Bauerle's Bank Notes

Shifting Tides

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Eastern Canada's Bay of Fundy is a canyon-like estuary where the St. John River, which has been called the Rhine of North America, meets the Atlantic Ocean. The city of St. John, New Brunswick, stands at the juncture of the river and the bay. The difference between low tide and high tide is 28 feet. The waterfall where the river meets the sea reverses direction twice daily. Water flows over the rocks from the sea into the river as the tide comes in, and then back over the rocks from the river into the sea as the tide goes out. The impact of the tidal shift influences the river as much as 30 miles inland.

The International Monetary Fund's semi-annual World Economic Outlook (WEO) issued last week signaled similarly strong changes of position, though not outright reversals, currently underway among large, interdependent national economies. The Financial Times Wednesday headlined the first of two articles about WEO conclusions, "Cheap natural gas lifts US manufacturing: Energy-intensive exports."

> Cheap natural gas has delivered a boost to US manufacturing exports, the International Monetary Fund has found. Advances in shale rock drilling have driven a sharp rebound in US gas production, pushing prices in the States to a steep discount to markets in Europe and Asia. US gas sells for $4 per million British thermal units, compared with $10 in Europe and close to $18 in Asia.
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> The price gap has led to a 6 percent average increase in US manufactured product exports, the IMF wrote in its twice-yearly World Economic Outlook.
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> While energy costs represent a relatively small share of total input costs, "the lower natural gas price in the United States, which is likely to persist, has had a noticeable effect on US energy-intensive manufacturing exports," the IMF report said.

The second Financial Times article based on the WEO addressed economic conditions generally.

> Yesterday, [Oliver Blanchard,] the chief economist of the International Monetary Fund presented an outlook that cuts global growth forecasts again-this time by 0.2 percentage points to 3.8 per cent for 2015-a change driven by weaknesses in the eurozone, Russia and Brazil. . . .
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> "There are two major forces shaping what happens in different countries," said Mr. Blanchard in an interview ahead of yesterday's IMF World Economic Outlook. "One comes from the past: the legacies of the crisis." Those legacies, such as large debt overhangs, affect the eurozone in particular.
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> The other is the risk of sustained slow growth and Mr. Blanchard fears it is already shaping what happens today. "When you anticipate growth is going to be lower, then you don't invest as much," he said. . . .
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> One of Mr. Blanchard's favoured solutions for reviving global growth is public investment. Indeed, the WEO argues that greater capital spending by governments can be close to a free lunch, with returns in taxes high enough for countries to spend without increasing their ratio of debt to national income. "There is a strong case to be made for more public investment, for demand-style reasons in the short term, and supply-side reasons in the longer run," he says.
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> The US and Germany are prime examples, Mr. Blanchard said, of countries where there is a backlog of high-return infrastructure projects. He added that their governments should make the most of record low borrowing costs and reap the large macroeconomic benefits that come from increasing demand.

Both reports are good news for bankers who act on them. In the last generation, foreign state-subsidized competition battered U.S. manufacturers. I first wrote about this phenomenon in 1978 in the Cornell International Law Journal. I argued that foreign state instrumentalities should not enjoy sovereign immunity from prosecution under U.S. antitrust law for their anti-competitive practices in American markets. In the intervening years, U.S. manufacturing suffered grievously and American banks withdrew financing from the sector in response. Primary metals, autos and transports were all out of favor. Wall Street instead stoked debt demand among consumers, who bought record quantities of goods manufactured overseas. Banks also consumed one another in a wave of consolidation that eliminated most Midwest banks, which had grown to prominence serving manufacturing enterprises.

A reinvigorated American manufacturing sector needs capital. Banks that embrace that opportunity stand to earn reasonable risk-adjusted returns on equity. Banks best positioned to benefit are located in the Midwest and Southeast due to cost-of-doing-business advantages those regions share relative to Northeast and Mid-Atlantic states. Specific advantages that will advance the new U.S. manufacturing economy include:

- Natural resources. In addition to relatively inexpensive natural gas as reported by the Financial Times, process water (as opposed to drinking water) is a resource needed in large quantities for manufacturing. Unlike the Western U.S., the Eastern U.S. has water in abundance. Needed too are improvements to, or replacement of, century-old water distribution and purification systems. See Blanchard's comment about infrastructure projects as an economic, and banking, opportunity.

- Population of educated workers. Fifty-eight percent of the U.S. population resides east of the Mississippi River. SAT scores of area high school students are one of the few key metrics for Sony Corporation's plant location decisions. American colleges and universities remain concentrated east of the Mississippi. Their graduates are the workforce technology-enabled manufacturers need most.

- Transportation infrastructure. The Eastern U.S. is honeycombed with railroads, highways, the Great Lakes, rivers and ports. Eastern seaports' usefulness will only grow as the Panama Canal expansion project is completed. Manufactured goods need to get to market and that is relatively easy to accomplish in the Eastern U.S.

Bankers today have a once in a generation opportunity to support the agenda that the IMF's WEO articulates: to make America competitive again in the world manufacturing economy. Wage rate gaps persist, but are narrowing somewhat. America's recent disadvantage is partly offset by culturally and politically determined differences in manning strategies, as well as by lower costs in other areas, including energy (see above). People are eager to work. The days of autoworkers smoking pot while working at GM's Lordstown Assembly plant are history. Moreover, government knows it needs business, just as business knows it needs government. Needed most are common sense, hard work and courage to embrace the future rather than live in fear of repeating the errors that led to the gloom of recent years.