Monday April 20th, 2015

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, April 20th

Front Page Headline, Wall Street Journal – "U.S. Congress Appears to Be Shying Away from Spending Curbs. Reporter Nick Timiraos writes: At first glance, fiscal austerity remains the order of the day in Congress, where Republican leaders are working

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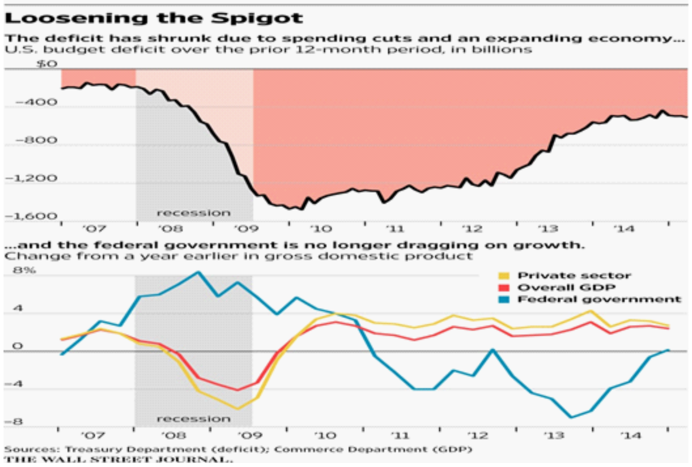
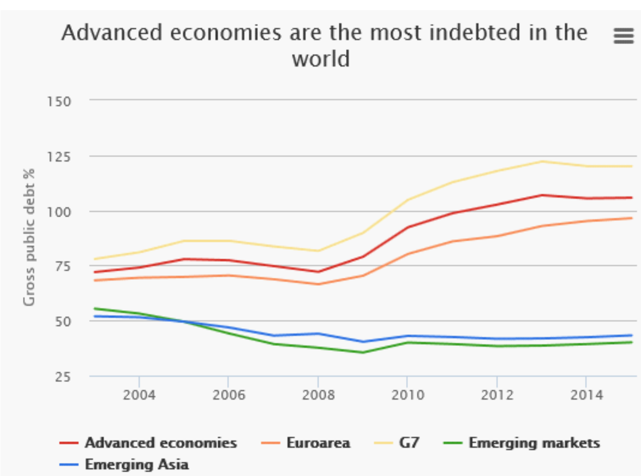
to complete a budget that would reduce $5 trillion (U.S.) in projected spending over the next decade. A closer look reveals signs that the era of spending restraint is easing. Alec Phillips, a political economist at Goldman Sachs, observes: 'Congress is finished cutting spending and if anything is more likely to add to it.' Firstly, in order to boost military funding, in March House Republicans approved a back door way to eradicate the across-the-board spending curbs – known as the sequester – which Congress approved in 2011. Many Republicans have stated that the 0.2% increase in military spending permitted under the sequester for the fiscal year 2016 is insufficient.

President Barack Obama also wants to boost the defense budget, but has indicated that any increases must be matched by an equal amount in non-military spending. To obviate that, Republicans would increase a separate account for war spending – which isn't subject to the sequester – by $38 billion (U.S.), essentially matching the 7% increase proposed by the White House. Representative Mick Mulvaney (R., S.C.) noted: 'We broke the spending caps and then lied about doing it. When it comes to spending, we seem to have lost our focus.' Secondly, just last week lawmakers overwhelmingly passed a bipartisan agreement to set new formulas in order to calculate the way physicians and other health providers are paid when they treat patients on Medicare, i.e. the federal health program for the elderly and disabled. The change ends more than a decade of legislative measures for a system which had repeatedly threatened to reduce doctors' remuneration levels. The affirmative votes faced little opposition even though the agreement adds $140 billion (U.S.) to the budget deficit over ten years. Only eight of 100 senators voted against the bill, together with 37 of 435 House members.

