Monday May 21st, 2012

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

# THAT WAS THE WEEK THAT WAS


Monday, May 21st

Front Page Headline, Manchester Guardian – "Greece is in Danger of a Humanitarian Crisis: Alexis Tsipiras. In an interview with the Guardian's Athens correspondent, Helena Smith, the leader of the Greek radical left-wing party Syriza, Alexis Tsipiras warns:

## MONDAY, MAY 21ST
### Victoria Day Holiday in Canada

'Greece has arrived at the point where the austerity measures have proved disastrous. After two packages of financial support which were accompanied by very harsh (austerity) measures, recession remains at monumental levels, unemployment has soared, social cohesion has collapsed and Greece is in danger of a humanitarian crisis. In addition, we're not seeing results. Neither is the debt being reduced effectively, nor is the deficit. Moreover, the recession is not subsiding. Consequently, we can't insist on a program that has proven to be catastrophic and ineffective. We have never been in such a bad place … and we cannot accept this is the future of a European country. Precisely, we recognize the problem is European and it will spread to the rest of Europe. We are sounding the alarm bell and appealing to the people of Europe to support us in an effort to stop this descent into only what can be called a social hell." See Economic Winter, The Ongoing Saga of the European Debt Crisis, Greece: The Beginning of the End.

- Front Page Headline, Manchester Guardian – Fitch Places Three Cypriot Banks on Credit Watch Negative. Since the Cyprus banking sector holds large amounts of Greek debt, Fitch Ratings blames the credit rating uncertainty over Greece's future, noting that Cypriot banks remain highly sensitive to heightened risks in Greece; especially if it were to leave the EMU. In a statement Fitch warned: 'In the event that the new general elections scheduled for June 17th. fail to elect a government with a mandate to continue with the EU- IMF program of fiscal austerity and structural reform, Greece's exit from the EMU would be probable, which would likely result in a widespread default on private sector (debt); as well as sovereign euro-denominated obligations."

- Front Page Headline, Washington Post – "Group of Eight Summit Meeting Issues Joint Statement. Following a weekend meeting at Camp David, Maryland, the leaders of the world's eight richest countries affirmed they would promote investment and infrastructure, as they also sought to reduce government debt."

- Front Page Headline, New York Times – "A Generation Hobbled by the Soaring Cost of College. Since there are in excess of $1 trillion (U.S.) in student loans outstanding in America, crippling debt is no longer confined to dropouts from for-profit colleges, or graduate students who owe on many years of education; some of the overextended debtors in years past. As prices soar, statistically, a college degree remains a good lifetime investment, but it often comes with an unprecedented financial burden. According to a Department of Education survey of 2007-8 graduates, about two-thirds of bachelor degree graduates borrow money to attend college, either from the government or private lenders; with the total number of borrowers probably considerably higher, since the survey excludes borrowing from family members. In 2011, the Federal Reserve Bank of New York reported the average debt was $23,300 (U.S.), with 10% owing more than $54,000 (U.S.) and 3% owing more than $100,000 (U.S.). The average debt for bachelor degree graduates who had secured loans ranged from under $10,000 (U.S.) at elite schools such as Princeton and Williams College, which have plenty of wealthy students and enormous endowments, to nearly $50,000 at some private colleges with less affluent students and smaller financial aid. According to the data reported by the colleges, the current balance of federal student loans nationwide is $902 billion (U.S.), with an additional $140 billion (U.S.) estimated in private student loans … The extraordinary growth in student loans has deep roots and the cast of contributing characters – college marketing officers, state lawmakers wielding a budget axe and wide-eyed students and families – has been enabled by a basic economic dynamic: an insatiable demand for a college education at almost any price, with plenty of easy-to-secure loans, primarily from the federal government. Approximately, 11% of college students now attend for-profit colleges and they receive about a quarter of all federal student loans and grants. According to the Department of Education, the cost of college tuitions and fees has continued to increase faster than the rate of inflation; even faster than health care costs. If this trend continues through 2016, the average cost of a public-college education will have more than doubled within just 15 years … Of course, economists and many parents believe than the only thing worse than graduating with lots of debt is not attending college at all, since endless studies have shown that graduates earn more over a lifetime. Moreover, most college students in the United States do manage to eventually repay their student loans. To that end, the Obama administration has doled out more grants and loans than ever before to an increasing number of college students, with the goal of setting the United States first among developed nations in college completion. The balance of federal student loans has grown by more than 60% over the last five years. In 2007, while Congress made certain the interest rates on many of those loans were well below commercial rates, the prospect of preventing those lower rates from doubling in July, is the subject of considerable debate among lawmakers. However, even if student loans are what many economists consider to be 'good debt,' an increasing number of borrowers are struggling to repay them, while in the process, becoming mired in a financial morass. Department of Education data shows that payments are being made on just 38% of the balance of federal student loans, down from 46% five years ago. The balances are unpaid because the borrowers are either still in school, have postponed payments, or have stopped paying altogether. The latest available data indicates nearly 10% of borrowers who began repayments in 2009, defaulted within two years, about double the rate of 2005. Indeed, growing student debt hangs over the economic recovery like a dark cloud for a generation of college graduates and indebted dropouts. A new study by Rutgers University revealed 40% of recent college graduates had deferred making any major purchase, such as a car and about half possessed a full-time job."

