Economic Scenario Planning

FORECASTING FOR THE COVID-19 RECESSION

prevedere

Introduction

As of late, we are continually bombarded with news on whether the stock markets are at a new low, if COVID-19 virus cases have reached a peak, the increases in unemployment, not to mention negative U.S. election-related information and more. Beyond the noise and numbers, business leaders question how the pandemic-led economic uncertainty will impact their business interests long-term.

Economists have been modeling potential economic recovery scenarios by using V and U letters to indicate patterned economic amelioration. Others ponder a W-shaped recovery, which indicates a dip followed by another dip. This additional level of possibility forces recovery scenarios to consider a potential second wave of the virus, prompting another round of shutdowns. Regardless of the rebound, this alphabet soup of possible scenarios makes it challenging to plan.

What does all this mean for your business? And do you need to reevaluate your forecast?

Today's leaders have faced unique challenges, from marketplace chaos to the constant change in consumer behavior dynamics. However, one of the heaviest demands to date seems to be how to transform a business into a truly data-driven organization.

The solution lies in recent technological advances that enable predictions on how economic, industry, and consumer trends may impact future business outcomes.

It's an approach called Intelligent Forecasting, and it's already changing how companies forecast performance and strengthen outcomes. But this process begs the question: How does an organization apply intelligent forecasting in a volatile economic environment where the rules are no longer clear?

A Brief Look at Intelligent Forecasting Pre-Pandemic

Advances in machine learning, advanced algorithms, cloud computing, and Big Data have made intelligent forecasting a reality.

Intelligent forecasting solutions systematically identify and quantify the influence of economic and other external factors on future business outcomes.

It's a breakthrough that increases the accuracy, efficiency, and timeliness of planning and forecasting. And its impact is being felt across the enterprise, from the Senior Executive team to FP&A and the Office of the CFO to Operations, Marketing, and Sales.

TRADITIONAL FORECASTING	INTELLIGENT FORECASTING
Manual	Automated
Internal Data	External & Internal Data
Time Consuming	Objective
Static	Constantly Updating
One-Offs	Repeatable at Scale

What is the Future for Business?

Every forecast and model before the crisis has essentially been rendered inept and discarded. But the process of forecasting and planning remains applicable. With the decline of COVID-19 cases, it's time to prepare for what comes next. It's already time to ask ourselves what's going to happen in the second half of the year and into early 2021. This process begins with identifying new relevant leading indicators.

It is crucial to strive for realistic planning with reasonable expectations. This brings us to hard-hitting impact statements in terms of what the baseline scenario looks like when it comes to thinking about planning for the second half of the year. At Prevedere, we've been putting together baseline scenarios in consideration of the full range of options. When we talk about the potential impacts, we have prepared highlights of a likely baseline scenario to begin planning for the second half of 2020. This looks different for every business.

Is there a way to build forecasting scenarios that look at a conservative, moderate, and potentially harsh economic model planning? Yes. We have to consider all scenarios from the extreme Great Depression to a minor recession even when we're probably going to be somewhere in between. Scenario planning provides "baseline scenarios" that include optimistic, median, and pessimistic scenarios. It's vital to forecast with a broader range of expectations, particularly at this moment in history, considering the elevated uncertainty. With infinite possibilities, understanding the importance of data is critical.

Data as the Key to Scenario Planning

To mimic what is going to happen in the United States or any other country from an economic crisis perspective, we generally look at leading indicators that often signal recessions one, two, three quarters in advance. Throughout the COVID-19 pandemic crisis, those indicators were virtually useless because of the rapidity of the economic downturn.

We've been through a shock factor, a lot like a light switched from on U.S. economy was humming along with relatively strong GDP growth a spending right up until we were all told to practice social distancing, and nonessential businesses, and fi nally to shelter in place. Quite literally economy was fl ipped upside down, spiraling into a recession. We don't have any traditional leading indicators for this crisis, but we can look at the timing of how events transpired in other countries to predict what the rebound might look like.

ECONOMIC SCENARIO PLANNING

Historical leading reliability

Some indicators have value because of their consistent ability to signal economic downturns and recoveries throughout past business cycles. There may not have been early economic signals for this recent downturn because of the sudden health-related nature of the event. But early clues of recovery from economic indicators that have traditionally signaled recovery months ahead of others are still likely.

For example, Average Hours Worked is an excellent leading indicator and can signal future potential changes in the unemployment rate, as hours tend to be cut before people are laid-off. Similarly, Hours Worked with existing employees rise before hiring begins. Therefore, Hours Worked may be a better indicator to watch than the unemployment rate depending on our needs.

Frequency and Timeliness of Data

Due to the forced measures put in place to curb the health pandemic, we have witnessed an unprecedented swift change in economic conditions. As a result, we selected several choice indicators based on their "first mover" status as being either real-time or near real-time (daily, weekly measures) to help our businesses gain a realistic view of current events.

Many traditional government data sources publish data monthly or even less frequently. And while some of these monthly datasets are still valuable to watch for economic reasons, we try to pair them with datasets released on a shorter timeline that will help signal current conditions faster.

ECONOMIC SCENARIO PLANNING

Frequency and Timeliness of Data (cont.)

