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The Economic Recovery Plan - -
An Excuse for Inaction !

Ten months ago, a survey of the state of the nation would have suggested a number of areas that demanded attention by our law givers and the President. While there might be differences about priorities, most people would have included on their "things to do" list fixing Social Security and Medicare, addressing global warming, dealing with immigration issues, plus a number of foreign affairs situations.

Foreign affairs problems (aside from trade) are beyond the purview of these letters, so we won't be talking about them. But, looking at the other problems of importance, it is striking that virtually nothing has been done. And to that list of inaction, one could add a variety of other concerns, some lower down on the scale of urgency and others perhaps deserving first rank status.

Also ten months ago our monthly letter discussed another problem, subprime mortgages. After reviewing the questionable practices that had occurred, we observed:

> Holders of interests in bundled [subprime] mortgages (largely pension funds and other institutional investors) do not revalue them on a daily basis, but await periodic ratings by a rating service, like Moody's and Standard and Poor. Thus, there may be a good deal of overvalued investments in the hands of those holders.

Of course, those chickens have now come home to roost.

We don't quote our earlier letter to suggest any prescience on our part. Quite to the contrary, the point is that observers outside the banking and investment communities, with no particular expertise in mortgage matters, were aware of the problems long ago. One can only speculate about when the insiders knew about the coming dangers.

The subprime crisis has proved to be extremely costly. The stock market is reeling, consumer confidence has declined, and credit has dried up. The latter consequence will make it all the more difficult to use lower interest rates to alleviate a downturn in the economy. As major lenders are borrowing and cutting dividends to shore up their capital, they will be zealously protecting that capital by carefully locking the barn door to new loans, even as the Fed relaxes rates.

Since the motivation underlying the subprime crisis has basically been greed (greed by borrowers seeking to acquire assets they could not afford and greed by lenders and investment facilitators pocketing large origination and syndication fees), it is hard to see how regulators were able to stand by without knowing what was going on or doing anything about it.

What is particularly sad about this train wreck is how dealing with it is likely to further postpone action on the list of important issues our country faces. The efforts to prime the economy with tax reductions or rebates could well preclude any new expenditures or efforts on longer term problems and are likely to generate that kind of political wrangling that has made it impossible to achieve consensus on the big issues. And, of course, we have the political season (for another ten months) that will further complicate the legislative process.

The one optimistic note is that the electorate now seems so bemused by the need for “change” that every candidate now trumpets him or herself as the agent of that change. One might say that the biggest change we need is from inaction to action, and maybe the candidates, the Congress and the President will get that message.

Turning to the specifics for this month:

- Scrap and Pig Iron. It looks as if we might be returning to the wild days of late 2004 and early 2005. Number 1 dealer bundles and #1 busheling (Chicago) shot up by $80 (over 20%) to $415 and $420 per mt, respectively. These are close to record prices. Following a similar pattern, the spot price for Brazilian pig iron (cif New Orleans) increased by $40 to $450 per mt. After hovering at the $375 level for several months through last September, the price is now 20% higher.

- Natural Gas. The Nymex contract price increased by 64 cents to $7.84 per mcf. While prices have not gotten close to the stratospheric levels we saw in the last half of 2005, they are up by over 40% since last September.

- Ocean Freight. You may recall that we dropped this category about a year ago, since the Baltic Capesize Index (heavy tonnage bulk carriage) had not significantly varied for months. That has changed. After staying around the 6,000 level for a long period, the index shot up to 15,945 last November. (In October, 2001, it was 1,076.) Since then, it has declined sharply to 8,732. It appears that the "China syndrome" came back, at least for a while at the end of 2007.

- Exchange Rates. Despite the woes of the American economy, the dollar has recently strengthened against the euro and pound. As of this writing, the euro is at $1.45, up a penny since last month, but down significantly from the $1.50 level a few weeks ago. The pound is now worth $1.95, off six cents from last month and eleven cents over the last two months. The Canadian dollar is at 96 cents, three cents below last month.

As always, we welcome your comments and suggestions. This letter will be posted on our website, www.coreysteel.com and on the international site, www.steelonthenet.com.