Monday July 9th, 2012

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, July 9th

Front Page Headline, Thomson Reuters - “Euro Zone Fragmenting Faster Than EU Can Repair It.

Monday, July 9th

- On June 29th. European Union leaders agreed in principle to establish a joint banking supervisor for the 17-nation euro area, based (upon the auspices of) the European Central Bank (ECB), although most of the critical details remain to be negotiated. The proposal was a tentative first step towards a European banking union which could eventually feature a joint deposit guarantee and a bank resolution fund, in order to prevent bank runs or collapses from sending shock waves across the continent. The leaders agreed that the euro zone’s permanent bailout fund – the 500 billion euro ($620 billion U.S.) European Stability Mechanism (ESM), would be enabled to inject capital directly into banks on strict conditions, once the joint supervisor position is established. However, the rush to put the initial elements of such a system in place by next year may be arriving too late … Deposit flight from Spanish banks has been gaining pace and it is not clear that a euro zone agreement to lend Madrid up to 100 billion euros in rescue funds will reverse the flows, if investors fear Spain may face a full sovereign bailout. Many banks are reorganizing, or being forced to reorganize along national lines, accentuating a deepening north-south divide within the currency bloc. An invisible financial wall, potentially as dangerous as the Iron Curtain, which once divided eastern and western Europe, is slowly being constructed inside the euro zone. The bond yield gap between north European creditor countries, such as Germany and the Netherlands, whose financing costs are at an all-time low and south debtor countries, such as Spain and Italy where bond yields have risen to near pre-euro levels, threatens to entrench a protracted divergence. Since government credit ratings effectively set a floor for the financing costs of banks and businesses within their jurisdiction, the best-managed Spanish or Italian banks or corporations, must pay far more for loans, if they can obtain them, than their worst-managed German or Dutch peers. The longer that situation persists, the less chance there is of an (economic) recovery in southern Europe and the further the wealth gap will widen between north and south. With ever higher unemployment (rates) and poverty levels in southern countries, a political backlash – already fierce in Greece and seething in Spain and Italy – seems inevitable. Even a one trillion euro cheap loan injection by the ECB bought only a few months’ respite.”

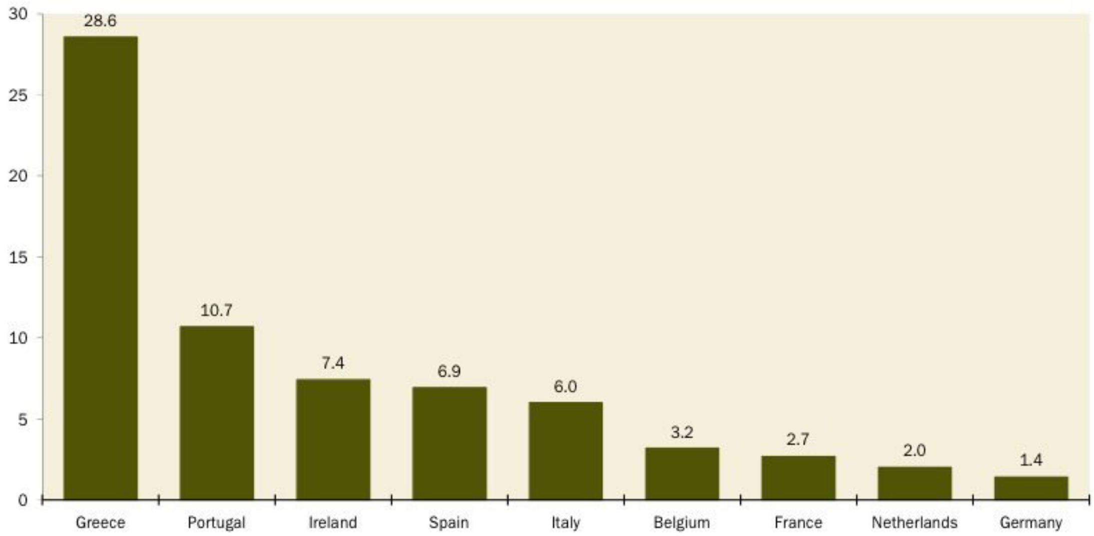
- Statistics Canada reports municipalities issued $7 billion (CAD) worth of building permits in May, up 7.4% from April and the highest level in 5 years; citing higher construction plans for institutional buildings in Alberta, British Columbia and Saskatchewan and for multi-family dwellings in British Columbia

