



Dear Friends of IEWC, here is my account:

Industry News

Like the rest of the markets, the Wire Index fell slightly this month, closing at 113.0 on the 18th. The Index is down 8% since the end of last year. [Click here](#) for more information and historical data on the Wire Index.

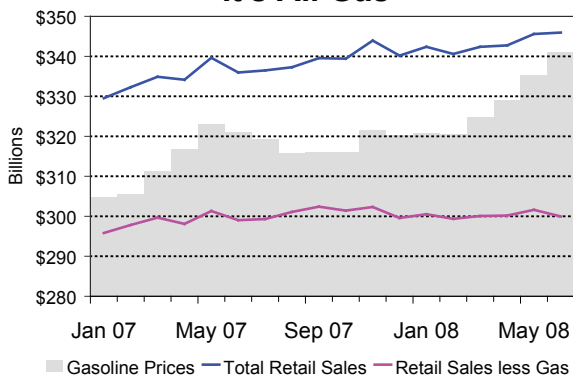
The wire and cable industry is facing a relentless stream of price increases. Just as copper prices held fairly flat over the past six months, costs for just about everything else used in manufacturing and transporting wire and cable products are on the rise. Manufacturers cite double digit cost increases for PCV resins, plasticizers, polypropylene, polyethylene, Neoprene, silver, aluminum, tin, packaging, transportation and energy. With most of these cost increases rooted in the rapid climb in oil prices, manufacturers continue to play catch-up as they struggle to deal with their own supply chain cost issues.

General Cable continued its foray into international markets late last month, acquiring a majority position in its Philippine joint venture, Phelps Dodge Philippines, Inc., a partly-held subsidiary of Phelps Dodge International Corp., which General Cable acquired in the fourth quarter of 2007. General Cable increased its stake from 40% to 60%, purchasing the shares from its joint venture partner, Anscor, a Philippine holding company. [Read the online press release here.](#)

US Economy

Times have been better for the US economy. While I still believe that the probability of an official recession is less than 50%, a soft market is evident. One of the most discouraging statistics from these troubled times is the employment numbers, which have shown six straight months of declining payrolls and an unemployment rate increasing one percentage point in the last 13 months. Pessimists are quick to point out that the economy has never survived six straight months of job loss without a recession, but I (an optimist) would direct your attention to the rate at which payrolls have declined. During the previous four recessions payrolls have decreased at an average monthly rate of -.13%, -.18%, -.13% and -.16% respectively, while the current decline amounts to an average of only -.05% per month. Any loss of jobs is a bad sign, but the current trend leaves ample room for hope.

It's All Gas



As businesses usually make hiring and firing decisions in reaction to the current economic situation, employment is a lagging indicator. Some of the more current and forward looking indicators are showing rays of light. The Purchasing Managers Index, a timely, qualitative survey of purchasing managers around the country rose to 50.2 in June, signaling expansion for the first time in four months. Although still down year-to-date, Industrial Production is holding strong and trending up as of June's reading. Also, the housing market seems to be hitting something of a floor, with housing starts holding close to 1,000,000 units annually for the last seven months and existing home sales steady around 5,000,000 units annually. The worst may already be behind us.

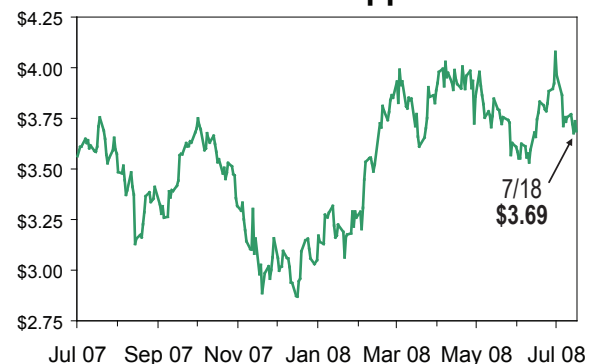
As I have argued [before](#), the external effects of the problems in the housing and financial sectors remain fairly muted. Fannie, Freddie and other financial institutions are in obvious trouble, but the idea that increased foreclosures and mortgage-related stress would take a bite out of consumer spending simply has not panned out. Higher gas prices, on the other hand, are taking a toll on consumers' buying power. As shown in the graph above, total retail sales have continued to climb close to trend since the housing market really went south in the third quarter of last year. Removing sales at gas stations (mostly fuel, but including beef jerky and potato chips), retail sales are flat since the end of last year. This squeeze on discretionary income is real, but the long-term effects are minimal. The market is forcing conservation, and consumer habits are changing. When gas prices finally plateau or turn around (they will), consumers will once again be able to expand their purchases beyond the pump. You may find yourself in a smaller car or house, but in the long-term, the economy – and the environment – will be all the better for it.

Copper

Copper seems to have found a comfortable place between \$3.50 and \$4.00, trading mostly within these bounds since copper prices escalated at the beginning of this year. Prices seem to be restrained by concerns that the broader economic slowdown is hurting demand, though the continually weakened dollar keeps the dollar-denominated price of the metal from falling much either. As soon as one of these pressures gives way, copper is likely to move in the corresponding direction.

