

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE  
**THAT WAS THE WEEK THAT WAS**



**Monday, July 15th**  
Front Page Headline, Globe and Mail – “Loblaw to Purchase Shoppers Drug Mart.”

Monday, July 15th

Loblaw Cos. Ltd. announces it has finalized an agreement to acquire pharmaceutical retailer Shoppers Drug Mart for \$12.4 billion (CAD) in cash and stock. The combined company – on a pro-forma basis last year – would have recorded \$42 billion (CAD) in revenue; \$3 billion (CAD) in earnings before interest, taxes, depreciation and amortization and \$1 billion (CAD) in free cash flow. Loblaw Executive Chairman Galen Weston commented: ‘This transformational partnership changes the retail landscape in Canada. With scale and capability, we will be able to accelerate our momentum and strengthen our position in the increasingly competitive marketplace ... The two companies are establishing a truly innovative platform for the future, based upon the championing of health, wellness and nutrition.’



Source: Globe and Mail

- The Federal Reserve Bank of New York reports its Empire State manufacturing index rose to a reading of 9.5 in July from a level of 7.8 in June – citing a higher gauge for new orders of 3.8 from minus 6.7 in June – resultant from higher housing and automobile sales. Readings greater than zero for the index signal manufacturing expansion in New York State, northern New Jersey and southern Connecticut.
- The Commerce Department reports U.S. retail sales rose by 0.4% in June – following a downwardly revised gain of 0.5% in May – citing reduced demand at building material outlets and restaurants. Russell Price, an economist at Ameriprise Financial Inc. in Detroit noted: “The retail sales figures are disappointing in comparison to expectations, but the overall picture is still encouraging given the (recent) job growth numbers and improved household balance sheets.”
- Rightmove Plc, a London-based property website operator, reports U.K. house prices rose by 0.3% in July – the 7th. consecutive monthly increase – to an average 253,658 pounds (\$383,300 U.S.). Rightmove Director Miles Shipside commented: “A combination of apparent economic stability internationally – or at least less widely reported turmoil – and some signs of an economic upturn nationally, mean more home movers are willing and able to increase their financial commitments. Barring a raft of economic news, we expect the positive impact of this on the property market to continue.”
- The National Bureau of Statistics reports China’s gross domestic product (GDP) growth slowed to an annual pace of 7.5% in the April to June quarter, while the Bank of China stated: “The government will increase incentives to support small businesses to try to stabilize (economic) growth.” Sheng Laiyun, a National Bureau of Statistics spokesman observed: “The (economic) slowdown is partly the result of Beijing’s efforts to reform the economy – a program aimed at reducing its reliance upon exports and investment – and encourage more domestic consumption.”
- London-based Markit Economics – a data analysis firm – reports of 11,000 manufacturers and services providers in 17 countries surveyed between June 12th. and June 26th., the proportion expecting an increase in business activity over the coming 12 months exceeded the proportion expecting a decline by 30 percentage points, down from 39 percentage points in February. Markit noted that the decline in business confidence was most evident in the United States and China, with smaller declines reported in the euro zone and Japan. Chris Williamson, chief economist at Markit, observed: “The deterioration in business optimism in the U.S. suggests the pace of economic growth is slowing sharply, compared to that seen earlier in the year and calls into question the ability of the economy to continue generating jobs at anything like the pace seen in recent months. Any thoughts of an imminent tapering of the Federal Reserve’s stimulus (program) are looking premature on this basis.”
- Front Page Headline, Daily Telegraph, U.K. – **“Fitch Ratings Downgrades EFSF.** As a direct result of its sovereign debt credit rating downgrade of France last week, Fitch Ratings downgrades the European Financial Stability Facility to ‘AA’ (High) from ‘AAA’; since the EFSF’s creditworthiness depends on that of the countries which provide its financing requirements. While the EFSF has been superseded by the European Stability Mechanism, it still manages the rescue loans to Greece, Ireland and Portugal.
- Lloyd’s TSB reports its bi-annual U.K. corporate confidence index rose by 11 percentage points to 30% over the past six months and is now well above its historic average of 21%. Some 50% of British firms expect sales to grow in the second half of this year, with only 14% bracing for a decline. Broadly speaking, the survey revealed British companies expect to increase spending on machinery and equipment; as well as hire more staff over the next six months.

