

# A Different Recovery for Household Spending

BY JOHN A. WEINBERG

Economic statistics tell us that the bottom of the Great Recession — and, thus, the starting point of our current recovery — took place in June 2009, four years ago. Things have been getting better during the recovery, but they're still not that great. Growth has been anemic, averaging about 2 percent per year since the recovery began, compared with more than 3 percent from 1950 to 2000. While unemployment has fallen to 7 percent, its lowest rate since November 2008, much of that decline has been the result of people dropping out of the labor force, making it harder to gauge just how much improvement in labor market conditions we've actually seen.

The fact that growth in economic output is still relatively slow invites a closer look at its largest component: household spending on goods and services. Consumption spending by households represents nearly 70 percent of GDP. What hints can it give us about our recent past — and, perhaps, our future?

Like GDP, household consumption spending settled into a new, lower trend rate after the recession, at least for now. It has been growing, but weakly. In terms of constant (inflation-adjusted) dollars, it has averaged 2.2 percent annual growth during the recovery, markedly less than the 2.9 percent growth it saw from 2001 to 2007.

To be sure, there are a number of reasons why this is unsurprising. The scale of the dislocation during the Great Recession — in terms of both unemployment and loss of wealth — was bound to leave an impression. Indeed, some have wondered whether the Great Recession scarred an entire generation, in much the same way a generation was scarred by the Great Depression. Milton Friedman and Anna Schwartz, in their book *A Monetary History of the United States*, noted that the Depression instilled “an exaggerated fear of continued economic instability, of the danger of stagnation, of the possibility of recurrent unemployment.” The Great Recession will surely not have a long-term effect of the same magnitude, but it is reasonable to assume that it is part of the reason for the trend in household spending that we are seeing today.

In addition, household spending is likely influenced by a pattern of greater volatility in income, a pattern that was in place before the recession. Research by Karen Dynan of the Brookings Institution, Douglas Elmendorf of the Congressional Budget Office, and Daniel Sichel of Wellesley College has found that the volatility of household income

increased about 30 percent, on average, between the early 1970s and the 2000s. Women's earnings became less volatile while men's became more so. Although the findings are skewed by increased variability at the top of the income distribution, there is also evidence that volatility has increased for lower-income workers.

Finally, a swath of workers in the middle of the income and skill distribution has been affected by technology trends and other trends that have left the demands for their skills relatively stagnant or declining as their jobs become automated. At the same time, these trends have resulted in

increased relative demand for high-skill workers and some low-skill ones. This relative decline of the middle tier of workers is sometimes referred to as a “hollowing out” of the workforce. Like the increase in income volatility, hollowing out began in earnest well before the Great Recession; it dates to around 1980.

But if rising income volatility and hollowing out both preceded the recession, why didn't we see negative effects on spending earlier? Why did spending

continue to grow during the 1990s and 2000s (up to the financial crisis) at roughly its historical pace?

The answer may be that those years were exceptional in ways that masked the downward spending pressures. Normally, we expect consumption spending to be driven by people's labor incomes and their beliefs about their future labor incomes. In the 1990s and 2000s, households seem to have drifted away from this principle.

One likely reason is the run-up in house prices, contributing to rising household wealth, which buoyed consumption growth. Another plausible reason is the expansion of consumer credit during this period. Moreover, these two effects probably reinforced one other; people felt wealthier, and therefore used tools such as credit cards and home equity lines of credit to tap into that wealth.

Today, in most parts of the country, it seems likely that it will be a considerable time before consumers again treat their housing equity as a source of spending money on the scale that they did during the boom years. Thus, the longer-term trends affecting income growth and volatility prospects for many households may well continue, for some time, to keep household spending on its present track of relatively slower growth. **EF**

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