

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



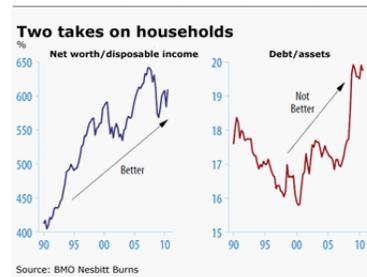
Monday, December 20TH

Moody's Investors Service downgrades the senior and subordinated debt ratings of Allied Irish Banks, Bank of Ireland, EBS Building Society, Irish Life & Permanent and Irish Nationwide Building Society.

MONDAY, DECEMBER 20TH

The downgrades follow Moody's announcement on Friday that it was cutting Ireland's sovereign debt rating by five levels to Baa1, just three levels above junk-bond status. The rating agency stated: "The banks' debt ratings are affected by the downgrade of the Irish government, as the high degree of systemic support from the government had so far largely mitigated the pressure stemming from a much weaker stand-alone credit profile of these banks. They will come under further pressure because of the government's drastic austerity package of tax hikes and spending cuts."

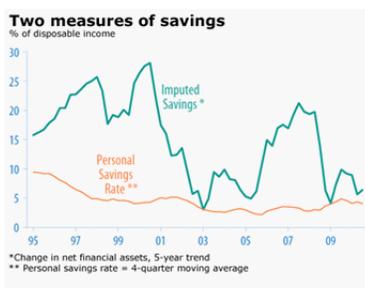
- In light of rising Canadian consumer debt levels, Canada's Office of the Superintendent of Financial Institutions (OSFI), which regulates Canadian banks and insurers, is requiring lenders to do more testing of the risks that consumer debt poses to their balance sheets. Last week, Statistics Canada reported the ratio of household debt to disposable income is at a record 148.1%. In a recent interview, OSFI Chair Julie Dickson stated: "We are asking many more questions about how banks are monitoring (loan) portfolios, including secured loans."



- The City of Vallejo, California reveals its post-bankruptcy blueprint, approved by the City Council in November, regarding how it will administer \$195 million (U.S.) of unfunded pension obligations, its largest liability. The Municipality will postpone interest payments to bondholders, reduce employee benefits, create a rainy day-fund and allocate \$5 million (U.S.) for unsecured creditors. The City's bankruptcy-exit plan, including the post-bankruptcy blueprint, must be presented to the court by January 18th. This type of local patchwork financial stability plan is likely to be mirrored all across America during the next two years, as municipal bankruptcy filings accelerate. However, the majority of them are likely to be doomed to failure as declining gross domestic product (GDP) rates drain municipalities of their tax revenues.

TUESDAY, DECEMBER 21ST

- The research group GfK NOP reports the U.K. consumer confidence index remained at a reading of minus 21 in December, unchanged from November and the lowest reading since July





- The TD Bank Group announces the acquisition of Chrysler Financial from private equity group Cerberus for \$6.3 billion (U.S.) in cash. In a statement, the TD cited: "The acquisition will give TD a platform for asset generation in the North American automotive lending market, enabling it to significantly grow its consumer loan portfolio."
- According to a U.S. chain stores sales survey released by New York-based International Council of Shopping Centers and Goldman Sachs Group, American retailers posted a 4.2% sales increase last week, as more consumers completed their Christmas shopping
- The Office for National Statistics reports Britain's budget deficit grew to a record 23.3 billion pounds (\$35 billion U.S.) in November, excluding government support for banks, underscoring the challenge facing Prime Minister David Cameron as his government prepares to implement the deepest spending cuts since World War II. According to the Daily Telegraph, Business Secretary Vince Cable commented: "There is a constant battle going on behind the scenes" between his Liberal Democrats and the Conservatives, over how to reduce the budget shortfall.
- New York Attorney general Andrew Cuomo sues Ernst & Young, accusing the accounting firm of aiding and abetting Lehman Brothers (its client) "engage in a massive accounting fraud" by misleading investors about the investment bank's financial health. The lawsuit focuses on Ernst & Young's approval of a much criticized accounting maneuver that permitted off-book balance sheet debt prior to the close of fiscal quarters. The lawsuit alleges: "the surreptitious removal of tens of billions of dollars from Lehman's balance sheet to create a false impression of Lehman's liquidity, thereby defrauding the investing public." The lawsuit seeks the return of more than \$150 million (U.S.) in fees that Ernst & Young collected for work performed for Lehman from 2001 to 2008, plus investor damages.
- The Russian Interior Ministry launches a criminal investigation into an alleged embezzlement by the Bank of Moscow, as pressure grows on former Moscow Mayor Juri Luzhkov, who was fired by the Kremlin last September amid allegations he managed the City's affairs as a personal fiefdom. Mr. Luzhkov's wife, Yelena Baturina, has become Russia's richest woman operating a vast construction and property business.
- The Washington-based International Monetary Fund (IMF) announces the completion of its sales program totaling 403.3 tonnes of gold bullion. Most direct sales were to various central banks, including one large transaction with the central bank of India, as well as sales on the open market. Barring the emergence of any other sizeable sales program, central banks are likely to be net buyers of gold bullion on the open market in 2011.
- In a U.K. Telegraph article, International Business Editor Ambrose Evans-Pritchard reports that Andrew Bosomworth, general manager of Pimco's portfolio investment in Europe, recently stated that current European Union policies are untenable in the absence of fiscal union and will lead to a breakup of the Euro. In an interview with the German newspaper Die Welt (The World), Mr. Bosomworth commented: "Greece, Ireland and Portugal cannot get back on their feet without either their own currency or large transfer payments. These countries could rejoin the EMU after an appropriate debt restructuring and (currency) devaluation would let them export their way back to health. The euro crisis is not over by a long shot. Market tensions will continue into 2011."
- In a recent interview with CBS 60 Minutes, American research analyst Meredith Whitney highlighted state and local debt as the biggest problem facing the U.S. economy in 2011 and one that could derail its recovery: "There's not a doubt in my mind that you will see a spate of municipal bond defaults. You could see 50 to 100 sizeable defaults, or even more. This will amount to hundreds of billions of dollars' worth of defaults." American cities and states have debts which total about \$2 trillion (U.S.). New Jersey Governor summarized the problem: "We spent too much on everything. We spent money we didn't have. We borrowed money just crazily. The credit card is maxed out and it's over. We now have to get to the business of climbing out of the hole. We've been digging it for a decade or more. We've got to climb (out of debt) now and the climb is harder." At Long Wave Analytics, we have been warning of this looming day of reckoning for many years. See also, Winter Warning, December 1, 2008 – In One Hell of a State.

