

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



Monday, March 14th, 2011

On Friday, an earthquake with an epicenter 231 miles offshore northeastern Japan and measuring 8.9 on the Richter scale, unleashed a mega-tsunami causing enormous loss of life and property devastation in the Tohoku region; including Sendai, Minamisanriku

MONDAY, MARCH 14TH

and Kamaishi City; as well as the village of Higashimatsushima. Seventy countries have responded with offers of aid assistance: search and rescue teams and equipment; doctors and medical supplies; emergency shelters; and water and food provisions. The rebuilding effort from this widespread natural disaster will take years and the cost could reach an estimated \$180 billion (U.S.). In January, Japan's Ministry of Finance projected the government's outstanding debt would increase by 5.8% to a record 997.7 trillion yen (\$11.8 trillion U.S.) – representing 210% of gross domestic product (GDP) – in the 2012 fiscal year commencing April 1st.

- The Bank of Japan injects 15 trillion yen (\$183 billion U.S.) of liquidity into the financial system and doubles the size of its asset purchase plan to 10 trillion yen, in an effort to ensure financial stability amid a selloff in stocks and a surge in credit risk. Policy makers warned they were concerned corporate and consumer sentiment would worsen, in the aftermath of Friday's catastrophic tsunami and ensuing disruption in factory output.
- Over the weekend, European Union (EU) officials broadened the size and scope of their 440 billion euro (\$614 billion U.S.) bailout fund, eased the terms of Greece's rescue loans and placed the onus for containing any further turmoil in the credit markets, squarely on the shoulders of individual EU member states
- Moody's Investors Service warns that insurance and reinsurance companies around the world face heavy losses resulting from Friday's massive earthquake and tsunami in Japan which could negatively impact credit ratings within the two sectors. Moody's noted: "Among Japanese domestic insurers, the non-life sector is highly concentrated with three groups – MS&AD Insurance Group, Tokyo Marine Group and NKSJ Group – accounting for almost 90% of the market. A meaningful portion of losses will flow to the global reinsurance industry (including various Lloyd's syndicates), as catastrophe reinsurance covering Japanese earthquakes is a large market."
- In a BBC radio interview, U.K. Foreign Secretary William Hague warned: "If Gaddafi continues to dominate much of the country, well this would be a long nightmare for the Libyan people and Libya would be a pariah state for some time to come." Secretary Hague's comments followed reports that forces loyal to Colonel Gaddafi attacked two coastal cities held by rebels and intense fighting continued for control of Brega – the site of a large oil terminal located near the rebel capital of Benghazi.
- According to the Bank for International Settlements' (BIS) most recent quarterly report, the total exposure of foreign banks to all debt obligations of the countries of Greece, Ireland, Portugal and Spain exceeds \$2.5 trillion (U.S.). The BIS reports: "While the risk of policy mistakes by central banks is rising in many mature economies, any premature tightening (of monetary policy) could jeopardize the economic recovery and risk sparking expectations of deflation."

