Monday August 10th, 2015

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, August 10th

The Conference Board of Canada reports its index of the nation's business confidence rebounded to a reading of 105.6 in the 2nd. quarter from a level of 86.5 in the 1st. quarter citing: "a reversal of the decline it experienced following the oil price shock.

MONDAY, JUNE 1ST

Even with the recent cuts in the energy sector, Canadian firms are more likely overall to undertake major investments in structures, as well as machinery and equipment, which could spur gross domestic product (GDP) growth in the second half of this year."

- In a preliminary estimate, the Federal Statistics Office reports the Russian economy contracted by 4.6% in the 2nd. quarter – its largest decline in six years – following a drop of 2.2% in the 1st. quarter. Moreover, analysts warned that this initial figure is likely to be revised downward as sectoral statistics – which include retail sales, industrial production and household incomes – point to an even steeper drop in real terms.

- Front Page Headline, Daily Telegraph U.K. – "Chinese Warning Lights Flash as Factory Gate Prices Tumble. The National Statistics Bureau reports China's producer price index (PPI) declined by 5.4% on a year-to-date basis, the steepest drop since October 2009. Meanwhile, another report disclosed that China's exports contracted by 8.3% in July as compared with July 2014. Together, the fastest decline in factory gate prices and tumbling Chinese exports last month are putting further pressure on Beijing to launch new stimulus measure in order to support the economy. Indeed, HSBC analysts expect the Bank of China to lower its benchmark interest rate by 1/4 of 1% in the second half of this year, as well as reduce the domestic banks' required reserve ratio – or deposits that lenders are required to hold in reserve – by a further 2%. In an interview with the Daily Telegraph, Zhu Guangyao, China's vice finance minister, stated: 'While there are very big challenges facing the global economy, I am confident that our government will be able to steady the recent stock market sell-off."

- Front Page Headline, Globe and Mail – "Brazil Faces Political and Economic Chaos. Columnist Stephanie Nolen reports from Rio de Janeiro: Brazil's political and economic crisis deepened last week as President Dilma Rousseff's popularity and the value of the real hit extraordinary low points. Jose Alvaro Moises, a professor of political science at the University of Sao Paulo, observed: 'Brazil is in a very tense moment with an uncertain future. Few people in Brazil feel comfortable saying what might happen in the coming months, or even the next few days.' One strand of the crisis concerns the economy. There is a recession provoked by the end of a commodity boom, growing unemployment and inflation at its highest rate in a decade. The real hit

3.52 against the U.S. dollar last week, its lowest value in 12 years and the country's investment grade credit rating is imperiled. The government of President Rousseff had a plan to revive the economy through fiscal reform. However, the austerity proposals have stalled in Congress, where her political enemies have seized an opportunity to attempt to bring her down.

Eduardo Cunha, president of the lower house of Congress, whose party was nominally part of Rousseff's coalition has seized on her weakness. Mr. Cunha has blocked a series of austerity bills, put forward others to increase spending and opened a series of inquiries into government; prior to publically disavowing President Rousseff last month. Two entire parties left the coalition last week. Brazil's business community, no fan of the President, did emerge in defence of the government, pleading for stability in an attempt to staunch the economic damage. In a joint statement last week, the federations of industry of Rio and Sao Paulo demanded: 'It's time to put personal and political ambitions aside and aim to work for Brazil's interest.' Ms. Rousseff has shown herself incapable of either uniting the country, or even her coalition. According to a poll released last week by the research institute Datafolha, only 8% of Brazilians now believe that Ms. Rousseff is now doing 'a good or great job,' the lowest figure recorded since the country returned to democracy in 1985. The poll also found that 66% of people believe that Congress should undertake formal proceedings to remove her from office.

