



CONSUMERS VIEW ECONOMIC PROSPECTS WITH CONFIDENCE: SLOWER GROWTH, BUT NO END TO EXPANSION IN SIGHT

Consumer Confidence Remains Near Record Peak

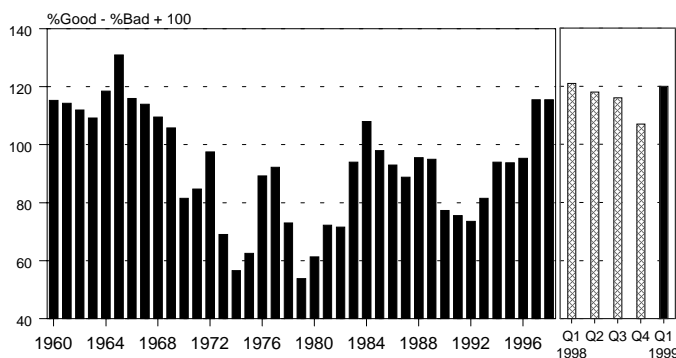
The Index of Consumer Sentiment was 105.7 in the March 1999 survey. Although this was just below the 108.1 recorded in February, the March figure was still higher than anytime during the second half of 1998. The small March loss was due to slightly less favorable prospects for economic growth, reflecting the growing belief among consumers that interest rates will rise during the year ahead.

While the March survey recorded the third consecutive small year-to-year decline, the prevailing level of consumer confidence remains extraordinarily high and the data give no indication of an emerging downward trend. Indeed, the March survey completes the eighth consecutive quarter that the Sentiment Index has averaged above 100.0, establishing the longest sustained period of consumer confidence, outdistancing the prior record set during the mid 1960's. Overall, the March data indicate that the outlook for consumer spending will remain strong, with the pace of spending easing only slightly through the balance of 1999.

Expansion Expected To Reach Teens!

What is even more remarkable than having the expansion reach its eighth birthday, already the second longest expansion in 150 years, is that consumers expect the expansion to become a teenager! In the March 1999 survey, the majority of consumers expected the current expansion to continue for another five years. Regaining the small losses recorded in the second half of 1998, the long term outlook for the national economy is now more favorable than anytime since 1965 (see the chart).

Outlook for National Economy During Next 5 Years



The current expansion is comparable to the record 1960's expansion in more ways than just its length. The most notable similarity was that during the first few years of both expansions consumers expressed widespread concerns about persistently high unemployment despite otherwise favorable views about the economy. Then as now, it was the reduction of those concerns that prompted consumers to adopt an exuberant outlook—a term that was indeed used to describe consumers in 1965, but it was never used with the qualifying “irrational.”

While the early years of both expansions were similar, the economic developments that marked the closing years of the 1960's expansion are unlikely to be repeated. Inflationary expectations nearly doubled by the end of 1966 over the levels that prevailed in the early 1960's, which marked the beginning of the long inflationary spiral that took nearly two decades to tame.

The endogenous factors that produce inflationary spirals require both rising wage demands among workers as well as the willingness of consumers to validate any resulting price increases by their spending behavior. Indeed, the hallmark of an inflationary psychology is that whether

acting as workers or consumers, people expect and accept inflation as the norm. Unlike the mid 1960's, the recent data give no indication that consumers either expect more rapid wage increases or any less willing to resist product price increases. In sharp contrast to the 1960's, the actions of today's consumers act to restrain rather than accelerate inflationary trends.

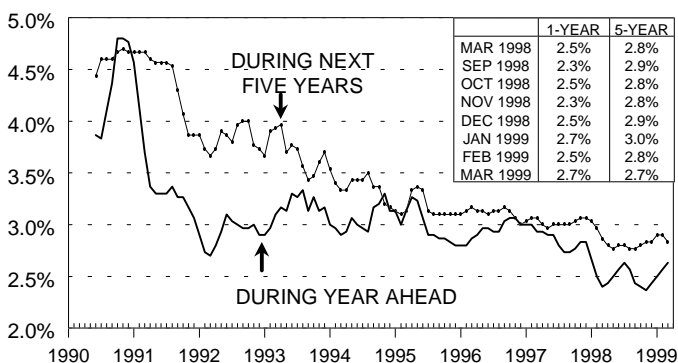
Indeed, the greater concern is the potential implications of a disinflationary psychology. The recent accommodation to smaller nominal income increases was facilitated by the widespread apprehensions about job prospects earlier in the expansion as well as by falling inflation rates. Just as consumers' sense of financial progress has become increasingly dependent on declining inflation rates during the past few years, rising inflation rates—even if still at relatively low levels—will have a correspondingly greater impact on their sense of financial well-being.

