

Present and future consumption effects of COVID-19 induced uncertainty

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Abstract

Consumption comprises roughly 70% of the U.S. GDP. Assessing COVID-induced uncertainty effects on consumption offers policymakers information necessary to take steps to help the economy recover efficiently. Furthermore, charting the emergence of new consumption habits during the pandemic can enable businesses to adapt to the "new normal." Analyzing uncertainty levels, consumer sentiment, and fluctuations in consumption, I find that COVID-19 has lowered consumption levels but altered consumption patterns. While I expect consumption levels to rebound once the pandemic ends, consumption patterns may never be the same again.

Introduction

With the surge in the unemployment rate and a prolonged period of income instability, consumers are generally feeling less optimistic about economic recovery after COVID 19, and it is a rational decision to restrain household spending and secure money in the banks to prepare for future financial difficulties. Looking at figure 1, we can see that the U.S. consumer confidence level dropped dramatically from March to April. In figure 2, we see a spike in U.S. personal saving rates in 2020, which hit 33%, a historic high, in April. The sudden movement in the two series is hardly a coincidence; they both reveal the severe uncertainties consumers experienced in April. Furthermore, according to figure 3, countries, including Italy, France, UK, and South Korea, also saw an enormous increase in savings rates and steep declines in consumer spending. Saving cash is a rational method of securing financial-viability in the future. Still, a collective increase in saving, which is equivalent to reduced consumption, can be catastrophic for an economy given the large share of GDP constituted by consumption. Central banks and governments must enact appropriate fiscal and monetary policies to promote consumption.

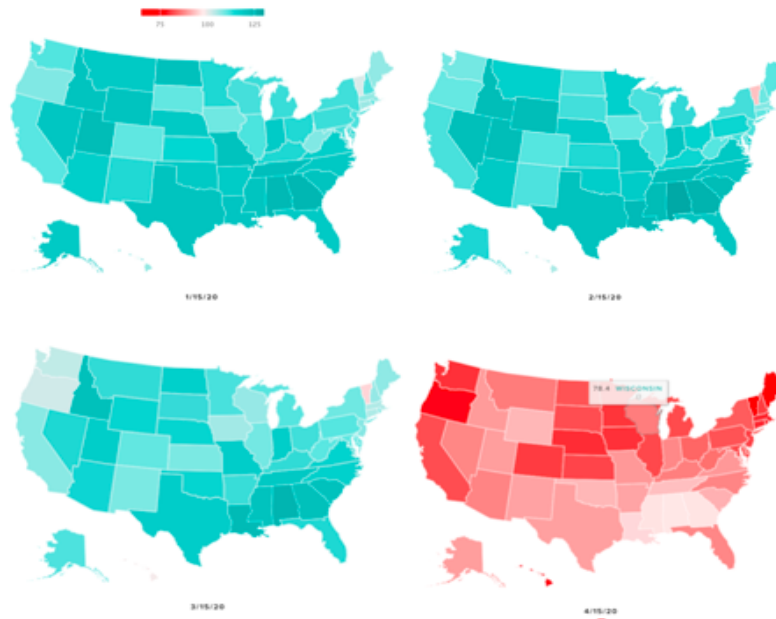


Figure 1: Heat map recording the shift of consumer sentiment from Jan.15 (top left) to April.15 (bottom right).

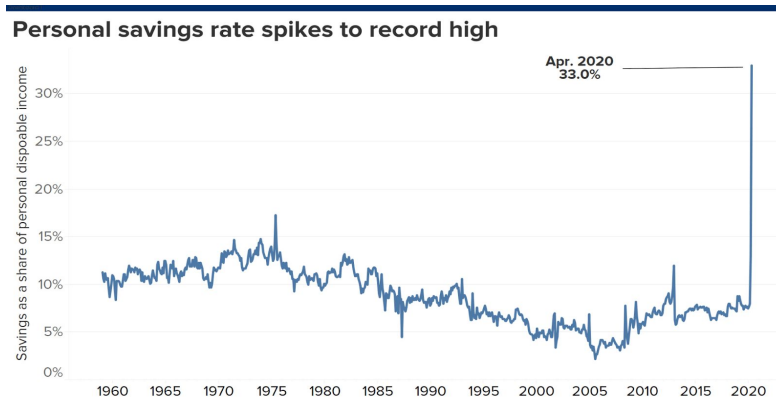


Figure 2: US saving rates reach the historical high in Apr. 2020.