- The National Bureau of Statistics in Beijing reports the nation’s consumer price index declined by 0.6% in June compared with May – the largest month-over-month drop in two years – but was still up by 2.2% on a year-over-year basis

- Front Page Headline, Financial Times – "Spain Granted More Time to Reduce Deficit. According to a European Commission (EC) official, as soon as tomorrow, Spain will be allotted more time to meet its steep budget deficit targets. In return, however, Prime Minister Mariano Rajoy must commit to a new round of tax increases in order to bolster revenues. Spain will be allowed to relax its deficit target for this year to 6.3% of gross domestic product (GDP), an increase from the previous target of 5.3%. Spain must also reduce its budget deficit for 2013 to 4.5% of GDP instead of 3% and to 2.8% by the end of 2014 – in effect, granting the Rajoy government an extra year to meet its targets. Meanwhile, the yield on Spain's 10-year bonds has again exceeded the 7% level."

CHART 14: INTEREST RATES DIVERGE IN THE EUROZONE TO THE PRE-EMU LEVELS

10-Year Government Bond Yield
(percent)



Source: Bloomberg, Gluskin Sheff

Tuesday, July 10th

- The Office for National Statistics (ONS) reports U.K. factory output rose by 1.2% in May, boosted by an additional working day, after the government moved a public holiday to June. The ONS specified: "Within our thirteen manufacturing categories, production increased in eight during May from the previous month and declined in five." Philip Shaw, an economist at Investec Securities in London commented: "Today's U.K. manufacturing data is a very good number, but it's entirely because of the extra day during the month. Underneath it all, it's hard to say what the underlying path of manufacturing is, but I think the broad implication is that it continues to struggle."

- The Customs Bureau reports China's imports rose by only 6.3% in June on a year-over-year basis while export growth slowed to 11.3%, despite the trade surplus increasing to $31.7 billion (U.S.). Tim Condon, an economist at ING Financial Markets in Singapore commented: "There's something bad for everyone in this (report). On the import side, the news is just bad, plus evidence of weak investment spending reinforces hard-landing worries (for China)."

- Front Page Headline, New York Times – "Regulators Charge Futures Brokerage Firm and CEO with Fraud. The Commodities Futures Trading Commission (CFTC) charges Peregrine Financial Group (PFG) and its Chief Executive Officer Russell Wasendorf with fraud and making false statements, after the firm's primary regulator, the National Futures Association, determined that an account which was supposed to hold $225 million (U.S.) of customer money actually held just $5 million (U.S.). A further review revealed PFG had been falsifying its records as far back as 2010. In a formal complaint, the CFTC has asked a federal court to appoint a receiver for the firm and freeze its assets: 'PFG and Wasendorf have used customer funds for purposes other than those intended by its customers, and consequently, have misappropriated these funds. The whereabouts of the funds is currently unknown."

- Vancouver-based Goldcorp Inc. announces a reduction its 2012 gold production guidance to an estimated 2.4 million ounces from a previous estimate of 2.6 million ounces, due to operating delays at its Red Lake mine in Ontario and inadequate water supplies at its Penasquito mine in Mexico. Goldcorp President and CEO Chuck Jeannes commented: “While I am disappointed, our focus is on addressing these issues promptly and in a manner supporting the long-term opportunities at these key assets. We look forward to the resumption of mining in areas of the high grade zone at Red Lake, while a team is assessing opportunities to redress water deficiencies at Penasquito.”

