Monday August 20th, 2012

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

# THAT WAS THE WEEK THAT WAS

## Monday, August 20th

Front Page Headline, Bloomberg News – **"Bundesbank Reinforces Its Criticism of ECB Bond Purchase Plan.**

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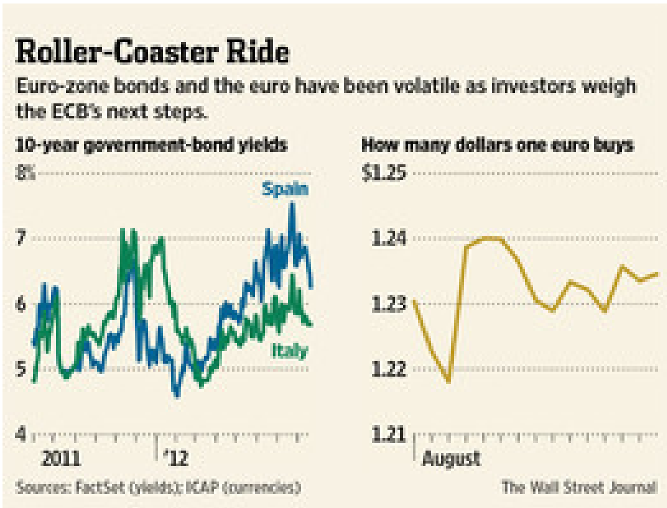
- In its monthly report, Germany's central bank restates: 'The Bundesbank holds to the opinion that government bond purchases by the Eurosystem are to be seen critically and entail significant stability risks. The new program could be unlimited and decisions about potentially far greater sharing of solvency risks should be taken by governments or parliaments, not by central banks.' Likewise, as reported in the Daily Telegraph, U.K., Otmar Issing, – a former European Central Bank chief economist and one of the founding fathers of the euro – recently observed: 'The less politicians address the root of the problems, the more they look with their expectations and demands to the ECB, which was not established for this. It is a central bank and not an institution to rescue governments threatened by bankruptcy. Also, a central bank always acts as a lender of last resort for the banking system, but it does not rescue governments."

- Front Page Headline, Daily Telegraph U.K. – **"Germany Supports ECB Bond Purchase Plan Against Bundesbank.** Jorg Asmussen, the powerful German member of the European Central Bank's executive committee – an appointee of Chancellor Merkel – signaled his full support for the bond purchase plan of ECB President Mario Draghi, dismissing warnings from the German Bundesbank that large scale purchases would amount to debt monetization and equivalent to a bailout rescue of insolvent states in breach of European Treaty law. Mr. Asmussen asserted: 'A currency can only be stable if its future existence is not in doubt."



