LONGWAVE group

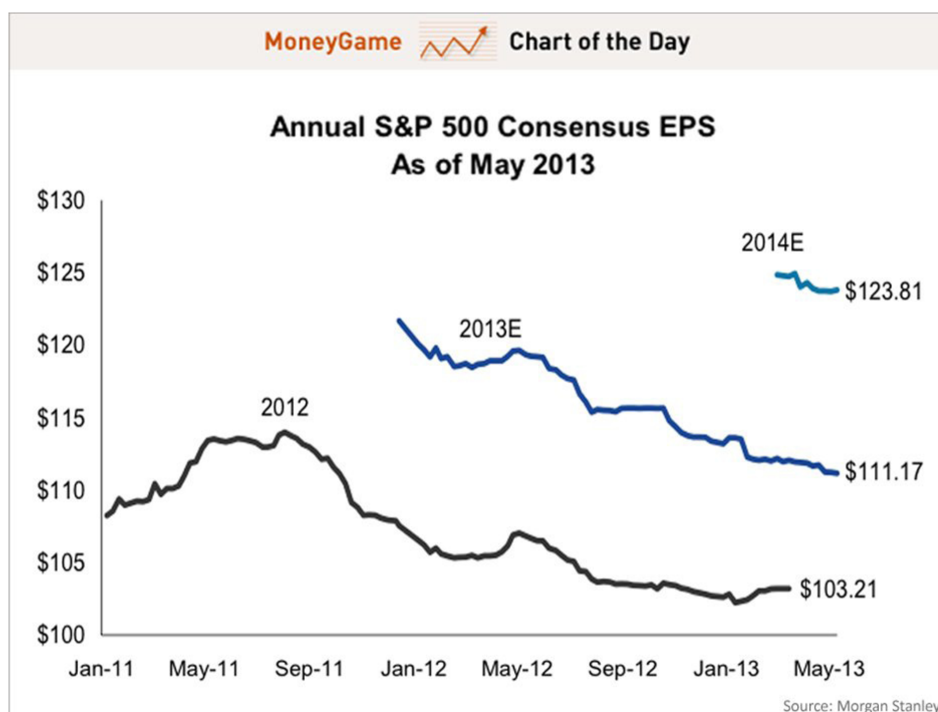
UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, May 13th
Front Page Headline, Business Insider – **"Outlook for U.S. Corporate Earnings Worsens.**

Monday, May 13th

In a research comment, Adam Parker, an analyst at Morgan Stanley notes: 'In aggregate, U.S. companies have exceeded their earnings per share (EPS) estimates in the 1st. quarter, but negative 2013 guidance has driven analyst estimates lower. Over the past month, analysts have downwardly revised their S&P 500 earnings estimates by 0.3%. We expect S&P 500 EPS of $103 (U.S.) and $110 (U.S.) in 2013 1nd 2014, respectively, well below consensus estimates of $111 (U.S.) and $124 (U.S.).' As can be discerned from the chart below, the outlook for American corporate earnings has only been going down."



- The Commerce Department reports U.S. retail sales rose by a seasonally adjusted 0.1% in April, following a 0.5% decline in March. Andrew Grantham, an economist at CIBC World Markets, commented: 'Low gasoline prices combined with the current low inflation environment in general, are helping to offset the impact of higher taxes and encouraging households to raise spending in other areas.'

A Lowe's Home Improvement Store outlet in New York City Source: Getty Images

Tuesday, May 14th

- The non-partisan Congressional Budget Office (CBO) reports the U.S. budget deficit for fiscal 2013 will shrink by 58.4% to $642 billion (U.S.) on a year-over-year basis, citing stronger than expected tax receipts and payments to the Department of the Treasury by the government-owned mortgage financiers Fannie Mae and Freddie Mac. Furthermore, the CBO is forecasting that the federal budget deficit will decline to $560 billion (U.S.) in fiscal 2014 and continue to fall in fiscal 2015, before beginning to grow again.

