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The Great Uncertainty: US consumer confidence and behavior during inflationary times

Our latest Consumer Pulse research shows that there's more pressure than ever on consumer confidence. But despite a general feeling of pessimism, there are signals of hope in consumer behavior.

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Whether it's at gas pumps or in grocery stores, people across the United States have been feeling a pinch in their pocketbooks this summer. Inflation is the highest it's been in decades, and consumers are worried and jittery, adjusting how they spend and save. But not all consumers are the same. Although consumer confidence overall has plummeted to a new low, savings are high, and there's nuance to how people are responding—depending on age group, income level, and what they're buying.

Our latest research draws from a survey conducted in July 2022 and reveals the complexity of US sentiment and behavior during these uncertain times, as the pandemic becomes endemic and inflation is top of mind. Although our findings do not capture consumer responses to the US government's strong jobs report in late July, or to the softening of inflation announced in early August, it is nonetheless clear that, amid the dark economic mood of this summer, there are glimmers of hope. The implications for companies are clear: focus on resiliency and cost but also make intentional bets for longer-term growth. Companies should also seek to understand the nuanced sentiments and behaviors among different groups of consumers and the categories in which their businesses operate.

The eight charts below represent findings from our latest Consumer Pulse Survey, which was in the field from July 6 to July 10, 2022, and included perspectives from more than 4,000 adults in the United States (sampled and weighted to match the general US population). We combined the results with third-party data to help understand not just what consumers tell us but also how they behave. These insights build on the work we have undertaken since March 2020, when we began to regularly conduct consumer surveys and combine our research and analysis with third-party data on US spending to glean insights into how consumer sentiment has shifted since the COVID-19 pandemic began.

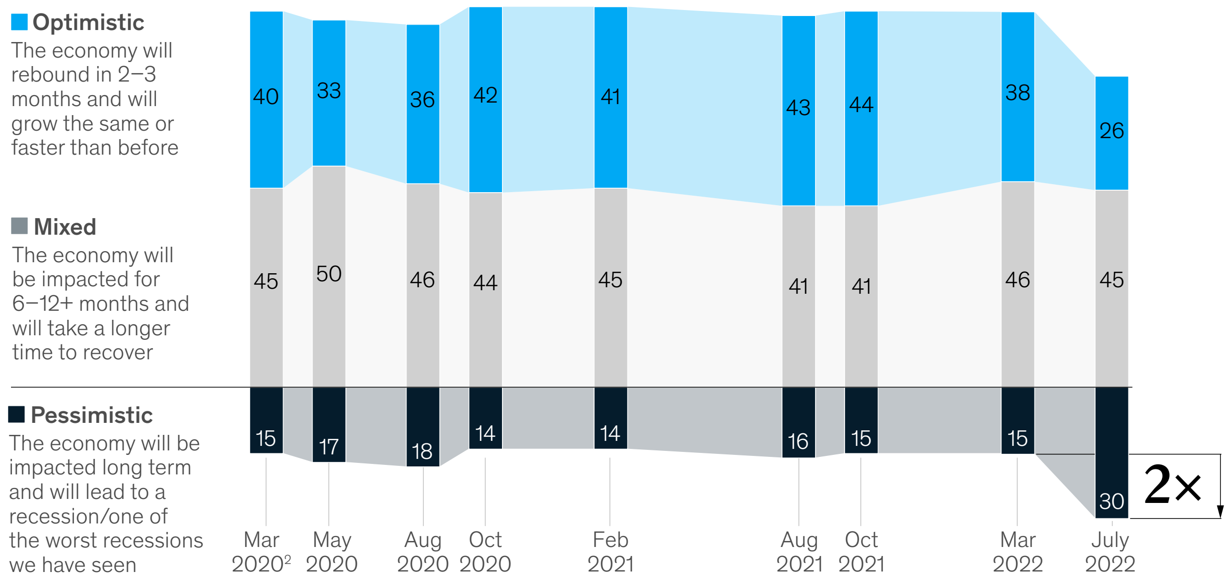
The implications for companies are clear: focus on resiliency and cost but also make intentional bets for longer-term growth.

Consumer confidence has plummeted to a new low. Although the pandemic created turmoil in global markets for more than two years, people had, until this summer, been remarkably consistent about their feelings on the economy. Since March 2020, we've asked consumers about their confidence in the US economy multiple times, and each time well over 80 percent of respondents expressed a view that the economy will either rebound and continue to grow in only two or three months, or that the economy will be impacted for six to 12 months, with recovery taking a bit longer.

