LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

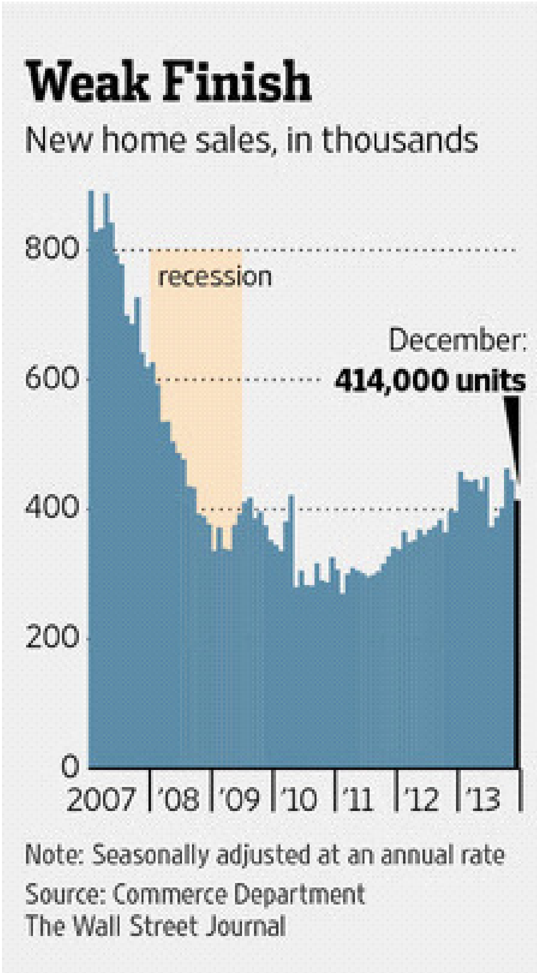
Monday, January 27th

Front Page Headline, Zero Hedge – "Bundesbank's Confiscatory Recommendation to Bankrupt Euro Zone Nations: First 'Bail In' Your Rich Citizens. In what is sure to be met with cries of derision across the European Union (EU), in its monthly report, Ger-

MONDAY, JANUARY 27TH

rmany's Bundesbank declared that countries about to go bankrupt should draw upon the private wealth of their citizens through a one-off capital levy before asking other states for financial assistance. As reported by Reuters, the Bundesbank stated: 'A capital levy corresponds to the principle of national responsibility, according to which taxpayers are responsible for their government's obligations before the solidarity of other states is required. It is not the purpose of European monetary policy to ensure solvency of national banking systems or governments and it cannot replace necessary economic adjustments or bank balance sheet restorations. (Slyly, the Bundesbank notes that it would not support an implementation of a recurrent wealth tax in Germany because it would harm economic growth). The Bundesbank's tough stance comes after years of euro zone sovereign debt crises which resulted in five government bailouts; as well as several bond market interventions by the European Central Bank (ECB) … Unfortunately, reaching consensus on such tough action might require an economic environment last seen in the 1930s."

- The Commerce Department reports U.S. new home sales declined by 7% in December to a seasonally adjusted annualized pace of 414,000 units from a downwardly revised 445,000 units in November, citing inclement wintry weather – the coldest December since 2009 – kept potential buyers at bay.



- The Munich-based Ifo Institute reports its German confidence index – based upon a survey of 7,000 business executives – rose to a reading of 110.6 in January, following a level of 109.5 in December. Thomas Gitzel, an economist at VP Bank AG in Vaduz, Liechtenstein forecast: 'The traffic lights for a powerful German economic recovery are green. Until now the German economy has relied upon solid domestic demand. For the coming quarters, there is now a justifiable hope that global trade will also perform apace."

- Front Page Headline, Financial Post – "Canada's Finance Minister to Unveil Cautious Federal Budget on February 11th. From his seat in the House of Commons, Canadian Finance Minister Jim Flaherty announced: 'There's no doubt the federal budget will be balanced in fiscal 2015, since in order to meet that target, we are going to be cautious by not spending a lot of money in the current fiscal year." Will Flaherty get us somewhere?

TUESDAY, JANUARY 28TH

- The Conference Board reports its U.S. consumer confidence index rose to a reading of 80.7 in January from a level of 77.5 in December. Lynn Franco, the Board's director of economic indicators commented: 'Consumers' assessment of the present situation continues to improve, with both business conditions and the job market rated more favourably. Looking out six months, consumers expect the economy and their earnings to improve.'