- Front Page Headline, Globe and Mail – **"Oil Sands Production to Surge amid North American Supply Shock: IEA.** In a new report, the Paris-based International Energy Agency projects Canadian oil production to surge over the next 5 years, but warns that oil sands production will be greater than current pipeline capacity can accommodate. The IEA projects oil sands production to increase by 1.3 million barrels per day by 2018, raising production of total Canadian liquids to 5 million barrels per day in 2018, from 3.7 million today. While the increase in oil output will be limited in 2014 and 2015 given pipeline constraints, growth rates should subsequently accelerate."

- Front Page Headline, Globe and Mail – **"Fitch Upgrades Greece's Credit Rating by One Level.** Fitch Ratings upgrades Greece's sovereign debt credit rating to 'B' (Low) from 'CCC' with a stable outlook, citing the country's progress in cutting its budget deficit. Fitch noted: 'While the economic price tag for Greece has been high in terms lost output and rising unemployment, the capacity for economic recovery remains in doubt. Nonetheless, sovereign debt relief and an easing of fiscal targets have lifted central bank measures of economic sentiment to a three-year high and the risk of a euro zone exit has receded.' Ben May, an analyst at Capital Economics in London commented: 'Greece is less on a knife's edge than it was months ago, but I'm not sure that the worst is over because the fundamental problems are still there."

- The National Federation of Independent Business (NFIB) reports its small business optimism index rose by 2.6 points to a reading of 92.1 in April, more than offsetting the decline in March. The April report is based upon a survey of 1,873 randomly selected small businesses in the NFIB's membership.

Wednesday, May 15th

- The New York Federal Reserve reports the Empire State manufacturing index declined to a negative reading of minus1.4 in May from a positive reading of 3.1 in April, citing a major drop in corporate inventory building and a decline in new orders. Separately, the Washington Federal Reserve reported U.S. industrial production fell by 0.5% in April, citing a big drop in utilities output and a decline in manufacturing. Capacity utilization declined to 77.8% in April, from a downwardly revised 78.3% in March.

A New York manufacturing plant Source: Bloomberg News

- The Labor Department reports the U.S. the Producer Price Index (PPI) declined by a seasonally adjusted 0.7% in April, citing a decline in food and energy prices

- Luxembourg-based Eurostat reports the gross domestic product (GDP) in the 17-nation euro zone declined by 0.2% in the 1st. quarter, following a decline of 0.6% in the final quarter of 2012. The economic slowdown has spread to the euro core with the German economy expanding less than forecast in the 1st. quarter; France slipping into recession and Italy's economic contraction exceeding estimates.

- The Canadian Real Estate Association reports the nation's existing home sales declined by 3% in April on a year-over-year basis, compared to 15% in March. Toronto-Dominion Bank economist Sonya Gulati commented: "While the numbers suggest that the impact of the tighter mortgage insurance rules put in place last July are temporary, there simply is no economic impetus for a full-fledged housing comeback in the offing. The current spring home-buying season should be mediocre at best."

- Statistics Canada reports the nation's factory sales declined by 0.3% in March to $49.5 billion (CAD), the 3rd. decline in four months, citing lower sales in the petroleum, coal and chemical manufacturing industries. Overall, sales fell in 10 of 21 industries, representing approximately one-third of Canadian manufacturing.

- Front Page Headline, Globe and Mail – **HSBC Plans 14,000 Additional Job Cuts by 2016.** HSBC Holdings PLC strives to drive profits and cut annual costs by up to another $3 billion (U.S.) in the face of sluggish growth outside of Asia.

- Front Page Headline, Globe and Mail – **"B.C. Liberals Win Majority Government.** For months, the polls had indicated that Premier Christy Clark was far behind NDP Leader Adrian Dix and many people, particularly in the Canadian media, thought a change was inevitable after 12 years of Liberal rule. **Wakeup call to the greater Vancouver media: Alarmed by the consistency of the polling results, as well as by the recent televised Party Leaders' debate, British Columbians turned out in force yesterday and in the advance polls last week to exercise their franchise.**

