

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



Monday, January 23rd

Front Page Headline, MarketWatch News – “EU Imposes Ban on Iranian Crude Oil Imports. The 27-nation European Union agrees to block all imports of Iranian crude oil and petroleum products – although existing oil contracts can be honoured until July 1st. –

MONDAY, JANUARY 23RD

as it applies additional pressure on the Iranian government to terminate its nuclear program. The embargo also applies to imports of petrochemical products from Iran and forbids supplying the country with technology or funds for use in this sector. Moreover, while initiating a freeze on assets of the Iranian central bank within the EU, the following statement was issued by the European Council: “Given the EU’s serious and deepening concerns over the Iranian nuclear program, the Council has broadened the EU’s restrictive measures against that country. Today’s decisions target the sources of finance for the nuclear program, complementing already existing sanctions.”

- Front Page Headline, MarketWatch News – “IMF Urges Action to Avoid 1930s Moment. In a Berlin speech to the German Council on Foreign Relations, Christine Lagarde, Managing Director of the International Monetary Fund warns: ‘What we must all understand is that this is a defining moment. It is not about saving one country or region. It is about saving the world from a downward economic spiral. It is about avoiding a 1930s moment, in which inaction, insularity and rigid ideology combine to cause a collapse in global demand. That is my core message to you today: although the economic outlook remains deeply worrisome, there is a way out. We need a larger firewall, stronger (economic) growth and deeper integration in the euro zone to stem the (debt) crisis after the many false starts and half measures seen in 2011. Now the world must find the political will to do what it knows must be done. The (political) turbulence seen in 2011, stemmed from a lack of collective determination to

reach a cooperative solution, both in Europe in the debt crisis and in the U.S. with the debt ceiling debacle.’ Ms. Lagarde’s remarks are timely; ahead of the World Economic Forum’s annual meeting in Davos on Wednesday and an EU Summit meeting in Brussels next Monday.”



Christine Lagarde in Berlin.

Source: MarketWatch News

- Front Page Headline, Globe and Mail – “U.S. Economy May Never Fully Recover: Carney. In an interview on CTV’s Question Period, Bank of Canada Governor Mark Carney states: “In terms of the nature of the U.S. (economic) recovery, it’s going to take a number of years before they get back to the America that we used to know. In fact, they are not in our opinion ultimately, going to get back to the U.S. we used to know. The (economic) weakness south of the border is costing the Canadian economy \$30 billion (CAD) in lost exports. However, (domestic) consumer

spending and business investment will prevent Canada from sliding backwards. Those two sectors will be key in countering the (economic) slowdown outside Canada and government austerity measures at home. We see household sector consumption continuing to grow around 2% and more activity in housing than we previously had thought. Moreover, it is vital for Canada to look for new trading partners in the Asia-Pacific region and elsewhere to prevent the economy from being dragged down by the United States. It's going to take multiple visits and multiple initiatives; not obviously, from the public sector alone, but clearly a focus from the private sector. That is absolutely essential for developing our future and it's a key element of our medium term (economic) growth." At Longwave Analytics, we believe the Bank of Canada is much too optimistic. See Economic Winter, January 13/12 – Longwave Analytics Economic Outlook for 2012.

