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Consumer Confidence Wobbles Under Weight of Housing Slump

ANN ARBOR. Consumer confidence fell in October mainly due to falling home prices. “Consumers have expressed growing concerns about the housing slump and these concerns have spilled over to less favorable prospects for the overall economy,” according to Richard Curtin, the Director of the Reuters/University of Michigan Surveys of Consumers. The overall level of confidence is still well above the point that signals an impending recession. “Each downward step in confidence increases the probability of recession, which is still below 50%, but not comfortably so,” Curtin said. Falling home prices as well as higher food and fuel prices will make consumers much more cautious spenders. Overall, the pace of growth in real personal consumption is expected to slow to 2.0% over the next four quarters, with the weakest quarterly growth rate of about 1.0% at the turn of the year.

The Index of Consumer Sentiment was 80.9 in the October 2007 survey, down from 83.4 in the August and September surveys, and significantly below the 93.6 recorded in October of 2006. All of the October loss was in consumers’ assessments of future economic prospects. The Index of Consumer Expectations, a closely watched component of the Index of Leading Economic Indicators, was 70.1 in the October 2007 survey, down from 74.1 in September, and significantly below the 84.8 record last October. The Current Economic Conditions Index was 97.6 in the October 2007 survey, nearly identical to the 97.9 in September, and well below the 107.3 recorded last October.

Declines in the value of their homes were reported by 28% of all homeowners in October, well ahead of the 17% recorded three months ago, and above the 1992 peak of 24% recorded during the last housing slump. “The data indicate accelerating declines as 22% of homeowners anticipated declines in the value of their homes during the year ahead in October, up from 14% three months ago,” said Curtin. Homeowners expect a reprieve over the longer term, as two-thirds expect renewed increases, with an annual average expected gain of 3.7% over the next five years.

Additional declines in housing starts and home sales can be expected in the months ahead. Consumers held two opposite views on market conditions: more consumers than any time in the past half century mentioned the availability of discounted home prices and the fewest consumers thought home selling conditions were favorable because of those same price declines. “Since most home buyers are also home sellers, the perceived loss from selling loomed much larger than the perceived gain from buying, causing people to postpone their purchases,” Curtin said.

The majority of consumers in October did not judge overall economic prospects favorably, either for the year ahead or over the next five years. While the proportion of consumers who expected a rising unemployment rate was twice as high as during the best of times during the late 1990's expansion, it is about half the levels recorded prior to the past two recessions. “Although consumers anticipate a slowdown in the pace of economic growth in the year ahead, consumers do not expect an upsurge in the unemployment rate, the signature of a recession,” said Curtin.

Personal financial expectations remained depressed by high fuel and food prices. Given their strained budgets, especially among lower income households, consumers will continue to insist on price discounts when making purchases. This indicates that there will be renewed stress on the profit margins of retailers and product suppliers during the upcoming holiday season.

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