

GLEANINGS II - 737
Thursday November 23rd, 2017

Erratum - One of you pointed out that in Gleanings 736 I had mistakenly referred to Alabama's "Roy" Moore as "Roger" Moore - Mea Culpa!

Canada's GDP growth built on 'feet of clay'? - In September the OECD identified Canada's 2017 3.2% GDP growth rate as the highest among the G-7 countries. But earlier this week its Economic Outlook update said that our household debt had "continued to rise from high levels" and that in the Fourth Quarter, at 100+% of GDP, it was the highest of all major economies. And almost simultaneously StatsCan came out with a report that in 2016 the aggregate deficit of all federal-, provincial-, & municipal-, governments had been C\$18.1BN, up from C\$12.9BN in 2015 (compared to C\$62BN in 2009 & C\$9.7BN in 2008).

Five percent of the NYSE Composite Index gain YTD is accounted for by a single stock, China's Alibaba (something President Trump has never acknowledged, nor may even be aware of) - It was listed on the NYSE in September 2014 via the largest ever, US\$25BN, IPO at US\$68/share (even larger than the US\$22BN China Agricultural Bank's IPO four years earlier) and at last report traded at US\$191.19, nearly 3x its IPO price (which gives it a market capitalization of US\$487BN, 40+% greater than ExxonMobil's 335BN).

ICOs (Initial Coin Offerings) - constitute an unconventional & controversial way of raising money through the sale of crypto currencies for real money, currently at a monthly rate of US\$50MM. The volume done has grown meteorically : six in 2014 & seven in 2015, each for < US\$100MM, 36 for US\$500MM in 2016 &, YTD, 149 for US\$2.8BN. There are concerns in many quarters the crypto currency phenomenon is unregulated & thus potentially vulnerable to scamming; so last September 4th Beijing banned all issuance of ICOs within the PRC & ruled that the US\$400MM raised from an estimated 100,000 Chinese had to be refunded.

President Xi has made it a priority to minimize capital outflows - among others by imposing a limit of US\$50,000 on the amount that its citizens can legally take out of the country, by shutting down platforms that trade crypto currencies, by placing limits on the amount that Chinese citizens can invest abroad in property, entertainment & sports teams & generally by placing curbs on payments abroad. But as *I learnt long ago*, there is no end to human ingenuity where money is concerned; so on earlier this week the authorities 'bust' a Guangdong-based 'underground bank' & arrested the seven people behind it, who had, by various nefarious means, enabled 10,000+ Chinese citizens to funnel US\$3+BN safely abroad - *Not surprisingly so the Hongkong-, Shanghai-, Shenzhen stock exchanges had big 'down days' in its wake, with 2,800+ of the 3,400 A shares in the Shanghai Composite Index experiencing an average 2.9% decline (its largest daily percentage drop in 11 months) in an environment already spooked by fears of a tighter monetary policy ('underground banks' may be illegal but that doesn't seem to have stopped their plentiful creation; thus last year alone the authorities busted over 380 of them, with total assets in the US\$130+BN range).*

Tesla's new Roadster - This was Tesla Motors' first sports car a decade ago. Now it has announced plans to come to the market in 2020¹ with an upgraded four-seater model with a retractable roof, a 1,000 km range, an acceleration from 0-100 kms in 1.9 seconds, from 0-160 kms in 4.2 seconds & a top speed of 402 kms, and a price tag in the US\$200,000 plus range .

¹ That is if the company is still around by then; for, while its US\$53BN market capitalization is greater than Ford's US\$48BN, it still has to show a profit.

Zimbabwe - Recent events in the country that led to Mugabe's resignation were stage managed by 75 year-old Emmerson Mnangagwa, with the military 'doing the heavy lifting', to ensure that the President's wife Grace would never succeed him. A lawyer, most of whose legal studies took place in jail in the pre-independence era, Mnangagwa has been an ally of Mugabe since 1970's War of Independence & instrumental in Mugabe's political survival after the 2007 coup attempt & the 2008 Presidential election (when Mugabe came second in the first round to Morgan Tsvangirai who, after an outbreak of violence, chose not to run against him in the second round). Over the years he served Mugabe in a number of ministerial posts (& nurtured ever closer links with the country's military & security establishment) until December 2014 when Mugabe made him Vice-President in which capacity he got into a pissing match with Grace Mugabe² on the Old Man's succession. This led to him being sacked by Mugabe on November 6th, after which he fled to South Africa. After the Zimbabwean Parliament moved on November 21st to impeach him & Mugabe responded by resigning, Mnangagwa returned to Zimbabwe in time to be sworn in as its President on Friday November 24th ..

