

**Quote of the week** : “In the run-up to the financial crisis, banking became about banks, not *about* businesses, transactions not *about* relations, counterparties not *about* clients” - Bank of England Governor Mark Carney in his June 7<sup>th</sup>, 2016 address to the graduating class of the University of Alberta Business School on the occasion of his receiving an honorary Doctorate (*i.e. the industry had focused on profit as an end in itself rather than as a by-product of its value-added service.*

**Canada’s ‘CPP reform’** - This may well be a case of politicians seeking to fix something that isn’t broken. Thus, according to Laval University Economics Professor Stephen under *the three/four-legged public pension system of the federal Old Age Security-, Guaranteed Income Supplement-, & Canada Pension Plan- programs, and provincial top-ups*, “Retirees in the lowest fifth of the income distribution have incomes greater than what they had before they retired<sup>1</sup>.” And according to Philip Cross of the Macdonald-Laurier Institute (*an Ottawa-based independent public policy think tank founded in 2010 to “make poor quality public policy unacceptable in Ottawa*) the real pension issue is “the unsustainable gap between the *underfunded & fiscally unsustainable defined benefit pensions of public servants (and those of almost?) everyone else*”.

**GHG (Greenhouse Gas Emissions) in Canada** - In 2009 in Copenhagen the Harper government undertook to cut Canada’s 2020 greenhouse gas emissions, in line with the US, by 17% from their 2005 level. While by 2014 the US had cut them by 5.8% from to 6,700-, megatonnes of CO<sub>2</sub> equivalent, by 2014 Canada’s had declined by just 2.1% to 2005’s 732 megatonnes. Furthermore, according to Ottawa’s December 2015 Second Biannual Report to the United Nations Framework Convention on Climate Change, it expects them to be in the 749-790 megatonne range by 2020, i.e. 20-27% in excess of their supposed target.

**GLEANINGS II - 664**  
**Thursday June 23<sup>rd</sup>, 2016**

**RATE HIKES UNCERTAIN AS FED PONDERERS HEALTH OF RECOVERY**  
**(G&M, David Parkinson)**

- Last December the Fed finally raised its Federal Fund rate target to 0.25%-0.50% & seemed set to start a long-awaited tightening cycle. But on June 15<sup>th</sup> the FOMC voted unanimously<sup>2</sup> to maintain that rate target, acknowledging the presence of two elephants in the room, one conspicuous in both the announcement & Janet Yellen’s subsequent press conference, i.e. the suddenly uncertain domestic labour market, & the other the possible Brexit. And while she in her press conference spoke optimistically about the economy regaining its momentum, in May industrial production had fallen a bigger-than-expected 0.4%, the biggest drop in nearly 2½ years & the third decline in four months.

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<sup>1</sup> “Plus ça change, plus c’est la même chose” : Ottawa’s Interdepartmental Committee on the Canadian Retirement Income System in the late 1970’s, a multi-year study of the system at that time, came to a similar conclusion early-on in its deliberations.

<sup>2</sup> Incl. Kansas Fed President Esther George who alone in the past two meetings had championed an immediate rate hike, and St. Louis Fed President James Bullard, once a avowed ‘hawk’ & multiple rate increase proponent, who now believes that, due poor productivity growth, the US economy is so weak that a single 0.25%, rate hike will suffice for the foreseeable future..

*The Fed now calls for 2016 GDP growth of 2.0% (vs. 2.4% six months ago), & the market sees no chance of a rate hike at the next, late July, next FOMC meeting & 39% in the rest of the year.*

### **INVESTORS HOLD BIGGEST CASH PILE SINCE 2001 (Reuters)**

- A Merrill Lynch survey of 213 global fund managers with AUM of US\$654BN published June 14<sup>th</sup> & entitled No Bulls on Bear Mountain found that, rattled by worries over Brexit & policy makers' inability to bolster fragile global economies, and despite bond yields never having been lower & the rates on more & more bank deposits now negative, there is more cash in their hands than there had been at any time since 2011. Furthermore that they had cut their equity holdings to a four-year low<sup>3</sup> & increased their exposure to bonds, albeit to still historically low levels. And the percentage of them who think both stock-, & bond-, markets are overvalued was the fourth-highest in the 13 years Merrill has been tracking this number, while over one-third think fiscal policy is too tight.

