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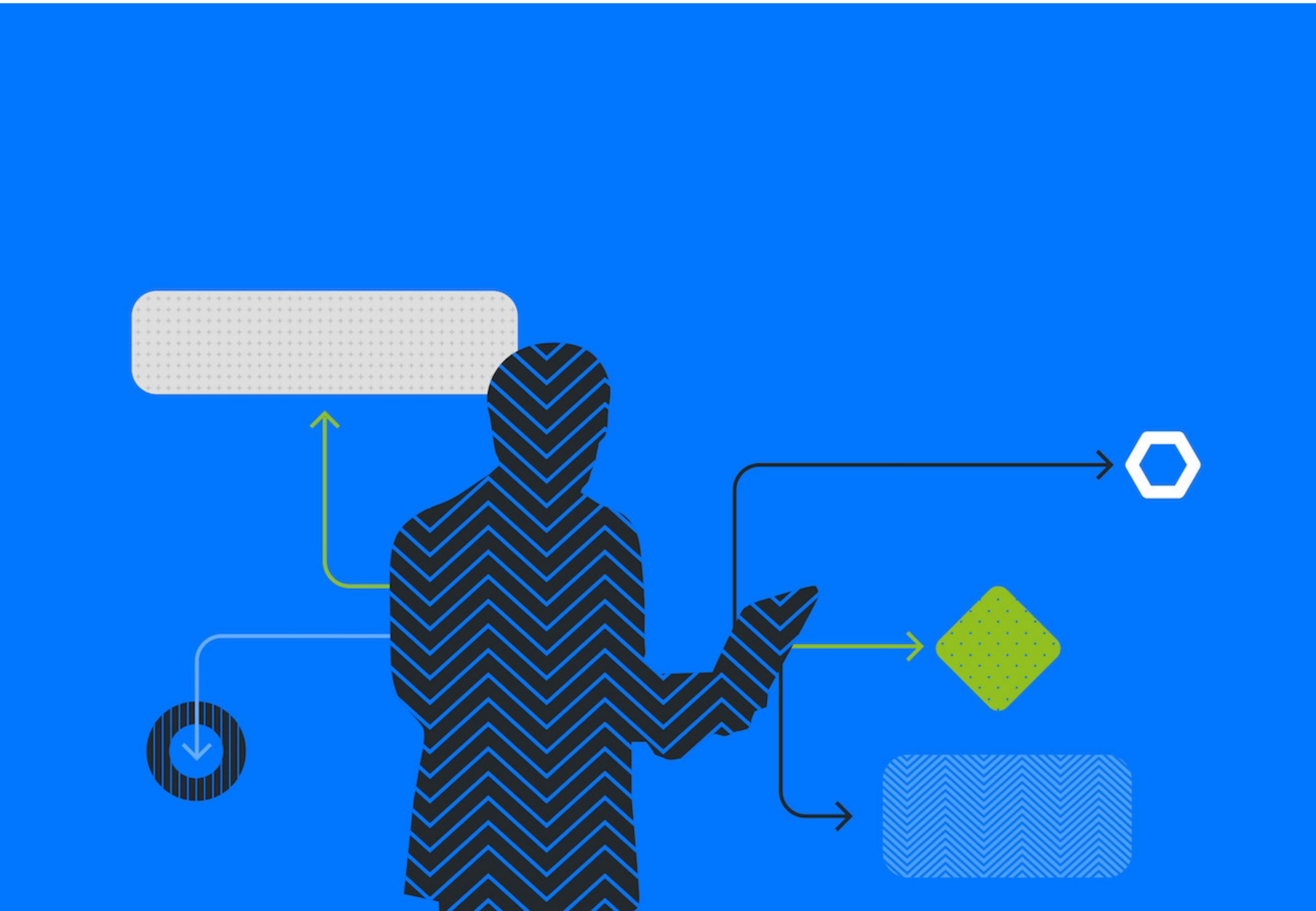
Forecasting Consumer Behavior Trends During a Recession in 2023



Outlook on recession and consumer behavior

Recession is coming

Prevedere's economist team expects the economy to enter into a recessionary period beginning towards the end of Q2 of 2023, and most likely extend through the second half of this year. As of May 2023, the earliest leading indicators are suggesting that recovery will start to take hold by early 2024. Although this downturn may be relatively short-lived, consumers will shift their buying behaviors as a result.

It will be essential for business leaders to forecast and plan for these shifts to maximize all revenue potential during this challenging business cycle. In this report, we share our current expectations for the ways that Americans will change their habits at a macro level and key trends that FP&A teams must monitor over the second half of the year.

Initial expectation for shifting buying patterns

At the start of this recession, we expect consumers to start feeling some initial hesitation in their spending habits and begin "trading down." For example, before pulling back on dining out altogether, they may initially pull back on frequenting more expensive, full-service restaurants and opt for cheaper, quick-service alternatives. That could also result in the decision to cook more meals at home instead of purchasing higher-priced food service alternatives. As a result, there may be a bump in grocery store spending during the earliest months of the recession. But as the recession continues, consumers will increase their cutbacks on more discretionary products, such as private label brands, and ultimately forgo higher-priced, indulgent items altogether.

During the second half of this year, the category that will experience the greatest challenges will most likely be higher-priced durable goods as consumers have historically shown a tendency to start postponing these types of purchases. This includes items such as furniture, new homes, and new vehicles.

