May 7, 2015

## All Eyes on the Consumer

It appears that the first quarter may have been even worse than we thought. The CNBC rapid update—consensus estimates from a panel of forecasters—registered a decline of 0.3 percent as of yesterday.

Clearly, the year didn't start out so well, but here at the Atlanta Fed we have not yet lost faith. We are sticking to the narrative that 2015 will be another solid year of recovery.

That said, our faith is not blind and, befitting data-dependent policymakers, we need to make some call about what it will take to shake our confidence. In a speech delivered yesterday (May 6) in Baton Rouge, Louisiana, Atlanta Fed President Dennis Lockhart pointed to our current lodestar:

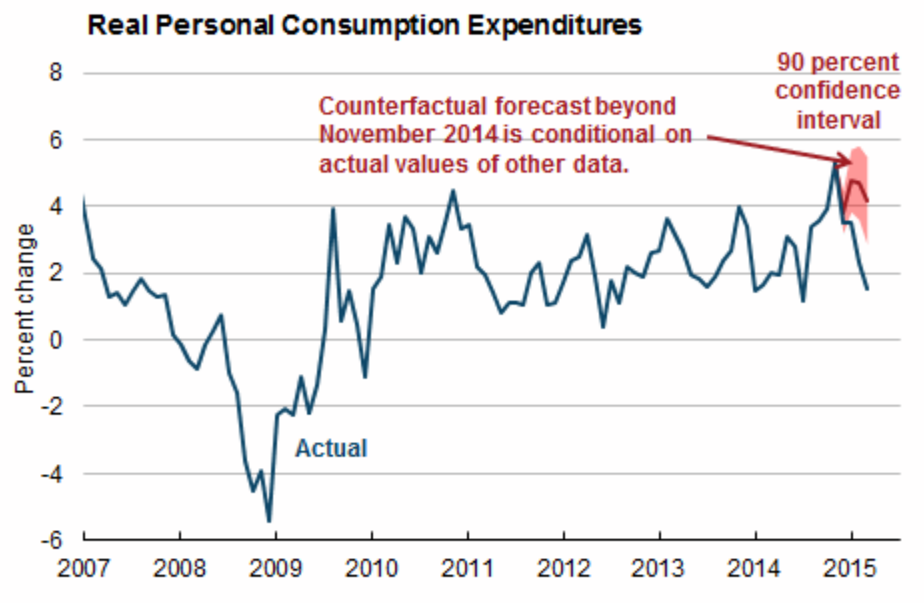
> As I assess the possible and necessary contributors to a rebound in the second quarter and thereafter, attention has to fall on consumer spending, in my view.

Is there a case for optimism? We think so, and it is based on the assumption that the fundamentals supporting consumer spending have been stronger than the actual recent pace of expenditures. President Lockhart continues:

> What's up with the consumer? It's puzzling. The fundamentals supporting consumption growth seem strong. I consider consumer fundamentals to be real personal income growth, household wealth, access to credit, and consumer confidence. Consumer confidence is, in turn, highly influenced by the broad employment outlook.

To be more precise about that sentiment, the chart below illustrates an experiment based on a simple model that incorporates President Lockhart's description of "fundamentals." To be even more precise, we ask the following question: What would we have predicted for consumer spending growth during the past four months based on the history of actual consumer spending and its relationship to income, employment (and unemployment), confidence measures, and wealth (specifically, equity prices)? We also threw inflation and oil prices into the mix for good measure.

Here's what we got:




Note: "Other data" include real disposable personal income, payroll employment, the unemployment rate, the indices of consumer confidence and consumer sentiment, personal consumption expenditure prices, the S&P 500 Index, and an average of Brent and West Texas Intermediate oil prices. Data indicate four-month percent change and are a seasonally adjusted annual rate.

Source: Author's calculation from data from the U.S. Bureau of Economic Analysis, the U.S. Bureau of Labor Statistics, Standard & Poor's, the Conference Board, Reuters/University of Michigan surveys of consumers, the Energy Information Administration, and the *Wall Street Journal*

In other words, the "fundamentals" suggest the four-month annualized growth of consumer spending should have been in excess of 4 percent, as opposed to the approximately 1.5 percent we actually saw. That is a story we don't expect to persist, and our current view of the year is that first-quarter consumer spending results are not indicative of future performance.

Consumers are, of course, a forward-looking bunch, and it is possible the recent weak spending reflects a looming reality not captured by the simple model described above. But our forecast for now is that consumers will move to the fundamentals, and not vice versa.

As President Lockhart said in Louisiana: "Stay tuned."


*By Dave Altig, executive vice president and research director of the Atlanta Fed*

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