Connecting Macro to Sector: consumer products and retail

EY-Parthenon Macroeconomics Team
and firm industry leadership

EY Parthenon
Building a better working world

Executive summary: US consumers keep spending, albeit more cautiously amid cooling but still elevated prices, a softening labor market and tightening credit conditions

- **US backdrop:** Our outlook for the US economy has improved materially, as unique post-pandemic economic dynamics appear to be making a soft-landing scenario more plausible. The labor market is gently cooling, with the unemployment rate still sitting near all-time lows while inflation has rapidly declined. With real wage growth turning positive, this has led to a gradual slowdown in consumer spending despite ongoing headwinds from elevated prices and interest rates and tightening credit conditions. The latest GDP figures showed the economy continued to grow at a healthy clip in Q2, and high-frequency data confirms a recession isn't on the near-term horizon. Against this backdrop, we have further reduced our probability of a recession over the next 12 months to 40%. Still, we continue to see downside risks to growth from tighter credit conditions, the restart of student loan payments, uncertainty regarding the lagged economic impact of monetary policy and a weak global economic backdrop.
- **State of the sector:** The strong July retail sales points toward consumers' willingness to continue spending. However, amid elevated prices and interest rates, consumers are increasingly acting with financial prudence and reshuffling their spending month to month. With employment expected to moderate further, the disposable income tailwind from slower inflation will be largely offset by slower income growth. As such, we believe a downshift in consumer spending is poised to materialize in the latter part of the year, as the buffer from excess savings shrinks, student loan repayments restart, credit conditions remain tight and household finances deteriorate. We anticipate consumer spending will advance 2.3% in 2023 and register muted growth of 0.9% in 2024.
- **Inflation:** The latest Consumer Price Index (CPI) data confirmed that a disinflationary environment remains in place. Headline inflation ticked up 0.2 percentage points (ppt) to 3.2% year over year (y/y) as base effects turned less favorable and core inflation fell 0.1ppt to 4.7% y/y. We see headline inflation easing to 3.0% y/y in December, while core CPI inflation is likely to ease toward 3.8% y/y by year-end.
- **Talent:** The labor market continues to show signs of rebalancing, with cooler labor demand leading to a gradual moderation in wage growth. The economy added 187k jobs in July (fewer than anticipated), and job openings fell to their lowest level in over two years in June. While layoffs remain low, job creation has become significantly less broad-based as businesses take a more conservative approach toward hiring and pay. We continue to expect further hiring freezes and strategic resizing decisions along with some continued moderation in nominal wage growth in the coming months, but we don't anticipate a severe employment pullback. We see the unemployment rate rising from 3.5% toward 3.8% by year-end and around 4.3% by the end of 2024.
- **Globalization, supply and channel:** Supply chain bottlenecks are clearing. Imports from China continue to decline as the US and other Western economies pursue "de-risking" trade strategies, i.e., a reduction in dependency on Chinese goods in addition to implementing restrictions on China's access to advanced technology. E-commerce has maintained the large share of retail spend gained during the pandemic, now nearing 25% of total retail spend, highlighting the criticality of an omnichannel approach. Wholesalers and retailers alike grew inventories in 2021–22. This behavior has cooled, as inventory levels are now moving sideways and contracting in some segments.
- **Financial conditions and transaction activity:** The Fed raised the federal funds rate range by 25 basis points (BPS) to 5.25%–5.50% at the July Federal Open Market Committee (FOMC) meeting, more than likely marking the end of a historic tightening cycle. Given our outlook for continued disinflation and softer economic momentum, we remain of the view that the Fed will keep the federal funds rate unchanged throughout the remainder of the year. The restrictive monetary policy by the Federal Reserve and tight credit conditions act to hamstring capital access and borrowing for firms. This environment has also impacted investment and M&A activity, including private equity, which has seen material slowdown across all sectors and industries.

Source: EY-Parthenon

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

Five "no regret" actions to build resilience amid elevated uncertainty

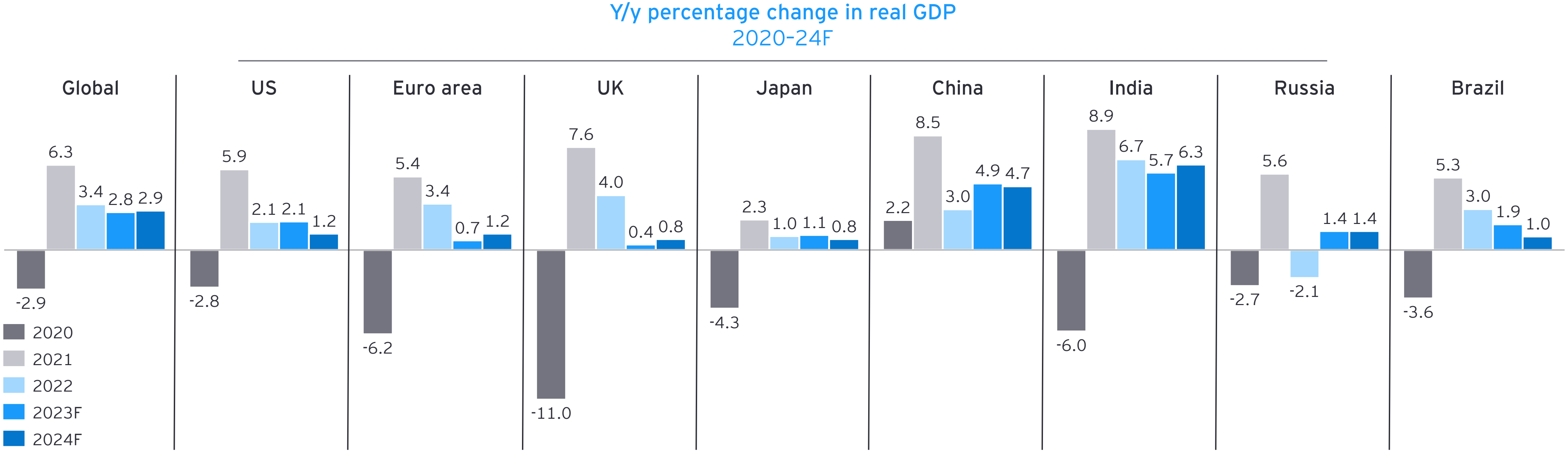
1. Maintain a holistic pricing strategy
2. Reinforce talent resilience and productivity growth
3. Understand the supply-side drivers
4. Adapt to the new cost of capital
5. Align strategies with stakeholder priorities

Source: EY-Parthenon

Agenda

- **Macroeconomic backdrop**
- Sector trends and perspectives:
  - State of the sector
  - Inflation
  - Talent
  - Globalization
  - Financial conditions and transaction activity
- Key EY contacts

Global growth has downshifted to a slower gear, and a worsening economic slowdown in China casts a cloud over an already conservative global outlook



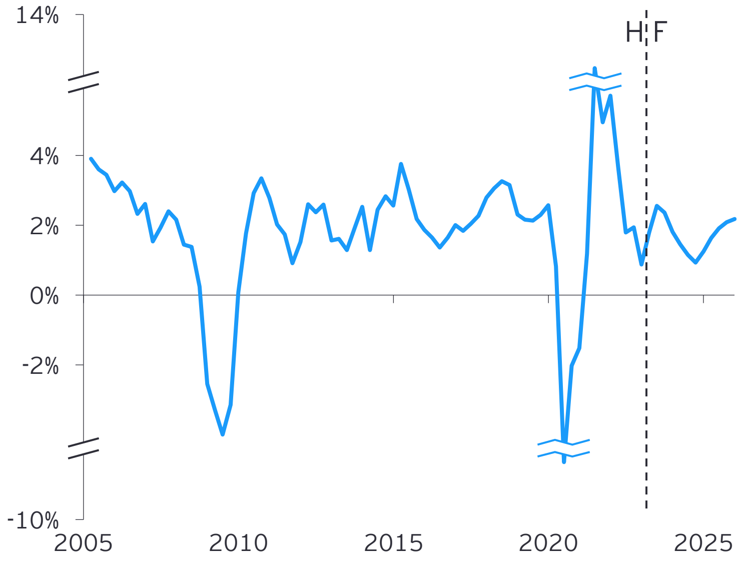
- Global growth is projected to slow to 2.8% in 2023 and see a muted recovery to 2.9% in 2024. Below-trend growth is expected across most advanced economies, with localized recessions in Europe, modest growth in the US and Japan, and moderate growth momentum across most emerging markets. Economic activity in China has weakened significantly in recent months, and stress in the property sector has resurfaced, posing downside risks to the global outlook. A worsening of China's economic slowdown and a surge in global interest rates and financial market volatility could adversely affect global economic activity.
- Inflation has declined markedly in many economies thanks to falling commodities prices, easing supply chain disruptions and slower demand for manufactured goods. Germany is now experiencing producer price deflation, while China is grappling with growing deflationary pressures stemming from weak domestic demand. Cooling inflation trends have allowed most central banks to slow the pace of interest rate hikes, and we expect most major central banks will have reached the end of their tightening cycle by year-end. But with core inflation (excluding food and energy) still excessively elevated across many regions, policymakers will display a hawkish bias toward higher-for-longer interest rates and will be unlikely to discuss rate cuts until 2024.

Source: EY-Parthenon

EY Parthenon

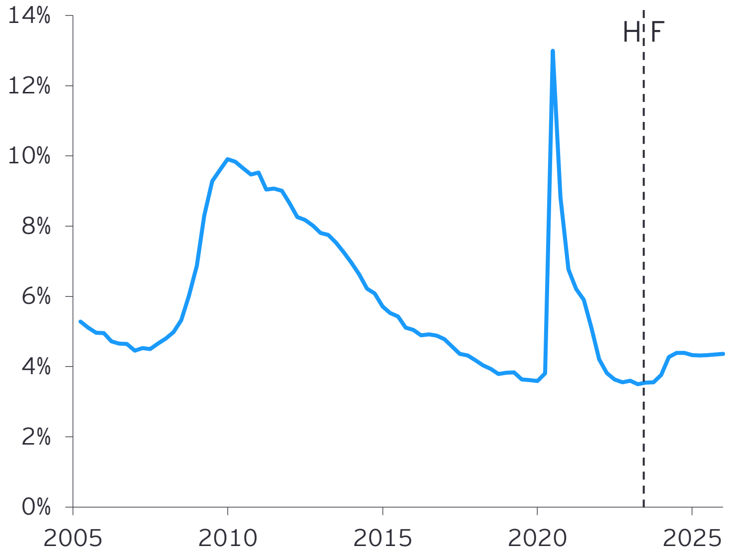
Slower business and consumer spending, softer labor market conditions, and cooler inflation trends are expected as we move into 2024, but a retrenchment isn't foreseen

US y/y real GDP
2005-25F



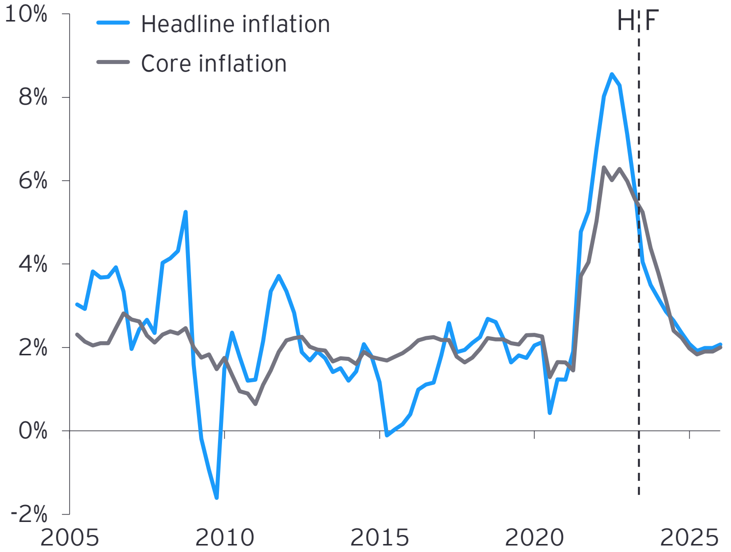
GDP growth
2022: 2.1%
2023F: 2.1%
2024F: 1.2%

US unemployment rate
2005-25F



Unemployment rate
Q4 2022: 3.6%
Q4 2023F: 3.8%
Q4 2024F: 4.3%

US y/y percentage change in CPI
2005-25F



Core CPI inflation (y/y)
Q4 2022: 6.0%
Q4 2023F: 3.8%
Q4 2024F: 2.0%

Key risks: Fed tightening, tighter credit conditions, financial market volatility, China's economic challenges

Source: EY-Parthenon

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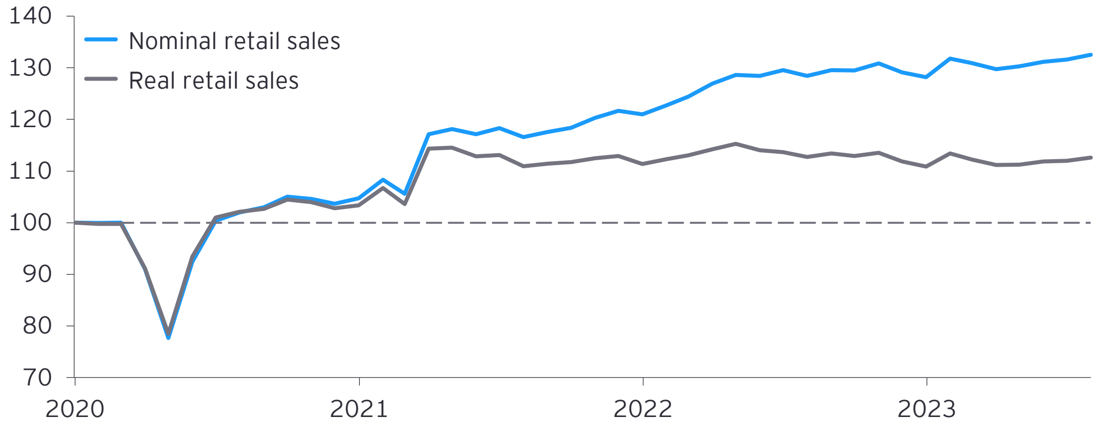
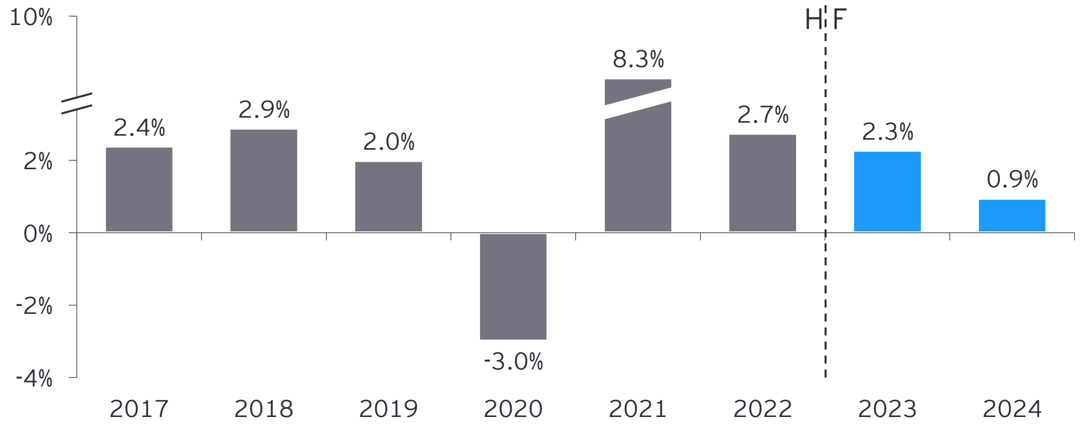
Consumers are still spending but with more discretion; households' budgets will come under pressure, with slower income growth and student loan payments set to restart on October 1

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



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



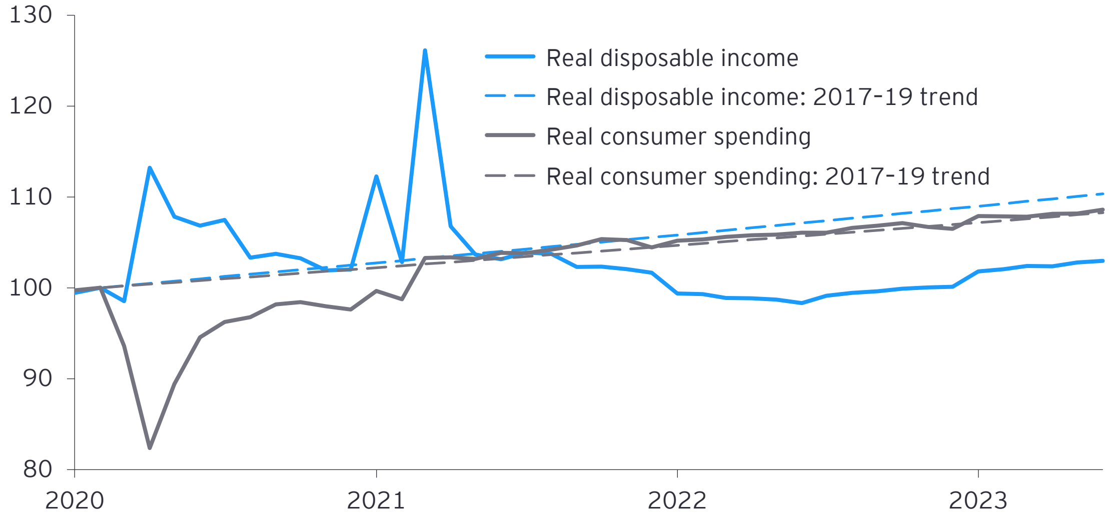
- Retail sales posted a stronger-than-expected 0.7% gain in July as consumers spent more online, at sports and clothing stores and on dinner and bar outings. Still, they exercised more discretion on furniture, electronics and cars.
- Control retail sales – a key gauge of consumer spending trends that strips out volatile retail segments – posted a strong 1.0% increase following an upwardly revised 0.6% gain in June.
- Looking at the broader trend, consumer spending has decelerated, but not collapsed. Momentum in retail sales picked up from 1.6% y/y to 3.2% in July, but this largely reflects base effects from a weak July in 2022. More broadly, the pace of sales has slowed from 7.4% y/y in January, and in inflation-adjusted terms, retail sales are 0.1% lower relative to last year.

- There is a greater sense of optimism regarding the economy and inflation, but consumers are still acting with financial prudence amid elevated prices and interest rates. Slower employment and disposable household income growth in the coming months will likely mean ongoing consumer cautiousness, but we don't foresee a retrenchment.
- Reduced excess savings, the resumption of student loan payments and tight credit conditions will further weigh on households' budgets even if falling inflation should provide a tailwind to real wages. We project that consumer spending will grow just 2.3% in 2023 and a muted 0.9% in 2024. Averages are somewhat misleading, however, as spending momentum is expected to reaccelerate through 2024.

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

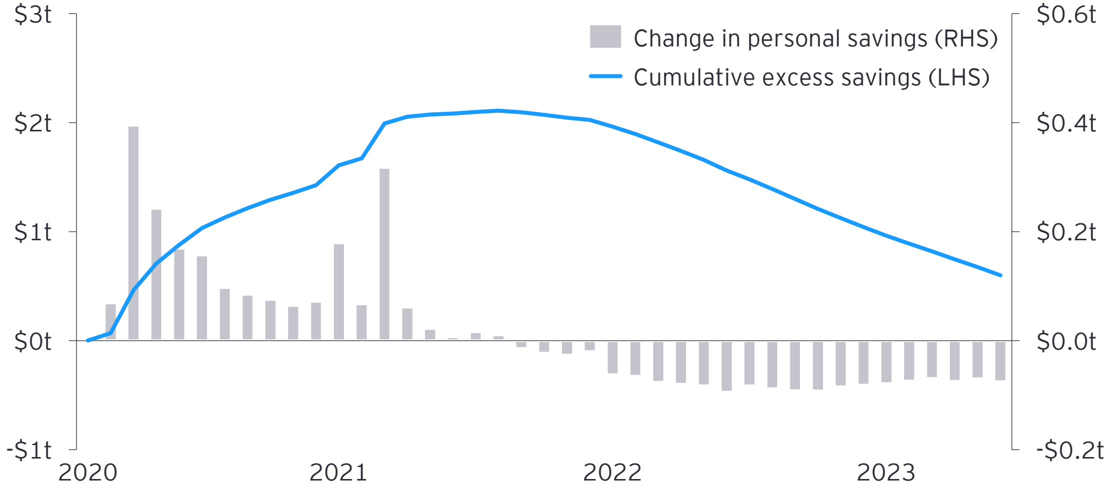
While slower inflation is lifting real wages, wage growth compression and slower employment growth will likely lead to a slowdown in consumer spending momentum

US real consumption expenditures and disposable income
January 2020–June 2023 (February 2020 = 100)



- The ongoing rebound in real disposable income — reflecting still-solid wage gains amid cooling inflation — has been a key support to consumer spending. Real disposable income rose 0.2% month over month (m/m) in June and was up in 11 of the past 12 months, supporting consumers' purchasing power as they continue to face elevated prices.
- Cooling inflation and robust labor markets have supported a rebound in consumer sentiment in recent weeks, even if absolute levels of confidence remain depressed in early August. Weak sentiment points to cautious consumer spending amid elevated prices and rapidly dwindling excess savings.

US change in and cumulative excess personal savings[1]
February 2020–June 2023



- After building up savings at an unprecedented rate during the pandemic, households have been drawing down on these funds rapidly over the past 18 months. We estimate that excess savings have declined about 70% to $600b on aggregate and that excess savings for lower-income families have largely been depleted.
- While remaining excess savings along with a resilient labor market help explain consumers' staying power in the face of higher inflation and interest rates, the impetus is rapidly fading. As such, excess savings should not be viewed as a key source of income supporting a steady pace of spending going forward.

