Priorities and Politics

The races for the 2012 elections have started and neither party is looking ahead with a great deal of confidence when they check the polls. The most common voter reaction at the moment is frustration with the President, Congress and both parties – not to mention their state and local leaders. The old political adage has never been more accurate – it's the economy, stupid. The problem is that voters want to address two very separate issues and that requires some very different government response. In many cases the same voter wants two diametrically opposed policies to be implemented at the same time and that presents the political leaders with a no-win situation as they will get little credit for what they do attempt while being vilified for what they don't do.

The economic growth that had been anticipated for the year has not been manifesting. Although there has been growth it has been tepid and has not had the impact on critical segments of the economy that had been hoped for. To the political leadership, the only factors that really matter are those that the average person responds to and these include employment and prices. The surge in inflation may not have alarmed the Federal Reserve but it has shocked the consumer and all but eliminated the boost to the economy that was supposed to come from reduced social security taxes. The bulk of that extra cash seems to have been directed at paying for the gas hike.

The expectation had been that employment numbers would be taking off by now but each month they have remained anemic as new claims surge every other week. The news is not getting appreciably worse but the sense had been that things were going to be much better by this point in the year. The longer the unemployment rate stays high the more frustrated the voters gets as this is the one economic indicator that matters the most to people – even if they have a job. There is overall uneasiness that as long as there are people still losing their jobs they stand to be the next in the unemployment lines.

Analysis: This is the dilemma for the politicians. Which crisis should be addressed if they want to remain in office? Do they stay committed to the longer term issues of the deficit and debt reduction or do they switch gears again and return to programs designed to boost the economic recovery? The voter is not much help on this decision as they are still asking for both. There remains an attitude that deficit reduction is simply a matter of cutting waste but the problem is that many voters define waste as anything that doesn't apply to them. Given that definition the politician can cut nothing without offending some constituency. If the decision is made to do more to boost the economy there will be additional spending decisions made and that implies that other programs will need to be cut or the deficit will have to burgeon further.

Both parties would love to see some kind of general economic growth take place. They know that most large corporations have more money in reserve now than they have had in years. The problem is finding a way to pry it out. The decision to hold cash is a reaction to the dramatic changes in the financial community and the fact that growth prospects are limited and thus far nobody has a sense of when things change.

Greek Mess Threatens to Engulf Europe and the World

Timing is everything. The assumption all along has been that Greece would default at some point as there is too much debt to deal with given the resources available for Greece. There is no way that austerity plans can be draconian enough to deal with the challenge and there is no way that a nation that treats tax evasion as a national sport is going to reverse course fast enough. The majority of analysts have assumed that Greece was headed for one of three equally unpleasant outcomes – a total default on obligations that would render Greece financially radioactive for years, a forced restructuring of these debts that would result in much the same attitude among investors or a scenario in which Greece would be cast out of the Eurozone altogether. This would do little to help Greece in any way but it would at least isolate some of the problems from the rest of Europe.

The hope as far as Europe is was concerned was that Greece would be able to hang on for a while longer – at least long enough for the other threatened economies to get their act together. The inevitable decline in Greece does not mean that the same fate awaits Portugal, Spain, Ireland and others but if Greece skids into real crisis in the next few months the impact on the other states will be more severe. The plan was for Greece to come to grips with its default by sometime next year but it now looks like the worst case scenario is likely to emerge as early as July of this year.

(Continued)

Analysis: It all comes down to the investors. The plan had been to keep them calm enough to exercise patience. That is not working out as planned and by all accounts the investors are bolting from Greek debt as well as that from the other threatened nations. They are expecting to get slammed and are therefore getting ready to pull out en masse. They expect that bondholders are going to get restructured and will lose most of the value of the bond or they will be forced to accept much delayed interest payments. The Greek debt is now trading at a 25% and that is a full 23 points worse than German debt. This is double the yield from a year ago when the crisis started to manifest.

The situation is made much more complex by the type of investor involved in much of the Greek debt. They are the least likely to exercise patience and restraint. As the Greeks economy faltered in the last few years the traditional bondholder did the prudent thing and sold out. These are the investors that treat bonds as secure, the ones that buy bonds instead of stocks because they are generally more risk averse. If you want excitement and volatility you do not generally choose government bonds, these are the instruments that one puts in a portfolio to protect assets. As these investors abandoned the Greek debt and that of the other struggling nations, they sold to a different kind of bond investor. These were the risk takers that saw very favorably priced bonds with high yields. The assumption made by these investors was that Greece and the others would be rescued by the Eurozone and the IMF and therefore their risks would be mitigated by these bailouts. If the chances of a rescue diminish, the bondholders that had been betting on seeing their high yield gambles pay off begin to rethink their position. That is what is happening right now. Some of those who jumped in to the market expecting the guarantees to protect them are now watching the Eurozone leaders back away from those commitments and they are looking to dump their holdings before things get even worse. There are still investors that believe that the EU will find a way to keep Greece from tumbling off the precipice but if the situation continues to darken they will bail as well and the bottom drops out.