But now that inflation has accelerated to its highest rate in four decades, the mood has turned darker. Thirty percent of our respondents say they are feeling pessimistic, and that we may be headed toward one of the worst recessions we've ever seen. That's twice as many feeling glum now than throughout the entire pandemic. We're not the only ones to report sinking sentiment. The University of Michigan, which has been tracking consumer sentiment since 1952, also reported record low sentiment this summer.

Consumers are twice as pessimistic about the economy today than they've been throughout the pandemic.

Consumer confidence in US economy,[1] % of respondents



[1]Question: What is your overall confidence level surrounding economic conditions in the US? Rated from 1, "very optimistic" to 6, "very pessimistic." Optimistic = respondents selecting "very optimistic" and "optimistic" options; pessimistic = respondents selecting "very pessimistic" and "pessimistic" options; mixed = respondents selecting "somewhat optimistic," "somewhat pessimistic" options. Figures may not sum to 100%, because of rounding.
[2]Average of weekly pulse surveys for Mar 2020.
Source: McKinsey US Consumer Pulse Surveys; sampled and weighted to match the US general population 18+ years

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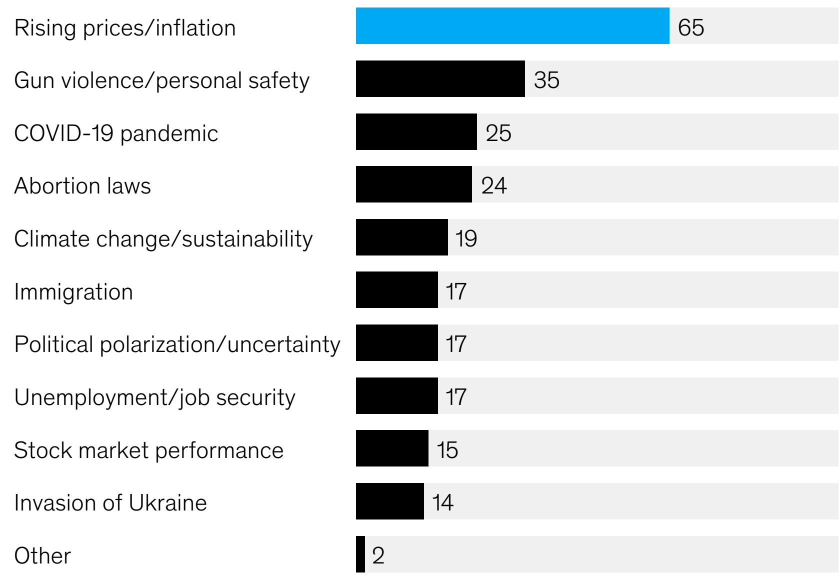
Inflation woes are top of mind. With the consumer price index rising 9.1 percent year on year in June 2022, it's no wonder everyone's fretting about what they see at the cash register. Similar to the sentiment shift we saw in Europe earlier this summer, rising prices are people's biggest worry. When asked about their top three concerns right now, nearly two-thirds of our survey respondents say inflation tops their list, far outweighing other economic, political, and personal concerns, including COVID-19.

Not everyone in the United States is equally concerned about inflation, though. There's a striking difference in outlook between generations. Among baby boomers, 75 percent say rising prices are their top worry, while 71 percent of Gen Xers say the same. But the breadth of concern drops with age: 55 percent of millennials and only 44 percent of Gen Zers say inflation is their biggest source of stress. For Gen Zers, personal and political topics rise to the top of their concerns, alongside inflation.

Two-thirds of US consumers are concerned about inflation.

Top 3 concerns,[1] % of respondents



[1]Question: What are the greatest source(s) of concern for you right now? (choose as many as 3 from provided list of options).
Source: McKinsey US Consumer Pulse Survey, July 6–10, 2022; n = 4,009 sampled and weighted to match the US general population 18+ years