1. 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

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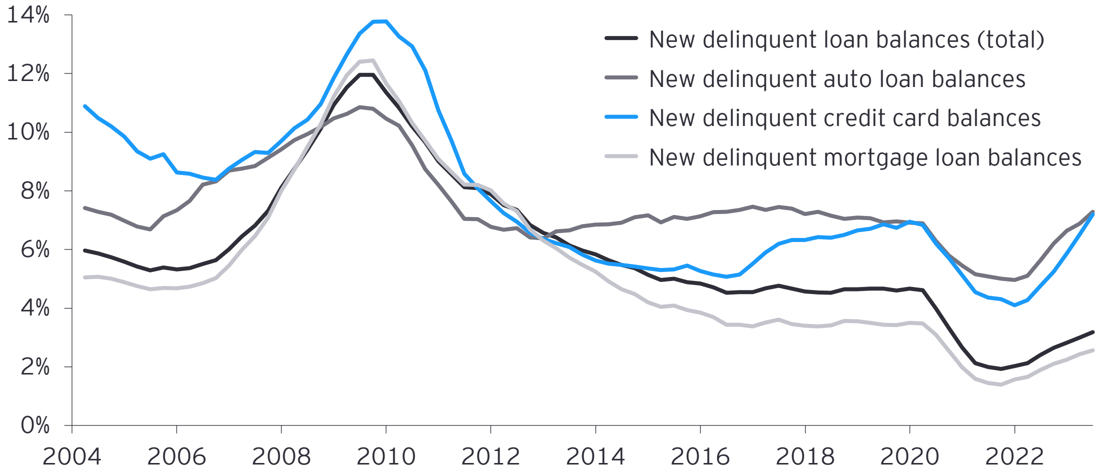
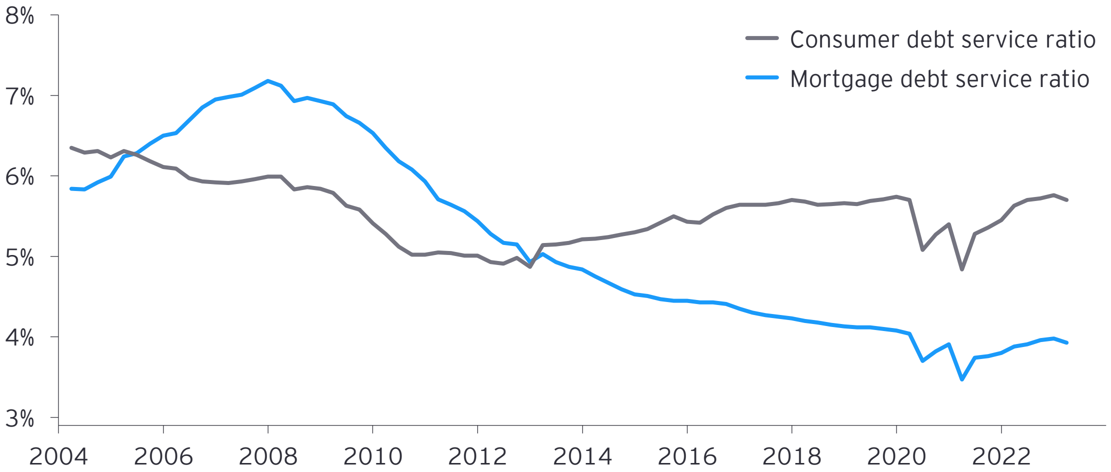
Households' finances aren't unhealthy, but delinquencies are starting to creep up, and debt servicing costs are expected to rise as we move into 2024

US new delinquent loan balances, 30+ days (as a percentage of current balance)
2004 Q1-2023 Q2



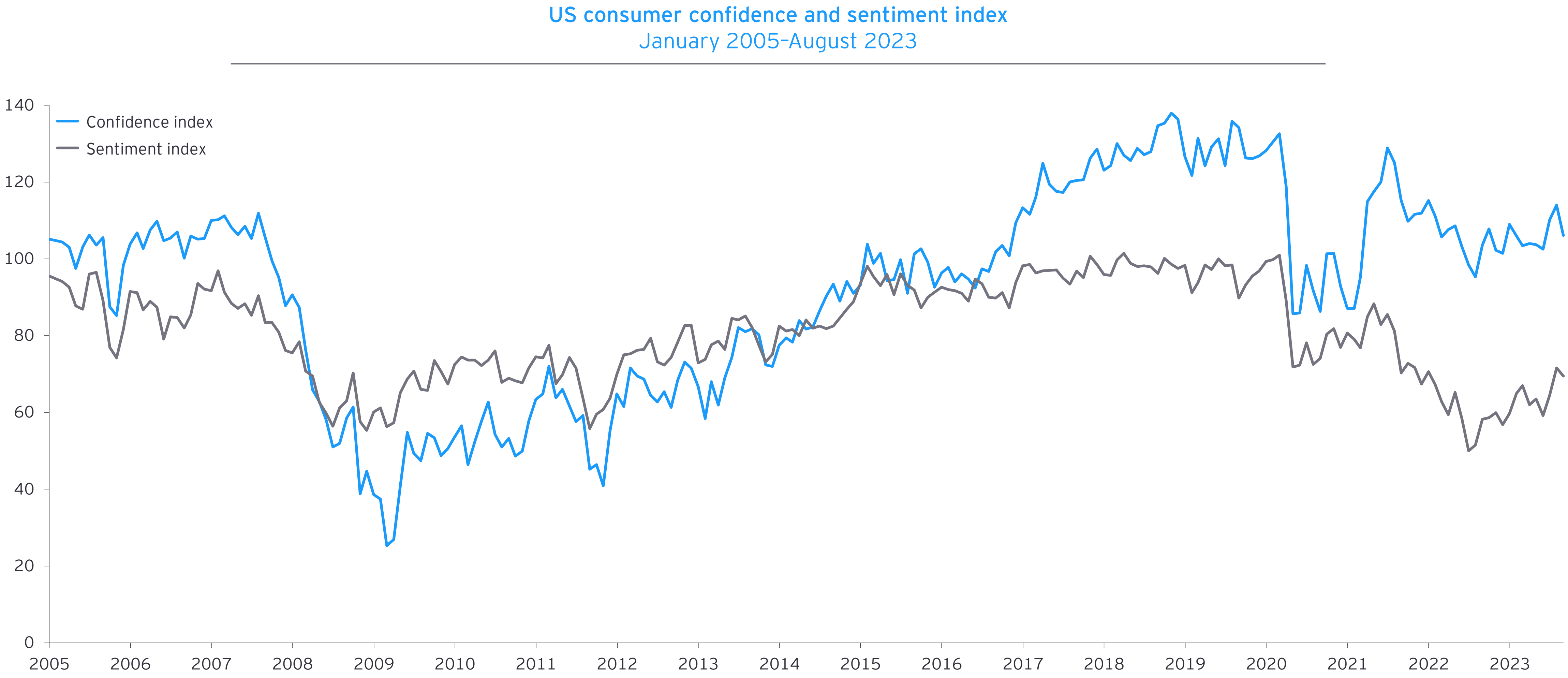
US debt service payments as a percentage of disposable personal income
2004 Q1-2023 Q1



- Household leverage, wealth and savings are not concerning, but fragilities are appearing, with the share of credit card debt and auto loans in delinquency rising. This is a concern, especially for lower-income families.
- The 30-day delinquency rate (new delinquencies) on consumer loans is still low, but it has rebounded markedly from its pandemic low in mid-2021. In the latest quarterly report from the New York Fed, the most notable upticks were reported for delinquencies in credit card and auto loan balances. The delinquency rate on credit cards reached 7.20% in Q2, up from 4.76% the year before. Delinquencies on auto loans have also risen markedly and are now back to pre-pandemic level amid higher interest rates and elevated used car prices.
- Consumer debt burdens have also been rising. The ratio of debt service payments relative to income for mortgages has climbed back toward its pre-pandemic level of 4.0%, while the ratio for consumer debt is now in line with its Q1 2020 level of 5.7%. Overall, we anticipate consumers' debt-servicing ratio and delinquency rates will deteriorate further as consumers come under increasing pressure from slower income growth, higher interest rates and still elevated prices.
- Moreover, the restart of student loan repayments on October 1, which we estimate represents about 5% of disposable income for some individuals, is a key downside risk to the consumer outlook. It will curb households' spending power, especially at the lower end of the income spectrum, and will likely lead to some deterioration in household finances into 2024.

Source: Federal Reserve Bank of New York Consumer Credit Panel; Federal Reserve Board; EY-Parthenon

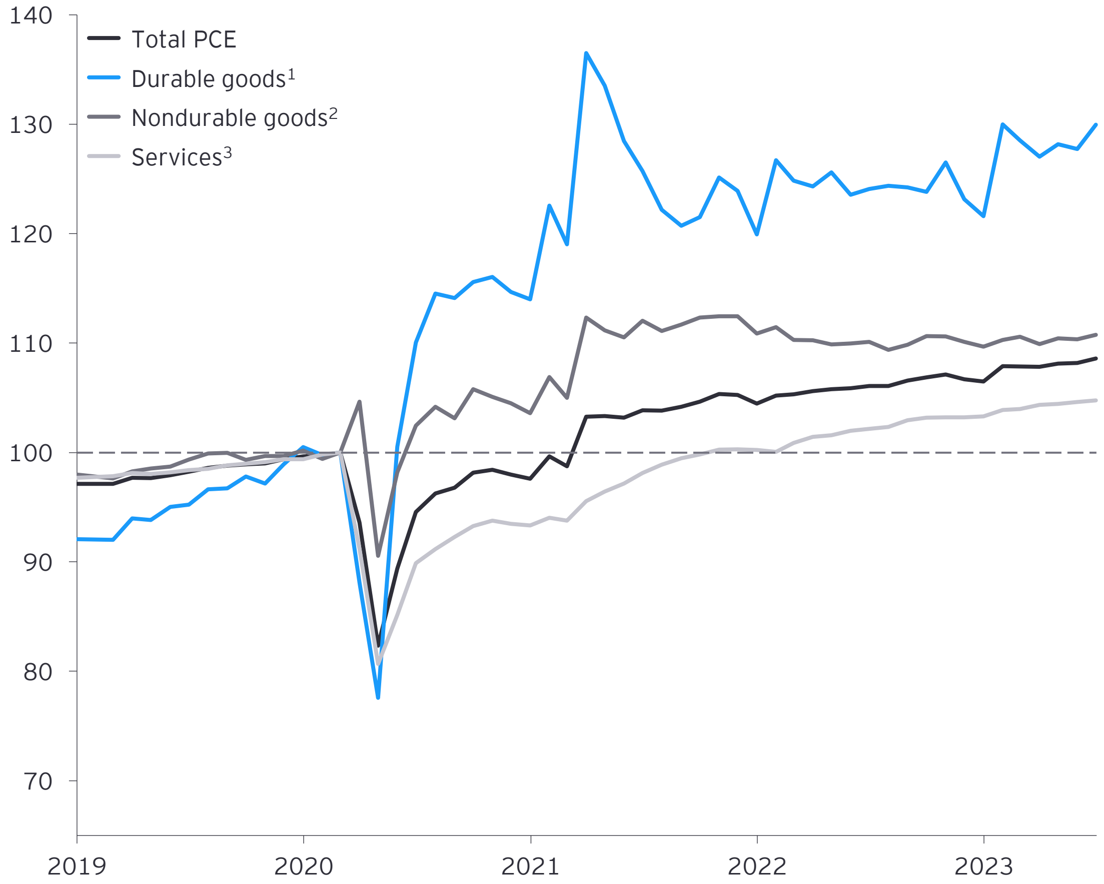
Consumers' attitudes gauged by survey-based measures have improved compared to last year but remain below pre-COVID-19 levels



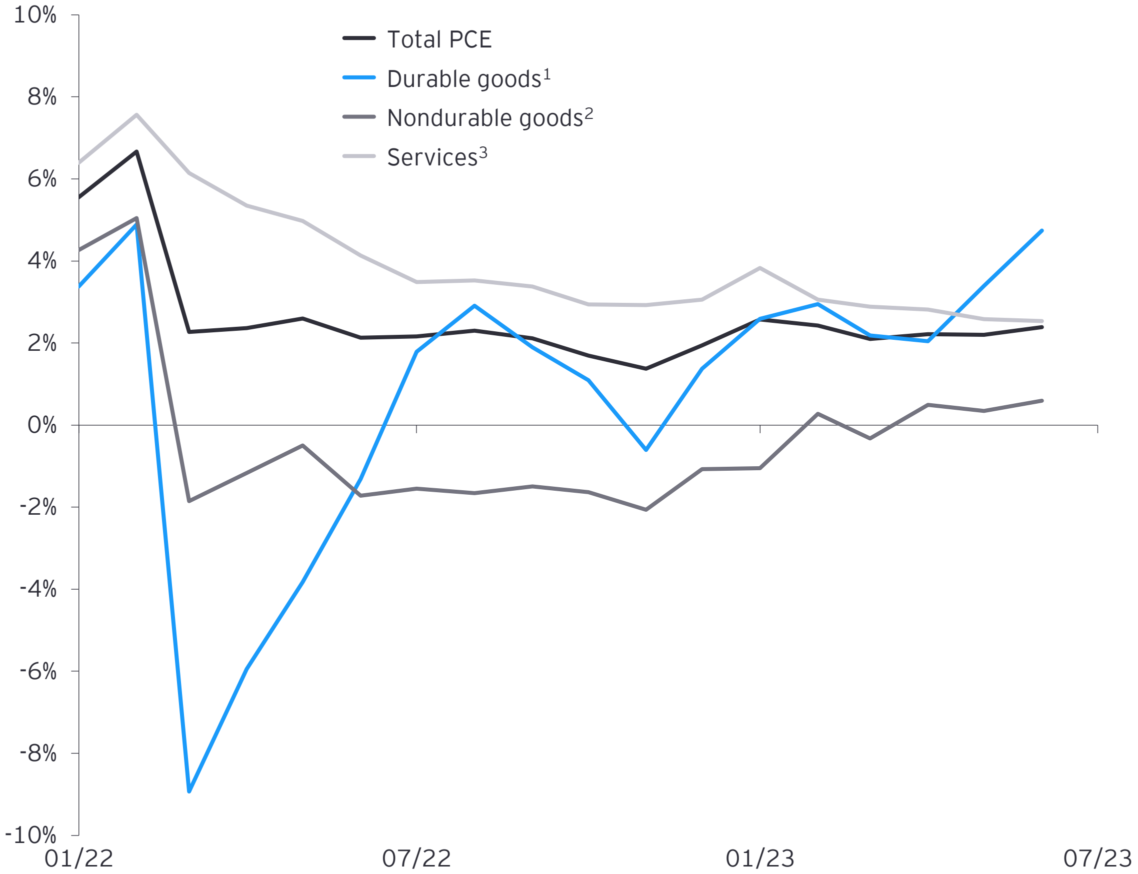
Source: US Census Bureau; US Bureau of Economic Analysis; US Conference Board: EY-Parthenon

Real consumption (adjusted for inflation) shows continued positive trajectory against a backdrop of recession concerns; the post-pandemic rotation toward services is cooling

US real personal consumption expenditure (PCE)
January 2019–June 2023 (February 2020 = 100)



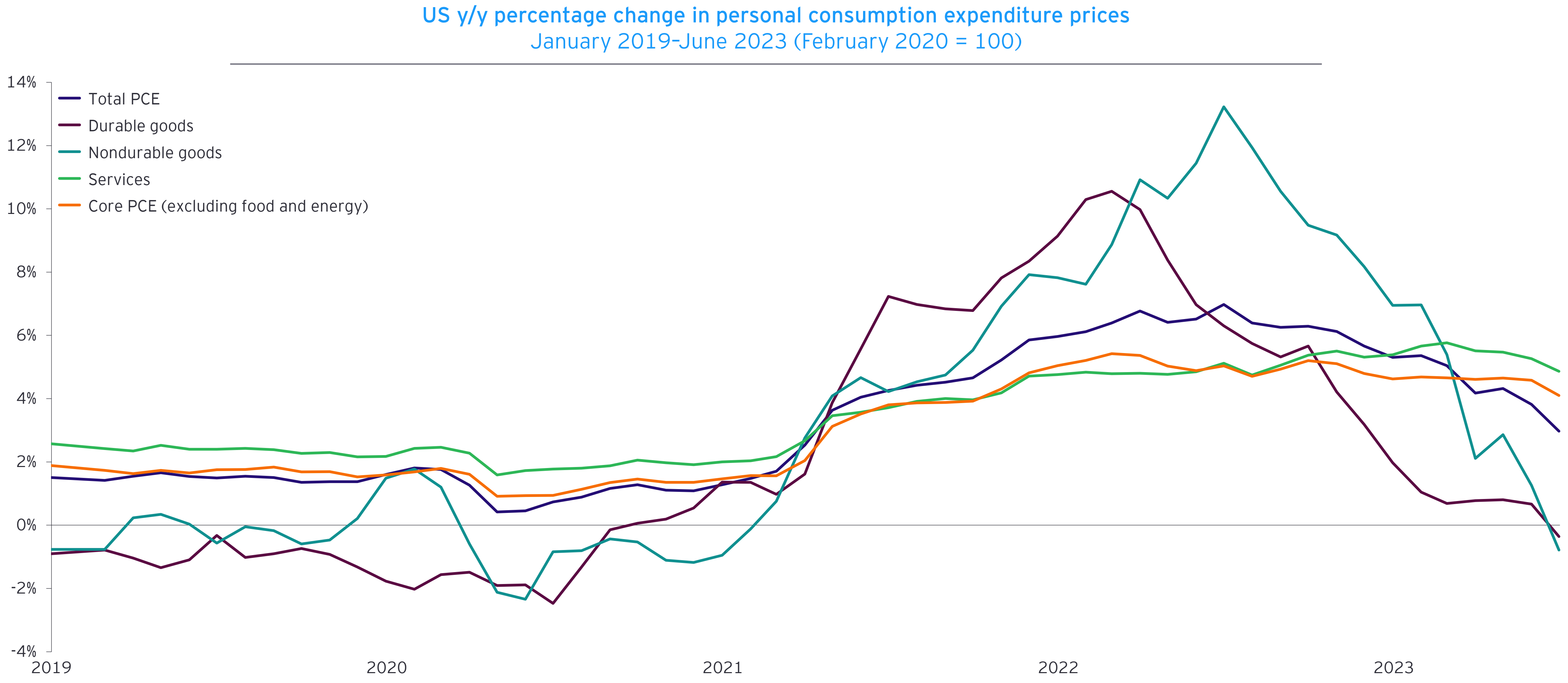
US y/y percentage change in real personal consumption expenditure
January 2022–June 2023



1. Includes motor vehicles and parts, furnishings and durable household equipment (appliances), and recreational goods and vehicles.
2. Includes food and beverages (groceries), clothing and shoes, and gasoline and other fuels.
3. Includes housing and utilities, health care, transportation, recreation, food services and accommodations, and financial services and insurance.

Source: US Bureau of Economic Analysis; EY-Parthenon

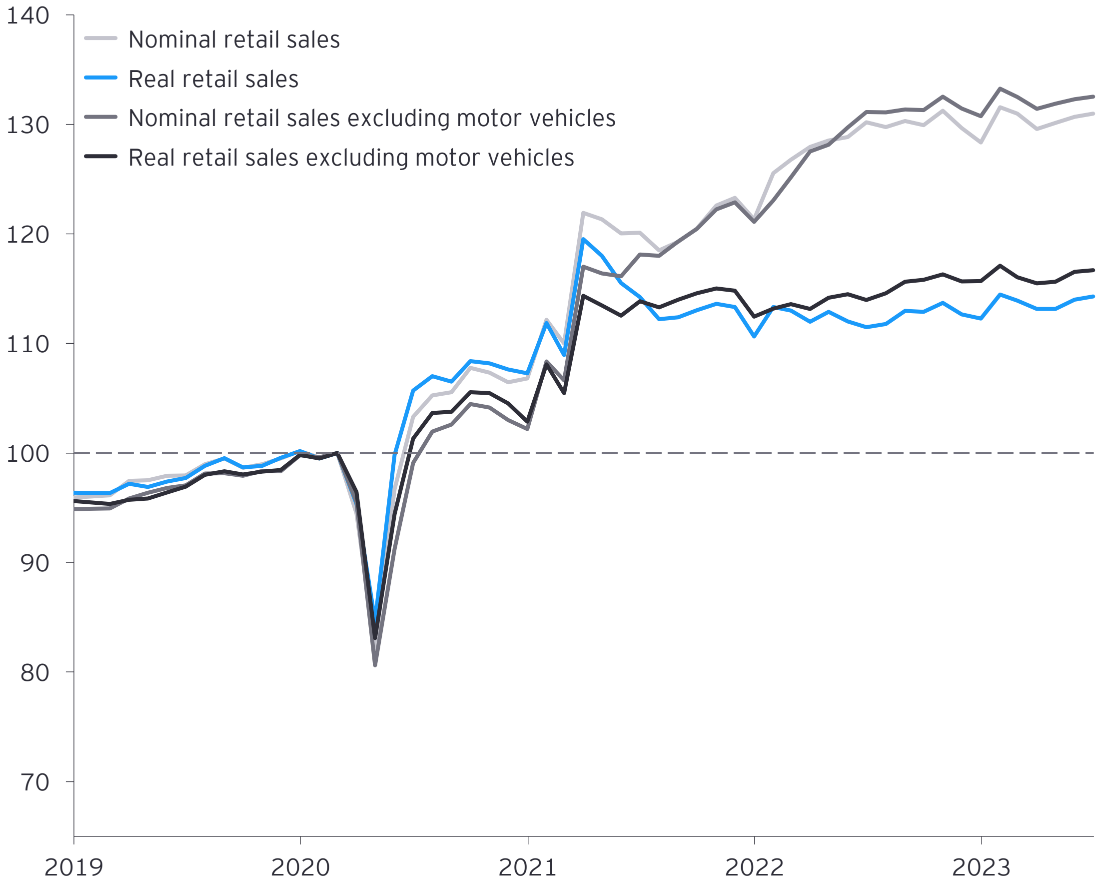
While goods prices have been on a disinflationary path, service inflation is now the main driver behind still-elevated price levels



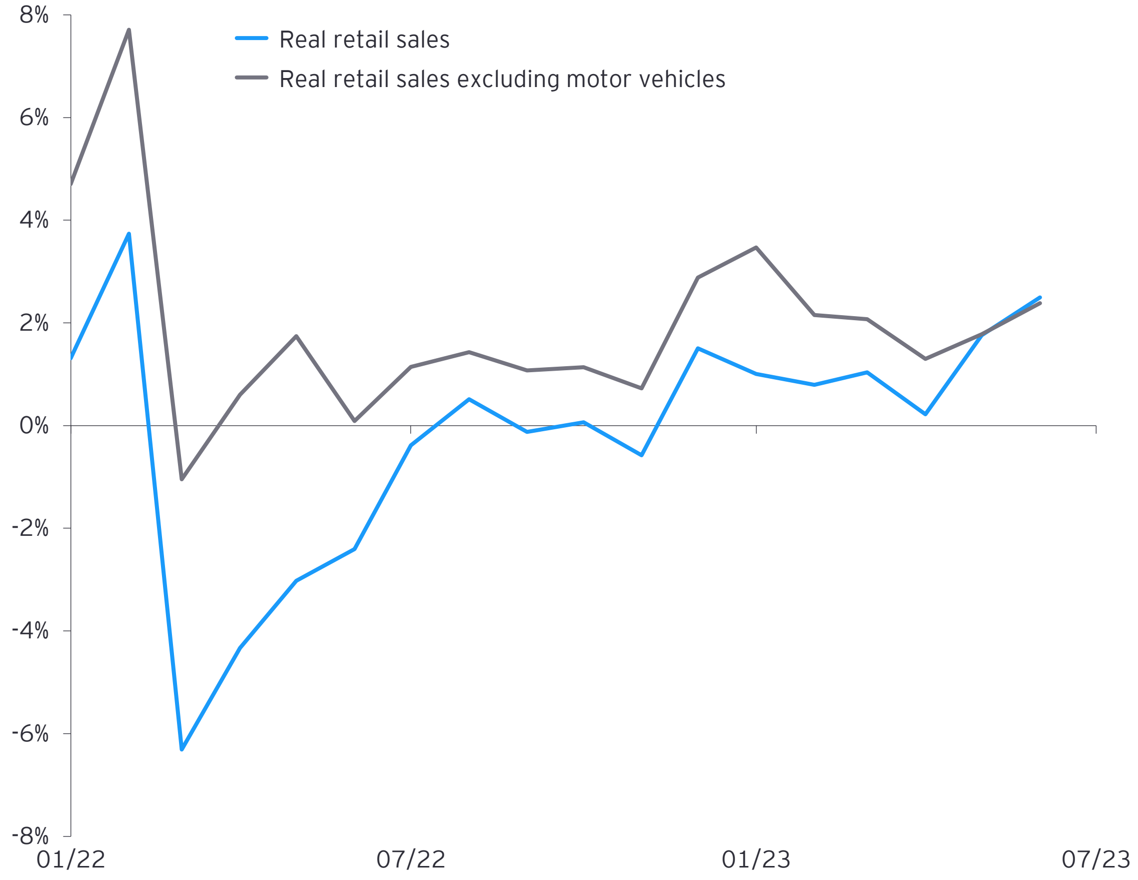
Source: US Bureau of Economic Analysis; EY-Parthenon

