Monday September 3, 2012

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, September 3rd

Front Page Headline, Der Spiegel – **"European Stability Mechanism Needs Germany: CEO Klaus Regling.**

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Labour Day Holiday in Canada and United States

In an interview with the German publication Der Spiegel (The Mirror), the chief executive officer of the European Financial Stability Facility (EFSF) – and CEO designate of its successor bailout fund the European Stability Mechanism (ESM) – Klaus Regling stated: 'Without Germany, the ESM doesn't make any sense. The ESM won't succeed if the German Federal Constitutional Court rules against it on September 12th." **Wakeup call for Mr. Regling: If the Karlsruhe-based court rules that Germany would be relinquishing too much sovereignty under the new ESM mandate, then the country must draft a new constitution, necessitating a plebiscite.**

EFSF CEO Klaus Regling — Source: Associated Foreign Press

- The Ministry of Employment reports France's unemployment rate reached 10% in August, as the number of unemployed persons surpassed the 3 million mark for the first time since 1999. Employment Minister Michel Sapin confirmed the total on French radio and warned: "The unemployment numbers will likely worsen."

- Front Page Headline, Wall Street Journal – **"Dutch Socialists Challenge EU Austerity Measures.** The popularity of the Dutch Socialist Party, led by Emile Roemer, has soared ahead of the September 12th. elections, based upon the party's pledge to change the austerity policies of the current center-right governing coalition. If Mr. Roemer's apparent support is maintained on election day, the Socialists could significantly boost their presence in the 150-seat lower house, where the party currently has just 15 seats. Mr. Roemer wants the European Central Bank (ECB) to play a more active role in taming the sovereign debt crisis, favours giving Greece more time to cut its deficit, but opposes German-led plans to surrender more national power over economic policy to Brussels. Mr. Roemer argues: 'Political union isn't possible in this Europe where the differences are so great, between north and south. The sovereign debt crisis has shown that the European Union's economic rules, negotiated in the Dutch city of Maastricht in 1992, need far-reaching changes. The Maastricht agreement is just not valid any more. Times have changed and politicians must also change when that occurs."

- Front Page Headline, Bloomberg News – **“ECB Bailouts Are Here to Stay: Merkel.** Making an appearance at a Bavarian political rally in Abensberg, northeast of Munich – in anticipation of the impending annual Oktoberfest – German Chancellor Angela Merkel addressed members of her Bavarian Christian Social Union sister party: ‘Countries such as Greece deserve our solidarity, as long as they meet commitments for overhauling their economies. We must press for reforms in other countries even if they sometimes say that we’re hard-liners. We need a strong Europe because we can’t assume so much (debt) that tomorrow we won’t have anything left and we’ll be at the mercy of the financial markets.’ Meanwhile, German Finance Minister Wolfgang Schaeuble reiterated: ‘Europe shouldn’t raise false expectations over the ECB’s ability to stem the (sovereign debt) turmoil, by leaning on indebted nations such as Italy and Spain.’

German Chancellor Angela Merkel in Abensbe Sources: AFP/Getty Images

Tuesday, September 4th

- Front Page Headline, MarketWatch News – **“Draghi Remarks Fuel Italian, Spanish Bond Rally.** In a private meeting with members of the European Parliament late Monday, European Central Bank (ECB) President Mario Draghi declared that the ECB would be acting within its current mandate by purchasing European Union member bonds out to a maturity date of three years. When leaked to the press by a lawmaker, Mr. Draghi’s comments sparked a rally in Italian and Spanish bond prices, as 2-year yields declined by 25 basis points to 2.38% and by 30 basis points to 3.00%, respectively.

- The Tempe, Arizona-based Institute for Supply Management (ISM) reports its U.S. factory index declined to a reading of 49.6 in August following a level of 49.8 in July – the lowest reading in 3 years – citing an ongoing contraction in the manufacturing sector. Russell Price, an economist at Ameriprise Financial in Detroit, stated: “Manufacturing has largely stalled ... and we don’t really expect a robust acceleration anytime soon.”

