THE U.S. ECONOMY IS LIKELY TO FACE FURTHER PROBLEMS BEFORE THE YEAR IS OUT

And It Will Impact On Asia

The **O**rganisation of **P**etroleum **E**xporting **C**ountries (OPEC) appears to have been correct in stating, on or about May 12, that increasing OPEC's flow of oil to the international marketplace would not bring down the price of crude oil.

Mr Purnomo Yusgiantoro, the President of OPEC, said, on May 12, 2004, that it was the aim of OPEC to stabilise the price of oil on international markets.

At the time of this statement, Mr Purnomo Yusgiantoro said that OPEC was, as at that date, pumping about 2 million barrels of oil in excess of official OPEC supply limits.

On The **N**ew **Y**ork **M**ercantile **Ex**change (NYMEX), on May 12, 2004, the price of light sweet crude oil for May delivery was about $US40.35 per barrel, and, for June delivery, the price was about $US40.77 per barrel.

Last Friday, the price of light sweet crude oil on The NYMEX was being settled at $US41.25 per barrel for August delivery, with the price for September delivery, being about $US41.30 per barrel.

OPEC has vowed to increase oil exports by some 500,000 barrels of oil, daily, but there are, now, grave questions, being raised, as to the effect that this increase will have on world markets.

Iraq, where terroristic attacks are damaging oil installations and oil pipelines, almost daily, is suffering, badly: It cannot maintain exports of 2 million barrels of crude oil on a daily basis, simply because it cannot guarantee the integrity of its oil infrastructure.

Further, as was widely reported, just last week, certain **V**ery **L**arge **C**rude **C**arriers (VLCCs) were refusing to put into certain Iraqi ports, as their crews were very concerned for their safety.

The last-reported such incident was in respect of the crew of a VLCC, owned by the shipping company of Mr George Chao, the Chairman of Wah Kwong Shipping.

On June 2, 2004, the price of light sweet crude oil hit $US42.56 per barrel – and last Friday's price was not far off that level.

For the US economy, the relatively high price of international oil will be felt at the petrol pumps where consumers will have to pay more to fill up the tanks of their vehicles with refined fuels, such as unleaded petrol or diesel fuel.

This will subtract from consumer spending, generally, because there will, eventually, be less disposable income available in the family budget for the purchase of replacements of household items, clothing and accessories, luxury items, and/or a new family motor car.

Higher prices for petrol at the pumps do impact on consumer spending in the US, to be sure.

Late in the month of May, consumer confidence in the US declined markedly, but recovered, somewhat, in the month of June.

The phenomenon was consistent with the increase in the price of petrol, which rose to more than $US2 per gallon.*

(* **TARGET** is referring to a US gallon, as opposed to an Imperial gallon: US gallon = 3.79 litres; Imperial gallon = 4.55 litres)

It would appear that, at about $US2 per gallon, US consumers balk, some, very loudly, too.

While short incidents of petrol prices, rising to or past $US2 per gallon, may not have much of a long-lasting effect, the probability now exists that $US2 per gallon for petrol may become the norm in the US rather than the exception.

Unless, of course, the US Government intervenes, one way or another.

If it should transpire that $US2 per gallon for unleaded petrol is accepted as being the norm for US consumers – and there is evidence, now, that it might – then, it is quite likely to erode consumer confidence in the US Government.

And, there is ample evidence to suggest that, in fact, this has, already, taken place.

High prices of energy will impact on the entire North American Continent, including Canada.

As **TARGET** has stated, many times in the past, when the US catches an economic cold, other countries, including nearly all of Asia, catch economic pneumonia.

Industrial Production

It was only last Thursday (Please see **TARGET** Intelligence Report, Volume VI, Number 134, published on Monday, July 19, 2004) that this medium reported a release from the US Federal Reserve Board in respect of industrial production for the month of June.

