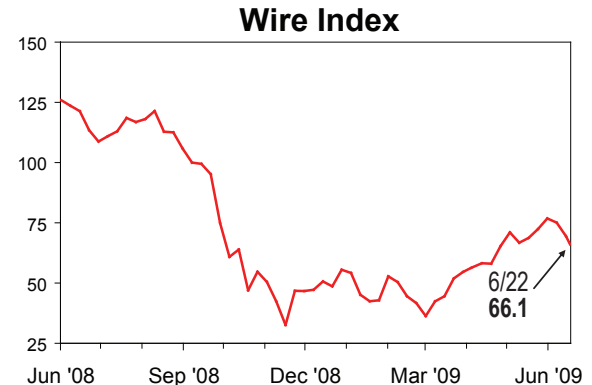




Dear Friends of IEWC, here is my account:

Industry News

After recording three weeks of solid gains, the Wire Index fell back during the last couple weeks, closing at 66.1 on the 22nd of this month. This is just below the 68.7 recorded at this time last month. The index continues to find support from the broader market rally as well as rising copper prices – a short-term financial boost for an industry with significant inventory exposure to the volatile metal. The Wire Index tracks the market value-weighted stock performance of six publicly traded wire and cable manufacturers and distributors. Click on the graph to the right for a list of these companies and historical data on the Wire Index.



US Economy

Thoroughly battered and bruised, the US economy now shows increasing signs of stabilization. Though operating well below 2007 levels, the pace of decline in the manufacturing sector has slowed considerably. Tallying up the damage, monthly shipments of US manufactured durable goods are at 80% of pre-recession levels. The Fed's Industrial Production Index reveals a similar decline with durable goods production at 77% of December 2007 levels. Employment in the sector stands at 84% of prior staffing levels suggesting that many companies have not yet made the necessary reduction in workforce. The Conference Board's Leading Economic Index turned decidedly positive in the previous two months, signaling an improvement in economic activity in the near future. Manufacturers' inventories are also headed in the right direction, declining 5% since the end of last year. Though this inventory reduction is painful for the many suppliers waiting idle for new orders, the adjustment is a necessary condition for economic recovery. Not until inventory/sales ratios are back down to pre-recession levels can a sustainable increase in manufacturing activity take hold. Even the housing market has leveled off with housing starts and existing home sales largely unchanged in the past six months. Barring another unseen financial panic, I remain confident that in a couple of quarters we will look back at this summer as the official end of the recession.

Public Debt

A nation's debt, both to its own citizens and to its foreign creditors, is not inherently a problem. In good times and bad, virtually every industrialized country in the world carries some level of public debt. The problem that does creep up on occasion is the size of a nation's debt, but even that is a relative measure. Recent IMF estimates project US debt at 87% of GDP through the course of 2009 – higher than Germany's 79% and the UK's 65%, but still significantly lower than Japan's projected 217% burden. As shown in the graph below, while the US national debt climbs almost endlessly in nominal terms, measured as a percentage of the country's annual output, the level of debt is still less than the cumulative amount at the end of World War II.

The recent surge in debt is not unusual given the severity of the current recession, as rising unemployment increases demands for jobless benefits and stimulus spending against a shrinking tax base, forcing increased borrowing. The timing of the surge, however, is problematic. For starters, it's not World War II. The US spends a whopping 4.6% of GDP on its military, but this defense spending and the other programs sapping the budget are more structural and less temporary than previous wartime budgets. Even more, the rush of government borrowing comes on the cusp of significantly increased entitlement healthcare spending with the retirement and aging of the baby-boomers. The same IMF study forecasts a climb in US public debt to more than 106% of GDP in another five years, largely as a result of increased entitlement spending.



To get out of debt, governments generally have three options. They can apply fiscal controls with higher taxes and less spending, allow higher inflation, or default on previous bond issues. The first option is the most responsible, but also the most difficult. Higher inflation slowly erodes the real value of outstanding loans, and acts as a discrete tax on holders of a nation's currency to reduce the public burden. Quite devastatingly, governments can also choose to default on its debt, refusing payment to existing lenders and therefore reducing the amount owed.

As the national debt grows in size, a couple of problems emerge. The larger the outstanding bill, the more difficult it becomes for a government to borrow additional sums in its bond issues. Understanding a government's limited options for getting out of debt and the political challenge of responsible fiscal adjustments, investors begin to expect some combination of default and inflation as treasury debts increase. With these heightened risks for the future, investors demand a higher interest rate on their loans to the treasury to compensate, which increases the treasury's cost of borrowing. This pain is not limited to the treasury, however, but crowds out private investment as well. As the government pays increasingly attractive interest rates to its investors, businesses are also forced to pay more in interest in order to compete with the

BY THE
NUMBERS
(US)

**Industrial
Production**
(Apr to May change)

-1.1%

**May
Unemployment**

9.4%

Retail Sales
(Apr to May change)

+0.5%

**Mfg.'s New Orders
for Durable Goods**
(Mar to Apr change)

+1.7%

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

-1.3%

treasury's higher-yield offerings. These increased financing costs make business operations more expensive and curb investment, ultimately detracting from economic growth.

