Monday February 9th, 2015

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

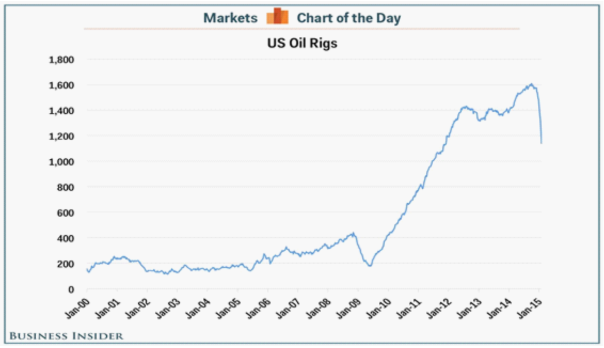
THAT WAS THE WEEK THAT WAS

Monday, February 9th

Front Page Headline, Wall Street Journal – "OPEC Foresees More Oil Demand / Less U.S. Output. Reversing a former prediction in a new monthly report on the oil market, the Organization for Petroleum Exporting Countries now foresees demand will be 29.2

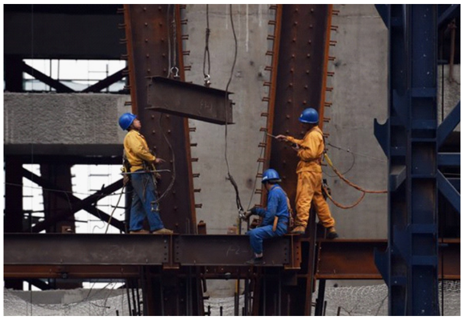
MONDAY, FEBRUARY 9TH

million barrels a day this year, an increase of about 100,000 barrels per day compared with 2014. Separately, OPEC forecast that the U.S. oil supply will increase more slowly by only 130,000 barrels a day – less than previously expected for 2015 – because lower oil prices have forced a large number of American drilling rigs to shut down.



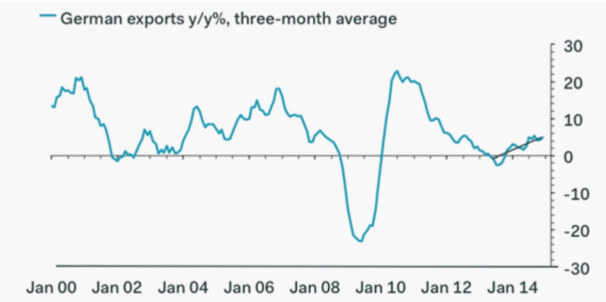
- Canada Mortgage and Housing Corp. (CMHC) reports the nation's housing starts rose by 4.3% in January to a seasonally adjusted 187,276 units, following a revised 179,600 units in December, previously reported as 180,300. Laura Cooper, an economist with the Royal Bank of Canada, observed: "The expected slowing in housing starts in energy dependent regions during January failed to materialize; indicating at this stage, the commodity price plunge is not yet negatively feeding through to confidence channels and into homebuilding activity."

- Front Page Headline, New York Times – "China's Heavy Industry Records Sharp Downturn. Heavy industry in the world's second largest economy is experiencing a much sharper downturn than was apparent or expected even several weeks ago. As demand dwindles, steel prices in China have declined by 12% in the first five weeks of the year, almost as much as in all of 2014. The tonnage of China's imports of rubber, iron ore, oil and other industrial materials also fell sharply in January. Moreover, the global market for bulk freighter charters is in a free fall, already below levels in the worst days of the global financial crisis in late 2008 and early 2009. While the slowdown seems to be mirrored to a lesser extent in other sectors, the full scope of China's economic weakness is obscured by limited data, as the country prepares for a nationwide, week long holiday beginning February 18th. in observance of the Lunar New Year. Louis Kuijs, chief China economist at the Royal Bank of Scotland, commented: 'While it's too early to be saying China is moving toward a disaster, there's nothing in this recent data about which to be cheery."



