

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



Monday, May 27th
Front Page Headline, Bloomberg
News – “U.K. House Prices Rise
Most in Six Years.”

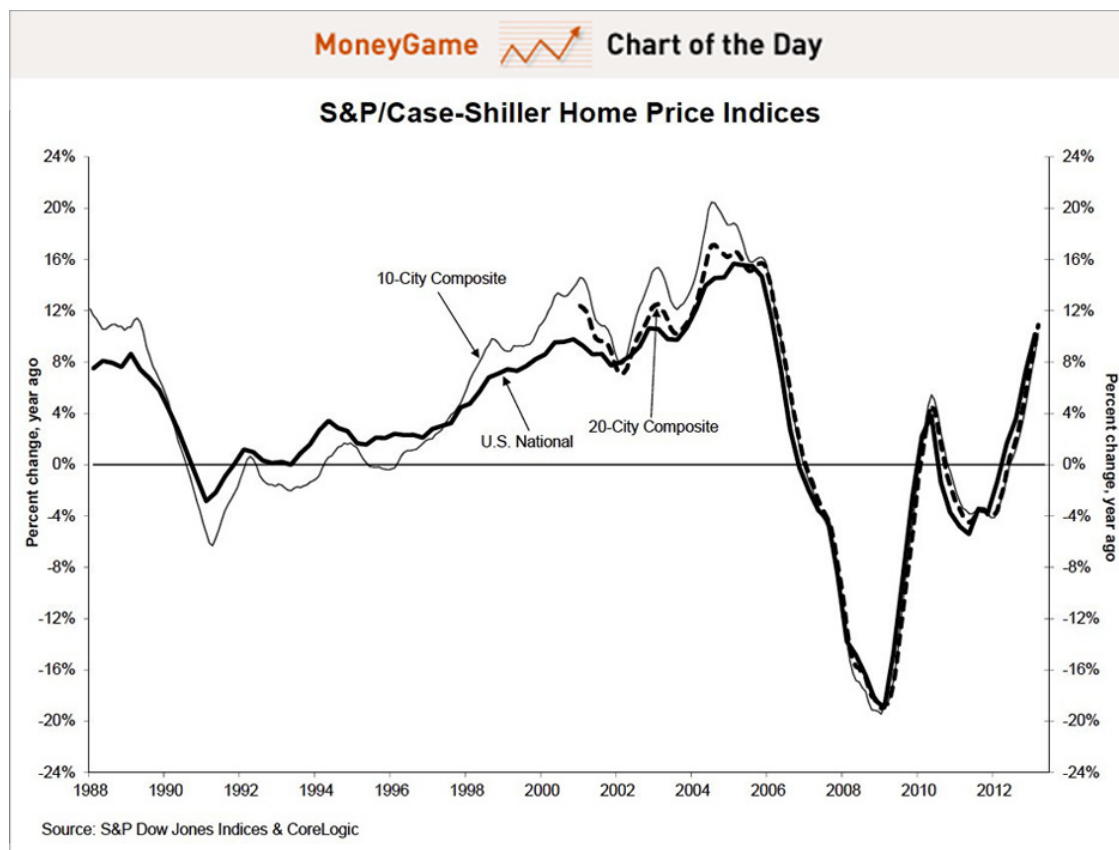
Monday, May 27th Memorial Day Holiday in the United States of America

London-based property researcher Hometrack Ltd. reports average home values in England and Wales rose by 0.4% this month – the biggest monthly increase since May 2007 – citing a shortage of inventory in the greater London area. Hometrack’s Director of Research Richard Donnell commented: ‘The impetus for rising house prices is originating almost exclusively from London and the southeast. Elsewhere, housing market conditions are improving gradually, with prices trending slowly upwards.’

