# Inflection ahead

## Anticipating the consumer downcycle

accenture

Macro Foresight

# Contents

# Executive Summary

Note: This point of view was written with data as of March 15, 2023.

## What's happened?

**In 2022, the consumer spending impetus created by economies re-opening hit up against a deepening cost-of-living crisis.** Consumers pushed through inflation headwinds by drawing on savings buffers accumulated during the pandemic, trading down to budget products, and cutting back spending on big-ticket durables most sensitive to rising interest rates. This allowed spending to remain mostly resilient, especially in the US.

## What's next?

**This year, the consumer cycle will likely reach an inflection point.** The tailwinds provided by savings buffers and "revenge" spending on services post-re-opening will be outweighed by converging headwinds—the persistence of inflation and high interest rates, increasing household wealth erosion from falling asset prices, and growing income and employment uncertainty. A significant slowing of consumer spending is likely, with high risk of whiplash and cliff effects.

## Which consumers will be most impacted?

Analysis based on US data suggests **lower-income consumers (0-40th income percentile) will face the greatest pressure to cut spending**. This group has relatively higher exposure to recent inflation patterns, higher debt burdens, lower accumulated excess savings and a high share of total wealth exposed to falling house prices. **Across age groups, those under the age of 40 are expected to be most vulnerable to a consumption squeeze**, for similar reasons as low-income groups, but also because of their high reliance on consumer credit for spending, which leaves them more exposed to rising borrowing costs.

## Which spending categories are most at risk?

Categories where US consumers have traditionally reined in spending during previous recessions—**furniture, cars, tobacco and gasoline—are likely to be affected this time as well**. Some differences from prior recessions can also be expected, however, due to specific spending patterns of vulnerable low-income and young consumer groups, and growing consumer price sensitivity for certain items in a prolonged high-inflation environment. Discretionary categories such as **apparel and dining out are expected to see bigger retrenchment in consumer demand** this time around. Among essentials, spending on **utilities, housing and home appliances is likely to be harder hit**.

## What does this mean for businesses?

Three implications stand out. First, the likelihood that the consumer spending inflection will be sudden and sharp means **companies that opt for a "wait-and-see" approach risk being caught off guard and unable to course-correct in time**.

Second, **playbooks from prior recessions, even if proactively deployed, are unlikely to prepare companies for the unprecedented dynamics of this consumer downcycle**—post-pandemic normalization colliding with a multiplicity of economic headwinds.

Third, because not all consumers will feel and react to the economic squeeze equally, **companies will have to contend with growing differentiation in demand and price sensitivity across their customer segments**. In this context, finding the right balance between proactivity, reactive agility and adaptability to nuanced consumer circumstances will be key.

## How should they respond?

In anticipation of these consumer pressures and spending shifts, companies should consider some of the following strategies to **get ahead of the market, build resilience and capture recession-time opportunities:**

- Help vulnerable consumers first, pursue sales second
- Create dynamic data-driven pricing strategies
- Leverage targeted marketing and loyalty programs
- Explore ecommerce channels to capture more price-conscious consumers
- Stress-test the P&L against different spending slowdown scenarios

# Where are we in the consumer cycle?

# The COVID-19 pandemic caused huge swings and distortions in consumer spending.

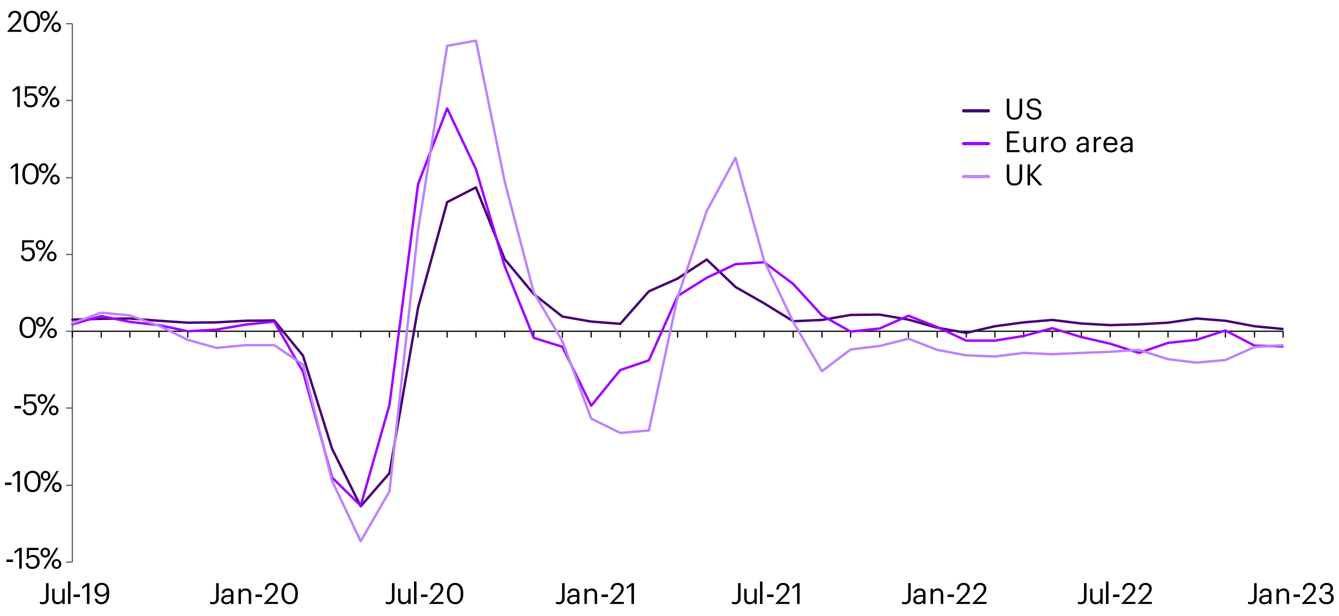
Initially, widespread uncertainty about the impact on employment and the economy triggered a sharp pullback in spending. Then, as governments responded forcefully with a range of monetary and fiscal stimulus measures, consumer confidence and desire to spend rebounded (Figure 1).

With large swaths of the global population still under COVID restrictions, however, the ability to act on that desire remained severely constrained, particularly for contact-intensive services. **Demand pivoted sharply from services to goods. And consumer preferences shifted markedly in response to a perceived "new normal" of remote working and digital rather than face-to-face interactions**.

Categories like home improvement and digital fitness saw significant renewed interest as a result, trends that Accenture tracked in its 2020 report The Big Value Shift. But, as global supply chain disruptions created shortages of such goods, many consumers were again unable to fully spend and began to accumulate "excess" savings. At their peak, these savings reached an estimated USD 2.4 trillion in the US, equivalent to 13% of annual household disposable income (Figure 2 on page 10).[i]

**Figure 1: Inflation-adjusted consumer spending**

Real (inflation-adjusted) consumer spending, 3-month avg. % change




Notes: Consumer spending series for US is personal consumption expenditures (PCE); for Euro Area and UK, series data is retail sales.
Sources: BEA, BLS, Eurostat, ONCS, Accenture Strategy analysis

Since most major world economies began fully re-opening in early 2022, many of these shifts in consumer behavior have started to unwind. Overall spending has gradually rotated back to services and demand for many goods that were popular during the pandemic has receded. However, this normalization of spending patterns coincided with new economic challenges: a global surge in inflation (including an acute energy price shock) and a rapid rise in interest rates. This has squeezed real incomes and made the consumer spending rebound due to re-opening less forceful than it might otherwise have been.

Thus far, consumers have been navigating these economic headwinds by drawing on their excess savings, trading down to budget products, and cutting back spending on the big-ticket durables that are most sensitive to rising interest rates, as well as other discretionary goods. The extent to which consumers have leaned on these coping levers varies by region. In the US, for example, they've drawn down more savings than in the UK and Euro area. In the UK, they've opted for cutbacks on big-ticket durable items. And, while consumers globally have shifted toward private labels (+3.5%), this has been most pronounced in emerging markets across Latin America (+27.4%) and Eastern Europe (+18.1%).[ii]

As the post-pandemic rebound in spending on services runs its course, the consumer cycle is likely to enter a more pronounced downturn phase in mid-to-late 2023. Exactly how this slowdown plays out is highly uncertain. Spending patterns observed in recent recessions may not be repeated this time, since advanced economies haven't experienced this combination of slowing growth, high inflation and high interest rates since the 1980s. For companies, this means heightened uncertainty in two key areas. First, the magnitude of additional price increases they can pass onto consumers before triggering demand destruction and/or loss of market share. Second, which customer segments will rein in spending the most given their relative exposure to economic headwinds.

# What factors will shape the consumer outlook going forward?

# The resilient consumer spending over the past year is unlikely to last much longer.

An inflection point is approaching in the coming quarters, when the tailwinds behind consumer spending—excess savings buffers, fiscal support to households and the rebound in services spending post-re-opening—will begin to be outweighed by prevailing headwinds—inflation, falling asset prices, growing income uncertainty and rising borrowing costs. When this balance tips, there is a high risk of consumer whiplash, which could result in large cliff drops in consumer spending rather than gradual and modest cutbacks.

While we expect this inflection dynamic to occur globally, there will undoubtedly be differences in its timing and velocity across markets. There are also likely to be outliers such as China, which is just beginning its economic re-opening and where consumers have significant pent-up demand and a large pile of excess savings to unleash.

The following dynamics of each key consumer headwind and tailwind will influence when this inflection point might hit in different markets and how large subsequent cliff effects in spending might be.

# Tailwinds

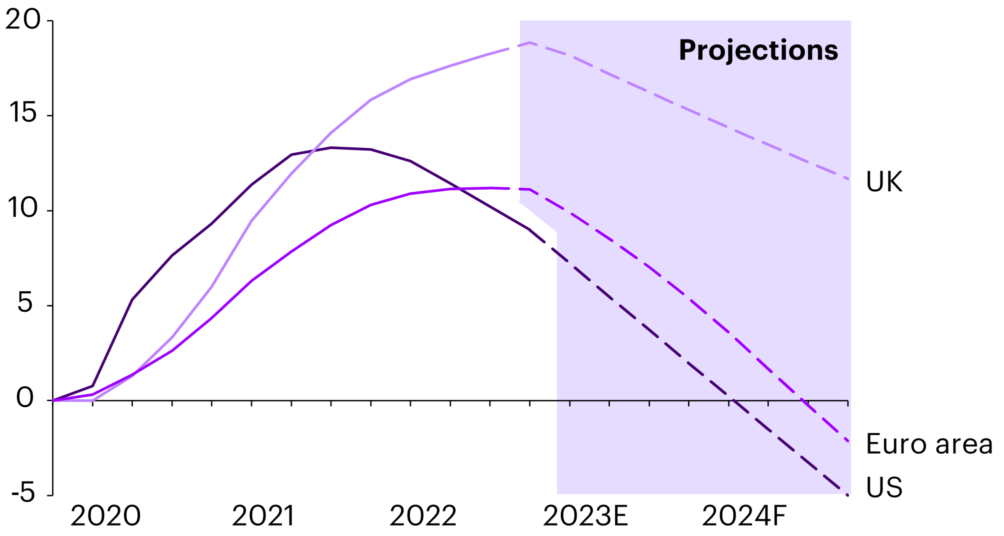
## 01

## The rate at which households' excess savings decline

US households have already been dipping into their excess savings since early 2022, depleting around a third of their peak buffer. Households in Europe, meanwhile, have been much more conservative with their savings buffers, beginning to tap into them only in late 2022 as the winter energy crisis on the continent intensified. A model-based extrapolation of these recent drawdown trends (Figure 2)[1] suggests US consumers will find their excess savings depleted sometime towards the end of this year. Meanwhile, accumulated excess savings for UK and Euro area households are expected to last well into 2024. However, falling asset prices, inflation, employment uncertainty, and declining affordability of consumer credit may cause consumers to curtail spending sooner than expected, to help preserve savings buffers. Indeed, US households already showed increasing caution over the winter, raising their savings rate by 1.3 percentage points between October 2022 and January 2023.

**Figure 2: Households' stock of excess savings**

Percentage of disposable income




Notes: Actual data is as of Q4 2022 for US, and Q3 2022 for Euro area and UK. Stock of excess savings is the accumulated savings (over and above the pre-pandemic trend saving rates) from 2020 until today.

[1] Projections assume that, starting in Q1 2023, consumers reduce saving rates to below both pre-pandemic trend rates and all-time historically-low rates.

