Monday August 27th, 2012

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, August 27th

Front Page Headline, Daily Telegraph U.K. – **"China Announces $1.25 trillion (U.S.) of Economic Stimulus Projects.**

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On a weekend visit to Guangdong – the heartland of China's export industry – Chinese Premier Wen Jiabao promised that the government would intensify its efforts to boost the economy but warned: 'There will still be a lot of challenges and uncertainties in exports going forward ... Many negative factors will continue to affect stable economic operations in the second half and the problems of boosting growth remain relatively large. Facing the current difficulties, we must improve the operating environment for companies and enhance corporate confidence. However, China's economic fundamentals have not changed. We have many good conditions and optimistic factors which will help stabilize economic growth.'

Chinese longshoreman stacks bales of wire cable for export Source: Reuters News

- The Munich-based Ifo Institute reports its German business confidence index – based upon a survey of 7,000 executives – declined for the 4th. consecutive month to a reading of 102.3 in July, following a level of 103.2 in June. Jens-Oliver Niklasch, an economist at Landesbank Baden-Wuerttemberg commented: "Recent economic data are not encouraging. The construction industry and the export industries will experience a slowdown in the coming months."

- The National Statistics Institute reports Spain's gross domestic product (GDP) contracted by a downwardly revised 0.3% in 2010 – previously reported as a 0.1% contraction – and expanded by a downwardly revised 0.4% in 2011 – previously reported as an expansion of 0.7% – citing the nation's exports were weaker than prior calculations

- Front Page Headline, New York Times – **"China's Huge Inventory Stockpiles**. Following three decades of torrid economic growth, China is encountering an unfamiliar problem with its newly struggling economy: huge inventories of unsold goods which are cluttering shop floors, clogging car dealerships and filling factory warehouses. The glut of everything from steel and household appliances to cars and apartments is hampering China's efforts to emerge from a sharp economic slowdown. It has also produced a series of price wars and led manufacturers to redouble efforts to export what they cannot sell domestically. The severity of China's inventory overhang has been carefully masked by the blocking or adjusting of economic data by the Chinese government – all part of an effort to boost confidence in the economy among business managers and investors. However, last week the main private survey of China's manufacturers revealed that inventories of finished goods rose much faster in August than in any month since the survey began in April 2004. Interviews with business owners and managers across a wide range of Chinese industries presented a picture of mounting stockpiles of unsold goods. Business owners who manufacture or distribute products as varied as dehumidifiers, plastic tubing for ventilation systems, solar panels, bed sheets and steel beams for false ceilings reported that sales had declined over the last year and showed little sign of recovering. While the Chinese auto industry has grown tenfold in the last decade to become the world's largest, now it is beginning to look more like Detroit during the 1980s. Inventories of unsold cars are soaring at dealerships across the nation. Quality problems are emerging and buyers are becoming disenchanted as car salesmen increasingly resort to pressure tactics to clear clogged dealership lots. Geoff Broderick, the general manager of Asian operations at J.D. Power & Associates – a global consulting firm – commented: 'I worry that China is going down the same road that the U.S. travelled and it takes quite some time to fix that."

