

The End Of The End Of The Recession?

By Tyler Durden
With Special Thanks To David Rosenberg, Chief Economist and Strategist,
Gluskin Sheff + Associates, Inc.

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Introduction

- ▶ Zero Hedge is pleased to provide its perspectives on the highly pertinent topic of the ongoing recession
- ▶ This presentation has been prepared in collaboration with the terrific work of David Rosenberg, Chief Economist & Strategist, Gluskin Sheff + Associates Inc.
- ▶ We believe an aggressive “fact-finding” investigation into the true depths of the recession is critical due to increased pressure by members of the Mainstream Media and conflicted Investment Banks to present a myopic, unjustified opinion
- ▶ Furthermore, opinions based on overoptimistic projections and “hope” are the primary reason the Credit Bubble persisted as long as it did
 - ▶ If the general population and regulatory authorities had approached rating agencies about the optimism quotient in their faulty models, it is likely that the current correction would have been nowhere near as severe
- ▶ As there is an all too real threat of a relapse into the same kind of optimistic zeal and the resultant formation of yet another asset bubble, Zero Hedge is presenting the factual side of the story
- ▶ We demand that readers question any and all assumptions presented herein (as well as everywhere else) on this most critical subject

The U.S. Consumer = 70% Of U.S. GDP

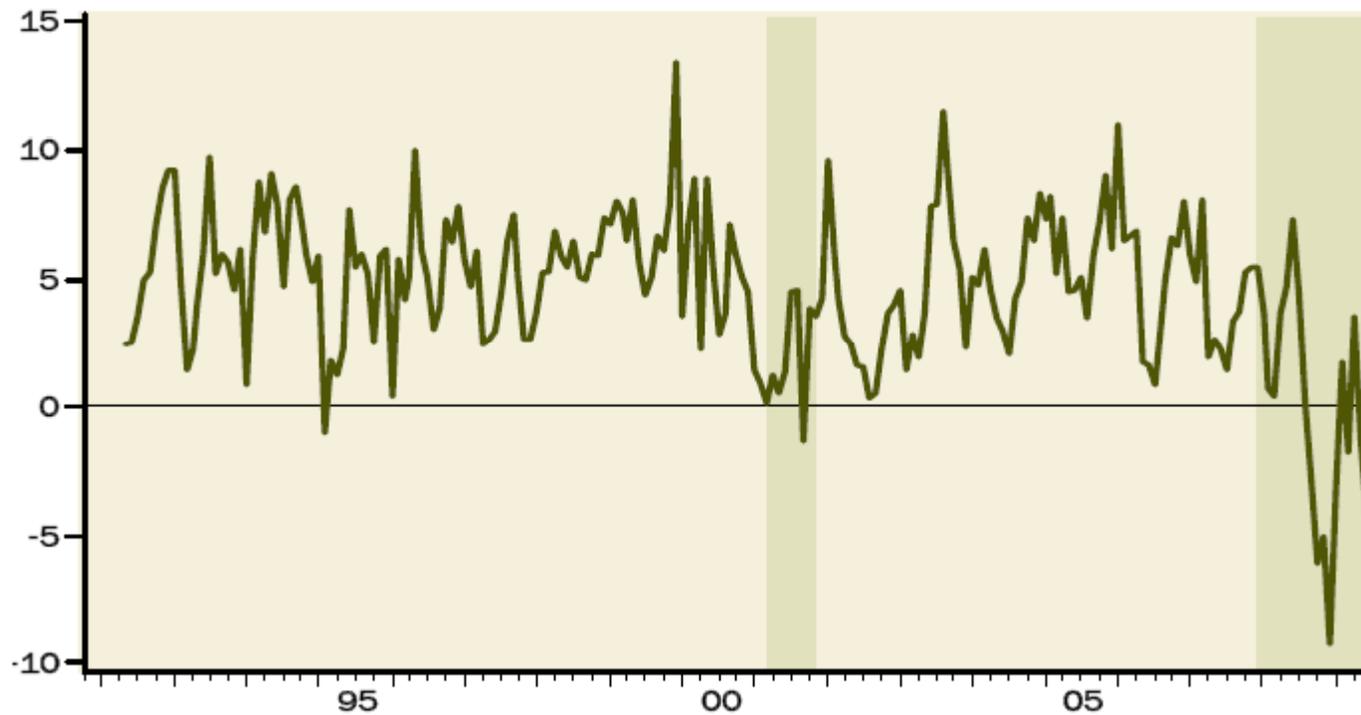
The U.S. Consumer

- ▶ Core June retail sales dipped 0.1%, the fourth decline in a row
- ▶ 4.2% annual rate decline over past four months: except for days after Lehman collapse, this is the worst periodic trend in history
- ▶ Organic wage-based income has declined in three of the last four months
 - ▶ Stimulus 2 is approaching
- ▶ Department stores -0.4%, building materials -0.9% (11 out of 12 months), furniture sales -0.2%, restaurant receipts -0.9%, drug store sales -0.3%
 - ▶ Offset by vehicle sales +2.3% and electronics +0.9%
- ▶ Channel checks indicate weak auto sales in July, while Redbook survey indicates chain store sales are down 5.7% in July, well below plan

The U.S. Consumer

▶ The Double Dip In Retail Sales Picks up

United States: Retail Sales excluding Autos, Gasoline and Building Materials
(four-month percent change at an annual rate)



Shaded region represent periods of U.S. recession
Source: Haver Analytics, Gluskin Sheff

The U.S. Consumer

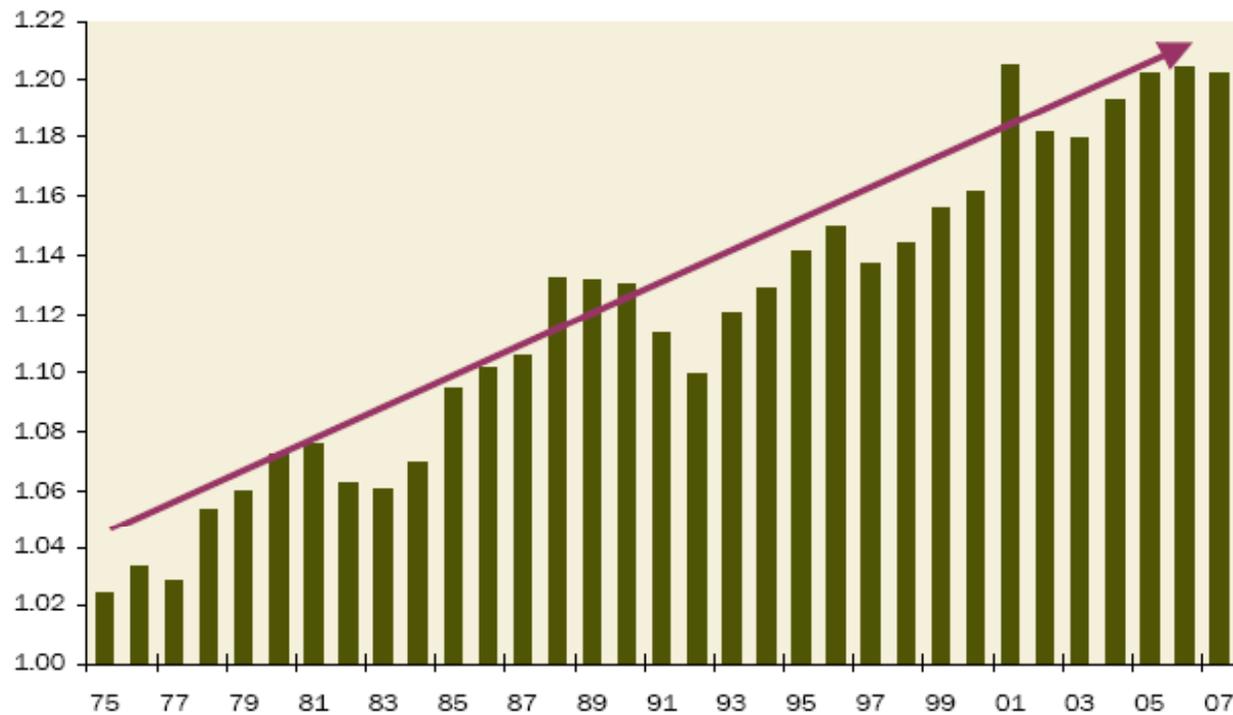
- ▶ Japan had a real estate and a credit bubble, but did not have the US consumption bubble
- ▶ Enter the Era of (Car) Frugality
 - ▶ Auto sales are down 30% below replacement demand despite a 35% drop in gasoline prices
 - ▶ Car SAARs of 15-20 million are a relic of a credit bubble period – the prevailing trends is 9-10 million SAAR despite gimmicks like “cash for clunkers”
- ▶ One quarter of the country is a three-car family; the readjustment with the new normal will likely keep auto sales low for at least seven years
- ▶ The consumption bubble impacted housing much more than autos
 - ▶ From 1980 to 2000 US household formation averaged 1.3 million per year while housing starts were at 1.4 million units annually: a 100,000 obsolescence gap
 - ▶ Gap increased to 600,000 in 2001-2007: household formation slowed to 1.2 million while starts increased to 1.8 million
 - ▶ Average home has increased in size by 20% to 2,600 sq. feet, from the pre-bubble era: the extra space was filled with useless junk also purchased during the bubble

The U.S. Consumer

- ▶ Too many cars on the street

United States

Ratio of Vehicles to Licensed Drivers
(ratio)



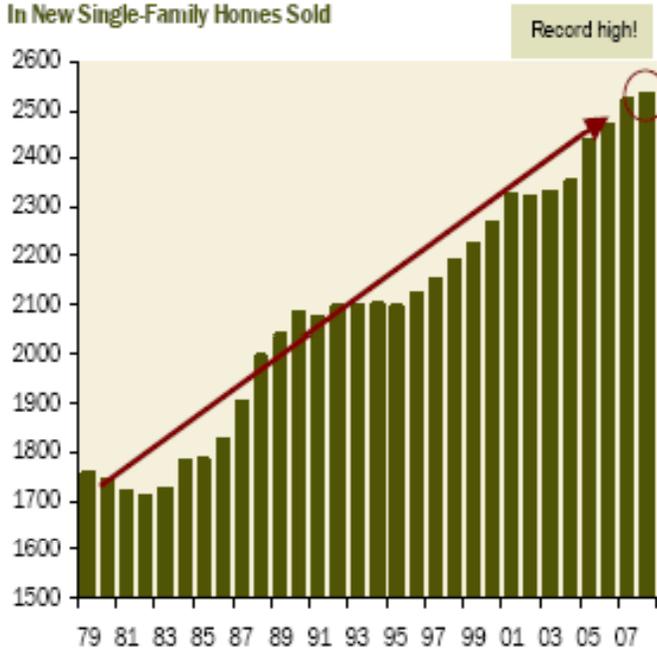
Source: Haver Analytics, Gluskin Sheff

The U.S. Consumer

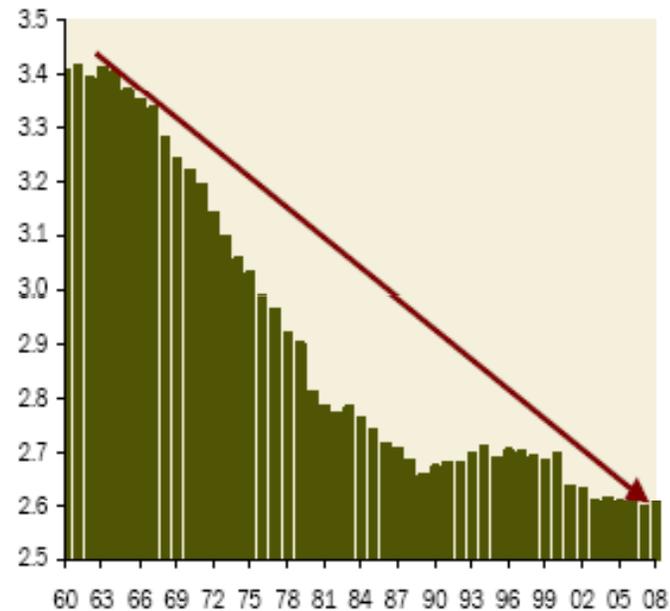
- ▶ Too many big houses

United States

Average Square Feet of Floor Area
In New Single-Family Homes Sold



Persons per Household at a Record Low
(persons/household)



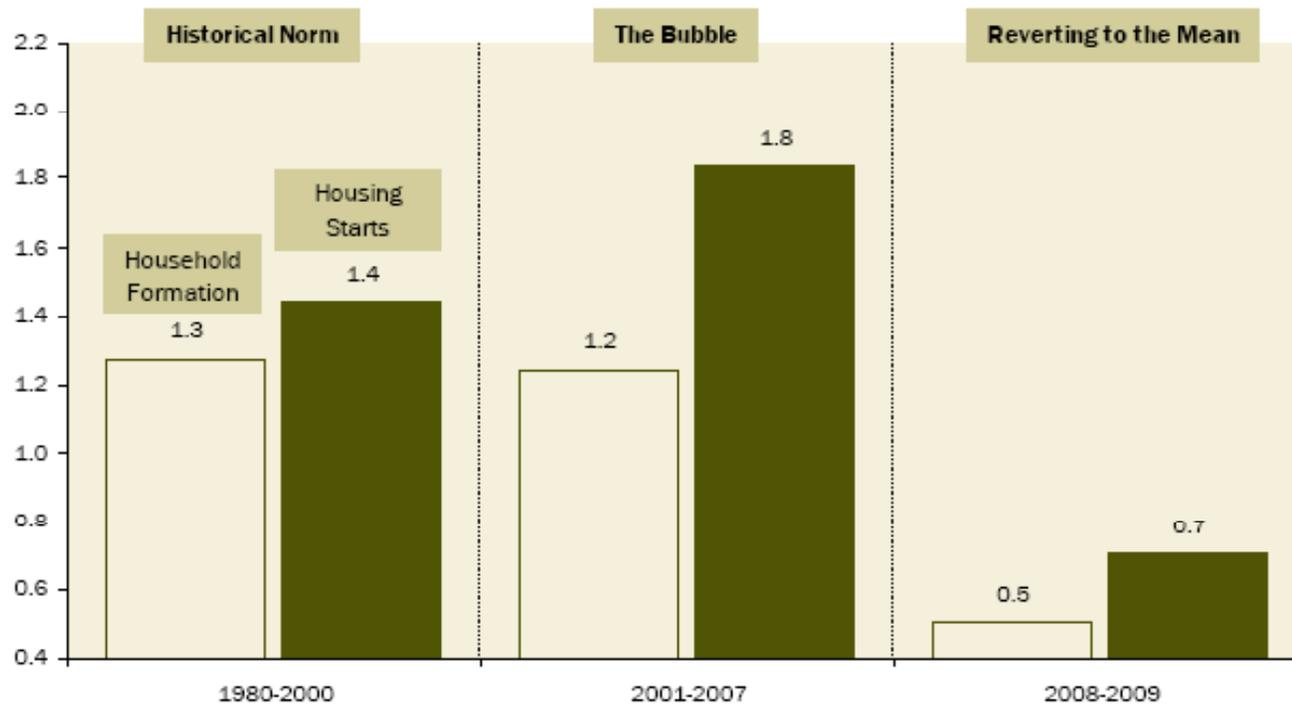
Source: Haver Analytics, Gluskin Sheff

The U.S. Consumer

- ▶ Housing mean reversion will be painful

United States

(average annual change in household formation and annual average level of housing starts: millions)



