Monday June 6, 2011

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, June 6th

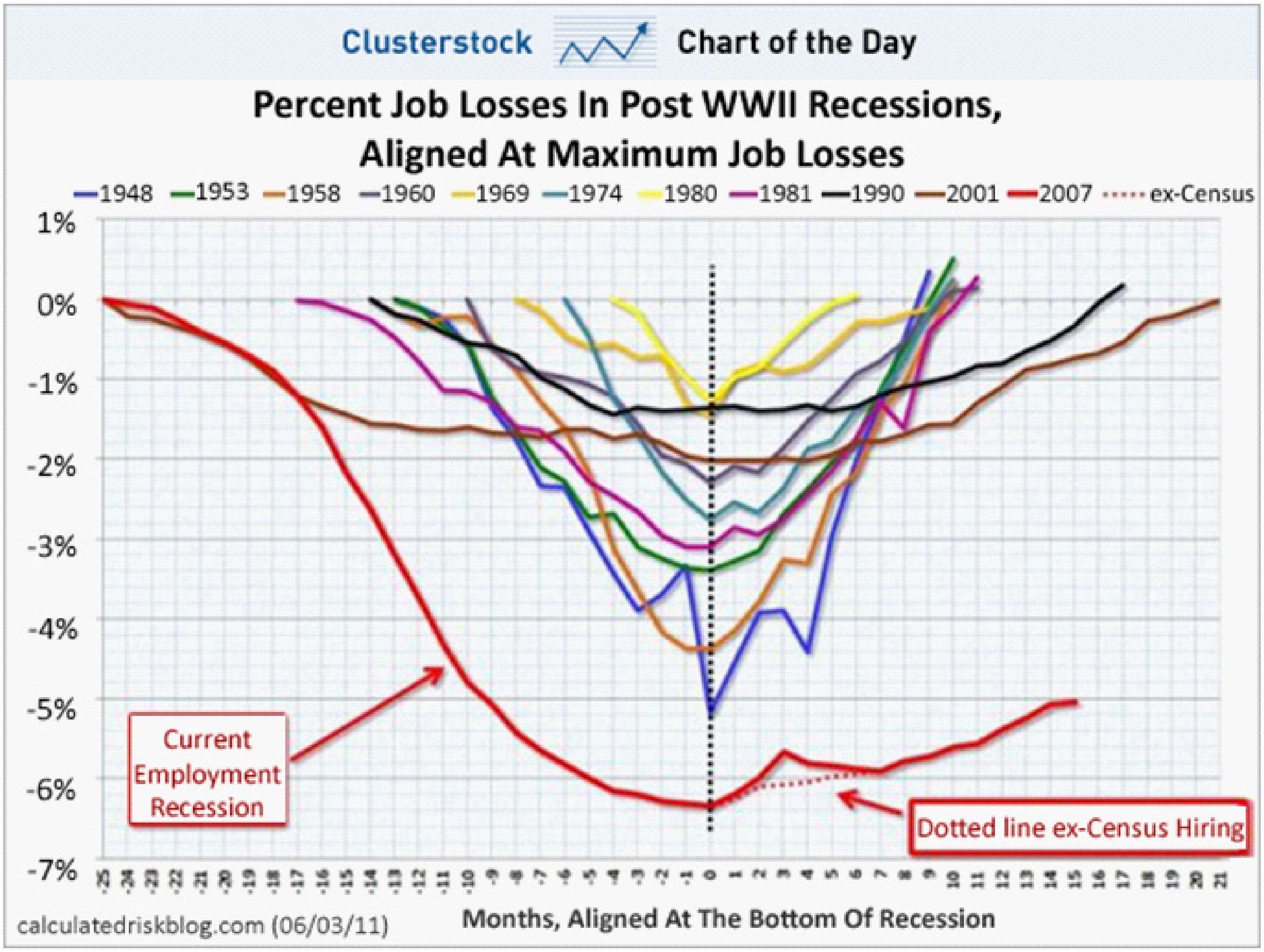
Canadian Finance Minister Jim Flaherty tables a slightly revised, but basically optimistic budget, forecasting Canada's economy will grow by 2.8% in 2012 and by 2.7% in 2013. Simultaneously, Mr. Flaherty

MONDAY, JUNE 6TH

warns: "We're building a significant consideration for risk. The two biggest risks being the European sovereign debt situation and the danger of contagion in the private sector arising from that and secondly, the debt and deficit situation in the United States."

