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#### Industry News

The Wire Index rode an upward trend this past month, recording a six month high of 58.2 on the 17th. The Index benefited from the broader market rally, as well as rising copper prices. As copper prices climb from their winter lows, wire and cable manufacturers and distributors enjoy appreciating inventory values, mitigating the threat of accounting write-downs from copper's previous tumble and helping profitability and stock prices in the near term. The Wire Index closed at 58.0 on the 24th of May, up more than 78% from the cycle's bottom in November, a turning point noted the following month in December's newsletter.

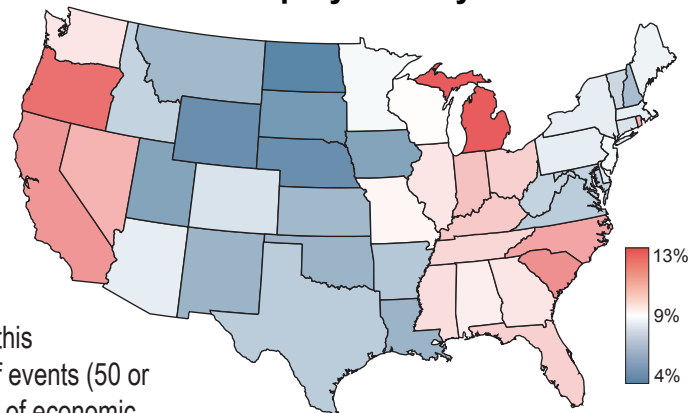
#### US Economy

The economy continues to show more positive signs, but the collective stream of economic data implies mostly a decelerating decline and not yet a complete reversal. The bounce in commodities and stabilization of price indices show that a deflationary spiral has not taken hold, and durable goods manufacturers reported the first increase in new orders since last summer, but monthly retail sales and housing starts fell back from their increases in the first months of this year. The overall more positive economic reports still suggest that the recession will see its official end sometime this summer.

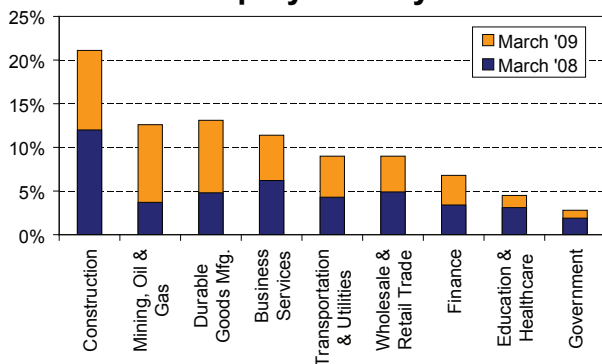
Employment, arguably the broadest indicator of economic progress, remains depressed and is likely to continue its decline throughout the rest of this year. Unemployment is a lagging indicator, in that it reacts slowly during a recession and often lingers well after the cyclical bottom is reached. Although businesses generally consider their workforce to be a variable cost given the US' relatively flexible labor laws, the dynamics of training, severance, workforce morale and emotional attachment make employment the least variable of variable costs. For this reason, businesses tend to shed workers only after the recession has made an irreversible impact on revenue streams, and wait to hire until market activity makes a sustained comeback. Confirming this trend, the Bureau of Labor Statistics reported a record high count of mass layoff events (50 or more layoffs at a single employer) during the month of March, even as the pace of economic decline became notably softer.

As shown in the graphics, the pain of the recession has been felt unequally across both geographies and industries. The map above reveals that the recession remains very regional in the US. Most of the more manufacturing-intensive Midwest and Southern states bear above average unemployment rates, with the troubled automotive industry pushing Michigan's unemployment rates to the highest in the country at 12.6%. The Western United States has not fared much better, with higher unemployment in Nevada and along the Pacific coast – areas particularly hard hit by housing foreclosures and an idle construction industry. At the same time, the Central Plains region and New England are relatively well, with unemployment rates below the country's 8.5% average. Breaking out unemployment by business sector also tells of a disproportionate recession. The construction industry had already shed many jobs by this time last year, but still had the highest change in unemployment during the

#### US Unemployment by State



#### US Unemployment by Sector



last twelve months. The mining and resource extraction sector maintained relatively low unemployment a year ago as the commodity boom led producers to increase output, but shed jobs rapidly as demand for raw materials and prices fell back. The manufacturing sector also had below average unemployment a year ago and has since developed one of the worst employment situations. Conversely, workers in education, healthcare and government, typically less flexible labor forces, remain relatively unphased by job losses.

Entering the 17th month of the recession with unemployment still on the rise, it is clear that this is the worst recession since the 1930's, both in severity and length. The Great Depression, however, which peaked unemployment at 25%, still presented a much more dreadful state than we have today or are likely to see anytime soon.

#### Copper

Since falling quickly to a low of \$1.25/lb last December, copper futures have climbed steadily upwards this year, holding above \$2.00 for most of the last month. This sustained bounce in copper values suggests that investors became overly pessimistic in the hysteria of late last year, pushing futures below levels justified by actual supply and demand forces.