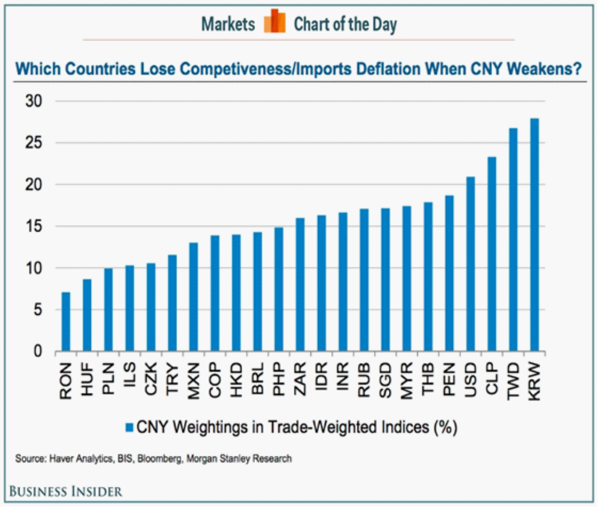
The backdrop for all this is the giant corruption investigation that began at Petrobras, the parastatal energy company and which has spread to include almost every construction firm in the nation and more than 70 politicians from nearly every party. Prosecutors say suppliers paid at least $1.7 billion (U.S.) in bribes to obtain Petrobras contracts and that a percentage of those bribes was funneled to politicians and political parties. Perversely, the corruption investigation can be seen as an indicator of the health of Brazil's democracy. While prosecutors and police are investigating powerful figures without interference, the revelations about the scale of the graft have enraged the public. (In point of fact, Ms. Rousseff was energy minister, thus chair of the Petrobras board of directors during much of the period under investigation.) Moreover, the politicians under investigation have been among Ms. Rousseff's most bitter opponents. For example, Mr. Cunha is alleged by a key informer to have accepted a $5 million (U.S.) bribe. So, the net effect of the inquiry is to strangle, not bolster, the democratic process.

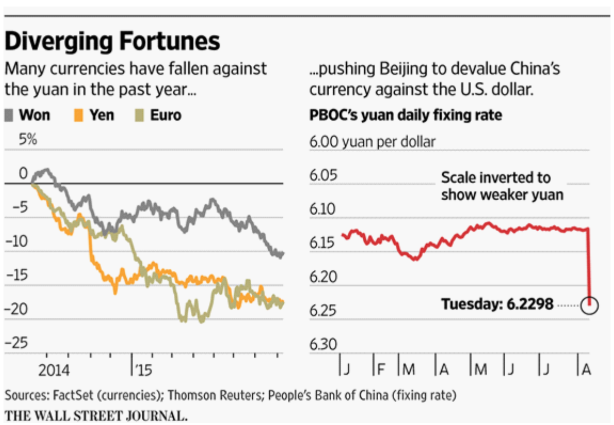
- President Rousseff is doing her best to remind Brazilians that they elected her just 10 months ago. As she inaugurated a housing project in the Amazon region last week, Ms. Rousseff stated: 'I know what it's like to live in a dictatorship. The votes I received are the source of my legitimacy and no one is going to take that away.' Impeachment of President Rousseff is now openly discussed in every quarter. While most legal experts agree that there is no case for it, Ms. Rousseff has not been directly implicated in any of the corruption investigations at Petrobras; plus could only be impeached for corrupt or criminal actions while she has been President. However, it is Congress, under the leadership of Mr. Cunha, who will decide if the process goes forward. It will require a two-thirds vote from both chambers and at this point, Ms. Rousseff still controls the Senate. Prof. Moises added: 'While impeachment is a growing likelihood and would, at least, offer a way out of the crisis, it would also come with huge costs of its own. I must admit, I don't see how we are going to get out of this."

