Report for September 2010

Issued October 1, 2010
National Association of Credit Management

Combined Sectors

"If you are a big fan of volatility, you will like this month's Credit Managers' Index (CMI)," said Chris Kuehl, Ph.D., the National Association of Credit Management's (NACM) economic advisor. "The positive trends that we saw in last month's manufacturing data were replaced by some negative trends, while the service sector that looked so stressed in August seemed to come back to life in September. If just the CMI numbers were considered, one could conclude there really wasn't much going on and that everything was pretty stable. After all, the combined CMI reading went from 53.3 to 53.8. The real story is that this truly dramatic activity reversed the pattern of the previous month."

This pattern reflected the general confusion in the greater economy. Employment data managed to improve week over week at the same time that durable goods orders declined. Then, within the goods category itself, the gains in machinery manufacturing were offset by big drops in the aerospace sector. Some of this volatility can be attributed to the height of election season and Congress being in high gear—at least as far as rhetoric is concerned—and these various moves and countermoves influence business decision making from one week to another; meaning industries are delaying usual decisions as they try to determine if any of these changes will affect them.

Economists are starting to describe this recovery as a "growth recession," a term that could only be hatched by the dismal sciences Kuehl said. It refers to the fact that the recession essentially ended from a technical point of view in the summer of 2009. That was the conclusion of the National Bureau of Economic Research (NBER) with its examination of a host of factors alongside the traditional measures of GDP growth or decline. In fact, the NBER assessment of the economy held that the recession really began in 2007. What makes these assessments by the semi-official arbiter of all things recessionary interesting is they correspond with observations one could make by looking at the CMI data of the past few years.

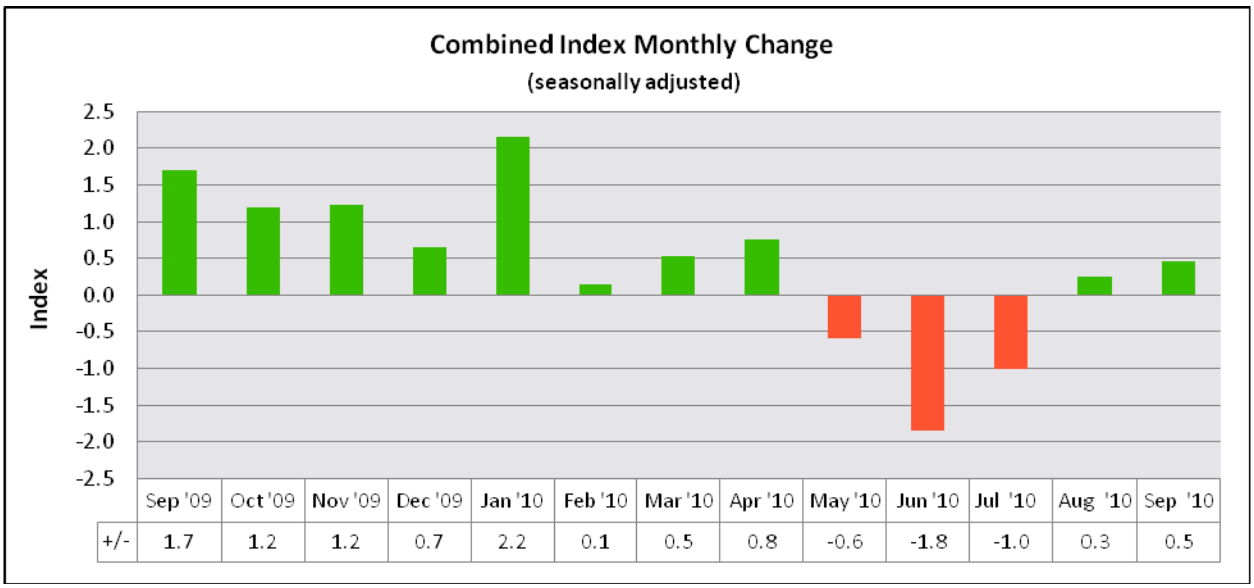
By looking at the year-over-year numbers (*see* the Manufacturing and Service Index Levels graph below), it is apparent there was solid growth taking place by September 2009 and this growth carried forward through the rest of the year. Go back a few more months and look at the CMI numbers from the summer, and it is apparent that a turnaround was underway by May and June 2009—exactly the moment NBER determined the recession was coming to an end.

More interesting yet is the CMI data from 2007 when the rest of the country was still enjoying the boom. There were already some signs of trouble within the data: more disputes were appearing, there was more dollar exposure and there were more signals that sales were eroding. There was even a harbinger of things to come, as far as credit was concerned, as there was a reduction in both credit applications and applications granted. The numbers in 2007 were still solid and there was still growth but troubles were on the horizon.

