Executive briefing

Macroeconomic outlook and impact on businesses

April update
Week of April 17, 2023

EY-Parthenon Macroeconomics Team

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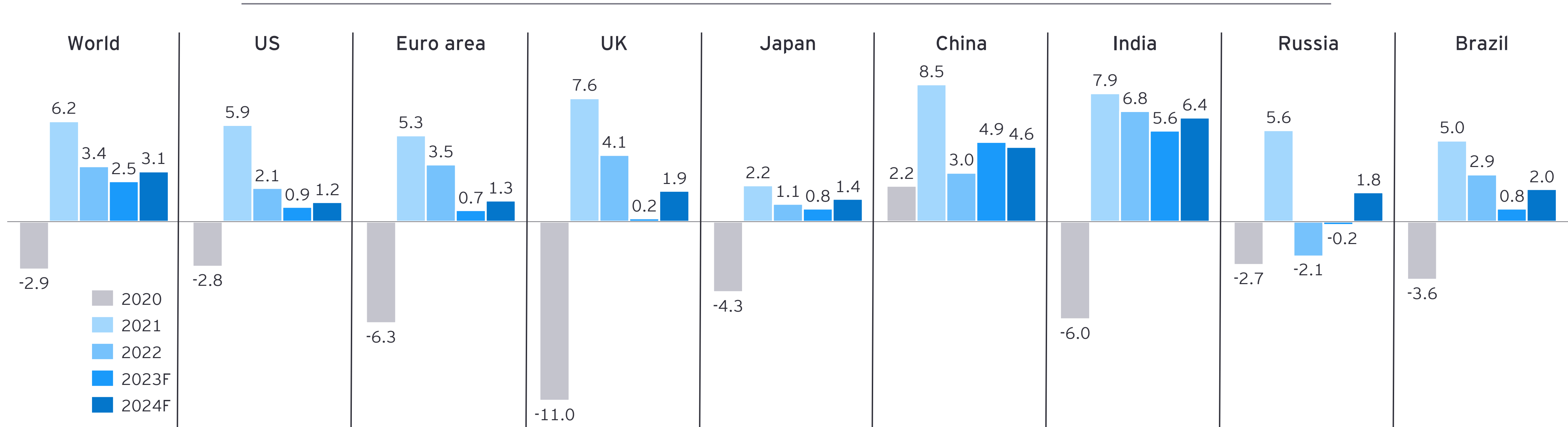
Global economic growth will be sluggish this year and gradually rebound in 2024; the slowdown will be more pronounced across advanced economies

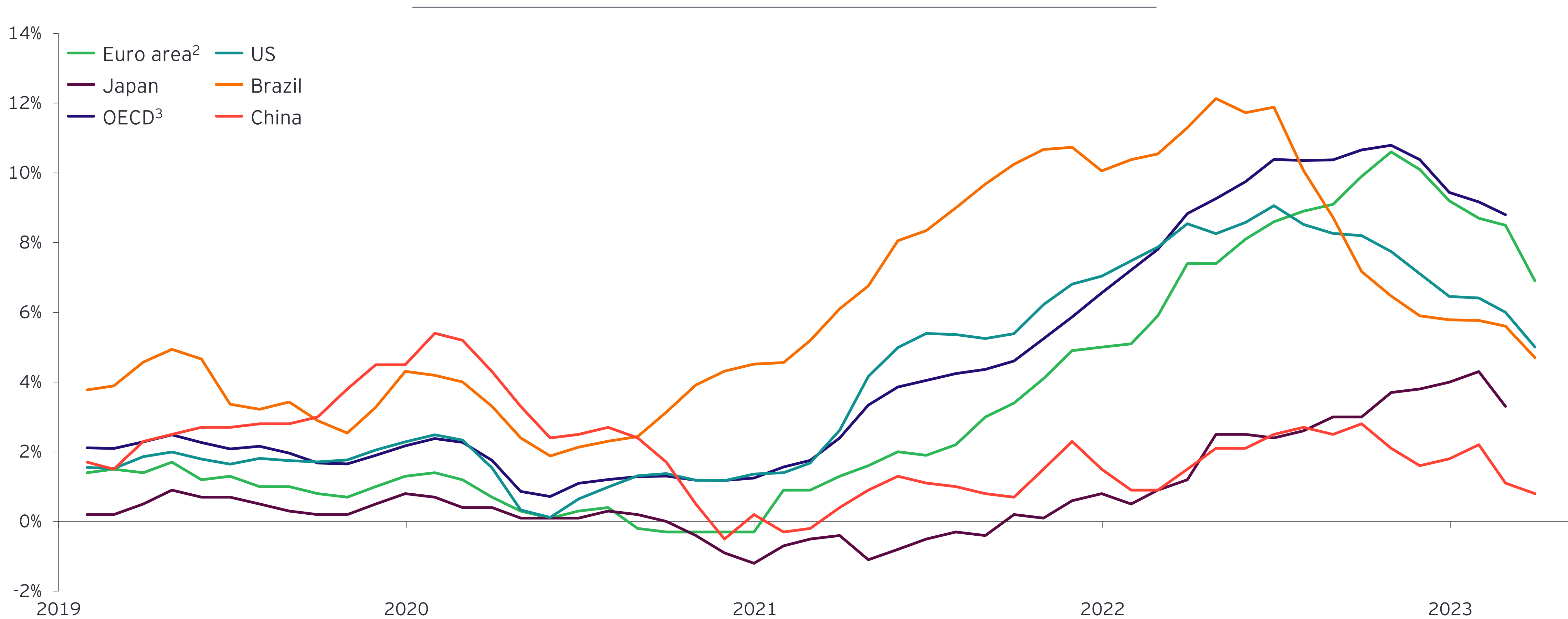


- Global growth continues to slow in the face of elevated inflation, higher interest rates, tighter financial conditions and the lingering impact of the war in Ukraine. The threat of global financial instability in the wake of the recent banking turmoil is an additional risk clouding the outlook. We expect global growth will slow to 2.5% this year from 3.4% in 2021, before rising modestly to 3.0% in 2024. The slowdown will be led by advanced economies, while emerging markets should show some relative resilience led by mainland China's reopening and relative economic resilience in India.
- Global inflation is moderating, but it remains elevated and is showing some signs of persistence, especially when excluding food and energy price inflation. Central banks will err on the side of caution and favor maintaining higher policy rates this year to avoid the risk of losing the battle over inflation.

Source: EY-Parthenon

EY Parthenon

A global disinflationary process is underway, but elevated inflation and prices remain a constraint on consumers and businesses and are keeping central banks on high alert

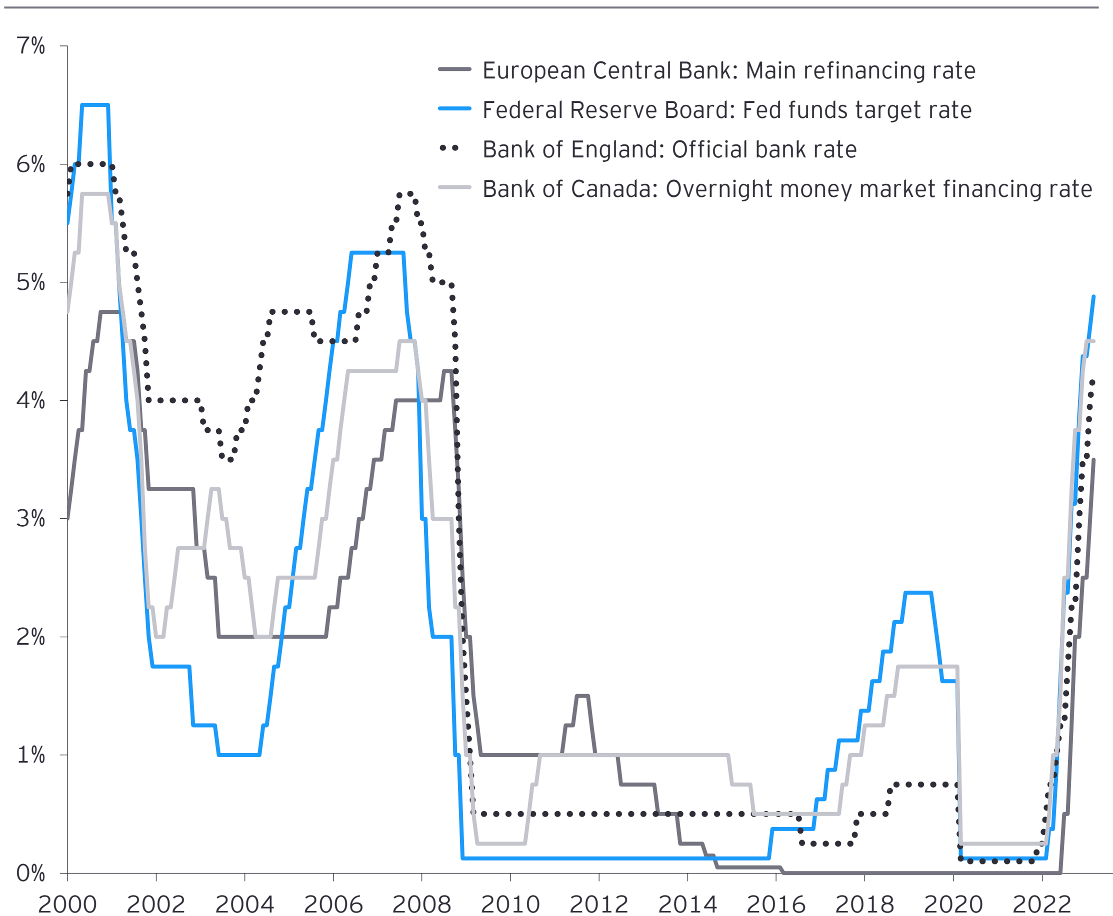


1. Data for Japan and OECD is only available through January.
2. Euro area includes 19 countries.
3. OECD total includes all 38 OECD member countries.

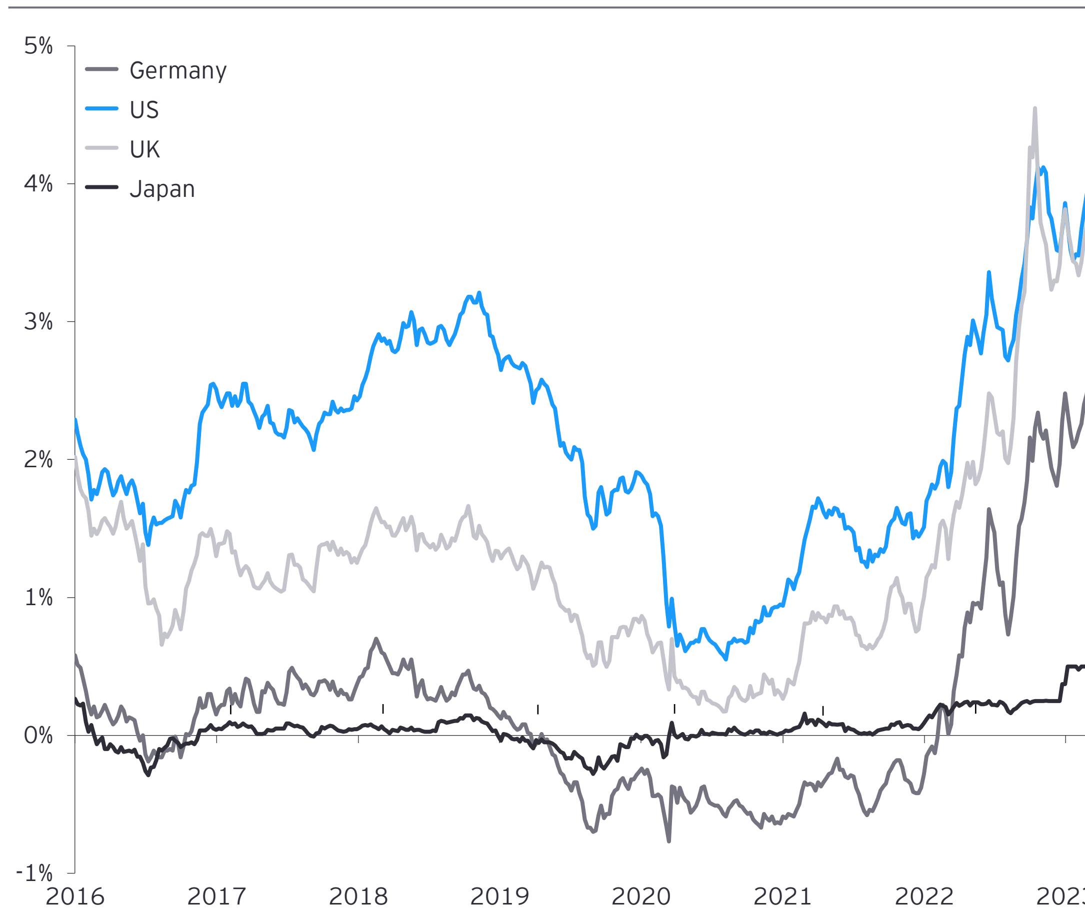
Source: OECD; EY-Parthenon

The end of global monetary policy tightening cycle is near; central bankers must tread carefully as they balance financial stability risks and price stability risks

