UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

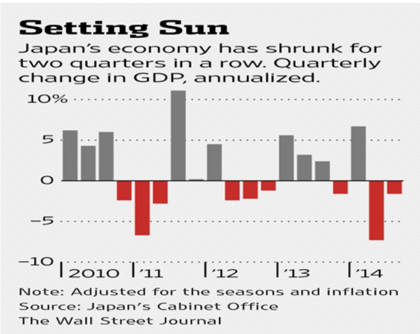
Monday, November 17th

The Federal Reserve reports U.S. industrial production declined by a seasonally adjusted 0.1% in October, following a downwardly revised increase of 0.8% in September, previously reported as a 1% gain; citing reduced production by automakers and lower de-

MONDAY, NOVEMBER 17TH

mand at utilities and mining companies.

- Japan's Cabinet Office reports the nation's gross domestic product (GDP) contracted by a 1.6% annual rate in the 3rd. quarter ended September 30th. Yoshiki Shinke, an economist at the Dai-ichi Life Research Institute observed: "No sector of Japan's economy looks encouraging. Today's GDP data will leave another traumatic memory for Japanese politicians about sales tax hikes." In an interview with reporters today, Japan's Prime Minister Shinzo Abe stated: "Since the GDP figures were not good, we will be deciding whether or not to introduce another sales tax increase scheduled for October next year, only after careful analysis." Masamichi Adachi, an economist at JP Morgan Chase in Tokyo, noted: "Japanese companies got the economic outlook wrong again, thinking this time would be different because of Abenomics. The very anemic economic recovery will cause Japanese companies to be cautious about increasing investment or inventories domestically."



- Front Page Headline, Bloomberg News – "The G-20 Revisited. In an op-ed, former Pimco CEO Mohamed El-Erian writes: Despite the enormous efforts of its Australian hosts, the weekend's meeting of the Group of 20 leaders in Brisbane will be remembered more for the theatrics of Russian President Vladimir Putin than for breakthroughs on the solutions that a sluggish global economy desperately needs. Not all was lost for either that summit or, for the Asia-Pacific Economic Cooperation meeting in China a few days earlier. However, the accomplishments were not only, generally disappointing, but also, much more bilateral than multilateral. From his confrontation with Canadian Prime Minister Stephen Harper to his abrupt early departure from the summit 'to get some sleep,' Putin dominated much of the G-20 news coverage. In addition, with discussions failing to de-escalate tensions in Ukraine, the West is again having to consider additional Russian sanctions, the risks for its own economies, notwithstanding.

  However, in the middle of this the G-20 managed to sign off on anti-tax evasion measures and on anti-corruption guidelines. Moreover, leaders took another step forward on a pro-GDP growth approach as each offered specific structural reforms to be taken at the national level. However, the problem remains this is unlikely to lead to the much needed breakthroughs in economic growth and job creation needed in the G-20 countries. The missed opportunity was unfortunate, given that the world's most powerful leaders met at a time when global GDP growth is slowing, as Japan's poor GDP contraction number should be a further loud wake-up call. Due to the incomplete response, increasingly ineffective central bank policies face the risk of fueling financial instability down the road. If anything, both the G-20 and APEC meetings confirmed again that multilateralism struggles these days, both outright and relative to bilateralism. The most notable accomplishment to emerge this week was bilateral. The agreements between China and the U.S., notably on climate change responses were the result of old-fashioned two-country diplomacy carried out separately from multi-country negotiations. Moreover, they reflected how common interests between the world's two leading economies can produce agreement without requiring the convergence of the culture, values and mind sets … Here is where multilateral meetings may help these days: They provide world leaders with air cover for delicate bilateral negotiations, without all the expectations and pressures which accompany more traditional two-country summits. However, long gone are the days of the London G-20 meeting in April 2009 when proper multilateral coordination and agreements on meaningful actions helped the world sidestep economic depression."

- Front Page Headline, Manchester Guardian – "Red Warning Lights Flashing on Global Economy: Cameron. In a starkly downbeat assessment, British Prime Minister David Cameron writes: Six years after the financial crash that brought the world to its knees, red warning lights are once again flashing on the dashboard of the global economy. The euro zone economy is teetering on the brink of a possible third recession with high unemployment, declining gross domestic product (GDP) growth and also the risk of falling prices. Even emerging market economies which were the driver of GDP growth in the early stages of the economic recovery are now slowing; as well as stalled trade talks, instability in the Middle East, war in Ukraine and the spread of Ebola."

