

Money, Macro & Markets Monitor

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IN THIS ISSUE:-

EUROPE:

Whatever, Mario!

CHINA:

Has the industrial earnings cycle peaked?

US DEBT:

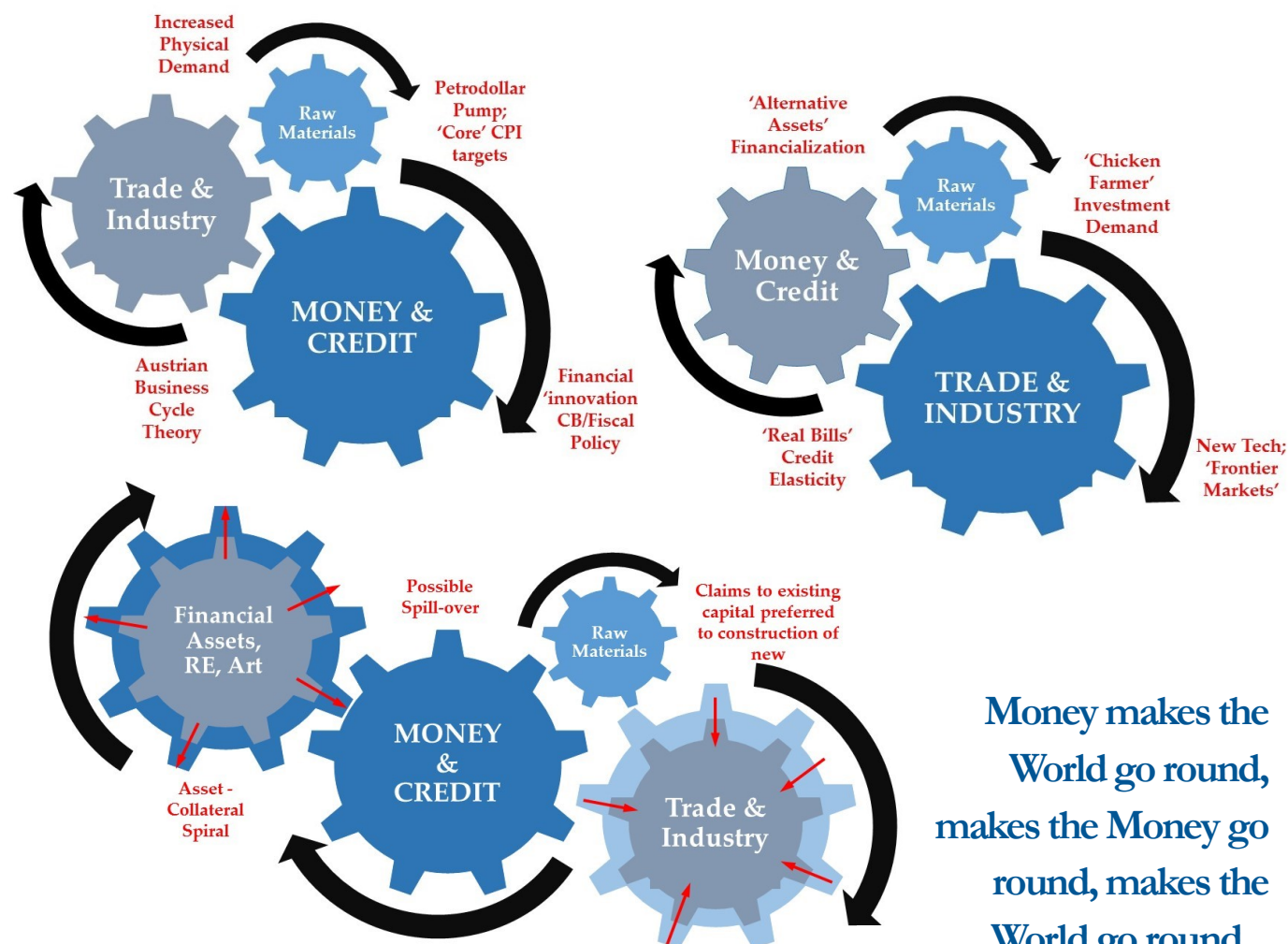
Levels OK but growth a concern

TECH:

Hard-ware—soft numbers

GOLD & ENERGY

Clueless and friendless, respectively



Money makes the
World go round,
makes the Money go
round, makes the
World go round...



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Poor old Mario Draghi! He really must feel that, no matter what, he just don't get no respect!

How else do we explain his tetchy – even truculent – performance at the ECB forum this week?

So bombastic was he that, in his opening address, he even stooped to a men's bathroom taunt about just HOW much more successful his increasingly controversial 'Asset Purchase Programme' was than the various stages of the Fed's QE equivalent.

Nor did modesty prevent the inclusion of a none-too subtle reference to his infamous 'whatever it takes' *coup de main* - if it did also omit any hint that this particular coach-and-horses set was driven through both the ECB's mandate *and* its practices of governance all of five years ago, now.

It was also just a touch ironic that, on the day Two-Bubbles Carney tried to mitigate some of the malign consequences of his ludicrously lax monetary policy in the UK by forcing the banks to make greater provisions against consumer debt exposures, Mario the Magnificent was trumpeting *his* success in getting his people to live similarly beyond their means.

