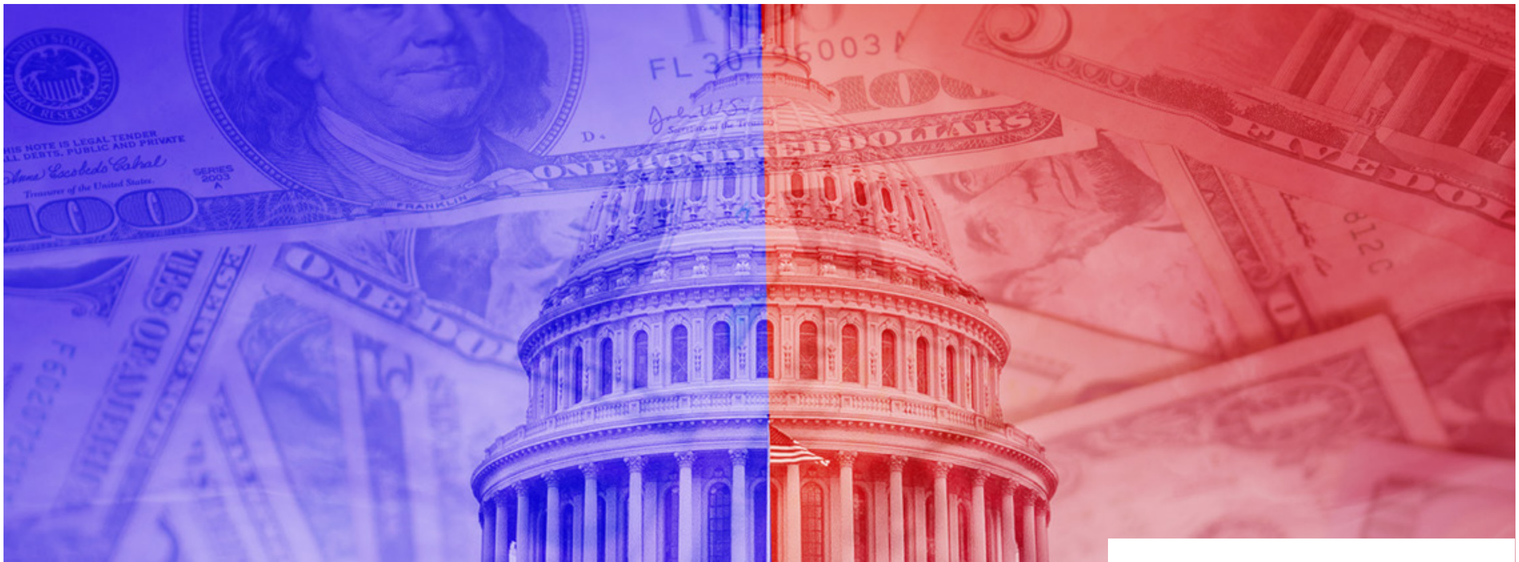


Conflicting Views on the Economy Complicate Policy Decisions and Political Messaging

We soon will be heading into the homestretch of a year that historians almost certainly will judge to be a most consequential one for several reasons, notably our upcoming presidential election. It is widely recognized that our nation has become more deeply divided politically over the past decade or so, with that division reflective of highly polarized opinions and positions on a host of social, cultural, public policy and economic issues.

There was a time when most Americans could generally agree on whether the economy was performing well or not, at least directionally. This no longer seems to be the case. A Harris poll conducted in May indicated that 56% of respondents believed the U.S. economy was in recession — a belief belied by the preponderance of economic data — along with other misguided views on how the economy is doing.[1] The Biden administration's attempts to tout the President's various accomplishments on the economic front ("Bidenomics") earlier in the campaign season mostly fell flat and weren't connecting enough with likely voters, many of whom said they weren't yet seeing its effects. Moreover, the various COVID-related financial relief measures for most Americans that ran into late 2021 got President Biden little love from likely voters prior to his exit from the race. Polling respondents continue to give President Biden low marks on his handling of the economy[2] despite abundant evidence that the United States is experiencing relatively healthy economic growth — far better than year-ago expectations and stronger than most other industrialized nations. The disconnect between economic statistics indicating resilience and public perceptions of a faltering economy is vexing, to say the least.