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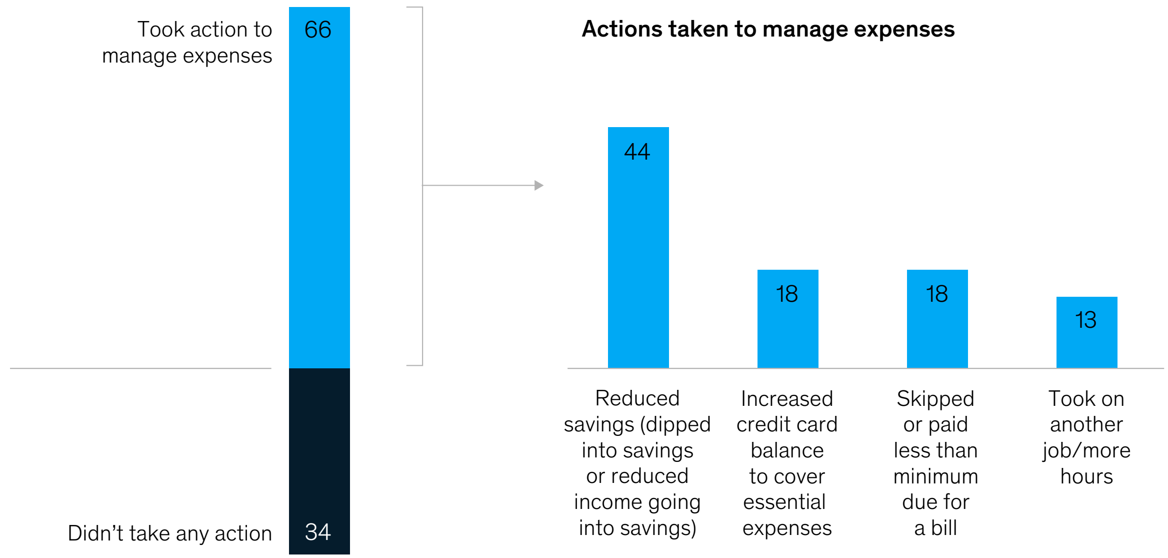
Consumers are changing how they manage their finances. In response to rising inflation, 66 percent of consumers are taking action. Within this group, 44 percent are either dipping into their savings or reducing the amount they're setting aside. Eighteen percent are charging more to their credit cards, and another 18 percent aren't paying their bills in full. Thirteen percent are taking on extra work for more income.

Interestingly, although younger consumers are less concerned about inflation, they are more active in managing their balance sheets, with more than three-quarters of Gen Zers and millennials making adjustments. That drops to two-thirds of Gen Xers and 55 percent of boomers doing the same.

Two-thirds of consumers are actively managing their balance sheets, with most reducing savings to cover expenses.

Share of respondents reporting having taken defensive financial actions,[1] %



[1]Question: Which, if any, of the following have you done in the past 4–6 weeks? % respondents selecting any of the given financial options shown.
Source: McKinsey US Consumer Pulse Survey, July 6–10, 2022; n = 4,009 sampled and weighted to match the US general population 18+ years

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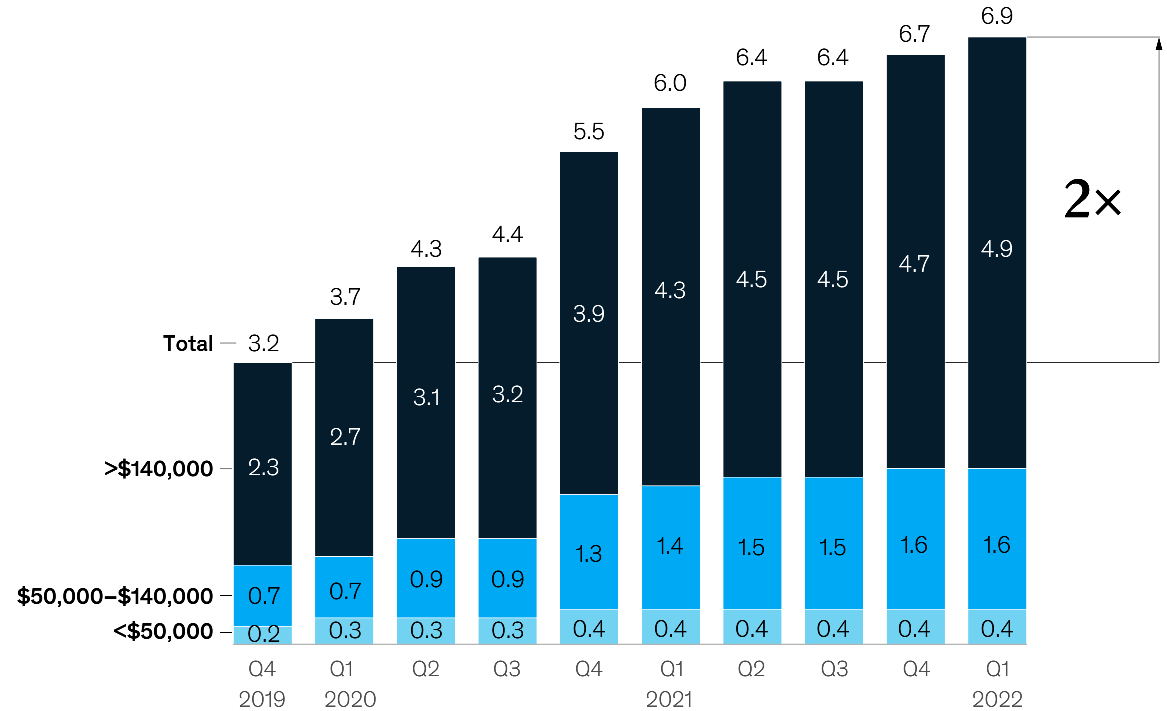
Most US consumers have good nest eggs. Even with the volatility of the markets, most US consumers have a good amount of savings to dip into. Over the course of the pandemic, as stimulus checks arrived in the mail and people pulled back on spending on expensive experiences like travel, bank accounts grew larger, with wealthier households saving twice as much as they did prepandemic. For middle-income families, the growth has been more modest. Low-income households are just now starting to see their bank accounts shrink, with cash holdings reduced by 0.5 percent between the fourth quarter of 2021 and first quarter of 2022.