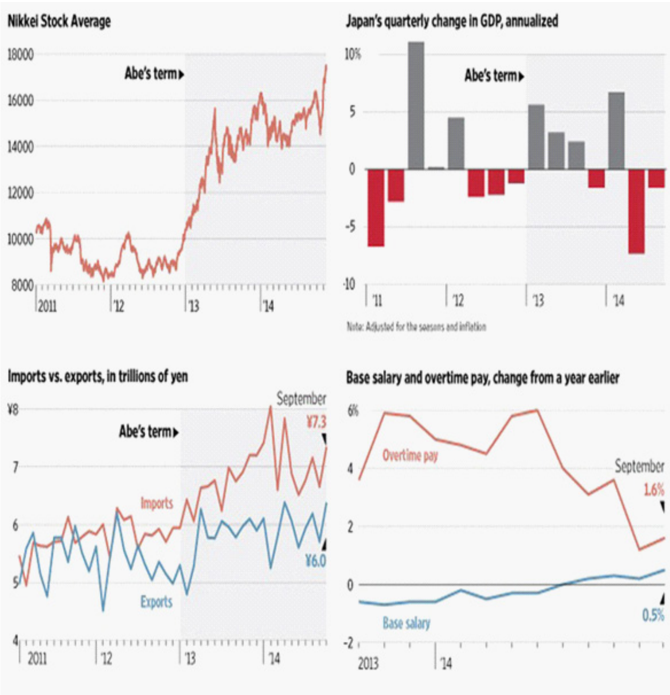
British Prime Minister David Cameron.
Source: AFP / Getty Images

TUESDAY, NOVEMBER 18TH

- Front Page Headline, Globe and Mail – "Keystone XL Put on Hold as Bill Stalls in U.S. Senate. An effort by Keystone XL pipeline supporters to challenge U.S. President Obama's decision-making authority over the project failed today when the bill fell one vote short of the 60 votes needed to proceed. However, the showdown over the pipeline that will export Canadian oil sands crude from Alberta to U.S. refineries on the Gulf Coast should certainly obtain Senate approval in January when a new Republican majority assumes power in the Senate.

- Front Page Headline, Bloomberg News – "Abe Calls General Election / Postpones Sales Tax Increase. At a press conference, Japanese Prime Minister Shinzo Abe calls for an early election date on Sunday, December 14th. in an effort to extend his term of office and salvage his economic policies; following yesterday's report from the Cabinet Office which revealed the domestic economy had contracted by 1.6% in the 3rd. quarter – its second consecutive quarterly contraction – thereby, placing the nation in a technical recession. Mr. Abe also announced an 18-month postponement of another sales tax increase, previously scheduled for October, 2015."

Is Abenomics Failing?



Source: Wall Street Journal

- The Labor Department reports the U.S. producer price index (PPI) rose by 0.2% in October, following a decline of 0.1% in September; citing slightly higher prices for food and services outweighed a drop in energy costs.

- The National Association of Home Builders (NAHB) / Wells Fargo builder confidence index rose to a reading of 58 in November from a level of 54 in October, citing the positive influence of continuing low mortgage rates and a lower official unemployment level. In a statement, Kevin Kelly, a homebuilder and developer in Wilmington, Delaware, commented: ‘NAHB members in many areas of the country continue to see increasing buyer traffic and signed contracts.’

- The Mannheim-based Zew Center for European Economic Research reports its index of investor and analyst confidence – which aims to predict economic developments six months in advance – rose to a reading of 11.5 in November from a level of minus 3.6 in October. Alexander Koch, an economist at Raiffeisen Schweiz in Zurich, noted: ‘Recent GDP data indicates the euro zone continues to be mired in a very slow economic recovery. At present, the fundamentals do not argue for an acceleration in the speed of economic activity.’

- Front Page Headline, Daily Telegraph U.K. – “S&P Warns: ECB Entering Very Dangerous Territory. Credit rating agency Standard & Poor’s has warned: ‘The European Central Bank’s plans for one trillion euros of monetary stimulus is fraught with risk and is likely to fail without full-blown bond purchases. The ECB’s purchases of ultra-cheap loans to banks cannot generate more than 40 billion euros of net stimulus once old loans are repaid, given regulatory curbs placed on lenders.’

