Monday June 11th, 2012

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, June 11th

Front Page Headline, Daily Telegraph UK

- "Spooky Parallels between the Great Depression and the Euro Crisis.

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- In the popular imagination, the (economic) slump of the 1930s was set off by the sharp declines in share prices in the Wall Street Crash of 1929. In fact, the direct effect of the Crash was probably not that great. More important was the international banking crisis which followed the collapse of the Austrian bank, Kreditanstalt, in 1931. This time we have not (yet) had major weaknesses in share prices, but we have experienced a major asset price collapse, namely in real estate prices – in America, Spain and Ireland. As a direct result, we have certainly witnessed a major banking crisis. This was also a key feature of 1930s America. The depressing aspect of today's situation is that the banks are so weakened by the combination of losses on past loans and fears of a euro meltdown, that even administered interest rates close to zero are not having much of a stimulative effect. Moreover, tighter regulation has made banks more risk adverse at just the time that economy recovery demands that they should be more enterprising. Regarding policies to get out of the mess, there are both similarities and differences. In 2009, there was an international conference in London to try to sort out the problem. The same thing had occurred in 1933. Then, as now, it does not seem to have done any lasting good. In the 1930s, the possibility of reaching a global solution was hampered by the difficult relationship between the old hegemonic power, the U.K. and the new powers, Germany, the U.S. and Japan. Today, the U.S. is the declining hegemonic power, squaring off against China and the emerging markets. Then a rigid fixed exchange rate system, the Gold Standard, was a key part of the problem. Today, this role is played by the euro. For good measure, we also have the informal fixed exchange rate system operating between the U.S. and much of the emerging world. Just as today, the Great Depression occurred against a backdrop of the British Government struggling with a high level of debt. Indeed, the problem was much worse. In 1929, the ratio of U.K. Government debt to gross domestic product (GDP) was 162%, compared to only 65% now. Interestingly, in America the equivalent figure was 14%. It did not reach 50% until World War II. Step forward the European Central Bank (ECB), which presides over an economic area roughly as large as the U.S. It has been hobbled by a combination of inexperience and the impossible political pressures created by the euro. As recently as July 2011, the ECB was raising its administered lending rate to head a supposed inflationary danger. Interestingly, it also raised its administered interest rate in July 2008, just as the world was heading into an economic recession. The ECB is still refraining from cutting its administered lending rate to zero, as the economic situation surely demands. In the early 1930s, the world also suffered from weak political leadership. In Germany, Weimar governments bumbled on ineffectively; in France, there was a rapid succession of weak leaders; in the U.K. there was the era of Stanley Baldwin and Ramsay MacDonald; in the U.S. President Hoover famously built a dam, but not much else. There were great leaders around from the past, such as Lloyd George in the U.K. – and those yet to come to power – Winston Churchill and Franklin Roosevelt.

