



DECLINE IN CONSUMER CONFIDENCE SLOWS: SUSTAINED GAINS DEPEND ON REVIVAL IN JOBS AND WAGES

Confidence Post Cautious Gains

The Index of Consumer Sentiment was 77.6 in the March 2003 survey, down 9.1 Index-points from three months ago and 18.1 Index-points from one year earlier (see the chart below). Although consumer confidence began to revive as soon as the war started, the Sentiment Index for the month as a whole did not show much improvement since only one-fifth of the total sample was interviewed after the start of the war. The gains after the war started were due to falling oil prices and rising stock prices.

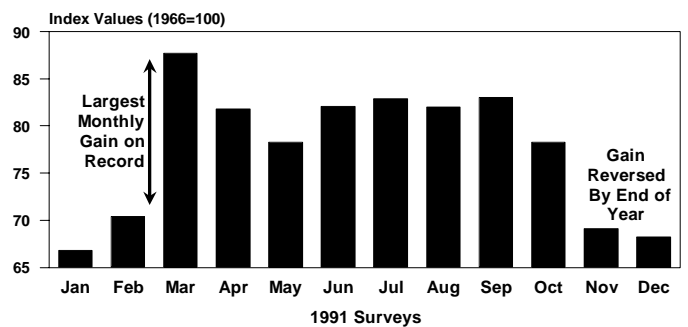
The current state of confidence remains volatile given the widespread anxiety about how long the war will last, the potential number of casualties, and the possibility of domestic terrorist attacks. If the war lasts longer or there are more casualties than consumers had originally anticipated, confidence could again decline, and if the war is concluded more quickly than now expected, confidence could rise even more in the month ahead.

While it is too early to provide any assessment of how much optimism will be restored by the successful conclusion of the war, the data indicate that the likely impact will be limited due to continuing anxiety about domestic terrorist

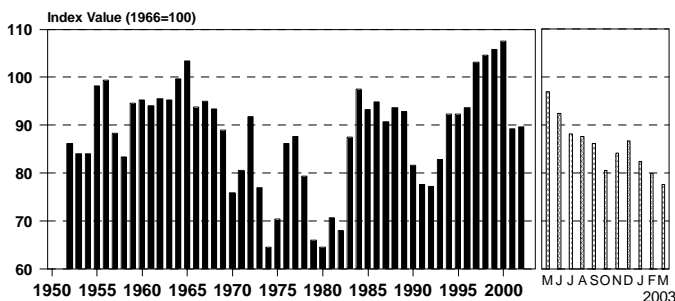
attacks as well as persistent concerns about job and wage prospects. The central issue is not the size of the rebound but whether subsequent changes in job and wage prospects will act to reinforce the gains or reverse the initial gains as happened in 1991.

Following the successful conclusion of the first Iraqi war, the Index of Consumer Sentiment posted the largest one-month gain ever recorded (17.3 Index-points, amounting to an increase of 25%). By the end of 1991, however, the Sentiment Index reversed all of that gain, with the Sentiment Index slumping back to the same low level it was at the start the year (see the chart below).

Change in Consumer Confidence After First Gulf War



Index of Consumer Sentiment

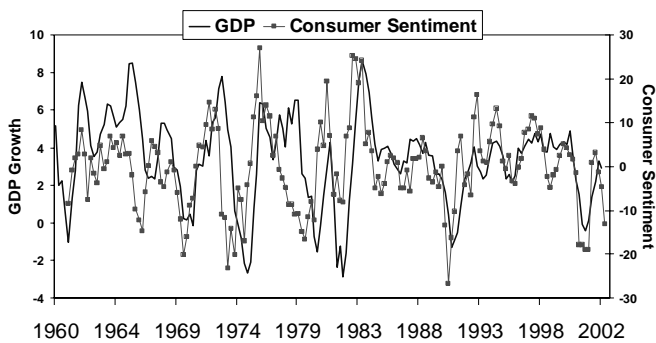


Even if the Sentiment Index did rebound to the mid 80's following the end of the war, this would only reverse the losses recorded during the past three months, leaving the Index ten points below the 2002 high and twenty-five points below the last cyclical peak. To be sure, the return of confidence to its long term average would be welcome, but it would not be sufficient to restore consumer spending to robust levels. Consumers remain concerned about the level of their outstanding debts and want to add more to their savings and reserve funds. Overall, the data indicate that consumer spending will remain subdued through 2003.