  Jean-Michel Six, S&P’s chief European economist noted: ‘Doves on the ECB’s governing council know that the loan plan is unworkable, but are going through the motions in order to persuade German led hawks that all conventional measures have been exhausted, even if this means a debilitating delay. Risks of a triple-dip recession have increased. The ECB has one last arrow and that is quantitative easing (QE) of one trillion euros, needed to restore the M3 money supply to trend growth … The ECB is moving into very dangerous territory. Their own credibility is at risk as they assume additional risk, but it is necessary.’ S&P has also stated that the Bank of England has greatly underestimated the degree of slack in the British economy and risks killing the economic recovery by tightening monetary policy too soon. Mr. Six elaborated: ‘We don’t see any tangible signs of a housing bubble, except in a few streets in London. The U.K. economy is cooling off, but it is nothing about which to be alarmed. However, we do think a premature administered interest rate increase could put the economic recovery in jeopardy. There is a long way to go before deciding the horse is going too fast and needs to be reined in.’

  Key officials at the ECB continue to air their differences in public. Jens Weidmann, the governor of the German Bundesbank, has stated: ‘There is nothing automatic about further stimulus and a one trillion euro increase in the balance sheet is an expectation, rather than a target. Indeed, the purchase of government bonds – independent of legal limits – would set significant, additional false incentives. We would also encourage governments to relax fiscal austerity.’ By contrast, ECB President Mario Draghi has been nudging further towards full QE, stating explicitly that government bonds might be added to the mix of assets to be purchased.

  ECB Chief Economist Peter Praet insisted in categorical terms that the ECB is neither bluffing, nor playing with words: ‘We say we are confident because we are going to get the volume and if that is not sufficient, we are ready to take additional measures and broaden the base of purchases immediately.’ In their warning, S&P stated that the ECB will have to launch radical stimulus to curtail a deep deflationary slump in the end, despite whatever is said in Germany. Indeed, S&P were insistent that the pool of assets that can be purchased must be broadened to include a 2.2 trillion euro pool of bank bonds and ultimately sovereign bonds. Nothing can be done until the European Court has ruled on a former case involving its back-stop plan for Italian and Spanish debt (OMT). Mr. Six confirmed: ‘That has to be behind us.’

  It is unclear whether the OMT case will, in fact, clear the air. Euroceptic groups and professors in Germany are already planning to file a new case against QE at the German Constitutional Court if the purchases escalate, arguing that the scale entails large liabilities for the German taxpayer and circumvents the budgetary sovereignty of the Bundestag. They argue that QE is fiscal policy by stealth, conducted outside democratic control. Some experts say such a case would give the Bundesbank the legal excuse it wants to step aside from any ECB bond purchases, effectively rendering the ECB action null and void. Mr. Six did state: ‘QE is a necessary condition for economic recovery in Europe, but it is insufficient in and unto itself. The question is, where does this bridge take us? The euro zone can survive a couple more years of miserable GDP growth, but it can’t go on forever like this before people lose hope. There is political risk almost everywhere.

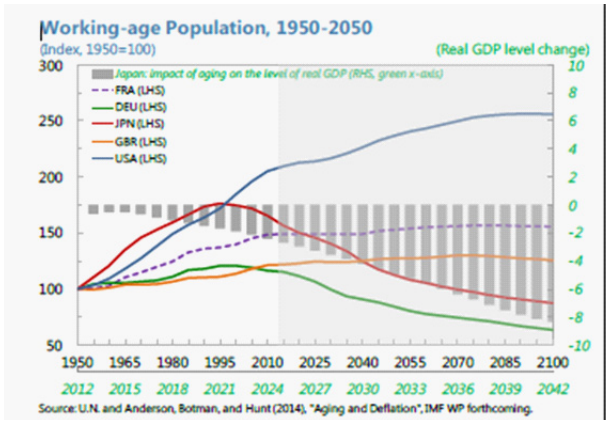
Regarding Britain, S&P stated: 'The output gap used to measure how far the economy is falling short of its potential is still 4.5% of GDP. This is much higher than the 1% estimate used by the Bank of England to justify talk of early administered interest rate increases.' Mr. Six observed: 'The U.K. capital stock has been less damaged than widely assumed by the economic crisis, while abundant immigration has created a pool of cheap labour that is holding down wages.' Economists are deeply divided over the size of the output gap – a soft indicator which is very difficult to measure – nevertheless, it has acquired totemic status. The International Monetary Fund (IMF) and the OECD club of rich states both have estimated close to 1%, while the Office for Budget Responsibility is at 1.4%. Yet a number of private analysts agree with Standard and Poor's. Andrew Goodwin at Oxford Economics noted the gap is 4.4% based upon weak productivity trends and historic evidence that financial crises do not destroy much existing plant. Mr. Goodwin reasoned: 'There is still a lot of spare capacity in the U.K. economy. The fact that wage growth has stayed so low for so long is evidence of this. Neither do we think there should be any administered interest rate increases until the end of 2015 at the earliest, nor do we believe there will be any.' S&P praised the Bank of England for doing a 'very smart job' in its response to the financial crisis by allowing inflation to overshoot its target at crucial phases, effectively eroding the debt burden by boosting nominal GDP. Mr. Six allowed: 'This has improved Britain's debt ratios.' The contrast with much of the euro zone is striking. The ratio of public debt to GDP has been rising quickly in the most heavily indebted EMU economies, overwhelming any gains from austerity cuts."

