Monday January 24th, 2011

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, January 24TH

The U.S. Postal Service, which lost a record $8.5 billion (U.S.) in 2010, announces the closing of 2,000 post offices beginning in March, in addition to the 491 closings that it announced last year.

MONDAY, JANUARY 24TH

The Postal Service is also reviewing another 16,000 outlets that are operating at a deficit and lobbying Congress to change the law, so it can close the most unprofitable among them. Currently, the law allows the Postal Service to close offices only for maintenance problems or lease expirations, unrelated to profitability issues.

- In a Financial Times op-ed, former U.S. Deputy Treasury Secretary Roger Altman and Richard Haass, President of the Council on Foreign Relations warn: “The danger of the government’s debt and deficit (burden) is greater than most Americans understand. Not even the United States can indefinitely run up debt at the current, astronomical rate. If our leaders do not rein it in, global financial markets will ultimately force a solution. In other words, adjustment will either be done by the U.S. or to it. The latter scenario would mean ugly budget changes: larger than necessary, indiscriminate and imposed virtually overnight. No one can predict when the markets might move on America, but it is a question of when, not if. The result would be an age of American austerity. No category of federal spending, from the Department of Defense to Medicare, would be spared. Taxes on all or most individuals and businesses would rise. Economic growth would slow. The consequences for America’s international role, and for world stability would be profoundly negative.” There is no way this debt can be repaid, the creditors know that, but for their own reasons continue to play the game. See also, Winter Warning, January 26, 2011 – Economic and Financial Outlook for 2011.

- According to San Francisco’s Bay Citizen, despite the city’s anticipated budget deficit for fiscal 2011 of $360 million (U.S.), San Francisco’s retirees will receive cost-of-living adjustments (COLAs) totaling $170 million (U.S.), in addition to the regular COLAs. Three weeks ago, an actuarial firm reported that the $13.1 billion (U.S.) San Francisco Employees’ Retirement System had an unfunded liability of $1.6 billion (U.S.) – triple its shortfall of a year earlier. Let the madness continue!

- Bloomberg News reports U.S. mortgage giants Fannie Mae and Freddie Mac have amassed a combined inventory of 242,000 foreclosed residential properties totaling a record $24 billion (U.S.) – a fivefold increase over the last 3 years. The foreclosure rate continues to outpace the number of potential new home buyers by a goodly margin.

- Reuters reports concerns that the U.S. Federal Reserve could suffer losses on its massive bond holdings have driven the central bank to adopt a little-noticed accounting change with huge implications; i.e. enabling the Fed to avoid insolvency. Essentially, the change allows the Fed to denote losses by the various regional banks that comprise the Fed system, as a liability to the Treasury, rather than a reduction to its capital. It would then simply direct future profits from Fed operations toward that liability. Roll the dice, boys!

TUESDAY, JANUARY 25TH

- The Reserve Bank of India (RBI) raises its repurchase interest rate, the rate at which it lends money to commercial banks, by 25 basis points to 6.5%. In a statement accompanying the RBI's quarterly review, central bank Governor Duvvuri Subbarao cited: "Inflation is clearly the dominant concern. Even as the inflation rate itself remains uncomfortably high, the reversal in the trend of inflation is striking."

- According to the S&P/Case Shiller home price index, the prices of single-family homes in 20 major U.S. cities fell by 1% in November – the fourth consecutive monthly decline – citing the continuing glut of houses on the market. On a year-over-year basis, home prices fell by 1.6%.

