NEW MEXICO
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FINANCIAL FEED

2023.5

Combating Inflation

Money management strategies to weather the storm

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NEWMEXICO BANK & TRUST Powered by HTLF

New Mexico Bank and Trust operates with local autonomy, and our bankers are devoted to gaining an in-depth understanding of each client's financial relationship. This level of commitment enables us to provide banking services that feel more like an extension of your family, rather than just a partner. Our unparalleled dedication to the client experience is reinforced by our parent company, HTLF.

Our unique model empowers our geographically diverse group of banks with cutting-edge technology, efficiency, and strength, while our local bank brands provide commercial, small business, and consumer banking services. Our deep local roots and longstanding connections enable us to offer a personalized touch that you won't find at larger banks. In partnering with HTLF, we provide our clients with a full range of products and services from treasury management services to lending solutions, we have the expertise and resources to compete at any level.

We remain committed to our mission of enriching lives one client, employee and community at a time and look forward to continuing to be the bank you can always depend on.

ECONOMIC TRENDS

Several factors caused growth to slow coming into 2023. Lingering Covid disruptions, rising energy prices, and continued supply issues made it difficult for many middle-market firms to expand.

MIDDLE MARKET & SMALL BUSINESS CHALLENGES

Survey results from HTLF clients and findings from other research have identified inflation, labor shortages, and labor costs as their three most significant challenges in 2023.

TACTICS TO COMBAT INFLATION

Inflation has been at the top of everyone's mind. Business owners felt the sting of increased prices, higher energy costs, and diminishing sales as many Americans kept their cards and cash in their wallets. With inflation persisting into 2023 business leaders must take action today to reduce the impact of inflation on their finances.

LABOR FORCE CHALLENGES

There's a "now hiring" sign in every window. Business leaders around the country might be optimistic regarding cooling inflation, but they remain pessimistic about maintaining their workforce. What role does 'quiet quitting' play in this puzzle? And how will curbing employee burnout lead to increased productivity?

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Businesses across the U.S. displayed a great deal of resilience over the last fifteen months as they overcame various post Covid challenges. Many challenges from 2022 have spilled over into 2023 and new obstacles have left some business leaders uneasy. As the Fed continues to wrestle with inflation and the labor war carries on, having a reliable financial partner on your team to provide counsel and help guide decision-making will allow you to manage with confidence. In compiling survey results from our clients and reviewing reliable sources, we've created the Financial Feed to provide you with valuable insights to help you conquer potential challenges and capitalize on opportunities.

A Message from Andres Garcia

Financial partners you can count on to help you achieve growth goals

American business leaders have gone through a lot over the past few years. Between the Covid-19 pandemic, supply chain disruptions, the Russo-Ukrainian war, inflation, and shortages in every sector, it's incredible how resilient American business owners have shown themselves to be.

They must be ready to carry that same resilience into 2023.

New Mexico Bank and Trust sourced data from business leaders across the country to determine where they stand as 2023 unfolds. What are some of their biggest challenges—and what best practices can they employ to thrive in the new year?

Data shows that inflation, labor shortages, and rising labor costs ranked highest among 2023's looming challenges. Last year saw surging economic optimism as we moved out of the pandemic and back toward a sense of normalcy. Their ability to tackle supply chain issues while pivoting towards significant change—such as adopting remote and hybrid work models at a moment's notice—certainly paid off.

Despite economic challenges, middle-market businesses have been able to adjust and cope with the numerous post-Covid issues. To support our clients in making informed decisions, we have gathered reliable data to outline the macro and local economic conditions.

This report will unpack how business leaders can face these challenges head-on while preparing themselves for a potential slowdown. Middle-market research shows sustained growth among these firms, despite ongoing macroeconomic pressures.

Our clients displayed an unprecedented ability to grow through hardship. Their flexibility through uncertain times helped them remain confident in their businesses, a confidence we promise to parallel as we move through 2023. As your trusted financial partner you can count on, we will continue to provide counsel and help you overcome challenges in 2023 and beyond.

Andres Garcia
Head of Commercial Banking

Andres joined New Mexico Bank & Trust in May 2021. He has more than 16 years of experience in the areas of business banking, treasury management, and credit with a strong background in the commercial and industrial (C&I) segment. He's held increasing leadership roles throughout his career as a result of his record for driving sustainable growth, achieving goals, and acquiring and maintaining relationships. Andres has a bachelor's degree in Finance and Political Science from New Mexico Highlands University and currently serves as a board member for Adelante. He's also a member of the New Mexico Bankers Association and Albuquerque Regional Economic Alliance and was a recent board member for Junior Achievement of New Mexico.