Goldcorp President and CEO Chuck Jeannes Source: Globe and Mail

- Canada Mortgage and Housing Corp. (CMHC) reports the nation’s housing starts rose by 10% in June on a year-over-year basis to a seasonally adjusted annual pace of 222,700 units; driven by urban multi-family condos and apartments

- Front Page Headline, National Post – “Enbridge’s Michigan Oil Spill Response Reveals Several Shortcomings. Following an extensive investigation into a July 2010 oil pipeline spill in Michigan, the U.S. National Transportation Safety Board (NTSB) put the blame squarely on Enbridge for the disaster, citing a failure to fix known and growing cracks in the 50-year old pipeline due to corrosion, inadequate training of personnel, deficient integrity-management procedures and an oil spill response plan that was insufficient for a major incident. American investigators provided a rare picture of Enbridge’s culture; finding a lack of communication between different sectors of the company, employees who were reluctant to report errors for fear of being fired, first respondents who failed to respond and a lack of learning from previous incidents. Indeed, Enbridge, the largest transporter of crude oil from Western Canada to the United States, appeared to be asleep at the switch when the pipeline rupture occurred, since it took the company more than 17 hours to respond to the incident. Meanwhile, 20,082 barrels of crude oil gushed into Talmadge Creek and eventually, into the Kalamazoo River. Almost 4,000 animals were affected and 320 people reported symptoms consistent with crude oil exposure. Cleanup efforts are ongoing and related costs have exceeded $767 million (CAD). Enbridge’s response was so poor that NTSB Chairwoman Deborah Hersman likened it to the behavior of the ‘Keystone Kops’ – referring to the incompetent policemen in silent film comedies of the early 1900s. Ms. Hersman concluded: ‘This accident was a result of multiple mistakes and missteps by Enbridge. In the future, I urge the company to pursue safety with the same rigour it pursues profit.”

Wednesday, July 11th

- Front Page Headline, MarketWatch News – “Spain Unveils 65 Billion Euros in New Austerity Measures. In a speech to parliament, Spanish Prime Minister Mariano Rajoy announces 65 billion euros ($79 billion U.S.) in new austerity measures in an effort to meet new budget deficit targets agreed upon with euro zone partners. The additional austerity measures, which will be applicable through 2014, include an increase in the standard rate of value added tax (VAT) to 21% from 18%, a reduction in unemployment benefits for new claimants, a salary cut averaging about 7% for state employees and billions of euros in savings from local government reforms. Prime Minister Rajoy stated: ‘We are trying to maintain a path that is not easy, short or comfortable. We cannot avoid it because it’s the only route which leads to (economic) recovery.”

- The Commerce Department reports the American trade deficit declined by 3.8% to $48.7 billion (U.S.) in May from $50.6 billion (U.S.) in April as imports fell to their lowest level in three months, citing declining crude oil prices and weakening demand for consumer goods. Jay Bryson, an economist at Wells Fargo Securities LLC in Charlotte, N.C. commented: “Exports are holding up, but looking ahead we are going to see pretty weak numbers given the economic slowdown abroad. The U.S. economy has slowed also, as import growth has definitely softened.”