Despite inflationary pressures, US consumers have twice as much in cash savings than they did before the COVID-19 pandemic.

Short-term holdings of cash equivalents by annual income group,[1] $ trillion



Note: Figures may not sum to 100%, because of rounding.
[1]Includes money market fund shares and checkable deposits and currency; income groups correspond roughly to 80th–99th percentile, 40th–80th percentile, and 0–40th percentile in 2020.
Source: US Bureau of Labor Statistics; Federal Reserve Board; McKinsey analysis

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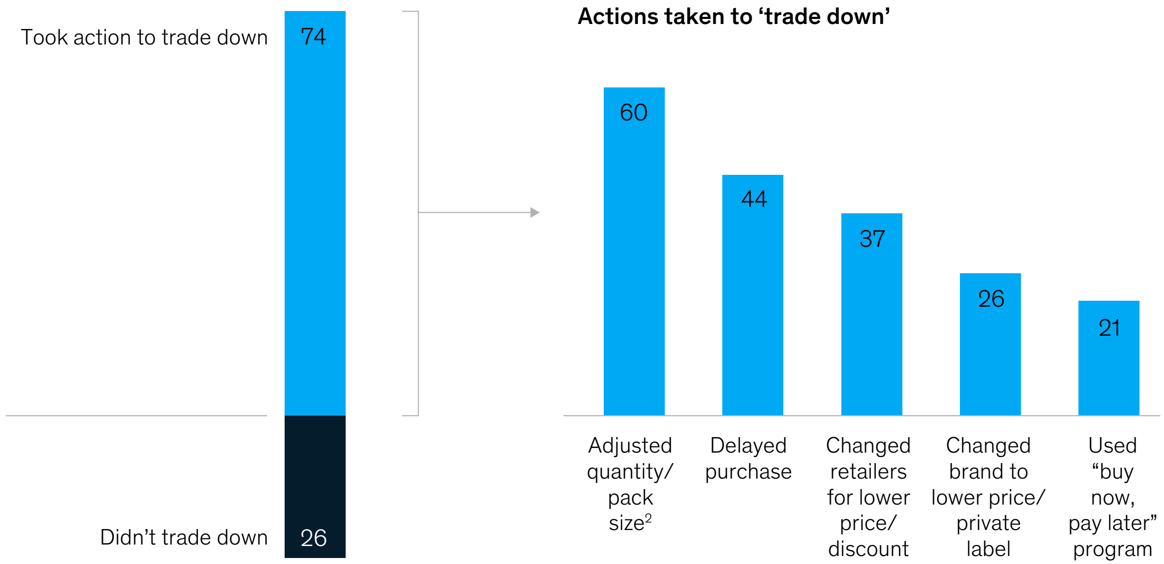
Consumers are changing their shopping habits—but not all in the same way. With prices rising dramatically so quickly, people are changing the way they spend. Seventy-four percent of our survey respondents say they're trading down, with half of them saying their money doesn't go as far as it did before, 43 percent making adjustments to save more, and 29 percent saying that they can't pay their bills.

