

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

## THAT WAS THE WEEK THAT WAS



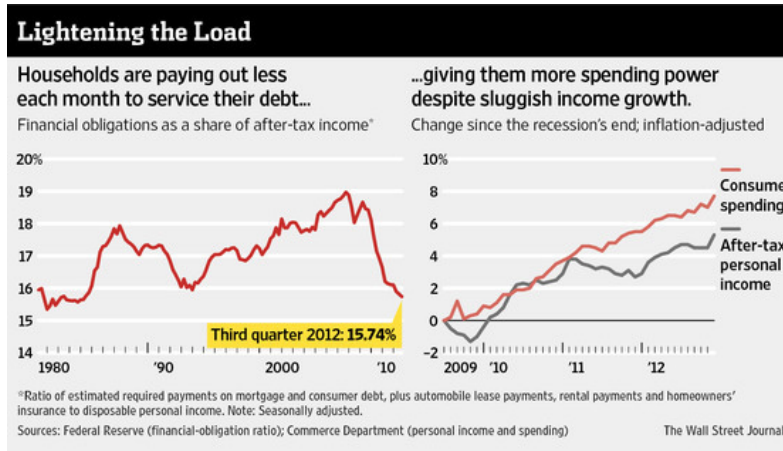
Monday, December 24th  
Front Page Headline, Globe and Mail –  
“OMT Could Become EU’s Cement  
Life Jacket.”

Monday, December 24th

The European Central Bank’s announcement (a few months ago) to establish an Outright Monetary Transactions (OMT) program commits the ECB to purchase unlimited amounts of sovereign bonds of financially distressed European Monetary Union (EMU) countries. The ECB would purchase short-term bonds contingent upon an austerity and economic reform package negotiated with the financially challenged country. While the OMT has yet to become operational, its mere presence has served to lower the bond yields of the two countries most likely to request assistance – Spain and Italy – from their debt crisis highs. Spain is in rough shape. Its economy is in deep recession and its debt to gross domestic product (GDP) ratio is soaring. Spain’s 25% unemployment rate is the highest in the Western world and its banks have required capital injections ... By requesting a loan under the OMT program, the extra austerity commitments could easily deepen the Spanish recession, thereby placing Spain’s budget deficit targets out of reach. The country could also become gripped by anti-austerity strikes and protests, as it was earlier this year. Spanish bond yields would rise again, forcing the ECB to purchase more and more bonds ... Such a downward spiral could cause Spain’s financial collapse, resulting in the breakup of the euro zone.” **See also, Economic Winter, Will Germany Exit the European Monetary Union? (2) – The Pain in Spain Is Far From on the Wane and ECB’s Outright Monetary Transactions (OMT) Will Punish Equities, September 21, 2012.** [www.longwavegroup.com/economic-predictions](http://www.longwavegroup.com/economic-predictions)

Front Page Headline, Globe and Mail – “**Greek Tax Evasion Remains a Serious Problem: EU/IMF.** According to a November report by the European Union and the International Monetary Fund, Athens has collected only half the tax debts and completed less than half the audits required under previously specified targets set by the EU Troika. The report noted: ‘The Troika expresses concern that Greek authorities are falling idle and that the drive to fight tax evasion by the very wealthy and the free professions is at risk of weakening. By the end of September, Greek authorities had conducted 440 audits on suspected wealthy tax evaders, compared with a full-year target of 1,300. Approximately, 1.1 billion euros (\$1.4 billion U.S.) of overdue taxes had been collected, less than the 2 billion euros targeted. The Troika urges Greece to improve tax collection and focus on the cases most likely to produce results. Doctors and lawyers are a good place to start.’ Tax evasion is endemic in Greece, making it more difficult for the government to bolster its revenues under its 240 billion euro international bailout agreement. With revenues falling short and the austerity-ravaged country obliged to meet its fiscal targets when its GDP is contracting for a fifth consecutive year, Athens is raising taxes on middle-class wage earners who can’t hide their income. Following Christmas, the Greek parliament expects to enact a new tax law raising 2.5 billion euros.”

- Front Page Headline, Wall Street Journal – **“U.S. Households Gradually Lighten Debt Load.** The Federal Reserve reports American consumers spent 10.6% of their after-tax income on debt repayments in the 3rd. quarter, the lowest level since 1983. When added to other required payments which aren’t classified as debt – such as rent and auto leases – the figure rises to 15.74%, also near a 30-year low.”