In that release, The Fed reported weaker figures for June, compared with May – The Industrial Production Index fell from May's figure of 116.50 points to 116.20 points – a 0.26 percentile drop.

The lower production levels resulted in capacity utilisation to fall by about 0.40 percent, Month-on-Month.

The Fed's Industrial Production Index indicated, inter alia:

1. Manufacturing decreased, Month-on-Month, by 0.10 percent; and,

2. The production of consumer goods decreased, Month-on-Month, by 0.70 percent.

While, on the one hand, it could be held that the fear of inflation in the US may be said to be abating, somewhat, on the other hand, this situation is akin to a 2-edged sword that faces the US economy.

While one swallow does not make a spring, of course, statistics, pouring out of various US Government departments do not augur well for the economy, overall.

One must remember that industrial production in the US is a large constituent of the national output and, as such, it points the way to the state of the economy.

Retail Sales

Retail sales in the US fell, also, in the month of June, according to the US Government's Bureau of The Census.

Sales of motor vehicles in the US were responsible, in large part, for a decline of about 1.10 percent in National Retail Sales for the month June, compared with a gain of about 1.40 percent in the month of May, seasonally adjusted.

The following is taken from the release of The Bureau of The Census, dated July 14:

National Retail Sales
(Month-on-Month Percentage Changes)

Category	June 2004	May 2004	April 2004
Food and Beverage Store Sales	(0.10 percent)	0.80 percent	0.10 percent
Clothing and Accessory Store Sales	(0.50 percent)	1.40 percent	(2.10 percent)
General Merchandise Store Sales	(0.20 percent)	1.10 percent	(0.80 percent)
Food Services and Drinking Places Sales	(0.80 percent)	0.30 percent	(0.10 percent)
Gasoline Stations Sales	(0.90 percent)	5.00 percent	(0.20 percent)

While Year-on-Year sales in the above categories of National Retail Sales may appear to tell of an improved picture in the US, it is evident that there is a clear indication of the beginning of a reversal of this trend.

Rising interest rates in the US and the amount of disposable income at the household level are, obviously, responsible for the drawstrings to be kept tighter on family purses.

Consumers, simply put, do not have the wherewithal to spend as they did in the past.

And, lurking in the background, as a principal reason for the downturn in consumer spending, is the high price of energy, which is having a very telling effect on budgets, from households to US industrial complexes to multinationals.

US motorcar manufacturers are having to rethink their future strategies, too, because American-made, petrol-hungry motor vehicles are fast becoming unpopular in many parts of the country, for obvious reasons.

Also affecting the ability of Mr and Mrs America to spend in stores are near record debt burdens, brought about by the relatively cheap price of money that has existed over the past few years, and a decided slack demand for motor vehicles, new homes, and home-related goods.

TARGET notes that June's retail sales in the US posted their largest falls since February 2003.

Whether or not the July sales' statistics will eclipse the declines of June's sales will be interesting to watch; it has been suggested that, due to gains in the job market, there could well be a waning of such declines.

Against this prospect, however, as energy prices continue to maintain their present high levels, no doubt, employers in the US will look to cut costs in order to stay competitive in the marketplace, domestically, and internationally.

The Possibility Of A Housing Bubble Collapse

At this juncture in the US economy, nothing could be more dramatic than a sudden collapse in the price of houses.

Depending of the severity of such a collapse, it has the possibility of being more devastating to the economy than a collapse of 33 percent in the current value of the key index of The New York Stock Exchange, the Dow Jones Industrial Average, or a similar drop in the value of the Composite Index of The NASDAQ.

In the month of June, The US National Association of Home Builders reported a softening in its Index: From 69 points to 67 points, equivalent to a 2.90-percentile drop, Month-on-Month.

Rising mortgage rates are impacting on house sales, both in the primary market and the secondary market.

The fixed, 30-year mortgage rate is, today, more than 6 percent per annum.

