

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS



Monday, June 14TH

The New York-based Conference Board reports China's leading economic indicator rose by 1.7% to a reading of 147.1 in April, versus a level of 144.5 in March

MONDAY, JUNE 14TH

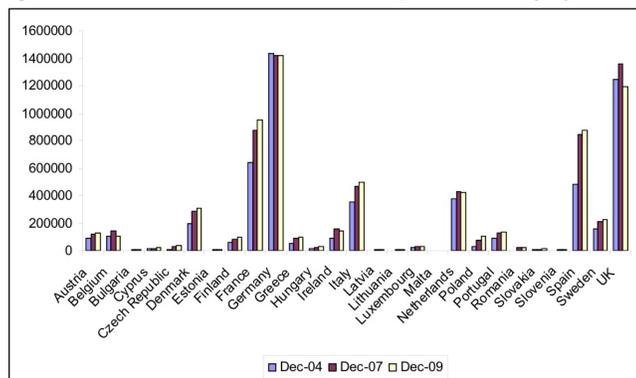
- Moody's Investors Service downgrades Greece's sovereign debt to Ba1 from A3, citing: "The B1a rating reflects our analysis of the balance of the strengths and risks associated with the euro zone/IMF support package. The package effectively eliminates any near-term risk of a liquidity driven default and encourages the implementation of a credible, feasible and incentive-compatible set of structural reforms, which have a high likelihood of stabilizing debt service requirements at manageable levels. Nevertheless, the macroeconomic and implementation risks associated with the program are substantial and more consistent with a Ba1 rating. The outlook on all ratings is stable."
- The Office for Budget Responsibility (OBR) revised U.K. economic growth forecasts to 2.6% for 2011, from the prior government's 3.25% estimate; while predicting 2.8% GDP growth for 2012 and 2013, plus 2.6% growth for 2014, compared with the 3.5% predicted in March for each of those three years. Also, the OBR revised downward Britain's net borrowing forecast for the five fiscal years to 2015 by 23 billion pounds (\$33.45 billion U.S.) to a total of 544 billion pounds, citing expectations for higher tax receipts and a lower unemployment rate. Chairman Sir Alan Budd, former member of the Bank of England's Monetary Policy Committee, commented: "This is our best shot at an impossible task. What we do want to emphasize is that all our findings are very uncertain, that's simply inevitable."
- Eurostat reports euro zone industrial production rose by 9.5% in April on a year-over-year basis

- According to a report by the National Governors Association and National Association of State Budget Officers, 39 U.S. states expect lower general fund spending for the fiscal year which begins July 1st. President Obama has sent a letter to lawmakers calling for \$50 billion U.S. to help small businesses and state and local governments facing budget cuts: "It is essential that we continue to explore additional measures to spur job creation and build momentum toward (economic) recovery, even as we establish a path to long-term fiscal discipline. Budget cuts are leading to massive layoffs of teachers, police and firefighters; and hundreds of thousands of additional jobs" could be lost if swift action isn't taken.

TUESDAY, JUNE 15TH

- The National Association of Home Builders reports its U.S. housing market index declined to a reading of 17 in June from a level of 22 in May, reflecting the expiration of the \$8,000 (U.S.) tax credit for first time home buyers
- The European Central Bank (ECB) reports it loaned Spanish banks 85.6 billion euros \$105.7 billion (U.S.) in May versus 74.6 billion euros in April
- The Office for National Statistics reports the U.K. consumer price index declined to an annual rate of 3.4% in May from 3.7% in April, citing a drop in food prices and slower price appreciation for alcohol, tobacco and gasoline

Figure 1: Total household debt in the EU27 in 2004, 2007 and 2009 (Cm)



Source: ECB, NB: Due the lack of data availability, for December 2004 in the cases of Cyprus (December 2005), Malta (January 2005) and Slovakia (January 2006) the nearest available month for which data was available was used

- According to the U.K. Telegraph, German households are the most indebted of the 27 European Union countries, followed by the British, French and Spanish – (See chart above)

WEDNESDAY, JUNE 16TH

- New York State Governor David Paterson and legislative leaders tentatively agree to allow the State and municipalities to borrow nearly \$6 billion (U.S.), effectively a bridge loan, in order to meet their required annual payments to the State pension fund. In a classic maneuver, they will borrow the money to make the payments to the pension fund – from the same pension fund. Under the plan, the State and municipalities would borrow the money to reduce their pension contributions for the next three years, in exchange for higher payments over the following decade. They would begin repaying what they borrowed, with interest, in 2013. Mr. Paterson and other State officials are hoping the stock market will have rebounded to such a degree by that time, that the State’s overall pension contribution obligation will have been reduced. Gov. Paterson, with the Dow Jones Industrial Average fluctuating in the area of 10,400 today; a snowball in Hell has a better chance of survival than does success for your plan.
- The U.S. Federal Housing Finance Agency (FHFA) announces both the preferred and common shares of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) are being delisted from the New York Stock Exchange. Both firms were placed into U.S. Government conservatorship in September, 2008.
- The Canadian Real Estate Association reports home sales declined by 8.5% in May to 40,393 units compared with April
- The Commerce Department reports U.S. new home construction declined by 17.2% in May from April

