Money, Macro & Markets Monitor

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29th May 2017

Increased Physical Demand
Raw Materials
Petrodollar Pump; 'Core' CPI targets
Trade & Industry
MONEY & CREDIT
Austrian Business Cycle Theory
Financial 'innovation CB/Fiscal Policy

'Alternative Assets' Financialization
Raw Materials
'Chicken Farmer' Investment Demand
Money & Credit
TRADE & INDUSTRY
'Real Bills' Credit Elasticity
New Tech; 'Frontier Markets'

Financial Assets, RE, Art
Possible Spill-over
Raw Materials
Claims to existing capital preferred to construction of new
MONEY & CREDIT
Trade & Industry
Asset - Collateral Spiral

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

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Spinning plates & grinding gears

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Price action mirrors the early '80s lows

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Volume I, Issue 2

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Amid the swirl of rumour that surrounds any of China's policy moves, the week ended with an officially-denied suggestion that the PBoC was forcing banks to surrender to it those dollar deposits which it had allowed them to accumulate (the reserves it had 'decentralized', one might say) over the past couple of years.

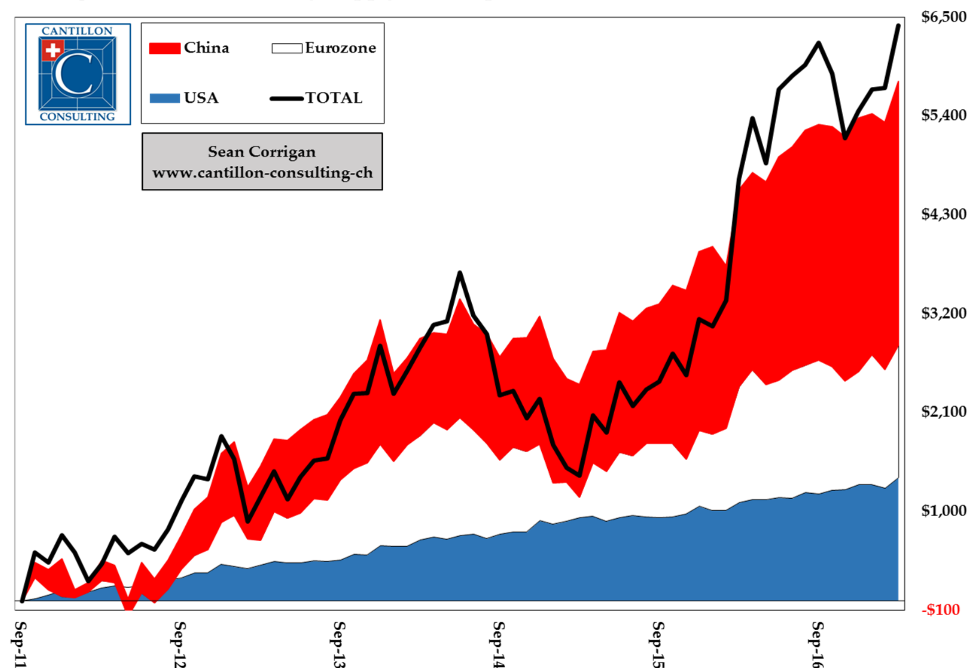
Coming hard on the heels of a slightly arcane declaration that the PBoC would henceforth exert a certain 'counter-cyclical' influence at the daily fix (i.e., lean against moves on the part of the ostensibly freer market which it had once deemed inadvisable), this could only serve to heighten suspicion that all is not really well in the Middle Kingdom.

