philly.com
anything & everything philly

Posted on Wed, May. 27, 2009

Consumer Confidence Index up third straight month

By Jeff Gelles

Inquirer Staff Writer

The economy is getting better, so consumer confidence is up. Or is it the other way around?

After a year and half of recession and nine months of news about financial crises, that question remains a chicken-and-egg riddle. But this much is clear: Consumers and investors are ready to embrace good news wherever they find it.

Yesterday, the Conference Board reported the third straight monthly rise in its familiar Consumer Confidence Index, and the biggest jump since April 2003. The stock market seemingly surged as a result, with major indices up more than 2 percent. The Dow industrial average rose 196.17, to 8,473.49.

The survey was plainly good news, especially as a measure of rising optimism.

In the May survey of 5,000 households, the overall Consumer Confidence Index rose to 54.9 - its highest level since September, when the collapse of Lehman Bros. Holdings Inc. and call for bailouts made "financial meltdown" part of the everyday lexicon.

But more impressive was the rise in expectations for how the economy would look six months down the road. Despite the continuing rise in joblessness, the index's subset known as the Expectations Index leapt more than 21 points in May to 72.3, its highest since December 2007 - the month the U.S. economy fell into recession.

The Expectations Index is considered an economic bellwether, said Lynn Franco, director of the business group's consumer-research center. Franco said higher confidence-index numbers were correlated with periods of strong economic growth.

Economists say that survey data are useful in gauging consumers' sentiments and that consumers' sentiments in turn are important to the health of an economy in which consumers account for two-thirds of spending.

"Psychology plays a big part in the business cycle," economist Ed Yardeni, president of

Yardeni Research, said yesterday. "When people want to believe that the economy should improve, it usually does. That's the power of positive thinking."

Yardeni said it was also telling that consumers seemed willing to look past the continuing decline in housing prices that was also in the news yesterday. Standard & Poor's said its Case-Shiller National Home Price index had declined 19.1 percent in the first quarter of 2009 compared with last year's first quarter, the largest drop in its 21-year history.

Yardeni and other economists said the drop in housing values created a negative version of the "wealth effect," said to occur when people own assets, such as stocks or real estate, that appear to have climbed in value.

Even if consumers have no intention of selling their homes or cashing in their portfolios anytime soon, the sense of wealth makes them more willing to spend savings or buy items on credit.

Yardeni said the "negative wealth effect" appeared to be offset by the recent rise in stock prices. The Dow industrials have gained about 30 percent since the index dipped to nearly 6,500 in March.

Scott Rick, a University of Michigan marketing professor who studies how behavior often diverges from economists' view of the purely rational, said consumers were typically affected by the type of anxieties that had soared during the recession, including concerns about job loss or declines in asset values. "Anxiety and distress are a major brake" on spending, Rick said.

Conversely, consumers are more willing to spend freely, especially on smaller impulse purchases, when they expect things to get better.

"A lot of us are very ready to spend future increases in wealth or income," said Rick, formerly a lecturer at the University of Pennsylvania's Wharton School. "Even if it's bad today; if we expect tomorrow to be rosy, we're ready to act on that today."

The Expectations Index is based on replies to three questions about people's expectations for how the economy will look in six months with regard to employment, family income, and business conditions. In each case, respondents are asked to say whether their expectations are positive, negative, or neutral.

Despite the relative optimism, consumer sentiment is far from heralding a recovery. The Expectations Index last topped 100 - its 1985 benchmark - in January 2005. The overall Consumer Confidence Index has not topped 100 since August 2007.

Contact staff writer Jeff Gelles at 215-854-2776 or jgelles@phillynews.com.