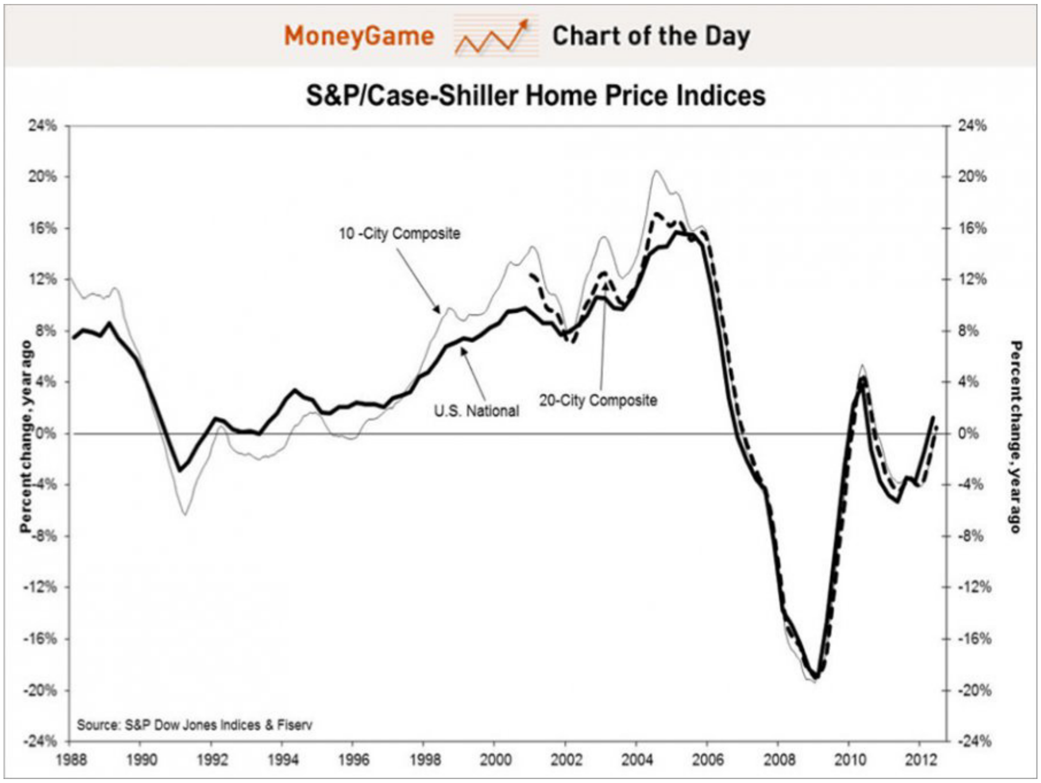
- Front Page Headline, Daily Telegraph U.K. – **"Despite Debt Crises, Britons Continue to Spend Like Drunkards.** There is mounting evidence that a false market is operating in our appreciation of consumer debt, state borrowing and the viability of pensions and healthcare. A baleful gap has emerged between what voters think is occurring and what is really transpiring. This should not be surprising when so many in high offices appear equally baffled. Included in the thought process is a mixture of deceit from unscrupulous politicians, trade union leaders and financial services providers and the result is a broad misunderstanding and a legacy of misery for future generations. Compare this month's update from the British Banker's Association (BBA) on personal debt with forecasts from the Office for Budget responsibility (OBR). The BBA reported: 'We continue to see the household sector increasing deposits and repaying debts … of both mortgages and unsecured lending and growing strongly as households seek to reduce borrowing.' However, the OBR's figures reveal that household debt has risen in every quarter since the beginning of 2011 and is expected to climb by a further 26% – from 1.58 trillion pounds to 2 trillion pounds – by the end of 2016. The credit binge just continues to grow.

  During the decade prior to the credit crunch, Briton's household debt rose from 90% of disposable income to more than 160% and it remains above 150% today. A collective failure to grasp the scale of damage still being done to the economy by persistently overstretched consumers is why policy responses have been so ineffective … As Disraeli noted: 'Statesmen think of the next generation, whereas politicians care only about the next election. Those seeking power keep spending (in order) to buy approbation and then send the bill to people who are not on the electoral register, i.e. those too young to vote being tomorrow's taxpayers.' What we have witnessed is inter-generational theft. In leaving today's newborn babies with ballooning debts, unfunded pensions and a dysfunctional housing market, we have stolen their future and rendered ourselves morally bankrupt."

