GLEANINGS II - 819
Thursday August 8th, 2019

Bayer's Monsanto-legacy RoundUp-caused cancer lawsuits - They have been multiplying like rabbits. Initially, in March 2017, six months after Bayer had succeeded in its takeover bid for Monsanto, there were 40. By last January 1st, seven months after the takeover had finally been approved by the US regulators, their number had grown to 11,000 &, after hitting 13,400 in April, by July 11th they numbered 18,000 - *And it may be spreading; for two months ago an Australian gardener filed the first-ever non-US suit. So far three cases have gone to court & Bayer lost them all. And even though the ridiculously huge initial awards were much reduced on appeal, the final awards were still large enough to wipe out Bayer's equity base if even only half of those 18,000 claimants got US$7MM each (a fraction of the final awards in the above three cases) - the Bayer executive must rue the day they didn't walk away from the deal when the US regulators created a respite for 'sober second thought' for them.*

China's non-SOE financial sector about to be overstressed? - Last May Beijng bailed out the Baoshang Bank in Inner Mongolia's nearly 3MM inhabitant Baotou City by simply nationalizing it. Not entirely surprisingly so, this resulted in small banks all over the country having the doors of their traditional funding sources slammed shut in their faces. Then on July 29th the Bank of Jinzhou in Liaoning province Northeast of Beijing was bailed out by three state-owned banks led by the ICBC (the world's largest lender). And this week the government of Shandong Province, a couple of hundred miles South of Beijing, was hunting for a" group of strategic investors" to infuse capital into the Hengfeng Bank to "enhance its strength and operational capacity" [*& subsequently found one in the form of the* <u>*Central Huijin Investment Trust*</u>*, a unit of the CIC (China Investment Corp., a Chinese souvereign wealth fund with AUM of about US$1TR (largely since it is the repository of the Chinese government-owned shares in a number of the country's largest banks)]. But this may only be Scene 1 of Act 1; for according to Jason Bedford, the Vancouver-born, UBC Poli Sci grad who now is UBS' Director of Asian Financials' Research & who three years ago already warned of the "dangers in the shadows of the Chinese banking system" & some time ago red-flagged these three banks, China's small banks face a potential capital shortfall of 2.4TR yuan/US$340BN & the entire non-state-owned Chinese financial system an "asset in distress" problem of 9.2TR yuan/US$445BN, roughly equivalent to 3% of GDP (thereby suggesting that China's entire financial structure is little more than 'house of cards').*

Cost of the two-plane Air Force One replacement project - According to the Washington Post, while early in his Presidency Trump complained about its US$4BN cost & two month ago bragged about forcing Boeing to cut its cost by US$1.6BN, the <u>Air Force Magazine</u> says the latest Pentagon estimate is that the project will end up costing US$5.2BN, US$4.7BN for the planes & the rest for new hangar building-, & other ancillary-, costs - *to put this into perspective, the base price for a Boeing 747-8 is US$358MM & that for the upgraded 747-8 "VIP" version, that comes complete with what its marketing pictures suggest is a luxuriously accoutered large meeting room & dining room for 14, two special living areas with sofas, low tables & a big-screen TV, a private office, a guest cabin with an ensuite bathroom & a private living room, a number of fully-equipped bathrooms & a 'spacious' master suite with 'panoramic views', another US$200MM or so. So American taxpayers would be justified in asking what accounts for the additional US$1+BN (more than 3x the plane's base price) now apparently budgeted for each of the two planes.*

Example of the impact of a tariff on retail prices paid by consumers - Canada has exceedingly stiff (250+%) tariffs on dairy products As a result, while the US average retail cost of a liter of milk is the equivalent of C$0.99 & that of domestic cheddar cheese C$7.07, in Canada their cost is C$2.47 & C$13.79 respectively - *All this to protect 12,000 dairy farmers, two-thirds of* *them in Québec, whose costs of production are artificially boosted by Canada's ill-conceived & long-outdated supply management/quota system (that requires new entrants into the industry to spend as much as 10x as much on the license to produce milk than on the cow that would produce it. So, simply put, the dairy tariffs cost Canadians each year $100+ per capita for the milk, they may, or may not, drink (never mind the cheese, yoghurt & other dairy products they may consume) - so taxpayers, drink up, so as to get at least get your money's worth!*

