Monday December 1st, 2014

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, December 1st

The Tempe, Arizona-based Institute for Supply Management (ISM) reports its U.S. manufacturing index declined slightly to a reading of 58.7 in November from a level of 59 in October. Separately, Markit Eco-

MONDAY, DECEMBER 1ST

nomics reported its final U.S. manufacturing index for November declined to a reading of 54.8 from a level of 55.9 in October, the lowest reading in ten months.

- The Washington-based National Retail Federation (NRF) reports 'Black Friday' weekend retail sales declined by an estimated 11% compared with the sales level in 2013. In a conference call, NRF Chief Executive Officer Matthew Shay observed: "The 'Black Friday' weekend and the holiday season are a marathon, not a sprint. This will continue to be a very competitive shopping season."

Japan's Prime Minister Shinzo Abe. Source: Bloomberg

- The National Bureau of Statistics and the China Federation of Logistics and Purchasing in Beijing report China's purchasing managers' index (PMI) fell to an eight-month low reading of 50.3 in November, led by an undisclosed number of factory closures. Readings above 50 indicate an expansion in manufacturing activity. Julian Evans-Pritchard, an analyst at Capital Economics in Singapore, commented: "The recent cut in the Bank of China's benchmark lending rate will do little to boost domestic economic activity unless followed by a loosening of quantitative controls on lending which, given concerns over mounting credit risk, will likely cause policymakers to remain somewhat cautious."

- Front Page Headline, Moody's Global Credit Research – "Moody's Downgrades Japan's Credit Rating. Literally two weeks prior to the Japanese election date of December 14th., Moody's Investors Service downgraded Japan's sovereign credit rating from Aa3 to A1 with a stable outlook, citing: 'The key drivers for the downgrade are the following:

1. Heightened uncertainty over the achievability of fiscal deficit reduction goals.
2. Uncertainty regarding the timing and effectiveness of GDP growth enhancing policy measures, against a background of deflationary pressures.
3. In consequence, increased risk of rising Japanese Government Bond (JGB) yields and reduced debt affordability over the medium term.

The A1 rating reflects the government's significant credit strengths, including a large, diverse economy with a strong external position, very high institutional strength and a very strong domestic funding base. The stable outlook reflects the broad balance, between upside risks including significant fiscal consolidation and a resumption of economic growth, and downside risks including intensification of deflationary pressures and loss of economic momentum. This rating action does not affect Japan's Aaa foreign currency, local currency country and bank deposit ceilings. Those ceilings act as a cap on ratings which can be assigned to the obligations of other entities domiciled in the country."

- London-based Markit Economics reports its European Monetary Union (EMU) manufacturing sector's purchasing managers' index (PMI) declined to a reading of 49.5 in November from a level of 51.4 in October. Chris Williamson, chief economist at Markit, commented: "The situation in euro area manufacturing is worse than previously thought. Not only is the performance of the sector the worst sen since mid-2013, but also, there is a risk that renewed rot is spreading across the region from the core. While Germany's export engine has stalled, new business is also falling in both France and Italy, boding ill for production in coming months … In addition, euro area price pressures remained on the downside in November."

- Yesterday, in a referendum named 'Save Our Swiss Gold' voters rejected an initiative which would have compelled the Swiss National Bank to hold at least 20% of its 522 billion franc ($540 billion U.S.) balance sheet in gold. At Longwave Analytics, we greatly doubted this would be approved since the Swiss National Bank (SNB) has a solid history as a notorious money printer and whose monetary policy is unlikely to be altered any time soon. See also, The Week That Was – Thursday, November 27, 2014.

- Front Page Headline, Globe and Mail – "Canadian Manufacturing PMI Holds Steady. The RBC reports its Canadian manufacturing purchasing managers' index remained unchanged at a reading of 55.3 in November, a 12-month high. The RBC report stated: 'November data indicated a strong and accelerated expansion of Canadian manufacturing production. The latest upturn in output volumes was the fastest for three months and much stronger than the average seen since the survey began in late 2010. A number of survey respondents commented on improving demand from export clients, especially those based in the U.S.' The RBC index is published by the Royal Bank in association with the Supply Chain Management Assn. and financial information services company Markit Economics."

