Monday July 6th, 2015

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, July 6th

The Tempe, Arizona-based Institute for Supply Management (ISM) reports its index for the U.S. services industry and other non-manufacturing companies rose slightly to a reading of 56.0 in June, following a

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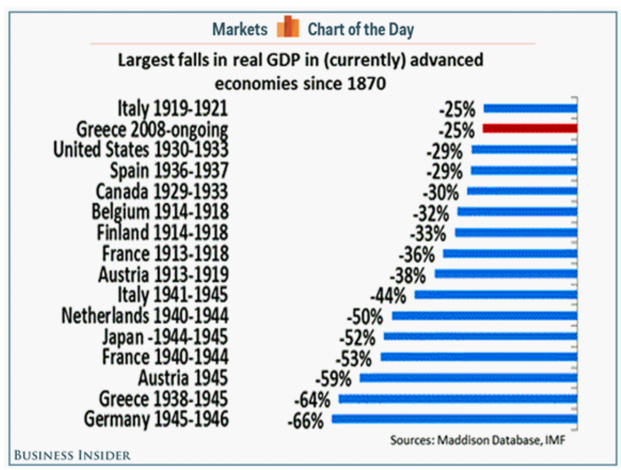
level of 55.7 in May; while the new orders component rose to a reading of 58.3 from 57.9. Readings above the 50 mark indicate an expansion of business activity. Anthony Nieves, chairman of ISM's services survey, noted: "We're beginning to see a slow, but steady incremental growth trend emerge in business activity on a month-over-month basis."

- Front Page Headline, Bloomberg News – "Greece Enters New Showdown with Europe. Following the Greek voters' rejection of further austerity measures in yesterday's referendum, Greece's Finance Minister Yanis Varoufakis tendered his resignation in a bid to expedite the country's negotiations with European creditors. In a press release, Mr. Varoufakis stated: 'Following the announcement of the referendum results, I was made aware of a certain preference of some Euro group participants … for my absence from future negotiation meetings; an idea that Prime Minister Tsipras judged to be potentially helpful to him in reaching an agreement. For this reason, I am leaving the Ministry of Finance today.' Meanwhile, the European Union (EU) has given Greek Prime Minister Alexis Tsipras just hours to produce a plan to keep his country in the euro and stave off economic disaster as citizens suffer under a second week of capital controls. Speaking from the Elysee Palace in Paris, German Chancellor Angela Merkel stated: 'Time is running out. It will be important tomorrow that Greek Prime Minister Tsipras tells us how this should move forward. The last offer that we made was a very generous one. On the other hand, Europe can only stand together if each nation assumes its own responsibility.'

- Front Page Headline, Business Insider – "Largest Declines in Real GDP since 1870. While Greece's current collapse in gross domestic product isn't the worst recorded in recent history, it is interesting to note that it is one of the few not related to war. See chart below compiled by RBS Economics.



TUESDAY, JULY 7TH

- Front Page Headline, Globe and Mail – "S&P Downgrades Ontario's Credit Rating to 'A' (High). Citing the Province's 'very high debt burden and very weak budgetary performance,' Standard & Poor's has downgraded Ontario's credit rating to 'A' (High) from 'AA' (Low). S&P elaborated: 'Ontario has been slow to fully introduce the spending controls and revenues needed to eliminate its structural operating deficit, which has caused its tax-supported debt level to approximately double since fiscal 2008.' Douglas

Porter, chief economist at the Bank of Montreal, characterized the downgrade as 'a fairly significant move by Standard & Poor's. To some extent it reflects the fact that Ontario has experienced a relatively large increase in debt since the 2008 recession. In point of fact, by some measures, we have witnessed the fastest buildup of debt among the ten provinces, not only in terms of Canadian dollars per se, but also in terms of a percentage share of the overall economy."

