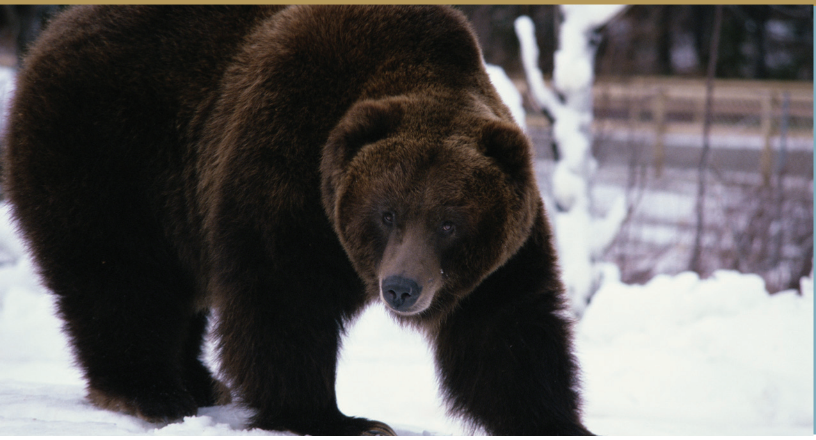
Volume 22 | Issue 1 . November 8, 2010

LONGWAVE group

THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

WINTER WARNING



The Impending Implosion of America

In our Winter Warning of October 20, 2008, "Closing the Barn Door After the Horse Has Fled" – "The Wolves of Avarice" – we warned "if Senator Obama is elected President, together with a Democratic majority in the Senate and twenty seats gained in the House of Representatives, then decidedly, there will be change in America … economic change for the worse!" As formerly jubilant American voters of November, 2008 have discovered, Barack Obama's presidential campaign founded on "hope and change" has transformed him to a "lame-duck" President in fairly short order. Not surprisingly, the results of the recent mid-term elections revealed an angry and frustrated electorate. Since Republicans now have firm control of the House of Representatives and Democrats cling to control of the Senate, politicians will be forced to work together in a co-operative and bipartisan manner in order to achieve any progress, or compromise with any contested legislation. Moreover, with a myriad of formidable problems and challenges currently facing the nation, Americans are literally crying out for leadership from the White House. Alas, we are not optimistic that anything meaningful will materialize on that front.

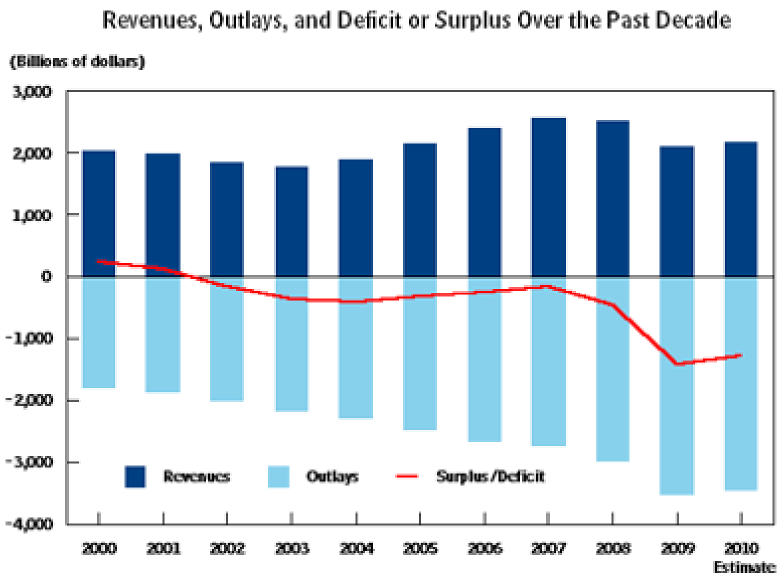
The Politics of Gridlock

In our Winter Warning of September 28, 2009, "The American Greenback Will Be Cast into the Hazard" – we warned "with Barack Obama likely to be a one-term President, the American electorate, engulfed in debt and facing inevitable tax increases to pay for soaring government deficits, could ultimately embrace a political alternative of scary proportions." The unspoken goal of the rejuvenated Republican camp is, no doubt, to ensure Barack Obama becomes a one-term President. Already, Mr. Obama has invited Republican leaders to the White House to discuss a compromise for extensions to the Bush tax cuts that are slated to expire on January 1, 2011. It is quite obvious that nobody in America is in favour of tax increases, however, there is mixed support for government spending cuts where the margin for same still exists. Assuredly, an economic civil war could erupt in 2011 between liberals and conservatives regarding taxation reform, repeal of the health care bill and government spending. However, Republicans are likely to be stubborn, determined and patient in their agenda; setting their sights on the Presidential election in 2012. Political gridlock in America is a clear and present danger in 2011.