Gold price - Earlier this week, after the Chinese Yuan weakened to < 7 to the US$, the US Treasury formally designated China as "currency manipulator" (*which is akin to a teenage murderer of both his parents pleading for mercy since he is an orphan; for at least some, if not much or most, of its weakness is a function of Trump's trade war*). This helped to explain the price of gold this week topping US$1,500 for the first time since August 31st, 2011 [when it hit an all-time high US$1,828 (a 5x rise in 11 years), subsequent to which it slid to US$1,054 by December 2015 only to slowly recover to US$1,127 by December 2016 & US$1,187 by August of last year, after which its recovery rate quickened to US$1,340 last February & US$1,420 on July 23rd, & then rocketed to US$1,465 last Monday August 5th & to US$1,501 at the time of writing on Wednesday August 7th - *This won't do much for confidence in the current economic/financial situation & has prompted 'gold bugs' to forecast further price rises to as much as US$5,000.*

There have been two major new developments in the global gold market. First & foremost, after decades of being a net **seller**, the global central bank complex has since 2011 been a significant net **buyer** of gold to the tune of 300+ tonnes a year (i.e. 10% of the newly mined production & 0.9% of their total official gold holdings). And secondly that China, the country with just the sixth largest official gold holdings (1,900 tonnes vs. the US' 8,000 [2]. Germany's 3,400, Italy's 2,500, France's 2,400 & Russia's 2,000) & for years the world's largest producer of newly mined gold [3] (most recently at a 400+ tonne annual rate, none of which has found its way into the world's gold markets), that has been hoovering up gold from other sources, at last report at a 1,500 tonne annual rate, now is estimated to directly or indirectly control as much as 18,000 tonnes of the stuff (i.e. 10% of all gold ever mined), in what could become at some point a threat to the current US dollar-based international monetary system.

US corporate bond market - An article entitled "First come, first served" in the July 13th <u>Economist</u> is truly worrisome - For it contains a tiny, 2.5" x 2", chart headed "US primary dealer*s'* holdings of corporate credit" that shows that their inventories of corporate bonds have gone from US$280BN to US$25BN in the past decade (which it says is due to the new *post-Great Recession so-called* 'Volcker' rules that make less attractive for them to use their capital to trade bonds for their own account) - *this has all but ended their role as corporate bond 'market makers' (those who buy securities from willing sellers to 'warehouse' them until they find willing buyers to*

---

[2] The validity of which number has long been the subject of speculation since it has never been confirmed by a third party audit for as long as anyone still alive can remember. And such doubts were given some substance a few years back when Germany sought to repatriate the US$300MM of its official gold holdings that had long been held for safekeeping in the vaults of the New York Fed. For first it was told that this request would take several years to accommodate and then, when that time line was shortened & it got its gold back sooner, the numbers on the some of the gold bars it received from the New York Fed did not match those on the books of the German Bundesbank.

[3] South Africa that once was the world's largest gold producer, with 619 tonnes in 1993 (the year before Apartheid ended) at last report was relegated to eighth place with just 123 tonnes behind China (400), Australia (312), Russia (282), US (250), Canada (193), Indonesia (190) & Peru (155).

take them off their hands at a profit). But this activity is what has historically created 'liquidity' in the corporate bond market (i.e. the ability of investors to sell securities at a fair price at any time) and the grease that made the OTC (Over The Counter) corporate bond market [4] *operate efficiently & smoothly. Meanwhile, in the past decade the size of the corporate bond market has gone from US$3.5TR to US$6.2TR; in other words, while once a US$3.5TR market floated on US$280BN-worth of market making dealer inventories, today's US$6.2TR corporate bond market has only US$25BN in dealer market making capability to help it function smoothly (so in economic/financial terms the 'leverage'* [5] *in the corporate bond market has gone up twenty-fold to 250x). Secondly, in the past decade the average creditworthiness of the corporate bond market has declined; for while then its share of BBB-rated (i.e. the lowest "investment grade") bonds was 36%, today it is a 30-year high 49% (as investors in the low interest environment have 'chased income' by buying higher-yielding-, but lower quality-, bonds). And this has created another serious risk element, namely that, since many institutional investors, by law or 'house rules', can only invest in "investment grade" assets; so if the US economic situation were to weaken & put pressure on corporate profits, & hence on corporate borrowers ability to pay interest on their debt, resulting in credit rating cuts, these investors would have to get such now "junk" bonds off their books &, with lower dealer inventories, there would be fewer willing buyers to sell to (& panic could ensue). And finally, to increase the system's potential exposure to risk even more, a significant share of corporate borrowing in recent years has been to fund corporate 'share buybacks' (last year to the tune of nearly US$1TR); while for years that has contributed to President Trump's much vaunted 'stock market on wheels' phenomenon (since it shrinks the supply side of the stock market & hence has a price-firming effect), as a result the leverage/debt-to-equity ratios in many corporations' balance sheets has gone up (thereby reducing their ability to cope with 'rainy day' economic conditions). What all this adds up to is that these three 'stacked' leverage hikes have seriously enhanced the risk of a domino effect-like implosion of the US corporate bond market that would reverberate through the global financial system to the point where it could become unhinged. And the really scary part of such a scenario is that, as has often been the case in the pst, it could come like a thunderclap on a bright, sunny summer day & catch many people with their pants down, thereby setting the stage for panic (with afterwards, as is always the case, they asking themselves afterwards "why didn't I see that coming?").*

