GREENFIELD
CULTIVATING GROWTH

MACROECONOMIC SNAPSHOT

SEPTEMBER 2022

EXECUTIVE SUMMARY

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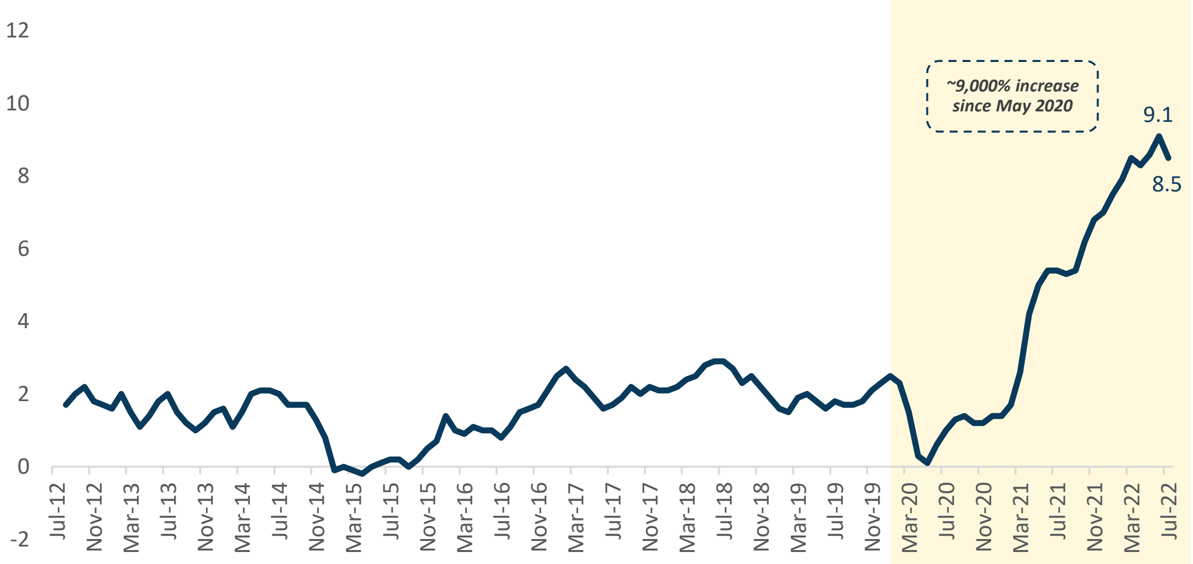
As we have seen since the beginning of 2022, the economic situation in the US and Europe is rapidly changing, with inflation peaking near record levels and the US Federal Reserve hiking interest rates quickly and dramatically in response. These macro factors, which are also affected by the geopolitical situations in the world, are dramatically affecting technology companies and startups. While we do not specialize in the macro climate, we wanted to provide the ecosystem with a summary of the key macroeconomic metrics that are rapidly changing. We believe that investors and founders should be aware of these changes and apply first principles to try and understand the effects it might have on their businesses.

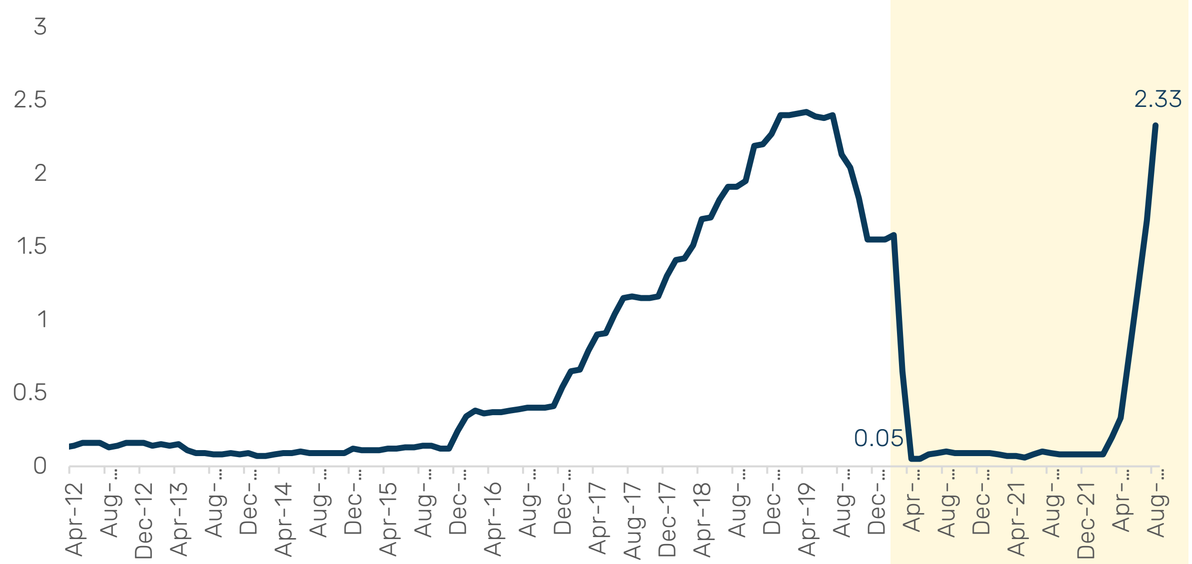
- As a reminder, we recently published in our Q2inReview report, a compilation of all capital raises within Israel's tech ecosystem, insights into the state of the venture market, and started seeing some slowdown in the Israeli venture market, which is correlated to the macroeconomics effects that we will discuss in this report
- Inflation remained high last month (July 2022) at 8.5%, after peaking at 9.1% in June
    - The 9.1% peak represents a 40+ year high
- The Fed funds effective rate is 2.33%, and forward markets anticipate a rise to 3.40% by the end of the year. In the recent Jackson Hole meeting, the Fed has announced that they are planning to keep playing on the aggressive side to do whatever it takes to bring down inflation to their 2% YoY target
- Narrow technical recession has set in given negative GDP growth in Q2 2022 of (0.9)%, following a (1.6)% drop in Q1 2022
    - Atlanta Fed (GDPNow) is predicting 1.4% growth in GDP for Q3 2022
- The US housing market has not yet been broadly affected, but is most likely on a correction course due to the rise in interest rates and stagnant economy; we could expect a decline in housing pricing (in some areas in the US)
- Brent crude is still relatively elevated, but at ~$100 is ~18% off its recent high of $122
- Consumer Confidence Index (CCI) and Purchasing Managers Index (PMI) are on the decline, both are indicators to the growth and strength of the economy
- PMI is hitting 2 years low, but remains above 50 and still above pre-COVID levels
- Unemployment remains at an all-time low territory at 3.6%, but participation rate has fallen off slightly for the first time since Covid
- Bond yields have spiked since the beginning of 2022; however, they have started to decline in recent weeks

