Economics

Economic Indicator — September 13, 2024

Rate Cut Expectations Not Full Remedy for Consumer Sentiment

Summary

Consumer sentiment rose in early September amid prospects of lower rates in the year ahead. Yet uncertainty around the presidential election and slowing jobs market are holding back optimism. Not to mention, while inflation isn't as big of a problem as it once was, higher prices remain a challenge for consumers.

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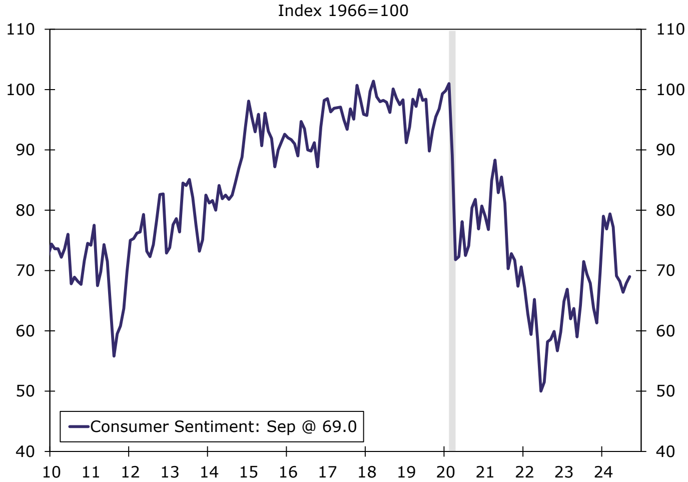
Consumer Sentiment Index
Index 1966=100



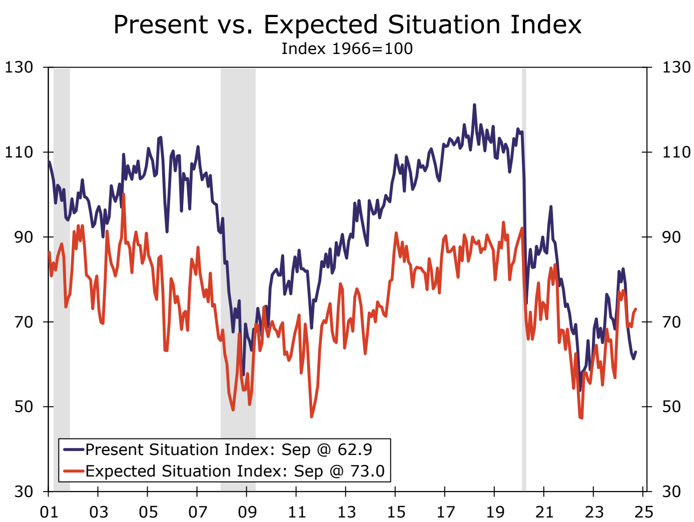
Source: The University of Michigan and Wells Fargo Economics

Going to Take More Than Declining Rates to Boost Sentiment

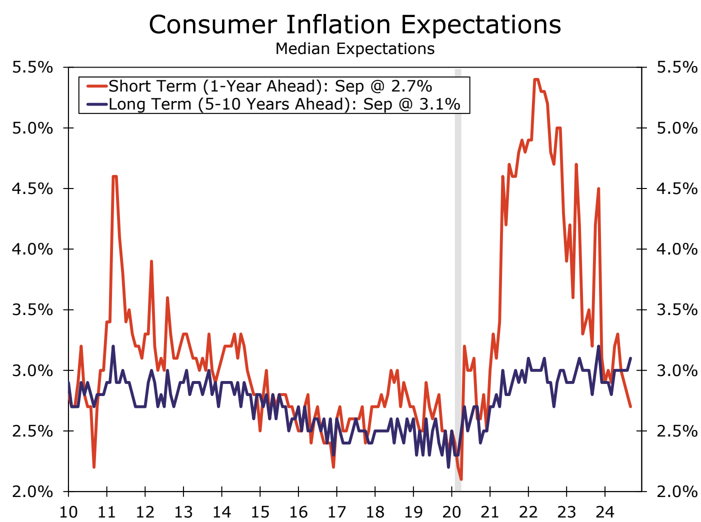
Consumers grew a bit more optimistic in early September. The preliminary read of Consumer Sentiment ticked up to 69.0, which marks the second consecutive monthly gain. Both views on current conditions and expectations about the future improved and propelled sentiment higher earlier this month (chart). Like many market participants, consumers are getting excited for potential Fed easing. A majority of consumers expect interest rates to fall over the next year, with 54% of respondents saying so, which matches a historical high last hit in mid-1980. Yet even with the prospect of lower yields boosting sentiment, it remains at depressed levels. Sentiment is still well off its pre-pandemic level and remains below its post-pandemic high as consumers remain uncertain about the economy (chart).

There is no shortage of reasons holding back sentiment today, but the presidential election is playing a big a factor in uncertainty. It's worth noting that survey responses for this preliminary sentiment read closed ahead of the recent presidential debate. As we noted in a special report earlier this year, elections are historically a damper on sentiment, regardless of political affiliation. While the election leaves many households uncertain, Democrat household sentiment has received a jolt since Biden resigned from the race and Harris entered it. The sentiment of those who see themselves as Democrat rose to 92.6 in early September, up from 83.0 in July, while those identifying as Republican or Independent have not moved much.

It's not just the upcoming election that is weighing on sentiment either. While sentiment tracks personal finances more closely than employment conditions, consumers also made note of a slowing jobs market throughout a number of their responses. After reaching a post-pandemic high in January, a smaller share of consumers (just 40.6% in early September) continue to expect higher income over the next year. The accompanying release also made note that a rising share of households reported hearing negative news on unemployment, and "When asked whether unemployment or inflation will pose the more serious problem for consumers in the next year or so, less than 40% of consumers chose inflation, down from 53% just four months ago." While the inflation problem isn't as big of an issue as it once was, it's still a factor influencing consumer moods.



Source: The University of Michigan and Wells Fargo Economics



Source: The University of Michigan and Wells Fargo Economics

The Anchor Holds

Inflation expectations diverged a bit in September. Median year-ahead inflation expectations declined to 2.7% from 2.8% in August (chart). Meanwhile, long-term inflation expectations rose to 3.1% from 3.0% a month prior. Some of the reprieve in short-term expectations may be due to a decline in gas prices, as prices at the pump are one of consumers' most visible price gauges. National average gasoline prices have fallen over a dime a gallon thus far in September. Even with the uptick of a tenth, long-term inflation expectations still remain broadly well anchored—they've remained with a narrowband of 2.8%-3.1% so far this year—something the Fed continues to keep a close eye on.

In Chair Powell's Jackson Hole speech, he made reference to the role inflation expectations have had on the post-pandemic economy. In particular, he noted that "disinflation while preserving labor market strength is only possible with anchored inflation expectations." Inflation expectations remaining broadly well-anchored have facilitated the possibility of achieving a soft landing. Long-term inflation expectations, as measured by the median-expected inflation rate in five-to-ten years, have remained at about 3.0% for the better part of the three years since inflation started accelerating in earnest.

Prior to the pandemic, long-term inflation expectations moved within a narrowband around 2.5%. It is really quite remarkable that inflation expectations have only increased about 0.5 percentage points over this horizon when accounting for the fact that for almost the entirety of 2019, when long-term expectations were around 2.5%, CPI inflation was running lower than the Fed's 2% target on a year-over-year basis. Inflation would go on to accelerate by nearly seven percentage points by mid-2022, and expectations for the long term only rose about half a percentage point. With the outlook for inflation continuing to moderate, there is runway for inflation expectations to ease in the coming months.

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