
LONGWAVE GROUP
IAN GORDON ECONOMIC FORECASTER & INTERPRETER OF THE KONDRATIEFF CYCLE

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

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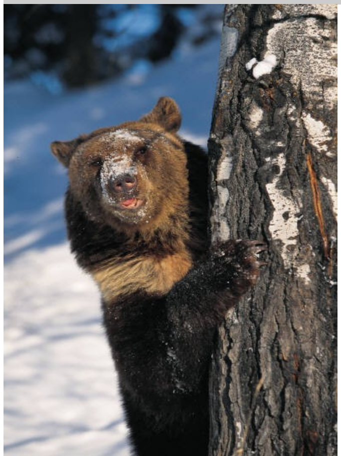
WINTER WARNING



Weak Sisters in the Euro Zone

In our Winter Warning newsletter of April 13th. *No Man Is an Island, Entire of Itself*, in addition to Ireland, we identified two other troubled economies within the Euro Zone. Accordingly, outlined below is the current economic plight of the Kingdom of Spain and the Italian Republic.

The Kingdom of Spain

In a mid-February /09 report, Moody's Investors Service highlighted several eastern European countries as being particularly vulnerable to an economic depression. Indeed, Hungary, Romania, Croatia and the Balkan states are all enduring huge budget deficits and mounting foreign debt obligations. Today, however, economic malaise is also permeating throughout western Europe to include the Iberian Peninsula of King Juan Carlos de Bourbon. In the decade 1996 to 2006, Spain's gross domestic product grew at an average annual rate of 3.7%, reflecting the surge in home building and attracted millions of immigrant workers from Latin America, north Africa and eastern Europe.

Now, with the collapse of the country's housing market, the ranks of the unemployed have swelled to a record 4.01 million people, representing17.4% of the country's work force, double the European Union average. Within the past 18 months, 700,000 construction jobs have been lost, but in the 1st. quarter of 2009, it is the services sector (which includes the tourism industry) which has suffered the most job losses. Indeed, according to the National Statistics Institute, since January, Spain has been losing jobs at a rate of almost 9,000 per day. Spain's wage inflation has priced its work force out of Europe's markets and in the coming months, economists expect the Spanish unemployment rate to exceed 20%, with over 5 million people out of work. Moreover, Prime Minister Zapatero's 70 billion euro economic stimulus plan could cause Spain's budget deficit to exceed 8% of GDP this year, more than double the Euro zone limit. We are inclined to agree with these predictions.

The Italian Republic

As we know, hindsight is always 20/20, but it is becoming increasingly obvious that Italy should never have been invited into the European Monetary Union (EMU) carrying a sovereign debt load nearly double the Maastricht Treaty limit. Indeed, Italy's public debt now totals in excess of 106% of its gross domestic product and its fiscal deficit exceeds 4% of its GDP. Italy's financial plight is now so grave that it actually might benefit from leaving the Euro, in order to allow its economy to determine the correct exchange rate. A recent analyst report by HSBC states that it is difficult "*to exaggerate the scale of Italy's economic problems. The government has squandered the windfall benefits of joining the Euro, delayed economic reform and as a result, unit labour costs have increased by over 40% since 1995.*" In effect, Italy has become chronically overvalued against the other euro zone countries, with neither an escape route, nor, a disaster plan in place.

Sadly, following elections held earlier this month, the Italian government appears to lack both the political will and the voting power to generate any serious economic reform plan. Ratings agency Standard & Poors recently threatened a downgrade of Italian sovereign debt unless Rome took "*urgent*" measures to resolve Italy's fiscal crisis. The agency stated that "*the long-term debt rating could be lowered this year, if no signs of a sustainable and coherent debt reduction strategy emerge.*" Moreover, Mr. Joaquin Almunia, the European Union's monetary affairs commissioner recently told a group of bankers and fund managers that the markets were "*not properly pricing the risk*" of Italian sovereign debt. Mr. Almunia further stated that bond yield spreads between Italian debt issues and German bunds "*may widen further to reflect the default risk in Italy*" which has the world's largest stockpile of public debt after Japan and the United States. Et tu, Brute?

Solidarity Forever?

Yesterday, the Canadian Auto Workers Union (CAW) 8,000 factory workers voted on a final potential agreement with Chrysler Canada, ceding perks and making concessions totaling $240 million (CAD) annually, in the hope that their jobs would be salvaged because Chrysler would be granted Canadian government financial assistance. To their credit, rank-and-file common sense prevailed with an 88% ratification vote. Regrettably, such an outcome, however, does not occur as a result of any brilliance displayed by union leaders. Indeed, during recent negotiations, Ken Lewenza, CAW's national President, said he felt that "*a cannon was being held to his head*" by Chrysler and the Canadian government, in order to gain concessions from the union. In a statement released last week, Mr. Lewenza denounced the federal government and Chrysler for making "*painful*" demands on his members based on misleading financial information. "*We will work to defend the interests of Canadian autoworkers*", Mr. Lewenza said, arguing that his union has a track record of making Canadian auto plants competitive; "*if Chrysler goes into bankruptcy protection, it will not be because of us*". When will union leaders like Mr. Lewenza ever recognize the economic reality of the day? The answer is probably never! Their attitude is that Chrysler should be grateful that their employees report for work every day and that the company management owes them a living.

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