Report for July 2018

Issued July 31, 2018

National Association of Credit Management

Combined Sectors

There have been lots of troublesome rumblings as far as the performance of the economy is concerned. One can already see people shaking their heads and mumbling about the ways of the economist—always finding the dark cloud behind the silver lining. What could be wrong with an economy that is sporting the fastest quarterly growth seen in four years (4.1% in Q2), the lowest rates of unemployment in years (between 3.8% and 4%) and a dramatic expansion of exports? "It seems that credit managers are seeing some of these warning signs and are not as impressed with these good news reports," said NACM Economist Chris Kuehl, Ph.D. "In fact, some of the issues can be read in those same reports. Much of what drove the fast growth in Q2 came from higher export levels, which took place as buyers of soybeans and other agriculture products rushed to get their orders filled before tariffs took effect. Sales will now start to fall like a rock."

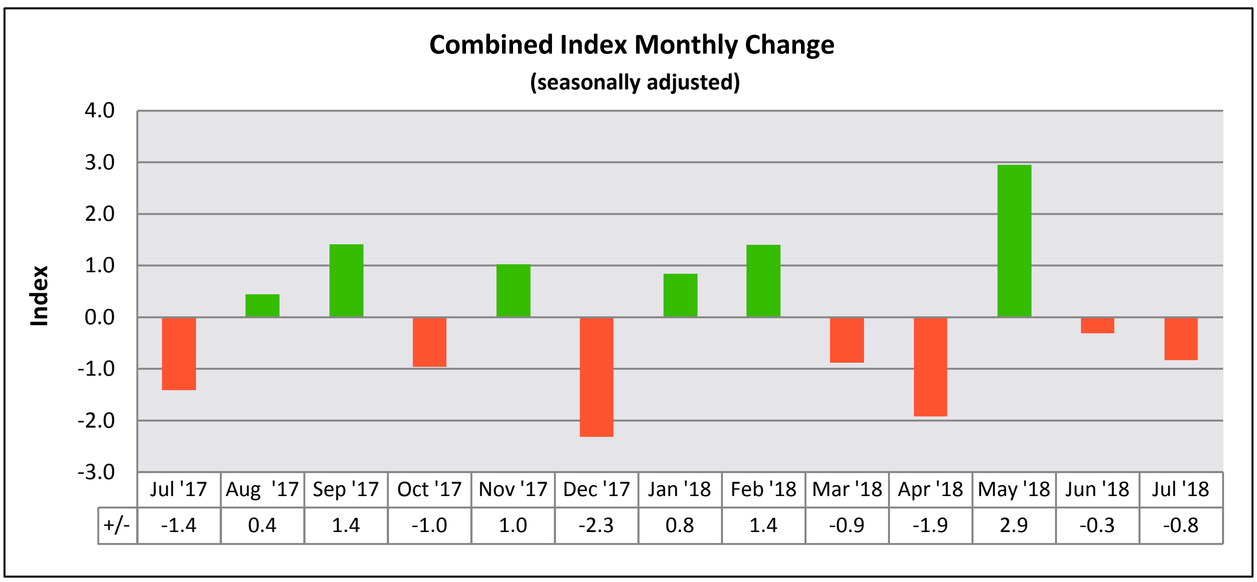
Looking at this month's Credit Managers' Index (CMI), there are several areas that seem less than encouraging. The combined score slipped a bit from 56.3 to 55.5—still well into the mid-50s and the expansion zone (anything above 50), but with a score lower than it has been the last two months. The index of favorable factors dropped, but it remained thoroughly within expansion territory at 63.1 after hitting 64.9 the month prior and 65.7 the month before that. The index of unfavorable factors stayed close to what it had been previously—50.5 after a reading of 50.6 in both May and June. As always, the story is in the details.

