BUSINESS INTELLIGENCE BRIEF

May 29, 2020

NATIONAL AND INTERNATIONAL NEWS AFFECTING LOCAL BUSINESS

Short Items of Interest – US Economy

- **Herd Immunity –** As the limitations of the mass quarantine become more and more obvious there has been a great deal of discussion around the concept of herd immunity. Simply stated this is when a significant percentage of a population has contracted an infectious disease and have acquired a certain level of immunity. The virus stops spreading as there are fewer people transmitting it. The effort to quarantine the entire world was never intended to do more than slow the spread to the point that hospitals could keep pace. To get to herd immunity levels requires the infection of around 70% of the population and even the hardest hit communities are at perhaps 30% at this point. Given that 98% of those infected will have a mild version a herd immunity level of disease will mean that around 6 million people would get a version that requires hospitalization (based on 2% of the 70% of the US population required for herd immunity).

- **Will April Be the Worst Month? –** The expectation is that April numbers will be absolutely miserable across the board. Retail activity utterly collapsed and for the most obvious of reasons. The mandated shutdown of business meant that consumers were not able to spend on anything – even if they wanted to. Now that there has been a certain level of cautious reopening the consumer looks to be engaged to some degree. It is not yet clear to what extent as there are still many restrictions and consumers are still wary. Anecdotally it appears that Boomers are spending more consistently than either Gen-X or millennials. They are still the generation that buys things while the other two are more service and experience buyers and these sectors of the economy have not been opening as readily as the others.

- **Inflation Threat? –** Once again there has been a move by some investors to start hedging against an explosion of inflation. The logic is that all the stimulus money that has been pouring into the system will result in higher prices and debased currency value. This fear prompted a similar flight to gold and other hedges at the time of the 2008 recession. The inflation surge did not take place as expected in 2008-2009 and will likely not manifest this time either. The drivers of inflation have been wage hikes, commodity price hikes and floods of money into the hands of the consumer. There is no wage hike on the horizon with 40 million people out of work, oil prices are lingering at $30 a barrel and the stimulus money has barely made a dent in terms of consumer income.

Short Items of Interest – Global Economy

- **Global Employment Crisis for New Graduates –** The 2008-2009 recession created a “lost generation” of young workers and this recession threatens to be much worse. There are very few entry level opportunities in an environment where tens of millions of people are losing their jobs but more importantly for the new graduate is the move towards working from home. That is an option for the person that knows their job and the people they work for and with. It is not an option for the untrained and unfamiliar new employee. The business community has been slashing internships and refusing to hire new people. This lack of opportunity will mark this generation for the rest of their working lives.

- **UK Death Rate is Highest in Europe –** Since the outbreak in Europe the numbers of deaths have varied dramatically from nation to nation. For weeks, the rates in Spain and Italy have been the highest in the EU (Spain at 580 per million, Italy at 548). The UK has now suggested its death rate is 891 per million as they are trying to count indirect fatalities. Spain has been attempting to do the same and under that system their rate is 921. The challenge with these fatality rates is that it is hard to identify precisely what role the virus has in a patient death. The virus weakens people that are already weak from underlying issues and from age related maladies. Would they have died without exposure to COVID 19? That is nearly impossible to determine.

Surprisingly Upbeat Data from Credit Managers' Index

There is a temptation to look at this month's data and start cheering wildly but it would probably be a good idea to show some restraint – at least for the time being. After a catastrophic month in April there are signs of a recovery showing up in May. As usual, there are plenty of caveats but it is important to remember that the CMI is very often a harbinger of things to come due to the nature of credit management. The focus of a credit manager is always on the future – trying to gauge the likelihood of getting paid 30,60,90,120 days from now. The data this month would suggest that many are seeing a better future ahead and it may be possible to assert that April will be the bottom of this crisis and conditions should improve from this point.

Over the last few months, the majority of the damage has been seen in the favorable factors as the lockdown recession took its toll. It was impossible for the majority of the business community to function at any level under these conditions but now there appears to be a slow and halting movement to allow the recovery of the economy and this appears to be resonating with the data in this month's CMI.

