

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



## Monday, September 13TH

Yesterday, the 27 member countries of the Basel Committee on Banking Supervision agreed, in effect, that banks would be required to triple their tier one capital ratios from 2% to 7% by 2019.

### MONDAY, SEPTEMBER 13TH

This ratio measures the highest quality capital base that banks hold against potential future loan losses. However, critics of the agreement, known as Basel III, argued that the capital definitions, timetable and overall ratio had been diluted to gain the support of Germany and other states. Critics also warned that delaying new rules on liquidity standards until 2015, could endanger the financial system.

- Last week, it was the Organization for Economic Co-operation and Development (OECD). This week, it's the International Monetary Fund (IMF) delivering a similar message of encouragement for governments to inject more stimulus spending into their domestic economies. In remarks at a labour forum with the International Labour Organization, Dominique Strauss-Kahn, managing director of the IMF warns: "The financial crisis won't be over until unemployment declines significantly." Mr. Strauss-Kahn urged governments to start factoring back-to-work policies into their overall budget equation for stoking economic growth. Accordingly, we repeat our OECD question of last week to the IMF this week: just how much additional debt would the IMF recommend the United States incur? With the U.S. mid-term elections a scant 50 days away, any additional economic stimulus is basically on hold at the moment.
- The National Bureau of Statistics reports China's industrial output rose by 13.9% in August on a year-over-year basis, compared to a 13.4% increase in July; while the country's consumer price index rose by 3.5% in August on a year-over-year basis, compared with 3.3% in July.

- What's this? The OECD returns with its latest report on the Canadian economy. The Paris-based think tank suggests Canadian governments should proceed with budget-cutting efforts starting in 2011 and the Bank of Canada should continue with interest rate increases, although at a more "measured" (central bank speak for "carefully considered") pace. At Longwave Analytics, we are perplexed at the OECD recommendation that the Bank of Canada should continue to raise the Bank Rate at a time when both the Canadian and American economies are weakening. Just last week, the OECD opined: "The (current) slowdown in global economic growth would be more pronounced than expected." Here we have a classic example of a major league economic "think tank" speaking out of both sides of its mouth at the same time.
- At an investor forum in New York, former U.S. Treasury Secretary Henry Paulson warns the U.S. risks losing its economic superpower status unless it tackles the deficit and national debt: "I can't think of any time in the history of a superpower continuing to be one, if they don't have a strong economy and fiscal system. Our (fiscal) problems are obvious; ones that we can fix and (have) got to fix." In the short term, the federal deficit could exceed \$1.4 trillion (U.S.) by the current fiscal year ending September 30th. Over the long term, according to estimates from the Congressional Budget Office (CBO), a worst case scenario could see the public debt reach 185% of gross domestic product by 2035. Mr. Paulson worries that while U.S. politicians will take measures to address the debt problem, he is unsure whether it will require a crisis event to initiate action.

WEDNESDAY, SEPTEMBER 15TH

Given the high probability of political gridlock looming in Washington after the November mid-term elections, we believe it will take an economic crisis event to change the bleak deficit outlook.

TUESDAY, SEPTEMBER 14TH

- The December contract for gold bullion closes at a new record high of \$1,271.70 (U.S.) per troy ounce
- The Commerce Department reports U.S. retail sales rose by 0.4% in August compared with downwardly revised gain of 0.3% in July, citing increased sales at clothing and department stores; as well as sporting goods outlets
- Moody's Investors Service places the Royal Bank of Canada's 'AAA' credit rating "on review for possible downgrade" citing "on a firm-wide basis RBC has expressed a strategic target to maintain a 25 to 30% earnings contribution on average from the capital markets segment, which Moody's considers high"
- At the World Alternative Investment Summit, the annual Niagara Falls conference of the hedge fund industry, investors were warned to maintain their focus on the sovereign debt issue because the possibility of a sovereign default remains alive and well. Alex Jurshevski, a debt recovery expert at Toronto's Recovery Partners, warned: "When it comes to restructuring and reducing debt on a global scale in numerous economies at once, it's never been done. Moreover, there are a lot of reasons to believe it won't work this time, starting with governments' chronic inability to cut spending. In addition, the globe's traditional banker and source of bailout money, the United States, is in tough shape. Running for shelter will be difficult in a scenario where the public debt crisis spins further out of control, sovereign defaults and even bankruptcies of whole nations eventually become a widespread occurrence rather than a possibility and civil unrest ensues as populations lose whatever confidence they had left in their governments."