Mall shoppers at Westfield Shepherds Bush in London. Source: ALAMY

Tuesday, August 28th

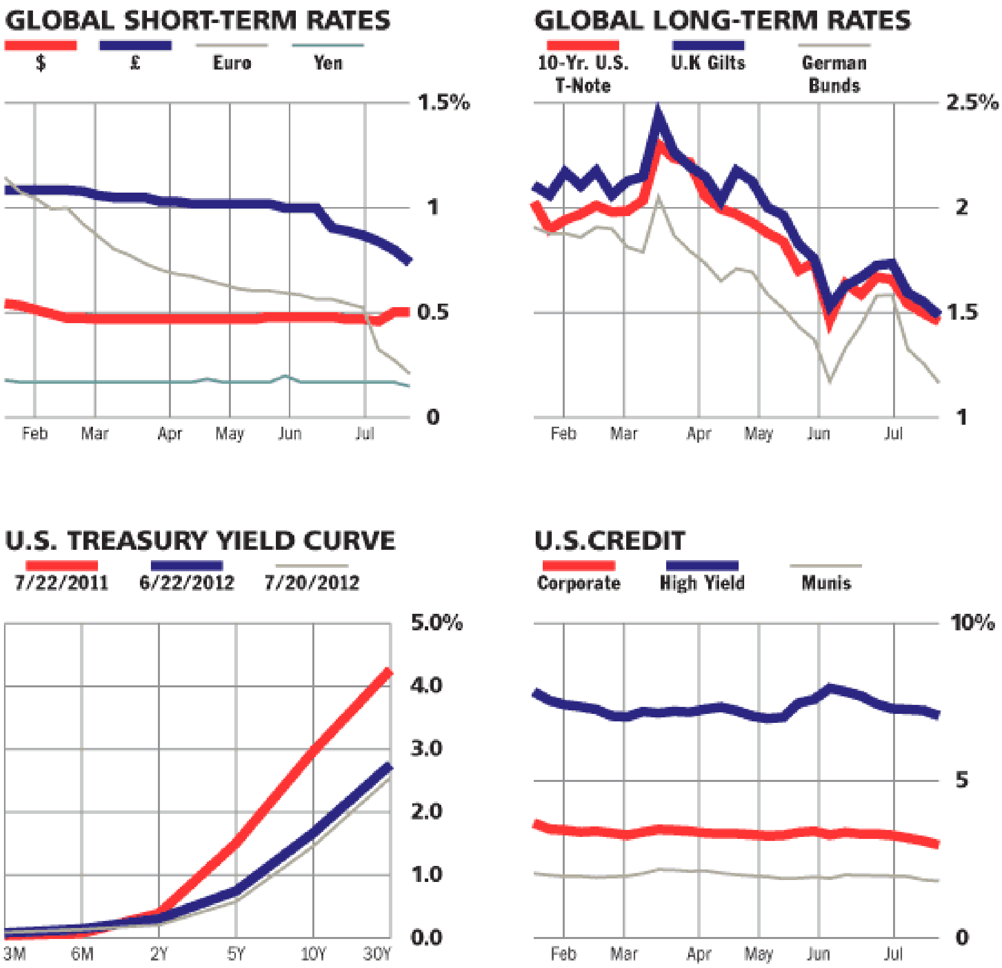
- S&P/Case Shiller reports its U.S. 20-city composite index registered a 2.3% advance in June, matching upwardly revised gains in May and taking the year-over-year move into positive territory – for the first time in almost two years – with a gain of 0.5%. David Blitzer, chairman of the index committee at S&P Dow Jones Indices commented: "We seem to be witnessing exactly what we need for a sustained (housing) recovery; monthly (price) increases coupled with improving annual rates of change. The (housing) market may be finally turning around."



- The New York-based Conference Board's U.S. consumer confidence index declined to a reading of 60.6 in August, following a level of 65.4 in July – the biggest drop in 10 months – citing households grew more pessimistic about employment prospects and the overall economic outlook. Jim O'Sullivan, an economist at High Frequency Economics in Valhalla, New York commented: "The consumer is still very cautious as the labor market remains relatively weak. There's a lot of uncertainty about (fiscal and economic) policy ahead of the (November) election and fuel costs have (recently) accelerated."

- Front Page Headline, The Slog – **"Standby for the Big Guns Barrage**. A Swiss bank credit specialist relates: 'I think too many observers are underplaying the Spanish banking liquidity situation. European Central Bank (ECB) President Mario Draghi knows what to do and how to do it, but I think only in the last few days has he grasped its size and inevitability. We're talking very, very big here: this (bailout) is going to dwarf anything done for Greece and it's going to make the ECB 200% responsible for stopping the (euro) collapse.' The depth of Spain's banking problems was made brutally clear today when affluent Catalonia officially requested a total bailout; hoping to apply for 5.23 billion euros from Madrid. Mr. Draghi has been playing a dangerous game of poker with Madrid … Monies equivalent to 7% of Spain's GDP was withdrawn from its banks during July, a total that overtook anything the European Union (EU) has seen since the euro's inception. Potential ECB bond purchases, notwithstanding, from this point forward it's about an irreversible liquidity decision by the ECB and it's about the euro."

