LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, December 31st

Front Page Headline, Bloomberg News – **"U.S. Reaches Statutory Debt Limit: Geithner.**

Monday, December 31st

In a letter to Congress, U.S. Treasury Secretary Tim Geithner confirms the United States Government has reached its statutory debt limit of $16.4 trillion (U.S.), necessitating emergency steps announced last week in order to maintain funding for the government and avoid default. Mr. Geithner stated: 'Effective today, I have declared a debt issuance suspension period for the Civil Service Retirement and Disability Fund and for the Postal Service Retiree Health Benefits Fund, until February 28, 2013. Federal retirees and employees will be unaffected by these actions and the funds will be made whole following the congressional increase in the statutory debt limit."

- HSBC reports China's manufacturing purchasing managers' index (PMI) rose to a final reading of 51.5 in December from a level of 50.5 in November, the highest reading since May 2010

- Front Page Headline, New York Times – **"Europe's Sovereign Debt Crisis Affords No Relief on the Horizon.** European Union (EU) officials have struggled to turn things around by debating new treaties, providing bank bailouts and securing more funding. Looking ahead into 2013, the European Commission (EC) can offer nothing close to good news: 'The economic and employment outlook is bleak.' The crisis, now in its fifth year, continues unabated, exhausting unemployment benefits, devouring savings accounts and dashing dreams of an easy retirement. Over the past year, the countries most adversely affected by the crisis – Portugal, Ireland, Greece and Spain – have struggled to reduce their outstanding debts. They have raised taxes, laid off workers, reduced services and have begun charging for medical care that had been free for decades. However, they were joined in their misery, of trying to survive on less and less resources. No amount of austerity seems to be enough, as businesses continue to fail at a rapid pace, Europeans who thought they were safe lost their jobs and those who continued to work saw their salaries reduced." **See also, Economic Winter, Will Germany Exit the European Monetary Union? (2) – Greece: Ask Not for Whom the Bell Tolls, It Tolls for Thee, September 21, 2012.** www.longwavegroup.com/publications/economic_winter/2012/_pdf/Economic_Winter_V43_I1-Will-Germany-Exit-European-Monetary-Union_2.pdf

- Front Page Headline, Times of London – **"Merkel Warns Britain over Regulatory Restraint.** German Chancellor Angela Merkel issues a thinly veiled warning to the City of London in a New Year message that will be seized upon by British euro skeptics. On the eve of an election year where she hopes for a third term, Mrs. Merkel made it clear in her annual address to the nation that there was more work to be done to restrain Europe's financial markets. While Mrs. Merkel blames America for triggering the euro zone's woes, she also believes that British-backed lenient regulation played a key part and she is determined to move towards European Union (EU) banking and economic union this year. However, Mrs. Merkel also knows that she must tread carefully to avoid EU measures which will be seen as punishing the City at a delicate moment for British relations with continental Europe. British Prime Minister David Cameron is preparing to make a keynote speech on the EU this month that will demand that powers to be returned from Brussels to Westminster, probably including the effective right to veto measures regarded as damaging to the financial services industry, which comprises up to 10% of the British economy … Mrs. Merkel explained to her fellow citizens: 'The (sovereign debt) crisis is a long way from being defeated. Internationally, more needs to be done in order to exercise control over the financial markets. The world has not sufficiently learned the lessons of the devastating 2008 financial crisis. Never again can we allow irresponsibility like back then to happen. In a social market economy, the state is the guardian of order and that is something upon which people should be able to rely' … Germany has expressed support for the financial transaction tax advocated by France. Although Britain has the right to opt out, it is viewed in London as a measure that will make Europe less attractive to global business. Britain is also determined to avoid the EU's proposed banking union and its new bank regulator based in Frankfurt."

German Chancellor Angela Merkel Source: Times of London

Tuesday, January1st New Year's Day Holiday in Canada, Europe and the U.S.