TUESDAY, DECEMBER 2ND

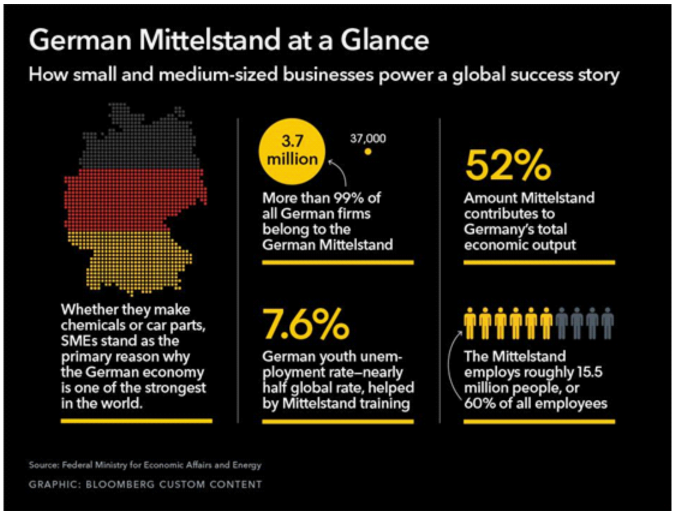
- The Commerce Department reports U.S. construction spending rose by 1.1% in October to a seasonally adjusted annual level of $971 billion (U.S.), following a revised decline of 0.1% in September.

- Front Page Headline, Bloomberg News – "Russian Woes Worsen as Recession Looms. In an interview with reporters, Russia's Deputy Economy Minister Alexei Vedev stated: 'While the elements of instability affecting the domestic economy range from structural to geopolitical, one of the key factors is the lower price of oil. Urals, our chief export oil blend, will probably average $99 (U.S.) a barrel in 2014 – a downgrade from an earlier forecast of $104 (U.S.) – its price is forecast to decline to an average of $80 (U.S.) in 2015. The economy is also suffering from sanctions imposed over the conflict in Ukraine. Accordingly, our gross domestic product (GDP) may contract by 0.8% next year compared with our earlier estimate of 1.2% for GDP growth."

WEDNESDAY, DECEMBER 3RD

- Roseland, New Jersey-based ADP Research reports U.S. private sector companies added 208,000 jobs in November. Ian Shepherdson, chief economist at Pantheon Macroeconomics in White Plains, NewYork, noted: 'The labor market is looking pretty healthy. The only real issue is the hourly earnings numbers, which remain stubbornly depressed.'

- London-based Markit Economics reports the composite purchasing managers' index (PMI) for the euro zone services and manufacturing sectors declined to a reading of 51.1 in November – a 16-month low – from a level of 52.1 in October. Markit's chief economist Chris Williamson commented: 'The PMI survey results indicate that current European Central Bank (ECB) monetary policy initiatives have not yet made a meaningful impact on business or consumer confidence. More aggressive policy measures are likely to be required.'

