GMAC Is a Big Soft Spot In Global Debt Bubble

by Paul Gallagher

General Motors Acceptance Corporation (GMAC)—the huge $300 billion credit finance company, sitting at the valve between the overblown U.S. real estate bubble and the deflating auto sector—is facing big debt trouble in 2005-06. The trouble is driven by the falling dollar, rising interest rates, and falling auto sales. GMAC is far larger than all the other combined parts of its parent General Motors; its debt, at about $260 billion, is bigger than that of any other American corporation except the huge government-sponsored Federal National Mortgage Agency (Fannie Mae), whose mortgage debt it invests in. During 2005, GMAC will be caught simultaneously in a shrinking real estate bubble, in the tar pit of falling global auto sales, and possibly in the unpaid obligations of General Motors' pension plan. GMAC could play a major part in a collapse of the dollar and dollar credit markets.

"GM Decline to Junk Shows Waning Confidence in Automaker," headlined a long, March 8 Bloomberg News analysis of the fallout from February's sharp drop in U.S. auto sales. During 2004, General Motors tried to pump up its sales with circus-level rebates for auto buyers of more than $5,000 per vehicle (the entire U.S. auto sector gave an average $2,700 rebate on every vehicle in 2004, but GM's doubled those of the other makers). When, at the beginning of 2005, it tried to reduce the rebates somewhat, while oil, gasoline, steel, and industrial commodity prices were zooming up and total auto sales were falling, GM hit a wall; its January sales were 9% below a year earlier, and February's were 13% down despite its having suddenly lowered prices in mid-February. Its bonds' credit rating is now just one notch above junk, with a "negative outlook" from Fitch rating agency pointing the way to junk-bond status within weeks or months.

'Thunderstorm Over Detroit'

With recent years' ruinous "rebate battles," depending in turn on the Greenspan Fed's extremely low interest rates of 2001-04, auto has become, like textiles and other globalized industries, a race for cheaper wage and pension costs to overcome falling net revenue. GM, which owns Vauxhall in Britain, Saab in Sweden, and Opel in Germany, also lost $2.6 billion in Europe last year. GM is laying off 12,000 workers across Europe; where strikes and demonstrations have slowed this down, as in Opel's plants in Germany, GM is getting wage cuts instead. Other European automakers are also losing sales, and waging price battles; they have joined everyone else in competing primarily to export cars to the United States.

But in the deindustrialized U.S. economy, the auto workforce has shrunk by 70% since 1980—at an accelerating pace since 2000—and in the hundreds of smaller firms of the auto parts/auto supply industry, is becoming increasingly a non-union, low-wage, and even minimum-wage sector (see *Interview*). It now has far more pensioners than working employees. Michigan UAW local president Eugene Morey cites Henry Ford's famous principle—auto workers have to be readily able to buy the cars they make—and points out that this principle can't be violated across the auto sector, without paying the consequences in the whole economy.

"Thunderstorm Over Detroit," was the Swiss *Neue Zürcher Zeitung*'s headline Feb. 26, forecasting "dramatic turbulence" as GM tries to prepare to refinance or pay $44.7 billion in debt in 2006, and Ford to refinance or pay $37.1 billion on its $174 billion total debt. Tensions rise on corporate bond markets, as new debt is used to pay large volumes of old debt amid rising interest rates and rapidly falling credit ratings. Neither GM nor Ford, "financial firms now producing cars as a hobby," are Faraday Cages, safe from being struck by lightning—in 2006, the Swiss daily wrote. But it could strike earlier.

The London *Financial Times,* in a March 5 article on "Renewed Concerns Over GM's Creditworthyness," reported that "bond traders are now concerned about the fundamental outlook of the company." With that massive refinancing lying ahead, it is already having to pay 3-4% higher than Treasury bond rates. For comparison, on 10-year corporate bonds: Pharmaceutical giant Merck paid 4.65% in early March on a $1 billion issue; GM would pay about 7.45% with its current rating, and 8.25% or higher if and when it falls to junk. Bond analysts are not forecasting bankruptcy now; but, says one at Credit Suisse, "If their borrowing costs rise very quickly and they can't generate the cash they need for new products, then it becomes a vicious cycle."

GM replaced the top officials of its sales division on March 4. Its primary parts maker Delphi (which was a division of GM until 2000) fired its chief financial officer on March 5, and its president is in process of resigning as an "Enron-style" accounting scandal makes its financial situation far worse. Delphi's credit rating was knocked down two notches to below junk in early March: on March 8, it notified 4,000 of its salaried (i.e., non-United Auto Workers-member) retirees that it is ceasing to pay into their healthcare plan, and they are on their own. This desperation move was supposed to save Delphi $500 million a year. The same day, GM itself increased its new indefinite layoff announcement in Lansing, Michigan—where it is closing both a Chevrolet/Pontiac plant and a Delphi parts plant—to 3,700; the layoffs

were moved up to May 9.

