

BUSINESS INTELLIGENCE BRIEF

October 26, 2018



NATIONAL AND INTERNATIONAL NEWS AFFECTING LOCAL BUSINESS

Short Items of Interest – US Economy

- **Consumer Sentiment Up but Not as High as Before** – The level of consumer confidence has been elevated all year and this is better than it being lower than usual but given that consumer confidence surveys can be notoriously fickle it is hard to really understand what they are indicating. This month the level of confidence has dipped a bit but not to the point that it is of great concern. The more important factor is likely the reason why the consumer is less enthusiastic. The rate of unemployment remains very low, the economy has continued to grow at over 3.0%, the stock market has been performing (until quite recently). The most worrisome point seems to be overall political leadership. There is little faith in the leaders of the country if they are expected to navigate the challenges of inflation, slow growth or any of the other economic issues that have emerged of late.
- **Underemployment Remains a Huge Issue** – The good news is that unemployment is down and that means that lots of people have jobs. Do they have good jobs or employment that matches with the skill level? That has been a much harder question to answer. The rate of underemployment has been assessed as high as 55% and in certain fields it has been even higher than that. An underemployed person is described as someone who has a job but they are significantly overqualified for it. This is the college graduate working at a job that only demanded a high school diploma. The major problem for business is that this employee is much more likely to leave for another employer as they are well aware they should be commanding a higher salary. It is an even bigger issue for new college graduates than for the general public as there are many students that majored in esoteric subjects that don't translate well into the world of work.
- **Stock Market Continues to Suffer** – The selloff has continued along with some daily recoveries. It isn't exactly a rout but the S&P 500 has been getting awfully close to real contraction territory. There is not one thing that has spooked the global markets – more a general sense that things are not going as expected and that has been pointing to a real recession. Thus far the sense is that most of this damage can be attributed to general nervousness and an expectation that something has to give.

Short Items of Interest – Global Economy

- **The Border Confrontation** – If there is a more hapless group of exploited people in the world today it would be hard to find. The “caravan” of desperate people fleeing Central America to somehow reach the US has grown to the thousands. Trump has ramped up his anti-immigration rhetoric as it plays to his base, combat troops are being dispatched to the part of the country that will need it. Few have tried to get to the bottom of this crisis. The refugees that are fleeing Honduras are fleeing a brutal autocracy which has already seen much of their population flee into exile. It is now likely that troops will be sent although it is not clear in what capacity. All of this misses the point. These are refugees and not migrants. They are fleeing violence in a nation that is falling apart and they can't stay or return. The only real solution lies in fixing the broken Honduran economy and political system.
- **Turkey and the Khashoggi Incident** – The issue of the Saudi killing of an ardent critic of the Crown Prince was going to complicate the region but the reason this has exploded is due to the use of the crisis by Reccip Tayyip Erdogan. The Turkish authorities unearthed the details of the scandal and Erdogan has been using the opportunity to burnish his own reputation and to unseat Saudi Arabia as the more influential nation in the Middle East. The irony is that Erdogan has been responsible for numerous attacks on journalists and his jails are full of those who had the temerity to attack him.

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The Legacy of Paul Volcker

Over the last few decades the US has featured some of the most influential and powerful central bankers in the world. Alan Greenspan has just released another book that illustrates the era he presided over and the issues that now grip the central banking community. Paul Volcker is about to release his long-awaited memoir and by all accounts it will be a volume designed to describe the era he lived in and how he wants to be remembered. It is also a call to action by perhaps the most engaged Fed Chair the US has ever had. His enduring claim to fame will be his radical moves to crush inflation in the 1980s. The staggering rate hikes imposed by the Fed ended a major inflation threat but also plunged the US into a recession. He has gone on to advise Presidents and to consistently serve as a critic of the modern banking system and its tendency to stagger from one self-made crisis to another. Perhaps the most interesting and lasting aspect of this memoir will be his call to others to take stock of where the country is right now and what needs to be done. He laments the lack of public service motivation in those that ostensibly serve the country.