Inflation and Interest Rates Over Time

U.S. Inflation Rate, 2012-2022 (%)



U.S. Federal Funds Rate, 2012-2022 (%)



Trend Explanations and Implications Moving Forward

Upward Inflationary Pressure

- **Drivers of inflation:** sharply rising labor costs, factory shutdowns, global shipping backlog, and pent-up consumer demand
- **Today**: consumer prices have climbed more than 8% over the past year – fastest rate of increase in 40 years
  - With demand outpacing supply, inflation will continue to erode the purchasing power of consumers
  - Vehicle prices up ~7%, food prices up ~10%, and energy prices up ~42% since last year

Monetary Policy Response

- The Fed is tightening monetary policy to fight inflation. Specifically, it is raising the short-term interest rate that it controls directly (aka the Fed funds rate)
- Central bank officials use this rate to slow down the economy – in this case to weaken demand so that supply can catch up
  - Most recently, the Fed raised interest rates another **0.75%** to about **2.25%** to **2.50%.**
  - In addition, the fed communicated that they would remain aggressive with interest rate raise in order to bringdown inflation to their 2% yearly target
- Because higher interest rates mean higher borrowing costs, people will eventually start spending less. Ideally, the demand for goods and services will drop and cause inflation to slowdown
- By increasing the federal funds rate, the Fed is effectively trying to shrink the supply of money available for making purchases

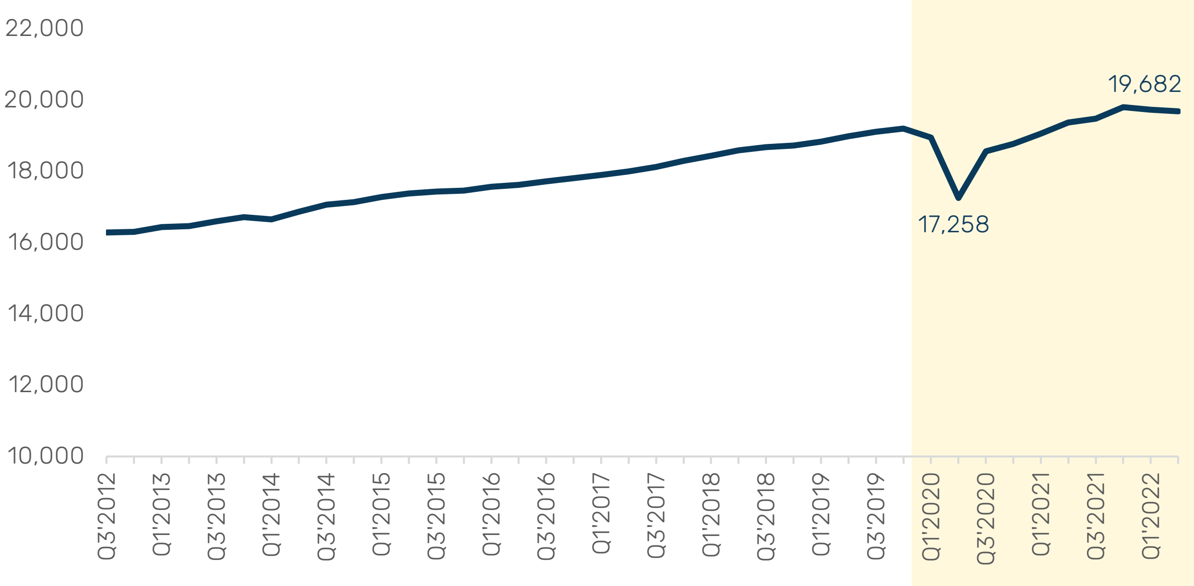
Looking Ahead

- The benchmark interest rate will likely end the year around 3.4% and around 3.8% in 2023
- The Fed is seeking to raise interest rates enough to curb inflation without causing a recession—a so-called **soft landing**
  - The risk is that demand falls too much, which could lead companies to cut production and layoff employees, pushing the economy into a recession