## Tuesday, July 16th

- The Washington Federal Reserve reports U.S. output at factories, mines and utilities rose by 0.3% in June, citing higher production levels for automobiles and computers.
- The Washington-based National Association of Homebuilders/Wells Fargo reports its index of U.S. builder sentiment rose to a reading of 57 in July – the highest reading since January 2006 – following a level of 51 in June. Brian Jones, an economist at Societe Generale in New York noted: “We are seeing a significant increase in demand for new residential dwellings. Rising mortgage rates are also influencing potential buyers.”

- The Labor Department reports the U.S. consumer price index (CPI) rose by a seasonally adjusted 0.5% in June – led by a sharp increase in gasoline prices – and was 1.8% higher on a year-over-year basis. The core rate, excluding the food and energy categories, rose by 1.6% from June 2012. Both figures remain below the Federal Reserve's 2% target.
- The Office for National Statistics reports the U.K. consumer price index rose by 2.9% in June on an annual basis – the highest rate since April 2012 – up from 2.7% in May. Chris Williamson, chief economist at Markit Economics commented: "Inflation clearly remains the U.K.'s bug bear and calls into question just how long this economic recovery can persist. High prices seem set to continue to erode (consumer) purchasing power, curbing the overall pace of economic growth."
- Front Page Headline, New York Times – **"Missing: The Food Stamp Program – by the Times Editorial Board.** "We'll get to that later." That was the dismissive answer from House Speaker John Boehner last Thursday, when asked if the House would restore the food stamp program (now known as the Supplemental Nutritional Assistance Program, or SNAP) it had just coldly ripped out of the farm bill. "Later," he said, Republicans will deal with the nation's most important anti-hunger program. "Later," maybe, they will think about the needs of 47 million people who can't afford adequate food, probably by reducing the average daily subsidy of \$4.39 (U.S.). However, right then their priorities were clear, as a bare majority rushed to provide \$195.6 billion (U.S.) over 10 years to Big Agriculture. Most of the money went to subsidies for crop insurance and commodities, demanded by the corn, rice and sugar barons who fill campaign coffers. The choice made by the House in cutting apart the farm bill was one of the most brutal, even in the short history of the House's domination by the Tea Party. Last month, the chamber failed to pass a farm bill that cut \$20.5 billion (U.S.) from food stamps because that was still too generous for the most extreme Republican lawmakers. So, in the name of getting something – anything – done, Mr. Boehner decided to push through just the agriculture part of the bill. For decades, farm subsidies and food stamps have been combined for simple reasons of political expediency. Farm-state lawmakers went along with food stamps to keep the crop subsidies flowing; urban lawmakers did the reverse. The coalition may have been an uneasy one and it cost the taxpayers untold billions in wasteful payments to growers. However, that was the price for helping the hungry. As the Center on Budget and Policy Priorities has repeatedly showed, the food stamp program has long been one of the most effective and efficient anti-poverty programs ever devised. When counted as income, SNAP benefits cut extreme poverty nearly in half, a new study shows. Most families who receive the aid have an adult who is employed. Now that the coalition has been sundered, the future of food stamps is threatened. If the program is not restored to the 5-year farm bill, it will necessitate financing through annual appropriations, which places it at the mercy of the Republicans' usual debt ceiling stunts and government shut-down threats. House leaders said they would submit a food stamp bill "later," but that will probably include the right wing's savage cuts and unprecedented incentives for states to shut out poor families. Neither will pass in the Senate, nor, the White House. The only way forward is for a joint Senate/House conference committee to restore the food stamp program to the farm bill (the Senate bill contains a far more modest \$4 billion U.S. reduction in food stamps). Since compassion is no longer an incentive for the House, the threat of a cutoff to the big lobbyists will have to work, just as it always has.

