BUSINESS INTELLIGENCE BRIEF

May 28, 2021

NATIONAL AND INTERNATIONAL NEWS AFFECTING LOCAL BUSINESS

Short Items of Interest – US Economy

- **So Far Consumers are Driving Recovery –** There are few groups harder to predict than consumers. The word fickle has to be applied to this group in almost any situation and that always vexes those that are trying to get a read on the economy as a whole. As the lockdowns have eased and the threat of the pandemic starts to fade, there was an expectation as far as consumer behavior was concerned but there are never guarantees. Thus far the consumer is reacting as they were expected to. Spending has rebounded in those service categories such as food service, travel and tourism. At the same time the spending on goods has remained fairly steady as well. Inflation has not yet dulled demand as it is expected to. As long as people have the money, they seem willing to spend it and that continues to drive recovery. The question now is how long this situation lasts.

- **Mixed Assessments from Intelligence Community –** The two prevailing theories regarding the emergence of Covid-19 have split the global intelligence community. One set of analysis suggests this was a naturally occurring phenomena – a virus that jumped from animals to humans as has been the case with hundreds of other viral infections. The other theory is that the virus was developed in a Chinese lab and somehow escaped. China claims the virus was created by the US military and deployed in Wuhan. The real issue here is that China has made it impossible to know. Any attempt to investigate has been thwarted. Outside investigators have been banned and those in China that have been seeking answers have been imprisoned. This kind of obfuscation has only fueled the conspiracy theorists and makes dealing with this outbreak and others in the future extremely difficult.

- **Tariff Battle Gets Serious –** The US steel sector had been getting slammed for many decades. The production of steel in the rest of the world had exploded and many of these nations had deliberately subsidized that output. The US was awash with imported steel and domestic producers were unable to keep pace. The tariffs on that imported steel were designed to address that issue but these also caused the price of steel to go up for manufacturers in the US. Today the steel sector is doing better as there have been higher prices and there has been extensive consolidation. The Europeans want those tariffs removed and have made the first move by reducing tariffs imposed on the US. Will the US follow and reduce steel and aluminum tariffs? Not if the steel sector can stop it.

Short Items of Interest – Global Economy

- **European Labor Crisis –** The good news for the European consumer is that lockdowns are ending all over the EU and people will be able to resume some of their old patterns. The bad news is that there are not enough people willing to go back to work. Service sector establishments have been unable to reopen as they have no staff. Restaurants are still closed or have very limited hours, retailers are not open, tourist attractions remain shut. The workers that are not showing up fall into two broad categories. There are those that are getting enough aid and support to remain out of work and there are those that remain fearful of the virus and are still avoiding exposure.

- **Colonial Coping –** It has been decades since the end of European colonial influence in Africa but the lasting impact is still a subject of intense debate. In the last several months there have been a variety of gestures made by European nations towards nations in Africa. The Germans are promising over a billion dollars to Namibia in compensation for actions during German colonial occupation. France has publicly asserted it played a role in the Rwandan genocide by not acting in time. The reality is that most of the current issues in Africa are down to the governments that have been in power since the 1960s but these nations inherited a host of problems created by the colonial powers – from infrastructure deficits to the scars of exploitation.

Credit Managers – Looking to the Future and Confident

As credit managers are well aware, their interests are often oriented towards the future. It is the nature of the task. As decisions are being made regarding credit and credit terms, the issue is not what the situation is now but rather what it will be in 90 days or 120 days or longer. This is an important point to remember when looking at the Credit Managers' Index. It is really an assessment of what is likely to happen or at least what credit managers think is likely to happen. When the numbers are as consistently good, as they have been the last few months, it is a signal that economic conditions are expected to be positive in the next quarter or two.