Macroeconomic Conditions

Business leaders express confidence despite signs of a potential slowdown

About 200,000 middle-market businesses in the U.S. encompass one-third of the private-sector GDP. They also employ some 48 million people. They proved their resilience during the 2007-2010 Global Financial Crisis (GFC), creating 2.2 million jobs across all major industries.

Ranging from private and public entities to family-owned firms, the significance of these companies to the national economy is impossible to ignore.

National Center for the Middle Market (NCMM) reported[1] middle market companies of all sizes and across all industry segments experienced growth of 10% or more for both revenue and employment. Despite economic pressures, overall confidence levels are on the rebound after dipping in 2022.

According to the Federal Reserve District Summary of Commentary on Current Economic Conditions[2], economic activity remained flat with interest rates and inflation continuing to weigh on economic activity causing respondents uncertainty or increased pessimism about the outlook. Capital Economics supports these feelings with their prediction of a mild[3] recession this year, as aggressive interest rate hikes impact consumption and investment. On the brightside they also predict inflation to fall back more rapidly than the Fed anticipates, with rate cuts being a possibility in late 2023.

Regardless, middle market owners must remain cautious, as nationwide confidence in long-term expansion isn't as high as in 2022. Don't slam on the brakes, but stay wary of your gas pedal.

SOURCES

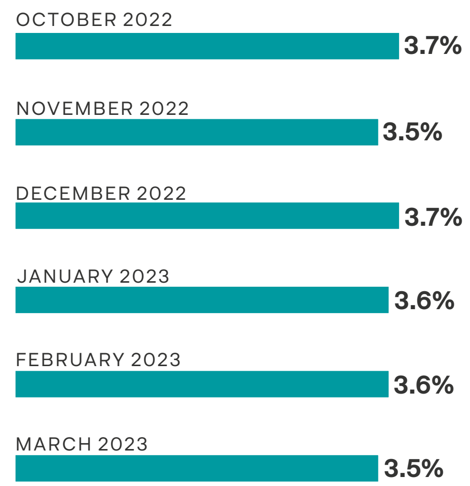
[1] *National Center for the Middle Market: Year-End 2022 Middle Market Indicator*

[2] *Federal Reserve District: Beige Book.*

[3] *Capital Economics: Global Economic Outlook.*

Unemployment Rate

In percent, seasonally adjusted.

