Monday May 16, 2011

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

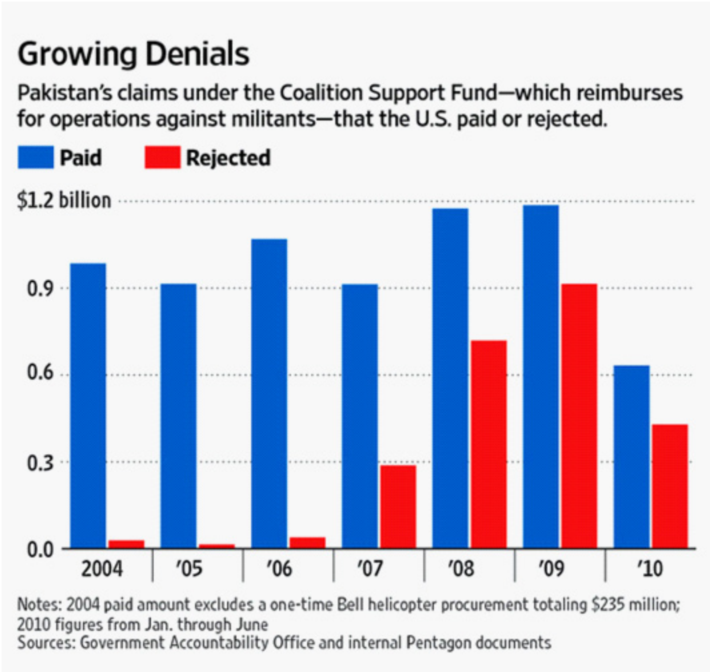
THAT WAS THE WEEK THAT WAS

Monday, May 16th

Stating this is a "critical moment" in relations between the U.S. and Pakistan, Senator John Kerry (D.-Mass.) arrives in Islamabad with a firm message for Pakistan: Cooperate more in uprooting terrorists based in Pakistan, or face losing vital American assistance.

MONDAY, MAY 16TH

Al Qaeda notwithstanding, what about the suspicion of an element of American aid filtering through to the Taliban. On many occasions, former President George Bush insisted that 'the U.S. was at war with Islamic extremists and not Islam itself.' This statement has never been widely accepted by Pakistanis attending the scores of madrassas (religious schools), as well as the continuous hordes of Taliban fighters.



- The White House and congressional Republicans are in a political gridlock situation over passage of trade agreements with South Korea, Columbia and Panama, amid a dispute over federal assistance to trade-displaced workers which reflects broader tension over government spending. Obama administration officials issued an ultimatum stating they wouldn't submit the trade deals for congressional approval until Republicans agreed to renew the expired Trade Adjusted Assistance program, for workers idled by foreign competition. The contagion of Washington political gridlock spreads like an untreatable cancer from the U.S. statutory debt limit to international trade issues.

- In a New York Times op-ed entitled Your So-Called Education, U.S. researchers Richard Arum and Josipa Roksa report: "We found that large numbers of the students were making their way through college with minimal exposure to rigorous course work, only a modest investment of effort and little or no meaningful improvement in skills like writing or reasoning. For instance, in a typical semester, 32% of the students did not take a single course with more than forty pages of reading per week and 50% did not take any course requiring more than twenty pages of writing over the semester. The average student spent only twelve to thirteen hours per week studying – about half the time a full-time college student in 1960 spent studying – according to labour economists Philip S. Babcock and Mindy S. Marks. Unsurprisingly, a large number of the students showed no significant progress on tests of critical thinking, or complex reasoning or writing, that were administered when they began college and then again at the end of their sophomore and senior years. If the Collegiate Learning Assessment – the test which we used – were scaled on a traditional 0 – 100 point range, 45% of the students would not have demonstrated gains of even one point over the first two years of college and 36% would not have shown such gains over four years of college … The situation reflects a larger cultural change in the relationships between students and colleges … students are increasingly considered, by themselves and their colleges, as "clients or consumers." When 18-year-olds are emboldened to see themselves in this manner, many look for ways to attain an education credential effortlessly and comfortably. Moreover, they are catered to accordingly and the customer is always right."

The retailer/consumer relationship conclusion as reasoned above by researchers Arum and Roksa, notwithstanding, at Longwave Analytics, we must ask: what is missing from this picture? The rate at which many U.S. states are slashing their education budgets; the fact that Latin is no longer taught in high schools and the many distractions available to students (from cell phones to Blackberrys): "While M.B.A. students' quantitative skills are prized by employers, their writing and presentation skills have been a perennial complaint. Employers and writing coaches say business school graduates tend to ramble, use pretentious vocabulary, or pen too casual e-mails," according to the Wall Street Journal.

