Monday December 22nd, 2014

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, December 22nd

The National Association of Realtors (NAR) reports U.S. existing home sales declined by 6.1% in November to a seasonally adjusted annual pace of 4.93 million units – the lowest level in six months – following a revised rate of 5.25 million units in October,

MONDAY, DECEMBER 22ND

previously reported as 5.26 million units. Gennadiy Goldberg, an economist at TD Securities in New York noted: “The existing home sales report suggests that the U.S. housing market remains on a somewhat volatile footing.”

- Front Page Headline, Globe and Mail – “Russia Entering Fully-Fledged Economic Crisis. At a Moscow news conference, former Russian finance minister Alexei Kudrin asserted: ‘Since the government has been too slow to address the country’s economic situation, today I can say that Russia is entering a real, fully-fledged economic crisis and next year the population will clearly feel it. Indeed, economic sanctions over Ukraine, rather than falling oil prices, are primarily behind the collapse of the ruble, so Russia now risks having its sovereign debt credit rating downgraded to junk status during 2015.’ Mr. Kudrin has also criticized President Putin’s response to Western sanctions imposed following Russia’s annexation of Crimea and his subsequent support for the loyalist fighters.”

Russia’s former finance minister Alexei Kudrin.
Photo source: AP

- The European Commission (EC) reports its preliminary index of consumer confidence for the 18-nation member European Monetary Union (EMU) rose to a reading of minus 10.9 in December, from a level of minus11.5 in November, citing a boost to real incomes from falling oil prices.

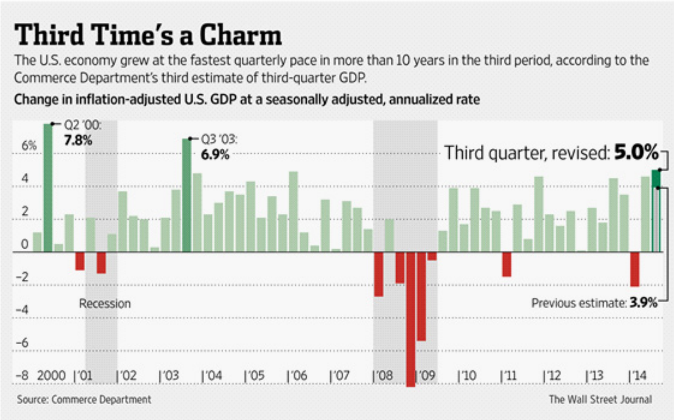
TUESDAY, DECEMBER 23RD

- The Commerce Department reports U.S. new single-family home sales declined by 1.6% in November to a seasonally adjusted annual rate of 438,000 units, the slowest pace in four months. Stuart Hoffman, an economist at PNC Financial Services Group in Pittsburgh, Pa. commented: “The U.S. housing market should continue to improve in 2015 with continuing low mortgage rates and higher employment growth. There seems to be no fundamental weakening taking place, just more of the very gradual improvement in the housing market.”

- Statistics Canada reports the nation’s gross domestic product (GDP) grew by 0.3% in October to an annualized $1.65 trillion (CAD), following a 0.4% gain in September. Bill Adams, an economist at PNC Financial Services Group noted: “The 1.5% increase in Canadian oil and gas extraction is the most notable statistic in the October report. Lower oil prices haven’t yet dragged on Canada’s energy output, perhaps because producers may have locked in long-term prices prior to the 4th. quarter’s price plunge.”

- The Commerce Department reports U.S. durable goods (those expected to last for at least three years) orders declined by 0.7% in November, following a 0.3% increase in October and led by lower demand for metals, computers and electrical equipment.

- The Commerce Department reports the U.S. gross domestic product (GDP) grew by an upwardly revised seasonally adjusted annual rate of 5% in the 3rd. quarter, previously estimated at 3.9% and up from the 2nd. quarter's growth rate of 4.6%. Mike Jakeman, an economist at the Economist Intelligence Unit (EIU) observed: "There is a positive U.S. economic feedback loop transpiring at the moment. Job creation is improving at the strongest rate in 15 years. More people working means more income, which means more private spending, which means more business investment, which means more hiring."



