INFLATION AND RECESSION IN A NUTSHELL:

WHAT YOU NEED TO KNOW AND WHAT YOU NEED TO DO

7 Business Strategies to Weather Turbulent Economic Times

JULY 2022

Content

- Summary
- An Inflationary State of Affairs
- Inflation: What You Need to Know
- Are We Headed for a Recession?
- Impact of Inflation on Business
- Inflation: What You Need to Do
  - 7 Strategies to Deal With Inflation
- Final Word
- Sources

Summary

With consumer prices on the rise, what seemed like transitory inflation is turning into a longer-term problem that may persist well into 2022 and beyond, potentially driving the economy into a recession. Compounded by the global Covid-19 pandemic, labor shortages, the Russia-Ukraine war and supply chain disruptions, inflation is driving many companies to rethink their business strategies and take steps to counteract its effects.

To effectively combat inflation- and recession-related challenges, business leaders should consider a variety of strategies–in addition to raising prices. In this eBook, we will explore some of these strategies and delve a bit deeper into the nature of inflation and recession.

An Inflationary State of Affairs

The Federal Reserve (the central bank in the U.S., known as the Fed) initially referred to the current state of inflation as “transitory.” But this latest inflationary period can no longer be considered temporary. Inflation rates, as measured by the Consumer Price Index (CPI), have been increasing sharply for over a year, rising beyond the normal 2% to 4% range to 9.1% in June, the highest inflation rate since December 1981.
The Fed has said it expects inflation to slow to 2.6% by the end of 2023 and 2.2% by 2024—an optimistic forecast not shared by most Wall Street economists.

The goods that are most affected by inflation are fuel and energy, food and other household goods, airfare, and housing.

Here are some of the **latest price increases** reported by the U.S. Bureau of Labor Statistics in June:

ENERGY PRICES ROSE TO 41.6% YEAR OVER YEAR, THE HIGHEST INCREASE SINCE APRIL 1990

Motor fuel - **60.2%**
Gasoline - **59.9%** (the largest 12-month hike since March 1980)
Fuel oil - **98.5%** (down from 106.7% in May, which saw the largest increase in the history, since 1935)
Electricity - **13.7%** (the largest increase since April 2006)
Piped gas service - **38.4%** (the largest increase since October 2005)

FOOD PRICES SURGED TO 12.2%, THE HIGHEST SINCE APRIL 1979

Butter and margarine - **26.3%**
Fruits and vegetables - **8.1%**
Cereals and bakery products - **13.8%**
Meats, poultry, fish and eggs - **11.7%**
Pet food - **10.3%**
Food away from home - **7.7%**

SHELTER COSTS INCREASED 5.6%, THE HIGHEST SINCE FEBRUARY 1991

Rent of primary residence - **5.8%**
Household furnishings and operations - **9.5%**
Lodging away from home - **10%**

OTHER

Transportation services - **8.8%**
Public transportation - **23.7%**
Airline fares - **34.1%**
Used cars and trucks - **7.1%**
New vehicles - **11.4%**
Motor vehicle parts and equipment - **14.9%**
Apparel - **5.2%**
Medical care services - **4.8%**
Health insurance - **17.3%**

Personal Consumption Index

In addition to the CPI, the Fed uses another measure for inflation known as the Personal Consumption Expenditures Index. Like the CPI, the PCE index has risen sharply in the past year, reaching a record 6.6% in March then dropping to 6.3% in April, staying unchanged in May (the latest figures as of the publishing of this content). The Fed is predicting a year-end inflation rate of 5.2% as measured by the PCE index.

Interest Rate Hikes

In response to burgeoning inflation pressures, the central bank has been raising interest rates. On June 15, the Fed raised its Federal Funds Rate (FFR, the average interest rate that banks pay for overnight borrowing in the federal funds market) by 0.75 percentage point to a FFR that ranges from 1.5% to 1.75%—the biggest increase since 1994, noting it may raise the rate to as high as 3.8% by 2023.

On July 27, the Fed again raised its benchmark interest rate by another 0.75 percentage point to a range of 2.25% to 2.5%. This was the fourth rate hike in five months.

Many economists believe the combination of high prices and high interest rates could or will slow down the economy and cause a recession, but as of May, the Fed was predicting the economy will weaken but not fall into recession.

Inflation: What You Need to Know

What Is Inflation?

Inflation is the continuous and accelerating rise in prices of goods and services and the decline of the purchasing power or value of a given currency over a certain period of time, usually a year. When an economy is experiencing inflation, its currency can lose much of its value.

In the U.S., inflation is monitored by the Federal Reserve, the country's central bank. The Fed has an inflation target of about 2% and adjusts monetary policy to combat inflation if prices rise too much or too quickly.

When Does Inflation Happen?

Inflation occurs when money supply increases faster than economic growth and/or when the supply of goods or money decreases.

What Causes Inflation?

The price hikes that are associated with inflation have two main causes: **demand-pull inflation** and **cost-push inflation.** Both are linked to the fundamental economic principles of supply and demand.

Demand-Pull Inflation

Demand-pull inflation happens when consumer demand for goods or services increases but supply remains the same, causing prices to go up. Demand-pull inflation can be the result of a healthy economy or a sudden increase in popularity of certain products. In a healthy economy, people and companies make more money, which increases their purchasing power and spending. As demand for goods increases, supply decreases, thus increasing prices.

Companies that produce popular goods can play a role in inflation by raising prices simply because consumers are willing to pay more for these goods.

Cost-Push Inflation

Cost-push inflation occurs when production costs go up, supply of goods goes down and demand remains the same. The added costs of production are passed down to consumers in the form of higher prices for the finished goods, resulting in inflation. Frequently, an external event, such as a natural disaster, international trade agreement or war, hinders companies' abilities to produce enough goods to keep up with consumer demand.

For example, the destruction of corn crops by a flood can raise prices across the economy because corn is used in many products. Wages, too, can affect the cost of production. When the economy is performing well, and the unemployment rate is low, labor shortages can occur, prompting companies to increase wages to attract qualified candidates, thus increasing production costs that are then passed down to consumers as price hikes.

How Is Inflation Measured?

