

November 7, 2021

To: Members of the MDP Class of 2021-2022

Fr: Andy Davies

Re: Very Interesting Overview of Consumer Thinking Right Now

What do you think
after you read this
article?

Looking forward to seeing all of you real soon on November 17!

Andy

"America's Economy is Strong, Even if it Doesn't Feel That Way"

By NEIL IRWIN

Americans are, by many measures, in a better financial position than they have been in many years. They also believe the economy is in terrible shape.

This is the great contradiction that underlies President Biden's poor approval ratings, recent Republican victories in state elections and the touch-and-go negotiations over the Biden legislative agenda. It presents a fundamental challenge for economic policy, which has succeeded at lifting the wealth, incomes and job prospects of millions of people — but has not made Americans, in their own self-perception, any better off.

Workers have seized the upper hand in the labor market, attaining the largest raises in decades and quitting their jobs at record rates. The unemployment rate is 4.6 percent and has been falling rapidly. Cumulatively, Americans are sitting on piles of cash; they have \$2.3 trillion more in savings in the last 19 months than would have been expected in the pre-pandemic path. The median household's checking account balance was 50 percent higher in July of this year than in 2019, according to the JPMorgan Chase Institute.

Yet workers' assessment of the economy is scathing.

In a Gallup poll in October, 68 percent of respondents said they thought economic conditions were getting worse. The share who thought things were getting better was lower than in April 2009, when the global financial crisis was still underway. And it is not merely a partisan response to the Biden presidency. In the University of Michigan's consumer sentiment survey, Republicans rate current economic conditions worse than Democrats do — but both groups give ratings about as low as they did in the early 2010s, when unemployment was much higher and Americans' finances were a wreck.

The reasons seem to be tied to the psychology of inflation and the ways people assess their economic well-being — as well as the uneven effects that rising prices and shortages have on different families. It may well be shaped by the psychological scars of the pandemic, one manifestation of this being an era of exhaustion.

Regardless of the exact causes, after decades in which the availability of jobs (or lack thereof) drove economic sentiment, inflation now appears to have become the more powerful force.

"The major issue is rising inflation and falling confidence in economic policies," said Richard Curtin, who has overseen the University of Michigan survey for decades. "Consumers see rising prices, and they see no policies that would correct it."

There is no doubt that prices are rising rapidly — the Consumer Price Index is up 5.4 percent over the past year, and there are shortages and other inconveniences that do not show up in inflation data but reflect the same underlying phenomenon.

But that follows years of relatively low inflation; the index has averaged only 2.8 percent a year over the last three years. And higher prices have arrived at the same time — probably not coincidentally — as a surge of federal spending has inflated Americans' bank accounts. This includes stimulus payments of \$2,000 per person earlier in the year and a child tax credit worth up to \$300 a month per child since the summer.

Americans seem to be relatively optimistic when asked more narrowly about the outlook for their incomes, or for the job market.

"They're telling us, looking ahead they expect business conditions to get better, they expect more jobs, and they expect incomes to rise," said Lynn Franco, senior director of economic indicators at the Conference Board, a business research group. Its consumer confidence index fell a bit in late summer but rebounded in October.

To economists, higher wages and higher prices for consumer goods are two sides of the same coin, and a spurt of inflation creates both winners and losers. In the last few months at least, the public hasn't appeared to view it that way — and inflation and related shortages seem to loom particularly large in their overall perception of the economy.

Any group of individuals might end up better or worse off in a time of elevated inflation, depending on whether they're debtors or creditors, and whether their wages rise faster or slower than the particular goods they buy.

A restaurant worker who has received an 11 percent pay increase over the last year — the average for the leisure and hospitality sector, according to government data — probably has higher spending power despite high inflation.

But many people are losers in times of rising prices — and even those who may end up being net winners can end up feeling the pain of higher prices more intensely than the benefit of higher wages or more manageable debts.

