UPDATED: MARCH 2022

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U.S. MACROECONOMIC UPDATE FOR RETAIL & CPGS:

THE GOOD, THE BAD, & THE UNCERTAIN

INTRODUCTION

2022 OVERVIEW: INCREASING MARKET UNCERTAINTY

Throughout 2020 and 2021, the pandemic created a sharp contrast in the success of CPG and retail brands across the U.S. Some companies did remarkably well while others struggled to survive. This disconnect is primarily a result of the industry-based disparity between goods and services driven by compulsory and voluntary behavioral changes during the pandemic.

With mandatory measures lifted and consumer behaviors starting to return to normal, it is reasonable to anticipate a return to the pre-pandemic economy. But it is important to recognize that the impact of the pandemic will be lasting which will result in new conditions that will be dissimilar from both those that existed in 2018 and 2019 prior to the pandemic and the ones experienced during the pandemic (2020 and 2021).

Retailers and CPGs that experienced unprecedented growth from the pandemic need to begin to prepare for a new economic landscape, one not driven by the pandemic. Online retailers and grocery stores, for instance, had a drastic increase in sales in 2020 and 2021. On the contrary, there were companies that were utterly devastated by the pandemic, such as restaurants and businesses in the hospitality and leisure industry. These trends are poised to flip in 2022, as services become a more prominent part of consumer spending.

Regardless, 2022 has seen the emergence of unrelated but equally impactful global developments that will cause concern throughout 2022. Retailers and CPGs that understand these uncertainties and properly prepare will be able to weather the economic and geopolitical headwinds.

INTRODUCTION

IMPACTS OF GEOPOLITICAL CONFLICT ON RETAIL AND CPGS

Russia's invasion of Ukraine has roiled commodity markets, pushed up energy prices, strained global financial markets, and created tremendous economic uncertainty. As is the case with all periods of uncertainty, the duration of the disruption will be critical to the economic outcomes. The crisis is putting tremendous strain on consumer prices in the short run.

Without the ability to offset potential shortfalls in the supply of Russian crude oil, Americans will have to pay more at the pump. Food prices, which experienced unprecedented growth in the second half of 2021, are likely to rise, given that Russia and Ukraine are the largest exporters of some vital agricultural commodities. Longer-term disruptions from a dissolution of economic ties could have unparalleled ramifications for globalization.

One of the biggest causes of uncertainty right now is how long will the conflict last, and how far will western allies go in sanctioning Russia?

The situation continues to evolve, and currently, there's no telling how long the conflict will last. With Russia cut off from accessing its foreign reserves and most Russian companies and financial institutions barred from accessing the western financial system, and with the precipitous fall in the Ruble, it is unclear how long Russia can withstand the economic pressures. Similarly, it remains unclear what additional sanctions can be imposed on Russia or its allies and the willingness of Western alliances, particularly Europe, have to rachet up the existing sanctions.

While the crisis continues, Americans need to prepare for sustained inflationary pressures and potentially even more supply chain challenges as retailers and CPGs struggle to manage the impact of this crisis.

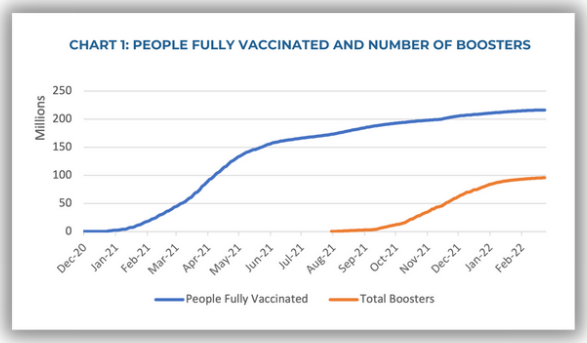
This report takes a look at the good, the bad, and the uncertain for Retail and CPGs in 2022 for these three categories: COVID, the economy, and the consumer.

