Monday January 26th, 2015

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, January 26th

Front Page Headline, Bloomberg News – "S&P Downgrades Russia's Credit Rating. Standard & Poor's lowers Russia's sovereign debt credit rating to BB (High) from BBB (Low) i.e. junk status, with a negative outlook. In a press release, S&P cited:

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'Russia's monetary policy flexibility has become more limited and its economic growth prospects have weakened. S&P also acknowledges a heightened risk that Russia's external and fiscal buffers will deteriorate due to rising external pressures and increased government support for the domestic economy.

- Front Page Headline, Institute for Political Economy – "Russia in the Cross Hairs. Author Paul Craig Roberts – a former associate editor of the Wall Street Journal – writes: 'Standard & Poor's downgrade of Russia's credit rating is, without any doubt, a political act. It proves what we already know; that the American rating firms are corrupt political operations. Remember the investment grade rating which the American rating agencies gave to obvious sub-prime junk issues of mortgage-backed securities? These rating agencies are paid by Wall Street and like Wall Street, they serve the U.S. government. A look at the facts serves to establish the political nature of the downgrade. Don't expect the corrupt U.S. financial press to look at the facts. However, we will put the facts into context with the U.S. debt situation. According to the debt clocks available online, The Russian national debt is 11% of the country's gross domestic product (GDP). America's national debt is at least 105% of its GDP. The Russian national debt per capita is $1,645 (U.S.), while the American national debt per capita is $56,952 (U.S.). The size of Russia's national debt is $235 billion (U.S.), less than one quarter of a trillion. The size of America's national debt is $18 trillion (U.S.), i.e. 76.6 times larger than the Russian national debt. Putting this into perspective: America's GDP is $17.3 trillion (U.S.) and Russia's GDP is $2.1 trillion (U.S.). Ergo, America's GDP is 8 times greater than Russia's GDP, but the U.S. national debt is 76.6 times greater than Russia's national debt. Clearly, it is the U.S. sovereign credit rating which should have been downgraded to junk status.

However, this will never happen because any American credit rating agency that told the truth would be closed and prosecuted, absurd charges notwithstanding. The rating agencies would be guilty of being anti-American and they know it. Never expect any truth from any Wall Street denizen. They lie for a living … One of Russia's problems is its central bank. For the most part, Russian economists are the same as the neoliberal incompetents who exist in the Western world. The Russian economists are enamored of their contacts with the superior West and with the prestige that the image these contacts give them. As long as the Russian economists agree with the Western ones, they get invited to conferences abroad. These Russian economists are de facto U.S. agents, whether they realize it or not.

Currently, the Russian central bank is squandering the large Russian holdings of foreign reserves in support of the Western attack on the rouble. This is a fools' game that no central bank should play. The Russian central bank should remember, or learn if it does not know, of Soros' attack on the Bank of England. Russian foreign reserves should be used to retire the outstanding national debt. The remaining American dollars should be dumped in co-ordinated actions with China to destroy the U.S. dollar, the power basis of American imperialism.

Alternatively, the Russian government should announce that its reply to the economic warfare being conducted against Russia by the government in Washington and Wall Street ratings agencies is default on its loans to Western creditors. Russia has nothing to lose, since Russia is already cut off from Western credit by U.S. sanctions. A Russian default would cause consternation and crisis in the European banking system, which is exactly what Russia wants in order to destroy Europe's support of American sanctions. In my opinion, the neoliberal economists who control Russian economic policy are a much greater threat to the sovereignty of Russia than economic sanctions and U.S. missile bases. To Survive Washington, Russia desperately needs people who are not romantic about the West.