Greenland's ice is melting dramatically - The effect of the recent European heat waves has spread to Greenland. Since June 1st, the start of its ice loss season, its ice sheet is said to have shrunk by 240,000 megatonnes (i.e. 240,000,000,000 tonnes), releasing enough water into the world's oceans to raise their levels by nearly 1 centimeter. By comparison, in 2012 the amount of the Greenland ice melt was 290,000 megatonnes for the entire season (*and that was unusually high because the entire Greenland ice sheet had experienced melting as the temperatures had gone above freezing at even its highest elevations).*

---

4 Unlike the stock market where Buy & Sell orders are matched technologically, in the bond markets where securities are far less standardized & a single issuer may have issued dozens of different types of bonds outstanding, in the bond markets matching BUY & SELL orders still require human 'market maker' intervention.

5 For those of you not familiar with the concept of financial leverage, the following may help. Assume that both you & a friend are buying houses, you with a 10%-, & he with 25%-, downpayment. In that case you would be leveraged 9x & he only 3x and, if the economic/financial biomass ever hit the fan, his ability to adapt to the drastically changed economic environment would be far greater than yours.

US Deficit - In the first nine months of the fiscal year ending September 30th the US federal deficit was up 23.1% YoY to US$747.1B. At this rate the entire year's deficit will come in at US$959BN, well short of the forecast US$1,092BN. But that is the good news. The bad news is that this would be a post-2012 high, 64% up from 2016, the last Obama year (when GDP grew by just 1.5%), & amounts to 5.2% of GDP (& almost twice the 50-year average 2.9% deficit-to-GDP ratio) at a time the economy is supposedly "strong" & not warranting such a high ratio).

US job creation YTD - The CW is that the US economy is "strong" [although the first of three readings of the Second Quarter annualized GDP growth rate was 2.1% (down from 3.1% QoQ & little more than half the 4% Trump had promised)] and, if the Atlanta Fed's GDPNow reading & its Blue Chip Consensus are anything to go by it may well be revised downward in subsequent readings. And the CW is at odds with the fact that YTD the average monthly new job creation rate (after May's was cut from 72,000 to 62,000 & June's from 244,000 to 193,000) is the lowest in almost a decade. Thus this year's first seven months' average is now 165,000 vs. 227,000 in 2018, 185,000 in 2017, 200,000 in 2016, 231.000 in 2015, 242,000 in 2014, 187,000 in 2013, 180,000 in 2012, 168,000 in 2011 & 91,000 in 2010 (the first post-Great Recession year) - *And my reading of the latest financial market gossip came across an observation that the Fed's GDP growth forecasters have begun to build into their forecasts the possibility of a "significant downshift" in the Third Quarter GDP growth rate from the Second Quarter's preliminary 2.1%, as business spending remains soft & the new job creation rate seems headed in the same direction.*

US national debt - As of December 31st, 2018 it was US$21.5BN, up 10.9% from 2016, 20.7% from 2014 & 80.6% from 2009 (*with much of the latter's growth 'front-ended' by the four US$1+TR deficits in the 2009-2012 fiscal years as the economy was in-, or recovering from-, the Great Recession*). This may be setting the stage for the scenario laid out by the CBO (the non-partisan Congressional Budget Office) that envisages a decade of annual budget deficits averaging US$1.2TR - *And there is a 'dark cloud the size of a man's hand' on the US financial system's horizon : for, while over 25% of the national debt is now "intra -governmentally held", most of that is accounted for by Social Security Trust Funds that, with the population aging, within the next decade will start experiencing shrinking net cash flows that will impair their ability to help fund 'off-market' the government's failure to make the current generation of taxpayers pay their way.*

US touches a nerve in Beijing - On August 6th Julie Eadeh, a US Consular official in Hongkong, met with Joshua Wong, a 22 year-old top local democracy activist recently released from jail (again) [6]. Beijing's response was swift : the Ministry of Foreign Affairs lodged a formal complaint with the US Consul-General, urging US diplomatic personnel not to engage with "anti-Chinese forces" & the Beijing handmaiden Ta Kung Pao local newspaper published an article with Ms. Eadeh's personal details incl. the names of her children, prompting the US State Department to accuse the Chinese government of having leaked the information & calling doing so the behaviour of a "thuggish regime" which then prompted the Ministry of Foreign Affairs to fire back with a scathing statement implying that the US conduct of foreign policy was unacceptable.