B.C. Premier Christy Clark celebrates victory. Source: Globe and Mail

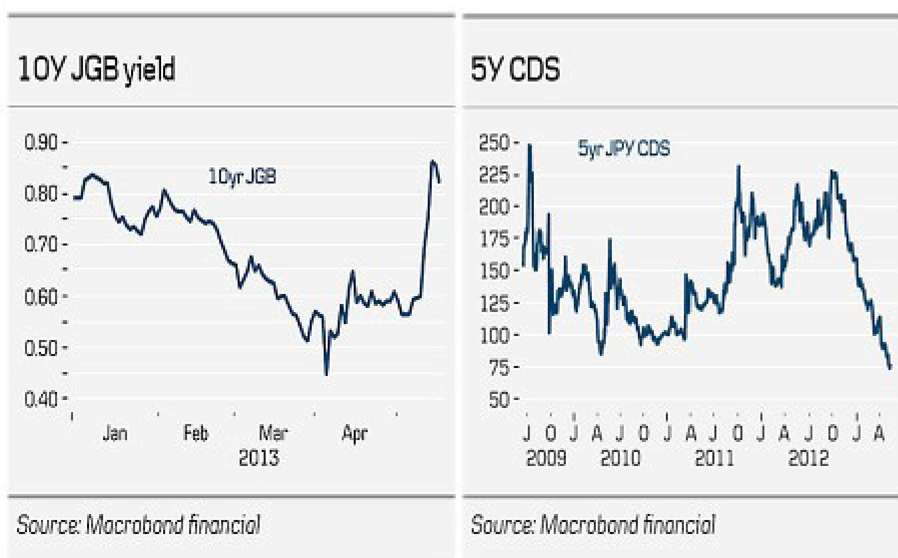
Thursday, May 16th

- Front Page Headline, Daily Telegraph U.K. – **"Pope Francis I Calls Upon World Leaders to End the Cult of Money.** During an address to foreign ambassadors in the Vatican, Pope Francis I had some strongly worded remarks for the 'dictatorship of the global financial system. Free-Market capitalism has created a tyranny and human beings are being judged purely by their ability to consume goods. Money should be made to serve people, not to rule them. The gap between rich and poor is growing and the joy of life is diminishing in many countries. The worship of the golden calf of old has found a new and heartless image in the cult of money and the dictatorship of an economy which is faceless and lacking any truly human goal. The Pope loves everyone, rich and poor alike, but the pope has the duty in Christ's name, to remind the rich to help the poor, to respect them, to promote them."

His Holiness Pope Francis I Source: Reuters

- Front Page Headline, Daily Telegraph U.K. – **"Japan Storms Back on Weak Yen, but Asia Trembles.** Japan's economy has roared back to life as the radical reflation policies of Premier Shinzo Abe propel a surge in consumer spending, but fears are growing that the tumbling yen could ignite a broader Asian crisis. Japan's gross domestic product (GDP) grew at a 3.5% annual rate in the 1st. quarter, vindicating the government's efforts to break the country's deflation psychology and lift it out of its 20-year ice age. Retail sales are soaring as a'wealth shock' electrifies the economy. The Nikkei Index has risen by 70% since November, with foreign hedge funds among the first to jump on the bandwagon. The weaker yen is already delivering a powerful punch, accounting for almost half the GDP growth. The yen has declined by 30% against the U.S. dollar and China's yuan since August, and 37% against the euro. The yen's slide has raised concerns that Japan is exporting deflation through a 'beggar-thy-neighbour'drive for export share – a claim rejected by Tokyo ... Albert Edwards from Societe Generale notes: 'The yen's decline may prove the catalyst that pops China's credit bubble. That loss of exchange rate competitiveness after years of soaring wages leaves China vulnerable to a deflationary monetary squeeze and should ring alarm bells. This closely echoes the situation in the period leading to the 1997 Asian currency crisis.' To date, the G7 global powers have turned a blind eye to the falling yen, deeming it a side effect in Japan's fight against deflation. Washington has grumbled privately, but broadly accepts that a revival of economic growth in Japan is a net gain for the world economy. However, the protests from Korea and China are growing louder. Standard & Poor's Jean-Michel Six commented: 'The yen effect risks pushing the euro zone towards deflation. Japan competes head-on with Germany in the same products and this is already putting pressure on German exporters in the Chinese and U.S. markets. Korea is very worried about the yen, and Germany should be also.' The five-year futures markets are already pricing in a higher risk of deflation in Germany than in Japan, an almost unthinkable development just months ago. Japan has been stuck in 1% deflation for years, an effect which has slowly poisoned debt dynamics. The centerpiece of 'Abenomics' is the full mobilization of the Bank of Japan, drawing on policies that pulled the country out of the Great Depression in the 1930s. After years of economic paralysis, the new BOJ team under Haruhiko Kuroda has launched quantitative easing on a vast scale, buying $1.4 trillion (U.S.) of bonds across the yield curve spectrum. The BOJ is injecting $75 billion (U.S.) per month, almost as much as the Federal Reserve in an economy one-third of its size. This has stirred talk of a 'wall of money' flooding global markets, with up to $1 trillion (U.S.) leaking out in a revival of the yen 'carry trade.' It has not happened yet, but Societe Generale reports that Japanese investors have repatriated money so far this year to take advantage of the boom at home, selling a net $59 billion (U.S.) of foreign stocks. While Japanese investors have been net buyers of foreign bonds over the past three weeks, it has been in 'very modest' amounts and offset by foreign inflows into Japan.

