

# BUSINESS INTELLIGENCE BRIEF

January 11, 2019



## NATIONAL AND INTERNATIONAL NEWS AFFECTING LOCAL BUSINESS

### Short Items of Interest – US Economy

- **Shutdown and Unemployment** – The government shutdown has now lasted longer than any of the previous episodes and with both sides as dug in as they ever were there is no end in sight. The impact on the 800,000 employees has started to become severe and there have been significant problems for those who once relied on various government services. It is also starting to have an impact on various economic issues. For example, there has been a surge in claims for unemployment by the furloughed federal workers and the very long string of positive job numbers will likely come to an end this month. Another impact is that much of the data traditionally collected by the government is not being collected and that will rob analysts of the information they need to understand what is happening in the economy right now.
- **More Voices of Caution at the Fed** – If there is one message that is coming from the Federal Reserve at the moment it is that there is no need to rush. The latest minutes and Jerome Powell's comments before Congress have been reiterated by statements from several of the regional heads of the 12 Fed banks. It is a call for something of a time out – a period of introspection before taking any further action. The current shutdown crisis only complicates things and the sense is that further interest rate hikes should be put on hold for a while – at least until there is a more secure impression of where the economy is headed for the remainder of the year.
- **The Attack of the Inverted Yield Curve** – The several trillion-dollar question is whether an inverted yield curve signals a recession, causes a recession or really doesn't have much to do with a recession. The inverted yield curve is when long term yields drop below short-term yields and this inversion has indeed preceded each of the last five recessions. The long-term yields are set by the bond market and the short-term yields are set by the Fed. Right now, the bond market has come to the conclusion that the Fed is driving rates up too far and too fast and they worry that this will set up a recession along the lines of the one triggered by Paul Volcker's Fed in the 1980s. Those who question the connection between the yield curve and recession point out that many things are different this time around – most notably the impact of the Fed buying six trillion worth of bonds and the fact that many of the traditional buyers (China, Japan, Middle East) are not buying as much.

### Short Items of Interest – Global Economy

- **Confusion in Syria** – Nobody seems to have a clue what the US policy in the Middle East these days – despite the lengthy speech made by Secretary of State Mike Pompeo in Egypt. President Trump has indicated twice before that he would pull troops out if Syria and neither time saw a troop withdrawal. This latest assertion caused his Defense Secretary to resign and sparked contradictory comments from John Bolton – the National Security Advisor. Now it seems that some of the 2500 troops are heading home but nobody knows if there will be more. None of the analysts agree with Trump's assertion that ISIS has been defeated and none of the regional leaders are of that opinion. The Kurds in Syria are feeling betrayed and that has affected the extent of Kurdish support for the US in Iraq. The US has utterly confused ally and enemy alike.
- **Brexit Chaos Builds** – Supporters of a definitive break from the EU have been handing Prime Minister Theresa May one defeat after another on the issue and she has become increasingly desperate to find a way to salvage a deal. Nothing is working and the UK seems destined to hurtle towards a "no deal" Brexit that leaves the country completely cut off from Europe. There is no appetite at all for a changed deal on the part of the Europeans as they believe the British will suffer far more than any nation in Europe will. Analysts universally agree – even those who support Brexit. They acknowledge the pain Britain will feel but they still think gaining that sense of sovereignty is worth whatever price.

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## Credit Manager's Index Dips a Little

It can be tempting to read too much into the monthly changes that take place in the Credit Managers' Index. Not that these fluctuations are unimportant but longer-term trends tend to be more informative when it comes to the status of the overall economy. This month saw the combined score fall back to levels seen in October and on one level this is disappointing. It would have been nice to see the index keep tracking upwards but it is important to remember that any reading over 50 suggests growth and a reading of 54.2 is certainly respectable. There is a lot about this last month that seems to signal that changes are coming and one could reasonably add the CMI data as another of those indicators. As we leave the last of 2018 behind there are building concerns over everything from trade to the specter of inflation and all against a backdrop of labor shortage and possible government engagement in everything from regulation to future stimulus.

