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The 'value now' consumer: Making sense of US consumer sentiment and spending

US consumers' sentiment and their spending patterns have been out of sync. Here's how executives can make sense of the mixed signals.

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In McKinsey's latest ConsumerWise research, consumers report feeling more optimistic about the US economy than they have all year. Even so, US consumer optimism overall is still lower than prepandemic levels, and more than half of consumers (53 percent) report mixed feelings or being pessimistic about the state of the economy.

For decades, consumer sentiment and consumer spending have moved in sync—when people feel unsure about the economy, they spend less. But in the last couple of years, that hasn't been the case. Consumer sentiment cratered when inflation surged and has not really recovered. The same is not true for spending. In fact, our consumer research shows that, even when we adjust spending for inflation, in aggregate, consumers are spending more than they were before the pandemic and are spending more each year.

While some consumer categories are seeing spending growth slow, the US macroeconomy has been strong, buoyed by cooling inflation, still-low unemployment, and higher wages that have outpaced inflation. This has kept total spending moving but has not improved sentiment, which is still far below prepandemic levels. People's perception of their well-being has simply not budged.

What is going on? Why are consumers spending even as they remain pessimistic about overall economic prospects? It appears we have entered a new chapter in consumer behavior: the era of the "value now" consumer. In part to cope with feeling relatively downbeat about the economy, consumers today are optimizing their purchases, spending money in ways they think yield the greatest value, and ascribing value to purchases in new ways. Consumers aren't just chasing low prices but getting the best bang for their buck, oscillating between trade-offs and splurges, depending on the category. While they may not *want* to overspend, given their lack of optimism and concerns about prices, they seem to have the means to spend. And when they are really inspired, they'll splurge.

With sentiment no longer being a sure predictor of spending, consumer executives need a new, clear way to get an accurate picture of consumer preferences and behavior. Otherwise, executives may overlook strategies that would improve their performance both when spending is strong and during downturns.

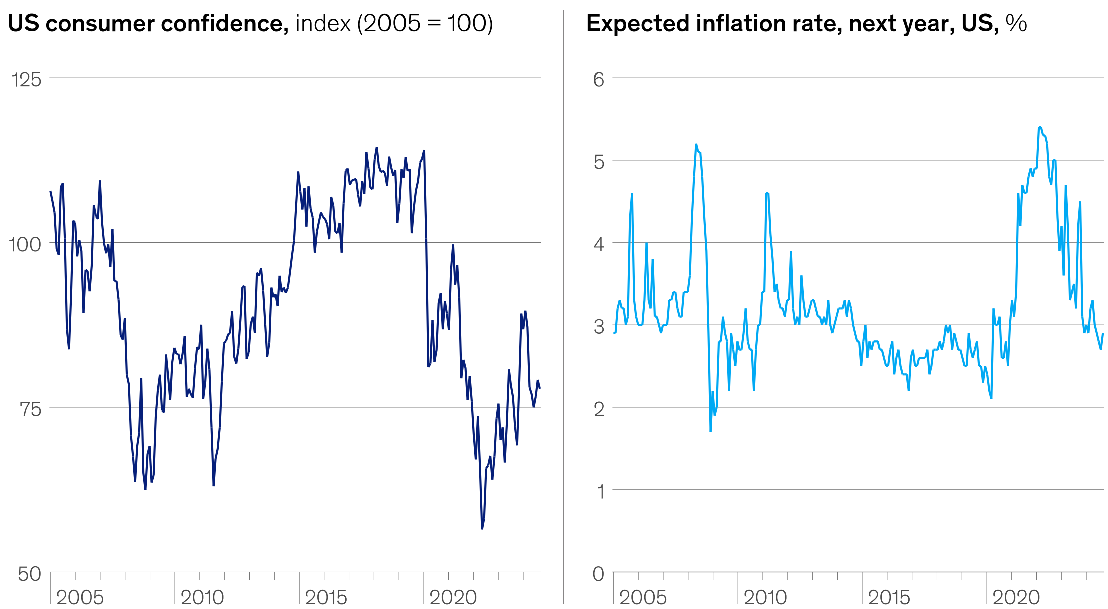
In this article, we'll look at the macroeconomic factors linked to consumer spending, the new dynamics shaping consumer behavior, and what consumer businesses should do about them. These insights can be helpful during periods of consumer uncertainty but will also be useful to consumer businesses should the economic forecast become clearer.

