Subject: Five Patterns in Consumer Responses to Inflation November 18, 2022
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The US has experienced over a year and a half of high inflation, which has shaped consumer views toward their finances as well as the economy, contributing to the all-time low recording of sentiment this summer. By October 2022, year-ahead inflation expectations were 5.0% and long-run expectations were 2.9%; both measures are considerably elevated and remain above the Federal Reserve's target of 2% inflation. Against this backdrop, in August, September, and October of this year, the surveys asked consumers about changes in their attitudes and spending, both current and future. This special report will review five patterns in consumer perceptions of the influence of inflation on their economic decisionmaking and discuss potential implications for consumer spending behavior going forward.

These surveys show that consumer behavior continues to be guided by their economic expectations and sentiment. Throughout 2022, consumers have expressed how inflation has eroded their living standards, closely tracking the proliferation of negative news they hear about inflation. We can now see the effects on behavior as well: a majority of consumers have adjusted to their expectation of continued inflation by adjusting their spending. Moreover, an even larger share of consumers are planning spending cuts in the year ahead. Their attitudes toward dissaving and borrowing suggest that this future spending response may be amplified as consumers draw down their savings. Critically for policymakers, advance buying motives—a component of inflationary psychology— do not yet appear to be widespread, but they are favored by a sizable minority of consumers and remain a risk for the future.

The survey questions discussed appear at the end of the report. Some of these measures were collected in 1979 and 1981, providing some historical context, though by then consumers had already adjusted to a decade of high inflation.

1. About 60% of consumers have already scaled back their spending in response to inflation, and even more consumers plan spending cuts in the year ahead

Overall, about 8% of consumers reported that they had stopped buying things with particularly large price increases over the past year, and an additional 51% reported cutting back on their spending. The spending categories cut back by the most consumers in the past year cover both necessities and discretionary purchases, including food/groceries (reported by 19% of households), household items including durables (13%), and eating out/entertainment (12%).

Less than 40% of consumers reported no change in their spending habits, compared with 61% in 1981. The extent of the response varied across the population in expected ways (see table). Lower-income consumers were more likely to adjust their spending than those with higher incomes. Likewise, college educated consumers were more likely to keep their spending unchanged in contrast to those with less education. Consumers between the age of 45 and 64 were considerably more likely to scale back spending than those younger or older. Across all of these demographic groups, a much larger share scaled back their spending in 2022 than in 1981. Interestingly, more Republicans and Independents than Democrats reported spending adjustments this year, though political affiliation was not included in 1981.

Spending Responses to Inflation, 2022

	Last 12 months			Next 12 months		
	No change	**Cut back**	**Stopped**	**No change**	**Cut back**	**Stop**
All Consumers	**39%**	**51%**	**8%**	**36%**	**53%**	**8%**
Age						
18-44	41	51	6	41	51	5
45-64	32	55	10	31	58	9
65 and older	46	44	8	36	49	11
Income						
Lower third	28	57	12	28	58	11
Middle third	39	52	7	35	55	8
Upper third	51	43	5	45	47	5
Education						
High school or less	31	60	8	33	60	7
Some college	34	54	12	28	58	12
College degree	48	46	6	45	48	6
Political Affiliation						
Democrat	50	43	7	47	45	8
Independent	37	54	8	35	55	8
Republican	35	56	8	30	61	9

Note that consumers may cut back spending on goods with large price increases without necessarily reducing total expenditures, consistent with continued growth in retail sales and PCE. However, PCE growth has recently slowed down. The large share of consumers planning to cut back or stop spending in response to high inflation in the year ahead show that this slowdown is likely to endure. About 58% of consumers reported already having adjusted their spending, and 61% reported plans to scale back their spending in the future. The demographic patterns for past spending adjustments continued to hold for planned spending changes as well. Taken together, families with fewer resources have needed to cut back their spending in order to weather this inflationary period. However, almost half of consumers at the top of the income distribution adjusted their spending with an even larger share planning cutbacks ahead, showing the wide reach of inflation and the risk to consumer spending to come.

