

SURGE IN US CONSUMER SENTIMENT POINTS TO REBOUND IN RETAIL ACTIVITY

**The University of Michigan consumer sentiment index increased 2.3 points to 102 in early March, the highest reading since January 2004 and within the top 9% of historical values (Chart 1)*

The current economic conditions index increased 7.9pts to 122.8, the best reading on record, and likely a reaction to the higher take-home pay from the Tax Cuts and **Jobs Act (Chart 2). The report noted that “favorable mentions of the tax reform legislation were offset by unfavorable references to the announced tariffs on steel and aluminum — each was spontaneously cited by one-in-five consumers”*

**The increased confidence, especially over the near term, points to a rebound in retail sales in March and Q2 after the recent soft readings. But the 1.4pt drop in the consumer expectations index to 88.6 indicates that some moderation in private consumption growth is likely later in the year after the near-term tax-induced boost*

Sentiment indicators proved to be reliable predictors of the solid gains in 2017 private consumption when disposable incomes lagged behind and our prior work has shown that they are more useful indicators when elevated, so we put additional weight on this optimism and it underpins our expectation that real private consumption growth will remain strong this year. In addition to the higher disposable incomes resulting from tax reform, consumers have grown more optimistic about labor market conditions, with many who were previously sidelined returning to the labor market and finding jobs (Chart 3). Indeed, the number of job openings surged to 6.3mn in January and preceded the large 313k increase in nonfarm payrolls in February (Chart 4). A reacceleration in job growth would provide an additional boost to aggregate personal income and private consumption gains.

The share of consumers reporting better household finances than a year ago increased 5 percentage points to 59%, with 47% of households (from 39% prior) reporting higher income versus a year ago (Chart 5). These increases reflect the effects of tax reform.

Consumers’ perceptions of current buying conditions are broadly positive, with 85% reporting that it is a good time to buy a major household item, compared to 81% before, and only 11% stating that it is a bad time to buy (from 15% prior) (Chart 6). The share of households that think it is a good time to buy a house increased 2pp to 70%, because interest rates are rising (Chart 7). We have yet to see it materialize, but this perception of the housing market raises the chance of a near-term temporary surge in housing activity as people rush to lock in rates at current low levels in fear of further increases.

The expected inflation rate over the next year rose 0.2pp to 2.9%, the highest since March 2015 (Chart 8). Although the Fed focuses mainly on long-run consumer inflation expectations, which remained unchanged at 2.5% in March, sustained increases in **year-ahead inflation expectations could catch the Fed’s attention.**

