Subject: February 2016 survey results. February 26, 2016
From: Richard Curtin, Director

Consumer confidence nearly recovered the entire small loss it recorded at mid month, with the Sentiment Index finishing February just 0.3 Index-points below January. Although consumers are not as optimistic as at the start of last year, the Sentiment Index is just 6.5% below the cyclical peak of 98.1 set in January 2015. Such a small decline is hardly consistent with the onset of a downturn in consumer spending. By way of contrast, in January 2007, the Sentiment Index reached a cyclical peak of 96.9 and then declined by 27% to 70.8 in the February 2008 survey. At that time, the sharp drop came with the early warning that "declines of this magnitude have always been associated with subsequent recessions." Needless to say, the current decline of just 6.5% hardly merits a recession warning, although it does indicate a somewhat slower expansion in consumer expenditures—to 2.7% in 2016, down from 3.1% in 2015. Most of the decline from last year's peak has been in how consumers view year-ahead prospects for the economy, while the outlook for their personal financial situation has improved to its best level in ten years. Rather modest wage gains as well as very low inflation have meant that consumers expect increases in their real incomes during the year ahead. Consumers' most important concern involves how much the slowdown in GDP growth will affect employment growth. At present, consumers anticipate a slight negative impact on jobs.

The Fed seeks a helping hand to lower real interest rates from an old foe: inflationary psychology. Higher inflation expectations can accelerate declines in real interest rates and thereby stimulate spending. The risk associated with this strategy is the Fed's ability to "fine-tune" the resulting inflationary psychology, containing expectations to their target of 2%. Past experience strongly suggests inflationary psychology creates its own acceleration dynamic that is difficult to control. While this is the most frequently cited risk, it is not the most probable. The more likely risk at present is that consumers will react by reducing their spending, despite the lower real interest rates, due to falling inflation-adjusted incomes. This reaction is hardly new to consumers, as the erosion of their incomes due to price increases had repeatedly ended spending booms during the inflationary era of the 1970's. Moreover, consumers already hold very favorable views of market prices as well as interest rates on purchases of homes, vehicles, and household durables. The reason for the minor slowdown in projected consumer spending during 2016 involves not inflation or real interest rates but uncertainties regarding job and wage growth.

Consumers expected an average annual rate of inflation of 2.5% over the next five years in the February 2016 survey, down from 2.7% one month and one year ago. This was tied for the lowest expected long term inflation rate since this question was first asked in 1979. In the past six months, the average expected long term inflation rate was just 2.6%, the lowest ever recorded. The year-ahead expected inflation rate was 2.5% in February, unchanged from January and down from 2.8% in last February's survey; the last time year-ahead expectations were lower was during the recession-depressed levels in 2008-09.

The proportion of households that reported an improved financial situation rebounded to 47% in February from 40% in January, to regain last February's level. Importantly, reports of net income gains were the highest since last February. When asked about expected income gains in the year ahead, an increase of 1.9% was anticipated across all households. This rate of increase was tied with the January 2015 reading and the highest since September 2008. Overall, consumers judged their financial prospects for the year ahead more favorably in the February 2016 survey than any other time since October 2006.

Twice as many consumers mentioned hearing of unfavorable rather than favorable economic developments in the February survey, in sharp contrast to a year ago when consumers reported more favorable developments. While it was still true that more consumers expected the economy to improve rather than worsen in the year ahead, they have nonetheless increasingly thought that economic conditions would be less satisfactory. Good times were expected by 41% in February, down from 46% last month and 51% last year. Importantly, consumers still view longer term economic prospects favorably. The main issue for consumers is that they anticipate that the economic slowdown will continue to trim employment growth in the year ahead.

	Feb 2015	Mar 2015	Apr 2015	May 2015	June 2015	July 2015	Aug 2015	Sept 2015	Oct 2015	Nov 2015	Dec 2015	Jan 2016	Feb 2016
Index of Consumer Sentiment	95.4	93.0	95.9	90.7	96.1	93.1	91.9	87.2	90.0	91.3	92.6	92.0	91.7
Current Economic Conditions	106.9	105.0	107.0	100.8	108.9	107.2	105.1	101.2	102.3	104.3	108.1	106.4	106.8
Index of Consumer Expectations	88.0	85.3	88.8	84.2	87.8	84.1	83.4	78.2	82.1	82.9	82.7	82.7	81.9
Index Components													
Personal Finances—Current	121	117	120	111	119	116	120	111	111	111	113	110	118
Personal Finances—Expected	126	122	124	123	125	122	124	121	127	122	124	124	128
Economic Outlook—12 Months	118	116	124	113	125	115	111	100	101	106	103	107	97
Economic Outlook—5 Years	109	105	109	102	104	101	100	93	101	105	105	102	104
Buying Conditions—Durables	156	155	158	150	163	161	152	151	154	160	167	166	159