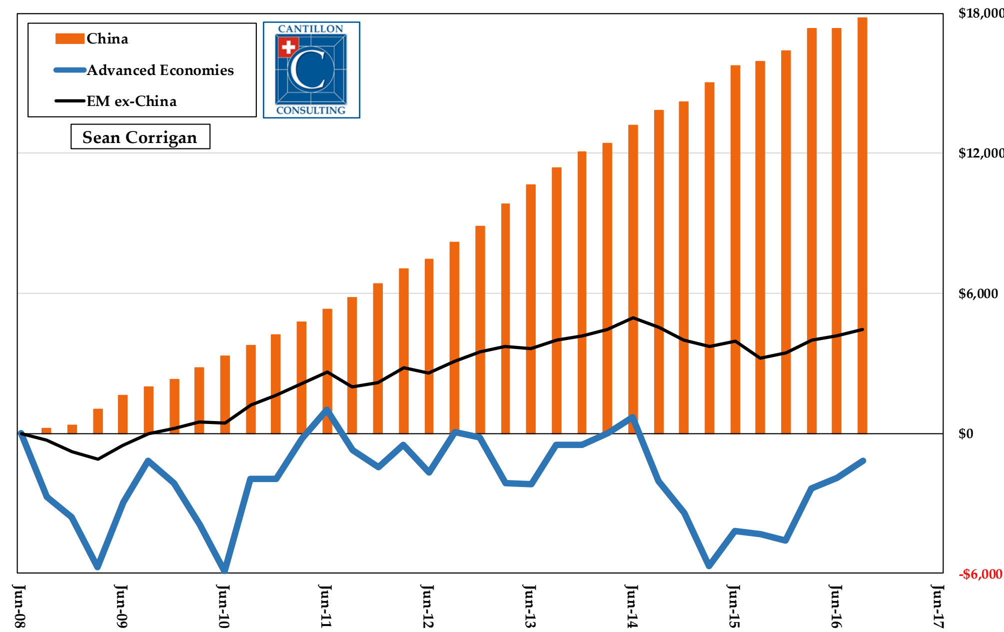
Amid bond suspensions, brokerage fines, and insurance embargoes, the other telling news was that the regulator had arm-twisted lenders to the rust belt, Heilongjiang province into extending—and even increasing—loans to the many local zombie firms there and 'marketisation' and 'deleveraging' go hang!

The charts to the right provide a sobering reminder of just how hard Beijing must work to keep all such plates spinning in the air.

The upper one shows that, among the 25 advanced and 8 emerging economies whose numbers we aggregate, since the GFC, China has been responsible for just under half the world's additional supply of money (reckoned in USD) and the lower shows that (up to QIII last year) it had similarly contributed $17.8 trillion out of a total reported $21.0 trillion of worldwide new credit extended to private non-financial entities.

In achieving the latter, the BIS tells us that its debt stock climbed 355%, versus 55% for other EMs, and in stark contrast to a partly exchange rate-driven decline of just under 2% in the advanced nations. As a consequence, such obligations have more or less doubled as a proportion of GDP with little diminution in the pace of additions evident even during periods when the PBOC is supposedly being 'prudent'.