The measure does include a provision to shift some costs onto higher income Medicare beneficiaries, which Republican leaders believe made the agreement an initial step toward a broader overhaul of entitlement programs. Nevertheless, Maya McGuiness, president of the Committee for a Responsible Federal Budget which advocates debt reduction, commented: 'Adding to the budget deficit is completely at odds with the budget which was just passed.' So, why are fiscal restraints easing? Realistically, the budget deficit has shrunk considerably over the last six years due to spending reductions and an improving economy which has generated more revenue. Moreover, lawmakers are finding that years of spending reductions are beginning to exert more bite, especially at the Pentagon. On the current path, defense spending as a share of gross domestic product (GDP) will decline by 2025 to its lowest levels in more than sixty years; a trend which Defense Secretary Carter termed 'dangerous' in a recent speech. According to the Congressional Budget Office (CBO), budget deficits are expected to hover around 2.4% of GDP over the next three years; below the annual average of 2.7% for the past 40 years. However, the CBO is forecasting that budget deficits will grow again after 2017, as Medicare and Social Security spending increases to support significantly more baby boomer retirees."

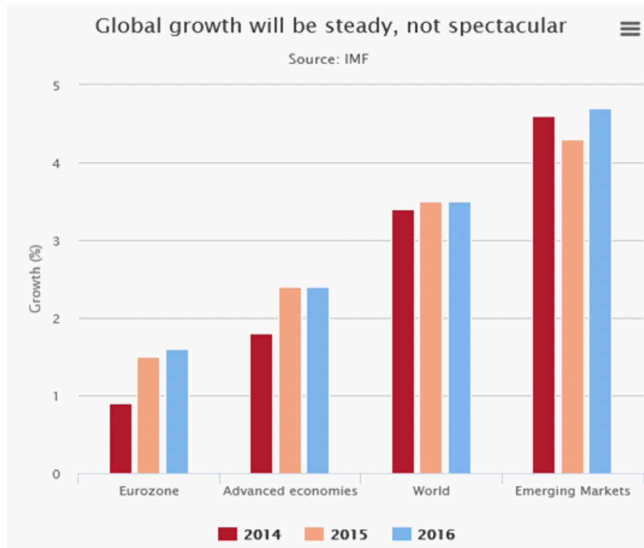


- Front Page Headline, Daily Telegraph U.K. – "Caveat Creditor as the IMF Mulls Unpayable Debts. The International Monetary Fund has literally sounded the alarm on the exorbitant levels of debt across the world. The theme trailer to its fiscal forum on the 'political economy of high debt' plays on our fears with the haunting tension of an Alfred Hitchcock thriller. An early 1800's quote from Thomas Jefferson flashes across the screen in blood-red colours: 'To preserve their independence, we must not allow our rulers to load us with perpetual debt.' We learn that public debt in rich economies declined from 124% of gross domestic product (GDP) at the end of the Second World War to 29% in 1973; a dream era which we have left behind. Since then, the debt burden has climbed at a compound 2% rate per annum, accelerating into an upward spiral to 105% of GDP after the Lehman crash in 2008. It is as if we had fought another world war.



A baby boom and surging work force enabled us to grow out of debt in the 1950s and 1960s without noticing it. No such outcome looks plausible now.

The IMF's World Economic Outlook describes a prostrate planet caught in a low-growth trap as the population ages across the Northern Hemisphere and productivity sputters. Nor is this malaise confined to the West. The fertility rate has collapsed across the Far East. China's work force is shrinking by three million people a year. The report warns of a 'persistent reduction' of the global GDP growth rate since the great recession of 2008-2009 with no sign yet of a return to normal: 'Moreover, lower potential GDP growth will make it more difficult to reduce high public and private debt ratios.'



