

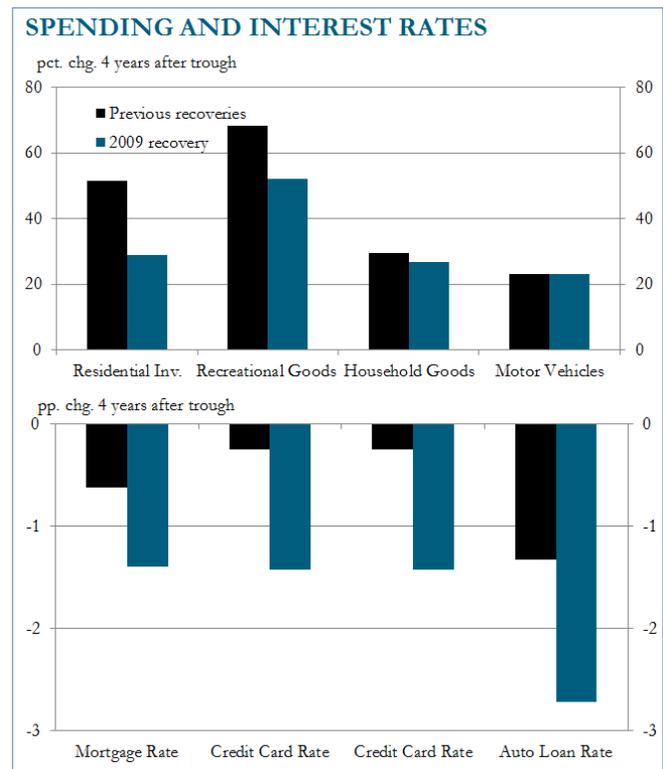
The Weakened Influence of Low Interest Rates on Durable Goods Spending

By [Willem Van Zandweghe](#) and [John Carter Braxton](#)

Despite record-low interest rates, the pace of the current economic recovery has been only moderate. One reason is that the positive impact of lowered interest rates on consumer purchases of durable goods has diminished. Had the boost from lowered rates stayed as strong as it was in previous recoveries, on average, durable goods spending from the beginning of 2012 to midway through 2013 could have contributed almost half a percentage point more to quarterly GDP growth.

In the first four years of the current recovery, real GDP increased only slightly more than half as much as might be predicted based on average real GDP growth following the recessions of 1981-82, 1990-91, and 2001. An important driver of GDP growth, consumer spending has been similarly subdued in the current recovery. Consumer purchases of durable goods—including housing, household goods, vehicles, and recreational goods—are a type of spending particularly sensitive to interest rates. When lowered interest rates spur a rise in durable goods purchases, the increased spending can contribute to a revival of GDP growth.

But in the current recovery, real durable goods spending has rebounded more gradually than in previous recoveries on average. The chart below divides durable goods spending into residential investment, recreational goods, such as consumer electronics, household goods, such as furniture and appliances, and motor vehicles. The top panel of the chart compares average growth in the 1981-82, 1990-91 and 2001 recoveries (black bars) with growth in the current recovery (blue bars)—in each recovery considering the four-year period following the business cycle trough. Residential investment in the current recession has increased less than 30 percent over four years, compared with its vigorous rebound of more than 50 percent on average in the previous recoveries. In the current recovery, the rebound in spending on recreational goods and on household durables has also been slower. Motor vehicles spending initially lagged behind previous recoveries, but after four years has caught up.

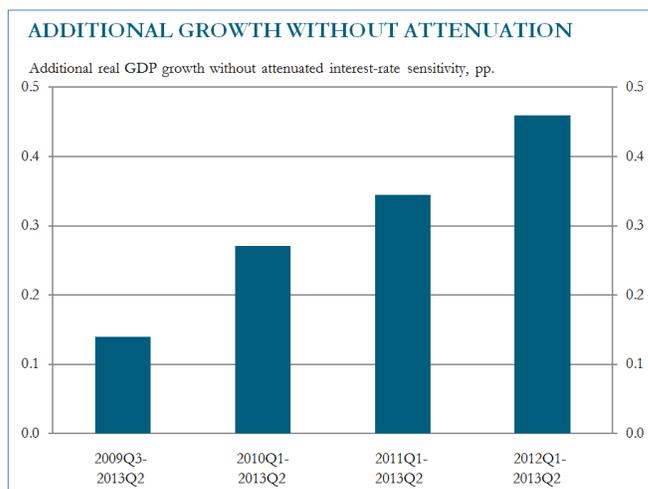


In contrast, as shown in the bottom panel of the chart, real interest rates fell more sharply in the first four years of the current recovery than in the same period of the previous recoveries. The chart shows declines in the interest rates relevant for each given category of durable goods purchases: the real 30-year mortgage rate for residential investment, the real interest rate on all credit card accounts for recreational goods and

household goods, and the real four-year auto loan rate for motor vehicles. Rates for all categories declined more in the current recession; in the case of motor vehicles, the current decline was almost 1½ percentage points more than the average of previous recessions.

A statistical model that relates real durable goods spending to real interest rates, lending standards and real disposable income confirms that the sensitivity of this type of spending to interest rates has diminished.* While the estimated interest-rate sensitivity of durable goods spending in previous recoveries was negative and highly significant, it was no longer significantly different from zero in the current recovery.

The statistical model can be used, in a counterfactual exercise, to assess how much more real GDP growth might have been achieved in the current recovery if the interest-rate sensitivity of durable goods spending had remained at the average level estimated for previous recoveries. The counterfactual exercise shows that the impact on real GDP growth of weakened interest-rate sensitivity has increased as the recovery has progressed. In other words, the rate of quarterly real GDP growth that might otherwise have been obtained has grown larger each year.



This chart shows how much larger the contribution from durable goods spending to real GDP growth would have been, if the sensitivity of such spending to interest rates had not weakened. The additional boost to growth would have been concentrated in the later years of the recovery, because real interest rates declined sharply in 2011. For example, the real mortgage rate and auto loan rate declined by ¼ percentage points during 2011, following declines of less than ¼ percentage point in 2010. Thus, the magnitude of the additional boost to growth is somewhat diluted when averaged across all of the first four years of the recovery (first bar): across that whole period, the quarterly rate of real GDP growth might have averaged 0.14 annualized percentage point higher, had the interest-rate sensitivity not weakened. But from the beginning of 2012 to midway through 2013 (last bar), the model suggests that the average contribution of durable goods spending to quarterly real GDP growth could have been 0.45 percentage point higher than what was observed.

A number of driving factors may have contributed to the diminished interest-rate sensitivity of durable goods spending. Possible factors include tight credit conditions in the aftermath of the financial crisis, reduced value of collateral after the bursting of the housing bubble, and heightened risk aversion and uncertainty about future incomes in the face of elevated unemployment.

* For more, see Van Zandweghe, Willem and John Carter Braxton, 2013. *“Durable Goods Spending: Has It Become Less Sensitive to Interest Rates?”* Federal Reserve Bank of Kansas City, Economic Review, fourth quarter. The views expressed are those of the authors and do not necessarily reflect the positions of the Federal Reserve Bank of Kansas City or the Federal Reserve System.