- Statistics Canada reports the nation's merchandise trade deficit widened to $3.3 billion (CAD) in May, following a $3 billion (CAD) deficit in April; the eighth consecutive monthly trade shortfall. For the first five months of this year, the country has recorded a massive trade deficit totaling $13.6 billion (CAD). Exports declined for the fifth consecutive month in May and are now down by 2.1% from the same period in 2014. In a research note, Nick Exarhos, an economist at the Canadian Imperial Bank of Commerce (CIBC), observed: "The rotation toward business investment and non-energy exports has yet to materialize, so given the larger than anticipated retrenchment year to date, the Bank of Canada has reason to provide a follow-on cut in the Bank Rate as soon as next week."

- The Commerce Department reports America's trade deficit widened by $1.2 billion (U.S.) in May from April to $41.9 billion (U.S.). Exports declined by $1.5 billion (U.S.) in May to $188.6 billion (U.S.), while imports fell by $300 million (U.S.) to $230.5 billion (U.S.).

- Front Page Headline, Financial Times – "Greece Given Five Day Deadline to Avoid Bankruptcy. Following an emergency summit of all 28 European Union (EU) members on Sunday, Greece was given five days to reach an agreement with its creditors or face bankruptcy. European Commission (EC) President Jean Claude Juncker commented: 'While I remain strongly against Grexit (a Greek exit from the euro zone), I can't prevent it if the Greek government is not doing what we expected. We have a Grexit scenario prepared in detail; as well as a scenario as far as humanitarian aid is concerned.'

- Meanwhile, German Chancellor Angela Merkel warned: 'I must see to what extent the Greek government is ready and willing to close its fiscal gap via structural measures. This is certainly a challenge of a different nature than it was just ten days ago because over the past couple of weeks the economic situation in Greece has not improved, not at all.' European Council President Donald Tusk opined: 'Our inability to reach an agreement may lead to the bankruptcy of Greece and the insolvency of its banking system. For sure, it would be most painful for the Greek people.'

Greece's new Finance Minister Euclid Tsakalotos (seated right). Source: Financial Times

WEDNESDAY, JULY 8TH

- Statistics Canada reports the value of the nation's municipal building permits fell by 14.5% in May to $6.7 billion (CAD), citing declines across all major types of projects from hospitals to condominiums and industrial sites. Permits for non-residential construction fell by 16% to $2.77 billion (CAD) while residential permits declined by 13.5% to $3.93 billion (CAD).

- In the release of the minutes of the June 16-17 monetary policy meeting of the Federal Open Market Committee (FOMC), it was adjudged: "Committee members will need additional information indicating that U.S. economic growth is strengthening, labor market conditions are continuing to improve and the inflation rate is moving back toward the Committee's objective of 2% prior to raising the administered Federal Funds rate from its current target range of 0% – 0.25%. Generally, while committee members perceived the risks to their projections of U.S. economic activity and the labor market as balanced, they expressed a number of reasons to be cautious in assessing the economic outlook. These included uncertainty about whether Greece and its official creditors would reach a bailout agreement; the likely pace of economic growth abroad – particularly in China – and the slow pace of U.S. consumer spending

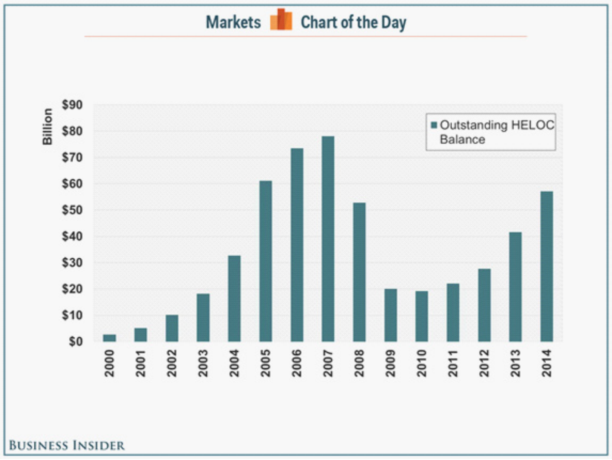
U.S. Federal Reserve Chairwoman Janet Yellen.
Photo source: Wall Street Journal

