

**Note** : It would be worth your while googling & reading John Mauldin's latest From the Front Lines column entitled ZIRP and NIRP<sup>1</sup> : Killing Retirement As We Know It (especially the first half); for it explains the box that decades of bad fiscal management have gotten the developed world into & the extent to which the Fed's recent policies are contributing to bringing the situation to a head.

**Quote of the week** - "We are doing (*with negative interest rates*) something the world has never seen ... We do not know how this will play out ... (*We*) are sitting with billions of dollars or euros in an insurance company ... in Europe and they will bear a negative interest ... We would be better off with a very big mattress in Europe that we just stick all this money in ... It distorts everything." - Warren Buffett (more on this 'below the line').

**China's foreign policy** - According to Robert D. Blackwell, a Senior Fellow at the New York-based Council on Foreign Relations & Kurt Campbell, CEO of the Washington-based Asia Group LLC, a strategy advisory firm, "China's foreign policy may well be driven increasingly by the risk of domestic political conditions ... Economic growth and nationalism have ... been the two founts of legitimacy for the Chinese Communist Party and, as the former wanes, [Chinese leader Xi Jinping] will likely rely increasingly on the latter ... to protect his position ... (and) most probably stimulate and intensify Chinese nationalism." - *an old trick, creating a foreign bogeyman at times of stress.*

**Changing economics?** - In the 18 months to December 31<sup>st</sup>, 2015 the US average gasoline price at the pump tumbled 29% & the number of miles driven by Americans grew 5%, whereas during a similar 18 months' period in the early 1980s, when oil prices also started a multi-year slide, gasoline prices declined 8% & the number of miles driven increased by 2.4% - *while some of this will be attributable to cars now being far more fuel-efficient, this does not alter the fact that the 'pump priming/multiplier' potential of lower gasoline prices at the pump has markedly declined.*

**Gold** - Last November's low was US\$1,064, by yearend it was US\$1,104 & on February 29<sup>th</sup> US\$1,234. While last year physical gold-backed ETFs suffered net redemptions of 133.4 tonnes, in January alone they experienced net new inflows of nearly 60 tonnes. On January 4<sup>th</sup> the TSE Gold Index was 125 & on February 29<sup>th</sup> 180. In January US sales of Eagle gold coins were up 53.1%-, & in February 4x-, YoY (although down MoM). BullionByPost, Britain's largest online bullion dealer, one month ago had one-day record sales of £5.6MM & another London gold dealer, ATS Bullion, in the first ten days of February sold 4,000 gold bars & coins, up from 1,500 YoY - *might this be a harbinger of a loss of public confidence in the economic/financial outlook?*

**Natural gas prices** - In Canada they are now hitting \$1 (down from something closer to \$10 a decade ago), as an unusually mild winter has resulted in far lower than usual withdrawals from storage. Gazprom is now getting US\$5.27 for the gas it sells to Europe, less than half the US\$10.69 it was getting in August 2014. And the average price for LNG imported by Japan last January was US\$7.90, down from US\$10.20 YoY.

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<sup>11</sup> These acronyms stand for "Zero"-, & "Negative"-, Interest Rate Policy respectively.

**One typically overlooked reason for reducing the likelihood of any Fed rate changes this year** - In the past it has tended to tread lightly in Presidential election years for fear that any move it made would become a political football. And given the animosity towards the Fed in the GOP, with Trump even calling for an audit of the Fed, it will likely do even more so this year.

**Sales of North American Class 8 Trucks<sup>22</sup> are down** - In January they came in at 18,062 units, down 35% MoM & 48% YoY; according to Jonathan Starks, the COO of FTR, the agency tracking this, "Orders in 2014 equaled a strong 376,000, 2015 was down from that to just 284,000 (23,667/month), and now 2016 is starting off weaker" - *a leading indicator?*

