BUSINESS INTELLIGENCE BRIEF

July 26, 2019

NATIONAL AND INTERNATIONAL NEWS AFFECTING LOCAL BUSINESS

Short Items of Interest – US Economy

- **Not as Bad as Feared –** As recently as yesterday the estimate for Q2 growth was at 1.8% according to some analysts and economists. A few had the rate up around 2.5% but the majority expected a fall to under that 2.0% threshold. The first iteration of that second quarter performance was respectable – 2.1% growth. It is a far cry from the 3.1% pace set in the first quarter but that was expected. The important thing is that it was not as low as many had feared. The hero was the consumer as they continued to pick up the pace in the face of all those expected headwinds. The fact is that most of those inhibitions have yet to really play out. The trade and tariff war has been much more bark than bite as the majority of these tariffs have not been imposed although they remain on the table and may become a factor later.

- **Better than Expected in Q2 but 2018 Was Worse –** With the numbers that came out for the second quarter comes the revisions to last year's numbers and the conclusion is that growth in 2018n was not as good as had been thought. There was an assumption that the momentum from the start of the year was enough to carry growth through the rest of the quarters but the reality is that growth started to stumble as soon as the third quarter and by the end of the year growth failed to stay in the 3.0% range. It has been the goal of the administration to see consistent growth above 3.0% but even with the tax cuts and additional spending that goal was not reached.

- **Durable Goods Gain –** After two months of decline the level of durable goods orders came back up and fairly sharply. Thus far all the activity seems to be in the aerospace category. The two months of down data are connected to the issues surrounding the Boeing 737 Max. The production of that plane has been stalled and so have orders. This month the aerospace sector staged a rebound due to the Paris air show as this is the event that stimulates the most buying and even the 737 Max had orders. The assumption is that Boeing will eventually get the plane back in the air with all the proper permissions and many airlines will be eager to start making up for lost time.

Short Items of Interest – Global Economy

- **Erdogan Continues to Pressure Central Bank –** the Turkish central bank cut interest rates as has been the demand of the business community and Erdogan but the cut was not deep enough to satisfy the President. He has been blaming the struggles of the Turkish economy on the rates but that is not an opinion shared by most economists. The central bank has tried to hold the line on inflation and worries that even this latest cut may be too much. Turkey's bigger issues revolve around alienating many of its trading partners.

- **Currency Manipulation –** Trump has been asserting that every other country in the world is actively trying to manipulate their currencies so that they can gain a trade advantage against the US. It is certainly true that the dollar has been gaining strength against virtually all other currencies and it is equally true that this makes US exports more costly but there is no evidence at all of a deliberate policy. There has been no artificial buying or selling. The dollar has gained for old fashioned reasons. The US stock market has been on fire and everybody wants a piece and then there is the fact the US has slightly higher interest rates. The dollar is not so much strong as all the other currencies are weak.

- **Impact of Iranian Sanctions –** The new sanctions that have been imposed on Iran are not having much additional impact on Iran as they already have to deal with a stringent set of restrictions. The impact is being felt by other nations in the region – UAE, Kuwait, Qatar, Oman and others that have been serving as conduits for trade into and out of Iran.

How Relevant Will This ECB Move Be?

The head is on his way out but is not leaving quietly. Mario Draghi has all but promised a major move towards stimulating the Eurozone economy next week although he has still not provided all the specifics. The investment community has obviously decided that this is a done deal as they have driven bond yields to near all-time lows. It is certain that interest rates will be dropped but it is still a bit of a mystery as to how far down they will go. The bigger question is whether there will be other steps taken to boost the economies of Europe. The latest data from Germany has been deeply concerning as there is no expectation that Germany will be able to pull itself out of the mire – much less pull the rest of Europe along. The list of nations facing an impending financial crisis is long and getting longer and Draghi seems determined to put some measures in place prior to handing the reins over to Cristine Lagarde.

Analysis: The yields on the German bond has fallen to yet another all-time low of 0.46% and that compares with a rate of 0.6% just last October. What is worse is that there is no reason to expect that tumble to stall anytime soon – the German economy is looking stressed for the remainder of the year and well into 2020. The investors are starting to get interested in Italian bonds again as they now expect the ECB to resume some version of its bond buying program and that would mean a market developing for these bonds again. Currently they are nearly useless and can be had at a very low price. All of this has meant the euro has tumbled against the dollar again – down by 3.0% thus far this year and at its lowest point in three months.

The question that hangs over all of this ECB activity is whether it will accomplish anything at all. The fact is that central bank activity is limited in terms of its ability to push growth. This is a point that has been harped on but bears repeating given the incessant pressure placed on the banks by politicians and many in business. It is especially disingenuous for the political leaders to place this kind of pressure on the central banks as it is fundamentally the responsibility of fiscal policy to boost economic growth and this policy is squarely in the hands of the legislatures and the executive branch. Monetary policy is intended to be a braking mechanism more than it is an accelerator. The ECB is going to do what it can to make access to money cheaper with the hope that banks will elect to lend more and that is based on the business community wanting to borrow. In order for central bank interest rate cuts to have any kind of impact there has to be desire to both lend and borrow and the current rates have to be seen as some kind of inhibiting factor. If the rates are too high for companies to justify the debt the central banks can lower the rates to the point that debt makes sense. Very few would argue that rates are prohibitive at the moment. There is plenty of access to capital so it is hard to see how slightly lower rates will make a big difference. In fact, many analysts are fearful that lower rates will only encourage bad behavior.

