BUSINESS INTELLIGENCE BRIEF

June 14, 2019

NATIONAL AND INTERNATIONAL NEWS AFFECTING LOCAL BUSINESS

Short Items of Interest – US Economy

- **No Bang for the Buck –** Tariffs are a tool that many nations have used over the year and some with great success. The primary rationale for the imposition of this tax on consumption is to offset an imbalance of some kind. Another nation is exporting its output to the US because it can provide that good cheaper than it can be made domestically and that may be due to very cheap labor or deliberate subsidies. The tariff is supposed to level the playing field to a degree but that only works if the tariff is considered permanent enough to entice domestic producers to engage. Trump's tariffs have been failures as they are notoriously temporary. They have been little more than negotiating tools and few domestic producers trust they will stay in place so they choose not to invest. The end result is nothing but short-term pain and no long-term gain – the conclusion of the vast majority of economists that have examined these policies.

- **Slight Rise in Jobless Claims –** Last week revealed a small rise in the number of first-time filings for unemployment – 222,000 a number up by 3,000 from the prior month. The four-week moving average also rose slightly to 217,750 – up by 2500 from the prior month. These are not numbers that cause alarm and the overall jobless data is still historically low. One of the more interesting job numbers is the quit rate that is part of the overall JOLTS data. It is currently at 2.3% and that is higher than it has been in close to twenty years. This is a sign of significant confidence among workers as they assume there is another job waiting for them should they decide to quit their current position.

- **Corporate Expectations –** One of the more baffling developments has been the expansion of corporate debt. On the one hand it is understandable given the low interest rates but there seems to be a naïve assumption that none of the current economic issues will come back to bite these borrowers. They are assuming that the Fed will cut rates and keep that cheap money coming and that allows them to continue this record pace of borrowing. The assumption is that rates will be cut three times by the end of 2020 despite the fact that nobody at the Fed has come even close to suggesting that is a possibility.

Short Items of Interest – Global Economy

- **Bolsonaro Gets Rid of Another Moderate –** The right-wing leader is still presiding over a government of three distinct groups who do not like one another at all. There are the ideologues that share Bolsonaro's extremist world views, technocrats that are focused on making things work and a set of pragmatic former generals that advocate slow change. In recent weeks there have been scandals enveloping the ideologues but Bolsonaro has been firing the technocrats and the pragmatists as his sons have started to play a much bigger and more confrontational role.

- **Swiss Women on Strike –** For all its progressive reputation Switzerland is far behind the other European nations when it comes to gender equality. Women are paid less than half what men are paid for the same job. This is the nation that did not give women voting rights until 1971 and it was not until 1985 that women were allowed to work or open a bank account without the permission of their husband. The strike taking place today involved tens of thousands of women from a wide variety of sectors demanding equal pay and treatment in the workplace.

- **Tanker Attacks Driving Up Costs –** The attacks on two oil tankers have been attributed to Iran although there has been no formal claim of responsibility. The aim seems to be to drive up the price of oil. The markets reacted quickly with a 4% rise and this may go higher as tankers will start to choose longer and more expensive routes and will have to pay higher insurance costs. There will even be demands that they pay for additional security.

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Deficit and Debt – Does Anybody Really Care Anymore?

The latest report from the Treasury Department should be giving those that still care about fiscal prudence a heart attack. The combination of good news and bad news was much more threatening than it might appear at first blush. The good news is that tax revenues were far higher than they have been in recent years. There was a 2.0% increase - $2.3 trillion. This was due to the fact that there is essentially full employment and all those workers are paying into the revenue system for the government. This is what is supposed to happen and is why maintaining high levels of employment are so vital to the budget. The problem is that these revenue hikes have not been nearly enough to offset the higher levels of government spending. That spending rose by 9.0% and that is over $3.0 trillion. The budget deficit from last October to May was $739 billion as compared to the deficit between October of 2017 and May of 2018 when the figure was $532 billion. The bottom line remains as simple as it always has been. If one does not want to run a burgeoning deficit there must either be higher taxes or reduced government spending. If even full employment and a generally robust economy is unable to lower the deficit there has to be action on either revenue or spending and most likely both.