**US Debt-to-GDP ratio** - In the five years ended December 31<sup>st</sup>, 2013 the US National Debt grew at a 14%-, & GDP at just 2.7%- CAAGR, and its Debt-to-GDP ratio from 76% to 101% (& to 103 in 2014). As a result, as one market observer put it earlier this week "After ten years of sub 3% growth, the government's debt burden, the entitlements and the cost of multiple wars have expended the ability to respond to cheaper credit." And BoAML recently produced a chart showing that, while total global fixed income government debt had jumped from US\$26TR on January 1, 2013 to US\$37TR by June 30<sup>th</sup>, 2014 (up 42% in just 18 months, although it has since leveled off at around US\$40TR), since mid-2014 the portion thereof with negative yields has gone from zero to US\$10+TR, *without any noteworthy positive impact on the rate of economic growth. And yet Fed Chair Janet Yellen had the effrontery to tell Congress last February 11<sup>th</sup> that negative interest rates are "working more than I can say I expected."* - *How so, please?*

**GLEANINGS II - 656**  
**Thursday March 3<sup>rd</sup>, 2016**

**MOODY'S CUTS CHINA'S OUTLOOK (Reuters, Aly Song)**

- On March 1<sup>st</sup> the PBOC cut the bank reserve ratio by 50 bps, freeing up US\$100BN more cash for *bank* lending. The next day, just a few days before the National People's Congress was to rubberstamp the 13<sup>th</sup> Five-Year Plan<sup>33</sup> *that Xinhua says shows a "politically confident China"*, Moody's cut the outlook for China's Aa3 credit rating from "stable" to "negative". Reasons given included "Without credible and efficient reforms, China's GDP growth could slow markedly as a high debt burden dampens business investment & demographics turn increasingly unfavourable", an expectation that its fiscal strength will continue declining, the fact its FX reserves have shrunk in the past 18 months by US\$782BN (20+%) & *by 15% in the past four months*<sup>44</sup>, & the large stock of contingent sovereign liabilities, such as SOE-, & local government-, debt and that of its

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<sup>22</sup> Gross Vehicle Weight of 33,000 lbs/14,969 kg, i.e. dump trucks & highway tractors.

<sup>33</sup> It envisages a doubling of GDP during the current decade (i.e. at a CAAGR of 7.2%), which, even though the double digit rate of the early years of this decade gave it a good headstart, implies a rate of GDP growth during the rest of the decade that looks like more than just a little 'stretch'.

<sup>44</sup> Which PBOC Vice-Governor Yi Gang recently *rather glibly* dismissed as "mainly due to a rise of FX assets in residential accounts and a reduction of FX liabilities **which are not likely to last long** (bolding mine), both of which are a sign of a lack of confidence in their currency).

“policy banks” (the Agricultural Development-, the China Development-, & the Export-Import-, Banks). While Moody’s puts actual government debt at 40.6% of GDP (as of yearend 2015), S&P last July estimated corporate debt in 2014 to have risen to 160%, twice the US level & up from 120% YoY. And Fitch, also on March 2<sup>nd</sup>, noted “the 50bp cut to the reserve requirement ratio for Chinese banks on Tuesday together with record loan growth in January, could point to an increasing likelihood that the authorities are shifting policy to enable more credit-fueled growth ... Rolling over more debt will only delay, and not resolve, an expected rise in non-performing loans”.

*Nevertheless, on the day of Moody’s news the Shanghai Stock Index was up 4%.*

### **U.S. SHALE’S MESSAGE FOR OPEC : ABOVE \$40, WE ARE COMING BACK** (Reuters, Devika Krishna Kumar)

- While a year ago, major shale producers said they needed oil above US\$60 to crank up output again, now they say it would take much less. While Deloitte has warned that up to one-third of (*small*) shale oil producers face bankruptcy, some bigger ones dream big. Continental Resources says it will boost capital spending to hike production 10% if oil hits the low-to-mid 40s. CEO Jim Volker of Whiting Resources, North Dakota’s top producer, told analysts that, while it will stop fracking wells by late March, it “would consider completing” others if oil went to US\$40-45 (vs. US\$70 less than a year ago). Hess, another big player in North Dakota, has cut the cost of a new Bakken well there by 28% in the past year. Bill Thomas, Chairman of EOG Resources Inc. said “it’s no longer enough to be the low cost producer in U.S. horizontal shale ... EOG’s goal is to be a competitive, low-cost producer in the global market” & that it has “an inventory” of 3,200 well sites capable of yielding 30+% returns at US\$40 oil. And Apache Corp. says that, while its 2016 output will down by up to 11% YoY, it would match its 2015 output level if oil were to average US\$45 this year. The main reason for this optimism is the large number of wells already drilled but not yet fracked *that could be brought on line at a relative modest cost*, 945 of them in North Dakota alone as of December 31<sup>st</sup> (up from 585 in mid-2014, when prices started crashing).

