

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



Monday, June 7th

The Federal reserve reports U.S. consumer credit outstanding increased at a seasonally adjusted annual rate of 0.5% in April to \$2.44 trillion (U.S.)

MONDAY, JUNE 7TH

- Germany's Chancellor Angela Merkel announces a government austerity plan to cut welfare benefits, introduce new taxes and shed 10,000 public sector jobs, in order to save 80 billion euros (\$96 billion U.S.) through 2014. At a news conference, Ms. Merkel stated: "Germany, as the biggest (European) economy, has the outstanding task of setting a good example. The last few months have shown, in connection with Greece and other euro states, what an outstanding significance solid finances have; that they are the precondition for being able to live in stability and prosperity."
- The U.S. Financial Crisis Inquiry Commission (FCIC) issues a subpoena for documents from Goldman Sachs Group, citing Goldman refused to submit the documents voluntarily. The FCIC is demanding that Goldman provide a key for identifying customer names, as well as a way of matching specific documents to the commission's request for information. The subpoena also demands documents relating to Goldman's mortgage-backed securities underwritings; as well as interviews with a number of Goldman executives most knowledgeable about "transactions between AIG and Goldman."



- The Bank of America agrees to pay \$108 million (U.S.) to settle Federal Trade Commission (FTC) claims that Countrywide, the mortgage lender it acquired in June 2008, cheated more than 200,000 thousand customers facing foreclosure on their homes. The FTC stated the settlement represented one of the largest ever against a company. The charges involved activity at Countrywide prior to its acquisition by the Bank of America. Let the record show how this settlement reflects the incompetent takeover due diligence conducted by former B of A President Ken Lewis. See Winter Warning, February 2, 2009 – The Clash of Cultures.

- The Labor Department reports California's non-farm payrolls declined by 2.5% in April on a year-over-year basis, compared with a 1.1% decline nationally. Moreover, the most populous state's 12.6% unemployment rate far exceeded the national rate of 9.9% in April. Combined with a \$19 billion (U.S.) budget shortfall through June 2011, slow employment growth will definitely figure prominently in Tuesday's state primaries and November's mid-term elections.
- Chrysler is recalling 288,968 Jeep Wranglers in the U.S. from the 2006 to 2010 model years, due to a potential brake fluid leak. The company is also recalling 284,831 Dodge Grand Caravan and Chrysler Town & Country minivans from the 2008 and 2009 model years, because a wiring problem can cause a fire inside the sliding doors. Another 76,430 Wranglers and 34,143 minivans are being recalled in Canada, Mexico and other international markets.

TUESDAY, JUNE 8TH

- The Canada Mortgage and Housing Corp. (CMHC) reports the country's seasonally adjusted annual rate of housing starts ebbed to 189,100 units in May from a revised 201,800 in April. The report arrives amid signs that Canada's resale market is slowing. Bob Dugan, chief economist at CMHC's market analysis centre, commented: "Housing starts declined in both the singles and the multiples segments in May and is consistent with our forecast that starts for 2010 will shrink to 182,000 units."
- General Motors announces it is recalling 1.5 million vehicles worldwide to address a problem with a heated windshield wiper fluid system that could lead to a fire. The recall affects several pickup trucks, sport utility vehicles, crossovers and passenger car models from the 2006 to 2009 model years. Jeff Boyer, GM's executive director of safety, stated: "While our analysis shows the number of incidents is very small compared with the number of vehicles on the road, we want our customers to have complete peace of mind."
- In a special report, Fitch Ratings warns Britain faces a "formidable" challenge to put its public finances in order, since the country's debt has grown faster than any other 'AAA' rated sovereign nation and the deficit reduction needed to stabilize its debt is among the highest of the world's advanced economies. Fitch stated that although the Conservative-Liberal Democrat coalition government has acted "very quickly" to make deficit reduction a top priority, it wasn't "completely obvious from policy statements that the new government will adopt lower government (deficit) forecasts throughout the medium term."

- Attending a dinner at the Woodrow Wilson International Center for Scholars, Federal Reserve Chairman Ben Bernanke commented: "My best guess is we'll have a continued (economic) recovery (but) it won't feel terrific. The reason it won't feel terrific is that the economy is not going to grow fast enough to put back (to work) eight million people who lost their jobs within a few years. So far, the (economic) news is pretty good. We've seen the consumer coming back and firms spending more. There are some signs the private sector is picking up the baton and moving the economy forward." Since the U.S. national debt recently surpassed the \$13 trillion level, we suggest Mr. Bernanke does his country a great disservice by constantly rearranging the deck chairs aboard the U.S.S. Titanic. The chairman should get with the economic reality of the times and admit that the U.S. is in the same boat as the U.K.
- The Prime Minister of Hungary, Viktor Orban, announces a 29-point budgetary plan, including cuts in public sector wages and new levies on banks, as part of its efforts to reassure nervous bond investors that the country can reach its budgetary targets. Introducing the measures before Parliament, which is expected to approve them, Mr. Orban stated: "The time has come to replace the country's old economic system with a new one."

