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ECONOMIC TALKING POINTS

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So Just What Are Consumers Thinking?

In less than a week, we got two highly conflicting reports on consumer confidence.

The Conference Board issued its release today and it showed a near collapse in optimism. Their latest index of consumer confidence plummeted 10 points, from 62.7 in May to 52.9 this month. Its two major components also fell. The present situation index dropped to 25.5 in June versus 29.8 in May, and the expectations index nosedived to 71.2 from 84.6. These are truly ugly numbers and pundits immediately sought out reasons for the downturn in spirits, pointing to the lackluster growth in jobs, worries about the European debt crisis, the shaky stock market, and a still weak real estate sector.

However ---just two business days earlier --- another respected organization surveying consumer confidence found Americans to be in the best mood in more than two years!! The University of Michigan's Consumer Sentiment index jumped to 76 in June, from 73.6 in May. Not only that, both of its two key sub-components moved higher as well: It's current conditions index climbed to 85.6 in June, from 81 in May, while the index of consumer expectations rose to 69.8 this month, from 68.8.

Such sharp disagreement by two respected confidence gauges at this critical juncture in the recovery obviously creates lots of uncertainty about a sector that contributes 70% of all economic activity.

So -- are households growing more anxious about the economic outlook, as the Conference Board report suggests? If true, that would be a bad omen for consumer spending. That certainly was on the mind of investors today. All the major stock indices

tanked once news emerged about the disturbing drop on consumer confidence.

Or, as the University of Michigan survey indicates, are Americans more hopeful that economic conditions, including the job market, are improving and that it's OK to ramp up spending?

When faced with such a conflict, we have to go back to a few basics.

First, the Conference Board and the University of Michigan have two different methodologies (obviously) when surveying consumer moods and that likely played a role in their vastly different conclusions. Let's briefly review how they conduct their surveys and whether the process itself may color their outcome.

The Conference Board

At the start of every month, the Conference Board mails out questionnaires to a sample of 5,000 households nationwide. Those households have about 18 to 22 days to respond before the cutoff date. Of the 5,000 households, roughly 3,500 respond by the monthly deadline. Since the surveys are initially mailed early in the month, they arrive about the time the Labor Department releases its much anticipated report on employment conditions. Thus changes in the job market can greatly affect the mood of consumers and how they'll likely fill out those questionnaires. Given the disappointing news on May employment, which saw only 41,000 new private jobs filled, down from 218,000 the previous month, it does not surprise me that consumer confidence turned sour immediately after that.

The University of Michigan

The folks at the University of Michigan take a different approach to evaluating what consumers are thinking. No questionnaires are sent out. Instead, they conduct telephone surveys every month. Calls are made to 500 households, but not all at once. Two sets of calls are made each month. The preliminary release comes out mid-month and is based on interviews with 200 to 300 households that begin in the final days of the previous month and continue right up to the middle of the surveyed month. (By the way, at the risk of complicating this, some 40% of the households were also called 6-months earlier and they are now contacted again to see if their confidence level has changed in the interim.) The final monthly release comes after reaching the remainder of the 500 households during the second half of the month.

Many experts favor the University of Michigan series for at least two reasons. First, by spreading out the calls across the entire month, households are not as likely to be overly influenced by the unexpected news of one or two economic indicators. Secondly, the quality of the responses coming from telephone interviews may be better than simply tabulating answers from a mailed questionnaire. In any event, it is interesting to point out that the Conference Board's own Index of Leading Economic Indicators chooses to use the University of Michigan survey to see where the economy is headed.

A second important way to assess which of the two confidence measures may be more accurate is to look at how consumers are actually behaving. Are Americans shopping?

Well, we got a fairly upbeat report yesterday on personal spending for May, one that beat out even consensus forecasts. Consumer outlays jumped both in nominal and real terms. (Check out yesterday's [*Economic Talking Points*](#) to see why the government report was such a positive one.)

Earlier in the month, the government released May retail sales, which did decline after eight consecutive months of increases. But a close read shows that special factors played a role in the May fall off. There was a sharp drop in home improvement sales as government rebates to stimulate purchases of energy efficient products came to an end. Secondly, and this has to be viewed as good news, gasoline station sales declined because the price of gas had fallen for the month.

This morning we got other good news. While nearly everyone focused on the awful Consumer Confidence numbers, the International Council of Shopping Centers came out with a bullish report on consumer spending. Their survey showed that weekly chain store sales for the week ending June 26 jumped by a hefty 2.1%, --- the biggest gain since April 3rd --- and year-over-year sales strengthened to 3.0%, its best showing in three weeks.

The bottom line here is that we ought not respond in knee-jerk fashion to a bad Consumer Confidence report, especially when it is so inconsistent with another major survey on household moods ---and when actual spending data indicate that consumers show no sign of cutting back on shopping.

Our take is that US economic fundamentals are better than what is portrayed in today's Consumer Confidence Index and the subsequent sharp drop in the stock market. That's why we expect to see some positive employment news on Friday with both an upward revision for May and a larger increase in private payrolls in June.

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