BUSINESS INTELLIGENCE BRIEF

August 23, 2019

KC CHAMBER

NATIONAL AND INTERNATIONAL NEWS AFFECTING LOCAL BUSINESS

Short Items of Interest – US Economy

- **China Retaliates –** As expected the Chinese have reacted to the US tariff threats and have imposed their own tariffs on another $75 billion worth of US goods. The US has indicated that it will impose tariffs on $300 billion worth of Chinese imports into the US. The announced tariff imposed by the US was almost immediately tempered by a decision to delay some of these until after the Christmas season but many of the restrictions remained in place. The Chinese tariffs will hit mostly the auto sector this time around as they had already hit the US farm sector with their refusal to buy any more of the US output. The most affected part of the auto sector will be the aftermarket but these restrictions will hurt the big US carmakers that have invested in China.

- **Tax Cuts? –** It has been hard to keep up with the changes in tax strategy. One minute there is talk of cutting payroll taxes as Obama did and the next minute the idea is shelved. The latest word comes from Larry Kudlow and it provides just a little clarity. It appears that any tax cut would be delayed until next year and Kudlow suggested that it would come during the campaign (of course it would). The caveat at the moment is that no tax cut would occur unless the economy showed real signs of slowing and it has also been suggested that this cut would be aimed at the middle class and small business. The case for a tax cut right now is pretty weak but if there are a couple of quarters of struggle it would be easier to justify. The problem is that providing that cut would be an admission that the economy was in trouble and that goes counter to the current Trump narrative.

- **Traffic Congestion as Economic Indicator –** One can now add another odd measure of how well the economy is doing – the length of the commute. The fact is that with high levels of employment comes a high level of people on the road getting to and from work. The average length of a commute in the US has increased by twelve minutes a day and that is now attributed to people living further from their place of employment. This is congestion – pure and simple. There are simply many more cars on the road and there are also more trucks as there has been more freight activity. Add in the fact that infrastructure has been neglected for years and there is a real problem.

Short Items of Interest – Global Economy

- **No Give on Irish Backstop –** There were assertions in the British press that Angela Merkel was willing to renegotiate the Brexit deal with the UK and reconsider the Irish backstop but the German Chancellor has emphatically denied it. The EU is demanding a customs union with Northern Ireland so as to avoid a hard border but the Brexiters assert that this ties the UK to the EU and would rather risk the hard border and the potential for a resumption of the conflict over the status of Northern Ireland.

- **Macron Rescues G-7 Meeting –** The reaction of the G-7 nations to the latest series of Trump assertions threatened to turn the meeting into a gripe session until the French President cut through the fog with a series of assertions. The first is that the world needs to get on with it as Trump has become nothing more than a distraction. There will be no help from the US and that is ok – Europe can do without the US and UK and it is time they did. How this plays out in the meeting will be interesting but patience with Trump has been exhausted.

- **Global Recycling Crisis –** It all sounded like such a good idea and a simple one. All the world had to do was collect the stuff it was going to throw away so that it could be reused. To make it even simpler the US consumer was allowed to toss it all in one bin and count on somebody else to sort it. That somebody else was China and they no longer want to do this. The US recycler is pretty lazy it turns out and can't follow instructions so almost 40% of what shows up at a recycling center is useless. The programs are now all losing money and may be abandoned.

Watching the Central Banks

Watching every shoulder shrug and gesture and parsing every word uttered by a central bank official has been a thing for a good long while but rarely to the extent it has become of late. The power of the central bank has been significant for decades and there has long been some degree of tension between these arbiters of monetary policy and the politicians that control the fiscal side of things but that tension has been accelerated of late due to some of the major policy decisions that have been made and by the threats to continued global growth. Today and tomorrow the central bankers of the world meet at their annual retreat in Jackson Hole, Wyoming. There is not a general feeling of panic but nearly all in attendance are feeling beleaguered to one degree or another.