-o-o-o-o-o-o-o-o-o-o-o-o-

HOW TRUMP THINKS TARIFFS WORK (AND HOW THEY ACTUALLY WORK)
(The Atlantic, Annie Lowrie)

---

6 Wong is the scion of a local Chinese Christian family & a political activist since age 13 years of age who, six years ago, at age 16, orchestrated a public rally attended by over 100,000 people.

- In May President Donald Trump hiked tariffs on $200BN of Chinese imports in another salvo in his year-long trade war with Beijing, prompting the latter to retaliate with tariffs on $60BN of American products, warning it would "never succumb to foreign pressure". His argument is that tariffs will force concessions from Beijing and benefit US manufacturers & economy, tweeting "Tariffs will bring in FAR MORE wealth to our country than even a phenomenal deal of the traditional kind. Also much easier & quicker to do.... Tariffs will make our Country MUCH STRONGER, not weaker. Just sit back and watch!" But so far his belief tariffs make the US stronger, the deals more phenomenal & the trade war easier to win has foundered on Beijing not only not backing down but showing no sign of doing so any time soon, while US businesses & consumers have had to bear the tariffs' still modest-, but nevertheless measurable-, costs.
- Trump thinks protectionism is a necessary economic philosophy & tariffs a potent weapon, a direct tax on Beijing, a way of sapping Chinese manufacturers & one of raising revenue from China, aiding domestic business & giving Washington leverage in trade negotiations. Thus he tweeted "Tariffs are NOW being paid to the United States by China of 25% on 250 Billion Dollars worth of goods & products ... The massive payments go directly to the Treasury of the U.S." But this is not how it works. Beijing is no more likely to fork over billions of yuan for Trump's tariffs than Mexico's government is to pay for his border wall; rather, tariffs are paid by US importers of Chinese goods who pass *at least some of* their cost on to US consumers; so his tariffs are raising costs for US businesses & families. And while last May he argued this dynamic didn't exist & "Tariffs paid to the USA have had little impact on producer costs, mostly borne by China", that same month Princeton, Columbia & New York Fed economists produced a paper that said, among others, "Although in principle the effect of higher tariffs on domestic prices could be offset by foreign exporters lowering the pre-tariff price they charge for their goods, we find little evidence *there*of in the terms of trade up to now" & estimated that by late 2018 the tariffs were costing American consumers $1.4 billion in real income a month, while the New York Fed said the tariffs on Chinese imports were costing a 'typical US household' $831 a year.
- As to tariffs bringing "FAR MORE wealth to our country", while the trade war thus far has not caused tremendous macroeconomic damage, it has hit certain industries hard (*automobiles, technology & farming*), increased the CPI-, & negatively affected GDP growth-, marginally (with one analysis finding that the pain was worst in heavily Republican *less urbanized* counties. But the cost might become greater this-, & *next election-,* year.

Still, never to be confused by facts, on July 12th in an interview President Trump told Milwaukee WI-based WTMJ' TV's Charles Benson, "We are doing great with the farmers now in a lot of ways. One way is we're giving them $16 billion out of all the money were are collecting ... Sixteen billions dollars all comes out of the tariffs that we have gotten from China" and again at a July 30th new conference he referred to "taking in billions and billions of dollars from China in the form of tariffs."

<u>FROM PHONE MAKERS TO FARMERS, THE TOLL OF TRUMP'S TRADE WARS (Reuters)</u>

- President Trump's announcement on July 31st (the day after the latest bilateral trade talks had wrapped up in Shanghai without any significant progress) [7] that he would impose,