*Their cash position is a clear indication of the bankruptcy of the central banks' much ballyhooed 'unconventional monetary policy' thinking that ignores the age-old market bank adage that "you cannot push on a string" (i.e. while jacking up rates will stop people from borrowing & investing money, lowering them doesn't make them borrow & invest).*

### **LONGER-TERM BONDS GAIN FAVOUR (Bloomberg)**

- According to Merrill Lynch YTD US corporate bonds maturing in 15 years or more have been among the best performing asset classes, up over 12+% (vs. 2.94% for the S&P 500, 3.87% for 3-5 year corporate paper, & 8.32% for junk bonds). So investment managers like Loomis Sayles & Franklin Templeton have been piling into them.

*This illustrates how yield-hungry & short term-focused, and unconcerned about possible Fed rate hikes, even 'sophisticated' investors have become, for the longer the maturity & the lower the liquidity of a bond, the greater its potential for serious losses if interest rates were to rise.*

### **CARGO DROP SENDS WARNING OF A SLOWDOWN (G&M, Eric Atkins)**

- In the last quarter the number of intermodal containers hauled by the major North American railways was down a bigger-than-expected 7% QoQ. According to Jean-Jacques Ruest, CN's EVP & Chief Marketing Officer "Intermodal is probably the most diverse indicator of what the economy might be doing ... It's not a Canadian phenomenon ... not a CN phenomenon, it's a North American phenomenon." The drop in the movement of containers, which carry imported goods, is said to be due to rising inventories as consumer spending slows (although low fuel prices have made road transport also more competitive).

*The reason given by the industry for the container traffic slowdown is contrary to the fact that in May US retail sales were up sharply as inflationary pressures were building (driven by import prices that, due to the less strong dollar, recorded their largest increases in over four years).*

### **U.S. ELECTION PUTS NAFTA BACK ON THE TABLE (G&M, Gordon Isfeld)**

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<sup>3</sup> YTD global equity funds have posted an outflow of US\$106BN from mostly developing markets.

- Trump has called NAFTA “a disaster” & wants to scrap or renegotiate it and Clinton, while not supportive of his idea for a wall along the Mexican border, has also been critical of it.

*Both, however, are likely targeting the relationship with Mexico first.*

### **HOUSING CRASH IN CANADA COULD COST MORTGAGE LENDERS ALMOST \$12 BILLION, MOODY’S WARNS (NP, Barbara Schechter)**

- A June 20<sup>th</sup> Moody’s report warns of “systemic vulnerabilities” in the Canadian mortgage market that would be exposed if it were hit by a US-style housing meltdown. Such an event could result in losses of \$12BN for the Canadian banks & up to \$6BN for mortgage insurers, incl. *government-owned CMHC*, & cause house prices to fall by up to 35%. Among the vulnerabilities noted is the potential for downward pressure on house prices from a ‘sub-group of lightly regulated mortgage lenders’ that it estimates account for 6% of Canada’s \$1.6TR mortgage market whose riskier loans would likely go into default first & cause a chain reaction that “in the event of a housing downturn ... could exacerbate house price declines”. But since 75% of the mortgage debt is held by the six large banks & the Desjardins Group,. Moody’s concludes “We believe that while a US-severity mortgage event would lead to substantial losses, it would not threaten bank solvency.”<sup>4</sup>

*Between 2006 & 2014 Canada’s home mortgage debt (incl. home equity loans that since 2011 have grown from zero to 15% of it) has grown at 9+% annually & from 53% to 78% of GDP as Canadian home owners have used the equity in their homes to maintain their life style.*

### **CANADA’S ARMS EXPORTS TO MIDDLE EAST NOW SECOND LARGEST AFTER U.S. (Huffington Post, Daniel Tencer)**

•The global defense trade hit a record US\$65BN in 2015, and Canada, *with sales up 38.6% YoY*<sup>5</sup>, ranked 6<sup>th</sup> *among arms exporters*, up from 10<sup>th</sup> in 2013 & 2014. But according to the *Jane’s Defense Weekly* Canada, once sixth in arms exports to the Middle East, has leapfrogged Britain, France, Germany & Russia into second place, behind the US, with 2015 sales of US\$2.7BN. This comes at a time of frenzied military spending in the Middle East that has made it the world’s top arms importer & Saudi Arabia the world’s largest buyer of imported arms, with the U.S., Canada, France & U.K. the main ... beneficiaries thereof.

*This was due to a policy decision by the Harper government that contributed to the erosion of Canada’s historic stature in the world that Trudeau seems to be unable/unwilling to reverse.*

### **COMIC’S PARTY HAS EYES ON NATIONAL POWER AFTER MAYORAL WINS (AP)**

- In Rome’s June 19<sup>th</sup> two candidate run-off election Virginia Raggi, a lawyer & the candidate for the 5-Star movement, an anti-establishment, ‘big tent’ group, trounced the

<sup>4</sup> \$12BN is less than the common equity Tier 1 capital of the National Bank of Canada, the smallest of Canada’s biggest six banks & a mere fraction of the of the largest, the Royal Bank of Canada.