Analysis: The financial world will be listening intently to these speeches as they seek to get some clue regarding what they are thinking about and considering as far as policy moves. The fact of the matter is the economy as a whole is sending mixed messages and the politicians are more confused than usual. One issue that will be often remarked upon, but probably in private meetings, is the continued frustration with the political leaders who seem to have abandoned their duties while at the same time criticized the bankers for not doing something to address the mess made by these same politicians.

The central banks have a dual mandate and under the best of conditions this can be a tough balancing act. They seek to keep the economy from getting caught up in an inflation spiral and that is really what they are best equipped to accomplish. They can hike interest rates, reduce the rates banks are paid for their deposits, adjust the reserve ratio, sell bonds and engage in any number of other tactics designed to put constraints on the money supply – strangling the growth of inflation. At the same time the central bank is supposed to be encouraging growth and full employment so they do not want to do excessive strangling. If rates are too low the risk of inflation goes up and rates that are too high will encourage the development of a recession. In an ideal world the central bank can focus most of its attention on the control of inflation and leave the stimulating to the fiscal authorities. Over the last few years it has been the legislatures and the executives that have consistently dropped the ball. The tax cuts and spending hikes have come too late and have been too small or ill-targeted and the central banks have been harshly attacked for not doing enough to compensate for the failure of the fiscal authorities.

As the central bankers gaze up at those lovely mountain views the conversations will center on whether the threat to the global economy is imminent recession or the eventual emergence of inflation. The central bankers do not divide neatly into categories of hawk and dove but there are clear leanings. In the last meeting of the Fed's Open Market Committee there were dissenters who opposed the quarter point reduction in the Fed Funds Rate. Esther George (Kansas City) and Eric Rosengren (Boston) both asserted the US economy was not in need of this stimulus and they were joined in that assertion by Patrick Harker of the Philadelphia Fed. It is not that they see an imminent threat from inflation but they do not see enough of a slowdown to warrant rate cuts and they remain concerned that low rates have been damaging small banks and has led to reckless behavior by investors and corporations. The fact is that corporate debt is near an all-time high as many corporate strategies have involved borrowing cheap money so that they can buy back stock and thrill their investors. That debt will become a major issue if there is a recession and their revenue starts to falter.

The other central bankers have other issues. Germany is arguably in a recession already and is expected to sink deeper into it through next year. The German government is only now starting to talk about a fiscal stimulus. Japan's central bank continues to struggle with the chronic deflation that plagues the Japanese. The Bank of England has been trying to sound the alarm on the issue of Brexit but has not been able to get through to the Brexiters and Boris Johnson. The Reserve Bank of India is under intense political pressure and so are the central banks in Mexico and Brazil as the populist leaders of these countries are demanding the banks turn on the spigot and risk a surge in inflation – something both of these nations have very bitter experience with.

Uncomfortable Reports from the Purchasing Managers' Indices

The flash version of Markit's PMI report was released yesterday and the news isn't very encouraging. The flash version is based on 80% of the final report and by the time the final report is released (in about a week) there may be some minor change but the overall direction will be in line with what was released yesterday.

Analysis: The US manufacturing sector slipped to the worst level since 2009. The index fell below the 50-line and registered 49.9 as opposed to the 50.5 that had been expected. The major factors in that decline were a very sharp drop in export activity and a dramatic slowdown in new order activity. The US has seen the trade war slam its exports and as business gets more uneasy about the future it slows down new activity such as hiring or buying new machinery.

There were some slightly better readings in the Eurozone but this was all due to some residual strength in the service sector as the manufacturing data continued to fall. The data from the Chinese PMI also fell and there were declines throughout the world. The signal is clear enough – business is getting cautious and has started to worry about the advancing possibility of a global recession. This tends to become something of a self-fulfilling prophecy as this caution brings about the very slowdown that everybody is worried about. The ISM index will be released at the start of September and all eyes will be on it to see if it also shows that data has sunk into contraction territory.

