A Prevedere Report

# U.S. Macroeconomic Conditions for Retailers

## *Weathering the Storm*

# 2023 Overview
# Weathering the Storm

Less than a year ago, there was good reason for retail executives to be optimistic about the economic environment. While the pandemic created significant challenges, many companies experienced growing sales once the economy reopened. With many expecting the inventory challenges to diminish and inflation to be transient, the greatest roadblocks to a return to normalcy seemed to be dissipating.

Unfortunately, this optimistic perspective did not come to fruition. For business leaders in the retail industry, the narrative of 2023 has become weathering the storm in a downmarket that is being driven by uncertainty and volatility. To navigate through this challenging environment, it will be essential for executives to understand the key economic indicators that act as drivers for their businesses during these uncertain economic times.

In this new complimentary report, Prevedere's economist team provides insights into three major trends that leaders in the retail industry will need to follow closely in 2023:

- Inflationary Conditions
- The Health of the American Consumer
- Global Trade Policies

# Inflationary Conditions

In 2022, inflation rose at unprecedented rates. But, despite the current high rate of inflation, headline and consumer prices excluding food and energy are beginning to slow down. This trend should continue to progress throughout the year.

It will be essential for leaders at retail companies to track these indicators to determine how their company should be handling inflationary pressures on their business:

- The Federal Reserve
- Flexible and Sticky Prices
- Supply Chain and Commodity Pricing

## The Federal Reserve

Despite raising interest rates at an unprecedented pace, the Federal Reserve is only just beginning its fight to lower inflation to a healthy level. As such, inflation will continue to be an important indicator for business leaders to track in 2023 and keep top-of-mind. Prevedere's economist team currently forecasts that inflation will return to within a comfortable range for the Federal Reserve by the end of the year.

## Tracking Flexible and Sticky Prices

One of the most important things for business leaders to watch will be the movement or co-movement of flexible and sticky prices to track inflation. Items with sticky or slow-moving prices have leveled off but remain nearly three times their levels from before the pandemic. This group of items includes housing costs or services and tends to take longer to change. This is in contrast to flexibly priced items, such as food and entertainment, which can vacillate quickly and change the trajectory of inflation rates in a shorter period of time. As flexible prices decline, inflationary pressures can drop quickly.

## Supply Chain and Commodity Pricing

Despite being one of the greatest pain points for the last few years, the expectation is that supply chain issues will lessen this year and commodity prices should not come close to the levels that were experienced in 2021 and 2022. This should serve to ease inflationary pressures and greatly benefit U.S. companies. Despite this positive trend, any major changes in trade policies in China could hinder this trend and mitigate the needed drop in the inflation rate.




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# The Health of the American Consumer

If you look back at the American consumer during the last three years, you might get whiplash. The pandemic strengthened the consumer as they benefited from government stipends, growth in their savings, and increased sentiment. And looking back even further, the consumer really carried the economy throughout the last decade since the great recession in 2008-2009.

This trend came to an end in the second half of last year. 2023 could be the most challenging year for Americans in more than a decade. Executives in the retail industry will face significant challenges as a result. In order to increase sales this year, it will be key to strategically target consumer segments that are in the best position to spend. There are three key areas to watch:

- Personal Savings Rate
- Consumer Sentiment
- Government Programs

## Personal Savings Rate

Americans' savings reached all-time savings during the pandemic due to the pandemic but that has come to an end. However, most of that excess savings have been depleted and the cost of credit has increased. As a result, American consumers will have to be more budget conscious than in prior years. Additionally, most of the COVID-era benefits to consumers are expiring so many low-income Americans will lose that safety net.

## Consumer Sentiment

One indicator used to forecast economic recovery is consumer sentiment. This indicator fell significantly in Q3 2022, followed by a modest recovery during the following quarter. As the Fed raises interest rates the expectation is that financial conditions will tighten across the economy, leading to a potential rise in job losses and unemployment. If this scenario results in a further drop in consumer sentiment then Americans will most likely pull back their spending even more, producing an economic downturn that could continue through 2023 and into 2024.

