Monday January 28, 2013

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, January 28th
Front Page Headline, Globe and Mail – **Moody's Downgrades Several Canadian Large Banks.**

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Moody's Investors Service downgrades the credit rating of the Bank of Nova Scotia, Bank of Montreal, Canadian Imperial Bank of Commerce, National Bank of Canada and the Caisse Centrale Desjardins by one level, citing: 'High Canadian house prices and record levels of consumer debt have left the banks vulnerable to a slowing Canadian economy.' Moody's also downgraded the 'AAA' credit rating of the Toronto-Dominion Bank by one level citing 'concerns about the increasing size of its U.S. operations, where the TD Bank faces more competition than in Canada.' David Beattie, vice-president and credit officer at Moody's elaborated: 'Canada's banks (still) rank second behind Singapore's in terms of credit outlook and are roughly on a par with Australian financial institutions."

- The Commerce Department reports orders for U.S. durable goods – those expected to last at least three years – rose by 4.6% in December, driven by a 10% gain in aircraft orders and following an increase of 3% in November

- The National Association of Realtors (NAR) reports its U.S. pending home sales index declined by 4.3% in December to a reading of 101.7 following a 1.7% increase in November. NAR chief economist Lawrence Yun commented: "The tightening (home) supply limitation appears to be the main factor holding back contract signings in the past month. The supply of homes costing less than $100,000 (U.S.) is tight in much of the country, so first-time buyers have fewer options."

Tuesday, January 29th

- S&P/Case-Shiller report while their index of property values in 20 U.S. cities rose by 5.5% in November on a year-over-year basis; the index of 10 major metropolitan areas declined by 0.2% in November from October and the 20-city index fell by 0.1%. On a seasonally adjusted basis, the indexes were up 0.5% and 0.6%, respectively. David Blitzer, chairman of S&P's index committee, commented: "Winter is usually a weak period for housing, which why we now see about half the cities with declining month-to-month prices, compared to 20 out of 20 seeing rising prices last summer."

- The New York-based Conference Board reports its index of U.S. consumer confidence declined to a reading of 58.6 in January – the lowest reading since November 2011 – from an upwardly revised level of 66.7 in December previously reported as 65.1. In a statement, Lynn Franco, the Conference Board's director of economic indicators, commented: "The increase in the payroll tax has undoubtedly dampened consumer spirits and it may take a while for not only, confidence to rebound, but also, consumers to recover from their initial pay cheque shock." Consumers' views on the outlook for the labour market were also weaker.

- Front Page Headline, Wall Street Journal – **"FOMC Monetary Policy is a Drag on the Economy.** In an op-ed, John Taylor – a professor of economics at Stanford University – writes: 'As the Federal Open Market Committee meets this week, the Federal Reserve Chairman and his colleagues will be looking at an economic recovery which has been far weaker than expected. Early in 2010, they predicted that (GDP) growth in 2012 would be a robust 4%. It turned out to be a disappointing 2%. Moreover, as the (economic) recovery fell short of their expectations, they continued and then doubled down on the emergency (marketplace) interventions used in the (financial) panic during 2008. The Fed increased purchases of U.S. Treasurys and mortgage-backed securities and now they indicate that more large-scale purchases are planned. They kept extending the near-zero federal funds rate and now foresee that rate will remain in place for at least several more years. Unlike its actions taken during the (financial) panic, the Fed's policies have been accompanied outcomes. While the Fed points to external causes, it ignores the possibility that its own (monetary) policy has been a (negative) factor. At the very least, (Fed monetary) policy creates a great deal of uncertainty. People recognize that the Fed must eventually reverse course. When the economy begins to improve, the Fed will have to sell the assets it has been purchasing (in order) to prevent (higher) inflation. If the Fed's asset sales are too slow, the bank reserves used to finance the original asset purchases pour out of the banks and into the economy. However, if the asset sales are too fast or abrupt, they will drive bond prices down and interest rates up too much, causing a recession. Those who say that there is no problem with the Fed Funds rate and asset purchases because inflation has not increased to date, ignore such (potential) downsides. The Fed's current zero Fed Funds rate policy also creates incentives for otherwise risk adverse investors – retirees, pension funds – to amass questionable investments as they search for higher yields as they attempt to bolster their miniscule interest income. Low (interest) rates also make it possible for banks to roll over, rather than write off, bad loans, locking up unproductive assets. Also, extraordinarily low (interest) rates support and feed the spending appetites of Congress and the President, increasing deficits and (the national) debt. More broadly, the Fed's excursion into fiscal policy and credit allocation raises questions about its institutional independence and accountability. This tends to reduce public confidence in the central bank." **At Longwave Analytics, we note that Professor Taylor overlooked the possibility of the Fed unwinding the fixed income holdings on its balance sheet, by allowing them to mature instead of outright sales, especially within a rising interest rate environment, whatever the cause.**

