/17 and in 3Q/18 3.5%, the latter number is now five months out of date, and in last year’s final quarter is expected to have been 2.8% & in the current quarter 2.5%;
 - “Our economy is the envy of the world” - *while many of the literally dozens of countries whose GDP is growing much faster than that of the US by his definition are “sh**hole” countries, they also include India (current growth rate 7.4%), Ghana (7.6%), China (6.2%), Indonesia (5.2%) & Ireland (4.0%) that between them have 10x the population of the US & 86% of its GDP (in current US dollar terms & a great deal more on a ‘purchasing power parity’ basis);*
 - “the economy is thriving as never before” : *last year US GDP growth was up 3.0% YoY & this year is expected to do so at 2.5%. But, while there have been no years since 2005 in which GDP grew by more than 3.0%, in the 15 years before there were a plethora of them, incl. 2005 (3.3%), 2004 (3.8%), 2000 (4.1%), 1999 (4.7%), 1998 (4.5%), 1997 (4.5%), 1996 (3.8%), 1994 (4.0%), and 1992 (3.6%);*
 - “I will get it built”, even if it (The Wall) may only may be a “see-through steel” one - *what was possibly more significant was his seeming concession that it would be built in places selected by the Border Patrol on the basis of where it was be most needed (rather than from sea to sea?). And the Democrats on the bipartisan committee appear to have sought to tempt the President by agreeing to include in its proposal US\$2TR (up from US\$1.3TR last May) for “barriers” along the US-Mexican border; and*
 - “Drug prices have had the single largest decline in 46 years” - *The Kaiser Foundation’s Rabah Kamal, Cynthia Cox & Daniel Mc Dermott may beg to differ; for in their December 18th, 2018 article entitled “What are the recent and forecasted trends in prescription drugs”, there was one chart that showed that their prices had declined three times in the past decade, by 0.7% in 2010, 0.6% in 2012 & 0.3% in 2017 but were expected to have gone up by 5.8% in 2018.*

VENEZUELA : THE RISE AND FALL OF A PETROSTATE

(Council on Foreign Relations, Roccio Cara Labrador)

- Home to the world’s largest oil reserves, it is a case study of the perils of petrostatehood. Petrostates have three attributes :

⁸ The decline in their number had actually started in the latter Obama years as the recovery from the Great Recession gained momentum.

- government income is deeply reliant on the export of oil & gas;
- economic & political power is highly concentrated in an elite minority; and
- political institutions are weak & unaccountable, and corruption is widespread.
- In their initial stage petrostates attract large flows of foreign capital which strengthens their currency and, by making imported goods cheaper, destroy labour-intensive domestic industries like agriculture & basic manufacturing as a result of which their economies develop an unhealthy dependence on imported consumer goods and a vulnerability to fluctuating oil prices & to potential capital flight.
- Some indicators tell Venezuela's story :
 - oil sales account for 98% of export earnings and 50% of GDP;
 - oil output has been declining for ages : it peaked in 1998 at 3.5MM bbls, as recently as 2013 was still 2.9MM bbls and at last report was 1.15MM bbls;
 - its GDP has now shrunk by double digits for three years & *is expected to continue shrinking to the point where by 2022 it will be 66% less than in 2015*;
 - it has missed billions of dollars of debt service payments since it defaulted in 2017;
 - annual inflation is in the 80,000% range; and
 - as things have gotten worse, President Maduro has become more autocratic.
- Maduro's survival depends on the continued support of three critical allies, Russia, China & Cuba : **Russia's** dates back to a 2006 US\$2.6BN arms deal with the then Venezuelan president Hugo Chavez for jet fighter aircraft (to be paid for by oil at discount prices), since followed by a further US\$10BN in arms sales. Russia also helped Maduro out in late 2017, acting as a lender of last resort by rescheduling US\$3BN of its debt so that he could meet its debt servicing obligations to others. A couple of years before Chavez died in 2013 **China** loaned him US\$70BN to be paid for by oil deliveries (China is the third largest market for its heavy oil, after the US & India) again at a discounted price (of which the residual still outstanding is estimated to be US\$13BN that President Xi has refused to "reschedule". And he has been wary of Maduro defaulting and, as a result, has been talking to the opposition & would likely shift his support to the Guaido side if guaranteed full repayment) (*If he worries about the repayment of such a relatively picayune amount, might this say something about China's financial situation?*). And **Cuba** has long been Venezuela's strongest supporter, supplying Maduro with intelligence & counter-intelligence personnel for both internal-, & external purposes & since 2000 with doctors, nurses, teachers engineers & other professionals in exchange for discount-priced oil to the point that there are now 15,000 Cubans resident in Venezuela.
- Time line for Venezuela's descent into having 90% of its citizens live in extreme poverty & most of the remaining 10% having fled to neighbouring countries (thereby creating a major humanitarian crisis & stressing foreign relations in the region) :