- New York City Mayor Michael Bloomberg announces a \$3.3 billion (U.S.) 'Vision 2020' plan for 130 municipal projects to be completed within three years including: new parks, housing, ferry service and environmental improvements for New York's 578 miles of shoreline to enable real estate development and improve recreation. In a statement, Mayor Bloomberg elaborated: "New York City has more miles of waterfront than Seattle, San Francisco, Chicago and Portland combined; but for decades, too many neighbourhoods have been blocked off from it." Over the last decade, New York City has purchased about 400 acres of waterfront land for parks and it has rezoned more than 700 acres of industrial land for housing and waterfront access in Brooklyn, Queens, Staten Island and the Bronx. The City is also spending \$1.6 billion (U.S.) to upgrade water treatment plants and additional millions to protect wetlands and enhance drainage. A new East River ferry service will commence in the spring between Brooklyn, Queens and Manhattan.
- Fitch Ratings affirms Britain's 'AAA' sovereign debt credit rating with a stable outlook, praising: "The strong budgetary consolidation effort undertaken by the coalition government. The affirmation reflects that the U.K.'s 'AAA' ratings remain underpinned by its high value-added, wealthy and flexible economy; strong financial flexibility underpinned by a deep government bond market and the British pound's continuing status as a 'reserve currency' as well as political and social stability. The main risks to the U.K. remain the threat of a double-dip recession and the potential for new (loan) write downs in the banking sector that could force the government to increase its support for Britain's major banks."
- In a note to clients, Seth Klarman of Boston-based Blau-post Group LLC warns: "While restoring U.S. government fiscal sanity will be bad for the economy and financial markets, the alternative is worse. Governments that run huge deficits, promise entitlements that will be next-to-impossible to deliver and depend upon the beneficence of foreigners to stay afloat, inevitably must collapse – perhaps not imminently, but eventually, as Greece and Ireland have recently discovered." See also Winter Warning, February 15, 2011 – It's Still the Debt, Stupid
- According to Treasury International Capital System (TICS) data, released by the U.S. Treasury Department, foreign demand for U.S. stocks, bonds, notes and other financial assets totaled \$51.5 billion (U.S.) in January, compared with net purchases of \$62.5 billion (U.S.) in December. Chris Rupkey, chief economist at Bank of Tokyo-Mitsubishi in New York commented: "The U.S. remains the safest of safe haven countries for global market investors to park funds in times of rising geopolitical risks. Investment monies are not gushing into the U.S. like they did in prior months, but there is still no sign in the data that investors are worried the U.S. will not be able to rein in deficit spending." Wakeup call for investors: At Long Wave Analytics, we believe that foreign and domestic investors alike should be very worried that Washington's political gridlock will prevent America from solving its federal deficit and debt problems. We believe the time is rapidly approaching when investors begin to balk en masse at purchasing U.S. Treasuries (witness the recent total liquidation of U.S. Treasury holdings by Pimco's Total Return Fund) which in turn will cause the U.S. dollar to drop dramatically and U.S. Treasury yields and the Federal Funds rate to soar.

TUESDAY, MARCH 15TH

- Japan's stock market crashes on panic selling after Prime Minister Naoto Kan announced a "substantial amount" of radiation was leaking from Tokyo Electric Power's Fukushima Dai-Ichi nuclear power plant number 2 reactor, damaged by Friday's massive earthquake and devastating tsunami. By afternoon trading, the Nikkei Stock Average had declined by more than 14% on a fresh wave of indiscriminate selling across all sectors, before recovering to close down 10.6% on the day.
- Moody's Investors Service downgrades Portugal's long-term sovereign debt credit rating to A3 from A1 with a negative outlook, citing "a possible need for the country to recapitalize its banks. The government faces significant challenges; not the least a less supportive economic environment. The country's gross domestic product (GDP) is expected to decline this year and experience a weak economic recovery in 2012."
- The ZEW Center for Economic Research in Mannheim reports its index of German investor confidence declined to a reading of 14.1 in March from a level of 15.7 in February, citing the warning from the European Central Bank (ECB) that it may raise administered interest rates soon and the shock of Japan's biggest earthquake on record causing a crash in global stock markets
- In a statement following a regularly scheduled meeting in Washington, the Federal Open Market Committee (FOMC) reported: "The U.S. economic recovery is on a firmer footing and overall conditions in the labor market appear to be improving gradually. The inflationary effect of increased commodity costs will be transitory and FOMC officials will pay close attention to the evolution of inflation and inflation expectations." The FOMC also affirmed its 'quantitative easing' plans to complete the purchase of \$600 billion (U.S.) of Treasury notes and bonds through June.

- The Labor Department reports U.S. import prices rose by 1.4% in February, citing increases in the price of food and crude oil
- By a vote of 271 to 158, the U.S. House of Representatives passes a 'continuing resolution' bill to fund the federal government until April 8th. over the opposition of 54 Republicans, many of whom expressed frustration with Congress' budget battles. The legislation now goes to the Senate, where leaders of the Democratic majority vowed it will soon be forwarded to President Barack Obama for signage.
Wakeup call for 54 House Republicans: Welcome to Washington political gridlock!

