

Research Department
Federal Reserve
Bank of
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Coals and Switches

In the midst of a recession, the Christmas spirit may be somewhat lacking. Indeed, there have been four other recession Christmases in the past quarter-century, most notably in both 1973 and 1974. And once again, after reading front-page stories of falling employment and income, retailers are filling their advertising pages with ads trumpeting pre-Christmas rather than post-Christmas clearance sales.

Buyers may yet mob the stores and rescue the season with a last-minute rush, as they did last year. But beyond that lies the larger question of how households will act in the new year, because their spending behavior will strongly influence the way the economy works its way out of recession. (After all, consumer spending accounts for two-thirds of the nation's total spending.) Saving is an increasingly attractive alternative to spending in the current environment, and although dampening current retail-business activity, it serves to boost future buying power by stimulating increased investment and productivity.

Christmas scene

Yet for many retailers, everything depends on this one season of the year. In 1980, December alone accounted for 14.2 percent of all apparel-store sales and for 15.8 percent of all sales of department stores and other general-merchandise outlets. Also, last year, liquor and TV-appliance stores rang up 11 to 12 percent of their entire sales in the one merry month of December. Moreover, the two months of November and December accounted for more than one-fourth of total apparel and general-merchandise sales last year, as they did in other years as well.

Those two months always provide a strong opportunity—and also a danger—for the nation's retailers. In that period, they aim for an enormous volume with only a modest increase in overhead, thereby hoping to create a much higher level of profits. But if

their huge inventories of appliances, perfumes, jewelry, toys and clothing are not sold within this brief time-span, they have little choice but to stage post-holiday or even pre-holiday sales, which bring in the customers but at reduced profitability for the stores.

Weakening environment

Sales prospects this season look unpromising simply because so many potential customers are out of work. In November, 8.4 percent of all civilian workers were unemployed, and the rate seemed likely to approach the 9.0-percent figure reached towards the end of the 1973-75 recession—the highest level of the past generation. In the last two months, the jobless rate has jumped almost one full percentage point, following an employment decline of 940,000 jobs since midsummer.

Despite weakening employment, real disposable income—a major determinant of retail sales—has been recovering this year from the mid-1980 recession low. That trend strengthened, at least temporarily, in October on the heels of the first (5 percent) stage of the three-stage income-tax reduction. But more to the point, real incomes have been improving because of a deceleration in inflation. (The consumer-price index, after adjustment for the volatile mortgage-financing component, rose at an 8.6-percent annual rate over the past six months, compared with a 10.0-percent rate of increase over the preceding six-month period.) And every percentage-point decline in the inflation rate represents an even greater boost to consumer income, in real terms, than consumers received from the initial \$17-billion income-tax reduction.

Still, most measures show only modest growth or even a weakening of consumer income over the past decade. For example, median family income (on a real after-tax basis) has fallen below the levels of the late 1970s, and is even nine percent below the

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peak 1972 level (see chart). This reflects the doubling of inflation indexes over the past decade, as well as the tripling of the Federal burden of income and social-security taxes.

The net worth position of consumers (in real terms) appears to have moved in the opposite direction—weakening this year after a sharp improvement over the past decade. Over the 1969-79 decade, consumer assets (excluding common stock) soared from \$1.1 trillion to about \$2.6 trillion. Even after adjustment for inflation and debt obligations, the real net worth of consumers rose 23 percent during this period. But the disappearance of inflation-based increases in home equity has now offset part of the earlier upsurge in consumer net worth. The point to remember is that Americans during the 1970s cashed in significant amounts of the increased values of their homes—perhaps \$25 billion or more in each of the last several years. That spending stimulus—felt in the markets for cars, campers, education, vacations and other consumer items—is now missing in the wake of the recent decline in home values and tightening of lending terms. Households are no longer able to obtain 30-year fixed-rate mortgages at negative real interest rates. To them, housing henceforth will represent only shelter, and not a boundless source of financing for other types of consumer purchases.

Credit expansion

Against this background of financial uncertainty, households have become decidedly cautious in their handling of debt. The delinquency rate (30 days and over) for installment loans dropped to 2.30 percent at midyear—down sharply from the 2.94-percent peak of a year ago. Moreover, the ratio of consumer installment credit to personal income reached 13.3 percent this September—down sharply from the mid-1979 peak of 14.9 percent. (But until two decades ago, the debt ratio never exceeded 10 percent of income.) The recent decline in the ratio may represent an unwinding of the inflationary pressures which stimulated consumers to take on such heavy debt burdens in the 1970s.

The rapid inflation of the past decade made credit usage more attractive, because consumers expected the fixed repayment amounts to constitute a declining percentage of their inflation-bolstered incomes. Also, the “real” interest rate declined during this period; for example, the personal-loan rate charged by major finance companies hovered around 20 or 21 percent from 1976 to 1979, while the personal-consumption price index accelerated from a 5-percent to a 9-percent rate over that period. Indeed, the reported consumer-debt burden would have risen even more if consumers had not used so much mortgage debt for consumer purposes, with (for example) many homeowners taking out second mortgages in order to convert the capital gains on their homes into spending power.

