Monday January 10th, 2011

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, January 10th

Statistics Canada reports the nation's building permits declined by 11.2% in November to $5.5 billion (CAD), citing lower construction plans for multi-family dwellings in British Columbia and commercial buildings in Ontario

MONDAY, JANUARY 10TH

- The General Administration of Customs reports China's trade surplus declined by 40% to $13.08 billion (U.S.) from $22.9 billion (U.S.) in November. In a note to clients, Bank of America–Merrill Lynch analyst Ting Lu stated: "The data indicate China's export sector is facing a structural cooling. In terms of growth, it is likely that imports will outpace exports in the coming months and the days in which China's shipments abroad grew by 20% annually are over – at least for now."

- U.K. and Chinese companies sign $4.04 billion (U.S.) of commercial agreements in the energy and automotive sectors. The agreements were announced after a meeting between British Deputy Prime Minister Nick Clegg and China's Vice Premier Li Keqiang, who is making a 9-day tour of Europe, which is China's largest export market. In a statement, Mr. Clegg remarked: "Together, today's deals will safeguard 700 jobs in the U.K. and are estimated to have the potential to create many more." The U.K. government also announced that Mr. Clegg and Mr. Keqiang discussed global issues, such as international security and climate change, in which the U.K. and China will work closely together. In 2010, the U.K. was China's third largest trading partner in Europe. According to Liu Xiaoming, China's ambassador to the U.K., bilateral trade reached a record high $40.2 billion (U.S.) between January and October, up 30% from 2009.

TUESDAY, JANUARY 11TH

- The Bank of China, one of the country's big four state-owned banks has opened trading in the yuan to customers in the United States, representing an explicit endorsement by Beijing in the fast growing market in the yuan (also known as the renminbi) and a significant step in the country's plan to foster global trading in its currency

- The European financial stability facility, the 440 billion euro ($570 billion U.S.) euro zone bailout fund, is marketing its first bond issue of 5 billion euros among investors in Europe, the U.S. and Asia. Japan has pledged to purchase more than 20% of the issue, raising expectations that other international investors will participate. Indeed, bankers close to the issue are confident of attracting support from sovereign wealth funds in China, Norway and the Middle East. The issue is expected to be priced next week.

- California Governor Jerry Brown announces $12.5 billion (U.S.) of spending cuts in the State's budget for fiscal 2012, including a 10% pay reduction for most State employees. Governor Brown remarked: "These (spending) cuts will be painful, requiring sacrifice from every sector of the State, but we have no choice."

WEDNESDAY, JANUARY 12TH

- Portugal auctions 1.25 billion euros ($1.62 billion U.S.) of government bonds in two tranches: 650 million euros of 3-year bonds maturing in 2014 and 599 million euros of 9-year bonds maturing in 2020. The 3-year issue produced an average yield of 5.396%, up 140 basis points from a previous auction in October and the 9-year issue had an average yield of 6.719%, down 8 basis points from the last auction. Portugal needs to issue 20 billion euros in bonds this year to finance its budget deficit and maturing debt.

- The Federal Statistics Office in Wiesbaden reports Germany's gross domestic product (GDP) grew by 3.6% in 2010, following a 4.7% decline in 2009, citing stronger exports and improving domestic demand

- The Office for National Statistics reports the U.K trade deficit expanded to 8.7 billion pounds ($13.59 billion U.S.) in November, from an upwardly revised 8.6 billion pound deficit in October. Alan Clarke, an economist with BNP Paribas, commented: "We expect U.K. exports to improve further, especially given signs of buoyancy in key trading partners such as Germany. Meanwhile, the likely softening in domestic demand on the back of public sector spending cutbacks and sluggish household consumption should reduce demand for imports."

- According to recent calculations by Reuters credit analyst Ed Rombach, the average duration of the U.S. Federal Reserve's new bond portfolio is just under 5 years; and every one basis point increase in the 5-year U.S. Treasury yield results in a paper loss of about $65 million (U.S.). On its purchases of Treasurys since November 12th. the Fed has accumulated paper losses approximating $2.3 billion (U.S.). Bob Eisenbeis, chief currency economist at Cumberland Advisors and former manager of research at the Atlanta Fed, warns: "What would be the international reaction if the Fed suddenly had to be recapitalized? I don't think that would bode well for Treasurys, or for the dollar, or for anything else. It would be embarrassing." The understatement of the day, to say the least.