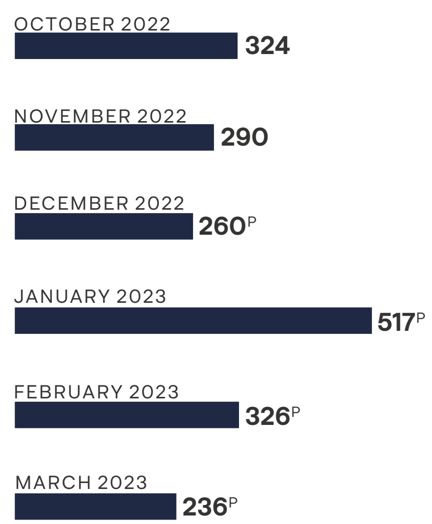


Source: U.S. Bureau of Labor Statistics https://www.bls.gov/eag/eag.us.htm

Change in Payroll Employment

Number of jobs, in thousands, seasonally adjusted

P Preliminary

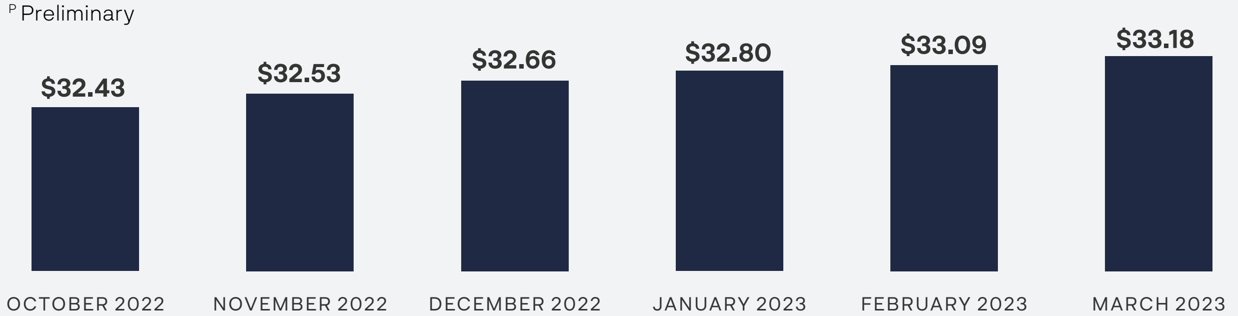


Source: U.S. Bureau of Labor Statistics https://www.bls.gov/eag/eag.us.htm

Average Hourly Earnings

Average Hourly Earnings for all employees on private nonfarm payrolls

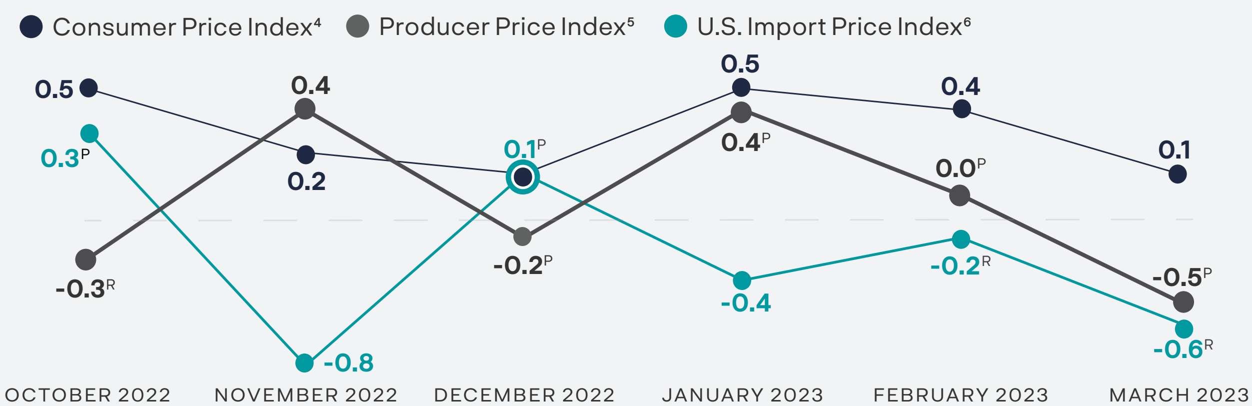
P Preliminary



Source: U.S. Bureau of Labor Statistics https://www.bls.gov/eag/eag.us.htm

Consumer, Producer and U.S. Import Price Index

[4] All items, U.S. city average, all urban consumers, 1982-84=100, 1-month percent change, seasonally adjusted. [5] Final Demand, 1-month percent change, seasonally adjusted. [6] All imports, 1-month percent change, not seasonally adjusted P Preliminary R Revised



Source: U.S. Bureau of Labor Statistics https://www.bls.gov/eag/eag.us.htm

"I have a glass half full outlook on what's to come in 2023. I do believe labor, rate volatility, and supply chain issues will remain a challenge for New Mexico businesses, but, overall, I am very optimistic in what 2023 will bring."

- ANDRES GARCIA

Middle Market and Small Businesses'

Most Significant Challenges in 2023 and Beyond

HTLF clients survey results found that, as of Q4 2022, most mid-sized and small business owners cited inflation, labor shortages, labor costs, and supply chain issues as their most significant challenges.

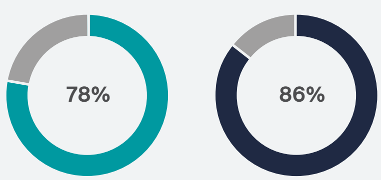
HTLF's client base aligns with broader mid-market trends, making the survey a relevant general indicator. Meanwhile, the National Center for the Middle Market reports economic confidence levels are bouncing back after the dipping in 2022. Consider the following findings from NCMM's Year-End 2022 middle market indicator survey.

Confidence in Economy

NCMM's Middle Market Indicator: Year-End 2022

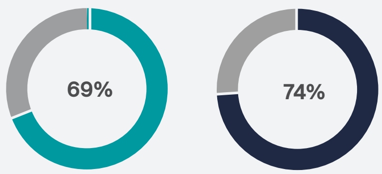
2022 Q2 | 2022 Q4

CONFIDENCE IN LOCAL ECONOMY



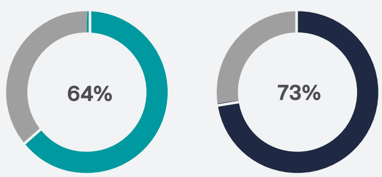
86% of middle market leaders expressed confidence in their local economy, compared to 78% in the second quarter of 2022.

CONFIDENCE IN NATIONAL ECONOMY



74% said they felt confident in the national economy, compared to 69% in the second quarter of 2022.

