

US “Cash for Clunkers” Already Stripped Out

The US government effort to bolster the car industry through providing incentives for people to trade in their inefficient clunkers for a new car has been a wild success. But the planning that went into the system seems to have been sadly lacking. The idea was one that was pioneered by Germany who launched their version in January of this year. The intent was the same, to stimulate the domestic auto industry with an incentive to trade away cars that were not helping the nation’s fuel efficiency in the first place. The German program started out with an allocation of \$7 billion and looks set to move to at least \$10 billion. This, in a nation that has a much smaller population than the US and a much smaller population of vehicle owners. The US program allocated only \$ 1 billion and it appears that the program has been outstripped already. There are discussions underway regarding what to do now – suspend the program only days after its start or allocate more money to the effort.

The threat to the dealers is that they will not get the government money promised if their deals hit the government too late. There will also be a lot of potential car buyers frustrated with the promise and its abrupt withdrawal. In the beginning it was pointed out that \$1 billion was a paltry sum and would be far less than required but these warnings were disregarded. Now the program is on the edge of becoming a fiasco as opposed to an economic stimulus.

Analysis: There is a bigger issue at stake in this debate. The pattern of the last several months has been compromise to the point of failure. The stimulus package was supposed to be focused on job creation and infrastructure and in the end it was weakened by the need to appease all of the political constituencies involved. The money has been slowly leaking into the economy and in a wide variety of ways – far from the rush of funding focused on job growth that it was supposed to be. The stimulus money is just starting to flow into most of the country and that is at least four months slower than had been planned. The money that was supposed to provoke banks to increase lending has not accomplished that goal in the manner initially anticipated although TARP funds did manage to keep the banking system from collapse.

The pattern has been repeated in a variety of programs. The original idea has been focused on the most immediate of economic priorities but the powers that be can’t seem to get past their own individual agendas and priorities to implement a clean and efficient program. The cars for clunkers idea did not work perfectly in Germany either but that was more a result of consumer preference as many decided to buy fuel sipping foreign models rather than the BMWs and Mercedes that the German government had hoped. The US version of the program might have learned some lessons from the Germans but the series of compromise moves needed to get it through Congress made the plan vulnerable to the critiques that have been leavened against it thus far.

Japan Teeters on Edge of Economic Progress

There was a time that Japan grabbed the headlines that China does today. This was the first of the Asian “miracle economies” and at the time it was the most unlikely of nations to reach that peak. It had been one of the most isolated of countries for generations – safe behind the ocean that surrounded it. They had been spectacularly lucky over the years, beating back the Mongol invasion of Kublai Khan with the help of a typhoon that came to be called kamikaze (divine wind). They defeated the Russians in 1905 and held off the western encroachments through the next decades before they pushed their luck in the 1930s and 1940s. Japan’s recovery after the Second World War was nothing short of spectacular and by the 1970s it looked as if they would take over the world. By the 1990s the economy was in tatters – facing an almost decade long period of decline and deflation. The nation clawed its way back in the last ten years but has slipped again and faces that specter once again.

The latest data shows that deflation has reared its ugly head once again and the Japanese government is in no position to do much about it. The rate of consumer price decline is as steep as was in the 1990s although there are some different factors this time. There has been a 1.7% decline in core consumer prices in the last year and that is a record. At the same time the Japanese are looking at a record level of unemployment – jumping up to 5.6%. This jobless number is made more serious by the fact that the burden has been mostly imposed on the younger Japanese that have been seeking to enter the work force. They are being dubbed the “lost generation”.

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Analysis: In the last couple of weeks there has been a wave of conflicting data coming from Japan and the challenge now is to sort out what is meaningful and what isn't. There is also the issue of what this all means to Asia and the rest of the world. As China has become the darling of the investors and analysts, there is also the question of what Japan still means to the progress of the world economy. The short answer to the latter question is that Japan is the second largest GDP in the world – still substantially higher than China and it will be several years before they lose that position even if conditions do not improve. The Japanese companies have become global players and have transcended the borders of Japan in many ways. Some have almost ceased being Japanese entities but they still play a powerful role in the country's domestic economy. Japan is the world's leading export nation and the yen is a dominant currency alongside the dollar and euro. In other words, Japan has not lost its ability to influence the world's economy.

The three most important issues in Japan today are the threat of deflation, the expansion of the country's industrial output and the imminent defeat of the ruling Liberal Democratic party in elections scheduled for the end of August. Each of these will have profound long term impacts on Japan and its relationship with the rest of Asia and the world.