- Meanwhile, in a new report, Parliamentary Budget Officer Kevin Page cautions that the federal government may be counting on too optimistic an outlook for the Canadian economy and too high a savings estimate from cost reduction programs. Breaking with tradition, Mr. Page's office (PBO) is projecting Canada's gross domestic product (GDP) will grow by 2.2% in 2012 and 2.3% in 2013 – 0.6% and 0.4%, respectively, less than the economic forecasts made by Finance Minister Flaherty: "PBO judges that the balance of risks to the private sector outlook continues to be tilted to the downside. Firstly, PBO believes there is a downside risk to the average U.S. (economic) outlook. Secondly, the recent strength in the Canadian dollar has outpaced the rebound in commodity prices. Thirdly, exceptionally low interest rates have helped fuel the rebound in consumer spending, but have also helped push household indebtedness to historic highs … PBO contends that the government won't be able to balance the federal budget in fiscal 2015, unless it takes additional measures to cut spending or increase taxes … PBO estimates that Ottawa will add $128 billion (CAD) to the national debt within the next five years, well in excess of the $93.6 billion (CAD) that Ottawa is projecting." At Longwave Analytics, we view the PBO's economic forecasts as overly optimistic.

- William Dunkelberg, chief economist for the National Federation of Independent Business (NFIB), issues the following statement regarding May job numbers, based upon the NFIB's monthly U.S. economic survey to be released on Tuesday, June 14th. The survey reflects 733 randomly-sampled small business owner respondents: "After solid job gains early this year, progress has slowed to a trickle. The two NFIB indicators – job openings and hiring plans – that predict the unemployment rate both fell, suggesting that the rate itself will rise. May's jobs numbers will disappoint; meaningful job creation on Main Street has collapsed. Twelve percent (seasonally adjusted) of small business owners reported unfilled job openings (down 2 points). Further indications of minimal future (employment) growth include the fact that during the next three months, (only) 13% plan to increase employment (down 3 points), while 8% plan to reduce their work force (up 2 points). These figures yield a seasonally adjusted net negative 1% of owners planning to create new jobs, a three point loss from April. Overall, reports of job layoffs have returned to historically normal levels. However, the percentage of owners hiring has not recovered to levels historically consistent with two years of (economic) expansion. With 25% of owners still reporting weak sales as their primary business problem, there is little need to add employees, especially given the uncertainty about future labour costs arising from new regulation and legislation. If Congress doesn't deal effectively with the trillion dollar (Federal) deficit, we'll have plenty to keep us worried."



- In a meeting with the Republican caucus last week, U.S. President Barack Obama set a July 4th. goal to reach a debt ceiling agreement – a date also endorsed by House Speaker John Boehner (R.-Ohio) – which would eliminate the possibility of a sovereign debt downgrade by the rating agencies. Mr. Boehner warns that federal budget talks, led by Vice President Joe Biden and involving lawmakers of both parties aren't making enough progress. A Democratic Capitol Hill aide familiar with the Biden group talks remarked yesterday: "The general consensus is that the first trillion (dollars) in cuts is doable and the second trillion is doable but painful." The Biden group resumes talks on Thursday.

- In a speech to the International Monetary Conference in Atlanta, U.S. Treasury Secretary Tim Geithner appeals for new global standards for derivative trades warning: "Failure to coordinate internationally would lead to a race to the bottom, as companies seek out jurisdictions with the weakest rules. Just as we have global minimum standards for bank capital – expressed in a tangible international agreement – we need global minimum standards for margins on uncleared derivatives trades." The Group of 20 industrial and developed nations set December 2012 as a deadline to create a more transparent system for the nearly $600 trillion (U.S.) over-the-counter derivatives market.

TUESDAY, JUNE 7TH

- The Labor Department reports the number of job openings in the U.S. declined by 151,000 to 2.97 million in April, the fewest since January. Henry Mo, an economist with Credit Suisse in New York, commented: "We've got a very weak, very mild (economic) recovery which does not create enough demand for labour. Even if all the open positions were filled overnight, we'd still have almost 11 million workers without jobs."

- In a Financial Times op-ed entitled: Failure to lift the U.S. debt ceiling risks fresh crisis, Glenn Hutchins, Vice Chairman of the Brookings Institution, opines: "If America fails to meet even the modest challenge of lifting the debt ceiling, currently $14.3 trillion (U.S.), we will signal weakness and disarray to the world. Confidence in the U.S. will be shaken and the financial markets – which expect a deal – will quake. Immediately after lifting the debt limit or ideally as part of it, we must take resolute action on the long-term deficits. Otherwise, our economic future will be at risk as businesses will be cautious about investing with such uncertainty and rather will fortify their balance sheets domestically and channel their resources to faster-growing and better managed economies abroad … Already, the rating agencies have announced that our 'AAA' sovereign debt credit rating is at risk – which was historically unthinkable. Well in advance of our theoretical expiration date (15 years of additional borrowing capacity), credit is likely to evaporate, interest rates to spike, the dollar to wobble and a crisis to unfold – suddenly and ferociously as markets are wont. Having depleted both our financial and reputational capital, we will have only painful remedies left at our disposal. America's corporate executives and entrepreneurs recognize that, if we are to prosper as a nation, we must foster the political conditions necessary for progress on the deficits. It is clear that there is no path to a political solution that is composed of only spending cuts or revenue increases. Both have to be on the table … Economic research suggests that, in periods of fiscal consolidation, spending cuts are more effective than tax increases in cutting deficits, while avoiding a double-dip recession. So, we must stomach major spending cuts – including addressing entitlements and defense – not just discretionary spending … While budget balance is ideal, our realistic goal ought to be establishing and then reducing our nation's outstanding debt as a share of gross domestic product (GDP). This must be based upon realistic assumptions for (economic) growth, unemployment and tax revenue. The time is long past for 'rosy scenarios' which the markets won't believe. Hard choices will have to be made. Additionally, customary ways of budgeting – short-term, piecemeal, reversible and unpredictable – must be jettisoned in favour of a long-term comprehensive strategy. Any solution that is credible to financial markets will require a decade or more of ironclad commitment." See also, Winter Warning dated March 30, 2011 – The Coming International Trade Crisis – Summary.