A construction site in Beijing.
Photo sources: Agence France-Presse – Getty Images

- Front Page Headline, Business Insider – "Germany's Ballooning Trade Surplus Reaches a Record Level. Destatis, the German federal statistics office, reports the nation's seasonally adjusted trade surplus widened to a record 217 billion euros in 2014, with exports totaling 1.134 trillion euros ($1.28 trillion U.S.) and imports registering 916.5 billion euros. Critical economists note that while Germany is a competitive exporter, perpetually weak demand for foreign made products tends to moderate imports.



Source: Pantheon Macroeconomics

TUESDAY, FEBRUARY 10TH

- Front Page Headline, Globe and Mail – "IEA Expects Crude Oil Prices to Remain in Double Digits through 2020. In a new report, the Paris-based International Energy Agency commented: 'Oil producing countries shouldn't count on a demand response to reflate prices over the next several years. However, the oil market should stabilize by mid-2015 as a result of declining production in key countries such as Russia, Columbia and Venezuela and much slower supply growth in the United States and Canada. The result is that barring any unexpected supply disruption, or any energy related change in policy, the oil market rebalancing will likely occur relatively swiftly; but will be comparatively limited in scope, with prices stabilizing at levels higher than recent lows, but substantially below the highs of the last three years."

- Front Page Headline, Globe and Mail – "CAD's Decline Due to Economy's Performance: Gov. Poloz. Speaking to reporters at today's meeting of G20 finance ministers and central bank governors in Istanbul, Bank of Canada Governor Stephen Poloz insisted: 'The purpose for the recent lowering of the Bank Rate to 0.75% was to add stimulus to the slowing economy. I honestly reject the notion that I'm talking down the Canadian dollar and I reject the notion that we're being purposeful about that. Trying to control the level of the Canadian dollar is not on the table. Our job is to understand the context of the economy and adjust short-term interest rates to meet our 2% inflation target."

- The Central Bank of Russia (CBR) announces it has launched a new SWIFT style payment service aimed at moving away from Western financial dominance. The system is already operating and will be fully functional within six months. The regulator stated the new service will allow credit institutions to transmit messages in a SWIFT format through the CBR to all Russian regions without restrictions. The calls to disconnect Russian banks from the global internet bank SWIFT system came amid the deterioration of relations between Russia and the West and the introduction of sanctions. However, SWIFT itself does not intend to switch Russia off the system, stating while a number of countries applied pressure on it, SWIFT will not be joining the anti-Russia sanctions campaign.

  Alla Bakina, director of the CBR's national payment system stated last November that the cost of transmitting financial messaging will be comparable to those of similar services in the marketplace. Ramilya Kanafina, a deputy director, revealed the CBR plans to complete Russia's switch to its SWIFT alternative by May of this year. SWIFT is a global banking transaction system used by most international banks. The information which the system carries, including payment instructions, is securely exchanged among financial institutions. The SWIFT system began operating in 15 countries in 1973 and is now used in 210 countries.