- Front Page Headline, The Business Insider – **“The Global Demise of Pension Plans.** Anyone in the western world who’s 10-15 years away from collecting their first pension payments shouldn’t expect to receive very much, if anything, when the time arrives. Obviously, this is because the global economy has significantly deteriorated. Essentially, it’s also because pension plans are the ultimate pension schemes. Not helping are the U.S. Federal Reserve monetary policies which are based upon maintaining the prevailing level of interest rates (and U.S. Treasury yields) as low as possible. As recently reported in a Barron’s article entitled: Top Pension Fund Sends a Warning, The California Public Employees’ Retirement System (Calpers) – the nation’s largest public pension fund at $233 billion (U.S.) – reported a mere 1% rate of return on its investments in the fiscal year ended June 30th. Earlier this year ... Calpers lowered its discount rate – the actuarial figure determining the amount that must be earned and reinvested now to meet future payout requirements – for the first time in a decade to 7.5% from 7.75%. That figure represents combined assumptions of a 2.75% rate of inflation and a 4.75% rate of return. From the charts depicted below, what we see is hugely unrealistic annual rate of return assumptions combined with equally huge underfunding: i.e. burning at both ends.”



Source: Barrons Statistics / Bloomberg

Wednesday, August 29th

- The Commerce Department reports U.S. gross domestic product expanded by a 1.7% annual rate in the 2nd. quarter ended June 30th., revised from the 1.5% prior estimate

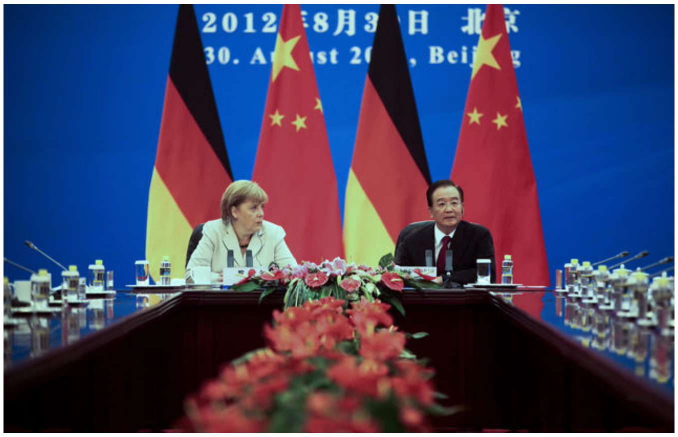
- In its latest Beige Book report of anecdotal information on business activity collected from contacts nationwide, the U. S. central bank cites: “Reports from the twelve Federal Reserve districts suggest economic activity continued to expand gradually during July and early August across most regions and sectors, with employment holding steady or growing only slightly. Many districts reported some softening in manufacturing, either a slowdown in the rate of growth, or a decline in the level of sales, output or orders. Across the districts, few manufacturing firms reported any major hiring or layoffs.”

- Front Page Headline, Financial Times – **“ECB’s Draghi Rebuffs Germans over Euro QE Plans.** In an article published in the German newspaper Die Zeit (The Times), European Central Bank President Mario Draghi rebuffed German criticism of his attempts to stem the euro zone sovereign debt crisis, as the ECB drafts plans to intervene in the bond markets by purchasing government debt issues (also known as quantitative easing). Mr. Draghi stated: ‘It is justified for the ECB to use exceptional measures as part of its mandate to maintain stable prices in the euro zone. Fulfilling our mandate sometimes requires us to venture beyond standard monetary policy tools.’ Mr. Draghi appeared to be addressing the disagreement between ECB officials and Germany’s Bundesbank, Europe’s most influential central bank. The Bundesbank opposes ECB sovereign bond purchases aimed at restraining financing rates for euro zone member states such as Spain and Italy. However, German Chancellor Angela Merkel has expressed support for the ECB’s intended plans. Mr. Draghi elaborated: ‘While there is no need to move to the extreme of a United States of Europe, the euro zone needs a new architecture to create prosperity for all member states. In particular, Germany must remain an anchor of a strong currency, at the center of a zone of monetary stability within a dynamic and competitive euro area economy. Only a stronger economic monetary union can provide this.” Meanwhile, in a recent interview, Bundesbank President Jens Weidman warned: ‘An ECB policy of sovereign bond purchases would be too close to state financing via the money press and risks creating new problems.’ Moreover, Jurgen Stark, a former ECB executive board member, who resigned last year to protest the ECB’s crisis management, was quoted in the German press this week as stating: ‘the ECB has repeatedly crossed red lines.”

