

Research @ Citi Podcast, Episode 51: Are U.S. Consumers Still Consuming?

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Guest: Steven Zaccone, U.S. Broadlines and Hardlines Retail Analyst, Citi

Anne Malone (00:00)

Hi, everyone. Welcome to the Research @ Citi podcast. I'm Anne Malone, the North America Head of Equity Research at Citi. I'm pleased to introduce Steve Zaccone, who covers Broadlines and Hardlines at Citi.

Today we're going to cover a whole bunch of things, all of it surrounding the consumer, spending trends now, and, of course, what the future holds. Steve, it's great to have you here.

Steven Zaccone (00:25)

Thanks, Anne, for having me on. Happy to be here.

Anne Malone (00:38)

The other day, a client approached me and was pretty excited and curious and asked if analysts get frustrated when we're in a market that's so overshadowed by macro factors, implying that fundamentals don't seem to hold as much sway.

In my mind, the consumer space is a new twist on that. One would think the macro would have more impact on consumers, but the resilience is so notable. And I think you and the team tried to cover that in your recent Macro-to-Micro note. What's your take on the consumer?

Steven Zaccone (01:00)

Yeah, I think it's a great question. And we tried to dig in on this in this note. We brought together 12 analysts, the economics teams, so we really got a broad view.

And, you know, "resilient" is the word that we've heard. And I think it really makes sense, because it's been an uncertain time in terms of the consumer backdrop. There's been challenges that we've had to deal with, whether it's been tariffs that have popped up this year, geopolitical uncertainty.

On the flip side, there have been some tailwinds. The wealth effect is very real for the middle- to upper-income consumer. Equity markets are at all-time high. Housing prices are high.

The unemployment picture has been held in. It seems to be weakening a bit, which we can go into. But still, generally speaking, things have been pretty good from an economic backdrop.

So, I'd say resilient is a good theme. There are certain categories that have been better than others, but resilient has been the theme we've heard, and it seems to continue to be the view going forward.

Anne Malone (02:06)

And that's the Citi view, that this resilience and the tailwinds and headwinds are still going to continue?

Steven Zacccone (02:14)

Yes, yes. The Citi view: No recession on the horizon, right? We've seen somewhat of a weakening labor market, which could be something to watch in the back half of the year. We are seeing tariff costs trickle into products. That's going to be something that's a focus for the consumer as we get into the fall here, and then most notably into the holiday season. Are you going to have to pick what you're going to purchase because prices are up?

But yeah, I think the offset is rate cuts are happening, which should be a tailwind. You still have that wealth effect. Balance sheets are in good places. That higher-income consumer is probably driving most of the spending overall. And you've had some fiscal policy, with the tax cuts that are becoming permanent, which should be a tailwind as we get into 2026. It seems to favor more the middle- to upper-income consumer, but these are all tailwinds that continue.

Anne Malone (03:11)

So many different ways I could take this conversation, but I'm just going to pick one. Let's start with tariffs.

Some of the numbers in that report, the wallet winners and losers are pretty stark. I'm going to quote you: "The effective tariff rate on U.S. imports is just a notch or two below 20%, up from around 2.5%." What does that do to prices, inflation, and — maybe most importantly — my credit-card balance?

Steven Zacccone (03:39)

Yeah, prices are up, right? And I think there are certain categories where it's worse than others. So, if you think about furniture, it's really the poster child of "we don't really do that in the United States" in terms of production. And even some production that's done here is imported. So that's an area where pricing could be up mid- to high single digits, maybe even double digits. And it probably staggers in terms of price increases.

There's other places where if you're largely domestically sourced or you don't have as much pricing increase, maybe you're only up low single digits. But in terms of goods, that is where you're seeing a lot of inflation.

On the services side, take a restaurant's world, for instance. You're not going to see a lot of tariff inflation there. The theme there has been really labor costs have been up and food inflation, and that's been an ongoing theme. It's not necessarily a new shock this year. If anything, it's probably easing a bit, like services inflation.

So, when you think about the areas that are really most impacted by tariffs and that 20% number you cited, it's more the hardline retail categories that are imported goods.

Anne Malone (04:54)

So is the thought we haven't seen inflation, or we haven't seen inflation yet?

Steven Zacccone (05:03)

We've seen inflation, right? I mean, if we rewind to 2021, 2022, we saw a lot of inflation. And I think what was different then is the consumer was flush with cash. And you were able to pass that price on, there was relatively inelastic demand, if we go back to Economics 101.

I think the focus here in the back half of the year, as you start to see tariff costs trickle in, is "What is the elasticity of demand?" There are certain categories — take auto-parts retail, for instance, which is needs-based. Your brakes are broken, your battery dies, you have to fix it. You can only defer that for so long. That's a relatively inelastic product. That's imported.

Furniture, electronics? A little bit more discretionary in nature. Maybe you'll be more choiceful if certain product pricing is up a lot. Maybe you'll defer something and make an alternative purchase. I think that's where there's a very big focus on elasticity of demand as we get into the back half of the year.