TUESDAY, MAY 17TH

- Dominique Strauss-Kahn, Managing Director of the International Monetary Fund (IMF), was widely considered the French Socialist Party's best chance to wrest the presidency from Nicholas Sarkozy in 2012. Mr. Strauss-Kahn's arrest last weekend in Manhattan could greatly influence the outcome of France's next general election. Meanwhile, senior European officials are now calling for his resignation at the IMF. Maria Fekter, Austria's Finance Minister commented to reporters in Brussels: "Considering the situation that bail was denied, Mr. Strauss-Kahn must determine for himself that he is hurting the institution."

- At Berkshire Hathaway's recent annual meeting , Chairman Warren Buffet (the media-dubbed Oracle of Omaha) stated: "The United States is not going to have a debt crisis because we can print unlimited quantities of paper dollars." This is not the first time the Oracle has uttered this statement which the press has recently branded as 'silly.' In the past, we found this insight so ignorant that it was unworthy of commentary. Perhaps, advancing age is beginning to take some toll, because the Oracle's elevator no longer appears to be going all the way to the top floor.

- The Commerce Department reports U.S. housing starts declined by 10.6% to an annual rate of 523,000 in April, following an upwardly revised 585,000 in March, previously reported as 549,000; indicating little change in the moribund American housing market

- According to Bank of America/Merrill Lynch's latest monthly business sentiment survey, only 10% of fund managers expect stronger global economic growth next year, down from 27% in April and 58% in February; citing the European sovereign debt crisis as the biggest risk to growth

- The Federal Reserve reports U.S. industrial production was unchanged in April, following a gain of 0.7% in March; citing an 8.9% drop in automobile production with the disruption in supplies of auto parts, due to the Japanese earthquake and tsunami

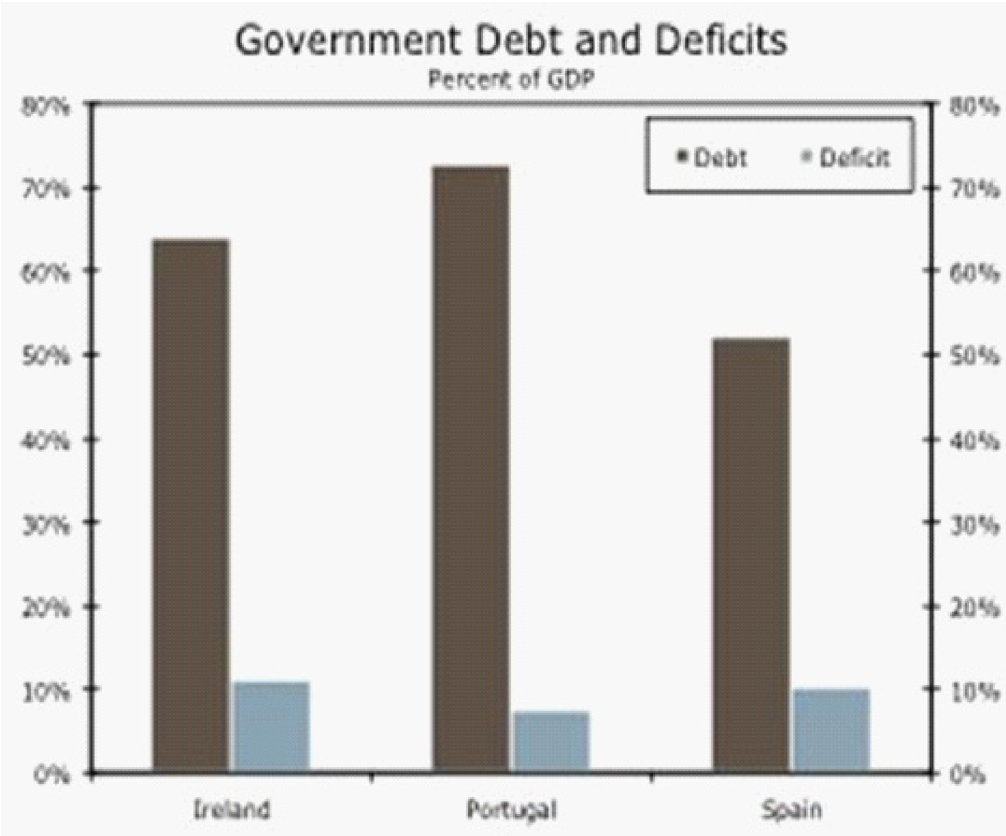
- The Office for National Statistics reports U.K. consumer prices rose at an annual rate of 4.5% in April, following a 4% increase in March. Core inflation (excluding energy, alcohol, food and tobacco) increased by 3.7% from an annual rate of 3.2% in March.

