

Economics Group

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Consumer Sentiment Slips in August

The University of Michigan's Consumer Sentiment index declined 0.2 percentage points in August to 89.8. Consumers expressed less optimism about current conditions but sentiment remains at a solid level overall.

Consumers Feel Cautiously Optimistic

The University of Michigan's Index of Consumer Sentiment fell in late August and ended the month marginally below its July reading at 89.8 (top chart). The drop was concentrated in the current economic conditions component, which fell 2 points to 107.0. Consumer expectations for future economic conditions rose 0.9 points in August, although expectations fell from their preliminary reading earlier in August. Consumers feel pretty good about their current finances but are worried about big-picture headline issues such as the upcoming presidential election, global geopolitical events, and the outlook for interest rates. Buying conditions fell 3 points in August but remain in their recent range, which has coincided with strong growth in consumer spending.

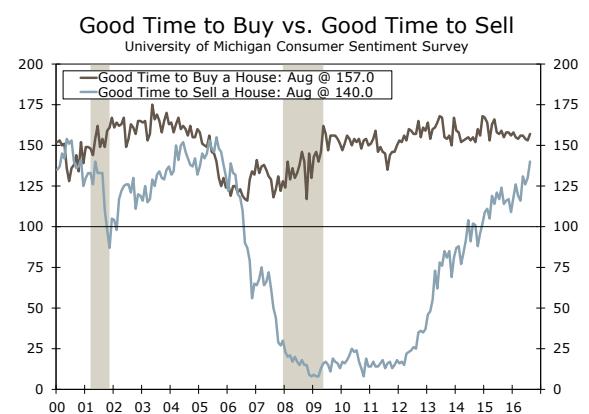
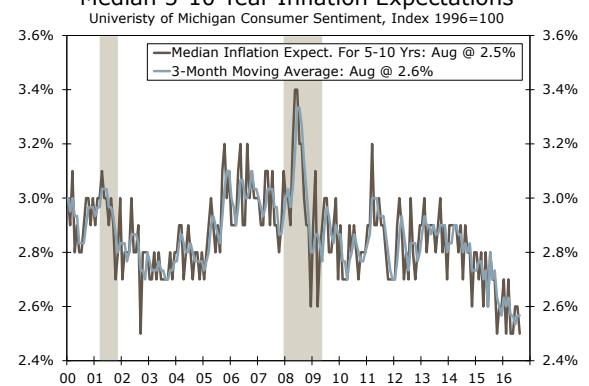
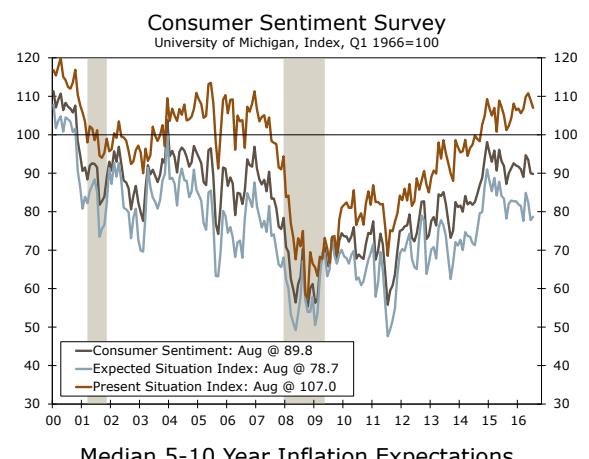
Current Finances Are Ok

The current personal finances index fell 3 points in August to 118 but consumers still feel reasonably upbeat about their current finances. The proportion of consumers stating that their finances had improved over the past year remains relatively high at 44 percent. Consumers are less certain about the future, however, with a lesser 29 percent expecting their finances to improve in the coming year.

Consumers also continue to express a great deal of confidence that inflation will remain low for the foreseeable future. Inflation is expected to average just 2.5 percent over the next five to ten years, down from 2.6 percent in July and 2.7 percent one year ago (middle chart). Inflation expectations are back down at their lowest level since the survey began more than fifty years ago. Expectations for interest rates have also fallen, although 52 percent still expect interest rates to rise over the next year, down from 63 percent one year ago. The proportion of households expecting interest rates to rise during the next year is the lowest it has been in 22 months.

The drop in inflation and interest rate expectations is likely to be of particular interest to the Fed. While households are expecting inflation to rise at a pace comfortably above the Fed's 2 percent target, consumers have historically overestimated inflation by a considerable margin. The current low expectations for inflation suggest that more time will be needed for inflation to return to the Fed's comfort zone. The drop in expectations for higher interest rates is also noteworthy, because the Fed would like to avoid surprising the financial markets and public, which drives home the need for the Fed to be transparent and convincing with their communications.

While inflation expectations hit new lows, consumers have noticed that home prices have ratcheted up. Home selling conditions have risen to their highest level since 2005, while home buying conditions have fallen slightly over the past year (bottom chart).



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