CONFIDENCE IN GLOBAL ECONOMY

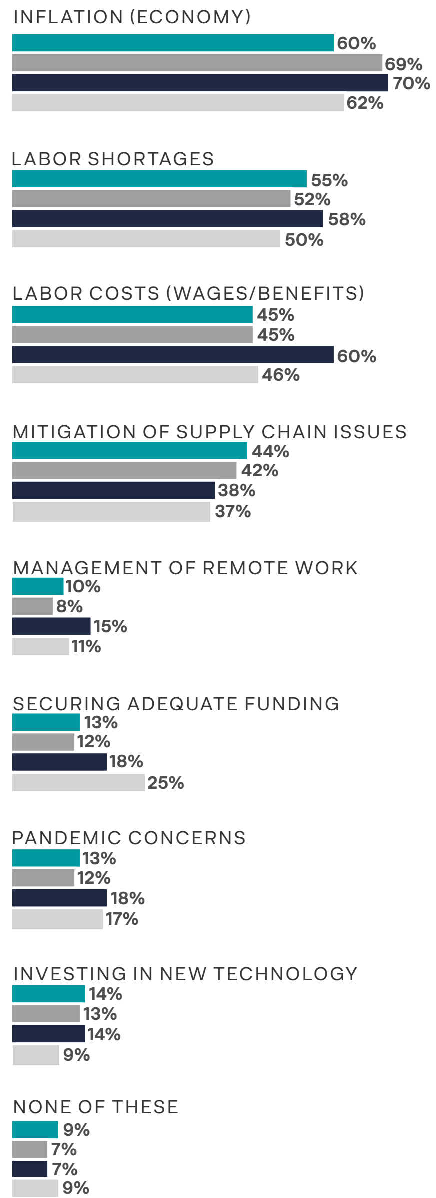


There was an increase with 73% middle market leaders expressing confidence compared to 64% in the second quarter of 2022.

Most Significant Challenges

Quarterly Trend

- HTLF Overall Q1 2022 (359)
- HTLF Overall Q2 2022 (201)
- HTLF Overall Q3 2022 (257)
- HTLF Overall Q4 2022 (163)



"Just like our clients, we need to think and operate differently. Although we cannot fix supply chain issues or stop interest rates from increasing, we can offer solutions and ideas to soften the blow and ease the downward pressures this economy is driving."

— ANDRES GARCIA

THE LABOR TALENT WAR

The U.S. labor market appears headed for some turbulence. Reflecting an expected slowdown in economic growth, as of February of 2023, the Congressional Budget Office[4] projects unemployment to rise from 3.6 percent in Q4 of 2022 to 5.1 percent by the end of 2023, averaging 4.7 percent for 2023 as a whole.

Yet, at the same time, intense competition for employment talent continues to impact the U.S. labor landscape: despite projected job losses, the market continues to favor those looking for work. As Forbes puts it, the "Labor Talent War" is intensifying, leading to a talent shock in 2023 that companies must also prepare to face. To attract and retain the talent they need, employers must be ready to mold their working environment to fit the new world. This includes job flexibility, workplace diversity, and authentic leadership.

Leaders need to re-skill and upskill their workforce to meet the demands of the Fourth Industrial Revolution. These steps include hiring new employees, using low- and no-code software, and creating a culture of continuous learning. The pandemic caused many people to reevaluate their careers, resulting in mass resignations across many sectors.

FINANCIAL INSTABILITY

Although many are predicting a decrease in inflation, businesses should consider preparing for many economies to stagnate or shrink.

According to NCMM's Year-End Middle Market Indicator, economic factors such as inflation, higher interest rates, and possible slowdown may be influencing the reduction in appetites for investment.

The International Monetary Fund[5] supports the notion of financial instability and possible recession with global growth forecast to slow from 3.2 percent in 2022 to 2.7 percent in 2023.

[4] *Congressional Budget Office: The Economic Outlook for 2023 to 2033 in 16 Charts*

[5] *International Monetary Fund: World Economic Outlook Report October 2022*

COMBATING INFLATI

Money management strategies to weather the storm

Congressional Budget Office states the Feds preferred measure of inflation - personal consumption expenditures (PCE) is projected to remain above the Federal Reserve’s long-term goal of 2 percent through 2024[4].

PCE is a measure of the spending on goods and services by people in the United States. The Congressional Budget Office predicts inflation to slow gradually with a PCE price index of 3.3 percent in 2023 and 2.4 percent in 2024[4]. Of course this is largely attributed to the Federal Reserve's interest rate hikes, which present new growth challenges for business owners.