Those that have been pushing for rates to trend higher rather than lower are not arguing that inflation is an issue at the moment. The fact is that inflation remains nearly non-existent and this has been a shock. The rationale for higher rates rests on other factors. The first is that cheap money has allowed risky activity in the stock market. Investors can borrow a lot of cash and put that money in a very lively market, make that loan money back and then some, turn around and do it again. A big reason for all the frenetic market activity is all that borrowed money. All of this works until there is a serious market correction and suddenly the bottom will drop out. The other issue is that low interest rates make it hard for small banks to make money from deposits and that has forced banks into much riskier strategies.

The point is that interest rates and access to capital are not the problem as far as growth is concerned. It is not even clear that dramatic spending by the government would really accomplish all that much. Then challenge now is that additional spending and deep tax cuts will add significantly to already very serious debt and deficit issues and that limits the gains that might have been made. The primary issue that has inhibited growth has been the uncertainty over global trade and global growth. The global business community is trying to adjust to this new trade reality but the changes have been halting and unpredictable. The fact is that China is the number two economy in the world and developed into a major engine of global growth. That they have slowed to levels not seen in over 25 years means they are no longer providing the boost they once did. Add in a dramatically slower Europe and a slowing US economy and a downturn is imminent – one that lower interest rates will have little impact on.

Aid to Farmers – Too Little and Too Late?

The farm sector has been slammed this year and from a number of directions. The trade war with China resulted in the imposition of import tariffs by China that reached $60 billion. That would have been a hammer blow all on its own but then there were the massive spring floods that prohibited farmers from planting. The response from the USDA has been to allocate $16 billion in aid to the affected farmers.

Analysis: When the loss from trade is $60 billion and the weather-related losses are estimated at twice this number it is hard to see that $16 billion in aid will accomplish much. The majority of this assistance is likely to go to the largest operations given the steps that will have to be taken to get access to that aid. The farm community has been upset with the trade restrictions faced all over the world and there has long been concern that the US does very little to protect that market. It is not only hard to sell into China now but it remains hard to sell to Europe or Japan or dozens of other states that protect their own domestic agricultural producers. These restrictions can be handled by US farmers in most years but when there are other challenges the capacity to react is reduced.

Will Brexit Provoke Another UK Election?

The statements from Boris Johnson have been about what was expected. There has been bombastic assertion that he will break the deadlock on the issue and that the UK will exit from the EU by the October 31 deadline regardless. The problem is that nothing substantial has changed as far as the issue is concerned. Johnson asserted that the Europeans “must” return to the negotiating table and within hours the European response was an emphatic – NO. There is absolutely no support for a repositioning and Europe seems quite content to watch the UK crash out of the EU with no agreement at all. Johnson still faces opposition within his own party and certainly faces opposition from the Labor Party (although they have plenty of internal divisions of their own). He even has to contend with even more radical positions on Brexit from Nigel Farrage and the Brexit Party (once known as the Republicans).

Analysis: What are the real options that face Johnson? There is the distinct possibility that nothing is accomplished by the time of the deadline. The plan is to get a new deal from the EU and then to push it through Parliament and neither of these actions seem likely at this point. Europe is in no mood to accommodate the bombastic and critical Johnson and those who oppose him in parliament have their eye on the next election and hope they can hang a big failure around his neck. If Johnson can’t budge Europe and can’t work out something that pleases the Euro supporters, he will have little choice but to call for a new election and that is a very high risk move for him. Johnson may have been able to drum up support in the Tory party but his national poll numbers are miserable. The only thing that saves him at this point is that Jeremy Corbyn’s numbers are just as bad if not worse.

The second possibility is that somehow Johnson succeeds in spite of himself. This would be a scenario in which the Europeans agree to open negotiations and then make some key concessions on issues such as Ireland and trade between the EU and UK. The next step would be getting that new plan through the parliament and that would involve winning the support of both those that really want a clean break and those that really want to stay in the EU. The chances of Johnson pulling this off is very slim given his limitations as diplomat. It is far more likely that he angers all the people he needs support from. If this scenario comes to pass there will be a desire to call an election so that the Tories can reap some rewards and exploit the weakness of the opposition.

The most likely situation at this juncture is a snap election that throws the Brexit issue back to the public albeit indirectly as they will not be engaged in a referendum but in voting for either a Labor alternative or a Tory one. The looming danger from a new election is unleashing some very ugly politics. The debate in parliament over Brexit has become an economic issue primarily but that is not how the issue has been framed in the public eye. To the majority of pro-Brexit voters this is still about immigration and cultural threats. It will very quickly descend into nationalistic rhetoric and racism and that will further polarize the politics of the day. The election will devolve into a contest between populist right and populist left and the vast middle of the electorate will be facing very unappealing options.