- The Labor Department reports the U.S. producer price index declined by 0.3% in May, following a 0.1% drop in April, citing significant reductions in the cost of food and energy
- U.K. Chancellor of the Exchequer George Osborne proposes the division of the Financial Services Authority (FSA) into three new agencies, including a bank regulating subsidiary within the Bank of England. At the heart of the proposed overhaul, which requires approval by Parliament and would be implemented by the end of 2012, is an empowered Bank of England. In addition to its current responsibility for monetary policy, the central bank will assume responsibility for preventing systemic risks and day-to-day supervision of the U.K. Financial sector, including foreign companies that operate in the City of London, through a newly formed subsidiary, tentatively named the Prudential Regulatory Authority.
- U.S. Senate and House of Representative lawmakers have agreed to a liability standard for credit rating agencies, declaring that investors can sue them if their views of financial products are deemed “grossly negligent.” Lawmakers also agreed to establish a new quasi-government entity designed to address conflicts of interest inherent in the credit rating business, after the Securities and Exchange Commission (SEC) studies the matter.
- BP PLC agrees to place \$20 billion (U.S.) into a fund to compensate victims of the Gulf of Mexico oil spill and announced it would cancel shareholder dividends for the first three quarters of this year to offset that cost
- The Board of Directors of the California Public Employees Retirement System (Calpers) votes to demand a higher contribution from California’s general fund, in order to pay for government employee pensions. However, Calpers’ investments lost \$55.2 billion (U.S.) during the 2008 – 2009 fiscal year and the State’s general fund faces a \$19 billion (U.S.) deficit in its fiscal year beginning July 1st. David Crane, economic advisor to Gov. Arnold Schwarznegger and a Calpers board member praised the board’s decision in an interview: “It’s painful, but in a way, it’s owning up to the truth. Pension promises are debt and the longer their payment is deferred, the more costly they become.”

THURSDAY, JUNE 17TH

- The Philadelphia Fed index of manufacturing activity fell to a reading of 8 in June from a level of 21.4 in May
- The Conference Board’s index of U.S. leading economic indicators rose by 0.4% in May, after holding steady in April

- The Baltic Dry Index, a widely followed measure of shipping traffic, has registered a 34% drop in ocean freight rates over the last three weeks, foreshadowing a slowdown in international trade. The index, which is a key indicator of consumption and manufacturing trends, has declined to 2,784 points, reflecting the reduction in shipping industry prices to transport dry raw materials over 26 global routes.
- The Labor Department reports initial claims for state unemployment benefits increased by 12,000 to 472,000 in the week ended June 12th.
- Spain raises 3.5 billion euros (\$4.3 billion U.S.) by auctioning 3 billion euros of 10-year bonds at an average yield of 4.864% and 479.2 million euros of 30-year bonds at an average yield 5.908%. The bid-to-cover ratios (investor demand multiple) for these two issues was 1.89 times and 2.45 times, respectively.
- The Bureau of Labor Statistics reports the U.S. consumer price index declined by 0.2% on a seasonally adjusted basis in May from April. The core rate, (excluding food and energy) rose by 0.1% and by 0.9% on a year-over-year basis, citing higher prices for housing, apparel and medical care.

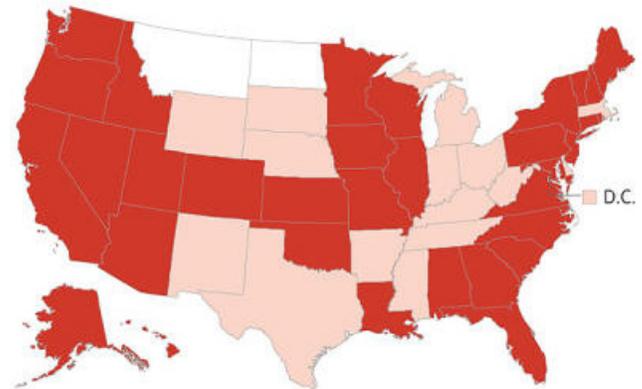
- Fitch Ratings warns it may take massive bond purchases by the European Central Bank (ECB) to prevent Europe's sovereign debt crisis from escalating out of control. At a global banking conference in London, Fitch's director of sovereign ratings, Brian Coulton remarked: "There has been an unwillingness (by the ECB) to follow through and markets are going to want to see (the colour of) the ECB's money. It will require hundreds of billions of euros, in my opinion."
- The Commerce Department reports the U.S. current account deficit widened to \$109 billion (U.S.) in the 1st. quarter from a revised \$100.9 billion (U.S.) in the 4th. quarter of 2009
- August gold bullion futures close at a record high of \$1,248.70 (U.S.) per ounce on the Comex division of the New York Mercantile Exchange