Inflation typically is expressed as the annual change in prices for everyday goods and services such as food, furniture, gasoline, apparel and transportation. As a broad measure, it is the percentage at which prices for consumer goods and services increase each month.

$$\text{INFLATION RATE} = \frac{\text{(current price - former price)}}{\text{former price}}$$

Several metrics, called indexes, are used to measure the inflation rate. Because no single index captures the full range of price changes in the U.S. economy, economists must consider multiple indexes to get a comprehensive picture of the rate of inflation.

CPI

The Consumer Price Index is the most commonly used measure of inflation in the U.S. The CPI determines how much consumers are paying for things by measuring prices for a “basket” of goods and services, tracking prices in eight major categories: food and beverages, housing, apparel, transportation, education and communication, recreation, healthcare, and other goods and services. The CPI basket is kept mostly constant over time for consistency, but it is tweaked occasionally to reflect changing consumption patterns—for example, to include new hi-tech goods or to replace items no longer widely purchased.

The CPI is considered the benchmark for measuring inflation in the U.S. This index is especially important because it is used to calculate cost of living increases for Social Security payments and for many companies’ annual raises. It is also used to adjust the rates on some inflation-protected securities, such as Treasury Inflation-Protected Securities (TIPS).

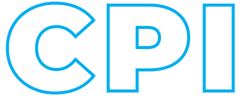
PPI

The Producer Price Index tracks changes in the prices of goods and services that domestic producers sell each month, such as the price of fuel, farm products, chemical products and metals. The PPI is a measure of inflation at the wholesale level that is compiled from thousands of indexes measuring producer prices by industry and product category. Producer prices can rise when producers face an increase in tariffs, higher oil and gas prices to transport their items, or other issues, such as the impact of a long-lasting pandemic, war or natural disasters.

The PPI plays an important role in business contracts. Businesses that enter into long-term contracts with suppliers often use the PPI to automatically adjust the rate they pay for raw goods and services over time. Otherwise, suppliers would lock themselves into years-long contracts at rates that might erode their purchasing power over time.

PCE

The Personal Consumption Expenditures Price Index tracks how much things actually cost by measuring a broader range of consumer expenditures than the CPI. For instance, the PCE counts the price of healthcare procedures even when the government and insurance help pay for them. It also updates the basket of goods it uses for calculations based on what consumers are actually spending money on each month, rather than limiting data to a fixed set of goods. Consequently, it tends to be less volatile, and it is the index the Fed prefers when making monetary decisions regarding inflation.



Inflation Isn’t Always a Bad Thing, But...

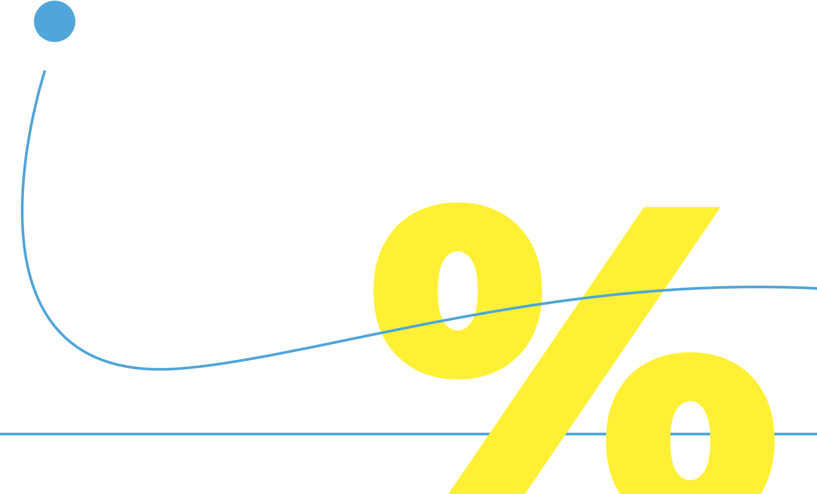
Whether inflation is good or bad depends on the circumstances. Many economists consider small or moderate price gains as a sign of a healthy economy because it can lead to higher wages and job growth.

Because inflation leads to higher prices for basic necessities, such as food, housing and fuel, it can frustrate consumers and have a negative impact on society. People's incomes typically do not increase as much as prices for goods and services, making it more difficult for them, especially low-income households, to purchase essential items.

As prices increase and consumers' purchasing power declines, so does their real, inflation-adjusted incomes, making erosion of real income the single biggest cost of inflation. Real income is a proxy for the standard of living: when real incomes rise, the standard of living rises and vice versa.

Because inflation makes money saved today less valuable tomorrow, it can interfere with people's ability to retire. For example, if you earned 5% from investments in stocks and bonds during a period of time when the inflation rate was 3%, you only earned 2% in real terms.

When allowed to get out of hand, inflation can rise dramatically and plunge economies into long periods of instability. When Venezuela's inflation rate hit 929,790% (or up to 1,698,488%, depending on the source of the data) in 2018, it caused the economy to collapse and countless of citizens to flee the country. A year later, at 9,586%, Venezuela still had the highest inflation in the world. In 2008, Zimbabwe experienced one of the worst cases of hyperinflation ever, with an estimated annual inflation of 500 billion percent. Such high levels of inflation force countries to take difficult and painful policy measures to bring inflation back to reasonable levels, sometimes by giving up their national currency, as Zimbabwe did.



Who Benefits from Inflation?

While consumers experience little benefit from inflation, investors can experience gains when they hold assets in markets affected by inflation. For example, those who have invested in energy companies will see their stock values increase as energy prices go up.

Some companies can benefit from inflation if they are able to increase prices as a result of increased demand for their products and services. If, for instance, the economy is performing well and housing demand is high, real estate developers can charge higher prices for their homes. Some companies deliberately withhold supplies from the market to cause prices to rise.

How Inflation Affects the Stock Market

Inflation booms historically have proven problematic for the stock market. During inflation, tangible assets (e.g., a house) tend to hold their value better than financial assets (e.g., stocks).

How Policymakers Deal With Inflation

The Fed is responsible for monetary policy that includes maintaining a stable rate of inflation. The bank's Federal Open Markets Committee (FOMC) has determined that an inflation rate of about 2% is optimal for employment and price stability.

