

Report for July 2019

Issued July 31, 2019 National Association of Credit Management

Combined Sectors

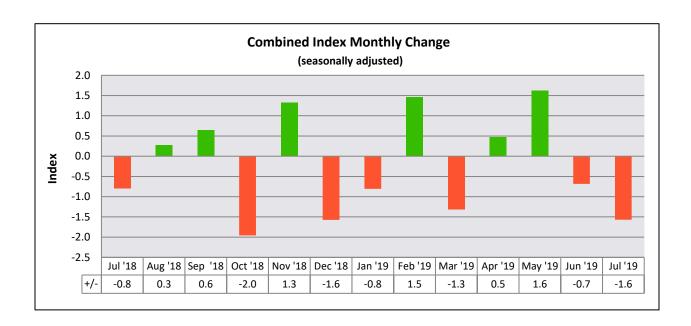
This has been a year that tests the mettle of an economist and illustrates why the meteorologist remains such a kindred spirit. The expectation at the start of the year was that economic decline was both inevitable and imminent. The impact of the 2018 tax cuts had faded, consumers were losing confidence and headwinds from trade wars and slower segments of the economy (such as housing) would have an impact on everything from employment to the stock market. Yet, "here we are at the mid-point of the year and the data still points to a decent growth rate for the U.S. economy," said NACM Economist Chris Kuehl, Ph.D. "The worrisome part is that some of the more reliable future indicators, including the CMI, are starting to falter."

The combined index dropped this month as it fell from 55 to 53.4. This is still not as drastic a decline as has been experienced by the Purchasing Managers' Index which tumbled to an even 50, but it is still the lowest reading since January. January's 53.4 had previously held the record as the lowest reading seen since 2017. In the last year, the combined index has only been lower than 54 a total of three times. The index of favorable factors took the biggest hit by dropping from 61.4 to 58.6. This measure has only been under 60 a total of four times in the last year; this month's reading was the lowest of them all. The index of unfavorable factors stayed close to what it had been the month before with a reading of 50, down from 50.7 in June.

Breaking down the factors that go into the favorable and unfavorable categories illustrates the problems affecting the credit sector. Sales slipped from 60.4 to 58.4, nearly as low as it was in March of this year. It seems a long way from the 65.9 notched in May. The new credit application numbers fell a little from 62.4 to 60.8, but this category remains respectable. The real concern is with the dollar collection numbers as they have tumbled from 60.3 to 56.6, back to the readings last seen in March. The amount of credit extended also fell quite a bit and hit 58.7 after having been at 62.5 the month before. This marks the first time this category has been under the 60 line in over a year. "There is simply not as much credit on offer these days," Kuehl said.

The breakdown of the unfavorable factors also provides some insights. The rejections of credit applications stayed almost the same as it had been in June (up from 52.4 to 52.6). Kuehl noted, "That is good news given the decline in the number of applications. It means those applying are generally qualified." The accounts placed for collection is not such a good news indicator as it has plunged out of the expansion zone (a reading above 50) deep into contraction territory. The reading now is 46.2 from the previous month's 50. This would be more alarming if this category had not generally been in the mid-40s for most of the year. The disputes category actually improved and left the contraction zone with a reading of 50.5 down from 48.6 the month before. The dollar amount beyond terms got mired even deeper in contraction with a reading of 46.1 after being at 49.8. The dollar amount of customer deductions gained a little ground and moved further into expansion territory with a reading of 51.2 compared to 50 in June. The filings for bankruptcy numbers remained almost exactly where they had been with a reading of 53.2 compared to last month's 53.5. "The issues that have contributed to more accounts out for collection and reduced dollar collection have not become serious enough to boost the bankruptcy numbers," he said. "What is of some concern is many of the bankruptcies are taking place with larger companies and they have tended to come in the retail sector as well as in industries that rely heavily on global trade—import side or export side."

