

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



Monday, June 9th

Canada Mortgage and Housing Corp. (CMHC) reports the nation's seasonally adjusted annualized pace of housing starts rose to 198,324 units in May, following an upwardly revised 196,687 units in April.

MONDAY, JUNE 9TH

Bill Adams, an economist at PNC Financial Services Group, commented: "The housing starts trend to date in 2014 looks to become a year of activity comparable to 2013, but markedly lower than prior to the mid-2012 tightening of CMHC underwriting standards."

- Japan's finance ministry reports the country's gross domestic product (GDP) grew by an annualized 6.7% in the 1st. quarter – upwardly revised from an initial reading of 5.9% – confirming the fastest pace of GDP growth since the 3rd. quarter of 2011. Mitsumaru Kumagai, an economist at the Daiwa Institute of Research, noted: 'Companies don't tend to ramp up spending ahead of a sales tax hike – effective last April 1st. – so the GDP increase likely reflects improvements in corporate profits and diminishing slack in domestic demand.'
- Front Page Headline, Mish's Global Economic Trend Analysis – "Significant Softening in U.S. Personal Income Tax Revenues. While total state tax collections have increased in each quarter of the last four years, the Nelson A. Rockefeller Institute reports a significant decline in U.S. personal income tax revenue growth in the third and fourth quarters of 2013. Early figures for the first quarter of 2014 indicate even further softening in state tax collections and possible declines in personal income tax collections. In many states, officials have been facing extraordinary challenges in forecasting income taxes due to uncertainties related to capital gains, which can have a large impact on estimated taxes paid in December and January; as well as on payments

with tax returns filed in April. This year, the uncertainty has been heightened due to the strong performance of the stock market in 2013 and the unintended consequences of the fiscal cliff. Calendar year 2013 resulted in being a remarkable year for the stock market, gaining 19% as measured by the S&P 500 Index, creating a favourable environment for capital gains.

On the other hand, many taxpayers appear to have accelerated income from calendar year 2013 to calendar year 2014 in order to avoid, higher federal tax rates, likely creating a trough in capital gains in 2013. This creates great uncertainty for states! Was the stock market strong enough to more than offset the trough effect related to the fiscal cliff, so that capital gains would be strong in 2013, or would the latter effect dominate, resulting in a larger decline in capital gains?

In a follow up report, the Rockefeller Institute's compilation of preliminary data from 46 states shows that collections from major tax sources increased by an insignificant 0.7% in nominal terms in the 1st. quarter of 2014, compared to the same quarter of 2013. This is the weakest growth since the 1st. quarter of 2010. Among 46 early reporting states, 37 states reported gains while nine states reported declines in total tax revenue collections. Personal income tax collections declined by 0.4% in nominal terms. This is the first time since the first quarter of 2010 that states reported lower income tax collections. The growth in sales tax collections was also weak at 1%, while corporate income tax growth was at 5.6%.

Table 1: State Income Taxes Showed Declines in the First Quarter of 2014
Percent Change in State Tax Collections vs. the Same Quarter a Year Ago

Year/Quarter	PIT	CIT	Sales	Total
2008 Q1	4.8	(1.4)	0.7	2.6
2008 Q2	8.1	(7.0)	1.0	5.4
2008 Q3	0.9	(13.2)	4.7	2.8
2008 Q4	(1.9)	(23.0)	(5.3)	(4.0)
2009 Q1	(19.4)	(20.2)	(8.4)	(12.2)
2009 Q2	(27.7)	3.0	(9.5)	(16.3)
2009 Q3	(11.5)	(21.3)	(10.1)	(11.0)
2009 Q4	(4.1)	0.7	(4.8)	(3.1)
2010 Q1	3.6	0.3	0.1	3.3
2010 Q2	1.3	(19.0)	5.7	1.9
2010 Q3	3.9	0.5	4.3	5.3
2010 Q4	9.8	12.1	5.5	7.9
2011 Q1	13.6	4.1	6.4	10.5
2011 Q2	15.8	18.3	6.1	11.5
2011 Q3	9.1	0.9	2.0	5.1
2011 Q4	2.9	(3.3)	2.9	3.1
2012 Q1	4.4	3.6	5.0	3.9
2012 Q2	5.7	(3.0)	1.7	3.5
2012 Q3	5.3	8.5	1.8	3.0
2012 Q4	10.9	3.0	2.7	5.1
2013 Q1	18.1	9.4	5.6	9.1
2013 Q2	18.5	10.3	5.2	9.5
2013 Q3	5.0	1.5	5.8	5.7
2013 Q4	0.4	4.6	5.6	3.5
2014 Q1 (preliminary)	(0.4)	5.6	1.0	0.7

