Monday October 21st, 2013

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

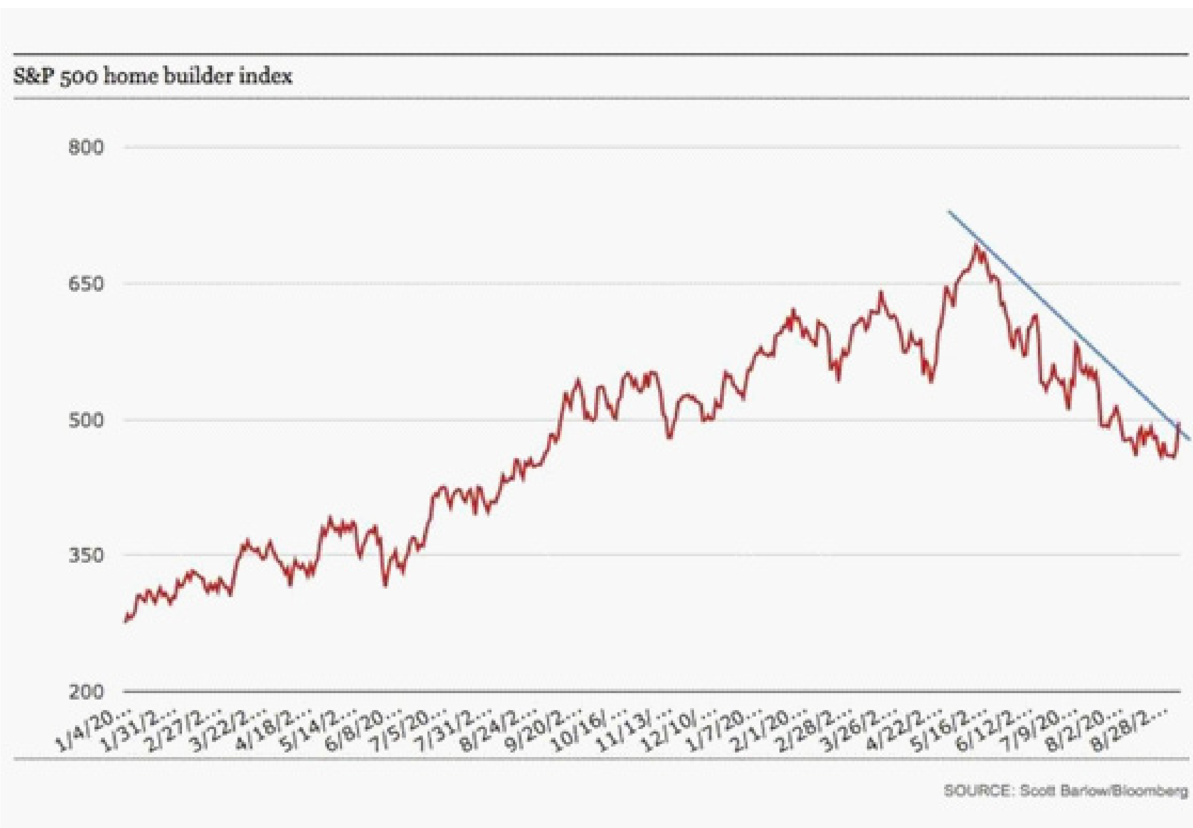
THAT WAS THE WEEK THAT WAS

Monday, October 21st

The Commerce Department reports U.S. construction spending rose by 0.6% to a $915.1 billion (U.S.) annual rate in August. Separately, the National Association of Realtors reports U.S. existing home sales

MONDAY, OCTOBER 21ST

declined by 1.9% to a 5.29 million annual pace in September from a downwardly revised 5.39 million annual rate in August, citing higher mortgage rates as the main influence.

