August 29, 2009

Reluctance to Spend May Be Legacy of Recession

By PETER S. GOODMAN

AUSTIN, Tex. — Even as evidence mounts that the Great Recession has finally released its chokehold on the American economy, experts worry that the recovery may be weak, stymied by consumers' reluctance to spend.

Given that consumer spending has in recent years accounted for 70 percent of the nation's economic activity, a marginal shrinking could significantly depress demand for goods and services, discouraging businesses from hiring more workers.

Millions of Americans spent years tapping credit cards, stock portfolios and once-rising home values to spend in excess of their incomes and now lack the wherewithal to carry on. Those who still have the means feel pressure to conserve, fearful about layoffs, the stock market and real estate prices.

"We're at an inflection point with respect to the American consumer," said Mark Zandi, chief economist at Moody's Economy .com, who correctly forecast a dip in spending heading into the recession, and who provided data supporting sustained weakness.

"Lower-income households can't borrow, and higher-income households no longer feel wealthy," Mr. Zandi added. "There's still a lot of debt out there. It throws a pall over the potential for a strong recovery. The economy is going to struggle."

In recent weeks, spending has risen slightly because of exuberant car buying, fueled by the cash-for-clunkers program. On Friday, the Commerce Department said spending rose 0.2 percent in July from the previous month. But most economists see this activity as short-lived, pointing out that incomes did not rise. Some suggest the recession has endured so long and spread pain so broadly that it has seeped into the culture, downgrading expectations, clouding assumptions about the future and eroding the impulse to buy.

The Great Depression imbued American life with an enduring spirit of thrift. The current recession has perhaps proven wrenching enough to alter consumer tastes, putting value in vogue.

"It's simply less fun pulling up to the stoplight in a Hummer than it used to be," said Robert Barbera, chief economist at the research and trading firm ITG. "It's a change in norms."

Here in Austin, a laid-back city on the banks of the Colorado River, change is palpable.

A decade ago, Heather Nelson gained a lucrative job in telecommunications and celebrated by buying a new Ford sport utility vehicle with leather seats and an expensive stereo system. Today, Ms. Nelson, 38, again has designs on a new vehicle, but this time she plans to buy a Toyota Prius, the fuel-efficient hybrid.

In December, Ms. Nelson was laid off from her six-figure job as a patent attorney at a local software firm. Self-assured, she exudes confidence she will land another high-paying position.

But even if her spending power is restored, Ms. Nelson says her inclination to buy has been permanently diminished. Through nine months of joblessness, she has learned to forgo the impulse buys that used to provide momentary pleasure — $4 lattes at Starbucks, lip gloss, mints. She has found she can survive without the pedicures and chocolate martinis that once filled regular evenings at the spa. Before punishing heat and drought turned much of central Texas brown, she subsisted primarily on vegetables harvested from her plot at a community garden, where only one oasis of flowers remains.

Once intent on buying a home, Ms. Nelson now feels security in remaining a renter, steering clear of the shark-infested waters of the mortgage industry.

"I'm having to shift my dreams to accommodate the new realities," she said. "Now, I have more of a bunker mentality. If you get hit hard enough, it lasts. This impact is going to last."

For years, Americans have tapped stock portfolios and borrowed against homes to fill wardrobes with clothes, garages with cars and living rooms with furniture and electronics. But stock markets have proven volatile. Home values are sharply lower. Banks remain reluctant to lend in the aftermath of a global financial crisis.

Households must increasingly depend upon paychecks to finance spending, a reality that seems likely to curb consumption: Unemployment stands at 9.4 percent and is expected to climb higher. Working hours have been slashed even for those with jobs.

Economists subscribe to a so-called wealth effect: as households amass wealth, they tend to expand their spending over the following year, typically by 3 to 5 percent of the increase.

Between 2003 and 2007 — prime years of the housing boom — the net worth of an American household expanded to about $540,000, from about $400,000, according to an analysis of federal data by Moody's Economy.com.

Now, the wealth effect is working in reverse: by the first three months of this year, household net worth had dropped to $421,000.

"Not only have people lost money, but they don't expect as much appreciation in the money they have, and that should affect consumption," said Andrew Tilton, an economist at Goldman Sachs. "This is a cultural shift going on. People will save more."

As recently as the middle of 2007, Americans saved less than 2 percent of their income, according to the Bureau of Economic Analysis. In recent months, the rate has exceeded 4 percent.

Austin has fared better than most cities during the recession. Increased government payrolls enabled by the state's energy wealth have largely compensated for layoffs in construction and technology. Local unemployment reached 7.1 percent in June — well below the national average. Housing prices have mostly held. Yet even people with high incomes appear reluctant to spend.

"The only time you do a lot of business is when you throw a sale," said Pat Bennett, a salesman at a Macy's in north Austin. "You see very little impulse buying. They come in saying, 'I need a pair of underwear,' and they get it and leave. You don't really see them saying, 'Oh, I love the way that shirt looks, and I'm just going to get it.' "

Mr. Bennett attributes frugality to a general uneasiness about the future.

"Our parents had the Depression," Mr. Bennett said. "This is like a mini-shock for the baby boomers after the go-go years."

At a mall devoted to home furnishings, many storefronts were vacant, and survivors were draped in the banners of desperation: "Inventory Clearance," "50% Off," "It's All On Sale."

But at the Natural Gardener — a lush assemblage of demonstration plots that sells seeds, plants and tools for organic gardening — business has never been better.

Sales of vegetable plants swelled fivefold in March over past years. The company added a public address system and bleachers to accommodate hordes showing up for vegetable-growing classes.

Part of the embrace of gardening stems from concerns about the environment and food safety, says the company's president, John Dromgoole. Momentum also reflects desire to save on food costs.

"People are very interested in shoring up against losing their jobs," he said.