

kcFED **Economic BULLETIN**

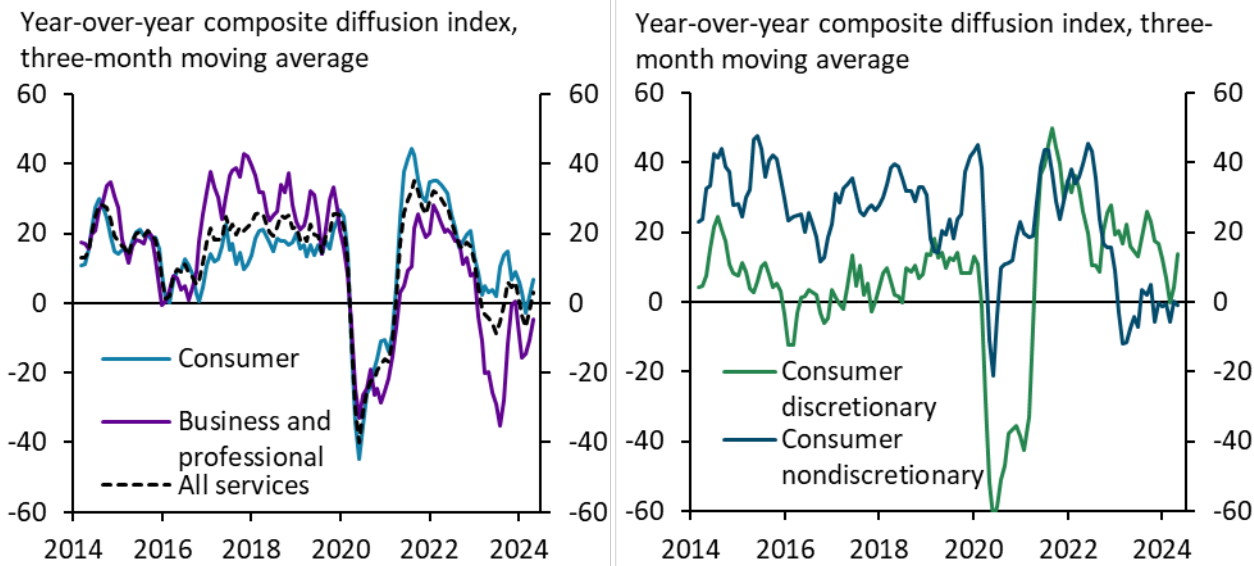
Consumer Discretionary Sector Has Boosted Recent Regional Services Activity as Business and Professional Activity Slows

By Chad Wilkerson and Chase Farha

The Kansas City Fed’s monthly services survey tracks business activity for a wide variety of services firms in the Tenth District. We segment the results into consumer services (both discretionary and nondiscretionary) and business and professional services and find that the consumer sector has been stronger than the business and professional sector recently, driven by discretionary services. Accordingly, consumer services firms report greater pricing power, expected wage growth, and capital expenditures.

The Kansas City Fed’s monthly [services survey](#) shows that services activity in the Tenth District has been relatively flat over the past year, indicating that nearly as many firms are reporting contraction as are reporting expansion.¹ However, this aggregate picture of services activity may mask important variation across subsectors. For example, supply and demand for consumer services, such as retail and restaurants, may differ from that for business and professional services, such as transportation and real estate. Indeed, the left panel of Chart 1 shows that the net share of consumer services firms (light blue line) reporting positive growth has been higher than the net share of business and professional firms (purple line) since 2021.² Although growth has slowed in both of these subsectors following strong initial rebounds from the pandemic, consumer services activity still remains expansionary, while business and professional services activity has been negative since 2023.

