

Special Commentary — May 10, 2021

Why Choose? A Case for Spending Growth in Services AND Goods

Summary

- A seismic shift in spending on services is right around the corner, but our analysis of prior cycles suggests that there is scope for continued growth in durable goods spending even though some demand for these big-ticket items has been pulled forward.
- To date, through March, the level of durable goods consumption is already 28% ahead of where it was prior to the crisis, compared to a scant 1% for overall consumer spending. The durable goods spending spree is quite unique to this cycle.
- Consider, it would take five years in a typical recovery for durable goods spending to rise as much as it has over the past 13-months, and we have never seen a 13-month spending surge on durable goods as strong as we are currently experiencing.
- In analyzing the past four economic cycles, durable goods spending to date has accounted for a little less than 40% of the average growth typically seen over an *entire* economic cycle. This suggests that, although this has been an unparalleled period of strength for durable goods consumption, there is still further room for growth.
- With the public health situation improving and the economy continuing to gradually reopen, households are again preparing to direct consumption toward services. We expect the sizable pickup in services spending to be the primary driver of consumer spending in the second half of the year, but our analysis demonstrates that it need not come at the expense of a complete collapse in goods spending.

Economist(s)

Tim Quinlan

Senior Economist | Wells Fargo Securities, LLC
tim.quinlan@wellsfargo.com | 704-410-3283

Shannon Seery

Economist | Wells Fargo Securities, LLC
shannon.seery@wellsfargo.com | 704-410-1681

Is the Party over for the Goods-Spending Boom?

Consumer spending has been a key driver of the post-COVID economic recovery. Yet, most of the outlays thus far have been on goods rather than services. There is a seismic shift on the very near horizon in which spending will transition back to the much-larger services category. This report explores whether the full reopening of the service economy needs to come at the expense of further growth in goods outlays.

Our work finds that spending on goods is already several years ahead of where it typically would be at this stage of the cycle. In ordinary circumstances, when demand is pulled forward like that, a soft patch follows. For some durable goods categories, that is indeed what we expect. But on balance, we see scope for goods spending to continue, if not completely undaunted, at least without a period of prolonged weakness.

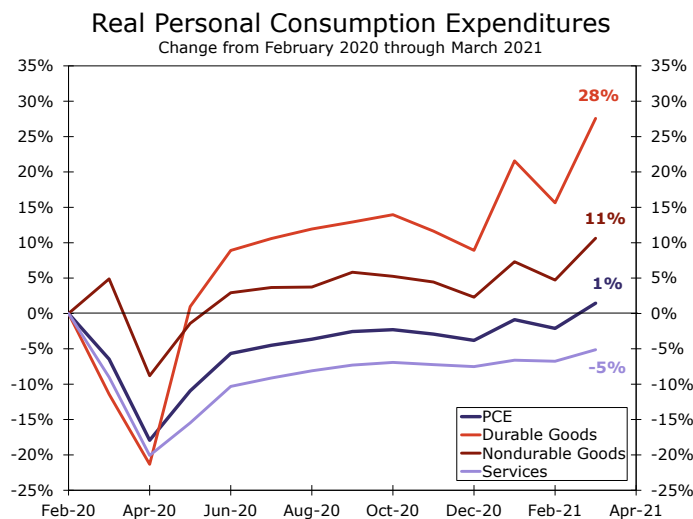
One key factor that could sustain goods spending is the record household savings banked up over the past year. Another consideration is that although goods spending is well-ahead of where it would be in prior cycles, it still has a long way to go to reach the typical full-cycle increase. Where danger could be lurking is within those categories which have already enjoyed a surge in spending typical of a full-cycle increase. But the substantial accumulated household savings could mitigate some downside risk, even for these categories which have already seen huge gains. The key question is whether those demand dynamics that drove such outlays in the first place were unique to the pandemic era. A top concern for us is spending on autos, the definitive example of durable goods.

In a Typical Rebound, It Would Take Five Years to See This Kind of Growth

Real goods spending is 16% ahead of its pre-pandemic February 2020 level. The strength has been most evident in outlays on big-ticket items meant to last a few years, causing durable goods consumption to soar 28% ahead of where it was prior to the crisis (Figure 1). The durable goods spending spree is quite unique to this cycle and the peculiar circumstance of households largely unable to spend on services while also finding themselves on the receiving end of several rounds of government stimulus checks. Flush with cash and few places to spend it, this category is way ahead of where it typically is at this stage of the economic cycle.