Slower Economic Growth and Higher Unemployment Expected

Recent trends in the Index of Consumer Sentiment indicate a slowdown in GDP growth during 2003 (see the chart below). The majority of consumers thought that the economy had already weakened. Indeed, nearly nine-in-ten consumers reported hearing of unfavorable economic developments in the March 2003 survey, with rising unemployment the most frequently cited development.

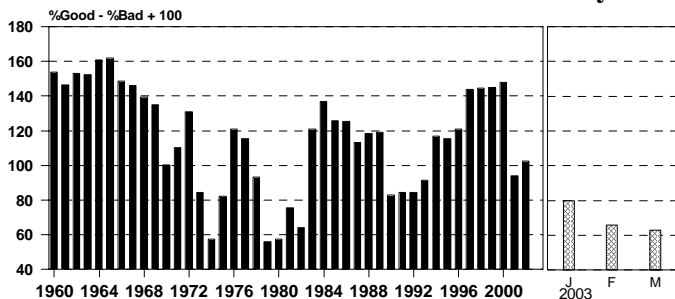
Change in Consumer Sentiment and Annual Growth in GDP



When asked about the prospects for the national economy during the year ahead, 63 percent of all consumers expected bad times financially in the country as a whole in the March 2003 survey. The outlook for the economy has nearly reversed during the past year: last March nearly as many consumers expected good times as now expect bad times. Indeed, the March 2003 reading was the bleakest outlook held by consumers since the recession of the early 1990's (see the chart below).

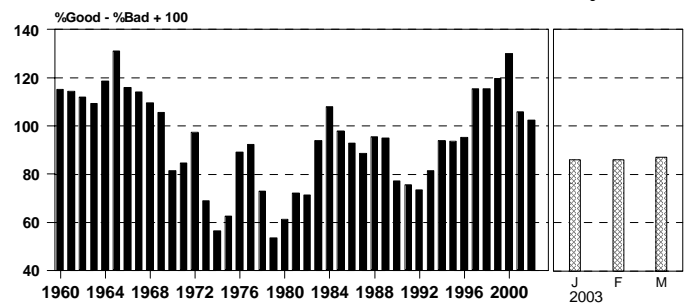
While consumers did express the view that the war with Iraq had made business more hesitant to invest in expansion and job creation, these concerns were already quite high even before concerns about the war arose. Importantly, a quick end to the war is unlikely to reverse the larger declines recorded as long ago as early 2001.

Year-Ahead Outlook for National Economy



The temporary and modest additional negative impact from the war as well as the more substantial and long lasting problems consumers now anticipate can be seen from a comparison of the near and longer term outlooks. Over both time horizons, economic prospects are clearly lower than in prior years, but unlike the additional declines in the near term outlook, the longer term outlook has remained unchanged (see the chart below). Overall, half of all consumers expected bad times financially over the next five years. This negative view has remained unchanged for the past six months, and continues to be significantly worse than the more positive views held a year ago.

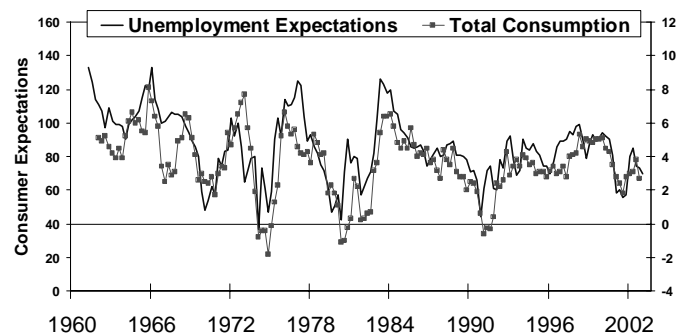
Five-Year Outlook for National Economy



The main concern of consumers is that the slower pace of economic growth that they now anticipate will result in a rising unemployment rate. In the March 2003 survey, 44 percent of all consumers expected the unemployment rate to increase during the year ahead, compared with just 14 percent that expected any reduction. These figures have remained unchanged over the past six months.

