



Crisis Note 2.1.0 – The Road to Manufacturing
July 23, 2025

The following is commentary from our July 2025 newsletter.

We are in a period of very high volatility, with non-market activity, namely Trump administration actions, impacting economics and asset prices.

While the administration has identified many important problems, these have taken decades to brew, and cannot be turned around with the stroke of a pen. **The road to manufacturing and exporting has many roadblocks.**

The teams in the administration seem to lack the understanding of the history of changes in global economics, capital flows, wage inflation, and pollution export that resulted in the US giving up manufacturing to become a debt-fueled consumption economy that primarily builds (large) housing. Manufacturing is now only 10% of GDP, down from about 28%. This took 40 years to accomplish, and will take as long to unwind. While supply chain simplification and on-shoring had started during COVID, this is certainly not possible in one presidential term.

In addition, there seems to be a failure to understand how products are made, and no realization that specialized skills and physical materials that we used to have 30 years ago no longer exist in the US. Both of these will be necessary to restart production of products that we current import. Imported steel, aluminum and copper in particular are going to be impossible to replace in the near term.

While capital and energy and even required raw materials are available, there are significant bottlenecks:

- **Labor:** skill sets of labor, willingness of labor to perform required tasks, and high labor costs
- **Education:** lack of technical, trouble shooting and thinking skills in many parts of the population – school systems are seriously lacking, and need competition to raise educational standards
- **Raw materials:** for example, while rare earths and copper deposits exist in the US, the time required to rebuild infrastructure such as mining and smelts can take decades. Look up recent interviews with the CEO of Freeport. Development of mines and smelters in the US has been stalled and existing smelters are mothballed and their ability to be restarted is questionable.
- **Current environmental regulations,** a result of virtue signaling by wealthy countries including the US, simply export pollution, and as a result export manufacturing, to other countries that are willing to burn coal and pollute with byproducts to make products cheaply. Global warming has not stopped, as demand for stuff continues growing as it can be made cheaply by China and Asia in general.
- **Energy costs** in the US are high due to environmental and labor regulations of all sorts – anti pipeline, anti energy-transmission-cables, anti-nuclear, Jones Act, etc. creating further hurdles rates to manufacturing.
- **Per capita energy demand is high** due to truck ownership instead of cars (see '[Chicken tax](#)'), long commuting distances, and too large and inefficient housing, competing with manufacturing for energy. (See "[Route of All Evil](#)")

Mini Case Study – US Cars and Trucks

- Trump complains about Japan not buying US cars. The reality is that the US does not make cars that can be used in Japan (which is a right hand drive country), or in many other parts of the world. Not a single RHD drive car is made in the US, even though there have been no barriers to selling and exporting cars to Japan. In addition, we don't make small autos, a result of the afore mentioned Chicken Tax – protectionism has resulted in our auto makers being able to generate greater profits from making trucks, and so they don't build small cars – they import them. Our trucks are not in demand and don't work for much of the world's needs, and cannot even be parked in most cities in the world where roads are much smaller and narrower, and where gas costs more.
- The Ford F150, the best selling US truck, weighs 5000 lbs, has < 20mpg in cities, an 80 inch width, and a 209 to 250 inch length. The height is maybe good, as third world countries have a lot of potholes. They also cost a lot - \$35k barebones, up to \$60k – \$80k and higher with options. I know someone with a \$100k+ F150.
- There are Ford F-150s in Japan. Here are 27 [used Ford F-150 offers in Japan](#). They range from Y 2million for a 1997 (\$13.6k) to Y 10 million (\$68k) for a 2021.
- The best selling truck in the rest of the world is the Toyota Hilux. This has been featured on Top Gear as being indestructible. It is sold in 180 countries, so there is plenty of demand for trucks, and is the best selling pickup in Europe and Australia. Dimensions: 73 inches wide, 209 standard length, 3163 to 4762 lbs, 30-35 mpg, A barebone HiLux costs \$12,000 and can get to \$60,000.