COMEX copper closed at \$3.69/lb on the 18th, with world copper inventories up more than 6% from this time last month.

COMEX Copper



Conference Board
Leading Index
(May to June change)

-0.1%

June
Unemployment

5.5%

Retail Sales
(May to June change)

+0.1%

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

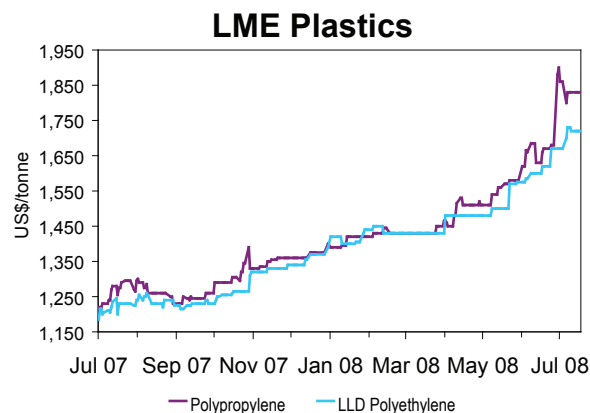
+0.0%

June
CPI Inflation
(over prev. 12 months)

+5.0%

Polymers

It is difficult to trace the exact price that wire and cable manufacturers pay for the variety of polymer compounds used in the manufacturing process, but the London Metal Exchange (LME) offers a good general view of polymer prices through its futures market for polypropylene and linear low-density polyethylene contracts. As shown in the graph to the right, prices on these contracts have risen significantly throughout the last three months, with polypropylene and LLD polyethylene prices up more than 31% and 21% respectively, since the beginning of this year. As mentioned above, these higher prices are causing quite a disruption in product prices within the industry. With a close tie to the run-up in crude oil and natural gas prices, don't expect the current trend to reverse until these input resources turn first.



Oil Speculation

The US Congress has introduced a number of bills this year aimed at curbing oil speculation, with one titled the *Energy Markets Emergency Act of 2008* passing the House by a vote of 402-19. The bill is still far from law, but the message concerns me. The current spike in oil prices may seem like an emergency, and the economic frustrations they cause are painful, but these bills are only misguided efforts to find a scapegoat for high oil prices.

The speculation targeted in this legislation occurs in the futures markets. Futures markets are a forum for creating and exchanging futures contracts – agreements to buy and sell specific quantities of a commodity at a specified time and price. On the NYMEX, for example, traders can enter into contracts to exchange 1,000 barrels of crude oil as far off as December of 2016. The price specified on this contract as of the 18th is \$129.04/bbl. Traders enter into these contracts taking a long or short position, committing to buy or sell, respectively, oil at that price during that month. If oil prices end up higher than \$129 in Dec. '16, the long position earns a profit (and the short position takes a loss); vice-versa if oil prices fall. These contracts are important tools used by a variety of industries to hedge against price changes. An oil company can guarantee today's prices on next year's product by taking a short position on a 2009 contract, and an airline can hedge against higher fuel costs with a long position. A speculator is simply someone trading in the market without any vested interest in the physical commodity, trading only to make a profit on price changes and settling contracts in cash instead of taking delivery of the commodity.

As the above example suggests, futures contracts are a zero-sum game. For every speculator making a killing on the current spike in oil, someone else loses his shirt. In theory, this trading has no effect on the actual (spot) price paid for a barrel of oil. The relationship is often likened to gamblers at a sporting event; bets can do nothing to change the actual outcome of the match. If futures trading occurred in secret, I would agree, but futures market activity is widely publicized and sends a constant signal to the physical commodity markets. Carrying the analogy further, a boxer who discovers 10-1 odds against him may begin to wonder if everyone else knows something he doesn't, entering the ring without the confidence needed to win. In the same way, futures markets can encourage traders to buy or sell a commodity based on expectations of future supply and demand balances.

That said, any effect that futures markets have on commodity prices can only be temporary. When all is said and done, today's oil consumers are still willingly paying \$120+ for a barrel of oil. If futures markets drove oil prices to unjustified heights, consumers would cut back, producers would pump more, and we would quickly find ourselves in pools of excess oil (which would, of course, drive the price back down). Oil prices might seem "unjustified" in the short-term, but only because supply and demand are severely inelastic, in that they react very slowly to changes in price. As gas prices climb, it takes years for drivers to make a significant shift from SUVs to smaller vehicles and it requires a decade or more to discover and develop new oil wells for production.

With supply and demand so inelastic in the short-term, the markets are vulnerable to swift price changes rooted in speculation. Restricting futures trading, however, will only increase the long-term price of oil and other commodities. Speculators provide much needed liquidity to futures markets, creating willing participants on the other end of contracts created by businesses looking to create a legitimate hedge. Limiting this flexibility will increase the risk that producers and consumer seek to mitigate, effectively increasing their cost of doing business. Futures markets may be sending the signal a little louder than consumers would prefer to hear, but that doesn't mean that we should stop listening.

Sincerely,

Brian Hirt
M.A. Economics
IEWC Business Analyst
BHirt@iewc.com
262-957-1118