- Front Page Headline, Globe and Mail – **“Moody’s Lowers EU Credit Rating Outlook.** Moody’s Investors Service lowers the European Union’s credit rating outlook to negative from stable, citing: “It is reasonable to assume that the EU’s creditworthiness should move in concert with the creditworthiness of its key member states, namely Great Britain, France, Germany and the Netherlands.” In maintaining the EU’s ‘AAA’ credit rating, Moody’s noted its “conservative budget management and the creditworthiness and support provided by its 27 member states. However, a deterioration of the creditworthiness of certain EU member states, could prompt a future EU credit rating downgrade. In addition, a weakening of the commitment of the member states to the EU and changes to the EU’s fiscal framework which leads to less conservative budget management, would be (deemed) credit negative. Moreover, it is reasonable to assume the same probability of default by the EU on its debt obligations (commensurate with) the probability of default by the most highly rated (individual) EU member states.”

- Front Page Headline, Globe and Mail – **“Spain Injects 4.5 Billion Euros into Bankia.** The governing board of Spain’s Fund for Orderly Bank Restructuring (FROB) agrees to inject 4.5 billion euros into Bankia, a state-backed lender still losing billions of euros. The FROB stated: ‘By this measure, we restore the group’s regulatory capital ... and guarantee the security of deposits, plus the group’s access to all possible sources of financing. This money represents an advance on a broader capital injection to be made ... under a (pending) euro zone agreement. The size of the full injection will be decided during the coming weeks.’ The above notwithstanding, the New York Times reports the capital and human flight from Spain now includes members of its educated and business elite who are fed up with the lack of job opportunities in a country where the jobless rate has reached 25%. Jose Garcia Montalvo, an economist at Pompeu Fabra University in Barcelona, observes: ‘No doubt there is a modicum of panic. The extremely wealthy people have already taken their money out. Now, professionals and mid-range people are moving their money to Germany and England. The mood is very, very bad.”

- Front Page Headline, Wall Street Journal – **“Auto Makers Post Strong U.S. Sales in August.** Chrysler Group, General Motors and Ford Motor Corp. all report double-digit U.S. sales gains in August compared to the same period a year ago. Italy’s Fiat SpA posted the biggest increase with U.S. sales up by 34%. Jenny Lin, an economist at Ford, noted: ‘I think that pent-up demand is the main force behind American retail auto sales.”

- Front Page Headline, Financial Times – **"U.S. Accuses BP of Gross Negligence in Gulf of Mexico.** The U.S. Department of Justice (DOJ) intends to prove at trial that gross negligence or willful misconduct by BP (formerly British Petroleum) caused the 2010 Deepwater Horizon disaster in the Gulf of Mexico. In a ferociously worded memo, filed with the New Orleans court which is hearing the civil case over the oil spill, DOJ lawyers accuse BP of 'a culture of corporate recklessness. The behavior, words and actions of these BP executives would not be tolerated in a middling size company manufacturing dry goods for sale in a suburban mall. Yet they were condoned in a corporation engaged in deep water drilling activity, that no less a witness than Tony Hayward (the former BP chief executive officer) described as comparable to exploring outer space.' The memo also accuses Transocean, owner and operator of the Deepwater Horizon rig, of gross negligence, highlighting the role of its staff alongside BP's in having 'stunningly, blindingly botched a vital test of whether the oil well had been properly sealed.' If the DOJ can establish gross negligence, the penalties under the U.S. Clean Water Act could total $21 billion (U.S.), dependent upon how much oil was spilled. Compensatory and punitive damages would be in addition to that total."

- Front Page Headline, Daily Telegraph U.K. – **"Brinkmanship as Spain Warns over Bailout Terms.** In an escalating game of brinkmanship, Spain's Finance Minister Luis de Guindos in an interview with the German newspaper Handelsblatt stated his country is not yet willing to sign a Memorandum relinquishing fiscal sovereignty to European Union inspectors: 'First of all, we must clarify the (bailout) conditions. The (sovereign debt) crisis engulfing the euro region is larger than any one country, so we are warning northern Europe not to treat Spain as a scapegoat. My colleagues are aware that the battle for the euro will be fought in Spain. Right now, Spain is the breakwater for the euro zone, so solidarity would be well advised.' Prior to the governing council's meeting on Thursday, German Chancellor Angela Merkel travels to Madrid tomorrow for talks with Premier Mariano Rajoy to negotiate conditions for a full sovereign rescue of 300 billion euros, beyond the 100 billion euro bank rescue already agreed upon. Basically, the European Central Bank (ECB) has tied its hands under an implicit agreement with Germany, announcing that it cannot proceed until Spain and Italy request assistance from the euro zone's bailout funds and submit to tough conditions."

Wednesday, September 5th

- The Bank of Canada maintains its Bank Rate at 1%, citing: "Global growth prospects are unfolding as expected, evidenced by a widespread slowing of economic activity."

