LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, July 16th

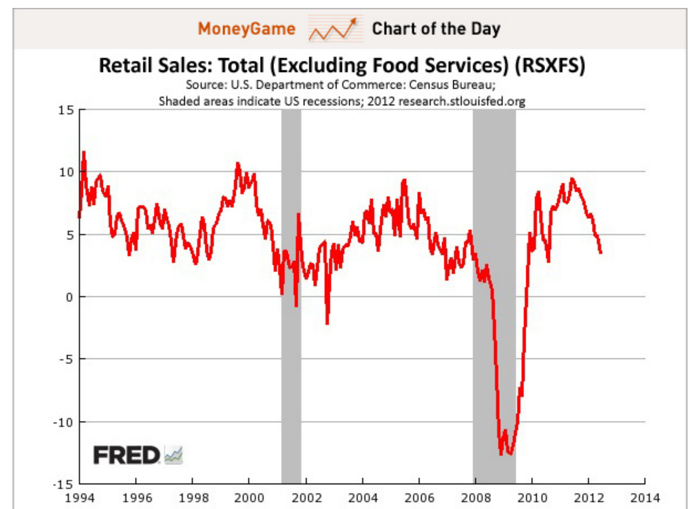
Front Page Headline, Bloomberg News - “Worst Drought in a Generation Assails U. S. Farm Economy.

Monday, July 16th

- The U.S. Department of Agriculture declares at least 1,000 counties in 26 states as natural disaster areas, the broadest declaration ever issued. From Indiana to Arkansas to California, damaged crops and stricken rural economies are threatening to drive food prices to record levels. Michael Swanson, agricultural economist at Wells Fargo in Minneapolis commented: ‘Instead of retreating from record highs, food prices will (continue their) advance. It might be a $50 billion (U.S.) event for the economy, as it blends into everything over the next four quarters.”

A vast corn crop withers for lack of water in the U.S. Midwest.
Source: Daniel Acker / Bloomberg News

- The Commerce Department reports U.S. retail sales declined by 0.5% in June, following a drop of 0.2% in May. Michael Carey, an economist at Credit Agricole CIB in New York commented: “This was certainly a slowdown from the first quarter. Consumers are just pulling back and you’re not likely to see a significant pickup from here.”



- The Federal Reserve Bank of New York reports its regional manufacturing index rose to a reading of 7.4 in July following a level of 2.3 in June. The so-termed Empire State Index surveys New York state, northern New Jersey and southern Connecticut

- Front Page Headline, Irish Times – “Spanish Protestors March on Parliament. Firefighters, police in plain clothes and civil servants attempt to march on the Spanish parliament in a protest over austerity measures, only to find the way blocked by police in riot gear. Police officers got involved in shoving matches with demonstrators in Madrid who numbered more than 1,000 in the latest in a series of demonstrations against deficit-cutting reforms announced last week by Spain’s Prime Minister Mariano Rajoy. Firefighters wore black helmets and some of the police who took part wore shirts identifying them as union representatives. The austerity measures include the suspension of one of 14 pay cheques civil servants receive each year, specifically, the one usually paid just before Christmas. Civil servants’ wages were already cut by an average of 5% in 2010. Spanish consumers also face a higher value added tax (VAT), as well as cuts in government spending and services beginning in September, as part of an austerity package designed to save 65 billion euros through 2015.”

Civil servants shout slogans holding placards during a protest in central Madrid over government austerity measures.
The placards read: ‘This is a stick-up.’ Source: Sergio Perez / Reuters News

- Front Page Headline, Wall Street Journal – “U.S. to Launch Broad Review of Futures Firms. Regulators will conduct a sweeping review of futures firms across America, seeking to ensure that the firms’ bank accounts contain the cash documented. The broad investigation is being initiated in the wake of the scandal at Peregrine Financial Group Inc. where more than $200 million (U.S.) in customer funds has gone missing. In a statement last week, the firm’s founder, Russell Wasendorf Sr. confessed to a 20-year fraud, throughout which he forged bank statements to confound the firm’s regulator, the National Futures Association.”