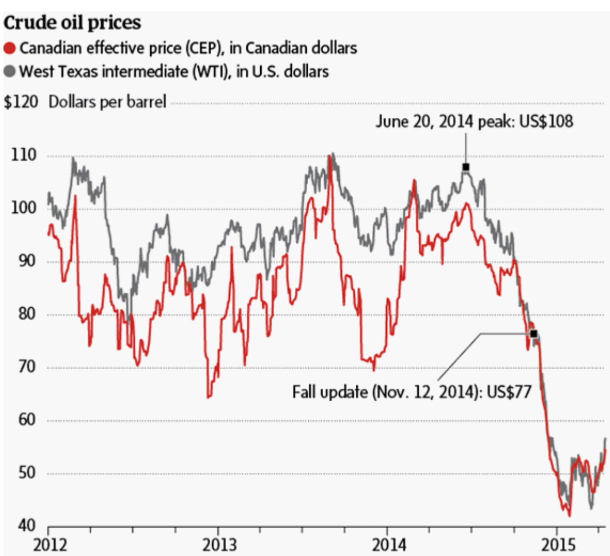
The whole world has been drawn deeper into a Faustian Pact. Total public and private debt levels have reached a record 275% of GDP in rich countries and 175% in emerging markets. Both are up 30 percentage points since the Lehman crisis. Nobody knows for such whether this is benign, or how it will end. The haunting fear this year for the IMF lords of global finance is that the debt may never be repaid. Caveat creditor."

TUESDAY, APRIL 21ST

- Front Page Headline, Globe and Mail – "Canada's Fiscal 2016 Budget Focuses on Manufacturing and Small Business. In his federal government budget speech delivered in the House of Commons, Canadian Finance Minister Joe Oliver stated: 'Some have questioned the role of the manufacturing sector in Canada's future economic success. We do not. For this government, the words Made in Canada continue to fuel pride and inspire confidence. Today, I am announcing a 10-year extension of the accelerated capital cost allowance, which allows companies to take generous write-offs for new equipment. This measure will cost $1.1 billion (CAD) over the next four years.' Avery Shenfeld, chief economist at CIBC, commented: 'The manufacturing sector is the one we're relying on to enable stronger growth in the country's gross domestic product (GDP), particularly if … the resource bounty is not as generous as we thought it would be. The tax incentive is a useful hand of support to those manufacturers who are prepared to increase their investment in capital equipment that is necessary to enhance productivity.

I am also announcing that the government will gradually reduce the small business tax rate from 11% to 9% beginning in 2016. This will represent the largest tax rate cut for small businesses in more than 25 years and will save small businesses $2.7 billion (CAD) over four years. We have cut taxes and slashed red tape and will continue to do both.' Small businesses will also benefit from a new financing support – to be administered by Export Development Canada – in order to assist them to reach markets in developing countries.

Jason Myers, CEO of the Canadian Manufacturers and Exporters Association observed: 'The Canadian tax system is now considerably more attractive for new investment than the United States or Germany.' Canada's marginal effective tax rate for new investment in manufacturing will be 9.1% in 2016, compared with 31.7% in the United States and 26.4% in Germany."

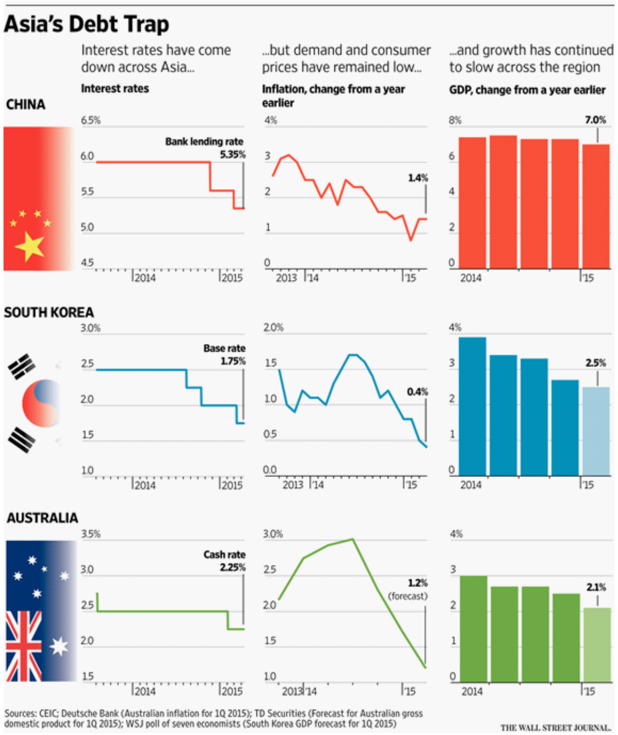


Source: Federal Budget

- Statistics Canada reports the value of Canadian wholesale trade declined by 0.4% in February to $53.62 billion (CAD); its lowest level in six months, following a revised 2.9% drop in January previously reported as 3.1%. The building materials and supplies subsector recorded the largest decline in dollar terms in February, falling by 2.7% to $7.45 billion (CAD) on widespread weakness. Sales in the motor vehicle and parts subsector declined by 1.4% to $8.81 billion (CAD), their lowest level in 10 months. In all, sales fell in three of the seven subsectors accounting for 51% of the wholesale trade total.