Most of those trading down either adjusted the quantity or pack size of their purchases (60 percent), which is the primary method of trading down for necessities, or decided to postpone a purchase (44 percent), typically for nonessential items. Across categories—but particularly in footwear, groceries, home improvement, and apparel—more lower-income consumers say they delayed purchases than those with higher incomes. People are also trading down by going to lower-priced stores, switching to brands that cost less, or adopting a buy now, pay later approach.

Three-quarters of consumers are changing their shopping behavior.

Share of respondents reporting changing shopping behavior to 'trade down,'[1] %



[1]Question: Within the past 3 months have you done any of the following when purchasing a product (asked across multiple categories)? Trade-down behavior includes one or more of the following answer choices: shopped from a lower-priced retailer, shopped from lower-priced brand, bought private label, bought a brand for which you had a coupon, used buy now, pay later, delayed a purchase, bought a larger-size pack for lower price, bought smaller size or quantity, made more shopping trips in search of discount.
[2]Consolidates respondents who answered "Bought a larger-size pack/bulk quantity with lower price per serving/unit (than you normally would)" or "Bought a smaller size or quantity than you normally would because of current prices." These categories had minimal overlap for a given respondent.
Source: McKinsey US Consumer Pulse Survey, July 6–10, 2022; n = 4,009 sampled and weighted to match the US general population 18+ years

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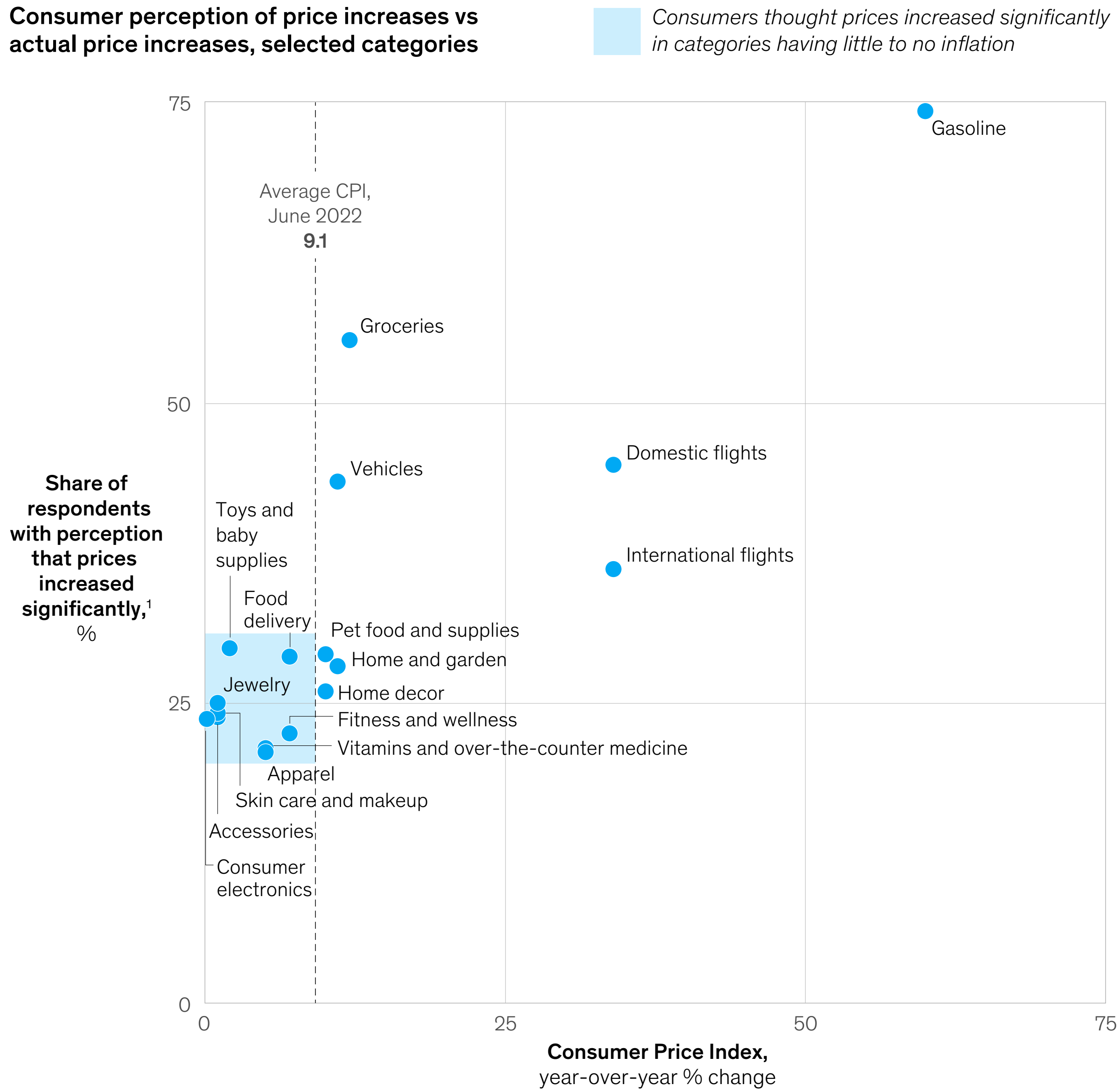
Perceptions of inflation don't always match reality. With the dollar-per-gallon amount dominating headlines and airwaves, it's no great surprise that consumers think gas prices have skyrocketed—because they have. The rising cost of groceries and air travel are also part of this summer's inflation chatter.