The implications for the other states are bound up with these investor reactions. The logic will assume that if Greece doesn't get a rescue than the others will not and that makes investing in their bonds as risky as investing in the Greek bonds. The whole rescue operation for the struggling nations is based on the engagement of the investor. There is not enough public money to bail these nations out unless there is engagement from the private sector. The assumption had been that Greece would not have to borrow any more money this year and that would give the other nations some time to get their affairs in order. Greece announced that it would need another $17 million from the IMF by the end of June and this has sent some shock waves through the system – especially given the fact that the IMF is essentially leaderless at the moment. The fear is that all of this could start to cascade at a very rapid rate if there is an overall lack of confidence among investors. They are looking at an IMF without a director and a Eurozone that is deeply divided between those who want to bail out Greece and those who do not favor that action. The credit rating institutions are poised to dump more bad news on the struggling states and that could precipitate a panic reaction that wrecks the whole plan.

Consumer Spending Slows

The manufacturers carried the economy along for much of the year – reacting to the demands from the overseas markets and the fact that business was trying to boost its inventory level. The consumer was missing in action for the majority of this period but at the start of the year it looked like there was some life showing in the retail community. That promise has yet to be fulfilled as the year proceeds and now the manufacturer has run out of steam. The latest data shows an anemic retail picture as the average consumer has returned to their frugal and cautious ways. The only gains that have taken place in terms of retail spending have been due to the higher costs of food and fuel and that is the kind of gain that one would prefer to avoid.

Consumer spending rose only 0.4% in April and that is less than the 0.5% rate notched in March. It was thought that spending has been a bit more robust in March but the numbers were revised downward. The spending hike was only 0.1% once adjusted for inflation and that marked the second month in a row these figures were that low. The consumer is not seeing their income levels rise in this period and that is causing more stress yet. The savings rate has also fallen to 4.9% and that is the lowest it has been since the recession caused people to start trying to deleverage. The fact is that many people have been forced to dip into their reserves to pay for the price hikes at the pump and elsewhere.

The off thing is that consumers are reporting that they are actually more optimistic than they have been in a while but many analysts think these readings are temporary at best and represent a short lived reaction to the fact that gas prices faded a little from where they had been. Though it is true that the price per gallon sagged from a national average of $4.05 to $3.70, the price remained close to a dollar higher than it was at this time last year. The prediction was that gas prices would sag by around 40 cents and they did – small consolation when one looks at the hike from just a few months ago.

Analysis: The jury is out on the economic rebound. It has not stopped altogether and the GDP numbers are still going to be in positive territory for the second quarter. There is no double dip recession to consider but neither is there a rebound that will make everyone start to feel that happy days are near. The economy is stuck in a very low gear and that does not bode well for employment, the housing sector, retail or any other segment of the economy. The sense is that there is nothing left to jump start the system until there is a compelling reason for the business community to start spending the cash they have put aside. The Catch-22 is that business will not spend that money until the consumer gets engaged and the consumer can't get engaged until that money is spent and jobs are created for the workers who are also the consumers. It is a matter of who will blink first. The export markets have been fading as the rest of the world slumps and that puts more pressure yet on the US consumer.

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Boost for Alternative Energy or Overreaction

The nations of Japan and Germany have started to make some dramatic moves as regards alternative energy. These decisions will either ramp up the development of wind and solar and geothermal or it will result in a massive investment that sets back the goals set by those most concerned about climate change. The single most affected technology in all this will be that of nuclear power. Just six months ago the solution for a world concerned with the impact of greenhouse gas was the radical expansion of nuclear power. The leading advocates of nuclear energy included Japan, Germany, France, China and to a lesser extent the US. Today Japan and Germany have both taken steps that will place the expansion of nuclear energy on the very bottom of the list of alternatives. The disaster in Japan has utterly crushed the political support for the expansion of nuclear energy despite the fact that engineers have repeatedly pointed out that the crisis only exposed the vulnerability of the old systems. The newer facilities would not have experienced any of the crisis but the fact that a section of Japan is now a radioactive hotspot as threatening as the one that remains at Chernobyl has all but ended support for the development of nukes.

