

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



Monday, September 19th

Headline Globe and Mail, Business Section—"A fragile Europe approaches 'tipping point' Finance ministers, central bankers find no agreement in bringing Greece's finances to heel."

MONDAY, SEPTEMBER 19TH

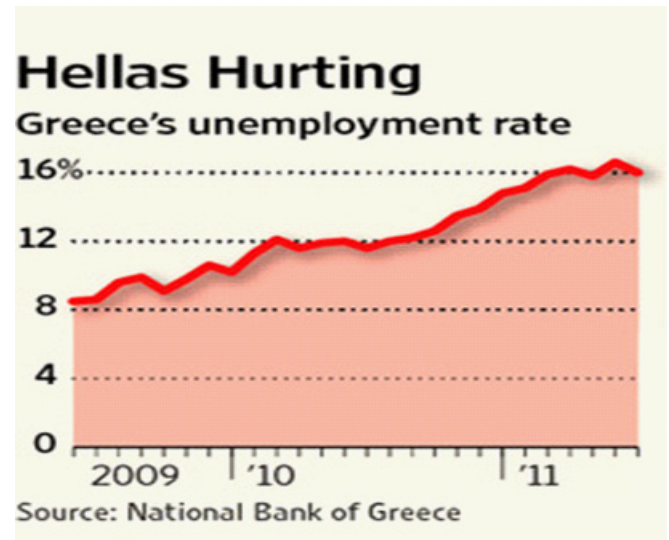
- Following last week's decision by euro zone finance ministers to postpone a decision regarding the next round of financial aid for Greece, representatives of the auditing team from the European Union (EU), the International Monetary Fund (IMF) and the European Central Bank (ECB) will hold a conference call with Greek officials today to confirm Greece's compliance with last year's 110 billion euro (\$151.6 billion U.S.) bailout. In the meantime, in a statement issued after an emergency cabinet meeting, Greek Finance Minister Evangelos Venizelos trumpeted: "Greece must plan for additional austerity measures in order to prevent the nation from being made the scapegoat for European and international institutions looking to hide their own lack of competence and inability to give a definitive and complete answer to attacks against the euro. Greece has been blackmailed and humiliated as a result of the (financial) crisis, leaving the country no choice but to achieve its 2011 and 2012 fiscal targets, push the budget into primary surplus as soon as possible and implement structural changes to boost competitiveness and productivity." An incredibly arrogant attitude emanating from a federal finance minister whose government risks running out of cash as soon as October and thereafter, could be reduced to issuing IOU's.
- Front Page Headline, Wall Street Journal – "New Obama Deficit Plan. Nearly half of the \$3.6 trillion (U.S.) proposal is to come from taxes. Republicans oppose fresh levies. See Winter Warning, The Demise of the American Dream, September 28, 2011.
- According to Market Watch, Cheng Siwei, a former vice chairman of the standing committee of the National People's Congress, informed the World Economic Forum last week in Dalian: "Our version of the U.S. subprime crisis is the (bank) lending to local governments (currently estimated as high as \$1.7 trillion U.S.) which is causing defaults." Moreover, the spread of unofficial "shadow banking" outside the official banking system has recently prompted the China Banking Regulatory Commission to warn banks to prevent their staffs from facilitating peer-to-peer lending to individuals.
- Standard & Poors (S&P) downgrades Italy's sovereign debt credit rating to 'A' from 'A' (High) citing, "the country's weak economic growth rate and fragile government coalition will make it more difficult to forestall the growing debt crisis sweeping the euro zone. More subdued external demand, government austerity measures and upward pressure on funding costs will likely push economic growth below the base projections that S&P made last May, when it lowered Italy's ratings outlook."

TUESDAY, SEPTEMBER 20TH

- The ZEW Center for European Economic Research in Mannheim reports its index of investor and analyst 6-month business outlook declined to a reading of minus 43.3 in September from a level of minus 37.6 in August, the lowest level since December 2008

