Monday May 18th, 2015

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, May 18th

The National Association of Home Builders / Wells Fargo group reports its U.S. housing market index declined by 2 points to a reading of 54 in May, citing a 2 point drop in the sub-index of current sales of single family-homes to a reading of 59. David Crowe,

MONDAY, MAY 18TH

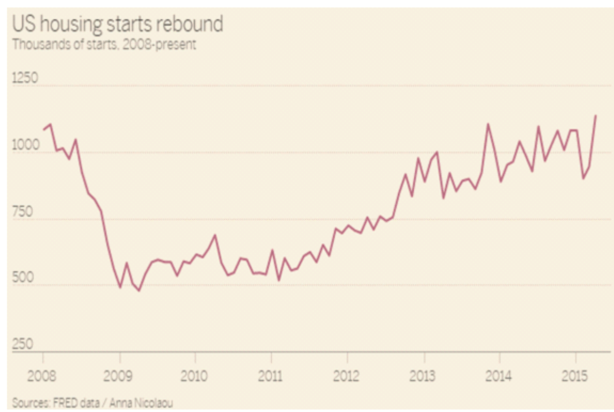
Victoria Day Holiday in Canada and Great Britain

NAHB's chief economist commented: 'Consumers are exhibiting caution and seeking to be on a more substantial footing before purchasing a home. However, since mortgage rates remain low and house prices are affordable, these factors should spur the release of prospective demand in the coming months.'

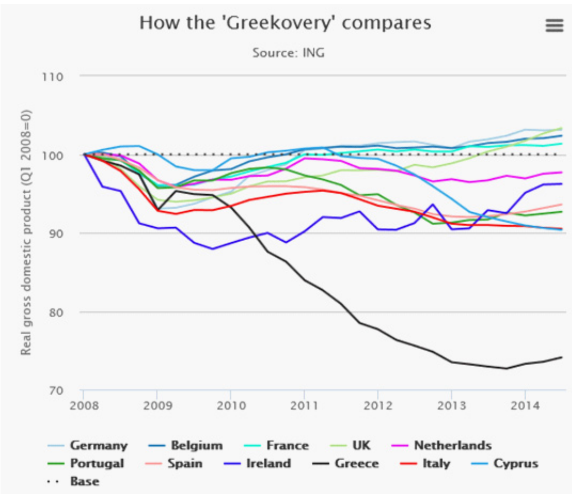
TUESDAY, MAY 19TH

- The U.S. Census Bureau and the Department of Housing and Urban Development jointly report: "Privately-owned housing starts in April were at a seasonally adjusted annual pace of 1,135,000 units, representing a 20.2% increase over the revised March estimate of 944,000 units; the fastest pace since late 2007. Single-family housing starts in April were at an annual rate of 733,000, which is16.7% above the revised March figure of 628,000 units. Separately, privately-owned housing units authorized by building permits in April were at a seasonally adjusted annual pace of 1,143,000 units, representing a 10.1% increase over the revised March estimate of 1,038,000 units. Single-family authorizations in April were at a rate of 666,000, which is 3.7% above the revised March figure of 642,000."

In a research note, Ted Wieseman, an economist at Morgan Stanley observed: "Household formations appear to be showing a solid underlying increase to a pace more in line with the demographic trend of around one million per year based upon growth in the adult population; following a persistently sluggish post-recession trend closer to 500,000." A note to clients from Fundstrat Global Advisors predicts: "We see housing as the tip of a spear, ultimately beginning a chain of events leading to a $1 trillion (U.S.) increase in investment spending over the next five years."



- Front Page Headline, Daily Telegraph U.K. – "Greece's Economy Is Bleeding 600 Jobs a Day. According to figures from the Hellenic Confederation of Commerce and Enterprise (ESEE), the gridlock over the country's euro zone future is resulting in record numbers of lost jobs and a destruction of economic growth potential. ESEE notes that since Syriza took office in late January, an average of 50 small businesses have closed shop daily, with approximately 613 jobs being destroyed every single day. Having suffered from the worst depression in the developed world since the 1930s, -- losing 25% of its output – Greece's renewed political crisis has shattered the fragile business confidence in the country. Surveys by the ESEE show the Greek economy would need 25 billion euros just to recover the losses it has incurred since snap elections were called in December. While more than one third of all bank loans are now classified as non-performing, the ESEE notes that more than 95% of all applications for bank loans are rejected every day. Meanwhile the Leftist government has stopped paying its domestic suppliers, in order to hoard the cash it needs to meet its monthly public sector obligations.



