

**Quote of the week :** “Why look for conspiracy when stupidity can explain so much” - Johann Wolfgang von Goethe, an influential, if not the most influential, German writer of all times (who lived to the ripe old age of 82 during the second half of the 18<sup>th</sup>-, & the early 19<sup>th</sup>-, centuries).

While the media’s attention was focused in the Iran & P5+1 negotiations, Washington in May quietly approved a US\$1.9BN arms sale to Israel (as part of Bush 43’s 2007 US\$30BN 10-year military aid package for it). While much of it involved defensive materiel, it also included a large number of offensive ‘bunker-busting’-, & other ‘deep-penetration’-, bombs that Israel would need to have a reasonable chance of success if, & when, it chooses to attack Iran’s nuclear facilities.

Another North-South schism may be developing in Europe; for while in the North there is still much support for the idea of not allowing the import of goods from Israeli suppliers in the West Bank and pressuring it to deal with the Palestinian issue, Greece this week signed a military pact with Israel, and Greece & Italy recently took part in joint exercises with the Israeli air force, while Italy’s Prime Minister, Matteo Renzi, this week called supporters of the idea of boycotting Israeli goods “stupid”.

To the extent that new car sales are a barometer of consumer confidence, it is worth noting that in June European car sales surged 15% MoM (the biggest such increase in over five years), thereby raising YTD car sales growth to 8% YoY.

Last week China announced, for the first time in over six years, the size of its central bank’s official gold holdings, saying they had increased by 57% to 1,658 tonnes, about half the most conservative outside estimate. This number is not being taken seriously by many (as was the case with its recent announcement that GDP had *conveniently* grown at a 7% annual rate in the Second Quarter, *while electricity output, a proxy for the level of economic activity, had been flat?*). What drove part of this skepticism was the fact that China as the largest gold producer in the world had averaged 400 tonnes of newly-mined domestic gold production in the interval, with there having been being little, if any, evidence that even part of it had flowed into commercial channels (thereby raising the question as to how much gold Beijing may have squirreled away in the coffers of official entities other than the central bank (such as ministries, sovereign wealth funds & even the PLA).

Since 2003 Russia has delivered six Talmar-class guided missile-carrying frigates built in St. Petersburg & Kaliningrad shipyards to the Indian Navy. On July 17<sup>th</sup> it announced it had chosen India’s Pipavan shipyard in Gujarat, President Modi’s home state, owned by billionaire Anil Ambani’s Reliance Group (that had acquired it only last March for the princely sum of US\$130MM) to be its local partner in the building of the next three or four such vessels at a cost of US\$3+BN - *this is part of an evolving arms race in South-, East-, & Southeast Asia, incl. Australia.*

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**Thursday July 23<sup>rd</sup>, 2015**

**WORRIES GROW AS SERIOUS DROUGHT HIT SAO PAULO, BRAZIL (CNBC, M. Ward)**

- The city is in the grips of its worst drought in half a century. While normally at this time of the year its main Cantareira reservoir, would have 155 BN gallons of water (8,000 gallons for each of its 19MM in habitants) in it, today it is dry & the city has had to fall back on secondary, emergency reserves. As a result, while before the drought the city’s water system was supplying 8,700 gallons per second to the city, today that is down

60% with the result that in some parts of the city water is available for only two hours a day (& when there is no water, water conservation measures have no meaning). According to the World Bank's Senior Water and Sanitation Specialist Juliana Garrido "Sao Paulo's current drought is both unprecedented and unpredicted". And since the city depends heavily on hydro power for its electricity, the drought has prompted the price thereof to rise, creating further hardship, & boosting the trend towards the development of energy sources other than hydro (*Thus it's not altogether surprising that, when President Dilma Roussef late last month visited President Obama to mend fences after having been upset by reports that the NSA had hacked into her emails), the two signed an agreement to have their countries get 20% of their energy needs from non-hydro renewable sources by 2020*).

