

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



Monday, January 17TH

Canada's Finance Minister Jim Flaherty announces new federal mortgage rules which will reduce the maximum amortization period from 35 years to 30 years, for government-backed insured mortgages with loan-to-value ratios of more than 80%.

MONDAY, JANUARY 17TH

In addition, Ottawa will lower the maximum amount Canadians can borrow to refinance their homes from 90% to 85% of the value of their houses.

- Responding to queries from the Wall Street Journal and the Washington Post prior to his 4-day state visit to the U.S. which commences tomorrow, Chinese President Hu Jintao postulates: "The U.S. and China should abandon the zero-sum cold war mentality. We should respect each other's sovereignty, territorial integrity and development interests." Liu Qin, a researcher at the China Institute for International Studies in Beijing, comments: "This visit serves as a connection point for the next generation of Chinese leaders and will lay a solid foundation for the next ten years. The biggest achievement for this trip will be a strengthening of mutual trust and setting a tone for future strategic development." In addition, President Jintao stated: "The current international currency system is a product of the past. The monetary policy of the United States has a major impact on global liquidity and capital flows and therefore, the liquidity of the U.S. dollar should be kept at a reasonable and stable level." Hu's on first.
- Czech Republic Deputy Finance Minister Jan Gregor announces plans to auction as much as 2 billion euros (\$2.66 billion U.S.) of bonds during 2011, with the timing dependent upon market conditions, citing "Investors are registering the credibility of the Czech Republic."

- In a UK Telegraph op-ed, International Business Editor Ambrose Evans-Pritchard warns: "European Monetary Union (EMU) policies are pushing Southern Europe into a systemic political crisis...There is an awful possibility – or probability – that German uber-growth will increase the (financial) pain for peripheral Europe before it offers a meaningful lifeline to Club Med through trade stimulus. The central assumption of EU policy is that a rising economic tide will ultimately lift all boats. It is a fatal self-deception. A rising tide in Germany is precisely what risks shattering weaker vessels...That is to say, Germany must be prepared to do for Southern Europeans what it has already done for its own kin in East Germany, but on six times the scale. Or, she can pull the plug, by quietly signaling to the Verfassungsgericht that Berlin would not be too angry if the eight judges declared the European Union's (EU) rescue machinery to be unconstitutional, ending the European Monetary Union (EMU) as we know it. What is clear is that the status quo is ruinous. The slow suffocation of nations still under Fascist rule just one generation ago, cannot end well for liberal democracy in Europe." At Longwave Analytics, we cannot understand how anyone could realistically expect Deutschland to rescue all of the 'weak sisters' in the EMU. Correspondingly, no one should expect China to provide a financial bailout for the United States of America. One wonders whether Mr. Evans-Pritchard is attempting to 'beat the drum' with a critically constructive rhythm, or is he attempting to subtly justify Britain's non-membership in the EMU with benefit of 20/20 hindsight? Either way, we rather deem this article not to be representative of Mr. Evans-Pritchard's personal best.

TUESDAY, JANUARY 18TH

- The Office for National Statistics reports the U.K. inflation rate rose by 3.7% on a year-over-year basis in December following an annual gain of 3.3% in November, citing higher food and fuel prices. In a newspaper interview, the Bank of England's markets director, Paul Fisher, commented: "The inflation rate is very uncomfortable, but it will probably peak during the current quarter." David Tinsley, an economist at the National Australia Bank in London, warned: "Inflation above 4% in the first quarter looks almost inevitable and it adds to the pressure on the Bank of England. The first interest rate increase (of the year) is looking increasingly likely in May, but April isn't impossible."
- Bank of Canada Governor Mark Carney leaves the Bank Rate unchanged at 1% warning: "The global (economic) recovery is proceeding at a somewhat faster pace than policy makers had anticipated last fall, although risks remain elevated. Uncertainty overseas, the strong Canadian dollar and poor corporate productivity performance will hold back exports." The fact that Canada's trade deficit narrowed sharply last October and November, due to a significantly lower level of imports indicated a slowing of the Canadian economy; which will likely be reflected in the gross domestic product (GDP) report for the 4th. quarter of 2010.
- A new report by CIBC World Markets forecasts the Canadian unemployment rate will be 7.5% this year and 7.1% in 2012. Economists Benjamin Tal and Emanuella Eneajor warn: "Additional cuts to (government) spending should see compensation expenses drop on wage restraint, employment attrition and selective job cuts. As was seen during the 1990s period of (government) budget tightening, a 1% drop in the deficit to GDP ratio meant an approximate 1% reduction in the public sector headcount, suggesting the labour market could lose around 35,000 government positions this year."
- According to a recent report prepared by the Asia Pacific Foundation of Canada and the China Council for the Promotion of International Trade, a survey of more than 1,300 mostly small and medium-sized enterprises (SMEs) from China shows strong interest in investing in Canadian manufacturing. About 8% of the Chinese companies surveyed indicated they planned to invest in Canada within the next three years. Among those companies, the average size of intended overseas investment is \$16.1 million (U.S.).