*More worrisome for Alberta is the fact that Hess CEO John Hess recently told Reuters that, rather than deeming US shale oil a “swing producer”, it should be considered a “short-cycle” producer that can stop, and/or restart, production within a year (a differentiation that seems rather artificial, since the outcome is the same, a dampening effect on any serious future price increases).*

### **IRANIAN ELECTIONS DEAL A BLOW TO HARDLINERS AS REFORMISTS MAKE GAINS** (Saeed Kamali Dehghan & Ian Black)

- In the February 26<sup>th</sup> election, a “list of hope” reformist-backed candidates headed by the Stanford University-educated & committed reformist Mohammad Reza Aref, was on track to take all of Tehran’s 30 parliamentary seats (*in the 290 seat Majlis*), with moderates & independents sympathetic to President Hassan Rouhani leading outside

the capital, & early results for the 88 member Assembly of Experts<sup>55</sup> showed Ayatollah Akbar Hashemi Rafsanjani<sup>66</sup> leading the pack. The reformists are gaining the upper hand because of their alliances with successful candidates in other camps, incl. Ali Motari, a cultural conservative but political ally of the moderates, who was second in Tehran only to Aref, & Ali Larjani, the conservative speaker of the Majlis who is sympathetic to Rouhani & expected to win in Qom, a conservative bastion. And the list of those about to lose seats is as revealing as that of those about to gain them; for it includes Gholam-Ali Haddad-Adel, a hardliner close to Khomeini & the No.1 on the “principalist” candidate list for the Majlis, & two ultra-conservative ayatollahs likely to lose theirs in the Assembly, one of them its Chairman.

- Rouhani said on Twitter the big turnout<sup>77</sup> had created a “new atmosphere in the country” & another attributed to Rafsanjani that no one could resist the will of the people & that “Those not favoured by the people should leave”, although he was later quoted by the state IRNA news agency as saying “The competition is over and the phase of unity and cooperation has arrived ... The time after the election is the time for hard work to build the country.” Credit for the reformists’ success is going to former president Mohammad Khatami who, although under house arrest, with the media not allowed to even mention his name, early in the campaign released a video online urging political activists to unite behind the “list of hope”. Nevertheless, according to Sadegh Zibakalam, a professor of politics at Tehran University “We can’t say the ultra-conservatives were defeated, but the conservatives can’t say *either* that they received a huge mandate.”

*This outcome was the more impressive, given the pre-election efforts made to skew the results in the conservatives’ favour (thus of the 12,000 people wanting to run for the Assembly over half were ‘disqualified’). And with the Supreme Leader aging, the Assembly election (which occurs once every 8 years, vs. four years for the Majlis) came at an inconvenient time for the conservatives. But it won’t be clear sailing for the reformists going forward ; for there were 250 parties in the election & hence there will be lots of scope for the conservatives to fish in the resultant muddied waters of the two highly fractured bodies. And two days after the election, the Ayatollah Khomeini in his first post-election comments praised the high turnout, saying “I thank Iran’s wise and determined nation ... and I hope the next parliament will act responsibly towards the people<sup>88</sup> and God.”*

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<sup>55</sup> Usually a lacklustre event, this time it was not; for it will likely elect a successor to a Supreme Leader who at age 76, with rumours making the rounds last May that his prostate cancer had metastasized, may have ‘one foot in the grave and the other on a banana peel’.

<sup>66</sup> A key Rohani ally who has been at odds with Khomeini for years & in 2013 was not allowed to run for the Presidency (against Rouhani & seven others).

<sup>77</sup> According to the Interior Minister 50% in Tehran & 62% overall (which was, however, well short of the 72.8% in the 2013 Presidential election (that Rouhani won with 50.8% voter support in the first round against seven other candidates, with the runner-up getting just 16.5% of the votes).