Tuesday, May 28th

- The New York-based Conference Board reports its consumer confidence index rose to a reading of 76.2 in May from a level of 69 in April, citing rising property values and higher stock prices are boosting household finances.
- Front Page Headline, Bloomberg News – “**Moody’s Raises Outlook for U.S. Banking Industry to Stable.** In a statement released to the media, Sean Jones, a Moody’s Investors Service analyst, commented: ‘We expect U.S. gross domestic product (GDP) will grow between 1.5% and 2.5% through 2014, helping banks avoid losses ... Sustained GDP growth and improving employment conditions will help banks protect their now stronger balance sheets. After another year of reducing credit-related costs and restoring capital, U.S. banks are now even better positioned to face any future economic downturn.’”
- Front Page Headline, Bloomberg News – “**Caribbean Defaults Resulting from Worse-Than-Cyprus Debt Load: Moody’s.** In a recent report, Edward Al-Hussainy, a Moody’s analyst for the Caribbean identified ‘Jamaica and Belize, which restructured about \$9.5 billion (U.S.) in domestic and global bond issues this year for the second time since 2006, as facing a high probability that they will default again. A sustained reduction in debt in the Caribbean region over the next decade will require a combination of aggressive fiscal consolidation and increased economic growth. However, both goals are becoming increasingly out of reach. Default becomes a self-reinforcing cycle, since restructured debt must be serviced at higher interest rates.’” S&P Case-Shiller report their U.S. 20-city composite index of property values rose by 10.9% on a year-over-year basis in March – the biggest 12-month gain since April 2006 – following a 9.4% gain in February. Brian Jones, an economist with Societe Generale in New York, commented: ‘We have a continuing, gradual (housing) recovery, since the recent data remains solid.’”

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- Front Page Headline, Financial Post – **“Germany Warns of Revolution as Youth Unemployment Threatens to Render Europe Asunder.** Speaking at a conference in Paris, German Finance Minister Wolfgang Schaeuble warned: ‘We need to be more successful in our fight against youth unemployment, otherwise we will lose the battle for Europe’s unity. Policies aimed at boosting youth employment must focus on small and medium-sized enterprises, since they are the main entry point for youth to the labour market.’ Germany, along with France and Italy, backed urgent action to rescue a generation of young Europeans who fear they will not find jobs, with youth unemployment in the European Union (EU) standing at nearly 25%, more than twice the adult rate. Italian Labour Minister Enrico Giovannini stated: ‘We must rescue an entire generation of young people who are scared. We have the best-educated generation and we are putting them on hold. This is not acceptable.’ German ministers told the conference that, to help young people to find jobs, Europe must continue on the path of structural reforms in order to boost its competitiveness, as well as make good use of available EU funds, including 6 billion euros that leaders have set aside for youth employment for 2014-20. More than half of Spain’s under 25-year olds are jobless, as are nearly 40% in Portugal. In Greece, youth unemployment soared to a record 64% in February. The youth unemployment crisis will be a central theme of a June EU leaders’ summit, and German Chancellor Angela Merkel has invited EU labour ministers to a youth unemployment conference in Berlin on July 3rd.”

EU'S BRUTAL YOUTH UNEMPLOYMENT

UNEMPLOYMENT RATE, AGE 25 AND UNDER

Q1 2013, SEASONALLY
ADJUSTED

European Union*	23.5%
Euro area**	24.0%
Belgium	22.2%
Bulgaria	29.0%
Czech Republic	19.2%
Denmark	14.8%
Germany	7.6%
Ireland	30.5%
Spain	55.8%
France	26.3%
Cyprus	32.3%
Lithuania	24.8%
Luxembourg	19.3%
Malta	14.7%
Netherlands	10.4%
Poland	28.1%
Portugal	38.2%
Slovenia	24.4%
Slovakia	34.7%
Finland	19.9%
Sweden	24.4%

*27 countries ** 17 countries

SOURCE: EUROSTAT
JONATHON RIVAIT / NATIONAL POST



Demonstrators protest financial emigration in Madrid.

