

Quote of the week : “The Federal Reserve policy of holding rates too low for too long in the middle of the last decade clearly helped create the environment for the housing bubble and the distortions in the financial markets that were at the root of the Great Recession. The Federal Reserve is once again making the mistake of leaving rates too low for too long and bringing about distortions that are creating bubbles all over the world, especially in the emerging markets.” - John Mauldin (*central bankers’ attempts at ‘fine-tuning’ economies have over the years at best only had mediocre results; for central bankers are not endowed with ‘second vision’, and as bureaucrats are more comfortable in a crowd than being contrarian, & as human beings always able to find reasons why “this is not a good time” to do whatever needs to be done. And, what is perhaps most worrisome is that since the start of the Great Recession, the Fed has deep-sixed the central bankers’ traditional sense of collegiality & made it clear to its foreign counterparts that the impact of its actions on them is none of its concern.*

Robert Fulks is Pressure Pump Director of Switzerland-based-, but Houston-headquartered-, Weatherford International Plc, the world’s No. 4 purveyor of oilfield services. On April 22nd, at the 34th Annual Conference of CERAWEEK, purportedly the “premier annual gathering of energy industry leaders-, experts-, government officials-, & policy makers”, in Houston, he told an interviewer that half the 41 *surviving* companies (*down from 61 on January 1, 2014*) providing hydraulic fracking services in the US will either “be dead or sold by year end” - *almost coincidental with this, Weatherford announced it was hiking the number of employees in its 56,000 global work force to be let go from the earlier announced 8,000 to 10,000, thereby bringing the total number of employees the four largest oilfield service providers in the world plan to lay off to 49,500.*

On June 6th the Union Pearson Express will officially go into service in Toronto. It will connect the downtown Union Station with the Pearson International Airport, take only 25 minutes platform-to-platform (even in rush hour), operate on a 15-minute schedule 19½ hours a day, cost \$27.50 one-way (*half the current cab fare*), take 1.2MM car trips off the road in its first year & by 2018 carry 2.35MM passengers - *this has to be a further blow to the ‘value’ of Toronto taxi licenses, the price of which slumped from \$360,000 to \$100,000 in the two years ended mid-2014. While some have blamed Uber, the real reason likely is the City Council move in February 2014 to ease out all existing ‘plates’ by 2024 & replace them with new ones requiring holders to drive the taxi him-, or her-, self for at least 167 hours a month, thus ending the present system whereby a small number of individuals hold many cab licenses that they rent out drivers at rates that give them double digit net returns on their investment & significant (paper) capital gains, and constitute an important pressure group agitating for higher taxi fares that then ‘justify’ higher rental rates & impart a higher value to their plates.*

The Chinese stock market is “on wheels”; somehow this is hard to reconcile with the fact that its cement production in February was **down** 13% YoY while a year earlier it had been **up** 17% YoY (*i.e. it was below its two year-earlier level*) & that the IMF forecast of China’s GDP growth in 2016 is 6.3%, down from 6.8% this year, the inverse of what it expects for GDP growth in the emerging markets as whole (that it expects to rise from 4.3% this-, to 4.7% next-, year).

In a recent interview the former UK Chancellor of the Exchequer (from 1983-1989 under Prime Minister Margaret Thatcher), Nigel Lawson, told the WSJ’s Simon Constable, that he was not worried about deflation & that the Man in the Street actually likes the lower prices, that he was happy that Britain had stayed out of the Euro, the introduction of which had been a politically-, not economically-, driven move, & that the Euro now needs “an orderly dissolution”.