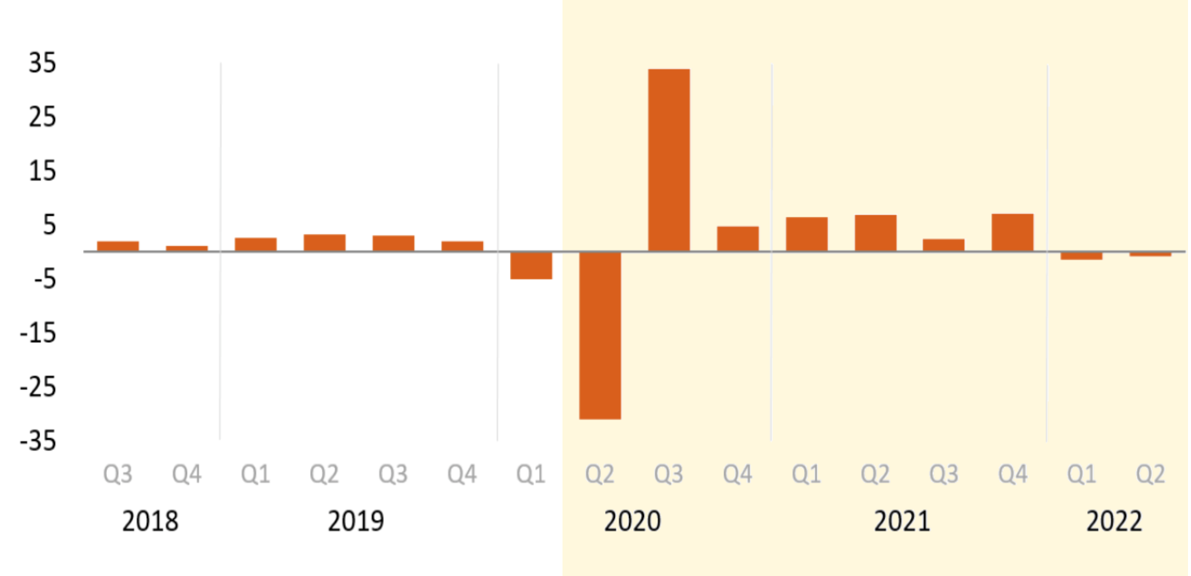
Sources: Labor Department's Bureau of Labor Statistics, Federal Reserve

Real GDP Overview

U.S. Real GDP, Seasonally Adjusted, 2012-2022 ($B)



Change in U.S. Real GDP, Seasonally Adjusted Annual Rates (%)



Trend Explanations and Implications Moving Forward

Cooling Economic Growth

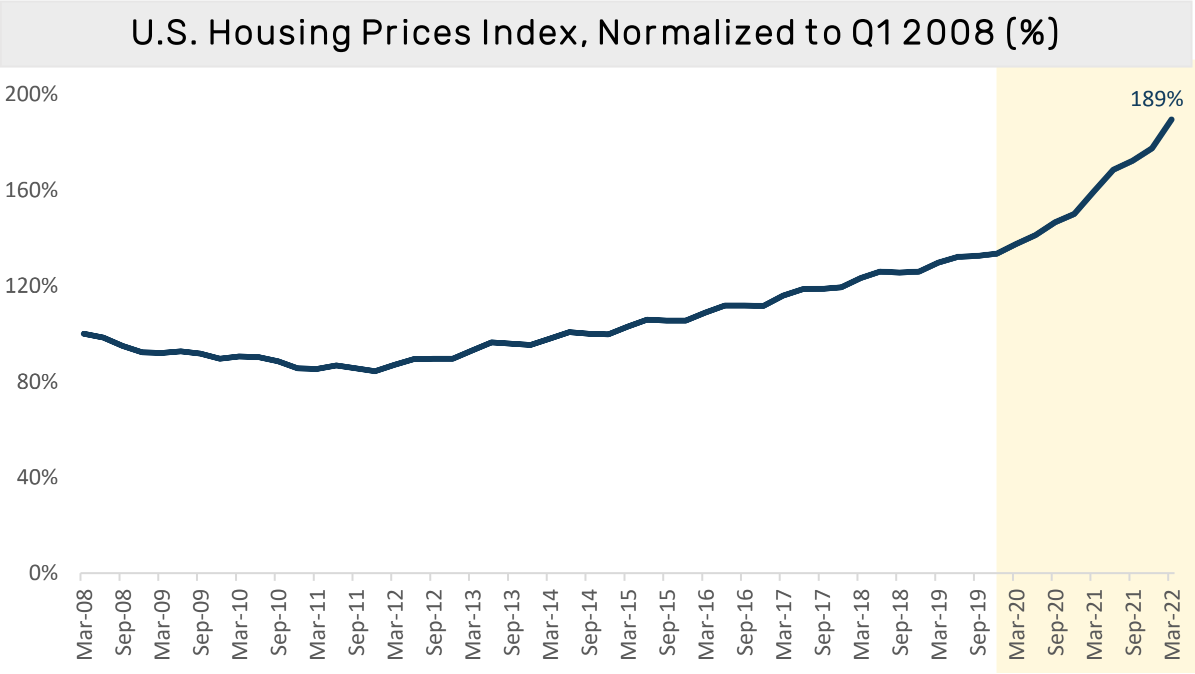
- The upward growth trajectory in the U.S. was disrupted when real GDP fell unexpectedly by **1.6%** in the first quarter of 2022 and most recently **0.9%** in Q2. This occurred after a nearly 7% gain during the previous quarter, prompting forecasters to lower growth projections for 2022 and 2023
- **Factors that have contributed to declines in GDP:** sizable decreases in real net exports and inventory investment → combined to subtract 4 percentage points from real GDP growth
- On the bright side, personal consumption expenditures and nonresidential (business) and residential fixed investment combined to account for over 3 percentage points of real growth