- In a speech to the Canada China Financial Summit 2015 in Toronto today, Canadian Finance Minister Joe Oliver warned: "Faced with greater global economic instability, such as stock market volatility in China and the debt crisis in Greece, now more than ever, we must stay the course and continue with our plan to grow our economy through lower taxes." Highlighting the increasing importance of China to Canada's economy, Mr. Oliver cited: "Today, more than 400 Canadian companies operate in China. Moreover, Canada has dramatically increased its trade with China, as exports to China have more than quadrupled since 2003. With merchandise trade totaling $78 billion (CAD) in 2014, that makes China our second largest trading partner. While Canada and China have clearly made great strides together, tremendous potential exists to grow this trade relationship much further. Recently, we took an important step forward in deepening our financial relationship by establishing a renminbi trading hub in Canada; the first in North America. It was a landmark in a long line of important steps to deepen bilateral commercial, diplomatic and cultural ties." Wakeup call for Mr. Oliver: Firstly, if you keep lowering taxes without corresponding spending reductions, you will be unable to achieve your goal of a balanced federal budget. Secondly, if the Canada/China relationship is to soar to new heights, why has Canada not joined Australia, the U.K. and an host of others by seeking membership in China's Asian Infrastructure Investment Bank?

Canadian Finance Minister Joe Oliver
Photo source: Canadian Press

- Front Page Headline, Financial Times – "S&P Downgrades Chicago's Credit Rating to 'BBB' (High). Citing Chicago's weakening credit quality as the municipality struggles with a high debt load, Standard and Poor's has downgraded Chicago's credit rating from 'A' (Low) to 'BBB' (High) while maintaining a negative outlook. John Kenward, an S&P analyst, noted: 'The downgrade is based upon our view of the city's structural imbalance, which we believe will necessitate the adoption of corrective budget measures over several years. In our opinion, the city has not yet fully identified a credible plan to address the imbalance. I must warn that we could downgrade the credit rating further should city officials fail to incorporate a credible plan to address the growing budgetary imbalance within the next six months."

- Front Page Headline, Business Insider – "Is an American Homeowner Borrowing Frenzy Unfolding? Double Lined Funds' researcher Jeff Gundlach raises concerns about American homeowners borrowing more funds against their residences. Home equity lines of credit (HELOC) are revolving loans like credit cards, which are collateralized by the equity in a borrower's home. The credit line is usually available to the borrower for a fixed period, generally ten years. At the end of that period, the line balance can either be renewed, or repaid by the borrower. The Experian chart below reveals the amount of money that Americans have borrowed against their homes since the year 2000. The fact that outstanding HELOC balances are returning to housing bubble levels suggests to Gundlach that homeowners may be entering a borrowing frenzy.



Primary source: Experian

THURSDAY, JULY 9TH

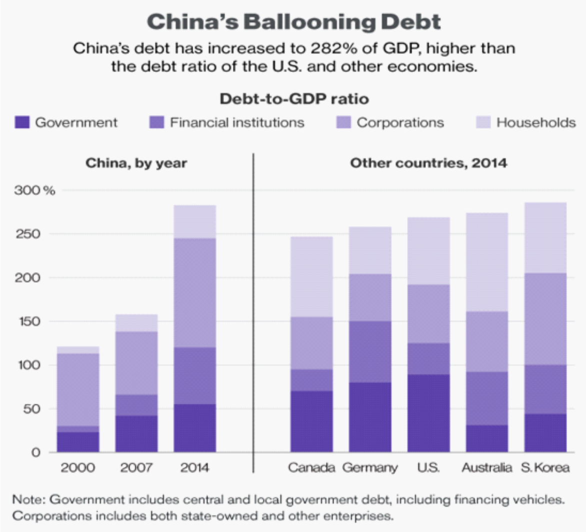
- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 15,000 to 297,000 in the week ended July 4th. while continuing claims increased by 69,000 to 2.33 million in the week ended June 27th.