- Front Page Headline, Bloomberg View – "What Syriza's Election Victory Means for Greece and the EMU. In an op-ed, Mohamed El-Erian, chief economic advisor to Allianz, writes: 'According to exit polls, the Coalition of the Radical Left known as Syriza, placed first in the Greek elections yesterday with at least 36% of the vote. The result could even give Syriza an absolute majority and if so desired, allow it to govern without a coalition partner … This is the first time Syriza is in a position to form and lead a government. Its popularity reflects intensifying economic and social frustrations among Greek citizens, including the perception that their long sacrifice hasn't yielded any meaningful gains, let alone any hint of an end to what they see as years of austerity and deprivation. An alternative economic approach was at the core of Syriza's electoral campaign. Its program, which rejects austerity and seeks debt reduction, was pursued with vigor by the party's leader Alexis Tspiras, who frequently took swipes at Germany, including personal attacks on Chancellor Angela Merkel. He argued that the most influential power in the European Monetary Union was too obsessed with austerity in its approach to Greece. This had led to concerns that Greece could exit the EMU. A so-called Grexit would entail the return of a national currency to replace the euro, losing access to the European Central Bank (ECB) financing windows, and most probably, less financial support from the European Union (EU) and the International Monetary Fund (IMF). An exit from the euro would require the Greek government to counter the immediate threat of significant disruptions, embrace a new medium-term economic vision, strengthen its domestic institutions and pursue a different relationship with European partners that would preserve the country's access to free trade and certain financing arrangements. It would also raise doubts about some other countries in the region, leading to a repricing of individual and collective risk factors. Grexit concerns have been amplified by indications that, particularly compared with 2010-2012, Germany appears less concerned about the negative spillovers for the euro zone and for good reason; given the still incomplete efforts to strengthen the region's institutional structures. For example, regional financing mechanisms have been strengthened, banks have been subjected to more rigorous stress testing and a significant portion of national debt has been refinanced with longer maturity dates and at lower yield levels."

TUESDAY, JANUARY 27TH

- The Commerce Department reports U.S. new single family home sales rose by 11.6% in December to a seasonally adjusted annual pace of 481,000 units. For all of 2014, new home sales totaled 435,000, a 1.2% increase from 429,000 units in 2013.

- The S&P/Case Shiller group reports its 20-U.S. city house price composite index declined slightly by 0.2% in November. David Blitzer, chairman of the index committee at S&P Dow Jones Indicies, commented: "With the spring buying season still a month or two away, the housing recovery has barely reached first base. Prospects for a home run in 2015 aren't good."

- The Commerce Department reports U.S. durable goods (products meant to last for at least three years) orders declined by 3.4% in December.

- The New York-based Conference Board reports its consumer confidence index rose to a reading of 102.9 in January, following a revised reading of 93.1 in December, citing declining unemployment and lower fuel costs buoyed consumers' outlook.

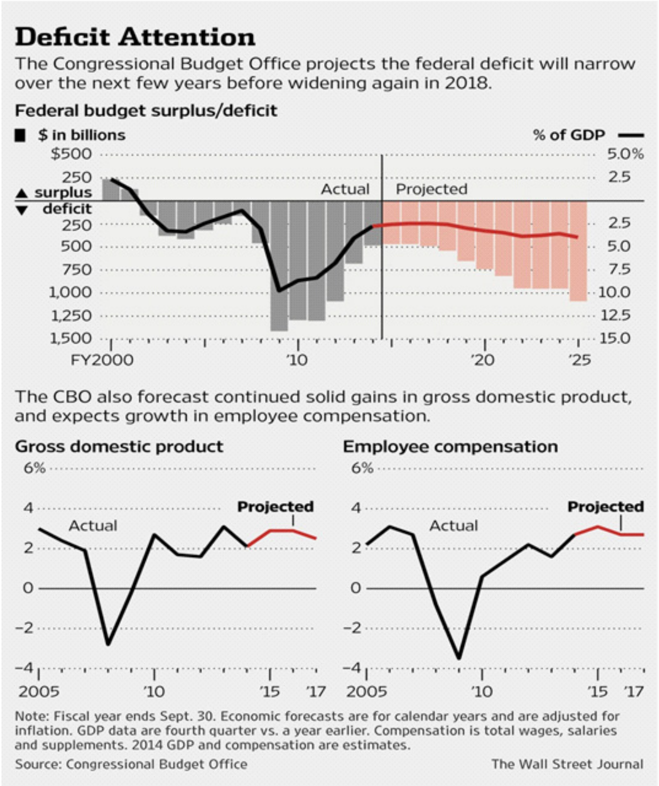
WEDNESDAY, JANUARY 28TH

- Statistics Canada reports it has revised the nation's December employment data revealing a bigger loss of 11,300 jobs from a previously reported decline of 4,300 jobs, including a gain in full-time positions reduced to 35,000 from 53,500. Part-time job losses improved to 46,300 from a loss of 47,700 previously reported on January 9th. The official unemployment rate for December was revised slightly higher to 6.7% from 6.6%.