### Wednesday, July 17th

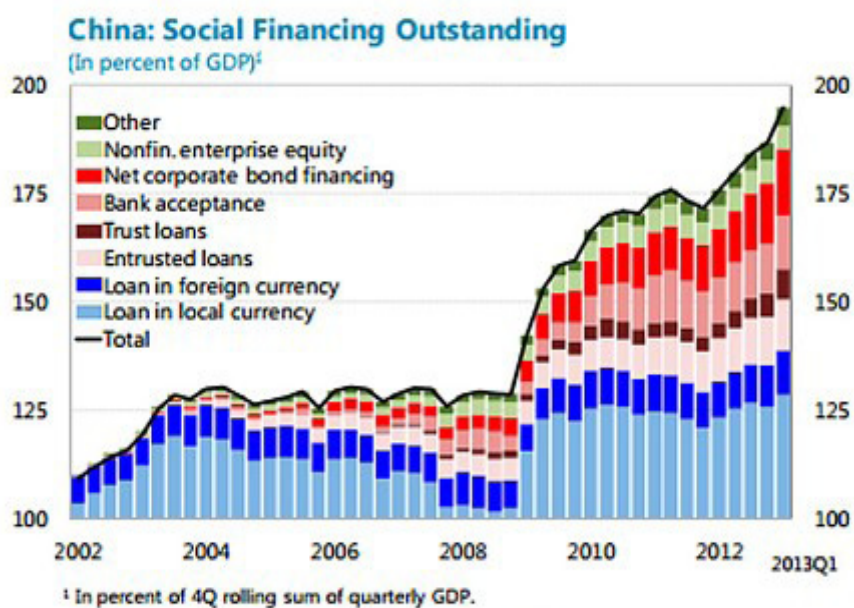
- Front Page Headline, Bloomberg News – **"Federal Reserve's Bond Purchases Not on Preset Course: Bernanke.** In testimony before the House Financial Services Committee, Federal Reserve Chairman Ben Bernanke stated: 'We're going to be responding to the (economic) data. If the data are stronger than we expect, we'll move more quickly to reduce purchases (of fixed income securities). If data don't meet the kinds of expectations we have about where the economy is going, then we would delay that process, or potentially increase (our) purchases for a time. At present, labor markets are far from satisfactory, since the unemployment rate remains well above its long-term normal level and rates of underemployment are still much too high. In addition, the risks remain that tight federal fiscal policy will restrain economic growth over the next few quarters by more than we currently expect, or that the debate concerning other fiscal policy issues, such as the status of the (statutory) debt limit, will evolve in a way that could hamper the (economic) recovery. Separately, the Federal Reserve released its periodic Beige Book business survey, concluding: 'Residential real estate and construction activity increased at a moderate to strong pace in all reporting districts. Manufacturing expanded in most districts since the previous report.'

- The Commerce Department reports U.S. housing starts declined to an annualized pace of 836,000 units in June from a revised 928,000 rate in May. The drop was led by a 26.2% fall in multi-family projects, which are more volatile than work on single family homes.



Source: Bloomberg News

- Front Page Headline, Daily Telegraph U.K. – **“China Defies IMF on Mounting Credit Risk and Need for Urgent Reform.** The International Monetary Fund’s Article IV on China states – as clearly as the IMF dares – that ‘excess credit has been pushed to the outer limits’ of sanity, as the financial system and the economy take each other down in a mutually reinforcing spiral. As one can discern from the first chart (below), total credit has increased from 129% to 195% of gross domestic product (GDP) since 2008 and has completely departed from its historic trend. Plainly, the great mistake was to keep the foot on the accelerator in 2010 and 2011, long after the Lehman crisis had subsided.