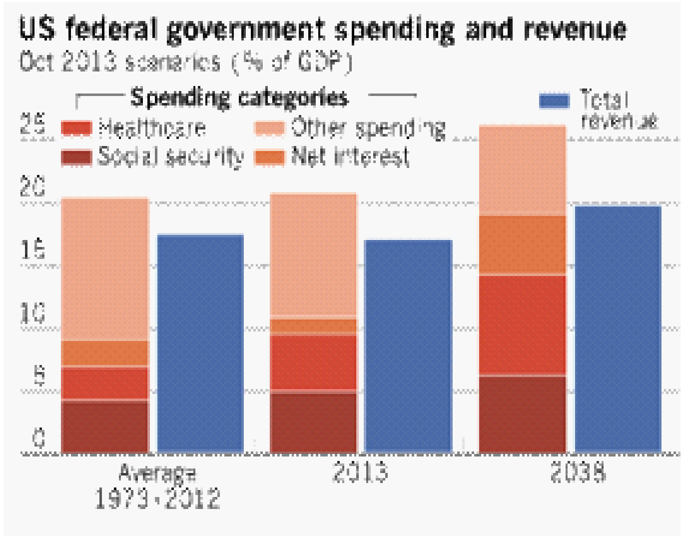


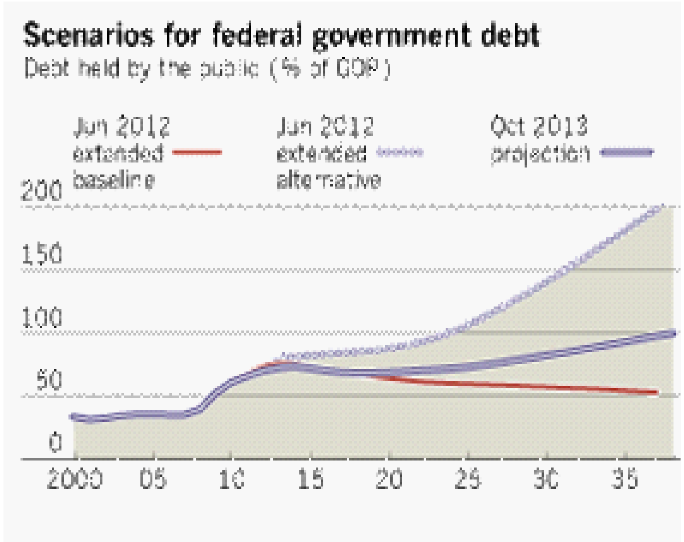
- Front Page Headline, Financial Times – "FHFA Seeks $6 Billion (U.S.) Penalty from BofA. The U.S. Federal Housing Finance Agency – the housing regulator that oversees Fannie Mae and Freddie Mac – is seeking a penalty in excess of $6 billion (U.S.) from the Bank of America, asserting it broke securities laws when selling a total notional value of $57 billion (U.S.) of bad mortgage-backed securities to the two government-owned mortgage companies. While the FHFA has already extracted a $13 billion (U.S.) penalty from JP Morgan Chase for breach of securities laws, the Bank of America case continues to be fought in court."

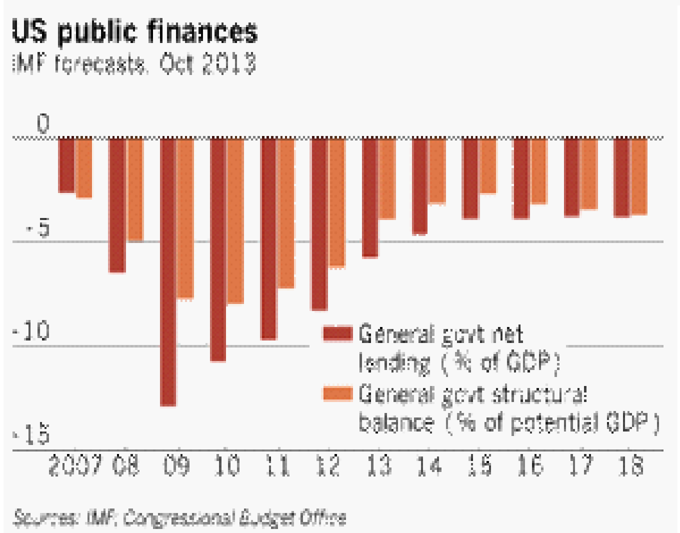
- The Office for National Statistics (ONS) reports U.K. retail sales – excluding fuel sales – rose by 0.7% in September, following a decline of 2.1% in August citing: "All of this (sales) growth can be attributed to an increase in the quantity of goods purchased in furniture stores."

TUESDAY, OCTOBER 22ND

- Front Page Headline, Financial Times – "The Reality of America's Fiscal Future. In an op-ed, reporter Martin Wolf waxes prolific: 'The real (Congressional) debate is not about the debt, (rather) it is about whether (or not) the citizens will fund the government. From the frenzied political battle and clashes of opinion of recent weeks, an observer might conclude that the U.S. faces fiscal catastrophe. It does not. The fiscal position has improved dramatically and poses no medium-term risks. The only fiscal crisis (which) the U.S. faces is one inflicted by a purported desire to avert one. The real issue is what government Americans want and how they choose to pay for it … It is about whether (or not) Americans will pay the taxes required to fund the government they have legislated. The U.S. has created major social programs. However, Congress seems unable to agree on the taxes needed to pay for them, while sustaining essential state functions at a reasonable level. This struggle is disguised behind the rhetoric on unsustainable debt and disincentive effects of modest increases in taxation." Wakeup call for Mr. Wolf: At Longwave Analytics, we believe that the majority of Americans are against paying higher taxes for just about everything and anything. Moreover, not only do most Americans reject any entitlement (i.e. Medicare, Medicaid, and Social Security) reductions, but also, politicians in Congress are very reluctant to raise any taxes, being fearful that will adversely affect their re-election prospects.

