AGENDA

Boards Grapple with 40-Year Inflation High and Looming Recession

Almost 60% of CEOs foresee a short, mild recession

By Frederic Lee | July 5, 2022

With inflation levels hitting decades-old highs and the **Federal Reserve** continuing to raise interest rates, boards must brace for the possibility of a coming recession, according to market observers.

OnBoard CEO **Paroon Chadha** told Agenda that inflation must be top of mind for boards when it comes to scenario analysis, planning and oversight in the next few quarters. "Recession is likely in the short run, and of course a certainty at some point after a 13-year expansion cycle," said Chadha, adding that risk of recession is high right now, especially with supply not expanding quickly enough to help dampen inflation.

"The [Federal Reserve] is actively trying to curtail inflation by dampening demand, by raising interest rates, until inflation and demand falls," said Chadha in an email, adding that all of this is bound to impact output as the Fed continues to pump the brakes.

Fed Chairman **Jerome Powell** said during a June 22 **Senate** hearing that a recession is possible as a result of its actions, although the Fed is not trying to "provoke" one.

Executives seem pessimistic on the economic outlook. Almost 60% of CEOs in a May 19 survey from the **Conference Board** said they expect that inflation will come down over the next few years, but that the U.S. will have a short, mild recession, which the **Federal Reserve** offsets — called a "reverse soft landing," according to a report on the survey authored by **Lynn Franco**, senior director of economic indicators and surveys at **The Conference Board**.

Meanwhile, 11% of CEOs in the survey foresaw a more challenging recession, and 20% said inflation will stay elevated over the next few years as U.S. growth slows significantly, according to the report.

"Furthermore, 60% of CEOs expected the short-term economic outlook to worsen, up from just 23% in Q1 2022. However, over the coming year 63% said they expect to expand their workforce and 38% said they expect to increase their capital budgets," Franco wrote.

The Consumer Price Index for all urban consumers increased 1% in May on a seasonally adjusted basis, after rising 0.3% in April, the **U.S. Bureau of Labor Statistics** reported June 10. Over the last 12 months, the all-items index increased 8.6%, before seasonal adjustment, according to the bureau.

The all-items index increase was the largest 12-month increase since 1981, according to BLS. The all-items index minus food and energy rose 6% over the last 12 months, and the energy index rose 34.6% over the last year, which is the largest 12-month increase since 2005.

The increase was broad-based, according to the bureau's economic news release, with the indexes for shelter, gasoline and food being the largest contributors.

“Inflation impacts employees, customers, and customers’ customers,” said Chadha, adding that it drains cash, reduces margins, and can sneak up on any business that is not paying attention. On one hand, he said, much of the focus is about evaluating risks, slowing down capital expenditures and conserving cash. “On the other hand, scoping new opportunities that often come with a tighter environment, including shoring up talent, is important as companies must not lose their innovation mindset.

“The depth and frequency of reporting to the board on how the company is responding to inflation needs to strike a balance between keeping the board informed without unduly burdening or distracting management,” Chadha said.

Above all, he said, boards need to prepare to stay agile through this period and be prepared to make decisions faster than their competitors, stay ahead of the trends and anticipate changes in buyer behaviors.

In assessing risk, boards have to consider the increased cost of capital and continued higher labor and material costs. Additionally, he said, maintaining or securing liquidity across various macroeconomic scenarios should be risk committees’ prime consideration over the next 18 to 36 months.

“While in an inflationary period boards should continue support connecting their enterprise digitally, so they have real data on their customers and their spending patterns,” said Chadha, whose company Onboard develops board management software.

Specifically, Chadha said, boards should reevaluate which topics need to be escalated from committee overview to the full board over the next few quarters. Tools that “enable good planning and communication across the organization, including getting the appropriate reports to the board, are a huge asset” going into these inflationary or recessionary times, he said.

Washington’s Take on Inflation

During last month’s hearing, Powell said that inflation remains well above the Federal Reserve’s longer-run goal of 2%. Over the 12 months ending in April, total personal consumption expenditures (PCE) prices rose 6.3%, he said, adding that excluding the volatile food and energy categories, core PCE prices rose 4.9%.

Powell said that price pressures have spread to a broad range of goods and services. “The surge in prices of crude oil and other commodities that resulted from Russia's invasion of Ukraine is boosting prices for gasoline and fuel, and is creating additional upward pressure on inflation, and Covid-19-related lockdowns in China are likely to exacerbate ongoing supply chain disruptions,” said Powell.

The Federal Reserve recently raised the target range for the federal funds rate by 75 basis points, to 1.50% to 1.75%, and a further increase of 50 to 75 basis points is expected in July, “bringing the total increase for this year to 2.00-2.25 percentage points — something that seemed unthinkable just a few months ago,” according to the **World Economic Forum**.

The Federal Reserve anticipates that ongoing rate increases will be appropriate, said Powell, adding that the pace of those changes will depend on the incoming data and economic outlook.

Powell said that he doesn’t think that gas prices or the cost of groceries will fall as a result of the Federal Reserve’s interest rate increase, adding that if interest rates from the Federal Reserve go up, people’s demand will decline, and supply and demand can come into better balance.

Sen. **Elizabeth Warren** (D-Mass.) said during the hearing that interest rate increases from the Federal Reserve make it more likely that companies will fire people and slash hours in order to shrink wage costs.

“Inflation is like an illness, and the medicine needs to be tailored to the specific problem, otherwise you could make things a lot worse,” said Warren, warning that right now, the Federal Reserve has no control over the main drivers of rising prices, “but the Fed can slow demand by getting a lot of people fired and making families poorer.”

While President **Biden** is working to straighten out supply chain kinks and increase energy supplies, the Federal Reserve could tip the U.S. economy into a recession through its policies, said Warren.

How Companies See It

Companies are also warning investors about how the economic environment could impact them.

For example, in its June 24 10-K, **Casey’s General Stores, Inc.**, said that the conflict in Ukraine has resulted in historically high oil and other commodity prices, “which, coupled with a recent period of high inflation, has significantly increased the cost of fuel and other products we sell.”

“We may not always be able to recapture these higher input costs through pricing strategies or otherwise,” the convenience store chain said, adding that unfavorable economic conditions that affect the agricultural industry, fuel prices and unemployment levels can affect consumer confidence, spending patterns and miles driven, which can cause customers to "trade down" to lower-priced products.

Furniture company **La-Z-Boy Inc**. stated in its June 21 10-K that during fiscal 2022, the price of materials in its upholstery manufacturing process increased, driven by inflationary cost pressure, supply chain challenges and higher demand for certain raw materials.

“As we begin fiscal 2023, we expect raw material prices to remain at historically high levels in many categories due to price inflation in our core materials and global supply chain complexities,” the furniture company stated.

Fears of a possible recession are also influencing consumer spending, as well as inflation, unemployment and other factors, according to the furniture company.