On his return home on November 22nd Mnangagwa told an enthusiastic welcoming crowd that he would "lead the nation into a new and unfolding democracy" & pledged "to be your servant". But after decades of gross mismanagement, the economy is now in dire straits : the 'formal' economy's unemployment rate is the 90% range & the banks are in such dreadful shape that daily ATM withdrawals are limited to US\$20. Moreover, transfers of power in Africa more often than not are a matter of "same shit, different pile", i.e. just a matter of a different set of thieves enriching themselves at the expense of the hoi polloi. And he is one of Zimbabwe's wealthiest people, his sobriquet "The Crocodile" is not a complimentary one, and he has long been Mugabe's "enforcer" &, as such, has over the years been held responsible for the death of tens of thousands of fellow Zimbabweans, most prominently so during the 1980s ZANU-ZAPU Shona-Ntebele (82-16%) power struggle between Mugabe & Joshua Nkomo. And the West will be faced with a quandary : either support the new regime financially & risk having its generosity squandered, or leave the field to Beijing that loves fishing in muddy waters & has already been doing so in Zimbabwe for a number of years.

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South African-born (in 1965), she has lived in Zimbabwe since age four. In the late 1980s, while Mugabe's personal secretary, she became his mistress & had two children with him while she was still married to Zimbabwe Air Force now Wing Commander Stanley Goreraza (with whom she had a son, the now 33 year-old Russell Goreraza, who recently made the headlines for celebrating the arrival of two custom-built Rolls Royces that cost him as much as £4MM, & who in 2015 was found guilty of "culpable homicide" & sentenced to two months in jail for killing a pedestrian in a car accident), & he to Ghana-born Sally Hafrion, after whose death in 1992, she married Mugabe in 1996 in an "extravagant Roman Catholic ceremony" that the local media called the "Wedding of the Century". After the 2002 election the EU imposed sanctions on 71 Zimbabweans, incl. Grace Mugabe, in retaliation for the Mugabe regime having banned EU observers from the election (a move subsequently mimicked by the US). In 2007 she enrolled in the undergraduate program of China's Renmin University (admitting after graduation in 2011 that she still wasn't proficient in Chinese), in 2014 she became Head of the Zany-PF ruling party's Women's Wing & was instrumental in Vice President Joice Mujuru's replacement with Emmerson Mnangagwa, and in 2015 was awarded, after just a couple of months in the program, a Ph.D. "In Orphanages" by her husband, in his capacity as Chancellor of the University of Zimbabwe. Along the way she was responsible for the construction of three new Presidential palaces, and acquired a large real estate portfolio at home and abroad & the sobriquet of "Gucci Grace" for her shopping trips abroad, and a reputation for physically attacking, or having security guards or her sons attack, people who displeased her.

THE NEXT BIG CYBER ATTACK COULD TURN AMERICA'S LIGHTS OFF

(BW, Max Chafkin & Dune Lawrence)

- In its early phase people will just blame the weather, an accident or just corporate incompetence. It happened in the Western Ukraine two years ago (& again last year in the Ukrainian capital) when malicious ‘Trojan’ software blacked out several hundred thousand people. Most Americans & Europeans are not taking such events seriously even as they have become almost routine³. And experts say that the hackers behind the Ukraine outages have also already wormed their way into the systems that run the US energy grid; thus last month the FBI & DHS issued an ‘alert’ about a “multi-stage intrusion campaign” targeting the industrial control systems in the critical, interconnected infrastructure of the “energy, water aviation, nuclear and manufacturing sectors”. And intelligence analysts say that at least four, *not particularly US-friendly*, countries (China, Iran, North Korea & Russia) have the ability to hack into critical US systems).

Thus a few years ago already some unfriendly source hacked into the personal computer of the then US Secretary of Defense. And the Russians have even coined a name for such activities, the “Gerasimov Doctrine”; for in February 2013 Gen, Valery Gerasimov, Russia’s Chief of the General Staff, contributed a 2000-word article to the Russian trade paper, The Military-Industrial Kurier, in which he laid out a new theory of modern warfare that looks to hacking, rather than head-on confrontations, as the primary means of attacking an enemy.