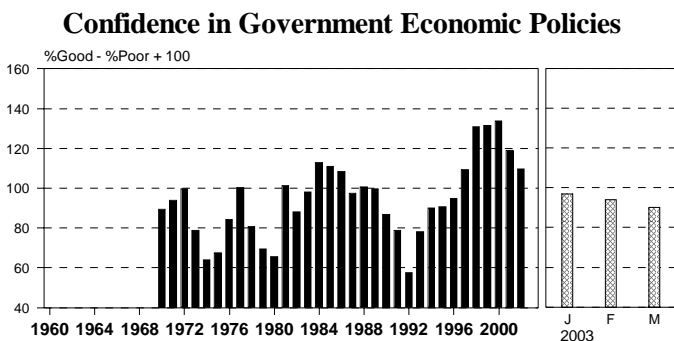
These heightened concerns about future job prospects have made consumers more cautious spenders. The data on unemployment expectations indicates that the annual growth rate in total personal consumption expenditures is likely to be about 2½% in 2003 (see the chart below).

Unemployment Expectations and the Annual Growth in Personal Consumption Expenditures



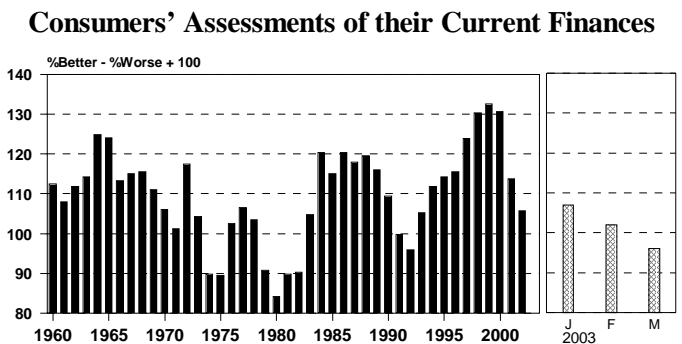
Confidence in Government Policies Continues to Decline

Consumers voiced the least confidence in government economic policies since President Bush first entered office. Indeed, more consumers rated policies unfavorably than favorably in the March survey. Among all consumers, 31 percent held unfavorable views of current economic policies compared with 21 percent that held favorable views. After the conclusion of the war, consumers will be even more disappointed if new policies are not proposed that address their concerns about faltering job and wage prospects.



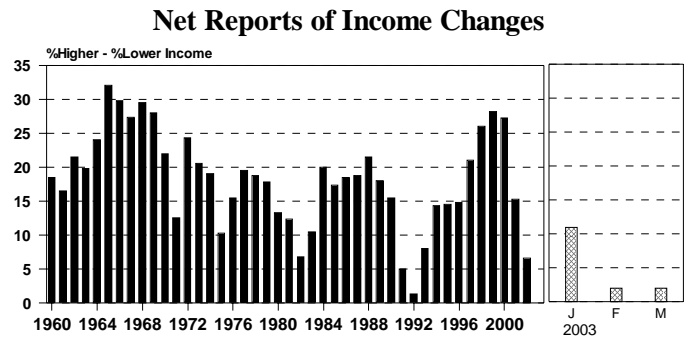
Increasing Personal Financial Distress

Consumers' assessments of their own financial situation continued to weaken in the March 2003 survey. Among all households, 36 percent reported that their finances had improved, down from 38 percent one month earlier and 42 percent one year ago. Reports of worsening finances rose to 40 percent from 36 percent one month earlier and 29 percent one year ago. This was the bleakest assessment by consumers of their current finances in more than ten years (see the chart below). While the impact of rising energy prices was more frequently reported in March (13 percent), these complaints remained relatively low compared with the 1990 peak (24 percent) and well below the peaks recorded during the energy crisis in the 1970s (48 percent).



