

Economic Indicator — June 16, 2023

Inflation Expectations in Retreat as Sentiment Hits Four-Month High

Summary

Sentiment is improving, albeit at still-depressed levels. We think the bigger story in today's University of Michigan survey is the fact that inflation expectations are rolling over.

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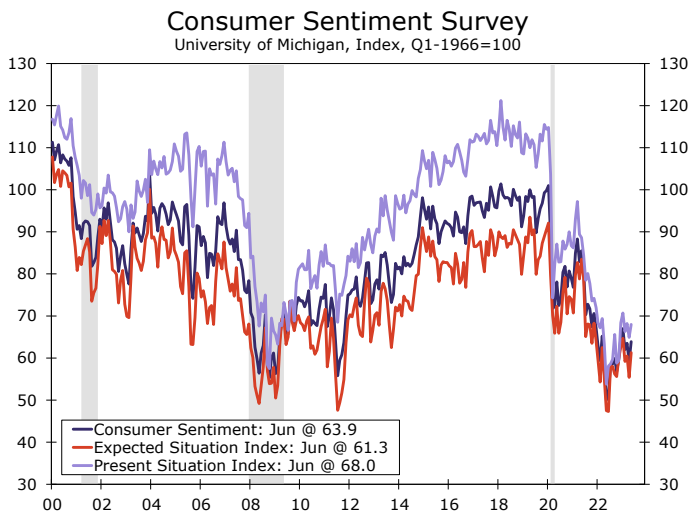
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Are Inflation Expectations at Last Beginning to Turn Lower?

Policymakers at the Federal Reserve have identified the forward-looking inflation expectations measures in this survey as a factor used to gauge the future trajectory of price growth. The 5-10 year outlook for inflation edged slightly lower to come in at 3.0% in June, though that is only one tenth of a percent off the highest expected inflation reading over this cycle. That is not the sort of retreat in inflation expectations policymakers will need to see to become convinced that inflation expectations are finally headed lower after a 15-month regimen of rate hikes.

Still, we can point to a few factors that are somewhat more encouraging in terms of the tide beginning to turn. For starters, the 1-year expected change in inflation has been falling on trend since last year and in today's report it fell to just 3.3%, which is the lowest expected inflation for the short term since early 2021. Another factor is that prices at the grocery store are no longer soaring at the double-digit pace that they were not so long ago. While grocery store spending may not comprise a huge share of overall personal consumption, it has an outsized influence on consumer price expectations, as the nearby [chart](#) shows. The red line is the year-over-year change in the "food at home" component of the consumer price index. Past turning points in this series have been associated with eventual shift in inflation expectations.

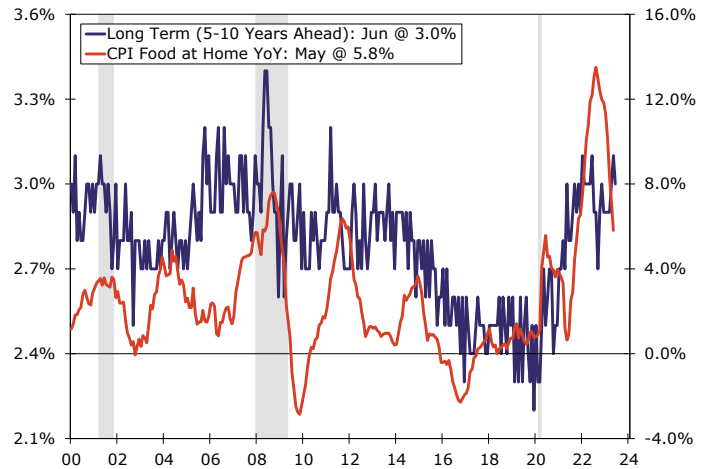
Broad Improvement

Just about every major component of today's report on consumer sentiment from the University of Michigan moved in a favorable direction for economic growth. Though all of these measures are still historically rather low, the respective indexes for overall sentiment, current conditions as well as expectations all notched gains of at least three points. Arguably the most compelling development is the 5.9 point jump in expectations to a four-month high of 61.3.

Still, in a business cycle that has been characterized by the uncanny staying power of the consumer, sentiment has not always been the most reliable predictor of actual consumer spending. Sentiment has been in broad decline over the past two years. Yet consumer expenditures have gradually climbed higher on trend throughout this period. This comes despite high inflation, the fastest rate hikes in 40+ years and persistent warnings of a coming, yet perpetually postponed recession.

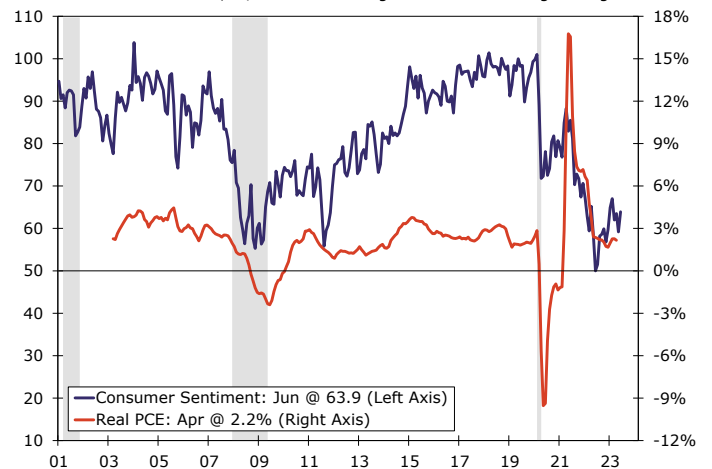
Still, the incremental moves in sentiment often provide useful contextual clues as the short term trajectory for actual spending as the nearby [chart](#) conveys.

Long Term Inflation Expectations vs Food at Home
Expected Year-over-Year Inflation Rate; Year-over-Year



Source: University of Michigan, U.S. Department of Labor and Wells Fargo Economics

Consumer Sentiment vs. Personal Consumption
Index 1966=100; Yr/Yr Percent Change of 3-Month Moving Average



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

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