Inflation Expectations

Near and long term inflation expectations converged to the same level in March. For the year ahead, consumers expected an inflation rate of 2.7%, above last month's 2.5% and the decade low of 2.3% recorded in 1998.

In contrast to the small increase expected during the year ahead, long term inflation expectations fell, indicating that consumers expect some temporary increases but not a sustained resurgence in inflation. In the March survey consumers expected an annual inflation rate of 2.7% during the next 5 years, down from 2.8% last month, returning to the decade low first recorded in 1998.

**Expected Median Inflation Rates
(Three month moving averages)**



Rising Interest Rates; Slower Economic Growth

Interest rates were expected to increase during the year ahead by 57 percent of all consumers in March, up from 44 percent in February. In contrast, just 8 percent of all consumers expected interest rates to be lower by this time next year. The anticipated increases in interest rates prompted consumers to view prospects for economic growth somewhat less favorably.

To be sure, the increase in unfavorable expectations was only minor, with the proportion expecting bad times over the next twelve months rising to just 24 percent in March from 17 percent in the February 1999 survey. This shift has moved consumers back toward the expectation that the pace of economic growth would slow during the year ahead—but only slightly.

Despite the anticipated slowdown in the pace of economic growth, job prospects have remained quite favorable, weakening by only a minor amount. Overall, one-in-four consumers in the March 1999 survey expected the national unemployment rate to increase during the year ahead. This represented a decline in concerns about job prospects from the fourth quarter of 1998, when one-in-three expected rising unemployment.

Perhaps the most important aspect of consumers' views about future income and job prospects is that they do not anticipate the slowing pace of growth to result in a recession. When asked about long term economic prospects, the majority of consumers expected the economy to be free of any recessionary downturn during the next five years. The March 1999 survey established the longest period of sustained optimism about long term economic prospects recorded since the mid 1960's.

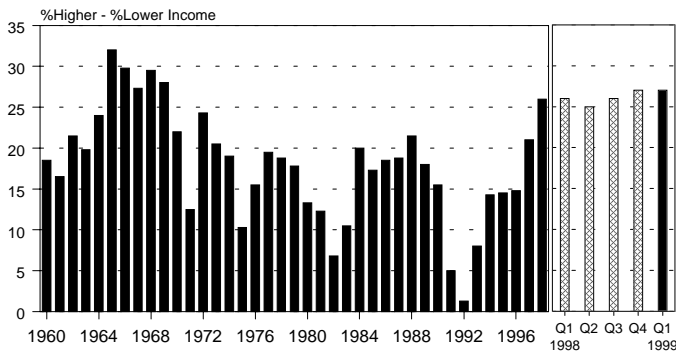
Personal Finances Remain Strong

Consumers continued to judge their personal financial situation quite favorably in the March 1999 survey, with half of all households reporting that their finances had recently improved. When asked about the year ahead, very few consumers expected their financial situation to worsen—just 6 percent in the March survey.

These favorable financial prospects were based on the expectation of modest income increases as well as

continued low inflation. The March 1999 survey continued to record widespread income gains. Only during the mid 1960's was there a higher recorded incidence of income gains among households (see the chart below).

Net References to Income Gains

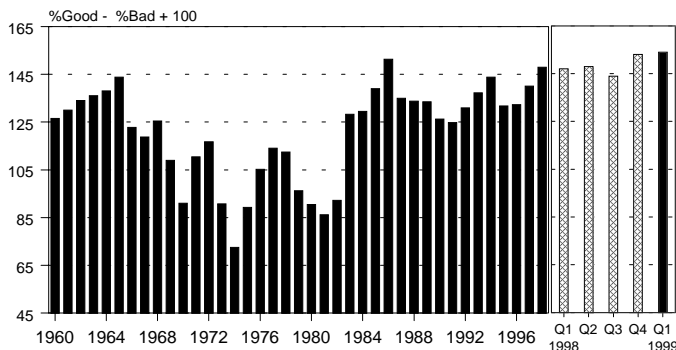


Vehicle Buying Attitudes Remain at Record Levels

Vehicle buying attitudes remained at the same very favorable levels recorded during the past six months (see the chart below). Among all consumers in the March 1999 survey, 70 percent rated buying conditions favorably.

