

# ECONOMIC VIEWPOINT

## The Ambivalence of US Consumers

By Francis Généreux, Principal Economist

The US economy has been holding up well in the face of high interest rates. The labour market and consumer spending have been especially resilient. Real consumption growth has been surprisingly robust despite polls and consumer confidence surveys suggesting Americans are downbeat and unhappy. Inflation continues to be the biggest pain point for households, though factors like political affiliation appear to be affecting consumer sentiment as well. Consumer behaviour is also being influenced by interest rates (though less than expected) and household saving habits.

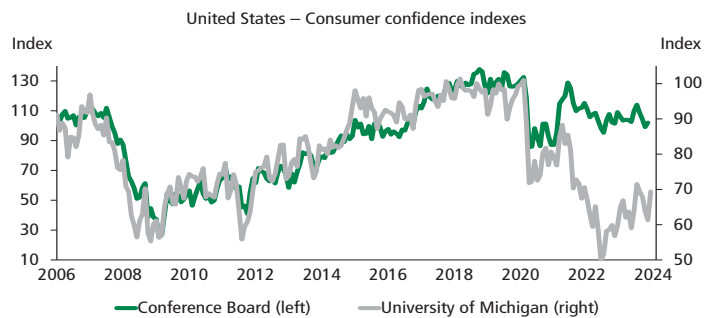
We've been concerned about the strength of US consumption since policy rate hikes began in the winter of 2022. Just a few months later, in April 2022, we published an [Economic Viewpoint](#) outlining key threats to consumer confidence and spending, such as the end of government pandemic relief programs, soaring inflation and higher interest rates. But the counterpoints to these challenges were the robust labour market and its ability to support personal income.

While most of these factors continue to weigh on households, US consumer spending is nonetheless holding up. Real consumption rose at a 3.6% annual rate in the third quarter of 2023. Spending then continued to climb in October with a 0.2% month-over-month increase. And it now appears that the holiday season is off to a pretty good start, based on anecdotal information, consumer and business surveys, and preliminary card transaction data from late November on.

Even though US consumers have continued to spend, at least until now, they're not feeling terribly cheerful. In fact, the consumer confidence indexes show that sentiment has been low since summer 2021 (graph 1). Before the pandemic, consumer spending would have slowed sharply if consumer confidence was this low (graph 2).

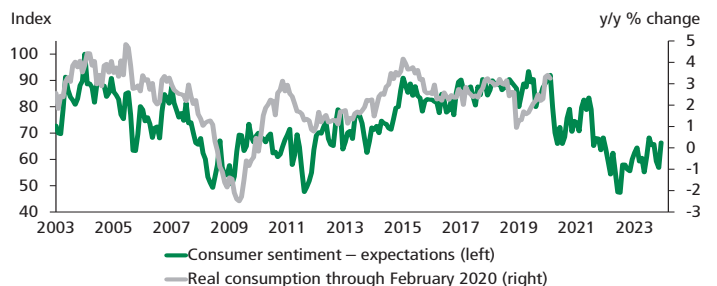
This is despite certain reassuring economic conditions, the most obvious of which being the strong labour market. Nearly 12 million jobs have been created since June 2021, including 2,552,000 in 2023. But there are some decidedly more negative factors, like the rising cost of living. Since June 2021, real personal income has declined 0.8% and real hourly wages have fallen 2.0%. For households, the key pain point is clearly the

**GRAPH 1**  
US Consumer Confidence Remains Low



Sources: Conference Board, University of Michigan and Desjardins Economic Studies

**GRAPH 2**  
Weak Consumer Confidence = Lower Consumer Spending



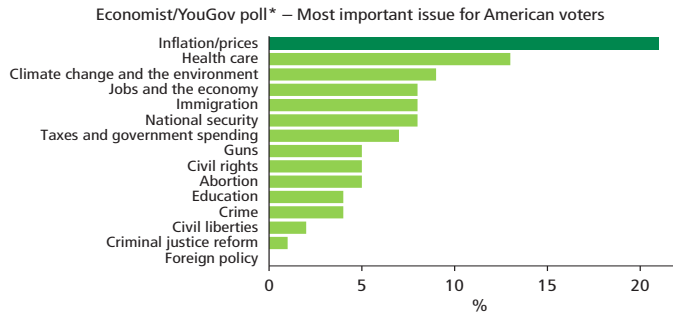
Sources: University of Michigan, Bureau of Economic Analysis and Desjardins Economic Studies

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erosion of their purchasing power due to high inflation. Inflation is also the number one political issue for Americans, ahead of health care, the environment and the overall economy (graph 3).