Central bank rates
2000-23



Long-term interest rates[1]
January 2016-April 2023



Source: Respective countries' central banks; EY-Parthenon

EY Parthenon

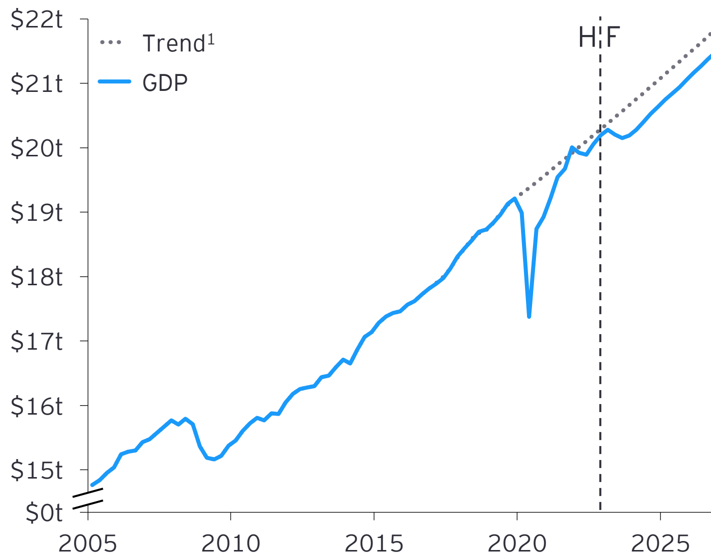
Buckle up: the US economy is losing speed, and a short landing strip is in sight

- **Outlook:** The economy is unwell. It's not the flu, but it is a sore throat. And it's unlikely to get better in the coming months. The combination of persistently elevated prices, high interest rates and now tightening credit conditions will weigh on business investment, consumer spending and the transactions markets in the coming months. Even though the economy is not currently displaying broad-based economic imbalances, recessions are often nonlinear psychological events that unfold rapidly. We continue to see a midyear recession. We anticipate a modest recession with a peak-to-trough GDP contraction around 0.7% this year. We forecast real GDP will grow 0.9% in 2023 and 1.2% in 2024, after a 2.1% advance in 2022.
- **Employment**: The labor market is showing definite signs of loosening, with slower job growth, easing hours worked, moderating wage growth and rebounding labor supply. Layoffs have also been gradually creeping higher, though we believe job cuts will be limited as the labor market turns given business executives' reluctance to let go of valuable and prized talent pools. We continue to anticipate reduced hiring, strategic resizing decisions and wage growth compression. We also see the economy losing around 600k jobs in the coming quarters, with the unemployment rate rising toward 4.5% by year-end.
- **Consumer behavior**: While household finances aren't unhealthy, vulnerabilities are increasingly apparent in the form of rising new delinquencies, increasing debt-servicing ratios and tighter credit conditions. And the full effect of recent banking-sector turmoil and the associated tightening in credit conditions has yet to be felt. Further softening in the job market in coming months — the last remaining leg propping up the consumer — will likely trigger a pullback in personal consumption. Consumers may have been able to manage the burden of elevated prices thanks to their savings and increased use of credit, but that simply cannot replace organic income growth in the medium term. We anticipate consumer spending will advance a modest 1.5% in 2023 after a 2.8% increase in 2022.
- **Inflation**: The latest inflation data — consumer prices, wholesale prices, import prices and wages — leaves little doubt that the disinflationary process is well underway. Headline Consumer Price Index (CPI) inflation cooled 1.0 percentage point (ppt) to 5.0% year over year (y/y) — its lowest since May 2021. Core CPI inflation rose 0.1ppt to 5.6% y/y, but it remains 1.0ppt below its September 2022 peak. Slower growth in final demand for goods and services, easing housing price inflation, and moderate wage growth should combine in the coming month and lead to faster disinflation than expected by the consensus and Fed policymakers. We see inflation falling with accelerating momentum this year, but core inflation will likely end the year around 3%, well above the Fed's 2% inflation target.
- **Federal Reserve:** With the Fed adopting a dual track approach distinguishing monetary policy tools from macro-prudential tools, we anticipate a final rate hike of 25 basis points (bps) in May. While the Fed will maintain its posture of "not even thinking about thinking" about rate cuts in the coming months, we maintain our view that rate cuts are a strong possibility before the end of the year. These will likely initially come as a recalibration exercise, but once there is ample evidence of inflation having sustainably declined toward the Fed's target, rate cuts may become larger and more rapid.
- **Domestic risks**: The odds of a recession have risen due to heightened financial market volatility, tightening credit conditions and economic uncertainty. While labor market conditions still look relatively resilient, an abrupt shift in sentiment along with a rapid tightening of financial conditions could push the economy into a recession, with businesses and consumers retrenching. The need to raise the debt ceiling represents another risk to the outlook, as a failure to raise or suspend the statutory debt limit would trigger severe financial market turbulence and potentially lead to a self-inflicted recession. Geopolitical tension between the US and China is also an important risk.

Source: EY-Parthenon

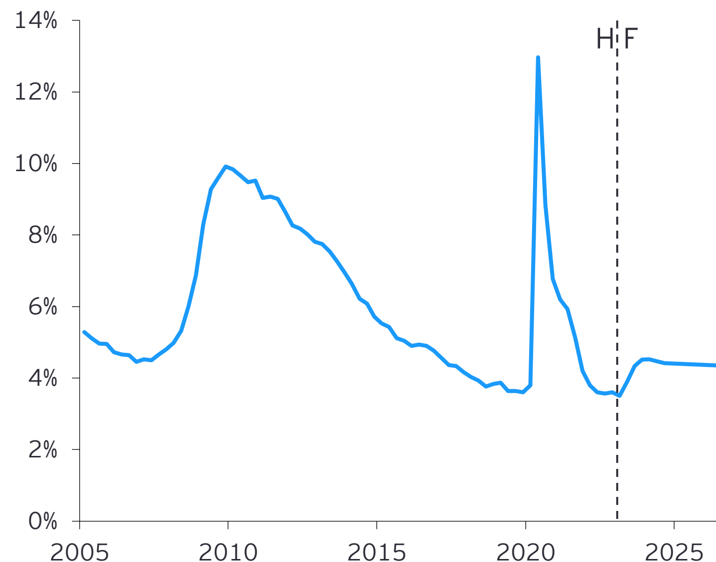
The US economy will likely lapse into a mild recession, with a modest GDP contraction in coming quarters, deteriorating labor market conditions and easing inflation

US real GDP 2005-26F



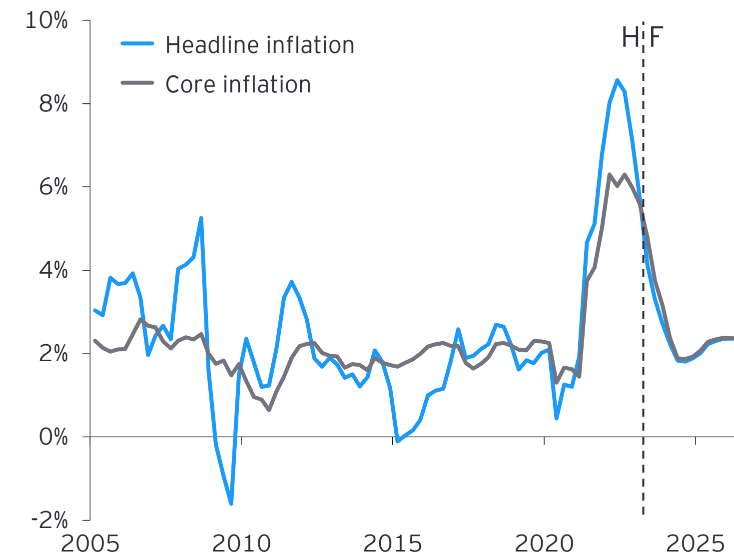
GDP growth
2022: 2.1%
2023F: 0.9%
2024F: 1.3%

US unemployment rate 2005-26F



Unemployment rate
Q4 2022: 3.6%
Q4 2023F: 4.5%
Q4 2024F: 4.4%

US y/y percent change in CPI 2005-26F



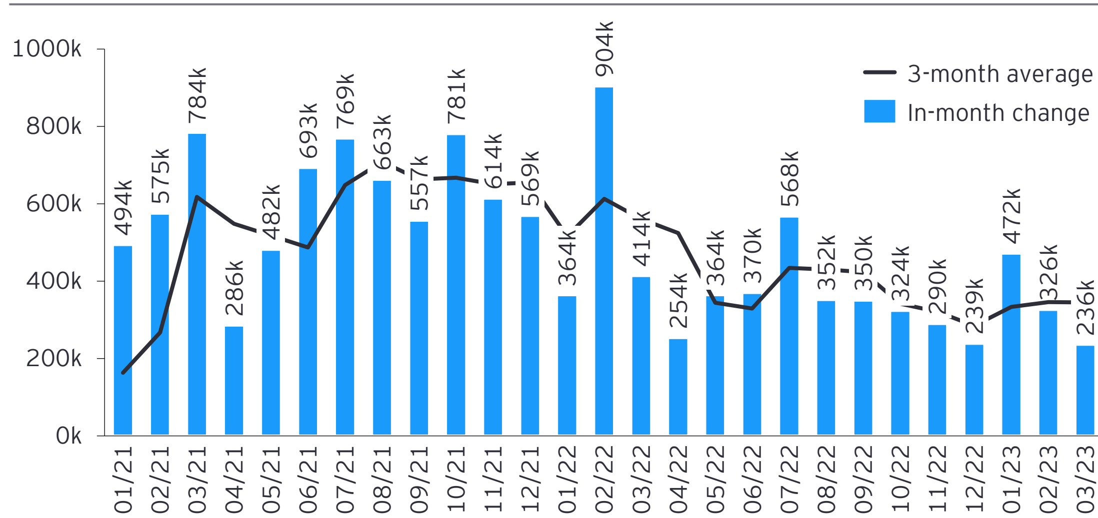
Core CPI inflation (y/y)
Q4 2022: 6.0%
Q4 2023F: 3.1%
Q4 2024F: 1.9%

Key risks: financial market turmoil, Fed policy tightening, global recession, debt ceiling

