Bell Bank

Commercial Insights

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The Top 3 Challenges for Business Leaders as Inflation Rises

The historic inflation levels over the past year have created a broad set of challenges for business leaders. Whether it's a store manager hiring and training workers, a manufacturer expanding their facilities, or a chief financial officer approving and financing new projects, inflation has made business decisions and execution more difficult. These factors create pressure on profit margins, especially with greater economic uncertainty.

This is true across the country and in many parts of the Midwest. Inflation in recent months has been hotter in the region than across the rest of the country, and on a year-over-year basis, inflation in the Midwest has been worse than in the West and Northeast. The Twin Cities in particular have experienced a rise in consumer prices of 8.7% over the past year, adversely affecting the diverse variety of industries across Minnesota and neighboring states.

This is due in no small part to the historic strength of Minnesota's job market. According to the latest Bureau of Labor Statistics Local Area Unemployment Report, Minnesota's unemployment rate has dropped to 1.8% from 2.0%. The decline marks Minnesota as the state with not just the lowest unemployment rate in the country, but the lowest any state has ever registered since they began tracking these numbers.

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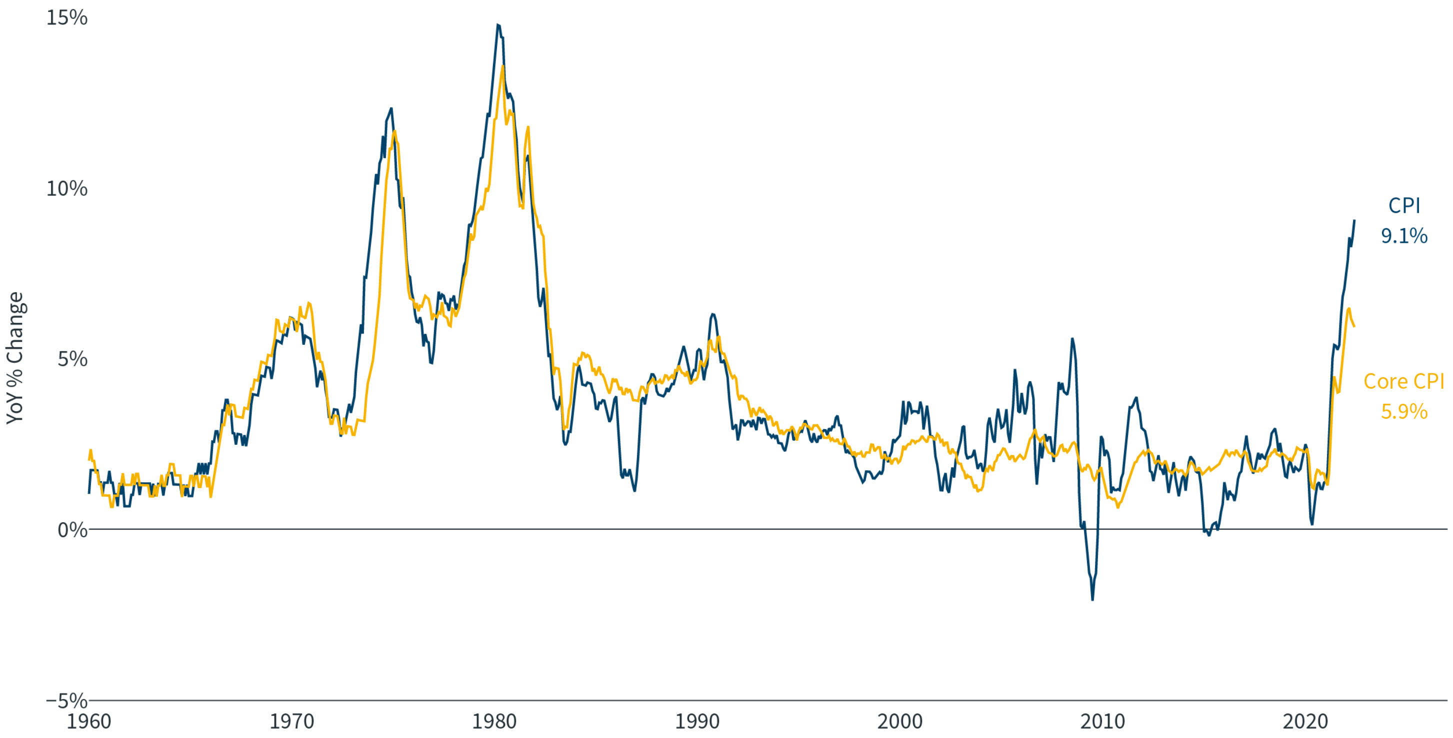
Consumer Price Index