- In its latest World Economic Outlook Update, the International Monetary Fund (IMF) has lowered its global economic growth forecast for 2015 to 3.3%, down from its April projection of 3.5%; as well as lowered its projection for Canada's gross domestic product (GDP) growth to 1.5% for this year, down from 2.2% in its April forecast. The IMF stated: “We are citing one-off factors for the unexpected economic weakness in North America, such as harsh winter weather, port closures and a strong downsizing of capital expenditure in the oil sector. Outside of North America, positive and negative surprises are roughly offsetting. Growth in output and domestic demand in emerging markets and developing economies has broadly weakened, as expected.”

- Canada Mortgage and Housing Corporation (CMHC) reports the nation’s housing starts increased to a seasonally adjusted annual pace of 202,818 units in June, following a downwardly adjusted 196,981 units in May. In a press release, Bob Dugan, CMHC’s chief economist elaborated: “The trend in housing starts increased in June as multiple starts trended upward, offsetting a downward trend in single-detached home starts … While seasonally adjusted multiple starts have increased by 53% from February to June and are at their highest level since September 2012, they are expected moderate during the coming months.”

- Front Page Headline, Gold Arrow Partners – “China’s Debt Bomb. According to a McKinsey estimate, China’s total borrowing soared to 282% of gross domestic product (GDP) by the middle of 2014 from 158% in 2007. That represents the fastest increase of any emerging market and almost double the increase in the U.S. and U.K. prior to the 2008 financial crisis. It could be an even bigger problem than the numbers indicate. The frantic pace of new lending means it’s difficult to figure out how many loans are not being repaid. Regulatory loopholes and widespread shadow banking practices complicate the picture.

  Moreover, under a murky system of implicit guarantees, it’s not clear just how much of the debt is backed by China’s government, or who would be allowed to go bankrupt. Local and regional governments have borrowed an estimated $4 trillion (U.S.) of the total – the size of the German economy – and some used shorter term, off-balance sheet borrowing to fund dubious infrastructure and real estate projects. Chinese authorities have allowed few defaults, although in April power equipment maker Baoding Tianwei became China’s first government-owned enterprise to halt payments on domestic borrowings, while homebuilder Kaisa Group became the first property developer to fail to mature its foreign-held bonds. To ease the crunch, banks are exchanging $322 billion (U.S.) of high-interest debt owed by local governments for low-interest bonds with longer maturity dates.



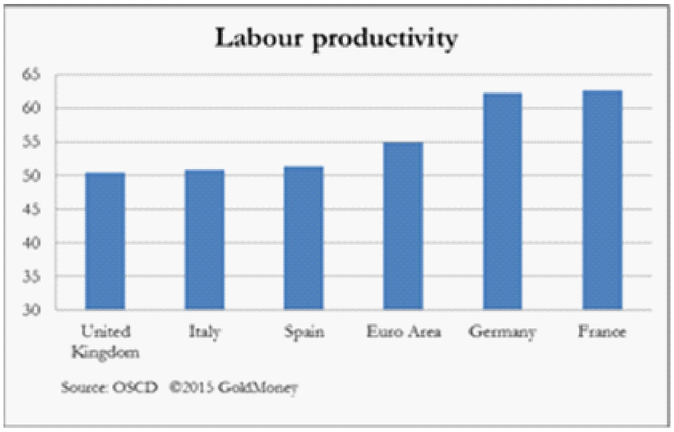
Source: McKinsey

During the 2008-2009 financial crisis, Beijing ordered local governments to build roads, bridges and other public works to keep the economy pumping and workers in jobs. That set off a borrowing binge which has invited comparisons with Japan’s debt bubble of the 1980s. Japan’s bubble popped in a property and stock market crash, leaving zombie banks saddled with bad debt. China has witnessed economic busts before. In the late 1990s, at least one quarter of the nation’s credit soured after years of state-directed lending, triggering a $650 billion (U.S.) bailout of state banks. The latest debt has been amassed amid China’s slowest economic growth period in 25 years and President Xi Jinping’s push to steer the economy toward consumption and away from debt-intensive heavy industry and exports. Since the central government retains controls over banks, foreign exchange and capital flows, it can manipulate the financial system in order to contain the debt burden and defuse the risk of a blowup. There’s an assumption that the government will funnel money into the economy to prevent a wave of defaults, which has also helped fuel China’s rocketing stock market. At the same time, officials are keen to introduce more free-market discipline, which could increase their tolerance for bankruptcies.