Anne Malone (06:13)

So this is probably a good time to start talking about the wealth effect. And from that, I can't help but connect it a little to the subcategories, right? Because not everyone needs to go on a cruise, but everyone needs to eat. So let's talk a little about that. It seems saying the consumer is resilient very much has to do with where you are in the wealth effect.

Steven Zacccone (06:38)

Yeah, the middle- to upper-income has really been leading. And part of that is driven by the fact that you've had this wealth effect with asset prices at all-time highs, led by the equity markets. Housing prices are still high. You have good balance sheets. And in terms of the employment picture, white-collar employment is still really strong.

Where we've seen some more challenges has been on the lower-income side. They're perennially challenged, but I think they've also been dealing with very high inflation for food for the last couple of years and other areas of inflation.

If you look forward, it still feels like the middle- to upper-income are going to be the ones that outperform. They're probably able to deal with a little bit of tariff cost inflation. Equity markets, if they continue to grind higher, that's a net positive for that group. And if the labor market weakens just for the lower-income consumer, it probably doesn't trip up that middle- to upper-income.

So where does that benefit? I mean, you tend to think of categories that are exposed to the homeowner that probably sees a recovery. There's a debate a little bit more on rate cuts there in general. Luxury is an area that's kind of lagged, but maybe that has a bit of a recovery. If you think of just the secular shift in spend, travel has done well for the U.S. consumer. That probably continues. You think of some of the leisure and hotel ways to play that.

I think conversely, on the lower-income side, when you look at staples, that's been an area where you have seen some weakness. Even in restaurants, you have seen some weakness. And that's where that lower-income consumer is prioritizing how they spend their dollars. Do they have to trade down to private label when they go to the grocery store? Do they have to prioritize how far their dollar goes when they're going to a quick-service restaurant? Is there one choice that you get a better option or value than others?

So I think the lower-income is one where you've really had a focus, if the consumer has to make choices. Middle- to upper-, I don't think you've had that as much. We'll see if that changes over the next six to 12 months, if you feel a little bit more tariff cost inflation. But that low-income is where you've had to make more choices.

Anne Malone (08:51)

It's now three quarters of the way through 2025. Is there any conversation that needs to be had on COVID or post-COVID, or recovery from there, or things that have changed permanently? Or are we past that conversation?

Steven Zacccone (09:08)

It's a good question. It feels like we're past the hangover period, right? In the report and some of the good government data that's out there, there's a good focus on personal consumer expenditures and durable goods have kind of stabilized. They were areas of weakness the last couple of years as there was that pent-up demand to travel and go out to eat. And 2024 and then 2025, we've really seen a stabilization in terms of those goods categories. People are buying the TV, buying the appliance, right? Like there's replacement cycles in furniture. We'd love to see rate cuts happen for some of these big-ticket goods. And we'd love to see the housing market improve because that really gets some of these categories going. But generally, we've seen a stabilization.

I would say from a services perspective, we outperformed in the period past the pandemic. You've probably seen some normalization. People probably push back on going out to eat at restaurants when the pricing gets a little bit too high. So it feels like we're in a bit of a normalization after some really strong years of growth in those sectors.

Anne Malone (10:17)

Isn't it amazing? Five years ago, the common wisdom was no one would ever cruise again. And look at that area of strength. Let's talk about resilience.

Unemployment — you said you wanted to touch upon that a bit. And is that, again, back to our lower-income vs. middle-income? That the spike in it is in that same consumer who seems stressed?

Steven Zaccone (10:42)

I think so. That's a big focus right now because when you look at some of the consumer-sentiment data out there, it's not great. It's deteriorated. I think some of that, though, is a bit more weighed towards that lower-income consumer that you've been feeling years of grocery inflation that's very high, right? Now, maybe the unemployment picture is weakening a bit. I think that's the focus going forward.

I said earlier, the low-income consumer feels perennially challenged, and I think that holds true. The tax cuts that are going to become permanent, there's good analysis looking at some of the refund checks that could go out next year, that they're somewhat retroactive. So, there could be some benefits to the consumer that hit in the first quarter of '26.

But the sweet spot is like \$90,000 household income and above. So it still feels like that middle- to upper-income consumer is going to be in a better position. Now, the Fed has noticed it, right? And I think they've recognized that the labor market is weakening. So it's nice to see you've got that caveat that you could see some rate cuts, which should be stimulative anyway. But I think that could probably benefit that middle- to upper-income consumer anyway. It could be positive for asset prices, which is really on the balance sheet of a middle- to upper-income consumer more broadly.

Anne Malone (12:04)

E-commerce, we don't talk about that as much as we used to. Do we all know it exists, and the shift is largely over? I have to admit I'm still someone who heads into a store, but I do use my Amazon account. So where does e-commerce play into this?

