Economic Indicator — October 25, 2022

Confidence... Consumer Confidence

Summary

The labor market may still appear tight at present, but today's consumer confidence report points to a cooling trend with the smallest share of households in 18 months viewing jobs as "plentiful." Factor in rising inflation expectations and no wonder present situation fell to an 18-month low.

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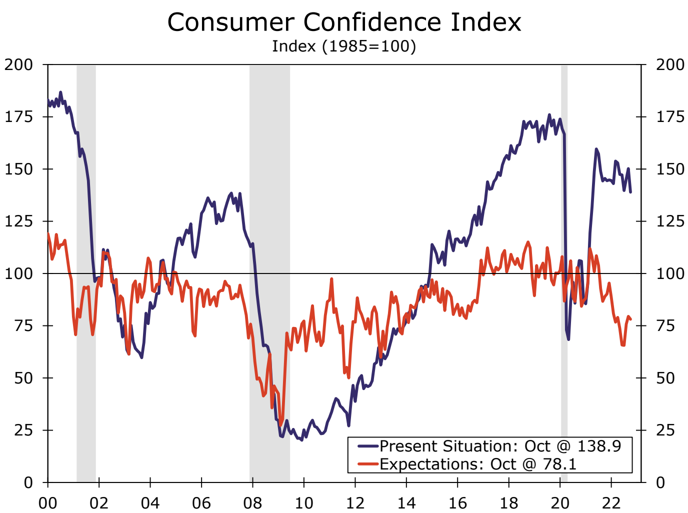


Source: The Conference Board and Wells Fargo Economics

Confidence Shaken And Stirred

Consumer spending may be holding up, but confidence is shaken. Consumer confidence fell to 102.5 in October even as the prior month's reading was lowered by revisions. The weakness was particularly evident in consumers' assessment of the present situation which fell to its lowest level since April 2021 (chart). Expectations are holding up a bit better, but also fell during the month.

The retrenchment in confidence highlights how rising core inflation and growing fears about whether aggressive rate hikes by the Federal Reserve will push the economy into recession is weighing on optimism.

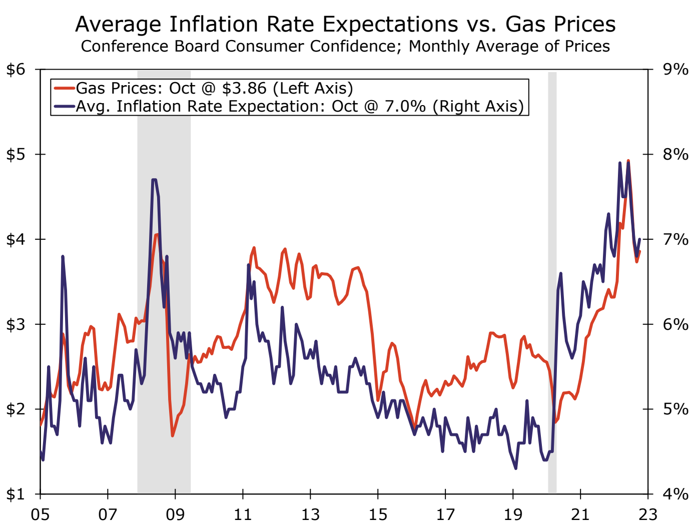
We have been closely monitoring the uncanny staying power of the consumer in this cycle and have long maintained that the drivers of spending are not sustainable. So far though, consumers have been pulling out all the stops to not just make ends meet, but to continue to increase spending even in the face of high inflation as well as the rate hikes designed to slow it. The famed economist Milton Friedman observed that monetary policy acts with a lag that is long and variable. The rattled confidence revealed in today's report is consistent with our view that consumers cannot rely on savings forever. We expect spending to slow in coming months before declining outright in the second quarter of 2023 ushering in a mild recession.

007%

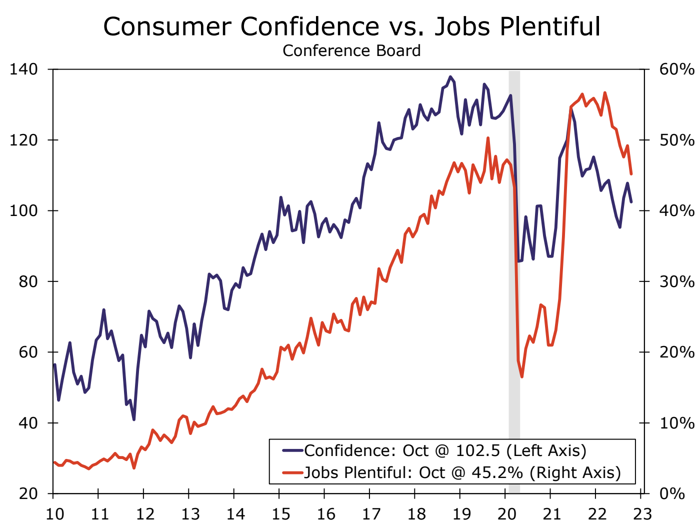
One of the most consequential questions in economics at present is whether the Fed can get inflation back under control without causing a recession. Key to answering that is the extent to which expectations for higher inflation are becoming anchored. Inflation expectations from the University of Michigan's consumer sentiment release typically get all the attention, and rightfully so with their earlier read on expectations. But in today's elevated inflation environment, it's also worth paying attention to the year-ahead average expectations from the Conference Board.

Average consumer inflation expectations inched higher to 7% in October after declining the previous four months. As the nearby chart shows, moves in gasoline prices go a long way toward influencing broader inflation expectations, even though gas purchases typically make up a small share (~3%) of consumer expenditures.

Gas prices vary quite a bit by geography, but the national average price per gallon was over $5 in June before trending lower through September when prices hit a recent low of $3.67. Prices are moving up again with the average daily price month-to-date in October at $3.86, likely putting some upward pressure on views of coming inflation. We expect the Fed continues to find some solace in the fact that medium-to-long term expectations from the University of Michigan remain well-anchored through early October.



Source: The Conference Board, Bloomberg Finance L.P. and Wells Fargo Economics



Source: The Conference Board and Wells Fargo Economics

Labor View to a Kill

Of equal importance when it comes to the trajectory of economic conditions is consumers' views on the labor market. How households view their job situations and prospects directly influences their willingness to spend, and with decades-high inflation not meaningfully weighing on spending to date, job prospects may arguably be more important for consumption decisions today. Inflation has largely eroded households' purchasing power, and consumers are relying on their balance sheets to spend. But that's a lot easier to do when you're comfortable with your job security. If households were to increasingly grow pessimistic about their labor prospects, that would likely have a larger effect on their spending habits than if inflation holds in at these elevated rates for a few months yet.

To that end, the smallest share of households in 18 months viewed jobs as "plentiful" in October. There is still a relatively low share of households reporting jobs as hard to get, which is consistent with the low unemployment rate and overall tightness that still exists in the labor market. Putting the two views together, the labor differential (the difference between those viewing jobs as plentiful less those who view jobs as hard to get) has also rolled over. As seen in the nearby chart, employment conditions have a large bearing on the overall confidence index, and as the Fed's tighter policy stance to quell inflation weighs on demand, we expect to see some deterioration in the labor market. This will keep downward pressure on consumer confidence for some time.

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