Sources: Bureau of Economic Analysis, ONS, Eurostat, Accenture Strategy analysis

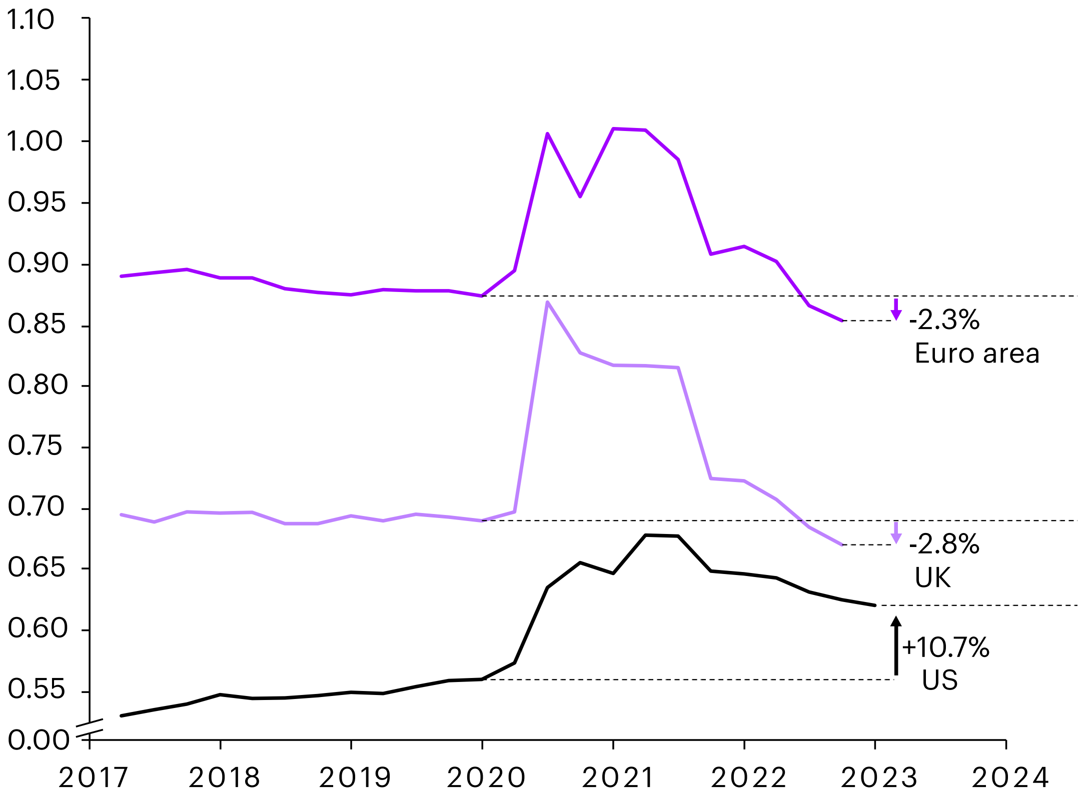
# 02

## How long the services spending rebound lasts

The pre-pandemic ratio of spending on goods relative to services has been restored in the UK and Euro area (Figure 3). Consumers there appear to have used most, if not all, of their pent-up demand on "revenge spending" on discretionary services. The US still has some way to go in this rebalancing, however, suggesting strong spending on services could still be seen in 2023, supporting overall consumption.

**Figure 3: Relative growth of real consumer spending on goods vs. services**

Goods-to-services spending ratio




Sources: BEA, Eurostat, ONS, Accenture Strategy analysis

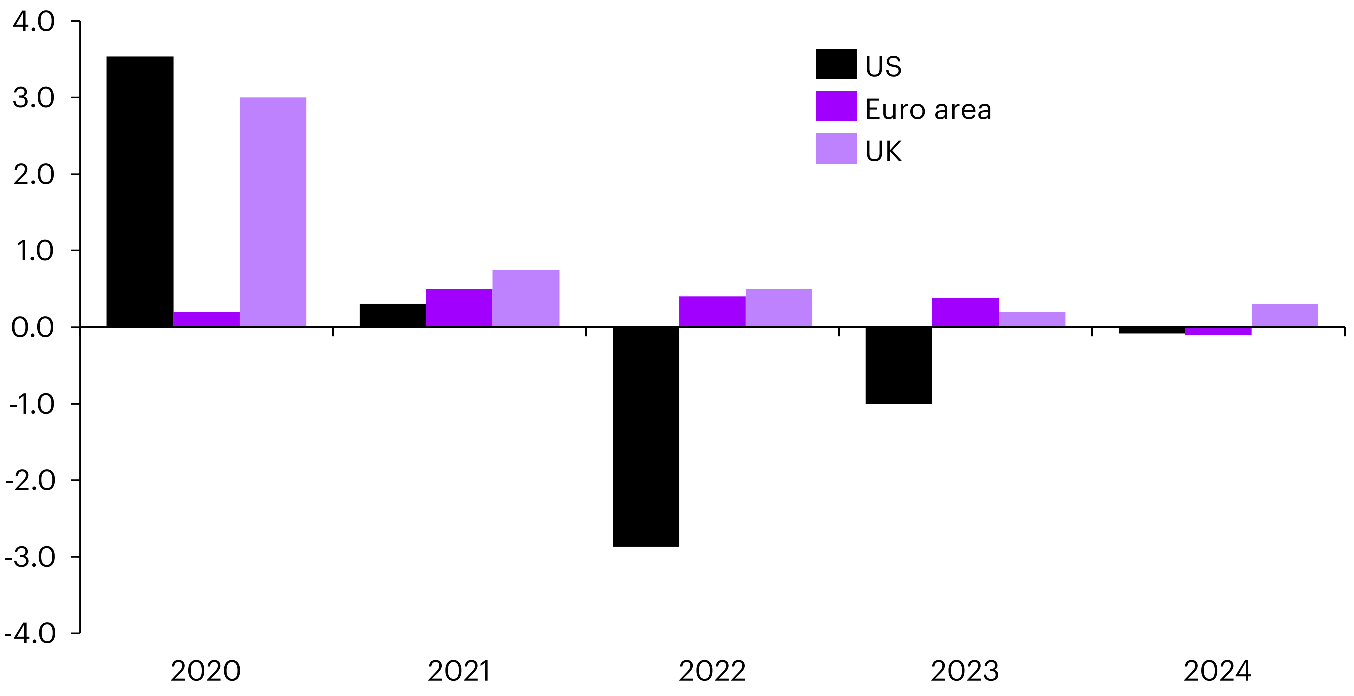
## 03

## When fiscal support to households is withdrawn

The impulse from fiscal stimulus on consumer spending is at different stages across regions. In the US, most of this fiscal support was frontloaded during the pandemic and has all but dissipated by now following the expiration of the expanded child tax credit in early 2022. While the loss of this support was a net drag on household income in 2022, this drag is likely to diminish in 2023 and turn neutral going forward (Figure 4), as the passage of any new fiscal measures targeted at households seems unlikely. Meanwhile, in the Euro area and UK, fiscal support to households was ramped up again in late 2022 to help mitigate the cost-of-living crisis, particularly rising energy prices. These measures should continue to provide a tailwind to consumer spending in 2023, but are scheduled to fade starting in 2024 unless extended.

**Figure 4: Fiscal support impulse to GDP growth**

Percentage points




Note: Figures are annual average impact, but there is significant intra-quarter variation in size of impulse depending on when measures were launched.

Sources: Brookings Hutchins Center, European Central Bank (ECB), Bank of England.

# Headwinds

## 04
## How long inflation persists

The recent easing of inflation in the US and Europe has been mainly due to the retreat in energy prices (Figure 5). However, renewed energy price pressures are likely in mid-to-late 2023 as the Chinese economy re-opens, OPEC+ asserts its pricing power, and Russian oil production falls in response to bans and price caps. In addition, tight labor markets in the UK and US are likely to keep wage pressures and inflation elevated in labor-intensive sectors such as services.

## 05
## How wage growth develops

The story of labor markets globally in 2022 was one of strong demand continuing to outstrip supply, even as labor force participation rates improved. As a result, nominal wages across grew substantially in the US (6.2% on average in 2022), and the UK (5.8%), although less so in the Euro area (4.1%).[2] With overall labor demand softening and layoffs on the rise, some of these wage pressures should reduce in 2023, though elevated wage growth is still expected in certain sectors owing to ongoing labor shortages and skills mismatches. Uncertainty around the labor market impacts of a prospective recession could make consumers uneasy about their employment security and income prospects, and likely more cautious in their spending.

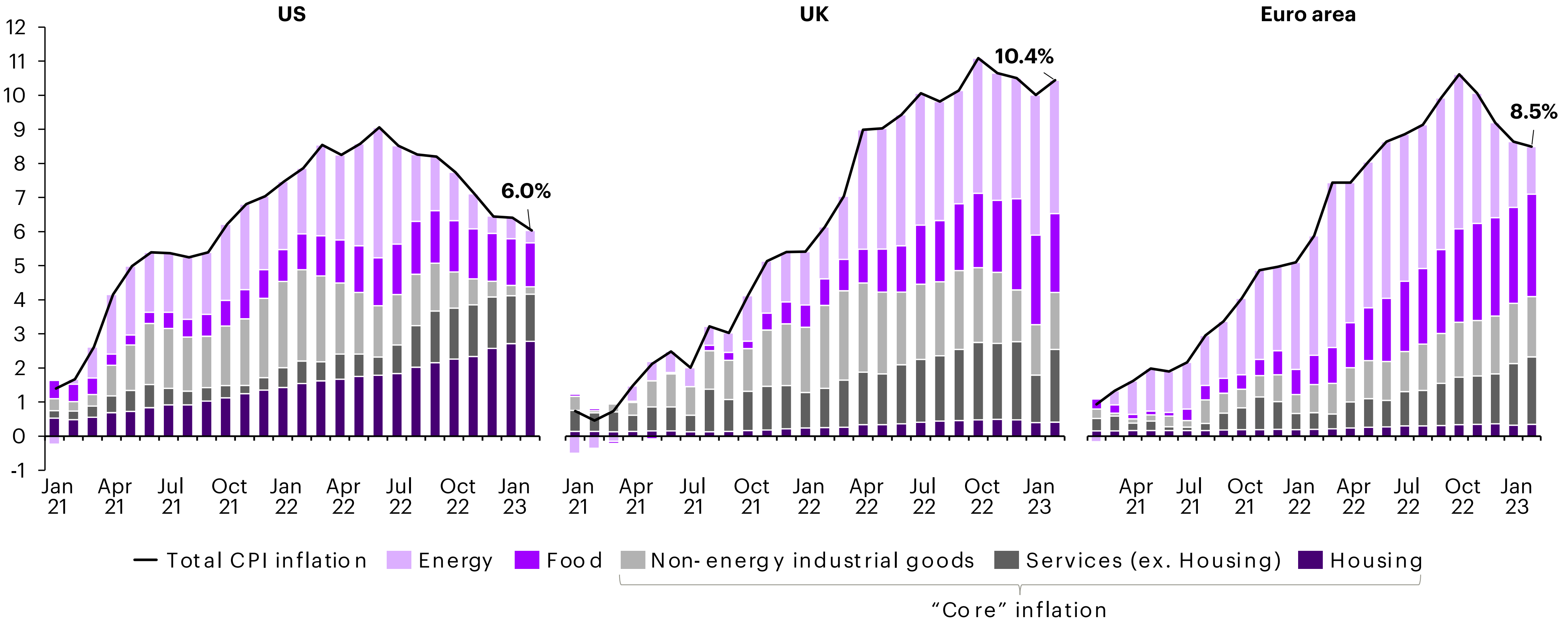
## 06
## Strength of wealth effects from declining asset prices

Persistent inflation is expected to put pressure on central banks to maintain high interest rates throughout 2023, or even raise them further. Rate hikes are a drag on financial asset values and home prices and thus a negative hit to household wealth. Historically, wealth effects have been a key driver of household spending decisions,[iii] particularly for bigger-ticket items. House prices are already down 2.5% in the US since mid-2022 and 4% in the UK (Figure 6) as housing market corrections in these countries continue to unfold. Equity markets in Europe have rebounded strongly in 2023, but in the US the Russell 3000 is still down by 13.5% since the beginning of 2022 (Figure 7), and market volatility remains high. A continuation of this wealth erosion may begin to weigh more heavily on consumers, especially as their excess savings dwindle in parallel. This would reinforce the imperative to curtail spending.