During economic downturns, the Fed can help stimulate the economy by decreasing interest rates, which makes the cost of borrowing money (for businesses and consumers) cheaper, thus encouraging consumption. Lower interest rates also mean less earnings on savings, which further pushes spending. More spending leads to more demand, which can prompt inflation.

To counteract inflation, the Fed raises interest rates in order to slow down demand and rising prices. The question the Fed and economists wrestle with is how much action from the central bank is needed to bring inflation under control. There are two potential scenarios:

1 | A “soft landing” is when supply chain shortages ease and the Fed is able to slow the economy down gently without causing a recession. In this optimistic scenario, companies are forced to lower their prices as supply and demand come into balance.

2 | The less optimistic scenario occurs when supply issues persist, leading the Fed to raise interest rates more drastically to slow demand enough to bring rising prices under control.

The Fed also can impose monetary discipline by fixing the exchange rate—tying the value of its currency to that of another currency and thereby its monetary policy to that of another country. But when inflation is driven by global rather than domestic developments, such policies may not help.

Related Terms

Deflation

Inflation can be contrasted with deflation, which occurs when prices across a sector of the economy or the entire economy drop and the purchasing power of money goes up. This may sound like a good thing, but deflation can hurt the economy.

When prices are falling, consumers delay making purchases because they anticipate lower prices in the future. This lack of spending means less economic activity, less income generated by producers, lower wages and diminished economic growth.

Most of today's economists believe that maintaining low, stable and predictable inflation—a policy known as inflation targeting—is good for the economy. When inflation is low and predictable, it is easier to capture it in price-adjustment contracts and interest

rates, reducing its distortionary impact. Knowing that prices will be slightly higher in the future gives consumers an incentive to make their purchases sooner, which boosts economic activity.

Hyperinflation

Hyperinflation occurs when inflation rises very quickly and the value of currency tumbles rapidly, crippling consumers' purchasing power. Hyperinflation is defined by prices that rise by at least 50% each month. Hyperinflation usually happens during war or civil unrest that render currency effectively worthless. One of the best-known examples of hyperinflation took place in Germany in the early 1920s, when prices rose by tens of thousands of percent each month, crushing the German economy.

Stagflation

Stagflation occurs when inflation remains high but economic growth stalls and unemployment increases. Normally, when unemployment goes up, demand for goods and services goes down as people curb their spending. Lower demand means lower prices, helping to recalibrate consumers' purchasing power. When stagflation happens, however, prices remain high even as consumer spending decreases, making it increasingly expensive to buy the same goods.

Are We Headed for a Recession?

The U.S. economy shrank by 0.9% during the second quarter of 2022, down from a first-quarter contraction of 1.6%, thus slowing down for two consecutive quarters and meeting the criteria to potentially be declared in a state of recession.

This lower GDP and the highest inflation rates in 40 years have Americans expecting a recession to be officially declared any day now (as of the publishing of this eBook).

What Is a Recession?

A recession occurs when general economic activity declines for two consecutive quarters and when the National Bureau of Economic Research (NBER) makes the recession official. The NBER relies on more than the GDP to declare a recession. It defines recession as a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production and wholesale-retail sales.

Under that definition, the drop in first-quarter 2022 GDP does not constitute a recession. If the GDP drops again in the second quarter, a recession will stop being speculation and become official. According to the NBER, there have been 34 recessions in the U.S. since 1854.

Although they are a normal, temporary, albeit unpleasant part of the business cycle, recessions can cause significant economic pain and have major effects that alter the economy. Recessions usually are marked by widespread layoffs, bankruptcies, foreclosures, higher borrowing costs and turbulence in the stock market.

What Causes a Recession?

There are several economic theories that attempt to explain why and how an economy falls into a recession. These theories are based on real economic factors, financial factors, psychological factors or all of the above.

Economic Factors

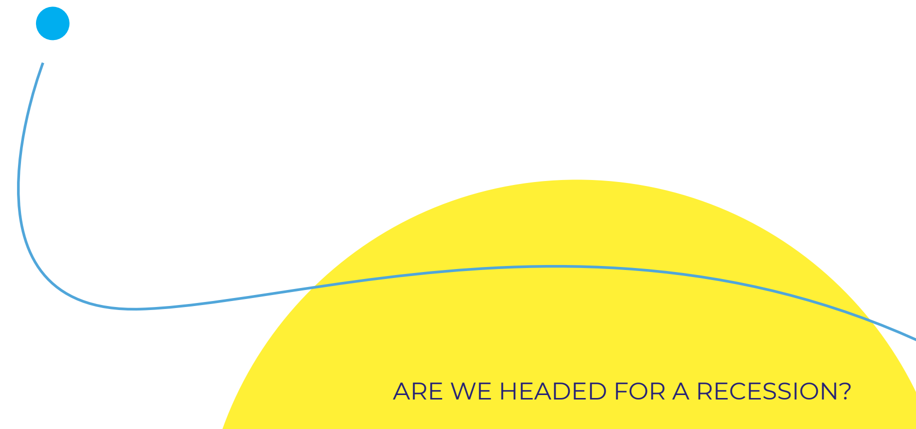
Economic factors consist of real changes and structural shifts in industries. For instance, a recession could be triggered by a sudden, sustained spike in oil prices due to a geopolitical crisis that simultaneously raises costs across many industries, a revolutionary new technology that makes entire industries obsolete, or a pandemic that leads to lock-downs, supply issues and labor shortages.

Financial Factors

Theories that explain recessions as dependent on financial factors typically focus on either the overexpansion of credit and financial risk during the good economic times preceding the recession or the contraction of money and credit at the onset of the recession, or both. Monetarism, which blames recessions on insufficient growth in money supply, is a good example of this type of theory.

Psychological Factors

Psychology-based theories of recession look at the excessive exuberance of a preceding boom time or the deep pessimism of a recessionary environment to explain why recessions can occur and persist. For example, Keynesian economics maintains that once a recession begins, for whatever reason, the pessimism of investors can become a self-fulfilling prophecy of curtailed investment spending based on market pessimism, which leads to lower incomes and reduced consumption spending. Minskyite theories blame the speculative euphoria of financial markets and the formation of financial bubbles based on debt which inevitably burst for recession, combining psychological and financial factors as the cause.



