

Quote of the week - "Should you find yourself in a chronically leaking boat, energy devoted to changing vessels is likely to be more productive than energy devoted to patching leaks." (*or to bailing?*)- Warren Buffett (a lesson that central bankers should take to heart!)

Brexit fallout - According to the FT, Chancellor of the Exchequer George Osborne has plans to cut the UK's corporate tax rate to 15%, or less (*from the current 20%*) to "offset the shock to investors from the Brexit vote." And elsewhere it was reported that UKIP leader Nigel Farage had decided to retire since "his political ambition had been achieved".

Dhaka terrorists - Like the 9/11 perpetrators & the Detroit "underwear" bomber, these young men came from privileged-, not deprived-, families; according to a Bangladeshi government official all had "gone to top schools and universities and seemed like normal middle class men".

Global negative-yield debt outstanding - According to Fitch the volume of sovereign debt with a negative yield now stands at US\$11.7TR-equivalent, up 12.5% in the past month, with roughly US\$2.6TR of it having a maturity of seven years or more, up nearly 100% since April.

GLEANINGS II - 666
Thursday July 7th, 2016

OUTAGES REBALANCE OIL MARKET (Reuters)

- Oil markets have been oversupplied for the past two years. But the glut has begun to ease, in part due to a string of unforeseen events, incl. wildfires in Canada¹, rebel attacks on pipelines in Nigeria & the economic crisis in Venezuela, that have helped reduce global oil output by 2MM bbl/d in recent weeks. A survey of 27 economists & analysts shows they now expect Brent crude to average US\$45.20 this year (well above its US\$41.13 average YTD), up US\$1.60 from their forecast last month & their fourth straight higher forecast,

But Goldman Sachs thinks this is temporary & that in 2017 oil will again be in (significant) surplus. Ditto for the Paris-based IEA : while it cut its 2016 surplus forecast, it did so only from 1.5MM bbl/d to 800,000 bbl/d & expects it to grow again next year to 1.3MM bbl/d. In June there was a small uptick in the US rig count & OPEC production hit an all-time high 32.82MM bbl/d on higher output in Iran, Libya & Nigeria. And Morgan Stanley warns the prospect of US\$50 oil has encouraged US shale oil producers to boost production from their most profitable fields, with Adam Longson, its commodity strategist, warning "the rig count in the highest initial production counties of Permian Midland (basin) continues to march higher and is not far from its 2015 peak." The demand side of the equation will be affected by any slowdown in global GDP growth & according to JPM it has been inflated by China YTD adding up to 1.2MM bbl/d to its strategic petroleum reserve (that it could be filled to capacity in as little as three months' time). According to the WSJ within the next 12 months more than 500,000 bbl/d of new production will come on stream from tie-back wells¹ in the Gulf.. And longer term, the supply side will see new production from, among others, Exxon's big new discovery off the coast of Guyana & Statoil's John Sverdrup 'elephant' field.

¹ This is not quite correct, the initial impetus for lower oilsands output came from maintenance work the producers started doing last April.

¹ New wells drilled from existing platforms being connected to existing pipelines to market.

OIL PRICE TO CLIMB THIS YEAR (Postmedia, Gordon Kent)

- The Deloitte Resource Evaluation and Advisory group reported on July 5th that lower production & stock piles mean that oil prices are likely to strengthen into the new year. So, it now expects US\$50 oil this year & US\$53 oil in 2017 (up from its April forecast of US\$44 & US\$49 respectively). But it expects slower future output growth as producers use their incremental cash flow to pay back debt & maintain dividends rather than hike investment *in new production facilities*. So it is gloomier about the longer term outlook expecting US\$73 oil by 2022, down from its US\$80 forecast last April. And it notes that North America now accounts for just 35% of the world's active oil drilling rigs, the first time in 23 years that its share thereof has fallen below 50%.

While the number of active drilling rigs in operation outside North America declined 30% in the past two years, their number had actually increased marginally in Russia & declined by only 6% in the Middle East (with the result that, whereas two years ago the region accounted for 31% of the active rigs outside North America, today that has risen to 41%).

U.S. JOBLESS CLAIMS INCREASE (Reuters)

- In the week ended June 25th initial claims for unemployment benefits were up 10,000 WoW to a seasonally adjusted 268,000 (vs. an expected 267,000) but the four week moving average was unchanged at 266,750. Be that as it may, they have now been below the 300,000 tipping point into a weak job market for 69 weeks.

This does not quite jive with other indicators that suggest the economy may be slowing down.

