<u>GLEANINGS II - 891</u>
Thursday July 29, 2021

Quote of the week – "It is without question a very challenging time and President Biden is doing the very best he can, to try to get our democracy to ... function in a very difficult situation. I think his heart is in the right place . He is working as hard as he can ... to see if he can't get at least some bipartisan cooperation ... But the bottom line is that these forces that are in play within the country are very difficult to control and we don't know what direction we're going to be able to take and whether or not ultimately we can restore our democracy to the original hope of our forefathers in terms of our ability to govern". Leon Panetta [1] - *Biden promoting 'social infrastructure' goals may be squandering financial & political capital on initiatives to divvy, not grow, the economic pie (akin to running up one's credit card balance to buy groceries?). Regardless of all MMT (Modern Monetary Theory) theorizing, 'running up debt today, often comes at the cost of future growth'.*

*And the need to 'grow the pie' is long overdue. In the past six decades **real** US GDP grew at a 3.1% annual rate in the 1960s, 4.1% in the 70's, 3.5% in the 80s & 3.8% in the 1990s, but by only 1.9%% & & 2.3% in the first two decades of this century! And it's ironic that, while during the former the Fed's discount rate averaged 5.00% in the 60s, 9.00% in the 70s, 9.50% in the 80's, & 6.00% in the 90's, in the latter two it did so by just 2.75% & 1.50%. And matters cannot have been helped by the fact that, according to the St. Louis Fed US government spending as a % of GDP went from 17% in 1960 to 18.2%in 1970, 20.7% in 1980, 21.01% in 1990 (the Reagan/Bush 41 era), 17.5% in 2000 (the Clinton one), 23.1% in 2010 (Bush 43's) & 31.3% in 2020 (& now it is estimated to be in the 40+% range). So Biden's country & party might be better served if sought to convince Americans to 'pull together' to deal with the nation's challenges. Voters forgive politicians a lot, except being bad at the business of politics and Biden's & Pelosi's political leadership has been anything but stellar!*

Canada has long been grossly mismanaged fiscally! - In the 51 fiscal years since the end of FY 69 Ottawa has had only 11 years of budget surpluses, from FY97 up to & including FY07 (i.e. during the last six years of the Chretien regime, the 3 years of Paul Martin's, and the first of Harper's, and again in FY15, the year of Harper's swan song). And it doesn't matter that the US in those 51 years had only three years (1998-2001) of surpluses.

Government of Canada 'alchemy' – On August 27, 2015, in the run-up to the October 2015 election, Justin Trudeau promised three years of $10BN budget deficits to "kick-start" the economy [2] & balanced budgets thereafter, but four months later already reneged on that. And

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1 Now 83 years of age, he is the son of Italian immigrants who owned a restaurant in Monterey CA. A lawyer he served as an officer in Army intelligence (1964-66), started his life in politics as a Congres- sional political assistant (1966-71), practiced law for five years (1971-76), was a Democratic member of the House from 1977 to 19-93 [incl. four years as(1989-93) as Chair of the House Budget Commit- tee], and then in succession was Director of the OMB (1993-94), White House Chief of Staff (1994-97), Director of the CIA (2009-11) & Secretary of Defense (2011-2013). In 1997 he & his wife Sylvia founded & became Co-Directors of the Panetta Institute for Public Policy at the California State University, Monterey Bay, of which he has been Chairman of the Board since 2013

2 Which seems to have been at best only marginally successful; for while in the period years 2012-2014 (the three calendar years before he became Prime Minister) Canada's GDP had grown by 7.2% in the years 2016-2018 (i.e. the first three calendar years of his Prime Ministership) it grew by 6.3% and in the three pre-COVD-19 years (2017-2019) by 7.1%.

in its first three years the Trudeau government's budget deficit never came even close to his $10BN target & thereafter only got worse Thus in FY20 (to March 31, 2020, only six weeks after COVID-19 had hit the headlines & the stock market been routed) his government spent $363BN & had a $29BN deficit (i.e. 8% of total expenditures) & in the year ended last March 31, it spent $479BN & had a $354BN deficit, i.e. revenues only covered 30% of its spending. (with 70% paid for with "funny money".) And with an election now rumoured for September 13 [depriving all MPs first elected in 2015 (i*ncl. at least 10 Liberals*) from the six year eligibility provision for a pension at age 55], while the latest polls indicate a 35.1%, 28.5%, 19.9%, 7.1% & 8.4% Liberal. Conservative, NDP, BQ & Other split, reports are that Conservative MPs are far better funded than those of the other parties; so hopefully Canadians, when they mark their X on Election Day will remember that Trudeau has proven himself to be a lousy leader not worth & being given a second term as the leader of a majority government (& replace Diefenbaker as Canada's 10th longest-serving Prime Minister?).

