"What is the Big Mac Index?"

By Tommy Williams, CFP®

Last week, the United States government might as well have hung a sign on the front door of the Capitol that read, "Gone negotiating. We'll be back in…however long it takes." In 2013, the U.S. government closed for 16 days. About 850,000 federal workers were furloughed and 6.6 million workdays lost. The shutdown affected private companies that worked with the government, too, and the U.S. economy took a hit.

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The prospect of kicking off 2018 with a government shutdown didn't appear to concern investors too much. Barron's reported the Dow Jones Industrial, Standard & Poor's 500, and NASDAQ indices all finished the week higher.

The lack of response from investors isn't all that surprising. Geopolitical events – from the Brexit vote to the U.S. bombing Syria to the North Korean nuclear escalation – have had little lasting effect on markets. The president of a financial research firm told The New York Times, *"geopolitical events may be widely feared, and there will often be a knee-jerk market reaction when they're unexpected, but seldom do they have a lasting impact. Underlying economic trends and monetary policy are far more important."*

That has been the case with previous U.S. government shutdowns. However, Investor's Business Daily (IBD) wrote this time might be different:

"Government shutdowns always have been primarily over government spending, but this one will be mostly over an ideological divide on immigration, with budget issues playing a secondary role. That raises the risk that the partial government shutdown could be a long one and have more serious economic consequences than investors expect."

IBD suggested it wouldn't be long before the negative economic effects of dysfunctional government consume any economic gains

delivered by tax reform. That may provide an incentive for our elected officials. Of course, a temporary agreement was reached only to position us for further debate in the next few days. It seems to be a day to day, minute to minute debate.
On another topic, I know you've been wondering about: Purchasing Power Parity. Purchasing power parity, or PPP, is a simple idea with a tongue twister of a name. When two countries have PPP, a basket of goods costs the same amount in both countries after the exchange rate has been factored in.

The Economist developed an entertaining measure of PPP. It's called 'The Big Mac Index.' The index doesn't measure a basket of goods. It simply considers the cost of a hamburger in 120 countries around the world. The index was updated for January 2018 and showed burger costs varied when translated into U.S. dollars. For example:

In Switzerland, a burger costs $6.26
In United States, a burger costs $5.28
In the Euro area, a burger costs $4.84
In Britain, a burger costs $4.41
In China, a burger costs $3.17
In Russia, a burger cost $2.29

The Economist reported: *"If the local cost of a [hamburger] converted into dollars is above $5.28, the price in America, a currency is relatively expensive; if it is below the benchmark, it is cheap. The average cost of a [hamburger] in the Euro area is €3.95, or $4.84 at the current exchange rate. That implies the euro is undervalued by 8.4 percent against the dollar."*

Overall, PPP is better aligned across the globe. One reason is the improving health of world economies. China remains the most undervalued currency among wealthier nations. In emerging markets, like Russia, currencies remain undervalued relative to the United States.

PPP provides economists with an apples-to-apples measure for comparing the wellbeing of countries and consumers. On a similar topic, I would be remiss if I did not leave you with the age old question, *"What do they call a quarter-pounder in Paris?"*

into directly. The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful. This material was prepared in part by Peak Advisor Alliance.

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