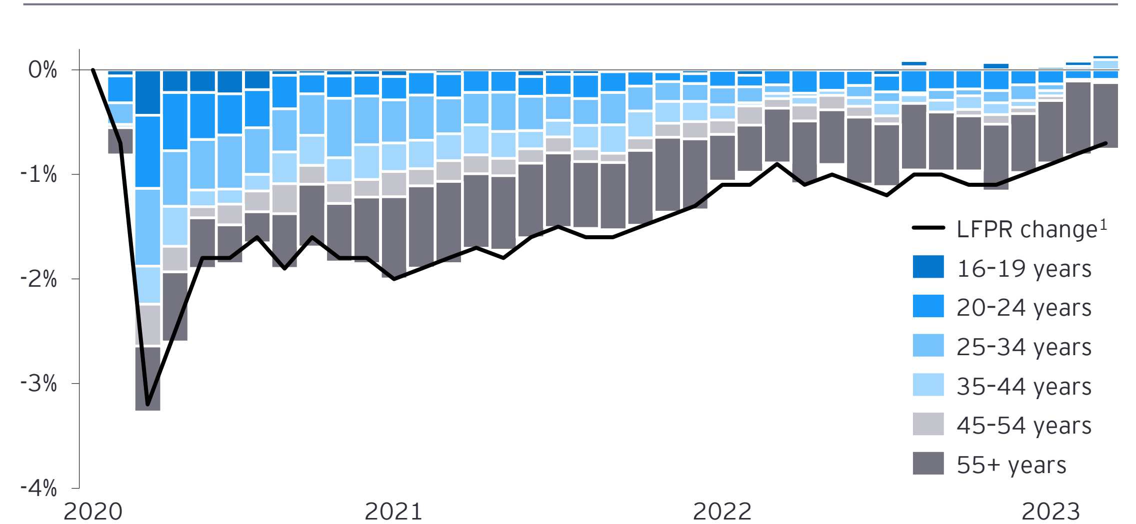
1. Pre-COVID-19 trend line reflects annual GDP growth at 1.9% through 2026.
Source: EY-Parthenon

Slower job gains and rising labor force participation point to a welcome easing of labor market tightness and abating wage growth pressures

US m/m change in total nonfarm employment
January 2021-March 2023



Contribution to US labor force participation rate change relative to February 2020
February 2020-March 2023



- The US economy added a moderate 236k jobs in March, in line with consensus estimates, following an upwardly revised 326k gain in February. Factoring the downward payroll revisions of 17k jobs in January and February, the three-month moving average of job gains was essentially flat at a still robust 345k.
- The private sector added a moderate 189k jobs, but job growth diffusion remained relatively subdued with only 60% of the private sector occupations seeing gains – the third lowest reading since the pandemic.
- The unemployment rate fell 0.1ppt to 3.5% in March, near its 50-year low of 3.4%, with the decline reflecting a strong increase in employment as measured by the household survey.

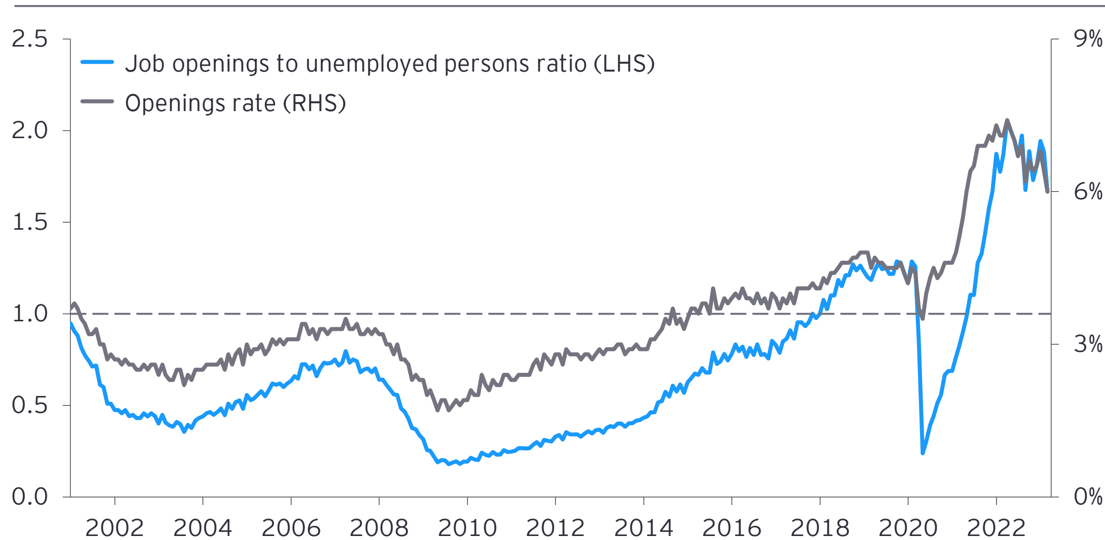
- In a very encouraging sign, the labor force participation rate rose for a fourth consecutive month to 62.6% in March, while the employment-to-population ratio rose 0.2ppts to 60.4% – both post-pandemic highs.
- A stronger supply of labor is a positive development for the inflation outlook as it can act as a relief valve against elevated wage pressures. At the same time, labor force participation remains constrained by the ongoing retirement of baby boomers as well as the continuing immigration shortfall. Encouragingly, legal immigration has begun to catch up over the past year following steep declines during the pandemic, though it remains below pre-Trump levels.

1. Labor force participation rate.
Source: Bureau of Labor Statistics; EY-Parthenon

EY Parthenon

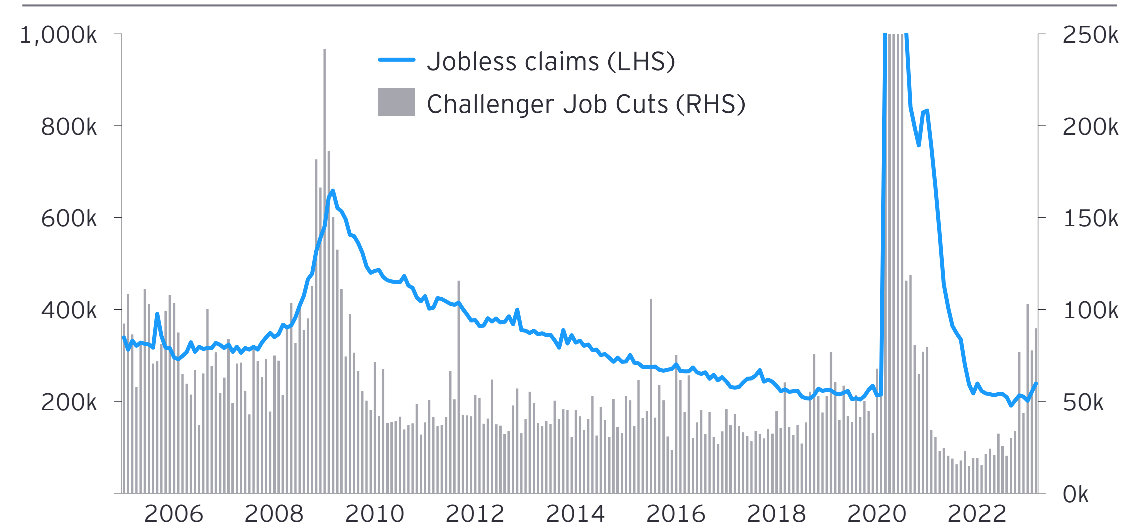
The labor market slowdown will intensify in coming months with fading labor demand, reduced hiring and a rise in layoffs

US job openings to unemployed persons ratio
December 2000–February 2023



- Key labor market indicators also indicate that the tight labor market is undeniably loosening. In February, job openings fell by over half a million and settled below the 10-million mark for the first time since April 2021. Over the past two months, job openings have declined by 1.3 million, with the moderation in labor demand visible across most industries.
- The ratio of openings per unemployed dropped 0.2 points to 1.7. While this is the lowest level since November 2021, it remains elevated pointing to a still tight labor market. Layoffs remained low as well, as companies hold onto their valued talent pool. At the same time, recent upward revisions to weekly unemployment claims – a proxy for layoffs – and a significant increase in layoff announcements point to increasingly cautious hiring.

US jobless claims and cuts
January 2005–March 2023



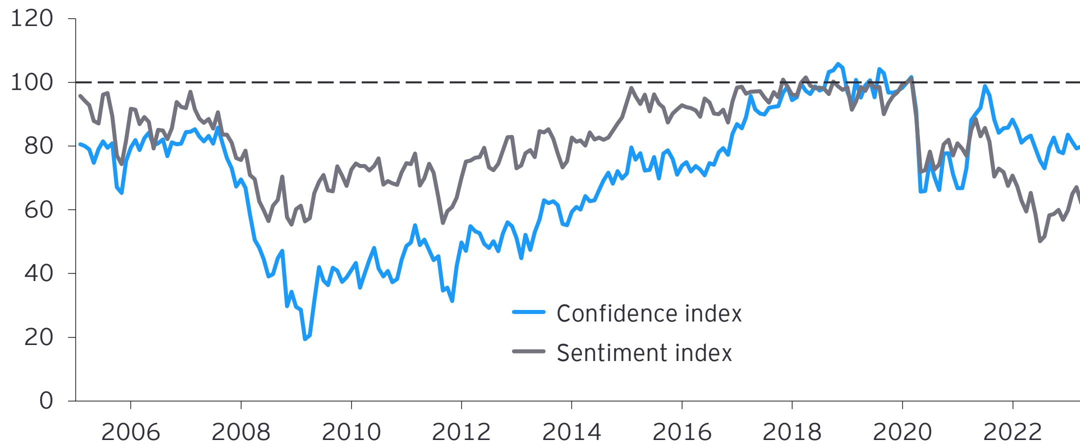
- With much effort having been poured into hiring and training over the last 18 months, executives are reluctant to let go of their prized talent pools. As such, reduced hiring and wage growth compression rather than broad-based layoffs are being considered as alternatives to keep a lid on labor costs.
- Looking ahead, we expect labor demand will continue to soften as companies grapple with slower demand, weaker profitability, continued cost pressures and tighter credit conditions. Yet, the labor market downturn will be mild by historical standards, with the unemployment rate likely to peak near 4.5% by year-end.

1. Count of announced monthly US job cuts provided by outplacement firm Challenger, Gray & Christmas.
Source: Bureau of Labor Statistics; EY-Parthenon

EY Parthenon

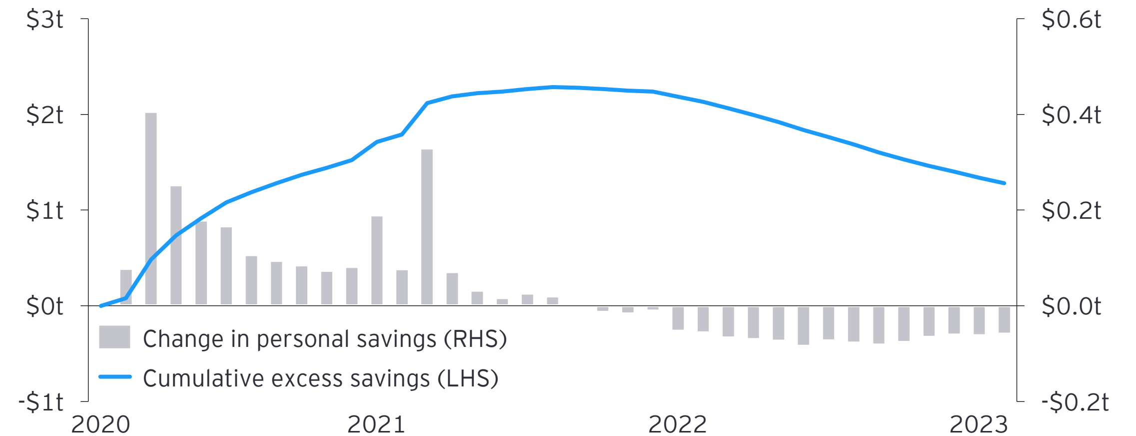
Wary consumers are tightening their purse strings amid dwindling savings buffers, tighter credit conditions and softening employment conditions

US consumer confidence and sentiment index
January 2005-April 2023[1] (January 2020 = 100)



- Consumer attitudes improved slightly in April after deteriorating in March but remain low. The University of Michigan's consumer sentiment index edged up to 63.5 in April, reflecting improvements in both current and expected conditions. Looking ahead, softening labor market trends and rising financial market and economic uncertainty will likely keep consumers' morale muted.
- Consumer inflation expectations for the year ahead registered a surprising 1ppt increase to 4.6% from 3.6% in March, the largest increase in two years. This indicator has been volatile in recent months and points to elevated uncertainty over the short-term path of inflation. However, long-run inflation expectations have held steady at 2.9% for the last 5 months.