- Front Page Headline, Globe and Mail – **“Bears Won’t Hibernate in Their Dens in 2013.** In a recent interview, Ian Gordon, founder of the Longwave Group, forecasts: ‘We’re of the opinion that we’re extremely close to a major stock market peak and following that, we’re going into a real bear market. We’re convinced that the Dow Jones Industrial Average low of March 2009 will be pierced once this bear market resumes. The stock market must ultimately reflect the reality of the deleveraging economy, so it’s going to be pretty drastic. Moreover, we’re absolutely certain there will be some sort of black swan event that this time the U.S. Federal Reserve won’t possess the ammunition to overcome.’ Mr. Gordon is a dedicated follower of the Kondratieff economic wave theory, which holds that capitalist economies endure recurring booms and busts over long-term cycles running 40 to 60 years. Mr. Gordon has moulded the theory by dividing the long cycle into appropriate seasons. At this time, he is convinced the global economy is in the midst of winter, otherwise known as a deflationary depression. Mr. Gordon has held similar strong convictions for years, only to be thwarted by activist central bankers and their money printing presses. A lot of the extra liquidity pumped into financial markets in the wake of the global crisis found its way into equities. From a particularly bearish perspective, the good news is that the exhaustion of such extreme central bank intervention supports the likelihood of an eventual stock market crash.”



Ian Gordon, Longwave Group

Tuesday, December 25th

Christmas Day Holiday in Many Western Countries

Wednesday, December 26th

Boxing Day Holiday in Canada and the United Kingdom

- New York-based research firm SpendingPulse – which tracks total U.S. sales at stores and online via all payment forms – reports U.S. retail sales rose by a marginal 0.7% from October 28th. to December 24th. SpendingPulse Vice President Michael McNamara commented: “We are looking at modest to marginal retail sales growth from a year ago. Weather events (Hurricane Sandy) and the fiscal debate both anchored the holiday season in terms of growth. The media coverage, which did a thorough job of explaining the negative consequences of the fiscal cliff, created this subdued trend in consumer confidence and spending.”
- Front Page Headline, Bloomberg News – **“Children Die as Indian Government Nutrition Program Fails.** Great Value Foods’ truck deliveries of a tasteless yellow nutritional powder – funded by a \$2 billion (U.S.) government program for India’s youngest and poorest – were curtailed last August. All two-year old Jailal’s mother had left to give her son was boiled rice, the only food she could afford on an annual income of about \$75 (U.S.). On September 23rd. Jailal died, strapped to his mother’s bosom as she roamed the countryside for help. Integrated Child Development Services – India’s only government program to nourish as many as 160 million children under the age of six – has failed those in the Kaushambhi district of the state of Uttar Pradesh and tens of millions of others around the country. Instead, the program has allowed a web of private firms to take over distribution, in defiance of orders from the Supreme Court of India. Corrupt politicians and their criminal syndicates have looted as much as \$14.5 billion (U.S.) in food intended for public distribution to families in Uttar Pradesh alone. More than three-quarters of India’s 1.2 billion population eat less than the daily minimum targets set by the government. This ratio has risen from about two-thirds in 1983.”



A mother holds her malnourished 13-month old child in Uttar Pradesh.

Source: Bloomberg

- S&P/Case-Shiller reports its composite index of 20 U.S. metropolitan area home prices rose by 0.7% in October – on a seasonally adjusted basis – and by 4.3% on a year-over-year basis. David Blitzer, Chairman of the index committee at Standard & Poor’s commented: “Higher year-over-year price gains plus strong performances in the Southwest and California – regions that suffered during the housing bust – confirm that housing is now contributing to the economy.” However, analysts cautioned that U.S. house prices still face downward pressure from a likely increase in the sales of foreclosed and distressed properties and reduced buying by investors and speculators.

- Front Page Headline, Globe and Mail – **“Egypt Adopts Currency Controls.** Political turmoil over the past month has raised fears among ordinary citizens and investors that the Egyptian government – which has delayed funding negotiations with the International Monetary Fund until January – may not be able to get its fragile finances under control. Accordingly, Egypt has banned travelers from carrying more than \$10,000 (U.S.) in foreign currency into or out of the country and forbids forwarding money via the mail, as officials express concern over pressure on the country’s pound currency and a rush by Egyptians to withdraw their savings from banks. Separately, Standard and Poor’s downgraded Egypt’s long-term sovereign debt credit rating to ‘B’ (Low) from ‘B’, with a negative outlook, citing: ‘Another downgrade is possible if deepening political turbulence undermined efforts to support the economy and public finances.’”
- Front Page Headline, Bloomberg News – **“U.S. Will Reach Statutory Debt Limit on Monday.** In a letter to congressional leaders, U.S. Secretary of the Treasury Tim Geithner warns: ‘The federal government will reach the statutory debt limit on December 31st. In order to avert a U.S. default, the Treasury Department will take action to create about \$200 billion (U.S.) in headroom under the debt limit. However, given the significant uncertainty which now exists with respect to tax and spending policies for 2013, it is not possible to predict the effective duration of these measures.’”