*Meanwhile apart from the California & Sao Paulo droughts, in North Korea the official Korean Central News Agency admitted on June 16<sup>th</sup> that the worst drought in a century has caused 30% of the rice paddies to dry up and that "Water level of reservoirs stands at the lowest, while rivers and streams (are) getting dry". And there are serious drought problems in all or part of Ethiopia, Eritrea, Somalia, Sudan, Uganda, Afghanistan, Pakistan, China, India, Iran, Australia & Morocco (countries that between them account for well over one-third of the world's population), while a recent OECD report projected that, due to industrialization, urbanization & thermal power generation, global water demand will increase by 55% by 2050.*

#### **DIM CRUDE PRICE OUTLOOK MAY FORCE MORE SPENDING CUTS (Reuters, R. Galbraith)**

- The world's major oil companies are expected to report another sharp drop in quarterly profits (by as much as 40% YoY). And while they seldom scale back capex spending in the middle of a fiscal year, with oil prices lurching lower following the Iran nuclear deal, this time they may nevertheless decide to do so, even though the profitability of their 'downstream' (i.e. refining) operations in some cases have improved sharply, in the case of Total, Europe's largest refiner, to as much as US\$54, up from US\$47 QoQ & US\$11 YoY ( although Exxon & Chevron are not sharing in this bonanza), while they are expected to start shrinking again in the current quarter.

*Meanwhile the market for crude looks as if it will remain oversupplied for some time to come.*

#### **INVESTORS SHOULD DIP THEIR TOES IN THE US\$1-TRILLION WATER MARKET (FP)**

- Bejia Ma is a 'thematic investment strategist' at Bank of America Merrill Lynch. She recently said in a Note to Shareholders that, with California's ongoing water crisis now in its fourth year, investors searching for the next big investment theme should think water (which she thinks will create a US\$1TR market opportunity by 2020 in four areas : water treatment, water management, water infrastructure & supply, and water-friendly<sup>1</sup> energy), observing "We see the fastest 3-5Y growth coming in ... water treatment and recycling, more efficient usage [smart meters, high efficiency irrigation<sup>2</sup>, surface-, &

<sup>1</sup> A significant share of America's water usage is accounted for by thermoelectric power plants and, more recently, hydraulic fracking in the oil patch.

<sup>2</sup> It has been estimated that in hot places like Arizona as much as two-thirds of the water used in agriculture to irrigate crops using the sprinkler-, or centrepivot-, systems in wide use evaporates before it can do the crops any good; worse still, since the salt content of the water that evaporated stays in the soil, these systems speed up soil salination/degradation.

groundwater-, storage, EMs (China), water-friendly energy (solar & wind), and desalination”], listing Grupo Rotoplas S.A.B. de C.V., a Mexican-, & American Water Works Company Inc., a US-, water infrastructure company, and two water energy friendly companies, Enphase Energy Inc. & First Solar Inc. as companies with high exposure to the global water scene and/or the California drought,

*Water is going to be **the** issue of the 21<sup>st</sup> century. Wars are going to be fought over it; for, if push comes to shove, we can live without oil, but without water are good for only about five days, with the last three of them spent in a coma. So long-term investors should not just “dip their toes” in the water business, broadly defined, but consider making it a priority area for investment.*

### **WEAK INFLATION NOT THE CONUNDRUM MANY BELIEVE (WSJ, Michael S. Derby)**

- New research by the San Francisco Fed says that the Fed’s failure to get inflation back up to desired levels for three years isn’t the problem many people believe it to be. Thus in a note made public on July 20<sup>th</sup>, San Francisco Fed economist Kevin Lansing wrote “this does not yet signal a statistically significant departure from the target after accounting for the ever-present volatility of monthly readings ... recent inflation behavior departs only mildly from earlier patterns.” He says that the long-term relationship between inflation & the amount of unused capacity *continues to hold*, so that the weak inflation of recent years can be explained by the economy’s weakness of recent years. And he is optimistic that it will eventually rise since “Continued improvements in production and employment relative to their long-term trends would be expected to put upward pressure on inflation.”

*One historic problem has been that once the inflationary beast gets the bit in its teeth, it can be hard-, & require extraordinary measures-, to stop (as those who lived through the Paul Volcker Fed Chairmanship era can attest to).*

### **INSTITUTIONAL PROJECT DEMAND DRIVES ARCHITECTURE BILLINGS INDEX TO HIGHEST MARK SINCE 2007 (The American Institute of Architects)**

- In June the ABI hit 55.7, up from 51.9-, & the New Projects Index 63.4 vs. 61.5-, in May, due to continued *strong* demand for projects such as new education & healthcare facilities and public safety & government buildings (the ABI is a leading indicator of construction spending with a 9-12 month lag). But AIA Chief Economist Kermit Baker warned “The June numbers are likely showing some catch-up from slow growth earlier this year. This is the first month in 2015 that all regions are reporting positive business conditions and aside from the multi-family housing sector, all design categories appear to be in good shape ... *but* The demand for new apartments and condominiums may have crested with index scores going down each month this year and reaching the lowest point since 2011.”