- Front Page Headline, Wall Street Journal – "Asian Debt Soars, Threatening GDP Growth. While Asian countries borrowed heavily in order to maintain gross domestic product growth during the financial crisis, they couldn't break the habit even as the global economy began to recover. Now they are feeling the hangover. GDP growth is slowing fast across the continent as consumers and businesses focus on repaying debt. While central banks have reduced administered interest rates pushing currencies lower, Asian economies haven't rebounded. Demand has remained weak, keeping wages stagnant and price advances anemic, making debts even more difficult to repay. This dynamic could adversely affect the region's economic prospects significantly, potentially dragging down global GDP growth rates. Paul Sheard, chief economist for Standard and Poor's Ratings Services (S&P), noted: 'The problem is that people have already assimilated too much debt. Even if administered rates go to zero, people are not going to borrow money.'

  Half of global debt issued over the past seven years went to emerging market economies, much of it to Asia. According to the McKinsey Global Institute, China alone accounted for about one third of the increase in debt globally since 2007. Debt levels in several Asian countries, such as China, Malaysia, Thailand and South Korea, are higher than they were before the Asian financial crisis of the late 1990s. Some countries, such as South Korea, Malaysia and Australia, have household debt-to-income levels greater than the U.S. had prior to its financial crisis. Countries in the region had been careful about debt after the pain of the Asian crisis. That allowed them to borrow in order to maintain GDP growth and serve as a buffer for the rest of the world during the global financial meltdown. However, Asia kept borrowing even after the crisis. There is an element of irony in Asia's debt binge. The U.S. debt boom that led to the financial crisis was made possible in part by low interest rates caused by high savings rates in Asia. Countries in the region, particularly China, gobbled up U.S. Treasurys, driving down bond yields in the broader economy. Today, super loose monetary policies in the U.S., Europe and Japan have caused cash to flood into Asia. Yield-hungry investors have driven down bond yields, allowing governments, companies and individuals to borrow huge amounts at record low rates.

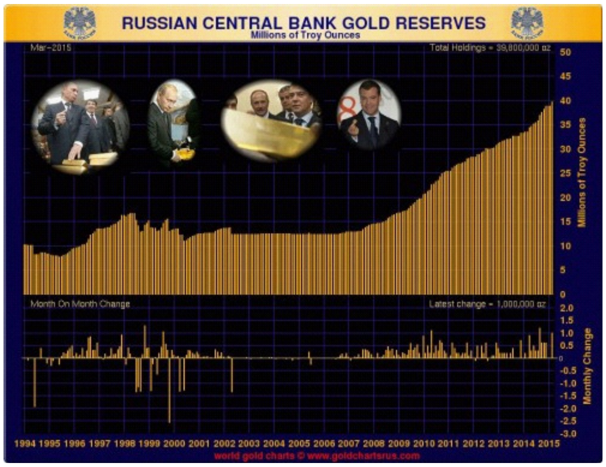


The borrowing has played out differently across the region. In China, giant state-owned businesses, real estate developers and local governments loaded up on debt. In Malaysia and Thailand, it was consumers who borrowed to fund the trappings of a middle class lifestyle, such as in cars and appliances.

Commodities producers across the region assumed debt in the belief that surging demand and high prices would create huge payoffs for speculative investments. In Japan, the government continued to live beyond its means, pushing the economy's already high total debt to 400% of annual GDP, by far the highest level in the world. Even excluding Japan, debt in Asia rose to 205% of GDP in 2014, compared to 144% in 2007 and 139% in 2006, just prior to the Asian financial crisis, according to calculations by Morgan Stanley. In China, total debt rose to $28.2 trillion (U.S.) in mid-2014, or 282% of GDP, up from $7.4 trillion (U.S.) in 2007, according to McKinsey. The ratio is 269% in the United States.

