

On June 1st Liu Mingfu was the guest of honour at a party in Washington's tony Georgetown district to mark the publication, the month before, of the English translation of his 2010 book *The China Dream* (whose title President Xi Jinping has adopted as his favourite slogan). A retired PLA colonel, Liu's thesis is that to replace the US as the world's most powerful country all China needs to do is to pour more resources into its military, so that the US wouldn't dare interfering with its business in East-, & Southeast-, Asia - *Small wonder Xi is working hard to make the PLA less corruption-ridden (& more combat-ready)*. While Liu is, of course, 'talking his own book', *China's defense spending has for years already been growing at double digit annual rates (which is now, finally, prompting an arms race in the region. But there may be a risk, that in following this path Beijing could fall into an arms' race trap like that which three decades ago caused the Soviet Empire to implode (something Xi may be trying to avoid by taking a policy path that is the direct opposite of Gorbachev's loosening of the Communist Party's controls)*.

One joker in the global oil supply pack of cards is the US "fracklog", the 3,000+ US oil wells drilled but not yet fracked (that represent a significant non revenue-producing "sunk cost" millstone around many oil companies' necks) that could be brought on stream quickly at a relatively modest cost. So it may be a harbinger of things to come that Calgary-based Enerplus, a medium-sized oil producer that last February cut its 2015 capex budget by 40% YoY to \$480MM, this week announced it would restore \$60MM of these cuts to fund a reduction of its North Dakota fracklog well inventory in the latter half of this year. For according to CEO Ian Dundas "*Price conditions have changed somewhat in the last three or four months (i.e. WTI has recovered from < US\$50 in late January & again in mid-March to the US\$60 range) ... (and) we ... have seen some ("a good 15%") cost improvement*".

According to Capital Economics' Simona Gambarini central banks can take much of the credit for putting a floor under the gold price in recent years. For they increased their share of total global demand from 2% in 2010 (i.e. before the price crashed) to 14% in 2013 & 2014. And the World Gold Council estimates that 120 tonnes of gold was added to global official reserves in the First Quarter, with Russia alone buying 30 tonnes in March (& another 8.3 tonnes in April). Elsewhere, Austria announced plans last month to 'repatriate', over the next five years, 140 tonnes (i.e. *half of its total official gold holdings*) currently in the vaults of the Bank of England (as a result of which the share thereof that will be held on its own soil will go from zero to 50%, with the other 50% split between the Bank of England (30%) & Switzerland (20%).

Just as there is said to be a disconnect between the 'official' & 'real' US unemployment rates since the former don't include those not looking for work (an allegation seemingly borne out by a participation rate that, at 62.9, is only 0.2% up from its 36-year low), there appears to be another one, & a more serious one, between the two rates for young (18-29 year) adults. For according to Generation Opportunity, a non-partisan youth advocacy group, while the official young adult unemployment rate is 7.9% (vs. 5.4% overall), the real rate for them, including the 1.8MM individuals who have given up looking for work, is 13.8%. And many have large student loan debts (while the *absolute* amount of most classes of non-mortgage consumer debt is not all that different today than it was a decade ago - except for auto loans loan that are up 35% to nearly US\$1TR), the volume of student loans outstanding more than tripled, from US\$350BN to US\$1.16TR. This, & their employment outlook generally, likely helps to explain why in the past decade the number of 18-21 year-olds still living at home has risen from 50% to 55% and, more stunningly, that of 25-34-year-olds from <11% to almost 15%. And this, in turn, may explain why US retail sales growth has been so uninspiring; for as the Christian Science Monitor reported "Mall Stores Close In Doves" (especially those catering to the 18-29 year-old crowd), total retail sales have barely budged YoY, & in 8 of Wal-Mart's last 9 quarters it reported lower sales.

The Turkish election results were more than just a slap in the face for President Recep Tayyip Erdogan¹; it was more like getting two black eyes & a bloody nose at the same time. For, while he sought a two-thirds majority so as to enable him to drastically alter Turkey's political system, all he got was barely 40%, & for the first time ever there is now representation in Parliament of a group associated with the Kurdish minority. While not a home run, it certainly was a base hit for democracy, & a warning for those in power too long not to believe their own press releases.

