Monday July 26th, 2010

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, July 26TH

The federal bankruptcy office reports Canadian personal and business bankruptcies declined to 11,526 in May, down 13% from the same period a year ago

MONDAY, JULY 26TH

- The Commerce Department reports U.S. new home sales rose by 23.6% in June to a seasonally adjusted annual rate of 330,000 units from a revised drop of 36.7% in May to a record low 267,000 unit level, after an 8% federal subsidy for first-time buyers expired at the end of April
- In an interview with Bloomberg News in Washington, Federal Reserve Bank of Philadelphia President Charles Plosser commented: "Talk of new efforts to stimulate the economy is premature right now. I don't think the (economic) data have been sufficiently compelling one way or another. Varying economic data make it very hard from month to month to really get a good signal as to what's going on. I hope the (economic) clouds will begin to clear in the next month or two and we'll get a little better picture of where we actually stand."
- BP's board of directors announces Robert Dudley will assume the post of chief executive officer on October 1st., replacing Tony Hayward, as the company looks to rebuild its position in the U.S., after battling the biggest oil spill in U.S. history

TUESDAY, JULY 27TH

- The Standard & Poor's/Case Schiller 20-city U.S. home price index rose by 1.3% in May from April

Home Prices, year-to-year

San Francisco	▲ 18.3%
San Diego	▲ 12.4
Washington	▲ 7.4
New York	▼ 0.4
Las Vegas	▼ 6.5

Source: S&P/Case-Shiller

- The Conference Board reports its consumer confidence index declined to a reading of 50.4 in July from a level of 54.3 in June, citing: "Concerns about business conditions and the labour market are casting a dark cloud over consumers that is not likely to lift until the job market improves. Given consumers' heightened level of anxiety, along with their pessimistic income outlook and lackluster job growth, retailers are very likely to face a challenging back-to-school season."
- The National Conference of State Legislatures (NCSL) reports U.S. state budget deficits are expected to total \$83.9 billion (U.S.) for fiscal 2011, citing the most significant portion of the shortfall may be the reduction in federal aid for medical programs. In addition, almost half of all states report fiscal 2011 budget gaps represent 10% or more of their general fund; the largest being Nevada at 45%, followed by New Jersey, Arizona, Maine and North Carolina with at least 20%.

- The U.S. State Department announces it is delaying its decision on a permit for a $7 billion (U.S.) pipeline project intended to deliver crude oil from the oil sands area of northern Alberta, Canada to the Texas gulf coast. The Department stated it would wait to complete a full environmental impact assessment and then allow for an additional 90 days of federal interagency consultation. The Department provided no timeline for completion of the environmental assessment, but at the least, a decision on the permit would be delayed until the end of this year.

WEDNESDAY, JULY 28TH

- The Commerce Department reports U.S. durable goods orders declined by 1% in June, citing reduced demand for airplanes, electronics, machinery and steel

- In testimony to the U.K. parliament Treasury Committee, Bank of England Governor Mervyn King stated: "I am arguing that we have room to use monetary policy in either direction and I don't want to prejudge where it will need to go. The debate is about the appropriate degree of stimulus, not about applying the brakes. The wider economic problems around the world underline the fact that we can't be confident that the recovery and demand, output and employment here in the U.K. will be sustained."

- Boeing Co. reports a net profit of $787 million (U.S.) in the 2nd. quarter, down 21% from $998 million (U.S.) in the same period a year ago, citing lower revenues in both its aviation and defense businesses

- The Reserve Bank of India (RBI) raises its key lending rate by 50 basis points to 4.5%, citing its estimate for wholesale price inflation in India of 6% this year

- Irvine, California-based Realty Trac Inc. reports a record 269,962 U.S. homes were seized in the 2nd. quarter and predicts that foreclosures will probably exceed one million homes this year