The deflation issue is in many ways the most pressing as Japan has a long and miserable track record when it comes to this economic problem. Throughout the 1990s the country dealt with consistently falling prices but even then the decline was not as steep as it has been in the last year. On the surface it would appear that falling prices would be a good thing for consumers – certainly better than an outbreak of inflation. The problem is that deflation sets in and begins to erode the ability of companies to make any money. Suppliers begin to abandon the effort as they simply can't sell their output profitably to a consumer that keeps assuming that prices will fall. The Japanese are especially vulnerable to deflation as this is a culture that has a proclivity towards saving in the first place. If there is uncertainty about future prices the instinct is to hoard money and wait. At some point the production in the nation simply halts or moves away from the domestic market. Much of what has fueled the export centric strategies of Japanese companies has been the battle against deflation at home. The encouraging note in all this is that the majority of the price decline has been the result of the lowered cost of energy. Given that Japan is completely dependent on energy imports this is not a bad thing but if the price decline accelerates the impact on productivity could be highly detrimental.

The second issue is the positive factor and the real question is how secure the progress might be. For four straight months the Japanese have seen an increase in industrial production. The latest increase was about half what it was in the previous month but there has been growth and that is the important part at the moment. The fundamental question is what is fueling the increase if the domestic economy is still moribund and facing deflationary threats? The easy answer is that Japan must be seeing an increase in exports and that is true but questions should occur immediately. If the US economy and the European economy are still in trouble, who is Japan exporting to? For the most part the Japanese are shipping to other Asian states but that only scratches the surface of the issue. China has become a major target for Japanese exports as one would expect but Japan is also getting better at shipping to the other states in the region and that could have a profound impact on Japanese growth as well as theirs. It is also evident that Japan is getting better at exploiting some of the new markets in the world – everywhere from South Asia to Latin America and even parts of Africa. The point of all this is that Japan is becoming a fierce competitor in regions they had not been attracted to in the past and that has implications for the US, Europe and China. In particular India has become a major destination for Japanese exports and that is expected to grow in the years to come.

Hanging over all this is the election that threatens to bring the Democratic Party of Japan to power for the first time since its founding in 1998. The DPJ made a brief run at leadership in the middle of this decade but fell short of putting their leader at the helm. The ruling Liberal Democratic party has been in control of the country continuously since the end of World War II except for a brief period in the middle of the 1990s when a series of smaller opposition parties cobbled together short live coalitions. The DPJ is a much more populist party and one that takes its support from the liberal middle class and the blue collar workers of Japan. It is promising some of the most radical changes Japan has seen in decades. They will not all come to pass but the attempts to root out the influence of the bureaucracy, address the social issues in Japan and redistribute wealth will have some profound implications for the nation.

Southwest Jumps into Fray Over Frontier

The nearly moribund Frontier Airlines has suddenly attracted a lot of attention as rival airlines seek to bolster their position in the lucrative Denver market. The airline was the target of Republic Airways, a holding company for several regional airlines that had been Frontier's biggest creditor. Now the bid has been challenged by Southwest in a move that surprised many in the airline industry. Southwest wants to improve its position in Denver but the Frontier purchase would be a risky one in many ways.

Analysis: The operational model for Southwest has been consistent – flying point to point as opposed to the hub and spoke system employed by many of the legacy airlines. They have also reduced their maintenance costs by flying one kind of airplane almost exclusively. The Frontier system uses a different airplane and they are not point to point flyers. It is assumed that Southwest will be able to convert them but the effort will take time and cost money at a time when the airline business is highly stressed. On the other hand Southwest gets an opportunity to dominate this market and that could be worth the effort. At the very least this interest will cost their rivals more money to but what is left of Frontier.

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STRATEGIC GLOBAL INTELLIGENCE

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ETA Retains Strength in Spain

The car bomb killed two members of the Spanish Civil Guard and another bomb that was defused would have killed many more. The Spanish continue to do battle with the terror group known as ETA. They are ostensibly interested in independence for the Basque territory in the north of Spain but over the last few years their political manifesto has been almost incoherent and it looks like most of the violence has been for its own sake. The government under Jose Luis Rodriguez Zapatero had been trying to negotiate with what was left of the EDTA leadership but these talks broke down at the beginning of the year and the ETA terrorist declared that the cease fire was over. Car bombings and attacks started almost immediately – one of the most deadly was the detonation of a parking garage that killed two and injured many others. In the history of the conflict between ETA and the government there have been almost 900 deaths attributed to their attacks.