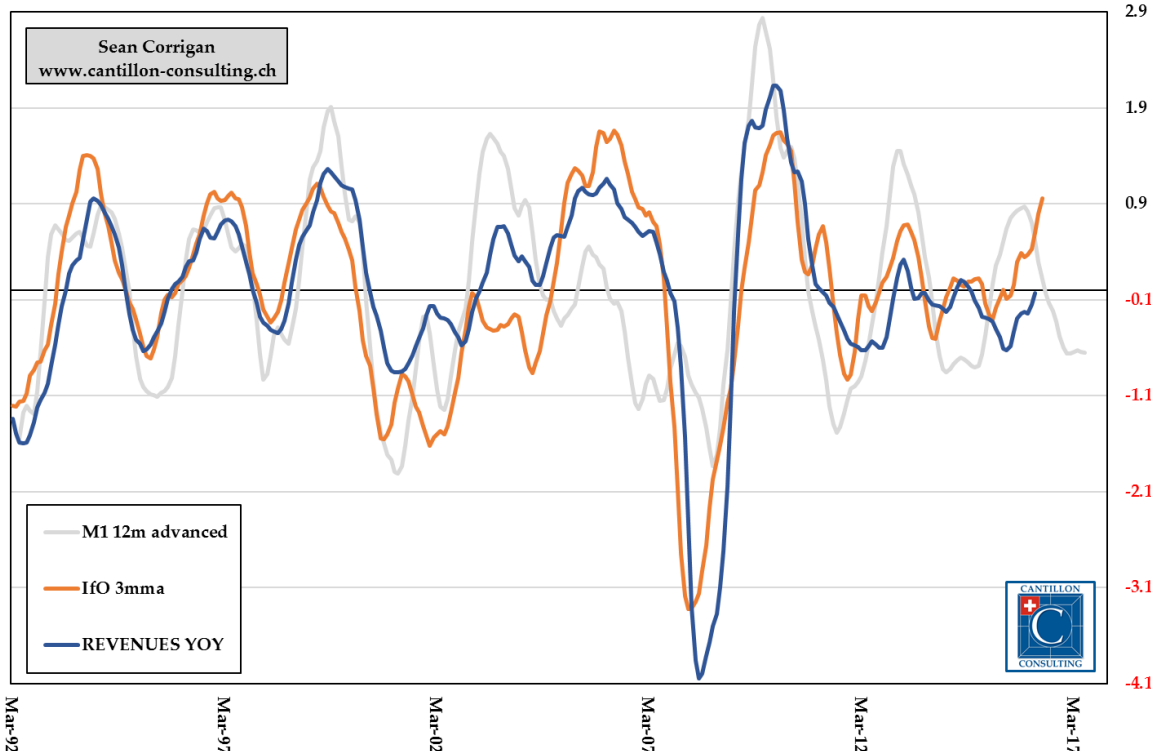
'According to our Bank Lending Survey,' he gloated, 'our latest easing phase has coincided with a strong rebound in demand for consumer credit to purchase durable goods' Very reassuring!

Apparently, too, Europe's recent – and highly belated – climb out of its slough of despond is all down to him. No entrepreneur would have expanded his payroll; no eager job-seeker would have refocused or retrained; no-one would have taken the hard decision to uproot themselves and move to a different country (read: Germany) to find work if it hadn't have been for the APP, was the clear implication of his address.

Grazie mille, Mario!

A man who occasionally indulges in the career bureaucrat's empty, ritual chiding of his ostensible political masters for their reluctance to undertake meaningful, but electorally risky 'structural reform' even had the gall to delight in the fact that, compared with the dark days of 2014, 'fiscal policy has become more supportive' – i.e., that

'Hard' v 'Soft' German version: IfO v Business revenues & M1, normalized: Source - IfO, Buba



As ever, more abundant money has—with a lag—caused cash registers to tinkle more frequently and that, in turn, has left IfO respondents feeling more positive about conditions. Watch that current tick down in M1 though; it might spoil the party.



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not only individuals, but also governments, are increasingly outspending their resources, thanks to the ECB's open-handedness.

Then there was that comic moment when, ignoring the upheavals involved in Brexit, despite the wilful helplessness of the authorities in confronting either a partly self-inflicted migrant crisis or the ongoing threat of atrocity; regardless of the new schism opening up between 'Old' and 'New' Europe to add to those between North and South; overlooking the continued torment of Greece, the banking disasters in Italy, or the dangerous sabre-rattling on Russia's western approaches, Mario reached for a full, Spinal Tap-style measure of rhetorical overkill to declare that:-

'Today, things have changed. Political winds are becoming tailwinds.

There is newfound confidence in the reform process, and newfound support for European cohesion, which could help unleash pent-up demand and investment.'

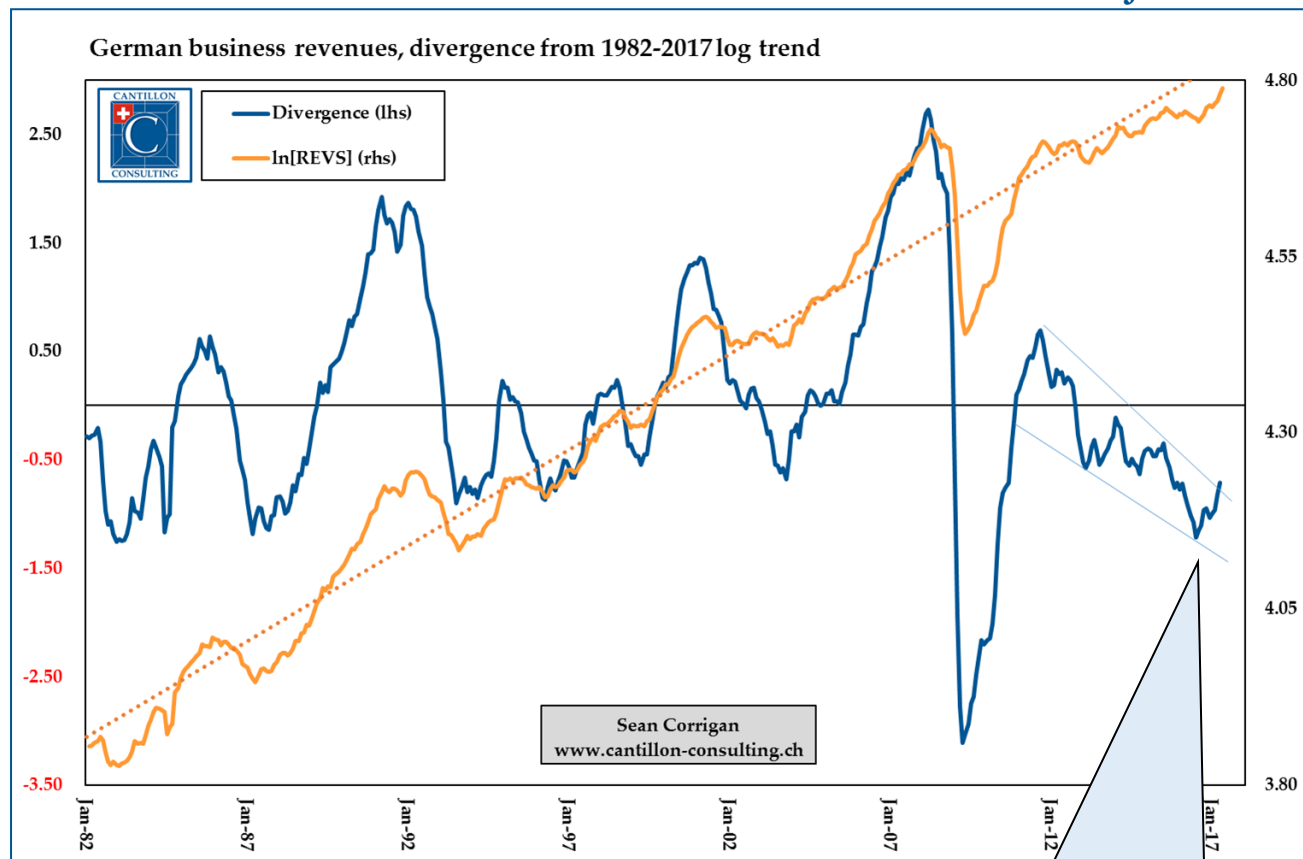
It clearly looks like Emmanuel Macron came back down from Mount Sinai the other week with Mario's beloved Phillips Curve boldly chiselled on his tablets