This month's data cooled down a little from what it was last month but not by much. These are still very healthy and still firmly in the expansion zone. The combined score for the month went from 60.6 to 59.8 – about where it has been since January. The last time the combined numbers were in contraction territory was in May of 2020. The index of favorable factors also remained quite robust but slightly down from April's readings. The index is at 66.7 and was at 68.2. The index of unfavorable factors also dipped a little but remained firmly in expansion territory with a reading of 55.2 compared to 55.6 the month before. As is usually the case, the interesting material is in the details.

The sales numbers have been beyond robust for months now. The memories of readings as low as 28.6 and 54.1 are fading as these readings have been above 70 for six of the last eight months. The latest reading is at 73.2 and slightly down from April's 74.7. The new credit applications number also remains very high at 64.6 but a bit below the 65.9 notched in April. The dollar collections number slipped a little more than the others as it went from 63.1 to 60.0. This is hardly concerning given that the number remains above 60 but this is a category we watch aggressively, after all "it isn't a sale until we are paid". The amount of credit extended stayed right where it was the month prior with a reading of 69.0.

There was a little more variety in the unfavorable categories. The rejections of credit applications reading actually improved very slightly as it went from 53.0 to 53.1. There was a bigger change in the category of accounts placed for collection as it went from 59.6 to 54.2 but that is a reading similar to what it has been the last few months. The reading for the disputes category improved a little and went from 51.3 to 53.7. There has been a little less controversy over what position companies find themselves in. The dollar amount beyond terms reading slipped back to where it has been in previous months – going from 59.4 to 57.1 and that is where the reading was in March (57.0). The dollar amount of customer deductions stayed very close to last month at 53.6 as compared to 56.0. The filings for bankruptcies improved to the best reading seen in a year. It is now at 59.3 and that is well above the average for the last twelve months. The shake-out in most of the business community seems to have taken place and those companies that were severely weakened by the pandemic have met their fate and left the survivors to seek market share.

Manufacturing Sector - The manufacturing sector is starting to enter an interesting stage. Last year the performance of manufacturing was far better than had been anticipated due to the fact consumers started to shift their emphasis from services to buying goods. The money that was poured into the economy ended up driving everything from appliances to cars and electronics. Now the consumer has an opportunity to return to the service economy and early evidence shows that this is precisely what they are doing. Does this mean a sharp reduction in demand for those goods?

The combined score for manufacturing remains quite strong but a bit weaker than it was in April. It is now back to where it was in March with a reading of 59.2 compared to 61.4. The index of favorable factors also returned to March levels with a reading of 67.1 compared to 68.7 in April. The index of unfavorable factors repeated that same pattern – returning to the 54.0 level seen in March after hitting 56.6 in April. It would seem that April was a bit on an anomaly but the important part is that these numbers are still firmly in expansion territory.

The sales numbers are still very strong although a little off the pace from last month. The current reading is at 71.3 and the previous month they were at 75.6. This is a reading that takes numbers back the levels in February. The new credit applications data stayed almost exactly where it had been – 64.4 this month and 65.4 the month before. Not at the high levels seen in January and February (68.6 and 66.9 respectively) but still very solid readings. The dollar collections data slipped very slightly from 64.7 to 64.4 and there was little movement as far as the amount of credit extended as it went from 68.9 to 68.2. In general, the favorable categories were stable.

The majority of the change was taking place in some of the unfavorable categories. The rejections of credit applications remained very similar with a reading of 53.3 compared to 53.8 in the prior month. One of the big shifts was seen in the accounts placed for collection reading as it went from 65.4 to 54.0. This month's numbers are back to levels seen earlier in the year and that indicates that April numbers were likely an anomaly. The disputes numbers returned to the expansion zone with a reading of 51.2 compared to the 49.6 registered in April. The readings for dollar amount beyond terms also fell from its lofty peak last month – slipping from 61.3 to 55.2. This number combined with the data from the accounts placed for collection suggests there are more issues appearing in the manufacturing sector that have challenged companies. The dollar amount of customer deductions slipped from 52.8 to 51.1 but overall, this reading was reasonably stable. On the brighter side the data for filings for bankruptcies improved by quite a bit as it moved from 56.7 to 58.8. The concern is that these numbers may start to deteriorate if the issues of collection and slow pays continue to develop.