The sales category fell from its unusually high level of 69.6 to a reading of 63.9, the lowest since January. Kuehl noted the impact of the tax cuts may have started to fade, but these numbers are thoroughly in the 60s and still solid. The new credit applications category improved over last month with a mark of 61.2 compared to 60.5. This is quite a bit less than was notched the month before in May when it hit 63.8. The always mercurial dollar collections number dropped by quite a bit, but still stayed in the 60s as it went from 63.2 to 61, while the amount of credit extended stayed close to what it has been for the last few months at 66.1. It was at 66.2 in June and 66.8 in May. Kuehl suggests bigger requests from larger companies are being handled.

The rejections of credit applications improved a little from 51.2 to 52.5. This is especially important given that requests in general are down. Kuehl said there had been some hope that accounts placed for collection were going to steadily improve as they had broken back into expansion territory last month with a reading of 51.3, but this month the reading was back in the contraction zone at 49.9. The data for the disputes category dipped further into contraction with a reading of 47.7 after 48.3 in June. The dollar amount beyond terms category has been problematic all year—that variability has been responsible for much of the total index volatility. It was at 49.2 last month and fell to 47.4 this month. The dollar amount of customer deductions is now at 47.9 after being at 48.1 in June. The best news of the month comes from the category of filings for bankruptcies, which improved quite a bit from 55.7 to 57.4. Kuehl said "this suggests most companies are continuing to muddle through whatever challenges they are facing and have not elected to give up altogether."

"The fear now is some of the factors that had been keeping the economy functioning reasonably well are starting to fade. Inflation threats are becoming very real with the recent rise of wages to accompany the rise in commodity prices," he explained. "If there are further hikes due to the tariff and trade wars, the inflation threat becomes imminent and serious and very difficult to walk back from."

Combined Manufacturing and Service Sectors (seasonally adjusted)	Jul '17	Aug '17	Sep '17	Oct '17	Nov '17	Dec '17	Jan '18	Feb '18	Mar '18	Apr '18	May '18	Jun '18	Jul '18
Sales	62.8	62.2	67.3	66.8	68.3	59.2	63.0	66.8	64.1	65.8	69.6	69.6	63.9
New credit applications	59.7	61.2	60.5	62.8	63.7	57.3	59.8	63.3	62.7	62.2	63.8	60.5	61.2
Dollar collections	60.2	58.9	60.0	60.2	63.1	59.1	58.7	62.9	59.6	46.7	62.5	63.2	61.0
Amount of credit extended	64.1	66.7	66.3	65.5	67.8	61.8	64.3	66.4	66.2	66.1	66.8	66.2	66.1
Index of favorable factors	**61.7**	**62.2**	**63.5**	**63.8**	**65.7**	**59.4**	**61.4**	**64.9**	**63.2**	**60.2**	**65.7**	**64.9**	**63.1**
Rejections of credit applications	51.9	52.2	52.5	51.8	52.4	51.4	51.8	51.5	53.3	51.0	51.3	51.2	52.5
Accounts placed for collection	48.9	48.7	50.3	49.5	50.5	49.8	51.7	49.8	50.4	48.7	49.0	51.3	49.9
Disputes	48.8	49.1	51.7	47.6	48.3	49.7	49.6	49.6	47.7	48.0	48.1	48.3	47.7
Dollar amount beyond terms	48.3	47.4	50.4	47.3	47.5	49.3	47.0	49.9	47.2	46.4	49.4	49.2	47.4
Dollar amount of customer deductions	48.1	49.2	49.8	48.7	48.9	49.7	49.7	49.1	49.8	48.4	49.7	48.1	47.9
Filings for bankruptcies	53.6	55.3	56.2	55.3	55.1	55.0	55.2	55.4	55.2	53.8	56.4	55.7	57.4
Index of unfavorable factors	**49.9**	**50.3**	**51.8**	**50.0**	**50.4**	**50.8**	**50.8**	**50.9**	**50.6**	**49.4**	**50.6**	**50.6**	**50.5**
NACM Combined CMI	**54.6**	**55.1**	**56.5**	**55.5**	**56.6**	**54.2**	**55.1**	**56.5**	**55.6**	**53.7**	**56.6**	**56.3**	**55.5**



Manufacturing Sector

"The sector that seemed to get the biggest boost from the tax cuts was manufacturing as many of the small- and medium-sized companies struggling to emerge from the recession were finally able to purchase the machines they had needed for years. The larger companies spent more of that windfall on stock buybacks and internal activity, but the mid-market stuff has been taking off," Kuehl said. "The problem that lies ahead is that this same group will feel the impact of the trade wars and tariff battles through the end of this year and into next."