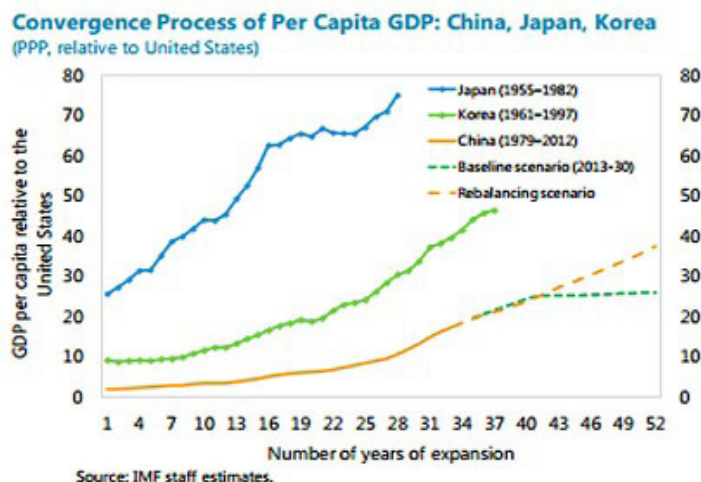
Source: IMF Staff Estimates

The deeper thrust of the IMF report is that the growth model of the past 30 years is exhausted. The low-hanging fruit has been picked. If the Communist Party fails to take radical action, it will soon be caught in the middle income trap ... Since 2008, loans have jumped from \$9 trillion (U.S.) to \$23 trillion (U.S.), a faster pace of debt accumulation than in any major episode of the past century. The IMF notes: 'Wealth products and trusts – a disguised second balance sheet of banks totaling \$2 trillion (U.S.) – over time, could evolve into a systemic threat to financial stability. A sudden loss of confidence could trigger a (bank) run and ignite a severe credit crunch. At present, the authorities still have sufficient tools and fiscal space to address potential shocks. However, failure to change course and accelerate reform would increase the risk of an accident or shock that could trigger an adverse feedback loop.' China has been warned. Dismissively, Beijing replied that 'vulnerabilities are well under control. The fast growth of wealth products and trusts are a healthy sign of market-based intermediation and any risks are manageable. Bad loans in the banking system remain low and Chinese banks possessed some of the highest capital and provisioning ratios in the world.'

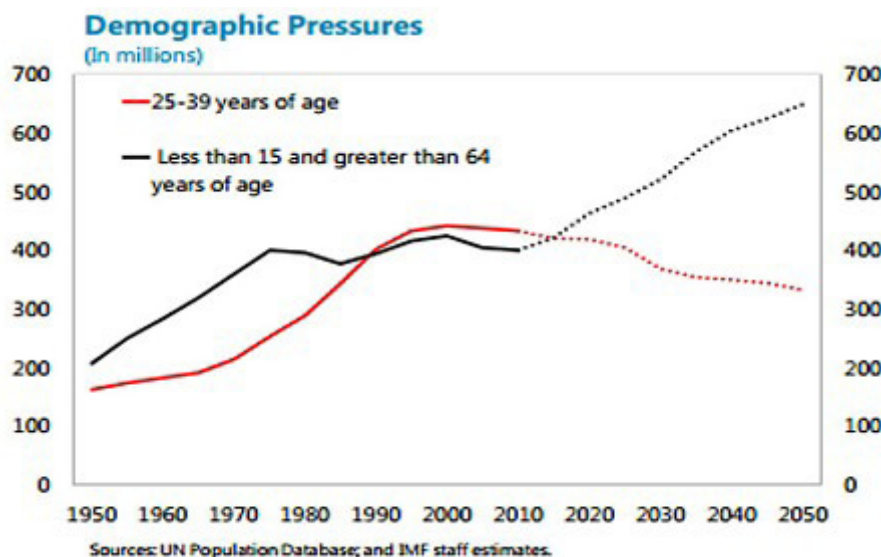
It may (well) be that the barrage of criticism lately from the IMF, Fitch and others has nettled Beijing more than it admits, hence the violent stress test of the banking system in late June. Indeed, if it was a stress test, one wonders what they learned as the interbank market seized up in a Lehmanesque moment and intra-day Shibor rates exploded to 30%. Xia Bin, a pro-reformer at China's Development Research Center believes it is time to end the happy talk and brace for condign punishment: 'We need to find ways to let the bubble burst and write off the losses we already have as soon as possible, (in order) to avoid an even bigger crisis. It means hard days and the bankruptcy of some companies and financial institutions.' Above all, it means reform because the debate over China's GDP growth rate is surreal, since the country is already in the grip of an unprecedented financial crisis. Beijing University Professor Michael Pettis expects China's GDP growth rate to fall to 3% or 4 % over the 10-year term of President Xi Jinping, which would come as a shock to many. He argues that (such a trend) may not be a bad thing, provided the government bites the bullet on reform and provided the Chinese people are at least given a bigger share of the (economic) pie. Headline (GDP) growth would collapse, but household income would not. This is what occurred in Japan after the Nikkei bubble burst. The Chinese people would hardly feel the difference and the social upheaval that everybody fears might never happen.

