Economics

Special Commentary — May 24, 2021

Recreation Renaissance

How a Rebound in Leisure Spending Holds the Key to Growth

Summary

- With goods spending already well-above its pre-pandemic level, a seismic shift to services outlays is imminent. This report unpacks just how large a services boom we're expecting and how important a role leisure spending plays in the recovery.
- Real services spending remains 5.1%, or $272 billion, below its pre-pandemic, Q1-2020 level through the first quarter of this year.
- Our forecast puts the level of services spending roughly $700 billion higher than it was in the first quarter of this year by the end of 2021. Matching the growth rate from the prior expansion, that's equivalent to *more than four and a half years* of typical spending packed into nine months.
- A majority of services spending is already back above its pre-pandemic level, driven by three major consumption categories we've dubbed as "staples": *Housing & utilities, financial services & insurance* and *health care*.
- It is the four consumption categories associated with leisure activity that remain below their pre-pandemic level: *food services & accommodation, recreation services, transportation services* and *other services*.
- These "discretionary" expenditures are all categories that stand to benefit from a resurgence in leisure activity and vacation travel this year, and they represent the areas poised for the fastest growth amid the services sector surge we expect to see in coming months.

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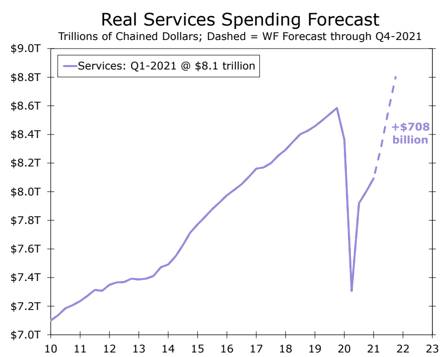
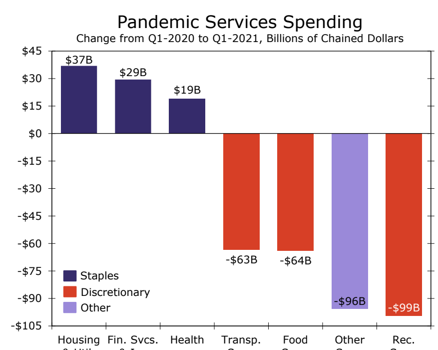


Source: U.S. Department of Commerce and Wells Fargo Securities



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The Economy Will Take Off If You Will

The robust economic rebound over the past year has been driven largely by consumer spending and while the bulk of that spending has so far been on goods, a seismic shift to the much-larger services category is imminent. Our forecast looks for the service sector to see the equivalent of more than four years of typical spending packed into the remaining three quarters of this year—it's an earthquake. This is central to our above-consensus forecast for consumer spending this year and this report looks at the important role that leisure spending plays in this unprecedented surge.

Consumers are flush with cash, and over the past year, when given the opportunity to spend, without exception they have. Outlays on both durable and nondurable goods have fully recovered and gone on to new highs. Even within services, in the places where people *can* spend their money like housing, financial activities and even health care, spending has fully recovered pandemic-related losses. For the most part, it is just the fun stuff that is left—the activities that have been out-of-bounds amid restrictions and social distancing requirements. Leisure spending on things like dining out, hotels, travel and various categories of recreational services will be a key engine of growth over the next few quarters.

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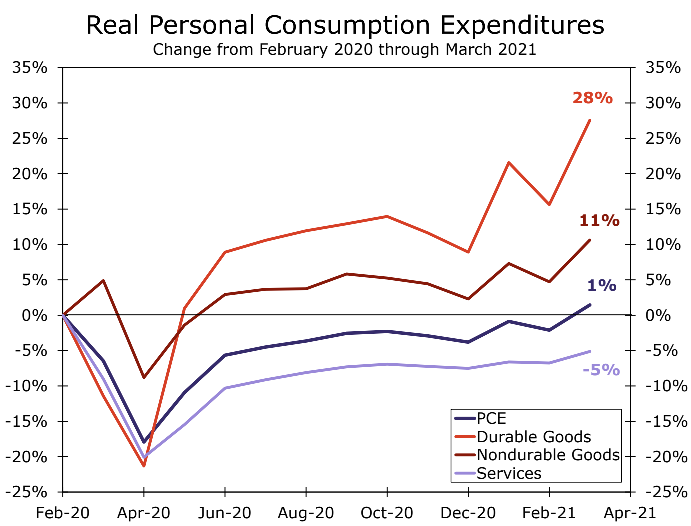
The Sleeping Giant Is Waking

