

BUSINESS INTELLIGENCE BRIEF

May 24, 2019



NATIONAL AND INTERNATIONAL NEWS AFFECTING LOCAL BUSINESS

Short Items of Interest – US Economy

- **More Positioning?** – If there was any doubt that the trade war with China is really all about politics and posturing the latest offers from the White House should dispel it. A few days ago, the Trump position on Huawei – the mammoth telecoms company in China – was that it constituted a grave and imminent threat to national security. Today it is a bargaining chip. If the Chinese give ground on some other issues the ban on dealing with Huawei would be lifted without any changes at all to the way that they conduct their business. This has been the pattern with the trade talks from the start. Granted, this is usual pattern in negotiations but it has been hard to determine just what is the goal of these talks. In the beginning it seemed the focus was on reducing the US deficit with China through gaining better access to their market but the aim of the talks is far murkier now.
- **How Much Does This Cost the Consumer?** – The cost to the consumer when trade wars ensue can be a slippery subject. The truth is that this conflict will affect each consumer differently depending on what they buy. The New York Fed has taken the same approach employed by those that track consumer inflation. They identified a basket of goods that a typical consumer would buy in the course of a year and concluded that the tariff war will cost the consumer \$831 dollars a year. This is right in the middle of estimates regarding consumer impact.
- **Price is the Key Issue in Housing** – There has been a substantial drop in sales of new homes despite the fact that mortgage rates have stayed relatively low and the average prospective homeowner is still in the market for that new home. The unemployment rate remains at a record low and that is generally the most important motivator for new home demand. The inhibiting factor has been the price of homes as the majority of builders have been concentrating on the higher end homes and have been constructing far fewer starter homes. Even the multi-family units have been at the higher end of the rental scale.

Short Items of Interest – Global Economy

- **May Calls it Quits** – It was considered inevitable but the decision by Theresa May to resign was still a bit of a shock. Most assumed that she would stay in power until the next deadline on a Brexit deal or until some kind of agreement was reached. Her decision makes it clear there is absolutely no unity in the Conservative Party on the issue (and none in the Labor Party for that matter). The likely replacement for her as the leader of the party is pro-Brexiter – Boris Johnson. She will stay in place as “caretaker” until mid-July when the new leader should be in place. It is expected that the contest will be very fragmenting and may even cause some Tory MPs to quit the party altogether.
- **Hong Kong Losing any Sense of “Special Status”** – When Hong Kong was relinquished by the British it was agreed that the city would have a unique place in China – a position where many rights and privileges would be retained. This deal has eroded over the years as pro-mainland parties have come to dominate the local legislature. Now a law has been passed that allows the PRC to extradite people from Hong Kong to prosecute and that eliminates the independence of the Hong Kong judiciary. Dissenters can now be brought to mainland China for trial and punishment.
- **Us Vs. Them** – The rise of global nationalism is proceeding at a rapid pace. In nation after nation the defining issue in campaigns has been hostility to the “other”. India just swept an overtly anti-Muslim party to another five years. The anti-immigrant stance of politicians in Europe and the US propels the average voter more than any other issue. China is growing more assertive and intolerant of minorities and civil wars are raging all over Africa as ethnic groups attack one another. It is the defining issue of the day.

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Landslide in India

For the last several months the polls in India indicated that Prime Minister Narendra Modi and his BJP (Bharatiya Janata Party) was in electoral trouble. He was widely expected to win a second term but the consensus view was that he would have considerably less support in parliament and might even have to try to form coalitions with parties not all that sympathetic to the goals of the BJP. The outcome has been far different than these assumptions suggested. His victory was sweeping and the BJP has more seats in parliament than they had before. Modi becomes the first Indian Prime Minister in decades to see his party sweep to reelection and the breadth of the win was nothing less than stunning. The failure of the pollsters suggests that they are not capable of gauging the attitude of the voter – especially the rural and the poor. They turned out in massive numbers and supported the BJP. The cities were closer but even there the opposition Congress Party lost ground.