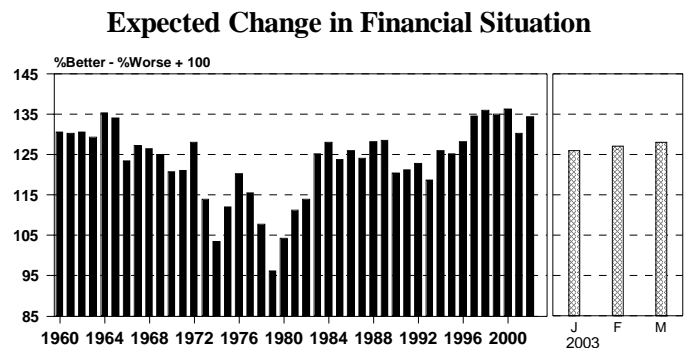
The more important reason cited by consumers for their financial reversals has been the slowdown in wage growth. Among all consumers nearly as many reported income declines as reported increases—a difference of just 2 percentage points. Overall, 29 percent reported gains and 27 percent reported income declines in March 2003.

The data on changes in disposable income has been much more favorable than these financial evaluations by consumers. Indeed, income declines were reported by more households in the March 2003 survey than any other time during the past ten years. The difference is that consumers judge progress in their personal finances based on wage growth and not by the tax cuts that have made disposable income trends more positive.



Personal Financial Outlook Dims

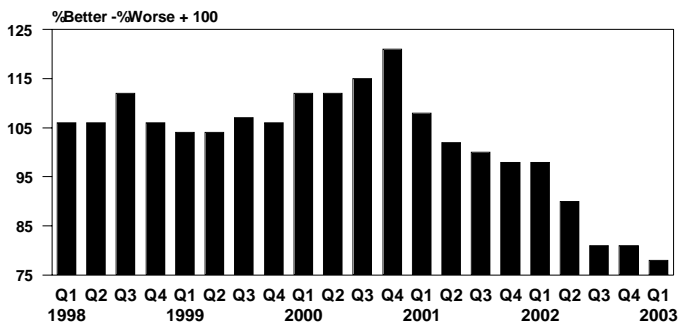
In comparison to the dismal appraisal of their current financial situation, consumers viewed their future financial prospects more favorably due to the relatively low inflation rate they anticipated for the year ahead. In the March 2003 survey, 42 percent of all consumers expected their financial situation to improve during the year ahead, just ahead of the 40 percent recorded in February. Although the overall decline has been much less pronounced, personal financial prospects remained near the least favorable levels recorded in more than five years.



Long term Savings Needs Remain High

Over the past five years, the surveys have included a question about consumers' assessments of whether the chances of achieving a comfortable retirement income had improved or worsened (see the chart below). The cumulative declines in stock prices have had a significant impact, as 42 percent of all consumers under age 65 reported that their chances had worsened in the most recent survey. This was the highest proportion recorded during the past five years. These and other data suggest that consumers will continue to shift their budget priorities toward saving more out of their current incomes.

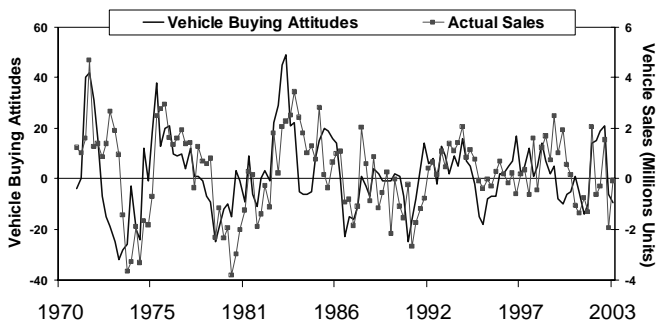
Change in Likelihood of a Comfortable Retirement Income Among Respondents under age 65



Bigger Discounts, Fewer Vehicle Sales

Consumers expressed less positive attitudes toward buying conditions for vehicles, although they did expect manufacturers to offer even larger discounts in the months ahead. Overall, recent trends in vehicle buying attitudes suggest that total vehicle sales will post a decline of about 1/2 million units in 2003 compared with 2002 (see the chart below).