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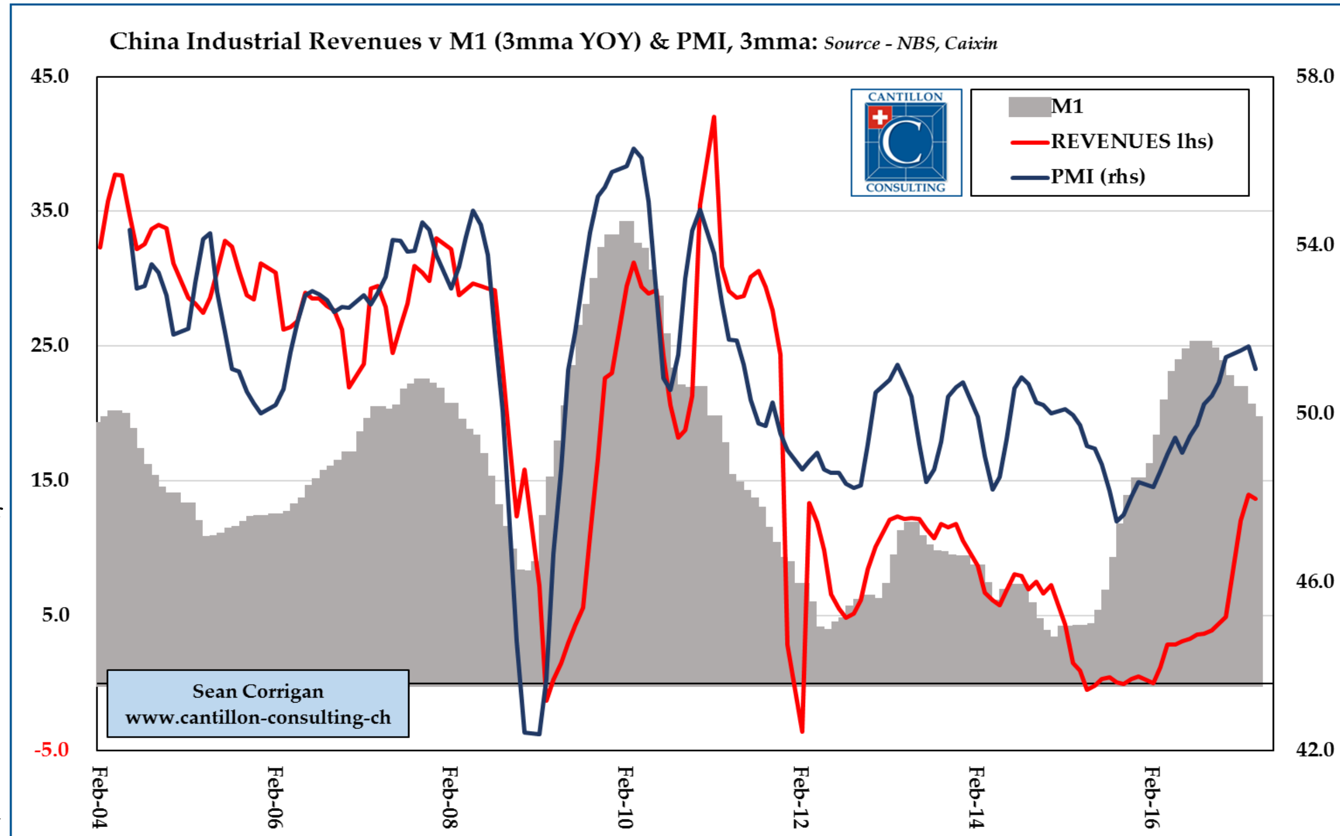
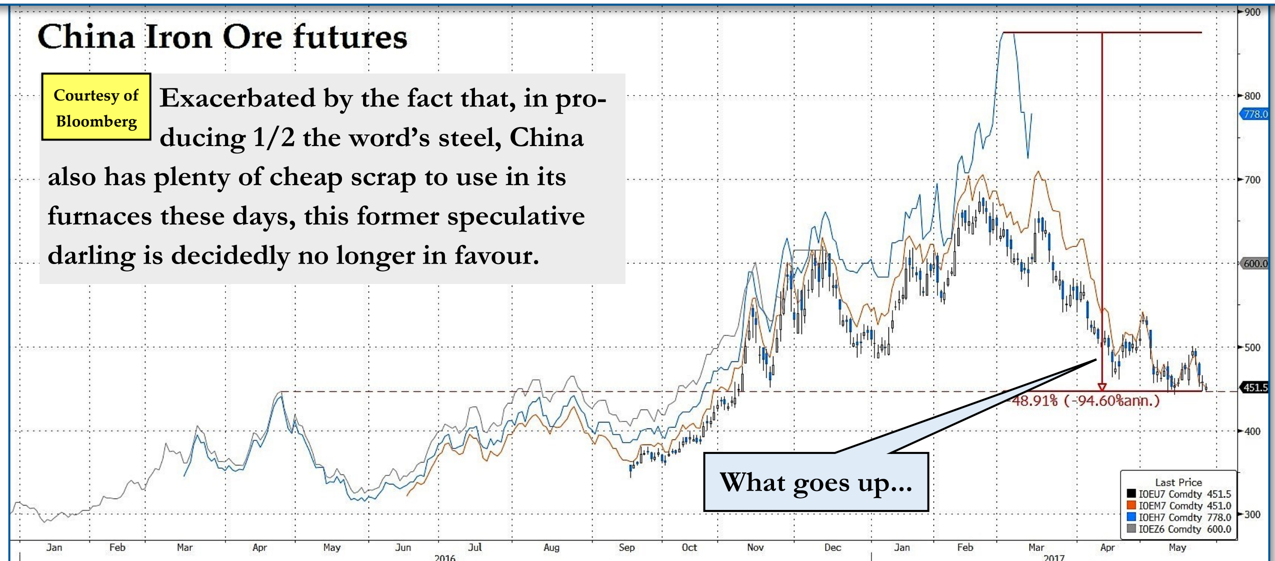


Any Austrian worthy of the name would have their antennae twitching at such an evolution since it is highly likely to conduce to a significant degree of capital wastage, in the form of what we call 'malinvestment'.