- In prepared remarks from Atlanta, Federal Reserve Chairman Ben Bernanke sends a strong signal to the markets that the Fed will not loosen monetary policy further, despite recent weak economic data, citing: "The economic recovery appears to be proceeding at a moderate pace. The U.S. economy is, (not only) recovering from both the worst financial crisis and the most severe housing bust since the Great Depression, (but also), it faces additional headwinds ranging from the effects of the Japanese disaster to global pressures in commodity markets. In this context, monetary policy cannot be a panacea."

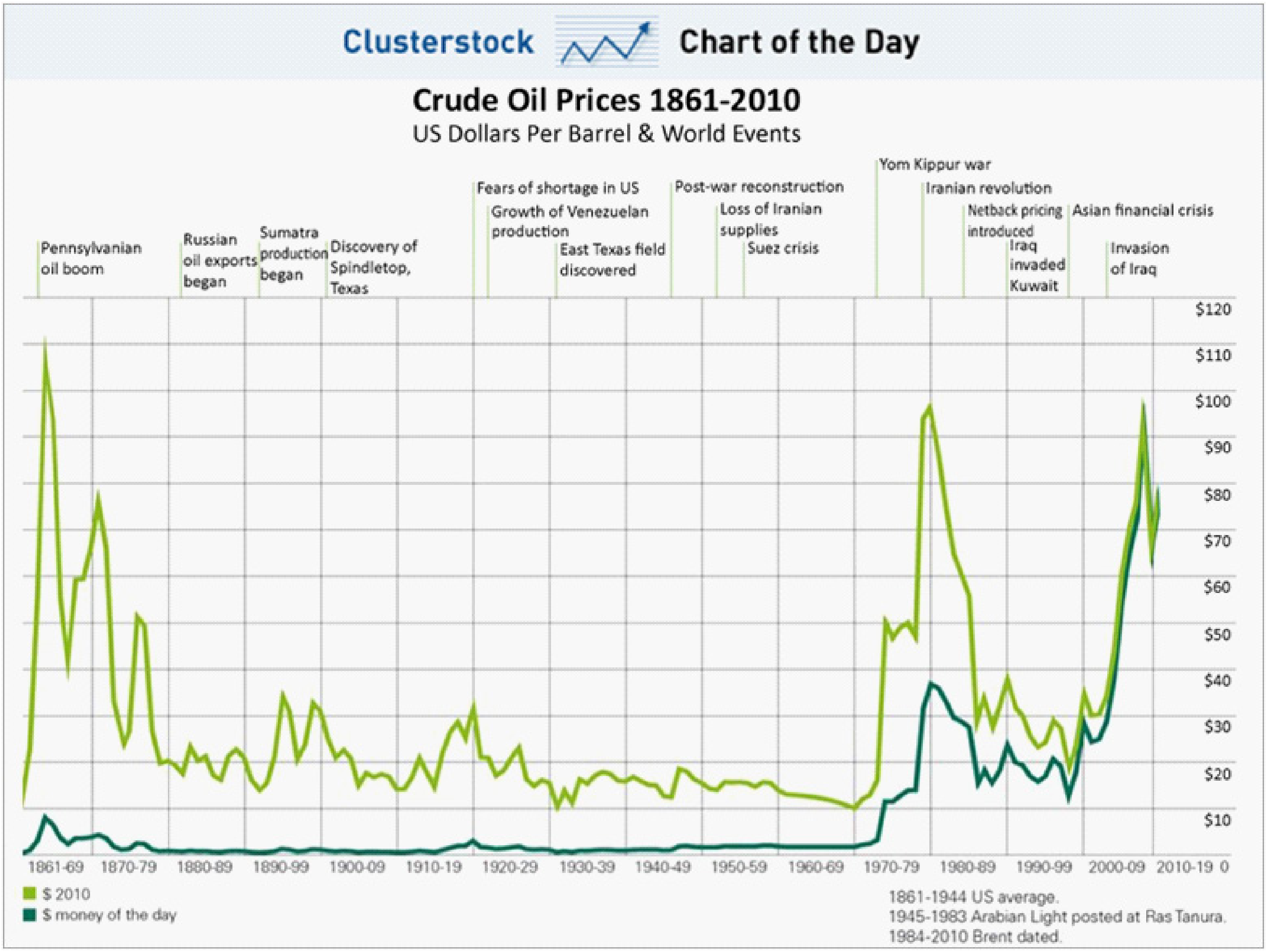
- The Economy Ministry reports German factory orders rose by 2.8% in April from an upwardly revised decline of 2.7% in March previously reported as a drop of 4%, citing stronger demand for industrial goods, such as railway products. Carsten Brzeski, an economist at ING Group in Brussels commented: "Clearly, there is no reason for the German industry to grumble. Production is firing on all cylinders and richly filled order books give little cause for serious concerns."