Low confidence despite lower inflation: What gives?

By several measures, the US economy is strong. Despite fluctuations in recent jobs reports, the unemployment rate was 4.2 percent in November 2024, a slight uptick from earlier in the year, but a near-historic low nevertheless. According to our research, private sector wages are up more than 25 percent since December 2019, outpacing inflation and driving real income gains across the middle- and lower-income brackets. Despite all this, US consumer confidence remains below prepandemic levels (Exhibit 1).

Exhibit 1

Even though inflation has slowed, consumer confidence remains below prepandemic levels.



Note: Data through Oct 2024.
Source: University of Michigan; McKinsey analysis

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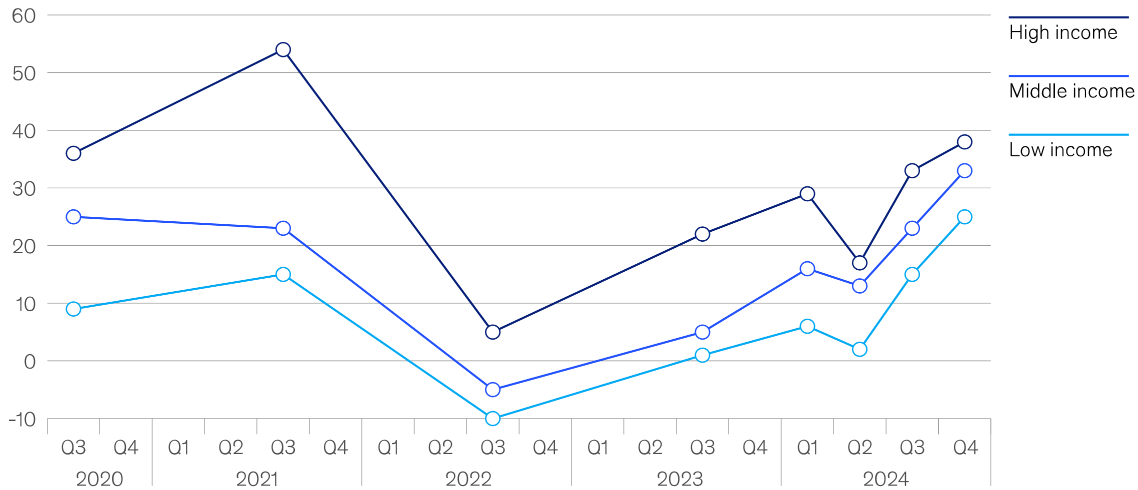
From January to April 2024, US consumer confidence rose to its highest levels since 2021. Even so, most consumers reported mixed feelings or pessimism about the economy, and from May through November, sentiment was again lower. Unsurprisingly, higher-income consumers reported feeling more optimistic than middle- and low-income consumers (Exhibit 2).

Exhibit 2

The economic-optimism gap between low- and high-income consumers has narrowed compared with early 2024.

Net optimism in US economic conditions, by income level,[1] %



[1]Net optimism calculated as the share of optimistic minus the share of pessimistic in response to the question: What is your overall confidence level surrounding economic conditions? Low income = annual income <$50,000; middle income = annual income $50,000–$99,999; high income = annual income ≥$100,000.
Source: McKinsey ConsumerWise Global Sentiment Surveys