- The University of Michigan / Thomson Reuters group reports their U.S. consumer confidence index declined slightly to a final reading of 93.6 in December, from an initial level of 93.8.

- Front Page Headline, Times of London – "Credit Rating Outlook Sets Russia on Road to Junk Status. Standard & Poor's has placed Russia's sovereign credit rating outlook on negative watch, warning: 'A rating downgrade could occur in the near future. We have been forced to reconsider Russia's sovereign credit rating because of the impact of the country's weakening economy on its financial system.' The threat of a credit rating downgrade raises the prospect that Russian government debt could be reduced to junk status within weeks, which would likely lead to a bout of forced selling by international investors unable, or unwilling, to own bonds not deemed to be investment grade."

Russian Prime Minister Dmitri Medvedev: 'Russia risks a deep recession.' Source: The Times of London.

WEDNESDAY, DECEMBER 24TH

- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 9,000 to 280,000 in the week ended December 20th., the lowest level in seven weeks, while continuing claims increased by 25,000 to 2.4 million in the week ended December 13th. Gennadiy Goldberg, a strategist at TD Securities LLC in New York, commented: "The ongoing improvement in the U.S. labor market, together with a lack of significant layoffs, enables hiring to better translate into a decline in the unemployment rate."

- Front Page Headline, Daily Telegraph U.K. – "France's Unemployed Set New High Level. The French Labour Ministry reports the jobless total in mainland France rose by 27,400 in November to a record high 3.49 million people, an increase of 5.8% on a year-over-year basis. The increase was, not only the third consecutive monthly jump, but also the sharpest among the unemployed aged 50 or over, up by 11% on the year. French President Francois Hollande has seen his popularity decline to the lowest rating in French polling history, with a key factor being his failure to keep promises to tackle unemployment."

French President Francois Hollande.
Photo source: Associated Press

THURSDAY, DECEMBER 25TH

Christmas Holiday in Canada, U.K., U.S. and EMU

FRIDAY, DECEMBER 26TH

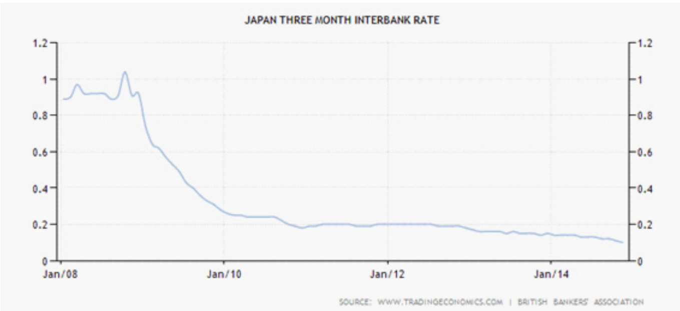
Boxing Day Holiday in Canada, U.K.

- Front Page Headline, MasterCard – "U.S. Retail Sales Rise by 5.5% Over 2013 Holiday Season. In its Spending Pulse bulletin, MasterCard reports the 5.5% increase in U.S. retail sales – excluding automobile sales – reflected an additional shopping day between Black Friday and Christmas Eve this year in comparison with the 2013 holiday season."

- Front Page Headline, Financial Times –"Japan's Consumer Price Index Declines to 14-Month Low. The Japanese Finance Ministry reports disinflationary pressures from lower oil prices forced the nation's core annualized CPI – excluding taxes – to decline slightly to 0.7% in November from 0.9% in October. Moreover, the most recent quarterly manufacturing sector survey by the Bank of Japan revealed that companies' forecasts of factory prices were weaker in December than in October, almost across the board."

- Front Page Headline, Contra Corner – "The Keynesian End Game Crystalizes in Japan's Monetary Madness. Author David Stockman writes: If the Bank of Japan's (BOJ) mad money printers were treated as monetary pariahs by the rest of the world, it would at least imply that a modicum of sanity remains on the planet. However, just the opposite is the case. Establishment institutions like the International Monetary Fund, The U.S. Department of the Treasury, as well as several major central banks urge them on; while the Keynesian arson squad, led by Professor Krugman, actually faults Japan for being too tepid with its stimulus policy. Now arrive several new data points which absolutely confirm that Japan is a financial madhouse; even as its monetary policy model is embraced by mainstream officials and analysts peering from a distance. Front and center is the newly reported fact from the Cabinet Office that Japan's household savings rate plunged to minus 1.3% in the most recent fiscal year; thereby, entering negative territory for the first time since records commenced in 1955. Indeed, Japan had been heralded as a nation of savers only a generation ago. During the era before its plunge into bubble finance in the late 1980s, households routinely saved 15% to 25% of their income.