- U.S. House Majority Leader Eric Cantor (R-Va.) warns Republicans wouldn't agree to raise the national debt ceiling without assurances of government spending cuts: "We are simply not going to accept an increase in the (national) debt limit without serious cuts and reforms. If our votes are needed and I assume the President thinks so, then we will be acting to ensure the people that elected us that Washington's spending binge is over." What Majority Leader Cantor and House Speaker Boehner fail to recognize is that America's national debt cannot be expunged by spending cuts alone – VAT anyone?
- Complex securities in Europe worth 760 billion euros have been threatened with credit downgrades by Standard & Poors (S&P) after the credit rating agency changed the way it analyses the issues. S&P's publication of a list of securities placed on "credit watch negative" could unsettle the fragile recovery of Europe's securitization markets. S&P revealed that the European list covered 1,986 classes of notes in 968 different securitizations; about 30% of the region's entire structured finance market.
- As a preview to its annual high-profile meeting in Davos, Switzerland, the World Economic Forum (WEF) warns that the world's expected economic growth rate will require the support of an extra \$100 trillion (U.S.) of credit over the next decade. Written in conjunction with consulting firm McKinsey, the report stated: "Pockets of credit grew rapidly to excess and brought the entire financial system to the brink of collapse. Yet, credit is the lifeblood of the economy and much more of it will be needed to sustain the (economic) recovery and enable the developing world to achieve its growth potential."

WEDNESDAY, JANUARY 19TH

- The Commerce Department reports U.S. housing starts fell by 4.3% in December to a seasonally adjusted annual rate of 529,000 units, following a slightly revised 553,000 units in November. Permits for new construction rose by 16.7% to an annualized rate of 635,000 mainly centered on condominiums and apartment buildings with 5 or more units, and were issued ahead of announced building code changes in California, Pennsylvania and New York state, effective January 1st.
- During Chinese President Hu Jintao's state visit to America, the White House announces \$45 billion (U.S.) of commercial transactions with China, including \$19 billion (U.S.) of orders for 200 Boeing aircraft and agreements with American agriculture, technology and telecommunications companies

- Jules Kroll, founder of Kroll Bond Ratings Inc. announces the entry of his company into the rating agency industry, currently monopolized by Moody's Investors Service, Standard & Poors (a unit of McGraw Hill) and Fitch Ratings (a subsidiary of Fimalac SA of France). In an interview, Mr. Kroll stated: "The incumbents avoid doing due diligence, so, to provide the deep dive investors want on ratings, the company will look beyond the information that issuers provide and will make regular use of corporate consulting and security firm K2 Global" – a separate company managed by Mr. Kroll's son Jeremy.
 - In an interview with the Financial Times, Kaoru Yosano, Japan's Minister for Economic and Fiscal Policy warns: "Japan has hit a critical point where it risks losing investor confidence if politicians fail to reach agreement on how to rein in the ballooning national debt. We face a dreadful dream that one day the long-term interest rate might rise; so we have to be very careful (to) ensure the credibility of our economy and the credibility of our government."
 - Anthony Thomas, a senior analyst at Moody's warns: "Portugal is likely to incur a credit rating downgrade within 3 months because of its high level of public debt and its related debt affordability level, amid concerns over the lack of economic growth and funding difficulties for the country's banks. Statistically, the overwhelming probability is that we will take a downward rating action."
- THURSDAY, JANUARY 20TH
- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 37,000 to 404,000 in the week ended January 15th. while continuing claims fell to 3.861 million from 3.887 in the week ended January 8th.
 - The National Bureau of Statistics reports China's gross domestic product (GDP) grew by 9.8% in the 4th. quarter, following a gain of 9.6% in the 3rd. quarter, citing broad growth from factory output to capital investment
 - Turkey's central bank cuts its benchmark lending rate to a record low 6.25%, citing a continuation of its policy to impede the rapid inflow of speculative investment, or so-called 'hot money.' In a statement, the bank's monetary policy committee signaled "additional measures" would be taken to limit credit expansion, stressing: "the net effect of the measures which have been taken, or are envisaged under the new policy, is tightening."
 - According to informed sources, New York Governor Andrew Cuomo is considering the dismissal of 10,000 to 12,000 State employees as he prepares to submit his budget for the 2012 fiscal year, which begins in April. New York State is faced with a potential \$10 billion (U.S.) budget deficit, encompassing 15% of its projected expenditures. Governor Cuomo is also drafting a health care budget aimed at cutting \$2.1 billion (U.S.) from the State's share of projected Medicaid funding.
 - In a State address, Michigan Governor Rick Snyder announces his support for a new bridge (to replace the existing Ambassador Bridge) connecting Detroit to Windsor, Ontario; the continent's busiest international border crossing: "We have secured \$550 million (U.S.) in funding from Canada for construction of the U.S. portion of the road system for the bridge and a matching grant from the U.S. Federal Highway Administration. Only private sector investment will be used to build the bridge itself. The new bridge will create jobs, strengthen our economy and help establish Michigan as a hub for global commerce."
 - The National Association of Realtors reports U.S. existing home sales rose by 12.3% in December to a seasonally adjusted annual rate of 5.28 million units. The trade group's chief economist Lawrence Yun commented: "Higher mortgage rates pulled some prospective buyers off the fence last month, fearing that mortgage rates may rise again."
 - Vallejo, California, the largest American municipality in bankruptcy, files a plan of adjustment in U.S. Bankruptcy Court in Sacramento, proposing to pay general unsecured creditors 5% to 20% of their claims and end court control of its finances. More than 1,000 proofs of claim have been filed, including 969 general unsecured claims, 12 unsecured priority claims and 32 secured claims. Creditor claims, including those of retirees and former employees, that listed a specific amount totaled about \$479 million (U.S.). In the filing, the municipality stated: "While the City regrets that it cannot pay a higher percentage, the fact is that the City lacks the revenues to do so, while maintaining an adequate level of municipal services, such as the provision of fire and police protection and the repairing of the City's streets." The plan must first be voted upon by creditors, before U.S. Bankruptcy Judge Michael S. McManus rules whether or not to approve the proposal. Visualize that scenario unfolding all across America over the next several months.