The *usually left-leaning* Guardian newspaper believes the kingmaker in the May 7th UK elections may well be the very Scottish National Party that last year lost the independence vote but support for which has surged to the point where polls suggest it may get 50 of Scotland's 59 seats (while in 2010 it got six & never has had more than 11) - *Most, if not all, of these will, however, come out of Labour's hide. While the experts are said to be 'puzzled' by this seeming resurrection from the dead, the answer seems simple : why "buy the cow, if you can get the milk through the fence". Independence would have been a scary big step, like leaving home for the first time, that would have given up the security of the British welfare system at a time that the primary source of Scottish wellbeing in recent decades, the oil & gas industry, seems in dire straits, while bloc voting within the existing system could pay off big-time (just ask Quebeckers).*

The Klagenfurt-based Hypo Group Alpe Adria (HGA) was Austria's fifth-largest bank operating not just in Austria but also in Germany, many of Yugoslavia's successor states, Bulgaria, Hungary & Ukraine. In 2009 it was nationalized by the Austrian state of Carpathia to avoid its collapse, with taxpayers taking a big hit. About a year ago, it was split into three separate entities, a Balkan unit (that is in the process of being sold), an Italian unit, & a "bad bank" called the HETA Resolution AG, the assets of which were to be liquidated over time as things got better. But on March 1st things got infinitely worse when the Financial Market Authority of Austria reported HETA had a capital deficiency of not just of 4BN Euros as had been earlier believed (on an 18BN Euro balance sheet) but one almost twice that large (7.6BN Euros)¹ & imposed a tear-long moratorium on all its debt service payments & principal repayments. One problem is that in setting up Heta Carinthia provided guarantees far in excess of its annual 2.7BN Euro budget. Another that the Austrian government doesn't want to get involved for fear of damaging its credit rating (while Moody's still rates it Aaa, S&P has had a AA+ rating for it for some time, & on February 15th Fitch cut its rating from AAA to AA+). And, finally, there has been talk that the eventual outcome will involve the first-ever case of a "bail-in" (when even secured creditors must take a "haircut" before taxpayers will step in), which will be hard on some German banks that hold significant amounts of Heta paper - *It's amazing how little coverage this has received in the media, especially so given the fact that a year ago Austria's Chancellor, Werner Faymann, had the colossally bad judgment to warn that a Heta failure would be comparable to that of the KreditAnstalt in 1931 that during the Depression triggered a financial crisis (& heralded the onset of a dark period in Austria's history).*

At last report the bonds of no fewer than ten European countries (Austria, Belgium, Cyprus, Czech Republic, Denmark, Finland, France, Netherlands, Slovakia & Sweden) were trading at negative yields out to at least two years, while in Germany this was the case out to eight-, & in Switzerland to ten-, years. With the yield on German 30-year Bunds, for instance, at 0.60% (& it has been lower) it is hard to understand why any serious investor would buy this paper since the odds are overwhelmingly in favour of yields being far higher for much of their life. And European companies have been capitalizing on this investor shortsightedness by issuing long term-, & even perpetual-, bonds at record low interest rates.

¹

Part of it apparently due to the fact that the uncoupling of the Swiss franc from the Euro, & the subsequently increase in the value of the former, had been devastating to home owners with HGA/Heta mortgages denominated in Swiss francs.

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DEAL OR NO DEAL (NYT, Thomas L. Friedman)

- The efforts to get a nuclear deal with Iran are now at a difficult & critical stage; for while one can negotiate a simple arms control deal with someone you don't trust, as with the Soviet Union during the Cold War, or a complex one with someone you do trust, like Japan or South Korea, it's quite different when the deal is complicated & the adversary not trusted; for the more moving parts there are, the greater the scope for cheating. And while for us this is just an arms control agreement, for Iran it constitutes an "identity crisis". Historically, revolutions at some point undergo a cultural rebalancing that breaks the revolutionary fever & returns a *new* 'normalcy'. But this has yet to happen in Iran, while its young people are increasingly losing, *if they haven't already done so*, the revolutionary fervor, the clerics (& the Revolutionary Guards?) are (*desperately?*) trying to keep it alive; for if Iran were to become 'normal', there would be no room in it for their medieval thinking. In addition, there is also a hard core in Tehran for whom nuclear weapons are a hedge against invasion (& a *means of national self-aggrandizement?*).
- Obama believes the last 36 years of a US-Iran Cold War have stymied US Mideast policy & that starting to break it down could be akin to Nixon's visit to China in 1972 that marked the beginning of the end for their 25-year Cold War & opened up a lot of *commercial* opportunities. And, if not brought back into the fold, Iran with its 80MM people & a stable government *such as it is* in a sea of failed-, near failed-, or at some point in the future likely-to-fail-, states will seek to exploit voids therein, which scares the daylight out of the generally weak Arab governments that have traditionally depended on, & if Iran is left unchecked, will continue to look on, the US for succour.

