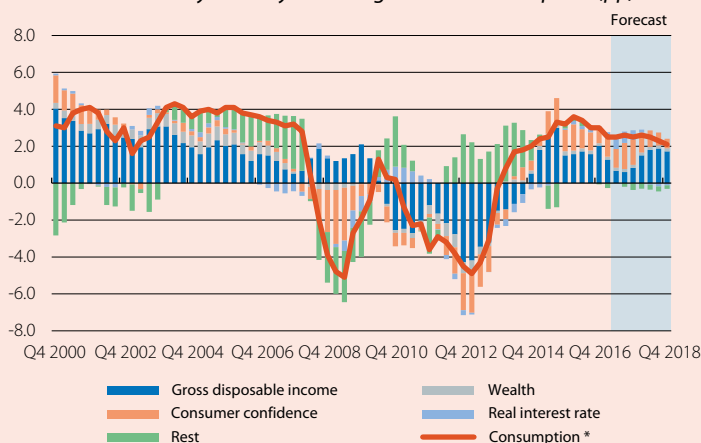CONSUMPTION: NEW TRENDS

The recovery of consumption in Spain: reasons and outlook

The evolution of consumption of Spanish households, which accounts for almost 60% of GDP, determines the cyclical situation of Spain's economy. That is why we need a close examination of how households spend their money and the key conditioning factors throughout the economic cycle. The first article in this Dossier attempts to achieve precisely that. By way of introduction, job creation, increased confidence and favourable financial conditions are the main factors behind private consumption's dynamic performance in the current recovery. These factors will continue to support consumption, especially of durable goods, over the coming quarters.

Household consumption has been growing non-stop since mid-2013.[1] Its growth rate has been faster than expected, easily outperforming the rate recorded for the euro area as a whole over the same period. However, it is still 3.9% below the peak reached before the crisis due to the huge adjustment carried out during the recession.[2] Two quite different recessionary periods can be observed. Consumption began its first downward phase early in 2008 due to the international financial crisis and the bursting of the real estate bubble, falling by 6.5% in just five quarters. Subsequently, after a year of very slight growth (0.3% quarter-on-quarter on average), in Q3 2010 private consumption declined again, this time for a longer period, falling to its lowest level in Q2 2013 and accumulating a 14.3% drop compared with its pre-crisis figure.

Determining factors of consumption

Contribution to the year-on-year change in real consumption (pp)

Note: * Year-on-year change (%). Data in real terms.
Source: CaixaBank Research, based on data from the INE, the European Commission and the Bank of Spain.

The underlying factors behind these two recessionary phases for consumption are quite different (see the enclosed chart).[3] In the first phase (2008-2009), the decrease in consumption was not accompanied by a fall in households' gross disposable income (GDI). In fact, GDI continued to increase at a similar rate to the one recorded over the five years prior to the crisis (an annual average of 2.3%). We can therefore conclude that other factors led to the decline in consumption during this period, in particular plummeting consumer confidence, which fell from levels similar to the historical average in 2007 to an all-time low in February 2009. Confidence was lost due to uncertainty, given the worsening economic outlook. Households therefore increased their savings for precautionary reasons,[4] resulting in less consumption.

In clear contrast, the second period of sharp falls in consumption (2010-2013) was characterised by a big decrease in GDI, resulting especially from job losses and, to a lesser extent, wage containment. Other factors also played their part, such as the deterioration in consumer confidence, a decline in the net wealth of households, both financial and real estate, and tougher conditions to access credit. All the ingredients for a recessionary cocktail.

The turning point for the consumption trend came in the second half of 2013, when it started to recover and gradually picked up momentum, reaching a growth rate close to 3% between 2015 and Q2 2017, on average. This exceptional performance by consumption is due to the aforementioned factors starting to have a positive effect. Firstly, the economic recovery is substantially boosting job creation, resulting in growth in GDI even though the still necessary wage containment is acting as a lid on this growth. Improved expectations regarding the labour market trend are also having a positive effect on consumption. Specifically, the better economic conditions are not only encouraging consumption among those directly benefitting (such as people finding employment) but are also boosting consumption among other households. For instance, those who already had a job but are now less afraid of losing it. This confidence effect is the reason why savings are currently a significantly below their historical average.

1. Specifically, in real terms, 10.5% cumulative growth between Q3 2013 and Q2 2017, an annual average of 2.5%. In nominal terms, cumulative growth was 9.3%, an annual average of 2.2%.
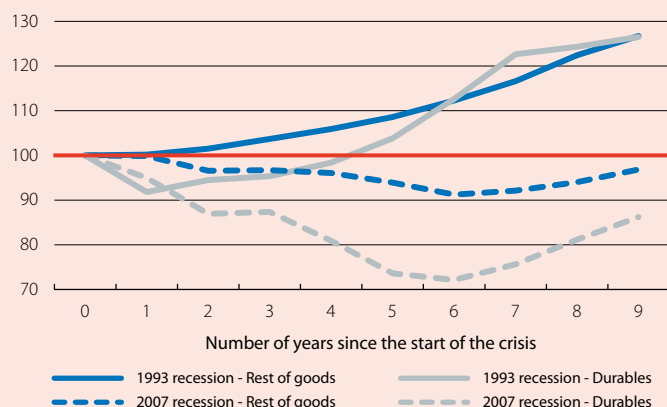2. In this article the data are in real terms, unless otherwise specified.
3. Contributions to the variation in consumption are based on an estimate in two steps. In the first step, a univariate regression of consumption and GDI has been estimated (year-on-year change). The residuals from this first stage are used as a dependent variable for a second regression, in which the explanatory factors included are consumer confidence (lag), household net wealth and the real interest rate.
4. The savings rate rose from 5.9% in 2007 to 13.4% in 2009, significantly higher than the historical average of 9.6%.

