Monday April 13th, 2015

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

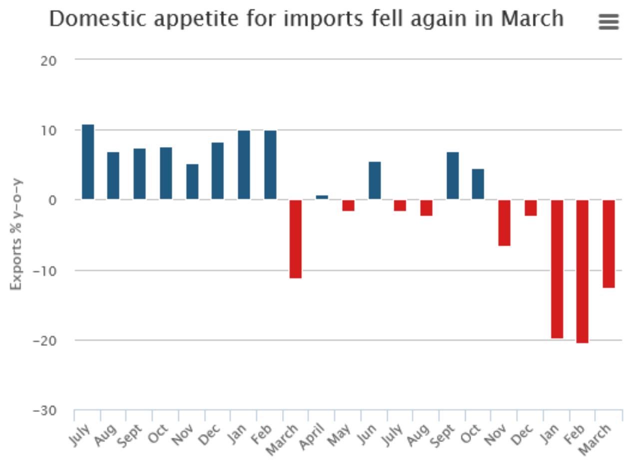
THAT WAS THE WEEK THAT WAS

Monday, April 13th

The General Administration of Customs reports China's exports contracted by 15% and imports declined by 12.7% in March on a year-over-year basis; resulting in a trade surplus of only $3.1 billion (U.S.) for the

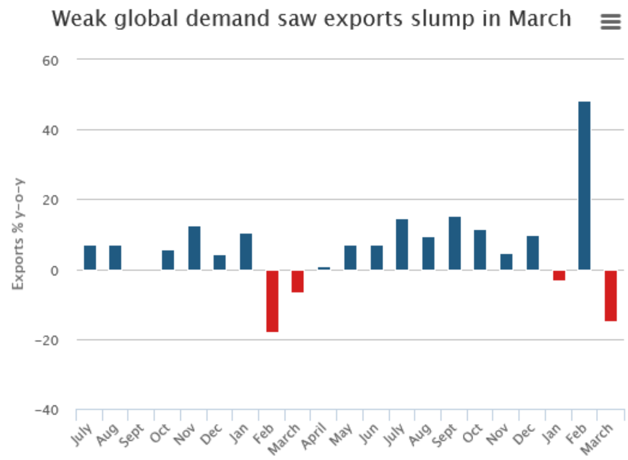
MONDAY, APRIL 13TH

month. Louis Kuijs, an economist at RBS in Hong Kong, commented: "The export figure in particular was much worse than expectations. It leads to warning flags both on global demand and China's level of competitiveness."

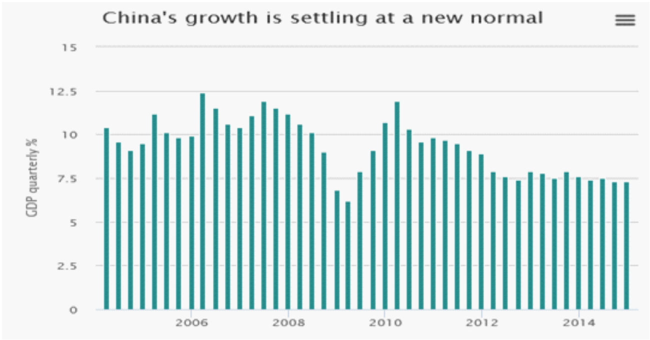


Source: Highcharts

Michael Hewson, an analyst at CMC Markets, observed: "These data misses raise concerns that, not only is the Chinese economy failing to rebalance with demand remaining low, but also, the global economy's demand for China's exports is also falling back, raising concerns about the state of the global recovery as well. A significant brake on China's gross domestic product (GDP) growth could now begin to ripple out across the globe."

