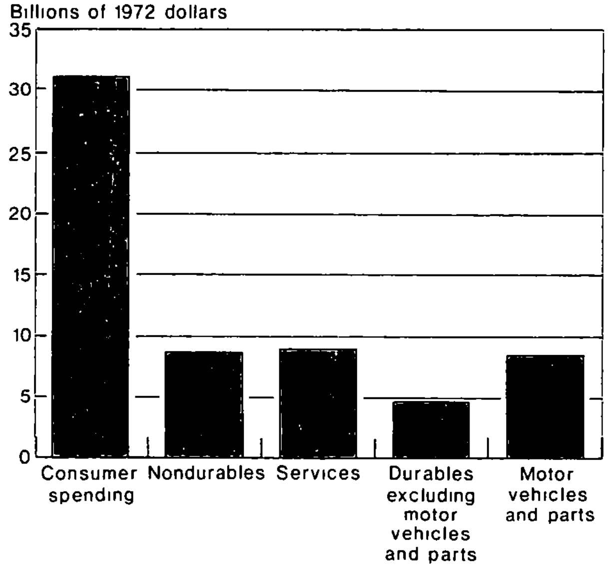
Why Consumption Surged in the First Half of 1983

The strength of the economy over the first half of this year surprised many forecasters who earlier had predicted a below-average recovery in economic activity Most of the economy's advance reflected a burst of consumer spending, much of which occurred in the second quarter, when the personal saving rate declined from 5 4 percent to 4 percent Between the fourth quarter of 1982 and the second quarter of 1983, real consumer expenditures rose $31 billion, more than two thirds of the increase in GNP This surge in spending

Composition of the Consumer Spending Surge in the First Half of 1983

Seasonally adjusted changes



Source: National Income and Product Accounts.

by households was fairly widespread among nondurables, services, and motor vehicles (chart). What caused households to go on a spending spree? Was it foreseeable before the recovery got under way?

Part of the spending surge may have reflected unintended purchases, e.g., expenditures on heating fuel because of the unusually cold weather in April and May. However, we estimate that almost half of the pickup in consumer spending can be attributed to three developments perhaps not easily foreseen or evaluated at the start of the recovery. These developments were the steep rise in the stock market into 1983, the decline in oil prices, and the extent to which automobile manufacturers provided incentive financing.

The *stock market* climbed more than 50 percent between mid-1982 and mid-1983, the largest advance in the value of stocks in the postwar period (Table 1). In particular, over the second six months of this recovery, stocks surged by more than in any other corresponding period since the 1950s. In dollar terms, the value of stocks expanded by about $600 billion between mid-1982 and mid-1983, a gain of about $270 billion in 1972 dollars.

How much did consumer spending rise as a result of this increase in the net worth of households? Economists have long been of the view that changes in wealth affect consumer spending (in addition to the primary influence of changes in income) and, based on historical relationships, have made estimates of such effects. According to the Federal Reserve-MIT-Penn (FMP) econometric model, consumption of nondurable goods and services can be expected to climb over the course of two years by about 4 percent of a sustained gain in stocks, with most of the increase occurring in the first twelve months. In addition, purchases of consumer durables should expand by about 0.4 percent of the gain. These estimates, applied to the 1982-83 advance in stocks, indicate an increase in real consumer spending over the first half of 1983 of $6.2 billion, or 20 percent of the observed surge in consumption (Table 2). Almost half of this impact on consumer spending can be attributed to the continued strength of the stock market during the first two quarters of this year.

Spot *oil prices* fell about $3 a barrel, or 10 percent, between the fourth quarter of 1982 and the second quarter of 1983. The decline in oil prices was passed along to consumers quickly. For instance, excluding the five cent increase in Federal excise tax on gasoline that went into effect in April 1983, gasoline prices in the April-to-June period stood 6.3 percent below their level in the fourth quarter of last year. This drop in prices essentially reflected a complete passing through of the lower oil prices, as the cost of oil represents about three fifths of the price of a gallon of gasoline. With households directly consuming about 2 billion barrels of oil a year, the cut in price was equivalent to an income gain in current dollars of $6 billion, or about $3 billion in constant dollars. Assuming that about 90 percent of this income gain was spent, the oil-price decline would account for about $2.7 billion in additional purchases over the first half of the year, 9 percent of the total advance of consumer spending.

Automobile manufacturers in the first half of this year broadened their *incentive-financing programs* to encompass almost all their domestic automobile models and light trucks. This development resulted in an average loan rate of 12 percent between January and June, compared with 14.4 percent in the fourth quarter of 1982. This lower interest rate raised car sales primarily for two reasons. First, by reducing the effective price of a car or light truck by about 4 percent, the lower rate increased the number of cars desired by households. Second, as the lower rate might have been viewed as temporary, the programs may have encouraged consumers to push ahead their purchases of a car. As a result, using the FMP model, we estimate that the lower interest rates led to an increase in real expenditures on cars of about $2.5 billion over the first half of this year. With this figure as a benchmark, we estimate that the incentive programs bolstered the sales of light

Table 1

Rise in the Stock Market

In percentage change

Trough of market	First six months of market recovery	Second six months of market recovery	First twelve months of market recovery
June 1949	9 4	25 0	36 8
September 1953	13 7	23 5	40 4
December 1957	15 8	19 3	38 1
October 1960	21 1	6 8	29 4
July 1970	31 1	4 7	37 2
December 1974	38 4	−2 2	35 3
March 1978	25 2	−1 4	23 5
April 1980	27 8	5 3	34 6
June 1982	32 8	17 8	56 4

Sources Estimated by authors using Standard and Poor's Dividend Price Ratio, and National Income and Product Accounts

Table 2

Some Determinants of Consumer Spending: Estimated Impacts in the First Half of 1983

In percent

Determinant	Change from recent trough or peak of determinant	Impact on consumer spending as a share of total rise in consumer spending
Rise in stock market	56	20
Decline in oil price	−10	9
Decline in automobile loan rates	−17	13

Sources Estimated by authors using Standard and Poor's Dividend Price Ratio, National Income and Product Accounts, *Ward's Automotive Reports*, Federal Reserve *Bulletin*, U S Department of Energy, and *Platt's Oilgram Price Report*

trucks by $1 5 billion Thus, the incentive programs may have accounted for about 13 percent of the rise in consumer spending over the first half of the year

To summarize our analysis, we estimate that three developments—the steep rise in the stock market, the drop in oil prices, and the automobile incentive programs—can explain more than 40 percent of the rise in consumer spending over the first half of 1983 This conclusion, of course, leaves room for other factors to have played a role. For example, households may have increased their spending partly in anticipation of the July tax cut. A reliable estimate of the extent to which this was so is, however, difficult to obtain Finally, the question remains why the surge in consumer expenditures was concentrated in April and May. While it is probably impossible to answer this question satisfactorily, we conjecture that people's views of the economy improved significantly in April, when employment began to rise sharply after being almost flat over the first three months of the year With this change in their outlook, households may have at last responded to the three developments that had already improved their ability to purchase goods and services In any case, since the spring the advance of the stock market has slowed, oil prices have stabilized, and automobile incentive programs have been scaled back considerably. These circumstances most likely help explain the slower growth of consumer spending in the third quarter

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