Source: The Nelson A. Rockefeller Institute

While the decline in income tax collections is not surprising, the softening in sales tax collections is less expected and more worrisome. Among 41 early reporting states, sales tax collections showed declines in 11 states, with Arizona and California reporting the largest declines at 16.7% and 9.9%, respectively. The large declines in Arizona are mostly attributable to the expiration of a temporary 1% tax increase for the fiscal years 2011 to 2013. For the nation as a whole, the unusually cold winter weather may have temporarily depressed consumer shopping, contributing to the sales tax revenue slowdown.

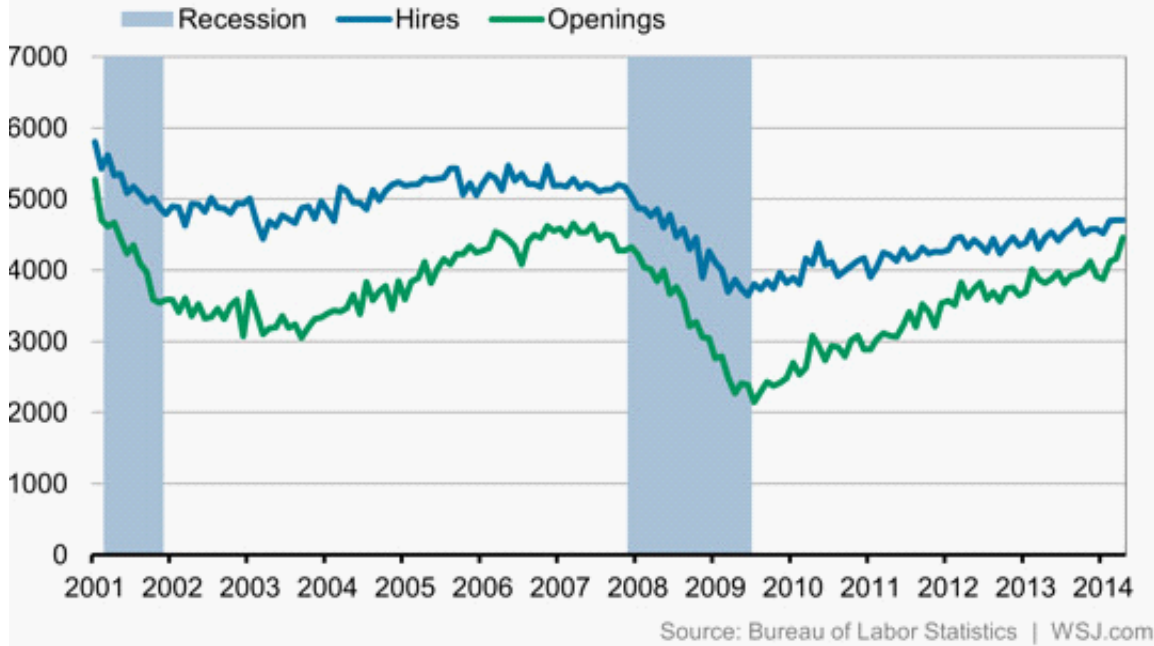
The declines in income tax revenue in the 1st. quarter of 2014 likely reflect lower payments on the 2013 tax year of estimated taxes due in January. We expect that income tax collections will show further declines in the 2nd. quarter of 2014, when 2013 income tax returns due on April 15th. were filed.”

TUESDAY, JUNE 10TH

- The Labor Department reports U.S. job openings rose by 3.1% to 4.5 million in April, the highest level in 7 years. Hirings and layoffs were unchanged.