About 13 percent of workers have a paycheck that is unchanged over the last year, ac-

cording to data from the Atlanta Fed. Many retirees receive pensions that are not adjusted for inflation.

And it is middle- and high-income earners whose pay gains were least likely to have kept up with inflation. Over the 12 months ended in September, those in the top quarter of earners experienced 2.7 percent gains in hourly earnings, compared with 4.8 percent for the lowest quarter of earners. For lower earners, that follows years leading up to the pandemic in which pay gains exceeded inflation rates.

The details of what a person buys can have an outsized effect on how acutely he or she feels the pain of inflation. For someone who has had no need to buy an automobile this year, steep inflation in cars and trucks has been a non-issue.

Now consider someone whose car broke down and who needs another one to get to work. A rise in prices of 40 percent for used cars and trucks since the start of the pandemic amounts to a costly burden. The same applies to many other physical goods that have been in short supply, like home appliances.

Rising costs for staple goods tend to influence people's percep-

Psychological effects of inflation appear to have the upper hand.

tions of inflation. Gasoline prices, for example, are visible on big signs on every street corner, and have risen 74 percent from their pandemic lows of May 2020.

But they are below their levels for most of 2011 to 2014, and average earnings have risen sharply since that period. To look at it one way, in October it took about six minutes of work at the average private sector wage to earn enough to buy one gallon of regular unleaded gasoline. In October 2013, it took almost nine minutes of work.

To get a better idea of why elevated inflation can contribute to such negative assessments of the economy, it helps to go beyond the details of wage and price trends in 2021 and turn to a piece of economic research from the 1990s, conducted by Robert J. Shiller, the Yale economist.

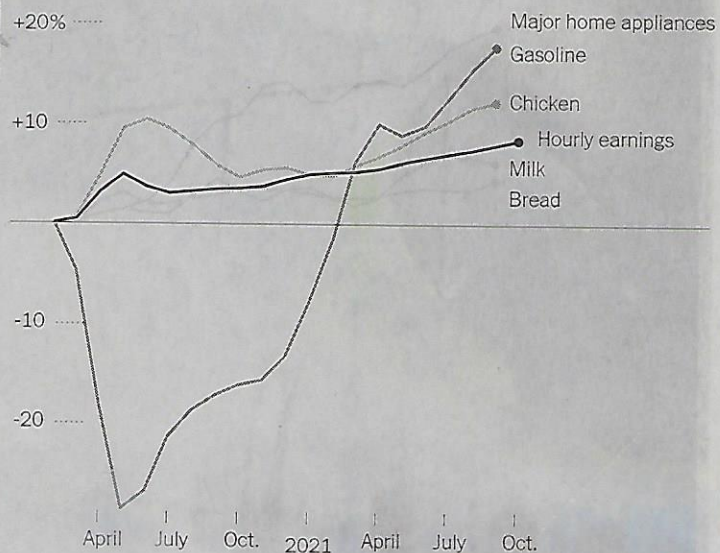
He led surveys to try to ascertain why inflation, even at moderate levels, frustrated ordinary citizens so much more than economic theory implied it should. He found that people did not believe they would receive adequate raises to keep up with rising prices. He also found that people believed it would hinder overall economic growth; that it would be harmful to national morale; and that it could fuel political chaos or damage national prestige.

"In answering questions about what is really important and what our national leaders really ought to pay attention to, people may tend to rely on some deep intuition derived from life's experiences," Professor Shiller wrote in 1997. The idea of inflation, he continued, evokes "arbitrary injustice, arbitrary redistributions and social bitterness," and "memories of social situations in which morale and a sense of cooperation were lost."

That may be what makes the inflation surge such a tricky policy problem: It can be about something more profound than dollars in people's pockets and the price of a gallon of gas.

Prices Are on the Rise

Americans' perceptions of the economy can depend on some prices that are rising faster than hourly wages. Below, changes in prices since February 2020.



Source: Bureau of Labor Statistics (two-month moving averages are shown)

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