Consumer Confidence

Every month, the news media reports on the U.S. Consumer Confidence Index, as reported by the Conference Board. The Index is supposed to be a snapshot of American's confidence in the economic near future of the country. It is just one of the many economic components that allow economists to predict future consumer spending, purchasing, demand, etc.

Why exactly this means so much to the experts is a mystery.

The public sometimes bases its "confidence" of the economy on no more than a fleeting comment heard on the radio or television, a newspaper or internet headline, or an expert's prediction. Therefore, when economists survey the citizens for their opinion about the future economy, the citizens will of course eventually mimic the experts. This information is circular and virtually pointless.

How accurate is the public's perspective on the economy? When we look back at recent history, we learn that economic recessions actually begin earlier than people recognize, while employment and the stock market can continue to grow long after the economy officially begins its decline.

The public is most attentive to economics, national budgets, deficits, and trade during the Presidential election years. That is when they see, read, and hear the most about national issues. Since we often link the economy with presidents and elections, here are some examples, using data from the National Bureau of Economic Research.

Most people believe the Great Recession began in the fall of 2008, just before the election (Obama versus McCain). Throughout 2008, many economists insisted that the economy was on sound footing. Since that conviction benefitted the party occupying the White House, the Republicans agreed and claimed the economy was fine and the future looked bright. Naturally, the Democrats disagreed.

Then the banks failed, the stock market tumbled, the housing market went bust, and the Great Recession began. Barack Obama won the election and for the first few years of his presidency, he and his economic team faced a terrible recession.

That is what the public believes are the facts. Yet, the truth is somewhat surprising. The recession did not begin just weeks before that election. We now know that it actually began nearly a year earlier, in December of 2007. When did it end? Surprisingly, just months after the inauguration, in June of 2009, the Great Recession officially ended, and the slow path to recovery began.

Something similar happened after the 2000 elections (Gore versus W. Bush). Many experts believed that George W. Bush was inheriting an incredible, robust economy that would produce budget surpluses for years. Naturally, the public agreed and consumer confidence was high. Yet, less than 2 months after Bush took office, a recession began in March of 2001. Unemployment lagged behind and did not significantly rise until later that year – after the attacks on 9/11.

Conversely, jobs are often stubborn to return even long after a recession ends. During the 1992 election (Bush versus Clinton versus Perot), much of the debate focused on budget deficits and unemployment rates that experts were projecting to rise in the following years. The Clinton campaign, the Perot campaign, and economists, claimed that the recession was deepening, and the economy was on the verge of collapse. Once again, the public's view mirrored the experts on Election Day in November of 1992.

In hindsight, we learn how wrong the experts and the public were. That recession actually ended in March of 1991, more than a year and a half before the election. Far from collapsing, the economy was already on the rebound by the end of 1992.

In these examples, it is clear that by the time consumers develop a momentum of rising confidence, the economy has already entered a downturn. Likewise, confidence is often at its lowest even after a depressed economy begins to improve.

Many stock experts use the people's "herd mentality" to make money on investments. Since people tend not to recognize the business cycle, and believe that the economy will remain the same for the foreseeable future, the shrewd investor knows that the best time to sell is when the people are confident and ready to buy. When the people lose their confidence and want to sell, that is often the best time for a wise investor to buy.

The monthly U.S. Consumer Confidence Index gives the impression that economists calculated a meaningful economic measurement. However, herd mentality only tends to see the direction the herd is already moving, and it takes a great deal of effort for that direction to change.

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