CPI and Ex Food and Energy, YoY % Change



Latest data point is Jun 2022
Sources: Clearnomics, U.S. Bureau of Labor Statistics

As a result, there has never been a more important time to carefully consider all costs to a business by asking a few tough questions. The silver lining is that it may also be the perfect time to make strategic investments when competitors are hesitant, including buying new equipment, increasing automation, expanding office space, and more. Doing so can help businesses of all types to prepare for the years and decades of growth ahead.

Prices continue to rise at a historic pace

Prices have accelerated as consumer demand recovered from the pandemic, partly fueled by stimulus checks and other government programs. The pandemic itself created supply chain disruptions and bottlenecks which limited the supply of goods at exactly the worst time. The war in Ukraine and further lockdowns in countries like China have hurt the availability of commodities, especially energy. Emergency monetary policy by the Fed and other central banks also increased liquidity in the system, adding further fuel to inflation.

As a result, inflation has reached its highest level since 1981 when inflation was falling and 1978 when inflation was rising. For households, many of these costs are necessities and can't be avoided. High prices for food and gasoline directly impact consumer pocketbooks. Higher fuel and transportation costs, among many other input costs, also impact businesses across industries.

Producer prices show a similar trend. The Federal Reserve Bank of Minneapolis' Beige Book reports that "about three-quarters of manufacturers at a recent event indicated that their input prices have risen faster since the beginning of this year than last year, compared with fewer than 10 percent who reported that prices increased at a slower pace." The Producer Price Index, which measures the prices that suppliers charge, is also at four-decade highs.

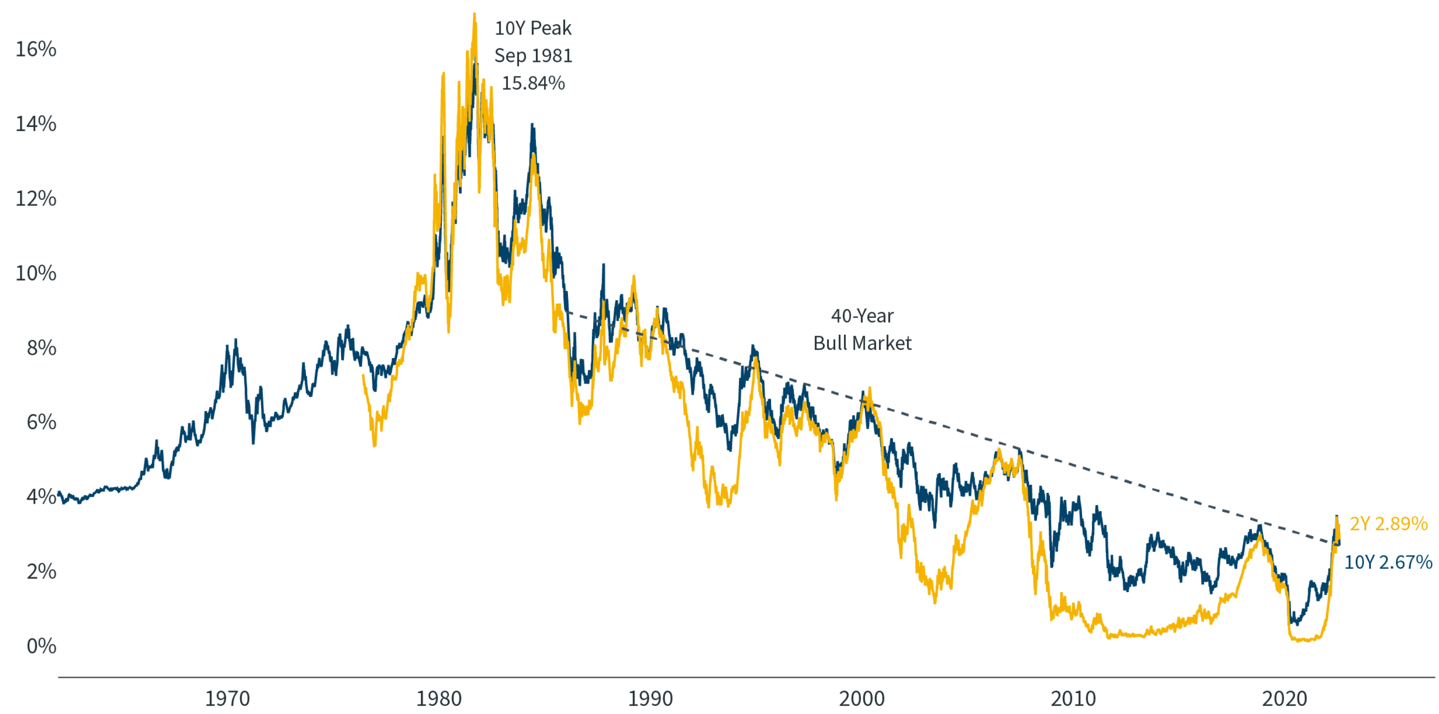
Fortunately, there are some signs that inflation may begin to ease in the coming months. Gasoline prices have already fallen alongside oil and wholesale gasoline prices from refiners. Some agricultural commodities have come down as well. Still, even if inflation lifts slightly, the pace of price increases is still the fastest in generations.