Job Openings Galore

The monthly level of job openings and hires, seasonally adjusted, in thousands



- The National Federation of Independent Business reports its U.S. Small Business Optimism Index rose by 1.4 points to a reading of 96.6 in May, not only the highest reading since September 2007, but also, the third consecutive month of increases in the index. In addition the survey cited: “price increases are more widespread than at any time since 2008.”
- The National Bureau of Statistics reports China’s consumer price index (CPI) rose by 2.5% on a year-over-year basis in May, up from a 1.8% level in April. Lui Huiyong, an economist at Shenyin & Wanguo Securities in Shanghai, noted: “The recovery in pork prices, together with last year’s low base, helped spur the faster price increases.”

WEDNESDAY, JUNE 11TH

- Front Page Headline, Bloomberg News – “World Bank Lowers Global GDP Growth Forecast. In its Global Economics Prospects Report, the Washington-based World Bank has lowered its gross domestic product growth outlook for the world economy to 2.8% for 2014 from its 3.4% forecast of last January. Inherent within this adjustment is a downward revision for the U.S. GDP to 2.1% from 2.8%; as well as reduced GDP outlooks for Brazil, Russia, India and China. Optimistically, the Bank left its global economic growth estimate for 2015 unchanged at 3.4%.

Indeed, the Bank’s Report stated: ‘The global economy got off to a bumpy start this year, buffeted by poor weather in the United States, financial market turbulence and the conflict in Ukraine. Despite the early weakness, global economic growth is expected to accelerate as the year progresses.’

- Front Page Headline, Globe and Mail – “Canada’s Agriculture Minister Labels U.S. a ‘Schoolyard Bully’ on Trade Issues. In an interview with Reuters, Gerry Ritz stated: ‘I see more potential in negotiating a bilateral trade agreement with Japan’ than within the more ambitious Trans-Pacific Partnership (TPP) which aims to lower trade barriers in member countries.



Canadian Trade Minister Gerry Ritz

Photo source: Globe and Mail

Mr. Ritz also confirmed: 'It would take a sea shift for Canada to offer significantly more access to its protected dairy, poultry and egg industries.' Last month, Japan declared it would not abolish tariffs in five key agricultural sectors. Last week, American dairy farmers threatened to oppose the TPP pact if Japan and Canada did not agree to accept substantially more dairy imports. Mr. Ritz continued: 'I don't entertain any such thing in the near future ... In those areas, Canada's sensitivity is no different than sugar and cotton are for U.S. trade negotiators.'

- Front Page Headline, Financial Post – "Moody's Lowers Credit Rating Outlook for Canadian Banks. As governments in many countries implement 'bail-in' provisions to avoid taxpayer-funded bank bailouts, Moody's Investor Services announced it was lowering the credit rating outlook for Canada's largest seven banks to negative from stable 'in the context of previously announced plans by the Canadian government not to implement a taxpayer bail-in regime, in the unlikely event that a Canadian bank needed to be bailed out.' In an interview, David Beattie, a Moody's vice-president, stated: 'The Canadian government's objective is to spare the public purse. Senior bank bondholders would be taking a hit prior to any taxpayer considerations.' The outlook changes by Moody's affect all seven of Canada's biggest banks: Toronto-Dominion; Royal Bank; Bank of Nova Scotia; Canadian Imperial Bank of Commerce; National Bank; Canadian Western and Bank of Montreal."

THURSDAY, JUNE 12TH

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by a seasonally adjusted 4,000 to 317,000 – from an upwardly revised 313,000 – in the week ended June 7th. while continuing claims rose by 11,000 to 2.614 million in the week ended May 31st.
- The Commerce Department reports U.S. retail sales rose by 0.3% in May, following a 0.5% gain in April, citing increased sales of automobiles and trucks; as well as significantly higher sales at home improvement stores.
- Front Page Headline, Financial Post – "Fully Priced Housing Market and High Household Debt Remain Biggest Threats to Canadian Economy: Bank of Canada. In a press conference following the release of the central bank's semi-annual Financial Systems Review (FSR), Bank of Canada Governor Stephen Poloz stated: 'After weighing the risks to financial stability through our improved framework, our level of comfort as policymakers remains roughly what it was six months ago. Our analysis reveals that household imbalances remain the most

important vulnerability and could amplify the impact of external shocks.'