## TUESDAY, JANUARY 24TH

- Front Page Headline, MarketWatch News – “Japan’s Central Bank Cuts Economic Forecast. The Bank of Japan’s Policy Board lowers its economic forecast for fiscal 2012 ending in March, from a projected gross domestic product growth range of 0.2% to 0.4% to a GDP contraction level between minus 0.3% and 0.4%, citing: ‘Economic growth prospects will likely be lower for fiscal 2012, due to the revision of past GDP statistics in addition to the slowdown in economies abroad. Despite the headwind of a strong yen, the economy is expected to gradually return to a moderate recovery path in the first half of fiscal 2013.’”
- The Office for National Statistics reports Britain’s budget deficit – excluding support for banks – narrowed to 13.7 billion pounds (\$21.3 billion U.S.) in December, compared to 15.9 billion pounds in the same period a year ago. Philip Shaw, an economist with Investec Securities in London, commented: “The figures are better than expected and it looks like Chancellor (of the Exchequer) Osborne will meet his forecasts. If we see a revival in the economy, the (budget) plans will remain on track. If not, he’ll have to rethink.”
- In a new job vacancy survey, Statistics Canada reports there were 3.3 unemployed people in Canada for every job vacancy in the 3rd. quarter of 2011. The survey provides estimates of the number and rates of job vacancies at broad industrial levels for Canada, the provinces and territories, and by size of enterprise.
- Front Page Headline, Globe and Mail – “IMF Warns: It’s All About Europe. In an update of its World Economic Outlook, the International Monetary Fund warns: ‘European leaders must try harder to resolve the continent’s debt crisis, or risk driving the world into another recession ... Global gross domestic product (GDP) will expand by 3.3% in 2012 – previously forecast as 4% in September 2011 – as a surprisingly resilient United States economy offsets a mild recession in the euro zone. Global (economic) growth prospects dimmed and risks sharply escalated during the 4th. quarter of 2011, as the euro area (debt) crisis entered a perilous new phase. European efforts to shore up the finances of its weakest members; to devise a strategy to backstop its banks and to stoke economic growth are entering their third year. Investors lost patience at the end of 2011, driving up the sovereign bond yields of every major European country, with the exception of Germany. The continent’s banks are retrenching, which is taking a toll on the economy by restraining credit. Austerity measures in most nations are further hampering economic growth. The cumulative result will be an economic contraction in the euro zone of 0.5% in 2012, compared with (last) September’s forecast for (economic) growth of about 1%. The euro zone will continue to struggle in 2013, managing (GDP) growth of only 0.8%.”
- Survey compiler Markit reports its Eurozone Purchasing Managers’ Index rose to a reading of 50.4 in January from a level of 48.3 in December, citing a surprise upturn in the service sector, however the overall economy continues to struggle for any traction outside of Germany and to a lesser extent France
- Front Page Headline, Market Watch News – “President Obama Outlines Plans for a U.S. Economy ‘Built to Last.’ In his annual State of the Union Speech, U.S. President Barack Obama urges big banks, multinational corporations and millionaires that they must do more to enable the American middle class achieve an economic recovery. The President served notice that he plans to assist homeowners trapped in debt, students struggling to pay for college and companies that would return jobs to America. In comments aimed at the financial industry, President Obama insisted that Wall Street must play by the rules like millions of other Americans. The President also stated that the U.S. Justice Department will be establishing a criminal task force to expand investigations into the abusive lending and packaging of risky mortgages that led to the housing crisis. ‘We cannot settle for a country where a shrinking number of people do really well. My goal is to restore our economy where everyone gets a fair shot and their fair share.’”

TUESDAY, WEDNESDAY 25TH

- The Finance Ministry reports Japan posted a 2.5 trillion yen (\$32 billion U.S.) trade deficit for 2011 – its first annual shortfall since 1980 – citing the strong yen, a global economic growth slowdown and a high domestic demand for energy imports. Yoshiaki Shinke, a senior economist at the Dai-ichi Life Research Institute commented: “We believe there is a high possibility that weakening external demand will cause Japan’s gross domestic product (GDP) to contract in the October – December period at a 1.5% annual rate, following a 5.6% annualized expansion in the 3rd. quarter.”
- Front Page Headline, Wall Street Journal – “Fed Expects Low Fed Funds Rate Through 2014. In his most recent press conference, Federal Reserve Chairman Ben Bernanke announced that he expects the administered Fed Funds rate to remain close to zero through the calendar year of 2014. Fed officials believe that by signaling that the Fed Funds rate will stay low for a protracted period will, not only serve to maintain other short-term interest rates at historically low levels, but also, influence long-term U.S. Treasury bond yields to remain low. By employing such an easy monetary policy, the Fed deems this initiative as the best methodology to spur consumer confidence and loan growth; as well as business investment and employment growth: ‘While (economic) indicators point to some further improvement in overall labour market conditions, the unemployment rate remains elevated. Strains in global financial markets continue to pose significant downside risks to the (U.S.) economic outlook.’”
- Front Page Headline, Wall Street Journal – “State of Illinois Sues Standard & Poor’s. The Illinois State Attorney General sues S&P alleging the ratings agency misled investors when it assigned ‘AAA’ ratings to mortgage-backed securities which later imploded during the financial crisis. In an interview, Illinois’ top prosecutor Lisa Madigan claimed: ‘S&P sought higher profit and catered to the requests of banker clients at the expense of the quality of its ratings. Every opportunity that S&P has publically, they talk about their independence and how their ratings are objective; but then when you actually look at what happens inside the company, you see they really abandon those principles. They were willing to use every trick that they had to give an issue a higher rating in order to satisfy their customer.’ S&P has repeatedly been singled out by prosecutors for its financial-crisis era ratings compared to its top competitors Moody’s Investors Service and Fitch Ratings.” At Long Wave Analytics, we wonder whether this is connected to S&P’s downgrading of U.S. Treasuries from ‘AAA’ to ‘AA’ (High) in July 2011.
- The National Association of Realtors reports U.S. pending home sales declined by 3.5% in December, following a 7.3% gain in November, citing record low mortgage rates still being offset by an increase in foreclosures. Moreover, 33% of realtors reported at least one contract was cancelled during the 4th. quarter, up from 18% of realtors reporting in the 3rd. quarter.
- Front Page Headline, Daily Telegraph U.K. – “Harvard Economics Professor Kenneth Rogoff Warns on Interest Rates. In an interview at the World Economic Forum in Davos, Kenneth Rogoff, co-author of the book ‘This Time Is Different,’ warns: ‘Any rise of more than 100 basis points (a full percentage point) in long term government bond yields would spell big trouble for everyone. Europe has a big governance problem on top of its debt problem. I think there will be major difficulties in resolving the current (debt) crisis. The scale of the problem is so huge, that I don’t see how it is possible for countries to grow their way out of the debt overhang.’”



