Monday January 20th, 2014

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

# THAT WAS THE WEEK THAT WAS


Monday, January 20th

Rome-based Istat reports Italy's industrial orders rose by 2.3% – on a seasonally adjusted basis – in November, citing a strong 4% increase in domestic orders.

## MONDAY, JANUARY 20TH

### Martin Luther King Jr. Holiday in the United States

- The Beijing-based National Bureau of Statistics reports China's gross domestic product (GDP) rose by 7.7% in the 4th. quarter of 2013 on a year-over-year basis, citing a lower level of factory output and reduced investment expenditures by businesses. Dariusz Kowalczyk, an economist at Credit Agricole CB in Hong Kong, commented: "China's (economic) growth momentum was increasingly weakening as the quarter progressed. Economic expansion will likely decelerate (further) this year."

## TUESDAY, JANUARY 21ST

- The Mannheim-based ZEW Center for European Economic Research reports its index of investor and analyst expectations – which focuses on predicting economic developments six months in advance – declined to a reading of 61.7 in January from a seven-year high level of 62 in December. A ZEW gauge of euro zone GDP growth expectations rose to a reading of 73.3 in January from a level of 68.3 in December. In a research note, Carsten Brzeski, an economist at ING Groep NV in Brussels, commented: "The fundamentals of the German economy remain strong. There are sufficient arguments in favour of an acceleration of GDP growth, rather than in favour of a drop in soft indicators."

- Front Page Headline, Financial Post – "Fitch Ratings Turns Neutral on Canadian Housing Market Outlook. According to Fitch's Global Housing and Mortgage Outlook for 2014: 'We expect house prices to remain 'broadly flat' in Canada in contrast to Britain, Australia and Germany; where (house) prices will rise due to low mortgage rates, solid GDP growth and increased availability of credit. The Canadian government is exerting a moderating influence on the country's housing market, following concerns over the long term viability of household debt levels and high house prices. This should lead to muted (mortgage) lending in 2014 and 2015. With house prices having increased significantly faster than income and GDP over the last decade, affordability in Canada is very stretched despite record low administered interest rates. Fitch expects affordability to remain stretched in 2014, as (house) prices remain broadly flat on a national level, while GDP will grow."

- The International Monetary Fund (IMF) announces it is revising its estimate for gross domestic product (GDP) growth in the U.K. to 2.4% in 2014 from its 1.9% estimate of last October; citing easier credit conditions and a higher level of consumer confidence. For 2015, the IMF expects Britain's economy to expand by 1.9%.

- Front Page Headline, Globe and Mail – “Bombardier Announces 1,700 Job Layoffs from Aerospace Division. The layoffs represent 6% of the Bombardier Aerospace work force, affecting 1,100 employees at the major manufacturing and assembly locations in Montreal and Mirabel, Quebec and 600 employees in the United States. Yesterday, Bombardier Aerospace disclosed that aircraft orders during 2013 had declined to 388 units from 481 units the previous year. In a memo to employees, Human Resources Vice President Sylvie Bourdon stated: “Stricter controls over spending must be implemented (in order) to ensure that we consistently meet our budget throughout 2014.”


Source: Getty Images

- Front Page Headline, Financial Times – “Former Virginia Governor and Wife Charged with Accepting Bribes. Former Virginia Governor Bob Mc Donnell – whose term of office ended last November – and his wife Maureen have been charged with illegally accepting gifts from Jonnie Williams Sr. – a Richmond businessman – and in return tried to help him with State support for his business of dietary supplements. The indictment alleges: ‘Mr. Williams paid for an entire luxury shopping trip to New York for Mrs. McDonnell in 2011, expending at least $10,000 (U.S.) at Oscar de la Renta, about $2,600 (U.S.) at Bergdorf Goodman and approximately $5,685 (U.S.) at Louis Vuitton … In all, the McDonnells received $140,000 (U.S.) in gifts from Mr. Williams.”

## WEDNESDAY, JANUARY 22ND

- In releasing its monthly monetary policy statement, the Bank of Canada left the Bank Rate unchanged at 1%, while highlighting: “The inflation rate is expected to remain well below the Bank’s 2% target for some time, therefore the risk of disinflation has grown in importance. The strengthening of the global economy – together with the recent depreciation of the Canadian dollar against the U.S. dollar – should foster a broadening of the composition of (economic) growth. The timing and direction of the next change in the Bank Rate will depend upon how new (economic) data influences this balance of risks. As yet, there are no signs of a rebalancing towards exports and business investment.”