- Front Page Headline, National Post – **"Unemployed Youth Will Cost Canadian Economy $23 Billion (CAD) over Next Two Decades.** A new research report by Martin Schwerdtfeger at the TD Bank warns: 'We estimate that the legacy of unemployment for the young will last up to two decades in the aftermath of the 2008-09 financial crisis and the damage to Canada's gross domestic product (GDP) will be about 1.3% – or about $23 billion (CAD) – in 18 years. Being unemployed at a young age can have a long-lasting impact on an individual's career prospects – a phenomenon known as scarring. The economy also suffers from lost output and multiplier effects. Youth unemployment in Canada peaked at 16.4% in July 2009, from a pre-crisis level of about 11%. Today, the rate remains elevated at 14%, about twice the national average. Canada will suffer a wage loss of $10.7 billion (CAD) by the time youth employment is expected to return to pre-crisis levels in about three years and a $12.4 billion (CAD) loss to GDP over an 18 year period."

- Front Page Headline, National Post – **"Stuck in Reverse, Detroit Rolls Closer to Bankruptcy.** General Motors and Chrysler, together with Ford Motor gave the motor city its identity and survived near death experiences, after filing for bankruptcy during the financial crisis. Now, however, Detroit itself is edging closer to a similar precipice, only unlike the automakers, the City's chances of obtaining a federal bailout are almost non-existent. The story of Detroit's decline is decades old: its tax revenue and population have shrunk and labour costs have remained uncompetitive. The City's budget problems have deepened to such an extent that it could exhaust its cash position in a matter of weeks or months; ultimately being forced into the largest ever Chapter 9 bankruptcy filing in the United States. Frustrated by the lack of concrete progress, Michigan Governor Rick Snyder, a Republican, last month appointed a team of accountants to audit Detroit's finances. The audit could result in a State takeover of Detroit's finances through the appointment of an emergency financial manager. Such a manager, who would seize control of the City's cheque book, could then propose federal bankruptcy court as the best option. Governor Snyder, who has deemed the situation 'a crisis in terms of financial affairs' said the audit team would deliver its report in February. Rick Jones, chairman of the republican majority caucus in the State Senate, noted: 'Detroit is teetering on the verge of bankruptcy after the City Council has failed to make the necessary cuts to deal with having a smaller population. I would like to see an emergency manager installed to fix the City's problems. If that failed, there would be a case for finding a way to shrink the Detroit municipal area.' Detroit's population is now just over 700,000 – down by 30% since 1990 – but the City must still provide services to an area encompassing more land than San Francisco, Boston and the Borough of Manhattan. While Democratic Mayor Dave Bing and the Detroit City Council have moved to reduce spending and initiate reforms to stave off a takeover, including layoffs and wage and benefit cuts, the progress may not be enough for Michigan officials and lawmakers

... Signs of decline are everywhere – in a rising crime rate, streets without lights and block after block of abandoned buildings. The murder rate of one per 1,719 people in 2012 was more than 11 times the rate in New York City. The unemployment rate is above 18%, more than twice the rate for the country as a whole. Eric Scorsone, a Michigan State University economist who has written papers on municipal bankruptcy and on the State's emergency manager laws, notes: 'A bankruptcy would be complicated. The interests of creditors would likely collide with those of labour unions."

