

# BUSINESS INTELLIGENCE BRIEF

June 21, 2019



## NATIONAL AND INTERNATIONAL NEWS AFFECTING LOCAL BUSINESS

### Short Items of Interest – US Economy

- **Reduction in Jobless Claims** – There continues to be good news on the employment front despite the occasional bump in the data. Last week there was a slight increase in the number of first-time jobless claims but this week the number fell slightly. The end result is a stable level of employment. The challenge as far as employment is concerned is not that there is a shortage of jobs. There is instead a surplus of jobs that has reached well over a million. The issue is that companies are struggling to find the people with the qualifications they need. This is one reason that the Phillips Curve has not been reliable as far as estimating wage inflation. Many less qualified people are getting hired and are being paid less than would be expected until they gain the experience they need to command a higher wage.
- **It's the "Global" Economy, Stupid** – The Fed has completed its June meeting and did what was generally expected – i.e. nothing. There were very few who asserted the Fed would decide to lower rates as they have been signaling all along that this would not be the month they elected to shift. The interesting aspect of the meeting was the rationale developed to justify a rate cut in the future should that decision be made. It will come down to the global economy – if it continues to sag it will drag the US economy down with it to some degree and that would provide the threat to US growth that would justify a rate cut. The unstated factor to watch is tariff policy. The US has threatened tariffs on almost every nation but has followed through on very few. If some of these stick, the global economy stutters and US exports will suffer as a result.
- **Backtracking on Drone Issue** – The Iranians claim that the surveillance drone they shot down was over their territorial waters and the US insists that it was over international waters. The initial reaction from the US was a bellicose assertion that Iran "had made a very big mistake" and some inferred that this would be sufficient provocation for US retaliation. Today the statements from the White House suggest that Iran may not have done this intentionally and that appears to be an attempt to ratchet down tensions. The oil markets have been all over the place for the last two days.

### Short Items of Interest – Global Economy

- **Putin Reacts to Popular Anger** – For all the gains that Russia has made in terms of regaining its global influence there has been nothing much to show for his efforts on the economy and the average Russian is fed up. There have been five consecutive years of falling income at the same time that prices have been rising. The fact is that Russia has been described as a "gas station masquerading as a country" and with oil prices in steady decline the country has lacked the income needed to improve the lot of the average person. Putin is now admitting something has to be done but thus far there have been no plans described and frankly there is nothing much that can be done until and unless oil prices go up.
- **Japan's Consumer Price Inflation Dip** – The rate of inflation has fallen again and that is not necessarily a good thing. The core rate is now at 0.8% annually and just last month it was at 0.9% per year. The headline rate is just as low at 0.7% and that is down from 0.9% the previous month. The effort to steer away from deflation has been very challenging no matter what the Bank of Japan has tried to do. The sense is that there will be a tax hike later in the year but this low level of inflation has made that move a bit more complicated.
- **Tories Narrow the Field** – The race to replace Theresa May as leader of the Conservative Party and thus the new Prime Minister of the UK has been narrowed to a run-off between Boris Johnson and Jeremy Hunt and the choice could not be much starker – a leading Brexiter and the man that describes himself as the "serious candidate".

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## Pretty Much as Expected

There was not as much drama at this week's Fed meeting as some had expected but there were certainly some odd discussions as the Open Market Committee deliberated over what to do about interest rates. As expected, there was a decision to stand pat despite the not-so-veiled threats from Trump. If ever there was a case to be made for Federal Reserve independence it would be this President. He has asserted that he wants to fire Fed Chair Jerome Powell or at least demote him. Neither of these actions are seen as part of the President's purview as Congress makes the final decisions as far as who is on the Fed. Trump has tried to place ideological allies on the Board but this has been a recent development. Up until the last several months the choices Trump made were quite mainstream. He elevated Powell to Chair and selected Randy Quarles, Richard Clarida and Michele Bowman. Last year, two of his other selections ran out of time for their consideration but were also mainstream (Marvin Goodfriend and Nellie Lang). It was only this year that Trump has tried to place more unusual candidates and they were rejected early (Herman Cain and Stephen Moore).

**Analysis:** The issue that has raised Trump's ire is the unwillingness of the Fed to lower interest rates in response to some slowing of the economy. It is the contention of the Trump White House that pulling rates down to 2.25% or 2.0% will prove dramatically stimulative but analysts and economists do not agree. It is certainly true that some additional borrowing might take place but coming down from an historically low rate is not going to change many business strategies. On the other hand, the lower rates are still causing concern over issues like inflation, an inflated stock market and savings. One of the members of the Open Market Committee is Esther George of the Kansas City Fed and she has consistently pointed out that historically low rates have encouraged very risky borrowing and lending. People are taking out big loans at low interest and investing in the markets. It is a good strategy as long as the market boom lasts but should the momentum cease these borrowers will be in trouble and so will the banks that loaned the money. She has also been very worried about the ability of small banks to make money the traditional way. There is no incentive for people to save at the bank or buy instruments like a certificate of deposit. George wants rates back to the point that savers get some kind of return and speculators have to be a bit more cautious.

