

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS



Monday, February 21st

The National Statistics Agency reports Mexico's gross domestic product (GDP) grew by 5.5% in 2010, the most since 2000

MONDAY, FEBRUARY 21st

- The Munich-based Ifo Institute reports its German business climate index increased to a reading of 111.2 in February from 110.3 in January, citing higher exports, increased business investment and a lower unemployment rate
- BP PLC announces it will take a 30% stake in 23 oil and gas production contracts in India, operated by Reliance Industries Ltd. for \$7.2 billion (U.S.). BP Chief Executive Bob Dudley commented: "India is one of the fastest growing economies in the world. By aligning ourselves with Reliance, we will access the most prolific gas basin in India and secure a place in the fast growing Indian gas markets, creating a genuinely distinctive BP position."
- Moody's Investors Service lowers the outlook for Japan's sovereign debt rating to negative from stable, citing: "The rating action was prompted by heightened concern that economic and fiscal policies may not prove strong enough to achieve the government's debt reduction target and contain the inexorable rise in debt, which already is well above levels in other advanced economies. Japan's very large economy and very deep financial markets provide the wherewithal to absorb economic shocks. Nevertheless, the inexorable rise in government debt suggests that actions are urgently needed to retain a path of fiscal consolidation."
- The State of Michigan approves a plan for Detroit to close about half of its public schools and increase the size of average classrooms to 60 students over the next four years, in order to eliminate a \$327 million (U.S.) deficit. The plan was submitted in January by Robert Bobb, Detroit Public Schools' emergency financial manager. Mr. Bobb said the deep cuts were necessary if the district hoped to be solvent again without additional state aid. However, he warned that the strategy was ultimately ill-advised because it will likely drive even more students away, depriving the district of needed state funds, which Michigan apportions on the basis of enrollment. See also, Winter Warning, February 16, 2011 – It's Still the Debt, Stupid – The Motown War Zone

TUESDAY, FEBRUARY 22ND

- The S&P / Case Shiller index of home values in 20 U.S. cities declined by 2.4% in the 12 months ended December 31, 2010. Michelle Myer, a senior economist at Bank of America Merrill Lynch Global Research in New York commented: "Home prices are still declining amid excess supply. Although transactions have started to pick up (recently) buyers are looking for very low prices. There is a backlog of distressed properties and it will flow into the market this year. We (still) expect to see a gradual drop in prices."