Thursday, August 30th

- The Labor Department reports U.S. initial claims for state unemployment benefits were unchanged at 374,000 in the week ended August 25th. matching the upwardly revised figure from the previous week, while continuing claims declined by 5,000 to 3.32 million in the week ended August 18th.

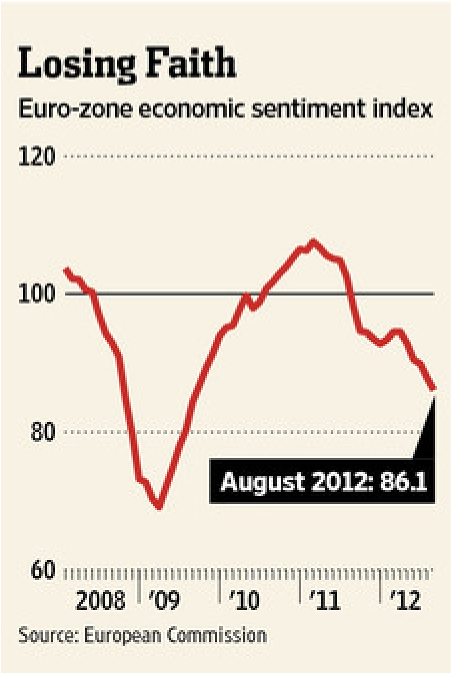
- Front Page Headline, Bloomberg News – **“More Euro Zone Reforms Needed: Wen Jiabao.** Amid bilateral talks in the Great Hall of the People in Beijing, Chinese Premier Wen Jiabao warns German Chancellor Angela Merkel that the southern states of the euro zone must take steps to prevent the region’s sovereign debt crisis from worsening. ‘Our main worries are twofold: First is whether Greece will leave the euro zone and second is whether Italy and Spain will adopt comprehensive rescue measures. Resolving these two problems rests with whether Greece, Spain and Italy and other countries, have the determination to reform.’ With decisions affecting the European Union’s future pending within the coming two weeks – from European Central Bank policy makers, German Constitutional Court judges and the Dutch electorate – Premier Jiabao added: ‘Upon the condition of fully evaluating the risks, China is willing to continue investing in the euro zone sovereign debt market.” **See also, Economic Winter – Will Germany Exit the European Monetary Union, August 17, 2012.**



German Chancellor Angela Merkel and China’s Premier Wen Jiabao.
Source: Getty Images

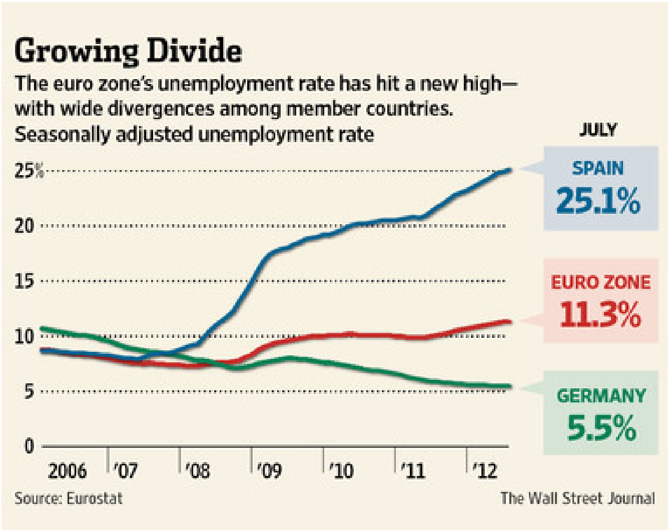
- Back-to-school shopping enabled U.S. retailers to deliver strong sales numbers for August, with Gap Inc., Target Corp., Macy’s Inc. and Nordstrom Inc. leading the industry. The strong retail showing for August belies other consumer concerns as noted by Steven Wood, chief economist at Insight Economics: “Households continue to worry about a difficult job market, the European sovereign debt crisis, the forthcoming ‘fiscal cliff’ challenges; as well as the political gridlock in Washington and the uncertainty surrounding the presidential election campaign.”