Most suppliers for both GM and Ford were already at or below junk-bond grade before the latest sales reports, and are now being further downgraded—i.e., they cannot borrow from anyplace but GMAC to stay in business. Delphi and Visteon, Ford's biggest parts supplier, are demanding airline-style "givebacks" from the United Auto Workers (UAW), and defaulting on benefits. In 2003 and 2004, both companies got the UAW to agree to the despised "two-tier wage" system where newly hired workers earn $14 an hour, while the UAW contract calls for $25. The same conditions obtain all through the chains of auto suppliers.

The Pension Collapse Threat

There is an additional threat: GM's pension fund is underfunded by $17 billion (funded at only 80% of its obligations), and the Bush Administration is pushing new "pension reform" legislation which will heavily penalize companies with underfunded plans, and with damaged credit ratings. "Auto will probably be the next sector [after steel, and now the airlines] whose pensions may collapse" one expert told *EIR.* If GM goes to junk-bond credit status, "a lot of things change respecting its pension funds," he said, both under existing pension regulations, and more so if the Bush Administration's "reform" of the Pension Benefit Guaranty Corporation (PBGC)'s rules passes Congress. The PBGC insures and regulates private corporate pensions. The "things" that change in junk-bond status, all mean requiring from the company, both much higher PBGC premium payments per worker, *and* much higher payments into the pension fund itself. GM would have to assume the obligation, for example, that each one of its workers will retire at the earliest possible point, and take his or her entire pension as a lump sum at retirement.

U.S. Airways has used bankruptcy to shed these pension obligations; United Airlines is close to doing the same; like the steel companies and many other sectors before them.

If General Motors were to attempt the same, the whole $300 billion debt bubble of GMAC would be up in the air.

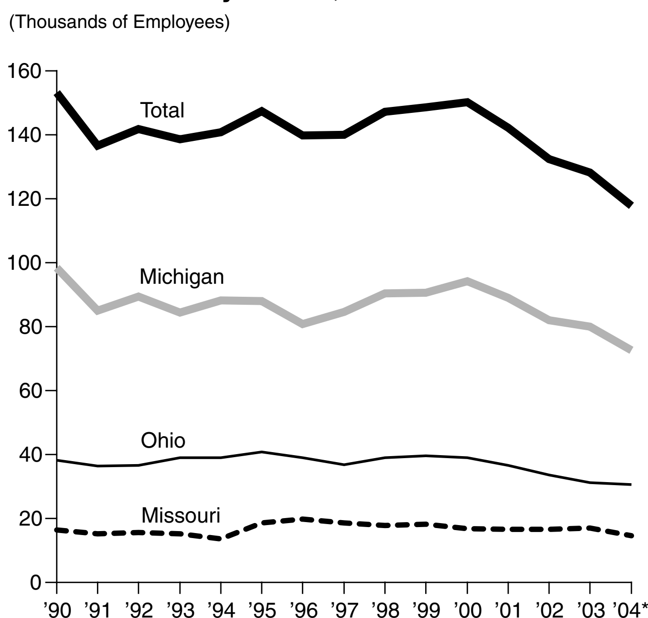
In fact, on Jan. 13, GM announced that it wants to separate from its huge credit finance subsidiary, "to try to protect GMAC from GM's sinking credit rating," the *Detroit Free Press* reported. GM wants to create, before the end of 2005, a new holding company called Residential Capital Corp., to include GMAC—much of whose assets now are in mortgages and mortgage-backed securities—and another GM subsidiary called Residential Funding, Inc. GMAC debt is now just two notches above junk, but they obviously think it would improve if detached from General Motors. Unsaid, is that this could prepare GM (the auto company) for a declaration of bankruptcy, followed by an attempt thereby to "lose" its UAW pension fund.

But the Pension Benefit Guaranty Corporation, itself already more than $23 billion in deficit, could not simply absorb the obligations to GM's hundreds of thousands of pensioners, plus the loss of its pension insurance premium payments. It would defend itself, with a government lien against—GMAC.

FIGURE 1

Drop in Auto Manufacturing Employment in Three Primary States, 1990-2004

(Thousands of Employees)



*Preliminary estimates for Dec. 2004

Source: United States Bureau of Labor Statistics.

Standard and Poor's credit rating agency already assessed this threat in an August 2004 analysts' report, "Assessing the Risk of Pension Plan Terminations on U.S. Auto Lease Securitizations," which specifically discussed GMAC. "Standard and Poor's is concerned with the following scenario," the analysts wrote: "The corporate sponsor [of the pension plan, GM in this case] files for bankruptcy; the sponsor or the PBGC terminates the pension plan . . . ; and the PBGC attaches a lien to whatever assets are available. . . . The titling trust [GMAC, holder of hundreds of thousands of auto loans and leases] therefore, as a bankruptcy-remote entity, and a part of the sponsor's controlled [corporate] group, could be . . . a target of lien attachment by the PBGC." And they noted, "Standard and Poor's assumes the risk of a GM and GMAC insolvency is high" because of the low credit ratings (which have gotten lower since the analysis was written).

Thus, a pension blowout like that of the 1990s in steel and the last four years in airlines, is one of the threats of the "thunderstorm" over the U.S. auto/finance companies' huge debt.