Brazilian President Dilma Rousseff.
Photo source:

TUESDAY, AUGUST 11TH

- Front Page Headline, Business Insider – "PBOC Devalues Yuan. The surprise move by the People's Bank of China put the midpoint of the yuan's peg against the U.S. dollar about 2% below where it had been in an attempt to give the country's slowing economy a boost. In a research note to clients, analysts at Morgan Stanley observed: 'The major victims of the currency policy change in China are countries with high export exposure, such as Australia and New Zealand, as well as several countries across emerging economies, particularly in Asia. Countries which are coincidentally also suffering from issues of disinflation and over capacity include Korea, Taiwan, Singapore and to a lesser extent Thailand.'



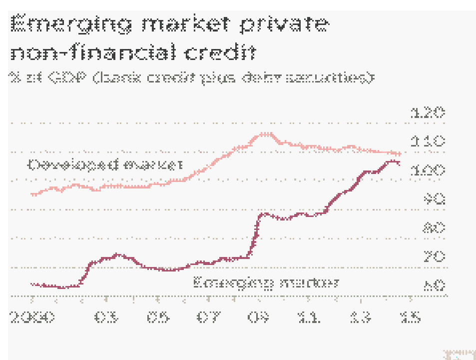


- Canada Mortgage and Housing Corp. (CMHC) reports the nation's housing starts declined to a seasonally adjusted annualized pace of 193,032 units in July, from a downwardly revised 202,338 units in June. In a research note, Robert Kavcic, an economist at BMO Capital Markets, commented: "While there are regional weak areas and strong areas, there is hardly a hint of recession in the CMHC figures. Overall Canadian construction activity continues to look very sturdy."

- Front Page Headline, Globe and Mail- "Following Marathon Negotiations, Greece and Creditors Reach Bailout Agreement. Greece and its international lenders reached an 85 billion euro bailout agreement today after talking through the night, saving the country from financial ruin and raising hopes it can make a major debt repayment next week. After a 23-hour session which began yesterday morning, exhausted Greek officials emerged in a central Athens hotel to announce the two sides had agreed upon terms of a three-year agreement, barring a couple of minor issues that were being sorted out. In addition, the agreement still needs political approval from euro zone member countries.

Once approved, the agreement will close a painful chapter of aid talks for Greece, which fought against austerity terms demanded by creditors for much of the year before relenting under the threat of being forced out of the euro zone. After reaching an agreement in principle last month on keeping Greece in the euro, the latest round of talks began in Athens three weeks ago to craft an agreement covering details of reform measures, the timeline for their implementation and the amount of aid needed. A Greek Finance Ministry official noted the pact would be worth up to 85 billion euros in new loans over three years. Greek banks would receive 10 billion euros immediately and would be recapitalized by the end of the year. Greek officials have stated they expect the accord to be ratified by parliament on Wednesday or Thursday and then vetted by euro zone finance ministers on Friday. This would pave the way for aid disbursements by August 20th. when a 3.2 billion debt payment is due to the European Central Bank (ECB).

- Front Page Headline, Financial Times – "Enormous Increase in EM Debt Sounds Alarm. According to a new analysis by JP Morgan, emerging market private sector debt has surged by a huge 33% of gross domestic product (GDP) since the global financial crisis, heightening the risk of further financial crises. JP Morgan's analysis suggests that the debt burdens of emerging market companies and households have soared from 73% of GDP in 2007 to 106% at the end of 2014; virtually as high as in the developed world, where private sector debt levels have been declining.