Given the rising mismatch between government revenues and outlays, and the problems associated with it, governments around the world will eventually need to change their approach. In the euro area, the unified currency and the inflation-hawk European Central Bank make inflation an unlikely option. While some of the EU's weaker members will and are facing pressure on their credit ratings, default still remains unlikely. The most probable outcome is some measure of fiscal control, and with tax rates already relatively high throughout much of Europe, the debt issue may force some needed spending and entitlement reform. For the US, Japan, Canada, the UK and the world's other most advanced, debt-ridden economies, the risk of default is essentially nil. The US treasury, for example, has the unique ability to tax the world's largest economy. As politically unpopular as it would be to raise taxes, the government does reserve the right; and the country's generally law-abiding citizens assure that such an increase would generate higher tax revenues to meet the nation's dues. Just having this capability at its disposal ensures that the US will continue to fund its debt and turnover its bonds without any threats to its creditworthiness. With the possibility of default mostly off the table, the future brings an uncertain mix of higher taxes, less spending and inflation. Expect a policy shift towards one or more of these once more normal economic growth resumes.

Cash for Clunkers

Buried in the supplemental war funding bill headed to the White House for signature is a spending provision nicknamed "Cash for Clunkers." Leaving the details up to your own research, the program essentially provides a cash benefit ranging from \$3,500 to \$4,500 for US residents to trade in actively used vehicles with low mileage ratings for a new vehicle with sufficiently higher MPG. The bill is similar to the various scrappage schemes that proved popular in Europe and Canada over the past year.

The US program and its European cousins have and will give a short-term boost to auto sales, but the economic rationale for the scheme is rotten. It is no secret that this direct subsidy for the auto industry is supported by the many struggling auto manufacturers, dealers and parts suppliers around the US; but the benefits of the program end there. As I wrote in this past [February's edition](#) of the *Hot Wire*[™], replacement rates for autos (current stock / annual production) in the US have almost doubled from their historical average in the past two years, climbing to an unsustainable high of 25 years. This program should speed up the return to a more normal 13-15 year auto replacement rate, but the demand created by the program will be artificial and wasteful. To get the cash benefit, consumers will trade in an otherwise road-worthy vehicle to be scrapped. Since the taxes used to fund the program might have just as well come straight from the pocket of the consumer making the deal, the net trade is the hastened destruction of a vehicle valued up to \$4,500 in exchange for the incentive to purchase a new vehicle with slighter better MPG. Even the most expensive carbon offsets put the environmental savings of the typical driver's switch from a 15 to 35 MPG vehicle at less than \$120/year, making any such trade-in a serious destruction of wealth. Why not have the government give us all a check to remodel our perfectly fine kitchens? Why not dole out cash incentives to replace your two-year-old laptop? If Home Depot or Dell had a better lobby, these might have made it in the bill too.

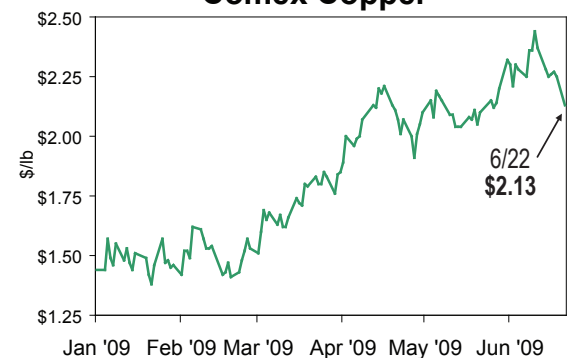
Populist economics are at play. This crutch to the automotive industry will only delay the reorganizations that need to take place. Enjoy the benefit of your increased automotive wire sales, but remember that there's no such thing as a free lunch.

Copper

Copper futures prices marched steadily upwards this past month towards an eight-month high of \$2.44/lb on June 11th, before settling back to close at \$2.13 on the 22nd. The run up in pricing largely revolves around the buying and consumption patterns of China, the world's largest consumer of copper. In a recent report from China's General Administration of Customs, copper imports recorded their fourth monthly increase in May to a record high of 337,230 tonnes, more than 2.5 times the level recorded in May of 2008. Copper prices will remain volatile as the world stabilizes and begins to recover from the recession, but the price strength during the first half of this year suggests that the long-term price for copper may be well above the \$1.25/lb low found at the end of last year.

The *Hot Wire*[™] is free! Email me to sign up.

Comex Copper



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