WEDNESDAY, NOVEMBER 19TH

- Front Page Headline, Daily Telegraph U.K. – "Japan's Abenomics Can Survive Quadruple-Dip Recession.

Premier Shinzo Abe is trying to prevent a Japanese debt crisis. Source: EPA

In an op-ed, International Business Editor Ambrose Evans-Pritchard writes: Abenomics is alive and well. Japan's crash into its fourth recession since 2008 is a nasty surprise for Premier Shinzo Abe, but it tells us almost nothing about the central thrust of his reflation blitz. The mini-slump is chiefly due to a one-off fiscal shock in April. Mr. Abe defied warnings from Keynesian critics and unwisely stuck to plans drawn up by a previous (DPJ) government to raise the consumption tax from 5% to 8%. The essence of Abenomics is monetary reflation a l'outrance to lift the country out of deflation after two Lost Decades. The unstated purpose of this "First Arrow" is to lower administered interest rates and raise the growth of nominal GDP to 5%, deemed the minimum necessary to stop Japan's debt trajectory from spiraling out of control. This is a formidable task which may ultimately fail. Public debt is already 245% of GDP. Debt servicing payments are 43% of fiscal revenues. The population is expected to decline from 127 million to 87 million by 2060. Given this grim set of mathematics, the inertia of the pre-Abe era was inexcusable.



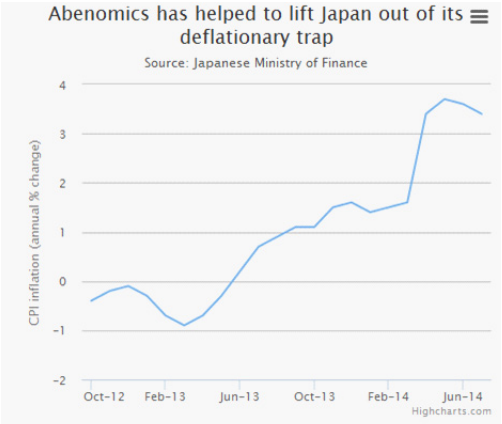
Takuji Aida at Societe Generale noted: 'The consumption tax increase was an unnecessary diversion from Mr. Abe's reflationary goals, but will not have a lasting effect. The contraction of Japanese GDP by 0.4% in the 3rd. quarter – following a 1.8% decline in the 2nd. quarter – is certainly a public relations embarrassment, but it is less dreadful than meets the eye.' The economy expanded by 0.2% when adjusted for inventory effects. Machinery orders rose for a fourth month in September to 2.9% and retail sales increased by 2.3%. Danske Bank's Fleming Neilsen believes Japan's economy will be growing at a 3% rate again this winter.

Mr. Abe has shrugged off the tax debacle without much political damage. He has called a snap election for December 14th. which he is likely to win heartily and suspended plans for a further increase in the sales tax to 10%, previously expected in October 2015. The Bank of Japan is learning – after a false start

– how to pack a punch. The first round of quantitative easing by Governor Haruhiko Kuroda was botched. A large chunk of the 75 billion (U.S.) of asset purchases each month was squandered on a futile attempt to increase bank reserves and double the monetary base.

Professor Richard Werner at Southampton University stated: 'This is completely useless because it has no impact on the economy. This largely repeats what the Japanese government did from 2001 to 2006. What they need to do now is buy bonds from outside the banking system.' Tim Congdon at International Monetary Research has commented that QE is potent only if the assets are bought from 'non-banks'such as pension funds and life insurers because they typically hold longer term bonds.

