UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, September 17th

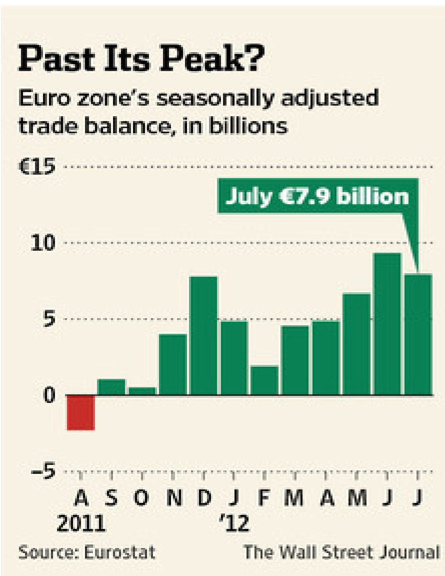
Front Page Headline, Globe and Mail – **"Merkel Urges Cautious Approach to ECB Regulation of Banks.**

Monday, September 17th

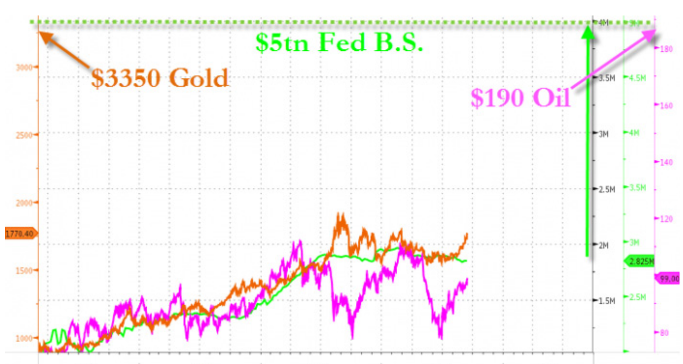
In a Berlin news conference, German Chancellor Angela Merkel warned: 'It is pretty unlikely that the ECB's regulatory body would be operational by January 1st. because it's better to proceed more slowly to ensure a regulator of high quality. It is not a matter of acting in haste with the end result not working; rather it's about gaining back credibility.' The creation of a pan-European banking regulator must be approved by the European Union's 27-member states."

Chancellor Merkel appears at a Bundespressekonferenz in Berlin. Source: Reuters News

- Eurostat reports the euro zone's trade surplus declined to 7.9 billion euros ($10.27 billion U.S.) in July from 9.3 billion euros ($10.59 billion U.S.) in June on a seasonally adjusted basis, citing a decline in imports reflecting reduced euro zone demand. Howard Archer, an economist at IHS Global Insight, commented: "The July export data heightens concern that weakened global (economic) growth is now increasingly holding back foreign demand for euro zone goods. Furthermore, the recent upward move in the euro to a 4-month high above $1.31 (U.S.) last week, will not help euro zone exporters."



- Front Page Headline, Le Metropole Cafe – **"B of A Foresees Fed Assets Surpassing $5 Trillion (U.S.) by the End of 2014.** The Bank of America predicts at least another two years of constant monetization – which would send the Fed's balance sheet to a grand total of $5 trillion (U.S.), as the Fed adds another $2.2 trillion (U.S.) of mortgage backed securities and $2.8 trillion (U.S.) of Treasurys to the current total – leading to prices of $3,350 (U.S.) per troy ounce of gold and $190 (U.S.) per barrel of crude oil."



Source: Bank of America

- The Federal Reserve Bank of New York's manufacturing index – also termed the Empire State Index – which covers New York, northern New Jersey and southern Connecticut, declined to a reading of minus 10.41in September —the lowest since April 2009 – following a level of minus 5.85 in August, citing a softening of exports, restrained business investment and a slowdown in household spending. Guy Berger, an economist at RBS Securities in Stamford, Ct. commented: "The momentum has turned negative in manufacturing with no imminent rebound (expected) over the near term."

- Front Page Headline, Wall Street Journal – **"White House Files Trade Complaint Against China.** In a filing with the World Trade Organization (WTO) the Obama administration charges Beijing with providing unfair export subsidies to its auto sector. In a countervailing move, China took a complaint over a new U.S. tariff law to the WTO. The law, signed in March, allows the U.S. to levy some import tariffs on Chinese goods."

