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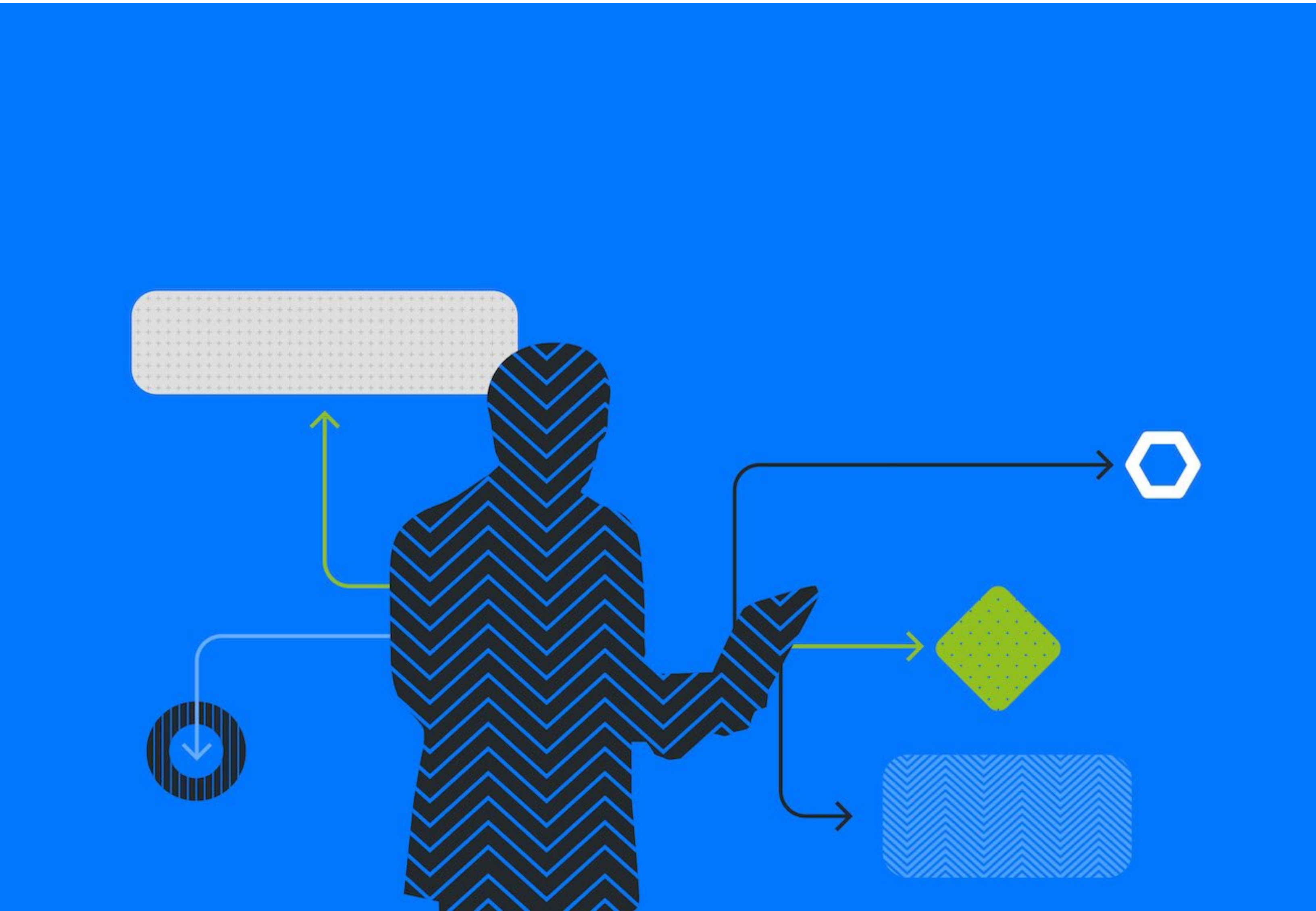
Four economic trends that will shape forecasting and planning in 2024



A challenging market ahead

Despite earlier predictions of a recession throughout 2023, the U.S. economy has shown resilience and maintained its momentum so far this year. However, as the fourth quarter of 2023 begins, there are growing concerns about the economic outlook heading into next year. Leading economic indicators suggest that the U.S. economy may face challenges towards the end of this year and into 2024. The current outlook is calling for headwinds that would create volatility in different areas of the economy that could impact individual businesses significantly.

