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BUSINESS INTELLIGENCE BRIEF

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Unemployment and Rebellion

There are many triggers involved when a nation suddenly surges into political upheaval. The populations in Tunisia and Egypt have articulated a myriad of complaints against the regimes they seek to replace – everything from corruption to oppression. At the top of the list of issues that propel a nation into political chaos is the rate of unemployment – especially among the younger members of society. The IMF issued a warning to both Tunisia and Egypt last year and there are dozens of other nations that have received the same grim report from the IMF. Most of these countries will not see the riots and demonstrations that have engulfed North Africa but they will suffer damage in other ways.

The rate of youth unemployment in Tunisia is 30% and in Egypt it is 25%. In many other states in the region it is above 20%. The rate for urban youth with less than a high school degree in the US is between 35% and 40%. This situation is described by the IMF as a "ticking time bomb". The states affected by the protests would need to add 20 million jobs to handle the current population and millions more by the end of the decade.

Analysis: Unemployment is a major issue at any age but from a societal point of view, a high rate of youth unemployment is especially threatening. There are three reasons that most analysts consider this to be the most serious problem. The first is that young men require far more structure in their lives in order to remain productive parts of society. In the simplest of terms this means that unemployed males commit more crimes, engage in more anti-social activity and are more prone to destructive habits – everything from suicide to drug abuse. They are also prime candidates for recruitment by extremists groups.

The second issue is that being unemployed at this point in life makes people exceedingly unstable. Men can not marry without the stability of a job; people are often unable to establish homes of their own, women are unable to start families. The person's life is on hold and there is no sense of when it can all begin. This is an even bigger issue if the young person has been educated and was led to believe that there would be a future. This frustration builds to levels that provoke violence of one kind or another.

Finally there is the utter waste of talent and resources for a nation as many of its best and brightest remain out of the economic mainstream. The longer they remain excluded the more likely it is that they will never be able to enter the economy in a meaningful way. This creates extreme bitterness and frustration.

The impact of high unemployment levels in the young population is on full display in Egypt right now but it is an issue with developed nations as well. Japan has its "lost generation" and the US will struggle for decades to place the students who graduated in the last two or three years and have not been able to start their careers in earnest.

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Credit Managers Index Shows Loosening of Trade Credit

The latest Credit Managers Index for January has been released and there is some truly encouraging indicators showing up this month – most notably in the area of credit availability. These are some excerpts from the larger report. If you wish to receive the full report – complete with all those exciting charts and graphs – contact ksanchez@armadaci.com

The assertion has been that this is the transition year that 2010 was supposed to be. The "green shoots" that started to appear about this time last year wilted and died by the end of spring but 2011 is starting to show some signs of greater economic stability. This trend has been noted in several indexes and indicators and the Credit Managers Index is no exception. There was an overall improvement in the numbers – from 55.8 to 56.4 and that marks the highest point reached in the combined index since April of last year when the index hit 56.5. What makes this latest number more encouraging is that there is an expectation that the index will continue to see improvement over the next several months. Back in April that high point was followed by steady decline that took the index all the way back to 53 in August before a slow rebound got underway.

The most encouraging of the sub-sectors this month is that which indicates the amount of credit extended. The jump from 61.7 to 64.8 is very significant as this the signal that many have been waiting to see. Over the last few months there have been indications that business activity has started to pick up and this has been reflected in the CMI by increases in sales and an increase in new credit applications. In the last month both of these indicators have slowed a little while still remaining robust. Sales dropped from 65.9 to 63.5 and that is still very respectable given that the holiday season has been completed. The rate of new credit application slowed from 60.1 to 58.6 but that is also somewhat attributable to the arrival of a generally slow time of year as compared to the last quarter.

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Analysis: The fact that “credit extended” has sharply increased despite the slowdown in sales and credit applications indicates that there is more credit coming available than in previous months – quite a bit more. This sector has not seen readings this high since the recession began – one would have to go all the way back to early 2008 to see numbers above 62 – much less at 64.8. The fact is that credit as a whole is loosening up in the US as reported by the banks. As the lenders get more active, there is more commercial credit appearing as well. Companies are far more willing to offer credit and they seem to have opportunities to engage with their clients as many companies start to consider their expansion opportunities in the coming year.

This was not the only piece of good news in the index. There was improvement across the board in the negative categories. The rejection of credit applications was subdued and there was improvement in the accounts placed for collection category. Even disputes and bankruptcy data showed improvement. Over the last few months there has been a positive trend in terms of these negative factors and this has been identified as an important trend in previous years.

