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Something to Think About

OAKWORTH CAPITAL BANK

COMMON CENTS

This morning, the Bureau of Labor Statistics (BLS) released The Employment Situation report for the month of May 2017. I will cut to the quick, and tell you it might be one of the more boring releases of its type I have ever read. So much so, I felt sorry for the folks who had to compile the data by the time I finished reading the thing.

In a lot of ways, I found it similar to, say, one of Nicholas Sparks' books. Yep, I kind knew how the report would end when I first picked it up. Except the ending of The Employment Situation was '*Table B-9. Indexes of aggregate weekly hours and payrolls for production and nonsupervisory employees on private nonfarm payrolls by industry sector, seasonally adjusted,*' as opposed to a well-telegraphed, melodramatic plot machination (usually involving either the death or sickness of a loved one/interest). Indeed. To say there was an element of 'déjà vu all over again' would be an understatement.

But, wasn't there anything in the report which shed some kind of new light on the economy, etc.? Absolutely not. It suggested a modestly growing GDP, coupled with modest earnings growth. It was the economic report equivalent of conference/banquet chicken.

With that said, it is/was likely decent enough to keep the Federal Reserve on track to raise the overnight lending target at its next official FOMC meeting on 6/14/2017. In all probability, according to the futures market, the Fed will increase the overnight lending target rate between member banks 0.25% (25 basis points) to take the 'range' to 1.00-1.25% from the current 0.75-100%. In fact, the odds are so overwhelming the Fed will do just that the markets will likely freak out a little if it doesn't. The direction will depend on what the official statement says after the meeting.

As a result, I imagine just about all variable rate debt in the country will be a little more expensive by this time next week. Sorry.

Of greater interest, if not importance, was the President this week. While some might wonder about his decision to pull out of the Paris Agreement, I was a little more, um...er…, bemused with his continued condemnation about German trade surpluses. Don't get me wrong, pulling out of the climate control deal was big news, real big, and the President hasn't made any friends in doing so. However, in a lot of ways, non-binding international agreements are just that, non-binding. Further, as any businessperson will tell you, that which isn't measured and enforced doesn't get done, even if the intentions are beyond reproach and well meaning.

Now, I have read a pretty fair amount on climate change; not an exhaustive amount, mind you, but undoubtedly more than the average person (and quite possibly more than the average politician). My conclusions are rather simplistic, decidedly so. Unless a scientist can prove to me otherwise, the most effective way of reducing mankind's impact on the environment/climate is rather straight forward. It has nothing to do with more fuel efficient cars or manufacturing methods. It doesn't even have anything to do with coal or other fossil fuels, let alone fancy converters and chimney stack brushes. Nope. The only fail proof, and I mean guaranteed, way of reducing mankind's impact on the environment is to reduce, well, mankind. No matter how hard I try otherwise, I keep

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coming back to that.

After all, the UN projects there will be an additional 1.5 billion inhabiting the earth by 2030, and each one of them will need to be clothed, housed, and fed. They might even want to go occasionally go somewhere. All of that will require a lot of energy, because it takes a lot to melt rocks to make steel, aluminum, tin, iron, copper, etc. Further, how many more trees will need to cut down for wood and all its many wonderful uses? How many more acres will we need to plant to feed this horde of folks? Let alone the livestock, because some of this increase in people will occasionally want some protein! How much more nitrate and other fertilizers will we use to generate the necessary yields? If the seas are already 'unfished,' what will they be with another 1.5 billion hungry mouths to feed in 13 years?

Yep, 7 billion people have an impact on nature, and 8.5 billion will have even more.

Shoot, the estimate is there will be 11 billion people on earth by 2100. You know what? I am not volunteering to "go first," and I am not going to put my children on the list nor any potential grandchildren either. I mean, Social Security is already underwater, and we need more people paying INTO the system not LESS.

Yes, that was meant as a joke, actually a lot of it was.

As for railing against Germany's trade surpluses, one can hope the President is merely playing to his base, as opposed to being completely serious. First, Germany's trade relations with the US are through its membership with the EU; that was an original purpose of the EU, to serve as a substantial trading block in a global economy where individual European countries were becoming less relevant. Second, as a member of the Eurozone, Germany's export driven economy has benefitted tremendously by being lumped in with countries like France, Greece, and Spain, who have been known to run trade deficits from time to time (if not normally). As a result, Germany's trading currency is weaker than it would be if Germany had its own currency. This makes its exports that much cheaper.