- In 1973/74 the five months OPEC embargo (*that ended in March 1974*) of countries backing Israel in the October 6th to 25th Yom Kippur War quadrupled the price of oil (from US\$3 to US\$12 in little over a year) ⁹ and made Venezuela *suddenly* the country with the highest per capita income in Latin America, prompting rampant graft & *public* mismanagement (it has been estimated that in the 25 years to 1997 US\$100BN was embezzled).
- In 1976 the then President Carlos Andres Perez nationalized the oil industry & created PDVSA as the national oil company. In the 1980s, when there was an oil glut & oil prices plummeted (*from US\$35 in 1980 to less than US\$10 in 1986*), Venezuela's economy contracted, inflation soared and the country amassed massive foreign debt by purchasing refineries (incl. Houston-based Citgo), requiring an IMF bailout.
- In 1992 Hugo Chavez, then a middle level Army officer, launched a coup that failed but that made his name & led to him being voted in as President in 1998 on a socialist platform pledging to reduce poverty & inequality. While he did reduce the poverty rate by 20%, it also led to a decline in oil production (from 3.5MM bbl/d in 1998 to 1.5MM bbl/d in 2013, the year of his death, & to 1.15MM bbl/d at last report) by firing hundreds of experienced PDVSA employees after they had gone on strike in 2002 and by selling oil at discount prices to countries in the region, first & foremost Cuba (*and raping the PDVSA's cash flow to support the budget (so that it lacked money to spend on infrastructure maintenance & on exploration & development, the bread & butter of sustainable oil production?)*)
- By his death in 2013 reserves had declined & the national debt doubled. This paved the way for Maduro who has so far ended term limits, taken control of the Supreme Court, harassed the press & closed independent outlets, and nationalized hundreds of private businesses & foreign assets, incl. those of ExxonMobil & ConocoPhillips.

Trump recently spearheaded a move to recognize Juan Guaido, since January 5th the President of the opposition-controlled National Assembly (that Maduro two years ago had replaced with a "Constituent Assembly" of party yes-sayers) as the country's 'legitimate' President, in which he has since been joined by Canada, the EU, the OAS, the Lima Group ¹⁰ & Australia, but not by China, South Africa, Cuba, Egypt, Syria, Turkey & others of the same ilk. The key issue is the outcome of the May 2018 elections in which Maduro got 67.84% 'voter support' despite the fact that in the four months prior he had gotten over 50% support in only two of twenty polls, and in one poll as little as 13.7% . And in a way Guaido is right, for under the Venezuelan Constitution the President of the National Assembly is second in line to the President. And if things don't improve soon, the lack of food is so severe for so long that Venezuelans must "loot or starve" and soon Maduro will preside over a charnel house of dead bodies.

⁹ I was at an OECD meeting in Paris in February 1973 at which a staff paper forecast the price of oil (that had been in the US\$2.50- US\$3.00 range for 25 years) could hit US\$10 by the end of the decade and was all but laughed out of the room & accused of having been 'high' on something when they composed it, after which it hit US\$12 thirteen months later & US\$37 by the end of the decade.

¹⁰ It was established in August 2017 in Lima by representatives of 12 nations (Argentina, Brazil, Canada, Chile, Columbia, Costa Rica, Guatemala, Honduras, Mexico, Panama, Paraguay & Peru) with the goal of bringing the Venezuelan crisis to a peaceful end.