Steven Zaccone (12:25)

It's a great question. The biggest shock in terms of e-com is probably over, right? In terms of the increase as a percentage of retail sales, you're running in 21%, 22% of

overall retail sales today. Our forecast in this report we did with our internet team gets to like 27% by 2029.

Anne Malone (12:50)

Is that a U.S. number or a global number?

Steven Zaccone (12:52)

That's a U.S. number.

Anne Malone (12:54)

And I assume the rest of the globe is running behind?

Steven Zaccone (12:56)

Probably lower. Yeah, I would think so. I mean, Amazon is leading it, right? We cover some of the big retailers as well, the Walmarts, the Costcos of the world. The shock has really happened. Now it's just like a continual grind higher.

I think what's fascinating with e-com is, "How does it change with the growth of AI?" Because I think there's implications for consumers, how they search for product. And that has ramifications for, "How do I get to this retailer that I used to previously just go to a search engine and look it up?"

I would get to retailer ABC; now it's like, "How do I survive in the world of the ChatGPTs?" There's elements of how shopping changes where you may have AI shopping for you and you don't really go to the store. It's really powerful, too, for some of these retailers where years ago you go to a home-improvement store because the person who worked there knew how to do the paint, or the plumbing, or whatever. Now if you've got an associate that has some AI capabilities and tools at their disposal, they can really help you make that purchase.

So I think that's really the next step function when it comes to the consumer and how they make purchase decisions. How does AI inform those decisions? And who are the companies that are really prioritizing the investment to gain that share?

Anne Malone (14:19)

We went almost 15 minutes without bringing up AI, that was kind of an impressive record. Outside of retailing though, do you see a big impact? I think AI, that first thought is always customer service. So, I guess leisure, hotels, restaurants, they can all find some productivity gains as well?

Steven Zaccone (14:42)

Yeah, it's probably productivity gains there. I would think that's probably the opportunity. What we've heard from retailers is the search function is the first thing because so many companies were built on, "I go to Google, I search 'comfy couch,' and it's going to send

me to the top locations.” Right? Now if you're not starting your search journey there, where do you go?

From a productivity standpoint I think that's where it can probably help into leisure and stuff. In the restaurant world, I think we've seen automated kitchens, that's a big theme that Jon Tower can probably elaborate on in his space. But there's definitely changes that are happening and it's a continued area of investment for these consumer companies, both capex and opex.

Anne Malone (15:31)

Right. Across every space, right? So no reason that consumers should be any different. Before we get to closing this out, I can't believe it's September. So, what are you thinking about for holiday? What's the thoughts there?

Steven Zaccone (15:44)

The forecasts from industry-wide, even ours, are fairly encouraging. Last year was a good holiday season. If you remember last year, the election caused a lot of distraction for the consumer, call it September, October. And then what we saw was just a relief, regardless of what political party you were. It was like, “Oh, it's over.” Right? “The headlines, I don't have this distraction anymore.” So people really went out and spent during the holiday season last year.

So it is somewhat of a tough compare. But I think the view right now is cautious optimism. I brought it up before, and I think it's important to highlight though, is that you're going to see some tariff costs trickle into the assortments. And I think the messaging from a lot of consumer companies is they started post-Labor Day, that's when you started to see bigger price increases. And we'll have to see how that plays out.

I think there are certain categories that are going to be more inelastic. I would think because of the tariff costs, you're going to see a lot more promotional messaging. Like, “Who's going to be able to drive traffic?” But cautious optimism is how most people think about holiday.

The last thing I'd say is these tariff things, it's very unknown, because you could see a scenario where things come in a little bit weaker than expected — there are certain categories where things can get very promotional. Paul Lejuez covers some of the apparel names, and he's a little bit more cautious, just because it's difficult to pass on price in categories where you don't historically have pricing power — some of the categories where you're more inelastic, like grocery, auto parts, retail. Even home improvement. You can pass on that price and others where it's much more competitive of an industry. It's challenging.

Anne Malone (17:30)

Talk about cautious optimism. Let's finish it with, "You've laid out this view, what could derail the consumer?" What's the one thing that is the most worrisome that could derail the whole thing?

Steven Zaccone (17:42)

What worries me is we've grinded higher in terms of the equity markets for the last three years. You had two years in a row of 20% returns for the S&P 500. This year continues to be really strong. If you see a pullback in the equity market of greater than 10% or 20% again, I think that's always a concern for that middle- to upper-income consumer. That's holding up spending.

And then I would say the employment picture. It's weakening a bit. It seems like the Fed has a handle on it and will cut rates. If it really deteriorates, that would be an incremental concern. I think the equity markets have been long and strong. If that changes, then you have that middle- to higher-income consumer that has to rethink how they spend.

Anne Malone (18:28)

Makes sense. Thank you, Steve. Always an interesting conversation.

This podcast was recorded on Sept. 24, 2025. Be sure to join us for our next Research at Citi podcast, which will feature our U.S. economist, Veronica Clark, with Rob Rowe, and they'll be doing a Fed update. Thank you.

Disclaimer (18:46)

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