

GLEANINGS II - 728
Thursday September 21st, 2017

Cyber security - SEC Chairman Jay Clayton revealed on September 20th that last year hackers had penetrated its electronic system for storing public company filings & may have traded on the information thus obtained. And the WSJ reported that hackers had for months roamed undetected in Equifax Inc's computer network before finally being found out last March (i.e. five months before it went public with the news)- *many years ago I was taught that no tank could ever be designed that could be impervious to an anti-tank weapon designed to defeat it - I wonder if the same might not be true for cybersecurity, and that this is another case of "asymmetric warfare"; for hackers, like terrorists, only need to pick one of an endless array of potential targets while cybersecurity must allocate its limited resources to whatever it believes may be the most likely of multitudes of potential targets.*

OPEC's weighted average fiscal breakeven export price - According to the EIA the average in 2013 was US\$85 in 2013 & that the minima for its various members ranged from US\$42 for Qatar & US\$48 for Kuwait through US\$85 for Saudi Arabia, US\$95 for Venezuela & US\$105 for Nigeria to US\$110 for Iran - *This is what likely has enabled Qatar to hold its own in Saudi Arabia's quarrel with it & illustrates how current crude oil prices create fiscal nightmare/potential social unrest scenarios for other OPEC members & has undermined the viability of the Saudi-inspired output restraint program .*

Political correctness on steroids - The city of Brookline, Mass. is one of the 14 municipal entities within Greater Boston. Founded five centuries ago, it was until 1705 known as the Hamlet of Muddy River. But today, with an area of 17.7 sq.km. (most of it water) & 60,000+ residents (<1% of Greater Boston's), its claims to fame incl. being the late JFK's birthplace, having the highest population density of-, & more Ph.Ds per capita (14%) than-, any US city & a median household income 37% above the national average, and that in the 2016 election the 27,000 people who voted there produced one of the most lopsided (88.4-11.6) Hillary wins anywhere in the nation. In November its five member Board of Selectmen will have two resolutions on its plate. One would change its name from Board of Selectmen to Board of Selectwomen (despite the fact that three of its current five members, incl. the Chairman, are males) & the other to change it to anything that would be more gender-neutral, with Board member Heather Hamilton saying she is looking forward to "an interesting hash out." Brookline residents generally are in favour of a more all-inclusive title, like "select people" or "select persons" since that probably "would make everybody happy" - *One has to be a 'living in rarified air' Ph.D. to believe anything can make "everybody happy."*

Today's OPEC meeting - According to some sources it will be pre-occupied with the continued high production levels of Nigeria & Libya that have increased their output by 550,000 bbl/d in the past year, thereby nullifying about half the cutbacks by other OPEC members (although Nigeria claims to have complied with the production 'cap' imposed on it). And others say that, *in contradiction of anecdotal evidence*, the production restraint program is working & the inventory 'glut' diminishing. One thing that apparently is not on the agenda is whether to extend the program past March 31st; that decision has been deferred until January.

US federal budget balance as a % of GDP - Between 1965 & 1991 it went from +0.2% to -4.4% after the 1990/91 recession (with a five year bulge at the near -6% level during the Reagan years, due to tax cuts & the defense buildup *that brought the Soviet Union to its knees*). In the Clinton years it improved steadily from -3.9% in 1993 to + 2.3% in 2000. Tax cuts, the 2000/02 recession & the Iraq War worsened it again to -3.4% by 2004 after which it improved to

-1.1% in 2007 before skyrocketing to 9.8% in 2009 (*largely due to the US Treasury's TARP programs that, while marketed as designed to "stabilize the US financial system, restart economic growth and prevent avoidable foreclosures", in reality most benefitted the very banks whose financial shenanigans had been responsible for the Great Recession*). And while it improved to -2.4% in 2015, in FY 2016 (to September 2016) it had worsened again to -3.2%.

