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A New Trend for U.S. Household Spending

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"U.S. holiday retail sales could fall for the second year in a row as rising unemployment and stagnant wage growth curb gift buying."

—Reuters, October 6, 2009

According to the latest forecast by the National Retail Federation (NRF), U.S. holiday sales are predicted to fall 1 percent in 2009. This decline comes on the heels of a 3.4 percent drop in 2008's holiday sales. If the 2009 forecast is accurate, it will be the first time since the NRF began tracking such statistics in 1992 that holiday sales have fallen consecutively for two years.

Most retailers depend heavily on the sales volume registered between Thanksgiving and Christmas (holiday sales). The past two years, though, have been difficult. In 2008, the recession and the financial crisis caused sales to plummet. In late 2009, however, the economy and financial markets have improved considerably from a year earlier, but sales are still expected to remain weak. One reason for 2009's weak holiday sales is that shoppers are increasingly reluctant to purchase gifts with credit cards. According to the NRF's 2009 Consumer Intentions and Action Survey, only 28.3 percent of holiday shoppers will use credit cards; this is 10.6 percent lower than one year ago.

This new reluctance to buy on credit has occurred at the same time that the personal saving rate has been rising; this is a dramatic departure from the recent past. Over the past 25 years or so, U.S. households have saved smaller and smaller proportions of their income. At the same time, household borrowing increased steadily. As households assumed more debt, their debt service became a larger proportion of their household spending. The debt service-to-income ratio—the percentage of a household's disposable income[1] that goes to service that debt—rose to a historical high of 13.9 percent in the third quarter of 2007. As households devote a larger percentage of their income to debt service, they have less income to devote to purchasing goods and services—or holiday gifts. Since the second half of 2008, however, U.S. households have become reluctant to incur additional debt by credit card purchases. This reluctance, in large measure, is due to the legacies associated with the financial crisis and the recession that followed. Two key legacies have been increased uncertainty among consumers about their jobs—the unemployment rate in late 2009 was at its highest point in more than 25 years—and declining household net worth.

Faced with the possibility of layoffs, pay freezes, or pay cuts, people started to save more and became reluctant to add to their debt burdens as the recession deepened. Although the financial health of some banks and financial institutions may have made it difficult for some consumers to obtain credit in 2009, households instead seem to be responding more to another problem that has developed: a sharp drop in their household wealth. Between the second quarter of 2007 and the first quarter of 2009, the net worth of U.S. households declined by a little more than $17 trillion, roughly 27 percent. This decline stemmed mostly from falling house prices and falling stock prices. The sharp decline in net worth pushed households to spend conservatively. Working in tandem with this, consumers were striving to pay down the large amount of debt they acquired over the past several years.

Higher household saving rates could result in both positive and negative impacts to the U.S. economy. In the long run, all else being equal, an increase in saving will lead to higher investment rates, stronger productivity growth, and therefore higher real incomes and higher real consumption. In the short run, reducing consumption, which is an important component of gross domestic product (GDP), will slow GDP growth. Consumption spending, especially on durable goods, typically rises strongly during the initial stages of a recovery. However, during this recovery period, for the reasons noted above, many economists believe that the growth of consumption spending will be weaker than normal, resulting in a slow recovery. It will be interesting to see how the rise in the household saving rate affects the recovery from this recession.

—By Yang Liu, Research Associate, Federal Reserve Bank of St. Louis

[1] Disposable income is personal income minus personal current taxes.

Recent Articles and Resources on U.S. Household Spending

"Personal Saving and Economic Growth" by Daniel L. Thornton, Federal Reserve Bank of St. Louis *National Economic Trends*, December 2009.

Thornton examines the fear that a rising saving rate could hamper the economic recovery. He looks at some historical data for some possible outcomes.

"Household Retrenchment" by Riccardo DiCecio and Charles S. Gascon, Federal Reserve Bank of St. Louis *National Economic Trends*, April 2009.

"Economic misfortunes have caused many to reassess their finances, triggering sharp reversals in borrowing and spending habits."

"The U.S. Personal Saving Rate" by Elizabeth La Jeunesse, Federal Reserve Bank of St. Louis *Liber8 Economic Information Newsletter*, October 2007.

La Jeunesse discusses the low U.S. personal saving rate from the third quarter of 2005 through 2007 and its ramifications on the U.S. economy.

Free Data Sources and Reports

Data: Personal Saving Rate
Description: Monthly data from 1959 to the present; downloadable in tables, graphs, or files. Personal saving is the portion of personal income that is not spent on current consumption but is instead used to provide funds to capital markets or invested in real assets such as residences.
Published by: Bureau of Economic Analysis (BEA)
Location: http://research.stlouisfed.org/fred2/series/PSAVERT

Data: Household Debt Service Payments as a Percent of Disposable Personal Income
Description: The estimate of the ratio of debt payments to disposable personal income. Debt payments consist of the estimated required payments on outstanding mortgage and consumer debt. Data from the *Household Debt Service and Financial Obligations Ratios* publication.
Published by: Board of Governors of the Federal Reserve System
Location: http://www.federalreserve.gov/releases/housedebt/default.htm
or in downloadable chart of graph formats from
http://research.stlouisfed.org/fred2/series/TDSP

Data: Civilian Unemployment Rate
Description: Percentage of unemployed civilian population of the United States
Published by: U.S. Department of Labor: Bureau of Labor Statistics
Location: http://research.stlouisfed.org/fred2/series/UNRATE

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