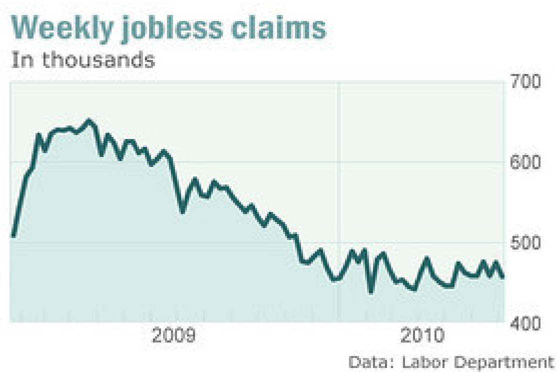
- The U.S. Census Bureau reports 18.9 million U.S. homes stood empty during the 2nd. quarter as the home ownership rate declined to 66.9%, the lowest since 1999

- In its latest Beige Book report, the Federal Reserve stated that economic conditions continued to improve in most of its 12 regional districts, but the advances were modest, with retail sales posting only small gains and housing and construction remaining weak. The availability of bank credit remained tight.

- In declaring a fiscal "state of emergency," California Governor Arnold Schwarzenegger issues a new executive order requiring state employees to take three days off per month. The administration calculates the payroll savings will amount to $147.2 million (U.S.) per month, about $80 million (U.S.) of that from the general fund. However, unlike previous policy, this order has no termination date: furloughs will end when lawmakers pass a 2010 – 2011 budget; but that could involve weeks or months after the Legislature reconvenes on Monday, August 2nd. Also, unlike previous policy, the new executive order exempts employees who work in several departments; including the Highway Patrol and the Department of Fire and Forestry Protection. The Governor made the decision this week after state controller John Chiang said that unless lawmakers enacted a budget soon, the State's cash position would go into the red by October. Mr. Chiang said he'll start issuing IOUs in August or September, in order to conserve funds for as long as possible. Jean Ross, executive director of the California Budget Project, a Sacramento-based independent think tank recently remarked: "We are on the verge of system failure." See also, Winter Warning, July 26, 2010 – In One Hell of a State (2)

THURSDAY, JULY 29TH

- The U.S. Labor Department reports initial claims for state unemployment benefits declined by 11,000 to 457,000 in the week ended July 24th.while continuing claims increased by 81,000 to 4.57 million in the week ended July 17th.



- Barrick Gold reports a net profit of $783 million (U.S.) in the 2nd. quarter, compared with a profit of $492 million in the 2nd. quarter of 2009, citing increased production and a higher average realized gold price. Also, Barrick's board of directors authorized an increase in company's annual dividend rate from 40 cents (U.S.) to 48 cents (U.S.) per share

- Suncor Energy reports a net profit of $480 million (CAD) in the 2nd. quarter, compared with a net loss of $51 million (CAD) in the same period a year ago, citing additional upstream production as a result of its merger with Petro-Canada

- Potash Corp. of Saskatchewan reports second-quarter earnings of $472 million (CAD) – more than double the $186.2 million (CAD) earned in the same period a year ago, citing a continuing recovery in fertilizer demand and a $69.6 million (CAD) special dividend from an investment in Israel Chemicals. President and Chief Executive Officer Bill Doyle commented: "The demand for food has tightened global grain supplies, increasing the importance of addressing nutrient deficiencies in the soil. This is expected to strengthen demand for all nutrients, especially potash, in the near and long term."

- In an interview with Dow Jones Newswires, Steve Hess, senior sovereign debt analyst for the United States at Moody's Investors Service, warns: "The Obama administration must spell out a credible plan to deal with its swollen debt, if it wants to keep its 'AAA' credit rating." Further, Mr. Hess added the U.S. government doesn't appear to have a plan at this point. The Obama administration will not have a 'credible' debt reduction plan for at least the next six months, or perhaps no plan at all, especially if the demon political gridlock rears its ugly head after the November mid-term elections

- In an interview with the Globe and Mail, Scotia Capital currency strategist Sacha Tihanyi comments: "We continue to be concerned over the lack of anything more than lip service by government officials being paid towards the need for U.S. fiscal consolidation, instead, using double-dip recession fears as a buffer to political pressures. The euro's outperformance against the American dollar today, with a break of the 1.305 level reminds us that the United States can no longer rely on the sovereign (debt) risks of others to bolster its fortunes and keep government bond yields restrained."