What had been fuelling the housing market of the US was the relatively low, debt-service component of the budgetary considerations to the family unit.

But that is set to change if the US Federal Reserve Board continues to raise The Fed Funds' Rate.

In a survey, conducted by The National Association of Home Builders, it was learned that builders are expecting a slowdown in the sales.

The question is, of course: How fast will sales slow?

A graduation decline will result in builders, slowing down the pace of construction, thus permitting supply-demand factors to ameliorate the situation.

But, if there is a fast erosion of sales, many builders could find themselves, going to the wall.

The National Association of Home Builders charts, what it terms, Traffic of Potential Buyers.

It noted that, in the month of June, the Traffic of Potential Buyers dropped, Month-on-Month, by about 5.45-percentile points, to 52 points.

As for actual sales of homes in the US, they have been in decline since the last quarter of 2003.

There is a strong probability that there will, before the year is out, be a glut of new homes on the market, with no, or few, takers.

Then, prices of homes, both new and used, will fall rapidly and, depending on the severity of the price falls, take many a builder down the greasy pole into insolvency.

<u>Inflation In The US</u>

Turning back, once again, to the high price of oil on international markets, as **TARGET** has stated, on many occasions, the knock-on effect of high energy prices is that they are inflationary – in the extreme.

Throughout the world, today, airlines are passing on the higher costs of jet fuel to passengers in order to try to recover positions.

Fuel oil to airlines represents anywhere between 15 percent and 30 percent of operational costs, depending on the type and age of aeroplane, being flown, and what various airlines determine to define as *'operational costs'*.

Shipping companies, trucking companies, bus companies and so on are all having to impose surcharges on their customers in order to account for the higher cost of fuels.

These additional costs will be with consumers for the foreseeable future.

In capitalistic societies, it is with a great deal of reluctance that companies reduce costs to customers.

The US Bureau of Labour Statistics, a division of The Labour Department, announced, just last Friday, that the **C**onsumer **P**rice **I**ndex (CPI) had risen in the month of June by 0.30 percent.

(The CPI is the US Government's index of the retail prices of basic household goods and services)

The reason for the increases: The higher price of energy.

These are the findings of this important, US Government department:

		Percentage Change Month-on-Month			Annualised Change in Percent		
CPI for all Urban Consumers	**Weights**	**June**	**May**	**April**	**Three Months**	**Six Months**	**Twelve Months**
All Items	100	0.30	0.60	0.20	4.80	4.90	3.20
Food and Beverages	15.451	0.20	0.90	0.20	4.90	3.20	3.70
Housing	40.04	0.30	0.40	0.40	4.10	3.80	2.60
Apparel	4.819	0.20	0.30	00.00	2.00	2.00	0.50
Transportation	17.77	0.80	1.70	0.10	10.90	12.90	5.60
Medical Care	5.563	0.30	0.30	0.40	3.80	4.80	4.60
Recreation	6.124	0.30	(0.20)	0.20	1.10	1.70	1.20
Education and Communication	6.068	0.20	00.00	0.30	1.80	1.80	2.10
Other Goods and Services	4.164	0.10	0.10	0.10	1.30	2.10	2.00
Special Items							
Energy	6.717	2.60	4.60	0.10	33.50	36.00	17.00
Food	14.432	0.20	0.90	0.20	5.10	3.20	3.80
Ex Food and Energy	78.851	0.10	0.20	0.30	2.30	2.60	1.80

One, immediately, on scanning the above table, notes the effect of energy costs on the CPI.

TARGET recognises that, during the month of June, the price of petrol in the US rose by about 3.10 percent, after an increase in the month of May of about 8.10 percent.

It is on the rise, again, contrary to that which many economists had expected.

The single, most-important question for the period, up to the US Presidential Elections of November, this year, is whether or not crude oil prices will continue to rise.

If they continue to rise, or stay above the $US40 per-barrel level, the US economy could be in for a very rough ride.

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