Harvard Economics Professor Kenneth Rogoff in Davos, Switzerland. Source: Associated

- Front Page Headline, Business Insider – “George Soros Warns of Financial Collapse, Class Warfare and the Rise of Evil. In an interview with Newsweek from Davos, legendary investor George Soros waxed prolific: ‘At times like these, survival is the most important thing. Europe is confronting a descent into chaos and conflict. In America, I predict riots in the streets that will lead to a brutal clampdown, which will dramatically curtail civil liberties. The global economic system could even collapse altogether. I am not here to cheer you up. The situation is about as serious and difficult as I’ve ever experienced in my career. We are facing an extremely difficult time, comparable in many ways to the 1930s, the Great Depression. We are facing now a general retrenchment in the developed world, which threatens to put us in a decade of more stagnation, or worse. The best-case scenario is a deflationary environment. The worst- case scenario is a collapse of the financial system.’”

- Front Page Headline, The Slog – “Greek Debt Talks: Club Med Begins to Melt Down. In Lisbon, things with no provenance at all were going badly wrong: Portugal’s sovereign bond yields leapt to new euro highs, as the markets worried / factored in the certainty that Lisbon will also eventually default on its debt commitments ... Portuguese 3-year bond yields soared over 19%; while its 10-year bond yield surpassed 15 % and 5-year maturities just failed to reach a yield of 19%.

#### THURSDAY, JANUARY 26TH

- The Commerce Department reports U.S. new home sales declined by 2.2% to a seasonally adjusted annual pace of 307,000 units in December, negating the sales gains of November; while U.S. durable goods orders rose by 3% in December, citing stronger orders for airplanes and machinery
- The Labor Department reports U.S. initial claims for state unemployment benefits rose by 21,000 to a seasonally adjusted 377,000 in the week ended January 21st. while continuing claims increased by 88,000 in the week ended January 14th. Those people who have exhausted their traditional benefits and are receiving emergency or extended benefits under federal programs declined by 188,612 to about 7.64 million in the week ended January 7th.
- In its latest distributive trades survey, the Confederation of British Industry (CBI) reports 44% of 135 retailers contacted had experienced a decline in sales during January. CBI Chief Economic Advisor Ian McCafferty commented: “Shoppers have curtailed spending across the board at the start of the new year after taking advantage of early (price) discounting in December. Family budgets are under continuing pressure, with inflation still high and wage increases modest.”
- Front Page Headline, National Post – “Major Changes Coming to Canada’s Pension System: Harper. In a keynote speech to the World Economic Forum in Davos, Canadian Prime Minister Stephen Harper announced: ‘The federal government will bring forward major transformations to the country in the coming months in areas such as the retirement pension system, immigration, science and technology, investment and the energy sector. Of those reforms, lowering the rising costs of the country’s pension system is particularly critical.’ It now appears that the Conservative government could be poised to gradually change the Old Age Security system, in order to raise the age of eligibility to 67 years from 65 years.”