<sup>88</sup> Over half of whom are under the age 30, many of them well-educated. What was really interesting was the photo heading this article; for it featured four young women in their 20's showing their ink-stained forefingers as evidence they had voted, only one of whom wore a hijab as we know them in Canada that merely showed her face, while the others all showed lots of hair, with the latter's head scarves & the former's hijab displaying a range of colours, none of them black.

## **SAUDI PIVOT TO AUSTERITY COULD STOKE CIVIL UNREST (WP, Hugh Naylor)**

- The low oil prices have the Saudi government struggling to sustain its cushy government jobs-, costly state handouts-, & tax-free living-, status, causing it to initiate austerity measures, incl. cuts in the spending & subsidies that have long bought the Kingdom *social* stability. All this is attributed to King Salman's *favorite* son, 30 year-old Prince Mohammed bin Salman, who is Head of Economic Planning as well as Defence Minister & who is said to be determined to wean the country off its dependence on oil<sup>99</sup> & to reform a bloated & opaque public sector (*which he has been part of for his entire career, such as it was*). He has even raised the possibility of imposing taxes, telling The Economist "Were talking about taxes or fees ... supported by the citizen" (although ruling out income taxes). And with the other Persian Gulf kingdoms being in a very similar boat, there is talk of a region-wide VAT (Value-added tax) to be introduced in 2018.

*But diplomats & analysts warn that this 'pivot' risks triggering unrest in a conservative society<sup>100</sup> resistant to change. Higher gasoline prices in particular are really offensive in a country with no public transportation where for at least seven months of the year it's too hot to walk any distance. And social instability here is **the** prime potential intangible in oil price forecasting.*

## **STRIKES AND WORKERS' PROTESTS MULTIPLY IN CHINA. TESTING PARTY AUTHORITY (WP, Simon Denyer)**

- The China Labour Bulletin, a Hongkong-based workers rights' group, recorded 2,774 strikes/protests in China in 2015, double those in 2014. Their number jumped after last August's yuan devaluation & stock market crash, mainly in manufacturing & construction, and most markedly in Guangdong Province (that abuts Hongkong). While this challenges a Party machine that bases its legitimacy on its ability to deliver greater citizen wellbeing, experts say it won't threaten its vise-like grip on power but matters to local officials whose careers depend on their ability to *head off and, if necessary*, stamp out local social unrest. Rising wages have made Guangdong a victim of its own success as factory owners look for cheaper venues elsewhere, although, according to Albert Park, Director of the Institute for Emerging Market Studies at the Hongkong University of Science & Technology, the global economic slowdown has been a factor. And Andrew Polk, a Beijing-based Conference Board China economist expects more structural unemployment as the economy transitions from heavy industry to services; for "You can't have a coal miner suddenly becoming a bank teller."

*It is worth noting that President Xi Jinping himself seems sufficiently concerned to be transforming himself into Mao 2.0, as he borrows more & more from the latter's playbook.*

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<sup>99</sup> In his most famous work Candide (first published in 1759), Voltaire at some point dismissed Canada, that was then under attack by the British, & fell to them a year or so later, as "quelque arpents de neige" (a few acres of snow); and without oil Saudi Arabia could likely be equally dismissed as 'a few acres of sand'.

<sup>100</sup> In which King Salman himself is supposedly among the more conservative elements.

**NATO CHIEF : PUTIN IS ‘WEAPONISING’ REFUGEE CRISIS TO ‘BREAK’ EUROPE**  
(The Telegraph, Matthew Holehouse)

- Gen. Philip Breedlove, the Supreme Allied Commander Europe & Head of the US European Command, said on March 2<sup>nd</sup> “Together Russia and Assad are deliberately weaponising migration in an attempt to overwhelm European structures and break European resolve” & the Russian Ambassador to London *seemingly sort of, very obliquely*, confirmed this in the social media by saying the ceasefire in Syria involving the Russian forces “will alleviate the migration crisis in the EU”. Meanwhile the pressure on Greece keeps building with 2,000 or so new arrivals every day<sup>1111</sup>, one-third of them now children as families seek to join their husbands & fathers who succeeded last summer in getting to Germany (where Chancellor Merkel’s personal approval rating is up 8 points MoM to 54%, suggesting that she may have weathered the earlier storm of criticism over her asylum policy), as its neighbours have all but closed its borders with Greece.