Retail activity is showing resiliency relative to concerns of slower economic activity

US retail sales indexes
January 2019–June 2023 (February 2020 = 100)



US y/y percentage change in real retail sales measures
January 2022–June 2023



Source: US Bureau of Economic Analysis; EY-Parthenon

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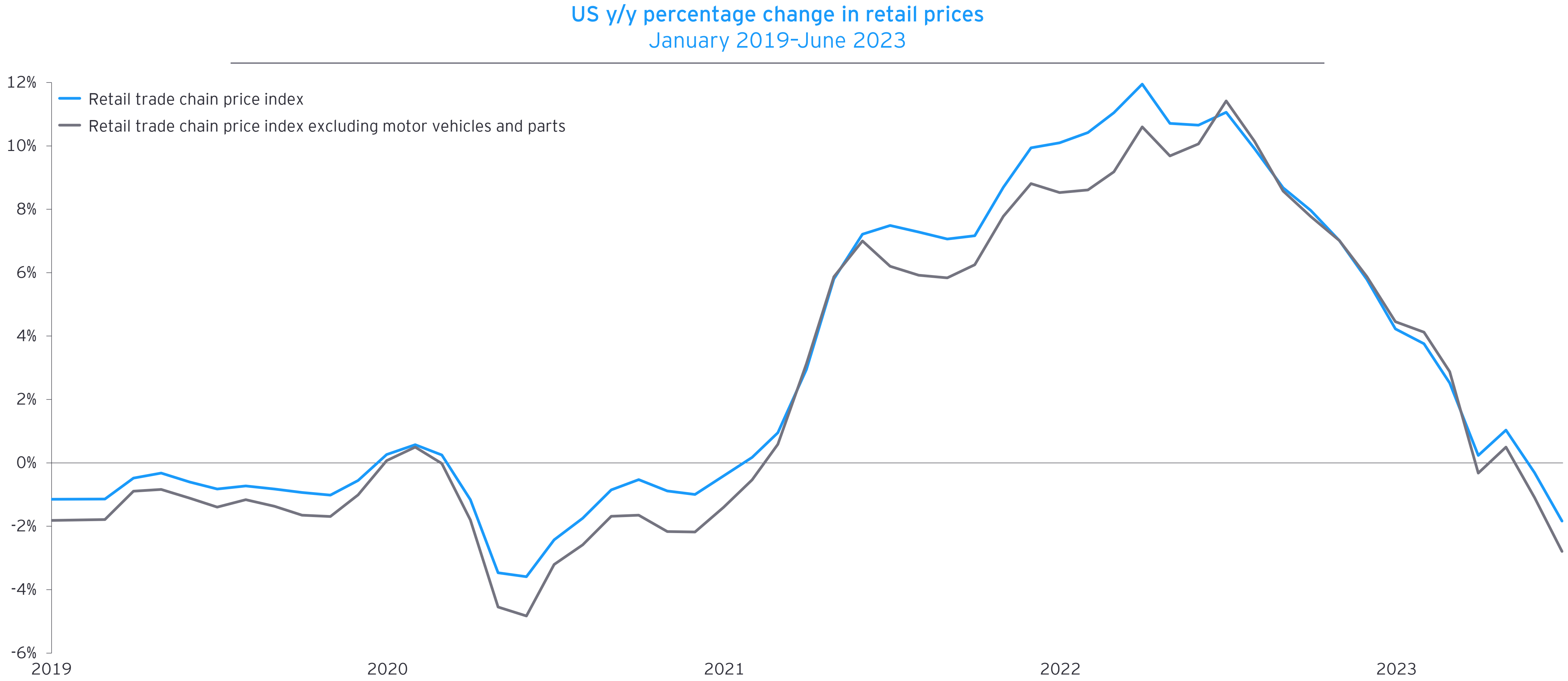
Overall, retail prices are softening following two years of elevated pricing growth as demand tempers

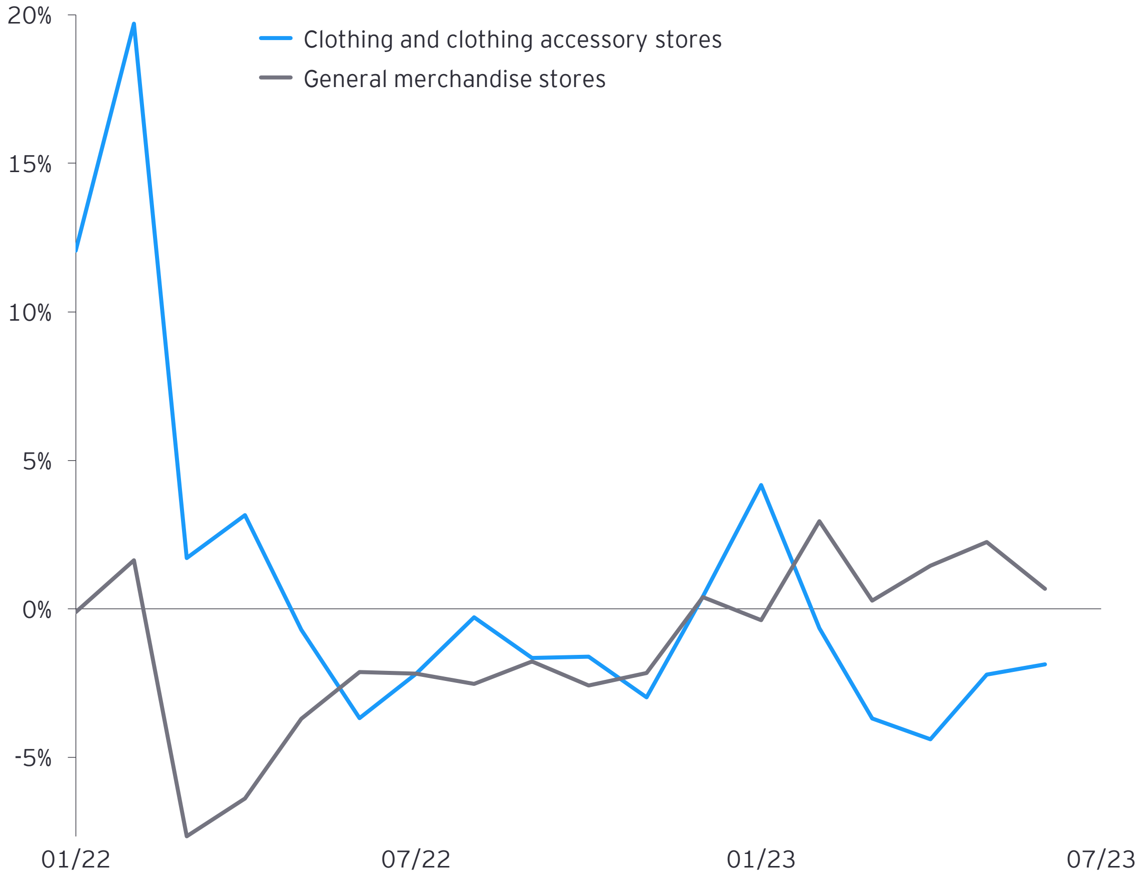


Source: US Bureau of Economic Analysis; EY-Parthenon

Clothing and general merchandise sales have been sideways to down in real terms in 2023 thus far, as consumers make more selective spending decisions

US real retail sales
January 2019–June 2023 (February 2020 = 100)

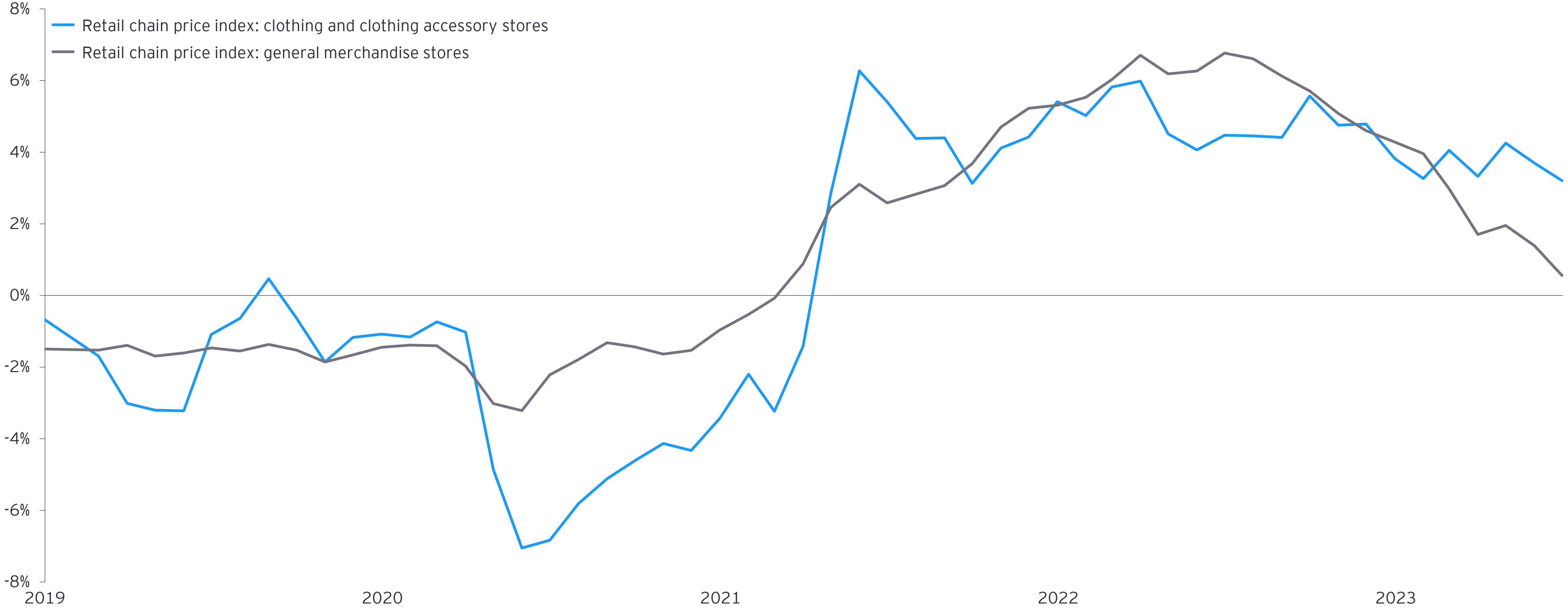
US y/y percentage change in real retail sales
January 2022–June 2023



Source: US Bureau of Economic Analysis; EY-Parthenon

While price growth is decelerating, price stickiness, especially for clothing, may steer discretionary spend away from this segment

US y/y percentage change in retail prices
January 2019–June 2023

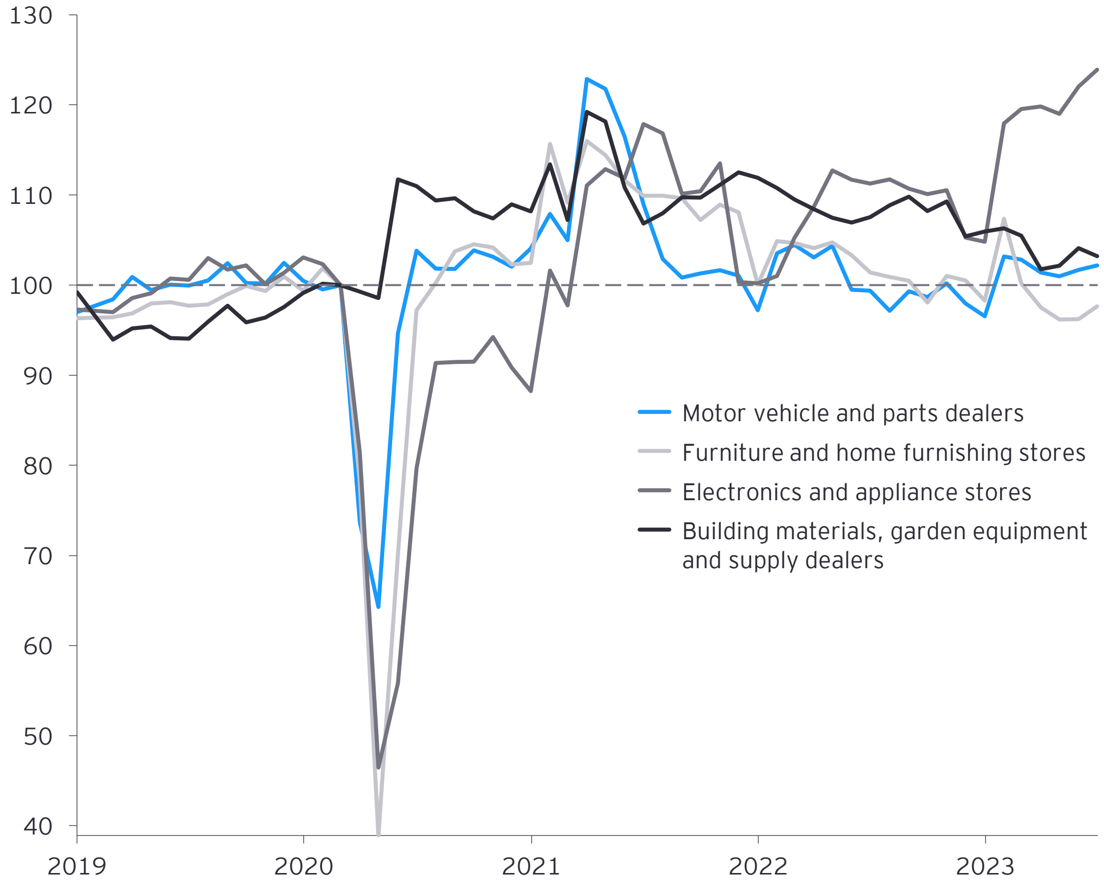


Source: US Bureau of Economic Analysis; EY-Parthenon

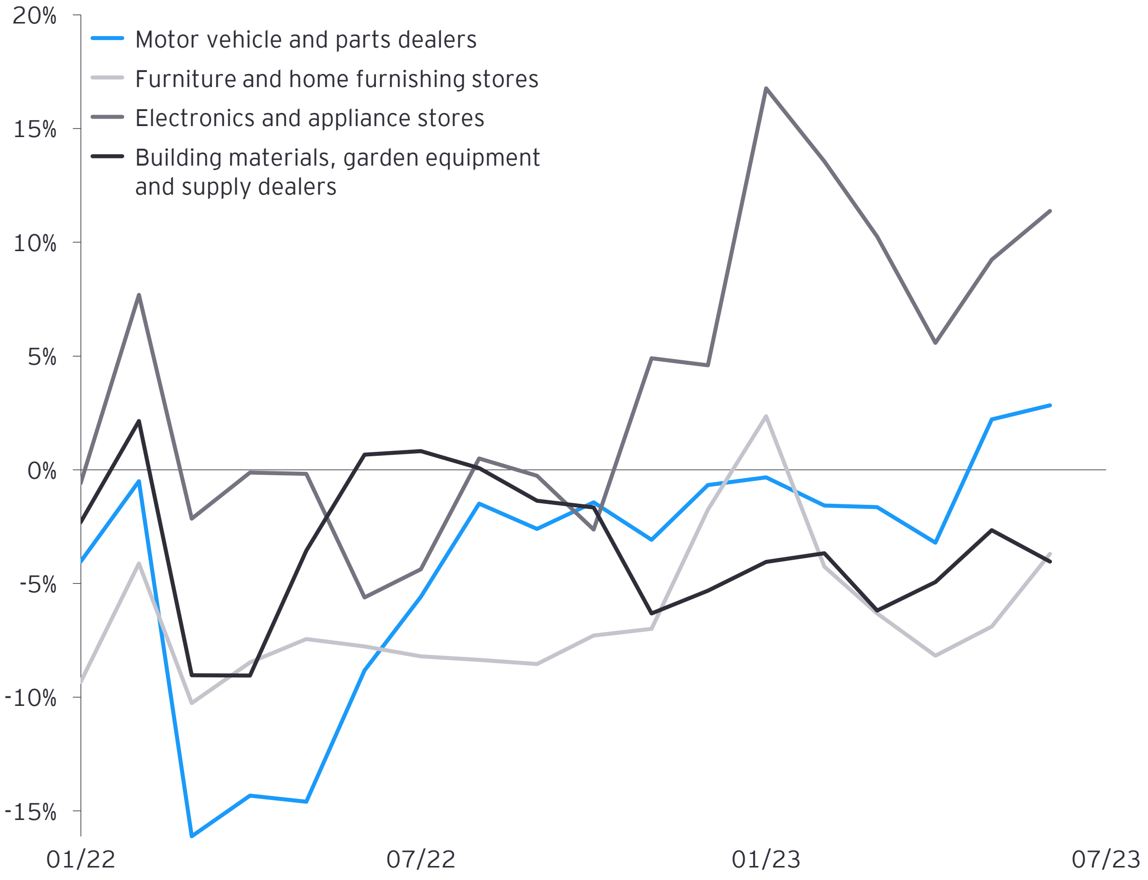
EY Parthenon

Electronics and appliance retailers are seeing strong activity in 2023, while home furnishings and building materials stores are seeing a slowdown compared to last year

US real retail sales
January 2019–June 2023 (February 2020 = 100)

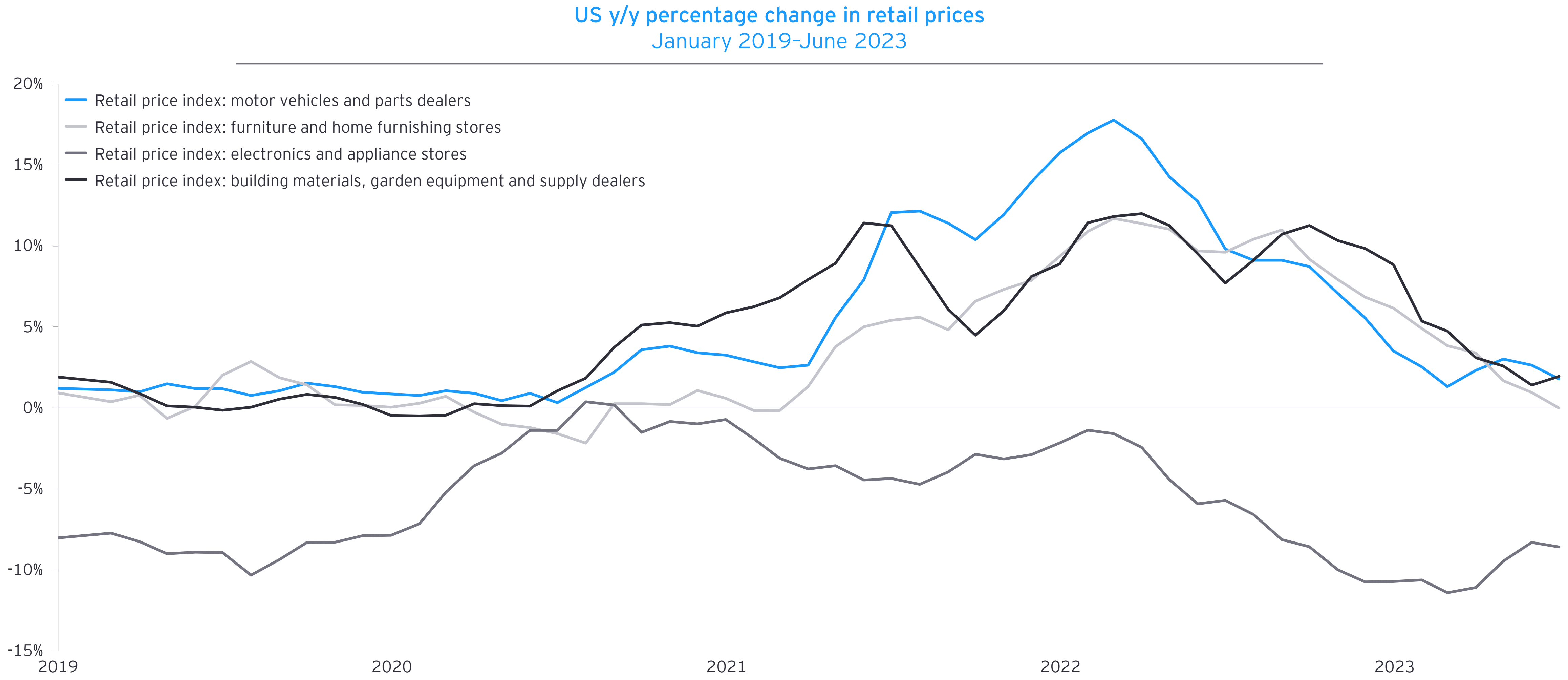


US y/y percentage change in real retail sales
January 2022–June 2023



Source: US Bureau of Economic Analysis; EY-Parthenon

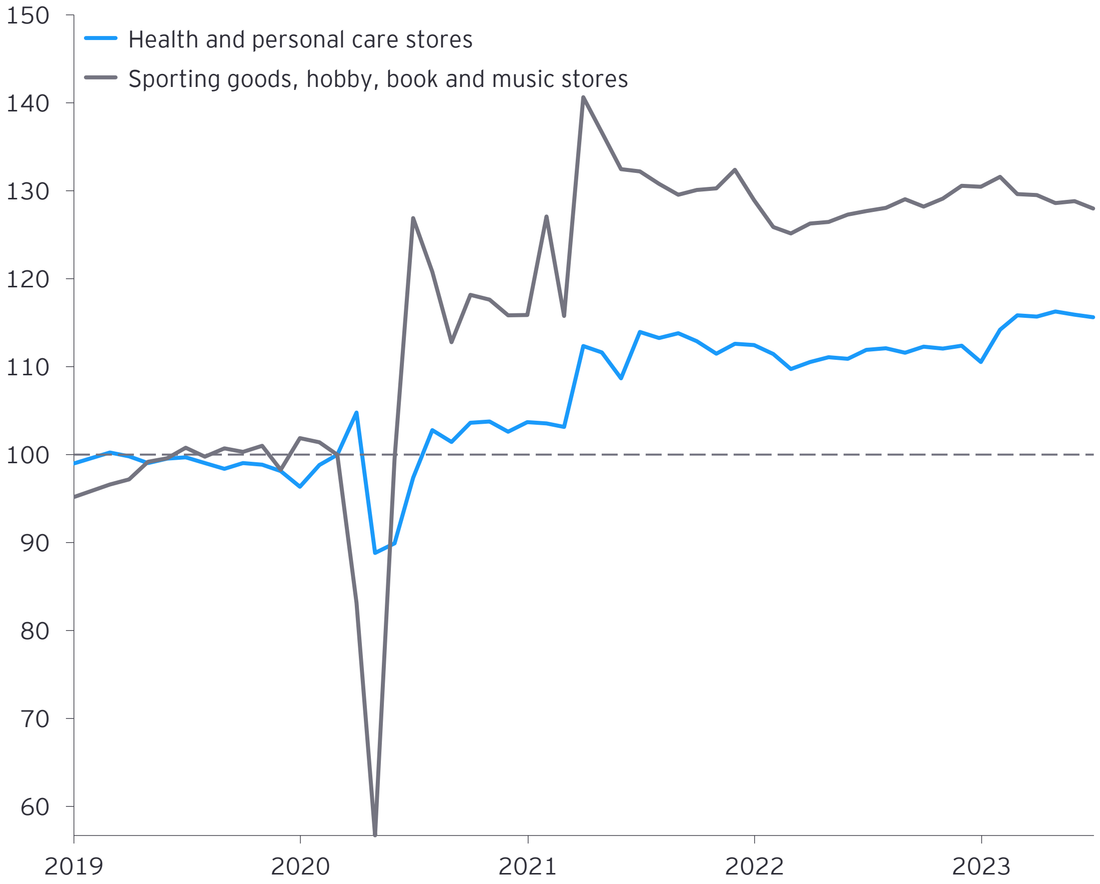
Electronics and appliance real sales activity may be supported by favorable pricing trends; price growth is slowing for other durable product categories



