



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

Newsletter

March 2011

With All The Uncertainty, Will The Recovery Continue in 2011?

If you read the news, listen to newscasts, connect with the internet or just talk to business associates, everything seems like a mixed blessing these days. In a very real sense, it is. Almost everything that is happening has different potential short run and long run implications.

With each new headline, our clients ask us, how will the next 6 months to a year turn out given what is happening now? What is good for the next 6 months to a year, often may be bad for the long run.

Unemployment reports, petroleum prices, manufacturing, exports, retail sales, bank lending, among others all seem to indicate that the expan-

sion will continue into 2012. The economic data continues to support a recovery that will continue, but at a slowing pace.

The concerns are the dual impact of how things are developing. Often the impact of recent economic trends will help fuel the recovery in the short run, but accelerate a trend that will hurt the economy in the long run.

For example, the M2 money supply is up 4.3% from one year ago, as the Fed continues to inject dollars into the economy. For now, this will help retail sales and encourage banks to increase lending. All of this will help manufacturing. By the same token, our GDP has not grown fast enough to support this level of M2 increases.

By mid 2013, the impact of this trend will be increasing inflation and investment dollars driven overseas. So what is helpful in the short run may be very harmful in the long run,

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803 Sheridan Road, Glencoe IL 60022 ■ (847) 242-1000 ■ Web: www.LRLevin.com ■ LLevin@LRLevin.com

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given how other factors are developing in the economy. Exports are up, but the cost of oil has driven up the trade deficit to new highs.

As we will discuss in more detail later in this **Newsletter**, petroleum and gasoline prices are an example of a negative whose major impact could come in the long run. If the unusual spike in gasoline prices caused by the Libyan crisis don't go too much higher and don't last more than the next quarter or so, that alone will not stop the recovery in 2011.

The Japanese disaster may do more to change the outcome of 2011. Japan may not be able to continue buying U. S. treasuries to fund our debt. Japan's need to rebuild at home could disrupt trade patterns. Cutting spending and reducing the deficit is even more critical now with debt sales to Japan in question. It is too early to tell what effect Japan will have.

Even if rising petroleum and gasoline prices don't do excessive short term damage, in the long run, they will contribute significantly to long run inflation and reduced liquidity in the economy.

The Fed's maintaining historically low interest rates is another factor that should help maintain the recovery in 2011. However, these low interest rates, under existing conditions, will cause dislocations in the free market system and contribute to higher inflation in the years to come. Again, a mixed blessing.

Increasing manufacturing, exports, and historically low interest rates should help offset the stalling housing market and the slow growth of private sector jobs during 2011. *What would you do differently now depending on how the outcome in 2012 and 2013 is affected by these factors?*

These trends mean that 2011 represents excellent opportunities for profit to those who can stay ahead of developing trends in their sector of the economy. Your business plans should factor in rapidly changing emerging trends in markets to maintain a perspective that is forward looking and realistic. You need to adjust quickly as trends migrate.

Only by preparing strategic action steps in advance for each contin-

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agency that may develop as the year progresses and recognizing what may follow, can your business take maximum advantage of opportunities in these uncertain times.

Will The Libyan Gasoline Price Spike Derail The Recovery?

Will the unusual spike in gasoline prices caused by the Libyan crisis go much higher, and will the elevated level last more than the next quarter or so? *Why is this a critical component of the economic cycle?*

The U. S. consumes approximately 140 billion gallons of gasoline each year. We represent about 27% of the world's usage of gasoline. The price of gasoline and diesel fuel can have a profound effect on the economy. As the cost of fuel rises so does the cost of distributing product throughout the U. S..

There is a direct correlation between the cost of gasoline and con-

sumer's disposable income. In January 2008, as the recession approached, the price of regular gasoline was \$3.11 a gallon. By January 2009 the price had fallen by \$1.37 a gallon, which over the course of the year equated to a tax reduction helping the economy move toward recovery.

Today we face the reverse problem. Gasoline prices have been rising, taking liquidity out of the economy. Compared to January of this year, Mid-East unrest is taking approximately \$167 million dollars a day of liquidity out of the economy. That is more than \$61 billion dollars a year if this continues.

This alone would not derail the recovery this year, especially if the price disruption did not last more than a couple of months. It is when we compare where we are today to gasoline prices in early 2010 that we see the real impact.