Bank of Canada Governor Stephen Poloz.
Source: Canadian Press

- Front Page Headline, Daily Telegraph U.K. –“World Economic Forum: Davos, Switzerland. Speaking at a panel of business leaders, Christophe de Margerie – chief executive officer (CEO) of French energy giant Total Petroleum – told Davos delegates: ‘Don’t take this as being provocative, but I think Europe should be reclassified as an emerging country. In terms of economic policy, the continent needs to start from scratch in order to overcome the twin evils of high unemployment and stagnant gross domestic product (GDP) growth.’ In turn, Axel Weber, chairman of Zurich-based UBS Investment Bank, remarked: ‘The euro zone (economic) recovery is no reason (for investors) to get excited. Actually, if you look (closely) at the (economic) recovery, it’s lacklustre and uneven across European countries … this is not enough to close output gaps and it’s not enough to create jobs. Europe is under threat and I’m really still concerned. While the mood in financial markets has improved, the situation in the economy has not improved. Markets are currently disregarding risks, particularly in the periphery. Despite political pressure, I expect some banks not to pass the European Central Bank’s stress test in November. As that becomes clear, there will be a reaction in the financial markets.’ Speaking at the same panel, Ken Rogoff – Harvard University economist and co-author of ‘This Time Is Different’ – warned: ‘The youth unemployment situation in Europe is really frightening. With more than 50% of young Spaniards out of work, Spain is losing part of a whole generation. Europe is squandering the scarce resource of its youth, badly needed to fortify an ageing society as the demographic crunch unfolds.”

Axel Weber, Chairman of Zurich-based UBS Investment Bank. Photo source: Bloomberg

- Front Page Headline, Daily Telegraph U.K. – "U.S. Treasury to Exhaust Funds Sooner Than Expected. In a letter sent to Congressional leaders today, U.S. Secretary of the Treasury Jack Lew warned: 'Protecting the full faith and credit of the United States is the responsibility of Congress, because only Congress can extend the nation's borrowing authority. No Congress in our history has failed to meet that responsibility. I respectfully urge Congress to provide certainty and stability to the economy and financial markets by acting to raise the statutory debt limit before February 7, 2014 and certainly prior to late February."

### THURSDAY, JANUARY 23RD

- The New York-based Conference Board reports its U.S. index of leading economic indicators – focused on the outlook for the next three to six months – rose by 0.1% in December, following a revised increase of 1% in November.

- The Labor Department reports U.S. initial claims for state unemployment benefits rose by 1,000 to 326,000 in the week ended January 18th. while continuing claims increased by 34,000 to 3.06 million in the week ended January 11th.

- The National Association of Realtors (NAR) reports U.S. existing home sales increased by 1% in December to an annual pace of 4.87 million units, the first sales increase in five months. The median price of an existing home rose by 4.65% to $198,000 (U.S.) in December from $189,200 (U.S.) on a year-over-year basis.

- HSBC and Markit Economics report China's purchasing mangers' index (PMI) for the manufacturing sector declined to a preliminary reading of 49.6 in January, compared with a final reading of 50.5 in December.

- Front Page Headline, Wall Street Journal – "GOP Seeks Policy Leverage from Debt Ceiling Debate. House Republicans are considering demanding a small number of discreet policy changes – most notably to the 2010 Affordable Care Act – as an opening salvo in negotiations over raising the federal government's statutory debt limit. House GOP leaders have made no final decisions on their debt ceiling plans, which will be a main focus during a strategy session at a Maryland resort next week. Evidently, party leaders believe a 'clean' debt ceiling bill, devoid of policy demands, would be unable to pass the Republican controlled House. They are thinking about how to write a bill which can attract broad support from Republicans while attracting Democrats who may be needed to pass the bill and would certainly be needed in the Democrat-led Senate. Any plan to tie policy changes to a debt limit increase will again put Republicans on a collision course with President Barack Obama and Senate Democrats, who have stated that it shouldn't be used as leverage for ancillary policy demands. That leaves unclear what course each party would take if Democrats reject the GOP demands. Rep. Pete Roskam (R.Ill) – a member of the House GOP leadership – commented to the WSJ: 'The two parameters are that the U.S. cannot default and a clean debt ceiling increase cannot pass the House. The question is what constitutes the offer that the White House can't refuse?' The U.S. Treasury has stated that the statutory debt limit must be raised within weeks, in order that the nation can continue to pay its bills. Yesterday, Treasury Secretary Jack Lew warned that without any action by Congress, the government would exhaust its borrowing authority by late February." (See Wednesday above).