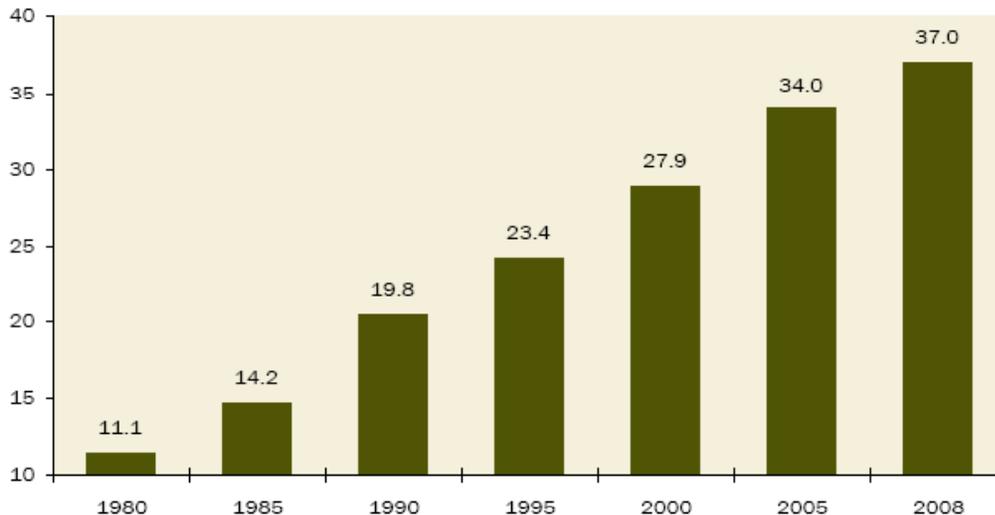
Source: Haver Analytics, Gluskin Sheff

The U.S. Consumer

- ▶ Record household ownership (adjusted) of non-housing durable goods
 - ▶ People own 20% more “stuff” than last consumer recession in 1990-1991 and 40% more than the early 1980s.
 - ▶ Green shoots are completely meaningless in light of this new mean reversion to the “getting small” model

United States

Household Ownership of Consumer Durable Goods
(\$ thousands per household)



Source: Haver Analytics, Gluskin Sheff

The U.S. Consumer

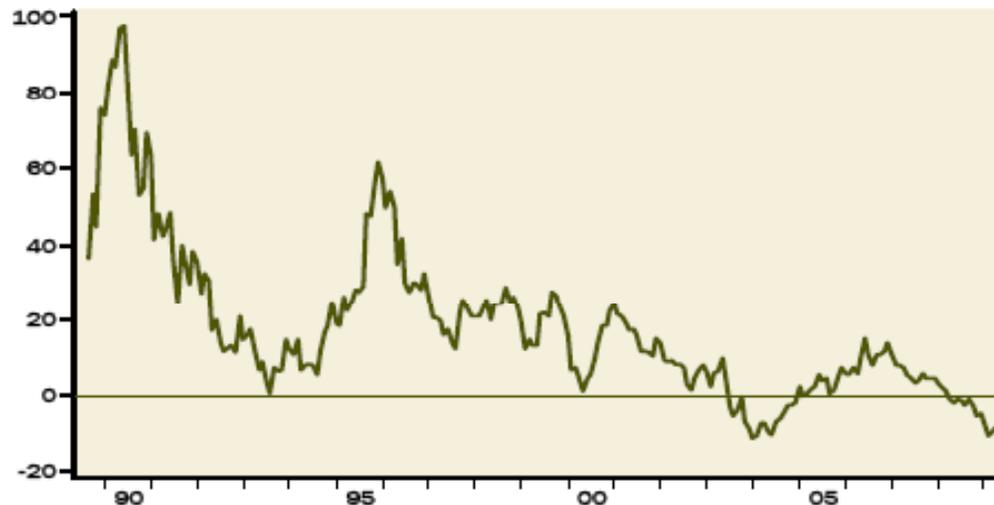
- ▶ Consumer deleveraging continues unabated despite all efforts by the Fed and the administration
- ▶ New credit card issuance has plunged 38% year to date, and the average limit on new credit cards has declined by 3%
- ▶ In May consumer credit contracted by \$3.3 billion, the fourth decline in a row: the longest declining period since 1991
- ▶ Since Lehman collapse, consumer credit (excluding mortgages) has contracted by \$53 billion: an 11.5% annual rate, a record decline
- ▶ Weekly bank lending through June show further shrinkage
- ▶ This is a highly deflationary development: all the government can do is cushion the blow
- ▶ Former IMF Chief Economist Ken Rogoff: **“The kind of deleveraging we need to see takes six or eight years ... The retrenching of the U.S. consumer is a huge adjustment the whole world is going to have to absorb”**.

The U.S. Consumer

- ▶ Record decline in consumer credit since September 2008

United States

Consumer Credit Held by Pools of Securitized Assets
(8-month % change at an annual rate)



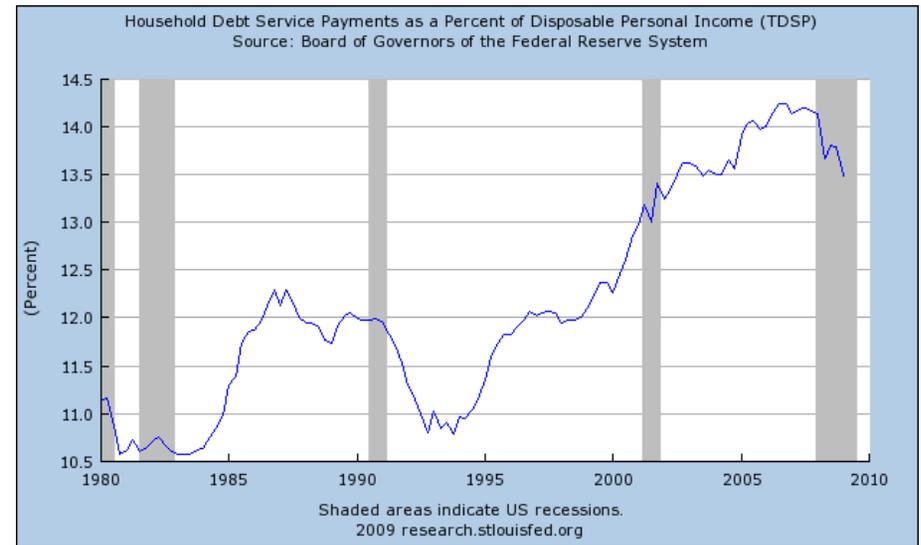
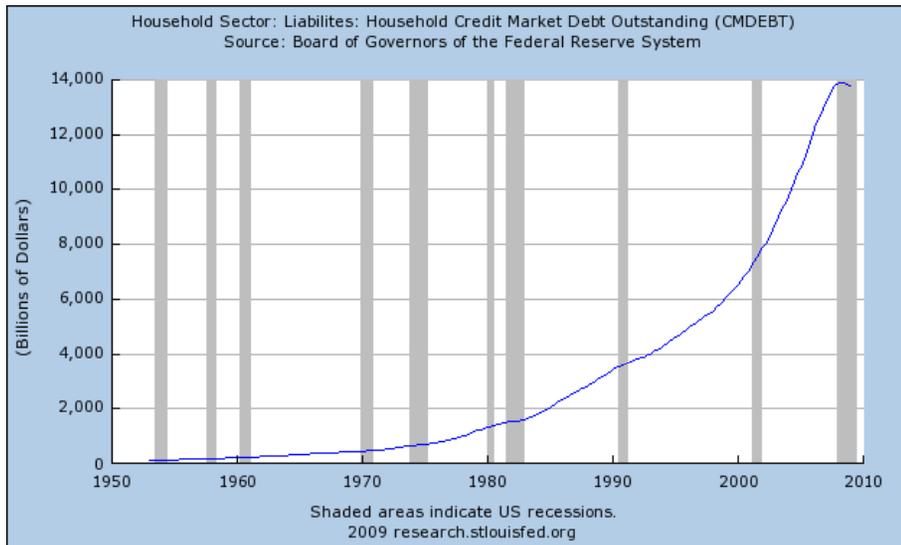
Note: Data before 1990 are based on trailing operating earnings;

data after 1990 are based on forward operating earnings

Source: Haver Analytics, Giuskin Sheff

The U.S. Consumer

- ▶ Household credit has a long way to go before reverting to a new, frugal normal
- ▶ Consumers are increasingly weary of maxing out credit cards (unless their strategy is to subsequently file for bankruptcy)



Business Outlook And Conditions

Business Outlook And Conditions

- ▶ May Business sales decline 0.1% for the month, and an unprecedented 18% YoY: if not a depressionary, definitely a recessionary signal
 - ▶ Excluding auto the decline was 0.3% and 17.3% YoY

United States

Total Business Sales

(year-over-year percent change)



Shaded region represent periods of U.S. recession

Source: Haver Analytics, Gluskin Sheff

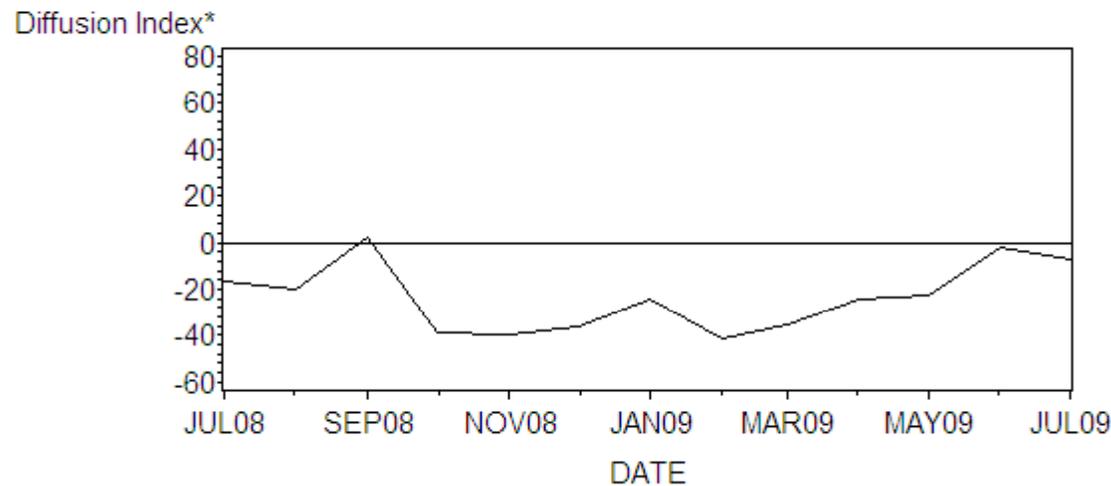
Business Outlook And Conditions

- ▶ The Philly Fed's Business Outlook Index came in at -7.5 in July, from -2.2 in May, a 10 month continuing contraction
 - ▶ Everything was negative yet the deterioration in the employment component was strongest, which moved to -25.3 from -21.8.
 - ▶ Inventories, at -15.4 from -15.3 indicates that the business restocking story remains a myth
 - ▶ Shipments did not confirm what the NY Empire index claimed the day before
 - ▶ The Philly Fed shipment data swung to -9.5 from +2.1
 - ▶ Margins are getting squeezed (outside of Goldman and Intel?) because prices-received fell to -21.5 from -16.6 (no inflation here) while prices-paid went to -3.5 from -13.0 (margin compression was also evident in that NY Empire index too).
 - ▶ NY Empire Index showed that 62% have reduced their production plans for the second half of the year; 21% stated they are boosting output.
 - ▶ This compares to the July 2008 survey which showed 35% intending to cut and 22% planning to raise production — and we know how the second half of 2008 turned out.
 - ▶ **When asked whether the fiscal stimulus was having a positive impact on the business, fully 93% said “no”.**

Business Outlook And Conditions

- ▶ July Philly Fed Index contradicts other optimistic data

Current General Business Activity Diffusion Index
Seasonally Adjusted



*Diffusion indices represent the percentage of respondents indicating an increase minus the percentage indicating a decrease.