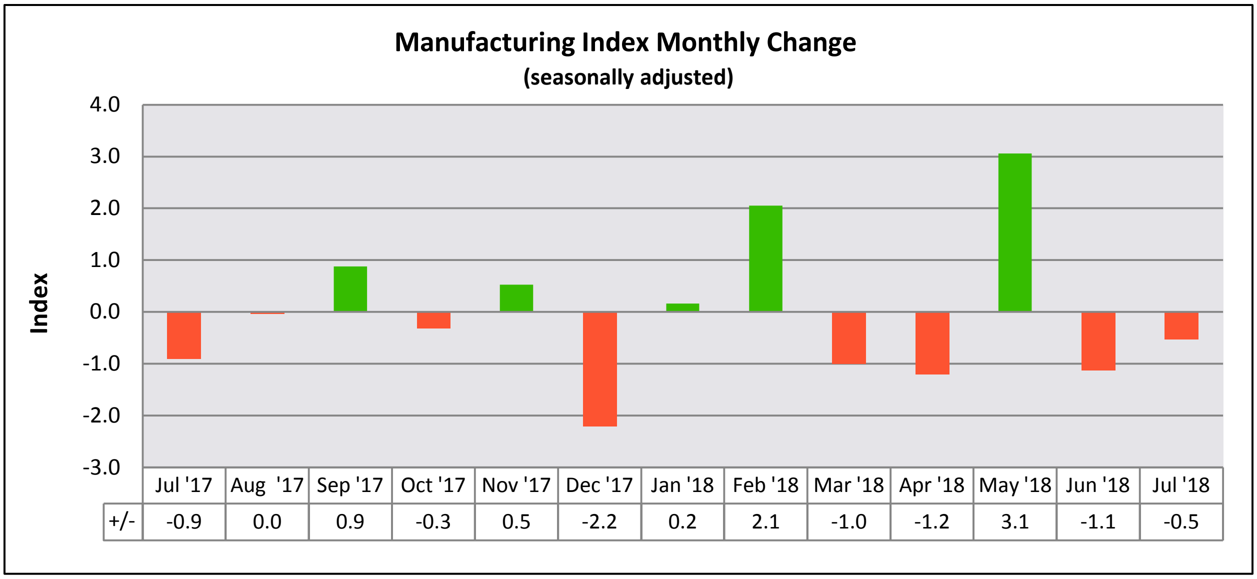
The combined manufacturing score this month is very similar to what it was last month. It barely moved from 55.9 to 55.4 and is nicely placed in the middle of the 50s. The index of favorable factors slipped a bit from 64.6 to 62.1, but readings in the 60s remain very solid and thoroughly in expansion territory. The index of unfavorable factors also showed a lot of stability with a reading of 50.9 after June's 50.1. Kuehl suggested there was quite a lot of stability this month, but that may not be the case for much longer.

The sales numbers fell quite hard, but last month was also unusually high at 69.1. This month, the reading was 62.4, certainly still very acceptable. The new credit applications category fell out of the 60s for the first time since January as it went from 60.2 to 59.5. The dollar collections number slid a little as well, but not all that far (63.3 to 61.5). "This has been a volatile number all year, but has recently calmed down quite a bit as it seems that fewer of the manufacturers are having cash flow issues," he said. The amount of credit extended stayed almost the same at 65.1. May's reading of 66.4 was followed by June's 65.7.