But when it comes to other categories, there's a misalignment of consumer perception to reality. Take, for example, consumer electronics, skin care and makeup, and toys and baby supplies. Around 30 percent of our respondents think that there's been a significant markup in prices in at least one of these categories, but the inflation for such products has been less than 2 percent. In other categories, the inverse is true. For example, only a quarter of respondents think prices have gone up a lot for home and garden supplies, which is a category whose prices have gone up more than 11 percent.

With the exception of gas, groceries, and travel, consumers' sense of inflation doesn't match actual price increases.

Consumer perception of price increases vs actual price increases, selected categories



[1]Question: Within the last 4–6 weeks, how have you observed prices changing across the following categories? Share of respondents selecting "prices increased significantly."

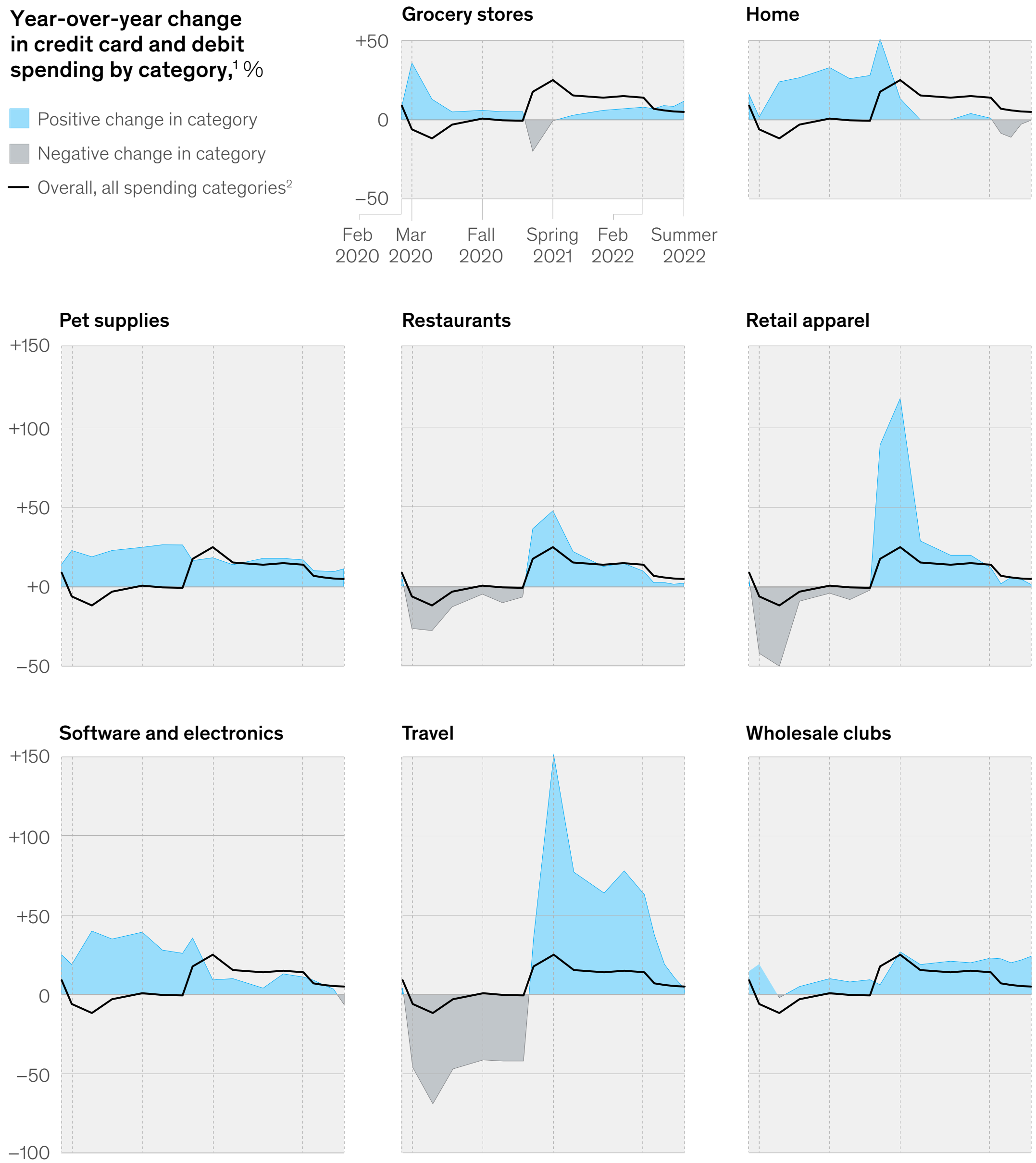
Source: US Bureau of Labor Statistics; McKinsey US Consumer Pulse Survey, July 6–10, 2022; n = 4,009 sampled and weighted to match the US general population 18+ years; McKinsey analysis