- The European Commission (EC) reports its Economic Sentiment Indicator (ESI) increased to a reading of 101.3 in July from an upwardly revised level of 99.0 in June. In a statement the EC cited: "Most respondents in the industrial sector reported substantial improvements in their order books, however, managers were cautious on their production expectations."

- Germany's unemployment rate declines to 7.6% in July, its lowest level in nearly two years

- In an attempt to "provoke debate" on the effectiveness of the current monetary policy stance of the Federal Reserve Open Market Committee (FOMC), St. Louis Fed President James Bullard warns: "Promising to remain at a zero (Fed Funds rate) for a long time is a double-edged sword. The policy is consistent with the idea that inflation and inflation expectations should rise in response to the promise, and that this will eventually lead the economy back toward the targeted equilibrium of higher nominal (interest) rates and inflation. But the policy is also consistent with the idea that inflation and inflation expectations will instead fall, and that the economy will settle in the neighbourhood of the unintended steady state, as Japan has in recent years … in which interest rates are near zero while prices are in a deflationary state. One problem, Mr. Bullard claims is that central banks remain "completely committed to interest rate adjustment as the main tool of monetary policy, even long after it ceases to make sense." Instead, Mr. Bullard argues the "appropriate tool" for battling inflation expectations at such times is to expand "quantitative easing," a policy of the Fed buying long-term fixed income securities. While a policy of quantitative easing may influence the rate of inflation higher in the longer term, over the short to medium term such a monetary policy, not only keeps the prevailing levels of bond yields and interest rates low, but also, serves to monetize the national debt – something Federal Reserve Chairman Ben Bernanke has vowed several times not to do

- U.S. Securities and Exchange Commission (SEC) charges Samuel and Charles Wyly, two Dallas billionaire brothers with wide ranging business interests, with reaping more than $550 million (U.S.) in undisclosed capital gains, as a result of insider trading. The SEC alleges that the Wylys created an "elaborate sham of trusts and subsidiary companies" in off-shore jurisdictions to sell $750 million (U.S.) in stock of various companies where they held board positions. Lorin Reisner, deputy director of the SEC's enforcement division elaborated: "The cloak of secrecy has been lifted from the complex web of foreign structures used by the Wylys to evade securities laws. They used these structures to conceal hundreds of millions of dollars of gains in violation of the disclosure requirements for corporate insiders."

- The U.S. Justice Department charges Dominick Carollo, Steven Goldberg and Peter Grimm, all of whom are former employees of General Electric finance units, with fraud and conspiracy. In a prepared statement, Christine Varney, assistant attorney general at the Justice Department's Antitrust Division, alleged: "The individuals charged today allegedly, participated in complex (securities) fraud schemes and conspiracies to manipulate what was supposed to be a competitive (bidding) process."

FRIDAY, JULY 30TH

- The Commerce Department reports U.S. gross domestic product (GDP) grew at a 2.4% annual rate in the 2nd. quarter, following a 3.7% annual pace recorded in the 1st. quarter, as a scarcity of jobs eroded consumer spending, leaving any potential economic rebound dependent upon an acceleration in business investment

- The Thomson Reuters/University of Michigan index of consumer sentiment declined to a reading of 67.8 in July from a level of 76 in June

- The Institute for Supply Management—Chicago Inc. reports its business barometer increased to a reading of 62.3 in July from a level of 59.1% in June

- According to a report by the International Monetary Fund (IMF), the U.S. financial system remains fragile and American banks subjected to additional economic stress, may need to raise as much as $76 billion (U.S.) in additional capital. The IMF suggests that while the American banking system is stable: "pockets of vulnerabilities linger. Home prices, commercial real estate loans and (slower) economic growth have the potential to cause shocks that could expose (small and medium-sized) banks to more losses."

