Monday May 28th, 2012

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, May 28th

Front Page Headline, Globe and Mail – "Spain's Bond Yields Spiral as Debt Crises Deepens.

Monday, MAY 28TH

- The yield on Spanish 10-year bonds spikes above 6.50% as Prime Minister Mariano Rajoy informs a news conference: 'There are major doubts over the euro zone and that makes the risk premium for some countries very high. That's why it would be a very good idea to deliver a clear message there's no going back for the euro. There will not be any (European) rescue (required) for the Spanish banking system.' While Prime Minister Rajoy supports the proposal that the new European Stability Mechanism (ESM), which is set to replace the existing European Financial Stability Fund (EFSF) in July, be empowered to lend directly to banks; government sources told Reuters that Spain may bolster Bankia's balance sheet with sovereign bonds in return for shares in the bank." See Economic Winter, The Pain in Spain is Far From on the Wane, May 18, 2012.

- The Canadian Real Estate Association (CREA) reports the national MLS Home Price Index rose to a reading of 154.7 in April, up 5.2 points on a year-over-year basis, led by metropolitan Toronto. In a news release, CREA President Wayne Moen commented: "Canadian home price gains are generally expected to moderate, however, there are a few hot spots where prices are being fuelled by … a tight housing supply. Toronto has less than two months of supply compared to six months nationally.

- Front Page Headline, Financial Times – "Greece Warned of Public Finances Collapse. Former Greek Prime Minister Lucas Papademos warns: 'Greece's public finances could soon collapse, leaving salaries and pensions unpaid, unless a stable government emerges from the forthcoming June 17th. election. Conditions are deteriorating faster than expected with cash flow likely to turn negative in early June, amid a sharp decline in tax revenues and a loosening of spending controls.' Mounting anxiety that Greece will experience further political instability and a possible exit from the euro zone has prompted many Greeks to postpone making tax payments and has also recently accelerated withdrawals of deposits in excess of 3 billion euros from local banks."

- Front Page Headline, Financial Times – "Moody's Warns on LBO Debt Defaults. In a new report, Moody's Investors Service warns: 'Europe's struggling economy, stricken banks and turbulent financial markets will cause at least 25% of Europe's 254 unrated private equity deals with debts totaling 133 billion euros to default by 2015. If the continent's high yield bond market – a vital source of funding for new and existing leveraged buyouts (LBOs) by private equity groups – shuts down for extended periods, this figure could double.' While Moody's declined to name which companies fell under its unrated universe, fund managers stated it probably included Alliance Boots, the biggest LBO in European history at 12.4 billion pounds. Overall, Moody's noted the U.K. represented the biggest part of the looming maturity wall, with 54 billion euros of debts coming due over the next three years, followed by Germany and France."

Tuesday, MAY 29TH

- The New York-based Conference Board reports its U.S. consumer confidence index declined to a four-month low reading of 64.9 in May from a revised level of 68.7 in April

- According to the S&P/Case Shiller index of property values, home prices in 20 U.S. cities declined by 2.6% in the 12 months ended March 31st. – the smallest one-year drop since December 2010 – following a 3.5% decline in February

- The Spanish government reports the nation's retail sales declined by a record 9.8% in April, prompting the Bank of Spain to warn that "the economy (GDP) will contract again in the current quarter." While the yield on Spanish 10-year bonds hovers at 6.50%, the yield on Spain's 2-year notes spikes to 4.7%, more than double their 2.2% yield level of just two months ago.

- Front Page Headline, King World News – "A Primary Bear Market Signal Has Been Confirmed: Richard Russell. The long-time author of the Dow Theory Letters recommends: 'Investors should follow a course of utmost caution. The Dow Jones Industrial Average recorded a high of 13,279.32 points on May 1st. This DJIA high was unconfirmed by the Transports Average. The two averages then turned down and broke below their April lows. This action confirmed that a primary (equity) bear market is in progress. It was a textbook bear (market) signal."