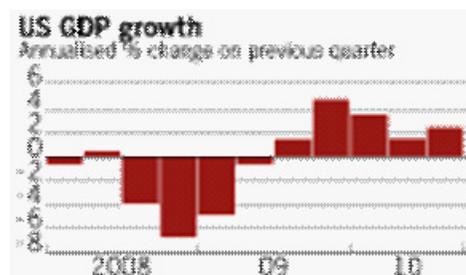
- Statistics Canada reports Canada's inflation rate rose by 0.1% in November to an annual rate of 2%, down from 2.4% in October, citing a decline in energy, food and clothing prices

WEDNESDAY, DECEMBER 22ND

- The U.S. Treasury Department releases the Financial Report of the United States for the fiscal year ended September 30, 2010. This report was instituted under former U.S. Treasury Secretary Paul O'Neill during the George W. Bush Administration, in order to identify the mounting liabilities of federal government entitlement programs, such as Medicare, Medicaid and Social Security. The report discloses that the U.S. federal government's net operating cost, or fiscal deficit, increased to \$2.08 trillion (U.S.) from \$1.253 trillion (U.S.) in fiscal 2009, as spending and liabilities increased for social programs. Separately, the U.S. Senate approved a compromise bill to fund the federal government until March 4, 2011.
- U.S. Congressman Dennis Kucinich (D-OH) introduces a dramatic new proposal to establish fiscal integrity, reassert Congressional sovereignty and regain control of monetary policy from private banks: "The staggeringly bad employment and economic numbers represent a massive problem which cries out for bold action. Rather than crossing our fingers and hoping that banks will finally lend some of the billions of public dollars they haven't thus far seen fit to lend, we can take action. My bill would replace the Federal Reserve's System's dependence on private banks to create credit. In its place, a Monetary Authority under the Treasury Department would directly inject liquidity into the economy by purchasing much needed public infrastructure repair. Today, we have idle capital, millions of able-bodied but unemployed workers, unused equipment, and record low (administered) interest rates. These conditions are the best possible time to make a long-term investment in our nation's infrastructure. My bill would do exactly that." There you have it – proposed legislation that would empower the U.S. Congress to direct U.S. Treasury Secretary Tim Geithner to carry out specific aspects of U.S. monetary policy. At Long Wave Analytics, we wonder what makes Senator Kucinich think Treasury Secretary Geithner can perform economic miracles any better than Federal Reserve Chairman Bernanke?

- The National Association of Realtors reports U.S. existing home sales increased by 5.6% in November from October, to a seasonally adjusted annual rate of 4.68 million units
- Statistics Canada reports the nation's retail sales increased by 0.8% in October, citing higher sales of home furnishings, automobiles and gasoline

- In its latest review of the Canadian economy, the International Monetary Fund (IMF) warns Canadians' record levels of mortgage debt, credit card debt and lines of credit represent a significant threat to the country's economic recovery. The IMF report states: "(Economic) growth is expected to be muted in the second half of 2010 and (during) 2011, as household debt has run up to high levels, housing markets are cooling and fiscal stimulus is waning. (Economic) risks are tilted to the downside, with a key risk that the global (economic) recovery stalls." Charles Kramer, the IMF's mission chief to Canada, stated: "The Bank of Canada can afford to lower administered interest rates and the federal government has the fiscal room to delay its plan to balance the budget, if the outlook for economic growth deteriorates."
- The Commerce Department reports the U.S. gross domestic product (GDP) grew at an annual rate of 2.6% in the 3rd. quarter, a slight upward revision from the 2.5% estimate of a month ago