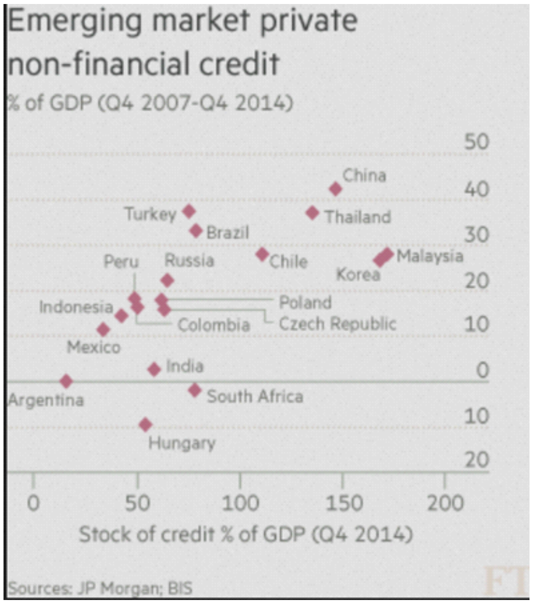


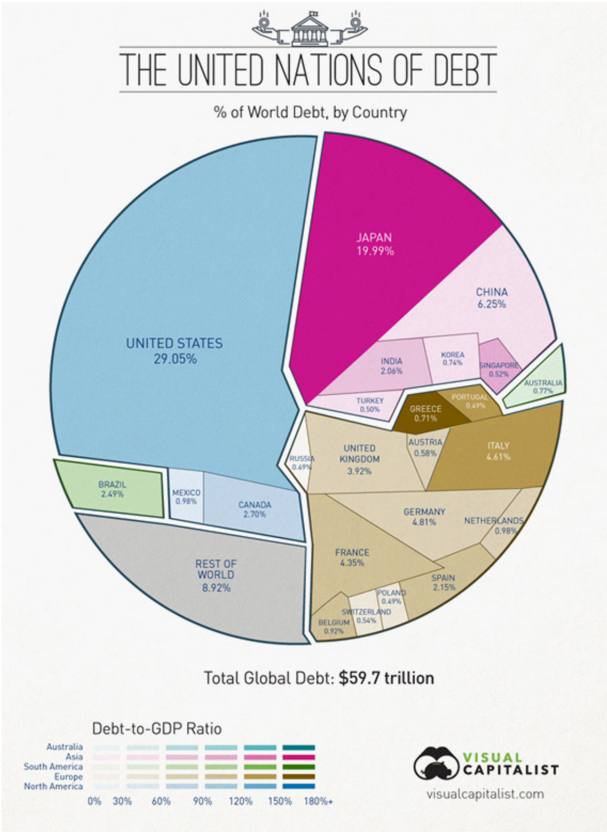
Joseph Lupton, an economist at JP Morgan, commented: 'In previous research, the International Monetary Fund (IMF) discovered that an increase in the ratio of debt to GDP of five percentage points or more in a single year signals a heightened risk of an eventual financial crisis. Indeed, nearly half of the EM countries analyzed have registered sustained increases at close to this amount over the entire period.' Moreover, although the figures include domestic bank debt, cross-border loans extended to the non-bank private sector and debt securities issued by non-financial companies, it does not include shadow banking, due to a lack of data in many countries. As a result, JP Morgan estimates that it is understating total private debt by about 10%. It greatest fear is that the supply of credit could tighten sharply, triggering a crisis in some EM economies.

Mr. Lupton notes that banks in a number of EM countries are already tightening lending standards in response to rising loan delinquencies and tighter funding conditions. However, even if this does not escalate he believes the rapid escalation of private sector debt will pose a major headwind for emerging market GDP growth in the coming years. Citing the example of developed markets since the financial crisis, where economic growth has arguably been held back by household deleveraging Mr. Lupton believes the same phenomena is poised to happen in emerging markets: 'Emerging markets are just at the beginning of what is going to be a long and painful deleveraging cycle. After seven years of an easy credit binge fueled by the Fed, the tide is going out and what's going to be left to see is the quality of assets which have been purchased over this period. There are going to be plenty of assets which will not be able to weather the Fed rate-hiking process.' Mr. Lupton admits to being downbeat on the global economy as a whole, given that emerging markets now account for about 40% of global GDP, approximately twice the level during the 1997-98 EM crises, meaning an economic slowdown will have a greater effect on the world at large. Furthermore, Mr. Lupton believes the threat is not fully understood: 'We get a lot of feedback from clients emphasizing the increase in external corporate debt, but in many ways that pales versus the domestic debt that has been amassed.'

