Monday April 6th, 2015

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, April 6th

The Institute for Supply Management (ISM) reports its U.S. non-manufacturing purchasing managers' index (PMI) – including companies in the service sector such as retail and health care – declined slightly to a

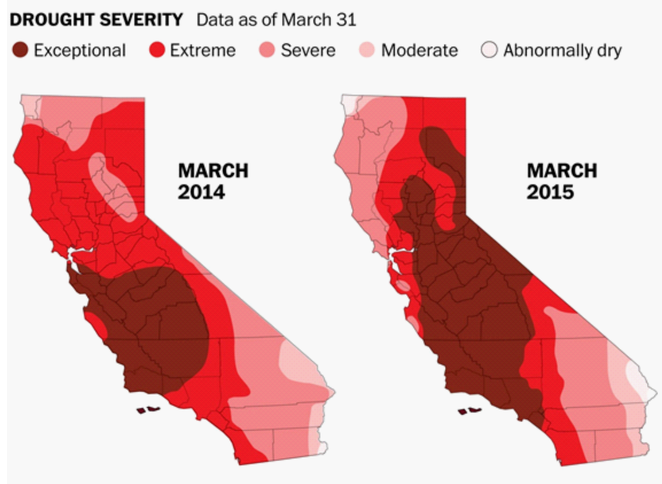
MONDAY, APRIL 6TH

reading of 56.5 in March from a level of 56.9 in February. Readings over 50 indicate more businesses are expanding than contracting.

- Front Page Headline, Groundwater Crisis Escalates Beneath California Crops. Even as the worst drought in decades ravages California and its cities face mandatory cuts in water usage, millions of pounds of thirsty crops like oranges, tomatoes and almonds continue to stream out of the state onto the nation's grocery shelves. However, many experts warn the way that California farmers have accomplished that feat is a case study in the unwise use of natural resources. Farmers are drilling wells at a feverish pace and pumping billions of gallons of water from underground, depleting a resource that was critically endangered even before the drought – now in its fourth year – began. While California … has strained to adapt to the changing climate, scientists warn that improving its management of precious groundwater supplies will shape whether the state can continue to supply more than half the nation's fruits and vegetables from an arid climate. As a drilling frenzy unfolds across the Central Valley – California's agricultural heartland – the consequences overusing groundwater are becoming plain to see. In some locations, water tables have dropped by 50 feet or more in just a few years. With less underground water to buoy it, the land surface is sinking by as much as one foot a year in spots causing roads to crumble and bridges to crack. Shallow wells have run dry, depriving several poor communities of water. Scientists warn that some of the underground water-storing formations – typically, saturated layers of sand or clay – are being permanently damaged by the excess pumping and will never again store as much water as farmers are now extracting. Jay Famiglietti, a NASA scientist in Pasadena, exclaims: 'Climate conditions have exposed California's house of cards. The current underground water withdrawals far outstrip the replenishment reality. We cannot keep doing this!"

The extent of drought in California

California Gov. Jerry Brown imposed the state's first-ever mandatory water restrictions this past week. After four years of severe drought conditions, water agencies will be required to cut output by 25 percent.



Source: National Drought Mitigation Center — THE WASHINGTON POST

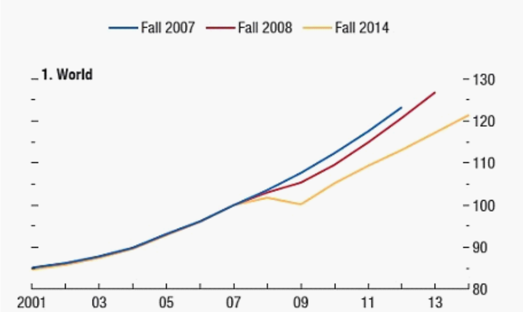
TUESDAY, APRIL 7TH

- The Federal Reserve reports despite a 5% decline in revolving debt – i.e. credit card debt – of $3.7 billion (U.S.), American consumer credit – total debt ex mortgages – rose by a 5.6% annual rate for a seasonally adjusted increase of $15.52 billion (U.S.) to $3.34 trillion (U.S.) in February. This mostly resulted from higher non-revolving credit – such as student loans and automobile loans – which grew at a 9.4% annual rate, up from a 5.8% pace in January.

