The Consumer Confidence Index: From Subjective Households of America to the Toolbox of Businesses and Investors

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The Conference Board reports an essential lagging economic indicator known as The Consumer Confidence Index, otherwise known as the CCI. The CCI measures the consumers' confidence in current financial conditions as well as expectations over the next 6 months, the index is currently at 100.05. For a full analysis of the Consumer Confidence Index, it is necessary to integrate an examination of the makeup and calculation of the CCI. This paper will explain the use and importance of the CCI, and take a look at the behaviors from various cycles in the past as well as the contemporary one, and finally provide an ancillary viewpoint on the forecast of the CCI for the holiday season.

The Conference Board, an independent non-profit business membership and research association, releases the Consumer Confidence Index to investors on the final Tuesday of every month. The survey for the board is administered by Nielsen, an international provider of analytics and information in the consumer markets. The survey is presented to 5,000 households and asks them 5 questions; three of which ask them about their expectations for the next 6 months, which all work to make up the "expectations index". The remaining two questions ask about present household financial status and either make up the "present situation index". The survey asks the households to answer each question as either "positive", "negative", or "neutral". To calculate the index, Nielsen divides each question's positive answer by the total of the positive to negative responses, this proportion is known as the "relative value". The relative value for each of the five questions is compared to the relative values from 1985, which has an index value of 100. This is done by dividing the new relative value by the indexed relative value. The identification of the relative values produces a "index value" for each question. The index values for each question are then averaged out and the resulting number is the Consumer Confidence Index. The data is calculated using this method in the United States and its nine census regions (Investopedia). The charts given in figures 1-4 and the CCI values given from the Organisation of Economic Cooperation and Development, abbreviated to OECD, is amplitude adjusted version of the Consumer Confidence Index.

If the calculated value is less than the indexed value, then the consumer's confidence is somewhat pessimistic. In other words, the mentality of the consumer has strayed away from consuming and transitioned towards saving. If the number is too low, that can reflect a contraction in the market cycle, displaying lackluster confidence. This can be linked to an unhealthy economy, with signs of decreased productivity, which is almost always followed by a high unemployment rate and lower wages. If the value is 100 then the consumers are neutral or optimistic about the economy in its present state as well as its stability over the next half-year. If the value is greater than 100, the consumers are satisfied and optimistic with the economy. A value over 100 can indicate an increase in demand for business spending in anticipation for the upcoming consumer pay-outs, which makes up 70% of the United States GDP. This would increase earnings and as a result, increase the price in a share of stock. This is highly relevant to the current time of the year with the holiday season approaching. If the CCI is too high then we can run into the issue of higher spending and less saving which if big enough can bring on a higher inflation. If inflation is too high, the Federal Reserve has to step in and raise the federal funds to curb inflation and because of the higher rates the economic growth slows. When inflation becomes elevated then the value of the USD in exchange markets would rise reducing exports and increasing imports and which in consequence could result in a noticeable CCI decrease.

Once the 2007 mortgage crisis in the United States became an international banking catastrophe, Lehman Brothers, one of the biggest investment banks, collapsed on September 15, 2008. This launched massive bailouts for various financial institutions. The United States refused to bail out the Lehman Brothers causing a massive hit on the stock market. The global financial system was shocked after the investment bank with $700bn of liabilities went bust. This caused all assets and funds in the global money market to freeze, and subsequently damaged insurance companies and banks in developed countries who couldn't obtain money (Independent). After, the global economy entered a recession, unemployment rates soared to nearly 10 percent while the world rebuilt themselves from the massive financial crisis. During that time the Consumer Confidence Index fell to its lowest point of 97.13 from 110.81 in January of 2007, refer to the black arrow in figure one, at the beginning of the recession. Towards the end of 2009, the United States was exiting the recession that became the beginning of a period of expansion.