- The New York-based S&P/Case Shiller group reports their index of property prices in 20 U.S. cities rose by 13.7% in November on a year-over-year basis – the biggest 12-month gain since February 2006 – citing a limited inventory of available properties as a factor in sustaining home prices.

- The Commerce Department reports U.S. orders for durable goods – those products expected to last at least three years – declined by 4.3% in December. Drew Matus, an economist at UBS Securities in Stamford, Connecticut noted: "Right now, the biggest roadblock to spending on new equipment is that business leaders are being extraordinarily cautious."

- Front Page Headline, Financial Times – "Barclays Announces Branch Closures and Job Layoffs. Barclays Chief Executive Officer (CEO) Antony Jenkins announces plans to seriously reduce the cost structure of the bank, by closing 25% of its 1,600 branches in the U.K. and by eliminating hundreds of investment banking jobs. The move illustrates the U.K. bank's need to improve profitability in the face of a tougher regulatory climate. The branch closures also highlighted how banks across the world view new technology as a unique chance to improve customer service while cutting costs. A London-based analyst familiar with Barclays' plans – but who wished to remain anonymous – envisaged: 'I think that what we are now witnessing is a fundamental 100-year transformation of the banking industry.' Other U.K. banks, including Lloyds Banking Group and Royal Bank of Scotland, are expected to follow Barclays lead by closing branches and replacing some with smaller sites in supermarkets; as well as by encouraging more customers to use new smartphone applications. Mr. Jenkins – who replaced Bob Diamond in 2012 – has focused on reforming Barclays' culture and improving profitability with a plan to cut 1.7 billion pounds ($2.82 billion U.S.) of costs by 2015."

- Front Page Headline, Daily Telegraph U.K. – "Rising Risk that German Constitutional Court Will Block Bundesbank Rescue Plans for Southern Europe. The risk is rising that the Karlsruhe-based German constitutional court will severely restrict the euro zone bond rescue scheme for Italy and Spain and may well reignite the euro zone debt crisis by prohibiting the German Bundesbank from participating. The Frankfurter Rundschau newspaper reports that the Court's verdict has been delayed until April, due to, not only the complexity of the case, but also, intense differences of opinion among the eight judges. The longer the case transpires, the less likelihood that the Court will rubber stamp requests from the German government for a ruling that supports the agreed bailout machinery. One legal expert close to the case – but preferring to remain anonymous – observed: 'This is potentially very serious, particularly (occurring) at a time when investors are already worried about emerging markets. While I doubt that the Court will ban bond purchases outright, it could demand changes which greatly complicate the situation."

The German Constitutional Court in Karlsruhe.
Source: Reuters

- The Office for National Statistics reports the U.K. gross domestic product (GDP) expanded by 1.9% in 2013. In a speech to the Royal Economics Society at the Bank of England, U.K. Business Secretary Vince Cable proclaimed: "Britain is now experiencing a real (economic) recovery. Over the last six months or so, there has been a positive change in economic sentiment … Despite a decline in real earnings, consumers have displayed the confidence to begin spending again and making use of rising house prices – at least in London and the southeast – to borrow more easily."

U.K. Business Secretary Vince Cable
Photo Source: Getty Images

WEDNESDAY, JANUARY 29TH

- Front Page Headline, MarketWatch News – "FOMC Stays the Course by Tapering another $10 Billion (U.S.). As per market expectations, the Federal Open Market Committee took another gradual step toward exiting its quantitative easing program by reducing the pace of monthly bond purchases to $65 billion (U.S.) from January's level of $75 billion (U.S.). In an excerpt from its formal statement, the FOMC noted: 'Information received since the Federal Open Market Committee met in December indicates that growth in U.S. economic activity accelerated in recent quarters. Labor market indicators were mixed, but on balance showed further improvement. While the (official) unemployment rate declined, it remains elevated. Household spending and business fixed investment advanced more quickly during recent months, while the recovery in the housing sector slowed somewhat. Fiscal policy is restraining economic growth, although the extent of restraint is diminishing. While the inflation rate has been trending below the Committee's longer run objective of 2%, longer-term inflation expectations have remained stable … The Committee also reaffirmed its expectation that the current exceptionally low target range of 0% to 0.25% will be appropriate for at least as long as the (official) unemployment rate remains above 6.5%."