- Front Page Headline, Wall Street Journal – **"Euro Zone Economic Slide Deepens.** Data monitoring firm Markit reports the composite purchasing managers' index for the 17-nation euro zone declined to a reading of 46.3 in August from a level of 46.5 in July, citing a month-over-month contraction in business activity across the manufacturing, retail and services sectors of the economy."

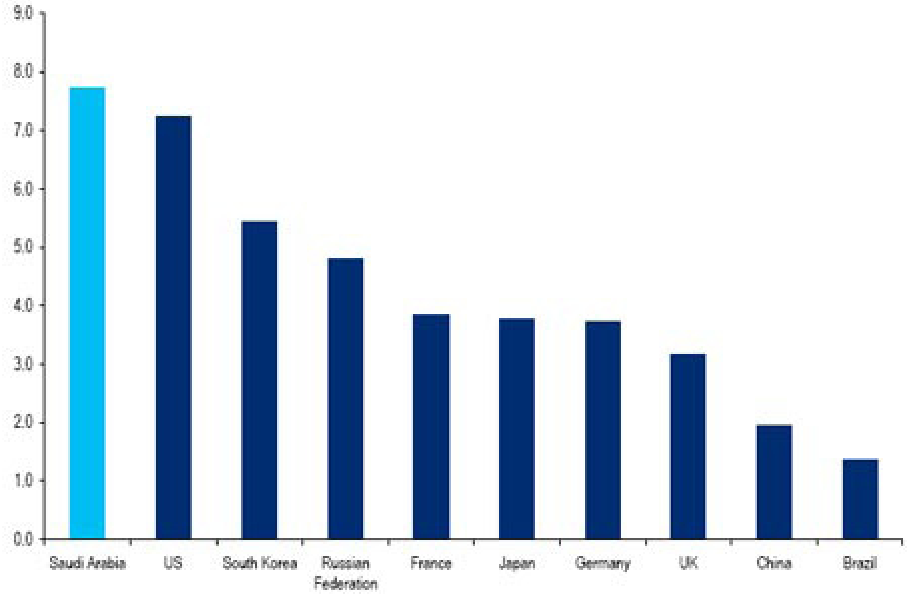
- Front Page Headline, Financial Times – **"Weak Auction for German 10-Year Issue.** The Bundesbank auctions 3.6 billion euros of 10-year government bonds maturing in 2022 at an average yield of 1.42%. The bid-to-cover ratio of the amount allotted to investors was a low 1.1 times and fell short of the 5 billion euro target for the issue.

- Front Page Headline, Financial Times – **"Euro Zone Demands Greece Adopt a 6-Day Work Week.** Greece's euro zone creditors are demanding that the government introduce a six-day working week as part of the stringent terms for the country's second bailout. The demand in a letter from the 'troika' – the European Commission (EC), the European Central Bank (ECB) the International Monetary Fund (IMF) – which insists on radical labour market reforms; from minimum wages to overtime limits to flexible working hours. The 'troika' inspectors return to Athens this week to scrutinize Greek observance of its bailout terms. They are expected to deliver a verdict in October which will decide whether Greece is ultimately allowed to remain in the European Monetary Union (EMU)."

- Front Page Headline, Daily Telegraph U.K. – **"Saudi Oil Well Expires.** A new report from Citigroup by researcher Heidy Rehman concludes that Saudi Arabia could be an oil importer by the year 2030. 'Saudi Arabia is the world's largest oil producer at 11.1 million bpd. and exporter at 7.7 million bpd. It also consumes 25% of its production. Energy consumption per capita exceeds that of most industrial nations. Oil and its derivatives account for 50% of Saudi electricity production, used mostly for residential use (read air conditioners). Peak power demand is growing by 8% per annum ... Moreover, Saudi Arabia produces 9.6 billion cubic feet of natural gas per day, all of which is consumed domestically. The country is looking to increase gas production to 15.5 billion cubic feet per day by 2015, implying a 2011-15 compound annual growth rate (CAGR) of 12.7%. However, peak power demand is growing by almost 8% per annum. At Citigroup, we believe that Saudi Arabia must locate new sources to meet residential and industrial demand.'

