

DISCOUNTED AMERICA

A Revival of US Manufacturing May Require New Industrial Policy

Waterfront Buildings, Vallejo California | Edited by Gregor Macdonald

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This week on StockTwits.TV:

Brian Shannon
Of AlphaTrends
Wraps Up the Market
After an Historic Week

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DISCOUNTED AMERICA

The great manufacturing centers of America's 19th Century continue to lay dormant, but could they live and breathe once again? There is no question that Washington is now on a passionate mission to increase US exports. But something more than improved port architecture and a much lower dollar may be required. With the trillions the US is already spending on the unemployed, it may be time for new industrial policy.



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A NOTE FROM THE EDITOR

Welcome to StockTwits Macro Weekly, the weekly magazine of the StockTwits investment community. Each issue features a core essay, written by the Editor. Around this, we build in the key news events and observations, from the past week. [To have each issue sent to you, sign up here.](#)

You will also find StockTwits Macro Weekly functions as a live document, that is eminently clickable and is therefore a helpful launching pad to other relevant content. Feedback from readership is welcome, and we are always on the lookout for written contributions from the community: gregor@stocktwits.com



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DISCOUNTED AMERICA—Two years ago the City of Vallejo, a strategically located town in the north bay of San Francisco with a rich history, declared bankruptcy. The filing came at the end of a mammoth housing boom in California, with regions such as the SFBay as one of its epicenters. Values had risen so far and so fast in Berkeley, the Peninsula, and San Francisco itself, that real estate “pioneers” had eventually gone to places like Benicia, and Vallejo in search of lower pricing. The sales history of homes from 1999-2009, easily accessible [on sites like Redfin](#), tell the tale. It’s not hard to find vintage Spanish-style and historic Victorians that moved from the 200K range in 1999 to the 500-600K range in 2006. Where are those prices now? Most fell back to the 200K level at minimum during the first part of the crash, but since the city bankruptcy of 2008 have now fallen even further. With the eventual collapse of the police department and the state takeover of the public schools, many homes in Vallejo can now be purchased for less than 100K. Indeed Vallejo, has become dirt cheap. And that’s intriguing. Because across America whether its land, commercial real estate, or houses the country is now getting down to price levels that create some possibilities. Furthermore, in non-dollar terms, *terra firma* in the United States is getting even cheaper. Do these trends simply continue to all the way to zero, or does deeply discounted America finally trigger some new economic trends?



It’s clear what Washington wants. As addressed in last week’s StockTwits Macro Weekly, [Steel Wheels](#), the contours of a unified strategy are now emerging from Washington. First, the swing is now underway to fix up railroads and port infrastructure from coast to coast to smooth the exports of wheat, coal, lumber, and other soft commodities for which the US is well known. Second, The President is basically on an Exports Warpath, writing an Op-Ed in the New York

Indexes

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|------------|----------|--------------|-----------|-------------|------------|
| INDU 11444 | TNX 2.61 | GOLD 1397.70 | VIX 18.26 | SPX 1225.25 | DXY 76.780 |
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StockTwits.TV: Market Wrap-Up w/ Brian Shannon



This was an historic week for United States monetary policy, and the mid-term elections did not disappoint either. More importantly from a trader's perspective, the main US stock indexes have now reached back to the April highs. So, what comes next for US stocks? Last we heard, the deflationists were telling us the April highs would never be bested. Well, on the weekly close the SP500 notched 1225. To get a feel for where we stand, let's check in with [Brian Shannon](#).

Brian does an excellent show every Friday afternoon that wraps up the week's action. While Brian absolutely agrees that the market is currently overbought, he once again poses a useful and very simple question: why would you try to top-tick the market at its current level? Indeed, many have been trying to do so for some months. See Brian's take on Gold, Semiconductors, and the SPX on StockTwits.tv. [Watch the show here](#).

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Times on Friday, [Exporting Our Way to Stability](#). He is following that up with a foreign trip to India that practically looks like a sales junket as the US sells all manner of military and civilian aircraft and hardware to Delhi. This, by the way, comes close on the heels of an [enormous sale of weaponry to Saudi Arabia](#), the largest ever. Finally, the FED and Treasury are playing the most crucial role of all: hammering the dollar lower to make US exports competitive.

A tour of population data during the 19th century turns up the unsurprising linkage between waterways, ocean access, and the great population centers of America. Cities like Baltimore, San Francisco, and Philadelphia--not cities like Los Angeles or Phoenix--ruled the day and for obvious reasons. What's intriguing is that many of these cities today have vast inventories of wasting commercial real estate with frontage on ocean going rivers, or on bays that lead to the ocean. Few anticipated in 2008 that real estate prices would not only fall to such low levels, but would sustain themselves at such low levels for this length of time. Any tour through national commercial real-estate listings shows that a lot of property is merely falling back into the hands of city and state governments for non-payment of taxes. In truth, a great swath of industrial America has already priced itself to zero, and languishes in a world *without a bid*. While many have concluded that manufacturing jobs will never return to the United States, one economist in particular, Jeff Rubin, thinks that such a reversion to North American-centered manufacturing is imminent.