<sup>5</sup> A rate of growth exceeded only by Israel among the world’s largest ten arms exporters.

candidate of Premier Matteo Renzi's *reformist* Democratic Party & with 67.2% voter support became, at age 37, its first female-, & youngest-ever, mayor. A similar upset occurred in Turin, in Northwestern Italy's Piedmont region, *Italy's fourth-largest city & a major business & cultural centre*, where a relatively unknown 32 year-old woman became its new mayor.

*The populist, anti-establishment, environmentalist & Euro-sceptic 5-Star movement was founded in 2009 by Beppe Grillo, a professional clown. In the 2013 general election it got 25.5% of the votes but only 17% of the 630 seats in Parliament. It now sees these results as a springboard to greater national power in the early 2018 parliamentary elections, especially since the ruling Democratic party didn't do well in the mayoralty elections elsewhere in the country.*

### **ISIS FIGHTERS HEADED TO FRANCE, BELGIUM FOR POSSIBLE ATTACKS (AP)**

- Belgium's Derni re Heure tabloid reported on June 15<sup>th</sup> that the country's anti-terrorism office had warned police that fighters with access to weapons had left Syria ten days earlier bound for Belgium & France (*both of which, after earlier terrorists incidents are still at a high level of terrorist alertness*). This was the latest report of them seeking to travel without passports via Turkey & Greece to Europe. So French Prime Minister Manuel Valls on June 15<sup>th</sup> repeated his earlier warning that the world faced a long war to defeat terrorism.

*France right now may be particularly at risk because the June 10<sup>th</sup> - July 10<sup>th</sup> European soccer championships in Paris must represent an near-irresistible target.*

### **BORDERS SHUT AFTER JORDAN SUICIDE ATTACK (AP)**

- On June 21<sup>st</sup> a cross-border suicide attack at the last entry point into the Kingdom still open to Syrian refugees killed six members of Jordan's security forces & wounded 14 more. So it closed it, leaving thousands of would-be refugees stranded in the Syrian desert beyond its border with no ready access to food & water. King Abdullah issued a statement, without going into specifics, warning that security comes first & that Jordan will "respond with an iron fist" to anyone threatening it, and government spokesman Mohammed Omani said Jordan had warned for months that militants are mingling with the refugees flowing into two rapidly expanding encampments just inside its border, posing a serious security threat.

*Although no one had as yet taken credit for it, apparently a pickup truck packed with explosives speeded through a border gate & was made to explode, driver & all, near a Jordanian army post.*

### **CHINA DUMPING MORE THAN TREASURIES... (Bloomberg, Andrea Wong)**

- Since 2014 China's FX reserves have declined 20% as the PBOC sold US dollars to support the Yuan & offset *private* capital outflows. While, after selling US\$250BN of UST bonds, its sale thereof has slowed, between July 2015 & last March it also liquidated US\$126BN (38%) of its US\$327BN US equity holdings.

*And yet the US dollar strengthened significantly during the period.*

### **DETENTION OF VILLAGE LEADER SPARKS OUTCRY (AP)**

- In 2011 the 13,000 inhabitant fishing village of Wukan, in Guangdong Province (next to Hongkong) became a symbol of grass roots defiance against China's ruling Communist Party when its residents engaged in mass protests against local party leaders whom they accused of selling their farm land without paying compensation. For while complaints about deals between party officials & developers in land sales are common (& *source of social unrest*) in rural China, in Wukan, rather than making arrests, the provincial government agreed to an election that led to 65 year-old Lin Zuluang, a protest leader, being elected, & in 2014 re-elected, as village chief & Communist Party chairman. But on June 17<sup>th</sup> police swooped in to surround government buildings & arrest Lin who had been planning a meeting with the villagers to discuss the latest illegal lands grabs, with the result that, despite a major police presence, thousands of villagers took to the streets again on Sunday June 19<sup>th</sup>.