Other factors also helped boost reported debt figures during this period. With the expansion of credit cards, many consumers began to use credit rather than cash, paying their outstanding balances in full at the end of each billing period. (According to one survey, nearly 40 percent of all bank credit-card debt is repaid during the billing period.) With the upward shift in tax brackets, many borrowers reduced their real debt burdens through itemized deductions of interest payments on their income-tax forms. Demographics also played a part in the upsurge, in view of the growing proportion of the population in the credit-dependent 25-44 age category. During this period, 68 percent of families with a head aged 25-44 utilized consumer installment credit, while the proportion dropped to 58 percent for families with a head aged 45-54.

Credit contraction?

These various growth factors may weaken during the 1980s. With the growing maturity of credit-card usage, the cash-substitution factor may not boost the reported credit statistics as much as it did in the past. With the reduction in income-tax burdens, consumers may not utilize itemized deductions as frequently as in the past. And although most of the population growth in this decade is concentrated in the 35-44 age category, that

cohort may not use much more credit than it did in the heavy borrowing 1970s. Above all, with inflation declining and real interest rates remaining quite high, the debt-financed flight into goods seems much less symptomatic of the 1980s than of the 1970s.

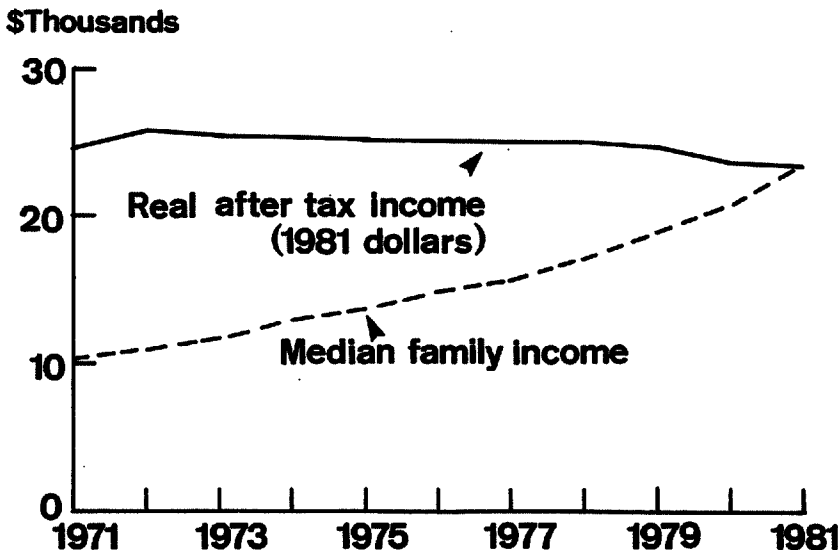
At this juncture, saving rather than spending has suddenly gained new respectability. The most enticing advertisements this Christmas are not the retailers' ads for jewelry or electronic toys, but rather the financial institutions' ads for tax-deferred individual retirement accounts (IRAs). In glittering prose, they describe how a 30-year-old depositing \$2,000 a year can, by the magic of compound interest, be transformed into a millionaire by retirement age. The new tax law, while encouraging Christmas buying through the tax-cut approach, may have offset part of that stimulus by encouraging more saving through an expanded IRA program.

The shifting environment suggests that saving—not spending—is the "in" thing for the 1980s. This is relevant to the phenomenon described by F. Thomas Juster in the June 29 issue of *Fortune*: "Contrary to the popular impression, over recent years U.S. consumers have been squirreling away about the same

percentage of their income in cash savings as the Western Europeans and nearly as much as the Japanese. The main reason personal-savings rates abroad are two to three times those in the U.S. is that the use of debt abroad is niggardly." Juster argues that the best way to encourage saving would be to entice consumers to borrow less. Congress could do this, for example, by reducing the subsidies—tax deductions for interest payments and property taxes—that have helped create such an enormous demand for mortgage debt. That particular proposal may be politically unrealistic, but the recent trend toward reduced credit expansion, by definition, means a boost to the personal-saving rate.

In sum, retailers may experience a less-than-fabulous Christmas season in 1981, partly because of recession pressures on employment and income, and partly because of a shift in attitudes from spending to saving in an environment of reduced inflation. But future Christmases should be brighter as more households channel their funds into saving and investing, thereby boosting productivity and supporting future gains in living standards.

William Burke



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

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 12/2/81	Change from 11/25/81	Change from year ago	
			Dollar	Percent
Loans (gross, adjusted) and investments*	154,817	418	9,635	6.6
Loans (gross, adjusted) — total#	133,931	411	10,960	8.9
Commercial and industrial	40,527	330	4,001	11.0
Real estate	55,446	59	5,484	11.0
Loans to individuals	23,334	3	626	2.6
Securities loans	2,056	117	805	64.3
U.S. Treasury securities*	5,616	116	1,103	16.4
Other securities*	15,270	109	218	1.4
Demand deposits — total#	43,320	1,778	4,524	9.5
Demand deposits — adjusted	28,940	1,089	5,295	15.5
Savings deposits — total	30,040	460	723	2.5
Time deposits — total#	87,202	430	17,706	25.5
Individuals, part. & corp.	78,676	295	18,321	30.4
(Large negotiable CD's)	33,988	269	6,759	24.8
Weekly Averages of Daily Figures	Week ended 12/2/81	Week ended 11/25/81	Comparable year-ago period	
Member Bank Reserve Position				
Excess Reserves (+)/Deficiency (-)	79	97		99
Borrowings	5	2		65
Net free reserves (+)/Net borrowed(-)	75	95		35

* Excludes trading account securities.

Includes items not shown separately.

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