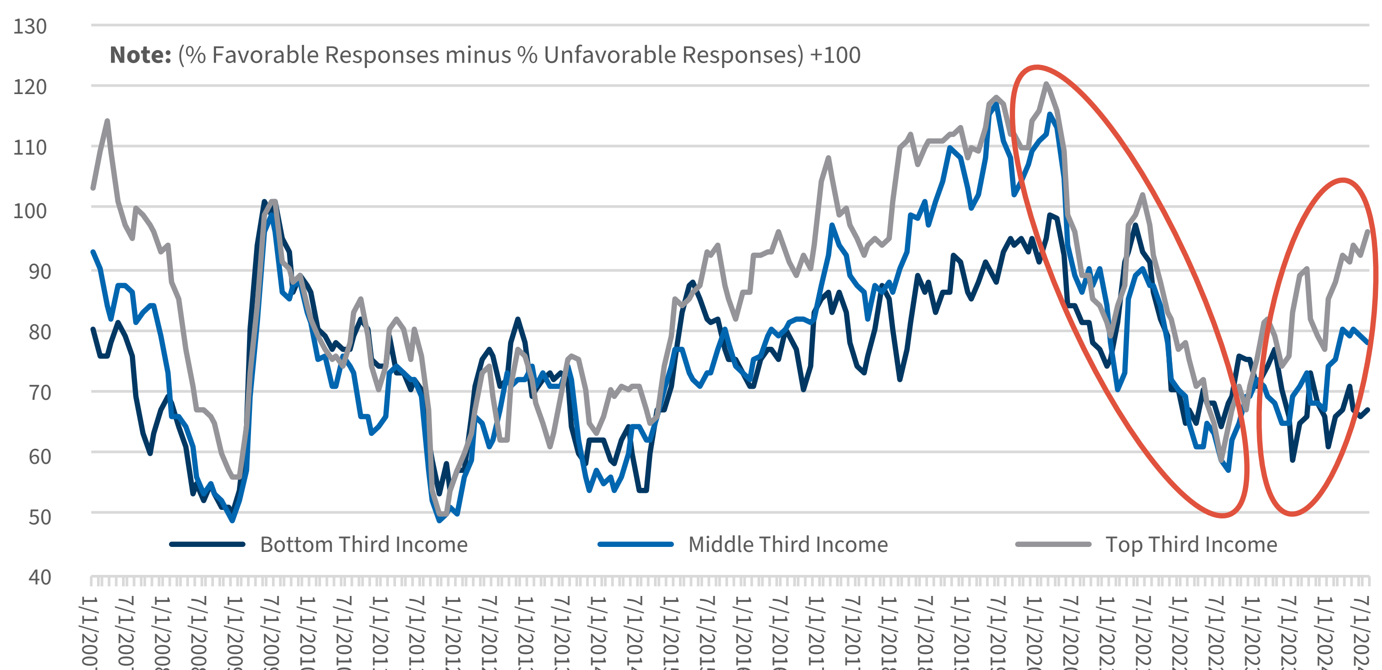
Americans may have starkly differing views on how the domestic economy is performing, and those perceptions are shaped more by income differences than by political party affiliation, though political leaning does influence economic perceptions for both Democratic- and Republican-identifying respondents. Higher-income households almost always have more upbeat views on the economy than lower-income households, but for decades, polling trends on economic matters by income cohorts at least could be counted on to move together directionally, more or less, albeit with a persistent gap separating them.

However, today some of these economic polling trends are moving in different directions when broken down by income groups. Meanwhile, nearly all U.S. equity indices, a daily market "poll" of how the economy is doing, are near all-time highs. To paraphrase Dickens, it is the best of times, it is the worst of times — and figuring how it all shakes out is a challenge for policymakers. Meanwhile, political messaging about the economy can be a fraught path for our presidential candidates and down-ballot politicians who make broad generalizations that don't consider these wide economic divides.