Dow Jones World Stock Index Source: Stock Charts.com

Wednesday, MAY 30TH

- The National Association of Realtors reports the index of U.S. pending home sales declined by 5.5% in April, following a revised 3.8% gain in March. Yelena Shulyatyeva, an economist at BNP Paribas in New York commented: "The pattern of housing demand is sluggish and volatile. Until the supply issue is resolved, we could see further declines in (house) prices and the housing market will continue to hover around the bottom. The market may ultimately improve gradually; but we don't expect anything better than that."

- Front Page Headline, MarketWatch News – "Spain Ejects Clean Power Industry. Since Spain halted subsidies for new renewable energy projects last January, companies such as wind turbine manufacturer Gamesa Corp. Tecnologica SA and solar park developer T-Solar Global SA are locked out of their home market for new business. In an interview, European Wind Energy Association CEO Christian Kjaer commented: "They destroyed the Spanish market overnight with the moratorium."

- Front Page Headline, Bloomberg News – "Moody's Downgrades Nine Danish Financial Institutions. In a statement released in London, Moody's Investors Service downgraded the credit rating of Danske Bank A/S – Denmark's largest bank – from A2 to Baa1, citing 'an (economically) weak operating environment, pressurized asset quality and poor profitability.' Other Danish bank credit ratings downgraded by two levels included Jyske Bank A/S and Sydbank A/S; while Spar Nord Bank A/S and Ringkjoebing Landbobank A/S were reduced by one level."

- The European Commission (EC) reports its economic sentiment indicator declined by 2.3 points in May to a reading of 90.6, its lowest level in 30 months, citing falling confidence across all business sectors, especially in the manufacturing and retail industries

- Front Page Headline, Financial Times – "Investors Rush for 'Safe Havens' as Euro Debt Fears Soar. Yield levels for 10-year U.S. Treasurys, German Bunds and U.K. Gilts reach new lows as investors react to perceived disjointed policy responses to the sovereign debt crises in Spain and Italy. The yield on 10-year U.S. Treasurys fell as low as 1.62% – a level last attained in March 1946 – while the yield for German Bunds of similar maturity reached a record low of 1.26% and the yield on 10-year U.K. Gilts hit 1.64% , the lowest yield since records commenced in 1703. Gary Jenkins, CEO of Swordfish Research – an independent credit analysis company – commented: 'These are extremely (low yield) levels because we are in an extremely perilous situation. Investors just want to put their money some place where they think they will get it back … Spain is too big for half measures. The next intervention cannot be just massive in size; it must display a total commitment." At Longwave Analytics, we believe it is just a matter of time before the sovereign debt crisis spreads to the United Kingdom and the United States, at which point both nations will lose their perceived 'safe haven' status.

- Front Page Headline, Daily Telegraph U.K. – "EC Warns UK School Standards Threaten Economy. A key report from the European Commission warns: 'Britain's poor educational standards pose one of the biggest threats to the long-term success of the economy. Too many students in the U.K. are leaving school functionally illiterate and innumerate with no qualifications, at a time when the economy increasingly needs medium and highly skilled workers. By focusing on basic skills training, rather than addressing the chronic problem of student dropouts, government education policy is not helping. The U.K. continues to have too many people with low skill levels, resulting in inequality and skills mismatches. The economic costs of this problem are likely to increase over time, if it is not effectively addressed. Britain has higher levels of student dropouts – currently 15% – than the European Union (EU) average for all subgroups except for migrants … In addition, the U.K. housing market remains a long-term threat to economic stability. Household debt is too high and can only be rectified if house prices decline relative to disposable incomes. Planning restrictions and the undersupply of new homes has allowed the housing market to overheat, creating a dangerous internal imbalance that is a source of macroeconomic instability."

