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Success Doesn't Really Solve the Problem

The crux of the problem is that growth isn't growth. That is to say that there are all kinds of ways to define growth. The good news is that the US manufacturing sector is doing far better than had been expected. The weak dollar has opened up global markets and the technological advances that have been driving innovation in manufacturing have made US companies more competitive than ever. The growth of production in the US has been one of the few high points in the last few years. This would be unadulterated good news if it were not for the fact that manufacturers are operating far differently than they did in the past. This is a new world for production – one that places the emphasis on technology and robotics and this is the prime reason that the US has managed to regain some of its production from the competitors that had been attracting so much business away from the US.

In the past this would also have meant that millions of people would be flocking to work in the booming manufacturing community but this is a different world. The people who once labored in assembly line based manufacturing are looking for new ways to make a living and the jobs that are on offer are those that require skills and training that are not all that common. This is no longer the sector that provides entry level work opportunities for the legions of people coming out of high school looking for employment. The politicians still refer to growth in manufacturing as a job engine but that is not really the case. What is really needed is a more effective education system to provide the workers needed in the future. Manufacturing is not the sector that will pull the unemployment numbers down.

Analysis: The challenge for the economy going forward is that service sector jobs will be the entry level opportunities in the future and these are far less lucrative than those that were once provided by the factories and manufacturing facilities. The economy is already dependent on the service sector for 80% of the GDP and the bulk of the hiring but in the past decades the service sector was more diverse. There were many high level service sector jobs and there were jobs that were less advanced. The trend over the last decade has been for more of the lower paid positions and fewer of the higher value position in the service economy. The technology that has changed the world of the manufacturer has also altered the service sector world.

If the future of employment rests in the service sector it will be far harder for the economy to recover much momentum as too many of these jobs are lower paid. Meanwhile the manufacturing sector will be contributing to the growth of the nation's GDP while helping lower the trade deficit. It is just not going to be a major contributor to the growth in employment. That will mean that the message from the political leaders will have to change. They will have to focus on the contribution from the manufacturer as their productivity gains and less on the job angle while they try to figure out what to do with millions in the service sector.

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Bernanke and the Fed Gets Aggressive

It was not that many years ago that Fed Chairman Ben Bernanke went to the House Budget Committee and the Senate Banking Committee prepared to be grilled and skewered over every nuance of Fed policy. It was hours of grilling and justification of Fed policy and explanations of all that the Fed intended. The appearance this week was a reversal of that tradition, that much was pretty obvious. The statements by Bernanke were about as pointed as they could be. The issue of fiscal policy or rather the lack of one was the focus of the conversation. In no uncertain terms Bernanke blasted the constant bickering as destructive to the US economy and he made it very clear that consistent failure was going to lead the US down the same path as Europe only with no Germany to bail out the US economy.

This is not the first time Bernanke or others from the Fed have assailed members of Congress for their inactivity on fiscal matters but the speech was far more pointed and the threats more distinct. The testimony before Congress was quite literally flipped on its head with the Fed taking shots at the politicians. The chairman of the House committee was a willing partner in this assault. Paul Ryan assailed his colleagues and essentially accused them of cowardice when it came to making the tough decisions needed to rescue the economy from a fate similar to that of the Europeans.

There was some criticism of the Fed's policies on stimulating the economy as well but in both cases Bernanke essentially dismissed the critique and laid most of the blame back on Congress. It was a typically civil affair and the criticism was not strident but the commentary from Bernanke alongside the writing that has come from various Fed officials leaves no doubt regarding what the central bankers believe must happen and soon.

(Continued)



Analysis: The Fed is certainly not alone when it comes to frustration with fiscal policy. This has been an issue for all the central bankers over the last few years. The US debate has been calm as compared to the arguments that have been voiced by the leaders of the Japanese and British central banks. There have been sharp critiques leveled at the US and Europe by bankers in Canada, Australia, India and China as well. The issue is the same for all of them. It starts with the basic division of labor when it comes to the economy. The two sides of economic management are supposed to be monetary and fiscal – the central bank handles monetary policy and has a focus on stability and inflation. The fiscal matters of the country are the purview of Congress and the Executive to a degree. They are supposed to be focusing on the issues of growth. When one side or the other fails in its core mission the other has to step in to some degree. In past years Congress has pushed against tight monetary policies set by the Fed in order to stimulate more growth but that has not been the issue this time. The Fed has been the entity pushing growth and that has been a concern among those at the Fed and worries many outside the Fed that fear its focus on inflation has been compromised.