The rejections of credit applications improved quite a bit from 50.6 to 53.5. He suggests this is especially good news in light of the fact that credit applications have generally been down and those applying are creditworthy. The category of accounts placed for collection was exactly the same as it was the month before at 50.6. There has been very little movement in that category for the year, bouncing between 49 and 51. The disputes reading shifted deeper into the contraction zone going from 47.9 to 47. Dollar amount beyond terms at 48.1, which has also been very volatile, stayed very close to what it was the month before (48.7). The dollar amount of customer deductions also showed stability with a reading of 46.9 after June's 46.6. The best news of the month comes with the category of filings for bankruptcies as it went from 56.2 to 59.1, as close to 60 as this category has come in several years.

"Manufacturing has been on a roll for the bulk of the year. That has been obvious by looking at the favorable factors and their persistent positioning in the 60s," Kuehl said. "What is worrisome is that there are still lots of sagging readings in the nonfavorable sectors. If companies are still struggling to get out of a rut this long into a robust recovery, what will they look like when there are issues later with a slowing economy?"

Manufacturing Sector (seasonally adjusted)	Jul '17	Aug '17	Sep '17	Oct '17	Nov '17	Dec '17	Jan '18	Feb '18	Mar '18	Apr '18	May '18	Jun '18	Jul '18
Sales	64.0	60.8	65.0	67.4	68.2	59.2	62.7	65.8	62.5	66.2	69.6	69.1	62.4
New credit applications	60.6	61.8	59.0	61.8	64.5	56.5	57.8	65.2	62.4	60.8	62.4	60.2	59.5
Dollar collections	61.1	59.3	60.4	59.5	60.9	58.9	58.7	62.8	59.5	46.1	63.5	63.3	61.5
Amount of credit extended	64.5	66.1	64.0	65.2	67.4	60.7	63.4	65.9	65.3	66.0	66.4	65.7	65.1
Index of favorable factors	**62.5**	**62.0**	**62.1**	**63.5**	**65.3**	**58.8**	**60.7**	**64.9**	**62.4**	**59.8**	**65.5**	**64.6**	**62.1**
Rejections of credit applications	52.9	52.8	52.5	53.7	52.6	51.5	51.8	51.5	54.1	52.4	53.4	50.6	53.5
Accounts placed for collection	49.8	49.7	50.1	48.6	51.5	50.3	51.2	50.1	51.0	49.8	51.3	50.6	50.6
Disputes	47.8	47.3	53.0	48.2	47.1	48.8	48.4	47.6	46.0	48.0	46.9	47.9	47.0
Dollar amount beyond terms	49.4	49.2	51.9	48.6	48.2	50.1	45.0	48.5	46.5	46.8	50.2	48.7	48.1
Dollar amount of customer deductions	47.6	48.0	48.5	47.1	45.7	49.1	46.6	47.7	48.7	48.4	48.4	46.6	46.9
Filings for bankruptcies	53.0	55.5	54.7	56.0	55.4	54.4	55.3	56.3	55.6	55.1	58.0	56.2	59.1
Index of unfavorable factors	**50.1**	**50.4**	**51.8**	**50.4**	**50.1**	**50.7**	**49.7**	**50.3**	**50.3**	**50.1**	**51.4**	**50.1**	**50.9**
NACM Manufacturing CMI	**55.1**	**55.0**	**55.9**	**55.6**	**56.1**	**53.9**	**54.1**	**56.2**	**55.2**	**54.0**	**57.0**	**55.9**	**55.4**



Service Sector

The service sector was strong enough last month to avoid the dip that manufacturing experienced, but not strong enough to avoid it two months in a row. The sector is a very broad one, which always complicates the process of assessing what happens in the category overall. It includes retail, health care, professional services, construction and transportation (among others), and they do not perform in lock step.