- In an interview with Handelsblatt newspaper, Lars Feld, nominated by the German cabinet to a 5-member panel of economists who advise the German Government and a professor at the University of Freiburg, was quoted: "I don't believe that Greece will manage to deal with its debts without a cut and then German guarantees will come due."

FRIDAY, JANUARY 21ST

- Bank of America Corp., the largest U.S. bank by assets, reports a \$1.24 billion (U.S.) loss in the 4th. quarter of 2010 compared to a \$194 million (U.S.) loss in the same period in 2009; citing higher provisions for faulty mortgage loans, litigation and a write down of the value of its subsidiary Countrywide Financial Corp. The legacy of lawsuits and bad loans left by former CEO Ken Lewis, continues to haunt the Bank of America.
- U.S. President Barack Obama will appoint Jeffrey Immelt, CEO of General Electric, to chair his private-sector panel of economic advisors, replacing former Federal Reserve Chairman Paul Volcker.
- Insee, France's national statistics office, reports its index of confidence among manufacturing executives rose to a reading of 108 in January from a revised level of 102 in December
- According to informed sources, Reuters has learned that Spain is planning a partial state takeover of the country's weakest savings banks (known as cajas), by converting them into conventional banks and seek a stock market listing; in order to persuade skeptical investors that they are good investments. FROB, the state-backed bank restructuring fund, would then become a stakeholder in the banks that fail to attract private investment. Indubitably, if an investor isn't skeptical, he/she is inclined to be gullible.

- Statistics Canada reports the nation's retail sales rose by 1.3% to \$37.3 billion (CAD) in November, citing gains at new car dealerships and at automotive parts dealers; as well as at food and beverage stores
- According to the latest New York Times/CBS News poll, regarding methods to reduce chronic annual federal deficits, Americans overwhelmingly responded that in general, they prefer cutting government spending to paying higher taxes. However, their preference for spending cuts, particularly in government programs that benefit them, dissolves when they are presented with specific options related to Medicare and Social Security, the programs that directly touch the most people, but are also the biggest drivers of the government's projected long-term debt. Nearly two-thirds of Americans chose higher payroll taxes for Medicare and Social Security over reduced benefits in either program. Asked to choose among cuts to Medicare, Social Security, or the nation's third largest spending program – the military – a majority by a large margin, chose cuts to the Pentagon's budget. At Longwave Analytics, we have repeatedly warned that there is very little support for higher taxes in America. However, what Americans fail to recognize or appreciate is that neither, the federal budget deficit, nor, the national debt burden can be solved by spending cuts alone. Obviously, this applies to state and municipal governments as well.

CLOSING LEVELS FOR FRIDAY, JANUARY 24TH.
WEEKLY CHANGE

Dow Jones Industrial Average	11,871.80	+ 84.42 points
Spot Gold Bullion (February)	\$1,341.00 (U.S.)	– \$19.50 per oz.
S&P / TSX Composite	13,258.60	– 205.46 points
10-year U.S. Treasury Yield	3.41%	+ 9 basis points
Canadian Dollar	100.68 cents (U.S.)	– 0.39 cent

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