Analysis: What happens when there is a deficit of this size and one that appears to be with us forever? The simple answer is the government must borrow and this is done through the sales of bonds. The US theoretically has a debt limit but it is routinely exceeded after the politicians have had an opportunity to wring their hands and decry the situation they are responsible for. The US now has a debt that is well over 100% of its $20 trillion GDP and that is a debt that would take generations to pay down. That is assuming that anybody has a desire to do so and thus far there is no evidence that Congress or the Executive have such a desire.

There have been arguments asserting that carrying this debt is not really much of a problem given the unique position the US occupies in terms of global finance. The demand for US treasuries is high and always has been. They are the most secure of all government issued bonds and there will always be a market for them. The challenge would come if the bonds were required to carry very high yields in order to make them appealing. This is what crushed nations such as Greece, Portugal and many of the emerging market nations. The US has never had to contend with this and it is certainly not an immediate concern given the low yields that are dominating the global bond market today. Is this a situation that will last forever? Not likely. That means that at some point the US will be facing much higher levels of debt service and that has an impact on the federal budget.

This may be the most worrisome aspect of this debt load. It is not that the US will be unable to borrow in the future – there will always be a market. The problem is that debt service right now is chewing up between $350 and $400 billion of the overall federal budget and that number goes up every year. This makes debt service a significant portion of the annual budget – behind only spending on Social Security, Medicare, Medicaid and the military. In less than ten years interest on the debt will be almost 3.5% of the national GDP. That is more than all the non-discretionary spending, more than the military, more than Medicaid. All other categories of federal spending are dropping and interest on the debt is rising.

It has been argued for years that debt and deficit can be addressed with growth alone. If the US is falling further and further behind despite the 3.6% level of unemployment and growth that was at 3.1% in the first quarter it is clear the problem will get far more threatening when the economy slows down and the federal government has to start paying out millions of additional dollars for unemployment compensation and other assistance programs. In a perfect world (at least for economists) the government would take advantage of growth years to add revenue through additional taxes. There would also be opportunities to reduce spending but as is too often the case these opportunities were wasted as taxes were cut and spending increased.

Fed's Next Move?

How times have changed. It was only a few months ago that economists and analysts were in near universal agreement that the Fed would be likely to hike interest rates yet this year – maybe as soon as the summer. All the indicators seemed to be pointed towards that increase – a booming economy, low rates of joblessness and an improvement in investor confidence as well as consumer confidence. Now 75% of those same economists are convinced that the Fed will drop rates and perhaps as soon as the summer. What changed the attitude and is there any sign that the Fed decision makers share this change of heart?

Analysis: The economy has started to stutter and that has analysts changing their tune. Growth is thought to have peaked in Q1 and may be slowing to as little as 2.0% in the third quarter. The trade wars have many investors on edge and has affected overall business confidence as well as consumer confidence. The fear is that these stresses will conspire to pull growth down to levels that would compel the Fed to act and at the same time there seems no real reason to hike rates as there has been little push from inflation.

Thus far there has not been a shift in attitude by the Fed although there have been statements from Jerome Powell and some others that signal there is willingness to consider a cut if the economy continues to decline. Right now, that reduction in activity has not really manifested but there are certainly enough warning signs to cause modest concern. The big worry is the investment community as there has been a collective movement towards security. Equity markets are starting to lose some of their luster in favor of bond markets and that has driven yields down radically. There is now a great deal of conversation around the inverted yield curve and that has the Fed worrying more about the slowdown than was the case earlier.

Politics, War and the Oil Business

Just last week the word from the oil markets was that US oversupply and a reduction in global demand for oil was contributing to an unusual decline in the per barrel price of oil at a time of year that usually sees price hikes. This is summer driving season in the US and that often drives the price up. The sigh of relief that was heard from the oil consuming public was short lived as politics and the threat of conflict in the Middle East reared its ugly head. The latest incident drove global oil prices up by 4.0% overnight. Two oil tankers were attacked in the very sensitive Gulf of Oman. At this point no country or group has claimed responsibility for the attack but most assume that this was carried out by the Iranians or with the support of the Iranians. Since the US pulled out of the nuclear deal and elected to step up sanction pressure on Iran there has been open hostility between Iran and the US as well as US allies. It remains unclear whether these are attacks actually coordinated by Iran or carried out by groups affiliated with Iran.