Indeed, the only downbeat note – as crazy as it seems to anyone not handicapped by an MIT macroeconomic mindwarp – was that inflation was not roaring along a little more vigorously.

In that Orwellian doublethink which so many of our monetary masters have been trained to adopt, as well as *'War is Peace. Freedom Is Slavery. Ignorance is Strength'*, it now appears that *'Scarcity is Prosperity'*.

How else are we to interpret this particular passage (emphases added):

'...one explanation for the slow improvement in inflation dynamics is that we are still suffering the after-effects of price shocks in global energy and commodity markets, which have led out-



Despite having made a new outright high, those revenues are actually well below trend. Will the last few months' acceleration last long enough to regain it? Given their current dominance in the move, sales to the EZ will decide the issue



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put and inflation to move in different directions...

Can this mean anything other than: *'if those dreadful engineering and entrepreneurial geniuses hadn't exploited America's much less debilitating legal approach to resource extraction and so helped raise every family's standard of living by pumping copious amounts of shale gas and oil, I'd be even more of a hero than I think I am now?'*

For all his posturing, the truth is a little less glorious.

If we look at the last two years during which Draghi's latest scheme has been in operation, we find that the European central banks (the ESCB) have jointly expanded loans and securities purchases by just over €2.9 trillion – putting them a cool 116% over their starting point.

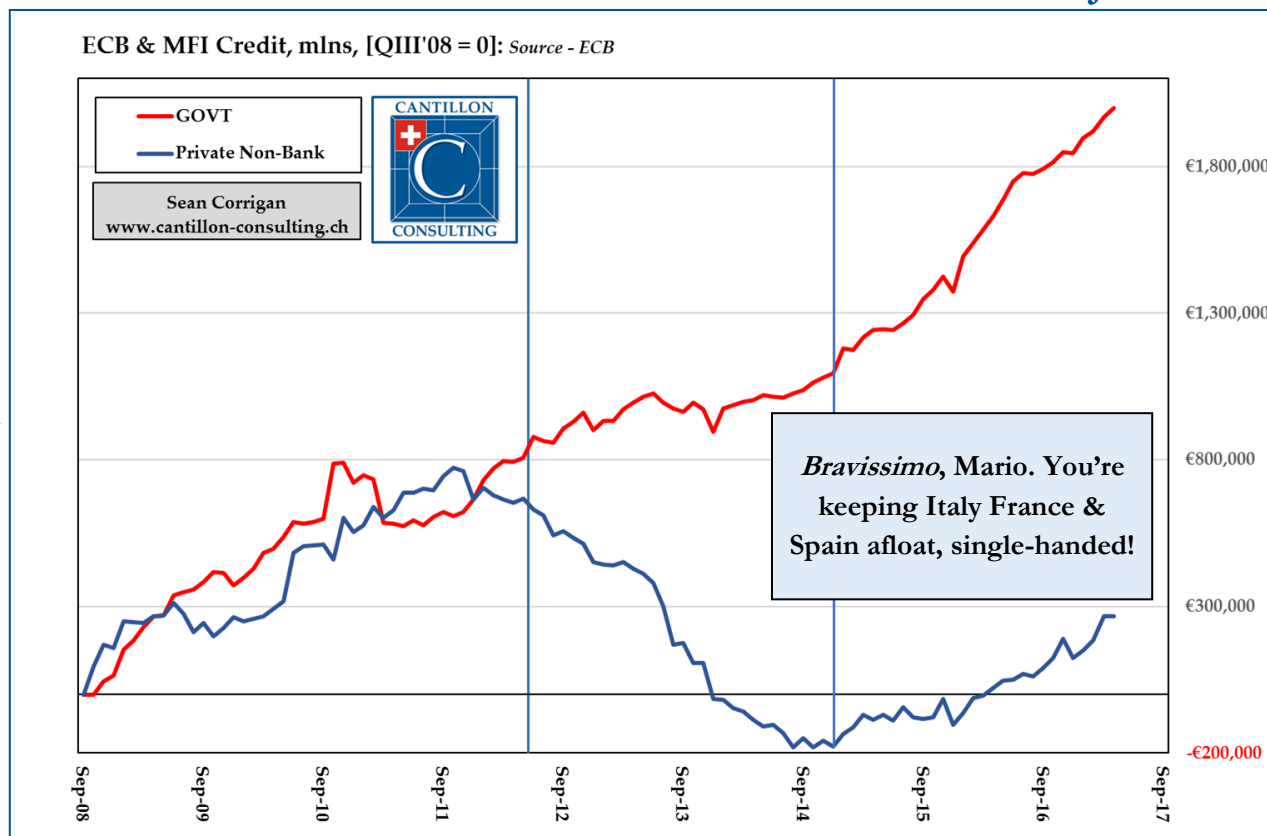
Of that sum, just under €1.2 trillion has gone to buying government debt (an effective €240 billion of it sourced from punters abroad and a like amount from EZ banks, each seemingly only too happy to offload their exposure into Mario's resting bid). Another €1.6 trillion in round numbers went to the banks and a residual afterthought of €205 billion to the private, non-bank sector.