[2] For US, nominal wage growth is based on Atlanta Fed Wage tracker; for UK, ONS data on average weekly earnings in the private sector; for Euro area, data on posted wages collected by Indeed.

## Figure 5: Drivers of recent CPI inflation

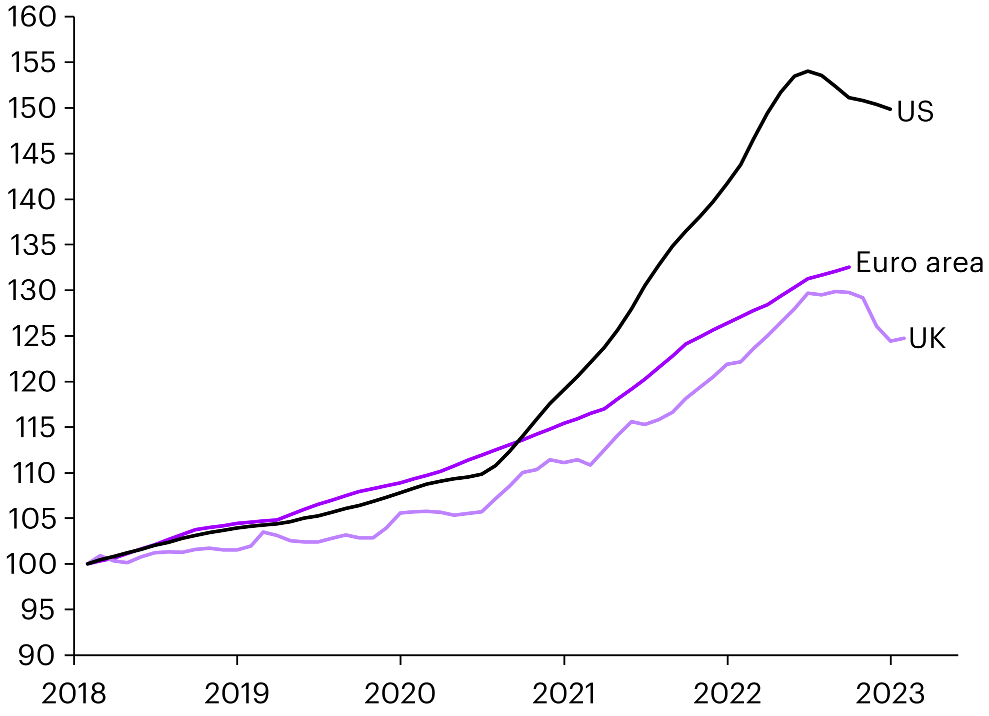
Year-on-year % change and % point contributions from major goods and services categories




Sources: BLS, ONS, Eurostat, Accenture Strategy analysis

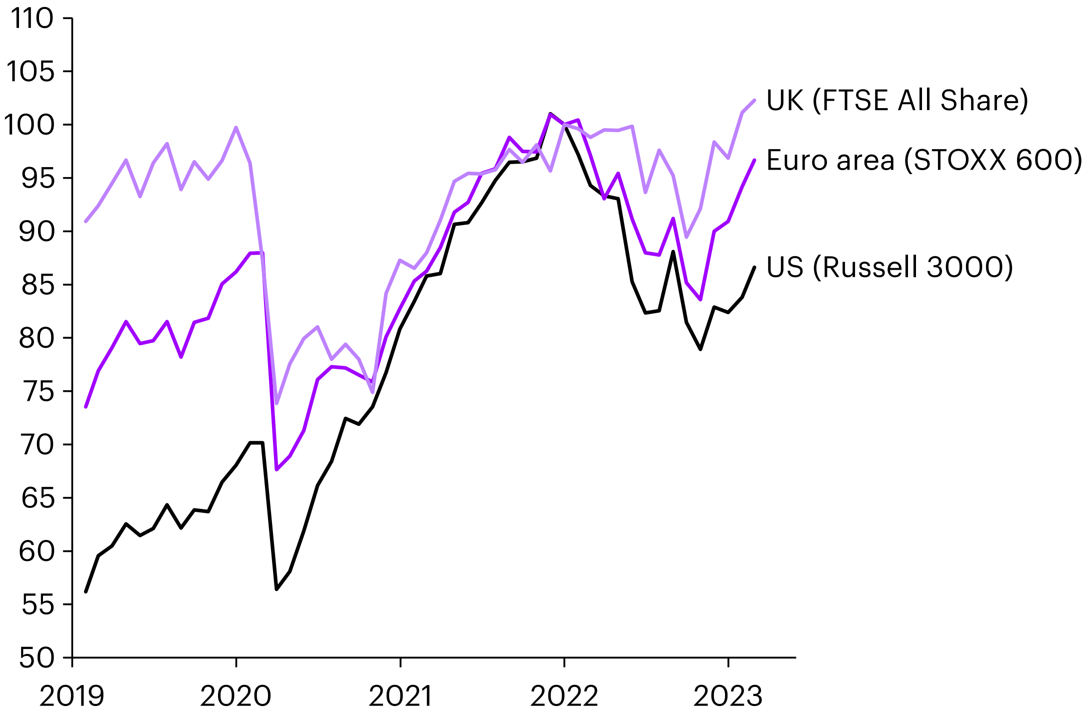
## Figure 6: House price indices

Index (Jan 2018=100)




## Figure 7: Stock market performance

Index (Dec 2021=100)




Sources: S&P, Halifax, ECB, Accenture Strategy Analysis

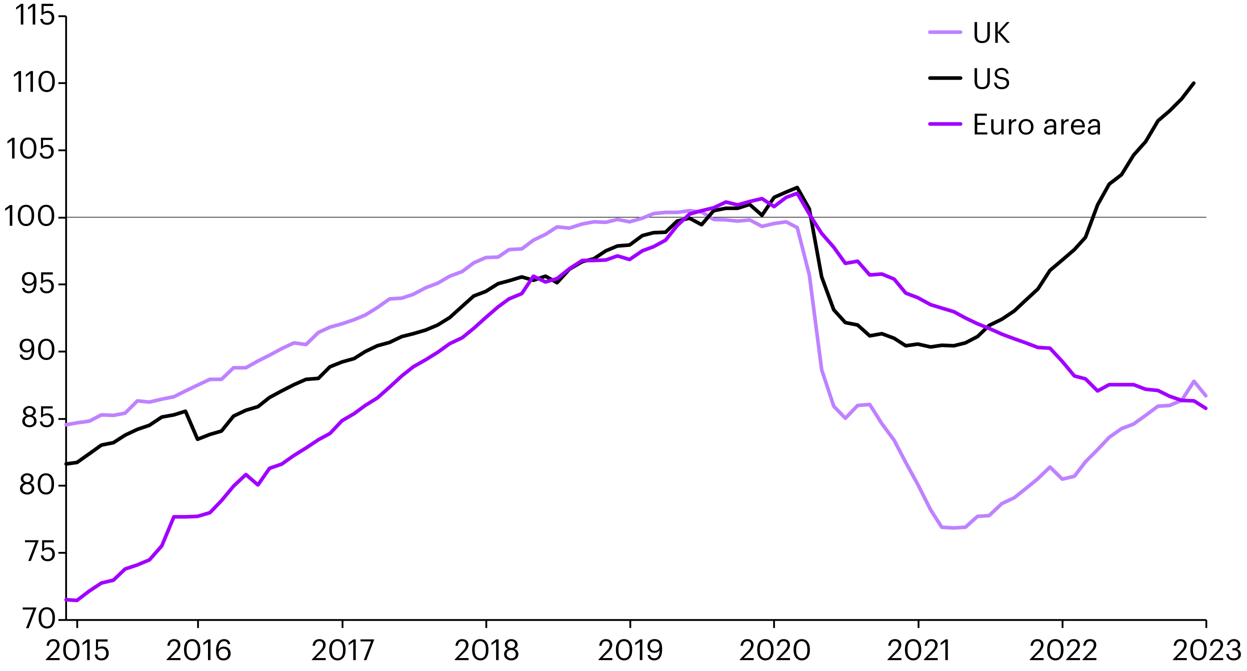
07

# Reliance on consumer credit

As financial and economic headwinds intensify, many consumers are increasingly being forced to borrow to maintain spending levels, in some cases even to cover basic expenses. In the US, credit-financed spending has already pushed households' outstanding consumer credit above pre-pandemic levels. In the Euro area and UK, in contrast, there is still room for consumers to use credit to support spending before their debt levels return to or exceed pre-pandemic levels.

**Figure 8: Consumer credit**

Index (2019=100)




Note: US series is revolving consumer credit only. UK data is for credit card lending only, and Euro area data for Consumer credit up to 5 years in maturity.

Sources: Federal Reserve, Bank of England, ECB, Accenture Strategy analysis

# Which consumer groups are most vulnerable?

## The relative pressure that these economic and financial factors place on consumer spending will not only vary by region, but also by consumer segment.

To better understand which parts of the consumer population might be more or less impacted, Accenture analyzed data on these factors for US households across two key socio economic dimensions: income and age.

A proprietary Consumer Vulnerability Index was constructed which scored the relative pressures that consumers in each income quintile and age group face from each of the seven key economic and financial factors.[3] An overall "vulnerability" score was then calculated for each consumer group based on a weighted average of that group's scores for each economic and financial factor (see Appendix for details). While this assessment based on US consumers dynamics is not necessarily representative of all other consumers markets, it is nonetheless instructive.

[3] Fiscal support was excluded as a dimension from the vulnerability index, as pandemic-time fiscal support measures to households in the US have expired and thus unlikely to be a relevant determinant of consumer spending decisions going forward.

**Based on this Vulnerability Index (Figure 9), several key findings emerge:**

### Almost all income and age groups face at least a modest degree of pressure to cut spending.

With a score of 3 representing an average degree of vulnerability, only the highest income quintile group and oldest age group are below this score. All other groups exhibit above-average vulnerability to the economic and financial forces assessed in the index, and thus pressure to rein in future spending.

### Among income levels, consumers under the most relative pressure sit within 0-40th income percentile.

The key drivers of this pressure are the higher effective inflation rate these lower-income consumers face, their lower levels of accumulated excess savings, and their high shares of total wealth held in housing, which leave them exposed to a real estate market correction.

### Among age groups, consumers under the age of 40 are most vulnerable.

Largely because of the same reasons as for low-income groups, but also because of their high reliance on consumer credit for spending (leaving them exposed to rising borrowing costs). Consumers in the middle two age groups (from 40-69) are not far behind in their overall vulnerability, however, with their exposure stemming mainly from high debt burdens (relative to income) and negative wealth effects from falling financial asset prices.

## Figure 9: Consumer Vulnerability Index[4]

| Component weights | 25% | 25% | 5% | 5% | 20% | 15% | 5% | |
|---|---|---|---|---|---|---|---|---|
| | Inflation | Income | Borrowing costs | | Savings buffers | Wealth effects | | |
| **Income Quintile** | **Inflation** | **Wage growth** | **Debt-to-income** | **Borrowing reliance** | **Excess deposits** | **Housing wealth** | **Financial wealth** | **Overall vulnerability** |
| 80 - 100 | 1.5 | 4.5 | 4.5 | 2.0 | 1.0 | 2.0 | 4.5 | **2.6** |
| 60 - 80 | 2.5 | 4.0 | 3.5 | 4.0 | 3.5 | 2.5 | 4.0 | **3.3** |
| 40 - 60 | 4.0 | 3.5 | 2.5 | 3.0 | 3.0 | 3.0 | 3.0 | **3.1** |
| 20 - 40 | 4.0 | 2.5 | 2.0 | 4.0 | 5.0 | 4.0 | 2.5 | **3.7** |
| 0 - 20 | 3.5 | 2.5 | 4.0 | 2.0 | 5.0 | 4.5 | 2.0 | **3.6** |
| **Age group** | | | | | | | | |
| 70> | 2.0 | 3.5 | 3.5 | 3.5 | 2.0 | 3.0 | 3.0 | **2.7** |
| 55 - 59 | 3.5 | 4.0 | 4.0 | 3.0 | 3.0 | 2.0 | 4.0 | **3.3** |
| 40 - 54 | 3.0 | 3.5 | 4.0 | 2.0 | 3.5 | 3.0 | 4.0 | **3.3** |
| <40 | 4.5 | 2.0 | 2.0 | 4.5 | 4.5 | 4.5 | 2.0 | **3.6** |
| **Rationale** | Groups facing higher inflation rates see their purchasing power squeezed more | Higher nominal wage growth allows consumers to better offset rising prices and makes them less vulnerable | Higher debt levels relative to income indicate consumers may be less willing to take on additional debt for spending, or less able to service existing debt if interest rates remain elevated | Groups with higher historical reliance on consumer credit for spending and greater recent growth in borrowing are more exposed to rising interest rates | Higher excess deposit holdings relative to income give consumers a financial cushion and reduce pressures to cut back their spending | Groups for which housing accounts for a larger share of total net wealth are more exposed to declines in house prices associated with a real estate market correction | Groups that have a higher share of their net wealth in financial instruments (ex. deposits) are more exposed to declines in financial asset prices (i.e., a further stock market correction) | |

