

# Changes in consumption result in fundamental substitution effects

hpo economic commentary, 1<sup>st</sup> quarter 2021

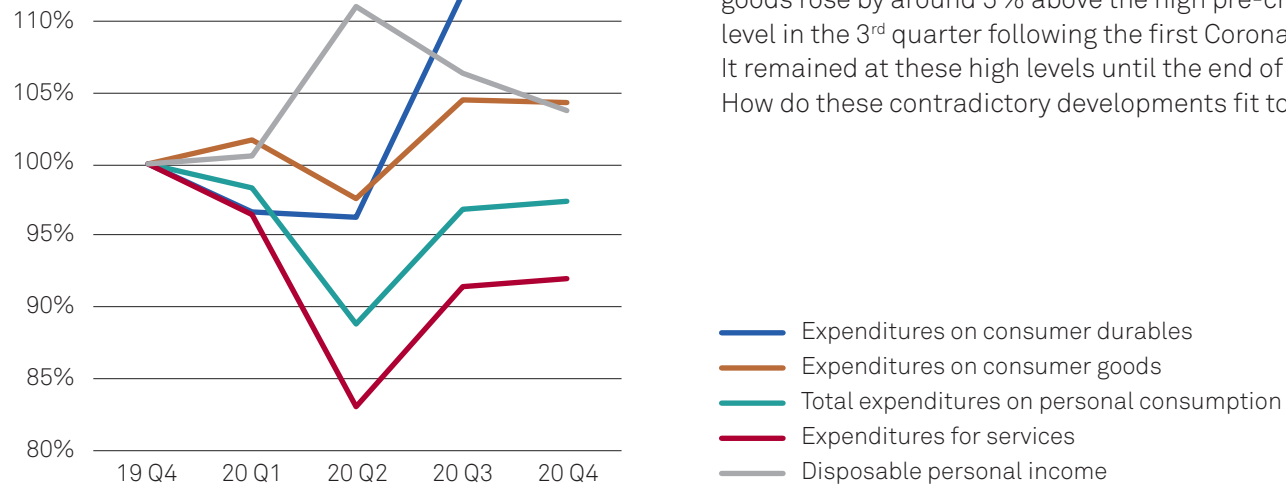
## Demand for consumer durables in the U.S. is booming.

The consumption cycle is the long-term pacemaker of the real economy. Developments in the various branches of the capital goods industry ultimately depend on it.

A good look at the figures in the U.S. shows that extraordinary things are happening in consumption. The following points would suggest a decline in consumer goods sales:

- Increase in unemployment rate by two-thirds to 10% in one year
- Increase in savings rate by 90% from December 2019 to December 2020
- Consumer sentiment has been consistently below 100 since April 2020 and thus in contractionary territory

However, it is surprising that demand for consumer goods rose by around 5% above the high pre-crisis level in the 3<sup>rd</sup> quarter following the first Corona wave. It remained at these high levels until the end of the year. How do these contradictory developments fit together?



## Development of personal consumption expenditures and disposable income in the U.S.

Source: Bureau of Economic Analysis (BEA)

The increased savings rate can be attributed to the officially imposed consumption restraint during the lockdown and significant economic uncertainty.

The total personal consumption expenditure has fallen in 2020 and mainly consists of the following expenditure categories:

- Services (e.g., vacations, restaurant visits, health): historically unique decline
- Consumer goods (e.g., food, clothing): distinctive increase compared to pre-crisis levels
- Consumer durables (e.g., furniture, automobiles, recreational equipment): extreme increase in expenditures in 2020

Considering the depth of the recession, the impressive increase in consumer durables spending is very unusual. Due to generous temporary unemployment supports in the U.S. as well as the booming stock markets, we have the paradoxical situation of household disposable income rising 4% year-on-year in the fourth quarter of 2020. This amid the worst recession in recent history.

# Rollercoaster ride in various industries

## Individual industries have plummeted, while others are benefiting from enormous orders.

The shifts in consumption described above can also be observed in Europe and Asia, although to a lesser extent.

What do these developments mean for our target group, the manufacturers and producers of capital goods (e.g., mechanical engineering), and consumer durables?

As outlined above, the lockdown measures led to considerable shifts in consumption within a very short time. While individual industries have plummeted, others are benefiting from record-high orders. The overall result is extraordinary volatility in demand for capital goods, which will continue in the coming quarters. We expect short boom phases in several sectors over the next few months, mainly due to catch-up effects.

The main question that remains is how sustainable these substitution effects will be:

- **Scenario 1:** If the substitution effects have a longer impact (several years), they will change the long-term trend growth in individual sectors.
- **Scenario 2:** If the substitution effects only have a short-term impact until we hopefully get the pandemic under control around summer/fall 2021, there is a great risk of excesses. Industries that are now

benefiting from the substitution effects may fall into an ordering hole in the second half of the year. Industry sectors that are now particularly suffering from the disruptions could benefit in the short-term until the development returns to the longer-term path.

Since people value their habits and the changes in behavior were imposed temporarily, there is much to suggest that most of the substitution effects are of a temporary nature (Scenario 2). Individual effects, such as the increased demand for the own living situation, could also mean longer-term changes in consumer habits.

As already expressed here several times, hpo forecasting believes that the long-term real economic cycles are the dominant factors for order development in the industry, even in times of a pandemic. The latest data seem to support this view for the most part, even if it is still too early to make a final assessment.

The real economic cycles analyzed by hpo forecasting indicate that – following a long boom phase until 2018/2019 – we are now experiencing the start of a longer phase of rather subdued economic development. Only industries with very robust trend growth will be able to sustainably counter this in the long term. Even if Scenario 1 with sustained substitution effects in

consumption actually occurs in individual sectors, this effect will be overshadowed by the general economic influence. Short-term excesses and subsequent compensation effects are likely to remain observable (keyword: high volatility).

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