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BONDS CRASH ACROSS THE WORLD AS DEFLATION TRADE GOES HORRIBLY WRONG (The Telegraph, Ambrose Evans-Pritchard)

- According to Gabriel Stein at Oxford Economics the Eurozone's (narrow) M1 money supply has grown at an annualized 16.2% over the past six months & the broader-based M3 at 8.4% (a post-2008 high). This has now prompted a rapid unwinding the 'deflation trade' (*betting that it was the main threat to the economy & that hence interest rates will remain low, or go lower still, for some time to come*) with a vengeance. So on June 10th) the yield on 10-year Bunds (*that hit a low of 0.89% last February 28th*) blew through the 1.00% level with the slightest of ease; ditto in the US where the yield on the benchmark 10-year UST bond jumped 48 bps to 2.47% in just eight trading sessions (& where *Allianz-owned, Newport Beach-based PIMCO* shocked the market by revealing its Total Return Fund (*with AUM of US\$110BN still the world's second largest bond fund*) had cut its holdings of UST paper by almost two-thirds, to 8.5, in just one month).
- The bubble now unwinding with unusual ferocity (because new regulations have reduced the markets' liquidity), according to Mr. Stein operated on "the greater fool" theory, i.e. whatever price one pays, there will always be some sucker to sell it to at a higher price, & that "Now we are returning to sanity", and another observer noting that government bonds had offered "rather than yield at no risk ... risk at no yield."
- How this now will unfold for the world as a whole depends on the Fed. For US futures contracts still aren't pricing in a rate rise in September and, while the Fed is implicitly forecasting rates of 1.875% by the end of next year, are still betting on 1.25%, something the IMF warned two months ago risks a "cascade of disruptive adjustments" (*i.e. panicking*) once the Fed pulls the trigger. And nobody knows what will happen when the spigot of global cheap dollar liquidity is turned off; for dollar indebtedness outside US jurisdiction has increased almost five-fold in 15 years to US\$9TR (*increasingly by borrowers without US dollar revenue flows that there have also assumed the exchange risk*), making the world more dollarised and vulnerable to Fed action than ever. And, as the HSBC's Stephen King wrote in a recent report The World Economy's Titanic Problem, 'we have used up almost all our fiscal and monetary ammunition, and may face the next global economic downturn with no lifeboats'. And while at a Bloomberg forum six weeks ago, New York Fed President Bill Dudley said "We at the Fed take the potential international implications of our policies seriously", he also said that interest

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Who last month told a group of Muslim leaders from Latin America that "It is alleged that the American continent was discovered by Columbus in 1492 ... In fact, Muslim sailors reached the American continent 314 years before Columbus in 1178 ... In his memoirs, Christopher Columbus mentions the existence of a mosque atop a hill on the coast of Cuba." - while there is growing evidence that people elsewhere in the world were aware of the existence of the American continent long before Columbus made it official, there has not been a shred of evidence to date that would support his claim that Muslims were among them.

rates should be 3.5% once inflation returns to 2% & hinted that the Fed may opt for a fast tightening cycle similar to that of the mid-1990's (*when it raised its interest rate by 0.25% at eleven FOMC meeting in a row*) when it caught the market off guard, and contributed to the emergence of the East Asia Crisis & Russia's default.

Raghuram Rajan, the Governor of the Reserve Bank &, seemingly justifiably so, a rising star on the central bank firmament, has been prominent, & vocal, among those who have criticized the Fed about its growing disregard, since the onset of the Great Recession, for the impact of its policies on the world outside the United States.

CALLING TIME ON ZERO RATES AND QE (Reuters, Mike Dolan)

- More & more influential bankers, watchdogs & economists, while still of the view that super-easy credit & QE were the right medicine to nurse economies out of a systemic bank shock, credit crunch & deflation scare, are now saying that zero interest rates have outlived their usefulness, and that money printing & bond buying is now causing more problems than they're worth. They also worry about the resultant lack of financial & monetary policy scope to deal with fresh economic-, or financial market-, shocks and, as Russ Koesterich, Black Rock's Chief Strategist, puts it that "Classic safe haven plays (*first & foremost UST securities?*) may not be as safe as advertised".
- On the other hand, Ben Bernanke, *the godfather of QE & now, among others, at Brookings*, last week insisted that the real problem in dealing with the financial crisis had been that too much had been expected from central bankers and that "If fiscal policy makers took more of the responsibility for promoting economic recovery and job creation, monetary policy could be less aggressive"

In the process 'Helicopter Ben'² blithely ignored the fact that he had been the only person in the world who could have kept their feet to the fire but, instead, had chosen to be their, only too willing, handmaiden in their short-term gain, long-term pain policy approach).