---

[7] This move seems to have been inspired by the China-hating peter Navarro, Trump's China-hating Foreign Trade Adviser, Peter Navarro, but opposed by his Trade Representative Robert Lighthizer & National Security Adviser John Bolton (the former of whom was a member of the US negotiating team at the recent Shanghai talks & both of them 'hawks on the China trade file). And Trump's seemingly backing away a bit from his July 31st proposal may well be due to the fact that

effective September 1st, a 10% tariff on the remaining US$300BN of Chinese imports, his latest salvo in the year-long trade war between the world's largest two economies. Listed below is some fallout of his push to rewrite the terms of trade with China & others :

a) His tariffs have disrupted international supply lines, roiled global financial markets & encouraged *US* manufacturers to invest in new plants outside the China (*rather than at home, as he had anticipated*) & prompted many economic forecasters, incl. the IMF, to mark down their global GDP growth forecasts for this year & next;

b) According to Fitch these new tariffs will shave 0.4% off global GDP growth;

c) With farmers *in Trump-supporting, less-urbanized states* being the *third*-hardest hit *by China's counter-measures* (*after the automobile-, & technology-, sectors)*, Washington has so far earmarked US$28BN in aid for them, of which by the end of June US$8.6BN had been disbursed;

d) Total US soybeans exports to all countries are down 27% YoY from US$20.6BN & US exports to China by 77% to just $2.5BN;

e) His tariffs are costing the US technology sector US$1.3BN a month, with Apple two months ago already saying they would further slow down its iPhone sales in China[8], reduce its overall competitiveness & reduce its tax payments to the US Treasury *in the form of taxes*, while according to the US Consumer Technical Association his planned new tariffs will raise the price of iPhones by an average $70, that of laptop computers by $120 & that of video consoles by $50;

f) GM projects the tariffs & associated higher raw material costs will add US$1BN-, & Fiat-Chrysler that it will add 750MM Euros/US$832MM-, to their cost of production & Harley-Davidson that retaliatory EU tariffs will cost it US$100MM this year alone, while Winnebago & John Deere plan pass their tariff-driven higher costs on to their customers (*that in the case of the latter have already been hard hit directly by the Chinese counter measures)*; and

g) According to the *Washington-based* American Action Forum [9] the tariffs on steel and aluminum imports cost users almost US$5BN last year.

While hitherto most of the impact of Trump's tariffs has only indirectly affected US consumers, the consensus is that his latest tariff proposals would hit them harder more directly.

Lighthizer's & Bolton's case has been strengthened by feedback from Beijing that President Xi is said to have been personally affronted by Trump breaking the understanding he thought he had reached with him at the late June Osaka G-20 Summit & to the fact farm sector leaders have become more critical of him because in response to his July 31st Navarro-inspired announcement Beijing had suspended **all** US farm product imports.

8 In fact, it has been reported that Huawei has experienced a "patriotic surge" in its domestic smart phone sales. Moreover, the Company may have taken some wind out of the sails of Trump's attempt to use it as a pawn in his China trade war policy by its August 8th announcement that its supply chain is now completely independent of the US which, if true, would be a remarkable achievement in such a short time (although not inconceivable in a totalitarian state context).

9 A ten year-old conservative 'issue advocacy' group founded a decade ago by the late Fred Malek, who also founde of Thayer Capital (a Washington DC-based US$1.2BN private equity firm) and served as Deputy Chairman of the RNC (Republican National Committee, as President of Marriott Hotels & of Northwest Airlines, and as Assistant to Presidents Nixon & Bush 41, and was an active player in every modern day GOP Presidential campaign except Trump's. The current Chairman of its Board is the former Minnesota Senator Norman Coleman.

<u>CHINA'S RARE EARTH PRODUCERS SAY THEY ARE READY TO WEAPONIZE THEIR GLOBAL SUPPLY STRANGLEHOLD TO PASS ANY TARIFF AS A COST TO US CONSUMERS</u> (SCMP, Eric Ng)

- On August 7th the Association of China Rare Earth Industry, which represents nearly 300 rare earth miners, processors & manufacturers issued a statement that its members "resolutely support the nation's counter-measures against US import tariffs on Chinese products ...*and that* US Consumers must shoulder the cost of US-imposed tariffs."

Given the degree of government control over the industry, *this has been taken as a sign that Beijing is now ready to turn its global near-monopoly in the production & sale of rare earth materials critical to the hitech industry into a trade weapon -The rare earth 'group' consists of 17 chemical elements with unique electric and/or magnetic qualities vital to the electronic-, & clean energy-, industries. China currently produces 70+ percent of their global output & controls 85% of the world's rare earths' processing capacity'. While the US still imports the lion's share of its rare earth needs from China, two years ago the long-closed Mountain Pass mine in California was rehabilitated & last year produced 18,000 tons of rare earth material with the result that YTD imports from China have declined YOY (although the Mountain Pass mine still depends on Chinese firms to process its raw ore); so the US rare earth imports' role as a weapon in Beijing's trade negotiating quiver, while still very significant enough not to have been included in any of Trump's tariff initiatives, may now be past its 'best before' date.*