BUSINESS INTELLIGENCE BRIEF

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KC CHAMBER

NATIONAL AND INTERNATIONAL NEWS AFFECTING LOCAL BUSINESS

Short Items of Interest – US Economy

- **Small Hike in New Claims for Unemployment –** The summer is a period of job volatility as one would expect. There are sectors of the economy that temporarily boom as people head out on vacation and there are sectors that slump. The auto industry often lays people off for a month or two while the plants are retooled and while they are out of work, they get unemployment. The teachers in some areas are able to draw unemployment during the summer as well. The latest data showed that claims for unemployment were up a little this past week but overall there has been little change and the job market remains steady. The shortage of qualified workers remains the most vexing issue for business.

- **Minimum Wage Debate –** As expected the Democrats in the House of Representatives passed a bill that would increase the federal minimum wage to $15 an hour in the next six years. The bill is largely symbolic as it stands no chance of passage in the GOP dominated Senate. This has been an issue that has preoccupied economists for years as there are arguments that can be made for opposing and supporting the idea. It would certainly benefit those that would see a raise and that would boost consumer activity. The major problem is that many low wage workers will lose their jobs as businesses strive to keep their labor costs under control. The people that have the lowest skill level are the ones at the greatest risk as many will be replaced by machines and robotics in some manner.

- **Slight Rise Expected as Far as Consumer Confidence is Concerned –** The University of Michigan consumer survey is due out today and is expected to be slightly more upbeat. No really big changes but the fact that consumer sentiment has held on as long as it has is bit of a surprise. The sense had been that consumers would be heading into a bit of a funk by now with all the worries about the trade war and the upcoming political battles. Thus far they are more motivated by the good unemployment numbers and the continued lack of inflation.

Short Items of Interest – Global Economy

- **Europeans Weigh in on Trump Attacks –** The furor over the remarks that Trump has made regarding four Democratic congresswomen has now reached Europe as Germany's Angela Merkel has rebuked Trump for his "racist rant". The animosity between Merkel and Trump is certainly nothing new but several others in Europe have expressed similar feelings. It remains unclear whether this attack was Trump expressing his personal animosity or a political ploy. If it is the latter the Democrats have walked squarely into the trap as it has made these four women the face of the Democrats to many voters. Merkel has called this out and warned the Democrats to avoid losing control of their own identity as she has seen that process play out in German politics.

- **Spanish Government Remains in Flux –** The Socialists are trying to put together a workable government but they lack a majority in the parliament and must rely on allies to get anything passed. The Sanchez government does not want to form a formal alliance with the hard left Podemos group as that would likely cause their centrist allies to defect but Podemos is refusing to cooperate with Sanchez unless they are offered that formal affiliation. This has created a stalemate that will make it hard for Sanchez and the Socialists to pursue the reforms they had promised.

- **Ebola Outbreak in DRC –** The surge in cases of the Ebola virus in the Democratic Republic of Congo has prompted the World Health Organization to issue an emergency declaration. The situation is not yet as dire as it was in West Africa a few years ago but given the war-torn nation and the almost complete absence of government in many regions there is considerable fear.

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Three (or Maybe Four) Theories Regarding Interest Rates

There are not ,many activities that investors seem to enjoy more than trying to predict the actions of the Federal Reserve as well as the other central banks in the world. It is obvious why this becomes such a preoccupation given the role these rates play in everything from bond value to the activity of the corporate community. In past years the Fed chairs were very careful to keep information to themselves and seemed to delight in keeping the investment community off balance - Alan Greenspan was not called "the Sphinx" for nothing. Today the central banks around the world are committed to policies of transparency and openness. This has not stopped investors from spending a lot of time puzzling out what they think the Fed is thinking from one meeting to the next. There are at least three theories regarding what the Fed's Open Market Committee is likely to do with the Fed Funds rate: leave the rates right where they are for another few months, lower them by a quarter point or lower them by a half point. It is highly unlikely but there is a fourth possibility and that would be to hike them by a quarter point.

Analysis: The level of interest rates is the fundamental tool a central bank uses to affect the economy. The presumption is that higher rates discourage borrowing and lending and lower rates encourage borrowing and lending. The Fed has dual mandates to both promote job growth and to stave off inflation and the interest rate tool is far more efficient at the latter than the former. Traditionally the Fed concentrates more attention on inflation than on expansion – leaving the stimulating mostly to the legislature and the executive. It is assumed by many that controlling inflation is the only motivation for hiking rates but there are other considerations. If rates are low it is hard for small banks to make money as they have a hard time attracting deposits, low rates contribute to reckless borrowing as we have seen of late. Low rates also affect the value of the currency.