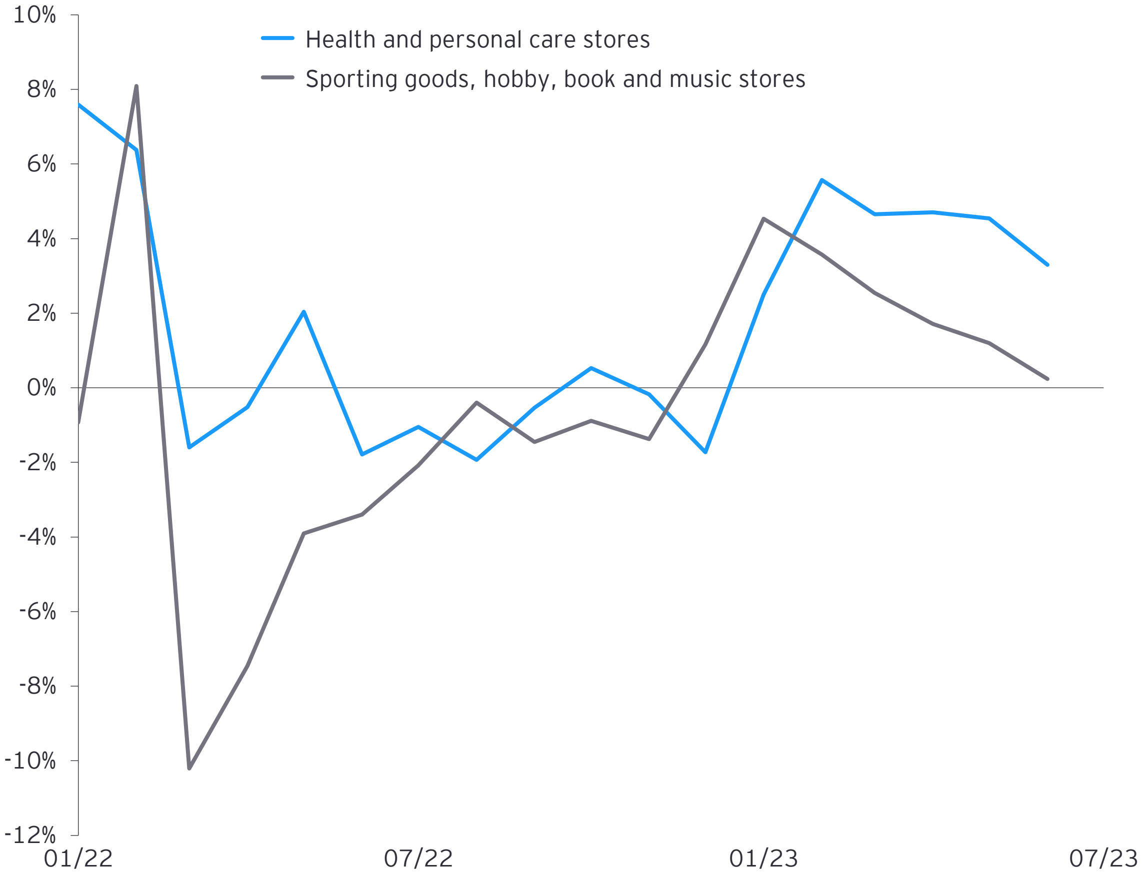
Source: US Bureau of Economic Analysis; EY-Parthenon

Real sales activity for health and personal care as well as sporting and hobby retailers is largely moving sideways at present after year-over-year lifts in early 2023

US real retail sales
January 2019–June 2023 (February 2020 = 100)

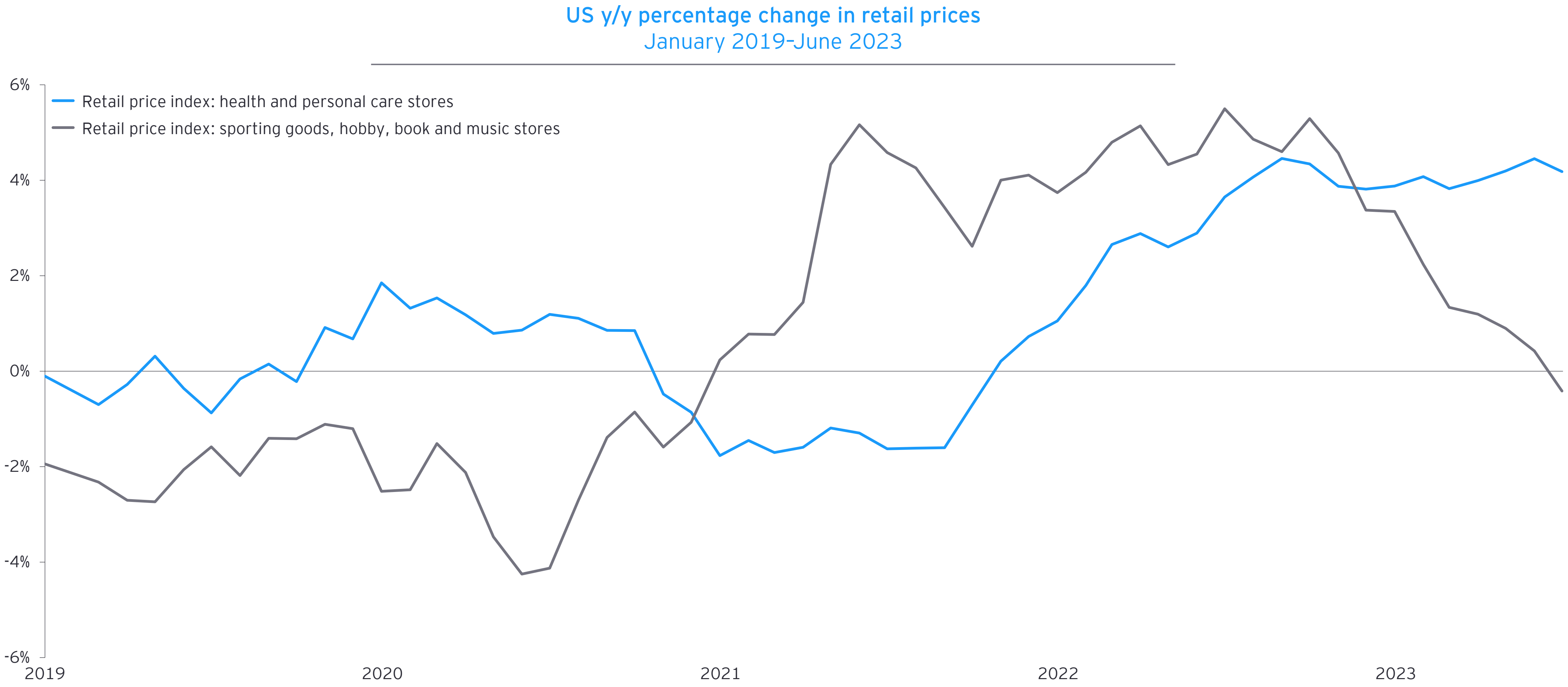


US y/y percentage change in real retail sales
January 2022–June 2023



Source: US Bureau of Economic Analysis; EY-Parthenon

Price growth is dampening for sporting and hobby stores amid slowing demand; health and personal care price growth remains elevated



Source: US Bureau of Economic Analysis; EY-Parthenon

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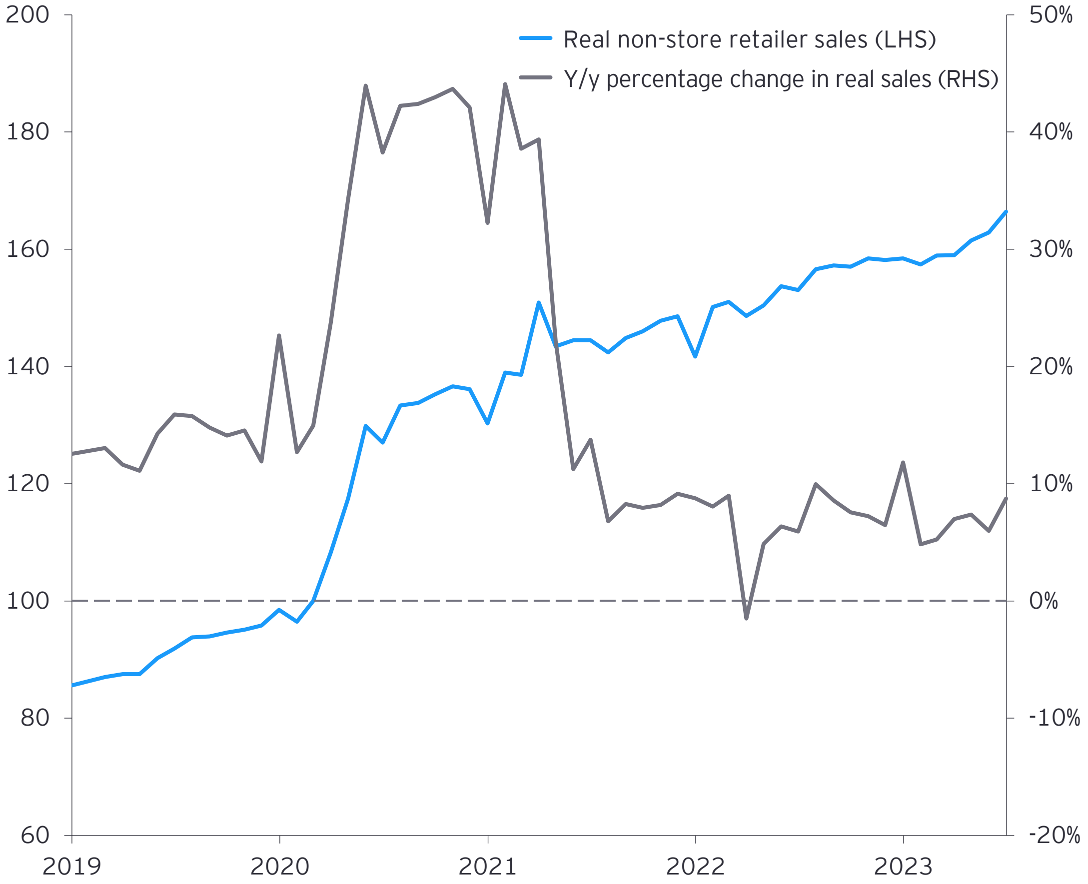
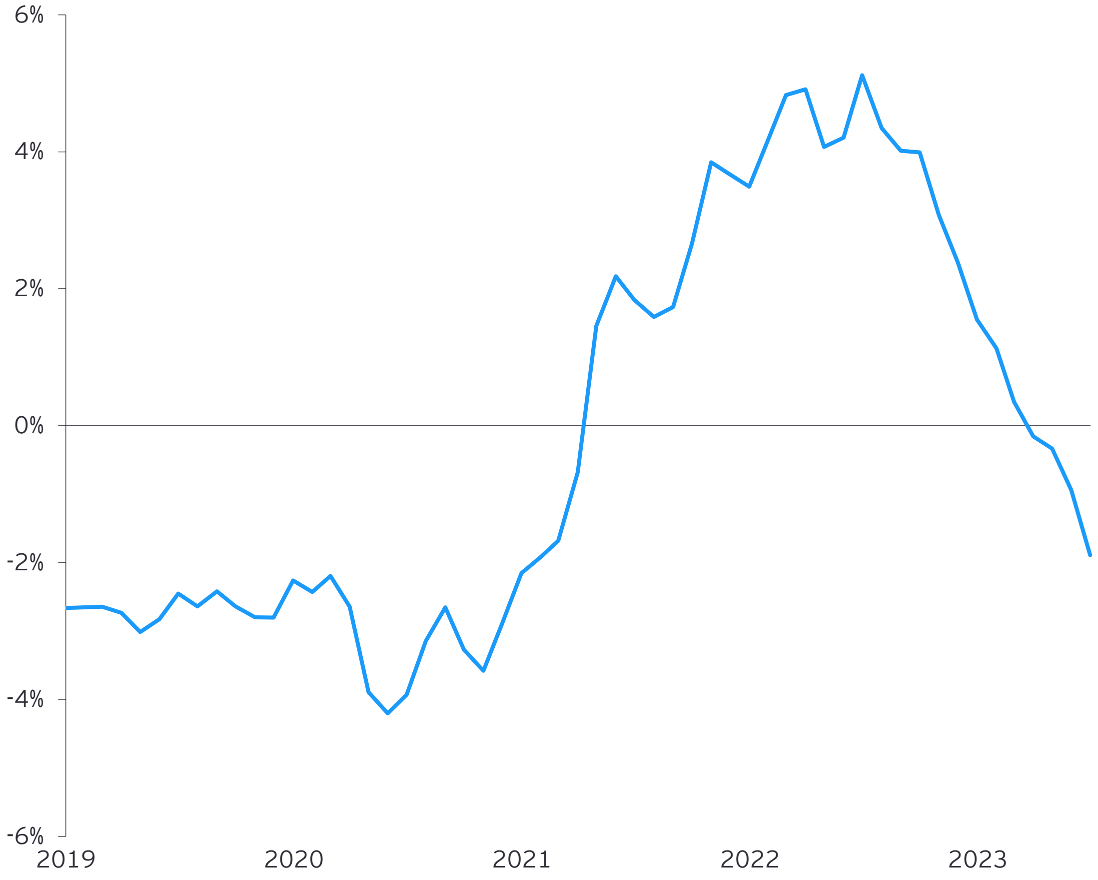
E-commerce and non-store retailers continue to see positive real growth following the COVID-19 surge, though at more metered levels, showing share gain for this channel

US real retail sales
January 2019–June 2023 (February 2020 = 100)

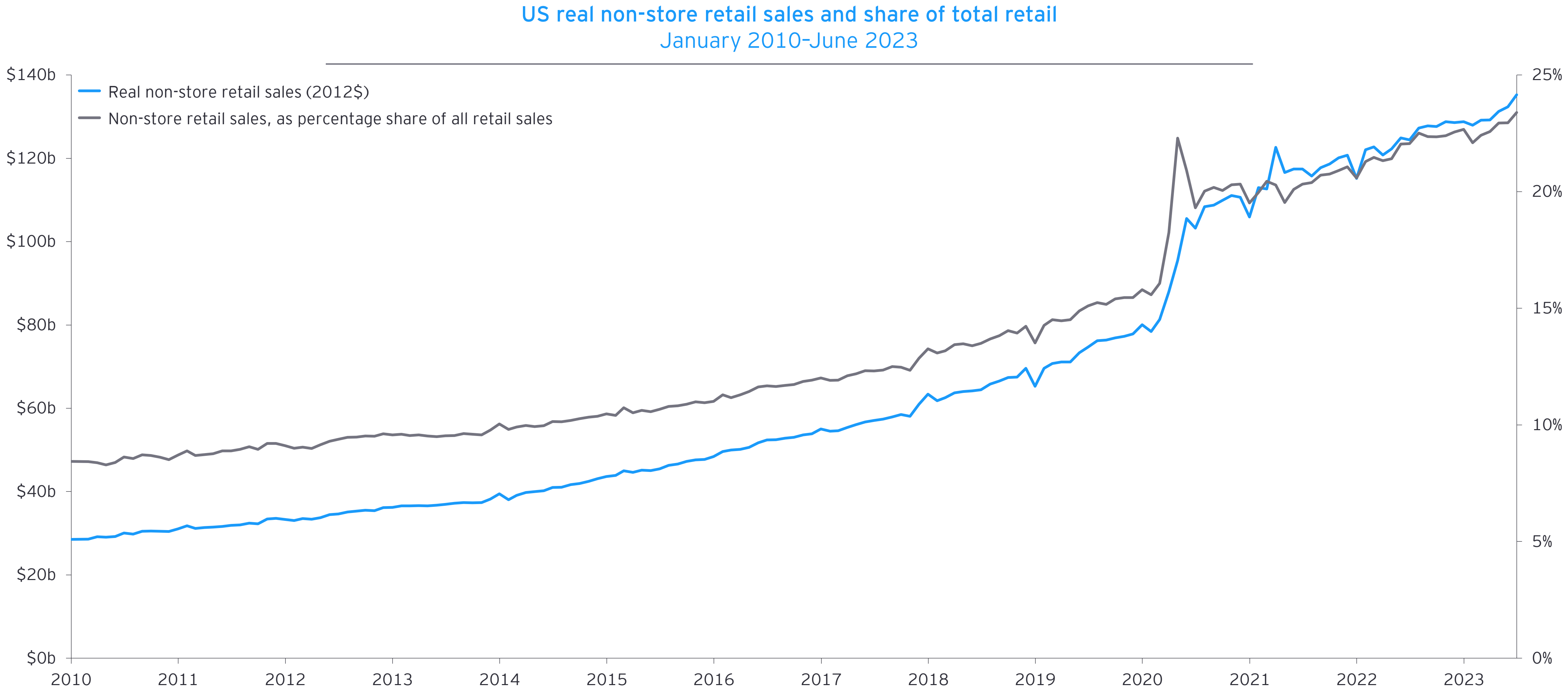


US y/y percentage change in retail prices: non-store retailers
January 2019–June 2023



Source: US Bureau of Economic Analysis; EY-Parthenon

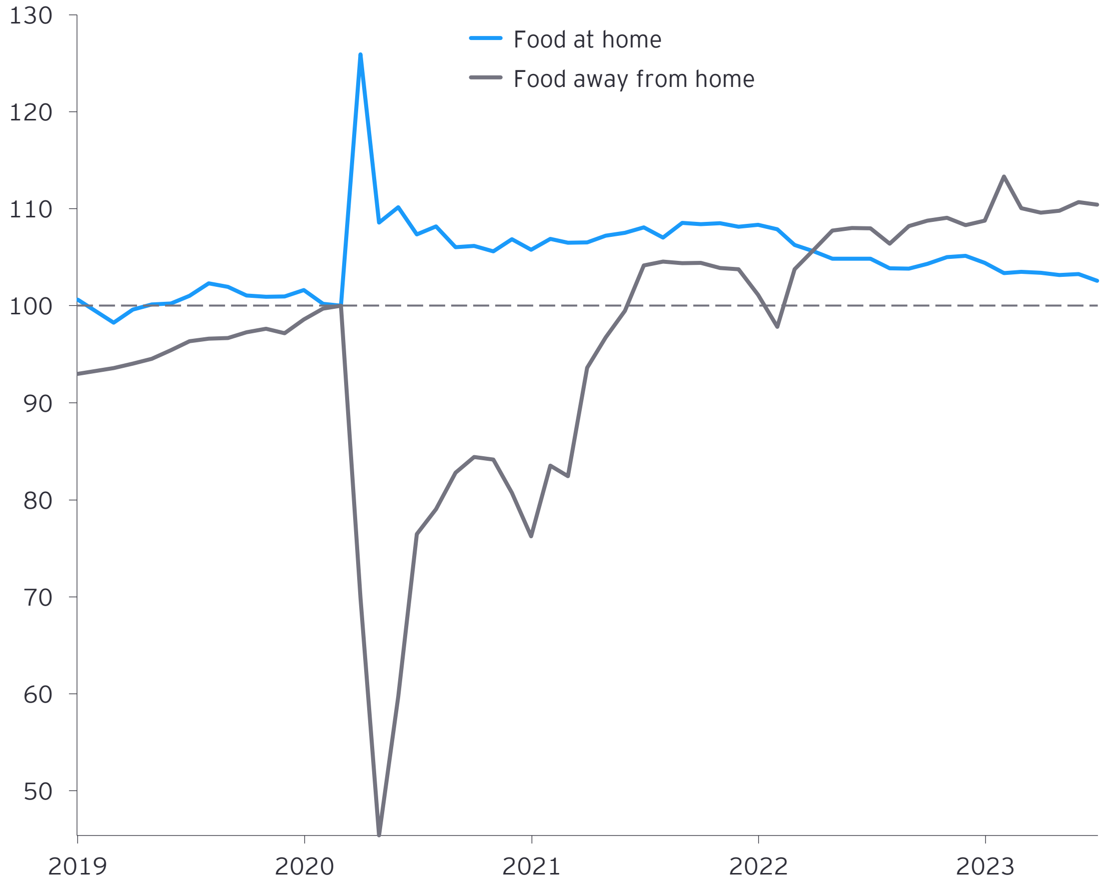
E-commerce continues its long-term trend growth in level and share after a spike during the pandemic; the channel now represents nearly 25% of all retail spend



