US Economics | North America

Business Conditions: Layoff Commentary Creeps In

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Worries over tighter credit conditions continue to weigh heavily on sentiment in May. Layoffs are creeping into corporate commentary in some industries. Cost management initiatives such as layoffs and hiring freezes remain a top focus among companies in response to economic uncertainty.

	May 22	Jun 22	Jul 22	Aug 22	Sep 22	Oct 22	Nov 22	Dec 22	Jan 23	Feb 23	Mar 23	Apr 23	May 23
Morgan Stanley Business Conditions Index (seasonally adjusted)	**60**	**41**	**41**	**39**	**41**	**33**	**25**	**45**	**56**	**59**	**63**	**44**	**44**
MSBCI (3-month moving average)	51	48	47	40	41	38	33	35	42	54	60	56	51
Morgan Stanley Business Conditions Index	65	38	42	42	42	27	29	45	55	61	65	35	50
Manufacturing Subindex	100	50	60	50	33	33	33	60	40	64	63	67	50
Services Subindex	50	29	31	33	50	20	25	33	67	59	67	25	50
Price Index	94	96	85	91	85	86	64	77	86	92	88	85	69
Prices Paid Index	100	100	95	100	100	91	91	70	90	81	90	79	54
Composite MSBCI	**59**	**47**	**47**	**43**	**40**	**44**	**41**	**38**	**40**	**47**	**45**	**34**	**39**
Advance Bookings Index	88	50	63	50	40	43	50	25	40	38	50	20	40
Credit Conditions Index	30	38	35	38	38	27	29	36	36	47	35	15	30
Business Conditions Expectations Index	50	19	27	29	27	32	32	32	27	50	38	38	47
Hiring Index	65	54	46	50	46	59	38	41	41	39	42	38	37
Hiring Plans Index	70	58	50	35	38	45	38	41	41	44	46	35	37
Capex Plans Index	55	62	65	54	50	59	58	50	55	61	58	58	43
Memo: % reporting increase over previous 3 months													
Hiring	50	31	15	17	23	36	8	9	9	22	15	15	7
Hiring Plans	50	31	15	10	15	18	8	9	9	22	15	0	0
Capex Plans	10	23	31	8	8	18	33	9	27	33	31	15	0

Note: Headline index seasonally adjusted, all else not seasonally adjusted.
Source: Morgan Stanley Research

The MSBCI survey highlighted that tighter credit conditions stemming from recent funding pressures continued to weigh heavily on business sentiment in May. The May survey was conducted from May 8 to May 10.

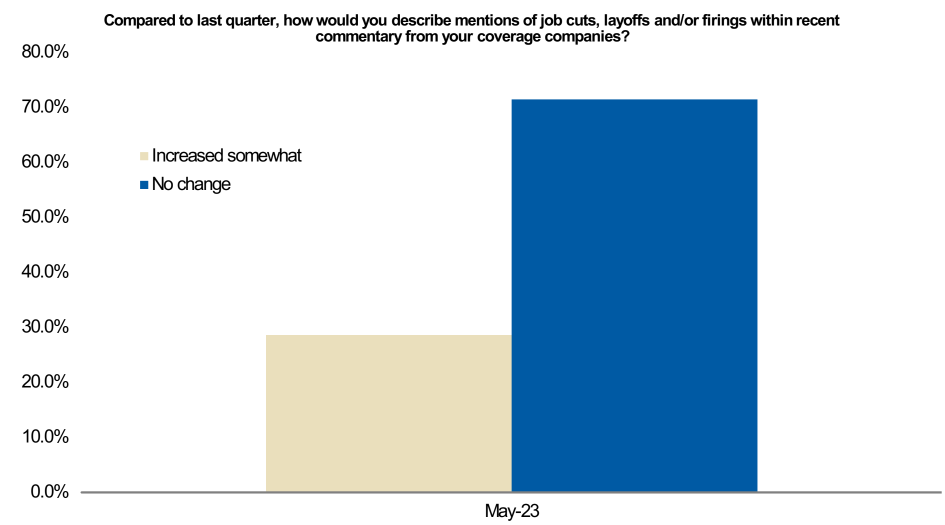
The Morgan Stanley Business Conditions Index (MSBCI) remained unchanged at 44 (+50 = Expanding). [1] In the underlying details, the Services Subindex rose 25 points to 50, moving back into expansionary territory. **The Manufacturing Subindex slipped, falling to 50 from 67, but continued to show resilience - in line with our call that the ISM PMI bottomed in March.**

Special Questions

For the past few months, we have included special questions in our survey to gauge how recent developments are affecting current and expected future conditions across industries under our analysts' coverage.