The Japanese have now stated that they plan to go all out in favor of the new technologies of alternative energy. This means that no effort will be spared to develop wind and solar and other alternatives. This will have one of two impacts. The best case scenario is that Japan will put the effort needed into the development of alternatives and conservation and this will allow the price of these alternatives to come down. The effort could plow the way for the rest of the world to adopt these technologies and in a few years the world will be getting more and more of its energy from the sun, wind and waves.

The other alternative is not so positive. The Japanese and others are planning to use the current options other than nuclear while they develop the alternatives. That means use of natural gas when available but it also means oil and coal. These are considered stop gap measures but how long these are in the mix will depend on how fast the alternatives are brought to speed. Here is the risk. Thus far even the most ambitious advocate for wind and solar and the like has been reluctant to assert that these will be able to supply more than a fraction of energy need and now the intent is to make these options carry the full load. That is an incredibly ambitious expansion and will require radical changes in the way that people use energy. The fact is that the majority of the alternative technologies require that people and businesses produce a great deal more on site than they do now. The alternatives do not lend themselves to the big centralized power plants and that means that there will have to be far more localized production. That is a societal change as much as it is an energy shift.

Analysis: The positive scenario holds that great progress is made in developing these alternatives and the world soon faces a much improved energy plan that reduces its dependence on fossil fuel consumption without adding the risks of nuclear power. The threat of global warming is reduced and the world is well on its way to some sense of energy sustainability. The not so positive scenario holds that the development of these alternatives is harder than it appears and the world stays committed to the use of fossil fuel for longer than expected. It had been assumed that nuclear power would be the technology that bridged between the use of oil and coal and gas to the use of wind and the sun. Now the intent is to jump that bridge and proceed directly. It is a gamble that could pay dividends for many generations or it could make an already serious situation worse.

Campaign for IMF in High Gear

The campaigning for the leadership of the IMF is intense and Cristine Lagarde is working to make all the right assertions at the same time that she is looking at the potential meltdown of Europe. The fact is that she will be faced with an immense crisis the moment she takes the post – assuming that she does so. The situation in Greece is dire and that means that the IMF is going to have to make a decision on additional funding soon. The nations that are demanding statements of support from Lagarde are not all that concerned with what happens in Europe and seeking assurance that she will pay close attention to their issues. She has to convince the Brazilians, Indians and Chinese that she is in their corner while all the while looking over her shoulder at the simmering disaster in the EU.

Analysis: It is not that these nations are unaware of the risks from a Greek default but they have been waiting their turn for a long time. The effort to place one of their own in that post evaporated in part due to the European crisis but that does not mean that they will be content to sit on the sidelines and wait for the next opportunity. The IMF is going to have to be a more universal institution in the years ahead and will be limited in what it can devote to those traditional concerns.

Libyan Rebels Running Out of Cash

The uprising against Muammar Kaddafi has been financed largely with the oil that had been captured by the rebels. They have been using that stock to buy supplies and weapons and this has allowed the NATO nations to avoid having to incur even greater expense in their effort to support them. That supply of oil is running out and quickly. The refineries have been the scene of heavy fighting and production has been compromised in the last several weeks. The rate of oil sales has slowed as there has been an attempt to conserve what remains. If the oil supply is depleted, the rebels will be dependent on the NATO nations to finance the whole effort and that is not going to be a welcome development given the cost of the conflict already and the economic strains that affect these nations. The sense is that there is a renewed effort to bring this conflict to an end because everyone knows what the financial implications will be if it is not ended soon. The capacity for support is limited and there is no realistic assumption that the US will be able to step in and handle more of it.

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Remembering

Memorial Day has come and gone and for most of us this has been a long awaited holiday and an opportunity to start thinking about the summer to come. Every year there are editorials about the lack of attention paid to remembering. It is supposed to be a day devoted to the ancestors. It is a day to remember the sacrifices that people have made to defend our nation and this is a very worthy thing to commemorate. There are other sacrifices though – subtle but just as worthy of attention. This was a weekend to remember those in our families that have died and as we think about their lives it is important to understand what they meant to us.

It is easy enough to think about the immediate family – the parents and grandparents and the brothers, sisters and even children. The ones who don't readily come to mind are the more distant ancestors that paved the way. In recent weeks my wife has been engaged in some serious genealogy research on her family as well as mine and the discoveries are fascinating. It becomes apparent what had to take place to deliver us all to where we are today. As we think about those we lost it is important to remember those who we never knew but whose influence is in all of us.

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