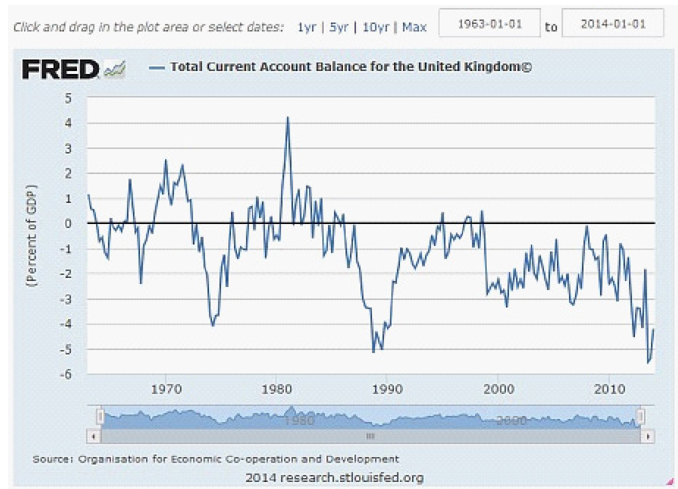


- Front Page Headline, Globe and Mail – "Bank of Canada Leaves Bank Rate Unchanged at 1%. In his final monetary policy statement for 2014, Bank of Canada Governor Stephen Poloz remarked: 'Canada's economy is showing signs of a broadening recovery. The hoped-for sequence of rebuilding which will lead to balanced and self-sustaining gross domestic product (GDP) growth may finally have begun, with stronger exports to the U.S. beginning to drive investment and employment. Meanwhile, the consumer price index (CPI) is stronger than expected due to the temporary effect of a lower Canadian dollar and sector specific factors which have caused higher meat prices and telecommunications costs. However, underlying inflation remains below our 2% target and weak oil prices pose an important disinflationary risk to our inflation forecast."

Bank of Canada Governor Stephen Poloz.
Source: Globe and Mail

- Front Page Headline, Daily Telegraph U.K. – "Britain Inspires Global Confidence Because It Seeks to Live Within Its Means: Chancellor of the Exchequer George Osborne. In an op-ed, International Business Editor Ambrose Evans-Pritchard writes: For sheer brass, it is difficult to beat the outlandish claims of Chancellor Osborne. This comes a day after Societe Generale noted: 'The U.K. cannot compete, is on an unsustainable course and has carried out zero structural reform' – a view held to varying degrees by a great number of economists around the world. Britain has a current account deficit of 5.2% of GDP, in spite of the post-Lehman devaluation.

It is the worst of any major country and just about the worst in our peacetime history. The Office for Budget Responsibility (OBR) has raised its estimate of the likely budget deficit by 1.5% of GDP annually to 2018. It is becoming entrenched. This is prima facie evidence that we are not living within our means. The money is not being spent on imports of machinery to drive future manufacturing, or on technology to raise our economic speed limit. We are importing global capital at a rate of 5% of GDP to cover incurable shopping habits. We used to get away with it because of high earnings on overseas investments, but we are now in a low yield world. Besides, our net international liabilities are creeping up each year. There is no free lunch. On the fiscal front, Britain has a deficit of 5% of GDP a full five years into the economic recovery, when GDP growth is at 3% and should be generating a windfall of tax revenue. This is a prima facie evidence of a chronic reliance upon state borrowing to perpetuate a consumption model.



The budget deficit is 4.4% in France, 1.5% in Italy and 0.2% in Germany. The U.S. deficit – once similar to ours – has declined to 2.8% of GDP on a quarterly basis. Britain just sticks out like a sore thumb.

Mr. Osborne has told us that 'warning lights are flashing over the global economy and geopolitical risks are rising.' If so, it is remarkable that he can so boldly predict a balanced budget by 2018 and a surplus of 23 billion pounds by the end of the decade. Should we enter a new global economic downturn with a fiscal deficit already so high; borrowing will spike to 10% of GDP in short order. That is the harsh reality. This is not to say that spending should be slashed overnight. Fiscal tightening must be administered at the right therapeutic dose. The euro zone debacle has shown that austerity for the sake of it makes matters worse, causing debt to GDP ratios to increase faster. The British state can borrow for 10 years at an interest rate of 1.9%. It should do so without compunction, but only for the right purpose. The question that the Chancellor must answer as this Parliament draws to a close is whether his deficit – for it is his now – is being spent on infrastructure projects that boost our economic growth over the long term, or whether it is propping up the old credit-driven model which he vowed to reform. The OBR has forecast that household debt will increase from 146% of income to 180% by 2019. They might as well tweet that Britain has learned absolutely nothing. If this is correct, then Mr. Osborne has wasted his chance to end the British disease.