- HSBC agrees to pay $62.5 million (U.S.) to settle a lawsuit brought by investors of Dublin-based Thelma International Fund, which lost money as a result of Bernard Madoff's fraudulent Ponzi scheme. In a statement, HSBC warned: "The settlement should not be deemed to be evidence of, or an admission or concession with respect to any claim of any fault, or liability, or wrongdoing, or damage whatsoever."

WEDNESDAY, JUNE 8TH

- Greece's statistics agency reports the country's unemployment rate rose to 16.2% in March – 40% higher than in March 2010 – and youth unemployment now exceeds 42%, as Athens prepares to cut more public sector jobs and close agencies amid a series of measures aimed at reducing its mountainous debt burden – via parliamentary vote by June 30th. Separately, the German government wants Greece to offer all sovereign bondholders a 7-year extension of maturity dates, as a condition for additional financial aid from Berlin. In a letter to his European Union colleagues, German Finance Minister Wolfgang Schauble demands: "a quantified and substantial contribution by bondholders as a condition for German support for a new aid program for the government in Athens … Should the European Union fail to reach agreement on new payments to Greece by mid-July, we face the real risk of the first disorderly default within the euro zone."

- Canada Mortgage and Housing Corp. (CMHC) reports the nation's housing starts increased to a seasonally adjusted annual rate of 183,600 units in May from 178,700 in April. Bob Dugan, chief economist at CMHC's Market Analysis Centre cited: "an increase in multiple (unit) construction in most provinces and in rural (housing) starts."



- In a press release, Organization of the Petroleum Exporting Countries (OPEC) secretary general Abdullah El-Badri announces: "Unfortunately, we are unable to reach a consensus to reduce or raise (oil) production, but I hope OPEC will meet again in three months." Gulf Arab delegates related that Iran, Venezuela and Algeria were among the six countries refusing to consider an output increase. However, Saudi Oil Minister Ali-al Naimi confirmed that Saudi Arabia was committed to supplying market requirements.

- In a press release, Moody's Investors Service confirms: "the United Kingdom's sovereign debt credit rating at 'AAA' with a stable outlook, however, as we've being saying for a while, in a situation of lower (economic) growth combined with weaker-than-expected fiscal consolidation, we would reconsider our stance." Andy Chaytor, a strategist with the Royal Bank of Scotland, commented: "I'm not sure there's much new information in the press release, however, it does remind the market that the U.K. might have a good path, but you can't altogether ignore the vulnerability of that path."

- Attending a financial forum in Beijing, Li Daokui, an advisor to the People's Bank of China, comments to reporters: "An American debt default could undermine the U.S. dollar and Beijing needs to persuade Washington from pursuing this course of action. I think there is a risk that a U.S. debt default may happen. The result would be very serious and I really hope that they would stop playing with fire." China is the largest creditor of the United States, holding in excess of $1 trillion (U.S.) of Treasury debt as of the end of March. The U.S. Treasury Department has stated it will not be able to borrow in the fixed income market beyond August 2nd. The Obama administration has warned of “catastrophic consequences” if the U.S. were not able to service its outstanding debt. See also Winter Warning May 10, 2011 – The Unraveling of Debt – What Happens if the U.S. Statutory Debt Ceiling Isn’t Raised?

- In its periodic Beige Book economic survey, the U.S. Federal Reserve disclosed: “Businesses stated the U.S. economy expanded over the past two months, with most of the Federal Reserve’s 12 districts reporting growth in the manufacturing sector and an improving labour market. Looking forward, contacts in most districts were generally optimistic about the (economic) outlook, although less so than (in) the previous report.” As reported in the Wall Street Journal, other recent economic data has been dour, with separate economic reports revealing a decline in factory orders, unemployment continuing high and consumer confidence remaining tenuous.