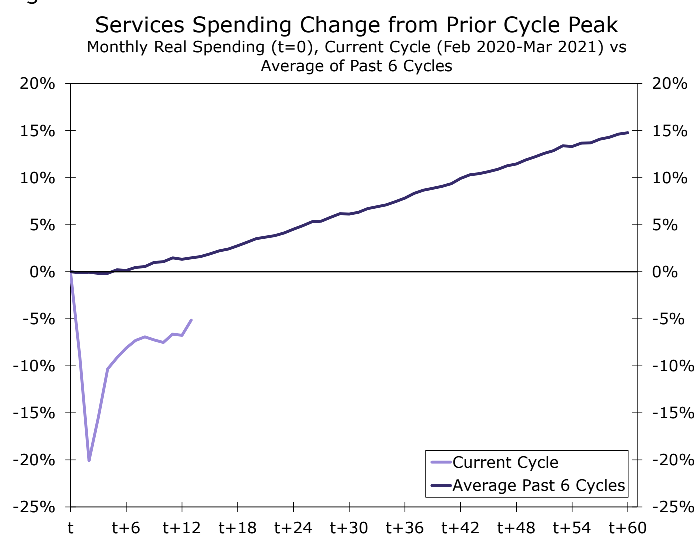
Held back only by leisure spending and a category simply called "other services" (to which we will return in a moment), real services spending is still 5.1% below its pre-pandemic, February 2020 level, even as goods spending has soared (Figure 1). This is very unlike what typically happens in an economic downturn. The purple line in Figure 2 is the same calculation as the purple line in Figure 1. It is the change in services 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 services consumption over the past six economic cycles going back to the mid-1970s. The point is that when recessions come along, households usually continue spending on services even as they cut back sharply on durables spending. Since consumer spending on services is typically twice as large as outlays on goods, the steady growth, even in hard times, acts like a heavy keel and keeps consumer spending from weighing down the economy during stormy times.

Figure 1



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

Figure 2



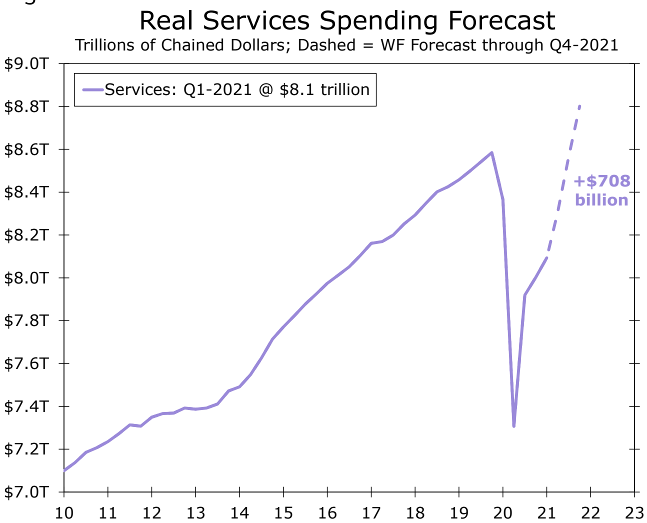
Source: U.S. Department of Commerce and Wells Fargo Securities

For the past year, the pandemic flipped the script on this story, suppressing the large service sector...until now. For all the heartache and economic pain suffered in the past year in the services economy, the other side of this crisis is now in sight. As the economy reopens, spending on services is the key to the consumer and broader economic recovery.

For now, services spending still has some ground to regain. In a period of record highs in most measures of good spending, it is easy to overlook how large a gap still exists between services spending now and where it was prior to the pandemic. Although 5.1% may not sound like much, in dollar terms that services spending gap is $271.8 billion. Between 2011 and 2019, real service spending grew on average about $150 billion per year. In other words, if we matched the spending growth of the prior expansion, it would take almost two years from now to grow services spending back to where it was before the pandemic. Note, however, that we expect a lot more than just getting back to the pre-pandemic level; that milestone could be reached as soon as the second quarter. The big point we are trying to get across is that between now and the end of the year, our forecast puts the level of services spending roughly $700B higher than it was in the first quarter (Figure 3). That's more than four and a half years of typical spending packed into nine months. It's an earthquake.