If Trump was of the opinion that the Fed would be cowed by threats, he was likely disappointed in the outcome as the vote was nine to one in favor of keeping rates just where they are. The lone dissenter was St. Louis Fed chief James Bullard. He is somewhat mercurial and is neither a reliable hawk nor dove. His contention is that a real trade war is imminent and will be waged throughout this year and next as it will make good political fodder. The rest voted to stay where they are and that includes ultra-hawks like George and doves like Charles Evans in Chicago. At this point there is no sign of buckling under White House pressure.

The statements that have been coming from the FOMC hint that a rate cut is not out of the question later this summer or early fall. The determining factor will be the status of the global economy. The US economy continues to grow at a respectable rate but the threat comes from the potential for a protracted trade war. The pessimistic assert that the China-US dispute will not be settled anytime soon and that the tariffs and trade restrictions will compromise global growth as well as growth specifically in the US. The more optimistic assert that much of the trade dispute is posturing on the part of both the US and China and that a deal will be struck. The Fed is essentially waiting to see which of these two positions are most accurate.

## Fresh Signals Regarding China

If the critical issue for the Fed and others worried about global growth is the chance of a deal between China and the US that averts a trade war then there appears to be more encouraging news on a daily basis. First it was a softening of the rhetoric aimed at China in advance of the G-20 meeting. This more conciliatory tone has been adopted by the Chinese as well. There had been a hint that Xi would refuse to meet privately with Trump but the Chinese have since insisted that this was not a consideration. The next signal came from Robert Lighthizer – the chief US negotiator. He will be meeting with his Chinese counterpart prior to the Xi-Trump meet and he suggests that this will be to “work out some details”.

**Analysis:** If this is all to be believed it would suggest that a deal is working out that allows both nations to essentially declare victory and move on. This doesn't mean an end to trade tensions or even that prior tariffs will be lifted but it may mean that the draconian steps that had been threatened by both nations will be abandoned – at least for now. It is likely that bashing China will remain part of the Trump strategy just as bashing the US will remain part of Xi's political arsenal. The point is that these exchanges will be mostly bark and very little bite. This seems to be what the global markets are assuming as they have been having some good days of late despite some negative news on other fronts.

The assumption at this stage is that the two leaders will end their meeting with an agreement to resume formal talks but it is unlikely that any definitive will emerge other than a delay in imposing harsher tariffs on one another. This would temporarily provide some relief for US farmers that want to sell to China and US firms that want to source from China. A more permanent solution seems pretty distant at this stage but the global markets seem happy enough to see a cease fire at this juncture. The rest of the G-20 attendees will be happy to see this truce as well and can be expected to make their opinions known.

## Mexico Approves USMCA

The supposed replacement for Nafta has been approved by the Mexican legislature by an overwhelming majority. The USMCA was created by the Trump team as a revision of the agreement that Trump had called the “worst trade deal ever”. The vast majority of analysts in the US, Canada and Mexico have held a much different opinion and have credited Nafta with allowing significant expansion of the economies of all three nations. It is useful to review the origins of the North American Free Trade Agreement as this has bearing on what has been suggested as its successor. Thus far the prospects for its passage through Congress or the Canadian parliament are relatively bleak.

**Analysis:** In the mid-90s the US faced a new threat to its economic position – hard as this is to believe these days. There was serious concern that the European Union would come to usurp the US position as the dominant economy, the euro would emerge as the new global currency and the development of new markets in Asia and elsewhere would be the task of Europe. The EU was new and exciting and dynamic and much of its strength was based on a division of labor between the northern Europeans and those in the southern tier. Germany, Netherlands and the Scandinavian countries invested in Spain, Italy, Greece and others or used migrant labor from East Europe (especially Yugoslavia). This proved to be a potent combination and was pressuring the US companies who found no effective way to compete other than to decamp and move production to Asia and Latin America and other developing regions. That was when it was considered urgent for the US to match the EU advantage by creating its own trade union that would unite resource rich Canada with the low labor and production costs of Mexico and the business and investment community of the US. There were those that asserted that Mexico would siphon jobs from the US but the reality is that those manufacturing jobs were leaving anyway. The only question was whether they would go to China or elsewhere in Asia or to Mexico and in fact most were lost to automation and robotics. Mexico buys close to 90% of all its imports from the US and China buys less than 8% so it seemed a pretty logical decision to favor Mexico.