Home eviction tsunami around the corner? – On Saturday August 1, the US federal home eviction moratorium that prevented renters from being given notice and/or being evicted from their homes for non-payment of rent will expire (*and only ten states & DC have supplementary renter protection in place, most of which will also expire within the next month or so*). In the aggregate renters owe landlords US$23BN, i.e. US$3,700 per household (*so roughly one in ten US households could become homeless*). The highest incidence of rent arrears is in Alabama & Mississippi, Alaska, Southern California, the Carolinas/Georgia region and Minnesota & South Dakota. In New York City some 400,000 renters are behind, while percentage-wise the most affected municipal entities include Jenkins County GA (3,500 households) – 24.3%, Sullivan NY (30,000) – 18.9% & Fresno CA (173,000) - 17.6%.

Shiller CAPE (Cyclically Adjusted Price Earnings) ratios – On June 30 they were :

Country	2021	2020	2019
United States	37.73	29.35	31.00
India	33.38	23.29	27.91
Canada	25.49	21.67	23.69
Japan	25.34	21.58	24.67
Italy	24.17	18.71	21.20
China	18.43	15.80	15.71
Spain	18.22	12.36	14.54
UK	15.05	13.22	15.77
Hong Kong	14.62	14.84	14.61
Russia	10.96	8.21	9.65

What I first learnt about the stock market was that the 'normal' P/E ratio range is 10 to 20 [3] *& that the further it is outside this range, the greater the need for caution; for >20x a stock may be overpriced, while <10x there may be indicative of undue management and/or survival problems/risks, that would justify some study & independent thinking. I have never owned a stock with a P/E of >20 but have made some nice money with some with P/Es of < 10.*

3 To put this in perspective, topping a long list of 'high P/E stocks ' is Green Dot, a pasadena CA-based, 1,200 employee, 22 year-old company, purportedly the world's largest prepaid credit card company and is lshown as having a P/E of 4,611x and two names I recognized ,Tesla with 658x & Moderna with 269x.

This will be a big week for US corporate earnings – For it will feature 2Q earnings reports from the GAFAM/FAAMG companies (Google/Alphabet, Apple, Facebook, Amazon & Microsoft [4] [5]) &, at midweek, the regular two-day Fed FOMC meeting – In his usual post-FOMC press briefing Fed Chair Jerome Powell told those present that the US economy is still a "good deal away" from making progress towards fulfilling "its dual mandate of stable prices & maximum employment" &, has "some ground to cover on the labor market side" and that the Fed was "not considering cutting its purchases of mortgage-backed securities" *(MBS)* before the overall tightening process begins ... There is little support for the idea of tapering MBS earlier than Treasurys" (although conceding some support, once the process begins, for tapering MBS faster than Treasurys). Still, Gus Faucher, Chief Economist at PNC Financial Services [6] believes that "with its July 28 meeting the FOMC has started the tapering clock".

VIEs (Variable Interest Equities) – Foreigners who buy 'Chinese stocks' are being misled. For by law foreigners cannot own shares in Chinese companies. So, rather than getting an equity interest in a Chinese company, their money goes into an offshore 'financially-engineered' product without ownership rights. For to get around the law a Chinese company must create an offshore entity in, say, the Caymans with "certain carefully curated" (*i.e. "arranged* ") economic interests in the company" that don't entail ownership rights. In other words, investors get shares in a company with only a contractual relationship with the Chinese company, rather than the 'real thing'. So a VIE is unlike an ADR (American Deposit Receipt) which represents a specified number of shares of a foreign company held in trust for the investor by an American bank. And recently introduced regulations now deprive investors from getting an insight into Chinese companies' finances & operations; for they stipulate that Beijing's regulators must 'process' company reports before they can be published.