Optimists believe concerns about China’s debt are overblown. In that view, companies and local governments can simply grow their way out of the problem as an expanding economy supports borrowers and creates inflation, which erodes the burden of debt repayments. China’s high savings rate and its current account surplus also help. Pessimists believe the debt situation is not self-correcting. They expect policy makers to tackle nonperforming loans in order to stave off defaults. Options include reducing interest rates, expanding debt swaps, clamping down on non-bank lending, pushing for asset sales and encouraging more companies to raise money via equity issues. Charlene Chu, a former Fitch Ratings analyst known for her warnings about China's debt, believes: 'the dangers are increasing as China's economy slows down and lower inflation threatens to make debts more difficult to repay. There's a risk that China's debt could remain a drag on global economic growth for decades."

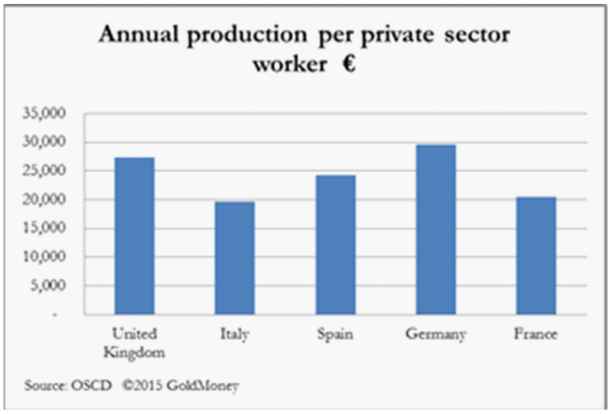
FRIDAY, JULY 10TH

- Front Page Headline, GoldMoney – "Productivity Misconceptions. Researcher Alasdair Macleod writes: In the media warmup for Wednesday's U.K. budget, the public was informed of Britain's poor productivity position and Chancellor of the Exchequer George Osborne subsequently confirmed that his priority is to address it. Comparative figures for Europe quoted by the BBC were sourced from the Organization for Economic Cooperation and Development and are replicated in the chart below.



The chart represents gross domestic product (GDP) per hour worked, using the U.S. dollar on a purchasing power parity basis across various European Union (EU) nations. It shows the U.K. as lagging other European countries badly, which presumably is why Chancellor Osborne feels the need to act. These statistics are misleading. France is depicted as even more productive than Germany, which cannot be true. France's unemployment rate is at 12%and private sector employment is only 62% of the OECD's 'economically active population.' This is not a productive economy. Furthermore, the public sector is 57% of GDP, compared with 44% for the U.K. Attempting to measure average hourly productivity the OECD way is simplistic and based upon assumptions. The formula is GDP divided by total hours worked, so we are being asked to take GDP for granted, when in fact it is an incomplete summation of production value.

Moreover, in the GDP there is no distinction between product commanded onto the market by government and goods and services freely demanded by consumers. Plus, we cannot know hours worked because very few businesses today clock employees into work and then determine beverage, comfort and lunch breaks. We cannot construct a better and more relevant productivity indicator, based upon the cost of employment, which is not addressed by the OECD approach. Government, which is an economic cost, should be eliminated from all estimates of production by removing the sector from GDP entirely in order to isolate the area we actually want, which is the private sector. The costs of supporting the state, as well as the taxes which fund unproductive government spending, should also be removed from private sector GDP. Because we produce to enable consumption, this means as proxy for the cost of government subtracting all taxation from private sector GDP, whether it is on production or on consumption. Next, only the employed and self-employed in the private sector should be included in the divisor by eliminating public sector workers and the unemployed. The result of all these changes produces a very different result, as in the chart below.



