

## US CONSUMER SENTIMENT JUMPS, DEFYING STOCK MARKET CORRECTION

*\*The University of Michigan Consumer sentiment index covering the first half of February jumped 4.2 points to 99.9 – second highest of the recovery – as consumers shrugged off the sharp stock market correction, seemingly lifted by the healthy jobs markets, rising incomes and prospects of tax cuts (Chart 1)*

*\*Both the current and future economic conditions increased, indicating a robust pace rate of near-term and medium-term spending*

*\*Sentiment indicators in 2017 proved to be reliable predictors of the solid pace of consumer spending even as disposable income growth lagged behind*

*\*The survey showed that consumers were more optimistic about their finances, business conditions and unemployment, and viewed buying conditions as very favorable, while their inflation expectations remained well-anchored*

The increase in sentiment is encouraging following the jump in interest rates and the sharp decline in equity prices in early February, and coincides with the changes in tax withholding schedules as part of the implementation of the Tax Cuts and Jobs Act that will raise take home pay for most households. Many households likely have been positively surprised by the increase in take home pay, as surveys indicated that a large share of households were not expecting to benefit. Moreover, in response to tax reform, a slew of companies have announced special one-time bonuses, with some also increasing the minimum wage rate. Besides the tax benefit, the historically low unemployment rate, combined with the short supply of qualified workers, is forcing firms to raise compensation.

The percentage of households rating their finances as better than a year ago increased to 55% from 49%, with a plurality (43%) reporting higher incomes (Chart 2). Moreover, the mean of the probability consumers assigned to real income gains over the next year increased to 55.8%, compared to 51.5% before. Consumers were already confident in their finances and the economic outlook, driving the saving rate under 3%, and it appears that trend will continue.

Indeed, a higher share of consumers think it is a good time to buy major household items (up to 81% from 77% before, Chart 3). More thought it was a bad time to buy a vehicle as demand has already peaked.

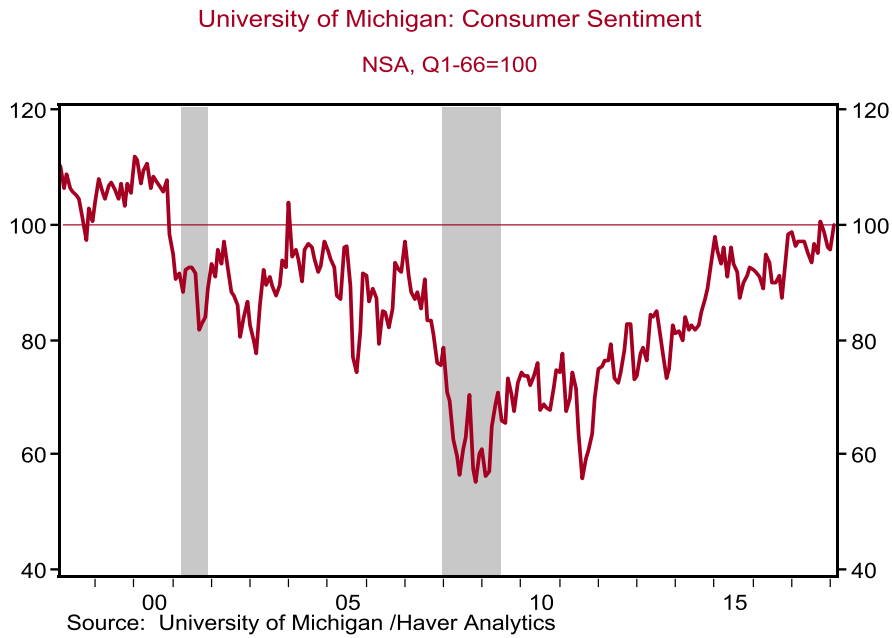
Greater share of consumers believe it is a good time to buy a home (up to 70% from 67% before), because of rising interest rates (Chart 4). In the 2013 “Taper Tantrum”, a jump in rates caused a near-term surge in home sales as households rushed to lock-in mortgage rates in fear of further increases.

Equity prices may provide less support to consumption than last year, but other favorable factors should ensure that consumers continue to be the main drivers of economic growth.

*In the last year, we have emphasized that when confidence measures are among the highest of all of their historic readings—both on the consumer and business surveys—we find that they are reliable predictors of future consumer spending and business investment. Accordingly, we take note of this strong University of Michigan Consumer Sentiment Index that was conducted during the abrupt stock market sell off. If other surveys that mirror confidence also hold up, that would confirm our expectations that the economy is continuing to build momentum.*