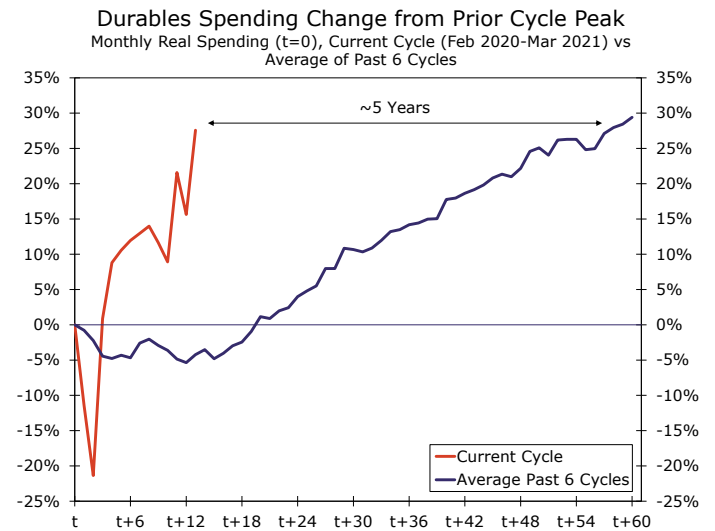
The red line in Figure 2 is the same calculation as the red line in Figure 1. It is the change in durables consumption since February 2020. In Figure 1, we compare it to spending on other major categories in this cycle, and in Figure 2, we compare it to the typical trajectory of durables consumption over the past six economic cycles going back to the mid 1970s. What the historical record tells us is that when recessions come along, households usually cut back sharply on durables spending for the first year and a half. Around two years in, momentum picks back up as consumers take advantage of low interest rates to finance purchases amid an improving economic backdrop. But this cycle has been very different. With durables spending already 28% ahead of its prior peak, spending has risen to a point typically seen five years into an economic recovery.

Figure 1



Source: U.S. Department of Commerce and Wells Fargo Securities

Figure 2



Source: U.S. Department of Commerce and Wells Fargo Securities

A Spending Boom Unmatched Since at Least the 1950s

For a little more than a year now, it has been impossible to spend on many services, a dynamic we have called “forced thrift.” Coupling behavioral changes with an influx of cash from fiscal stimulus unleashed a durable goods spending spree unlike anything ever seen. In data going back to 1959, there has never been a 13-month spending surge on durables as strong as we have seen over the past year. The fact that this spending boom has occurred alongside the highest average personal saving rate since at least the 1970s attests to the massive size of the stimulus programs.

To varying degrees, consumers spent on everything from recreational goods to home furnishings and appliances. Every major category of goods except gasoline is well-above its pre-pandemic level (Figure 3). Although 2020 will be remembered as a tough one for retailers, some store types actually reported the best sales year on record.

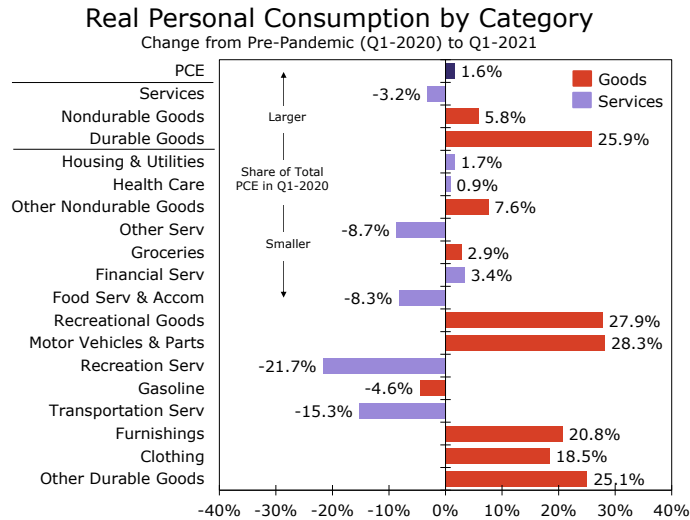
As Good As It Gets?

The unparalleled strength in goods consumption we have experienced raises the question of how sustainable goods spending will be as the larger service sector reopens amid increased vaccinations. To estimate how much further durables spending has to run, we calculated how far durables spending

typically gets above the prior-cycle peak during a business cycle and compared it to where durables spending is today relative to its Q1-2020 level.

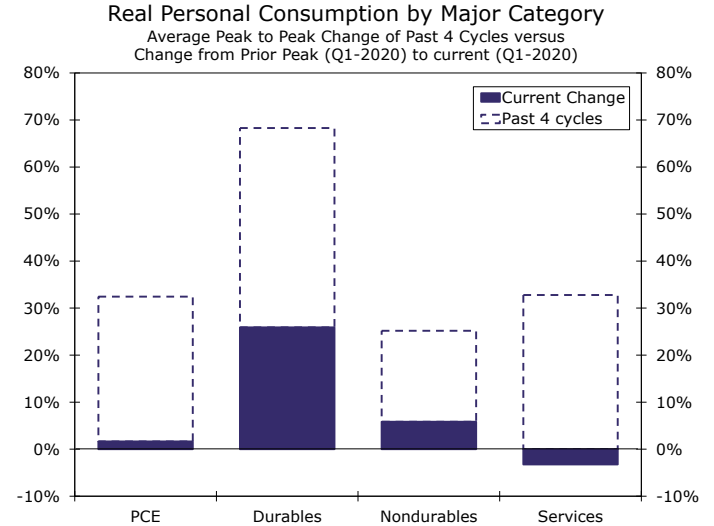
To that end, [Figure 4](#) demonstrates durables spending typically rises nearly 70% ahead of its prior-cycle peak on average during a cycle, and durables is already over 25% ahead of its peak as of Q1-2021. In other words, growth in durables spending to date has accounted for a little less than 40% of the growth we typically see over an entire cycle.

