Economic Indicator — March 11, 2022

Consumer Sentiment Falling in the Face of Rising Inflation

Summary

Against a backdrop of worsening inflation, consumers now expect their personal finances to deteriorate in the year ahead by the largest share since the survey started in the mid-1940s. That is a top takeaway from the preliminary University of Michigan survey of consumer sentiment for March. Headline consumer sentiment fell to 59.7, its lowest since 2011.

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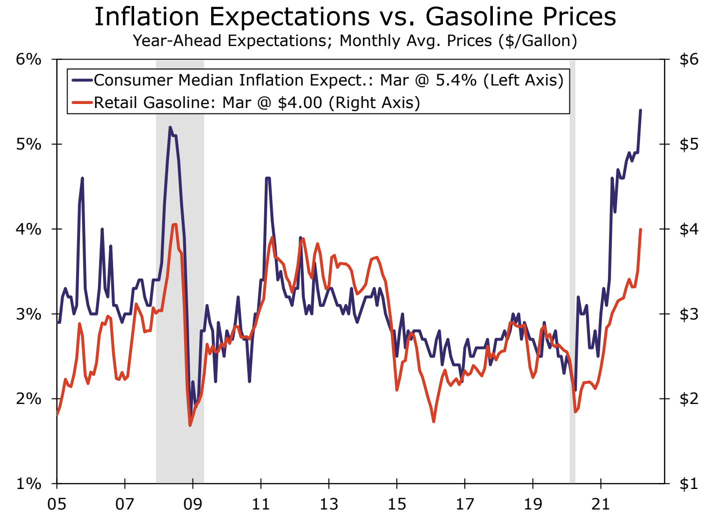
Pain at the Pump + RTO = Less Money for Other Spending

The accompanying text cut right to the chase : "The greatest source of uncertainty is undoubtedly inflation and the potential impact of the Russian invasion of Ukraine." Roughly one in four respondents spontaneously mention the war in eastern Europe during March's preliminary survey.

Inflation expectations rose to a four decade high. Coming as it did on the day after we learned that CPI inflation rose to a fresh 40-year high as well, the takeaway is clear: inflation is the top threat to consumer spending. As our latest forecast update makes clear: the Russia-Ukraine war makes that problem worse.

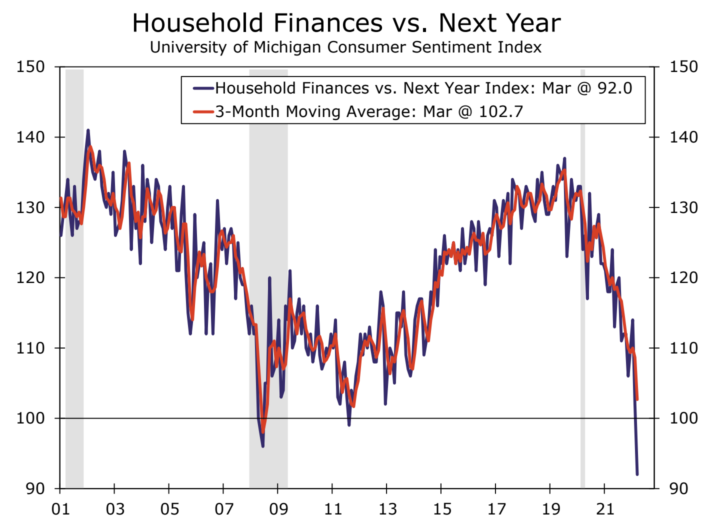
One of the most visible and regularly purchased products is gasoline. With gasoline prices at record highs, consumers expect additional increase of 50 cents in gas prices over the next year. Last month, the expected gain was just 15 cents. The fact that gas prices are soaring comes at a particularly bad moment as many workers are reacclimating to the return-to-office (RTO). With many consumers having spent close to nothing on a commute for the past two years, the combination of RTO & higher prices at the pump have scope to impact wallet share — the leftover funds for discretionary spending — particularly for lower income households.



Source: University of Michigan, Bloomberg Finance L.P. and Wells Fargo Economics

Personal Finances Hit a Wall

As we turn the corner into 2022, consumers are also wishing for the days of 2021 when it comes to their finances. The index comparing current household finances vs. a year ago fell to its lowest level in around nine years. This was partially responsible for the slight decline in the current conditions index. However, what was more shocking than consumers' comparison to where they are now is where they think they will land in a year. According to the official press release, "Personal finances were expected to worsen in the year ahead by the largest proportion since the surveys started in the mid-1940s." Those expecting finances to worsen in the year ahead climbed seven points to 33% while those expecting financial conditions to be better fell to 25% from 28%, which brought the household finances vs. next year balance index to its lowest since 1980 (chart). Less than half of consumers are expecting higher income in the next 12 months, with 54% expecting that their income will be less than inflation in the next couple of years, a share that has been "topped in only six surveys since the mid-1970s." This likely also translated into an overall more pessimistic view for the country, the index measuring whether the country will have continuous good times over the next year fell 14 points to 52, the lowest since the fall of 2011.



Source: University of Michigan and Wells Fargo Economics

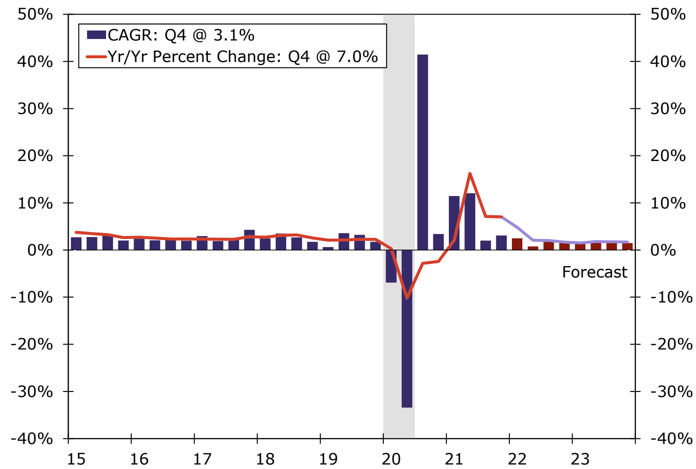
The Not So Magnificent Seven

All is not lost. Consumers are still sitting on savings accrued over the past couple of years that can help shoulder the burden of higher prices. The return to the office may be a drag, but it comes as many office workers are earning more than they were two years ago. The tight labor market is pushing up wages and salaries; though they are not always on pace with inflation. Still, inflation was high in January and that did not stop real personal spending from rising 1.5% in January; that was the biggest monthly increase since stimulus payment went out in March 2021.

Inflation may be the biggest problem for consumers, but it is not the only challenge. As the Fed tries to tame high prices, we expect it will raise rates six times this year. The higher cost of borrowing that will be in place by the start of 2023 could dent consumer outlays, particularly on durable goods.

The strong start in January sets up consumer spending for a decent first quarter, but outlays in real spending could get squeezed in the second quarter and remaining quarters of the year as consumers contend with higher prices.

Real Personal Consumption Expenditures



Source: U.S. Department of Commerce and Wells Fargo Economics

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