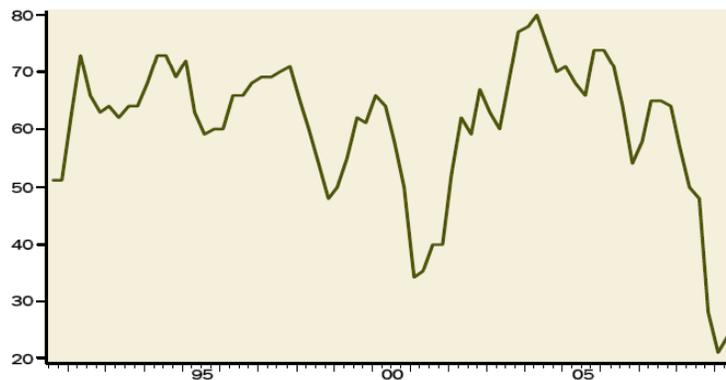
Source: Federal Reserve Bank of Philadelphia

Business Outlook And Conditions

- ▶ MAPI Business Outlook Index reading of 24 is second lowest on record
 - ▶ This is less than half the 50 level a year ago and the 65 level two-years ago
 - ▶ Capex plans stayed at a record low of 14 last quarter
 - ▶ Profit margins edged down to 18 from 19 — a new all-time low

United States

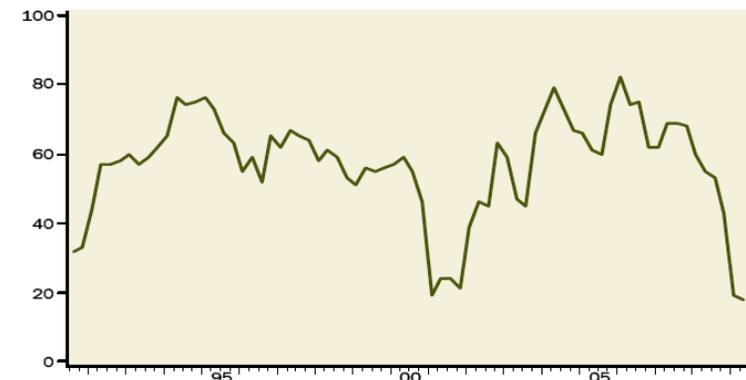
MAPI Survey: Composite Business Index
(50+ = Growth, not seasonally adjusted data)



Source: Haver Analytics, Gluskin Sheff

United States

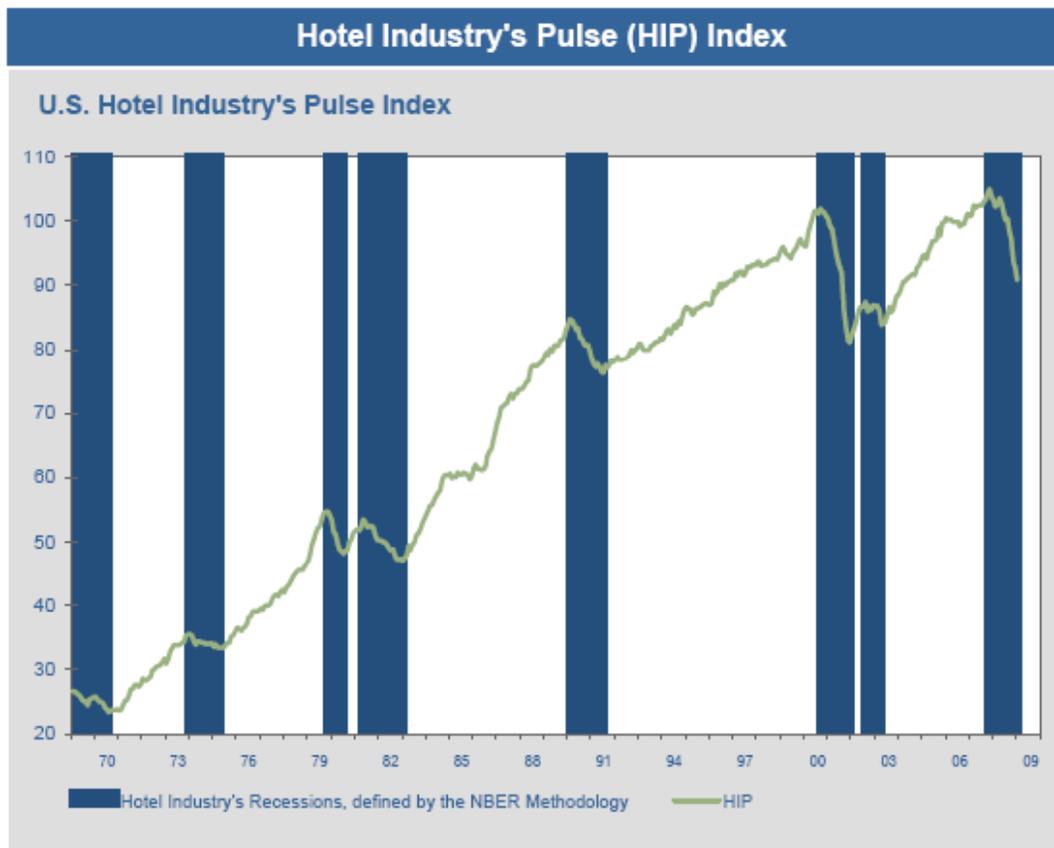
MAPI: Profit Margins Index {Cur Qtr vs Year-ago Qtr}
(50+ = Growth, not seasonally adjusted data)



Source: Haver Analytics, Gluskin Sheff

Business Outlook And Conditions

- ▶ The Hotel Industry Pulse (HIP) Index indicates a dramatic downturn
 - ▶ The lodging industry, a proxy for business health, provides no indication there is any economic improvement on the horizon

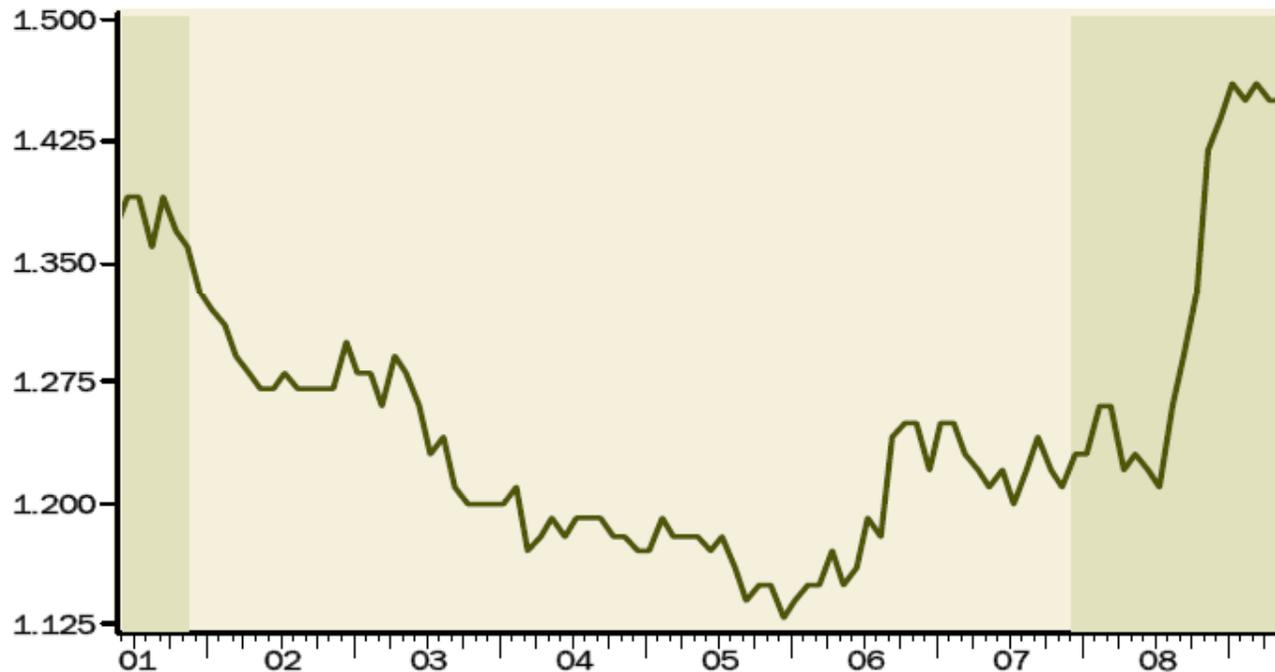


Industry & Manufacturing

Industry & Manufacturing

- ▶ Inventory-To-Sales Ratio in Manufacturing indicates restocking to commence

United States: Manufacturing Inventory-to-Sales Ratio
(ratio)



Shaded region represent periods of U.S. recession
Source: Haver Analytics, Gluskin Sheff

Industry & Manufacturing

- ▶ Inventory bounce in the works? No!
 - ▶ UPS package volumes in June - 4.7% YoY, -3.9% in March, -2.1% in December
 - ▶ Weakness accelerating
 - ▶ Railroad carloadings 18.8% below the levels from last year, when the economy was already 8 months into a the recession
 - ▶ Containerboard pricing: “While we think prices remain stable in July, we're not convinced prices have bottomed for the cycle. We're even less swayed by arguments about a prospective pricing initiative this autumn.” – Mark Wilde, Deutsche Bank
 - ▶ Producer pricing for building paper and board fell 0.6% in June and is down in each of past four months
 - ▶ YoY trend is at near-record deflation levels of -12.2%
 - ▶ PPI for cyclical paper board and containers fell 0.9% in June and also is down 4. months running
 - ▶ Paperboard prices down eight months in a row: -1.5% in June and -4.0% YoY

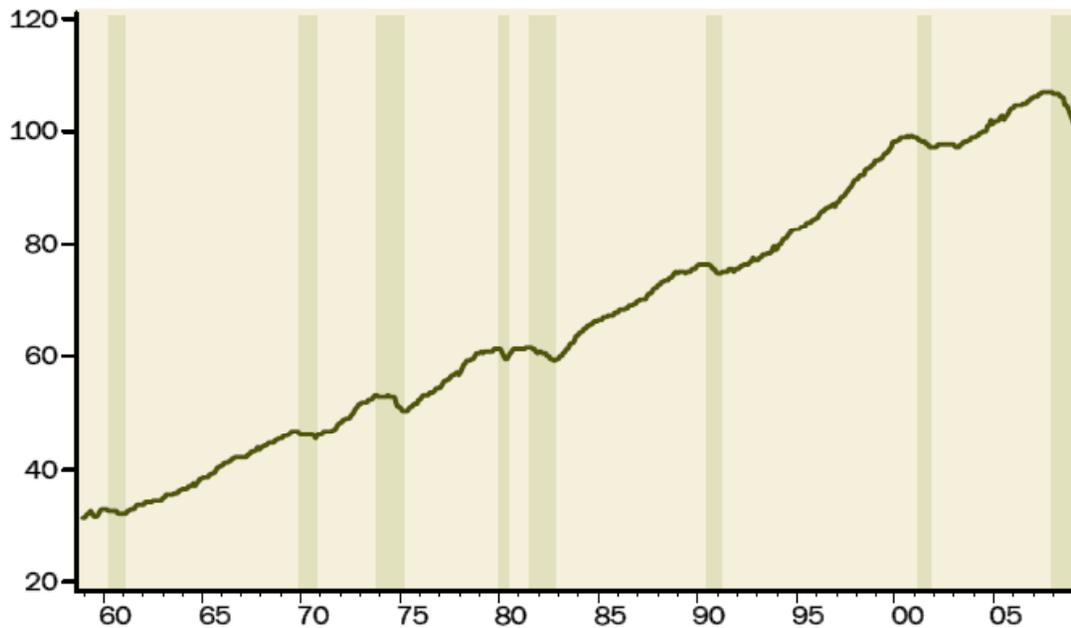
Industry & Manufacturing

- ▶ Leading Indicators improving as Coincident Index continues to fall
- ▶ Recessions do not end until this index hits a bottom

United States

Composite Index of 4 Coincident Indicators

2004=100 (I)

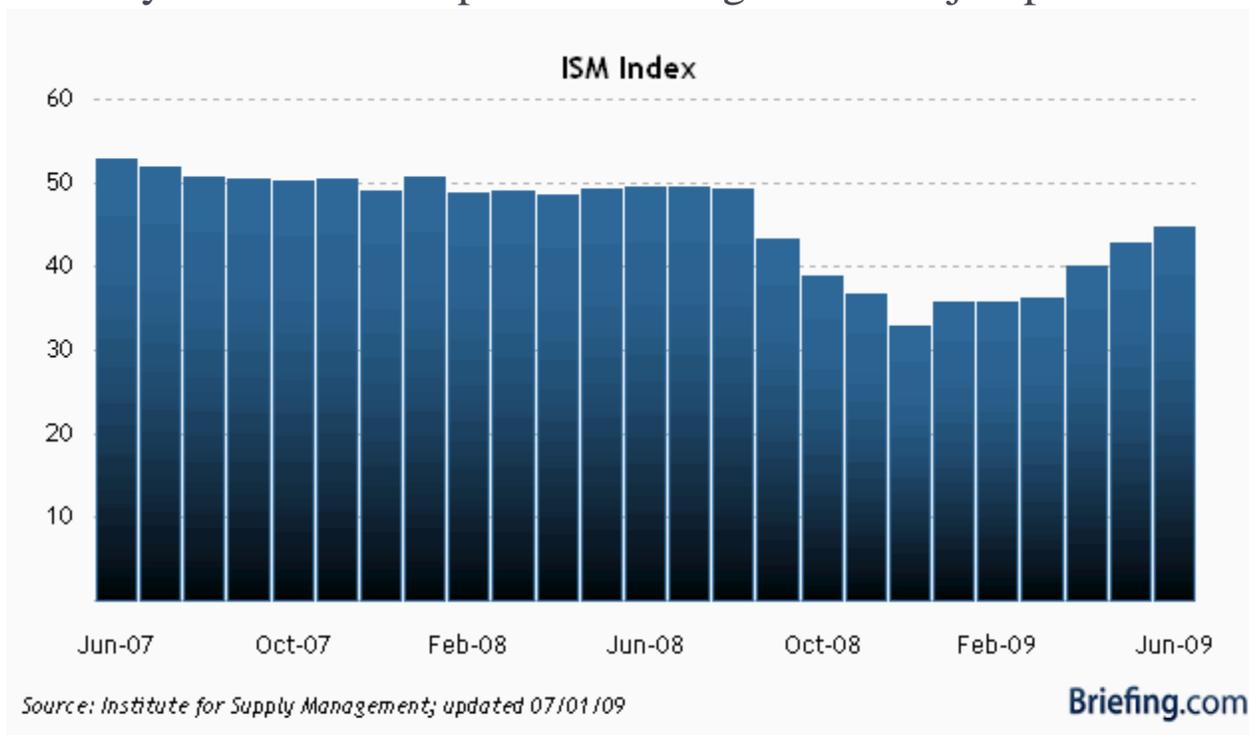


Shaded region represent periods of U.S. recession

Source: Haver Analytics, Gluskin Sheff

Industry & Manufacturing

- ▶ Is the ISM index misrepresenting industrial reality?
 - ▶ Since the ISM bottomed last December — and despite its 12 point advance **industrial activity has collapsed at a 13% annual rate**. Not only that, but the industrial production diffusion index, which is lagged by a month, sagged to 33.3 in May from 41.0 in April even though the ISM jumped from 40.1 to 42.8.

