McKinsey & Company

2023, a Testing Year

U.S. Macro Economic Overview: Past and Present Indicators, and Future Scenarios

Strategy & Corporate Finance Practice, Risk & Resilience Practice, and the McKinsey Global Institute

June 8, 2023

US macro in eight numbers

Current expectation is flat to negative GDP growth for 2023

5.5%

April 2023 Core CPI. Momentum has shifted from headline to core. Fed will not cut

+3.2M

Excess job openings in March with near 50-year low unemployment rate of 3.5%

+4.3T

Additional cash put in the bank by US consumers from 2019Q4 to 2022Q4

>7%

Fed funds rate risk if Fed struggles to slow momentum in the labor market and inflation

~1/2 CPI

Excess price increases passed to consumers because of cyclical demand and wage pressures

2X

Increase in **wage rate growth** vs. pre-COVID-19

63.5

Consumer confidence remains near lowest levels seen since GFC, but improving

-1.7%

2024 downside GDP growth in scenario with entrenched inflation and aggressive tightening vs. 0.4% and 2.0% upsides

Source: BLS; Bureau of Economic Analysis; Federal Reserve Board; NBER; University of Michigan; McKinsey analysis, in partnership with Oxford Economics; McKinsey analysis

Agenda

US macro snapshot: inflation and interest rates

US macro snapshot: labor markets and the consumer

Scenarios to test your tactics and strategy

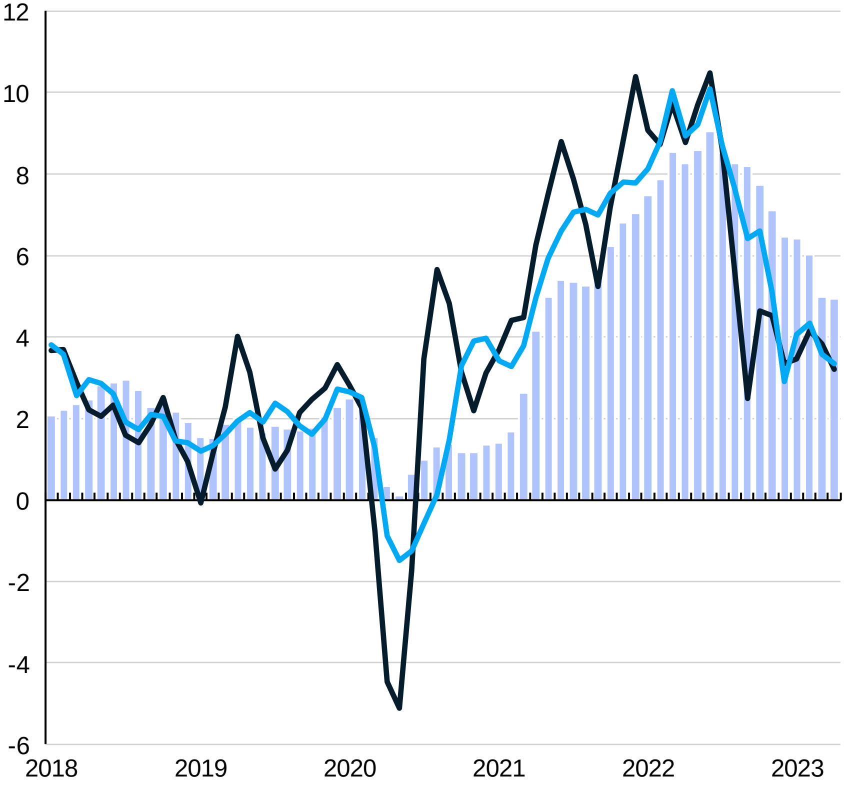
US inflation peaked, but Core CPI growth remains uncomfortably high

Inflation rates are remaining steady or declining on a 3- and 6-month annualized basis

3-mo 6-mo. 12-mo.