While neither the Leftist government, nor international creditors are showing signs of capitulation, the ESEE is pushing for an agreement 'even if it is mediocre or below expectations, in order to allow the Greek economy to feel free at least to operate for the remainder of 2015."

WEDNESDAY, MAY 20TH

- Front Page Headline, Bloomberg News – "Six Major Banks Fined $5.8 Billion (U.S.). The U.S. Department of Justice has announced Citicorp, Barclays Plc, JP Morgan Chase & Co. and Royal Bank of Scotland have agreed to plead guilty to felony charges of conspiring to manipulate the exchange rates of U.S. dollars and euros by aligning proprietary trading positions prior to the exchange rates being set, thereby suppressing competition in the marketplace.

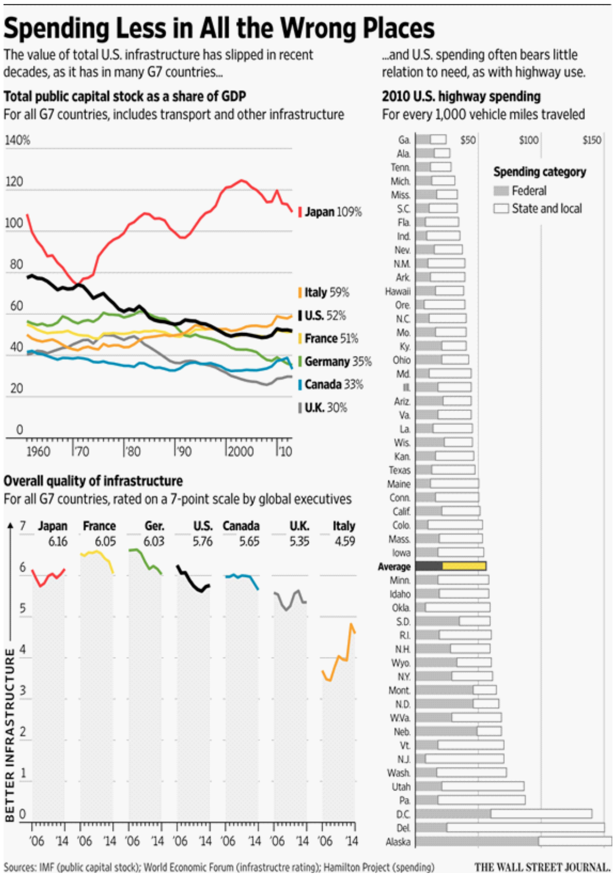
  In addition, the main banking unit of UBS AG has agreed to plead guilty to a wire fraud charge related to manipulation of the London Inter-Bank Offered Rate (LIBOR). The Swiss bank, the first to cooperate with antitrust investigators, was granted immunity in the currency probe. In a press release from Washington, U.S. Attorney General Loretta Lynch emphasized: 'This scheme represented a brazen display of collusion. Be it known, the U.S. Department of Justice intends to vigorously prosecute all those who tilt the economic system in their favour, who subvert our marketplaces and who enrich themselves at the expense of American consumers."

- Front Page Headline, Bloomberg News – "Minutes of April 29th. FOMC Meeting Prolong Current Monetary Policy: When the Federal Open Market Committee decides to commence removal of monetary policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and an inflation rate of 2%. The Committee currently anticipates that, even after employment and inflation are near mandate consistent levels, economic conditions may for some time, warrant keeping the target Federal Funds Rate below levels the Committee views as normal over the longer term."

- Statistics Canada reports the nation's wholesale sales rose by 0.8% in March to $53.94 billion (CAD), following two consecutive monthly declines. Higher sales were recorded in five of seven subsectors, accounting for 66% of the wholesale trade total. The building materials and supplies subsector recorded the largest increase in dollar terms in March, rising by 2.8%; while the motor vehicle and parts subsector advanced by 0.7%.

- Front Page Headline, Wall Street Journal – "Quality, Not Just Quantity, of Domestic Infrastructure Demands Attention. Columnist Greg Ip writes: 'Amtrak's deadly derailment in Philadelphia last week has again reawakened domestic concerns that the U.S. spends too little on highways, railroads, bridges and other aging infrastructure. Indeed, a recent Fox News report revealed as many as 61,000 bridges across America are structurally deficient. Lost in the debate over the quality of federal investment, however, is an equally pressing problem, i.e. the quality of such spending. Federal government infrastructure investment is not directed to the projects with the biggest payoff in productivity, safety or environmental protection.