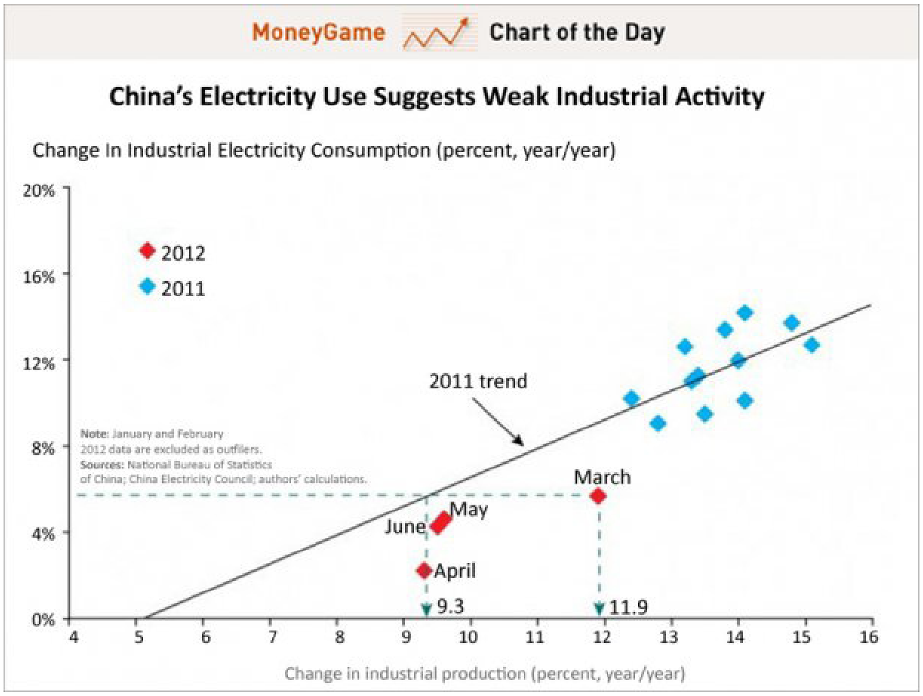

- Front Page Headline, Financial Times – **"Paul Ryan's Deficit Reduction Plan for America Lacks Credibility.** In an op-ed, columnist Martin Wolf opines: 'We are told U.S. Representative Paul Ryan – Mitt Romney's Vice Presidential running mate – is the man with the deficit-cutting plan. Not for this conservative policy wonk are the phoney figures or evasions of cowardly politicians. Mr. Ryan is a man whose integrity his opponents must respect. Yet this story has one drawback: it is false ... This is what David Stockman –Director of the Office of Management and Budget under (former President) Ronald Reagan and a true conservative – wrote in the New York Times on August 13th: 'Mr. Ryan's plan is devoid of credible math or hard policy choices. Of the $1 trillion (U.S.) tax expenditures that the plan would attack, the vast majority would be derived from slashing popular tax breaks for employer-provided health insurance, mortgage interest, 401 (k) accounts, state and local taxes, charitable giving and the like, not to mention low rates of capital gains and dividends ... As far as Social Security and Medicare are concerned, commencing in 2022, Mr. Ryan's plan would shred the measly means-tested safety net for the vulnerable: the roughly $100 billion (U.S.) for food stamps and cash assistance for needy families and the $300 billion (U.S.) for Medicaid.' Over the next decade, the Ryan plan is inadequate and incomplete."

- Front Page Headline, National Post – **"Canadian Banks Facing Revenue Challenges.** In a statement, Fitch Ratings warns: 'We expect retail loan growth to decelerate in the second half of 2012, as the housing market cools and new regulations aimed at curbing residential lending take effect. Given the sheer size of the consumer loan book on Canadian banks' balance sheets, continued earnings improvement in commercial lending may not offset the slowdown on the retail side. Furthermore, earnings from capital markets and wealth management activities are expected to trend downward as global uncertainty, mostly related to Europe, began eroding investor confidence in April."

## Tuesday, August 21st

- The Office for National Statistics reports Britain posted a budget deficit – excluding government support for banks – of 557 million pounds ($878 million U.S.) in July, compared with a surplus of 2.84 billion pounds a year ago; citing a huge decline in corporate tax receipts, partly due to the closure of the Elgin gas field in the North Sea for leakage problems. The British Chamber of Commerce issued a statement: "This figure highlights the huge challenges facing the U.K. in restoring credibility to its public finances. To maintain credibility, we need to persevere with spending cuts, but supplement them with forceful policies to boost (economic) growth."

