

# Research Department Federal Reserve Bank of San Francisco

November 7, 1975

## Again, the Consumer

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Business forecasters have been placing the responsibility for a full-fledged recovery on the backs—or the wallets—of the consuming public. To date, their faith hasn't been misplaced, since the bulk of the recovery of the past two quarters can be traced to an upsurge in consumer spending. The improvement in the inventory sector was involved in the third-quarter upturn, but that too was due to consumers' wiping inventories off the shelves.

### Heavy consumer buying

In real terms, consumer expenditures have increased at almost a 7-percent annual rate for two successive quarters, while other final sales have remained near their recession lows. (Final sales equal GNP less the change in inventories.) The sharpest growth has been in consumer durable-goods sales, which increased, even after adjustment for rising prices, at a 12-percent annual rate in the second quarter and a 23-percent rate in the third quarter. In addition, sales in other consumer markets also expanded significantly in real terms during this period. The upsurge was supported by a major turnaround in consumer borrowing, with new credit extensions rising impressively during the third quarter.

Spending totals of course were much larger in dollar terms, because consumer prices rose at more than a 7-percent annual rate in both the spring and summer

quarters. Strong price pressures have been evident all across the board, and substantially so in several important markets. Over the past six months, used-car prices have risen at an 18-percent annual rate, gasoline at a 20-percent rate, and meat and poultry prices at a 42-percent rate. In contrast, rents, apparel and household durables have all risen at annual rates of 4 percent or less, and prices of cereals and bakery products have actually declined.

Whether the business recovery can be sustained depends partly on the level of income, but also on intentions to spend out of current income and to go into debt. Such decisions depend on consumer confidence in the future.

Real disposable income actually declined in the third quarter from the second-quarter high—which benefitted from tax rebates and hikes in social-security payments—but it still remained considerably above the recession low. Little information is currently available on the comparative health of various consumer categories, but some economists detect the existence of a two-tiered market, with higher-income households maintaining their earlier consuming and spending patterns, while other groups are forced to prune their budgets severely. To sustain the recovery, the mass market of middle- and lower-income groups must increase purchases of durable goods and other consumer products.

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## **Burden of debt**

One key factor limiting consumer purchasing power until recently has been the rising burden of consumer instalment debt. (Instalment credit now totals about \$154 billion, of which 46 percent is held by commercial banks.) A common rule-of-thumb holds that the burden of consumer debt becomes excessive if it exceeds 14 percent of disposable personal income. However, that ratio has consistently exceeded 14 percent in recent years, reflecting such factors as the increasing concentration in the population of young adults, who typically are heavy users of consumer credit.

With the recession decline in new extensions of credit, the ratio has fallen from 15.2 percent in January-August 1974 to 14.3 percent in the comparable period of 1975, but it has still remained high in historical terms. Throughout the recession, credit extensions at the banks increasingly were directed into personal loans (including check credit) and credit cards, which suggests that consumers' attempts to maintain ordinary living standards forced them into debt—or forced them to stay in debt longer by spreading out repayments. Credit unions, who concentrate on

loans of this type, were the only lenders that increased their share of the market during the recession.

In contrast, bank customers generally reduced their borrowing for durable-goods purchases in the year ending this August. Auto loans, which account for 41 percent of all bank credit, dropped more than \$2 billion in a year's time. Credit extensions for mobile homes were down slightly over the year, while home-improvement loans held their own.

## **Heavy repayments**

Consumers have taken strong steps to increase their liquidity this year, reflecting their uneasiness with this heavy debt burden as well as with a weakening real-asset position caused by inflation. Much of the heavy consumer saving this year has represented repayments of debt; such repayments have risen 3 percent over a year ago, and are more than one-fourth higher than three years ago.

Households generally are still relatively cautious. Even disregarding the high second-quarter saving rate, which was affected by the tax-cut windfall, savings have averaged 7.6 percent of disposable income during the first and third

quarters, which is in line with the high saving rate of the earlier years of this decade. Still, with the recent reduction in the debt burden, and with the growing conviction that inflation is abating and employment and income improving, consumers may now be more willing to take on new debt.

These improved circumstances suggest why the markets for autos and other durable goods have strengthened in recent months.

The ratio of auto credit to disposable income has fallen to the lowest level since early 1971, providing the basis for new credit extensions in that sector. Detroit now expects a 10-percent increase in sales for the 1976 model year, to about 10.0 million units. This would be below the record pace of 10.7 million units in 1972 and 11.8 million units in 1973, but it still represents heartening progress for this turnaround year.

Joan Walsh

#### PUBLICATION AVAILABLE

A publication entitled *Nation-Spanning Credit Cards* is available by writing or calling any office of the Federal Reserve Bank of San Francisco. It is an up-to-date analysis of the rapid growth of bank credit cards, with emphasis on the nationwide coverage by two major card plans. The study describes the advantages to cardholders and merchants from widespread credit card usage, technological developments enhancing the spread of a general electronic-payments system, and the increasing profitability of card plans with the growing maturity of the industry.

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**BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT**  
(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 10/22/75	Change from 10/15/75	Change from year ago	
			Dollar	Percent
Loans (gross, adjusted) and investments*	85,567	- 1,402	+ 2,290	+ 2.75
Loans (gross, adjusted)—total	64,011	- 1,202	- 2,732	- 4.09
Security loans	861	- 960	- 258	- 23.06
Commercial and industrial	22,724	- 271	- 1,473	- 6.09
Real estate	19,619	+ 41	- 368	- 1.84
Consumer instalment	10,039	- 9	+ 275	+ 2.82
U.S. Treasury securities	8,727	- 113	+ 4,571	+ 109.99
Other securities	12,829	- 87	+ 451	+ 3.64
Deposits (less cash items)—total*	86,193	- 1,048	+ 5,639	+ 7.00
Demand deposits (adjusted)	23,588	- 1,002	+ 870	+ 3.83
U.S. Government deposits	387	+ 43	+ 77	+ 24.84
Time deposits—total*	60,556	+ 85	+ 4,297	+ 7.64
States and political subdivisions	5,780	+ 18	- 347	- 5.66
Savings deposits	21,216	+ 93	+ 3,200	+ 17.76
Other time deposits‡	30,004	+ 93	+ 1,312	+ 4.57
Large negotiable CD's	15,867	- 15	+ 713	+ 4.71
<b>Weekly Averages of Daily Figures</b>	<b>Week ended 10/22/75</b>	<b>Week ended 10/15/75</b>	<b>Comparable year-ago period</b>	
<b>Member Bank Reserve Position</b>				
Excess Reserves	18	40	-	2
Borrowings	7	2		50
Net free (+) / Net borrowed (-)	+ 11	+ 38	-	52
<b>Federal Funds—Seven Large Banks</b>				
Interbank Federal fund transactions				
Net purchases (+) / Net sales (-)	+ 1,029	+ 848	+ 918	
Transactions of U.S. security dealers				
Net loans (+) / Net borrowings (-)	+ 354	+ 665	+ 770	

\*Includes items not shown separately. ‡Individuals, partnerships and corporations.

Information on this and other publications can be obtained by calling or writing the Public Information Section, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco 94120. Phone (415) 397-1137.