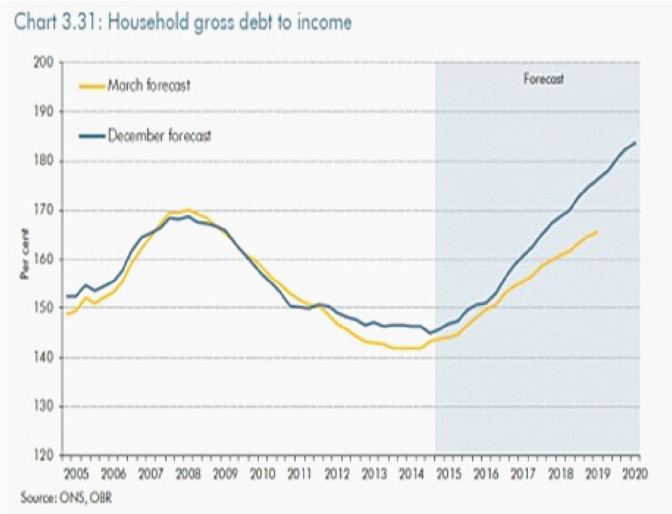


Chart 3.31: Household gross debt to income

Jean-Michel Six, chief Europe economist at Standard & Poor's recently stated: 'I don't see that anything is being done to improve the British competitiveness gap.' Britain's output per hour is 21 percentage points below the G7 average, the widest productivity gap since the early 1990s. It is true that Britain has created 500,000 jobs over the past year – as much as the rest of the EU combined – and this makes the productivity figures look worse than they are. It is certainly a better outcome than the labour 'hysteresis' of rotting skills caused by mass unemployment in southern Europe. This government has presided over the creation of 2 million new jobs in the private sector. The handover from Gordon Brown's Leviathan to a leaner state is occurring. Total managed expenditure has declined from 45.5% to 43% of GDP since the financial crisis and will in theory be the lowest since the Second World War within four years. Let us never forget that Mr. Osborne inherited the fiscal legacy from Hell.

It is also true that the U.K. has jumped to second spot behind Switzerland on the Global Innovation Index, as the Chancellor has told the House of Commons. Yet, one could equally ask why the U.K. ranks 45th. on the World Bank's 'Doing Business' index for starting a new enterprise, or 68th. to register a property, or 70th. to obtain electricity – with a delay of 126 days compared with an OECD average of 77 – or, why it takes 437 days and costs twice the OECD level to enforce a contract. The World Economic Forum states that Britain ranks 37th. for the burden of government regulation and 63rd. for the quality of maths and science education. These are deep failings. The Coalition has neither done much about them, nor has there been much sustained effort to switch the tax and incentive structure of the British economy from self-indulgence to production, or to change the fundamental way we organize our economic affairs as a nation. To do so would ruffle feathers. There lies the rub. For all the superficial likeness, the Anglo-Saxon GDP growth stories in Britain and America have nothing in common. America has cut its current account deficit from 6% to 1.9% of GDP. It is on track to achieving energy independence by 2018, igniting a revival of its chemical, plastics, glass and steel industries along the way … One recovery is durable, the other is on borrowed time. The Chancellor told us he would 'stay the course.' A change of course might be preferred."

THURSDAY, DECEMBER 4TH

- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 17,000 to a seasonally adjusted 297,000 in the week ended November 29th. while continuing claims increased by 39,000 to a seasonally adjusted 2.36 million in the week ended November 22nd. Gregory Daco, an economist at Oxford Economics in New York observed: 'If jobless claims are below the 300,000 threshold, the labor market picture is one of ongoing payroll gains and gradually firming wage growth.'