What we are seeing now is that the economy was in better shape at the beginning of 2010 than it is now. In January, sales numbers were in the 60s and stayed there through May before declining through the summer. The future looks better, but only marginally. The slow activity underway during the last few months should better reflect the pace of progress to be expected in the months ahead. "The weakness in credit extension is going to continue to be a major factor and that will continue to affect sales as well. The negative issues have not become markedly worse, but they continue to be bigger concerns than they were earlier in the year, especially for the manufacturing segment," 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)	Sep '09	Oct	Nov	Dec '09	Jan '10	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep '10
Sales	49.9	51.1	55.0	56.7	60.7	60.9	65.0	65.7	64.5	59.0	57.2	57.6	58.6
New credit applications	50.0	52.7	55.4	54.2	57.0	57.7	57.5	57.4	58.6	57.4	54.1	54.6	54.8
Dollar collections	53.4	54.7	55.8	58.0	61.3	61.1	61.9	62.1	59.7	59.4	56.3	57.7	60.0
Amount of credit extended	49.3	53.6	54.6	55.2	58.8	59.4	61.3	61.3	60.2	55.9	56.0	57.1	58.7
Index of favorable factors	**50.6**	**53.0**	**55.2**	**56.0**	**59.4**	**59.8**	**61.4**	**61.6**	**60.7**	**57.9**	**55.9**	**56.7**	**58.0**
Rejections of credit applications	48.4	49.0	49.3	50.1	51.4	51.0	50.1	50.9	50.7	51.0	52.0	50.7	49.1
Accounts placed for collection	45.3	47.1	49.5	50.9	50.7	50.4	51.1	50.6	54.5	51.4	49.3	51.1	50.4
Disputes	50.8	51.0	49.6	51.0	51.4	52.2	52.2	51.7	51.3	50.4	50.6	50.9	50.8
Dollar amount beyond terms	48.1	48.1	49.0	51.4	52.2	52.0	51.5	51.9	50.2	49.1	49.4	47.0	49.1
Dollar amount of customer deductions	51.8	50.5	51.3	51.3	52.5	51.2	51.7	55.7	51.8	50.3	50.5	49.6	50.6
Filings for bankruptcies	51.5	52.6	53.0	50.5	54.7	56.3	55.3	57.6	57.6	56.6	55.0	56.9	55.7
Index of unfavorable factors	**49.3**	**49.7**	**50.3**	**50.8**	**52.2**	**52.2**	**52.0**	**53.1**	**52.7**	**51.5**	**51.1**	**51.0**	**50.9**
NACM Combined CMI	**49.8**	**51.0**	**52.3**	**52.9**	**55.1**	**55.2**	**55.7**	**56.5**	**55.9**	**54.1**	**53.0**	**53.3**	**53.8**



Manufacturing Sector

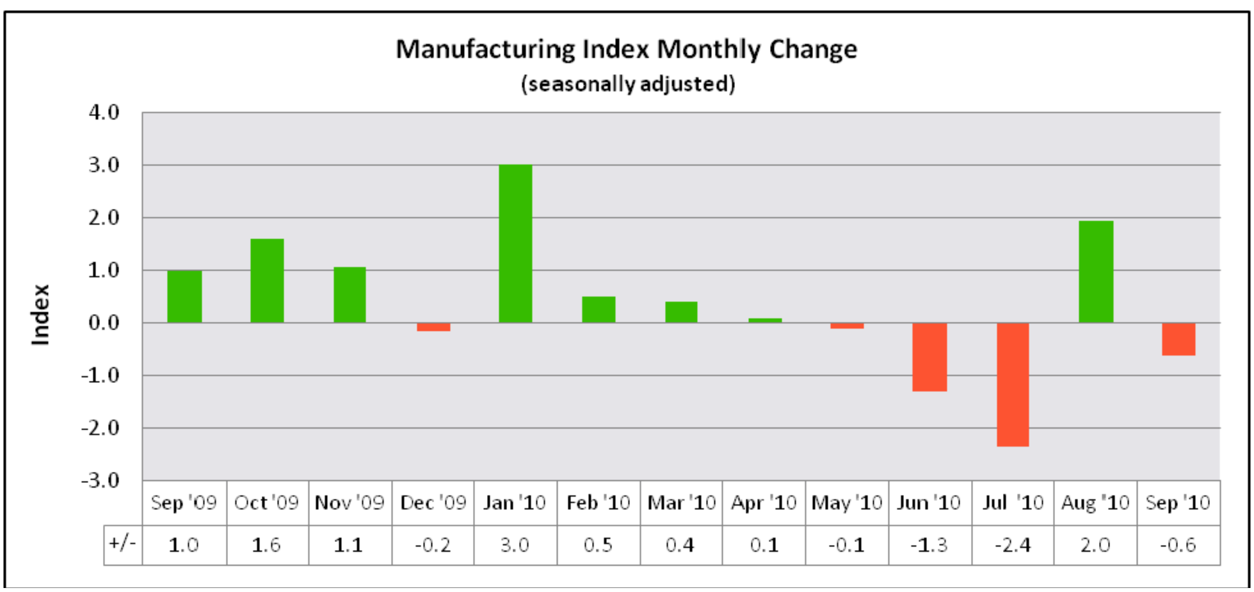
A startling shift took place in the manufacturing sector this month. In many categories, conditions noticeably worsened from just a month ago, but in others, the data remained fairly consistent from August. Sales declined from 59.4 to 57.9, which is back to the sector's low point reached in June. There was not much change in the level of new credit applications or amount of credit extended, but sales numbers depressed the sector anyway. The positive indicators shifted upward just a little on the strength of dollar collections, but it was the negative category that has created the most concern.