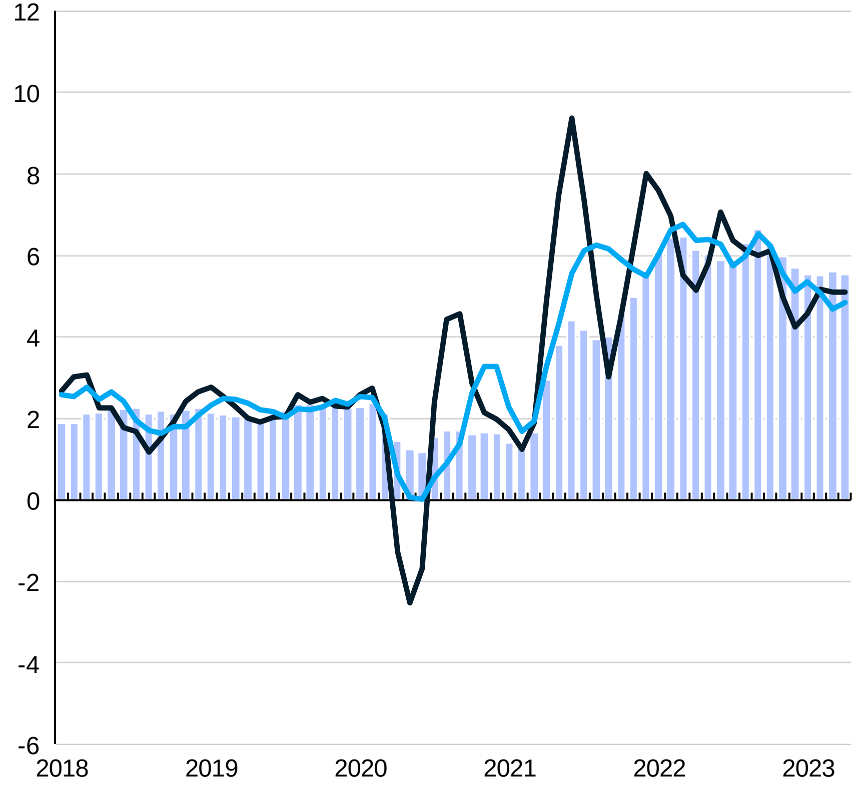
Change in headline CPI—all items

Annualized percent change, through April 2023



Change in core CPI—all items excluding food & energy

Annualized percent change, through April 2023



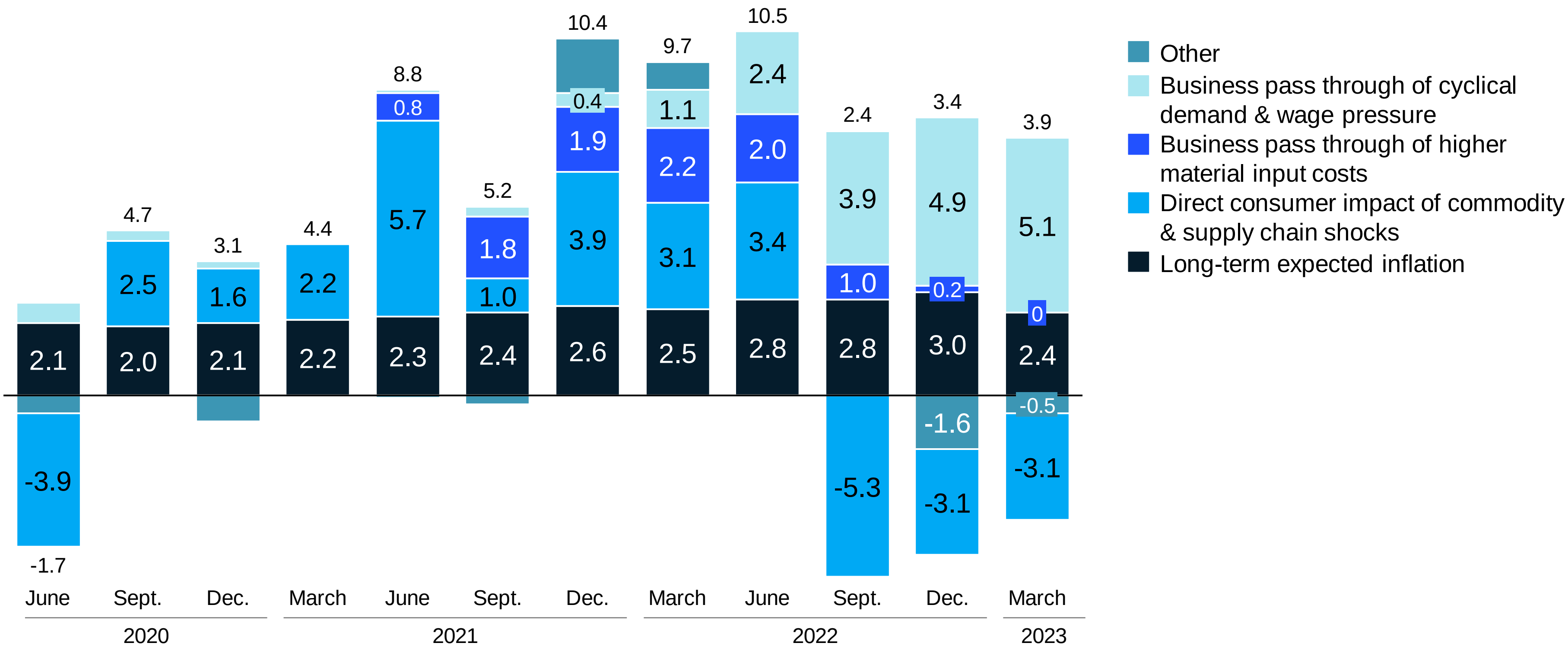
Source: BLS, McKinsey analysis

Demand-driven wage pressures have taken over as the dominant drivers of US inflation

Fall in commodity prices has helped bring down headline inflation

US Consumer Price Inflation

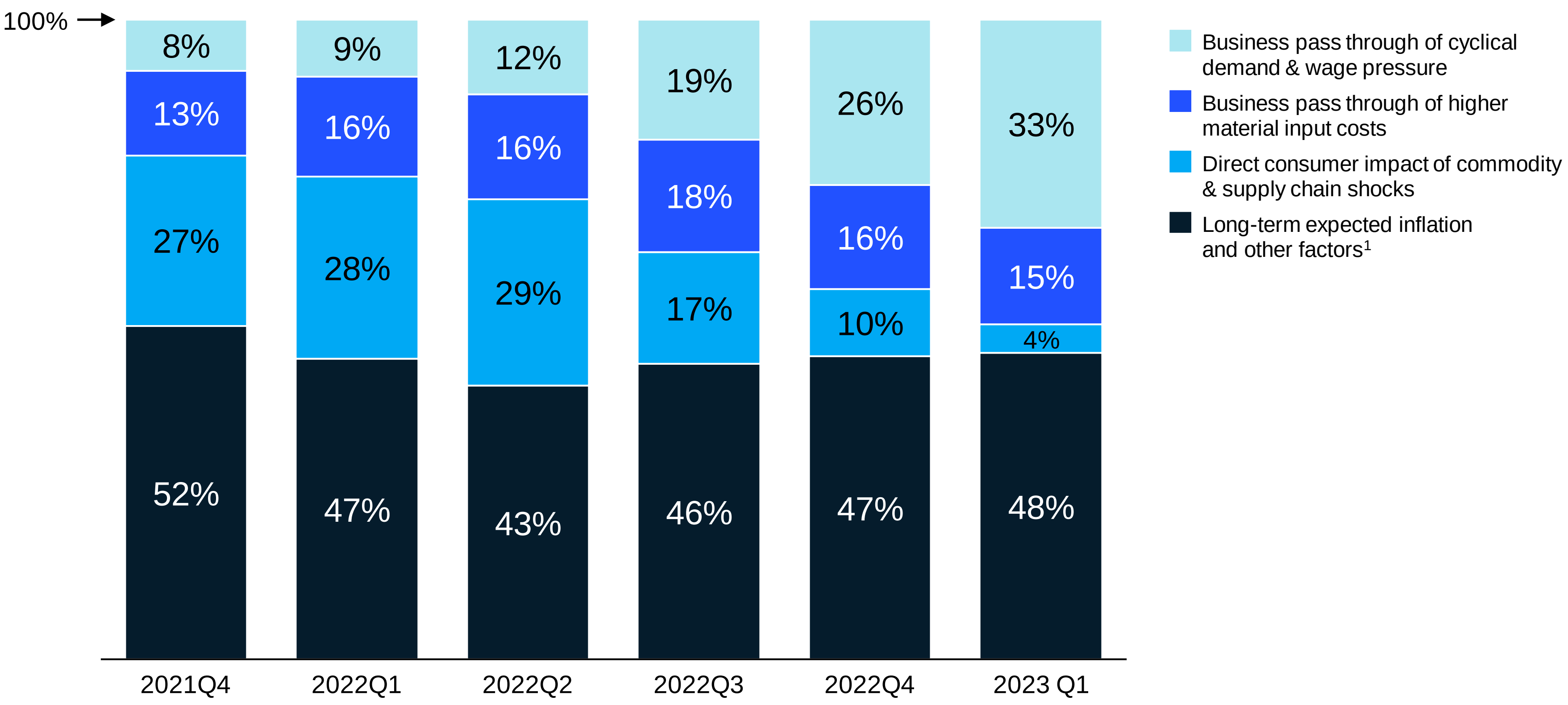
Percent, 3-month annualized change



Commodity & supply chain shocks were major causes of inflation through 2022Q2 when wage pressures started increasing materially

Wage pressures and cyclical demand factors now explain a third of cumulative inflation since 2020 Q1

Drivers of cumulative US Consumer Price Inflation
Percent contribution to total inflation from 2020Q1 to end-date



1. "Other factors" are small, contributing 0-3 percentage points to total

Source: Laurence M. Ball, Daniel Leigh, and Prachi Mishra, "Understanding U.S. Inflation During the COVID Era", Brookings Institution, September 2022; Regis Barnichon, Luiz E. Oliveira, and Adam H. Shapiro "Is the American Rescue Plan Taking us back to the '60s?", FRSFB Economic Letter, October 2021, BLS, Federal Reserve Banks of Cleveland and Philadelphia, McKinsey analysis

