# Report for August 2010

**Issued September 1, 2010**
**National Association of Credit Management**

## Combined Sectors

The trend in data this past week was hardly encouraging, resulting in another chorus of pronouncements regarding an imminent return to recession. The housing market remains in the doldrums, GDP numbers were revised down in reaction to the worsening trade deficit numbers and there was a decline in the markets. In the midst of all this gloom comes the latest iteration of the Credit Managers' Index (CMI) and it is looking much like a beacon of hope. Over the last several years, the CMI, issued monthly by the National Association of Credit Management, has proven over and over that it is somewhat prescient when it comes to bigger economic trends. The precipitous decline in the CMI in June and July 2008 presaged the overall collapse of the economy three or four months later. The index started to gain as early as October 2009, followed by the rest of the economy, which showed some recovery by the end of the year (5% growth for the quarter). Worsening conditions began to appear in the CMI as early as May of this year followed by the economy as a whole in June and July.

"The good news coming from the August CMI is that the index showed some modest recovery, which was more dramatic in the manufacturing sector than in services," said Chris Kuehl, Ph.D., NACM economic advisor. "If the past is any prologue, this may signal some slow improvements in the overall economy within the next month or two. This optimistic assessment is tempered by the fact that the service sector remains weak and, given the size of this sector in the U.S. economy, as a whole remains a significant drag on overall recovery."

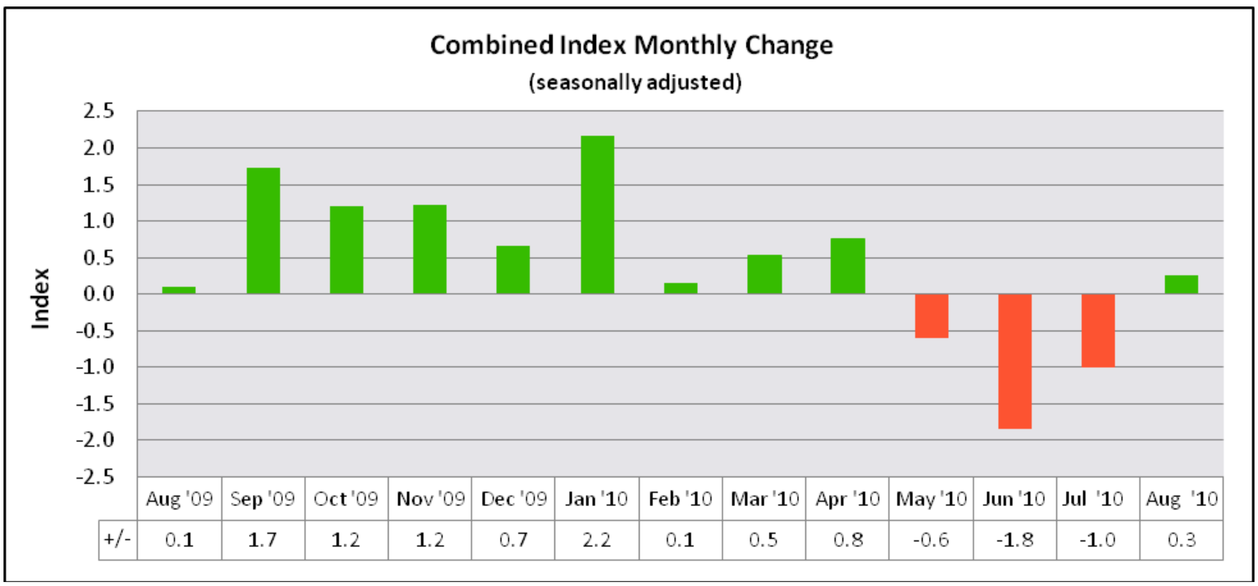
The improvement in the index—from 53.0 to 53.3—stems from small adjustments in areas that traditionally signal distress. The number of accounts placed for collection improved, invoking a number of suggestions as to why this is the case. Part of the reason, Kuehl noted, is that many of the weakest creditors have now exited the system—they have folded. There is also some renewed patience on the part of creditors according to survey respondents' comments: a willingness to work with accounts because improved business conditions may be on the horizon. The natural preference is to get paid by a customer and keep them in the system. Having to resort to collection usually means the relationship is destined to deteriorate. There is now a growing sense that patience may be rewarded should the economy stage any sort of turnaround in the coming months.

