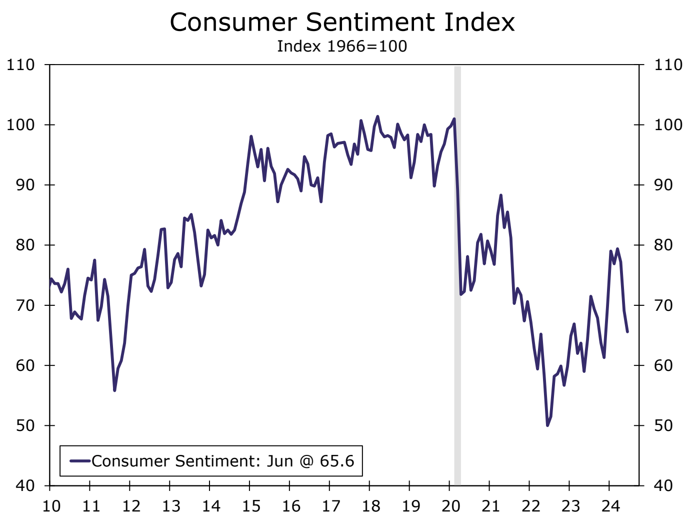
Economic Indicator — June 14, 2024

Still in a Slump: June Marks Third Straight Slip in Consumer Sentiment

Summary

Today's softer-than-expected reading puts consumer sentiment at roughly the midpoint of where it has been over the past two years. The *growth* in prices may be coming down, but *prices* are not and that is weighing on households, particularly those in the middle most apt to feel the squeeze.



Source: The University of Michigan and Wells Fargo Economics

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Why the Long Face?

Consumer sentiment in the current cycle bottomed in the summer of 2022 when it touched a low of 50.0 in June of that year. The two years since then have been characterized by only a modest rebound despite steady growth in consumer spending. That rebound stalled this March and today's reading for June marks the third consecutive monthly decline. In fact, the current reading of 65.6 roughly marks the midpoint between the high of 79.4 in March and the cycle low of 50.0 reached two years ago this month (chart).

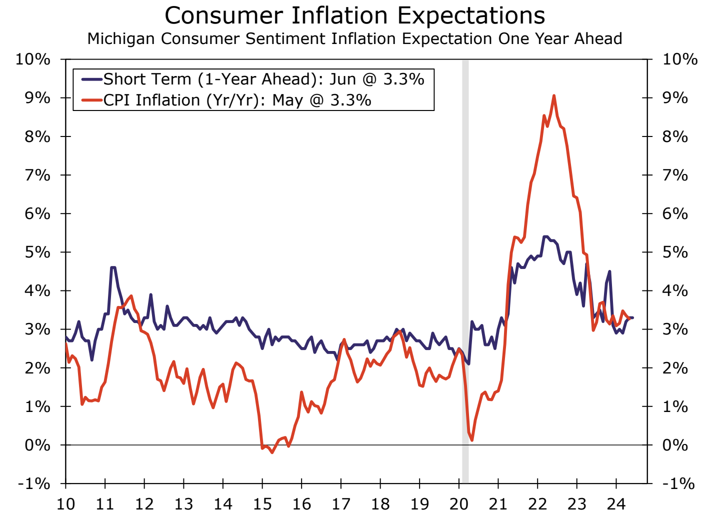
The factors typically associated with rising sentiment moved in the right direction in early June with the stock market notching record highs and gasoline prices falling, albeit more modestly than in May. In last week's employment report there were some mixed signals. Today's slack sentiment reading is more consistent with the household survey which showed net job losses and a rising unemployment rate in May.

While price growth is at last coming closer in line with the Fed's 2.0% target, the price level remains high. A $15 lunch may not be meaningfully higher than it was 12-month ago, but it still *feels* expensive. Price growth is coming down, but prices are not; for too many households that feels like inflation is still a problem.

As the road back to 2% inflation becomes clearer with May's CPI report, consumers are following in tow with a trend lower in inflation expectations. In June, year-ahead inflation expectations were flat at 3.3% and long-term 5-10 year ahead inflation expectations increased a touch to 3.1%. Following this week's downside surprise to CPI, short-term inflation expectations and the year-over-year headline CPI are now both running at 3.3%.

At face value, it appears that consumers are not expecting the rate of inflation to come down over the course of the next year. However, it has historically been the case, particularly during the prior expansion, that consumers tended to overestimate where inflation would be in a years time, as demonstrated in the nearby chart by the blue line running above the red line during most of the 2010s. During the decade of expansion between 2010 and 2020, consumers' year-ahead inflation expectations averaged about 2.9%. This contrasts sharply with the average year-over-year CPI rate of about 1.8% over the same decade.

With year-ahead inflation expectations now only 0.4% above their 2.9% average from the last cycle and continuing to trend downwards, they remain broadly well-anchored.



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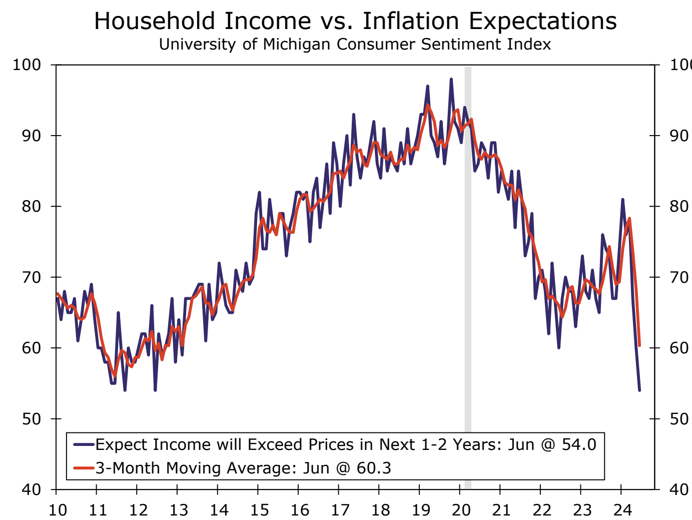

Source: University of Michigan and Wells Fargo Economics

Even so, inflation is still a top concern. The mean percentage of respondents expecting income to beat inflation over the next two years fell to 54% in May (chart). Price pressure continues to be felt by *all* households, but higher prices were cited the most by middle-income families as the reason for poor personal finances. This dynamic likely reflects the purchasing basket of these consumers, but it also may indicate the lower income growth of this group in recent years.

While inflation is still running at an elevated rate and price gains tend to compound for consumers, the recent concern may stem from moderating incomes. The labor market is softening, exhibited by lower demand for workers and less voluntary exits by employees, and households are taking notice. The mean percentage of higher-income people expecting income to rise over the next year fell to 44.1% in early June, which is the lowest since the start of the pandemic in April 2020. Pre-pandemic this measure averaged around 52%. We've long cautioned that consumer spending was set to moderate amid a softening jobs market as income has once again become the driving source of purchasing power. Households are awake to the fact that income growth is slowing, the question is will that translate to less spending?

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