

# BUSINESS INTELLIGENCE BRIEF

October 30, 2018



## NATIONAL AND INTERNATIONAL NEWS AFFECTING LOCAL BUSINESS

### Short Items of Interest – US Economy

- **Inflation Remains Tepid** – There are many ways to measure inflation and some are more variable than others. Economists are often dinged for the way they treat core inflation numbers. We routinely ignore the price of fuel and food as these can be very volatile month to month and that makes it hard to make accurate assessments of how much inflation is changing from one year to the next. There are also criticisms of index numbers like the Consumer Price Index as it is based on a basket of goods that the average consumer buys and that may or may not be all that accurate. The index the Federal Reserve pays the most attention to is the Personal Consumption Expenditure Price Index and the latest iteration of the PCE shows that it rose by only 0.1% in the last month. That is slow inflation growth and that provides the Fed more breathing room. This means they are unlikely to make any real changes to their interest rate plan.
- **Home Price Gains Continue to Falter** – The gain in home prices fell below 6% for the first time in over a year. The Case Shiller index looks at home prices year over year and they had been going up at a rate over 6% for many months. This last comparison showed a gain of only 5.8% and that reinforces the notion that home prices are falling across the board. The drop has been larger in some of the hotter markets but now the damage is appearing in a wide swath of the nation's markets. The fact is that demand is off from what it has been and there are simply fewer buyers that can afford the new higher mortgage costs. The slowdown was spotted some months ago as far as new homes are concerned but it is now manifesting in the existing home sales.
- **The "Caravan" Threat** – There are few issues as politically charged as immigration this year and all of the angst that has developed on both sides has manifested with the migrant caravan that has been making its way through Mexico towards the US. Some facts would be in order but they are few and far between. The organizers of this group are activists in Honduras who are hoping to put pressure on the regime to deal with the rampant drug crime and political violence so it is true this is not a spontaneous migration. The majority of those in the group are legitimate refugees fleeing violence but, in a group, this big there are elements that are more violent. Mexico has been slowing the advance and has already given 2,000 of these people asylum in Mexico. The caravan is a large number to be sure but has now fallen to around 3,000 people and that is far less than the average number that come to the US (500 thousand a year or around 9,000 a week)

### Short Items of Interest – Global Economy

- **Eurozone Economy Stutters** – The rate of growth in the Eurozone has fallen to levels not seen since 2014 and much of the problem stems from the declines in Italy and the faltering of the German consumer. In both countries the analysts are blaming concerns over politics as the major problem as in both countries the business community has reported being essentially on hold pending some clue as to what kind of policies will be developing. Italy is by far the biggest worry as the EU is furious with their budget plan and has been threatening to start fining them.
- **Intense Debate with Chinese Economic Circles** – Two prominent Chinese economists have been attacking the very nature of the Chinese economy as the real culprit in the expanding trade war with the US. They argue that it is state capitalism that is at fault and not some plot developed by the US and Europe. The argument has been made repeatedly by western economists but never before by anyone in China – at least not publicly. These remarks come from prestigious scholars at a prestigious school and they were not censored and that is more than a little significant.

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## Is the Party Over?

It should be noted that economists are generally the party poopers in the crowd. We are, after all, called the dismal science for a reason and always seem to have the ability to find the dark cloud behind every silver lining. The economy in the US has been pretty good of late – it is hard to argue with an unemployment rate of 3.8% and growth that is consistently above 3.0%. Compared to the majority of the other industrialized nations the US has been on a roll for several years now. What is not to like? Granted there have been concern expressed about such issues as the national debt and deficit, the acute and worsening labor shortage and the impact of trade wars and tariffs but thus far these concerns have not been enough to really slow down the economy's momentum. Is there some reason to think that the economy may have reached its peak and has nowhere else to go from this point but down?