- In a press release following its regularly scheduled monetary policy meeting, the Federal Open Market Committee (FOMC) reported it had unanimously voted to maintain its Federal Funds rate unchanged in the 0% - 0.25% range citing: "The Fed judges that it can be patient in beginning to normalize the stance of monetary policy."

- Front Page Headline, New York Times – "CBO Foresees End to Declines in U.S. Federal Budget Deficit. In updating its federal budget deficit outlook of last August, the non-partisan Congressional Budget Office in Washington forecast: 'The federal deficit will decline to $468 billion (U.S.) this fiscal year and to $467 billion (U.S.) in fiscal 2016, i.e. 2.5% of the nation's gross domestic product (GDP), from $483 billion (U.S.) in the fiscal year ended September 30, 2014. Thereafter, the budget deficit is projected to steadily increase; to $489 billion (U.S.) in 2017 and to $953 billion (U.S.) by 2023. By fiscal 2025, the annual deficit will again exceed $1 trillion (U.S.). Under current policy, the federal government will add $7.6 trillion (U.S.) to the current $18 trillion (U.S.) national debt over the next decade. Such a large and growing federal debt would have serious negative consequences, including increasing federal spending for debt servicing (interest payments), restraining economic growth in the long term, giving policy makers less flexibility to respond to unexpected challenges and eventually heightening the risk of a fiscal crisis.' With no changes in policy, aging baby boomers will take increasingly more of the federal government's money, with less and less available for anything else. Social Security expenditures will increase to 5.7% of GDP in 2025 from 4.9% next year. Health care spending will rise over that period to 6.2% from 5.3%, while spending to service the national debt will double to 3% from 1.5%.

  Senator Orrin Hatch (R. - Utah) – Chairman of the Senate Finance Committee – acknowledged: 'The CBO's report is clear. Entitlement spending, if not reformed, will drive our deficits and debt to unsustainable levels in the very near future and unsustainable entitlement expenditures will continue to crowd out spending in other areas. Political leaders in Washington must stop turning a blind eye."



THURSDAY, JANUARY 29TH

- The National Association of Realtors (NAR) reports its U.S. pending homes sales – contracts which have been signed but not yet closed – declined by 3.7% in December, following a downwardly revised increase of 0.6% in November; previously reported as a gain of 0.8%. Lawrence Yun, the NAR's chief economist, commented: "With mortgage rates at low levels not seen since early 2013, the strength in existing home sales in forthcoming months will likely depend upon the willingness of current home owners to realize their home equity gains from the past couple of years and trade up."

- The Federal Statistics Office in Wiesbaden reports Germany's inflation rate declined by 0.5% in January on a year-over-year basis; the first negative annual rate in the last five years. Christian Schulz, an economist at Berenberg Bank in London, warned: "Euro zone inflation is likely to remain negative in the first half of this year before base effects and the lower euro exchange rate could return the inflation rate into modestly positive territory. A return to the ECB's 2% target remains a distant prospect."

- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 43,000 to a seasonally adjusted 265,000 in the week ended January 24th., the lowest level since April 2000; while continuing claims fell by 71,000 to 2.39 million in the week ended January 17th.

- According to the Annual GFMS Gold Survey – a division of Thomson Reuters – The Central Bank of the Russian Federation purchased 152 metric tonnes of gold bullion during the first eleven months of 2014 – an increase of 123% compared with 2013 – worth $6.1 billion (U.S.) at today's prices. Ross Strachan, an analyst at the GFMS research group, commented: "Given the economic sanctions, there is no attraction for the Russians to be doing anything which is helpful to the U.S. and Europe. Therefore, gold is one asset which Russia can purchase which doesn't do that …While official sector purchases are forecast to continue, given low international oil prices and growing budget deficits in many purchasing nations, it appears unlikely gold purchases will accelerate." Matthew Turner, an analyst at Macquarie, noted: "Russian purchases of gold bullion represent a clear positive for the gold price. Russia remains a long way off from needing to sell gold." See also, Long Wave Group: Ian's Investment Insights – January 30, 2015.