US National Debt to GDP ratio – After WW II it was 120%, due to cost thereof. That was 'worked down' over the next 35 years to 34%, during the Reagan/Bush/early Clinton years 'crept up' to 65% only to decline again during Clinton's "make welfare what it was meant to be : a second chance, not a way of life" second term welfare reform era to 56%, but worsened to 82% by the end of Bush 43's-, & to 106% of Obama's-, second terms – *Once upon a time government deficits could legitimately be deemed a function of taxpayers receiving more services from government than they were paying for by their taxes, whereas today many taxpayers believe they are due to government ineptitude & inefficiency in delivering services¹, and to featherbedding & catering to, often small, special interest groups.*

Widening Brent/WTI price gap - On July 12th of this year it was US\$1.25. But two months later, on September 11th, it was US\$6.33. While much of the credit therefore is given to Hurricane Harvey having reduced US refineries' demand for oil, their European counterparts *for the same reason* upped their runs (as is disproportionately beneficial to their bottom lines). And a more fundamental reason for the relative weakness of WTI is the growth in US crude oil production.

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FED KEEPS US RATES STEADY, TO START PORTFOLIO DRAWDOWN IN OCTOBER (Reuters, Howard Schneider)

- On Wednesday September 20th, *after the two-day FOMC meeting*, it announced that, despite the recent bout of low inflation, interest rates would remain unchanged but that it expected one more rate hike before yearend (*generally expected in December*) and that in October it would start reducing its US\$4.2TR portfolio of UST-, & MBS-, securities, citing the low unemployment rate, the growth in business investment spending & the moderate but durable rate of economic growth as justification for these decisions.

In her subsequent press conference Janet Yellen conceded the recent low rate of inflation was a 'mystery'. And she told reporters the economy was robust enough to withstand rate hikes & reducing the Fed's US\$4.5TR balance sheet and that, while inflation may be lifted by higher prices for gasoline & other products & growth depressed by the storms, history suggested these effects will be temporary. The market expects the balance sheet reduction program will be 'eased in' initially by just not 'rolling over' maturing bonds, rather than by outright sales.

TRUMP REBOUNDS AFTER POLLING SLIDE (Politico, Steven Shepard)

- In our latest poll, conducted during a four day period ended September 17th, his approval rating was back up to 43% (up from 39% MoM). And other polls (Gallup's &

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There is no premium on efficiency in the public service since the more inefficient one is, the more people are needed to do the same work & the bigger the empire, the fatter bigger the pay cheques of those in charge. And the 'entitlement syndrome' runs rampant in the public sector.

RealClearPolitics') show a similar trend. He seems to have benefitted from his response to the Harvey & Irma hurricanes & his recent outreach to the Democrats in Congress, while the negative reaction to his Charlottesville response has waned. His approval rating among Republicans went from 73% to 80% & among independents from 35% to 40%, while among Democrats it remained unchanged *in the low double digit range*.

Be all that what it may, the fact remains that at 43% his approval rating at this point in his first term lags that of all other presidents in modern polling history & is a long way from where it has to be for him to have real clout 'inside the Beltway'.

AMID NEW SANCTIONS TRUMP CALLS NORTH KOREA'S LEADER A 'MADMAN' WHOSE REGIME WILL FACE NEW TESTS (WP, David Nakamura)

- Kim on September 21st reacted angrily to Trump's recent actions calling him a "mentally deranged dotard²" & his UN speech "unprecedented rude nonsense", saying "I will make the man holding the prerogative of the supreme command of the United States pay dearly for his speech ... I am now thinking hard about what response he could have expected when he allowed such eccentric words slip off his tongue ... Whatever Trump might have expected, he will face results beyond his expectation", adding he would "tame" Trump "with fire". *Not to be outdone*, Trump tweeted on the 21st that Kim was a "madman" who brings famine & death on North Korea. Meanwhile, North Korea's Foreign Minister said in New York his country may test a hydrogen bomb in the Pacific to fulfill Kim's vow to take the "highest level" action against the US (US officials believe North Korea carried out its first underground hydrogen bomb test on September 3rd).

Beijing has become concerned enough to be prodded into some concrete action by warning some of its banks to refrain from facilitating third party business with North Korea.

