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Weekly Economic Update

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We are largely going to take a pass on the employment report. The 304,000 gain was obviously strong, but with a 90,000 downward revision to last month's booming 312,000 increase we are suspicious of a coming offset or revision. After revisions, November and December averaged 209,000 -- in line with the 211,000 over the prior four months. The six month average for both payroll and household jobs gains increased rapidly in the first half of 2018 and tailed off in the second half – exactly as one would expect from an economy with 4.2% growth in Q2, 3.2% in Q3 and 2.5% for Q4 (according to the Atlanta Fed). Average Hourly Earnings and the Employment Cost Index show wage growth has accelerated, so an easing in hiring should be expected. We note that Q4, productivity should again be weak, and that wages are already well above inflation plus productivity, squeezing margins. We expect the US economy will slow in the first half and employment and wage growth as well.

Our research focuses on how and where CEOs of multinational firms and global investors will allocate their capital as they look for comparative advantages that will produce better returns. Most economic research and commentary concentrates on policy changes and their impact on the economy. In our view there are two kinds of policy changes – those advocated for by lobbyists trying to enhance returns on a deal they have already have decided deserves review and those determined by politicians hoping to influence investors by offsetting already undesirable circumstances. Analysis by our good friends at Strategas confirms that lobbying works, which is why capitalists commit money to the effort in the first place. The investment community generally agrees that government interference, however justified, is not constructive to the efficient allocation of resources. We believe the global economy has slowed and will continue to in early 2019 in response to two major government directed policy decisions – the massive US fiscal stimulus via a tax cut and spending increases and China's credit crunch to lower debt levels. The trade war no one lobbied for and the government inspired Brexit vote are exacerbating those mistakes. The only good news is that investors have voted with their feet causing equity market declines that finally caught the politicians' eyes. We expect China's recent stimulus will continue, the trade war will reach an unsatisfactory but negotiated pause, and that Brexit will be extended. That's what investors and CEOs are lobbying for -- and politicians should enact.

We have stated that the next cycle may be different than the prior two as it will be harder to invest even more in China given rising costs and trade issues. To determine where businesses may go next, we evaluated every country in the world with more than 25 million people (enough scale to matter and instructive for nearby nations). We used current per capita income as our filter as it indicates the level of development currently supported by comparative advantages and government policies. Our commentary separates targets into four categories: the suburbs where finance and services dominate; rustbelt nations where industry dominates, but at high cost; Sunbelt nations which will attract industry from the rustbelt; and resource producers whose comparative advantage is less about labor. We further disaggregated the US, China and India into smaller blocks as their regions are as big as nations.

CURRENT EXPORTERS OF INDUSTRY

	PER CAPITA INCOME	POPULATION (MILLIONS)	GDP (BILLIONS)
US Northeast	70541	63948	4511.0
US West	67881	52704	3577.6
US Midwest	56477	58673	3313.7
US Resource	56042	63631	3566.0
Germany	48669	82439	4012.2
US South	48621	88340	4295.2
France	42930	65481	2811.1
U.K.	42260	66959	2829.7
Japan	40105	126855	5087.5
Italy	34349	59217	2034.0
South Korea	32046	51339	1645.2
Spain	31059	46441	1442.4
Taiwan	25535	23758	606.7
Saudi Arabia	23186	34141	791.6

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This first set of high income nations are the greatest potential losers of industry. Note that the US Northeast and West are suburbs and Texas, the Plains and Mountain states are resource providers. The US Midwest has by far the most exposed producers with average incomes at over $56,000 compared to $48,000 in the US Southeast – roughly equal to Germany, which is now putting auto plants there (Mercedes, BMW and Volkswagen). France and the UK are more expensive than Japan, and Italy and Spain are in the same range as South Korea. Only technology (less prevalent in Italy and Spain) saves these nation's industrial bases. Taiwan is the low cost industrial producer at $25,000, but also the smallest. We point them out to show the contrast with the rest of Asia and China.

