CONSUMER SPENDING: RECOVERY AND BEYOND

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After several years of very sluggish growth in consumer demand, the period ahead should bring some welcome changes. The combination of economic recovery, personal income tax cuts, and moderate inflation is providing the most significant boost to real income in years. Productivity—a crucial element in the growth of income and standards of living—has improved markedly from the dismal performance of the late 1970s and should continue to rise more rapidly in the years ahead. The prospects are good that we will be able to avoid the spiraling prices for energy and food that have had so damaging an effect on the purchasing power of middle and lower income consumers. In most respects demographic changes will reinforce the economic trends. Slower growth in the adult population and a shift in age structure as the baby boom generation ages will bolster income per capita and per household, favoring growth in demand for more discretionary and income-sensitive goods and services.

HOUSEHOLD BUDGETS THROUGH THE MID-1980s

Consumer spending during the next several years will be dominated by recovery from the recent recession and preceding years of weak economic activity. The most dramatic change, already underway, is that consumers will spend an increasing share of their budgets on autos, appliances, furniture, and other durable goods (see **Figure 1**).

1. As **Figures 2 to 5** indicate, inflation-adjusted expenditures per household on many key durable goods remain below peaks reached three and even four years ago. The result is a substantial backlog in demand which will require several years to satisfy. A rebound in sales of durable goods is typical during an economic recovery since these are the types of purchases which are most readily sacrificed or postponed during recessions. However, the rebound effect in this recovery should be especially strong because of the very long period of poor economic conditions and the persistence of extremely high consumer finance rates.

2. Strong underlying demand for housing, as witnessed by the rapid surge in housing starts and home sales as soon as mortgage rates began to ease, is providing a major boost to sales of housing-related goods. Demand for appliances and furniture will continue to expand in the next several years so long as significant increases in mortgage rates and home prices can be avoided.

3. The demographic trends are favorable, especially since the baby boom generation is swelling the number of consumers in the prime auto purchase and household formation years (see **Figure 6**). A large fraction of these consumers are dual-earner couples with above-average incomes, another plus for demand.

