

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE  
**THAT WAS THE WEEK THAT WAS**



Monday, May 10TH

The European Union (EU), the European Central Bank (ECB) and the International Monetary Fund (IMF) combine resources to mount a 750 billion euro (\$980 billion U.S.) support package for EU member

MONDAY, MAY 10TH

countries struggling with gaping budget deficits and formidable funding problems, notably, Greece, Portugal and Spain. The package consists of a 440 billion euro loan pledge funded by EU countries, a 60 billion euro loan commitment from the EU's budget and up to 220 billion euros from the IMF, which had already contributed 30 billion euros to Greece's emergency loans. In addition, the ECB will expand its liquidity provisions with other central banks, including Canada's, renew dollar liquidity swaps with the U.S. Federal Reserve and create a program to allow the ECB to purchase EU sovereign government debt.

- A report prepared for the Quebec government warns that a national securities regulator would put thousands of jobs at risk. Finance Minister Raymond Bachand stated that single regulator headquartered in Toronto, would deprive Quebec "of an important support for its economic development and contribute to weakening Montreal as a financial centre." Quebec has already filed a lawsuit against the federal government's initiative.
- The State of Israel announces it has joined the Organization for Economic Co-operation and Development (OECD), an elite group of 31 industrialized economies. The Paris-based OECD welcomed Israel along with Estonia and Slovenia, citing "Israel's scientific and technological policies have produced outstanding outcomes on a world scale." OECD secretary-general Angel Gurría commented: "This new chapter in the history of the organization confirms our global vocation as the group of countries that searches for answers to the global challenges and establishes standards in many policy fields; such as environment, trade, innovation or social issues."
- The Federal National Mortgage Association (Fannie Mae) requests another \$8.4 billion (U.S.) in government assistance. The U.S. government has already injected \$137.5 billion (U.S.) into Fannie Mae and its cousin the Federal Home Loan Mortgage Corp. (Freddie Mac), since seizing the two mortgage financing giants in August, 2008. That money covers losses on mortgages that the companies bought or guaranteed during the housing boom, allowing them to continue buying new loans. For the time being, quarterly requests for additional cash infusions are basically, a formality. Late in 2009, the Obama administration committed to cover all losses by the two companies through 2012.
- The Royal Bank of Scotland (RBS) announces 2,600 job layoffs mainly from its insurance division, which owns well-known brands such as Churchill and Direct Line. European Union (EU) pressure has been blamed for the cuts, which the bank cited were driven by the need to prepare the insurance business for a sale by 2013 – the deadline imposed by the European Commission for the operation's disposal.
- The U.S. Securities and Exchange Commission (SEC) has warned Moody's Investors Service that it may sue the company for making "false and misleading" statements as part of its application as a ratings organization. The SEC sent Moody's a Wells notice – the regulator's method of signaling that it is considering legal action against a firm. Moody's revealed that it received the notice on March 18th. and disclosed it on a quarterly filing on Friday, May 7th.

## TUESDAY, MAY 11TH

- The June spot future price for gold bullion closes at \$1,220.30 (U.S.) per ounce, surpassing the December 3, 2009 all time high spot future close of \$1,218.30 (U.S.) per ounce, marking an upside price breakout on the chart
- The U.S. Senate approves an amendment to sweeping bank reform legislation that would direct the U.S. Treasury Department to study and make recommendations about how to end the government's control of mortgage finance giants Freddie Mac and Fannie Mae in a way that minimizes costs to taxpayers. The amendment directs the studies to examine different options, such as their breakup or privatization. The amendment was adopted by a vote of 63 to 36.
- In Canberra, Australia's Treasurer Wayne Swan releases his budget, forecasting a \$40.8 billion (AUD) deficit for the fiscal year ending June 30, 2011 and a \$1 billion (AUD) surplus for the fiscal year ending June 30, 2012. Stephen Walters, chief economist at JP Morgan Chase in Sydney, cites Australia's "big (economic) advantage is that we've got this big wave of mining investment coming down the pipe and prices" of commodities rising.
- New York Attorney General Andrew Cuomo launches a civil lawsuit against Ivy Asset Management, a unit of Bank of New York Mellon, and former chief executive Lawrence Simon and chief investment officer Howard Wohl, citing they failed to disclose information that pointed to problems at Bernard L. Madoff Investments. Mr. Cuomo alleges that Ivy's internal memos and e-mails reveal that Ivy had discovered that Mr. Madoff was not investing in the manner he had described. Yet Ivy and its executives refrained from telling investors, for fear of losing out on lucrative fees. According to Mr. Cuomo, Ivy made about \$40 million (U.S.) over 10 years for advising several large Madoff investors, but Ivy's clients lost in excess of \$227 million (U.S.). In a statement, Mr. Cuomo commented: "Ivy and its former co-principals saw the trouble with Madoff coming around the bend, but instead of guiding their clients through the financial waters, they sold them down the river. They shamelessly, profited from their own clients' impending misfortune."
- After the Conservatives and Liberal Democrats agree to a 5-year commitment to form Britain's first coalition government since the Second World War, David Cameron becomes Prime Minister of the United Kingdom. Speaking outside Number 10 Downing Street, at the end of five days of tense political negotiations, Mr. Cameron pledged to tackle Britain's 163 billion pound deficit, reform the U.K. political system and repair the country's society.