- Statistics Canada reports the nation's New Housing Price Index rose by 0.3% in November following an advance of 0.1% in October

- In a recent speech in Frankfurt, Axel Weber, Governor of Germany's Bundesbank, warns: "The optimistic assumption of some observers that Europe's debt crisis has been contained, seems premature to me. There are several good reasons to look into 2011 with cautious optimism, not least the economic outlook. At the same time, there remain – also in Germany – important challenges in terms of cleaning up the financial system and getting state finances in order. The outlook for 2011 depends on the extent to which the right lessons are drawn from the (sovereign debt) crisis. The responsibility for the debt crisis in the euro area lies primarily with fiscal policy, not with the financial markets. The affected countries must themselves restore the (investor) confidence that's been lost, which requires ongoing budget consolidation and a reduction in debt levels."
  Wakeup call for U.S. President Obama: 'He who hath ears to hear, let him hear.'

- Illinois Governor Pat Quinn congratulates fellow Democrats after the State Legislature voted to raise the State personal income tax rate by 67%, from 3% to 5%; and the State's corporate taxes to 7% from 4.8%. Senate President John Cullerton (D-Chicago) remarked: "We have just come through the worst economic crisis in our lifetime and we have not paid our bills. We are going to have to cut (spending) even with this tax. We're going to have to spend less money than we have in the last two years and it's going to be tough. But we are going to have our bills paid."

- In its latest 'beige book' survey, the U.S. Federal Reserve reveals all of its 12 districts reported some form of strengthening in economic activity during November and December, citing the expansion was "moderate," as strength in the manufacturing and retail sectors were offset by weakness in real estate and financial services. With unemployment high and inflation low, economic conditions were defined as "improving" in the Boston, New York, Philadelphia and Richmond Fed districts. The economy in the Cleveland, Atlanta, Chicago, St. Louis, Kansas City and Dallas Fed areas increased "modestly to moderately." The Minneapolis Fed region "continued its moderate recovery," while that of the San Francisco district "firmed further."

THURSDAY, JANUARY 13TH

- The Labor Department reports the U.S. Producer Price Index rose by 1.1% in December, the most in 11 months, citing higher prices for food and fuel

- The Labor Department reports U.S. claims for state unemployment benefits increased by 35,000 to 445,000 in the week ended January 8th. while continuing claims declined by 248,000 to a seasonally adjusted 3.88 million in the week ended January 1st. Scott Gibbons, a Labor Department spokesman, commented: “The data can be particularly volatile in the first few weeks of January, since many people don’t file claims right away and state unemployment offices are open fewer hours, leading to administrative delays.”

- Irvine, California-based Realty Trac Inc. predicts the number of American households receiving a foreclosure filing will increase by about 20% in 2011, as unemployment remains high and banks resume home seizures. A record 2.87 million U.S. properties received notices of default, auction or repossession in 2010, a 2% increase from 2009.

- Statistics Canada reports the nation’s trade deficit narrowed sharply to $81 million (CAD) in November from $1.5 billion(CAD) in October, citing an unexpectedly large decline of 3.2% in imports – an indication that Canada’s domestic economy was slowing rapidly as the year was coming to a close

- In a luncheon speech to the Canadian Club, Margaret Franklin, Toronto-based Chair of the Chartered Financial Analyst (CFA) Institute, stated: “The RCMP’s Integrated Market Enforcement Team (IMET), which is responsible for investigating Canada’s biggest securities crimes, is one of the weakest links in the chain of enforcement in Canada and should be revamped from top to bottom. I continue to be shocked that industry participants aren’t outraged and demanding stronger enforcement because this is about trust.”

- The United Kingdom ends it default retirement age of 65 years

- The Commerce Department reports the U.S. trade deficit narrowed by 0.3% to $38.3 billion (U.S.) in November, citing “faster (economic) growth overseas and a weaker U.S. dollar boosted demand for American-made aircraft and industrial supplies like cotton.”