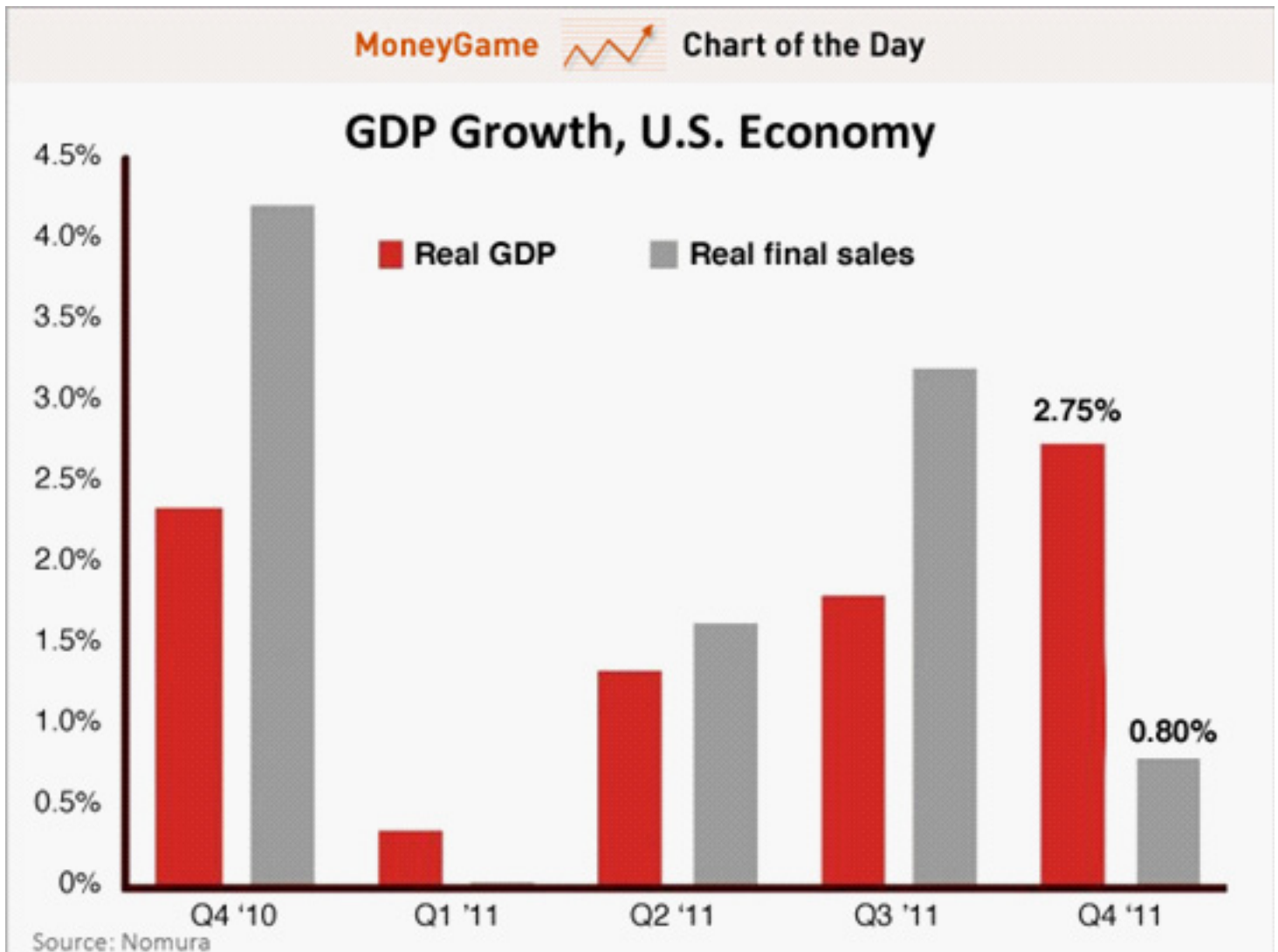
- Front Page Headline, Dow Jones Newswires – “Bondholders Accept Lower Coupon Rate on Greek Debt. Private-sector bondholders appear ready to accept a coupon rate of 3.75% on new Greek long term bonds that will be issued in a mid-March refinancing, which also involves a voluntary ‘haircut’ agreement.”