  The Bank of Japan's monetary blitz is a high-risk strategy since any suspicion that it aims to inflate away Japan's public debt – $10 trillion (U.S.), or 245% of GDP – could upset a fragile equilibrium and cause life insurers and pension funds to slash their bond holdings. No developed country has ever before recorded such a high level of public debt. While 93% of the government bonds are held domestically, this does not mean that Japan is immune to a debt crisis. Yields on 10-year government bonds (JGBs) have doubled since Mr. Kuroda unveiled his plans. They spiked to 0.92% last week in the biggest sell-off for a decade before the BOJ intervened.



So far, this appears benign. Danske Bank commented: 'Rising JGB yields should be viewed as a success, since they mean the BOJ has finally convinced markets that it will defeat deflation. The plummeting cost credit default swaps used to insure against a Japanese sovereign debt is a sign that investors think the policy reduces the risk of a financial crisis.' Junko Nishioka from RBS noted: 'The danger threshold for 10-year JGB yields is around 3%. That could trigger a market event.' An increase to that level risks triggering a banking crisis, since Japanese lenders hold government bonds worth 80% of GDP with smaller regional banks most at risk. Danske Bank also observed: 'The Kuroda strategy will boost nominal GDP and therefore, help to bring Japan's debt burden under control by averting a deflationary debt-compound trap. However, the JGB yield spike is highly significant and may be the harbinger of a global bond rout as the cycle turns, perhaps later this year or in 2014. It is a wake-up call. We advise keeping an eye on the Japanese bond market.

- The Labor Department reports the U.S. consumer price index (CPI) declined by 0.4% in April, following a drop of 0.2% in March, citing lower prices for gasoline

- The Commerce Department reports U.S. housing starts declined by 16.5% in April to an annualized pace of 853,000 units, following a revised rate of 1.02 million in March. Meanwhile, building permits rose by 14.3% in April, the highest level since June 2008.

- The Federal Reserve Bank of Philadelphia reports its manufacturing index declined to a reading of minus 5.2 in May from a positive level of 1.3 in April, citing a drop in new orders and causing factories to reduce employment and hours of work. Readings below zero signal contraction in the area covering eastern Pennsylvania, southern New Jersey and Delaware.

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 32,000 to 360,000 in the week ended May 11th.

Friday, May 17th

- Front Page Headline, Wall Street Journal – **"Italy Initiates Steps to Revive Economy.** Italy's new government announces 3 billion euros ($3.86 billion U.S.) in economic measures aimed at offering relief to households and workers amid the country's longest post-war recession. At a news conference following a cabinet meeting in Rome, Prime Minister Enrico Letta declared an unpopular tax on primary residences would be suspended and an extra 1 billion euros would be pumped into a wage supplement program. Among other measures yet to be announced, the government has identified youth unemployment as a national priority."

