Consumers Are Doing Alright, So Far

But Elevated Inflation, High Interest Rates Remain Worries

By Christine Cooper and Rafael De Anda

The University of Michigan last week reported the preliminary results of its consumer sentiment survey for June, finding that anxiety appears to be diminishing — possibly due to resolution of the debt ceiling crisis.

It's been a rollercoaster ride for consumers since the onset of the pandemic, understandably so. The sentiment index fell to its lowest level in the history of the series in June 2022, just as inflation hit 9.1%, then improved as easing prices in recent months evidently lifted consumers' spirits.

All components of the survey ticked higher in May, including assessments of the current economic situation but also expectations of future conditions, which notched a surprising 5.9-point gain.

Small businesses disagree and are generally quite worried about the direction of the economy. The National Federation of Independent Business survey of business optimism ticked higher for the first time in three months but remains in the doldrums, with respondents citing still clogged supply chains and labor shortages as roadblocks to stronger sales. Notably, a net 32% of business owners report raising average selling prices, with higher percentages reported by retail, wholesale and construction businesses.

Despite still rising prices, consumers have not been holding off on spending. Retail sales rose by 0.3% in May over the prior month, much higher than expected, and followed a 0.4% gain in April.

Surprisingly, the fastest rise in sales was in building materials and garden equipment, growing by 2.2% over the month despite weaker residential construction, a sign that homeowners themselves are sprucing up their homes and gardens for the summer. Sales at car dealerships also saw a sizeable jump, rising by 1.4% in May, as broadly expected. Automobiles have been in short supply and a deficit of auto sales is still largely being supplied.

In contrast, where over the past 12 months sales at restaurants and bars have outperformed all other major categories, that pent-up demand from pandemic closures appears to now have been satisfied and life is returning to normal. Sales were only 0.4% higher in May than April. The big loser in sales this month was at gasoline stations, but that pullback in spending was more due to a fall in prices than a drop in demand.

How long consumers will continue to spend is an open question. For more than a year, the Federal Reserve has been raising its overnight lending rate, boosting the rate by 500 basis points higher, the sharpest path in more than 40 years, and policymakers have signaled they are not done yet. This is making it more costly for households to borrow money and for businesses to invest in their operations or in expansion. Consumers have been leaning on credit cards and personal loans to finance recent purchases but are now facing interest rates of 20% on credit cards and 11% on personal loans.

Yet the labor market remains robust. The three-month average of job gains was 283,000 in May, with a startling 339,000 jobs added in that month alone. The unemployment rate is near historic lows, job openings are still elevated, layoffs are slowing and claims for unemployment benefits have barely ticked higher, with continuing claims also muted. Annual wage gains have been strong, although still below the rate of inflation.

So far, the economy has proved quite resilient despite high inflation and interest rates, but at some point, these rates will begin to bind and spending will slow. It doesn't seem we're quite there yet.