Amazon Crisis Builds

The fires that are raging in the Amazon jungle are the worst that Brazil has ever seen. There have been a reported 74,000 fires and that is up 84% from the number last year. The destruction has been horrendous and the damage has implications for the entire world. This region has been referred to as the "lungs of the world" as it produces over 20% of the oxygen for the planet and is the single largest collector of carbon leached from the atmosphere. The threat from greenhouse gas pollution is amplified by these fires as they not only destroy the forest and its ability to be a carbon sink but the fires themselves are belching more carbon and other pollutants on a daily basis than all the vehicles on the road in the US in a week. The reaction of the Brazilian government has been utterly bizarre.

Analysis: There has been almost no attempt to control the blazes and the Bolsonaro regime has even refused assistance from other nations. The fact is that Bolsonaro favors the expansion of these fires as this has been the way that tracts of the Amazon have been cleared for years. The farmers move into the land that has been burned to plant crops. The problem is that jungle soil is very poor and these farms are only productive for a year or two and then the operation has to move on. They leave behind land that has the consistency of concrete and is good for absolutely nothing. The jungle does not return and it can't be used for growing crops either.

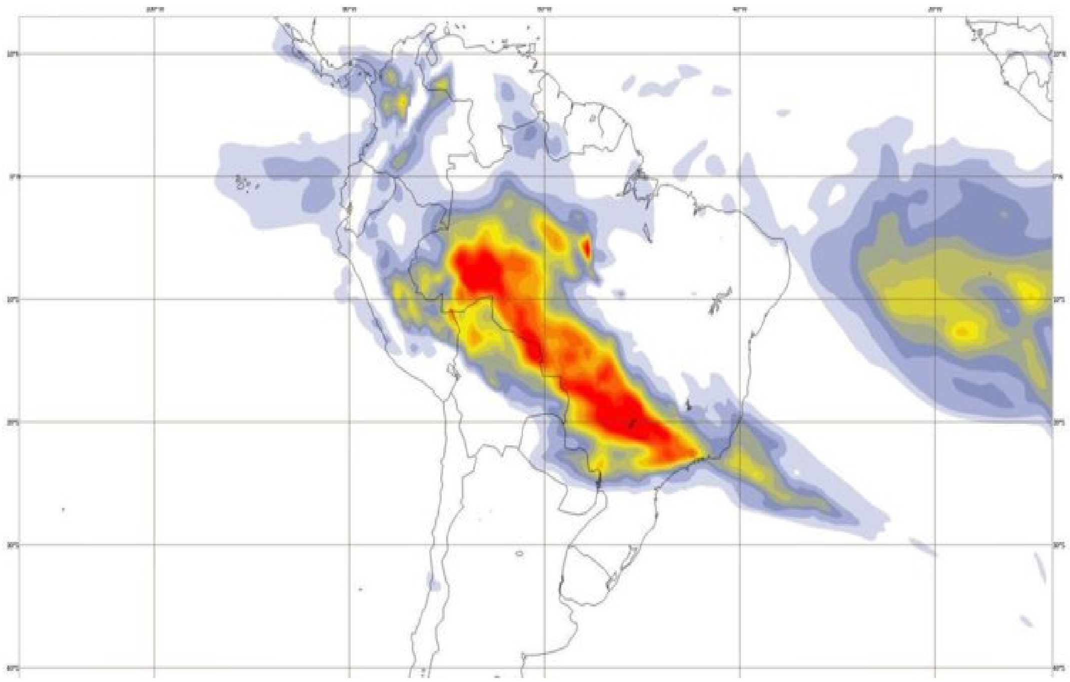
Bolsonaro has made one ridiculous claim after another. He has asserted the fires are being deliberately set by environmentalists to make him look bad and he has also asserted that it is the work of rival nations. He has denied the fires exist and has asserted the satellite pictures are fake and from a Hollywood movie. These statements and the total inaction have infuriated the European leaders and this is likely to affect the future of the trade agreement that was signed between the EU and Mercosur. The deal has been developing for years and would be one of the biggest arranged by Latin nations in decades. The pact's full members are Brazil, Argentina, Uruguay and Paraguay. Venezuela is a full member but was suspended in 2016. Associate members include Bolivia, Chile, Colombia, Ecuador, Guyana, Peru and Suriname. The nation that stands to gain the most from this agreement is Brazil as it opens a whole host of market opportunities in the EU.