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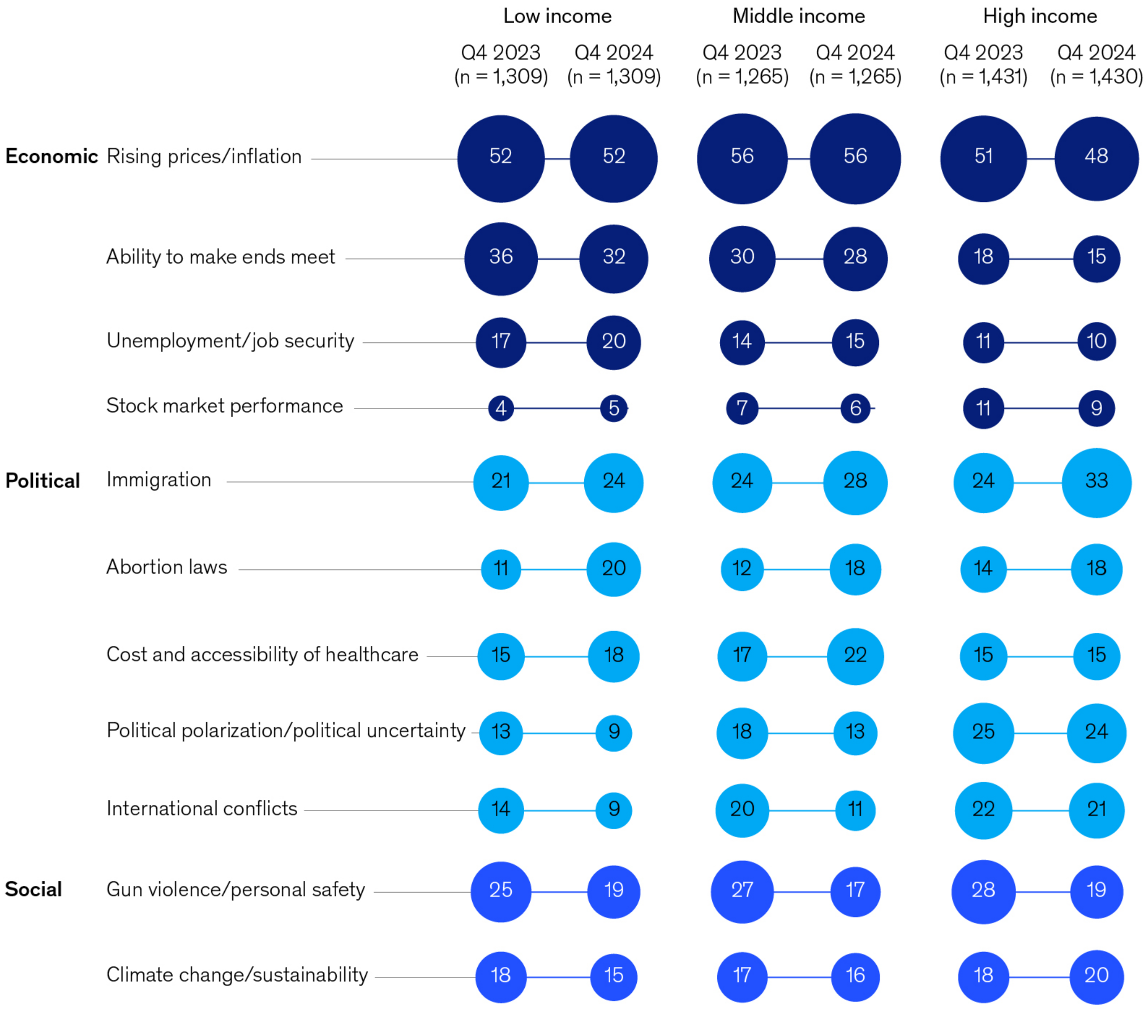
Higher interest rates and higher food prices are a bigger worry for low- and middle-income consumers than for high-income consumers. Indeed, we see these anxieties reflected in our consumer survey data: More low-income consumers report having economic concerns compared with high-income consumers, more of whom report having political concerns (to be sure, high-income consumers still report concerns about inflation) (Exhibit 3).

Exhibit 3

More low- and middle-income consumers cite economic concerns, while more high-income consumers report political concerns.

Share of respondents indicating issue is a top 3 concern, by income level,[1] US, nonexhaustive, %



[1]Low income = annual income <$50,000; middle income = annual income $50,000–$99,999; high income = annual income ≥$100,000.
Source: McKinsey ConsumerWise Global Sentiment Surveys

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Yet, people continue to spend more. In mid-2024, we asked consumers what they expect to spend in a variety of categories over the next three months, and they said they anticipated spending less across most consumer categories, particularly the nice-to-have discretionary categories related to experiences and self-expression. But in fact, real spending growth over that period was flat or grew for many of these categories (Exhibit 4).

Three categories of consumer spending decisions

The data reveal that consumers are ascribing value to their purchases in new ways. To illustrate this, we categorize consumer spending into three groups: economizing, maintaining, and splurging. At any given time, a single consumer could be economizing in some categories, maintaining spend in others, and splurging in others still.