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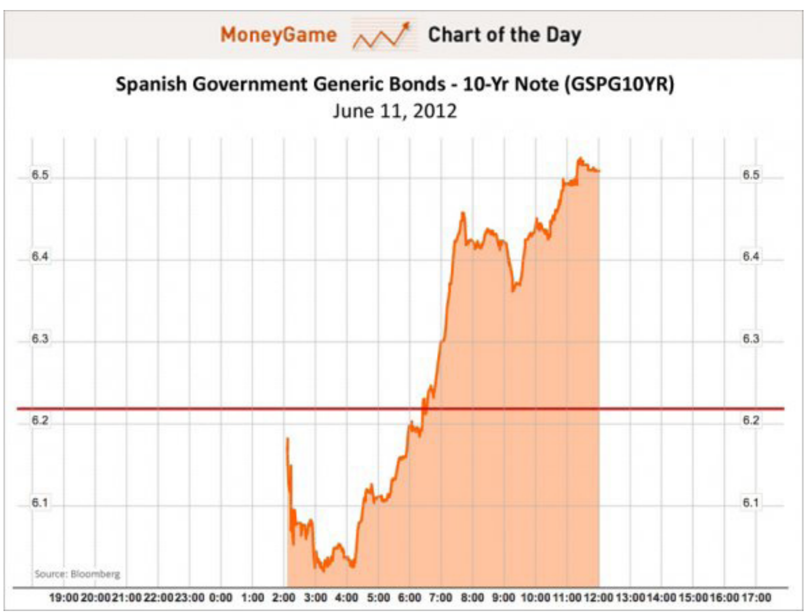
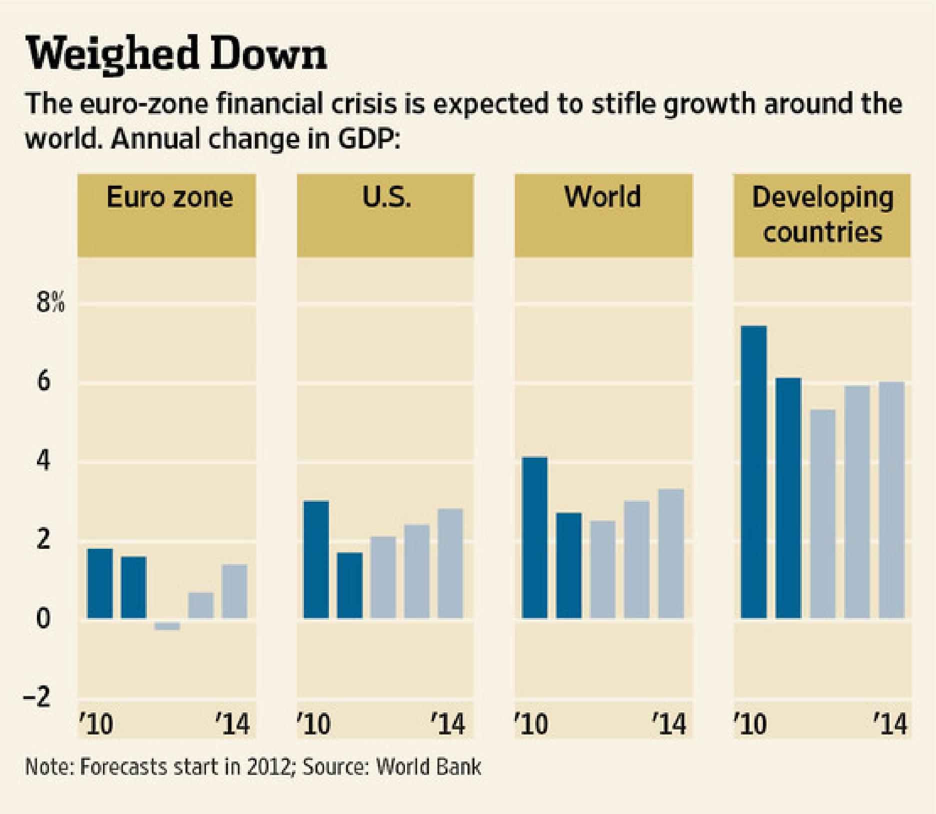
- Front Page Headline, Business Insider, - “The 100 Billion Euro Spanish Bailout Disaster. Following Spain’s request to the European Union (EU) for a 100 billion euro bailout for the country’s banks, a mid-day bond selloff ensued as fixed income investors became concerned that Spain’s outstanding bonds would become subordinate to any new loans from the EU. This angst was readily apparent when the yield on Spanish 10-year bonds traded higher by 29 basis points to close the day at 6.51%. In its request for aid, Spain specified that it only sought assistance for the financial sector – which has been crippled under the dual burdens of a housing bubble and a sovereign debt crisis – and not for the government. However, the Eurogroup’s response to the Spanish request reveals that, whatever Spain’s desires, the loan might come with a bit of the dreaded government conditionality. In its statement accepting the Spanish Government’s appeal for aid, the Eurogroup specified that ‘the policy conditionality of the financial assistance should be focused on specific reforms targeting the financial sector, including restructuring plans in line with EU state-aid rules and horizontal structural reforms of the domestic financial sector.’ However, reports from officials of the EU ‘troika’, the European Commission (EC) the International Monetary Fund (IMF) and the European Central Bank (ECB) would be responsible for administering the loan, troubled investors concerned that the bank funds could be supplied with strict conditions on the Spanish government. In the cases of Greece, Ireland and Portugal, such restrictions have often proved damaging to economic growth, pushing countries deeper into recession.