WEDNESDAY, JUNE 9TH

- In testimony before the House Budget Committee, Federal Reserve Chairman Ben Bernanke commented: "Although the support to economic growth from fiscal policy is likely to diminish in the coming year, the incoming (economic) data suggest that gains in private final demand will sustain the recovery in economic activity. The (U.S.) economy appears to be on track to continue to expand through this year and next." At Long Wave Analytics, we completely disagree with Chairman Bernanke's view that the U.S. economy can grow its way out of its current government deficit and national debt problems; as well as reduce a continuing high rate of unemployment.
- In its latest beige book report, the U.S. Federal Reserve stated: "Economic activity continued to improve since the last report across all 12 Federal Reserve districts, although many districts described the pace of growth as modest. Higher input costs were not being passed along to customers and wage pressures continued to be minimal. Contacts indicated that the potential (negative) impact on the tourism industry along the coastline of Louisiana, Mississippi, Alabama and western Florida could be substantial."

- According to the Financial Times, the U.S. Securities and Exchange Commission (SEC) has accelerated its inquiries into a complex mortgage-backed underwriting by Goldman Sachs in 2006, that was not part of the civil fraud charges against the bank in April. SEC interest in Hudson Mezzanine Funding, a \$2 billion (U.S.) collateralized debt obligation (CDO), heightens amid settlement talks with Goldman regarding accusations that the bank defrauded investors in an Abacus underwriting, a similar CDO, in 2005.
- Basis Yield Alpha Fund Master (BYAFM), an Australian hedge fund, sues Goldman Sachs for \$1 billion (U.S.), claiming the bank made “misleading statements” in connection with a Timberwolf issue, a complicated mortgage-backed security that the bank underwrote in 2007. BYAFM, which imploded as a result of a series of levered investments in mortgage-backed securities, paid \$78 million (U.S.) for securities with a face value of \$100 million (U.S.), just as the market for collateralized debt obligations (CDOs), backed by sub-prime mortgages, deteriorated. Goldman also provided financing for the purchase, on which BYAFM lost \$56 million (U.S.). The lawsuit also claims the loss on its investment in Timberwolf and Goldman’s subsequent margin calls “forced BYAFM into insolvency.”
- In a speech to an investment forum in Singapore, Naoyuki Shinohara, a managing director of the International Monetary Fund (IMF), warned that the European sovereign debt crisis could spread to Asia: “Adverse developments in Europe could disrupt global trade with implications for Asia, given the still important role of external demand.” Mr. Shinohara also warned that although Asia’s bright growth prospects were currently attracting capital, “further increases in global risk aversion could see capital flows change direction quickly.”
- The U.S. warns Germany that Berlin’s unilateral ban on naked short selling should not be allowed to jeopardize any economic recovery. In a Berlin interview, U.S. Treasury Secretary Timothy Geithner stated: “I think we all agree that we want more conservative restraints on capital and leverage, but such action must be designed with care so it makes the system more stable in the future, but doesn’t create a risk of financial headwinds to the economic recovery.”
- The Labor Department reports U.S. claims for state unemployment benefits declined by 3,000 to 456,000 in the week ended June 5th. while continuing claims declined by 255,000 to 4.46 million in the week ended May 29th. In a research note, Ian Shephardson, an economist with High Frequency Economics, writes: “With (jobless) claims stranded at this level, big private sector payroll gains are just not on the agenda. In short, the downward trend in (job) layoffs, which began in the spring of 2009, is clearly over, at least for now.” According to the National Employment Law Project, Congress has allowed the extension of some unemployment benefits to lapse, so as many as 1.2 million jobless people could see their benefits expire this month. However, Congress is presently drafting extensive tax and jobs legislation that would authorize the extension of various unemployment benefits through November of this year.
- The Bank of England’s Monetary Policy Committee leaves its key lending rate at a record low 0.5% and maintains its asset purchase (quantitative easing) limit at 200 billion pounds (\$291.3 billion U.S.), as it awaits Britain’s new coalition government to reveal the extent of its fiscal austerity measures in a June 22nd. budget
- Statistics Canada reports the New Housing Price Index rose by 0.3% in April, following an identical increase in March
- In a lengthy report, the bipartisan Congressional Oversight Panel has concluded that the U.S. government, which owns nearly 80% of insurance giant American International Group (AIG), is likely to “remain a significant shareholder in AIG through 2012 and it is unclear whether taxpayers will ever be repaid in full.” The Panel warned that American taxpayers “remain at risk for severe losses” because the the government “failed to exhaust all options” before committing taxpayer funds to AIG. The report noted that a controversial decision by the New York Federal Reserve in late 2008 to pay out AIG’s trading partners in full on \$62 billion (U.S.) in soured mortgage trades “distorted the marketplace” and protected AIG creditors at the expense of taxpayers. “Billions of taxpayer dollars were put at risk, a marketplace was forever changed and the confidence of the American people was badly shaken.”
- The Commerce Department reports the U.S. trade deficit widened to \$40.3 billion (U.S.) in April, the highest level in 16 months as exports declined for the second time in three months