- The Commerce Department reports U.S. housing starts declined by 5% to an annual pace of 571,000 units in August, citing foreclosures, falling house prices and continuing high unemployment. Also hindering construction are tighter mortgage lending standards, despite record low mortgage rates.
- In its latest World Economic Outlook, the International Monetary Fund (IMF) warns: "Canada's current 7.3% unemployment rate is poised to average 7.6% this year and 7.7% in 2012, as the global economy enters a dangerous new phase ... and Canada's gross domestic product (GDP) will grow by 2.1% this year and by 1.9% in 2012 ... The lower economic growth forecast stems from fiscal withdrawal and the ripple effects of a U.S. growth slowdown to 1.5% this year and 1.8% in 2012. On a global basis, the IMF has cut its 2012 economic forecast to 4%, warning of: "severe repercussions to the world economy without swift policy actions by euro zone and U.S. governments." IMF Chief Economist, Olivier Blanchard stated: "Strong policies are urgently needed to improve the (economic) outlook and reduce the (downside) risks."
- The European Court of Human Rights in Strasbourg, France, rules: "Russia's government acted unfairly and violated the rights of the now defunct oil behemoth Yukos, but the Court is not ready to rule on the Yukos claim of \$98 billion (U.S.) in damages." Yukos – a major Russian taxpayer whose primary subsidiary once produced as much oil as all of Libya – was dismantled by Russian authorities after the arrest of its owner and founder Mikhail Khodorkovsky. Former President Vladimir Putin's Kremlin then orchestrated a preordained guilty verdict from the farcical Russian judiciary, sentencing Mr. Khodorkovsky to two successive 7-year prison terms. In an op-ed published yesterday in the Kommersant Vlast magazine, Mr. Khodorkovsky remarked: "Those who fabricated criminal cases against me and my colleagues in 2003, wanted to take for free the country's most profitable oil company with a market value of \$40 billion (U.S.)." Western governments best take heed and gird their loins for the reascension of Mr. Putin to the Russian Presidency in a preordained election victory in March 2012. Beware of the ideo of March!
- According to the Wall Street Journal, the United States is accusing China of imposing wrongful "countervailing and anti-dumping" duties on American chicken and poultry exports, citing the fees will cost U.S. poultry producers an estimated \$1 billion (U.S.) by year end. American Trade Representative Ron Kirk cited: "The U.S. is seeking consultations with China through the World Trade Organization (WTO)."

- According to the Financial Post, Greece has vowed to make further cuts in its bloated public sector before a second conference call with its international lenders, from whom Athens must attain more loans in order to avoid bankruptcy in October. The International Monetary Fund (IMF) has told Athens to cut the public sector workforce and payroll, close inefficient state entities and fight tax evasion. The Greek government has cut public sector pay and pensions, but has balked at sacking more civil servants, a key component of the governing Socialist party's electorate.



- Headline Globe and Mail Report on Business—"Europe braces for Greek default Italy downgrade shows regions' debt problems spreading as frustration mounts over Athens' lack of progress." By Brian Milner
- Headline National Post, Financial Section-GREEK FEARS SNUFF RALLY—"The phone starts ringing off the hook....our clients want us to sell everything." Stocks sag under load of political risk." By David Pett.
- In a new report by Moody's Investors Service prepared for the Canadian Imperial Bank of Commerce – which has a relatively high level of consumer credit exposure – the rating agency warns: "The rising trend in household loans is credit negative for the Canadian banking system. We are concerned that Canadian consumers are relying on low interest rates to support high debt loads. The credit worthiness of Canadian banks depends upon the continued financial health of the Canadian consumer. While robust growth in consumer credit has driven strong system-wide earnings year to date, this trend will be constrained as households reach borrowing limits at the same time the economy shows anything beyond tepid growth." According to the National Post, last week Statistics Canada reported that

the nation's household debt – as a share of personal disposable income – rose to a record 150.8% at the end of June. The increase, which leaves the ratio slightly higher than in the United States – where it was 148% in the first quarter of this year – is largely due to strong (real estate) price appreciation. Way to go, Canada, time to come down from your lofty self-congratulatory perch.

### WEDNESDAY, SEPTEMBER 21ST

- Following a two-day meeting in Washington, the Federal Open Market Committee (FOMC) announces it will extend the maturity base of the Federal Reserve's balance sheet by selling about \$400 billion (U.S.) of Treasury notes maturing within 3 years and purchasing a similar amount of Treasury bonds maturing within a range of 6 to 30 years, through June of 2012. In a prepared statement, the FOMC acknowledged: "Since there are significant downside risks to the economic outlook – including strains in global financial markets – this initiative should put downward pressure on longer-term interest rates and help make broader financial conditions more accommodative." At Longwave Analytics, we believe while this Fed action – akin to 'placing a finger in the hole of the dyke' – may serve to moderate Treasury yields in the longer maturity range and flatten the Treasury yield curve to a limited extent, however, it won't provide much in the way of stimulus for the U.S. economy, or alleviate the growing federal debt and deficit problems.
- In a vote of 230 to 195, the U.S. House of Representatives defeats a bill which includes \$3.65 billion (U.S.) in aid to victims of Hurricane Irene and other natural disasters, raising the spectre of a federal government shutdown since the disaster relief was attached to a measure needed to fund the government until November 18th. The federal government's fiscal year ends on September 30th. and Congress is in recess next week.
- Front Page Headline, Bloomberg News – "BofA, Wells Fargo Downgraded by Moody's. Moody's Investors Service downgrades the long-term senior debt credit rating of Bank of America to Baa1 from A2, with a negative outlook ... Moody's downgrades the long-term credit rating of Wells Fargo to A2 from A1, also with a negative outlook.
- Front Page Headline, Bloomberg News – "Greece Accelerates Spending Cuts to Avoid Debt Default. Greek Prime Minister George Papandreou's government announces accelerated budget cuts, targeting civil servants' wages and pension payments to keep emergency loans flowing."