Spend growth is slowing down—but still growing—in some categories and channels more than others. As consumers trade down and some begin to dip into their savings, their spending is starting to decelerate in some areas. Yet there's still growth, with overall credit and debit spending up 5 percent year over year (real growth, adjusted for inflation). In particular, real credit and debit spending is growing (up 9 percent in the past year) with high-income consumer. At 2 percent growth, middle-income households are spending slightly more than last year, while lower income households are spending slightly less than last year by 2 percent.

While spending has slowed for some categories that saw increased activity during the pandemic, such as home and electronics, other categories are still experiencing double-digit growth. Real credit and debit sales of cosmetics have gone up 16 percent, and pet supplies sales have grown 11 percent. Categories that showed recovery in 2021, such as retail apparel and restaurants, have been holding fairly steady this year.

As for retail channels, some value-focused retailers that offer essentials are also seeing strong growth. Wholesale-club and discount-store credit and debit sales growth have gone up 24 percent and 11 percent, respectively. And at 12 percent growth, grocery stores have seen their strongest month since before the pandemic.

Although real spending is decelerating, some categories and channels are still experiencing growth.



[1]To better demonstrate the impact of inflation on growth, data for this period were adjusted for inflation and compared with the equivalent prior period not adjusted for inflation. Credit card spending data include Amazon sales and exclude categories in which other forms of payment (cash, check, bank transfers, payment plans, etc) are made. Major spend groups often excluded are healthcare, car/truck sales and services, business goods and services, financial services, utilities, etc.
[2]Includes spending in categories and channels not shown.
Source: Credit card and debit card spend data, Affinity Solutions; Amazon spend data, Stackline

