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ECONOMICS GROUP

SPECIAL COMMENTARY

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Confidence: Does Anyone Have Any?

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Across a broad array of confidence indicators, from consumers to small businesses to the heads of the largest companies in the country, confidence is at low tide. While some indices have seen marginal improvement in recent months, it is hardly time to celebrate the newfound confidence that might lead to a forecast of above trend economic growth. The level of most indicators remains at or near multi-decade or even all-time lows as the economic downturn has pummeled the feelings of both households and business people across the country. Still, something can be said for the fact that most confidence indicators have stopped falling or have reversed at least temporarily. This mirrors much of the information we are seeing in the "hard" data across the economy and gives us some hope for growth, but not yet a boom.

Figure 1

Confidence Summary

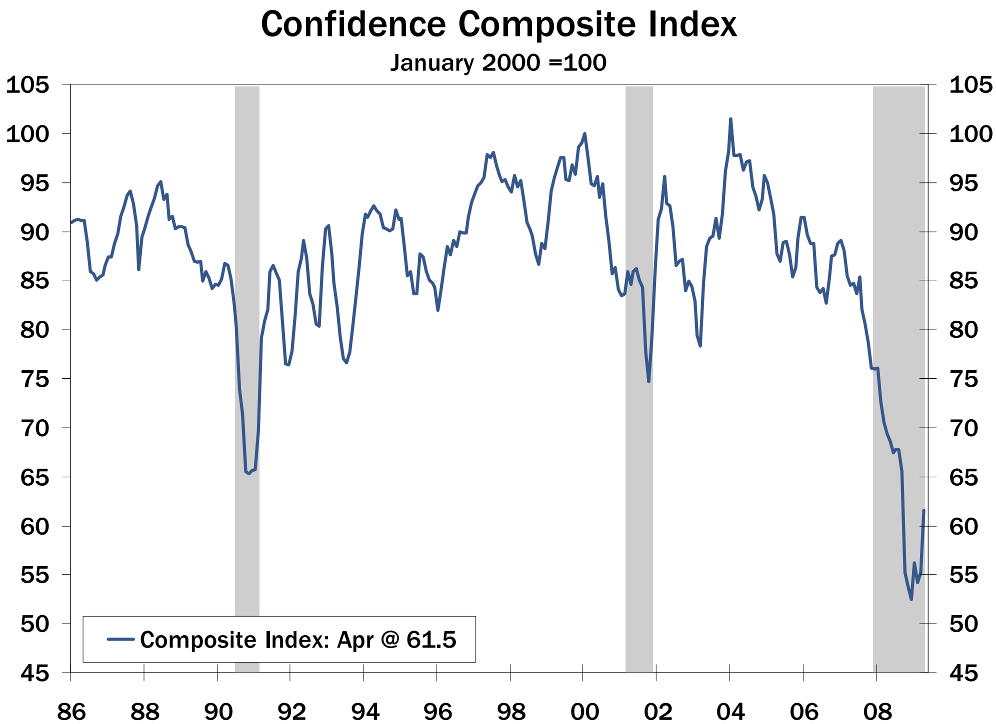
Indicator	Current	Current Date	Trough	Trough Date	% Recovery	Recent Peak	Peak Date
Consumers							
Consumer Confidence	39.2	Apr-2009	25.3	Feb-2009	54.8%	111.9	Jul-2007
Consumer Sentiment	65.1	Apr-2009	55.3	Nov-2008	17.7%	103.8	Jan-2004
Businesses							
CEO Confidence	30.0	Q1-2009	24.0	Q4-2008	25.0%	73.0	Q1-2004
ISM Mfg.	40.1	Apr-2009	32.9	Dec-2008	21.9%	61.4	May-2004
ISM Non-Mfg.[1]	43.7	Apr-2009	37.4	Nov-2008	16.8%	61.3	Aug-2005
NFIB Small Business	81.0	Mar-2009	81.0	Mar-2009	0.0%	107.7	Nov-2004
Composite Index	61.5	Apr-2009	52.5	Dec-2008	17.2%	101.5	Jan-2004

[1]Excluded from composite due to limited history.