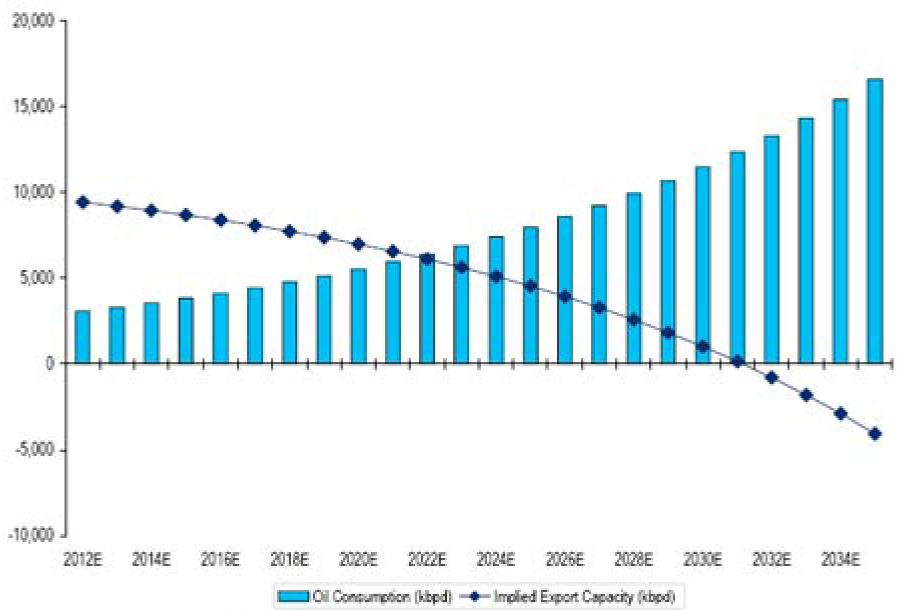
  This may concentrate a few minds in The Kingdom. The country is already planning an 80 gigawatt nuclear program, although they are woefully short of nuclear power experts. Saudi Arabia also has big hopes regarding solar projects based upon successes of solar farms in California. Acquisition of both solar and nuclear power would enable The Kingdom to export more of its oil production. Additionally, a great deal could change as new desalinization filters should drastically reduce domestic energy consumption. Accordingly, Saudi fuel subsidy policies may also change."

Figure 4. Selected Countries — Primary Energy Consumption per Capita (toe), 2011



Source: BP Statistical Review, UN & Citi Research

Figure 7. Sensitivity Analysis – Consumption Grows in Line with Peak Power Demand (kbpd)



Source: BP Statistical Review, UN & Citi Research

Thursday, September 6th

- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 12,000 to 365,000 in the week ended September 1st. while continuing claims fell by 6,000 to 3.32 million in the week ended August 25th. The number of people who have exhausted their traditional benefits but who are now receiving emergency or extended benefits under state or federal programs declined by about 11,800 to 2.27 million in the week ended August 18th.

- According to Roseland, New Jersey based- ADP Employer Services, U.S. private sector employment increased by 201,000 workers in August, the biggest gain in five months

- Front Page Headline, Bloomberg News – **"ECB Officials Adopt 'Outright Monetary Transaction' Program.** At a Frankfurt news conference, European Central Bank President Mario Draghi announced: 'This unlimited bond purchase program will focus on maturities out to 3-years and enable us to address severe distortions in government bond markets which, in particular, originate from unfounded fears on the part of investors of the reversibility of the euro. Under appropriate conditions, we will have a fully effective backstop to avoid destructive scenarios with potentially severe challenges for price stability in the euro area. Governments must stand ready to activate the European Financial Stability Facility, or the European Stability Mechanism in the bond market when exceptional financial market circumstances and risks to financial stability exist – (attendant) with strict and effective conditionally – because the ECB reserves the right to terminate bond purchases if governments don't fulfill their part of the bargain."

European Central Bank President Mario Draghi.

Source: Bloomberg News

- In a new report, the Paris-based Organization of Economic Cooperation and Development (OECD) suggests that the German economy will contract by 0.5% in the current quarter and by 0.8% in the 4th. quarter. Pier Carlo Padoan, the OECD's deputy secretary general and author of the report noted: "With the euro (sovereign debt) crisis still the most important risk facing the global economy, further policy action is required to instill more confidence in the European Monetary Union (EMU)."

Friday, September 7th

- The Labor Department reports U.S. non-farm payrolls increased by 96,000 in August – following a downwardly revised July gain of 141,000 – previously reported as an increase of 163,000; as well as a downwardly revised June gain of 43,000, previously reported as 64,000. The U.S. official unemployment rate fell to 8.1% from 8.3% in July.