Armed with this impressive influx of cash, Eurozone banks were happy to pass the benefits on to the productive sectors of the economy, yes? Well, barely, since they in fact granted only €240 billion of new credit – and so replaced the government debt they had formerly held, one might loosely argue.

The upshot of all this manoeuvring? €940 billion in support payments to the state versus €450 billion to the private non-bank sector. Not exactly the mix for which one might have hoped and that >2:1 split looks even worse in percentage terms where the state proportion increased by more than a quarter overall (at a 10% p.a. pace) and private credit inched up a measly 3.8% - registering a glacial annualized gain of just 1.5%.

Was this modest increment really supposed to have effected the dramatic renaissance that Draghi claims?

Indeed, looking back further, to June 2016's 'whatever it takes' moment, the €970 billion monetized between then and the end of 2016 was just more than the total, Zone-wide increase in government debt recorded for the period (five-sixths of that due to France, Italy and Spain, alone). At the same time that Leviathan was be-





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ing so handsomely feasted, the private sector famine saw its borrowers shed €1/2 trillion in credit. outstanding

Take it back another jump to the start of the implosion itself, all the way to September 2008, and the private sector change just about crawls back into the plus column, but the state now swallows up over €1.8 trillion of largesse, almost funding all of our 'Three Amigos' €2.1 trillion joint cumulative deficit in the interim – none of it in breach of the ECB's sacred 'mandate', of course.

As we frequently remark to those raging about how central banks have enriched the super-rich Few at the expense of the citizenry at large, much more attention should be paid to the fact that the hard-working, tax-paying, self-reliant Many have been even more shamefully ripped-off in order to feather-bed the anti-productive bureaucratic hordes, their corporate cronies, and the outright feckless who populate the welfare rolls alongside the genuinely needy.

Draghi and his peers may preen that they have finally promoted employment through effectively abolishing interest on capital, but they have done much more to *hinder* both the redeployment and the profitable expansion of the workforce, not just by keeping zombie firms in business but by sparing the public sector the need to effect the economies and make the adjustments to today's radically altered circumstances which the private sector has had to undertake and, moreover, to undertake while carrying so much central bank-financed deadweight upon its back.

Markets reacted aversely to Draghi's comments that deflation (!) had given away to reflation and also to his confused mumbling about being able to '*look through*' all manner of airy-fairy influences on '*core inflation*' which, he asserted, were disguising the '*underlying inflation dynamics*' (sic). Bunds put on around 10bps in yield and the euro added a point-and-a-half to hit a 10-month high.

'*Draghi gets hawkish*,' screamed the scribblers in response, not picking up the nuance that his closing calls for '*prudence*', and '*persistence*' were clearly meant to imply: '*Beruhigen Sie sich, Jens. The last Italian bank has not yet been made safe!*'



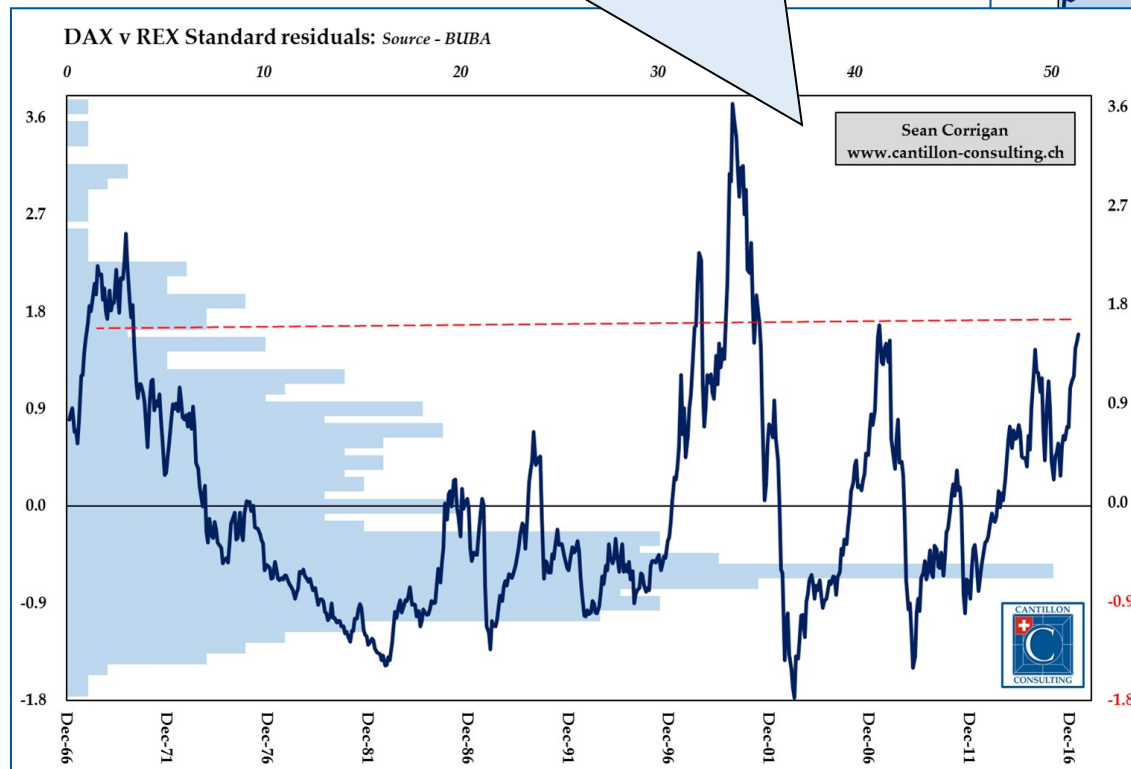


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Here we use those same revenues to give some context to the DAX (shown here the price, not the usual performance, index). Unlike the S&P, this has not yet approached the Techmania peak. If not exactly worrisome, it can hardly be described as 'cheap', however

If we next compare DAX returns to those to be had from German bonds (the REX index), equities' growing richness becomes more apparent. If not yet beyond all precedent, only a modest rise in record-duration bond yields would soon push us towards past extremes.