- Moody's Investors Service cuts its stable outlook for Iceland's Baa3 foreign currency debt to 'negative' and warns it may lower the island's sovereign debt rating to junk status, arguing the country's lenders could require state support. In an interview, Iceland's Economy Minister Gylfi Magnusson responded: "Moody's is taking it too far because the Treasury is far from defaulting. The rating is already lower than is merited; saying that the (credit) grade could possibly be lowered further is undeserved."

- The New York Federal Reserve purchased $12 billion (U.S.) of agency mortgage-backed securities in the week ended December 31st., which brought total purchases to approximately, $1.123 trillion (U.S.) for 2009 and which will be capped at $1.25 trillion (U.S.) by March 31, 2010

- Statistics Canada reports the country's gross domestic product (GDP) grew by 0.1% in May, after being flat in April

- Outlined below is a partial summary of an Economic and Budget Issue Brief entitled Federal Debt and the Risk of a Fiscal Crisis issued earlier this week by the Congressional Budget Office in Washington. "Further increases in federal debt relative to the nation's output (gross domestic product, or GDP) almost certainly lie ahead if current policies remain in place. The aging of the population and rising costs for health care will push federal spending, measured as a percentage of GDP, well above the levels experienced in recent decades. Unless policymakers restrain the growth of spending, increase revenues significantly as a share of GDP, or adopt some combination of those two approaches; growing budget deficits will cause (the national) debt to rise to unsupportable levels.

  Although deficits, during or shortly after a recession, generally hasten economic recovery; persistent deficits and continually mounting debt would have several negative economic consequences for the United States. A growing level of federal debt would increase the probability of a sudden fiscal crisis, during which investors would lose confidence in the government's ability to manage its budget, and the government would thereby lose its ability to borrow at affordable (interest) rates. It is possible that interest rates would rise gradually as investors' confidence declined, giving legislators advance warning of the worsening situation and sufficient time to make policy choices that could avert a (fiscal) crisis. But as other countries' experiences show, it is also possible that investors would lose confidence abruptly, and yields on government debt would rise sharply.

  If the United States encountered a fiscal crisis, the abrupt rise in (bond yields) and interest rates would reflect investors' fears that the government would renege on the terms of its existing debt, or that it would increase the supply of money to finance its activities, or pay creditors and thereby boost inflation. To restore investor confidence, policymakers would probably need to enact spending cuts or tax increases, more drastic and painful than those which would have been necessary, had the adjustments come sooner."

  As prophetic a warning as this is regarding the current trend in U.S. government deficits and the cumulative national debt picture, it will undoubtedly fall upon the Obama administration's deaf ears until at least the first quarter of 2011, by which time it may already be too late to reverse. Certainly, President Obama, despite all the flowery rhetoric from time to time, will not take up the cudgel on this subject until the results of the November midterm elections have been tabulated and the recommendations from his National Commission on Fiscal Responsibility and Reform have been tabled in December. Obviously, the near term risks are that the mid-terms will produce a state of political grid-lock in Washington, from which no meaningful legislation can be enacted; as well as non-binding recommendations from the bipartisan commission which may place a heavy emphasis on spending cuts, while avoiding any recommendations to increase taxes.

In the current stage of a weakening U.S. economy (2.4% GDP growth in the second quarter) and an unemployment rate of at least 9.5%, the notion of increasing taxes is politically unacceptable on every level. For a politician of either party to even hint at the merit of the introduction of a VAT (value-added tax) into America's budget plan is to blaspheme in a most hideous manner, notwithstanding the fact that most developed economies already possess one – Spain 23%, Canada 12%, the United Kingdom 20% next year – to name a few. At Long Wave Analytics, we continue to expect that an economic civil war will erupt early in 2011 between the conservative and liberal camps, as the Kondratieff winter enters its second phase (an inflection point), implying a continuation of the deleveraging process, high unemployment and a definite risk of social unrest.

CLOSING LEVELS FOR FRIDAY JULY 30th.		WEEKLY CHANGE
Dow Jones Industrial Average	10,465.90	+ 41.28 points
Spot Gold Bullion (August)	$1,181.70 (U.S.)	– $6.10 per ounce
S&P/TSX Composite	11,713.40	– 0.88 points

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