Source: Conference Board, ISM, NFIB, University of Michigan and Wachovia

Clearly a lack of confidence, primarily after the collapse of Lehman Brothers, the AIG rescue and the lock-up in credit markets, was a major concern for the outlook and for policy makers. After September, the economy proceeded to plunge at the fastest pace since 1958 over the following two quarters. Restoring confidence for both consumers and businesses alike will be a key cog to putting the economy back on solid footing. Consumers who lack confidence hold back on purchases of big-ticket durable items such as cars and appliances as well as investment in homes. Businesses scale back on their purchases of capital equipment, reduce hiring plans or outright cut workers as their confidence dries up. We expect that confidence may have seen its trough across sectors, but just as the economy will be slow to repair the damage sustained and regain strength so to will confidence need time to rebuild.

Figure 2



Source: Wachovia

While by no means an official series, we find it a useful exercise to combine the various indicators into a simple composite (Figure 2). While much of the variation present in each of the series is washed out, we can still glean some information from the general level of confidence in the economy. The composite index has bounced off the bottom and is up about 17 percent since the end of last year. Still, confidence remains down by more than 10 percent over the past year and is just 60 percent of the highs reached during the last expansion. Much like the components of the series, we see a picture of improvement in the confidence composite, but progress is limited and from extremely low levels.

Consumer Confidence

Consumers certainly have more confidence today than just a few short months ago, but they are not celebrating the current economic conditions. The Conference Board's measure of confidence is up more than 50 percent over the last two months alone, but that is off an all-time low in the series. Confidence is still down nearly 40 percent over the past year and almost 65 percent since the peak of the last cycle. Improvements have largely been concentrated in expectations for future economic conditions, where the series has jumped higher and is nearly flat over the past year.

Consumers' assessment of the present situation, on the other hand, is still near its recent low and is down more than 70 percent over the past year. Consumers seem to have some hope that the economy will improve in the coming months, a definite turnaround from late 2008 when it seemed like there would be no end to the economic malaise and financial instability.

Figure 3

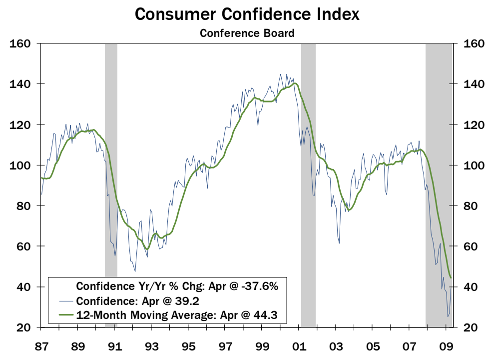
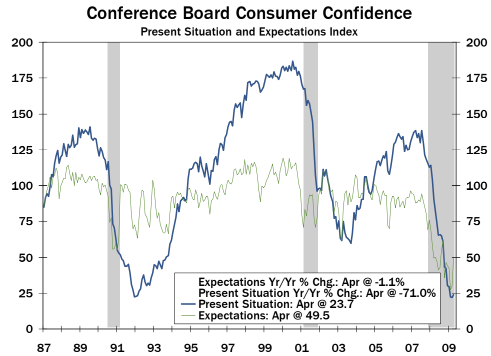


Figure 4



Source: Conference Board and Wachovia

We are still concerned about the condition of the labor market and how it will affect confidence in the coming months. While the April jobs report showed nonfarm payrolls falling at their slowest pace since last October, we still lost more than a half million jobs in the month. Consumer confidence has a strong historical relationship with the unemployment rate, which will likely rise to more than ten percent by year-end and will also continue rising in early 2010. With the labor market beginning to show signs of stabilization, confidence may get some help, but we would not expect a lasting and significant move higher until the labor market sees real improvement.

Consumer Sentiment

The University of Michigan's measure of consumer sentiment currently shows a similar but by no means identical picture of the U.S. consumer. Consumer sentiment has been somewhat range-bound, with only one real breakout, since spring 2008 (Figure 5). The decline in sentiment came earlier than the Conference Board measure of confidence, as the impact of rapidly higher gasoline prices affected sentiment over the first half of last year. Much the same as the Conference Board measure, sentiment about the future has picked up quicker than the assessment of the present situation. As with consumer confidence we are concerned that the dismal state of the U.S. labor market will weigh on consumers for several more months. We would like to see a convincing breakout in consumer sentiment, in the low 70s at a minimum, before we are willing to celebrate consumers' newfound belief in the economy.