U.S. Treasury Secretary Geithner.

Source: Associated Press

- Front Page Headline, Daily Telegraph U.K. – **“America Lambastes China Over Trade Breaches.** In his year-end report to Congress, U.S. Trade Representative Ron Kirk stated: ‘Now eleven years after it joined the World Trade Organization (WTO), China’s trade policies and practices in several specific areas remain of particular concern to the United States. At times, China’s regulatory authorities seem to pursue anti-dumping and countervailing investigations, while imposing duties for the purpose of striking back at trading partners who have exercised their WTO rights in a way which displeases China. A range of policies has raised increasing concerns that China has not yet fully embraced the key WTO market principles of market access, non-discrimination and transparency. China’s only partial adoption of the rule of law has exacerbated this situation.’ Mr. Kirk’s report accuses Chinese officials of running rough-shod over foreign firms, forcing them to relinquish trade secrets in clear violation of WTO rules. The report also targets ‘a wide range of alleged abuses including subsidies, attempts to disallow foreign imports and companies and failure to enforce intellectual property rights. Moreover, restraints on exports of rare earth metals, tungsten, molybdenum and other raw materials; as well as the manipulation of export rebates, are leading to tremendous disruption worldwide. The root problem is the heavy state role in the economy and the top-down structure of industrial planning.’ Meanwhile, Beijing’s Development Research Centre has issued a clarion call for reform, warning that China will be left behind in the ‘middle income trap’ unless it discards its economic growth model and embraces the free market.’”
- Front Page headline, Daily Telegraph U.K. – **“Overtaxed France Should Review Its Deficit Target: IMF.** In a new report, the International Monetary Fund warns that weaker than expected GDP growth means that France will miss its 2013 target for a deficit of 3% of gross domestic product. The IMF is now predicting a shortfall of 3.5%. IMF directors stated: ‘It would be unwise for the French government – which has already passed huge budget cuts – to implement

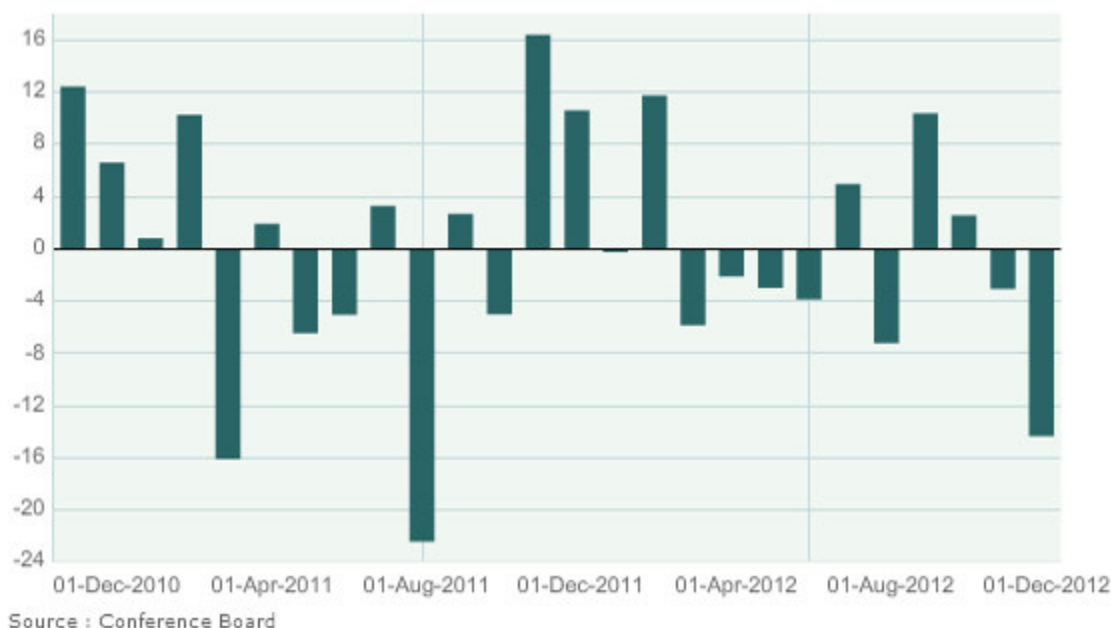


further fiscal measures in order to hit the target.’ In a conference call, Edward Gardner, the IMF’s chief economist for France, stated: ‘There isn’t much of a case for accelerating measures further in response to a weaker economic environment. Whether it’s 3% or 3.5% next year matters less to the extent that France can give reasonable and credible assurances about the direction of its policies. We think that France is hitting a (taxation) limit where there is very little scope for raising taxes further without contracting economic activity. Our recommendation is that France discuss the (taxation) factor within a broader European context.’