- Front Page Headline, Financial Times – "China Becomes Top Gold Consumer in 2013. China has overtaken India as the world's largest gold consumer due to soaring purchases of jewellery, printed Panda coins and small gold bars. According to the Thomson Reuters GFMS gold survey – the most widely followed report on the industry – Chinese demand approached 1.2 thousand tonnes last year; a fivefold increase since 2003."

Gold buyers examine inventory at a Shenzhen showroom. Source: AFP

## FRIDAY, JANUARY 24TH

- Front Page Headline, MarketWatch News – "Wal-Mart Announces 2,300 Layoffs at Sam's Club. Wal-Mart Stores plans to lay off about 2% of the warehouse club's work force, in order to reduce the ranks of the subsidiary's middle management. It's the biggest round of layoffs in four years at Sam's Club which accounted for about 12% of Wal-Mart's $114.88 billion (U.S.) 3rd. quarter 2013 revenue. In an interview, Sam's Club CEO Rosalind Brewer explained: 'Over the years, we've migrated to a top heavy structure in our management. What these layoffs enable is the alignment of the number of assistant managers to the sales of the club and to where our growth areas are."

- Front Page Headline, Daily Telegraph U.K. – "$60 (U.S.) Oil Will Finish Russia's Putin Regime: William Browder. In an interview with the Telegraph's Ambrose Evans-Pritchard at the World Economic Forum in Davos, London-based Hermitage Capital Management CEO William Browder expounded: 'There is nothing behind the façade of Vladimir Putin's regime in Russia. All it will take is a drop in the price of oil to $60 (U.S.) a barrel and Putin will be gone within a year. You'd be surprised how brittle the system really is. The fiscal break-even price of oil required to balance the Russian budget is now $117 (U.S.) a barrel. A protracted slide in the price of crude oil would force the Kremlin to dig deeply into its reserve funds and in turn, that would ignite further capital flight. Russia's $499 billion (U.S.) foreign exchange reserves would not prove much of a defence in the end. We saw this in 2008 when everything fell apart in a few months, even though Russia had the world's third largest reserves. It wasn't supposed to happen but it did.' A drop in the price of Brent crude to $60 (U.S.) is not impossible. Both Deutsche Bank and Bank of America have warned of a potential glut in oil this year, as sanctions against Iran are phased out and Libya's exports revive. The U.S. is expected to add more than one million barrels per day this year to global supply.

  Mr. Browder continued: 'Russia is already primed for Ukraine-style street protests. The catalyst could be oil, or the secondary effects of Federal Reserve tapering as it exposes structural rot across the Brics universe. There is no ideological fervor to sustain the regime, despite Putin's attempt to create a new form of ideological conservatism with his attacks on gays. As soon as there is trouble, Putin's allies will abandon him.' Mr. Browder has been sentenced to nine years in prison by the Putin justice machinery, punishment for his campaign in the U.S. for the Magnitsky sanctions against top Russian officials. He faces an international extradition warrant and must be careful where he travels. Interpol refuses to enforce it, deeming it politicized. Britain, Germany and the Netherlands tell him they will not respect the warrant, however he takes his chances if he travels anywhere else in Europe; let alone to any state across the world without a fully functioning rule of law. It should be obvious to any extradition court that he is a target of state persecution, but he can't be sure. Mr. Browder elaborated: 'Russian officials tortured and murdered my Moscow counsel (the late Sergei Magnitsky) to get at me; like sticking pins into a voodoo doll.'

  For those investors preparing to jump back into the Brics and mini-Brics, Mr. Browder has a cautionary warning: 'Emerging market stocks are a lot cheaper now, however they are not cheap enough yet. A lot of ill-informed money went into those countries during the credit boom. The next big thing coming is that some of these countries will begin to close their capital accounts. We're already witnessing it in Egypt and Brazil in different ways. People will start asking themselves which country will be next. Once this begins, people may find that they can't get their money out again."

