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Economic Indicator — January 14, 2022

Consumer Sentiment Falls: Yes, Case Counts Are Soaring, but So Are Expenses

Summary

Consumer sentiment fell to 68.8 in January. While soaring COVID case counts no doubt played a role in the decline, the University of Michigan cited inflation as the key issue weighing on consumers.

Economist(s)

Tim Quinlan
Senior Economist | Wells Fargo Economics
Tim.Quinlan@wellsfargo.com | 704-410-3283

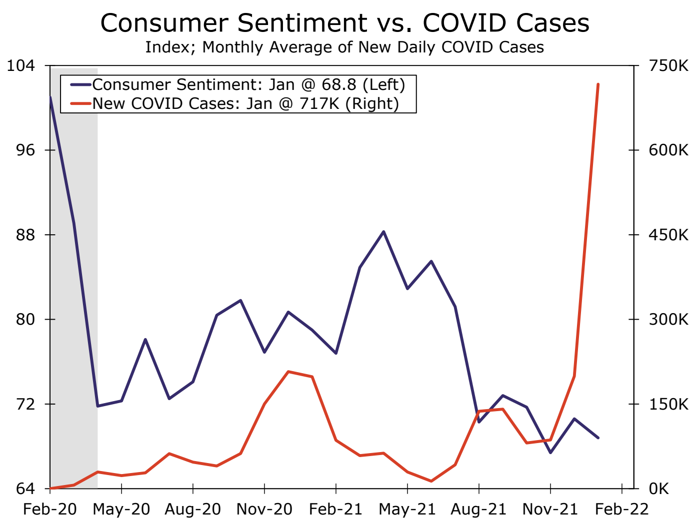
Sara Cotsakis
Economic Analyst | Wells Fargo Economics
Sara.Cotsakis@wellsfargo.com | 704-410-1437

Trifecta of Disappointment as Consumer Sentiment Wilts in January

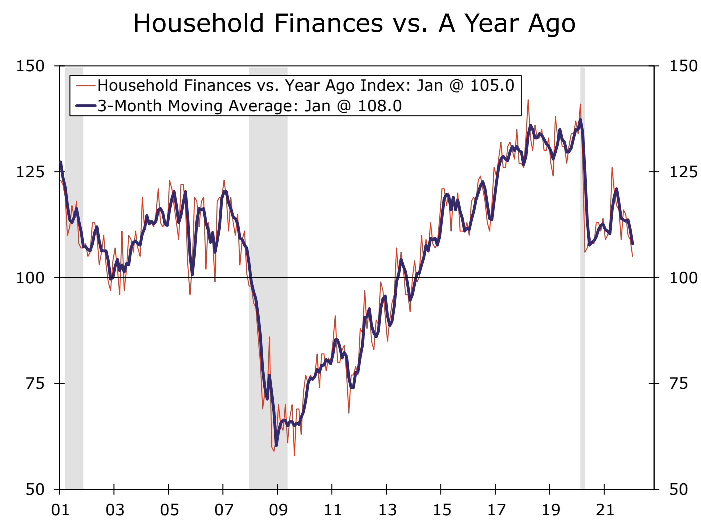
Our argument that consumers will be resilient in the face of the Omicron variant took a few body blows in today's economic data. On the heels of a sharp decline in December retail sales, a deterioration in the preliminary estimate for the University of Michigan's consumer sentiment survey does little to brighten the outlook for consumer spending. Consumer sentiment slipped to 68.8 in January from 70.6 in December. This report completes a trifecta of disappointing economic data this morning, along with declines in both retail sales and industrial production for December.

We have maintained that consumers are increasingly less fazed by each successive wave of COVID, but at some point, the sheer volume of cases can weigh on their mood even if the impact on activity is less pronounced. The Omicron-related surge has resulted in case counts three times higher than any prior peak, which is hard to ignore. Still, we suspect that Omicron is more of a boogieman that makes for easy explanations. Our take is that inflation is the more warranted concern with prices rising the fastest pace in nearly 40 years.

Regardless of how the latest COVID surge is playing out with consumers, the surge has also led to further labor shortages as employees have to take time to quarantine, a factor which could be impacting current business conditions measures.



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



Source: University of Michigan and Wells Fargo Economics

Consumers Fear Inflation Will Outpace Income This Year

Year-ahead inflation expectations climbed to 4.9% after subsiding to 4.8% in December. Expectations will likely remain high as we anticipate inflation will reach their peak pace of 7.0% in the first quarter, which will keep prices top of mind. With businesses raising prices more than at any other time in the last few decades, inflation is not going away. The NFIB survey, released earlier this week, pointed to the pressure consumers will likely face as the share of businesses currently raising prices stayed within two points of its all-time high.

There are some potential bright spots that we are at or near an inflection point with inflation. According to that same NFIB survey, the share of firms planning to raise prices in the next three months dropped five points to 49%, the lowest since September. Another encouraging sign was that among consumers reporting their household finance situation vs. a year ago, a smaller share experienced higher prices. That share dropped to 24% from 27% last month. That said, this is still a very notable proportion, as the only reason with a higher share than "higher prices" was "higher income" at 35%. This is yet another clear example of the current push and pull between inflation and rising wages & salaries. While consumers are making more, much of that is having to go toward spending on necessities. Overall, the household finances vs. a year ago index dropped four points to 105 in January.

The key question is whether or not income will keep pace with inflation, Only a little more than a third of consumers think it will. The mean percentage of consumers expecting their family income will beat inflation in the next five years stayed at 36.1%, where it has been for the past three months.

This Won't be the Last of Shaken Confidence, but Spending Will Remain Intact

Our baseline expectation is that consumer spending will still grow at an above-trend rate this year. Yes, prices are certainly weighing on consumers' mindsets—that is certainly evident in today's report. Note however that the Conference Board's measure of consumer confidence rose in December, though the present situation index did slip slightly. Confidence will likely be shaken in the next couple of months amid these lingering risks. Even so, there has been a recent disconnect between sentiment and spending measures.

Make no mistake, the virus will disrupt activity, but we don't see it being as much of a headwind as the outbreak around the Delta variant last summer was in terms of the extent to which it will weigh on consumption. If hospitalization rates start to spike commensurate with cases, that may change, but for now inflation is the bigger danger to the consumer outlook.

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Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Mark Vitner	Senior Economist	704-410-3277	Mark.Vitner@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Charlie Dougherty	Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Shannon Seery	Economist	332-204-0693	Shannon.Seery@wellsfargo.com
Nicole Cervi	Economic Analyst	704-410-3059	Nicole.Cervi@wellsfargo.com
Sara Cotsakis	Economic Analyst	704-410-1437	Sara.Cotsakis@wellsfargo.com
Jessica Guo	Economic Analyst	704-410-4405	Jessica.Guo@wellsfargo.com
Karl Vesely	Economic Analyst	704-410-2911	Karl.Vesely@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

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