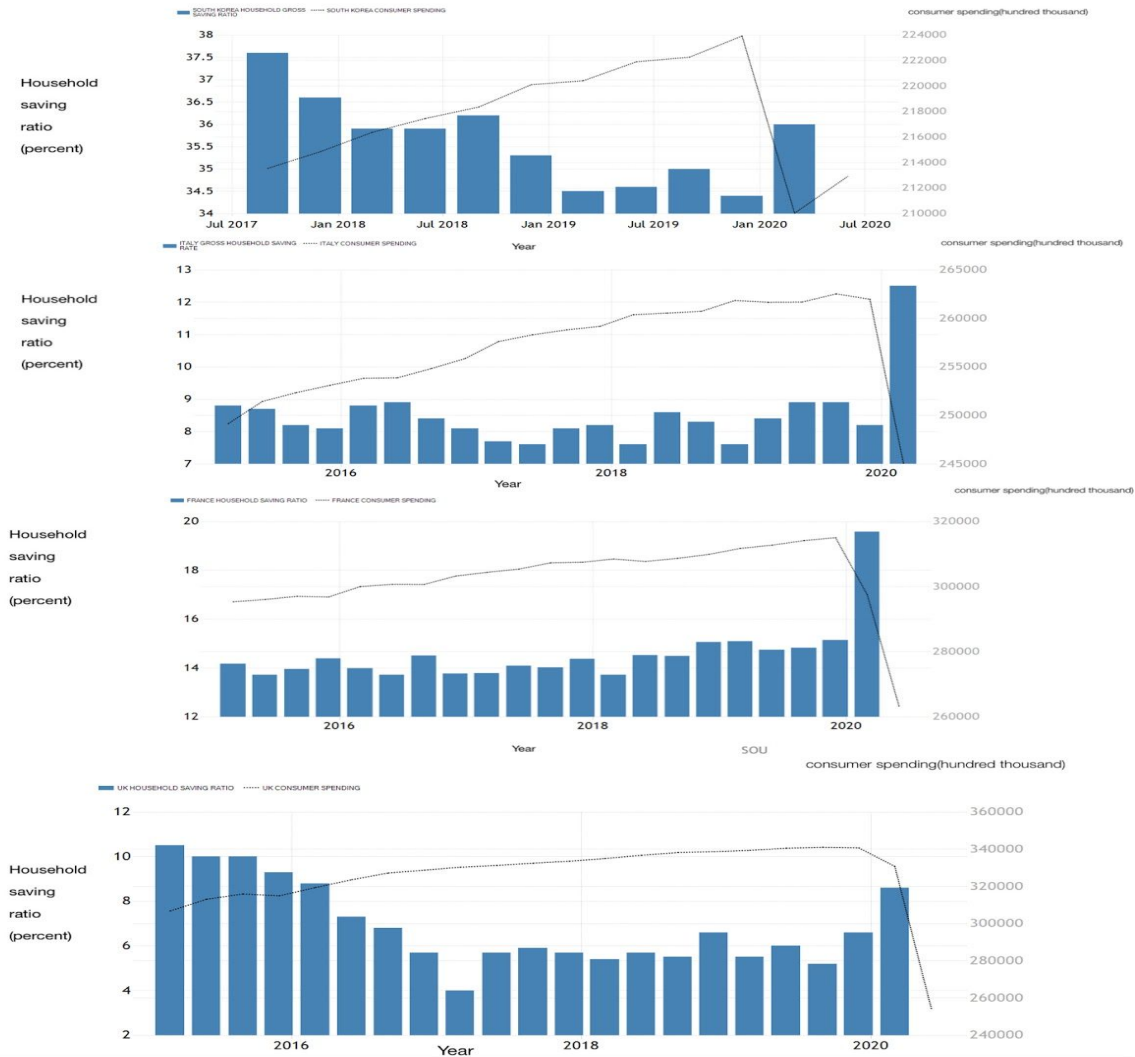


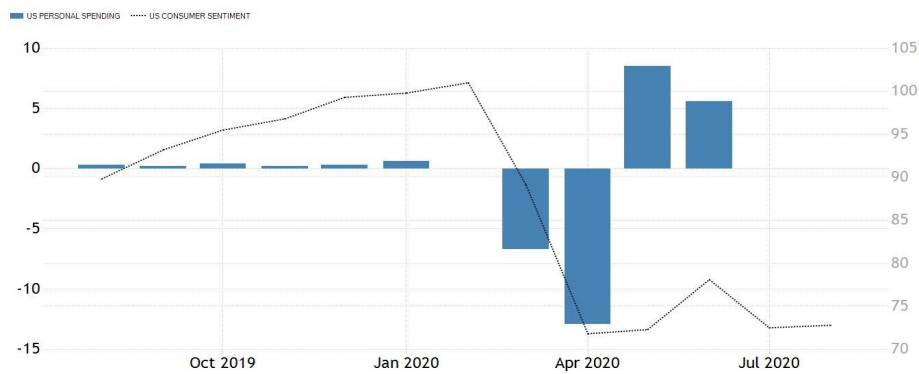
Figure 3: Household saving ratio surge as consumer spending decline in South Korea, Italy, France, UK.

This paper presents both potential and existing policies, including greater unemployment insurance, infrastructure projects, and offering checks, which can incentivize consumer spending. I also discuss why the consumption level won't continue to decline once COVID-19 ends based on the permanent income hypothesis.

Also, I analyze the shift in consumption patterns and investigate the new consumer habits that are likely to stick even beyond COVID. I provide examples of new consumer habits or the "new normal." Then I analyze how companies adopt new modes of sale and explain the mutual benefits these changes bring. I discuss which habits are likely to remain after the end of the pandemic. Lastly, I evaluate the COVID-19 implications for businesses to attract consumers.

Consumption level

With many expecting their income to continue to fall in the coming months, consumers may modify their buying behavior. Even though there was a massive spike in both grocery and household spending, as households stayed home and negative public expectations of COVID spurred 'panic buying,' we see sharp drops in spending for restaurants, retail, air travel, and public transport, which resulted in the decline of net consumption. In figure (4), U.S. Bureau of economics forecast there would be a 6.7% drop in U.S. personal spending in March and a 12.9% drop in April. In reality, it ended up being a 13.6% drop, the most significant drop on record due to the coronavirus pandemic. However, personal spending in the U.S. increased by 8.5 % in May. In June, there was an increase of 5.6%. This increase resulted