A large majority of respondents indicated that companies did not see an increase in mentions of job cuts, layoffs, and/or firings within recent commentary from their coverage companies (Exhibit 1). The respondents that did note an increase in commentary, relative to last quarter, were in **packaging and mid-cap chemicals, biotech, autos**, **and hard-line retail.**

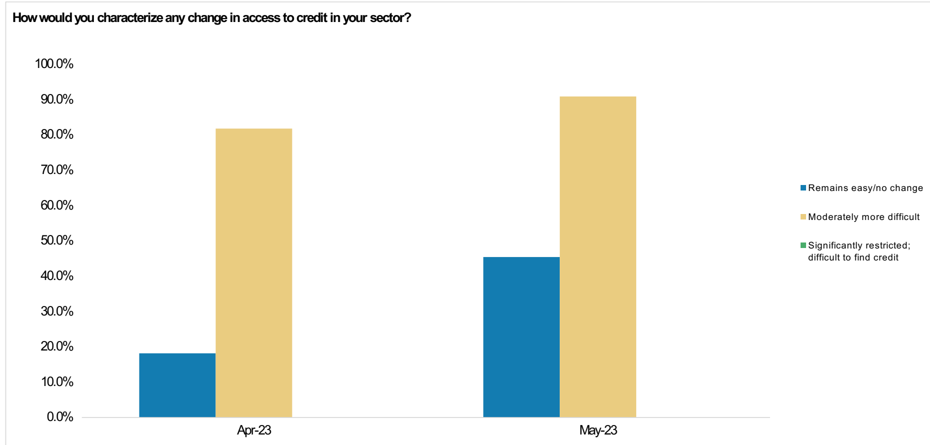
Exhibit 1: Commentary on Firings, Layoffs and/or Job Cuts is Popping Up in Select Industries



Source: Morgan Stanley Research

An overwhelming majority of respondents noted that companies feel it is **"moderately/more difficult" to access credit within their sector**. Pressure was broad-based across various industries including **telecom services, construction, business services, multi-industrials, REITs, power & utilities, autos, macro, midcap banks, hard-line retail, and midcap infrastructure software**. Companies stated that **higher credit spreads** were the main source of credit pressures. This is in line with our bank analysts' view of a meaningful increase in funding costs ahead, which will **lead to tighter lending standards, slower loan growth, and wider spreads**.

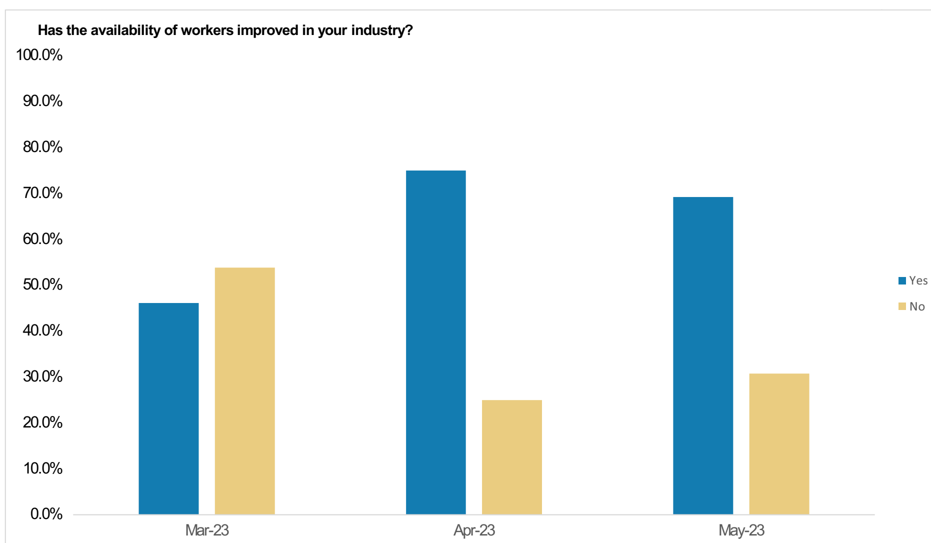
Exhibit 2: Tighter Credit Conditions Begin to Bite as Firms State it is Moderately/More Difficult to Access Credit