The central bank of Russia's headquarters in Moscow. Source: RIA Novisti

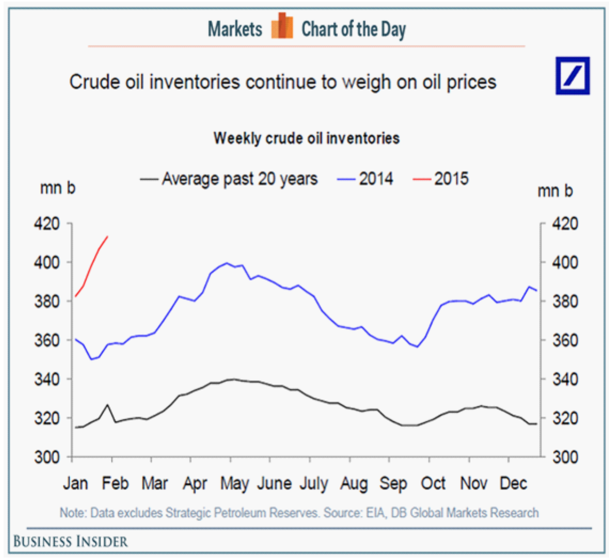
WEDNESDAY, FEBRUARY 11TH

- The U.S. Department of the Treasury reports the federal government's budget deficit increased to $17.5 billion (U.S.) in January compared with $10.3 billion (U.S.) in January 2014. For the first four months of the current fiscal year the deficit widened to $194.2 billion (U.S.) from $182.8 billion (U.S.) the same period a year ago. While the deficit has gradually narrowed since 2012, the fourth consecutive year in which it topped $1trillion (U.S.), the Congressional Budget Office (CBO) has forecast a deficit of $468 billion (U.S.) for the current fiscal year ending September 30th.

- Front Page Headline, Daily Telegraph U.K. – "Germany Faces Impossible Choice as Greek Austerity Revolt Spreads. International Business Editor Ambrose Evans-Pritchard writes: 'The political centre across southern Europe is disintegrating. Establishment parties of centre-left and centre-right – La Casta as they say in Spain – have successfully immolated themselves enforcing EMU debt deflation. Spain's neo-Bolivarian Podemos party refuses to fade. It has endured crippling internal rifts. It has shrugged off hostile press coverage over financial ties to Venezuela. Nothing sticks.

  The insurrectionists who came from nowhere last year – with Trotskyist roots and more radical views than those of Syriza in Greece – are pulling further ahead in the polls. The latest Metroscopia survey gave Podemos 28%, while the ruling conservatives have declined to 21%. The once great PSOE – Spanish Workers Socialist Party – has fallen to 18% and risks fading away like the Dutch Labour Party, or the French socialists, or Greece's Pasok. One can defend EMU policies, or one can defend one's political base, but one cannot do both. As matters stand, Podemos is on track to win the Spanish elections in November on a platform calling for the cancellation of 'unjust debt,' a reversal of labour reforms, public control over energy, the banks, and the commanding heights of the economy, plus withdrawal from NATO. Europe's policy elites can rail angrily at the folly of these plans if they wish, but they must answer why ex-Trotskyists threatening to dismantle market capitalism are taking a major EMU state by storm. It is what happens when 5.46 million people lack jobs, when two million households still have no earned income, when youth unemployment is still running at 51.4% and house prices have declined by 42%, six years into a depression. It is pointless protesting that Spain's economy is turning the corner, a contested claim in any case. There comes a point when a society breaks and stops believing anything its leaders say. The European Union elites themselves have run their currency experiment into the ground by imposing synchronized monetary, fiscal and banking contraction on the southern half of the EMU, in defiance of known economic science and the lessons of the 1930s. It is they who pushed the euro zone into deflation, thereby pushing the debtor states into accelerating compound interest traps. It is they who deployed the EMU policy machinery to uphold the interest of creditors, refusing to acknowledge that the root cause of Europe's crisis was a flood of excess capital flowing into vulnerable economies. It is they who prevented a U.S. style economic recovery from the financial crisis, so they should not be surprised that such historic errors are returning to haunt … Bild Zeitung devoted two pages this morning to warnings that a Greek exit (Grexit) from the EMU would cost Germany 63 billion euros, or much more once the Target2 payments through the ECB system are included. The unpleasant discovery that Germany's target2 exposure can in fact go up in smoke, might make it untenable to continue such support."

- Front Page Headline, Business Insider – "U.S. Crude Oil Inventories Highest in 80 Years: EIA. America's crude oil supply is still soaring. In a press release, the Energy Information Administration reported: 'U.S. crude oil inventories increased by 4.9 million barrels last week. At 417.9 million barrels, U.S. crude oil inventories are at their highest level – for this time of year – in at least the last 80 years.' Following the release of this date, West Texas Intermediate (WTI) crude oil futures fell below $50 (U.S.) a barrel to close trading at $49.38 (U.S.). See charts below.