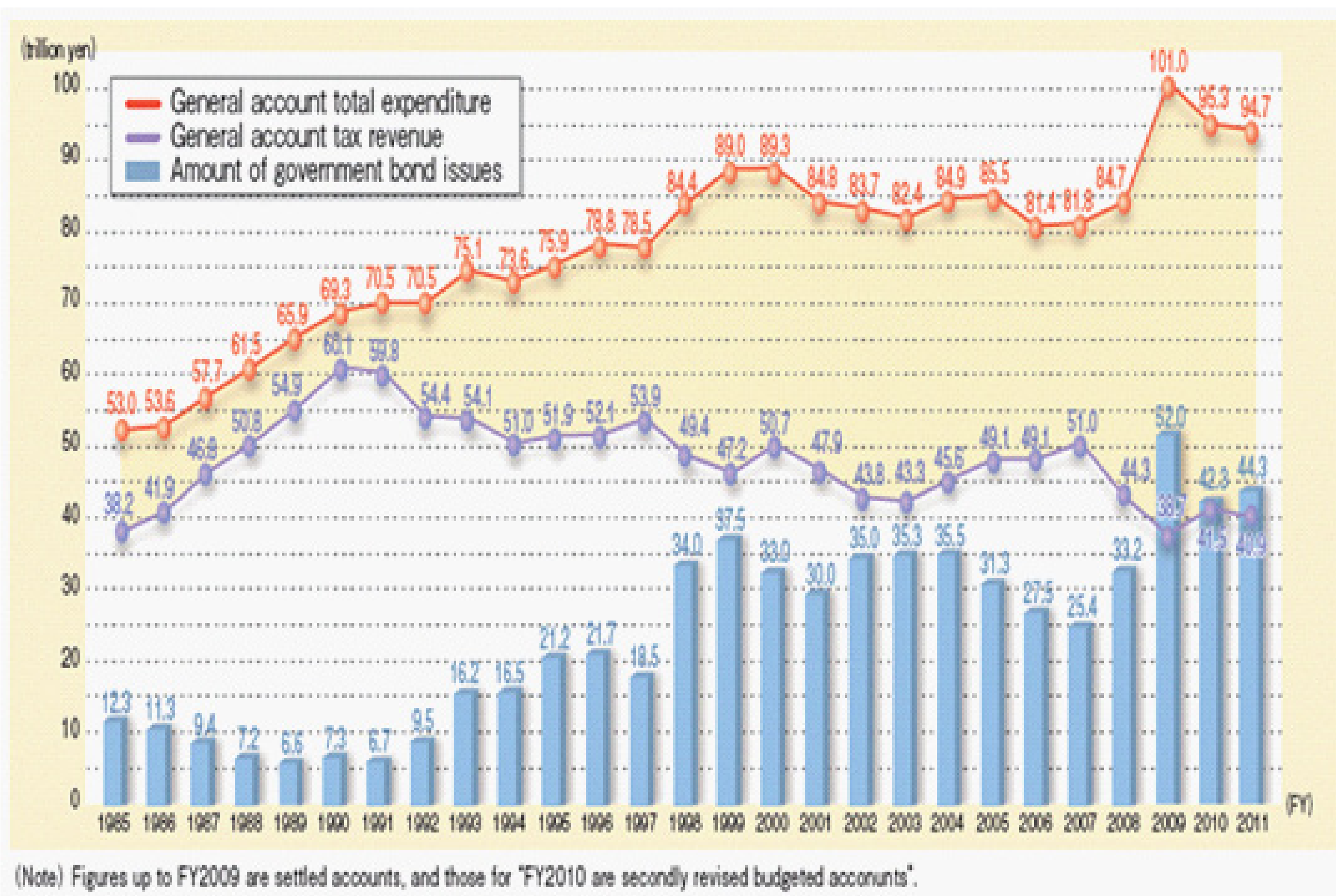
However, after nearly three decades of Keynes, Japan has now stumbled into an insuperable demographic/financial trap and one that is unusually transparent and rigidly delineated, to boot. Since Japan famously and doggedly refuses to accept immigrants, its long-term demographics are rigidly baked into the cake. Accordingly, anyone who will make a difference over the next several decades has already been born, counted, factored and included in the projections. Thus, Japan's work force of 80 million souls will decline to 40 million by 2060. Simultaneously, its current 30 million retirees will continue to increase, meaning that its retiree rolls will ultimately exceed the number of workers. Given those daunting facts, it follows that on the eve of its demographic bust, Japan needs a high savings level and generous interest rates to augment retirement nest eggs; a strong exchange rate to attract foreign capital in order to help absorb its staggering $12 trillion (U.S.) of public debt – which already stands at a world leading 230% of gross domestic product (GDP) – and rising real incomes in order to shoulder the heavy taxation which will be unavoidably necessary to close its fiscal gap and contain its growing public debt. However, with its debilitating Keynesian fiscal and monetary policies now refreshed on steroids under Abenomics, nearly the opposite conditions prevail today. Most notably, no Japanese household or institution can earn any return on liquid savings.



