

Quote of the week - “The purpose of terrorism is to terrorize, it’s the only way a small country can take on a great nation and have a chance of winning.” - Vladimir Lenin

Another global economic headwind? - According to JPMorgan global productivity is growing at a “meagre 0.3%” pace this year. This has been most pronounced in the EM economies where it actually contracted during the 12 month ended June 30th, 2015. So it cut its estimate of global growth by 0.2% to 2.6%. On the other hand, it expects unemployment in the US & UK to fall faster than expected; while this will strengthen labour’s bargaining power, it expects its impact on the CPI to be muted by limited corporate “pricing power” (the ability to pass rising costs on to customers).

Increasing murder rates YTD in many US cities - As of August 31st Milwaukee had reported 104 murders, up 76% YoY from 59, St. Louis (136, 60%, 85), Baltimore (215, 58%, 138), Washington, D.C (105, 44%,73), & New Orleans (120, 22%, 98). Police attribute this to a greater availability of guns & tendency to settle disputes with guns, not fisticuffs & baseball bats.

Canada’s budgetary situation - Last spring’s Budget forecast a \$2.4BN surplus for the fiscal year ending March 31st, 2016. But the ‘fiscal update’ Bill Morneau, Canada’s new Finance Minister, just two weeks in the job, tabled on November 20th, estimated that anemic commodity prices & weak growth at home & abroad, will turn that into a \$3BN deficit - *this makes for an inauspicious jumping-off point for the \$10+BN in annual net new spending Trudeau did commit himself to. Sooner or later he will have to grow up & face the reality of having to renege on some campaign promises¹, that many voters in any case take for what they are, moves to win votes, and that in four years they will have forgotten all about them and will only care about whether he had upset them along the way and about his latest promises².*

ISIS is a different kettle of fish from al-Qaeda - It controls territory & has tens of thousands of fighters willing to lay down their lives for their cause whereas al-Qaeda operates from caves in Afghanistan & has mere handfuls of martyr candidates. Despite its eighth-century religious beliefs, ISIS is very adroit, far more so than al-Qaeda ever was, at using the 21st century social media to advantage, as a result of which it has managed to tap into a wellspring of financial support within the conservative Salafi/Wahabbi Muslim community & of dissatisfaction with the status quo among young people worldwide. So while al-Qaeda was all but neutralized by cutting off its head, ISIS is like the multi-headed Hydra monster of Greek mythology that grew two new heads for every one lopped off, until Heracles neutralized it by unconventional means - *Alas, the Putins, Hollandes & US Republicans of this world are not given to ‘out-of-the-box thinking’ (& neither are the hoi polloi), and seem intent on spending untold billions on the exercise of ‘hard power’, at least some of which might well have been spent more fruitfully & cost-effectively on ‘soft power’ in the ‘war for the hearts & minds’. In the 21st century the exercise ‘hard power’ has been singularly ineffective, if not counter-productive, & provided a poor return on the untold billions spent in, among others, Afghanistan & Iraq; for it ignores the age-old adage that “one catches more flies with honey than with vinegar” & focuses on treating*

¹ As he just did with the tally of 25,000 refugees to be brought in by December 31st.

² In 2004 the then Liberal leader Dalton McGuinty rose to power on a platform of no tax increases only to almost immediately introduce health care premiums, saying they were not tax increase. So the Canadian Tax Payers Foundation took him to court for breaking his campaign promises only to have the judge dismiss the case on the grounds that, as he wrote in his ruling, anyone who expects a politician to keep his promises is a fool (or some equally explicit language).

the symptoms, not the disease (i.e. the fact that some of the young people's dissatisfaction is not without foundation & should have been addressed long ago). For the impressions of the former hard-line right-wing German parliamentarian & now author, Juergen Toedenhoefer, gained during an ISIS-approved visit to its territory that came in just minutes ago, Google Seven Impressions of a Different Journey; it provides food for thought.

The cost of the Canadian government's '25,000 Syrian refugees by yearend' program - a leaked government document made available to the CBC places the cost of resettling them 25,000 at \$1.2BN over six years, 'front end-loaded' to the extent of \$876.7MM during the remainder of the fiscal year ending March 31st (i.e. \$6.8MM per day & \$35,000 per capita).