**Analysis:** There are few who assert that a real recession is around the corner although a significant number of analysts are hinting that a short and sharp downturn could happen towards the latter part of 2019 or perhaps early 2020. The more common assessment is simply that growth falters a little and comes down from the high that has been experienced in the last several months. Growth in the second quarter was a very unexpected 4.2% and third quarter was still robust at 3.5%. On further examination the Q2 numbers were somewhat inflated by the impact of the trade and tariff threat – many companies trying to get their exports and imports in the pipeline before these restrictions emerged for real. The expectation for the future is growth that returns to the norm of the last decade or so – between 2.0% and 2.5%. The Federal Reserve has one of the more pessimistic outlooks with growth at around 1.8% by the end of next year.

Although this is close to what normal used to look like and far from a recession, it will still have a significant impact on several aspects of the economy. The pace of stock market growth would slow and perhaps enough to be in real correction territory. The Fed would be affected because there would be less reason for rate hikes. That may well put the Fed in an uncomfortable position of seeing inflation creeping back up but watching a slowing economy at the same time. They will be in a tough spot regardless of what they do. Hike rates to battle inflation and an already slowing economy starts to really weaken. Fail to raise rates in order to keep stimulating the economy and risk an outbreak of inflation that would require more draconian action later. There will be political implications as well. A slowing economy will affect the prospects of those who have been most linked to the growth of the last few years – Republicans.

There have been two primary motivators for the economic growth that has been seen in the past few years – consumer spending and the spending by the government. Both of these motivators have started to fade. The consumer was pushed to spend more by the tax cuts and that was precisely what was supposed to happen. The problem with consumption spurred by tax changes is that its impact is relatively short lived with most of the response taking place early in the year and then a slow fade afterwards. It is not like getting a raise or expecting that a raise will be imminent. The government spending role is similarly limited. Congress pushed additional money (\$300 billion) into the economy above and beyond what had been planned and that propelled a good bit of spending activity. That has likewise faded since the start and it is unlikely that there will be another round of spending anytime soon.

The one thing that might stimulate would be a boost in business investment. That has been one of the key missing factors. There was a little burst of activity at the time of the tax cuts but not quite as much as had been anticipated. The larger companies tended to focus on stock buybacks and a variety of merger and acquisition efforts. The small and mid-sized companies did a good deal more of the investment that was intended by these cuts but they have done so with a good bit of caution. At the time of the cuts, the intent was to goose the economy to the point that more companies would be doing well and thus paying more taxes even as their tax rate went down. That has not happened and the revenues coming to the government have been severely restrained. Given that there has been additional spending at the same time that revenues are falling, the upshot is a higher debt and deficit as all that additional activity has been spurred with borrowed funds. This is a pipeline that can't be counted on for much longer. The conversation regarding budget cuts has centered on reducing spend on programs like Social Security and Medicare but this would only make the problem of reduced consumer spending worse.

## Treasury Returns to 2010 Numbers

The Treasury is set to issue over a trillion dollars of debt this year and that is a number that has not been seen since 2010 when the US was still deeply mired in the recession. The reason for this immense debt is easy enough to see. The large tax cuts were not offset by additional revenues as had been planned. Instead of addressing the debt and deficit issues facing the country with higher taxes and less spending, the decision was made to go in exactly the opposite direction with a substantial reduction in revenue coupled with a large increase in spending.

**Analysis:** There is nothing inherently wrong with pursuing a policy like this – it is considered standard operating procedure when an economy is in the throes of recession but the US economy is not in the same position it was in during the last period of record debt issuance. This is not 2010 and the economy can be said to be booming. If ever there was a time to address the issue of debt and deficit it would be right now. The best course of action would be to combine a revenue boost with a big cut in spending but this combination is clearly deadly to an average political career.

## Brazil Gets Its New Strongman

This outcome was obvious weeks ago and the second round of voting in Brazil only confirmed it. Jair Bolsonaro is the new President of Brazil as he defeated the candidate of the ruling Worker's Party by over eleven points. The success of the far-right politician has shocked the region as well as many other nations throughout the world. It has come as a shock to many in Brazil as well. He is the polar opposite of the leaders that have been in power in Brazil for the better part of two decades. When Inazio "Lula" da Silva won the election for President in 2003 it was seen as a power shift as far as Brazil was concerned. The left leaning Worker's Party has never finished more than distant third but the population had grown weary of the two traditional groups that were loosely categorized as center-left and center-right. Lula had tried three times before but in 2003 he changed from a fringe candidate of the left to one determined to break through. He remained popular to the end of his second term but by then it was already obvious that patience was wearing thin and his designated successor – Dilma Rousseff – was never able to capture the attention of the public. It was also at the end of his term that corruption allegations began to swirl around many members of the ruling party and eventually the accusations reached Lula himself and he was sent to prison.