The money market rate which determines deposit money yields was driven from a high of 1% at the time of the financial crisis to one tenth of 1% today, which is to say, almost nothing. However, what is even more astounding is that the yield on the 10-year Japanese Government Bond (JGB) fell to an all-time low of 0.31% in recent trading. Given the militant insistence of the BOJ that it will hit its 2% inflation target come hell or high water, it is accurate to say that the official policy of Abenomics is to cause holders of the government's long-term bonds to lose their shirts.

In point of fact, failing to think more than one step ahead, the BOJ actually wants banks, households and other financial institutions to sell their bonds at a handsome profit. That is to say, the BOJ's bond purchase program is now so massive that it is buying 100% of the government's gross debt issuance. In practical terms, this means the float of public debt is actually being reduced and that the JGB market for all practical purposes has been extinguished by the BOJ.

There is nothing left except one relentless bid by the Bank of Japan. Recent data from Japan's government pension insurance fund (GPIF), for example, show that the GPIF alone has already sold billions of dollars of JGBs to the BOJ. Needless to say, this radical monetization of the entire government bond market is an act of financial suicide. The BOJ now dares not stop the printing presses because absent the central bank's monster bid, bond yields would gap up violently. Yet, 40% of Japan's government revenue already goes to service its gargantuan public debt.