The fact that business bankruptcies fell a bit is another example of the change felt in the credit community. The weakest customers have already left the system and those that remain generally look strong enough to survive. In sales, there were some small changes in a positive direction and a pretty impressive improvement in dollar collections. Overall, the CMI is consistent with other observations made by economists this week.

Some parts of the economy are doing far better than others. Unfortunately, the down sectors are the bigger drivers in the overall economy—housing being at the top of the list. As is indicated by looking more closely at the CMI manufacturing numbers, the gains are being made in the industries that have been sustaining the economy for most of the last six months. Manufacturing has seen improved performance in sectors related to energy development, health care and, to a lesser extent, electronics. Even automotive has started to show a little improvement and, if recent numbers from the rail sector are any indication, there may be more manufacturing gains in the months to come. "Rail is often referred to as the canary in the coal mine for the economy and carloads have spiked in the last two months, a very good indicator of future manufacturing activity," said Kuehl.

*See page 5 of this report for information about the methodology and factors used to measure economic performance.*

| Combined Manufacturing and Service Sectors (seasonally adjusted) | Aug '09 | Sep | Oct | Nov | Dec '09 | Jan '10 | Feb | Mar | Apr | May | Jun | Jul | Aug '10 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Sales | 48.4 | 49.9 | 51.1 | 55.0 | 56.7 | 60.7 | 60.9 | 65.0 | 65.7 | 64.5 | 59.0 | 57.2 | 57.6 |
| New credit applications | 49.3 | 50.0 | 52.7 | 55.4 | 54.2 | 57.0 | 57.7 | 57.5 | 57.4 | 58.6 | 57.4 | 54.1 | 54.6 |
| Dollar collections | 50.5 | 53.4 | 54.7 | 55.8 | 58.0 | 61.3 | 61.1 | 61.9 | 62.1 | 59.7 | 59.4 | 56.3 | 57.7 |
| Amount of credit extended | 48.0 | 49.3 | 53.6 | 54.6 | 55.2 | 58.8 | 59.4 | 61.3 | 61.3 | 60.2 | 55.9 | 56.0 | 57.1 |
| **Index of favorable factors** | **49.1** | **50.6** | **53.0** | **55.2** | **56.0** | **59.4** | **59.8** | **61.4** | **61.6** | **60.7** | **57.9** | **55.9** | **56.7** |
| Rejections of credit applications | 49.0 | 48.4 | 49.0 | 49.3 | 50.1 | 51.4 | 51.0 | 50.1 | 50.9 | 50.7 | 51.0 | 52.0 | 50.7 |
| Accounts placed for collection | 43.6 | 45.3 | 47.1 | 49.5 | 50.9 | 50.7 | 50.4 | 51.1 | 50.6 | 54.5 | 51.4 | 49.3 | 51.1 |
| Disputes | 49.7 | 50.8 | 51.0 | 49.6 | 51.0 | 51.4 | 52.2 | 52.2 | 51.7 | 51.3 | 50.4 | 50.6 | 50.9 |
| Dollar amount beyond terms | 46.2 | 48.1 | 48.1 | 49.0 | 51.4 | 52.2 | 52.0 | 51.5 | 51.9 | 50.2 | 49.1 | 49.4 | 47.0 |
| Dollar amount of customer deductions | 50.6 | 51.8 | 50.5 | 51.3 | 51.3 | 52.5 | 51.2 | 51.7 | 55.7 | 51.8 | 50.3 | 50.5 | 49.6 |
| Filings for bankruptcies | 45.8 | 51.5 | 52.6 | 53.0 | 50.5 | 54.7 | 56.3 | 55.3 | 57.6 | 57.6 | 56.6 | 55.0 | 56.9 |
| **Index of unfavorable factors** | **47.5** | **49.3** | **49.7** | **50.3** | **50.8** | **52.2** | **52.2** | **52.0** | **53.1** | **52.7** | **51.5** | **51.1** | **51.0** |
| **NACM Combined CMI** | **48.1** | **49.8** | **51.0** | **52.3** | **52.9** | **55.1** | **55.2** | **55.7** | **56.5** | **55.9** | **54.1** | **53.0** | **53.3** |