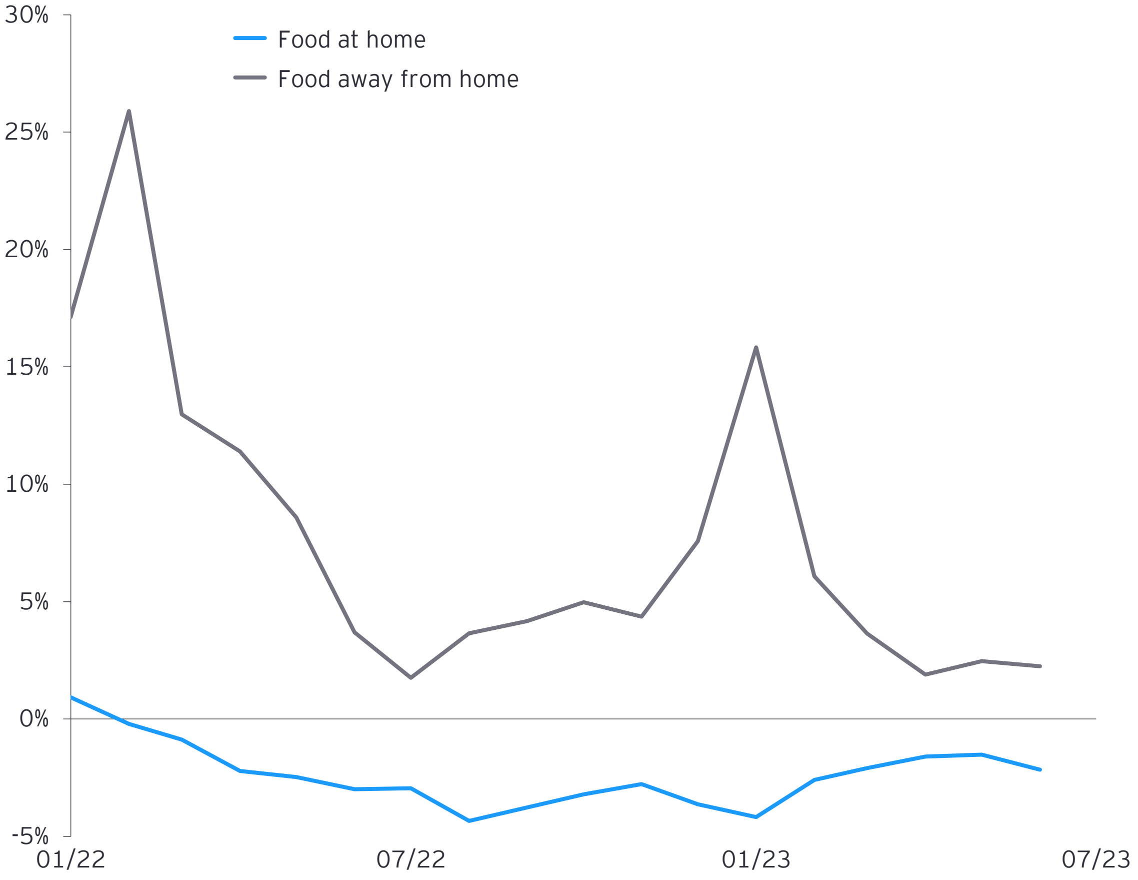
Source: US Bureau of Economic Analysis; EY-Parthenon

Dining out has seen growth since 2021 as consumers recalibrate behavior post-COVID-19

US real retail sales
January 2019–June 2023 (February 2020 = 100)



US y/y percentage change in real retail sales
January 2022–June 2023



Source: US Bureau of Economic Analysis; EY-Parthenon

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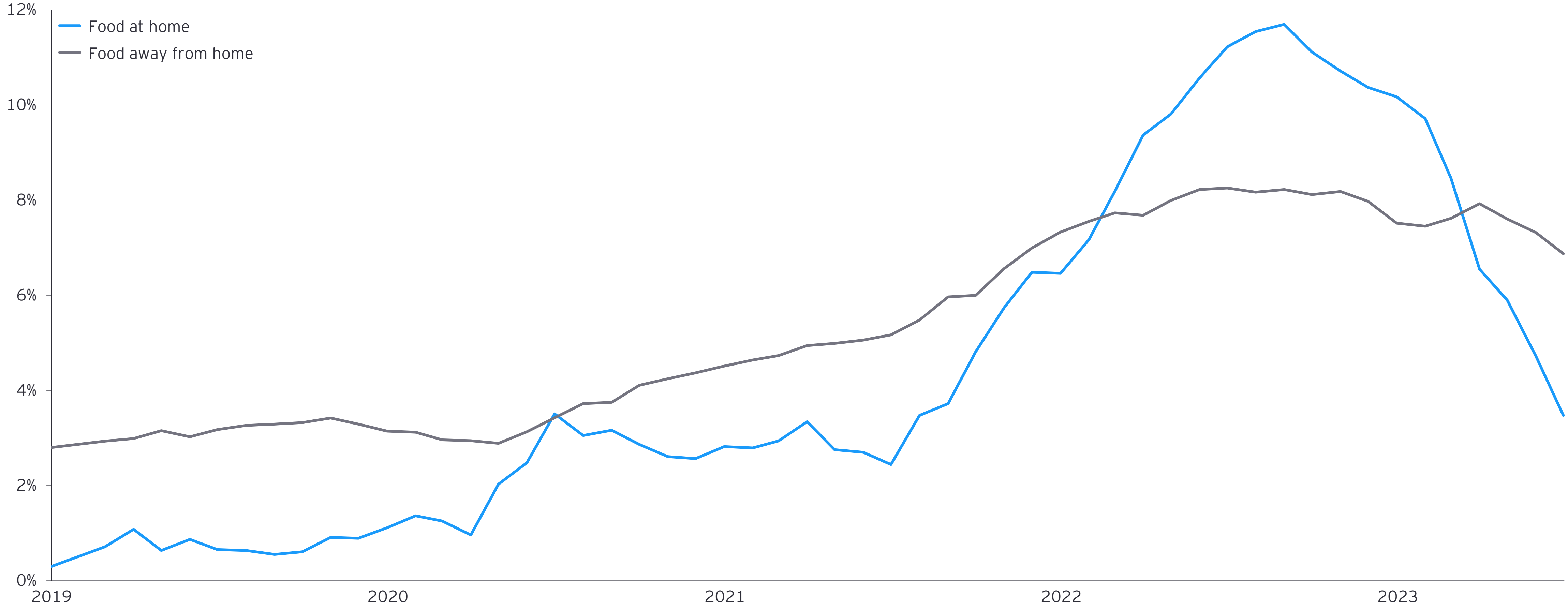
Grocery inflation continues its downward trajectory, while price inflation at restaurant services exhibits more stickiness

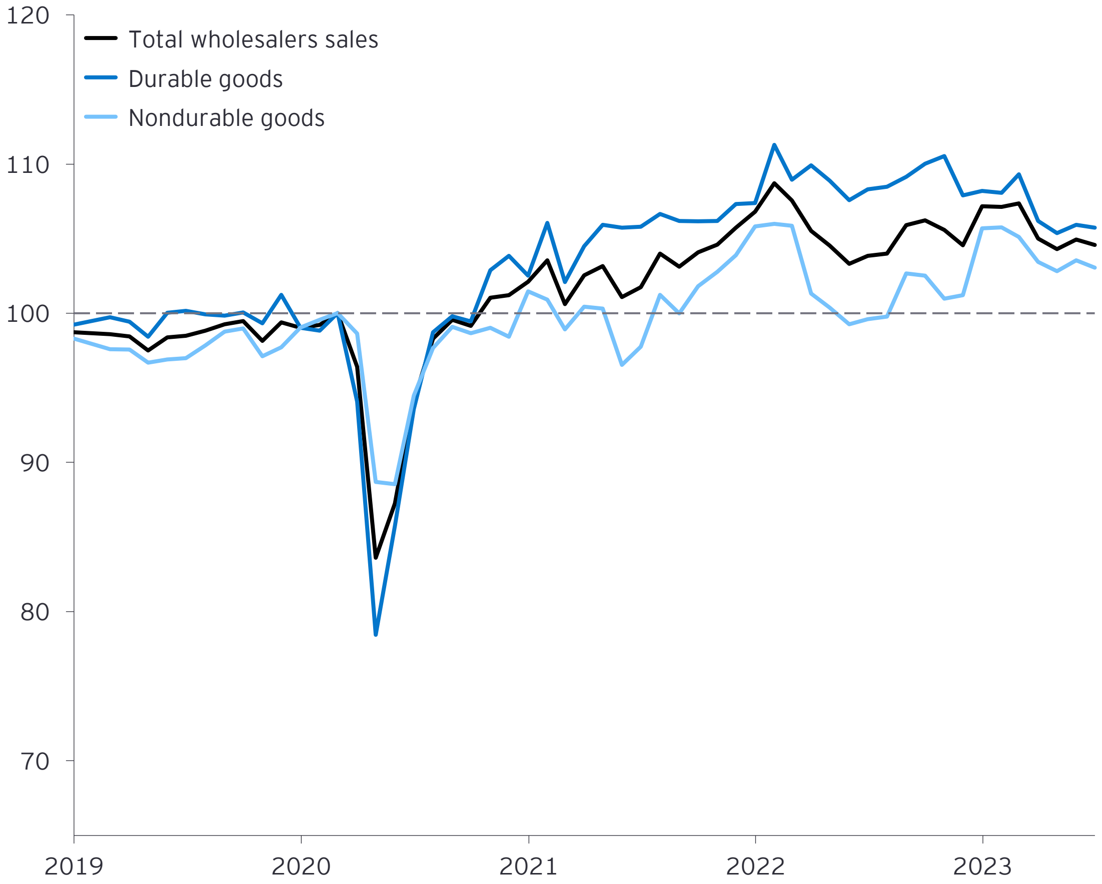
US y/y percentage change in retail prices
January 2019–June 2023



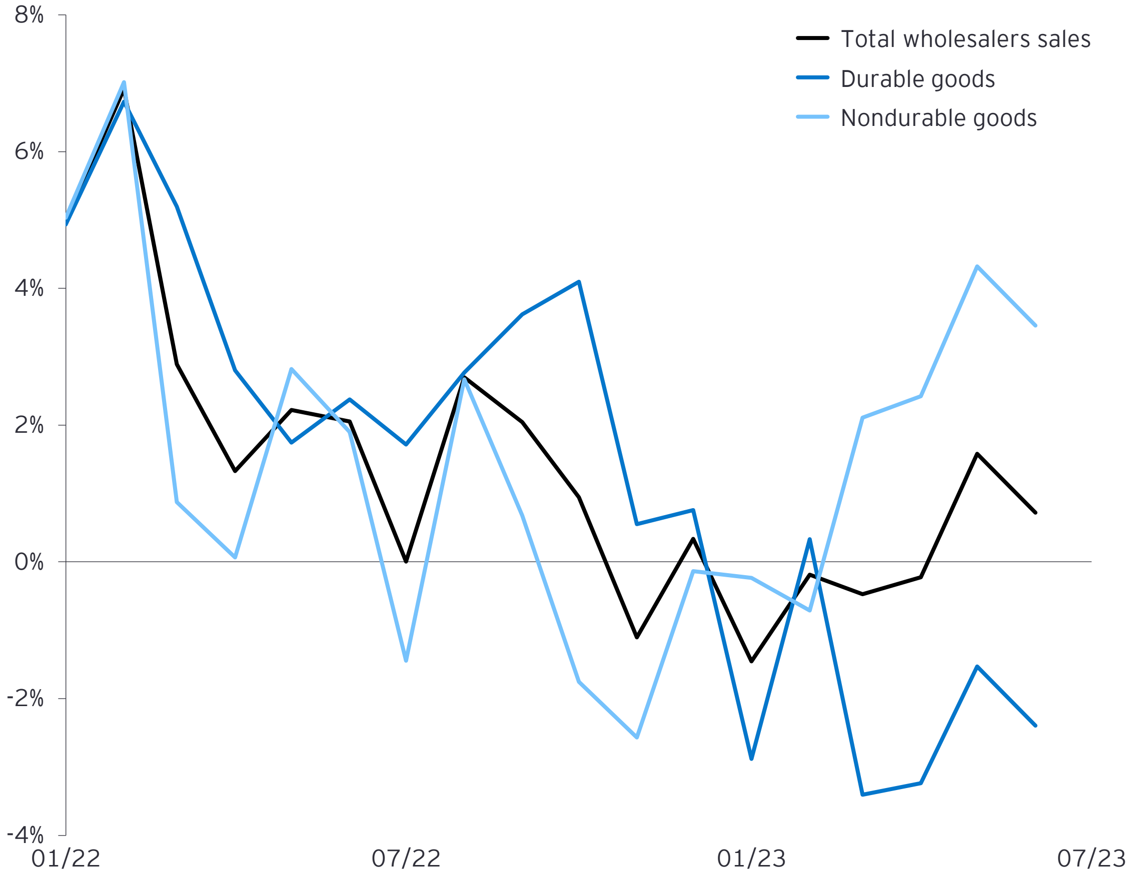
Source: US Bureau of Economic Analysis; EY-Parthenon

Wholesaler activity has largely moved sideways on a real basis thus far in 2023

US real merchant wholesalers sales
January 2019–June 2023 (February 2020 = 100)



US y/y percentage change in real merchant wholesalers sales
January 2022–June 2023



Source: US Census Bureau; EY-Parthenon

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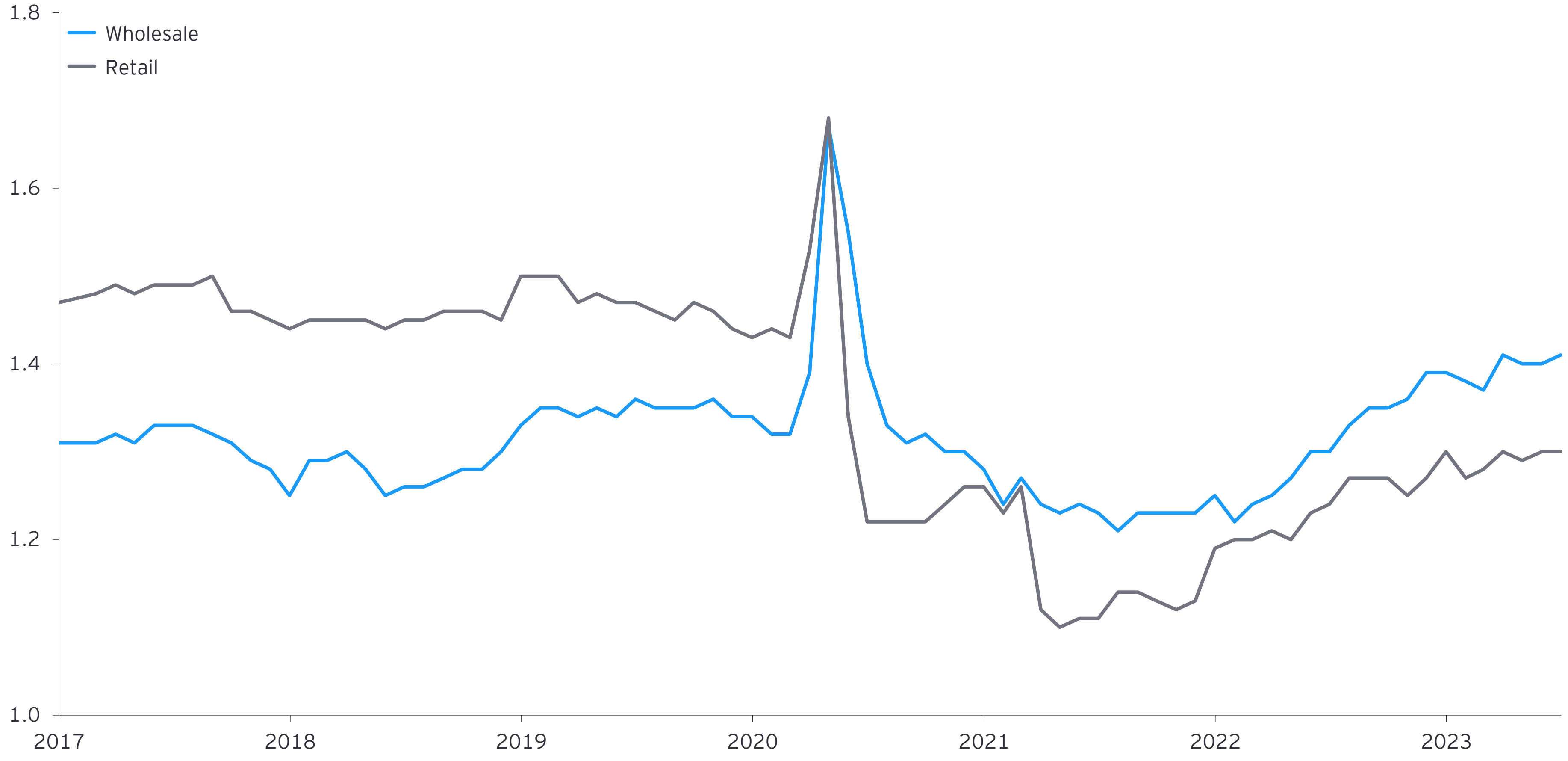
Retail inventories are stabilizing below their pre-pandemic I/S ratio, even if they have rebounded from their 2021 low, while wholesale inventories are looking slightly elevated

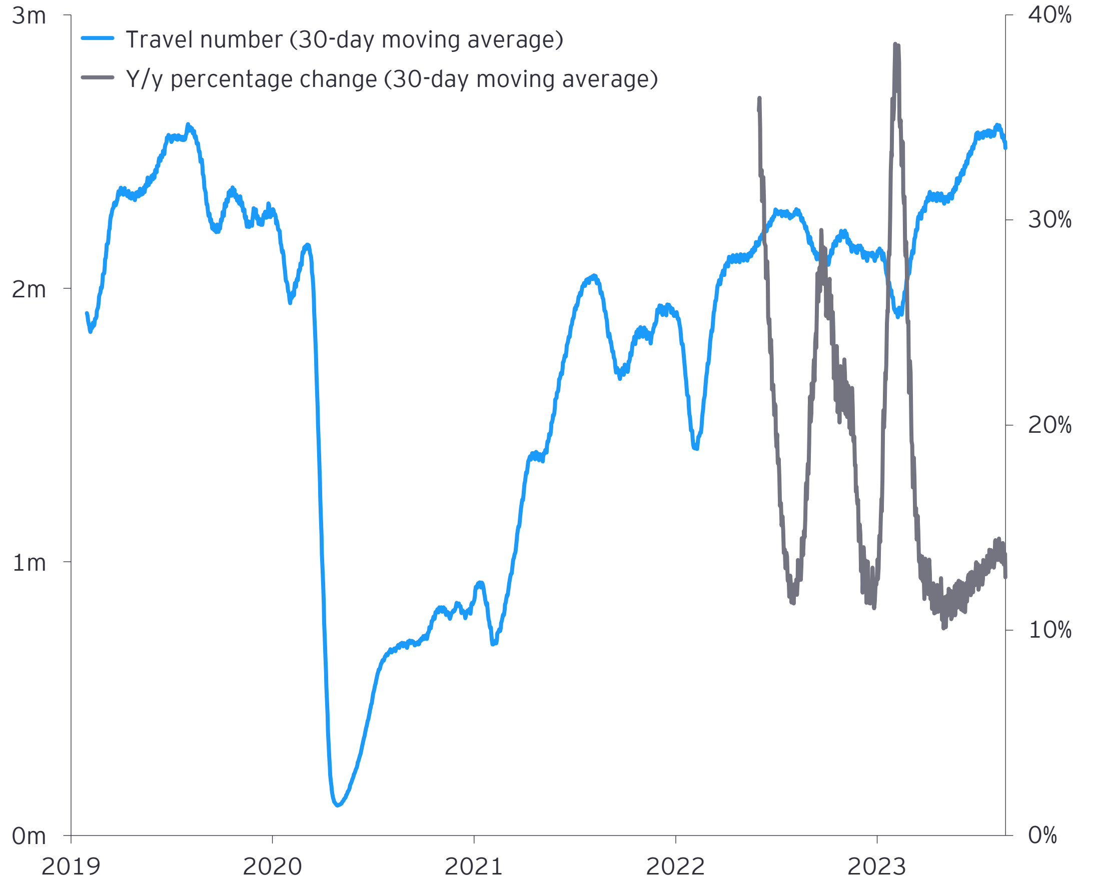
US inventory/sales (I/S) ratio
January 2017-June 2023



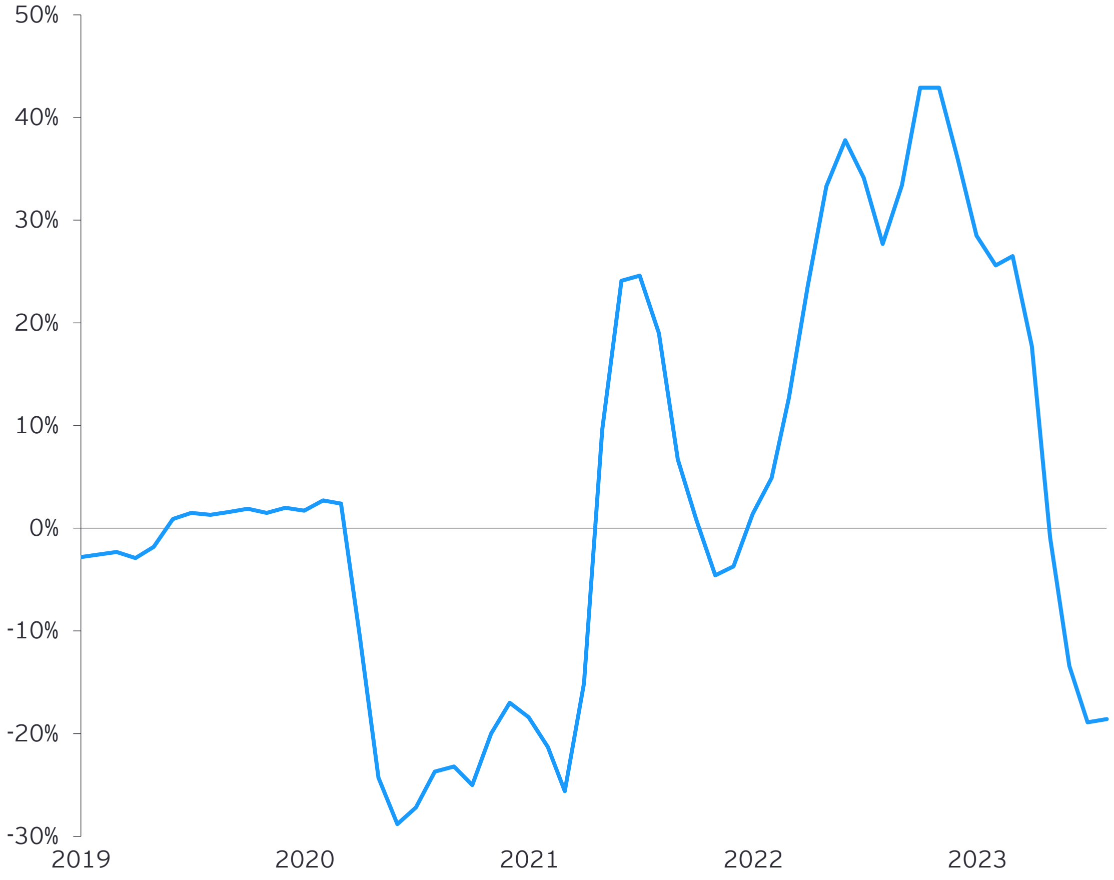
Source: US Census Bureau; EY-Parthenon

Air travel volumes have seen positive growth thus far in 2023, supported by domestic ticket price deflation