THURSDAY, DECEMBER 23RD

- The Reuters/University of Michigan consumer sentiment index rose to reading of 74.5 in December from a level of 71.6 in November. The report contends while consumers' employment expectations have improved, views of their financial situations "have remained quite negative due to the widespread expectation of stagnant incomes"
- Fitch downgrades Portugal's long term sovereign debt rating from AA (Low) to A (High) with a negative outlook. Fitch stated: "The downgrade reflected an even slower reduction in the current account deficit and a much more difficult financing environment for the Portuguese government and banks, than it had envisaged last March. Failure to meet its 2011 deficit targets would erode confidence in the medium term sustainability of public finances that underpin the debt ratings. Portugal's current ratings are based upon the government retaining (bond) market access and did not assume that it would seek financial support from the European Union and/or the International Monetary Fund."

- The Commerce Department reports U.S. new home sales rose by 5.5% in November to a seasonally adjusted annual rate of 290,000; up from a downwardly revised 275,000 in October
  - The Labor Department reports initial claims for state unemployment benefits declined by 3,000 to a seasonally adjusted 420,000 in the week ended December 18th. While continuing claims fell by 103,000 to 4 million in the week ended December 11th.
  - The recent experience of the small city of Prichard, Alabama, could prove to be a leading economic indicator for municipalities across America in 2011. Earlier this year, this municipality exhausted its employee pension funds, so it curtailed monthly payments to 150 retirees, thereby, breaking a state law which mandates it to pay its promised retirement benefits in full. Former San Diego city attorney Michael Aguirre, has urged that California city to declare bankruptcy and restructure its own outside pension obligations. Mr. Aguirre commented: "Prichard is the future. We're all on the same conveyor belt. Prichard is just a little further down the road."  
See also, Winter Warning, December 15, 2008 – The Penchant for Pensions
- FRIDAY, DECEMBER 24TH
- In order to counter a persistently higher inflation rate that reached 5.1% in November, the Bank of China raises both its benchmark one-year lending rate and its one-year deposit rate by 25 basis points, to 5.81% and 2.75%, respectively
  - Master Card Advisors' Spending pulse reports U.S. online sales rose by 15% this holiday season to \$36.4 billion (U.S.) compared to \$31.5 billion a year ago, citing "aggressive marketing" by web-based retailers
  - Statistics Canada reports the nation's gross domestic product (GDP) rose by 0.2% in October, following a decline of 0.1% in September, citing growth in the mining and oil and gas sectors; as well as in wholesale trade, real estate and transportation
  - By a vote of 156 to 142, Greece's governing socialists approve a 2011 austerity budget to cut 5 billion euros from the fiscal deficit, through higher consumer taxes and further cuts in health and defense spending
  - In a newspaper article, jailed former Russian Yukos oil tycoon Mikhail Khodorkovsky lashes out at Russia's Prime Minister Vladimir Putin as "pitiable and trapped in the cynical political establishment he has created, indifferent to the fate of the (Russian) people." Mr. Khodorkovsky stated corruption had increased tenfold since Mr. Putin came to power in 2000 and disputed the prime minister's claims to have boosted stability in Russia (refer to the news media on the Sergei Magnitsky ordeal of 2005). He drew a direct link between corruption and the outbreak of racial clashes in Russian cities over recent weeks that have exposed a dangerous surge in ultra-nationalism in the country. "Don't fool yourself, thousands and thousands of suddenly brutalized youngsters are a clear signal that our children see no future for themselves. This is clearly the threatening result of Putin's stability (policy)." In a December 2nd. article, Globe and Mail reporter Carl Mortished stated: "Since the collapse of Communism, the Russian state has withered into a kleptocracy in which government officials, not only, tolerate crime but are actively engaged in it in a high level. The extent of official corruption goes way beyond police protection rackets and the extortion of bribes for business permits by petty bureaucrats. A hungry world will suck oil and metal out of Russia, paying tithes to a state looted by gangsters and the Russian people will continue to fester and suffer until they finally lose patience with authoritarian rule. On present evidence, that will not happen soon." At Long Wave Analytics, we believe that Mr. Khodorkovsky continues to be railroaded by Mr. Putin, as he expects to be sentenced next week to another 6 years in prison. As "pitiable" as Mr. Putin is, the western world is equally "pathetic" by comparison. Consider the International Olympic Committee granting the 2012 Winter Olympics to Russia. Consider the Fifa executive granting the 2018 World Cup tournament to Russia. Consider the United States and European Union encouraging Russian membership in the World Trade Organization (WTO). All of these landmark events are prized by the Russian leadership, in order to garner western legitimacy and endorsement for its mafia style of government. We would not invest a plug nickel into Russia.

CLOSING LEVELS FOR FRIDAY, DECEMBER 24TH.  
WEEKLY CHANGE

Dow Jones Industrial Average

11,573.50 + 81.59 points

Spot Gold Bullion (February)

\$1,380.50 (U.S.) + \$1.30 per ounce

S&P / TSX Composite

13,383.20 + 181.74 points

U.S. Treasury 10-year yield

3.40% + 5 basis points

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