

Consumer Sentiment Index: a barometer of mood or a leading signal of activity?

Consumer Confidence Indexes are computed in many countries around the world. In Australia we have the Westpac – Melbourne Institute Consumer Sentiment Index.

These indexes are often interpreted as reflections of the populace's confidence in their economic environment. A positive change is heralded as a sign of favorable economic times (including good economic management) while, a negative result is, shall we say, less well received.

Recently, the Governor of the Reserve Bank of Australia, Glenn Stevens, was reported as using the words "trend" and "random noise" with respect to the June reading of the Westpac – Melbourne Institute Consumer Sentiment Index. What noise? What trend?

First, a bit of information about the computation of the Index.

The Westpac – Melbourne Institute consumer sentiment index is computed as the balance of five questions put to 1200 Australian households each month. The questions include the respondents' assessment of: (i) their family finances compared with one year ago; (ii) their expected family finances over the next 12 months; (iii) expected economic conditions in Australia over the next 12 months; (iv) expected economic conditions in Australia over the next 5 years; and (v) whether they think it is a good or bad time to buy major household items (like a new fridge or TV).

The Index is computed as the net balance of favorable responses to unfavorable responses and benchmarked to 100. In other words, when the Index is at 100, the number of optimists exactly matches the number of pessimists in the survey. A number less than 100 means that more respondents are expressing unfavorable views.

In June, we reported that the Westpac – Melbourne Institute Consumer Sentiment Index fell for the second consecutive month, by 2.6 per cent to 101.2, following a 1.3 per cent fall in May. Is this negative reading something that policy makers and businesses should worry about? Is this noise? Or is this part of a downward trend?

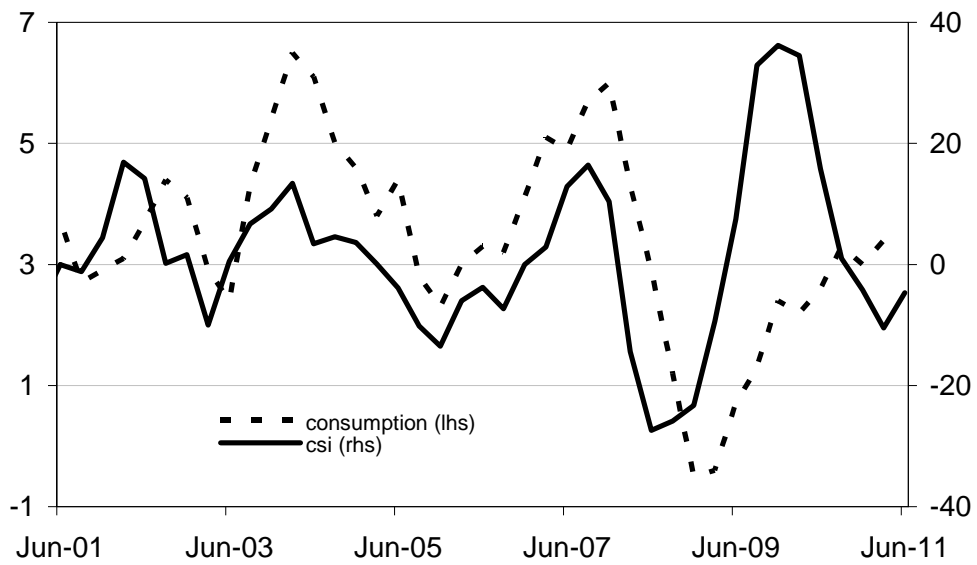
There is most certainly a degree of noise around each survey result. Survey respondents react to, and their views about the economic environment are coloured by, the news broadcasts and infotainment around them. Like moods, sentiments go up and sentiments come down and each month's reading invariably reflects aspects of personal circumstances and news.

But it would be imprudent to dismiss the underlying trend, be it up or down, inherent in these surveys.

A picture is worth a thousand words. In the accompanying chart, we can see that changes in the Consumer Sentiment Index moves with changes in official measures of household consumption. But note how the Consumer Sentiment Index turns before the turn in household consumption.

In other words, consumers signal a change in their behaviour well before we pick up the change in the official statistics. Given the lag in the release of official data, this is not information to be lightly dismissed. Putting this in pragmatic terms, when the majority of households repeatedly report that they are pessimistic about the future, policy makers and businesses should take note – widespread negativity often translates into a decline in spending!

**Consumer Sentiment Index
and Household Consumption (annual % changes)**



Source: ABS and the Melbourne Institute

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