

Mood swings

Economist Insights

People rely on stereotypes, even in the world of finance. But do they reflect reality? US consumers are typified as exuberant spenders compared to their UK and Eurozone counterparts. Whilst US consumer spending has re-bounded strongly since the financial crisis, consumer confidence remains low relative to pre-crisis levels. Not so in the supposedly gloomier UK and Eurozone. But for the economy what matters is what people do, not what they say.



Joshua McCallum
Head of Fixed Income Economics
UBS Asset Management
joshua.mccallum@ubs.com



Gianluca Moretti
Fixed Income Economist
UBS Asset Management
gianluca.moretti@ubs.com

Stereotypes are used as commonly in finance as they are in the rest of life. The brain uses stereotypes because it believes them to be 'right enough' and saves brainpower if you can just make assumptions rather than have to think about them. Sometimes this is a useful time-saving mechanism, at other times it can lead us down the wrong path.

Consider one of the most enduring stereotypes of the last few decades: the US consumer. Often referred to as the 'consumer of last resort', the exuberant and ever positive US consumer never allowed anything to get in the way of their spending. Of course, this stereotype took a beating during the financial crisis, when all that debt-fuelled spending finally came to a crashing end. Yet since then US consumption has picked up more than in other major economies. Credit has started expanding again. Does this mean that the US consumer is back on form?

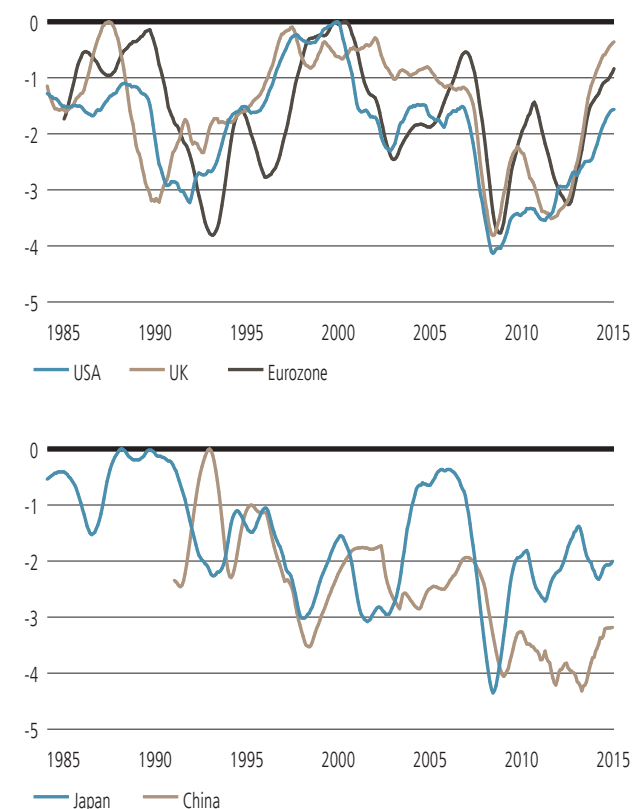
US consumers may well be happier, but they have not recovered all their swagger. In fact, US consumer confidence is still further below its past peaks than consumer confidence in the Eurozone and the UK (chart 1). Despite their stereotypical image - always grumbling about the economy and the weather - it is the UK consumer who is closest to peak form. The Eurozone consumer, stereotyped as gloomy and cautious, is also almost back to previous highs. Investors, at least in the western hemisphere, have less strongly established stereotypes of Japanese and Chinese consumers, but one thing is for sure: from a historical perspective they are not as happy as they have been.

Of course, one consumer's 'peak' confidence is not the same as another's. US consumers are now about as optimistic as they were in the mid 2000s, and they were as free-spending

then as they were during the supposedly more confident days of the late 1990s. Eurozone consumers may well still be gloomy, but they are closer to their least gloomy level.