- Front Page Headline, Daily Telegraph U.K. **"Spain Shuns Further Austerity Measures as Social Unrest Spreads.** Spanish Finance Minister Luis de Guindos rules out further budget cuts needed to qualify for a euro zone bailout, leaving it unclear whether the European Central Bank (ECB) can activate its bond purchase plan in its attempt to stabilize bond markets. Mr. de Guindos has declared that Madrid's 100 billion euro austerity measures are sufficient to meet a deficit ceiling of 6.3% of gross domestic product this year; although it remains an open secret that Spain will miss this target. Germany's parliament is unlikely to approve any bailout without deeper fiscal cuts, but further austerity risks pushing Spain into civil conflict. Tens of thousands marched in Madrid at the weekend to protest against drastic budget cuts, including a 7% reduction in public workers' wages. The protests followed a traumatic week in Catalonia, where 1.5 million people took to the streets amid a wave of secessionist demands. Spain's attempt to resist a bailout until virtually forced by the bond market leaves the euro zone at an impasse. The ECB cannot purchase Spanish bonds until Madrid formally requests help from the ESM and signs a memorandum ceding fiscal sovereignty. Mr. de Guindos has called upon the EU to fulfill its pledge to recapitalize the Spanish banks directly with ESM funds, but Germany will not agree until the regulatory body is firmly established."

Spanish Finance Minister Luis de Guindos Source: Associated Press

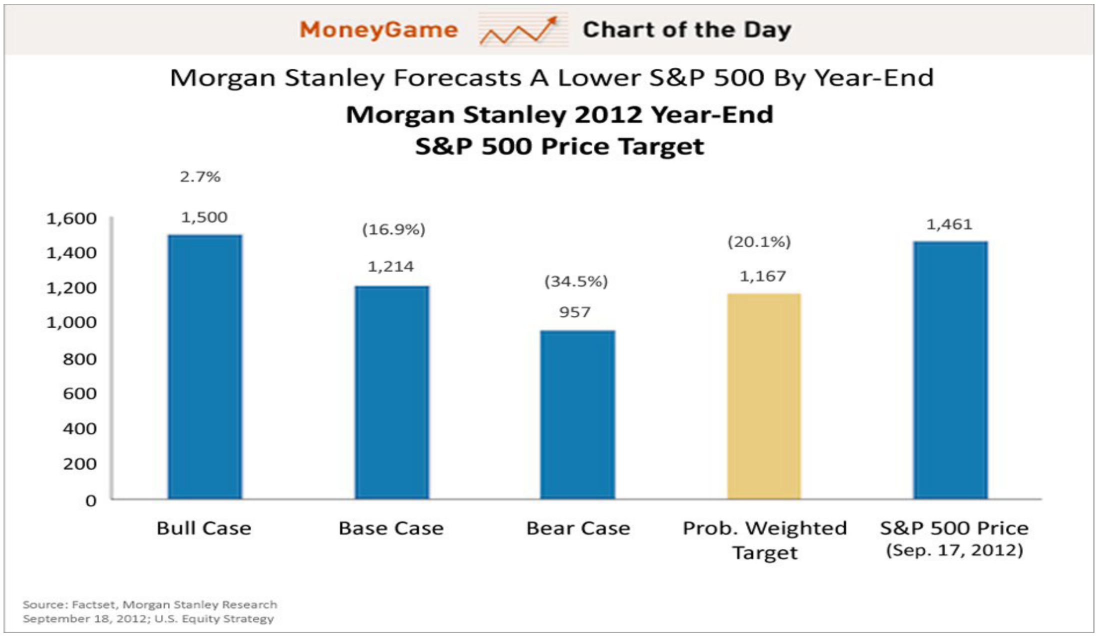
Tuesday, September 18th

- Front Page Headline, Bloomberg News – **"Deposit Flight from Europe's Banks Eroding Confidence in Euro.** According to data compiled by Bloomberg, a total of 326 billion euros ($425 billion U.S.) was withdrawn from banks in Spain, Portugal, Ireland and Greece in the 12 months ended July 31st. The flight of deposits from these four countries coincides with an increase of about 300 billion euros at banks in seven nations considered the core of the euro zone – including Germany and France – almost matching the outflow. That is leading to a fragmentation of credit and a two-tiered banking system, blocking economic recovery and hindering European Central Bank (ECB) policy in the third year of the sovereign debt crisis. Alberto Gallo, an analyst of European credit at Royal Bank of Scotland in London commented: 'Capital flight is leading to the disintegration of the euro zone and divergence between the periphery and the core. Companies pay 1 to 2 percentage points more to borrow in the periphery countries. Economic growth will not resume with such divergence.'