But despite the Fed’s efforts to tamp inflation, many signs are pointing toward a slowdown in 2023, making a recession possible—if not probable. If this is true, business leaders must prepare ahead of time. Steps might include—erring on the side of caution; expecting slumping sales, tightening budgets, and experiencing increased difficulty securing capital.

To combat inflation, companies must clearly understand how and where they spend their money. This requires end-to-end spending visibility by business process, function, and cost category. Business leaders can leverage forecasting and budgeting tools to obtain detailed insights into spending patterns. Cut back on spending by renegotiating contracts with suppliers, reducing inventory levels, and streamlining processes for more efficiency.

With inflation carrying into 2023, owners must take action now to reduce the impact of inflation. With the right strategies and financial partners, you can do more than survive the inflation storm—you can thrive.

Begin with a full evaluation of your company's financial health. Understand that net income and operating profit margins are both important indicators of your company's financial standing.

Your net income reflects profit value after deducting company expenses, while operating profit margins indicate earnings before interest and taxes, serving as a sound basis for measuring cost management and sales generation. Itemizing assets and liabilities help paint a clearer picture of a firm's current debt and financial health.

Rising interest rates, elevated labor costs, and supply chain issues have put extreme pressure on New Mexico businesses, particularly those with significant debt service requirements or that require day-to-day working capital support, typically known as net investors. This has led to a decrease in liquidity, which is something we will continue to monitor in 2023 and beyond.

— ANDRES GARCIA

To weather inflation in 2023, companies must focus on scalable growth and thoughtful reinvestment programs. Find ways to increase purchasing and pricing capabilities while minimizing reliance on volatile labor markets and maximizing top-line revenue while maintaining high employee retention rates.

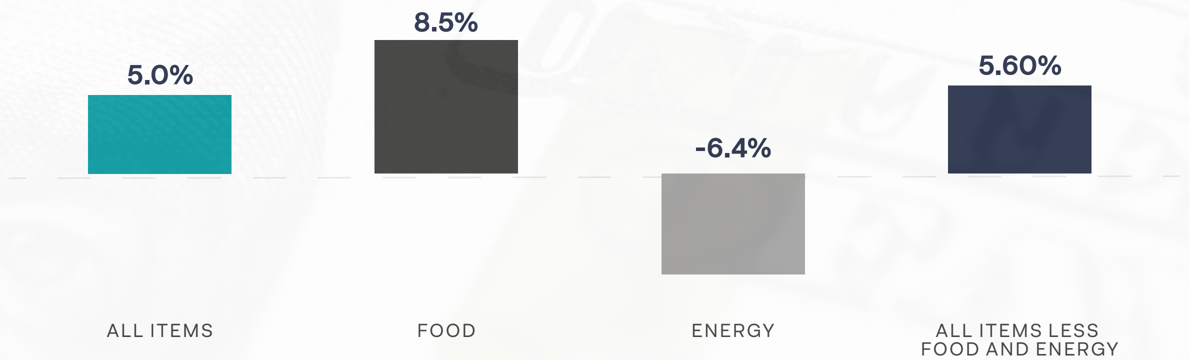
Detailed spending visibility is essential to establishing end-to-end spending transparency. Differentiate between necessary and frivolous spending and re-align costs with strategy.

According to Deloitte survey data[6], 39% of chief financial officers expect the American economy to enter a period of "stagflation"—the intersection of high inflation and economic stagnation. Furthermore, 46% of those surveyed expect a recession in 2023.

As business owners battle the 'two-headed stagflation monster'—as The Economist[6] puts it—some may consider passing increased costs onto the customer. For example, in 2022, McDonald's raised the price of cheeseburgers in the UK for the first time in nearly 15 years. This tactic is risky, though: most customers react poorly to visibly higher prices. Essential goods and trusted brands can pull it off, but non-essentials and new businesses will struggle.

[6] https://www.economist.com/the-world-ahead/2022/11/18/companies-must-battle-the-beast-of-stagflation

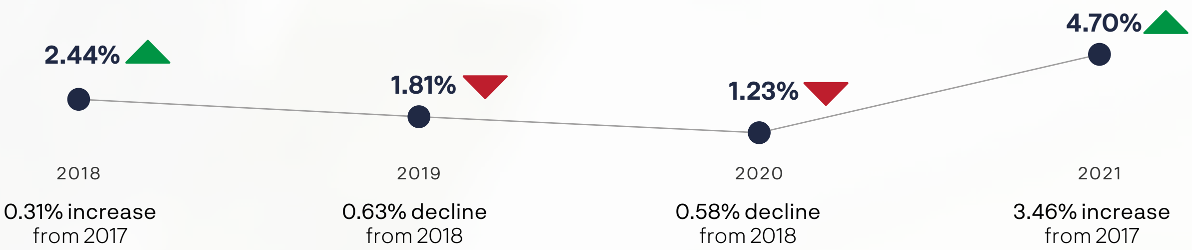
12-month percentage change, Consumer Price Index, selected categories, March 2023, not seasonally adjusted