2. Consumers who scale back their spending have lower sentiment and higher inflation expectations

		Sentiment	Inflation Expectations	
Spending Response	**%**	**Index**	**1 year**	**5-10 year**
Past 12 months				
No change	39	70	3.8%	2.7%
Cut back	51	51	5.2	3.0
Stopped buying	8	51	5.0	3.1
Next 12 months				
No change	36	74	3.5	2.7
Cut back	53	51	5.2	3.0
Stop buying	8	43	5.2	2.8

The differential responses to inflation also reflect variation in consumer sentiment. Those who reported cutting back or stopping spending on things with large price increases this year averaged 51 on the consumer sentiment index, while consumers who did not change their spending patterns held sentiment that was about 20 points higher, which is still very low from a historical perspective.

Consumers who adjusted their spending have higher inflation expectations as well, above 5% in the year ahead. Meanwhile, those who have continued spending as usual expect short-run inflation to reach a median of 3.8%, and they expect lower inflation in the long run as well. Similar patterns hold for planned changes to spending in the year ahead. Consumers who anticipate an economic downturn or higher inflation for the economy are pulling back their spending, showing that consumer behavior continues to be influenced by their confidence in the economy and their expectations for the future.

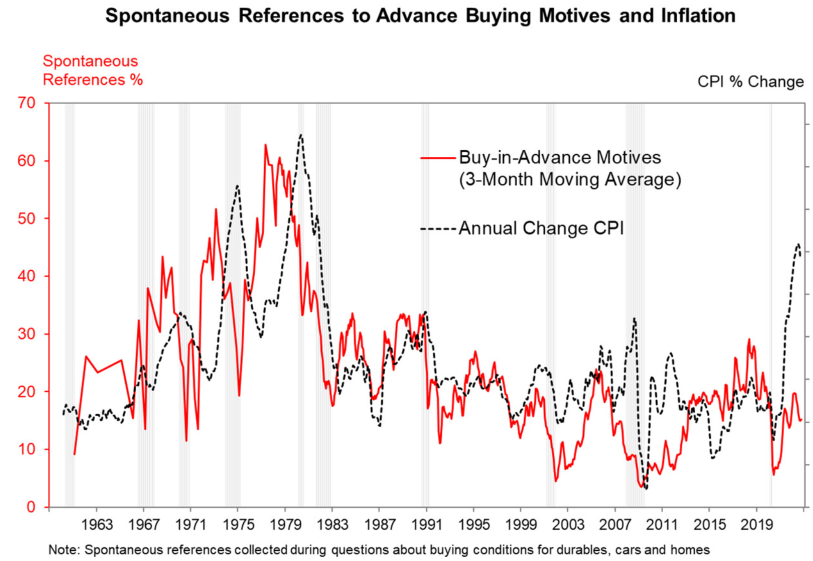
3. Consumers are more reluctant to borrow for major purchases than to dissave, which suggests that consumers may pull back their spending even more as they draw down their savings

During the 1970s, the appeal of savings and the distaste for debt were both influenced by the inflationary environment. The left panel of the table below reports respondents' willingness and readiness to draw on savings or incur new debt for major purchases. Currently, 20% of consumers who report having savings believe dissaving for this purpose is reasonable; this reading is well below the 1979 and 1981 values. An even lower share of consumers are willing to increase borrowing to make such purchases. Overall, those who are willing to dissave or borrow have considerably higher sentiment and lower short-run inflation expectations than those who are unwilling, again showing the importance of expectations on consumer attitudes toward spending.

	To make major purchases given their current situation…		In times of rapid inflation…	
	OK to use savings	**OK to use credit**	**Bad idea to save**	**Better to borrow**
2022	20%	14%	12%	7%
1981	29	14	19	10
1979	29	16	23	12

As seen in the right panel of the table, the proportion of all consumers agreeing that it was a "bad idea to save as much as possible during times of rapid inflation" fell from 23% in 1979 and 19% in 1981 to just 12% this year. Similarly, the share of consumers favoring borrowing during times of rapid inflation also fell from 12% in 1979 and 1981 to just 7% now. For borrowing, consumer attitudes are likely also shaped by interest rates; during this interview period, the Federal Reserve announced two large rate hikes, which led to increases in borrowing costs for consumers.