- In a Reuters News interview, Fitch Ratings warns: “Even a short-lived /technical default by the U.S. government would suggest a crisis of governance from a sovereign credit and rating perspective. Fitch would first place ratings on a ‘negative watch’ if lawmakers failed to enact an increase in the U.S. debt ceiling by August 2nd., when the Department of the Treasury will have exhausted extraordinary measures to avoid a default. The first test for ratings will come two days later, when $30 billion (U.S.) of Treasury bills mature. If the government fails to repay them in full, Fitch will lower the rating on those specific securities to ‘B’ (High). However, the real deadline arrives on August 15th. when $27 billion (U.S.) in Treasury notes and $25 billion (U.S.) in coupon payments come due. If the government misses those, Fitch would downgrade the sovereign issuer ratings to ‘restricted default’ and lower all Treasury securities to ‘B’ (High). Although such an event (such as a short-lived Treasury bill default) may not permanently impair the capacity of the government to service its obligations, it is unlikely that its ‘AAA’ status would be retained in the short to medium term.” David Riley, a senior analyst of sovereign ratings at Fitch commented: “Clearly the political signals which are coming (from Washington) are a source of concern. We know from previous experiences – both with the government shutdown and previous episodes with the debt ceiling – that although you get a lot of brinkmanship, ultimately, it does get resolved.”

- According to an analysis by USA Today, the federal government’s financial condition deteriorated rapidly last year, far beyond the $1.5 trillion (U.S.) in new debt assumed to finance the budget deficit. The U.S. government added $5.3 trillion (U.S.) in new financial obligations in 2010, largely for retirement programs such as Medicare and Social Security. The amount of unfunded financial entitlements now totals a record $61.6 trillion (U.S.). The gap between spending commitments and government revenue for 2010 equals in excess of one third of the nation’s gross domestic product (GDP). Medicare alone added $1.8 trillion (U.S.) in new liabilities, more than the current record deficit prompting heated debate between Congress and the White House over increasing the debt limit. Social Security added $1.4 trillion (U.S.) in obligations, partly reflecting longer life expectancies. Federal and military retirement programs added considerably more to the financial yoke as well.