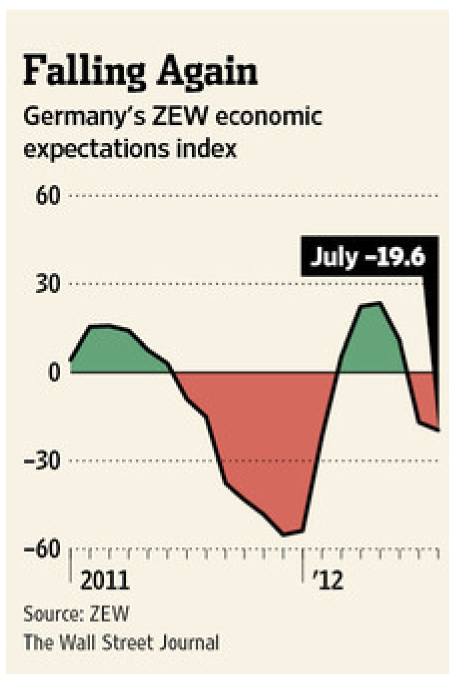
- Front Page Headline, Daily Telegraph U.K. – “Moody’s Downgrades 13 Italian Banks. Moody’s Investors Service downgrades the credit ratings of 13 Italian banks by one or two levels, with Unicredit and Intesa Sanpaolo both being lowered to Baa2 from A3. Moody’s cited: ‘Today’s actions follow the weakening of the Italian government’s credit profile. Along with the increase in the risk of sovereign bond defaults, the downgrade of Italy’s long term credit ratings to Baa2 also indicates a similarly increased risk that the government might be unable to provide financial support to its banks in financial distress. Italian banks have substantial exposure to the domestic economy and high direct exposure to Italy’s (outstanding) sovereign debt.”

Tuesday, July 17th

- The Federal Reserve reports U.S. industrial production rose by 0.4% in June following a 0.2% increase in May, citing gains by auto makers and the output of heavy machinery. Separately, the Labor Department reports the U.S. consumer price index (CPI) was unchanged in June, following a decline of 0.3% in May.

- The National Association of Home Builders/Wells Fargo sentiment index rose by 6 points to a reading of 35 in July, the highest level since March 2007

- The Mannheim-based Center for European Economic Research reports its ZEW Index for German economic expectations declined to a reading of minus 19.6 in July, following a level of minus 16.9 in June



- Front Page Headline, Financial Times – "U.S. States Warned to Confront Fiscal Threats. In a new report, the State Budget Task Force, co-chaired by former Federal Reserve Chairman Paul Volcker and former Lieutenant Governor of New York Richard Ravitch, warns: 'Deep, long-term budgetary problems are threatening the ability of American states to meet their obligations to retirees, creditors and citizens, who rely upon local governments for education, public infrastructure, health care and safety. Pension funds for state and local governments are underfunded by about $3 trillion (U.S.) – using conservative assumptions – and health care liabilities for public sector retirees exceed $1 trillion (U.S.).' Mr. Volcker elaborated: 'Essentially, our goal is to inform the public of the gravity of the issues and the consequences of continuing to postpone actions to achieve structural balance. It is characteristic of markets that they don't react until there is a crisis and they obviously don't perceive this as a crisis today."

Wednesday, July 18th

- The Commerce Department reports U.S. housing starts rose by 6.9% to an annual pace of 760,000 units in June – the fastest pace since October 2008 – following an upwardly revised rate of 711,000 units in May. Stephen Stanley, an economist at Pierpont Securities LLC in Stamford, Connecticut, commented: "Low financing costs certainly help at the margin, but the biggest thing is affordability in terms of the pricing. While housing is making a modest contribution to (GDP) growth, unfortunately, it feels like everything around it is crumbling."

- Front Page Headline, Manchester Guardian - "Euro Zone Leaders Must Take Decisive Action: IMF. As the yield on Spain's outstanding 10-year bonds hovers near 7%, in its annual report on the euro zone's policies, the International Monetary Fund warns the European Central Bank (ECB) must cut interest rates further, commence a sizeable package of quantitative easing and wade into bond markets to drive down sovereign credit financing costs. The IMF expressed concern about 'reinforced bank-sovereign linkages – the increasingly close connection between struggling banks, many holding billions of euros of government bonds and their respective home states – which in many cases have been forced to offer them financial assistance. This vicious circle could further weigh on (investor) confidence, (economic) growth and public debt trajectories.'