In the FSR per se, the central bank maintains: 'Our financial system remains robust. Canadian banks are well capitalized, financial markets are functioning well and financial market infrastructures are supporting core financial market activities. However, vulnerabilities still exist. Despite some signs of a soft landing, for instance, property valuations are stretched and there are signs of overbuilding in certain segments of the housing market. Canadian households are highly leveraged. Household debt-to-income ratios remain at historically high levels, despite a recent moderation in the growth of mortgage credit and continued low interest payments on mortgage debt. Still, a sharp correction in house prices could be sparked by a global economic shock that would lead to higher unemployment and hamper households in servicing their debts. Such shocks could be imported from a major financial disruption in China, home of the world's second largest economy after the United States, given its more fragile banking sector.

This could result in a steep drop in global commodity demand and prices that could have a moderately severe impact on the Canadian economy and financial system. Likewise, any serious disruption of the euro zone's financial system could have global consequences, possibly caused by market concern about the adequacy of bank balance sheet repair, or a sudden economic shock related to more geopolitical stress in Ukraine and Russia.

However, if there were a possible weak point within the current structure of the country's banking system, it could be found in smaller financial institutions dotted across Canada – many serving small communities – such as credit unions, trust companies and small investment and mortgage funds. While these operators account for only a small share of the market, a disproportionate share of their business is oriented to more risky areas. In addition to the potentially lower credit quality of their loan portfolios, some smaller financial entities have business models that are less diversified from either a sectorial, or a geographical perspective. Two main areas of concern are non-prime lending – aimed mainly at borrowers who do not qualify for insured mortgages – and non-residential mortgages and construction loans, owing to their more cyclical nature. During the past several years, smaller banks and trust companies have become more active in this market area."