Consumers more frequently based their favorable views of vehicle buying conditions on attractive prices, cited by 34 percent of all consumers—the highest proportion in five years. Low interest rates on vehicle loans also boosted favorable buying attitudes, reported by 30 percent of all consumers in the March 1999 survey.

Vehicle Buying Attitudes

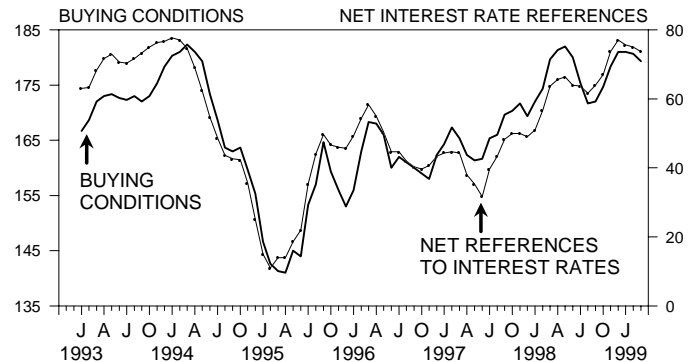


Home Buying Attitudes Retreat From Peak Levels

Consumers' attitudes toward buying conditions for homes weakened slightly in the March 1999 survey, but still remained at quite favorable levels. The recent decline was primarily due to increases in mortgage interest rates, although two-thirds still judged current rates attractive. The trend in references to mortgage rates has consistently shown a close correspondence to overall home buying attitudes (see the chart below).

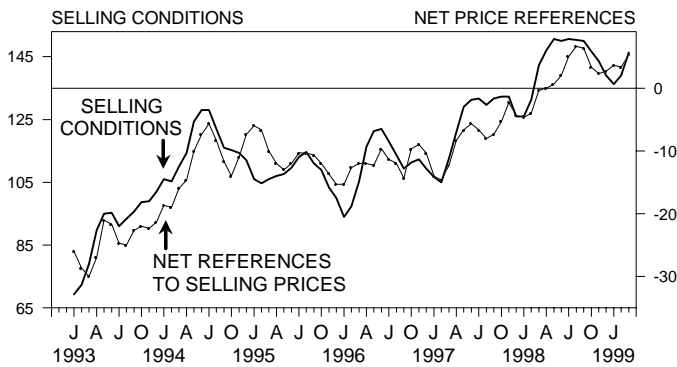
When asked to explain their views of home buying conditions, the proportion of consumers that cited attractive home prices was just 13 percent in the March survey, barely above the decade low of 12 percent recorded in the February 1999 survey. While prices were viewed as less attractive for buying homes, those same price trends made selling homes more attractive.

Assessments of Home Buying Conditions and Trends in Mortgage Rates among Home Owners



Home owners were also asked about home selling conditions, an important component of their overall views since home buyers are usually home sellers as well. During the past several months views of home selling conditions have rebounded, moving back toward the record favorable levels recorded in early 1998 (see the chart on the next page). Whereas trends in mortgage rates dominated consumers' assessments of home buying conditions, trends in home prices have dominated home owners' views of selling conditions. The renewed strength in consumers' assessments of home selling conditions has provided an important source of support for overall trends in home sales.

