Americans Are Eating Out Like Crazy As They Complain About Inflation and High Rates

Eating out, more formally known as Food Away from Home ("FAH") or Away from Home Dining, is a large component of U.S. retail sales and consumer spending, accounting for $975 billion of sales last year, or approximately 18% of U.S. retail sales — more than sales at supermarkets and grocery stores. The category includes all forms of eating out, including fast food (usually called "quick service" these days), casual dining and fine dining, as well as prepared food delivery orders to the home. As measured by the U.S. Census Bureau, the category is called Food Services & Drinking Places, and includes bars and cafes as well.

Spending in this category tells a lot about the state of the consumer. Especially for lower- and middle-income Americans, eating out more frequently is one of the first indulgences when consumers have a few extra bucks in their pockets or bank accounts, and one of the first spending cutbacks when they are feeling pinched. *(Do I really need that $5 latte four times a week?)* It's a painless cutback for most consumers when times get tough. FAH is considered discretionary spending but is less sensitive to economic conditions than big ticket purchases, such as furniture or electronics, and is more akin to spending in categories like theme parks, concerts or movies. Hence, FAH is a good indicator of consumers' financial health and general spending mood at any given moment. Judging from FAH spending since mid-2022, most Americans have been feeling perfectly fine for many months despite high inflation and the Federal Reserve's best efforts to slow the economy. In fact, Americans are eating out more than ever recently, and this belies the notion that consumers are pulling back much on spending as rate hikes and high inflation eat away at disposable income. On the contrary, FAH spending has accelerated to date in 2023 [**Figure 1**] despite economic headwinds that confront most consumers.

The U.S. GDP advance report for 1Q23 also put to rest any idea that consumers are pulling back on the reins when it comes to their spending. While real GDP growth was a paltry 1.1 percent for the quarter,[1] that meager growth rate was attributable to declines in business spending and investment, while consumer spending was vigorous — ahead of expectations — and kept overall economic growth from turning negative. Real growth of 3.7 percent in personal consumption expenditures in 1Q23 was healthy in both the goods and services categories. Undeterred shoppers not only absorbed inflation hits in their purchase baskets but generated solid real growth above that. Some economists pointed out that consumer spending in the first quarter was front-loaded by a strong January and slowed in the subsequent two months. That may be so, but it hardly explains why shoppers have yet to meaningfully curtail their spending after nine months of aggressive Fed tightening and sticky inflation. The enduring strength of the labor market primarily accounts for robust consumer spending, while the Fed's efforts to date have slowed inflation from peak rates but have hardly dented hiring and wage growth, with the unemployment rate currently sitting at a more than half-century low.

As deeply as it suffered during the depths of the pandemic, the FAH category has benefited hugely since Americans started to resume their normal lifestyle habits beginning in late 2021. Initially, it began as "revenge dining," which, like the phenomenon of "revenge travel" represented pent-up demand and binge spending in categories that consumers had to curtail almost entirely during the worst phase of the pandemic. But "revenge spending" impulses that prevailed in the reopening phase of post-COVID life have mostly faded, and Americans are eating out more frequently today because, well, they can — meaning they still have the desire and financial means to satisfy this indulgence. Such spendthrift behavior for FAH continues even as menu prices have been hiked substantially since the onset of the pandemic, undercutting arguments that a recession is imminent or that inflation can return to the Fed's target rate any time soon. In short, most consumers are still feeling well enough financially to absorb inflation hits in their everyday spending without pronounced cutbacks.

Retail sales in the FAH category took a huge hit in 2020, declining by 16 percent per Census Bureau data, but were cushioned to a fair degree by surging delivery/pick-up sales during the pandemic. Food establishments that survived to the other side of COVID-19 have not had time to look back. Unlike consumer spending categories dependent on in-person customer visits that have struggled to return to pre-pandemic activity or volume levels, FAH nominal sales in 2022 were 26 percent above 2019 sales, a compounded annual growth rate ("CAGR") of more than 8.0 percent and accelerated to a CAGR of 9.3 percent in 1Q23 vs. 1Q19 [**Figure 1**]. Real (i.e., inflation-adjusted) monthly sales growth year over year ("YoY") for FAH since mid-2022 has comfortably exceeded its long-term average rate of 2.5 percent. FAH sales relative to total retail sales (excluding auto & gas) is finally back to its pre-pandemic level of 18 percent [**Figure 2**], which reflects both the long climb back for FAH relative to other retail categories and surging retail sales overall since 2020.

FAH sales were trending favorably prior to COVID-19, with its share of retail sales expanding by 200 basis points between 2015 and 2019, a sizeable increase. Americans have never had so many dining out options, be it price points, more ethnic menus, better food quality and healthier eating choices. Moreover, home-cooked meals increasingly have become more of a hassle for time-harried consumers and two income households while the price difference between FAH and meal preparation at home narrowed in the decade prior to COVID.