- Front Page Headline, Mineweb – "Russian Central Bank Gold Purchases Renewed with a Vengeance. According to a Russian central bank announcement on its latest gold reserve position, it appears that Russia added one million ounces of gold bullion (31.1 metric tonnes) to its holdings during March after a two month hiatus, bringing its total reserves to 39.8 million ounces (1,237.9 metric tonnes). There had been speculation that Russia had been reducing its gold purchases due to the economic difficulties related to the lower price for crude oil and western sanctions. While the lack of any increase in the early months of the year is a familiar pattern, the March increase represents the highest seen since last September when the central bank added 1.2 million ounces (37.3 metric tonnes), which itself was the largest monthly total in sixteen years. The big March gold reserve addition could thus be a signal that Russia is strongly returning to its gold buying spree.

  Russia's strong gold buying pattern over recent years – it purchased about 150 metric tonnes in 2014and 77 metric tonnes in 2013 – is being interpreted as a potential geopolitical weapon and a way of adding credibility to its currency position. This is in the face of what it sees as a major attack on the ruble by the U.S.-led West over its moves seemingly designed to destabilize the new Ukraine government and persuade it to neither pursue membership in the European Union nor NATO, which Russia deems would be a threat to its national security.



Source Mineweb

- Front Page Headline, Mish's Global Economic Trend Analysis – "Pending Pension Crisis. In general, pensions in the State of Illinois are 39% funded, even after the massive rally we have experienced in financial assets since 2009. Some of the pension funds in the worst shape are only about 20% funded. While various cities in Illinois have pension problems, the City of Chicago has a huge pension crisis right now … I have been working with the Illinois Policy Institute on pension and bankruptcy issues. While there are a number of cities in Illinois that are ready to file for bankruptcy, the State disallows it. The fundamental problem is these cities have made more promises than they can possibly keep. Moreover, there is the problem that both policemen and firemen can retire after 20 years' service and collect up to 70% of their earnings based upon the five highest year's salaries. There was a lot of pension spiking over the last few years where policemen worked overtime – which counts towards their best five years – so these workers stand to collect far more in retirement than they actually earned while working. Taxpayers are actually funding the employees' portion of the pensions via excessive wages and direct contributions.

Chicago has issued General Obligation Bonds to fund current expenses, which is illegal. There are bonds outstanding in Illinois which are tax exempt on the basis that they are supposed to be funding long-term infrastructure expenses, but are actually funding short-term needs. Taxes in Illinois are already obscene. A homeowner with a $600,000 (U.S.) property can expect to pay up to $15,000 (U.S.) per year for property taxes … Pensions are so underfunded in Illinois that they will likely go bust in the next economic slowdown. Meanwhile, negative bond yields are sweeping the globe. How will states, cities and towns fund themselves and their pension obligations in an era of potentially negative nominal bond yields?"

WEDNESDAY, APRIL 22ND

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Front Page Headline, Bill Holter – "Greecing the World. Bill Holter writes: Soon to be front page news again will be Greece and its insolvency. The question will remain (for a time) whether or not Greece remains in the European Monetary Union (EMU), leaves by choice or gets asked to leave. I am not even certain if being forced out is a legal option. The latest news is a claim that Greece will be funded with a monthly credit card payment of 5 billion euros by Russia … then later denied by Russia. The other news was 'federal Greece' after raiding pension plans, is now confiscating local reserves for 'the good of the nation.' The populace is becoming very antsy as demonstrations and violence have begun to erupt again.

Let's look at the second piece of news first since it was the most predictable, as was the reaction. Of course, confiscation of balances was going to occur sooner or later. Not only was this a given, but it was also a given to spread elsewhere. History is strewn with precedent where bankrupt governments scratch and claw at anything they can … so did anyone not expect this? Greece is mathematically broke and is in the same boat as a homeowner who lost his job. Greek officials are digging into retirement balances, the credit cards have all maxed out, they have already borrowed from relatives and are in the process of selling their furniture and anything else not nailed down. They are broke and any monies loaned to them might as well have been placed on a bonfire for the heat value because they will not be repaid.

