

#### Box 4

### HOUSEHOLD SPENDING, CONSUMER CONFIDENCE AND DURABLE CONSUMPTION

Euro area household spending has risen steadily since the end of the recession in 2009. However, the speed of the recovery in private consumption has been relatively modest by historical standards and consumption growth has been weaker than overall economic growth. While quarter-on-quarter euro area GDP growth has averaged 0.5% since the recovery began in the third quarter of 2009, consumption growth has averaged only 0.2%.<sup>1</sup> By contrast, the European Commission's consumer survey has signalled a stronger rise over the past 18 months, with the consumer confidence indicator currently above the historical average. This box looks further at the insights into consumption developments obtained from the Commission's survey.

The European Commission's consumer survey asks participants questions about their personal circumstances and their views on the general economic outlook. The overall consumer confidence indicator summarises responses to four questions about households' views of the general economic situation, unemployment developments, their personal financial situation and their intentions with regard to saving.<sup>2</sup> In the past the consumer confidence indicator was closely correlated with aggregate euro area consumption developments, although it tended to follow the broad cyclical movements of consumption (e.g. year-on-year growth) more closely than short-term developments (e.g. quarter-on-quarter growth). However, the series obtained from another question in the survey, which is not used to compile the indicator of consumer confidence and which asks whether consumers intend to make a major purchase in the near term, has displayed a slightly higher correlation with developments in private consumption than the indicator of consumer confidence or any of its components.<sup>3</sup> In the past this series also moved quite closely in line with the overall consumer confidence indicator. However, more recently they have diverged: while overall consumer confidence has signalled a continued cyclical expansion

1 See the box entitled "The current euro area recovery across expenditure components from a historical perspective", *Monthly Bulletin*, ECB, February 2011.

2 For more details on the European Commission's consumer survey, see the box entitled "Compilation, usefulness and recent developments in the euro area consumer confidence indicator", *Monthly Bulletin*, ECB, March 2010.

3 The question asks "Compared to the past 12 months, do you expect to spend more or less money on major purchases (furniture, electrical/electronic devices, etc.) over the next 12 months?".

in consumption growth, the series for households' intentions to make major purchases started to decline again at the beginning of 2010 (see Chart A).

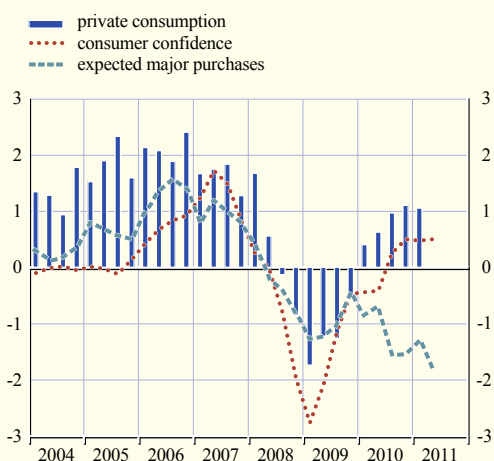
The decoupling of the two series appears to be related to divergent developments in euro area households' durable and non-durable consumption.<sup>4</sup> As Chart B shows, most of the upturn in consumption during 2010 was driven by households' purchases of non-durable goods and services. The contribution from durable consumption was broadly neutral, as positive contributions from the consumption of durables excluding cars were offset by a sharp decline in purchases of cars following the end of the government schemes which had encouraged car purchasing during the recession. The survey series reflect those developments: while consumer confidence has moved in line with aggregate consumption, the series on major purchases has tracked recent developments in the consumption of durable goods, which remained subdued during 2010, reasonably closely.

One possible explanation for the current weakness in durable consumption is that it reflects an adjustment following an accumulation of durable goods in the run-up to the crisis. Prior to the recession, households had increased their purchases of durable goods and had built up a stock of durables. With the onset of recession and the worsening outlook for employment, income and wealth, households may have been more cautious when deciding whether to purchase additional durables. Household spending on durable goods declined rapidly during the recession, although the adjustment was interrupted as governments in some euro area countries introduced incentives to encourage consumers to purchase cars. However, with those schemes being phased out during 2010, households' durable consumption has again turned negative.

4 Eurostat does not publish a breakdown of euro area private consumption into durable and non-durable consumption. In this box, euro area aggregates have been approximated using available country data covering approximately 80% of the euro area. See the box entitled "Household consumption of durable goods during the latest recession", *Monthly Bulletin*, ECB, July 2010.

**Chart A Euro area private consumption and survey data**

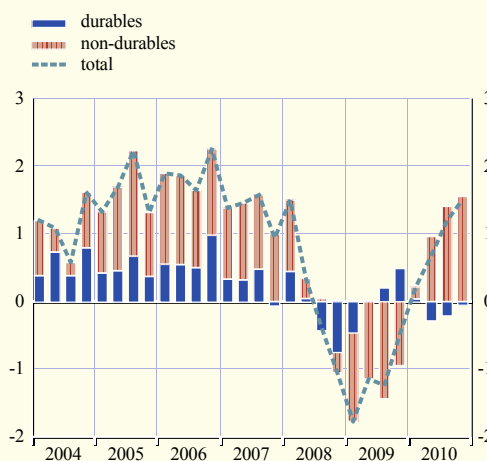
(annual percentage changes; standard deviations from series means)



Sources: European Commission and Eurostat.

**Chart B Breakdown of euro area private consumption**

(annual percentage changes; percentage points)



Sources: Eurostat and ECB calculations.

Another possible factor is that the high level of unemployment and continuing economic uncertainty may have made consumers reluctant to make major purchases or to increase spending once the recovery was under way. By their nature, durable goods tend to be more expensive. Moreover, they tend to last and can be used repeatedly, providing consumers with a flow of services over a number of years. This implies that they have some of the attributes of assets. Thus, the decision to purchase durable goods requires some confidence on the part of households about the economic outlook. With the prospects for real disposable income growth being relatively subdued – affected by the limited improvements in labour markets, fiscal retrenchment and rising commodity prices – and with uncertainty still elevated, households may have remained cautious about committing to large expenditures in the initial stages of the recovery.

To sum up, the European Commission's consumer survey helps shed some light on recent developments in euro area household spending. While the overall consumer confidence indicator has registered a gradual improvement since the recovery began, private consumption growth has been relatively modest in the euro area, partly reflecting consumers' continued reluctance to commit to large expenditures, as indicated in the European Commission's survey. That may point to persistent uncertainty affecting household spending decisions, which is likely to affect euro area consumption in the near term.