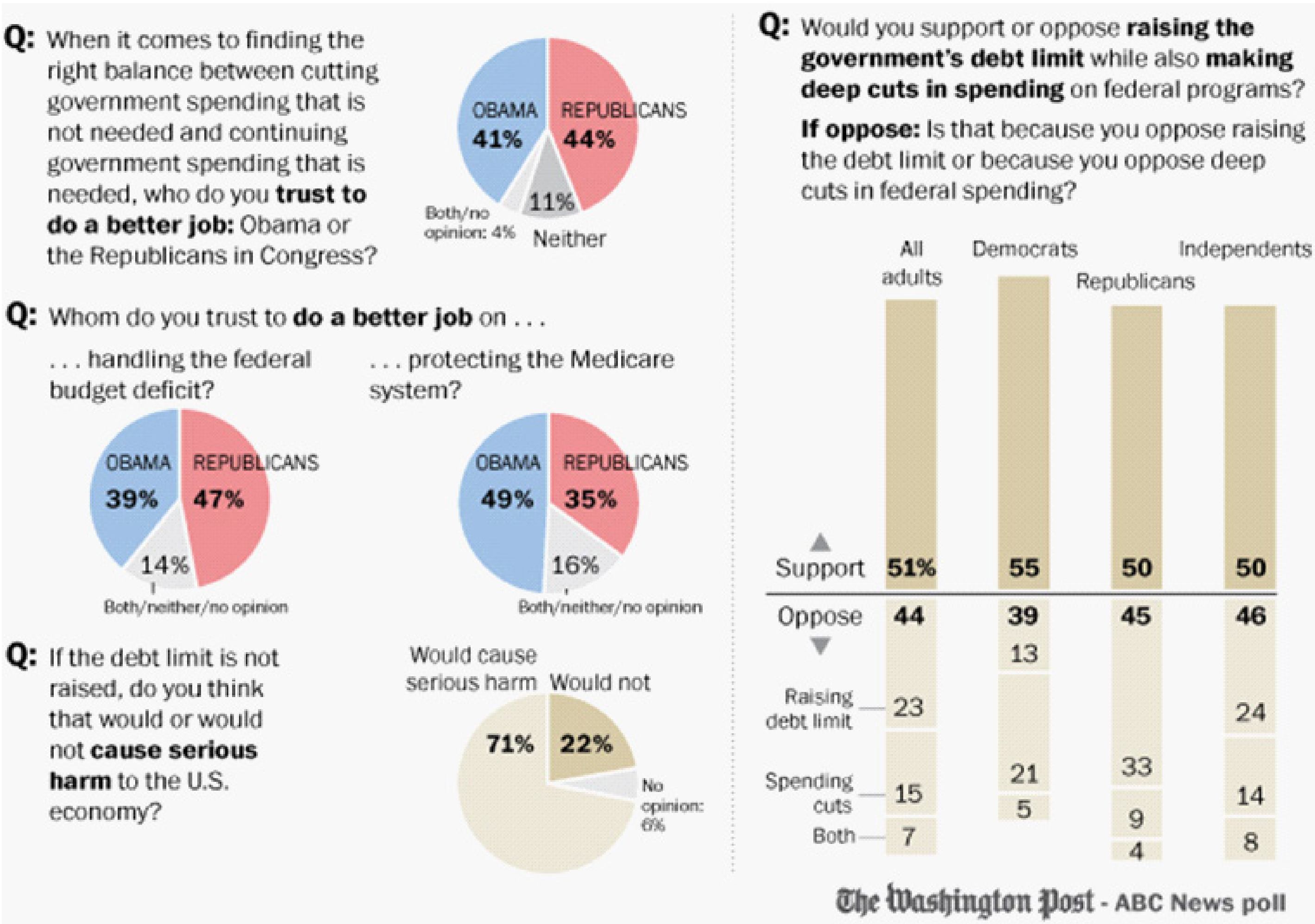
THURSDAY, JUNE 9TH

- The Labor Department reports U.S. claims for state unemployment benefits increased by 1,000 to a seasonally adjusted 427,000 in the week ended June 4th. from an upwardly revised 426,000; while continuing claims declined by 71,000 to a seasonally adjusted 3.68 million in the week ended May 28th.

- Statistics Canada reports the nation’s trade deficit widened to $924 million (CAD) in April from $417 million (CAD) in March, citing a decline in exports to $36.3 billion (CAD) led by machinery and equipment; industrial goods and materials; as well as automobiles

- Following two consecutive years of frenetic sales levels, car sales in China rose by only 6.1% in the first 5 months of 2011. Jenny Gu, a senior market analyst at J.D. Power in Shanghai commented: “While demand (for cars) may increase slightly in the autumn, it’s unlikely to be anything close to the surge in 2009 and 2010.”

- At a news conference following the European Central Bank’s (ECB) monthly monetary policy meeting which left its benchmark rate unchanged at 1.25%, ECB President Jean-Claude Trichet warned: “Strong vigilance (on rising inflation) is warranted,” hinting at another possible rate hike in July following the 25 basis point increase in April. Separately, the Bank of England left its Bank Rate unchanged at 0.5% and its asset purchase plan unchanged at 200 billion pounds ($328 billion U.S.).



Torn on the Statutory Debt Limit
A Washington Post-ABC poll queries public opinion regarding the U.S. debt limit

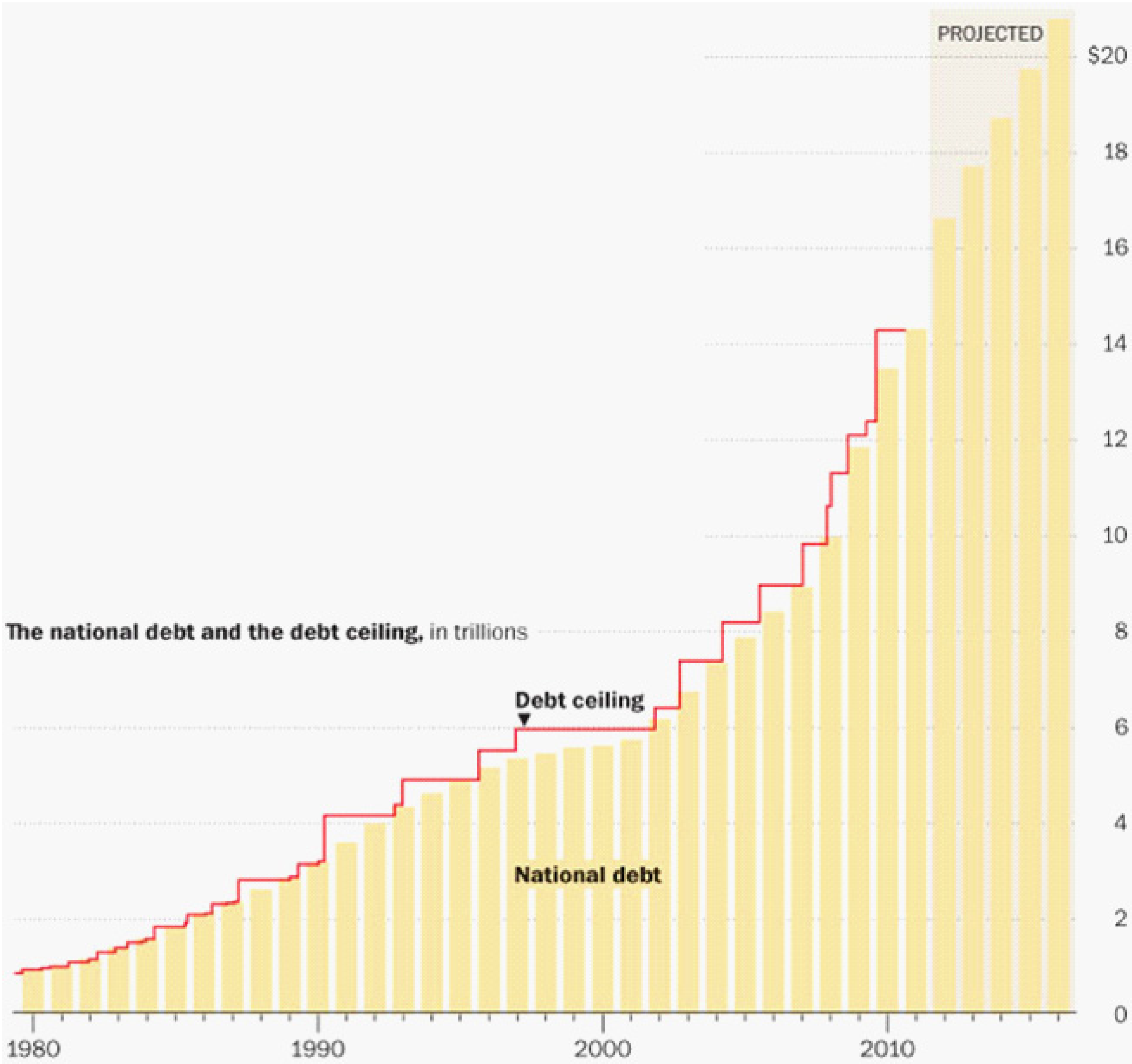
- Congressional leaders emerge from the fifth round of talks/negotiations regarding the raising of the U.S. statutory debt limit led by Vice President Joe Biden, offering few specifics on progress toward a comprehensive deficit-reduction agreement, but pledging to accelerate the pace of their meetings. Three meetings have been set for next week.