Source: Reuters

- Front Page Headline, Daily Telegraph U.K. – **“Portuguese Bestseller Calls for Euro Exit.** Portugal is waking up. A new book calling for Portugal’s withdrawal from the euro and a return to the escudo has vaulted to the top of the bestseller list. The incendiary tract – ‘Porque Debemos Sair do Euro’ (Why We Should Leave the Euro) – is written by Professor Joao Ferreira do Amaral from the Instituto Superior de Economias Gestao (ISEG). The professor has already secured the backing of Luis Antonio Noronha Nascimento, the chief justice of Portugal’s Supreme Court ... The new book makes a poignant parallel with Portugal’s subjugation by Philip II of Spain, and its travails as a captive province of the Spanish Empire for 60 years. ‘In 1581, Portugal surrendered to Spain. In 1992, it laid itself at the feet of a European Commission (EC) increasingly answering to Germany’s tune. There was no referendum and the voters were never consulted. The Portuguese elites, who hoped to benefit richly from European Structural Funds, cavalierly handed over our currency – and with it our monetary sovereignty. The rest is history.’ From 2008 onwards, the EC broke with tradition and became an organ at the service of a new power. The Portuguese economy succumbed, choked by the new mark. The tragedy was widely told in advance. In the 1990s, several voices had alerted us to the dangers of joining the single currency. Of course, one of them was the economist Joao Ferreira do Amaral himself, now relishing his bitter/sweet moment of vindication. The nub of his argument is that a euro exit is not a luxury choice. It is the only possible way for Portugal to recover given the current European Monetary Union (EMU) structure. Unlike some, the professor does not think the situation will improve for Portugal, even if the euro zone sovereign debt crisis calms down. On the contrary, further damage will be even greater. He warns that the euro could rise to \$1.50 (U.S.) or \$1.60 (U.S.), leading to the final devastation of Portugal’s manufacturing industry, which often competes directly with China, emerging Asia and North Africa ... Portugal’s combined (non-financial) public and private debt has reached 370% of gross domestic product (GDP), the highest in the world after Japan. The difference is that Japan remains a fully sovereign nation with a sovereign central bank and currency and therefore, can try to remedy the situation. The Portuguese economy is shrinking by 3% to 4% a year and keeps missing its deficit targets – like Greece before it, although less dramatically – as it chases its own tail in a downward deflationary spiral. The crucial point is that nominal GDP is contracting violently. This means that the nominal debt load is rising on a shrinking nominal base, what is known as a negative ‘denominator effect.’ **See also, [Economic Winter, The Rise of Populism Within the European Monetary Union, March 15, 2013.](#)**

Wednesday, May 29th

- Front Page Headline, New York Times – **“Prominent Economist Flees Russia after Interrogation.** A prominent, liberal-minded economist has fled Russia under pressure from government investigators, as the Kremlin’s year-long crackdown moves beyond protestors and their leaders to elite power-brokers who are suspected of supporting them. Sergei Guriev, who wielded significant influence under the presidency of Dmitri Medvedev, has been questioned repeatedly in a case that stems from a report of which he was a co-author that harshly criticized the treatment of Mikhail Khodorkovsky, the imprisoned oil tycoon and Putin rival. Mr. Guriev’s flight comes amid a series of probes which focus on insiders who, investigators believe have offered support to the opposition movement. Behind their suspicions lies an uncomfortable truth: among the businessmen and technocrats who comprise Moscow’s ruling class are many who hold relatively liberal views and some who – whether they admit it or not – are uncomfortable with the repressive, conservative course Mr. Putin has set since his return to the presidency. Until now, they have felt relatively safe. Aleksei Makarkin, an analyst at Moscow’s Center for Political Technologies observed: ‘This means that no one has immunity. If any representative of the elite enters into a relationship with the opposition, he takes a great risk.’ Mr. Guriev would not comment on his decision and has stated that he is vacationing with his wife and children in France. However, a friend, who spoke on condition of anonymity, said Mr. Guriev left Russia abruptly, because ‘he had reason to believe he could be deprived of his freedom ... Following the most recent round of questioning, Mr. Guriev sought counsel from a number of influential people in Moscow who normally would protect him and he was given the advice that he was not safe.’