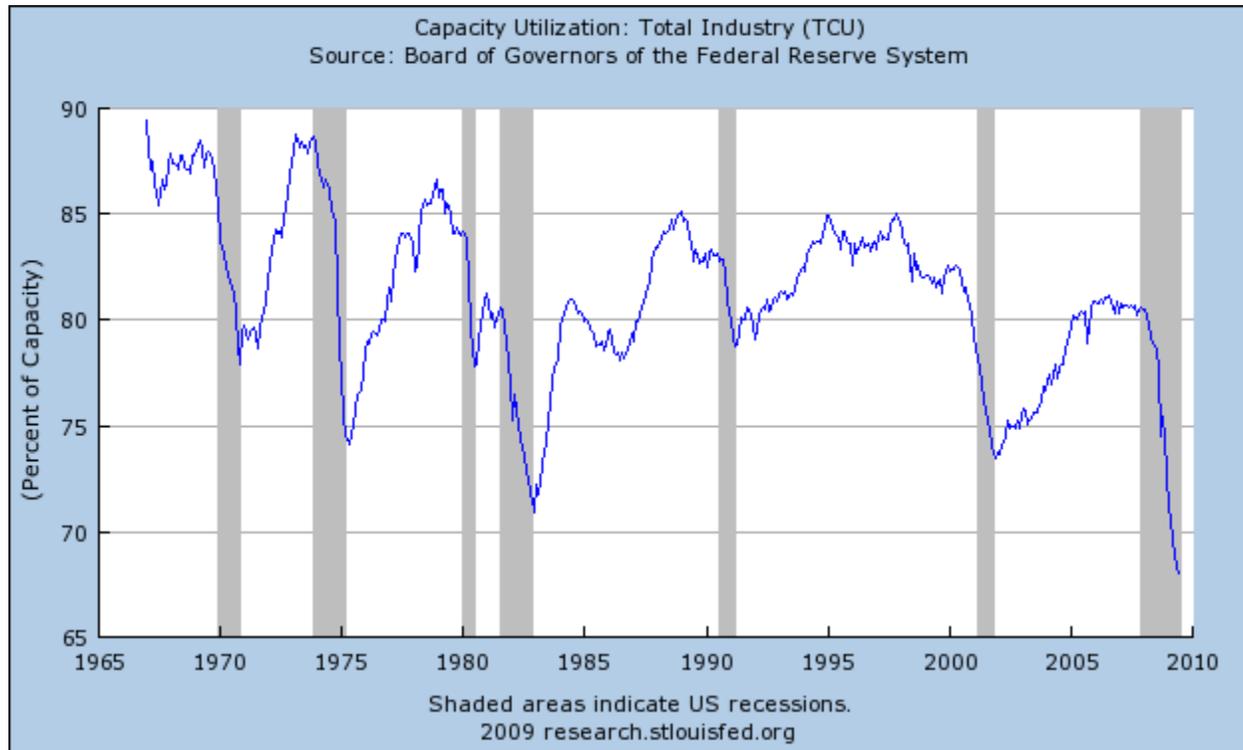


Industry & Manufacturing

- ▶ Total Industrial production fell 0.4% MoM
 - ▶ Utilities jumped 0.8% after four months of contraction
 - ▶ Manufacturing output sagged 0.6% and is down a hefty 15.5% on a YoY basis.
 - ▶ In the manufacturing sector and declines were broad-based across construction supplies (-0.2%), materials (-0.6%), machinery (-1.9%), and computers/electronics (-1.1%)

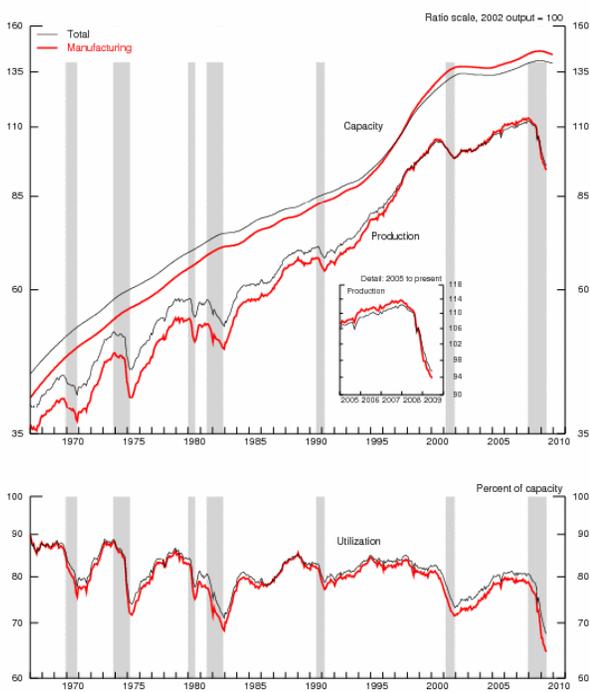
Industry & Manufacturing

- ▶ The new, low normal will continue for many years: Capacity Utilization Rates are probing record lows
 - ▶ The amount of “slack” in the economy is staggering



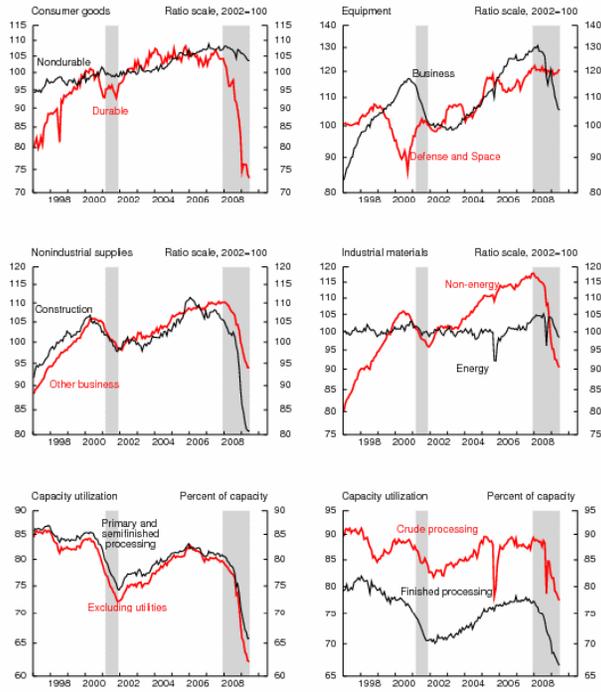
Industry & Manufacturing

1. Industrial production, capacity, and utilization



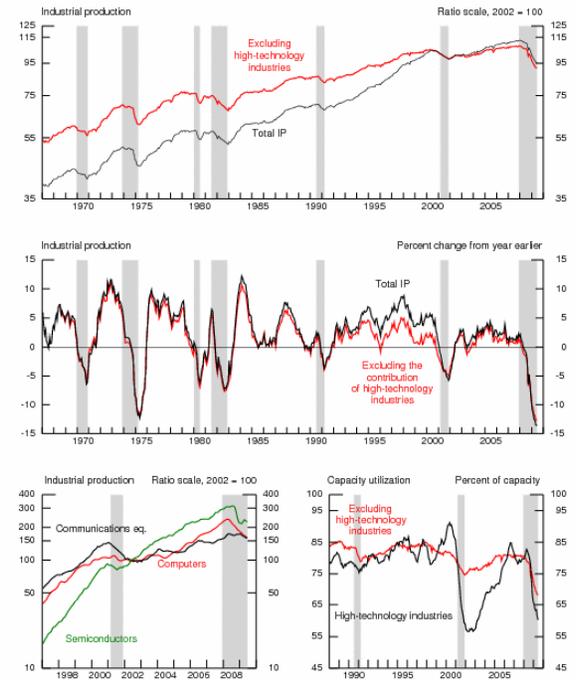
Notes: The shaded areas are periods of business recession as defined by the National Bureau of Economic Research (NBER). The last shaded area begins with the peak as defined by the NBER and ends at the trough of a 3 month moving average of manufacturing IP.

2. Industrial production and capacity utilization



Notes: The shaded areas are periods of business recession as defined by the National Bureau of Economic Research (NBER). The last shaded area begins with the peak as defined by the NBER and ends at the trough of a 3 month moving average of manufacturing IP.

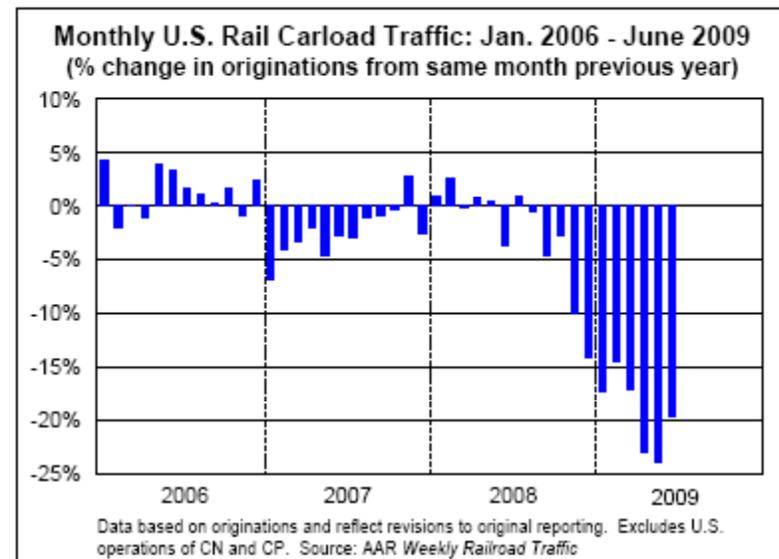
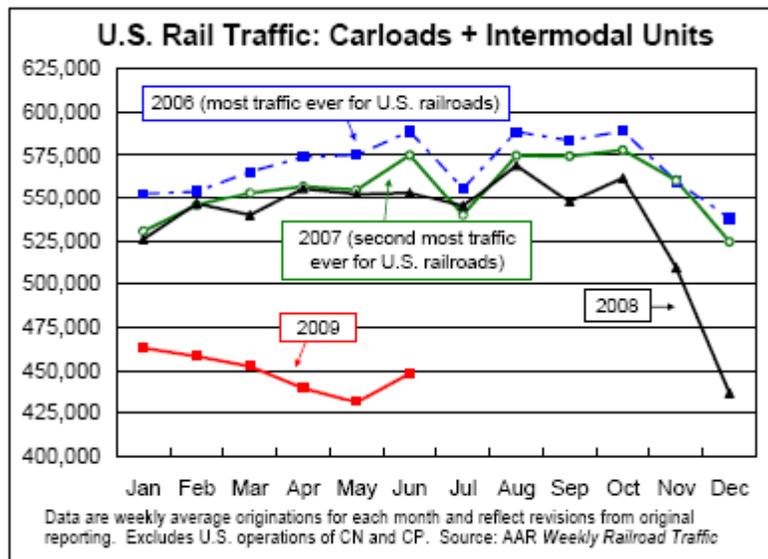
3. Industrial production and capacity utilization, high-technology industries



Notes: High-technology industries are defined as semiconductors and related electronic components (NAICS 334412-9), computers (NAICS 3341) and communications equipment (NAICS 3342). The shaded areas are periods of business recession as defined by the NBER. The last shaded area begins with the peak as defined by the NBER and ends at the trough of a 3 month moving average of manufacturing IP.

Industry & Manufacturing

- ▶ As a proxy for economic arteries, railroad traffic speaks volumes about a healthy economic system (or the lack thereof)
 - ▶ Plunging 2009 YoY traffic confirms a new, much weaker, “normal” level
 - ▶ Keyword: “Slack”



Unemployment

Unemployment

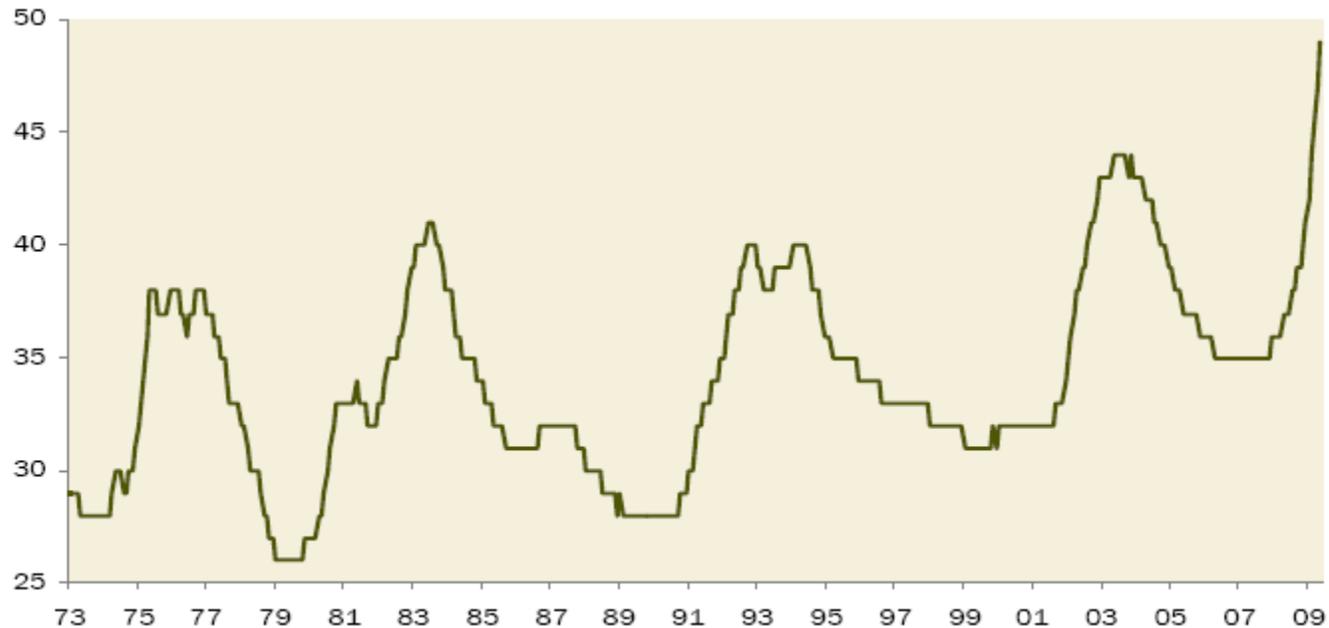
- ▶ The seasonal factor fudging:
 - ▶ Claims dropped 47,000 to 522,000 in the July 11th week, on top of a 48,000 slide the week before — combined falloff of 95,000.
 - ▶ At the same time, the non-seasonally adjusted data soared 108,000 over the past two weeks.
 - ▶ Go back to the same two weeks in 2008 and you will see that a similar decline in unadjusted claims (-115,000) translated into an 18,000 drop in the seasonally adjusted data.
 - ▶ Something with the seasonal factors is at play here; not the economy.
- ▶ July 18th initial claims of 554,000 equate to payroll losses of 300-400,000
- ▶ Continuing claims down 88,000 to 6,225,000: is this indicative of a real second derivative improvement?
- ▶ NO!
 - ▶ People have been on unemployment insurance so long it has expired
 - ▶ Benefits exhaustion rate hit a record 50%
 - ▶ Americans are rolling into various extended benefits programs such as Emergency Claims and Extended Benefits, **which surged by 170,000 in the last week alone**