There are those who draw some comfort from the fact that the higher market rates recently in evidence are a sign that a healthy degree of discipline is now being imposed but, even if that were true, it overlooks the fact that, for far too long, all too little restraint has been effected and that therefore the best they can hope for is that no *new* misallocation is taking place to go along with the old.

We are not quite so sanguine, however, and consider this—together with the partial inversion of the yield curve—more likely to be the first symptom of the onset of that peak-Boom distress which Hayek called '*investment which raises the demand for capital*' - i.e., the point where the overstretched will pay almost anything for short term funds in order to plug the holes in their badly misscheduled tally of income and outgo.

As the graph on this page shows, the current deceleration in money growth has not yet been enough to reverse the inflationary expansion of revenues and hence to depress the PMI readings too badly, but we would still worry that a market reliant on so much borrowed money must therefore also be on borrowed time. Certainly, company 'profits' cannot currently be prettified by gains made in commodities, housing, or the stock market itself, meaning any underlying business weakness is almost bound to show up in a fairly unequivocal manner in the months ahead. Be careful!



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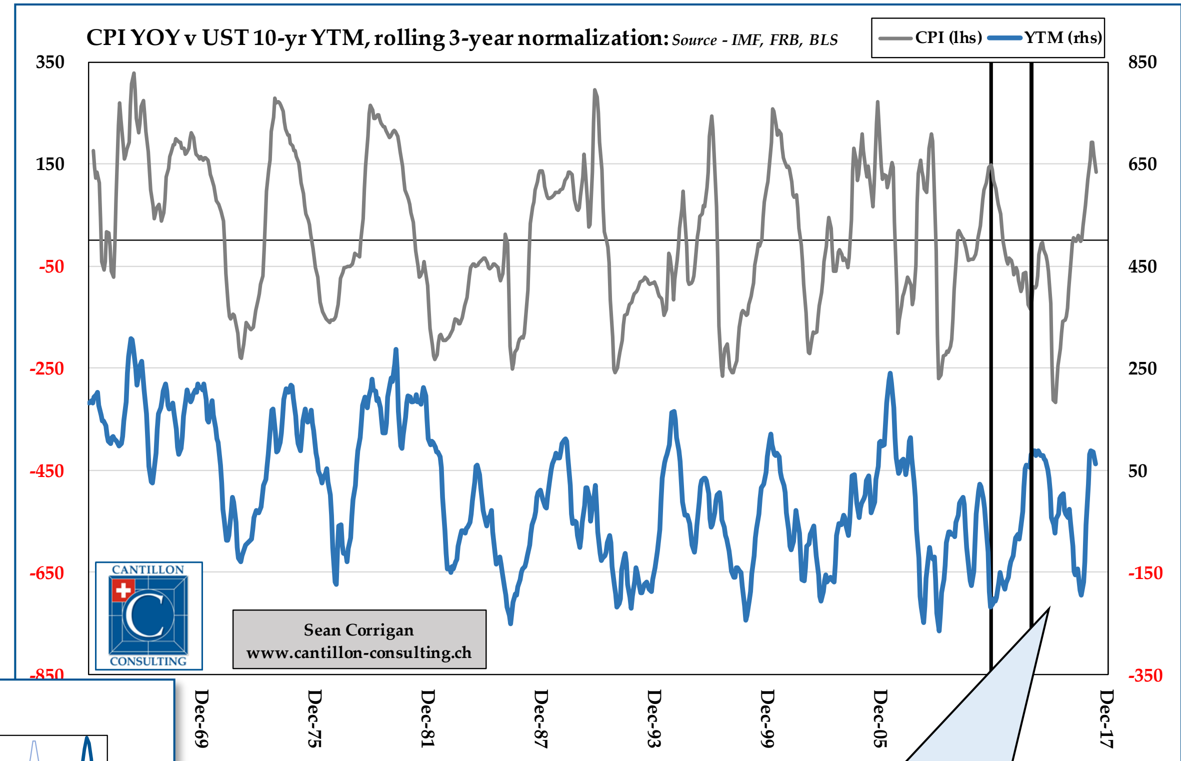
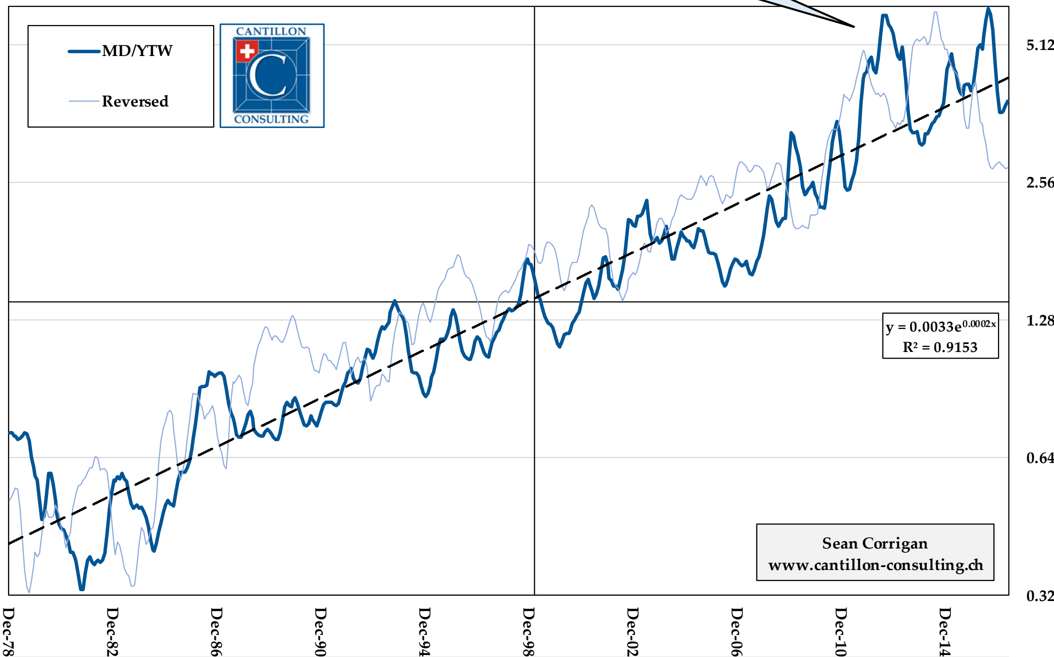