Tuesday, June 12th

- Front Page Headline, Globe and Mail – “Fitch Downgrades 18 Spanish Banks. Less than a week after Fitch Ratings cut Spain’s sovereign debt credit rating by three levels to ‘BBB’, the agency downgrades CaixaBank, Bankia SA and Banco Popular Espanol; as well as 15 other Spanish banks. In a statement, Fitch expounded: ‘In particular, Spain is expected to remain in recession through the remainder of this year and 2013, compared to the prior expectation that the economy would benefit from a mild recovery next year.’ Separately, in response to Spain’s 100 billion euro ($126 billion U.S.) bailout request for its banks yesterday, James Nixon, an economist with Societe Generale warned: ‘The bailout, equivalent to 9.5% of Spain’s gross domestic product (GDP), will push the country’s ratio of debt to GDP to about 90% in 2013. While the extra debt should not undermine Spain’s solvency, it may yet significantly exacerbate Spain’s funding difficulties.’ Indeed, the yield on Spain’s 10-year bonds rose by another 25 basis points today in active trading, reaching an intra-day high of 6.80%, then closing at a euro era high of 6.72%.

- Front Page Headline, Wall Street Journal – "World Bank Reduces Global GDP Forecast. The World Bank lowers its global gross domestic product growth forecast to 2.5% for 2012, mainly due to concerns emanating from Europe which are depressing tourism, business confidence and international trade in developing economies. World Bank economist Andrew Burns warns: 'We're in very precarious (economic) times yet again, with years of volatility ahead for the global economy, even if Europe manages to calm its sovereign debt crisis for the time being.'



- Front Page Headline, Wall Street Journal – "U.S. Blasts Russia Over Syria. The Obama administration accuses Russia of supplying helicopter gunships to the Assad regime in Damascus, linking Moscow to Syria's deadly civil unrest, as the United Nations' top peacekeeper declared that the conflict now bears the hallmarks of a civil war. U.S. Secretary of State Hillary Clinton announced: 'A shipment of attack helicopters is on the way to Syria from Russia, which will escalate the conflict quite dramatically. We have confronted the Russians about stopping their continued arms shipments to Syria. From time to time they have assured us not to worry because everything they're shipping to Syria is unrelated to their actions internally. That's patently untrue.'

Flames and smoke rising from a building in Homs on June 8th. Source: APF/Getty Images

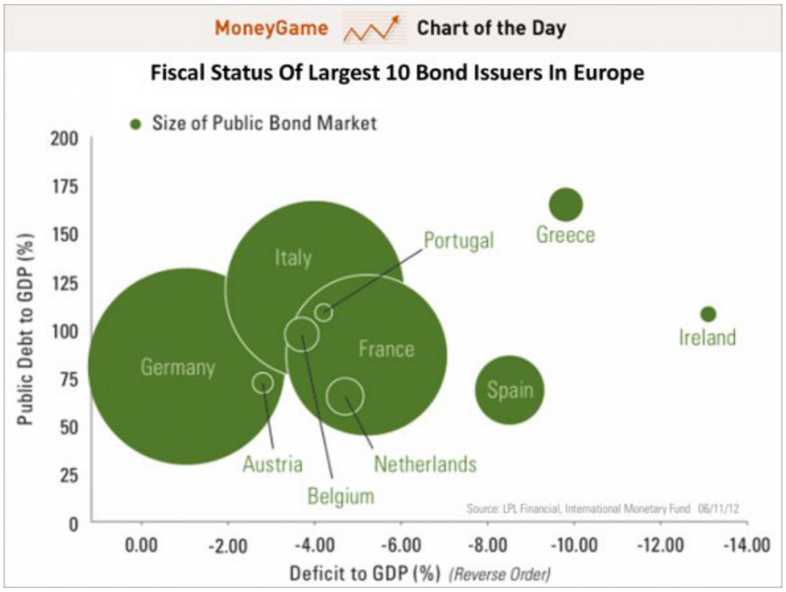
- Front Page Headline, Financial Times - “Russian Protesters Defy Crackdown. Columns of flag-waving, cheering demonstrators stretched out across the Moscow boulevard ring as far as the eye could see. Rather than keep people at home, a tough, new anti-protest law and the arbitrary harassment of protest leaders swelled the ranks of the demonstrators. Filip Dzyadko, former editor of Moscow magazine Bolshoi Gorod – who resigned last week following a clampdown on editorial policy – stated: ‘Every time the Kremlin commits another stupid act, it draws more people out onto the street.’ The law which Mr. Putin signed last Friday states participants at public gatherings – where order is deemed to have been violated with injury or damage to property – can be fined up to 300,000 roubles ($9,200 U.S.), about 60 times the previous maximum.