- Prices in Japan, as measured by the gross domestic product (GDP) deflator, have been declining almost without interruption since 1994. According to Bloomberg News, this year, Fast Retailing Co., Asia’s biggest clothing chain, whose Uniqlo brand offers 790-yen ($9.50 U.S.) fleeces, will open 44 stores abroad compared with 36 in Japan. By 2020, Fast Retailing plans to open at least 200 stores in the U.S. Yoshimasa Maruyama, a senior economist with Itochu Corp. in Tokyo, notes: “Retailers like Uniqlo were able to ride the wave of deflation and grow. To win these pricing wars at home, companies had to keep cutting workers’ pay, and that’s spiraled down with prices falling and then falling some more, with deflation never ending.” Fast Retailing’s CEO has predicted that “overseas revenue may overtake domestic revenue within four years.” See also, Special Edition, October, 2010 – Inflation or Deflation? That is the Question

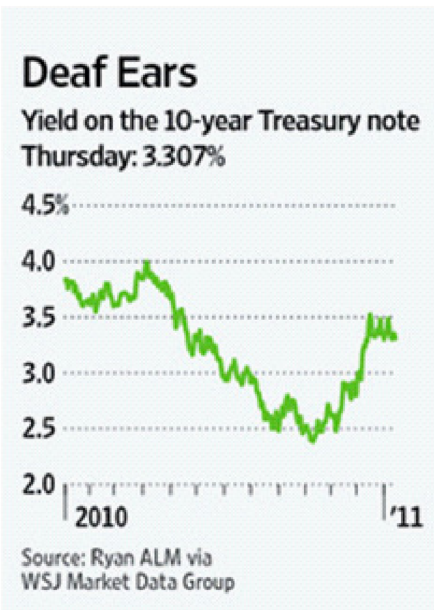
- In its report, the ‘AAA’ Sovereign Monitor, Moody’s Investors Service warns the United States, France, Germany and the United Kingdom that they need to improve control of the rising costs of pension and health care subsidies; noting that the U.S. and Britain have recently experienced the steepest increases in government debt. However, all four countries still have balance sheets that are compatible with their ‘AAA’ ratings: “Longer term, the countries face dramatic (cost) increases arising from aging-related pension and health care subsidies. These future costs must be brought under control if these countries are to maintain long-term stability in their debt burden credit metrics. Moreover, we have become increasingly clear about the fact that if there are not offsetting measures to reverse the deterioration in negative fundamentals in the U.S., the likelihood of a negative outlook over the next two years will increase.” The U.S. national debt now totals $14,075,100,000,000.

- Spain auctions 3 billion euros ($3.9 billion U.S.) of 5-year bonds at an average yield of 5.54%; 97 basis points higher than the previous issue last November

- Portugal auctions 1.25 billion euros ($1.62 billion U.S.) of government bonds maturing in October 2014 and June 2020, following a 1.1 billion euro private placement of bonds with China earlier this week

- In a Forbes article, reporter Robert Lenzner discloses: "The giant U.S. banks are permitted to accrue interest on non-performing mortgages until the actual foreclosure occurs, which on (the) average takes about 16 months. As a result, many bank financial statements actually look much better than they really are. At foreclosure, all the phantom income is removed from the banks' books. This means that Bank of America, Citigroup, JP Morgan and Wells Fargo can report unpaid accrued interest on an estimated $1.4 trillion (U.S.) of face value mortgages on the 7 million homes that are in the process of being foreclosed." Madeleine Schnapp, director of macro-economic research at TrimTabs, an economic consulting firm 24.5% owned by Goldman Sachs, warns: "These banks face a potential loss of $1 trillion (U.S.) on non-performing mortgages."

- According to a Reuters/Ipsos poll, 71% of the American public is overwhelmingly opposed to raising the U.S. debt limit.



FRIDAY, JANUARY 14TH

- In a prelude to the forthcoming battle over spending cuts and the debt limit, House Speaker John Boehner (R-Ohio) frames America's debt as essentially the fault of the Democrats: "President Obama and Congressional Democrats have been on a job-destroying spending spree that has left us with historic unemployment and the most debt in U.S. history. If they want us (Republicans) to help pay their bills, they are going to have to start cutting up their credit cards. Washington has an illness called spending. The debt is a symptom of that illness and the American people want it cured." See also, Longwave Blog, January 12, 2011 – Geithner Urges Congress to Raise Debt Limit

- The Canadian Real Estate Association (CREA) reports home sales declined by 14% in December on a year-over-year basis. CREA chief economist Gregory Klump commented: "Sales may be starting to plateau in some of Canada's most active and expensive housing markets. Combined with a pickup in new listings and further interest rate increases, the stage is being set for smaller price gains and a further deceleration in the growth of mortgage debt."