Wednesday, January 30th

- The Commerce Department reports U.S. gross domestic product (GDP) – the volume of all goods and services produced – contracted by 0.1% in the 4th. quarter of 2012, citing lower corporate inventories and the biggest drop in defence spending in 4 decades

A man visits one of Boeing's AH-64D Apache attack helicopters at an airshow. Source: Bloomberg

- The European Commission (EC) reports its economic sentiment indicator rose to a reading of 89.2 in January following a level of 87.8 in December. It was the third consecutive monthly increase in the index, which is now at its highest level since June 2012. However, it remains well below the long-term average of 100 going back to 1990.

- Front Page Headline, Financial Times – **"FOMC Cites Pause in U.S. GDP Growth.** 'Information received since the Federal Open Market Committee met in December suggests that growth in economic activity paused in recent months, in large part because of weather-related disruptions and other transitory factors. Employment has continued to expand at a moderate pace, but the unemployment rate remains elevated. Household spending and business fixed investment advanced and the housing sector has shown further improvement. Inflation has been running somewhat below the Committee's longer term objective, apart from temporary variations which largely reflect fluctuations in energy prices. Longer term inflationary expectations have remained stable ...(In order) to support continued progress toward maximum employment and price stability, the Committee decided that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens. In particular, the Committee decided to keep the target range for the Federal Funds rate at 0 to 1/4 percent and currently anticipates that this exceptionally low range ... will be appropriate (for) at least as long as the unemployment rate remains above 6.5%." **Unsurprisingly, in its press release the FOMC has refrained from any direct commentary about the inexorable increase in the U.S. national debt level – upon which its current asset purchase program is based – which will likely reach the $17 trillion (U.S.) mark by mid-May.**

- The National Statistics Institute reports Spain's gross domestic product (GDP) contracted by 0.7% in the 4th. quarter of 2012 and by 1.4% for the year as a whole. During parliament's weekly question session, Prime Minister Mariano Rajoy stated: "We knew that 2012 was going to be a bad year. A stimulus plan and a strategy for youth employment and entrepreneurship will reach lawmakers soon." **Wakeup call for Prime Minister Rajoy: Better late than never? Your economy has only been dying for the past 4 years. Better still ... get a life!**

People demonstrate against job cuts at bailed out Bankia in Madrid. Source: Associated Press

Thursday, January 31st

- Front Page Headline, Bloomberg News – **"Senate Passes 3-Month Suspension of U.S. Debt Limit.** By a vote of 64 to 34, the U.S. Senate passed legislation – recently passed by the House of Representatives – to suspend the federal government's statutory debt limit for 3 ½ months until May 19th., temporarily removing the risk of a U.S. Treasury default. Senate Majority Leader Harry Reid commented: 'Raising the possibility that the United States could default on its obligations every few months is not an ideal way to run a government. However, a short term solution is better than another, imminent manufactured crisis.'

- The Commerce Department reports U.S. household purchases – which account for about 70% of the American economy – rose by 0.2% in December, following a gain of 0.4% in November, citing lower fuel costs, some job gains and holiday season retail discounts

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 38,000 in the week ended January 26th. to 368,000

- The Nuremberg-based Federal Labour Agency reports the number of unemployed German workers declined by a seasonally adjusted 16,000 to 2.92 million in January. Heinrich Bayer, an economist at Postbank Research in Bonn, commented: "The German Labour market convinced (investors) with a distinct robustness in the second half of 2012 and the beginning of this year. Neither (sovereign) debt crisis, nor economic weakness can hurt it. However, it's too early to sound the all clear because the labour market reacts with delay to economic developments. The unemployment rate could still rise."