Watershed in Global Trade? - According to the IMF Directory of Trade Statistics, since the turn of the century the US' share of global trade has declined from 80% to 27% and that of China risen from 17% to 70% (*in part due to the US 'outsourcing' manufacturing to China?*). And according to the World Bank, in 2019 the ratio of exports as a percentage of GDP was 57% for China vs. 8% for US (and 44% for the EU, 36% for Mexico, 33% for South Korea, 26% for Canada, 17% for the UK & 14% for Japan).

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DRAWING FURTHER APART : WIDENING GAPS IN THE GLOBAL RECOVERY
(IMF, Gina Copinath)

- The global economic recovery continues but with a widening gap between advanced-, & emerging market/developing-, economies. Our latest global growth forecast of 6% for 2021is unchanged from the previous outlook *report* but its composition has changed. Growth prospects for the former have improved by 0.5% but this is offset by a downward revision of the latter, (*largely?*) driven by a downgrade for emerging Asia.

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4 That between them account for over one-fifths of the total capitalization of all S&P 500 companies

5 That have P/Es of 33.90, 33.49, 31.91, 79.41 & 39.44 respectively.

6 Pittsburgh PN-based, with assets of US$470BN, it's the nation's seventh-largest bank (after JPM with US$3.2TR, BoA with US$2.3TR, Wells Fargo with US$1.8TR & Citi with US$1.7TR

Forecast GDP Growth Rates

	2020	2021	2022
World Output	-3.2%	+6.0%	+4.9%
Emerging & Developing Economies	-2.1%	+6.3%	+5.2%
EM & Middle Income Economies	-2.3%	+6.5%	+5.2%
Low Income Economies	+0.2%	+3.9%	+5.5%

- In closing three caveats are added. Fiscal action should be nested within a credible medium-term fiscal framework to ensure debt remains sustainable. Central banks should avoid prematurely tightening policies but be prepared to move quickly if inflation expectations show signs of de-anchoring (*i.e get out of hand?).* And the *global* recovery is not a sure thing unless the pandemic is beaten back quickly.

The writer (age 49) has been the IMF's Chief Economist & Director of Research since October 2018. She is on a leave of absence as Harvard's John Zwaantra's Professor of International Studies and Economics. The 11th holder of the post [7], & the first woman to do so, she is a naturalized US citizen & an Overseas citizen of India who by age 30 had amassed a BA from the University of Delhi, MAs from that university & from the Delhi Scool of Economics, and from the University of Washington, and a PhD from Princeton

FAULT LINES IN THE WORLD ECONOMY (The Economist)

- The pandemic caused a fearsome economic slump, but now an awesome boom is in full swing & stock markets are on a tear, and the global economic growth rate at an exuberant post-2006 high. But (*at least?*) three fault lines below the surface will determine who will prosper & whether this most unusual recovery can be sustained.
- One divides the 'jabs' from the 'jab-nots'; for only those countries that get lots of vaccines into arms will be able to tame COVID-19 & so far only one in eight people in the world is "fully protected", *with the evidence growing that this may not apply to the increasingly dominant Delta variant?* The second applies to the supply & demand situation. A shortage of microchips has disrupted the manufacture of electronics & cars, The cost of shipping goods from China to US West Coast ports has quadrupled (*and that of shipping them through the Suez Canal must also have risen after its blockage?* [8]). And other problems may pop up. In some countries (*North America?*) people seem more interested in having a drink in a bar than in working behind the bar in a bar. House prices have surged, which soon will affect rents, both of which could contribute to inflation. And finally there is the question of the withdrawal of stimulus. Rich country central banks have bought assets worth over US$10TR (10+% of global GDP) and they are nervously wondering how to extricate themselves without causing a flap in capital markets by doing so too quickly (as China may already have done?). And in some countries the flow of "stimmies" may soon end.

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7 You are never too old to learn and it came as a big surprise to me that Wm,C.Hood, a former boss of mine in the Department of Finance held the post for seven years from 1980.

8 MV Ever Given, at 220,940 tonnes & a length of 400 meters, and one of the world's largest container vessels, that caused that mess, finally arrived in Rotterdam on Thursday July 28, three days late.

But the pandemic recession has now been ruled the shortest ever; officially it lasted only two months (March/April 2020), half as long as the 1980-, & one-quarter the 2001-, ones.