- Statistics Canada reports the nation's retail sales declined by 0.2% in December, due in part to lower automobile sales, following an upwardly revised gain of 0.6% in November
- The Conference Board reports U.S. consumer confidence rose to a reading of 70.4 in February from a level of 64.8 in January
- In a 55-page report, the Government Accountability Office (GAO) warns: "The U.S. Treasury (Department's) past success at managing cash and debt when near or at the debt limit, is no guaranty that it can continue to manage successfully in the future and may be misleading. Failure to raise the (national) debt limit in a timely manner, could have serious negative consequences for the Treasury (securities) market and increase borrowing costs. Although the U.S. Treasury (Department) has a variety of measures it can take to avoid bumping up against the current (national) debt limit, these measures have not kept pace with the growth in borrowing needs. Assuming current borrowing trends, our estimates show that the borrowing capacity provided by the extraordinary actions, would be sufficient to meet the government's borrowing needs for as little as a few days to a few weeks, during certain times of the year." The GAO recommends that Congress work to better align spending and revenue decisions that drive debt, as well as changes in the (national) debt limit. Since 1995, Congress has increased the (U.S. national) debt limit twelve times to its current level of \$12.294 trillion.
- According to the Wall Street Journal, Russia's potential membership in the World Trade Organization (WTO) will be a central item on the agenda when Prime Minister Vladimir Putin meets with European Union (EU) leaders in Brussels on Thursday, but the country is still facing a considerable amount of uncertainty in its bid to secure entry. Vladimir Chizhov, Russia's ambassador to the EU, alerted the press that Mr. Putin will inform the EU "that Russia hopes to finalize WTO accession in the next few months and certainly, by the end of 2011." However, business leaders and trade officials from the U.S., the EU and the WTO, suggest that Russia's admission is far from assured. Anka Schild, an analyst with Business Europe, the Brussels-based alliance of industry lobbies, observes: "The business community is still skeptical. Russia would be a more attractive market if it were more open." At Longwave Analytics, we profess our cynicism when it comes to the subject of Russia's potential membership in the WTO. How can global trading powers / partners trust a mafia-style Kremlin, with its ponderous chain of murder, torture and theft forged over the past decade? See Sergei Magnitsky, One Year On <http://www.economist.com/node/21013016>
- From the Institutional Risk Analyst newsletter, an article entitled Is it Global Weimar? "The global nations, like their counterparts in the U.S., are making it up as they go along, but none are yet conceding the reality that debt restructuring and reduction must occur in order for the real economy to recover. After both World Wars, the European nations largely defaulted on foreign debt to the U.S. and other creditor nations, while mostly repaying internal creditors. This reduction in foreign debt service, allowed the allied nations to import more goods and recover much faster than had foreign holders of war time debts been repaid at par / (face value). In contrast to the direct approach taken to debt restructuring in the 1920s and the 1950s, today the response by the Federal Reserve and other industrial nations can best be described as a weak effort at 'Global Weimar,' whereby the U.S. central bank expands the core supply and provides credit to other central banks, in the hope that reflation will occur. All this in an effort to support the fiction of asset valuations on a global basis and delay the day of reckoning with respect to debt default. However, can any reasonable observer look at Ireland or Spain, or even the United States of America and expect these nations to repay their accumulated (government) debt obligations at par / (face value) at maturity?"
- In a Washington Post op-ed entitled Who Rules America? AARP – columnist Robert Samuelson writes: "The great question haunting Washington's budget debate is whether our elected politicians will take back government from the American Association of Retired Persons (AARP), the 40 million-member organization that represents retirees and near-retirees. For all the partisan bluster surrounding last week's release of President Obama's proposed budget, it reflects a long-standing bipartisan consensus not to threaten seniors. Programs for the elderly, mainly Social Security and Medicare, are left untouched. With an aging population, putting so much spending off-limits inevitably means raising taxes, shrinking defense and squeezing other domestic spending – everything from the FBI to college aid. Power is the ability to get what you want. It suggests that you control events. By these standards, AARP runs government budgetary policy, not presidents or congressional leaders. Obama says we must 'win the future,' but his budget (and, so far, the Republicans' too) would win the past and lose the future. The massive federal debt would continue to grow because, without restraining retiree spending, there's no path to a balanced budget. The aging infrastructure (roads, airports) wouldn't get needed repairs. The already-stressed social safety net for the poor would be further strained. We would cut the Department of Defense budget while

China's military expands. All this is insane. It's not the agenda of a country interested in its future. But it's our agenda. Look at Obama's budget. Under his proposals, annual federal spending rises from \$3.7 trillion in 2012, to \$5.7 trillion in 2021. Social Security, Medicare and Medicaid (the three major entitlements) account for 60% of the projected \$2 trillion increase. Higher interest payments on the debt – mainly reflecting our inability to control big entitlements – account for 31%. Altogether, that's 91% of the increase; the rest of government accounts for 9%. But AARP sets overall priorities. Its power derives from the fear it inspires in senators, representatives, presidents and political candidates. They worry that they'll be assaulted and rejected by hordes of angry seniors infuriated by any possible loss of benefits and mobilized by AARP ... By 2021, continuous annual deficits would boost the publically held federal debt to almost \$19 trillion, up from \$9 trillion in 2010. So the possibility of a financial crisis, triggered by unmanageable debt levels, would survive even if Obama's budget were adopted. Obama repeatedly says he will deal with "entitlements" – and does nothing.