U.S. WEIGHS WHETHER TO STAY IN IRAN NUCLEAR DEAL (Reuters, Michelle Nichols)

- The US said on September 20th it is weighing whether the 2015 Iranian nuclear deal, that Trump once called an "embarrassment", serves its national security interests. He told reporters he has made a decision (*whether or not to pull out of it*) but wouldn't tell them what it was. But the deal continues to have the support of the other five nations (Britain, China, France, Germany & Russia) that were involved in negotiating it, and Iran doesn't expect him to abandon it. That same day representatives of these six countries met *for one hour & 20 minutes behind closed doors* at the United Nations, creating an opportunity for the US Secretary of State Rex Tillerson & his Iranian counterpart, Mohammad Javad Zarif to have a long discussion, their first ever. The outcome apparently was an agreement that there had been no violations of the deal by Iran. But the concerns remains that any US pullout would will trigger a massive regional arms race-, & increase tensions-, in the Middle East (*at a time that, with the price of oil being what it is, the nations there can ill afford either*).

In mid-October Trump must fish or cut bait. For that is the next time the State Department must report to the Commander-in-Chief, as it is required to do every three months, if Iran has kept to its part of the deal. And if Tillerson, as expected, were to report this to be the case & Trump overrules him, he will not just upset all the others involved in the deal but also risk having

² A weak or senile old person.

Tillerson terminate what is by all accounts is a relationship neither of them is happy with (Tillerson because he doesn't share much of Trump's foreign policy prejudices & Trump because Tillerson is not someone who kowtows to his every pronouncement).

U.S. POLICY EXCLUDES CANADA FROM DEFENCE (CP, Lee Berthiaume)

- On September 14th officials from Global Affairs Canada & National Defense warned the House of Commons Defence Committee that, after several provocative nuclear & ballistic missile tests by North Korea, is studying to what extent Canada is ready for an attack by North Korea, that it was only a matter of time before North Korea could launch an attack on North America. And a little while later the top Canadian officer at Colorado Springs-based NORAD (North American Aerospace Defence Command), its Deputy Commander Lt.-Gen. Pierre St-Amand, *raised eyebrows when he told it* "We're being told in [Colorado Springs] that the extant U.S. policy is not to defend Canada ... That's the policy that's stated to us. So that's the fact that I can bring to this table."

In 2005 the then Liberal Prime Minister Paul Martin decided not to join Bush 43's US ballistic missile shield program & Prime Minister Justin Trudeau last month said that Canada's position on the issue is not "going to be changed anytime soon" (a position he already seems to be backing away from). So the Canadian governments' traditional 'on the cheap' defense policy of riding on the US coattails has enabled the US to adopt a 'forward defense' strategy' (that since Roman times has been to neutralize external threats before they breach the national borders), which in this case means shooting down over Canada any North Korean missiles coming in via the Polar route. Welcome Mr. Trudeau to the real world of not-so-sunny-ways!

GLOBAL LIQUID-FUEL USE TO GROW BY 19% (Reuters, Stefan Wermuth)

- According to the USEIA's Septmeber 15th 2017 International Energy Outlook Report global consumption of petroleum & other liquid fuels will grow from its present 95MM bbl/d to 113MM bbl/d by 2040, with non-OECD countries accounting for most of it & demand by the OECD member countries declining slightly from their present levels.

The authors of this report must have been following orders from up high or smoking something other than tobacco, for this conclusion is highly questionable. For China, that accounts for one-eighth of total global crude oil consumption, has announced ambitious plans to 'fast-track' the conversion of its entire internal combustion engine-driven vehicle fleet to electric power & 13 others countries (Austria, Denmark, France, Germany, India³, Ireland, Japan, Netherlands, Norway, Portugal, South Korea, Spain, United Kingdom) that account for another one-fifth of global crude oil consumption have made similar noises, albeit without any detailed plans. Goldman has gone on record as saying that, based on its estimate of the growing shift to electric cars, "peak oil demand" could come as soon as 2024, & the Daimler Group⁴ just announced that UPS (United Parcel Service) will be the first US commercial customer for its battery-powered eCanter trucks & that it plans to (rapidly?) expand its electric truck production

³ The inclusion of China & India in this group is significant, because they account for one-third of the world population & for the world's largest pool of a growing middle class that is starting to appreciate that, while car ownership is still status symbol, the untrammled use thereof produces the foul air environment that detracts from their enjoyment of their nouveau riche status