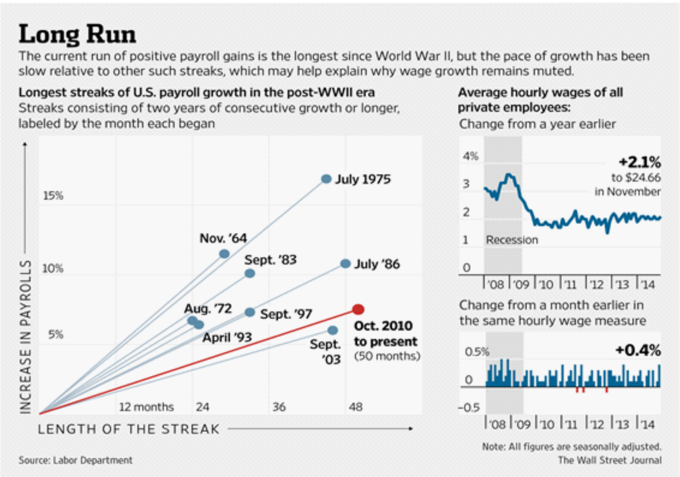
FRIDAY, DECEMBER 5TH

- The Commerce Department reports U.S. factory orders declined by 0.7% in October – following a drop of 0.5% in September – excluding transportation – orders fell by 1.4%.

- The Economy Ministry in Berlin reports German factory orders rose by 2.5% in October – following an upwardly revised increase of 1.1% in September – and by 2.4% on a year-over-year basis. David Milleker, chief economist at Union Investment GmbH in Frankfurt observed: "The disappointing economic reports over the past few months are a reflection of extremely muted domestic investment demand. Since capacity utilization itself has remained quite high, investment should actually be fairly decent."

- Statistics Canada reports the nation's trade surplus narrowed to $99 million (CAD) in October, following a downwardly revised surplus of $307 million (CAD) in September, previously reported as $710 million (U.S.).

- The Labor Department reports U.S. non-farm payrolls soared by 321,000 in November, the largest number of jobs in almost three years, following an upwardly revised gain of 243,000 in October. In a statement, Jason Furman, Chairman of the White House Council of Economic Advisors, commented: "To create an environment in which this hiring process can continue, it is critical that Congress take the basic steps needed to fund the government and avoid creating disruptive and counterproductive fiscal uncertainty. We have an opportunity to work together to support the continued growth of higher-paying jobs, by investing in infrastructure, reforming the business tax code, expanding global markets for America's goods and services, making sensible reforms to the immigration system and raising the minimum wage."



- Statistics Canada (Statscan) reports the nation's labour participation rate – the percentage of the population aged 15 and over in the work force – remained unchanged at 66% in November, a 13-year low. Andrew Fields, a labour market analyst at Statscan, noted: "The real reason for a stagnant labour participation rate is because a large proportion of Canadians are aging and exiting the labour market."

- Front Page Headline, Globe and Mail – "S&P Downgrades Italy's Sovereign Credit Rating to BBB (Low). While maintaining a stable outlook, S&P projected Italy's national debt – which at 132% of GDP is proportionately the highest in the euro zone after Greece – would reach 2.256 trillion euros ($2.77 trillion U.S.) by the end of 2017, some 80 billion euros higher than it forecast last June. S&P stated: 'Such a large increase in debt, plus consistently low GDP growth and eroded competitiveness, are not compatible with a BBB credit rating. We are now forecasting Italy's GDP growth will be just 0.2% in 2015 and will average 0.5% over 2014 – 2017."

- The Commerce Department reports the U.S. trade deficit narrowed by 0.4% to $43.4 billion (U.S.) in November, while September's shortfall was upwardly revised to $43.6 billion (U.S.) from a previously reported $43.03 billion (U.S.); citing lower crude oil prices failed to offset an increase in demand for imported items, such as computers, automobiles and food products. Indeed, imports of capital equipment, including semiconductors and machinery, reached the highest level on record back to 1992.