## TUESDAY, MAY 22ND

- The National Association of Realtors reports U.S. existing home sales rose by 3.4% in April to a seasonally adjusted annual rate of 4.62 million units, following a downwardly revised 4.47 million units in March, previously reported as 4.48 million units. Steven Wood, chief economist at Insight Economics commented: "Although the data seem to imply that there is a relatively good balance between buyers and sellers, it is unlikely that home prices can recover on a sustained basis until the number of distressed properties is more significantly reduced."

- Front Page Headline, MarketWatch News – "OECD Lowers Euro Zone GDP Forecast. In its latest economic outlook, the Paris-based Organization for Economic Cooperation and Development now forecasts euro zone gross domestic product to contract by 0.1% in 2012, before returning to growth of 0.9% in 2013. 'Elections in a number of euro zone countries signal a rise in reform fatigue. A combination of enduring financial fragility, rising unemployment and household pain may spark political contagion and adverse market reactions. Fiscal consolidation and structural measures must proceed to make the process as growth friendly as possible. Policy makers should consider taking steps to pave the way for the joint issuance of Eurobonds."

- Front Page Headline, Bloomberg News – "Republican Extremism Stalls Spending Cut Agreement: Reid. In a letter to Republican Senators, Harry Reid (D., Nev.) Senate Majority Leader, stated: 'Congress won't be able to prevent federal spending cuts scheduled for 2013, unless Republicans allow tax increases in a deficit reduction plan. Once Republicans are willing to abandon their commitment for more tax breaks for multi-millionaires and special interests and their plans to end Medicare, I am confident that we can reach an agreement. Unfortunately, it appears that Republicans' blind adherence to Tea Party extremism is making it impossible to reach this sort of balance agreement before the (November) election.' Senator Reid was responding to May 17th. correspondence forwarded to him from 41 Republican Senators, urging him to act now in order to avert the so-termed 'fiscal cliff' awaiting at the end of the year. If Congress doesn't act, the George W. Bush-tax cuts on wages, capital gains, dividends and estates will expire at the end of 2012. Also, automatic spending cuts of $1.2 trillion (U.S.) over 10 years to the Defense Department and other programs will take effect in 2013. Several investment dealer economists have calculated that the 'fiscal cliff' could reduce gross domestic product (GDP) in the United

States by 3 – 4%. At Longwave Analytics, we do not expect the Republican Party leadership position of no tax increases to change due to its allegiance and fealty to Washington lobbyist Grover Norquist's Taxpayer Prevention Pledge. In short, the stage is being set for another serious round of Washington political gridlock should Democratic U.S. President Barack Obama be re-elected on November 6th. However, should the Republican Party emerge with a 'united government' the fiscal deficit and national debt challenges will surely be tackled from solely the expenditure side of the budget ledger."