  Inadequate funding, badly targeted, is a recipe for undermining the country's long term economic potential. Bridges raise productivity; but bridges to nowhere don't. Aaron Klein of the Bipartisan Policy Center – a think tank – notes: 'Outside of a very few new small programs, it is nobody's job in Washington to figure out which roads or bridges require investment. It is a decentralized structure where state and local authorities are highly empowered.' For example, the federal government sends money to the states for highways based upon a formula linked to the gasoline tax that each state contributes to the Highway Trust Fund, which is not necessarily correlated with what roads receive the most usage. The Hamilton Project – another think tank – notes that federal spending per 1,000 miles travelled per vehicle varies from $12 (U.S.) in Georgia to $98 (U.S.) in Alaska. A similar number of miles were driven in Tennessee and New Jersey, but Tennessee received 42% more federal government funding.



Such arbitrary constraints are endemic. Investment in Amtrak's profitable Northeast Corridor line is compromised by the railway's congressional mandate to also operate money-losing long distance routes. New York's La Guardia and John F. Kennedy airports, despised by travelers as outdated, inconvenient and unpleasant, are profitable enough to have justified an overhaul years ago. However, their owner, the Port Authority of New York and New Jersey, had to plow $8 billion (U.S.) into rebuilding the World Trade Center site. On a number of criteria, infrastructure spending has slipped. According to the Congressional Budget Office (CBO), state, local and federal investment in transportation and water infrastructure has gradually declined from close to 3% of gross domestic product (GDP) in the early 1960s to 2.4% in 2014. Since the country's infrastructure needs change over time, this doesn't automatically indicate underfunding. For example, the Interstate highway system only needs to be built once. A different way to evaluate the adequacy of infrastructure is to examine the value of all public capital in place, adjusted for inflation. According to the International Monetary Fund, that so-termed capital stock has trended down as a share of gross domestic product in most big countries. This is particularly the case in the U.S. which suggests annual capital spending is not keeping pace with economic growth, plus normal wear and tear.

Federal government investment has been squeezed from all sides: caps on discretionary spending, competition from costly social benefit programs and serious reluctance to raise the gasoline tax or other taxes; which leaves borrowing. With interest rate levels so low, the IMF thinks debt-financed investment could virtually pay for itself by boosting demand in the short term and productivity in the long run. However, that comes with a caveat: the investment must be efficient. Yet, measuring the impact of public capital is no easy matter. The CBO believes that, on average, the return on federal investment is only about half that of private investment. Partly, that's because some public works have purposes other than raising economic output: i.e. monuments boost national pride, medical research improves the quality of life and bicycle paths reduce pollution. However, it's also because some federal investments are poorly targeted and in some cases reduce private, state or local investment.

The ideal approach to federal investment would be to rank all possible projects by their return, both monetary, such as user fees and non-monetary, such as less time spent in traffic. Those with the highest return could get funded first. However, no such system exists. The present system tends to favour new projects even when a maturing economy with more density in cities would favour rehabilitating existing infrastructure, or using it more efficiently, such as with electronic tolls, congestion pricing and even apps that find free parking spots. There are ways around such constraints. For example, in 2010, Britain drew up a national infrastructure plan that prioritizes projects which maximize economic value because they complement a regional transport network, or better utilize an existing asset. Moreover, Canada has established a government corporation to evaluate and fund public / private partnerships. In the U.S. the equivalent idea is a national infrastructure bank. The federal government would seed the bank with capital with which it would then extend loans, or loan guarantees to state, local and private borrowers. A professional staff would choose projects based upon economic and technical merits, the contribution to national and regional growth, job creation and environmental benefit. Since 2007, both Republicans and Democrats have backed various infrastructure bank proposals, but they haven't gone anywhere.

That's because lawmakers' political priority is to shore up the Highway Trust Fund, which is running out of money and about to expire, unless reauthorized by Congress. So for the foreseeable future, America will have to get by with constrained infrastructure budgets, badly targeted."

THURSDAY, MAY 21ST

- The National Association of Realtors (NAR) reports U.S. existing home sales declined by 3.3% in April to a seasonally adjusted annual pace of 5.04 million units, following a revised annual rate of 5.21 million units in March.