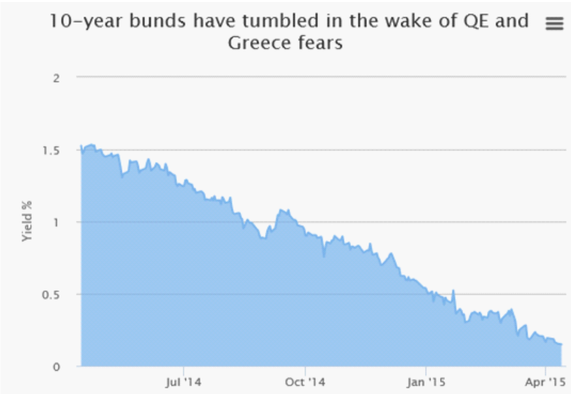


Source: Highcharts



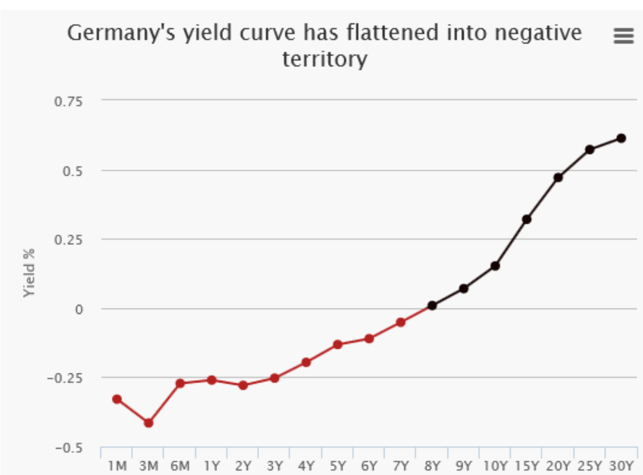
Source Highcharts

- Front Page Headline, Daily Telegraph U.K. – “Germany’s Sovereign Government Debt Becoming Overpriced. Columnist Mehreen Khan writes: Fixed income investors have been warned of the risks of holding German government debt, as an unprecedented European Central Bank (ECB) quantitative easing program sends the country’s 10-year bund yield towards zero. The 8-year bund yield has already veered into negative territory and is likely to be joined by 10-year bunds which now trade on a yield basis of 0.15%, down from 0.54% in January. See chart below.



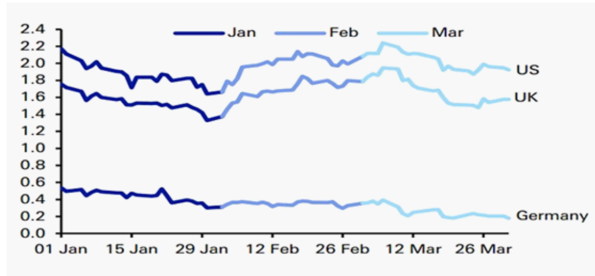
Source: Highcharts

However, analysts are warning the market for German government sovereign debt is now becoming dangerously overpriced. David Roberts of Kames Capital warns: ‘German bunds are vulnerable to a potentially poisonous cocktail of resurgent inflation and wage increases. If one looks at German bunds in any term other than the shortest possible maturity, the risk becomes very clear.’ Strategists at Bank of America Merrill Lynch warn: ‘A swift increase in German bund yields would burn many investors. We think German bunds look overpriced, given the strong real estate market, strong domestic economy and heightened risk in inflationary expectations.’



Source: Highcharts

Robert Kuenzel at Daiwa Capital Markets warns: ‘The ECB’s large-scale asset purchases are draining liquidity from euro sovereign bond markets.’ Divergent monetary policies between the ECB and the U.S. Federal Reserve have resulted in yields on euro zone debt pulling away from U.S. Treasury yields. See chart below.



Source: Deutsche Bank, Bloomberg Finance LLP

TUESDAY, APRIL 14TH

- The Commerce Department reports U.S. retail sales rose by 0.9% in March to a seasonally adjusted $441.4 billion (U.S.), following a revised decline of 0.5% in February, previously reported as a drop of 0.6%. Michael Feroli, an economist at J.P. Morgan Chase commented: “This outcome confounds all the standard consumer spending models. Job gains, wealth gains, low gas prices and very high consumer sentiment index readings would all point to solid consumer spending increases. Instead, American consumers’ high level of confidence seems only to be matched by their conservatism.”

