

BUSINESS OWNER OPTIMISM SPIKES WHILE CONCERNS LINGER OVER HIRING, NEW PNC SURVEY SHOWS

ANALYSIS BY PNC CHIEF ECONOMIST Gus Faucher

The U.S. economy is in solid shape in the second half of 2023, with a historically low unemployment rate, solid job gains and good growth in consumer spending. But inflation, although slowing, remains well above the Federal Reserve's 2% objective.

Because of elevated inflation, the central bank has aggressively tightened monetary policy over the past couple of years in an attempt to cool off the hot economy and reduce inflationary pressures, particularly from the labor market. As a result, both short-term and long-term interest rates are at their highest levels in more than a decade. This has resulted in a slowing in interest-rate sensitive sectors such as housing and big-ticket consumer purchases.

With the Fed expected to keep interest rates high in the near term and given the gradual way that higher interest rates work to slow the economy, PNC's baseline outlook is for a recession starting in early 2024, as the economy feels the full impact of this tightening in monetary policy. But the recession should be mild given a continued shortage of labor that will discourage layoffs, solid consumer balance sheets, and a well-balanced housing market. PNC's baseline forecast is for a small contraction in economic output of less than 1% next year and a gradual increase in the unemployment rate to around 5% by early 2025. There is still a decent chance that the economy will avoid recession in 2024, albeit with weaker growth. Inflation should slow the Fed's 2% objective in 2024.

A 21-YEAR HIGH 77% OPTIMISTIC ABOUT BUSINESS PROSPECTS

PNC's latest semi-annual survey of small and mid-sized businesses, which concluded August 9, shows that business owner optimism about the outlook for their own businesses in the next six months has reached a 21-year high amid strong expectations for sales, profits and demand.

Highly Optimistic about Own Business

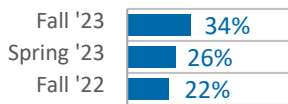
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Despite many economists' predictions for a shallow recession by early 2024, business leaders' hopes about their own companies have risen sharply this fall, with over three-quarters (77%) feeling highly optimistic compared to 49% last fall and 60% in spring.

Highly Optimistic about National Economy

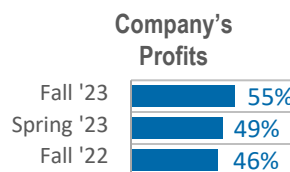
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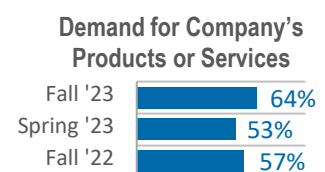
Owners' outlook for the national, local and global economy has also improved significantly over last spring and fall. Almost half (47%) are highly optimistic about the local economy, compared 29% last fall. A third (34%) are highly optimistic about the national economy compared to 22% a year ago.

Profit and demand expectations are higher with 55% expecting profits to rise (compared to 46% last fall) and 64% expecting an increase in demand in the next six months (compared to 57% last fall). Expectations for sales are similar to the spring survey, with 62% expecting an increase. Nearly two-thirds (65%) attribute their greater optimism for their business to confidence in their ability to run it.

Expect Increase in the next six months



Company's Profits



Demand for Company's Products or Services

HIRING ON HOLD

Hiring remains a challenge, however. Nine in 10 employers intend to hold steady on hiring with just 9% planning to increase their staffing and just 1% expecting layoffs. Among businesses looking to hire employees, one in three (35%) say it's become harder to hire qualified employees over the past six months, similar to last spring (36%) and a year ago (39%). The most common reason employers say it has become harder to hire is that there are not enough applicants overall (49%). Other reasons cited are candidates' lack of experience or skills (22%), high salary/benefit requirements (14%), and inability to meet legal/security requirements (6%).

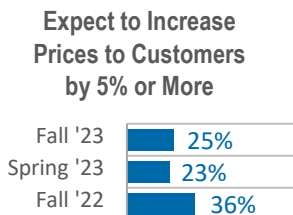
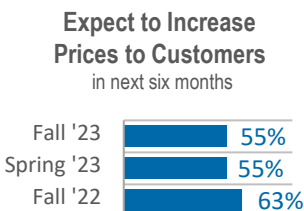
Expect # of Full-Time Employees to Stay the Same in next six months



Harder to Hire Qualified Employees vs. six months to a year ago, among those hiring



INFLATION EXPECTATIONS EASE



As inflation has eased over the last year, so have owners' expectations on raising prices. More than half (55%) of businesses say they expect to increase prices in the next six months, unchanged from last spring but significantly fewer than a year ago (63%).

Main justifications for increasing customer prices have shifted somewhat. Favorable market conditions top the list (38%), but a growing number identify keeping up with rising labor costs (32% vs. 21% last spring). Nearly three in 10 (29%) report raising prices to keep up with rising non-labor costs.

Fewer expect their price increases to be 5% or more as compared to last fall (25% vs. 36% in fall 2022) while 56% are expecting a more moderate raise of 3% to 4%, significantly up from a year ago (38%).

The steady drumbeat of Federal Reserve rate hikes over the past year has caught the attention of business owners. Two-thirds (65%) of respondents expect Fed rate hikes to have an effect on their business over the next year, including 31% who say they anticipate rate increases will put pressure on profits.

SUPPLY CHAIN CONCERNS ABATE



Business leaders' top concern for their business in the next six months has shifted from supply chain disruptions to costs. Nearly a quarter (23%) are most concerned about the cost of materials, up from 9% last fall, while 14% are most concerned about labor costs, up from 4% last fall. More than four in 10 (43%) of construction firms say material costs are their top concern.

Four in 10 (39%) expect inventory levels to increase in the next six months, higher than last fall (26%). Half of manufacturers (50%) and a majority of retailers (57%) expect rising inventory.

EMPLOYEE STRATEGIES

One in three business owners (33%) expect to increase employee compensation, up from 24% in the spring but fewer than last fall (40%). More than four in 10 employers (43%) report increased compensation requirements among their workforce and 38% say the need for flexible hours or remote work has increased.

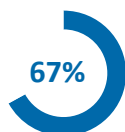
Expect to Increase Employee Compensation

in the next six months



Employers are taking a variety of measures to attract and retain employees: 35% have standardized flexible work options; 27% have changed benefit packages and 23% have standardized their hiring, promotion or compensation practices.

FLEXIBILITY REMAINS TOP OF MIND



Flexible Work Arrangements are Important to the Business
among those with employees

Two-thirds (67%) of employers say flexible work arrangements are important to the business. Among those who have standardized flexible work options and consider flexible work arrangements important to their business, 60% say it helps attract and retain employees and 38% believe their policies enhance the reputation of the business.

SEEKING ARTIFICIAL INTELLIGENCE



One in three business owners (33%) believe Artificial Intelligence (AI) applications could be useful to their business. AI relevance is highest for manufacturing businesses (47%). Among those who consider AI useful, more than four in 10 (44%) are already using AI applications, while 45% are evaluating or planning to implement applications in the next year or two.