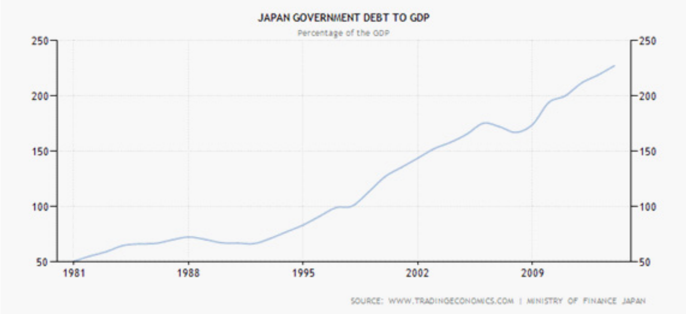


Source: Contra Corner

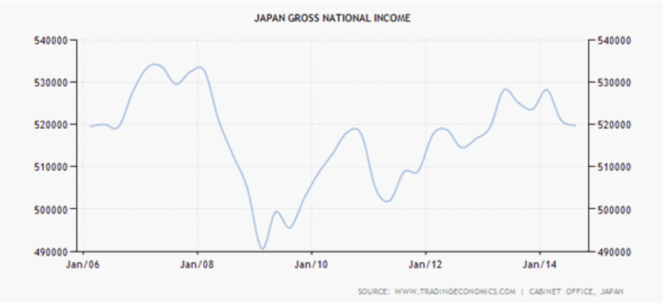
A 180 basis point increase in average bond yields would absorb the remaining revenue, so 100% of government revenue would then be pre-empted by debt servicing costs. Obviously, this amounts to a fiscal Looney Tunes scenario, but it is nonetheless embedded in the math. Even after the consumption tax increase from 5% to 8%, Japan's general government is spending about 100 billion yen per year, while obtaining only 50 trillion yen in tax revenue. As is evident in the chart above, this yawning gap has been building since the early 1990s when Keynesian missionaries converted the local fiscal apparatus to the religion of deficit financing. Now, having wasted 25 years figuratively building highways and bridges to nowhere, the Abe government has obtained a mandate not to raise taxes further until at least 2017. This means that the public debt will continue to soar and that the BOJ will be under unrelenting pressure to monetize 100% of the new debt issues, lest it risk a devastating flaring up in bond yields. That makes for a juxtaposition that is out of this world. Since the early 1990s, Japanese bond yields have been falling owing to the BOJ's financial repression and supplemented by the disinflationary boom stimulated on a global basis by central bank fueled credit expansion.

Source: Contra Corner

JGB yields are zero bound; in fact, maturities out to two years are already trading at negative yields. By the same token, the public debt burden has been climbing relentlessly since the early 1980s, owing to the embrace of Keynesian fiscal policies, as so vividly demonstrated in the graph below. Now, owing to Abenomics, another 7% to 10% of GDP will be added annually to the public debt in the years just ahead.



The desperate nature of Japan's debt trap could not be more vividly depicted than in the chart below. In yen terms, Japan's national revenue has not experienced any net growth since 2006 and Abenomics has not helped at all. In the 3rd. quarter, nominal yen GDP matched that of January 2013.