The Fed has pursued the loosest monetary policy seen in years and it has all but pledged to stay committed to that policy for the next two to three years. The interest rates have been at zero since the recession started. Banks are getting next to nothing for the money they hold at the Fed while reserve ratios have declined. There have been two rounds of quantitative easing and the suggestion of a third as the Fed does what it can to hold down long term interest rates. There is not much more the Fed can do to push the economy forward except to use its influence and research to push policy. This has meant that Bernanke is far more vocal on these issues than is the norm. This is one of the areas where he came in for criticism. The Vice-Chair of the House committee made a point of attacking Bernanke over his comments on housing and foreclosure as the Fed Chair has been supportive of the suggestions that have been made by the Obama administration. The response from Bernanke was anything but contrite as he asserted that few sectors of the economy were as important as housing and something had to be done to get this issue under control.

The commentary by many of the members of the Federal Reserve has been generally consistent although there are certainly those in the various Federal banks that do not share the enthusiasm for the loose policy promoted by the Fed Chair. What they do share is his frustration with Congress and they tend to agree that this inaction has been the main reason for the Fed's aggressive engagement in policy designed to push growth in the economy. They do not like seeing the Fed shift focus from inflation but they fully understand that most of the problem is that the Fed has been forced to step into a void.

The critique of Congress is basic and it is the same critique that has been leveled at other legislatures around the world. The primary issue is the inability of Congress to make up its mind regarding what its policy will be. The deep divisions between the two parties have meant utter stalemate and there is absolutely no sign of compromise or cooperation on anything of substance. The path chosen by Congress is both and neither. There are those who fiercely advocate for a budget that is balanced and oriented towards debt reduction but are unwilling to make the unpopular decisions required to get there. If the goal is debt and deficit reduction there is no path available that doesn't include deep spending cuts and much higher taxes on everybody. It is not possible to tinker with a few reductions and some budget freezes, whole departments and functions will need to be eliminated. Taxing a few rich guys will not be enough, the tax hikes will have to affect everybody and significantly. Those who do not want to engage in this austerity program have to turn to rapid economic growth if they want to dig out of the debt and that would mean pushing aggressive stimulus efforts along the lines of those that were tried at the start of the recession – only much larger. It has been estimated that it would take a trillion dollar stimulus plan to budge an economy this size. There is absolutely no appetite for something this grand but without it there is no reasonable means by which to get the economy back on track and that is the point of the Fed's critique. The US is facing a crisis that could very well become as serious as that facing Europe and there is no will on the part of Congress to take action. Drifting along while yelling at the other side is not going to accomplish much.

Battle Over Dodd-Frank

The Dodd-Frank law was passed almost two years ago in the wake of the financial collapse that triggered the recession. The ostensible goal of the reform effort was to reduce the risk to the financial system posed by big banks. This was the too-big-to-fail discussion and the focus of the legislation was supposed to be reducing the chances that these banks could put the economy in jeopardy again while reducing the chances that the government would have to come to their rescue again. The critics have been pointing out that this law has given rise to over 500 new banking regulations and that most of these have been impacting the smaller banks far more than the big banks it was aimed at. The fact is that the biggest banks are bigger now than ever and the bulk of Dodd-Frank has been affecting the banks that had nothing whatever to do with the financial crisis.

Analysis: The banking system in the US is not engaged in the recovery as it should be or that it wants to be. The credit environment is weak as banks are fearful and unsure of what they can and can't do. It has been almost two years and the regulations keep coming. It is estimated that it will be mid-2013 before the regulatory environment is established enough for banks to function normally. The Fed has been trying to loosen the monetary policy of the country by making money easier to get. Lower interest rates don't help much if the banks can't find ways to lend. The defenders of Dodd-Frank point to the reforms that control the bigger banks but the critics point out that the big banks are not affected much while the small and independent banks have been burdened with regulations and demands that cripple their ability to serve the communities they are in.



Mixed Messages in Europe

The data that has come from Europe in the last week is causing analysts to scratch their heads. There is a little piece of good news for every piece of bad news and this is making it harder to figure out what the European situation will be as the year progresses. The British are now being warned that they will be facing recession in the first half of the year and perhaps for the whole of 2012 unless there are some steps taken to break away from the austerity plan. The latest think tank study suggests that there be a tax cut and a spending hike in the next couple of months despite the fact that not much progress has been made on dealing with the nation's debt and deficit. At the same time there has been another reduction in growth forecasts in Ireland. The expectation is that Ireland will also flirt with another real recession. Given that Greece is already there while Italy and Spain teeter on the edge, it is becoming more certain that Europe as a whole will slide into recession at some point in the next few months. The only real question at the moment is how long this visit to recession will last. The optimists assert that it may only be a quarter but the more pessimistic analysts assert that the recession could last all year and even stretch into 2013.