US TSA (Transportation Security Administration) checkpoint travel number and y/y percentage change
January 2019–August 2023



US y/y percentage change in CPI: airline fare
January 2019–July 2023



Source: US Transportation Security Administration; US Bureau of Labor Statistics; EY-Parthenon

EY Parthenon

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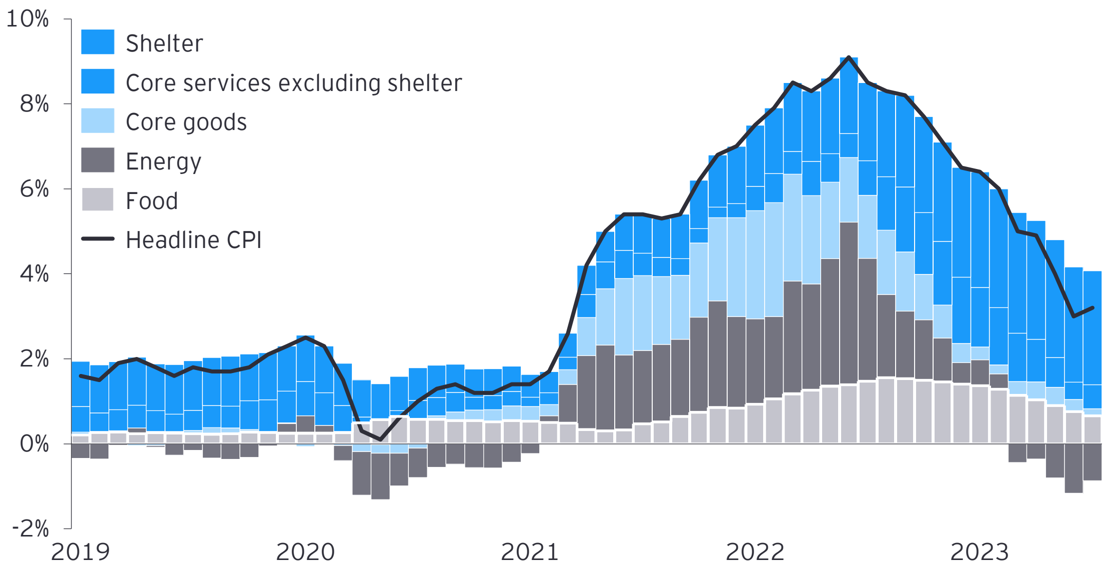
  - Talent
  - Globalization
  - Financial conditions and transaction activity
- Key EY contacts

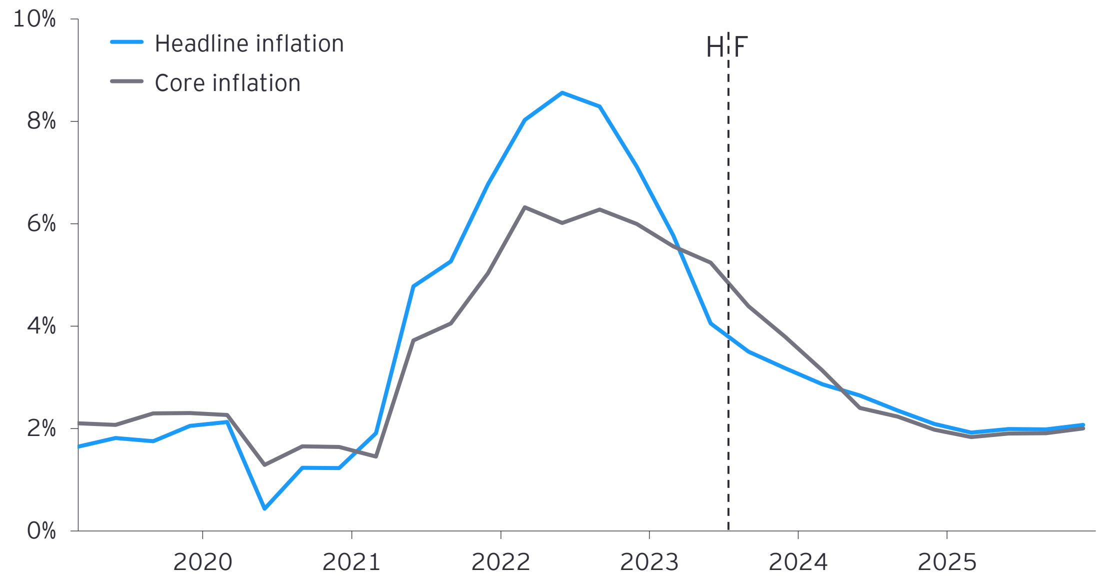
Headline inflation has rapidly dropped to 3%, but the "free disinflationary lunch" from lower energy, food and goods price inflation is over and progress to 2% will be slower

US y/y percentage change in CPI, contribution by category
January 2019–July 2023



- The July CPI report offered more evidence that inflation pressures are abating. Headline CPI rose 0.2% m/m for a second consecutive month in July, in line with expectations. Encouragingly, core CPI prices (excluding food and energy) also rose 0.2% m/m in July for a second straight month − the smallest back-to-back increase in core CPI since February 2021.
- On an annual basis, headline CPI inflation rose slightly, up 0.2ppt to 3.2% y/y in July as base effects turned less favorable. Core CPI inflation fell 0.1ppt to 4.7% y/y – its slowest pace since October 2021 – and rose at a 3.1% annualized pace over the past three months, compared to 5.0% and 4.1% in May and June, respectively.

US y/y percentage change in CPI
2019–25F



- In the near term, the temporary uptick in headline CPI inflation should extend into August amid higher energy prices and unfavorable base effects, but headline inflation should ease back down later this year. Core CPI inflation, meanwhile, is likely to ease further toward the low 4% in August and September.
- Softer demand for goods and services, the pass-through from slower housing inflation, and cooling wage growth should lead to continued disinflation in H2, especially for the core measure. By December, we foresee headline and core CPI inflation easing to around 3.0% y/y and 3.8% y/y, respectively. However, renewed upward momentum in energy prices and potential pass-through into core inflation pose upside risks to the inflation outlook.

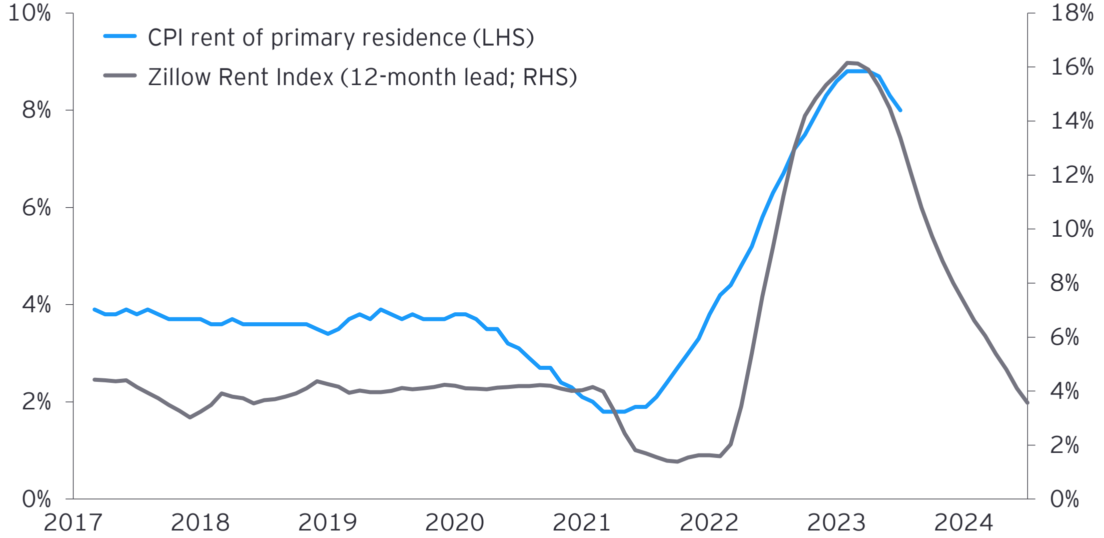
1. Headline CPI includes the prices on a fixed basket of goods. Core CPI removes the CPI components that can exhibit large amounts of volatility from month to month, such as food and energy.

Source: US Bureau of Labor Statistics; EY-Parthenon

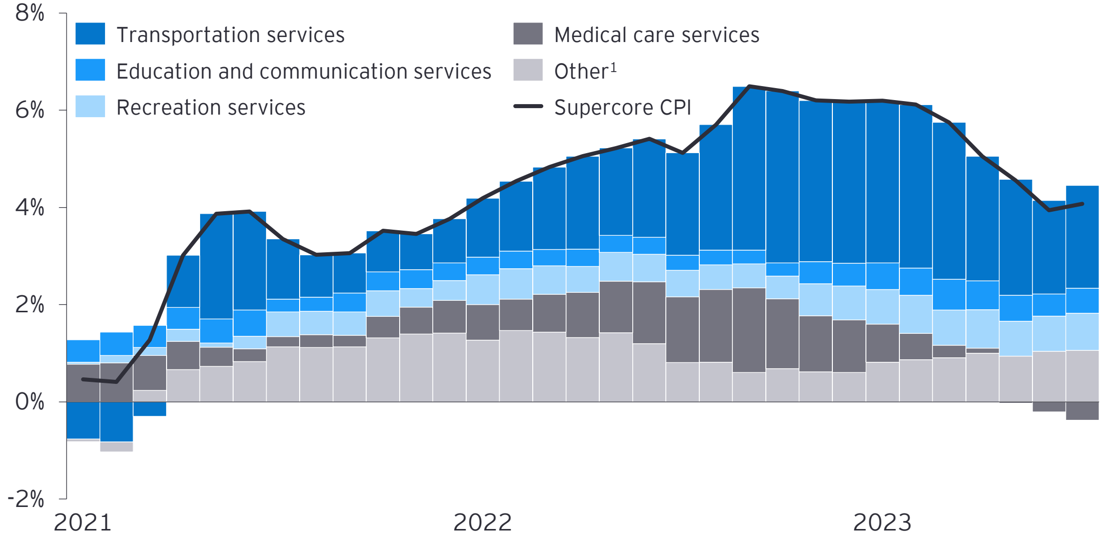
EY Parthenon

Elevated services inflation is now the main core inflation driver, and moderating shelter and transportation prices should lead to further disinflation

US y/y growth in rent
March 2017–July 2024F



US y/y growth in core CPI services excluding shelter
January 2021–July 2023



- Services inflation remained elevated in July, rising 5.7% y/y for a second consecutive month with housing inflation accounting for 75% of the monthly gain. Encouragingly, housing disinflation is gaining momentum. Shelter costs rose a moderate 0.4% m/m for a second consecutive month in July, with rent prices rising 0.4% m/m – their lowest print since March 2022 – and owners' equivalent rent rising 0.5% m/m.
- We're clearly past peak inflation on the housing front, with shelter cost inflation showing a gentle easing from 8.2% y/y in March to 7.7% y/y in July. Housing disinflation will pick up momentum in the coming months. The Zillow Rent Index, which captures rents of units currently advertised on the open market, points to a rapid cooling in CPI inflation toward 5% by year-end.
- Given the expected decline in rent inflation, the trajectory of core services inflation excluding shelter costs, which makes up a quarter of the CPI basket, will be critical to the inflation outlook. This "supercore" measure, which is closely watched by the Fed, rose 0.2% m/m in July – slightly faster than in June but still down from the 0.4%–0.5% pace at the start of the year. Importantly, we believe this measure isn't as good at capturing the pass-through from wage pressures as the Fed has indicated.
- With the strong disinflationary impulse from commodity and goods prices now over, further disinflation in supercore inflation will be needed to bring inflation closer to the Fed's 2% target. Transportation services[2] prices will be particularly important to watch. They have accounted for about half of supercore inflation over the past year, with price increases concentrated in travel and auto-related services such as car insurance and repair.

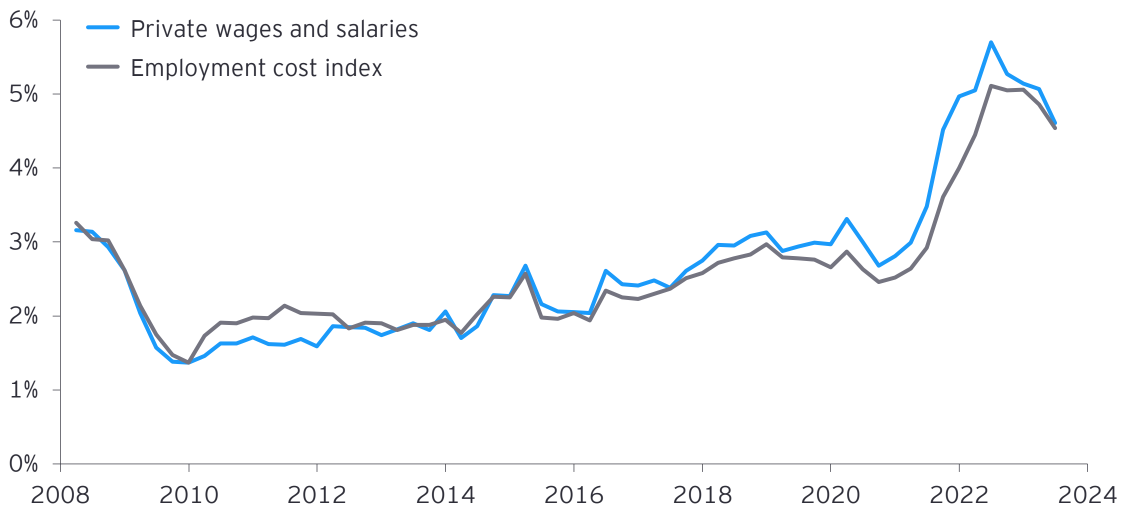
1. Includes water, sewer and trash collection services; household operations; and other personal supercore services.
2. Includes leased vehicles, vehicle rental, vehicle maintenance and repair, vehicle insurance, vehicle fees, and public transportation (including airline fares).

Source: US Bureau of Labor Statistics; Zillow; EY-Parthenon

EY Parthenon

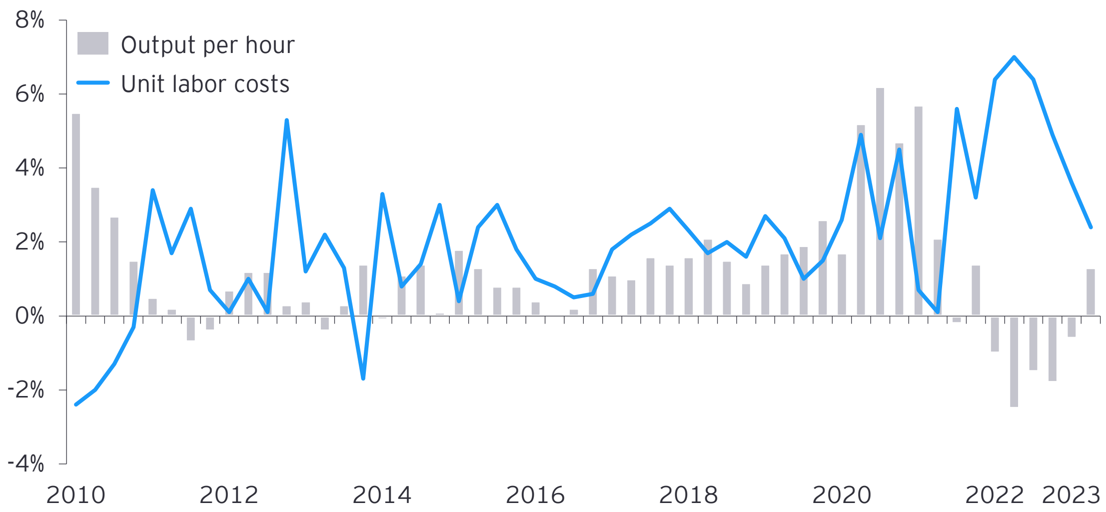
Wage pressures have begun to moderate amid a gradual loosening of labor market conditions; rebounding productivity growth could also help ease labor cost pressures

US y/y percentage change in employment cost index
Q1 2008–Q2 2023



- While wage growth remains well above the Fed's comfort zone, the latest ECI data points to a gentle moderation in labor cost pressures amid signs of labor market rebalancing. The Employment Cost Index (ECI) posted a 1.0% quarter over quarter (q/q) advance in Q2 – the slowest pace in two years and much lower than the 1.2% average gain over the past four quarters.
- Encouragingly, headline ECI compensation fell 0.3ppt to 4.5% y/y, its slowest pace since Q1 2022, though still well above the 3% pre-pandemic pace. Meanwhile, private sector wage growth fell a notable 0.5ppt to 4.6% y/y – its lowest since Q3 2021 and 1.1 ppt below its Q2 2022 peak of 5.7%. Looking ahead, we continue to expect a moderation in wage gains in the coming months as labor market conditions soften and the demand for workers comes closer into balance with a rebounding labor supply.

US y/y percentage change in productivity and unit labor costs
Q1 2010–Q2 2023

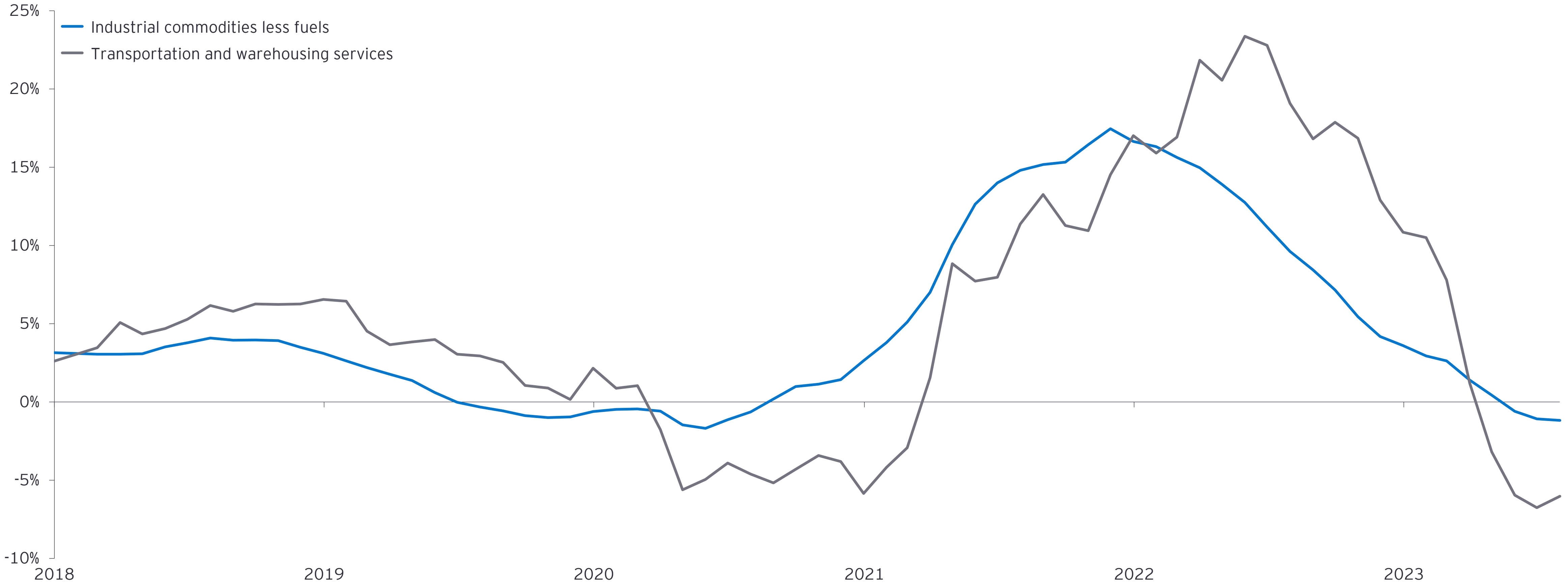


- Productivity bounced back strongly in Q2, rising at a stronger-than-expected 3.7% annualized clip. The trend in productivity growth climbed back in positive territory for the first time since 2021, up 1.3% y/y in Q2. When accounting for the stronger productivity trend, unit labor costs rose a modest 1.6% annualized in Q2, pointing to an environment where labor cost pressures are gradually easing.
- The revival in productivity growth echoes anecdotal evidence we are picking up from our conversations with business executives. With the increasing value and cost of labor and the higher cost of capital, we have seen several examples of businesses focusing on ways to boost labor productivity and process efficiency via greater retention efforts, long-term training programs and the incorporation of new technologies, including generative AI, machine learning and quantum computing.

