Report for May 2011

Issued May 31, 2011

National Association of Credit Management

Combined Sectors

The bottom seemed to drop out of the economic recovery in May. The first signs of trouble started to manifest in the April, but by the end of May these threats had become very real and the economy took some steps backwards. The Credit Managers' Index (CMI) data in April had hinted at the problems with declining numbers in areas like sales, credit extension and dollars beyond terms, but by May these areas and others showed definite strain. "The momentum of the economic rebound has been reversed for the time being and for reasons that should not come as a shock to many," said Chris Kuehl, PhD, managing director of Armada Corporate Intelligence and National Association of Credit Management economic advisor.

The biggest drop in May was in sales. The 59.4 reading is the lowest since September 2010, and this decline was felt in both the manufacturing and service sectors. There is widespread concern that the consumer was retreating from spending again as retail numbers in general have been tepid. The only reason for an increase in retail activity is due to the hike in gas and food prices. These have forced more spending on the part of the consumer, but this spending has come at the expense of almost every category of retail.

"The CMI data reflects the decline in demand at the manufacturing and wholesale level, and it is very likely that consumer retail numbers will dip correspondingly in June," said Kuehl. "The CMI data generally presages activity in the consumer sector as it reflects the activity in the commercial sector."

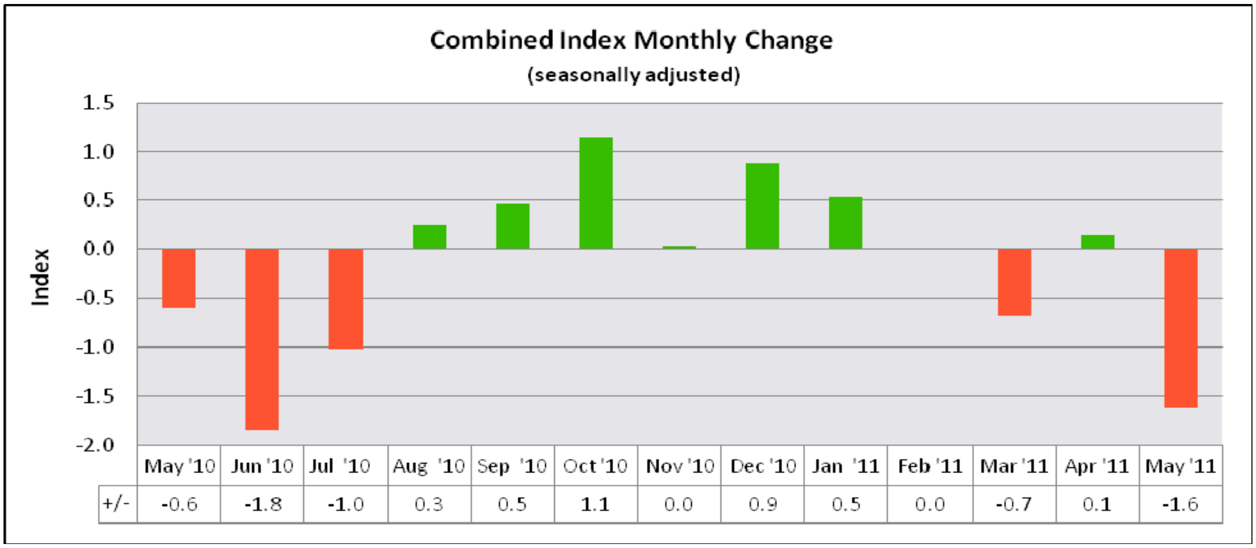
There are other trouble areas showing up in the data this month. Dollar collections dropped to a level last seen in August 2010 as many companies found themselves in trouble as they were forced to start contending with inflation even as their business opportunities remain limited. This started to show up in April and has since accelerated. As companies start to exit the recession, they often face some severe competitive pressure, as there is nearly always a market leader ready to put pressure on a given industry. As the market leader starts to become aggressive and goes after market share, other competitors in that sector have to keep pace—even if they are not ready. They start to spend more despite limited resources as they fear losing their market position. Add in an inflation surge and there will be some real consequences. Within a very short period of time there will be cash flow challenges unless the expected demand manifests—and as has been pretty obvious that demand has yet to manifest. The inflation that is complicating the financial situation for companies is also hitting the consumer and having a negative impact.