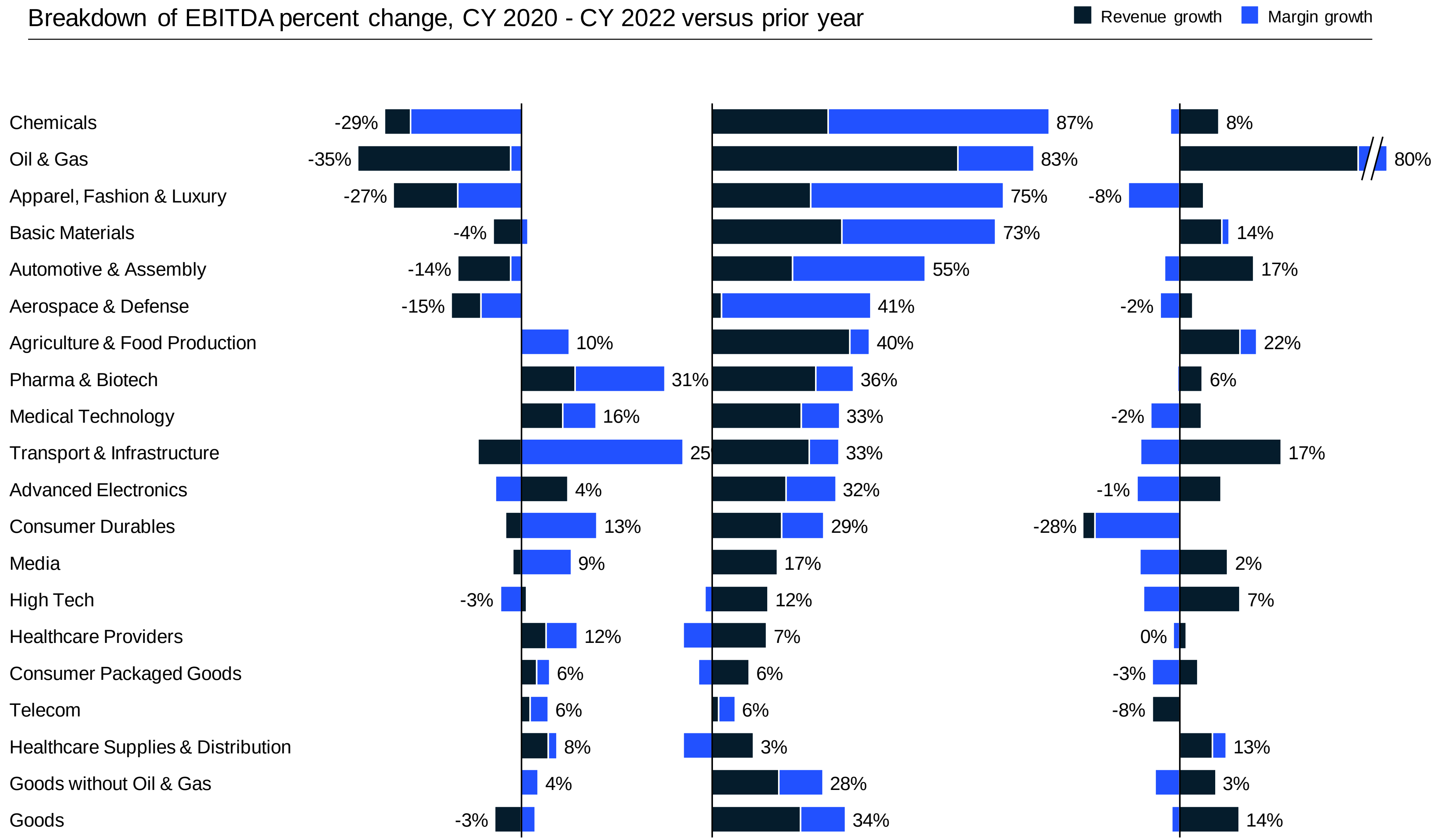
“”

I think the biggest thing is that after the experience of the last couple years, businesses have now understood that pricing is a lever again. And as I talk to the folks in my district, I'm hearing people still out there pushing price to try and test where the levels of in-elasticities really are

Tom Barkin, Richmond Fed President, February 15, 2023

The impact of the goods industry-wide growth wave of 2021 is unwinding, reducing pricing power and compressing margins