Analysis: One of his pet peeves is the current central bank focus on an inflation rate of 2.0% as he really does not see that it matters all that much whether the rate is 1.5% or 2.5%. He has especially irritated by those who worry about deflation and feel compelled to push inflation higher for fear of settling into that pattern. He has long been a critic of this focus and keeps pointing out that Japan is a very different economic system with only limited applicability to other economies. The deep worry about the ravages of deflation stem from the experience of the Japanese economy and the decade long period of stagnation. It is agreed that this kind of economic crisis is something to be avoided but he also points out that Japan is vulnerable in a way that most other nations are not – certainly not the US. The Japanese are simply bad consumers and can't be relied on to spend their way out of an economic slump, something the US consumer does routinely.

His second major issue is his concern over the impact of a decade of creative policies collectively known as quantitative easing. The central banks pulled out all the stops in an attempt to fend off any sort of economic downturn. Even with all that effort there was still a Great Recession and now there is argument over whether these measures made it more or less of a problem. The result in his estimation is a situation where there is far too much leverage and far too much debt. This is something that plagues every level of the economy – consumers, business and the government. The debt load for every sector is far too high and leaves no room to maneuver when there is a financial issue. It is his opinion that there will be a number of financial crisis situations emerging in the not distant future as there is no room for any sort of setback. Each little blip in the economy can quickly explode into a full-blown crisis.

The third issue for Volcker revolves around whether anybody learned anything from the last crisis. He asserts that the banks and other institutions are slipping back into old patterns of behavior – activity that he was trying to address with the Volcker Rule that prohibited banks from engaging in proprietary trading. He has been relentless in his criticism of what motivated these banks in the first place and that ties into his overall position on the role of government and service.

His concern has been that too few seem to have any faith at all in the government or any of the agencies that have been tapped to lead the economy. His assertion is that people have tended to throw all of the activities of government into one bucket and can't make distinctions anymore. The whole conversation has deteriorated to the point that nobody believes anyone even when there are demonstrable facts. Volcker also decries the lack of proportion. No sacrifice is tolerated – no sense of doing something as it is good for the society as a whole. It is a system that makes it very hard for institutions like the Fed to function as they do almost all of their work indirectly. The system relies on lenders and borrowers responding to the encouragement of a low interest rate without getting carried away and inviting too much risk into their operations.

Third Quarter GDP Looks Better than Expected

The anticipated rate of growth in the third quarter was around 3.1% and the actual number was 3.5%, a marked improvement over what had been assumed. As with most data these days there was both good and bad news in this latest report. The good news is that there was a lot of solid consumer spending that drove growth this last quarter and that consumer impact was coupled with a nice surge in the level of government spending. The concerning part is that business investment has tapered off from what it was when the tax cuts were first introduced.

Analysis: The wait now is for the inevitable revisions and by most accounts they will show incremental improvement as more of those consumer gains are tallied. Consumer numbers will likely go up and business investment may have slowed to accommodate the confusion that has surrounded the trade barriers. It is not news to see the consumer carry this load but it is somewhat unexpected that such a major alteration in trade flows would begin to develop when there is such a small amount of consumer reaction thus far.

There was little doubt that GDP numbers would come off their very high Q2 levels as there was a lot of reaction to the potential trade and tariff wars. That has now dissipated to some degree and more traditional concerns have emerged. This likely means that future revisions will be less dramatic than they might have been. If one separates out the reactive elements of the second quarter reading the real growth was thought to be around 3.1% as opposed to 4.2%. That Q3 came in at 3.5% lends credibility to that assumption.

Excitement and Challenge for the Economist

This has been a tumultuous year for economists and analysts. I realize this sounds a little lame given all the other stuff that takes place in the course of a year – everything from hurricanes to fires to crime and health scares but we have had our share of the unexpected and inexplicable. Some of this has been generated by a President that leaps in an out of economic issues in a cloud of tweets and leaves everybody wondering what just happened. But there have also been indicators that are not indicating what they used to and reliable theories that are suddenly not all that reliable. The big movements in the economy are making their way through – everything from exiting the age of the Baby Boomer to the rapid pace of robotics and automation. Just this week we said goodbye to yet another icon of the past as Sears finally seems to have succumbed to the inevitable. Where are we now at the end of 2018 and what does all this say about 2019.