Then there is the simple fact trade deficits happen for one primary reason: you consume more than you produce. Just as the best way of reducing humanity's impact on the environment is to reduce the number of humans, the best way of reducing our trade deficit with the Germans is to quit buying the stuff they make. We can make it more complicated than that, but the most effective way to reduce a trade deficit is to simply cut back on consumption. That is IF reducing a trade deficit is of paramount importance. Quit buying stuff….go without, and save your money. Fun? No. Impossible? No; after all, we have been around as a species for quite a while, and were able to make do without a lot of the stuff, if not most, which drives our trade deficit today.

Finally, and you won't read this a lot, the US exports a lot of goods. That isn't the 'problem.' Consider this: in 1968, the year I was born, the US exported $33.63 billion worth of goods. This was equal to 3.57% of Gross Domestic Product (GDP) for that year. 'We' imported $32.99 billion worth of products, which amounted to 3.50% of GDP. In 2016, the US exported $1.4557 trillion worth of goods to the rest of the world, which was 7.84% of GDP. However, and this is a big number, we IMPORTED $2.20821 trillion worth of stuff, or 11.89% of GDP.

As such, the problem isn't with our exports, as other countries are consuming more of what it is we make, in both absolute, nominal terms and relative to current measure GDP. No. The problem, if it truly is one, is we have vastly increased our consumption in this country. To that end, total personal consumption expenditures in 1968 equaled about 59% of GDP, and last year (2016) they amounted to about 69%. Simply put, we just consume more stuff. Further, today's import of, say, a heart/lung machine from Germany might show up in the I component today, but the impact will be felt in C (consumer expenditures) moving forward...as we demand more healthcare as a percent of the economy. The same could be said for a lot of the industrial components we purchase from Germany which are due to our increased demand for things like utilities, etc.

Still, that tells only part of the story. The rest of the world views the US as a good long-term investment, and it has been. After all, IF our trade balance was the sole determining factor in the strength of our currency, the US dollar would have completely fallen apart by now...and I mean collapsed. It hasn't, but why? Well, because foreigners essentially give our dollars back to us in the form of investment. We all know foreigners own a lot of US Treasury securities, right? Well, that has enabled Washington to vastly increase expenditures without vastly increasing the Federal tax load, as crazy as

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that was to write and probably read. However, it is true. This foreign demand for Treasuries has also kept long-term interest rates lower than they would be ordinarily but for our continued trade deficit. Oh yeah, foreign investors also like to gobble up things like US stocks, and that helps your 401K more than you might imagine. Finally, as we all are very aware in Alabama, foreign companies sometimes set up shop in our country by building, I don't know, auto and aircraft production facilities. To that end, there isn't a GM or Ford production or assembly facility in Alabama, but the Germans, Koreans, and Japanese all have one.

They got the money to build the things from somewhere….us.

So, from an aggregate economic perspective, a trade deficit is only a problem IF the money does NOT come back into the economy through the 'capital' account. It does in the United States. Further, and I had to do a double take on this, the Germans have a "direct investment position on an historical cost basis" in the United States equal to, get this, $255.471 billion.

You see, we get A LOT of our trade deficit back through foreign investment in the "American Way." Our currency would collapse if we didn't. Certainly, we could quit buying foreign stuff, and our trade deficit would go down. However, so would overall GDP and, correspondingly, foreign capital inflows. Since our currency has significantly rallied relative to the rest of the world since 2013, you can intuit the global demand for dollars has been greater than the explosion in our trade deficit since then.

Basically, the problem with Germany's trade surplus is this: 1) it 'benefits' from using a currency that is weaker than Germany's would be if it still used the mark, and; 2) the Germans just don't buy enough stuff, arguably to their own detriment. I don't know. However, they seem pretty pleased to take our dollars and give a lot of them back to us...which is a nice thing to do. Shucks, if I pay you $100 for something I value, and you give me $25 back, man, I will keep doing that as long as I possibly can. Oh yeah, that is about what the Germans have been doing….about.

In the end, President Trump has an economics degree from Wharton, so he knows all of this. However, that ain't his game or how he got elected. That is why I was more interested in his economic comments than his pulling out of the Paris Agreements….I know he knows better and so does he. Basically, what is the endgame here? Does he have something up his sleeve here, or is he just trying to talk down the dollar...because that seems to have been the end result? If that is his actual intention, a weaker dollar will improve the trade deficit, or should. I suppose we shall see.

I can tell you this though: it is a lot more unpredictable than recent Employment Situation reports and Nicholas Sparks' books, by a long shot.

Disclosure