Fed Chairman Bernanke (far left). Source: AFP Getty Images

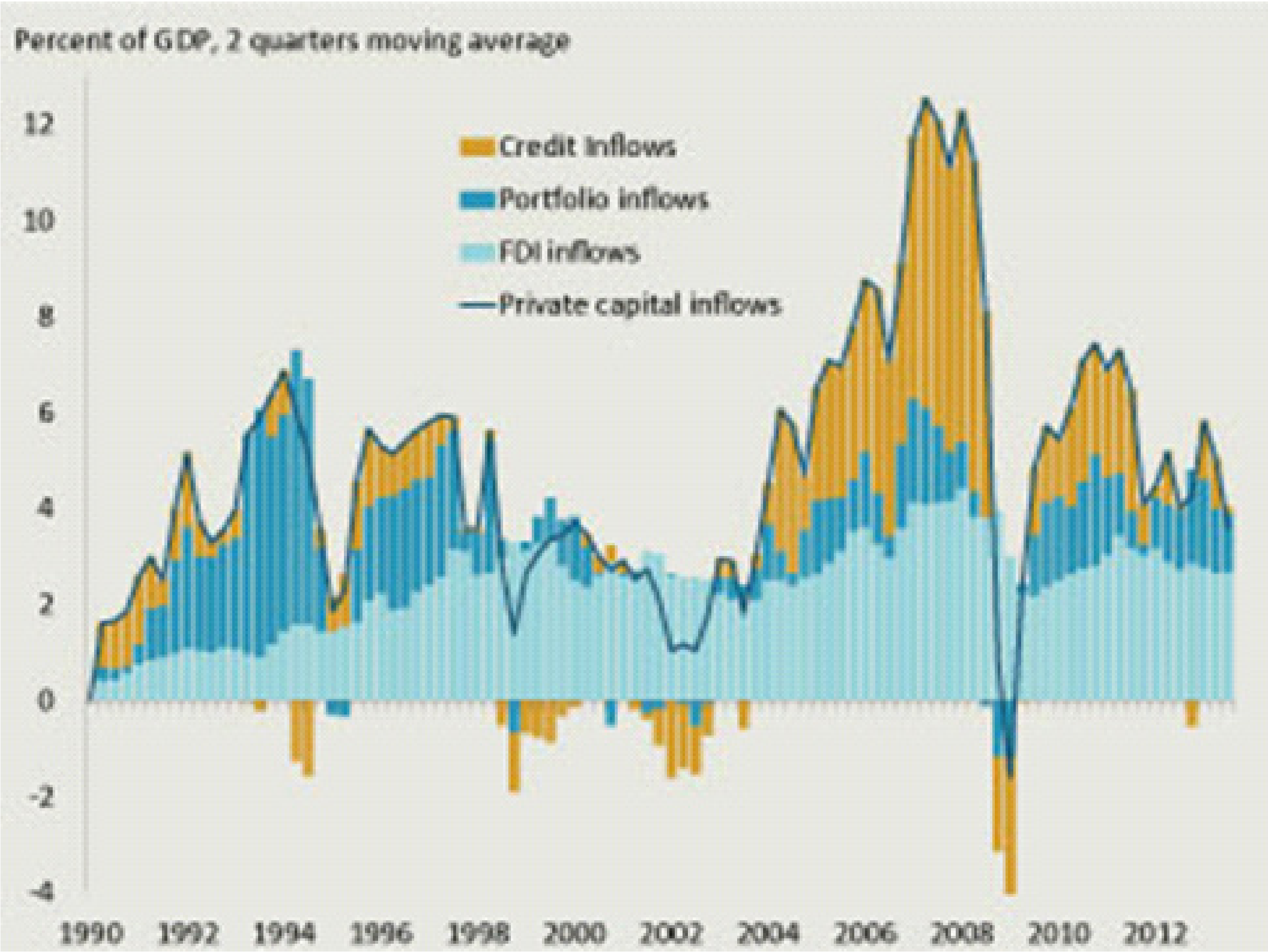
THURSDAY, JANUARY 30TH

- The Commerce Department reports U.S. consumer spending rose by 3.2% in the 4th. quarter, following a 4.1% increase in the 3rd. quarter. The acceleration in demand was broadly based as business investment and exports also advanced, overshadowing the domestic damage from the 16-day partial shutdown of federal agencies.

- The National Association of Realtors reports its index of U.S pending home sales declined by 8.7% in December, following a revised drop of 0.3% in November, previously reported as a gain.