Mini Case Study Home Construction

- Home construction (and housing consumption) is one of the largest non-services, non-government components of GDP. Housing in total is about 15% of GDP.
- There are 2 primary drivers: interest rates (for mortgages) to facilitate affordability, and construction costs. Construction costs are over 64% of the sales price of a new home, and are impacted by raw material cost. Of this about 30% is lumber. Of that, 30% is from Canada, so about 9% of the construction cost of a home.
- Our current tariffs on Canadian lumber are up to 14.54% from 8.05% previously, and a further increase to 34.45% has been announced.
- Thus Canadian tariffs will increase new housing costs, and when combined with higher interest rates, will lead to a slowdown in demand.
- Also, about 50% of copper demand is from new home construction, and copper tariffs of 50% have been proposed, another increase in construction costs.
- However, if housing demand declines, it might solve some of our copper importing trade deficit, but not in a good way.

There are many other barriers that will not get solved anytime soon.

A direct result of the tariffs has been a reduction in orders due to an inability of companies to plan without input and labor cost clarity. Expecting an increase in input costs, which many companies believe cannot be passed onto consumers without collapsing demand, there's been a spate of buying and stockpiling inputs ahead of tariffs, but this is starting to wane as container volumes to the US are declining. Stories about small businesses considering shutting down as a result are regularly in the press. The only industry groups that appear happy are the unions, although it's not clear that a reduction in demand is helpful for the workers they represent. Most sources are expecting a significant reduction in GDP, both in the US and globally, to result.

There is a demand for lower energy costs with the help of Saudi Arabia. But this is going to lead to energy supply shrinking, and US drillers shutting production as the sales price of the oil falls below their breakeven cost of production. Rather than making capital investments, they will continue to return cashflow and capital to their shareholders.

There is a recognition of the failure of our education system by the administration. But it does not seem to recognize that this is a result of changes that started happening in 1979, and which cannot be reversed overnight. Math still start in kindergarten. Our school system does not provide a consistent education – my wife is tutoring a 7th grader, about to get moved to 8th, who can barely read, (although he can speak many languages and is smart) - he just finished 2nd grade math with her, and was never taught subtraction. He attended public schools without being taught anything for his entire life. His parents are poor, work multiple jobs, are not educated themselves, cannot help the children do homework, and rely on the school system to educate their kids.

Another example – I was recently in a record store and I bought a 99c album, and my total after tax was \$1.04. The person at the register was an adult. I gave her \$20, and told her hang on, I'll give you 4c or 5c. Her response: I've already entered the \$20 into the register, so I can't take the 5c. She could not subtract, and relied on her machine, and dug out a ziplock bag and counted out 96c in change, in addition to the \$18 in bills, which is what the register said to do.

Yes, we need more tradesmen. But without basic skills, good luck to them if they can't read a manual, or use a ruler, or add or subtract, or think on the fly. Replacing workers with AI or robots to increase productivity seems to be the refrain. And what about unemployment in that case? But other parts of the economy, such as our food supply, rely on labor, and will be impossible to convert.

Then there is the fiscal issue. The BBB was meant to be paid for with savings from DOGE. These savings don't exist, in the size required, yet the bill has passed. The argument is that huge tariff revenue is going to be realized, which will pay for the debt and service.

Given that tariffs will get passed on to consumers through higher prices, this will reduce consumption and thus GDP as a result of the inflation that will be created. There will be a push for higher wages to compensate for the inflation, and such compensation is also already built into social security payments through COLA adjustments. This will require even more governmental debt issuance.

Another \$3T to \$5T in debt is expected by many. I'd guess even more. Who is going to buy this debt? Ultimately, I am expecting more QE.

I don't see US Yields declining anytime – this also means higher annual interest costs, that are already greater than \$1T. I think the 10yr UST can easily get to 7% or higher.

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Rewinding the movie

One way to think about rates and asset prices is to view the past 30 years, from 1995 to 2025, as being a temporary artificial state, with rates being depressed and asset prices inflated as a consequence of Paul Volcker's 1985 Plaza Accord. The failure of central banks to understand or recognize these changes, which resulted in the Yen Carry Trade being born and funding global excesses, led to the conversion of the US economy from a producing one to a debt-funded-services-consuming one.

The double whammy of the Fukushima Daiichi disaster, which shut down nuclear energy in Japan, followed by the Ukraine-Russia war have finally resulted in inflation in Japan, and Japanese rates are rising. The Japanese, who have suffered 0% GDP growth, no inflation, and no wage growth for decades, as their savings fled to create prosperity and excesses in the rest of the world, are now experiencing political turmoil as inflation bites. This is resulting in repatriation of capital back to Japan and will result in the deleveraging of global balance sheets as Japan raises rates to fight inflation.