Figure 5

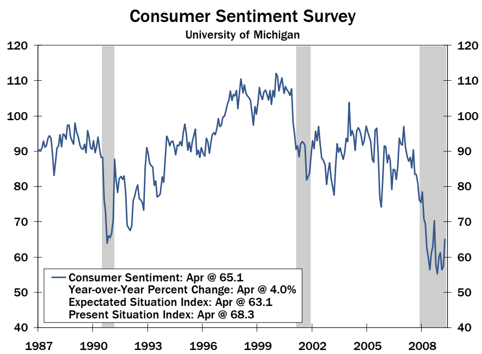
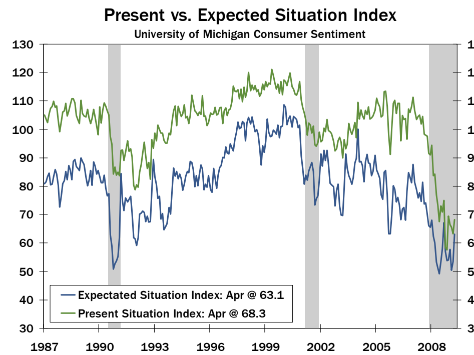


Figure 6



Source: University of Michigan and Wachovia

Conference Board: CEO Confidence

Moving from the consumer side indicators to those related to business or executive confidence presents a more complete and varied picture of the economic and financial landscape. While some of the business confidence indicators have rebounded off of their low marks set in recent months, others have yet to see the similar improvement.[1]

Figure 7

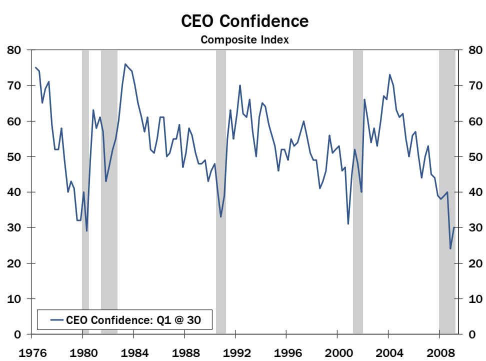
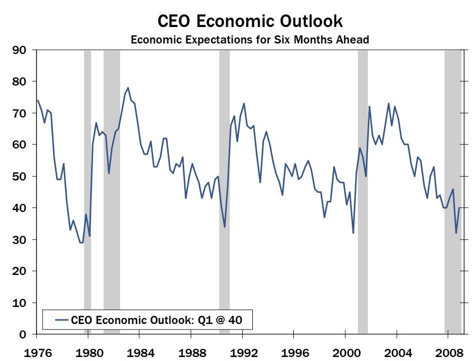


Figure 8



Source: Conference Board and Wachovia

The Conference Board's measure of business executive or CEO confidence moved slightly higher in the first quarter off of a new all-time low set at the end of last year. Still it is clear that business executives are less confident in today's economy than at any point in the history of the survey (back to 1976). The worry, of course, is that with business leaders so down on the outlook for the economy and their businesses they will be less likely to invest in equipment and seek new employees. These kind of actions, while prudent in an economic downturn, obviously reinforce the economic cycle, taking funds out of the hands of upstream suppliers and consumers. While the composite headline index has barely moved from its all-time lows, CEOs are actually in a slightly more optimistic mood on the economy, specifically over the next six months (Figure 8). The index has improved marginally over the last quarter, but did not decline so dramatically relative to past downturns.

[1] Admittedly, part of the issue relates to the speed of data release. Those indicators that still lag back to March or the first quarter have not had as much time to demonstrate improvement.

NFIB Small Business Optimism

Small businesses have not demonstrated feelings of relief as of yet, with the National Federation of Independent Business (NFIB) small business optimism index reaching yet another all-time low in March. After briefly attempting to rally late last summer, the index started falling to new lows late in the year and continued the trend into the first quarter of 2009. This downturn has hit every business, whether large or small, quite hard, so it is no surprise that small business owners are just as despondent about the economic outlook as CEOs at major corporations.

Figure 9

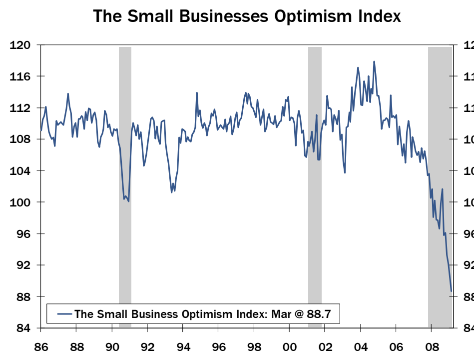
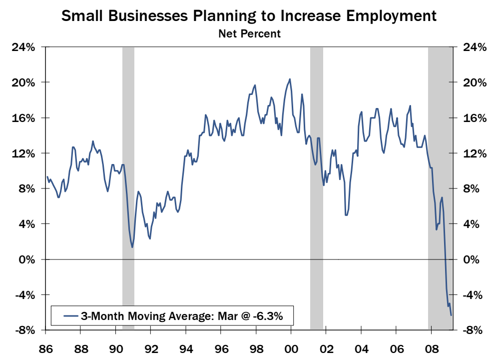