*Gen. Breedlove likely gives Putin too much credit; all he did was to take advantage of an opportunity created for him by the West. But he may now be angling for a solution on his terms, before his domestic house of cards collapses around his ears.*

**GOVERNMENT SAYS IT HAS LOST TRACK OF OVER 130,000 ASYLUM SEEKERS (DT)**

- In response to a question in Parliament by the opposition Left Party, Angela Merkel’s government said that last year 13% of the 1.1MM registered as asylum seekers had never arrived at the refugee accommodation assigned to them & many had simply gone elsewhere or “underground illegally”. This came just two months after reports the authorities were searching for 12 asylum-seekers who had vanished & were thought to have crossed the border using forged passports from the same source as the Paris attackers.

*It’s hard to believe that in such a large crowd there would not be some, maybe even quite a few ‘bad apples’. Someone did some creative thinking recently, suggesting that young male Syrians undergo major military training in preparation for returning to their homeland to liberate it (although at what risk that, once there, some might go over to ‘the other side’)*

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**TUCKING 10,000-YEN BILLS UNDER THE MATTRESS SPELLS WORRY FOR ABE**  
(BB, Toru Fujioka)

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<sup>1111</sup> According to Frontex, the EU border agency, 131,000 migrants arrived in Europe in the first two months of this year. 30x as many as during the year earlier period.

- Last year demand for them was up 6.2% last year to a post- 2002 high (they now account for 92% of all its bank notes in circulation) even as the population declines and the use of credit cards & electronic payment grows. The sale of safes had doubled in the six months. This is of concern for Prime Minister Abe & BoJ Governor Haruhiko Kuroda since hoarding cash, instead of putting it to productive (???) use by spending it undermines their efforts to spur consumption & reflate the economy. According to Hideo Kumano, an economist at the Dai-ichi Life Research Institute “Overall, the trend of more cash at home reflects concern about the outlook for the economy among households. This isn’t a good thing.”

*While in Japan savers don’t get charged yet for putting/keeping money in the bank, interest paid is so minuscule (0.001%) as to make the opportunity cost of hoarding cash irrelevant.*

### **CIRCULATION OF SWITZERLAND’S 1,000 FRANC NOTE JUMPS (WSJ, John Letzing)**

- Since the Swiss National Bank introduced negative interest rates (*that are now -0.75%*), demand for them has risen dramatically : in December 2015, SF45.2BN-worth was in circulation, up 12% YoY. Large denomination bills are under increasing scrutiny everywhere, with the ECB considering withdrawing the 500 Euro note, there being pressure in the US to do away with the US\$100 note & Larry Summers pushing for a global agreement to stop printing any large denomination bank notes.

*Purportedly the reason for doing away with these notes is to make life more difficult for the criminal element in society. But this is a subterfuge; for it has been transacting in, & hoarding, large denomination notes for years, if not decades, but now, with the creation of bitcoin, has an alternative & less need for cash. Rather the **real** reason is that large scale cash hoarding by common folk is deemed to undermine the effectiveness of negative interest rate policies.*

### **SWEDEN GETS CLOSER TO BEING THE FIRST CASHLESS SOCIETY WITH NEGATIVE INTEREST RATES (Business Insider, Jim Edwards)**

- In Sweden *already* if you use too much cash, banks call the police since you might be a terrorist or a criminal & the banks have started removing ATMs from rural areas (to the annoyance of the locals). And according to Credit Suisse the rule of thumb in *all of* Scandinavia is that “If you have to pay in cash, something is wrong.”
- With negative interest rates in a cashless society, people are thought to have only two choices, spend it or let the bank nibble away at it, which in theory will spur economic growth<sup>1</sup><sup>2</sup>. During the period 2009 to 2014 inclusive the average value of bank notes & coins in circulation in Sweden waned by 25% to 80BN kroner as its GDP waxed by 11.3%. So two trends are converging on Swedes simultaneously: less cash & negative interest rates, and hence less scope for them to ‘hide’/sit on money. But resistance to & resentment of-, & protests against-, the drift towards the extinction of cash is starting to build.