US change in and cumulative excess personal savings[2]
February 2020-February 2023



- With income growth outpacing spending growth in recent months, the personal saving rate has been trending higher and reached 4.6% in February, about 2ppts above its June 2022 low. The recent rise in the personal savings rate may be an indication of precautionary savings amid rising economic and financial uncertainty.
- Even as the personal savings rate edges higher, it remains below its pre-pandemic trend, which points to a continued depletion of the excess savings accumulated during the pandemic. We estimate that they have declined about 40% to $1.3 trillion on aggregate and that excess savings for lower-income families have been depleted to offset inflation. As such, excess savings should no longer be viewed as an alternate source of income supporting spending.

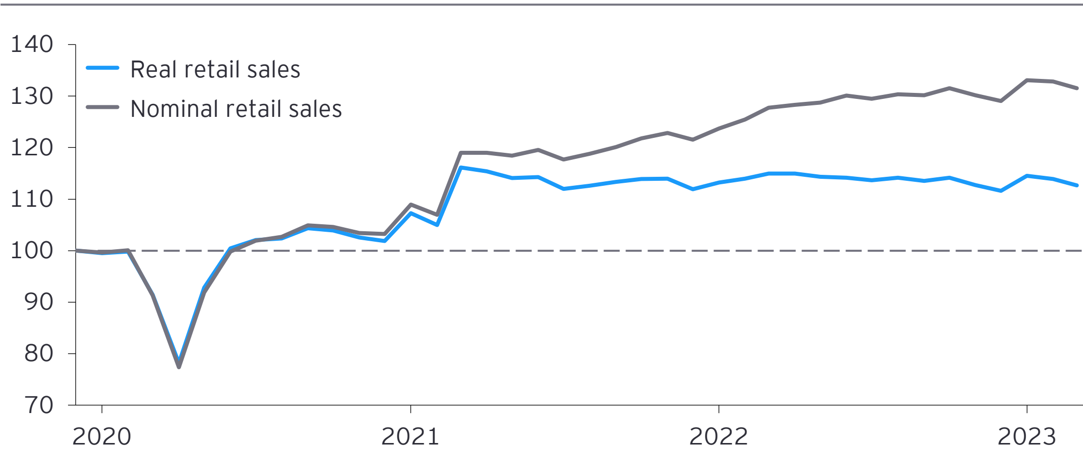
1. Data for confidence index only available through March 2023.
2. Excess personal savings is defined as the cumulative stock of savings above what consumers would have saved if income and spending would have maintained their pre-pandemic pace.

Source: US Census Bureau; Bureau of Economic Analysis; EY-Parthenon

EY Parthenon

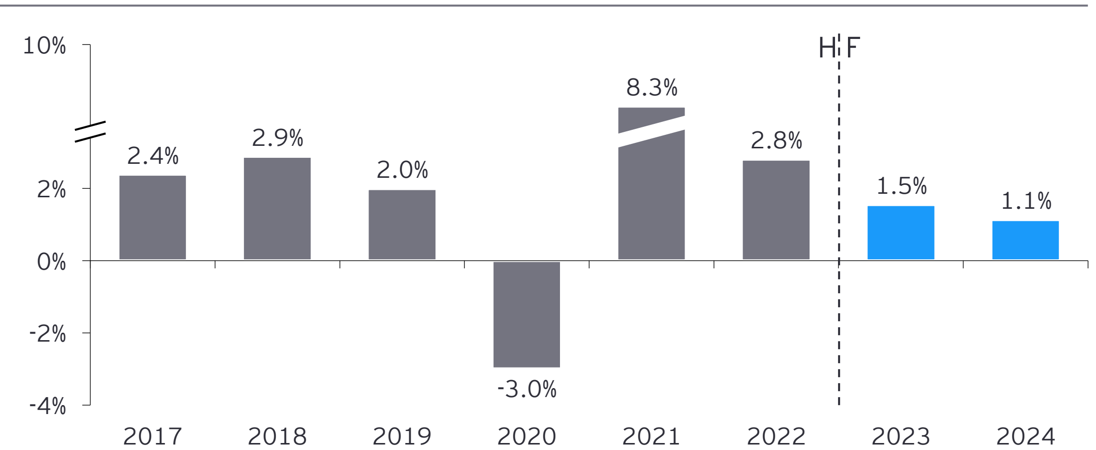
Tighter credit conditions and reduced personal income momentum point to slower consumer spending amid an environment of elevated prices

US nominal and real retail sales indexes
December 2019–March 2023 (December 2019 = 100)



- Retail sales fell more than expected in March amid rising financial and economic uncertainty and as consumers continued to grapple with elevated prices, higher interest rates and reduced access to credit. Nominal sales declined 1% over the month, with sales declining across most categories.
- Control retail sales, a key gauge of consumer spending trends that strips out volatile components, posted a 0.3% decline after rising strongly in the prior two months.
- The latest data keeps consumer spending growth on track to grow around 4% in the first quarter of the year. Such robust performance, which will be featured in the upcoming Q1 GDP report on April 27, will be regarded by some as a sign of underlying consumer strength. However, the latest report confirms the consumer engine lost significant momentum as the quarter progressed, setting the stage for weak consumption growth in the second quarter.

US y/y percentage change in real personal consumer expenditures
2017–24F



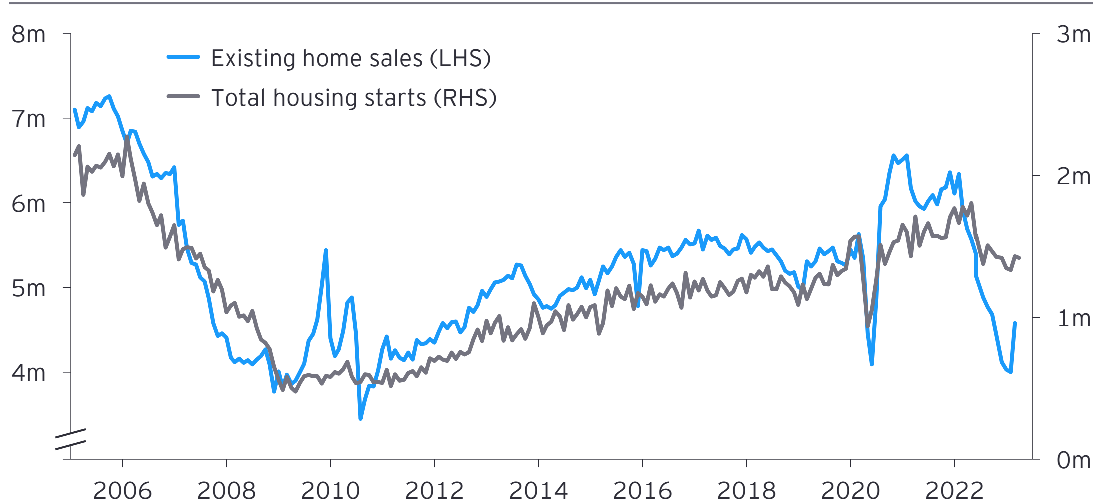
- A downshift in spending attitudes should come as no surprise. The cumulative effect of historically high inflation, rising interest rates and reduced access to credit is already taking a toll on consumers' ability and willingness to spend. And the full effect of recent banking-sector turmoil and the associated tightening in credit conditions has yet to be felt.
- Recent data on household spending and credit growth points to a K-shaped consumer spending pattern in 2023, with low- and median-income families exercising more spending restraint and families at the higher of the income spectrum still spending, albeit with more discretion.
- Looking ahead, further softening in the job market in coming months — the last remaining leg propping up the consumer — will weigh on income growth and likely trigger a pullback in personal consumption. We anticipate consumer spending will advance a modest 1.5% in 2023 after a 2.8% increase in 2022.

Source: US Census Bureau; Bureau of Economic Analysis; EY-Parthenon

EY Parthenon

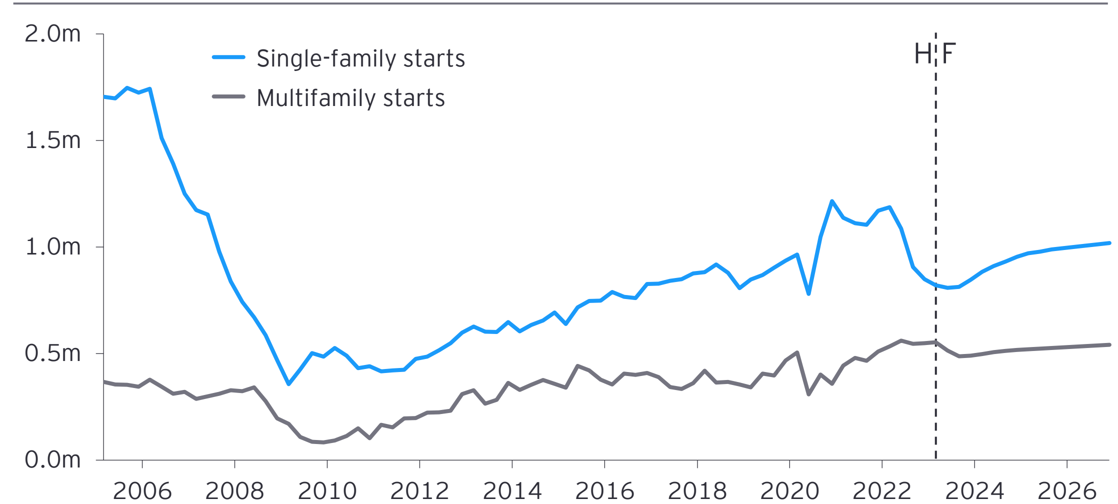
The housing market is showing some signs of stabilization at very low levels, but elevated mortgage rates, low affordability and tighter credit conditions will limit growth

US existing home sales and housing starts
January 2005-March 2023[1]



- Housing starts edged down 0.8% to 1.42m unit in March from a downwardly revised 1.43m units in February. All the weakness reflected a reversal of February's jump in the multi-family starts segment which declined 6.7% in March. On the other hand, single-family permits posted a monthly gain of 2.7%. Meanwhile, Existing home sales posted their first increase since January 2022 by jumping 14.5% in February.
- The National Association of Home Buildings (NAHB)/Wells Fargo Housing Market Index (HMI)[2] continued to recover in April, with sentiment rising 1 point to 45 on the back of rising current sales.

US new housing starts
2005-26F



- While recent declines in Treasury yields have pushed mortgage rates below their peak and spurred a rebound in housing demand in recent weeks, they are once again rising, and tighter lending standards along with deteriorating economic conditions will maintain pressure on activity in the coming months.
- Against this backdrop, the slowdown in home prices should intensify. The median home price fell on a year-over-year basis for the first time since February 2012, ending a record streak of 131 consecutive months of year-over-year increases. We forecast annual home price growth to contract over 6% y/y in the second half of 2023.

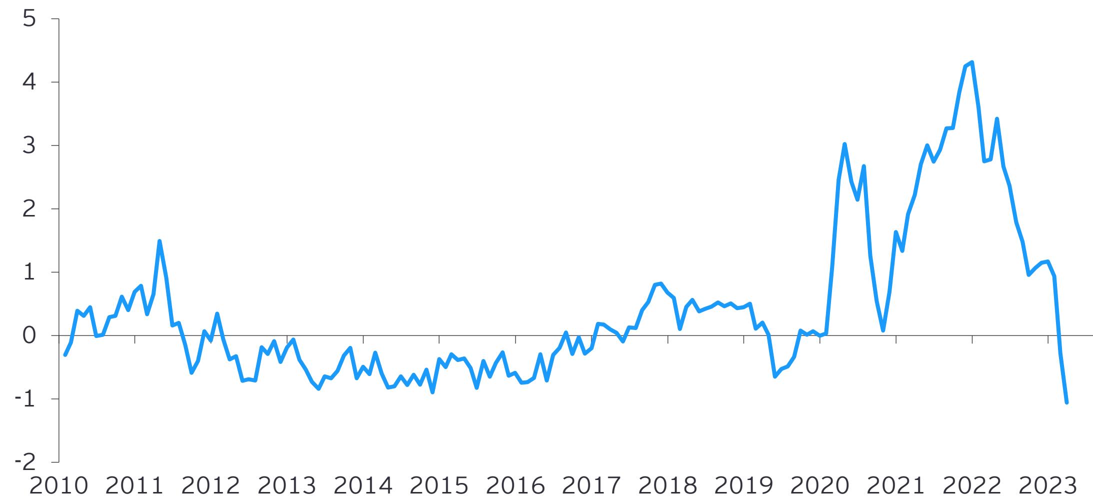
1. Data for total housing starts is only available through January 2023.
2. The NAHB Housing Market Index is a gauge of builder opinion on the relative level of current and future single-family home sales.