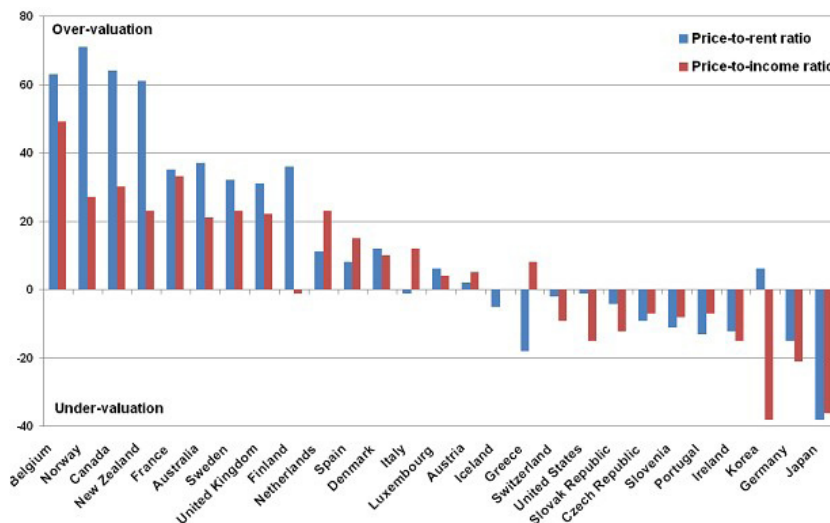
Russian economist Sergei Guriev.

Source: Reuters

- Front Page Headline, Wall Street Journal – **“EC Releases Italy from Budget Oversight.** The European Commission releases Italy from the so-termed Excessive Deficit Procedure – heightened oversight for countries with high deficits – offering Rome some modicum of relief. The EC decision rewards two years of austerity policies which have reduced Italy’s budget deficit, at a price of a severe and protracted economic contraction and a higher level of unemployment. To some extent, it vindicates the tax increases and spending cuts which former Prime Minister Mario Monti began implementing in the autumn of 2011 and will likely give the current government a reprieve from further belt-tightening.”
- Front Page Headline, Daily Telegraph U.K. – **“No Saviour in Sight as World Credit Cycle Rolls Over.** The HSBC index for the global business cycle reached a three-year high around Easter and has since rolled over. Today may be as good as it gets for the world economy. Any country that has failed to lock in a self-sustaining economic recovery by now must expect to pay the price for the failings of its policy establishment and some risk a slide into outright deflation. Fredrik Nerbrand, HSBC’s global asset analyst stated: ‘We see evidence building for a cyclical (economic) downturn. We find it highly troubling that the euro zone is still mired in a recession at the same time as our cyclical indicators appear to have peaked ... Slowing (GDP) momentum should send shivers down the spine of any investors who are long risk.’ Yet (equity) markets are gambling that central banks will come to the rescue again if needs be. Perhaps, but only after they have first struck a blow against moral hazard and demonstrated their distaste for asset bubbles. The central banks (will) take their time. Mr. Nerbrand believes: ‘They will not act until the (stock) markets have already priced in a sub-optimal outcome.’ That’s London Canary Wharf dialect for a nasty sell-off.”

