Durable Goods Deflation Is Wonderful

***e*Research Corporation** is pleased to provide an article by Scott Grannis for his Blog, "Calafia Beach Pundit".

In this article, Mr. Grannis applauds China for helping make global consumer goods become much cheaper.

The article is reproduced below, beginning on the next page, or you can go to this specific Blog at the following link: **Durable goods deflation is wonderful**

You can also visit Scott Grannis' Home Page for his Blog at the link below:
http://scottgrannis.blogspot.ca/

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Bob Weir, CFA: Director of Research

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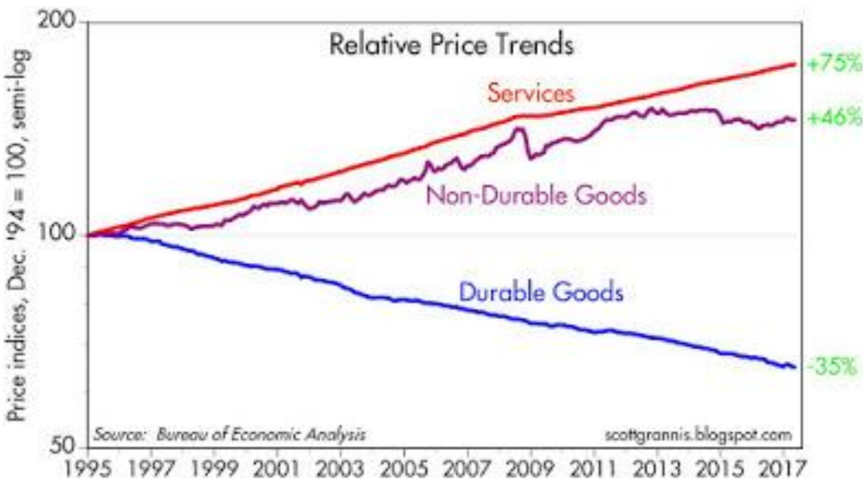
Durable Goods Deflation Is Wonderful

I have been featuring this chart off and on for years, and it is worth repeating once again.



The chart shows the evolution of the Personal Consumption Deflators for Services, Non-durable Goods, and Durable Goods.

It starts in 1995 because of three reasons: (1) that was approximately the year that China began to be an export powerhouse; (2) it was a year after China's major devaluation against the dollar, and the first year that the yuan began to stabilize against the dollar; and (3) it was the first year ever that the U.S. durable goods deflator experienced a decline of more than a few months.

I think it is not a coincidence that the emergence of China as a major exporter of durable goods (e.g., TVs, computers, cameras) coincided with the beginning of a sustained decline in the prices of durable goods. If there has been an identifiable source of deflation in the U.S. economy, it has not been the Fed, but the vast increase in the productivity of the Chinese economy, and the vast increase in the volume of imported Chinese goods to the U.S. economy. Thanks to the industrialization of China, the world has been able to produce manufactured goods much more cheaply than ever before.

This has been a boon to just about everyone in the USA, and the first chart is also proof of that.

Consider that the price of "services" is largely driven by wages, and service sector workers are about 86% of total payrolls. What the chart shows is that the earnings of the great majority of U.S. workers have increased 2.7 times more than the price of durable goods. In other words, an hour's worth of work for the typical American today buys 2.7 times more in the way of durable goods than it did in 1995. When it comes to durable goods, the average American's purchasing power has nearly tripled over the past 22 years, thanks largely to China.

As these next two charts show, China did NOT become an export powerhouse by unfairly devaluing its currency. On the contrary, the yuan has *appreciated* in real terms vis-a-vis the currencies of its trading partners by about 75% since 1995, as the second chart on the next page shows.

Furthermore, China's reserves have been relatively stable for the past several months, and this suggests that the yuan is likely to remain relatively stable—there is no hanky-panky going on (significant increases or decreases in forex reserves are symptomatic of an inappropriately-valued currency).

It is encouraging that Trump has dropped his threat to "punish" China for boosting our purchasing power so dramatically. We could use more countries like China, and so could the world. When it comes to trade, everyone is a winner.

BW: See ABOUT THE AUTHOR on the following page.

ABOUT THE AUTHOR

Scott Grannis was Chief Economist from 1979-2007 at Western Asset Management, a Pasadena-based, global manager of fixed-income portfolios for institutional clients.

He now enjoys keeping up on economics, markets, and politics from his condo overlooking Calafia Beach on the southern California coast, where he likes to think that he is immune to Wall Street group-think.

Married for 45 years to his Argentine wife, Norma, he has four children and five grandchildren (four boys and one girl).

He is a believer in supply-side economic theory, as practiced by his mentors, the late Jude Wanniski, Art Laffer, and Larry Kudlow. John Rutledge is another of his mentors, from the days that they worked together at Claremont Economics Institute.

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