The problem is most acute in Asia. Hong Kong (293.2%) and Singapore (178.9%) have the highest ratios of private non-financial debt to GDP; although their status as regional financial centers with a concentration of banking and capital markets activity may skew the figures somewhat. However, even apart from this duo, the highest ratios are found in Asian countries such as Malaysia (170.7%), South Korea (167.2%), mainland China (147.1%) and Thailand (134.4%).

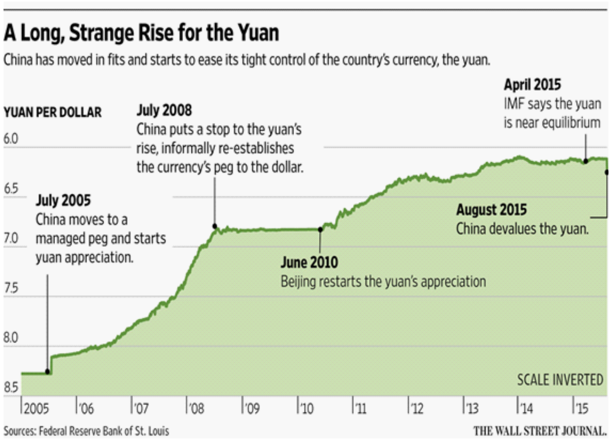
Hong Kong and Singapore have also seen the largest increases in their private non-financial debt to GDP ratios since the end of 2007, with Hong Kong's level rising by 110.5% to $868 billion (U.S.) and Singapore's by 63.3% to $541 billion (U.S.). Aside from these two countries, mainland China has seen the largest increase in debt levels since 2007 with a 42.7% gain. Moreover, China possesses the largest stock of private non-financial sector debt in U.S. dollar terms at $14.97 trillion (U.S.), i.e. more than half the $26.38 trillion (U.S.) of such debt in the 20 EM countries analyzed by JP Morgan. The next largest piles of debt were found in South Korea $2.3 trillion (U.S.), Brazil $1.161 trillion (U.S.) and India $1.2 trillion (U.S.)."





WEDNESDAY, AUGUST 12TH

- The People's Bank of China (PBOC) intervenes in the foreign exchange market to support the yuan, following yesterday's devaluation of about 2% against the U.S. dollar.



- The Job Openings and Labor Turnover Survey (JOLTS) reports the number of job openings in the U.S. declined slightly in June to 5.25 million from 5.36 million in May, while the number of voluntary resignations rose to 2.75 million from 2.73 million in May. The report highlights the gap between job openings and hires, a mismatch which suggests that employers haven't been able to find workers with the desired skills at the salary being offered.

- The National Bureau of Statistics reports China's industrial production rose by 6% in July on a year-over-year basis, down from 6.8% in June. HSBC economist Ma Xiaoping commented: "While Beijing's latest move to devalue the yuan will help boost China's exports, it needs to introduce more measures to spur domestic demand."

THURSDAY, AUGUST 13TH

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 5,000 to 274,000 in the week ended August 8th. while continuing claims increased by 15,000 to 2.27 million in the week ended August 1st. Jennifer Lee, an economist at BMO Capital Markets in Toronto, commented: "Initial claims have been below the 300,000 level since February and the American economy has shown plenty of improving signs since then, in deference to the global economy."

- The Commerce Department reports U.S. retail sales rose by 0.6% in July, citing higher demand for automobiles, furniture and clothing. Eleven of the 13 major retail categories reported higher sales levels. Harm Bandholz, an economist at UniCredit Group in New York, observed: "The consumer driven recovery of the domestic economy continues on track. The fundamentals are in place for solid consumer spending, so the outlook remains strong for the second half of the year."

- Statistics Canada reports the nation's new home prices rose by 0.3% in June, the biggest monthly increase since August 2014 and were led by a 0.6% gain in metro Toronto. Builders cited higher material and labour costs, as well as higher land development costs as major influences in the home building market, which excludes apartments and condominiums.