Wednesday, January 2nd

- Front Page Headline, National Post – **"Fiscal Cliff Averted as Bipartisan House Vote Supports Taxation Compromise.** Maneuvered into a political corner, House Republicans sorted glumly through unsavoury fiscal cliff choices amid a New Year's Day struggle that wore into the night, casting doubt on emergency legislation to prevent widespread tax increases and painful across-the –board spending cuts. Yet, as Capitol Hill lights burned late in an extraordinary second straight night of negotiations, a clamour for revisions became tempered by concerns that the Senate would refuse to consider any changes, sending the bill into limbo and saddling Republicans with the blame for a whopping middle-class tax increase … Rep. Jack Kingston (R., Ga.) conceded: 'We've gone as far as we can go. I think people are ready to bring this to a conclusion and know that we have a whole year ahead of us (for additional fights over spending).' Rep. Steve LaTourette (R., Ohio) noted: 'There's a concern about the (financial) markets, but there's a bigger concern which is getting this right, something we haven't been very good at over the past two years."

- Front Page Headline, Bloomberg News – **"Fight Over Statutory Debt Limit Looms.** While the fiscal bill passed by Congress solves an immediate dilemma – avoiding income tax increases for most Americans and simultaneously, taxing top-earners more – it leaves unanswered a longer term question of taming the federal deficit and national debt.

Republicans have immediately turned their attention to their next battle: that of counting on the need to raise the nation's $16.4 trillion (U.S.) statutory debt limit in an attempt to force President Barack Obama to accept cuts in entitlement programs such as Medicare. Congress must act as soon as mid-February to prevent a government default and the dispute may reprise a similar 2011 episode which led to a downgrade of America's sovereign dent credit rating. In a statement after the vote, House Speaker John Boehner commented: 'Without meaningful reform of entitlements, real spending controls; as well as a fairer, cleaner tax code, our debt will continue to grow and our economy will continue to stumble.' The compromise agreement which cleared the House and Senate yesterday falls short of any grand bargain on fixing the debt which some leaders had hoped to achieve. Former Senator Alan Simpson (R., Wy.) and Erskine Bowles, a chief of staff under former President Bill Clinton – co-chairmen of president Obama's deficit commission that proposed a $4 trillion (U.S.) solution of tax increases and spending cuts, today called the new legislation 'truly a missed opportunity.' **At Longwave Analytics, we expect Congress will raise the statutory debt limit to at least $18 trillion (U.S.) by the end of February. It is also quite likely that both Moody's and Fitch Ratings will downgrade America's sovereign debt credit rating to 'AA' (High) from 'AAA'.**

- The Tempe, Arizona-based Institute for Supply Management (ISM) reports its manufacturing index rose to a reading of 50.76 in December from a level of 49.5 in November, citing a higher demand for exports

- Markit Economics reports its euro zone manufacturing purchasing managers' index edged lower to a reading of 46.1 in December, following a level of 46.2 in November. Chris Williamson, Markit's chief economist commented: "The euro zone manufacturing sector remained entrenched in a steep downturn at the year end. Thus, the region's recession looks likely to have deepened, possibly quite significantly in the final quarter."

- Front Page Headline, Daily Telegraph U.K. – **"Portugal Warns EU Troika to Relax Austerity.** In a speech to the nation, Portuguese President Anibal Cavaco Silva calls for urgent action to halt the recessionary spiral, warning Europe's leaders that the current austerity course has become 'socially unsustainable. Fiscal austerity is leading to declining output and lower tax revenue. We must stop this vicious circle. There can be no way out of the (debt) crisis until policy is set in the interests of the Portuguese people; as well as foreign creditors. We have arguments and we should use them firmly." Popular anger is growing over the Troika's fiscal shock therapy, which will force income tax rates up by 3.4%; as well as introduce a plethora of surcharges and fees. It aims to cut Portugal's budget deficit to 4.5% this year, primarily through tax increases. Meanwhile, Portugal's unemployment rate has risen from 13.7% to 16.3% over the past year, reaching 39% for youth. David Owen, an analyst at Jeffries Fixed Income, observed: 'Investors are willing to give Portugal the benefit of the doubt right now, but the country still hangs in the balance. Our concern is that the fundamental economic situation is still worsening. The European Central Bank's monetary policy is still too tight. They need to implement quantitative easing and cut overnight lending rates to zero.'