WTI crude oil futures trading pattern:
Source: Business Insider

THURSDAY, FEBRUARY 12TH

- The Commerce Department reports U.S. retail sales declined by a seasonally adjusted 0.8% in January, following a 0.9% drop in December. However, restaurant and bar sales actually rose by 11.3% on a year-over-year basis.

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 25,000 to a seasonally adjusted 304,000 in the week ended February 7th. while continuing claims declined by 51,000 to 2.35 million in the week ended January 31st.

- Front Page Headline, GoldMoney – “Unemployment and Groupthink. Researcher Alasdair Macleod writes: On Friday, February 6th. the U.S. Bureau of Labor Statistics (BLS) released its employment estimates for January, which being better than market expectations, caused U.S. Treasury yields to rise and precious metal prices to trade sharply lower. Earlier that week, Gallop Chairman Jim Clifton wrote: ‘The official unemployment rate, as reported by the U.S. Department of Labor is extremely misleading.’ Mr. Clifton’s comments attracted considerable notice, not the least because Gallop is an independent company whose business is the compilation of statistics. Furthermore, it is unusual for a senior business figure to criticize a government department so openly. His basic point is that if you are unemployed and have stopped looking for work in the last four weeks, you are no longer classified as unemployed. Moreover, if you perform a minimum of one hour of work in a week and are paid at least $20 (U.S.), you are deemed to be employed, etc. etc. This is hardly news to those of us who have been skeptical about the veracity of official statistics. In point of fact, included in BLS statistics are 102 million adults deemed to be not in the work force, or officially unemployed. Then, there are those people who are only employed on a part-time basis, but counted by the BLS as employed. As Jim Clifton points out, if one adds these 34.7 million people to the BLS’ 102 million figure, only 44.2% of U.S. adults are actually employed for 30 hours or more per week; in other words fully employed in any common sense definition. This is the true indication of the state of employment in America. The BLS could be more candid in presenting its numbers, but being a government department, one must accept the fact that it presents these figures in the best possible light. However, the BLS is completely open about its methodology and any member of the public can make his own assessment. So, assuming that caveat emptor should apply, the fault for accepting the BLS headline without question lies with the investing public, careless enough to be influenced by sell-side analysts and the media.

  The result is that markets move on what amounts to state-sponsored misinformation. Unemployment statistics are only one example of the fodder for groupthink that has become the bedrock of macroeconomics and financial analysis. Groupthink is ‘a psychological phenomenon which occurs within a group of people within which the desire for harmony, or conformity, results in an irrational, or dysfunctional conclusion.’ This definition from Wikipedia perfectly describes the relationship between U.S. government statistics and the financial markets. It is a shame: employment statistics have the potential to be the one number in macroeconomics which informs us of the true state of the domestic economy. The two other major statistical variables, gross domestic product (GDP) and the Consumer Price Index (CPI), are badly flawed. Nominal GDP informs us of the quantity of transactions, not the quality; ranking wasteful government spending equally with consumer-driven economic progress. Furthermore, government statisticians use every trick they can to minimize rising prices; otherwise no growth in real GDP would have been recorded since the Lehman crisis. We cannot claim that the true state of the U.S. labor market is being concealed from us. One needs to think for himself and not dismiss from our minds comments by businessmen such as Jim Clifton of Gallop. That one does is evidence that ‘irrational and dysfunctional conclusions’ drive our statistical interpretation, therefore all financial markets and should not be confused with rational analysis.”

FRIDAY, FEBRUARY 13TH

- The Thomson Reuters / University of Michigan preliminary consumer sentiment index for February declined to a reading of 93.6 from a final January reading of 98.1. In a press release, Richard Curtin, director of the Michigan Survey of consumers observed: “Low gas prices have especially helped lower income households, although consumers now widely anticipate that gas prices will creep upward over the next 12 months.”

- The Labor Department reports U.S. import prices fell by 2.8% in January, citing lower oil prices and a strong U.S. dollar; while December’s decline was upwardly revised to 1.9%, previously reported as a drop of 2.5%.