THE TWO BIGGEST RISKS NOW ARE CHINA AND INFLATION (BB, Adam Haigh)

- One pivotal question facing forecasters is whether 2018 will mark the turning point for markets as the central banks wind back the extraordinarily high levels of stimulus that have fueled asset-price growth in recent years. But that is not what preoccupies Larry Hatheway, the Chief Economist of Zurich-based GAM (Global Asset Management); for in an interview on Bloomberg TV he said that his two greatest concerns for the next 3-6 months were the possibility of a (major) slowdown in economic growth in China spurred by the authorities’ restraint of credit growth and, although there is currently little evidence thereof, a surge in inflation in the US, Europe and/or Japan, none of which markets are currently anticipating.

GAM was founded in 1983 & has AUM of SF131.3BN/US\$135BN & Hatheway (age 59) has a BA from Princeton, an MA from Johns Hopkins & a Ph.D. from the University of Texas, and joined GAM two years ago after 13 years as Chief Economist of UBS Investment Banking

FED POLICY MAKERS SAY RATE INCREASE LIKELY WARRANTED SOON

(Reuters, Jason Longe & Howard Schneider)

- The minutes of the October 31st-November 1st FOMC meeting, which kept rates unchanged, were released on November 22nd & showed that all of its members agreed the economy was poised for strong growth & that some saw improved chances Congress will pass tax cuts that would boost business investment. More specifically they noted “Participants expected solid growth in consumer spending in the near term supported by ongoing strength in the labor market ... and many participants thought that another increase in the target range for the federal funds rate was likely ... warranted in

³ The Baltic states have been intermittently exposed to such Russian-initiated events for a decade.

the near future.”⁴ The minutes also showed that its members engaged in what has become a regular debate over why inflation has for several years remained below the Fed’s 2% target, with most of them agreeing that tightness in the labor market would likely “fuel higher inflation in the medium term”, some expressing concern about the inflation outlook & a couple concerned enough about the persistently weak price gains to suggest that the Fed ought to consider a new *policy* framework that would commit it to allow higher inflation to make up for periods of low price rises. And Fed Chair (*until February 2nd when she will resign from the Board*) Janet Yellen stuck to her prediction that inflation will soon rebound towards the Fed target (although since - *on November 21st* - she confessed she is *now* “very uncertain” about this & open to the possibility that prices could remain low for years to come).

Meanwhile, the Atlanta Fed’s GDPNow live GDP growth rate fluctuated from 2.9% on October 30th to 4.5% on November 2nd & back again to 3.4% on November 22nd, while the average of the ten top-, & bottom-, ten private sector economists’ forecasts ranged from 3.2% to 2.4%, and the preliminary University of Michigan Consumer Confidence Index for November was 98.5, down from the 162 months’ high 100.7 in October.

MICHAEL FLYNN BREAKS TIES WITH TRUMP LAWYERS OVER RUSSIA INVESTIGATION (AP)

- The lawyers for Trump’s former National Security Adviser have cut off communications with the President’s legal team.

Since it is common practice in major criminal investigations for defense lawyers to routinely share information, this is taken as a sign that Flynn has “rolled”, i.e. agreed to a “deal” with Special Counsel Robert Mueller to start cooperating with him, i.e. to start ‘ratting’ on the Trump crowd, in exchange for preferential treatment.

US TRADE REP CONCERNED AFTER LATEST ROUND OF NAFTA TALKS (AP)

- In a November 21st statement, two days after the conclusion of the fifth round of talks, in Mexico City, Robert Lighthizer, Trump’s Trade Representative, expressed concern about the lack of progress in the renegotiation of the North American Free Trade Agreement, saying he had seen no evidence that Canada or Mexico were willing to accept the changes proposed by the US team & that without a rebalancing of the agreement a satisfactory result would not be reached. That same day a trilateral, post-talks statement was released that, without providing specifics, said progress had been made on a number of chapters in the treaty & that the next (i.e. sixth) round of talks was scheduled for January 23rd-28th in Montreal.

Last weekend’s meeting was a relatively low-key affair; for neither the three Ministers responsible nor Mr. Lighthizer himself had bothered to attend. One of the key points, if not the key bone of contention, is the Trump demand for a ‘sunset clause’ in the amended treaty that would automatically terminate it in five years unless all three parties to it agreed to extend it (a provision that Canada & Mexico contend will create a degree of uncertainty incompatible with long-term corporate planning). Meanwhile the US Chamber of Commerce stepped up its efforts

⁴ The Fed has increased rates four time in a tightening cycle that began 23 months ago and predicts one more this year (i.e. at its December 12/13 meeting), & three more in 2018

to save NAFTA by issuing a report saying a NAFTA pull out will be most hurt 12 states (Arizona, Indiana, Iowa, Michigan, Missouri, Nebraska, North Carolina, North Dakota, Ohio, Pennsylvania, Texas & Wisconsin) that had accounted for 50+% Trump's Electoral College votes.