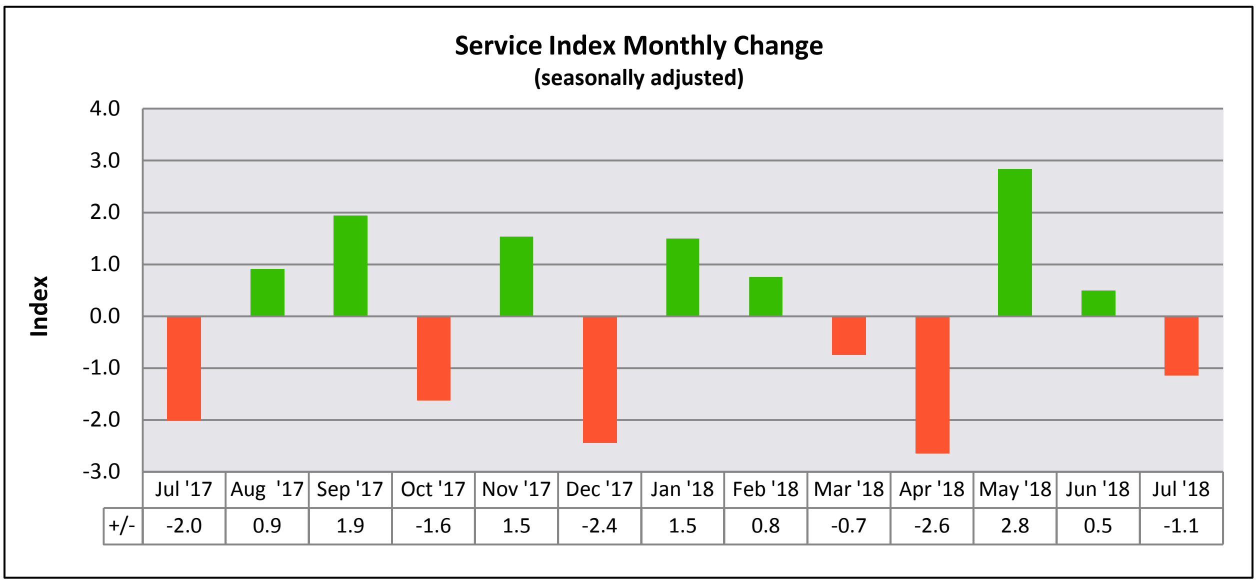
The combined score for services was 55.6, just a little less than it was in June when the number was 56.8. This remains in the middle of the 50s and healthy. The index of favorable factors slipped from 65.2 to 64, and the index of nonfavorable factors dropped from 51.1 to 50.1. This is not a big change, but more of a change than was registered the month previous.

The sales reading dropped from that startling high of 70.1, but is still very solidly in the 60s at 65.3. The new credit applications number improved quite a bit. It is the time of year for this to take place as retail starts to build inventory. It was at 60.9 and is now at 63. The dollar collections number slipped a little though and is teetering on the edge of the 60s (from 63 to 60.5). There was a little improvement in the amount of credit extended as it went from 66.8 to 67.2.

The rejections of credit applications stayed almost the same as the month before, dropping slightly from 51.8 to 51.5. This is still good news given there was a substantial increase in the number of new applications. The accounts placed for collection category slipped back into contraction territory with a reading of 49.3 from a respectable 52 in June. The disputes category stayed firmly in contraction at 48.3 after being at 48.6 the month before. The dollar amount beyond terms also languished in the 40s with a reading of 46.8 after being at 49.7 in June. “This has been a troublesome category for months as slow pays have been rising one month and falling the next,” Kuehl said. The dollar amount of customer deductions also fell (49.6 to 48.8). As with the manufacturing data, the bright spot was filings for bankruptcies. There was not much change and the numbers stayed in the mid-50s with a reading of 55.8 after last month’s 55.1.