Thursday, May 30th

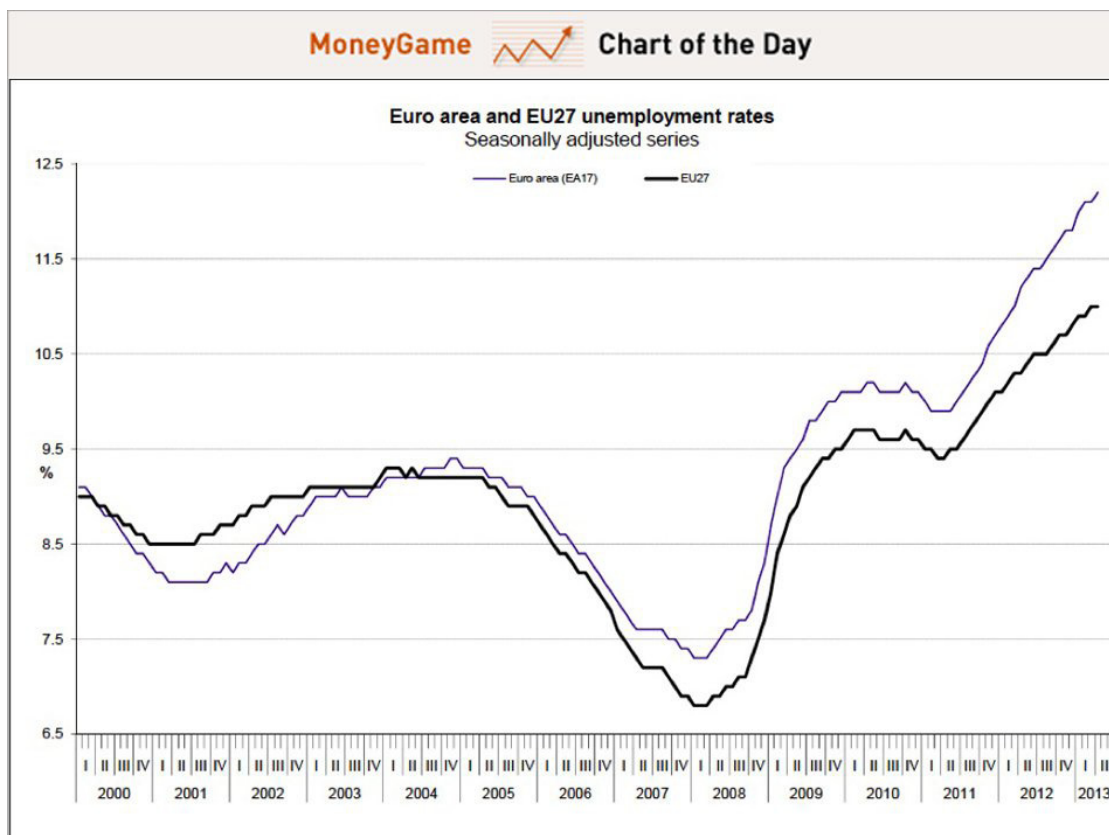
- Front Page Headline, Globe and Mail – **“S&P Affirms Province of Ontario’s Credit Rating.** Standard and Poor’s Ratings Services affirms its ‘AA’ (Low) credit rating for the Province of Ontario, but lowers the outlook to negative from stable. S&P credit analyst Mario Angastiniotis commented: ‘While recognizing the sluggish growth in the U.S. and the European recession pose risks to the (global) economic outlook, we believe that the (Ontario) government’s forecast for real GDP growth – which underpins its fiscal plan – is reasonably cautious. The Province continues to have a large, wealthy and well-diversified economy, although it still faces a significant (budget) deficit. As a result, the revised outlook reflects S&P’s view that there is at least a 33% chance that we could lower the long-term (credit) rating by one level within the next 12 months.’ While Ontario’s budget deficit is expected to be \$9.8 billion (CAD) in fiscal 2012-13, it is projected to climb to \$11.7 billion (CAD) in fiscal 2013-14.”
- Front Page Headline, Daily Telegraph U.K. – **“Belgian, Norwegian and Canadian House Prices at Least 60% Too High: OECD.** A study by the Organization for Economic Cooperation and Development, which compared house prices with local wages and rents, suggests Belgium, Norway and Canada are the most expensive markets compared with their own long-term averages; followed by New Zealand, France and Australia. British house prices are 31% too high compared to rents and 21% overpriced against incomes. For cheap property, the research points to Portugal, Ireland, Germany and Japan ... The OECD concluded: ‘House prices are high and in some cases continue to rise; in Norway, Sweden, Canada and New Zealand, pointing to the risk of a correction, especially if mortgage rates were to rise or income growth were to decline.’”



