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SLOW EVOLUTION OF CONSUMER SPENDING

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KEY TAKEAWAYS

Consumer spending has been slow to recover after the Great Recession relative to other economic downturns.

We see signs that consumer spending could accelerate, especially if the relatively tight labor market finally results in higher wages for workers.

Consumer debt levels have declined since the Great Recession and have not increased thus far in the recovery.

Consumer spending dominates the composition of the U.S. economy, trending at about 70% of gross domestic product (GDP). But how have consumers fared in the aftermath of the Great Recession and financial crisis that began 10 years ago? Data show that relative to other economic recoveries, consumer spending has rebounded at a much slower rate. And, there does seem to be some truth to the widely circulated idea that consumers have shifted their spending patterns, focusing more on experiences. However, this shift should not be overstated. There has been strong growth in consumer spending in traditional goods as well. Consumers have not taken on additional debt relative to incomes or GDP. Growth in spending may be slower than in other recoveries, but it also may be more durable.

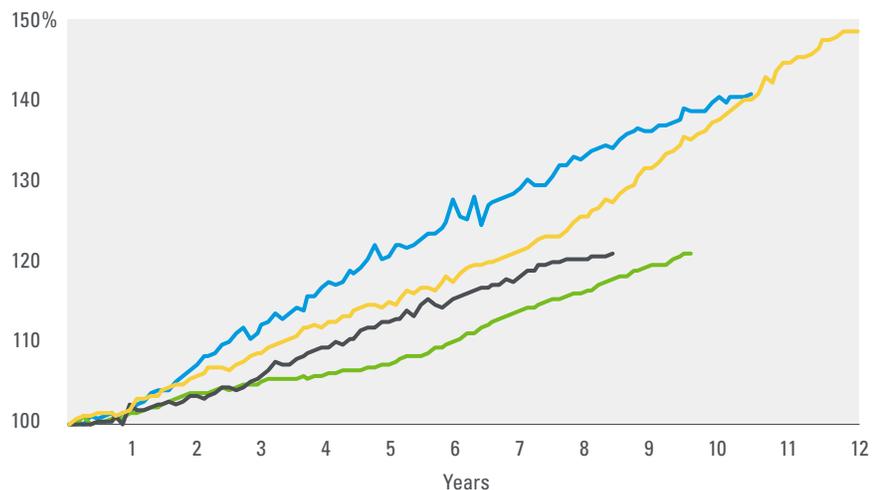
CONSUMER RECOVERY — STEADY BUT SLOW

Because consumer spending represents such a significant percentage of U.S. GDP, it is hard to think that we can have marked improvement in GDP growth without an increase in consumer spending. Business investment is also a major

1 CONSUMER SPENDING GROWTH HAS LAGGED PRIOR RECOVERIES

Cumulative Increase in Consumer Spending, Percent Change

● Dec 1982–Jun 1990 ● Mar 1991–Feb 2001 ● Dec 2001–Nov 2007 ● Jul 2009–Jul 2017



Source: LPL Research, Bureau of Economic Analysis 08/11/17

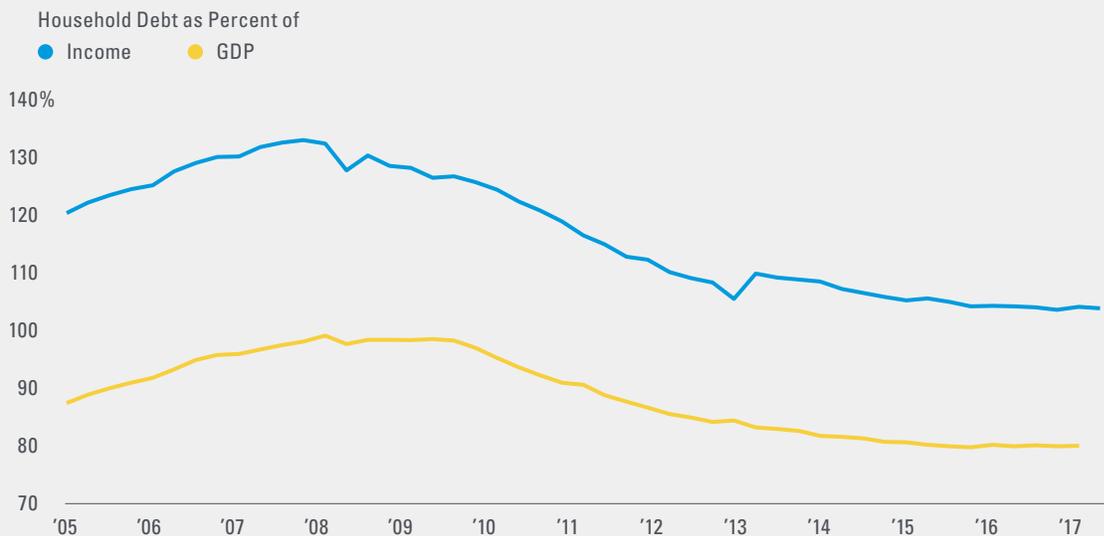
Data are as of 06/30/17.

component of GDP, but why do businesses invest? The answer is ultimately to create more goods and services to sell to consumers. Thus, consumer spending patterns tell us a great deal about the health of the economy, but also provide some foresight into our economic future.

