BUSINESS INTELLIGENCE BRIEF

February 1, 2019

NATIONAL AND INTERNATIONAL NEWS AFFECTING LOCAL BUSINESS

Short Items of Interest – US Economy

- **Shutdown and Jobs Data –** This month's report on the jobs data will be affected to some degree by the government shutdown as some 800,000 employees of the federal government were not being paid and most were eligible for unemployment assistance for all or part of that period. This is a temporary issue (provided there is not another shutdown) but the part that is not temporary is that which involves the hiring and firing in the private sector. There were about 22,000 business that work with the federal government affected and many of them may have been forced to reduce their workforce as well. Then there are the businesses that lost customers as federal employees stopped spending. This impact will likely be greatest where the government employee is the dominant consumer.

- **Hiring the Unqualified –** One aspect of the report that will be examined closely will be the type and quality of the new hires. Last month the total hiring was a bit of a shock as few had expected to see 300,000 new jobs. Buried in that data was the observation that many companies have started to lower their standards when it comes to hiring. They are no longer hiring aptitude as they can't find people with the required skills. Now they are hiring attitude and hoping that they will be able to train these employees well enough to contribute sooner than later. The expectation is that it will take from 18 months to 36 months to get maximum productivity from these new hires.

- **Herman Cain for Fed Job? –** With the expiration of the last Congress there are still two vacancies on the seven-person Board of Governors and two of the nominees that had been put forward by the White House saw their invitations expire. Marvin Goodfriend from Carnegie Mellon looks to be nominated again but Nellie Liang may not be. Herman Cain – former CEO of Godfather's Pizza and a one-time Presidential candidate has been suggested as well. One of his notable suggestions has been to return to the gold standard – a move that most economist pan as absurd and completely devastating to the global economy.

Short Items of Interest – Global Economy

- **Kicking the Brexit Can –** As the deadline for an exit from the European Union looms, the UK and the EU are facing unpleasant options. In truth there is no desire on the part of either the British or Europeans to see the UK stumble out of the EU with no agreement at all. This would devastate the British economy but it would hurt the Europeans as well. The rumblings seem to suggest that there will be some kind of short-term deal to extend the deadline long enough for some new ideas to develop or perhaps give the UK time to consider another referendum on leaving the EU.

- **Progress with China? –** There have been some vague statements from the White House that suggest that concessions have been made by China sufficient to delay the imposition of more tariffs on March 1. There have been no specifics as yet and it may well be that no deal is reached but the talk is now about a summit between Trump and Xi that would result in some kind of mutually face-saving deal that could allow both to claim some modicum of victory. It appears the US is backing away from demanding structural reforms in favor of China buying more from the US.

- **Massive Deal Between Europe and Japan –** While the US is locked in a war of wills with China and most of its other trading partners the EU and Japan have signed the largest bilateral agreement ever. The pact eliminates almost all tariffs between the two entities and is expected to dramatically increase the levels of trade between the two signatories. Consumers in both regions are expected to see lower prices and better variety almost immediately. Both Japan and the EU indicated that their deteriorating relationship with the US was a major factor as far as this trade deal was concerned.

The January Credit Managers' Index Looks a Bit Weaker

CMI data has been collected and tabulated monthly since February 2002. The index, published since February 2003, is based on a survey of approximately 1,000 trade credit managers in the second half of each month, with about equal representation between the manufacturing and service sectors. The survey asks respondents to comment whether they are seeing improvement, deterioration or no change for various favorable and unfavorable factors. There is representation from all states, except some of the less populated, such as Vermont and Wyoming. The computation of seasonality is based on the formula used by the U.S. Census Bureau and most of the federal government's statistical gathering apparatus, making it possible to compare the CMI diffusion index with comparable indices, such as the Purchasing Managers' Index (PMI) and other manufacturing and service sector indices.