Analysis: The issues that seemed to propel support for Modi varied considerably from one region to another. His supporters among the members of the business community reacted favorably to his economic reform plans and his pledge to take on China as the world's preeminent manufacturer. The poor responded to his pledge of job creation and the expansion of aid and assistance. Granted, the business community wonders how all these promises to the poor will be paid for and thus far Modi has been vague about his plans. Most assume that taxes will have to be hiked but nobody really has a sense of how that will be accomplished.

The issue that seemed the most potent for voters was also the most controversial. The BJP is a Hindu nationalist party and has always made a point of this orientation. In Modi's first run at leadership he worked to downplay that nationalism and made a solid show of reaching out to the Muslim population (which is over a third of India). Over the last five years the nationalism reasserted itself and was an important part of the campaign this time around. In the last few years there has been a considerable rise in anti-Islamic sentiment and extremist groups have attacked Muslims – even engaging in lynching and torture. The BJP leaders have been accused of turning a blind eye to these attacks and Modi has shifted further and further towards the nationalist position. The result was a near overwhelming Hindu voter support for Modi.

The main opposition party is the Congress Party and this vote was one of the most crushing defeats they have suffered in their long history. The leader of the Congress Party is Rahul Gandhi – great grandson of Jawaharlal Nehru, grandson of Indira Gandhi and son of Rajiv and Sonia Gandhi. This made him the inheritor of the Gandhi legacy but he has never been comfortable in that role. He has been described as a technocrat and not a politician and that was evident in this election. Even those that have been long time supporters of the Congress Party were uncomfortable with his leadership and now there is a question as to whether the Gandhi dynasty survives this defeat. The fear within the ranks of the Congress Party is that a leadership challenge will cause a serious split over who would lead. Some would support Rahul; some would support his far better liked sister-Priyanka. Still others would reach beyond the Gandhi family.

The most salient question now is what Modi does with his next five years. He has promised to continue the economic reforms that would allow India to take advantage of the challenges that China has been facing, has promised jobs and has promised massive aid packages aimed at the poor but he has also supported a lean budget and limited tax increases. He has indicated that a more confrontational posture will be adopted towards Pakistan and that feeds into the anti-Muslim attitude that has grown in recent years. His relations with the US are decent but Modi and Trump are far from boon companions. He has asserted that India wants a "strongman" and he asserts his autocratic style fits the times. Free from worries about reelection he will likely be that much more assertive in his second term and he has the parliamentary support to back up his plans.

Markets Not Pleased

The markets did not react all that much when trade talks broke down between the US and China a week or so ago and that surprised many. It now seems that investors thought the breakdown was nothing other than a ploy and that an agreement would be worked out soon enough. Now it seems the attitude has soured drastically and investors are understanding the implications of a full-on trade war. The S&P is heading for its worst month since 2017 and there has been a stampede out of the equity markets into treasuries that have lowered the yield to levels last seen in 2015 when the Fed started raising interest rates. The yield curve debate has started up again and many now assume that a recession is either imminent or at the very least conceivable.

Analysis: The bottom line is that investors (and the business community as a whole) are worried about the global economy as a whole – not just the situation that has evolved between the US and China. In the last twenty years China has supplanted Japan as the growth motivator in Asia and has taken its place alongside the US as global growth engine. Germany once propelled the European Union but with growth rates that barely reach 2.0% in a good quarter that engine has run out of steam. It is the US and China that do the majority of the buying and selling and with both of them facing uncertain economic futures the rest of the global market is faltering.

Opinion is still split when it comes to the trade impasse between China and the US. Many still think the current situation is a negotiating tactic and that both nations will become more conciliatory once the impact of the trade fight becomes more obvious. Others note that neither Trump nor Xi appear ready to back down as the fight serves a domestic political purpose. A resolution would need to be sold to supporters that really do not want a deal with "the enemy".

The Country of the Future.....