Thursday, December 27th

- The Conference Board reports its U.S. consumer confidence index declined to a reading of 66.5 in December – its lowest level since November 2011 – from a reading of 80.9 in November. Lynn Franco, director of economic indicators at the Conference Board noted: “A similar decline in consumer expectations was experienced in August 2011 during the debt ceiling discussions.”

### Monthly change in consumer-expectations index



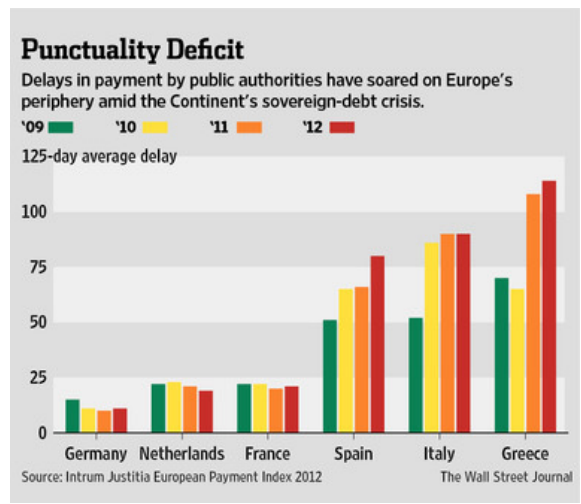
- The Commerce Department reports U.S. new home sales rose by 4.4% to an annual pace of 377,000 units in November – the most since April 2010 – following a revised pace of 361,000 units in October. Neil Dutta, director of U.S. economics at Renaissance Macro Research LLC in New York commented: “The housing market is probably in the early stages of a positive feedback loop of low mortgage rates, tight inventory and rising prices. It’s not likely to get to the heydays of the last boom, but the market is improving.”
- Front Page Headline, Daily Telegraph U.K. – “**Spanish Housing Crisis to Worsen.** In a new report, real estate consultants RR de Acuna & Asociados warn that home prices in Madrid, Barcelona and in other major cities in Spain will decline by a further 30% in a relentless slide until 2018, but it may even be worse in sunbelt regions where 400,000 Britons either live or own homes. Additional losses could reach 50% and linger for a protracted period of 10 to 15 years in those places where construction proliferated during the bubble, bringing the total decline from peak to trough towards 75%. Fernando Rodriguez de Acuna, the group’s vice-president, elaborated: ‘The (housing) market is broken.’

We calculate that there are almost 2 million properties waiting to be sold. Spain has made no progress at all over the past 5 years in clearing the domestic inventory. There are 800,000 existing homes on the market and developers are holding a further 700,000 completed units. Another 300,000 have been foreclosed, while 150,000 are in foreclosure proceedings; plus another 250,000 units still under construction. It's crazy." **See also, Economic Winter, Will Germany Exit the European Monetary Union? (2) – The Pain in Spain Is Far From on the Wane. (2), September 21, 2012.** [www.longwavegroup.com/publications/economic\\_winter/economic\\_winter.php](http://www.longwavegroup.com/publications/economic_winter/economic_winter.php)



Friday, December 28th

- Front Page Headline, Wall Street Journal – **“Spain Buries Itself in Unpaid Bills.** Local governments across Spain, facing a steep drop in revenue and largely unable to borrow money from banks or financial markets, have been paying their suppliers of goods and services months behind schedule. The delays amount to interest-free loans to fund government operations and are pushing companies to the brink of bankruptcy. A recent government report determined that for the first 10 months of this year, regional Spanish governments had accumulated bills for providers, interest payments and other obligations totaling 13.7 billion euros (\$18.1 billion U.S.), more than 1% of Spain’s gross domestic product (GDP). Many companies have dismissed workers, forcing up a national unemployment rate which exceeds 25%. According to Spain’s judiciary, a growing number are filing for bankruptcy – 27% more through September of this year than in the same period in 2011. Strikes and street protests have erupted over late payments. Angel Sal Carranza, a professor at ESADE Business School in Barcelona, exclaimed: ‘Money is really, really scarce and the suppliers have to bear the brunt of the situation. It is putting a further break on economic activity.’”