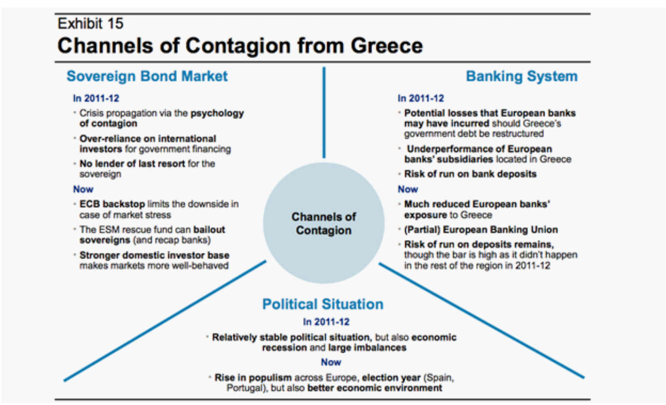
- Front Page Headline, Financial Times – “An Economic Future Which May Never Brighten. Reporter Martin Wolf writes: Initially, it seems to be a puzzling scenario and one might wonder whether it is possible at all: economic output can be at potential, but still not be sustainable. Yet a chapter of the International Monetary Fund’s (IMF) World Economic Outlook (WEO) illuminates just this scenario. Indeed, we may even be living in it now. Economic output is at potential when it does not generate inflationary or deflationary pressure … Output is financially sustainable when spending patterns and the distribution of income are such that the fruit of economic activity can be absorbed without creating dangerous imbalances within the financial system. It is unsustainable if generating enough demand to absorb the output of the economy requires too much borrowing and real rates of interest that are far below zero, or both.

To envisage how that predicament might arise, begin by imagining an economy which is balanced in the sense that the amount of money which households and businesses wish to save is exactly the same as the amount they wished to spend on physical investments … However, suppose growth of potential output then fell sharply. The level of desired investment would also decline because the necessary capital stock would be smaller. However, the amount that people wished to save might not fall, or not by as much; in fact, if people expect to be poorer in the future, they might even wish to save more. If so, real interest rates might have to decline sharply, in order to restore balance between the levels of investment and savings.

Such a decline in real interest rates might also trigger an increase in the prices of long-term assets and an associated surge in credit. These effects would offer a temporary remedy to the faltering demand. However, if the credit boom collapsed later, leaving borrowers struggling to refinance debt, demand would then operate under a double burden. The medium-term consequences of excess debt and a risk adverse financial sector would aggravate the longer-term consequences of the weaker potential gross domestic product (GDP) growth. The WEO illuminates one important aspect of such a story. Potential economic output, it argues, is indeed growing more slowly than in prior years. In the advanced economies, the output decline began in the early 2000; while in emerging economies, post 2009. See charts below.

Source: IMF

- Front Page Headline, Business Insider – "Greece Is Preparing for Default. According to The Financial Times, Greece is preparing to default on at least some of its outstanding debts. The country has entered a very dire fiscal situation. It desperately needs to unlock bailout funds from its creditors, however, progress negotiating those funds is slow at best. If Athens doesn't receive its next 7.2 billion euro ($7.58 billion U.S.) bailout tranche by the April 24th. at a Euro group meeting of the European finance ministers, default becomes considerably more likely and it seems as if the Greek government is already preparing for the worst … One government official has recently stated: 'We have come to the end of the road. If the Europeans won't release bailout funds, there will be no alternative to a default.' According to German media reports last weekend, Greece's creditors want a more solid and detailed plan of reforms, as well as an understanding regarding how such reforms would progress through the Greek parliament. To date, what plan has been presented by Greece is insufficient. The chart below reveals why euro zone officials may be less concerned about a Greek default now, since the risk of contagion to the rest of Europe is reduced.



Source: Morgan Stanley

The situation has deteriorated to the point where Morgan Stanley analysts believe: 'Unfortunately, continued Greek full membership in the European Monetary Union (EMU) has become an outside scenario for us, with a subjective probability of only 40%. Either an exit from the euro or a suspension of the membership via the introduction of capital controls instead, seem more likely to us; with a subjective probability of 25% and 35%, respectively. Given that we foresee the risk of Grexit rising to 60% once the country is forced to impose capital controls, we compute a total probability of 45% for a Grexit."