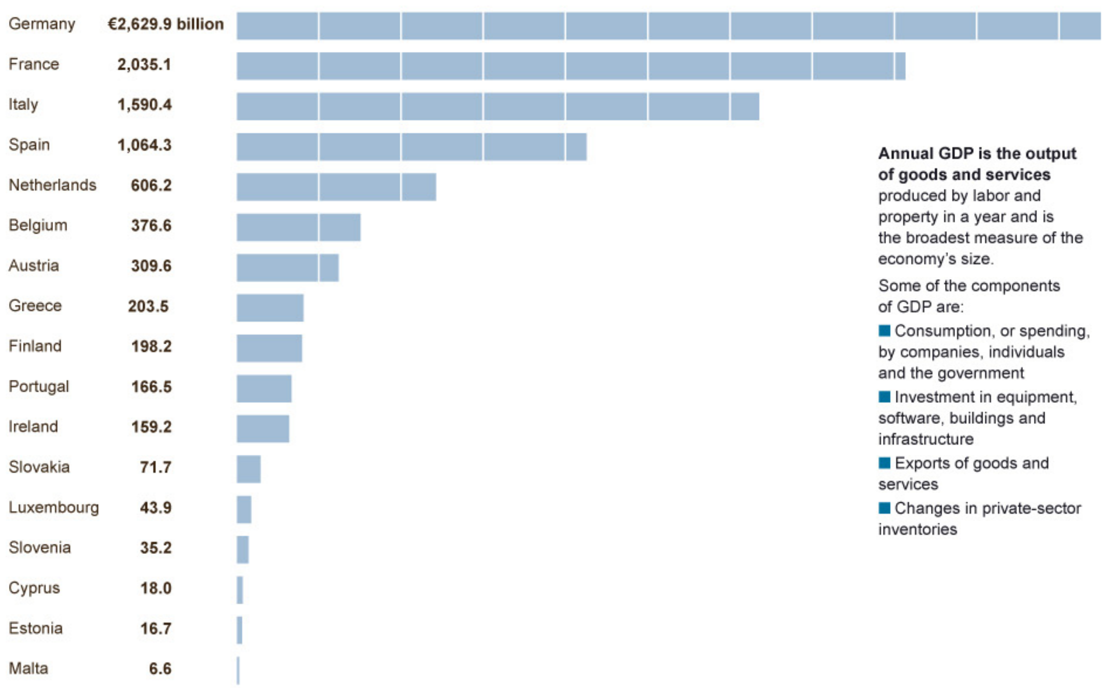
- Statistics Canada reports the nation’s trade deficit widened to $793 million (CAD) in May – following a deficit of $623 million (CAD) in April – as imports climbed by 0.4% to $39.7 billion (CAD) on increased demand for energy products ahead of anticipated production closings for maintenance. Leslie Preston, an economist at the Toronto-Dominion Bank commented: “Exports continue to be soft as external demand ebbs. Earlier we could point to strength in imports as a sign of a strong domestic economy, but the import trend is beginning to look flat also, as Canada’s economic growth is decidedly modest.”

Container ships are loaded at Terminal Systems in Delta, B.C.
Source: Lyle Stafford / Globe and Mail

- Front Page Headline, Globe and Mail – "German 10-Year Bond Yield Hits Record Low at Auction. The German government auctions 4.153 billion euros ($5 billion U.S.) of 10-year bunds at an average yield of 1.31%, the lowest yield ever on record for that term, while the bid-to-cover ratio was 1.5 times. The auction results underline investor concern that Madrid may need a full state bailout, which would stretch the limits of the European Stability Mechanism (ESM) and leave the EU bloc defenseless in case the sovereign debt crisis engulfs Italy, one of the largest bond markets in the world."

- Destatis, Germany's Federal Statistics Office, reports the nation's consumer price index (CPI) declined by 0.1% in June from May and rose by 1.7% on a year-over-year basis – the lowest annual reading since December 2010 – citing primary influences from food and energy prices. The German CPI has remained within the comfort range of the European Central bank (ECB) which targets an annual inflation rate for the euro zone at slightly below 2% over the medium term.

European Union Gross Domestic Product in 2012
European commission * summer 2012 estimates



*The executive arm of the 27-member European Union, of which 17 member states use the euro.