Figure 1*
Consumer spending share:
durables

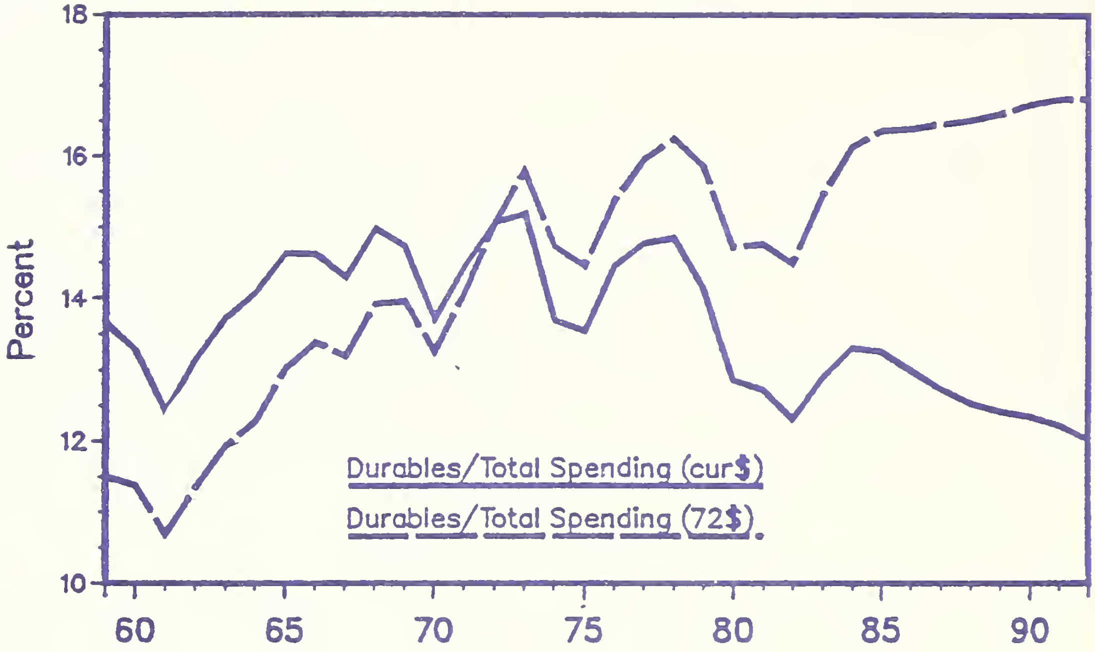
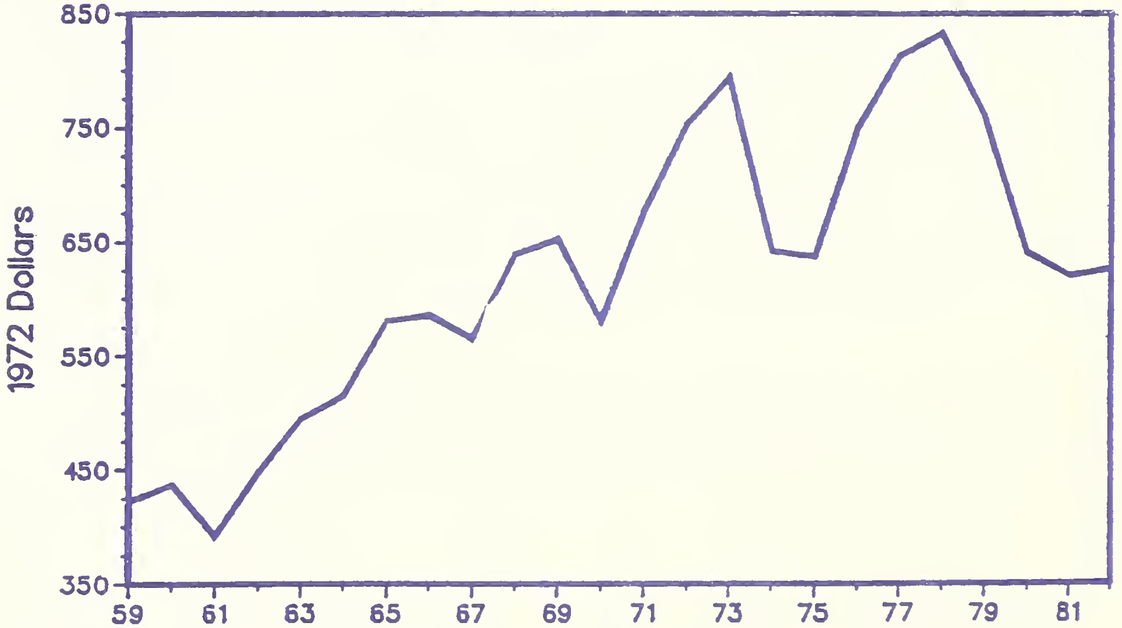


Figure 2*
Consumer spending per household:
autos and parts



*Figures are based on the Moderate Growth Scenario.