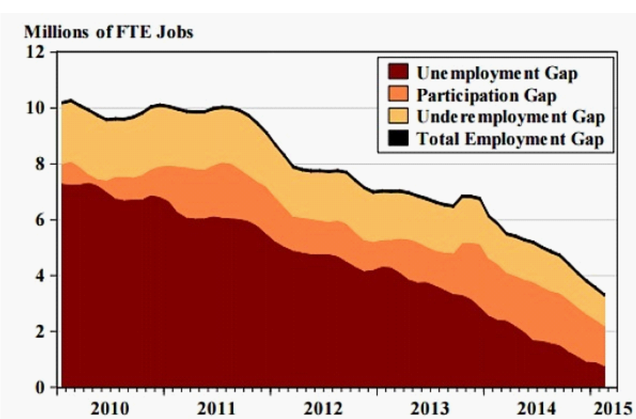
This leads us to the 5 billion euros Russia allegedly will forward or lend to Greece. If this is true, it's another masterful move by Mr. Putin. NATO sanctions will expire within the next sixty days and must be voted upon unanimously in order to be renewed. Perhaps Mr. Putin has pulled a page right out of American politics … just buy a vote and continue on down the road? I suspected this would happen and even though it buys a little time and if true, it does not change the big picture at all. Greece is broke! It cannot and will not ever repay what has been borrowed, especially post 2012 debt. One way or another, Greece will default sooner rather than later. So why does tiny Greece matter to anything in the grand scheme? Referring back to my last article, 'The Mother of All Margin Calls' is at the root of it. Even to this day … Greek debt is carried on the books of bank portfolios at par. It doesn't matter that trades take place at 50% of par or much less, because Greek debt is used as tier one capital and herein lies the problem.

Let's examine this from two different angles, firstly from a carrying standpoint and secondly, from a lending standpoint. They both arrive at the same ugly destination but via different routes. French and German bank portfolios are stacked with Greek sovereign debt and if these holdings were marked even close to present value, the losses would be staggering. Remember this is tier one capital, considered as good as gold. How will they replace the holes punctured into their collateral structure? I would also remind you that the European Central Bank (ECB) itself holds 100 billion euros worth of Greek debt. How does the issuer of the currency account for a 50% haircut, or even a complete wipeout? From where will the new capital be sourced? Remember, margins are already razor thin and in some cases undercapitalization exists even with this fake accounting. Of course, this will hit home with the Greek banks themselves. Looking at this from another angle, since the Greek debt is tier one capital, banks can an already have loaned amounts of up to ten times present value off the Greek debt. The problem is not just the write down and the need to raise new capital, much of what has been loaned out will need to be redeemed at a discount. What does this do to the markets and the real economy? Obviously, forced sales of financial instruments will occur, as well as real businesses closed.

A death spiral is caused both financially and economically which will not be stopped and will only spread like a wildfire! The one additional angle to examine is the derivatives created from the Greek debt. Looking at credit default swaps (CDS), there is no doubt that someone will have to pay when the insurance is claimed. In many instances, CDS happens to be ten times or more of the underlying debt itself; so these 350 billion euros may very well have insurance outstanding of 3.5 trillion euros. Who has this kind of money to settle up? In many cases, European banks, which actually holding Greek debt in their portfolios, are also issuers rather than buyers of CDS. This is called a 'Texas Hedge' with double or more exposure!

Going full circle, we looked at the Fed's reverse repo agreements spiking in volume. This can only be explained by the need for collateral for the financial system. What will a Greek default do? It will create the need for even more collateral and lots of it to keep the façade of solvency intact. Although Greece is not a big player, think of it as a minor repair for the car for the couple who have maxed out all avenues of credit. Even a small hiccup is enough to upset this margined cart because of insufficient capital. Greece fit the description! It is by no means all by itself, since the entire financial system is Greece to one extent or the other. Greece is the only canary which will expose and impose margin calls across the globe. I would like to mention one more canary in this coal mine, i.e. bookies are no longer taking bets on Greece's default and exit from the euro zone!"