- Front Page Headline, Daily Telegraph U.K. – "Doctors Striking to Protect 50,000 Pound a Year Pensions. Experts in the pension field prescribe a reality check for doctors threatening strike action, pointing out that medical professionals comprise 75% of public sector workers who enjoy index-linked pensions in excess of 50,000 pounds ($77,500 U.S.) a year. Actuaries, the mathematicians who advise pension funds, calculate that the average doctor retires on an index-linked, risk-free final salary pension of 48,000 pounds ($74,400 U.S.) a year. By comparison, their patients would need to save more than one million pounds ($1,550,000 U.S.) to purchase that much income, which is why only one in 20 savers buying private sector pensions with an annuity, can afford any inflation protection at all … While final salary pension plans remain the norm in the public sector, doctors classing themselves 'unfairly targeted' by the changes in the public sector may find a lack of sympathy from a person waiting for a hip replacement operation, especially when that person may be on a state pension of 107 pounds ($166.00 U.S.) a week."

- Front Page Headline, the Business Insider – "We're in a State of Total Emergency: Felipe Gonzalez. Spain's ex-premier and elder statesman Felipe Gonzalez warns: 'This is the worst (economic) crisis we have ever lived through.' The warning was issued as the yield on Spanish 10-year bonds hovered around 6.50% – 525 basis points over comparable German bunds and as the IBEX index of stocks in Madrid has declined to levels prevalent in 2003. Spain is in a state of financial crisis which demands some kind of rapid response from the European Union."

Spain's IBEX stock market index Source: Bloomberg News

Thursday, MAY 31ST

- Payrolls processor Automatic Data Processing Inc. (ADP) reports the average monthly gain for U.S. private sector payrolls over the April/May period is 123,000 compared with a pace in excess of 200,000 during the 1st. quarter. Joel Prakken, Chairman of Macroeconomic Advisors which produces the report for ADP, commented: "The sharpness of the deceleration (in the pace of hiring) seems consistent with other incoming data suggesting the economy is being weighed down by heightened uncertainty over the European sovereign debt crisis and by growing concerns about domestic fiscal policy."

- The Commerce Department reports the U.S. gross domestic product (GDP) rose by a revised 1.9% annual pace during the 1st quarter, down from the previous estimate of 2.2%. The report also disclosed that corporate profits rose at the slowest pace in over three years and wage gains revised lower at the end of 2011. Richard DeKaser, an economist at Parthenon Group in Boston, commented: "The phrase that (currently) best describes our economy is muddling along."

- The Labor Department reports U.S. initial claims for state unemployment insurance benefits increased by 10, 000 to 383,000 in the week ended May 26th. from a revised 373,000 the prior week, while continuing claims declined by 36,000 to 3.24 million in the week ended May 19th.

- The Institute for Supply Management-Chicago Inc. (ISM) reports its barometer of business activity declined to a reading of 52.7 in May – the lowest level since September 2009 – from a reading of 56.2 in April, citing the sovereign debt crisis in Europe and the economic slowdown in China caused some businesses to reduce spending and hiring. Tom Porcelli, an economist with RBC Capital Markets in New York, commented: "When you're in a fragile economy and the world around you is showing severe stress fractures, it's going to impact us. We're seeing those headwinds blow through the U.S. economy."

- Front Page Headline, Financial Times – "Spain Reveals 100 Billion Euro Capital Flight. Madrid was dealt a double blow today after it revealed that almost 100 billion euros in capital – about 10% of the country's GDP – had left the country in the first three months of the year and the European Central Bank (ECB) President Draghi severely criticized Madrid's handling of Bankia, the troubled Spanish lender. Investor concerns have mounted recently, over Madrid's ability to contain its twin economic and financial crises, which have forced government financing costs to euro-era highs. Data published by Spain's central bank appeared to corroborate earlier assessments by economists that foreign investors were selling Spanish assets, while Spanish banks were increasing their holdings of domestic bonds, aided by cash accessed through the ECB's three-year liquidity operations. Raj Badiani, an economist at IHS Global Insight, observed: 'My concern is that we haven't yet seen the most recent numbers, which could be far worse. We are witnessing a perfect storm." In a damning indictment of Spain's handling of the problems at Bankia, its third largest lender, ECB President Mario Draghi noted that 'national supervisors had repeatedly underestimated the amount a rescue would cost."