This information is not only more relevant than the OECD's estimate of productivity, but it is also more useful for international businesses interested in the relative costs of employment. In fact, we should take this one step further and consider the position from our statistically averaged employee. The following table shows the estimated net income of an employee whose cost of employment to an employer is equal to the national average production per private sector worker as shown in the revised chart above.

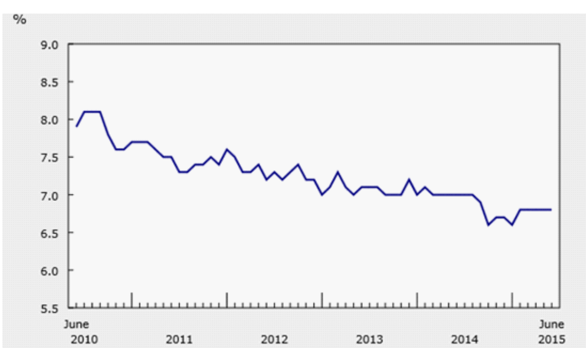
Currency - EUR	UK	Italy	Spain	Germany	France
Average private sector worker production	27,396	19,623	24,331	29,528	20,545
Employment taxes	-3,867	-8,340	-8,516	-11,811	-12,327
Net of employment taxes	23,529	11,283	15,815	17,717	8,218
Estimated income tax	-1,420	-2,821	-4,745	-2,193	-88
Take-home pay per month	1,842	705	923	1,294	677
Local currency equivelent	**£ 1,307**	**€ 705**	**€ 923**	**€ 1,294**	**€ 677**
GBP/EUR 1.4100					

Source: GoldMoney

We now have a new perspective on the subject of productivity. In order to match the high productivity rates shown in the OECD's productivity statistics, a French worker takes home only 834 euros per month and the Italian worker not much more. For them there is little point in working. However, the Brit's take-home pay is more than any of the others, including that of the average German employee. What this exposes is the principal determinant of productivity is not the relative skill and dedication of workers as suggested by the OECD's figures, but the cost of employment. After paying employment and income taxes, an employer can less easily afford to pay a living wage in France and Italy. It seems bizarre that official indicators of productivity ignore employment costs, which after all is far more relevant to prospective employers. Let us hope that someone draws this to Chancellor George Osborne's attention."

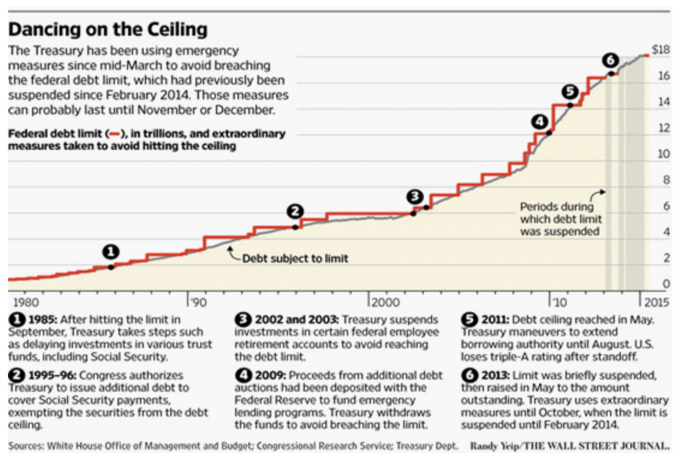
- Statistics Canada reports the nation's overall employment declined by 6,400 jobs in June, as the addition of 64,800 full-time positions was offset by the loss of 71,200 part-time positions, so the official unemployment rate was unchanged at 6.8%. Most of the new jobs were created in the public sector, up by 42,200, while 26,300 private positions were lost. In addition, the number of self-employed Canadians fell by 22,200.