Figure 3



Source: U.S. Department of Commerce and Wells Fargo Securities

Figure 4



Source: U.S. Department of Commerce and Wells Fargo Securities

How Often Do You Have to Replace an Automobile?

Durables spending has clearly grown the most out of every major spending category, but what this exercise makes clear is that there is still room for growth in durables this cycle. This is also true of the underlying goods categories.

That said, some categories are at risk of demand having been pulled forward. Of all the durable goods categories, growth in auto and parts consumption is the closest to its typical full-cycle growth. To date, this category has already experienced about 80% of the typical growth we see in a full cycle. In addition to supply problems, particularly the sourcing of semiconductors, the auto industry must confront the reality that it has already seen a majority of its typical full-cycle sales growth.

The next highest category is *other durables* (jewelry, therapeutic equipment, luggage, communication equipment), where growth, to date, has accounted for 45% of typical growth. At the other end of the spectrum, and perhaps most remarkable, is the recreational goods spending component, which is nearly 30% ahead of its prior peak today, but that only accounts for 16% of the typical growth that we see in this category over an entire cycle.

Case for Sustained Goods Spending, if Supply Chains Don't Get in the Way

The pivot toward services consumption should be around midyear if the share of those vaccinated rises and the economy continues to gradually reopen. Services will become the primary driver of consumer spending but that need not come at the expense of a collapse in goods.

An ample amount of excess household savings, the likelihood of more time at home even once the crisis has passed, and low borrowing costs should sustain demand for goods. The biggest risk, at present, is not a lack of demand but rather a lack of supply. The surge in spending over the past year has depleted inventory levels with retail inventory-to-sales ratios hovering at record lows. Supply constraints are weighing on domestic production of goods while transportation bottlenecks at U.S. ports are also delaying deliveries of consumer goods from abroad. These supply problems all have the potential to hamper sales. If retailers cannot get their hands on products, no matter how strong demand remains, sales will suffer.

Subscription Information

To subscribe please visit: www.wellsfargo.com/economicsemail

The 2021 Annual Economic Outlook: *Aftershocks and Divergence in the Post-Pandemic Economy* is available at wellsfargo.com/economicoutlook

Via The Bloomberg Professional Services at WFRE

And for those with permission at research.wellsfargosecurities.com

Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	International Economist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	International Economist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economist	(704) 410-1681	shannon.seery@wellsfargo.com
Hop Mathews	Economic Analyst	(704) 383-5312	hop.mathews@wellsfargo.com
Nicole Cervi	Economic Analyst	(704) 410-3059	nicole.cervi@wellsfargo.com
Sara Cotsakis	Economic Analyst	(704) 410-1437	sara.cotsakis@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com

Required Disclosures

This report is produced by the Economics Group of Wells Fargo Securities, LLC, a U.S. broker-dealer registered with the U.S. Securities and Exchange Commission, the Financial Industry Regulatory Authority, and the Securities Investor Protection Corp. Wells Fargo Securities, LLC, distributes this report directly and through affiliates including, but not limited to, Wells Fargo & Company, Wells Fargo Bank N.A., Wells Fargo Clearing Services, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Europe S.A., Wells Fargo Securities Canada, Ltd., Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. Wells Fargo Securities, LLC is registered with the Commodity Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. Wells Fargo Bank, N.A. is registered with the Commodity Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. Wells Fargo Securities, LLC and Wells Fargo Bank, N.A. are generally engaged in the trading of futures and derivative products, any of which may be discussed within this report.

The information in this report has been obtained or derived from sources believed by Wells Fargo Securities, LLC to be reliable, but Wells Fargo Securities, LLC does not guarantee its accuracy or completeness, nor does Wells Fargo Securities, LLC assume any liability for any loss that may result from the reliance by any person upon any such information or upon any opinions set forth herein. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sale of any security or other financial product or as personalized investment advice. Wells Fargo Securities, LLC is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company. © 2021 Wells Fargo Securities, LLC

Important Information for Non-U.S. Recipients

For recipients in the United Kingdom, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority. For the purposes of Section 21 of the UK Financial Services and Markets Act 2000 ("the Act"), the content of this report has been approved by WFSIL, an authorized person under the Act. WFSIL does not deal with retail clients as defined in the Directive 2014/65/EU ("MiFID2"). The FCA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. For recipients in the EEA, this report is distributed by WFSIL or Wells Fargo Securities Europe S.A. ("WFSE"). WFSE is a French incorporated investment firm authorized and regulated by the Autorité de contrôle prudentiel et de résolution and the Autorité des marchés financiers. WFSE does not deal with retail clients as defined in the Directive 2014/65/EU ("MiFID2"). This report is not intended for, and should not be relied upon by, retail clients.

SECURITIES: NOT FDIC-INSURED - MAY LOSE VALUE - NO BANK GUARANTEE