- According to the average forecast of bankers, traders and investors attending the London Bullion Association conference in Montreal – the largest gathering of the gold industry – gold bullion will reach new record highs in excess of \$2,000 (U.S.) per ounce in 2012
- The National Association of Realtors reports U.S. existing home sales rose by 7.7% in August to a seasonally adjusted annual pace of 5.03 million homes, citing sales were driven by an increase in foreclosures, evidence the housing market remains weak
- Following the agency's downgrading of Italy's sovereign debt credit rating last week, Standard & Poors (S&P) downgrades the credit ratings of leading Italian banks Mediobanca and Intesa Sanpaolo to Aa2 from Aa1 with a negative outlook citing: "The negative outlooks on the long-term ratings on the banks reflect the possibility we could lower their ratings (again) – all other things being equal – should we lower our ratings further on the Republic of Italy."

### THURSDAY, SEPTEMBER 22ND

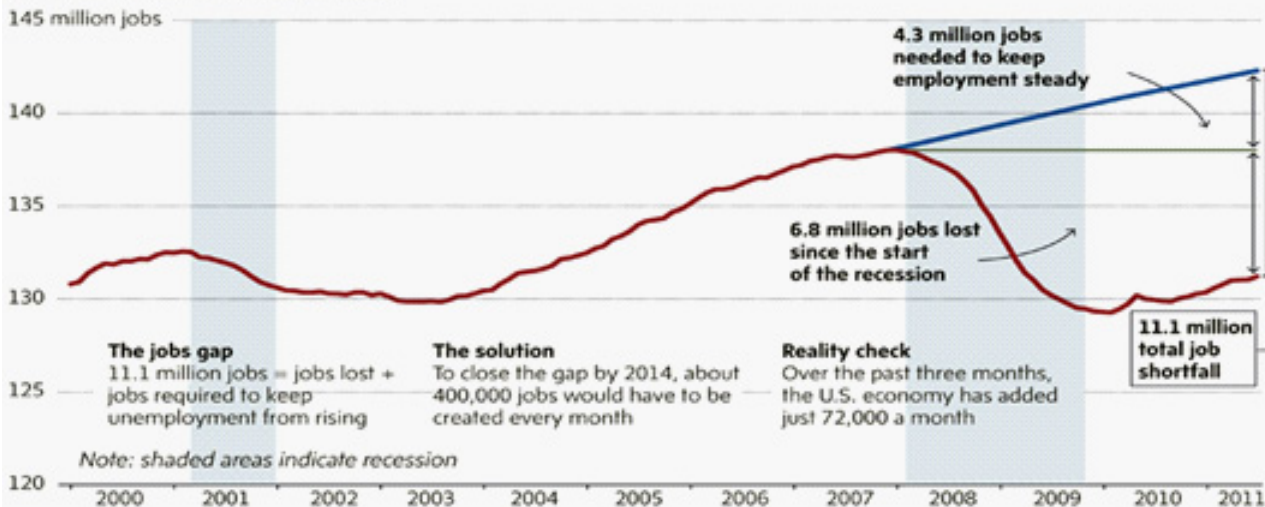
- Front Page Headline, Washington Post – "Justice Department Audit Finds 'Wasteful' and Extravagant Spending. Justice Department auditors criticize a \$76 (U.S.) per person luncheon at a conference in a San Francisco Hilton hotel."
- Front Page Headline, National Post – "Finance Minister Flaherty Defends \$90,000 (CAD) Per Day Consulting Contract. Canada's Finance Minister extols the value of hiring private sector advisors to assist Finance in finding \$4 billion (CAD) of spending cuts to balance the federal budget."
- Headline Financial Times "Fed 'twist' seeks to boost US economy- Push to drive down long-term interest rates. Sign that slowdown has alarmed Bernanke." By Robin Harding. "The US Federal Reserve launched 'Operation Twist' on Wednesday in a bold attempt to drive down long-term interest rates and reinvigorate the faltering economy."
- "The central bank said it would buy \$400 billion of long-dated Treasuries, financed by the sale of an equal amount of bonds with three years or less to run." Do you really think that this will make any difference, Mr. Bernanke? The American consumer is tapped out and reducing borrowing costs won't reignite borrowing, nor will it induce banks to lend. 'It's the Debt, Stupid!'