SAUDI ARABIA'S ARAB SPRING AT LAST - THE CROWN PRINCE HAS BIG PLANS TO BRING BACK A LEVEL OF TOLERANCE TO HIS SOCIETY (NYT, Thomas L. Friedman)

- I never thought I'd live long enough to write this sentence : "The most significant reform process underway in the Middle East today is in Saudi Arabia. But unlike the other Arab Springs - all of which emerged bottom up and failed miserably, except in Tunisia (*where it all started*) this one is led top down by the country's 32 year-old Crown Prince, Mohammed bin Salman and, if it succeeds, it will not only change the character of Saudi Arabia but the tenor of Islam across the globe".

Friedman, who usually writes with 'his feet firmly on the ground', this time seems engaged in wishful thinking, with 'his head in the clouds', as evidenced by his conclusion that "only a fool will predict its success - but only a fool would not root for it". For Crown Prince Mohammed (aka MBS) has 'bitten off' far more than he can chew & in the process has gored more oxen than he will be able to cope with (especially if his father, King Salman, who will turn 82 on December 31st & long has been rumoured to suffer from early dementia, were to die, or as the latest rumours have it, abdicates to make MBS King. Little, if any, of what he has managed or promoted so far has been successful. He is in desperate fiscal straits & his anti-corruption crusade is little more than a subterfuge to strip assets from those confined to the Riyadh Ritz Carlton regardless of whether they were legitimately accumulated or not. His main support base is among the Millennial Generation (of whom there are far fewer in Saudi Arabia than there are Shiites) who will support him for only as long as he delivers on their optimistic expectations. And the greater the tension he induces in the Middle East, the less likely the Aramco IPO will generate the cash critical to his plans. Throughout history top-down 'revolutions' have seldom resulted in real change & more often than not only in a re-arranging of the deck chairs on the Titanic. And according to the Jerusalem Post Dr. Joel Guzanski from Israel's Institute for National Security poured cold water on the idea of a budding Israeli-Saudi friendship by telling The Media Line (a non-profit American news agency covering the Middle East) "There is a lot of exaggeration here ... Lots of Israelis see MBS' assertiveness favorably as a positive thing. But I think his conduct is restless and is already hurting American, and possibly Israel's interests in the region ... Israeli and Saudi interests do not overlap entirely regarding Iran and Lebanon ... as both countries have very different views regarding the method to deal with these threats", while the Media Line quoted King College London's Dr. Andreas Krieg, a Middle East security analyst, as slamming MBS as an "authoritarian autocrat who seems to disregard any form of consensual governance, even with the family ... MBS has so far failed on every front in foreign and security policy ... He is hotheaded, paranoid and lacks any strategic patience."

N. KOREA SPONSORS TERROR : US (AP, Matthew Pennington & Zeke Miller)

- On November 20th President Trump placed North Korea's "murderous regime" back on America's terrorism blacklist (that for a decade had been limited to Iran, Sudan & Syria); in so doing he said this was "long overdue" & that "In addition to threatening the world (*or rather the US?*) by nuclear annihilation, North Korea has repeatedly supported acts of terrorism, including assassinations on foreign soil (*most prominently that with nerve gas last February of his half brother Kim Jong Nam in the Kuala Lumpur airport*). It had previously been on that list for two decades ending in 2008 when it had been removed in an unsuccessful bid to salvage the international talks aimed at it halting his father's

nuclear efforts. This will increase its already growing isolation due to the US' sanctions restricting its trade, foreign assistance, defense sales & export of sensitive technology & and further sour the relations between Washington & Pyongyang (that recently has turned uglier with “old” and “short and fat” name calling on Twitter).

While this move has strong support in Congress, it may not have been, from a US perspective, the smartest of moves; for it will feed Un’s paranoia about being attacked by the US & prompt him to accelerate-, rather than slow down-, his ICBM/nuclear weapons development program, thereby increasing the potential risk to South Korea & Japan, and possibly the US itself.