U.S. Customs and Border Protection Agriculture specialists inspect flowers for foreign pests or diseases in the cargo center at Miami International Airport. Source: Getty Images

- The Federal Statistics Office in Wiesbaden reports German gross domestic product (GDP) expanded by 0.7% in the 4th. quarter of 2014, following an expansion of 0.1% in the 3rd. quarter. Separately, the European Union's (EU) statistics office in Luxembourg reports the euro zone GDP grew by 0.3%. Nick Kounis, a research analyst at ABM Amro Bank in Amsterdam, noted: "These GDP reports are not a prelude to booming times to come, but we are beginning to see signs of a more convincing economic recovery."

- Statistics Canada reports the nation's factory sales rose by 1.7% to $52.4 billion (CAD) in December, citing higher sales of motor vehicles and machinery more than offset lower crude oil prices. New factory orders increased by 1.5% to $52.6 billion (CAD), while unfilled orders rose for a fourth consecutive month, by 0.3% to $91.2 billion (CAD).

- Front Page Headline, Silver Arrow Partners – "The Template for How the Next Financial Crisis Will Unfold. Anyone looking to get their head around how the next financial crisis will unfold should consider what's occurring in Europe today. Continental Europe is ground zero for the whole debt bomb implosion, not because it has the most debt, but because it's politically and economically on a very unstable footing. Some 19 countries share in the European Monetary Union (EMU), with all of them in varying degrees of socialism – the public sector accounts for roughly one in three employees in Germany's allegedly 'free market' economy – and varying shades of broke: even Germany has a real debt to gross domestic product (GDP) exceeding 200%. In this regard, Europe gives the rest of us a front-row seat to learn how things will unfold when the serious problems arise and the political and financial elite are at risk of losing their power and wealth. Investors have endured this mess multiple times in the last three years. The most notable cases involved Spain and Cyprus. The formula is as follows:

1. A problem first arises.
2. Various political and financial officials state that the problem is contained and there's nothing to worry about.
3. Months later, the market and mainstream media become aware … usually when the problem is already a massive crisis and a bank holiday needs to be declared.
4. Individual investors lose a considerable amount of money, while the same people who caused the problem are not fired, fined or jailed; never are truthful about the full scope of the problem; but claim they can solve the problem and have all the answers.

Consider the story of Bankia, which was formed by merging seven bankrupt regional Spanish banks in 2010. The new bank was funded by Spain's government rescue fund … which received 'preference shares' in return for over four billion euros in funding for the bank; of course, all provided by taxpayers. These preference shares yielded 7.75% and would be redeemed before ordinary investors if Bankia failed again. So immediately, the Spanish government was taking taxpayer money to obtain preferential treatment over ordinary investors and said taxpayers. Indeed, those investors who owned shares in the merged Bankia lost their shirts. They lost everything when the new bank was created. Bankia was taken public in 2011. Spanish investment bankers convinced the Spanish public that the bank was a fantastic investment. Over 98% of the shares were sold to Spanish investors.

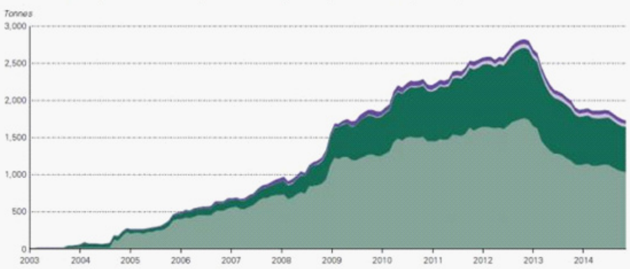
One year later, Bankia was bankrupt again and required the single largest bailout in Spain's history: 19 billion euros. Spain assumed control of the bank again and trading in Bankia shares was frozen in the marketplace. When the inevitable bailout took place, Bankia shareholders were forced to realize huge losses as part of the transaction. The vast majority of these were individual investors; not Wall Street or its European equivalent. Bankia currently faces a lawsuit involving at least 140,000 claims for the improper marketing of shares. So, that was two investor disasters in as many years. Bankia was taken public a second time in May 2013. Once again the Bankia share price promptly collapsed, losing 80% of their value in a matter of days. Once again, it was ordinary investors who were destroyed. Indeed, the situation was so terrible that a police officer stabbed a Bankia employee who had sold him over 300,000 euros worth of shares. The banker had convinced him that Bankia was a great investment.