The spike up in prices due to inflation and Mid-East unrest, combined, are taking approximately \$300 million dollars a day worth of buying power out of the economy. Annually that represents more than \$116 billion

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dollars a year in reduced purchasing power.

Should gasoline prices remain at this elevated level for a sustained period, it will have a decidedly slowing effect on the recovery.

There has been talk of releasing oil from the national emergency reserve. We only have slightly more than a month's supply in the national reserve. Given the situation in the Middle East, one could see a scenario where instability in numerous countries, including Saudi Arabia, could spin out of control and actually cut off much of our basic supply of oil from that region.

If that were to happen, our national defense would require every drop of oil in the national reserve. To use the reserve now, when there is plenty of oil available from Saudi Arabia and others, would be premature and foolish.

What should the government do in response to the petroleum supply problems we now face? We need a rational long term energy policy approach. The U.S. and Canada have substantial available oil reserves to

handle the next 100 years if we once more begin exploring and use them wisely.

This would permit a long term, phased development of alternative energy sources. Electric cars and trucks are not, in the foreseeable future, feasible alternatives. For one thing, it takes far too much petroleum, natural gas, wind mills, and solar panels to produce the electricity that electric cars and trucks would consume.

If the government wanted, and could afford to invest, it should underwrite the conversion of long haul trucking to natural gas from diesel fuel. We have ample low cost natural gas reserves. This would dramatically reduce oil imports. Even without government subsidies, the government could promote private sector development of this approach.

Opening up oil drilling would also bring down petroleum prices and with them, gasoline prices, with an immediate benefit to the recovery. We need to explore all clean power alternatives including clean coal alternatives and modern nuclear power

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plants to improve and lower the cost of electric generation. We cannot restore jobs and promote manufacturing without paying real attention to our power industry.

Provided the government acts responsibly, the recovery should survive the Middle East crisis and temporarily elevated gasoline prices.

Is Unemployment Getting Better?

When my son was serving in Operation Iraqi Freedom there was a saying that if the Defense Department called, good news would be “the soldier was only wounded, but thankfully not dead. The February unemployment report seems to fit in that category.

The report showed the number of people losing their jobs fell to 1.1 million since November, the largest three-month decline since 1967. That doesn't mean that the 24.7 million unemployed can or will get jobs in the next few years.

With approximately 2/3 of the industries measured adding jobs in

February, 222,000 jobs were added. This is the most industries to show a gain in 13 years. The breadth of the industries increasing employment is indeed good news.

But, if we look at the past 12 months, the private sector has only added an average of 106,000 jobs a month. The average factory work week is only 40.5 hours with average overtime of 3.3 hours. The economy needs to create 350,000 new private sector jobs a month to return to a “normal” employment level in the next 5 years.

In February, 43.8% of unemployed had been out of work for 27 weeks or more. The reduced unemployment rate came from people who had been unemployed so long that they were no longer even counted. Such high levels of chronic unemployment meaningfully reduces economic liquidity and buying power.

If this rate and level of chronic unemployment persists into 2012, we will experience economic disconnects that will have a very negative effect on the future economic cycle.

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Recent Cartoon

**The economy is going to be Sunny,
Bright, and Beautiful**

**The economy is going to be Rainy,
Snowy, Hailing.**



THE WISE OLD OWL

As the current economic cycle progresses, many sectors of the economy are becoming increasingly unstable. The falling value of the dollar and rising taxes and fees at the national, state, and local level are making it increasingly advantageous to move investment out of the U. S. to other markets. The international trade deficit is growing rapidly, lead by higher oil and raw material prices. Food costs are rising dramatically with the staples used in many products, such as corn up 88%, wheat up 76% and soybeans up 37%. Since a 1% change in food costs takes about \$12 billion dollars of liquidity out of the economy, it is clear that inflation caused by poor government planning, such as quantitative easing, will hurt employment and slow the economy.



The instability in so many sectors subjects the economy to possible rapid deterioration as 2011 progresses. 2012 may be even more challenging. You should be moving aggressively to take advantage of these disconnects and out maneuvering your competition.

Begin your strategic action plans now so you can adjust as your opportunities change. The only thing better than skating to where the puck is going to be, is controlling the play so the puck is where you want to be when you get there. Call us, we can help.

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