⁴ That also includes Freightliner, Mitsubishi Fuso & Mercedes Benz.

as lower cost, longer range batteries become available in two or three years' time. Solar power is increasingly competitive & the small scale version thereof that is gaining prominence in some developing countries has the advantage of not needing capital-intensive infrastructure (just as cell phones obviated their need for costly landlines). Big Oil is falling all over itself to gain exposure to 'alternate energy'. And current crude oil demand levels are overstated by the fact that in the past three years crude oil inventories have increased by close to 1MM bbl/d [with China's SPR (Strategic Petroleum Reserve) alone accounting for over half thereof].

RISING CREDIT-TO-GDP GAPS SIGNAL BANKING SYSTEM VULNERABILITY (CP)

- Last week StatsCan reported that in the Second Quarter the amount Canadian households owe relative to their disposable income had hit a record high 167.8%, up from 166.6% QoQ. And this week the BIS reported early warnings signals, due to their overheated housing markets, of "vulnerability" in the credit-to-GDP ratios of the banking systems of Canada, China & Hongkong; for Canada's credit-to-GDP "gap" is 11% above its long-term trend, and China's & Hongkong's are 22% & 35% above theirs.

The Bank of Canada, OECD & IMF have for some time been issuing not dissimilar warnings about Canada & last May Moody's downgraded Canada's Big Five banks (TD, the world's 26th largest by assets, to Aa1 & the other four to Aa3⁵). And now, on September 20th, the OECD in its Interim Economic Outlook report, while quite bullish on the short-term outlook for the Canadian economy (that grew at a 4.5% annual rate in the Second Quarter), warned of the "looming vulnerability" of the Canadian housing market as a result of the swelling household debt levels & rising interest rates (the Bank of Canada has twice raised its benchmark rate in the past two months).

'IT'S MOST CERTAINLY A TAX INCREASE' : MANITOBA PREMIER CONSIDERING HEALTHCARE PREMIUMS (Global News, Lauren McNabb)

- In a September 13th news conference Brian Pallister announced his government is looking at healthcare premiums since "There's got to be an end at some point or we'll have to shut down other departments of government to keep funding the healthcare costs we have." BC, Alberta & Ontario already do have health care premiums. In BC they are a monthly \$78 per person (*which can really add up for families*)⁶, Alberta introduced them in 2015 for those earning over \$50,000, and Ontario introduced them in 2010 at a rate of \$60 for those with taxable incomes of \$21,000 that increases by \$60 for every additional \$1,000 in taxable income.

This came four months after a surprise announcement last April that, in the context of focusing on better ways to deliver healthcare services & improve efficiency, three of Winnipeg's six hospital emergency departments would be closed, a move that left the healthcare worker unions "shocked and concerned" [although only one, at the Concordia Hospital, that had the dubious distinction of having the longest wait time in Canada (8.6 hours vs. a national average of 3.1 hrs, although the Victoria-, & St. Boniface-, hospitals weren't much better, with 6.7 & 6.5 hours

⁵ Which is not all that bad since JPMorgan, the world's 6th biggest by assets is rated Aa3, Bank of America, the 9th-, & Citigroup the 13th-, both Baa1, and Deutsche Bank, the world 15th largest, A3.

⁶ And it will be interesting to see if its new NDP government will follow through on the Liberals' pre-election promise to cut them by 50%.

respectively] would actually be closed & the other two repurposed. Pallister was for five years an MLA & for another eight an MP, in 2012 was elected leader of the Manitoba Conservative Party & in 2016, riding a wave of a desire for change⁷, sent the NDP incumbents packing, increasing his seat count in the Legislature from 19 to 40 & reducing theirs from 35 to 14 on only a small shift in the popular vote (because the Conservative support base is outside the City of Winnipeg where it takes fewer votes to elect someone to the Legislature).