ARE WAGES AND BENEFITS GROWING FASTER THAN WE THINK?

(Real Time Economics/WSJ, Jeffrey Sparshott)

- The Labor Department reported on June 10th that in March its Employer Costs for Employee Compensation (ECEC) index had jumped 4.9% YoY, with *the cost of wages & salaries* up 4.2% to US\$22.88 & that of benefits up 6.4% to US\$10.61 (with health care costs up only 2.5%), well above the 1.2% YoY gain as recently as the Third Quarter of 2013. While the Department's Employment Cost Index (ECI) shows a lower number (2.6%) for the First Quarter, it too had accelerated from 2.2% in last year's Third & Fourth Quarters (with UBS economist Samuel Coffin "suspicious" the ECI is understating reality since "Labour market structure has been changing, which ECI is ignoring."

The accompanying chart showed that the ECI indeed had followed a 'smoother path' & that the ECEC had indeed been more volatile (and more reflective of the 'real time' situation)?

CHINESE FIRMS ARE LEAVING THE U.S. TO RELIST AT HOME (BB, Ben Scent)

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For his proclivity to try & address solve problems by 'printing money'.

- According to Pacific Crest Securities LLC this is in part because scrutiny of their business will be less & in part because share gains have been far greater there³, with Cheng Cheng, one of its analysts, saying some feel “unloved” & others expect to get “higher valuations in China ... by going private and relisting in the domestic market.”

This trend is expected to grow. YTD just three Chinese companies did IPOs worth US\$163MM in New York, vs. fifteen & US\$29.5BN last year (with the latter number, however, distorted by Ali Baba's US\$25BN⁴ IPO - potentially another (tiny) nail in the US global hegemony coffin.

US POLICE KILL MORE IN DAYS THAN OTHER COUNTRIES DO IN YEARS (The Guardian, Jamiles Lartey)

- In the first 24 days of 2015, police in the US (pop. 319MM) fatally shot more people (59) than the police in England & Wales (pop. 57MM) did in 24 years. In Iceland (pop. 323,764) there has been only one fatal police shooting (in 2013) in its entire 71-year history while in Stockton, Cal. (pop. 298,118) there were three between January 6th & March 4th, 2015. In 20 years (1992 - 2011) there were 94 fatal police shootings in Australia (pop. 23.1MM), while in the US there were 97 in March of this year alone. Canada (pop.35.2MM) averages 25 fatal police shootings a year while in California (pop. 38.8MM) there have been 97 YTD. And in Finland (pop. 5.4MM) police fired six bullets in total in all of 2013, while in Pasco, Wash. (pop. 68,000) police responding to a report of rocks being thrown at cars, fired 17 rounds at Antonio Zambano-Montes, “five or six” of which actually found their target.

Canada's number will surprise many Canadians who think theirs is a 'nice, peaceful country'.

ISIL USES WATER AS A WEAPON (AP)

- As Iraqi forces struggle to claw land back from ISIL in the country's western Sunni heartland Anbar Province, whose capital, Ramadi, ISIL captured last month, on June 4th ISIL cut the flow of water through a dam on the Euphrates River they control, threatening irrigation-, & waste water-, systems downstream in government-controlled territory.

This is not the first time that ISIL has done so; for earlier this year it took similar action at another dam they then controlled near Fallujah, also in Anbar province. This serves to highlight the growing global importance in the 21st century of water, & of the control thereof; for if need be, Man can live without oil, but without water human life quickly comes to a screeching halt!

SYRIAN REBELS SEIZE LARGEST ARMY BASE IN DERA'A (al-Jazeera)

- On June 9th, after a 24 hour battle a force of 2,000+ rebel fighters operating under the banner of an umbrella group calling itself the Southern Front Alliance seized control of this town near a strategic highway from Damascus to its Southern border with Jordan,

³ The Bloomberg China-US Equity Index gained 32% in the past 12 months vs. the Shanghai Composite Index's 149%

⁴ Jack Ma, Alibaba's founder & still its controlling shareholder recently said that if he had to do it over again he would have kept his company private since “Life is tough when you IPO”, & that he had only chosen to list his company on the NYSE because “we were rejected by Hongkong”.

which was the home base for the Syrian Army's 52nd brigade & where the anti-al Assad uprising had its beginning.