Figure.1. CCI from Late 2007 to Present Time
Source: OECD

Consumer Confidence Index is a lagging indicator, meaning that changes had happened in a target of variable interests, often confirming trends and giving investors and businesses prior notice of possible future movements (Investopedia). This is an example of a lagging indicator because the CCI began to descent in January of 2007, refer to the red arrow in figure one, after the speculation of recession. This is confirmed by the continual sporadic movement and downward digression. Holds point in the fact that the first real sign of a confirmed crisis occurred when an American real estate investment trust with a large stake in the subprime mortgage market filed for bankruptcy on April 2nd, 2007. Additionally, when the markets drop the CCI has been low in anticipation or drops at proper release. Therefore, one can call the Confidence Consumer Index a procyclical indicator because it moves in the same direction as the economy. (thoughtco, Moffat)

Since the expansion began in mid-2009, the CCI can be at the end of long term increase with a lot of sudden drops and spikes reflecting the big movements in global markets considering numerous financial events beginning at credit agencies and trickling to bailouts and trade wars. The first big dip in the current cycle leading up to the frightening low occurs when an earthquake and tsunami hit Japan, the world's third-largest economy. This causes markets in London to take a hit due to english based companies with ties to energy, mineral, and insurance. This is followed by Moody's, a credit rating agency, knocking down Greece's credit rating from Ba2 to B1, a 3 rating knockdown. This reflected the sudden downward drop in the confidence of investors because it added to the financial stress of the peripheral eurozone. Some countries that make up the peripheral eurozone is Greece, Ireland, and Portugal. Greece and Ireland accepted rescue packages from the International Monetary Fund and the EU. Portugal was on the brink of a bailout which would leave Spain exposed as a result of their large accumulation of debts. This lowered the CCI from 99.3 to 99.1. In April the CCI lowers to 99 when Standard and Poor's, another credit rating agency, took a look at the amounting United States debt and reports that the European crisis may affect the U.S. in cutting the outlook from "stable" to "negative" for the first time since Pearl Harbor in 1970. This foreshadows the heavy speculation of a default on loans by Greece which led to a huge selloff of the euro. The S&P sees this and stresses that the non-immunity of the U.S. from the foreign debt crisis. This is followed by the DOW Jones Industrial Average and the FTSE 100 in London falling more than 125 points. Subsequently, in August, the European leaders worked out a new deal to stimulate the Greek economy. S&P posed another threat to the United States and downgrades the Gold-Plated Triple A to an AA+ as congress passes a new debt ceiling act. By the end of August, the CCI was 98.2 after starting at 99.3 at the beginning of March.

The decrease in the CCI is all in parallel to the events leading up to the closing of August. The investors did not have proper footing at any point to try and grasp the situation to increase confidence in the present and future conditions of the household. The credit agencies like Moody's and Standard & Poor held investors in their hands when it came to knocking Greece's credit rating down after they warned U.S. investors about the possibility of a European debt crisis coming across the Atlantic and the downgrade of the U.S. sovereign debt from Gold-Plated Triple A. This was reflected when the euro sold off and the DOW JIA and FTSE 100 dropped more than 1 percent.

Figure 4 and 5 show the behavior comparison of the market, using the DOW JIA, and the CCI for the same starting time of September 2008. This shows the effect of the DOW JIA falling

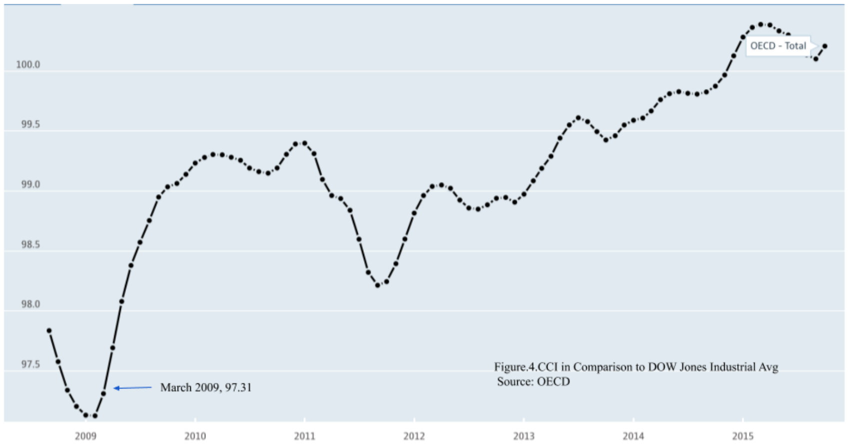


Figure.4.CCI in Comparison to DOW Jones Industrial Avg
Source: OECD


Figure.5. DOW Jones Industrial Average in Comparison with CCI
Source: TDAmeritrade