The Fed watches and examines the state of the economy with an eye towards the future as they know that changes in the interest rate takes several weeks and perhaps months to work through the economy. At the start of the year it appeared that there was sufficient growth to justify a steady position on rates. The US had been growing at around 3.0% for the bulk of 2018 and the start of 2019 was also robust. The betting was that Fed policy would remain unchanged and that rates would stay at 2.5%. There was no motivation to push rates up as there had been no sign of either wage inflation or commodities-based inflation.

By the end of the second quarter the situation had changed and many were suggesting that rates needed to come down. The consensus view is that the growth rate had started to fall although the more recent data has indicated that growth will be around 2.0% as opposed to the 1.8% that had been forecast earlier. The consumer has been coming to the rescue with better retail performance but there are still worries about the future of the US export sector. The trade wars and tariff wars have been more bark than bite thus far but none of the threats have been eliminated completely and that keeps the analysts on edge. It has been the status of the global economy that has been worrying the Fed and they have suggested that if rates go down it will not be because the US economy is in trouble – at least not right now. The sense is that the Fed wants to be cautious about all this and will only lower rates by a quarter point.

There are a few who assert that a half point reduction is in the realm of possibility as the Fed may want to make a real statement and give the economy a jolt. Thus far this is a minority position but the argument can be made if one accepts a few assumptions. The first is that all these trade related threats will come to pass in one way or another. This will mean a drastic reduction in US exports and a much higher price for consumers. That inflation could also trigger caution by the Fed but the presumption is that the Fed will react to the growth issue more than the inflation issue. Another assumption is that flushing the economy with cheaper money will be stimulative and that is a big assumption given that most companies are struggling to find the labor force they need to expand.

The Fed is not nearly as inscrutable as they have been in past years but there remains a desire to keep some of its cards close to the vest and there will rarely be definitive statements regarding intent. The best that can be gleaned is what the Fed members are watching and how they would be likely to react.

New Labor Secretary?

The resignation of Alexander Acosta has opened up another Cabinet level post and the presumed nomination to replace Acosta is Eugene Scalia – the son of the late Justice Antonin Scalia. He served as solicitor for the Labor Department during the Bush administration and is a partner in a law firm that specializes in labor issues. His position is generally pro-employer and he has been criticized by those in the Democratic Party that favor expanded protections for unions and workers in general. He has taken strong positions on labor negotiations and recruitment as well as right to work.

Analysis: One of the areas that Acosta was working on was labor force development. It had been a priority during his tenure and there are several programs in place designed to train more people for the jobs that are going unclaimed. The manufacturing sector alone is expected to need 3.7 million people in the next five years and it is anticipated that there will be a shortage of over 2 million. The same situation confronts transportation, construction, health care and many others. It is not clear whether these efforts will get the same attention under a new leader but the business community will be lobbying hard for the effort to be a high priority. These programs have ranged from providing more money to develop trade schools to financing the retraining of people who seek to get into these careers in the immediate future.

What Lagarde Means to ECB

The choice of Cristine Lagarde to be the new head of the European Central Bank was shocking on several levels. The first is that she wanted the job in the first place as she has been seemingly very happy with her role as the head of the IMF. Remember that she came into this post at a very sensitive moment and has been credited with rescuing the reputation of the organization after the sordid scandals surrounding the previous head – Dominique Strauss-Kahn. Beyond the fact that many were surprised at her interest, there is the fact that her credentials are unusual for this position. In past years the head of a central bank had to come with extensive background in banking or economics. This has not only been true of the ECB but for almost every central bank in the world. Of late there has been interest in selecting people with different skill sets to better fit a different central bank environment. Lagarde is a diplomat and a lawyer with extensive experience as a communicator. She relied heavily on the analytical team at the IMF and in her previous positions in the French government and has never made excuses for this approach. It is very likely that her style and experience as a negotiator is what made her appealing.

Analysis: She will face three tough areas which will test that negotiating prowess sooner than later. Her first challenge will be in managing the governing board of the ECB itself. The men and women on that board represent some widely varied approaches to ECB policy. On one extreme she will have Jens Weidmann from the German Bundesbank. He was thought to be the favorite to replace Mario Draghi and he would have been radically different than Draghi as he has been a consistent critic of the bank's stimulus efforts, bond programs and the like. He is the ultra-hawk and represents Europe's economic engine. On the other extreme are some of the representatives of the southern tier states that want to expand all of the stimulative plans that had been offered up in the past. Should the ECB be aggressive in terms of growth or cautious in terms of inflation? This will be a fundamental question for Lagarde and she will have ardent opposition no matter what she chooses to support.