Bottom line, there is a major gap down to the next set of nations, which are competing to take industry away from the global rustbelt nations. The most expensive is the Greater Shanghai area (Shanghai, Jiangsu and Zhejiang) at $15,000 – 40% cheaper than Taiwan, which is why the Taiwanese semiconductor industry moved to Suzhou long ago. We were surprised by this list of leading Sunbelt areas as far more than we expected are still in China (in red). The main European competitor, Poland, is already as expensive as the most costly areas in China. Russia is seen more as a resource producer and doesn't attract much foreign capital. Turkey attracts investment capital, but foreign direct investment has been sliding since Erdogan's second election in 2007. In Asia, Malaysia is seen as a competitor for technology, especially in the Penang region, but its cost would be higher than Greater Shanghai if we included Singapore as its financial hub (as we did with Hong Kong in Southeast China). Thailand, long a focus of Japanese investment, has recently stabilized its political situation. There are six Latin nations on this middle income list. Argentina's conservative post-Kirchner government has not attracted foreign investment. Brazil is just taking its first steps on the same path with Bolsonaro. Mexico is moving in the opposite direction with Liberal Obrador replacing Conservative Nieto. Venezuela is trying to decide who runs the government. Peru and Colombia, both members of the Pacific Alliance with Mexico and Chile, realize that scale is critical to attracting capital. The last two non-Chinese options on the list, South Africa and Iran remain relatively isolated due to politics. Bottom line, most of the most attractive locations for future investment that would have gone to the East Coast of China as in the past two cycles – or wants to move from there now -- is still in China.

CURRENT IMPORTERS OF INDUSTRY

	PER CAPITA INCOME	POPULATION (MILLIONS)	GDP (BILLIONS)
Greater Shanghai	15567	159695	2485.9
Argentina	14462	45102	652.3
Southeast China	14160	155938	2208.0
Poland	13821	38028	525.6
Russia	10955	143896	1576.4
JinJingJi + SD	10889	211207	2299.9
Turkey	10537	82962	874.2
Brazil	9895	212393	2101.6
Malaysia	9755	32454	316.6
Mexico	9318	132328	1233.0
Chongqing+Hubei+Shaanxi	9087	127037	1154.4
Liaoning+Jilin	8159	71233	581.2
Hunan+Jiangxi	7212	113815	820.9
Venezuela	6890	32780	225.9
Henan+Anhui	6853	156758	1074.2
Peru	6731	32934	221.7
Sichuan	6654	82330	547.9
Thailand	6590	69306	456.7
Colombia	6379	49850	318.0
South Africa	6179	58065	358.8
West China	5860	65736	385.2
Guangxi+Guizhou+Yunnan	5701	131157	747.7
Iran	5289	82821	438.0

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Our third list of budding markets for future industrial investment shows another large gap between its highest priced market and the prior lists cheapest (actually second as we will ignore Iran) – falling over 30% from $5700 in Southern China to $3900 in Indonesia. Indonesia is the largest nation we did not disaggregate on this list with almost 270 million inhabitants. Next up is the combined states of Delhi and Haryana at $3500. Delhi itself is $5600, but has a population under 17 million. We combine them as New Delhi acts as the financial hub for the greater region. The Philippines at $3000 is another frequently mentioned ASEAN location for next generation development. Below that of the ten regions with incomes between $2500 and roughly $2000, seven are in India – which is why that nation is at the top of the list for "Next China." Vietnam falls within that range, and is attracting low end businesses from nearby Guangdong – buy with the result of skyrocketing prices as the world is trying to pour a lake into a pond. Egypt, Nigeria and Kenya are Africa's low cost offerings. China is already in Nigeria and Kenya aggressively financing and building infrastructure.

NEXT GENERATION FOR INDUSTRY

	PER CAPITA INCOME	POPULATION (MILLIONS)	GDP (BILLIONS)
Indonesia	3876	269536	1044.7
Dehli & Haryana	3457	42139	146
Philippines	2976	108106	321.7
Egypt	2501	101169	253.0
Maharashtra	2500	112374	281
Telangana	2500	35287	88
Viet Nam	2354	97429	229.3
Karnataka	2400	61095	147
Tamil Nadu	2300	72147	166
Kerala	2300	33406	77
Gujarat	2200	60440	133
Andhra Pradesh	2000	84581	169
Nigeria	1994	200962	400.7
Kenya	1702	52215	88.9
Bangladesh	1602	168066	269.2
Pakistan	1541	204596	315.3
Myanmar	1264	54336	68.7

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Our conclusion is that while there will be a spreading out investment during the next cycle, China will still attract the lion's share and its growth will continue to be a dominant and divisive force in the global economy. India, currently a $2.5 trillion economy growing at over 7%, will be frequently compared to China – but its path will be different simply because unlike China which grew with little competition, it will always be challenged by the huge Chinese economy and its drive for global development. We expect both of these 1.4 trillion population nations will be at the top of the global growth list in 2019 and 2020, lifting millions more out of poverty and providing so much labor competition that inflation remains a back burner issue for the foreseeable future.