Additionally, discretionary travel spending tends to drop during economic downturns, although the impact may be less dramatic for younger generations who prioritize travel. Nonetheless, there is still likely to be some impact on this category as it is an area that is highly reliant on increased discretionary spending.

Three trends to watch

Tight labor market

The tight labor market is significantly impacting the health of the U.S. economy. However, there are early signs that it is easing, as initial unemployment claims are starting to increase.

It's important to note that the labor market has been uneven, with most of the volatility in layoffs and job losses concentrated among the highest-income earners in tech, finance, and professional business services. The rest of the labor market has remained tight, resulting in elevated wage growth overall, particularly for lower-wage earners in the lowest quartile. As a result, many consumers have maintained their jobs and confidence in the face of economic volatility, as businesses have been hesitant to let go of labor due to the challenge of finding it in the first place. Despite inflationary pressures, higher interest rates, higher borrowing costs, and concerns in the banking sector, income and employment support have enabled consumers to maintain some spending.

Americans have a level of financial support that wasn't present during previous recessions. This has led to lag in consumer behavior changes from the time that larger economic shifts occur.

End of COVID-era consumer benefits

During the pandemic, the government launched benefits programs that have been supporting consumer spending during the last few years and are set to expire in 2023. The first is the increased amount of SNAP benefits and the payout of pandemic EBT benefits. Many of the Americans that were enlisted in these programs were also showing tendencies to spend high dollar amounts as a result of these allotments. As the rollback of these programs started in March 2023, there was evidence that these consumers chose to tap into their disposable income rather than pull back on their purchases. This will not be sustainable for this group throughout the upcoming recession.

Another benefit that is ending is the deferral of college student loan payments, which has been in place since the early months of the pandemic. Unless new regulations about loan forgiveness are implemented, repayments for many student loans will have to start again by the end of summer. The student loan debt in the U.S. is significant, and many Americans opted to use the deferment of payments interest-free for discretionary spending purposes. Once this group needs to resume paying those loans, the ability to maintain their current level of spending will be impacted during the second half of this year.

Post pandemic behaviors

There are several trends that emerged during the pandemic that have become the new normal or post-pandemic norm. These trends have undergone a structural shift due to the pandemic, resulting in a new normal that is different from the trends prior to the pandemic. The first and most obvious trend is working from home, with consumers spending more time at home and not commuting as much. Although there was a big shift back to offices, a large portion of people have continued working remotely and will continue to do so indefinitely. This shift has also led to consumers cooking more at home and consuming more food at home.

Another trend likely to stay is the desire for the gig economy and flexibility in the workday. This trend is particularly popular among younger generations who seek the level of flexibility and control over their work schedule that the gig economy offers. E-commerce and other non-store retail shopping avenues have also seen a significant boost in popularity during the pandemic, with consumers increasingly turning to online shopping for convenience and ease. Although e-commerce has returned to pre-pandemic levels, there has been a structural shift toward online shopping that is likely to continue.

Finally, social media's impact on buying decisions has become a significant trend, with online reviews and social media influencers playing an increasingly important role in brand awareness and consumer behavior. This trend was already underway prior to the pandemic but was greatly accelerated during the pandemic as consumers spent more time at home and on social media.
All of these trends have undergone a structural shift and will continue to shape consumer behavior moving forward.

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Keys to forecasting in 2H 2023

Planning for success

Despite the fact that the recession is projected to be relatively mild and short-lived, it will cause consumers to shift their buying behaviors in the second half of 2023. We recommend that FP&A teams keep three things in mind when forecasting these changes on behalf of their organization:

1. **Every business and industry is different.** Each industry and each company has a unique set of consumer behavior metrics that are relevant and impactful for understanding their core consumer. It's important to keep in mind that forecasting is not a one-size-fits-all solution when it comes to these business-specific metrics. FP&A teams must know the economic indicators that serve as the business drivers for their company and how changes to that data can impact sales.

2. **Expect gradual shifts.** Not everything happens at once, especially when it comes to changes in consumer behavior. These shifts occur gradually over time, with consumers starting by slowly reducing their spending on higher-priced items. Eventually, they may skip purchases altogether before ultimately scaling back significantly. This gradual process underscores the importance of monitoring a company's leading indicators. By identifying these small indications and understanding the timing between when these occurrences happen to the moments that it impacts business sales, executives can gain valuable foresight into larger trends and have the ability to adjust planning accordingly. This insight can prove invaluable in making strategic decisions that position your company for success in the long term.

3. **Watch for the trade-down effect.** There will be a trade-down effect happening across industries. While it is important to monitor spending changes among a company's core audience displays, it will be absolutely critical to monitor for new behaviors that have historically emerged within your category at all price points during previous downturns. There may be opportunities to increase sales among consumers that have not typically been considered core buyers during the last few years.

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Conclusion

The early signs of new recessionary buying habits have already begun to appear, indicating more slowdowns in sales of high-priced items and interest rate-sensitive durable goods, as consumers start to postpone many of those purchases. We are likely to see an adoption of budget consciousness and price consciousness, leading to a trade-down effect across industries.

FP&A teams must have the right processes in place to monitor external indicators in real-time as new data is released. This will be critical for forecasting the ways that these trends will impact their company's sales and allow for executives to adjust their plans accordingly. Perfecting this approach will put any company in the best position to maximize revenue in 2023 and 2024.

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– *Gartner report on Emerging Technologies*

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