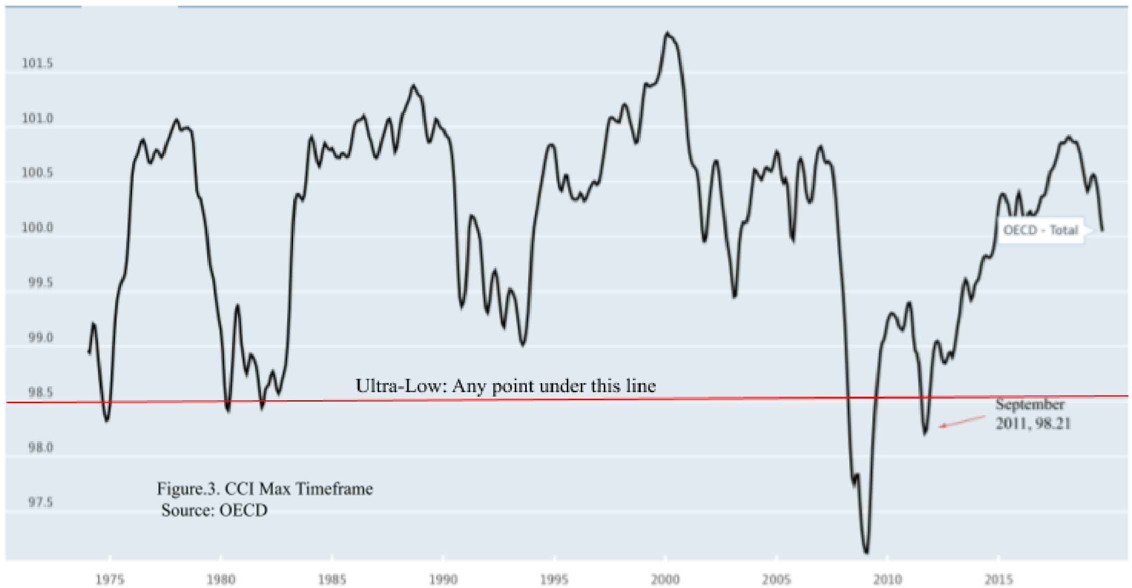
from the reestablishment of rating by credit agencies and their effect on the consumers and the market.

Other noticeable drops to note is December of 2010 ending at a 99.39 and then falling to 98.84 in June of 2011 and then to 98.21 in September of 2011. The big decrease in the CCI can be linked to the investor reaction of Portugal finally getting bailed out and Greece getting bailed out for the second time. The Federal Reserve announced that they were working on more monetary stimulus with putting considerable weight on different forms of quantitative easing, which helped keep interest rates low. After the end of July, consumers begin shopping again despite the lack of credit card usage and also allowed consumers to take on auto and education loans due to the monetary stimulus. This, in turn, serves as a confidence booster and raises the CCI to 98.5 during July of 2012 and 99.08 in February of 2013. But, increased government spending and decreased tax revenues cause the debt-to-GDP ratio of the United States to be at 103% higher than any time since World War II. At the time the U.S. debt was $16.4 tr and the GDP was $15.9 tr. This completed the 2nd inverted triangle in December 2012 due to the rising concerns of the growing debt not being under control. After oscillating between May and July. The CCI took a minor hit on October 1st when the government was shut down until October 17th. The CCI fell to 99.61 from 99.43 The shutdown occurred after the mounting debt spilled over into D.C. and produced a congressional budget standoff. This caused a large influx in the government workers not in work and not getting paid. The government shutdown potentially deterred 120,000 jobs from being created (The Council of Economic Advisors). This caused a drop in confidence across the nation's households as an issue arose of if the employees that were temporarily absent due to the shutdown cut their consumer spending. As the borrower's balance keeps rising it will make the bill more difficult to afford and show creditors overextension and heavy utilization of supply that will pose the possible risk of being behind on payments. This also occurs during the holiday months which is when there is a peak in consumer spending and borrowing.