- The Commerce Department reports the U.S. current account deficit narrowed to $117.41 billion (U.S.) in the 2nd. quarter, following a downwardly revised deficit of $133.62 billion (U.S.) in the 1st. quarter, previously reported as $137.31 billion (U.S.)

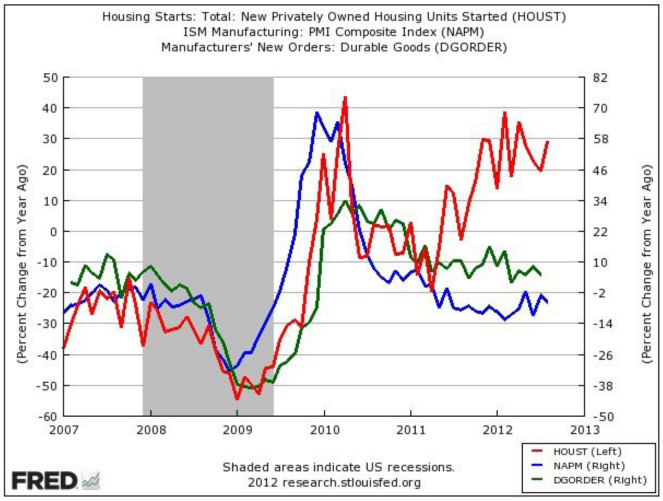
- Front Page Headline, Daily Telegraph U.K. – **"IMF Bailout Plans Face Serious Challenges.** A new staff report from the International Monetary Fund (IMF) reveals some tensions behind negotiations over rescue and austerity programs for beleaguered euro zone countries, when the ultimate political responsibility for measures is controlled by European Union (EU) institutions. The IMF has comprised part of the troika – along with the European Commission (EC) and the European Central Bank (ECB) – contributing 120 billion euros to the 403 billion euros of bailout programs for Greece, Ireland and Portugal over the past two years. IMF officials found the euro zone's convoluted decision-making processes slow and at key moments, bailouts were overruled by the EC and the ECB since they threatened the stability of the European Monetary Union (EMU) banking system. The IMF has argued that private investors and banks should shoulder their share of losses in order to ease the debt burden on governments facing bankruptcy. While the EU has ruled out debt restructuring in order to preserve the euro zone's integrity, the IMF envisions the writing down, or the renegotiation of debts, as an important way of making public finances sustainable, especially for Greece and Ireland. An EC spokesman commented: 'We have a very good working relationship (with the IMF) and the report does not just focus on debt restructuring."

- In an updated report, Morgan Stanley analyst Adam Parker predicts the U.S. Standard & Poor's stock market index to finish the year about 300 points lower at 1,167 than today's close of 1,461. Mr. Parker cites corporate earnings growth is volatile and very poor, while historic price-to-earnings ratios at this time of year suggest a stock market downturn. "Currently, investors are overpaying for cyclical earnings. Most industry groups appear to be over-earning right now."

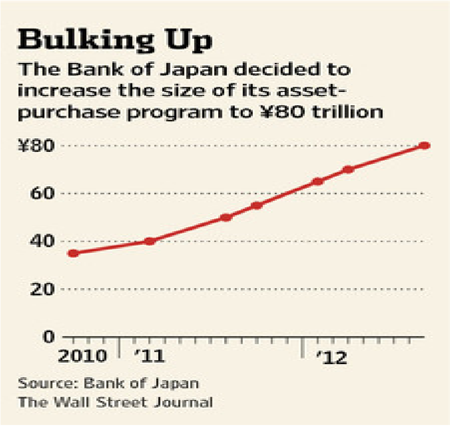


Wednesday, September 19th

- The National Association of Realtors reports U.S. existing home sales rose by 7.8% to an annual pace of 4.28 million in August – the most since May 2010 – citing record low mortgage rates, more affordable properties and a limited supply of new homes



- At a Tokyo news conference, Bank of Japan (BOJ) Governor Masaaki Shirakawa announces an aggressive easing of its monetary policy amid the current global slowdown. The BOJ policy board increased the size of its bond purchase program to 80 trillion yen ($1.01 trillion U.S.) from 70 trillion yen and extended its deadline to the end of 2013: "Since an economic recovery is unlikely before the end of the fiscal year next March, the Bank of Japan deemed it necessary to act so that Japan's economy will not be derailed from a track toward sustainable economic growth under price stability."