Note that the two tops, Sep'12 & Aug'16, are roughly analogous to the Aug'81 & July'84 lows. Symmetry is drawn out by the light plot which is the same series reversed in sense and direction

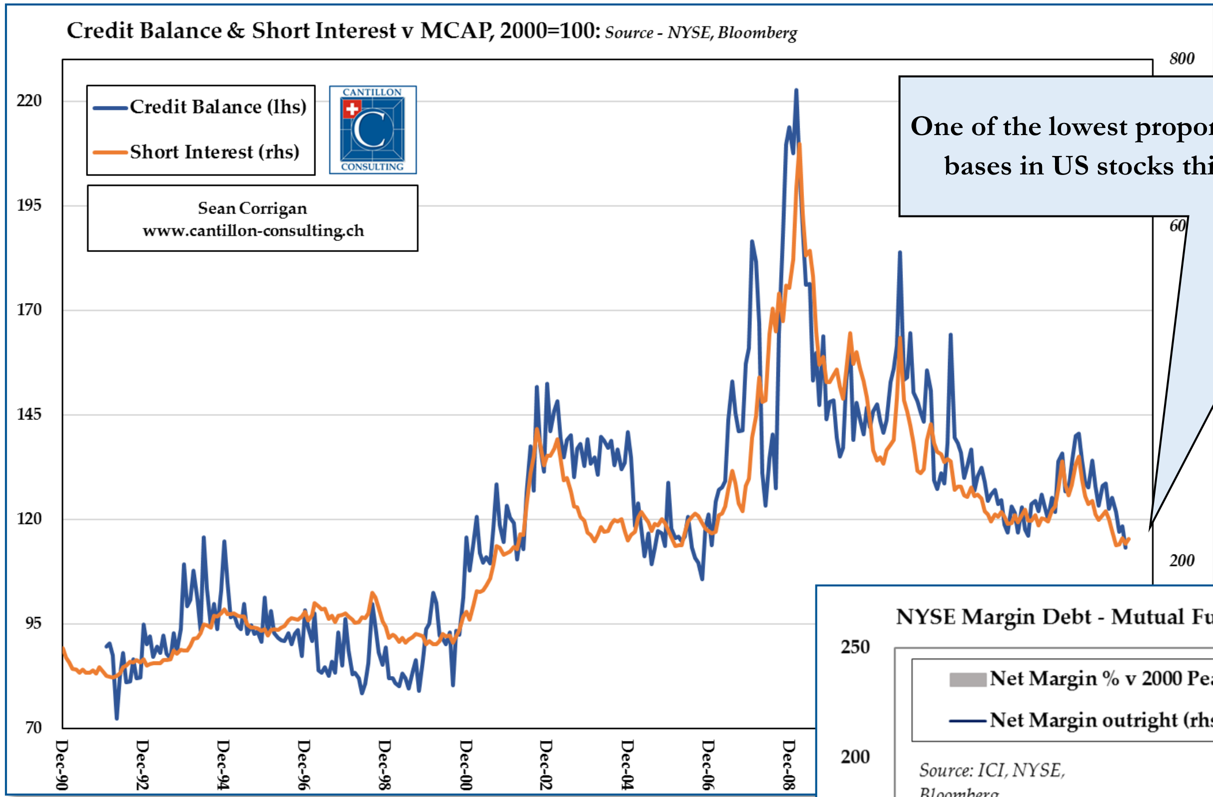


For all the fuss about what the reduction in yields at the long-end might portend, we can largely attribute it to the usual process of repricing as CPI gains settle down a touch