- Front Page Headline, Washington Post – "Economists Have Discovered How Bad U.S. Unemployment Really Is. Wonkblog reporter Matt O'Brien writes: The U.S. Labor Department's unemployment data doesn't reveal the full story. All it discloses is how many people are actively looking for work, but can't find it. However, it omits the 'shadow unemployed' who want full time jobs but have either given up looking for them, or can only find part-time jobs … According to economists Danny Blanchflower and Andrew Levin, this shadow unemployment information means the U.S. jobs hole is three times as big as it would appear … So, instead of being one million full-time jobs short, as the unemployment rate states, the U.S. economy is about 3.5 million short. See chart below.

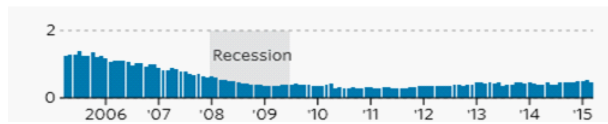


Source: Blanchflower and Levin

THURSDAY, APRIL 23RD

- The Commerce Department reports U.S. new home sales declined by 11.4% in March to an annualized pace of 481,000 units, a four-month low; following an upwardly revised February level of 543,000. Michael Feroli, an economist at J.P. Morgan Securities in New York, commented: 'While there are opposing forces at work in the domestic housing market, the overall trend still looks reasonably favourable. On the positive side are low mortgage rates and improving job growth, which are being countered by a limited supply of available homes and lingering tight lending standards.'

U.S. New Homes Sales over the Past 10Years in Millions

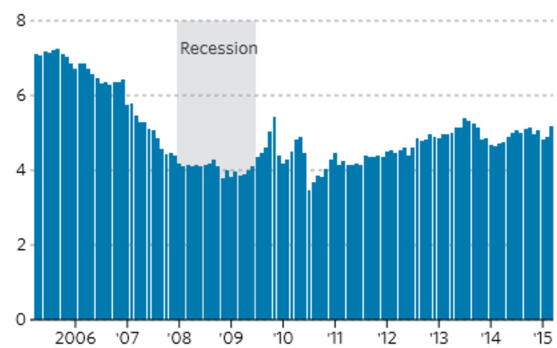


Sources: National Association of Realtors / Federal Reserve Bank of St. Louis

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 1,000 to 295,000 in the week ended April 18th., while continuing claims rose by 50,000 to 2.33 million the week ended April 11th.

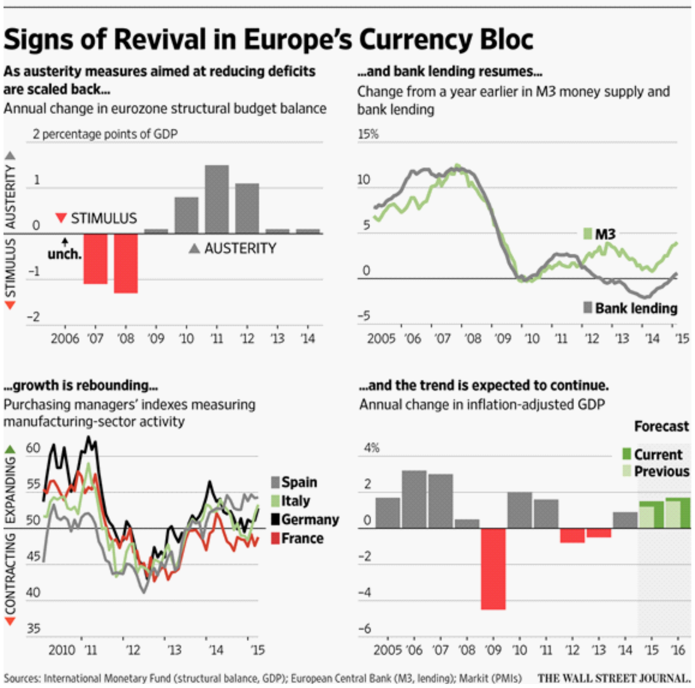
- The National Association of Realtors (NAR) reports U.S. existing home sales rose by 6.1% in March to a seasonally adjusted annual pace of 5.19 million units, the highest level since September 2013.