Breakdown of EBITDA percent change, CY 2020 - CY 2022 versus prior year

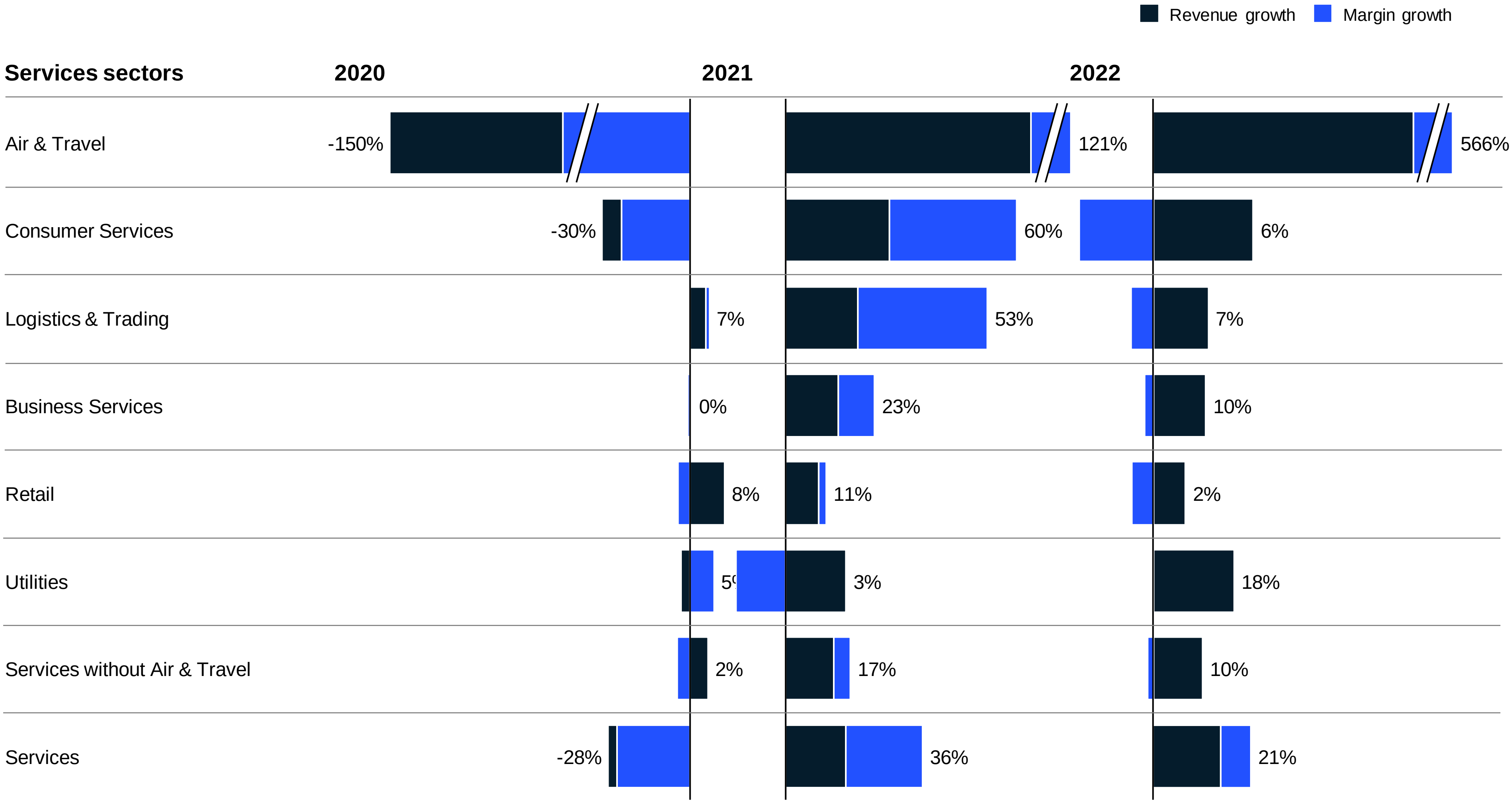


Note: Sample includes goods companies within the set of the 2,000 most valuable US companies with Q4 2022 EBITDA and revenue data available. Excludes Big Tech (5 companies). N = 867. Years are aligned with calendar years for companies with fiscal years that do not end in December

Source: S&P Global Market Intelligence, McKinsey Corporate Performance Analytics

Services companies are also starting to experience margin compression

Breakdown of EBITDA percent change across time periods, CY 2020 - CY 2022 versus prior year



Note: Sample includes services companies within the set of the 2,000 most valuable US companies with Q4 2022 EBITDA and revenue data available. N = 227. Years are aligned with calendar years for companies with fiscal years that do not end in December

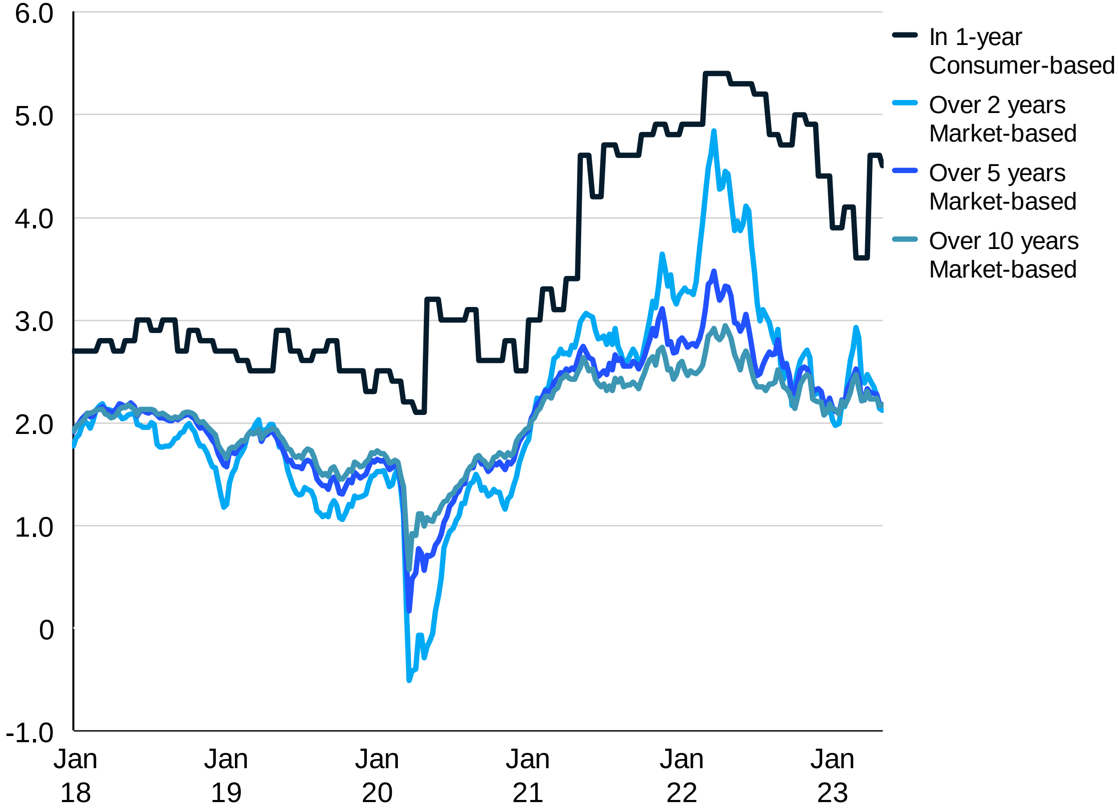
Source: S&P Global Market Intelligence, McKinsey Corporate Performance Analytics

The Fed continues to win “hearts and minds” in the bond market

5- and 10-year expectations continue to remain where the Fed wants them

Expectations of future inflation over coming years

Percent, through May 5, 2023



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We believe that events in the banking system over the past two weeks are likely to result in tighter credit conditions… It is too soon to determine the extent of these effects and therefore too soon to tell how monetary policy should respond. As a result, *we no longer state that we anticipate that ongoing rate increases will be appropriate to quell inflation; instead, we now anticipate that some additional policy firming may be appropriate.*

Fed Chair Jerome Powell, March 22, 2023

Source: BLS, Haver Analytics, Federal Reserve Board, McKinsey analysis

We see two potential scenarios for Fed action to keep an eye on

Persistent wage and price inflation creating upside risks for rates

Maintain data-dependent stance

Continue to raise interest rates (e.g., by a steady 25 basis points at each meeting)

- Look for multiple readings on core inflation show month-on-month declines
- High likelihood of recession, as signals on declining inflation show up in the data with a time lag relative to declining activity.

Make "the call" to stop raising rates

Make a bet that tight financial conditions will bring core inflation down and deliver a soft landing

- Former Fed Chair Greenspan made the bet in the late 1990s could sustain full employment without overheating
- Greenspan stopped raising rates despite uncomfortably high inflation with no clear data on productivity

The Fed's Jackson Hole retreat in late August may be the next critical turning point

- There will be four more core CPI readings and three meetings of the Federal Open Market Committee before August
- Jackson Hole could be the moment Powell declares victory if the economy shows signs of soft landing.
- Jackson Hole could also be when Powell is forced to admit "continuing challenges" because of a recession, or because a bet to stop raising rates needs to be reversed as the economy is still running too hot.