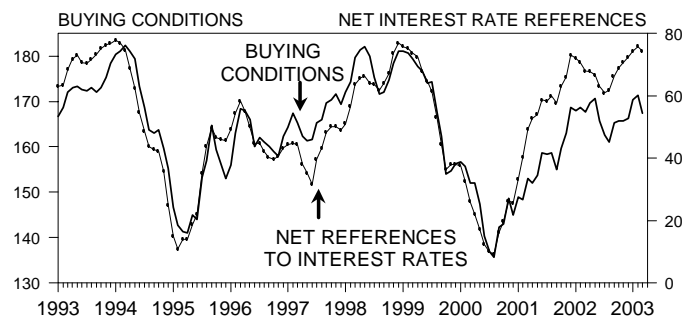
Vehicle Buying Attitudes and Total Vehicle Sales (Year-to-year change in series)



Home Buying Weakens Despite Low Mortgage Rates

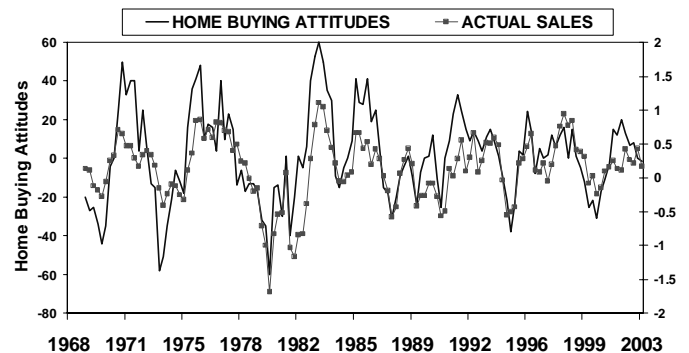
Although home buying attitudes have remained at favorable levels, they nonetheless posted a significant decline in the March 2003 survey. Among all consumers, 75 percent rated home buying conditions favorably, down from 80 percent in each of the prior three months. The March decline was recorded despite the fact that consumers continued to mention low mortgage rates at near record levels (see the chart below). Uncertainty about their future job and income prospects were the main reason for the overall decline in home buying attitudes. As a result, many home owners have viewed mortgage rates more favorable for refinancing—to both lower their debt repayments as well as provide them with more financial latitude.

Home Buying Attitudes and Mortgage Rates



The current level of home buying attitudes is sufficient to support favorable levels of sales of new and existing homes, but not to provide any increases sales activity (see the chart below). As a result, new home sales like vehicle sales are unlikely to add to GDP growth during the year ahead as the annual growth rate in residential investment and vehicle sales can be expected to be negative.

Home Buying Attitudes and Sales of New and Existing Homes (Year-to-year changes in series)