REEKING, OOZING ALGAE CLOSES SOUTH FLORIDA BEACHES (NYT, Les Neuhaus)

- On July 1st Gov. Rick Scott declared states of emergency in Martin-, Palm Beach-, St Lucie-& Lee counties *due to the proliferation of stinking green & blue algae 'blooms' along their shorelines, with the Florida Department of Environmental Protection counseling locals to stay out of the water & keep pets & livestock out of it, and not to use it on their lawns*. This isn't a new problem & is a function of competing environmental, residential & agricultural interests & of the failure by state officials to invest in managing the demands of growth.

Lee county is on Florida's Southwest coast & is the state 9th well-to-do county, while Martin, Palm Beach & St. Lucie are strung North to South along its Southeast coast (from where the Gulf Stream is believed to be carrying algae as far North as Georgia) & rank 3rd, 5th & 32nd among Florida's 67 counties. Between the four they are home to over 12% of Florida's 20+MM inhabitants. The source of the problem for all four is Lake Okeechobee, 130 miles South of Orlando, Florida's largest sweet water lake, from which, prior to the onset of the hurricane season, the Corps of Engineers has been releasing water (because its level is one foot higher than it was at the same time in 2013, the last time there was a serious algae crisis) to keep an 80 year-old dike from failing.

PROTECT MINNESOTA'S BOUNDARY WATERS (NYT, Walter F. Mondale & Theodore Roosevelt IV)

- The state's 1.1MM acre (1718 sq. mi) Boundary Waters Canoe Area Wilderness (BWCA), with its 1,200 miles of streams, many lakes & rich fauna is one of America's most popular wilderness destinations. But it is now under threat from a proposal to develop a huge *copper/nickel/platinum* mine on the South Kawishiwi River (which drains into the BWCA). For this would require the stockpiling of sulfide-laden waste rock on the surface that produces sulfuric acid which then leaches into, & poisons, the *local & downstream* surface water eco system. So in March Minnesota Gov. Mark Dayton announced he opposed the project, calling the BWCA one of his state's "crown jewels" & a "national treasure" & in April Interior Secretary Sally Jewell called BWCA a "special area" & for a study to "better understand the value of the land and water and potential impacts of development."
- The company behind the project is a major global copper producer, *LSE-listed Antofagasta* plc, *65%-controlled by Chile's Luksic family*³. To make it happen will require a renewal of two long-expired mineral leases issued in 1966⁴ *before modern environmental laws were enacted* & the *federal* Bureau of Land Management is considering whether to do so, or not, & has asked the Forest Service if it would consent to their renewal (to which the latter's response was that it is "considering withholding consent"). Over the years Presidents Roosevelt (*both Teddy & FDR*), Truman & Carter have acted to protect this wilderness area and President Obama should join them by imposing a 20-year mining moratorium.

Canada has a dog in this fight since the BWCA abuts the Canada-US border for 150 miles/240 kms As to the US Forest Service, it recently said it intends to block the lease renewal idea and all exploration for, & development of, potential mining opportunities in the Rainy River watershed of Northeastern Minnesota. And it is conducting a 'public input process' between June 20th & July 20th, incl. a public meeting on July 13th at the Duluth Entertainment & Convention Centre (at which environmental activists, incl. Theodore Roosevelt IV, are likely to be well represented & vocal).

PUERTO RICO MAKES HISTORIC DEFAULT (CNN.com, Heather Long)

- *In mid-May the White House agreed to a revised Republican-sponsored 'Puerto Rico rescue bill' that would enable its government, under the supervision of a federal oversight board, to start restructuring its US\$72BN (US\$20,000 per capita) debt. On June 30th President Obama signed it into law & within hours Puerto Rico Gov. Alejandro Garcia Padilla issued an Executive Order saying it would stop making payments on its debt, incl. its general obligation (GO) bonds and the next day Puerto Rico did in fact default on US\$800MM of them (the first time since the 1930's Great Depression that a state/state-like entity has defaulted on GO debt), saying it was in "dire" financial state, with just US\$350MM cash⁵. Since it had already defaulted three times *in the recent past* on other bonds & had been warning for months it wouldn't have the money to pay for this*

³ That after having owned for some time 40% of this property became its sole owner in January 2015 with its US\$85MM takeover, at a 284% premium over market, of TSE-listed Duluth Minerals.

⁴ That predated the 1978 Boundary Waters Canoe Area Wilderness Act, the main purpose of which was 'to protect and preserve the lakes, waterways and forested areas of the BWCA so as to enhance public enjoyment of its unique landscape and wildlife' and to 'restrict logging, mining & the use of motorized vehicles, *incl. motor boats*, in it.

⁵ I.e. less than two weeks of expenditures.

debt either, the default didn't much affect markets. As being 'out of money', it has yet to release audited financial statements for 2014, never mind anything more recent, something Dominic Frederico, CEO of Assured Guaranty, an insurer of Puerto Rico debt, calls "really troubling from a creditor point of view." While defaults usually trigger law suits, the bill Obama signed on June 30th specifically forbids bond holders from suing until the Oversight Board, that has yet to be appointed, comes up with a plan.