The combined score for the CMI is still thoroughly mired in contraction territory with a reading of 44.1 but last month it sat at 40.6. The index of favorable factors had plunged to levels not seen since the recession of 2008 – sitting at 32.0. The data this month shows a gain to 39.5. That is still very, very low and no reason to celebrate but it is heading in the right direction. The index of unfavorable factors gained a little as well – moving from 46.3 to 47.2. Obviously, this remains in contraction territory but it is significant that the negatives have not worsened and may in fact be improving.

Last month the sub-categories told a very bleak story. These numbers were as low as they have been in the history of the CMI. The improvement this month still leaves the data in contraction territory but there was considerable concern that these numbers would get even worse before starting to rebound. The sales numbers fell like a rock the last couple of months – from 64.0 in February to 39.5 in March and a crushing 20.0 in April. This month's gain is significant but still leaves the index near historical lows with a reading of 28.6. The new credit applications number rose to 43.3 from 31.1 and that is a very good sign that companies are starting to prepare for the rebound that was promised this summer. The dollar collections data also seemed to leave the thirties behind with a reading of 43.2 as opposed to the 35.5 notched the month prior. The amount of credit extended stayed roughly the same as it had the month before as it moved from 41.6 to 42.8. It is not a huge move but it is a move in the preferred direction.

The unfavorable factors have not been as miserable as the favorables as there has not been enough time for these issues to start kicking in. This was the month when there was an expectation of more angst in these numbers but so far, the data is holding more or less steady. The rejections of credit applications fell just slightly from a reading of 52.7 to 51.9 but the important consideration is that it remains out of contraction territory. There was an improvement in accounts placed for collection as it moved from 47.4 to 49.1. This has been one of the crucial markers as far as the index is concerned. Collections will start as creditors are unable to meet their obligations but thus far there has not been time for these issues to develop given that the crisis is roughly two months old. The disputes category improved a little as it climbed from 50.8 to 51.5. There has also been a slight rebound in the dollar amount beyond terms reading. As business was locked down, the majority became very guarded as far as cash flow was concerned. This led to a huge surge in slow pays and a reading of 27.6. The latest number is still deep in contraction territory at 32.4 but it is an improvement, nonetheless. The dollar amount of customer deductions climbed out of contraction territory by moving from 49.4 to 50.9. The filings for bankruptcies numbers started to fall however and that is a concern. The number in April was 50.2 and now it is sitting at 47.3. This is the first time the bankruptcy numbers have been below 50 in several years. This is a sign that already weak companies are succumbing to the lockdown recession.

Manufacturing Sector - The numbers this month are certainly not great but they are better than they were the month before and right now we will take any bit of good news on offer. The wholesale collapse in the favorable factors seems to have slowed although the readings are still very firmly in contraction territory. There was not a great deal of change as far as the unfavorable categories are concerned. The overall readings showed that the decline has started to slow and reverse – if only by a very narrow margin. The index was at 42.0 last month and is now all the way up to 44.2. Not the most inspiring level but hopefully the beginning of a trend that would extend over the next few months.

Last month the damage in the favorable categories was considerable and it drug the entire index down to levels not seen in several years. The data this month still shows the damage but there has been some slightly more encouraging news as the numbers went from 34.3 to 38.6. Whatever optimism this generates is tempered by the knowledge these readings were at 62.0 in February and had not been below 56 in over a year. The shift in the unfavorable factors was far less dramatic as it went from 47.2 to 47.8. but at least it is hovering close to the expansion zone. The details within the categories tell the story.

The sales data stayed in the 20s although there has been a slight improvement from 21.4 to 27.5. That remains a very long way from the readings as recently as February when it hit 65.7. There has been a complete crash in the sales of manufactured goods. The biggest gain came with the category of new credit applications as this went from 35.7 to 43.2. This is still a very low reading but far better than had been seen earlier. The dollar collections data also jumped back into the 40s with a reading of 40.5 as compared the 35.0 notched the month before. The amount of credit extended data slipped a bit from 45.1 to 43.0 and that is not such a good development. It suggests that those that are seeking and getting credit have been slowing down.