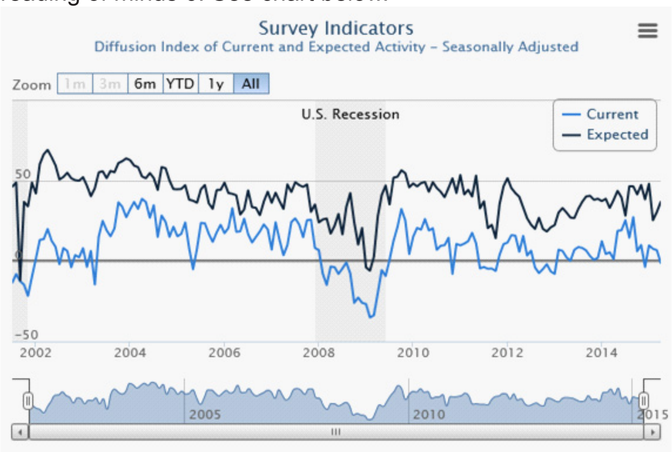
- The Labor Department reports the U.S. producer price index (PPI) rose by 0.2% in March, following four consecutive months of declines, citing: while energy prices rose by 1.5% in March, wholesale food prices fell by 0.8%, declining for the third consecutive month.

WEDNESDAY, APRIL 15TH

- Statistics Canada reports the nation's manufacturing sales declined by 1.7% in February, citing lower automobile and aerospace sales, following a downwardly revised January sales calculation of a 3% decline; previously reported as a 1.7% gain. In a research note, Krishen Rangasamy, an economist at the National Bank of Canada in Montreal, commented: "The Canadian factory data was very disappointing, additionally considering the sharp downward revision to the prior month. Real factory shipments have declined by about 5% during January and February, the biggest two-month drop since the last recession."

- The U.S. Federal Reserve reports U.S. industrial production declined by 0.6% in March, following a 0.1% increase in February. Over the 1st. quarter, industrial production fell at an annual rate of 1%; the first quarterly decline since the 2nd. quarter of 2009. Most of the decline in the 1st. quarter resulted from a significant drop in the drilling and servicing of oil and gas wells in excess of 6% at an annual rate.

- The Federal Reserve Board of New York reports its Empire State Manufacturing Index declined to a reading of minus 1.2 in April from a level of 6.90 in March. The new orders index remained negative for the second consecutive month, falling 4 points to a reading of minus 6. See chart below.



Source: Federal Reserve Board of New York

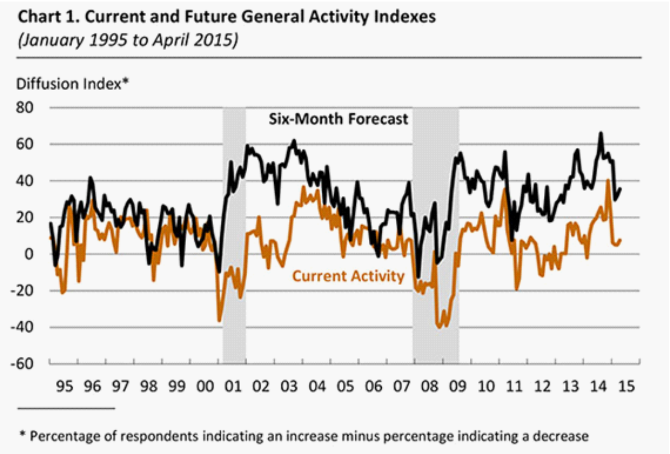
- The National Association of Home Builders (NAHB) / Wells Fargo group reports U.S. builder confidence for newly built, single-family homes rose by 4 points in April to a reading of 56 in its housing market index (HMI). NAHB Chairman Tom Woods, a home builder in Blue Springs, Missouri, noted: "As the spring buying season commences, home builders are confident that current low mortgage rates and continuing job growth will draw consumers into the housing market."

THURSDAY, APRIL 16TH

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 12,000 to a seasonally adjusted 294,000 in the week ended April 11th. while continuing claims declined by 40,000 to 2.27 million in the week ended April 4th.