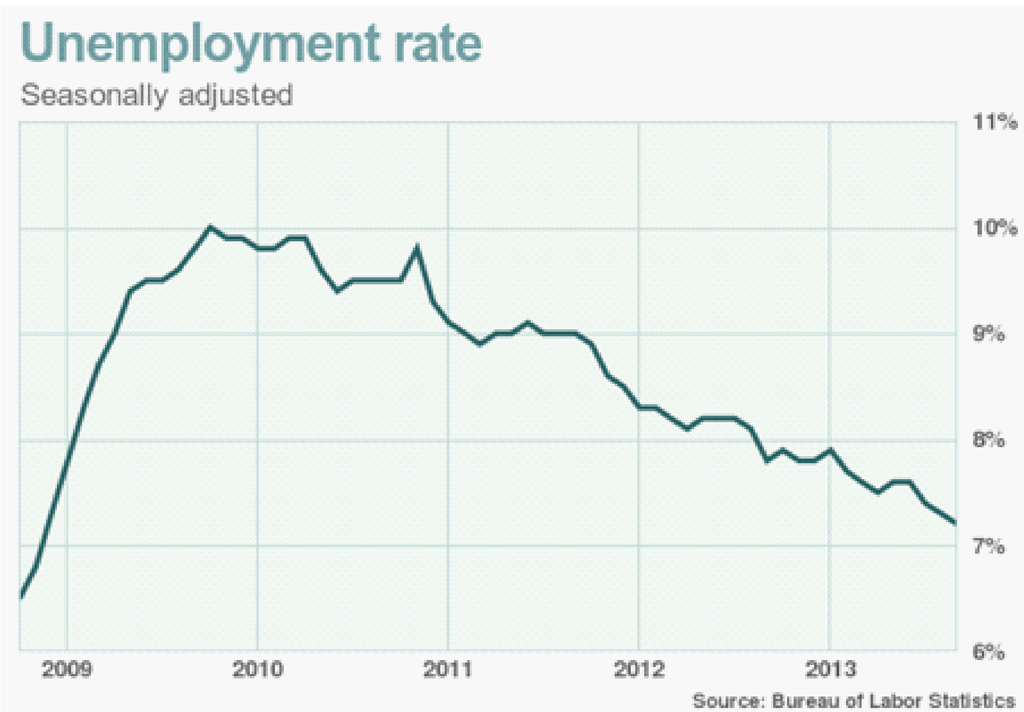


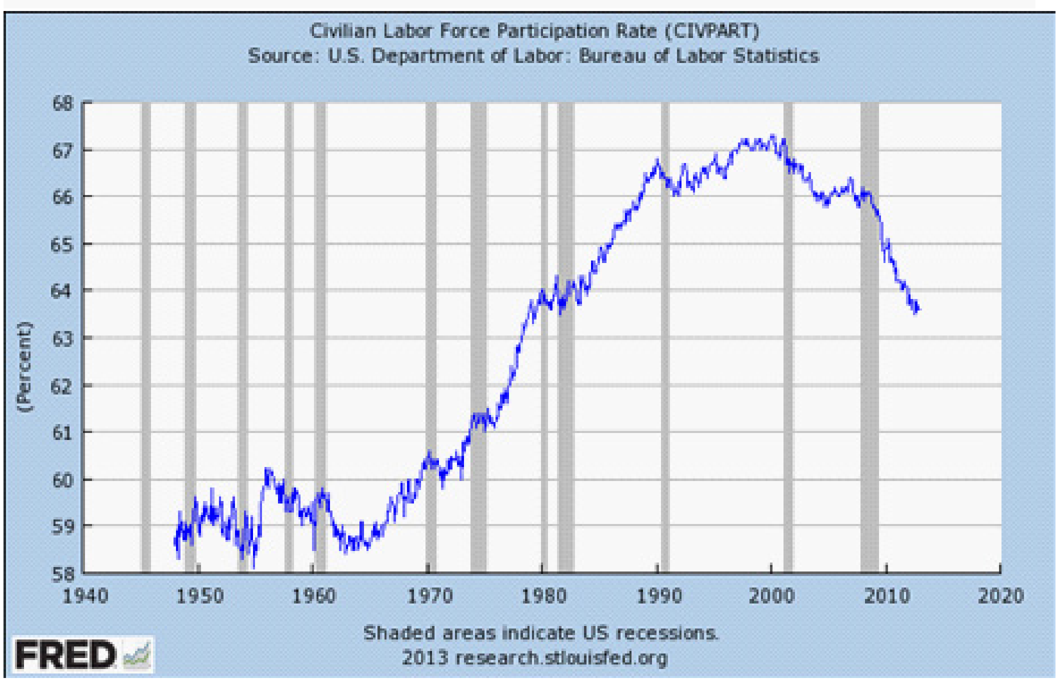




Three charts: Sources: IMF, Congressional Budget Office

- The Labor Department reports U.S. non-farm payrolls increased by 148,000 in September, following an upwardly revised increase of 193,000 in August, previously reported as 169,000; while the official unemployment rate declined slightly to 7.2% from 7.3%, its lowest level since November 2008. Meanwhile, the U.S. labor force participation rate – a measure of how many people are looking for work – held steady at 63.2% in September, a 35-year low.