**U.S. UNEMPLOYMENT RATE SINCE 1990**



**EMPLOYMENT SHORTFALL**



**The jobs gap**

11.1 million jobs = jobs lost + jobs required to keep unemployment from rising

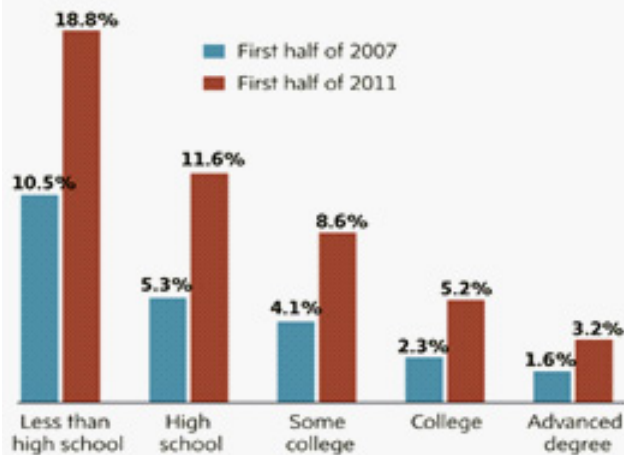
**The solution**

To close the gap by 2014, about 400,000 jobs would have to be created every month

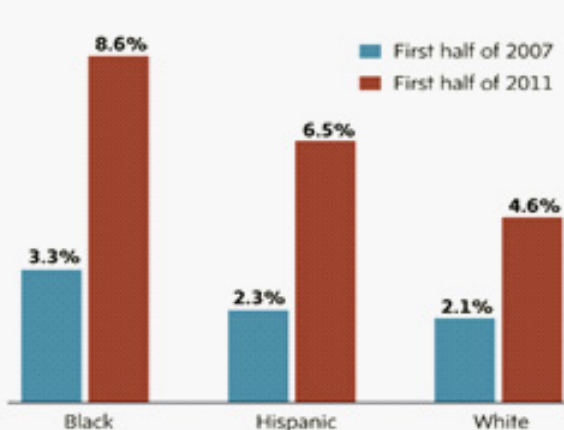
**Reality check**

Over the past three months, the U.S. economy has added just 72,000 a month

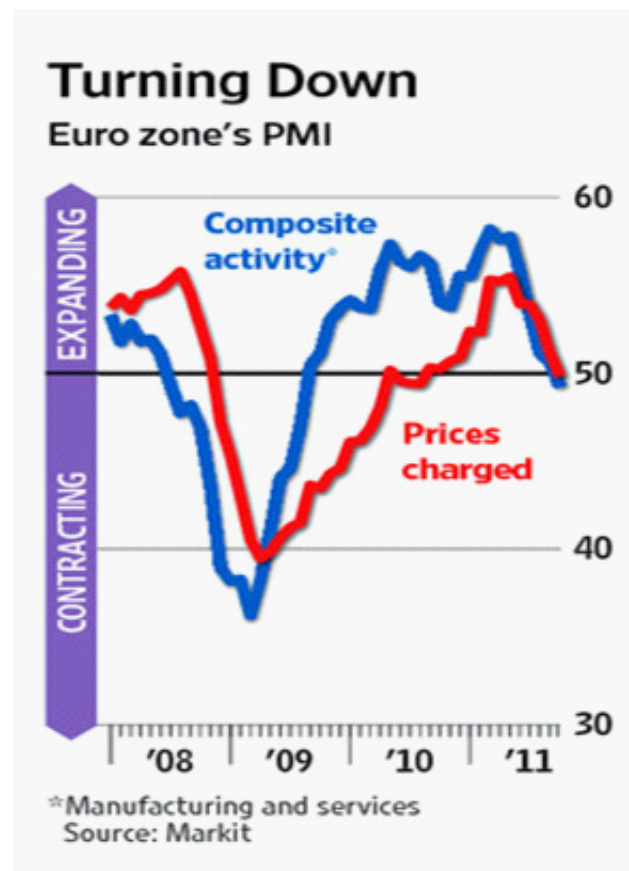
**UNEMPLOYMENT RATES BY EDUCATIONAL ATTAINMENT 2007 and 2011**