CMI Executive Summary - As 2019 started there was a great deal of conversation regarding how the year would progress in comparison to 2018. The sense was that 2018 was a "pull out all the stops" year and 2019 would not likely feature that kind of encouragement. There will be no big tax cut in 2019 and there will be no low interest rate environment as had been provided by the Federal Reserve. There was not even the momentum in terms of growth that had been provided at the end of 2017. The first sets of data that have been coming in have shown that there was good reason to be worried. The Purchasing Managers' Index trended lower and so did the December CMI. Now that January is in there was still more decline although nothing precipitous. The optimists are asserting that this is just a "breather" and they expect recovery in the second half of the year. The more pessimistic assert that this will be just the start and that conditions will steadily worsen through the year.

This month's data is not a lot different than it was the month prior but the trend has been down and that has created some concern regarding the rest of the year. It will take some good news to force the index to start trending in the opposite direction. The combined index fell a bit from 54.2 to 53.4. This remains in expansion territory – where it has been for the majority of the year. The bad news is that this the lowest reading seen in the last twelve months and that is hardly the direction preferred. The change was extremely slight as far as the favorable factors are concerned and in fact, they went up from 59.4 to 59.5. The bad news is that these least two months have been the only two that have been below 60 in the last year. The bad news came with the index of unfavorable factors as this reading slumped into contraction territory with a reading of 49.4 compared to the 50.8 that had been notched in December. The last time these numbers were that low was in April of 2018. Up to this point the decline in the CMI data was felt primarily in the favorable categories and the unfavorable stayed relatively stable. Now there are some new signs of real distress among creditors.

It was only a month or two ago that the four categories included in the favorable sector were all reading in the 60s and now only one remains in that classification. The others are all still in the high 50s and that certainly continues to signal growth but the pace has slowed a little. The "sales" category improved a little from 59.0 to 59.7 and that is getting close to that 60 line again. The "new credit applications" also moved back up a little but stayed under the 60 line as it went from 57.5 to 58.2. The all-important "dollar collections" number dropped a bit from 59.3 to 59.0 and the "amount of credit extended" dropped but stayed in the 60s with a reading of 61.2 as compared to 61.9 the month prior.

There was a slight improvement in the "rejections of credit applications" number as it went from 51.4 to 51.8 and that is good news given the applications for credit have been a little weak. The decline in the category of "accounts placed for collection" is a bit more worrisome. It was at 49.7 and is now at 48.2. The "disputes" category sunk as well – going from 49.6 to 47.1. There was a similar drop in "dollar amount beyond terms" as it shifted from 49.3 to 47.4. The downward trend continues with the "dollar amount of customer deductions" as these went from 49.7 to 48.0. The "filings for bankruptcy" sagged but stayed in the expansion category by going from 55.0 to 53.8. The message is loud and clear – companies are having issues and this has started to affect their ability to keep pace with their obligations. There has been enough of a slowdown in some sectors to impact the data. The numbers are still in the high 40s and not all that far from expansion but the trend is not in the preferred direction and is likely to get worse as the year progresses.

Manufacturing Sector - The good news story from much of 2018 was the resurgence of the manufacturing sector in the US. Lots of factors played a role in this growth and the question for 2019 is whether they will still be providing that positive impetus. Last year there was a tax break that allowed companies to buy machinery that had been planned for years, the consumer came back to life and demand was up for a variety of factory goods and the growth of the global economy stimulated the export sector. There will be no tax cut this year, the consumer has been slowing down and the global economy is not expected to grow at the pace it did last year – the IMF just downgraded growth again on the eve of the Davos meeting.

The favorable and unfavorable numbers both weakened and enough to start creating some worry. The overall favorable factors went from 58.9 to 57.7 while the overall unfavorable readings went from 50.7 into the contraction zone with a 49.9 mark. The total for the whole of the manufacturing sector went from 54.0 to 53.1. These are lower numbers than would be preferred but not really cause for panic just yet. The overall score remains in growth territory as do the favorable numbers. Even the unfavorables are just barely in the contraction zone.

Credit Managers' Index (continued)

The "rejections of credit applications" actually improved a little – going from 51.6 to 53.3. That is especially good news given that there has been a decline in the applications for new credit. It suggests that those that are applying are generally credit worthy. The "accounts placed for collection" slipped into contraction territory with a reading of 49.7 compared to 50.3. The "disputes" category also shifted deeper into contraction territory with a reading of 46.8 as compared to the prior month at 48.6. The "dollar amount beyond terms" moved into contraction territory as well – going from 50.0 to 49.1 and there was a significant decline in the category of "dollar amount of customer deductions" as the reading went from 49.1 to 46.7. The "filings for bankruptcies" stayed stable enough as it moved from 54.4 to 54.0.