Interest rates are rising

Rising inflation has prompted the Federal Reserve to lift interest rates. This directly raises the cost of borrowing across the board for both consumers and businesses. Businesses that are seeking financing to expand, engage in capital projects, build new plants, and more, should explore various ways of funding these projects.

Historical Interest Rates

10-year and 2-year yields since 1960



Latest data point is Jul 29, 2022

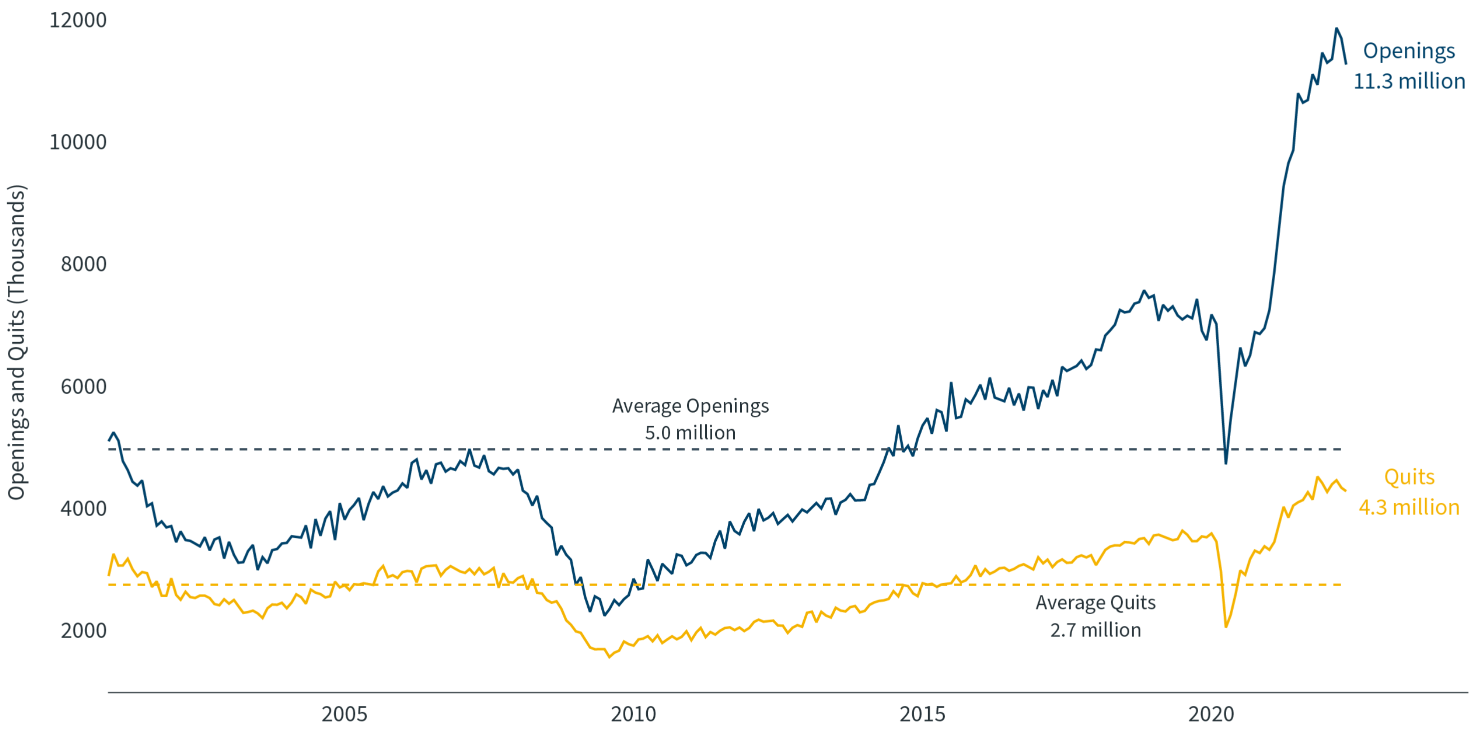
Sources: Clearnomics, Federal Reserve

To make matters worse, if financial conditions continue to tighten, many worry that there could be an economic pullback which could affect consumer spending and profit margins. Still, the Federal Reserve Bank of Minneapolis' Beige Book documents that "consumer and business contacts said it was still too early to gauge the net effects of interest rate increases on consumer spending" as other factors such as inventory shortages were having larger effects than interest rate changes.

In challenging environments like these, it is important to distinguish short-term economic conditions from long-term business goals. Key capital investments should be reassessed to ensure their viability, but not delayed simply because of the rising rates environment. As long as the returns on these projects exceed their hurdle rates, they might still make sense. Also, while interest rates have risen, they have been stuck in a range in recent months and are still quite low historically. Businesses should not lose sight of

Job Openings and Quits

The number of job openings and quits per the Job Openings and Labor Turnover Survey (JOLTS)



Latest data point is May 2022

Sources: Clearnomics, U.S. Bureau of Labor Statistics long-term opportunities simply because interest rates are rising or there is more economic uncertainty.

Hiring is challenging