This is only one of several recent setbacks for the al-Assad regime in a multifaceted melee which has it fight three opposition groups in various parts of the country at the same time : ISIL, the the Nusra Front, the local al-Qaeda affiliate, & the Southern Alliance (the latter being the only one deemed sufficiently 'moderate' to get covert US support via the CIA, despite it often cooperating with Nusra against both government forces & ISIL. It is interesting to see on a map how little of Syria the regime controls (basically a narrow sliver South to Damascus from the Alawite heartland in the Northwest).

'LEHMAN MOMENT' UNLIKELY IN CHINA, ACCORDING TO FORMER FED HEAD (China Daily, Emma Dai)

- On June 9th he told the 1,200 attendees at a two day session of World Business Forum (WBF) in Hongkong, the first ever to be held there, that the Chinese government is facing a lot of challenges, incl. the quality of bank loans, shadow banking concerns & property market fluctuations but that a "Lehman moment" isn't likely in China; for "The government is pretty much aware of the risks and has all the resources to tackle the problems as they emerge."

Over time many governments that were "aware of the risks" & had "the resources to tackle the problems" were nevertheless sideswiped by financial market eruptions that evolved faster than they could react (although the totalitarian nature of China's regime likely improves its odds of it being successful in doing so).

EU SWIFTLY DISMISS LATEST GREEK REFORM OFFER (Reuters, Renee Maltezou)

- Despite signs that Prime Minister Tsipras is adopting a more conciliatory tone as time runs short for a deal, on June 9th, only hours after he had sent Brussels his latest proposal on tax, debt & the budget, proposing further value-added tax hikes & higher *primary* budget surplus targets, EU officials declared it was not acceptable to Greece's creditors, with one official commenting "What has been submitted is not sufficient to move the process forward." And frustration is growing among Greece's fellow Eurozone members as witnessed by an observation by Alexander Stubb, Finland's Finance Minister, that "We will do everything to keep Greece in the euro zone ... but our patience is running out." He is nevertheless still scheduled to meet to meet with Chancellor Merkel & President Hollande on Wednesday June 10th (*which, in the event, was deferred to the following day & ended, as usual, inconclusively*).

It is beginning to look more & more as if Tsipras will be the first to blink; for, unlike past arbitrary deadlines, June 30th is a 'hard' one; if so, one wonders about domestic impact thereof; for he has done little to prepare his fellow Greeks for the eventuality they won't get their way. And let there be no doubt about it, even if this hurdle is overcome & Greece remains in the Eurozone, it will nbe a running sore for years to come.

ICELAND'S ECONOMY RECOVERED AFTER IT LET BANKS GO BUST (The Independent, Hazel Sheffield)

- A decade ago Iceland was the first country to 'go into the tank' when its banks got in trouble & its economy imploded. But, while other countries bailed out their banks, it let

them collapse & only protected their domestic depositors (& *despite great pressure from the UK & Dutch governments, made their foreign depositors take their lumps*⁵). In what some people regarded as a violation of free market economics, it imposed capital controls that limited what people could do with their money. Rather than propping up its currency, it led it find its own level (so it went from roughly US\$0.16 to less than half that in the 12 months ended September 2008⁶, causing inflation to rise nearly five-fold, to 19%, during the same period). But inflation at last report was 1.6%, unemployment, that had been 3% in 2007 & *had peaked at 9.2% in September 2010*, was 4.6% in April (*albeit it up from 3.9% MoM*), and the National Debt-to-GDP ratio that peaked at 95% in 2011 was down to 82% last year & is expected to hit 74% this year. And, *best of all*, it is expected to this year become the first country in Europe to exceed its pre-crisis level of economic output, according to the IMF achieved all this 'without compromising its welfare model of universal healthcare and education' & in last February the CEO, Chairman, Head of its Luxembourg operation & the largest shareholder of Kaupthing, one of the collapsed banks, were sent to jail for between four & five years for market manipulation, with Special prosecutor Olafur Hauksson declaring "Why should we have part of our society ... not being policed or *being* without responsibility ... It is dangerous that someone is too big to investigate - it gives a sense there is a safe haven.

While there is some truth in the argument of the detractors of Iceland's (& Ireland's) achievements that what works in small population, micro-economies is not workable in large ones, this overlooks the fact that, when the chips were down, the hoi polloi in these countries were willing to take a longer-term view & put up with hard times in the short run, rather than mindlessly insisting that, come what may, they were 'entitled to their entitlements', thereby tying the hands of their political leaders.

⁵ Although in the end they didn't because their governments covered their losses, followed by unsuccessful attempts by the latter to be reimbursed by Iceland

⁶ A level around which it has basically fluctuated since.