- Front Page Headline, Daily Telegraph U.K. – "IMF Warns Global Economy Mired in Permanent Stagnation. International Business Editor Ambrose Evans-Pritchard writes: In an advance chapter from next week's World Economic Outlook, the International Monetary Fund warns: 'Lower potential economic growth will make it more difficult to reduce high public and private debt ratios. It is also likely to be associated with low equilibrium real interest rates, meaning that monetary policy in advanced economies may again be confronted with the problem of the zero lower range if adverse gross domestic product (GDP) growth shocks materialize.

Figure 3.1. Output Compared to Precrisis Expectations
(Index, 2007 = 100)

Output across advanced and emerging market economies remains much lower than was expected before the onset of the global financial crisis, and its growth path has also been lower.



The developing world is likely to limp along with average GDP growth of 1.6% from 2015 to 2020, too little to make a dent on the edifice of public debt left from the Great Recession. Global bourses have charged ahead of reality, soaring to new highs despite a 25% slump in levels of business investment since 2008. There has been a chronic lack of spending on the equipment and computer software which drive gains in competitiveness.

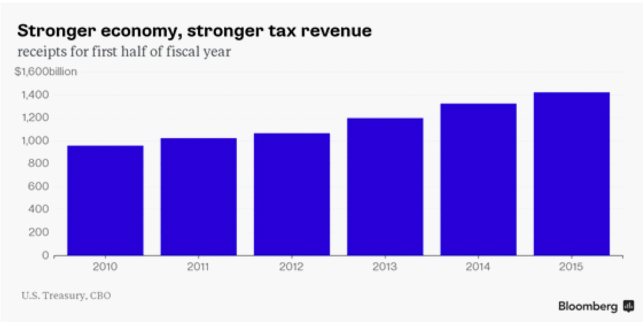
This development is worrying because business investment is essential for supporting the economy's future productive capacity. In some countries, weak business investment has contrasted with the ebullience of stock markets, suggesting a possible disconnect between financial and economic risk taking. The great hope is that booming asset prices will trigger a surge of investment, allowing economic fundamentals to catch up with markets. However, it is far from certain this will happen unless governments change policy and launch a blitz of spending on infrastructure and research to unlock frozen capital and unleash a virtuous circle. Both Europe and the U.S. began to falter at the turn of the century. Total factor productivity growth – the primary driver of wealth creation – slid from 0.9% to 0.5% even before the collapse of the financial system in 2008.'

The emerging world has since succumbed to the same malaise as it runs into structural barriers and exhausts the low-hanging fruit from easy catch-up growth, forcing the IMF to downgrade its global GDP growth forecasts repeatedly since 2011. Productivity in these countries has almost halved from 4.25% to 2.5% since the Lehman Brothers crisis and is likely to fall further as they hit the technology frontier, where the middle income trap lies in wait for any that fail to adapt in time. Many need root-and-branch reforms of their product and labour markets, plus an assault on excess regulation. The IMF report almost seems to describe a spent world where the great leap forward from the computer age and the internet is already over and little more can be squeezed out of universities as the marginal return to additional education keeps falling. Casting a shadow over all else is the demographic crunch. The working-age population will be shrinking at a rate of 0.2% in Germany and Japan by 2020, with South Korea close behind and China following on hard. Almost the whole of Eastern Europe faces an ageing crisis." See also, <u>Economic Winter, It's Still the Debt, Stupid – March 21, 2014.</u>