The index of favorable factors had been as high as 64.1 just three months ago in February. Now that index has fallen to levels not seen since October of last year. The index shows that there is still some growth in terms of credit applications and that bodes well for the future assuming that conditions improve and the rate of approvals starts to grow again. Right now there is still a sense that conditions will improve as the threat of inflation fades, but if the threat continues to advance there is likely to be another wave of negative responses.

"The most dramatic changes in the overall index represent an early warning of some bad times ahead if conditions do not improve on the inflation and growth fronts," said Kuehl. As recently as January all index categories were above 50 and that suggests expansion. Today, there are three important categories that have slipped into the 40s and that creates concern. The biggest drop was in dollars beyond terms—a slide from 50.7 to 46.5. Overall, the combined index fell 1.6%, from 55.8 to 54.2. Many companies are having problems staying current as the costs of inputs rise while their markets remain moribund. Kuehl said that, thus far, there has been little increase in areas like disputes, accounts out for collection and bankruptcies, but if the past is any pattern these areas will reflect the strain in the months to come as business customers continue to grapple with cash flow.

The inflation hike is not solely responsible for the problems manifesting in May, but it is playing a significant role for sure. The plain fact is that most businesses have not seen a return of previous demand as yet and that leaves them very vulnerable to higher costs. The big hike in gas pricing has worked its way through the economy and will be having an impact for the next few months and beyond if its march upward resumes.

Combined Manufacturing and Service Sectors (seasonally adjusted)	May '10	Jun	Jul	Aug	Sep	Oct	Nov	Dec '10	Jan '11	Feb	Mar	Apr	May '11
Sales	64.5	59.0	57.2	57.6	58.6	60.8	61.9	65.9	63.5	66.3	64.7	64.5	59.4
New credit applications	58.6	57.4	54.1	54.6	54.8	56.8	58.2	60.1	58.6	60.3	59.8	58.8	58.2
Dollar collections	59.7	59.4	56.3	57.7	60.0	61.9	58.6	60.7	60.9	63.4	60.0	61.3	58.7
Amount of credit extended	60.2	55.9	56.0	57.1	58.7	59.8	61.2	61.7	64.8	66.5	64.4	64.7	62.1
Index of favorable factors	**60.7**	**57.9**	**55.9**	**56.7**	**58.0**	**59.8**	**60.0**	**62.1**	**62.0**	**64.1**	**62.2**	**62.3**	**59.6**
Rejections of credit applications	50.7	51.0	52.0	50.7	49.1	51.4	51.0	50.8	51.2	51.4	50.8	50.8	51.5
Accounts placed for collection	54.5	51.4	49.3	51.1	50.4	51.7	52.5	51.5	52.5	49.9	52.1	50.5	50.3
Disputes	51.3	50.4	50.6	50.9	50.8	49.9	50.8	49.2	51.0	49.2	48.9	49.3	48.8
Dollar amount beyond terms	50.2	49.1	49.4	47.0	49.1	50.9	48.9	53.4	51.5	50.6	49.7	50.7	46.5
Dollar amount of customer deductions	51.8	50.3	50.5	49.6	50.6	48.9	50.2	49.6	50.6	50.1	49.3	49.9	48.6
Filings for bankruptcies	57.6	56.6	55.0	56.9	55.7	57.0	56.3	55.4	59.1	56.0	57.4	58.1	58.1
Index of unfavorable factors	**52.7**	**51.5**	**51.1**	**51.0**	**50.9**	**51.6**	**51.6**	**51.7**	**52.6**	**51.2**	**51.4**	**51.5**	**50.6**
NACM Combined CMI	**55.9**	**54.1**	**53.0**	**53.3**	**53.8**	**54.9**	**55.0**	**55.8**	**56.4**	**56.4**	**55.7**	**55.8**	**54.2**



Manufacturing Sector

The decline in manufacturing has been sudden and most unwelcome. Since the recovery started to gather some speed last year, it has been the manufacturer that has led the way. This is not a normal development when compared to past recessions, as the customary hero in those previous downturns has been the consumer. This time consumers have been left on the sidelines while the manufacturing sector stepped up. The prime motivation for that growth has been the export market and the fact that many companies had been striving to beef up their inventory levels. There have been declines in both motivators.