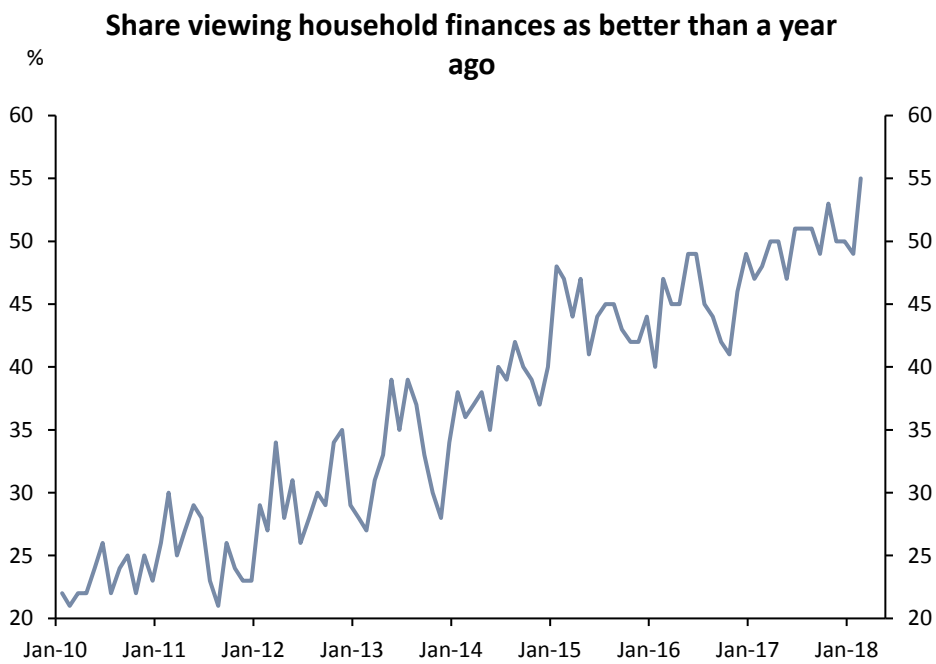
16 February 2018

Chart 1: University of Michigan Consumer Sentiment



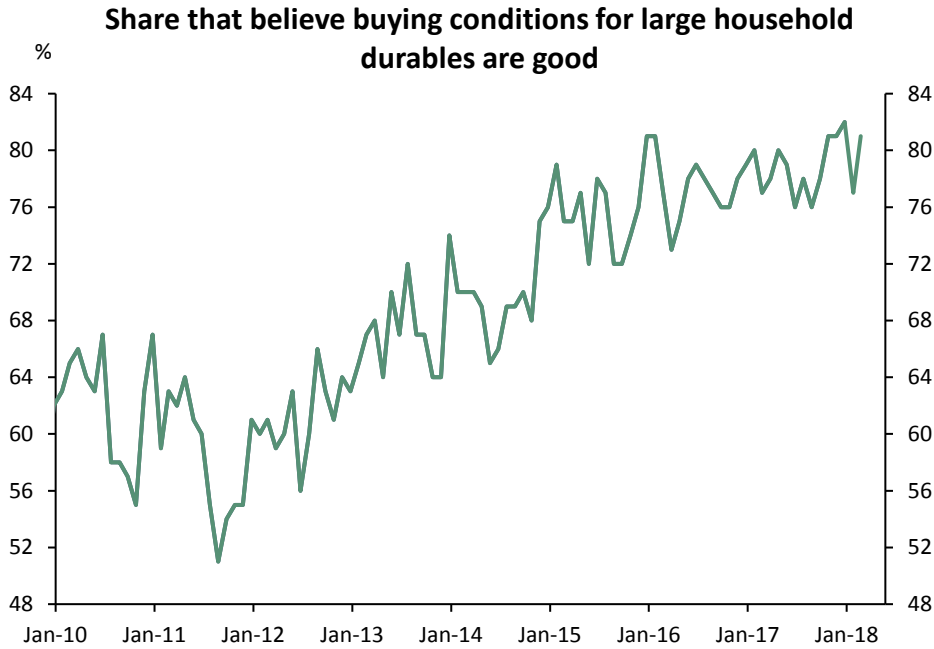
Source: Monthly data. Source: University of Michigan and Haver Analytics

Chart 2: Share of Consumers Viewing Household Finances as Better than a Year Ago



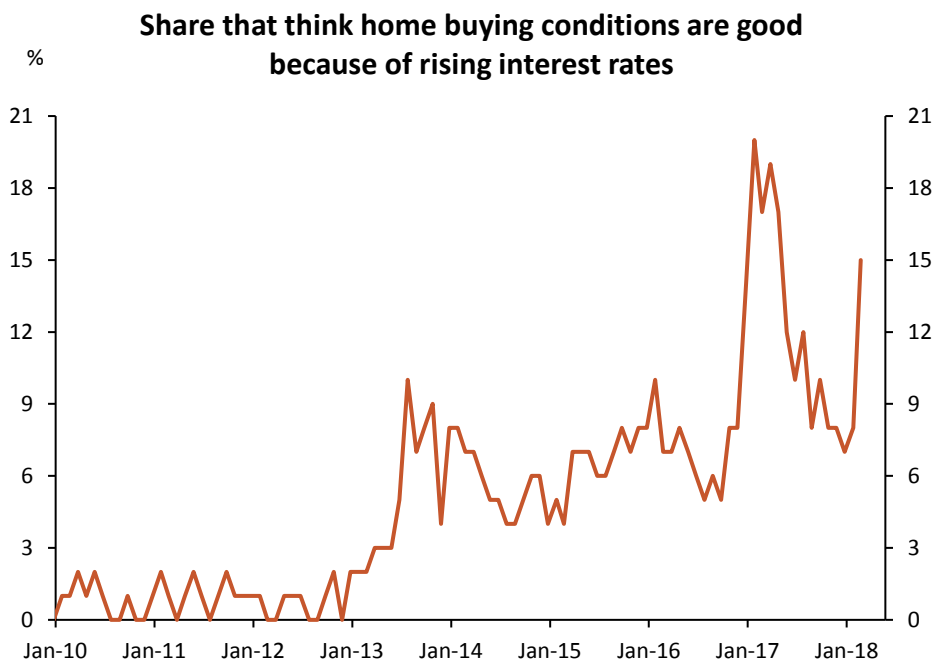
Source: Monthly data. Source: University of Michigan and Berenberg Capital Markets

Chart 3: Share of Consumers that Believe Buying Conditions for Large Household Durables are Good



Source: Monthly data. Source: University of Michigan and Berenberg Capital Markets

Chart 4: Share of Consumers that Think Home Buying Conditions are Good Because of Rising Interest Rates



Source: Monthly data. Source: University of Michigan and Berenberg Capital Markets

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