There may have been a steady number of credit applications in the month, but more of them were rejected than in the past—a slide from 52.6 to 49.6. This suggests that credit is tightening again, as most other economic reports seem to reinforce. The banks are not yet in the game and their caution has flowed over into companies that would have offered more credit opportunities in the past. Almost every negative category showed increased stress. There were more disputes, more accounts placed for collection, more dollars beyond terms and more bankruptcy filings. The manufacturing sector seemed to be booming through much of the year as many companies attempted to build inventory levels in anticipation of better news. The expectation at the start of the year was that conditions would steadily improve through the year and by the third and fourth quarters, there would be some solid growth—remember all the talk about “green shoots”?

Now that expectation has been shattered and some bets made earlier in the year are not paying off that well. The inventory build is leaving many companies with more than they can sell and financial projections have been revealed as overly optimistic. Thus far, the pain is showing up in delays and slow pay, but it will not take much to send many of these companies into more severe tail spins.

At the same time that these issues are showing up in the manufacturing CMI, there are signs of improvement in other data sets. Durable goods orders were down last month due to issues in the aerospace industry, but other business sectors were gaining, especially in machine tools and office support equipment. That could bode well for the future. The fact that the CMI is essentially split between decent news on the positive indicators and bad news with the negative indicators suggests a transition of some kind is underway. It could trend in either direction in the months to come—it likely all depends on the resumption of more normal levels of consumer demand.

Manufacturing Sector (seasonally adjusted)	Sep '09	Oct	Nov	Dec '09	Jan '10	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep '10
Sales	48.7	52.0	56.3	55.8	61.8	62.5	66.9	65.2	66.0	59.1	56.1	59.4	57.9
New credit applications	50.5	52.9	56.8	55.2	54.0	57.8	57.9	57.1	58.9	58.9	53.7	54.3	54.4
Dollar collections	52.1	55.7	53.1	56.0	61.5	59.6	61.4	60.9	59.7	59.0	53.0	60.1	61.1
Amount of credit extended	48.8	53.5	53.4	55.2	59.2	60.7	62.0	62.1	58.9	58.2	55.8	56.0	57.3
Index of favorable factors	**50.0**	**53.5**	**54.9**	**55.6**	**59.1**	**60.2**	**62.1**	**61.3**	**60.9**	**58.8**	**54.6**	**57.5**	**57.7**
Rejections of credit applications	48.9	49.6	49.5	49.5	52.4	51.4	50.9	52.3	51.6	51.8	52.0	52.6	49.6
Accounts placed for collection	46.3	47.1	49.5	51.0	51.3	51.0	51.9	52.0	54.3	54.3	48.5	52.8	51.9
Disputes	49.5	50.9	48.0	50.1	50.7	51.9	51.5	51.8	50.0	50.6	50.8	51.3	50.0
Dollar amount beyond terms	48.3	47.9	50.0	51.4	52.5	53.3	51.3	52.2	50.1	50.3	50.4	51.0	49.6
Dollar amount of customer deductions	50.8	49.9	50.3	49.8	52.2	51.3	51.6	50.8	51.0	49.2	49.9	48.4	49.4
Filings for bankruptcies	51.7	52.1	55.4	46.6	55.4	56.5	54.8	56.6	59.5	55.6	53.4	57.1	55.8
Index of unfavorable factors	**49.2**	**49.6**	**50.4**	**49.7**	**52.4**	**52.6**	**52.0**	**52.6**	**52.7**	**52.0**	**50.8**	**52.2**	**51.1**
NACM Manufacturing CMI	**49.6**	**51.2**	**52.2**	**52.1**	**55.1**	**55.6**	**56.0**	**56.1**	**56.0**	**54.7**	**52.4**	**54.3**	**53.7**