**Scoring:**
**1 = Least vulnerable**
**5 = Most vulnerable**

Sources: BLS, Accenture Strategy analysis

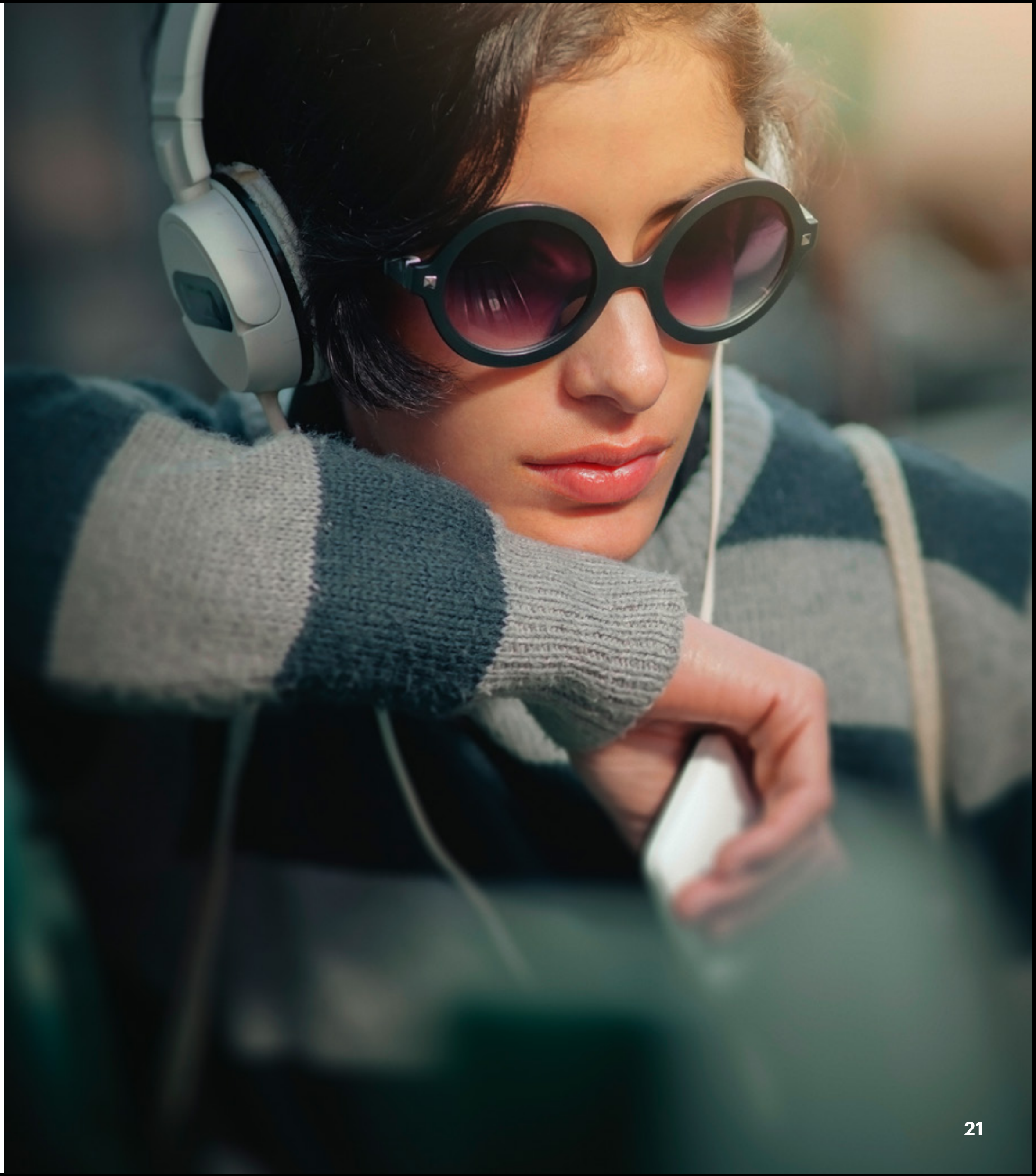
[4] Accenture's Consumer Vulnerability Index was calculated using 7 indicators for economic and financial pressures faced by consumer groups. The indicators in each dimension are: (1) Relative inflation rate experienced by each consumer group; (2) Q4 '22 Year-on-year nominal wage growth; (3) Q4 2022 Debt-to-income ratio per consumer unit; (3) Product of the average consumer credit (ex. Student loans)-to-annual consumption ratio for 2012-2019 and the latest Q3 '22 Year-on-year percent change in consumer credit (ex. student loans); (4) Ratio of excess deposits per household to annual household income; (5) Q4 '22 net housing wealth share of total net wealth; (6) Q4 '22 net financial wealth (ex. deposits) share of total net wealth.

# Which spending categories will be most impacted?

## The natural starting point for assessing where consumers may cut spending is to look at how they have adjusted their spending during previous recessions (Figure 10).

Historically, discretionary spending patterns have tended to vary with different types of recessions. During recession episodes accompanied by high energy prices—such as during the early 1970s and the Gulf War in 1990-91—spending on fuel-intensive durables such as vehicles declined significantly, while spending on experience goods such as recreation and dining was less affected. During a high-inflation and high interest rate episode such as the 1980's double dip recession, spending on household furnishings and travel was particularly hard hit. Across all recessions since the 1970s, consumer electronics has been the most resilient category, indicative of consumers' reluctance to forego spending on entertainment-related goods even during times of economic hardship.

Spending cutbacks on essentials have relatively been milder, on average, during prior downturns, as one might expect. Among categories, consumers have tended to rein in spending the most on appliances and gasoline. Housing, healthcare and telecommunications, on the other hand, have been least impacted.



## Figure 10: Changes in spending on discretionary and essential consumer categories during prior US recessions

| Discretionary | ▲ ★ ■ Energy Crisis 1973 - 1975 | ▲ ★ ■ Double Dip 1980 - 1983 | ▲ Gulf War 1990 - 1991 | ● Dot-com Bust 2000 - 2001 | ● Global Financial Crisis 2008 - 2009 | Average across recessions |
|---|---|---|---|---|---|---|
| Dining out | -0.6% | -0.4% | -0.1% | 1.0% | -2.7% | -0.6% |
| Household furnishings | -2.0% | -4.1% | -2.3% | 5.1% | -9.7% | -2.6% |
| Electronics | 4.8% | 3.0% | 2.7% | 11.8% | 6.1% | 5.7% |
| Entertainment & recreation | 6.0% | 2.1% | 0.0% | 1.1% | -2.2% | 1.4% |
| Personal care | -3.9% | -1.8% | -2.6% | 0.5% | -1.5% | -1.8% |
| Apparel | -1.2% | 1.5% | -0.2% | -0.3% | -3.3% | -0.7% |
| Vehicles | -16.2% | -5.4% | -9.2% | 6.7% | -12.9% | -7.4% |
| Alcohol | 2.9% | 0.5% | -1.2% | 1.1% | -3.1% | 0.1% |
| Tobacco | -0.8% | -1.4% | -5.1% | -1.6% | -8.2% | -3.4% |
| Travel | 3.1% | -4.0% | -1.6% | -7.8% | 0.9% | -1.9% |
| **Essentials** | | | | | | |
| Housing | 4.8% | 1.0% | 1.2% | 2.0% | 3.1% | 2.4% |
| Home appliances | -3.1% | -4.9% | -1.0% | 3.1% | -5.0% | -2.2% |
| Groceries | -2.3% | 0.1% | -0.3% | -0.1% | -1.4% | -0.8% |
| Healthcare | 3.7% | 0.2% | 1.3% | 4.3% | 2.3% | 2.4% |
| Utilities | 1.0% | | 1.2% | -6.5% | -2.4% | -1.3% |
| Telecom | 5.9% | 1.2% | 2.0% | 2.3% | 1.6% | 2.6% |
| Fuel | -6.8% | -1.9% | -1.4% | 0.0% | -3.2% | -2.7% |
| Public transport | 3.1% | -4.2% | 6.8% | 2.9% | -2.6% | 1.2% |
| Education | -1.3% | | -0.2% | 0.1% | -1.2% | -0.5% |

**Recession features key**

- ▲ Energy supply shock
- ★ High inflation
- ● Financial/Asset market imbalances
- ■ High interest rates

Note: Percent changes are calculated based on average level during recession relative to the level in the quarter immediately preceding start of recession

Sources: Accenture Strategy analysis, U.S. Bureau of Economic Analysis (BEA)

This time, however, the consumer spending response is unlikely to resemble patterns of individual past recessions or even an "average" of those recessions because of the unprecedented multiplicity of headwinds confronting consumers—high inflation, energy price shocks, high interest rates, and financial and housing market corrections. No single past recession has featured a concoction of all these shocks at once.

Moreover, as revealed in the consumer vulnerability assessment in Figure 9, the combination of these economic and financial headwinds is hitting lower-income and younger consumers hardest. The spending patterns of these most pressured groups may therefore drive important differences in category-level consumption dynamics compared to prior recessions.

**The Consumer Vulnerability Index can therefore help inform the outlook for different spending categories, when viewed in combination with information on:**

**Where consumer groups who are under the most stress tend to spend their income**—i.e., categories that are most ripe for cutbacks in spending

**Items for which consumers' price sensitivity has recently been high**—i.e., categories that are most susceptible to large demand drop-offs in the face of continued price increases

# Spending patterns of vulnerable consumer groups

Figure 11 highlights the spending categories, both discretionary and essential, where the risk of consumer cutbacks may be greater this time around compared to the average of declines observed over the past five recessions (excluding the COVID-19 pandemic). This can be viewed as a "vulnerability-adjusted" cutback risk that factors in the vulnerability index scores of each consumer group and the categories in which more vulnerable consumer groups spend a larger share of their budget than do less vulnerable groups.

**Based on this assessment, spending cutback risks among discretionary categories are expected to be broadly similar to previous recessions, and even potentially lower in categories such as travel.** For apparel, however, the cutback risk is expected to be higher, owing to the high share of wallet spent on this category by both younger and lower-income consumers.

**When it comes to essentials, higher cutback risks may be expected this time around for utilities, groceries and housing.** This mainly reflects the larger share of spend by lower-income groups on these categories, as the other most vulnerable group—younger consumers—actually tends to spend relatively less of its budget on groceries and utilities.