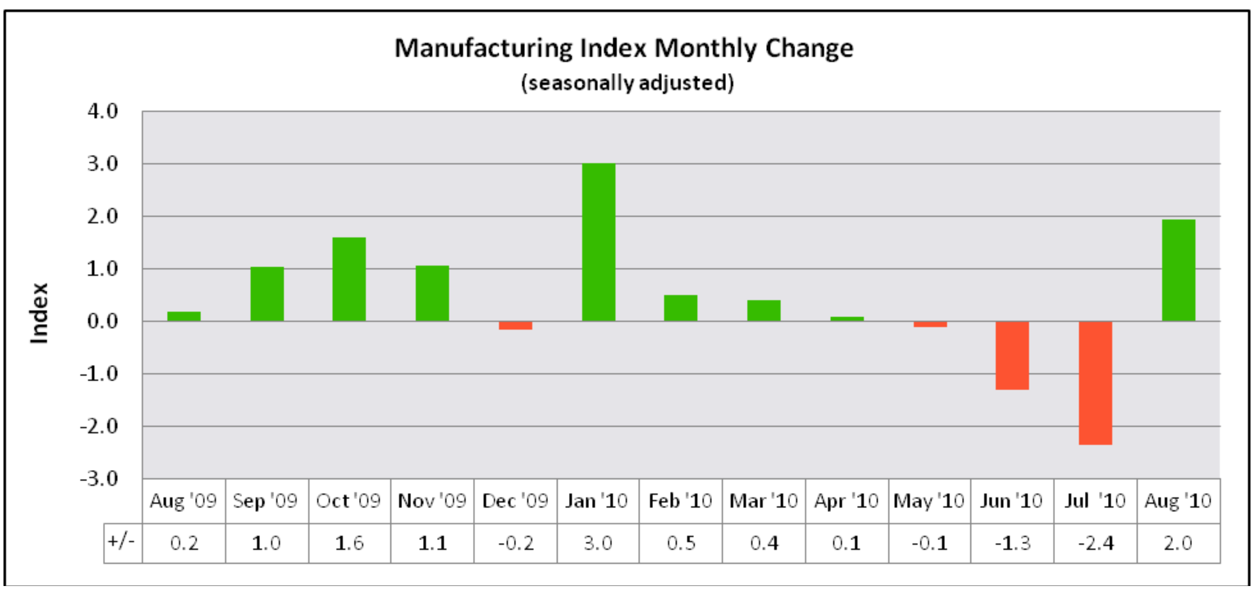

## Manufacturing Sector

The biggest gain was in this part of the economy—a pattern that has been in place for much of the year. It is somewhat unusual to see the industrial community leading the charge on economic recovery as this is usually the task of the consumer. Granted, the surge from manufacturing can't carry the load alone, at least not for much longer. The consumer needs to get in gear to buy up the newly-created inventory. The CMI data also shows that manufacturing has not yet finished its growth for the year.

New sales jumped from 56.1 to 59.4, taking the index back to what it was in June and higher than at any time in all of 2009. Other good news comes from dollar collections, gaining from 53.0 to 60.1—a substantial jump and close to the highest numbers registered for the year. This improvement seems to come from the fact that many manufacturers that emerged from the recession intact are in better financial shape than they were last year. This is the key point when assessing the long-term impact of the recession. It has been referred to at times as "creative destruction" of a sort. The downturn forces some companies out of business, which opens up market opportunities for those that survive. Now that the culling has taken place, the manufacturers that remain are picking up business at a more rapid clip than in the past 18 months.

There was also substantial improvement in some of unfavorable factors. There were far fewer accounts placed for collection and fewer situations where customers fell behind in their debt. The reduction in bankruptcy activity again suggests that the real damage has already been done in the manufacturing community. It is not possible to assert that there will be no further expansions of bankruptcy, but it does appear that the economically driven failures have run their course and business failures from this point on will be attributable to mistakes made by the businesses themselves or the fact that these companies are in heavily stressed industries.