WEDNESDAY, FEBRUARY 23RD

- The Mortgage Bankers Association reports its index of U.S. mortgage loan applications increased 13% in the week ended February 18th. citing the average interest rate on 30-year fixed mortgages fell to 5%
- Japan reports a trade deficit of 471.4 billion yen (\$5.7 billion U.S.) in January, as exports to Asia declined and higher commodity prices increased the cost of imports
- In its annual Fiscal Risk Index report, risk analyst Maplecroft warns: "The United Kingdom is at extreme risk of another economic crisis" due to the pension and health care-related pledges made to its aging population. "Higher taxes, more spending cuts and longer working lives will be needed to prevent the country from going bankrupt."
- The National Association of Realtors reports U.S. existing home sales increased by 2.7% in January to a 5.36 million annual level, citing a rising demand for distressed properties as investors took advantage of lower prices

THURSDAY, FEBRUARY 24TH

- Crude oil futures extend their rally with the April contract reaching \$100 (U.S.) a barrel, as social unrest in Libya causes supply disruptions in its oil production of 1.8 million barrels per day.

In a macro sense, Libya is a relatively small oil producer, being ranked as the world's 18th. largest producer in the world and ninth in terms of reserves.

Saudi Arabia is the world's second largest oil producer after Russia with output of 9.8 million barrels a day and reserves of 265 billion barrels. The Kingdom has pledged to supplant any production shortfall in the world's daily oil output from Libyan disruptions.

Iran's oil production is 4.2 million barrels per day and possesses reserves of 138 billion barrels. The Islamic Republic poses an extreme risk in the Middle East, not only due to internal dissension, but also, because the hard-line Islamist government is a definite threat to Israel. Political risk analyst Ian Bremmer observes: "The fact that Iranians are going to become more assertive and provocative is something that can scare oil markets."

Russia, as the world's largest oil producer at 10.1 million barrels per day and reserves of 74.2 billion barrels, is rather a low risk when it comes to potential interruptions in supply. As ever, the Kremlin maintains an iron grip on its natural resources of crude oil and natural gas because it needs the revenues to offset imports. Demonstrating an unusual burst of neighbourliness, the Kremlin has offered to increase natural gas exports to the European Union, to cover any lost production from Libya and elsewhere.

Algeria, however, poses an extreme oil production risk because it compares closely to Egypt and Tunisia in several ways. With oil production of 2.1 million barrels per day and reserves of 13.4 billion barrels, Algeria has an unpopular government backed by the military. President Abdelaziz Bouteflika assumed office in a 1999 election widely recognized as fraudulent. The country suffers from high unemployment, housing shortages, poor basic infrastructure and chronic corruption.

Egypt is likely to remain unstable until a September election determines who will form a government, following the recent ouster of President Hosni Mubarak. For the next six months, the Egyptian army will likely remain firmly in control. Egypt consumes domestically most of the oil it produces, so it is not an exporter on the world's markets. However, Egypt does control the Suez Canal, a key oil trade route and it possesses a very large Arab population. Any threat of a Hard-line Islamist government coming into power would surely upset the oil market.

- The Commerce Department reports U.S. durable goods orders rose by 2.7% in January, following a decline of 0.4% in December, citing renewed demand for aircraft and transportation equipment