Figure 3 *
Consumer spending per household:
furniture

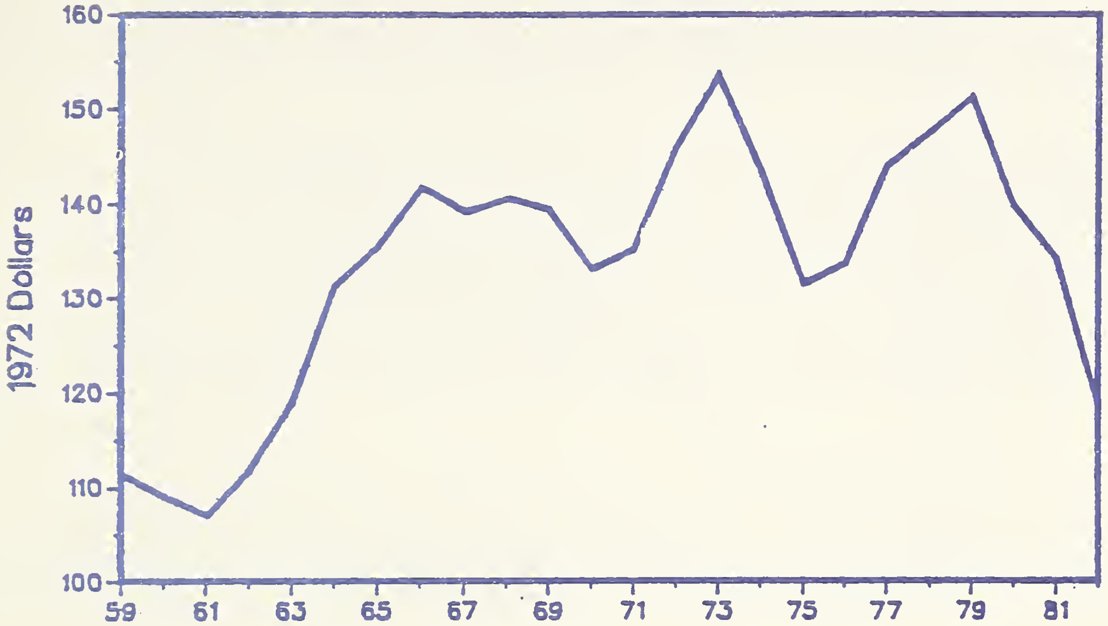
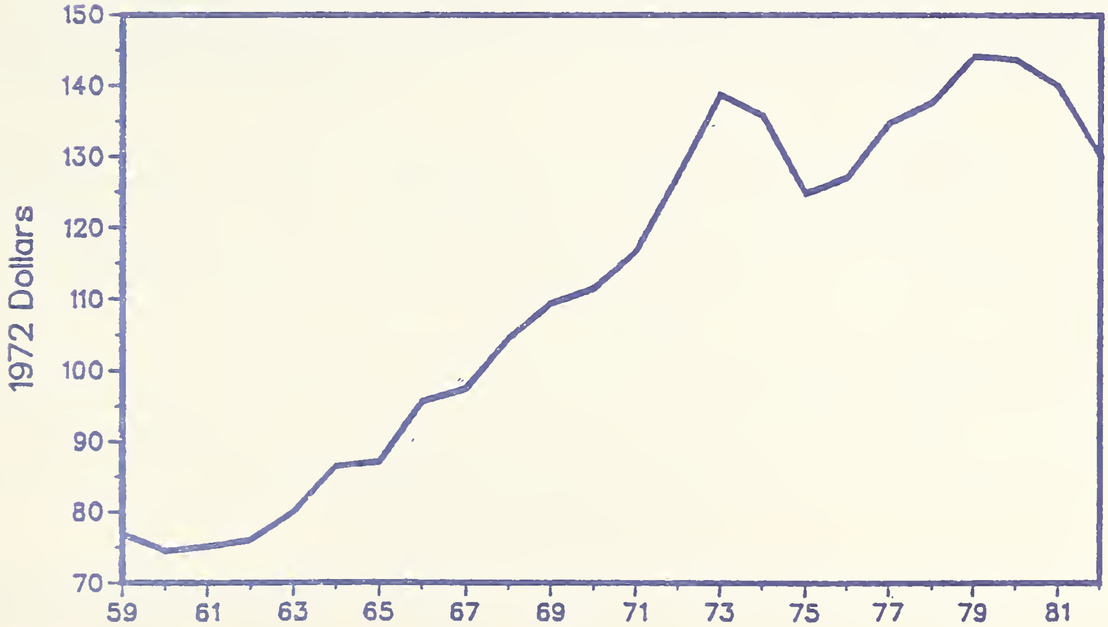


Figure 4*
Consumer spending per household:
kitchen appliances



*Figures are based on the Moderate Growth Scenario.