Economizing on ‘lower value’ items

Consumers are both telling us they will spend less in the categories in which they are “economizing” and then actually spending less in these categories. This indicates that consumers perceive less value in these categories compared with other categories. Nonalcoholic beverages and cars and trucks are two examples of categories in which consumers are economizing. For some of these goods, macroeconomic factors may play a role in shaping consumer perception. Take cars and trucks: High interest rates and high prices reduce the perceived value of these goods in consumers’ minds compared with their value before those dynamics shifted. As a result, consumers might opt to spend on automotive parts and repair services to extend the life of older cars and trucks, rather than purchasing new automobiles.

Making trade-offs to maintain spend

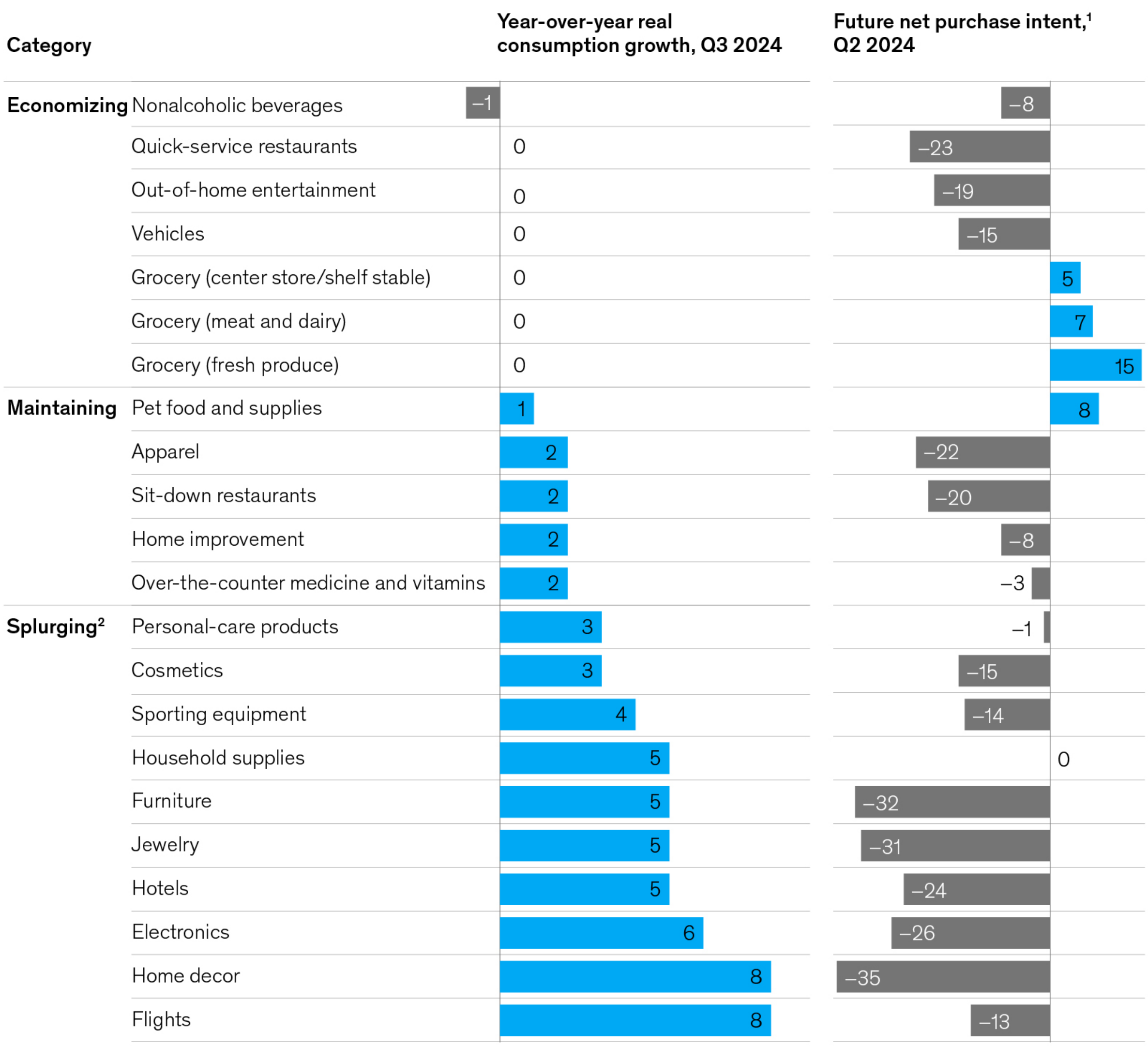
In some categories, the spread between net purchase intent—or the share of consumers who said they would increase spend in a given category minus the share who said they would decrease spend—and real consumption growth shows consumers maintaining their spending levels, even when they say they don’t plan to. This includes purchases on pet care services, apparel, and dining out at sit-down restaurants.