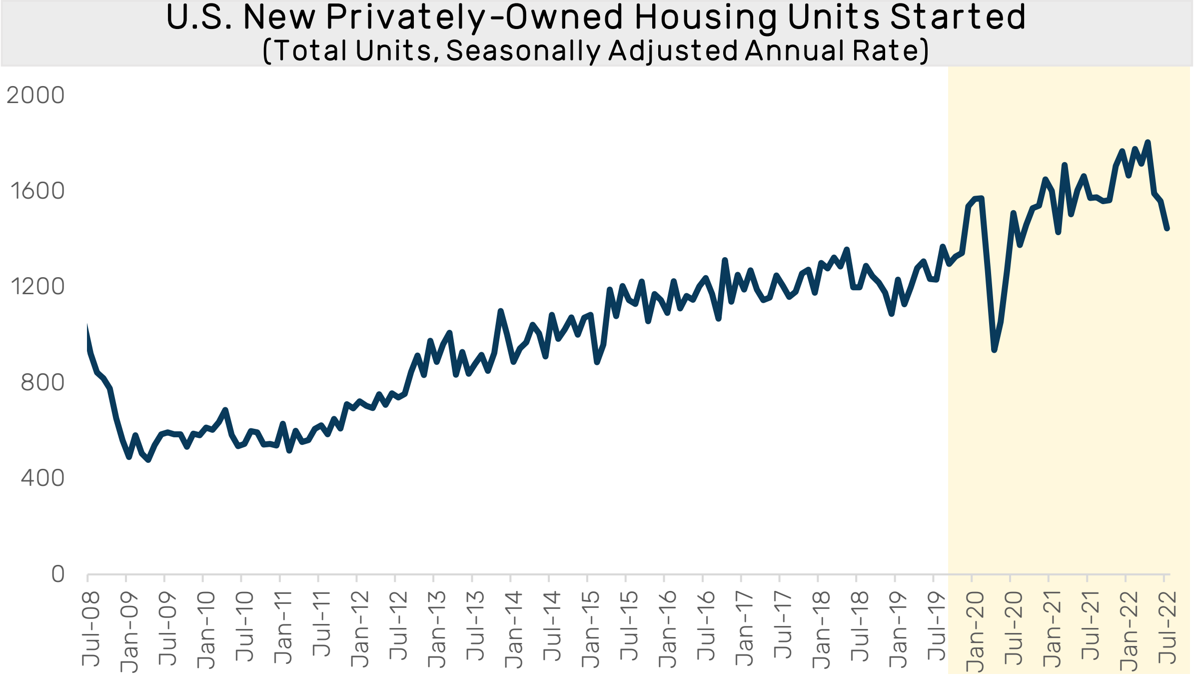
Looking Ahead

- Economic growth seems to continue to cool throughout 2022
    - Some of the reasons for the last two quarters decline in Real GDP Growth include high inflation and rapid monetary tightening, which curb consumption and business investment growth
- The GDPNow model estimate for real GDP growth (seasonally adjusted annual rate) in the third quarter of 2022 is 1.4%

Sources: Federal Reserve Bank of St. Louis, U.S. Bureau of Economic Analysis

Housing Market Trends





Trend Explanations and Implications Moving Forward

Housing Prices Since '08 Crisis

- The housing market has generally recovered. Although prices fell **33%** during the Great Recession, they have rebounded and are now up more than **50%** since hitting the bottom of the market
- The housing market is entering a new phase: homes are more available, buyers may be more scarce, and certain sellers may not want to put their houses on the market
- Home prices have soared largely due to inflation, low supply, and pandemic-fueled demand over the past two years
- The median selling price for existing homes stands on $403,800 after reached a record high of $413,800 in June

Recently Falling Starts

- Housing starts in the U.S. dropped **7.25% month-over-month** to an annualized rate of **1.446 million units** in July 2022, the lowest figure since February of last year
- The housing sector has been cooling due to soaring prices and mortgage rates
- Single-family housing starts sank 8.1% to 982,000 while starts for units in buildings with five units or more came in at 568,000
- Sustained declines in housing starts often serve as a sign that the economy is slowing down and a recession may be imminent

Looking Ahead

- The nation's housing market might be on a correction course:
  - Rising interest rates and a stagnant economy are already diminishing the rapid home-price appreciation the housing market has experienced over the past year
  - Several economists predict the deceleration in home prices will continue as homebuyer demand wanes
- As the Federal Reserve continues to take aggressive actions to curb inflation, mortgage rates will likely rise further, crushing affordability and curbing demand within the housing market. As a result, it's predicted that inventory will continue to increase, housing deals will fall through, and some sellers might have to reduce prices