COVID-19 VACCINES AND VARIANTS

With the recent decline in COVID-19 cases, there is reason to be optimistic about the COVID's impact on the economy in 2022. Since the wave of Omicron in January, the vaccination rate in the U.S. has been rising (see chart #1), and the spread of COVID has fallen (see chart #2).

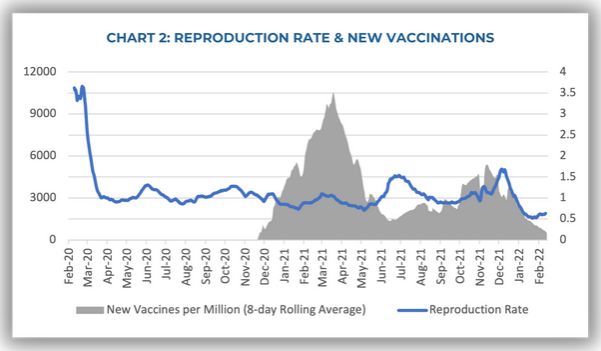
The Good

Vaccination rates are up, and new cases are down. Studies about the long-term efficacy of vaccinations rates are showing that current vaccines offer long-term protection against severe cases of COVID-19 (hospitalizations and deaths).



The Bad

Vaccine and booster long term efficacy. New research has found that most of the widely available vaccinations only offer temporary protection against infections, suggesting that we may see future waves of COVID-19 when new variants can evade existing antibodies.



The Uncertain

What will be the ongoing impact of COVID? One of the most significant sources of global uncertainty right now is the impact that COVID-19 could have on Asia countries, which have lower levels of previous infection rates and continue to implement zero-COVID policies. Given the importance of Asia in global supply chains, shutdowns in local economies could disrupt already strained supply chains. This presages more inflationary pressures at a time when global inflation rates are approaching highs not seen in four decades.

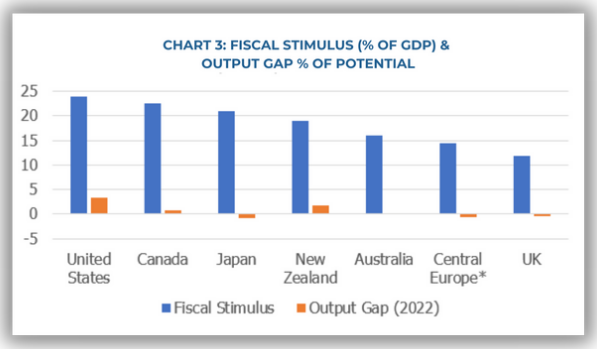
THE ECONOMY

ECONOMIC RECOVERY

2022 should prove to be the first year we regain some pre-pandemic level of economic normalcy. Overall, we expect the economy will continue to grow in 2022, although the uncertainties around that outlook have increased. The year has already had a tumultuous start as companies faced supply chain disruptions and backlogs, a challenging labor market, rising wage pressures, higher costs of capital, and now increasing uncertainty from geopolitical conflicts.

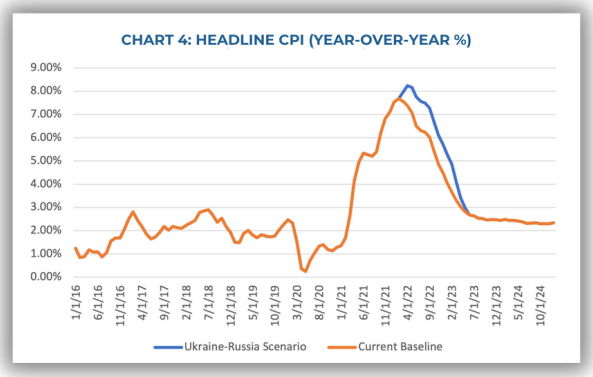
The Good

U.S. economic recovery. The U.S. economy is on sound footing. The unemployment rate is low, hiring remains strong, and wages are rising for most workers. Household leverage remains in check, and the financial system remains resilient despite the prospects of rising rates and an upsurge in geopolitical uncertainty. This is true for most developed economies.