Chart 1: Tenth District consumer services firms have experienced stronger growth than business and professional firms recently, driven primarily by discretionary consumer activity

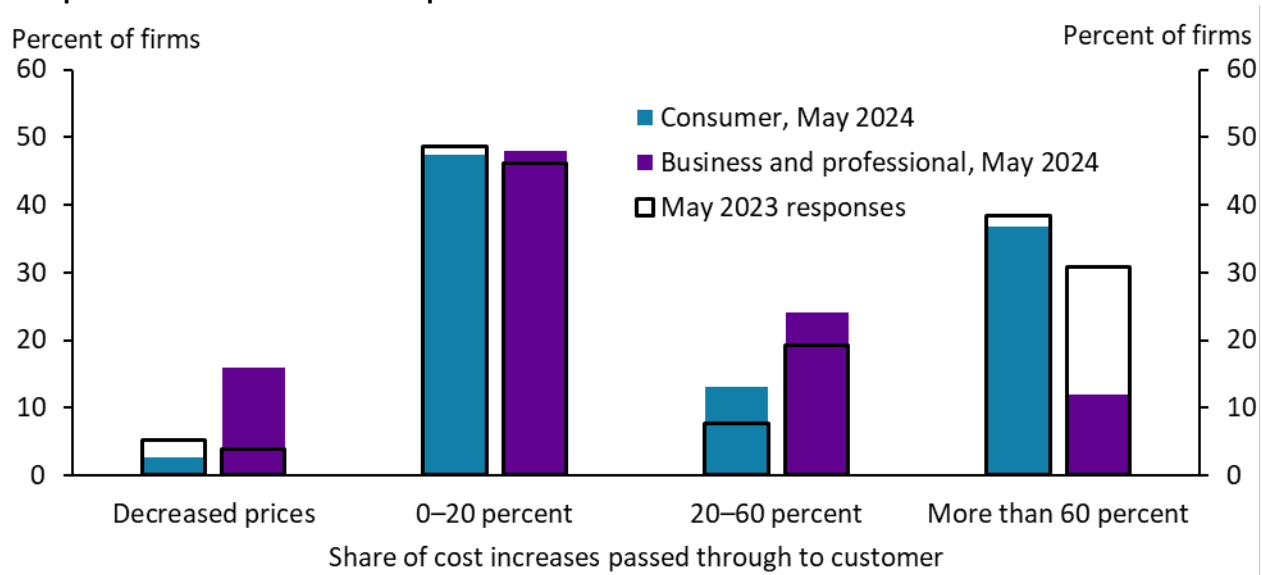


Notes: Chart shows the net percentage of firms reporting increasing activity relative to a year ago. A positive number indicates growth in activity, and a negative number indicates decline.
 Source: Federal Reserve Bank of Kansas City.

Notably, the recent gains in consumer activity have been primarily concentrated in discretionary services such as restaurants and hotels rather than nondiscretionary services such as healthcare and grocery stores.³ Discretionary activity (right panel of Chart 1, green line) was hit hardest during the initial stages of the COVID-19 pandemic, with a reading more than 40 points lower than that of nondiscretionary services (dark blue line) at the trough in June 2020. In the past two years, however, consumer discretionary activity has continued to grow while nondiscretionary activity has stayed mostly flat.

Differing trends in demand for consumer services and professional services are further reflected in firms’ ability to pass through cost increases to the customer. Chart 2 shows the share of cost increases that consumer firms (blue bars) and business and professional firms (purple bars) reported they were able to pass through in May 2024 (shaded area) compared with May 2023 (black borders). In May 2023, both firm types had relatively similar abilities to pass through cost increases. By May 2024, however, firms’ experiences had diverged: consumer firms’ pricing power was little changed, but business and professional firms’ pricing power had fallen substantially. For example, the share of consumer firms reporting they were able to pass through more than 60 percent of costs to their customers stayed just under 40 percent in both 2023 and 2024. In contrast, the share of business firms reporting they were able to pass through more than 60 percent of their costs fell from 31 percent in May 2023 to 12 percent in May 2024. In addition, 16 percent of business and professional firms reported having to *decrease* prices in 2024. Together, the results in Chart 2 indicate that lower demand is reducing pricing power for professional services while demand stays steady for consumer services.