Food is another area in which consumers are maintaining their spend. Despite the impact of inflation on food prices, consumers have not necessarily cut back on their food spending. Instead, people across income groups seem to be evaluating how to get the most perceived value from their food purchases, which may include making trade-offs. Sometimes that means shopping at lower-priced retailers. (Some of these retailers, such as Aldi, are responding to increased demand for their goods by opening more stores, while others, such as Target, Amazon, and Walgreens, have announced price cuts to grocery and household items to stay competitive.) Other times it means cooking at home (often taking advantage of precut or partially prepared ingredients) instead of ordering from restaurants or buying food that is more convenient to prepare but might also be more costly.

Exhibit 4

Consumers said they would reduce their spending in most categories—but real consumption growth shows they did otherwise.

Consumption growth and future net purchase intent, by category, % (n = 4,000)



[1]Question: Over the next 3 months, do you expect to spend more, about the same, or less money on these categories than usual? Net intent calculated as share of respondents who said they would increase spend for the category minus the share who said they would decrease.
[2]Top goods/services with the largest divergence between intent and real consumption growth. Not comprehensive.
Source: Bureau of Economic Analysis (accessed Q4 2024); McKinsey ConsumerWise Global sentiment data

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Consumers are also ascribing value to food-related spending in new ways. For example, they are spending more at sit-down restaurants, and they are also maintaining their spend on fresh food (no surprise, given the growing interest in health and wellness). This suggests consumers want to have elevated food experiences, though we do see them trading down in subcategories where they find private label brands satisfactory. One takeaway for business leaders: Consumers will spend more on branded food, but only if they perceive there to be value differentiation from private labels. Category innovation that excites consumers or offers them a new experience is especially important here.

Splurging on 'high value' goods and services

Consumer behavior has been most incongruous with sentiment when consumers have splurged. This has happened even though consumers reported plans to cut back on spending on some categories, such as hotels, flights, home decor, and electronics. In reality, consumer spending in these categories has increased. Consumers across income and age groups have selectively splurged for much of the past two years, though the intent to splurge[1] is highest among high-income Gen Zers and millennials.

The experience economy—US consumers' shift of their spend away from products and toward experiences—has driven much of consumer splurging over the past year (though its prevalence emerged years earlier). Consumers with disposable income splurge on flights and hotels; consumers with less cash, meanwhile, often report splurging on experiences such as dining out. Purchases related to self-expression have also accounted for some of the consumer splurging.

Can consumers afford to keep spending?

A range of economic factors show that consumers are in better shape than sentiment indicators and survey data suggest. It's worth noting that consumers in lower-income brackets have felt the squeeze on their wallets due to inflation, higher borrowing costs, and high home prices and rents. Delinquencies on auto loans and credit cards have been rising since interest rates began moving up, reflecting this stress.[2] Even so, consumers are still spending. Consider the following factors:

— *Income growth is strong across the income distribution.* Our analysis shows that households with an average income of around $48,000 in 2023 saw their income increase at an 8.1 percent annual rate from December 2020 through June 2024, or 2.6 percent annually in inflation-adjusted terms. Households with an average income of around $135,000 saw a 7.4 percent annualized increase, or 1.9 percent after inflation, according to our research.

— *Households held $8.7 trillion in cash in June of 2024.* This is nearly twice as much cash when compared with disposable income and pre-COVID-19 norms. Looking across the

[1] In McKinsey's ConsumerWise Surveys, "intent to splurge" is defined by quantifying the share of respondents who answer affirmatively to the question, "about products and services you will spend money on, do you plan to splurge/treat yourself over the next 3 months? For example, are there categories of products or services where you expect to make more expensive purchases than normal or purchase something to treat yourself?"

[2] Data from the *Quarterly report on household debt and credit*, Federal Reserve Bank of New York. November 2024.

income distribution, liquid assets held by the middle 60 percent of households ranked by income also jumped post-COVID-19 and remain near record highs.[3]

— *Consumer borrowing has risen, but so has income.* Looking at household debt-to-income ratios, households' leverage is in fair territory. This is true both on average and across the income distribution. As noted, 90-plus-day delinquency rates on credit cards and auto loans have risen since rate hikes began. Companies should keep an eye on these metrics, but these rates are not yet outside of what we have seen historically.