Source: Morgan Stanley Research

A majority of respondents indicated that companies continue to see evidence of an increase in the availability of labor in their industry (Exhibit 3). Respondents that noted an improvement in labor supply were in industries currently facing severe worker shortages, including **construction, restaurants, and hardline retail**. On balance, some companies reported **having better staffing levels recently. This month's survey highlights job gains are decelerating broadly in line with our expectations, with further signs of slack creeping in.**

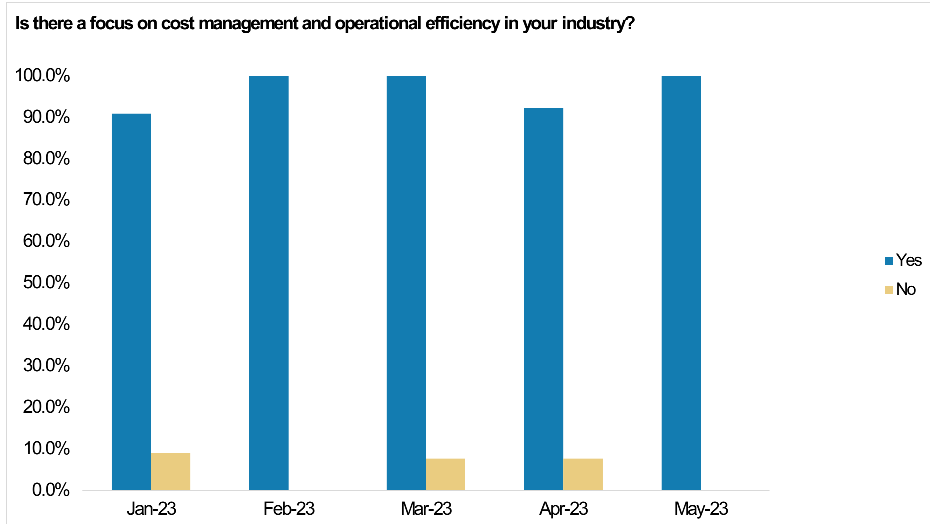
Exhibit 3: Worker Availability Improves in Industries Facing Severe Labor Shortages - such as Construction, Restaurants, and Retail.



Source: Morgan Stanley Research

All respondents this month reported that companies under their coverage are focused on cost management and operational efficiency initiatives (Exhibit 4). Respondents noted that **hiring freezes and layoffs** remain the most predominant cost management strategies that companies are implementing.

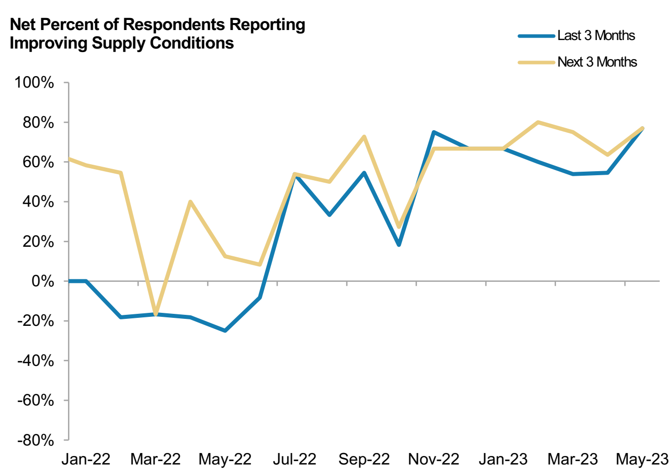
Exhibit 4: Cost Management Initiatives Remain a Key Focus



