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CLIENT BULLETIN

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➢ *Japan*

The scope of the human tragedy is the real story in the wake of the earthquake and tsunami in Japan. Economics takes a back-seat during times like these. Keep an eye on the highly disciplined and industrious people of Japan. Following the Kobe earthquake in 1995 their manufacturing activity was back to pre-quake levels inside of twelve months. After a ***90%*** decline in industrial production during World War II Japan was back to its' pre-war economic production within a decade and Hiroshima was a thriving metropolis by 1950.

➢ *Oil Part II*

Last month we examined the drivers of oil prices. This month we'll take a look at the price of oil's effect on the U.S. economy and its' inflationary role.

➢ *Oil and the Economy: A Tax on Consumers*

The primary transmission mechanism by which higher oil prices impact the U.S economy is through gasoline prices, even though U.S. consumers pay substantially lower prices for gasoline than our friends in Europe because they have much higher taxes on gas. Increased gas prices eat into the amount of disposable income that American consumers have left to spend on other goods. Therefore, higher oil prices can be said to act like a "tax" on the U.S. economy.

➢ *Inflationary?*

While it can't be proven, the most "known" price of any particular good service in American is the price of a gallon of gasoline. As such, when oil and gas prices rise, the tendency is for American consumers to believe there is an inflation problem as this rise in prices is reflected in the Consumer Price Index (CPI). But here is where the plot twist comes in; though higher energy costs show up in the near term as "inflation", the intermediate to longer term impact of sustained high gas prices is actually deflationary.

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If American consumers are suddenly paying $0.50 more per gallon of gas today than they were a year ago, it means they have less money available to go to the movies or buy clothes. As a result, higher oil prices act as a giant speed-bump for the U.S. economy. Unlike most other types of spending, paying more for gas doesn't help our economy much as most of the money goes overseas where the oil is produced.

- ***Unemployment - Two Steps Forward, One Step Back***

The economic recovery is finally starting to get some traction in terms of bringing the unemployment rate down. Don't be alarmed, however, if the unemployment rate blips back upward simply due to the way it is calculated. In the unemployment calculations there is a classification for "marginally attached" workers – those who have looked for work at some point in the last 12 months but are not considered unemployed since they did not look for work in the 4 weeks leading up to the employment survey. As the labor market continues to improve, these workers, encouraged by this more positive data, may go back to looking for a job, causing the unemployment rate to move higher.

- ***Municipal Fears***

Unlike the federal government, states and the 8,900 different local government entities that can take on debt on behalf of their constituents don't own a printing press. That's why a handful of experts in public debt financing are warning of significant municipal defaults and even bankruptcies. Throw in a poorly researched 60-minutes episode and other media coverage that is long on drama and short on analysis and you get a very nervous municipal bond market. Most reports point to the annual deficit faced by many municipalities, including California's $25.4 billion deficit this year.

- ***Municipal Perspective***

While deficit figures like California's are eye-catching, the debt obligations of states and cities are not the problem. Troubled Illinois, for example, owes about $2 billion on its debt annually but that is just 4% of its total budget. Why would it default on ***all*** of its debt to relieve itself of ***4%*** of its total budget? Defaulting on such a small account would significantly drive up its cost of borrowing thereby negating the benefit of relieving itself of the obligation to make debt payments. The real problem, it is now clear, is that states and cities have burdened their future finances with impossible pension and healthcare obligations to current and former employees which is why you are seeing new legislation in Wisconsin, Ohio and other states. More on this to come…

- ***Quote of the Month***

"Don't worry about the world coming to an end today – it's already tomorrow in Australia." Charles Schultz

The information contained in this newsletter is of a general nature and should not be acted upon in your specific situation without further details and/or professional assistance.