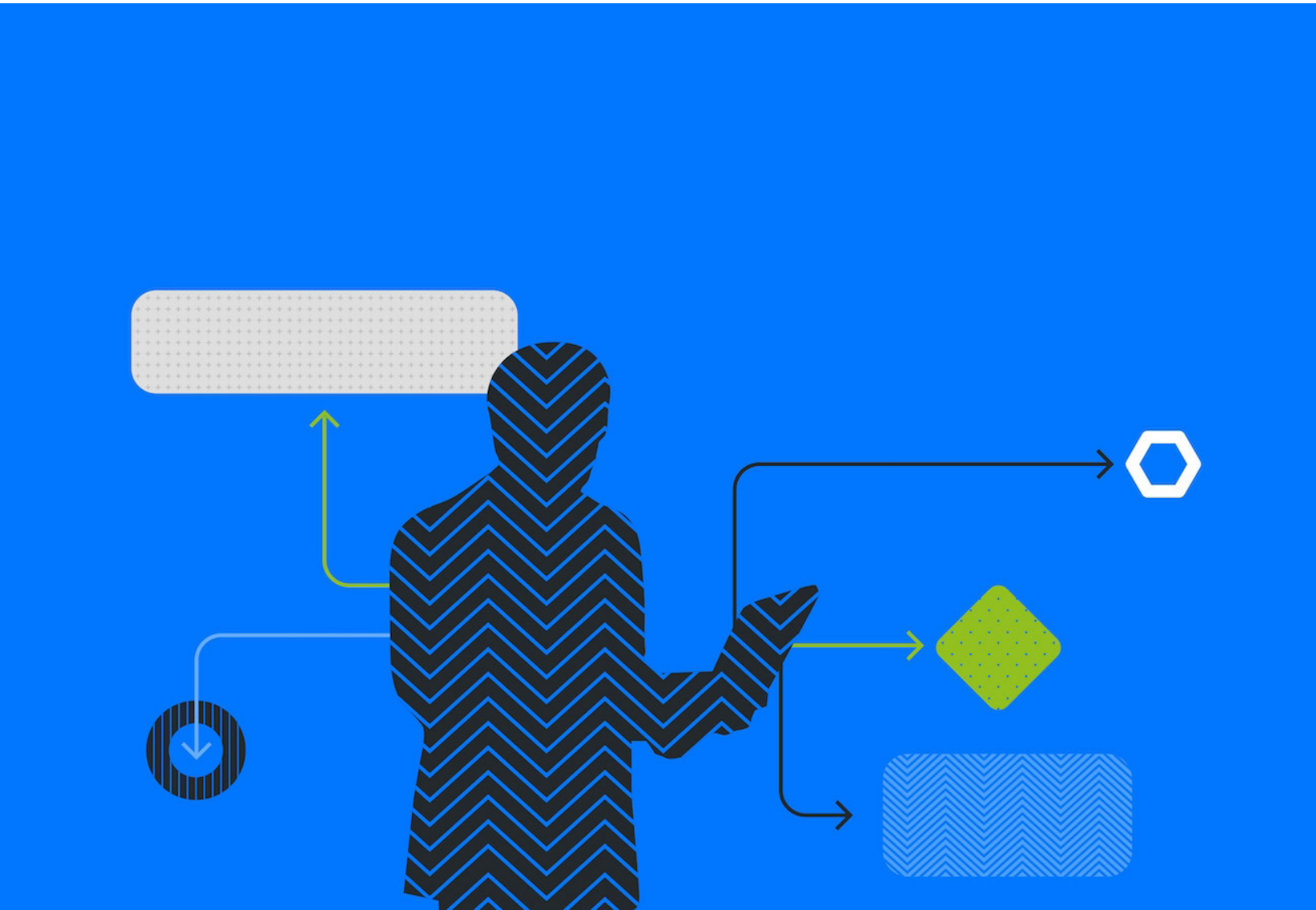
prevedere

Five trends to watch during the coming economic downturn



Introduction

Taken at face value, the latest headlines about Q3 GDP growth may have executives breathing a sigh of relief and thinking a recession has been averted. This is not the case. Last quarter's GDP is a false positive, and it would be a grave mistake for business leaders to assume the worst has passed and invest as they would during a period of robust growth. The reality is that executives need to plan for a down market. We are still on the backside of the current economic business cycle and have not yet reached the bottom. A lingering recession in 2023 is a reality.

Why the false positive?

The economic growth in Q3 was largely driven by the U.S. increasing net exports as the trade deficit unexpectedly narrowed, a mild increase in government spending, and a boost in the services sector as consumers returned to more normalized spending patterns on services and away from the pandemic-driven habits that were fueled by limited access to services.

This increase in net exports was a one-time occurrence, and the economy will not likely see the same bump in the next quarter. Taking this into account, overall consumer spending, which accounts for the largest portion of economic activity, slowed during Q3.