The Fiscal Deficit and the U.S. Greenback

The American fiscal deficit for the year ended September 30, 2010 totaled $1.3 trillion (U.S.) equivalent to 9% of gross domestic product (GDP) and is on an unsustainable trajectory. At present, both Federal Reserve Chairman Bernanke and Treasury Secretary Timothy Geithner possess an inconsequent mindset when it comes to the federal deficit. They believe that the federal budget deficit can be eradicated through economic growth. Their priority is unlimited economic stimulus injections, such as quantitative easing (QE) initiatives (the printing of money),which they believe will induce GDP growth, increase government tax revenues and spur share prices higher in the stock market. In its most recent economic policy statement, the Federal Open Market Committee (FOMC) tried to justify its latest QE initiative by referring to its primary mandate to foster "maximum employment and price stability."

Interestingly, by comparison, it is the legislated mandate of the Bank of Canada to "preserve the value of the Canadian Dollar" by keeping inflation low and stable. Attending the Asian-Pacific Economic Co-operation (APEC) forum in Kyoto, Japan on the weekend, U.S. Treasury Secretary Geithner remarked: "We (the U.S.) will never use our currency as a tool to gain a competitive (trade) advantage. The United States is committed to a strong dollar." While this policy statement may be wishful thinking in theory, assuredly, it is a definite falsehood in practice. If Mr. Geithner doesn't understand how the U.S. is blatantly eroding the purchasing power of the dollar via its QE policy, then he should either resign out of ignorance, or along with Mr. Bernanke, fully admit to the fact that such policies are followed at the behest of the owners of the Federal Reserve, i.e. a consortium of banks led by the Rothchilds of Europe. The sooner Congress can force a Federal Reserve audit in the new year, the better.