Unfortunately, the reform drive has yet to advance much beyond hot air. The IMF elaborated: 'Progress with rebalancing has been limited and is becoming increasingly urgent. A decisive shift toward a more consumer-based economy has yet to occur.' China is still diverting 48% of GDP into investment, the highest in the world and far higher than the figure in Japan or Korea during their catch-up (growth) spurts. Consumption is still stuck at around 35% of GDP, which matters for the rest of us. It means that China remains reliant upon export-led (economic) growth, flooding Western markets with excess goods by means of a suppressed currency and subsidized state credit. The IMF expects China's current account surplus to rebound from 2.5% of GDP to 4% by 2018. That surplus will amount to about \$600 billion (U.S.), enough to perpetuate the crisis of over-capacity which lies behind our global malaise.

China's savings rate has continued to grow, not because the Chinese have uniquely Puritanical habits, rather because workers never receive the money in the first place. The lion's share goes to the great state entities, which are the patronage machines of the Party. Not only, are these behemoths defending their turf with tooth and claw, but also, they have powerful allies in the standing committee. Chart 2 (below) shows that China will fail to replicate the break-out spurt achieved by Japan and Korea, if it clings to the status quo. Per capita income will languish at about 25% of America's GDP per capita through the decade.



This will happen just as China's aging crisis and demographic crunch hit in earnest. The workforce is already shrinking. It shed 3 million people last year. The IMF expects the 150 million reserve army of cheap labour in the country to evaporate by the end of the decade ... This will mean a drastic shortage of labour by 2030. (See Chart 3 below.)



Given that the United States will keep growing towards 400 million people as China's population shrinks, the basic maths imply that America will continue to be the world's dominant economic and strategic power for the next century. All those extrapolation charts of a Chinese-led planet which enthralled us all in the BRICS hysteria of 2008 will look very silly indeed, unless China heeds the IMF's advice."

Thursday, July 18th

- Front Page Headline, Daily Telegraph U.K. – **“Germany Refuses New Debt Relief for Greece.** During a day of political clashes in Athens, German Finance Minister Wolfgang Schauble warned: ‘Greece must stop lobbying for a second restructuring of its debt. We must stick to what has been agreed upon. Anything else is not in the best interest of Greece. If you take guarantees and then you are discussing a haircut, you are a liar. You will destroy any confidence.’ Mr. Schauble admitted that Greece may ultimately need a second bailout package as public debt spirals to 176% of gross domestic product (GDP) this year, higher than when Greece first defaulted. The privatization plan intended to gradually reduce the debt has stalled. Meanwhile, Russia's Gazprom has withdrawn from an agreement to purchase Depa, the Greek gas utility. However, Mr. Schauble insisted that talk of writing off loans from European Monetary Union (EMU) bailout funds, or imposing losses on northern euro zone taxpayers would have a devastating impact on support for Greece ... Professor Yanis Varoufakis at Athens University commented: ‘Private investment has declined by 22% over the past 12 months and is still crashing. The banking sector is completely zombified. Companies cannot get a loan. The calamity continues and there is absolutely nothing in sight to reverse it. The Hellenic Confederation of Merchants expects the Greek economy to shed another 195,000 jobs this year as 55,000 small firms go bankrupt.’
- Front Page Headline, Financial Times – **“Moody's Raises U.S. Credit Rating Outlook to Stable.** Citing improvements in the American economy and lower budget deficit forecasts, Moody's Investors Service raised its U.S. sovereign debt credit rating outlook to stable from negative. While Moody's continues to rate U.S. Treasuries at ‘AAA’, Standard & Poor's maintains a rating of ‘AA’ (High).

- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 24,000 to 334,000 in the week ended July 13th. – while continuing claims increased by 91,000 to 3.11 million in the week ended July 6th. – citing the difficulty in seasonally adjusting the data due to the annual closure of auto plants for retooling. Those people who have exhausted their traditional benefits and are now receiving emergency or extended benefits from state or federal programs fell by about 24,200 to 1.64 million in the week ended June 29th.



U.S. auto plants shutting down to retool for the new model year.