FRIDAY, JANUARY 30TH

- Front Page Headline, GoldMoney – "More Euro Tragedy. Researcher Alasdair Macleod writes: Despite the uncertainties present ahead of the Greek general election, the European Central Bank (ECB) proceeded to announce a quantitative easing (QE) program of 60 billion euros per month from March 2015 to at least September 2016. What makes this interesting is the mounting evidence that QE does not bring about economic recovery. Even Jaime Caruana, General Manager of the Bank for International Settlements (BIS) and who is the central bankers' central banker, has publically expressed deep reservations about QE. However, the ECB ploughs ahead regardless. The Keynesians at the ECB are befuddled in their thinking. They are unable to answer Caruana's points, dismissing non-Keynesian economic theory as 'religion' and they sweep aside the empirical evidence of Keynesian policy failures. Instead, they are panicking at the spectre of too little price inflation, the continuing decline in euro zone bank lending and now falling commodity prices. To them, it is a situation that can only be resolved by monetary stimulation of aggregate demand applied via increased government deficit spending. This is behind the supposed solution of the ECB's QE program, most of which will involve national central banks in the euro-system supporting their own national governments' finances. The increased socialization of the weaker euro zone economies, especially those of France, Greece, Italy, Spain and Portugal, will inevitably lead to unnecessary economic destruction. QE always transfers wealth from savers to financial speculators and other early receivers of the new money. Somehow, the impoverishment of the working and saving masses for the benefit of the central bankers' chosen few is meant to be good for the economy. Commercial banks will be corralled into risk-free financing of their governments instead of lending to private enterprise. This is inevitable as long as the Single Supervisory Mechanism (the pan-European banking regulator) with a missionary zeal, is discouraging banks from lending to anyone other than governments and government agencies. So, the only benefit to employment will come from make-work programs. Otherwise, unemployment will inevitably increase as the states' share of GDP grows at the expense of their private sectors.

It may be that by passing government financing over to the national central banks, the newly-elected Greek government can be placated. It will be difficult for this rebelling government to refuse free money, despite how angry it may be about austerity. However, this is surely not justification for Eurozone-wide monetary policy. While the Greek government might find it easier to appease its voters, courtesy of easy credit through the Bank of Greece, hard money Germans will be horrified. It may be tempting to think that the ECB's QE relieves Germany from much of the peripheral euro zone's financing, therefore Germans are less likely to oppose the ECB's QE. Not so, because the ECB is merely the visible head of a wider euro system, which includes the national central banks, through which there are other potential liabilities. The principal hidden cost to Germany is through the intra-central bank settlement system, TARGET 2, which should only show minor imbalances. This was generally true before the banking crisis, but since then substantial amounts have been owed by the weaker southern nations, notably Italy, to the stronger northern countries. Today, the whole of the TARGET 2 system is being carried on German and Luxembourg shoulders as creditors for all the rest. Germany's Bundesbank is owed 461 billion euros, a figure which is likely to increase as the debtors' negative balances continue to accumulate.

The Currency Effect

The immediate consequence of the ECB's QE has been to weaken the euro against the U.S. dollar and importantly, it has forced the Swiss franc off its peg. The sudden 20% revaluation of the Swiss franc has generated significant losses for financial institutions which were short the franc and long the euro, which happens to have been the most important carry trade in Europe, with many mortgages in central and Eastern Europe denominated in Swiss francs as well. The Greek election has produced a further problem with a developing depositor run on her banks. Doubtless both the carry trade and the Greek bank problems can be resolved, or covered up, but problems such as these are likely to further undermine international confidence in the euro, particularly against the U.S. dollar, forcing the Federal Reserve to continue to defer the normalization of monetary policy.

This was the background to the Fed's Open Market Committee (FOMC) meeting this week and the resulting press release can only be described as a holding operation. FOMC statements such as: 'The Committee judges that it can be patient in beginning to normalize the stance of monetary policy' are indicative of fence sitting, or a lack of commitment either way. However, it is clear that despite the official line, the U.S. economy is far from 'expanding at a solid pace' and external events are not helping either. For proof of that, one need look no further than the slowdown of America's manufacturing and production facility, i.e. China.