It hasn't been all gravy for dining-out chains and the rest of the FAH sector. Worker shortages remain a challenge, labor costs have risen sharply in recent years, as have food costs since COVID-19, pressuring operating margins even as systemwide sales growth remains strong. For all the menu price hikes put through since COVID, many operators have been unable to pass on all their cost increases to customers. There is also more competition than ever for consumers' food spending dollars, and store unit-growth has gotten crowded in many large markets.

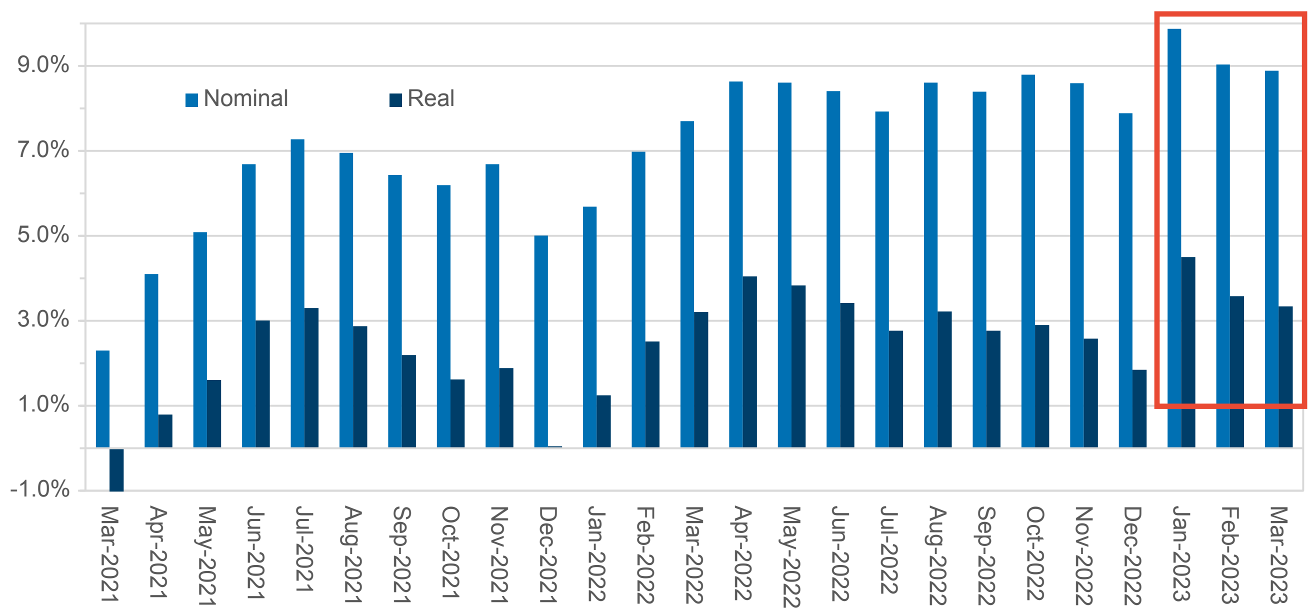
Despite these challenges, equity markets are loving the FAH sector these days, which has handily outperformed the broader market since the end of 2019 [**Figure 3**] despite the nosedive in 2020, with most of this outperformance occurring since mid-2022 and coinciding with the acceleration of FAH sales and solid earnings results through 1Q23. Overall, the S&P 1500 Restaurant Index has outperformed the S&P 1500 Composite Index by 16 percentage points (43 percent vs. 27 percent) since the end of 2019.

There has been an uptick of Chapter 11 filings in the retail sector, including the FAH segment, in 2023, leaving some to wonder whether the uninterrupted consumer spending spree since 2020 is finally running out of steam. That does not appear to be the case, except for purchases requiring financing, such as autos. However, unsustainable spending growth in the post-COVID period eventually had to subside to more normal rates, and that is where we are today. YOY sales growth in most consumer spending categories, including FAH, continues to exceed the running rate of inflation.

Failures among retailers and FAH chains this year are mostly attributable to long-running competitiveness issues at those companies rather than industrywide weakness or consumer spending exhaustion. (Just go through that list of names if you doubt it.) Reorg Research noted that there have been five Chapter 11 filings by restaurant chains to date in 2023,[2] mostly small-to-mid-sized fast food franchisees. Certainly, FAH operators continue to confront challenges to contain ongoing cost pressures, but the sector is in better shape today than could have been imagined coming out of the pandemic. If there is a recession looming, nobody told the lines of customers across the country waiting for their overpriced gelato or fancy salads. Americans are still eating out to their hearts' content.