## Government Programs

Although there will not be another jolt from more direct federal stimulus or payments, there are government programs that can increase the health of the consumer. First, the cost-of-living adjustment for social security was one of the largest ever with an increase of 8.7% from the prior year. With inflation falling quickly, the purchasing power of those on social security will increase dramatically, allowing for some relief in 2022. Additionally, SNAP benefits or food subsidies have increased substantially on account of the Thrifty Food Plan. This benefit should ease the strain on the lowest-income households trying to buy basic necessities.

# Global Trade Policies

For good reason, there has been much focus on the relationship between the U.S. and China. But the significant attention to that specific relationship has overshadowed other significant challenges for global trade around the world.

There is reason to believe that in 2023, the push against globalization that has been building for years throughout the U.S., Europe, and Asia will continue. This can have a significant impact on retailers throughout many business areas including supply chain, inventory planning, and the ability to grow profits globally. With more governments actively pursuing new regulations for companies there are key areas to follow:

- China
- European Regulators
- Strength of the U.S. Dollar

## China is the Wildcard

The reality is that despite efforts to "on-shore" or diversify the geographies of their production, many U.S. companies are still heavily reliant on China. China's growing economic and logistical importance in the global economy means that any adverse events locally will reverberate globally. So, whether it will be due to new outbreaks of COVID, factory closings, or unpredictable reactions to proposed U.S. trade policies, there is potential for new challenges that can significantly hamper businesses. The good news in the short term is that the supply chain has opened up and for the foreseeable future, commodity prices should not have major fluctuations unless an unforeseen event takes place.

## European Regulators

While there has been much focus on the Chinese government, European regulators will impact businesses that operate globally. Like the Federal Reserve, the European Central Bank is also raising interest rates to fight inflation but it might be more important to watch as regulators pursue threats to competition, tax policies, and sustainability in 2023. These trends could make it more challenging for U.S. companies to grow sales across the continent.

## Strength of the U.S. Dollar

One of the benefits of the Federal Reserve slowing its rate hikes will be some weakening to the U.S. Dollar, which has been particularly strong throughout the pandemic. This will open more opportunities for multinational corporations to increase foreign profits and grow exports. While this could prove to be some good news, it will be just as important for business leaders to monitor the strength of foreign buyers, who could experience slowdowns in their respective countries.

# How should Retail executives approach forecasting and business planning in 2023?

The U.S. economy will almost certainly experience recession-like conditions throughout 2023, which could last into 2024. With a baseline expectation that there will be a challenging but ultimately mild downmarket for most of the year, an unforeseen external event could have the potential to add additional volatility to an already fragile economy and trigger a more severe and prolonged recession. The impact that economic events can have on a company's revenue has never been more apparent, and there is no question that economic indicators that act as business drivers must be included in any business forecasts.