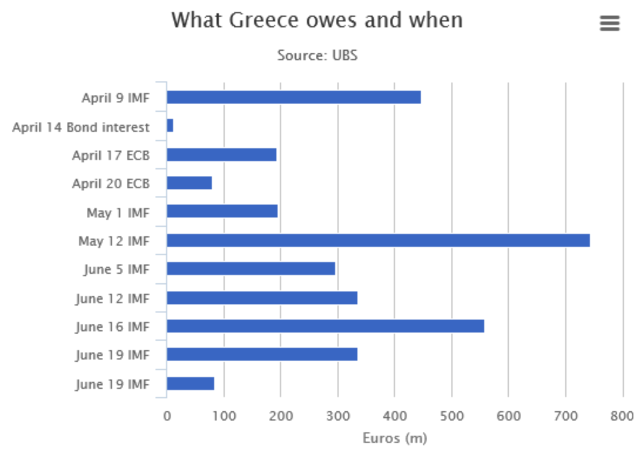
- The Commerce Department reports U.S. housing starts increased by 2% in March to a seasonally adjusted annual pace of 926,000 units, following a revised rate of 908,000 units in February, previously reported as 897,000.

- The Federal Reserve Bank of Philadelphia reports its manufacturing business outlook index rose to a reading of 7.5 in April from a level of 5.0 in March, citing the survey's current new orders index as virtually unchanged.



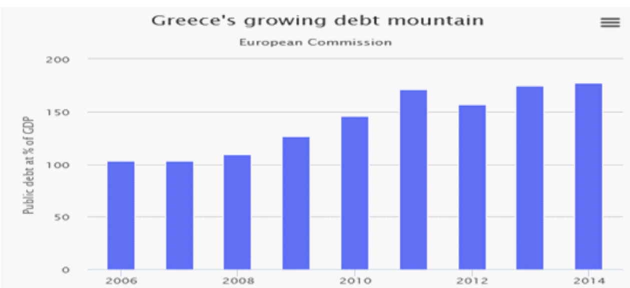
Source: Federal Reserve Bank of Philadelphia

- Front Page Headline, Daily Telegraph U.K. – "Greek Government Mulls Compulsory Transfer of Cash Reserves from State-Owned Enterprises. Greece has received no emergency funds from its European creditors since August 2014, but faces a 2.5 billion euro loan repayment to the International Monetary Fund (IMF) in the May/June period. While Greek officials had reportedly made an informal request to delay loan repayments to the IMF, Christine Lagarde, the IMF's managing director, acknowledged: 'Repayment delays would mean additional contributions by the international community and some of those countries are in more dire straits than the one seeking delays.' Greek Prime Minister Alexis Tsipras disclosed: 'There remain four areas of disagreement over the country's reform program, including labour relations, the social security system, the VAT increase and the rationale regarding the development of state property.'



Source: Daily Telegraph U.K.

According to the Hellenic Statistical Authority, Greece's public debt reached 177% of gross domestic product (GDP) in 2014, or 317 billion euros, up from 154% of GDP in 2012.

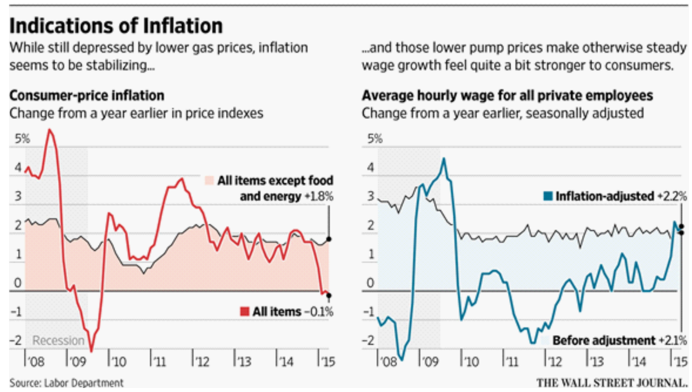


Source: Daily Telegraph U.K.

