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Zak Stambor

# Consumers kept spending in August despite hotter-than-expected inflation

Article

**The situation:** There have been a lot of positive indicators for retailers to feel good about lately.

**US consumers keep spending.** The personal consumption expenditures index—a broad measure of consumer spending on goods and services—rose 0.4% month over month (MoM) in August following a 0.2% MoM decline in July, per the US Commerce Department. Spending on services rose 0.8% MoM, while falling gas prices pushed goods spending lower for the second month in a row.

**And they're feeling better about the economy.** Even though the Federal Reserve's preferred measure for core inflation came in hotter than expected—rising 0.6% MoM after being flat in July—post-tax personal income edged up 0.4% MoM, a tick above the headline 0.3% inflation. That has consumers cautiously more optimistic about their finances: Both the University of Michigan's consumer sentiment index and the Conference Board's consumer confidence index ticked up in September. And Gallup's economic confidence index rose modestly in September after a relatively large improvement in August.

**But even as strong consumer demand and better wages buoy sentiment, there are signs of trouble ahead.**

**The Fed isn't happy:** Inflation's persistence will likely keep the Fed firmly in rate-hike mode to cool demand.

- Interest rates have to come back off the basement floor "for some time to have confidence that inflation is moving back to target," said **Lael Brainard**, Federal Reserve vice chair, in a speech on Friday. She said the Fed is "committed to avoiding pulling back prematurely."

**Other warning signs:** There are other reasons for retailers to be concerned.

- **Consumers are saving less money.** The personal savings rate was just 3.5% in August, down from 9.5% a year earlier, per the Commerce Department.
- **Sixty-two percent of consumers have less confidence in the economy than they did 12 months ago**, per Verint. And 76% of those respondents say they're cutting back on spending.
- **Many shoppers plan to spend judiciously this holiday season**, according to a Numerator consumer survey: 74% of consumers are wary of splurging on premium or luxury items; 46% plan to pull back on dining out or ordering food delivery; 41% will cut back on spending on apparel; and 32% will reduce spending on toys and games.


**The big takeaway:** In normal times, retailers could feel good about their holiday sales prospects given the positive consumer spending momentum, wage increases, and an uptick in consumer confidence ahead of the holidays. But in this inflationary environment, many of those signs may drive the Fed to keep raising interest rates aggressively, which will hinder growth.

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