16 March 2018

Chart 1: University of Michigan Consumer Sentiment



Source: University of Michigan/Haver Analytics

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

Chart 2: University of Michigan Consumer Sentiment Current Conditions Index



Source: University of Michigan/Haver Analytics

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

Chart 3: Labor Force Participation Rate for Prime Working Age



Source: Bureau of Labor Statistics/Haver Analytics

Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

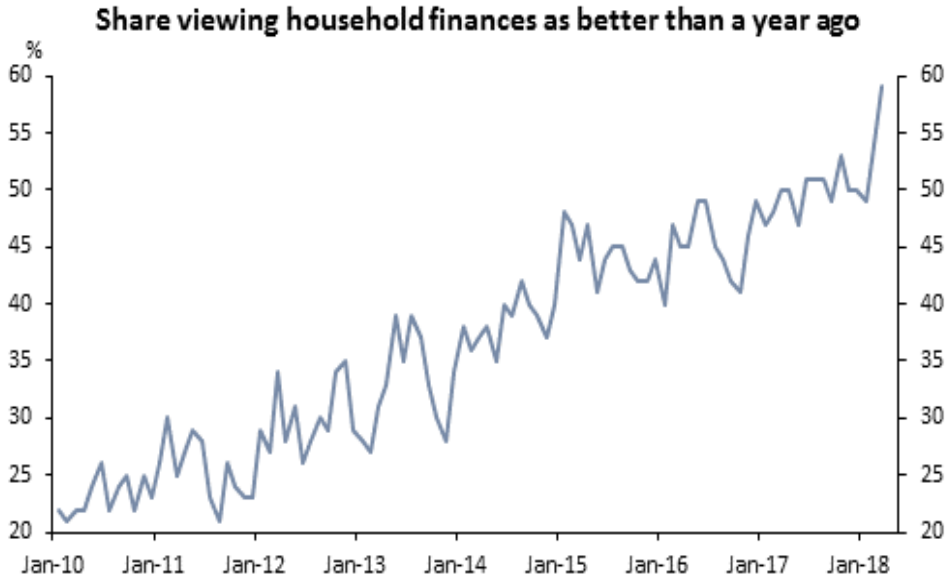
Chart 4: Total Job Openings



Source: Bureau of Labor Statistics/Haver Analytics

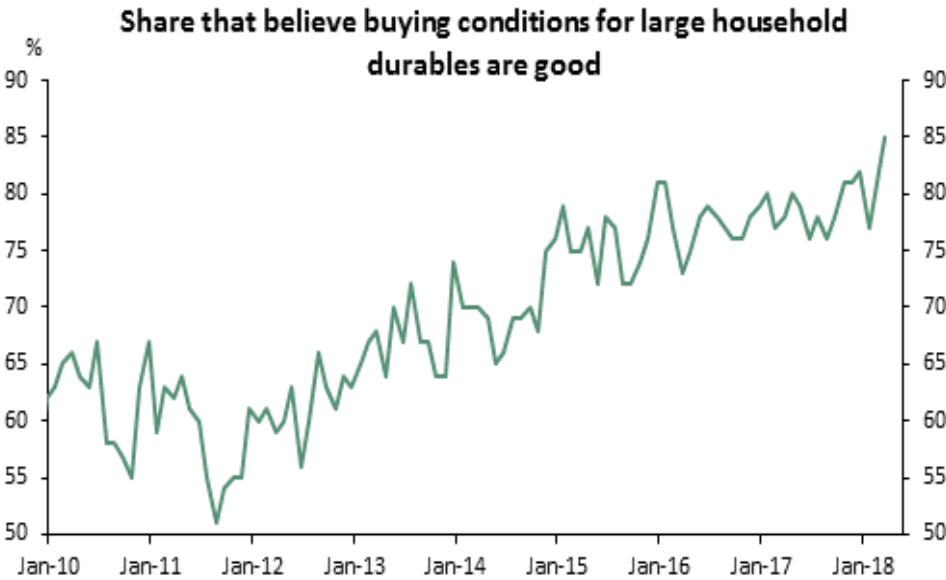
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 5: Share of Consumers Viewing Household Finances as Better than a Year Ago



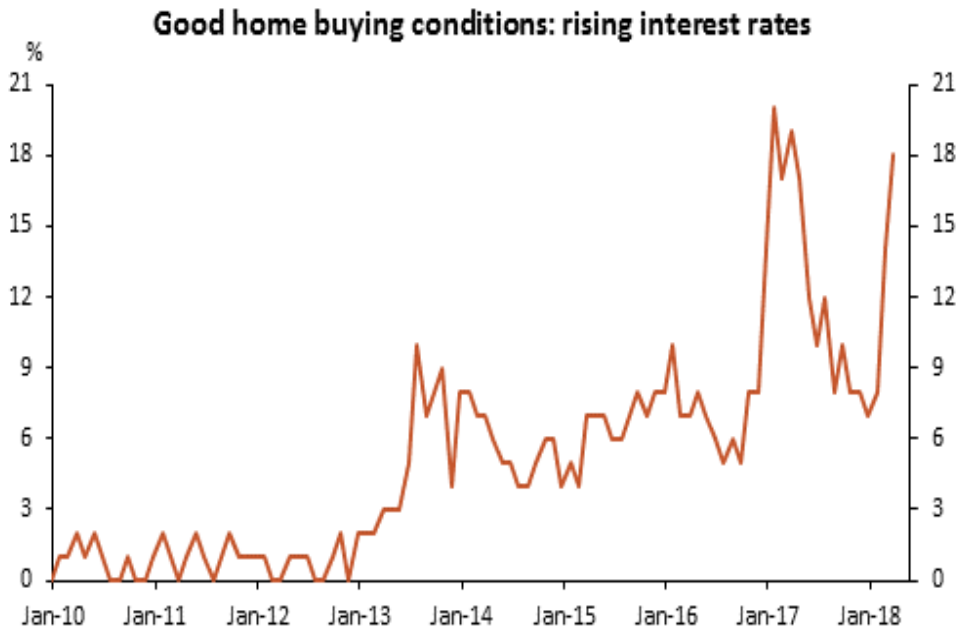
Source: Monthly data. Source: University of Michigan, Bloomberg and Berenberg Capital Markets

Chart 6: Share of Consumers that Believe Buying Conditions for Large Household Durables are Good



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

Chart 7: Share of Consumers that Think Home Buying Conditions are Good Because of Rising Interest Rates



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

Chart 8: Consumer Expectations for the Inflation Rate A Year Ahead



Source: University of Michigan/Haver Analytics

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

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