**Examples of adjustments consumers could make to their spending on these essentials include:**

- Becoming more efficient with household energy and water consumption
- Trading down food at home, opting for cheaper products and private labels
- Looking for cheaper rental housing

## Figure 11: Categories at risk of spending cutbacks (past recessions vs. current context)

| | Average change in spending during past 5 US recessions | Cutback risk based on prior recession patterns | Spending share among more vs. less pressured consumer groups | Adjusted cutback risk in current context |
|---|---|---|---|---|
| **Discretionary** | | | | |
| Dining out | -0.6% | Medium | Similar | Medium |
| Household furnishings | -2.6% | High | Similar | High |
| Electronics | 5.7% | Low | Similar | Low |
| Recreation | 1.4% | Low | Similar | Low |
| Personal care | -1.8% | Medium | Similar | Medium |
| Apparel | -0.7% | Medium | Higher | High |
| Vehicles | -7.4% | High | Higher | High |
| Alcohol | 0.1% | Low | Similar | Low |
| Tobacco | -3.4% | High | Similar | High |
| Travel | -1.9% | Medium | Lower | Low |
| **Essentials** | | | | |
| Housing | 2.4% | Low | Higher | Medium |
| Home appliances | -2.2% | Medium | Similar | Medium |
| Groceries | -0.8% | Medium | Higher | High |
| Healthcare | 2.4% | Low | Lower | Low |
| Utilities | -1.3% | Medium | Similar | High |
| Telecommunications | 2.6% | Low | Similar | Low |
| Fuel | -2.7% | High | Higher | High |
| Public transport | 1.2% | Low | Similar | Low |
| Education | -0.5% | Medium | Similar | Medium |

Note: This recession average excludes the COVID-19 pandemic that was a non-representative economic downturn

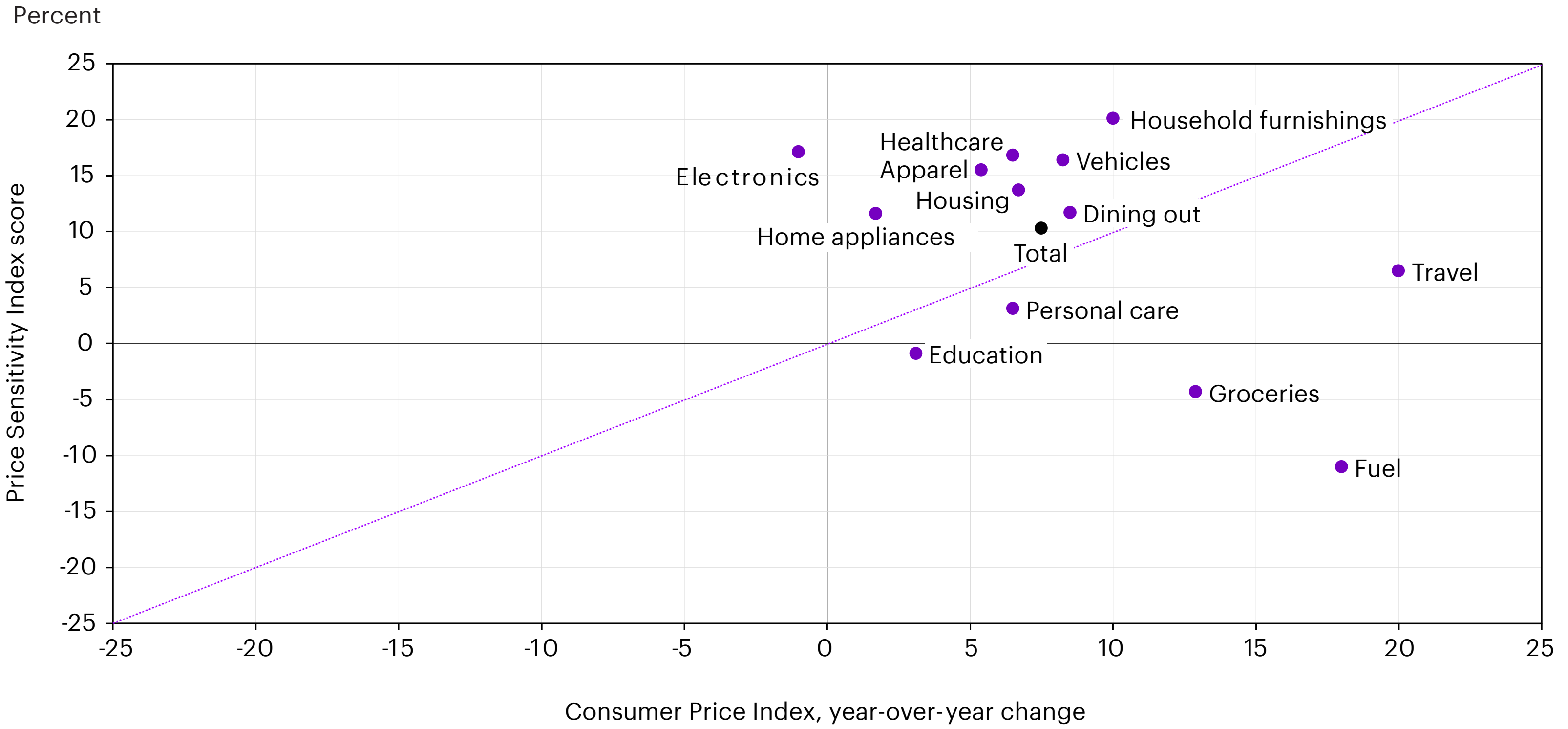
Sources: Accenture Strategy analysis, U.S. Bureau of Economic Analysis (BEA)

# Products with high consumer price sensitivity

After a year of passing on their rising costs to consumers, many businesses are now wrestling with the uncertainty of how much they can keep increasing prices for their products without risking significant demand destruction or loss of market share. Recent consumer surveys carried out by Morning Consult highlights some categories for which consumer demand may be most sensitive to any further price increases.[iv] The key gauge of this is a price sensitivity index which tracks the shares of surveyed consumers who, upon encountering higher-than-expected prices while shopping, elected to go ahead with the purchase versus walk away. For any given category, if the share of consumers facing "sticker shock" who walked away exceeds the share who purchased anyway, that category has a positive price sensitivity index score.

**Figure 12: Recent inflation and consumer price sensitivity, by consumption category**

Price Sensitivity vs. Consumer Price Inflation




Note: Price sensitivity scores are as of September 2022, and plotted against September 2022 CPI inflation to preserve comparability.

Sources: Morning Consult, Accenture Strategy analysis

Figure 12 plots these consumer price sensitivity scores for different spending categories in relation to each category's recent price inflation. While both fuel and travel have seen large price increases over the past year, there has been limited impact on consumer demand for these categories (evidenced by their low price sensitivity scores). We can expect this relationship to persist over the next 12 months as consumers continue to seek experiences as part of their post-pandemic revenge spending. Demand for groceries has also proven relatively price inelastic, in large part due to their essential nature, but also because many consumers continue to work from home and because prices for dining out have been rising rapidly in tandem (due to both higher food costs and staff shortages).

Meanwhile, discretionary categories that could see a large demand drop-off in the event of future price increases include vehicles, home furnishings, electronics and apparel. The high consumer price sensitivity scores relative to the inflation rates for these items suggest consumers are unlikely to be able to bear much higher prices. Among essentials, consumers have been showing the most heightened price sensitivity for housing, healthcare and appliances.

## Overall risk assessment

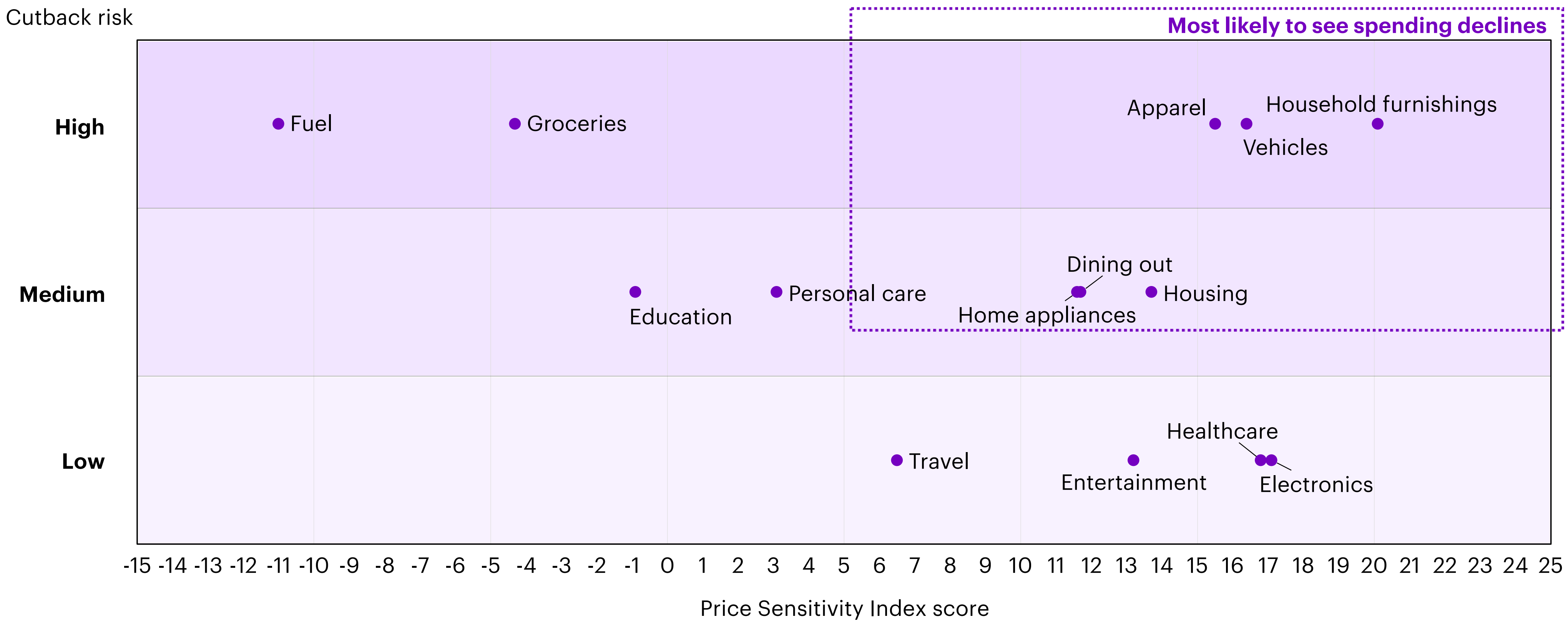
By combining the two frameworks, we can visualize which categories are most at risk both because they are more heavily purchased by vulnerable consumer groups and because recent consumer demand for these categories has been highly price sensitive (Figure 13). The results suggest that the products most at risk (those in the top right quadrant of Figure 13) are generally big-ticket durables—vehicles, furniture and appliances—that consumers can easily delay purchasing until the economic outlook improves. Among everyday goods and services, apparel and dining out are most at risk of cutbacks, while housing is the main essentials category likely to see reduced spending.

There is an additional nuance to consider. For categories in the top left quadrant of Figure 13—which are medium-to-high cutback risk based on consumer vulnerability but where consumers have demonstrated high capacity to absorb recent price increases—even if additional price increases do not trigger significant spending cutbacks, they could induce consumers to trade down more intensively. This is supported by a related Morning Consult survey measure of consumer trading down behavior. In recent months it has shown that a greater share of consumers shopping for groceries and personal care products have, when confronted with price sticker shock, elected to trade down rather walk away from the purchase.[v]

**The results suggest that the products most at risk (those in the top right quadrant of Figure 13) are generally big-ticket durables—vehicles, furniture and appliances—that consumers can easily delay purchasing until the economic outlook improves. Among everyday goods and services, apparel and dining out are most at risk of cutbacks, while housing is the main essentials category likely to see reduced spending.**

## Figure 13: Combined overall spending cutback risk assessment

Price Sensitivity vs. Vulnerability-adjusted cutback risk




Sources: Morning Consult, Accenture Strategy analysis

# Business Implications

## An inflection point in consumers' spending trajectory is fast approaching, and companies must anticipate and proactively prepare for this shift.

When this moment comes, consumers' spending pullbacks may be sharp and unprecedented, and the categories most impacted are different from those of past recessions. Companies adopting complacent "wait and see" attitudes not only risk falling behind the curve, but also not having sufficient time to course-correct if cliff drops in spending do indeed materialize.

The good news is that savvy retailers and other consumer-facing companies can use this "calm before the storm" period to implement strategies that help them get ahead of the market, build resilience and even capture recession-time opportunities. These strategies revolve around understanding consumers' circumstances and differentiated pressures, and reflecting these in pricing, marketing, product assortment and financial planning.

**Companies adopting complacent "wait and see" attitudes not only risk falling behind the curve, but also not having sufficient time to course-correct if cliff drops in spending do indeed materialize.**

## 01
# Be helpful to vulnerable consumers first, pursue sales second

Times of economic hardship offer brands the chance to build sizable moats around their businesses that provide long-term growth. They can do this by leading with empathy, recognizing that most consumer wallets are shrinking. Consumers are looking for affordability, but also small luxuries. When they choose to shop with a particular brand, their loyalty should be reciprocated with a quality experience and a feeling they're getting value. Companies should also see this moment as an opportunity to persuade their customers to make more sustainable purchasing choices, emphasizing that crises are a good impetus for impactful behavioral shifts, and adapting their products and costumer engagement strategies to facilitate such shifts, as detailed in Accenture's Breaking the Stalemate report.

## 02
## Create a dynamic, data-driven pricing strategy

Pricing in a fluid and uncertain economic environment is challenging for brands and retailers. To develop a dynamic pricing strategy, there are three key elements to consider, each requiring strong data and analytics capabilities:

- Understand how much additional cost can be passed on to consumers. After the highest rates of inflation seen in decades, blanket price increases may no longer be effective. Analyze which consumers are buying which products and avoid significant price increases for those which consumers tend to view as more discretionary or for which recent price sensitivity has been high.