As Friedman puts it "None of this is a good reason to reject the deal (if one can be had), just a reason to ensure it ends up right (or at least as right as possible).

ABE : US, JAPAN CLOSE TO TPP TRADE DEAL (WSJ, Gerald Baker)

- On April 20th *Japan's* Prime Minister Shinzo Abe told the WSJ "we think an agreement between Japan and the US (*on the TPP*) is close, but we're hoping that even more progress will be made", & that he expected to arrive at an understanding with President Obama that it is "extremely beneficial for both countries" when he visits Washington on April 28th. Early the next day, *i.e. April 21st*, US & Japanese negotiators concluded a marathon negotiating session *that presumably laid the groundwork for just that.*

The Trans-Pacific Partnership (TPP) would be a US-inspired regional regulatory & investment treaty of 12 Pacific Rim countries that attempts to counteract China's growing influence in the region. Canada is notionally one of the twelve but one big issue that has stood in the way of progress being made with its inclusion has been Ottawa's insistence that its dairy-, poultry-, & egg supply management systems are not up for discussion (despite the fact that millions of Canadian consumers pay much higher-than-justifiable prices for their dairy products, poultry & eggs to sustain a system that has resulted in ever-higher valuations of the quotas that entitle one to produce these products, elimination of the dairy portion of which alone is estimated would cost Ottawa \$30BN to compensate Canada's 12,000 dairy farmers, half of them in Quebec, for their 'loss of property'). But Mr. Harper may soon have to fish or cut bait; for by all accounts Prime Minister Abe of Japan, the other country among them with a highly-protected farm industry, has agreed to throw it at least partly under the bus as the price of admission.

PART-TIME 'SLACK' MAY BE NEARING ITS END AS FED DEBATES HIKE **(Reuters, Howard Schneider)**

- The Fed watches the level of part-time employment (by those who would like to work full-time), as a measure of labour market health. But a Reuters/Ipsos poll found there is now only a modest gap between the hours workers were working & wanted to work. Moreover, over 33% of those working < 30 hours were satisfied with the hours they were working at the wage rate they were getting, or wanted to work less; and while the rest wanted more hours, only 23% of them wanted to work full-time (i.e. 40 hours). This suggests that part-time employment may be approaching levels that prevailed prior to the Great Recession. Similarly, government surveys have shown that the percentage of those working part-time but wanting to work full-time is now 4.5%, down from 6.5% at the end of the recession & closing in on the 3.9% average of the more than four decades prior to the recession. This will give the Fed one less reason to delay raising interest rates from the near-zero level it has now kept them for over six years.

Meanwhile, the Fed is said to be concerned that booming asset management industry may have insufficient liquidity to meet any upsurge in redemptions in a financial crisis by investors panicked into 'cashing out'. And Newport Beach, Cal.-based PIMCO, still the manager of the world's largest bond fund says that, while the Fed will "probably" start raising interest rates in September, many traders don't seem as yet fully prepared for such an event; so it has been 'underweighting' the 'front end' of the yield curve in its portfolios that it expects would be hardest hit if traders were to be rudely awakened to reality.

US SINGLE-FAMILY LANDLORDS ARE RAISING RENTS (BB, John Gittelsohn)

- Large buyers, i.e. those who bought at least 10 homes a year, have invested US\$68BN in 528,000 single family rental homes *during, & since, the recession*, but have slowed their expansion as house prices started rising, So now they are turning their attention to growing their revenues & plan to do so by an average 5.7% this year, in part driven by the fact that in the case of at least three such listed companies, Silver Bay Realty Trust Corp., Starwood Waypoint Residential Trust & America Residential Properties, their share prices are below their IPO (Initial Public Offering) price.