| **Manufacturing Sector** (seasonally adjusted) | Aug '09 | Sep | Oct | Nov | Dec '09 | Jan '10 | Feb | Mar | Apr | May | Jun | Jul | Aug '10 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Sales | 48.4 | 48.7 | 52.0 | 56.3 | 55.8 | 61.8 | 62.5 | 66.9 | 65.2 | 66.0 | 59.1 | 56.1 | 59.4 |
| New credit applications | 48.6 | 50.5 | 52.9 | 56.8 | 55.2 | 54.0 | 57.8 | 57.9 | 57.1 | 58.9 | 58.9 | 53.7 | 54.3 |
| Dollar collections | 51.3 | 52.1 | 55.7 | 53.1 | 56.0 | 61.5 | 59.6 | 61.4 | 60.9 | 59.7 | 59 | 53.0 | 60.1 |
| Amount of credit extended | 48.9 | 48.8 | 53.5 | 53.4 | 55.2 | 59.2 | 60.7 | 62.0 | 62.1 | 58.9 | 58.2 | 55.8 | 56.0 |
| **Index of favorable factors** | **49.3** | **50.0** | **53.5** | **54.9** | **55.6** | **59.1** | **60.2** | **62.1** | **61.3** | **60.9** | **58.8** | **54.6** | **57.5** |
| Rejections of credit applications | 50.6 | 48.9 | 49.6 | 49.5 | 49.5 | 52.4 | 51.4 | 50.9 | 52.3 | 51.6 | 51.8 | 52.0 | 52.6 |
| Accounts placed for collection | 43.3 | 46.3 | 47.1 | 49.5 | 51.0 | 51.3 | 51.0 | 51.9 | 52.0 | 54.3 | 54.3 | 48.5 | 52.8 |
| Disputes | 48.2 | 49.5 | 50.9 | 48.0 | 50.1 | 50.7 | 51.9 | 51.5 | 51.8 | 50.0 | 50.6 | 50.8 | 51.3 |
| Dollar amount beyond terms | 48.1 | 48.3 | 47.9 | 50.0 | 51.4 | 52.5 | 53.3 | 51.3 | 52.2 | 50.1 | 50.3 | 50.4 | 51.0 |
| Dollar amount of customer deductions | 50.4 | 50.8 | 49.9 | 50.3 | 49.8 | 52.2 | 51.3 | 51.6 | 50.8 | 51.0 | 49.2 | 49.9 | 48.4 |
| Filings for bankruptcies | 47.3 | 51.7 | 52.1 | 55.4 | 46.6 | 55.4 | 56.5 | 54.8 | 56.6 | 59.5 | 55.6 | 53.4 | 57.1 |
| **Index of unfavorable factors** | **48.0** | **49.2** | **49.6** | **50.4** | **49.7** | **52.4** | **52.6** | **52.0** | **52.6** | **52.7** | **52.0** | **50.8** | **52.2** |
| **NACM Manufacturing CMI** | **48.5** | **49.6** | **51.2** | **52.2** | **52.1** | **55.1** | **55.6** | **56.0** | **56.1** | **56.0** | **54.7** | **52.4** | **54.3** |