Canadian Prime Minister Stephen Harper Source: National Post

#### FRIDAY JANUARY 27TH

- The Commerce Department reports U.S. gross domestic product (GDP) expanded at an annual rate of 2.8% in the 4th. quarter of 2011, citing a huge build-up in corporate inventories, net of which GDP growth was only 0.8%. Subscribers should also note that U.S. consumer credit increased by \$20.4 billion (U.S.) in November alone, encouraged by heavy, seasonal retail price discounts.
- Front Page Headline, Globe and Mail – “Fitch Downgrades Five Euro Zone Countries. Fitch Ratings downgrades the sovereign debt credit ratings (see in parenthesis) and assigns a negative outlook for Cyprus (BBB-Low); Italy (A-Low); Spain (A); Belgium (AA) and Slovenia (A) citing: “The affected countries are vulnerable in the near-term to monetary and financial shocks. Consequently, these sovereigns, in Fitch’s view, accrue the full benefits of the euro’s reserve currency status. Overall, today’s rating actions balance the marked deterioration in the economic outlook with both the substantive policy initiatives at the national level to address macro-financial and fiscal imbalances; as well as the initial success of the European Central Bank’s (ECB) three-year Long Term Refinancing Operation in easing near-term sovereign and bank funding pressures.”
- Front Page Headline, Globe and Mail – “Ottawa on Track to Beat Deficit Target. Canada’s Finance Department reports the federal government is well ahead of schedule in reducing the size of its fiscal deficit, as November’s shortfall totaled \$1.9 billion



(CAD), well below the \$4.5 billion (CAD) recorded in the same month a year ago. For the first eight months of the current fiscal year which ends on March 31st. Ottawa's deficit stood at \$17.3 billion (CAD), well ahead of the \$26 billion (CAD) recorded in the same period of fiscal 2011."

- The National Statistics Institute reports the number of Spain's unemployed rose by 295,300 to 5.27 million in the 4th. quarter of 2011, equal to about 23% of the nation's work force. Nearly 1.6 million Spanish households currently house no working members and 48.6% of people under the age of 25 are unemployed. The job crisis is helping to compound Spain's fiscal situation due to spiraling benefit payouts and waning investor confidence that the country will be able to service its debts, let alone repay the principal.

- Front Page Headline, Wall Street Journal – "Portugal Restructuring Certain; Ireland, Spain Likely: Rogoff. In an interview from the World Economic Forum in Davos, Switzerland, Professor of Economics at Harvard University and co-author of This Time Is Different, Kenneth Rogoff warns: 'The current improvement in the debt markets of peripheral euro zone countries is an illusion. The European Central Bank (ECB) is financing them and that's why the yield spreads have narrowed. Euro zone governments clearly want to stretch it out, but eventually, they must absorb the losses of the banks that are buying (peripheral) debt with short term ECB financing. It's clear that we will need restructurings in Greece and Portugal, probably also in Ireland ... You can't just ask the peripheral countries to 'grin and bear it' and pay because they are being asked to do things politically, that have just never been done. Historically, consider the case of Romania, where former dictator Nicolae Ceausescu became fixated on repaying the country's debt. They did it, but none could obtain heat during

the winter. The people were miserable. It's simply not sustainable in a democracy."