- Front Page Headline, Washington Post – "Coalition Urges Tax Increases, Entitlement Cuts to Reduce National Debt. In a news conference at the National Press Club in Washington, a coalition of business leaders, budget experts and former politicians announces a $25 million (U.S.) campaign to build political support for a strategy to raise more money through a simplified tax code and spend less on Social Security, Medicare and Medicaid. Co-chaired by former Pennsylvania Governor Ed Rendell and former New Hampshire Senator Judd Gregg, the campaign proposes to launch a social media drive to persuade lawmakers to approve a plan similar to the Bowles-Simpson framework by July 4, 2013, replacing $600 billion (U.S.) in abrupt tax hikes and sharp spending cuts which are otherwise set to take effect in January. The campaign will also press for one of this fall's presidential debates to be focused on offering plans for debt stabilization, which at $16 trillion (U.S.) is now larger than the American economy. However, the most important development may be the creation of a Business Leaders Council which includes the chief executives of 100 of the Fortune 500 companies. Honeywell CEO David Cote – who also served on the Bowles-Simpson commission – stated: 'The Council will lobby lawmakers on Capitol Hill, as well as people in their own communities. After watching last summer's train wreck, when lawmakers came within days of defaulting on the national debt, there are a lot of us who are a little scared about the $600 billion (U.S.) fiscal cliff looming in January. Going over that cliff would drive a worldwide recession. So, what we're trying to do is get all politicians on all sides mobilized to say, yes, there's a solution here. The math on this is simple. It's the political will that's been lacking.'

- Front Page Headline, Market Intelligence Report – "Twenty Facts Every Investor Should Know about the U.S. National Debt.

1.It took more than 200 years for the U.S. national debt to reach $1 trillion. In 1986, the U.S. national debt reached $2 trillion. In 1992, the U.S. national debt reached $4 trillion. By 2005, the U.S. national debt doubled again and reached $8 trillion. This year, the U.S. national debt is surpassing the $16 trillion mark.

2. If the average coupon rate on U.S. Treasurys increases to just 7%, the U.S. government will be spending more than $1 trillion per annum on interest alone.

3. If today you began spending one dollar every single second, it would take you longer than 31,000 years to spend $1 trillion.

4. Since President Barack Obama took office, the U.S. National Debt has increased by an average of more than $64,000 per taxpayer.

5. Barack Obama will become the first American President to run deficits of more than $1 trillion during each of his four years in office.

6. If you were alive when Jesus Christ was born, and you spent $1 million every single day since that point, you still would not have spent $1 trillion by now.

7. The U.S. national debt has increased by more than $1.6 trillion since the Republicans gained a majority in the House of Representatives. To date, this Congress has added more to the national debt than the first 97 Congresses combined.

8. During the Obama administration, the U.S. government has accumulated more new debt than it did from the time George Washington became president to the time that Bill Clinton became president.

9. If Bill Gates gave his entire fortune to the U.S. government, it would only cover the U.S. budget deficit for 15 days.

10. Today, the U.S. government debt to GDP ratio is well in excess of 100%.

11. A recently revised IMF policy Paper entitled "An Analysis of U.S. Fiscal and Generational Imbalances: Who Will Pay and How?" projects that U.S. government debt will increase to about 400% of GDP by the year 2050

12. The United States already has more government debt per capita than Greece, Italy, Portugal, Ireland or Spain.

13. At this point, the U.S. government is responsible for more than one third of all the government debt in the entire world.

14. Mandatory federal spending surpassed total federal revenue for the first time ever in fiscal 2011. That was not supposed to happen until about the year 2060.

15. The U.S. government has total assets of $2.7 trillion; but total liabilities of $17.5 trillion, excluding $4.7 trillion of intra-governmental debt currently outstanding.