Though there remains the hint of the 'widow-maker' about instituting aggressive shorts in the bond market, the clock is ticking. Subtracting CPI leaves essentially no return, whereas the thick part of the last six decades' prominent mean/median for the pair's difference is around 2.5%.

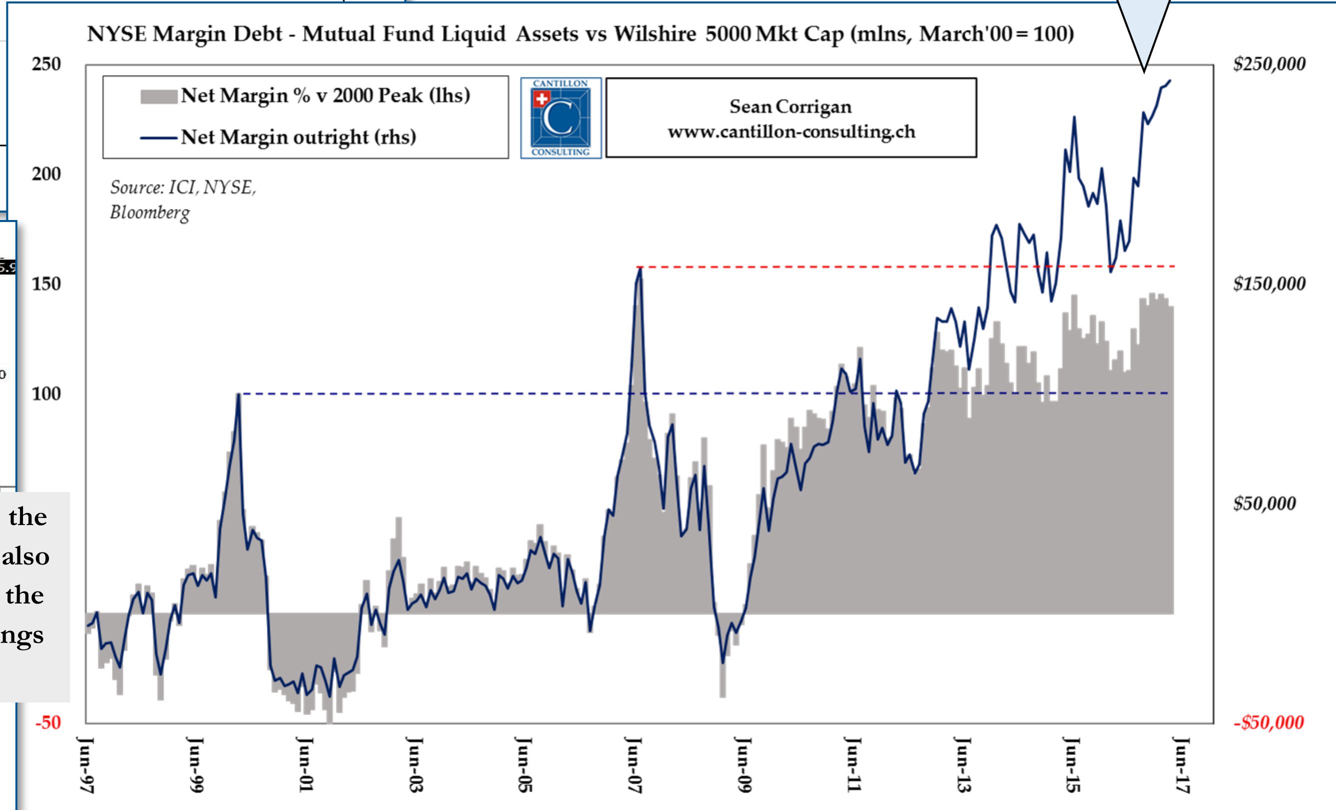
Remember that not only are yields low but, by extension, the concomitant long durations mean price risk is high and sensitivity to adverse data elevated.