Might this be 'the canary in the coal mine' for junior US government bonds? These GO bonds are guaranteed by the Puerto Rican constitution and thus, at least in theory, their holders have a first dibs on its revenues & must be paid before anyone else, something that Gov. Padilla disagrees with, arguing that paying teachers, emergency personnel & for other 'critical needs' must come first.

AMERICAN CITIZEN SETTLER CHILD KILLED IN HER SLEEP (AP)

- In the early morning of June 30th a 17 year-old Palestinian high school dropout snuck into a fortified Jewish settlement, broke into a house & stabbed to death a 13 year-old girl asleep in her bed, before being killed himself by security guards. This was only the latest, in a nine month wave of Palestinian attacks on Jews & prompted Prime Minister Netanyahu to declare "The entire world needs to condemn this murder, just as it condemned the terrorist attacks in Orlando and Brussels."

The very next day a Palestinian woman from the same clan as the youth who killed the girl was shot dead when she tried to stab an officer during a security check outside a (contested) Hebron shrine & Palestinian gunmen in a car in the West Bank overtook, & opened fire on, one driven by a cousin of Yossi Cohen, the head of Mossad, killing him & wounding his wife & two teenage children before fleeing. These events prompted the Israeli government to send in hundreds of soldiers in a show of strength, to limit all movement except for humanitarian cases in the entire 700,000+ resident Hebron governorate (the southernmost & largest in area & population on the West Bank, where the 17-year-old had hailed from), to withdraw the work permits of all its residents, to arrest six Palestinians, incl. the sister of the attacker, to announce that it would cut the tax revenues it collects for the Palestinians each month since some of it had gone to the families of attackers & to announce approval of 1,400 new housing units for settlers in contested areas, 840 in East Jerusalem & 560 in Ma'ale Adinum, in the West Bank right outside the city.

4 KILLED, 5 HURT IN SUICIDE BLAST IN MEDINA (AP)

- On Monday evening, July 4th, a suicide bomber detonated his vest outside the mosque where the prophet Mohammed is buried, one of Islam's holiest sites that is visited by millions of Muslims each year, just as thousands of worshippers were about to hold sunset prayers there. This was the third suicide bombing attack in Saudi Arabia that day (although in the other two the only casualties were the suicide bombers themselves). While no group has claimed responsibility for the blasts, Iyad Madani, the Secretary-General of the 57 member nation, Jeddah-based Organization of Islamic Co-operation⁶, said the attacks are an attempt to destabilize the Kingdom whose security, he says, is "the cornerstone of security and stability in the region and the Islamic world."

⁶ The President of which is Turkey's President Recep Tayyip Erdoğan.

The vast majority of those being killed by terrorists in the name of Islam are Muslims; in time this could prove their undoing.

EU FALLING APART : FORMER ITALY PM WARNS BLOC DISINTEGRATING **(Daily Express)**

- *Long before Britain's actual Brexit vote Mario Monti observed "The EU is going through a crisis which leads me and others for the first time to consider whether we are not heading towards disintegration ... for the EU has never been hit by such a high number of different crises of this gravity ... What I am concerned about is that, although the EU has developed ... historically through a process of crises, responses to the crises, and advancement this time around it may well not happen ... the degree of mistrust and sheer prejudices between North and South and between East and West has never been so high and so unashamedly vocal". And he bemoaned the fact power had shifted away from the unelected Brussels-based Commissioners to national leaders (whom he accused of pandering to euroscepticism so as to boost their own "personal political" interests domestically).*

The date of this media 'peg' was April 26th, two months before the Brexit referendum in Britain, & shortly after Germany's Martin Schulz, the President of the European Parliament, had voiced not dissimilar concerns. And Monti is an ardent Europhile, not a critic of the EU in its present form, as befits someone who for a decade was an EU Commissioner (from 1995 to 1999 for Intellectual Matters, Services, Customs & Taxation & from 1999 to 2004 for Competition until the then incoming Prime Minister Silvio Berlusconi decided not to re-appoint him). And his bemoaning the shift "from unelected Brussels Commissioners to national leaders" shows the extent to which the self-perpetuating, empire-building Eurocrats are out of touch with reality.