To examine how consumers are doing in the aftermath of the Great Recession, we compared the current recovery with those following the three previous recessions [Figure 1]. The x-axis of the chart represents the time since the recovery began and the y-axis represents the cumulative increase in spending, together depicting the increase in consumer spending after each of the past recessions. We can see that consumer spending has only increased by about 20% during this recovery, which is just half of the 40% rebound in spending that occurred following the recessions that ended in 1982 and 1991.

The chart also shares some details related to the increase in consumer spending, however anemic, which provide some optimism for the future. This recovery, while extended, is still younger than two of the previous three post-recession recoveries, though it is approaching the duration of recovery that began in December 1982. Most of the recent weakness relative to the other recoveries occurred in the first five years of the recession, as shown by how flat the current recovery's line is, relative to the others. However, during the fourth year of the recovery, the pace of the increase in spending started to pick up. Spending patterns now look consistent with the rate of recovery after the recession of the early 1980s, though not nearly as robust as the recovery that began in the early 1990s. But it is hard to argue that consumers are overconfident in their spending. Overconfidence is one of factors in our proprietary

2 CONSUMER DEBT BELOW PRE-CRISIS LEVELS



Source: LPL Research, Bloomberg 08/11/17

Data are as of 06/30/17.

[LPL Research Over Index](#) that examines potential warning signs of future recessions.

One of the other components of the Over Index is overborrowing. However, we do not see signs of overborrowing, at least not from consumers [Figure 2]. Consumer debt, whether measured as a percentage of GDP or income, may be high relative to longer-term averages, but both measures are below the high levels reached at the beginning of the financial crisis. Debt levels have stopped declining, but have not reaccelerated. This suggests that the economic expansion, however long, may have farther to go.

3 SPENDING INCREASE — NOT EVERY SECTOR IS LAGGING

Goods & Services	Cummulative Increase Q4 2009 – Q2 2017
Recreation Goods & Vehicles	112.1%
Spending by U.S. Residents Abroad	74.4%
Home Goods & Maintenance	65.4%
Recreation	54.6%
Communications	47.4%
Auto & Related	44.7%
Clothing	25.3%
Health	24.7%
Hotels & Restaurants	19.7%
Food & Beverages	11.4%
Housing & Utilities	8.5%
Energy	-0.8%
All Consumer Spending	21.1%

Source: LPL Research, Bureau of Economic Analysis 08/03/17

Data are as of June 30, 2017.

ARE OUR PURCHASES CHANGING?

One common refrain is that consumer spending is changing, stemming in part from the confluence of technology and the larger millennial demographic that has grown up in the digital world. Services have represented the majority of consumer spending since the 1950s; in most years, the relative portion of spending on services, rather than goods, has increased.* Are we spending more on “experiences” as opposed to traditional goods and services? The answer is a definite, “yes...but” [Figure 3].

We can see that there has been an above-average increase in categories that we clearly would consider both discretionary (no one really needs a new R.V.) and geared to leisure activities. For example, spending on recreation has increased 54.6%. This includes tickets for theme parks, concerts, theater, and movies, and similar spending. It also includes gambling, which accounts for about half of this increase, as more states and municipalities approve casinos to boost tax revenue. Communications spending, mobile phones, and high-speed data packages have also increased dramatically. However, what is most eye-opening is that U.S. residents’ spending abroad increased dramatically. International travel is perhaps the ultimate “experience” expenditure. It also is the province of the more affluent consumers.

Not all of the increases in consumer spending follow this pattern. For example, according to the St. Louis Federal Reserve, spending on cars and personal trucks has increased significantly. Total vehicle sales fell under 10 million per year at the depths of the Great Recession and are now over 17 million. Despite this increase in sales, at 11.6 years, the average age of cars and light trucks on

*St. Louis Federal Reserve, *On the Economy*, October 2015.

To complete the Over Index, LPL Research measures trends in three broad economic drivers: spending, borrowing, and confidence. For each of these three drivers, we found four diverse components that reflect the economic activity of that sub-index from a different angle. The Over Index takes each of the subcomponents and uses a sophisticated statistical process to normalize and index each data series into an overall score for each of the three drivers. The combined aggregated data helps to measure the likelihood that the economy is showing signs of overactivity and that we may be approaching a cyclical peak.

the road is the oldest ever. There may be pent-up demand for cars and trucks coming as people look to replace older vehicles. An improving jobs market, and the possible resulting increase in wages, is likely to further this increase in consumer spending.

The data show one other interesting fact. Spending on housing itself has only increased 8.5%. This is likely because while some areas have shown a sharp rebound in housing prices, others have seen little increase in prices. This is probably due in some way to the delay in household formation by many people in their 20s and 30s. However, spending on household goods (furniture, carpeting, and other household goods) is up 65.4%. As a nation, we have increased spending much more on what goes in our homes than on the homes themselves. Maybe the inside of our homes, what we show our friends when we have them over to entertain, or the increasingly elaborate home theater systems many of us own, can also be considered “experiences” as well.

CONCLUSION

Slack consumer spending has been a major reason that GDP growth in this economic recovery has been so lackluster. Although this has been frustrating for some, there are reasons for optimism. The pace of spending increases is now closer to normal after a sluggish start early in the recovery. Consumers have had stable debt levels relative to GDP and personal income. Going forward, a better job market should help improve consumer balance sheets and therefore boost spending. Although services spending may always dominate, the increased emphasis on communications and experiences has been a meaningful change in consumption, which could change the opportunities for investors going forward. ■

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Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory

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