- Front Page Headline, Financial Times – "Spain Faces Extra Risk to Financing Costs. As Spain's sovereign debt crisis deepens, investors are warily eyeing a trigger that could send yields on the country's sovereign debt into bailout territory. The number to watch is the difference between the Spanish 10-year yield and that of a basket of 'AAA' rated European debt. If that yield spread remains wider than 450 basis points – as has been the case since Monday – the situation facing Madrid could deteriorate. The reason is LCH.Clearnet, Europe's dominant clearing house. At that level, LCH could decide to impose additional margin requirements on banks using Spain's government debt as collateral to secure short-term funding in repurchase – or 'repo' deals. Such a move risks aggravating the liquidity issues affecting Spanish lenders. Analysts expect LCH to possibly raise the margin requirement within days. LCH typically imposes an additional margin requirement of 15% when the yield spread exceeds 450 basis points. Today, Spain's 10-year bonds were trading at prices reflecting a 470 basis point yield spread."

- Front Page Headline, Financial Post – "Capital Flight Occurring All Over Europe. Peter Schaffric, a fixed income strategist at RBC Capital Markets warns: 'Anecdotal evidence suggests that over most of 2010, 2011 and early 2012, the largest portfolio shifts out of peripheral Europe took place into German bunds and surrounding credits. Yet there is accumulating evidence that this behavior is changing and actual flight out of Europe is taking place."

Friday, JUNE1ST

- The Labor Department reports U.S. non-farm payrolls increased by only 69,000 in May from a downwardly revised gain of 77,000 in April; while the official unemployment rate rose slightly to 8.2% from 8.1% in April

- The Tempe, Arizona-based Institute for Supply Management reports its manufacturing index declined to a reading of 53.5 in May, following a level of 54.8 in April

- The gauge of manufacturing activity in the 17-nation euro zone declined to a 3-year low reading of 45.1 in May – the 10th. consecutive month of contraction – while the unemployment rate rose to 11%, the highest level on record

- The National Bureau of Statistics reports China's purchasing managers' index for its manufacturing sector declined to a reading of 50.4 in May, following a reading of 53.3 in April

- Statistics Canada reports the nation's gross domestic product (GDP) expanded at a 1.9% annual rate in the 1st. quarter, citing consumer spending and total domestic demand grew at the slowest pace since 2009

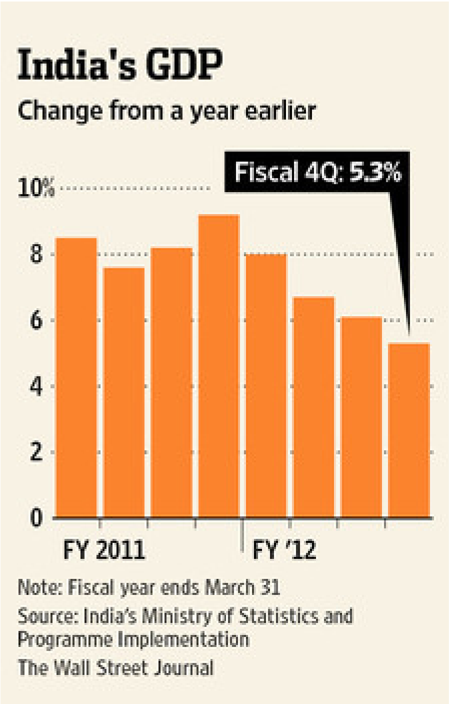
- Front Page Headline, Globe and Mail – "GM Announces Plant Closing in Oshawa, Ontario. General Motors informs the Canadian Auto Workers Union (CAW) that the company will begin shutting down its consolidated assembly line in the 4th. quarter of the year, eliminating 2,000 jobs by June 2013 and reducing the number of GM employees in Canada to about 8,000."

- Front Page Headline, Wall Street Journal – "Europe's Central Banker Urges New Union. In testimony to the European Parliament, European Central Bank (ECB) President Mario Draghi urges Europe's political leaders to establish a centralized euro zone 'banking union to protect depositors and prevent failed banks from threatening the financial system. When regulators are faced with banks needing more capital, they underestimate the problem and then come out with a second, third or fourth assessment; as with the Franco-Belgian bank Dexia and Spain's Bankia. That's the worst possible way of doing things. Everybody ended up doing the right thing, but at a high cost and price." Olli Rehn, a Vice President of the European Commission (EC), put the stakes for Europe in even more stark terms yesterday: 'We need both a genuine stability culture in the euro zone and its member states; as well as a much upgraded capacity to prevent contagion and reduce financing costs for its members. This is the case if we want to avoid a disintegration of the euro zone and instead, make the euro survive and succeed."