Today, Bankia is fraught with a massive compensation lawsuit, whereby it must pay out between 200 million and 250 million euros to investors who bought shares during its initial public offering (IPO). Of course, this payout is based upon accounting standards which are at best massaged and at worst, likely outright fraudulent. Again, this is a bank that has wiped out investors three times in three years, so who knows what will happen. While certain items relating to this story remain unique, the morals to Bankia's tale can be applied across the board to the economy and financial community today. Those morals are:

1. Those mandarins in charge of regulating the financial system will lie, cheat and steal, rather than be honest to individual investors and the public whom they are meant to protect.
2. Any financial problem which surfaces will be handled via fraud or lies, rather than simply allowing those who committed wrongdoings to be fired, or sent to jail.
3. When a financial collapse finally does occur, it will be individual investors who take losses; not bank executives or politicians.
4. Any problem will be prolonged as much as possible, unlikely to be remedied for years, if ever. This is the template for the future."

- Front Page Headline, Zero Hedge – "Central Banks Purchase the Highest Amount of Gold Bullion in 50 Years. Researcher Tyler Durden writes: During 2014, the price of gold bullion went absolutely nowhere. The main reason for this was concentrated selling of 'paper gold' which witnessed some 150 metric tonnes of outflows from gold-backed Exchange Traded Funds (ETF), primarily from the United States. However, this represented a substantial slowdown from the 880 metric tonnes of gold ETF outflows in 2013 … Today, in the words of the World Gold Council: 'Sentiment expressed via paper gold has turned tentatively positive. To date in 2015, ETFs have seen inflows of about 60 metric tonnes, at least 90% of which has been into U.S. based ETFs.'

Chart 5: ETF holdings decreased in 2014, at a considerably slower pace than in the previous year



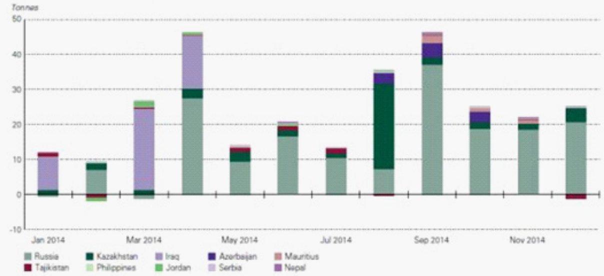
- ETF outflows slowed sharply in 2014; to 159t from 880t.
- Most of these outflows occurred in the second half of the year, driven by stronger US dollar expectations and more confidence in the US economic recovery.

Notes: Gold holdings are as reported by the ETF/ETC issuers. Where data is unavailable, holdings have been calculated using reported AUM numbers.
Source: Respective ETF/ETC providers; Bloomberg; The London Gold Market Fixing Ltd; World Gold Council

So, while one can debate just what was the net demand/supply for various other sectors, such as jewellery, technology and various gold investments, one thing is clear: central banks went on a shopping spree. According to the latest World Gold Council data, in 2014 the world's central banks went on a golden shopping binge to take advantage of the ongoing dumping of paper ETF gold resulting in bank net purchases amounting to 477 metric tonnes.

This represented a 17% increase over 2013's 409 metric tonnes. This was the second highest year of central bank net purchases for 50 years, only surpassed by the 544 metric tonnes added to global gold reserves in 2012. Russia was again the most significant buyer, adding 173 metric tonnes to its gold reserves.