Manufacturing did better than expected during the recession but has now started to feel the impact of the consumer shift back to services. There have also been consistent supply chain issues that have hampered the continued progress of the sector.

Credit Managers and the May Report

Service Sector - There has been a subtle shift in terms of the economic drivers and it has been reflected in the CMI data. The US has been a service sector driven economy for many years and that was interrupted by the pandemic and subsequent lockdown. The opportunity for the sector to resume operations has been reflected in some of the latest readings. The combined score improved to the highest level seen in well over a year with a reading of 60.4 compared to the 59.8 registered last month. The data for the index of favorable factors maintained the momentum set over the last few months with a reading of 66.4 compared to the 67.7 last month. The index of unfavorable factors improved a little and went from 54.5 to 56.4.

The sales numbers returned to the levels noted in March with a reading of 75.2 as compared to the 73.7 in April and 75.1 in March. The new credit applications data slipped but not by much as it registered 64.9 this month and was at 66.4 in April. The dollar collections numbers fell pretty dramatically – from 61.6 to 55.7 and that is similar to the decline noted in manufacturing. There are companies in distress as the rest of the economy starts to rebound. The amount of credit extended remained pretty stable with a reading of 69.8 compared to the 69.1 noted the month prior.

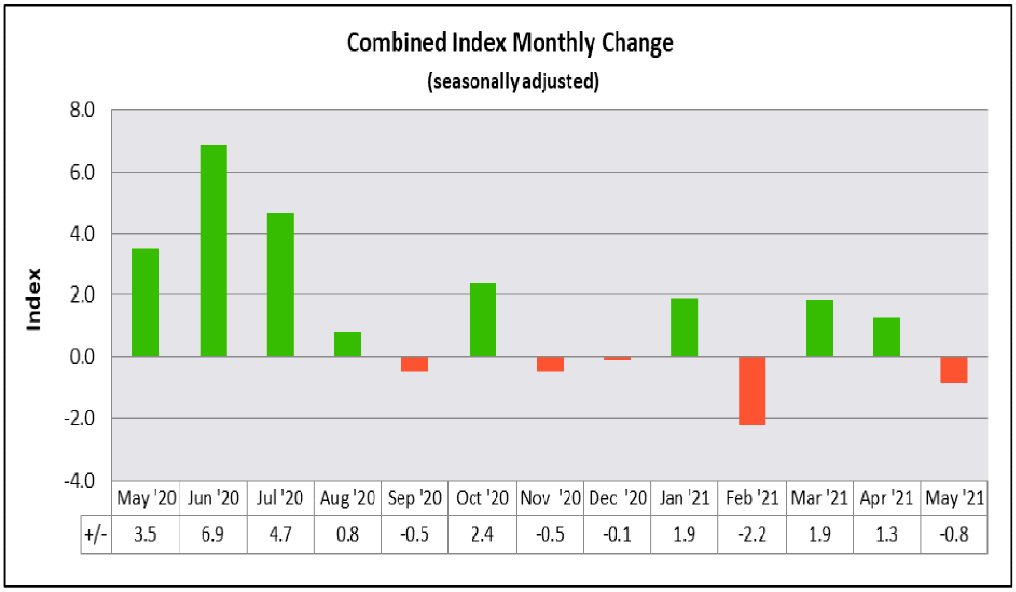
There was a little more volatility in the unfavorable categories. The rejections of credit applications were not one of the volatile sectors as this month the reading was at 52.9 and last month it was at 52.2. The movement in the accounts placed for collection actually improved quite a bit and that contrasts with the decline seen in the manufacturing data. It was at 53.7 and is now at 54.4. The stress in the retail sector has been easing a little as the lockdowns have been relaxed. The disputes category has shown some steady improvement as well – moving from 53.0 to 56.2. There was also improvement in the dollar amount beyond terms as it shifted from 57.5 in April to 58.9 this month. This was a very weak category for manufacturing and a much stronger one for services and that suggests the credit managers are witnessing that shift in consumer emphasis from goods purchasing to services. The dollar amount of customer deductions also registered a gain as it went from 53.1 to 56.1 and there was yet more positive news from the filings for bankruptcies category. It moved from 57.6 to 59.9. The overall sense is that services are strongly rebounding and that has been showing up in the retail sector as well as in hospitality, entertainment and travel.