The Bad

Inflation is here. The United States headline consumer inflation is at a multi-decade high of 7.5%. Before the start of the Ukraine conflict, we expected consumer price inflation would peak in February of this year at 7.7%. However, with the spillovers from the Ukraine-Russia conflict to U.S. consumer prices, we now expect prices won't peak until May at 8.2%. (see chart #4).



The Uncertain

Two main uncertainties hang over the global economy. One is how long and to what degree the Ukraine-Russia conflict will impact consumer prices. Easing supply chain bottlenecks and lower demand in 2022 should ease pressures excluding the Russia conflict. The balance between the normalization of supply chains and the impact of the conflict on prices will be vital in navigating price movements in 2022.

The other is Monetary policy. The Federal Reserve is poised to transition from its pandemic-induced policies of maximum accommodation to raising interest rates and altering its approach to supporting broader financial market liquidity. Unlike recent decades, this Fed will have to navigate extreme price pressures and geopolitical risks that threaten to destabilize financial markets and impact consumers. It will be a delicate balancing act fraught with high degrees of uncertainty.

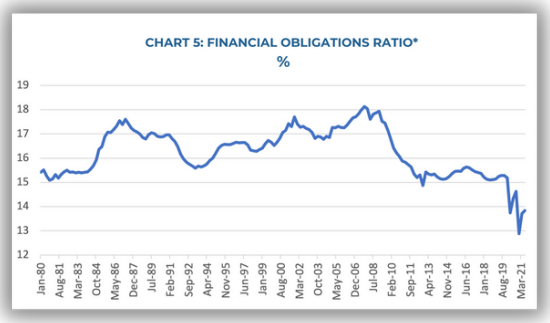
THE CONSUMER

THE AMERICAN CONSUMER

Before the pandemic, American consumers served to prop up the economy for the decade following the financial crisis. When the pandemic hit in 2020, unprecedented income support through government programs insulated household income from the pandemic's true impact on workers and businesses. But there is a new reality setting in for consumers in 2022.

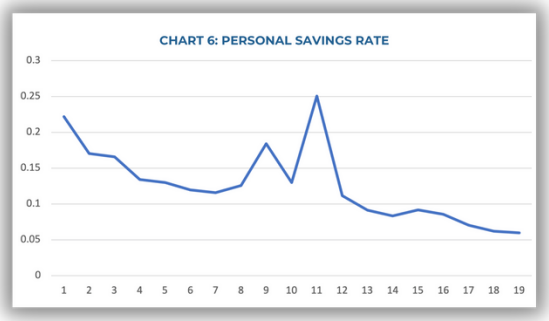
The Good

Consumer wellbeing. Consumer spending has been incredibly resilient, first propped up by unprecedented government support during the pandemic and then by extremely robust wage growth. Despite the hottest inflation the U.S. has seen in decades, consumers have maintained strong spending thanks to the drawdown of savings accumulated during the pandemic and an extremely tight labor market that continues to put upward pressure on wages.



The Bad

The consumer headwinds building. Consumer price tailwinds from multiple fronts will continue to put pressure on consumer wallets. Longer-term labor market trends will slow the recent wage growth acceleration, bringing wages back to a more sustainable trend toward the back half of this year and into 2023. Although spending is still up in the short term, it will decelerate substantially in response to persistent higher prices and waning stimulus.



The Uncertain

Consumer behavior. How will the consumer react to these market conditions that directly impact them? It is difficult to say whether Americans will revert to their pre-pandemic behaviors or continue the new habits they developed over the last two years. But that is only the tip of the iceberg, as they will face significant inflationary pressures. They will find that their income has fallen significantly with the halt in government stimulus and that they have spent much of the money they were receiving during the pandemic (see chart #6).

THE CONCLUSION

HOW SHOULD RETAILERS AND CPGS APPROACH FORECASTING AND BUSINESS PLANNING 2022?

With these challenges looming, retailers and CPGs need to think about planning strategically for 2022 and beyond. Business leaders must understand which COVID-19 habits have become sticky concerning specific customer segments to plan effectively for the coming year.