- Statistics Canada reports the nation's gross domestic product (GDP) rose by 0.3% in November, citing higher automobile and primary metal output; as well as increased mining production and crude petroleum extraction. In a note to clients, Emanuella Enenajor, an economist at CIBC World Markets, commented: "It's still far too early to sound the all clear on the Canadian economy. We expect the slowdown in the housing market and government (spending) cuts will weigh on GDP growth this year."

- Front Page Headline, Wall Street Journal – **"S&P Upgrades California / Downgrades Illinois.** Standard & Poors Ratings Services upgraded its credit rating for California's general obligation bonds to 'A' from 'A' (Low). S&P analyst Gabriel Petek cited 'the State's improving economy, a balanced budget and a plan from Democratic Governor Gerry Brown to reduce the State's debt in coming years. California has made some pretty significant structural progress on its fiscal imbalance and reduced its spending. Higher revenue, which was bolstered by a temporary tax increase and approved by the voters in November, also helped.' Simultaneously, S&P downgraded Illinois' credit rating to 'A' (Low) from 'A', citing 'a poor track record in addressing its pension crisis.' In a press release, Abdon Pallasch, assistant budget director for Illinois, announced: 'The State has delayed a bond issue scheduled for this week since the (fixed income) market is unsettled because of recent actions and comments by the bond rating agencies."

- Front Page Headline, Wall Street Journal – **"America's Poor Become More Concentrated in Northern Cities.** In a new report by the Federal Reserve Bank of Cleveland, researchers concluded: 'The Great Financial Crisis has increased the number of poor (people), bound them more closely together and left them concentrated in the cities of the northern U.S. The rise in overall poverty, as well as its increased concentration, is a distinct cause for concern because the disadvantages to an individual from being poor are thought to be either muted, or amplified, depending upon the poverty (prevalent) in their neighbourhood. Typically, neighbourhoods with many poor residents have less access to job opportunities, risk higher crime rates and incur a range of other social problems. Between 2000 and 2010, the total poverty rate in the U.S. rose from 11.3% to 15.3%. The government's official poverty threshold is a family of four earning just over $22,000 (U.S.) a year. The cause of the (upward) shift is no surprise because the financial crisis and its aftermath have been hard on all manner of households. Meanwhile, the (economic) downturn and weak rebound have taken place against the longer running trend of the nation's richest citizens, controlling a greater share of national wealth. While poverty tended to increase in all neighbourhoods, this increase was the most rapid in neighbourhoods which already had a large share of poor residents."