4. Advance buying motives—a component of inflationary psychology— do not yet appear to be widespread, but are favored by a sizable minority of consumers and remain a risk for the future



Cutting back on spending is one way to cope during an inflationary environment, but another strategy is to make large purchases now in order to avoid price increases in the future, particularly when inflation remains stubbornly high. Such advance buying motives can make expectations of future inflation a self-fulfilling prophecy, as accelerated buying creates further upward pressure on inflation, and as such, these attitudes are an important part of inflationary psychology. Since the 1960s, the surveys have tracked spontaneous mentions of advance buying motivations when consumers are asked about buying conditions for durables, homes, and automobiles. The chart plots the share of consumers spontaneously referencing that it is favorable to buy now to avoid future price increases. In the 1960s and 70s, sharp increases in buy-in-advance motives preceded each bout of high inflation.

More recently, the prevalence of such motives has risen from a low point in 2019 but has not reached the elevated levels preceding the inflationary spikes that began in the 1970s. That said, in the 1970s, it took a longer period of high prices for such an outlook to set in, and once it did, it returned quickly and repeatedly after waning. Therefore, the possibility that such motives may continue to climb remains in play. In today's context, one of the factors that has discouraged buying in advance is the lack of supply of durables, vehicles, and homes to buy. Consumers have begun to perceive that supply constraints for durables are easing, and if availability improves more broadly, consumer attitudes could shift quickly.

Favor advance buying? (direct question)	% 1979	1981	2022	Sentiment Index 2022	Inflation Expectations 2022: 1 year	5-10 year
Yes, buy now	18	23	27	63	5.1%	3.1%
Depends	6	8	8	52	5.2	3.0
No	71	66	62	58	4.7	2.7

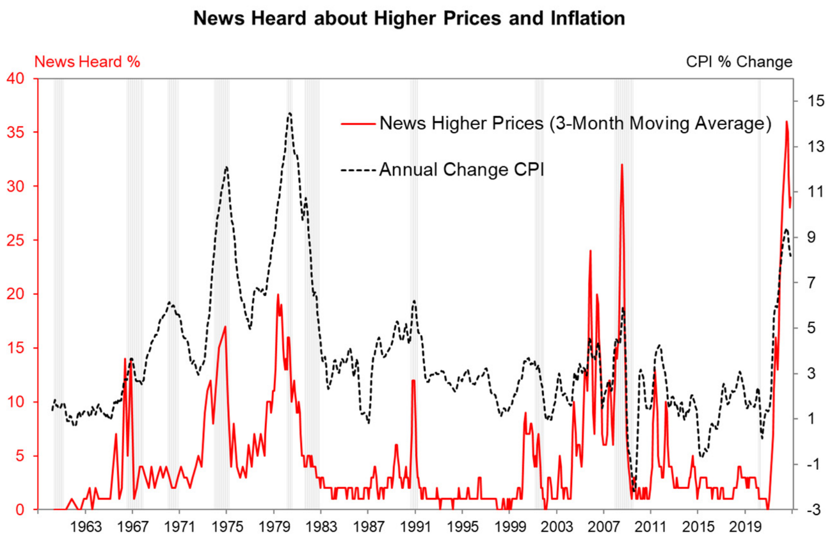
Note: Advance buying motives elicited via a direct question: "Should people buy large things such as houses, cars, appliances, or furniture before they are really needed to avoid higher prices in the future?"