- The Labor Department reports U.S. initial claims for state unemployment benefits rose by 10,000 to 354,000 in the week ended May 25th. while continuing claims increased by 63,000 to a seasonally adjusted 2.986 million in the week ended May 18th.
- The Commerce Department reports the U.S. gross domestic product (GDP) grew at a revised annual rate of 2.4% in the 1st. quarter, following an initial estimate of 2.5%, citing slower growth in inventories and a steeper drop in government spending
- The European Commission (EC) reports its index of executive and consumer sentiment rose to a reading of 89.4 in May from a level of 88.6 in April
- Statistics Canada reports the nation's current account deficit declined to a revised \$14.1 billion (CAD) in the 1st. quarter, following an initial estimate of \$15.6 billion (CAD)

Friday, May 31st

- Luxembourg-based Eurostat reports the euro zone unemployment rate rose by .01% in April to 12.2% – citing higher prices for food and services – but this understates those who have dropped out of the work force. The European Commission (EC) believes Italy's real unemployment rate is around 20% and not the declared rate of 11.2%. European Union (EU) President Herman Van Rompuy commented: "We are engaged in a race against time. In too many EU countries, there are too many people without jobs – particularly young people – reminding us that the (economic) battle is not yet won and further efforts are needed. I will be presenting proposals for spurring (economic) growth and jobs at a June summit of the currency bloc's leaders in Brussels."



