

Quote of the week - “Increasingly information is generated by those who wish to promote something or someone - a product, a cause, a political candidate or office holder - without arguing their case on its merits or explicitly advertising it as self-interested material either. Much of the press, in its eagerness to inform the public, has become a conduit for the equivalent of junk mail.” - from Christopher Lasch’s The Revolt of the Elites (first published in 1995, a year after his death from cancer at age 61). *A Columbia & Harvard alum, and history professor at the University of Rochester, he believed post-WW II ‘progress’ had led to the greatest threat to democracy in the late 20th century being the emergence of a professional & management elite that manipulated words & numbers for a living, lived in an abstract world in which information & expertise were the coin of the realm & hence more concerned with the global system than with regional, national & local communities, & tended to be estranged from the hoi polloi. Strangely enough, a octogenarian journalist friend of mine once told me that his father, a hard-drinking journalist of the old school, had told him not long before he died, decades ago, that the greatest change in his lifetime had been in advertising that ‘once had served to inform people but had since become all about convincing people to buy things they don’t really need’*¹.

Ageing of the US population - In 1970 its median age was 28.1 years, by 2010 it was 37.2 years & by 2015 37.8 years. As a result, the, potential GDP growth-limiting, ‘age dependency ratio’ went from 15.70% in 1970 to 19.35% in 2010 & 22.31% in 2015 (& is expected to grow to 35%-38% by 2035 (with 30% deemed the ‘tipping point’ at which an economy’s GDP trend growth rate turns negative - *what is truly disturbing is that, while during the period 1960-2010 the compound annual growth rate of the age dependency ratio was in the 0.49% range, in the five years ended December 31, 2015 it jumped spectacularly to 1.43%*).

Alabama Senator Jeff Sessions, Trump’s nominee for Attorney-General - A one-time state prosecutor, his nomination was strongly endorsed by the law enforcement community. But it is worth remembering that in 2008, during the Bush 43 era, the US Senate refused to confirm his nomination for a federal judgeship since he had called the NAACP & ACLU “un-American” & “Communist-inspired”. And now civil rights leaders are worried that as Attorney-General he will end the DoJ’s practice of investigating local police abuses (such as those in Ferguson, MO & Cleveland, OH last year). According to the ACLU, in recent years the DoJ had launched 23 such investigations, 14 of which ended in “consent decrees”, i.e. when the local agency involved strikes a deal with the feds to reform police practices (deals that Sessions in his introduction to a 2008 paper published by the Alabama Police Institute had denigrated as “an abuse of federal authority” & “an end run around the democratic process”).

OPEC’s oil production cutback scheme - It’s not off to a great start. According to Kuwaiti Oil Minister Essam Al-Marzouq (whose country heads OPEC’s Compliance Committee, that will have its first meeting on January 22nd), reports by producing nations have so far reflected a 60% compliance rate (& *talk is growing that a 70% rate might be the best to be had*)². Since both Saudi Arabia & Kuwait exceeded their target, other OPEC members must have vastly undershot theirs. And Russia, by far the largest of non-OPEC producer, has fallen short by two-thirds of its 300,000 bbl/d production cutback commitment, blaming unusually cold winter weather in Siberia

¹ And if that was true then, it is so in spades today!

² Since the total production cutback target was 1.8MM bbl/d, 1.2MM bbl/d from OPEC (almost half of it from Saudi Arabia) & 600,000 bbl/d from non-OPEC producers (one-half of it from Russia), an OPEC member 60% compliance rate & the Russian shortfall translate in just a 1.22MM cutback (*not enough to have a strong depressing effect on oil prices?*).

-If this were to lead to lower-than-expected oil prices, compliance could suffer further as cash-short producing nations that need oil revenue to pay their bills step up output to compensate.

Outlook for the US deficit - In 2009 it hit a post-WW II high US\$ 1,413BN (9.8% of GDP & up a nine-fold in two years). While by 2015 it had declined to US\$438BN (2.24%), this year it will go to 2.6% & it's forecast to hit 6% by 2026. And higher interest rates on more debt means that by 2020 the annual interest cost of servicing the US national debt will jump 50% to 3% of GDP.