David Singelyn, CEO of American Home 4 Rent, with 35,000 homes the largest publicly-traded single family home renter, told a conference in Miami "In the 2015 rental season, we're really seeing the ability to move rents up."

NETANYAHU TO SEEK EXTENSION AS COALITION-BUILDING STALLS (Times of Israel)

- On April 20th Prime Minister Netanyahu was set to ask President Reuven Rivlin for a two week extension to his coalition-building mandate that the law entitles him to after, the evening before, Jewish Home's Naftali Bennett had threatened to pull out of the talks over the Religious Affairs portfolio. Netanyahu looks close to finalizing deals with Shas & United Torah that will give them ministries & parliamentary committees with large budgets catering to their constituents & appears close to a deal with the economics-focused Kulanu party (of Moshe Kahlon). But he is still at odds with both Naftali Bennett (who tweeted that "Taking the religious affairs portfolio unilaterally from religious Zionism, and giving it to Shas is the end of negotiations with the Jewish Home [party]" & Avigdor Lieberman, both long time-, but not always tractable-, associates, both of whom

are making demands that way out of proportion with the number of Knesset seats they control (*both lost at least half of them in the election*) to the point where Netanyahu has signaled he may leave them out. And Lieberman won't budge on rolling back legislation on universal draft, conversion & marriage reform that the religious parties want changed, and his party's officials claim that if Netanyahu concedes these issues to Shas & United Torah (*as word has it he has*) the party will have no qualms joining the opposition.

- The job of forming a coalition appears to have been harder than anyone had expected to the point that Netanyahu is said to have been flirting with the idea of reaching out to his dovish rivals to form a unity government; hence the two week extension of his mandate. What he does now will have broad implications. For if he cuts deals with his hardline "natural partner" he will have a majority of like-minded partners² that would avoid much of the infighting that plagued his last government but that would quickly find itself on a collision course with the international community because it would be peace deal-averse & in favour of accelerated settlement construction, something that a unity government with his leftist rivals would, *at least for a while*, avoid. But during the election campaign he vowed to rule from the right & Tzachi Hanegbi, the Deputy Foreign Minister from Likud, told Israel's Army Radio on April 19th the prospect of Hertzog joining the coalition was becoming a possibility only due to the hard-ball approach of the rightwing parties.

On the BBC's Hardtalk program on April 23rd Yitzak Hertzog was adamant he wouldn't be part of a unity government. There seem to be two reasons. Pressure from inside his party to stay in opposition in the belief a rightwing Netanyahu government will be such a disaster that it will improve the party's chances in the next election. And his own distaste for becoming Netanyahu's shill to provide protective cover for him with the international community, a role Tsipi Livni filled in the last government & Ehud Barak in the one before.

IN HASAN ROHANI'S IRAN, YOU CAN FEEL THE WINDS OF CHANGE

(Independent, Jack Straw)

- My first visit to Tehran was in September 2001, shortly after 9/11 in the immediate aftermath of which Iran's then moderate President Mohammad Khatemi reached out to the US with moral-, & practical-, support in its struggle against al-Qaeda, only to be paid back later by Pres. Bush 43 by inclusion in his "Axis of Evil" (which contributed to his replacement, in 2005, by the radical Mahmoud Ahmadinejad). Since then I have been back a number of times but during my most recent visit as part of a Parliamentary delegation I was struck by the amount of infrastructure that had been put in place, & how much more relaxed people seemed to be since my last visit nine years earlier. President Hassan Rouhani's victory in 2013, after rising from 5% initial support in the polls to 55+% on election day, had been a surprise, & there now seems to be more lightness-, & more of a sense of freedom in the air (that I measure by how far young women dare to push their mandatory hijabs away from their foreheads). But he has a different row to hoe, what with the Supreme Leader, the Revolutionary Guards & Parliament being far more 'conservative' than he is (*& he thinks the times call for*). And his ultimate success or failure, will depend on the economy's performance on his watch, which in turn depends on an easing of what one minister called "crippling" sanctions. In the end, if no deal is made, Iran will remain isolated & the *effect of the* sanctions will slowly erode as Russia & China will distance themselves from them & pressure from European

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Assuming that Kahlon stays the course.

exporters, especially in Germany & Italy, against them mounts, without any guarantee as to Iran's nuclear activities, making the world more dangerous for all, incl. Israel.