(Last updated July 3, 2012)
The Wall Street Journal

- Front Page Headline, Financial Times - "U.S. Treasury 10-Year Bond Yield Hits Record Low at Auction. The United States Treasury auctions $21 billion of 10-year bonds at an average yield of 1.459%, the lowest yield on record for that term. Separately, the minutes of the Federal Reserve's Open Market Committee (FOMC) June meeting were released and revealed some of the 12 voting committee members thought that 'further policy stimulus would likely be necessary, while several others stated it might be needed if the economy lost momentum, or if the inflation rate became entrenched below the target range."

- Front Page Headline, Financial Times – "Magnitsky Legislation Opens Door to Wider Targets. When the Magnitsky bill first began wending its way through the U.S. Congress in 2010, its authors had one target in mind: to punish Russian officials responsible for the death of Sergei Magnitsky, a Moscow lawyer who blew the whistle on a government corruption case and died in jail at the age of 37 … As the legislation nears passage – potentially this month – the human rights lobby is on the verge of winning an important tool to influence U.S. foreign policy. When Magnitsky was doing some legal work for Hermitage Capital Management – a British investment fund – he discovered evidence that a group of Russian officials had effectively, stolen $230 million (U.S.) in tax payments made by Hermitage. When Magnitsky detailed his allegations, he was arrested in November 2008 and accused of fraud. Nearly a year later, he died in jail after being denied medical treatment. One U.S. Senate staff member commented: 'If the bill remains as it is now, this will be as much about (human rights) in China as in Russia."

- Front Page Headline, Financial Times – "HSBC Braces for $1 Billion (U.S.) Penalty. HSBC Holdings PLC will apologize to U.S. lawmakers next week for failing to have appropriate controls in place to ensure it did not facilitate the financing of terrorism and other criminal activities; for which analysts estimate may total as much as $1 billion (U.S.) in fines. In an internal memo to staff prior to the British bank's scheduled appearance in front of the U.S. Senate's investigative panel on July 17th. Chief Executive Officer Stuart Gulliver penned: 'Between 2004 and 2010, our anti-money laundering controls should have been stronger and more effective, and we failed to identify and deal with unacceptable behavior. It is right that we held accountable and that we take responsibility for fixing what went wrong. Further, I must warn you that HSBC is likely to face additional enforcement action from other U.S. authorities in the coming months."

Source: Financial Times

- Front Page Headline, Financial Times – "Effect of Libor on U.S. Mortgages Examined. U.S. lawmakers have raised concerns that the alleged manipulation of the London Interbank Offered Rate (Libor) may have harmed American households, raising the stakes on a scandal which thus far has been confined to Wall Street and the City of London. According to the U.S. Office of the Comptroller of the Currency, there are at least 900,000 American residential mortgages indexed to Libor which were originated between 2005 and 2009, the key period when Libor may have been rigged. Those mortgages carry an unpaid principal balance of $275 billion (U.S.). During periods when banks were allegedly attempting to push Libor higher, households with mortgages tied to the rate may have paid higher mortgage rates than necessary; and conversely if the opposite occurred. U.S. Senator Sherrod Brown, chair of the bank regulatory subcommittee of the Senate Banking Committee declared 'I think the U.S. government should be just as aggressive in getting to the bottom of this scandal as the U. K."