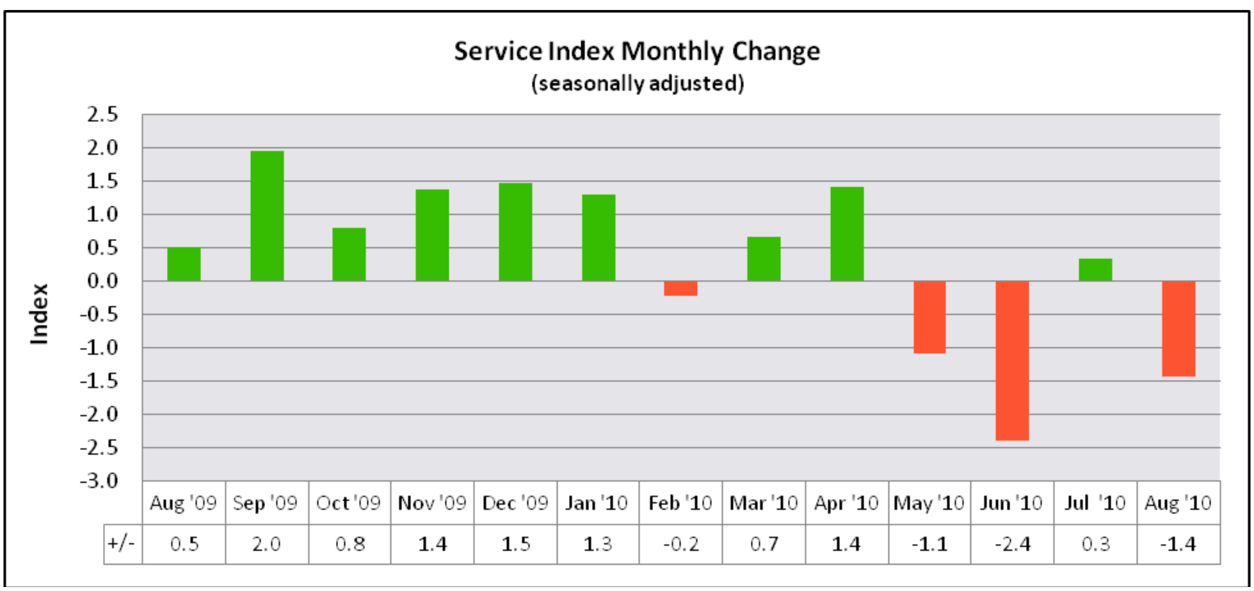



## Service Sector

Gains in the manufacturing sector performance were nearly undone by the poor performance of the service sector and that is a concern for the economy as a whole. It is widely known that the United States is highly dependent on its service economy and it is this sector that has to recover before there are any significant gains in employment. The news from the CMI is not going to gladden any hearts. There were dramatic declines in key areas. The drop in sales was significant and takes the index back to November 2009—not good news as the retail community tries to figure out what the holiday season is going to look like. There was also a decline in dollar collections signaling continued distress in the overall community. There is significant variation in service sectors performing well (health care and finance) versus those performing poorly (primarily retail, but throwing real estate into the equation as well).

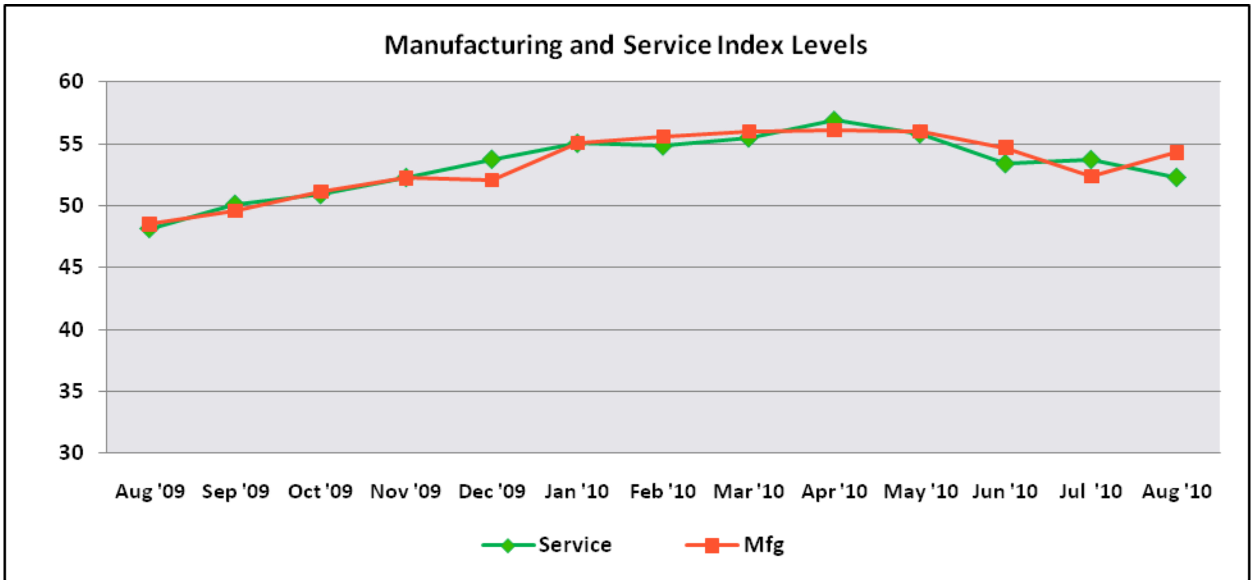
Almost all of the unfavorable factors became more so this month. Accounts placed for collection, rejections of credit applications and dollars beyond term all spiked. Bankruptcies and disputes didn't worsen, but there was no improvement either. Survey feedback indicated that the sorting out that occurred in manufacturing in 2009 is still under way in the service economy.