Caricature of the U.S. Fiscal Cliff Source: Wall Street Journal / Martin

- Front Page Headline, Financial Times – "Renminbi Begins to Go Global. Not so long ago, international use of the renminbi was limited to cash transactions along China's borders. Mongolian, Pakistani and Laotian traders accepted wrinkled Mao-emblazoned notes from Chinese visitors, but that was about as much as transpired. No longer: over the past three years, the renminbi has started to go global. British hedge funds buy and sell the currency at the push of a button, while corporations such as McDonald's – the fast food chain – and Tesco – the U.K. supermarket group – raise funds in the small but fast growing renminbi bond market. Just last month, U.K. Chancellor of the Exchequer George Osborne launched an initiative to aid the City of London develop into a 'western hub' for the renminbi, as China's foreign exchange controls are relaxed. While the steps to date have been small and incremental, many believe that the renminbi could ultimately, challenge the U.S. dollar as a global reserve currency. If this proves to be correct, its ascent will have a big impact on trade, investment and politics across the world. Pierre Gave of Gavekal, a Hong Kong-based research group, predicts the renminbi will become a major currency for trade between China and its Asian neighbours in the coming years, before spreading across the globe: 'The Asian region needs to rid itself of its dependence upon the U.S. dollar as a trading and finance currency. The renminbi is the only credible alternative." See also, Economic Winter, April 9, 2012 – China's Renminbi: The World's Next Reserve Currency?


China's Renminbi Source: Bloomberg News

- Front Page Headline, Daily Telegraph U.K. – "IMF Urges Britain to Accelerate Its Economic Recovery Plan. Warning that weak economic growth was putting the U.K. at risk of permanently high unemployment, the International Monetary Fund (IMF) called for swift and coordinated action between the Bank of England (BOE) and the U.K. Treasury. In an unusually alarmist assessment of the U.K., IMF Managing Director Christine Lagarde stated that 'U.K. economic growth is too slow and unemployment too high, so policies to bolster domestic demand are needed before low economic growth becomes entrenched.' However, Ms. Lagarde stressed that austerity had been the right course for the U.K., applauding George Osborne as 'courageous' and insisting that fiscal stimulus should only be considered as a last resort. 'When trying to imagine what the situation would be like today if no such fiscal consolidation program had been decided, I shiver.' The IMF placed the Bank of England at the centre of the recommended U.K. policy response, citing 'further monetary easing is required. The Bank should reassess the efficacy of cutting interest rates below 0.5% and conduct further quantitative easing above the current 325 billion pounds. Lowering the cost of credit must be another strand of the recovery efforts. The Bank should provide lenders longer term bank funding facilities to reduce funding costs' so households and businesses have access to more affordable loans. The IMF also recommended that the Bank of England take the regulatory pressure off lenders, by allowing them to replenish their capital tiers more gradually."

## WEDNESDAY, MAY 23RD

- The Federal Housing Finance Agency reports U.S. home prices rose by 2.7% in the twelve months ended March 31st. citing continuing record low mortgage rates

- The Office for National Statistics reports U.K. retail sales declined by 2.3% in April, citing a record rainfall kept consumers on the home front while fuel sales dropped

- Front Page Headline, Globe and Mail – "Spain Unable to Sustain High Financing Costs: Rajoy. Following a meeting with newly-elected French President Francois Hollande in Paris, Spanish Prime Minister Mariano Rajoy warned: 'Europe must find an answer. It is a must because we cannot go on like this for a long time, with large differences when it comes to financing ourselves. It is because of these (sovereign debt yield) differences that the (monetary) policies in which we Europeans believe, such as controlling government spending and reforms to encourage (economic) growth, ultimately have no effect." See also, Economic Winter, The Ongoing Saga of the European Debt Crisis – The Pain in Spain is Far From on the Wane, May 18, 2012.

- The Bank of Montreal reports a net profit of $1.03 billion (CAD) in the 2nd. fiscal quarter ended April 31st. citing a 7.8% profit growth from Canadian operations, while earnings grew by more than 100% from U.S. operations, following the acquisition of Wisconsin-based Marshall & Ilsley Corp. In terms of the Canadian economy, a bank spokesman commented: "Households are spending more cautiously in the face of elevated debt levels and higher gasoline prices. Housing market activity has softened in most regions and mortgage growth is showing tentative signs of slowing."