**Analysis:** To be frank Brazil has long been a highly corrupt society – at every level. The population has tolerated this corruption for decades but it has always been with a caveat. They expect their political leaders to be corrupt and that is basically acceptable as long as the problems facing the average Brazilian have been addressed and for the last ten years they have not been. The country sagged into a lengthy and bitter recession under Rousseff and she was unable to do anything to ameliorate the impact. The country that was once being hailed as the leader of the BRICs (Brazil, Russia, India and China) had fallen to new lows with double digit unemployment and very widespread poverty. This soon developed into a significant crime problem as desperate people did what they had to. The crime rate soared as the country fell deeper into economic distress. This has been the perfect environment for yet another outsider offering to reverse the course the nation is on.

The commentary by voters illustrates the depth of the resentment for the Worker's Party. They have projected on to Bolsonaro everything they want to change regardless of what he has actually said and done. He has been revealed to be deeply bigoted and highly dismissive of women. He has a very fond recollection of the days when the generals ran Brazil and longs for the return of those martial law days. He is antagonistic towards most business but vows to maintain the majority of the country's economic policy. He asserts that crime and corruption will be his priorities but has provided no detail as far as what these policies would look like. He has openly supported the approach that has been taken by Rodrigo Duterte in the Philippines. The police and various vigilante squads in that nation have killed some 60,000 people thus far on suspicion of being engaged with drugs or other illegal activity.

Right now, the Brazilians have been essentially ignoring what their new leaders says and claim that he is really a different person than he appears to be. They are expecting what amounts to a miracle as far as corruption and crime are concerned and most assume that the public will turn on him sooner than later.

## German Lame Duck

The decision by Angela Merkel to step down as head of the Christian Democratic Union signals that this long and illustrious career is now coming to an end. She still has three years left as Chancellor of Germany but that is a position that can be stripped away by the CDU if they want someone else in that role. The most likely scenario is she gets replaced about a year out from the election so that the new leader of the CDU gets some traction as being the new Chancellor but she could be replaced much sooner than this.

**Analysis:** Her decision to step down comes as her party had been engaging in serious warfare over her fate. The last few elections have not gone well for the CDU and this was expected to carry into the next round of national contests. Those who were vying for her seat can now spend their time attacking each other and less on attacking Merkel. Her removal is going to be challenging for Europe as a whole as well as Germany. There is no real alternative in terms of power and influence to represent Europe. The only three nations that have been able to play this role in the past have been Germany, France and Great Britain. The leaders of all three of these nations have domestic issues that matter as well and they remain far more interested in domestic affairs than global issues as that was Merkel's to take care of. Perhaps the new German leader will be able to inherit this crown but nobody even knows who that would be.

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## Things to Do This Week

Frankly there are lots of things to do this week but I can add one for those that have interest in things musical. The Liberty Community Chorus will perform their Fall concert this Sunday. As alert readers are well aware my lovely and talented wife is a member of this group and has been excited about this concert for some time. The inspiration is Gaelic songs and the whole concert will feature the music of the Emerald Isle and Scotland – but not the kind of thing one generally hears around St. Patrick’s Day. The Irish and the Scots have long been a deeply spiritual people and this has inspired some truly sublime music to celebrate their relationship to the divine and to nature. Even if some of the tunes are vaguely familiar you have never heard them through the combined voices of close to 100 people. If you have an opportunity please plan to attend – it will lift your spirits.

Celtic Tapestry will be performed at 3:00 on Sunday, November 4 at Gano Chapel on the campus of William Jewell College in Liberty. Tickets are \$12 for adults and \$10 for seniors. Students get in free. I would love to see you there.

## Five Things You Can Do with the Business Intelligence Brief

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