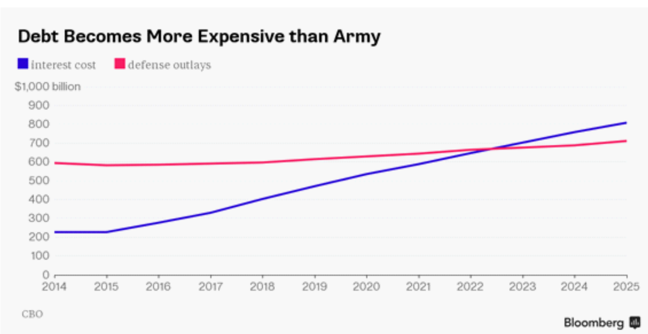
WEDNESDAY, APRIL 8TH

- Front Page Headline, Federal Reserve Minutes – "March Minutes Reveal FOMC Members Divided over Monetary Policy. Several judged the economic data and outlook were likely to warrant normalization of the Federal Funds rate target at the forthcoming meeting in June. Others stated that energy price declines and a strong U.S. dollar would continue to curb inflation, arguing for a higher Fed Funds rate later this year. A few felt the economy wouldn't be ready for a tighter monetary policy until 2016."

- In its Monthly U.S. Budget Review, the Congressional Budget Office (CBO) reported: "The federal government recorded a budget deficit of $430 billion (U.S.) for the first half of the current fiscal year ending September 30th. This is about $17 billion (U.S.) more than the shortfall recorded in the same span of fiscal 2014. For the full 2015 fiscal year, the CBO expects the budget deficit will probably be 2.7% of gross domestic product (GDP), compared with 2.8% in the previous fiscal year."

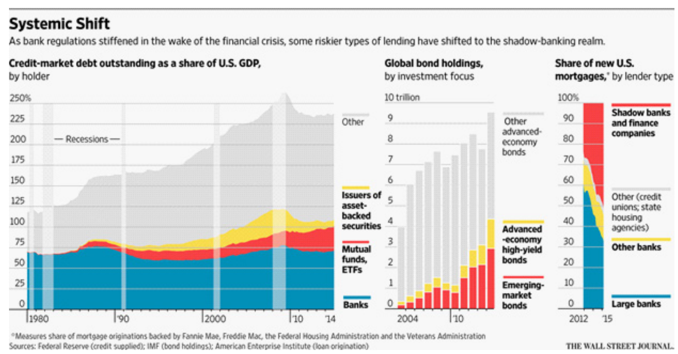


However, America can't have it both ways forever. According to the CBO, while revenues from individual and corporate taxes are expected to continue growing until 2018, a normalization of the Federal Funds Rate and yield levels for U.S. Treasury securities could triple net interest expenses to service the national debt to $704 billion (U.S.) by 2023; exceeding the amount of money America will spend on defense that year. See chart below.



- Front Page Headline, Globe and Mail – "Canada's Tory Government Plans Balanced Budget Legislation. In a speech to Toronto's Economic Club, Canadian Finance Minister Joe Oliver stated: 'The legislation would allow budget deficits in response to a recession, war or natural disaster; provided the event reduces federal revenues by at least $3 billion (CAD). Moreover, a finance minister who proposes a deficit would have to explain to a House of Commons committee how the federal government plans to return to a balanced position. Any deficit elimination plan would have to include a freeze on operating expenses and a wage freeze for cabinet ministers and deputy ministers."

- Front Page Headline, Wall Street Journal – "Post-Crisis Risk Casts a Darkening Shadow. Columnist Greg Ip writes: Squeezing risk out of the economy oftimes masks the fact that the risk re-emerges elsewhere. So it goes with efforts to make the financial system safer since the financial crisis. Regulators have forced banks to increase their capital buffers, terminate dangerous lines of business and pay more than $100 billion (U.S.) in penalties for bad behavior. As a result, risky activity is migrating to the shadow banking system where different threats may be growing. Shadow bank is a catch-all label for any entity that supplies credit, but doesn't fund itself with deposits as banks do. Shadow banks have long played a vital, innovative role in the U.S. Between 1980 and 2008, banks' share of the supply of credit to U.S. businesses and households fell from 44% to 20%. The rest came from finance companies, asset-backed securities, investment banks, institutional fund managers and government sponsored enterprises, such as Fannie Mae and Freddie Mac. Shadow banks were central to the mortgage bubble. Subprime mortgages were originated mostly by lightly regulated firms, bundled into securities and sold to opaque funds financed with short-term IOUs. When the subprime bubble burst, many died or shrank.