Thursday, July 12th

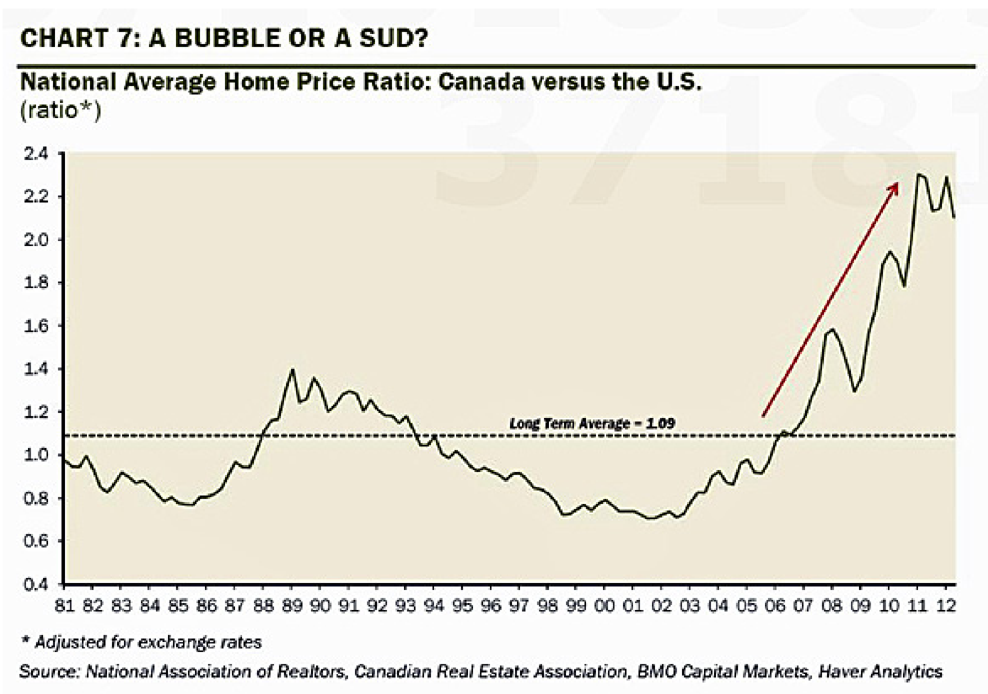
- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 26,000 to a seasonally adjusted 350,000 in the week ended July 7th. while continuing claims fell by 14,000 to a seasonally adjusted 3.3 million in the week ended June 30th. citing the decline likely stemmed from fewer auto sector layoffs than normal

- ELSTAT, Greece's statistics office, reports the country's unemployment rate rose to 22.5% in April, a sharp year-over-year increase from 16.2% in April, 2011. Platon Monokroussos, an economist at EFG Eurobank commented: "Given the fact that the jobless rate is a lagging indicator of broader economic activity, unemployment may not yet have reached its peak." Economic understatement of the week.

- Front Page Headline, Globe and Mail – "Peugeot Announces 8,000 Job Layoffs. French auto maker PSA Peugeot Citroen announces 8,000 job cuts and the closure of an assembly plant, as it struggles to contain mounting losses. The Aulnay plant located near Paris will halt production in 2014 as part of a drive to reorganize Peugeot's under-utilized domestic capacity. In a statement, Chief Executive Officer, Philippe Varin elaborated: 'The depth and persistence of the (debt) crisis impacting our business in Europe have now made this (corporate) reorganization project indispensable.' The company also stated it would be reporting a 700 million euro ($857.5 million U.S.) operating loss for the core car-making division in the first half of 2012."

- Front Page Headline, Bloomberg News – “Spain’s Bailout Forces Enormous Losses on Bank Clients. Maribel Martinez, 51, was counting on income from the 82,000 euros ($99,810 U.S.) of savings she invested in Bankia preferred shares two years ago after losing her job cooking meals for nuns at a Barcelona convent. A 1,435 euro dividend payment on the 7% preferred shares failed to arrive in her bank account on July 7th. On June 1st. the Bankia group had suspended 52 million euros of payments to holders of 3 billion euros of preferred shares sold in 2009 by Caja Madrid – one of its founding savings banks – after Bankia restated 2011 earnings to show a 3.3 billion euro loss. Missed payments may be the least of Martinez’s problems as the practice of selling preferred stock through branch networks, after debt markets dried up in 2009, returns to haunt banks and their customers. Holders of preferred shares sold by rescued by lenders such as Bankia risk losing part of their capital after European officials ruled banks should absorb losses under the terms of Spain’s 100 billion euro bank bailout. The memorandum of understanding on the terms of the bailout requested by Spain on June 9th. states: ‘Spanish authorities will require burden sharing measures from hybrid capital holders and subordinated debt holders in banks receiving public capital’ as part of efforts to minimize the restructuring cost to taxpayers. Valiente Martinez, Mirabel’s husband, who lost his job last year reacted: ‘We invested in the Bankia preferred shares, trusting in the good word of our bank’s branch manager, but our money has been effectively sequestered. What’s happening to our country now and to people like us makes me scared about the economy and the future.”