Figure 5*
Consumer spending per household:
wheel goods & sports equipment

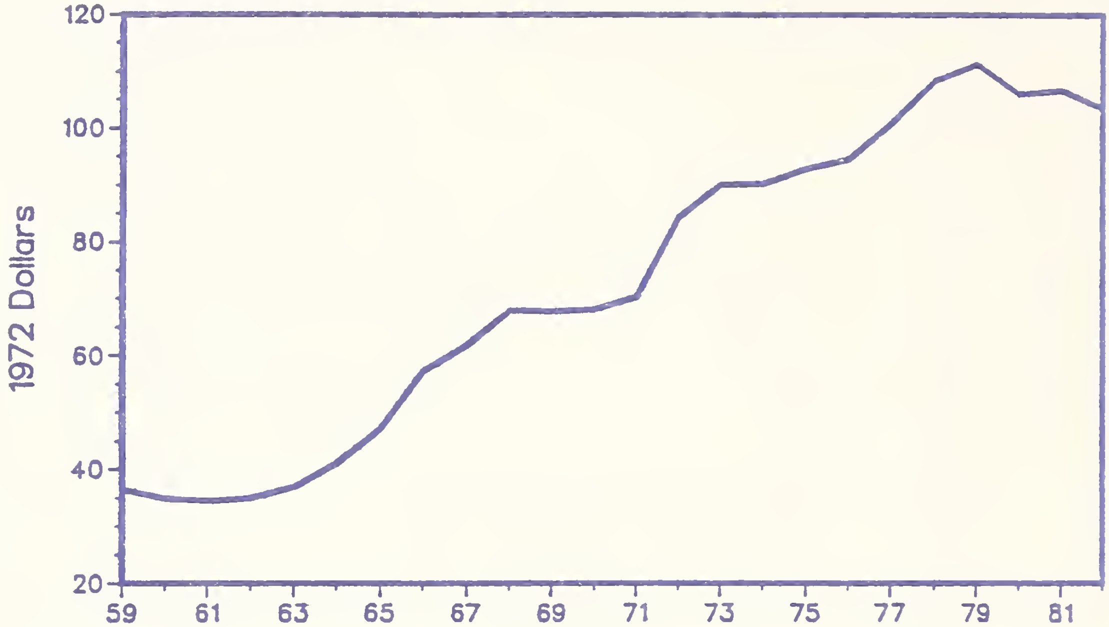
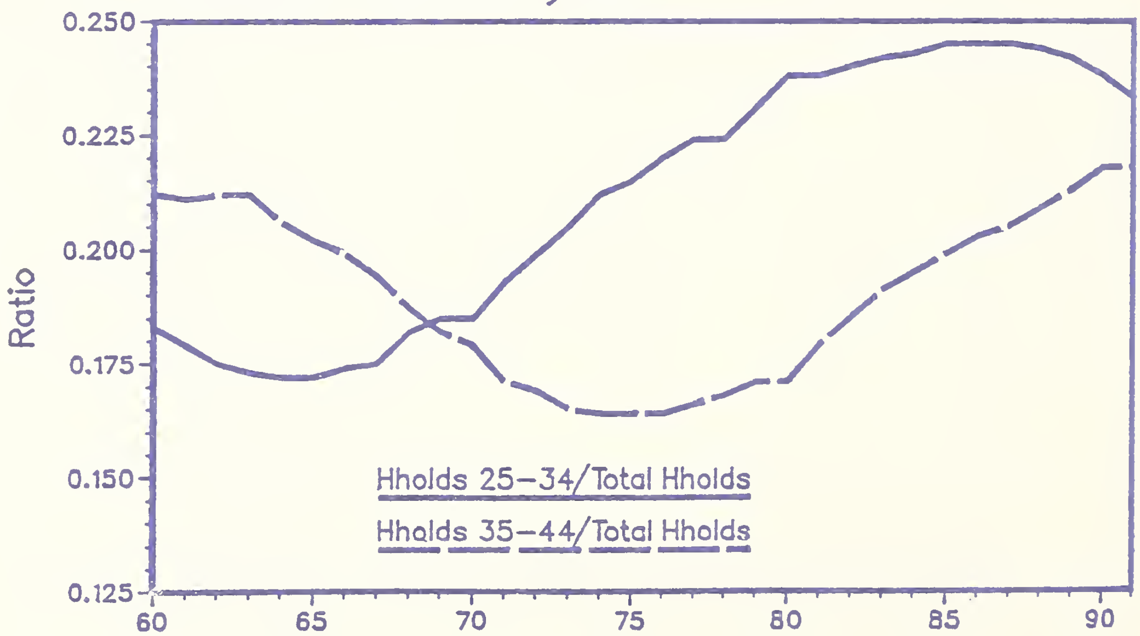


Figure 6*
Consumers in the prime
household-formation years



*Figures are based on the Moderate Growth Scenario.

4. Slow income gains and high interest rates have led to a major retrenchment in consumer credit purchases since 1979 (see **Figure 7**). Even with stepped-up credit demand recently, the ratio of installment debt to income remains modest and consumers generally are in a good position to finance major purchases.

5. Consumer confidence has soared to levels not seen since the early 1970s, with many people reporting that interest rates and other economic conditions favor buying homes, autos, and other durable goods (see **Figure 8**).

Demand for durables during this period could well turn out to involve some tradeoffs, especially between autos and housing-related durables. The key element is likely to be the trend in home prices and the cost and availability of mortgages. Should prices accelerate once again, many consumers will be priced out of the market. Slower growth in demand for housing may then encourage more auto purchases as many families decide to continue paying rent or remain in their existing homes. Similarly, if the housing market recovers more rapidly than expected—either because home prices remain relatively stable or because mortgage rates fall more rapidly—higher home payments and purchases of appliances and furniture may depress demand for autos and other types of durables, including electronics.