At Longwave Analytics, Mr. Jurshevski is preaching to the converted. As the U.S. deficit rapidly approaches \$1.4 trillion (U.S.) for the current fiscal year ending September 30th., the national debt surpasses \$13.5 trillion (U.S.) and is growing at the rate of \$200 billion (U.S.) per year – we rest our case.

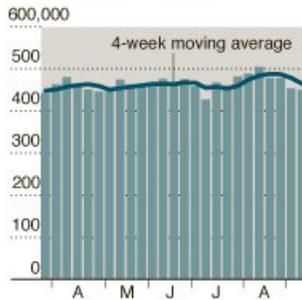
- The Japanese Government intervenes in the foreign exchange market by selling the yen and buying the U.S. dollar, which appreciated by 3%; and initiated gains posted by the euro and the Canadian dollar, now \$0.9740 (U.S.). However, for many of Japan's leading exporters, including Sony, Toyota Motor and Nissan Motor, the government's intervention arrives too late to materially affect their level of profitability for 2010
- The New York Federal Reserve Bank reports the Empire State manufacturing index declined to a reading of 4.1 in September from a level of 7.1 in August, citing the outlook for capital expenditures and employment ranged from flat to weak, respectively
- Statistics Canada reports the country's factory sales declined by 0.9% in July, following a revised 0.1% decline in June, citing reduced demand from the United States for automobiles, furniture and paper products
- The Canadian Real Estate Association reports home resale prices declined for the third consecutive month during August to an average of \$324,928 (CAD) from \$330,351 (CAD) in July and are now 6.3% lower than the record levels they reached last May
- France's National Assembly approves a broad retirement reform plan, including a highly contested measure to increase the retirement age from 60 to 62
- According to U.S. Social Security Statistics, the number of former workers seeking disability benefits has soared with America's economic problems. Applications to the program climbed by 21% to 2.8 million during 2008-2009. The growth is the sharpest in the 54-year history of the program and is threatening its fiscal stability.
- The Federal Reserve reports U.S. industrial production rose by 0.2% in August following a downwardly revised increase of 0.6% in July, previously reported as an increase of 1.0%. U.S. capacity utilization rose slightly to 74.7% in August from a revised level of 74.6% in July, well below the 1972-2009 average of 80.6%.

THURSDAY, SEPTEMBER 16TH

- The Labor Department reports U.S. claims for state unemployment benefits fell by 3,000 to a seasonally adjusted 450,000 in the week ended September 11th. while continuing claims declined by 84,000 to 2.484 million in the week ended September 4th.

**Jobless Claims**

Weekly number of people who have filed for unemployment benefits for the first time.



Source: Labor Department, via Bloomberg

- The Federal Reserve Bank of Philadelphia reports its regional economic index rose to a reading of minus 0.7 in September from a level of minus 7.7 in August
- Irvine, California-based Realty Trac Inc. reports U.S. home seizures climbed to 95,364 in August, setting a record number for the third time in the last 5 months. Foreclosure filings, including default and auction notices fell by 5% to 338,836.
- The Commerce Department reports the U.S. current account deficit rose to \$123.3 billion (U.S.) in the second quarter from \$109.2 billion (U.S.) in the first quarter. The current account is the broadest measure of volume of trade because it records the flow of goods and services; as well as investments, between the United States and other countries.
- The Reserve Bank of India raises its repo rate, at which it lends to banks, by 25 basis points to 6% and increases its reverse repo rate, at which it accepts excess deposits by 50 basis points to 5%, citing its continued fight against inflation
- Greece's Finance Minister George Papaconstantinou announces the government may not reach its revenue target for the current fiscal year, "but that is more than compensated by the fact that expenditures have been declining faster." Also announced were plans to market bond issues (diaspora bonds) to Greeks living abroad; citing there were as many Greeks living abroad as in the country itself.
- The Census Bureau reports the number of Americans living in poverty rose to 14.3% of the population, or 43.6 million, during 2009; up from 13.2% in 2008

- The Labor Department reports the U.S. producer price index rose by 0.4% in August, following a 0.2% increase in July, citing higher energy costs

**Producer Prices**

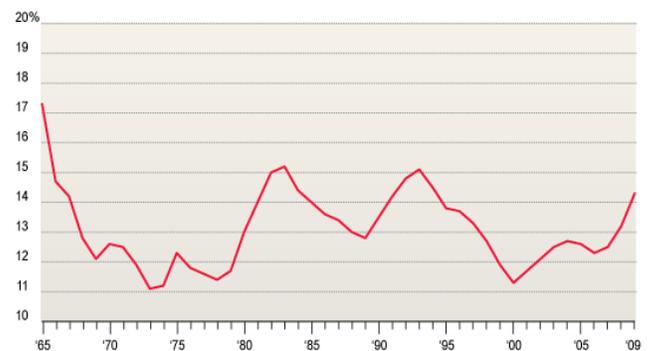
Index of finished goods prices, 1982=100, seasonally adjusted.