How to capture a clearer view of the consumer

In anticipating the pullback on aggregate consumer spending that never was, consumer businesses have left gains on the table. For example, after the global supply chain largely recovered from its pandemic-era shocks, many companies planned for a contraction in consumer spending and did not invest in additional production capacity. As a result, those businesses left sales on the table as consumers sought the products they needed elsewhere.

So will the other shoe drop? While spending across certain categories has decelerated, there has not been a wholesale pullback in spend. The cost-of-living crisis and higher-than-usual inflation have made life more difficult for lower-income consumers (consumer businesses that serve these consumers are seeing some pullback on spending). But if the job market remains strong, wage growth continues to outpace inflation, and household cash holdings remain high, the trends suggest consumers will likely continue to spend.

Still, in the face of this uncertainty, consumer executives would do well to invest in capturing a clearer and more predictive view of the consumer. As we've noted, consumer sentiment is just one metric businesses and economists can use to analyze consumers' spending habits. Companies should consider three additional themes to assess consumer behavior:

— *Overall stock of cash versus flows of cash.* If consumers have more cash in the bank, they can still spend. However, as their savings flow turns negative, they could decelerate spend.

— *The "value" of a set of goods or services.* Consumers are prioritizing certain categories over others based on the value they ascribe to the product or service. For example, experience-based goods—or goods that might elevate a consumer's experience through their use or are a means of self-expression, such as jewelry—are growing faster than goods less associated with experiences. Food brands with better flavor, nutrition, and/or a stronger connection to the consumer are competing with private label brands, which consumers have traded down to over the past year, to a greater extent.

— *Relevant segments of consumers.* Companies will benefit from deeply understanding their

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[3] Average incomes ranging from $45,000 to $130,000 for the 2nd and 4th quintiles.

customer base. Do potential consumers skew low- versus high-income? What do they value? Where do they shop today? Where might they shop tomorrow?

Gaining access to more real-time data to develop a granular understanding of the consumer will help. To that end, artificial intelligence and generative AI (gen AI) allow businesses to see consumer behavior in real time and forecast upcoming demand. A variety of data sources, such as social listening, transactions, and credit card data, can help personalize content, product recommendations, and offers at scale.

Take Walmart: In October, the retailer rolled out its Walmart Luminate Insights Activation platform, a self-serve tool that its suppliers can use in combination with the retailer's media solutions platform to drive sales. Consumer-packaged-goods players can use the platform's insights to analyze online shopper behavior before a purchase and to inform product development and retail strategies.[4] Multinational consumer goods companies have already started to use the platform.

Finally, consumer businesses must consider not only demographics but also psychographics and behaviors when conducting consumer segmentation. Understanding to what and why consumers ascribe value both from a functional (meaning convenience, performance, and quality) and emotional (meaning a sense of achievement or peace of mind) standpoint will help differentiate products and services. Consumer executives should identify the functional attributes and emotional value their products or services offer consumers. By pinpointing these attributes and values, brands will be able to better drive engagement and purchases within target consumer segments.

No matter how sophisticated data on consumer spending might become, no consumer executive has a crystal ball. Investing in growth while controlling costs, regardless of the business environment, is the next best thing: Businesses that drive growth during a downturn outperform their competitors and deliver higher-than-average total shareholder returns for years to come. To do that, consumer businesses will need to go on the offensive and invest in both their product offerings and their marketing.

Leaders can also plan for multiple realistic scenarios, modeling out actions that are "no regrets" and making investments where necessary. The key question for executives to ask is, "What, if anything, would we do differently if we knew which scenario will play out?" Based on this answer and their risk appetite, leaders will determine which combination of offensive and defensive strategies is best for their business.

In short: Consumer executives should pay attention not only to what consumers say but also to what they do, while investing in the right tools. Otherwise, consumer businesses will be left in the dark.

[4] Lisa Johnston, "Unilever eager to tap into Walmart's new on- and off-site consumer insights," *Consumer Goods Technology*, June 6, 2024; *Walmart Connect Blog*, "Walmart Luminate Insights Activation now available on Walmart Connect," blog entry by Bhanu Bhardwaj, October 2, 2024.

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