- Eurostat, the European statistical agency, reports euro zone construction declined by 0.3% in July and by 4.7% on a year-over-year basis; following a drop of 0.6% in June and a decline of 2.8% on a yearly basis.

- Front Page Headline, New York Times – **"Next School Crisis for Chicago – A Dwindling Pension Fund.** The Chicago Teachers' Pension Fund has about $10 billion (U.S.) in assets, but is paying out in excess of $1billion (U.S.) in benefits annually – considerably more than is being contributed. The fund, which has been forced to sell millions of dollars of investments in order to pay retired teachers, could collapse within a few years unless something is done. Laurence Msall, President of the Civic Federation – a local nonpartisan research organization – observes: 'This is a huge crisis. The problem does not become easier by waiting. As the issue grows, it starts to become an insurmountable obstacle.' Having foregone its pension contributions for many years, Chicago is supposed to start tripling them in another year, under state law. However, the school district has drained its reserves and cannot easily turn to the local taxpayers because of a cap on property taxes. Borrowing the money would be both difficult and expensive due to a recent credit rating downgrade. One of the few remaining choices would be to make deep cuts in other services. Like Chicago, many U.S. cities and school districts now face pension pressure after reducing their contributions in recent years to save money."

Thursday, September 20th

- HSBC reports its flash index for China's manufacturing output declined to a 10-month low reading of 47 in September, following a level of 48.2 in August. In a note to clients, Qu Hongbin, HSBC's chief economist for China commented: "China's manufacturing growth is still slowing, but the pace of the slowdown is stabilizing. Manufacturing activities remain lacklustre, thanks to weak new business flows and a longer than expected destocking process. This is adding more pressure to the labour market and has prompted Beijing to inject stimulus over the past weeks. The recent easing measures should be leading to a modest improvement in output from the 4th. quarter onwards."

- Research firm Markit reports the euro zone's purchasing managers' index declined to a reading of 45.9 in September, following a level of 46.3 in August. In a statement, Markit chief economist Chris Williamson commented: "The data indicate the business outlook is the gloomiest since early 2009. The pessimism is clearly reflected in headcounts falling at the fastest rate since January 2010, as companies seek to adjust to weaker demand."

- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 3,000 to 382,000 in the week ended September 15th. while continuing claims fell by 32,000 to a seasonally adjusted 3.272 million in the week ended September 8th. The number of people who have exhausted their traditional benefits and are now receiving emergency or extended benefits from state or federal programs declined by 217,823 to 5.17 million in the week ended September 1st. ”

Unemployed people attend a job fair at a Holiday Inn in New York City. Source: Scott Houtson/Corbis