- Front Page Headline, Daily Telegraph U.K. – "Germany's Bundesbank Halves GDP Growth Forecast to 1% for 2015. The central bank also lowered its GDP growth outlook for this year to 1.4%, compared with its previous growth estimate of 1.9%; but expects GDP growth to improve slightly to 1.6% in 2016. The Bundesbank cited: 'a loss of considerable momentum in the 2nd. and 3rd. quarters of this year' as responsible for a flatter GDP growth path year-to-date. Interestingly, Bundesbank President Jens Weidmann recently stated: 'There is reason to hope that the current sluggish economic phase will be short-lived.' Germany's manufacturing sector has suffered over the year as a result of ongoing geopolitical tensions over Russia and Ukraine. Tit-for-tat sanctions exchanged over the issue have neither helped Germany nor Russia. Last week, Russia's Finance Minister Anton Siluanov stated that sanctions were costing Russia's economy about $40 billion (U.S.) a year. After all, Germany is Russia's largest trading partner within the European Union (EU).

- Front Page Headline, GoldMoney – "Commodities and the U.S. Dollar. Each commodity market has its own story to tell: oil prices are falling because OPEC can't agree on production cuts, steel faces a glut from overcapacity and even the price of maize has declined, presumable because of good harvests. In local currencies, this is not so much the case. Of course, the difference between prices in local currencies and prices in U.S. dollars is reflected in the weakness in most currencies against the dollar in the foreign exchange markets. This tells us that whatever is happening in each individual commodity and in each individual currency, the common factor is the U.S. dollar. Perhaps, this is obvious, however the decline in commodity prices and the rise in the U.S. dollar must be seen in context.

  We should note that for most of the global population, the concern that we're facing global deflation – by which is commonly meant falling prices – is neither necessarily true, nor is a conclusion that a decline in the oil price indicates a sudden collapse in the demand for energy. When the dollar price of oil began to slide, so did the exchange rates for all other major currencies, confirming that a significant part of oil's price move was derived from dollar strength; which would have also been true of commodity prices generally. On the average, there has been a shift of preferences towards holding U.S. dollars and away from holding commodities. Viewed in this light, we can see that a trend in inventory destocking can develop solely for financial reasons, rather than for business reasons, because businesses which account in U.S. dollars face financial losses on excess inventory. It is the function of speculators to anticipate these decisions, which is what we have witnessed in recent months. Macroeconomists, who by definition are Keynesian or monetarists, are beginning to interpret falling commodity prices and a rising U.S. dollar as evidence of insufficient aggregate demand, which left unchecked will lead to deflation, higher unemployment, bankruptcies, falling asset prices and bank insolvencies. They warn that it is an outcome to be avoided at all costs, by ensuring that aggregate demand is stimulated so that none of this occurs. Whether or not they are correct in this assessment is not the point. They neglect to realize that some of the move in commodity prices is due to the U.S. currency itself as the numeraire of all prices.

For evidence of this, we need look no further than at the attitude of the Federal Reserve and every other central bank which targets price inflation as part of their monetary policy. In the formulation of monetary policy, there is no allowance for the possibility, nay likelihood, that in the future there will be a change in preferences against the U.S. dollar – or any other currency for that matter – in favour of anything else. The tragedy of this lack of market comprehension is that it's a fair bet that monetary policy will not only succeed in limiting the rise of the U.S. dollar – as it is designed to do – but also, ultimately undermining it when preferences shift the other way. The moral of the story is that the Federal Reserve and other central banks are … only fooling themselves. So, we should bear in mind that U.S. dollar strength is only a trend which can easily reverse course at any time."

CLOSING LEVELS FOR FRIDAY, DECEMBER 5TH.		WEEKLY CHANGE
Dow Jones Industrial Average	17,958.79	+ 130.55 points
Spot Gold Bullion	$1,190.40 U.S.)	+ $14.90 per troy oz.
Spot Silver	$16.30 (U.S.)	+ $0.74 per troy oz.
S&P / TSX Composite	14,473.70	– 271.0 points
10 – Year U.S. Treasury Yield	2.31%	+ 15 basis points
Canadian Dollar	87.47 cents (U.S.)	+ 0.06 cent
U.S. Dollar Index Future	89.355	+ 1.136 cents
WTI Crude Oil Futures	$65.84 (U.S.)	– $0.31 per barrel
DJIA / Gold Ratio	15.086	– 0.084 point
Gold / Silver Ratio	73.03	– 2.52 points