EU IS BOTH SYMPTOM AND POTENTIAL CURE (Metro, Joel Blit)

- *It would be too simplistic to attribute the outcome of the Brexit referendum to bigotry; doing so would preclude us from understanding the discontent that drove it. For while economic integration has been marketed as a rising tide that lifts all boats, according to the OECD the resultant income growth has benefitted relatively few people; thus in the US 47% of the growth in the resultant pre-tax income was captured by the 1% (& in Canada 37%), in part because while technological change creates massive wealth it creates relatively few jobs. So, unless they are willing to halt technological progress, governments must do a better job of improving the quality of life for all by offering higher quality public services & funding that by taxing the primary beneficiaries of technological change (the problem with that being that the corporations & individuals involved are the most internationally mobile; so tackling inequality will require greater international cooperation at the very time that one prime example thereof, the EU, is foundering. While the leavers were justified in feeling aggrieved, their anger at the EU was misplaced & will only weaken the one institution offering a model for fighting inequality.*

For a professor of international economics at the Ontario's University of Waterloo and a Senior Fellow at that city's Centre for International Governance Innovation⁷, he displays a remarkable lack of understanding as to what the EU had degenerated into over the past two decades..

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A think tank founded in 2003 by the then co-CEO of Research-in-Motion/ Blackberry in a 50-50 funding partnership with the Government of Canada.

ITALIAN BANKS UNDER PRESSURE AS POLITICAL CRISIS LOOMS

(Market Watch, Carla Moree)

- On Monday July 4th the shares of BMPS (Siena-based Banca Monte dei Paschi di Siena, Italy's third-largest bank &, founded in 1472, the world's oldest bank) slid 14% to an all-time low 0.329 Euros (US\$0.37)⁸ & the next day another 8.4% to 0.27 Euros) after it announced the ECB wants it to cut the volume of bad loans on its books to 32.6BN Euros (US\$36.3BN) by 2018 from its current 46.9BN Euros (i.e. from 27.8% to 19.3% of its current assets) & that it had until Friday July 8th to respond⁹. YTD BMPS's shares are down 76%, those of UniCredit, Italy's largest bank by assets, 63%, those of Banca Popolare Di Milano (#5) 64% & those of Intesa Sanpaolo (#2) 46%¹⁰.
- Italian banks are weighed down by 360BN Euro-worth of non-performing loans (18.1% of their total loans & 15+% of Italy's GDP) of which 70+% is owed by insolvent customers. And Erik Nielsen, UniCredit Group Chief Economist, opined in a July 3rd note 'The *banks*' average return on equity has been less than 2% during the past five years, neither enough to clear out the NPLs (*non-performing loans*) at a decent pace, nor to attract more capital..." And concerns about bank margins have mounted as the ECB's policies have pushed interest rates sharply lower.
- According to the WSJ the EC (European Commission) last week allowed Italy to use 150BN Euros in government guarantees¹¹ as short-term liquidity support to its banks but didn't support Prime Minister Matteo Renzi's plan to inject 40BN Euros of public money into its embattled banks since EU rules call for creditors, not tax payers, to take the first hit in the rescue of troubled banks. And Citibank, in a July 2nd note, said Italy's referendum on constitutional reform (to be held before November 1st), is "probably the single biggest risk on the European political landscape ... among non-UK issues"; for it could hurt Renzi's future as Prime Minister & "raises the risk of a Renzi-exit at a time when the upstart 5 Star movement is riding high in the polls" (& euroscepticism is extremely high).

*There is growing concern that the Italian banks are a 'financial leaning tower' & that a default by one of them could have a ripple effect-, & create panic-, across Europe's (& the global?) banking system. One measure of a bank's ability to survive is the ratio of its non-performing assets over its tangible equity **plus** loan loss provisions. This "Texas ratio" is < 10% for UBS & Credit Suisse, and Canada's TD-, & Royal-, banks, < 20% for Barclay's, Deutsche Bank & HSBC & < 25% for the Commerzbank, ING, Lloyd's, RBS & Standard Chartered, but 93% for Intesa Saopaolo, 96% for UniCredit & 142% for BMPS, Italy's largest three banks; small wonder the CDS (Credit Default Swap) rate for BMPS paper is at a level indicative of a 40% probability of default. And on Wednesday July 6th Valdis Dombrovskis, the EU's Financial Services Commissioner, told the European Parliament's Economic Affairs Committee, with reference to*

⁸ Down from 9.45 Euros on May 22, 2015.

⁹ Might the ECB be panicking? For this deadline seems unrealistically tight for such a crucial business decision.

¹⁰ Last year UniCredit was the world's 26th-, & Intesa Sanpaolo the world's 35th- largest banks (with assets one fifth, or more, greater than Canada's TD Bank & RBC), and hence deemed to be "global systematically important" banks.

¹¹ Which, given the Italian government's fiscal predicament, may not have much real value.

Renzi's efforts to take advantage of the Brexit to soften the EU rules which call for investors to take a hit before any public money can be used to rescue a lender, that the Italian banks were not in crisis because of Britain's Brexit vote but because of their long-standing low profitability & heavy burden of bad loans, saying "This is not a new development. It's something which is already happening since the beginning of the year." (With little or nothing done to keep it from contaminating banks elsewhere).