EVALUESERVE

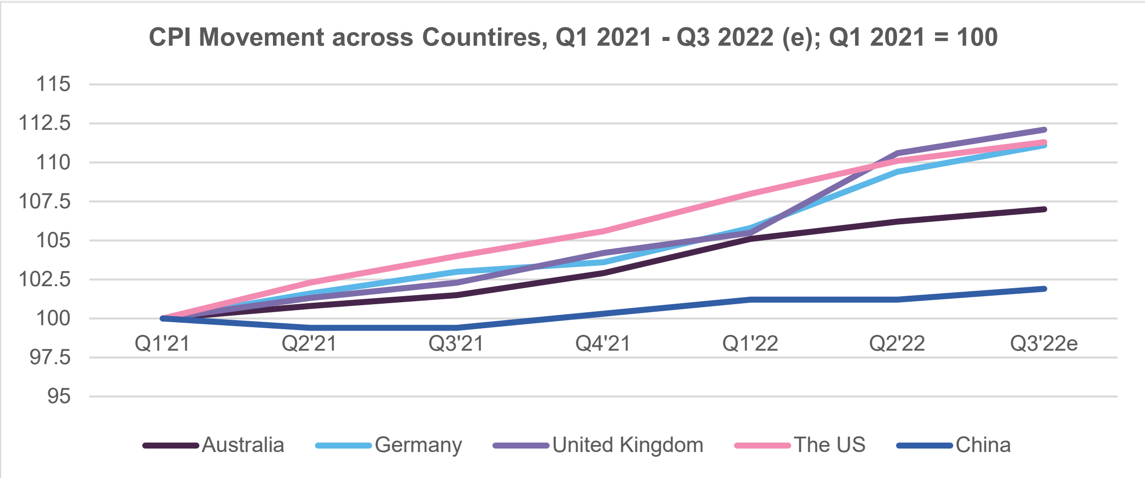
Businesses gear up for

impending supply chain bullwhip effect

There are signs hinting at an impending bullwhip effect on supply chains, which could mean that supply chain managers need to recalibrate their decisions with respect to the new emerging market realities. As governments eased COVID-related restrictions, economies across the globe witnessed a demand surge. Businesses ramped up production to meet growing demand. Furthermore, a worsening geopolitical scenario and trade embargoes drove businesses towards inventory building to mitigate the risks of production outages. However, these developments also created inflationary pressures, prompting governments across the world to increase interest rates. These measures are likely to douse the demand in the market, possibly triggering a bullwhip effect across supply chains.

Rate hikes across the world have triggered concerns of demand slowdown

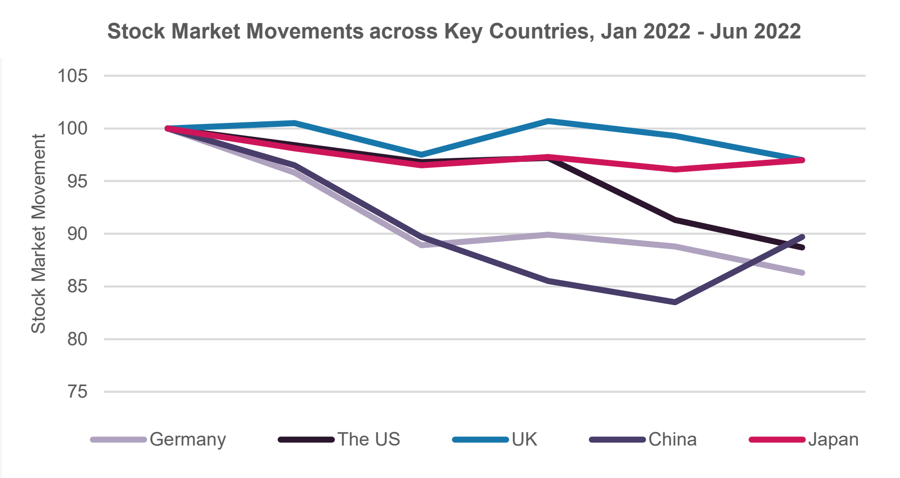
Rate hikes by governments across the world have triggered concerns of demand slowdown, as can be seen through the reactions across the markets and businesses. All major stock markets across the world have plunged this year, with S&P and Nasdaq shedding 25% and 33% respectively. Several retailers across the world have confirmed a shift in spending behaviour of customers, which confirms the potential of demand slowdown in the coming months.