- Front Page Headline, GoldMoney – "Welcome to the World of ZIRP Zombies. Researcher Alasdair Macleod writes: Administered interest rates in Europe, the U.S. and the U.K. were reduced close to zero in the wake of the Lehman crisis nearly seven years ago. Initially, zero interest rate policies (ZIRP) was a temporary measure to counter the price deflation that immediately followed the crisis, but since then, administered interest rates have been kept suppressed in the zero per cent range. It had been hoped that the stimulus of near zero administered interest rates would also guaranty economic recovery. While it has failed in this respect, resultant low bond yields have only served to encourage the rapid expansion of sovereign government debt. It is clear that central bank monetary policies are the problem. Instead of boosting an economic recovery, they have simply destroyed the mechanism which recycles savings into capital for production.

These monetary policies have realized Keynes' wish – expressed in his General Theory – that he 'looked forward to the euthanasia of the rentier', whose function in providing finance for entrepreneurs is to be replaced by the state: 'entrepreneurs who are so fond of their craft that their labour could be obtained much cheaper than at present.' Instead of storing the fruits of his labour in the form of bank deposits to be made available to the investing entrepreneur, the saver is discouraged from saving and instead, is being forced to speculate for capital gain. In that sense, ZIRP is the logical end-point of Keynes' ideal. The mistake is to subscribe to the ancient view that interest is usury and that it only benefits the idle rich, a stance that appeared to be adopted by Keynes. What Keynes missed is that interest rates are an expression of time preference, or the compensation for making money which is available today, in return for a reward tomorrow. If one attempts to ban interest rates by imposing ZIRP, then the vital function of distributing savings in the interests of progress simply ceases. An economy with ZIRP joins the ranks of the living dead.

In 1909, Ludwig Von Mises recognized this when he wrote that 'a falling value of money goes hand in hand with a rising rate of interest and a rising value of money with a falling rate of interest. This lasts as long as the movement of the objective exchange-value continues. When this ceases, then the rate of interest is re-established at the level dictated by the general economic situation.' Besides noting that Von Mises' analysis was independently confirmed by Gibson's Paradox, it may be helpful to restate it in easier to understand terms. History has shown that a borrower of good standing in a sound money economy that is stable would pay about 3% interest. If prices are rising his margins will improve and he will be prepared to pay more to seize the opportunity to profit. On the other hand, if prices are falling he can only afford to pay less and he will most likely restrict his future activities to those which he can finance from his own resources. It is this free market demand that sets interest rates and not the usurious lenders reviled by Keynes. In point of fact, a suppressed interest rate should make it profitable to borrow, but that is not the way a producer looks at it.

In order to be profitable, the marginal benefits of extra borrowing must exceed the costs of investing in production. A business with a good balance sheet will normally improve its existing products by reinvesting its own reserves without recourse to external funds under almost all conditions. Recourse to external funding implies a materially different product being planned, or that a significant expansion of productive capacity is being considered, i.e. a more risky step requiring greater capital expenditure, only to be undertaken when economic prospects are set fairly. It is this capital commitment which is missing, despite prolonged monetary stimulus. Central bankers are becoming acutely aware of the failure, which has only lured their governments into a deepening sovereign debt trap. That is why the Bank for International Settlements (BIS) has publically expressed concerns for some time now and why both the Federal Reserve and the Bank of England have expressed the wish to return to some sort of administered rate normality. It will be extremely difficult, but let us assume for a moment that administered interest rates are raised: what happens then?