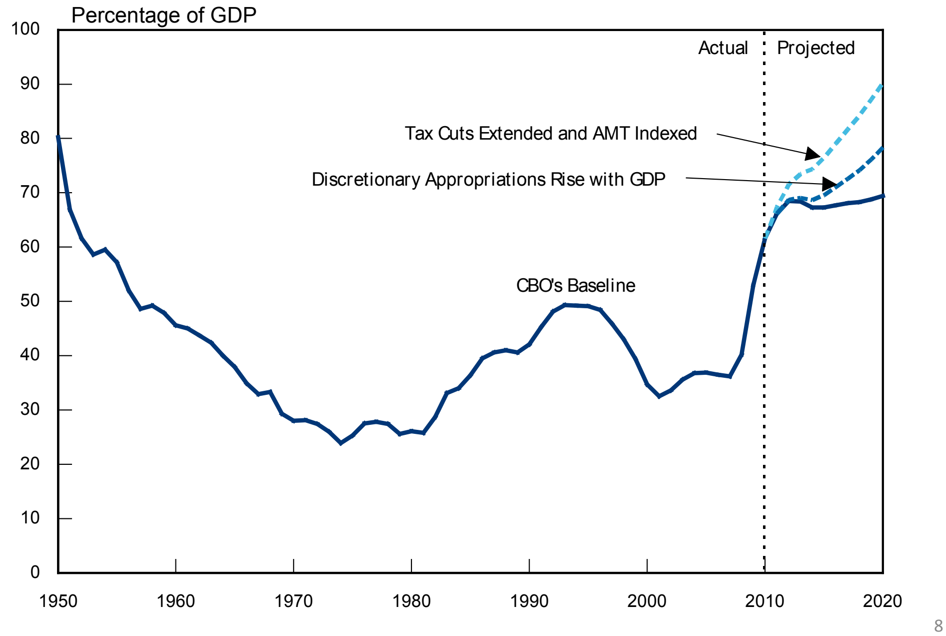


Source: U.S. Congressional Budget Office

The National Debt

The U.S. national debt now totals $13.7 trillion and will likely reach $14 trillion by the time President Obama delivers his annual State of the Union Message in late January. One of the phenomenal aspects regarding the size and growth of the U.S. national debt is that most Americans are oblivious to it. Whimsically, they believe that due to America's historical economic strength and the fact that foreign investors purchase U.S. Treasury notes and bonds, because they are naively deemed to be "a safe haven," that all is O.K. on the western front. What happens when interest payments on the outstanding national debt consumes such a disproportionate share of the federal budget that it necessitates major budget cutbacks of vital government departments? Sometime probably within the next 5 years, what a shock it will be to fixed income investors when they learn that United States sovereign debt has been downgraded from AAA to AAA (Low) with a negative outlook. Of course, bond investors will have made nominal yield and yield spread adjustments in the sovereign debt market long before then.

Rising Burden of Federal Debt Held by the Public



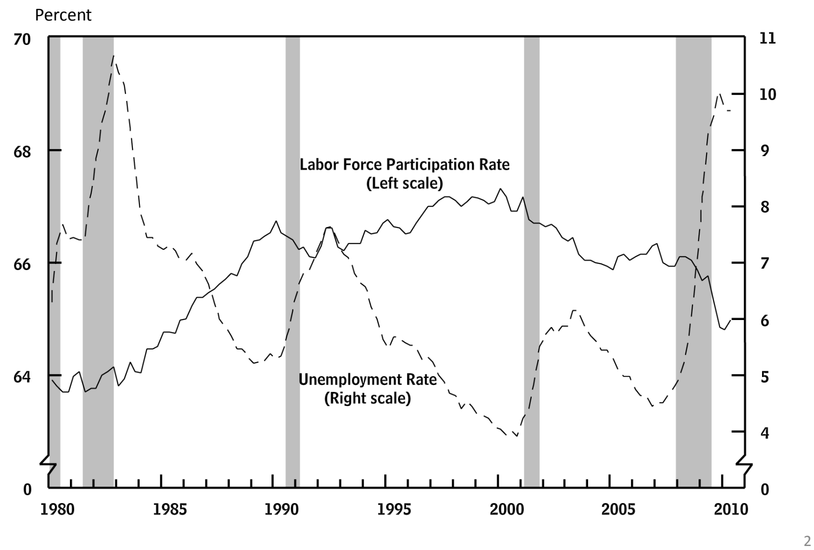
Source: U.S. Congressional Budget Office

The Scourge of Unemployment (2)

At present, contending with staggering levels of debt and virtually double-digit unemployment, the U.S. economy can be likened to a ship becalmed on the Sargasso Sea. Gross domestic product growth struggles to remain in positive territory, unmoved by an army of spent consumers. Mortgage debt, credit card debt and bank lines of credit have combined with the high unemployment rate causing consumers to reduce spending and focus more on deleveraging. Fifteen million Americans are currently out of work and it will take years to make an appreciable dent in that number. Exacerbating the jobless situation is the impact that global competition and advanced technology is having on American companies. U.S. manufacturing businesses are discovering they can increase production while employing fewer workers. The American middle-class assembly line worker has, to a large extent, been replaced by a foreign worker at significantly less cost.

While the official U.S. unemployment remained unchanged at 9.6% in October, John Williams, editor of Shadow Government Statistics, reports: “Of major significance, those large (payroll) revisions and the October gain largely were the result of seasonal adjustment gimmicks; they were not reflected in the underlying unadjusted numbers; so the underemployment rate remained unchanged at 17%.” Howard Segermark, of his own government relations and consulting firm notes: “The only numbers I believe out of Washington are the mile markers on I 95.”