Source: Federal Housing Finance Agency, Federal Reserve Bank of St. Louis

Oil and Gas Price Trends

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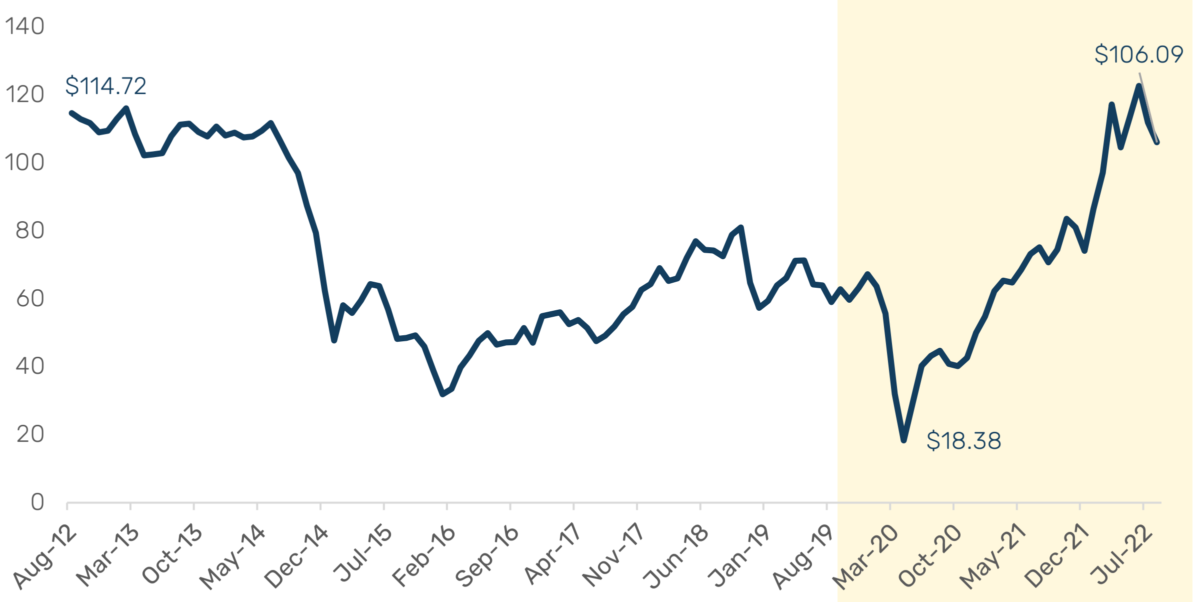
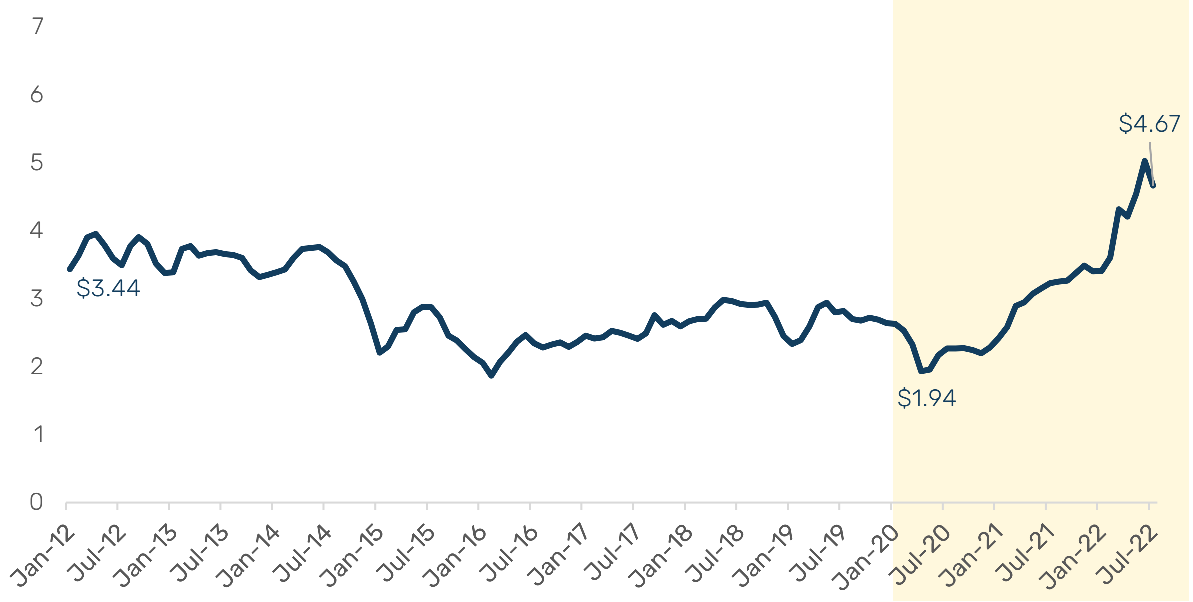
Brent Crude Oil Prices, 2022 ($)



U.S. All Grades All Formulations Retail Gasoline Prices ($/Gallon)



Trend Explanations and Implications Moving Forward

Fluctuations in Oil Prices

Business Today

"Oil futures have been volatile in recent weeks as traders try to reconcile the possibilities of further interest rate hikes that could limit economic activity, and thus cut fuel demand growth, against tight supply from the disruptions in the trading of Russian barrels because of the Western sanctions amid the Ukraine conflict."

Post-COVID Pain at the Pump

- High demand for crude oil and low supply pushed gas prices upward earlier this year by almost **50%**, reaching **$5/gallon** nationwide
- The biggest driver of the cost of gas had been the price of crude oil, which hovered around **$120 a barrel** in June
- However, drivers have received some much-needed financial relief at the pump, as gas prices have been trending downward for more than **50 consecutive days**. The average cost of a gallon of gas down almost a dollar since the June peak
- Gas prices have been declining for several reasons, including an increase in gasoline production and a decrease in the cost of crude oil. Recession fears have also knocked down prices

Looking Ahead

- High oil and gas prices are likely here to stay
  - Although soaring inflation and sluggish growth raise the likelihood of recession, global demand for oil is unlikely to fall enough to dent prices, as it did in 2008
  - The West's sanctions against Russia will yield insufficient alternatives, given that Russia accounted for 14% of global oil supply last year
  - As the Chinese government unwinds COVID-19 restrictions, pent up demand could push up prices. Demand in the U.S. has also remained resilient despite high prices
  - The upcoming winter in Europe and the U.S. is likely to increase the demand
  - Another broader factor is the hesitancy of U.S. producers to spend big money on extracting and refining fossil fuels given the widespread shift to renewable energy