Source: Morgan Stanley Research

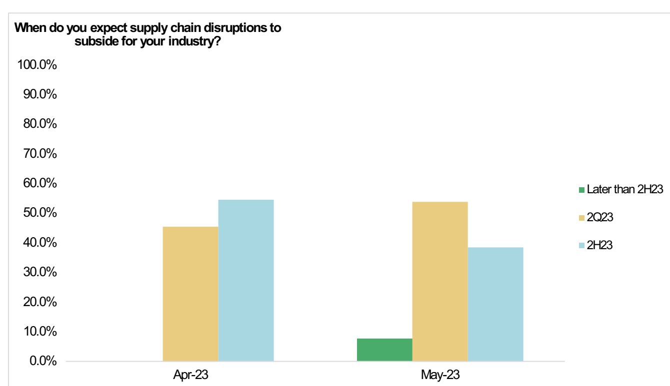
Respondents noted improving supply-chain conditions relative to last. The share of respondents reporting supply conditions improving over the last three months increased on the margin in May. Further, the share of respondents expecting supply chain conditions to improve in the next three months remains high (Exhibit 5 and Exhibit 6). On timing, 54% of survey participants see supply chain disruptions subsiding in 2Q23. Those who see disruptions subsiding in 2H23 came in at 39%, **as most respondents noted that supply chain pressures have been easing faster-than-expected** (Exhibit 6). **Industries such as restaurants, chemicals, packaging, multi-industrials report seeing supply chain improvements 2Q23**, while telecom services, construction, power & utilities, autos, and hard-line retail report seeing improvements later in the year.

Exhibit 5: Improvement in Supply Conditions Remains Gradual



Note: Data reports the net percent of respondents (improved - deteriorated); Last 3 months reflects answers to the question assessing supply conditions over the last 3 months; Next 3 months reflects answers to the question assessing expected supply conditions over the next 3 months
Source: Morgan Stanley Research

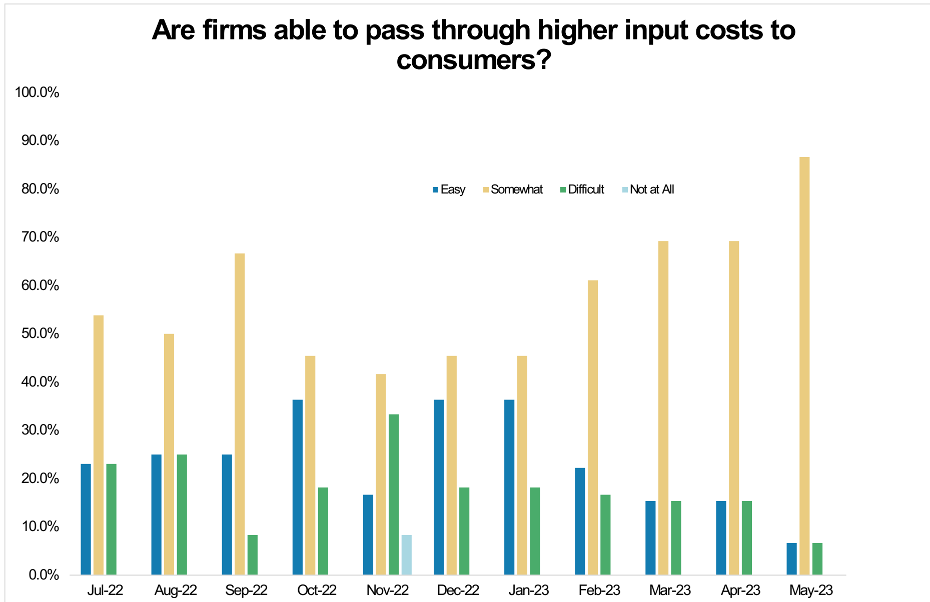
Exhibit 6: Expectations for Supply Chain Improvement this Year Remain Optimistic



Source: Morgan Stanley Research

On the pass-through of prices, the percentage of analysts in our survey indicating that companies find it easy to pass-through costs to customers declined (Exhibit 7). 87% of analysts reported that their companies have "somewhat" been able to pass on higher input costs, while the remaining analysts were evenly split between "easy" and "difficult". **Respondents indicating an ease in ability to pass-through prices were primarily concentrated in multi-industrials, while telecom services reported difficulties passing on cost increases to customers.**