One would think that all this negative news would be setting the tone for Europe and thus allow some focus on the most obvious issues at hand but there are the contradictory signals to pay attention to. The latest PMI numbers for the Eurozone had been expected to continue their decline. Last month the PMI was 48.3 and forecasts had called for it to slump a little more or stay the same. It has been in contraction territory for five months and it was not expected to break out this month. Imagine the surprised look on the faces of the economists when the PMI showed growth at 50.4. It is certainly the case that a reading of 50.4 is not cause for dancing in the streets but it is also true that this is the best showing since the end of last summer. If the trend holds through February there will be reason to think that a corner has been turned.

The mood of the European leaders has improved a little on the assumption that something may be happening with Greece as far as their bondholders are concerned. The progress on the treaty demanded by Germany has some encouraged as well. The problem is that these signs of progress are limited and there is a great deal more to do. The fact that there is some agreement is a good sign but that is a long way from real action and there are major economic and political hurdles to deal with, making it hard to determine if this is really good news or really bad news.

The data on retail sales came in and it was worse than originally thought. It looked like the holiday retail season had been pretty good but that improvement seems to have been illusory. The rate of sales dropped by 0.6% in November and by 1.6% in December. This was not what analysts thought they would see when the season began. The sales had appeared robust and there was more traffic than there was last year. Now there is a good deal of parsing taking place to figure out what went wrong with the assessment last year. The simple answer is that good activity in nations like Germany did not offset the poor performance in the struggling southern nations. The people with money did a lot of shopping but those who have been hit hard by the downturn did almost none at all.

Analysis: It would be a simple enough conclusion that Europe is still in dire economic straits except for the boost in the private sector as measured by the PMI. The gains in production seem counterintuitive given the weak data but this is the same phenomenon observed in the US right now. The past quarter has not been great but the expectation is that things will become far better in the not distant future. The real challenge for the analyst at the moment is figuring out why there is such an upbeat attitude about what happens the rest of the year. Is this mostly wishful thinking or is there substance to all this.

Violence in Egypt

The talking heads have been breathless on the subject of the soccer riots in Egypt. The assessment is typical of those who do not seem to have a grasp of the core issues as the commentary has been full of condescending rhetoric about a primitive people willing to go to war over a soccer game. This approach seems to forget that the center for soccer hooliganism is still Britain but beyond that the whole point was missed as far as Egypt is concerned. The soccer match may have provoked the outburst on that day but the motivation behind the actions far greater than anger over an outcome. Egypt is seething and the young population feels betrayed by those they thought would reform the country and address their needs.

Analysis: Egypt is still in the hands of those that ruled in the days of Hosne Mubarak. The unemployment rate is still exceedingly high for the young and they get angrier by the day. The soccer riots were just the latest manifestation and now the attacks have spread as people challenge police in the streets. The revolution may have started in Egypt last year but it is far from over.

Do Chinese Manufacturers Still Have Pride of Place?

The last section of our week long look at China and its challenges will examine the internal dynamics of the manufacturing sector. We have noted that China is losing some of its low cost edge to other competitors in the region and that it has struggles in competing with the more sophisticated nations. What about the internal dynamics of manufacturing? There is everything from labor unrest to issues of pollution. Look for this on the website this week. www.armada-intel.com If you have not taken advantage of our trial offer on the Executive Brief we invite you to sign up for some free issues by contacting ksanchez@armadaci.com. The Executive Intelligence Brief is the companion publication to the Business Intelligence Brief. It is part of the Armada Strategic Intelligence System and is more detailed and more far ranging than the BIB. It is our subscription based publication and is available to BIB readers at a discount.



Does Anything Work?

It has been a while since one of my patented rants and it just seems like a good time. The day started with the snapping of my glasses as I tried to clean them. I am now sporting an older pair and it is pretty obvious that my eyes changed. Frames are not exactly cheap and one would expect more than a year but that is just part of the pattern of product failure these days. I have been trying to put a protective film on the new I-Pad but the little spray bottle that is apparently crucial to the establishment of world peace will not spray. That has become a common theme in the last week. The spray bottles containing squirrel repellent didn't work either (although I suspect they may have sabotaged by the furry miscreants). Every year I do battle with the sprinklers we purchase as they universally fail to distribute water. You get the gist. We are surrounded with stuff that fails - items that seem to have been designed without the ultimate use in mind. Why is this?

One can go on at great length about the decline in quality and that is certainly an issue. There may be more to this given the reaction we usually have to these chronic failures. We just throw the junk away and buy more junk. Perhaps it is time for real consumer rebellion in the form of demanding more. If it doesn't work we need to demand a response other than a shrug of the shoulders. Beyond that we probably need to support those who refuse to make or sell the junk in the first place. I am not sure what one does about spray bottles that refuse to spray but I am through with crummy sprinklers – that's for sure.

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