A more recent sharp decrease was in August of this year when the CCI fell from 100.34 to 100.17. This is due to the U.S. Stock Market taking a pounding. Out of the 22 trading days in

Figure.2. Most Recent CCI Decrease
Source: OECD

August on half of those days, large caps teetered +/- 1 percent until by the end of the month all major stock classes fell under. During August, there were trade war tensions between the U.S. and China which affected the volatility with the large-cap stocks as many big companies have factories in China due to inexpensive labor force and lower taxes. Overall, this showed that trade tariffs do not benefit the economy because all major stock classes were affected and reacted to the stimuli of tariffs poorly. In middle to late August, the U.S. 30 Year Treasury hit a record low leading to a speculation of a recession, but strong data available emphasizes record unemployment lows and pickup in consumer spending which is inevitably sustaining the economy overall. Speculation of a global economic slowdown added to volatility rolling into September. The signals reported by Central banks around the world reported that they would lower interest rates to attempt an increase for the demand in the borrower market to encourage consumption in order to strengthen prospective economies.



If one would look at previous behaviors they will see previous ultra lows during times of recessions. Unlike the low of September 2011, the Consumer Confidence Index of 98.21, reflects the only ultra-low during the time of a healthy economy. This paper recognizes an ultra-low of the CCI as lower than a value of 98.5. In previous cycles, the lowest recorded value has been 98.33, in November of 1974, during a small recession in 1980 leading up to a bigger recession a year later. During this short leading behavior of this 6 month recession, there was big stagflation in the U.S. economy with no growth. This was at argument with the overextension of the Savings and Loans Industry in the low fixed-rate mortgage economy and that is followed by the fall in real estate and oil markets which causes many savings and loans companies to go bankrupt. The oil markets were extremely volatile from the Iranian Revolution of 1979 and Reagan's tax cuts to encourage lower-income savings and investment. The next ultra-low to pass this was January 2009 at 97.13. These low points were during the Great Recession caused by multiple events. The first major issue that led to this recession was when the U.S. Government failed to regulate the financial industry ultimately allowing the mortgage lending of toxic debt. Another issue is that the lending companies were taking on way too much risk and therefore when the depository banking system failed, the flow of credit dropped significantly.

In relation to the future outlook of the Consumer Confidence Index, The Conference Board expects a slow Q3 and Q4, but the economy still shows health and strength and so the Board does not think this will affect consumer spending in the coming months. Lynn Franco, a Senior Director of Economic Indicators at the Conference Board, said “While confidence could continue hovering around current levels for months to come, at some point this continued uncertainty will begin to diminish consumer’s confidence in the expansions.”. Due to heightening trade tensions throughout the fall months, the CCI was hit with the biggest drop in 9 months during September and October. The present expectations show to have an increase in optimism from consumers, but the expectations index decreased. This Decrease in the expectations index reflects the growing pessimism in the improvement of business conditions and in the labor market.

As of currently the Consumer Confidence Index is at 100.05 and the CCI has been on a downturn for the past 5 months. The overall trend of the CCI shows a continual downward retreat or flattening over the course of the next few months into 2020. This can be contributed to many large cap stock movements, Amazon, and heavy political influence with international trade tensions and continual impeachment news. The U.S. economy as a whole is on course for the 2%-3% GDP growth with the unemployment rate in its natural course, and there is no evidence of inflation or deflation so the overall outlook for the Consumer Confidence Index is positive considering economy outlook as a whole.

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Honor Code

I affirm that I have adhered to the Honor Code in this assignment.