While spontaneous mentions of advance buying motives have been continuously tracked since the 1960s, the surveys have occasionally queried consumers directly about such motives. In August of 1979 and 1981, and August through October of 2022, consumers were asked, "Should people buy large things such as houses, cars, appliances, or furniture before they are really needed to avoid higher prices in the future?" In 1979 and 1981, 25% and 31% of consumers favored advance buying; this share rose to 35% in the 2022 reading. This year, consumers favoring advance buying held higher inflation expectations both in the short run and the long run than those who did not, indicating that consumers' buying attitudes are consistent with their future expectations.

Overall, advance buying as a means to cope with inflation is viewed favorably by a significant minority of consumers, though how it compares to 1979 and 1981 depends whether it is measured via spontaneous mentions versus an explicit question addressing advance buying. As such, it is critical to monitor these attitudes along with inflation expectations going forward. The risks posed by these attitudes are also separate from the possibility of wage-price spirals, which would also push up inflation. At this time, though, while about half of consumers expect their incomes to rise over the next year, only 17% expect their gains to exceed inflation.

5. Consumers report more awareness of news on inflation than in the 1970s, which may influence their attitudes

Inflation appears to be taking on greater salience for consumer views on their finances and the macroeconomy. Their views are informed not only by their own experiences but also by their observations and impressions of the economic environment around them, including news they encounter.



Notably, consumers continue to report hearing unusual levels of negative news about the economy. The index of news heard about business conditions has plummeted precipitously from a reading of over 90 in spring of 2021 to an average of 23 between August and October of this year. This index has only been lower during two episodes in the last 60 years, during the summer of 2020 just after the pandemic began, and during the trough of the Great Recession.

For 9 consecutive months, over a quarter of consumers have specifically mentioned hearing about high prices negatively impacting business conditions in the US economy (see chart). Previously, this had only occurred in three other months, all during the Great Recession. In contrast, this measure peaked at 21% during the inflationary periods of the late 1970s. These patterns may reflect a few possibilities: there may be more sources of information on inflation now than before; news coverage might be more negative in this current environment; consumers who already have negative views of inflation may seek out news coverage that confirms their views; or a combination of the above.

The proliferation of news heard about inflation could amplify any underlying concerns: about 43% of consumers continued to cite high prices eroding their living standards between August and October 2022, more than double the 20% reading from a year ago. This sharp rise sits in contrast to the 1970s, during which it took several years and multiple inflationary episodes for such a large share of consumers to spontaneously mention the negative impact of high prices. At the same time, in spite of the escalation of negative information about inflation and the historic low sentiment reached in June of 2022, long run inflation expectations have remained in the narrow 2.9-3.1% range for 15 of the last 16 months. Taken together, inflation has clearly inflicted much pain on the personal finances of consumers, but as of yet, consumers do not expect the extended and repeated periods of inflation experienced in the 1970s. Still, consumers continue to plan spending adjustments for the year ahead. Time will tell how long the inflationary period persists and how it continues to shape consumer behavior.

Appendix: Question Text

Next, there are several questions about inflation. Many prices have gone up during the past year. If there were a major purchase that you wanted to make, do you think that now is a time when it would be O.K., to use some of your savings or is now a time when you would be especially reluctant to use some of your savings?

If there were something big that you wanted to buy, do you think that now is a time when it would be O.K. for you to buy on credit, or is now a time when you would be especially reluctant to take on new debt?

Should people buy large things such as houses, cars, appliances, or furniture before they are really needed to avoid higher prices in the future?

Generally speaking, in times of inflation do you think increasing your savings as much as possible is a good idea or a bad idea?

Some people say that in times of inflation it's better to borrow as much as possible while others think that people should avoid borrowing. What do you think, is it better to borrow as much as possible in times of inflation or that people should avoid borrowing?

In the past 12 months, have you (and your family living there) stopped buying things which have had particularly large price increases, cut down your buying, or have you continued to buy as usual?

What purchases have you (and your family living there) cut back or delayed the most?

In the next 12 months, will you (and your family living there) stop buying things which have had particularly large price increases, cut down your buying, or continue to buy as usual?

What purchases will you (and your family living there) cut back or delay the most?