Source: Bloomberg News

- Front Page Headline Bloomberg News – **“The City of Detroit Files Chapter 9 Petition for Bankruptcy.** Detroit, Michigan, becomes the largest American city to file for bankruptcy, seeking court protection from creditors while it tries to reduce long-term debt of at least \$18 billion (U.S.). In a letter authorizing Kevyn Orr – the city’s emergency manager – to file the petition, Michigan Governor Rick Snyder declared: ‘I authorize this necessary step as a last resort to return this great city to financial and civic health for its residents and taxpayers.’ According to U.S. Census Bureau data, Detroit has seen its population decline to 707,000, down 7% since 2010. Median household annual income was less than \$28,000 (U.S.) – compared with \$48,000 (U.S.) statewide – and more than 36% of residents lived in poverty as of 2011. Moreover, the city’s median home value of \$71,000 (U.S.) was barely half of the \$137,000 (U.S.) value statewide.”



An abandoned home neighbours the head office for General Motors in Detroit.

Source: Bloomberg News

- Front Page Headline, New York Times – **“European Golf Tour Finds Itself at a Crossroads.** As the world’s best professional golfers descend upon the Muirfield course in Gullane, Scotland for the 142nd. Open Championship – the European Tour’s sole event in England, down from five – Europe’s economic and unemployment problems have pushed the golf circuit to a crossroads. There is only one event held in Spain, six fewer than two years ago. The Irish Open was held in June with no title sponsor and the field for the Scottish Open – won last Sunday by Phil Mickelson – contained only two of the world’s top 25 golfers. The European circuit’s pool of skilled golfers is deeper than aspiring sponsors’ pockets, leading to a drain of player talent to the PGA Tour, where the purses are bigger, the travel demands are lighter and every course is well prepared for its close-up. Northern Ireland’s Graeme McDowell commented: ‘I’m playing my minimum on the European Tour this year for the first time in my career and it’s not something of which I’m particularly proud. It’s tough to compete against \$7 million (U.S.) to \$8 million (U.S.) purses week in and week out. The European Tour is struggling, we know that; so as players we are trying to develop a strategy to help combat that and really start restoring some big events to the (European) schedule.’”

## Friday, July 19th

- Front Page Headline, Globe and Mail – **“The Economist Ranks Canadian Executive MBA Program #1 Globally.** In its initial survey of top MBA programs, the Economist magazine has ranked the Kellogg-Schulich Executive Master of Business Administration program No. 1 globally. The Kellogg-Schulich EMBA program – which is also ranked No. 1 by the Financial Times of London – is a partnership between the Schulich School of Business at York University in Toronto and the Kellogg School of Management at Northwestern University in Evanston, Illinois.”
- The Office for National Statistics (ONS) reports the number of U.K. claimants for unemployment benefits declined by 21,200 in June to about 1.5 million, citing the eighth consecutive monthly drop and a downward revision to the May report.
- The Bank of China announces it is ending controls on bank lending rates in a move toward creating a market-oriented financial system to support economic growth. In a statement, the central bank elaborated: “This reform is to further develop the basic role of market allocation of resources, which is an important measure to promote financial support for the development of the real economy.” Mark Williams of Capital Economics noted: “This is a significant development for China’s financial sector in the direction of having lending rates determined by market forces rather than by government fiat.”
- Front Page Headline, Financial Post – **“Limits to Monetary Policy: Paul Jenkins.** In a Financial Post op-ed, Paul Jenkins – a former senior deputy governor of the Bank of Canada – warns: ‘The global economy needs a lot more than unconventional monetary policy to secure (economic) recovery and growth. A phenomenal expansion of central bank balance sheets has taken place in the aftermath of the global financial crisis, as central banks have aggressively pursued several types of unconventional monetary policy measures. In virtually all cases, it has involved liquidity and credit facilities, as well as outright asset purchases. In some cases, it has also involved forward guidance; that is policy commitments conditional upon future economic developments. The effectiveness of these unconventional measures has been hotly debated. Central banks have presented evidence that bond yields have come down, estimating the cumulative effect to have been from around 50 to 120 basis points at 10 years and have argued that portfolio rebalancing, wealth effects and signaling have all been positive for (economic) growth. Those on the other side of the debate, however, worry about the ability of central banks to unwind unconventional policies without generating significant uncertainty and volatility in markets, along with expressing concern about the risk of asset price bubbles or generalized inflation from prolonged monetary accommodation. Doing the counterfactual – what would have happened in the absence of these unconventional policies – is difficult, given the limited experience we have encountered with such measures. The balance of evidence, however, supports the view that the global economy would be worse off today if central banks had not taken these extraordinary actions. All indications point to the likelihood that we will be living with unconventional monetary policies for some time. While Federal Reserve Chairman Ben Bernanke has mused about a possible slowing in the pace of asset purchases, it would be conditional upon a steadily improving U.S. labour market, that is, data determined. Financial markets, being naturally forward looking, have nonetheless already begun to critically assess and react, perhaps over react to what some are calling “the beginning of the end of easy credit” and we have seen U.S. Treasury (yields) correct sharply in response. In the United Kingdom, the continued commitment to fiscal consolidation almost certainly rules out any unwinding of unconventional policies anytime soon. The European Central bank seems to have embraced forward guidance. In the case of Japan, an aggressive expansion of the Bank of Japan’s balance sheet has just been launched. Given the state of the global economy, unconventional monetary support should continue to be an important part of the policy mix to promote global economic recovery and growth. However, is it enough? **The challenges the global economy faces require far more than**



