Box 7

COMPILATION, USEFULNESS AND RECENT DEVELOPMENTS IN THE EURO AREA CONSUMER CONFIDENCE INDICATOR

This box explains how the European Commission's (DG ECFIN) indicator of euro area consumer confidence is compiled and assesses its usefulness in gauging developments in household spending as measured by private consumption. A comparison is also made between the current recovery and the recovery in private consumption in 1993.

The compilation of consumer confidence

On a monthly basis, the European Commission's consumer survey asks households a set of questions on finances, the labour market, and the economic situation, amongst other things, some of which are backward-looking questions, while others are forward-looking. For most questions, the respondents are offered six possible qualitative answers.[1] Each question is summarised as a percentage balance derived from the proportion of respondents opting for each of these response categories (dismissing the "stayed the same" and "don't know" responses). The consumer confidence indicator is calculated as the arithmetic mean of the four balances derived from the four forward-looking questions. Two of these questions relate to expectations regarding their personal situation, while the other two refer to aggregate developments in the given country.[2]

1 The response categories are typically structured as follows: (i) got a lot better; (ii) got a little better; (iii) stayed the same; (iv) got a little worse; (v) got a lot worse; or (vi) don't know.

2 The questions are as follows: (i) How do you expect the financial position of your household to change over the next 12 months?; (ii) How do you expect the general economic situation in this country to develop over the next 12 months?; (iii) How do you expect the number of people unemployed in this country to change over the next 12 months?; and (iv) Over the next 12 months, how likely is it that you will save any money?

Correlation between year-on-year private consumption growth and consumer confidence – 1985Q1 to 2009Q4

	year-on-year	quarter-on-quarter
Consumer confidence	0.72	0.47
Households' financial position	0.81	0.53
General economic situation	0.74	0.53
Unemployment (inverted)	0.59	0.37
Savings	0.53	0.31
Major purchases	0.87	0.53

Sources: Eurostat, DG ECFIN and ECB calculations.
Note: Even though the survey questions are forward-looking, the table displays the contemporaneous correlations, as they tend to be higher than the correlations with lagged consumer confidence.

Usefulness of the consumer confidence indicator in assessing consumption growth in the euro area

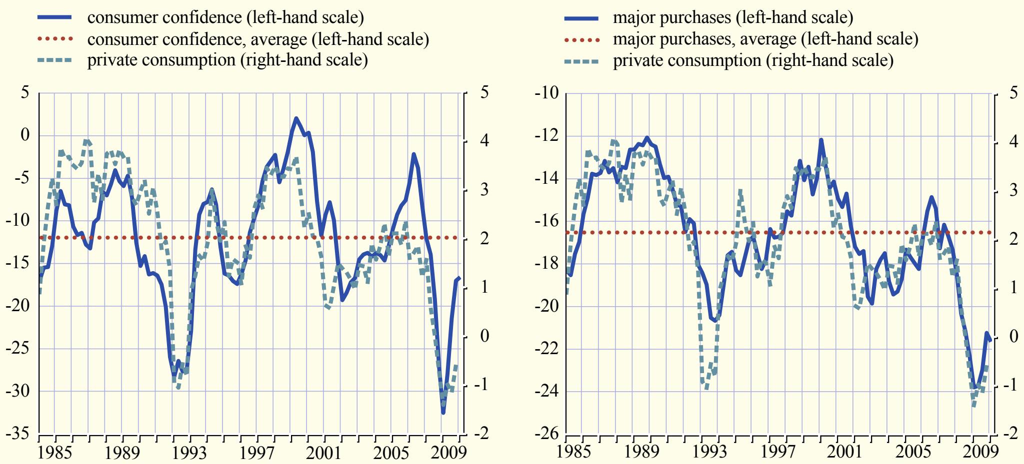
One major advantage of the consumer confidence indicator is its timeliness. The results are usually available monthly, at the end of the reporting period to which they refer. Even for the quarterly average this implies, for example, a lead-time of eight to nine weeks with regard to the date of release of quarterly private consumption figures. Recently, a flash estimate of this indicator for the euro area was introduced by DG ECFIN, bringing forward the availability of preliminary information by around ten days.

Overall, the consumer confidence indicator provides a reasonably good indication of trend developments in consumption, displaying a high correlation with year-on-year consumption growth (0.72, see the table), although the correlation with more volatile quarter-on-quarter movements in euro area consumption is much lower (0.47).

The assessment of the future financial position of households displays the highest correlation with year-on-year consumption growth, while the question on savings shows the lowest

Chart A Private consumption, consumer confidence and major purchases

(percentage balance; year-on-year percentage growth; quarterly data)



Sources: Eurostat, DG ECFIN and ECB calculations.
Note: Survey data for 2010Q1 are estimated with the results for January and February 2010.