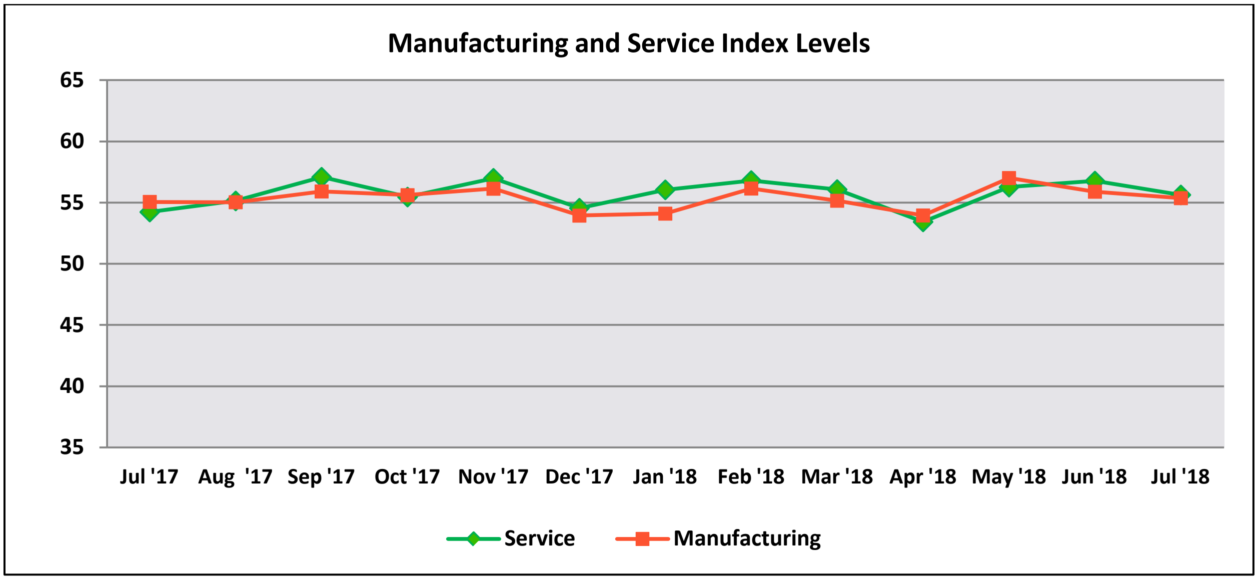
Service Sector (seasonally adjusted)	**Jul '17**	**Aug '17**	**Sep '17**	**Oct '17**	**Nov '17**	**Dec '17**	**Jan '18**	**Feb '18**	**Mar '18**	**Apr '18**	**May '18**	**Jun '18**	**Jul '18**
Sales	61.7	63.6	69.7	66.1	68.4	59.2	63.3	67.8	65.8	65.5	69.6	70.1	65.3

New credit applications	58.8	60.6	62.0	63.7	62.9	58.2	61.8	61.5	63.0	63.6	65.1	60.9	63.0
Dollar collections	59.4	58.6	59.5	61.0	65.4	59.4	58.6	63.0	59.8	47.3	61.5	63.0	60.5
Amount of credit extended	63.8	67.3	68.6	65.9	68.2	63.0	65.1	66.9	67.2	66.2	67.2	66.8	67.2
Index of favorable factors	**60.9**	**62.5**	**64.9**	**64.2**	**66.2**	**59.9**	**62.2**	**64.8**	**63.9**	**60.6**	**65.8**	**65.2**	**64.0**
Rejections of credit applications	50.8	51.5	52.5	49.8	52.3	51.2	51.8	51.5	52.4	49.5	49.2	51.8	51.5
Accounts placed for collection	48.1	47.8	50.6	50.3	49.6	49.3	52.1	49.6	49.7	47.7	46.7	52.0	49.3
Disputes	49.8	50.8	50.3	47.0	49.5	50.7	50.9	51.6	49.3	47.9	49.3	48.6	48.3
Dollar amount beyond terms	47.2	45.6	49.0	46.1	46.7	48.4	49.0	51.3	47.8	46.0	48.5	49.7	46.8
Dollar amount of customer deductions	48.6	50.4	51.1	50.2	52.1	50.4	52.7	50.5	50.9	48.3	50.9	49.6	48.8
Filings for bankruptcies	54.2	55.2	57.6	54.6	54.7	55.7	55.0	54.4	54.8	52.4	54.8	55.1	55.8
Index of unfavorable factors	**49.8**	**50.2**	**51.8**	**49.7**	**50.8**	**51.0**	**51.9**	**51.5**	**50.8**	**48.6**	**49.9**	**51.1**	**50.1**
NACM Service CMI	**54.2**	**55.1**	**57.1**	**55.5**	**57.0**	**54.5**	**56.0**	**56.8**	**56.1**	**53.4**	**56.3**	**56.8**	**55.6**