Unemployment

- ▶ Record number of unemployed seeing their benefits end:

United States

Unemployment Insurance Exhaustion Rate

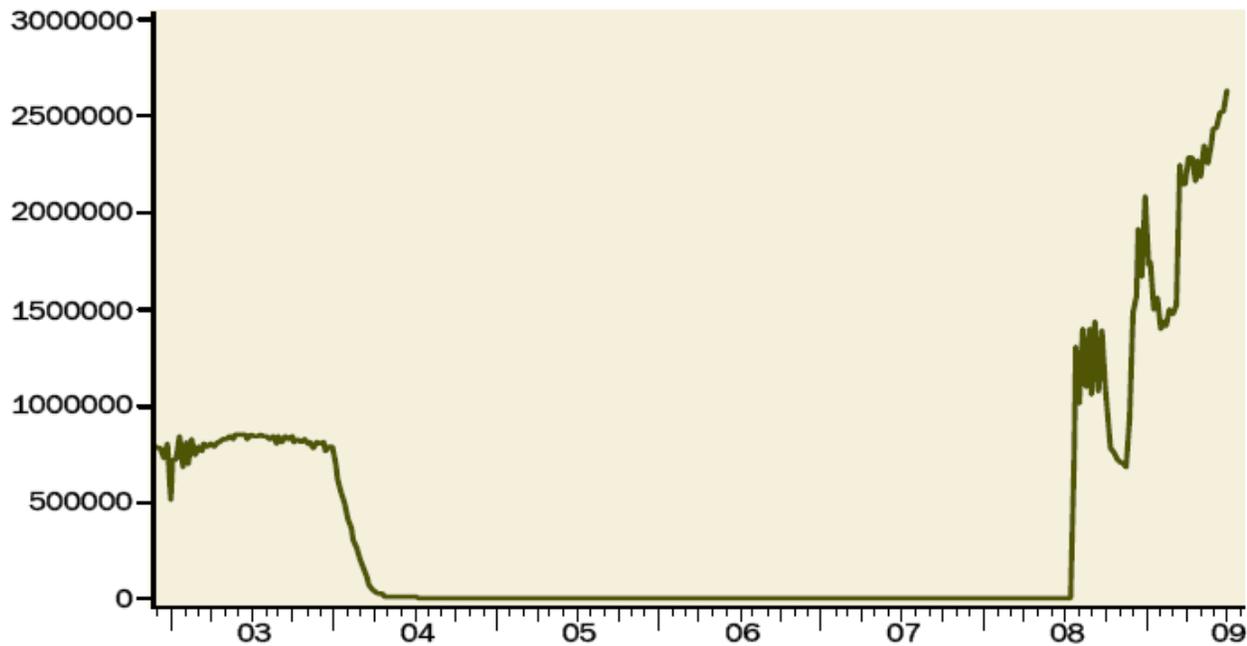


Source: Bureau of Labor Statistics, Gluskin Sheff

Unemployment

- ▶ The fallback once Unemployment Claims are exhausted :
 - ▶ Emergency Unemployment Compensation claims are accelerating

United States: Persons Claiming Benefits Emergency Unemployment Comp (EUC)
(number)

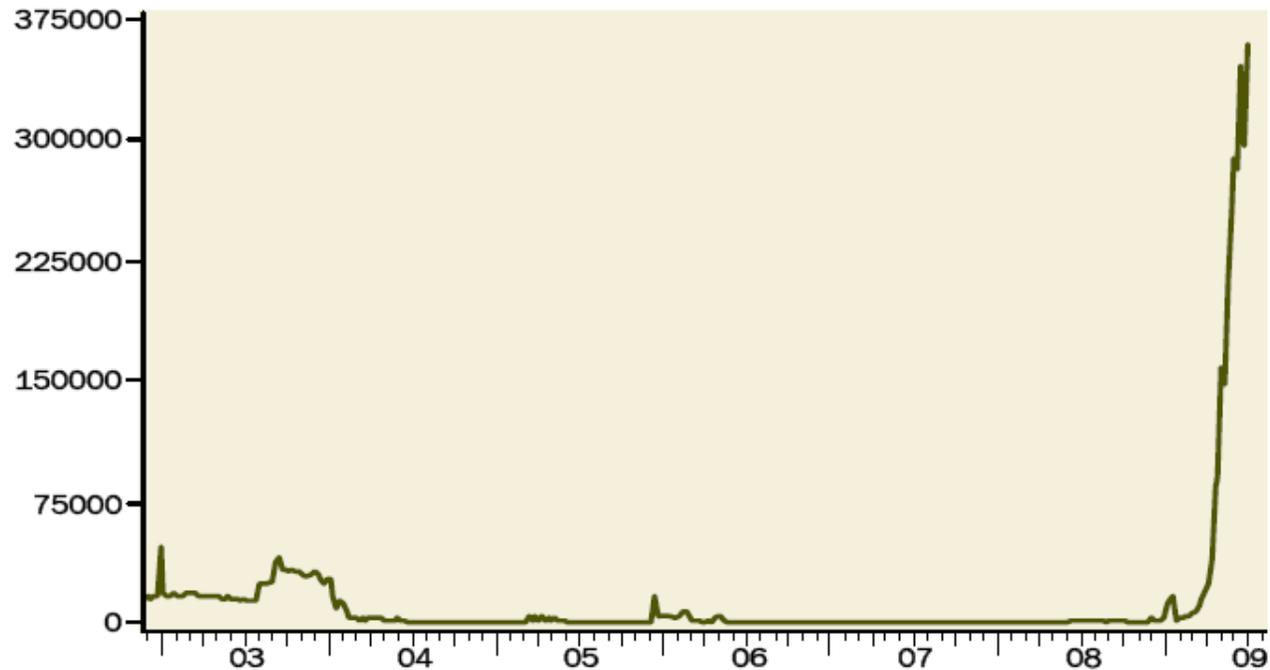


Source: Haver Analytics, Gluskin Sheff

Unemployment

- ▶ And Once EUC is over ...
 - ▶ People start claiming Extended Benefits

United States: Persons Claiming Benefits Extended Benefits
(number)



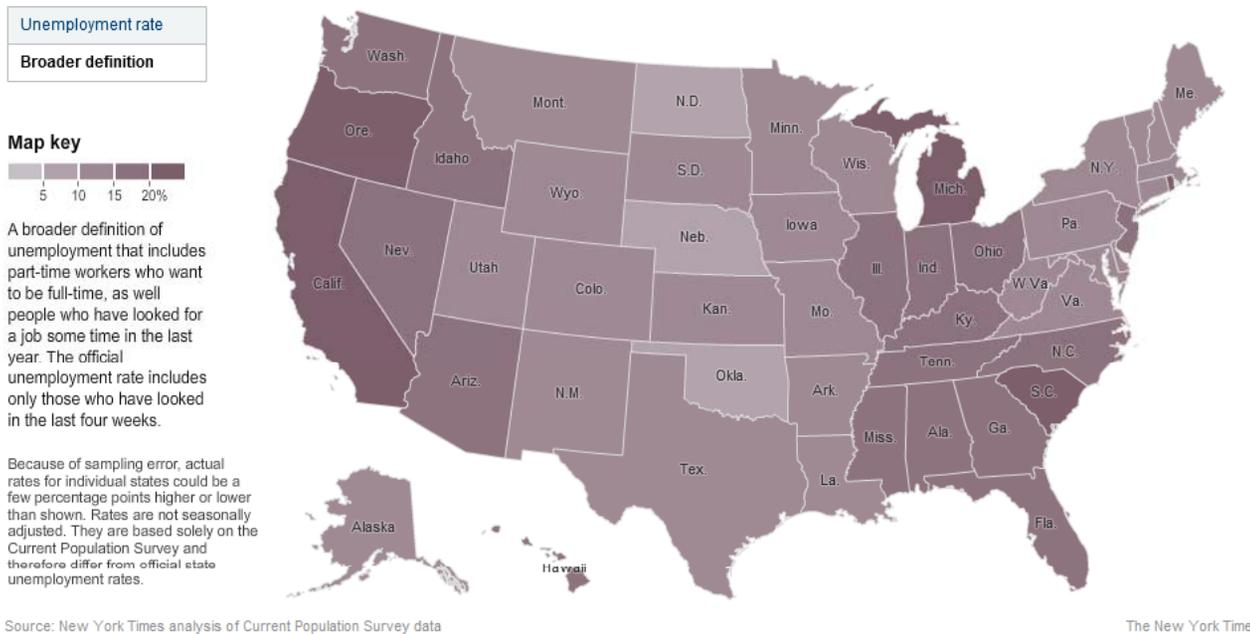
Source: Haver Analytics, Gluskin Sheff

Unemployment

- ▶ While “unemployment” is still below 10%, U-6, or the broader *underemployment* metric is at **16.8%**, 6.5% higher from a year ago
- ▶ Oregon, Rhode Island, Michigan, South Carolina and California are already above 20%, with Florida, Washington and North Carolina are close behind

Broad Unemployment Across the U.S.

Under a broader definition of joblessness, some states have rates higher than 20 percent. This rate includes part-time workers who want to work full time, as well some people who want to work but have not looked for a job in the last four weeks.



Unemployment

- ▶ The Fed is openly acknowledging its premature optimism on employment and has recently adjusted projections materially higher
 - ▶ Year-end unemployment rate to 9.8 - 10.1% from 9.2 - 9.6%
 - ▶ 2010-end unemployment rate to 9.5 - 9.8% from 9.0 - 9.5%
- ▶ FOMC Minutes: “labor market conditions were of particular concern to meeting participants”

Housing

Housing

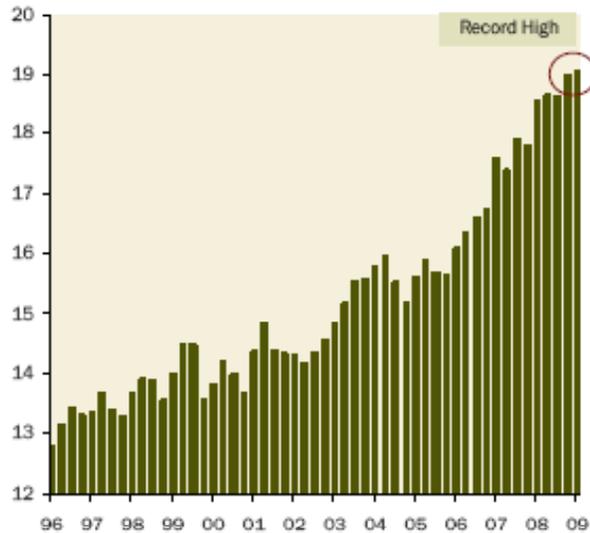
- ▶ New household formation is running around 900,000 annually (divorce rates have plunged as a result of the recession)
- ▶ Assuming two-thirds of that heads into houses (instead of rentals as is traditionally the case) the new normal for new home sales will be around 600,000 units – half the 1-1.4 million housing bubble range
- ▶ And then there is the excess supply: conservative estimates (pre moratorium REOs) assume two million units in the U.S. vacant and for sale, 900,000 above pre bubble norm
- ▶ Even if prospective buyers ignore all their negative predispositions about housing (and assuming builders keep starts near post-WWII lows), **it will still take five years to mop up excess inventory**
- ▶ Thus, house price deflation will be a secular, not cyclical trend and this will be an overhang to credit quality and prevent an improvement to the banking sector pregnant with excess real-estate

Housing

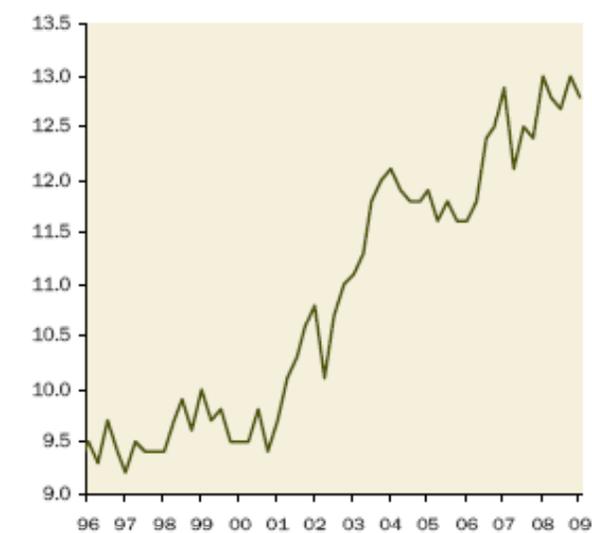
- ▶ Total housing vacancies/vacancy rates soar

United States

Total Vacant Housing Units
(millions)



Total Housing Vacancy Rate
(percent)