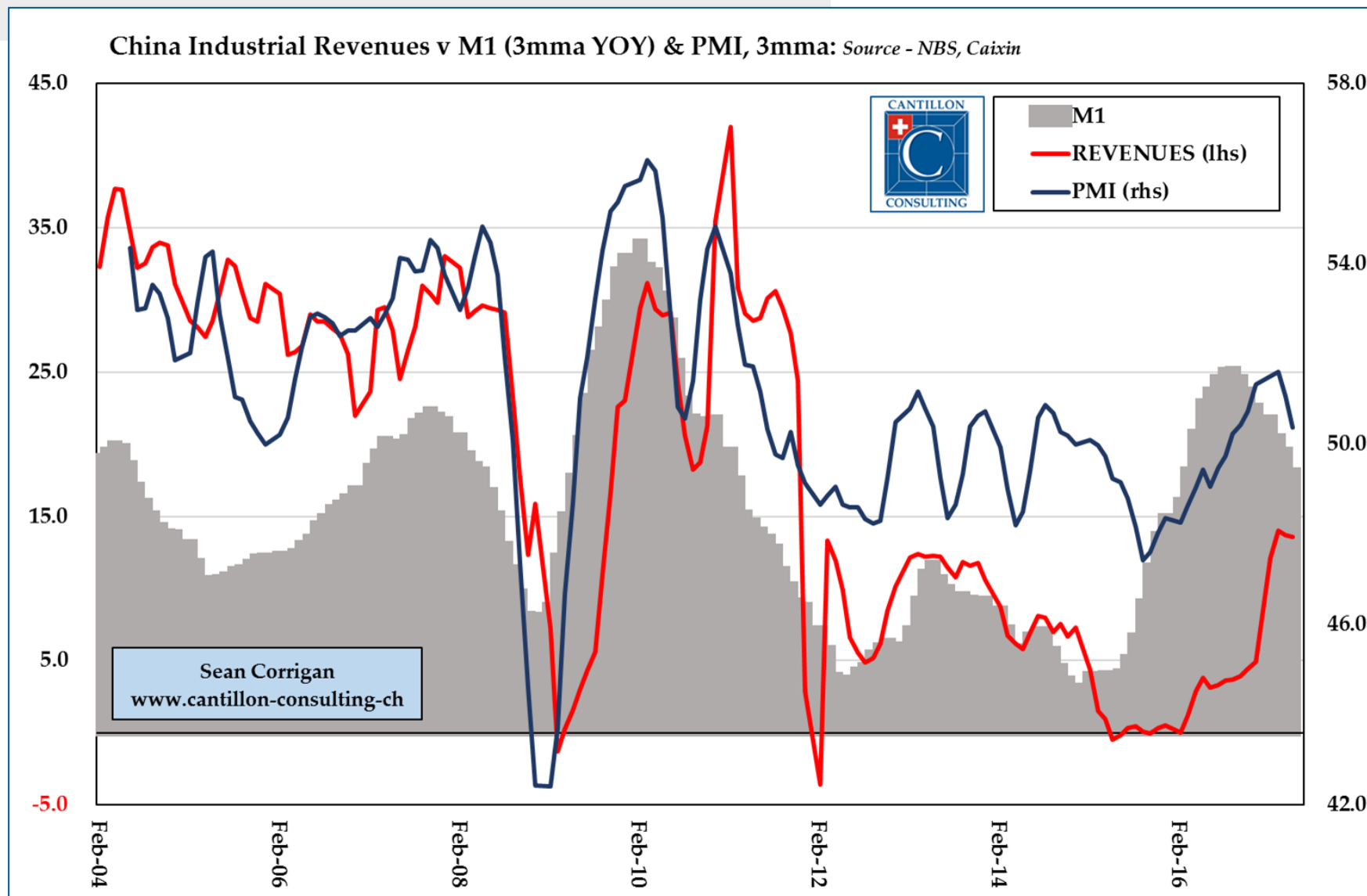


With a deceleration in money creation and amid the bearishly flattening curve to which it is contributing, one would expect revenue growth in China soon to slow. Given that the speculative air has at least temporarily been let out of both housing and commodities, there would also appear to be less scope for the misuse of balance sheets and credit lines to boost the bottom line in other, less –er– *operational* ways. Though the ‘National Team’—China’s equivalent of the US ‘PPT’ or Japan’s ‘PKOs’—will be protecting the downside into October’s key 19th National Congress, any such deterioration would soon expose the artificiality of current equity valuations.



