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ABSTRACT

This economic education publication features an article, "Does Consumer Confidence Measure Up to the Hype?," which defines consumer confidence and describes how it is measured. The article also explores why people might pay so much attention to consumer confidence indexes. The document also contains a question and answer section about deflation as well as a bulletin board. (BT)

Does Consumer Confidence Measure Up to the Hype?

Dawn Griffitts

Federal Reserve Bank of St. Louis, MO.

THE INSIDE VAULT

An economic education newsletter from the Federal Reserve Bank of St. Louis

DOES CONSUMER CONFIDENCE MEASURE UP TO THE HYPE?

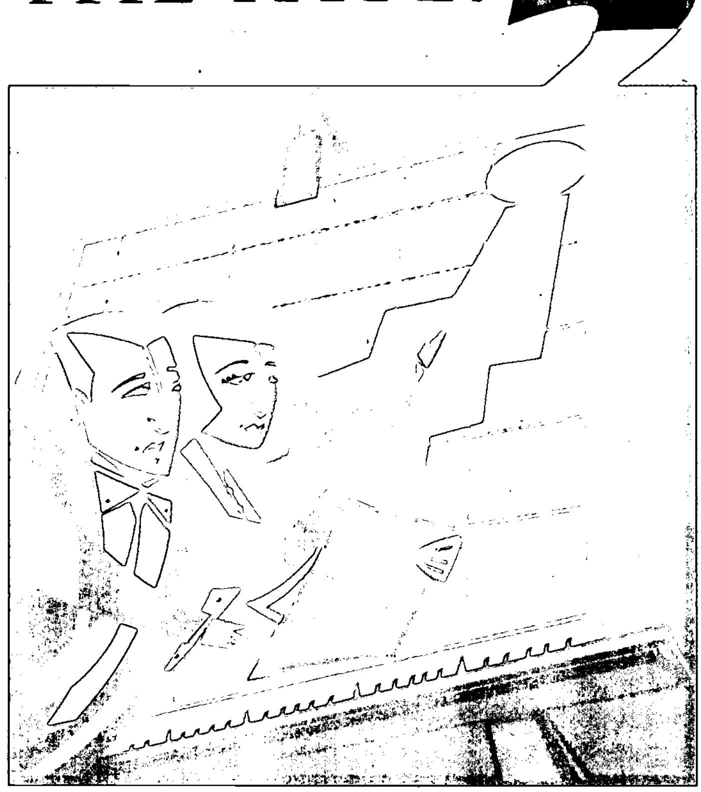
Every month, the two primary measures of U.S. consumer confidence, the University of Michigan's Index of Consumer Sentiment and the Conference Board's Consumer Confidence Index, are released with much media fanfare. The attention these indexes receive often centers on their potential to provide more information regarding current and future economic conditions—and the belief that changes in the two indexes may foreshadow changes in general economic conditions.

What Is Consumer Confidence and How Is It Measured?

"Consumer confidence" is a catchall phrase for the opinions and attitudes of consumers about the current and future strength of the economy. As a psychological concept, consumer confidence is difficult to measure. The University of Michigan and the Conference Board both measure consumer confidence by asking a random sample of consumers five questions about current economic conditions and expected future conditions (on back). Consumers also are asked to evaluate their personal financial situation.

After the surveys are conducted, the responses are compiled into a single number, called an "index" of consumer confidence. Changes in this x are meant to measure changes erall consumer confidence.

Interestingly, consumer confidence appears to correlate with the strength of the economy at the time of the survey. When the economy goes into a recession, consumer confidence generally falls sharply. When the economy expands, consumer confidence generally rises to high levels, often peaking before the economy enters a recession.



What's All the Fuss About?

One reason why people might pay so much attention to consumer confidence indexes is because they may provide an early signal regarding the strength of the economy. These survey data are released very quickly—in most instances long before other data measuring the strength of the economy are released. For example, the consumer confidence indexes for a given month are generally released toward the end of that month. In contrast, the personal consumption expenditure report, which measures what consumers actually did that month, is not available until the end of the following month. Thus, because consumer confidence is timely, it could be a useful early indicator of the economy's performance.