The Consequences for Gold

Until recently, central banks have restricted monetary policy to domestic economic management. However, this is now evolving into the more dangerous stage of internationalization via competitive devaluations. Today we have two major currencies, the yen and the euro, whose central banks are set to weaken them further against the U.S. dollar. Pound sterling, being tied to the euro through international trade, by default should weaken as well. To these we can add most of the lesser currencies, which have already declined against the dollar and may continue to do so. The Fed's 2% inflation target will become more remote as a consequence and this is bound to defer the end of the FOMC's 0-25% Fed Funds policy.

Accordingly, from all points of view, competitive devaluations should prove beneficial for gold prices. To date, this has been the case, with the price of gold bullion beginning to rise against all major currencies, including the U.S. dollar, and trading above 200-day and 50-day moving averages in bullish formation. From its November low, gold has risen by 13% against the U.S. dollar, 18% against the pound, 30% against the euro and 32% against the yen. The gold price increase against weaker emerging market currencies is correspondingly greater; fully justifying Asian caution about their government currencies as stores of value.

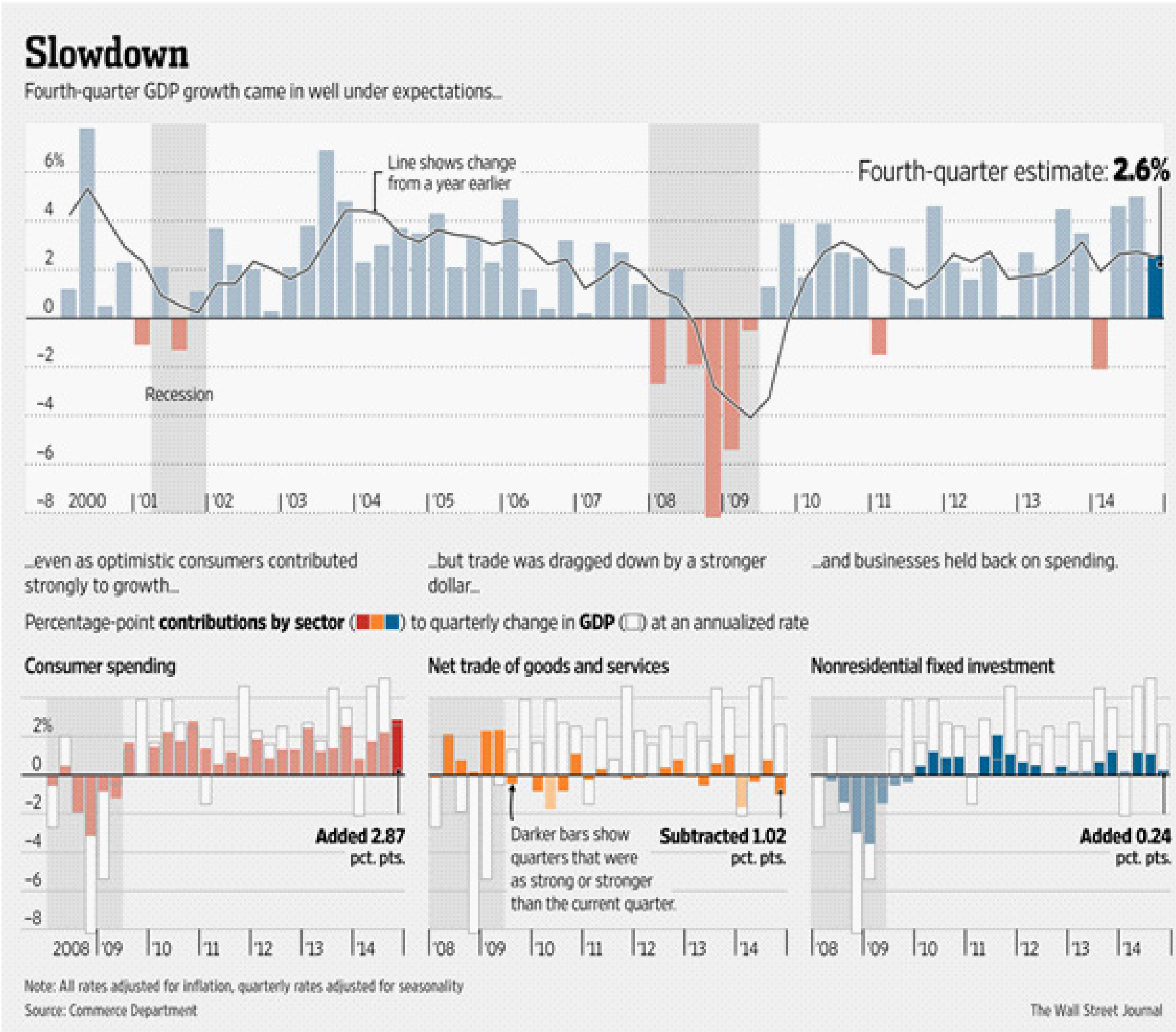
We know that Asian demand for gold bullion has absorbed all mine production, scrap and net selling of investment gold from advanced economies for at least the last two years. Indeed, the bear market in gold has been a process of redistribution from weak western hands into stronger eastern hands. So, if there is a revival in physical gold demand by the public in these advanced economies, it is difficult to see how it can be satisfied at anything like current prices, with lots of physical gold bullion already in firm hands. An improving gold price is an early warning of future monetary and currency troubles and it is now becoming apparent how they may unfold. The ECB move to give easy money to profligate euro zone politicians is likely to have important ramifications well beyond Europe. Together with parallel actions by the Bank of Japan, increasing demand for physical gold can now be expected in the advanced economies once more."