Rubin [explained at the recent ASPO conference in Washington, DC](#). that he remains with his view that the price of oil will erode and then eventually disrupt the global outsourcing and manufacturing model. In this model energy costs were ignored in pursuit of the cheapest labor to extract maximum savings. According to Rubin, only the most

high-value goods that offer an optimal mix of weight and profit margin will be able to carry on in such a dispersed manufacturing chain. For the rest of globally traded goods, especially steel and capital equipment, Rubin sees a return to domestic production. For North American cities like Philadelphia, Portland, Oregon and Vallejo, California this thesis offers promise. Provided it comes true.

One of the “minor glitches” in Rubin’s thesis however is that the very same increase in energy prices which he sees as the trigger to swing production back to North America, is the same dynamic that will weigh on the global economy. And in fact, this is already underway. The financial crisis crushed asset prices, did not bring relief in commodity prices, and has not created a new dawn of American manufacturing. Maybe it’s just early and perhaps once enough wage and commodity inflation feeds into *developing* world economies, then all-in manufacturing costs in *developed* economies can start to equalize on a local basis. The problem is that shipping costs over water are simply not that punitive. Yes, higher [bunker fuel](#) prices do increase costs. But, the “distance” from China to the rest of the world takes advantage of the fact that transport over water is the cheapest form of shipping. Those CSX commercials you see about the big advantage that rail has over trucks are spot-on. But even rail doesn’t beat the energy-advantage of water.

How cheap does America have to become, therefore, before it can site new manufacturing in the lower 48? Is it simply impossible, even for depressed cities like Philadelphia and Vallejo to re-launch as ready-to-ship production zones? One possibility is that the US government, already bearing the weight of over 2 trillion in transfer payments per year, may decide to foot the cost of revival simply to *possess* manufacturing in the country. Welfare, food stamps, unemployment insurance, and other carrying costs of an

What Money Printing?



Now that the FED has started another round of QE we are treated to the inevitable argument as to whether this actually means the FED is printing money. Operationally, the FED’s exchange of cash (Federal Reserve Notes) for existing Treasuries strikes many as a neutral asset swap, that is hardly inflationary. Indeed, that is the view expressed by the FED chairman himself and [he did so this weekend](#) at the FED’s getaway weekend on Jekyll Island. Is this true?

It’s certainly the view favored by hard-core deflationists, and chartalists. But you have to wonder: does the sanguine view about QE focus solely on [the operational mechanics of FED purchases](#), while ignoring the effects? After all, the FED action creates both *price improvement* in existing securities, and, leaves sellers holding a pile of zero-maturity, zero-interest bearing notes--also known as cash. Surely, this is more than a simple shift in the duration of large insitutional portfolios. This is not a national, but a global operation the FED is conducting. Fresh cash is going to work not only in other debt, but in global equities as well.

Breaking China



Has the market figured out yet that Washington is trying to break China? Perhaps so. It's quite obvious now that Geithner and Bernanke are playing hardball with Beijing, in their quest to ensure that the CNY-USD peg is eventually busted. The lever of course is the rising price of commodities. Energy, and in particular Food.

What's intriguing about the CNY-USD peg is that for so many years it worked to China's advantage, and there was nothing much the US could do to change the dynamic. But now, through the structural change in global commodity prices, the US has a hammer it can use against China and that's dollar debasement. And the prospects for winning this battle? They are limited only by the willingness of Geithner and Bernanke to see the gambit through, to its conclusion.

The response from Beijing has been unsurprisingly harsh. That said, using the dollar as a weapon has also brought a sharp rebuke from other nations. [Germany's Finance Minister said last week](#) "With all due respect, US policy is clueless." (And the currency wars played on.)

out-of-work population have helped to bloat total transfer payments to 2.3 trillion this year. | see: [Table 10 on page 11 of the latest BEA data release](#). | Why not just spend that money to revive industrial infrastructure? Meanwhile, while exports are indeed starting to respond to the Washington effort, the US continues to get hurt by the rising cost of imported oil. This suggests that, despite [surging demand for US agricultural exports](#), the US is going to have to conduct an almost mercantile-like industrial policy to get manufactured exports going again. Given post-war history this may sound like an almost bizarre option. However, when you consider the extraordinary measures the US is already undertaking to hold itself together, and the predictions of many that [QE will never end](#), a USA Inc. industrial policy no longer sounds so impossible.

--Gregor Macdonald, 07 November—Amherst, MA