Jack Straw was Tony Blair's Foreign Secretary from 2001 - 2006. One of you was kind enough to draw my attention to it because it still seemed relevant, even though more than a year old.

THE MYSTERY OF CHINA'S GOLD STASH MAY SOON BE SOLVED (BB, Jasmine Ng)

- There has long been speculation that Beijing has been stockpiling gold in its FX reserves as a means of diversifying them *away from the US dollar*. If it has done so, nobody really knows whether and, if so, to what extent it has done so (the last time it reported its gold holdings was in April 2009, at a time the price of gold was in the US\$1,000 range, when it said it had 1,054.1 tons in its FX reserves (i.e. about 1%³) although, our estimate is it may have more than tripled since, to 3,510 tons. China has been promoting the use of the yuan in international trade (something that has been hampered by it still being a long way from being freely convertible into other currencies). But it may be preparing to publish an updated account of its gold holdings in an effort to force the IMF to include the yuan in its SDR (Special Drawing Right) currency basket *which now is limited to the Dollar(47.8%⁴), Euro (32.9%), Sterling (12.1%) & Yen (7.3%) in the next five-year review of the composition of that currency basket (which is to be completed by December 31st)*. According to Bart Melek, Head of Commodity Strategy at TD Securities, "If you want to set yourself up as a reserve currency, you may want to have assets on your balance sheet other than other fiat currencies ... *and gold is ...* certainly viewed as a stable store of value for an up-and-coming global power".

Any number significantly higher than the 3,510 tons postulated by Bloomberg could have a significant impact on the price of gold.

PUTIN SAYS READY TO WORK WITH US (Reuters)

- On April 16th (*three days after he had lifted the ban on the sale of S-300 missiles to Iran*), Putin had his 13th annual phone-in TV show (*marketed as "Direct Line to Vladimir Putin", it seeks to reinforce his public image as a resolute leader capable of addressing-, dealing with-, & solving all problems, large or small*). This year, like last year, it lasted four hours (*& supposedly generated 3MM questions*). In it he accused the US of trying to dominate world affairs & wanting "not allies, but vassals", *of which he declared he would not be one*. And yet, just two days later, in an interview with the state-run Rossiya TV channel he said Russia had key interests in common with the US, saying "We have disagreements on several issues on the international agenda. But at the same time there

³ In a rare comment on gold, Yi Gang, the PBOC's Deputy-Governor, said in March 2013 that it might only be possible to invest 2% of its FX reserves in gold because the market is so small (*which likely was an intentionally obfuscating observation given the amount of gold known to have moved from West to East in recent years, part of which almost inevitably will have ended up in the PBOC's vaults, & the fact that 2% of US\$3.9TR in FX reserves at present gold prices would allow as much as a ten-fold increase of the PBOC's reported 2009 gold holdings*).

⁴ Rather interestingly, while the IMF estimates (???) the dollar makes up 63% of the world's central bank FX reserve holdings (& the Euro 22%), i.e. numbers quite different from their share of the SDR currency basket, the Society for Worldwide Interbank Financial Telecommunications estimated that in February the US dollar was the medium of exchange for 43% of the entire global payments flow, i.e. a share much closer to the SDR currency basket composition.

is something that unites us, that forces us to work together ... I mean general efforts directed at making the world more democratic and balanced, so that the world is more democratic. We have a common agenda.”

The most likely explanation is that this is part of the Kremlin's ongoing brainwashing of Russian public opinion. But there could possibly be another explanation : he may have been surprised by the fact that during his phone-in marathon there had been less interest than he might have expected in the Ukraine (that the Russian public has been led to believe is a country “occupied by the Americans) & more than he may have anticipated in economic issues (in dealing with which he appeared less self-assured than with political ones to the point of being flummoxed by one question about foreign currency denominated home mortgages).