Furthermore, inflation remained high. The Fed will almost certainly continue to raise interest rates in order to combat inflationary pressures, which in turn will continue to dampen demand as higher borrowing costs persist through the remainder of the year and into early 2023. Overall economic output will continue to decelerate, with a real recession developing early next year.

With a likely downturn on the horizon, here are five external trends that executives should be watching closely:

1. The labor market

This recession is going to have a different impact on the labor market than during past economic cycles. Right now, the labor market is extremely tight, with nearly two job openings for every unemployed person. Combined with factors like early retirement and lack of immigration, it is very challenging for businesses to fill open positions.

A softening economic environment will help alleviate some of this pressure, but we don't expect to see mass layoffs and increased unemployment to the same extent we have in past recessions. And while the unemployment rate will likely move higher next year, the rise will be mild. Currently, the economy is significantly underemployed relative to economic output. As such, softening economic output will simply help balance the labor market.

Key takeaway: Executives need to pay attention to much more than just the labor market in monitoring for signs of economic recession. Historically it is one of the most studied metrics in predicting softening economic conditions, but that will not be the case in this cycle. In reality, the labor market is actually a lagging indicator, so we do not typically see a rise in the unemployment rate until a recession is well underway, and will be relatively muted this cycle compared to historical rising trends in unemployment.

2. Commodity prices and inflation

The overall expectation is that inflation and commodity prices will begin to ease in 2023 and experience deceleration in the second half of next year as demand softens and the economy cools. However, this is not set in stone, and executives should understand how more rapid price gains and more significant price deceleration, or even deflation, could impact their organization.

Key takeaway: Scenario planning remains of critical importance. Commodity prices and inflation remain two of the most volatile and hard-to-forecast trends in the economy. As a result, preparing for a range of possible outcomes is necessary.

3. Consumer habits

When it comes to consumer habits, we've observed two current prevailing trends. First, people are spending more time at home, thanks to having more opportunities to work remotely, as well as nesting trends that developed during the pandemic and have persisted. This has leveled out to around 2.5%-4.5% more time spent at home than prior to the pandemic.

Second, there has been an interesting shift in e-commerce activity. Prior to the pandemic, e-commerce accounted for approximately 11.6% of retail activity on a seasonally adjusted basis. That number peaked at 16.4% during the pandemic, and has since declined to settle at around 14.5%, a number that is actually in line with the pre-pandemic trend line.

Key takeaway: Consumers are spending more time at home, but the major structural shift to e-commerce that was predicted during the pandemic hasn't quite come to fruition. Online shopping was rising before the pandemic, and while the pandemic saw a large uptick in activity, it has largely returned to its pre-pandemic trajectory. More consumers have returned to brick-and-mortar stores than initially thought, creating opportunities for continued growth for retailers in both their physical stores and online platforms

4. Consumer spending power and mindset

Consumers are becoming increasingly budget and savings-conscious in general, but especially at middle and lower-income levels. Recent consumer survey data indicates that they are looking to decrease overall spending, shop for sales more often, and use coupons to find the best deals. This is likely to continue through the majority of 2023.

Key takeaway: The days of 2021 and early 2022, when the consumer was willing to absorb any price increase without considering a competitive brand or product, are coming to an end and businesses should be prepared. Consumers will be more price sensitive during the next 12 months than they were during the previous year.

5. Sustainability

The current moment is seeing a very real and strong push toward sustainability, a movement not going anywhere anytime soon.

From a durable goods perspective, we see regulation is pushing toward sustainability, such as electric vehicles in California. Staying ahead of this can provide many opportunities for businesses long term.

Looking at lower-priced consumable goods, we are seeing some potential headwinds. According to a recent poll conducted by Kantar, the majority of respondents across nine countries reported that they are considering switching or have already switched to less-sustainable consumer goods due to the increased cost of living. For these smaller ticket items, we could see a near-term pullback from a cash-strapped consumer, but this is likely to be short-lived. Sustainability will again become the main focus for consumers when the economy is fully recovered by 2025.

Key takeaway: Companies investing in sustainability will have an edge in keeping current customers and attracting new ones when we start to see the economy reaccelerate. Given that this down cycle is likely to bottom out by 2024, an investment in sustainability makes sense in the long run.

Conclusion

Despite the most recent GDP report, executives should still be planning for a likely recession next year. During this downturn, it will be critical to monitor key external factors, including the labor market, commodity prices, inflation, consumer spending, and sustainability. Scenario planning with these indicators in mind can help business leaders to stay abreast during an uncertain economy and forecast accurately.

prevedere

prevedere

The right scenario planning platform will be key for successfully navigating recession and economic recovery in 2023.

Leading executives at Fortune 500 companies are leveraging Prevedere's scenario planning platform to gain a competitive advantage by knowing when to expect downturns or upturns in the economy.

Learn more about how Prevedere's recession scenario planning platform can help your organization maximize revenue growth despite market volatility.

Book a demo

Thank you

prevedere

Contact: **(888) 686-7746** or **inquiries@prevedere.com**