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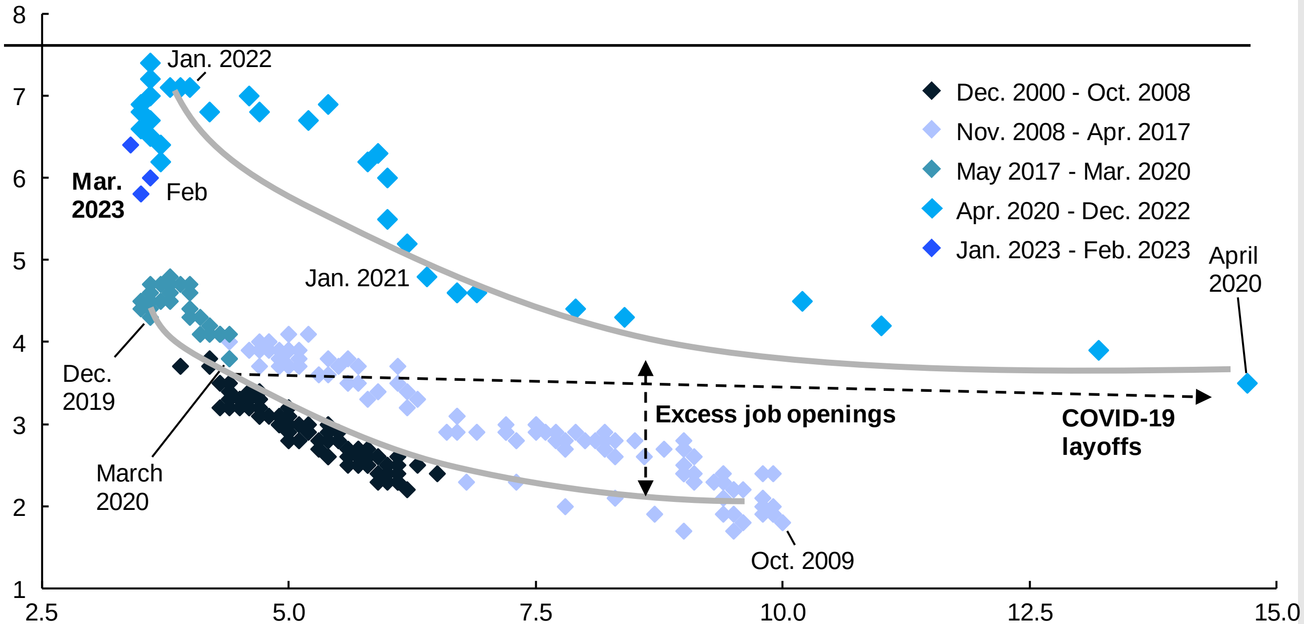
Scenarios to test your tactics and strategy

Labor market imbalances continue to stoke rapid wage growth

Job-openings ticked lower in March; relief of labor market pressures?

US Job openings rate
Vacancies as percent of total jobs available, through March 2023



US unemployment rate
Percent

+3.2M

Excess job openings, March 2023

9.6M

Job openings, March 2023

6.4M

Average job openings, April 2019 and February 2020, when unemployment rates were similar to today

Source: BLS, McKinsey analysis

Private sector wage growth has slowed, but the level of earnings is more than 18% above pre-COVID levels

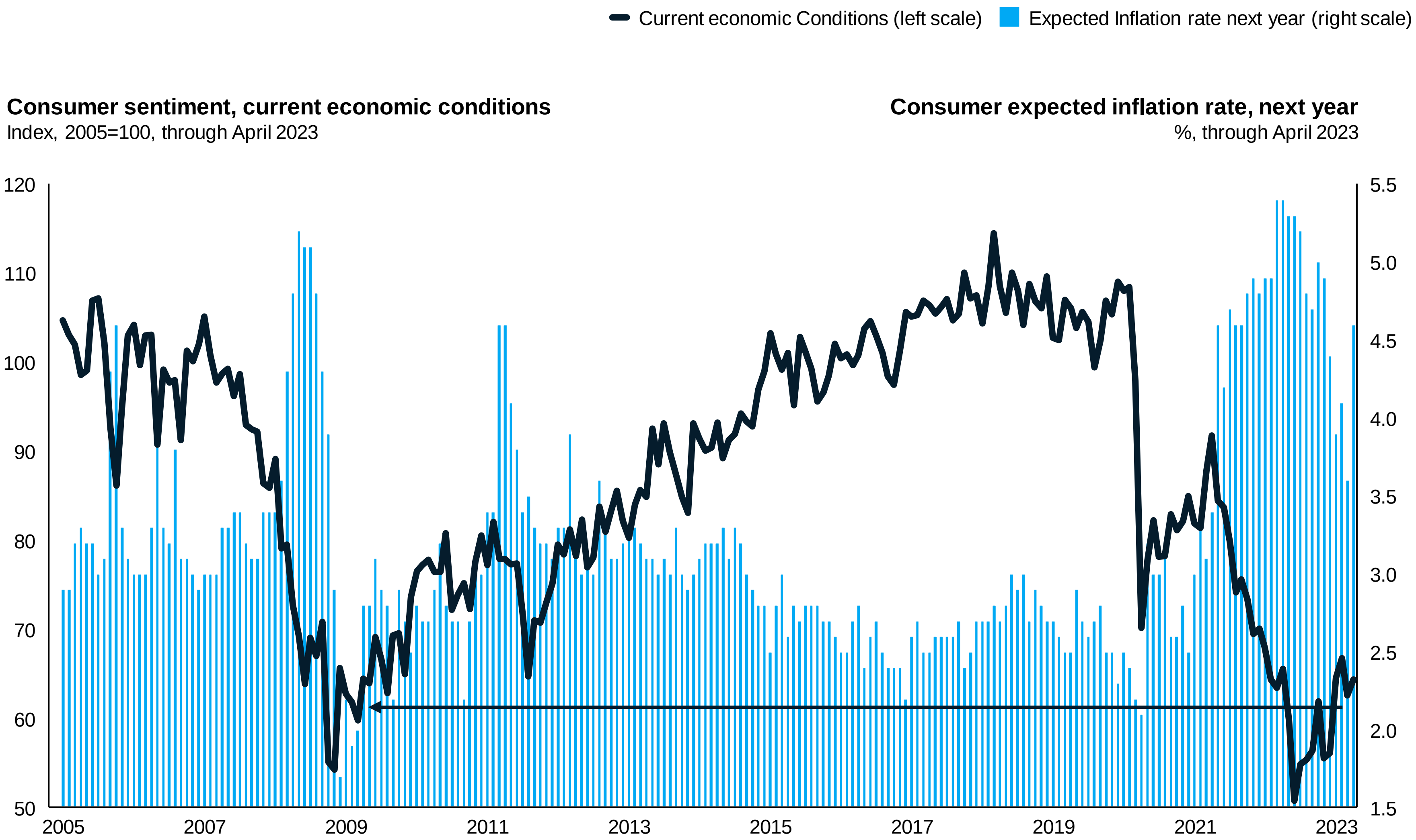
Average weekly earnings, compound annualized growth, percent