WEDNESDAY, MARCH 16TH

- The Labor Department reports the U.S. producer price index rose by a seasonally adjusted 1.6% in February, citing higher food and energy costs
- The Commerce Department reports U.S. housing starts declined by 22.5% to an annual pace of 479,000 units; while building permits fell by 8.2% to a 517,000 annual level. The pace of housing starts is the lowest level since 1984 and the second-lowest reading on records that date from 1959.
- The Commerce Department reports the U.S. current account deficit declined by 9.7% to \$113.3 billion (U.S.) in the 4th. quarter of 2010, citing increased sales of chemicals, industrial supplies and farm products
- Tokyo Electric Power reports a nuclear reactor containment vessel may have been breached at the damaged Fukushima Dai-ichi power plant, deepening Japan's nuclear crisis and increasing the risk of radioactive leaks
- The Office for National Statistics reports the U.K. unemployment rate rose slightly to 8% in the three months ending in January, as the ranks of the unemployed swelled by 27,000 to 2.53 million people. Employment Minister Chris Grayling commented: "There is good news and bad news in these figures. There's been a welcome drop in the number of people on (unemployment) benefits and the increase in full-time private sector jobs is a step in the right direction. However, the rise in overall unemployment is a real concern and underlines the need to press ahead with policies which will further stimulate (economic) growth in the private sector."

- Statistics Canada reports the country's factory sales increased by 4.5% in January, citing higher sales of automobiles and aerospace products

THURSDAY, MARCH 17TH

- The Federal Reserve reports U.S. industrial production declined by 0.1 in February, following a revised gain of 0.3% in January, citing reduced domestic usage of utilities but increased foreign demand for automobiles
- The Bloomberg Consumer Comfort Index declined to a reading of minus 48.5 in the week ending March 13th. from a level of minus 44.5 the prior week, reflecting consumer concern over high prices for food and fuel
- The Labor Department reports the U.S. Consumer Price Index rose by 0.5% in February, citing higher prices for raw materials, food and fuel
- The Conference Board's Index of U.S. leading economic indicators rose by 0.8% in February, following a 0.1% rise in January, citing improved employment prospects; as well as strengthening business investment and exports
- The Federal Reserve Bank of Philadelphia reports its index of general activity for regional manufacturers rose to a reading of 43.4 in March – its highest reading since January, 1984 – from a level of 35.9 in February
- Continuing its aggressive campaign against rising inflation, the Reserve Bank of India increases its repo rate – the rate at which the central bank lends to commercial banks – by 25 basis points to 6.75%; as well as raising its reverse repo rate – the rate at which it absorbs money from the system – by 25 basis points to 5.75%
- The electorate of Miami-Dade County, Florida, votes overwhelmingly to recall Mayor Carlos Alvarez from office in a special vote prompted by homeowner anger over an increase in property taxes. County Commissioner Natacha Seijas was also voted out of office and George Burgess, Miami-Dade County Manager resigned in sympathy. Herewith, a perfect and likely typical example of the impossible task an American municipal government has in balancing a local budget when half the homes in the county are valued at less than their existing mortgages. As we have oft stated, look for more situations like this to unfold across America and eventually result in local bankruptcies. There is no tolerance for higher taxes at any level across America.

- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 16,000 to 385,000 in the week ended March 12th. while continuing claims fell by 80,000 to 3.71 million in the week ended March 5th. Those people who have exhausted their traditional benefits and are now collecting emergency or extended benefits under federal programs increased by 54,000 to 4.36 million in the week ended February 26th.