- The Canadian Real Estate Association (CREA) reports seasonally adjusted sales activity declined by 4.4% in April compared to March, citing new mortgage rules introduced by the federal government at the end of March eliminating 35-year amortizations as a financing option, probably took first-time home buyers out of the market

- Statistics Canada reports foreign investment increased to $6.3 billion (CAD) in March, citing investors added $3.2 billion (CAD) of Canadian bonds to their holdings

- The National Association of Home Builders reports its U.S. sentiment index remained unchanged at 16 in May. Any reading below 50 indicates negative sentiment about the housing market outlook and the index hasn't been above that level since April 2006.

- The ZEW German economic sentiment index declined to 3.1 points in May from a level of 7.6 points in April. ZEW President Wolfgang Franz commented: "The strong economic momentum seen in the first quarter in Germany is not going to last. Risks such as the (debt) crisis in the euro zone and global economic imbalances should be recognized."



Source: The Telegraph UK

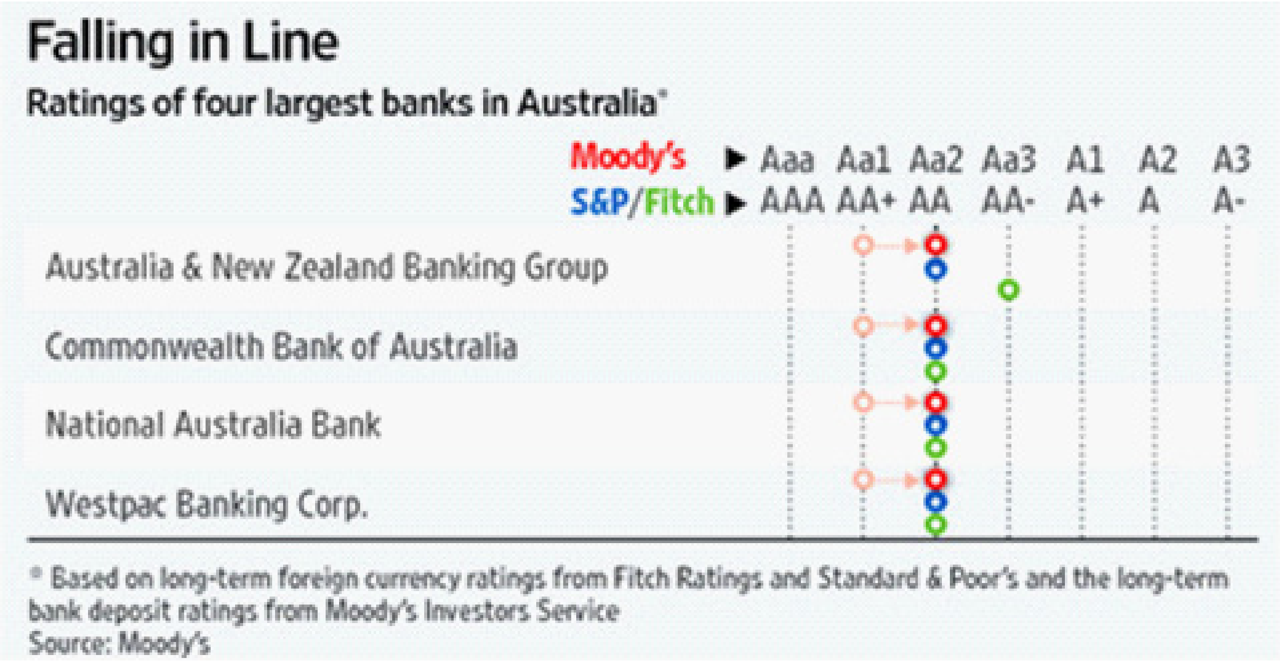
- At a Lisbon Council meeting in Brussels, European Finance ministers for the first time tabled the idea of talks with bondholders regarding the extension of Greece's debt repayment schedule, stating that last year's 110 billion euro ($156 billion U.S.) rescue has failed to restore Greece to financial health. Luxembourg President Jean Claude Juncker commented: "The European Union (EU) would consider 'reprofiling' Greek bond maturity dates, as part of a package including accelerated sales of state assets and deeper spending cuts. Those banks impacted by a total of over $70 billion (U.S.) of a Greek debt restructuring include: German $26.3 billion; French $19.8 billion; British $3.2 billion; Italian $2.6 billion; American $1.8 billion; Spanish $600 million; Japanese $500 million and other euro zone countries $15.7 billion.