Buyers need the best—or perhaps the *worst*—-of all possible worlds to win.



One of the lowest proportionate short-bases in US stocks this century...

...coupled with a bare 3% liquid asset ratio in mutual funds, this means less offset to margin debt, even though, as a % of MCap, it is otherwise unexceptional



Still no obvious catalyst for an end to the bull run while the fact of junk bonds also making new highs tends to reinforce the sense of calm. Such complacency brings its own dangers, of course.

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Not that there is an exact and inelastic bond between these two entities—viz., the global means of circulation and the dollar total of an important subset of what it is that is being circulated—but the recent divergence is nonetheless a notable one.

Should global money growth slow further (whether due to locally-exercised restraint or to a renewed strengthening of the USD numeraire), it would be hard to remain bullish on trade—and, more particularly, on *commodity*—prices

Global-70* M1+ v World Trade Prices, 3mma YOY%: *Source - IMF, BIS, WTO, CPB*

TRADE Px (lhs)
M1+ (rhs)

Sean Corrigan
www.cantillon-consulting.ch

Left axis: 20.0, 10.0, 0.0, -10.0, -20.0
Right axis: 25.0, 20.0, 15.0, 10.0, 5.0, 0.0, -5.0
Nov-87, Nov-90, Nov-93, Nov-96, Nov-99, Nov-02, Nov-05, Nov-08, Nov-11, Nov-14