- Fitch Ratings downgrades Greece's sovereign debt from 'BBB' (Low) to 'BB' (High) with a negative outlook, which "reflects that public debt sustainability is still very fragile and renewed access to market financing uncertain. While the IMF-EU program assumes that Greece can resume market access in 2012, Fitch believes that in the current market environment a high degree of uncertainty surrounds this goal and unfilled financing gaps could resurface." In a statement, Greece's Finance Ministry responded: "The downgrade cannot be justified. The progress in fiscal consolidation and in the field of structural reforms that together determine the medium- term sustainability of the Greek debt has been recently, positively assessed by the European Commission (EC), the European Central Bank (ECB) and the International Monetary Fund (IMF)."

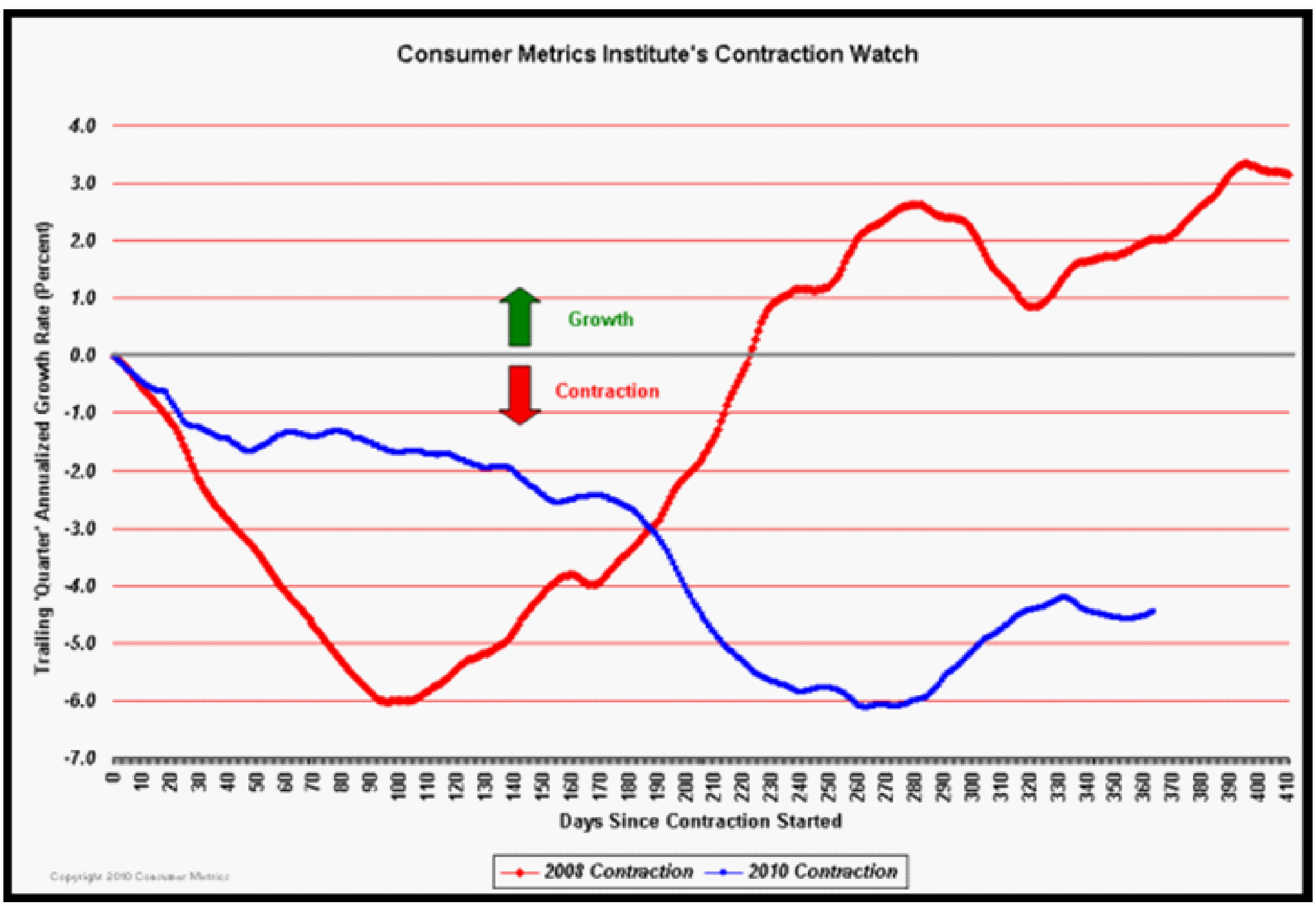
- In his first executive order as Governor of California, Democrat Jerry Brown orders State employees to return 48,000 cell phones paid for by the State; an austerity measure aimed at saving the State $20 million (U.S.) annually. Governor Brown elaborated: "It is difficult for me to believe that 40% of all State employees must be equipped with taxpayer funded cell phones. The current number of cell phones out there is astonishing."