Source: Haver Analytics, Gluskin Sheff

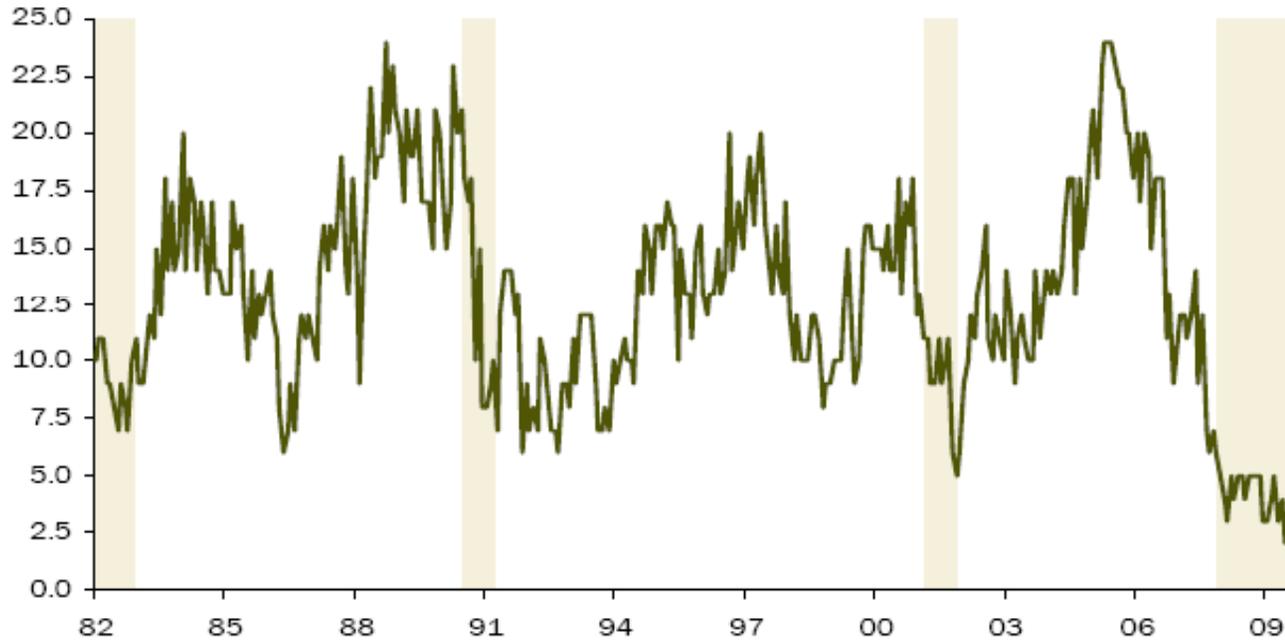
Housing

- ▶ As housing no longer viewed as an appropriate investment class

United States

University of Michigan Consumer Sentiment Survey

(% of respondents saying housing is a good investment + prices are going higher)



Shaded region represent periods of U.S. recession

Source: Haver Analytics, Gluskin Sheff

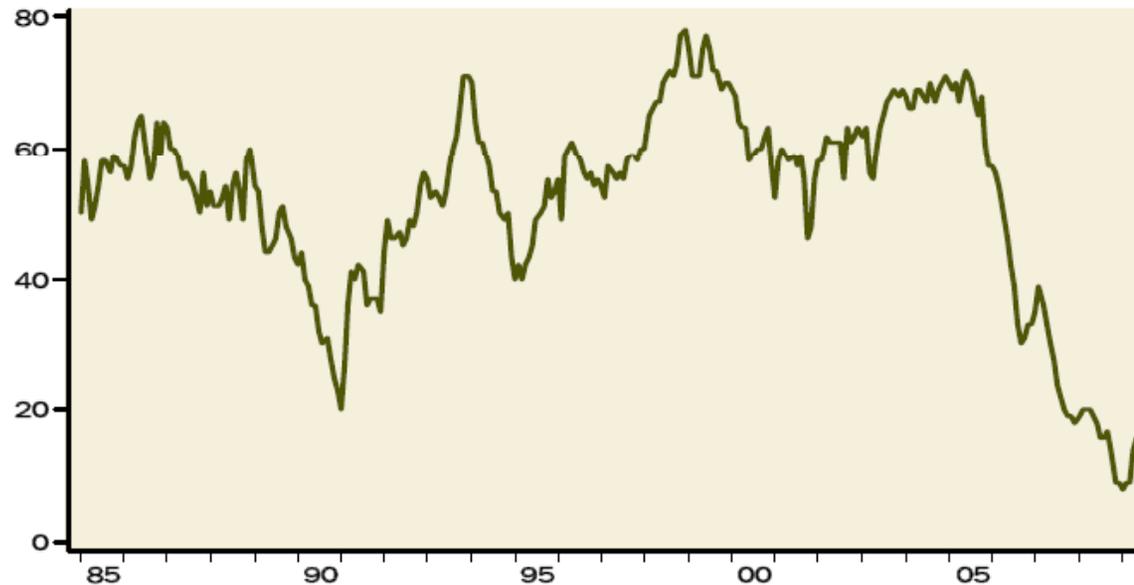
Housing

- ▶ NAHB housing market improved in July... To 17 from 15
 - ▶ The 8th worst print on record
- ▶ Sales outlook is stuck at 26, and anything under 50 is a contraction

United States

Home Builders: Housing Market Index {Composite}

(All Good = 100)



Source: Haver Analytics, Gluskin Sheff

Housing

- ▶ RealtyTrac disclosed that Q2 foreclosure activity was the highest on record
 - ▶ 1.9 million foreclosure filings in the first half of 2009, a 15% increase from the prior year period
 - ▶ June foreclosure filings of 336,173 were the fourth straight month exceeding 300,000
 - ▶ One in 84 housing units received at least one foreclosure filing in the first half
 - ▶ And all this is occurring on the backdrop of an industry-wide housing moratorium
 - ▶ According to Whitney Tilson, foreclosures have been temporarily cut by **66%** through moratoria which reduce supply
 - ▶ At some point the banks will need to release the flood gates – watch out below as millions of units in shadow inventory are unleashed on the few buyers out there
 - ▶ The Administration’s delay-the-pain mentality will bite it in the ass:
 - ▶ Whitney Tilson: “Five years from now when things look to be stabilizing, all of the terrible kick-the-can-down-the-road modifications that leave borrowers in 5-year-teaser, ultra-high leverage, 150% LTV balloon loans will start adjusting upward and it will be Mortgage Implosion 2.0. **These loan mods will turn millions of homeowners into over-levered, underwater, renters and ensure housing is a dead asset for years to come**”

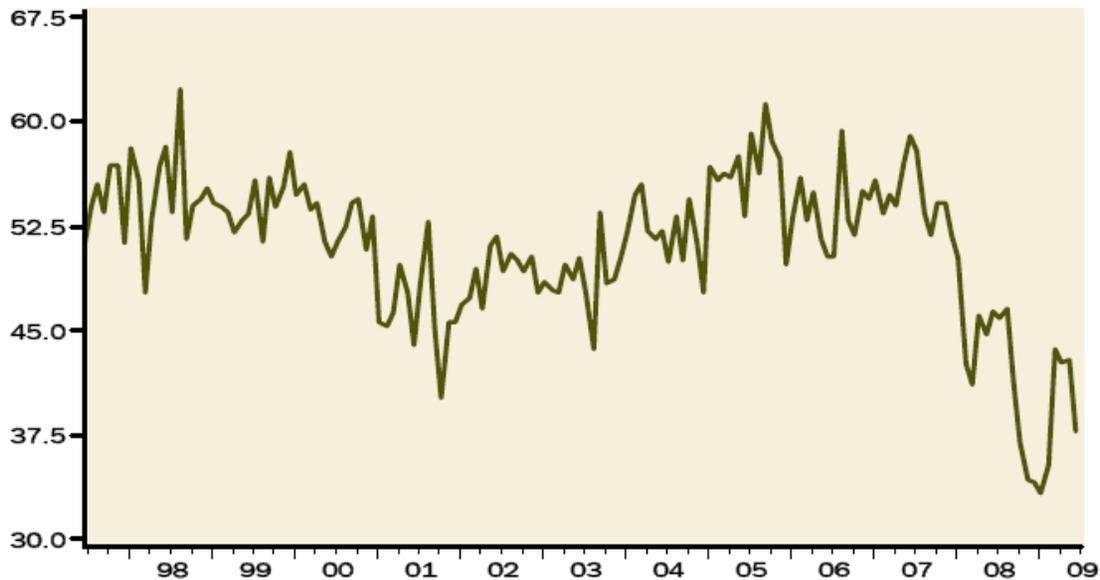
Housing

- ▶ Housing is bouncing off bottom
 - ▶ Architectural billings Index slipped five points last month to 37.7 - a sign residential construction is just bouncing along bottom

United States

AIA: Architectural Billings Index

SA, +50=Increasing



Source: Haver Analytics, Gluskin Sheff

The “Revenueless” Recovery

The “Revenueless” Recovery

- ▶ NFIB announced that sequential growth in nominal sales fell to lowest level in history: from -31 to -32
- ▶ Record number (31%) cited poor sales as top concern right now: there is **no top-line business** growth regardless of all talk about inflation, taxes, regulation and credit conditions
- ▶ This is at the heart of the Q2 reporting season: vast majority of companies beat estimates in Q1 by cutting costs, and only 46% beat vastly reduced top line forecasts
- ▶ Eventually equity market will demand revenue growth boosting visibility
- ▶ **This will not come for a long time: with real unemployment at 16.8% and industry operating rates at 65%, there is a record amount of slack in the economy, which make it impossible to lift prices on a meaningful basis**
- ▶ **Only 3%, the second lowest number ever, said they intend to raise prices going forward**

The “Revenueless” Recovery

- ▶ Starbucks revenue dropped 5.0%
- ▶ Southwest was the only airline to make money, but even here its revenues fell 8.8% (it laid off workers — 4.0% or 1,400 — for the first time ever)
- ▶ Coke did very well in China and India but its sales in the United States were down 4.0%
- ▶ GM sales were down 15% from already-depressed levels of a year ago
- ▶ Caterpillar was another bellwether that was treated with euphoria – yet even as it marked up its full-year EPS range from \$1.25 to \$2.25 a share, it trimmed its revenue guidance to a \$32-36 billion band (from \$31.5-38.5bln)
- ▶ Wells Frago saw non-performing loans in CRE skyrocket by 69% to \$7.6 billion

The “Revenueless” Recovery

- ▶ And here is the backstop for the new “Tech boom”:
 - ▶ Yahoo posted a 13% YoY drop in revenues even as EPS beat estimates by two cents
 - ▶ Apple was viewed as a big positive, but mostly due to a 303% surge in iPhone revenues; iPod revenues fell 11%, Mac revenues dropped 18% as the company cut prices to move volumes
 - ▶ Intel’s story seems to be one more of market share than economic revival seeing as rival AMD posted a 13% revenue slide
 - ▶ Lexmark (printer maker) posted a 20% reduction in its revenue base last quarter
 - ▶ Seagate’s revenues were down 19%
 - ▶ Western Union saw a 6.9% revenue decline
 - ▶ EBay’s revenues slipped 5.0% YoY (even as it raised 3Q guidance).
 - ▶ Qualcomm (#1 maker of chips for cell phones) saw its revenues dip to \$2.75bln from \$2.76bln

The “Revenueless” Recovery

United States

NFIB: Percent Reporting Higher Nominal Sales this Qtr, Net
(percent)



United States

NFIB: Percent Raising Average Selling Prices, Net
(percent)



The “Revenueless” Recovery

- ▶ After a nominal easing in earnings declines early in the reporting period, YoY earnings have plunged again back to -24% over the prior quarter



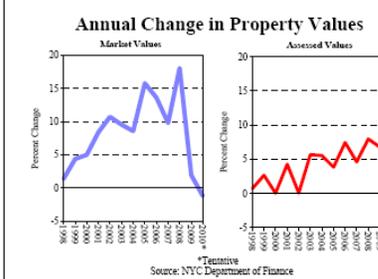
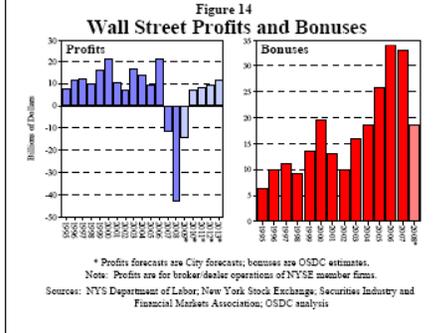
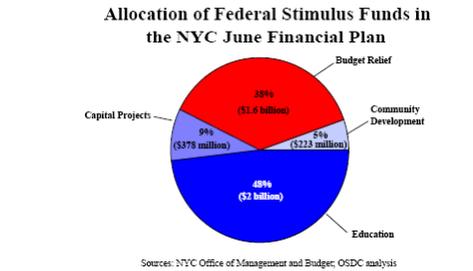
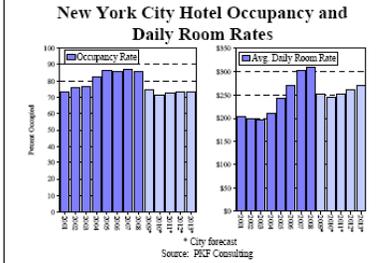
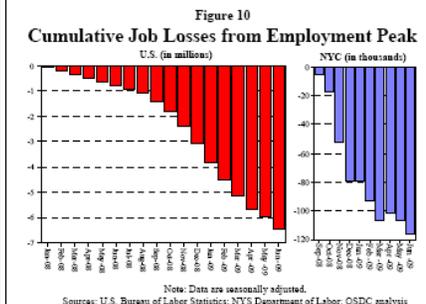
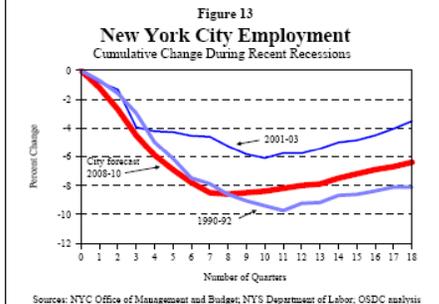
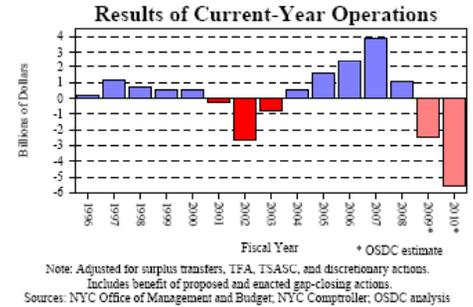
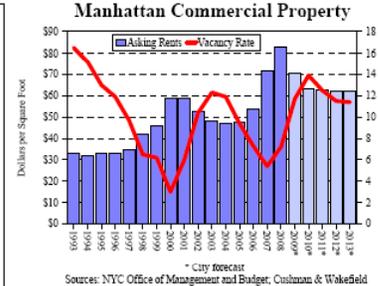
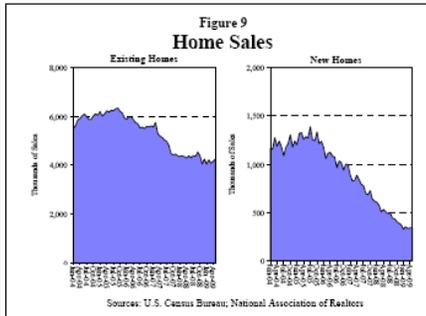
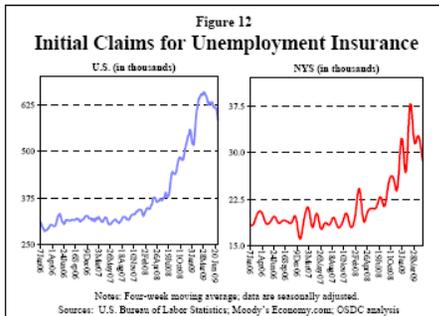
The State/Muni Budget Collapse

The State/Muni Budget Collapse

- ▶ US state tax revenues collapsed by 11.7% YoY, the largest decline since the records were first kept 46 years ago
 - ▶ 45 of 50 states reporting tax revenue decline
- ▶ Rockefeller Institute of Government estimates are pointing to a 20% slide in the second quarter!
- ▶ The cumulative state budget funding gap for 2010 is \$146 billion: **Obama's Stimulus is not working at the state level**
- ▶ California was the first “bankrupt” state, and the threat is spreading:
 - ▶ State governors are scrambling — in Illinois, Governor Quinn attempted to raise taxes but his proposal was shot down
 - ▶ Instead the state is facing deep spending cuts - a 14% slice to social services.