The oil glut - Worldwide onshore oil storage facilities from the US through the Middle East to China are filled to such an uncomfortably high level of capacity Patrick Rodgers, the CEO of EuroNav³, reported that clients want ships to go slow to help manage storage levels. And the oceans are awash with oil, albeit still in the holds of tankers. According to the FT "The amount of oil at sea is at least double the level a year ago." Recently a record 39 tankers with 30MM bbls of the stuff onboard were lined up outside Galveston/Houston & the wait time had gone from 3 to 5 days. Off the Indonesian & Malaysian coasts there are 35MM bbls "in storage" on 14 VLCCs, and another 10MM bbls on five VLCCs off the China coast. One VLCC is reported to have been "parked" since last September off the coast of Malta. And in preparation for the end of sanctions Iran is storing 40MM bbls on supertankers it owns (& other Persian Gulf another 8MM bbls).

The real terrorism 'risk' - The Economist noted that of the 745,000 refugees resettled in the US since 9/11 only two were ever arrested on terrorism-related charges (in Canada zero out of 265,000). As to Trudeau's '25,000 by year end' undertaking, the risk of bringing in terrorists has been ameliorated by excluding unaccompanied men (except those who are gay⁴) & limiting their number to women & children and families (*which from an economic/financial point of view in the short run may not make sense*) - *The risk of importing terrorists has been 'overhyped' by xenophobic rightwingers, headline-hungry media & toadying politicians; for there is likely a greater security risk for Canada (& the US) in the eventual return of the 100+ each of their citizens when they return from fighting for ISIS, or in home-grown 'lone wolves' who, disenchanted by-, disconnected from-, the world around them, seek to act out their frustration & anger, only the more so if they were to find themselves competing for jobs with newcomers in a 'soft' economy.*

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THE PARIS ATTACKS (Vue Weekly, Gwynne Dyer)

- After any major terrorist attack in the West, the question to ask is : what was its strategic objective? In the case of al-Qaeda's 9/11 attack it was textbook terrorist strategy : sucker

³ Isle of Man-based, & Antwerp-headquartered, it is the largest NYSE-listed independent crude oil tanker company in the world.

⁴ Well-intended but dumb. Excluding all young men was easy & sort of non-discriminatory; but given the attitude towards gays in the societies whence they came, they would not have come 'out of the closet' & therefore couldn't readily, in the time available, be ascertained to be so.

Washington into invading Muslim countries (*to invoke sympathy for their cause in "Arab Street" & the global Muslim family*). It had long sought to overturn Arab governments, so as to reshape their countries in its Islamist image but hadn't been doing so well in building the mass support needed to carry this off. So bin-Laden switched his target from Arab-, to Western-, governments, hoping to lure them into invasions that would radicalize Arabs & drive them into his arms. In 2003 George Bush kindly obliged him, & once his troops had moved in, there was a sharp decline in terrorist attacks in the West since more might prompt the invaders to pull their troops out again. And, yes, support for him did grow quickly & attracted Islamist fighters from many Arab countries.

- The entity once known as "al-Qaeda in Iraq" went through several name changes until, finally, in 2014 it became simply "Islamic State". But the key personnel & its long-term goals didn't change, even though its strategy has changed : with it now controlling much territory in Syria & Iraq, there's no more need for revolutions; so the core strategy now is simply conquest. And one reason there still are attacks on Western targets is that in 2013, when, after ISIS had created the al-Nusra Front in Syria & al-Qaeda then sided with it in an internal ISIS power struggle, it parted ways with al-Qaeda. Hence now two rival jihadi franchises are competing for supporters, with terrorist extravaganzas against Western targets being powerful recruiting tools. But ISIS also wants the Western attacks to cease; for it now has the trappings of a real state, with an army, borders & a functioning economy of sorts, and the attacks are interfering with its efforts to consolidate & expand it; so it hopes terrorist attacks in the West will cause it to pull out. And France was a logical target since French fighter jets are among those bombing it & its disaffected young people (*& not just the second/third generation Muslim immigrants?*) are a fertile recruiting ground.
- Under the circumstances terrorist attacks in the West by either or both Islamist franchises are a foregone conclusion, even in countries with smaller & better integrated Muslim communities (*with the US, the UK & Russia heading the list?*). And, with putting foreign 'boots on the ground' in Syria making matters only worse, the least bad option for the West may well be to ride out the terrorist campaign; for horrendous as the attacks may be shown to be on TV, statistically they pose a lesser risk its citizens than crossing a street.

The latter idea may be right but will be all but impossible to sell, especially so with the media doing the terrorists' dirty work by baying like hounds that picked up the scent of a hapless fox.

US BOMBERS FLEW NEAR CHINA-BUILT ISLANDS IN SOUTH CHINA SEA **(Reuters, Yeganeh Torbati)**

- On November 9th two Guam-based B-52 bombers⁵ overflew⁶ some &, ignoring calls from Chinese ground controllers, continued their mission undeterred, with the Pentagon announcing later "We conduct B-52 missions in international airspace in that part of the world all the time" & the White House's Josh Earnest telling reporters "We are ... concerned about protecting freedom of navigation, the free flow of commerce in the South China Sea ... And ...continue to encourage all parties ... to resolve their differences diplomatically and not use their comparative size and strength to intimidate their neighbours."

