Money, Macro & Markets

Although the US Non-Farm Payroll number may be not the most reliable of indicators – a cynic might say that its very arbitrariness is what makes it so valuable to the Bookies as a trade generator – a trawl through its statistical wreckage can still turn up a few nuggets of information about the state of the world's largest consumer nation.

Mostly, these are suggesting that the States have become a place where the late national holiday should be merged with that at the end of May to give us 'Labor Memorial Day' - in honour of the far too many unfortunates for whom a full-day's work has become a matter only of remembrance,

With the average duration of unemployment now at a post- WWII high of 24.9 weeks, and with 14.9 million officially unemployed, the US is currently 7.1 million man years in the hole, a figure some ~60% higher than at a previous peak in mid-1983 when the population was only 25% smaller. And that is to neglect the mass of labour-force drop-outs as well as the levels of *under*employment also being suffered, features which have taken the aggregate of hours worked 8.1% down from their from peak, the worst decline since at least 1964, while the manufacturing sector has so far shed 22% to hit a 70-year low.

More salutary still is the realisation that while the number of employed persons in the US has hit a 5-year low, the number with *full-time* jobs has fallen back to where it was in 1999 - and the ratio between the two measures has plumbed new depths in recent months. With the female representation in the labour force also recording unprecedented highs, the sociological - as well as the purely economic – stresses are well evident, as further underlined by the chart below which shows that, after a quarter of a century without any clear trend, there remains barely one man in full-time work (away from the farm) for every *four* members of the civilian, non-institutional population.

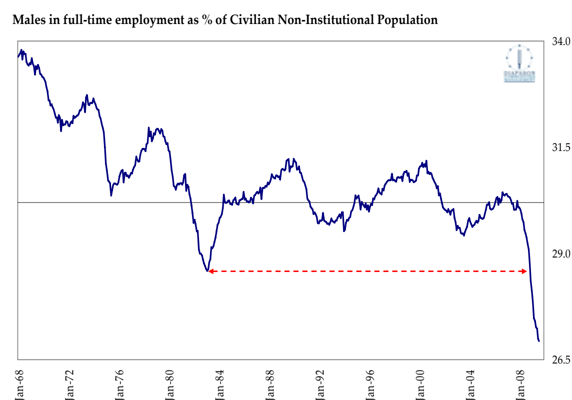

Figure 1: US Labour market: A (very) Few Good Men

And for more evidence of the jejune nature of business reporting (as well as the utter uselessness of most macromancy), headlines which trumpeted that *'UK manufacturing output rises three times as much as forecast'* sort of overlooked the fact that the aggregate has only managed to recoup some 8% of the staggering losses suffered over the prior 15 months, or that this stunning rally has moved the total up from 1973 levels – all the way to those of 1974!

Figure 2: UK MfG output. Are the miners still on strike?

Data from Germany did not even flatter to deceive – industrial production there fell, led by a second successive monthly drop in the capital goods sector. *Es gibt hier kein Wirtschaftswunder*.

Figure 3: German Capital Goods output.

Commodity Corner

On the face of it, the bursting of the bubble has radically altered the landscape for energy – possibly for the medium term. Indeed, if we look at the

experience of the second oil shock and the severe recession which followed it, we see that OECD oil consumption fell no less than 17% between 1979 and 1983 and – more strikingly still – that it was not until fifteen years later in 1994 that the former peak was again surpassed.

In fact, mid-low barrel consumption in Europe has *never* since revisited those earlier heights and while Japan did j-u-s-t manage this feat in 1994, consumption at the heavier end has fallen every year since. At the lighter end – dominated, of course, by motor gasoline –after the initial recovery, European use stagnated during the 90s and has fallen away every year since as diesel-engined road vehicles have come to predominate on the continent's roads.

Over the period of growth from 1998's real-terms low in crude oil prices to calendar 2007's peak usage, world consumption rose just over 15% (a compound annual rate of 1.6%) but to state this baldly is to disguise the key trend which was that while the OECD nations burned barely 5% more (CAR 0.5%), Non-OECD nations (less the FSU) set light to a quantity 38% greater by the end of it (CAR 3.6%).

In other words, the same trends of 'globalisation' - i.e., Western disinvestment and Eastern forced industrialisation - which have dominated the capital cycle also meant the emerging markets were responsible for ~80% of the growth in consumption (with China alone accounting for two-fifths of that), a development which took their market share from half that of the advanced economies to two-thirds and possibly on to *three-quarters* so far in 2009, if the latest IEA numbers are to be believed.