WEDNESDAY, MAY 18TH

- The International Monetary Fund (IMF) issues a warning that Greece's program to bolster its financial position would fail unless it sharply accelerated reforms, such as asset sales and spending cuts. Poul Thomsen, an IMF envoy, commented: "The Greek program will not remain on track without a determined reinvigoration of structural reforms in the coming months. Unless we see this invigoration, I think the program will run off track."

- In its 2011 European fraud survey, consultants Ernst & Young report more than one third of employees at large European companies are prepared to offer cash or lavish gifts and entertainment to win business; with Greek and Russian staff most likely to offer bribes. France and Norway had the cleanest slates, although two thirds of the 2,365 people surveyed across 25 European nations cited bribery and corruption as widespread in their country and nearly half were unaware of any company anti-bribery policy.

- Moody's Investors Service downgrades the credit rating of Australia's largest banks – among the world's most credit worthy – from Aa1 to Aa2, as ratings agencies accelerate their reviews of the global banking system. Moody's stated its review focused on the Australian banking industry's dependence upon the global wholesale lending market, through which big banks lend to each other: namely, Australia and New Zealand Banking Group; Commonwealth Bank of Australia; National Australia Bank and Westpac Banking Corp. Citing the impact of the downgrade on the perceptions of banks, Roland Randall, a strategist with TD Securities in Singapore commented: "It's part of a global move (by the rating agencies) to recognize the increased risks of banking pressures and while it was anticipated and largely priced into the market … it could still place even more pressure on (bank) funding costs."



- The U.S. Securities and Exchange Commission (SEC) proposes sweeping new rules to overhaul the ratings business – regulations that would force more stringent internal controls, potentially curb conflicts of interest and even mandate that the agencies periodically, test the competence of their employees. At a public meeting, SEC Chairwoman Mary Shapiro announced: "These rules are intended to help investors and other users of credit ratings, better understand and assess the ratings. It is a massive proposal." The S.E.C.'s five commissioners unanimously support the plan, which spans over 500 pages and is now open for public commentary for 60 days.

- According to a new study by the Urban Land Institute, the United States is falling dramatically behind much of the world in rebuilding and expanding an overloaded and deteriorating transportation network, which it needs to remain competitive in the global marketplace. Burdened with soaring deficits and with long-term transportation plans stalled in the Congress, the United States has fallen behind three emerging economic competitors; namely, Brazil, China and India.

- The release of the Federal Open Market Committee (FOMC) minutes of its most recent meeting in Washington indicate that voting members agreed that the first step of an exit from quantitative easing would be ceasing the reinvestment of proceeds from the sale of mortgage-backed securities. The FOMC further stated: "There would need to be a significant change in the economic outlook, or the risks to that outlook, before another program of asset purchases would be warranted."

- In a Wall Street Journal op-ed entitled The Hidden State Financial Crisis, research analyst Meredith Whitney opines: "My latest research into opaque state financial statements suggests taxpayers will be surprised by how much pensions are underfunded. Next month will be pivotal for most states, since it marks the fiscal year end and is when balanced budgets are due. The states have accumulated in excess of $1.8 trillion (U.S.) in taxpayer-supported obligations, in large part by underfunding their pension and other post-employment benefits. Yet over the past three years, there still has been a cumulative excess of over $400 billion (U.S.) in state budget shortfalls. States have already been forced to raise taxes and cut programs (in attempts) to bridge those gaps. Next month will also mark the end of the American Recovery and Reinvestment Act's $480 billion (U.S.) in federal stimulus, which has subsidized states through the economic downturn. States have grown more dependent upon federal subsidies, relying on them for almost 30% of their budgets. The condition of state finances threatens the economic recovery. States employ over 19 million Americans, or 15% of the U.S. work force; plus state spending accounts for 12% of U.S. gross domestic product … Today, states' off balance sheet debt totals over $1.3 trillion (U.S.) … and it accounts for almost 75% of taxpayer-supported state debt obligations." See also, Winter Warning, December 1, 2008 – In One Hell of a State and Winter Warning, July 6, 2009 – The Pension Predicament and America's Albatross – Unfunded Government Pension Liabilities