These numbers are worrying at this stage but not yet catastrophic. The slip into the contraction zone has been fairly recent and the data is not showing a deep collapse but the data shows that many companies are now struggling and there is nothing to suggest there will be a major economic surge that will help pull any of these companies out of this slump. As usual there are significant differences between the various sectors – energy related manufacturing is doing far better than agriculture for example. Health care manufacturing remains strong and automotive is holding its own.

Service Sector - The service economy has fared a little better than manufacturing this month as more of the readings are still in the 60s and generally in expansion territory. The sector is very diverse and that makes the data both intriguing and sometimes confusing. This data tends to be weighted towards retail and construction but health care plays a significant role as well. It is not clear that any of the government shutdown activity has affected the data at this point but if there is to be a reaction it would be in the service category given the potential impact on spending by consumers.

The overall CMI score for services went from 54.5 to 53.8 and that is the lowest reading since April of last year. This is not a point of panic at this stage as the data is still in the expansion zone but it is clearly weaker than it once was. The favorable factors data actually improved this month and got back into the 60s with a reading of 61.3 as compared to the 59.9 that was notched last month. The unfavorable index fell from 50.9 to 48.8 and that is more of a concern as that signals there is serious weakness in the creditor population showing up.

The "sales" reading regained a little lost ground and moved from 59.0 to 60.3 while "new credit applications" also made a nice positive move. It jumped from 58.2 to 63.0 and that was unexpected. It seems that many retailers gained additional confidence from the solid holiday season and expect the consumer to keep spending into the new year. That may turn out to be an inaccurate assessment given the recent slump in consumer confidence. The "dollar collection" numbers stayed right where they were the month prior at 59.6 and the "amount of credit extended" shifted down a little from 63.0 to 62.1

The "rejections of credit applications" fell a little but stayed out of the contraction zone by the narrowest of margins – moving from 51.2 to 50.3. The fact that this number is still in the 50s is good news given the number of new applications. The "accounts placed for collection" sunk deeper into contraction with a 46.7 reading compared to the 49.1 that was reported last month. This is getting worrisome as there are many more companies struggling to meet their obligations. The "disputes" category dropped out of the expansion category by shifting from 50.5 to 47.4. The "dollar amount beyond terms" also fell from 48.5 to 45.7. This is especially bad news given the data on collections as it suggests that even more trying times are ahead. These slow pays usually get worse unless there is some kind of economic rebound and that is not expected this year. The company that is falling behind now will be challenged to recover. The "dollar amount of customer deductions" also fell into contraction but not quite as dramatically as it went from 50.3 to 49.2. The "filings for bankruptcies" slipped but stayed in the expansion zone as it went from 55.6 to 53.6.

The focus is now on retail and the consumer. The US economy is unusually reliant on consumer activity as it accounts for some 80% of the GDP (in most European states it is closer to 65%). The consumer confidence levels have been dropping but these are always volatile and change very quickly and for a variety of reasons.