- Bank of America's subsidiary, Countrywide Financial – acquired by the bank in 2008 – is accused of "massive fraud" in a lawsuit filed in New York State Supreme Court, by a dozen institutional investors (including New York Life Insurance), claiming they were misled about mortgage-backed securities (MBS). According to the complaint, "Countrywide Financial was an enterprise driven by only one purpose: to originate and securitize as many mortgage loans as possible into MBS to generate profits for the Countrywide defendants without regard to investors who relied upon the critical, false information provided to them with respect to the related securities." The investors claim they bought hundreds of millions of dollars of Countrywide mortgage-backed securities between 2005 and 2007 because they wanted conservative, low risk investments. The relied upon term sheets, prospectuses and other materials provided by Countrywide that were recklessly, or knowingly false. The legacies, left by former B of A President and CEO Ken Lewis (now retired) and by former Countrywide Financial co-founder and CEO Angelo Mozilo, for ignorance and fraud respectively, continue unabated.

- In an update to its World Economic Outlook report, the International Monetary Fund (IMF) raises its 2011forecast for global economic growth to 4.4% from the 4.2% it predicted last October, reflecting stronger U.S. output based upon tax-cut extensions. IMF chief economist Oliver Blanchard commented: "Our forecast is that next year (economic) growth will be roughly the same as this year, but that's not going to make a big dent in the unemployment rate and risks to our predictions remain elevated. In advanced economies, activity has moderated less than expected, but (economic) growth remains subdued."

- The Office for National Statistics reports the U.K. gross domestic product (GDP) declined by 0.5% in the 4th. quarter of 2010, citing the poor December weather that blanketed much of the country with heavy snowfalls

- The Conference Board reports its U.S. Consumer Confidence Index rose to a reading of 60.6 this month from a level of 53.3 in December; the highest reading since 62.7 last May

- Statistics Canada reports the country' consumer price index rose by 2.4% in December on an annualized basis, citing higher gasoline prices which offset a decline in clothing prices

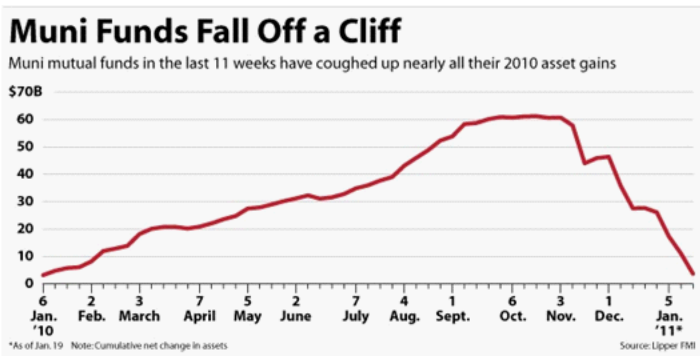
- A Reuters poll of 65 leading analysts, traders and fund managers reveals predictions that gold will average $1,450 (U.S.) this year and $1,420 (U.S.) in 2012. Robin Bahr, an analyst with Credit Agricole comments: "There are enough things to keep us worried going forward. In a year's time, hopefully there will have been some kind of resolution of the euro zone debt situation, and maybe then we will start to worry about the U.S. deficit or the deficit in Japan. So the fear factor won't totally be alleviated. There will always be something that the markets will have to worry about. For portfolio diversification, there will still be people wanting to diversify further into gold."

- The Labor Department reports the U.S. unemployment rate fell significantly in a handful of states during 2010, although most states closed the year with jobless rates comparable to those at the end of 2009

- The International Monetary Fund (IMF) issues its clearest warning to date that the latest U.S. fiscal stimulus is ill-judged, unlikely to foster economic growth and raises the risk of a bond crisis over the medium term. In an update to its World Economic Outlook, the IMF warns: "Although some targeted measures in the U.S. are justifiable at this juncture given the still weak labor and housing markets, the recently implemented stimulus is expected to deliver only a relatively small growth dividend (given its size) at a considerable fiscal cost. The absence of a credible, medium-term fiscal strategy would eventually drive up U.S. interest rates, which could prove disruptive for global financial markets and for the world economy." The IMF also warned that the federal government's deficit will remain embedded at 10.75% of gross domestic product (GDP) in 2011, with the national debt exceeding 110% of GDP in 2016. Caveat America!