- According to the New York Times, New York Attorney General Eric Schneiderman has requested information and documents from three major Wall Street financial institutions about their mortgage securities operations during the credit boom, indicating the existence of a new investigation into practices that contributed to billions of dollars in mortgage losses. Officials in Mr. Schneiderman's office have also requested meetings with representatives from the Bank of America, Goldman Sachs and Morgan Stanley; according to people briefed on the matter, but who were not authorized to speak publically. The inquiry appears to be quite broadly based, with the attorney general's request for information covering many aspects of the investment banks' mortgage pooling operations – i.e. the securitization of thousands of residential mortgages which were sold to investors at yields reflective of unwarranted credit ratings.

THURSDAY, MAY 19TH

- The Federal Reserve Bank of Philadelphia reports its regional manufacturing index declined to a reading of 3.9 in May from a level of 18.5 in April

- The National Association of Realtors reports U.S. existing home sales declined by 0.8% in April to a seasonally adjusted annual rate of 5.05 million units; following a downwardly revised 3.5% increase in March to 5.09 million units

- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 29,000 to 409,000 in the week ended May 14th. while continuing claims fell by 81,000 to 3.71 million in the week ended May 7th. The number of people who have exhausted their traditional benefits and are now receiving emergency or extended benefits under federal programs increased by 4,400 to 4.11 million in the week ended April 30th.

- The Conference Board reports U.S. leading economic indicators declined by 0.3% in April, citing fewer building permits, a shorter factory work week and reduced new orders for non-defense capital goods and consumer products

- Dominique Strauss-Kahn resigns his post of Managing Director of the International Monetary Fund (IMF) resolving: "I want to devote all my strength, all my time and all my energy into proving my innocence." Bonne Chance!

- Statistics Canada reports employers created 58,300 jobs in April, but mostly part-time in nature: "April's gains were fairly split between the public and private sector … with finance, insurance and real estate; as well as construction and support services expanding the most." The unemployment rate declined slightly to 7.6%.

- At a private dinner hosted by the United Jewish Appeal, Bank of Canada Governor Mark Carney stated that 'he doesn't see the U.S. addressing its fiscal deficit issues until after the 2012 election and is concerned that the bond market isn't sending America the signal that it needs to act now, due in part to huge Federal Reserve holdings of U.S. Treasurys' according to Avery Shenfeld, chief economist at CIBC World Markets. 'He said it will be a long time before there is a meaningful tightening in monetary policy in the U.S.'

  At Longwave Analytics, while we tend to agree with Mr. Carney about the futility of Congressional intentions in the short term, we are not particularly optimistic that the U.S. will be able to successfully address its fiscal deficit and national debt dilemmas post the 2012 election, for reasons oft stated in our previous publications:

  1. There exists no support among the U.S. electorate for higher taxes, despite the knowledge that the debt problem cannot be solved solely on the spending side. Today, Britain's VAT is 20% and Portugal's VAT is 23%. America needs to introduce a value added tax.

  2. Standard & Poors has already downgraded the U.S. credit rating outlook to negative, meaning America risks losing its 'AAA' sovereign debt rating within the next two years.

  3. The risk of rising U.S. Treasury yields and the loss of America's reserve currency status.

  4. Any significant cutbacks to entitlement programs such as Medicare, Medicaid and Social Security risk the probability of social unrest.

- The Los Angeles City Council approves a $6.9 billion (U.S.) budget that closes a $450 million (U.S.) budget gap, largely through cuts to fire and police departments. The budget also requires some city employees to contribute more to their retirement costs. Over the past two years, city leaders have cut municipal services, raised fees and eliminated 2,400 jobs through layoffs and early retirements.

- In a Financial Times interview, U.S. Senator Pat Toomey (R.-Penn.) attacks the U.S. Treasury Department warnings regarding the U.S. statutory debt limit: “The debt limit is the one opportunity this year, maybe this whole Congress, to insist on some real cuts in spending and some real reforms to this dysfunctional process that would allow us to get on a fiscally sustainable path.” One senior Obama administration official notes how logistically difficult it would be to introduce a prioritization scenario: “The slippery slope of deciding what to pay and what you wouldn’t pay is an impossible exercise.” Undeterred, Mr. Toomey declares: “Recent events have made it abundantly obvious that the (bond) market does in fact distinguish between different kinds of payments.” At Longwave Analytics, we surmise that Senator Toomey has never been employed as a bond dealer, but he certainly qualifies as America’s ostrich of the year.