Source: https://www.bls.gov/charts/consumer-price-index/consumer-price-index-by-category.htm

Inflation measured by Consumer Price Index

Reflects the annual percentage change in the cost to the average consumer acquiring a basket of goods and services that may be fixed or changed at specified intervals, such as yearly. The Laspeyres formula is generally used.



Source: https://www.macrotrends.net/countries/USA/united-states/inflation-rate-cpi

The Battle For Talent

Leaders are reexamining how they retain and recruit talent

Despite rising forecasts for unemployment, labor shortages continue to plague business owners of all shapes and sizes. Most experts concur that 2023 will bring some degree of economic downturn—they can't agree on the extent. Regarding labor forces, let's look to the past to see if it can shape the future.

The Global Financial Crisis at the end of the 2000s led to many employers cutting back their labor forces to stay alive. Fewer workers meant those still employed had to pick up the slack, which led to burnout and disengagement. When the economy recovered, some companies had difficulty hiring people back. Research from Korn Ferry[7] found similar patterns in the first few months of pandemic lockdowns.

Gallup finds, quiet quitters make up at least 50% of the U.S. workforce[8]. Defined as making the conscious choice to avoid work beyond one's job description or simply doing the bare minimum to remain employed, if not addresses quiet quitting can hurt your business.

According to Sally McKibbon, a career coach with Indeed, 'quiet quitting' refers to the shift away from the hustle culture that prevailed pre-Covid[9]. Quiet quitters aim to set more boundaries between their professional and personal lives. Burnout that may lead to quiet quitting mainly concerns Gen Z workers, who are more likely to experience this than previous generations due to their high levels of ambition and expectations for success.

Many business leaders began paying attention to the growing quiet quitting trend when data on productivity showed sharp and unexpected drops in 2022[10].

[7] https://hrexecutive.com/whats-in-store-for-talent-acquisition-in-2023/

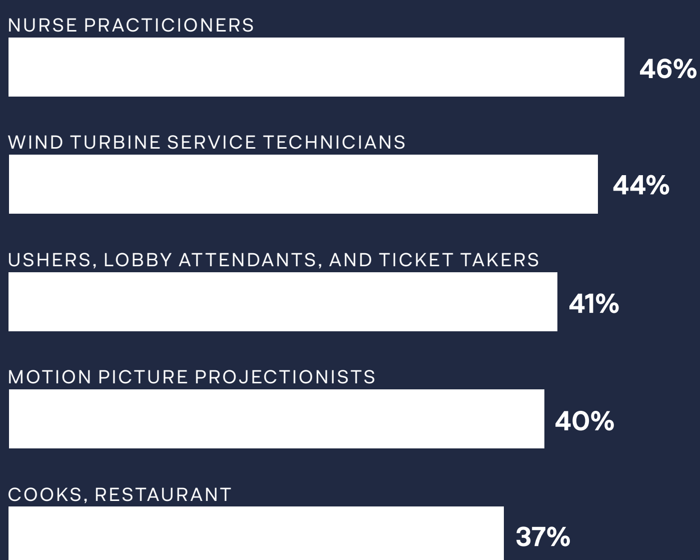
[8] https://www.gallup.com/workplace/398306/quiet-quitting-real.aspx

[9] https://www.myob.com/au/blog/quiet-quitting-and-maintaining-workplace-morale/

[10] https://www.piie.com/blogs/realtime-economics/record-us-productivity-slump-first-half-2022-risks-higher-inflation-and?utm_source=npr_newsletter&utm_medium=email&utm_content=20220909&utm_term=7224424&utm_campaign=money&utm_id=5861281&orgid=88&utm_att1=