Chart 6: Significant central bank purchasers in 2014

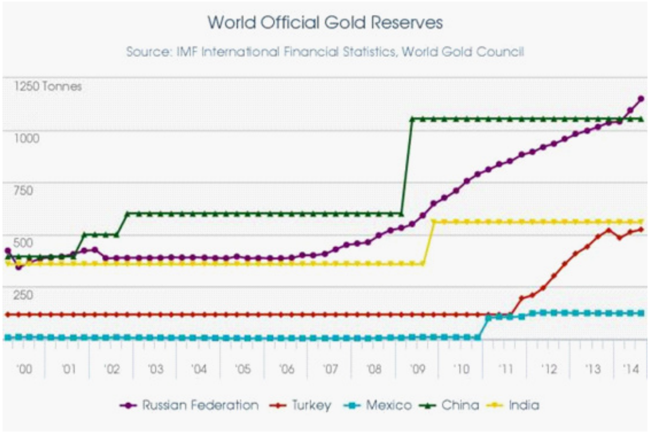


- Central bank purchases of 477t were the second highest for 50 years.
- Russia was again the most significant buyer, adding 173t to its reserves.

Note: Only includes purchases and sales as reported by the IMF as at February 2015.
Source: IMF IFS; World Gold Council

The World Gold Council reported: 'By far, Russia had the greatest appetite amongst those countries which increased their gold reserves. Russia accumulated an additional 173 metric tonnes – 36% of total central bank demand in 2014 – over a turbulent 12 months. The year 2014 was bookended by tension and uncertainty for the country, geopolitical antagonism with Ukraine and the resultant international sanctions at the beginning of the year and was followed by severe economic distress toward the end. Kazakhstan (48 mt), Iraq (48 mt) and Azerbaijan (10 mt) were also notable for the size of their purchases. Fortification and diversification of gold reserves, namely away from the U.S. dollar, continues to be the driving force behind this activity.

While purchases continued unabated, sales remained insignificant. Ukraine was the only central bank to significantly reduce gold reserves, falling by 44% to 24 metric tonnes; as well documented geopolitical struggles negatively impacted economic performance. Furthermore, sales under the Central Bank Gold Agreement (CBGA) were minimal. Actually, the final year of the third agreement only registered 6.8 metric tonnes, while the first year of the fourth agreement has seen less than half a tonne sold thus far.' If that was all which took place, Russia could actually be thankful to Ukraine for essentially transferring over its gold from Kiev to Moscow. However, there is much more here than meets the eye and the biggest wildcard remains China, as usual. According to official data, currently Russia has more gold reserves at 1,208.2 metric tonnes, than China. The difficulty is that China's gold reserves were only last officially updated in early 2009.



As everyone following the physical gold space knows, there are really only two key outstanding questions.

1. What is the updated total inventory of China's gold holdings? They are estimated to be between 3,000 and 6,000 metric tonnes.
2. What is the People's Bank of China (PBOC) waiting for, and when will it reveal this number?

With global geopolitical events shifting ever more quickly, plus developed world central banks increasingly losing control almost on a daily basis; China may have to answer both questions relatively soon.

CLOSING LEVELS FOR FRIDAY, FEBRUARY 13TH.		WEEKLY CHANGE
Dow Jones Industrial Average	18,019.35	+ 195.06 points
Spot Gold Bullion	$1,227.10 (U.S.)	– $7.50 per troy oz.
Spot Silver	$17.33 (U.S.)	+ $0.63 per troy oz.
S&P / TSX Composite	15,264.81	+ 180.89 points
10 – Year U.S. Treasury Yield	2.05%	+ 9 basis points
Canadian Dollar	80.25 cents (U.S.)	+ 0.40 cent
U.S. Dollar Index Future	94.185	– 0.50 cent
WTI Crude Oil Futures	$52.78 (U.S.)	+ $1.09 per barrel
DJIA / Gold Ratio	14.685	+ 0.248 point
Gold / Silver Ratio	70.81	– 3.12 points

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