Spending for nondurable goods, particularly food at home, is likely to decline as a share of consumer budgets in the years ahead as moderate prices allow consumers to buy more discretionary items (see **Figure 9**). However, some types of nondurable goods will benefit from the increase in discretionary income, including such items as food away from home, clothing, sports supplies, and toys.

Real demand for services is likely to remain fairly stable in the next several years as consumers rebuild their stocks of durable goods (see **Figure 10**). However, as a share of current dollar spending, the trend can be expected to continue upward since prices are likely to continue to rise more rapidly for services than for goods. Both because of high relative prices and because demand is sensitive to income growth, spending for services such as medical care and recreation should expand fairly rapidly. Americans are likely to continue to travel abroad in the next year or so as exchange rates remain favorable; other travel-associated expenditures should also expand given only moderate price increases for gasoline and transportation.

As employment in many of the hard-hit manufacturing industries begins to rise again, blue-collar unemployment rates will begin to recede. More job growth and rising real wages will go far toward bolstering the income of groups hardest hit by the recession—the young, one-earner families, and many lower income households. Stronger income gains for these consumers, together with more moderate price increases for food and fuels, should lead to stronger growth in the mid-price segment of many markets.

The rebound expected for some key categories of spending is summarized in **Table 1**. Most are durable goods, which will benefit from the combination of lower interest rates, a stronger housing market, faster income growth, and relatively modest price increases. But all tend to be discretionary purchases which should experience above-average growth rates through much of the decade ahead.

LONGER-TERM SPENDING PATTERNS

As the recovery process and the associated rebound in demand for durables are completed in the mid-1980s, some of the longer-term trends in spending should re-

Figure 7*
Consumer installment debt

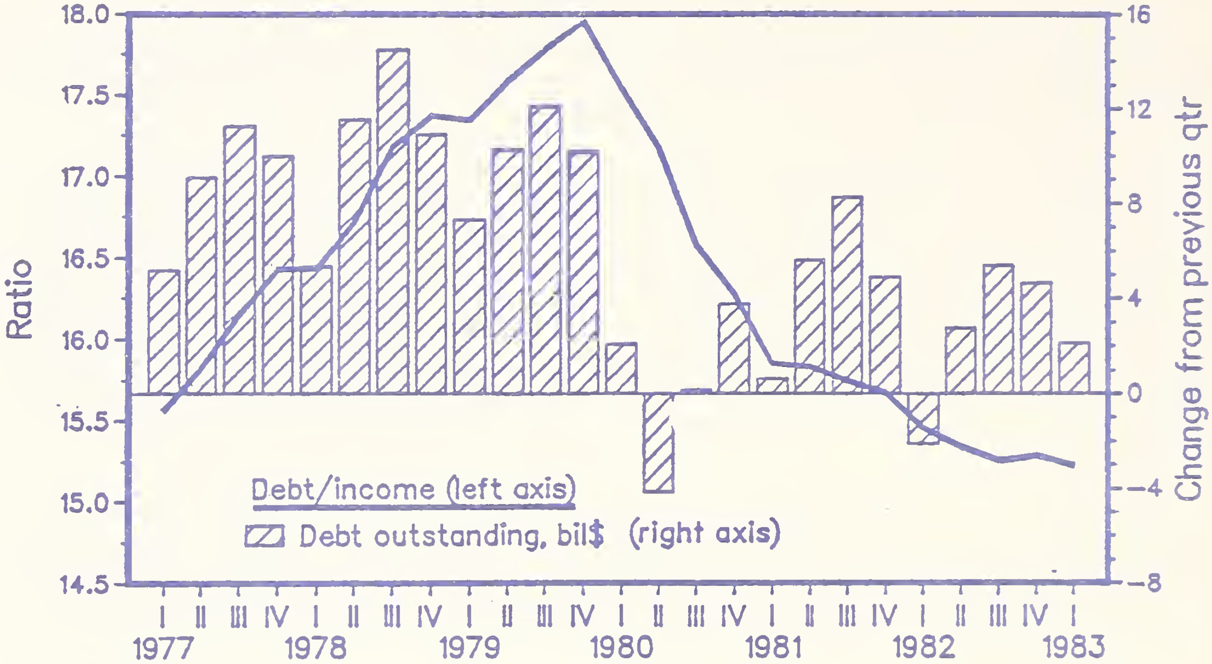
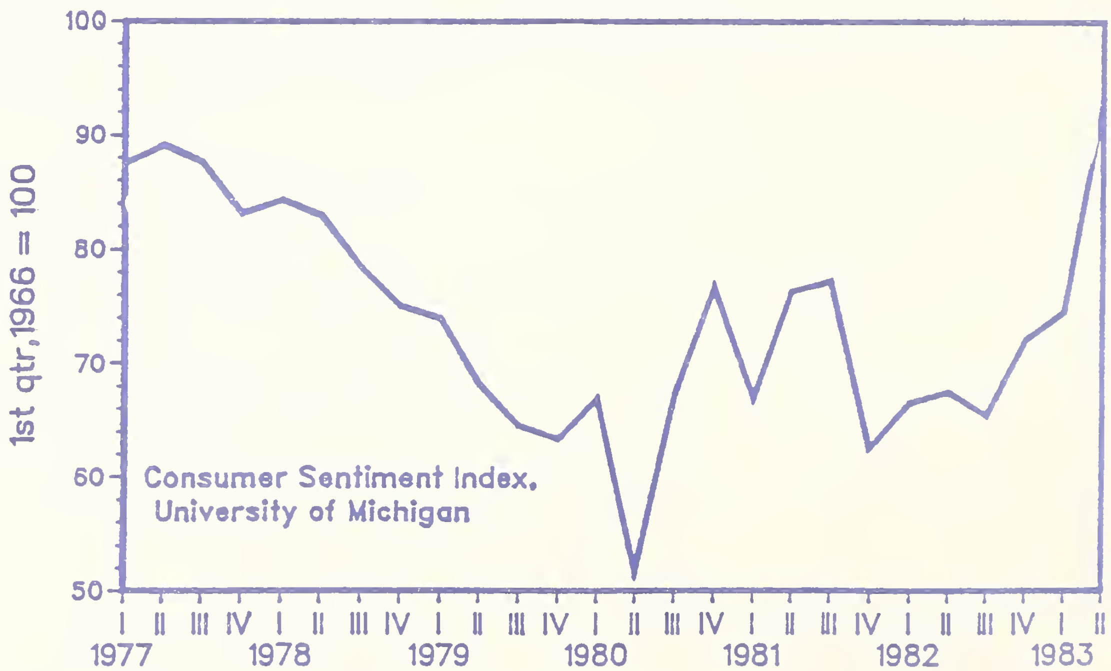