FRIDAY, JUNE 18TH

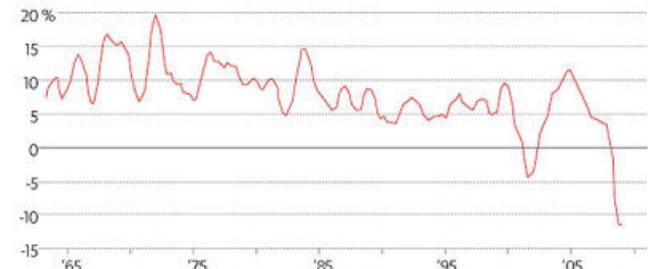
Red ink, from sea to shining sea

Forty-eight of 50 states face budget shortfalls this year. Many shortfalls amount to more than 20 per cent of planned spending. The plunge in state tax revenue is the worst on record.

BUDGET SHORTFALLS AS SHARE OF 2010 GENERAL FUND EXPENDITURES
 ■ 20% and above ■ Less than 20% □ No shortfall

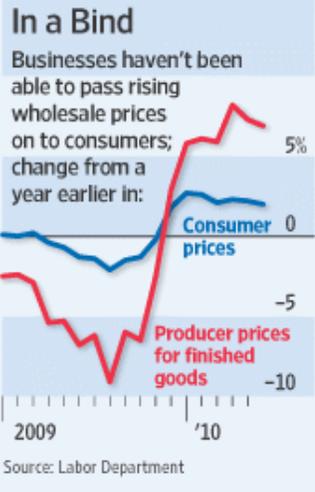


CHANGE IN STATE TAX REVENUE



KATHRYN TAM/THE GLOBE AND MAIL ■ SOURCES: U.S. CENSUS BUREAU; CENTER ON BUDGET AND POLICY PRIORITIES

- The U.S. Justice Department discloses federal prosecutors have charged 1,215 people in hundreds of mortgage fraud cases that resulted in estimated losses of \$2.3 billion (U.S.). In the last 31/2 months, authorities have made 485 arrests in the fraud cases, obtained 336 individual convictions and recovered more than \$147 million (U.S.). The U.S. Attorney General's Office reported: "We have seen cases that have resulted in dozens of foreclosures and millions in losses, as well as fraudsters who have bankrupted entire companies and national lenders who were not playing by the rules."



Source: Labor Department

- The State of California is facing a budget deficit of \$19 billion (U.S.) in the current fiscal year and is projecting a \$37 billion (U.S.) deficit for the next fiscal year commencing July 1st. Alarmingly, 48 American states are facing a total of almost \$300 billion (U.S.) in budget shortfalls for these two fiscal years. Only Montana and North Dakota are projecting balanced budgets for fiscal 2011. Many state legislatures and municipal governments, including Los Angeles, are laying off employees and cutting social services in an attempt to reduce projected deficits. Several states are lobbying for a federal bailout and President Obama is pressuring Congress for at least a \$50 billion (U.S.) rescue package for state and local governments.

At Long Wave Analytics, we have been reporting on this dilemma for about two years. Americans are resisting higher taxes; as well as cuts to benefits and entitlements. Thus, while there is no political will to raise taxes, states add to their problems by issuing more debt. While the State of California, along with many others, is in a hell of a straitjacket, what would America gain by bailing out state and local governments at the expense of the already debt riddled federal government? This may represent President Obama's river of no return.

See also Winter Warning, June 14, 2010 – The Long Wave Winter Monetary Crisis:

According to the World Gold Council (WGC), the Saudi Arabian Monetary Agency (the central bank) has “re-stated” gold reserves of 322.9 tonnes, more than the 322 tonnes it had previously acknowledged. The WGC also reported that the central banks of Russia, the Philippines, Venezuela and Kazakhstan have also been buying gold, indicating a revival of gold bullion as part of emerging economies’ official reserves. In an op-ed article, the U.K. Telegraph asserts “gold itself is reclaiming its historic role as the ultimate safe haven and benchmark currency.”

See also Winter Warning, June 14, 2010 – The Long Wave Winter Monetary Crisis:

Anadarko Petroleum, BP's 25% partner in the leaking Deepwater Horizon well in the Gulf of Mexico, has refused to contribute to the multi-billion dollar cleanup bill. In a statement, Anadarko Chief Executive Officer Jim Hackett noted he was “shocked” by information that has emerged from investigations of the accident: “It indicates BP operated unsafely and failed to monitor and react to several critical warning signs during the drilling of the Macondo well.”

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