Source: Macrotrends LLC, U.S. Energy Information Administration

Consumer Confidence & Purchasing Managers Indices

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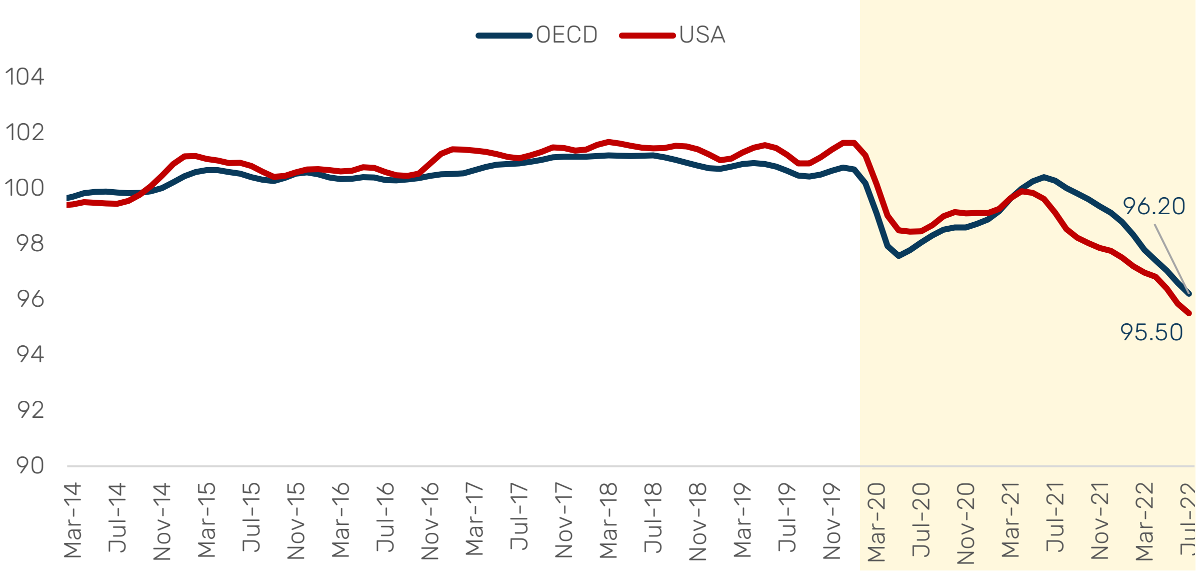
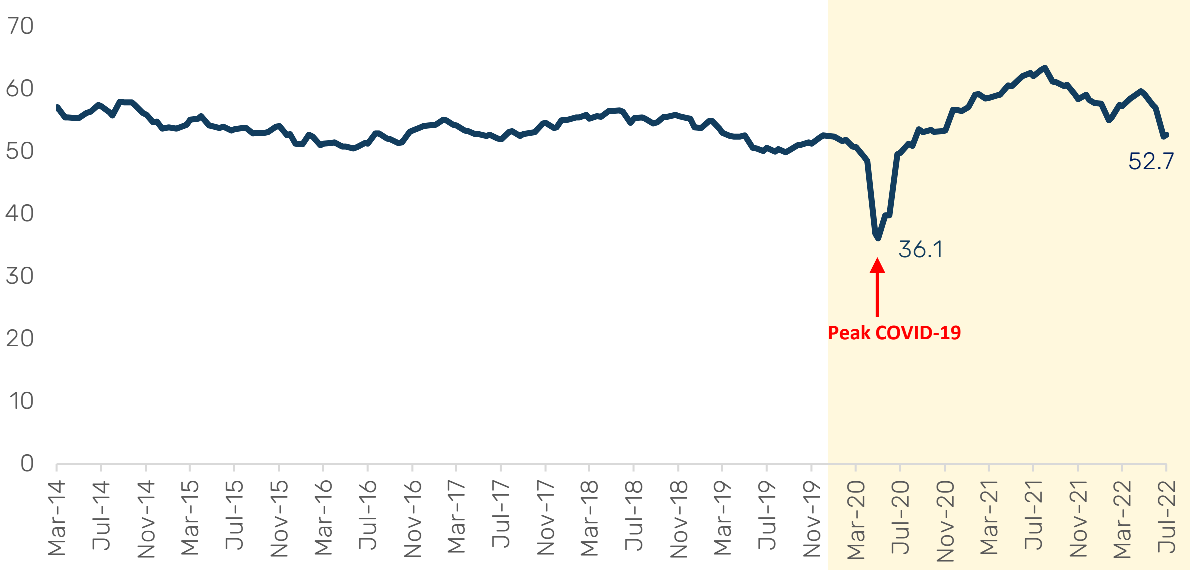
Consumer Confidence Index, U.S. and OECD, 2014-2022



Note: the OECD encompasses 38 countries across the world

U.S. Purchasing Managers Index, 2014-2022



Trend Explanations and Implications Moving Forward

Diminishing Consumer Confidence

- This consumer confidence index provides an indication of future developments of households' consumption and saving
- The current values below 100 indicate a pessimistic attitude towards future developments in the economy, possibly resulting in a tendency to save more and consume less
- From a macro perspective, rising inflation has clearly weighed on consumers' purchasing power by slowing gains in real wages and wealth
  - Interest rate hikes have further incentivized consumers to save dollars that can earn higher interest rates rather than spend their money

