Short Items of Interest – US Economy

• What Does Business Expect? – Much has been made of the improved confidence levels in the business community and among consumers. The majority of this confidence remains rooted in what is expected to happen as opposed to anything that has yet to take place. What areas do the business leaders think will change the most? According to some recent polls the top six areas of change and reform include changing the health care law, renegotiating trade agreements, reducing regulations at the federal level, immigration reform, reduced restrictions on energy development and tax reform. In this week’s Black Owl Report we look at each of these to determine how likely these changes will be and what will have to happen for them to come to pass.

• Weather and the Economy – By now we are used to the dire predictions that come with forecasts of bad winter storms. We know that flights will be canceled and that transportation in general will be affected. What is not so obvious is the impact of nice weather when it comes at the wrong time of year. As mentioned yesterday the rate of industrial production fell in the US over the last two months and almost all of that decline was due to the warm winter and the significant reduction in demand for electric output. This has ramifications beyond this season as it can easily lead to requests for higher rates given the fact that utilities lost money this winter.

• Why Do People Quit? – The latest JOLTS report showed that the quit rate has risen to around 2.2% and that is higher than it has been in several years. Why do people quit in the first place? As one would expect the primary reason is to look for a job that pays more but among millennial workers this is often the number two reason. It is often more important for this cohort to work in a place where they enjoy the community and among consumers. The majority of this confidence remains rooted in what is expected to happen as opposed to anything that has yet to take place. What areas do the business leaders think will change the most? According to some recent polls the top six areas of change and reform include changing the health care law, renegotiating trade agreements, reducing regulations at the federal level, immigration reform, reduced restrictions on energy development and tax reform. In this week’s Black Owl Report we look at each of these to determine how likely these changes will be and what will have to happen for them to come to pass.

Short Items of Interest – Global Economy

• Twenty Million at Risk of Starvation – The current food and famine crisis is the worst seen since the end of the Second World War and it is estimated that over twenty million people are at risk. The main factors have been political conflict and drought. The most affected nations include Sudan, Somalia, Yemen and Nigeria but every state in the Saharan region has been affected. Millions of people have been displaced by war and that has kept them from farming their fields. The lack of rain has affected millions more as the desert of the Sahara expands by hundreds of miles each year.

• Indonesian Criticism of US Trade Policy – The Finance Minister of Indonesia has been blunt of late and has accused the US of switching from being a trade advocate to the most protectionist state. This is a little overblown given the kind of trade strategies that have been pursued by Indonesia over the year but the point is well taken. The US has left the majority of the world in limbo and that has affected their strategies as far as trade and therefore the strategy for development.

• Liberal Leader Likely to Win in South Korea – Now that Park Geun-hye has been impeached her center-right party has all but vanished in the polls as even conservative regions have been distancing themselves from the corruption that destroyed her regime. The front runner to replace her is from the more liberal Minjoo Party. Moon Jae-in would be the first liberal leader the country has had in decades and this could usher in some major changes if his party wins enough support in parliament. This could change business and economic policy and there could even be shifts as far as North Korea is concerned. Not that Moon has been a fan of the Pyongyang regime but the liberal position is generally far less bellicose than the right has been. This could pose a problem for the US and Japan as they would not have a leader in South Korea that would back their more aggressive plays.
Trade Policy – The Ultimate Football

There are few topics that garner as much political attention as trade policy. The challenge is that there are always winners and losers when it comes to this kind of international exchange and the losers are far more specific and identifiable than the winners are. The two prevailing theories behind trade are absolute advantage and comparative advantage. Nobody has a problem with the former as this is when one trades for something that is not obtainable any other way. The US doesn’t have the ability to produce enough bananas to satisfy demand so the US buys them from somewhere else. The comparative advantage argument is far trickier as these are goods that can conceivably be made in the country but it just isn’t efficient to do so. The US is quite capable of producing tube socks and t-shirts but why should it. These are low value goods that can be obtained elsewhere at lower cost and that allows the US to put its resources to more valuable items. The political challenge is that this is not the way a domestic tube sock producers sees things.