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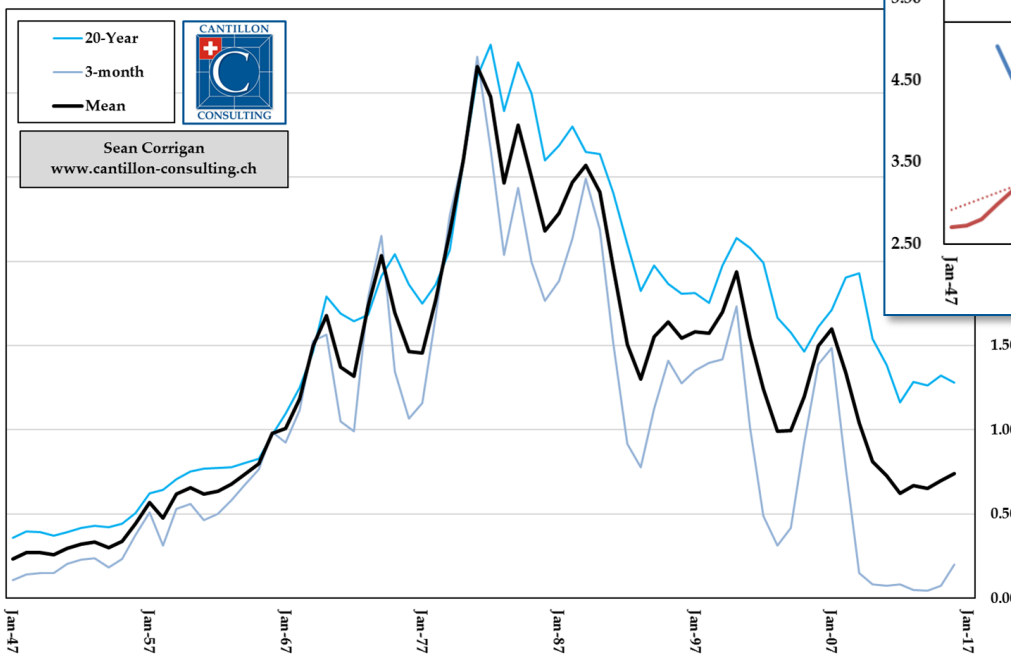
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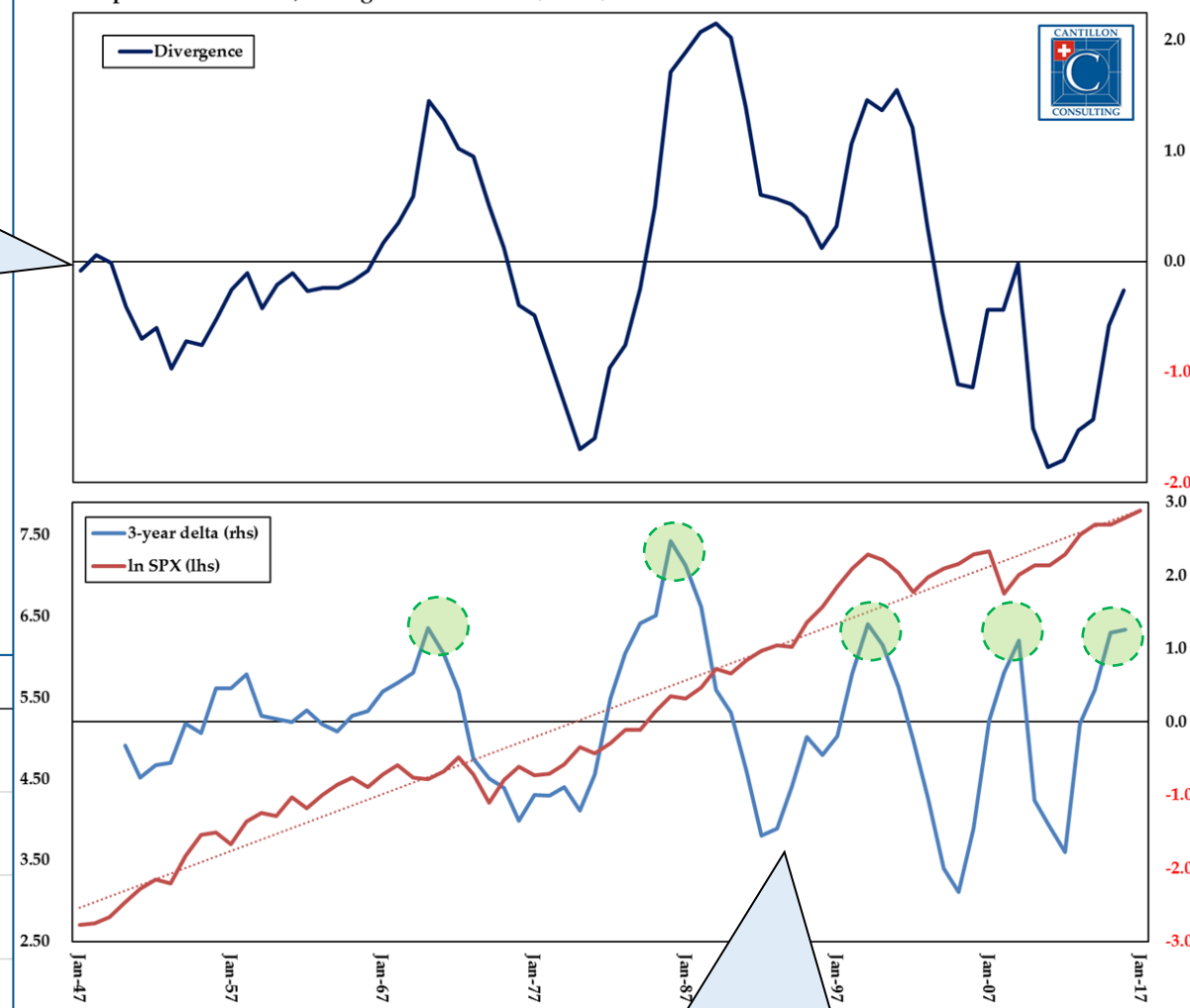
US Non-financial corporate debt levels as a percentage of overall economic activity are not yet too elevated when compared to their long-term rising *trend* even if the ratios themselves *are* near their peak

One comforting factor is that the cost of debt service is proportionately low, thanks to central bank intrusion in the market.
NB Implementation of Republican ideas about removing interest rate deductibility would have a big, adverse impact here.

Business Debt/GNE x Market interest rate, %: Source- FRB, Census, BEA, Moody's



Corporate Debt/GNE, divergences: Source - FRB, Census, BEA



Furthermore, the last few years' *growth* in that debt ratio is of a kind with those seen at the market tops in the late-60s, 1987, 2001 & 2008 (circled in green)



