MACRO PULSE™
December 2010 A Delphi Advisors Publication Volume 1, No. 12

Eye of the Storm?

Before the days of Doppler radar and other tools of the meteorological trade, residents of the Atlantic seaboard and Gulf coast sometimes confused the eye of a hurricane with the storm's end. Lulled into a false sense of security by the improved conditions, they mistakenly resumed their normal activities only to find themselves exposed when the backside of the storm arrived. We view the current economic situation as the eye of the recessionary "hurricane" that began in December 2007. Improvement among some indicators (e.g., the uptick in 3Q2010 GDP to 2.5 percent, and October's increase in orders for non-durable goods) have convinced many investors that nothing but sunshine and seashells lies in their future. Worse, many economic "meteorologists" – who should know better because of the (even if crude) forecasting tools at their disposal – are sounding the "all clear" and encouraging their audiences to ignore the cloudbanks gathering on the horizon.

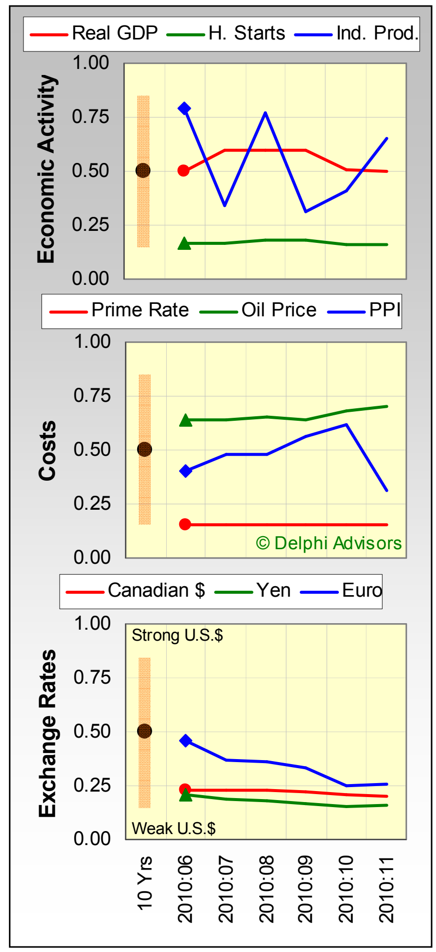

***Figure 1.* Previous six month's behavior of macroeconomic variables indexed relative to their historical 10-year min, max and average (lower and upper ends of the orange bars, and black dots, respectively)**

To what "cloudbanks" do we refer? The employment picture is perhaps the most obvious. The U.S. economy added only 39,000 non-farm jobs in November (50,000 in the private sector). Why "only?" Because the United States needs to create 100,000 jobs a month just to keep up with population growth. Further, while there was a net job gain, most of those jobs were part-time. Meanwhile, the number of persons employed *full time* fell for a sixth month, meaning that more than half of the full-time jobs gained between December 2009 and May 2010 have subsequently been lost again. Also, average work-week hours and hourly earnings have both stagnated; finally, the percentage of working-age persons who are either employed, or unemployed but looking for a job, is at its lowest level since the end of 1984.

Another troubling cloudbank is the amount of borrowing national governments will need to undertake in 2011. By some estimates, 15 countries will need to borrow a combined $10 trillion, equivalent to 27 percent of their total economic output and *twice the entire world's annual savings*. The final magnitude of the impact on interest rates from so much borrowing remains to be seen, but we think it is safe to predict the days of low interest rates are numbered; recent bond yield increases in the U.S., Germany, Japan, and the U.K. may be just the leading edge.

The Federal Reserve may attempt to stave off higher rates by monetizing some of the United States' share of that $10 trillion; but doing so risks depreciating the dollar, which could compound the recent rise in crude oil's price and dampen prospects for economic recovery. On the other hand, making no attempt to keep borrowing costs low will mean that the housing market and business investment "take it on the chin" once again, tipping the economy back into recession.

Given what we see coming over the horizon, rather than returning to business as usual, consumers and businesses should take advantage of the opportunity this temporary reprieve affords to shore up their defenses against the storm's next wave.

This report is a compilation of articles posted on our website (http://delphiadvisorsmacropulse.blogspot.com/); those articles relate recent economic developments to the U.S. forest products sector in much greater detail. They also provide context for our complete, 24-month forecast, which is contained in the *Economic Outlook* newsletter available through Forest2Market (http://www.forest2market.com/f2m/us/products/outlook). ■