

GLEANINGS II - 757
Thursday April 20th, 2018

CBO 10-year outlook - It was reviewed on these pages last week. And on April 17th the WSJ did so in an article headlined The National Debt is Worse than You Think - Today's outlook for revenue growth is based on a policy that's unlikely to pan out.

So much for the outlook for the Canadian economy? - On April 18th the Bank of Canada had one of its periodic rate setting meetings & decided to keep the its benchmark rate unchanged at 1.25%, but hinted it is likely to raise it "before summer". And in his opening remarks to his subsequent press conference Gov. Stephen Poloz said that, with inflation at 2% & the unemployment rate at a four decade low 5.8%, "the economy is growing at close to potential" - *In this context, it's worth noting that the Bank recently announced that in its rate decision deliberations it would be "guided" by an assumption that the potential growth rate now is 1.8%, up from the earlier 1.4% (while the realized rates of GDP growth had been 3.1% in 2010 & 2011, 2.5% in 2013 and 2.6% in 2014 (and the IMF just called for 2.3% growth this year and 2.0% in 2019). From the very outset, Poloz did not appear to be of the same "cut" as his predecessors, no matter how much he wanted to be Governor.*

Trump's Chief of Staff now past his "Best Before" date? - One thing Gen. John Kelly sought to do, & did achieve, upon becoming White House Chief of Staff was to make it mandatory for everyone in the White House, incl. daughter Ivanka & son-in-law Jared, to go through him before seeing the President (rather than having them walk into the Oval Office at will) so as to give Trump more time to think about issues (& *more importantly, to reduce the risk of him changing his mind on issues on the spur of the moment, depending on who had last spoken to him*). But the new White House Economic Adviser, Larry Kudlow, & National Security Adviser, John Bolton, now report directly to Trump and the question is how long Kelly will want to stay in his post, the more so since, with the departure of Messrs. Tillerson & McMaster, there are now just two "adults" left in Trump's retinue.

Trump pardons "Scooter" Libby - The now 67 year-old Libby, Dick Cheney's Chief of Staff, in 2007 was found guilty of perjury, and sentenced to 30 months in a federal jail & lost his license to practice law, as a result of the Special Investigation into the outing of ex-CIA operative Valery Plame (even though not held responsible for the "leak" itself). While President Bush 43 quickly commuted his jail sentence, he didn't touch the other aspects of his sentence (*something Trump pardon has now corrected*). While the President issued a statement that, while didn't know Libby personally, "He had heard he had been treated unfairly", this did little to remove concerns this was really intended as a shot across US Special Counsel Mueller's bow & led to an attempt by New York State's *Democrat* Attorney General Eric Schneiderman to have the State Assembly pass a law that would enable him to prosecute those pardoned by President Trump without running in any "double jeopardy" road blocks.

US corporate earnings - While nobody called them "bad", they didn't exceed expectations to the extent hoped & the consensus was they were" just OK". This applied especially to bank earnings growth that was "well below expectations" due to "soft" loan growth & a flattening of the yield curve (which reflects investor concerns about the macro-economic outlook).

US GDP growth rate - The initial Fourth Quarter estimate will be made public by the Commerce Department on Friday April 20th. The April 17th Atlanta Fed GDPNow reading was an annualized 2.0%, down from 2.8% on April 1st & 5.4% on February 1st (& well below the midpoint of the 1.8% to 2.7% range of private sector economists' forecasts). Meanwhile, on April 17th China

came out (*quite conveniently?*) with a 6.8% annualized growth number for its First Quarter GDP, *slightly* better than the expected 6.7%, on the back of robust property investment & resilient consumer demand, and despite a slowdown in the service-, & agricultural-, sectors (although it's expected that the rate will weaken in the coming quarters as Beijing puts the brakes on local government infrastructure spending, so as to keep down the buildup of their debt).

US/UK/French response to Syrian gas attack on its own citizens - The seemingly most remarkable aspect of this, that the media seems to have totally overlooked, is the total absence to date of any Russian response thereto - does this mean that Putin 'blinked'?