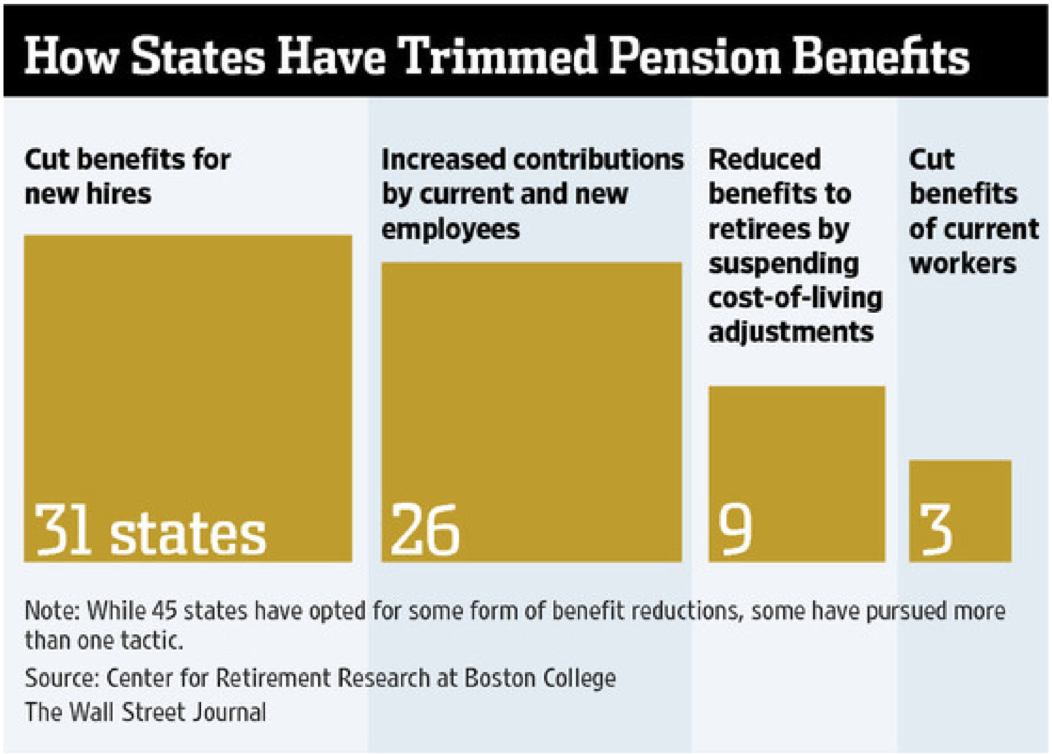
- Front Page Headline, Wall Street Journal – **“Bank of America Accelerates Job Cuts.** The Bank of America announces it is accelerating a broad cost-cutting plan to shed an additional 16,000 jobs by the end of the year; thereby relinquishing the title of the U.S. banking industry’s largest employer. The plan is designed to reduce corporate risk, generate more revenue from existing customers and utilize an investment banking operation inherited from Merrill Lynch to become a major deal maker on a global basis. B of A Chief Executive Officer Brian Moynihan is attempting to hasten the company’s transformation into a smaller, more efficient operation in order to increase profitability.” **The incompetent and ignorant legacy of former CEO Ken Lewis and his oversized ego continues to create headwinds for the Bank of America. See also, Economic Winter – The Clash of Cultures, February 2, 2009.**

- Front Page Headline, Deutsche Bank – **“Analysts Cite Merits of Gold Standard.** In a new report, Deutsche Bank analysts Daniel Brebner and Xiao Fu argue a gold standard is perfectly compatible with the workings of the modern global economy. Outlined below is an explanation of how they arrived at an estimate at how quickly the supply of gold would actually need to grow in order to support real growth in gross domestic product. ‘We begin by using general metrics for economic activity. There are several, including gross domestic product (GDP) and trade figures. However, the difficulty is eliminating the impact of significant credit growth on these figures to obtain the genuine, unassisted growth for a specific economy. For example, over the past 32 years, real GDP in the U.S. has averaged 2.7% per annum (CAGR). Over this same time frame, America’s population has grown by a 1.1% annual average. On this basis, average U.S. growth in GDP after a population adjustment is close to 1.6%. Of this rate, what has been the debt contribution to GDP growth? Simplistically, if we assume that credit (expansion) has contributed roughly 0.5% per annum, this leaves an average of 1.1% per annum increase in value, or productivity for the United States. For this reason, we believe that humility is a necessity; since there is considerable evidence to suggest that the impressive GDP growth rates and productivity advances experienced over the past several decades, have been temporarily boosted by the assumption of unprecedented quantities of debt, on a global level. On this basis, our expectation would be that the U.S. would need to grow its monetary base by only about 2.2% annually.” **See also, Economic Winter – All That Glitters Is Gold, October 19, 2009.**