Why Is the U.S. Economy Slowing Down?

The first-quarter downturn in the U.S. economy reportedly was caused by a sharp drop in exports, slower restocking of goods in stores and warehouses, and decreased spending by federal, state and local governments. However, during the same time, consumers and businesses spent heavily, with personal consumption expenditures, nonresidential fixed investment and residential fixed investment all increasing.

Recession Predictors and Indicators

Economists assess several metrics, generally accepted predictors, to determine whether a recession is imminent or already taking place, including the following:

— Leading indicators of macroeconomic trends such as the ISM Purchasing Managers Index, the Conference Board Leading Economic Index, the OECD Composite Leading Indicator and the Treasury yield curve.

— Officially published data from various government agencies that represent key sectors of the economy, such as housing statistics published by the U.S. Census. Changes in these data may slightly lead or move simultaneously with the onset of recession because they are used to calculate components of the GDP.

— Lagging indicators that can be used to confirm an economy's shift into recession after it has begun, such as a rise in unemployment rates.

Recessions and Depressions

A depression is a deep and long-lasting recession. Unlike inflation and recession, no specific criteria exist to declare a depression. Some unique features of the Great Depression of 1929-1933 included a decline of 33% in the quantity of goods and services produced in the U.S., an 80% loss of value in the stock market and an unemployment rate that briefly stood at 25%.

Is a Recession Now Inevitable?

It depends whom you ask. We may already be in a recession, but we will not know for sure until the NBER meets and makes a determination about it.

Some economists expect a recession this year; others don't. Some predict a "hard landing" in 2023 due to the Fed's attempts to cool inflation by hiking interest rates. Such monetary tightening, which is aimed at dampening inflation, could backfire if consumers and businesses pull back too quickly. After all, the country's economy relies on consumer spending for 70 cents out every $1 of GDP.

What Is the Risk of a Recession?

Most economists say the odds of a recession are low this year given the underlying strength of the U.S. economy. Consumers are spending, businesses are hiring, wages are growing. The labor market is in good shape with an unemployment rate of 3.6% (as of May 31), the lowest since February 2020, when it was 3.5% before rising to a high of 14.7% in April 2020 as a result of the Covid-19 pandemic.

Other economists are more pessimistic, predicting a recession by next year triggered by the Fed's recent and future interest rates hikes.

But next year is a different story. Many economists say that recession risks are higher in 2023, citing a longer period of increased interest rates that may extinguish consumer demand and trigger a severe economic downturn.

What the Experts Say

Recently, The New York Times published an article in which it compiled the opinions of a number of leading economists, analysts and strategists regarding the chances of a recession. The range of the forecasts is wide, from a relatively remote chance of a recession to an imminent downturn.

Here is what they had to say according to the report:

Low Probability

Deloitte: Daniel Bachman, who runs the U.S. economic forecasting team at the consulting firm, puts the chance of a recession at about 15%, "less likely than some analysts would have you believe."

Pantheon Macroeconomics: Ian Shepherdson, the chief economist of the research house, says that its "base case remains that a recession is unlikely," and that if there is one, it will be "brief and mild."

Morgan Stanley: Ellen Zentner, the investment bank's chief U.S. economist, notes that "accelerating inflation has been a common precursor to recessions." But despite high and rising inflation, the probability of a recession in the next 12 months is about 30%, according to the bank's models.

Citigroup: Economists at Citigroup, led by global chief economist Nathan Sheets, expect the U.S. economy to slow but not shrink, although "we see recession probabilities as appreciable and rising."

HSBC: Janet Henry, the bank's global chief economist, and her team are not forecasting a U.S. recession, "but our forecasts certainly paint a picture of a downswing that is just as uneven as the recovery that preceded it."

A Decent Chance

JPMorgan Chase: Economists at the largest bank in the U.S., led by chief economist Bruce Kasman, have raised their expected probability of a recession in the next 12 months to an "uncomfortably high" 35%. "The risks are skewed decisively to the upside on inflation and to the downside on growth."

TD Bank: The Canadian bank's economics team, led by chief economist Beata Caranci, is not expecting a U.S. recession, although "with growth close to stall speed, there is a very thin margin for error if another shock hits economies."

Credit Suisse: After deep cuts to its forecasts, the U.S. economy is on "the edge of a recession," according to the team led by Jeremy Schwartz, the Swiss bank's director of U.S. economics, but there are "buffers" that should shield the economy from "spiraling into a broader downturn."

Oxford Economics: The Federal Reserve has a "fighting chance" to tame inflation without causing a recession, writes Kathy Bostjancic, the group's chief U.S. economist. She has cut her forecasts for growth, which she says come "precariously close to tipping into a recession by mid-2023."

Close to a Toss-Up

— **Bank of America:** Ethan Harris, a global economist at the bank, expects growth to slow to almost zero in the second half of next year, with a 40% chance of an outright recession, and "only a modest rebound" in 2024.

— **S&P Global Ratings:** Beth Ann Bovino, the U.S. chief economist, writes that "economic momentum will likely protect the U.S. economy from recession in 2022." She puts the probability of a recession at 40 percent, adding that "it's hard to see the economy walking out of 2023 unscathed."

— **Goldman Sachs:** Analysts at the Wall Street giant have raised their predicted probability of a recession, but think that one can still be avoided (via "a feasible though difficult path"). David Mericle and Ronnie Walker put the odds of a recession at just under 50% over the next two years, up from 35%.

— **Fitch Ratings:** The team at Fitch Ratings, led by chief economist Brian Coulton, expects that economic growth will slow to just 0.1% per quarter in the second through fourth quarters next year, a pace that will put the economy "perilously close to the risk of technical recession."

— **Former Treasury Secretary Lawrence Summers** (source: Bloomberg TV)**:** Summers thinks a recession may start this year. "The risks of a 2022 recession are significantly higher than I would have judged six or nine weeks ago," he told Bloomberg Television on July 1, giving recession a 50-50 chance.