Analysis: During the campaign both the candidates turned their backs on trade as a general concept although for both this was a fairly recent conversion. Hillary Clinton opposed the passage of the Trans Pacific Partnership but in previous years she had referred to it as the gold standard of trade agreements. Donald Trump has taken advantage of many trade agreements over the years and commented more than once on the effectiveness of deals like Nafta. These were inconvenient positions in a campaign and were abandoned. This is not uncommon in the heat of political battle but once the race is won the President usually shifts back to a more generally pro-trade position and there are several reasons for this reversal.

Despite the headlines proclaiming the perils of a large trade deficit the US economy often gets more benefit than it loses from having that deficit. It is important to note that the vast majority of what the US imports is either consumer goods or commodities such as fuel and food. The US imports a great deal of oil still – even as the US has become a major producer again. The US also imports lots of food so that grocery stores can be full of out-of-season produce. The consumer is the net beneficiary of those consumer product imports as this saves them a lot of money. It has been asserted that an average consumer would spend around $8,000 more on the things they normally buy if these imports were not available. The US has become an exporter of services and high value manufactured goods and the jobs these exports support are far higher paying than the jobs that were lost in manufacturing cheaper consumer goods. This is cold comfort to those who had jobs producing these less valued products as they have seen their jobs vanish overseas.

Thus far the Trump administration seems to be sticking to the campaign rhetoric as far as trade is concerned. There is talk of very high tariffs on imported goods – especially those from Mexico and China. There has been a breakdown in talks over any new trade pacts and promises to tear up existing pacts like Nafta and Cafta and others. There has been development of an old concept with a new name – the Border Adjustment – and there have been all manner of assertions that trade is going to be reworked so that the US has an advantage. The truth is that has always been the goal and much energy has been spent on trying to eke out a better deal for the US. The problem is there is never a trade deal that is good for everyone. The TPP has been roundly assailed as bad for the US because it would have granted access to the US market for a lot of manufacturers in Asia. It is absolutely true the TPP would have cost more manufacturing jobs but that is not the whole story.

The TPP would have opened up several important markets for the US and one can argue that these are even more important than the ones lost. The agricultural sector would have seen far greater access than was present prior to the TPP deal and the services sector would have gained a lot of ground – especially law, accounting, banking and marketing. There would have been many jobs lost and fewer gained but the ones added would have been higher paying in general.

The border adjustment tax is a new version of an old concept that would essentially reverse the current tax advantages for importers and exporters. Changing the way these are handled would mean that exports would get a tax break and the importers would not. The problem that has developed every time this has been talked about is that these changes serve to make the dollar that much stronger and that essentially wipes out the advantage exporters would have had and continues to make imports lucrative.

It is hard to determine just what the trade situation will look like in the coming months. There have been some executive actions thus far – such as backing away from the TPP. But that was an agreement that had been killed in Congress last year. There is talk of revamping Nafta but nothing formal has begun. The additional tariffs and taxes will have to work through Congress and there is nothing to suggest they are on the same page with each other -never mind the White House.

The best guess at this point is that there will be targets as far as trade sanctions are concerned and other nations that will get very little attention. Mexico is in the cross hairs for a wide variety of reasons. It has become the whipping boy for many of the ills of the US economy regardless of the facts. It has been fifteen years or more since there was an exodus of jobs to Mexico from the US – today it is China that loses jobs to Mexico. Immigration has been blamed for many things but few grasp the economic benefit the US has received. The point is that Mexico is a target and there will be restrictions and tariffs that are directed specifically towards Mexico.

China will also come in for extended criticism and with greater justification. This is a country that overtly supports its manufacturing and export economies with every tool in the trade arsenal and the US has seen a lot of business decamp for the low costs environs of China. At the same time, there are many companies in the US that derive a great deal of benefit from working with China and they will defend that relationship.