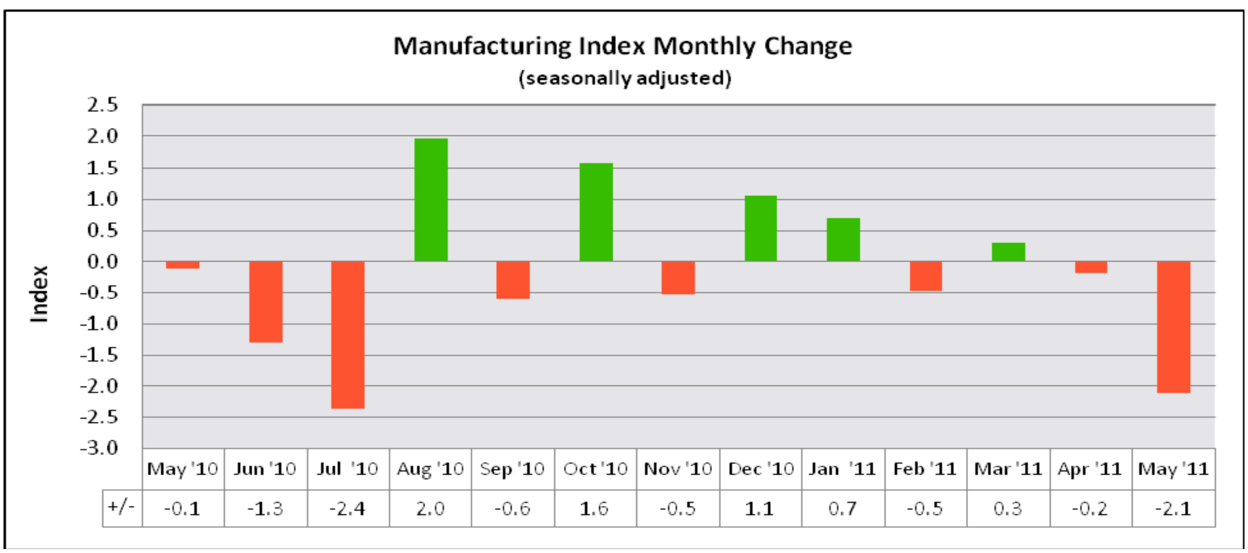
Sales numbers plummeted from a high in December of 66.6 to a May reading of 57.8, the lowest this factor has been since September and reflects the fact that there has been a reduction in demand from overseas markets. The two most important regions to the U.S. manufacturer remain Europe and Asia. The financial crisis in Europe is deepening, affecting the appetite for imports. In China, the focus has been on slowing the economy in order to take some pressure off of inflation and that has meant a reduced import demand. These sales declines have also meant that there have been fewer new credit applications and, thus, a reduction in the amount of credit extended. This is not a matter of credit managers rejecting applicants or judging companies to be unworthy of credit—there is simply much reduced demand.

The pain in the manufacturing sector is patently obvious by looking at the dollars beyond terms numbers. In April the subsector index was holding at a respectable 52.2, but in May the crash was precipitous. The manufacturing index fell to

45.8, the lowest in over 18 months. This category is now as bad as it was in the middle of the recession, meaning a great many manufacturers are in a cash flow crisis that could crush them in the near future. It is the squeeze many had referenced when the commodity price hikes began. The cost of everything manufacturers buy has gone up—oil, metals and other raw materials. Transportation costs are hiking as well. At the same time they are seeing no opportunities to hike their own prices, as consumers are still fragile. If this squeeze continues for much longer, there will be a radical increase in the factors that signal distress—the number of disputes, accounts out for collection and bankruptcies. Right now, these are somewhat stable but may not be much longer.