Decelerating Expansion

- The PMI index summarizes economic activity in the manufacturing sector
- A PMI over 50 represents growth or expansion in comparison to the previous month, while a reading under 50 represents contraction in the manufacturing sector of the economy
- US Manufacturing PMI is at a current level of ~52, down from ~57 in June and down from ~63 one year ago. This represents a change of -8.5% within two months and -17.5% from one year ago
  - Thus, the manufacturing sector of the economy seems to still be expanding but at a slower rate, likely due to the lasting impact of COVID-19 as well as ongoing supply chain hurdles

Looking Ahead

- After recent news that the Consumer Confidence hit a 16-month low, it appears that consumer confidence will continue to decline as dimmer views of the economy, inflation, and rate hikes persist
- Some experts claim that "there will only be a sustainable trend shift in consumer sentiment if there are successful peace negotiations on the war in Ukraine"
- Surveys reveal that consumers are much less likely to make big purchases like cars, vacations, and major appliances over the next six months

Employment Statistics

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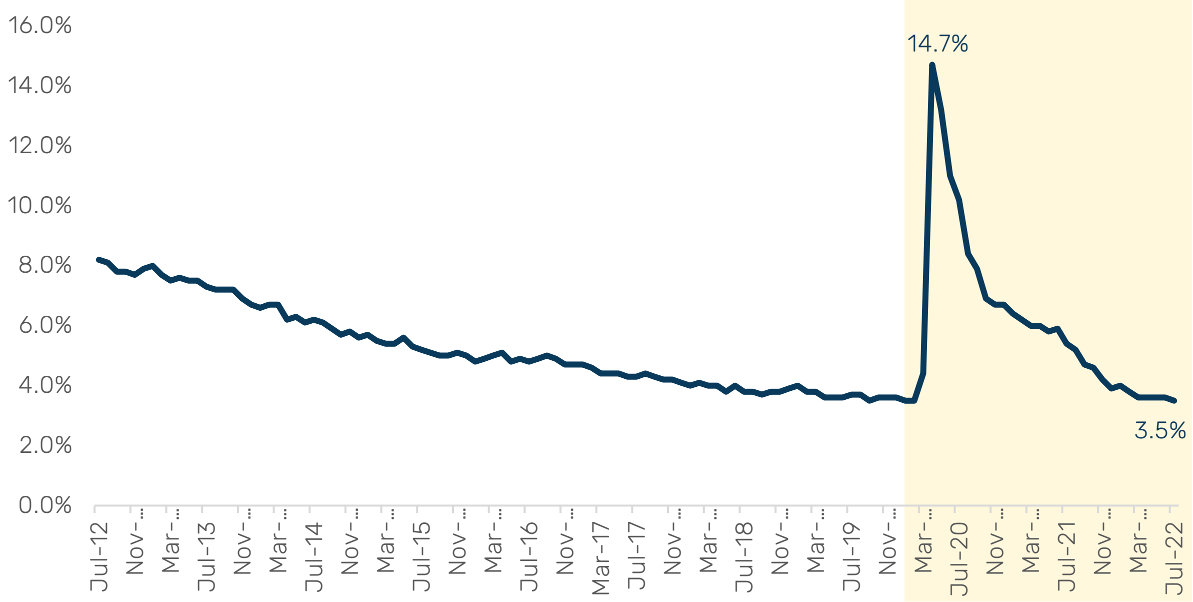
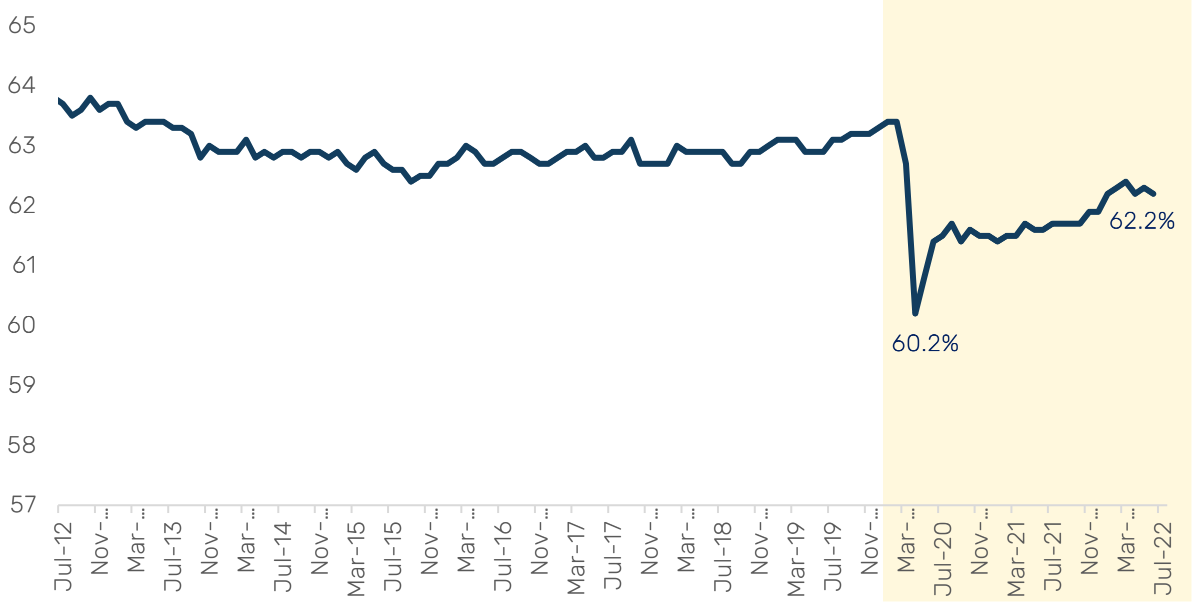
U.S. Unemployment Rate, 2012-2022 (%)