- Recognize that while discounts can be effective for clearing excess inventory, applying across-the-board price cuts may risk revenue from some products that consumers would be willing to pay full price for.

- Extensive visibility of the cost base can also help with pricing decisions. Understanding the input costs of specific products across the assortment mix will help businesses assess the impact of future cost shifts and determine what actions to take to protect margins.

## 03
## Leverage targeted marketing and loyalty programs

Customer retention will be pivotal to maintaining margins, especially among consumers under the most financial stress. As a result, brands should elevate their loyalty programs and consider adding features or expanding offerings, such as tiered pricing that starts with lower-cost options. For example, Netflix and Disney+ both now offer lower-priced ad-supported subscription plans.

In doing so, however, brands should not forget the top 5% of earners who may make up a significant portion of the revenue base. Targeted marketing campaigns for consumers less impacted by the macroeconomic environment could offer valuable growth opportunities in the short term.

## 04
## Explore ecommerce channels to capture more price conscious consumers

The pandemic saw explosive ecommerce growth for many brands. Convenience and speed of purchase are two of the most well understood drivers of greater ecommerce. Perhaps less well known is that online shopping also tends to yield better prices for consumers. Recent data shows online prices fell 1.6% year-on-year to December 2022, as compared with a 6.5% increase in the CPI for the same basket of goods.[vi] As consumers feel the squeeze, they may become even more active in seeking deals online. Companies can look to capitalize on this heightened consumer price consciousness by expanding their use of ecommerce channels.

## 05
# Stress-test the P&L against different spending slowdown scenarios

Multiple economic scenarios could unfold in 2023 and each will have different impacts on the bottom line. Stress testing the P&L against a range of scenarios (including extreme outcomes) and understanding which levers should be pulled to protect profitability, will be key. In some cases, quick wins and other marginal adjustments may not be sufficient, and business or operating model transformation may be required to respond to new consumer dynamics.

# Conclusion

Post-pandemic, the re-opening of economies gave significant impetus to consumer spending, driven by accumulated household savings and the understandable desire for consumers to get out and spend on services that had been denied during lockdowns.

Now, however, the dissipation of these tailwinds and intensification of economic headwinds are pushing consumer spending to an inflection point. Ongoing inflation, high interest rates, falling asset prices, and uncertainty about income and employment mean a squeeze on consumption is likely, with high risk of whiplash and cliff effects.

Companies must understand this will not be felt equally by all consumers and all categories. Our analysis shows the squeeze will likely be concentrated among lower-income and younger consumers. And while spending cutback patterns may resemble those of previous recessions, others will be novel and reflect the unprecedented economic context consumers find themselves in today.

A recessionary environment presents challenges, of course. But this is also an ideal time to focus on the loyalty of key customers and build a deeper moat around the brand for the long term. The strategies outlined above will help consumer-facing companies stay on course for growth as they, and their customers, face greater economic headwinds in the year ahead.

> **Ongoing inflation, high interest rates, falling asset prices, and uncertainty about income and employment mean a squeeze on consumption is likely, with high risk of whiplash and cliff effects.**

# Appendix: Consumer group vulnerability assessment details

The consumer vulnerability index was constructed based on indicators for 7 key economic and financial factors affecting spending decisions across consumer income and age groups.

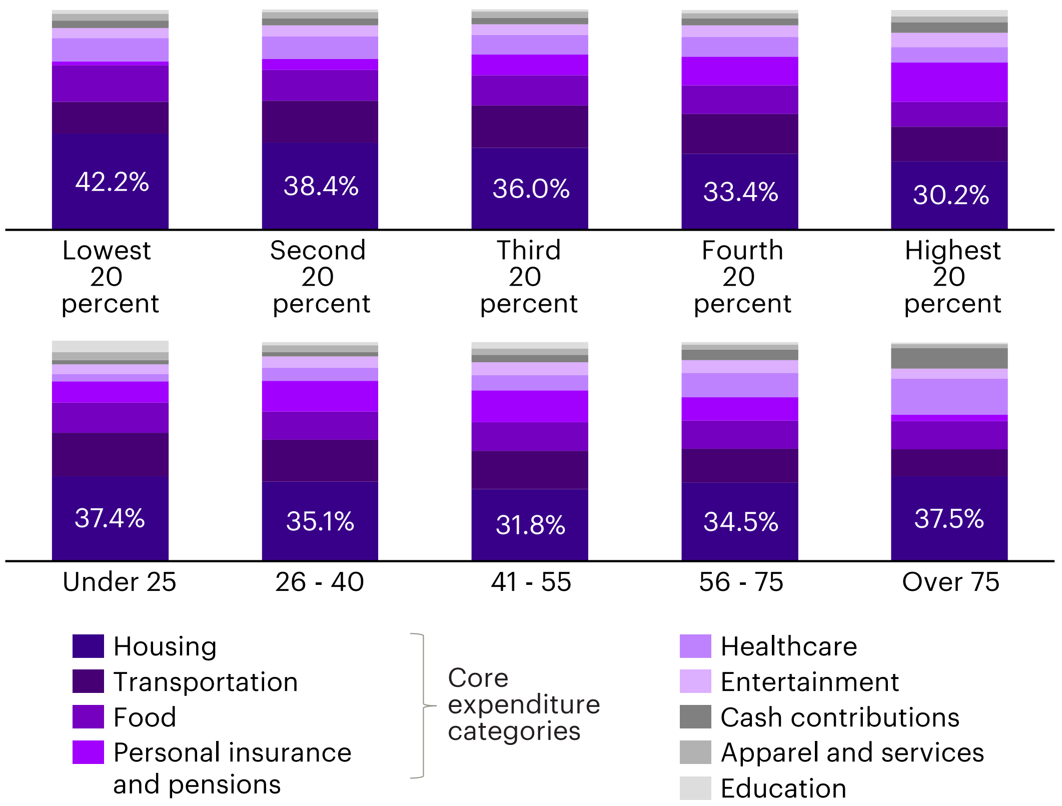
The weight assigned to each factor in the index is subjective and intended to reflect its approximate relative importance to consumer spending decisions. Broadly speaking, factors shaping real income (inflation and wages) carry the largest weight (50% combined), consistent with various empirical research on consumer behavior which finds that spending decisions are predominantly driven by income dynamics. Wealth effects are secondary in importance (20%), with housing wealth historically influencing consumption decisions more than financial wealth.[vii] Consumers' excess saving deposits are also assigned a high weight (20%) given their unique role in shaping consumer spending dynamics in this post-pandemic context. Finally, factors related to consumers' debt reliance and exposure to borrowing carry the smallest relative weight, though they are still collectively important (10%).

## Inflation

While annual CPI inflation in the US averaged 8.0% in 2022,[viii] not all households felt the pinch equally. Because consumption baskets differ across income and age groups (Figure 14), so do the effective inflation rates these groups face. For example, the bottom income quintile spends relatively more on housing/energy (42%) and food (16%), two categories where prices accelerated the fastest over the past year. Meanwhile, consumers under the age of 40 spend a larger proportion of their income on housing and transport.

**Figure 14: Income expenditure by income quintile and age**

% Change year on year

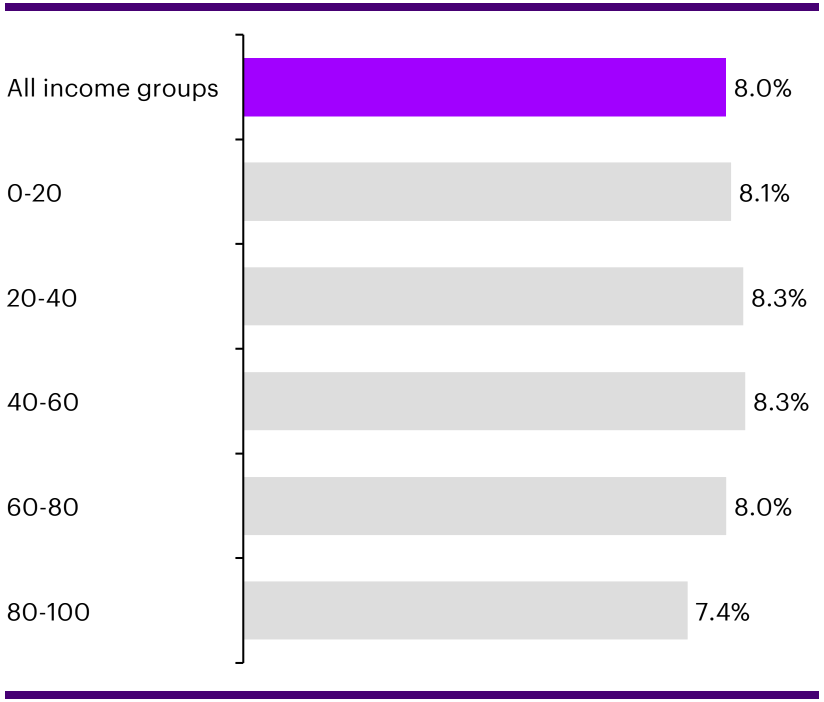



Sources: BLS, Accenture Strategy analysis

As a result, low-to-middle income households saw their cost-of-living rise between 8.1% to 8.3% (Figure 15) in 2022, significantly more than the 7.4% inflation experienced by households in the top 20th income percentile. Similarly, younger consumer cohorts faced higher inflation rates than did older ones (Figure 16).

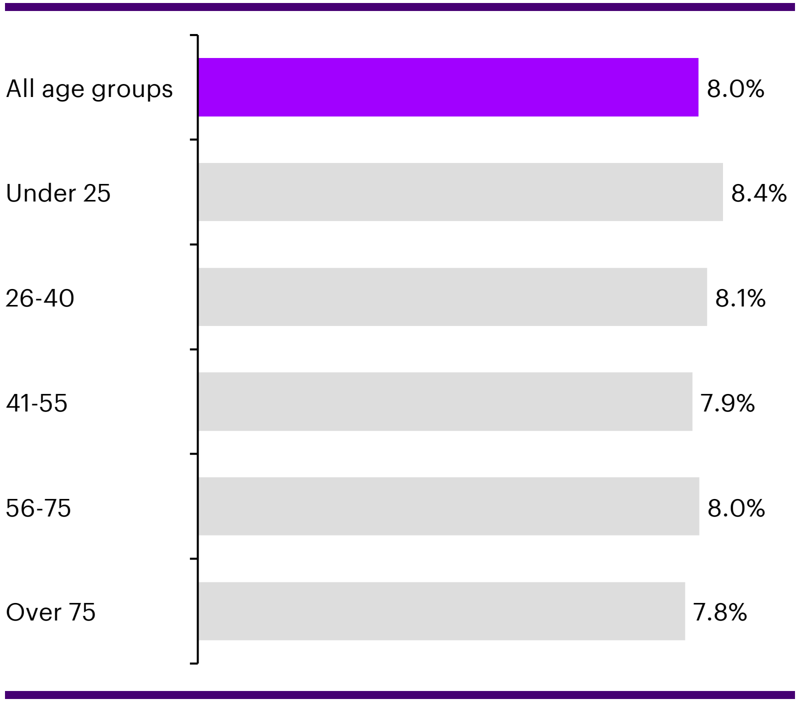
## Figure 15: CPI inflation faced by income quintiles

% Change year on year




## Figure 16: CPI inflation faced by age groups

% Change year on year



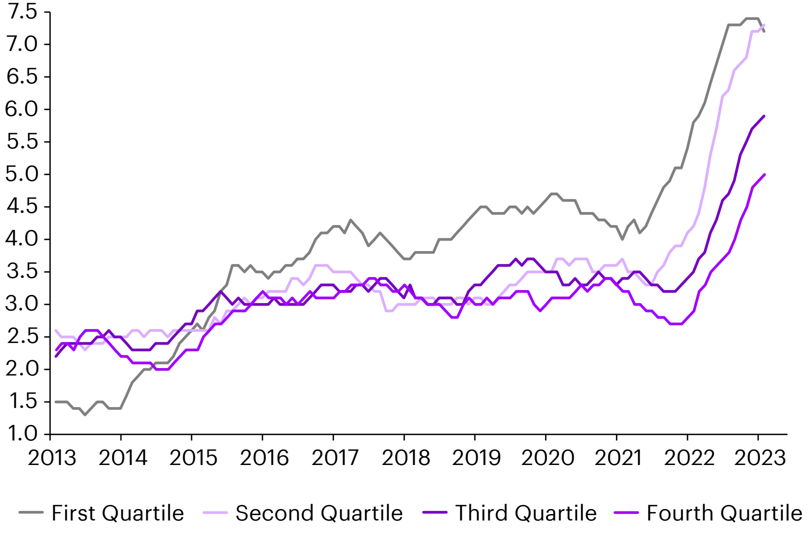

Sources: BLS, Accenture Strategy analysis

## Wage growth and income prospects

Since the beginning of the pandemic, nominal wages for the lowest-paying categories of jobs have been rising faster than for high-paying jobs[5] (Figure 17). This was, in large part, a response to the need to retain/re-attract workers to in-demand professions. While some overall loosening of labor markets is probable in 2023, tightness will likely remain in some of these relatively lower-paying sectors such as Leisure and Hospitality and Transportation, where worker shortages are still an ongoing issue. From this perspective, wage growth prospects for lower and middle-income households look relatively strong and supportive of consumption. The same is true of the youngest consumer cohort (ages 16-24), whose wages have been growing at double the rate of those for older cohorts (Figure 18).