- The Office of National Statistics reports U.K. manufacturing production rose by 2.3% in March from February, citing manufacturers benefited from the weaker pound which fueled exports

## WEDNESDAY, MAY 12TH

- The Commerce Department reports the U.S. federal government deficit totaled \$82.7 billion (U.S.) in April, marking the 19th. consecutive monthly budget deficit – the longest on record. For the first seven months of fiscal 2010 ending September 30th. the cumulative budget deficit totals \$799.68 billion (U.S.), which represents \$1.372 trillion (U.S.) on an annualized basis.
- The U.S. trade deficit expanded by 2.5% in March to \$40.4 billion (U.S.)
- Canada recorded a trade surplus of \$254 million (CAD) in March compared with a surplus of \$1.2 billion (CAD) in February
- The Wall Street Journal reports the U.S. Justice Department is investigating whether Morgan Stanley misled investors about mortgage collateralized debt obligations (CDOs) it helped structure, market to investors and sold short, as the domestic housing market imploded. Investigators are examining whether Morgan Stanley made proper representations about its roles.
- Spain's Prime Minister, Jose Luis Rodriguez Zapatero, announces a surprise 5% cut in civil service remuneration, in order to accelerate reductions to the country's deficit. This new austerity initiative follows intense pressure from Spain's European neighbours, the International Monetary Fund and the United States to introduce budget cuts, in order to attest to the credibility of the European Union's support for Greece and by association, other periphery members of the euro zone.
- Britain's new coalition government proposes an immediate 6 billion pound cut in public spending, winning enthusiastic support from Mervyn King, Governor of the Bank of England, citing: "the coalition's deficit reduction plan was strong and powerful; and that plans for 6 billion pounds of (spending) cuts this fiscal year, were sensible."
- According to the New York Times, Citigroup, Credit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs and Merrill Lynch are being investigated by New York Attorney General Andrew Cuomo, over allegations they misled ratings agencies, in order to inflate the investment rating grades of certain mortgage-related securities, in the years leading to the collapse of the U.S. housing market in 2008.