*Xi Jinping is very much aware sensitive that, when Gorbachev sought to loosen its Communist Party's control, the end result was its total loss of power. So he has less tolerance for popular sentiments than his predecessor, Hu Jintao. But the slowdown in the economy has led to mass layoffs that have left many workers disgruntled & feeling ripped off. So it's not surprising that according to the China Labor Bulletin, a Hongkong-based labour rights group, there were 2,700+ strikes & labour protests in China in 2015, more than twice that in 2014 (& 500+ just last January). But what he may be most fearful of is that the millions of migrant workers who have lost their jobs in the cities will, upon their return to their home villages, become activist instigators of social unrest.*

#### **'POWERFUL STORM' SET TO HIT ASIAN BANKING INDUSTRY (The Straits Times)**

- On June 22<sup>nd</sup>, in its latest annual banking review, McKinsey & Company said slowing global growth, the emergence of innovative finance start-ups & an increasing number of bad loans are combining to create a "powerful storm" for banks in the Asia Pacific region and that in the years ahead it faces three main threats :
  - the economic slowdown rolling across the region will result in annual profit growth of three-, rather than ten-, percent;
  - fintech start-ups offering financial products such as payment systems & lending platforms, as well as established companies outside the industry, such China's e-commerce giant Alibaba, will encroach upon traditional banking territory; and
  - the growing volume of non-performing loans, as interest-coverage ratios are declining at large companies throughout the region, will put added stress on them and require them to raise US\$400-600BN in new capital to cover their loan losses & maintain capital adequacy ratios.
- It advises banks to focus on services for the unbanked & underbanked, the expanding affluent middle class & SMEs<sup>6</sup>, to digitize & control costs, to address their non-performing asset & strengthen their balance sheets, and form alliances with fintech firms. And it concludes that "Banks that simply try to wait out the storm will likely find themselves struggling for survival, but those that take action can uncover growth opportunities ... that could help rekindle their momentum ... The most aggressive banks will not merely survive the turbulence; they will be strengthened by it".

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<sup>6</sup> Small, and medium-sized, enterprises.

*One cannot help but wonder whether its observations & advice do not apply equally well to banks in North America & Europe.*

### **PUTIN SAID TO WEIGH \$11-BILLION ROSNEFT SALE TO CHINA, INDIA** **(World Oil, Elena Mazneva)**

- Russia is said to be seeking buyers for 19.5% of state-controlled crown jewel Rosneft (that produces more crude than Exxon) for 700BN rubles (US\$11BN) & Putin to target China & India as the buyers. This would enable him to cover the budget shortfalls & meet his spending promises before his re-election bid in two years, and strengthen his geopolitical hand after his actions in Ukraine & Syria have driven relations with the US & Europe to a post-Cold War low. It would also balance out the near 20% stake in Rosneft that London-based BP acquired in 2013 and according to Vladimir Tikhomirov, Chief Economist at Moscow brokerage BCS Financial Group, “India and China aim to boost ties with Russia, while Russia’s options for investors in Rosneft are quite narrow.” While both have expressed an interest in Rosneft without, however, confirming a deal was in the making, in a June 17<sup>th</sup> interview at Putin’s Annual Economic Forum in St. Petersburg Indian Oil Minister Dharmendra Pradhan said “We are not rivals”, adding that India’s Oil & Natural Gas Corp. (ONGC) & China National Petroleum Corp. (CNPC) were already involved in joint projects and that “more would be nice.” And last month ONGC, India’s largest oil company, already agreed to pay Rosneft US\$1.2BN for 15% of Vankor, one of the largest Russian oil fields to go into production in the last 25 years, while on June 17<sup>th</sup> Rosneft sold 23.9% interest in Vankor to three other Indian companies, Oil India Ltd., Indian Oil Corp., & Bharat Petroresources Ltd. for a rumoured US\$2.02BN.

*While according to Tikhomirov “If oil prices stay at current levels ... Russia’s deficit will not be as critical as the Finance Minister predicts ... So Rosneft sale could wait until the next year”, Economy Minister Alexei Ulyukayev said on June 17<sup>th</sup> that he expects a deal this year, while Putin said earlier he wanted the transaction completed this year because “We need the money.”*

### **NORWAY TO BAN TRADITIONAL CARS** (AutoGuide.com, Jason Siu)

- Norway’s four main political parties are said to have come to an agreement on a new energy policy that would include a ban on gasoline-operated car sales as early as 2025, despite the fact that Norway itself is a major oil exporter.

*As in their decision 25 years ago to deposit 96% of its oil revenues into its new sovereign wealth fund<sup>7</sup>, Norwegian politicians, & Norwegian voters are far more far-sighted than their counterparts in other resource-rich jurisdictions, incl. Alberta.*

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That as of March 2015 had AUM of US\$882BN (i.e. almost US\$175MM for every single one of its residents) that made it the largest such fund in the world & accounted for 12.5% of their total AUM.