Source: Labor Department

- A report by the Congressional Oversight Panel faults the U.S. Treasury Department for bailing out the country's largest banks during 2008-2009 while most Americans faced difficult economic times. The report states: "The greatest consequence of the bail-outs may be that the government has lost some of its ability to respond to financial crises."
- A recent study conducted by the Boston College Center for Retirement research concludes Americans are \$6.6 trillion (U.S.) short of what they will require in order to retire; based upon projections for retirement income for American workers aged 32 to 64. The study notes that savings have been diminishing in recent years from declines in stock prices and housing values and it was commissioned by Retirement USA, a coalition of organized labour and pension rights advocates.

**U.S. Poverty Rate**

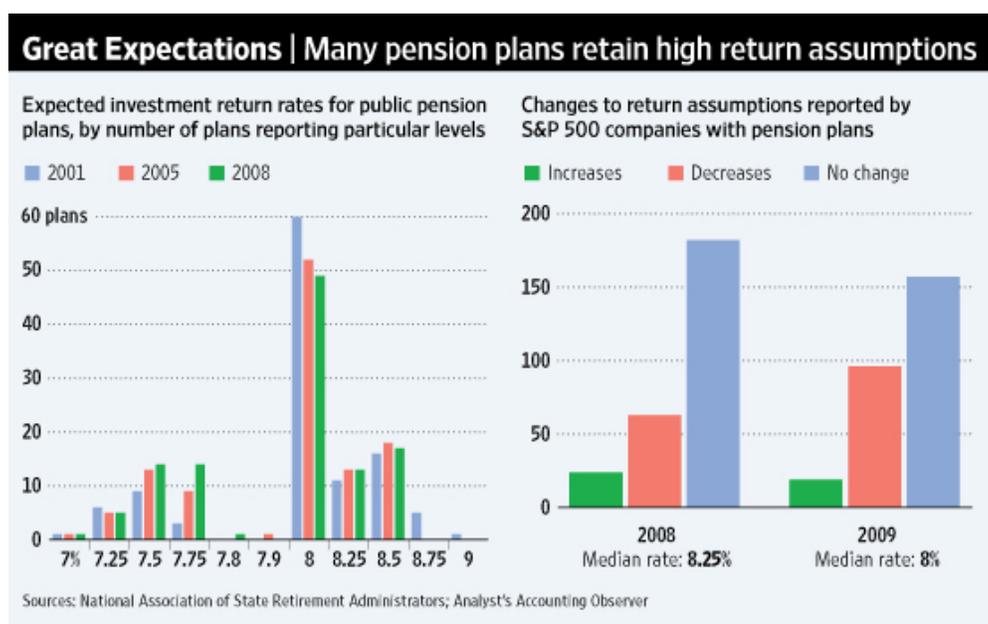


Source: Census Bureau

FRIDAY, SEPTEMBER 17TH

- The Labor Department reports the U.S. consumer price index rose by 0.3% in August, while the core rate (ex-food and energy) remained unchanged, citing continuing high unemployment and weak consumer demand
- The Thomson Reuters / University of Michigan consumer sentiment index declined to a reading of 66.6 in September from 68.9 in August, citing tax uncertainties and employment concerns

- According to a recent survey by the National Association of State Retirement Administrators, more than 100 U.S. public pension plans expect an 8% annual rate of return; the same level as in 2001. Matt Smith, an actuary for Washington State, recommended last year that the State retirement system cut its annual return expectation by 50 basis points to 7.5%, but was rejected by the State's funding council. Mr. Smith believes Washington State will eventually, lower expected returns; but it will be a slow process because that "will increase the cost of pension benefits and right now the budgetary environment is a big obstacle."



CLOSING LEVELS FOR FRIDAY, SEPTEMBER 17TH. WEEKLY CHANGE

Dow Jones Industrial Average	10,607.85	+ 145.05 points
Spot Gold Bullion (December)	\$1,275.90 (U.S.)	+ \$ 29.40 per ounce
S&P/TSX Composite Index	12,164.56	+ 67.46 points

Ian A. Gordon, The Long Wave Analyst [www.longwavegroup.com](http://www.longwavegroup.com)

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