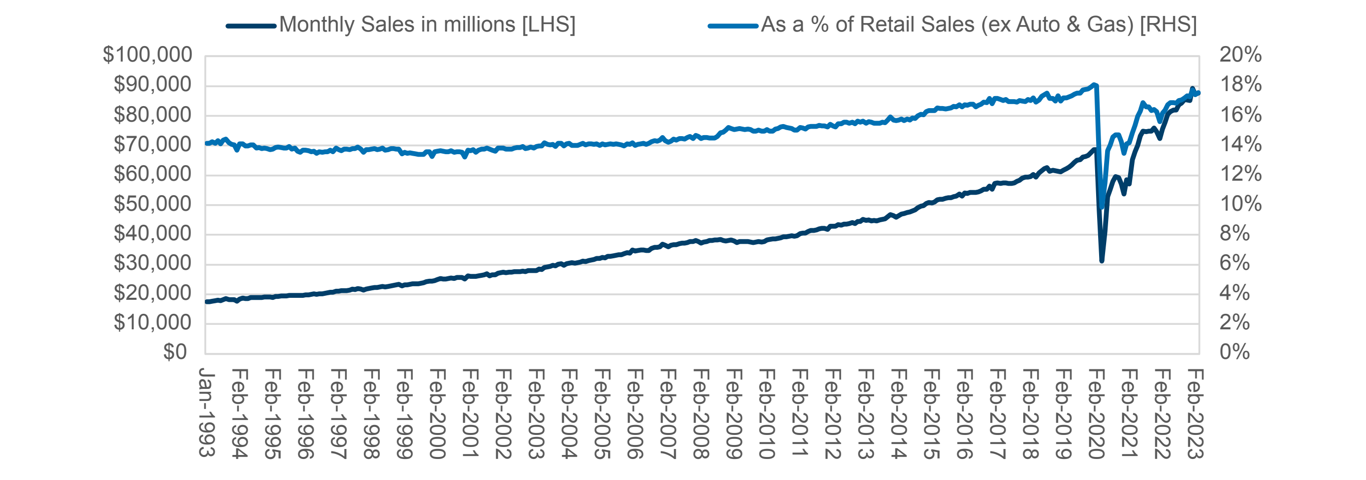
Figure 1: Food Away From Home: Monthly Sales

CAGR vs. 2019



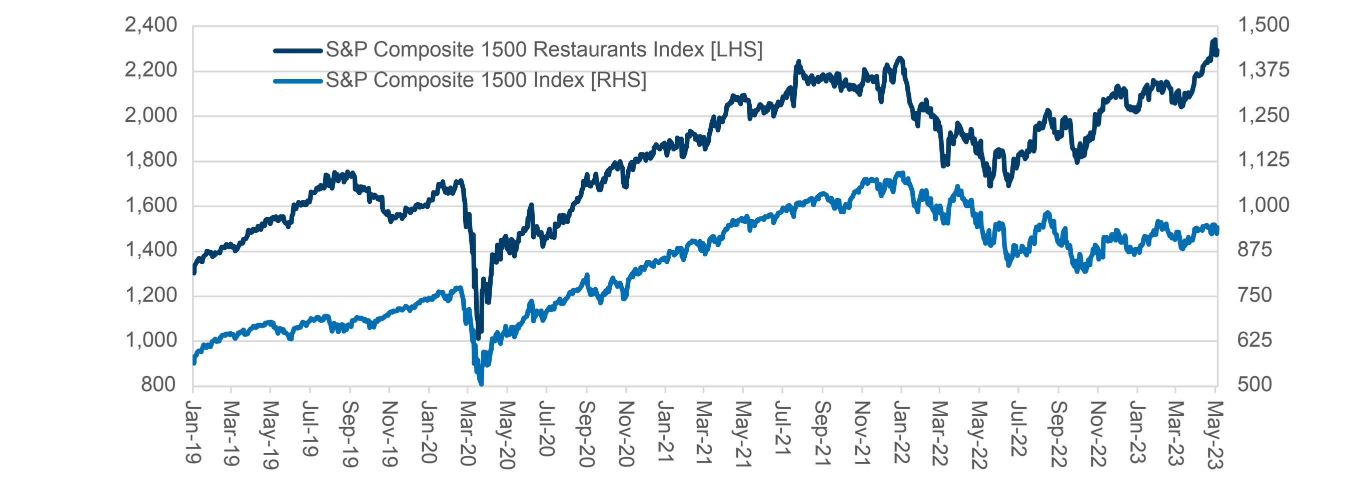
Source: U.S. Census Bureau, Monthly Retail Trade Report

Figure 2: Food Away from Home: Monthly Sales



Source: U.S. Census Bureau of the Census, Monthly Retail Trade Report

Figure 3: S&P 1500 Restaurant Index vs. S&P 1500 Composite Index



Source: S&P Capital IQ

Endnotes

[1] Bureau of Economic Analysis, *Gross Domestic Product*, First Quarter 2023, April 27, 2023

[2] Reorg First Day, *Consumer Discretionary Chapter 11's Are Up*, May 5, 2023

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