**just a continuation of unconventional monetary policies to secure recovery and growth. While more can and in some cases should be done by central banks, the limits of monetary policy must be recognized. The time these policies have offered for (fiscal) policies to be put in place and take hold may be running out.** In advanced G20 economies, we have a deficiency of demand, with unemployment remaining unacceptably high and still rising in some jurisdictions. **Balance sheets remain impaired with pressures of deleveraging and unsustainable debt levels still very evident. Implementation of financial sector reforms is far from complete.** Moreover, there is a pressing need for real sector structural reforms, ranging from product and labour market reforms to tax reforms to address the challenges of today's global economy. In the euro zone, the pace and degree of austerity must be recalibrated, banks need to be recapitalized and substantially more debt reduction is required. **When the Fed deems it appropriate to begin reducing its pace of asset purchases, a durable expansion – underpinned by more than just monetary policy – must be a prerequisite,** if the inevitable rebalancing of portfolios is to be absorbed smoothly. In the United Kingdom, restoring the health of its banking system must acquire a renewed urgency. In Japan, clear and effective communications are required to avoid market missteps about its bond buying program. In advancing G20 economies, as the engine of global growth since the onset of the (financial) crisis, their main near-term task is to continue to adjust the macro-economic levers of policy to support sustained (economic) growth. Given the differentiation across countries, these policy responses vary. A complicating factor has been the spillovers from the policies of advanced economies, including the market gyrations surrounding recent Federal Reserve communications about its pace of asset purchases. Still, key variables, such as exchange rates have broadly reflected medium-term fundamentals. The other critical challenge for advancing economies is to engineer key structural changes in recognition of underlying, longer term global forces at play, including their own rising presence and importance. These policies include those to support a shift of resources to growth oriented sectors, promote sound and transparent regulations and encourage more reliance upon the price mechanism as a way of doing business. In China, recent concerns among authorities about the rapid rate of credit expansion and growing presence of a shadow banking system, underscore the importance of placing priority in moving in the direction of interest rate and exchange rate market reforms, even if these are deemed among the hardest to do. Success in all these areas of structural reform requires policy platforms with clear roles and responsibilities. It is when there is a lack of clarity, or a perceived vacuum, about policy objectives and frameworks that problems arise.” **At Longwave Analytics, while we are well aware of the main thrusts of Mr. Jenkins’ analysis of the present tenuous state of the global economy; we note that he omits any reference to one sizeable problem of significant concern: that being the trillions of U.S. dollars’ worth of derivative securities and agreements of dubious value, currently held by banks on a global basis. Albeit, we suspect this may be the untold, yet underlying reason why Federal Reserve Chairman Bernanke is unwilling to commence phasing out his quantitative easing program at this time.”**

CLOSING LEVELS FOR FRIDAY, July 19th		WEEKLY CHANGE
Dow Jones Industrial Average	15,543.74	+ 79.44 points
Spot Gold Bullion (August)	\$1,292.90 (U.S.)	+ \$15.30 per oz.
S&P / TSX Composite	12,685.13	+ 222.95 points
10 - Year U.S. Treasury Yield	2.48%	– 11 basis points
Canadian Dollar	96.46 cents (U.S.)	+ 0.24 cent
U.S. Dollar Index Future (Spot Price)	82.44	– 0.498 cent
WTI Crude Oil (August)	\$108.05 (U.S.)	+ \$1.80 per barrel

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