To navigate the challenging market ahead, Prevedere's economist team has identified the following trends that every executive should take into consideration when building forecasts and plans on behalf of their organizations for 2024:

Rolling recession

The economic landscape is currently characterized as a "rolling recession," a term that is used to describe an economic cycle where various sectors experience contractions and downturns at different times, rather than the traditional definition of a recession in which an entire economy experiences two consecutive quarters of GDP contraction. While possibly avoiding the larger scenario, the expectation is that headwinds and contractions will ultimately occur across most major sectors.

This trend has been occurring for the last year as the housing market faced a downturn in the latter half of 2022 and early 2023, and manufacturing has experienced a contraction phase this year. While the housing market and manufacturing sector are both expected to be in recovery mode by midyear 2024, this rolling recession concept is anticipated to persist into the early months of next year, impacting consumer spending in the fourth quarter, and could continue through the first half of 2024.

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Consumer behavior

Consumer spending is facing several challenges that will likely result in a pullback during the final months of this year and into early 2024. Inflationary pressures, characterized by consistently higher prices over the past two years, have eroded the savings cushion that allowed consumers to maintain their spending habits. This cushion is gradually diminishing.

Additionally, the return of student loan repayments is set to consume a portion of discretionary income. Moreover, consumers have been accumulating credit card debt at an elevated rate, compounded by higher interest rates and a growing incidence of credit card delinquencies. This, coupled with stricter lending standards, creates a challenging environment for consumers.

These converging factors will likely lead to a pullback in consumer spending. As a result, the U.S. consumer will continue to become more budget-conscious. Behaviorally, it should be expected that consumers will actively leverage coupons, seek deals and promotions, engage in comparative shopping, and opt for value and private label brands over premium options. There could be a decrease in discretionary spending, especially on higher-priced items.

These shifts in consumer behavior are expected to occur during the final quarter of 2023 and continue into early 2024. The U.S. consumer is gradually running out of steam, necessitating a more frugal approach to spending and a focus on financial prudence in the face of these economic challenges.

Fed's rate hikes

As the Federal Reserve has grappled with inflation over the past year, there has been a clear and focused message: "higher for longer." As a result, there may be at least one more rate hike either later this year or in early 2024. Rate cuts, on the other hand, are not anticipated until the second half of next year at the earliest.

It should be expected that this overarching theme of sustained higher interest rates will last for 2024 and beyond. The Fed is cautious about making premature rate cuts, as their primary objective is to curb inflation, even if it means a slight economic slowdown. They intend to allow the current business cycle to play out without rushing to lower rates.

Business leaders should be prepared for a higher cost of credit and financing due to these elevated interest rates, extending at least through early 2024. Even when the Fed potentially begins to lower rates in the future, it won't be a swift or immediate process. Rates are unlikely to return to the near-zero levels seen in the aftermath of the financial crisis.

Corporate debt

The impact of rising interest rates on corporations and the ways that companies handle their corporate debt could have significant broader economic implications.

As interest rates continue to rise, corporations face increased costs when rolling over their debt. For companies with robust balance sheets, this may not be a significant issue. However, those with weaker financial positions might struggle to issue new debt or secure additional funding, potentially leading to debt defaults. Downgrades in credit ratings are also on the rise, resulting in higher borrowing costs. When combined with the elevated interest rates, this poses a significant challenge for corporations, especially those with less favorable financials.

The ability of companies to roll over their debt and obtain new funding is closely tied to the current asset values. As a result, the real estate industry, and more specifically, commercial real estate, is particularly vulnerable to these challenges. Any financial cracks in their balance sheets can escalate into larger problems.

The key impact on corporations lies in the higher cost of borrowing for their operations. It’s essential to recognize that these interest rates will likely persist for a considerable period, meaning higher borrowing costs will be a long-term concern. Simultaneously, tighter lending standards are emerging as banks seek to fortify their balance sheets, reducing their appetite for risk and making it harder for both businesses and individuals to access credit.

To navigate this environment, corporations need to incorporate these trends into their forecasting and planning. They must ensure that their financial positions can withstand the increased interest payments they may face in the foreseeable future.