U.S. Existing Home Sales over the Past 10 Years in Millions



Sources: National Association of Realtors / Federal Reserve Bank of St. Louis

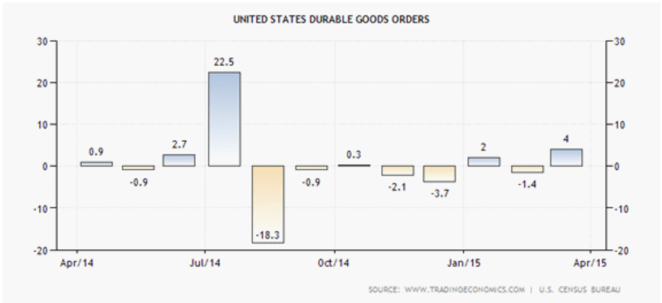
- Markit Economics reports its euro zone composite purchasing managers' index (PMI) declined slightly to a reading of 53.5 in April from a level of 54.0 in March. Jessica Hinds, an economist at Capital Economics in London, observed: "There is a clear risk that the euro zone composite PMI may fall further, as concerns about the situation in Greece and a possible euro exit intensify; raising the threat of a renewed economic slowdown." Marco Valli, an economist at Italy's Unicredit, noted: "European Monetary Union (EMU) data available to date suggest periphery countries have done comparatively well, with a good probability that their PMIs may reveal resilience when they are published in early May."



- Markit Economics reports the preliminary Purchasing Managers' Index for Manufacturing declined to a reading of 54.2 in April, from the final March level of 55.7. Chris Williamson, Markit's chief economist, commented: 'While American economic growth has clearly slowed in 2015, the goods producing sector is by no means collapsing under the strong U.S. dollar. Consequently, fears of a sharp economic slowdown look somewhat overplayed."

FRIDAY, APRIL 24TH

- The Commerce Department reports U.S. durable goods – those expected to last at least three years – orders rose by 4% in March, citing healthy sales of motor vehicles, computers and electrical equipment.



- Front Page Headline, Bill Holter – "Debt Is Better than Cash? Researcher Bill Holter writes: Last year puzzlement began wherein various bonds, bank accounts and even mortgages were being transacted with negative interest rates. How do any of these make sense? One pays the sovereign or corporate borrower in order to lend money to them … Wouldn't it be better just to take your money out of a bank or a brokerage house in order to avoid the negative interest and just bury it in a hole somewhere … I view what is occurring now as eating into the bone. Debt has become so highly priced, locking in guaranteed losses is now deemed to be wisdom. When viewed in history, this will not be seen as a tribe or nation gone mad, it will be seen as an entire human population loses sight of their senses and allowing the lunatics to operate the insane asylum … Debt is better than money is becoming the current belief in the world. In fact, with negative interest rates and bond yields prevalent, it can now be said that the world now values debt better than money … The fear of loss is so great that currency itself is being discounted against debt.   If you think this through, it says everything is worth nothing because the currency itself is bad and losing confidence." Bill Holter's works are featured on the Complementary Commentary section of www.longwavegroup.com

CLOSING LEVELS FOR FRIDAY, APRIL 25TH.		WEEKLY CHANGE
Dow Jones Industrial Average	18,080.14	+ 253.84 points
Spot Gold Bullion	$1,175.00 (U.S.)	– $28.10 per troy oz.
Spot Silver	$15.68 (U.S.)	– $0.55 per troy oz.
S&P / TSX Composite	15,408.33	+ 47.78 points
10 – Year U.S. Treasury Yield	1.91%	+ 4 basis points
Canadian Dollar	82.17 cents (U.S.)	+ 0.39 cent
U.S. Dollar Index Future	96.935	– 0.511 cent
WTI Crude Oil Futures	$57.15 (U.S.)	+ $1.41 per barrel
DJIA / Gold Ratio	15.387	+ 0.906 point
Gold / Silver Ratio	74.936	+ 0.808 point