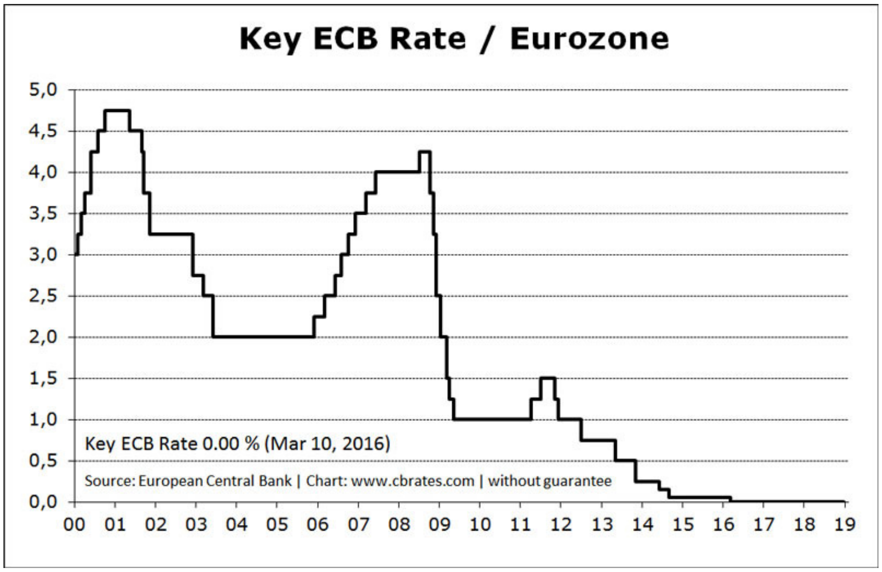
Spain Faces Another Election

The talks between the Socialists and Podemos have broken down again and Prime Minister Pedro Sanchez has been unable to form a working majority in parliament. This will mean that Spanish voters will be facing another election. It is unclear that voters would provide results that differ appreciably from what exists now. The Podemos demands have been steep – they want a number of very prominent positions in the government – far in excess of what their parliamentary numbers justify. Sanchez and the Socialists are refusing to cede that kind of power. The betting by Podemos is that Sanchez will buckle rather than risk losing seats in the election but polls suggest that more people back his position than not. The public does not seem ready to return to the center-right and many now see Podemos as less of a populist standard bearer and more as grasping politicians.

Analysis: The Spanish economy has been performing far better than had been expected and all this turmoil threatens to derail that progress. On the other hand, there are many in the business community that have been pointing to the policies outlined by the Socialists as major inhibitors as far as future growth is concerned. The fear is that Sanchez will agree to some of the more radical positions taken by Podemos to win their support without putting their leaders into those prominent roles. There are already plans for a higher minimum wage, higher taxes and expanded social programs. Podemos has asserted that taxes on corporations can be hiked dramatically and they have no fear of additional debt and deficit.

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 ECB rates have obviously been a lot higher in previous years and there are still those that lament the fact that rates were allowed to fall as low as they have been in the last few years. The previous bottom was seen as around 2.0% but the persistent slow growth that has marked the Eurozone seemed to justify the rates as low as essentially zero. Now that the ECB is talking about a rate cut there are questions regarding how – they are already at rock bottom. This is the reason that negative rates are now under discussion despite the risks implied in such a radical shift in central bank thinking.

Speaking this Month

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
09/17/19	Louisville	Kentucky Society of CPAs	Public
09/18/19	Springfield (Mo)	Institute of Management Accountants	Public
09/18/19	Chicago	Forging Industry Association	Private
09/19/19	Atlanta	National Association for Credit Management	Private

Humor Breaks

There is a great deal to be outraged and angry about these days. I find myself reacting almost every day to some new outrage and it can be mentally exhausting. This has made every opportunity to laugh all the more precious. Much of that laughter is generated by members of my own household – especially with the arrival of a new kitten. This one has been a real clown. But there are other sources available with the growth of YouTube. What interests me is the kind of thing that evokes laughter. I find some things utterly hysterical and other attempts fall flat or are actually pretty annoying.

My favorite stuff tends to be that which focuses on the absurdity of the everyday. The guy describing his life complete with the weird reactions of one's relatives. The observant person watching these crazy vignettes playing out in front of him every day. The self-deprecating observations. I can relate to these stories. My friend related his experience of combing his long-haired cat shortly after having repaired something with super glue. I leave that one to your imagination. The humor that leaves me unamused is that which insults and hurts and comes at someone's expense. When I need a guaranteed laugh, I have my reliable sources – Pink Panther movies, Victor Borge, Tim Conway and Steve Martin and Johnny Carson. Just mentioning them gets me to smile.

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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