- Statistics Canada reports the nation's retail sales rose by 0.2% in August, citing higher sales at food and beverage stores were partially offset by lower sales at motor vehicle and parts dealerships; as well as at gasoline stations.

- During Question Period, Canadian Finance Minister Jim Flaherty reported to the House of Commons that his incumbent Conservative Government is $7 billion (CAD) ahead of its targeted pace to balance the federal budget by the fiscal year ending March 31, 2015. Mr. Flaherty related: "Spending controls introduced by the government have succeeded better than anticipated; so the final tally on the government's 2012-2013 fiscal year will record an $18.9 billion (CAD) shortfall and not the $25.9 billion (CAD) deficit forecast in the budget of last March."

Canadian Finance Minister Jim Flaherty
Source: Canadian Press

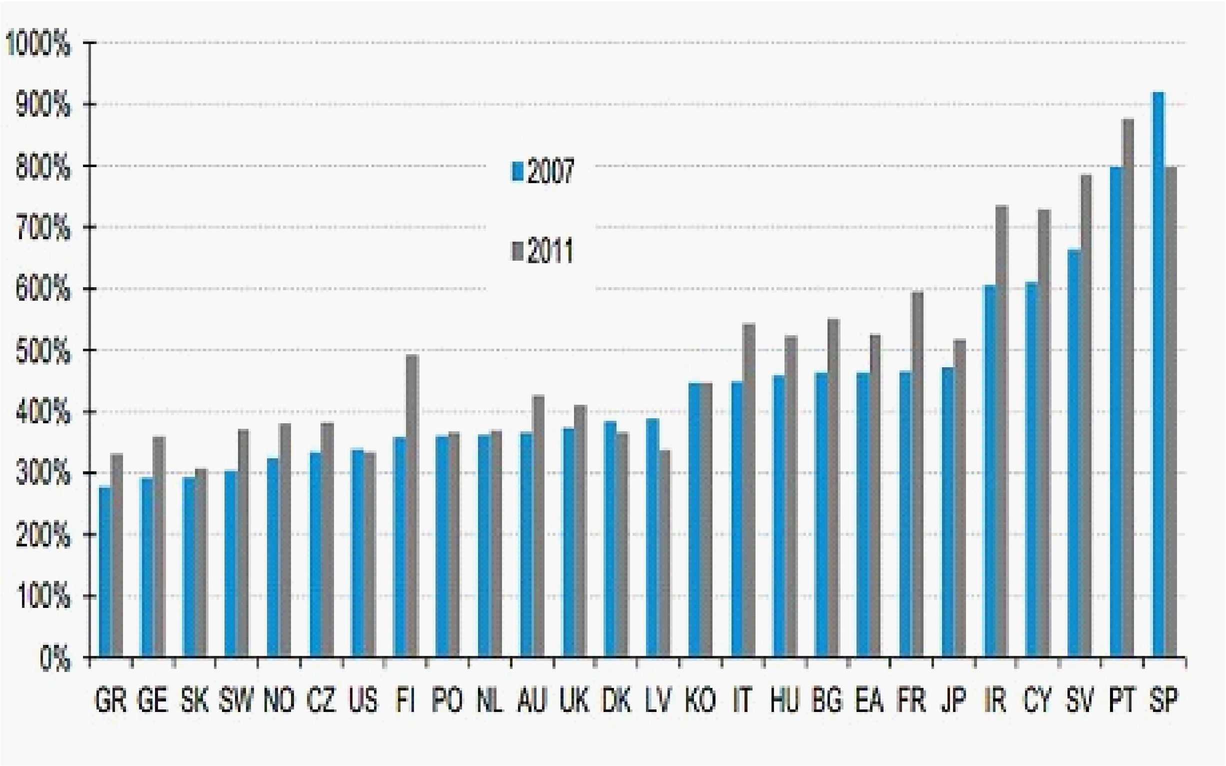
WEDNESDAY, OCTOBER 23RD

- Front Page Headline, Wall Street Journal – "Rabobank Faces $1 Billion (U.S.) Fine in Libor Settlement. According to people close to the negotiations, Dutch lender Groep NV is poised to pay about $1 billion (U.S.) to settle allegations that its money market managers / traders participated in a wide-ranging scheme to manipulate the benchmark London Interbank Offered Rate (Libor). The settlement has not been finalized pending approval of the Chicago-based U.S. Commodity Future Trading Commission (CFTC), which is leading the investigation together with the U.S. Department of Justice and the Financial Conduct Authority in the U.K."