Combined Manufacturing and Service Sectors (seasonally adjusted)	Jul '18	Aug '18	Sep '18	Oct '18	Nov '18	Dec '18	Jan '19	Feb '19	Mar '19	Apr '19	May '19	Jun '19	Jul '19
Sales	63.9	65.0	68.8	62.7	64.5	59.0	59.7	62.6	58.2	61.0	65.9	60.4	58.4
New credit applications	61.2	62.5	61.9	61.7	62.2	57.5	58.2	58.9	57.8	59.7	64.2	62.4	60.8
Dollar collections	61.0	62.6	62.8	57.5	60.9	59.3	59.0	59.1	56.6	59.1	59.8	60.3	56.6
Amount of credit extended	66.1	66.9	67.1	64.5	65.3	61.9	61.2	62.3	63.5	60.6	65.4	62.5	58.7
Index of favorable factors	63.1	64.3	65.2	61.6	63.2	59.4	59.5	60.7	59.0	60.1	63.8	61.4	58.6
Rejections of credit applications	52.5	52.2	51.8	51.4	51.4	51.4	51.8	52.1	51.2	52.0	51.8	52.4	52.6
Accounts placed for collection	49.9	49.0	50.2	48.8	48.2	49.7	48.2	49.0	46.4	48.5	47.0	50.0	46.2
Disputes	47.7	46.4	47.6	48.9	50.1	49.6	47.1	48.5	49.5	48.5	48.6	48.6	50.5
Dollar amount beyond terms	47.4	48.5	49.9	47.7	52.3	49.3	47.4	51.3	50.0	47.6	51.3	49.8	46.1
Dollar amount of customer deductions	47.9	48.7	48.6	49.5	49.6	49.7	48.0	50.0	48.8	49.7	49.3	50.0	51.2
Filings for bankruptcies	57.4	55.9	55.6	52.1	53.6	55.0	53.8	54.9	53.7	53.9	53.3	53.5	53.2
Index of unfavorable factors	50.5	50.1	50.6	49.7	50.9	50.8	49.4	51.0	49.9	50.0	50.2	50.7	50.0
NACM Combined CMI	55.5	55.8	56.4	54.5	55.8	54.2	53.4	54.9	53.6	54.0	55.7	55.0	53.4



Manufacturing Sector

Kuehl suggests that much of the manufacturing data of late has been contradictory. There have been gains in categories such as durable goods orders (once one separates out the aerospace data), but factory orders have been weak. The level of capacity utilization remains close to the preferred range between 80% and 85%, but the numbers slipped a bit. The data from the Purchasing Managers' Index has been teetering on the edge of contraction and now there is a substantial tumble in the Credit Managers' Index. There are really no simple answers here, but the most often cited is volatility. There are too many unknowns at the moment—everything from the potential impact of an expanded trade and tariff war to the travails of the Boeing 737 Max. Add in labor shortages and the looming reality of a truly nasty election year, and businesses in general are uneasy.

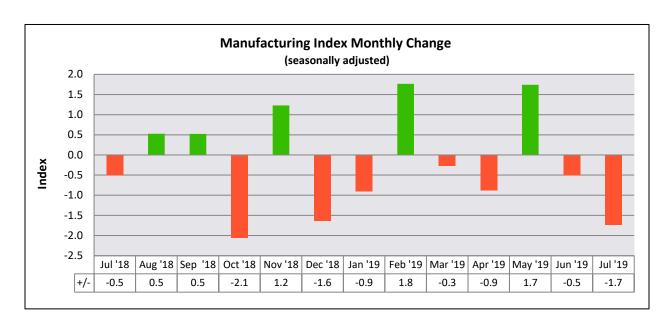
In July, the combined score for the manufacturing sector dropped to the lowest level since January. It now sits at 53.2. At the start of the year it was 53.1. This is certainly lower than it has been in recent months but not all that much lower as the high point was reached in May with a score of 55.4. The index of favorable factors dropped precipitously from 60.4 to 56., the lowest reading in several years. It is worth noting that in January the reading fell to 57.7 and subsequently recovered to 60 the next month. The index of unfavorable factors fell only slightly from the month before and most importantly managed to avoid sinking back into contraction territory. It is sitting at 50.8 after June's 51.3. The current reading is about where it has been for the year (49.9 in January, 51.4 in February, 50.7 in March, 50.2 in April, 50.3 in May).

The details in the subcategories tell a pretty compelling story. The sales reading stayed much as it was with a 57.6 compared to 58.5 in June. The category of new credit applications shifted down a little to 60 from 62.5. The big changes were with dollar collections and amount of credit extended. The former saw a plunge from 59.2 to 54.7, which is worrisome as it suggests that income flow is weakening fast. "The trepidation among some companies is manifesting with their reluctance to offer as much credit as they have in the past," Kuehl said. The drop in the credit extended subcategory went from 61.3 to 54.7. He added, "It is important to note that all these readings are still firmly in the expansion zone, but the trend is certainly not encouraging."

There was some similar movement of note in the unfavorable categories and there has also been some encouraging news. The rejections of credit applications stayed almost the same as the prior month with a reading of 53.4 from 53.8. The accounts placed for collection stumbled quite a bit. This seems consistent with the decline in dollar collections noted above. The reading last month was a healthy 53.5 and this month the reading was a miserable 46.7. The disputes category actually improved and entered expansion territory for the first time since March with a reading of 51 up from 48.3 in June. The dollar amount beyond terms slipped back into contraction territory with a reading of 48 after June's mark of 50.2. This was no surprise given the issues with dollar collections and the increase in accounts out for collection. The dollar amount of customer deductions improved quite a lot from 49.8 to 52.7, and that was a bit surprising. The filings for bankruptcies data improved slightly as well, as the reading went from 52 to 53.