*The emphasis on public sector spending is not matched by a like improvement of the fiscal situation at the state-, & municipal-, levels.*

### **U.S. JOBLESS CLAIMS DROP TO A 41½-YEAR LOW (Reuters)**

- The Labor Department reported on July 23 that during the week ended July 16<sup>th</sup> the number of new claims for unemployment benefits had declined 26,000 to a seasonally-

adjusted 255,000, their lowest level since November 1973 (*when the US labour force was about 40% smaller*). While this offset the increase in claims in June, there often are factors during the summer months that throw the Department's seasonal adjustment figures in disarray; so the four week moving average of claims may present a more realistic picture & it declined by only 4,000 to 278,500 (although & it has now been below 300,000 for 17 straight weeks, an unusually long stretch).

*This cannot help but be grist for the mill of the monetary policy hawks on the FOMC & weaken the case of the doves, and shorten the odds of an early launch of a Fed rate increase programme.*

### **SOCIAL SECURITY DISABILITY FUND TO RUN DRY NEXT YEAR (AP, Stephen Ohlemacher)**

- The trustees who oversee Social Security & Medicare reported on July 22<sup>nd</sup> that, unless Congress acts, the Disability Fund will run out of money in late 2016, triggering an automatic US\$193 drop in the US\$1,017 monthly payout to the average disabled worker & his/her family. Furthermore, they said there will be no cost-of-living (COLA) increase in payouts at the end of this year (that would mark only the third year without it in the four decades since COLA was introduced). Finally, it expects that about 7MM Medicare beneficiaries could face a US\$54 monthly premium increase for outpatient coverage. But the good news was that the Social Security's Retirement Fund has enough money in it to pay full benefits until 2035, one year later than believed to be the case a year ago (although Medicare's giant hospital trust fund self-destruction date, 2030, has not changed).

*While this comes at a bad time for US lawmakers, during the run-up to or, if they don't move posthaste during-, the presidential election campaign, they have only themselves to blame; for back in March 2011 already the Wall Street Journal carried an article drawing its readers' attention to the fact that the fund would run out of money "within four to seven years."*

### **TENSION BUILD BETWEEN CANADA, U.S. OVER TPP DEAL (G&M, Steven Chase)**

- Washington is frustrated with Ottawa because it believes that, while in the *earlier* Pacific Rim trade discussions the Harper government had undertaken to provide greater access to Canada's dairy & poultry markets, *as the talks enter the home stretch*, it has yet offered nothing concrete ahead of the July 28<sup>th</sup> meeting in Hawaii of the 12 countries' Trade Ministers *that many believe could conclude the negotiations*<sup>3</sup>. And, while the Canadian government is adamant that it did no such thing, with a spokesman for Canada's Trade Minister going saying "Canada did not agree to any specific measures in terms of an eventual Trans-Pacific Partnership agreement prior to joining the talks", Japan's Minister of State for Economic & Fiscal Policy last week publicly raised the possibility of the deal going forward without "one or two of the countries involved in the negotiations", telling a news conference on July 14<sup>th</sup> that "If there are countries that are ... not willing to reach an agreement at the Hawaii meeting, we can't afford to let the TPP go adrift for their sake" & Japanese news services later naming Canada as the laggard he had in mind.

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<sup>3</sup> And matters were likely not helped by Canada's Trade Minister Ed Fast, following comments by a number of US officials, incl. the US Ambassador to Canada, telling the Globe and Mail that "The Americans prefer to negotiate this agreement through the media" and he won't.

