

The impact of september 11 on defense industry stocks essay sample



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The impact of the World Trade Center tragedy of September 11 on the economy of the USA

The September 11 attacks in New York and Washington have already cost America thousands of lives and billions of dollars in damages. But those are only the direct costs. September 11th economists from the National Bureau for Economic Research announced that as of March, 2001, the economy was in recession. This was the earliest that they had “ called” a recession since they began this service but the thinking was clear. How could they go wrong? All measures of economic activity indicated that the third quarter of 2001 was going to produce negative real GDP numbers prior to September 11th, so the attacks would likely deepen the downturn. Further, they predicted the downturn would last into at least the fourth quarter. Indeed when the third quarter numbers were released real GDP had contracted.

The reasons for the contraction were many. The single biggest culprit was business, which had evidenced the rapid declines in investment and inventories that had accounted for almost the entire decline. Another precipitating event was the confused Presidential election outcome of 2000. The rapid slowing of the economy corresponded generally to the time when America spent a month wondering who its next President would be. On the other hand, because of seven interest rate cuts by the Federal Reserve in 2001, consumers kept on spending. The low interest rates kept mortgage and auto loan rates attractive.

Clearly the attacks of September 11th qualified as “ shocks” under any definition. Retail sales during the week of September 11th were dramatically

lower than they otherwise would have been. This, and a variety of other indices of consumer confidence all took very serious hits in the fall of 2001. Complicating things further, business confidence, which is typically measured by looking at businesses' hiring, layoff, and investment plans, was also adversely affected by the aftermath of the attacks. These effects in combination created the clearest example of an aggregate-demand shock in decades.

In response to the attacks, dramatic price reductions were the order of the day. The most notable of these was the reaction of the automobile industry. Within days of the attacks the executives of the major U. S. auto manufactures were meeting in Washington with the President and with the Chairman of the Federal Reserve, Alan Greenspan, to plot how to get through this rocky period. The result of those meetings was lower interest rates generally and dramatically more favorable automobile financing arrangements. Several manufacturers introduced 0% financing deals. Because these 0% car loans were for short loan periods and required exemplary credit, fewer than one-third of the cars sold during the time when these arrangements were available were at 0%. On the other hand, other arrangements were in place for the other customers and bank loans were quite favorable as well. As a result, auto sales from October, 2001, to February, 2002, were quite brisk.

What happened to the defense industry stocks?

Osama Bin-Laden's al-Qaeda operatives claim that the damage inflicted by their attacks on the US total more than \$1 trillion. While that figure is hard to

justify, true damage estimates are nonetheless, difficult to construct. The war on terrorism, and the ancillary increases approved in defense spending because of that war have added nearly \$100 billion annually to the federal budget.

After 11 September, defense stocks jumped in anticipation of increased defense spending, the war on Afghanistan and as a safe haven from the overall stock market falls.

The arms industry is unlike any other, supplying the means of death and destruction to effectively one type of customer, national governments. In the US, the major defence contractors have already transformed themselves. Only five majors remain – Lockheed Martin, Boeing, Northrop Grumman, Raytheon and General Dynamics – from 18 during the Cold War. Northrop Grumman, the maker of the B2 bomber and the much hyped Global Hawk, embodies the new defense company.

Northrop's Cold War B2 bomber

Since being prevented from merging with Lockheed Martin by the US government four years ago, it went on an acquisition spree that transformed into a leading supplier of integrated systems.

After being written-off, Northrop Grumman has just reported a profit rise of 4%.

Lockheed Martin, the world's biggest defense contractor and integrated systems specialist, has recorded a 5.4% rise, while General Dynamics,

maker of tanks, submarines and destroyers, jumped nearly 16% due to its combat systems unit.

The increased defense spending also comes at a good time for defense contractors in the civil aerospace industry, like Boeing and BAE Systems, where a downturn in commercial aviation has resulted in lower orders for passenger jets.

Boeing's 7% fall in second quarter profits could have been much steeper if it did not also build weapons.

Boeing's defense division

By mid-2001, airline and aerospace executives knew they were in trouble. The economy was slowing. Overall air travel and high-yield business traffic were declining. As a result, the airlines were forecasting losses of up to \$2.5 billion. Then came September 11. Last summer's "downdraft in business travel and yields" was bad enough, recalls Robert W. Baker, vice-chairman of American Airlines Inc. (AMR), "but 9-11 finished us off."

If the terrorist attacks decimated commercial airlines, they have had the opposite impact on America's defense contractors. Virtually overnight, downward pressures on the defense budget evaporated.