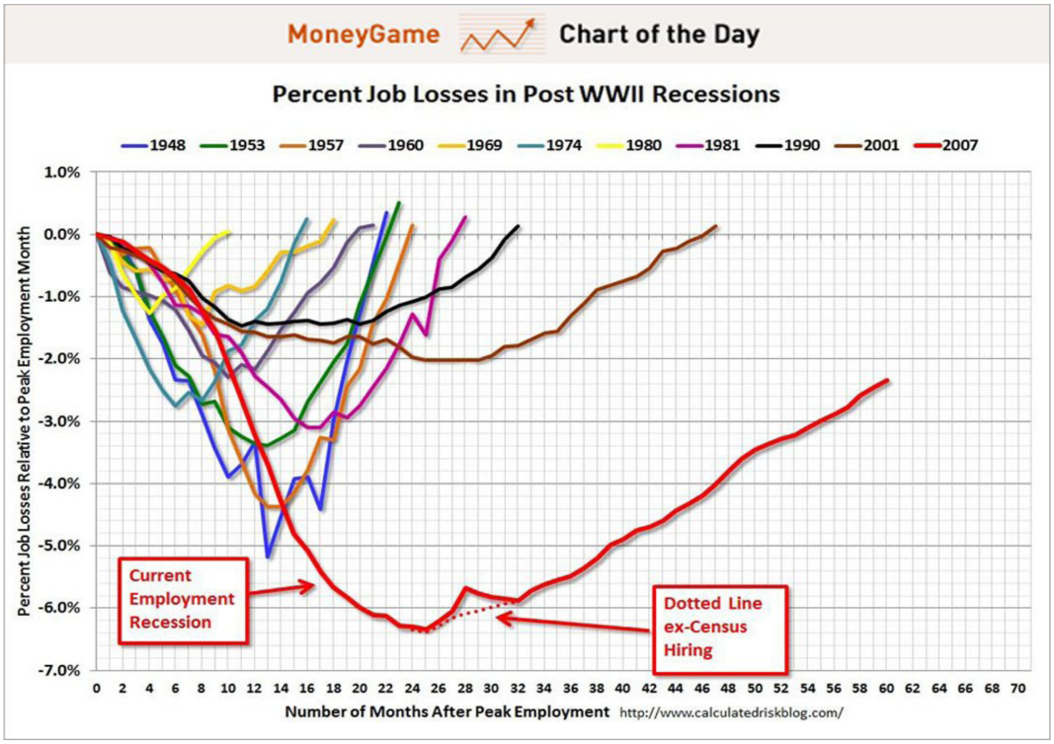
- Front Page Headline, Financial Post – **"Best Buy / Sears Canada Announce 1,600 Job Layoffs.** Two of Canada's biggest retailers, Best Buy Canada and Sears Canada announced 1,600 layoffs in what appears to be a turbulent and competitive year for the country's retail sector. Best Buy, the biggest retailer of electronics in the country, is laying off about 900 employees and announcing the closure of 15 big-box stores, representing about 10% of its square footage in Canada. The move arises as Best Buy feels pressure from online electronics retailers such as Amazon and Apple and as it follows its American parent with plans to open multiple smaller stores which are less expensive to operate. Meanwhile, Sears Canada, trying to staunch years of declining sales and profits, will lay off 700 employees, about 360 at its department stores, 300 from distribution centres and the remainder at head office and support areas. In an interview with the Financial Post, Mike Pratt, president of Best Buy Canada stated: 'By taking a proactive approach, in transforming our operations now, I have no doubt we will be in the best position to continue innovating our store experience for consumers and grow into the next decade.' This news unfolds just weeks before American mass merchant Target is set to open the first of its 124 planned stores in Canada."

- Front Page Headline, Financial Times – **"Spain's Rajoy Drawn into Corruption Scandal.** Spain's Prime Minister Mariano Rajoy has become embroiled in a growing scandal over secret cash payments to ruling party politicians after El Pais, Spain's biggest selling daily, claimed that the Prime Minister had received 25,200 euros each year since 1997 in payments made every three or six months, reproducing on its front page what it claimed to be pictures of the former Popular Party's accounting book. **A spokeswoman for Prime Minister Rajoy declined to comment.** The allegations come at a time when confidence in Spain's political elite has reached an all-time low with evidence mounting popular anger at a number of high profile corruption cases, including one brought against Inaki Urdangarin, son-in-law of Spain's King Juan Carlos de Bourbon, who is accused of embezzling millions of euros from charitable organizations. Antonio Argandona, professor of Business Ethics and Economics at IESE business school observes: 'The level of trust in Spanish politicians is very, very low and corruption is one of the main problems.' A recent poll for El Pais suggested that 96% of Spaniards believed that political corruption was very high."

- Front Page Headline, Financial Times – **"Wasendorf Jailed for 50 Years for Fraud.** A U.S. federal court has sentenced Russell Wasendorf, Sr. – the former head of collapsed futures broker Peregrine Financial Group – to 50 years in prison. The sentencing caps a dramatic fall for Wasendorf, 64, whose firm collapsed in July 2012 after a $215 million (U.S.) gap was discovered in customer funds. The discovery was discovered by Wasendorf's attempted suicide in a car outside his company's Iowa headquarters. A signed statement found next to a suicide note and his unconscious body contained his confession to a fraud that covered nearly two decades. Chief Judge Linda Reade sentenced Wasendorf to the maximum term in prison, without parole. The court ordered him to pay $215 million (U.S.) to more than 13,000 customers and imposed a $100 million (U.S.) fine. In September 2012, Wasendorf pleaded guilty to one count of mail fraud, one count of embezzlement of customer funds and two counts of lying to regulators. He admitted that he had stolen funds, at least in part, by secretly withdrawing money from customer bank accounts and then forging bank statements which omitted the withdrawals and inflated customer funds by more than $200 million (U.S.). Wasendorf would then submit false reports and forged bank account statements to regulators. Sean Berry, acting U.S. attorney commented: 'By lying to investigators and regulators, Wasendorf defrauded thousands of innocent investors out of a staggering $215 million (U.S.). The lengthy prison sentence imposed today is just punishment for a conman who built a business on smoke and mirrors."

