

THE EFFECTS OF THE FINANCIAL CRISIS ON ACTUAL AND ANTICIPATED CONSUMPTION

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October 2011

The Great Recession officially started in December 2007. Households suffered losses in the stock market, in housing equity and through unemployment. How households adjust their spending in response to such economic shocks is of great interest to both economists and policy makers. According to economic theory, the size of the response depends on the degree to which households are insured against such shocks and also whether the economic shock is permanent. Most shocks to wealth are not insured at all. Some shocks to income are insured, but often insurance, such as unemployment benefits, does not replace 100 percent of earnings. In the absence of complete insurance, households need to find ways of buffering shocks.

In this study, we used data from five waves of the Consumption and Activities Mail Survey (CAMS), which is a supplement to the Health and Retirement Study to quantify the effects of the Great Recession on consumption. CAMS collects longitudinal data on total household spending every two years from a sample that is representative of the U.S. population over the age of 50. We compared consumption changes between 2007 and 2009 — the period that spans the onset and trough of the financial crisis—with consumption changes over prior years (2001–2007). This comparison allows us to distinguish changes in consumption that are attributable to the financial crisis from changes in spending that would ordinarily occur among the age groups that we study. In our analyses, we stratified by stock ownership and by whether the respondent experienced unemployment to assess how the spending changes differed among those particularly affected by the financial crisis compared to the rest of the population. We concentrated on the population 50–65 so as to compare the effects of unemployment with effects from stock market changes, although we do make some comparisons with the population 65 or older.

Total spending in panel among households where the respondent was age 50 to 65 averaged over years 2001, 2003 and 2005 was \$41.6 thousand. Averaged over the succeeding waves it was \$40.4 thousand. Thus, spending declined over the period 2001–2007 by 2.8 percent or about 1.4 percent per year. This decline accompanied a reduction in average household size. Over the two years beginning in 2007 and ending in 2009, spending in panel declined by almost 10 percent. A differences-in-differences comparison suggests that the excess decline associated with the financial crisis and Great Recession was 7 percent. Among stock owners spending declined by 9.8 percent between 2007 and 2009 whereas it was practically constant during the years preceding the recession. Comparing the differences between owners and non-owners suggests that stock ownership was associated with a 3.8 percent decline in spending in the recession over and above that experienced by those not owning stocks.

Households are likely to adjust spending categories differentially in response to economic shocks. Spending on necessities such as food consumed at home is likely to be reduced less than spending categories that are optional, like dining out or home improvements. In addition, households may face some constraints that make it difficult to adjust some spending categories quickly. For example, reducing the consumption of housing services involves a move and most likely the sale of a house.

To quantify these differences we studied changes in spending by category of spending. The greatest declines in spending were on durable goods, dining out, and housing. The decline in spending on durable goods is understandable as many such purchases can be deferred. Likewise, households can substitute food eaten at home for more costly meals eaten away from home; as expected, purchases of food and beverages to be consumed at home showed a much smaller decline as a result. The

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decline in spending on housing is associated with reductions in home repairs and maintenance and home furnishing, all of which can be deferred.

We anticipated that the reduction in spending due to unemployment would be greater between 2007 and 2009 than between earlier two-year periods because of the actual difficulty of re-employment and because of reduced expectations of re-employment. While spending did decline substantially among households that transitioned from employed in 2007 to unemployed in 2009 (by 19%), it declined by 10% among households that were employed in both years. The additional spending reduction associated with unemployment was no greater between 2007 and 2009 than in earlier cross-wave comparisons.

We studied expectations about spending change at retirement. We found that following the recession workers close to retirement age were more likely to anticipate a spending reduction at retirement than before the recession. This is to be expected because such workers have fewer years of work remaining before retirement to recover from losses.

We compared spending change in the population 65 or over with spending change in the population 50–64. As would be expected due to the reliability of Social Security benefits and the lessened risk of unemployment, spending declines were less in the older population.

The financial crisis and the subsequent Great Recession directly impacted households via losses in the stock market, losses in home equity, and unemployment. Households reduced spending, indicating that these losses were unanticipated and not fully insured. We found that stock owners aged 50 to 65 reduced spending by more than non-owners from the same age band over the 2007 to 2009 period. While suggestive of a substantial wealth effect, it is premature to come to such a conclusion. Stock owners are more likely to own houses than non-owners and so they are more likely to have experienced losses in house value: some of the decline in spending by stock owners could be due to a loss of housing wealth. Stock owners are more likely to follow the stock market and therefore have reduced expectations about the future course of the stock market. Such altered expectations should lead to a reduction in spending. As far as unemployment and unemployment expectations are concerned, however, there is no reason to think that stock owners became more pessimistic about their employment prospects than non-owners.

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The research reported herein was performed pursuant to a grant from the U.S. Social Security Administration (SSA) through the Michigan Retirement Research Center (MRRC). The findings and conclusions expressed are solely those of the author(s) and do not represent the views of SSA, any agency of the federal government, or the MRRC.

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