TESLA BUILDS HUGE CHARGING STATION IN BEIJING (China Daily, Li Fusheng)

- China is now home to Tesla's largest two charging stations in the world. The one in Shanghai started operating October & that in Beijing was launched on November 17th. Each can service 50 cars simultaneously & the company says building two such large outlets in China in such a short time evidences its focus on customer convenience & commitment to the Chinese market. Tesla now has over 800 charging outlets in 170 Chinese cities (140 in Beijing alone) & expects to have 1,000 by yearend. China is one of Tesla's most important markets : in the Third Quarter its China revenue was US\$563MM, up 79% YoY, & accounted for 20% of its total global revenue.
- To attract more customers Tesla has started to modify its Model S sedans & Model X SUVs for the Chinese market & to retrofit its charging network to comply with local norms, and has entered into talks with the Shanghai government to build a car manufacturing plant in the region (that CEO Elon Musk said recently will come on stream in three years, making cars for the Chinese & other Asian markets, albeit not Models S & X but the smaller & cheaper Model 3 & the upcoming Model Y crossover).
- Since 2013 Tesla had delivered 250,000+ electric cars worldwide.

Last September, after a number of European countries announced plans to ban traditional internal combustion vehicles at some point between 2025 & 2040, Beijing announced it too was studying the possibility of a similar (but sooner?) ban of petrol-, & diesel-fueled-, vehicles in the context of its plans to move its industrial capacity onto a higher-tech growth path from its traditional emphasis on low-tech, low value-added consumer goods.

N. KOREA MILITARY OFFICERS PUNISHED (AP)

- South Korea's spy agency told lawmakers on November 20th that North Korea had punished two of its top military officers, incl. one widely seen as its most powerful official, during a highly unusual inspection of the military's powerful Political Bureau. According to Kim Byung-kee, a lawmaker who had attended the closed-door briefing by the National Intelligence Service, the inspection of North Korea's General Political Bureau had been the first of its kind in 20 years & had been prompted by its (*not further detailed*) “impure” attitude & those ‘punished’ included Vice Marshall Hwang Pyong Su (who as the military's top political officer was the country's second most powerful official after Kim Jong Un himself), his deputy Kim Won Hong & several others .

Hwang's downfall was apparently orchestrated by the senior Workers' Party official Choe Ryong Hae who once had been the military's top political officer & who therefore stands to gain from Hwang's fall from grace. And his success in doing so came as a surprise since Hwang has long been known for being very care-, & respect-, ful in his dealings with Un. On the other hand, since he came to power in 2011 Un has launched a series of high level purges to bolster his

grasp on power & to remove anyone who might pose a threat to his leadership. Be that as it may, Hwang is believed to have escaped with his life and, if so, would be luckier than some others, incl. Un's sexagenarian uncle (the son of his father's only sister), who had piqued UN & in December 2013 was blown to pieces by anti-aircraft cannon fire.

UK FACES LONGEST FALL IN LIVING STANDARDS ON RECORD **(BB, Simon Kennedy & Thomas Penny)**

- After analyzing the latest budget⁵, & the accompanying report by the OBR (Office for Budget Responsibility), the London-based independent think tank Resolution Foundation (founded in 2005 to ‘improve the standard of living of low-, & middle class-, families’), said on November 23rd that the UK economy is set to be £42BN/US\$56 BN (i.e. about 2%) smaller by 2022 than the OBR had predicted last March. Furthermore, that (real?) wages will not return to their pre-financial crisis level until at least 2025, that the average annual pay will be £1,030 lower by 2022 than the OBR’s March forecast & that between 2015 & 2020 household disposable incomes will decline for an unprecedented 19 quarters in a row. And its analysis was reinforced by the London-based Institute for Fiscal Studies’ (founded in 1969) finding that the OBR’s forecasts imply average earnings will be almost £1,400 lower in 2021 than had been predicted before the 2016 Brexit referendum. And the Resolution Foundation also said that 2017 productivity growth will, on a ten-year rolling average basis, be just 0.1%, the worst since the Napoleonic era, a problem recognized by the Chancellor of the Exchequer in his post-Budget interviews when he told the BBC “the way to deliver higher real pay growth is to improve productivity, there is no other solution ... You cannot generate high wage growth unless you’re being more productive”.

And high productivity growth is difficult to come by in an economy with a population as old, & as rapidly ageing, as the UK’s.

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That had disappointed millions of public sector workers who had hoped it would end the past five years' pay restraint policy & lift the annual 1% 'cap' on salary increases in place since 2013.