Some consumer segments are more vulnerable than others in this emerging "COVID 2.0" economy. Low-income consumers will have less spending power without the boost of added unemployment benefits and rising prices. At the same time, higher-income households may barely feel the pinch of inflationary pressures as they draw down excess savings from economic impact payments and strong returns on assets. Therefore, retailers and CPGs must understand the impact of economic conditions on their core customer base across all product lines.

The reality is that the economy remains unpredictable. Between the potential for new COVID variants, the current geopolitical tensions, and persistently high inflation, businesses are faced with an increasingly volatile economic climate.

Scenario planning becomes key to business planning and forecasting in an uncertain economy. Taking dynamic variables into account and planning for many different situations will best enable retailers and CPGs to react with agility to rapidly changing market conditions.

CASE STUDY

HOW KRAFT HEINZ NOW LEVERAGES GLOBAL DATA & PREDICTIVE AI TO NAVIGATE MARKET UNCERTAINTY

Overview

The Kraft Heinz Company (KHC) is one of the largest CPG organizations in the world. Forecasting and planning is a critical function, performed on a monthly, quarterly, and annual basis by worldwide teams. Budgets and resources are constantly re- assessed. In 2020, KHC reorganized and regrouped its categories into six new product platforms, supporting a transformational new growth strategy based on consumer behavior.

COVID has rocked even their most stable categories and triggered a new initiative to begin planning with macro-economic views and predictions of each of their key markets.

The Challenges

- Consumer Shifts in Behavior
- COVID + Volatility

Four Global Objectives

- Gain predictive insight into the new consumer behavior-based platforms
- Optimize resources for growth
- Build market volatility into planning and forecasting processes
- Create top-down macro views of markets

The Solution

- Leveraging Prevedere's global data repository and AI/ML engine and forecasting platform, KHC identified the key economic drivers that have the greatest impact on their revenue.
- These insights were used to improve the accuracy of internally generated forecasts.
- As a result, KHC integrated Prevedere's platform into their internal process to validate forecasts in real-time by correlating economic data and macro predictions.
- After a successful pilot resulting in a high degree of forecast accuracy and market visibility, KHC significantly expanded the number of predictive models across the organization, including Canada and 80 international territories.

The Outcome

KHC is prepared for all types of operating conditions, leveraging data-driven predictive analytics and economist intelligence due to:

- **Improved forecast accuracy** in which a 1% improvement results in millions of dollars of cost savings or revenue growth.
- **No more surprises** due to new confidence and ability to plan for future opportunity and risk.
- **Data-driven predictions** to help drive their supply chain decisions.
- **Real-time insights** and discovery of new and impactful consumer-level drivers.
- **Greater visibility** into financial metrics such as CAGRs, market size projections, among others.

GET IN TOUCH

UNDERSTAND TOMORROW TODAY WITH PREVEDERE'S PREDICTIVE AI

Market and economic uncertainty are impacting and disrupting the plans and strategies of organizations worldwide. Modern CFOs and finance leaders understand, quantify, and incorporate predictions of future volatility into their planning models and processes to manage risk and maximize opportunity.

It is now possible to easily augment strategic and operational planning with economic-based predictive intelligence.

By identifying a company's precise economic drivers, models can be created to deliver predictions for use as planning starting points, consensus forecasts, guard rails, and target market intelligence.

Proven Results

- Target Market Foresight
- Improved Planning Accuracy
- Risk Mitigation
- Growth + First Mover Competitive Advantage

About Prevedere

Prevedere is the leader in delivering global data, AI/ML econometric modeling, prediction monitoring, and economist interpretation of target markets for clients around the globe. We provide a layer of predictive AI insight that easily integrates into existing planning processes and systems.

Partnering with Prevedere provides instant access to the world's data, an advanced econometrics modeling engine, and a team of experienced economists, "Right in the palm of your hand," as stated by one of our customers recently.

GET IN TOUCH

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