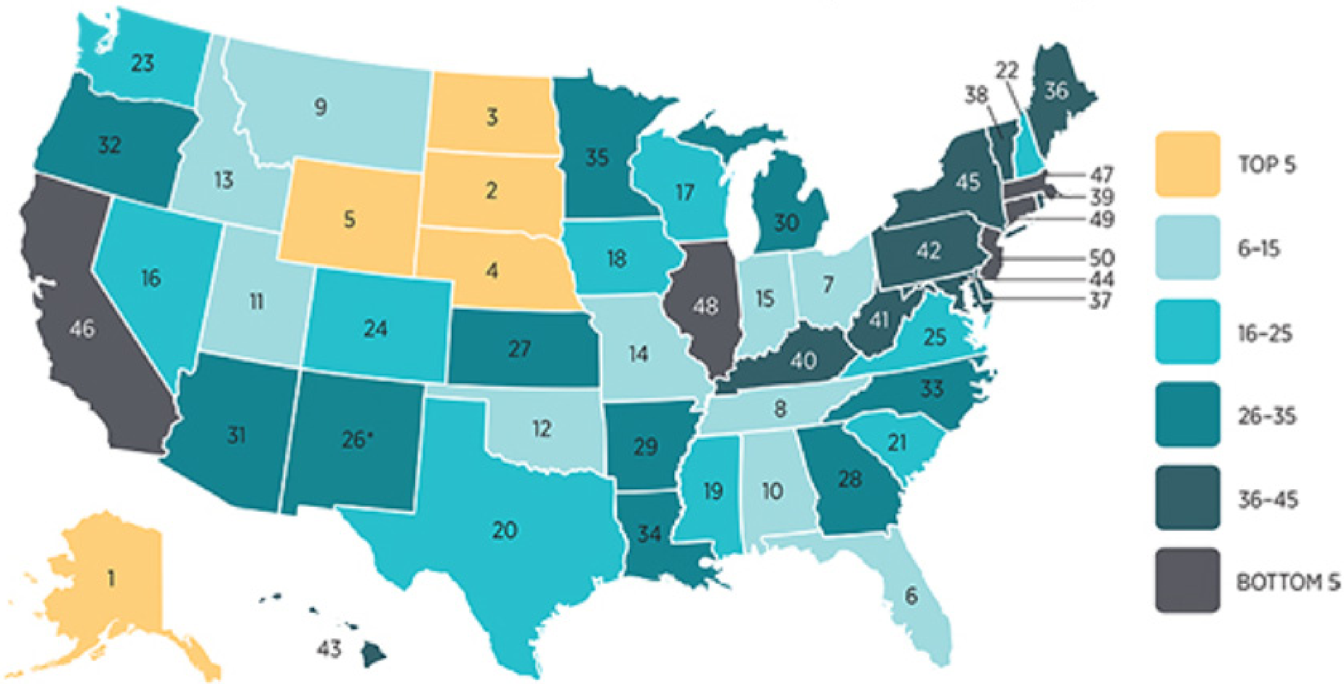
Russian President Vladimir Putin.
Source: Getty Images

- Front Page Headline, Mish's Global Economic Trend Analysis – "U.S. State Fiscal Conditions. In a recent study by George Mason University on American state fiscal conditions, at the bottom of the rankings are New Jersey and Illinois. New Jersey faces long-term solvency problems due in part to nearly 15 years of underfunding its state and local pensions. As detailed in the State Budget Crisis Task Force report of 2012, New Jersey has an estimated unfunded pension liability of about $25.6 billion (U.S.); as well as $59.3 billion (U.S.) in unfunded liabilities for the health benefits of retired teachers, police, firefighters and other government workers. Illinois has also underfunded its public pensions, resulting in an estimated state retirement system combined unfunded liability of $96.8 billion (U.S.) as of 2012. To cover the costs of its pension obligations, Illinois has bond issues to cover its annual contributions to the extent that 60% of Illinois' total outstanding debt is in pension bonds. In essence, Illinois is using long-term debt instruments to meet current year pension obligations. By contrast, Nebraska is constitutionally prohibited from incurring debt. As such, the long-term liabilities reflected in Nebraska's long-term solvency score are mainly due to claims payable for workers' compensation, Medicaid claims and other employee related items. With no significant bond debt, Nebraska has a much lower long-term liability per capita and a much lower long-term liability ratio than most other states. (See charts below.)