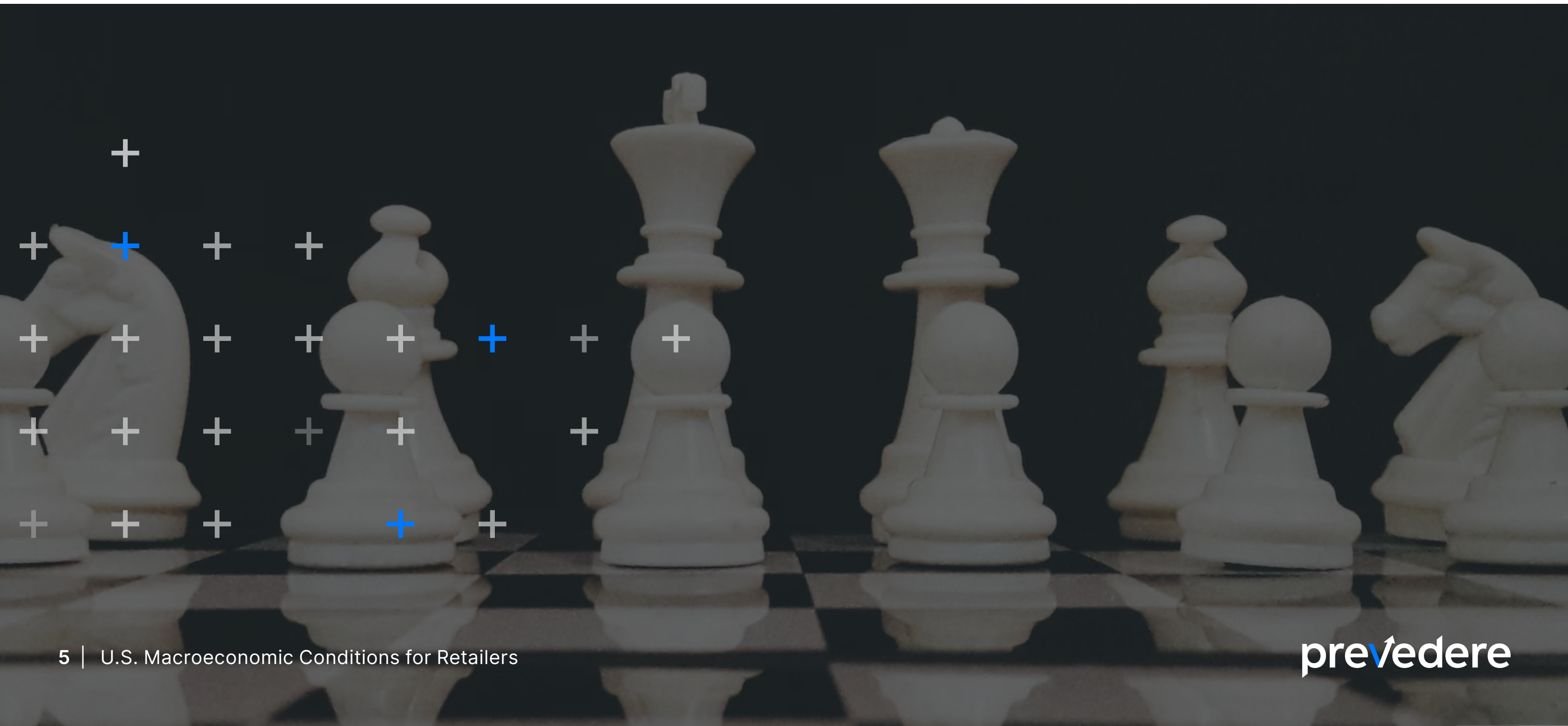
While no company will be able to completely avert the impact of recessionary conditions, Prevedere's economist team does not believe that the entire economy will experience the same effects equally. As such, it will be imperative that FP&A teams at retail companies have the right forecasting tools to identify growth opportunities that emerge in the market and plan for business growth in those areas.

But finding revenue opportunities in the downmarket is only the first step to success in forecasting and planning in 2023.

Every recession is followed by recovery. Business leaders must be able to accurately forecast the timing of this inflection point for their company. The cost of misjudging when the market will start to recover could cost a company more than a billion dollars:

- Project recovery too early and there is a danger that investments and cash flow are wasted while inventory sits in stores unsold for months.
- Project the recovery too late and a company will miss the initial timing to sell to consumers at the moment they have the desire to return to normalized buying habits. No company can afford to begin the recovery period trailing its competitors.

The key for CFOs and FP&A teams to ensure that they lead their companies into strong recovery will be heavily reliant on understanding the economic indicators that impact their business' revenue and their ability to incorporate those business drivers into their company's forecasting and planning process.



# To learn how these trends impact your business specifically, schedule a strategy call with a Prevedere Economist.

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