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Are higher prices thwarting consumer demand?

Article

The news: **US retail sales fell month-over-month (MoM) in May for the first time in five months** thanks in large part to a rapid decline in purchases of vehicles and other big-ticket items, per the US Commerce Department.

- The 0.3% MoM decline was below the Dow Jones-estimated 0.1% gain, according to CNBC.

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- **Excluding auto sales and purchases at gas stations, retail sales inched up 0.1% MoM**, the smallest gain in five months.
- On a year-over-year (YoY) basis, retail sales rose 8.1%. However, the Commerce Department's numbers are not inflation-adjusted, which means consumers are getting less for their money due to rising prices.

Digging into the numbers: **Consumer spending has significantly shifted away from big-ticket items** from January to May of this year.

- **Electronics and appliance store sales fell 1.8%** in those five months, while **furniture and home furnishings sales rose just 2.5%**.
- **Rising gas prices are partially to blame** as sales at gas stations soared 38.7%.
- **Restaurant sales**, which is the only services component in the report, **rose 23.6%**.

What's happening? The Commerce data and broader trend lines suggest that **US consumers' appetite for goods is softening** as some feel the pinch of rising prices and interest rates, while others shift their spending to services such as eating out, travel, and entertainment.

- Another factor driving the slowdown is that consumers are starting to lose their footing as they dip into their pandemic-padded savings and increasingly use credit cards.
- Retailers such as **Target** and **Best Buy** have cited consumers' shifting behaviors in recent earnings commentary. Target said the abrupt shift in spending left it with excess inventory in bulky categories like kitchen appliances, TVs, and outdoor furniture, and Best Buy noted slow home theater and computing sales hurt its year-over-year comps.

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Macroeconomic Trends that Are High Risk vs. High Growth on Their Business Model According to US CFOs, March 2021
% of respondents

	High Risk	High growth
A more intrusive regulatory environment in the US	34%	13%
US-China tension	27%	14%
Global trade and tax policy	26%	12%
Shifts in consumer behavior	23%	34%
Inflation	23%	11%
Increase in interest rates	20%	10%
Growth of digital economy	19%	46%
Work-from-home shift	14%	21%
Sustainability (net zero economy)	13%	16%
Policies promoting nearshoring or US reshoring	7%	11%

Note: n=182
Source: PwC, "US Pulse Survey," Dec 16, 2021

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Across the globe: A challenging retail picture isn't unique to the US.

- **Retail sales in China fell 6.7% MoM in May**, per China's National Bureau of Statistics.
- That said, China's May numbers were a marked improvement from an 11.1% MoM decline in April, when millions of residents were confined to their homes due to COVID-19 lockdowns.

Looking ahead: US retail sales (excluding auto) are expected to jump 7.5% YoY during the critical mid-July to Labor Day back-to-school period, per a forecast by Mastercard SpendingPulse.

- But that forecast doesn't account for inflation, which means the outlook isn't as optimistic as it seems at first glance.
- Mastercard expects shoppers returning to stores to be a key driver behind that growth, as its forecast calls for **in-store sales to rise 8.2% YoY**.
- Another important projection is the return of in-person events pushing up **apparel sales 8.7% YoY**.

The big takeaway: While US consumers have been incredibly resilient throughout the pandemic, they're starting to feel the impact of prolonged inflation as food and gas prices eat up more of their income.

- The challenging environment is going to force retailers selling discretionary items to find creative ways to drive sales.

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