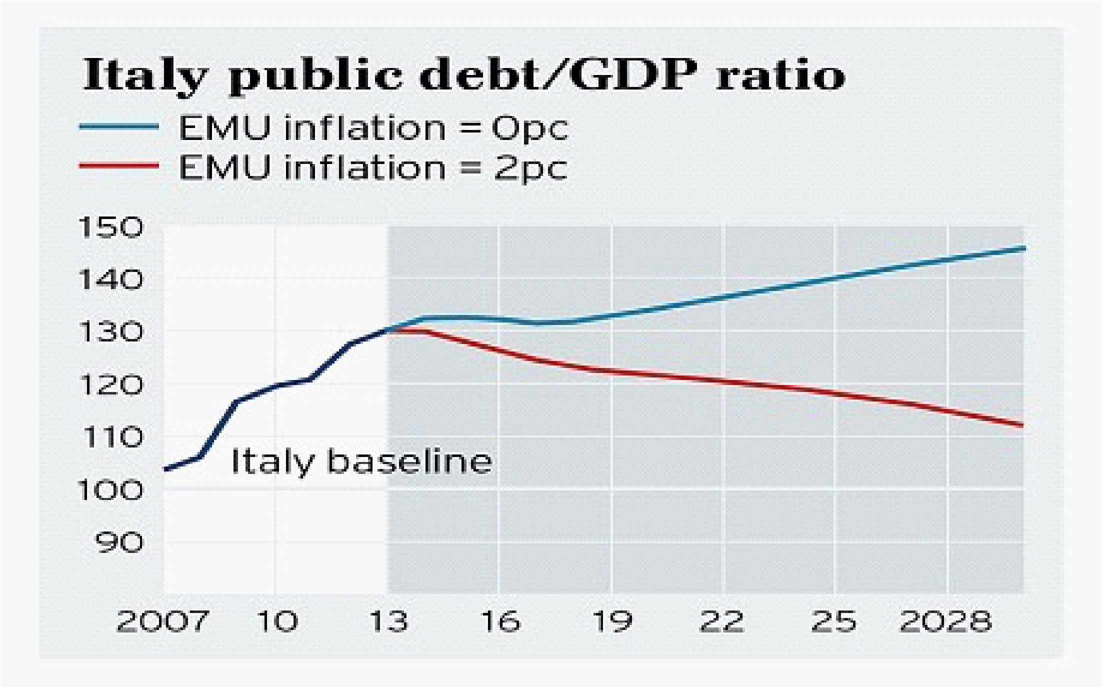
- Front Page Headline, Financial Times – "JP Morgan Nears $6 Billion (U.S.) Settlement with Investors. In addition to the $13 billion (U.S.) settlement JP Morgan has recently made with the U.S. Department of Justice, the bank is nearing a $6 billion (U.S.) settlement with institutional investors for similar charges that it marketed and misrepresented mortgage-backed securities to investors that were riddled with bad loans."

- Front Page Headline, Daily Telegraph U.K. – "Europe Is Sliding into a Deflationary Trap. The effect is already causing debt ratios in half a dozen countries to spiral upwards to the point of no return, making a mockery of the European Monetary Union (EMU) debt crisis strategy … What is clear is that once total debt exceeds 300% of gross domestic product (GDP), deflation becomes lethal. That is now the case across most of Western Europe. The headline inflation rate for the EMU understates the risk, especially for countries in the eye of the storm. A Eurostat index named 'HICP inflation at constant taxes' which strips out distortions created by austerity itself – chiefly VAT increases and other taxes – show that inflation declined to 0.9% for the euro zone as a whole in September. This is the lowest (level) since the Lehman crisis and far below the European Central Bank's (ECB) target of 2%. Over the past three months the trend has intensified. France, Italy, Spain, Portugal, Greece, Cyprus, Ireland, Slovakia, Slovenia, Estonia and Latvia have all seen price declines and already have one foot in deflation. Much the same is happening within the EMU sphere of Bulgaria, Romania, Hungary and the Czech Republic. Poland is at zero. Denmark is close and so is Sweden; prompting the angry resignation of Riksbank deputy governor Lars Svennson, one of the world's great monetary economists.

  The euro zone is one shock away from the Japanese syndrome and therefore, the danger of exploding debt (to GDP) ratios. As U.S. Federal Reserve Chairman Ben Bernanke stated in a 2002 speech: 'Deflation: Making Sure It Doesn't Happen Here. It is unforgiveable for any central bank to let deflation happen. Sustained deflation can be highly destructive to a modern economy and should be strongly resisted' ... The verdict is already in. According to International Monetary Fund data, Italy's debt to GDP ratio has jumped from 121% to 132% over the past two years despite a draconian fiscal squeeze and a primary surplus. Spain has soared from 70% to 94%; Portugal from 108% to 124% and Ireland from 104% to 123%. Such is the curse of the 'denominator effect' It is what happens when debt increases at a faster pace than nominal GDP. Europe's policy regime is inflicting ultra-austerity without offsetting monetary stimulus. You have to weep."



Europe's corporate debt has surged since 2007, while America's has declined. Source: Daily Telegraph U.K.