<u>BIDEN'S NEW CHINA DOCTRINE</u> (The Economist)

- *President Obama signed the TPP (Trans-Pacific Partnership) on February 4, 2016, four months after Hillary Clinton (who had once supported the idea) had nixed it since, in its final form, it didn't meet the "high bar" she had set for it. But on January 23,2017, three days after his inauguration President Trump signed an order for the US withdrawal.*
- And now Joe Biden is converting Trumpian bombast into a doctrine that pits America against China in a political struggle he says can only have one winner & that is based on a belief China is "less interested in coexistence and more... in dominance". So between them they have now engineered the most dramatic break in American foreign policy since the days of Richard Nixon, half a century ago.
- And while much of Biden's new doctrine makes sense, it's details contain much to worry about, if only because it is likely to fail. For, while he uses strident rhetoric to galvanize Americans into having more of an 'anti-Yellow Peril' Pearl Harbour spirit & a sense of national purpose, in its fine print it is full of industrial policy, government intervention, planning & controls. And his allies & potential allies are likely to be turned off, rather than be attracted, by his nationalism.

Playing the game by the other guy's rules is typically a losing proposition. And Biden's strategy seems similar to President Xi's, namely to subordinate economic-, to political-, considerations. This tends to build 'Giants of Steel with Feet of Clay' (Daniel 2 : 31-32) as Hitler found out the hard way, after he fell victim to the 19th century "Drang Nach Osten" siren song & Breshnev did when he got into an arms' race with Ronald Reagan. While the idea that membership in the WTO would make China a more "responsible stakeholder" in the US-structured-, & dominated-, post-WW II international community was proven to be flawed, there has long been proven to be much merit in the observation, attributed to Sun Tsu 2500 years ago, to "Keep your friends close and your enemies closer". And the Biden doctrine is breaking both bits of Sun Tsu's advice, alienating traditional-, & potential new-, allies and girdling his country's loins for a possible armed go-around with a country that has been 'buying' allies' left, right & centre, building a 'blue water' navy that could be a serious challenge to the post WW II US control of the oceans, launching the Belt & Road initiative, developing Mach 5 anti-aircraft carrier missiles & now reportedly building 100+ new LCBM silos, all activities with little real long-term economic benefits, as the country faces the demographic & economic challenges inherent in a shrinking & aging population.

<u>BANK OF CANADA SHOULD 'BE HUMBLE' ON INFLATION RISK</u> (BB, Shelly Hagan)

- In a Tuesday July 27 telephone interview he said that there is a chance that underlying price pressures in the *Canadian* economy will keep inflaion remain above the Bank's 1-3% 'control range' into 2023, whereas the Bank's official position is that inflation will remain above 3% for *just* much of this year before falling back closer to its target in 2022, with Bank of Canada Governor Tiff Macklem telling reporters "We expect the factors pushing up inflation to be temporary ..."
- But Dodge's view is that Macklem c.s. may be proven wrong & that by insisting it's all temporary they may "undermine their own credibility, which is unfortunate ... It's better

to be humble and say that's what we think, but of course there is a chance things could be different."

The June CPI was 3.1% YoY (vs. 3.2% expected), down from 3.6% in May & on an MoM 0.3%, down from 0.5% in May; much of this was due to the fact that in June gasoline prices were up 'just' 32%, down from 43% in May.

After teaching at Queen's University, his alma mater, as well as Johns Hopkins & UBC, Dodge joined the Canadian civil service & in time became one of the more iconic Ottawa 'mandarins'. He topped off his career by being Deputy Minister of Finance (1992-1997) & of Health (1998-2001) and Governor of the Bank of Canada (2001-2008). Now age 78, he has kept his hand in, among others by being associated with the Washington DC-based IIF (Institute of International Finance), Toronto-based CD Howe Institute & the prominent, once Calgary-, & now Toronto-, headquartered Canadian law firm of Bennett Jones.

His most worthwhile career achievement may well have been that, upon becoming Deputy Minister of Finance, he managed to convince the then Minister of Finance Paul Martin that the deficit was a problem that needed to be addressed urgently. And the fact that during much of his career he operated a (beef cattle) farm on the side likely caused him to be better grounded in the real world than many of his confreres.