- Front Page Headline, Financial Post – “Canadian House Prices Not Sustainable: Rosenberg. Referring to charts, Gluskin Sheff economist David Rosenberg writes: ‘Canadian home prices are on average twice the level of home prices in the U.S. Historically, average home prices had been close to parity. Which of the two do you think is going to correct relative to the other? Canada is carving out a market top, while the United States is seemingly carving out a bottom.”



- Front Page Headline, Financial Times – “Banks’ Libor Fines May Reach $22 Billion (U.S.). According to a Morgan Stanley analysis, twelve global banks which have been publically linked to the London Interbank Offered Rate (Libor) rigging scandal, could face as much as $22 billion (U.S.) in combined regulatory penalties and damage to investors and counterparties. The calculation excludes the potential fallout from ongoing U.S. and European Union investigations, which could result in multi-billion dollar fines.”

- Front Page Headline, Financial Times – “Honeywell CEO Warns of U.S. Debt Gridlock. In an article, Honeywell Chief Executive Officer David Cote urges business leaders to press politicians to agree on a solution to the country’s deficit and debt problems, as concern escalates that political gridlock in Washington is damaging the domestic economy. Mr. Cote warns: ‘The lack of political will to tackle the debt issue is creating uncertainty for companies facing investment and hiring decisions, which could lead to years of low economic growth, or even another financial crisis. CEOs can no longer sit on the sidelines. We need to ensure that debt resolution is a core part of the presidential election campaign.”

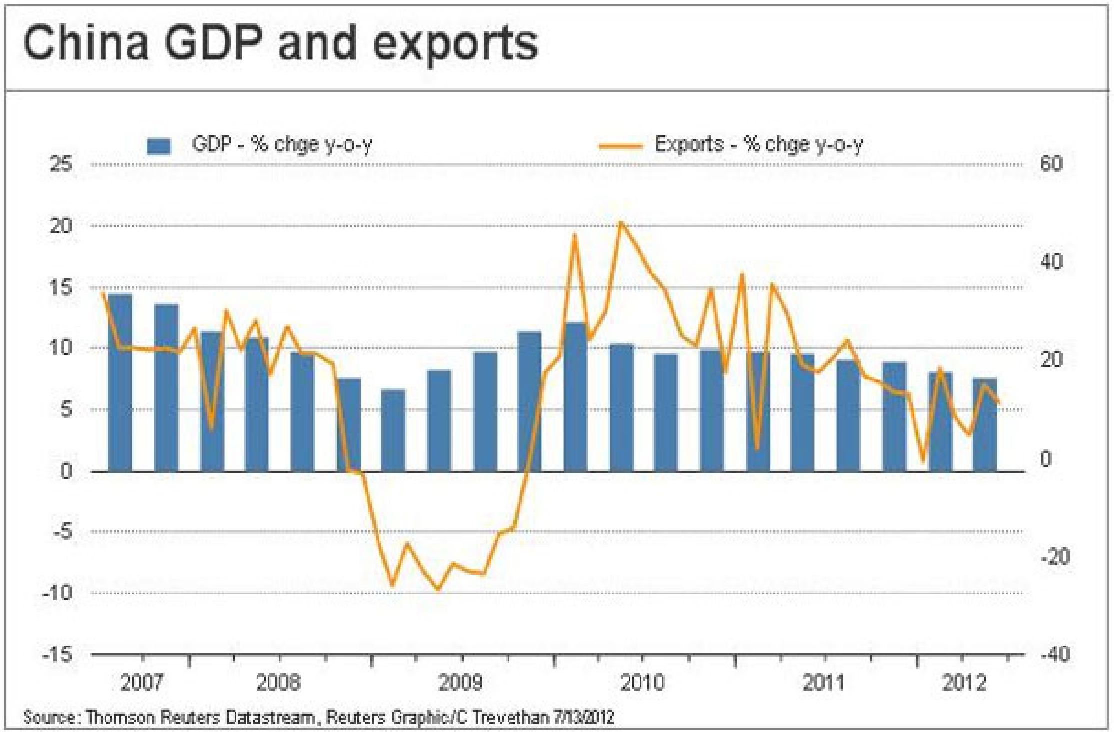
  See Also, Economic Winter, The Pathology of Debt and Erosion of Civil Liberties in America – February 1, 2012.