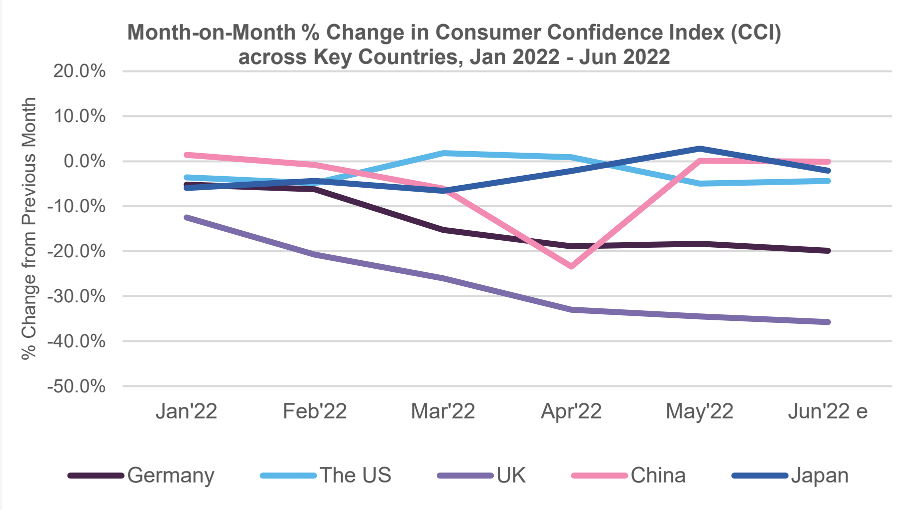


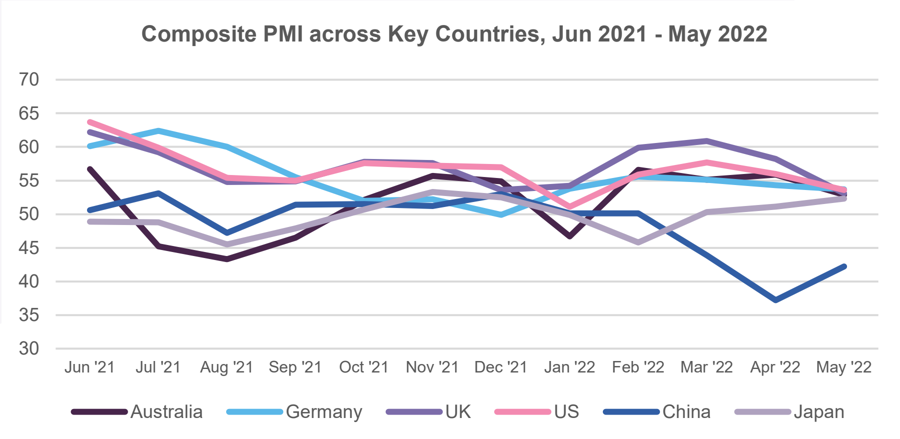
Notes: CPI stands for Consumer Price Index

Source: CEIC Database

Several governments across the world have announced interest rate hikes in the past few weeks in their bid to ease demand and check inflation. The prevailing interest rates in the US and UK are 1.75% and 1.25%, respectively, which are their highest in the past four decades. Still, the inflation rate in the US and UK are hovering around 6.3% and 9.1%, respectively as of May 2022, which are also the highest in these countries over the past several decades. In this scenario, the possibility of further increase in interest rates by governments cannot be ruled out to bring about a shift in the spending behaviour of consumers. The markets across US, UK, Germany, China, and Japan have reacted in almost a unison to such developments in the world economy, as shown below.







Notes: Stock market movements of Shanghai Shenzhen 300, TOPIX, DAX, FTSE 100, and NYSE indices were considered for this graph.