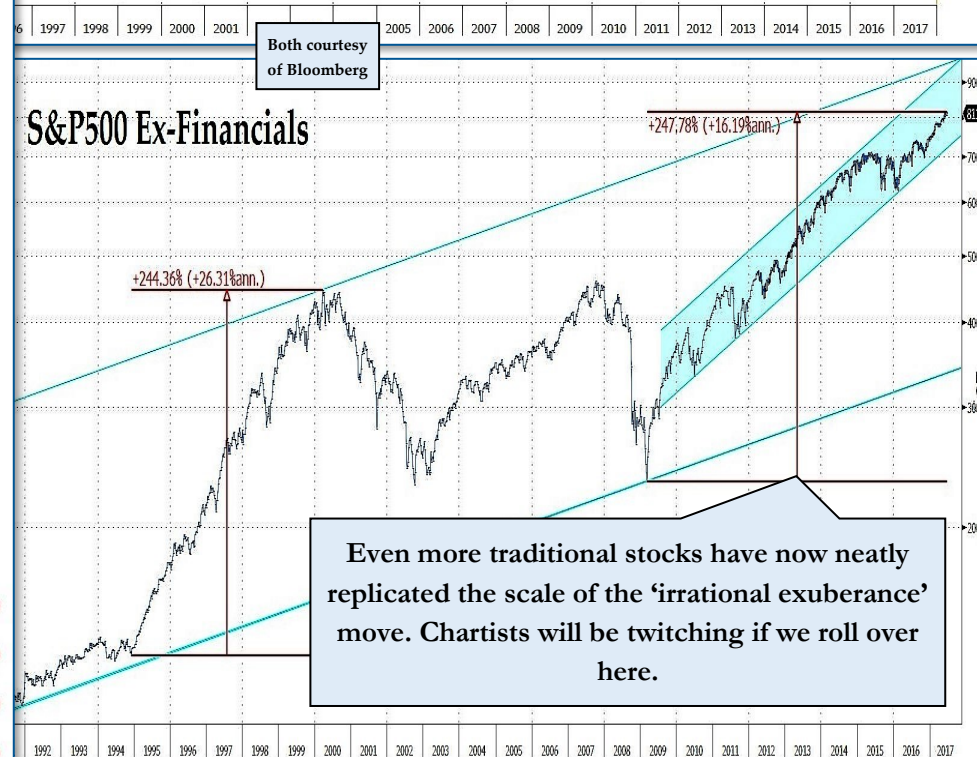
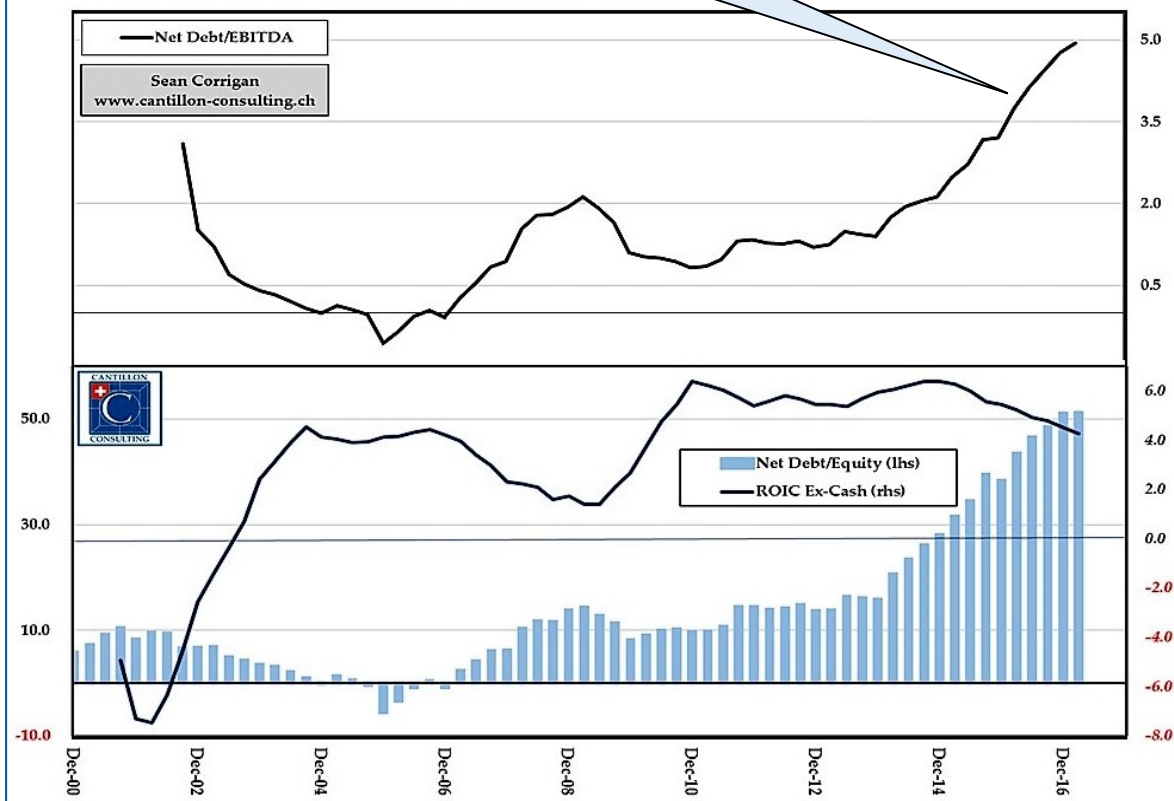
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One dirty secret is that, for *manufacturers* of Tech (as measured by Census in its definitive QFR report) returns on capital are falling and debt levels are rising dramatically. Good job most of the Nasdaq bellwethers don't actually *make* anything, eh?