The overall score for the CMI fell to 54.2 from the previous month's 55.8. This is certainly not a major drop but it is not the trend that had been hoped for. The last time the overall score was this low was in April when it fell to 53.7. Over the last several months the reading has been very close to 55 or 56. The favorable factors also trended down a little this month and in fact this was the movement that pulled the overall numbers down. The reading this month was 59.4 and that is the first time the data has been under 60 since December of 2017 when it was also at 59.4. There was also movement as far as the unfavorable factors were concerned but it was extremely slight and not much of a factor. It went from 50.9 in November to 50.8 this month.

As usual the detail paints the clearer picture. The dip in the favorable factors may be the most important development this month as this has been a stalwart until this month. For the first time since last December the combined index fell beneath 60 and ended with a 59.4 reading. All of the sub-categories also fell out of the 60s except for "amount of credit extended" but it nevertheless tracked at a lower level than the month prior. The "sales" reading went from 64.5 to 59.0, a mark not seen since December of 2017 when it hit 59.2. The "new credit applications" number fell from 62.2 to 57.5 and it was last at that level in December of 2017 when it rested at 57.3. The "dollar collections" number dropped but not quite as dramatically as some of the other readings. It went from 60.9 to 59.3. The "amount of credit extended" stayed in the 60s but went from 65.3 to 61.9. The slide in all these factors suggests there has been a slowdown and that would be consistent with some of the other data that has been seen in everything from the Purchasing Managers' Index to durable goods orders and capacity utilization.

The combined score for the unfavorable factors was a little less threatening but the numbers are still not good. The score went from 50.9 to 50.8 – virtually no change to speak of. There was similar activity as far as the sub-index readings are concerned. The "rejections of credit applications" stayed exactly where it was last month with a reading of 51.4. This is especially good news given that new applications are generally down. The "accounts placed for collection" actually improved a little but still fell short of escaping the contraction zone. It was at 48.2 last month and is at 49.7 now. The "disputes" numbers fell a little and dropped out of the expansion zone with a reading of 49.6 after one of 50.1 the month prior. The "dollar amount beyond terms" also slipped from 52.3 to 49.3. This is more worrisome as this is often the first sign of impending credit issues. The "dollar amount of customer deductions" stayed very close to last month but improved slightly with a reading of 49.7 as compared to 49.6. The "filings for bankruptcies" reading improved quite a bit with a reading of 55.0 after one of 53.6 the month before. Overall the non-favorables are stable enough but still very close to contraction territory.

**Manufacturing Sector** - The manufacturing sector has been a subject of intense interest for most of this year. The US economy is still very dependent on its service sector for jobs and the total GDP but all by itself the GDP of manufacturing in the US is as large as the eighth biggest country in the world and the sector is often seen as a kind of symbol for the overall success of the US economy. The numbers look a bit weaker this month and that is a bit worrying as far as the coming year is concerned. The combined score for the whole index slipped from 55.6 to 54.0 and that takes the reading back to where it was in October. The index of favorable factors fell out of the 60s for the first time since December of 2017. It is now at 58.9 and the month before it was at 63.2. The sub-index numbers showed the same kind of retreat. The "sales" numbers went from 64.2 to 59.0 while the "new credit applications" data shifted from 61.7 to 56.8 – a number that has not been seen since December of 2017. The "dollar collections" number fell from 61.6 to 59.0 and the "amount of credit extended" remained in the 60s but only by a whisker as it went from 65.4 to 60.9. The general sense is that there has been a slowdown in the manufacturing sector at the end of the year but as these numbers are similar to what they were in 2017 this is also a seasonal reaction. The retail community may come to life at the end of the year but the manufacturing community slows as the holidays tend to chew into productivity.