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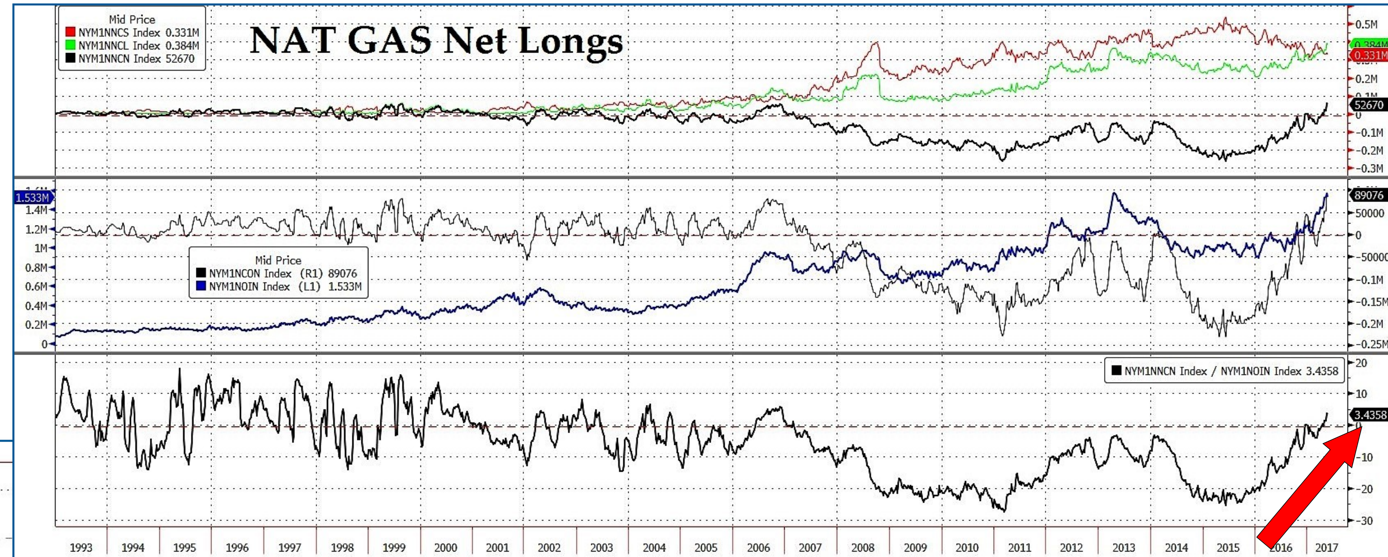
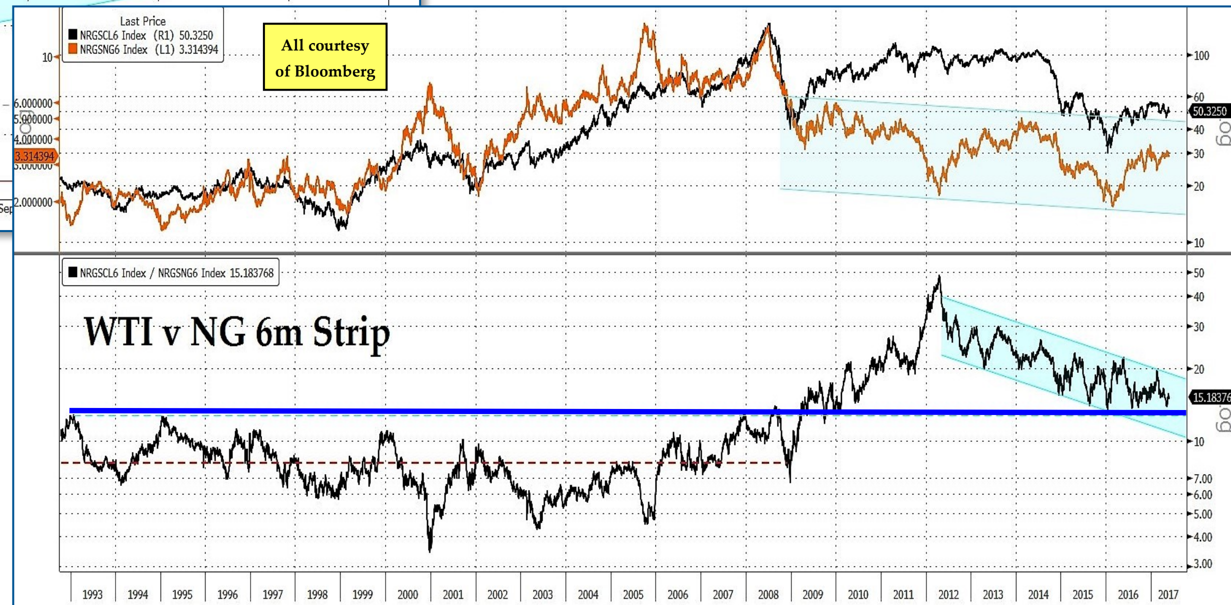


No longer the bridesmaid? Long-scorned in a glutted market, Nat gas is suddenly showing record O/I, record gross & net longs & the highest fractional reading in a decade.

Crude, meanwhile is still reeling from the shale renaissance. The return of less than a third of the bust's idled rigs has made good no less than 3/4 of its lost production. Bulls are capitulating and resistance is holding firm



Are we therefore about to see another leg down in the renormalization of relative pricing between the two?

Remember that, in terms of energy alone, the old mid-range of 7 to 8:1 makes perfect sense

BONUS CHART OF THE WEEK

Though still very much in the central volume bulge of a distribution which stretches for ~6 years either side of 2011-13's bull market top, a print above $1280 would constitute a clear trendline break for gold and, as such, would potentially see last summer's highs in the mid-1300s next being revisited.

Mean reversion is still very much the name of the game in the medium-term, however, so any such excitement may turn out to be relatively short-lived.

GOLD

Courtesy of Bloomberg

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