FRIDAY, MARCH 18TH

- Great Britain and France prepare for possible air strikes against Libyan forces loyal to Colonel Qaddafi, following the United Nations Security Council vote to impose a no-fly zone resolution against the Libyan leader. U.K. Prime Minister David Cameron informed Parliament in London that “in the coming hours” Britain would deploy Tornado and Typhoon jets, air-to-air refueling planes and surveillance aircraft to enforce the UN resolution. Mr. Cameron warned: “There will be a clear statement later today setting out what we now expect from Colonel Qaddafi,” adding he will attend a weekend meeting in Paris with the Arab League, hosted by France’s President Nicolas Sarkozy.
- In response to the UN action, Libya’s foreign minister Moussa Koussa informed the media in Tripoli: “My country will try to deal with this resolution. According to Article 25 of the UN Charter and considering that Libya is a member of the UN, then it is bound to accept the Security Council resolution and has decided (to order) an immediate ceasefire and the cessation of all military operations.” According to a statement from Europe’s air traffic control agency, as reported by the Associated Press (AP): “The latest information from Malta indicates that Tripoli (air control center) does not accept traffic.” AP reported the agency’s map showed that Libyan air space was off limits.
- Statistics Canada reports the country’s consumer price index rose by 0.3% in February, but the annual inflation rate fell by 0.1% to 2.2%, while the annual core rate (excluding food and energy) declined by 0.2% to 0.9%
- Speaking to the Brampton and Mississauga Boards of Trade, Canadian Prime Minister Stephen Harper declared next Tuesday’s federal budget will not increase government spending; rather it will cut the federal deficit by another 25% without imposing “job-killing” tax increases: “The (federal) spending control is real. Program spending this coming year is essentially flat. Now let me assure you, this will be neither on the backs of pensioners, nor need the provinces fear a shrinkage of federal transfer (payments) for health care or education.”

- The Federal Deposit Insurance Corp. (FDIC) launches a civil lawsuit against Kerry Killinger, a former chief executive officer of Washington Mutual and two other former executives, seeking \$900 million (U.S.) accusing them of a reckless “lending spree” in the knowledge that the housing market was in a bubble and failed to put in place the proper risk management systems and internal controls. David Schneider, the bank’s former president of home lending and Stephen Rotella, the bank’s former chief operating officer were also accused of negligence in their roles and responsibilities. In a 63-page complaint filed in federal court in Seattle, the FDIC alleges: “They focused on short-term gains to increase their own compensation, with reckless disregard for Washington Mutual’s long-term safety and soundness. The FDIC brings this complaint to hold these highly paid senior executives, who were chiefly responsible for Washington Mutual’s home lending program, accountable for the resulting losses.”
- The U.S. Federal Reserve informs the U.S. banking community it may return more cash to shareholders through stock dividends and initiate share purchase programs. Accordingly, JP Morgan Chase, Wells Fargo and Bank of New York Mellon all announce dividend increases.
- The Group of Seven industrialized nations implement a co-ordinated currency intervention by selling the Japanese yen, in order to assist Japan with export price competitiveness, in the wake of its devastating earthquake, tsunami and nuclear crises
- Nationwide reports its U.K. consumer confidence index declined to a reading of 38 in February – its lowest level since records began in May, 2004 – from a level of 48 in January.

Chart 1 - Nationwide Consumer Confidence Index



- Canadian energy giant EnCana Corp. agrees to purchase a 30% interest in Kitimat LNG, joining U.S. companies Apache Corp. and EOG Resources, intent upon building a \$3.5 billion (CAD) West Coast liquefied natural gas (LNG) export terminal. Renee Zemljak, EnCana's executive vice-president, commented: "EnCana is excited to join a leading-edge export project that has the potential to advance the North American natural gas industry and supply the growing demand for LNG, by serving a diverse market in the Pacific Rim."

CLOSING LEVELS FOR FRIDAY, MARCH 18TH.		WEEKLY CHANGE
Dow Jones Industrial Average	11,858.50	- 185.90 points
Spot Gold Bullion (April)	\$1,419.60 (U.S.)	- \$2.20 per oz.
S&P / TSX Composite	13,789.60	+ 115.35 points
10-Year U.S. Treasury Yield	3.27%	- 14 basis points
Canadian Dollar	101.60 cents (U.S.)	- 1.17 cent
U.S. Dollar Index Future (Spot Price)	75.56 cents	- 1.174 cent
WTI Crude Oil (April)	\$101.40 (U.S.)	+ \$0.24 per barrel

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