Boenning Morning Comment

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One of the confusing aspects of this economic recovery has been the absence of inflation, particularly as the labor force approaches full employment. Certainly, one reason inflation has proven so evasive is that the growth over the past 8 years since the end of the Great Recession has not yet fully absorbed all the excess capacity idled since then. Capacity utilization still stands well under the 80% threshold where history suggests inflationary pressures might increase. Some argue that the capacity utilization number is understated because a substantial part of the idle capacity is now either antiquated or economically so inefficient as it will never be brought back on line. But even allowing for some of that, it is clear that not only the U.S. but the world overall has more productive capacity in place than is necessary.

It isn't just manufacturing capacity either. We have written often of the excess in retail space. By some estimates, almost 50% of current retail selling space could be shuttered or converted to other purposes without creating any stress on the system. Certainly, over the past several years we have seen lots of stores converted to medical office buildings, gyms and restaurants. But soon there will be too many urgent care centers, too many gyms, and too many places to eat or drink. Before all is said and done, a lot of zombie malls are destined to be bulldozed into oblivion.

Technology has played an active role in creating so many disjointments. Internet shopping has eliminated much of the need for physical store space even as leading Internet retailers start opening shops on Main Street. Automatic teller machines have reduced the need for bank branches. Uber and other ride sharing, services that require technology to work efficiently have reduced urban demand for privately owned vehicles.

Interestingly, the persistence of weak commodity prices can also be tied to technology. Look at oil and gas, for instance. Fracking, whereby rocks are cracked to release oil and gas reserves, has opened up a huge new source of both oil and gas. Not only has fracking led to new supply; it has lowered the cost of producing a barrel of oil presuming the fields are rich in hydrocarbons. In most cases, in areas where the rocks are rich with oil, gas is produced as a bi-product. It's an afterthought, so to speak, with almost no cost attached to it. This by-product gas, therefore, proves to be even cheaper than the fracked gas found in places like Pennsylvania and Ohio, heretofore thought of areas of low cost production.

Twenty years ago, we were not only thinking that oil demand would outstrip the world's production capacity, the industry was uncertain where it might find the oil and gas to meet future needs. With today's geological seismic and related technologies, we now know with certainty where enough oil and gas lies to meet the needs for decades to come. The only issue is what is the cost of extraction and delivery. While it is possible that a protracted period of low prices could create temporary shortages as drilling in higher cost regions like deep offshore is curtailed, ultimately relatively brief periods of higher prices will bring on new production. In other words, prices can spike but high commodity prices won't be sustained. I have not even considered the impact that technology will play in the development of alternative energy resources including electricity, wind, solar and fuel cells. We can argue when the relative costs of these alternatives will rival that of traditional hydrocarbons, but there is little doubt that, over time, the costs of solar power, for instance, is only going to come down. In other words, there will be a cross over point; we just don't know when.

Technology affects all commodities. We can reach mineral sources never reachable before. Better equipment can extract base metals at lower cost. Any technology has helped to locate more sources. As a result, almost all minerals are in oversupply except during brief production surges. Finally, the ability to reclaim copper, aluminum and ferrous metals cheaply only adds to supply and puts a lid on pricing.

Even agriculture isn't immune. New science has helped farmers improve crop yields, use exactly the right amount of herbicides and water, and even determine which crop will generate the best yield on any given acreage. It might be corn one year and soy beans the next. Obviously, science today can't change the weather. The world has seen several years of strong crop yields relatively free of floods and droughts. Thus, agricultural products will still follow their own cycles. But the technology overlay still helps to reduce the average cost across a cycle.

The net result is that technology plays a key role across all markets from commodities to advanced manufacturing. Robots have been replacing humans in plants of years. New minimum wage laws are accelerating the implementation of kiosks and other advanced ordering terminals, particularly in fast serve restaurants. Keyless entry systems have replaced security guards.

The economic conclusion is that as the pace of technology change increases, so will the accompanying deflationary pressures. Inflation may spike occasionally during peak economic demand but is likely to stay low for a long time. That won't be lost on the Federal Reserve which, today, concludes its two-day FOMC meeting. It will keep rates low and will likely, once again, lower expectations for both further inflation and future interest rates this afternoon when it releases the results of that meeting.

Today, Sandra Bullock is 53. Kevin Spacey is 58. Hellen Mirren turns 72.

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