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U.S. ECONOMY ON TRACK TO BIGGEST GROWTH (WP, Heather Long)

- The vast majority of economists predict this expansion will break the record for length *since WW II (i.e. will last beyond June of next year)*. There are few signs of a recession coming soon and the tax cuts & infusion of government *deficit* spending are expected to cause growth to accelerate in the coming months. Goldman Sachs says there is a 90% chance this expansion will break the *120 months'* record set during the 1990's 'tech boom' when the economy grew uninterruptedly for a decade. Right now the Blue Chip consensus of 50+ economic forecasters calls for solid growth of 2.8% in both this & next year, with Allen Sinai¹, Chief Economist at Decision Economics, predicting "It will be the longest expansion ever ... I don't even think an attempt at impeachment would stop the underlying fundamentals of the U.S. and non-US economies of giving us good results."
- Trump's tax cuts, scaled-back regulations & higher government spending has created a large scale stimulus that is causing growth to rise, albeit at the cost of triggering an unprecedented expansion of the deficit (*and while the GOP accuses Obama of the same thing, he did so at a time the economy was 'in the tank', while Trump c.s. are doing it at a time that growth may not be "great" but still is OK*). And the IMF wrote in its latest World Economic Outlook report released on April 17th, "The US economy is projected to grow considerably faster than potential for a few years ... *although* the US tax reform will reduce growth momentum starting in 2020" & projected a 2.9% GDP growth rate this-, and 2.7% next-, year (but also predicted that the US will be the only advanced economy to have its debt-to-GDP ratio worsen in the next five years as its government budgets become even more unbalanced).

All above calls are far more bullish than the recent (more credible?) CBO forecast. The 'talking heads' seem to be "Jack and the Beanstalk" aficionados & few things have less credibility than a bunch of economists agreeing on the economic outlook. The US annual GDP growth rate in the nine years since the Great Recession has averaged an unusually low 'recovery' phase 2% per year, little more than half the 3.6% during the 1990s recovery from the late 1980's recession era, productivity growth has been anemic (averaging 1.2% in the past decade, vs 2.6% in the seven years before & 2.2% in the 1990s, the labour force participation rate is mired in a four decade-low level of < 63% level (almost 5 percentage points off its 2007 all-time high) &, finally, the broader-based "real" unemployment rate has gone from 16.7% in the Great Recession to

¹ Who at age 77 is getting a little "long in the tooth" (although I am not one to say so).

8.0% today (i.e. by 52%) while the “official” unemployment rate has done so from 9.8% to 4.1% (i.e. by 58%)².

U.S. HOUSING STARTS RISE, BUT SINGLE-FAMILY SEGMENT FALLS (Reuters, Lucia Mutikani)

- In March home building activity grew more than expected, with housing starts up 1.9% MoM to 1,319,000 units saar (seasonally adjusted annual rate) amid a rebound in the construction of multifamily housing units and weakness in the single-family segment (where starts were down 3.7% MoM to 867,000 units & the issuance of permits to build new single-family homes 5.5% to 840,000, a six months’ low). And a survey made public on Monday April 14th showed confidence among home builders down for the fourth month in a row amidst complaints about a scarcity of buildable lots & higher construction material costs (in part due to the imposition of new tariffs on Canadian lumber & other products) which they said was “pushing up prices and hurting housing affordability”.

This may affect the GDP growth rate only at the margin since new housing construction accounts for just 3-5% of GDP. What may be more significant for GDP growth is that the savings rate that went into the double digit range in the aftermath of the Great Recession only to crash to a ten year low of 2.4% last December, at last report (February) had risen to 3.4%.

AUTOS DRIVE U.S. RETAIL SALES REBOUND, SIGNALING CONSUMER SENTIMENT GAINS (Reuters, Lucia Mutikani)

- After three months of declines US retail sales rebounded in March at a 0.6% rate (whereas economists had expected 0.4%) to a level up 4.5% YoY as households bought more motor vehicles & ‘big ticket items’. While this made it look as if consumer spending was heading into the Second Quarter with some momentum, last month pickup in retail sales did little to change the expectations of a sharp QoQ slowdown in consumer spending during the First Quarter (which economists maintain is due to delays in the processing of tax refunds) from the robust 4% annualized rate in Fourth Quarter. And, while economists keep crediting a robust labour market for pushing up wage growth, consumer sentiment slipped in early April as households worried about the outcome of the Trump trade policies. In March auto sales jumped two percent (the biggest increase since last September) after declining 1.3% in February, with those at online retailers up 0.8%, at furniture stores 0.7%, at electronics & appliance stores 0.5%, and at restaurants & bars 0.4% while they were down 1.8% at sporting goods & hobby stores, 0.8% at clothing stores and 0.6% at building material stores. And in a separate, April 16th report the New York Fed said that its Empire State Index (that measures future business conditions) had tumbled seven points to 15.8, a 24+ months’ low.