The State/Muni Budget Collapse

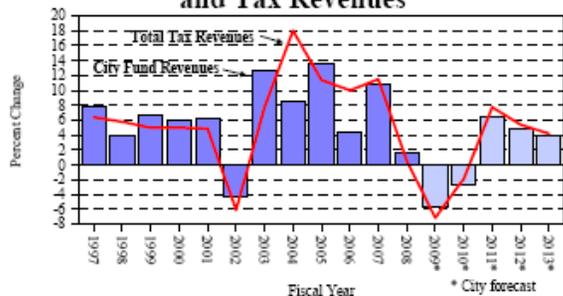
▶ New York City, the “Financial Capital of the World”, is on the brink



The State/Muni Budget Collapse

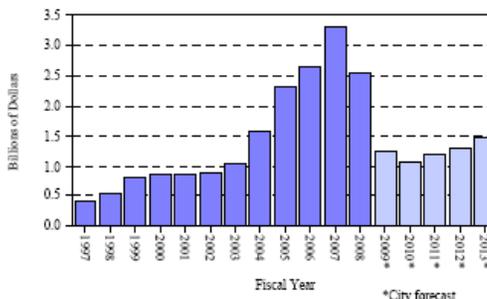
- ▶ NYC revenues were at bubble levels, expected to continue in perpetuity

Annual Change in City Fund Revenues and Tax Revenues



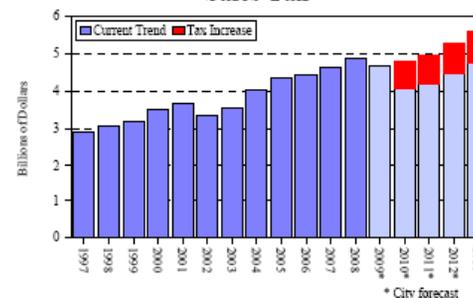
Note: Adjusted for debt service on TFA and tobacco bonds and the transfer of TSASC revenues.
Sources: NYC Comptroller, NYC Office of Management and Budget, OSDC analysis

Real Estate Transaction Taxes



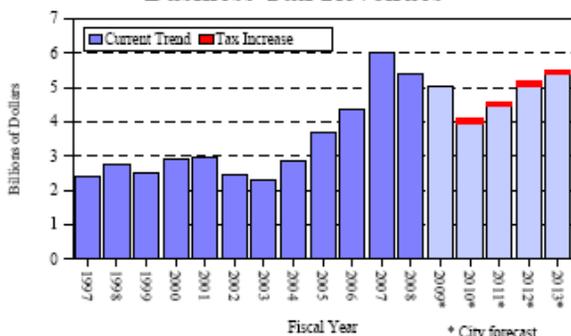
Sources: NYC Comptroller, NYC Office of Management and Budget, OSDC analysis

Sales Tax



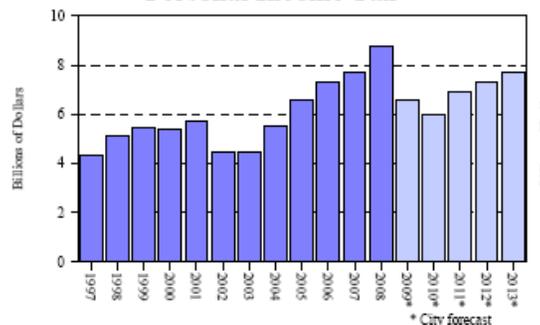
Sources: NYC Comptroller, NYC Office of Management and Budget, OSDC analysis

Business Tax Revenues



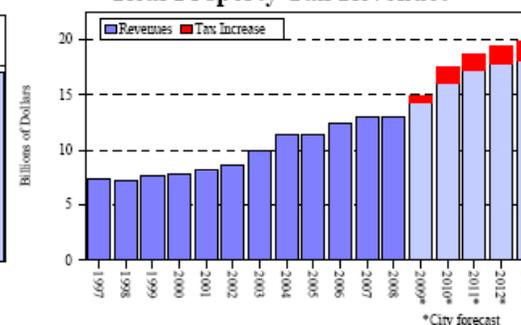
Sources: NYC Comptroller, NYC Office of Management and Budget, OSDC analysis

Personal Income Tax



Sources: NYC Comptroller, NYC Office of Management and Budget, OSDC analysis

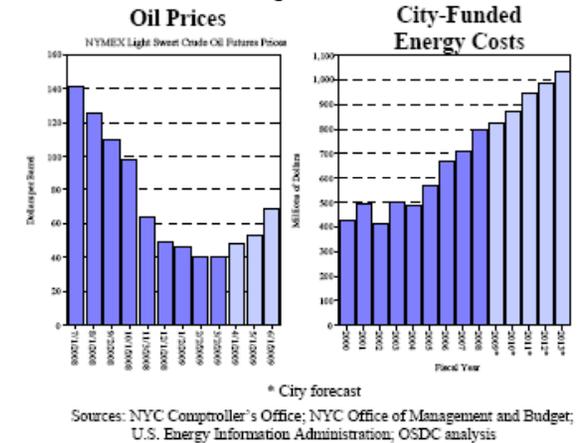
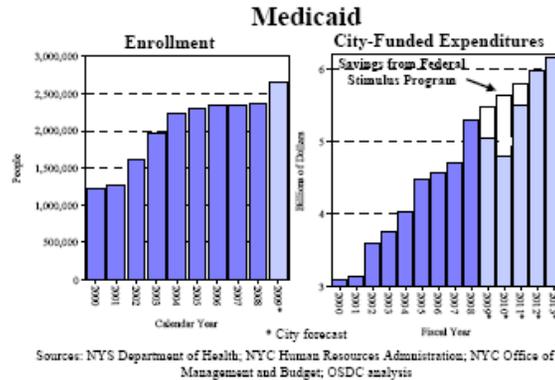
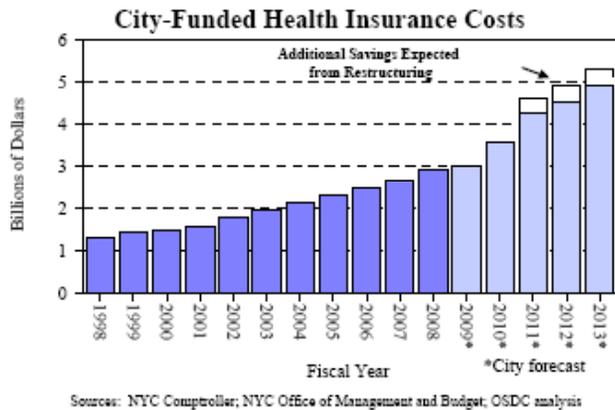
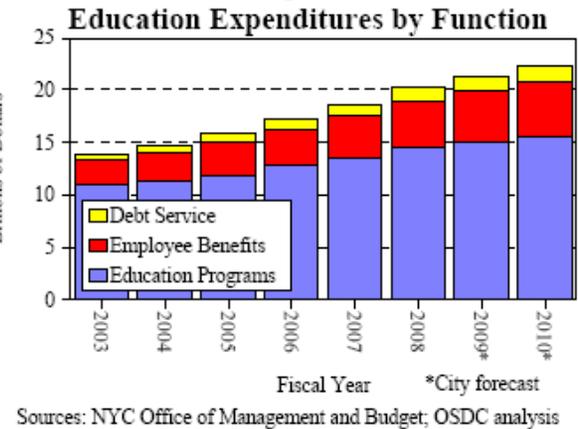
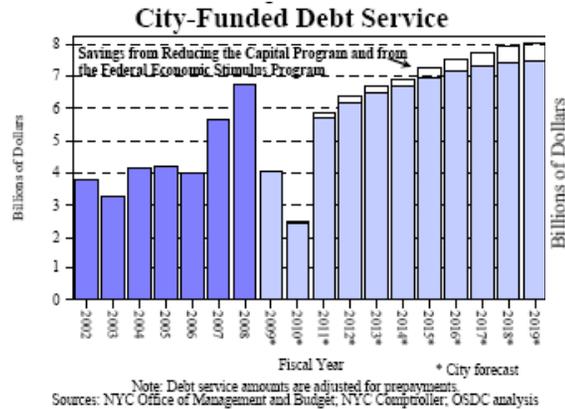
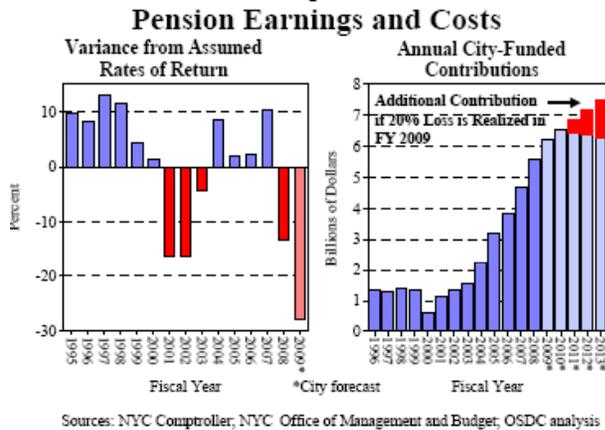
Real Property Tax Revenues



Sources: NYC Comptroller, NYC Office of Management and Budget, OSDC analysis

The State/Muni Budget Collapse

▶ While NYC costs and pension benefits keep escalating



Household Taxation

Household Taxation

- ▶ There are three tax increases on upper-income households that are now being proposed by the Administration and House Democrats to cover the health care plan, Social Security and deficit reduction.
- ▶ If these proposals live to see daylight, by 2011, we will see the top marginal tax rate jump 10 percentage points to 45%, back to where it was 30 years earlier
- ▶ Reagan's lesson is now completely forgotten
- ▶ Obama's Healthcare plan is a wealth redistribution mechanism

U.S. Bond Market

U.S. Bond Market

- ▶ While spreads have tightened across the board, credit news are getting worse
 - ▶ S&P downgrades hit a record in June
 - ▶ 15 companies were cut to junk (3rd most ever) and another 75 are on review for possible junk downgrades
 - ▶ Corporate defaults are running at 4x the pace of 2008, while corporate restructurings with debt-to-equity swaps are at a record
 - ▶ Non-gov't backstopped Commercial Paper market is showing no signs of life

United States

Commercial Paper Outstanding: All Issuers
SA, Bil.\$



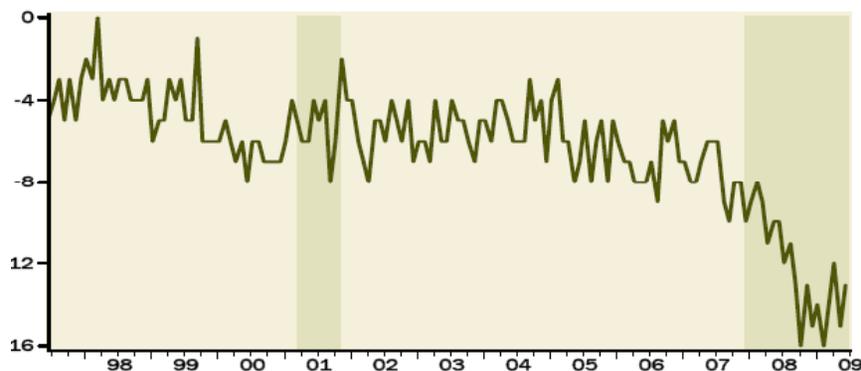
Source: Haver Analytics, Gluskin Sheff

U.S. Bond Market

- ▶ For all the talk of credit easing, up to now it is merely more hot air
- ▶ National Federation of Independent Business (NFIB) index at 87.8 from 88.9, well below 92.9 pre-Lehman level
 - ▶ Credit conditions for small companies remain inordinately tight, prohibiting business growth
- ▶ The inevitable failure of CIT will only exacerbate this problem

United States

NFIB: Percent Expecting Credit Conditions to Ease, Net
(percent)