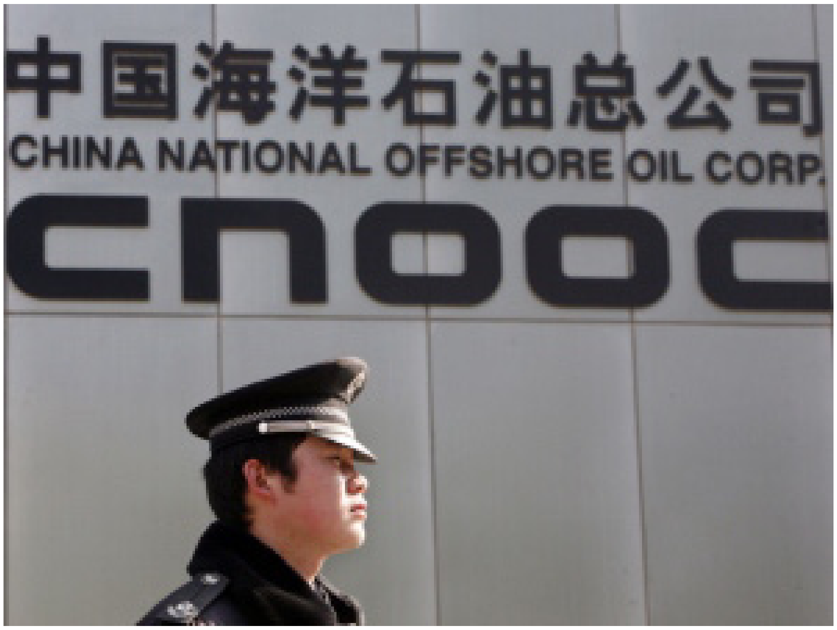
Friday, September 21st

- Statistics Canada (Statscan) reports the nation's wholesale sales declined by 0.6% in July, following a downwardly revised decline of 0.3% in June, previously reported as a drop of 0.1%. Separately, Statscan reports the country's consumer price index declined by 0.1% in July to an annual rate of 1.2% in August. Sal Guatieri, an economist at BMO Capital Markets, commented: "This report just reinforces the fact that inflation is not a concern for the Bank of Canada at the moment and will not likely be for some time."

- Front Page Headline, Wall Street Journal – **"State Pension Crisis Looms Despite Cutbacks.** Almost every American state has made cuts to its public employee pension plans, seeking relief from the economic downturn; however, to date the measures have fallen well short of bridging a funding gap approaching $1 trillion (U.S.). Since 2009, forty-five states have rolled back pension benefits for teachers, police, firefighters and other public workers; including cuts by Michigan and California earlier this month. Next week, Ohio Governor John Kasich is expected to sign legislation requiring various teachers to work longer and contribute more toward their pensions. The state measures indicate how economic forces are reshaping traditional rivalries, convincing lawmakers and labour leaders that past public pension plans are unsustainable. In Ohio and elsewhere, politically potent unions have locked horns with state officials over the pension cuts. According to researchers at Boston College, however, the new laws have trimmed only $100 billion (U.S.) from the $900 billion (U.S.) gap between what the states and their workers contribute to their retirement plans and what the states are obligated to provide in retirement benefits. Unfunded liabilities in many states grew to troubling levels after investment losses in the 2008 financial crisis depleted pension assets. While most states have approved some form of pension cuts, many have opted to apply those changes only to newly hired workers. This means most of the savings won't be realized for decades ... since changes made to the retirement plans of newly hired workers are expected to reduce pension costs by only 25% over the next 35 years." **See also, Economic Winter – The Pension Predicament (2), April 18, 2012.**



- Front Page Headline, National Post – **"CSIS Warns of Foreign Takeover Risks.** The same day shareholders of Nexen Inc. solidly voted to support the high-profile takeover offer by the China National Offshore Oil Co. (CNOOC) – a deal which still requires federal government approval – Canada's spy agency is warning 'such corporate takeovers can pose a threat to national security.' In its annual report, the Canadian Security Intelligence Service denotes: 'While the majority of foreign investment in Canada is transacted in an open and transparent manner, certain state-owned enterprises and private firms with close ties to their home governments have pursued opaque agendas, or received clandestine intelligence supports for their pursuits here. CSIS expects that national security concerns related to foreign investment in Canada will continue to materialize, owing to the increasingly prominent role that (state-owned enterprises) are playing in the economic strategies of some foreign governments."



A security guard outside CNOOC headquarters in Beijing. Source: Reuters

CLOSING LEVELS FOR FRIDAY, SEPTEMBER 21ST.		WEEKLY CHANGE
Dow Jones Industrial Average	13,579.47	– 13.90 points
Spot Gold Bullion (December)	$1,778.00 (U.S.)	+ $5.30 per oz.
S&P / TSX Composite	12,383.60	– 115.87 points
10-Year U.S. Treasury Yield	1.75%	– 12 basis points
Canadian Dollar	102.42 cents (U.S.)	– 0.55 cent
U.S. Dollar Index Future (Spot Price)	79.381cents	+ 0.546 cent
WTI Crude Oil (October)	$92.89 (U.S.)	– $6.11 per barrel

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