Source: International Monetary Fund

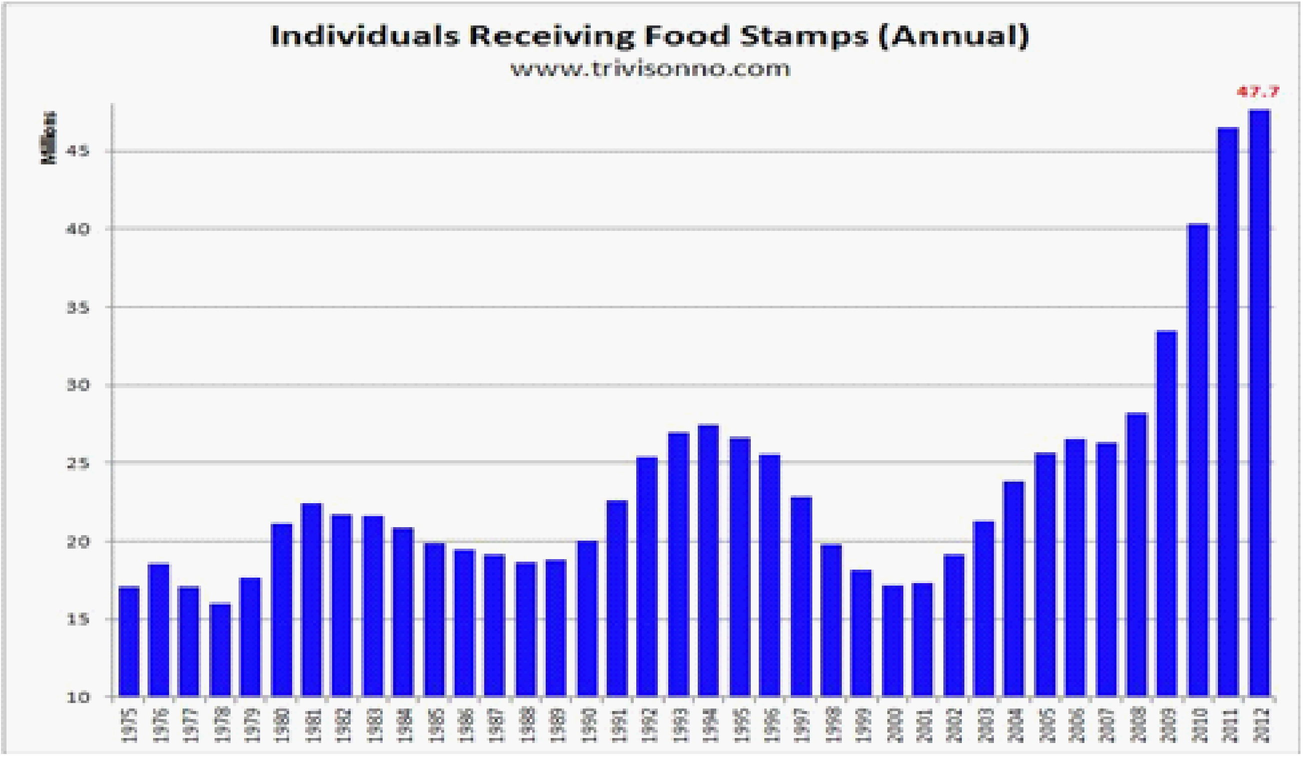
THURSDAY, OCTOBER 24TH

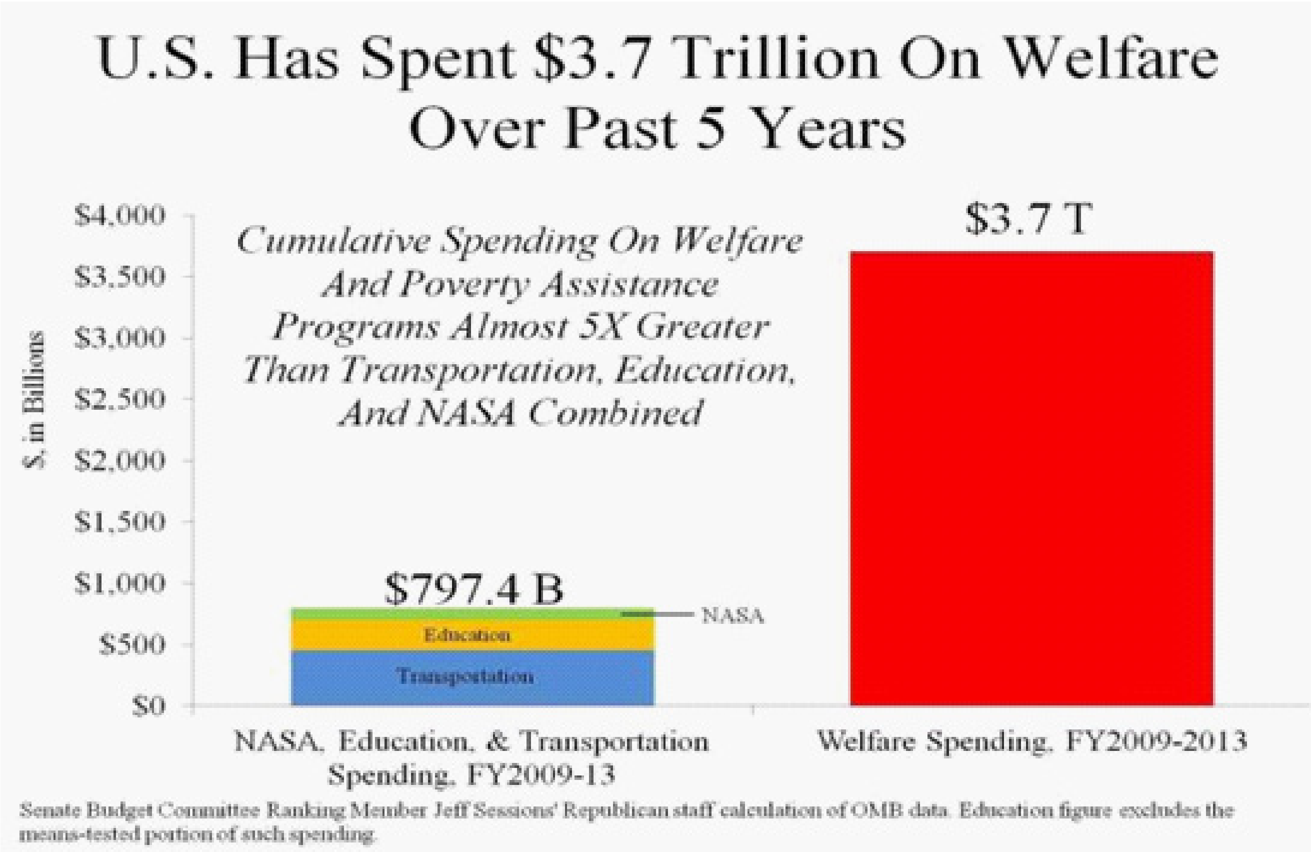
- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 12,000 to a seasonally adjusted 350,000 in the week ended October 19th. while continuing claims fell by 8,000 to 2.874 million in the week ended October 12th. In a note to clients, Ian Shepherdson, an economist at Pantheon Macroeconomics, observed: "Although we just don't know what is happening to the underlying trend in layoffs, we would hazard a guess that it is flat to slightly lower. We won't know for sure until we see a report of clean data, which probably won't be until the end of November."

- Front Page Headline, Daily Telegraph U.K. – "Citigroup Forecasts Greek Devastation / Relentless Debt Spirals in Italy and Portugal. A new euro zone report by a Citigroup economics team – led by ardent euro-federalist William Buiter and comprised mainly of Europeans – forecasts that Italy will flat line along in near permanent recession with economic growth of 0.1% in 2014, 0% in 2015 and 0.2% in 2016. The national debt will rise above 140% of gross domestic product (GDP), beyond the point of no return for a country with neither economic growth, nor sovereign currency. Citigroup's report states: 'We do not expect Italy's public debt (to GDP) ratio will enter a downward trend in coming years and we suspect that some form of debt restructuring (maturity lengthening and/or coupon reduction may eventually be likely.' Portugal is in an even worse state, with GDP growth of 0.6%, 0% and 1.0% over the next three years, with country's debt to GDP ratio reaching 149% by 2015 and unemployment rising again to 18.3%. The bank's report continues: 'Given the fiscal tightening still to come, ongoing private deleveraging and ensuing poor GDP growth prospects, doubts still exist about the sustainability of the Portuguese debt in our view. A second full bailout program remains a clear risk in the event of market sentiment deteriorating. In any case, we think a Greek-style public debt restructuring unlikely in the near future, but a restructuring of some government contingent liabilities is still possible. Furthermore, Greece will continue to be a catastrophe. The alleged stabilization will prove to be a false dawn. The Greek economy will contract by a further 2.9% in 2014 and 1.4% in 2015, forcing the unemployment rate to 32.4% and the debt to GDP ratio to 201%.' If Citigroup is broadly correct, Europe faces a lost decade that is far worse than anything suffered by Japan, which will render the region marginal in future world affairs and is likely to have non-linear political consequences. The lesson of the 1930s is that one must discredit both the moderate Left and Right before voters turn to extreme parties en masse."