Figure 10



Source: **National Federation of Independent Business and Wachovia**

Looking at one of the key sub-indices, plans to increase employment, small businesses continue to expect a contraction in their payrolls over the near-term (Figure 10). Small businesses on aggregate had never indicated that payrolls would be shrinking over the life of this survey (since 1986). Unfortunately, the series has yet to indicate an upturn is coming over the next few months. Small businesses will likely continue to cut back not just on staff but on any controllable expenses as they manage their way through an extremely deep economic recession. We do not expect a major turnaround any time soon, but we would be happy to see marginal improvement or even stabilization from the nation's small business community.

ISM Surveys

The Institute for Supply Management (ISM) has some of the longest running and most widely known surveys on business activity. While not a confidence survey per se the surveys do provide a feel for the marketplace from supply managers across industries. The long standing manufacturing index, which dates back to the 1940s, has improved in recent months off of its cycle lows. The lows seen in this cycle neared, but did not eclipse, the previous all-time lows set in the early 1980s and before that in the mid 1970s. The ISM, in its latest release, noted that at its current level the index is consistent with a slight but notable contraction in economic activity or GDP based on historical trends. While manufacturing businesses seem to indicate that conditions have improved, it is certainly not an all clear signal at this point. Supply managers in the manufacturing space continue to be concerned about the outlook going forward.

Figure 11

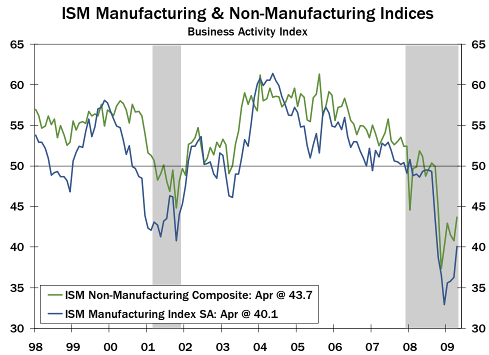
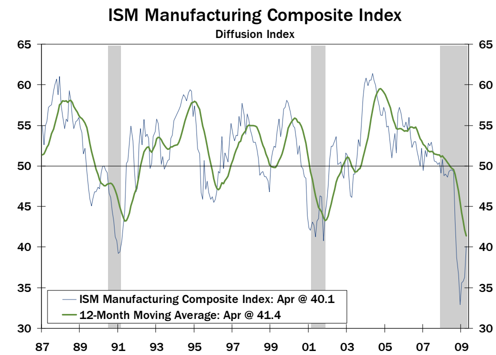


Figure 12



Source: Institute for Supply Management and Wachovia

Established in the late 1990s, the ISM non-manufacturing indices added coverage and visibility to the growing service sector. The non-manufacturing index (NMI) reached the low 60s during the expansion, but the trend has been declining for several years. Falling fast at the beginning of the recession, NMI reached record lows in the 30s. The pace of decline has slowed as recent increases bring the index closer to the 50 level, which separates expansion and contraction territory. The NMI currently stands below 50, indicating contraction for the seventh straight month. The ISM non-manufacturing index has been generally stronger than the corresponding manufacturing index, and if the trend holds as expected, the service sector will recover earlier and stronger once again. However, the perception of contraction will likely dominate for some time.

Confidence: Qualitative Feelings in an Economy Measured by Quantities

Confidence can be grouped with other character traits such as poise, grace and charm. When the dismal science takes hold of the term, however, the meaning changes. Confidence indicators are the only brand of economic indicators that deal with feelings, and thus are qualitative and not quantitative. As a subjective matter which cannot be directly measured or observed as, for example, prices are, confidence is difficult to quantify. Still, there is value in studying the various surveys of confidence. The surveys tend to be quite timely and are not excessively revised, providing a close-to-real time pulse of the economy from various perspectives. It is important for hard economic data to be supported by softer measures in order for a sustainable change in the current trend to take place. By the same token, a change in confidence alone is not enough to turn the economy. Taken together, qualitative measures of the present situation and future expectations as well as quantitative data can enhance our understanding of the economy, particularly an economy searching for a turning point.

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