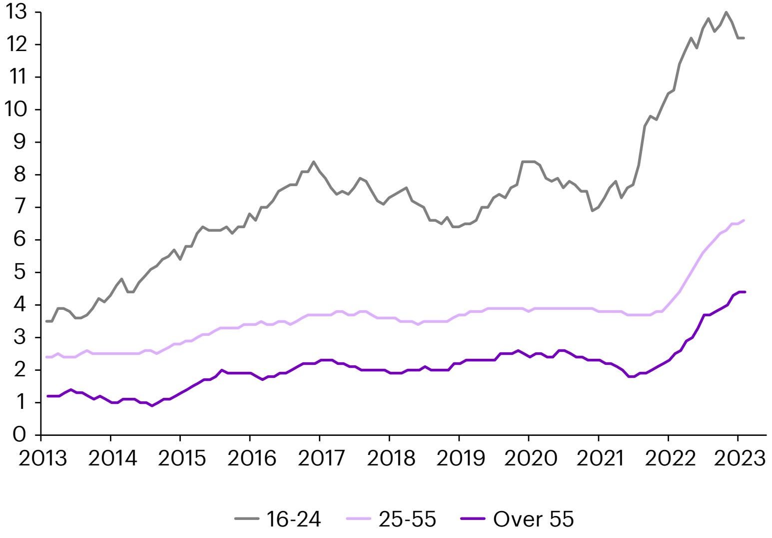
### Figure 17: Median wage growth by income quintile[6]

Percent (12-month moving average)




### Figure 18: Median wage growth by age group

Percent (12-month moving average)




Sources: Federal Reserve Bank of Atlanta, Accenture Strategy analysis

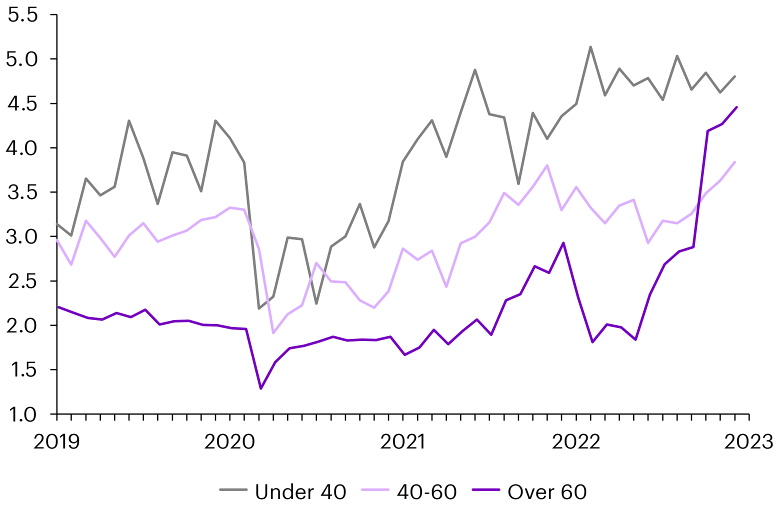
[5] Although it is not necessarily the case that the lowest-income households are employed in the lowest-wage jobs, there is enough of an overlap to make this indicator—wage growth by wage level percentile—a useful proxy of the wage growth experienced by different household income groups.

[6] Wage growth data is only available for income quartiles. The Consumer Vulnerability Index breaks out income groups into quintiles. It is therefore assumed that wage growth for the first and second quintile (0-40) equates to the first quartile.

Forward-looking income expectations from household surveys appear broadly consistent with these recent wage growth trends—lower-income and younger households expect the strongest relative income growth over the next 12 months. However, the expectations of middle and higher-income households suggest some reversal of recent income momentum, with middle-income groups expecting a slowing of growth and higher-income groups an increase. Similarly, older households, who have experienced the slowest recent wage growth, are expecting a rapid acceleration in income. The drivers behind these shifting expectations are not fully clear, but could be related to recent employment trends, with most layoffs concentrated in technology (where relatively fewer older people work) and financial services (where many middle-income workers are employed).

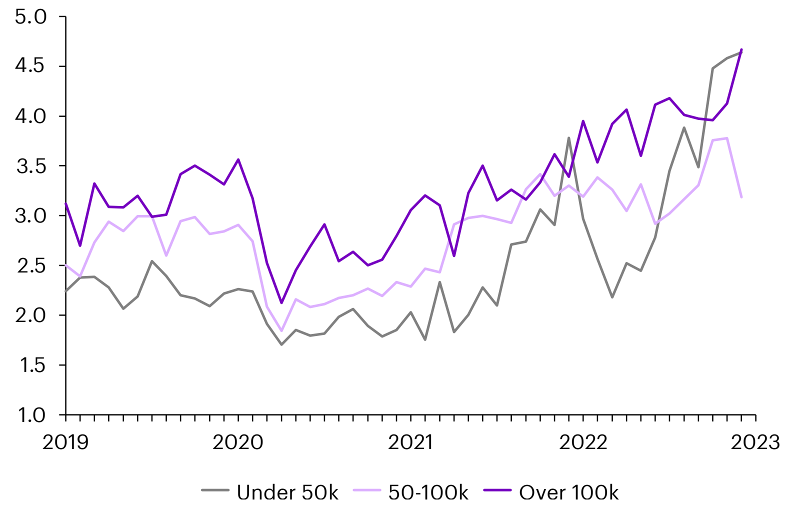
## Figure 19: One-year ahead household's income growth expectations (per age group)

Percent, by age group




## Figure 20: One-year ahead households' income growth expectations (per income group)

Percent, by income group



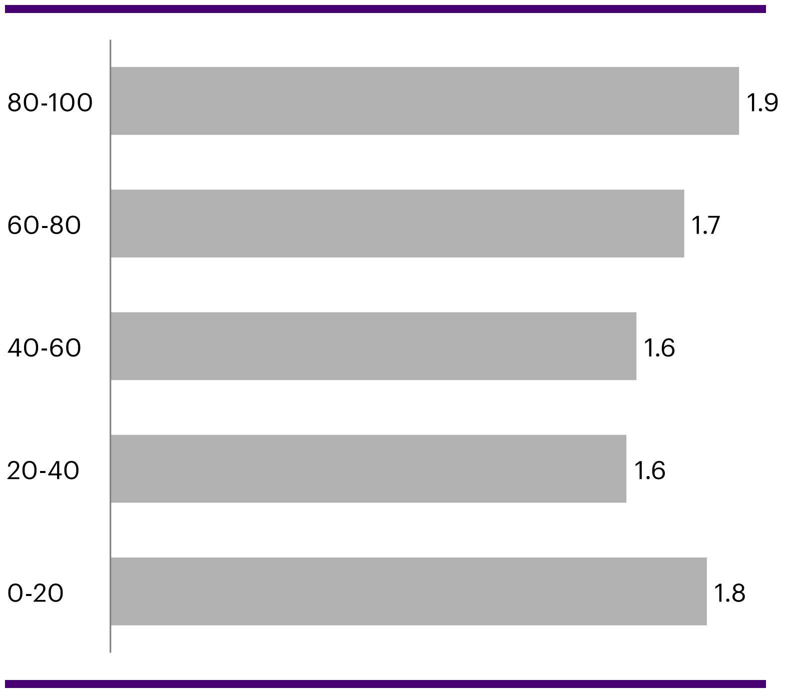

Sources: Federal Reserve Bank of Atlanta, Accenture Strategy analysis

## Debt burdens

Higher household debt levels relative to income indicate consumers may be less willing to take on additional debt for spending, or less able to service existing debt if interest rates remain elevated. Among income groups, the highest and lowest income quintiles have the highest estimated debt-to-income ratios. Among age groups, households between the ages 55-69 carry the highest relative debt burdens, while younger households (under the age of 40) have the lowest. These top-line numbers, however, obscure differences in the composition of debt across households groups, which has important implications for these groups' underlying exposure to a rising interest rate environment. For example, 40% of total mortgage debt is held by the 40-54 age group,[ix] and not greatly exposed to rising interest rates since mortgages in the US are predominantly fixed rate. The same is true of student loans, 55% of which are held by those under the age of 40, and mainly by the highest income quintiles.[x] In other words, young and middle-aged households are groups with high debt-to-income ratios that may actually have relatively low interest rate exposure based on their debt composition.

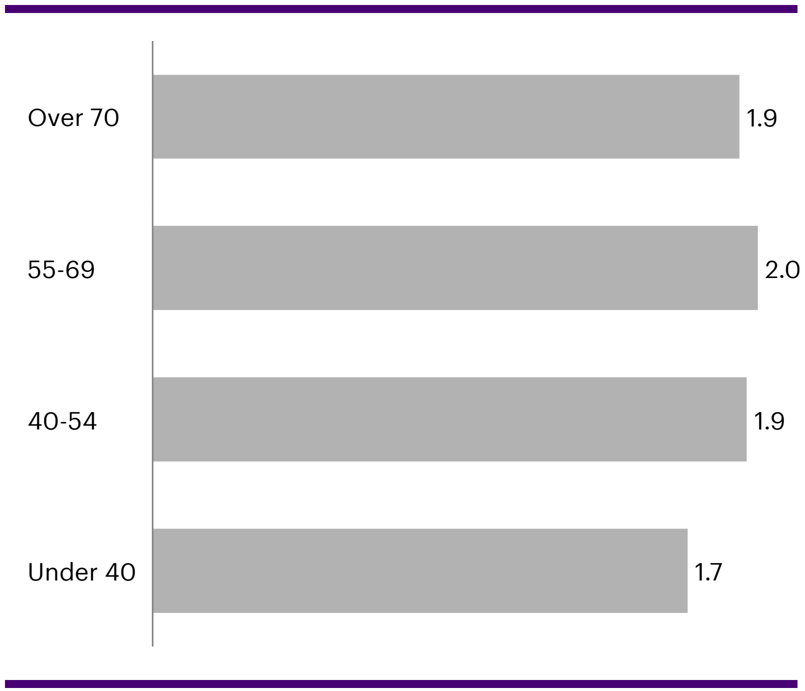
### Figure 21: Outstanding household debt by income group (Q3 2022)

Percent of annual household income




### Figure 22: Outstanding household debt by age group (Q2 2022)

Percent of annual household income



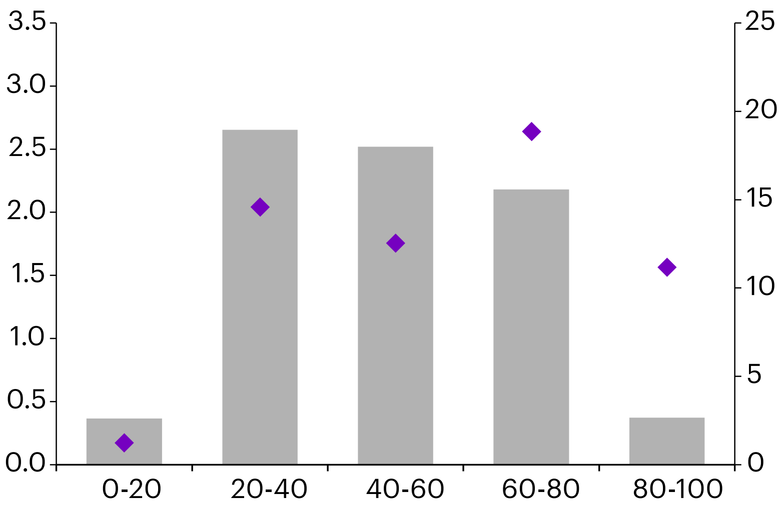

Sources: Federal Reserve, Bureau of Labor Statistics, Accenture Strategy analysis

## Consumer credit reliance

The degree of reliance on consumer credit by different household groups—and thus their vulnerability to rising borrowing costs—can be assessed on two dimensions. The first is the historical average dependence on consumer credit borrowing to finance spending, and the second is the recent increase in consumer credit as economic headwinds have intensified. Consumer groups that have both a high historical reliance on consumer credit and ramped up borrowing further over the past year in the face of high inflation will be under greater pressure to curtail spending or face a ballooning interest burden as rates continue to rise. On this basis, the bottom income quintile of consumers appears vulnerable—with both low historical reliance on consumer credit and a small increase in borrowing over the past year—but consumers in the 20-80th income percentile are all quite vulnerable (Figure 23). Among age groups, vulnerability to rising borrowing costs is polarized and concentrated in the youngest (under age of 40) and oldest (over 70) consumer groups (Figure 24).

