

Box 3

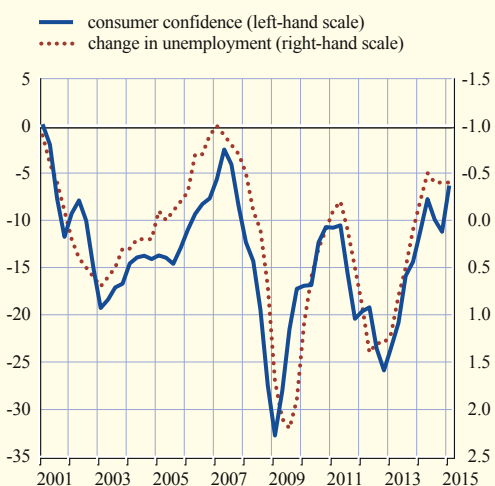
WHAT HAS BEEN DRIVING CONSUMER CONFIDENCE?

Euro area consumer confidence increased sharply in March 2015 for the fourth consecutive month to reach pre-crisis levels. This constituted a recovery from the drop in confidence recorded in the second half of 2014. Overall, the trend has been for growing consumer confidence since early 2013. This box takes a closer look at recent developments in consumer confidence and examines to what extent lower oil prices and lower unemployment have been driving this indicator.

The most recent rise in consumer confidence coincided with a gradual recovery in the labour market and lower oil prices. Notwithstanding a dip in the second half of 2014, euro area labour markets have been improving steadily since late 2012, which might have played a role in supporting consumer confidence (see Chart A). Furthermore, oil prices fell sharply in the second half of 2014 and have remained at low levels since then, boosting consumers' real disposable income and possibly also consumer confidence (see Chart B). Even though it waned somewhat during that period, available evidence suggests that consumer confidence typically reacts positively to lower oil prices.¹

Chart A Consumer confidence and changes in the unemployment rate

(balance of answers; annual changes in percentage points)



Sources: European Commission and ECB staff calculations.
 Note: The change in the unemployment rate in the first quarter of 2015 is based on data for January and February 2015.

Chart B Consumer confidence and oil prices

(balance of answers)

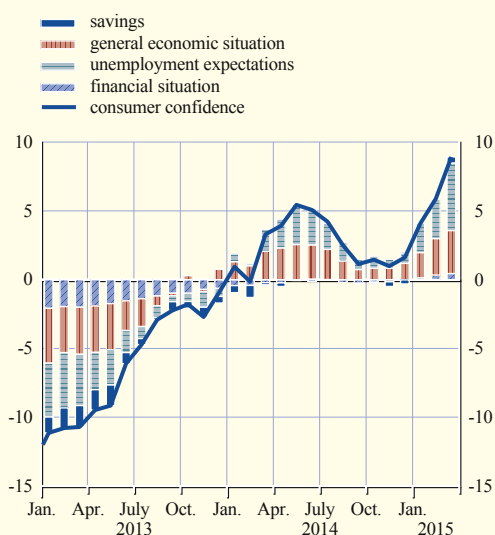


Sources: European Commission and ECB staff calculations.

1 For evidence from the United States on the reaction of consumer confidence to energy-related increases in real disposable income, see Edelstein, P. and Kilian, L., "How sensitive are consumer expenditures to retail energy prices?", *Journal of Monetary Economics*, Vol. 56, 2009, pp. 766-779. For more recent evidence on the impact of lower oil prices on US consumer confidence, see Aladangady and Sahm, "Do lower gasoline prices boost confidence?", FEDS Notes, 2015, available at <http://www.federalreserve.gov/econresdata/notes/feds-notes/2015/do-lower-gasoline-prices-boost-confidence-20150306.html>.

Chart C Decomposition of consumer confidence in sub-components

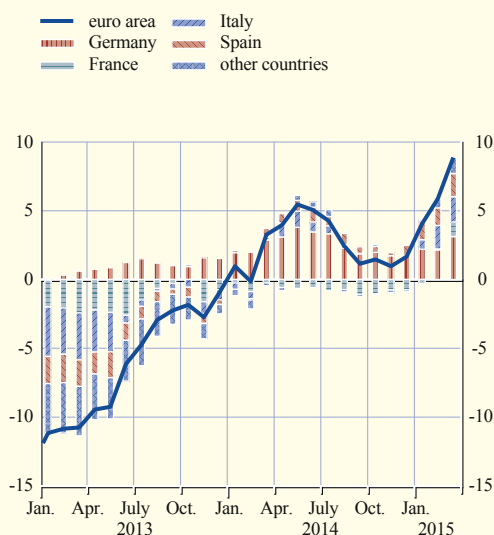
(balance of answers; difference from historical average)



Sources: European Commission and ECB staff calculations.
Note: Questions for each of the sub-components refer to expectations of households over the next 12 months.

Chart D Decomposition of consumer confidence across countries

(balance of answers; difference from historical average)



Sources: European Commission and ECB staff calculations.

The recovery in consumer confidence since early 2013 has been primarily driven by the significantly more positive assessment by households of future unemployment and the future general economic situation.² By contrast, households' assessment of their future savings and financial situation contributed only marginally (see Chart C). This suggests that labour market developments must have been a determining factor in recent improvements in consumer confidence. Households' assessments of the general economic situation are also highly correlated with their expectations of unemployment, suggesting that a larger share of total consumer confidence could eventually be explained by labour market developments. Nevertheless, it is important to note that although declining, the unemployment rate is still high in many euro area countries.

The increase in euro area consumer confidence was driven mainly by Germany, as well as Spain and Italy. In the latter two countries, the improvement in consumer confidence coincided with a decline in the unemployment rate. In Germany too, favourable labour market conditions, including a low and further declining unemployment rate, have been boosting consumer confidence. By contrast, consumer confidence in France has changed less over the past two years, in line with labour market developments. Moreover, owing to the lower weight of petroleum products in French consumption, the drop in oil prices has had a relatively lower direct impact on real disposable income, which might to some extent also explain the smaller improvement in French consumer confidence (see Chart D).

Econometric evidence confirms that increased consumer confidence in the euro area since early 2013 has been driven chiefly by improving labour market dynamics. At the same time lower energy prices have also to some extent contributed to the rise in consumer confidence. In the last quarter of 2014 increasing employment growth and lower oil prices have driven

² The consumer confidence index is composed of answers to the following four questions on households' expectations for the next 12 months regarding their financial situation, the general economic situation, unemployment and savings.

up growth in households' real disposable income to a level not seen since before the crisis. Even though some of the improvement in the labour market could also be related to lower energy prices, econometric evidence suggests that the rise in consumer confidence relates mainly to a genuine improvement in the labour market that is unrelated to lower oil prices. The renewed improvements in the labour market over the past few months are therefore an encouraging sign, as they should result in a more sustained and persistent recovery in consumer confidence, compared with a temporary increase in consumer confidence in response to lower oil prices.