**UNEMPLOYMENT RATES FOR COLLEGE GRADUATES By race**



- The Labor Department reports U.S. claims for state unemployment benefits declined by 9,000 to 423,000 – from a revised 432,000 – in the week ended September 17th. while continuing claims fell by 28,000 to 3.73 million in the week ended September 10th. The number of people who have exhausted their traditional benefits and are now receiving emergency or extended benefits under federal programs declined by about 256,000 to 6.89 million in the week ended September 3rd.
- Headline The Globe and Mail, Report on Business “Rash of bank downgrades signals return to the ‘danger zone’: IMF.” by Barrie McKenna
- “Europe’s big financial institutions are under pressure to quickly secure tens of billions of euros of new capital, as the continent’s spreading debt crisis increasingly engulfs the banking system.”
- “Highlighting the growing financial risks in Europe, Standard & Poor’s downgraded seven large Italian banks over the continent’s sovereign debt woes-a day after it downgraded Italy’s government debt. The downgrades show financial market angst is spreading from troubled government finances to troubled banks.”
- In the U. S., meanwhile Moody’s Investors Service on Wednesday downgraded the debt ratings of the three largest U. S. banks - Bank of America, Citibank NA and Wells Fargo, citing a reduced likelihood that the United States government would ride to the rescue in the event of a failure.”
- The Hong Kong and Shanghai Bank (HSBC) preliminary China Manufacturing Purchasing Managers’ Index (PMI) declines to a reading of 49.4 in September from a level of 49.9 in August, indicating a broadening slowdown in the Chinese economy
- The New York-based research group Conference Board’s index of U.S. leading economic indicators rose by 0.3% in August, following a gain of 0.6% in July. Steven Wood, President of Insight Economics LLC in Danville, California commented: “The data suggests continued modest economic growth through the year-end.”
- London-based Markit Economics reports its composite index – based upon a survey of purchasing managers (PMI) in Euro-area services and manufacturing industries – declined to a reading of 49.2 in September from a level of 50.7 in August, indicating economic contraction (below 50) for the first time since July 2009



- Baudouin Prot, Chief Executive Officer of BNP Paribas SA – France’s largest bank – announces staff reduction plans “of a significant magnitude, essentially, at our corporate and investment banking platforms.”
- Front Page Headline, Globe and Mail – “Markets Plunge as Gloom Deepens. Weak economic data from China, grim Fed outlook has investors fleeing stocks, commodities.
- Statistics Canada reports the nation’s retail sales declined by 0.6% in July from an upwardly revised gain of 0.8% in June – previously reported as 0.7% – citing weaker automobile sales at new car dealerships

FRIDAY, SEPTEMBER 23RD

- Front Page Headline, Wall Street Journal – “Market Rout Claims New Victim: Precious Metals. Investors dump gold, silver to pay for stock losses.”

MoneyGame  Chart of the Day

SG FCIs At Weakest Level Since Lehman Brothers' Collapse



Source: IMF, Consensus Economics, SG Cross Asset Research / Economics (Sep 2011)

- According to the Business Insider, Societe Generale's Financial Conditions Indices (FCI) are currently at their weakest levels since the collapse of Lehman Brothers in 2008.
- Front Page Headline, Wall Street Journal – "Is the World Heading for Another Recession? New economic data points to a decline in manufacturing activity in both China – a critical engine of the global recovery – and Europe, as sign businesses are bracing for slower (economic) growth." See also, Winter Warning, September 28th. – The Demise of the American Dream.
- Having finally voted approval for a government mid-November funding measure in the House earlier in the day; now the Senate rejects the bill by a vote of 59 to 36, increasing the pressure on party leaders to resolve an impasse tied to federal disaster relief funds ahead of a government continuing resolution set to expire at the fiscal year-end September 30th. In the meantime, House Speaker John Boehner commented: "With the Federal Emergency Management Agency (FEMA) expected to exhaust its current relief funding as soon as Monday, the only path to getting assistance into the hands of American families immediately, is for the Senate to approve the House bill."

CLOSING LEVELS FOR FRIDAY, SEPTEMBER 23RD.		WEEKLY CHANGE
Dow Jones Industrial Average	10,771.48	– 737.61 points
Spot Gold Bullion (December)	\$1,639.80 (U.S.)	– \$174.90 per oz.
S&P / TSX Composite	11,462.87	– 800.84 points
10-Year U.S. Treasury Yield	1.83%	– 22 basis points
Canadian Dollar	97.14 cents (U.S.)	– 5.01cents
U.S. Dollar Index Future (Spot Price)	78.302 cents	+ 1.758 cent
WTI Crude Oil (October)	\$79.85 (U.S.)	– \$8.11 per barrel

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