Sanctuary jurisdictions - Between 2009 & 2015 the Obama Administration deported an average 360,000 people per year. So Trump would have to spend a lot more on immigration officers & courts to deport even just 500,000/year (i.e. 4MM over eight years, far short of the number he has banded around). And his task will be complicated by the growing number of 'sanctuary jurisdictions' (junior government 'scofflaws' that not just implicitly-, but explicitly-, make life difficult for the federal immigration authorities. At last count their number included four states (incl California & Texas), 39 cities (incl. Chicago, Los Angeles, New York & San Francisco) and 364 counties (12% of the national total). While Trump has threatened to withhold federal funding from them, their leaders doubt he would, given its effect on the economy, while Jayashri Srikantiah of the Stanford Law says that case law validates sanctuary policies & that there are constitutional problems with coercing states into cooperating with financial threats.

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FED OFFICIAL SAYS STRONG JOBS DATA RULE OUT FISCAL BOOST
(FT, Sam Fleming)

- Over the past decade central banks have often been concerned that politicians were relying too heavily on monetary policy. With Donald Trump taking office next week, the Republicans are bent on investing more in public infrastructure & on radical tax reforms that could boost the federal deficit by trillions over a decade. But in a January 6th interview San Francisco Fed President John Williams (who this year has no vote in the FOMC)³ told this paper in a bullish assessment of the US economy's health that strong hiring & higher wage inflation⁴ show "the stars are aligning" in the US labour market & signaled support for three quarterly 0.25% rate increases this year, saying that, even though half the Fed policy makers are factoring in some fiscal loosening in their forecasts, the US economy doesn't need a short term fiscal boost; for it is already at full employment & inflation is closing in on the Fed's 2% target, and that if the economy were to growing faster *than expected*, 'we will have to raise interest rates faster'.

*The view that the US economy is at 'full employment' may seem at odds with the participation rate, that at < 63%, remains stubbornly at a several decade low (at last report it was 62.7%, down from 64.6% at the end-, & 66.4% at the beginning-, of the Great Recession). On the other hand, in only eight of the last 60 months has the monthly new job creation rate fallen short of the 145,000 level needed to have employment keep up with population growth.*⁵,

RATES HEADED UP AS INVESTORS LOOK TO 2017 (Kiplinger, David Payne)

- While according to Janet Yellen the Fed expects three 0.25% rate increases in 2017, Fed Board members' prognostications haven't always materialized. Be that as it may, rates are heading higher with the only question being whether '*nervous nelly*' bond holders continuing to dump bonds, will push bond yields up *faster than they otherwise might*. But no matter what she says, don't count on more than two rate increases; for the economy won't be strong enough to warrant more. For the fiscal stimulus effect of President-elect Donald Trump's proposed tax cuts will mostly occur in 2018, the strong US\$ & rising US interest rates (in part due to higher deficits & hence an increased supply of UST securities) will weigh on the economy, inflation will rise from 2.0% at the end of 2016 to 2.5% in all of 2017 due to wage pressures & firming energy prices (& *the impact on the cost of consumer goods of any protectionist initiatives by Trump?*).

He may be wrong in his interest rate call. For in recent weeks a number of Fed officials have indicated they are quite comfortable with a three-, & even a four-, rate increase scenario. (Kiplinger is a Washington-based purveyor of business forecasts & personal financial advice).

³ Once 'dove', he has more recently turned more hawkish (as has much of the FOMC).

⁴ The consensus 2017 inflation forecast among private sector economists is 2.5% (with 'outliers' as high as 3.5%). Janet Yellen herself on January 12 told a group of teachers at the Fed, & many more across the country via a web cast, that "Inflation has moved from a very low level, and it's now a little under our 2 percent objective ... it's very close." - *the thing about inflation that has been seen time again, is that it can have a self-fulfilling tendency, i.e. once an inflation expectation becomes part of the public psyche, the actual rate of inflation can, & often does, go farther faster than expected (at which point the only arrow in a central bank's quiver to fight it are brutally high interest rates - thus in the late 1970s the US inflation rate almost tripled to a peak of 14.8% in March 1980 prompting the Fed Fund rate to peak at 20% later that year).*

⁵ And at least some of the 'sticky' participation rate is a function of America's aging population.