A second way in which the consumer confidence survey information might prove useful is if responses to survey questions provide good forecasts of future economic activity. Consumer confidence serves as a convenient summary of the forecasts of many individuals based on a variety of infor-

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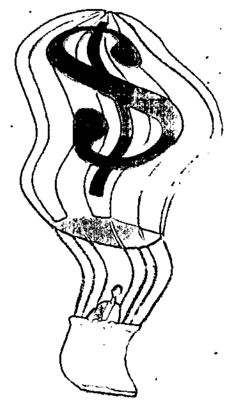


Q&A

***Q** If deflation means that prices are lower, why is it bad for the economy?*

A The effects of *deflation*, a sustained fall in the general price level, are substantially the reverse of those of inflation. Unanticipated deflation is costly to bearers of long-term debt—borrowers—because the dollars they pay back are more valuable than those they borrowed, i.e., those dollars have more purchasing power. Thus, creditors benefit at the expense of debtors.
In addition, owners of assets may find that the value of their assets has decreased, thus decreasing their wealth.

***Q** Wouldn't anyone gain from deflation?*

A Those with fixed money incomes would find their real incomes enhanced even without a change in their nominal incomes. And savers would find the purchasing power of their savings has grown—assuming those savings are in fixed-value monetary assets—because of the falling prices of goods and services.

***Q** So, some people are better off and some worse off during periods of deflation?*

A The fact that any given family may be an income earner, a holder of financial assets, an owner of real assets and a holder of debt simultaneously would probably cushion the redistributive impact of deflation. If the family owns fixed-value monetary assets such as savings accounts, deflation would increase their real value. As a holder of debt, a family would be repaying that debt with more valuable dollars. In addition, that same deflation may decrease the real value of any property assets such as a house or land that the family owns. Thus, many families could be simultaneously hurt and helped by deflation.

***Q** Is deflation worse than inflation?*

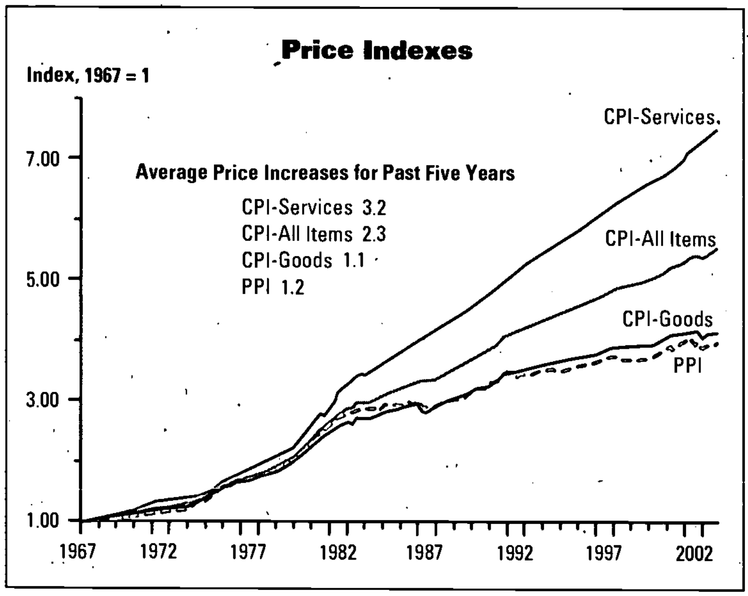
A Both deflation and inflation cost the economy in terms of output. Both also hurt business investment and may adversely affect families. The Federal Reserve is committed to maintaining price stability because it is necessary for sustainable long-term economic growth.

Economic Snapshot

1st Quarter 2003

	Q2-02	Q3-02	Q4-02	Q1-03
Growth Rate - Real Gross Domestic Product	**1.3%**	**4.0%**	**1.4%**	**1.6%***
Inflation Rate - Consumer Price Index	**3.5%**	**2.2%**	**2.0%**	**3.9%**
Civilian Unemployment Rate	**5.8%**	**5.8%**	**5.9%**	**5.8%**

****Preliminary Estimate***



Graph from February 2003 issue of *National Economic Trends*.

What is the difference between the CPI and the PPI?

The Producer Price Index (PPI) is a family of indexes that measures the average change over time in selling prices received by domestic producers of goods and services. The PPI measures price change from the perspective of the seller.

PPIs contrast with other measures, such as the Consumer Price Index (CPI), that measure price change from the purchaser's perspective. Sellers' and purchasers' prices may differ due to government subsidies, sales and excise taxes, and distribution costs.

Why have goods prices risen so much more slowly than services prices?

Tremendous advances in technology and productivity in goods production have produced cost savings in manufacturing.