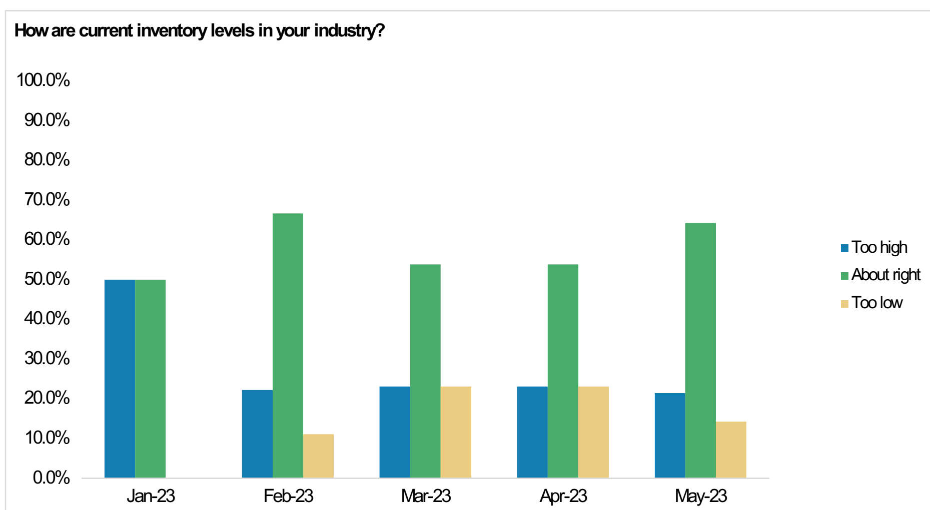
Exhibit 7: Firms Continue to Pass-through Costs



Source: Morgan Stanley Research

On inventory levels, responses from our survey indicate that new inventory orders may slow, as the majority of companies noted inventory levels remain sufficient. 64% of analysts reported that inventory levels at their companies were "about right" (Exhibit 8).

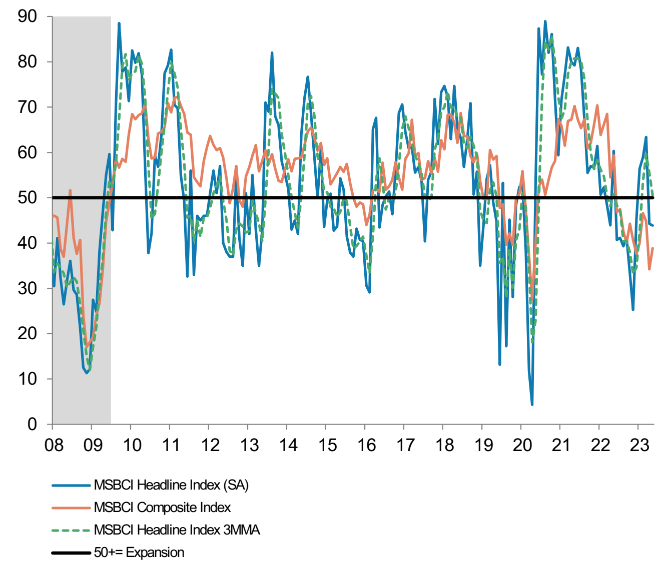
Exhibit 8: Companies Continue to Report that Inventory Levels Remain Sufficient



Source: Morgan Stanley Research

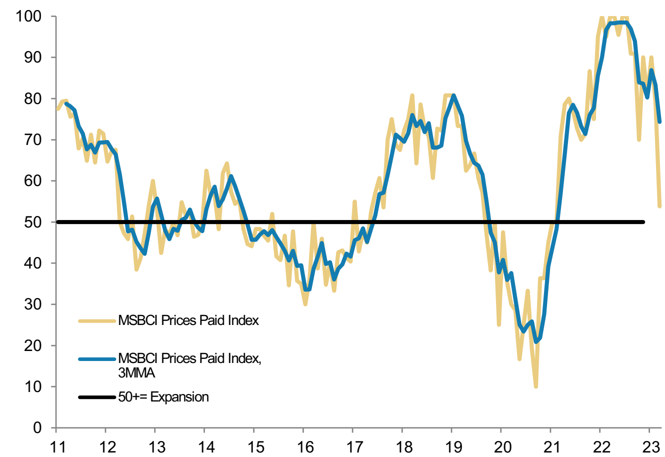
The MSBCI Composite Index, a gauge which fully synthesizes our analysts' views of their coverage companies, rose to 39 (+50 = Expanding) up from 34 in April (Exhibit 9). The Composite Index saw improvements in advance bookings and business conditions expectations. Price indicators, which moved lower, displayed signs of margin expansion among companies. The Prices Paid Index came down as businesses reported paying less for raw materials (Exhibit 10). The Price Index also fell (Exhibit 11) during the month. Pricing dynamics in May show that businesses reported their customers paying more for their goods and services. (Exhibit 12). [2]