16. American households are now actually receiving more money directly from the U.S. government than they are paying to the government in taxes

17. The U.S. Federal Reserve purchased approximately 61% of all government debt issued by the U.S. Department of The Treasury during 2011.

18. Today, the U.S national debt is more than 5,000 times larger than it was when the Federal Reserve was first created in 1913.

19. If the federal government began today to repay the U.S. national debt at the rate of one dollar per second, it would take over 480,000 thousand years to pay it off completely.

20. The official government national debt figure does not account for massive unfunded liabilities that the U.S. government faces in the years ahead. According to Laurence Kotlikoff, Professor of Economics at Boston University, the U.S. government is facing a future fiscal gap in excess of $200 trillion.

Thursday, July 19th

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 34,000 to 386,000 in the week ended July 14th. while continuing claims rose by 1,000 to 3.31 million in the week ended July 7th. Those people who have exhausted their traditional benefits but are now receiving emergency or extended benefits under federal or state programs declined by about 85,000 to 2.57 million in the week ended June 30th. Determining whether the labor market is improving or deteriorating has been more difficult in recent weeks because a reduction in the number of auto plant layoffs – typical at this point in the year – has thrown the Labor Department's seasonal adjustment process out of line.

- The New York State Labor Department reports New York City's seasonally adjusted unemployment rate rose to 10% in June, up from 9.7% in May. James Brown, a Labor Department economist, commented: "Despite (reasonably) strong job creation by New York City's businesses, the number of city residents with jobs is essentially flat over the previous 12 months."

- The Spanish Treasury auctions a total of 3 billion euros of 2-year, 5-year and 7-year bonds at yield levels of 5.20%, 6.70% and 7.03%, respectively. Rabobank strategist Richard McGuire commented: "All in all, a relatively soft set of (auction) results with the elevated accepted yields seen here, highlighting the constraints under which Spain continues to labour in terms of maintaining market access."

- Front Page Headline, Reuters News – "Exasperated International Creditors Read Greece the Riot Act. For three days earlier this month, senior inspectors from the troika of the International Monetary Fund, the European Commission and the European Central Bank met with officials of the new coalition Greek government, reviewing a track record of two years of broken promises to international creditors, who have pledged a total of 240 billion euros ($294 billion U.S.), to pull Greece back from the brink of bankruptcy. A troika official – wishing to remain anonymous – commented: 'As we suspected, the Greek ministers had fallen quite badly behind due to the election campaign, but they are trying very hard to put the train back on track. The troika's main task next week is to see how we can get restarted.' A Greek government aide confirmed: 'The troika was clearly angry but mostly fed up. They emphasized that Greece would not get any money unless it showed some progress.' Among a long list of failures, Athens has not completed any substantial privatizations and is behind on tax reform, restructuring the public sector and properly opening up markets and professions."

- Front Page Headline, Reuters News – "Merkel Wins Spanish Bank Bailout Vote. German Chancellor Angela Merkel easily wins a parliamentary vote on a euro zone rescue package for Spanish banks, despite growing unease in her centre-right coalition about the rising cost of Europe's debt crisis for German taxpayers. With each vote on the euro zone's debt crisis, concern about Germany's gradually rising liabilities has hardened, prompting a growing number of coalition lawmakers to rebel in recent decisions and cramping the government's room for maneuver in European policy. Appealing to lawmakers to support assistance for Madrid, German Finance Minister Wolfgang Schaeuble noted: 'Any problems in the Spanish banking sector are a problem for the financial stability of the euro zone."