- Statistics Canada reports the nation's retail sales – aided by unusually warm weather, particularly in Ontario – rose by 0.4% in March, citing higher sales of automobiles and recreational vehicles, clothing, footwear, sporting goods and garden equipment

- Front Page Headline, Wall Street Journal – "HP Announces 27,000 Layoffs. Technology giant Hewlett Packard plans to lay off about 8% of its work force by the end of fiscal 2014. The company's restructuring plans are expected to generate annual savings of between $3 billion (U.S.) and $3.5 billion (U.S.). In a statement, CEO Meg Whitman noted: 'These initiatives build upon our recent organizational realignment and will further streamline our operations, improve our processes and remove complexity from our business. Some of these actions are difficult because they involve the loss of jobs, but are necessary to improve execution and fund the company's long-term health."

- Front Page Headline, Wall Street Journal – "World Facing Most Economic Insecurity Since Great Depression: Lagarde. In a commencement speech to the John F. Kennedy School of Government graduates, International Monetary Fund Managing Director Christine Lagarde elaborated: 'The inability of 75 million young people to find a decent job and rising inequalities that strain the compact holding our society together, ignite a fear that the global economic engine will no longer deliver as in the past. I really wish that our generation could instantly forge a better legacy for you. We will keep at it."

- Front Page Headline, Wall Street Journal – "CBO Foresees 2013 Recession Risk. The non-partisan Washington-based Congressional Budget Office warns: 'The U.S. economy will likely fall into recession in the first half of 2013 if large tax increases and scheduled government spending cuts are permitted to take effect in January. The combination of tax increases and spending cuts – often referenced as 'the fiscal cliff' – would sharply reduce the federal deficit, but would temporarily arrest the economic recovery. We are projecting the economy would contract at a 1.3% annual rate in the first six months of 2013.' William Galston, a senior fellow at the Brookings Institution in Washington, commented: 'The idea of piling another recession on top of such a slow and incomplete (economic) recovery is quite horrifying from the standpoint of the well being of average families in this country. It would be unconscionable to permit that to happen, if there were obvious policy alternatives." Wakeup call for Mr. Galston: Try this on as a Republican policy alternative! It's called the Taxpayer Protection Pledge – i.e. no tax increases under any circumstances.

- Front Page Headline, National Post – "EU Urges Greece to Remain in Euro Zone. After nearly six hours of talks at a Brussels meeting with European Union leaders, German Chancellor Angela Merkel informed reporters: 'We want Greece to stay in the Euro, but we insist that Greece honours the commitments to which it has agreed.'

German Chancellor Angela Merkel (second from left)
Source: AFP/Getty Images


The euro breaks below $1.26 (U.S.)
Source: MarketWatch News

THURSDAY, MAY 24TH

- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 2,000 to 270,000 in the week ended May 19th. from a revised 272,000, while continuing claims fell by 29,000 to 3.26 million in the week ended May 12th. The number of people who have exhausted their traditional benefits but are now receiving emergency or extended benefits under state or federal programs declined by 4,800 to about 3 million in the week ended May 5th. Only 15 states and the District of Columbia were offering extended benefits during that period.

- The Commerce Department reports U.S. durable goods orders rose by 0.2% in April, following a 3.7% decline in March, citing a drop in demand for computers, electronics equipment and heavy machinery. In addition, core capital goods orders – considered a proxy for business investment plans – fell by 1.9%, after a 2.2% drop in March.

- Eurostat reports the euro zone composite purchasing managers' index (PMI) – comprising both the manufacturing and service sectors – declined to a reading of 45.9 in May from a level of 46.7 in April; marking its 9th. consecutive month below the 50-level which separates economic growth from contraction. Peter Dixon at Commerzbank commented: "We are definitely in a period of weakening global (economic) growth. It doesn't quite feel like 2008 yet, but the danger is we could get there very quickly."