Friday, February 1st

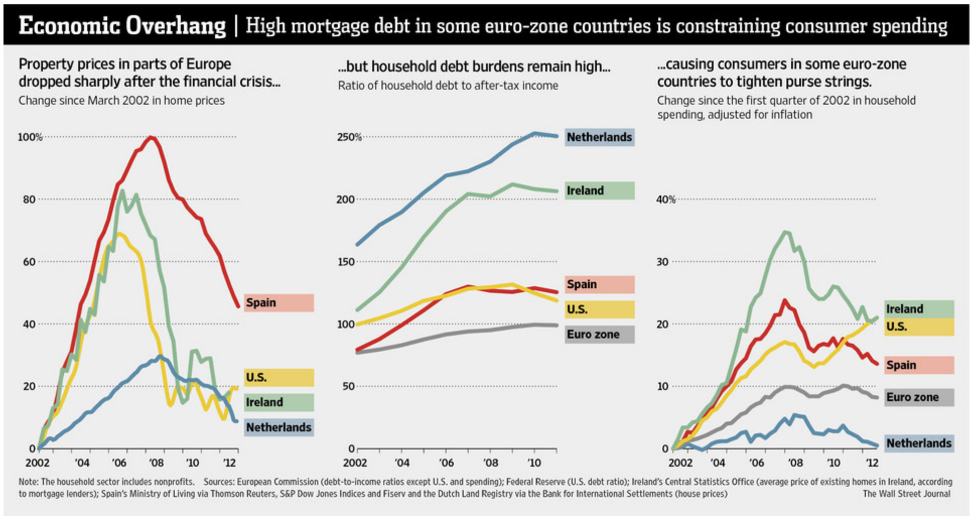
- The Labor Department reports U.S. non-farm payrolls increased by 157,000 in January, while the official unemployment rate edged slightly higher to 7.9%, citing the largest hiring gains occurred in retail (33,000), construction (28,000), health care (23,000) and wholesale trade (15,000). The Labor Department also issued its annual benchmark update, which aligned employment data spanning from April 2011 to March 2012 with corporate tax records. The revision revealed U.S. payrolls grew by an additional 424,000 within that period, on an unadjusted basis.



- The Tempe, Arizona-based Institute of Supply Management (ISM) reports its U.S. manufacturing index rose to a reading of 53.1 in January from a level of 50.2 in December. In a conference call with reporters, Bradley Holcomb, chairman of the ISM factory survey, stated: "While we're off to a great start to the year, we just have to see how things materialize. We're not out of the woods yet."

- RBC reports its Canadian manufacturers purchasing managers' index (PMI) – produced in conjunction with the Purchasing Management Association of Canada and Markit Economics – rose marginally to a reading of 50.5 in January from a level of 50.4 in December. Craig Wright, RBC'S chief economist commented: "The Canadian manufacturing sector experienced a relatively lacklustre start to the New Year amid ongoing global economic uncertainty. Since some of the more extreme downside risk scenarios look less likely now, we may see confidence in the global economy improve."