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 19,000 to 348,000 in the week ended January 25th. while continuing claims declined by 16,000 to 2.99 million in the week ended January 18th. Emergency and extended benefits for the longer term unemployed expired after Congress allowed the program to lapse at the end of 2013. On January 14th. the Senate failed to advance a Democratic plan to restore those benefits. Yesterday, Senate majority leader Harry Reid revealed that Senate Democrats are close to gaining enough Republican votes to pass a three-month extension for emergency and extended benefits.

- Front Page Headline, Daily Telegraph U.K. – "World Risks Deflationary Shock as BRICS Puncture Credit Bubbles. At the World Economic Forum in Davos, Switzerland, the International Monetary Fund's (IMF) Managing Director Christine Lagarde recently warned: 'We need to be extremely vigilant. The deflation risk is what would occur if there was a shock to those economies now at low inflation rates way below target. I don't think anyone can dispute that in the euro zone, the inflation rate is way below target levels.' While the IMF believes that probability could now be as high as 20%, it is not difficult to imagine what that shock



might be. It is already before us as Turkey, India and South Africa are all forced to defend their currencies as global liquidity drains away. In its latest report – Capital Flows and Risks in Developing Countries – the World Bank warned: 'the withdrawal of (monetary) stimulus by the U.S. Federal Reserve could throw a curve ball at the international (financial) system. If market reactions to tapering are precipitous, developing countries could see flows decline as much as 80% for several months. A quarter of these economies risk a sudden stop. While this adjustment might be short-lived, it is likely to inflict serious stresses, potentially heightening crisis risks."

FRIDAY, JANUARY 31ST

- The Institute for Supply Management's purchasing managers' index (PMI) for the Chicago manufacturing region declined to a reading of 59.6 in January, following a level of 60.8 in December; citing continuing slower car sales and home construction plans.

- Front Page Headline, Globe and Mail – "In Alberta, Renewed Optimism for Keystone XL Pipeline. The U.S. State Department has boosted hopes in Calgary and Ottawa for approval of the long-delayed Keystone XL Pipeline with a new report that concludes the project would not significantly boost greenhouse gas emissions. While Trans Canada Corp.'s five-year battle for approval is far from over, the State Department report addresses a key concern of U.S. President Barack Obama, who declared last summer that he would not approve the pipeline if it increased carbon pollution levels from oil sands development."

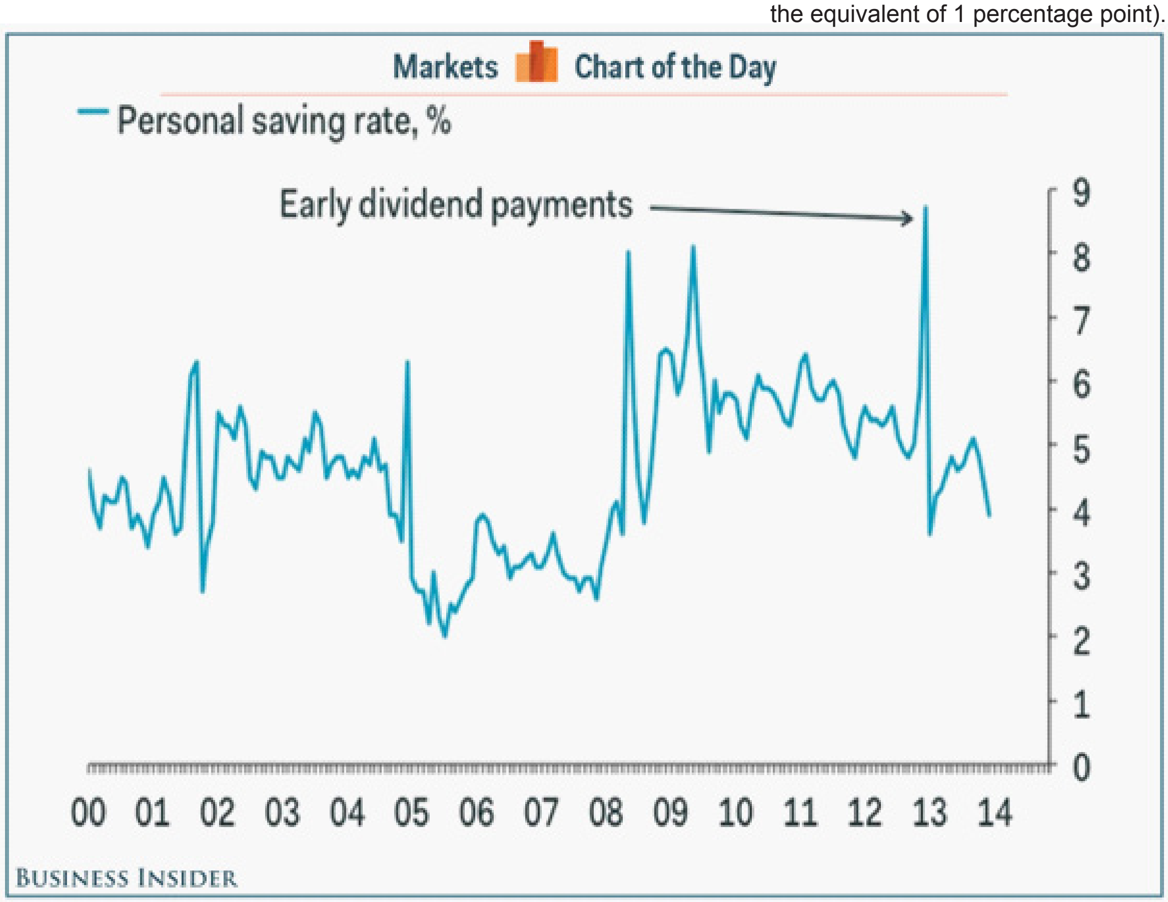
- In its latest Fiscal Monitor report, Finance Canada reveals the federal government posted a $614 million (CAD) deficit in November, raising the shortfall for the first eight months of the current fiscal year to 413.5 billion (CAD) … Finance Minister Jim Flaherty is preparing to deliver his fiscal 2015 budget on February 11th. Erasing the federal deficit by the end of fiscal 2016 is a major priority for the government.