The reaction by Spanish authorities has been swift but there appears little that can be done at this point. In the last few years the police have managed to break the back of ETA through the arrest or killing of key leaders. The original leaders of ETA have all been removed but the organizations functions as set of cells and some have survived with enough explosive capacity to continue their attacks. The cell that is operating now has been erratic and violent and may be more interested in criminal intent than politics as there is evidence of extortion as well as terror bombings. The Spanish reaction to the attacks in Majorca has been to shut down activity and travel, a decision that has not been popular in a tourist destination like this. The Spanish economy has been struggling as it is and this wave of attacks will only worsen the situation.

The fear is that these attacks will continue and possibly escalate although it has been noted that the bombs have been relatively unsophisticated and small. Previous bombing attacks have been more devastating and aimed at greater casualty rates. The sense is that this group is small and that will limit the damage they can do. Unfortunately this also makes it that much harder to catch them. The impact will be more psychological than anything else as it means that the long battle with the Basque terror groups may have started up again.

Analysis: In past years the advance of terrorism in Europe has been tied to economic problems and this appears to be the case this year as well. The terror groups rarely have much real support within the population but when people are worried about their financial future that support level swells – at least there are more disaffected people from which to recruit. Polls suggest that no more than 10% of the Basque support the ETA but there are enough angry people in the region willing to hide the terrorists. There is now evidence that terror groups are becoming more active in Italy and Greece as well. Thus far there has not been a resurgence of threat in Northern Ireland but authorities point out that the sliding of growth in the region is undermining the truce that was finally worked out between the IRA and the Ulster nationalists. Even in the US there has been a rise in militia activity as more people, are thrown out of work. This is one of the most serious developments that follow rising jobless totals. In past recessions these terror groups have seen their ranks swell and that confronts the government with problems they are ill-equipped to deal with in the middle of an economic crisis

Moldovan Opposition Can't Figure Out how to Cooperate

The enthusiasm on the part of the Moldovan opposition is turning out to be short lived. Despite winning enough seats in the parliament to make a stab at forming a government, the four opposition parties are finding it almost impossible to agree on what kind of government to form. It seems they have nothing in common other than opposition to the Communists. The key to all of this will be Marian Lupu – the former head of the Communist reform wing. He has to join in the coalition and lure some defectors from the Communists.

Analysis: There is a growing fear that the fragmented government will struggle on all fronts and frustrate the voters to the point they will bring back the Communists. This is the poorest nation in Europe and faces immense issues around economic collapse. Exports have all but vanished and the debt is huge. No matter which government finally emerges their tasks will be immensely complex

Iranian Protests Have Not Ended

The government of Mahmoud Ahmedinejad has tried to brutalize the protestors into halting their activities but it has yet to work. Thousands of mourners turned out to commemorate the deaths of those that were killed in previous protests and the police reacted with arrests and beatings. The tide has yet to ebb and in some respects the protests have become more effective.

Analysis: The Iranian situation is being described by many as chaos and there are some that assert that the President will soon be sacked by the hard liners – a move that could well provoke major waves of civil conflict. The unraveling of the regime appears to have gotten underway.



Unique Approach to Luring Tourists

It has to rank up there as one of the more creative ideas from the tourist industry. Mexico has been slammed hard by the outbreak of swine flu and needs to get those US tourists back into the hotels and resorts of the country. The average traveler gets a little worried when they hear about a flu pandemic that could kill them as well as the drug war that could explode in their hotel lobby at any moment. The Mexican reaction has been to offer free insurance for the rest of the year. That could be reassuring I suppose. But the message would have to be carefully crafted. It wouldn't really work to say "You'll get shot by drug dealers or get a killer strain of flu but don't worry – you are insured." One would have to be a bit more subtle about the benefits of the program.

Analysis: This idea has me thinking though. This could be a whole new gambit for areas that have issues. Hurricane season is about ready to fire up so how about a policy that pays off big when you are washed out to sea. I can just imagine the number of spouses that will be encouraged to take that trip to the Caribbean in the weeks to come – "go ahead, we will catch up with you later". There could be whole expeditions organized around disease – the malaria tour in Africa, a round the world trek following outbreaks of swine flu, a nostalgic visit to the origins of Ebola – it's ok – you have insurance. There is also the opportunity to use political mayhem to make a buck as who doesn't want to be at ground zero for a coup or insurrection. I see tour bus guides narrating the action – "on your left you can see the local militia opening fire on the civil guard and on your right you can see the tanks getting into position – don't forget to get your souvenir hand grenade at the gift shop." As they say – when you have lemons you need to make lemonade.



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