A good example is that we find value in looking at the VIX Volatility Index for a measure of uncertainty amongst investors, and therefore uncertainty in their expectations about future economic conditions. We also look at the NFIB Small Business Sentiment Index. The VIX has the benefit of being a real-time daily metric, compared to the Small Business survey, which is a monthly survey. Both are worth watching for the future recovery, but the VIX will be helpful for early signals in the days before the NFIB survey data is released for consumption.

In times of elevated uncertainty and broken forecasts, we understand that planning for the future will be challenging for the remainder of 2020 and beyond. It can also be challenging to know what to focus on. To address this

problem, our economist team handpicks indicators that we feel are critical leading signals for the economic recovery following this economic downturn. The "new data" informs the ability to conduct scenario planning unique to a business.

Our Economic Scenario Planning solution provides businesses with the key "leading indicators" that typically turn early in the business cycle, and therefore provide clues to a coming change in the economic environment.

The selection of indicators is based on a combination of factors, including leading historical reliability, relevance to the current crisis, and the frequency and timeliness of release date for the data. Judging by these three criteria, specific indicators become much more valuable for a business to watch than others.

The Economic Scenario Planning Solution

Prevedere developed the an economic scenario planning solution to address the current situation in which data is evolving at unprecedented rates and is not following the patterns that are used in traditional forecasting models.

The solution provides companies with a clearer vision as they revise their forecasts and identify potential scenarios that could impact industries. This offering enhances the ability for financial executives to build dynamic planning models for their organizations and adjust quickly to possible market changes in advance of any key inflection points.

Further, Prevedere's economic scenario planning identifies which economic indicators will impact a company's business, alerts them at the first signs of an economic inflection point, and helps to answer questions as to the projected length and longevity of those situations.

HERE ARE JUST A FEW EXAMPLES:

HEDGING AGAINST A SLOWDOWN AT A SPECIALTY RETAILER

How long can a product line keep growing at 20%? That was the question facing executives at a leading specialty retailer. Turns out, the product line was targeted at 18- to 24-year old women and leading indicators signaled that these consumers were getting squeezed. Prevedere's economic model projected a lower 8% growth rate, which represented a $300 million revenue miss. With this market risk exposed, the executive team put contingency plans in place for pricing and promotions and a stronger focus on online sales.

TAKEAWAY →

It can be politically tough to adjust a growth rate downwards. An objective, market-driven forecast can help leadership land on a realistic target. And if the forecast projects an unexpected softening in the market, people can take steps to protect profitability during the downturn.

❝ Market indicators give us a much better directional sense of where the business is going. ❞

— **DIVISION CFO**

PREDICTING MARKET SWINGS AT AN INDUSTRIAL MANUFACTURER

When the energy market took a dive in 2016, this manufacturer was caught off-guard. Demand dropped dramatically and the company was left with a sizable investment in unsold inventory. Now the manufacturer uses Prevedere to predict and prepare for market swings. Demand outlooks for the company's primary end markets (Energy, Automotive, and Commercial Construction) increase forecast accuracy. And supply chain executives have better information to manage inventory, production levels, and logistics.

TAKEAWAY →

Forecasting is tricky for manufacturers because they're often several steps removed from their end markets. Econometric models help manufacturers get a handle on what's driving end-market demand and when that demand is likely to increase or decrease over the next 12 to 24 months.

❝ The risk of having too much inventory is reduced, which has a positive impact on our use of working capital. ❞

— VICE PRESIDENT, CORPORATE STRATEGY & INVESTOR RELATIONS

PREDICTIONS COME TRUE AT A GLOBAL BEVERAGE COMPANY

In 2016, a world leader in premium beverages experienced a significant slowdown in sales despite a strong economy. Why? For answers, the North America CFO turned to Prevedere to determine the external factors driving beverage sales. Since then, Prevedere's econometric models accurately predicted a softening in the market in 2017 and a turnaround in 2018. The company has adopted Prevedere in its European and Asian operations and uses insights into future headwinds and tailwinds to optimize production, pricing, and marketing spend.

TAKEAWAY →

A strong economy doesn't always mean smooth sailing ahead. Business performance can be influenced by less obvious underlying drivers that may not be in sync with macroeconomic trends. Forecasts based on your unique leading indicators are a better predictor of future sales.

❝ I am able to maximize opportunities where the forecast is upbeat and minimize the impact where it isn't. ❞

— NORTH AMERICA CFO

Planning for "What's Next"

The platform offers three scalable solutions that can be customized for an individual company:

▶ The Watch List monitors for industry-level directional changes as new data is released and identifies upcoming economic inflection points.

▶ "What if" Scenario Planning assesses the impact of plausible economic scenarios and identifies the potential impact on a business, through customized models that are developed by Prevedere's team of economists.

▶ The (Re)Planning Tool leverages external indicators within a company's planning models to deliver clearer guidance and accuracy on the evolving impact of the economic situation in 2020 and beyond.

Economic scenario planning was built using Prevedere's ERIN Engine, which can be integrated into any data lake or data warehouse or can be imported into most BI and analytics tools, including Microsoft PowerBI, Tableau, SAS, Excel, and many others.

To learn more about Prevedere's Economic Scenario Planning Slution visit: www.prevedere.com/economic-scenario-planning

SEE

how economic activity
impacts performance

SOLVE

for upcoming risks
and opportunity

SUCCEED

with stronger, more
predictable results

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