"The bottom line this month is that some important warning signs are starting to flash," Kuehl said. "The decline in dollar collections is an immediate concern. If one combines the increase in collection activity as well as slow pays, the future looks considerably less optimistic."

Manufacturing Sector (seasonally adjusted)	Jul '18	Aug '18	Sep '18	Oct '18	Nov '18	Dec '18	Jan '19	Feb '19	Mar '19	Apr '19	May '19	Jun '19	Jul '19
Sales	62.4	66.5	68.2	62.3	64.2	59.0	59.1	61.7	58.4	58.6	63.3	58.5	57.6
New credit applications	59.5	61.4	61.8	61.5	61.7	56.8	53.3	58.6	61.2	59.8	63.9	62.5	60.0
Dollar collections	61.5	62.4	59.0	58.5	61.6	59.0	58.4	60.5	57.8	58.6	60.5	59.2	54.7
Amount of credit extended	65.1	67.1	68.5	63.7	65.4	60.9	60.3	59.2	63.9	58.5	64.6	61.3	54.7
Index of favorable factors	62.1	64.4	64.4	61.5	63.2	58.9	57.7	60.0	60.3	58.9	63.1	60.4	56.7
Rejections of credit applications	53.5	53.7	53.1	51.9	53.1	51.6	53.3	53.5	53.2	53.1	52.5	53.8	53.4
Accounts placed for collection	50.6	49.6	51.2	49.1	49.2	50.3	49.7	50.5	46.8	49.3	49.0	53.5	46.7
Disputes	47.0	45.8	48.7	48.7	49.6	48.6	46.8	48.7	50.2	47.7	48.2	48.3	51.0
Dollar amount beyond terms	48.1	48.4	50.2	49.1	50.3	50.0	49.1	52.8	51.0	48.5	51.8	50.2	48.0
Dollar amount of customer deductions	46.9	48.1	47.4	48.0	48.6	49.1	46.7	49.3	48.4	49.5	48.4	49.8	52.7
Filings for bankruptcies	59.1	56.0	56.0	50.9	52.2	54.4	54.0	53.3	54.6	53.3	52.0	52.0	53.0
Index of unfavorable factors	50.9	50.2	51.1	49.6	50.5	50.7	49.9	51.4	50.7	50.2	50.3	51.3	50.8
NACM Manufacturing CMI	55.4	55.9	56.4	54.4	55.6	54.0	53.1	54.8	54.6	53.7	55.4	54.9	53.2



Service Sector

For the service sector, Kuehl notes that the summer months can be vexing for those that depend on retail. It is too early for the holiday season to influence, although the back-to-school activity starts to gear up by the first of August. It is too late in the year to be dragged down by bad weather and the impact of tax time. Consumers are still spending, but their focus is on services as opposed to goods—they are traveling and vacationing so money goes to lodging, meals and entertainment. Retailers feel the pinch, but anything connected to leisure time gets a boost. The data this month shows decline in some areas, but not as dramatically as was demonstrated in the manufacturing sector.

The combined score slipped a bit from last month's 55.1 to 53.7 this month, but in March that reading had fallen to 52.6, so this month looks solid enough. The index of favorable factors stayed in the 60s with a reading of 60.5 after hitting 62.4 in June. Again, this is far superior to the readings last March when the numbers fell to 57.7. The index of unfavorable factors slipped into the contraction zone with a reading of 49.1 (same as last March) and a bit lower than it was in June when it hit 50.2. The sense is there was more stability in the retail sector.

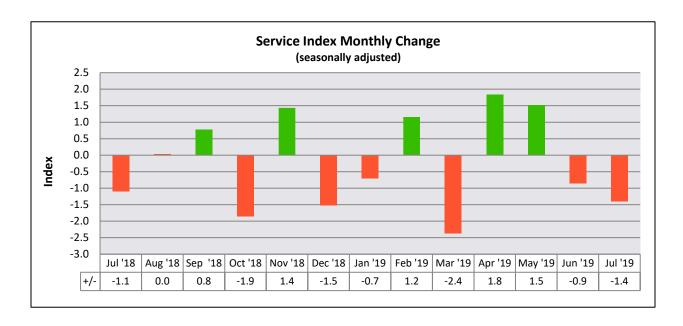
The sales data fell from 62.3 to 59.3, a significant drop but not as low as was seen in March (that was not a good month). The new credit applications stayed in the 60s with a reading of 61.6 after resting at 62.4 in June. There was some concern as far as dollar collections are concerned as this number fell out of the 60s with a reading of 58.4. The decline was not as dramatic as the decline in the manufacturing sector, and once again the reading in March was far worse at 55.5. The amount of credit extended stayed fairly consistent with a reading of 62.6 compared to June's 63.7. That was markedly different from the experience in the manufacturing data.