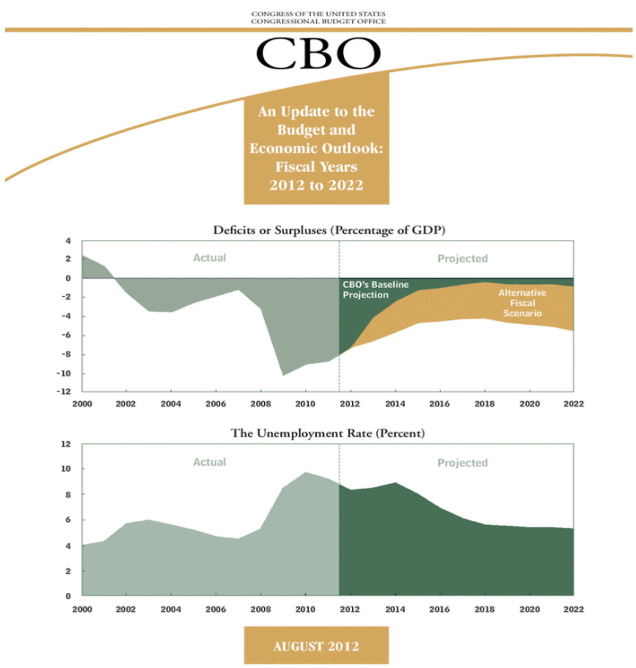
- Front Page Headline, Daily Telegraph U.K. – **"China's Asset Bubble Nears Danger Zone.** At an economic conference in Sydney, Australia, Kiyohiko Nishimura, the Bank of Japan's deputy governor and an expert on asset bubbles, warns: 'China's economy is now entering the danger zone. Credit and housing bubbles can remain benign as long as the work force is young and growing. They turn malignant once the ratio of working age people to dependents rolls over as it did in Japan. China's ratio will peak at about 2.7 over the next couple of years as the aging crunch arrives. It will then go into a sharp descent, compounded by the delayed effects of the one child policy. Not every bubble-bust episode leads to a financial crisis. However, if a demographic change, a property price bubble and a steep increase in loans coincide, then a financial crisis seems more likely.' The surge in Chinese home prices and loan growth over the past five years has surpassed extremes seen in Japan before the Nikkei bubble popped in 1990. Construction reached 12% of gross domestic product in China last year; it peaked in Japan at 10%."



## Wednesday, August 22nd

- The National Association of Realtors reports U.S. existing home sales rose by 2.3% to a seasonally adjusted annual pace of 4.47 million units in July, as inventories rose by 1.3% to 2.4 million units, representing 6.4 months of supply

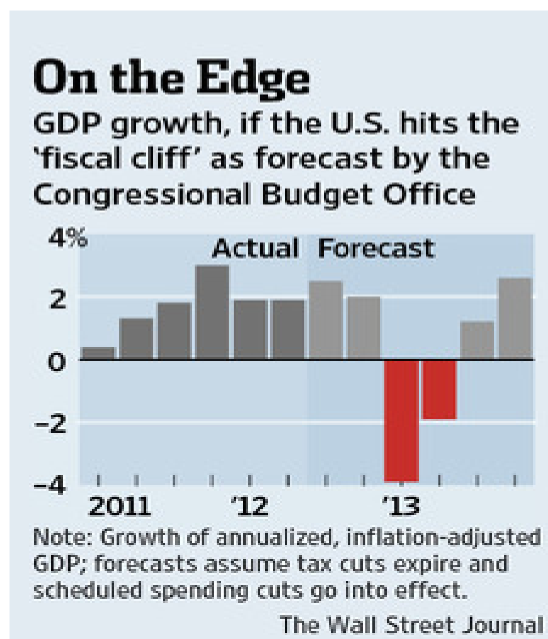
- In a semi-annual analysis, the non-partisan Congressional Budget Office (CBO) projects the U.S. budget deficit will total $1.1 trillion (U.S.) for the current fiscal year ending September 30, 2012 – about $100 billion (U.S.) lower than was envisaged last March, yet the fourth consecutive year of supra $1 trillion (U.S.) budget deficits– citing a 6% increase in tax revenue; a 1% increase in spending and compared to a $1.3 trillion (U.S.) deficit recorded in fiscal 2011. The CBO forecasts the U.S. deficit will total 73% of the nation's gross domestic product (GDP) this year, the highest level since 1950 and about twice as large as in fiscal 2007.