- The European Financial Stability Facility (EFSF) auctions 5 billion euros of 5-year 'AAA' rated bonds at a yield of 2.89% -- 58 basis points over comparable German bunds, to fund the first stage of the Irish loan package. With huge demand emanating from Asian and Middle Eastern investors, the issue was 9 times oversubscribed.

- According to the Bond Buyer, nervous investors established a new record of $4 billion (U.S.) for withdrawals from municipal bond mutual funds last week, as news headlines regarding increasing risk of potential defaults continued to influence people to redeem holdings in state and local government fixed income mutual funds.



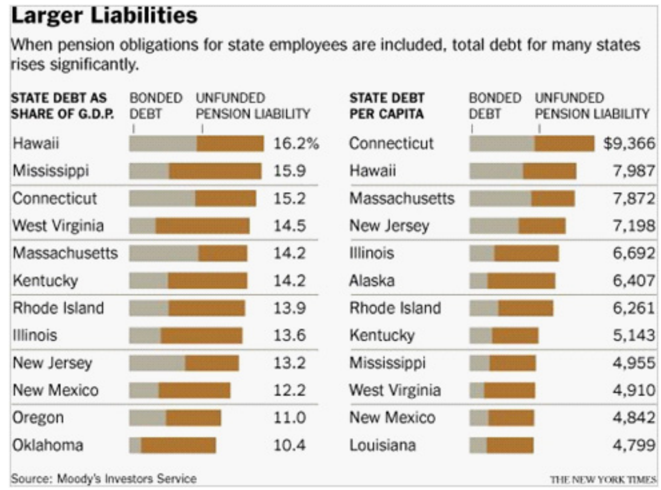
WEDNESDAY, JANUARY 26TH

- In a statement issued after a two-day meeting in Washington, the Federal Open Market Committee (FOMC) left its Fed Funds rate unchanged in a range of 0 - 0.25%, citing: "The economic expansion is continuing, although at a rate that has been insufficient to bring about a significant improvement in labor market conditions. Inflation is too low and unemployment too high, to be consistent in the long run with policy makers' congressional mandates for stable prices and full employment."

- The Congressional Budget Office (CBO) releases new estimates predicting the U.S. Government's deficit will likely reach $1.5 trillion in the current fiscal year ending September 30th. – a new record. The CBO also forecasts the U.S. economy will grow by 3.1% this year; but the unemployment rate will remain above 9%.

- The Commerce Department reports U.S. new home sales increased by 17.5% in December to a seasonally adjusted annual rate of 329,000 units

- Moody's Investors Service has initiated calculation of U.S. states' credit ratings by including unfunded pension commitments



- An Illinois appellate court strikes down an ongoing $31 billion (U.S.) state construction program, citing the plan violates the state constitution's "Single Subject Rule." The court noted the rule requires that a bill appropriating funds be confined to one subject, and that public funds must only be used for public purposes: "We find that a wide range of topics (in the Act) cannot be considered to possess a natural and logical connection." Governor Pat Quinn's office announced the State would appeal the decision.

- A New York State oversight board assumes control of Nassau County's finances, citing the county has a budget deficit of 1%. The Nassau County Interim Finance Authority (NIFA) now has the authority to review the operation and management of county government, approve borrowing and contracts and institute wage freezes.

- According to the New York Times, Moody's new approach may now turn the tide in favour of more disclosure. The rating agency announced that in the future, it will add states' unfunded pension obligations together with the value of their bonds and consider the totals when rating their credit. The new approach will be more comparable to how the agency rates corporate debt and sovereign debt. Under its new calculation method, Moody's discovered that the states with the biggest total indebtedness included Hawaii, Connecticut, Illinois, Kentucky, Massachusetts, Mississippi, New Jersey and Rhode Island.

- Bank of England Governor Mervyn King warns: "British families will see their disposable income devoured as they pay the inevitable price for the financial crisis. As a result, U.K. households face the most dramatic squeeze in living standards since the 1920s." Yes Mr. King, The Bank of England is solely responsible for the predicament British citizens are now facing.