The rejections of credit applications remained stable as well with a reading of 51.9 compared to the 51 noted in June. The accounts placed for collection numbers slipped deeper into contraction territory with a reading of 45.7 compared to 46.6 last month. "This is not the trend line that anyone wants to see at this stage," Kuehl said, "but it would appear that most of the companies struggling with this situation are in retail." The disputes category improved a little and left the contraction zone with a reading of 50 up from 48.8 in June. The dollar amount beyond terms slipped very badly. This is the worst of the unfavorable readings. It was at 49.3, within striking distance of expansion, but now it is plunging with a reading of 44.2—by far the worst mark in over three years. He suggests that there are many companies suddenly facing cash flow issues and falling swiftly behind in their obligations. The dollar amount of customer deductions slipped into contraction as well, but not as drastically as the numbers went from 50.3 to

49.7. The filings for bankruptcies also slipped, but still the numbers are in the mid-50s with a reading of 53.4 compared to 55 last month. "The fear is that all those slow pays will soon become collection issues and the next step after that will be bankruptcy filings," he said.

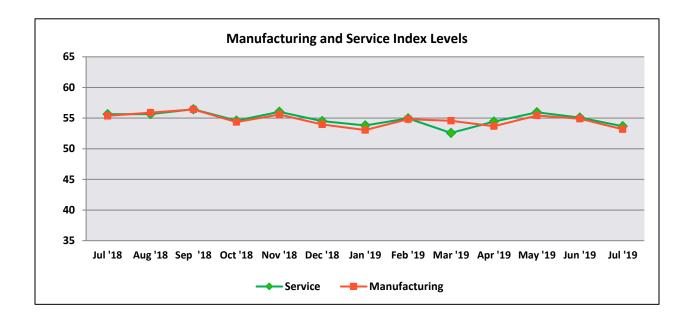
Kuehl thinks that all eyes will be on August sales and the levels of consumer confidence in the months ahead. If the coming holiday season is a weak one, there will be a lot of retailers in trouble. Many of them are already reeling from the impact of expanded online competition.

Service Sector (seasonally adjusted)	Jul '18	Aug '18	Sep '18	Oct '18	Nov '18	Dec '18	Jan '19	Feb '19	Mar '19	Apr '19	May '19	Jun '19	Jul '19
Sales	65.3	63.4	69.4	63.2	64.9	59.0	60.3	63.5	58.0	63.4	68.5	62.3	59.3
New credit applications	63.0	63.5	62.0	61.9	62.7	58.2	63.0	59.2	54.3	59.6	64.6	62.4	61.6
Dollar collections	60.5	62.9	66.5	56.4	60.1	59.6	59.6	57.7	55.5	59.6	59.1	61.4	58.4
Amount of credit extended	67.2	66.7	65.8	65.2	65.2	63.0	62.1	65.5	63.2	62.7	66.3	63.7	62.6
Index of favorable factors	64.0	64.2	65.9	61.7	63.2	59.9	61.3	61.5	57.7	61.3	64.6	62.4	60.5
Rejections of credit applications	51.5	50.7	50.5	50.9	49.7	51.2	50.3	50.8	49.1	50.8	51.2	51.0	51.9
Accounts placed for collection	49.3	48.5	49.2	48.4	47.2	49.1	46.7	47.5	46.0	47.7	45.1	46.6	45.7
Disputes	48.3	47.0	46.4	49.1	50.6	50.5	47.4	48.3	48.9	49.4	49.0	48.8	50.0
Dollar amount beyond terms	46.8	48.6	49.6	46.3	54.3	48.5	45.7	49.8	49.0	46.7	50.9	49.3	44.2
Dollar amount of customer deductions	48.8	49.3	49.7	51.1	50.7	50.3	49.2	50.6	49.1	49.8	50.1	50.3	49.7
Filings for bankruptcies	55.8	55.9	55.3	53.2	54.9	55.6	53.6	56.5	52.7	54.6	54.5	55.0	53.4
Index of unfavorable factors	50.1	50.0	50.1	49.8	51.2	50.9	48.8	50.6	49.1	49.8	50.1	50.2	49.1
NACM Service CMI	55.6	55.7	56.4	54.6	56.0	54.5	53.8	55.0	52.6	54.4	55.9	55.1	53.7



July 2019 versus July 2018

"This was most definitely a down month and one that was led into these doldrums by the manufacturing sector," Kuehl concluded. "The service side was more mixed, but retail doesn't appear to be as healthy as preferred as it prepares to enter the all-important holiday period."



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 Wyoming. 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:

 $\frac{\text{Number of "higher" responses} + \cancel{1} \times \text{number of "same" responses}}{\text{Total number of responses}}$

For negative indicators, the calculation is:

$\frac{\text{Number of "lower" responses} + \cancel{1} \times \text{number of "same" responses}}{\text{Total number of responses}}$

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, 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 11,000 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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