German Chancellor Angela Merkel — Source: Gero Breloer/AP Photo

- The National Association of Realtors reports U.S. existing home sales declined by 5.4% to an annual pace of 4.37 million units in June, citing a higher median price for a home resale of $189,400 (U.S.), up 7.9% from the same period a year ago

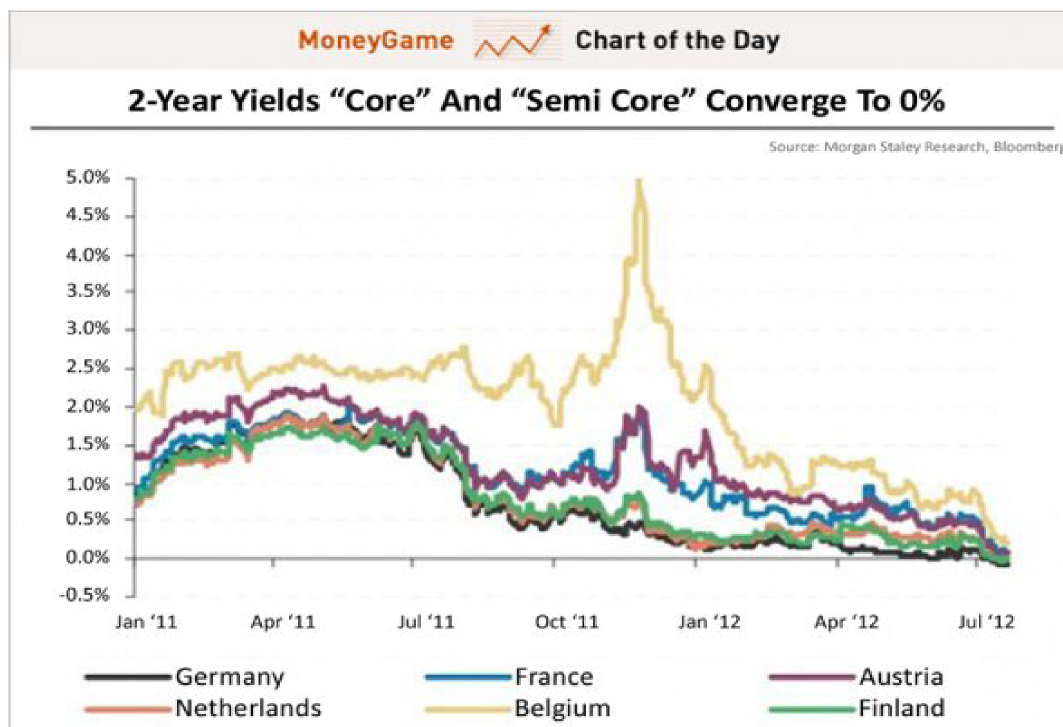
- Front Page Headline, Financial Times – "Big Banks Set to Announce 5,350 Job Layoffs. Three of the world's largest banks are preparing to lay off 5,350 investment bankers, as the banking industry struggles to adapt itself to continuing economic woes and the advent of new regulation. Morgan Stanley is cutting a further 4,000 jobs, Deutsche Bank is preparing to lay off about 1,000 of its investment banking staff, equivalent to about 10% of the unit's work force, while Citigroup is shedding 350 bankers. Citi analyst Kinner Lahkani noted: 'The euro zone debt crisis and the global macroeconomic environment have engendered a cyclically weaker revenue situation; with a possible 10% decline in the overall revenue pool across the banking industry,

in the areas of fixed income, currencies and commodities. Moreover, the whole industry faces structural change. The impact of over-the-counter derivatives reform, the Volcker rule and Basel III could lead to a 15-20% headwind on revenues over the next two to three years."