Lawrence Yun, NAR's chief economist, commented: 'Housing inventory has declined from last year and supply in many markets is very limited, which in turn is leading to higher prices and bidding wars.' Indeed, the NAR also reported that the median price on an existing home increased to $219,400 (U.S.) in April, up 8.9% on a year-over-year basis.

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 10,000 to a seasonally adjusted 274,000 in the week ended May 16th. while continuing claims declined by 12,000 to 2.21 million in the week ended May 9th., the lowest level since November 2000.

- Front Page Headline, GoldMoney – "Inaccurate Statistics and the Threat to Bonds. Researcher Alasdair Macleod writes: Statistics have become very misleading. Specifically, we are being badly misled into believing that America is teetering on the edge of price deflation, because the official U.S. rate of inflation is barely positive; a level that U.S. Treasurys and all other financial markets have priced in without realizing it is actually significantly higher. There are two possible approaches to assessing the true rate of price inflation. One can either reverse all the tweaks government statisticians have implemented over the decades to reduce the apparent rate, or one can collect a statistically significant sample of price data independently and turn that into an index. John Williams of Shadowstats.com is well known for his work on the former approach, but until recently I was unaware that anyone was attempting the latter. That is until Simon Hunt of Simon Hunt Strategic Services drew my attention to the Chapwood Index.

To quote from the website: 'The Chapwood Index reflects the true cost-of-living increase in America. Updated and released twice a year, it reports the unadjusted annual cost and price fluctuation of the top 500 items on which Americans spend their after-tax dollars in the 50 largest cities in the nation.' Therefore, it is statistically significant and it consistently shows price inflation to be much higher than that indicated by the Consumer Price Index (CPI). The table below shows this difference since 2011 and how it affects real gross domestic product (GDP).

	2011	2012	2013	2014	Cumulative
Chapwood Index	9.9%	10.7%	10.2%	9.7%	47.1%
Official CPI	3.0%	1.7%	1.5%	0.8%	7.2%
(Difference)	*6.9%*	*9.0%*	*8.7%*	*8.9%*	*39.9%)*
Nominal GDP	3.7%	4.2%	3.7%	5.6%	18.4%
Revised real GDP	-6.2%	-6.5%	-6.5%	-4.1%	-21.4%

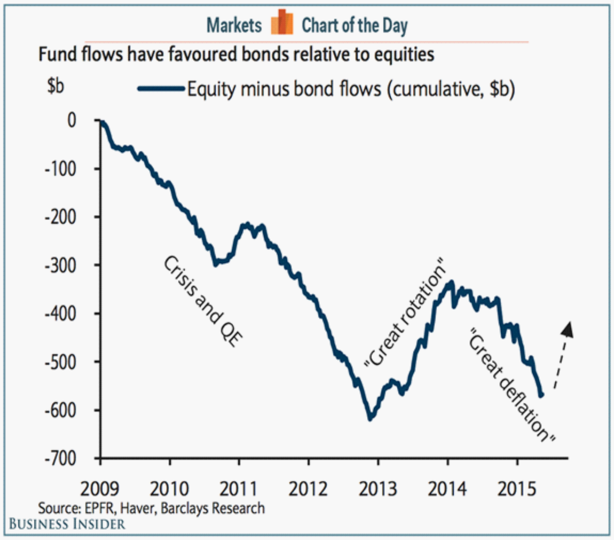
The Chapwood number in the table is the simple arithmetic average of the 50 cities. The year-in, year-out 10% inflation rate is notable. Furthermore, Chapwood shows the cumulative inflation rate as indicated by the CPI for the four years to be understated by 39.9% and using Chapwood numbers in place of the GDP deflator, real GDP has declined a cumulative total of 21.4% over the four years. No wonder the poor in America are suffering; when their wages and benefits cost-of-living adjustments (COLA) have been aligned to the CPI, i.e. they have fallen by nearly 40% in real terms over the last four years. The resulting decline in business on Main Street revealed by these figures explains why Wal-Mart is laying people off, closing stores and why trade associations continually issue disappointing trading assessments. Understated price inflation fundamentally distorts everything that is macroeconomic, from monetary policy to economic commentary. It misleads central bankers into thinking they are missing their inflation targets, when in fact they are exceeding them by a dangerously wide margin. It misleads analysts into thinking we are on the brink of a deflationary slump with prices perhaps about to collapse.