- The European Commission (EC) reports its economic sentiment indicator fell to a reading of 86.1 in August from a level of 87.9 in July, the fifth consecutive monthly decline and the lowest reading in three years. Jennifer MeKeown, an economist at consultancy Capital Economics commented: "There is clear evidence here that the euro zone as a whole – not just the periphery nations of Spain, Greece and Portugal – are in need of policy support," making reference to possible action by the European Central Bank.



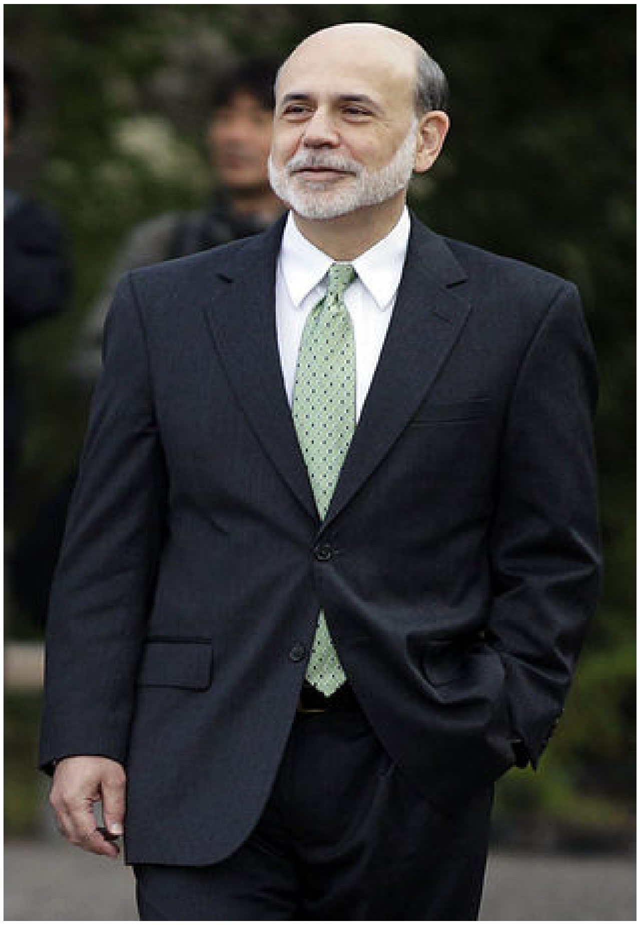
- Front Page Headline, National Post – **"Canadian Banks Post Record 3rd. Quarter Earnings, Boost Dividends.** The driver behind all five big Canadian banks topping analyst expectations by a goodly margin for the 3rd. quarter ended July 31st. was domestic personal and commercial banking operations, which continued to benefit from robust loan growth, mainly residential mortgages. It also marked the first time all five major banks have increased their dividends at the same time. Profit at the country's top lenders rose to $7.8 billion (CAD), up an astounding 45% from the same period a year ago. Banks were also helped by other operations such as capital markets and insurance, although for the most part, it was a question of no unexpected losses or write downs."

- Front Page Headline, Wall Street Journal – **"Euro Sovereign Debt Crisis Faces Judgment Days.** After an uncharacteristically calm August, European policy makers and financial markets are facing a tumultuous autumn marked by major showdowns in key euro zone battlegrounds. For years, policy makers have wondered what would happen if a large euro zone country like Spain, was unable to borrow money in large quantities. Now, they are edging closer to finding out. Demand for Spanish bonds is wilting fast and Spain must issue billions more (euros) to cover its deficits and repay outstanding debt maturing in October. Moreover, a Federal Constitutional Court ruling in Germany, regarding the legality of the European Union's new bailout fund (the European Stability Mechanism) and elections in the Netherlands, in which some lawmakers are advocating a euro zone exit – on the same September 12th. date – could upset the careful politics of Europe's rescue attempts. There are many reasons to believe that this fall's events are especially vital. With Spain and Greece on the ropes, European officials face stark choices. Central bankers must decide whether to shed their past preference for guarded action and launch a rescue with a major bond purchase program. Jens Weidman, governor of the German Bundesbank, has already clearly voiced his opposition."