RETAILERS RISK MULTI-BILLION EARNINGS HIT UNDER GOP TAX PLAN **(WSJ, Susan Pulliam)**

- GOP proposals to cut tax rates & keep jobs in the US risk whacking the earnings of US retailers by raising the cost of imported clothing, furniture & other goods. Among those be hardest hit by the “border-adjusted tax” would be Wal-Mart, Costco & BestBuy.

According to RBC Capital Markets’ Scot Ciccarelli it will cut Wal-Mart’s earnings 60% & Cosco’s 70%, and tip Best Buy’s bottom line into negative territory (but boost Home Depot’s by 8%).

WHAT EXACTLY IS THE GOP-CHAMPIONED ‘BORDER-ADJUSTED’ TAX? **(Market Watch, Greg Robb)**

- On January 9th House Speaker Rep. Paul Ryan (R-WI) met with members of Trump’s transition team to discuss tax reform and, more specifically, the plan to change the tax regime at the border by taxing imports 20% with exports not being taxed & made eligible for rebates. This is the most controversial component of the Republican plan to revamp the corporate tax code, While its detractors call it a “regressive consumer tax”, Harvard’s Martin Feldstein⁶ calls it is a “remarkably good deal” that could generate, “courtesy of foreign companies”, US\$120BN in new tax revenue ; or as he puts it “It’s as if the rest of the world will say ‘ we owe you an extra \$120 billion a year.’ “

Subsidizing exports & taxing imports is supposed to create incentives for domestic production especially so since the plan will no longer allow companies to reduce their taxable income by deducting their overseas expenditures. But there may be boulders in this idea’s path in the form of other countries’ retaliatory measures & WTO constraints. And one must wonder where Feldstein got the idea to portray this as a tax on foreigners, since it is not unlike a VAT (Value-Added Tax), a tax paid by Joe & Jane US Consumer.

WILL TRUMP’S PLAN REALLY BOOST DEMAND? (Project Syndicate, Martin Feldstein)

- The press & financial markets are seized by his proposal to cut taxes & spend US\$1TR on infrastructure over the next decade & their expectation this will boost aggregate demand has pushed long-term interest rates up by 50 bps. This is due to a misunderstanding of what he had said : he didn’t propose the government, in a Keynesian pump priming initiative, should carry out the investment itself but that “a deficit-neutral system of infrastructure tax credits would provide incentives for private businesses to build roads, bridges, tunnels, airports and so forth”. But Congress may not approve the large new tax credits this would involve & there is no guarantee businesses would respond as intended. And there is no reason to boost aggregate demand at this time; for with an unemployment rate of 4.9% the economy is for all intents & purposes at full employment, the tight labor market has caused the core CPI (i.e. ex food & energy) to rise 2.2% last year, vs. 1.9% a year earlier, & wages rose 2.4%, i.e. faster than inflation.

⁶ Age 77, he is President Emeritus of the National Bureau of Economic Research & an Honorary Fellow of Nuffield College, Oxford and was Chairman of Reagan’s Council of Economic Advisers for 21 months ended July 1984 (but left because as a “deficit hawk” he was uncomfortable with the US deficit having gone from next to nothing to US\$22.BN.

This article was published by the source in late November, likely well after Election Day, by a fiscal hawk. And the advocates of faster growth are overlooking the fact that the US economy's "trend growth rate" has been slowly decelerating since WW II to the point where now, as a mature economy with an aging population & lacklustre productivity growth, it appears to be < 2% (thus in the 24 quarters from the end of the Great Recession to that of 2015, in twelve the annualized GDP growth rate was < 2% & > 3% in just seven - Project Syndicate was founded in 1995, and is non-profit & based in Prague, the capital of the Czech Republic. It translates & distributes commentaries on a wide range of topics in dozens of languages, incl. Arabic, Chinese & Russian drawn from hundreds of member publications in over 150 countries (with a bias towards those in the developed world). And at various times it has been referred to as "one of the world's top five news sites" & "the world's smartest op-ed page."