Source: Mortgage Bankers Association; US Census Bureau; National Association of Realtors; EY-Parthenon

EY Parthenon

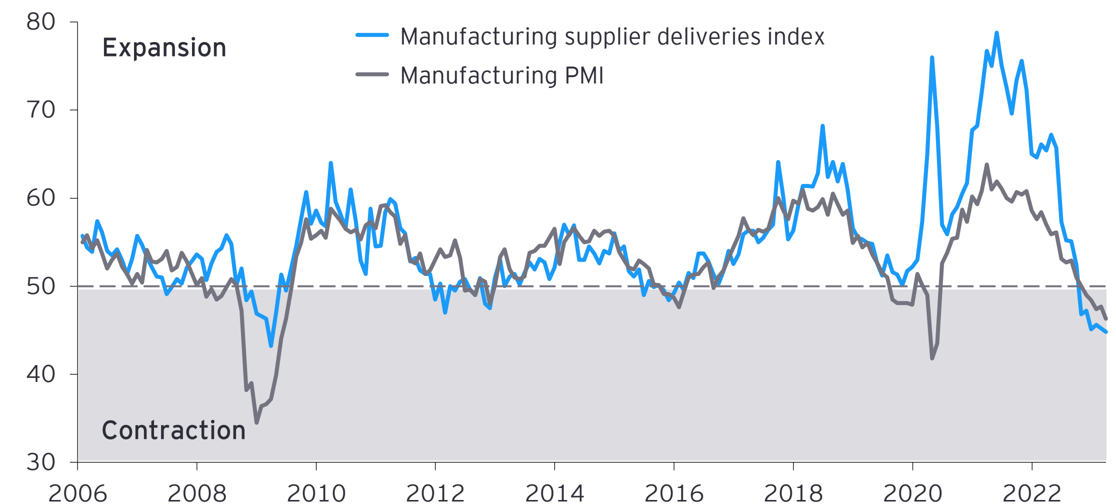
Global supply chain pressures have eased considerably despite lingering vulnerabilities as some of the easing reflects rapidly cooling manufacturing demand

Global supply chain pressure index (GSCPI)[1]
January 2010-March 2023



- The GSCPI, which tracks the evolution of global supply chain pressures, eased considerably in March and remained below the historical average. There were downward pressures from several factors, including significant improvements in European Area delivery times, European Area backlogs and Taiwanese purchases.
- While conditions appear to have normalized, the pandemic has exposed key vulnerabilities in global supply chains, which will continue to be challenged by geopolitical risks, elevated input costs, labor shortages and lingering disruptions from the pandemic.

US manufacturing PMI and supplier deliveries subindex[2]
January 2006-March 2023



- Factory activity showed continued weakness as the headline ISM manufacturing index fell further to 46.3 in March, the lowest since May 2020, and remained in contraction territory for a fifth straight month. Twelve of the 18 manufacturing industries surveyed reported a contraction in activity last month.
- Details of the report showed that all the subcomponents – orders, production, employment, deliveries and inventories – were in contraction territory for the first time since 2009. On a positive note, the prices index fell 2.1ppts to 49.2, partly reversing the rise in prices in February, and the supplier delivery index eased further.

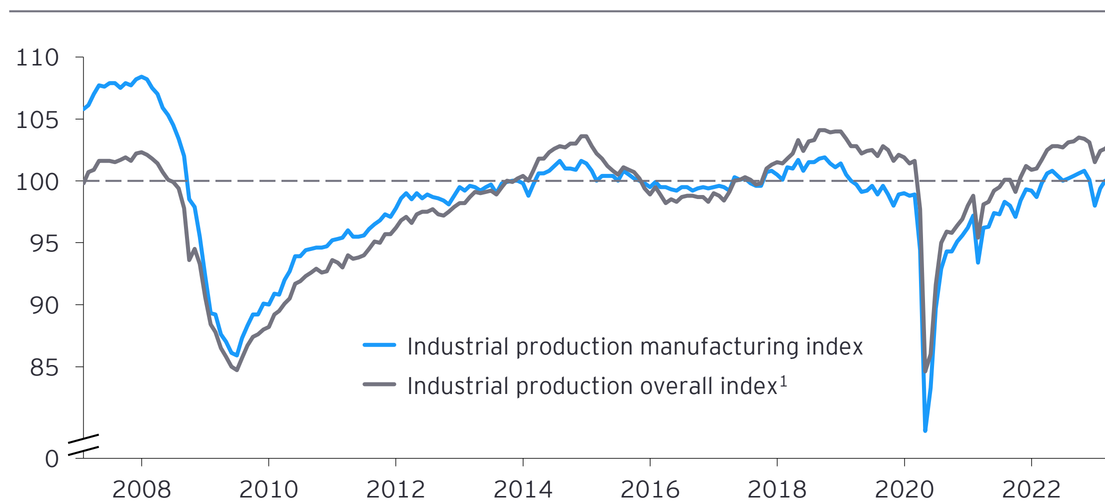
1. Index scaled by its standard deviation (0 = average value).
2. The ISM (Institute for Supply Management) measures PMI (Purchasing Managers' Index) by surveying manufacturing and service firms on their orders, production, employment, deliveries and inventories. The index indicates business activity in both sectors. This is a diffusion index, with readings above 50 indicating expansion and readings below 50 indicating contraction in activity.

Source: Federal Reserve Bank of New York; ISM; EY-Parthenon

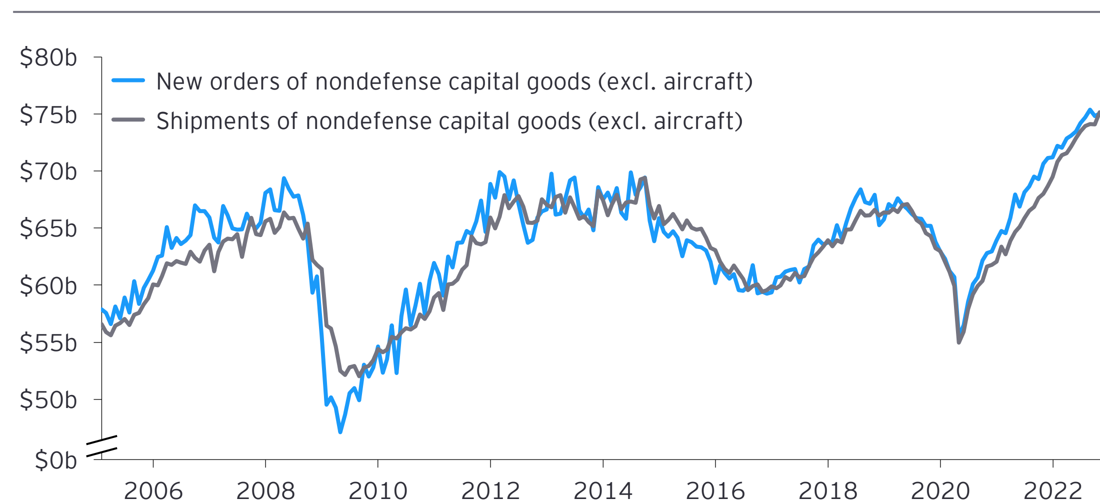
EY Parthenon

The outlook for industrial activity remains grim, as weaker demand at home and abroad and tighter credit conditions curb business spending plans

US industrial production indexes
January 2007–March 2023 (2017 = 100)



US value of new orders and shipments of nondefense capital goods (three-month moving average; nominal)
January 2005–February 2023



- Industrial production expanded at a moderate 0.4% pace in March, but the advance masked some underlying softness in manufacturing and mining output, which both fell 0.5%.
- The industrial sector had demonstrated resilience in the face of the broader economic slowdown for most of 2022, but the momentum has softened markedly. Higher interest rates and lower credit availability amid banking turmoil will weigh on industrial activity and business spending in the coming months.

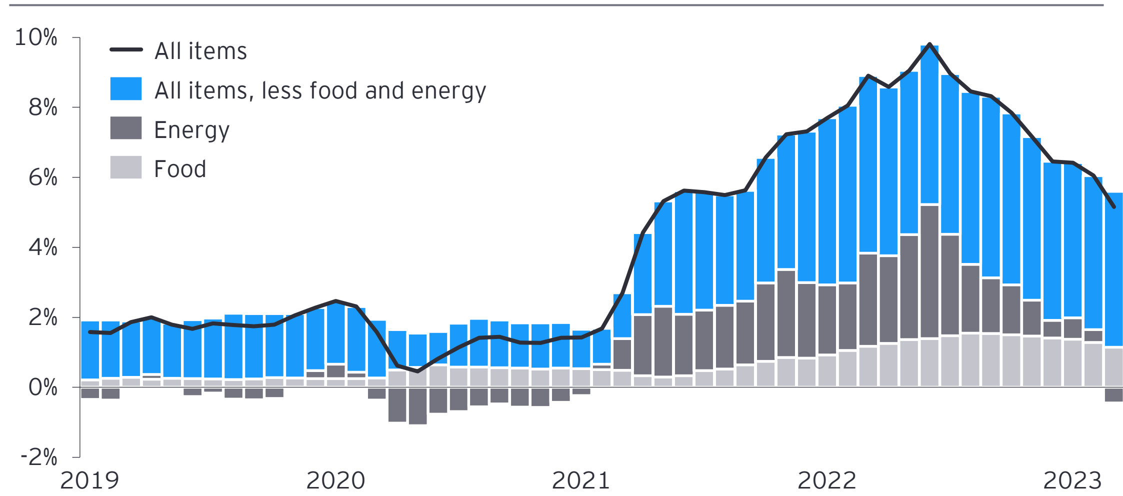
- Business sentiment appears to be shifting as demand slows with accelerating momentum and limited positive spillovers from China's reopening.
- Durable goods orders and shipments trends are deteriorating rapidly, indicating much slower equipment investment momentum in the first quarter of this year than at the end of 2022. With spending on structures under pressure from a higher cost of capital, it is increasingly likely that we'll see a business investment contraction in Q2 and potentially Q3.

