THE CONSUMER AS FORECASTER

By Fabian Linden

We are a people irrepressibly preoccupied with the nation's economic heartbeat. Each new official statistical release from Washington—unemployment, retail sales, industrial production, trade deficit, freight car loadings—is dedicatedly reported by the media and relentlessly assessed by the experts. Unfortunately, the economic forecasting fraternity's performance has been less than inspiring. The nation's consumers have a far better record in foretelling our economic fortunes. Recent history provides some compelling examples. With a near post-war record of seven years of business expansion, there have been intermittent warnings from the "experts" that trouble, sometimes big trouble, lies immediately ahead. But while the alarms have grown increasingly frequent, the economy continues to expand.

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Looking back to the early months of 1986, the consensus forecast of the major economic models routinely tracked by the Conference Board of the Consumer Research Center called for strong business growth of well over 3% in each of the four quarters of that year. But the Board's monthly Consumer Confidence Index signaled, through most of the year, an increasingly soft economy. And that, in fact, was the actual experience. In the second quarter the annual GNP growth rate was a negative 2%, and in the third quarter only a stingy 0.8%. By 1987, the experts had become somewhat more optimistic, but this time they failed by a large margin to anticipate the vigorous 5.5% growth of the economy in that year. Again, the consumer proved to be a far more reliable predictor. The confidence index registered increasingly positive readings throughout 1987.

The series continued to signal a favorable performance through most of 1988. The economic models, however, indicated a sluggish growth figure of only slightly over 1%. Once again, the message from consumers was right on. Growth in 1988 was strong in all four quarters, chalking up an annual gain of 3.5%. The story is substantially the same in 1989. While the professional forecasts ranged from softlanding to recession, consumers continued to suggest a good pace of business activity for the year. Although the final numbers are not yet in, we are likely to end 1989 with close to a 3% annual growth figure—very comfortable indeed.

The consumer's skill in telling us how it's going to be was impressively demonstrated right after the October 1987 stock market plunge. The major econometric modelbuilders widely predicted that the crash would precipitate a sharp drop in economic activity, and very possibly, a recession. Of the eight models routinely tracked by the Conference Board, four predicted negative GNP growth for the initial quarter of 1988, while the other four suggested an average growth of 1% or less. Based on a special consumer confidence survey conducted immediately after the crash, though, the Board noted that "while the consumers' spirits are not nearly as high as they were before the stock crisis, they are still above what is generally associated with an oncoming recession." By December, the Board reported: "Confidence on the Rebound." And what was the actual performance? GNP grew in the first quarter of 1988 at a heartening 4.0% rate and averaged about 3% in each of the subsequent quarters.

In the unnerving days immediately following the Dow Jones quake, fears were also widespread that Christmas sales would be down sharply and that feeble consumer demand in that critical season could push the economy into recession. However, based on consumer survey findings, the Board reported shortly after the crash that "the outlook for a reasonably Merry Christmas continues to be good." Again, in a special survey conducted in November, it indicated that Christmas 1987 would be "about the same as last year"—a prediction which proved sound. Christmas 1987 sales were up by about 1% over the year before.

Some years ago, a major financial publication, in reviewing the Board's confidence survey record, referred to the consumers' ability to predict economic developments as "uncanny." It is, in fact, neither uncanny nor canny. Survey participants are clearly not economic analysts, nor do they follow business news at all closely. However, people are evidently extremely sensitive to their own personal day-to-day economic experiences. More or fewer overtime hours on the job than the week before, the expansion or contraction of their plant's night shift, rumor that the company's back orders are strong or weak — these are the stuff that shapes the consumer's view of the economy. They also reflect the vigor of the nation's business at any particular moment.

The Conference Board's consumer confidence survey effectively tells us each month what is going on in thousands of businesses across the land. It provides, then, an instant playback of prevailing economic conditions. The consumer as wage earner is quick to detect changes in the economic pulsebeat at an early stage, well before changes become sufficiently strong to register on the Department of Commerce's extensive statistical indicators. The response of people to their personal economic experiences is demonstrated by the wide differences in consumer confidence reported from various regions of the country at any given time. For example, in the closing months of 1989, the US confidence index was running a moderate 2% ahead of the comparable period the year before. But in New England, which has been experiencing economic difficulties of late, the series was off by well over 20%.

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The Consumer Confidence Program

The Board launched its Consumer Confidence program monthly survey in 1967. In mid-1977 it expanded the program to a monthly series. The standard questionnaire is mailed to a representative nationwide sample of 5,000 homes, with an entirely new population contacted every month. The survey is conducted for the Board's Consumer Research Center by National Family Opinion, Inc. (NFO) of Toledo, Ohio. The response rate averages out at 75%.

The confidence survey consists of two questions on consumers' views of present conditions—the business situation and job availability—and three questions on their expectations for the six months ahead—the outlook for business, jobs, and their own financial situation. On all queries participants are given three response options—positive, neutral, or negative. In constructing the index, positive and negative replies are added together for each question, and the number of positive answers are expressed as a percentage of that total. For each of these series, in turn, the percentage is converted to an index figure with the year of 1985 equaling 100. Each series is also adjusted for seasonal variation. The total Consumer Confidence Index reported every month is the simple average of all five indicated indexes, each given an equal weight. There are also two sub-series: one based on the initial two questions that touch consumers' views of the prevailing situation; the other based on the remaining three that indicate expectations for the coming six months. The latter series — the "Expectations" component of the confidence index — has a slightly better forecasting performance than the overall series.

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THE CONSUMER ISN'T ALWAYS A GOOD FORECASTER

QUESTION: March 1971

Video cassettes are now under development. They would make it possible for you to play tapes of many different kinds of programs on your home T.V. screen, much as you play records on your phonograph today. [Given the estimated cost of between $400 and $800 for a VCR...] How likely is it that you would buy such a system when it becomes available—very likely, fairly likely, not too likely, or not at all likely?

Very likely	3%
Fairly likely	9
Not too likely	28
Not at all likely	60

NOTE: Survey by the Gallup Organization.

QUESTION: May 1989

Do you happen to own a V.C.R., that is, a videocassette recorder?

Yes	75%
No	25

NOTE: Survey by Associated Press/Media General.