It seems there are four major shifts underway and all four have been accelerating in terms of their influence on the economy. To contend with these will require a whole series of paradigm shifts that will affect how people live and work – not just in the US but globally. First there is the dramatic shift in labor and the impact it is having on many of the world's economies. The separation of people by what they do for a living is creating a chasm where there once was just a gap. It is near impossible to have a successful career without extensive education and training. The days of hiring on to some manufacturer in order to learn a skill on the job are nearly over. The manufacturer, the construction company, the transportation company and many others struggle to find qualified employees and don't have the time and resources to train people from "scratch". This currently means that companies struggle to find workers at the same time that millions of people are underemployed or working in jobs that do not allow them financial security. This will be a bigger issue in the years ahead due to a related shift.

Robotics and automation have been accelerating at an exponential pace. Not only are companies struggling to find the workers they need but they are also discovering that machines are capable of doing far more than was once possible. The robotic revolution may have started in the manufacturing sector but it has been spreading to health care and many service sector professions ranging from accounting to law and finance. The unskilled worker once worried about their jobs going overseas as their employer decided to outsource. Now they are losing their jobs to machines and robots and technology and these same machines are replacing the workers that once took the low skilled jobs away from people in developed world. China has the fastest rate of robot adoption of any nation in the world.

A third major shift is taking place among consumers. The department store is dead and even Wal-Mart has started to lose its juggernaut status. The consumer has embraced the internet wholly and relies on sites like Amazon and Wayfair to meet nearly all their needs. This displaces a whole profession – retail clerks are no longer needed and those that remain are generally low paid and lack any sort of expertise past operating the cash register. Stores are abandoning clerks altogether as shoppers ring themselves up and food providers are going in the same direction. If the consumer completely abandons the brick and mortar operation it will make it almost impossible to exert trade pressure as the buyer simply goes direct to a purveyor in China who ships the product without it ever entering the US merchandise flow.

The changes in the way that people make a living is creating what has been dubbed the "gig economy". This makes the worker a free agent in somewhat the same way that a musician is. The best example of this new paradigm is the ride-share concept. The driver works when they want to and essentially operate independently. It can be a great opportunity but just as with any other "gig" the threat is competition. The guy who was the only singer a club could book, might charge a lot of money but when there are dozens arriving every day there is no more leverage – ask the legions of hopefuls that land in Nashville every day. The guy that made lots of money as an Uber driver three years ago now waits for an hour to get a passenger at the airport. Just as with the musician – now people need that day job or two or three and there are more and more people that have to work many "gigs" to stay ahead. This changes the relationship between employer and employee as there is no longer an expectation of a lifetime employment experience that ends with a gold watch.

Analysis: The bottom line is that today's economy is doing quite well but it is also right on the edge of a tectonic change or two and that makes looking ahead more than a little unnerving. It is something of a truism in economic analysis that there is always a dark cloud behind every silver lining and this period has been no different as focus starts to turn towards the potential for storms.

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Oh Boy – Cat Stories!!!

I kid you not – people actually request these. Just yesterday I was giving a talk to a group that included some avid BIB readers and a horde of people demanded moreok.....it was one person but who am I to deny this loyal fan. As you all well know I am a multi-cat kind of guy and still have four. One of the elder members of the tribe passed away at 16 but the others are going strong (including the 19 years old). This is the transition season for these guys as the weather has started to cool. It is not as if we eschew indoor heating so I don't quite grasp why they all begin to act like we are emulating Nanook of the North but suddenly all four have become heat seeking missiles.

This means they are relatively easy to find these days as well. We have a heated bathroom floor and now we know exactly where Spike can be found on any given day. The only thing that peels him off the carpet is when the fireplace is going as it throws some significant heat. There are days when they want under blankets and other wraps and days when they hover over heating vents. Anytime the sun comes pouring through a given window there will be a cat lounging in the middle of the beam. What a bunch of drama queens and kings. Of course, they do the same thing in the summer but in reverse as they plop on top of the air conditioning vents. I suppose this is designed to make us feel like bad parents but we have not bought into this guilt as yet.

The highlight is the arrival of spring and summer when the windows are opened and all those lovely outside smells, tastes and sounds come wafting their way. They are not the least bit interested in being out there mind you but it needs close monitoring from a strategically positioned camera. They hang on that window sill all day.

Five Things You Can Do with the Business Intelligence Brief

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