Most worrying of all, bond markets have become more mispriced than even hardened bears realize; something that is very likely to be corrected through a financial shock. Just think of all those bonds which the banks have acquired as zero risk investments under Basel III rules. If bond markets discounted, as the Chapwood Index suggests they should, a U.S. inflation rate consistently around 10%, the 10-year U.S. Treasury yield should be at least that and possibly more. Its market price would almost halve to reflect that double-digit yield and the prices of lesser credit-worthy bonds would decline even more. This is a development for which all financial markets are wholly unprepared, not to mention the knock-on effects on stocks, derivatives and of course, mortgage rates."

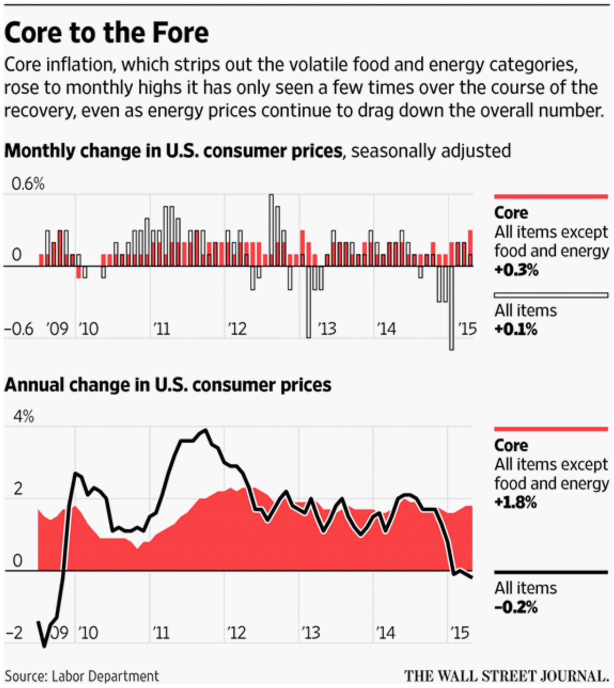
FRIDAY, MAY 22ND

- Statistics Canada reports the nation's consumer price index (CPI) rose by 0.8% in April on a year-over-year basis, following a 1.2% pace in March, citing lower energy costs. The core rate, which excludes eight volatile factors, rose by 2.3%, slightly lower than March's 2.4% rate. Separately, Statscan reported Canadian retail sales rose by 0.7% to $42.5 billion (CAD) in March, led by higher sales of motor vehicles and related parts.

- Front Page Headline, Business Insider – "Fund Flows Have Favoured Bonds Relative to Equities. With the stock market at an all-time high level, in a research note to clients, Jim McCormick, Barclay's global asset allocation analyst, observed: 'From 2009 to late 2012, bond inflows overwhelmed equity overflows despite the underlying strengths in global equity markets. That changed in early 2013, especially after Fed Chairman Ben Bernanke's speech in May. However, since the beginning of 2014, flows again have shifted in favour of bonds; a trend that gained steam in the second half of 2014, as fear of deflation began to take hold. While still in early days, it is notable that flows have yet to track the outperformance of equities relative to bonds so far this year. However, we see compelling reasons for the relative outperformance of equities to continue.' Disagreeing with this view, Barclay's U.S. equity strategist Jonathan Glionna expects the S&P 500 to end the year at the 2,100 level, which is only down slightly from the 2,130 level we're witnessing today."



- The Labor Department reports the U.S. consumer price index (CPI) rose by 0.1% in April, following a 0.2% increase in March. On a year-over-year basis in April, the core rate, which excludes food and energy, rose by 1.8%, unchanged from March.



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CLOSING LEVELS FOR FRIDAY, MAY 22ND.		WEEKLY CHANGE
Dow Jones Industrial Average	18,232.02	– 40.54 points
Spot Gold Bullion	$1,204.00 (U.S.)	– $21.30 per troy oz.
Spot Silver	$17.10 (U.S.)	– $0.43 per troy oz.
S&P / TSX Composite	15,200.76	+ 92.64 points
10 –Year U.S. Treasury Yield	2.21%	+ 7 basis points
Canadian Dollar	81.29 cents (U.S.)	– 1.89 cents
U.S. Dollar Index Future	96.137	+ 2.907 cents
WTI Crude Oil Futures	$59.72 (U.S.)	+ $0.03 per barrel
DJIA / Gold Ratio	15.143	+ 0.070 point
Gold / Silver Ratio	70.409	+ 0.509 point

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