Growth Rate in Housing Wealth Slows

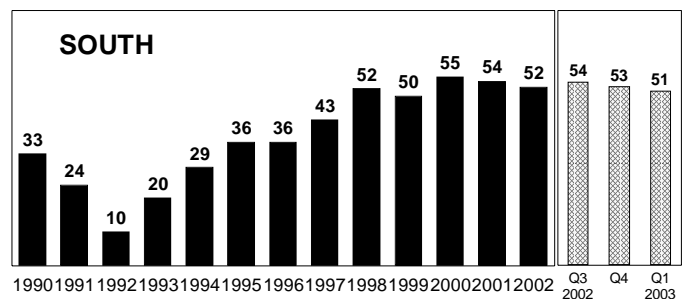
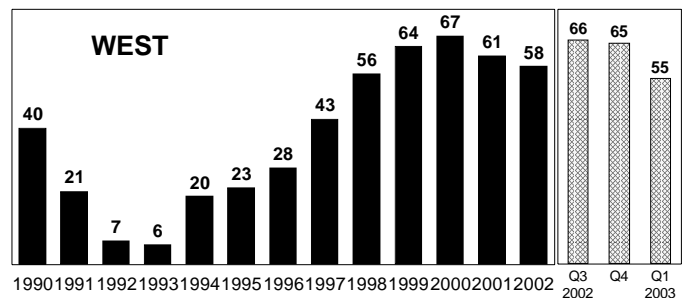
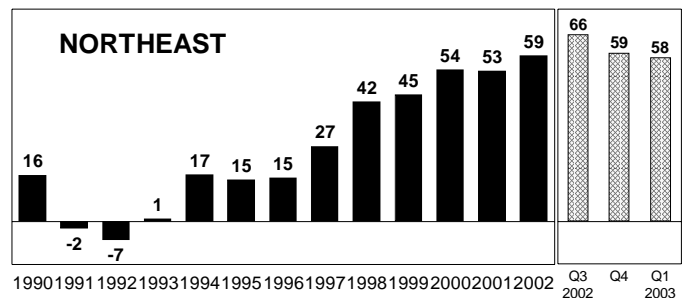
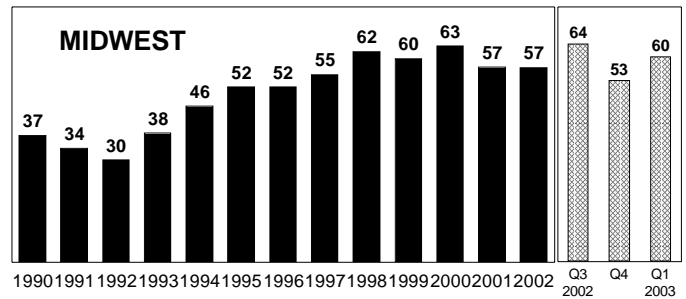
Slightly fewer homeowners reported increases in the value of their homes in the most recent surveys (see the chart below). While the majority of all homeowners still reported rising home values, the data does indicate a weakening overall pace of growth. Among all homeowners in the first quarter 2003 surveys, 61 percent reported that the value of their homes had increased during the past year. Although this was only slightly below the levels recorded in the prior two quarters, it remained twice as high as the lows recorded in the early 1990's.

There were substantial differences across regions, with residents of some regions reporting greater declines than in other regions. Only residents of the Midwest more frequently reported gains in the value of their homes in the first quarter. Among residents of the South, the proportion that reported gains in home values has slowly declined by only a modest amount.

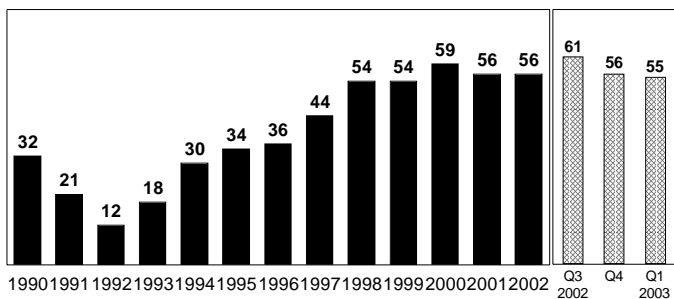
The largest declines were reported by residents of the West followed by residents of the Northeast. Moreover, homeowners in these two regions have recorded the widest swings in home values over the last decade. It is important to emphasize that the proportion of homeowners in the West and Northeast that reported gains remains quite high even if significantly below last year's levels. Indeed, reports of gains in home values remain more than twice as frequent as during the early 1990s.

Nonetheless, there is widespread concern that declines in home values could become a more significant problem in the year ahead. Falling home prices could have a significant impact on the formation of more general deflationary expectations among consumers. These declines could again be larger in the West and Northeast.

Net Change in Home Value By Region
(% Increase - % Decrease)



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



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The March 2003 survey included 504 interviews conducted between March 1 and March 27, 2003.