- Front Page Headline, Wall Street Journal – **“French Court Rejects 75% Income Tax Rate.** France’s top constitutional authority rules against a government plan to impose a top income tax rate of 75% on high net-worth individuals, as part of the austerity budget for 2013, aimed at reducing the budget deficit. The ‘exceptional solidarity contribution’ for the next two years contained in the 2013 budget was a keynote promise by Socialist President Francois Hollande in his election campaign earlier this year to increase the tax rate on wealthy people. However, the Constitutional Court ruled that ‘the plan to levy a 75% tax rate on annual incomes of more than 1 million euros (\$1.32 million U.S.) was illegal because it would have been applied to individuals and not to households, the basis for France’s income tax code. The (tax) measure that would have affected some 1,500 of France’s top earners was inequalitarian, since it meant that a household with two people – each earning just under a million euros a year – wouldn’t have been subjected to the tax while any person making more than a million euros would have to pay it.”
- Front Page Headline, Daily Telegraph U.K. – **“British Business Confidence Remains Fragile.** According to research compiled by the accountancy firm BDO International (formerly Binder Dijker Otte & Co.), the British Coalition Government has experienced the weakest spell of business confidence in two decades; averaging a score of 94.8 on the BDO Optimism Index, which surveys business people regarding their view on the economy. While a score of at least 95 indicates positive economic growth ahead, the index has a record of predicting short-term economic trends since its launch 20 years ago, but failed to predict the 2008 economic downturn. Peter Hemington, a partner at BDO and compiler of the report, noted: ‘Austerity has proved to be the wrong medicine for restoring (economic) growth. The U.K. economy remains weak with businesses expecting gross domestic product (GDP) to continue contracting over the short term.’”



U.K. Prime Minister David Cameron (left) and U.K. Chancellor of the Exchequer George Osborne

Source: Getty Images

- The National Association of Realtors reports its Pending Home Sales Index – based upon contracts signed in November – rose by 1.7 points to a reading of 106.4, the highest level since April 2012
- The Institute for Supply Management-Chicago reports its business barometer rose to a reading of 51.6 in December from 50.4 in November

CLOSING LEVELS FOR FRIDAY, December 28th		WEEKLY CHANGE
Dow Jones Industrial Average	12,938.11	– 252.73 points
Spot Gold Bullion (February)	\$1,655.90 (U.S.)	– \$4.20 per oz.
S&P / TSX Composite	12,316.12	– 69.58 points
10 - Year U.S. Treasury Yield	1.70%	– 6 basis points
Canadian Dollar	100.35 cents (U.S.)	– 0.31 cent
U.S. Dollar Index Future (Spot Price)	79.622 cents	– 0.001 cent
WTI Crude Oil (February)	\$90.80 (U.S.)	+ \$2.14 per barrel

Ian A. Gordon, The Long Wave Analyst [www.longwavegroup.com](http://www.longwavegroup.com)

Disclaimer : This information is made available by Long Wave Analytics Inc. for information purposes only. This information is not intended to be and should not be construed as investment advice, and any recommendations that may be contained herein have not been based upon a consideration of the investment objectives, financial situation or particular needs of any specific reader. All readers must obtain expert investment advice before making an investment. Readers must understand that statements regarding future prospects may not be achieved. This information should not be construed as an offer to sell, or solicitation for, or an offer to buy, any securities. The opinions and conclusions contained herein are those of Long Wave Analytics Inc. as of the date hereof and are subject to change without notice. Long Wave Analytics Inc. has made every effort to ensure that the contents have been compiled or derived from sources believed reliable and contain information and opinions, which are accurate and complete. However, Long Wave Analytics Inc. makes no representation or warranty, express or implied, in respect thereof, takes no responsibility for any errors and omissions which may be contained herein, and accepts no liability whatsoever for any loss arising from any use of or reliance on this information. Long Wave Analytics Inc. is under no obligation to update or keep current the information contained herein. The information presented may not be discussed or reproduced without prior written consent. Long Wave Analytics Inc., its affiliates and/or their respective officers, directors or employees may from time to time acquire, hold or sell securities mentioned herein. In addition, the companies referred to herein may pay a fee to Long Wave Analytics Inc. to be listed on [www.longwavegroup.com](http://www.longwavegroup.com). Copyright© Longwave Group 2010. All Rights Reserved.

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