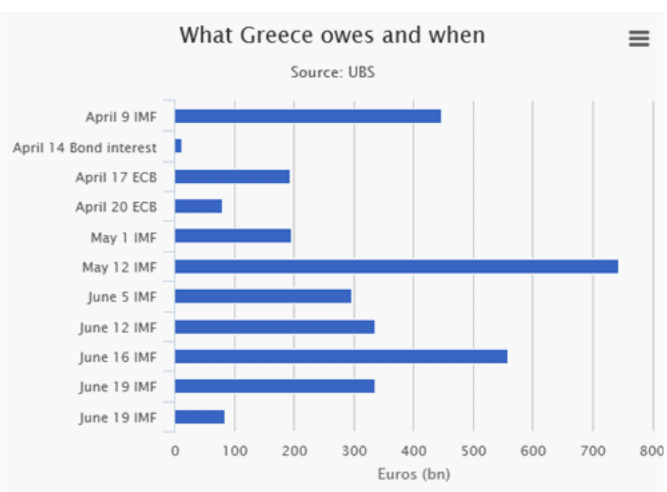
Banks have only partly filled the gap. Instead the primary beneficiaries have been other kinds of shadow banks, such as exchange-traded funds and private-equity funds. According to a new IMF report, the shift stems from 'tighter bank regulations, rising compliance costs and banks' deleveraging, i.e. reducing the ratio of their loans to capital, in order to absorb losses.'
In some cases, this makes the financial system safer because most alternative lenders lack the safety net of deposit insurance, or access to emergency cash from the Federal Reserve, hence they pay more to borrow. That is reflected in what they charge their customers: stiff interest rates, tough conditions and short maturity dates."

THURSDAY, APRIL 9TH

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 14,000 to 281,000 in the week ended April 4th. while continuing claims declined by 23,000 to a seasonally adjusted 2.3 million in the week ended March 28th. Neil Dutta, an economist at Renaissance Macro Data in New York, commented: "Low jobless claims are almost a precondition for a steady trend in the employment numbers. We are likely to witness some improvement in the employment data during April."

- Front Page Headline, Daily Telegraph U.K. – "ECB Supports Greek Banks as Default to IMF Is Averted.

According to Greek finance ministry officials, the European Central Bank has bolstered its emergency funding for Greece's stricken banks, as Athens honoured a 448 million euro loan repayment to the International Monetary Fund … Greek Finance Minister Yanis Varoufakis had sought reassurance from IMF Managing Director Christine Lagarde that Athens would be given enough flexibility to ensure it could still meet its wages and pension obligations this week. Speaking ahead of the IMF's bi-annual meeting in Washington today, Ms. Lagarde warned: 'What is now badly needed is not talk, but to actually proceed with the work. The Greek authorities, together with representatives of the European Central Bank, European Commission and the IMF have to sit down and really focus on the objective of what is best for Greece; which is restoring the economy, stabilizing it and by so doing re-establishing its sovereignty. It's a difficult path, but one which must be walked.'



Ms. Lagarde also urged: 'Countries must take advantage of the triple opportunities of low oil prices, low financing costs and the impact of the ECB's 1.1 trillion euro QE program, otherwise, it's to despair.'

Ms. Lagarde also warned: 'A new mediocre of low gross domestic product (GDP) growth could become permanent if countries fail to implement reforms. We must prevent that new mediocre from becoming the new reality.'

- Statistics Canada reports the nation's new home prices rose by 0.2% in February and by 1.4% on a year-over-year basis; matching the annual price gain registered in January. Separately, Statscan reported the value of Canadian building permits declined by 0.9% in February to $6.11 billion (CAD), citing construction plans for single family homes fell by 9.6%. Provincially, Quebec saw the largest drop in building permits overall, followed by Ontario and Alberta.