Chart 1: Confidence boost

Consumer confidence relative to pre-2008 peak, in standard deviations



Source: Conference Board, European Commission, Japanese Cabinet Office, National Bureau of Statistics China, UBS Asset Management

So if confidence, which is one of the most widely watched economic statistics, is not necessarily a good indicator of spending, what use is it? As so often with surveys, if you really want to find something useful you need to look under the hood. Generic opinions on confidence can get tangled up with other events: politics, foreign wars, terrorism, weather, even sporting success. It is better to ask more specific questions about what consumers plan or expect: are job prospects better or worse; is your income likely to be higher or lower; do you plan to make a major purchase? Actions speak louder than words, and even planned actions speak louder than words.

Chart 2: Confidence interval

Correlation between consumer confidence or its sub-components (6m moving average) against real consumption growth (6m on 6m growth rate), since 1985

| | Confidence | Jobs | Income | Buying plans |
|----------|------------|------|--------|--------------|
| USA | 0.59 | 0.74 | 0.58 | -0.12 |
| Eurozone | 0.72 | 0.56 | 0.81 | 0.71 |
| UK | 0.55 | 0.64 | 0.37 | 0.69 |
| Japan | 0.42 | 0.24 | 0.47 | 0.46 |
| China* | 0.38 | | 0.30 | |

Source: Conference Board, BEA, European Commission, Eurostat, ONS, Japanese Cabinet Office, National Bureau of Statistics China, UBS Asset Management.

* Note: Chinese data is since 1993 and is correlated against retail sales

Pretty much all confidence measures are fairly lousy at predicting consumption spending month-to-month or even quarter-to-quarter. But look at the underlying trend over six months or so and the relationship becomes a bit clearer. If we look at the correlation between various consumer confidence measures and growth in real consumption, the headline confidence measure is never the most useful. When looking at correlations, anything above 0.5 is interesting, and anything above about 0.7 is very interesting indeed. So in the Eurozone it is income expectations that are most important, while in the UK it is buying plans for major items.

In Japan and China there appears to be little correlation between confidence and spending, even when looking at the sub-components. In Japan this may represent the structural break from the early 1990s and the changing spending habits of a rapidly ageing population. In China, this lack of correlation may simply be because we do not have good measures of real consumption spending, or it may be a matter of rising standards: once people realise what they could have, they become less satisfied with what they actually have.

In the US overall confidence contains little information, but job prospects are very useful. They may be moodier, but thankfully they are not putting their money where their mouth is. As long as job prospects are strong, US consumers will spend. The Fed can take some confidence themselves from this, and safely ignore the recent drop in confidence as they approach their (likely) first rate hike.

The views expressed are as of November 2015 and are a general guide to the views of UBS Asset Management. **This document does not replace portfolio and fund-specific materials. Commentary is at a macro or strategy level and is not with reference to any registered or other mutual fund.** This document is intended for limited distribution to the clients and associates of UBS Asset Management. Use or distribution by any other person is prohibited. Copying any part of this publication without the written permission of UBS Asset Management is prohibited. Care has been taken to ensure the accuracy of its content but no responsibility is accepted for any errors or omissions herein. Please note that past performance is not a guide to the future. Potential for profit is accompanied by the possibility of loss. The value of investments and the income from them may go down as well as up and investors may not get back the original amount invested. This document is a marketing communication. Any market or investment views expressed are not intended to be investment research. The document has not been prepared in line with the requirements of any jurisdiction designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. The information contained in this document does not constitute a distribution, nor should it be considered a recommendation to purchase or sell any particular security or fund. The information and opinions contained in this document have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith. All such information and opinions are subject to change without notice. A number of the comments in this document are based on current expectations and are considered "forward-looking statements". Actual future results, however, may prove to be different from expectations. The opinions expressed are a reflection of UBS Asset Management's best judgment at the time this document is compiled and any obligation to update or alter forward-looking statements as a result of new information, future events, or otherwise is disclaimed. Furthermore, these views are not intended to predict or guarantee the future performance of any individual security, asset class, markets generally, nor are they intended to predict the future performance of any UBS Asset Management account, portfolio or fund. © UBS 2015. The key symbol and UBS are among the registered and unregistered trademarks of UBS. All rights reserved. 25190A