**Table 10. Descriptive Statistics for the Top Five Performers in Fiscal Condition Solvency**

| | Alaska | South Dakota | North Dakota | Nebraska | Wyoming | **State mean** |
|---|---|---|---|---|---|---|
| Cash ratio | 12.97 | 4.81 | 3.06 | 3.15 | 3.84 | **2.03** |
| Quick ratio | 13.33 | 6.96 | 5.09 | 4.25 | 4.21 | **2.87** |
| Current ratio | 13.45 | 7.06 | 5.13 | 4.27 | 4.33 | **3.07** |
| **Cash solvency** | **15.25** | **5.18** | **2.52** | **1.77** | **2.12** | **0.00** |
| Operating ratio | 1.38 | 1.07 | 1.36 | 1.04 | 1.24 | **1.04** |
| Surplus (deficit) per capita | $5,263.50 | $278.00 | $3,181.20 | $163.80 | $1,791.60 | **$364.20** |
| **Budget solvency** | **8.76** | **0.25** | **6.48** | **−0.21** | **3.72** | **0.00** |
| Net asset ratio | 0.82 | 0.28 | 0.51 | 0.26 | 0.67 | **0.01** |
| Long-term liability ratio | 0.04 | 0.10 | 0.18 | 0.04 | 0.07 | **0.41** |
| Long-term liability per capita | $3,748.00 | $769.70 | $4,111.00 | $296.80 | $2,570.90 | **$2,689.10** |
| **Long-run solvency** | **5.84** | **2.68** | **0.71** | **8.77** | **3.04** | **0.00** |
| Tax per capita | $9,825.70 | $1,597.40 | $5,637.40 | $2,288.30 | $4,904.50 | **$2,670.67** |
| Revenue per capita | $19,137.40 | $4,496.70 | $11,744.90 | $4,352.90 | $9,108.80 | **$6,093.03** |
| Expenses per capita | $13,873.00 | $4,218.70 | $8,613.30 | $4,199.00 | $7,317.20 | **$5,797.72** |
| **Service-level solvency** | **−7.69** | **3.51** | **−5.45** | **2.30** | **−4.27** | **0.00** |

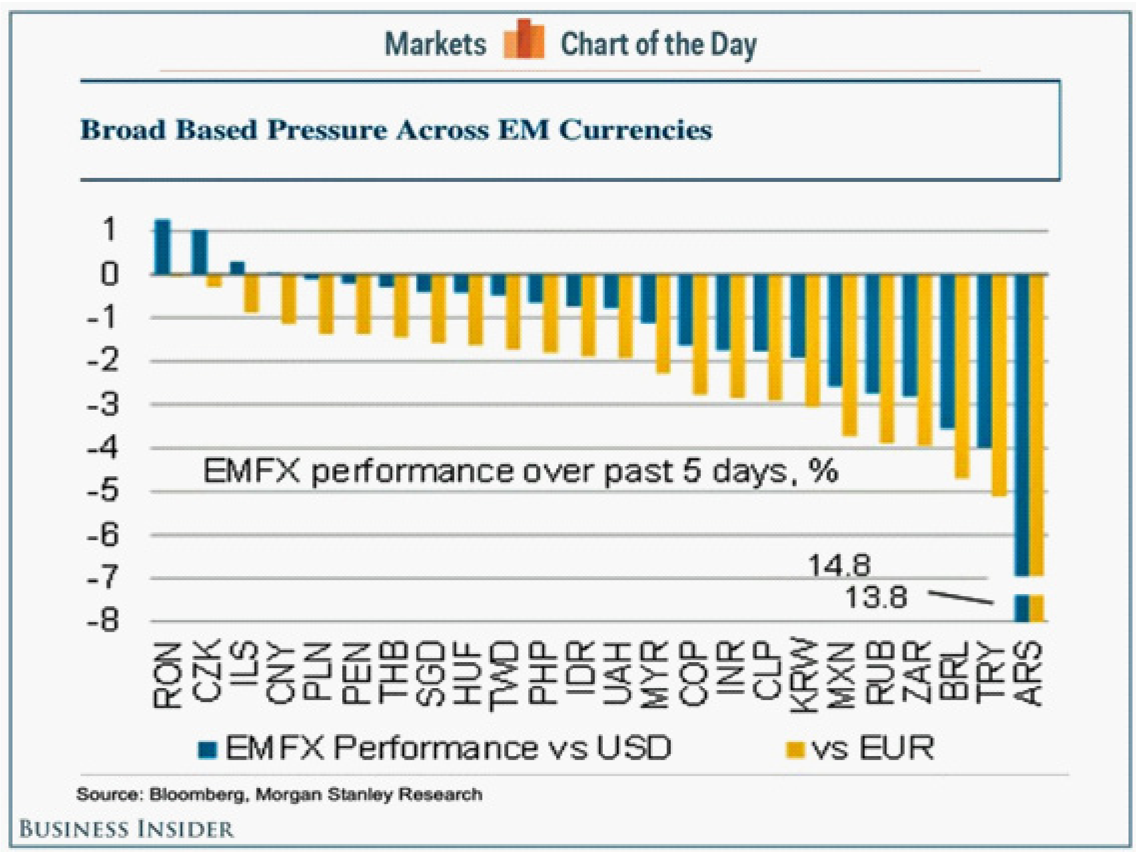
RANKING OF STATES BY FISCAL CONDITION (FISCAL YEAR 2012)




