



L. R. Levin Consulting, L.L.C.

Newsletter

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Will Growing Unemployment Negatively Affect When We Hit Bottom & The Recovery?

It is true that unemployment is a lagging indicator because businesses do not normally begin rehiring until they are sure that a recovery and increased demand is well on its way. This generally can take 12 to 18 months after a real recovery begins. That is one reason that soft indicators like the confidence indices are important. They can shed light on whether business will behave as if a real recovery is under way.

There is evidence that in this downturn, business began to slow layoffs and even began to do some limited hiring in the belief that we were hitting bottom and a recovery was imminent in the last half of the year. More recent economic data and government actions have apparently, however, negatively impacted business behavior.

It is also true that when unemployment reaches a certain level and a downturn lasts over a longer period of time, that it begins to push out the time until a bottom is actually reached and retards the strength of the recovery. People generally have resources that can carry them through a 12 to 18 month recession. As the time extends these resources are exhausted and buying power erodes.

It is because of the length of this downturn, coupled with the breadth and level of unemployment, that the recent figures have been so disconcerting. In June we reached 9.5% unemployment (14.7 million people). This only tells part of the story. The real

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level of unemployment is much higher. When you add the people who have not found jobs over the last 12 months and are not counted in the unemployed, the number of unemployed reached 21 million people in June!

June's job losses were widespread across all of the major industry sectors, with large declines occurring in manufacturing, professional and business services, and construction. Reflecting the approach to GM's and Chrysler's restructuring, automobile dealerships shed more than 9,000 jobs in June alone. The average workweek for production workers fell to the lowest level since we began keeping data in 1964 (45 years ago).

Taking the buying power of 21 million people out of the economy creates a meaningful down draft that is not easily counteracted. It is even more worrisome when you add to this factor; in June, 9 million people seeking full time employment were forced to accept part time work. To avoid this kind of impact is one reason economists believe real "stimulus" not "spending" needs to be applied early, when there is a serious dislocation in the economy such as caused this downturn.

Unemployment Is Now a Worldwide Problem.

China has 23 million unemployed in spite of major spending programs. In June, the 16 countries of Euro Zone hit 9.5% unemployment, the highest in 10 years. Euro Zone unemployment is now over 15 million people. Asian unemployment is running at a 5½ year high.

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Recent Cartoon FRANK & ERNEST



Will China's Aggressive Monetary Policy Hurt The U.S. Economy?

China has taken its campaign against the U. S. position in world trade to the next level. Its efforts with the International Monetary Fund are a case in point. Why does an obscure mechanism like "Special Drawing Rights" matter?

International trade is normally conducted using the 4 major international reserve currencies, the U.S. dollar, the Japanese yen, the European euro, and the British pound sterling. Thus, if India or Japan wants to buy oil from Iran they do so using one of the 4 major international reserve currencies which everyone recognizes. This means that the central banks of each nation keep a reserve of one or more of the major international reserve currencies

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to participate in international trade. Since World War II, the U.S. has had the most stable international currency and the largest volume of international trade. Today, most international trade is done in U.S. dollars with central banks around the world holding far more dollars and dollar denominated securities than any other individual foreign currency.

This has had an important role in several respects in stabilizing the U.S. economy. Even though we are a net importer, the foreign need for U.S. dollars keeps a great deal of those dollars at work off shore promoting world trade among other countries. This helps to reduce inflationary pressures here at home (less U.S. dollars circulating within the U.S.). Also the need for central banks and large foreign holders of U.S. dollars to put them to work, earning a return while they are holding them for trade, creates a demand for U.S. securities including government obligations such as treasury notes and long term bonds.

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This foreign demand helps to keep interest rates on U.S. government obligations low. Low inflationary pressures and interest rates today help to stimulate our economy.

So what does this have to do with “Special Drawing Rights” and China? The International Monetary Fund (“IMF”) in 1969 created the monetary medium called “Special Drawing Rights” (“SDR”) used primarily today by the IMF to account for transactions with member states. The value of SDRs is determined by the weighted average of the 4 major international reserve currencies. Until now SDR have never gained traction as a standalone international reserve currency.

China wants to change that, but with an important twist. China has urged that SDRs be changed to include the Chinese yuan as the fifth component currency. Under China’s proposal each of the 5 currencies, including the yuan, would have a 20% weighting in determining the value of SDRs. This would elevate the yuan to the level of the U.S. dollar, the Japanese yen, the European euro, and the British pound sterling as a major international reserve currency.