Exhibit 9: MSBCI and the MSBCI Composite: Recent Performance



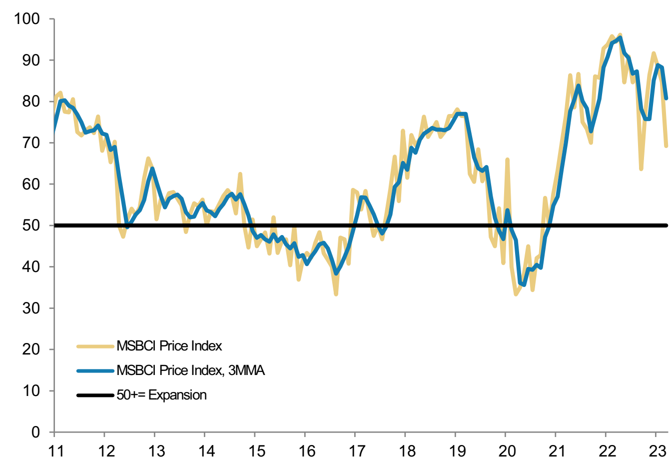
Source: Morgan Stanley Research

Exhibit 10: The MSBCI Prices Paid Index



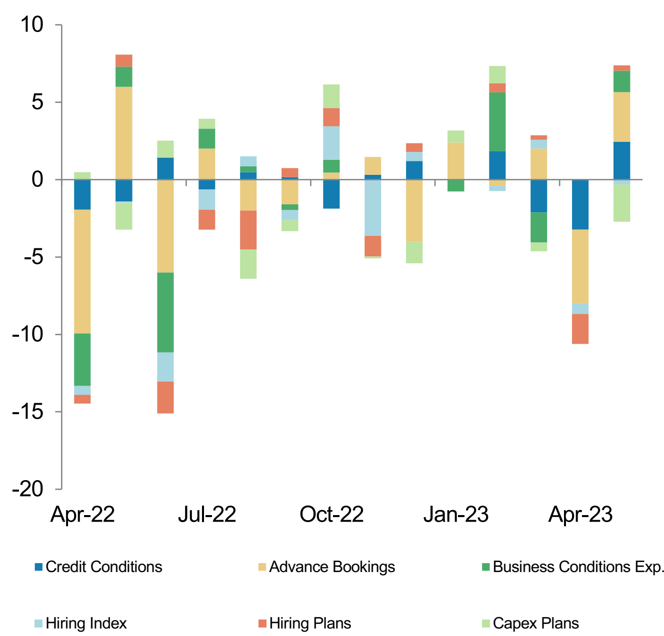
Source: Morgan Stanley Research

Exhibit 11: The MSBCI Price Index



Source: Morgan Stanley Research

Exhibit 12: Contributions to Changes in the MSBCI Composite

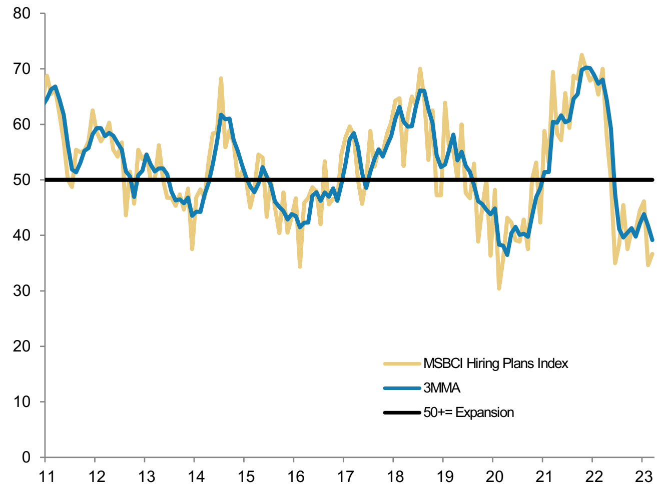


Source: Morgan Stanley Research

Responses in our survey related to the labor market were mixed. The MSBCI Hiring Index fell to 37 (vs 38 in April), while the MSBCI Hiring Plans Index rose to 37 (vs 35 in April). Both indexes remain in contraction territory (Exhibit 13). The MSBCI Capex Plans