Young demonstrators protest at dusk

Source: Associated Foreign Press

Thursday, January 3rd

- The Labor Department reports U.S. claims for state unemployment benefits increased by 10,000 to 372,000 in the week ended December 29th. while continuing claims rose by 44,000 to 3.25 million in the week ended December 22nd. Those people who have exhausted their traditional benefits and are now receiving emergency or extended benefits from state or federal plans declined by about 72,800 to 2.07 million in the week ended December 15th.

- Front Page Headline, Wall Street Journal – **"Spain Drains Social Safety Net for Funding Purposes.** Spain has been quietly tapping the country's richest pension fund – the Social Security Reserve Fund – as a buyer of last resort for Spanish government bond issues, raising serious concerns about the Fund's role as guarantor of future pension commitments. Now, however, the scarcely noticed funding spree, executed amid a prolonged economic crisis, is about to end because the fund is reaching its limit. At least 90% of the 65 billion euro ($85.7 billion U.S.) fund has been invested in increasingly risky Spanish sovereign debt – according to official figures – and the government has begun withdrawing cash in order to make emergency payments. Independently, financial analysts who study the fund have concluded that the government will soon have one less recourse to finance itself, as it faces another year of recession and painful austerity measures to close a sizeable budget deficit. That pressure could force Prime Minister Mariano Rajoy's government to seek a rescue package this year from the European Union's bailout fund – the European Stability Mechanism – a politically risky course Mr. Rajoy seeks to avoid. In addition, worries are emerging that Social Security reserves are diminishing more quickly than expected." **At Longwave Analytics, we perceive Prime Minister Rajoy's reckless funding as a recipe for disaster, likely to explode sooner rather than later. See also, Economic Winter, Will Germany Exit the European Union (2) – The Pain in Spain Is Far From on the Wane (2), September 21, 2012.** www.longwavegroup.com/publications/economic_winter/2012/_pdf/Economic_Winter_V43_I1-Will-Germany-Exit-European-Monetary-Union_2.pdf

- Automatic Data Processing (ADP) and Moody's Analytics report private sector jobs in the U.S. increased by 215,000 in December, following an upwardly revised gain of 148,000 in November, previously reported as 118,000

- Markit Economics and the Chartered Institute of Purchasing and Supply report the U.K. purchasing managers' index (PMI) for construction declined to a reading of 48.7 in December, following a level of 49.3 in November, falling farther below the 50 mark which separates expansion from contraction. Tim Moore, a senior economist at Markit, commented: "December completed a miserable year for the U.K. construction sector. Moreover, survey respondents are relatively subdued about the 2013 outlook amid reports from their clients that budgets will come under even greater pressure." Howard Archer, an economist at IHS Insight, noted: "The sector continues to face major headwinds; including reduced public investment and spending, an extended weak economy, a struggling housing sector and problems in obtaining funding for large-scale projects."