- HSBC reports its 'flash' China purchasing managers' index (PMI) – its preliminary indicator of China's industrial sector – declined to a reading of 48.7 in May, from a final reading of 48.3 in April. It marked the 7th. consecutive month that the PMI has been below the 50 level. Nikolaus Keis at UniCredit noted: "This series of very disappointing activity data from China – exports, imports, industrial production and retail sales indicators – all fell short of the most pessimistic forecasts. This PMI gauge for May is a further signal that internal and external headwinds are still biting into the economy."

- Markit Economics reports its 'flash' U.S. purchasing managers' index (PMI) declined to a reading of 53.9 in May from a level of 56 in April. Chris Williamson, chief economist at Markit, commented: "The cause (of the decline in the PMI) seems to lie largely with weak export sales, which likely reflects the deteriorating economic situation in Europe; as well as slower (domestic economic) growth in China."

- The Toronto-Dominion Bank reports a net profit of $1.69 billion (CAD) for the 2nd. fiscal quarter ended April 30th.. up from $1.4 billion (CAD) in the same period a year ago. However, the bank acknowledged that the pace of its earnings growth will be difficult to maintain, due to slower loan growth, record low interest rates squeezing profit margins and new regulations posing challenges.

- The Royal Bank of Canada reports a net profit of $1.56 billion (CAD) in the 2nd. quarter ended April 30th. – down 7% from the same period a year ago – citing a $202 million (CAD) loss provision realized on the buyout of RBC Dexia Services in April, 2011. In a conference call, RBC Chief Executive Officer Gordon Nixon commented: "These results, with the exception of the Dexia numbers, are very clean and they reflect solid performance in the Canadian banking, capital markets, insurance and wealth management segments."

- The Munich-based Ifo Institute reports its German business confidence index declined to a reading of 106.9 in May – following a level of 109.9 in April – the lowest since November 2011. Gilles Moec, European economist at Deutsche Bank warned: "Heightened financial market tension created by uncertainty over Greece, is likely to weigh further on consumer confidence, firms' investment decisions and crucially on banks' lending intentions."

- Front Page Headline, Reuters – "Spain's Debts Keep Rising / Miners Begin Strike. Spanish government sources confirm officials are at odds over how to refinance 36 billion euros of bonds maturing this year, as revealed in the budget plans from 17 autonomous communities. Spain's weak banks and overspending regions are at the heart of the euro zone debt crisis, due to concerns that expensive bailouts of ailing banks, such as the country's fourth largest lender Bankia, could force Spain itself to seek an international financial bailout. Economy Minister Luis de Guindos favours a centralized mechanism to control and issue debt for the regions, while others would prefer a system under the auspices of his ministry and based on lines of credit from the central government to regions which meet their deficit targets. The regions account for about 50% of the country's overall public spending and are responsible for their health care and education budgets, where cuts are likely to be made. The situation is especially difficult in Spain's two most indebted regions, Catalonia and Valencia, which account for about 60% of all regional debt maturing this year. Separately, Spanish coal miners began four days of strikes yesterday, to protest against cuts to government subsidies, which they argue will lead to the collapse of the sector. The strike call by Spain's two biggest unions affects about 8,000 workers in the 40 coal mines that remain open in the country."

## FRIDAY, MAY 25TH

- Front Page Headline, Bloomberg News – "Greek New Democracy Party Leads in Six Opinion Polls. Greece's New Democracy Party places first in all six opinion polls published in the country today, as party leader Antonis Samaras observed that the cost of leaving the euro zone would be greater than staying within the European Monetary Union (EMU). In a speech to party activists, Mr. Samaras noted: 'By unilaterally breaking its loan agreements with international lenders, Greece would go bankrupt and incur greater suffering.' According to a Kappa Research poll, New Democracy, which supports Greece's international bailout agreements, led by as wide a margin as 5.7% over Syriza, the main party opposed to the EU austerity measures."

- Front Page Headline, Bloomberg News – Iran Doubles Enriched Uranium Stockpile. According to a report by International Atomic Energy Agency (IAEA) inspectors, Iran tripled its production of 20% medium-enriched uranium in the three months ended February 24th. This material has world powers concerned that Iran may eventually use it to construct a nuclear weapon. Fereydoon Abbasi-Davani, the director of Iran's Atomic Energy Organization, responded to the report citing 'there is no reason to end enrichment of uranium at 20% concentration', which is easy to transform to the 90% level needed for a bomb.