The pattern has been seen before. As companies start to see increased sales and begin to anticipate growth opportunities in coming months, it is important that they get positioned to take on more debt if they need it for that expansion. If they are planning to access more credit they generally have to catch up on their current debt first. In the midst of the downturn the companies are trying at all costs to conserve cash flow and during that stretch they are more prone to stretching out their credit obligations. The result is reflected in the deteriorating situation in the unfavorable categories. As companies recover their position and catch up on their credit, they are in a position to request more and in a position to be granted that access. This is what seems to be happening now. Companies appear to be setting themselves up for more growth in the months to come. The data from the CMI is reflected in the latest economic numbers from the Purchasing Managers Index as well as surveys from groups like the National Association of Business Economists and the Conference Board. The index now stands at a level that normally signals more rapid expansion in the near future.

Manufacturing Sector - The trends that manifest in the overall score are emphasized in the manufacturing sector. The jump in amount of credit extended was truly impressive – from 61.6 to 66.2. That marks the highest point for credit extended since 2007 and takes the manufacturing sector to pre-recession levels as far as credit access is concerned. This is a very significant change and one that can lead to more aggressive growth in the months ahead.

At the time of the 2008 financial sector collapse, the manufacturers were actually having a pretty good year. Most of them had not seen declines in demand as late as the third quarter of 2008 and many had order backlogs that would have sustained them for months into 2009. The action that jerked the rug from underneath the manufacturers was the collapse in credit markets. In a matter of weeks the financial system imploded and suddenly companies could not finance raw materials purchases or new equipment. Soon thereafter the consumers started to feel the impact and the rest is history. Within a few months, the manufacturers were in severe distress and the index confirms those bleak days.

The index on sales deteriorated a little but no more than expected and there was also a slowdown on new credit applications. There was generally good news on the unfavorable factors but there were some exceptions – such as dollars beyond terms. The improvement in the unfavorable factors was a bit less dramatic than that with the favorable factors but that is due primarily to the startling improvement in the credit situation.

Part of the change in the credit situation stems from the fact that banks have been far more interested in the manufacturing community and this has trickled down to other credit opportunities. The machine tool makers are seeing increased demand and there has been an additional boom from the manufacturers that are seeking credit in order to accumulate some reserves in commodities and other raw materials. This has been an area where the manufacturers have been uninterested in carrying inventory but there is now some real fear of commodity price inflation and some companies are trying to hedge with some advance purchasing. The economy continues to be led by the manufacturing sector and this now seems secure for the duration of the recovery.

Service Sector - Service numbers were also improved in some categories but not as dramatically as those in manufacturing. Overall there was a dip in the combined numbers from last month – slowing to 61.7 from 62.2. This is still respectable but the extension of credit is far more limited than it has been in the manufacturing sector. There was a slight decline in the sales and new credit application numbers as well. Some of this is expected given the end of the heavy holiday season but the lack of credit access as compared to the manufacturers is more an indication of what lenders are more drawn to. The service community continues to be ragged in some areas and stronger in others. The areas that seem to be gaining are in the IT community, health care and to some extent in financial services but there remain serious issues in construction that weigh the whole index down.

The bad news is that this sector did not see the increase in activity that manufacturing has seen of late but the good news is that there has been steady performance throughout the last few months. The best news came with some of the unfavorable factors – a marked improvement in bankruptcy rates and dollar amount of consumer deductions. These numbers reflect the sense that most of the worst of the downturn is past and there should be some marked improvements by the second quarter.

When compared with other national numbers, the service indicators back up the uneven performance of some select sectors. Retail had its best December in more than five years – a 0.7% growth rate. At the same time, the entire housing market has slipped even lower and now rests at about where it was at the end of the 1990s.

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Global Manufacturing Continues to Surge – Good and Bad News

The January PMI numbers are coming out and the reactions vary. The US manufacturing community is growing at a very rapid clip and continues to be at the forefront of the economic recovery in the US. The expectation had been that the PMI numbers would flatten out a little from December but they improved dramatically – moving from 58.5 to 60.8. These are the best numbers seen in the index since 2004 and that is made the more impressive by the fact that this is a traditionally slow time for the manufacturers. The data was even better for the sub-index on new orders as it hit 67.8 after a reading of 62 in December. This suggests that there is considerable growth expected in the future as factories start to gear up to meet anticipated demand.

There are a few caveats to note however. Part of the increase in the PMI reflects the fact that manufacturers are buying far more inventory in raw materials than in the past. This is due in part to their desire to prepare for future demand but an even more urgent motivation is the need to react to inflation threats. The rise in commodity prices has been sharp and consistent and most of the manufacturers are fully expecting to see higher prices through the rest of the year and they are doing more inventory accumulation than they have in several years. This does not account for the entire jump in this month's PMI but it is an important factor.