1. Overall index includes manufacturing as well as mining and electric and gas utilities.
Source: US Census Bureau; EY-Parthenon

EY Parthenon

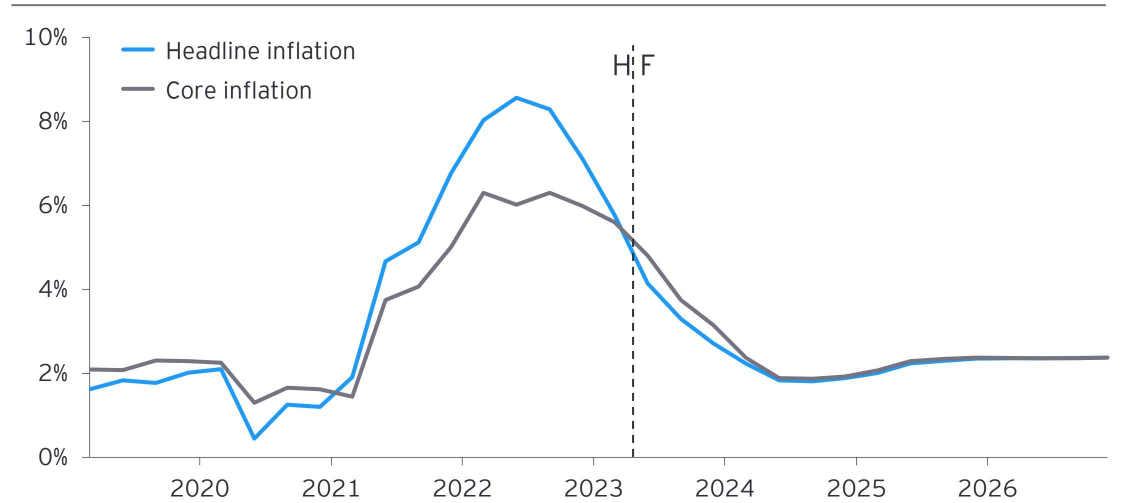
Reduced sequential momentum in inflation confirms the disinflationary process is well underway, despite latent core inflation stickiness

US y/y percent change in CPI, contribution by category
January 2019-March 2023



- The March CPI report left little doubt that the disinflationary process is well underway. Headline CPI rose 0.1% month over month (m/m) following a 0.4% gain in February. Falling energy costs and flat food prices helped keep headline inflation in check. Core CPI prices (excluding food and energy) advanced 0.4% after a 0.5% gain in February — in line with the average gain over the prior six months.
- Shelter costs posted their smallest gain since April 2022, with rent prices and owners' equivalent rent up 0.5%, their smallest advance since March 2022 and May 2022, respectively. This indicates that we may have passed peak sequential momentum in CPI shelter cost and points to strong disinflationary forces in the coming months as housing cost pressures ease significantly.

US y/y percent change in CPI
2019-26F



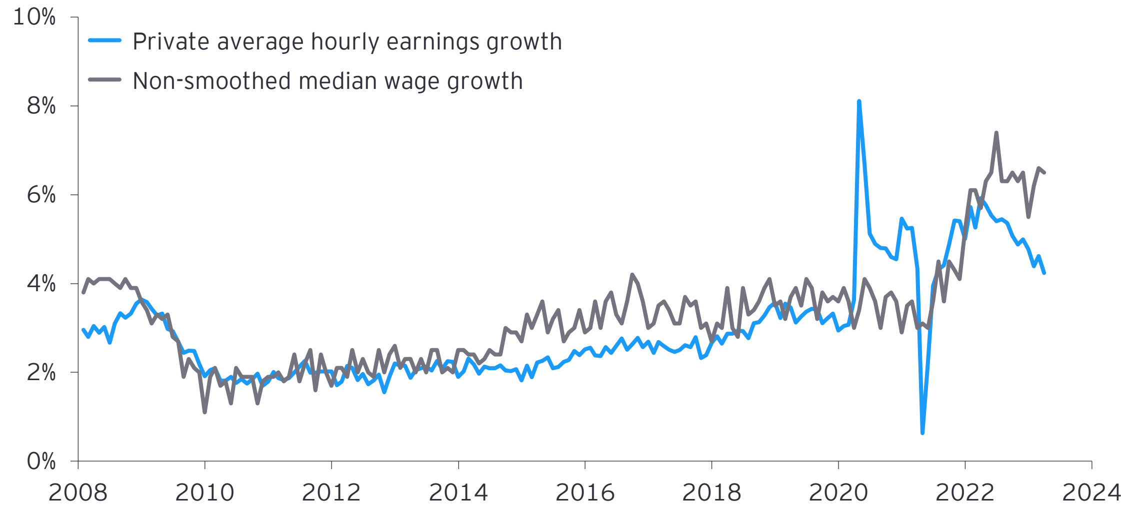
- Sequential CPI momentum has eased considerably relative to last year, helping push inflation much lower. Headline CPI inflation cooled 1.0ppt to 5.0% y/y — now 4.1ppts below its June 2022 peak and its lowest since May 2021. Core CPI inflation rose 0.1ppt to 5.6% y/y — largely due to base effects — but it remains 1.0ppt below its September 2022 peak.
- In the coming months, slower growth in final demand for goods and services, easing housing price inflation and moderate wage growth should lead to faster disinflation than expected by the consensus and Fed policymakers. But it will take time for inflation to sustainably return to the Fed's 2% inflation target, as we see headline and core inflation remaining above 3% until mid-2023.

Source: Bureau of Labor Statistics; EY-Parthenon

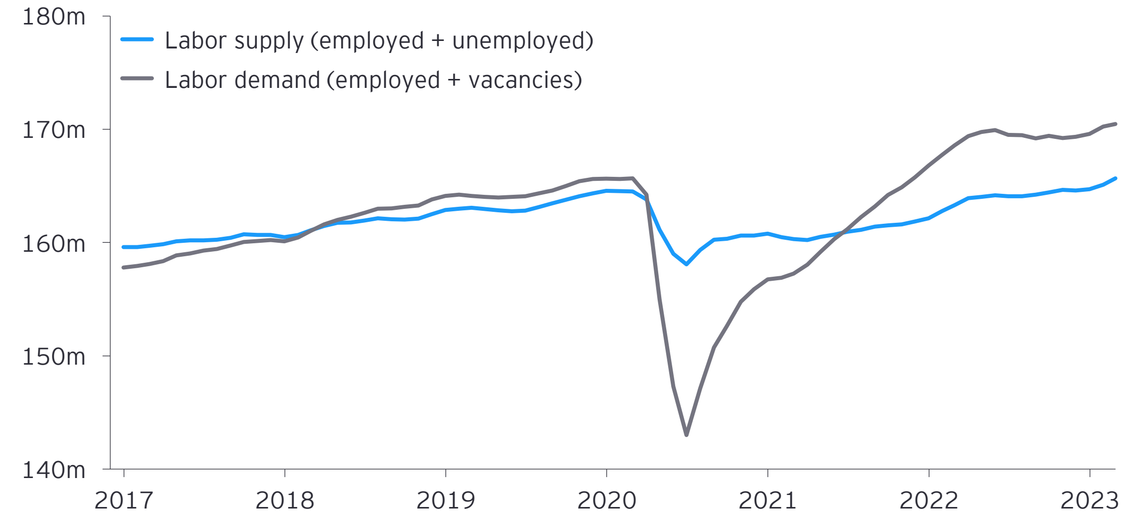
EY Parthenon

The moderation in wage inflation will continue, as labor demand softens materially and supply conditions ease

US y/y growth in median wage and private average hourly earnings
January 2008-March 2023



US labor demand and supply
December 2016-February 2023



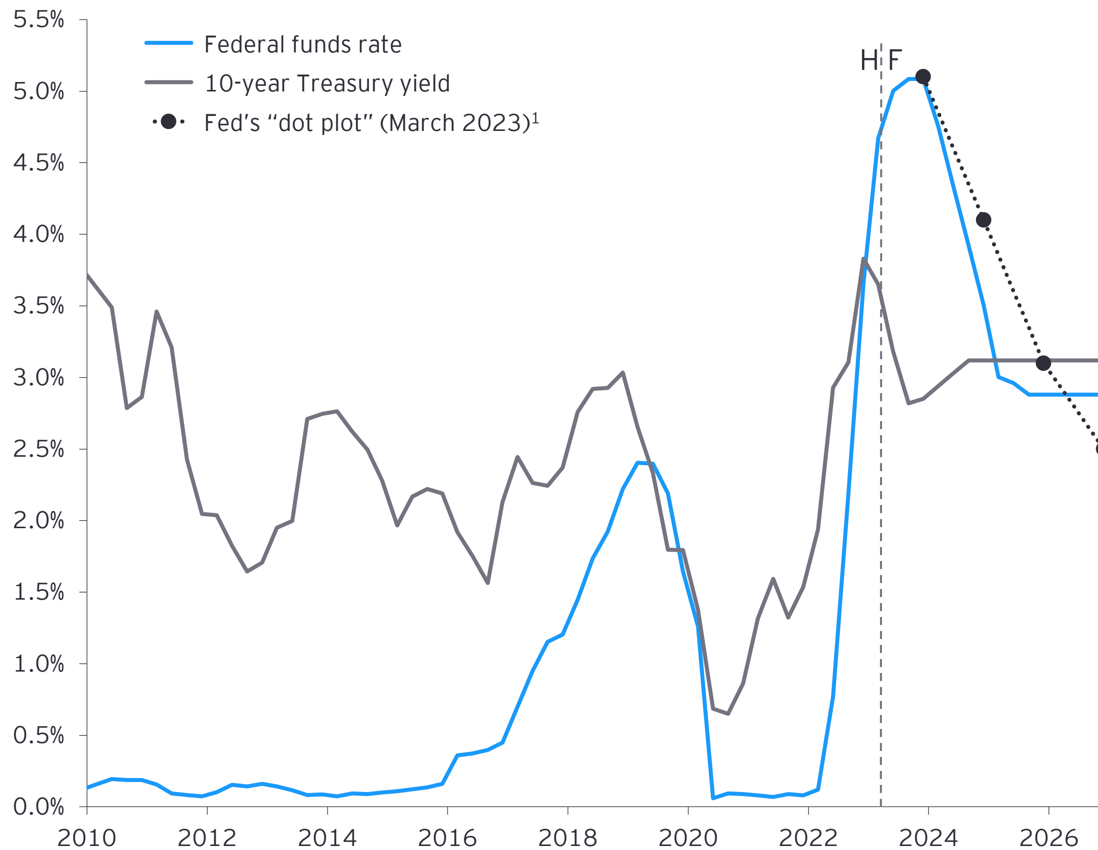
- Wage inflation remains elevated, but moderating sequential momentum indicates the pressure has begun to ease. Average hourly earnings from the Bureau of Labor Statistics' monthly jobs report increased modestly to 0.3% m/m in March following a 0.2% increase in February. The overall trend of wage growth softened to 4.2% y/y from 4.6% in February, though it partly reflecting base effects.
- In contrast, the Atlanta Fed's median wage growth tracker, which adjusts for compositional shifts in employment, is showing some signs of persistence as it ticked back up toward 6.5% after moderating at the end of 2022.

- Our conversations with business executives point to wage growth compression in the coming months, as companies are opting to reduce their hiring efforts and wage bills to keep a lid on labor costs.
- Looking ahead, we anticipate that wage gains will moderate further as labor market conditions deteriorate markedly and the demand for workers comes closer into balance with a limited pool of available workers.