- Front Page Headline, Washington Post – "BofA Found Liable for Countrywide Fraud. Yesterday in a Manhattan court a federal jury found the Bank of America liable for fraud, due to thousands of defective mortgages marketed by its Countrywide Financial subsidiary to government-backed Fannie Mae and Freddie Mac. According to the complaint, the two mortgage finance entities incurred more than $1 billion (U.S.) in losses after the housing market crashed in 2008-2010. Federal prosecutors learned of Countrywide's activities through Edward O'Donnell who served as underwriting manager at Countrywide. Mr. O'Donnell testified that he had warned his superiors the company's 'Hustle' marketing program was creating poor quality loans, but his concerns were ignored. Using Mr. O'Donnell's information, the U.S. Department of Justice filed a complaint last October under a powerful 1980s-era law known as the Financial Institutions Reform, Recovery and Enforcement Act, commonly called FIRREA. This law has a low burden of proof, strong subpoena power and a 10-year statute of limitations; twice as long as the usual limit for financial fraud cases. Most of Bank of America's legal woes emanate from its $2.5 billion (U.S.) takeover of Countrywide Financial in 2008, once one of the nation's largest home lenders. BofA officials acknowledged the bank has already paid $40 billion (U.S.) in mortgage litigation fees and repurchases of bad loans. In a statement, Manhattan U.S. Attorney Preet Bharara concluded: "In a rush to feed at the trough of easy mortgage money on the eve of the financial crisis, BofA purchased Countrywide, thinking it had taken over a cash cow. However, those profits were built upon fraud, as the jury unanimously found." Relentlessly, BofA former President and CEO Ken Lewis' legacy of ignorance and incompetence surfaces yet again to haunt the BofA hallways in Charlotte, North Carolina. See also, Economic Winter – Between a Rock and a Hard Place – March 1, 2010.

- Front Page Headline, The Weekly Standard – "America Has Spent $3.7 Trillion (U.S.) on Welfare Over Last Five Years. A new research report by Republicans on the Senate Budget Committee reveals: 'We have just concluded the fifth fiscal year since President Obama took office. During those five years, the federal government has spent a total of $3.7 trillion (U.S.) on approximately 80 different means-tested poverty and welfare programs. The common feature of means-tested assistance programs is that they are graduated based upon a person's income and – in contrast to programs such as Medicare and Social Security – they are a free benefit without any contribution from the recipient. The enormous sum spent on means-tested assistance is nearly five times greater than the combined amount spent on NASA, education and all federal transportation projects over that time.' In point of fact, $3.7 trillion (U.S.) is not the entire amount spent on federal poverty support, since the states


Individuals Receiving Food Stamps (Annual)
www.trivisonno.com
Millions
47.7


U.S. Has Spent $3.7 Trillion On Welfare Over Past 5 Years
Cumulative Spending On Welfare And Poverty Assistance Programs Almost 5X Greater Than Transportation, Education, And NASA Combined
$, in Billions
$797.4 B
$3.7 T
NASA
Education
Transportation
NASA, Education, & Transportation Spending, FY2009-13
Welfare Spending, FY2009-2013
Senate Budget Committee Ranking Member Jeff Sessions' Republican staff calculation of OMB data. Education figure excludes the means-tested portion of such spending.

contribute more than $200 billion (U.S.) annually to this federal nexus; primarily in the form of free low-income health care."

At Longwave Analytics, we would not be surprised to see the number of Americans receiving food stamps to average one million people per state by the end of 2013.

FRIDAY, OCTOBER 25TH

- Finance Canada's Fiscal Monitor – which tracks federal government revenues and expenses on a monthly basis – reveals the federal government registered a $2.3 billion (CAD) deficit in August, compared to a $3 billion (CAD) deficit in August 2012. As fiscal 2014 approached the halfway point, the federal deficit totaled $6.8 billion (CAD) compared to a $7.2 (CAD) deficit in the April to August period of 2012.
- Front Page Headline, Daily Telegraph U.K. – "BIS Warns of New Asian Crisis as Chinese Foreign Debt Soars. In a new report, the Bank for International Settlements warns: 'U.S. dollar loans, as well as other foreign currency loans, have more than tripled in the last four years; increasing from $270 billion (U.S.) to a conservatively estimated $880 billion (U.S.) by March 31, 2013. Foreign currency credit may give rise to substantial financial stability risks associated with U.S. dollar funding. Easy monetary policies of western central banks since the Lehman crisis have reduced the cost of foreign funding in East Asia, tempting companies to borrow heavily in U.S. dollars. The risk is that this process could go into reverse when the U.S. Federal Reserve shuts the spigot, triggering a dollar liquidity crisis across the region and causing even bigger (negative) ramifications than those during the East Asian crisis of 1997-1998."

CLOSING LEVELS FOR FRIDAY, OCTOBER 25TH.		WEEKLY CHANGE
Dow Jones Industrial Average	15,570.28	+ 170.63 points
Spot Gold Bullion	$1,352.50 (U.S.)	+ $37.90 per oz.
S&P / TSX Composite	13,399.42	+ 263.33 points
10 -Year U.S. Treasury Yield	2.51%	– 7 basis points
Canadian Dollar	95.65 cents (U.S.)	– 1.57 cents
U.S. Dollar Index Future	79.164	– 0.447 cent
WTI Crude Oil (December)	$97.85 (U.S.)	– $2.96 per barrel

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