Fastest Growing Professions Overall

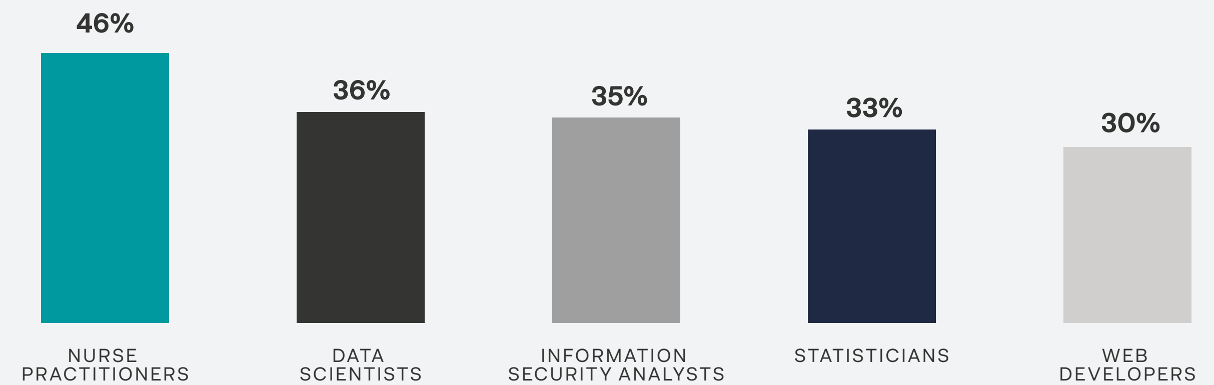
2021-31 Projected Growth



Source: U.S. Bureau of Labor Statistics https://www.bls.gov/emp/

Fastest Growing Occupations, Bachelor's Degree or Higher Required

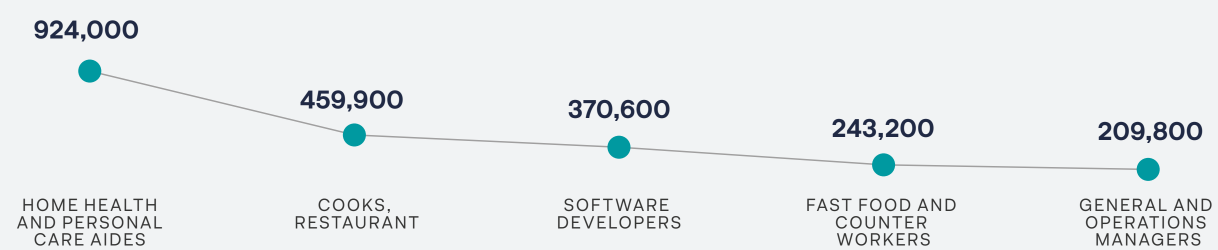
2021-31, Projected



Source: U.S. Bureau of Labor Statisticshttps://www.bls.gov/emp/

Occupations with Most New Jobs

2021-31, Projected



Source: U.S. Bureau of Labor Statisticshttps://www.bls.gov/emp/

Traditionalist leaders quickly pinned it on remote work. BlackRock CEO Larry Fink called for requiring his employees to return in-office, blaming remote workers for declines in productivity[11].

Data from 2020 and 2021 proves those traditionalists wrong[12]. Productivity jumped in Q2 2020 as offices shut down and employees worked from home. This trend continued through Q4 2021 and only dropped when return-to-office policies became popular in early 2022.

As we look ahead, talent acquisition experts believe data, tools, and culture are the keys to combating labor shortages and rising costs.

- **Data:** Talent acquisition leaders recognize the importance of attracting candidates from diverse and nontraditional backgrounds. Furthermore, 95% of CEOs consider diversity, equity, and inclusion (DEI) a top priority[13]. Conduct an in-depth analysis of your hiring process to see how your data aligns with current trends.
- **Tools:** Approximately 75% of recruitment professionals utilize technology to optimize their recruitment process[14]. Beyond conventional applicant tracking systems, research indicates that recruiters are leveraging automation and AI software for screening, scheduling, and interviewing applicants.
- **Culture:** According to INSEAD research, 45% of participants indicated that camaraderie and collaboration have declined since the onset of the pandemic[15]. Another survey found that 34% of new hires who quit within the first 90 days did so because of unsatisfactory work cultures[16].

Talent acquisition teams can significantly improve employee retention by conveying the company's culture to potential hires during the interview process. They can quickly identify candidates who can work well remotely by asking the right questions while aligning with the company's core values.

What happens when both challenges collide—when inflation and the labor market clash in the perfect storm? At a recent press conference, Federal Reserve Chair Jerome Powell discussed current interest rate hikes and their goal of lowering inflation. He noted the unbalanced labor market and anticipated that unemployment could reach 4.4% by the end of 2023, potentially leading to 1.3 million job losses[17]. He acknowledged that this was a possible outcome—but not a certainty.