- Front Page Headline, Globe and Mail – "S&P Lowers Credit Ratings for Five Spanish Banks. Standard and Poor's lowers its rating for Banco Popular, Bankinter and Bankia to 'BB' (High) from 'BBB' (Low); as well as the ratings of Banca Civica and Banco Financiero de Ahorros (Bankia's parent company). The credit rating cuts to 'BB' (High) take those banks into junk territory, underscoring the risks to the nation's financial sector.

- Front Page Headline, Wall Street Journal – "Moody's Downgrades Major Nordic Banks. Moody's Investor Service downgrades the credit ratings of a range of major Scandinavian banks including Sweden's Nordea Bank and Handelsbanken and Norway's DnB by one or two levels to 'AA3', citing their strong reliance on wholesale funding, low profit margins and low asset quality. Moody's elaborated: 'The funding and margin issues leave the banks susceptible to unexpected losses from which it would be a challenge for them to rebuild capital. There are also risks to asset quality, with the Swedish economy exposed to weakness in Europe and the banks' variable rate mortgage inventories vulnerable to interest rate changes."

- The Conference Board of Canada reports its consumer confidence index rose by 5.8 points to a reading of 80.8 in May, basically reversing a comparable downturn in April

- Front Page Headline, Cable News Network (CNN) – "What's a Trillion U.S. Dollars? A reminder from CNN that while a billion is a thousand million, a trillion is a thousand billion. Put in perspective, a trillion dollars is the number 1 followed by 12 zeros – or visualize this: one trillion $1 dollar (U.S.) bills stacked one on top of the other would extend nearly 68,000 miles (109.4 kilometers) into the atmosphere, or about a third of the way from the Earth to the moon.

- Front Page Headline, A Blog Link from the Slog – "An Allegory – Ship of Fools." Housed in the Paris Louvre, Dutch artist Hieronymus Bosch's 500-year old painting 'Ship of Fools' strikes a chord with various financial operators of the 21st. century – be they investment bankers, central bankers, finance ministers, hedge fund managers, corporate treasurers, chief executive officers or just plain stockbrokers – all, to some degree or other, have a reserved seat in the 'Ship of Fools.' In his oil on wood, 'Bosch is imagining that the whole of mankind is voyaging through the seas of time on a ship, a small ship that is representative of humanity. Sadly, every one of the representatives is a fool. This is how we live says Bosch: we eat, drink, flirt, play silly games, and pursue unattainable objectives. Meanwhile, our ship drifts aimlessly, and we never reach the harbour. The fools are not irreligious, since prominent among them are a monk and a nun, but they are all those who live 'in stupidity'. Bosch laughs and it is a sad laugh. Which one of us does not sail in the wretched discomfort of the ship of human folly? Eccentric and secret genius that he was, Bosch not only moved the heart, but also scandalized it into full awareness. The sinister and monstrous things that he brought forth are the hidden creatures of our inner self-love: he externalizes the ugliness within, and so his misshapen demons have an effect beyond curiosity. We feel a hateful kinship with them. The 'Ship of Fools' is not necessarily about other people, it is about us."

Bosch's 'Ship of Fools'. Source: The Slog.

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| CLOSING LEVELS FOR FRIDAY, MAY 25TH. | | WEEKLY CHANGE |
|---|---|---|
| Dow Jones Industrial Average | 12,454.83 | + 85.45 points |
| Spot Gold Bullion (July) | $1,568.90 (U.S.) | – $23.00 per oz. |
| S&P / TSX Composite | 11,576.47 | + 295.63 points |
| 10-Year U.S. Treasury Yield | 1.74% | + 2 basis points |
| Canadian Dollar | 97.13 cents (U.S.) | – 0.83 cent |
| U.S. Dollar Index Future (Spot Price) | 81.981 cents | + 0.892 cent |
| WTI Crude Oil (July) | $90.86 (U.S.) | – $0.62 per barrel |

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