from an unsustainable decrease in consumption of essential goods and services, season changes, or receiving money from the enactment of the CARES Act, which likely improved consumer sentiment, as seen in the figure above. In a nutshell, lower consumer confidence, embodying the uncertainty in financial-stability, can negatively affect consumer spending.



y: % change in spending x: Consumer Confidence Index around 100

Figure 4: Downturn of US personal spending (bars) while consumer (lines) sentiment stay low.

Consumption pattern

Consumers worldwide are forced to form new habits due to the risk of catching coronavirus through traditional purchasing methods. As a result, companies were forced into digital transformation. According to Deloitte's survey conducted in the week of May 11, most of the consumers across the 15 countries they surveyed still did not feel safe shopping outside. Even though 47% of respondents stated they felt safe going to the store, in countries that had seen further increase of COVID-19 cases, fear of a possible second wave kept the public from going back to the stores. Thus, we see a surge in e-commerce, and most sectors had seen more than 10%

growth in online customer base by July. According to a survey conducted by Kameleoon and Go Group Digital, only 15% of 5,128 respondents would switch back to offline channels.

Similarly, only 31% and 26% of respondents from Deloitte biweekly global surveys feel comfortable living in hotels and getting on planes in mid-May, respectively, and tourism and aviation industries have responded with strategic transformations. For example, Finnish Travel Industries have adopted V.R. technologies, which offer tourists the chance to experience their intended destinations without compromising personal safety.