The inventory build that was taking place at the start of the year has largely been completed and now the sector really needs consumers to get into the game and do what they have done in previous recoveries. Thus far, consumers have shown some signs of rebound, but the weight of the housing crisis and the desire to deleverage remain major barriers to progress.

Manufacturing Sector (seasonally adjusted)	May '10	Jun	Jul	Aug	Sep	Oct	Nov	Dec '10	Jan '11	Feb	Mar	Apr	May '11
Sales	66.0	59.1	56.1	59.4	57.9	59.3	62.2	66.6	64.7	65.1	65.4	63.9	57.8
New credit applications	58.9	58.9	53.7	54.3	54.4	54.9	57.8	59.1	57.7	59.6	60.6	60.3	58.7
Dollar collections	59.7	59.0	53.0	60.1	61.1	61.0	57.9	60.5	60.3	61.5	60.8	60.2	60.1
Amount of credit extended	58.9	58.2	55.8	56.0	57.3	59.9	61.2	61.6	66.2	67.6	64.5	66.5	61.4
Index of favorable factors	**60.9**	**58.8**	**54.6**	**57.5**	**57.7**	**58.8**	**59.8**	**61.9**	**62.2**	**63.4**	**62.8**	**62.7**	**59.5**
Rejections of credit applications	51.6	51.8	52.0	52.6	49.6	53.2	52.1	51.3	52.0	51.9	51.6	51.0	52.6
Accounts placed for collection	54.3	54.3	48.5	52.8	51.9	53.6	52.7	51.1	53.0	51.2	53.9	50.7	50.7
Disputes	50.0	50.6	50.8	51.3	50.0	49.5	48.6	48.1	49.8	48.2	49.0	50.5	49.2
Dollar amount beyond terms	50.1	50.3	50.4	51.0	49.6	55.2	49.4	53.9	52.1	51.3	51.6	52.2	45.8
Dollar amount of customer deductions	51.0	49.2	49.9	48.4	49.4	48.5	48.8	49.4	49.1	50.1	48.8	49.5	47.7
Filings for bankruptcies	59.5	55.6	53.4	57.1	55.8	57.7	56.7	56.5	60.2	53.9	57.2	56.8	56.4
Index of unfavorable factors	**52.7**	**52.0**	**50.8**	**52.2**	**51.1**	**52.9**	**51.4**	**51.7**	**52.7**	**51.1**	**52.0**	**51.8**	**50.4**
NACM Manufacturing CMI	**56.0**	**54.7**	**52.4**	**54.3**	**53.7**	**55.3**	**54.7**	**55.8**	**56.5**	**56.0**	**56.3**	**56.1**	**54.0**