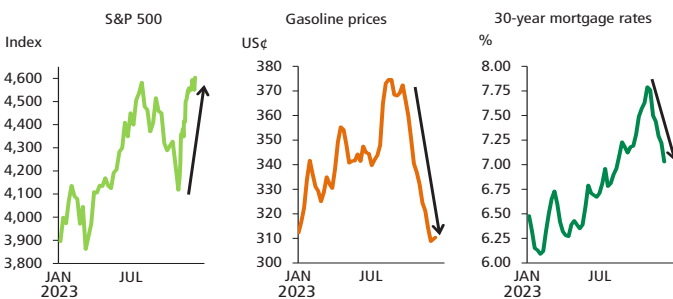
**GRAPH 3**  
Inflation Is by Far the #1 Political Issue for Americans



\* Conducted December 2 to 5, 2023  
Sources: The Economist/YouGov and Desjardins Economic Studies

However, recent numbers show that inflation is starting to ease, which should put Americans in a better mood. The year-over-year change in the consumer price index has plummeted from a high of 9.1% in June 2022 to “just” 3.1% in October 2023. As encouraging as this may be, households aren’t satisfied with a slower rate since it doesn’t make up for the massive jump in prices seen in the past few years. Fortunately, some factors are starting to have a bit more of an impact (graph 4). The sharp drop in gas prices over the past few weeks, lower retail rates and the stock market’s solid performance since late October have boosted consumer sentiment according to the preliminary version of the University of Michigan’s December survey. The index remains at historically low levels, however.

**GRAPH 4**  
Consumer Confidence Has Improved Recently Due to a Number of Factors

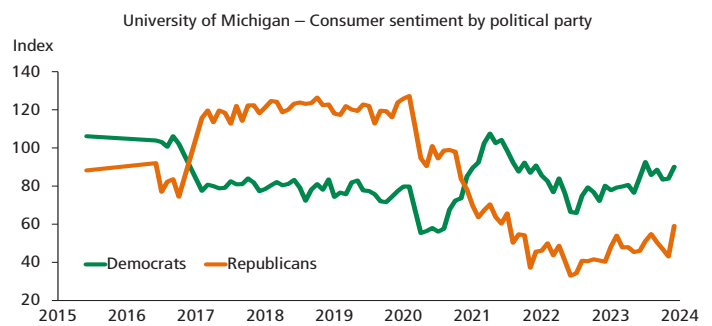


Sources: Datastream, Energy Information Administration, Mortgage Bankers Association and Desjardins Economic Studies

Beyond economic and personal finance considerations, there’s another important factor that influences US consumer confidence: politics. The ever-widening rift between the left and right is even apparent in consumer confidence indexes. Consumers’ perceptions of the economy’s strength and

their expectations are split along partisan lines. Changes in the University of Michigan consumer sentiment index at the beginning and end of Donald Trump’s presidency clearly show that Democrats are less confident when there’s a Republican in the White House, just as Republicans are less confident when there’s a Democrat in the Oval Office (graph 5). To a certain extent, this explains the current discrepancy between sentiment and spending. Low consumer confidence reflects a negative view of the Biden administration while consumption is being influenced by the actual health of the economy.

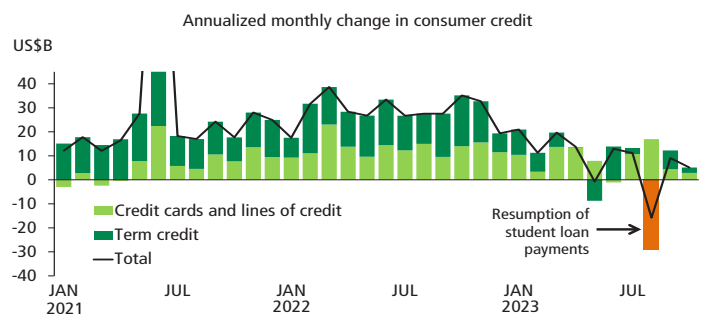
**GRAPH 5**  
Politics Play a Role in US Consumer Sentiment