And always will be. By now everybody has heard that rather tired characterization of Brazil, a reference to the fact that a nation with so much going for it has never been able to get it all together so that it can take advantage of its commodity wealth, its industrial capacity and its relatively well educated and hard-working population. Over the last 13 years one of the major impediments to Brazilian growth has been the rocky relationship with the US. The governments of both Inazio “Lula” da Silva and Dilma Rousseff were from the left – led by the Worker’s Party. There were some overtures from the Obama administration but the governments did not see eye to eye on much. There is a renewed effort to build cooperation between the US and Brazil now that their leader is referred to as the “tropical Trump”. It is assumed that Jair Bolsonaro will have a good relationship with the US President and that may indeed be the case. The problem is that Brazil and the US are definitely rivals when it comes to their core economies and that is not going to be easily overcome.

Analysis: There are three economic areas that separate Brazil and the US. By far the most important is agriculture. Brazil is one of the world’s largest producers of soybeans, wheat, rice and corn. It is also a world leader in the export of livestock. These are the same commodities the US produces and in many cases the Brazilians are the major competitor for US farmers. Right now, the success of the US tariff strategy against China is dependent on what Brazil does as they have the ability to supply China with the soybeans they need – even if the Chinese are cut off from the US. Brazil would like access to the US farm market and that is something that US farmers vehemently oppose.

There are also manufacturing conflicts. Brazil produces products that challenge US made version – everything from Embraer airplanes to all manner of construction equipment, oil field equipment, high tech hardware and so on. Brazil wants to sell more into the US and the US wants better access to Brazil but both governments are pursuing highly protectionist agendas given what their political supporters are requiring. The US has once again agreed to pay US farmers for their losses due to the tariffs imposed by China and now would not be a good time to suggest Brazil ship soybeans to the US. The Trump team has tried to get Bolsonaro to reduce sales to China and they have been rebuffed. The manufacturing sector is no different as Brazil makes many of the same products the US does.

Beyond these specific areas of conflict there is the fact that both leaders push ardent nationalism and that makes cooperation with any other nation challenging. Brazil wants to compete with the US for influence in Latin America and that is not a course of policy that the US favors. Brazil has its own ideas as to what to do about Venezuela and they do not always align with the plans put forward by the US. It is also important to understand that trade with Brazil is not a big deal for the US – it amounts to around \$200 billion a year and that is roughly a sixth of the trade between the US and Mexico. This is despite the fact that Brazil as a two trillion-dollar economy as compared to slightly less than a trillion for Mexico.

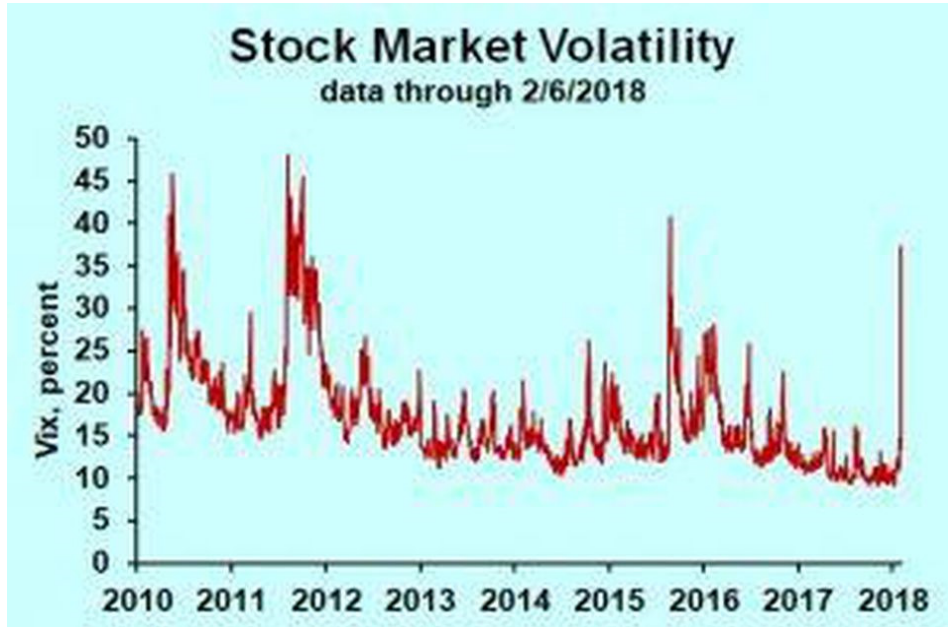
Another Nightmare for Belgian Politics?