The reaction of other nations to their PMI numbers has varied. China has been working diligently to reduce the growth in their manufacturing sector without seriously impacting jobs. The PMI for this month was flat and that was not what the Chinese had hoped to see. The real concern in China is inflation and there are rumblings that something more dramatic is in development in China if the growth rate continues to surge.

The index for the Eurozone rose to a nine month high of 57.3. The majority of that growth was contributed by Germany and some of the nations surrounding it but there was growth in many of the struggling nations as well – most notably in Italy. France showed some signs of expansion but outside the German economy most of the action was in the Netherlands, Austria and the Nordic states. The continued decline in activity in Greece, Spain, and Portugal constitute the biggest concern as they are not responding to any of the expansion in Europe as a whole.

The other fast growth markets in the world include Brazil – moving from 52.4 to 53.1 and India 56.7 to 56.8. These are nations that are starting to see some slow down as others catch up. South Africa moved from 51.7 to 54.6 while even Japan finally crested over the 50 mark by shifting from 48.3 to 51.4. The overall gains in manufacturing have come in part as credit opportunities have expanded and more companies start to feel some level of secure demand.

Analysis: The next few months will provide some interesting numbers as the various trends start to compete with one another. Will the demand that people expect to see actually start to manifest? Will the inventory build that has contributed to the latest expansion continue and will the inflation driven accumulation of raw materials make as much of an impact in the future as it has thus far? The sense is that all of these trends will be manifested for a few more months at least.

Will Concessions Make a Difference?

The mood in Egypt has started to shift but few are ready to assert that the demonstrations are winding down. The military is now clearly in control of the country and it appears that the real leader of the nation is now Omar Suleiman. Hosne Mubarak has declared that he will not run for election this year and will step down in September. The protestors still want him gone immediately but it appears that his reign is already over and that means that the protests will now have to aim at the military and that is a much different situation. It also appears that the opposition groups are eager to start campaigning for election in the coming months as the army has suggested that this is the proper path. The next few days will indicate whether the capitulation has been enough.

Analysis: At the same time that Mubarak has agreed to take himself out of the equation, there have been similar concessions in other threatened states. The leader in Yemen has declared that he will not seek another term and King Abdullah in Jordan dismissed his entire government and has installed a new set of leaders in an attempt to co-opt some of the opposition in his country. If these gestures work, the worst case scenarios that have been discussed in the last few days will start to fade. At the same time there will be a whole new set of considerations as these regimes try to figure out how to stay ahead of their populations.

No Panic in Oil Markets - Yet

The price of crude soared past $100 a barrel yesterday before settling back to the mid-90s. There is obviously a lot of tension in the oil sector for the moment but there is none of the frantic attitude that existed in 2008. There are two reasons that oil traders are far less worried than they have been. The first is that there is far more spare capacity than existed in 2008 as the economies of the world are coming off a recession as opposed to five years of boom. The second reason is that speculators in the oil sector are the ones that have always been engaged – not the late comers that caused all the wild fluctuations in 2008. That has been made evident by the reaction to Egypt.

Analysis: The speculators drove the price up by about $8 to $10 on factors such as the risk to the Suez Canal or the pipelines crossing Egypt. They also worried about the spread of protests to nations like Saudi Arabia. As these fears have subsided, the oil markets have started to relax. There isn't the wild rumor mongering that drove prices in 2008 and it appears that some sanity is returning already. That is very good news for the pace of global economic recovery.

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Snowmageddon

This has been quite the winter thus far. The latest blast has been affecting a wide swath of the nation with record snowfalls. The shutdown has been spectacular with everything from highways and airports to business closing down in response to the onslaught. There are some other interesting aspects as far as business reaction.

Yesterday was a day for many millions to stay home – to work from home. This seems to have created an unexpected set of actions. I have never taken so many phone calls and received so many e-mails. It seems that when people are not distracted by the meetings and conversations at the workplace they find other ways to be productive. The sense was that many people were catching up on their assignments given the opportunity to work undisturbed. Of course that also meant that I was getting a lot less done than I had anticipated.

Weather like this also tends to bring out the comparisons. My colleagues in the northern states have been amused by the reaction in states unaccustomed to the blast. This is the time of year they can exude a certain smug superiority and an assertion that this is all character building. This is also likely to have a positive impact on the economic recovery of some states. Those who have all the character they can stand are examining those brochures from Florida, California and Arizona with renewed enthusiasm.

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