Consumption of durables and the rest of goods in recessions
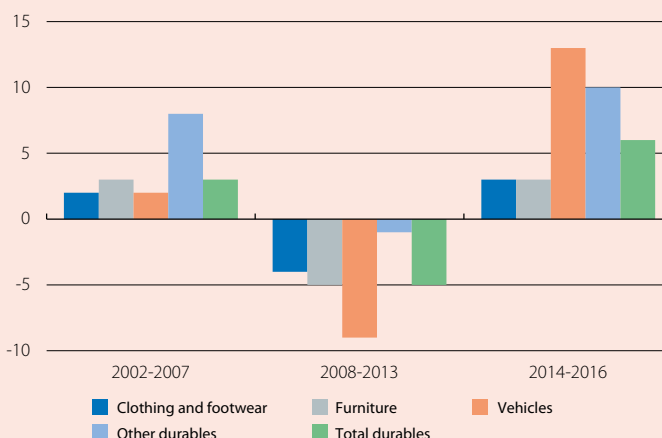
Index (100 = year the crisis started)

Number of years since the start of the crisis

— 1993 recession - Rest of goods   — 1993 recession - Durables
--- 2007 recession - Rest of goods   --- 2007 recession - Durables

Note: Data in real terms.
Source: CaixaBank Research, based on data from the INE.

Consumption of durables in different periods

Average annual change (%)

■ Clothing and footwear   ■ Furniture   ■ Vehicles
■ Other durables   ■ Total durables

Note: Data in real terms.
Source: CaixaBank Research, based on data from the INE.

Another reason for the recovery in consumption is the improved wealth of all households, both financial and real estate. That is, the recovery in the real estate market and in financial asset prices is supporting growth in net household wealth. This is very important in our current situation since household deleveraging is now at a very advanced stage, greatly improving their capacity to access credit. Financial conditions for consumer loans have also improved considerably thanks to the ECB's accommodative monetary policy and the fact that banks' solvency and liquidity ratios are now much improved (see the article «Situation and outlook for consumer financing» in this Dossier).

Given this highly favourable environment, CaixaBank Research expects the positive trend in the main determining factors for consumption to continue, resulting in solid growth, namely 2.6% in 2017 and 2.4% in 2018. Although job creation is expected to slow down slightly over the next few quarters, moderate wage rises and the continuing low level of inflation will support GDI growth in real terms. These forecasts also assume the savings rate will remain at around its current level of 6.5%. In any case, a 1pp increase in the savings rate from its current level, a rate more in line with that recorded in the period 2015-2016, would also be compatible with notable growth in consumption (around 2% in 2018).

There is, however, significant variation between different goods and services which is not revealed by the overall trend for spending. One especially relevant aspect that illustrates the particular features of the consumption trend in Spanish households over the last economic cycle is the pattern of adjustment in consumer durables. In broad terms, spending on durables, such as vehicles, furniture and domestic appliances, is very sensitive to the economic cycle since households tend to delay buying such goods during economic recessions (as shown by the second chart).[5] However, on this occasion there was also a marked adjustment in the consumption of other goods, unlike the consumption pattern observed in the less severe recession of 1993.

Another especially important observation is the time required for the consumption of durables to get back to its pre-crisis level. It took five years after the 1993 recession to return to the pre-crisis level of durable goods consumption, while this was still 14% below its pre-crisis level nine years after the 2007 recession. The cycle has been even more marked in the particular case of vehicle purchases. Although sales rose strongly in the period 2014-2016 (13.4% on average, see the third chart), the current number of registrations is only 72% of the figure reached at the pre-crisis peak (2005).

In short, the outlook for household spending and particularly on consumer durables is promising. As we have seen, all the underlying factors are encouraging: job creation is performing well, moderate wage rises are expected in a context of still low inflation, confidence is at an all-time high and financial conditions are favourable.

Judit Montoriol Garriga
Macroeconomics Unit, Strategic Planning and Research Department, CaixaBank

5. Based on the final consumption expenditure of households according to national account data (two-digit COICOP classification), the different products have been grouped into two categories: durables (codes 3, 5, 7.1, 8.2, 9.1, 9.2 and 9.3) and the rest of goods and services. See «La recuperación del consumo privado en España por tipo de producto y hogar», Bank of Spain, June 2017.