Belgium is a deeply divided nation and that is why it currently holds the European record for the length of time it took to form a government in 2010-2011. The country was without a functioning set of national leaders for 541 days. This is a nation divided by language, culture, religion and politics. The southern part of the nation is French speaking, Catholic and trends liberal. The north is Flemish, protestant and leans conservative. This weekend there will be new elections and it is once again unclear that any party will become successful enough at the polls to form a government. There are dozens of coalition combinations available but these smaller parties often demand far more than what the major parties are willing to cede.

Analysis: Polls suggest that the Socialists will win in the Francophone south and the Flemish nationalists (N-VA) will win the north. The third place party is a populist group that cuts across the country with a message of anti-establishment politics, antagonism towards immigration and deep suspicion of the EU despite, and maybe because, Brussels is the headquarters city for the EU. The fear is that once again no party will be able to cobble together a workable coalition and the government in place now will continue as a permanent lame duck system. Unity has been achieved on occasion and has always been rooted in economic policy and that will be the argument going forward. The country can ill-afford paralysis on economic issues when growth is less than 1.0% and Europe as a whole is worrying about Brexit.

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 for more details or to ask one of those questions.



Just a little reminder for those who sometimes forget that consistency is not the most common state for the stock market. The fact is that market volatility rarely follows any real pattern. It doesn't really match up with the underlying economy and often reacts to factors that in a few days are utterly forgotten. It is ruled by emotion and by algorithms that may or may not be grounded in reality. It is an amusing spectator sport – unless one has money in it.

Speaking this Month

06/05/19	Wichita	Kansas Society of CPAs	Public
06/06/19	Osage Beach	Missouri Society of CPAs	Public
06/13/19	Minneapolis	Minnesota Society of CPAs	Public
06/14/19	New York	NACM	Private
06/17/19	San Diego	Institute of Management Accountants	Public
06/19/19	Hilton Head	Chemical Coaters Association International	Private
06/20/19	Minneapolis	Minnesota Society of CPAs	Public
06/21/19	San Diego	North American Credit Services	Private
06/25/19	Kansas City	Mutual of Omaha Bank	Private
07/09/19	Kansas City	Plaza Club	Public
07/14/19	San Diego	IACC	Private
07/18/19	Iron Mountain	FHLB	Private
07/19/19	Lee's Summit	Lee's Summit Chamber of Commerce	Public

Being Part of that Young Old Designation

There are few places that leave a man such as myself as confused as a garden center. Not that I don't love wandering around and peering at all the pretty flowers but my normal job is pushing the cart and nodding appreciatively when a specimen is held up for my perusal. Today I tried to be helpful as my gardening expert tried desperately to get plants in the ground before the next deluge of 87 feet of rain. I offered to run to the garden shop and had a list of just four items. "Bring back three packs of rose begonias, a pack of impatiens called Punch and marigolds (without the stripey part)". Piece of cake I said. What an idiot!

First off there was nothing among the wide variety of impatiens called Punch and after twenty minutes of consultation with an employee I ended up with something called "lipstick". Just looked pink to me. The only begonia called Rose had red leaves and when I got home the variety desired had green leaves. They had green leaf varieties but none called Rose. I did manage to grab the non-stripey marigold. I was also searching for two herbs – lovage and burnett. I had heard of neither of them and have no idea what one does with either. I found the former but not the latter. Throughout I felt as if I had led a highly sheltered life as I see all these things get put in the ground but remain oblivious to their nuances. She is the Master Gardener, I am but the Master Hole Digger. I learned my lesson – next time I bring my cell phone and take pictures of everything!! At least she knows better than to send me to the fabric store!!

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.