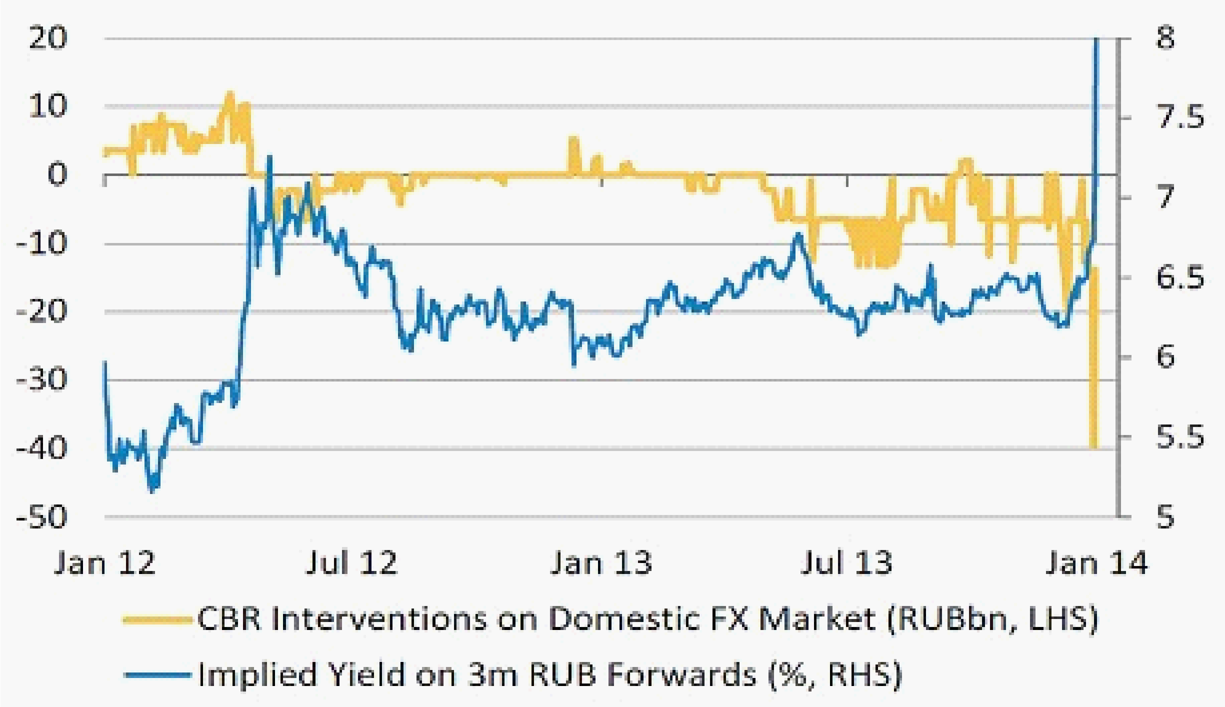
- Front Page Headline, Wall Street Journal – "Spanish Banks Still Battling Bad Loans. Three of Spain's largest banks reported earnings, indicating that despite their cleaner, leaner balance sheets and improving domestic economy, they are still paying for the country's real estate bust. Banco Bilbao Vizcaya Argentaria (BBVA), Caixabank SA and Banco Popular SA have all dramatically improved their capital strength since the onset of the euro zone sovereign debt crisis; but reported rising bad loans and falling net interest income in the final quarter of 2013. Net interest income is the difference between what banks earn from loans and the interest they pay on deposits. In a press briefing regarding the outlook for Spain's economy, BBVA Chief Operating Officer (COO) Angel Cano stated: 'We believe that the worst has passed and the bad loan ratio is beginning to stabilize. In fact, BBVA is open to selling its real estate servicing unit, as long as it would bring capital gains."