Counting on It

— **Berenberg:** Analysts at the German bank, led by chief economist Holger Schmieding, expect the U.S. economy to stagnate in late 2022 and shrink in the first three quarters of 2023, but only by a "relatively modest" 0.4% for the year. "With luck, the recession will be a shallow one."

— **Deutsche Bank:** Months ago, economists at the German bank forecast that the U.S. economy would tip into a recession by the end of 2023, but now they expect "an earlier and somewhat more severe recession," according to the team led by Matthew Luzzetti, the bank's chief U.S. economist. The team expects the economy to shrink 0.5% in 2023. Meanwhile, George Saravelos, Deutsche Bank's global co-head of FX Research, wrote in a July 1 research note that multiple GDP trackers he monitors have moved into negative territory for the second quarter, noting that "the U.S. economy may already meet the definition of a technical recession."

— **Wells Fargo:** A recession in 2023 "seems more likely than not," according to a report by Jay Bryson, the bank's chief economist. He predicts the economy will shrink 1% over two quarters next year, "one of the milder downturns in the post-World War II era," similar to the recession in the early 1990s. For something resembling a silver lining, he writes, "Because we think the downturn will not be especially deep, we do not expect the labor market to fall completely apart."

Already in a Recession

The Federal Reserve Bank of Atlanta's GDPNow model is projecting that the U.S. economy shrank 1% in the second quarter, slipping into negative territory after economic data showed consumer spending dropped in May, while domestic investments, another component of GDP growth, also fell (Forbes, Fortune). That's quite the dip from the tracker's early June prediction of an increase of 1.3% in the second quarter.

The model, which estimates GDP growth using a methodology similar to one used by the Bureau of Economic Analysis (BEA), has been steadily trimming its second-quarter GDP forecast based on updated economic data that has fueled concerns of a prolonged economic downturn in recent weeks.

If the Atlanta Fed's pessimistic outlook is correct, coupled with the 1.6% decline in GDP seen in the first quarter, it would mean two consecutive quarters of a shrinking economy.

Bottom Line

As we wait and see what the economy does, consumers and businesses must continue to face higher prices. Businesses will be constrained by supply-chain bottlenecks, labor shortages and increased production costs, and while worker wages are rising, inflation is absorbing those gains, pushing consumers' budgets in the red.

Additional sources for this section:

— **The New York Times**, "'Uncomfortably High': What Economists Say About the Chance of Recession," June 28.

— **Bloomberg Television**, "Larry Summers Says Risk of 2022 Recession Climbing," July 1.

— **Forbes**, "Are We Already In A Recession? Yes, According To Fed Indicator With 'Excellent' Track Record," July 1.

— **Fortune**, "The Economy Probably Just Plunged Into a Recession, According to a Real-Time Data Tracker Used by a Key Federal Reserve Bank," July 1.

Impact of Inflation on Business

As the price of goods and services climbs across the nation, consumers and businesses, especially small and mid-size businesses, are feeling the pinch. Inflation may be one of the most common economic challenges that businesses face, but managed incorrectly, it can cut profits, stunt growth and lead to bankruptcy.

Small businesses say inflation is, by far, their top concern, according to the latest MetLife & U.S. Chamber of Commerce Small Business Index. The survey, conducted between April 29 and May 17, found that inflation and related concerns are dominating small business leaders' thinking as Covid-19 concerns start to fade.

— 44% of the small businesses surveyed cite inflation as the biggest challenge facing small business owners, up from 33% last quarter and up significantly from 19% in Q3 2021, when the question was first asked.

— Nearly nine in 10, or 88%, are concerned about the impact of inflation on their business, with almost half, 49%, indicating they are very concerned, up from 44% in Q1 2022.

Inflation does not affect all companies in the same way, but it can have an impact on many business aspects, from profitability to customer satisfaction.

— Supply chain disruptions cause materials shortages, which increase production costs, hinder the production process and weaken inventory levels.
— Higher expenses limit cash flow and makes it more difficult to achieve profits.
— Price hikes turn some customers away.
— Cutting corners upsets employees and customers, and reduced profit margins upsets investors.
— Employees demand higher wages as their cost of living increases.

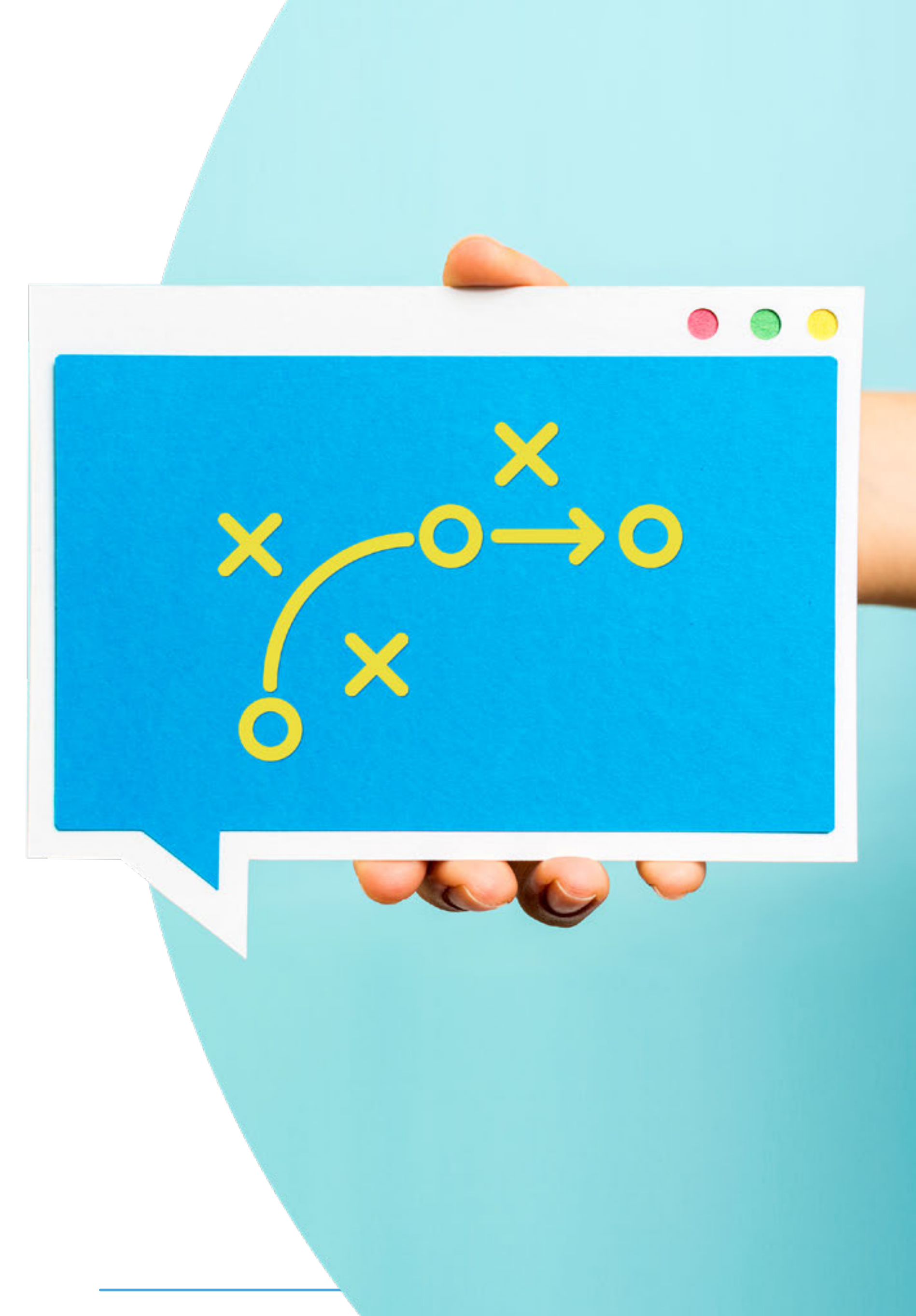
Inflation is a big problem that can be extremely challenging to manage. So how should managers respond to it?