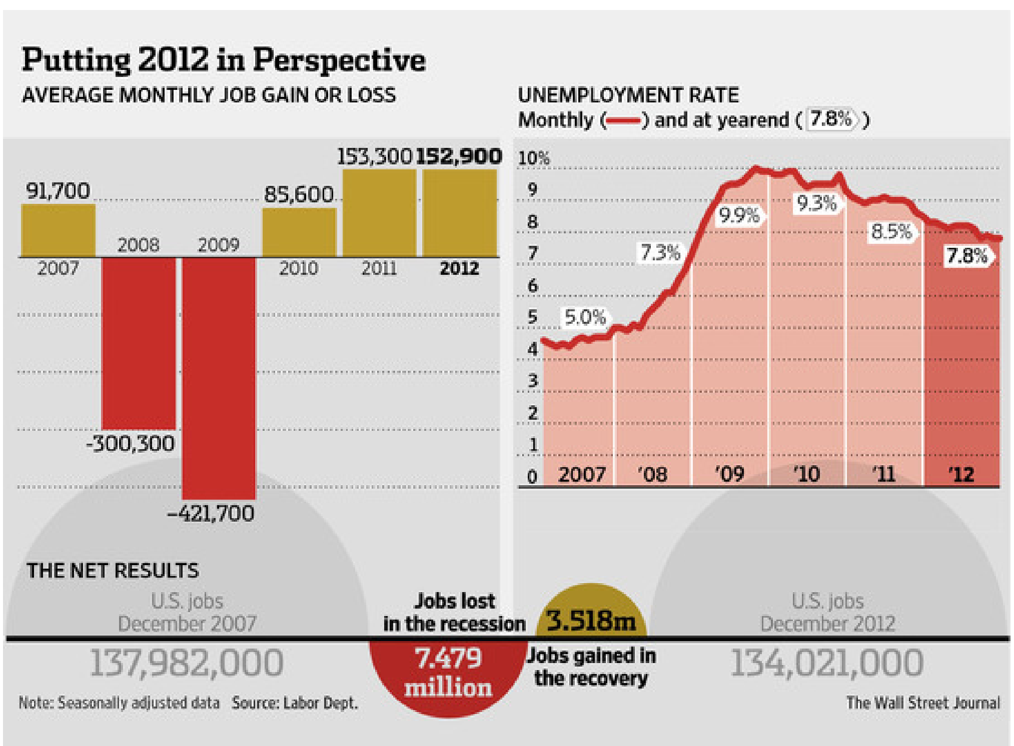
U.K. house building contracted for the 7th. consecutive month in December. Source: Associated Press

- Front Page Headline, Times of London – **"Southern Europeans Flee National Crises to Seek Employment in London.** Tens of thousands of southern Europeans are coming to Britain in search of work as the economies of Spain, Portugal and Italy remain firmly mired in the austerity doldrums. During the 1st. quarter of last year, 5,350 Spaniards and 5,370 Italians were allocated national insurance numbers in London. On a year-over-year basis, the number of national insurance registrations for Spaniards across Britain has soared by 25%. Cristina Martin, a waitress from Barcelona cites: 'With unemployment exceeding 25%, finding a job in Spain is very difficult. Everyone is becoming fed up with the economic crisis and if it continues like this, lots more people will leave. I have met a lot of Spanish people in London who have done the same. While it is much more expensive to live in London than it is in Barcelona, I couldn't earn in Spain what I earn in London.' Andrea Fraquelli, operations manager of the group of restaurants where Ms. Martin works, says he has never received so many CVs from jobseekers – most of them from Spain and Italy. According to Sofia Vazquez, marketing manager at Mundia Lengua – an Anglo-Spanish recruitment company – most of them end up working in hotels, restaurants, bars and big café chains such as Pret a Manger. 'It is much easier to find this work in London than it is in Spain. Young Spaniards see London as a city of opportunity."

- Front Page Headline, National Post – **"Auto Sales in France, Italy, Spain Decline to Multi-Year Low.** Registration data reveals car sales in France, Spain and Italy declined to the lowest level in over 30 years as austerity measures and higher taxes sap consumer demand. Italy's car sales, down 22.5% in December, fell by 19.9% for the full year to 1.4 million vehicles, the lowest levels since 1979. French car registrations dropped by 15% in December, leaving the full year down 14% to 1.9 million vehicles – the lowest since 1997 – according to the French industry group CCFA. Spain's December sales declined by 23% following a 20% drop in November. For all of 2012 sales were down by 13% to 699,589 cars, the lowest since industry association Anfac began keeping records in 1989. David Arnold, an analyst at Credit Suisse, commented: 'The new car market continues to decline in Europe, which is a trend we anticipate will continue through the course of 2013."

Friday, January 4th

- The Labor Department reports U.S. non-farm payrolls increased by 155,000 workers in December, following an upwardly revised gain of 161,000 in November. The official unemployment rate held steady at 7.8%, following a 0.1 upward revision in November's figure.