The combined score for the non-favorables improved very slightly from what it had been the month before – moving from 50.5 to 50.7. The sub-index numbers showed a bit more variety. The "rejections of credit applications" slipped from 53.1 to 51.6 but at least it managed to stay in the expansion zone. The "accounts placed for collection" improved and entered expansion territory by a small margin – going from 49.2 to 50.3. The "disputes" category sagged a little with a reading of 48.6 as compared to the 49.6 reading the month before. The "dollar amount beyond terms" stayed very close to what it had been the month prior with a reading of 50.0 compared to 50.3. The best news here is that the category stayed out of the contraction zone albeit by the narrowest of margins. The "dollar amount of customer deductions" improved a bit but remained in contraction territory with a reading of 49.1 compared to 48.6. The "filings for bankruptcies" reading improved a bit as it went from 52.2 to 54.4.

## Continued Credit Managers' Index

**Service Sector** - As with the combined CMI and the manufacturing sector there was a decline in the numbers when the service sector is considered. There is always a bit of a challenge with the service sector this time of year. The two biggest components of the sector are retail and construction and these go in opposite directions this time of year. It is a big moment for retail – obviously. It is a very slow period for construction and for obvious reasons. The upshot is some confusing readings from time to time. This month the combined score behaved similarly to manufacturing with a reading of 54.4 compared to 56.0 the month before. This is a number seen in October. The index of favorable factors fell a bit from 63.2 to 59.9 while the index of unfavorable factors fell but remained in expansion territory as it moved from 51.2 to 50.9.

The “sales” category slipped from 64.9 to 59.0 and it has been a year since this number was that low. Given that this is retail season a trend like this is not welcome. The “new credit applications” segment also fell – from 62.7 to 58.2. The “dollar collections” data didn’t fall all that drastically but it tumbled out of the expansion zone by moving from 60.1 to 59.6. The “amount of credit extended” stayed in the 60s but was reduced from what it had been – going from 65.2 to 63.0.

The variability was less pronounced in the non-favorable categories. The “rejections of credit applications” actually improved a little as it went from 49.7 to 51.2. Given that new applications were down this is good news indeed as it suggests that the applications that are being submitted are better than has been the case in the past (either that or standards are being lowered!). The “accounts placed for collection” also improved a little but remained stuck in contraction territory at 49.1 as compared to 47.2. The “disputes” category stayed almost exactly where it had been with a reading of 50.5 as compared to 50.6. The “dollar amount beyond terms” took a real tumble and that is worrying. It was in expansion territory at 54.3 just a month ago and now it has fallen into contraction territory with a reading of 48.5. This is not good as this is often the precursor to deeper issues down the road. The “dollar amount of customer deductions” remained stable as it only shifted from 50.7 to 50.3 and remained in expansion territory by the skin of its teeth. The “filings for bankruptcies” went from 54.9 to 55.6 and that is back to the numbers that were seen earlier this summer.