Chart 2: Consumer services firms have maintained pricing power over the past year, while business and professional firms are able to pass fewer costs to customers



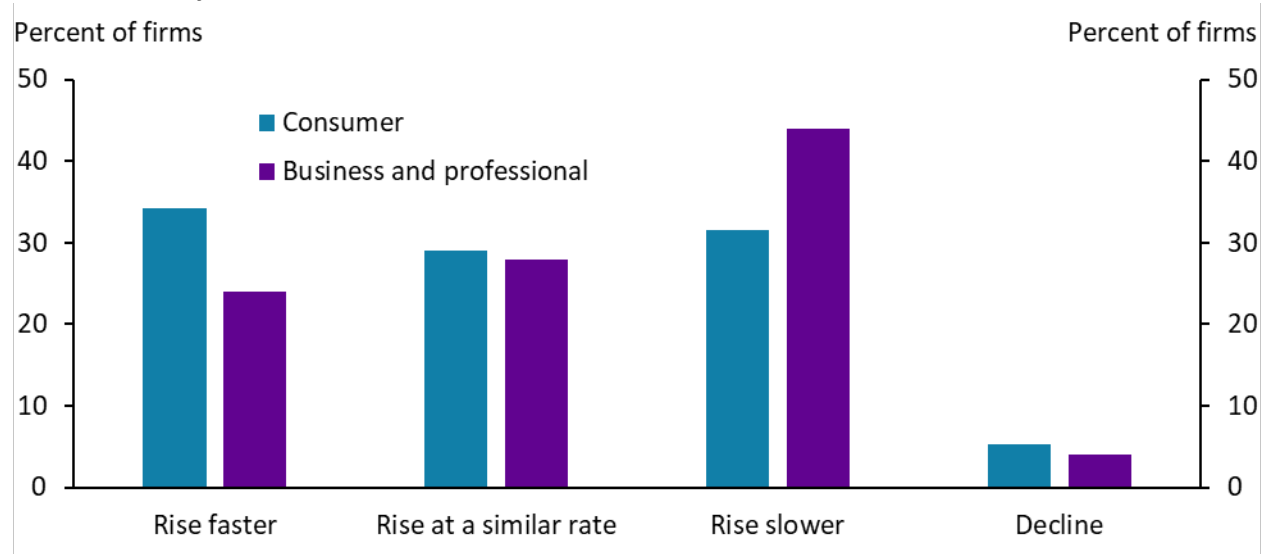
Note: Chart shows firms’ responses to the survey question, “If your firm is facing higher costs (inputs and labor), what share of those increases are you able to pass through to customers in the form of higher prices?”

Source: Federal Reserve Bank of Kansas City.

Employees’ wage growth can also reflect demand for their services, especially in a tight labor market. While rising demand can incentivize firms to offer greater wage increases to meet their demand,

softening demand may curb their willingness or ability to do so. Consistent with lower demand, a higher share of business and professional firms in the Tenth District expect to raise wages at a slower rate than they have in the past 12 months. Chart 3 shows that 44 percent of business and professional services firms (purple bars) anticipate slower wage gains in the coming year, and only 24 percent expect faster gains. In contrast, expectations for consumer services firms (blue bars) are more mixed, with 34 percent anticipating faster wage increases, 32 percent anticipating slower increases, and 5 percent anticipating wages to decline over the next year.

Chart 3: Business and professional services firms expect wage growth to slow this year in light of reduced activity