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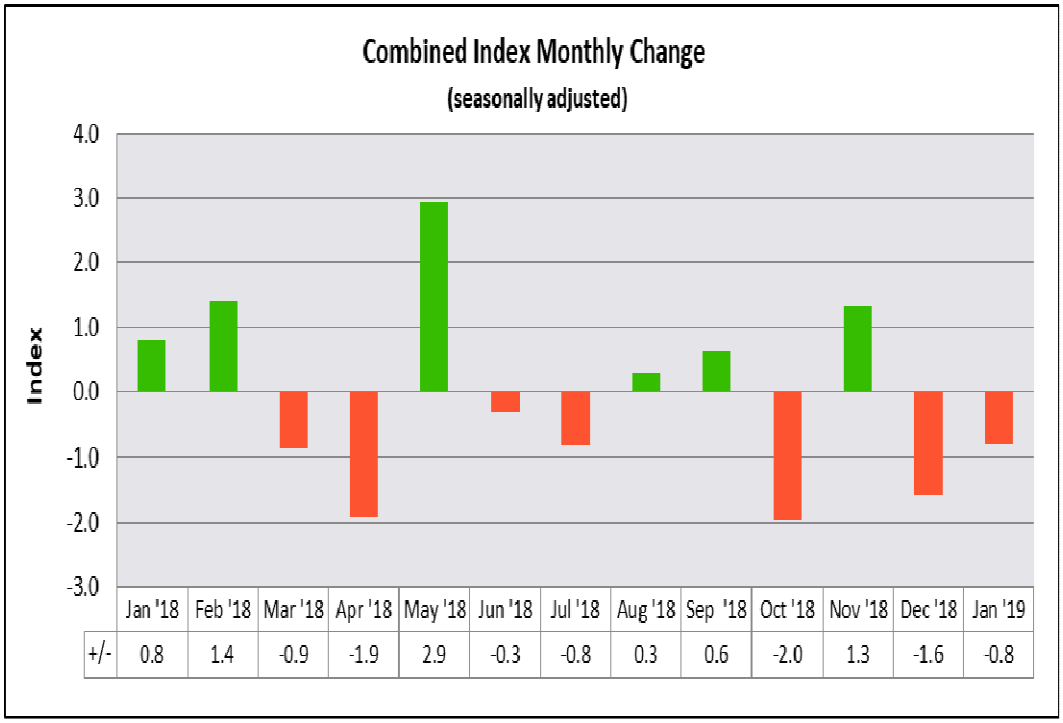

This issue of the Business Intelligence Brief is devoted primarily to the data in the Credit Managers' Index and the above chart is the one that develops from the data collected on both the manufacturing and service sectors. The CMI mas inspired by the Purchasing Managers' Index and share many of the strengths of the PMI. Most notably the data is unbiased – it just is. There is no real room for interpretation – either companies are paying their bills or they aren't. In many respects the CMI provides advance warning of what will appear in the PMI as credit managers generally do their jobs before the purchasing managers do theirs.

Speaking this Month

02/07/19	Las Vegas	Riemer Footwear Group	Public
02/12/19	Kansas City	Rubin Brown Manufacturing Summit	Public
02/21/19	Savannah	American Foundry Society	Public
02/22/19	Greensboro	North Carolina Society of CPAs	Public
02/26/19	Ft. Lauderdale	Food Manufacturing Assoc.	Public
02/27/19	Dallas	Triumph Business Capital	Private
02/28/19	Tampa	National Systems Contractors Association	Public

Willful Ignorance

It is time for a familiar rant. It is one I engage in more often than I would care to but the trigger for my outrage is just too common. I am not talking about airlines or bad customer service – not this time anyway. I speak of what can only be described as the dumbing of society. It absolutely astonishes me that at a time when more information is available at our fingertips than at any time in history we seem to have slipped into a stupor of stupidity. Three things of recent note have my hackles up this time.

The first is the observation that millions of people all over the world have become Holocaust deniers or know almost nothing about this heinous period of history. Almost a quarter of Americans do not believe it ever happened, 66% of millennials have no idea what it was along with 25% of young people in France and almost a quarter of Germans. It is utterly disgraceful. The second observation is the inane commentary on the cold weather this week "so much for that global warming huh". The arrival of this Polar Vortex is a direct result of climate change and its impact on the North Pole and there will be more of these. Then there has been the constant barrage of outright lies and half-truths on virtually any subject one chooses – from economics to health. It is not a good thing when so many people seem to wallow in their ignorance.

As in past rants I have a suggested solution to this threat. If you have not already acquired a copy of Steve Allen's book you really should. It is entitled "Dumbth: The Lost Art of Thinking". It contains "101 ways to reason better and improve your mind". Allen was a brilliant comedian, the creator of the Tonight Show as well as Meeting of the Minds and was a tireless advocate for being informed and able to intelligently navigate the world. I re-read this book regularly in order to keep my brain sharp and I recommend every person on the planet read it and read it often.

ARMADA

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