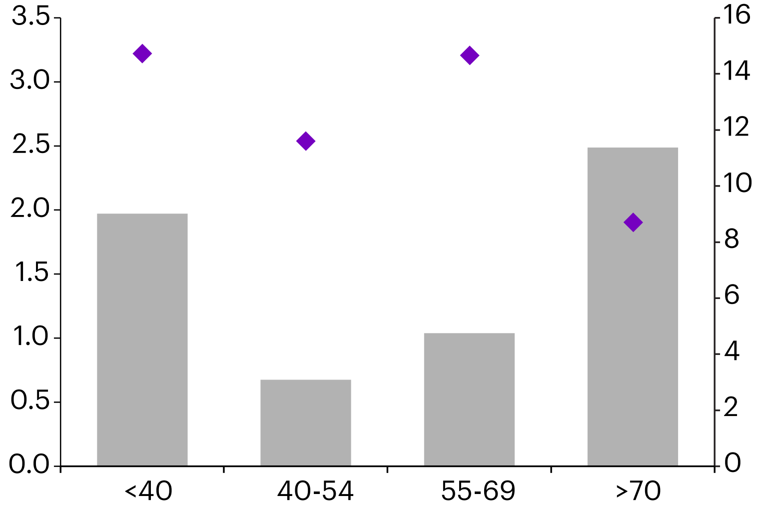
### Figure 23: Consumer credit by income group

Percent, Q4 2019 = 100




### Figure 24: Consumer credit by age group

Percent, Q4 2019 = 100




Recent YoY % increase in consumer credit (as of 2022:Q3)

Historical reliance on consumer credit (% of consumption, 2012-19 average)

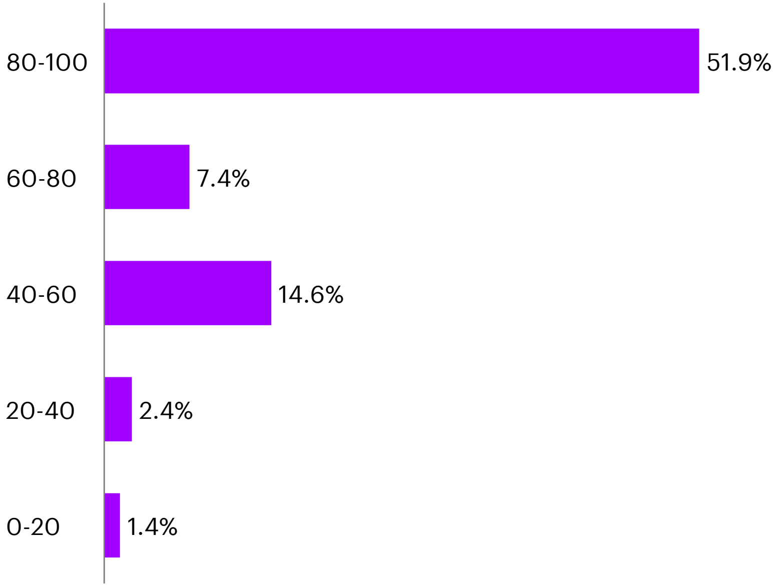
Note: Consumer credit measure used here excludes student loans.
Sources: Federal Reserve Board, Accenture Strategy analysis

## Excess savings deposits

The levels of household deposits held in banks are an indicative measure of excess savings, as these deposits are readily convertible into cash for spending. This deposit data suggests all income and age groups have been running down their cash buffers since Q2 2022. However, what is more striking is that these liquid "excess savings" are heavily concentrated among the top income quintile and older generations (Figures 25 and 26). Not only are these cash buffers much smaller for low-to-middle income consumers, but recent surveys suggest these groups are running down their limited reserves at an increasing rate,[xi] implying they could soon be depleted. This is yet another signal that younger and lower-income consumers could see their ability to spend diminish much sooner than other consumer groups.

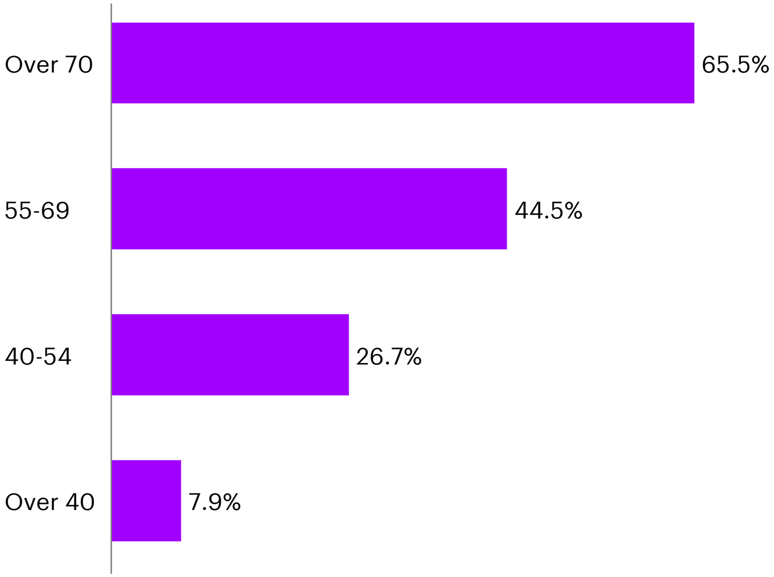
### Figure 25: Estimated "excess" deposit holdings per household by income quintile (as of Q3 2022)

Percent of total annual household income




### Figure 26: Estimated "excess" deposit holdings per household by age group (as of Q3 2022)

Percent of total annual household income



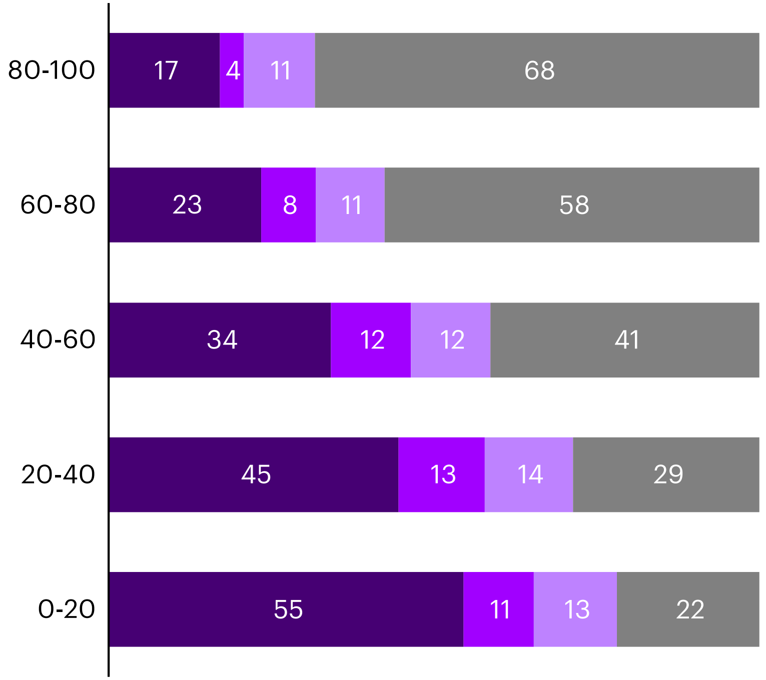

Sources: Federal Reserve Board, Accenture Strategy analysis

## Housing and financial wealth effects

The relative impact of declining housing and financial asset prices on different income and age groups depends largely on how much net wealth these groups hold in each asset class. Lower-income groups hold less of their net wealth in deposits and other financial assets and the majority (55%) in their homes (Figure 27), suggesting their spending decisions are likely to be more sensitive to declining house prices. The opposite is true for the top 20 percent of income earners, who have nearly 70% of their net wealth in non-deposit financial instruments. Among age groups, those under 40 have relatively even shares of wealth in housing versus financial assets (Figure 28), whereas older generations skew towards financial assets (more than 65% of total wealth). While changes in the value of both housing and financial wealth impact spending decisions, empirical research on consumer behavior suggests that housing wealth tends to be more influential, in part because households can borrow against their home equity to finance additional consumption.[xii] On this basis, lower-income and younger consumers—who have larger shares of their total wealth in housing—may face greater overall pressures to curtail spending due to negative wealth effects.

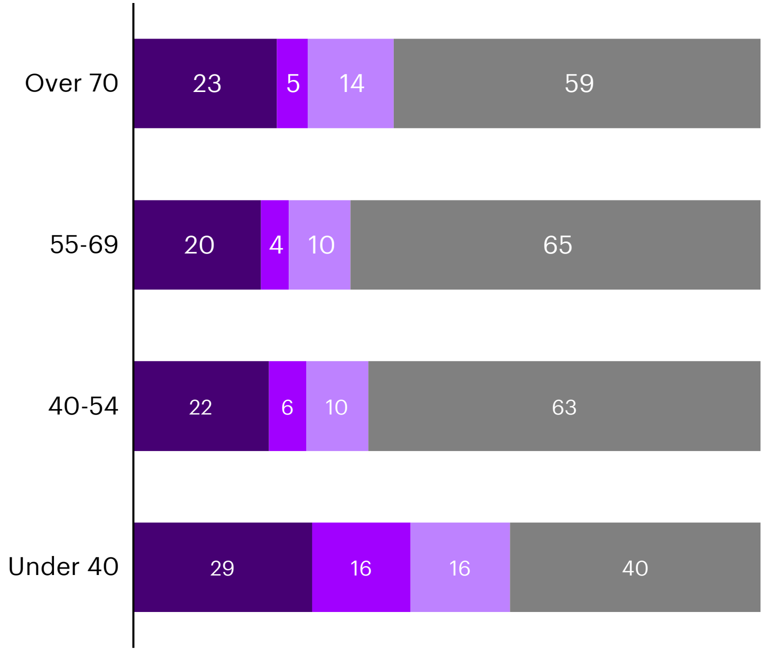
### Figure 27: Composition of household net wealth by income group

Percent of total




### Figure 28: Composition of household net wealth by age group

Percent of total




Housing Other nonfinancial Deposits Other financial

Sources: Federal Reserve Board, Accenture Strategy analysis

# References


**i** To arrive at the USD 10.2 trillion figure for the households' annual disposable income, we used the mean income after taxes per household, as suggested by the 2021 Consumer Expenditure Surveys (BLS), and multiplied by the total number of households in 2021 from the United States Census Bureau, Historical Households Tables.

**ii** NielsenIQ, How inflation is impacting private label sales trends globally, September 2022.

**iii** ECB, Private consumption and its drivers in the current economic expansion, May 2018.

**iv** Morning Consult, Measuring the impact of inflation on U.S. consumer spending, October 2022.

**v** Ibid.

**vi** Adobe, Online prices fall for fourth consecutive month, dropping 1.6% in December, January 2023.

**vii** IMF Working Paper, Analyzing the Effects of Financial and Housing Wealth on Consumption Using Micro Data. May 24, 2019.

**viii** Bureau of Labor Statistics, The Economics Daily, December 2022.

**ix** New York Fed Consumer Credit Panel/Equifax. Quarterly debt report, Q4 2022.

**x** Brookings Institution Who owes the most in student loans: New data from the Fed, October 9, 2020.

**xi** WSJ, The US consumer is starting to freak out, January 2023.

**xii** IMF Working Paper, Analyzing the Effects of Financial and Housing Wealth on Consumption Using Micro Data. May 24, 2019.

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