- Statistics Canada reports the nation's economy created 39,800 new jobs in December, while the official unemployment rate remains at a 4-year low of 7.1%. David Watt, chief economist at HSBC Bank Canada commented: "Although Canada experienced some solid job gains in 2012, employment is typically a lagging indicator. Thus, there is somewhat of a disconnect between the sluggish economy and the solid job creation. We don't expect that to continue. Instead we expect job creation to be more moderate in 2013, consistent with an economy which is struggling for momentum."

- Data provider Markit Economics reports its composite purchasing managers' index – based on a poll of executives across the euro zone's manufacturing and services sectors – rose to a reading of 47.3 in December from a level of 46.5 in November. Separately, the federal statistics bureau reports German retail sales rose by 1.2% in November and Eurostat reports its preliminary calculations indicate the euro zone's annual inflation rate was 2.2% in December, unchanged from November. Jonathan Loynes, an economist at consultancy Capital Economics noted: "The news that both activity and inflation in the euro zone remained subdued at the end of 2012, will increase the pressure on the European Central Bank (ECB) to provide further policy support ahead of next week's monetary policy meeting. The main message ... is that activity in the euro zone economy remains extremely weak."

- Front Page Headline, Globe and Mail – **"Auto Makers in Canada to Receive $250 Million (CAD) Subsidy.** At a Ford Motor plant in Oakville, Ontario, Canadian Prime Minister Stephen Harper announces the federal government is setting aside $250 million (CAD) for car companies and their suppliers by renewing the five-year Automotive Innovative Fund it established in 2008 signaling that Ottawa will keep offering money to sustain automotive jobs in the country's manufacturing heartland. The original fund, which required auto companies to invest their own money in order to access government cash, helped generate $1.6 billion (CAD) I research and development projects. Since 2000, Canada has added one new assembly plant – a Toyota Motor factory in Woodstock, Ontario – while General Motors, Chrysler and Ford Motor have closed five facilities. However, those four companies plus Honda have spent billions of dollars upgrading other auto plants in Canada. A senior federal government source was quoted to acknowledge: 'Our conservative government remains focused on creating jobs and keeping Canada's automotive manufacturing sector globally competitive and expanding."

- Front Page Headline, Financial Post – **"Canadians Increasingly on U.S. Property Buying Blitz.** The Washington-based National Association of Realtors reports foreigners purchased $82.5 billion (U.S.) in residential American real estate in the 12 months ended March 12, 2012. It was almost 9% of the $928.2 billion (U.S.) in total activity for the period. Foreign purchasing, led by Canadians' 25% share, is clearly on the rise, having totaled only $66.4 billion (U.S.) a year earlier. Unsurprisingly, the top four destinations for Canadians are the warm-weather states of Florida, California, Arizona and Texas ... Phil Wood, a Naples, Florida-based realtor observed: 'I've just seen a little more (buying) urgency with Canadians over the last several months. They seem to realize that certain areas, such as southwest Florida, prices are (currently) in a firming trend. They want to buy sooner rather than later. We have (Canadian) clients who won't use the property for 10 years, but want to lock in at current price levels. Canadians are ripe for the market. The Canadian economy is good, the currency exchange rate is good, mortgage rates are good and American prices are good."

CLOSING LEVELS FOR FRIDAY, January 4th		WEEKLY CHANGE
Dow Jones Industrial Average	13,435.21	+ 497.10 points
Spot Gold Bullion (February)	$1,648.90 (U.S.)	– $7.00 per oz.
S&P / TSX Composite	12, 540.81	+ 224.69 points
10 - Year U.S. Treasury Yield	1.90%	+ 20 basis points
Canadian Dollar	101.31 cents (U.S.)	+ 0.96 cent
U.S. Dollar Index Future (Spot Price)	80.501 cents	+ 0.879 cent
WTI Crude Oil (February)	$93.09 (U.S.)	+ $2.29 per barrel

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