According to McKinsey Digital, residential real estate developers have similarly attempted new modes of operation, as seen in their adoption of RXR Realty's remote tools. By investing in apps that enable and enhance contactless interactions, including residential and commercial aspects (e.g., real-time analytic on heating, cooling, and floor space optimization for tenants) before the pandemic, RXR Realty was able to perfect the application and adapt once COVID hit. Through inventing another platform--RxWell-- that provides tenants with information on air quality, occupancy level of a building, and food delivery options, RXR Realty was able to offer personalized service for customers that ensure their health and satisfaction.

Thus, we see a trend of innovation and product enhancement; both focused on enlarging the customer base through increased customer satisfaction.

Prospects for Consumption level and pattern

Consumption level

Even though financial uncertainty has negatively impacted consumption level, and thus GDP, the permanent income hypothesis, which states that people consume based on their expected income over their lifetime, suggests that consumption would not remain depressed after the pandemic ends. As long as policies that secure long term income, lessen economic uncertainty, and encourage consumption, demand revival will facilitate the expedited restoration of the economy. For instance, by enacting the CARES Act, a \$2.2 trillion economic stimulus bill, U.S. households under a certain income threshold are qualified to receive a stimulus paycheck. As a result, we saw households' spending increase by \$0.25 to \$0.30 per dollar of stimulus during the first week. In addition to the direct provision of money, the CARES Act allowed states to expand unemployment insurance. According to J.P. Morgan Chase Institute's research, the weekly \$600 supplemental aid states are offering in addition to their standard unemployment benefits has replaced lost earnings by more than 100% for two-thirds of eligible unemployed workers. Figure (5) shows the first benefit payments put unemployed households spending higher than employed household spending.

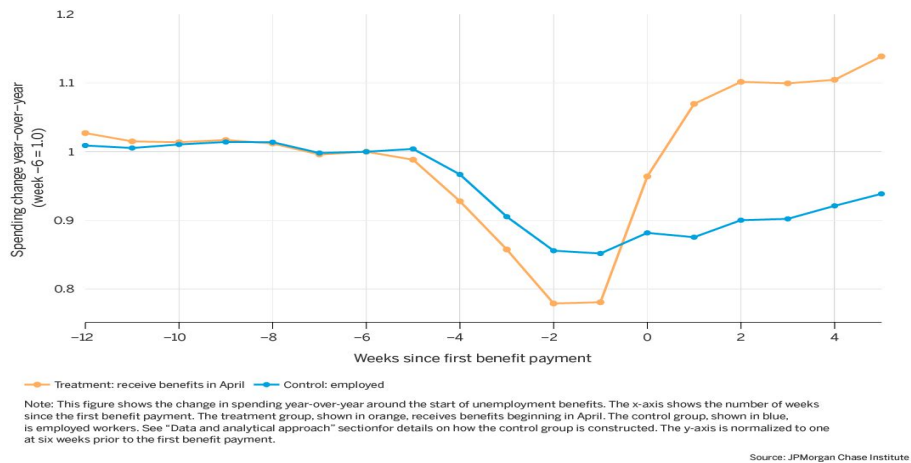


Figure 5: Spending Falls at Start of Unemployment and Rises when Benefit Payments Begin

Consumption pattern

To find out which behaviors are going to persist beyond the pandemic, we need to assess the extent to which consumers were satisfied or derived convenience from the new consumption habits that they were forced into by containment measures and the pandemic itself. China's opening would offer us some reference for the future of U.S. consumption patterns. Firstly, contactless delivery, putting food in self-pickup lockers, has increased in China due to its convenience. In the U.S, DoorDash is already adopting a similar approach of dropping food off at an agreed-upon location, making food delivery more efficient. Plus, even though mobile payments were already popular in China pre-COVID, the pandemic brought cashless payment technology to more than half of Chinese consumers and is expected to reach 60% of the population by 2023. And PayPal, the American company that developed a worldwide online payments system, has seen a 22% surge in revenue, \$221.7 billion worth of transactions, and 21.3 million new users--the greatest users growth on record-- from April to June.

In a survey conducted by McKinsey, 15% of those surveyed reported trying online grocery shopping for the first time amid the pandemic. 40% of them even intended to stick to this method after the crisis. Similarly, the U.S. online fitness market has seen a 50% increase in customer base since February 2020. Even though customers believed that at-home exercise would not meet their needs, 55% later changed their opinion. Further, 65% of those who tried digital exercise machines said they would stick with them even once gyms reopen.