The Role of Government in the Economy

There is no doubt that government plays a major role in the economy – it always has. On average government spending has taken up between 15% and 20% of the economy and at times that share has been close to 40% during recessions and emergencies. The budget that has been submitted by Biden would boost that share to 25% and would be the highest non-emergency level spend yet. The plans include a lot of traditional government spend on infrastructure and the kind of projects that private sector entities do not take on but it also contains a great deal aimed at social and political goals such addressing inequality, alleviating poverty and pursuing "green" solutions. As with all Presidential budgets, this is a wish list more than a workable plan as the decisions on spending will ultimately be made by Congress and there is little support for the plan as set out. Even many Democrats have reservations about the size of the budget and the taxation that would be required to implement it. There is a lot in this plan that serves a purely political purpose – an opportunity for legislators to vote for or against something and prove to their constituents they are doing as expected.

Analysis: The bigger question is how some of these real issues are to be addressed. Ludwig Von Mises once asserted that the "first job of an economist is to tell governments what they cannot do". It has been assumed that every issue and concern can be handled by government despite the abundant evidence this is not true – even when it comes to the economy. It should be obvious enough that the performance of the economy depends on the decisions of 340+ million people and the hundreds of thousands of businesses that interact with them. The notion that these millions of economic decisions can be micromanaged is a dangerous one. The role of government is basically to set the stage and provide the system. Building the infrastructure required to facilitate society is not something that can be left to the private sector but what people and business do with that infrastructure will be determined by the market. Reacting to societal challenges such as a pandemic, natural catastrophe or climate change will involve government but the decisions of millions of people will have just as big an impact.

Even with the Biden proposal the US would remain well behind the pace set by many other nations. The majority of European governments account for between 35% and 45% of their respective economies and countries such as China can be as high as 65% due to the extent of state-run enterprise.



The chart above shows the path the Credit Manager's Index has been on since the start of the pandemic. We are now a year away from the drastic collapse in March and April of 2020 when the index fell into the contraction zone in a big way. The dramatic recovery noted in May and June reflected the bounce back in the favorable factors and the delay in the manifestation of the unfavorables. The latest data is still very good but it drooped a bit from what was noted in the previous month.

Learning from the Wise

Remember that spate of books from a few years ago? Those “Everything I Need to Know I Learned in Kindergarten/Pre-school/the playground etc.” editions? I have my own version of this education. “Everything I Need to Know I Learned from my Cats”. There appears to be a formula for achieving bliss and it goes as follows.

Number one – sleep at least 20 hours a day. Not necessarily a deep sleep with all those pesky dreams about standing in front of an audience in one’s underwear but a nice period of chilling out and letting the world pass by. Number two – surround oneself with those that give you an opportunity to purr and get belly rubs. The humans in this household will so oblige at every opportunity and the feline five knows it. Number three – keep a schedule for the important stuff. Feeding occurs at set times and they know this down to the minute. It gives structure to the day and reassures them that staff remains attentive to their needs. Number four – maintain a cordial relationship with most but save real friendship for the worthy. Not that I suggest we all hide under the bed when confronted by strangers but we can and should reserve judgement before landing in somebody’s lap. Finally – number five – give of yourself. They clean one another, sleep next to one another, rush to each other’s aid when something is amiss and they extend this attention to us as well. When we are upset or hurt, they are right there offering concern and comfort and often bringing toys. That latter tactic could be employed by us all. The next time a friend or relative is in distress – bring something to play with.

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