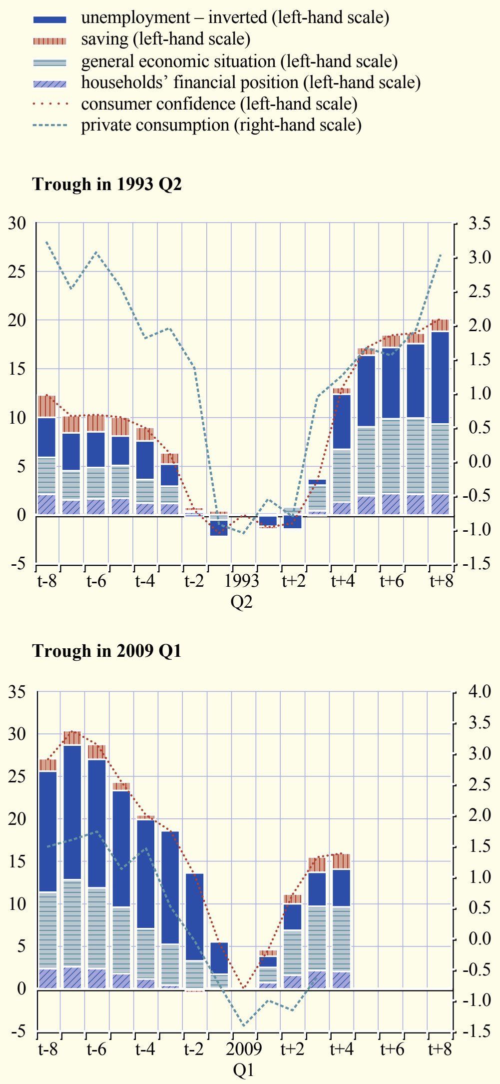
correlation. Notably, another question in the survey, which is not included in the indicator of consumer confidence, a question on major purchases planned, displays a higher correlation than consumer confidence and any of its components.[3] The high degree of co-movement between annual consumption growth, consumer confidence and major purchases is also illustrated in Chart A.

Recent developments and a comparison with the 1993 recovery

Although consumer confidence at the beginning of 2010 still remained below its long-term average, Chart A reveals that confidence has been rising since the beginning of 2009, following a protracted period of decline which started in the first half of 2007. However, consumption growth has not picked up to the same extent and the wedge between consumption and confidence was unusually large in the third quarter of 2009. In this respect, it is worth recalling that the profile of consumption growth has recently been heavily shaped by fiscal incentives geared towards boosting car sales in some countries. While these fiscal measures had an upward impact on consumption around mid-2009, they are likely to have had a downward impact towards the end of last year and at the beginning of 2010 owing to their withdrawal. It could be that these temporary measures are only partly reflected in the confidence indicator. Moreover, the unprecedented speed and depth of the recent downturn may not only have had an impact on the relationship between the percentage balance indicator of consumer confidence and annual consumption growth but also undoubtedly created challenges for statisticians in compiling macroeconomic indicators (e.g. seasonal and working day adjustment). Thus, latest estimates of consumption growth may be more prone than normal to future revisions. Chart B shows consumer confidence, the contributions from its components and annual consumption growth for the periods around the trough of the second quarter of 1993 and the first quarter of 2009, respectively.

Chart B Private consumption, consumer confidence and its components

(percentage balance; year-on-year percentage growth)



Sources: Eurostat, DG ECFIN and ECB calculations.
Notes: Consumer confidence has been rebased to zero in the quarters when annual consumption growth reached the trough: 1993 Q2 and 2009 Q1. The sub-components of confidence are illustrated as contributions to overall confidence. Survey data for 2010 Q1 have been estimated with the results for January and February 2010.

3 "Compared to the past 12 months, do you expect to spend more or less money on major purchases (furniture, electrical/electronic devices, etc.) over the next 12 months?"

The implications of the latest rise in consumer confidence can be examined in the light of developments in consumer confidence following the trough in consumption growth in the second quarter of 1993, when annual growth rates reached negative territories of a similar size as those in the first quarter of 2009 (around -1.0%). In the upturn, it was the assessment regarding unemployment and the general economic situation that drove consumer confidence. Thus, the most influential factor affecting households' consumption decisions was the views on the overall state of the economy underlying the rise in confidence, and not the views on the personal situation among households. This is somewhat surprising, as one would expect the views on the personal situation to be better determinants of turning points and upswings in consumption. On the other hand, it could be the case that expectations regarding the overall state of the economy better reflect cyclical developments than expectations regarding the personal situation.

Developments in consumer confidence and its components following the latest turning point in consumption growth in the first quarter of 2009 do not differ significantly from the experience following the trough of the second quarter of 1993. Again, it is the views on the overall state of the economy that explain the rise in confidence. However, the improvement in the assessment of unemployment is, up to the first quarter of 2010, smaller than in the previous recovery.

At the current juncture, it is probably too early to assess whether or not recent developments in consumer confidence signal a genuine turning point in consumption growth. However, unless consumption contracts further, the year-on-year rates of growth are likely to increase owing to base effects once the negative or subdued quarter-on-quarter growth rates in 2009 fall out from the year-on-year growth rates. Still, the speed and the strength of the recovery in consumption is very uncertain given the expected weakening of the impact of fiscal incentives for car purchases, the fact that consumer confidence is still below its long-term average and the weak outlook for labour markets. Moreover, the indicator regarding major purchases has displayed a more modest upswing than overall consumer confidence.