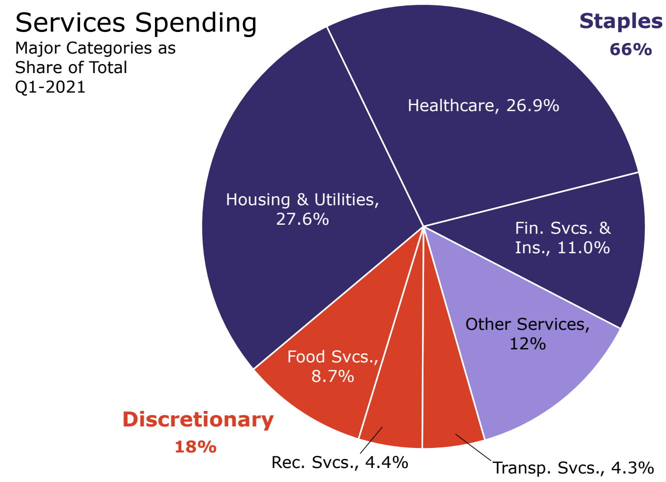
If that sounds too bold or unrealistic, consider this: Household savings in the first quarter alone was $4.12 trillion, annualized, which in round numbers is about $1 trillion in non-annualized-added savings just during the first quarter. Recall that two rounds of stimulus checks arrived in the first quarter and not all of it was spent. With that kind of money, consumers could use savings from the first quarter alone to pay for $700 billion in services spending this year and still have $300 billion to spare. This spending would not even call into service the accumulated store of savings accrued over the past year. That means money left over to sustain goods spending to boot.

Figure 3



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

Figure 4



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

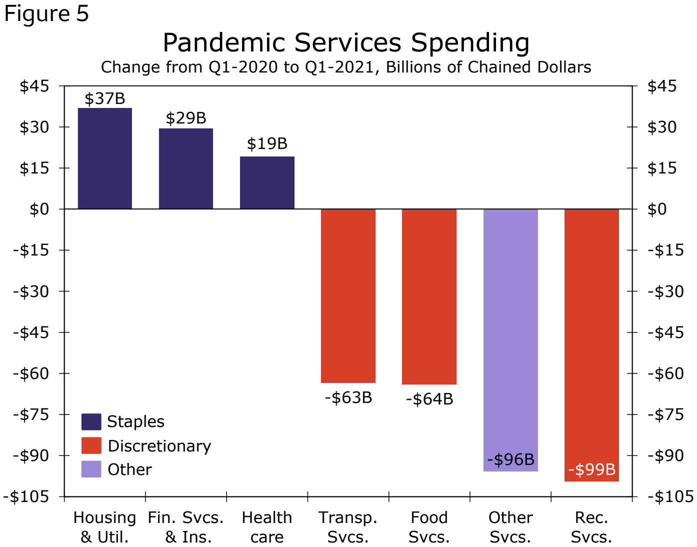
Counting Upon Your Discretionary Spending

There are seven major categories of services spending. Three have already fully recovered. *Housing & utilities, financial services & insurance* and *health care* are all above their pre-pandemic peak. On an inflation-adjusted basis, prior to the pandemic, these three categories together summed to just over $5 trillion or over 60% of all services outlays (Figure 4).[1] These three categories comprise the bulk of service sector spending and can be thought of as the "must-do" service outlays. Terms like consumer staples vs. consumer discretionary are more often used for capital markets analysis of various industry sectors. Economics doesn't use exactly the same categorization. The Commerce Department breaks out "Expenditures by Major Type of Product and by Major Function." Still, we can think of these three largest categories as fitting into a broader classification of staples spending within the service economy.

There are four remaining services categories that are still below where they were just prior to the pandemic: *food services & accommodations, recreation, transportation* and the catch-all category *other services* (Figure 5). If you back out "other services," the common denominator for all these remaining services categories is that they are all things you can do on vacation (we will tackle other services on its own in an upcoming report). Sure, some transportation spending is down because people are working from home, and part of the missed spending on meals and hotel stays is because business travel has not yet ramped back up fully. But these categories all stand to benefit from a resurgence in leisure activity and vacation travel, and they represent the areas poised for the fastest growth amid the services spending surge we expect to see in coming months. Nowhere is this more true than it is for recreational services; this category is down 21.7% from where it was in Q1-2020. That is the deepest hole of any major category of consumer spending including all goods and services categories.