Friday, August 31st

- Front Page Headline, Bloomberg News – **"Bernanke Keeps Fed's Options Open.** In a speech at the Economic Symposium in Jackson Hole, Wy., Federal Reserve Chairman Ben Bernanke stated: 'The costs of non-traditional (monetary) policies, when considered carefully, appear manageable, implying that we should not rule out the further use of such policies if economic conditions warrant.' **Since the next FOMC meeting – set for September 12th. – happens to coincide with the date of the Dutch election and the ruling of the German Federal Constitutional Court on a vital sovereignty issue, at Longwave Analytics, it is no surprise that Mr. Bernanke has chosen to bide his time.**



Federal Reserve Chairman Bernanke Source: Associated Press

- Front Page Headline, Bloomberg News – **"California Lawmakers Pass Broadest Public Pension Cuts in History.** The pension overhaul, which may save taxpayers as much as $35 billion (U.S.) over 30 years, would require new state employees to pay half the cost of their benefits and work a longer time frame before they can retire. The legislation also reduces formulas for calculating benefits and caps pension payments. California Governor Jerry brown – a 74 year-old Democrat – pressed for a revamp to show progress in curbing soaring retiree costs before he asks voters for both higher income and sales taxes in November. Public resentment of government employees has grown as taxpayers saw their own job prospects and benefits shrink in the longest recession since the 1930s. In a statement, Governor Brown acknowledged: 'This sweeping pension reform package will save tens of billions of taxpayer dollars and make the system more sustainable for the long term." The legislation would require new state and local government employees under the California Public Employees' Retirement System (Calpers) – the largest public pension in the U.S. – to pay for half of their benefits. Governor Brown has until September 30th. to either sign, or veto the legislation, or it becomes law without his signature."

- Front Page Headline, Bloomberg News – **"India's Poor Starving as Politicians Steal Food Worth $14.5 billion (U.S.).**

52 year-old Ram Kishen holding his government issued ration card in Satnapur.
Source: Bloomberg

Mr. Kishen, half-blind and half-starved, while entitled to subsidized rations, has received nothing from the village shop for 15 months. However, twenty minutes' drive from Satnapur ... a government warehouse five football fields long, bulges with stores of wheat and rice. Legally, those 57,000 tons of food are meant for Mr. Kishen and 105 other households in Satnapur with ration books. These storage facilities all over India are meant for some of the 350 million families living below India's poverty line of 50 cents (U.S.) per day. Instead, as much as $14.5 billion (U.S.) in food has been looted by corrupt politicians and their criminal syndicates over the past decade in Mr. Kishen's home state of Uttar Pradesh alone. The thefts have blunted India's only weapon against widespread starvation: a five decade-old public distribution system which has failed to deliver record harvests to the plates of India's most desperate. This thievery, like many others involving politicians in India, remains unpunished. A state police force beholden to corrupt lawmakers, an underfunded federal anti-graft agency and a moribund court system have resulted in five overlapping investigations over seven years, with zero convictions. Naresh Saxena, a Supreme Court Commissioner who monitors hunger-based programs throughout India, observed: 'This is the most mean-spirited, ruthlessly executed corruption because it impacts the poorest and most vulnerable in society. What I find even more shocking is the unwillingness to try and stop it."

- The National Bureau of Statistics and the China Federation of Logistics and Purchasing report the nation's manufacturing purchasing managers' index (PMI) declined to a reading of 49.2 in August following a level of 50.1 in July

- Front Page Headline, Money Talks – **"The U.S. Is on the Brink of the Greatest Depression of All Time.** Serial entrepreneur and author of 'The Conscience of a Libertarian', Wayne Allyn Root warns: 'America is in such deep trouble: for which the only solution is a radical restructuring of the politicians, the economy, plus the way Americans view personal responsibility versus government handouts. If those changes don't materialize, then Americans are facing a long economic decline and the eventual end of the United States. This time the results are going to be dramatically worse than in 1929. This time America is facing the greatest depression ever; because the great depression of the 1930s had neither the structural, economic and social problems, nor, the massive obligations which the country is now facing. Read the facts!

  1) In 1929, America was not $16 trillion (U.S.) in debt, plus facing over $100 trillion (U.S.) in unfunded liabilities. That's over $360,000 (U.S.) in debt per citizen.

  2) In 1929, most U.S. states were not bankrupt, insolvent and dependent upon federal government handouts to survive. Cook County, Illinois, which includes Chicago, now owes over $108 billion (U.S.) – the biggest portion of which is unfunded government employee pensions.