Figure 8*
Consumer confidence



*Figures are based on the Moderate Growth Scenario.

Figure 9*
Consumer spending share:
nondurables

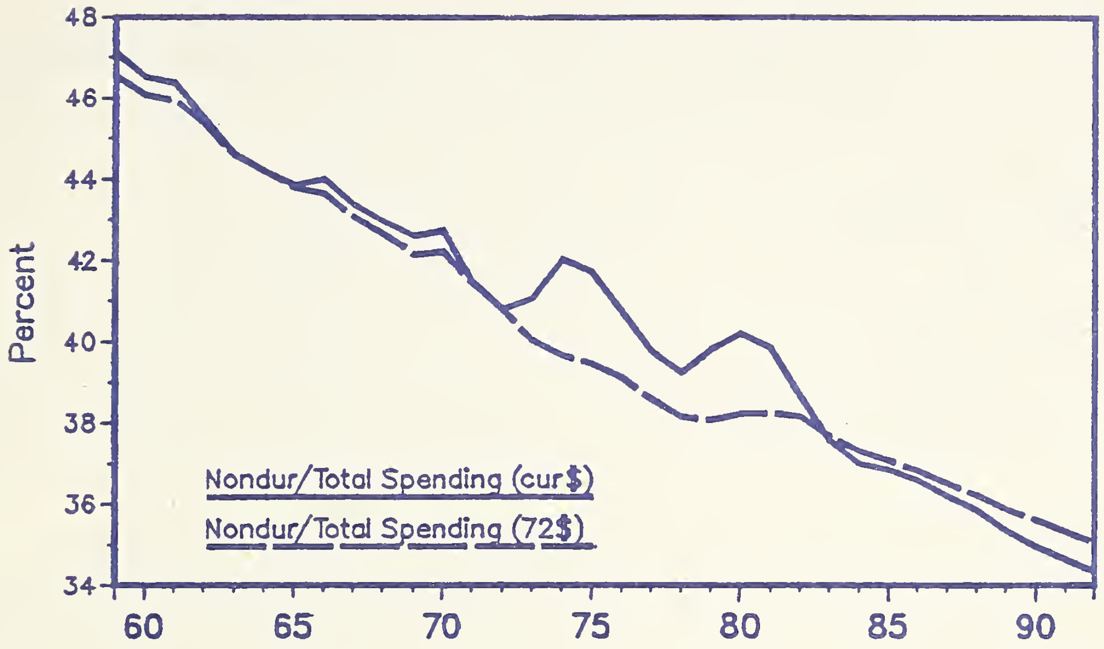
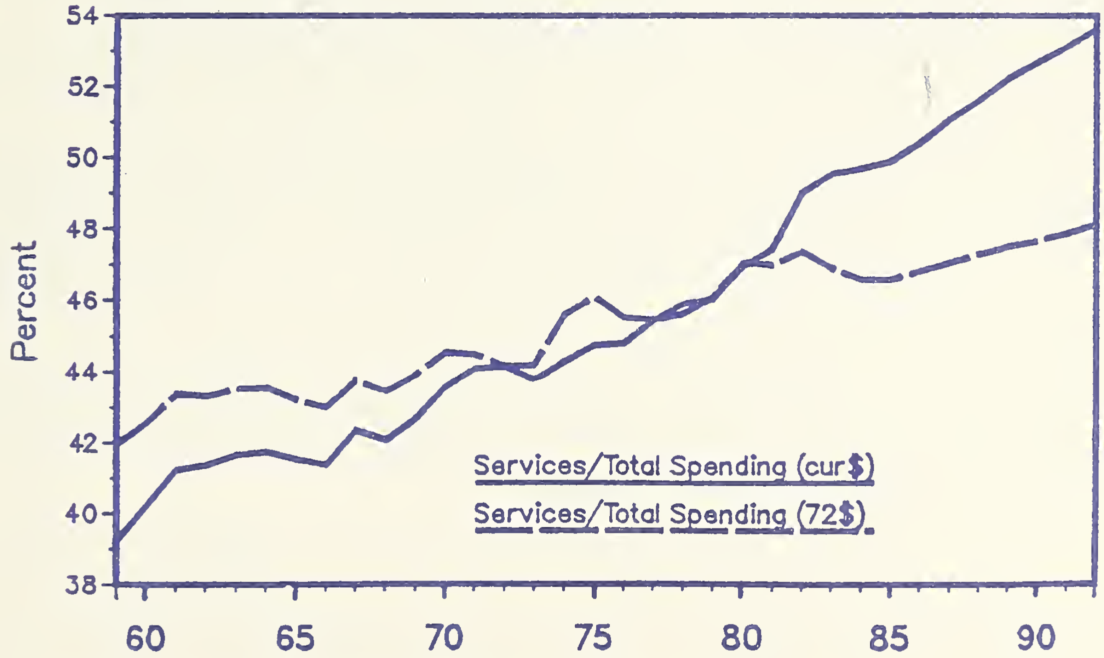


Figure 10*
Consumer spending share:
services



*Figures are based on the Moderate Growth Scenario.

Table 1
Recovery from the Stagflation of 1979-1982
Consumption Expenditures, 1972 Dollars
Moderate Growth Scenario

	Percentage Change	
	1979-1982	1982-1985
Motor vehicles*	-19.0	45.1
Furniture and bedding	-12.8	19.0
Floor coverings	-16.0	20.9
Kitchen appliances	-1.7	15.6
Medical appliances	-10.3	15.4
Wheel goods, sporting equipment	-4.3	18.5
Boats	-41.0	20.2
Pleasure aircraft	-40.9	20.1
Lodging	-8.1	13.9
Auto repair	-7.5	11.0
Airline travel	-29.4	10.5

*Change from peak reached in 1978

appear. Real demand for durables is likely to level off; lower prices relative to other goods and services will allow the share of nominal spending for durables to decline. In both real and nominal terms, the spending share for nondurable goods will continue to fall. As noted earlier, real demand for services is likely to remain stable as a share of total spending, although high relative prices will lead to a rising share in nominal terms.