THURSDAY, JANUARY 27TH

- The Labor Department reports U.S. claims for state unemployment benefits increased by 51,000 to 454,000 in the week ended January 22nd. while continuing claims rose by 94,000 to 3.99 million in the week ended January 15th. – citing severe winter weather in Alabama, Georgia, North Carolina and South Carolina in previous weeks prevented people from filing claims. A considerable number of those unemployed Americans filed last week, boosting the claims number.

- Standard & Poors (S&P) cuts Japan's credit rating to AA (Low) from AA with a stable outlook, citing persistent deflation and political gridlock which undermine efforts to reduce its 943 trillion yen ($11 trillion U.S.) national debt burden. S&P stated: "The government lacks a coherent strategy to address the nation's debt." Vice Finance Minister Fumihiko Igarashi recently commented: "The government must address its finances to avoid a debt crisis that could cause a global depression." Azusa Kato, an economist at BNP Paribas in Tokyo remarked: "I hope this serves as a warning for the Government, it has absolutely no sense of crisis. Once bond yields spike (upward) and the fire is lit, the amount needed to finance Japan's borrowing needs is going to jump and it's going to be too late."
  See also, Winter Warning, January 11, 2010 – It's The Debt, Stupid

- The Commerce Department reports U.S. durable goods orders declined by 2.5% in December, following an upwardly revised drop of 3.1% in November, citing weak demand for commercial and military aircraft

- The National Association of Realtors reports the index of U.S. pending home sales rose by 2% in December, following a revised 3.1% gain in November, citing low mortgage rates and reduced house prices

FRIDAY, JANUARY 28TH

- The Thomson Reuters/University of Michigan final index of consumer sentiment declined slightly to a reading of 74.2 in January from 74.5 in December

- For its initial estimate, the Commerce Department reports U.S. gross domestic product (GDP) grew by 3.2% on an annual basis in the 4th. quarter of 2010, slightly higher than the 2.6% growth pace recorded in the 3rd. quarter. For all of 2010, U.S. GDP increased by 2.9%, marking the biggest annual increase since 2005.

- According to GfK NOP Social Research, the UK consumer confidence index fell "an astonishing" 8 points to a reading of minus 29 in January, citing the 3% increase in the value added tax (VAT) to 20%. Nick Moon, GfK NOP managing director, commented: "In the 35 years since the index began, (consumer) confidence has only slumped this much on six occasions, the last being in the midst of the 1992 recession."

- In its Semi-annual Review, the Congressional Budget Office (CBO) reports: "Excluding interest, surpluses for Social Security become deficits of $45 billion (U.S.) in 2011 and $547 billion (U.S.) over the 2012 – 2021 period." The interest the CBO mentions is owed by the U.S. government to the Social Security trust fund, which is legally obligated to purchase U.S. Treasurys in exchange for revenues raised by Social Security payroll deductions. If benefit payments exceed tax receipts, the CBO uses the interest payments on the bonds to restore the difference between the two.

- North Chicago-based Abbott Laboratories announces 1,900 job layoffs mostly from its U.S. operations, with 1,000 of them in Illinois, citing the "challenging" economic environment. Abbott Chairman and CEO Miles White blamed the layoffs on the pressure of federal regulators; as well as the impact of the healthcare overhaul law.

CLOSING LEVELS FOR FRIDAY, JANUARY 28TH.
WEEKLY CHANGE

Dow Jones Industrial Average	11, 823.70	– 48.10 points
Spot Gold Bullion (February)	$1,340.70 (U.S.)	– $0.30 per oz
S&P /TSX Composite	13,437.60	+ 179 points
10-Year U.S. Treasury Yield	3.33%	– 8 basis points
Canadian Dollar	99.90 cents (U.S.)	– 0.78 cent