- Front Page Headline, Daily Telegraph U.K. – "IMF Loses All Faith in Euro Zone. In its latest report on the euro zone – 'Article IV Consultation' – the International Monetary Fund cites: 'The euro area (sovereign debt) crisis has reached a new and critical stage. Despite major policy actions, financial markets in parts of the region remain under acute stress, raising questions about the viability of the European Monetary Union (EMU) itself. The adverse links among sovereigns, banks and the real economy are stronger than ever. Financial markets are increasingly fragmenting along national borders. The euro area is at an uncomfortable and unsustainable halfway point. While it is sufficiently integrated to allow escalating problems in one country to spill over to others, it lacks the economic flexibility or policy tools, to deal with these spillovers. Crucially, the euro area also lacks essential financial and fiscal policy tools to stabilize the monetary union. As the crisis has illustrated, without a strong, common financial stability framework, banking problems are difficult to contain and resolve in an integrated market. Most of southern Europe is at serious risk of a debt deflation spiral and the dangers are masked by the austerity measures themselves. This disinflationary environment in much of the periphery will make it difficult for many countries to reduce the burden of debt. The deepening of the crisis suggests that its root causes remain unaddressed. The crisis calls for a much stronger collective effort now to demonstrate policymakers' unequivocal commitment to sustain the EMU. Only a convincing and concerted move toward a more complete EMU could arrest the decline in confidence engulfing the region. As a result, the pernicious feedback loop among banks and sovereigns, as well as market fragmentation, have been accentuated during the crisis. In some cases, the necessary provision of European Central Bank (ECB) liquidity has led to further sovereign bond purchases by banks, deepening this link even more. The adverse bank-sovereign feedback loops at the heart of the crisis have intensified. Concerns about banks' solvency have increased because of large sovereign exposures, particularly in periphery countries. Some sovereigns, in turn, are struggling to backstop weak banks on their own. Intra-euro area capital flight has created denigrating forces in sovereign bond markets, interbank markets and lending and deposit markets. A failure of a large and systemic bank could test the ability of the ECB and crisis facilities to stem contagion. Moreover, reform slippage at the country level could have large negative spillovers throughout the euro area. The fear of a euro area exit, if not countered swiftly and effectively, could spread to other economies perceived to have similar characteristics. Adverse feedback loops are stronger in a monetary union than elsewhere. These adverse feedback loops are amplified by the absence of a domestic exchange rate that could buffer the impact of intra-euro area sudden stops on the financing costs of sovereigns and that would help compensate the adverse impact of fiscal efforts on domestic demand compression by an exchange rate depreciation stimulating exports. Moreover, sovereign financing costs can rapidly spiral higher if market anticipations become pessimistic, making fiscal adjustment more difficult to achieve unless the monetary authority signals the possibility of future loosening (of monetary policy). Limited labour mobility in the euro area impedes adjustment to idiosyncratic shocks. If workers move in response to differences in wages and job opportunities, they reduce disparities in unemployment rates and real wages across regions. However, while there is some evidence that labour mobility in the euro area has increased in response to the crisis, it remains fairly limited. Only about one per cent of the working age population changes residence within their country in a given year and even fewer move between euro area countries. This compares to about three per cent in the United States, two per cent in Australia and slightly less than two per cent in Canada."

IMF Managing Director Christine Lagarde / EMU Symbol. Source: Daily Telegraph U.K.

- Front Page Headline, The Slog – “Brussels Is All Out of Fantasies. Most of the European Union (EU) members are already debtors – or are on the verge of it – as the European Stability Mechanism (ESM) has attracted close to zero ex-EU investors and European Central Bank (ECB) President Mario Draghi has as good as said that Brussels in general and the euro in particular, are dysfunctional. The entire EU – outside of Germany – is in recession, Greece has all but collapsed as a modern society, Turkey has an eye on Cyprus – as does Moscow – and … under-achiever Christine Lagarde has called time on International Monetary Fund (IMF) contributions.”



Friday, July 20th

- Front Page Headline, Bloomberg News – “Former B of A Executive Indicted for Fraud. According to an indictment filed in federal court in Charlotte, N.C., Phillip Murphy – former manager of Bank of America’s municipal derivatives desk – is charged with conspiracy to defraud the United States, wire fraud and conspiracy to make false entries in the bank’s records. In a statement, Scott Hammond – a deputy assistant attorney general in the Department of Justice Antitrust Division – elaborated: ‘Allegedly, Mr. Murphy participated in a complex fraud scheme and in conspiracies to manipulate a process which was supposed to be competitive. Recently at trial, the Division convicted several individuals in this investigation, which is ongoing.’ To date, thirteen former employees of Bank of America, JP Morgan Chase and UBS AG have pleaded guilty in the Justice Department’s investigation and who together with Wells Fargo and General Electric have paid more than $700 million (U.S.) in restitution and penalties.”