Credit Managers' Index Continued

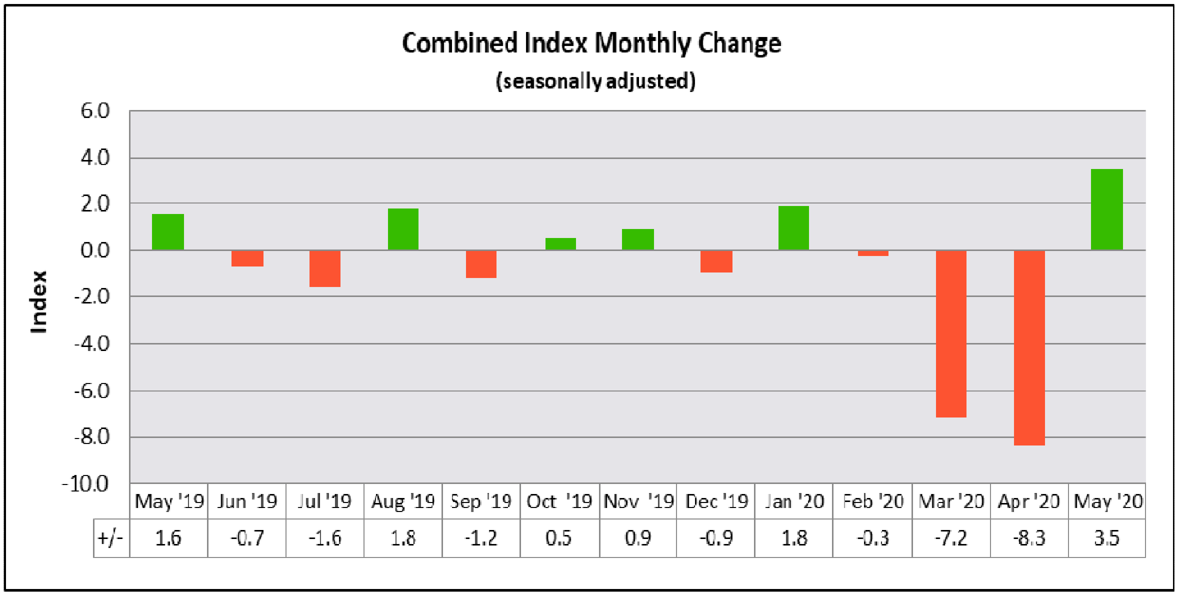
The data from the unfavorable categories has not changed as much. The rejections of credit applications improved a little and stayed in positive territory with a reading of 53.3 as compared to 52.8 the month prior. This would suggest that most of those that apply for credit are having some success. There has been stability as far as accounts placed for collection as the reading this month was 50.4 and last month it was at 50.0. There has not been enough time for many companies to get to the point that collection is an option but that could well develop in the next few months if there is a slow economic rebound. The disputes category saw an improvement from 50.6 to 51.6 and there was even some recovery as far dollar amount beyond terms. The reading is still bad but has climbed out of the 20s by notching a 31.9 as compared to the previous month at 28.6. The dollar amount of customer deductions remained very similar to what it had been – going from 50.1 to 50.5. The filings for bankruptcies slipped a bit from 51.1 to 49.3 and this is a concern. There had not been time for the bankruptcy issue to develop in previous readings but it is now clear that companies that were already weak are starting to get in some real trouble. This is a category that will require a lot of attention in the weeks and months to come.

Service Sector - Obviously there has been a near universal economic impact from the lockdown recession but there have been sectors that have been hit much harder than others and these will be the same sectors that will see the slowest pace of recovery. The service sector has the most challenges as far as maintaining the strict rules around social distancing and isolation as these are sectors that depend on interaction. The economy will be very sensitive to the pace of service sector recovery as the consumer spends close to 65% of discretionary income on services. The overall reading for services improved a little from 39.2 to 44.1, getting back to what it was in March. The index of favorable factors made a major leap closer to respectability with a reading of 40.4 after one of 29.8 in April. The change in the unfavorable category was not as dramatic but was also in the right direction as it went from 45.5 to 46.5.