June 16-20 and 24-25, 2003
Making Sense of Money and Banking

Federal Reserve Bank of St. Louis

This is a seven-day, three-credit course open to elementary and secondary teachers and other educators interested in integrating money and banking topics into social studies, language arts and math. The course will feature guest speakers from the Federal Reserve Bank of St. Louis, as well as tours, hands-on activities, simulations for classroom use and breakout sessions for elementary and secondary teachers. Registration through either Southern Illinois University at Edwardsville or the University of Missouri-St. Louis is required. Three hours of graduate credit will be awarded to educators completing the course.

To register for ECON 500B-501 through SIUE, contact Mary Anne Pettit at (618) 650-2583.

To register for ECON 310: Money and Banking through UMSL, contact Sarapage McCorkle at (314) 516-5249. Ask about scholarships for practicing teachers in Missouri.

For more information, contact Dawn Griffitts, manager of economic education at the Federal Reserve Bank of St. Louis, at (314) 444-8421 or call toll-free 1-800-333-0810, ext. 44-8421.

Fed Challenge 2003

An economic competition for high school students

Are you looking for a way to bring real-world economics into your classroom? Fed Challenge, a competition for high school students sponsored by the Federal Reserve Bank of St. Louis, calls for five-member teams to do research and analyze data about current economic conditions and then recommend a specific course for monetary policy. The student teams make 15-minute presentations before a panel of judges in a mock Federal Open Market Committee forum, followed by 15 minutes of Q & A. Look for fall coaching workshops and team registration information on our web site at www.stlouisfed.org/education/fedchal/.

For more information contact:

Memphis	Ellen Eubank (901) 579-2421
Little Rock	Lyn Haralson (501) 324-8240
Louisville	Faith Weekly (502) 568-9216
St. Louis	Dawn Griffitts (314) 444-8421

Fall Teacher Conference

A one-day conference for educators K-12

Mark your calendar now so that you don't miss the St. Louis Fed's fall teacher conference!

Conference Schedule

Oct. 21—Federal Reserve Bank of St. Louis, teachers grades K-8
Oct. 22—Federal Reserve Bank of St. Louis, teachers grades 9-12
Oct. 28—Louisville Branch Bank, teachers grades K-12
Oct. 29—Memphis Branch Bank, teachers grades K-12
Oct. 30—Little Rock Branch Bank, teachers grades K-12

There is no fee, but registration is required. Registration information will be sent in September, or visit our web site at www.stlouisfed.org/education.

Inside the Vault *is written by Dawn Griffitts, manager of economic education at the Federal Reserve Bank of St. Louis, P.O. Box 442, St. Louis, MO 63166. The views expressed are those of the author and are not necessarily those of the Federal Reserve Bank of St. Louis or the Federal Reserve System. Please direct all comments and questions about the publication to (314) 444-8421 or dawn.c.griffitts@stls.frb.org.*

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mation. Who knows? Consumers might be good at forecasting the economy. To the extent that these forecasts are useful for predicting economic activity, indexes of consumer confidence can serve as a leading indicator of the economy's strength.

When Trapped on a Deserted Island

Many research studies have attempted to determine if consumer confidence is a useful early signal of economic activity. Economist Phillip Howrey of the University of Michigan tested whether predictions of current period consumption growth can be more accurate by using results from the Michigan confidence index from that period. Howrey concluded that the Michigan index does provide some useful information for predicting the value of consumption growth, although the degree of improvement is generally small.

What about the possibility that consumer confidence might predict future economic activity? Several economists tested whether the value of the University of Michigan index from a month, say, January, was able to improve projections of February's consumption growth. They concluded that when consumer confidence is used as the only variable, it can significantly improve these forecasts.

Thus, if an economic forecaster were trapped on a deserted island with only data on consumer confidence, use of the consumer confidence measures to educate her guess about the economy's strength in general would not be a bad idea. However, consumer confidence is not data with "superforecasting" powers. Nonetheless, these data get super attention each month when they're reported.

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The University of Michigan's Survey Questions

1) We are interested in how people are getting along financially these days. Would you say that you (and your family living there) are better off or worse off financially than you were a year ago?
2) Now, looking ahead, do you think that a year from now you (and your family living there) will be better off financially, worse off or just about the same as now?
3) Now turning to business conditions in the country as a whole—do you think that during the next 12 months we'll have good times financially, bad times, or what?
4) Looking ahead, which would you say is more likely: that in the country as a whole we'll have continuous good times during the next five years or so, or that we will have periods of widespread unemployment or depression, or what?
5) About the big things people buy for their homes—such as furniture, a refrigerator, stove, television and things like that—generally speaking, do you think now is a good or bad time for people to buy major household items?

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