Thousands of Russians demand an end to Vladimir Putin’s rule. Source: Reuters

Wednesday, June 13th

- The Commerce Department reports U.S. retail sales declined by 0.2% in May led by a 2.2% decline in gasoline sales – the first consecutive monthly drop in two years – following a revised decline of 0.2% in April, previously reported as a gain of 0.1%

- Front Page Headline, Bloomberg News – “Rajoy Declares War on Central Bankers. Addressing the Spanish Parliament in Madrid, Prime Minister Mariano Rajoy related: ‘I am battling central bankers who are refusing to purchase the debt of peripheral euro nations. This is the battle we must wage in Europe and I am waging it.’ Prime Minister Rajoy has also published a letter to European Union (EU) leaders calling for the European Central Bank (ECB) to buy the debt of euro countries struggling to bolster their financial positions.”



- The Labor Department reports the U.S. producer price index (PPI) declined by 1% in May, following a 0.2% decline in April, citing lower prices for food and energy. Jeremy Lawson, an economist at BNP Paribas in New York commented: "The signs are that inflationary pressures are dissipating fairly quickly. From a producer prospective, it means since import costs are low, they can maintain relatively healthy (profit) margins. For consumers, it provides some relief and adds to purchasing power, at a time when their incomes are being constrained by very weak wage growth."

- Front Page Headline, Globe and Mail – "OECD Urges Bank of Canada to Raise Bank Rate. The Paris-based Organization for Economic Cooperation and Development – a high-powered economic research group backed by contributions from its 34 rich country members – offers a scenario: 'An increase in the Bank of Canada's Bank Rate of 25 basis points in the autumn of this year and identical increases on a quarterly basis throughout 2013, putting the administered interest rate at 2.25%. While that would still be a low rate by historical standards, it would likely represent a big enough increase to cause prospective home buyers to think twice before buying at current inflated prices.' The U.S. Federal Reserve has made a conditional pledge to leave its Federal Funds Rate in an extremely low range of 0 – 0.25% through the end of 2014.

- Front Page Headline, Globe and Mail – "Germany Warns Italy over Euro Zone Sovereign Debt Crisis. In an interview with La Stampa daily, German Finance Minister Wolfgang Schaeuble warned: 'If Italy continues along Prime Minister Mario Monti's path, there will be no risks. Italy has made huge progress under Mr. Monti's government which has taken austerity measures and launched pension and labour market reforms, since replacing Silvio Berlusconi's administration last November. This is acknowledged everywhere in Europe and by the markets. I can only hope that political forces in the Italian parliament and public opinion continue to decisively support him, because the road towards a return to sustainable (economic) growth, through structural reforms, improved competitiveness and a lower deficit is the right one."

- Front Page Headline, Daily Telegraph U.K. – "Moody's Slashes Spain's Credit Rating. Moody's Investors Service downgrades the Spanish government's credit rating to Baa3 from A3 and has also placed the country on review for a possible further downgrade. Moody's expects to conclude the review within the next three months. Moody's issued a statement citing: 'The decision to downgrade the Kingdom of Spain's (credit) rating reflects the following key factors: Firstly, the Spanish government intends to borrow up to 100 billion euros from the European Financial Stability Facility (EFSF) or from its successor the European Stability Mechanism (ESM) to recapitalize its banking system. This will further increase the country's debt burden, which has risen dramatically since the onset of the financial crisis. Secondly, the Spanish government has very limited fixed income market access, as evidenced both by its reliance upon the EFSF and ESM for the recapitalization funds and its growing dependence on its domestic banks as the primary purchasers of its new bond issues, who in turn obtain funding from the European Central Bank (ECB). Thirdly, the Spanish economy's continued weakness not only, saps the government's financial strength, but also, increases its vulnerability to a sudden halt to funding. This is an increasingly greater concern than would otherwise be the case, if there was a reasonable expectation of vigorous economic growth within the next few years. The review for a possible further downgrade will focus on the outcome of the ongoing external audits of the Spanish banking system, the conditionality and details of the EFSM/ESM loan agreement and the specific execution strategy developed for the banking system's recapitalization.'

