Voice of the CFO

As market volatility increases, CFOs prepare for the increasing likelihood of recession and give serious consideration to using AI for forecasting

KPMG LLP convened a cross-industry group of chief financial officers (CFOs) to talk about the increased likelihood of a recession given market volatility and financial market stress, as well as the possibility of using artificial intelligence (AI) for forecasting. Carl Carande, US vice chair and global head of Advisory, led the discussion and was joined by Ken Kim from KPMG Economics and Sanjay Sehgal, Advisory principal and head of Markets.

Ken Kim from KPMG Economics kicked off the session by saying that, despite hopes that the March rate hike would be the last one, the Fed probably has one more planned since they are still battling high inflation. Going forward, the Fed has to think about preserving financial stability and limit the negative reaction of the financial markets, which hinders the Fed's ability to raise rates given this new emergent concern.

The likelihood of recession

CFOs in attendance were concerned about recession and asked for clarification and context from Kim.

Kim said: "We think there is a high chance of recession by the middle of 2023—60 percent according to one Fed model—although most economists, including ourselves, believe it will be mild to moderate in terms of depth and duration." For context, he said that economists are expecting unemployment to reach 5–6 percent (from its current rate of 3.6 percent), which represents a much milder scenario than the 2008–09 recession when the unemployment rate went up to 10 percent.

One insurance industry CFO asked if the likelihood and severity of recession was different than it was 90 or 180 days ago, to which Kim responded that "it's probably marginally worse," but that's because we were already anticipating a recession.

Kim stressed that layoffs and retreat on investments in Big Tech could be warning signs of future disruption in other industries. "In general, we are seeing manufacturing activity weaken and industrial production as a whole turn negative," he said. "Unfortunately, manufacturing is usually a leading cyclical indicator of where the economy is headed, which we can see in the consumers' switch in focus away from discretionary goods spending toward services."

Key takeaways

- The Fed is likely to enact one more interest rate hike in 2023.
- The probability of recession by the middle of the year is around 60 percent, according to one Fed model. However, economists expect it to be mild to moderate in depth and duration.
- Consumer savings amassed during the early days of the pandemic have decreased from $2.2 trillion to $1.1 trillion, and households will probably shift their focus from spending to savings due to increased anxiety around a possible recession.
- CFOs continue to evaluate their financial and vendor relationships to ensure they are resilient through this economic cycle.
- CFOs are both excited and cautious about the use of AI for forecasting, as well as other applications as varied as supply chain management, insurance claim reviews, and corporate audits.

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A range of consumer impacts

A hospitality industry CFO queried Kim about the contrast between strong employment and consumer health on the one hand and slower business investment and lending constraints on the other hand.

He stressed that the economy was hitting those in lower income brackets harder and that he was concerned about the decrease in housing sales due to the sharp increase in mortgage rates. "We are seeing more loan delinquencies in that demographic, and their savings are being depleted by inflated prices for food, gas, and other necessities," said Kim.

"In contrast, those in the upper income brackets are still holding up pretty well, mostly due to excess savings or 'dry powder.'" At its peak, excess savings was $2.2 trillion with the predominant savings belonging to those in the upper income bracket. Although savings had decreased to $1.1 trillion as of February this year, "this could still act as a tailwind for about another 12 months before it is entirely exhausted based on prevailing trends," said Kim. Depending on several economic factors, however, consumers may shift from spending that money to saving.

Concerns about credit, liquidity, and resilience through this economic cycle

There was a fair bit of skepticism about the commercial real estate market with some CFOs expressing that, since there is market volatility, they are being more cautious in this realm. "The real estate market is now at the top of our risk assessment list," said one CFO.

A hospitality industry CFO stressed how their business is particularly impacted by real estate lending. "We are really seeing the smaller banks pull back and tighten up on lending requirements, which has an obvious impact on the development side of our business."

"Unfortunately, there is a longer-term downside to rate hikes and that is that the 10-year market yield is now 3.29 percent," said Kim. "This is a decrease of almost 100 basis points from the peak of 4.25 percent." The significance of this decrease is that fixed income market participants increasingly view the risk of recession as very high, especially now that banks are likely imposing even stricter underwriting conditions and tightening credit to both households and businesses.

Several CFOs discussed the need to evaluate relationships for resilience.

A manufacturing industry CFO said that they were reframing the risk profiles of the banks with which they do business, while a consumer-packaged-goods CFO stressed vendor relationships. "Now our Finance Risk Management Committee is revisiting our vendor relationships. We have made a few changes and tried to rebalance our risk profile, reset the limits, and reevaluate who those counterparties are."

Carl Carande, KPMG US vice chair and global head of Advisory, rounded out the discussion saying that organizations should take a hard look at vendor risk management.

The view on AI and forecasting

Building on the discussion from the CFO Forum in March, Sanjay Sehgal, KPMG Advisory principal and head of Markets, led a discussion on how CFOs can start considering using AI and machine learning tools for budgeting, planning, and forecasting, stressing that this was becoming more urgent in the volatile economic environment.

Sehgal presented the group with numerous intelligent forecasting use cases, which were met with great interest. "We have all this internal and external data, which can yield incredible insights if put through machine learning and AI. Ultimately, I think finance organizations will be able to use these technologies to automate and create a better forecasting process, including predictions on next-quarter sales or what margins are going to be. Certainly, it will be a huge improvement over the manual methods being used right now. Of course, you have to ensure these technologies fit within the culture of your organization. But now is the time to really think about how to leverage AI in core processes to create competitive advantage, while also increasing efficiency and accuracy."

Despite interest and optimism about AI's future potential, CFOs across industries from professional services to consumer-packaged goods said they were proceeding with caution, particularly when it comes to unsupervised use of ChatGPT.

One CFO shared that his company is having conversations about whether they should use AI and, if so, how they can put guardrails around its use. "Obviously, it's got huge potential," he said. "We've already got a playbook of potential ideas for how we might put it to use in the finance space, everything from early drafts of a press release to basic FP&A."

A professional services CFO stressed the need to hire and retain the requisite talent to use AI more strategically. "We have to do some reskilling, but I think this is going to be really important for us. And the finance team and CFO get to be a big part of this effort."

An insurance CFO shared that his company is already using AI across a spectrum of applications, including underwriting, assessing risk in claims payments, and estimating the cost to repair damage to a car or house.

Carl Carande punctuated the staying power of AI, telling the group that "ChatGPT and generative AI aren't going away. Companies need to figure out how to leverage them, and they need to start that process now."

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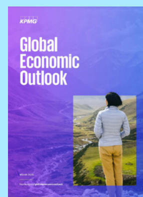
Additional insights



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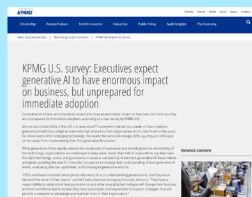

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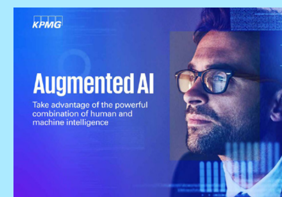

- Augmented AI

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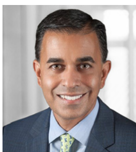

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