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Senate boots auto bailout, leaving White House to act

Retail sales and Michigan confidence reports not as bad as expected.

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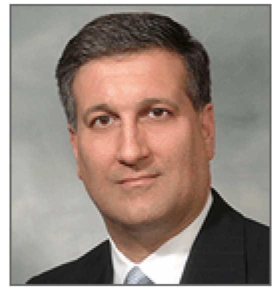

Philip J. Orlando

Despite the worst U.S. employment market in 26 years, the Senate late last week abandoned efforts to approve a $14-billion bridge loan to keep General Motors and Chrysler out of bankruptcy.

The Senate's rejection of the auto bailout came Thursday night, the same day the Bureau of Labor Statistics reported that initial jobless claims for the week ended December 6 surged to 575,000 workers — well above the 525,000 claims that had been forecast.

The four-week moving average for initial claims now stands at 540,500, its highest level since December 1982, and the total number of American workers collecting unemployment insurance has reached nearly 4.43 million, also the most since 1982. The U.S. economy has lost jobs in each of this year's first 11 months — a total of 1.91 million thus far — and the unemployment rate has hit 6.7% and could rise to 8.0% by the end of next year.

Bridge loan to nowhere

Against this dismal labor market backdrop, the Senate turned down a potential compromise to approve a short-tem financial lifeline to the auto industry, without which both General Motors and Chrysler have said that they will need to file for bankruptcy by year end.

Detroit's Big Three employ about 250,000 workers, and the broad derivative impact of a potential auto-industry collapse throughout the U.S. economy could affect as many as three million more employees.

While we're quite sure that Congress has little appetite for additional job losses, they likely also have little appetite to throw good money after bad in a so-called "Bridge Loan to Nowhere."

Four-point auto relief plan

As a result, Senator Bob Corker (R-Tenn.) drafted what we believe was a common-sense compromise to get a deal done, with both the taxpayers' and the auto companies' best financial interests mutually in mind, to create a viable and competitive auto industry for the long term. The proposal had four key elements:

- **Debt Load Reduction** — By March 15, the outstanding indebtedness of the auto companies needed to be reduced by two-thirds by forcing bond holders to accept either an equity swap or a combined debt-for-debt and equity swap.
- **VEBA Payment Changes** — The United Auto Workers (UAW) must convert half of the Voluntary Employee Benefit Association (VEBA) obligations for health care coverage to stock in each of the three respective auto companies, to aid their liquidity and cash flow.
- **Lower Wage Costs and More Competitive Work Rules** — The UAW must agree to a contract that immediately puts their wages and benefits on a par with their foreign auto competitors here in the United States., chiefly Honda, Toyota and Nissan.
- **Elimination of the Jobs Bank** — The UAW must immediately shut down the controversial jobs bank program, which pays employees nearly full wages when no work is being done.

If the stated conditions are not met, then the U.S. Secretary of Labor can force any of the non-compliant companies into a Chapter 11 bankruptcy filing on March 31, at which time a bankruptcy judge can impose these terms.

Regrettably, the UAW balked at the demand that their wages and benefits be competitive with foreign auto makers by next year, believing that they should retain their exorbitant pay scales through the end of their current contract, which expires in 2011.

White House to the rescue?

As a result, Senate Republicans held their ground, and General Motors and Chrysler are likely headed for bankruptcy unless the Bush administration steps in. Despite a significant decline in share prices overseas and in the United States early Friday morning, stocks ended up closing moderately higher for the day, as investors seemingly appreciated the backbone demonstrated by legislators.

Additionally, there is hope that President Bush might finance the auto industry's near-term financial rescue with funds from the Troubled Asset Relief Program (TARP). But with the first $350 billion nearly spent, Congress and Treasury Secretary Henry Paulson may have to seek release of the second $350 billion tranche, which Congressional leaders have said they were reluctant to do.

Alas, marginally positive news

Additionally, we received two marginally better-than-expected pieces of economic news Friday morning.

First, the preliminary University of Michigan Consumer Confidence reading for December was a stronger-than-expected 59.1, compared with consensus estimates for a 54.9 reading and versus a 55.3 final reading in November.

Second, both nominal and core retail sales in November weren't as bad as expected. True, the 1.8% headline decline last month was a record fifth consecutive month that retail sales were negative. But consensus estimates called for a 2.0% decline.

It is likely that merchants were so aggressive with their door-buster discounts over the important Black Friday Thanksgiving weekend, that they bought better-than-expected sales, but at a considerable price of lower profit margins.

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