Monday June 28th, 2010

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

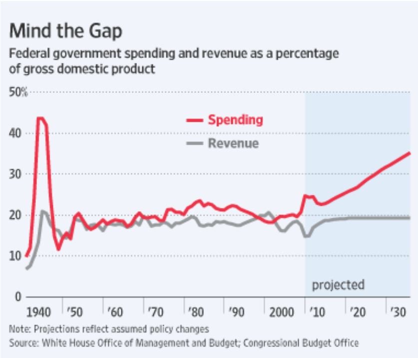
THAT WAS THE WEEK THAT WAS

Monday, June 28TH

The Commerce Department reports the savings rate for U.S. households rose to 4% in May from 3.8% in April; while consumer spending rose by 0.2% and personal income increased by 0.4% in May

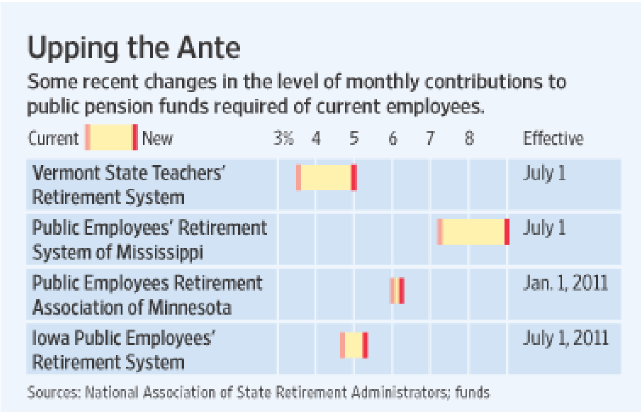
MONDAY, JUNE 28TH

- The G-20 Summit concludes in Toronto with the issuance of a joint communiqué by member states vowing to cut government deficits in half in most industrialized nations by 2013.
At Long Wave Analytics, we believe this will prove impossible for the U.S. to achieve. Certainly, nothing will be achieved in this regard for at least the next six months as the country approaches the mid-term elections in November and the tabling of the report from the bipartisan National Commission on Fiscal Responsibility and Reform in December. Since the recommendations forthcoming from this commission will not be binding upon the U.S. Congress, we continue to predict an economic civil war will erupt in the first quarter of 2011 as the Bush tax cuts expire, or, are 'temporarily' extended. Gross domestic product (GDP) growth will not pave the way for the country to resolve its deficit dilemmas because there isn't going to be any economic growth during this period. However, since further spending cuts and tax increases are politically unacceptable in America, the question is, will any state and /or municipal governments declare bankruptcy?



- In its annual report, the Bank for International Settlements (BIS) warns governments must cut budget deficits decisively and not delay in raising administered interest rates because "the combination of remaining vulnerabilities in the financial system and the side effects of such a long period of intensive care threaten to send the patient into relapse." At the Bank's annual general meeting, BIS General Manager Jaime Caruana commented: "We cannot wait for the resumption of strong (economic) growth to begin the process of policy correction. In particular, delaying fiscal policy adjustment would only risk renewed financial volatility, market disruptions and funding stress."

- Some U.S. public sector unions, in an attempt to avoid furloughs and layoffs, are accepting reduced pension benefits for current workers and retirees. In California, Governor Schwarzenegger's office announced tentative contract agreements with two unions, following two years of arguing over benefit cuts. Earlier this month, four other unions agreed to similar tentative contracts. Unions and workers' associations in states such as Vermont, Iowa, Minnesota, Colorado and Wyoming have also recently supported (pension) rollbacks, not only for new employees, but also, for current union members, whose benefits have long been considered sacrosanct. Pam Manwiller, chief negotiator and director of state programs for the American Federation of State, County and Municipal Employees in Sacramento, one of the six California Unions that has agreed to a tentative contract commented: "It was either the legislator was going to do it, or we were going to define it for ourselves."



- The Conference Board's Leading Economic Index for the euro zone declined by 0.5% to a reading of 109.7 in May, its first drop in 14 months. The index is an amalgam of 8 indicators of economic activity, including share prices, interest rate spreads, manufacturing purchasing manager's surveys, economic sentiment and residential building permits; and is designed to predict future economic activity. Jean-Claude Manini, the Conference Board's senior economist for Europe stated the decline suggested the rebound in euro zone (economic) growth may have peaked during the second quarter: "Employment may suffer from a wait-and-see attitude during the second half of 2010, but the effects of deficit reduction measures will be primarily felt in 2011."