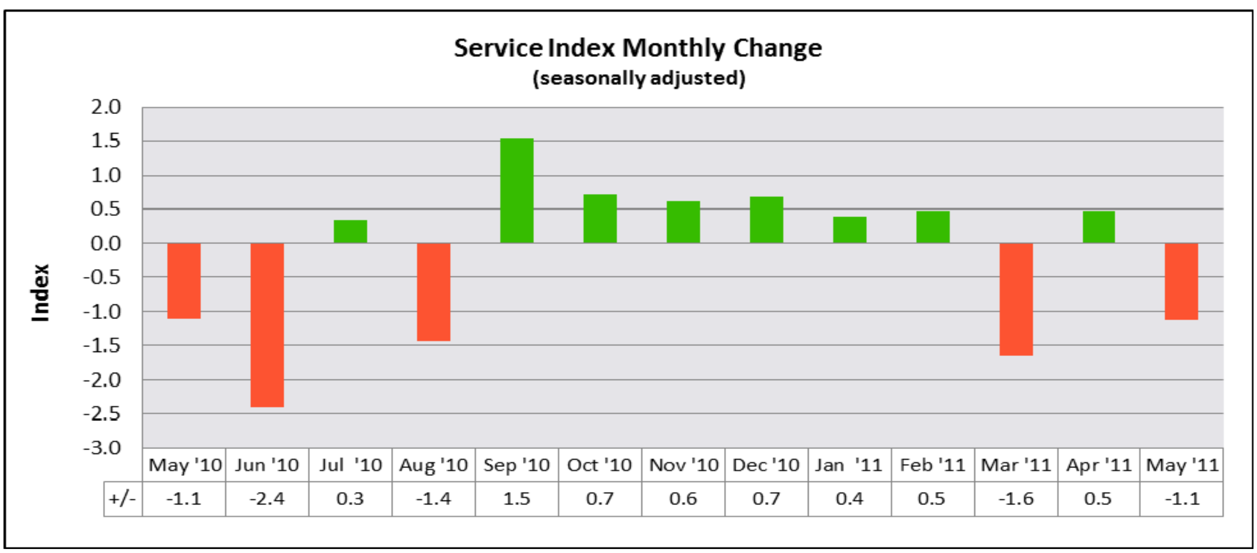
Service Sector

While there has not been quite such drama in the service sector, it is also down. Sales numbers are still above 60 but only barely. In February the index showed a high of 67.5 and in April sales had rebounded to 65. Now the sector index is sitting at 61.1. While this is certainly a respectable number, the trending is in the wrong direction and that is a concern. The index number that is showing the most stress is dollar collections as there has been a somewhat precipitous drop from 62.3 to 57.3. Though the manufacturing section is facing some evident weakness in the areas of credit applications and credit extension, the service sector is not seeing this as yet. Instead, there was a slight increase in the number of credit applications and a steady level of credit extended. The fact is that inflation pressure is slower to hit the service side of the economy.

As with the manufacturing community the hardest hit category was dollars beyond terms but the impact was less with the service sector. The decline was significant but not catastrophic, sliding from 49.2 to 47.3. The fact is that this category has been weak for over a year, reflecting the fact that service sector business has a chronic issue of cash flow. There has been some increase in the number of accounts placed for collection, but the number of disputes and bankruptcies both showed some small improvements. Things in the service side of the economy are not great but they are not getting appreciably worse, at least not at this point.

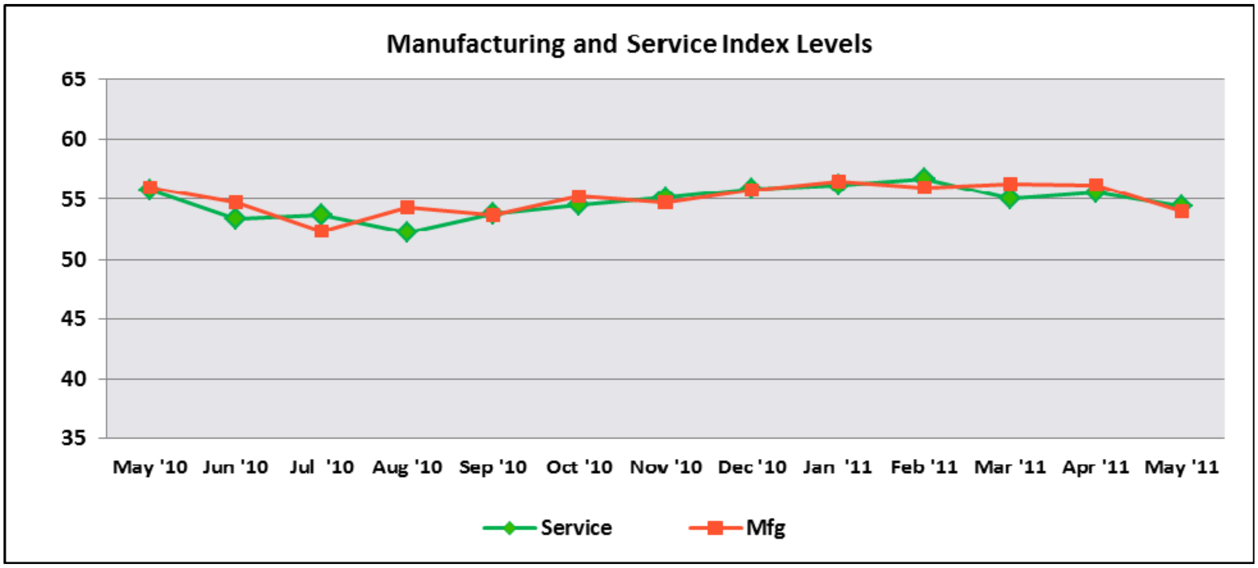
At some stage, the inflation impacting the manufacturing side will start to affect the service sector but not until the inflation threat expands beyond commodities. The sensitivity on the service side is primarily in terms of wages as service sector business is much more labor intensive. As long as unemployment rates are above 8% there is not likely to be appreciable wage inflation, which insulates the service community to some degree. The inflation issue will affect these companies at some point but not as quickly and as harshly as it has affected the manufacturer.