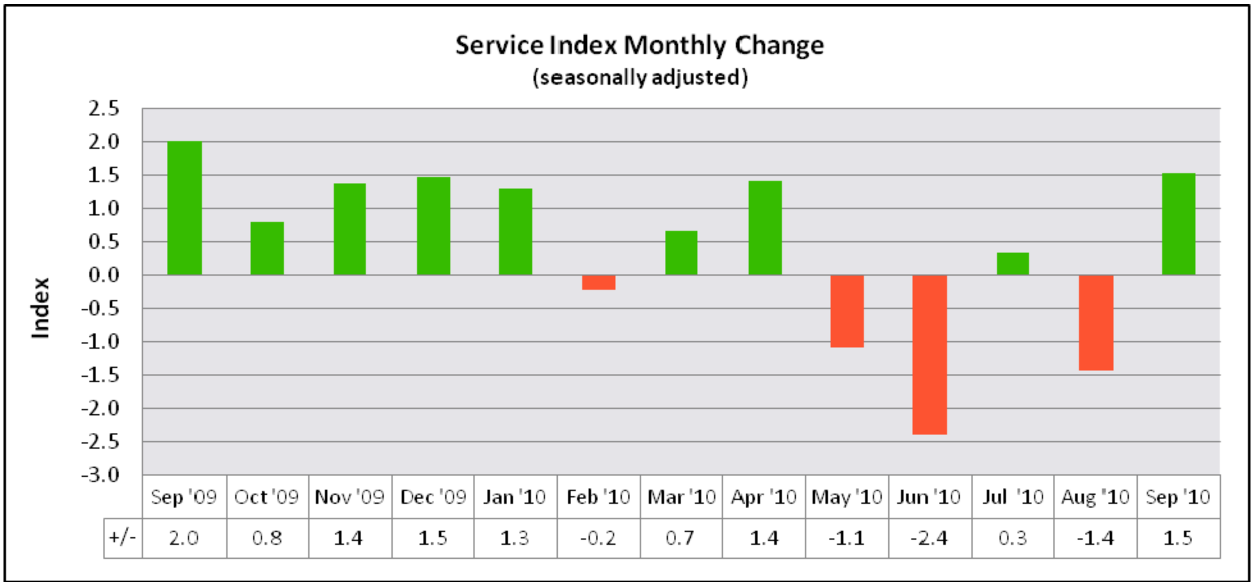
Service Sector

The two sectors swapped positions in September. In August it was the manufacturing index that surged ahead and provided some expectation of future growth, while the service index slumped to levels not seen since June. Now the good news is the service index is rising, especially in terms of the favorable factors. There was a dramatic jump in sales to 59.3 from the August 55.7. The last time sales made such an improvement was in May, when it rose to 63. Other categories to show progress were new credit applications and amount of credit extended. Dollar collections also jumped substantially from 55.2 to 59. This all signals a lot of very recent activity in the service sector, which is very good news for the entire economy as the service community is far larger than manufacturing in terms of job growth and GDP. The recovery of the economy as a whole is dependent on a rebound in services, and there is now some hope that this is finally underway.

There was also good news in terms of unfavorable factors, although the movement was not as dramatic. The most impressive gain was in dollar amount beyond terms, which went from 43.1 to 48.5. There have now been enough gains within the service sector to show some real growth. Given that the sector is highly diverse, it is still a little hard to pinpoint what is driving all this activity, but the sense is that slightly improved retail numbers and some slow improvement in the transportation sector have contributed to the gains.