FRIDAY, APRIL 10TH

- Canada Mortgage and Housing Corp. (CMHC) reports the nation's housing starts rose to a seasonally adjusted annualized pace of 189,708 units in March from a downwardly revised 151,238 units in February. In a research note, David Tulk, a strategist at TD Securities in Toronto, stated: "While we are bracing for more regional weakness in housing, low mortgage rates are expected to provide a potent offset."

- Front Page Headline, GoldMoney – "Confusion re: U.S. Unemployment. Researcher Alasdair Macleod writes: The American economic statistic that one would have deemed easy to quantify is the unemployed number. Just total the number of people on unemployment benefits and there's your answer. However, it is much more complex because in a large country like the United States, the potential labor force is estimated to be 250,080,000 across all 50 states plus Washington, D.C. Of this total 101,479,000 are not currently employed, a ratio of over 40% and of these only 8,575,000 is deemed to be actually employed. The reason this matters is because unemployment is one of the three key variables that macroeconomists use to formulate economic policy; the other two being gross domestic product (GDP) and the rate of price inflation. Indeed, the Fed's Open Market Committee has set the unemployment rate as one of its two policy targets. This becomes questionable at best when the officially employed are less than 10% of those who could be working but are not. Looking at the distribution of unemployment benefits doesn't help either. With benefits distributed on a rules-based system, many of the unemployed do not receive benefits. For example, in the U.S. there are 2,472,547 insured unemployed at the state level, compared with 8,575,000 officially unemployed; so less than 33% are actually receiving benefits and less than one in forty of those are in the not-in-labor-force category, making this figure useless for policy guidance as well.

The insured unemployed are tabulated on a weekly basis with the Initial Claims announcement by the Department of Labor. However, the number of officially unemployed is announced separately by the Bureau of Labor Statistics (BLS) on a monthly basis on the first Friday of the following month. The BLS works on very tentative estimates, while the insured employment figure – which is the hard number – forms only a small part of the overall picture. Estimates of population growth add to the confusion. According to the BLS, the total number of people not in the labor force has actually increased over the last year to March by 279,000, although the number classified as unemployed has fallen by 1,804,000. Even these figures will be revised long after they are relevant in the light of the next population census; but on the face of it the increase in jobs is not keeping pace with the estimated increase in the working population.

Job creation is an ongoing process, admittedly hampered by the reluctance of banks to lend to smaller businesses, which comprise the bulk of any economy's activity. Despite what the GDP reports disclose about economic growth or its absence, economic progress continues with people buying better mobile communications, new automobiles and flat-screen television sets. The tragedy of unemployment is these benefits are not affordable to most of the unemployed. It is not that they are work-shy: much of the problem is that in a zombie-like economy, scarce capital resources are not being redeployed productively while debt is mounting, so job creation becomes unnecessarily slow.

One would have thought that disappointing unemployment numbers would add to the evidence that the U.S. economy is weakening, already foreshadowed by falling commodity prices and the dramatic slide in shipping rates. There was such an event over Easter when the BLS announced that non-farm payrolls were 120,000 less than expected and the previous two months' figures were also downwardly revised by a further 69,000. Is this confirmation of an economy about to slide? Perhaps, but unemployment statistics are too unreliable as an indicator and should never have been adopted by the Federal Reserve as a policy tool."

CLOSING LEVELS FOR FRIDAYAPRIL 10TH.		WEEKLY CHANGE
Dow Jones Industrial Average	18,057.65	+ 294.41 points
Spot Gold Bullion	$1,204.60 (U.S.)	+ $3.70 per troy oz.
Spot Silver	$16.48 (U.S.)	– $0.22 per troy oz.
S&P / TSX Composite	15,388.43	+ 361.81 points
10 – Year U.S. Treasury Yield	1.95%	+ 11 basis points
Canadian Dollar	79.49 cents (U.S.)	– 0.62 cent
U.S. Dollar Index Future	99.281	+ 2.539 cents
WTI Crude Oil Futures	$51.64 (U.S.)	+ $2.50 per barrel
DJIA / Gold Ratio	14.991	+ 0.199 point
Gold / Silver Ratio	73.095	+ 1.185 points

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