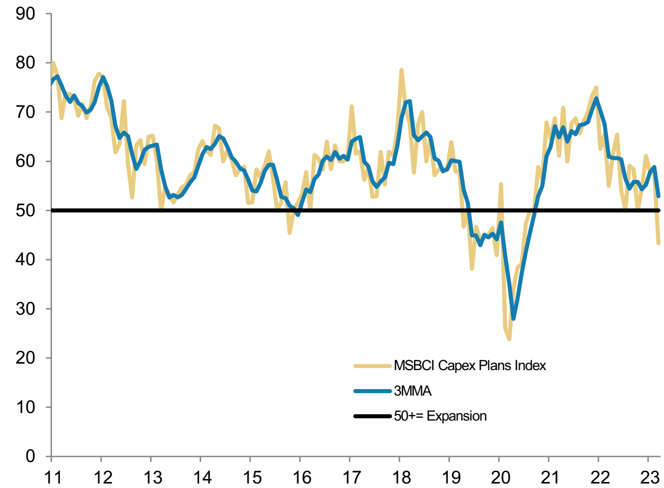
Index fell to 43 (vs 58 in April) in May, moving into contractionary territory, **as firms scaled back investment plans** (Exhibit 14).

Exhibit 13: Hiring Plans Remain Muted



Source: Morgan Stanley Research

Exhibit 14: Capex Plans Fell During the Month



Source: Morgan Stanley Research

The MSBCI Business Conditions Expectations Index, which measures 6-month forward expectations for activity, rose to 47 (vs 38 in April) in May. Expectations remained in contractionary territory as businesses expressed less optimism about future conditions.

What Respondents Are Saying on the Outlook

- **Telecom Services:** "Guidance largely reiterated with 1Q earnings."
- **Chemicals:** "destocking is ending which will provide for better sequential volume. likewise raw material costs are moderating and set to turn lower y/y in 3Q (if not sooner)."
- **Multi-Industry:** "March and April trends have held up far better than expected and book to bill remains above 1x with record backlogs and stimulus still to come."
- **Construction:** "Limited M/M change - company sentiment has generally remained upbeat, no/limited evidence of recessionary impacts."
- **Power & Utilities:** "Gas prices down, expect inflationary pressure to ease."
- **Gaming & Lodging:** "Business travel & leisure travel have largely reached a plateau with ebbs/flows based on the mix in any given quarter."
- **Restaurants:** "Some restaurants expecting a slower 2H23."
- **Mid-Cap Chemicals and Packaging:** "Destocking pressures should ease, but only modestly and underlying demand remains tepid at best."
- **Macro:** "There was some softening of enterprise demand after the mid-March banking crisis, but it wasn't widespread, and mostly isolated to PCs, Servers and Storage. Outside of that trends were largely consistent with 4Q, maybe a tiny bit

better this earnings season. Consumer demand is not as bad as feared either. Lastly, alot of my companies took their medicine quarters ago (i.e. restructuring, layoffs, etc.) so we have line of sight to some early signs of operating leverage as trends stabilize."

- **Power & Utilities:** "Similar 2023 earnings outlook."
- **Autos:** "Macro slowdown likely hits the consumer leading to a drop off in OE sales, flowing through to the dealers and suppliers."
- **Midcap Software:** "As tech layoffs look in rear view companies will be focused on IT priorities to drive further efficiencies."

Tracking Economic Conditions with the MSBCI

The MSBCI and its component indices have performed well in capturing turning points in the US economy. For a diffusion index, 50 serves as a rule-of-thumb breakeven level. Above 50, a greater share of survey respondents are reporting improvements in business conditions than are reporting worsening business conditions. But diffusion indexes only focus on directional changes (up, down, same) and don't provide information on magnitudes. Besides, the MSBCI surveys analysts and not firms, which complicates even more the mapping between the index and GDP.

We analyze the correlation between QoQ GDP prints and the MSBCI to shed some light on the relationship between the MSBCI and economic activity. Exhibit 15 plots the quarterly average of the MSBCI against real GDP growth, and Exhibit 16 plots the quarterly average of the MSBCI Composite against real GDP growth. To find the level of the MSBCI and MSBCI Composite associated with flat GDP growth, we calculated breakeven points for both of these indices, equal to the negative of the ratio of the estimated intercept and slope coefficient.

