



The Bailout of the Big Three

Amidst the financial crisis and deepening recession, the US Government faced another potential major catastrophe in the month of December when news of probable bankruptcies by the top three US automakers began to circulate. The US auto industry accounts for 11% of American manufacturing and nearly 4% of U.S. Gross Domestic Production (GDP). The failure of such an integral part of the US economy is unfathomable especially in the context of a crippled financial sector, rising unemployment and slowing global growth.

In early December, the CEOs of both General Motors (GM) and Ford approached Congress saying they would both not have enough cash to meet December's operating expenses. To ensure its survival, GM initially asked for US\$12 billion worth of loans and an additional credit line of US\$6 billion. Ford sought a credit line for as much as US\$9 billion. In total the requests of just these two companies had exceeded the US\$25 billion that lawmakers had initially considered for bailing out all three major automakers. Congress remained quite divided on whether the restructuring plans put forward by these companies would be enough to justify a bailout of such huge proportions. Should the Government just let them fail?

Representatives from all three automakers have responded to Congress' suggestion that bankruptcy might be in fact be a more efficient option, by saying it is not feasible in the current environment. According to Chrysler, both GM and Chrysler would need twice as much money to finance a bankruptcy as compared to the amount needed in US bailout loans. Experts estimate the cost of a GM bankruptcy to be in the range of US\$ 40 billion to US\$ 50 billion. GM's CEO has further argued that a bankruptcy is too risky in this environment of tight credit conditions and nervous investors. Even a government-supported bankruptcy could potentially scare away independent buyers leaving the cash strapped automakers in a worse off position.

In addition, one must consider the immediate economic cost of the simultaneous failure of at least two of the three largest automakers. This is arguably the major driver behind President Bush's intervention when Congress remained deadlocked on the issue. According to White House representatives, the immediate cost of letting the automakers fail is a 1% reduction in US economic growth and the loss of 1.1 million jobs, including those in the auto supply and dealership businesses.

While awaiting the verdict on the rescue of the industry, all three companies announced plans to shutter about 59 factories as they struggle to adapt to the worst sales outlook in 26 years. Other cash conserving strategies being explored by these companies include idling plants, forced vacation for employees, cutting production and delaying indefinitely all expansion efforts. Strategies surrounding reducing the number of dealerships in the US are also being actively looked at.

President Bush clearly emphasized his position which placed importance on the strategic economic importance of the industry on the 20th December 2008, when he announced that he would be providing emergency loans despite a personal

aversion to interfering with private enterprise. This is in the wake of an announcement by Congress that they were still unable to come to an agreement on the rescue of the automakers. President-elect Obama also supported this stance citing a larger responsibility to the broader health and stability of the economy. A total of US\$17.4 billion in emergency loans will be given to GM and Chrysler; US\$13.4 billion now and US\$4 billion in February (from TARP funds). Ford has said that it can continue operating without aid for now.

In exchange for the aid, both companies are to produce plans for substantial restructuring and other strategies to transform themselves into viable, profitable entities. The loan term is three years and will have priority over any other creditors. The automakers must also cut their debt by two-thirds, provide warrants for non-voting stocks, accept limits on executive pay and give the government access to financial records. Unions and management would have to negotiate a plan to have compensation structures and work rules which will make the US competitive with foreign automakers. The automakers have until 31st March 2009 to meet the conditions of the loan and will be monitored by the Treasury secretary to ensure compliance.

These plans are ambitious to say the least but are they realistic especially with regard to the stance of trade unions? Critics of Bush's decision say that while it has achieved the goal of short-term stability, the companies should have been made to agree to far more rigid and specific concessions. Other senators have questioned the wisdom of expecting US workers to conform to the same standards of their foreign counterparts. Further, potential legal action by dealers to block the closings may make it difficult for GM and Chrysler to achieve the targeted number of dealership closures. The strategy of reducing the dealer glut is a key cornerstone of the survival plan of the automakers. In addition, the wider health of the industry is under question with the news that Toyota has forecasted its first operating loss in 71 years based on plummeting demand for cars. The company lowered its North American sales forecast by 10% which does not bode well for the car industry as a whole including the beleaguered US automakers.

This begs the questions: "Is the bail out money a band-aid of sorts? Can this money buy these monoliths of companies the time needed to restructure drastically and quickly especially in an environment of falling demand for cars? Unfortunately these questions cannot be easily answered. However, two things are clear; firstly, GM and Chrysler cannot depend on revenues from sales growth to keep them liquid in the short to medium-term. Therefore to improve cash flows and profit margins, they cannot afford to be complacent and must faithfully stick to the restructuring plans that will be presented to Congress. Secondly, all stakeholders involved must take a long-term view of the health of these companies. In other words, stakeholders such as trade unions, suppliers, franchise holders or dealers, employees and management must be willing to work together and sacrifice in the short-term in order to ensure the long term survival of these companies.

The US Government continues to do everything in its power to prevent a long and deep recession. US officials will continue to face very difficult decisions such as this one as we head into 2009. For the time being it seems as though US officials will continue on the route it has chosen, that is, one of propping up its failing economy through the sheer force of political will and the unlimited resources of the Treasury.

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- NP braces for cut in gas station earnings
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- Christmas shaping up to be a good period for BICO
- UN agency says Caribbean will be hardest hit by tourism slowdown
- GMAC Gets \$6 Billion From Treasury to Revive Lending
- Credit Suisse Sells Fund Unit Stake for \$361 Million
- India Cuts Key Rates for a Fourth Time Since October

Table 1: Regional Market Performance (as at 31 December 2008)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
TTSE Composite	842.93	0.50	-3.33	-14.16	-14.16
All Trinidad	1,154.75	0.35	-2.26	-3.83	-3.83
JSE Index	80,152.03	3.73	-7.73	-25.76	-25.76
JSE Select	1,984.74	2.84	-8.61	-32.24	-32.24
All Jamaica	73,994.93	2.48	-7.81	-30.71	-30.71
BSE Composite	919.86	-0.13	-6.43	-10.59	-10.59

Table 2: International Market Performance (as at 31 December 2008)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
S&P 500	903.25	4.04	0.78	-38.49	-38.49
Nasdaq Composite	1,577.03	3.42	2.70	-40.54	-40.54
Dow Jones Industrial	8,776.39	3.64	-0.60	-33.84	-33.84
German Dax	4,810.20	3.91	3.01	-40.37	-40.37
FTSE 100	4,434.17	5.16	3.41	-31.33	-31.33
Nikkei 225	8,747.17	2.70	2.76	-42.86	-42.86
Hang Seng	14,387.48	1.43	3.59	-48.27	-48.27
DJ Eurostoxx	2,451.48	2.91	0.87	-44.28	-44.28

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