S&P CUTS CHINA'S CREDIT RATING, CITING RISK FROM DEBT GROWTH (Bloomberg)

- It did so for the first time in 18 years, after similar action by Moody's last May, cutting it from AA- with a negative-, to A+ with a stable-, outlook on the grounds that "China's prolonged period of strong credit growth has increased its economic and financial risks ... Although this credit growth has contributed to strong gross domestic product growth and higher asset prices, we believe it has also diminished financial stability to some extent." According to Andrew Polk, a co-founder of the Beijing-based research firm Trivium⁸ "It may feel (to the 'face-conscious' Chinese leaders) like ... the international community is piling on, and that will be frustrating."

There is no question this announcement came at an inopportune time, just weeks ahead of the (19th) Party Congress held every five years during which (on this occasion only the second tier) party leadership is reshuffled (during which President Xi is expected to try & change the informal 67 year retirement age rule so as to give him a chance of not having to retire himself in 2022).

COOL, CALM ... AND COASTING TO VICTORY (G&M, Gary Mason)

- A year ago German Chancellor Angela Merkel's chances of getting re-elected for a fourth term weren't promising. For the loyalty of even her most ardent supporters had been dented after her 'open door for refugees' policy had caused 1MM of them to come before she had slammed the door shut, & had put wind the sails of the ultra-right AfD (Alternative for Germany party) that now has representation in 13 of Germany's 16 state parliaments (*in the 2016 Mecklenburg Vorpommern-, Merkel home-, state election it got 20.8% of the vote, making it the second largest party there, ahead of her CDU party*).
- There may be two reasons for this. She has become good at making 'course corrections', according to one German commentator as a "navigator of the public psyche", such as when she changed her policy on asylum seekers since, as she put it, Germany had done its part & now it was time for the other countries to do theirs. And the second is that her low-key, subdued & hyper-intelligent approach to governing & her

⁷ In part because the year before the Province had been downgraded by Moody's, for the first time in fifty years, by Moody's from Aa1 to Aa2, citing a fast growing debt load & failure to reach its balanced budget targets - *It seems odd that Moody's downgraded Manitoba two years ago on the grounds of its fast-growing debt load (it had increased by 60% over five years to \$20.4BN) & its failure to reach balanced budget targets while it maintains Alberta Aa1 rating despite the fact that its debt in just two years has grown by 150+%, it has no balanced budget targets to speak of other than some loose talk about balancing the budget six years hence & that over 15% of its current expenditures are being funded with borrowed money (although in all fairness it should be noted that the Province still has a very low net debt-to-GDP ratio).*

⁸ That generates a daily tip sheet of headlines not covered by others that on September 21st featured Beijing Party Secretary Cai Qi's message that "Politics is forever of primary importance (that Trivium called "political correctness with Chinese characteristics).

sophisticated, unabashed support for globalization gives comfort to German voters in the perilous, unstable times we live in and are seen by them as a counterbalance to Trump's crass inward-looking isolationism. Thus a few years seen ago, when Putin, knowing she was nervous about dogs after once having been bitten by one, intentionally brought his black Labrador to a photo op with her, her fellow Germans just loved it when, asked about this afterwards, she put him in his place by responding "I understand why he has to do this - to prove he's a man ... he's afraid of his own weakness."

The polls suggest her right-of-centre Christian Democratic (CDU) party will emerge again as the largest party, albeit with near all-time low 36% voter support, & the left-of-centre Social Democratic (SPD) as the main opposition party (while support for it swelled from 22% to a 33% near-tie with the CDU after it got a new leader in March, it has since, largely due to his insipid performance, given up all of that gain). Of the 32 other parties running candidates in the September 24th election only four are expected to pass the 5% voter support threshold needed to get any seats in Parliament : AfD (far right) with 12%, Linke (far left) 11%, Free Democrat (moderate right) 9% & Green 8%. While the AfD has been syphoning off support from both the CDU & the SPD, its weakness is that it is strongest in the former East Germany, home to only about 20% of Germany's voters. So, while with 40% of those polled still calling themselves "undecided", anything could happen, the likely outcome will be another CDU/SPD 'Grand Coalition' (in which Merkel will be in a somewhat stronger position vis a vis her SPD counterpart Martin Schulz, who has been unable to capitalize on the fact that from 2012 to earlier this year he had been President of the European Parliament).