Sources: University of Michigan and Desjardins Economic Studies

There are other macroeconomic factors that influence households’ willingness or ability to spend, even if they don’t have a direct impact on consumer confidence. Interest rates are an obvious one. The increases that began in early 2022 have put pressure on borrowers. Consumer credit spending also seems to have slowed (graph 6). That said, so far the pullback hasn’t been as pronounced as expected, particularly in durable goods spending, which is surprisingly strong (graph 7 on page 3). Since the start of the year, real spending on durable goods excluding motor vehicles climbed 6.1%, while spending on nondurable goods or services was up 2.0%. Since durable goods spending is typically tied more closely to term credit, it would have been

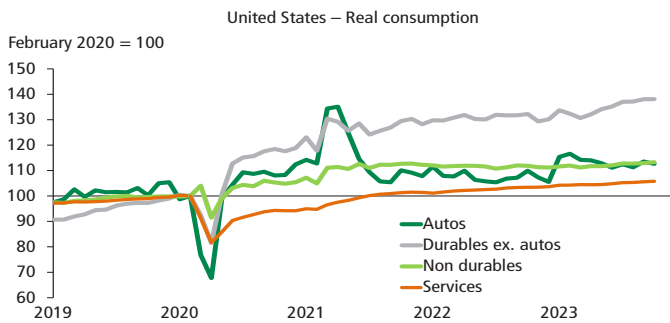
**GRAPH 6**  
Consumer Credit Growth Has Slowed Sharply, Especially for Term Loans



Sources: Federal Reserve Board and Desjardins Economic Studies

reasonable to expect rate hikes and tightening credit conditions to have a greater impact on it.

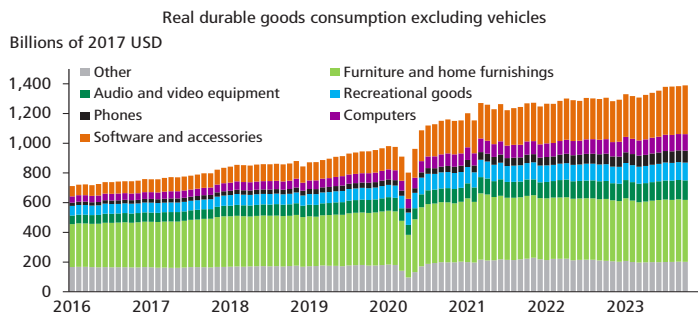
**GRAPH 7**  
**Durable Goods Spending Remains High**



Sources: Bureau of Economic Analysis and Desjardins Economic Studies

So why hasn't it faltered? One explanation is that software accounts for an ever-increasing proportion of durable goods consumption (graph 8). This type of spending, which is believed to be less dependent on credit, has increased by 16.0% in real terms since the start of the year. Excluding software, growth in durable goods consumption would have been 3.6%, which is still strong, but not exceptionally so.

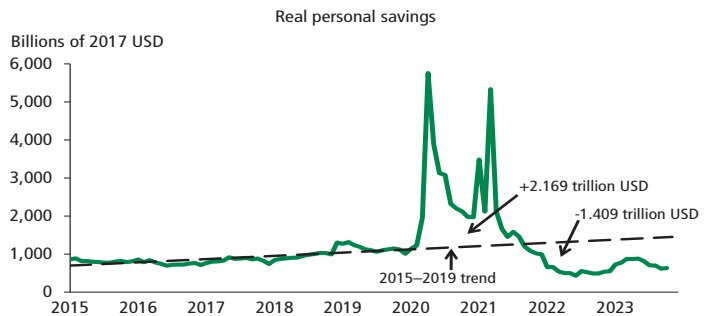
**GRAPH 8**  
**Software Accounts for a Growing Share of Durable Goods Consumption**



Sources: Bureau of Economic Analysis and Desjardins Economic Studies

Savings are another issue. One of the reasons households increased their spending despite declines in real income and rising interest rates is that they had savings to dip into. Consumers were able to build up significant reserves during the pandemic. But starting in the summer of 2021, people shifted from over-saving to under-saving (graph 9). At the same time, inflation began eroding the purchasing power of the money they had stashed away. While their excess savings are now dwindling, they haven't been drained yet. The extra cushion won't last forever though, and sooner or later households will need to rethink their spending habits.

**GRAPH 9**  
**Under-Saving Has Supported Spending**



Sources: Bureau of Economic Analysis and Desjardins Economic Studies

All in all, US household spending remains strong, but the situation is fragile. We expect real consumption to slow considerably in the first half of 2024. It will pick up again once interest rates start coming down, consumer confidence improves and the risk of a recession fades. But for now, the threat is real and the stakes are high, as the impact of US consumption on Canada and the global economy should not be underestimated.