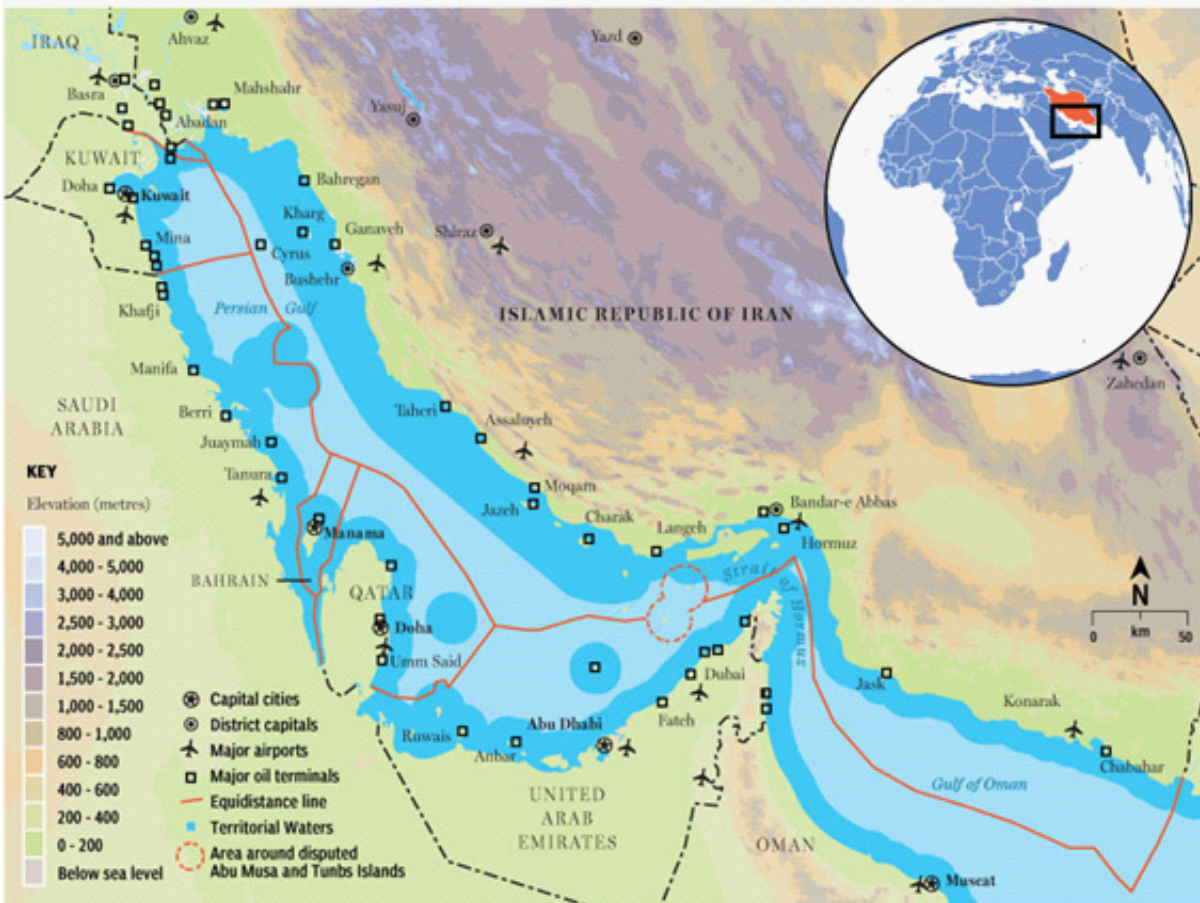
- Front Page Headline, Financial Times – “German Government White Paper Proposes EU Control Greek Budget. The German government wants Greece to cede sovereignty over tax and spending decisions to a euro zone ‘budget commissioner’ in order to secure a second 130 billion euro bailout from the European Union. Amounting to an extraordinary extension of EU control over a member state, the new commissioner would have the power to veto budget decisions taken by the Greek government, if they were not in line with targets set by international lenders. The new administrator, appointed by other euro zone finance ministers, would be responsible for overseeing ‘all major blocks of expenditure’ by the Greek government. The white paper proposes: ‘Budget consolidation must be placed under a

strict steering and control system. Given the disappointing compliance to date, Greece must accept shifting budgetary sovereignty to the European level for a certain period of time.’ Also, Athens would be forced to adopt a law permanently committing state revenues to debt servicing ‘first and foremost.’

- Front Page Headline, Financial Times – “Iran Poised to Ban Oil Exports to Europe. Iran’s parliament is threatening to ban oil exports to Europe as early as next week, in a move that could hamper the economically weak countries of southern Europe and force oil prices higher. Iranian legislators are reacting to the European Union’s ban on Iranian oil imports as part of the West’s sanctions package – to be implemented by July 1st. – against Iran’s nuclear program. However, any Iranian ban should have little overall impact on global oil markets which are currently well-supplied. Carsten Fritsch, an oil analyst at Commerzbank com

### GEOGRAPHY OF A CHOKEHOLD

*The nations ringing the Persian Gulf – Bahrain, Iran, Iraq, Kuwait, Saudi Arabia, Qatar and the United Arab Emirates – produce about 30% of the world’s oil, while sitting atop 57% of its crude reserves. But to get the oil to market, tankers must navigate the Strait of Hormuz, spanning only 50 km at its narrowest and susceptible to naval blockade, as Iran is now threatening.*



mented: 'Libya is now back to 80% of pre-war production levels and this is more than sufficient to offset any lost Iranian crude.'

CLOSING LEVELS FOR FRIDAY, JANUARY 27TH.		WEEKLY CHANGE
Dow Jones Industrial Average	12,660.46	– 60.02 points
Spot Gold Bullion (March)	\$1,732.20 (U.S.)	+ \$68.20 per oz.
S&P / TSX Composite	12,466.50	+ 69.40 points
10-Year U.S. Treasury Yield	1.89%	– 13 basis points
Canadian Dollar	99.93 cents (U.S.)	+ 1.23 cent
U.S. Dollar Index Future (Spot Price)	78.836 cents	– 1.32 cent
WTI Crude Oil (March)	\$99.56 (U.S.)	+ \$1.23 per barrel

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