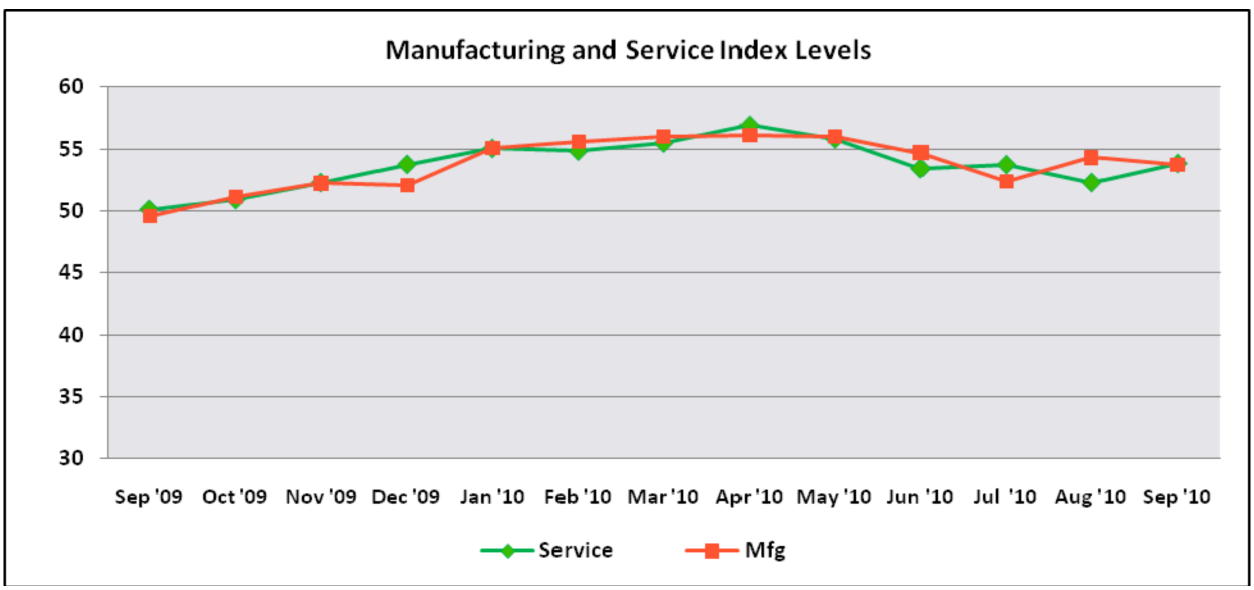
It is critical for the service side of the economy to register consistent gains given that this is the part of the economy that will ultimately address the job situation. The data from the last few CMI reports show volatility more than a clear trend, but at least for the moment the news is more positive than it has been since the start of the second quarter.

Service Sector (seasonally adjusted)	**Sep '09**	**Oct**	**Nov**	**Dec '09**	**Jan '10**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep '10**
Sales	51.0	50.3	53.7	57.5	59.6	59.3	63.0	66.3	63.0	58.8	58.2	55.7	59.3
New credit applications	49.5	52.4	54.1	53.2	60.1	57.6	57.1	57.7	58.2	55.9	54.5	54.8	55.1
Dollar collections	54.8	53.7	58.6	59.9	61.2	62.7	62.4	63.2	59.7	59.7	59.7	55.2	59.0
Amount of credit extended	49.8	53.8	55.7	55.2	58.3	58.2	60.5	60.5	61.5	53.7	56.3	58.1	60.0
Index of favorable factors	**51.2**	**52.5**	**55.5**	**56.5**	**59.8**	**59.4**	**60.8**	**62.0**	**60.6**	**57.0**	**57.2**	**56.0**	**58.4**
Rejections of credit applications	47.9	48.5	49.2	50.6	50.4	50.6	49.4	49.6	49.7	50.3	51.9	48.7	48.7
Accounts placed for collection	44.3	47.1	49.4	50.7	50.1	49.9	50.2	49.2	54.8	48.5	50.1	49.4	48.9
Disputes	52.1	51.0	51.2	51.9	52.1	52.5	52.9	51.6	52.7	50.3	50.5	50.5	51.5
Dollar amount beyond terms	47.9	48.3	48.0	51.4	51.9	50.6	51.6	51.7	50.3	47.9	48.4	43.1	48.5
Dollar amount of customer deductions	52.7	51.1	52.3	52.7	52.9	51.1	51.8	60.5	52.6	51.4	51.0	50.8	51.7
Filings for bankruptcies	51.3	53.0	50.7	54.3	53.9	56.0	55.8	58.6	55.7	57.6	56.6	56.6	55.5
Index of unfavorable factors	**49.4**	**49.8**	**50.1**	**52.0**	**51.9**	**51.8**	**52.0**	**53.5**	**52.6**	**51.0**	**51.4**	**49.8**	**50.8**
NACM Service CMI	**50.1**	**50.9**	**52.3**	**53.8**	**55.0**	**54.8**	**55.5**	**56.9**	**55.8**	**53.4**	**53.7**	**52.3**	**53.8**



September 2010 vs. September 2009

The two sectors swapped positions again this month—one would think it had become some kind of race. The most important aspect of the year-over-year report is that the CMI has been solidly above 50 for an entire year now. Perhaps "solidly" is an overstatement, but the fact is that there is less fear that the index will drop back into negative territory any time soon.



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:

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

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 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.

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

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