July 2018 versus July 2017

“The month-to-month curve has been pretty flat—basically a good thing given the fact that the favorable factors have been in the 60s consistently and the nonfavorables have been clinging to the bottom of what would be termed expansion territory,” Kuehl concluded.



Methodology Appendix

CMI data has been collected and tabulated monthly since February 2002. The index, published since February 2003, is based on a survey of approximately 1,000 trade credit managers in the second half of each month, with about equal representation between the manufacturing and service sectors. The survey asks respondents to comment whether they are seeing improvement, deterioration or no change for various favorable and unfavorable factors. There is representation from all states, except some of the less populated, such as Vermont and Idaho. The computation of seasonality is based on the formula used by the U.S. Census Bureau and most of the federal government's statistical gathering apparatus, making it possible to compare the CMI diffusion index with comparable indices, such as the Purchasing Managers' Index (PMI) and other manufacturing and service sector indices.

Factors Making Up the Diffusion Index

As shown in the table below, 10 equally weighted items determine the index. These items are classified into two categories: favorable factors and unfavorable factors. A diffusion index is calculated for each item with the overall CMI being a simple average of the 10 items. Survey responses for each item capture the change—higher, lower or the same—in the current month compared to the previous month.

For positive indicators, the calculation is:

$$\frac{\text{Number of “higher” responses} + \tfrac{1}{2} \times \text{number of “same” responses}}{\text{Total number of responses}}$$

For negative indicators, the calculation is:

$$\frac{\text{Number of “lower” responses} + \tfrac{1}{2} \times \text{number of “same” responses}}{\text{Total number of responses}}$$

A resulting CMI number of more than 50 indicates an economy in expansion; less than 50 indicates contraction.

Favorable Factors	Why Favorable
Sales	Higher sales are considered more favorable than lower sales.
New credit applications	An increase in credit applications says that demand is greater this month, which represents increased business if credit is extended.
Dollar collections	Higher dollar collections represent improved cash flow for the selling firm and the ability of buying firms to pay.
Amount of credit extended	An increase for this item means business activity is expanding with greater sales via trade credit.
Unfavorable Factors*	**Why Unfavorable**
Rejections of credit applications	Increased rejections of credit applications means more marginal creditworthy customers are seeking trade credit and being denied.
Accounts placed for collection	As this item increases, the selling firm is having trouble collecting accounts, or conversely, there is an increase in buyers not paying.
Disputes	Higher dispute activity often is associated with cash flow problems of customers. They dispute the invoice to defer payment until later.
Dollar amount of receivables beyond terms	As this item becomes higher, it means customers are taking longer to pay.
Dollar amount of customer deductions	Higher deductions often are associated with cash flow problems of customers.
Filings for bankruptcies	Higher bankruptcy filings mean cash flow difficulties of customers are increasing.

**Note: When survey respondents report increases in unfavorable factors, the index numbers drop, reflecting worsening conditions.*

About the National Association of Credit Management

NACM, headquartered in Columbia, MD, supports more than 13,000 business credit and financial professionals worldwide with premier industry services, tools and information. NACM and its network of affiliated associations are the leading resource for credit and financial management information, education, products and services designed to improve the management of business credit and accounts receivable. NACM's collective voice has influenced our nation's policy makers on federal legislation concerning commercial business and trade credit for more than 100 years and continues to play an active role in legislative issues that pertain to business credit and corporate bankruptcy. Its annual Credit Congress & Expo is the largest gathering of credit professionals in the world.

NACM has a wealth of member experts in the fields of business-to-business credit and law. Consider using NACM as a resource in the development of your next credit or finance story.

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