- Front Page Headline, Bloomberg News – **“China’s Growing Ranks of Elderly Beset by Depression.** According to a recently published survey, China’s elderly are plagued by depression, illness and poverty; highlighting the challenge the country faces as its restrictive family planning policy results in a surge in the elderly population. China faces the dilemma of becoming the first country in the world to grow old before entering the ranks of rich nations and paying for the surge in social-services demand. The survey was conducted during 2011 and 2012 by a team of academics from China, the U.S. and the World Bank who surveyed 17,708 people across China. According to the study: ‘Among people 60 years old and over, 22.9%, or 42.4 million, live on an annual income of less than 3,200 yuan (\$520 U.S.), compared to 15.1% of people aged 45 to 59. The proportion of China’s 1.3 billion plus population over age 60 is set to increase to 34% by 2050 from 12% in 2010. China is confronted with a rapidly aging population at a relatively early stage of her economic development, which limits the amount of financial resources available for supporting the elderly. China’s challenge is further magnified by the fact that more children are moving away from home, so declining fertility means the elderly will have fewer people to support them. Three decades of population planning which limited most urban couples to one child – and most rural families to one or two children – will cause a surge in China’s dependency ratio; a measure of the number of children and elderly against the working-age population. That means a smaller percentage of China’s population will be available to work ... Moreover, China’s elderly are more depressed than younger people, since 40%, or 74 million people over 60 display higher levels of depression symptoms. Approximately, 40 million elderly people in China have undiagnosed hypertension, or high blood pressure. However, China has done a remarkable job expanding health insurance to cover almost all elderly people, since 92% of the elderly with an urban residence permit and 94% with a rural permit, have some type of health insurance; higher than for working-age people aged 45-59.’
- Statistics Canada reports the nation’s gross domestic product (GDP) grew at an annual rate of 2.5% in the 1st. quarter citing a sharp increase in exports of energy, minerals and consumer goods, while growth in the 4th. quarter of 2012 was revised to 0.9%.
- The National Bureau of Statistics and China Federation of Logistics and Purchasing reports the country’s manufacturing purchasing managers’ index (PMI) rose to a reading of 50.8 in May from a level of 50.6 in April
- Front Page Headline, Globe and Mail – **“Province of B.C. Rejects Northern Gateway Pipeline.** The Province of British Columbia formally rejects Enbridge Inc.’s proposed Northern Gateway Pipeline to the west coast from Alberta, citing: ‘The company has failed to adequately explain how to cope with a major heavy oil spill on land, or in coastal waters.’ In its final written response to the federal panel which has been conducting hearings for the past 17 months, the B.C. Government stated it ‘cannot support the \$6 billion (CAD) project as currently presented because of its concerns over potential environmental damage and Enbridge’s ability to respond to disasters have not been (thoroughly) addressed.’
- Front Page Headline, Daily Telegraph U.K. – **“What Happens in Japan If, As or When Bond Yields Rise?** Naturally, this is a very important question because long-term bond yields are obviously lower than they would be in a normal world and at some point, if the western world ever returns to normalcy, they will trade higher. Needless to say, we also have plenty of evidence from some countries inside the euro zone that bond yields can rise when events are abnormal. However, there is a big difference between the fact that bond yields are rising and the reasons behind it. Indeed, after a recent increase in Japan’s 10-year bond yields to 1%, the new governor of the Bank of Japan, Haruhiko Kuroda, argued: ‘If Japanese gross domestic product (GDP) growth were to return to normal, then the country’s economy could service the national debt, even with 10-year yields at 3%. However, if bond yields were to rise without a full-blown economic recovery, then the consequences for the Japanese banking system would be quite challenging.’ Many think that is an understatement. Indeed, given the size of Japan’s sovereign debt – about 230% of GDP) – those most bearish about Japan believe this is the beginning of an uncontrollable decline in the yen and a larger increase in the rate of inflation than the Bank of Japan desires; both of which, far from contributing to an economic recovery, will actually put Japan into a new, more worrying phase of economic weakness.’
- Front Page Headline, Daily Telegraph U.K. – **“Is Brussels Trying to Force the U.K. Out of the European Union?** Today, the European Commission (EC) is set to take the U.K. to the European Court of Justice – the body intended to police EU treaties – over its rules on EU migrant workers’ access to benefits. The EC states the U.K.’s so-termed ‘right to reside’ test – a filter used to make certain that EU migrants are eligible to claim benefits – is illegal under EU law since British citizens pass it automatically. The U.K. Government is disputing this claim noting: ‘It is clear that the U.K. rules are in line with EU law.’ The legal details surrounding this case are hugely complex, as are the rules governing EU migrant workers’ access to benefits. Essentially, this situation is about the EU’s one-size-fits-all model sitting poorly with the U.K. ‘universalist’ welfare system which – unlike many other systems in Europe – is largely comprised of means tested benefits, rather than contribution-based benefits. The U.K. Government feels it needs a filter – practically and politically – to ensure migrants come to Britain to work, rather than to claim benefits. Legally, this is

a grey area, but it's clear that the EC is taking the strictest interpretation ... If public confidence in free movement is to be maintained, the U.K. Government simply must be able to demonstrate that it can protect its welfare system from abuse. So, we're looking at an almighty political row, since the U.K. Government has no choice but to fight this all the way. Purportedly, a ruling is not expected until 2015."

CLOSING LEVELS FOR FRIDAY, May 31st		WEEKLY CHANGE
Dow Jones Industrial Average	15,115.57	- 187.53 points
Spot Gold Bullion (August)	\$1,393.00 (U.S.)	+ \$6.40 per oz.
S&P / TSX Composite	12,650.42	- 16.80 points
10 - Year U.S. Treasury Yield	2.13%	+ 12 basis points
Canadian Dollar	96.45 (U.S.)	- 0.44 cent
U.S. Dollar Index Future (Spot Price)	83.296	- 0.344 cent
WTI Crude Oil (July)	\$91.97 (U.S.)	- \$2.18 per barrel

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