Indeed, the double-edged effects of the September tragedy are striking mixed chords at some giant aerospace conglomerates. Prior to 9-11, planners at Boeing Co.'s (BA) commercial division had been counting on a soft economic landing. Now, the unit is shedding up to 30,000 jobs, or one-third of its workforce, cutting production by nearly half-and as of December, <https://assignbuster.com/the-impact-of-september-11-on-defense-industry-stocks-essay-sample/>

writing off \$700 million to cover the economic impacts. Top suppliers of tires and engines, such as Goodrich (GR), General Electric (GE), and Pratt & Whitney, have likewise shaved thousands of jobs because the airlines have parked some 800 big, expensive airplanes and cut flights by at least 20%.

Boeing's defense division, in contrast, stands to get a lift. And the same goes for Northrop Grumman Corp. (NOC), which had begun to shake off its low-grade image on Wall Street even before the terrorist attacks. In a vivid turnaround, Northrop consolidated its leadership in electronics and sensors by acquiring Litton Industries Inc. Then it beat out rival General Dynamics Corp. (GD) to acquire Newport News Shipbuilding Inc. (NNS) But Boeing's year ended on a glum note: Lockheed Martin (LMT), the nation's No. 1 defense contractor, was picked to build the Joint Strike Fighter—at upwards of \$200 billion, the richest defense contract in history.

Some analysts do see positive trends emerging from the gloom in commercial aerospace. Large aircraft builders have been shrinking their sprawling cold-war-era factories to build planes more cheaply and quickly. The downturn will give the companies time to streamline factories further and make production lines more efficient. Layoffs will also be easier to justify, says Jon B. Kutler, chairman and CEO of Quarterdeck Investment Partners. “ September 11 provides domestic political cover, which will help them in the long run.”

With slowing sales, Boeing's battle with archrival Airbus Industries will intensify, and both companies will feel the pain. Although U. S. aerospace exports last year jumped 13% over the previous year, imports soared to their

sixth straight record, according to the AIA. U. S. imports of Airbus jets rose \$1. 9 billion last year, to \$14 billion. But the economic slump could force Airbus to cut production, from about 320 planes in 2001 to a predicted 289 this year.

Lockheed Martin – the world’s largest weapons contractor

Lockheed Martin is the world’s largest weapons contractor, a major player in the areas of nuclear weapons and ballistic missile defense. The company was recently awarded the world’s largest weapons contract ever, a \$200 billion deal to build the Joint Strike Fighter, a “ next-generation” combat jet that eventually will replace aircraft used by the Navy, Air Force and Marine Corps.

Lockheed Martin did not win the contract on force of personality alone, or fighter plane design. During the calendar year 2000, Lockheed Martin spent more than \$9. 8 million lobbying members of Congress and the Clinton administration, more than double the \$4. 2 million the company spent during 1999. Among the company’s newest lobbyists: Haley Barbour, the former chairman of the Republican National Committee. During the 1999-2000 election cycle, Lockheed Martin contributed just over \$2. 7 million in soft money, PAC and individual contributions to federal candidates and parties. More than two-thirds of that money went to Republicans. Lockheed Martin spends more on lobbying Congress than any of its competitors, spending a whopping \$9. 7 million last year. Only General Electric and Philip Morris reported more lobbying expenses last year.

Since September 11th, the weapons giant has been steaming along. Stock prices rose almost \$10, from \$39. 39 on September 10th to a high of \$48. 11 <https://assignbuster.com/the-impact-of-september-11-on-defense-industry-stocks-essay-sample/>

on November 12th , the stock is now steady above \$46. Lockheed Martin makes the ubiquitous F-16 fighter plane, the Hellfire missile, “ bunker buster” munitions and the massive C-130 transport plane. The F-16 plant in Ft. Worth, Texas expects to hire as many as 1, 200 factory workers to increase production. They have more than 200 orders to fill from foreign governments for 1999-2000.

As the largest military contractor, Lockheed Martin has a lot of jobs in the pipeline. The company wants to go highest tech with its “ combat Internet system,” a rugged handheld computer, that will put a “ dot-com face on the modern battlefield.” The company is hiring in Silicon Valley, looking to replace “ Rosie the Riveter” with “ Suzie the Software Programmer.” A recent Lockheed Martin job fair attracted 1, 300 applicants for 290 new positions in the company’s missile defense division. Even while Lockheed Martin celebrates its JSF successful, it is trying to shore up support for an additional \$3. 9 billion for development the F-22 Raptor.

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