Inflation: What You Need to Do

7 Business Strategies to Deal With Inflation

As businesses brace for a potential or imminent recession, they must find effective ways to deal with inflation right now. There are a variety of moves they can make to temper costs, increase efficiency and build more scalable growth platforms.

The following strategies can help you recalibrate your business at this critical time. They consist of both immediate and ongoing steps you can take to protect your business from the negative impacts of inflation and set it up for future success.



1 | Adjust Your Prices, Wisely

Inflation directly adds to the operational costs of your business and eats into your profit margins. So you should raise prices, right? Not necessarily.

Price hikes can offset increased costs, maintain cash flow and help the company stay profitable when inflation is high. But when you increase prices you risk losing loyal customers and turning away new ones who can't afford the higher prices or who don't see enough value in your product or service to justify paying more for it.

During a period of inflation, you should evaluate your prices on a regular basis and, if needed, increase them to ensure that you don't lose money as costs go up. Keep your eye on the market, not just your shop. Stay informed about what your competitors are doing with their prices. Consider a number of price strategies, but keep in mind the four C's.

The Four C's

— **Customers:** How important is price in your customers' purchasing decisions? What do they value more: your products/services or their price?

— **Costs:** How is inflation affecting your costs? Are labor, raw materials and other production costs significantly more expensive?

— **Competitors:** Have your competitors raised their prices? Consider a price hike to match, unless you are able to keep prices steady to gain market share.

— **Cash:** How is your cash flow? Your ability to hold prices steady depends on what your cash flow is doing.

Proven Price Strategies

One of the most common price strategies used during inflation is a blanket price increase. But given the risk of scaring away new and existing price-sensitive customers, raising prices across the board isn't always the right move.

Following are a few price strategies that can help you stay competitive and in the black. Remember that pricing decisions should not be based only on the short-term fluctuation of inflation, but also on your company's long-term strategy.

Prioritize High-Margin Products

Examine your profit margins carefully and evaluate potential solutions to increase those margins while continuing to deliver quality products and services. Most businesses have different profit margins across their product lines. If the market for certain products won't accept price hikes to bring their profit margin up to what it should be, then lower their priority, and focus on the goods and services that are most profitable.

Replace the Price Model

In recent years, companies in a wide range of industries have changed the way they charge their customers and shown that new price models, such as the subscription model, can bring numerous advantages. When you replace your prices instead of raising them, you can sell a lower price point because a per-month or per-unit consumption typically is much lower and more manageable for customers.

Bundle and Unbundle

Bundle multiple products at a higher price point or unbundle products and sell them at higher individual prices.

Reward Your Customers

Offer extra services, rewards, free shipping or a complimentary gift with each purchase.

Offer Installments

Offer payment installments to make it easier for your customers to buy your products or services.

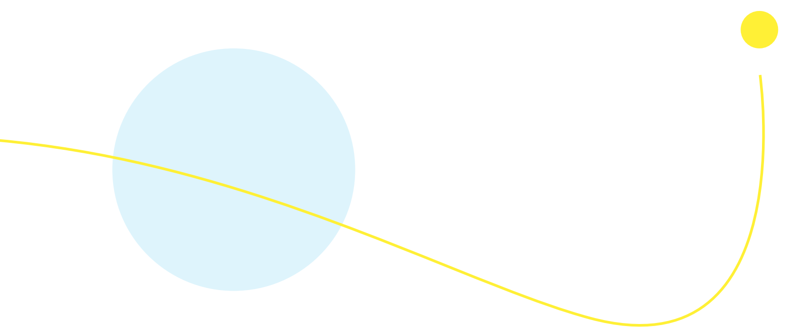
Invest on Customer Service

Invest in your customers' experience by strengthening customer service by simplifying the purchasing process, streamlining payments, gathering and acting on customer feedback, and personalizing all contact with your customers, among other tactics.

2 Reduce Your Costs

Cutting expenses is a vital part of dealing with inflation. Review your overhead costs and variable expenses and consider the value they bring to your operation. Avoid cutting costs that are essential to operational efficiency, employee wellbeing or customer satisfaction. The more affordable your expenses are, the more cash you can put toward replenishing inventory, retaining talent, marketing efforts and improving customer experience.

