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The Cost of Political Brinksmanship Hangs Over Financial Markets and the Future of Automotive Retail

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The U.S. economy requires about 140,000 new jobs per month simply to absorb new labor force entrants and make sure that unemployment gets no worse. Second quarter GDP growth was just 1.3 percent. No wonder job creation is disappointing.

Printed on the back of 2010 Federal income tax refund checks was an offer from the Federal Government: "Let us help you manage your money." In the midst of the budget debacle such a suggestion seems ludicrous. Default of the federal government hangs in the balance of the budget negations in Washington that could tag billions of dollars onto the cost of national borrowing. The government is already helping you manage your money by demanding it for a budget process that creates yearly deficits that defy the imagination.

Key political objectives are locked in this three-way struggle between the White House, Republicans in the House of Representatives and Democrats in the U.S. Senate. And the economic stakes are sky high. The President and the majority in the Senate wish to tie up a couple of additional percentage points of the Gross Domestic Product of the United States for use by politicians for the next several decades. By contrast, the majority in the House of Representatives suggests that the 80 percent of government funding that their key constituents currently provide should be enough.

As we go to press, the House is still struggling to pass a bill that raises the debt ceiling and cuts spending, and the Senate will likely contribute to compromise legislation. There is still time, but precious little of it.

Hanging in the balance of the budget debate is the fate of the inflation rate over future decades, and baby boomers largely underprepared for retirement would find themselves impoverished by the inflation rate that current spending trends will create if left unchecked. It would not take a double-digit rate of inflation to sorely reduce financial security in the "boomer's" golden years. Inflation of only 6 or 7 percent per year would insure catastrophic retirement outcomes and a slow growth economy that also under serves those of normal working age.

And the impact of the higher 24 percent of GDP sought by the administration, compared to the roughly 22 percent average of recent decades, has significant impact on slowing economic growth and the creation of jobs. The choice between significant taxes or even higher taxes and the choice between private sector jobs and government featherbedding of its own payroll are significant choices for the future.

The bond rating agencies are paying attention to debate on this grab of economic power in Washington, D.C. A reduction of yearly deficits for the long-term outlook will have to be accomplished if the U.S. wants to retain the AAA rating for its debt that has been enjoyed for recorded debt rating history.

Through CNBC and Fox, subject to interruptions to report on the financial problems in Greece and other parts of Europe, the whole world is watching the struggle in our democratic system about our future.

The protagonists in this critical drama have different ideological outlooks, but they all risk the wrath of the voter if the U.S. credit rating is squandered, and falls below AAA . The President is currently at political risk on the jobs issues. To support current spending, you would have to believe that shoveling more money into government creates long-term productive employment, even as state governments lay off their excessive hires and cut excessive state government benefit programs for state workers. Two decades ago the Federal Government cut the generous defined benefit pension for its new employees called Civil

Service Retirement System (CSRS) for a 401k type of plan it calls FERS for Federal Employee Retirement System, but the CSRS is driving deficit spending as many baby boomers in lifetime federal service retire under the old plan.

The U.S. economy requires about 140,000 new jobs per month simply to absorb new labor force entrants and make sure that unemployment gets no worse. There were just 18,000 jobs added in June, so the low May number can't be called an anomaly. Unemployment rate rose to 9.2 percent from the previous 9.1 percent in June. Republicans suggest that increasing taxes and spending more in Washington won't create meaningful jobs on Main Street. And it won't park many new cars on Main Street either. Given the amount of noise in the employment data, we should only conclude that the jobs outlook hasn't improved much in a statistical sense.

However, the economy is growing by less than 2 percent in the first half of the year according to the federal government's own numbers, and that is much of the reason for the slow private sector job growth as state governments add many names to the unemployment rolls. Second quarter GDP growth was just 1.3 percent. No wonder that job creation is disappointing.

Much of the loss of jobs in the economy in state government payrolls will continue over the next two years, an adjustment that must be made to address state government financial stability.

LACK OF GROWTH, JOBS AND NEW CARS TRIMS NEW LIGHT VEHICLE SALES IN MAY AND JUNE, BUT HELPS MANUFACTURING EMPLOYMENT

Lack of new car inventory, along with the slow growth and job creation in the overall economy, have trimmed recent new light vehicles sales. The effort to produce more new vehicles in U.S. factories is helping third quarter manufacturing activity and employment. That activity will be third quarter reports from the government. The private sector is creating employment activity based on the voluntary demand from consumers, but the demand by the Administration for higher fuel economy gains threatens to decrease employment in automotive production and retailing that could help meet the political pressure to lower the unemployment rate.