- Japan’s gross domestic product (GDP) contracted by 0.9% in the 1st. quarter, following an 0.8% contraction in the last quarter of 2010. In the wake of the March 11th. devastating earthquake and tsunami, Economy Minister Kauro Yosano predicted another quarter of declining output for the current three month period.

- According to life insurer Scottish Widows, about 44% of U.K. households are reliant upon two salaries, rising to 49% among people with children and 51% for those with a mortgage. Clive Allison, market director of protection at Scottish Widows commented: “Many millions of people are not protecting themselves in the unfortunate event of illness, an accident or death of the main bread winner, which is leaving them vulnerable and in many cases unable to afford to support their families.”

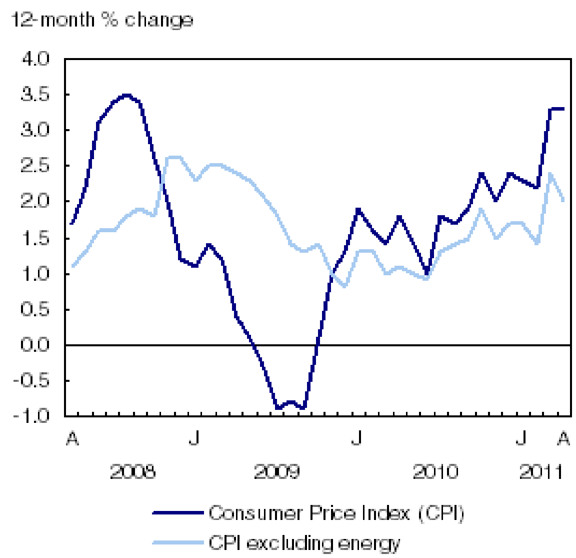
FRIDAY, MAY 20TH

- Fitch Ratings downgrades Greece’s sovereign debt credit rating to ‘B’ (High) from ‘BB’ (High) with a negative outlook, citing: “the scale of the challenge facing Greece in implementing a radical fiscal and structural reform program necessary to secure the solvency of the state and the foundations for economic recovery … Moreover, the greater emphasis on privatization has heightened the risk that the policy conditional funding under the EU-IMF funding will be delayed, given the political and technical obstacles to the realization of 50 billion euros of asset sales … The ‘B’ rating incorporates Fitch’s expectation that substantial new money will be provided to Greece by the EU and IMF and that Greek sovereign bonds will not be subject to a ‘soft restructuring or reprofiling’ that would trigger a ‘credit event’ and default rating from Fitch.” As a result, the yield on 10-year Greek government bonds touched a record 16.75%. See also, Winter Warning, May 10, 2011—The Unraveling of Debt

- After U.S. President Obama shocked Israel by announcing that the U.S. favoured an Israeli-Palestinian peace treaty based upon the borders extant at the time of the 1967 Arab-Israeli war, Israeli Prime Minister Netanyahu labeled those borders “not the boundaries of peace, (but) the boundaries of repeated wars.” With a grim-faced Barack Obama sitting beside him at the White House, Mr. Netanyahu added: “Peace based upon illusions will eventually crash against the rocks of Middle Eastern reality … While Israel is prepared to make generous compromises for peace, it cannot go back to the 1967 lines because those borders are (militarily) indefensible.”

- Statistics Canada reports the nation’s consumer price index (CPI) rose by 0.3% in April on a seasonally adjusted basis and remained unchanged at 3.3% on an annual basis, citing higher prices for energy. The core rate (excluding energy) increased by 2.2% on a year-over-year basis.

The 12-month change in the CPI and the CPI excluding energy



CLOSING LEVELS FOR FRIDAY, MAY 20TH.		WEEKLY CHANGE
Dow Jones Industrial Average	12,512.04	– 83.71 points
Spot Gold Bullion (June)	$1,508.90 (U.S.)	+ $15.30 per oz.
S&P / TSX Composite	13,652.27	+ 275.11 points
10-Year U.S. Treasury Yield	3.15%	– 2 basis points
Canadian Dollar	102.72 cents (U.S.)	– 0.51 cent
U.S. Dollar Index Future (Spot Price)	75.659 cents	– 0.051 cent
WTI Crude Oil (June)	$100.10 (U.S.)	+ $ 0.45 per barrel

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