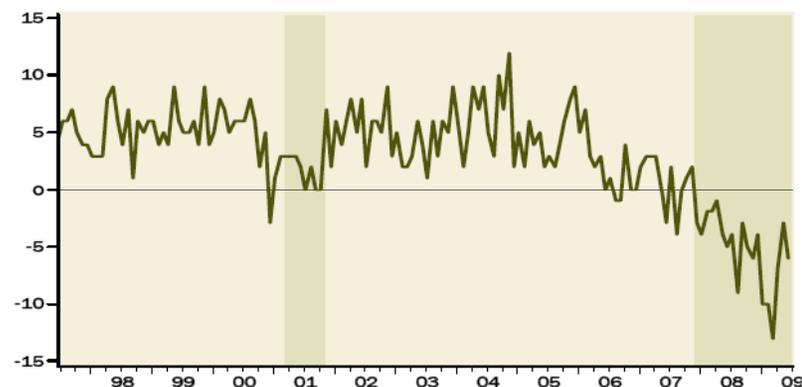


Shaded region represent periods of U.S. recession

Source: Haver Analytics, Gluskin Sheff

United States

NFIB: Percent Planning to Add to Inventories, Net
(percent)



Shaded region represent periods of U.S. recession

Source: Haver Analytics, Gluskin Sheff

Inflation/Deflation

Inflation/Deflation

- ▶ The Producer Price Index recorded a headline increase of 1.8% which was centered on energy and automotive (if anyone bought a Chrysler or a GM car in the last two months, please raise your hand)
- ▶ Some signs of improving trends in producer pricing power:
 - ▶ Processed chickens (+3.6% MoM and +7.2% YoY — much better than the overall PPI trend of -4.6%)
 - ▶ Soft drinks (+0.7% in June and +4.4% YoY)
 - ▶ Alcohol beverages (no comment -- +0.2% MoM and +3.8% YoY)
 - ▶ Pharma products (+0.8% MoM and +6.7% YoY)
 - ▶ Print media (+0.5% MoM and +8.0% YoY)
 - ▶ Aircraft engines (+0.2% MoM and +4.3% YoY)
 - ▶ Concrete (just ended a four month decline) and asphalt (up two months in a row — spiked 4.8% MoM in June) -- could be early sign of global infrastructure spending percolating

Inflation/Deflation

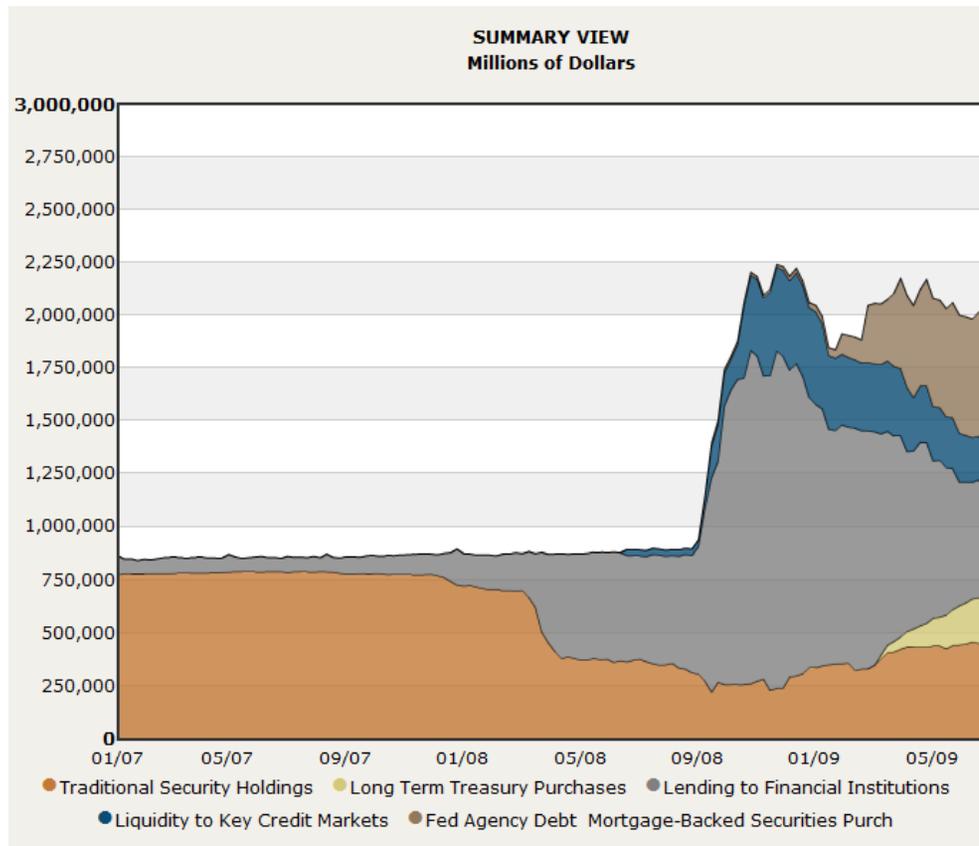
- ▶ While the previous page lists areas in manufacturing that have some pricing power, on the consumer side things are uglier
 - ▶ Most critically, rents, in tandem with wages, are disinflating rapidly.
 - ▶ The same trend is seen in air fares, medical care commodities (especially non-prescription drugs), delivery services, toys, and home improvement
- ▶ CPI sectors with pricing power:
 - ▶ Poultry prices at the consumer level are increasing - up 0.2% MoM and +3.6% YoY
 - ▶ Confectionary products and sweets too - up 0.2% MoM and +6.2% YoY
 - ▶ Soup prices are firm - up 0.8% MoM in June and 5.0% on a YoY basis
 - ▶ Soft drinks, also a price leader in the PPI, rose a solid 0.4% in the CPI and up 7.5% in the CPI report on a YoY basis
 - ▶ Other areas where pricing is looking decent is in autos (coming off depressed post-Lehman levels but have risen now sequentially for six months in a row)
 - ▶ Cable TV is okay — up 0.9% MoM and over 3.0% YoY
 - ▶ Women's clothing (but not men's) saw +1.6% MoM pricing in June — second month in a row of increase after a string of declines
 - ▶ It looks like hotel/motel pricing is starting to stabilize; ditto for movie prices
- ▶ Bottom line: the overall inflation rate is now running at -1.4% YoY
 - ▶ This is the lowest print since 1950

Inflation/Deflation

- ▶ Bottom line: the overall inflation rate is now running at -1.4% YoY
 - ▶ This is the lowest print since 1950
- ▶ The excess slack in the economy will take many years to be absorbed: there is no threat of real inflation in the future
 - ▶ FOMC Minutes: *“Members thought it most likely that the federal funds rate would need to be maintained at an exceptionally low level for an extended period, given their forecasts for only a gradual upturn in activity and the lack of inflation pressures”*

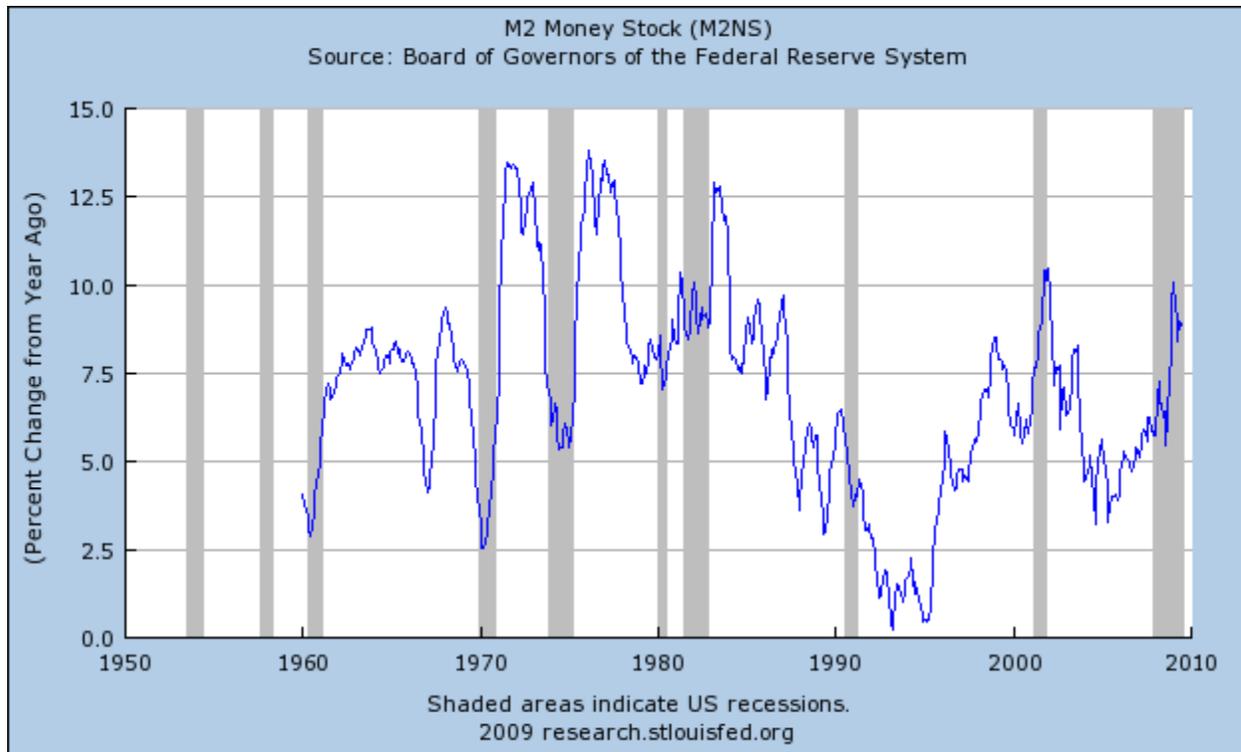
Inflation/Deflation

- ▶ The Federal Reserve's balance sheet has ballooned as a result of Quantitative Easing: open market purchases of trillions in treasuries and mortgage backed securities



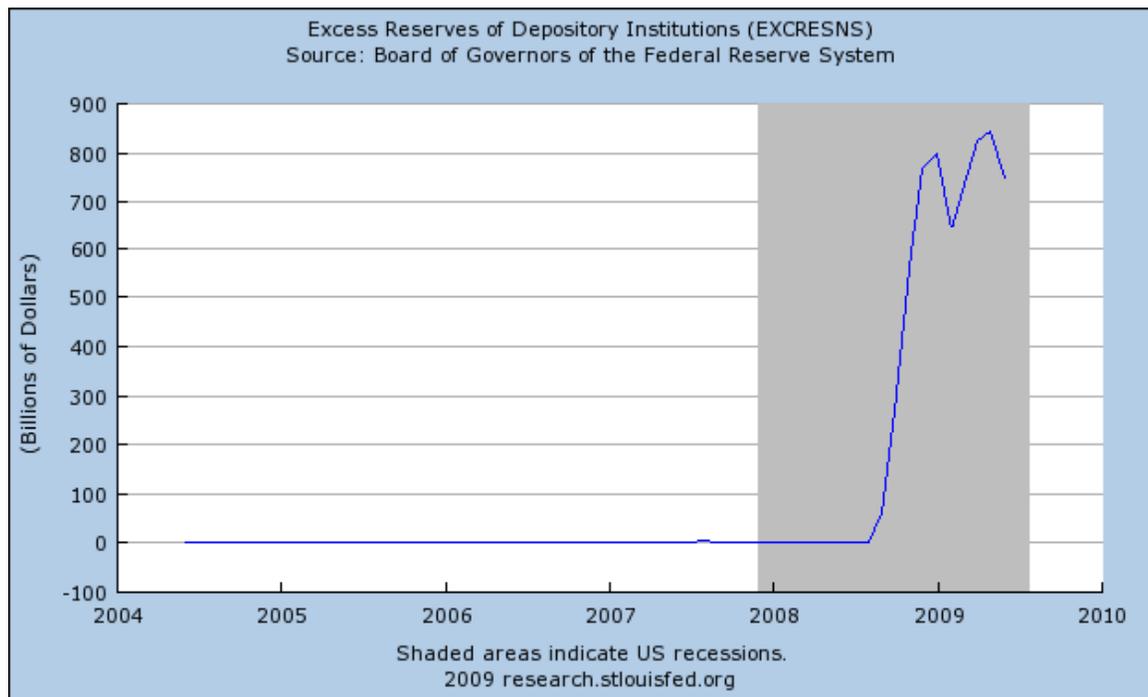
Inflation/Deflation

- ▶ Yet even as the Monetary Base has doubled to over \$2 trillion, the money multiplier has dropped by 50%, resulting in a virtually flat Monetary Supply (M2 Money Stock)
- ▶ Despite all posturing to the contrary, the Banks are not leveraging



Inflation/Deflation

- ▶ It is important to remember that on the asset side, there is \$750 billion in Excess Reserves of Banks which are **not** in circulation as currency, which is materially affecting the true monetary perspective
- ▶ Applying a roughly 5x multiplier to the Excess Reserves, results an almost \$4 trillion skew to the real monetary picture



Inflation/Deflation

- ▶ The end result is a dramatic collapse in the Velocity of Money
- ▶ Concerns by inflationists that Bernanke's printing presses will have a material inflationary impact soon are unfounded
- ▶ Additionally, as this money does not make its way to consumers (either from a supply or demand perspective), people end up not spending, and thus not competing for items on price
- ▶ Deflation will continue until this vicious cycle is broken
- ▶ The question then becomes how much more can the Fed grow its Balance Sheet liabilities before foreign countries completely shut down the spigot on purchasing U.S. Securities?
- ▶ The U.S. Federal Reserve is caught between a rock and a hard place:
 - ▶ **It has so far failed in its attempts to spur inflation, and any additional inflationary push could backfire materially, manifesting as an outright collapse in dollar denominated securities**

Conclusion

Conclusion

- ▶ Zero Hedge hopes to have demonstrated the tip of the iceberg on the topic of the Recession (and whether it is over): there is much more to be said on this topic
- ▶ We suggest that readers approach any definitive statements, be they from investment banks or the mainstream media, on the topic of the recession's duration, with infinite caution
- ▶ That said, by many metrics the economy is leaps and bounds away from anything remotely resembling a recovery
- ▶ The critical exercise is not to get caught up in everyday noise: there are many ways to push noise in one direction or another and to lead many to believe that signal is, in fact, the noise
- ▶ Keep in mind the noise is easy to uncover – it blares at your all day long from the mainstream media; the signal is much more difficult to trace, and usually involves a substantial dose of contrarian skepticism
- ▶ The take home message: seek the signal, avoid the noise, and do your own homework

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