This is increasingly happening. The Kuroda II package unveiled last month adds a further $12 billion (U.S.) or more of stimulus, heavily weighted to government bonds of 7 – 10 year maturities. It is an open secret in Tokyo that the BOJ will mop up bond holdings due for sale by the $1.2 trillion (U.S.) government pension fund (GPIF) as it shifts to equities under new portfolio rules. Mr. Congdon added: 'The second round of stimulus should prove much more effective. Broad M3 money supply in Japan has been growing at a rate of almost 5% over the last three months on a seasonally adjusted basis, suggesting that the foundations for a strong economic recovery six to twelve months later are coming into place. If there is a further pickup in M3, Japan could enjoy an economic surge not seen since the 1980s. Core inflation has slipped back to a six-month low of 1%, but this is a far cry from the chronic deflation before Mr. Kuroda took over the BOJ with his allies in the spring of 2013. Mr. Kuroda believes that headline inflation will reach the BOJ's target of 2% by mid-2015. Mr. Kuroda insists: 'A virtuous circle of economic recovery is under way. There is almost no slack in the labour market. An increase in nominal wages has been evident since this spring.' The reported decline in real wages was a statistical distortion caused by the sales tax increase. Monetary policy works with famously long and variable lag times and no major country in the post-war era has ever attempted such a radical experiment in money creation, or attempted quite so brazenly to monetize so much of the public debt stock. Mr. Abe relates that he has modelled his reflation drive on the monetary policies of Takahashi Korekiyo, who ordered the BOJ to go for broke in 1932 to a chorus of ridicule from the voices of orthodoxy across the globe, but the Japanese economy was booming by 1934."



- The Commerce Department reports U.S. single family housing starts rose by 4.2% in October to an annual pace of 696,000 units, while building permits increased by 4.8%. Ryan Wang, an economist at HSBC Securities in New York, commented: "Conditions in the housing market are at least stable and on the margin they appear to be improving slightly. We should expect continued gradual growth heading into the New Year."

THURSDAY, NOVEMBER 20TH

- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 2,000 to 291,000 in the week ended November 15th. while continuing claims fell by 73,000 to 2.33 million in the week ended November 8th. Gregory Daco, an economist at Oxford Economics in New York, observed: "Claims are still well under the 300,000 mark and they've remained there for a little over two months and that bodes well for payroll growth. We're seeing a strong trend for progress in the labor market." Separately, the Labor Department reported the U.S. consumer price index (CPI) was unchanged in October, while the core rate (ex food and energy) rose by 0.2%, following an increase of 0.1% in September.