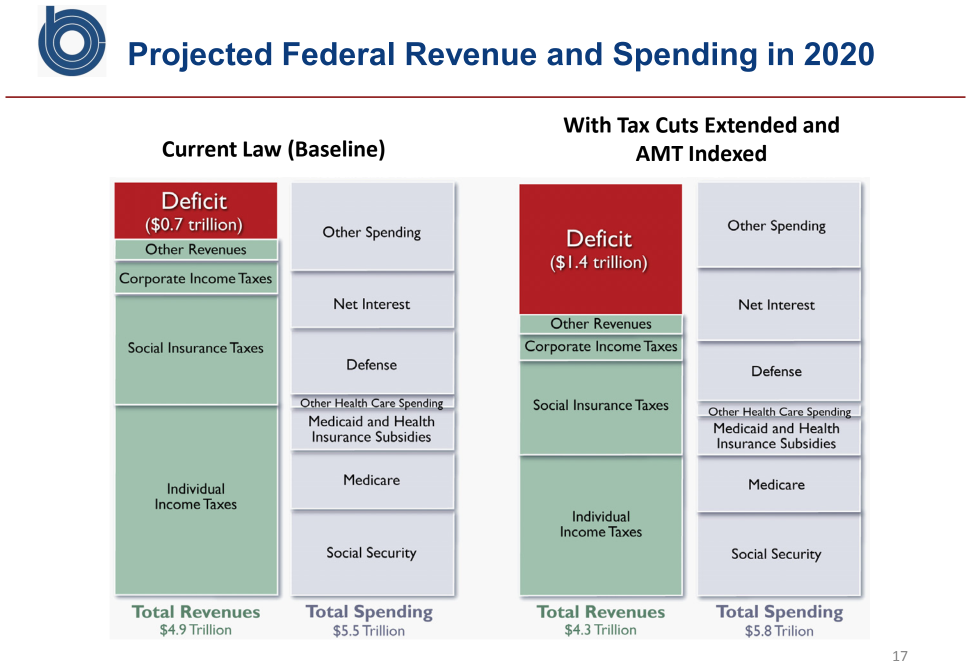
Labor Force Participation and Unemployment Rates



Source: U.S. Congressional Budget Office

The Downsizing of a Superpower

Around the globe, America is gradually losing its status and influence as a superpower. Most of its economic problems have been self-inflicted, due to many decades of depletion and mismanagement of its own resources. This has resulted in many years of current account deficits and trade deficits. Some of America's largest imports include: crude oil, nickel, nuclear fuel, tin, precious metals, petroleum products, electricity, foodstuffs and food grains. Moreover, it has not maintained its infrastructure at a high standard. Thousands of bridges are structurally deficient or functionally obsolete. A third of the nation's highways are in poor or mediocre shape. Massively leaking water and sewage systems are creating health hazards and contaminating rivers and streams. Weakened and under-maintained levees and dams tower over communities and schools. The power grid is increasingly maxed out, disrupting millions of lives and putting entire cities in the dark.



Source: U.S. Congressional Budget Office

Imperial Overstretch

In his book, The Rise and Fall of the Great Powers, author Paul Kennedy warns: the United States, "like imperial Spain around 1600 or the British Empire around 1900, is the inheritor of a vast array of strategic commitments which had been made decades earlier, when the nation's political, economic and military capacity to influence world affairs seemed so much more assured. In consequence, the United States now runs the risk, so familiar to historians of the rise and fall of previous great powers, of what might roughly be called 'imperial overstretch:' that is to say, decision makers in Washington must face the awkward and enduring fact that the sum total of the United States' global interests and obligations is nowadays far larger than the country's power to defend them all simultaneously."

Summation

Certainly, having forged itself a ponderous chain of debt on many fronts, the United States, the world's largest debtor nation, is in no financial position to defend all its global interests simultaneously. We believe that America's primary position in world affairs is corroding – opening the door for countries such as China, which is intent upon assuming the global leadership mantle both economically and militarily. In testimony to the House Financial Services Committee on February 25, 2010, U.S. Federal Reserve Chairman Ben Bernanke delivered a very blunt warning regarding the country's debt situation: "It is not something that is 10 years away. It affects markets currently. It is possible that bond markets will become worried about the sustainability of annual deficits over $1 trillion, and we may find ourselves facing higher interest rates even today. We're not going to monetize the debt. It is very, very important for Congress and the administration to come to some kind of program, some kind of plan that will credibly show how the United States Government is going to bring itself back to a sustainable position." About $2.3 trillion (U.S.) of announced monetization later, the above quote is just a bigger lie from the Pinocchio of all central bankers.

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Written By: Christopher Funston