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HUMAN RESOURCES & PAYROLL

Inflation Weighing on American Households

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Apr. 25, 2017

As interest rates continue their steady climb from historic lows, Americans are starting to feel the impact on their finances. In fact, increased inflation outweighed historic stock market highs and increases in home equity, leading to a 1.6 point decline in the Q1 2017, [Personal Financial Satisfaction Index \(PFSi\)](#).

A 3.2 point increase in the Personal Financial Pain Index, only partially offset by a 1.7-point Pleasure Index increase, led to the quarter-over-quarter *PFSi* decline. Despite the decline from the previous quarter, the *PFSi* is still firmly positive – at 17.5 points – meaning that Americans are feeling a good degree of personal financial satisfaction.

Despite the continued increase in inflation, the Q1 2017 *PFSi* results are strong in many areas. Home values in many areas are rebounding to pre-crisis levels and there have been sharp increases in New York City, Dallas, Seattle and San Francisco. In addition, a slight growth in job openings with a high number of available positions in the education and health services industries and particularly strong growth in the real estate sector.

Loan delinquencies, including mortgages, came in lower this quarter and have experienced a substantial turnaround since their high water mark in 2010. In addition, while underemployment was stagnant this quarter it is still significantly above the pre-recession norms. While all of these are good signs for consumers' financial satisfaction, the historic highs in the stock market were the single biggest contributor to the *PFSi*'s positive value this quarter. Particularly, information technology and health care stocks experienced sharp gains from Q4 2016.

“The recent stock market rally has put an exclamation point on the post-recession bull market, with investors seeing significant gains both quarter-over-quarter and year over year,” said Leonard Wright, CPA/PFS, member of the AICPA's Personal Financial Specialist (PFS) Credential Committee. “With stocks at or near historic highs, it's a great opportunity for Americans to take a look at their asset mix and consider rebalancing their portfolio and locking in recent gains.”

Interestingly, the *PFSi* has tracked with Americans overall feelings about their personal finances. A March 2017 telephone survey, conducted by Harris Poll on behalf of the American Institute of CPAs (AICPA) among 1,018 adults, found that Americans who were satisfied with their personal finances (64 percent) outweighed those who did not feel satisfied (35 percent) by nearly a two-to-one margin. However, there is room for improvement as only 13 percent feel completely satisfied with their personal finances while 16 percent are not at all satisfied.

Despite the overall positive results of the *PFSi*, Americans' personal financial satisfaction could be imperiled by rising inflation, which has been leading the rise in the Personal Financial Pain Index. In fact, rises in inflation run the risk of outpacing gains in hourly wages, essentially erasing workers' raises. Adding to the pain caused by inflation, personal taxes rose up slightly – and have been increasing slowly, but sporadically since 2009 – and are now in line with levels seen before the great recession.

Year-over-year statistics show a more positive story, with the *PFSi* up 2.1 points compared to Q1 2016. This increase has been driven primarily by gains in the stock market, captured in the PFS 750 Market Index and increases in economic optimism, captured in the CPA Outlook Index – both proprietary AICPA data. In addition, there has been a substantial decrease in loan delinquencies. However, the single biggest factor holding the *PFSi* back from greater heights is the sharp rise in inflation, which has moved from near-historic lows closer to a more traditional level.

According to the March AICPA survey, many Americans (41 percent) have felt an improvement in their personal financial satisfaction over the past year, with 14 percent saying their personal financial satisfaction has improved substantially and 27 percent saying it improved slightly. Only 17 percent felt a decline in their financial satisfaction, with 10 percent saying it was slight and 8 percent saying it was substantial. The remaining 40 percent say it stayed about the same compared to the same time last year.

“With inflation ticking up both quarter over quarter and year over year, it’s important to maintain perspective. Inflation is still in line with the Federal Reserve’s goal of around 2 percent, but the situation is definitely worth monitoring,” said Mark Astrinos, CPA/PFS, a member of AICPA’s PFS Credential Committee. “However, the recent increases in interest rates has left investors with concern for their fixed income investments, such as longer duration bonds. There is a silver lining for long-term investors. Higher rates will result in increased opportunities for higher interest-based income going forward.”

The *PFSi* represents the financial standing of a typical American. It is calculated as the Personal Financial Pleasure Index minus the Personal Financial Pain Index. These are comprised of four equally weighted factors, each of which measure the growth of assets and opportunities, in the case of the Pleasure Index, and the erosion of assets and opportunities, in the case of the Pain Index. Pleasure factors include the proprietary PFS 750 Market Index, comprised of the 750 largest companies by market capitalization trading on the U.S. markets, excluding ADRs, mutual funds and ETFs. The other components are the AICPA’s CPA Outlook Index, Real Home Equity Per Capita and Job Openings Per Capita. The pain components are inflation, personal taxes, loan delinquencies and underemployment.

If the *PFSi* readings are positive, Americans are feeling more financial pleasure than pain. Declines, even minor ones, do not necessarily mean Americans are feeling financially negative overall, but do signal a shift in momentum.

Additional information on the *PFSi* can be found at: www.aicpa.org/PFSi.

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