	Dec. 2017 – Dec. 2019 CAGR, %	**Dec. 2019 – Dec. 2021** CAGR, %	**Dec. 2021 – Apr. 2023** CAGR, %	**Dec. 2019 – Apr. 2023** Total change in level, %
Construction	2.9	4.0	5.8	+18.7%
Information, financial & business services	4.0	4.9	4.3	+18.4%
Leisure & hospitality	3.0	8.1	3.5	+22.7%
Wholesale & retail trade	3.3	6.2	4.0	+19.1%
Education & health	2.5	6.3	4.4	+22.5%
Manufacturing	2.1	3.8	3.5	+13.6%
Transport & warehousing	0.9	4.4	6.5	+21.4%
Private sector, total[1]	2.5%	5.2%	4.5%	+20.8%
Adjust for CPI	0.8%	0.9%	-1.3%	

1. Private sector workers, all industries; sector detail for Mining & Logging, Utilities, and Other Services, not shown

Source: BLS, Mckinsey analysis

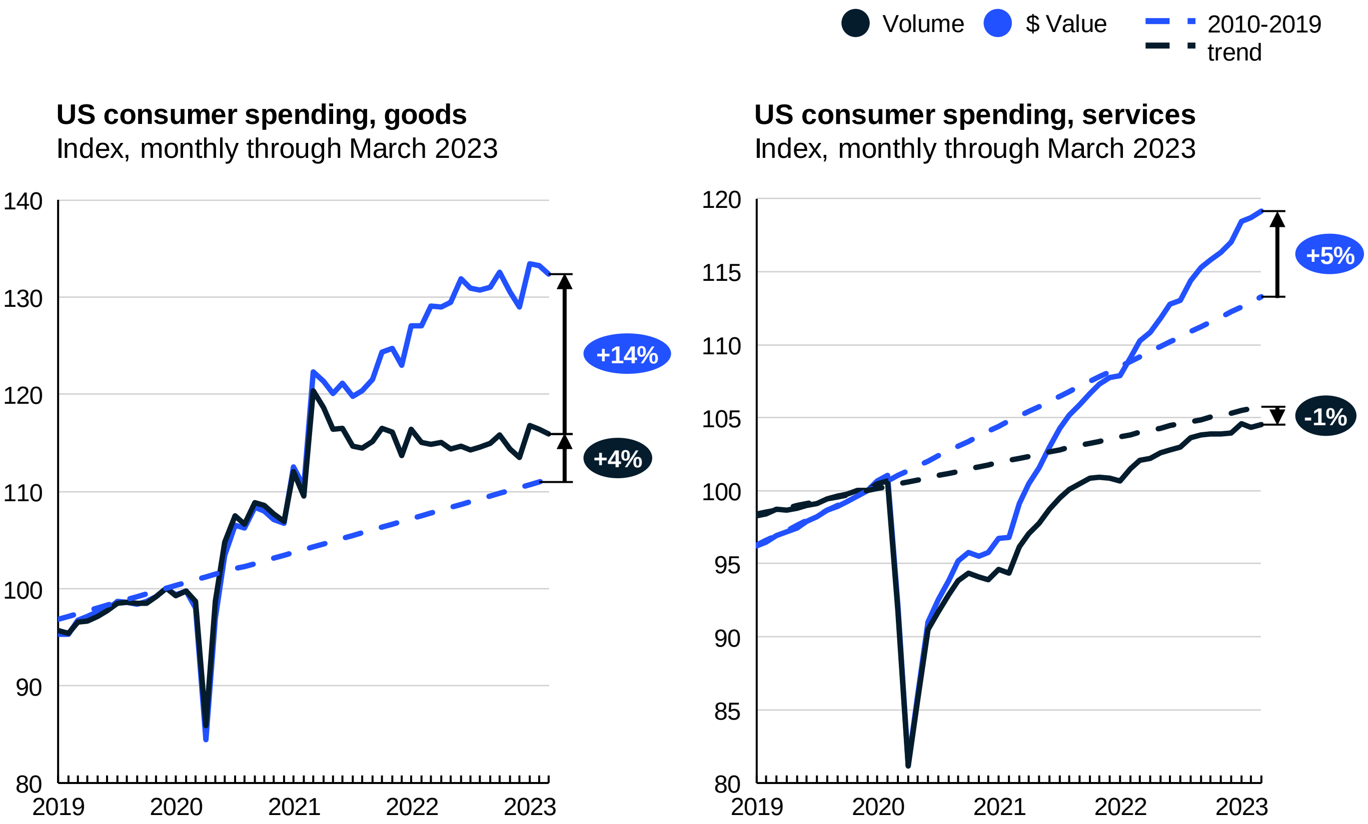
Consumer assessment of current economic conditions has come off record lows but remains depressed



Source: University of Michigan; McKinsey analysis

Goods purchases have flattened, and consumers are taking home less in the shopping cart

Spending on services in 2022 was $11.4T, nearly 2x spending goods of $5.9T



+$23.7T

Cumulative nominal spending on goods above trend since January 2020

-$10.2T

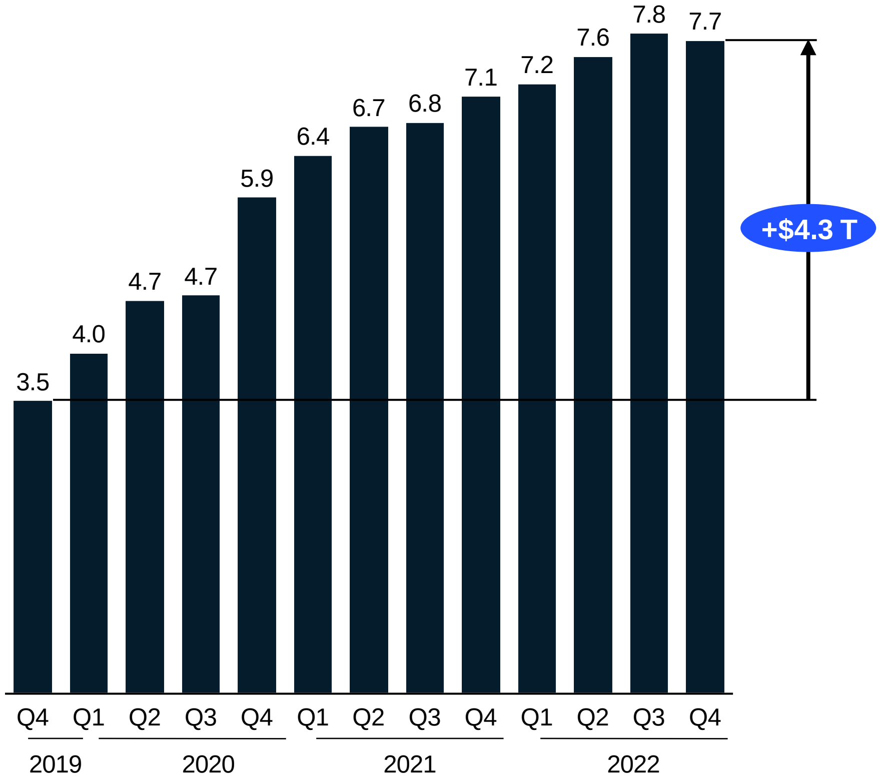
Cumulative nominal spending on services below trend since January 2020