Her second challenge will be with the other financial leaders of the EU. The Finance Ministers will all be expressing their opinions and will likely support the positions of their national representatives to the ECB. They have only indirect influence on the decisions of the ECB but policies supported by the ECB require the engagement and cooperation of European governments. There are still many in Europe that require bail outs and rescues and there is very definitely bail out fatigue in Germany as well as France.

The third area will be her relationship with the other global central banks. The dominant player in the world of central banking is the Federal Reserve of the US and she will likely have a good rapport with Jerome Powell but most definitely not with Trump. She will also have to develop a new relationship with the Bank of England as Mark Carney is stepping down. Then there is Haruhiko Kuroka from the Bank of Japan and several of the second-tier banks such as Reserve Bank of India, Reserve Bank of Australia, Bank of Canada, Bank of Mexico et. al. This may well be her greatest strength as she has had occasion to work with many of these leaders in her capacity as IMF head.

Turkish Shift

The relationship between Turkey and the US has fallen to the lowest point in decades. The animosity between Erdogan and Trump has become palpable and Turkey has reacted very harshly to the pressures that have been imposed by the US. This shift has been developing for years and is attributed to the emergence of Erdogan as an authoritarian leader. The conflict with the US has been accelerated as the US has been engaged with the conflicts in Iraq and Syria – mostly due to the fact the US has engaged with the Kurds. The Kurdish question is enormous in Turkey as Erdogan has made them enemy number one. The Trump sanctions on Turkey have further angered the Erdogan government and now Turkey has taken a radical step.

Analysis: The decision to purchase a missile defense system from Russia shakes the Turkish relationship with NATO to the core. They will no longer be allowed to fully participate as this defense system comes complete with Russian advisors and operators. The Turks have essentially signaled to the US and Europe that it has options. Russia and Turkey were once at odds and NATO saw Turkey as a front-line state but those days are now over. Turkey is entering the Russian orbit as Putin welcomes Erdogan with open arms. The US is likely to lose its military presence in Turkey sooner than later.

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.

GOVERNMENT DEBT LEVELS FOR SELECTED COUNTRIES

COUNTRY	GOVERNMENT DEBT ($ MM)	GOVERNMENT DEBT AS % OF GDP
Japan	9,551,520	236.4
Greece	377,722	181.9
Italy	2,296,070	131.5
US	15,148,757	82.3
Germany	1,912,791	64.1
Turkey	181,860	28.5

Source: Bloomberg, end-2017 figures

For all the issues that have affected Turkey in the last few years the country has avoided a trap that has affected many other nations. Their debt levels are really quite acceptable and that leaves them far more options than even the US. The Japanese have been in crisis for years and Greece has been struggling for a decade. The US situation worsens by the day and that debt as percentage of GDP will be close to 100% by the end of next year unless there are changes in the budget

Speaking this Month

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
08/27/19	Atlanta	Steel Market Update	Public
09/11/19	Milwaukee	Wisconsin Banker's Association	Public
09/12/19	Milwaukee	Assoc. of Women in the Metal Industries	Public
09/16/19	Lake Geneva	FISA – Dist. Serving Sanitary Processing	Public

Old Stomping Ground?

I had the opportunity to revisit my tender youth this week when I was invited to do a program for the FHLB in Iron Mountain, Michigan. This is way up there – on the border of Wisconsin and the Upper Peninsula of Michigan. Back in the 1960s my parents made an annual trek to the region to see some of Mom's relatives. We spent a week in places like Florence, Iron Mountain, Niagara, Iron River etc. After visiting this week, I can safely say it has changed a lot.

Back in the 60s one had few options as far as lodging – we usually stayed at Bucky's Cabins and I still remember the pervasive smell of fish everywhere. When we had occasion to do laundry in Florence we were urged to avoid the machines on the back wall – those were for the miners and clothes would come out rust colored. I also remember a place with the greatest sign ever – "Winslow's Funeral Home and Taxidermy". Never knew that was an option before then. I developed a fondness for pastries and learned that bars were supposed to be called taverns. Today they have all the chain hotels (I chose the Country Inn and Suites) and Bucky is long since retired. Still a lot of fish smell and the deep woods are never far off. The trip brought back lots of memories of hanging out with my dad and looking at the stars and the occasional display of the northern lights.

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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