- Front Page Headline, Thomson Reuters – “ECB Applies More Pressure on Greece, Curtails Collateral. Until a scheduled review of Greece’s bailout program is completed, the European Central Bank announces it is curtailing acceptance of Greece’s sovereign bonds and other collateral Greek banks use to access ECB funding. This ECB move – which analysts believe is aimed at increasing pressure on Athens to adhere to the commitments of its EU/IMF bailout – will force Greek banks to turn to their national Central Bank for Emergency Liquidity Assistance (ELA) funds. Those funds will be more expensive than funding available from the ECB’s regular liquidity operations. In a statement, the European Central Bank confirmed: ‘The ECB will assess their potential eligibility following the conclusion of the currently ongoing review – by the European Commission in liaison with the ECB and IMF – of the progress made by Greece under the second adjustment program.”

- Front Page Headline, Daily Telegraph U.K. – "Spanish Police Battle Anti-Austerity Protestors. Police fired rubber bullets to disperse crowds yesterday, as tens of thousands of angry Spaniards protested in 80 cities against the government's latest austerity package. Protestors flooded Madrid's main Puerta del Sol Square and the streets in front of parliament late into the night. Large deployments of riot police manned barricades in front of the legislature, fearing rising tensions could lead to violence. Large crowds also gathered in Barcelona and Bilbao, while leading Spanish newspaper El Pais estimated that more than 100,000 people had attended the rally in the capital. Marchers in Madrid carried Spanish flags bearing black bows for mourning and banners citing: 'No To the Cuts' and 'You Have Ruined Us."

Spanish protestors take to the streets of Madrid. Source: Associated Press

- Front Page Headline, Daily Telegraph U.K. – "IMF Suppressed Signs That Europe Was Facing Debt Crisis: Former Employee. In a blistering resignation letter, Peter Doyle, an economist in the International Monetary Fund's European Department, also used the letter to attack the appointment of Christine Lagarde, the IMF's Managing Director. The allegations are particularly embarrassing coming from someone who until last month was a senior official at the Washington-based institution and at a time when Europe's sovereign debt crisis shows little sign of easing. In a letter to Shakour Shaalan, Chairman of the IMF's Board of Directors, Mr. Doyle wrote: 'The substantive difficulties in these (debt) crises, as with others, were identified well in advance but suppressed here (at the IMF). The failure of the Fund to issue warnings was a failing of the first order, even if such warnings may not have been heeded. This failure has led to suffering in Greece and elsewhere, and left the IMF playing catch-up and reactive roles in last-ditch efforts to save the euro.' Mr. Doyle, whose 20-year career at the IMF included postings in Sweden, Denmark and Israel, also criticized the election of Ms. Lagarde: 'Even the current incumbent is tainted, since neither her gender, her integrity, nor, elan can compensate for the fundamental illegitimacy of the selection process.' The selection procedure for the top job at the IMF has come under increasing criticism for failing to reflect the changing economic balance of power in the world. Since the IMF's founding in 1944, a European has always occupied the highest office; while an American has always been President of the World Bank. It is not the first time that the IMF's approach to Europe's sovereign debt crisis has drawn criticism. In July 2011, an independent evaluation commissioned by the IMF concluded it had failed to criticize the fundamental weaknesses of the European Monetary Union (EMU). The evaluation added that the IMF's 'eagerness to play a role in the complex European policy process reduced the IMF's effectiveness to be an independent and critical observer of the European area.' In response, the IMF stated: 'We have no evidence Mr. Doyle's views were suppressed, or that any views were suppressed."

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CLOSING LEVELS FOR FRIDAY, JULY 20TH.		WEEKLY CHANGE
Dow Jones Industrial Average	12,822.57	+ 45.48 points
Spot Gold Bullion (September)	$1,582.80 (U.S.)	– $9.20 per oz.
S&P TSX Composite	11,622.91	+ 108.38 points
10-Year U.S. Treasury Yield	1.46%	– 3 basis points
Canadian Dollar	98.27 cents (U.S.)	– 0.29 cent
U.S. Dollar Index Future (Spot Price)	83.658 cents	+ 0.37 cent
WTI Crude Oil (September)	$91.83 (U.S.)	+ $4.73 per barrel

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