- The Bureau of Economic Statistics reports U.S. auto makers registered a 26% increase in sales of new cars and light trucks in May, despite signs the American economy is slowing. General Motors and Ford Motor Corp. reported sales rose by more than 10%. Chrysler Corp. LLC recorded a 30% increase, while Toyota Motor Corp. reported an 87% increase in sales. Researcher Autodata Corp. reported Americans purchased 1.33 million new vehicles in May, an annualized pace of 13.8 million vehicles, up from an 11.7 million rate a year ago, but down from April's 14.2 million pace.

- Front Page Headline, Wall Street Journal – "GM Acts to Pare Pension Liability. General Motors announces plans to reduce its pension obligations by $26 billion (U.S.) by overhauling its American pension plan for retired white collar workers. GM will transfer all assets and obligations of its salaried retirement pension plan and management responsibility to Prudential Financial Inc. via the purchase of a group annuity contract. Approximately, 42,000 of GM's 118,000 salaried retirees will have the option of taking a one-time payment, rather than receiving cheques on a monthly basis. While these pension plan changes require regulatory approval, GM also faces pressure from investors to address the $71 billion (U.S.) in pension obligations to union-represented factory workers. Their pension plan is underfunded by $10 billion (U.S.).

- India's Ministry of Statistics reports the nation's gross domestic product (GDP) rose by 5.3% in the January – March quarter and by 6.5% for the fiscal year ended March 31st. Manufacturing output contracted by 0.3% during the quarter compared to a 7.3% increase in the comparable period a year ago. The agriculture sector, which employs two-thirds of India's work force, grew by 1.7% in the quarter versus a 7.5% gain a year ago. The economic data poses a dilemma for the Reserve Bank of India, which is now faced with a clamor from businesses demanding administrative interest rate cuts to stimulate domestic growth. However, at its next monetary policy meeting on June 18th. it must weigh rising fears of slowing economic growth against continuing high inflation.



- In a press conference, Reserve Bank of India Deputy Governor K.C Chakrabarty warned: 'India's GDP could slide further unless authorities take steps to address fundamental weaknesses in the domestic economy. The rupee is depreciating due to real structural imbalances and financial sector measures (alone) will not solve it."

Protestors demonstrate against a fuel price increase in Mumbai Source: Reuters

- Front Page Headline, Wall Street Journal – "Stockton, Ca. Faces Municipal Bankruptcy Vote. Stockton, population 300,000, has struggled over recent years to deal with its financial problems, after suffering losses from the real estate crash and economic downturn. On Tuesday, June 5th. Stockton's City Council will vote on a resolution that would allow its city manager to declare the city bankrupt, if it is unable to reach an agreement with its creditors by the fiscal year end of June 30th. The City is in negotiations with 19 parties, including retirees, city workers, bondholders and bond insurers; as well as a tax organization that won a lawsuit against the City in 2003. Chapter 9 bankruptcy protection provides a financially distressed municipality with protection from its creditors, while it develops a plan for adjusting its debts."

CLOSING LEVELS FOR FRIDAY, JUNE 1ST.		WEEKLY CHANGE
Dow Jones Industrial Average	12,118.57	– 336.26 points
Spot Gold Bullion (August)	$1,622.10 (U.S.)	+ $53.20 per oz.
S&P / TSX Composite	11,361.20	– 215.27 points
10-Year U.S. Treasury Yield	1.45%	– 29 basis points
Canadian Dollar	96.21 cents (U.S.)	– 0.92 cent
U.S. Dollar Index Future (Spot Price)	82.799 cents	+ 0.818 cent
WTI Crude Oil (August)	$83.23 (U.S.)	– $7.63 per barrel

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