  3) In 1929, America did not have 21 million government employees with bloated salaries, obscene pensions and free health care for life. Today, 1 out of 5 federal employees earn over $100,000 (U.S.) per annum. Today, 77,000 federal employees earn more than the governors of their states. Staggering numbers of federal government employees retire at a young age with $100,000 (U.S.) annual pensions for life. Unfortunately, on the state and local levels, it's even worse. There are now nearly $4 trillion (U.S.) in unfunded pension liabilities for state government workers. Protected by their unions and the politicians they elect, government employees are bankrupting America. In Illinois, there are retired government employees making over $425,000 (U.S.) per year. Not only, could anyone have imagined this in 1929, but also, looking ahead there is no possible way to pay these bills.

  4) In 1929, Social Security, Medicare and Medicaid didn't exist. The federal government had no such obligations which threaten to consume the entire federal budget within a few years.

  5) In 1929, there was no such thing as welfare, food stamps, aid to dependent children, or English as a second language program. Americans didn't consider it the responsibility of government to pay for breakfast and lunch for students – let alone for illegal immigrants attending school. Who could have imagined that 15% of America's population would be on food stamps and the federal government would advertise to encourage even more Americans to sign up for food stamps and welfare?

  6) In 1929, legal immigrants wanted only to work. Today, we have millions of illegal immigrants and their children collecting billions of dollars in entitlements from U.S. taxpayers. In California, illegal aliens cost taxpayers $10.5 billion (U.S.) annually just for education, health care and incarceration. This is spreading across the country.

  7) In 1929, America had no federal disability program. Today, almost 11 million Americans are on disability. There are more citizens on the disabled rolls than the population of 39 of America's 50 states. This is far worse than the welfare or unemployment rolls which have time limits, because disability is forever. Moreover, 45% of returning veterans are claiming disability – a number which dwarfs all prior records in the history of warfare. No nation can afford this!

  8) In 1929, America had an education system that was the envy of the world. Today, our public schools are in shambles. We spend the most money in the world and obtain among the worst results. Today, teachers unions are in charge instead of parents. Our students graduate with few skills and are qualified for only low-paying manufacturing jobs which no longer exist, because they've been exported to China and India. What will this work force do for the rest of their lives? Live off the government dole? Who will pay for it?

  9) In 1929, taxes were much lower. Forget the tax rates, they were meaningless. In those days, America had a cash economy, so most businesses paid little or no taxes. Sales and FICA (Federal Insurance Contributions Act) taxes didn't exist. Today, the combined local, state, property, gas, sales, FICA and federal taxes are the highest burden in history. When income taxes were initiated in 1913, the average American was untouched. Only the wealthiest 350,000 Americans paid a 2% income tax. Today, the average American works until April 12th. just to pay his or her taxes. This stifles entrepreneurship and hinders financial risk-taking needed to create jobs.

The solution is actually simple: dramatically cut the size, scope and power of government; cut spending; cut entitlements; cut taxes; cut government rules and regulations which smother, damage and destroy businesses, prevent startups and kill jobs; reform Social Security, Medicare and Medicaid; reform public employee pensions; stop the wars (America can no longer afford to be policeman for the world); end or reform the Federal Reserve; end bailouts and stimulus packages (ask Japan about the failures of repeated stimulus); end the Democratic obsession with green energy and high speed rail (ask Spain about the waste in those two programs); encourage oil and energy exploration; encourage job creation by small business and the private sector; term limit politicians; institute school choice and back the U.S. dollar with a gold standard. Otherwise, like so many great empires of history, the United States may never recover from this unfolding greatest depression of all time." **See also, Economic Winter – The Pathology of Debt and The Erosion of Civil Liberties in America, February 1, 2012.**

CLOSING LEVELS FOR FRIDAY, AUGUST 31ST.		WEEKLY CHANGE
Dow Jones Industrial Average	13,090.84	– 67.13 points
Spot Gold Bullion (December)	$1,687.60 (U.S.)	+ $14.70 per oz.
S&P / TSX Composite	11,949.26	– 132.97 points
10-Year U.S. Treasury Yield	1.55%	– 14 basis points
Canadian Dollar	101.45 cents (U.S.)	+ 0.72 cent
U.S. Dollar Index Future (Spot Price)	81.272 cents	– 0.345 cent
WTI Crude Oil (October)	$96.47 (U.S.)	+ $0.32 per barrel

Ian A. Gordon, The Long Wave Analyst www.longwavegroup.com

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