## Chances of Recession

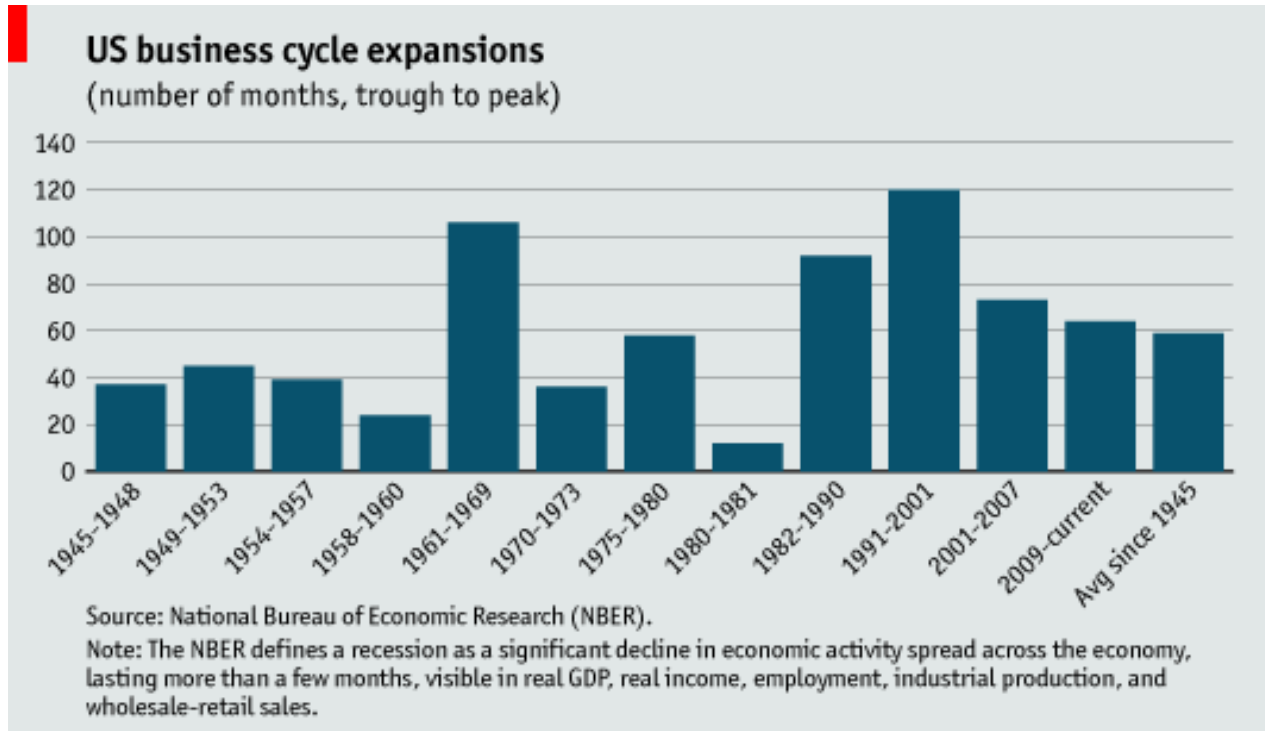
There are not many areas of economics more likely to make a fool out of forecasters than predicting a recession. It is akin to forecasting a rainy day in April. It is inevitable that the economy will stutter and experience a down period just as it is inevitable that the economy will experience some high points. Exactly when these periods develop is the challenge. The economy has been on a very long and productive run for nearly a decade and that is an unusually long string. That very success tends to bring the reversal as there will be pressure on commodity supply, wages and there will be productivity and capacity issues. The consumer starts to become wary and so do investors and there is an expectation of slower growth that becomes something of a self-fulfilling prophecy.

**Analysis:** At the moment about half the economists polled by the Wall Street Journal are expecting a recession of some kind by the end of this year or early in 2020. Most are not expecting a major downturn – nothing like the Great Recession that marked 2008 and 2009. This is likely to be one of those “V” or “U” recessions that feature a sharp decline and then a pretty rapid recovery. The speed of that rebound will depend on the willingness and ability of the government to act appropriately. When there is a recession the expectation is that Congress will accelerate spending at the same time that it cuts taxes. This is designed to stimulate the economy through consumer activity so the spending and tax cuts have to find their way to the wallets of the consumer as opposed to business. At the same time the Federal Reserve lowers interest rates so that business can borrow more cheaply and so that consumer loans such as mortgages, car loans and credit card rates are lowered. This is what worries analysts right now. Congress does not seem inclined to do the kind of spending that would be required and Fed rates are not high enough for a reduction to mean much.

The factors that are causing economists to think recession include the ongoing trade disputes between the US and China, the impact of the government shutdown, the volatility of the stock market and the potential for an incredibly nasty Presidential campaign that will pit the extreme right against the extreme left and leave the majority of consumers uneasy and confused.