Source: Bureau of Labor Statistics; EY-Parthenon

The Fed is on track to lift the policy rate above 5%, but recent financial market turbulence highlights the risk of overtightening and the lack of policy anchor

US interest rate forecasts, federal funds rate and 10-year Treasury yield 2010–26F

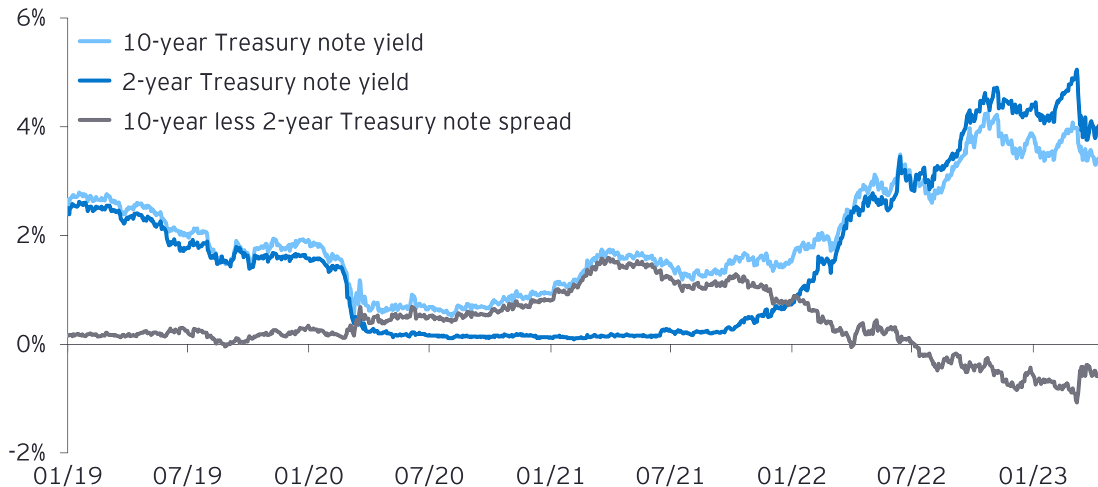


- The Fed proceeded with a "dovish" 25bps rate hike and adopted a dual track approach at its March policy meeting, distinguishing monetary policy tools to address price stability concerns from macro-prudential tools to address financial stability issues. The statement suggested the banking sector is sound and resilient, while Fed Chair Powell stressed the idiosyncratic nature of the stress and noted vulnerabilities weren't broad based.
- The Federal Open Market Committee (FOMC) minutes revealed Fed policymakers' mixed emotions amid a concerning banking stress episode. Stronger data on inflation, employment and economic activity had convinced excessively data-dependent Fed officials of the need to tighten monetary faster and raise rates higher than previously expected. However, banking sector developments and broad-based economic and financial market uncertainty led to a more prudent and dovish reassessment of the near-term policy trajectory.
- Despite our expectations for inflation to cool faster than consensus expectations, we anticipate one additional 25bps rate hike in May, at which point we anticipate the Fed will pause its tightening cycle at 5.00%–5.25%.
- While the Fed will maintain its posture of "not even thinking about thinking" about rate cuts in the coming months, we don't discount the possibility of a pivot around the late-summer Jackson Hole meeting. By that time, we anticipate the economy will be in a recession (in line with Fed staff projections) with slower private sector activity, job losses and potential adverse financial market ramifications.
- We maintain our view that rate cuts are a possibility before the end of the year. These will likely initially come as a recalibration exercise, but once there is ampler evidence of inflation having sustainably declined toward the Fed's target, rate cuts may become larger and more rapid.

1. "Dot plot" charts the median interest rate projection from the FOMC. The projections for the federal funds rate are the values at the end of the specified calendar year.
Source: Federal Reserve Board; EY-Parthenon

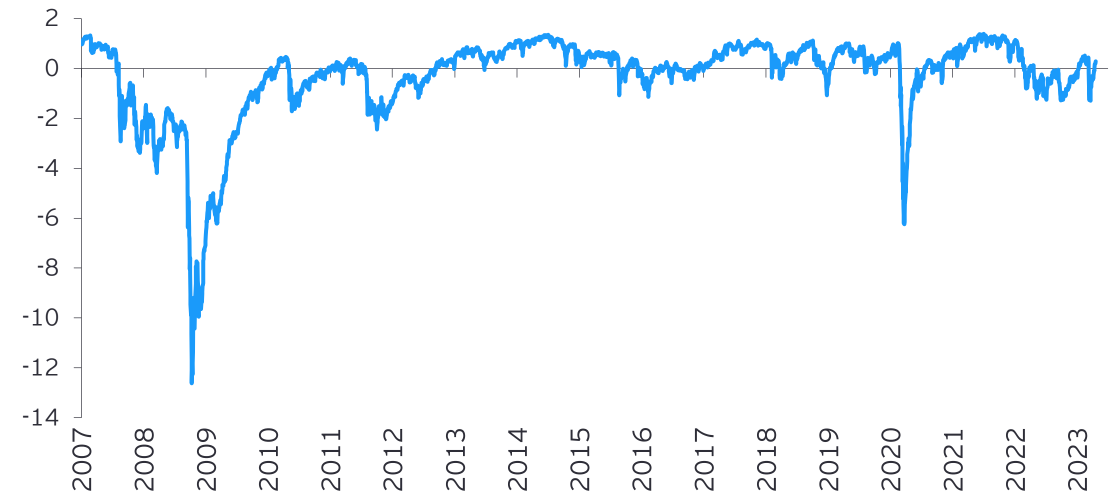
Financial conditions have normalized as the banking turmoil has eased, but traditional measures do not capture the coming tightening in lending conditions

US 10-year, 2-year, and 10-year less 2-year Treasury note spreads
January 1, 2019-April 18, 2023



- Treasury yields fell sharply amid the banking turmoil but have since rebounded modestly as investors readjusted their expectations for Federal Reserve rate hikes. The 2-year yield is still down over 90bps since the failure of some US regional banks and is currently trading around 4.2%. The 10-year Treasury bond yield is about 40bps lower from its peak in early March and is currently hovering around 3.6%.
- The yield curve, measured as the spread between the 2-year and 10-year Treasury yields, has steepened as a result although it remains deeply in negative territory. Historically, an inverted yield curve has been viewed as an indicator of a pending economic recession, while a resteepening of the curve typically signals that the economic downturn is imminent.

Bloomberg US financial conditions index[1]
January 2, 2007-April 19, 2023



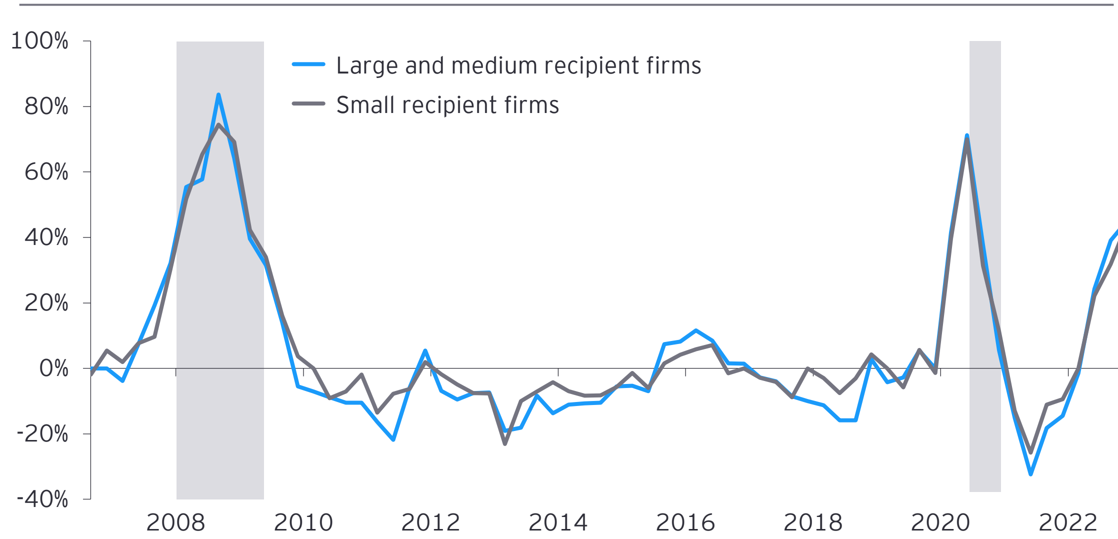
- Financial conditions tightened markedly as tensions in the US banking sector intensified in March but have loosened again. After declining to its tightest level since last fall, the Bloomberg financial conditions index has recovered nearly all the ground lost during the banking turmoil.
- A rapid and disorderly tightening of financial conditions represents a key risk to the outlook as it can lead to an abrupt private-sector retrenchment. Moreover, it is important to note that as the economy slows, it becomes more vulnerable to tighter financial conditions.

1. Weighted average of riskless interest rates, the exchange rate, equity valuations and credit spreads.
Source: Federal Reserve Board; Bloomberg; EY-Parthenon

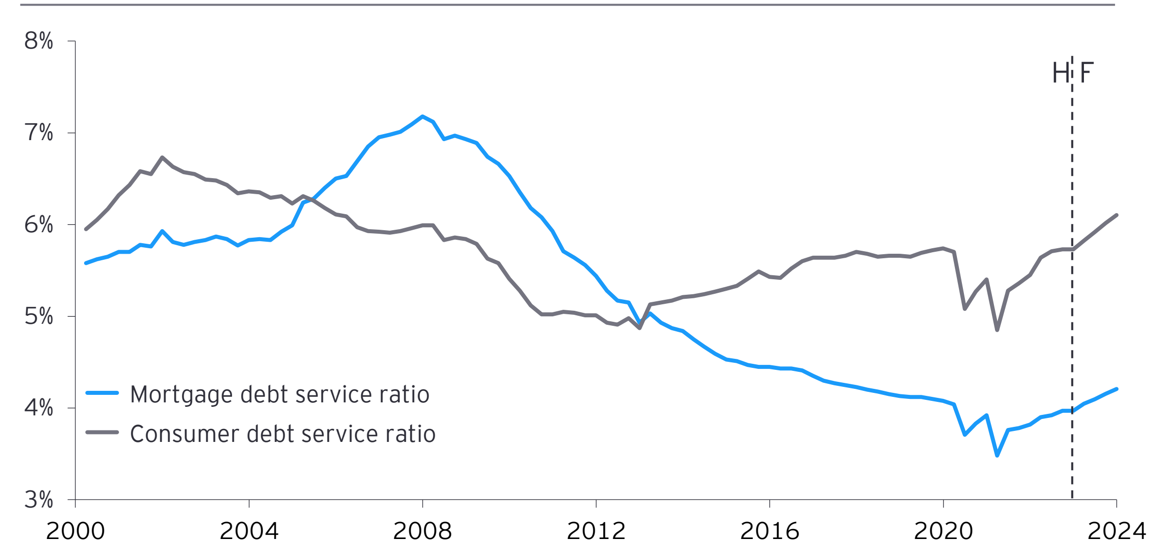
EY Parthenon

The banking turmoil has subsided, but uncertainty remains elevated and tighter credit access and terms for businesses and consumers will weigh on the economy for a while

US net percentage of banks tightening standards for C&I loans
Q4 2006–Q4 2022



Household debt servicing ratio
2000–23



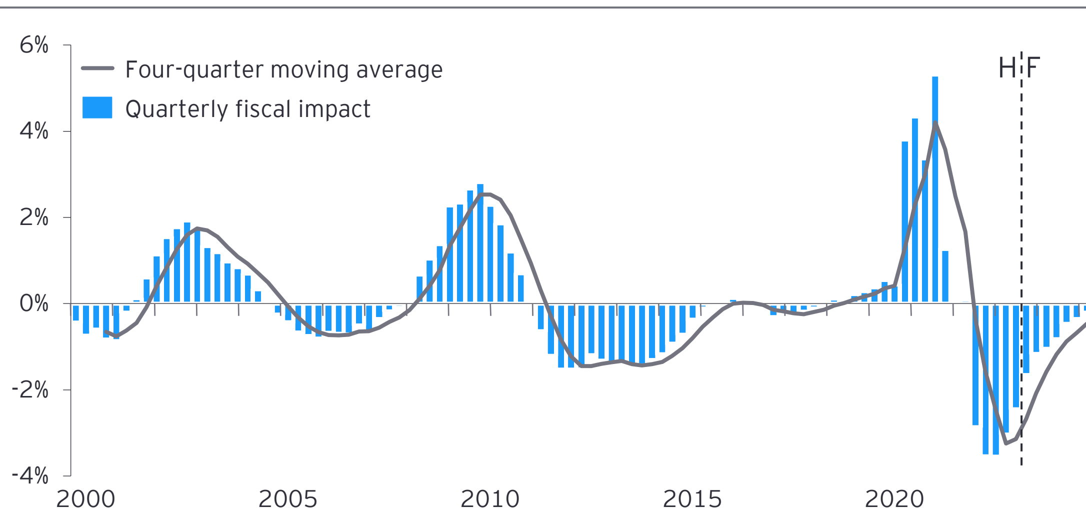
- Following some severe turbulence in the banking sector in early March, volatility has receded, and bond and equity markets have calmed. But even if the banking sector distress is over, the economy won't escape unscathed, and small and midsize businesses will likely suffer the brunt of the impact via tighter credit conditions.
- Lending standards had already tightened markedly before the March banking sector stress episode. The Senior Loan Officer Opinion Survey (SLOOS) from the Fed revealed that nearly half of banks had tightened standards on commercial and industrial (C&I) loans to firms of all sizes at the end of 2022.