All in all, this doesn’t seem to add up to a very “robust” First Quarter economy & to make for a slow start to the year that could make it more difficult to achieve stellar growth for the year as a whole. And since this was published, the number of net new jobs created in March came in at a

² Whereas the “official” unemployment rate as calculated by the BLS is based on only the number of those with a job and those actively looking for one, the “real” unemployment has a broader (& more realistic?) base that does not just include them but also those who have given up looking for a job as well as those who are uneremloyed. Moreover, the “official” rate assumed that a ‘job is a job’, regardless of whether it is part-, or full-, time.

six month's low 103,000 (half the close to 200,000 expected & barely enough to keep up with the monthly labour force growth) as the retail & construction sectors actually shed jobs, something that, according to BAML economist Joseph Song was due to "inclement weather". Meanwhile, the annual rate of increase in hourly earnings was 2.6%-, & 2.7%-, YoY in February & March respectively, i.e. it is closing in on the 3.0% that economists say is needed to get inflation to the Fed's 2% target (thus giving the Fed the excuse it needs to keep jacking up interest rates in a way that could offset the 'pump-priming' effect of an easier fiscal policy.

TRUMP LETTING HALEY TAKE THE HEAT DESPITE SIGNING OFF ON SANCTIONS (Politico, Eliana Johnson)

- According to three senior administration officials President Trump last week approved the airstrikes in Syria (*overruling Defense Secretary James N. Mattis who wanted to get Congressional approval first?*) **and** new sanctions on Russia, with one of them saying that "Russian sanctions were part of the agreed-upon plan ... going into the weekend ... As recently as Saturday April 14th that was reconfirmed as part of the plan." And the RNC on Saturday morning distributed 'talking points' on the previous day's airstrikes that specifically mentioned new sanctions with the words "We also intend to impose specific additional sanctions against Russia to respond to Moscow's ongoing support for the Assad regime, which ... enabled the regime's atrocities against the Syrian people". But the President Trump apparently halted the sanctions part of the plan on Sunday April 15th either since the Treasury didn't have the sanctions' package or because of the muted Russian response to Friday's air strikes. And after the President's new Economic Adviser, Larry Kudlow, told the press on Tuesday April 17th that UN Ambassador Nikki Haley had been "confused" when she had "got out ahead of the curve" & told the press on Sunday that new sanctions were coming, she fired back with "With all due respect, I don't get confused", forcing him into making a public apology.

Trump has done this time & again, changing his mind &, by accident or intention, leaving a 'spear carrier' hanging out to dry", And he was reported to have "fumed" earlier in the week when Vice President Pence's office announced that Ambassador Haley's Senior Adviser, John Lerner, would start doing double duty as Pence's National Security Adviser as well (since during the 2016 campaign he had produced anti-Trump TV ads) although Lerner announced on Sunday he was 'unable' to take the job.

CANADIAN HOME SALES PLUNGE 22.7%, PRICES DOWN 10% IN MARCH (CP, Armina Ligaya)

- According to the latest monthly sales data released by the CREA (Canadian Real Estate Association) in March, amid double-digit plunges in most housing markets, the number of Canadian homes sold had been down 23% -, & the national average price 10%-, YoY (with the Vancouver & Toronto markets accounting for most of the drag), as the level of sales activity hit a four-year low for the month, 7% below the 10 year average (even though on an MoM basis sales were up 1.3%). And according to TD's Senior Economist Michael Dolega markets are likely to remain under pressure from the recent regulation changes & higher mortgage rates, and the new provincial regulations in some regions.
- But in March 2017 national homes sales activity had been at an all-time high for that month, & the drop in sales this year came after several government policy changes last year to cool Canada's 'hot' housing market. Thus, as of January 1st some home buyers became subject to financial stress tests to prove they could service their mortgages at higher-than-current interest rates, thereby reducing the maximum they could borrow

to buy a home, as a result of which towards the end of last year home sales activity had been boosted by buyers trying to lock in a mortgage before the new rules came in effect. As a result of this home sales in this year's First Quarter slid to their lowest quarterly level in four years & in March the national average price for all residential properties was down 10.4% YoY to \$491,000 (and ex-Vancouver & Toronto, 2% to \$383,000).

So Ottawa, that not long ago bragged about the strength of the Canadian economy when the economy was growing at a 1% quarterly rate, 'went silent' when in the Second Half of last year after the growth rate suddenly decelerated to less than half that rate & private sector economists started cutting back their 2018 & 2019 growth forecasts. And a recent survey by Leger for Re/Max found that the stress tests had prompted one in three house buying hopefuls to forego buying a house, one quarter to compromise on the size of the house they were looking at & another fifth to make concessions on its location by buying in a cheaper neighbourhood.