Computer & Electronics, Returns & Ratios: Source - Census QFR





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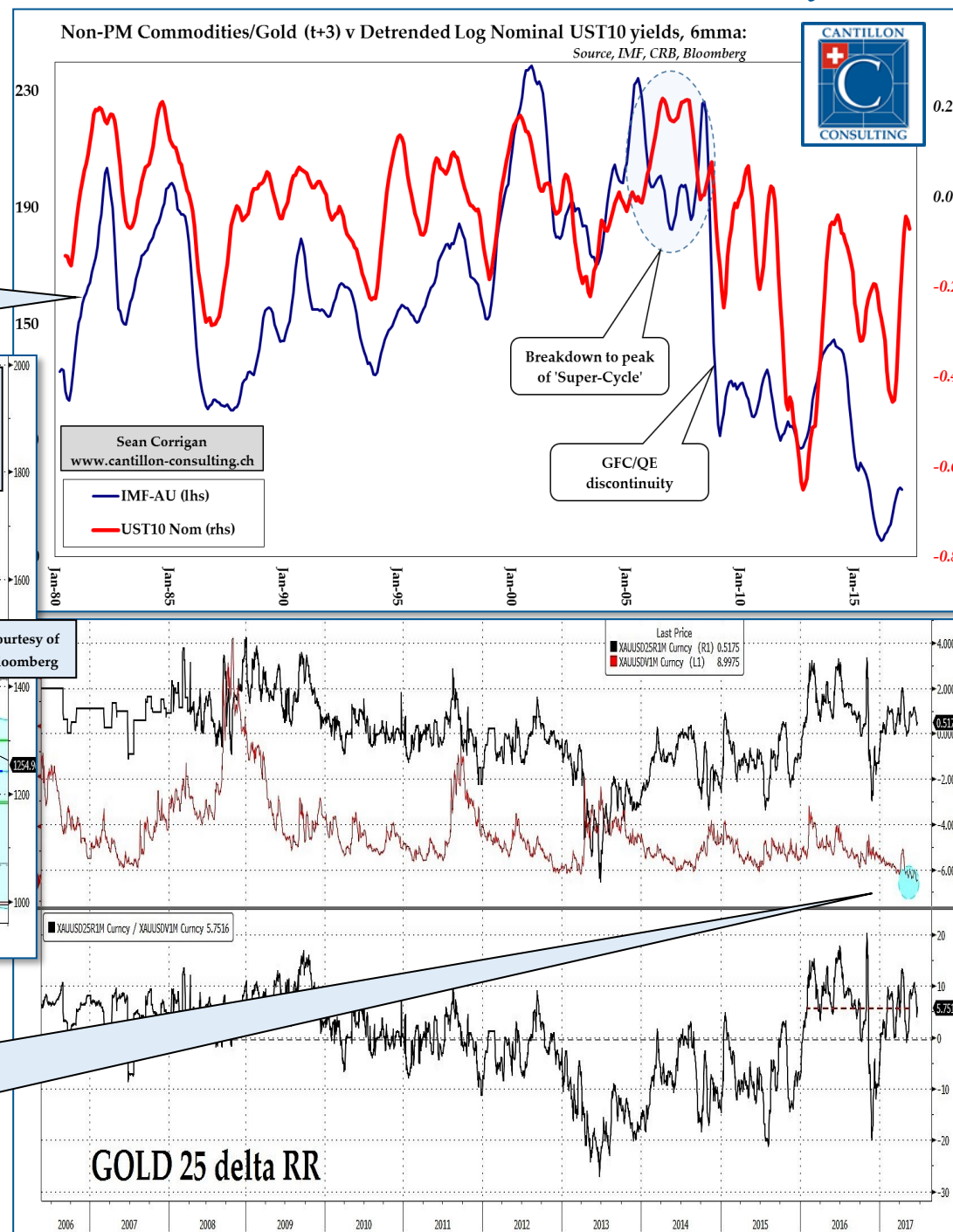
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In its role as a 'crisis asset', gold outperforms other commodities in step with 'flight-to-quality' surges into USTs in the bond market. But here, absent such a phase, the degree of relative over-valuation is striking



Courtesy of Bloomberg

With option volatility plumbing the depths as a result, it is inexpensive to position for an end to this stalemate. Overall this scaled put-call difference—or 'risk reversal', to use FX parlance—shows the market still commanded by (stale) bulls and hence perhaps more susceptible to a further decline than a rally.





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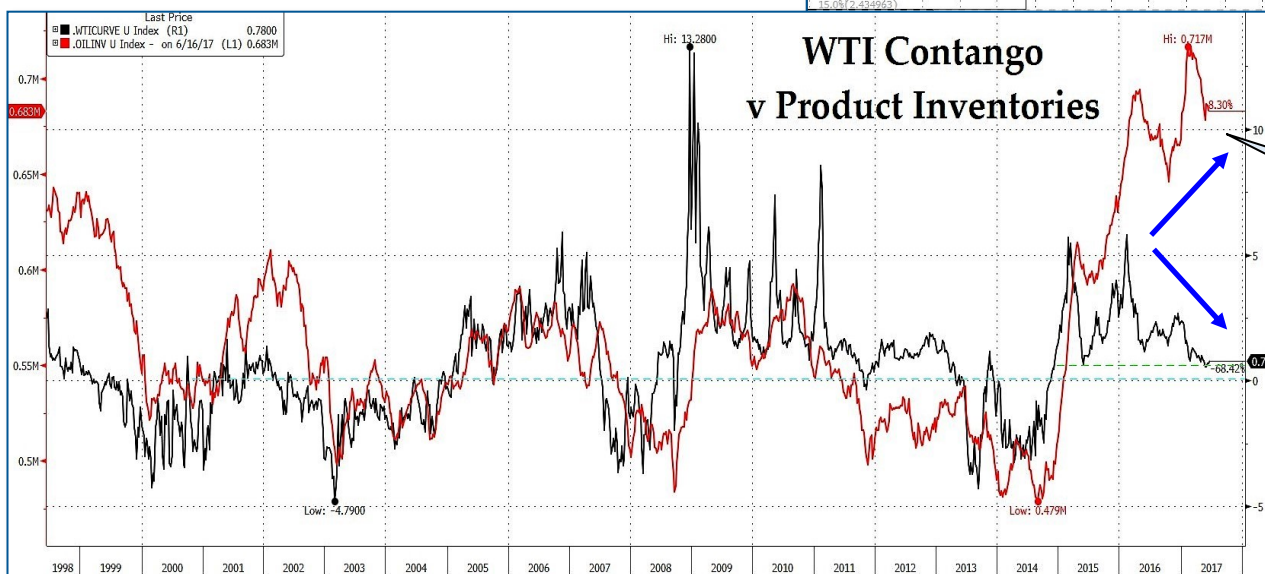
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The 'world' price of crude—proxied by Brent x the USD broad TWI—has fallen back to the high-volume price in the middle of the post-Shale Bust range. A short-term correction may be due, but might only offer better selling levels.

Natgas, meanwhile, unusual in not being partially protected by a sizeable short base, seems to be building a rather nasty head-and-shoulders formation. Could we really see new lows ahead?



All courtesy of Bloomberg



No matter how you squint at this chart, the flat curve (low contango) does not seem to make sense in view of the elevated visible inventories to hand. This discrepancy can only add to vulnerabilities at the front end as OPEC disillusion sets in



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