Source: US Bureau of Labor Statistics; EY-Parthenon

Easing commodities and logistics costs are alleviating pressures on producers as well as for consumers at checkout

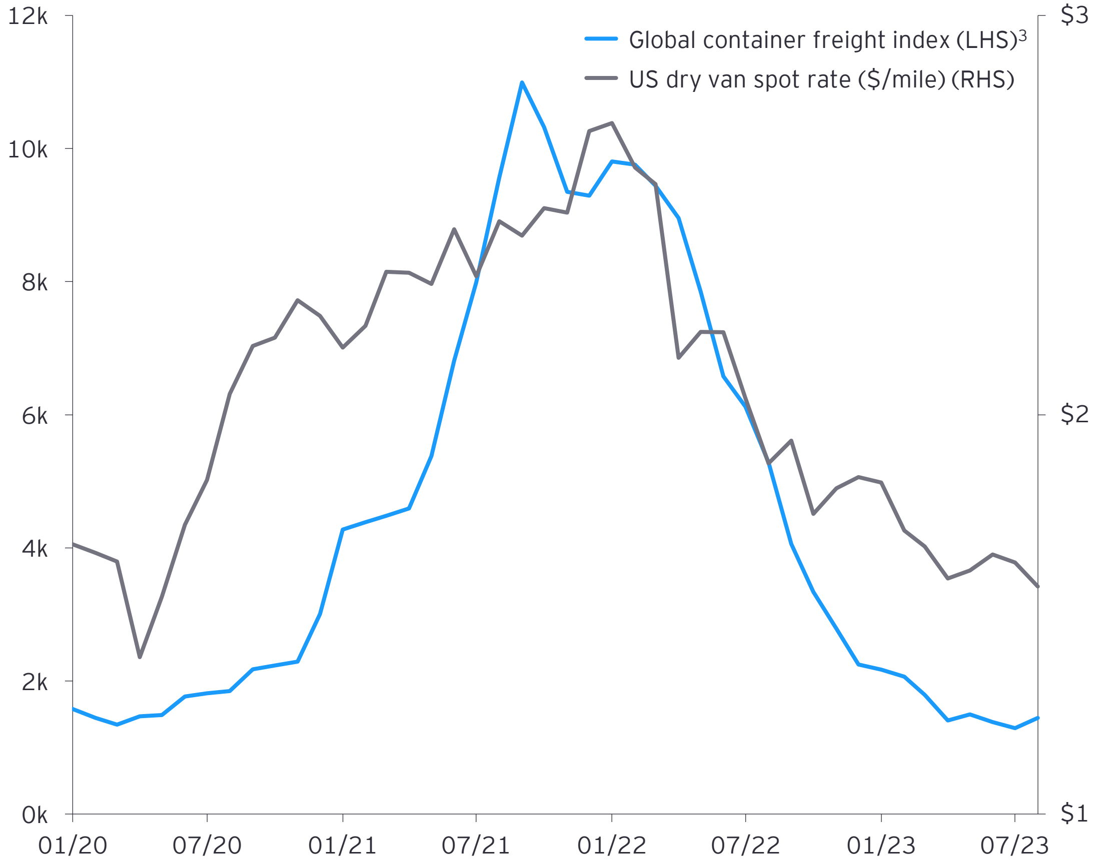
US y/y percentage change in PPI (producer price index)
January 2018–July 2023



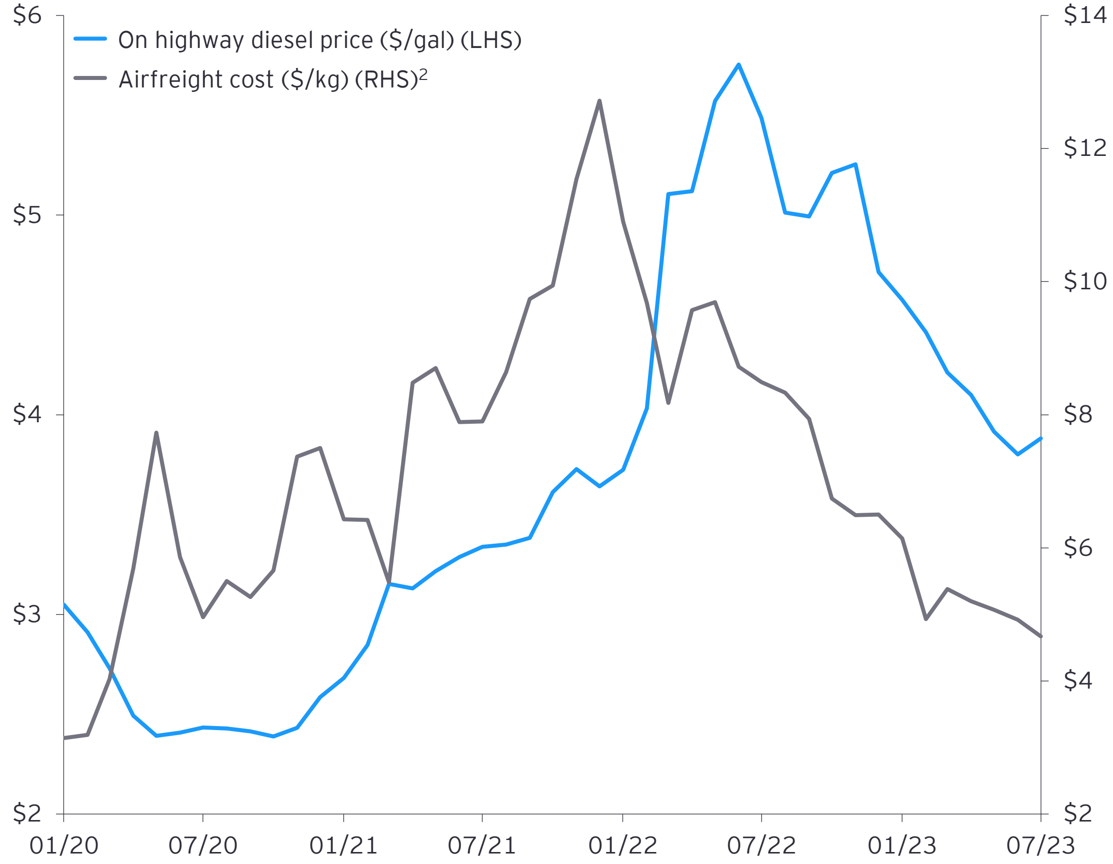
Source: US Bureau of Labor Statistics; EY-Parthenon

Shipping and logistics costs have continued to ease on reduced global demand, softening supply constraints and declining energy prices

Ground transportation index and rates
January 2020–August 2023[1]



US transportation unit costs
January 2020–July 2023[1]



1. Airfreight cost and on highway diesel price data only through July 2023.
2. Cost per kg from Hong Kong to North America.
3. Indexes measures the change in pricing along the main lanes for the cost of a 40-ft-equivalent (FEU) container, taking the weighted average of individual lane indexes. Freightos index is derived from a weighted average of 12 routes between Asia, US, Europe and South America.

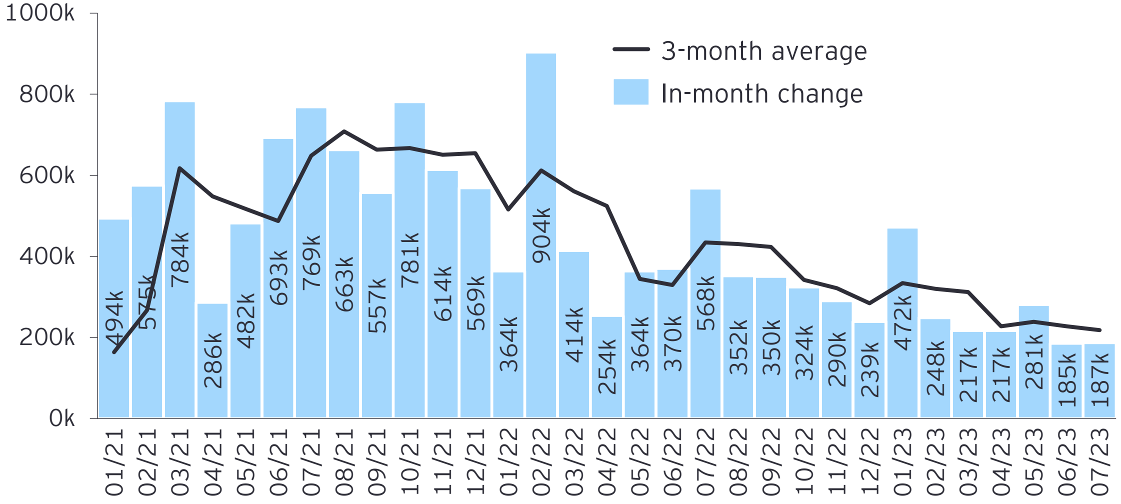
Source: Freightos; Arrive Logistics; Air Cargo News; Energy Information Administration; EY-Parthenon

EY Parthenon

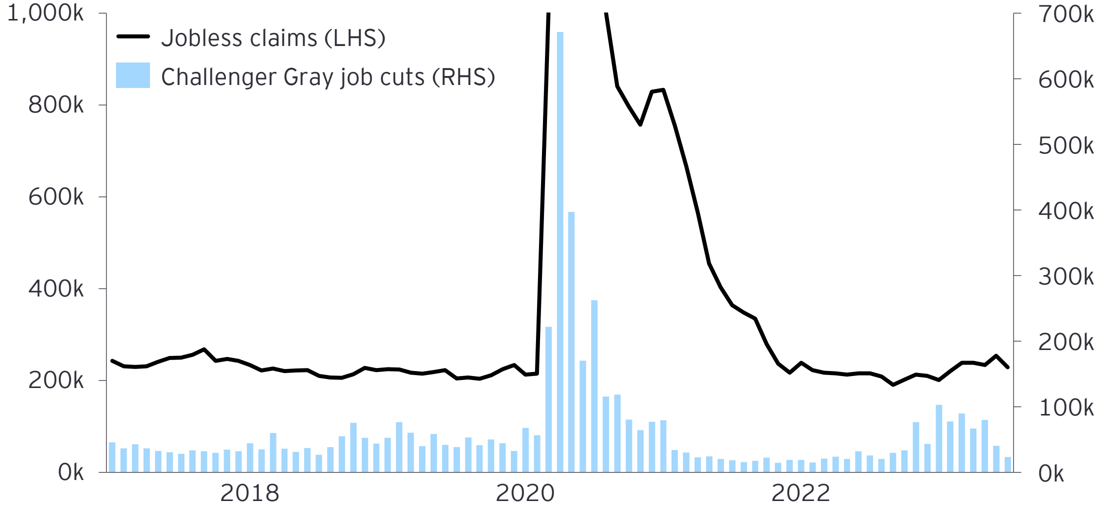
Agenda

Job growth continues to gradually cool, and the slowdown will extend into next year as higher interest rates and a softer domestic demand take a toll on hiring

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



US jobless claims and cuts
January 2017-July 2023

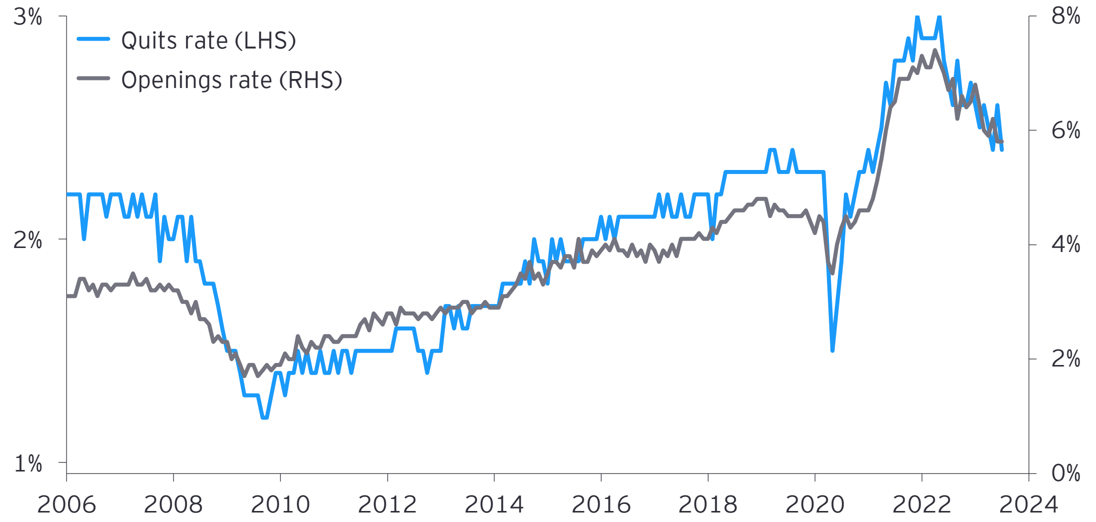


- The labor market continues to show signs of cooling. The pace of hiring slowed further in July with the economy adding 187k jobs, in line with the June gain. Moreover, net revisions to the prior two months showed 49k fewer jobs than previously reported, bringing the three-month moving average for payroll growth down from 228k to 218k in July, the slowest since January 2021.
- Employment in services rebounded by 154k after a sluggish 97k increase in June, while hiring in goods-producing industries rose by 18k after a 31k gain the prior month. Overall, employment gains were less broad-based, as the employment diffusion index – a measure of how many private sector industries are adding jobs – narrowed from 58.8 to 57.2 in July – the second lowest level since April 2020.
- Despite the slower pace of hiring, the labor market remains tight. The unemployment rate ticked 0.1ppt lower to 3.5% in July – a touch above the 54-year low reached in January and April of this year. New weekly filings for jobless claims, a proxy for layoffs, had been on a slight uptrend since the start of the year but have fallen back modestly in recent weeks, confirming that layoff activity remains low.
- We expect labor market conditions to soften further in coming months with slower hiring, strategic resizing decisions and wage growth compression. We foresee the unemployment rate rising toward 3.8% by year-end and 4.4% in mid-2024.

Source: Challenger; Gray & Christmas; US Bureau of Labor Statistics; EY-Parthenon

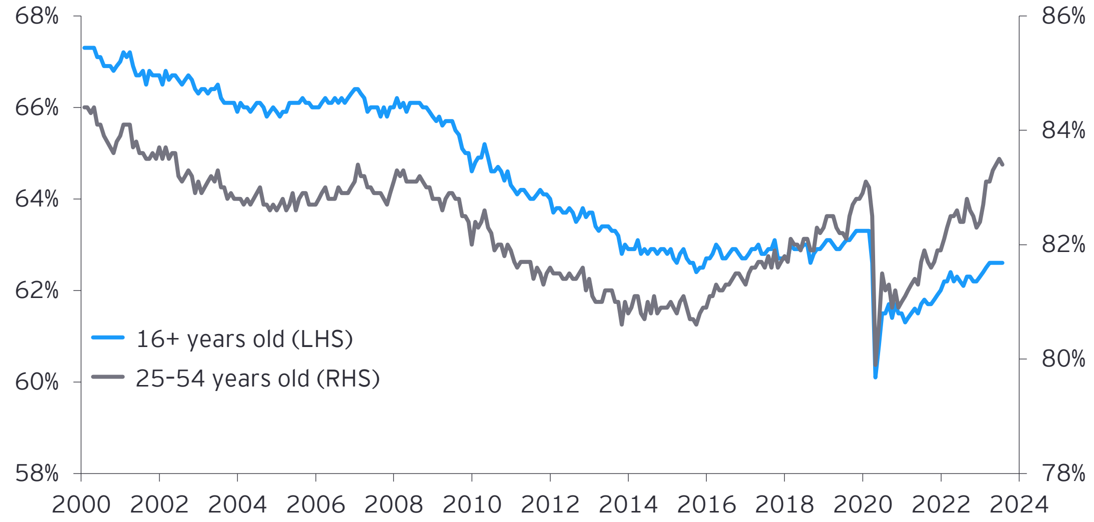
The post-pandemic labor market rebalancing via easing labor demand and a sustained rebound in labor supply is very encouraging, as it should help ease wage-cost pressures

US job openings and quits rates
January 2006–June 2023



- Job openings were down modestly in June, falling by 34k to 9.58m, their lowest level since April 2021. Even so, openings remain more than 2m above pre-pandemic levels. The hiring rate decreased 0.2ppt to 3.8%, while the quits rate, which reflects workers' confidence in the jobs market, fell back to 2.4%, just above its pre-pandemic level.
- The ratio of job openings per unemployed worker, which is closely watched by Fed officials, remained unchanged at 1.61 in June, its lowest level since October 2021. Overall, the data suggests that while conditions have moderated slightly, labor market tightness persists.

US labor force participation rates
January 2000–July 2023



- One encouraging development pointing to a continued labor market rebalancing is the rebound in the labor supply in recent months. The labor force participation rate held steady for a fifth straight month at 62.6% in July (reflecting the constraint of an aging workforce), and participation among the key prime-age cohort (25- to 54-year-olds) ticked down 0.1ppt to a still-elevated 83.4% in July after reaching a 15-year high in June.
- The strong recovery in prime-age labor force participation is a sign that robust (albeit slowing) labor demand is pulling workers back into the labor force. Reduced labor supply pressures could also help alleviate excessive wage inflation pressures.

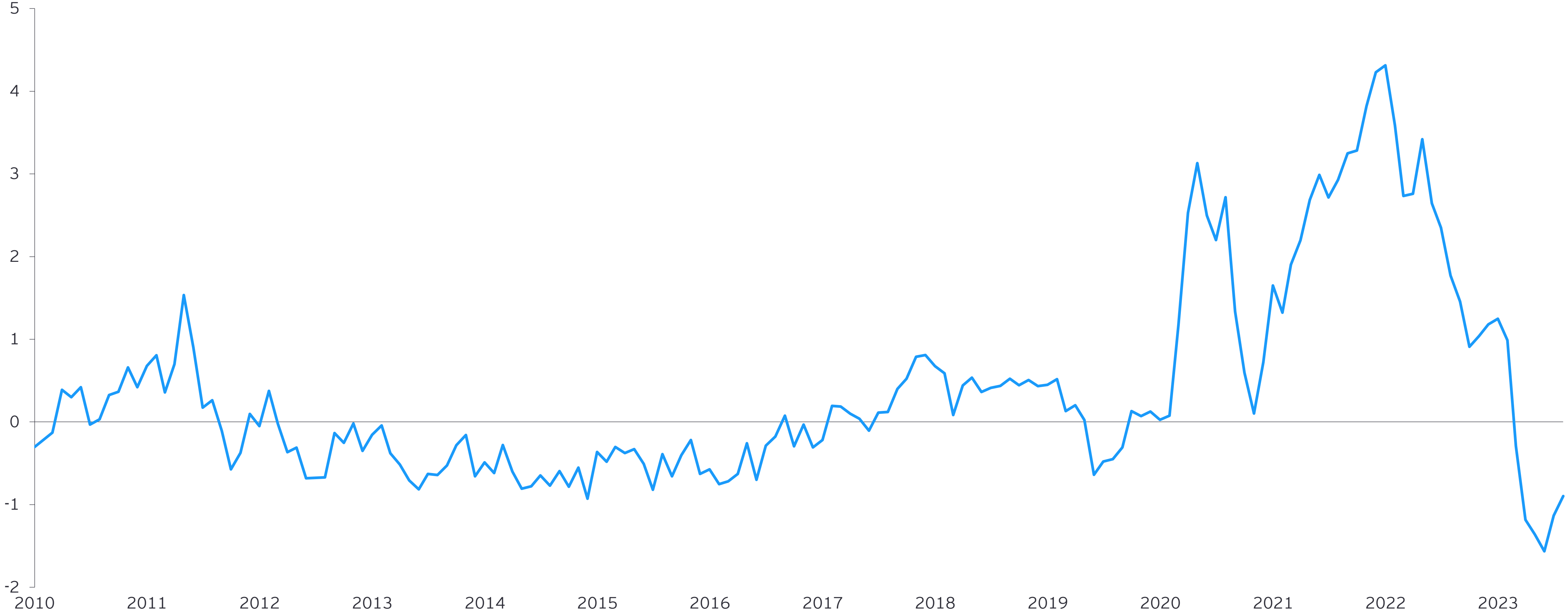
Source: US Bureau of Labor Statistics; EY-Parthenon

Agenda

- Macroeconomic backdrop
- **Sector trends and perspectives:**
  - State of the sector
  - Inflation
  - Talent
  - **Globalization**
  - Financial conditions and transaction activity
- Key EY contacts

Supply chain pressures that have characterized the last two years are loosening; however, nuanced geopolitical situations still loom as challenges

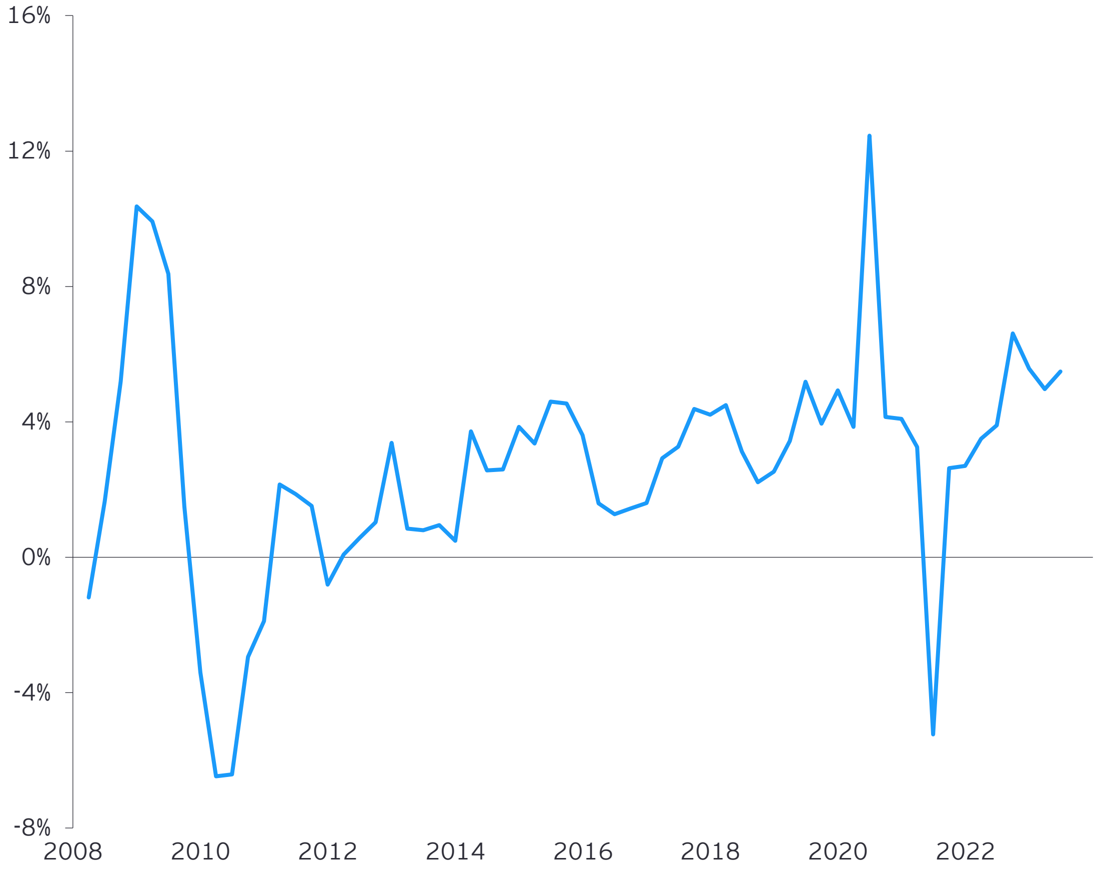
Global supply chain pressure index (GSCPI)[1]
January 2010–July 2023