ISRAEL'S SEARCH FOR PEACE MAY PASS THROUGH THE GULF (G&M, Rick Ekstein)

- Twenty-five years ago, when I first started doing business in the Persian Gulf region, no one could have imagined the warming of relations now unfolding between Israel & some key *Sunni Muslim regional players*. While this may not make the headlines, it is nevertheless happening if one knows where to look. One 'straw in the wind' indicative of the fact that once hostile regional leaders are increasingly viewing Israel as a valuable trade-, technology-, & security partner was the recent Air India announcement of direct Delhi-Tel Aviv flights through Saudi air space that once would have been a No-No.

But the flaw in the ointment is that the impetus behind this is a shared fear of Iran's growing influence in the region as it bankrolls rebel movements in Lebanon, Gaza & Yemen, and props up the Assad regime in Syria (where it is building up a permanent base, complete with advanced weaponry - the writer is co-owner, & until recently CEO, of Vancouver-based Western Forest Products, a 2,000 employee company that does business in 40+ countries on four continents & frequently has been among the "50 Best Managed Companies" in Canada..

PUTIN STILL WANTS DEAL WITH TRUMP, EVEN AFTER SANCTIONS, SYRIA ATTACK (Bloomberg, Ilya Arkhipov)

- After US sanctions crippled an entire Russian Industry³ and air strikes in Syria threatened the first direct clash between nuclear super powers since the Cold War, Vladimir Putin is seeking to dial down the tension. According to four people familiar with the matter (one of whom also said that the Kremlin has ordered officials to curb their anti-US rhetoric) he wants to give Trump another chance to make good on his *election campaign* pledge to improve ties-, & avoid escalation-, with Russia (provided this can be

³ Russia is still trying to come to grips with the economic impact of the latest set of US' sanctions on oligarch Oleg Deripaska's aluminum giant Rusal, the shares of which plunged 70% on the Hong Kong Stock Exchange (thereby wiping out US\$6BN of stock market valuation (some of which it recovered this week), threatening 100,000 jobs & worsening Russia's worst recession in two decades) although it recovered some this week after the US on April 6th, in its most punitive penalties since Russia became involved in the Eastern Ukraine four years ago, basically banned it from the dollar economy. Rusal operates mines, smelters & refineries from Ireland to Jamaica and accounts for 6% of global-, & 17% of non-Chinese-, aluminum output, and it has been affected so much by the US sanctions that its representatives were in China this week to try & talk Beijing into selling alumina to it and buying aluminum from it (the latter of which is expected to fall on deaf ears since China's aluminum storage facilities are bulging with the stuff)

done without him 'losing face') which, according to one of them, explains why on April 16th Russian lawmakers suddenly pulled a draft law that would have imposed *harsh* counter-sanctions on US farm-, drug & medical equipment-, aerospace-, and space companies. And, given the harsh language of the tweets that had emanated earlier from Trump that "missiles will soon be flying", the relatively limited nature of the weekend attacks on alleged chemical weapons facilities in Syria (where Russia is backing the government forces in a civil war) was seen in the Kremlin as a positive sign (& *an excuse for not retaliate in some manner?*).

- According to Igor Bunin of the Moscow-based Center for Political Technologies⁴ (that counts Kremlin staffers among its client base) "Putin is ready to make numerous deep concessions, but he has to appear like he's not losing ... he understands Russia cannot compete with the West economically and doesn't plan to go to war with the West."

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IKEA PREPARING FOR URBANIZED WORLD OF 'SMALL SPACES' AND 'THIN WALLETS' **(Bloomberg)**

- According to CEO Jesper Brodin on April 10th, company research suggests that by 2030 about 60% of the world's population (double the current ratio) will be, "living in small spaces ... with "thin wallets" in "large cities". So it is abandoning its customary 5-10-, & adopting a 3-, year planning horizon to keep up with a rapidly transforming *global* society.

He is differentiating between "urbanization" (that is already well over 50%) & "large cities", presumably because 90% of the population growth in the years to come is expected to occur in Asia & Africa where free-standing home ownership is less of a tradition & their burgeoning big city populations are more likely to be housed in (small) apartments) - thus while the average 'housing unit size' in the US is 214 square meters (2,350 square feet), 206 in Australia, 137 in Denmark & 76 in the UK, it is just 60 square meters in China and in Hong Kong developers have initiated the building of "nano flats" of just 18.55 square meters/200 square feet.

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One of Russia's oldest think tanks, the head of which is the above-named Igor Bunin.