The regions the US will continue to favor will be Europe (especially the UK). The US wants new deal with the British and others in the EU that have chafed under the rules of the EU. Look for the US to back Japan and South Korea as counterweights to China. There will be interest in working with Russia but they have little to sell other than their commodity wealth and right now the US has less need of that.
German Election Heat Up

The role played by Germany in Europe is hard to ignore and the same can be said for Angela Merkel. Throughout the past decade the Germans have been either driving events or they have been at the center of the discussion. The economic collapse of 2008-2009 hit the rest of Europe harder than it hit Germany as the German banks had not indulged in the kind of risky behavior as those in France, Spain, Italy, Greece and many others had. The Greek crisis with its threat of Grexit landed in Germany’s lap as they were the controlling factor as far as EU and ECB bailouts were concerned. It was Germany that pushed hard for the provision that so irked the UK that they decided to split from the EU altogether. Germany was once again at the heart of controversy with its decision to allow millions of refugees to enter from Syria and elsewhere in the Middle East and North Africa. In all of these situations and more Angela Merkel was at the center. She is either loved or hated in Germany and the rest of Europe for that matter and she is now facing the most severe test of her political career as she tries for a fourth term as Chancellor.

Analysis: Three month ago she did not really have a challenger as the Social Democrats had a lackluster leader with barely the votes to hold his party position. This was before the somewhat shocking decision by Martin Schulz to take the helm of the SPD. He had been the head of the European Parliament and had been considered an ally to Merkel. In a European context he still is but not as far as Germany itself is concerned. He has resurrected the Social Democrats and has managed to chew into Merkel’s lead every week. He even has coat tails and has been able to improve the competitiveness of SPD candidates in other races.

The message thus far has been clear enough – Merkel is too imperious and too blind to the real needs of the German people. He has attacked the immigration issue without reversing the SPD position supporting the idea of resettling the refugees fleeing the war in Syria. His attack has been focused in Merkel’s method – not really engaging with the legislators when the program was being launched. It was more edict than anything else and that has been her style. Schulz is proposing a more engaged leadership and one that pays attention to the working population and the poor. It is not quite a populist message as Schulz has a very government centered pedigree – it is more of the traditional center left approach that had fallen out of favor in France, Spain, Italy, Greece and others.

In many respects the campaign has become about style. The Merkel approach has been more and more “my way or the highway” and she has been impatient with those who have attacked her from within her own party on issues like immigration. Schulz has been the one preaching inclusion and that has allowed him a more nuanced position on immigration. He acknowledges the fears and concerns of the working class population that has the most contact with the new arrivals and he has managed to take some votes away from the xenophobic AfD. He still has a long way to go to defeat Merkel as her lead remains substantial in most of the country.

New Travel Restrictions Raise More Questions than Answers

The fact that electronic devices attract security attention is nothing especially new. The majority of travelers have been taking their laptop computers and devices out of their bags for screening for years. These devices can be rigged to be bombs and fairly easily. It has been deemed sufficient to subject them to scans and inspections but the latest edict from the US will require that passengers from eight Islamic states be prohibited from bringing them into the cabin. This has outraged the flying public given the ubiquitous use of these devices for business and entertainment purposes.

Analysis: The real issue is that these have only been banned in flights that originate from Saudi Arabia, UAE, Egypt, Jordan, and four others although there was a message released that suggested that there would be twelve states affected by the ban. The question is why other flights from other nations are not affected if there is a danger from these devices. Is it expected that a terrorist will not fly from Spain or France or Norway or any other nation. The security for airlines in Saudi Arabia has been ranked as the best in the world and Jordan is also considered as tough as Israel as far as protection is concerned. The ban applies to only states with a Muslim majority and seems to tie into the other travel bans the US has tried to impose and this has thus far been struck down as discriminatory and illegal. The reaction to the device ban has been a mixture of outrage and surprise and it is clear that there will be far more reaction down the road – especially if the ban is extended.