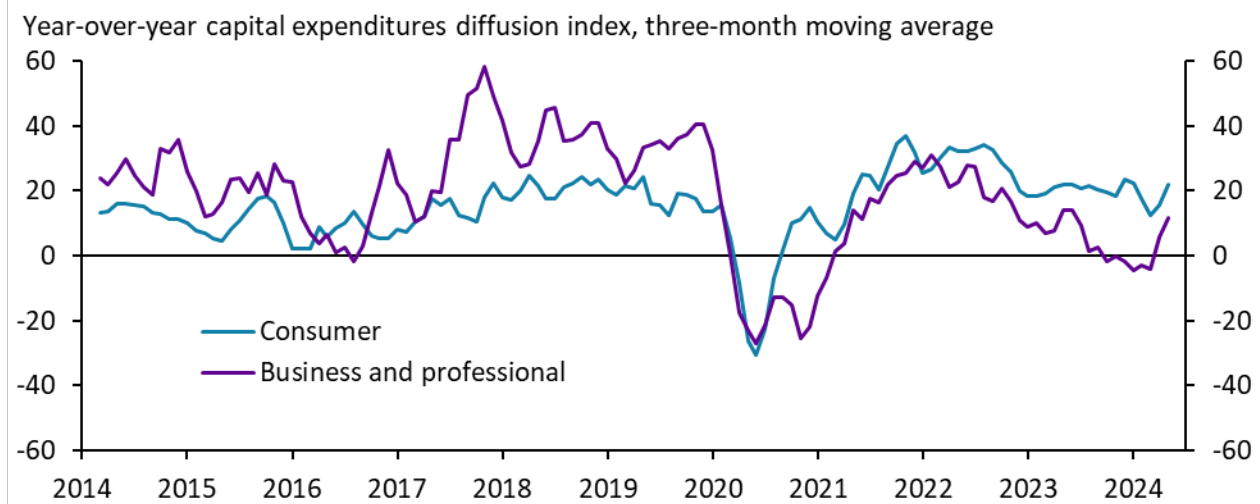


Note: Chart shows firms' May 2024 responses to the survey question, "Over the next year, what are your expectations for wages at your firm compared to the past 12 months?"

Source: Federal Reserve Bank of Kansas City.

Are these demand trends expected to continue? Growth in District firms' capital expenditures can provide insight into current conditions as well as their confidence for the future. Chart 4 plots the year-over-year diffusion index of capital expenditures, showing the net percent of firms increasing their investment for future growth. Like overall activity, a higher share of consumer firms (blue line) reported increasing or steady capital expenditures following their pandemic declines, resulting in a higher reading of the index. Capital expenditures flatlined for business and professional firms (purple line) in 2023, but the recent rise in capital expenditures for both consumer and professional firms indicates that both sectors remain confident in future prospects.

Chart 4: Recent increases in capital expenditures among consumer-oriented and professional service firms signal their confidence for the future



Source: Federal Reserve Bank of Kansas City.

Together, these results demonstrate that disaggregating services activity into subsectors can provide more insight into the drivers of changes in activity. Stronger growth in the Tenth District consumer discretionary sector has boosted regional services activity, but activity has fallen among business and professional firms since early 2023. Lower demand for business and professional services is reflected in the sector's reduced ability to pass through costs to consumers and lower expected wage growth. So far, consumer activity has seldom been negative since the start of the COVID-19 pandemic, and firms' capital expenditures signal that a greater share of firms in the services sector as a whole aim to further increase activity heading forward.

Endnotes

¹ The Tenth Federal Reserve District encompasses Colorado, Kansas, Nebraska, Oklahoma, Wyoming, and parts of Missouri and New Mexico.

² The benchmark measure of activity in the services survey is a composite diffusion index, a weighted average of the revenues/sales (50 percent), employment (30 percent), and inventories (20 percent) indexes.

³ The consumer discretionary category comprises the following types of firms (NAICS code): auto dealers (441), furniture/electronics/appliance retail (449), clothing retail (458), sporting goods/hobby retail (459), arts, entertainment, and recreation (71), and accommodation and food services (72). Consumer nondiscretionary firms comprise builders (236), wholesale trade (42), building material retail (444), food and beverage retail (445), health and personal care retail (456), gas stations (457), waste management (562), education (61), healthcare (62), repair and maintenance (811), and personal and laundry services (812). Business and professional firms comprise transportation and warehousing (48), information (51), real estate (53), professional, scientific, and technical services (54), management (55), and administrative and support services (561).

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