PARIS PEACE CONFERENCE IS RIGGED BY PALESTINIANS UNDER FRENCH AUSPICES **(Hares, Baran Rabid)**

- On January 15th & 16th a conference is scheduled for Paris in which foreign ministers & senior diplomats from 70 countries, incl. the US' John Kerry, will meet to reaffirm the international community's continued support for a two state solution (*or should it be in a last ditch attempt to snatch it from the dustbin of geopolitical irrelevance?*). For according to French President Francois Hollande support for the concept has weakened 'on the ground & in the mind' and "If we let it wither away, it would be a risk to Israel's security ... However, I am realistic in what this conference can achieve. Peace will only be done by the Israelis and the Palestinians and by no one else."
- But Netanyahu isn't buying any of this. Prior to a meeting with Norway's Foreign Minister (who told him later he had not changed his mind about attending), Netanyahu 'went public' saying "It's a rigged conference, rigged by the Palestinians and with French auspices to adopt additional anti-Israel stances", calling it "part of terrorist attempts to destroy any chance for peace". A leaked draft closing statement for the conference calls on Netanyahu & Abbas to declare their support for the two state solution & 'shake off' those of their officials opposed to it (like Naftali Bennett, Israel's Minister of Education), & notes the countries in attendance don't recognize any change in Israel's 1967 borders, incl. East Jerusalem, except those already agreed to by both parties in negotiations, & are committed to differentiate in all their actions between the territory in Israel proper & the settlements in that captured by Israel in 1967. *Even though this statement, by talking about the 1967 borders, explicitly recognizes Israel's 'right to exist', Netanyahu is said to be concerned this draft closing statement will be adopted by the EU Council of Foreign Ministers & by those of the "Quartet" (US, Russia, UN & EU) & prompt another UNSC resolution when it meets on January 17th to discuss the Israeli-Palestinian issue.*

This is vintage Netanyahu's myopic negativism, blinkered shortsightedness & 'my way or the highway' posturing. He is counting on the Trump being more sympathetic to his view than previous US Presidents⁷ (but worried Obama may want to have one more 'kick at the cat' while he still can?). And he objects in principle to all foreign 'muscling in' on the Israeli-Palestinian issue; for while he seems to think that if he can just get Abbas in a corner by himself he can bully him, not appreciating that, to paraphrase Henry Kissinger 'Any deal from which one side emerges deliriously happy & the other deeply unhappy, is not a deal with a future'. And

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In fact this conference has been portrayed by its detractors as an attempt by "enemies of Israel" & by its proponents as a warning to both Trump & Netanyahu as a reminder world opinion has become increasingly less sympathetic to Israel's policy stance on the Israeli-Palestinian issue.

domestically his position has been weakened by the recent poll showing a significant majority of Israelis would go along with some sort of a two state solution & by the criminal investigation of his finances that is now underway.

BIG QUESTIONS LOOM OVER SYRIAN CEASE FIRE (Vue Weekly, Gwynne Dyer)