The Black Owl Report – An Executive Intelligence Brief

There are a number of publications that come from Armada. You are familiar with the daily Business Intelligence Brief we distribute through various business organizations. This is written for the general business community and deals with the broad economy – national and global. The Black Owl Report is a nod to the “black swan” theories of Nassim Taleb and focuses on forecasting and the big issues that move the corporate community. They are designed to be companion publications. The BOR is subscription based ($84 per year). If you would like to take a look at the BOR please contact ksanchez@armadaci.com and we will start a one-month free trial – there are no obligations – just an opportunity to see additional publications.
These are quick summaries of articles that appear in a recent Black Owl Report. We invite you to start a one month trial subscription so that you can see the variety we offer in this publication.

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The Most Important Statement from the Fed. It’s a bit like ‘Captain Obvious’ to say that the Fed raised interest rates by another quarter-point. That’s old news. But, there are two things that are important to take away from the committee’s comments. First, to all consumers: “the simple message is that the economy is doing well”. And second, from Richard Fisher (former CEO of the Federal Reserve of Dallas), that the Fed is now “doing a good job” and is finally on track to get interest rates into a range that it should be in.

Can’t Believe What I Just Heard. O.K., we promised to try and cut down on the political side of our writing, and we’ll continue to shoot straight down the middle and remain business focused. But, I heard something today in a White House press conference that I can’t believe I heard. When asked about the current budget proposal cutting all funding to the UN – and the reporter asked what the administration’s position on the growing starvation problem (now hitting 20 million people across five countries in the Middle East and Africa) was, Mick Mulvaney (Omnibus Budget Director) said that “the President is focused on people in the US”.

Third Case of Bird Flu in Tennessee. A third facility has tested positive for Avian Influenza in Tennessee. The birds at the facility will be culled, just as they were at the last two facilities that had outbreaks earlier this month. Officials are still trying to “officially” let us know why the chickens are getting the flu – most of the facilities are fairly “sealed” from outside viruses. That being said, migratory birds can easily spread the highly contagious disease. But, there are two things we need to know about the virus – and one conspiracy theory to add-in.

Dutch Dodge the Populist Bullet. Analysts will be frantic for the next few weeks. Right up to the day of the election it was predicted that the ruling party VVD Party of Mark Rutte would be in a virtual tie with the insurgent populists of the Party for Freedom led by Geert Wilders. The VVD was expected to take perhaps 27 seats and Wilders would take 22. In the end, this was not the scenario that Dutch voters supplied. Rutte’s party won at least 33 seats and Wilders took just 20. That still makes the Party for Freedom the second largest in the Netherlands, but all of the other parties had already indicated that they had no desire to ally with him to form a coalition. Now that his party is 13 seats behind, there is even less reason to associate with him. Just like that...the populist wave in the Netherlands has seemingly peaked and dissipated. What does this mean for US business leaders?

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Why is it So Hard to Separate Facts from Opinion?

To be honest facts are not really a lot of fun – they just are. Something either happened or it didn’t and something either exists or it doesn’t. There is nothing all that interesting about this. The good part is that facts matter far less than their interpretation and meaning. The sun comes up at a specific time each morning – whether that is a good thing or bad depends on the individual and their desire for more sleep. There is really no such thing as a universal bad or good as it all comes down to the impact on the individual – the old Scottish adage that it is an ill-wind that blows nobody good. The tornado that rips your house to pieces provides work for those that will fix it or haul it away. To be sure there are tragedies that are good for nobody but in the political world there are always two sides (at least) to every story.

Right now, there are people that are strenuously arguing the existence of “alternate facts” and “fake news”. There is indeed a certain amount of outright fabrication but on closer examination this is really about interpretation. Many of these stories are not about the hard, cold facts but about what these mean. For example, there is verifiable fact regarding the Russian and Chinese efforts to penetrate US cyber security. What is not verifiable is intent. Why were they doing this and what impact did they intend to have? This is where opinion and analysis and argument come in and well it should. We have a great deal to argue about as we all have different opinions, preferences and beliefs. We just need to be honest in these debates and admit that this is what we are arguing about.