For the MSBCI headline index, we find that a reading above 33.0 is consistent with positive real GDP growth, and for the MSBCI Composite index we find that a reading above 46.1 is consistent with positive real GDP growth. Currently, the two measures are showing a bit of divergence on what they say about economic growth. With the MSBCI headline index at 44 in May, the index indicates that real GDP continues to grow. However at a level of 39, the MSBCI Composite index is showing economic activity contracted in May. Note from the chart below that the fit between the two series is not perfect, and the MSBCI should be regarded as one additional input in our forecast models.

Exhibit 15: MSBCI Above 33.0 is Consistent With Positive Real GDP Growth

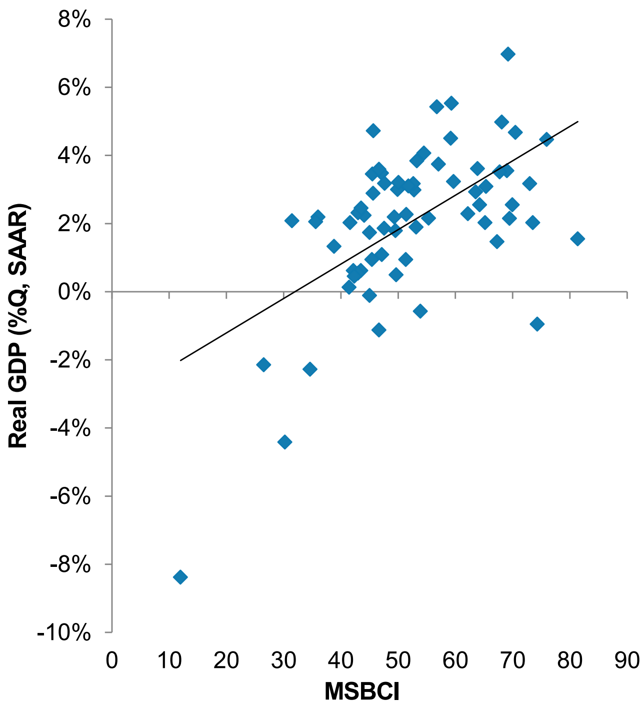
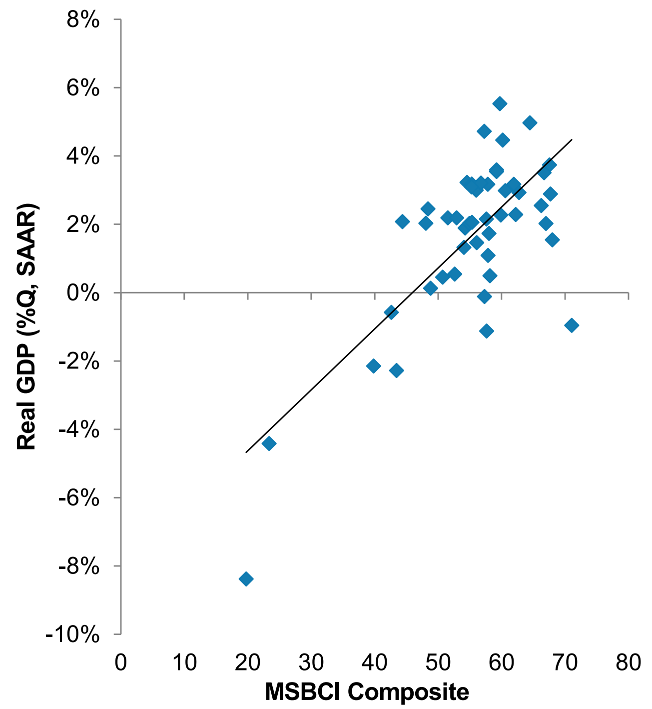


Exhibit 16: MSBCI Composite Above 46.1 is Consistent With Positive Real GDP Growth



Source: Bureau of Economic Analysis, Morgan Stanley Research

Endnotes

1 The MSBCI headline index is a sentiment indicator that reflects our analysts' responses to the following question: compared to a month ago, business conditions in my industry have: improved/worsened/not changed.

2 The composite MSBCI is calculated as a weighted average of the advance bookings index, the credit conditions index, the business conditions expectations index, the hiring index, the hiring plans index, and the capex plans index.

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