If your current cost-cutting measures are ineffective you may need to consider other methods, such as these:



- Relocate your business to a more affordable location or sublet part of your space.
- If you haven't yet, consider expanding remote work in your company.
- Consider substituting materials; you may find alternate products or ingredients that will save you money.
- Look for redundant positions or processes that can be eliminated or restructured.
- Cut initiatives that are not a core function of your business or that are underperforming.
- Renegotiate outdated contracts; expand your supplier network to get the best prices.
- Eliminate low-ROI marketing channels and double-down high-impact strategies like social media and email marketing.
- Cancel business subscriptions you don't use.
- Track and regularly evaluate your expenses for necessity and value.

3 Increase Efficiency and Productivity

To offset the cost of inflation, you need to become more efficient. You can do this by using the right business tools, streamlining your processes and retraining your staff. The better you put technology to work for you, the better you can manage inflation's rising costs and remain profitable.

Capitalize on Technology

One of the best ways to enhance efficiency and productivity is through technology. Technologies such as robotic process automation (RPA), workflow and intelligent document processing can free up workers and make each person more effective at creating value.

Start by identifying which of your business processes are the weakest and seeking a digital solution for the problem. If you own a restaurant, get the best point-of-sale system you can afford. If you manage a warehouse, invest in new shelving that allows you to boost productivity.

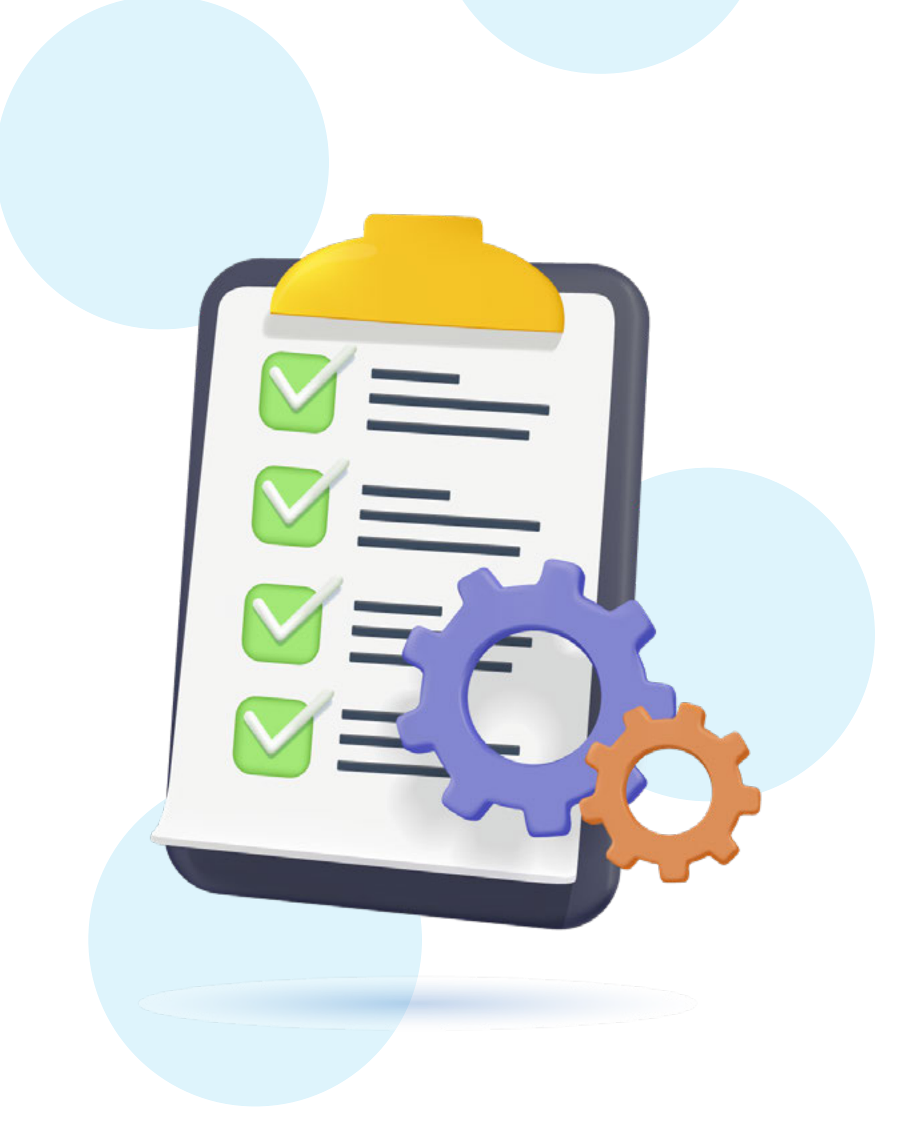
Consider the following solutions:

- Customer relationship management software to keep track of sales and customer connections.
- Inventory management software to track stock levels and analyze sales patterns.
- Payroll software to streamline bookkeeping and calculations.
- Project management software to organize workflows and facilitate collaboration.
- POS software to integrate customer payments with inventory management and email marketing.
- New industry-specific equipment such as medical devices or construction machinery.

Automate to Reduce Labor Costs

A tight labor market and inflation are not a good combination. Consider automating time-sensitive work such as scheduling, order taking, billing and collecting payments to lower your labor costs. Reducing work through automation allows your workers to focus on strategic value-added activities that benefit the business in the short- and long-term.

In addition to saving on labor costs, automation adds stability in an organization, which can be extremely helpful during challenging times such as the pandemic crisis and current inflationary period. Companies that invested more in automation before the pandemic reported more resilience during the crisis than those that had neglected automation.



4 | Retain Your Best Employees

Employees in the U.S. have been quitting their jobs in record numbers. In what has been called The Great Resignation, at least 4 million workers have quit their jobs each month during the last 12 months. In May, 4.3 million workers quit their jobs. April saw 4.4 million resignations, while March registered 4.5 million, February 4.35 million and January, 4.3 million.

Without strong employee retention efforts, you can lose valuable workers and struggle even further to meet customer demand. To retain your workforce you need to keep your employees happy. Along with higher pay and good benefits, numerous surveys show that most employees today want better working conditions, such as flexible work arrangements.