⁵ Cold War relics that first came into service in 1961 & are the longest-serving plane in the USAF.

⁶ 30,000+ feet up?

Excursions like this one, & that of the US naval vessel that recently came within 12 miles of these islands, likely are a necessary evil but nevertheless are akin to smoking in bed, or jay walking : sooner or later your number comes up, in this case either because Beijing decides it cannot afford the 'loss of face' involved any longer, or because of some 'black swan event' at the sharp end. And it can't be a coincidence that China a few days later, finally after 3+ years of haggling⁷, signed a US\$2+BN deal with Moscow for 24 'cutting edge' Su-35 jet fighters that, with their top speed of 2,500 kms/hr, would leave the 1,920 kms F-35, in their dust.

NEW AGONIES, ALLIANCES AS FED DEBATES POST-LIFTOFF PLAN **(Reuters, Jonathan Spicer)**

- Some in the Fed are starting to doubt their models . Fed officials' private & public comments show the debate now is about whether the US economy is returning to its old robust self or whether tepid growth, weak inflation & small wage hikes have become the 'new norm' after the deep 2007-2009 recession⁸. And the 17 Fed policy makers are far apart on the question of how high interest rates should go & how quickly they should get there; and the outcome of this debate will determine how far US rates will diverge from those in other *major* economies (whose central banks are still in an easing mode), & how far the US dollar will rise, hurting US exports & possibly triggering an emerging market sell-off.
- St. Louis Fed President James Bullard, a hawk, told a conference earlier this month "Some of our fundamentals about how US monetary policy works may have to be altered." And while Fed Chair Janet Yellen & her Vice Chairman Stanley Fisher insist that any tightening will be gradual (*with the upper end of the Fed's own forecast last September of where its key interest rate may be by the end of 2016 being 3%?*), there is as yet no consensus as to what "gradual" means *in this case*.

While the market seems to have priced in the FOMC members will initiate the first rate increase in seven years & is expected to take that in its stride, neither can be taken for granted; for the former are foot-draggers by instinct & the latter is easily 'spooked, no matter what anyone says.

WHY THE HOUSING REBOUND HASN'T LIFTED THE US ECONOMY MORE **(WSJ, Joe Light)**

- American homeowners are out of the home equity hole created by the housing crisis. But their home-bound wealth is now playing a much smaller role in the economy than before. According to the Fed home equity has almost doubled, to US\$12.1TR, & relative to market values has returned to close to its pre-crisis level. But this has failed to prompt them to draw it down as freely as they used to. While in the First Half of this year they borrowed US\$435BN against the equity in their houses, this was only one-quarter of the amount they had done in 2007 when home equity was as high as it is now. And according to Moody's Analytics while in the Fourth Quarter each dollar increase in home

⁷ Driven by, *quite justified*, Russian concerns the Chinese would use them to retro-engineer its own version (which must have been overcome by Putin's desperate need for foreign exchange).

⁸ This does not jive with the evidence presented in the Fed's September "Beige Book", the fact that hourly earnings in October grew at a 2.5% annual rate, a six year high, & the anecdotal evidence bubbling up from the work place, about growing wage pressures due to the activities of the 'higher minimum wage' lobby & a shortage of qualified workers.

equity gave rise to a two cent increase in consumer spending, this multiplier effect had been 3x as great in the pre-crisis era (& just 40% of the average during the 1990-2014 period). The main reason for this appears to be that home owners don't realize the extent to which their *home-bound* wealth has improved; thus, while according to CoreLogic, an *Irvine, Cal.-based purveyor of business intelligence*, the percentage of home owners who were underwater on their mortgages had declined to 8.7% by mid-2015 (from a high of 21% in late 2011) & according to Fannie Mae the percentage of them who thought they were still so had declined by just one percentage point to 27%, with its Chief Economist saying the real estate bust still looms large in home owners' minds & home equity is now seen as a more fleeting & volatile source of wealth that it used to. And lenders have also tightened up on the extent to which they will let people draw down some of the equity in their homes.

There may also be a significant element of people being less confident of-, & optimistic about-, life in general than they were a decade ago.