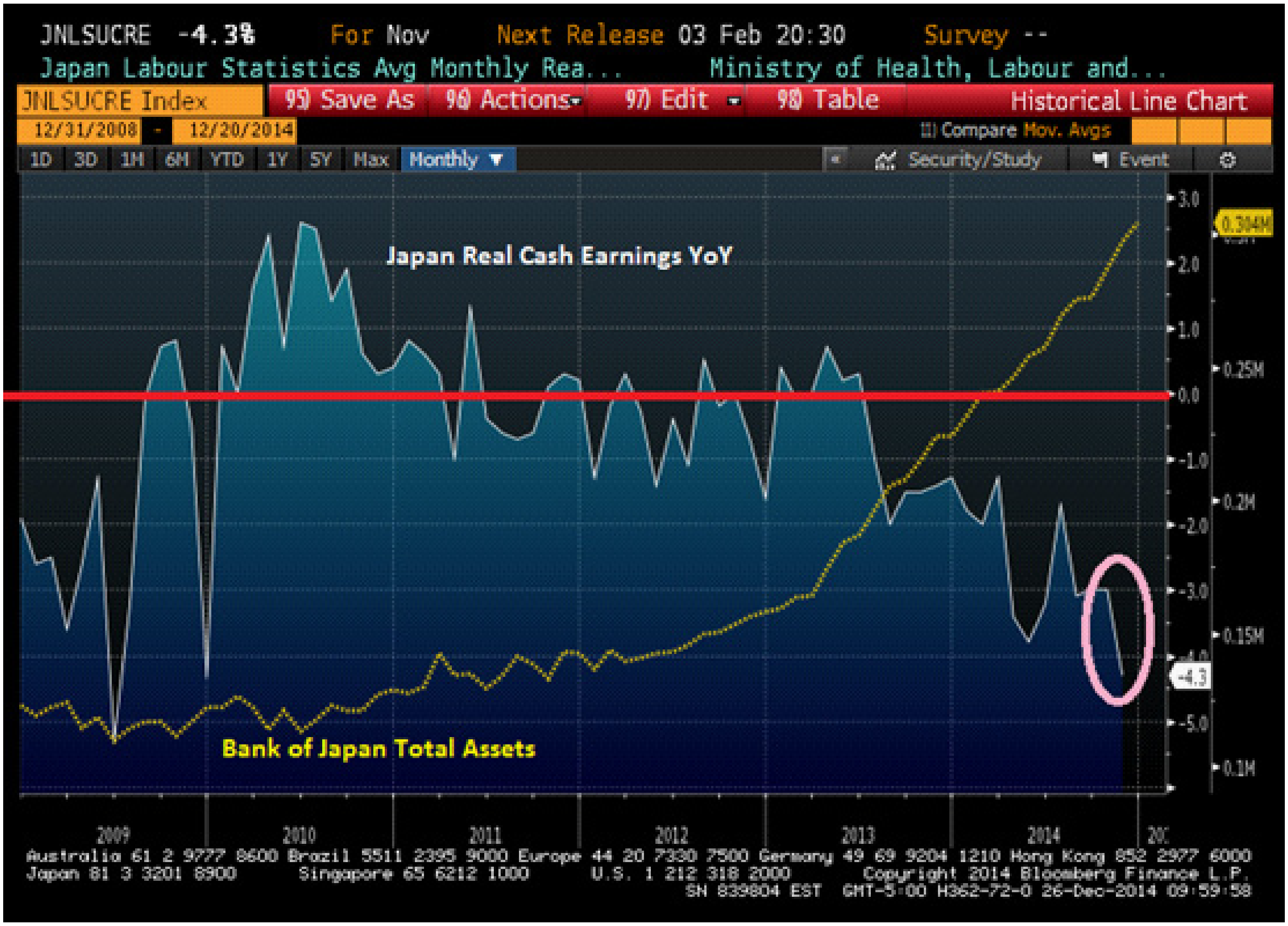


In short, Japan's fiscal equation is caught in a brutal vise in which the denominator (GNP) is stranded on the flat line, while the numerator (public debt outstanding) continues to soar. So, for the moment at least, Japan has resorted to 100% printing press financing of its public accounts. So here's the thing. The BOJ is destroying the yen and absolutely foreclosing the option of international capital inflows in the years ahead; save for short-term speculations by carry-traders in New York, London and the lesser gambling arenas around the globe. Consequently, the sharp fall of the exchange rate since 2012 is at risk for an accelerating plunge the longer that the BOJ prints massive amounts of new yen to finance 100% of the government's deficit.

Japanese Yen v/s the U.S. Dollar

Source: Contra Corner

In turn, a currency collapse means that the cost of living on an economic archipelago that imports 100% of its energy and most of its raw materials is bound to increase, causing real wages to decline. In point of fact, that marks another fraught incoming data point. In November, real cash wages plunged by 4.3% on a year-over-year basis, marking the 17th. consecutive monthly decline and the steepest slide since December 2009.



Source: Contra Corner

Thus, the Keynesian disaster is complete. Massive GOP money printing to fund the deficit is eroding real wages, thereby, mitigating against tax increases capable of closing the fiscal gap and reducing the financing burden. Also, the mad men at the BOJ are simultaneously, obliterating the domestic saver with ZIRP and warding off international investors with a plunging exchange rate. Consequently, there is no honest way to finance the public deficit, meaning that the printing presses will continue to run red hot. Such a monetary policy amounts to a financial suicide mission and is obvious. However, what is truly scary is that Japan's policy has been green lighted and adopted by governments and central bankers around the world."

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CLOSING LEVELS FOR FRIDAY, DECEMBER 26TH.		WEEKLY CHANGE
Dow Jones Industrial Average	18,053.71	+ 248.91 points
Spot Gold Bullion	$1,195.30 (U.S.)	– $0.70 per troy oz.
Spot Silver	$16.04 (U.S.)	– $0.03 per troy oz.
S&P / TSX Composite	14,609.25	+ 140.99 points
10 – Year U.S. Treasury Yield	2.25%	+ 9 basis points
Canadian Dollar	85.99 cents (U.S.)	– 0.16 cent
U.S. Dollar Index Future	90.046	+ 0.455 cent
WTI Crude Oil Futures	$54.73 (U.S.)	– $2.40 per barrel
DJIA / Gold Ratio	15.104	+ 0.217 point
Gold / Silver Ratio	74.52	+ 0.096 point

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