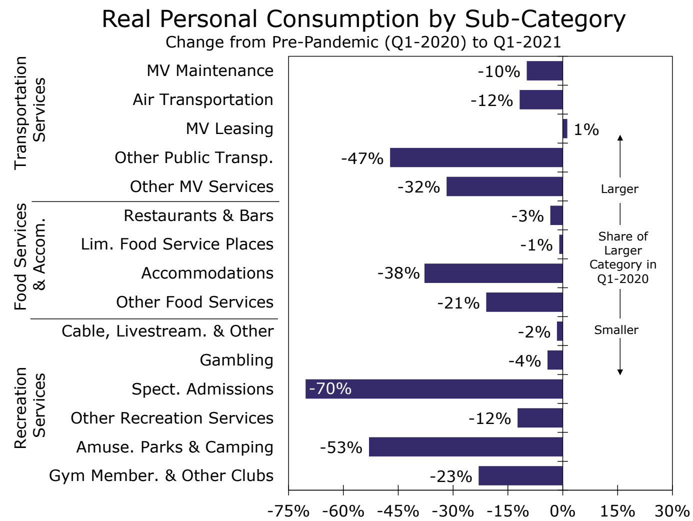
We now unpack the underlying spending components of these three hard-hit major consumption categories seen in Figure 6, and discuss where spending is apt to see the most growth this year. Please see the Appendix for details on the sub-category spending components.

Figure 5



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

Figure 6



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

Transportation Services: On the Road Again

The transportation services category is a fitting starting point for a discussion about "getting back out there" after a year spent mostly at home. More than half of the spending in this category is tied to motor vehicles in one form or another. Recall here that motor vehicle sales are captured in durable goods spending; here we are simply unpacking the service spending related to autos. Auto leases are counted as a service, and amid demand that is outpacing supply in auto sales, leasing has not surprisingly retraced its losses. In fact, it's the only sub-category in Figure 6 that is positive.

Motor vehicle maintenance & repair is the largest component of spending in this category. Data are not broken out further, but our guess would be that maintenance spending is actually up. With new cars in short supply, the price of used cars has shot up in recent months, so if this category is down we suspect it has to do with fewer repairs over the past year because people have been driving less. It is the same reason you might have received a partial refund on your auto insurance.

Air travel was hit hard early on in the pandemic, but some intrepid travelers have already been back flying the friendly skies. Those who may have been reluctant to fly previously might be packing their suitcases again after getting the vaccine. Eventually business travel will come back online as well, although that may be more of a 2022 story. Still, we expect spending on air travel to dig out over the next few quarters.

Perhaps the least surprising development here is that spending on public transit is still down roughly half from where it was prior to the pandemic; not many people have been clamoring to crowd onto a bus or train with a deadly airborne virus going around. This too is already changing; the NYC subway is now back in business and running 24 hours/day again. Taxicabs and ride-sharing, which also roll up under public transportation, are on an upward trajectory.

Food Services & Accommodations: Miss, What's the Old 96er?

The food services & accommodations category is still about $64 billion below where it was just prior to the pandemic. The two biggest sub-categories here are bars & restaurants along with limited food service places; together they account for about 80% of spending. The distinction between these similar sounding sub-categories is that limited service eating places are typically spots where patrons order or select items and pay prior to eating. As restaurants improvised over the past years shifting to delivery and take-out, most of the losses have been retraced. Both measures are down only slightly and in fact, the counterpart category in the monthly retail sales report has fully recovered. That is not to say there is no room for further growth. On the contrary, as seating limitations are rolled back and mask requirements are lifted people are eager to go out to eat again. This is as evident in high-frequency data like the jump in OpenTable's seated diners as it is in a walk through the restaurant districts in many American cities which are suddenly busy again.

Hotels obviously had no version of take-out to offer over the past year. No surprise then that accommodations spending is still down 38%, which is more than any other component in this category (Figure 6). While this space only accounts for 15% of this category's total spending, there is scope for a sharp rebound as business travel and especially personal vacations ramp up this summer. Many sought-after locations are already booked through Labor Day.

Other food services captures food provided to workers as well as food for the military. Also included here is spending at school cafeterias and at daycare settings as well as dining services at colleges and universities. As things get back to normal, we expect a full recovery in this small category as well. In fact, spending here could eventually get a lift from fiscal stimulus programs currently being considered on Capitol Hill which propose $45 billion in funding for K-12 nutrition as well as $200 billion for free universal pre-K for three- and four-year-olds, some of which would no doubt find its way into money for juice boxes and applesauce.

Recreation Services: I Know What You Did Last Summer

The surge in summer recreational products last summer was a defining characteristic of the crisis. Social distancing guidelines and stay-at-home orders led consumers to spend on goods that made at-home life more enjoyable. This drove recreational goods & vehicles spending 28% ahead of its prior peak, which leaves this category just shy of matching autos for the title of the most pandemic-related growth of any category. This is in stark contrast to the equivalent spending category on the services side, recreational services, which remains nearly $100 billion below its pre-pandemic level, the worst off of any major category of spending.