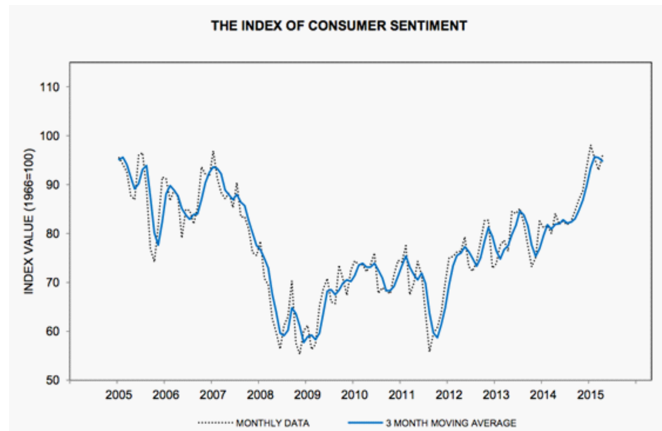
FRIDAY, APRIL 17TH

- Statistics Canada reports the nation's retail sales rose by a seasonally adjusted 1.7% in February, with gains recorded in all eleven sectors, led by a 2.2% increase in gasoline sales. Separately, Statscan reported the country's consumer price index (CPI) rose by 1.2% in March, following a 1% increase in February. In a research note, CIBC World Markets economist Nick Exarhos observed: "Today's economic data suggest that the Bank of Canada's zero percent gross domestic product (GDP) growth forecast for the 1st. quarter is perhaps too pessimistic. Another Bank Rate reduction by central bank Governor Stephen Poloz is now much less likely."

- The Labor Department reports the U.S. consumer price index (CPI) rose by 0.2% in March, citing broadly-based gains in rents, medical care, clothing and used vehicles. The core CPI, excluding food and energy, rose by 1.8% on a year-over-year basis. See charts at the top of the next column.



- The University of Michigan preliminary April consumer sentiment index rose to a reading of 95.9 – its second highest level since 2007 – following a level of 93.0 in March. See chart below.



Source: Business Insider.

- Front Page Headline, GoldMoney – "The Overvalued U.S. Dollar. Researcher Alasdair Macleod writes: There are two connected reasons usually cited for the current U.S. dollar strength: the American economy is performing better than all the others, leading towards relatively higher U.S. interest rates and this is triggering a scramble for U.S. dollars by foreign corporations with uncovered U.S. dollar liabilities. There is growing evidence that the first of these reasons is no longer true, in which case the pressure to buy U.S. dollars should lessen considerably. In arriving at this conclusion, we must be careful not to limit our thinking to the U.S. dollar exchange rate against other currencies. Arguably, they are in an even worse position, with quantitative easing programs active in both Japan and the euro zone failing to resuscitate industrial life, while the U.K. is in the middle of a heated election campaign. Instead, we should think in terms of the U.S. dollar's purchasing power for goods and services. Here the market is already skewed to one side: the public prefers to hold U.S. dollars and reduce debt rather than spend freely. This is because the consensus is that the consumer goods prices are not rising, ergo inflation is dead and buried.

Such unanimity is always dangerous and the mainstream fails to notice that far from an inflation free economic recovery, U.S. gross domestic product (GDP) growth appears to be stalling badly. This is hardly surprising since private sector credit remains tight. Depending on whose figures one uses, total American debt is estimated to be in the region of $57 trillion (U.S.), an increase of about $4 trillion (U.S.) since the banking crisis of 2008. However, federal government and state debt held by the public has increased by $6.7 trillion (U.S.) and large corporations have borrowed a further $2.3 trillion (U.S.) to buy back shares. Meanwhile, financial debt – which includes asset-backed securitizations of consumer debt – has declined by about $4 trillion (U.S.), while consumer debt directly held has fallen slightly. These rough figures suggest that credit for households and smaller businesses remains constrained.

Since mid-2014, financial markets have undergone a sea change, with the U.S. dollar strengthening sharply against the other major currencies and the price of oil collapsing along with the prices of a number of key industrial commodities. The Baltic Dry index—a measure of shipping demand – has recently declined to the lowest level ever recorded. Admittedly, there is a glut of ore carriers helping to drive shipping rates down, but there can be no doubt that trade volumes are down as well. Also, there has been hard evidence displayed with China's imports and exports having recently declined sharply.

Common sense says that from the middle of 2014 the world, ex-America, entered the early stages of an economic slump. Obviously, common sense took its time to grasp the U.S. reality, since it is only within the last month that mainstream economists have begun to cautiously downgrade their GDP forecasts. It is now impossible to ignore the confirmations which are arriving thick and fast. This week alone has seen inventories stuck on the shelves, small business optimism declining and the National Association of Credit Managers reporting serious financial stress and that was only on Monday and Tuesday. This is the background against which we must assess future U.S. dollar denominated prices.