Despite an abundance of statistical evidence indicating that inflation has moderated significantly in the past year, high prices continue to poll as the leading economic issue for most Americans, no matter how many columns Paul Krugman writes declaring near victory over high inflation while explaining in wonky terms that the high prices many consumers continue to gripe about are either illusory or bias-influenced views. As recently as July, a Statista poll indicated that 25% of respondents said the most important voting issue to them was inflation/high prices, more than double the next closest response.[3] In many instances, incomes of less-affluent households have not kept pace with cumulative inflationary impacts, while most consumer goods prices are not falling, they are just increasing at a more modest pace. Those pundits or politicians who argue that inflation is no longer a problem do so at the risk of sounding tone-deaf or condescending to many millions of Americans who insist that high prices continue to make everyday life unaffordable. No amount of statistical data can convince these households that they aren't still suffering from the effects of inflation in their daily experiences. Most Americans can correctly sense when they are falling behind financially or getting ahead, so why shouldn't they be believed? Assumedly they would know if their incomes had kept pace with inflation since 2020. Declaring that the inflation battle is just about over is effectively negating the top concern of a large percentage of Americans who insist they still are struggling with high prices.

Survey data reveals the extent of these divisions. The University of Michigan's Survey of Consumers is a monthly reading of consumer sentiment on a variety of financial and economic topics. A recurring question asks respondents their opinion (good, fair or poor) of government policy to combat inflation and unemployment. For several years prior to COVID-19, the response pattern was typical, trending positively across all income groups but with higher-income respondents consistently being more positive than middle- and lower-income respondents (**Figure 1**). However, once COVID-19 struck, responses converged regardless of income

Figure 1 - Opinions About Economic Policy of the Government To Fight Inflation and Unemployment



Source: University of Michigan Surveys of Consumers group, plummeting in the months after the pandemic struck, rallying in early to mid-2021 with the passage of the American Rescue Plan and the vaccine rollout, and then plunging again in 2022 as high inflation took hold (**Figure 1**). During this period, response differences among income groups narrowed to their lowest levels in a decade, becoming negligible at times, as most respondents felt the same way on this issue. But this convergence started to unravel in mid-2023, when the Top Income Tercile (33%) began polling positively as inflation began to moderate while the Bottom Income Tercile has trended sideways or lower in that time. Currently, the response gap to this question between high- and low-income groups is at its widest levels in several years and is approaching a level seen in 2007 after the housing bubble burst but prior to the Global Financial Crisis (**Figure 2**). Clearly, respondents' views of government response to inflation (and unemployment) now differ significantly between income groups, consistent with what most Americans have been telling various pollsters for over a year.