<sup>12</sup><sup>12</sup>

This will founder on the fact that where money is concerned there is no end to human ingenuity.

*But the potentially really sinister aspect of this is that under the “right’/’wrong, circumstances this could become yet another tool in the authorities’ tool box of privacy invasion tools.*

**The American primaries** - It’s a sad state of affairs when the world’s supposedly iconic democracy can do no better than come up, in a Presidential Election, with two yahoos & a non-entity on the one hand, & two super-annuated political warhorses on the other, most of them without much relevant experience at running anything bigger than a one man political office. But it’s early innings yet & it’s all but inevitable that at some ‘strategic moment’ the skeletons in the various candidates’ closets that the other candidates’ teams have been rooting through will start surfacing (of which John Oliver may just have given us a foretaste). That being said, the Democratic race is much more interesting than the GOP’s self-destructive, self-induced & self-emboweling one because in it the two hopefuls present such a sharp contrast, with Bernie more forward looking & tapping, from the Left into the same widespread, contemporary vein of public discontent, if not disgust, with ‘the system’ as it has evolved over time but at a dizzyingly faster rate in recent years, as Trump is doing from the Right (or wherever he may be coming from), whereas Hilary is the standard bearer of the now increasingly unacceptable “trust-us-as-we-continue-full-speed-ahead-until-we-hit-the-wall-at-90-mph” crowd (& since any Hilary-weakening enhances the possibility that Bloomberg will throw his hat in the ring to become the next President, tapping into the very same vein of discontent as Trump & Sanders have been doing **and** being someone many voters appalled by the choice presented to them by the two traditional parties could in good conscience vote for.

Groping through the entrails of the Super Tuesday results, they don’t seem as much of a victory as the Hilary camp has claimed & as the media have slavishly been telling the hoi polloi. For her Super Tuesday wins, with exception of delegate-rich Texas, were all in states with above average Afro-American populations (Alabama 78/19, Arkansas 66/30, Georgia 71/28, Tennessee 66/32 and Virginia 64/35) & there is only a limited number of those left, whereas Bernie beat her in the states with more ‘normal’ racial distributions (Colorado 59/40, Minnesota 62/38, and Oklahoma 52/48), essentially tied her in Massachusetts 49/50) and, of course did, & should have, beat her handily (86/14) in his home state of Vermont. And while the Hilary camp brags about her having 1,052 delegates on her side vs. Bernie’s 427, what **really** matters is that she has 595 committed voters vs. his 405, all the rest of hers are “super delegates”<sup>133</sup>.

One thing that could work to Bernie’s advantage is the difference in their campaign funding methodologies. Last year Hilary collected US\$114MM, 58% of it from bigger contributors, whereas Bernie brought in US\$75MM, half of it from 1.3MM individuals in 3.7MM contributions (i.e. each made on average almost three separate contributions); so it may be significant that in January, when the need to campaign ate into the time Hilary could devote to ‘closed-door’ fund raisers, she raised only US\$15MM vs. Bernie’s US\$20MM and that, when Bernie in his victory speech after his New Hampshire win asked supporters for financial support, US\$5.2MM flooded in online within 18 hours.

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<sup>1313</sup> Of which there are 717 (15% of the total delegate count at the convention) : 20 “distinguished party leaders” (incl. former Presidents), 21 governors, 46 Senators & 193 Representatives, and 437 DNC members, all of who will be free to change their vote until the very last moment on the convention floor, and for many, if not all, when push comes to shove, only one thing will matter : ‘electability’.



A much clearer picture will emerge within the next two weeks, with primaries scheduled for March 5<sup>th</sup> in Kansas, Louisiana & Nebraska (109 delegates), March 6<sup>th</sup> in Maine (25), March 8<sup>th</sup> in Michigan & Mississippi, and for US citizens living abroad, (179), March 12<sup>th</sup> in the North Marianas (6)<sup>144</sup>, and March 15<sup>th</sup> in Florida, Illinois, Missouri, North Carolina & Ohio (691).

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A US commonwealth located in the Pacific Ocean East of the Philippines.