THURSDAY, JUNE 10TH

- The European Central Bank (ECB) leaves its benchmark lending rate unchanged at 1%

- Statistics Canada reports the country's international trade balance recorded a surplus of \$175 million (CAD) in April, following a revised deficit of \$236 million (CAD) in March

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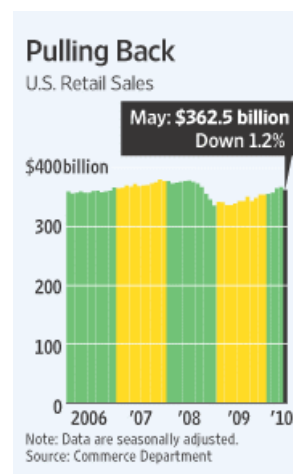
- China reports its exports rose by 50% in May, on a year-over-year basis, citing strong exports of textiles, steel and electrical machinery and equipment. Meanwhile, U.S. Treasury Secretary Tim Geithner continues to argue that China pegs the yuan at an unfair rate against the U.S. dollar, making Chinese products cheaper and negatively impacting U.S. exports. China's main export destination is the U.S. which imports 19.1% of Chinese goods. China unpegged the yuan from the U.S. dollar in 2005, linking it to a basket of currencies. It was then allowed to gain 21% against the U.S. dollar, before being quietly repegged in July, 2008.

- In a 2010 Global Economic Prospects Report, Andrew Burns, the World Bank's manager of macroeconomics, warns that government finances in the U.K., the U.S., France and other European advanced economies, are currently on an "unsustainable path. We're expecting that growth in the second quarter is also likely to be disappointing, quite possibly seeing negative (GDP) growth in several European countries and a double-dip (recession) in some of these economies. A second (economic) downturn in Europe could lead to a global fallout and have serious effects on East Asia, where exports and investment are large shares of economies."

- The U.S. Treasury Department reports the federal deficit totaled \$135.9 billion (U.S.) in May, bringing the deficit to \$935.6 billion (U.S.) for the first 8 months of the current fiscal year. At the current average monthly rate of \$117 billion (U.S.), the federal deficit will total \$1.4 trillion (U.S.) by the fiscal year ending September 30, 2010.

FRIDAY, JUNE 11TH

- The Reuters/University of Michigan U.S. consumer sentiment index rose to a reading of 75.5 in June from a level of 73.6 in May
- In his first address to Japan's parliament, Prime Minister Naoto Kan warns the country cannot continue to allow government deficits to increase, while state finances are under pressure from an aging and declining population. Mr. Kan stated: "It is difficult to sustain a policy that relies too heavily on issuing debt. As we have seen with the financial confusion in the European community stemming from Greece, our finances could collapse if trust in (our sovereign) bonds is lost and growing government debt is left alone." According to the International Monetary Fund (IMF) Japan had the largest public debt among industrialized nations at 218.6% of its gross domestic product (GDP) in 2009.
- The U.S. Treasury, which owns 61% of General Motors (GM), has chosen JP Morgan Chase and Morgan Stanley to be the lead underwriters for its initial public offering (IPO). GM has repaid an \$8.1 billion (U.S.) loan from the American and Canadian Governments, plus last month reported its first quarterly profit in three years. The company intends to repay more of its debts through the IPO, which could materialize later this year.



- Fitch Ratings downgrades the State of Illinois general obligation bonds to 'A' from 'A' (High) with a negative outlook. Fitch analyst Karen Krop warned: "Something significant needs to happen on either side of the (State) budget – either cutting spending or raising revenues. Illinois has budgeted to raise more than \$8 billion (U.S.) with bond (issues) in the current and next fiscal years. Now the State is relying on deficit borrowing and there doesn't seem to be an endgame." Illinois faces a \$13 billion (U.S.) budget deficit for the fiscal year that begins on July 1st. At least \$6 billion (U.S.) of that amount represents unpaid bills from the current fiscal year, which has prompted State prisons to release inmates early and State education boards to layoff 20,000 teachers and staff. The State legislature has now gone into recess, leaving Governor Pat Quinn to try and balance the State's budget.
- The Commerce Department reports U.S. retail sales declined by 1.2% in May versus an increase of 0.6% in April

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