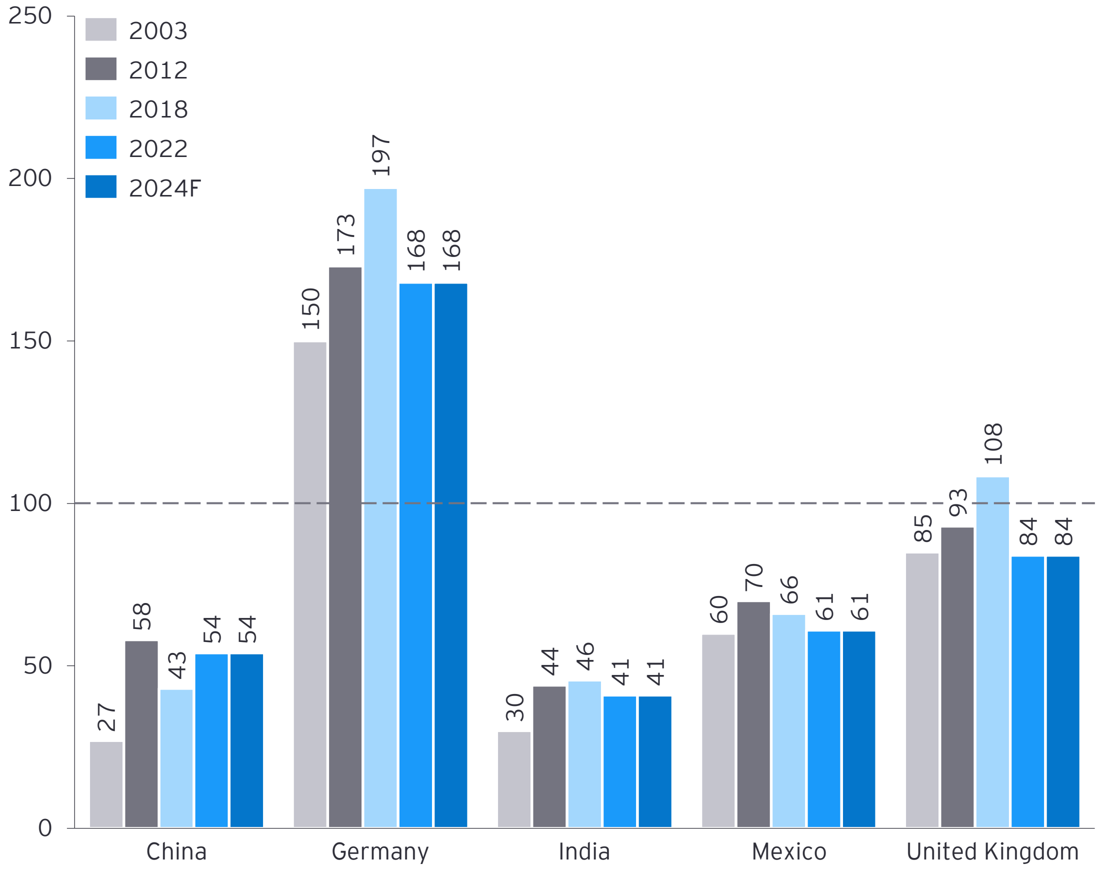
1. Index scaled by its standard deviation (0 = average value).
Source: Federal Reserve Bank of New York; Institute for Supply Management; EY-Parthenon

While US manufacturing unit labor costs continue to increase, the global cost landscape is shifting when considering productivity trends and foreign exchange rates

US manufacturing sector y/y percentage growth in unit labor cost
Q1 2008-Q2 2023



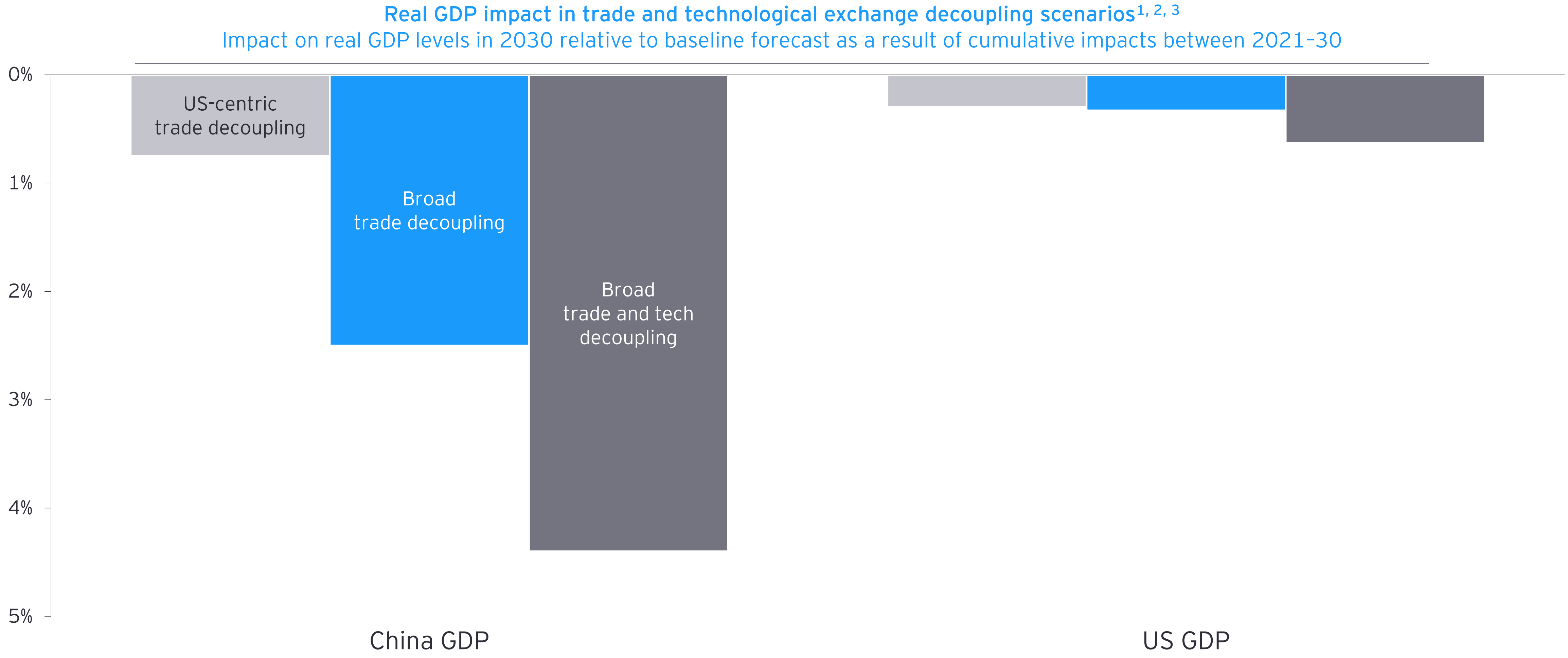
Global manufacturing unit labor costs relative to the US
2008-24F (US=100)[1,2]



1. Wages adjusted for productivity and exchange rates.
2. Global manufacturing unit labor costs relative to US.

Source: US Bureau of Labor Statistics; US Bureau of Economic Analysis; Oxford Economics; the Conference Board International Labor Comparisons program; EY-Parthenon

The combination of trade and technological decoupling would lead to a significant drag on global economic activity, with China suffering a larger impact



1. US-centric trade decoupling: Sharp rise in trade barriers between the US and China and a lesser rise involving other US allies.
2. Broad trade decoupling: US, NAFTA (North American Free Trade Agreement), Japan, Korea, Taiwan and western European economies raise trade barriers with mainland China and vice versa.
3. Broad trade and tech decoupling: In addition to "broad trade decoupling" scenario measures, US and EU simultaneously cut off access to all new technology and vice versa.

Source: Oxford Economics

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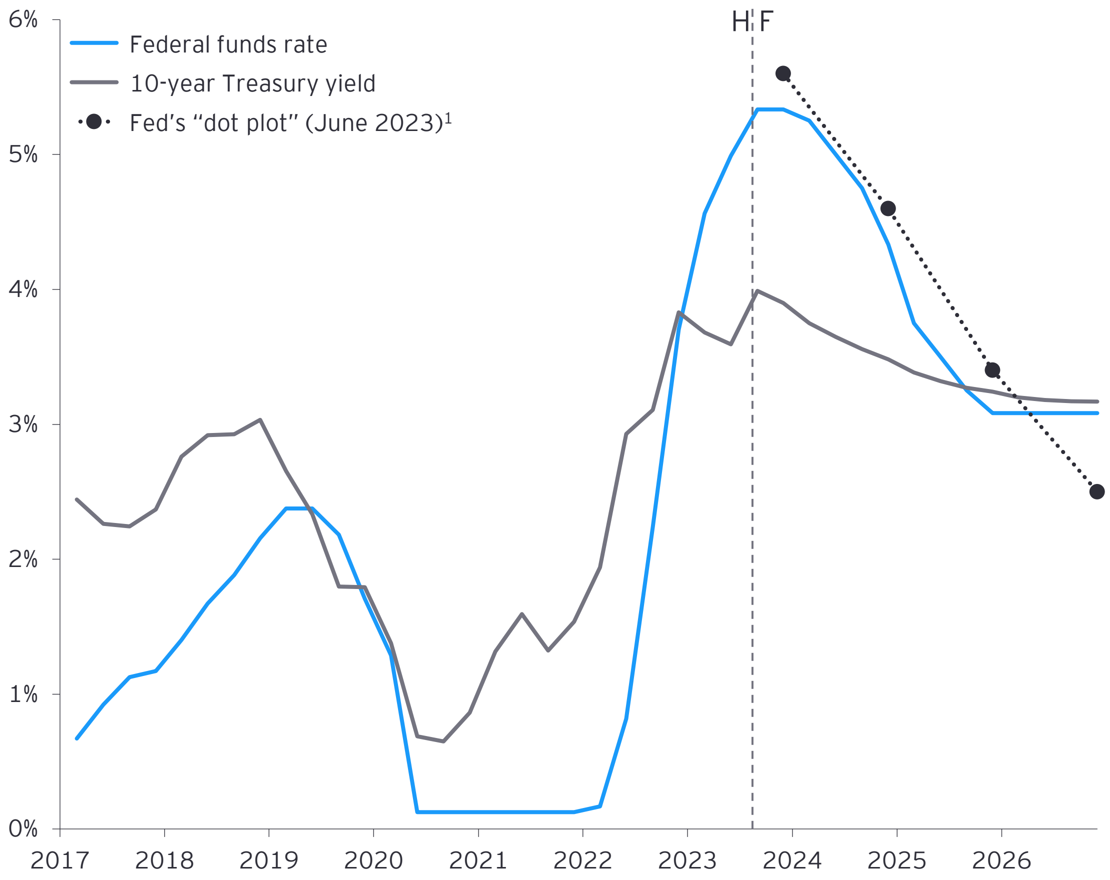
The Fed has likely reached the end of its hiking cycle, but it will maintain a hawkish lean in considering how long to maintain a restrictive stance; cuts are unlikely before March

US interest rate forecasts, federal funds rate and 10-year Treasury yield
Q1 2017–Q4 2026F



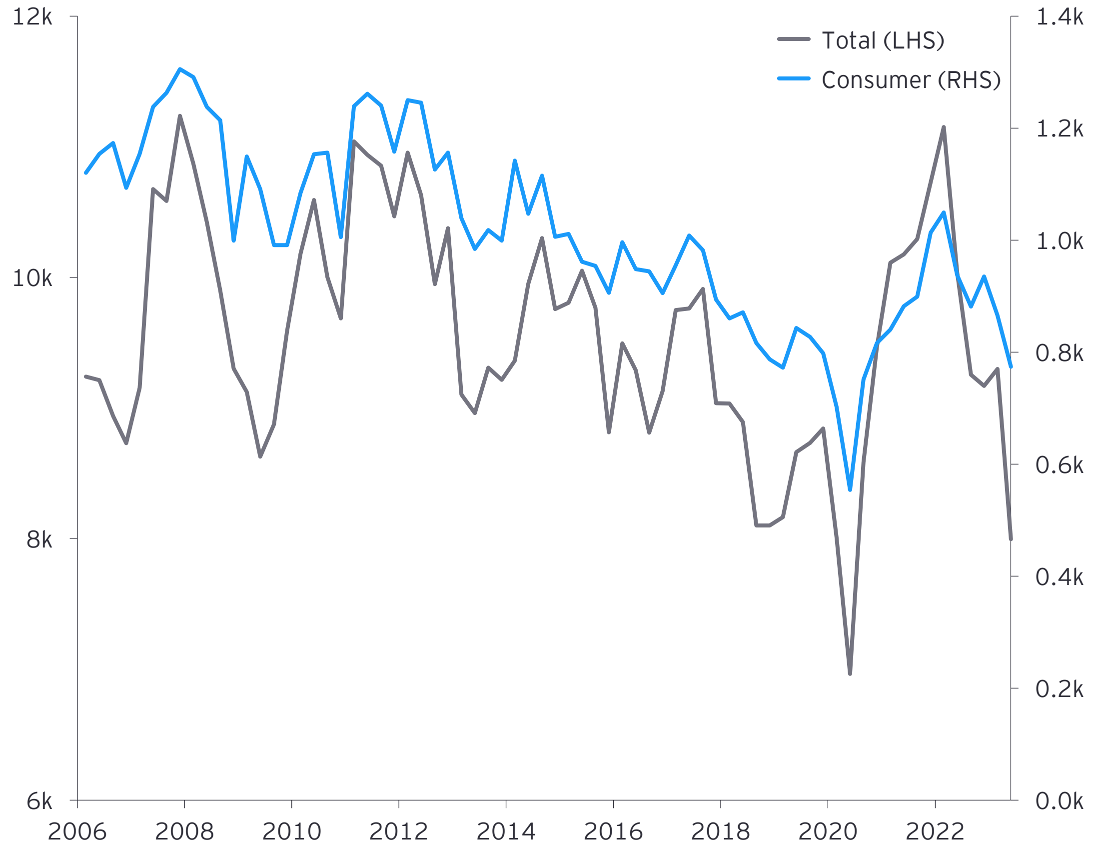
- As widely anticipated, the Fed raised the federal funds rate range by 25 basis points to 5.25%–5.50% at the July FOMC meeting, more than likely marking the end of a historic tightening cycle. Still, Fed Chair Jerome Powell maintained a hawkish posture during the press conference to avoid an undesired easing of financial conditions.
- The hawkish language from the June statement was maintained, noting that "in determining the extent of additional policy firming that may be appropriate," the Committee would factor the 500bps of rate hikes so far and the long and variable lags of monetary policy effects on economic activity and inflation.
- During the post-meeting press conference, Powell reiterated that core inflation remained elevated and that policy had not been restrictive enough for long enough to have its full desired effects. He noted that a more gradual pace of tightening did not entail the Fed going at every other meeting, but instead that it could be two out of three meetings, thereby ensuring the perception that September could be "live."
- The FOMC July meeting minutes revealed that almost all participants favored raising the federal funds rate by 25bps to 5.25%–5.50%, with only a couple of participants indicating that they favored leaving the target range unchanged. Most participants continued to see "significant" upside risks to inflation, which could require further tightening of monetary policy.
- Interestingly, FOMC participants continue to view a period of below-trend GDP growth and softening labor market conditions as necessary to bring inflation down toward the 2% target. This echoes Powell's remarks that while a path to a soft landing was possible, he didn't believe in the so-called "immaculate disinflation."
- Given our inflation and employment outlook, we remain of the view that the Fed will keep the federal funds rate unchanged in September and that, by the November FOMC meeting, there will be ample evidence that headline and core PCE inflation should close the year around 3.1% and 3.5%, respectively. While we believe most voting policymakers will favor holding monetary policy in restrictive territory rather than tightening it further, unanimous votes may become a relic of the past.

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.

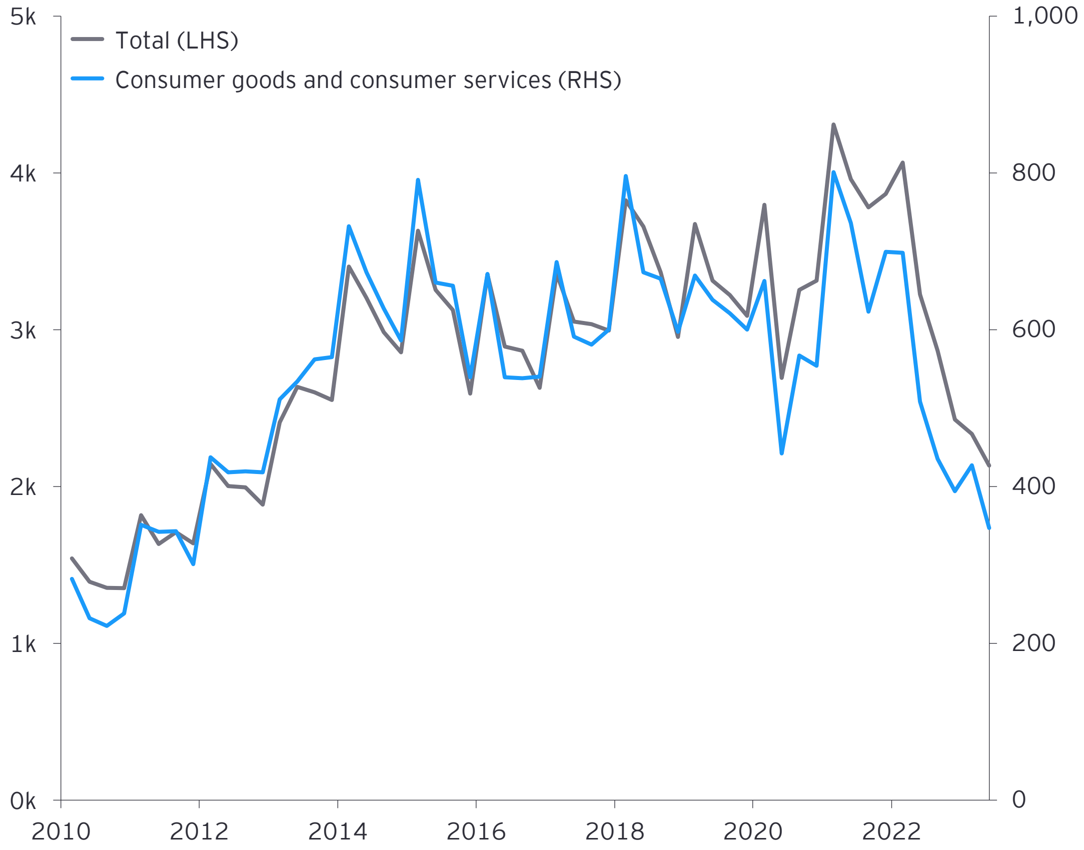
Source: Federal Reserve Board; EY-Parthenon

M&A and venture capital deal volume has slowed materially in the last ~12 months broadly as well as within the consumer industry specifically

Global M&A activity by volume
Q1 2006–Q2 2023



US equity financings for venture-backed companies by volume
Q1 2006–Q2 2023

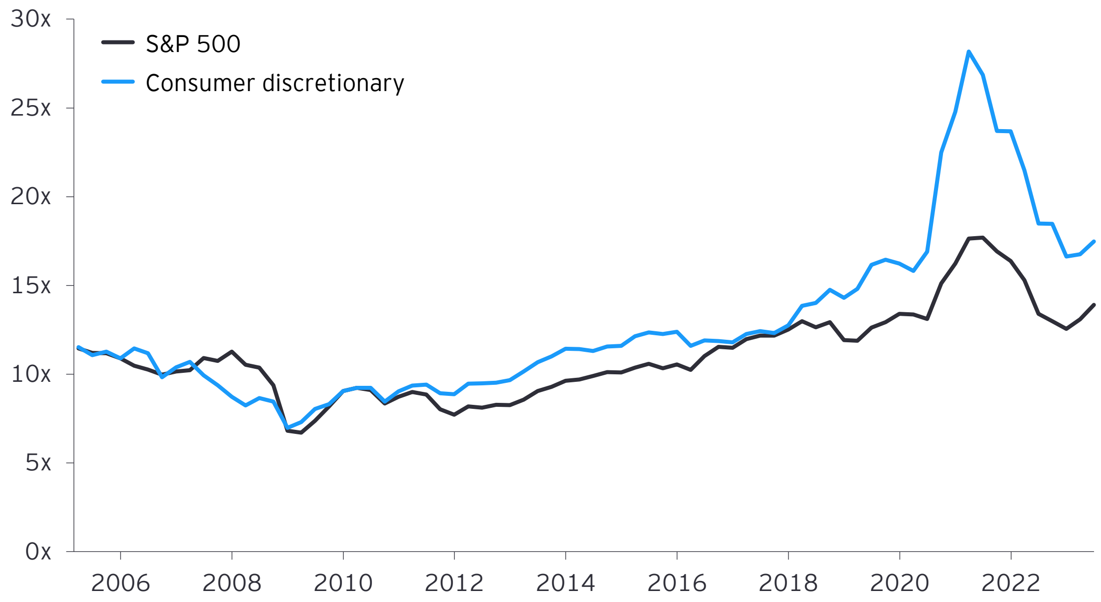


Source: White & Case; Crunchbase; EY-Parthenon

EY Parthenon

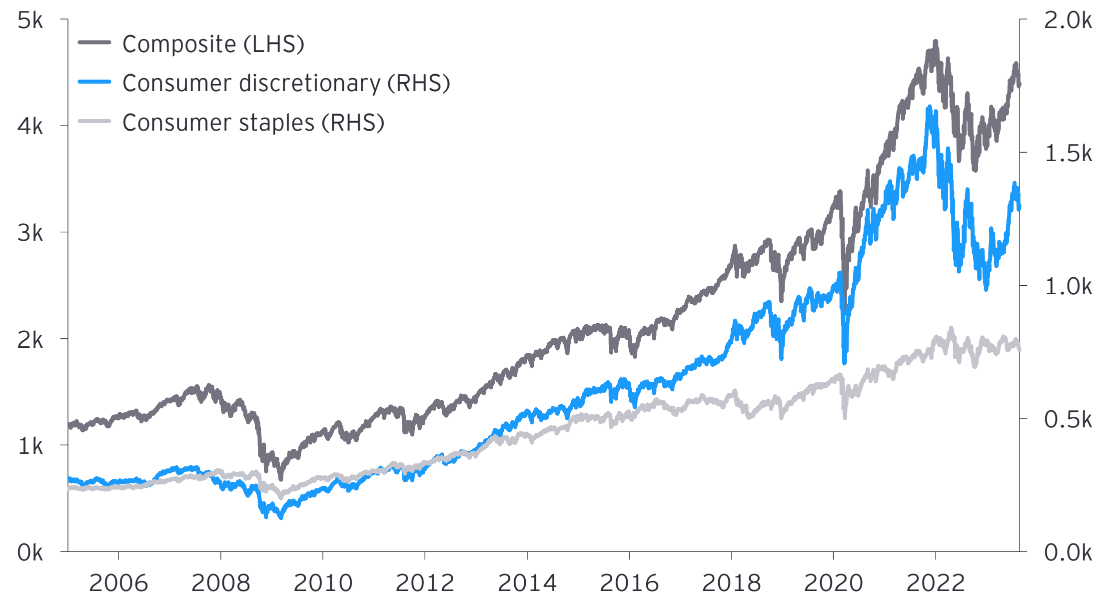
Public market multiples in the consumer space have reverted to pre-COVID-19 levels, as enterprise value/EBITDA multiples in the broader market dropped from record highs

Public market multiples[1]
Q1 2005–Q2 2023



- Valuation multiples in the consumer sector followed S&P 500 enterprise value multiples and dropped back to levels seen before the onset of the COVID-19 pandemic. While consumer multiples have historically tracked broad market multiples, the spike in valuation multiples within consumer was much more pronounced in 2021.
- Multiples for the consumer discretionary are currently at around 17.5x and ticking upwards, compared to S&P 500 multiples at 13x–14x.

S&P 500 indexes
January 2005–August 2023



- The index for consumer staples did recover from the COVID-19 crash but did not partake in the equity valuation surge seen in the broader market or compared to consumer discretionary. Similarly, it did not experience the drop from recent highs and subsequent bounce but was trending sideways since 2022.

1. Total enterprise value to EBITDA multiple, quarterly average.

Source: Capital IQ; EY-Parthenon

EY Parthenon

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EY Parthenon

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Explore the practice's Future Consumer Index for timely perspectives and point of views

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Individuals above are members of Ernst & Young LLP.
Please direct initial questions and requests to Dan, Henry and Ritik.

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