An increase in administered interest rates to more than one or two per cent will be accompanied by rising commodity prices. This much is evident from Gibson's Paradox. It would likely come about as speculative money flees financial assets, closes short positions in commodities and then seeks protection from a decline in the purchasing power of currencies. Businesses will see two things. Obviously, with bonds, stocks and residential property prices falling as bond yields rise, the business outlook would be deteriorating. However, with commodities and wholesale prices rising, reflecting a decline in money's purchasing power, businesses would be prepared to pay more interest to Keynes' rentiers. This is the basis behind Gibson's Paradox. Not that this is properly understood: macroeconomists have discovered that their theories have failed and they don't know why. They want to backtrack to safer ground, but are frightened of the consequences. Normalizing administered interest rates could generate a stock market collapse, risk setting off an avalanche of bankruptcies and make government finances wholly untenable. Higher bond yields risk triggering a second financial crisis which could also undermine currencies, pushing up price inflation.

While macroeconomic theories can be faulted on the basis of outcomes, there is little danger the systemic threat from a trend of rising administered interest rates is very real. On balance, it is a situation which calls for inaction justified by hope. After all, with the Fed Funds rate in a 0% to 0.25% range and $2.6 trillion

(U.S.) of commercial bank funds already on deposit at the Fed, could it be that even a small increase in the Fed Funds rate will just suck more deposit money out of the U.S. banking system, leading to a contraction of bank lending? Central bankers are beginning to see what it has been like for their colleagues in Japan, where for twenty-five years with zero administered interest rates nothing attempted seemed to work. Welcome to Keynes' world of euthanized savers and state-sponsored funding."

FRIDAY, AUGUST 14TH

- Front Page Headline, IMF Statement – "Europeans Need to Weigh Greek Debt Relief Well Beyond What Has Been Negotiated to Date. In a press release, International Monetary Fund Managing Director Christine Lagarde stated: The policy package specified in the Memorandum of Understanding (MOU) recently agreed upon between the Greek authorities and European institutions, with input from Fund staff, is a very important step forward. Not only does it reverse part of the previous backtracking which caused the previous program to go seriously off track, but also, it establishes wide ranging policies in order to restore fiscal sustainability, financial sector stability and a return to sustainable economic growth. I particularly welcome the authorities' efforts to overcome the serious loss of confidence in recent months through strong, upfront actions. Most of these actions have been fully specific in the MOU and key measures including the fiscal structural areas will be implemented as prior actions for the disbursement of the first European Stability Mechanism (ESM) tranche.

  In two areas that are of critical importance for Greece's ability to return to a sustainable fiscal and economic growth path, the Greek government needs additional time to develop its program in more detail. This is understandable.

  These areas are the specification of remaining parametric fiscal measures, not the least a sizeable package of pension reforms, needed to underpin the program's still ambitious medium-term primary surplus target, plus additional measures to decisively improve confidence in the banking sector. In this regard, I am encouraged by the Greek government's commitment to work with its European partners and the Fund in completing these essential reforms in the coming months. With the detailed specification of these outstanding reforms, the recently agreed upon MOU will entail a very decisive and credible effort on the part of the Greek authorities to restore robust and sustainable economic growth.

  However, I remain firmly of the view that Greece's debt has become unsustainable and that Greece cannot restore debt sustainability solely by means of its own actions. Thus, it is equally critical for medium and long-term debt sustainability that Greece's European partners make concrete commitments in the context of the first review of the ESM program to provide significant debt relief, well beyond what has been negotiated to date.
  In conclusion, I believe that the actions to be taken by the authorities prior to the time of the first review, in conjunction with the policies specified in the MOU, once they have been supplemented by the fiscal structure and financial sector reforms, as well as by significant debt relief; will provide the basis for a credible and comprehensive program to restore medium term sustainability. We look forward to working closely with Greece and its European partners in the coming months to establish all the elements needed for me to recommend to the Fund's Executive Board to consider further financial support for Greece."

- The Reuters / University of Michigan group reports its preliminary index of U.S. consumer confidence in August declined to a reading of 92.9 from a level of 93.1 in July. Richard Curtin, director of the Michigan Survey of Consumers, commented: "Now is the time to monitor consumer sentiment very carefully in case we do see some fallout from international problems. Lower gas prices at the pump are beginning to have a positive impact on consumer spending because a growing number of consumers no longer expect gas prices to quickly rebound."