- Front Page Headline, Business Insider – "The U.S. Personal Savings Rate Plunges to 2008 Levels. Today's release of U.S. personal income and spending data for December by the Commerce Department revealed that the U.S. personal savings rate has declined to its lowest level since 2008; excluding the outlier data point in January 2013 that resulted from a spike in early dividend payments related to the fiscal cliff and subsequent drop."

- Front Page Headline, Financial Times – "Stocks Suffer Worse January since 2010. Global equities recorded their worse start to a year since 2010, as turmoil in emerging markets left nervous investors seeking safety in highly rated government bonds, the U.S. dollar and the Japanese yen. At the close of New York trading, the FTSE All World Equity Index was down by 4.1% since the start of 2014; its worst January performance since a 4.4% decline four years ago. On Wall Street the S&P 500 fell 0.7% on the day to 1,782 – leaving it down by 3.6% on the year to date – and its first monthly loss since August, 2013."

- Front Page Headline, Daily Telegraph U.K. – "Emerging Market Currency Storm Spreads to Russia's Rouble. The simmering currency crisis in emerging markets has spread to Eastern Europe, forcing Russia and Romania to defend their currencies against capital flight and triggering a sharp increase in Hungary's bond yields. The Central Bank of Russia (CBR) has vowed 'unlimited intervention' to defend the rouble after it fell to a record low against a basket of currencies. Moscow has already burned through $7 billion (U.S.) of reserves since early January. Yields on Russia's two-year 'cross currency swaps' – closely watched by traders for signs of a liquidity crunch – rocketed up by 60 basis points yesterday to 7.6%. The yields have risen by 140 basis points in the past three weeks (100 basis points in yield is the equivalent of 1 percentage point).





Source: CBR, Haver Analytics, Morgan Stanley Research

While there is no single cause for the emerging market sell-off, the backdrop is a combined monetary squeeze by the U.S. Federal Reserve and the Bank of China, which are draining liquidity from the global system. Russia's central bank governor, Elvira Nabiullina, has vowed: "I will not permit a disorderly rouble slide, or risk widespread damage to the financial system. We are not planning to quit intervention."

In a conference call, James Lord and Meena Bassily – both at Morgan Stanley – warned: "Russia faces an invidious choice, since any attempt to defend the rouble automatically tightens monetary policy, forcing up bond yields. Russia learned a difficult lesson in 2008-2009 when it spent $200 billion (U.S.) of reserves defending the currency, but in the process caused a collapse of the money supply and destroyed part of the banking system. Yet it cannot risk a policy of benign neglect at a time of stubbornly high inflation and capital outflows which reached $63 billion (U.S.) in 2013."

CLOSING LEVELS FOR FRIDAY, JANUARY 31ST.		WEEKLY CHANGE
Dow Jones Industrial Average	15,698.85	– 180.26 points
Spot Gold Bullion	$1,239.80 (U.S.)	– $24.50 per oz.
S&P / TSX Composite	13,694.94	– 22.82 points
10-Year U.S. Treasury Yield	2.64%	– 8 basis points
Canadian Dollar	89.78 cents (U.S.)	– 0.53 cent
U.S. Dollar Index Future	81.252	+ 0.821 cent
WTI Crude Oil Futures	$97.49 (U.S.)	+ $0.85 per barrel

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