Analysis: The oil markets are reacting strongly as there is an expectation that things could easily worsen. Iran is angry at the US and the Trump position on Iran could not be much clearer although he has stated that he would welcome negotiations. The challenge is that the US has been unwilling to start these talks until Iran makes concessions that thus far the Iranians are not prepared to make. At the top of the list is abandoning their nuclear ambitions but right after that there is the continued support of radical Islamists in the region as well as various insurgent groups such as Hamas and Hezbollah. Iran is angry that its agreement to ratchet its nuclear ambitions down were ignored by the US and seems to be putting pressure on US allies in the region as well as global players.

The oil markets are not as worried about these attacks as they are about the potential retaliation from the US or other actors such as Israel. The US has moved a significant fleet into the region and they could begin to harass and possibly attack Iranian vessels. Right now, the talk is focused on using the US naval presence to protect tanker traffic but given the number of ships involved this would be a daunting task and would require a much bigger US or allied presence.

The price of oil is lower than expected and even these geopolitical tensions are not expected to push prices anywhere close to $100 or even $90 a barrel. The fact is that US oil producers can make up the shortfall should there be any. The producing nations are not considering a reduction in output due to these attacks although they may start to consider alternate routes that could add cost to shipping.

Challenge to Dollar as World Currency

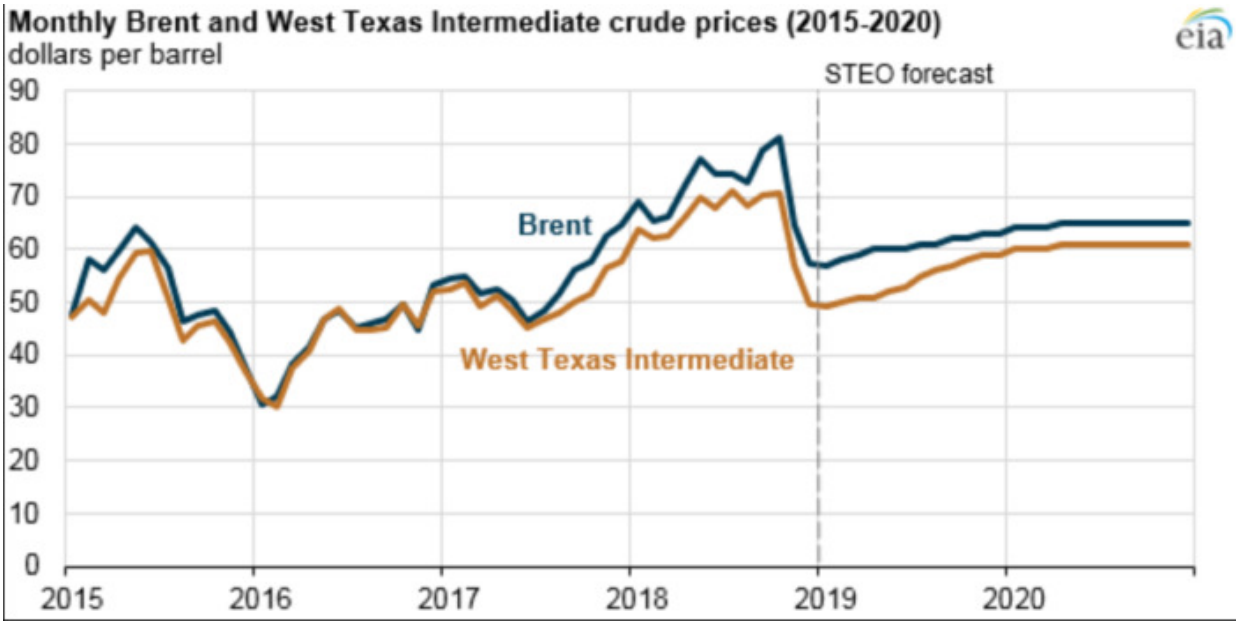
There are several reasons the dollar is the dominant world currency and there is no chance that it will lose that status anytime in the near future. There is a good chance that it will have to share some more of that influence with the euro if current trends hold. The dollar has become dominant for obvious and not so obvious reasons. The fact that the US is the world's largest economy is the prime motivator but as important has been the US position as the primary advocate for free trade and globalization. Under Trump that reputation has been lost and now the US is seen as an impediment more than supporter. This is giving the euro a better opportunity than has existed in decades and there are aggressive moves planned by the European Central Bank and the EU itself.