- Front Page Headline, Globe and Mail – **"Don't Blame Dollar for Exporters' Woes: Carney.** In an address to the Canadian Auto Workers (CAW) union, Bank of Canada Governor Mark Carney noted: 'Canada's export performance was the second worst in the G20 over the last decade, with only 9% of exports going to the fast-growing emerging markets such as China and India. While the consistent strength of the Canadian dollar must bear part of the blame for that, it is not the most important reason. In short, Canada's export underperformance prior to the financial crisis was more a reflection of the nations with whom we traded, rather than how effectively we did it. Canada is overexposed to the United States and underexposed to faster growing emerging markets. We must all recognize that the durable, high-paying manufacturing jobs of the future will be located in companies which invest to equip and train their workers and which are fully engaged in the global economy." **Having spent a great deal of time in 2010-2011 hinting at a higher Bank Rate himself, as well as bemoaning the persistently high level of the Canadian dollar relative to the U.S. dollar; at Longwave Analytics, we are heartened that Governor Carney and his central bank team of mandarins have finally performed some meaningful due diligence on the subject of Canadian exports."**

- Statistics Canada reports the nation's retail sales declined by 0.4% in June, following a 0.2% gain in May. In a research note to clients, Leslie Preston, an economist at the Toronto-Dominion Bank commented: "Consumers have begun the process of restraining debt growth, with overall household credit growth now at its slowest pace in 10 years and this will weigh on spending."

- Front Page Headline, Wall Street Journal – **"U.S. FOMC Ponders QE 3.** Minutes released today from the Federal Reserve's Open Market Committee policy meeting of July 31st. – August 1st. suggest that a new round of bond purchases, known as quantitative easing, was high on its list of options: 'Many (committee) members judged that additional monetary accommodation would likely be warranted fairly soon, unless incoming data pointed to a substantial and sustainable strengthening in the pace of the economic recovery.' Interestingly, the FOMC next meets on September 12th. – 13th., literally hours following the expected ruling from the German Federal Constitutional Court regarding a possible call for a referendum concerning a dramatic change in the German constitution."




- Front Page Headline, Globe and Mail – **"DBRS Study Warns of Pension Fund Shortfalls.** According to a pension study by debt rating agency DBRS Ltd. (formerly the Dominion Bond Rating Service) reveals North America's major pension plans have seen their cumulative funding shortfall exceed $389 billion (U.S.), leaving many plans facing critical funding shortfalls.

The study shows that the majority of 451 major Canadian and U.S. pension plans which were examined are entering the danger zone, where their funding shortfall is so large it is not easily reversed. The shortfalls are the result of weak markets harming the investment portfolios of pension plans, as well as declining interest rates hurting returns and boosting the funding obligations for future retirees. DBRS determined 53.4% of the pension plans it studied had assets below 80% of their funding obligation at the end of 2011, which means their funding shortfall had passed the 20% level. That compares to 45.7% of pension plans with funding falling below 80% in 2010. While there is no standard measurement of adequate funding for a pension plan, DBRS acknowledged it considers 80% to be a reasonable level of a shortfall from which companies can recover fairly easily. Below that level, the gap is so large that it becomes more difficult to fund. The growing shortfall is placing stress on employers, who are obligated to make contributions to their pension plans to return them to fully funded status, typically within five years. DBRS concluded the 451 pension plans studied – including 65 Canadian plans – had a combined financing deficit of $389 billion (U.S.) at the end of 2011; up 32% from $294 billion (U.S.) at the end of 2010. For companies to address this funding gap, employers must maintain high levels of contributions, since many plans have now entered the danger zone of funding status."

## Thursday, August 23rd

- The Labor Department reports U.S. initial claims for state unemployment benefits rose by 4,000 to 372,000 in the week ended August 18th. while continuing claims also increased by 4,000 to 3.32 million in the week ended August 11th. The number of people who have exhausted their traditional benefits but who are now receiving emergency or extended benefits under state or federal programs declined by about 48,300 to 2.33 million in the week ended August 4th.

- Front Page Headline, Reuters News – **"Greece Must Stick to Reforms: Merkel, Hollande.** German Chancellor Angela Merkel and French President Francois Hollande present a united front towards Greece, telling Greek Prime Minister Antonis Samaras that Athens should not expect leeway on its bailout agreement unless it sticks to tough reform targets. Chancellor Merkel stuck to her policy of deferring to a report due in September on Athens' progress by the troika of international lenders –the European Union (EU), the European Central Bank (ECB) and the International Monetary Fund (IMF) – before discussing flexibility on the bailout terms stating: 'It is vital that we all stay true to our commitments. However, we will, and I will encourage Greece to continue on its path to reform, which has demanded a lot of the Greek people. We want, I want Greece to be in the euro zone; it's a desire we have expressed since the beginning of the (financial) crisis. It is up to the Greeks to make the effort which is essential for that goal to be met."