Pricing for refined copper remains a global phenomenon. Continued consumption in China, the world's largest copper buyer, recently halved

BY THE  
NUMBERS  
(US)

**Industrial  
Production**  
(Feb to Mar change)

**-1.5%**

**March  
Unemployment**

**8.5%**

**Retail Sales**  
(Feb to Mar change)

**-1.1%**

**Mfg.'s New Orders  
for Durable Goods**  
(Jan to Feb change)

**+3.5%**

**March  
CPI Inflation**  
(over prev. 12 months)

**-0.4%**

the stockpiles at the Shanghai Futures Exchange. Altogether, this created a global inventory decline of almost 12%, the largest single month decline in more than a year. As inventories remain under pressure, we can expect prices to at least hold on to their gains for the immediate future. Comex copper closed at \$2.07/lb on the 24th of this month, up 44% from the beginning of this year.

### Emissions Regulation

Various emissions regulation programs are already in effect around the world and their prevalence is sure to grow

throughout the coming decade. The European Union began to phase in a cap and trade scheme limiting carbon dioxide emissions in 2005 following the Kyoto Protocol. The United States implemented a small-scale cap and trade program as part of the 1990 Clean Air Act, successfully curbing acid rain-causing emissions from 110 power plants.

The current administration is actively pursuing cap and trade legislation on carbon dioxide emissions in the US, and included funding from the sale of emission permits in outlays for the federal budget proposal. Although there is nothing about emissions regulation that will disproportionately affect the wire and cable industry, given some of the energy-intensive manufacturing processes involved in drawing, stranding and extruding wire, the evolution of emissions regulation is sure to affect this industry along with the next.

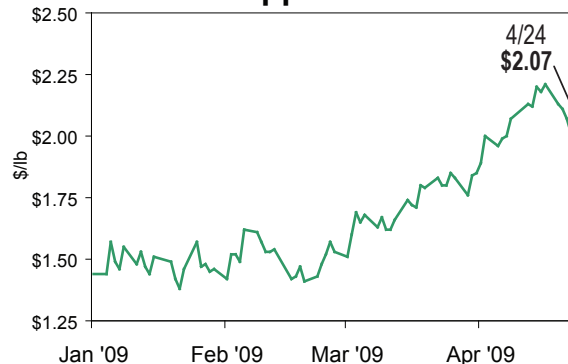
Surely, some of you reading this article are skeptical about the mere existence of global warming and the necessity of emissions regulation. As you might guess from my credentials, I am far from qualified to debate such scientific details. Political contention on the issue notwithstanding, there seems to be a growing popular and scientific consensus confirming the relationship between carbon emissions and environmental damage, making some method of increased emissions regulation a near certain part of our future.

Air pollutants are a classic example of a negative externality, a process creating a cost for external parties which is not internalized into the cost of the root transaction. Burning fuel in my car, for example, emits 20 pounds of CO<sub>2</sub> per gallon, each pound of which creates an environmental cost of, say, 5 cents. Where I only paid \$2.00/gallon at the pump for my fuel and a little bit of wear and tear on my car, including my environmental damage, the true cost of my driving is \$1.00/gallon more than what I actually had to pay. This results in me driving more than I might otherwise choose to if I was forced to internalize my environmental costs and pay \$3.00 for each gallon of gasoline I burn. Because externalities like this impose communal costs that no individual naturally bears financial responsibility for, the suspect transaction will occur more than what is socially optimal.

The current trend in emissions regulation has most governments pursuing some sort of cap and trade system, whereby regulators impose a limit on the permissible emissions within a certain region or industry below what participants would naturally emit. Polluters then buy and sell allowances for their emissions, driving up the costs of emitting and rewarding the most efficient participants, while still allowing emissions where it is most profitable and beneficial to do so. Although such a system can be an effective means for reducing emissions, the devil is in the details of execution. Having the government handout free emission allowances prior to the regulation, as was done in the EU, only invites *quid pro quo* politics. Monitoring emissions compliance against traded permits could also require an excessive amount of administrative work. Most importantly, by fixing the supply of allowable emissions and letting market prices for carbon permits fluctuate widely as they have in the EU system, businesses and consumers are unable to predict future emission costs with much certainty. "Green" investments, then, become a gamble, and their attractiveness oscillates with the price of carbon permits, like Prius sales with gas prices. A more effective approach, both in transparency and consistency, is a carbon tax. By fixing a clear, internalized price for carbon emissions, and possibly a schedule for increasing the tax, environmental investments become consistently viable. The word "tax" makes this type of program politically difficult, but such a program can become revenue neutral by reducing corporate and income taxes by a similar degree. This would weaken the disincentivizing tax on production and employment and shift some of the burden to polluting parties. A carbon tax would also increase the long term viability of renewable energy production like wind and solar projects, independent of the government's fickle and market-distorting subsidies for the industry. Curbing emissions may not be a welcome change, and will never be free, but we can still pursue the method that minimizes the cost to businesses and consumers.

**"This too shall pass." -King Solomon**

### Comex Copper Year-to-Date



Sincerely,

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