

Box 8

**RECENT DEVELOPMENTS IN CONSUMER CONFIDENCE AND THE LINK WITH PRIVATE CONSUMPTION**

Euro area consumer confidence increased in February 2012 for the second month in a row, following a steep decline seen in the second half of 2011. While consumer confidence remains far below its long-term average level, it stands well above the trough seen in March 2009 during the most recent recession. This box reviews recent developments in consumer confidence in the euro area and the four largest euro area countries, as well as the

usefulness of this indicator for the assessment of private consumption developments.

### Cross-country differences in consumer confidence

The recent improvement in consumer confidence in the euro area as a whole masks diverse developments across countries (see Chart A). Looking at developments since the most recent trough in confidence in March 2009, significant improvements in consumer confidence have been recorded in Germany and Spain. In France there has been a limited improvement, while in Italy consumer confidence, after having initially recovered, gradually declined to reach levels similar to those observed during the 2008-09 recession.

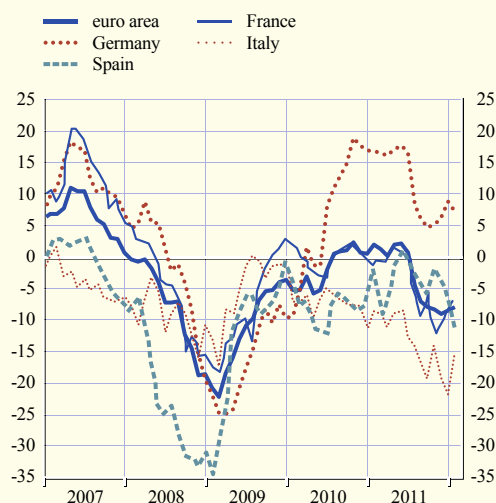
### Factors driving consumer confidence

To analyse in more detail what has been driving developments in consumer confidence since early 2009, it is necessary to look at all four components of the indicator, which correspond to questions from the European Commission's monthly consumer survey. Among other things, it asks respondents about their expectations regarding developments over the next 12 months in (i) the general economic situation, (ii) unemployment, (iii) their household's financial position, and (iv) their intentions with regard to saving. The consumer confidence indicator is the arithmetic mean of the survey balances<sup>1</sup> of these questions, with equal weights applied to all the questions. Chart B shows the contributions of the four components to the overall euro area consumer confidence indicator since its trough during the most recent recession.

At the euro area level, changes in expectations relating to unemployment developments made

**Chart A Developments in consumer confidence**

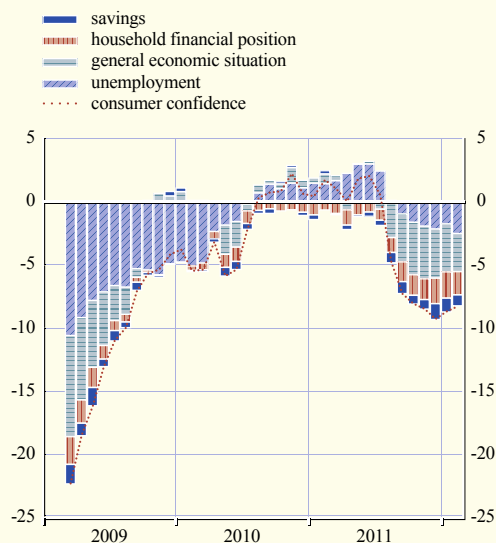
(percentage balances; deviations from long-term averages)



Sources: European Commission and ECB calculations.

**Chart B Consumer confidence in the euro area and contributions of components**

(percentage balances; deviations from long-term averages)



Sources: European Commission and ECB calculations.

<sup>1</sup> The survey balances for each component are computed as the percentage of respondents expecting an improvement minus the percentage of respondents expecting a deterioration, with the responses of "stayed the same" and "I don't know" being disregarded. They are expressed as percentage balances.

the largest contribution to the improvement in consumer confidence between March 2009 and June 2011, followed by changes in expectations regarding the general economic situation. The respondents' views on their expected savings and their household's financial position also improved, albeit to a lesser extent. In general, answers to the questions concerning the economy as a whole display far more variation over the business cycle than responses to the questions regarding the situations of individual households. Taking this into account, the contributions of the four components to the overall improvement in the consumer confidence indicator since early 2009 are broadly in line with long-term patterns. All the components show a high degree of co-movement, with all four contributing to the recovery in consumer confidence since the most recent trough, as well as to the drop in consumer confidence in the second half of 2011. Since the middle of 2011 all four components have stood below their long-term average levels, as shown in Chart B.