Most importantly, the uncertainty experienced, and the shift in lifestyles may cause permanent changes in the real estate industry. Building codes ordered due to safety concerns would halt the current trend of densification. Instead, enclosed office spaces and greater square footage

per person would be requested. Senior living facilities would either decline if the baby boomers are concerned about the risk of infection or expand if the facilities guarantee they can handle the virus most efficiently. As video conferences become more prevalent, the decline of cross-border business travels would lessen the demand for temporary hospitality properties and short-term leases. As e-commerce becomes more prevalent in the future, there would be less investment in malls and greater demand for industrial space. Finally, people would avoid coliving due to safety concerns. Changes in consumer behavior would lead to a significant amount of spaces becoming undesirable.

Role of governments, central banks, and firms

Governments and central banks should alleviate people's economic hardships and reduce uncertainty to elevate consumption levels. Firms may also take action to reshape consumption habits.

Governments

The government has already referred to the great recession and enlarge the stimulus package from \$800 billion in 2009 to \$2.2 trillion in 2020 when the pandemic starts spreading in the U.S. Further, the government should also coordinate infrastructure stimulus that would reinvigorate economies, bring more employment opportunities for people, and revitalize the supply chain related to construction. After the era of the Great Depression, the New Deal funded forward-looking projects, including delivering clean water, electricity, and telephones services to households. In 2009, the American Recovery and Reinvestment Act launched programs designed to provide high-speed internet, bridge the digital divide, and promote clean energy. Even though these recovery programs did continue to invest in traditional sectors, they demonstrated how forward-looking projects could provide benefits beyond lowering unemployment.

Central banks

On the domestic front, central banks can enact monetary policies to enhance consumption levels as well. By reducing interest rates, central banks discourage consumers from saving while offering individuals the incentive to take out loans and to consume. In the U.S., the Federal Open Market Committee (FOMC) has brought down its target range for the federal fund rate by 0-0.25% since March.3. It was a move aimed to decrease the cost of borrowing mortgages and auto-loans, which would also reduce the interest income savers get. Similarly, the Bank of England announced two emergency interest rate cuts during the COVID outbreak, bringing them to 0.1%, the lowest level in history.

On the international front, international swaps help stabilize foreign dollar markets. According to the Federal Reserve, the U.S. dollars liquidity swap lines maintain the supply of dollars in the global market and the flow of credit to U.S. households and businesses while stabilizing other countries' economies, which would ultimately benefit the U.S. economy if

international trades continue. The Federal Reserve has learned from the Great Recession and started promoting financial stability in early March instead of one year after the recession.

Firms

According to behavior psychology, consumers adopt habits based on beliefs. During times of uncertainty, people's beliefs begin to change. They are more open to trying new things, allowing companies to guide new consumer habits. Companies should adjust their products, customer experiences, and marketing communications based on consumer demand to succeed. According to McKinsey's investigation on consumer psychology, reinforcing positive new beliefs and aligning messages to consumer mindsets are key factors in influencing consumers long-term. Through innovative marketing, including sharing information via a combination of social media and televisions, and the exploitation of "peak moments" in the shoppers' experience, companies secure new customers. Consequently, the pandemic offers companies a chance to attract first-time consumers since they seek alternatives to adjust to the "new normal."

Conclusion

The global pandemic and the uncertainty it has created has led to sharp drops in consumption. Still, given the permanent income hypothesis, I do not expect that the level drop would be long-lasting. However, the changes in consumption patterns amid the pandemic are likely to last beyond it. Examples include contactless food delivery, cashless payment, telemedicine, online grocery shopping, home exercise tools, etc.

Governments stimulate consumption by offering unemployment insurance for either a prolonged period or a greater amount of money. To generate more jobs and income, the government can also initiate infrastructure projects. Central banks can similarly stimulate consumption and even business investment by lowering interest rates. International swaps could also ease the strains of pressures on the U.S. Money Market. While uncertainty has a negative effect on the macroeconomy, it also creates opportunities for businesses to innovate to meet new consumer needs in the "new normal." Though the governments and central banks play an essential role in fixing consumption levels, it is clear that firms are the dictating force in creating lasting consumer habits.

For references, click [here](#).