- Front Page Headline, Canadian Press – **"TransCanada Triumphant in Texas Court Battle over Keystone XL Pipeline.** In ruling that TransCanada Corp. is a 'common carrier' Lamar County Court-at-law Judge Bill Harris gives the Calgary-based pipeline company the right to 'eminent domain', enabling it to seize private property for its Gulf Coast Project. TransCanada aims to have this southern portion of the pipeline – which doesn't require a federal permit to proceed since it doesn't cross an international border – up and running by mid-to-late 2013. The company has all the approvals it requires from the U.S. Army Corps of Engineers. Meanwhile, TransCanada has submitted a new application for a permit to construct the northern portion of the pipeline, which would operate from the Canada-U.S. border into Montana and through Nebraska. TransCanada expects that segment to be in service in late 2014 or early 2015."

## Friday, August 24th

- Front Page Headline, Daily Telegraph U.K. – **"Delay Austerity until Economic Growth Returns: IMF.** In a report which focuses on the economies of Japan, the United States and the European Union, the International Monetary Fund urges governments to delay austerity measures until economic growth returns, or if that is not possible, to shift the burden of any fiscal consolidation onto higher taxes and larger benefit cuts. Even if only by osmosis, the IMF study will also likely add to the policy pressures on U.K. Chancellor of the Exchequer George Osborne. While recommending waiting if possible, the IMF acknowledged that some countries have no choice but to reduce their debt level: 'If fiscal consolidations need to be implemented during (economic) downturns, governments should prioritize increases in taxes and reductions in benefits. By switching the emphasis of the cuts, governments could maintain infrastructure spending. While these are painful decisions, abandoning productive programs destroys jobs while higher (net) taxes do not, at least over the short term." **At Longwave Analytics, we reiterate our long-standing conviction that during the Kondratieff winter cycle, economic growth will not return in a meaningful way until excessive government debt levels are expunged from the world's economies.**

U.K. Chancellor of the Exchequer George Osborne        Source: Reuters News

- The Commerce Department reports U.S. durable goods – those meant to last for at least three years – orders rose by 4.2% in July, citing a 54% surge in demand for civilian aircraft. However, demand for non-military capital goods – such as heavy machinery and communications equipment, excluding aircraft – declined by 3.4%, the most in eight months. Millan Mulraine, a senior strategist at TD Securities in New York, commented: "Domestically, there's uncertainty about the tax environment and globally, there's uncertainty about the outcome of the European sovereign debt crisis. This (report) is not engendering business investment and hiring … (rather it) suggests that the soft underbelly of the (economic) recovery may be extending into the 3rd. quarter."

- The Office for National Statistics reports U.K. gross domestic product (GDP) contracted by 0.5% in the 2nd. quarter; initially reported as a decline of 0.7%, citing upwardly revised data for construction and factory output. Michael Saunders, an economist at Citigroup Inc. in London commented: "The macro picture is that the U.K. economy … is unlikely to improve significantly during the balance of this year or in 2013. Britain's economy still faces powerful and persistent headwinds, evoking a prolonged stagnation."

| CLOSING LEVELS FOR FRIDAY, AUGUST 24TH. | | WEEKLY CHANGE |
|---|---|---|
| Dow Jones Industrial Average | 13,157.97 | – 117.23 points |
| Spot Gold Bullion (December) | $1,672.90 (U.S.) | + $53.50 per oz. |
| S&P / TSX Composite | 12,082.23 | – 7.66 points |
| 10-Year U.S. Treasury Yield | 1.69% | – 12 basis points |
| Canadian Dollar | 100.73 cents (U.S.) | – 0.37 cent |
| U.S. Dollar Index Future (Spot Price) | 81.617 cents | – 0.921 cent |
| WTI Crude Oil (October) | $96.15 (U.S.) | + $0.14 per barrel |

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