- Statistics Canada reports the nation's gross domestic product (GDP) contracted by a seasonally adjusted 0.2% in November, citing factory output slowed by 1.9% during the month; thereby, reducing the year-over-year GDP growth rate to 1.9% from October's 2.3% level.

- The Thomson Reuters / University of Michigan group reports their U.S. consumer sentiment index declined slightly to a final reading of 98.1 in January, following the preliminary reading of 98.2. Richard Curtin, the survey's director, commented: "While renewed strength in consumer spending should boost the pace of domestic economic growth in 2015, most consumers are counting on only modest income gains during the years ahead … forcing them to demand large price discounts in order to complete their purchases; thereby adding to disinflationary pressures."

- The Tempe, Arizona-based Institute for Supply Management (ISM) reports the Chicago purchasing managers' index (PMI) for the manufacturing sector rose to a reading of 59.4 in January, following a level of 58.8 in December. The ISM noted: "Business activity was led by a modest advance in the new orders sub-index and the order backlogs component."

- In a preliminary estimate, the Commerce Department reports the U.S. gross domestic product (GDP) grew at an annual rate of 2.6% in the 4th. quarter, following a 5% expansion pace in the 3rd. quarter; citing weaker business spending and a wider trade deficit.



- The National Statistics Office reports Spain's gross domestic product (GDP) grew by 0.7% in the 4th. quarter of 2014 and by 1.4% on a year-over-year basis. Raj Badiani, an economist at IHS Global Insight, commented: "Spain's increasingly broadly based economic recovery, suggests the country is well positioned to take advantage of supportive factors early this year; namely lower energy costs, lower taxes and a weaker euro."

- Front Page Headline, Mish's Global Economic Trend Analysis – "Greece Will No Longer Deal with the EC, ECB and IMF Troika. During a joint Athens news conference, Greek Finance Minister Yanis Varoufakis declared: 'Greece will no longer co-operate with the European Commission, European Central Bank and the International Monetary Fund Troika, because this position enabled us to win the trust of the Greek people.'

Visiting Athens for the first time since the elections, Jeroen Dijsselbloem, chairman of the euro zone finance ministers' committee retorted: 'I would warn the new Greek government against taking unilateral steps, or ignoring existing financial arrangements with lenders. The problems of the Greek economy have not disappeared overnight with the recent elections.'

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CLOSING LEVELS FOR FRIDAY, JANUARY 30TH.		WEEKLY CHANGE
Dow Jones Industrial Average	17,164 95	– 507.65 points
Spot Gold Bullion	1,279.20 (U.S.)	– $13.40 per troy oz.
Spot Silver	$17.26 (U.S.)	– $1.05 per troy oz.
S&P / TSX Composite	14,673.48	– 105.87 points
10-Year U.S. Treasury Yield	1.64%	– 16 basis points
Canadian Dollar	78.67 cents (U.S.)	– 1.82 cents
U.S. Dollar Index Future	94.846	– 0.148 cent
WTI Crude Oil Futures	$48.24 (U.S.)	+ $2.65 per barrel
DJIA / Gold Ratio	13.419	– 0.253 point
Gold / Silver Ratio	73.70	+ 3.10 points

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