- According to data posted on the company's website, Pacific Investment Management Co. (Pimco), the world's largest bond fund manager, reduced the amount of U.S. Government holdings in its flagship bond fund during December to its lowest level in nearly two years. Holdings of U.S. Treasurys, Government agency securities, Treasury Inflation Protected Securities (TIPS) and Treasury future and options for the Pimco Total Return Fund declined from 30% in November to 22% in December, the lowest level since 15% in February, 2009.

- According to a recent report by the Consumer Metrics Institute, which monitors daily consumer indicators; the last of the Bureau of Economic Analysis (BEA) gross domestic product (GDP) reports issued during 2010, indicated that the "real final sales of domestic product" were growing at an anemic 0.9% rate during both the 2nd. and 3rd. quarters of 2010. This number is calculated by reducing the headline GDP number by the net amount of goods being added to manufacturing inventories (and therefore not being sold to end consumers). Their characterization of the number as the “real final sales” within the economy is telling, and a 0.9% annualized growth rate over the course of the six middle months of the year is statistically indistinguishable from a flat economy. “However mediocre that growth may have been, at the end of 2010 the data that we track was materially weaker. The online consumers who we track still appear to be reluctant to take on new debt, and they remain cautious in their expectations for the economy in 2011. The heavily reported increases in holiday spending came primarily from reductions in personal savings rates, and that holiday ‘feel good’ spending may ultimately turn out to be merely brought forward to the 1st. quarter of 2011 – similar to holiday dietary indulgences preceding fervently resolved 1st. quarter diets. In any event, the consumers who we track are still contracting their year-over-year discretionary durable goods purchases at levels which indicate that something is still seriously amiss in this economy.

A look at our Contraction Watch chart reveals that our Daily Growth Index remained in year-over-year contraction from the middle of January, 2010 through the end of the year.

In the chart below, the day-by-day courses of the 2008 and 2010 contractions in our Daily Growth Index are plotted in a superimposed manner, with the plots aligned on the left margin on the first day during each event that our Daily Growth Index went negative. The plots then progress day-by-day to the right, tracing out the changes in the daily rate of contraction in consumer demand for the two events. The 2010 contraction event is now a year old, dating back to January 15, 2010. Although the chart clearly bottomed at about 9 months into the contraction (at roughly 270 days), the rise since that bottom has been neither steady, nor substantial. In fact, there is no way to forecast when the indicated contraction will end, based solely upon the recent course of the blue line.” Consumer metrics adds: “Corporate earnings can be a misleading indication of the health of national commerce. Major U.S. corporations are in a privileged position in the economic food chain, with access to overseas markets, commercial paper, cheap loans, ruthless human resources departments, governmental contracts and stimulus monies. The American people actually creating new jobs don’t have such access.”



CLOSING LEVELS FOR FRIDAY, JANUARY 14TH.
WEEKLY CHANGE

Dow Jones Industrial Average	11,787.38	+ 112.58 points
Spot Gold Bullion (February)	$1,360.50 (U.S.)	– $8.40 per oz
S&P / TSX Composite	13,464.06	+ 191.76 points
10-Year U.S. Treasury Yield	3.32%	+ 1 basis point
Canadian Dollar	101.07 cents (U.S.)	+ 0.24 cent