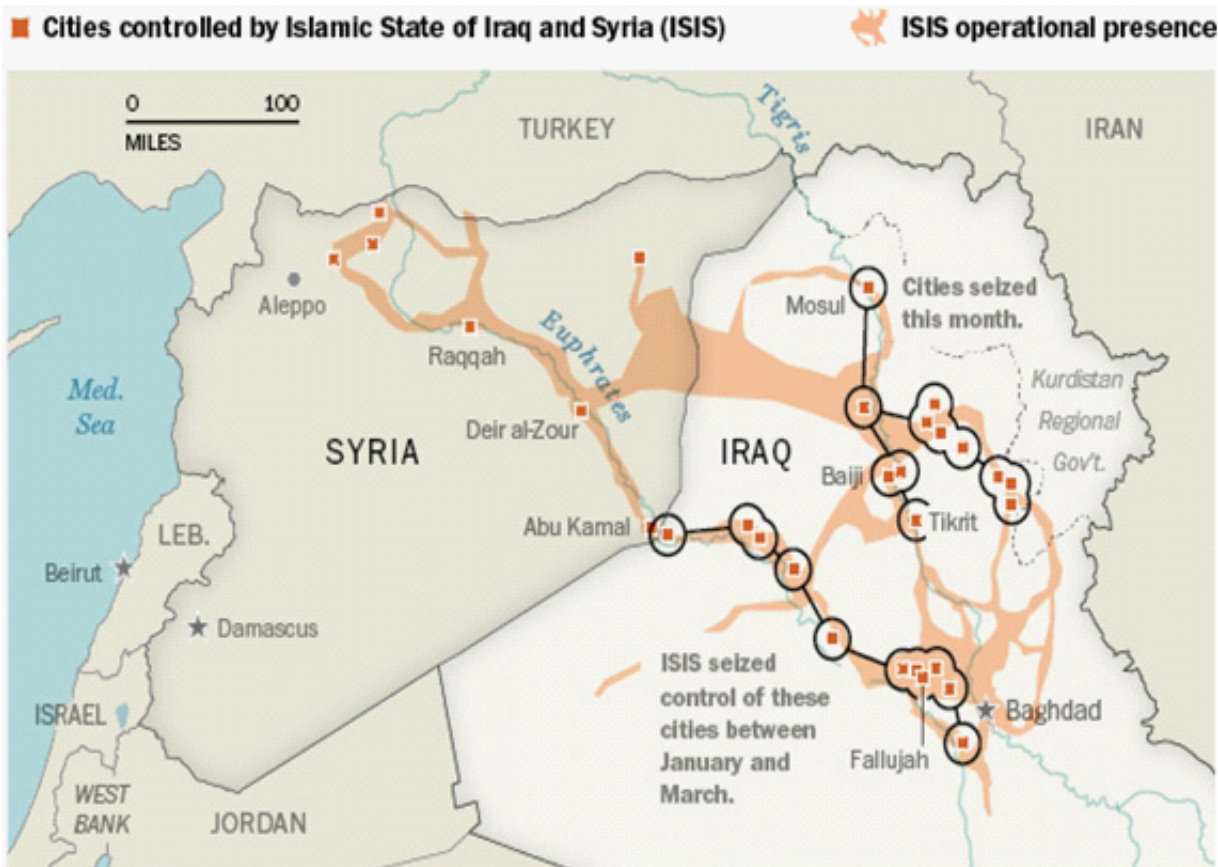


Bank of Canada Governor Stephen Poloz.

Source: Financial Post

FRIDAY, JUNE 13TH

- The Labor Department reports the U.S. producer price index (PPI) declined by a seasonally adjusted 0.2% in May – citing lower costs for energy products – and following increases of 0.6% and 0.5% in April and March, respectively. While the core rate, excluding food and energy, remained unchanged in May, on a year-over-year basis, the PPI rose by an unadjusted 2%, down from 2.1% in April.
- Statistics Canada reports Canadian factory sales declined by 0.1% in April, citing: “The decline was caused by partial closures at several oil refineries for maintenance and retooling work. Although such maintenance is commonplace during the spring months, the partial closures were more extensive than usual in April. In addition, aerospace and related parts industry production declined by 6.2%, having been up in the 1st. quarter. For the year-to-date, Canadian factory production is 15.5% higher than in the same period a year ago.”
- Eurostat – the European Union’s statistics office – reports the number of persons employed in the 18-country European Monetary Union (EMU) rose by 0.1% in the 1st. quarter of the year and by 0.2% on a year-over-year basis; the first annual increase since the 3rd. quarter of 2011. However, 18.7 million people were still without jobs in April and the unemployment rate remains close to the record high of 12.3% seen last year. Separately, Eurostat reported the euro zone’s trade surplus widened to 15.7 billion euros in April, up from 14 billion euros in the same period of 2013.
- Front Page Headline, Daily Telegraph U.K. – “S&P Raises Britain’s Sovereign Credit Rating Outlook to Stable. In raising the U.K.’s credit rating outlook from negative to stable, Standard & Poor’s Rating Agency affirmed Britain’s ‘AAA’ credit rating, citing: ‘the stable outlook reflects the country’s robust and broadening economic recovery and the further progress that the government is making on consolidating public finances. We expect the U.K. gross domestic product (GDP) to expand by almost 3% this year and by 2.5% in 2015; driven by business investment and private consumption ... We see improving credit and capital market conditions as supportive of GDP growth along with an expected gradual resumption of real wage gains.”
- Front Page Headline, Mish’s Global Economic Trend Analysis – “Repent or Die: ISIS. Al Qaeda forces have reportedly advanced to within 50 miles of Baghdad ... The Islamic State of Iraq and al-Sham has set out a list of Islamist behavioral rules for residents of Mosul and the surrounding area. The insurgents declared: “We are soldiers of Islam and we have assumed our responsibility to restore the glory of the Islamic Caliphate.
 1. All Muslims in the City of Mosul have been instructed to attend mosque for the five daily prayers. Anyone of its citizens who breaches this promise will have their hands cut off.
 2. No drugs, no alcohol and no cigarettes will be used.
 3. All shrines, graveyards and monuments will be destroyed.
 4. All women must dress in concealing clothing that preserves decency.
 5. Females must only go outside if necessary.Freedom loses out to the imposition of Islamist Sharia Law in Northern Iraq.



CLOSING LEVELS FOR FRIDAY JUNE 13TH.

WEEKLY CHANGE

Dow Jones Industrial Average	16,775.74	- 148.54 points
Spot Gold Bullion	\$1,274.10 (U.S.)	+ \$21.60 per oz.
S&P / TSX Composite	15,001.61	+ 162.71 points
10-Year U.S. Treasury Yield	2.60%	+ 1 basis point
Canadian Dollar	92.11 cents (U.S.)	+ 0.62 cent
U.S. Dollar Index Future	80.584	+ 0.160 cent
WTI Crude Oil Futures	\$106.91 (U.S.)	+ \$4.25 per barrel

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