Thursday, June 14th

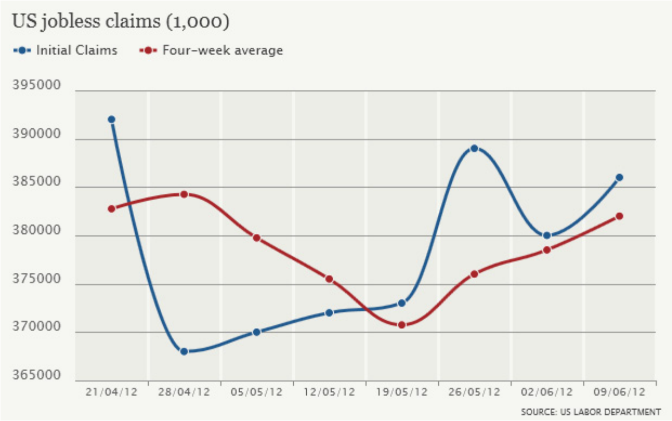
- Front Page Headline, MarketWatch News – "Stanford Sentenced to 110 years in Jail. Convicted of fraud last March, Allen Stanford – former billionaire and principal of Stanford Financial Corp. – is sentenced by a federal court in Houston, Tx. to 110 years in prison for this involvement in a $7billion (U.S.) Ponzi scheme."

- Front Page Headline, Bloomberg News – "Germany Will Lead Debt Crisis Debate: Merkel. In a speech to the Bundestag in Berlin, German Chancellor Angela Merkel stated: 'The European sovereign debt crisis and Germany's role in stemming it will be the central topic at this week's G-20 summit in Mexico. While Germany will use its leadership in the service of European unity, the euro and the global economy, we oppose seemingly easy solutions that risk backfiring. While all eyes are on Germany, we also know that Germany's power is not infinite. So, our responsibility as Europe's largest economy is to deploy our strength credibly, in order that we can be of full use to Europe. Finding a solution is a Herculean task, which requires European nations to embrace political union step by step, relinquishing some national powers in the process."

- Front Page Headline, Globe and Mail – "Massive B.C. Reservoir Could Double Natural Gas Output. Houston-based Apache Corp. reveals tests from a gas well in the Liard Basin – about 150 kilometres northwest of Fort Nelson, B.C. – as 'the most prolific shale gas test in the world in the best unconventional gas reservoir in North America.' Initial results show it contains enough gas to match Canada's entire current output for nearly a decade."

- Statistics Canada reports the nation's new housing price index rose by 0.2% in April, following a 0.3% in March, citing the metropolitan regions of Toronto, Oshawa, On. and Edmonton were the main contributors to the increase.

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 6,000 to 386,000 in the week ended June 9th. from an upwardly revised 380,000 in the week ended June 2nd. previously reported as 377,000



Friday, June 15th

- The Thomson /Reuters University of Michigan preliminary index of consumer confidence declined to a reading of 74.1 this month – the lowest level this year – from a reading of 79.3 in May

- The Canadian Real Estate Association (CREA) reports the nation's home sales declined by 3% in May, as the average house price registered $375,606 (CAD), slightly less than in the same month a year ago

- Rajat Gupta, a former Goldman Sachs board member, is found guilty of conspiracy and securities fraud, for leaking boardroom secrets to a billionaire hedge fund manager. He is the most prominent corporate executive convicted in the government's sweeping investigation into insider trading. Mr. Gupta is one of the 66 Wall Street traders and corporate executives charged with insider trading crimes by Mr. Preet Bharara – the United States attorney in Manhattan – since 2009. O those 60 have either pleaded guilty or been found guilty. Juries have convicted all seven defendants who have gone to trial. Judge Jed Rakoff se Mr. Gupta free until his October 18th. sentencing. He faces a maximum sentence of 25 years in prison.

Rajat Gupta leaving the federal courthouse in Manhattan.

Source: Lucas Jackson / Reuters

CLOSING LEVELS FOR FRIDAY JUNE 15TH.		WEEKLY CHANGE
Dow Jones Industrial Average	12,767.17	+ 222.97 points
Spot Gold Bullion (August)	$1,628.10 (U.S.)	+ $36.70 per oz.
S&P /TSX Composite	11,524.90	+ 24.27 points
10-Year U.S. Treasury Yield	1.73%	+ 9 basis points
Canadian Dollar	97.83 cents (U.S.)	+ 0.40 cent
U.S. Dollar Index Future (Spot Price)	81.488 cents	– 0.951 cent
WTI Crude Oil (August)	$84.03 (U.S.)	– $0.07 per barrel

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