- As Europe's major economies focus on debt reduction and tax increases in order to bring their budgets into better balance, they would be well-advised to consider the Irish experience. In 2008, Ireland's government adopted stringent austerity measures and imposed higher taxes, but is still struggling economically, with no rapid reversal in sight. Alan Barrett, chief economist at the Economic and Social Research Institute of Ireland recalled: "When our public finance situation blew wide open, the dominant consideration was ensuring that there was international investor confidence in Ireland, so we could continue to borrow and the prevalent attitude was 'Let's get this over with quickly.'"
  This is today's unrealistic investor mindset – instant gratification! Let the word go forth – there is no quick fix to the current global sovereign debt predicament! It must be understood that the unburdening from the global debt albatross will take time; and probably a lot more time than most investors have patience. (See also Winter Warning: It's the Debt Stupid, January 11, 2010)

TUESDAY, JUNE 29TH

- The Conference Board of Canada reports its consumer confidence index declined to a reading of 83.6 in June from a level of 89.3 in May

- The Conference Board reports its U.S. consumer confidence index declined to a reading of 52.9 in June from a downwardly revised 62.7 level in May, citing "increasing (consumer) uncertainty and apprehension about the future state of the economy and labor market."

- The Conference Board reports its leading economic index for China rose only 0.3% in April, downwardly revised from a gain of 1.7% reported previously

- The Standard & Poor's / Case-Shiller 20-city U.S. home price index rose by 0.8% in May, as 18 of 20 major cities reported price increases on a month-over-month basis, with only Miami and New York recording price declines

- In a recent speech, Atlanta Fed Governor Kevin Warsh warned the Federal Reserve would risk its credibility if it bought more assets (quantitative easing) to stimulate the economy. Purchasing more assets – to add to the $1.6 billion (U.S.) of mortgage-backed securities and U.S. Treasury notes and bonds it has bought since 2008 – is one option the Fed could undertake if it thought the economic recovery had stalled. However, Mr. Warsh's comments suggest he would oppose such a move: "I would want to be convinced that the incremental macroeconomic benefits (of purchasing more assets) outweighed any costs owing to erosion of market functioning, perceptions of monetizing indebtedness, crowding out of private borrowers, or the loss of central bank credibility."
  Federal Reserve Chairman Ben Bernanke is on record as stating many times: "We are not going to monetize the debt."

WEDNESDAY, JUNE 30TH

- Spain's 'AAA' credit rating has been placed on credit watch for possible downgrade by Moody's, who cited Spain's deteriorating economic growth prospects, the difficulty in implementing the government's austerity program and concerns over rising financing costs

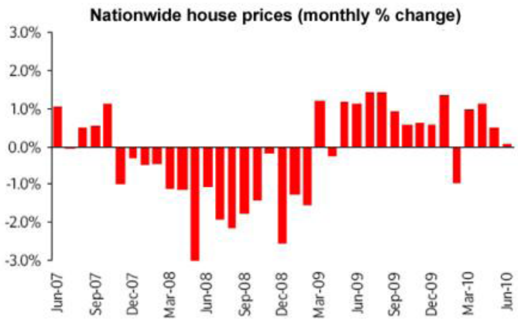
- Statistics Canada reports the country's gross domestic product (GDP) remained unchanged in April, citing declines in retail trade and the manufacturing sector

- The Institute for Supply Management – Chicago reports its business activity index declined to a reading of 59.1 in June from a level of 59.7 in May

- Lloyds Banking Group in the U.K. announces another 1,850 job layoffs, together with the closure of the 265 branch network of Halifax-branded offices, based within legal firms and estate agencies

- ADP Employer Services reports U.S .private sector payrolls increased by 13,000 in June, following a revised increase of 57,000 in May

- Nationwide reports U.K. house prices rose by 0.1% in June, following a 0.5% increase in May, citing the average price of a residential property at 170,111 pounds



- In an article entitled Time to Shut Down the U.S. Federal Reserve, U.K. Telegraph Business Editor Ambrose-Evans Pritchard chastises Dr. Kartik Athreya, a senior economist for the Richmond Federal Reserve, for "condemning economic bloggers as chronically stupid and a threat to public order." At Long Wave Analytics, since we have not graduated with a PhD in economics, ergo and by axiom, we surmise Dr. Athreya would include us among the great "untrained to the (economic) crisis." May we direct Dr. Athreya to our Winter Warning of September 14, 2009 – Behold A Pale Horse and He Who Sat Upon Him Was Named Death, and Hell Followed With Him: "Today, the expanding government debt bubble jeopardizes the very viability of the American central bank system. The only way to determine a market-based monetary system, completely backed by gold is to have the Federal Reserve System abolished. Deservedly, the Fed must be held accountable for the credit crisis. An increasing number of Americans following Ron Paul's leadership attest to this. As the economic crisis deepens, the collective anger will grow, perhaps, forcing the Fed's demise in 2013 – one hundred years after its birth."