The changes in the sub-categories have been dramatic. The sales numbers had hit levels that were truly catastrophic in April as the shutdown orders essentially closed 80% of all retailers and service outlets. The reading of 18.6 was unheard of in the history of the CMI. The numbers now are still quite awful but at least they are up drastically from April at 29.7. The new credit applications numbers jumped dramatically as well as this month the data showed a 43.5 as compared to the 26.5 last month. The dollar collections number also went up from 36.1 to 45.8 and that is a good sign as far as recovery is concerned. It would indicate that companies were both able to pay their creditors and that they were willing to. In the prior month, the desire to hoard cash was overwhelming the desire to stay current on their credit. The amount of credit extended shifted out of the 30s as well – going from 38.1 to 42.7. The fact is none of the favorable categories are in expansion territory and in January and February all of them were in the 60s and high 50s. It will be a while before these numbers recover but at least the worst seems to be over.

The rejections of credit applications slipped a little from 52.6 to 50.6 and this might actually be good news. It suggests that some are applying for credit that might not have in the recent past and that shows there is some newfound levels of confidence starting to appear. The accounts placed for collection slipped a bit as the reading went from 44.8 to 47.9. There has been time enough for companies to start to get in trouble as far as staying current. The disputes reading was a bit better with a 51.3 after the 50.9 last month. The dollar amount beyond terms has been a problem over the last few months and it is still in miserable territory. It is not as bad as it has been as it went from 26.6 to 33.0. The dollar amount of customer deductions jumped out of the contraction zone with a reading of 51.2 as compared to the 48.7 in April. The filings for bankruptcies stayed close to what it had been with a reading of 45.3 as compared to the 49.3 in April. The fact is that many retailers and others in the service sector were struggling even before the shutdown and this recession put them over the edge.

The service sector of the economy was the first to be hit and was arguably the hardest hit. It will also be the first sector to open back up and show growth. This will be a crucial time as the pressure will be intense. This is the sector that will expose more people to the virus, that is inevitable. If the number of cases remains within acceptable limits and fatalities are manageable, the economy will continue to open but a surge of infection and deaths will prompt talk of another shutdown and it is doubtful that many companies would survive round two of a lockdown.



For those that like their good news presented in graphs rather than in print we present the combined index from the Credit Managers' Index. We don't want to make a huge deal out of these numbers as they are still in the contraction zone but the fact is that credit managers tend to think in the future as they are mostly concerned about what the debtors will be like in 60,90, 120 etc. days – when they are due to pay. This improvement in the data indicates they are seeing some recovery down the road and not all that far away.

Speaking

We have been listing the upcoming speaking engagements as there have been readers interested in the opportunity to attend some of these events. Thus far there have been eleven presentations canceled or postponed until later this summer and into the fall. It is impossible to say which of the remaining meetings will take place but it would be a good bet to assume that all will be canceled in the coming days. There seems little point in listing these until there is some assurance they will not be cancelled.

Webinars and video conferencing have emerged as the replacement for these talks – at least for the time being. This may be something your organization or company would like to consider. I am more than willing – contact me at chris.kuehl@armadaci.com

Enabling a Crisis

Change can be dramatic and it can just as often be very subtle. In some ways the viral outbreak has presented the world with both varieties. The sudden and dramatic change that has been visited on the world by the pandemic has been obvious enough – millions of deaths and the ruination of the global economy but there have been more subtle changes that have shaped the way the world has reacted to the outbreak. Even ten years ago the reaction we see now would not have been possible.

From the start the world had few options as it was too late to engage in any other tactic other than quarantine. It was too late to test and too late to track. There was no treatment and no vaccine. That left only an attempt to isolate. The working world was shattered by the demand but millions were able to work from home due to the existence of the Internet. A vast network of delivery options allowed people to obtain what they needed and the Zoom call replaced meetings. We have never been better positioned to be totally cut off from one another.

Another subtle change has been taking place over the years and this has created a larger population of vulnerable people. The virus hits the elderly and those with underlying health issues hard and the fact is the world has many more people in that category than ever before. An aging population is a sign that society has the ability to extend people's lives but that extension comes with a demand for more spending on health care and the existence of a larger number of people who will be vulnerable to disease.

All of this change means we are always facing a "new normal". There is never an option to go backwards. The fact that we are learning to be isolated from one another will change society permanently. We don't yet know how we will change but in the past, we have been social beings that depend on one another. That dependence and interaction has been eroded. Will that make us more independent or will it damage our ability to interact with others? Will we embrace autonomy or suffer from isolation?

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