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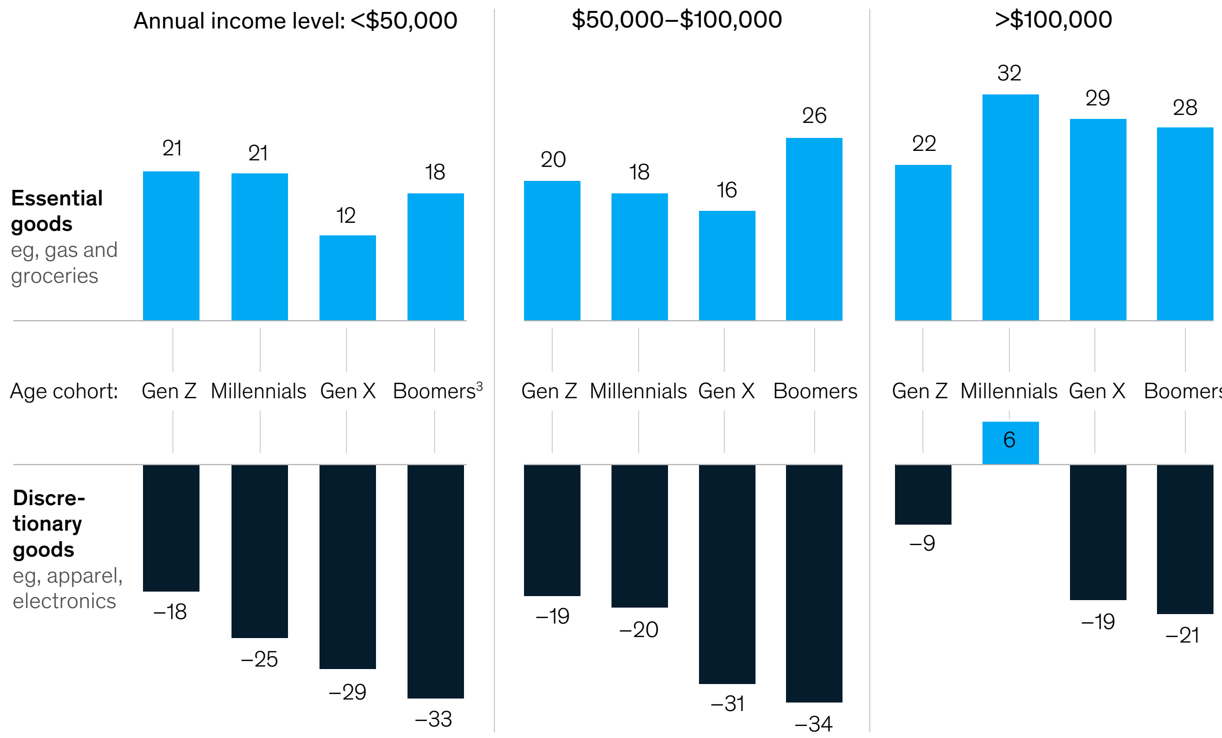
Consumers expect to increase their spending on necessities and tighten their belts when it comes to nonessentials. Across the board, consumers of all ages and income levels think they will spend more on essential goods like groceries and gas. When asked about their spending intentions for the next two weeks, more consumers expected to spend more for essentials (22 percent positive net intent) and less on discretionary goods (21 percent negative net intent). However, consumers' intention to spend is still much higher now than it was during the first few months of the pandemic (31 percent positive net intent).

However, optimism varies across income levels and generations. With the notable exception of Gen Z, higher-income consumers of all ages say that their spending will continue to grow whether or not they're buying necessities or discretionary goods. Millennials are especially optimistic—with high-income millennials indicating they plan to spend across almost every category, essential and discretionary. On the other hand, middle- and lower-income populations of all age ranges expect to forgo items and experiences that are not needed.

Consumers' intent to spend varies across income levels and generations.

Future spend net intent[1] by purchase type, age cohort, and annual income,[2] % of respondents



[1]Net intent is calculated by subtracting the share of respondents stating they expect to decrease spending from the share of respondents stating they expect to increase spending.
[2]Question: Over the next 2 weeks, do you expect that you will spend more, about the same, or less money on these categories than usual?
[3]Cohort also includes Silent generation.
Source: McKinsey US Consumer Pulse Survey, July 6–10, 2022; n = 4,009 sampled and weighted to match the US general population 18+ years

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In light of the complexities surfaced in our research, as well as current macroeconomic uncertainty, resilient growth is more important than ever. Consumer-facing companies should face today's challenges by focusing on the following:

— *Know your consumer.* Companies should continuously track swings in sentiment and spending, and leverage real-time insights and analytics to craft the right assortment, offering, and personalized customer touchpoints and communications.

— *Launch big growth bets.* With a refreshed view of consumers, retailers should pivot to promising combinations of consumers, subcategories, and strategies and place big bets with potential to double growth. Companies that make bold moves during uncertain times generate greater returns in future business cycles.

— *Self-fund growth through efficiency.* Retailers should rethink their value strategies and remove inefficiencies across both customer-facing and internal spend buckets. Greater growth can come from surgically reinvesting in areas like marketing and commercial spend optimization.

— *Create an agile operating model.* With consumer sentiment and behavior shifting from month to month, it's imperative to communicate frequently with the company leadership team, enable rapid decision making through test-and-learn sprint cycles, and be willing to quickly adapt operations to an ever-changing environment.

Companies that make bold moves during uncertain times generate greater returns in future business cycles.

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