- The Russians are organizing a ‘peace conference’ in Astana, Kazakhstan to be co-chaired by Putin & Turkey President Recep Tayyip Erdogan (who once was major Syrian rebel supporter)⁸. This will be a Russian show; for the US has not been invited & neither has Saudi Arabia. This raises the question as to what deal Erdogan may have cut with Putin, for Turkey has not (*at least not publicly*) abandoned its demand that Syrian President Bashar al-Assad must step down, while, due to Russia’s & Iran’s help, he has won the war & the rebels seem doomed, as all their outside supporters are deserting them : Turkey is playing footsie with Russia, soon Trump will be President & is expected to make Washington more Russia-friendly, Saudi Arabia is hopelessly over-extended in its war in Yemen, & Qatar, long one of the main paymasters of the rebels, recently spent⁹ US\$11.5BN on a 19.5% interest in Rosneft, Russia’s largest oil producer.
- While Astana may produce some sort of peace deal that vaguely promises an election at some *distant* future, Assad doesn’t plan to quit & Moscow won’t force him to. A military victory over Assad is no longer a realistic option, no matter what the hardcore Islamists, ISIS (which *still* controls much of eastern Syria & western Iraq) & the Nusra Front¹⁰ that still controls much of Northwestern Syria, say. But what may now happen to the Kurds, 10% of Syria’s population, whose forces control most of the Kurdish majority-inhabited areas in northern Syria & have carried most of America’s fight against ISIS. They are not Islamists, nor terrorists (*no matter what Putin & al-Assad may claim*¹¹) & have avoided any military confrontation with Turkey despite President Erdogan’s war against Turkey’s Kurdish minority (& *over the objections of the Iraqi government, against the Kurds in Northeastern Iraq*). They too haven’t been invited to Astana. Does Erdogan now have a free hand to tackle Rojava, the proto-state the Kurds have set up in Northern Syria? Assad would welcome that provided the Turks left after having done so, Putin could care one way or another & neither does Trump. And while the Turks would have a fight on their hands in the short term, longer term they have the man-, & fire-, power to wear the Kurds down (*especially if Iran, that too has a Kurdish problem*) were *to join the fray*. So even if the Astana conference goes according to Moscow’s plan, in the short term there will be no end to the fighting in Syria. But with no more money & weapons flowing to his opposition, ‘Assad will probably one day *again* rule over a united Syria’.

⁸ And who in November 2015 had mightily upset Putin when a Turkish jet fighter shot down a Russian one for, supposedly inadvertently, strayed across the Syrian-Turkish border.

⁹ The state-owned Qatar Petroleum Company has since September 2014 been under the direction of Saad Sherida Ak Kaabi, a Penn State graduate in petroleum & natural gas engineering who has launched a new strategy of having the company invest in foreign oil & gas production projects (despite the fact that Qatar has 138 years of oil & gas reserves and is the world’s largest exporter of LNG), This investment too suggests Qatar may be seeking to move out of the US’ orbit.

¹⁰ Now renamed the Front for the Conquest of the Levant, so as to disguise its al-Qaeda affiliation.

¹¹ It has become common practice for all dictators of all stripes, ‘tin pot’ or not, to refer to everyone who pro-actively opposes their self-serving policies as “terrorists”.

Without the Americans & the Saudis, the Astana conference will be like ‘the clapping of one hand’, for ISIS & al-Nusra said from the get-go that they wouldn’t come, even if invited, while the other rebel groups have since indicated they won’t come either since the al-Assad forces have broken the ceasefire time & again & have again started using barrel bombs against them. But Dyer’s prognostication may well come to nought. For any Assad victory likely will turn out to be Pyrrhic in nature¹² since when all is said & done, 20% of his pre-war subjects, with a disparate portion of the better-educated among them, has fled & almost twice as many have been ‘internally displaced’, the almost two decade-long drought, supposedly the worst in centuries (that prompted millions of rural people to migrate into the cities, in the process becoming imbued with anti-government sentiments), Aleppo, the country’s industrial heart, looks like a post-WW II German city (except that there won’t be a mini-Marshall Plan 2.0 to help it back on its feet), and his army is down to half its pre-civil war strength due to casualties, desertions or popular opposition to new recruitment¹³.

US NEEDS TO ‘WAGE WAR’ TO BLOCK OFF SOUTH CHINA SEA ISLANDS (Reuters)

- On January 11th, during his Senate confirmation hearing, Rex Tillerson, Trump’s Secretary of State nominee, suggested blocking Chinese access to the islands in the South China Sea over which it claims sovereignty (*contrary to the provisions of the UN’s Law of the Sea*) so as to send a message to Beijing that their access to them “is not going to be allowed.” Two days later, on the 13th, the Global Times¹⁴ in a editorial postulated that the US would have to “wage a large scale war” to prevent Chinese access to the islands & that Tillerson had better bone up on “nuclear power strategies if he wants to force a ‘big nuclear power’ to withdraw from its own territories”, while volunteering the information that he had made this comment in an attempt to impress his Senate questioners & was “the most likely of Trump’s *Cabinet* nominees to be vetoed by the US Senate.”

In dealing with Beijing such loose-lipped comments can-, & will, be used by Beijing against the US; for it will use any failure to follow through in its international dealings to gain support from other countries by bragging it had talked back to Washington & made it ‘back down’.