Fast forward some twenty-five years and the EU is not so intimidating. The US now has a solid manufacturing platform in Mexico but much in the way of manufacturing has returned to the US as more and more companies opt for robotics and technology to gain and keep an edge. The myth of the “giant sucking sound” persists and continues to be good campaign fodder but the reality is that Nafta has been a bulwark against the expansion of China and Asian business. The USMCA is supposed to continue that trend but there are questions that have made its passage problematic in the US and Canada. There are those that want it weaker and those wanting it stronger and all will be measuring the political impact of their position. Most assume that Canada will pass it if there are dispute resolution provisions that do not favor the US but Congressional passage relies on satisfying the union-oriented Democrats and the isolationist Republicans and that will be no easy task.

## Venezuela Destabilizes All of Latin America

By any definition Venezuela is a failed state – along the same lines as one of the classic collapsed regimes in Africa such as Zimbabwe or the DRC. By the end of this year there will have been in excess of 5 million people who will have fled Venezuela to escape the violence, street crime and persistent poverty. The vast majority of these refugees have ended up in Colombia but no nation in the region has been immune from this exodus. Analysts have been asserting that Venezuela will require decades to rebuild from the debacle of Chavez and Maduro but now it is thought that Colombia, Brazil, Ecuador, Guyana, Surinam and many others will be suffering the impact of the crisis for years. There are far too many people arriving with little more than the clothes on their back and there are no job opportunities for the majority of them.

**Analysis:** The political fear is that one of two things start to emerge. The first is that drug gangs and other violent groups will find ripe recruiting opportunities with these disaffected people. They are already signs that drug cartels are rebuilding in Colombia and there are further signs that groups seeking to emulate Farc are forming. This sets up a backlash from the right leaning nationalists that resent the influence of the migrants and would seek a more violent and forceful response to the refugees. The profound engagement by China and Russia in Venezuela also causes concern as there is fear that both of these nations may seek to meddle in the affairs of the other nations in the region. There had been hope that a nascent coup attempt by Juan Guaido would succeed but with Chinese and Russian money it was thwarted and the wind seems to have gone out of the opposition.

## 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.

## Mexico's drug cartels

Zones controlled by major cartels



As the US and Mexico work towards trying to figure out a workable new relationship in the era of Trump and AMLO there are old issues that will continue to vex. Not the least of which is the drug gang situation. It is no accident that the two largest cartels in Mexico are the ones that border the US – Sinaloa cartel and the Zetas. The Mexican position is that the US is more responsible for these gangs than is Mexico as the drug consumption is in the US. The Mexican police and military fight internal corruption as well as the gangs and now the great hope is the new National Guard – trained by elements of the US military. The assertion that this group will be assigned border duty along the Guatemalan frontier is not going down well in Mexico as a whole.

### Speaking this Month

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	Int'l Association of Debt Collectors	Private
07/18/19	Iron Mountain	Federal Home Loan Bank	Private
07/19/19	Lee's Summit	Lee's Summit Chamber of Commerce	Public
08/08/19	Grand Rapids	Federal Home Loan Bank	Private
08/15/19	Indianapolis	Federal Home Loan Bank	Private
08/20/19	Kansas City	Surety Association	Public
08/22/19	Tulsa	Institute of Management Accountants	Public
08/23/19	Chicago	National Association for Credit Management	Private

## **It Seems Like it has Been Hours**

Wasn't it just yesterday that I was complaining about airlines? Does this seem to be a theme of mine? Do I perhaps spend way too much time on these giant aluminum tubes? Over the years I have declared that I would never stray from the secure cocoon of Southwest Airlines but sometimes I am forgetful and naïve and try another. This week it was Delta as I needed to get to Savannah from San Diego and then from Savannah to Minneapolis. Southwest doesn't serve Savannah so it was Delta or nothing. I should have chosen the nothing option. Due to a host of organizational breakdowns exacerbated by weather I was stuck in Atlanta until 1:45 AM and arrived at my hotel at 4:30 AM. Seems Delta had no pilot for that flight so we had to wait four hours for them to find one with the qualifications to fly that specific plane. They found one at home in Orlando so we had to wait for him to make it to Atlanta.

The whole sorry experience was an exercise in how to do things incorrectly. First, create a fleet of planes that not everybody can fly and which can't be serviced at most of the airports they fly to. Second, have an antique boarding system that turns the process into a rugby scrum. We had a very narrow window to get everybody seated so we could close the doors and keep the cabin crew from timing out. We made it with two minutes to spare as people wandered all over the plane trying to remember that 19 comes after 18 and not the other way around. Top all of this off with surly gate agents and a flight crew that didn't want to take off as that meant they would be able to head to a hotel.

The next time I have Savannah or any other non-Southwest destination I will stick to my vows – “take Southwest as close as I can get and drive the rest of the way”.

## **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.**