Conventional wisdom would have us believe that an economic slump leads to an increased demand for cash as businesses are forced to pay down their debts. Essentially, this is the Irving Fisher debt deflation theory from the 1930s. It is for this reason that modern central banks exist and they stand ready to create as much money as may be required to prevent this from happening. Let us assume that they succeed. We then must consider another factor, which is the progress of monetary hyperinflation, since this becomes the underlying condition driving U.S. dollar prices. Central banks can nearly always debauch their currencies with impunity. Automatically, people think that money is stable and generally do not draw the conclusion that an increase in the level of prices is connected to an expansion in the quantity of money and credit. While they often admit that money buys less today than it did thirty or forty years ago and they are aware of the consumer price index trend, they may fail to appreciate that money can and does change its purchasing power from day to day. The result is they attach changes in prices not to money, but to factors affecting individual goods.

There are several factors which affect prices, one of which is an increase in the quantity of money, when that new money is spent on the goods being considered. Obviously, if the new money is not spent on consumer goods, but hoarded or spent on something else, an increase in the quantity of money will not lead to higher prices for items in a consumer price index. More importantly, however, prices are inherently subjective, which is why one cannot forecast tomorrow's prices. If you find this difficult to accept, just look at the average stock trader's record. If he is very good, he might have a 10% edge, but even then, he cannot tell you the levels tomorrow's stock prices. Subjectivity of prices is the consequence of changing preferences for money relative to individual goods. In the current economic climate with its restricted credit, people are understandably cautious about spending, which means their preferences for money is relatively high. However, not everyone shares the same preferences. Moreover, they are likely to be different across a variety of classes of goods as well, with commodities and raw material prices behaving differently from the prices of finished goods, even though they are linked.

To date, price increases due to monetary inflation have been generally restricted to financial markets and associated activities. Early speculators have done very well, with today's buyers being forced to pay considerably higher prices for the same investments. Despite this obvious phenomenon, speculators do not usually understand that it is the swing in preference from money towards financial instruments that is behind the current rise in prices. However, what if this relative preference begins to swing in favour of commodities? The swing in preference has meant the price of oil in U.S. dollars has already risen by 25% in recent weeks, or alternatively, one can say the purchasing power of the U.S. dollar has fallen by that amount. Copper, the commodity which should be collapsing as we go into a slump, has also risen, this time by 15% over the last two months.

Commodity traders who look at the charts will tell you that these are normal corrections in a bear market for the commodities involved. But how can this be, when we are entering a deflationary slump? The answer is simple: there has been a change of preference with respect to oil, where buyers value oil more than U.S. dollars and also for copper. This should not be confused with an increased desire to own oil and copper; rather, it is a reduced desire to hold U.S. dollars relative to these two commodities. If the idea that the U.S. dollar is weakening spreads from selected but economically important commodities, it could begin to alter the balance of preferences more generally, for which almost everyone is ill prepared. How long the process takes, we cannot know until it happens; but if the general public realizes it is the U.S. dollar's purchasing power going down instead of goods prices rising, it will be very difficult to stop its purchasing power from collapsing entirely."

CLOSING LEVELS FOR FRIDAY, APRIL 17 TH.		WEEKLY CHANGE
Dow Jones Industrial Average	17,826.30	– 231.35 points
Spot Gold Bullion	$1,203.10 (U.S.)	– $1.50 per troy oz.
Spot Silver	$16.23 (U.S.)	– $0.25 per troy oz.
S&P / TSX Composite	15,360.55	– 27.88 points
10 – Year U.S. Treasury Yield	1.87%	– 8 basis points
Canadian Dollar	81.78 cents (U.S.)	+ 2.29 cents
U.S. Dollar Index Future	97.446	– 1.835 cents
WTI Crude Oil Futures	$55.74 (U.S.)	+ $4.10 per barrel
DJIA / Gold Ratio	14.481	– 0.51 point
Gold / Silver Ratio	74.128	+ 1.033 points

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