Friday, July 13th

- Front Page Headline, MarketWatch News – "Moody's Downgrades Italy's Sovereign Debt Credit Rating. Moody's Investors Service downgrades the Italian government's credit rating to Baa2 from A3 with a negative outlook, citing: 'Italy is more likely to experience a further sharp increase in its financing costs – or the loss of market access – than five months ago, due to increasingly fragile market confidence. Moreover, Italy's near-term economic outlook has deteriorated, as demonstrated by both weaker economic growth and higher unemployment; which creates a risk of failure to meet fiscal consolidation targets."

- The Labor Department reports the U.S. producer price index (PPI) rose by 0.1% in June while the core rate (ex food and energy) rose by 0.2%, the same increase as in May. Michael Moran, chief economist at Daiwa Capital Markets in New York commented: "Some decline in commodity prices and a slower rate of economic growth in both the U.S. and globally, suggests restrained prices in the coming months."

- Front Page Headline, Thomson Reuters – "China's GDP Growth Slows to 3-Year Low. China's Statistics Bureau reports the nation's gross domestic product growth slowed to 7.6% in the 2nd. quarter on a year-over-year basis, the slackest pace in more than 3 years. Xianfang Ren, an economist at IHS Global Insight in Beijing commented: 'If China's economy does not record an upturn within the next few months, factories may have to lay off workers impacting the unemployment rate."



- Front Page Headline, Reuters News – "With Ego Too Big to Fail – Iowa Broker Admits 20-Year Fraud. Further to charges laid by the Commodities Futures Trading Commission (CFTC) on Tuesday (see above), FBI agents arrest Russell Wasendorf, Sr. CEO of now bankrupt Peregrine Financial Group (PFG), charging him with making false statements to regulators, with more charges to follow. Assistant U.S. Attorney Peter Deegan noted: 'Mr. Wasendorf faces decades in prison.' In the dramatic conclusion to a week-long saga that has shaken trader confidence in the trillion dollar U.S. futures markets, authorities released parts of a detailed statement in which one of the industry's best-known veterans explained how he had duped regulators in a more than $100 million scheme by forging bank documents. Mr. Wasendorf admitted: 'I was forced into a difficult decision. Should I go out of business or cheat? I guess my ego was too big to admit failure. So I cheated. I have committed fraud, for which I feel constant and intense guilt."

LONGWAVE group

CLOSING LEVELS FOR FRIDAY, JULY 13TH.		WEEKLY CHANGE
Dow Jones Industrial Average	12,777.09	+ 4.62 points
Spot Gold Bullion (August)	$1,592.00 (U.S.)	+ $13.10 per oz.
S&P / TSX Composite	11,514.53	– 145.12 points
10-Year U.S. Treasury Yield	1.49%	– 7 basis points
Canadian Dollar	98.56 cents (U.S.)	+ 0.46 cent
U.S. Dollar Index Future (Spot Price)	83.288 cents	+ 0.003 cent
WTI Crude Oil (August)	$87.10 (U.S.)	+ $2.65 per barrel

Ian A. Gordon, The Long Wave Analyst www.longwavegroup.com

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