- According to Bloomberg News, a U.S. government shut-down looms after lawmakers deadlocked yesterday over a Republican proposal to cut \$4 billion (U.S.) from a bill funding government agencies through mid-March. Senate Democrats are demanding a 30-day extension that would keep government agency budgets at their current levels. Lawmakers, who return to Washington next week from their President's day recess, will have just days to strike an agreement because the continuing resolution on spending expires on March 4th. Without an agreement, the Federal government will close down.
- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 22,000 to 391,000 in the week ended February 19th. while continuing claims fell by 145,000 in the week ended February 12th. to 3.79 million. The number of people who have exhausted their benefits and are now collecting emergency and extended payments under federal programs, declined by 55,330 to 4.45 million in the week ended February 5th.
- The Commerce Department reports U.S. new home sales declined by 12.6% in January to a seasonally adjusted annual level of 284,000. For December, sales were downwardly revised to an increase of 15.7% to a level of 325,000; previously reported as an increase of 17.5% to a level of 329,000.
- The U.S. Air Force awards a \$30 billion (U.S.) contract to Boeing Co. – to replace 179 of its aging aerial refueling tankers – over European Aeronautic Defense and Space Co.
- The Commerce Department reports U.S. gross domestic product (GDP) grew by 2.8% in the 4th. quarter of 2010, downwardly revised from its prior 3.2% estimate reported in January, citing deeper spending cuts by state and local governments
- By a vote of 51 to 17, the Wisconsin Assembly in Madison passes Governor Scott Walker's bill limiting the collective bargaining power of government workers' unions, whose members had occupied the State Assembly in protestation of the bill. Over the decades, State workers' unions have reaped healthy wage, benefits and pension gains, representing a significant percentage of the State's budget deficit and debt obligations, through the collective bargaining process. Wisconsin Senate Democrats, who must still vote on the measure, remained out of state in their attempt to block the bill by not enabling a quorum. Governor Walker commented: "I'm still holding out hope that, if not all 14, then some of those senators will see the wisdom of coming home."
- GfK Social Research reports its U.K. consumer confidence index rose slightly to a reading of minus 28 in February from a level of minus 29 in January. GfK's Managing Director Nick Moon commented: "Overall (consumer) confidence remains low. While the U.K. government will be relieved that consumer confidence has leveled out, such a small increase indicates that last month's astonishing figures were not an aberration."
- Vancouver-based Goldcorp Inc. reports a \$331.8 million (CAD) net profit for the 4th. quarter of 2010, compared with a \$66.7 million (CAD) net profit in the same period of 2009, citing higher gold and silver prices, as well as increased bullion production. The world's second largest gold miner by market capitalization increased its annual dividend by 11% to 40 cents (U.S.) per share. Goldcorp's board of directors also approved the full-scale development of the Eleonore project in Quebec and the Cochenour project in Ontario. These two projects are due to come into production toward the end of 2014.
- Both Fitch ratings and Standard & Poors (S&P) downgrade Libya's sovereign debt rating to 'BBB' (High) from 'A' (Low). S&P warns: "A more protracted political crisis, which we consider to greatly impair Libya's medium-term growth prospects, could lead us to lower the long-term and short-term ratings further. In such event and depending upon the severity of the crisis, the ratings might be lowered by one or more notches."

FRIDAY, FEBRUARY 25TH

- The Global Risks Atlas 2011 lists India, Russia and Indonesia as "high risk" growth economies. See also, Wednesday, February 22nd. commentary – Russia's Potential Membership in the World Trade Organization (WTO). Europe trumps all other regions with eleven out of twelve countries rated as "extreme risk" including: Italy, Belgium, France, Sweden, Germany, Hungary, Denmark, Austria, United Kingdom, Finland and Greece. While high national debt and public spending are two common denominators, the study finds it is the aging demographic that places these countries at extreme fiscal risk, due to increasing public expenditure for pensions and health care.
- The Thomson Reuters / University of Michigan overall index of U.S. consumer sentiment rose to a reading of 77.5 in February from a level of 74.2 in January

- According to the Washington Post, the former treasurer of one of America's largest mortgage firms – Taylor, Bean & Whitaker – pleads guilty in U.S. District Court in Alexandria, Va. to charges of participating in a \$1.9 billion (U.S.) fraud scheme. Desiree Brown, 45, of Hernando, Fla., was accused of participating in a scheme that contributed to the collapse of Colonial Bank in Alabama – one of the nation's largest regional banks.

CLOSING LEVELS FOR FRIDAY, FEBRUARY 25TH.
WEEKLY CHANGE

Dow Jones Industrial Average	12,130.45	– 260.85 points
Spot Gold Bullion (March)	\$1,410.38 (U.S.)	+ \$21.78 per oz.
S&P/TSX Composite	14,052.13	– 70.97 points
10-year U.S. Treasury Yield	3.41%	– 18 basis points
Canadian Dollar	102.18 cents (U.S.)	+ 0.80 cent

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