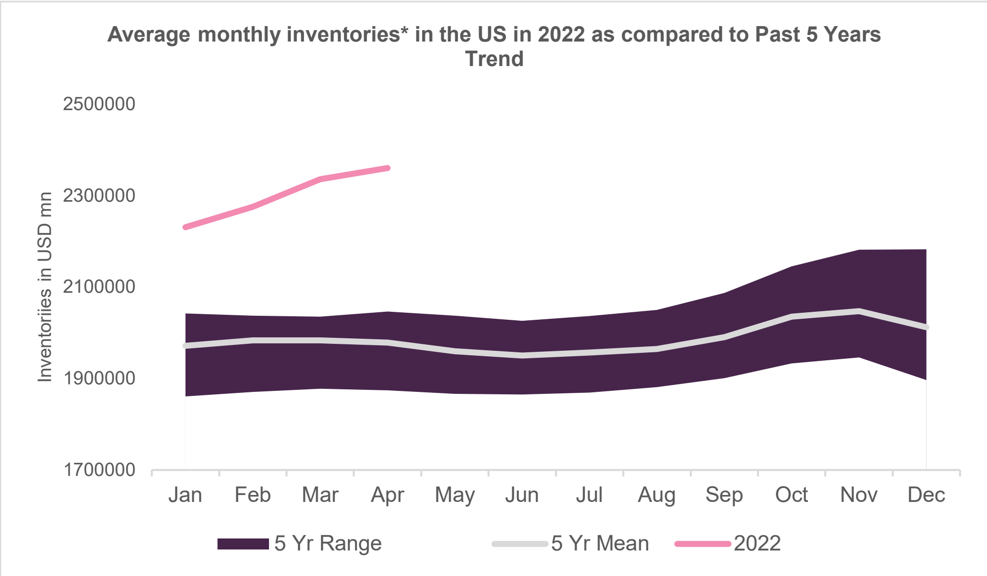
For all stock market indices the base is Jan 2022 = 100

PMI stands for Purchasing Manager's Index

Even other major indicators of economic outlook including consumer confidence and Purchasing Manager's Index (PMI) have reflected the unsavoury market sentiment to these economic developments across major economies.

Consumer confidence levels have weakened in all the major economies since beginning of 2022, as shown above. Even the PMI levels, though still in strong zone (above 50), have weakened for UK, US, Germany and Australia between March 2022 and May 2022.

Retail demand has already started showing signs of consumer pullback, which would only get further accentuated with the rate hikes. Consumer pullback has led some large retailers to cancel their shipment orders to push out the inventory already amassed. In Jun 2022, Target (a US based retailer) had to cancel orders from its suppliers for garments and home categories as it was witnessing dwindling profits owing to heavy discounts announced for inventory clearing.



*Notes: *Presents inventory data for Total Business including Manufacturing, Retail and Wholesale trade.*

Source: US Census Bureau.

Order cancellations in retail have started affecting the demand for other businesses

Order cancellations and demand pullback in retail sector have started affecting the demand for consumer durables, industrials, semiconductors, and other businesses.

Chinese manufacturing orders bound for exports have seen a decline of 20-30% this year as the US demand has started to moderate. This decline in Chinese manufacturing orders is driven mainly by uncertainties in economic scenario and weakening of demand, not as much by the shift of demand to other production centres within Asia. Even the export volumes of textiles and leather products from India have contracted by 10-20% over the last year.

One of the top chipmakers in Taiwan, Nanya Technology, has recently announced a possible revenue decline for the year as it sees the demand for consumer electronics weakening. Korean giant, Samsung Electronics, has recently put a temporary halt on its procurement orders to ease its swelling inventory amid rising inflation. The move from the Korean electronics giant indicates its somewhat pessimistic outlook on the demand scenario in the coming months.

New investments on supply chain need to be well evaluated

The cautious approach taken by Samsung and other businesses in procurement and inventory planning could be an indication of what other businesses would follow across sectors. As the money becomes dearer and demand becomes uncertain, businesses' investment stance in supply chains are likely to shift from 'aggressive' to 'cautious' or 'well-calculated'.

As the macroeconomic conditions turn demand-dissuading, businesses must recalibrate their capital investments in inventory, warehousing, or working capital; to avoid undue burden on financial health. Such critical decision making is often done by utilizing a comprehensive and tailored intelligence partner who could offer timely, accurate and bespoke business and market insights to support business decisions.

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