Source: BEA, McKinsey analysis

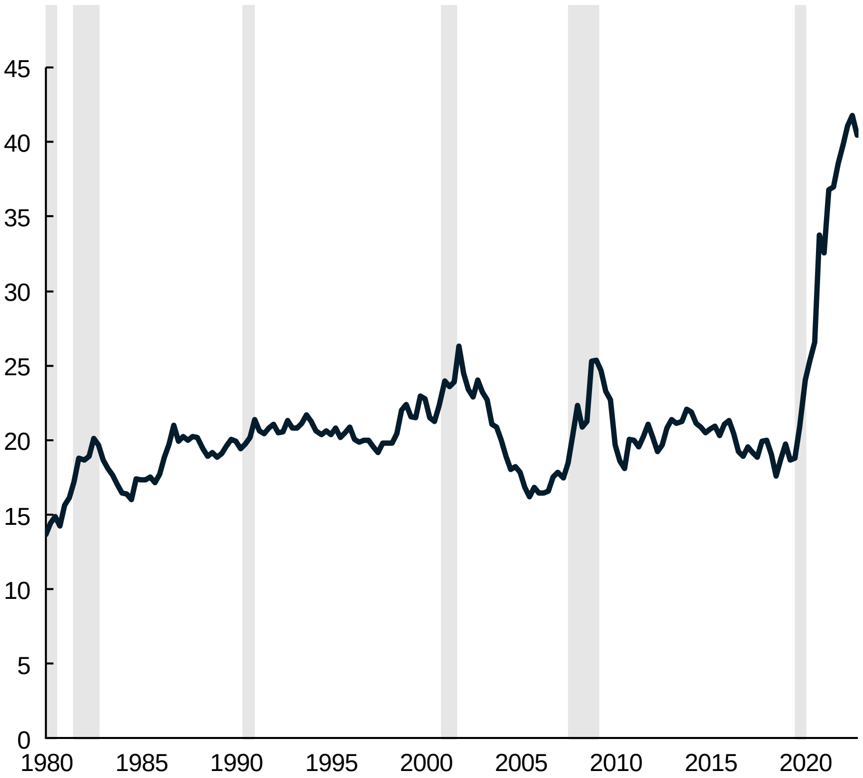
Cash holdings by households remain at unprecedented level

Household cash equivalents include checkable deposits, currency, and money market shares

Holdings of cash equivalents
$ Trillion, through 2022Q4



Holdings of cash equivalents
% of disposable income, through 2022Q4



Source: Bureau of Economic Analysis, Federal Reserve Board, NBER, McKinsey analysis

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Scenarios to test your tactics and strategy

A 2x2 or 3x3 world? Scenarios for 2023 and beyond

Can we pass the test and get on a path to long-term prosperity?

Long-term structural balance and international cooperation

How well supply can satisfy global demand at affordable prices in the medium and long term.

Strongly influenced by local regulation, geopolitics, and the rules of international exchange

C1 "Limited recession" Pre-COVID trend Inflation > target	**B1** "Soft landing" Trend growth ⊕ Inflation > target	**A1** "Soft landing" Trend growth ⊕⊕ Target inflation
C2 "Deep recession" Trend growth ⊖ Entrenched inflation	**B2** "Mild recession" Pre-COVID trend Inflation > target	**A2** "Soft landing" Trend growth ⊕ Target inflation
C3 "Extended downturn" Trend growth ⊖⊖ Inflation regime-change	**B3** "Shallow recession" Trend growth ⊖ Entrenched inflation	**A3** "Limited recession" Pre-COVID trend Inflation > target

Short-term level of fiscal support and stance of monetary policy

How well government spending and market-based incentives are targeted, and how the central banks are shaping financial conditions. Strongly influenced by national political dynamics

Leading in a 3x3 world

Embrace the 'harsh reality' that you just don't know what the outcome will be

Capitalize on the uncertainty to seize competitive advantage with the same intensity that you act on risks

Reiterate that much of what you do will not likely change and focus your organization on truly understanding the 3-5 decisions that matter

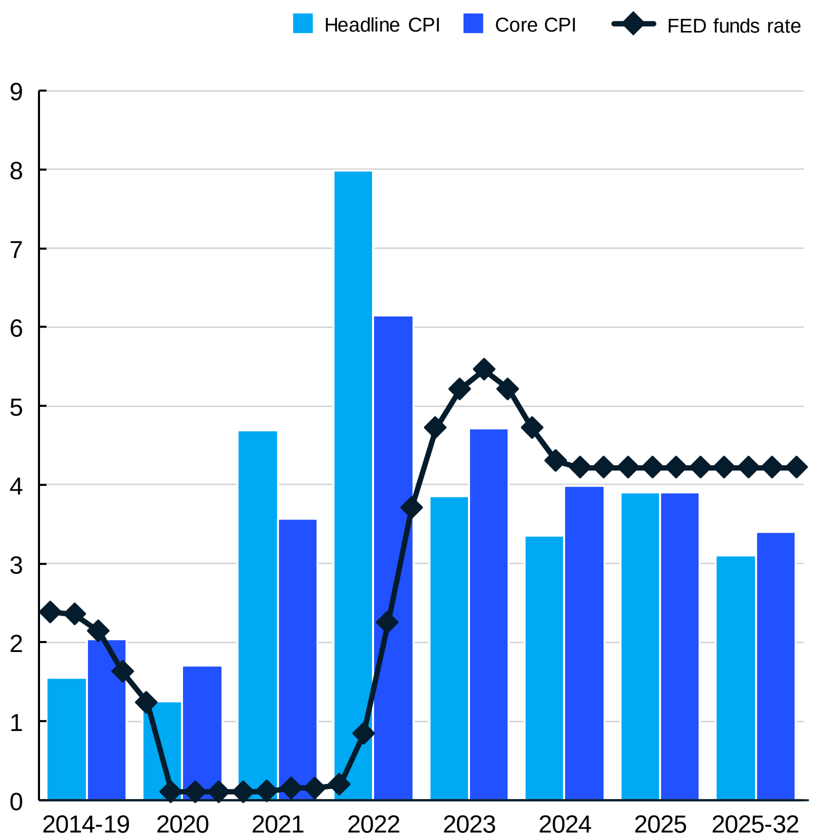
Capitalize on the uncertainty to seize competitive advantage

Focus with the same intensity on capturing opportunities that you use to mitigate risks