- The Economy Ministry in Berlin reports German industrial production rose by 1.3% in July, following a revised decline of 0.4% in June. Andreas Rees, chief economist at Unicredit in Munich commented: "German companies were performing well amidst euro zone (economic) turmoil. While we do not expect drastic declines in overall industrial activity, it is only a question of time before hard data will reflect what we already know from business sentiment figures – a drop in momentum in the coming months."

- The Office for National Statistics reports U.K. industrial production rose by 2.9% in July, the most since February 1987, as manufacturing rebounded from a 2.4% decline in June, partly affected by the extra public holiday for the Queen's Jubilee. Ross Walker, an economist at the Royal Bank of Scotland commented: "It appears that the bounce back in manufacturing is going to be somewhat stronger and we can be considerably more confident that there will be positive (GDP) growth in the third quarter."

- Front Page Headline, Globe and Mail – **"German Lawmakers, Media Decry ECB 'Blank Cheque'.** Germany's conservative press accuses the European Central Bank (ECB) of writing a blank cheque to indebted euro zone states by agreeing to purchase an unlimited amount of their bonds, while some government lawmakers threatened legal action to prevent the purchases. Many German conservatives share the concern of Bundesbank chairman Jens Weidmann that bond purchase plans, not only violate the ECB's mandate of not financing EU member deficits, but also, remove pressure on needy governments to institute reforms. 'ECB Sets off Germany's Alarm Bell' was the headline in the conservative daily Die Welt (The World). However, German Chancellor Angela Merkel has given her tacit support for the bond-purchase plan, noting: 'It buys time for vulnerable (euro) states such as Spain and Italy to implement tough (domestic) reforms.' New poll results published in Der Spiegel (The Mirror) revealed 54% of Germans want the country's Constitutional Court to declare Germany's participation in the European Stability Mechanism as unconstitutional, pending a referendum. The Karlesruhe-based Constitutional Court will issue its ruling on September 12th. **See also, Economic Winter – Will Germany Exit the European Monetary Union? – August 17, 2012.**

- Front Page Headline, Globe and Mail - **"Greek Judges, Prosecutors Join Austerity Protests.** Judges, public prosecutors and court workers gather in a rare demonstration at Greece's Supreme Court to protest against pay cuts which have also drawn the ire of police, fire brigade, coast guard and university staff unions. If salaries are reduced as part of the government's 11.5 billion euro ($14.4 billion U.S.) austerity measures for 2013-14, organizers of the protest threatened to cut operating hours at the country's severely backlogged courts. In an interview with the Associated Press, Vassiliki Thanou-Christofilou, Chairperson of the Association of Judges and Public Prosecutors, observed: 'Of course, it's not common to see judges protest, but about 200 of us were obliged to gather to express our opposition to the planned new (salary) reductions. The cuts are likely to be 20% or more, on top of previous reductions worth 38% of our salaries. So the pay levels will no longer safeguard the court officials' ability to live in a dignified way."

Vassiliki Thanou-Christofilou addresses the Association of Judges and Public Prosecutors. Source: AP

- Front Page Headline, Daily Telegraph U.K. – **"U.S. Economic Recovery Faces Risk of Wasted Election.** American opinion polls suggest that after November's election, Washington will remain a divided town. Barring a major shock, Republicans will control the House of Representatives while the Democrats will still be in control of the Senate. In the race for the White House, President Obama remains marginally ahead. If there's going to be a post-election compromise, it's most likely to be about how to cut America's $16 trillion national debt, rather than reduce the ranks of 21 million people who are either unemployed, or having to settle for part time work. Failure to find some middle ground will mean the 2012 election will have hurt, rather than helped, the U.S. economic recovery; something neither America, nor, the rest of the world can afford."

The stage is set at the Democratic National Convention in Charlotte, N.C.

Source: AFP

CLOSING LEVELS FOR FRIDAY, SEPTEMBER 7TH.		WEEKLY CHANGE
Dow Jones Industrial Average	13,306.64	+ 215.80 points
Spot Gold Bullion (December)	$1,740.50 (U.S.)	+ $52.90 per oz.
S&P / TSX Composite	12,268.01	+ 318.75 points
10-Year U.S. Treasury Yield	1.67%	+ 12 basis points
Canadian Dollar	102.16 cents (U.S.)	+ 0.71 cent
U.S. Dollar Index Future (Spot Price)	80.17 cents	– 1.102 cent
WTI Crude Oil (October)	$96.42 (U.S.)	– $0.05 per barrel

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