The demographic trends of the decade ahead will reinforce many of the long-term economic trends. Growth in the size of the population 25 to 34 years old will peak in the mid-1980s, dampening further growth in demand for some durable goods. Slower growth in the adult population and the addition of fewer households compared to the 1970s will also limit demand for housing-related durable goods. Slower population growth also implies only sluggish expansion in demand for goods such as food, which respond primarily to numbers of people. As we have pointed out, several demographic factors will bolster household income. These include the aging of the baby boom and the associated increase in that generation's relative income, the growing number of two-income families, and the continuing trend toward small households and families. Stronger income per household and per household member will combine with the growth in aggregate income to bolster demand for discretionary goods and services.

Both the economic and demographic trends point to relatively strong growth in labor-saving and leisure-enhancing goods and services. Thus the expanding markets of the 1980s include appliances which incorporate technological advances and provide convenience or entertainment, electronics and services which promise personal enrichment and improved skills, goods and services related to sports and physical fitness, and education and travel. Examples of these trends include the mass marketing of video recorders, the spread of cable television, recent experiments with electronic home-shopping, and the development of digital recording and playback.

Another strong market in the years ahead is the category including wheel goods, sports equipment, and "durable" toys. In the past decade growing interest in sports and physical fitness—much of this associated with the baby boom generation—together with the introduction of electronic games led to rapid growth in demand. Even with some market saturation of sports equipment and volatility of tastes, these products will continue to expand on the strength of real income growth, relatively modest price increases, and the large number of people in their middle years who are likely to retain at least some of their earlier interest in physical fitness. Oddly perhaps, in view of the low probability of any significant increase in the birth rate, the prospects are bright for sales of toys. The baby boom generation is likely to continue to have small families, but the sheer size of the generation is resulting in a large number of births. The number of children under 15, which declined at an annual rate of nearly 1 percent during the past decade, is expected to increase at nearly that rate during the decade ahead. It also appears quite likely that young families with more income will spend relatively large amounts on each child, offsetting the effects of fewer children per family.

As noted, as real disposable income increases more rapidly the share of household budgets spent for most types of nondurables will continue to decline. Slower population growth will be another limiting factor, especially in the case of food and other necessities. However, there are several important qualifications to this general trend. One is that continuing migration implies that some geographic areas—especially the Sunbelt and less urbanized areas—will achieve above average growth in demand for nondurables. Second, demand will be relatively strong for more discretionary items, even in such markets as food. Finally, demographic changes—including the maturing population and the greater affluence of two-income families—will bolster demand for products which are marketed to appeal to sophistication, status, or convenience.

By the mid-1980s, with the rebound in demand for durables largely exhausted, the long-term shift toward services will pick up speed. Several types of services look especially promising. Telephone and telegraph services are likely to benefit from new products and new forms of data transmission. Growth in real spending for medical care will continue to outpace expenditures for services in general, both because of the income sensitivity of medical care and above-average price increases. The expansion of cable television, movie sales to television, and casino gambling will continue to boost the recreation category. Even growth in auto repairs should be fairly brisk as older consumers keep cars longer and face an increasingly complex machine.

The central theme in this scenario for the 1980s is that despite only modest improvement in economic growth—the economy is not likely to return to the growth rates of the 1960s—the coincidence of less inflation, improved productivity gains, and demographic changes will strengthen household income. The result will be more rapid expansion in many areas of consumer spending, especially more discretionary goods and services. We have summed up many of these changes in Table 2 which shows the growth rates in real expenditures in markets expected to be the relatively strongest and weakest in the decade ahead.

Table 2
The Faster and Slower Growth Markets of the 1980s
Consumption Expenditures, 1972 Dollars
Moderate Growth Scenario

	Growth Rate (%) 1972-1982	Growth Rate (%) 1982-1992
Faster Growth		
All consumer goods and services	2.8	3.3
Motor vehicles	0.2	5.7
Floor coverings	3.0	4.7
Audio and video electronics	7.9	5.1
Wheel goods, sport equipment, durable toys	4.1	5.2
Boats	-5.0	5.6
Toys, sport supplies	4.6	4.5
Lodging	2.3	4.7
Airline travel	1.4	4.5
Private hospitals	5.4	4.1
Telephone and telegraph	6.6	4.5
Slower Growth		
Food at home	1.7	2.0
Alcohol	2.0	2.2
Tobacco	1.1	1.7
Toilet articles	0.8	2.5
Men's clothing	3.0	2.0
Footwear	3.6	2.3
Cleaning and paper products	-0.7	2.2
Stationery	1.9	1.7
Magazines, newspapers	-1.3	1.5
Railroads	-0.1	2.3