All business leaders know that hiring and retaining workers is one of the most difficult challenges today. This is true across the nation as well as in the Midwest. The Federal Reserve Bank of Minneapolis' Beige Book reports that "employee headcounts have grown more slowly than labor demand."

The growth of this mismatch between jobs and skills is apparent when examining the increase in job openings within the Midwest region. The Job Openings and Labor Turnover Survey (JOLTS) report published monthly by the Bureau of Labor Statistics highlights the job openings rate for the Midwest. Since July 2020 the job openings rate in the Midwest has grown to 7.5%, which represents the percentage of job openings compared to the number of those who have jobs or are searching for jobs. This is well above the February 2020 level of 4.4% as the prior economic crisis began.

Thus, even once employers are able to recruit skilled workers, they face the further challenge of retaining this talent. In such an environment, employers face greater pressure to invest in their current staff in order to maintain productivity and margins. This can be done by increasing training or providing employees with additional resources. In the long term, businesses can make capital investments in new equipment, more efficient processes, or automation. This tradeoff needs to be managed carefully by business leaders in order to optimize future growth.

Opportunities amid uncertainty

Business decisionmakers should continue to focus on long-term rewards despite the intermediate challenges. Maintaining discipline around financing and hiring needs is important today as prices rise, the Fed raises rates, and the economy decelerates. This may be the motivation many businesses need to seek opportunities to improve efficiency and productivity.

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