- The second quarter of U.S. stock market trading ends with the Dow Jones Industrial Average (DJIA) closing at 9,774.02, down 6.27% on the year-to-date; and the Standard & Poor' 500-stock index closing at 1,030.71, down 7.57% on the year-to-date (See Special Edition: Dow 1,000 Is Not A Silly Number, November, 2009)

THURSDAY, JULY 1ST
Canada Day Holiday

- Spain auctions 3.5 billion euros ($4.3 billion U.S.) of 5-year bonds at an average yield of 3.657% with a bid-to-cover ratio of 1.7 times; compared to a similar auction two months ago at an average yield of 3.532% and a bid-to-cover ratio of 3.532 times

- The China Federation of Logistics and Purchasing reports its purchasing managers' index declined to a reading of 52.1 in June from a level of 53.9 in May

- According to the Wall Street Journal, Democratic members of the National Commission on Fiscal Responsibility and Reform are suggesting "spending cuts would likely have to outweigh tax increases, if the nation is to seriously tackle its ballooning financial obligations." This suggestion was forthcoming as Congressional Budget Office (CBO) analysts issued projections that the U.S. federal debt would rise to 62% of gross domestic product (GDP) by the end of 2010; up from 40% at the end of 2008 and the highest level since the aftermath of World War II. Moreover, the CBO also projects federal spending will climb to 26% of GDP by 2020 and to more than 35% by 2035. CBO Director Doug Elmendorf warned lawmakers that the 2010 health care overhaul made a dent in health care spending, but that it "did not substantially diminish that challenge" of cost-cutting. In the meantime, during a visit to Racine, Wisconsin, President Obama commented that the rising national debt is a "real and legitimate concern" and that the nation must reorder its priorities to get control over federal spending. The President stated that the goal was achievable in a "gradual way, particularly on big ticket items. That's going to be our project for the next couple of years." Actually, Mr. President, U.S. debt and deficit reduction is going to require considerably more time than just the next couple of years, however, perhaps not of your time; since we fully expect that by January 20, 2013, you will then be known as former President Obama. At present, there is no political will to address the growing U.S. national debt problem, which has now reached $13.2 trillion. America ignores this dilemma at its peril.

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 13,000 to 472,000 in the week ended June 26th. while continuing claims increased by 43,000 to 4.62 million in the week ended June 19th. The continuing claims figure does not include the number of Americans receiving extended or emergency benefits under federal programs. Those people, who have exhausted their traditional benefits, and are now collecting emergency and extended benefits declined by 376,000 to 4.92 million in the week ended June 12th. The Labor Department estimates about 3.3 million people will be terminated from extended benefit rolls by the end of July, if the U.S. Congress fails to pass emergency legislation.

- General Motors reports U.S. vehicle sales declined by 13% in June compared to May, while Ford Motor reported an 11% drop

- The National Association of Realtors reports U.S. pending home sales declined by 30% in May from April, citing the expiration of the 8% tax credit for first time home buyers; and are down by 16% from the same period a year ago

- The U.S. Institute for Supply Management manufacturing index declined to a reading of 56.2 in June from a level of 59.7 in May

- U.S. construction spending declined by 0.2% in May versus a 2.3% gain in April

- The Riksbank, Sweden's central bank, raises its key lending rate by 25 basis points to 0.5%

FRIDAY, JULY 2ND

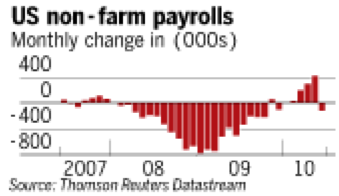
- U.S. factory orders declined by 1.4% in May

- The Reserve Bank of India raises the reverse repurchase rate to 4% from 3.75% and the repurchase rate to 5.5% from 5.25%

- Eurostat reports the euro zone unemployment rate remained unchanged at 10% in May

- The Chinese government raises its estimate for the country's GDP 2009 growth rate to 9.1% from 8.7%

- The Labor Department reports U.S. non-farm payrolls declined by 125,000 in June, citing a government cut of 225,000 temporary workers conducting the 2010 census and following an upwardly revised gain of 433,000 jobs in May. The unemployment rate declined to 9.5% in June from 9.7% in May.



- Australian Prime Minister Julia Gillard announces the government's reworking of a planned 40% tax on mining company profits, to a 30% tax on iron ore and coal assets only. The tax will apply when profits exceed an approximate 12% rate of return, rather than at the previously announced 6% rate.

- In a new report from the Center on Budget and Policy Priorities warns of the collective budget shortfall of $140 billion (U.S.) for most American states currently commencing their 2011 fiscal year. State tax revenues have fallen so drastically that as many as 900,000 additional workers could lose their jobs: "State fiscal crises aren't likely to go away soon and will probably get worse before they get better. The solutions states employ to close projected budget gaps will have painful effects on state residents and businesses; but pose a more modest risk to the national (economic) recovery." Mark Zandi, chief economist at Moody's Analytics, comments: "Without more (federal) assistance, states and cities will have no choice but to raise taxes and slash jobs and services, which could cut short the still fragile economic recovery and trigger (a double-dip) recession. Governments would have no effective way of responding at that point." Mr. Zandi, we suggest you gird your loins for a forthcoming full- blown depression wreaking 'Katrina-like' havoc on the American economy.