Professional forecasters share this sentiment and expect the unemployment rate to increase to 4.3% in the third quarter and 4.4% in the fourth quarter of 2023[18]. This will likely result in fewer job openings, pointing to a labor market near equilibrium. As such, labor costs should decelerate significantly.

Research indicates that when the unemployment rate approaches its equilibrium level, the Employment Cost Index (ECI) growth tends to decrease to approximately 3%[19]. In the two decades before the Covid-19 pandemic, average Personal Consumption Expenditures (PCE) inflation was 0.8 percentage points lower than ECI growth. An ECI growth rate close to 3% would be consistent with a PCE inflation rate of around 2%.

Should the market downturn in 2023, businesses must take a more measured approach to re-sizing their workforce. Have your talent acquisition team prepare for the worst-, average-, and best-case scenarios to prepare for whatever lies ahead. The eventual recovery goes hand-in-hand with the downturn, so ensure you're focusing on both equally.

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[11] *https://www.foxbusiness.com/markets/blackrock-ceo-larry-fink-discusses-inflation-esg-investing-energy-sector*

[12] *https://www.bls.gov/charts/productivity-and-costs/nonfarm-business-sector-indexes.htm*

[13] *https://www.summitleadership.com/whitepaper-talent-management-challenges/*

[14] *https://employvision.com/top-5-ways-technology-is-changing-the-way-we-find-talent/*

[15] *https://knowledge.insead.edu/leadership-organisations/great-covid-driven-teamwork-divide*

[16] *https://www.jobvite.com/wp-content/uploads/2022/03/JSN-2022-3-25.pdf*

[17] *https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20220921.pdf*

[18] *https://www.piie.com/blogs/realtime-economics/us-workers-wage-gains-2023-are-likely-exceed-inflation*

[19] *https://www.piie.com/publications/working-papers/low-inflation-bends-phillips-curve*

New Mexico Economy

Thriving with an innovative and collaborative business ecosystem

Head of Commercial Banking, Andres Garica discusses the state of the local economy and how the bank is partnering with business leaders in the community.

Q: How has inflation impacted your clients?

A: Inflation remains a problem. Talking with our small business owners, we've found that about one in four report that inflation was their single most important business problem. This is the worst it's been since the early 80's. Businesses are raising prices on their customers while increasing compensation to retain employees, so the pinch is on profits. They must pay higher dollars to attract qualified candidates for open positions. Inflation is putting a lot of pressure on all businesses; it's not just small businesses that are impacted.

Q: How have rising interest rates impacted your clients?

A: Interest rate increases are aimed at curtailing swelling inflation, but using interest rate hikes to bring down inflation creates a whole new set of problems for businesses, especially small businesses.

You can argue that interest rate changes hit small businesses harder because they don't have the same financial tools and flexibility as larger organizations – even though they are dealing with many of the same economic issues, such as labor shortages and ongoing supply chain problems.

Small businesses need to be prepared for the expected interest rate hikes. As we talk with our small business clients, most tell us they are watching and this is their top concern, especially since inflation goes hand in hand with interest rate hikes.

Q: How has the current labor market impacted your clients?

A: New Mexico isn't alone in dealing with a shortage of potential employees. Our state has a lower-than-average labor participation rate then the rest of the country. We do have a favorable cost of living, but our population is not growing like some other western states and, frankly, our population is getting older.

I wouldn't necessarily say that our clients have been able to overcome these challenges, but they have adjusted because of them. They've increased employee pay and offer more competitive benefits packages. The impact is lower revenue for the business.

Fortunately, we can help customers tackle some of this through a variety of solutions that improve productivity and maximize their cash cycle. In a time when every penny counts, we want to ensure we're having conversations about accounts payables, fraud detection, remote deposit, and other services so clients are aware they have options. Our clients are often time surprised by the depth of our solutions and how our team can better position their business to tackle challenges.

> *"In a time when every penny counts, we want to ensure we're having conversations about accounts payables, fraud detection, remote deposit, and other services so customers are aware they have options. Our clients are often time surprised by the depth of our solutions and how our team can better position their business to tackle challenges."*
>
> \- ANDRES GARCIA

Q: In what ways can the bank help clients overcome the looming challenges of 2023?

A: In this heightened rate environment, if we can save a customer 30 days of interest expense and maximize their existing labor force through Electronic Accounts Payables, we will improve their income statement (interest expense/labor costs) and provide additional liquidity to their balance sheet. Ultimately, the customer can capitalize on increasing depository rates. This is just one example, but as we continue to communicate with customers and understand their specific challenges and needs, we'll be able to provide appropriate products and services to match.

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