Italian Prime Minister Enrico Letta (right) and his deputy Angelino Alfano. Source: EPA

- The National Bureau of Statistics reports China's new home prices in April rose in 78 out of 80 cities tracked by the government. On a year-over-year basis, Guangzhou – capital of southern Guangdong province – reported the biggest increase with a 13.5% gain, while Beijing prices climbed by 10.3% and those in Shanghai rose by 8.5%. Chris Brooke, CEO for China at CBRE Group Ltd. commented: "Underlying housing demand is so strong that it's very difficult to control prices. The government needs to work on the supply side, making sure there's enough land to develop the private rental and affordable housing markets. The government must also look at something like an occupation tax, in order to impose a cost on holding empty property."

- Front Page Headline, Daily Telegraph U.K. – **"To Its Detriment, France Has Been Ignoring Its Problems.** In France, government spending accounts for 56% of gross domestic product (GDP), the highest in the euro zone. To a certain extent that would be unthinkable in most other currency bloc countries. Consumers, businesses and government operate a buy-French policy on just about everything from wines to cars. The result is that the effects of a loss of competitiveness can be disguised. However, now the chickens are coming home to roost. Since the European Monetary Union (EMU) was formed in 1999, German unit labour costs have risen by only 10%. At the peak, Greek, Irish and Spanish costs were up by 62%, 53% and 43% respectively. However, these countries have since managed to reduce their unit costs so that the equivalent figures are now 41%, 30% and 28%. Meanwhile, French costs have continued to increase. They are now up about 30% since 1999, putting France in the same position as Spain and Ireland. Moreover, France's share of world exports stands at about half of what it was in 1999. Indeed, export prospects don't look good, not the least since France is heavily dependent upon the weak peripheral economies, which take about 20% of her exports compared to only 13% of Germany's. Admittedly, the employment picture is not as bad as Spain or Greece, however, it is still pretty grim. The unemployment rate is 11%, compared to 5.4% in Germany. Over the past two years, the U.K. has created more than 400,000 jobs, while France has created fewer than 90,000. None of this is surprising when one considers what French employers must tolerate: the 35-hour work week; 'social charges' of about 50% over and above wages; employment protection legislation – which makes it almost impossible to fire anyone – high levels of industrial action and punitive personal taxation. The majority of foreign business people with operations in France agree it's a nightmare to do business there. France's fiscal position also looks pretty serious. Its debt to GDP ratio is already on course to reach 95% this year ... Meanwhile, French banks are seriously weak, with large exposures to the sovereign debts of the European periphery amounting to about 15% of France's GDP ... The problem is there is no indication of a reforming zeal in France. Indeed, the French government has moved in the opposite direction. It has even reduced the retirement age just when other governments are increasing it. Plus, France has a tradition of ungovernability. Getting tough reform legislation passed is not only, a matter of difficult electoral politics, but also, of winning battles in the streets ... Despite the seriousness of this situation, the French establishment's eye is not on the ball. It thought monetary union would unleash a wave of prosperity. Some hope. It now seems to think that completing the monstrous building that is the euro, will somehow fix the dodgy foundations underneath. However, unless France acts boldly to reform its economy – particularly its labour market – even the achievement of full fiscal and political union would still leave its economy languishing. Increasingly, France looks like a part of the southern periphery. As the French economic position worsens, the markets would do well to ponder the implications. When the next dollop of bailout money is required, will France be in a position to accept her share?"

CLOSING LEVELS FOR FRIDAY, May 17th		WEEKLY CHANGE
Dow Jones Industrial Average	15,354.40	+ 235.91 points
Spot Gold Bullion (June)	$1,364.70 (U.S.)	– $71.90 per oz.
S&P / TSX Composite	12,613.05	+ 23.96 points
10 - Year U.S. Treasury Yield	1.95%	+ 5 basis points
Canadian Dollar	97.17 (U.S.)	– 1.72 cents
U.S. Dollar Index Future (Spot Price)	84.12	+ 1.023 cents
WTI Crude Oil (June)	$96.02 (U.S.)	– $0.02 per barrel

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