RUSSIA BEGINS WITHDRAWAL FROM SYRIA (AP, Jim Heintz)

- On January 6th Moscow announced that, on orders of President Putin to “scale back”, it was withdrawing its warships from the Eastern Mediterranean coast (the biggest of which, the aircraft carrier Admiral Kuznetsov, had arrived there just two months ago, but

¹² Generally defined as ‘a victory that inflicts such a devastating toll on the victor that it is tantamount to a defeat’. It is named after King Pyrrhus of Epirus, a state in what is now Northwestern Greece, who in 280 BC, after invading Southern Italy decisively beat the Roman legions at Heracles (in the arch of the boot of Italy, and did so again two years later in the Battle of Asculum, up the peninsula one-third of the way to Rome, but in the process suffered such serious casualties (that being far away from home, he could not replace whereas Rome could) that while ‘he won the battle, he in effect lost the war’.

¹³ Even among his Alawite co-religionists, that historically have been the most politically reliable in the armed forces & hence provided the lion’s share of its officer & lower-ranked leaders; but the war has resulted in one-third of Alawites of military service age losing their lives.

¹⁴ A daily newspaper in the China Daily stable that is generally deemed a CPC mouth piece.

in its 'time on station' had played a decisive role by providing air support to al-Assad's forces in the final battle for Aleppo). But it is not clear how far Moscow intends to draw down its forces in Syria; for Putin himself has said that Russia will continue fighting "international terrorism" in Syria & supporting Bashar al-Assad's military (i.e. he has no intention of leaving altogether. And according to General Valery Gerasimov, the Chief of the Russian General Staff, "The success of the Syrian armed forces(???) in the liberation of Aleppo has created the necessary conditions for the peaceful settlement of the conflict ... that it will lay the basis for the political settlement of the conflict."

Putin became involved militarily in supporting Al-Assad in September 2015. Six months later, during a brief US/Russian brokered ceasefire & the launch of peace talks in Geneva, a few Russian units were withdrawn, only to be sent back in greater numbers weeks after the cease fire had collapsed & the peace talks gone nowhere. Such 'scaling back' is likely done for financial-, rather than political-, or military-, reasons; for the (foreign exchange) cost to the Russian Treasury of Putin's Syrian venture is said to have been US\$4MM/day range (i.e. US\$1.5BN annually), while his Ukrainian venture also entailed significant costs, at a time Russia's economy was gasping for air & tax revenues slipped.

SPANISH BANKS LOSE EU CASE ON MORTGAGE INTEREST REPAYMENTS **(Bloomberg, Stephanie Baden)**

- Many home loans in Spain (& some other European countries?) are of a floating rate nature & tied to 12 month EURIBOR (the Euro Inter-bank Offered Rate) that went from 5.39% in 2008 to -0.074% last November. While a significant share of the Spanish banks' 521BN Euro home loan portfolio features interest rate caps & floors, in May 2013 Spains' Supreme Court outlawed mortgage terms that prevent home loan borrowing costs from falling in line with their benchmark rates & in May 2016 a Madrid court ordered 40 banks to reimburse borrowers for all interest rate overpayments since the Supreme Court decision. Then, last December 21st the EU Court of Justice ruled that borrowers who paid too much on their home loans are entitled to a *full* refund from their bank, that any time limit on refunds (*a suggestion of the bank lobby*) is illegal, and that borrowers should not be bound by such 'unfair terms'. According to Dragh Quinn, an analyst at Keefe Bruyette & Woods "This (*the EU Court of Justice ruling*) comes as a surprise and at a bad moment for banks as most of them would have to make extra provisions to pay for this" (*that will have a deleterious effect on the CET1 ratio*).

This will cost the banks at least 4BN Euros (much of it not 'provided for'), will eat into their CET1 ratio¹⁵ & could conceivably lead to a 'black swan' event in the European banking system.

¹⁵ The ratio of a bank's retained earnings & common equity over its risk-weighted assets (currently set at 4.5% (although the ECB over Christmas informed the troubled Monte dei Paschi Italian bank that it needed to have an 8% CET1 ratio.