- Front Page Headline, Wall Street Journal – **"Lingering Bad Mortgage Debts Stifle European Recovery.** Eurostat reports average euro zone house prices declined further in the 3rd. quarter of 2012, dropping by 0.7% from the previous quarter. Prices in the Netherlands fell by 3.9% -- the biggest drop in the euro zone – and prices fell by 3.7% in Spain. Eight nations posted gains, including Ireland, where prices edged up by 1.6%. Charles Roxburgh, a director at consulting firm McKinsey & Co. in London, noted: 'There is a case for allowing overly indebted borrowers to default as the U.S. has done. You get short term pain, but you move through the problem more quickly. However, someone has to pick up the tab on it at some point.' Many European banks feel they can't afford to forgive billions of euros of housing debt, which leaves policy makers in a bind. Making it too easy to walk away from underwater mortgages would further weaken banks which have already received tens of billions of euros in government bailouts. Making it too difficult risks leaving a debt overhang which could hamper (economic) growth for years. Bankruptcy laws don't provide much of an escape hatch. In Ireland, laws until recently were so restrictive that only about 30 individuals had themselves declared bankrupt in 2011, according to the Irish Justice Department. The law required court supervision of individual finances for 12 years before remaining debts were forgiven – a period during which debtors had to allocate nearly all disposable income to creditors, couldn't operate their own businesses and often faced problems opening bank accounts. New personal insolvency legislation which passed late last year allows discharge from bankruptcy after three years, however many of the restrictions on debtors remain. Under Spanish bankruptcy laws, unpaid debts never go away and bankruptcy registers can make it difficult for people to lease apartments, or obtain cell phone contracts. In the Netherlands, people seeking debt relief can wait three years before being allowed into a restructuring procedure which siphons off most disposable income for up to five years. Following that, their remaining debts are recorded in a central registry for another five years."



- Front Page Headline, Daily Telegraph U.K. – **"Downing Street Warns Pensioners to Prepare for Difficult Decisions.** Some Conservative Members of Parliament, including the Work and Pensions Secretary, Iain Duncan Smith are convinced that U.K. pensioner benefits, such as winter fuel allowances, free bus passes and free TV licences, should be reviewed following the next election. Indeed, U.K. Prime Minister David Cameron has promised to protect pensioner benefits until the current Parliament ends in May 2015. At a regular briefing for journalists in Westminster, a spokesman for the Prime Minister professed: 'We have done an awful lot to help pensioners, however clearly, speaking generally; there are some difficult decisions to be made.' Some senior Liberal Democrats have called for pensioner benefits to be means tested from April 2015."

- Front Page Headline, Business Insider – **"Euro Zone's Biggest Bank Posts $26 Billion (U.S.) Write Down.** Spanish bank Santander, the biggest bank in the euro zone by market value, reports its net profit plunged in 2012 as it wrote off 19 billion euros ($26 billion U.S.) on bad loans and property assets in Spain. The charges slashed net profit last year by nearly 60%, but left Santander's balance sheet looking more secure. The bank stated it made 12.7 billion euros in provisions for non-performing loans in Spain and another 6.1 billion euros for Spanish real estate exposure, 18.8 billion euros in total. The loan provisions in 2012 left Santander with 73% of its bad loans covered, up from 61% previously. This also allowed the bank to meet new Spanish legislation requiring better coverage of real estate exposure. Spain's banking sector as a whole is expected to post in excess of 80 billion euros in new provisions on their 2012 accounts, in concert with a Spanish government initiative to reduce its bad loan exposure."

Photo: Wikimedia

CLOSING LEVELS FOR FRIDAY, February 1st		WEEKLY CHANGE
Dow Jones Industrial Average	14,009.79	+ 113.81 points
Spot Gold Bullion (February)	$1,669.40 (U.S.)	+ $12.80 per oz.
S&P / TSX Composite	12,768.83	– 47.80 points
10 - Year U.S. Treasury Yield	2.02%	+ 7 basis points
Canadian Dollar	100.36 (U.S.)	+ 1.01 cent
U.S. Dollar Index Future (Spot Price)	79.206 cents	– 0.532 cent
WTI Crude Oil (February)	$97.77 (U.S.)	+ $1.89 per barrel

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