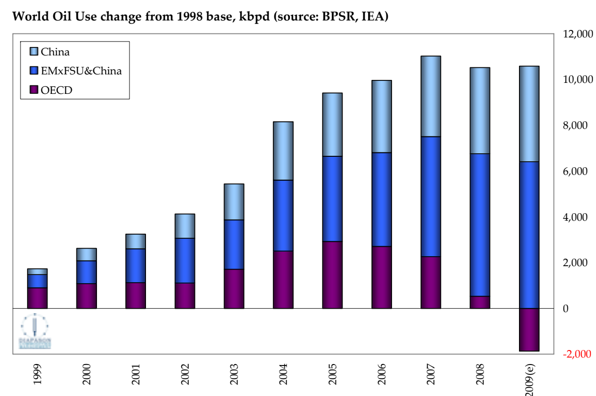

Figure 4: A Tiger in your Tank

Thus, the case for energy investment rests, inter alia, on three main propositions: that Western use will recover more rapidly than is being forecast from its current, 14-year lows; that the economic – upheaval we have suffered will do nothing to impair the model of multi-nationals and mercantilist governments lending Occidental consumers a good part of the wherewithal with which they buy the output of Oriental factories; and, finally, that the near-universal, inflationary tilt of policy will continue to increase factor prices, not least those of raw materials.

If any combination of these takes place, the medium-term outlook thereafter will further depend upon whether or not the last twelve-months' collapse in capital outlays are reversed sufficiently quickly to offset the depletion of existing resources, as well as upon the hostility of the swingeing taxes on breathing about to imposed in deference to that pairing of false profits, Marx and Lovelock.

The more immediate problem being faced is that even as higher prices have eroded OPEC compliance with its targeted 4.2Mbpd production cuts from ~80% to more like ~70%, Russia has also taken advantage by upping its output by some 300kbpd from the December lows. Meanwhile, US stocks and stock:use ratios of crude oil stand at 16 year seasonal highs and even China has managed to grow its inventories almost 20% from last summer, leaving the world with perhaps 62 days of supply on hand, a fifth more than normal . Among the products, the stats for motor gasoline in the US may be unexceptionable (as this consumer-oriented good shows more resilience to the recession than its industry-oriented barrel-mates), but the low-sulphur distillate ratio stands at a 12-year high, while that for jet kerosene has hit a 15-year equivalent.

All this has so far been enough to prevent crude from surpassing what is becoming a key resistance level around $75/bbl, forcing it to roll over bearishly when scaled by the USD TWI.

Matters have been even worse, of course, for natural gas, where a 12%, 450 bln cu ft, plunge in industrial use in the first half-year collided with the prolific successes of those lately exploiting America's vast, onshore shale gas deposits. Their sterling – if somewhat untimely – efforts meant that onshore production rose a cumulative 250 bln cu ft in the six months to June, even though the average

number of working rigs dropped 565 - or by nearly 40%. This glut has driven the market to the point where there is a very imminent danger of exhausting the nation's available storage capacity for gas, crushing the spot price and steepening the contango markedly.

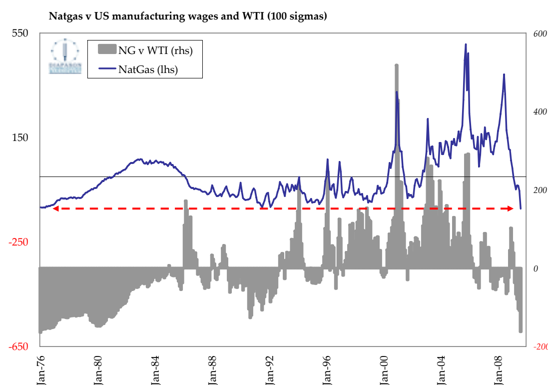

Figure 5: The Spirit of '76

The phoenix we hope is being hatched among the ashes of this (non-)conflagration is that with the number of working rigs now stuck at 7-year absolute - and 10-year seasonal - lows, the country's new found reliance on such 'non-conventional' gas for well over half of its onshore supply means that average depletion rates have been moved appreciably higher, since many of these horizontally-drilled wells lose up to 60% of their output in the first year, as opposed to the ~40% typically suffered by the rest. With gas at its cheapest in working-wage terms since at least the mid-1970s – and similarly testing the bounds of the chart relative to crude and its derivatives – the hope must be that while the market has been fixated by the looming injection ceiling, it has not paid sufficient attention to the possible effect of the coming fall-off in production on the scale of the winter rebound.

Figure 6a-c: Silver, Silver-TWI & Silver-Gold

For all the recent, much-merited focus on gold, note that silver has rather outperformed its yellow cousin. Historically, China – you may recall – had a silver-backed currency right up to the point FDR destabilized it in the 1930s, firstly by abandoning gold and secondly through the naked political trumpery of the Silver Purchase Act.

Might the Chinese be taking their revenge at last?

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