- Front Page Headline, Globe and Mail – "JP Morgan Chase Board Grants CEO Dimon a 74% Pay Raise. According to a regulatory filing, the board of directors of JP Morgan Chase has approved a $20 million (U.S.) pay package for Chairman and Chief Executive Officer Jamie Dimon for 2013 – an increase from $11.5 million (U.S.) in 2012. The increase is likely to stoke debate over executive pay and accountability, given the record breaking legal settlements extracted from the bank in 2013. JP Morgan paid more than $20 billion (U.S.) in fines and penalties related to an host of alleged misconducts … The New York Times reported that a vocal minority of board members opposed the pay increase and the directors elected not to restore Mr. Dimon's pay back to the level of $23 million (U.S.) it reached in 2011. The following year, the board halved Mr. Dimon's compensation to reflect his ultimate responsibility for massive trading blunders … For JP Morgan, last year represented an exercise in tackling legal woes which had accumulated since prior to the financial crisis. In November, the bank agreed to pay $13 billion (U.S.) to regulatory authorities in order to settle an host of probes by prosecutors into the bank's sale of mortgage-backed securities before 2009 … In a CNBC interview yesterday, Mr. Dimon stated that most of the regulatory probes focused on conduct which occurred at Bear Stearns and Washington Mutual before they were purchased by JP Morgan in 2008.

  Mr. Dimon noted: 'I think a lot of it was unfair, but I am not going to go into the details.' Activist investors were less than pleased. A representative of a large American pension fund who requested anonymity observed: 'Given the myriad of settlements that the Bank is still working through, this raise for the CEO is not the right signal. Rather, it sends out the signal that it's back to business as usual." See also Economic Winter, The Culture of Theft and Greed in the Investment Banking Industry, How Jamie Dimon Is Avoiding Criminal Prosecution Charges, November 17, 2013.

- Front Page Headline, Business Insider – "The Emerging Market Currency Bloodbath. Global markets are getting rocked and traders are focusing on the emerging markets. Morgan Stanley's Rashique Rahman commented: 'Emerging market weakness is widespread and after a long period of resilience is starting to impact the credit markets. In our view, there is no single proximate cause, rather the cumulative impact of a number of events has led to a deterioration in risk sentiment. Growing concern over China's macro trajectory and uncertainty over credit risk in China's trust and wealth management products are probably the main drivers; however, contributing factors to the spill over into other markets including Turkey's ongoing currency volatility and political concerns, weakness of the Ukrainian credit markets and the Argentine peso devaluation. Outlined below is Rahman's five-day bar chart of the major emerging market currencies against the U.S. dollar and the euro. To the far right is the Argentine peso (ARS), which fell by more than 13% against the dollar on Thursday."




| CLOSING LEVELS FOR FRIDAY, JANUARY 24TH. | | WEEKLY CHANGE |
|---|---|---|
| Dow Jones Industrial Average | 15,879.11 | – 579.45 points |
| Spot Gold Bullion | $1,264.30 (U.S.) | + $12.40 per oz. |
| S&P / TSX Composite | 13,717.76 | – 170.45 points |
| 10-Year U.S. Treasury Yield | 2.72% | – 10 basis points |
| Canadian Dollar | 90.31 cents (U.S.) | – 0.80 cent |
| U.S. Dollar Index Future | 80.431 | – 0.75 cent |
| WTI Crude Oil Futures | $96.64 (U.S.) | + $2.27 per barrel |

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