Conclusion: planning for 2024

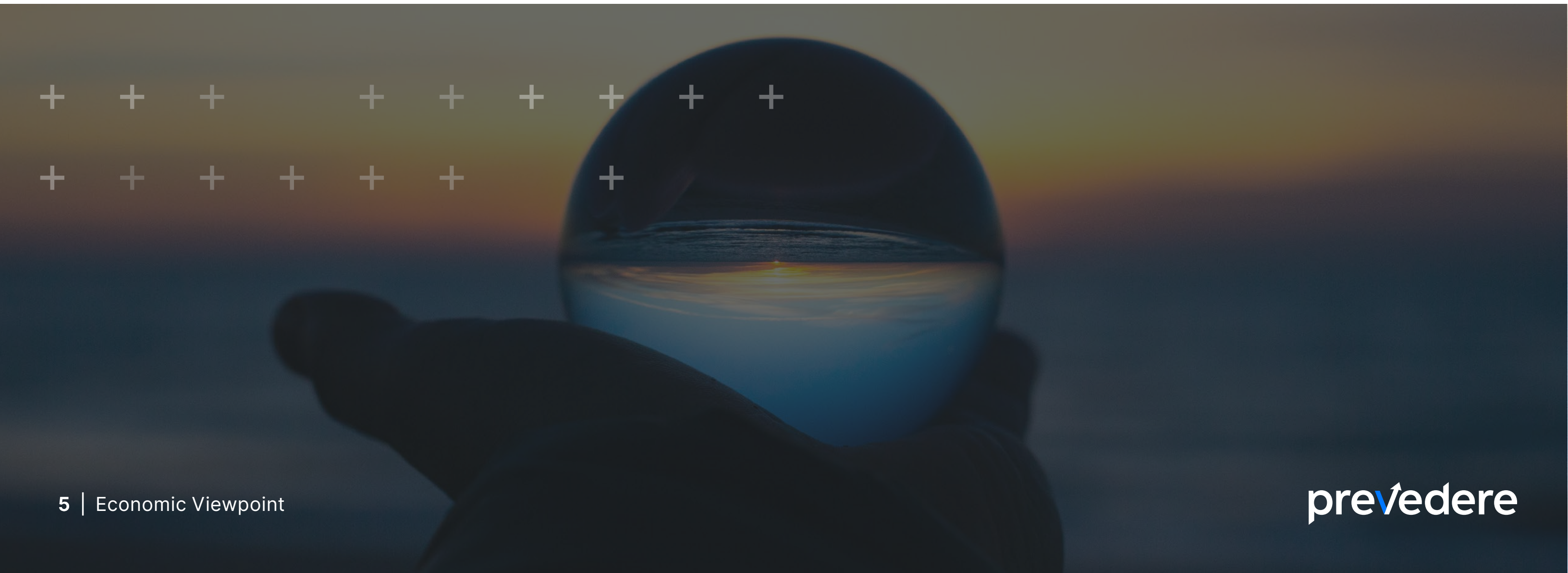
The overall economic outlook for 2024 is described as mixed, both in terms of industry-specific variations and timing differences. The first half of the year is expected to be marked by continued bumps and softness in various sectors. However, by mid-year, a more synchronized economic recovery is anticipated, with most sectors aligning in their recovery trends. While the overall annual GDP growth is not expected to be robust, it is not likely to contract either. This market volatility will create forecasting challenges for all businesses across the economy.

For business leaders and FP&A teams, there are three key elements to keep in mind when factoring these economic trends into the forecasting and planning for their company in 2024:

- **Non-linear Planning:** Avoid linear planning based on current conditions. Economic cycles impact businesses, and these cycles can bring periods of both growth and decline. Don't assume that your current situation will persist. If your business is struggling now, it's unlikely to stay that way indefinitely. Conversely, if things are going well, be prepared for changes. Plan with an awareness of business cycles and where your company is likely to be within its cycle in the future.

- **Expect Some Bumps in the Road:** At the macroeconomic level, anticipate a somewhat rocky road ahead. While a rolling recession may impact different industries differently, overall, there is likely to be some turbulence before improvement. Regardless of your industry, it's essential to recognize that, from a broader perspective, the economic environment may deteriorate before stabilizing.

- **Be prepared for high interest rates:** With the Federal Reserve signaling a "higher for longer" approach, businesses should factor in the likelihood of elevated interest rates. When planning, consider the cost of borrowing for your company. Even if rates begin to decrease in the future, it will likely be a gradual process, and they won't return to the exceptionally low levels seen in previous years. Be ready for higher interest rates both in the short term and the long term.



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