Mckinsey scenarios, March 24, 2023

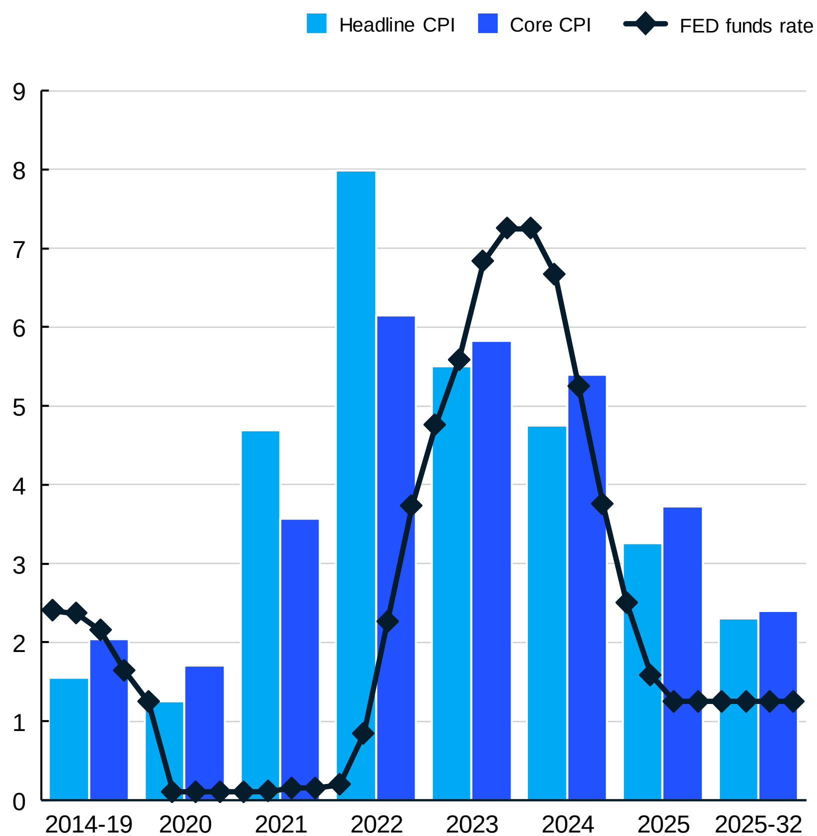
Inflation and interest rates: Scenario A1

Percent[1]



Inflation and Interest rates: Scenario C2

Percent[1]



1. CPI CAGR 2014-19, 2025-30; FED funds rate 2019 only, neutral rate 2025-30

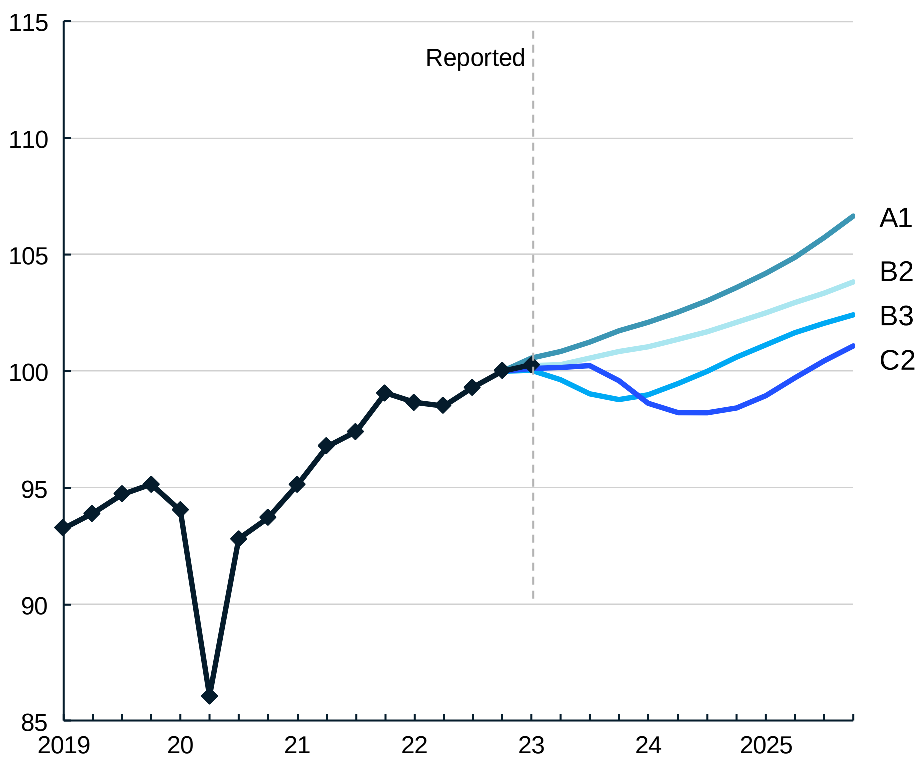
Source: National statistics agencies; McKinsey analysis, in partnership with Oxford Economics

Focus on the 3-5 decisions that matter

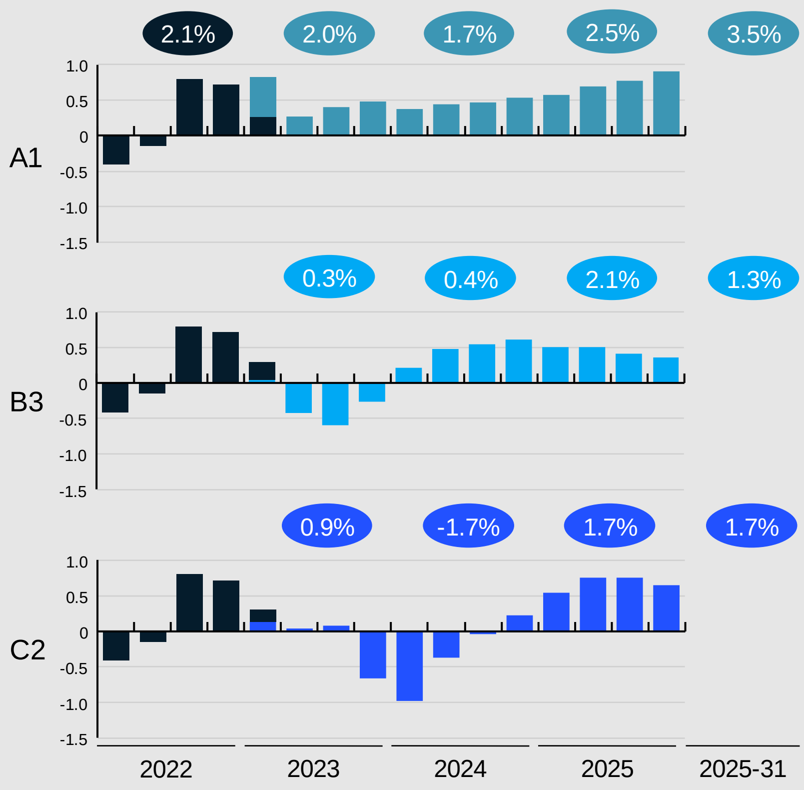
Reiterate that much of what you do will not likely change

Mckinsey scenarios, March 24, 2023

Real GDP
Indexed, 2022 Q4=100



Real GDP
Percent change, quarterly, annual, and CAGR



Source: National statistics agencies; McKinsey analysis, in partnership with Oxford Economics