Employee Retention Strategies

- Survey your employees to find out what they want and need to be more satisfied at work.
- Reevaluate your compensation structure for equity and competitiveness.
- Introduce benefits beyond health insurance, such as perks, wellness stipends or paid time off.
- Offer flexible work schedules and give employees more say over their shifts.
- Prioritize their wellbeing by promoting a healthy work-life balance and offering mental health resources.
- Recognize employees for their efforts in public; correct them in private.
- Align your employees with your vision, mission and core values.
- Empower your employees to do their jobs; provide the tools they need.
- Promote efforts that improve communication between departments and among employees.

5 | Revamp Your Supply Chain

You may not be able to inflation-proof your supply chain, but you can make it more cost-effective. Invest in supply chain sustainability and resilience measures, such as diversifying your vendors, renegotiating existing contracts and stockpiling critical materials.

Other measures focus on giving customers what they want when they need it, despite a higher cost. This may involve moving to domestic vendors or splitting orders among multiple sellers rather than choosing the lowest cost source.

Here are the top areas to address for supply chain resilience (NetSuite, March 2022):

— **Sourcing materials:** Strengthen relationships with current suppliers so you get preference when there's a disruption. Audit important suppliers to make sure they have adequate scale, geographic redundancy and downstream relationships. Add alternates where needed.

— **Demand planning:** Understand how not receiving materials from a given supplier will affect production, especially of top-performing SKUs.

— **Manufacturing downtime:** How can you meet demand when production teams and/or facilities are not operating at full capacity or are facing an unforeseen increase in orders? If the answer is "subcontractors or temp workers," make sure agencies are lined up and preapproved.

— **Warehousing:** Consider having a third-party logistics (3PL) provider on call in case a warehouse becomes unusable or you need to increase production to meet surging demand.

— **Inventory management:** Complete visibility into current inventory, including both finished and unfinished goods, is critical to making informed decisions.

— **Customer service:** When orders are delayed or can't be fulfilled due to a supply chain disruption, you need a clear line of communication with customers. Use crisis management best practices to explain what's causing the disruption and what you're doing to resolve the situation.

6 Shift Your Marketing Tactics

Market changes call for changes in your marketing strategy. For example, you may need to reposition a product or service in order to justify a price hike or target less price-sensitive customers. Here are the most important marketing moves you can make during a period of inflation or recession.

Revise Your Value Proposition

Your company's value proposition expresses the core of your competitive advantage the value your company promises to deliver to your customers. It is a statement that introduces the brand to consumers and articulates why someone would want to buy a product or service from your company instead of a competitor. Here are the principal elements of a value proposition:

- It speaks to your target market, your prospect customers.
- It addresses their pain points, offering a solution to their problem.
- It differentiates your product or service as superior to what the competition offers.
- It is persuasive and helps turn prospective customers into paying customers.

Inflation fuels competition. Now is a good time to examine your value proposition to ensure that it accurately reflects your company's promise in the most engaging way.

Invest in the Right Tactics

Do not neglect your brand during a period of inflation or recession. Brands that continue to invest in marketing throughout an economic crisis typically are better positioned to meet pent-up consumer demand once the economy stabilizes. Maintaining a healthy brand presence helps cultivate brand loyalty and attract new customers, even during tough economic times.

Following are the best digital marketing tactics to invest on during periods of inflation and recession:

— **Website optimization:** including search engine optimization (SEO), mobile optimization, design and user experience optimization, conversion rate optimization, website accessibility and content optimization.

— **Content marketing personalization:** such as blogs, infographics, eBooks and other content; used to establish thought leadership, increase website traffic and generate leads.

— **Video marketing:** such as live stream, video channels and podcasts—powerful and cost-effective tools that boost customer engagement and brand loyalty.

— **Email marketing:** provides some of the best lead conversion rates among all marketing channels.

— **Social media marketing:** an excellent way to amplify content across many networks; use organic and engaging content.

— **Influencer marketing:** provides several levels of influence, from mega-influences with more than a million followers to nano-influencers with 1,000 to 10,000 followers; focus on building relationships.

— **Other:** advertising (paid media) and public relations (earned media).

7 Diversify Your Revenue Streams

With so many factors to consider when dealing with inflation, it is no wonder that many businesses forget to consider other revenue streams. Relying heavily on one or two sources of income makes companies more vulnerable during periods of economic instability. By diversifying revenue streams, you can reduce your company's risk: if one area of your business ceases to be profitable, others can make up for it.

Consider ways in which you could grow your existing business with passive income streams that contribute to the overall health of your company without requiring too much work or money. For example, add an ecommerce website, rent out space that you own, develop products or services that can be sold on a subscription basis.

Final Word

Inflation is a fact of life. It's happened before. It's happening now. And it will happen again. The same goes for recession.

Businesses that can adapt quickly to a changing market and economy by using one or more of the strategies presented here are the ones that live to tell the tale.

The final answer to the inflation question is to always expect it and never underestimate it. Inflation can be a lesson learned, an opportunity for improvement rather than a problem to solve.

Sources

- U.S. Bureau of Economic Analysis
- U.S. Bureau of Labor Statistics
- Federal Reserve Board
- National Bureau of Economic Research
- Federal Reserve Bank of Atlanta
- U.S. Chamber of Commerce
- The Conference Board
- International Monetary Fund
- World Economic Forum
- World Population Review
- Trading Economics
- Harvard Business Review
- Funding Circle
- Investopedia
- Forbes
- Fortune
- Bloomberg
- CNBC
- NBC News
- CBS News
- The Wall Street Journal
- The New York Times
- Reuters
- Business Insider
- CNET
- Bankrate
- MarketWatch
- The Balance
- American Express
- Deloitte
- CNN
- Public Broadcasting Service
- HubSpot
- Wikipedia
- Optimizely
- VWO
- LOCALiQ

THIS E-BOOK IS A GIFT FROM GRAVITAL AGENCY

www.gravitalagency.com

ADDRESS

2010 Mcleary Street #1
San Juan, PR 00911

CALL US

787 - 424 - 4443

MAIL FOR INFO

info@gravitalagency.com