## What Else Can You Get from Armada?

As you peruse the Business Intelligence Brief you are no doubt wondering what else you might get from the authors of these reports. You are in luck as the BIB is not our sole publication. There is the Black Owl Report – published three times each week and aimed at the business executive. Keith Prather is the primary writer for the BOR and you can get a free one-month trial if you like. It is a subscription-based publication available for \$84 a year. In addition to these regular reports we do longer in-depth studies, white papers and analysis of breaking economic and business stories. Beyond all that we like to be responsive to our readers and regularly answer questions posed by our readers – just e-mail [chris.kuehl@armadaci.com](mailto:chris.kuehl@armadaci.com) for more details or to ask one of those questions.



The current business cycle expansion is the second longest the US has experienced since the end of the Second World War. Granted, this has often been an anemic growth period with very modest gains in some years but it is still an expansion that is pretty long in the tooth and that fuels the prediction that it will have to come to an end sooner than later. Not all of these expansion periods end in a recession – some just quietly fizzle out and then a new cycle starts to develop. The one we are in at the moment is likely to end with a recession period of some kind

### Speaking this Month

01/10/2019	Kansas City	Heartland Heroes	Private
01/14/2018	Detroit	Automotive Plastics and Rubber	Public
01/17/2019	Kansas City	Home Builders Association Breakfast	Public
01/18/2019	Kansas City	CCIM Breakfast	Public
01/22/2019	Appleton	Fox Valley Technical School	Public
01/23/2019	Milwaukee	International Credit Executives	Public
01/24/2019	Kansas City	NKC Business Council	Public
01/25/2019	Dallas	National Association for Credit Management	Public
01/26/2019	Kansas City	Military Officers Association	Private
01/28/2019	San Antonio	Pet Industry Leadership Conference	Public
01/30/2019	Orlando	FICAP	Public
01/31/2019	Kansas City	National Association of Remodeling Industry	Public

## The Political Disconnect

I had another opportunity to spend some time with the group of local business people that refer to themselves as the Heartland Heroes. This is always a very instructive session for me as it is an intimate group of successful business people who do far more than just listen to my blathering – it is very interactive with lots of questions and commentary. I get a chance to hear what is really on their minds and not surprisingly their concerns are not the same as the breathless media and the politicians would have us believe. It is also astonishing that their issues are so similar to each other despite the very wide variety of businesses represented – major construction groups, oil, health care, marketing, plumbing and heating and so on.

I know this will come as a shock but these people are not obsessed with a border wall or government shutdowns or whether the US has defeated ISIS or whether Russia worked to undermine the election in 2016. They all have their own opinions on these and other subjects and some of these opinions are passionate enough but these are not what keeps them awake at night as business owners. The top of the list of things that really matter is whether they will be able to find the workers they need and not one of them was confident that they would be able to. This has been a chronic problem for decades in the US and yet almost nothing has been done to address it. Not at a national level. If all those politicians rattling around in Washington really wanted to see the US grow and prosper into the next century the only thing they would be thinking about would be the training and educating of the future workforce.

## What Do We Mean by Intelligence?

The name of this publication is the Business Intelligence Brief. Why did we call it that? All three words mean something to us and inform what we do. The first is business. This is a very broad term as there are tens of thousands of different businesses and they have only a few things in common. Our intent is to provide the kind of information that helps people understand the world and helps them grow their business and make bigger contributions to the companies they work for.

That brings us to the intelligence part. We believe in providing intelligence that is actionable and timely. The aim is to be able to anticipate what is to come so that contingency plans can be developed. We are not reporters, we will rarely be involved in “breaking news”. We are analysts and we strive to provide answers to the key questions of “why” and “so what”.

Finally – we strive to be brief. That is far harder than one would assume. The temptation is to go on and on in detail but that is too much to digest. We simplify when we can but encourage readers that want more to reach out and ask.