- Households are also facing heavier debt burdens and will be impacted via more limited access to credit. The consumer debt service ratio – measured as the percent of disposable personal income dedicated to consumer debt payments – has risen from a historic low of 4.85% in Q1 2021 to 5.73% in Q4 2022. While this is still low by historic standards, we expect it to increase notably in coming quarters.
- We estimate that tighter credit and financial conditions will represent a drag on the US economy worth around 0.5% of GDP over the next year.
- Moreover, this will increase the odds of a US recession. While economic conditions still look relatively resilient, tighter credit growth along with financial market strains could push the economy into a recession.

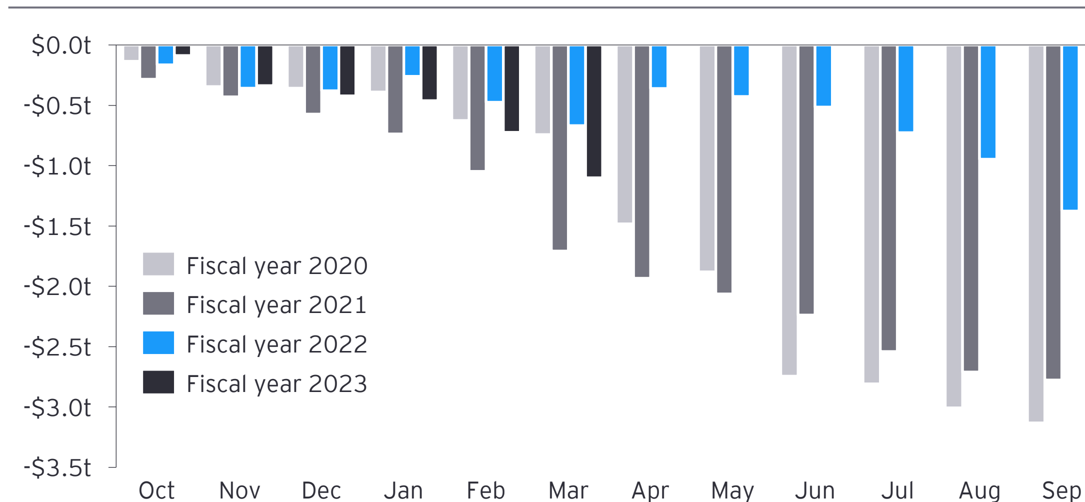
Source: Federal Reserve Senior Loan Officer Opinion Survey (SLOOS); National Federation of Independent Business (NFIB) Small Business Survey; EY-Parthenon

The worst of the fiscal drag is behind the US economy, though the impulse remains negative; the budget deficit is set to fall toward $1.1t in FY 2023

US contribution of fiscal policy to real GDP growth, annual rate
2000–24F



US federal budget deficit, annual total
FY 2020–23



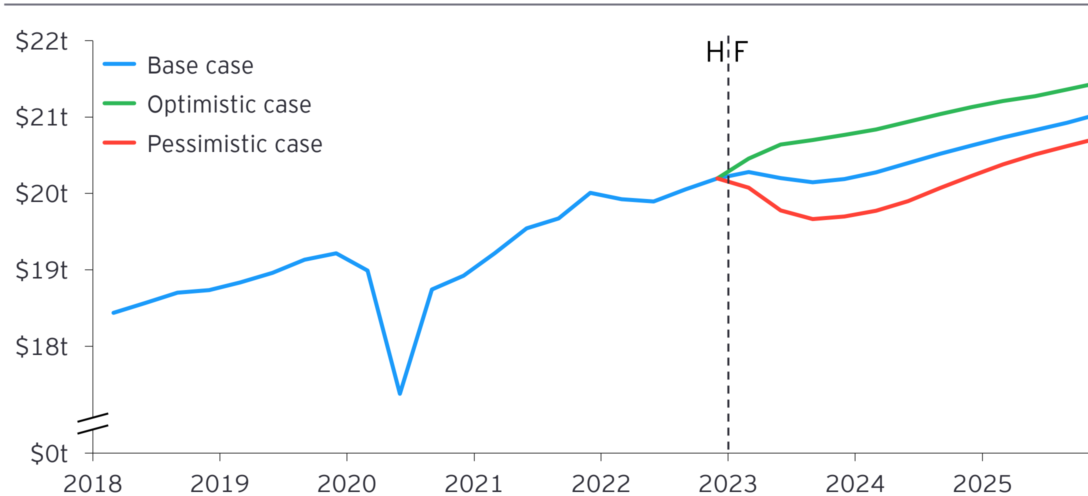
- As most federal pandemic support measures expired, the fiscal impulse, which tracks the impact of the change of the federal budget on the economy, turned sharply negative in 2022, reaching a near 4ppts drag on real GDP growth.
- While the fiscal impulse is expected to remain a burden on the economy in 2023, the impact on the economy will gradually ease this year. Still, the effect on growth is expected to remain negative over the next couple of years.

- The federal budget deficit was $1.4t in fiscal year 2022, about half of the deficit in fiscal year 2021. Treasury reported a budget deficit of $378b in March, and for the 2023 fiscal year to date, the federal government registered a budget deficit of $1.1t, compared to $668b for the same period last year.
- We anticipate the federal budget deficit will narrow to around $1.1t in fiscal year 2023 (which runs from October 2022 through September 2023). This would be the lowest budget deficit since fiscal year 2019, though we see risk of a larger deficit given the expected deterioration in the economic backdrop.

Source: Brookings; US Treasury; EY-Parthenon

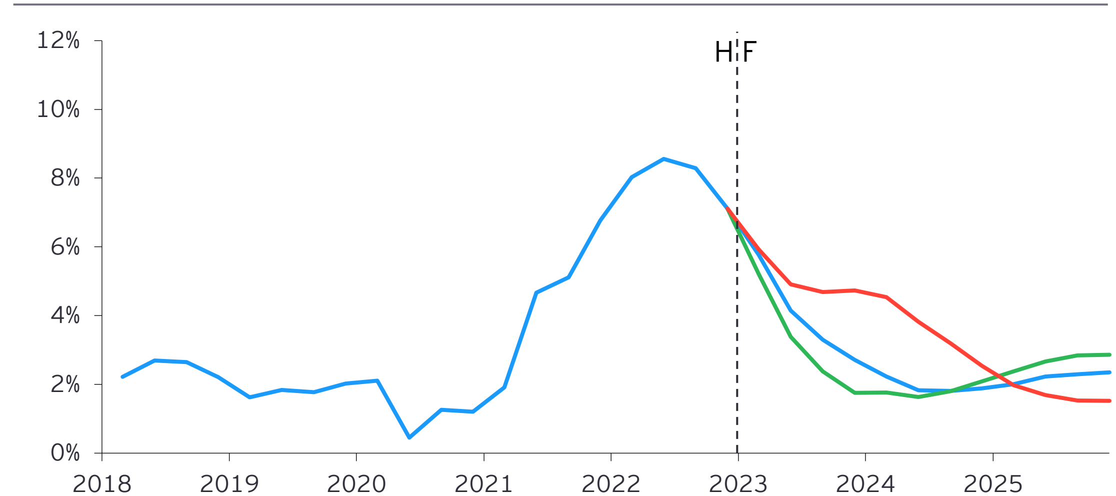
EY Parthenon

Amid elevated financial market uncertainty, key downside risks stem from a disorderly tightening of financial conditions with still-elevated inflationary pressures



Characteristics of a potential optimistic case:

- Significant easing of supply-side constraints, with global supply chain strains diminishing and the labor market rebalancing, and greater business efficiency gains leading to a significant easing of inflationary pressures.
- The consumer shows resilience, thanks to continued labor market gains, and continues to support domestic economic activity.
- Amid a sharp deceleration in inflation, the Fed pivots to a less hawkish stance and raises interest rates to a lower terminal rate than anticipated, managing a so-called "soft landing" of the economy.



Characteristics of a potential pessimistic case:

- Renewed global supply shocks stemming from geopolitical tensions lead to a renewed spike in energy, commodities and food price inflation, while persistent tightness in the labor market keeps wage growth and services inflation elevated.
- Rising inflation expectations lead the Fed and other central banks to tighten monetary policy more aggressively, leading to a severe and disorderly tightening of global financial conditions, with surging bond yields and plummeting stock prices.
- The cost-of-living crisis deepens, undermining private-sector confidence and keeping consumers and businesses wary of spending. Labor market conditions deteriorate rapidly, with the unemployment rate rising sharply.

Source: EY-Parthenon

EY Parthenon

In the current environment, firms must look to transform uncertainty into opportunity, which requires a holistic strategy framework factoring multiple alternative scenarios

Three key themes for 2023–24

1. A multispeed global economy
2. Peak inflation and employment robustness
3. Central banks' tightness with consequences

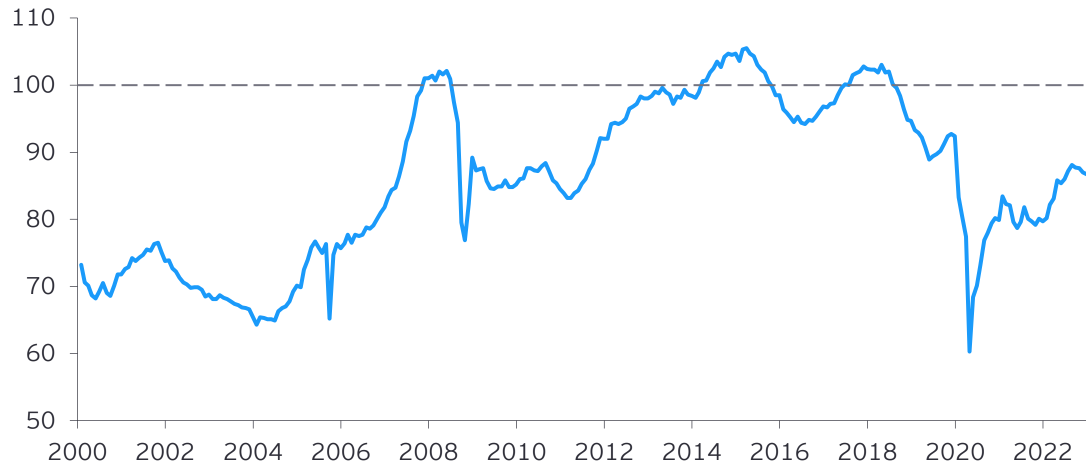
Five "no-regret" actions for business leaders

1. Execute upon a holistic pricing strategy
2. Maintain talent resilience and productivity
3. Understand supply-side drivers
4. Adapt to the new cost of capital
5. Align strategies with stakeholder priorities

Source: EY-Parthenon

Aerospace manufacturing has partially recovered from the pandemic, but lingering supply constraints and weaker final demand have constrained activity in the sector

US industrial production: aerospace and misc transportation equipment
January 2000–March 2023 (2017=100)



- US aerospace production has been softening since August of last year despite a partial recovery from the pandemic. Aircraft output has been constrained by labor shortages, supply delays and elevated production costs. Plans to speed up aerospace production have also been impeded by shortages of critical commodities, which are expected to improve in the second half of 2023.
- Boeing has increased the pace of manufacturing of its most popular 737 MAX aircraft at 31 aircraft per month, down from 42 aircraft per month before the production halt in May 2020. Encouragingly, certain Chinese airlines have resumed using the 737 MAX aircraft in their service. For either 2025 or 2026, Boeing plans to increase the output of its 737 Max planes to 50 units per month.

Monthly US passengers on domestic and international flights[1]
January 2016–December 2022

- As concerns around COVID-19 dissipate, air travel passenger volumes have gradually and largely returned to pre-pandemic levels. The return has been bolstered by strong domestic leisure travel activity. International travel and business travel are segments that are still under pressure, even if the former should benefit from China's recent reopening.
- Airfare inflation has eased moderately from 40% y/y at the end of 2022, but it remains elevated at 18% y/y in March. And with airfares being about 12% higher than pre-pandemic, this will weigh on travel demand over the coming months.

1. Flights departing from US airports.
Source: Federal Reserve; company websites; Bureau of Transportation Logistics; EY-Parthenon

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