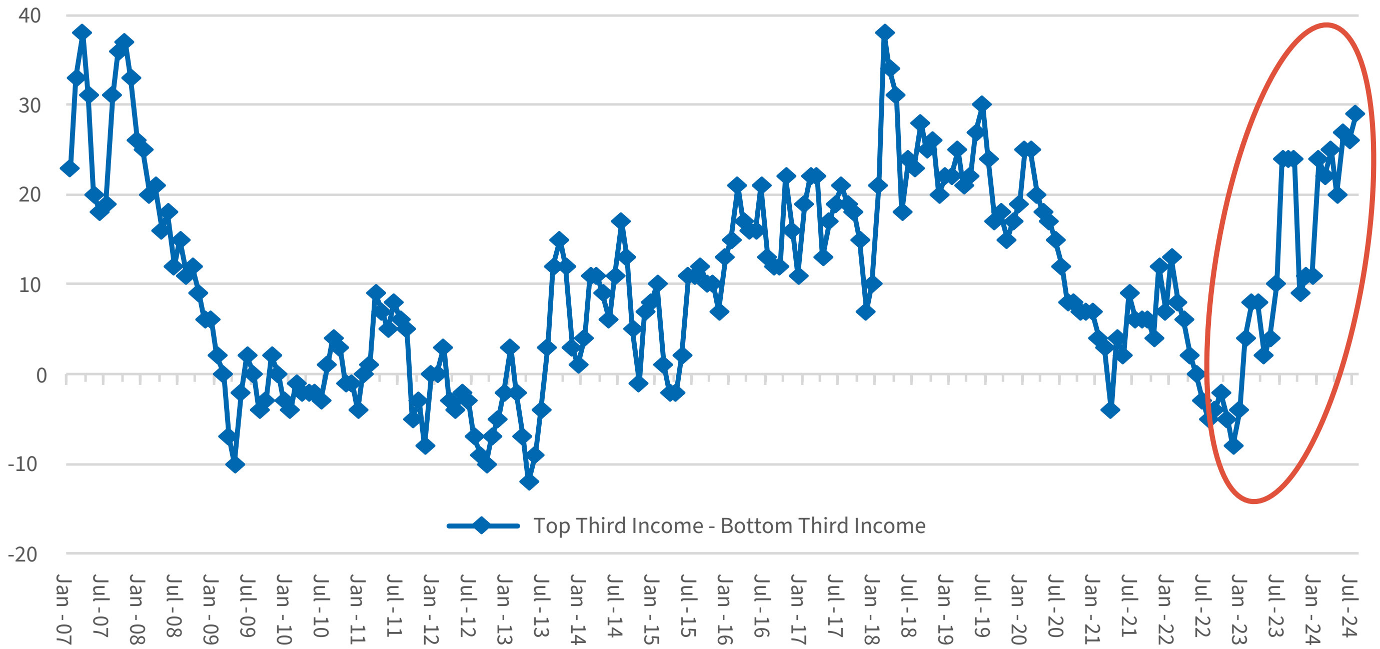
What could explain this divergence? The Bureau of Labor Statistics' annual Consumer Expenditure Survey reports[4] shed some light on this. For starters, the bottom two quintiles of income-earning households (i.e., the bottom 40%, or 55 million households with annual incomes under $50,000 in 2022) consistently spend more in total expenditures than they earn, causing them to borrow more as inflation takes a bigger bite of their spending budgets. Beyond exhausting all of their income, high inflation has a lasting impact on their finances, especially as the cost of credit increases. Its harmful impact carries forward and has an explicit added cost. The next income quintile (the middle 20%) barely earns more than it spends, and inflation surely has pushed some in that quintile into the red. It is only the top two income quintiles (i.e., the top 40%) that comfortably earn more than they spend, cushioning the blow of inflation. For the top income quintile (top 20%), inflation has been little more than an inconvenience, while accompanying higher interest rates allow them to earn more on financial assets, offsetting much of this impact. As for their expenditures, the top income quintile consistently spends as much as the bottom three income quintiles (bottom 60%) combined, meaning that their stepped-up spending can easily offset any spending cutbacks by lower- to middle-income Americans, potentially causing relatively robust top-line consumer spending growth to obscure what is going on beneath the surface. We hear about this anecdotally, as lower-income shoppers increasingly trade down to value-priced meals at their favorite fast food joints while hotels and flights for popular summer vacation spots were booked up months in advance. In such instances, aggregated economic data can be factually accurate and still be misleading.

As the Fed approaches its spotlight moment this month, it is very likely to enact its first cut in the Fed Funds rate in more than four years, some six months after financial markets first expected it to. Overall, the domestic economy has handled the Fed's monetary tightening policy rather well, with labor markets and consumer spending holding up admirably since mid-2022 in the face of the highest effective Fed Funds rate since 2000, though some pockets of the economy have been pinched harder than others, namely housing and commercial real estate.

The Fed has resisted pressure from financial markets and some politicians and market commentators to cut rates sooner, instead insisting on many months of persuasive data to solidify the case that inflation is under control before it moves. The Fed seems more wary of premature monetary easing later reigniting inflation than it is of an economic soft patch, and anyone familiar with America's recurring battle with inflation in the mid- to late-1970s can appreciate that concern. Another bout of inflation would be a gut punch for most households, while there is scant evidence to date of economic growth buckling under the weight of current interest rates, notwithstanding the weak jobs report for July. However, it seems the time has come when extended caution on the inflation front might do more harm than good, and so a highly anticipated rate cut is finally on the table this month.

What is less clear is how aggressive the Fed will be after that, and whether one or two more cuts of 25 bps will have much impact on the real economy going into 2025, especially for financially challenged companies and households. Markets may be overestimating the economic boost of gradual rate easing into next year as well as the benefits it will bestow to financially struggling Americans and the businesses that make and sell things to them. Cruise ship operators need not be concerned.

Figure 2 - Opinions About Economic Policy of the Government To Fight Inflation and Unemployment



Source: University of Michigan Surveys of Consumers

Endnotes

[1] Lauren Aratani, "Majority of Americans Wrongly Believe US is in Recession—and Most Blame Biden," The Guardian (May 22, 2024).

[2] Megan Brenan, "Confidence in Biden Economic Stewardship Historically Low," Gallup (May 6, 2024).

[3] "Most important issue for voters in the United States as of July 2024," Statista (July 30, 2024).

[4] "Consumer Expenditure Survey," U.S. Bureau of Labor Statistics.

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