The most important macro activity to watch is Japan. Here's a piece I wrote a few years ago – [The Greatest Risk is Here.](#)

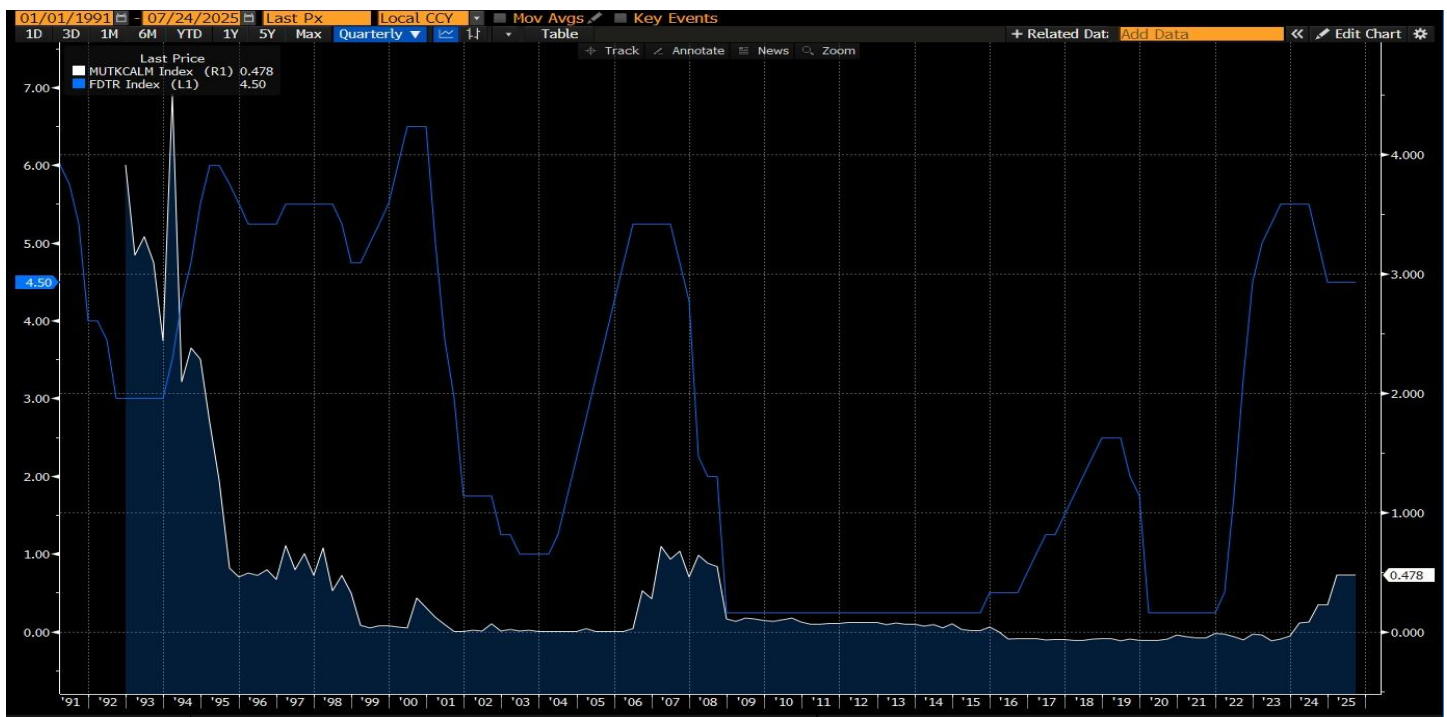
The Trump trade wars are likely to roll the movie of the past 40 years in reverse, to pre-Yen Carry rate levels.

In November 1994, the 10yr UST was at 8%.

The alternative is going to be \$20T (multiple-of-previous-QE large number) more in QE to lower rates.

Another possibility is a significant decline in the dollar, which would have to weaken to unprecedented levels for US wages to be competitive globally.

Charts to ponder – when will Japan de-lever the world?





Please call with questions.

Regards, Samir

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