*In the context of the TPP negotiations Japan has made some politically difficult concessions in its protectionist farm policies, and both Australia & New Zealand, that scrapped their dairy supply management systems years ago, now face oversupply problems<sup>4</sup>; for the build-up of their dairy industries since was a function of a growing demand from China that now has stalled. So none will have much sympathy for any attempt by Canada to preserve its dairy supply management system. For Harper c.s. this will be a lose-lose proposition he can ill afford in the run-up to this fall's election; for he hasn't been doing all that well in the polls and if he were to make any concession on supply management he would incur the wrath of all the vested dairy & poultry interests &, if he doesn't, he will have egg all over his face if, as a result, Canada were to be shut out of the TPP*

### **WILL PIGS DERAIL CHINA'S RATE CUTS? (Barron's, Shuli Ren)**

- The Shanghai Composite Index declined sharply in the last half hour of trading on July 24<sup>th</sup> on media reports that the soaring pork prices may force the PBOC to slow its rate cut program. For pork accounts for 10% of the CPI's food component & 3% of the overall CPI, and the price of pork has jumped 30% from its recent low in April.

*This may have been an overreaction; for while the CPI has moved up some from its recent low of 1.2% in May, it remains comfortably below the government's official 3.0% target.*

### **NETANYAHU STRUGGLES TO GOVERN (AP, Aron Heller)**

- The pretext for him calling an early election was that his then coalition was too unwieldy, and he needed a *clearer mandate* & a more stable government to carry out vital reforms. But his new coalition government has an even narrower base, just 61 seats in the 120 seat Knesset, which has made him vulnerable, even to unruly members of his own Likud Party. And after being criticized at home for having been unable to forestall the international community's nuclear deal with Iran, his problems were compounded when the Attorney-General ordered an investigation of excessive spending at his *official & private* residences. So while he says he is confident he can govern effectively (as other Israeli prime ministers have done with paper-thin coalitions), the view of Amit Segal, a political commentator for Channel 2 TV, is that "He can survive. The question is what quality of life he will have ... It's hard to see him pushing forward with anything big."

*Netanyahu's foremost ambition is to become the longest-serving Prime Minister in Israel's history.*

### **RIO TINTO POSTS SHARP RISE IN IRON ORE OUTPUT (CNBC)**

- On July 16<sup>th</sup> it posted a sharp 7% QoQ-, & a 9%YoY-, rise in its Second Quarter iron ore output, in an attempt to protect its position as the world's second largest iron ore producer & its No. 1 position in the Chinese market, even though two cyclones, in March & in May, & the resultant heavy rains in Australia, had caused it to lose 7MM tonnes of shipping capacity during the quarter. And Vale (the world's biggest iron ore producer) & BHP are also expected to shortly show sharp increases in production during the Quarter,

<sup>4</sup>

Dairy prices today are less than half of what they were in 2013 & are now below their 2009 level, and hit a 12½ year low in New Zealand last week as its dairy exports to China YTD are down 69% YoY

while for the year as a whole Rio Tinto is expected to report 15% higher YoY iron ore output.

*From < US\$10 per tonne in 2000, iron ore prices rocketed, on the back of burgeoning demand for imported iron ore from China (that in & by itself accounts for about half of global iron ore output capacity) to almost US\$190 in 2011, prompting massive capacity expansions by all major producers (that, among others, led to a 100MM tonne (3%) addition to capacity in the Second Half of last year alone) but that have been cut by about 75% since. While the uninitiated might have expected the weak price environment to have led to cutbacks in production, it has instead, for the moment at least, resulted in a fight for market share & attempts to cover high fixed 'sunk' costs.*

### **TICKETS TO PARADISE, AND BEYOND (The Economist)**

- Selling passports has become a boon for the Caribbean island nations of Antigua, Dominica, Grenada and St. Kitts & Nevis to the point where Timothy Harris, the Prime Minister of St. Kitts told his three colleagues recently “This is a remarkably rewarding industry”. And buyers of their passports get a bonus because all four countries now have ‘Schengen access’, i.e. its passport holders get visa-free access to Britain & 26 other European nations. Antigua, that only joined the business in 2013, had up the the end of June sold 510 passports (40% to Chinese & another one-third to denizens of the Middle East) and expects the proceeds of passport sales this year to account for 25% of government revenues. In St. Kitts the income from passport sales in 2013 accounted for 13% of its GDP & over one-third of the government’s revenue (although it has encountered some problems, being accused by the US Treasury of having accommodated ‘dodgy financial deals’, and being forced to stop Iranians & Afghans from buying its passports and to require that countries of birth & any possible name changes be revealed in applications for their passports.

*Referring to the sale of passports as an “industry” seems like an overly liberal interpretation of the word.*