

Box 2

Does consumer confidence predict private consumption?

Euro area consumer confidence has increased sharply since the end of 2014.

Despite its recent weakening, euro area consumer confidence remains high (see Chart A). The surge in consumer confidence seems to be related to improving labour market conditions, as well as higher real disposable income as a result of lower energy prices.¹

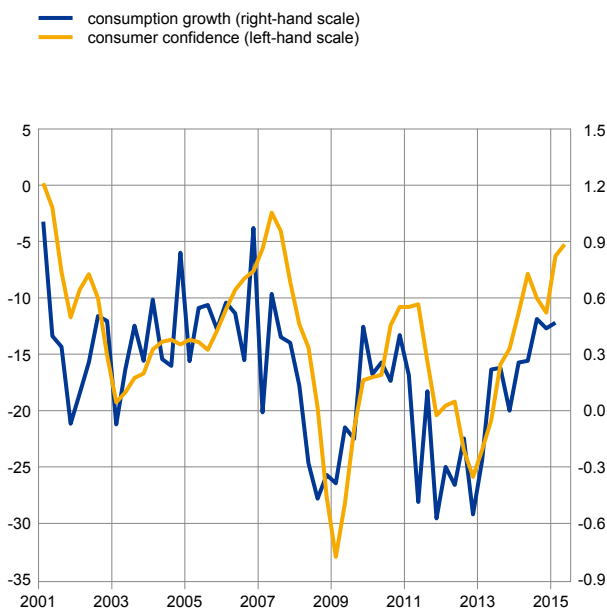
There is evidence that consumer confidence leads consumption growth.

The consumer confidence indicator is closely related to contemporaneous and future quarterly consumption growth (see Chart B). While this relationship does not imply causation, it nonetheless shows that consumer confidence is a good indicator for assessing consumption developments.

Chart A

Consumer confidence and consumption growth

(quarterly percentage changes; balances of responses)

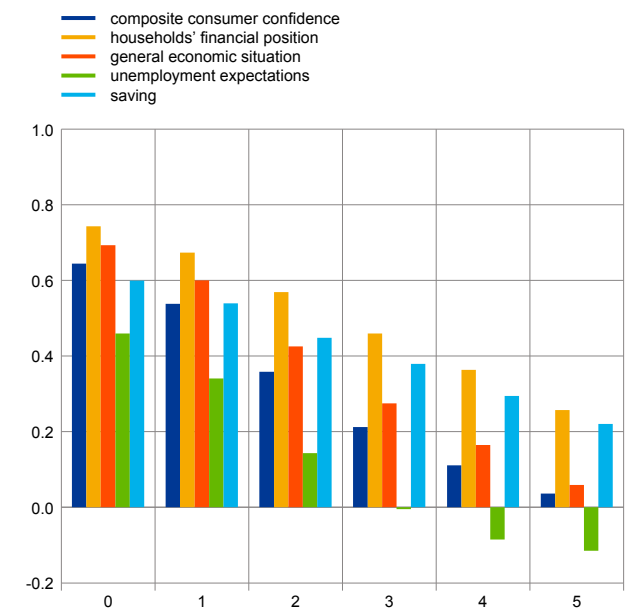


Sources: European Commission, Eurostat and ECB staff calculations.
Notes: Latest observation for consumer confidence refers to the second quarter of 2015 and for consumption growth the first quarter of 2015.

Chart B

Correlation between consumer confidence and current and future consumption growth

(x-axis: quarters ahead of future consumption growth)



Sources: European Commission and ECB staff calculations.
Notes: The correlations are computed using quarterly consumption growth and balances of responses. The sample period is 1996-2014.

¹ See "What has been driving consumer confidence?", *Economic Bulletin*, Issue 3, ECB, 2015.

Some questions underlying the consumer confidence indicator predict consumption growth in fact better than the indicator itself.^{2,3} The correlation of the question on respondents' personal financial situation with future consumption growth is significantly higher than that of the overall confidence indicator, especially at several quarters ahead (see Chart B). It does indeed seem intuitive that the "micro" questions on respondents' personal situation give a better prediction of consumption growth, as respondents should typically be better informed about their personal situation than the general macroeconomic situation. Chart B shows that the correlations between the "micro" questions and consumption growth remain relatively strong even at several quarters ahead.

Empirical evidence suggests that changes in consumer confidence are mainly a reflection of information that is also included in standard determinants of consumption. There are, broadly speaking, two contrasting views about the role of confidence in macroeconomics ("animal spirits" versus "news"). The first view posits that autonomous fluctuations in beliefs have a causal effect on economic activity ("animal spirits view"). The second view of confidence suggests that the correlation between measures of consumer confidence and subsequent consumption growth arises because confidence measures contain fundamental information about the current and future states of the economy ("news view"), which is also reflected in other macroeconomic variables. The available evidence for the euro area mainly supports the second view, namely that the predictive power of consumer confidence reflects information that is also available in standard determinants of consumption. However, as some of these determinants can only be observed with a lag, consumer confidence and its sub-components may indeed provide useful information for future consumption.⁴

Consumer confidence can be an important leading indicator due to its timeliness in providing information about current and future consumption growth. The indicator is usually available several weeks before data on key determinants of consumption (e.g. disposable income) become available. Monitoring consumer confidence can therefore be useful for policymakers.

² The four questions that are used to compute the consumer confidence indicator are those that relate to consumers' expectations about unemployment, the general economic situation, their personal financial situation and their personal saving ability over the next 12 months. Because responses relating to unemployment and the general economic situation vary to a much greater extent, they are given much more weight in the consumer confidence indicator. Therefore it cannot be ruled out that certain questions in the European Commission's consumer survey are better for predicting future consumption growth than the consumer confidence indicator.

³ See Jonsson, A. and Lindén, S., "The quest for the best consumer confidence indicator", *European Economy – Economic Papers*, No 372, 2009; and *Evaluation of the Joint Harmonised EU Programme of Business and Consumer Surveys*, European Commission, 2012.

⁴ See "Confidence indicators and economic developments", *Monthly Bulletin*, ECB, January 2013.