### The link with private consumption developments

The usefulness of consumer confidence for the assessment of private consumption developments in the euro area can be illustrated by looking at correlations between the survey balance and year-on-year and quarter-on-quarter real private consumption growth. Overall, the consumer confidence indicator displays a relatively high correlation of 0.72 with year-on-year private consumption developments (see Chart C and the table), while the correlation with quarter-on-quarter private consumption growth is 0.49.<sup>2</sup> Looking at sample periods of five years, the correlations vary significantly over time (see Chart D). In particular, over the period 2001-07 a temporary disconnect between the two variables occurred. In this period episodes of high uncertainty and geopolitical tensions

Chart C Private consumption and consumer confidence in the euro area

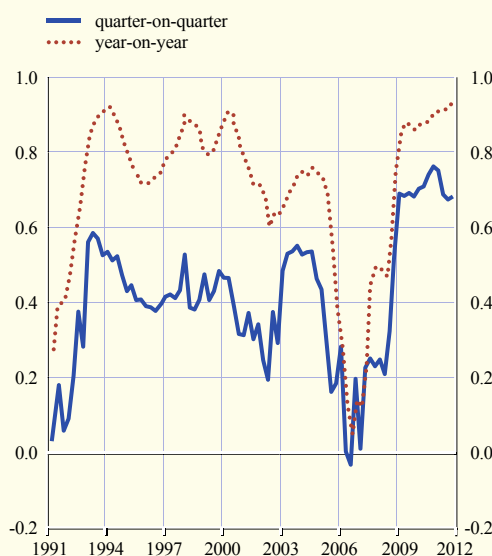
(annual percentage changes; percentage balances, standardised)



Sources: European Commission, Eurostat and ECB calculations.

Chart D The correlation between private consumption growth and consumer confidence in the euro area

(correlation over rolling five-year periods)



Sources: European Commission, Eurostat and ECB calculations. Note: The date on the x-axis denotes the end of the respective five-year period over which the correlation is computed.

<sup>2</sup> The survey questions are forward-looking, i.e. the results would be expected to correlate with future consumption. In practice, however, contemporaneous correlations are higher than correlations of current private consumption with past consumer confidence.

affected consumer confidence, while private consumption growth was rather stable. Thereafter, the correlation between the two variables increased markedly to a level above the historical average. This may reflect structural changes in the relationship between the two variables. This is also suggested by robustness checks on estimated parameters of simple regressions of private consumption growth (both in year-on-year terms and quarter-on-quarter terms) on consumer confidence over different sample periods.

#### Contemporaneous correlation between consumer confidence and real private consumption growth

	in year-on-year terms	in quarter-on-quarter terms
Germany	0.34	0.18
Spain	0.75	0.70
France	0.63	0.37
Italy	0.60	0.38
Euro area	0.72	0.49

Sources: European Commission, Eurostat and ECB calculations.  
Notes: The data refer to the period from the first quarter of 1985 to the fourth quarter of 2011 (for Italy, data are available only up to the third quarter of 2011).

The correlation between consumer confidence and real private consumption growth differs significantly across countries. Focusing on the four largest euro area countries, the correlation with year-on-year private consumption growth is relatively high for Spain, while somewhat lower for France and Italy and particularly poor for Germany (see the table). All four countries show fluctuations in the correlation over time, with the most recent five-year period showing a higher correlation than the preceding five-year period.

Overall, the usefulness of developments in consumer confidence for the assessment of real private consumption developments varies across countries and periods. Caution should be exercised in deriving conclusions about consumption growth on the basis of consumer confidence owing to the instability of relationships at both the country and euro area levels. However, this information can be useful in conjunction with other short-term indicators of consumption. The recent improvement in euro area consumer confidence may thus be seen as a positive signal for real private consumption growth in the period ahead.