U.S. Labor Force Participation Rate, 2012-2022 (%)



Trend Explanations and Implications Moving Forward

A Glimmer of Economic Hope

- Total employment rose by **242,000** in July, and the unemployment rate remained at **3.5%**.
  - The U.S. economy experienced extensive hiring throughout June, helping to try and steer the US from recession even as inflation eats into wages and interest rates continually rise
- Hiring has persisted even in industries vulnerable to interest-rate increases and shifting consumer habits
  - For example, construction firms, susceptible to a faltering housing market and higher mortgage rates, added jobs last month
- Broadly speaking, unemployment negatively impacts the disposable income of families, erodes purchasing power, and reduces an economy's overall output

Slowly Recovering Participation

- The labor force participation rate estimates an economy's active workforce by dividing the number of people aged 16 and older (who are employed or actively seeking employment) by the total population
- The portion of the population that is working or looking for work remains 1.2 percentage points below their February 2020 values, as Americans that left work during the pandemic are gradually returning to the workforce

Looking Ahead

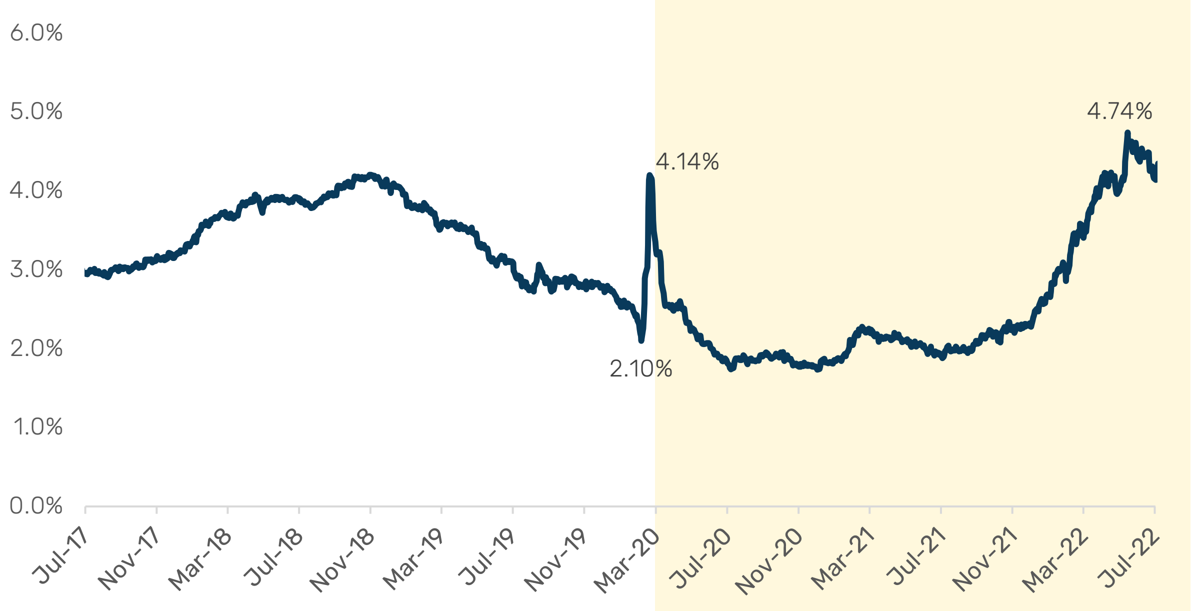
- As the Fed is taking stronger action to fight inflation, the economy could be taking another step towards a recession that could lead to a hiring slowdown and rising unemployment
- However, the strong labor market continues to represent a sliver of hope when it comes to avoiding some of the devastating implications of a recession
  - While a downturn is obviously inevitable, the labor market remains red hot in the U.S., a sign of strength during devastating macroeconomic times
- However, low unemployment rate might cause inflation to remain high for several years

Sources: U.S. Bureau of Labor Statistics, Federal Reserve Bank of St. Louis

High Yield & Investment Grade Indices

ICE BofA U.S. High Yield Index Effective Yield,
Not Seasonally Adjusted, 2017-2022 (%)

Investment Grade (Yield to Maturity), 2017-2022 (%)



Trend Explanations and Implications Moving Forward

Growing Bond Risk

- This index tracks the performance of U.S. dollar denominated below investment grade corporate debt publicly issued in the U.S. domestic market
- Essentially, the recent upward trend in the index means that investors are asking for higher interest rates to compensate for the greater risk of investing in corporate bonds
  - Companies with lower credit ratings are often at a higher risk of default during distressing macroeconomic circumstances
- Risk-averse sentiment has largely been driven by the geopolitical crisis in Ukraine, global inflationary pressures, and the growing aspects of a potential recession

Investment Grade

- This index tracks the total return anticipated on a bond if the bond is held to maturity
- Yield to maturity is expressed as an annual rate regardless of the bond's term to maturity
- The growing yield is directly correlated with the Fed's increase of the US interest rate to fight inflation
- The steepness of the rise in IG yields can indicate how deep the market expects the recession to cut, i.e., to what degree investment grade issuers will be suspected of potential default

Looking Ahead

- Bonds are considered to be a safer alternative to stocks, which might cause investors to turn to bonds if the recession will continue but the expected increase in interest rate is adding weight on bonds performance
- High Yield - bond index increases in recessions – the highest measure was 23% in November 2008 at the financial crisis. Therefore, if the recession will continue, we expect to see the index increasing as risks of defaults surge

Source: Federal Reserve Bank of St. Louis

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