Analysis: The push is to engage the euro in more trade transactions – especially those that do not directly involve business in Europe. The ECB is working hard to facilitate payment in euros between Asian nations and between Latin nations and Asia. Reserve managers started to diversify out of dollars to some degree after the 2008 crisis and much of that diversification went into the euro. Now there are more incentives planned to expand that use. It has been pointed out that the US is using sanctions and tariffs more and more aggressively and this makes the dollar less appealing.

The ECB is supportive as a stronger currency makes them far less subject to the actions of the Fed. The Fed influences the entire financial world and that gives the US extraordinary flexibility and clout. They plan to facilitate the euro's rise by creating a "euro safe asset" as well as deeper capital markets denominated in euro. None of this replaces the dollar but it creates alternatives and reduces the influence of the US as far as financial markets and trade are concerned. The euro is not the only currency that is making a run at the dollar – so too are the Chinese yuan and the Japanese yen. Both of these have much further to go as far as global currencies are concerned but both have substantial regional influence already.

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.



The projection as far as oil pricing is concerned has not yet wavered due to the oil tanker attack and it is not expected to react that much or for that long. This is assuming there is not some kind of escalation that puts more at risk or starts to affect actual production. The volatility that has marked the sector has started to fade a little but as we have seen with recent events that volatility can appear again at any time.

Speaking this Month

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
08/08/19	Grand Rapids	FHLB	Private
08/15/19	Indianapolis	FHLB	Private
08/20/19	Kansas City	Surety Association	Public

In Praise of Complaining

I saw a well-meaning little video the other day and its message was clear. People that complain and gripe are essentially the scum of the earth and will doubtless die miserable deaths – alone and shunned. The vignette showed several people complaining. One guy was being trampled by a young lady getting to her seat on the airplane – she spilled her drink on him, whacked him with her bag, stepped on his feet and sprawled all over the seat while conversing loudly on her phone. He scowled and objected to her rude behavior and the narrator opined that this action was uncalled for and churlish. I say hogwash.

How do we expect others to correct their behavior if there are no complaints? How does it serve the common good to tolerate rudeness and mistreatment? How are improvements to occur if nobody objects to shoddy workmanship, poor service, deliberate cheating and incompetence? I understand that there are chronic complainers that take things too far and I also understand there are ways to object that do not verge on hostility but I reserve the right to point out that certain actions and behaviors are unacceptable. One such opportunity presented itself yesterday.

I was simply trying to use the self-check-in kiosk at the Minnesota airport and no matter how I inserted my credit card nothing happened. The agent asked what the matter was. I said the machine was not working. She curtly responded – "You are doing it wrong". I have used dozens of these machines with no incident and had inserted my card in every conceivable way. "No, I think the machine is broken – can you direct me to one that works?" The response was sharper than before "There is nothing wrong with the kiosk – you don't know how to insert your card". I was getting a little irritated at this point and suggested she show me. Wonder of wonders it didn't work for her either. "The kiosk must be down" she opined. Really? I could not have guessed that. Thanks so much for assuming I am a blithering idiot incapable of sliding a card into a slot. A situation that demands a complaint in my opinion.

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.

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Armada Staff –Chris Kuehl, Keith Prather, Karen Sanchez P.O. Box 733 – Lawrence, Kansas 66044 – intel@strategic-briefs.com