Service Sector (seasonally adjusted)	May '10	Jun	Jul	Aug	Sep	Oct	Nov	Dec '10	Jan '11	Feb	Mar	Apr	May '11
Sales	63.0	58.8	58.2	55.7	59.3	62.2	61.6	65.1	62.3	67.5	63.9	65.0	61.1
New credit applications	58.2	55.9	54.5	54.8	55.1	58.7	58.6	61.1	59.4	61.0	59.0	57.3	57.8
Dollar collections	59.7	59.7	59.7	55.2	59.0	62.9	59.2	60.9	61.6	65.2	59.2	62.3	57.3
Amount of credit extended	61.5	53.7	56.3	58.1	60.0	59.6	61.2	61.8	63.4	65.4	64.2	63.0	62.7
Index of favorable factors	**60.6**	**57.0**	**57.2**	**56.0**	**58.4**	**60.9**	**60.2**	**62.2**	**61.7**	**64.8**	**61.6**	**61.9**	**59.7**
Rejections of credit applications	49.7	50.3	51.9	48.7	48.7	49.6	49.8	50.3	50.4	51.0	50.1	50.5	50.4
Accounts placed for collection	54.8	48.5	50.1	49.4	48.9	49.9	52.4	52.0	52.1	48.6	50.2	50.2	49.9
Disputes	52.7	50.3	50.5	50.5	51.5	50.3	52.9	50.3	52.1	50.1	48.7	48.1	48.5
Dollar amount beyond terms	50.3	47.9	48.4	43.1	48.5	46.6	48.5	52.9	51.0	49.9	47.8	49.2	47.3
Dollar amount of customer deductions	52.6	51.4	51.0	50.8	51.7	49.4	51.6	49.9	52.1	50.1	49.8	50.3	49.4
Filings for bankruptcies	55.7	57.6	56.6	56.6	55.5	56.3	55.9	54.3	57.9	58.2	57.7	59.5	59.8
Index of unfavorable factors	**52.6**	**51.0**	**51.4**	**49.8**	**50.8**	**50.4**	**51.8**	**51.6**	**52.6**	**51.3**	**50.7**	**51.3**	**50.9**
NACM Service CMI	**55.8**	**53.4**	**53.7**	**52.3**	**53.8**	**54.6**	**55.2**	**55.8**	**56.2**	**56.7**	**55.1**	**55.5**	**54.4**



May 2011 vs. May 2010

The year-over-year numbers are not trending in the direction preferred. They are now back to levels seen in the summer of 2010 when the recovery was just starting to show some steam. The sense is that a great deal of momentum has been lost and it is hard to see just what will boost growth in the future. The good news is that the index is still over 50 but at the current pace that may not be true for much longer.



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 in the second half 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:

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

For negative indicators, the calculation is:

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

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

The National Association of Credit Management (NACM), headquartered in Columbia, Maryland, supports approximately 17,000 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.

This report and the CMI archives may be viewed at http://web.nacm.org/cmi/cmi.asp.

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