## THURSDAY, MAY 13TH

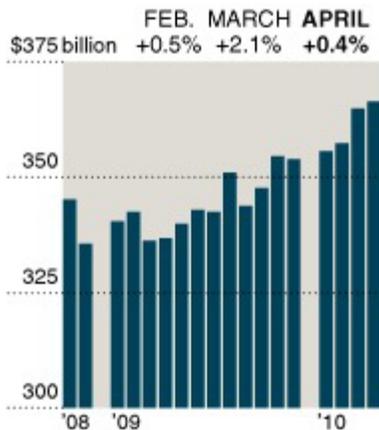
- The Labor Department reports initial claims for state unemployment benefits fell by 4,000 to 444,000 in the week ended May 8th. from an upwardly revised 448,000; while continuing claims rose by 12,000 to a seasonally adjusted 4.63 million in the week ended May 1st.
- A unit of China Investment Corp. (CIC) will invest \$817 million (CAD) to buy a 45% interest in an oil sands joint venture with Penn West Energy Trust. The partnership will develop Penn West's bitumen assets in the Peace River area of northern Alberta. Penn West announced that the joint venture "is an important element of our strategy, since it provides for the development of the assets from the current resource appraisal phase, to commercial scale development and production."
- Greece's Statistical Authority reports the country's unemployment rate rose to 12.1% in February from 11.3% in January, citing an increase of 38,000 people out of work for a total of 605,277
- According to SpendingPulse, which estimates consumer spending in all forms, U.S. retail sales (excluding automobiles) declined by 2% in April compared to March
- RealtyTrac Inc. reports while the number of U.S. households facing foreclosure declined by 2% in April on a year-over-year basis, banks still seized a record 92,000 homes last month
- Despite U.S. Treasury Department programs intended to ease access to credit for small American businesses, a recent report by the Congressional Oversight Panel concludes: "It is not clear that any of the programs ... in place to date had a noticeable impact on small business lending. If credit is unavailable, small businesses may be unable to meet current business demands, or take advantage of opportunities for growth, potentially, choking any incipient economic recovery."
- The European Commission (EC) proposes an EU centralized review of member countries' budgets, prior to their submission to sovereign parliaments, as an initial step toward a tighter integration of fiscal plans in Europe
- Eurostat, the European Union's statistics agency, reports the euro zone gross domestic product (GDP) expanded by 0.8% on an annualized basis, in the 1st. quarter
- Portugal's government announces new austerity measures including a "crisis tax" on wages and big companies, as part of a plan to reduce its budget deficit from 9.4% in 2009 to 4.6% in 2011. In addition, politicians and public sector managers will have their salaries reduced by 5%. Portuguese Prime Minister Jose Socrates warned: "These measures are absolutely necessary to defend our country, Europe and the single currency."
- The Italian government auctions 3 billion euros of 5-year notes at an average yield of 2.57% and 2 billion euros of 15-year bonds at an average yield 4.42%. While both auctions received solid investor demand, the 5-year tranche was sold at a premium of 2 basis points to comparable outstanding issues, but the 15-year tranche was marketed at a 9 basis point discount to comparable outstanding issues.
- The Office for National Statistics reports Britain's trade deficit with the euro zone increased to 7.5 billion pounds in March from 6.3 billion pounds in February, citing exports were steady at 21.4 billion pounds but imports rose to 28.9 billion pounds
- At his recent Inflation Report press conference, Bank of England Governor Mervyn King comments on the fiscal positions of the U.S. and the U.K. in relation to the recent financial problems encountered by Greece: "Every country around the world is in a similar position, even the United States; the world's largest economy has a very large fiscal deficit. One of the concerns in the financial markets is clearly – how will this enormous stock of public debt be reduced over the next few years? It's very important that governments, both in Britain and elsewhere, come to grips with this problem, have a very clear and credible approach to reducing the size of those deficits over, in Britain's case, the lifetime of this parliament (5 years), in order to convince markets that they should be willing to continue to finance the very large sums of money that must be raised from financial markets over the next few years, at reasonable interest rates."

## FRIDAY, MAY 14TH

- Statistics Canada reports manufacturing sales increased by 1.2% to \$44.5 billion (CAD) in March, led by automobile manufacturers and food processors
- The Commerce Department reports that U.S. retail sales rose by 0.4% to a seasonally adjusted \$366.4 billion (U.S.) in April. Meanwhile industrial production rose by 0.8% in April, compared with a 0.2% increase in March

## Retail Sales

Total retail and food service sales, seasonally adjusted.



Source: Commerce Department

- Introducing a revised budget for the fiscal year ending June 30, 2011, California Governor Arnold Schwarzenegger proposes to eradicate a \$19 billion (U.S.) deficit with \$12.4 billion (U.S.) in spending cuts and \$4.9 billion (U.S.) in higher taxes. Specifically, personal income taxes would rise by 5.1%; corporate taxes would be increased by 4.2% and liquor taxes would climb by 6.6%. An estate tax would be imposed; as would a 4.8% surcharge on residential and commercial insurance policies, to pay for fire protection. In addition, most state employees would endure a 10% reduction in wages; the mental health care budget would be cut by 60% and child care programs for the poor would be eliminated. Naturally, these revised budget proposals must be approved by the state legislature in Sacramento before being enacted into law. Not a hope in Hades, Arnold!
- In an interview with Germany's ZDF television, Deutsche Bank Chief Executive Officer, Josef Ackermann, comments on the financial outlook for the weak sisters of the euro zone: "I would doubt that Greece, over time, will be in a position to come up with the economic potential" to repay what it owes. "Europe must intensify efforts to turn around Greece's financial situation to avoid a need to restructure its debt, since this would (negatively) impact German banks. Italy and Spain will be strong enough to service their debt, but in the case of Portugal, things are more difficult."

Ian A. Gordon, The Long Wave Analyst

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- In its regular report on public finances, the International Monetary Fund (IMF) warns the world's rich economies are continuing to increase public debt and suggests steep increases in value-added-taxes (VAT) and excise duties as a way to reduce sovereign debt and deficits. The IMF states that "fiscal balances in the advanced economies are, on average, worsening. To bring the ratio of debt to gross domestic product (GDP) back to the pre-crisis average of 60% by 2030, advanced economies must tighten spending policies by a daunting 8.7% of GDP." Look not to the Obama administration to provide any leadership on this front. Indeed, at Long Wave Analytics, we expect that the U.S. gross domestic product could decline by 40% over the near to medium term, mirroring the depression experience of 1929-1931. This would take the GDP down to the \$8 trillion level and cause America's debt to GDP ratio to skyrocket to the 175% range.