Assessments of Home Selling Conditions and Trends in Home Prices among Home Owners

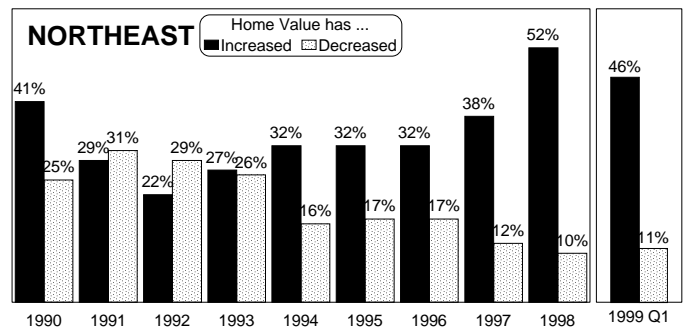
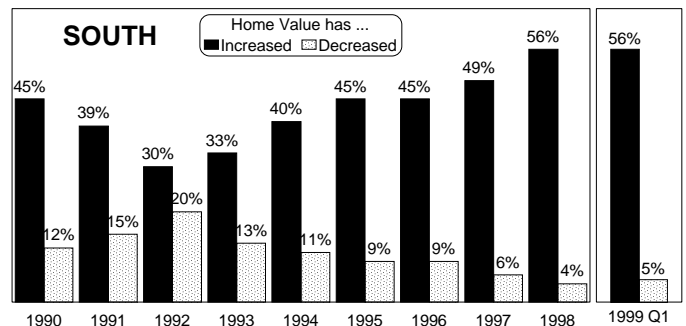
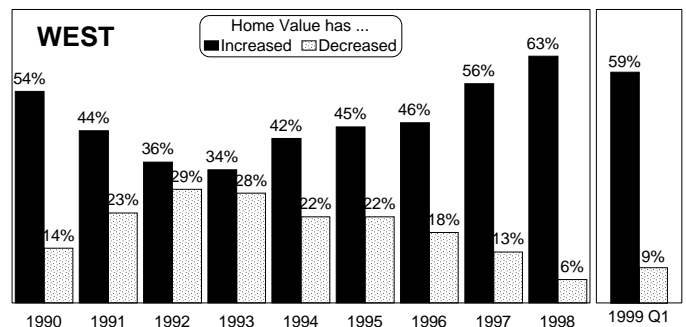
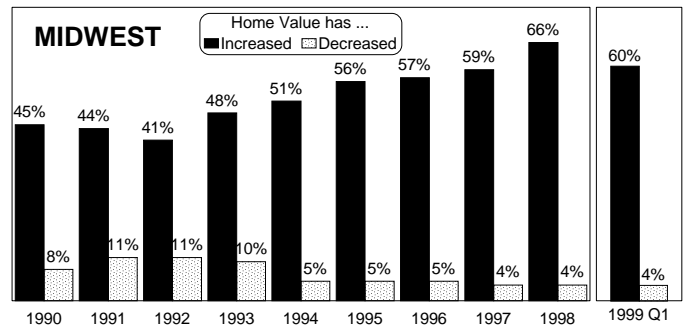


Reports of Increases in Home Values Remain Widespread

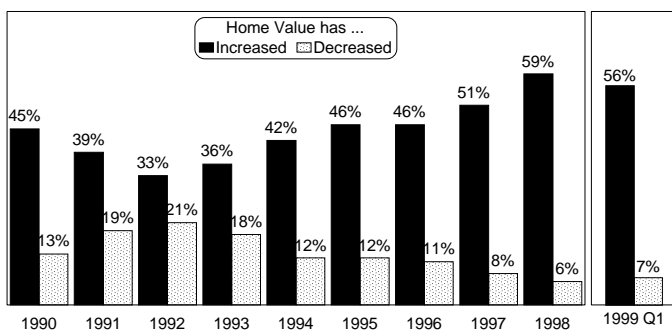
The proportion of home owners that reported net gains in the market value of their homes remained near the peak in the first quarter 1999 surveys (see the chart below). Year-to-year gains in home values were reported by 56 percent of all home owners in the first quarter 1999 surveys, only slightly below the 1998 average of 59 percent. Just 7 percent reported that their home had lost value during the past year in the first quarter 1999 survey—one-third the level recorded in 1992.

The slowdown in home value gains was reported by homeowners in all regions except the South (see the charts at right). Importantly, despite the small shifts, gains were reported more frequently in all regions in early 1999 than in any of the prior years during the 1990's.

Net Change in Home Value (% Increase minus % Decrease in Value)



Net Change in Home Value (% Increase minus % Decrease in Value)



The March 1999 survey included 500 completed interviews conducted from March 1 to March 25, 1999.