- Front Page Headline, Bloomberg News – "Canada Has Problems Other than Just Oil Prices. Steven Englander, a global currency strategist at Citibank, observes: 'Although Canada's recent trade figures were encouraging, the U.S. dollar value of the nation's non-oil exports has moved virtually sideways for several years.' Notably, the U.S. dollar value of Mexico's non-oil exports recently exceeded those of Canada, which has been unable to surpass its pre- financial crisis peak. The chart below highlights the previously sizeable gap between the two.

Englander explained: 'The relationship between the Canadian dollar and the Mexican peso is dead flat over the last three years, so Canada's dollar depreciation hasn't gained it any competitive advantage.' The Canadian dollar's effective exchange rate index has declined by 13% over the past year, punctuated by a 16% drop against the U.S. dollar. However, the loonie's narrow range relative to the Mexican peso has muted the potential benefits of a lower currency valuation and its rival for U.S. demand has continued to grab market share."

- The Canadian Real Estate Association (CREA) reports while the nation's existing home sales declined by 0.4% in July, average resale prices rose by nearly 9% on a year-over-year basis, reflecting a shift toward sales of more expensive single family homes in Toronto and Vancouver. Adrienne Warren, an economist at the Bank of Nova Scotia, observed: 'The persistence of exceptionally low mortgage rates will likely maintain a healthy level of home sales in the coming months.'

- Statistics Canada reports the nation's factory sales rose by 1.2% to $50.8 billion (CAD) in June led by gains in automobiles and chemicals, but tempered by a drop in metals.

- The Federal Reserve reports U.S. industrial production – a measure of output in the manufacturing, mining and utilities sectors – rose by a seasonally adjusted 0.6% in July, following a 0.1% advance in June, led by a 10.6% increase in the output of motor vehicles. Capacity utilization, which measures industrial slack, rose by 0.3% from June to 78%.

- The Labor Department reports the U.S. producer price index (PPI), which measures the prices that companies receive for goods and services, rose by a seasonally adjusted 0.2% in July, following a 0.4% gain in June. Core prices, which exclude energy and food prices, rose by 0.3%. In a research note, Ted Wieseman, an economist at Morgan Stanley, predicted: 'China's currency devaluation and the continued broad strength in the U.S. dollar against other currencies point to further, potentially substantial weakness in core goods prices in the months ahead.'

- Front Page Headline, GoldMoney – "RT Keiser Report Episode 796. In this video, GoldMoney's Head of Research Alasdair Macleod is interviewed about how gold could resolve today's monetary problems. See link below.

  https://wwwrt.com/shows/keiser-report/312323-episode-max-keiser-796/

LONGWAVE group

CLOSING LEVELS FOR FRIDAY, AUGUST 14TH.		WEEKLY CHANGE
Dow Jones Industrial Average	17,477.40	+ 104.02 points
Spot Gold Bullion	$1,112.70 (U.S.)	+ $18.60 per troy oz.
Spot Silver	$15.22 (U.S.)	+ $0.44 per troy oz.
S&P / TSX Composite	14,277.88	– 24.82 points
10 – Year U.S. Treasury Yield	2.20%	+ 4 basis points
10 – Year Gov't. Canada Yield	1.39%	– 3 basis points
10 – Year Sovereign Yield Spread	81 basis points	+ 7 basis points
Canadian Dollar	76.38 cents (U.S.)	+ 0.24 cent
U.S. Dollar Index Future	96.588	– 0.970 cent
WTI Crude Oil Futures	$42.50 (U.S.)	– $1.37 per barrel
DJIA / Gold Ratio	15.508	– 0.371 point
Gold / Silver Ratio	73.108	– 0.918 point

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