| **Service Sector** (seasonally adjusted) | Aug '09 | Sep | Oct | Nov | Dec '09 | Jan '10 | Feb | Mar | Apr | May | Jun | Jul | Aug '10 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Sales | 46.5 | 51.0 | 50.3 | 53.7 | 57.5 | 59.6 | 59.3 | 63.0 | 66.3 | 63.0 | 58.8 | 58.2 | 55.7 |
| New credit applications | 49.5 | 49.5 | 52.4 | 54.1 | 53.2 | 60.1 | 57.6 | 57.1 | 57.7 | 58.2 | 55.9 | 54.5 | 54.8 |
| Dollar collections | 50.5 | 54.8 | 53.7 | 58.6 | 59.9 | 61.2 | 62.7 | 62.4 | 63.2 | 59.7 | 59.7 | 59.7 | 55.2 |
| Amount of credit extended | 46.3 | 49.8 | 53.8 | 55.7 | 55.2 | 58.3 | 58.2 | 60.5 | 60.5 | 61.5 | 53.7 | 56.3 | 58.1 |
| **Index of favorable factors** | **48.2** | **51.2** | **52.5** | **55.5** | **56.5** | **59.8** | **59.4** | **60.8** | **62.0** | **60.6** | **57.0** | **57.2** | **56.0** |
| Rejections of credit applications | 48.5 | 47.9 | 48.5 | 49.2 | 50.6 | 50.4 | 50.6 | 49.4 | 49.6 | 49.7 | 50.3 | 51.9 | 48.7 |
| Accounts placed for collection | 43.7 | 44.3 | 47.1 | 49.4 | 50.7 | 50.1 | 49.9 | 50.2 | 49.2 | 54.8 | 48.5 | 50.1 | 49.4 |
| Disputes | 49.0 | 52.1 | 51.0 | 51.2 | 51.9 | 52.1 | 52.5 | 52.9 | 51.6 | 52.7 | 50.3 | 50.5 | 50.5 |
| Dollar amount beyond terms | 49.5 | 47.9 | 48.3 | 48.0 | 51.4 | 51.9 | 50.6 | 51.6 | 51.7 | 50.3 | 47.9 | 48.4 | 43.1 |
| Dollar amount of customer deductions | 51.1 | 52.7 | 51.1 | 52.3 | 52.7 | 52.9 | 51.1 | 51.8 | 60.5 | 52.6 | 51.4 | 51.0 | 50.8 |
| Filings for bankruptcies | 47.0 | 51.3 | 53.0 | 50.7 | 54.3 | 53.9 | 56.0 | 55.8 | 58.6 | 55.7 | 57.6 | 56.6 | 56.6 |
| **Index of unfavorable factors** | **48.1** | **49.4** | **49.8** | **50.1** | **52.0** | **51.9** | **51.8** | **52.0** | **53.5** | **52.6** | **51.0** | **51.4** | **49.8** |
| **NACM Service CMI** | **48.2** | **50.1** | **50.9** | **52.3** | **53.8** | **55.0** | **54.8** | **55.5** | **56.9** | **55.8** | **53.4** | **53.7** | **52.3** |



## August 2010 vs. August 2009

The two sectors swapped positions this month and aren't tracking as closely together as this time last year. The good news overall is that the index stayed above that magic 50 number for another month. The bad news is that the service economy very nearly dipped back into the 40s and if it continues that trend it could drag the whole index under in another month or two. The index is sitting at 53.3, but the service sector is hanging on at 52.3—the lowest since November 2009.




## Methodology Appendix

CMI data has been collected and tabulated monthly since February 2002. The index, published since January 2003, is based on a survey of approximately 1,000 trade credit managers near the end of each month, with about equal representation between the manufacturing and service sectors. The survey asks respondents to comment on 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 those from the Purchasing Managers, the Supply Chain Managers and others.

### 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.*

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## About the National Association of Credit Management

The National Association of Credit Management (NACM), headquartered in Columbia, Maryland, supports approximately 18,000 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 and education, delivering products and services, which improve the management of business credit and accounts receivable. NACM's collective voice has influenced legislative results concerning commercial business and trade credit to our nation's policy makers for more than 100 years, and continues to play an active part in legislative issues pertaining to business credit and corporate bankruptcy.

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