With the yuan as a major international reserve currency and the position of SDRs elevated, China would no longer need to hold as many dollars or treasury obligations. Moreover, China’s central bank in its just released annual report has called for the IMF to manage a part of its member’s reserves. Thus, instead of holding reserves in U.S. dollars, the Japanese yen, the European euro, and the British pound sterling, the central banks would hold SDR which could be used as a medium of international trade instead of a major international reserve currency.

These moves would materially reduce China and others need and demand for U.S. dollars creating an oversupply abroad. China’s call for a new global reserve currency has caused during the last few weeks, according to analysts, increased pressure on the U.S. dollar, causing it to fall in

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international trading.

Without objection from the U.S. the IMF has agreed to issues SDR denominated 5 year notes as a step toward creating a synthetic currency basket for world trade. In fact, large infusions of dollars into the IMF by the U.S. are now aiding this process. The next review of what reserve currencies will compose SDRs is in 2010. Should the U.S. need to increase it borrowing rate from 160 billion per week, experience higher interest rates, or meaningful inflation over the next 15 months, China’s actions will not prove helpful.

If the yuan were included in SDRs the size of Chinese exports would impact the valuation process. By under valuing the yuan to fuel its exports, China is increasing its bargaining position for 2010. In one example of dumping low priced goods, the U.S. International Trade Commission recently asked for punitive tariffs of 55% on Chinese tire imports. China’s current trade policy is to increase exports with cheap yuan while reducing the world market for U.S. goods and services.

Will Weakness In Real Estate Hurt the Economic Recovery?

The economy currently appears on track to bottom out by early 2010. Assuming that no major new burdens are placed on the economy, we should see a recovery begin by mid-2010.

One encouraging sign is that the low point in new home starts should be reached by September. This is important because economist believe that we need improvement in housing starts to achieve a viable broad-based recovery in 2010.

The data on single family housing starts has been stable for the last 3 months and there has been improvement in existing home sales. The fact that the data is at a 62 year low is evidence of how fragile the

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current signs are. **Multi-family housing** is still experiencing a dramatic drop. **Office Building** construction has dropped 8% since last September. This is worse than the 1983 recession, but to date better than in 2001.

Office Building Permits are down 45%, year over year, and 2/3 below the same 3 month period last year. With office employment down 1.8%, leasing is continuing to decline. The picture for **Commercial Construction** is even worse. Rapidly rising vacancy rates and lower rents continue to depress construction.

This reflects consumers cutting back across the board on their purchasing. The failure to include real broad based tax relief in the stimulus package has magnified the drop in consumer purchases. Commercial Construction is down more than 16% from last year, but not as much as in the 1990 and 1975 recessions. Again the longer than normal length of the downturn is beginning to play a role.

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Permits for new construction are 43.5% below last year, reaching the lowest level on record. Over the past three months construction permits are down 59.2%. Even after 2.7 billion in stimulus, **Educational Building Construction** permits, year over year, for the quarter are down 27%!

One major hurdle for the recovery is that, by year end, financing for billions of dollars of office, warehouse, and commercial properties will come up for reset. The criteria for refinancing these projects have changed materially from when they were constructed. Economists believe that the overwhelming majority of these projects will not qualify for reset under current criteria.

We could see a record level of defaults with a substantial number of these projects forced into distressed sales. This will depress real estate prices and dry up activity during the last half of 2009. Because the economy is still declining, the further impact of the year end reset could have a substantial negative effect on the recovery as we go into the first half of 2010.

The Wise Old Owl

When economic conditions so completely change the rules of the game, it is necessary to take a fresh new approach to how you formulate your go-to-market strategy and actions. Focused Scenario Strategic Planning workshops provides that fresh new approach for management teams.

In meeting this downturn successfully, our clients have found holding a one or two day workshop with their key management team to brainstorm the most effective ways to meet the challenges of the next 12 to 15 months made the difference in their increasing profitability.

By having us lead a highly interactive workshop with their key management team, they were able to create organization specific action steps that improved their branding, driving sales and revenues, and improving their cost structures, as well as other key initiatives.

After a careful assessment of the client's situation, we customized each workshop to the client's business and where the economy is headed for their industry segment.

[Click Here For More Information On Action Steps Workshops](#)

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