Canadian Unemployment Rate Currently at 6.8%



Source Statistics Canada

- Front Page Headline, Wall Street Journal – "Should the U.S. Congress Abolish the Federal Debt Limit? The Government Accountability Office (GAO) – an independent investigative arm of the U.S. Congress – raises this question in a new report that both quantifies the damage caused by past episodes of debt ceiling brinkmanship and offers Congress a few suggestions for possible ways out. At present, the report is particularly relevant right now because the U.S. Department of the Treasury has been using emergency measures to avoid breaching the federal borrowing limit since last March. Budget analysts estimate that the U.S. treasury department can use those measures, such as halting certain pension investments, until it is unable to no longer borrow money sometime this November or December. Raising the debt ceiling doesn't approve more spending by the federal government, rather it allows the government to borrow money in order to pay debts which it has already incurred. While debt limit increases have always been subject to political grandstanding, they were mostly routine until recent years; when emergency measures became the new habit. Worried about rising debt levels, conservative lawmakers have used the increase ritual as a pressure point to push for greater federal spending discipline.



In 2011, Standard & Poor's (S&P) downgraded America's sovereign 'AAA' credit rating to 'AA' (High) for the first time ever, after the U.S. Treasury came within days of being unable to pay for certain benefits such as Social Security. In October 2013, the U.S. government endured a 16-day long shutdown which coincided with nearly exhausting its borrowing authority. The GAO report found that during the most recent impasse, investors reported taking 'the unprecedented action of systemically avoiding certain U.S. Treasury securities' namely, those that would be expected to mature about the time the U.S. Treasury estimated it would exhaust its borrowing authority. U.S. Treasury securities are considered to have the full faith and credit of the U.S. government, yet some issues weren't being accepted as collateral. As a result, the GAO noted that those securities not only, suffered a drop in liquidity in markets where they are traded, but also, an increase in yield levels. The GAO report added that disruptions in the U.S. Treasury market extended into other areas, such as short-term funding. Moreover, investors indicated that they would take similar steps to systemically avoid certain U.S. Treasury securities during future debt-limit impasses.

The GAO estimated that borrowing costs for the U.S. government increased rapidly in the final weeks and days prior to the October 2013 deadline ranging from $38 million (U.S.) to $70 million (U.S.). Accordingly, the GAO proposed three options to replace the existing debt limit process.

1. Congress to agree to raise the debt limit as part of the annual process of passing a joint budget resolution. This would force Congress to agree to pay the bills when it decides to spend money, thereby limiting the potential for market disruptions.
2. Congress could provide the executive branch with the authority to raise the debt limit on its own, while reserving the power to stop the increase by passing a joint resolution.
3. Congress could dispose of the debt limit altogether, giving the executive branch broader power to borrow in order to pay for spending already approved by the Congress. This would mirror the arrangement currently used in New Zealand and the United Kingdom. See also: Economic Winter -- Implications of the Impending Collapse of the Fiat Paper Money System – February 20, 2015.

CLOSING LEVELS FOR FRIDAY JULY 10TH.		WEEKLY CHANGE
Dow Jones Industrial Average	17,760.41	+ 30.30 points
Spot Gold Bullion	$1,157.90 (U.S.)	– $7.80 per troy oz.
Spot Silver	$15.54 (U.S.)	– $0.12 per troy oz.
S&P / TSX Composite	14,411.07	– 271.32 points
10 – Year U.S. Treasury Yield	2.40%	+ 2 basis points
10 – Year Gov't. Canada Yield	1.68%	– 2 basis points
10 – Year Sovereign Yield Spread	72 basis points	+ 4 basis points
Canadian Dollar	78.87 cents (U.S.)	– 0.75 cent
U.S. Dollar Index Future	95.777	– 0.174 cent
WTI Crude Oil Futures	$52.74 (U.S.)	– $2.78 per barrel
DJIA / Gold Ratio	15.338	+ 0.128 point
Gold / Silver Ratio	74.511	+ 0.071 point

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