The Europeans are now threatening to back away from the deal in protest. The Irish and the French have already indicated this is what they wish to do and if they get a majority of the EU members to follow suit the pact will be negated. This seemed a fairly extreme reaction a few weeks ago but the actions of Bolsonaro have appalled the EU and so have his assertions that they are acting like colonial powers. His pattern of insults and attacks are not going over very well as the EU members are well aware that this agreement is better for the Mercosur nations than for them. There was concern that backing away from the deal would hurt Argentina and damage the prospects for Mauricio Macri's reelection but the emergence of the old Peronists in Argentina's primary has made it easier for the EU to walk away from the whole deal.

Creation of European Futures Fund

The Europeans are worried about the global dominance of the US and China when it comes to tech and tech related industries. The region has tried to fight the likes of Google, Apple, Alibaba and Huawei in court and through regulation but with very mixed results. The new strategy is to essentially take them on as business competition. The idea is to create a 100-billion-euro sovereign wealth fund that would be used to compete against these companies. European firms would have access to this money to undertake the massive expansion required to compete.

Analysis: The primary target is China although the US companies are of concern as well. The sense is that China heavily subsidizes the industrial giants that are dominating these sectors so Europe wants to fight fire with fire. The bulk of this money would go to France and Germany as these are the nations that have the industries that could compete. The challenge for those that want to create this fund is the smaller nations will get very little benefit from a fund that is going to be used by the two biggest nations and yet they will be contributing to the fund. There is also the fact that channeling money to a project does not guarantee success. The rivals that Europe will be going up against are well entrenched already and have deep pockets that will allow them to compensate for any move the German and French companies make. The EU will continue to attack these rivals through regulation and the courts so the fund will be one of many tools.



If there was any doubt as to the seriousness of the Amazon fire crisis this map should end the debate. This fire is threatening almost the entire Amazon and has the potential to destroy it completely. It will take decades to recover from the damage already sustained. The impact on climate change is brutal – accelerating the worst predictions of rising temperatures by decades. The impact that had been anticipated in thirty years is now expected in less than ten.

Speaking this Month

08/27/19	Atlanta	Steel Market Update	Public
09/11/19	Wisconsin Dells	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	Chicago	OMNIA	Public
09/20/19	Atlanta	National Association for Credit Management	Private
09/23/19	Louisville	Kentucky Society of CPAs	Public
09/24/19	Fargo	North Dakota Society of CPAs	Public
09/25/19	St. Louis	Missouri Society of CPAs	Public

Long Drives

This week featured a couple of four-hour treks as I journeyed to Tulsa from Kansas City to address the Institute of Management Accountants. Both routes were at least partially on two lane roads and this experience is far different from the pure Interstate version. When on those big four lane highways the world is distant and irrelevant – accessible only if one decides to take an exit. The two-lane drive puts one in closer proximity as it involves passing through small towns and the occasional suburb. The houses and farms are right there as one drives by and if one is so inclined there are places to stop that involve things like vegetable stands or curious little historical markers and museums. This trip passed through a town that aggressively promotes its position on Route 66 as well as a town devoted to its Indian casino.

There were homes that were as neat and orderly as one would find in a HGTV special and those that one would assume were abandoned except for the clothes on the line. The farms were lush and getting worked hard. Lots of cows and horses and the occasional collection of sheep and goats. The appearance of a bunch of camels and a small herd of bison was not expected. People's politics were on full display as well – Trump signs in one yard and Bernie signs across the street. A confederate flag waving next to the US flag and two miles down the road there was a rainbow flag next to another American flag. Lots of stuff for sale in the yards – a collection of antique tractors in one town and dozens of used lawn tractors in another. There were lots of cars and trucks beckoning new owners along with motorcycles, RVs, boats and what looked like an entire set of carnival equipment (Ferris wheel, tilting saucers, roller coaster and more).

All in all, a much more interesting trek than would be had on the main drag – even if one does get stuck behind a fair number of farm trucks hauling hay and animals and what looked like an alien spacecraft.

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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