Why the Holidays Could Be a 'Last Hurrah' for a Stretched U.S. Consumer

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The year is shaping up to be more fruitful than many retailers expected. But several companies say they squeezed a bit more out of drained shoppers—and economists say demand could dry up next year.

Sales were stronger than expected this fall, encouraging companies like Gap(GAP), Ralph Lauren (RL), TJX Cos. (TJX), E.l.f. Beauty (ELF), Home Depot (HD) and Walmart (WMT) to raise their year-end forecasts even as executives highlighted signs of consumer strain.

Shoppers are choosing cheaper brands, stocking up during sales and holding off on big-ticket buys, company leaders said. Many Americans are working hard to cover basic expenses after years of stubborn inflation, while wealthier consumers are holding off on large purchases, economists said.

"After the pandemic, people were buying a lot," said **Bernie Baumohl**, chief global economist at The Economic Outlook Group. "But you reach a saturation point. You've got all the flat-screen TVs, [all] the cars you need."

Consumer Spending Grows, Incrementally

Americans' feelings about the economy have improved in recent months, but consumer sentiment remains below pre-pandemic levels, according to the University of Michigan's Consumer Sentiment Index. Economists have been surprised by increases in core retail spending, which rose 0.4% in October, according to Commerce Department data. Meanwhile, credit delinquency rates remained "elevated" in the third quarter as credit-card balances rose, according to the New York Fed.1

Brands have capitalized by catering to a widespread hunt for lower prices. Marshalls and T.J. Maxx, "crush competition on value," the CEO of their parent company, Ernie Herrman, told analysts last week. Old Navy has made inroads with moderate- and high-earners, Gap CEO Richard Dickson said. And households with six-figure incomes propelled Walmart's growth, CEO Douglas McMillon said

Walmart has slashed prices on thousands of items, as did Target (TGT). But the third quarter was harder on Target, a business built less on kitchen staples, and more on apparel and other discretionary items. Target did more transactions last quarter, but they tended to be for smaller sums, executives said, with customers showing a more “pronounced” response to promotions than a year ago.

“As we look at shopping behavior and, certainly, behavior we've seen in Q3 and we expect to see going into Q4, we know that consumers are looking for value,” Target CEO Brian Cornell said recently. ”We think that's going to continue.”

High-Income Households Pull Back on Big Purchases

Many consumers are searching for ways to save on essentials, said Chedly Louis, vice president of corporate finance at Moody’s Ratings, but those with more money have an easier time taking advantage of savings strategies.

“That low- to mid-income consumer is generally going to the grocery store more often, but basket sizes are smaller,” said Louis. “That mid- to high-income consumer is more willing to shop at a Costco, at a Walmart, and buy in bulk.”

Affluent Americans are still spending relatively freely, said Oren Klachkin, a financial market economist at Nationwide Mutual Insurance Company. But they're reluctant to make major purchases because of high interest rates and uncertainty about how the next president's policies and geopolitical conflicts may shape the economy, he said.

That has curbed big-ticket sales at several retailers. Target shoppers are passing up TVs in favor of smaller indulgences like candles and vases, according to Executive Vice President Rick Gomez. Major home renovations have slowed, according to Lowe’s and Home Depot, which said transactions above $1,000 fell nearly 7% year-over-year in the last quarter. And demand for furniture is relatively weak, La-Z-Boy (LZB) and Williams-Sonoma (WSM) executives said on recent earnings calls.

The holiday shopping season may turn out to be a "last hurrah," according to **Baumohl**. "Consumers are fairly optimistic about the outlook for the economy,” he said. But “come next year, we’re going to see some of that confidence fade in large part because people are going to face the reality of their personal finances."

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