The details of recreational services, however, reveal some services also benefited from stay-at-home orders. What else can you do when you're stuck at home? Rent a movie. Streaming & rental services spending has fully recovered and remains 13% ahead of its pre-pandemic level as of the first quarter. But spending on streaming services could experience some slippage this year as the service sector reopens. The average American household now subscribes to four different video streaming services and as households are set to spend less time at home after the pandemic, it remains to be seen if any of these services are cut.[2] Spending at photo studios and repair of information processing equipment has held back the overall gain to date in the cable, live stream & other category, which remains 2% shy of its pre-pandemic level (Figure 6).

Spending on gambling has begun its recovery and remains just 4% below its pre-pandemic level, reflecting the reopening of many casinos in June and a surge in spending on lotteries, which perhaps reflects consumers who were awash with cash and little ways to spend it. As leisure travel picks up more rapidly this year, gambling consumption should continue to rise as should admissions, whether it be to amusement parks, camping grounds or spectator events. Spectator admissions, which includes movie theaters, live entertainment and spectator sports, defines the very activities unavailable throughout the pandemic and is unsurprisingly 70% below its pre-pandemic level and remains the worst off of any sub-category in Figure 6. This spending category should boom this year as households itch to participate in these long-awaited experiences. The overall desire for experiences should propel this hard-hit spending category higher, and we expect recreation services to be a key engine for growth in spending this year.

Time for Leisure to Get to Work

A seismic shift in consumption to the much-larger services category is imminent. Our forecast calls for more than four and a half years of typical spending packed into the next nine months. It's not any old rebound; it's an earthquake. The reopening of the service sector is giving way to an unprecedented level of pent-up demand for many services. Ample personal savings stocked up over the past year due to forced thrift throughout the pandemic as well as generous stimulus support leaves households in a strong position to spend, while the desire to get out and again participate in experiences has perhaps never been stronger. We expect services to be the main driver of consumer spending this year, led by discretionary spending in categories associated with leisure activities and vacation travel.

Appendix

Figure 7 Sub-Category Definitions

Major Category	Sub-Category Name	Sub-Category Details	Line Item*
Transportation Services	**MV Maintenance**	Motor vehicle maintenance and repair	188
	Air Transportation	Air transportation	203
	MV Leasing	Motor vehicle leasing (Auto leasing & Truck leasing)	190
	Other Public Transp.	Ground transportation (Railway transportation & Road transportation) Water transportation	196 204
	Other MV Services	Motor vehicle services *minus* Motor vehicle maintenance and repair & Motor vehicle leasing (Motor vehicle rental & Parking fees and tolls)	187 *minus* 188 & 190
Food Services & Accommodations	**Restaurants & Bars**	Meals at other eating places Meals at drinking places Alcohol in purchased meals	239 240 241
	Lim. Food Service Places	Meals at limited service eating places	238
	Accommodations	Accommodations (Hotels and motels & Housing at schools)	245
	Other Food Services	Food services *minus* Meals at limited service eating places & Meals at other eating places & Meals at drinking places & Alcohol in purchased meals (Meals at schools & Food furnished to employees, including military)	231 *minus* 238 & 239 & 240 & 241
Recreation Services	**Cable, Livestream. & Other**	Audio-video streaming, photographic, and information processing equipment repair services	214
	Gambling	Gambling (Casino gambling, Lotteries)	222
	Spect. Admissions	Admissions to specified spectator amusements (Movie theaters, Live entertainment & Spectator sports) Museums and libraries	209 213
	Other Recreation Services	Other recreation services (Veterinary Services, Package tours & Repair of recreational vehicles and equipment)	226
	Amuse. Parks & Camping	Amusement parks, campgrounds and related recreational services	208
	Gym Member. & Other Clubs	Membership clubs and participant sport centers	206

Source: U.S. Department of Commerce and Wells Fargo Securities
*Line Item from Table 2.4.6U Real Personal Consumption Expenditures by Type of Product, Chained Dollars

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

Endnotes

[1] The detailed services' data in this report reflect *Household Consumption Expenditures for Services* and do not include *Final Consumption Expenditures of Nonprofit Institutions Serving Households* (Line Item 338 in BEA NIPA Table 2.4.6U), which account for about 4% of total services spending. Figure 4, therefore, only reflects about 96% of total services spending. This category of services includes health, recreation, education, social & religious, foundations, social advocacy, civic organizations and professional advocacy services. Spending remains about 13%, or $52 billion, below its pre-pandemic level. (Return to Section)

[2] Prange, S. "Average U.S. Streaming Household Now Subscribes to Four SVOD Services." Media Play News. January 2021. (Return to Section)

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