- The Commerce Department reports the U.S. trade deficit contracted by 6.7% to $43.7 billion (U.S.) in April, citing a decline in auto and oil imports, while exports rose by 1.3% to a record 175.6 billion (U.S.) reflecting higher sales of fuel oil, petroleum products and computers

- According to a new CNN/Opinion Research Corp. national poll, U.S. President Obama's overall approval rating has declined to 48%, as a growing number of Americans worry that the U.S. economy is likely to collapse into another Great Depression within the next 12 months. While the poll indicates the overall economy remains the primary issue to the electorate, other economic components namely – unemployment, gasoline prices and the federal deficit – include three of the remaining four concerns within the top five.

- The Canadian Auditor General's final report on the G8 legacy infrastructure fund concludes that the federal government "did not clearly or transparently" identify how the money was going to be spent when it sought parliamentary approval for the funding. Moreover, the report criticized the utter lack of documentation to explain how and why 32 infrastructure projects in the Parry Sound-Muskoka region in Ontario were selected to receive the government largesse.

FRIDAY, JUNE 10TH



- In a Globe and Mail article entitled "U.S. panic over potential debt default well-founded," columnist Neil Reynolds postulates: "The U.S. Government maintains hundreds of trust funds, all designed to set aside and protect tax revenues collected for designated purposes. In practice, however, the government spends these revenues indiscriminately and deposits equivalent IUOs in the trust funds as debt. Impeccably, the U.S. Treasury (as required by law) pays interest on this debt – even paying one day's interest when trust fund money is collected one day and spent the next. (In essence,) the Treasury finances the interest payments by borrowing from itself. As a result, the Social Security trust fund contains IOUs totaling $2.6 trillion (U.S.) and the civil service pension fund contains IOUs for $798 billion (U.S.). The Medicare trust fund holds IOUs for $160 billion (U.S.) while the nuclear wastes trust fund lists IOUs of $47.8 billion (U.S.) … and so on, ad nauseum.

(Basically,) these trust funds contain the debt that the U.S. Government owes to itself, as distinct from the 'public debt' that it owes to others – individuals, companies and foreign governments. At the end of 2010, the government owed $4.6 trillion (U.S.) to itself and $9.3 trillion to the public, for a grand total of $13.9 trillion (U.S.) – since increased January through May to a grander total of $14.3 trillion (U.S.) – representing an increase of $3.7 trillion in the first 2 ½ years of the Obama presidency … In other words, the U.S. government is progressively more vulnerable to entitlement debt than to general-expenditure debt … because for the most part, trust fund debt is exempt from the infamous 'debt ceiling' that President Obama wants urgently to raise. Supposedly, the government needs to borrow (at least) another $2 trillion (U.S.) to (function normally past) the presidential elections in November, 2012.