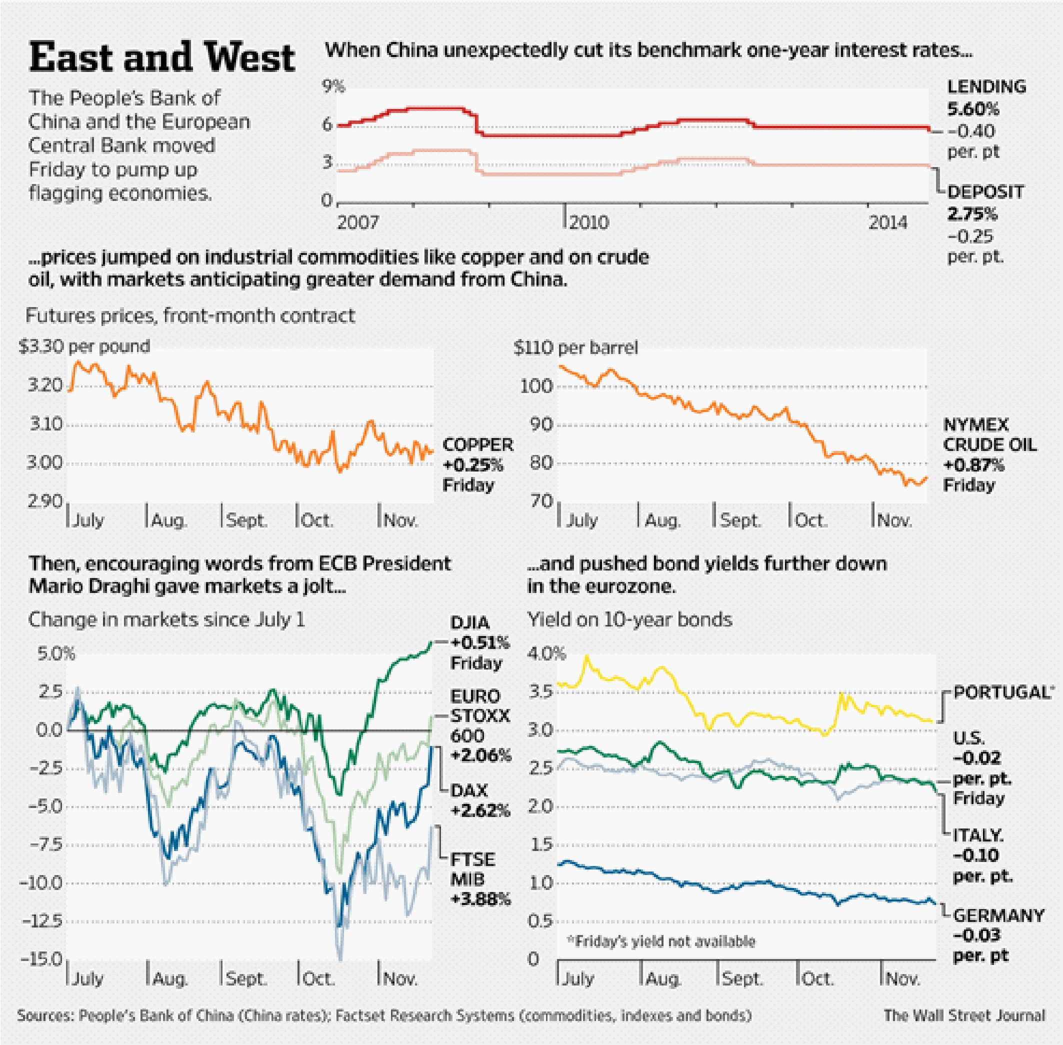
- The Washington-based National Association of Realtors (NAR) reports U.S. existing home sales rose by 1.5% in October to an annual rate of 5.26 million units – the highest pace since September 2013 and by 2.5% on a year-over-year basis. In a press release to reporters, NAR Chief Economist Lawrence Yun stated: "This is the first time this year where existing home sales have posted a year-over-year gain, indicating a successful U-turn."

- London-based Markit Economics reports its composite purchasing managers' index (PMI) for the European Monetary Union (EMU) manufacturing and services sector declined to a reading of 51.4 in November from a level of 52.1 in October. While an inexact predictor of gross domestic product (GDP), the PMI is generally accepted by investors as one of the best real-time guides to economic activity. A reading below 50 indicates contraction.

FRIDAY, NOVEMBER 21ST

- The Peoples Bank of China (PBOC) announces it is reducing its one-year benchmark lending rate to 5.6% from 6%, citing it was especially keen to assist smaller firms in gaining access to credit, stating: "The problem of difficult and costly financing remains glaring in the real economy." The PBOC also lowered its one-year benchmark deposit rate to 2.75% from 3% and allowed it was giving the banks more leeway in setting their own interest rates for depositors and borrowers. Li Huiyong, an economist at Shenyin and Wanguo Securities, noted: "The PBOC is cutting and liberalizing interest rates at the same time, so that the stimulus won't be so damaging."

- Statistics Canada reports the nation's consumer price index (CPI) rose by 0.1% in October month-over-month on a seasonally adjusted basis. However, despite a 4% decline in the price of gasoline, the CPI rose to 2.4% on an annual basis, driven by higher costs for clothing, footwear, alcohol and tobacco. Prices in seven of the eight major components of the CPI were up from September, while all eight components were higher on a year-over-year basis.



LONGWAVE group

CLOSING LEVELS FOR FRIDAY, NOVEMBER 21ST.		WEEKLY CHANGE
Dow Jones Industrial Average	17,810.06	+ 175.32 points
Spot Gold Bullion	$1,197.70 (U.S.)	+ $12.10 per troy oz.
Spot Silver	$16.41 (U.S.)	+ $0.13 per troy oz.
S&P / TSX Composite	15,111.31	+ 268.21 points
10 – Year U.S. Treasury Yield	2.31%	– 1 basis point
Canadian Dollar	88.91 cents (U.S.)	+ 0.23 cent
U.S. Dollar Index Future	88.279	+ 0.737 cent
WTI Crude Oil Futures	$76.51 (U.S.)	+ $0.69 per barrel
DJIA / Gold Ratio	14.870	– 0.004 point
Gold / Silver Ratio	72.985	+ 0.159 point

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