SLOW GROWTH COULD BE 'THE NEW REALITY', CENTRAL BANK SAYS **(FP, Gordon Isfeld)**

- Two years ago Bank of Canada Governor Stephen Poloz said the recovery from the Great Recession had been a "serial disappointment". And a study made public on November 19th, *Is Slower Growth the New Normal in Advanced Economies* by Abeer Reza & Subrata Sarker, both international economic analysts at the Bank, noted "growth in many advanced economies continues to disappoint ... Typically, growth rates during the recovery years are ... stronger than long-term averages as economies strive to catch up on lost capacity ... This time, however, growth has continually disappointed and forecasters have regularly adjusted their forecasts downwards." Thus, as the Bank points out, only annual growth in the advanced economies averaged 3.6% between 1985 & 2007 but during the 2010-2014 recovery mode era only 1.4%. And according to Benjamin Reitzes, a senior economist at BMO Capital Markets slower growth is the new normal. "And then it's going to slow further."
- The co-authors postulate that monetary policymakers could boost output by 'unconventional policies'⁹, **forward guidance** (with regard to the likely timing & direction of future interest rate changes, a practice pioneered by former Bank of Canada-, & now Bank of England-, Governor Mark Carney), **quantitative easing** (frenzied central bank bond buying in an effort to keep money flowing in the system, that is increasingly held to have progressively lost most of whatever effectiveness it ever may have had, & **reducing, if necessary into negative territory what central banks pay** on deposits from commercial financial institutions, *part of them so mandated by law (so as to force them to minimize those deposits & put the money thus freed up to more productive & more velocity of money-friendly uses)*). Their study also addresses the issue of the "neutral" - not too hot, not too cold - interest rate level for balanced monetary policy, saying "In Canada, the current neutral rate is more likely in the range of one to two percent, compared with our previous estimate for the mid-2000's of 2.5 to 3.5 percent ... *and claims that* Even though a decline in potential growth may reduce the neutral (interest) rate in many economies, monetary policy makers still have ample room to manoeuvre."

⁹ A popular 'catch-all', buzz word in central banking circles for new-fangled initiatives, few, if any of which seem have lived up to expectations & the main effect of which seem to have been to erode the once rock-solid reputation as 'masters of the financial universe'.

Even more telling is the relentless downward trend in the five year running average GDP 'trend' growth rate since WW II from 5% to today's 2% or so that will, if anything, get worsen in the years to come because the increase in the Baby Boomer-driven age-dependency rate will pose a drag on potential GDP growth. The last-quoted sentence must have been included for 'feel-good' reasons; for central bankers who once deemed themselves the "Masters of the Financial Universe" are distressed to the point of being panicked by the fact that the absence of political action on the fiscal policy front has led to an undue dependence on-, that has undermined its effectiveness to the point of causing them lose control over-, monetary policy.

CHINA'S EARLIEST MONTHLY ECONOMIC INDICATORS FLASH WARNING SIGN (BB)

- The MinxIn PMI (Purchasing Managers' Index) is compiled by the China Mingsheng Banking Corp.¹⁰ & the China Academy of New Supply-Side Economics¹¹, & based on monthly input from 4,000+, mostly smaller, companies. In November its manufacturing component slid to 42.4 from 43.3¹²-, & its non-manufacturing counterpart to 42.9 from 44.2-, MoM. This prompted Jia Kang to comment "China' economy hasn't bottomed yet and downward pressure are mounting" & a Nomura Holdings' Hongkong-based economist that this "suggests growth momentum remains soft." Other private sector indices also were soft : thus the Baidu¹³ SME Index, based on the 6+BN online searches for SME products & services it handles every day, also slipped, albeit only marginally so, from 98.4 to 98.2 (100 being its tipping point) while the New York-based Markel News International Index (based on a monthly polling of executives of Chinese companies listed on the Shanghai & Shenzhen Stock Exchanges, slumped to 49.9 from 55.6 in October.

Rather interestingly, the official Chinese Manufacturing PMI declined from about 51 to 50 in the three months ended last January & has since fluctuated in a narrow band around the latter while its MinxIn counterpart, that stood at about 50 in October 2014, currently is 42.4. Only part of the difference is likely accounted for by the fact the former is more heavily based on input from larger corporations, many of them SOEs being propped up by the government, whereas the latter is more biased towards input from the smaller company universe that is feeling more pain.

¹⁰ Based in Beijing & listed in Hongkong it was founded two decades ago as a largely private sector-owned entity; today much of its client base consists of smaller private corporations.

¹¹ Founded & still directed by Jia Kang, a 30-year Finance Ministry veteran, in his last posting as Director of its Research Intitute.

¹² Its tipping point into negative territory is 50.

¹³ China's near Wikipedia clone. Founded in 1996, it was listed on Nasdaq in 2005, included in the Nasdaq-100 two years later & last December had revenues of US\$7BN & assets of twice that.