In a report issued in May, the Congressional research service noted that trust fund debt is harder to manage than public debt … (since) it cannot be bought or sold on the open market … (assuredly,) the government assumes 100% of the risk. The government can redeem this debt only by repurchasing the accumulated IOUs – either by spending less or taxing more. From the White House comes a strident warning … of an impending catastrophe: a default on the national debt. Congress must raise the debt ceiling, now at $14.9 trillion (U.S.) by (at least) $2 trillion (U.S.) before August 2nd. – or else. Congress has dutifully increased debt ceilings many times since 1917, when the practice began and now does so once a year and occasionally, twice a year. For many years, the House of Representatives invoked the infamous 'Gephardt rule' – which automatically, 'deemed' the ceiling lifted whenever necessary and without any recorded votes. The Republicans abolished the Gephardt rule (at the beginning of this Congress); hence the (current) panic.

- In an interview with the Global Times, Guan Jianzhong, President of Dagong Global Credit Rating Co., the only Chinese agency that issues sovereign ratings, extrapolates: "In our opinion, the United States has already been defaulting by allowing the (U.S.) dollar to weaken against other currencies – eroding the wealth of creditors including China." Beijing reduced its holdings of U.S. Treasurys for the fifth consecutive month – by $9.2 billion (U.S.) to $1.145 trillion (U.S.) in March – 2.6% less than last October's peak level of $1.175 trillion (U.S.). Separately, Chinese foreign ministry spokesman Hong Lei urged the United States to adopt "effective measures to improve its fiscal situation."

- Judge Peter Corrigan, of the Cuyahoga County Common Pleas Court in Cleveland, upholds a February jury verdict against Ford Motor Corp., ordering the automaker to pay $2 billion (U.S.) in damages in a class-action lawsuit on behalf of 3,000 auto dealers who claimed Ford overcharged them on commercial truck sales. In a statement, Ford Motor responded: "We believe the trial court committed several legal errors and we will appeal the ruling. We are confident that it will be reversed."

- The City Council of Brea, California, recently voted unanimously to drastically reduce pensions for future employees and require current employees to pay as much as 4.5% of their salary into a retirement fund – an initial, groundbreaking achievement. The city of 40,000, about 30 miles southeast of Los Angeles, had negotiated the change with its unions and according to a city report, by 2012 employees will be contributing $1 million more to their pension benefits. According to an informal list monitored by the California Public Employees' Retirement System (Calpers), Brea is one of about 90 cities that have made changes to their pension plans. Calpers and the California State Teachers' Retirement System listed unfunded liabilities in excess of $112 billion (U.S.) at the end of fiscal 2009. Brea employees participate in Calpers.
  See also, Winter Warning, July 6, 2009 – The Pension Predicament and America's Albatross – Unfunded Government Pension Liabilities

- At a Frankfurt press conference, European Central Bank (ECB) President Jean-Claude Trichet pronounced: "We would say it's an enormous mistake to embark on a decision that would lead to a credit event for Greece – no credit event, no selective default." According to a German government memorandum recently circulated to other euro zone governments: "The ECB's position directly contradicts a German proposal to induce (bond) investors to swap Greek government bonds maturing between 2012 and 2014 for new bonds that would mature seven years hence. Such a bond exchange would probably amount to a 'selective' default by Greece."

- In a Huffington Post article entitled: Third World America: Forget Fast-Tracking to Anarchy – We've (Already) Arrived, contributing writer Janet Tavakoli documents: "This year, all hell has broken loose in downtown Chicago. Years of under hiring have resulted in a police force that is unprepared for wildings and gang violence … Tourists and residents have been attacked by mobs of youths on buses, on beaches, on bicycle paths, near the shops of the Magnificent Mile and outside their homes. Mobs of shoplifters have plagued 'Mug Mile' … Poorer neighbourhoods have long been war zones. The murder rate and gang violence in Chicago has been unacceptable for years. Yet the police force was gutted, handcuffed and muzzled. Police officers, both off-duty and uniformed, have been gunned down in the streets." Continuing high domestic unemployment and drug wars are contributing to higher crime rates and social unrest across America. This societal spiral can only worsen – an incessant concern!

Monday June 6, 2011

LONGWAVE group

- China posts a smaller-than-expected trade surplus of $13.1 billion (U.S.) in May because of soaring imports; as exports to the United States and the European Union declined to their weakest levels since late 2009

CLOSING LEVELS FOR FRIDAY, JUNE 10TH.		WEEKLY CHANGE
Dow Jones Industrial Average	11,951.91	– 199.35 points
Spot Gold Bullion (August)	$1,529.20 (U.S.)	– $ 13.20 per oz.
S&P / TSX Composite	13,084.00	– 433.91 points
10-Year U.S. Treasury Yield	2.97%	– 2 basis points
Canadian Dollar	102.22 cents (U.S.)	unchanged
U.S. Dollar Index Future (Spot Price)	74.864 cents	+ 1.204 cent
WTI Crude Oil (July)	$99.29 (U.S.)	– $ 0.93 per barrel

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"Those who cannot remember the past are condemned to repeat it." Santayana