Even with the less excessive demand for 52 miles per gallon the questions have to asked: Will the customers buy the mix of vehicles needed to meet that requirement, and what will be the cost of additional copper, lead, rare earth materials and other scarce materials needed to create the more exotic vehicle drivetrains that are needed to meet the new fuel economy standards.

Countries such as China and Russia will control some of the supplies of materials needed in greater amounts to create the higher mileage vehicles needed for the future sales mix. The fuel mileage improvements over a multi-year horizon will put upward pressure on vehicle prices and some commodity prices. The result? Consumers buy somewhat fewer new vehicles and some additional production goes out of the North American area.

What is needed in the next two working days is a down payment on reversing current budget trends in Washington. If that is accomplished, lifting consumer confidence in the process, the stronger new vehicle inventory available by mid-August should help the sales volume at dealerships.

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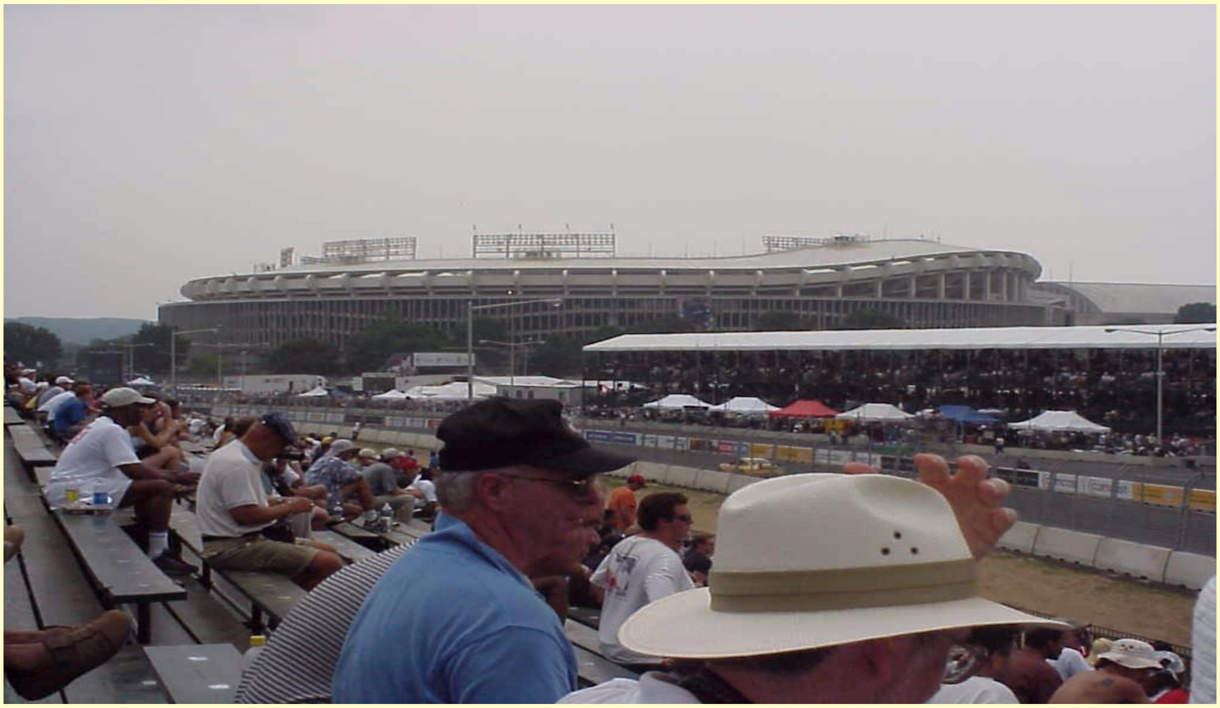

No, that is not the flying saucer that is responsible for the befuddled state of the U.S. Congress during the current crucial Budget Debate.

Rather, it is RFK Stadium, with the surrounding roads set up for the Grand Prix of Washington, D.C., which for three days in the summer of 2002 treated Washington to competitive Le Mans-style prototype and sports car racing within walking distance of the U.S. Capitol. Politically correct interest groups had the event cancelled in 2003, so this was a one-time only event. Before the golf cart cars are mandated, Economic Update wanted to remember Washington when summer was just a little bit different from the current situation.