



Economic Research

Irish Consumer Confidence is a puzzle

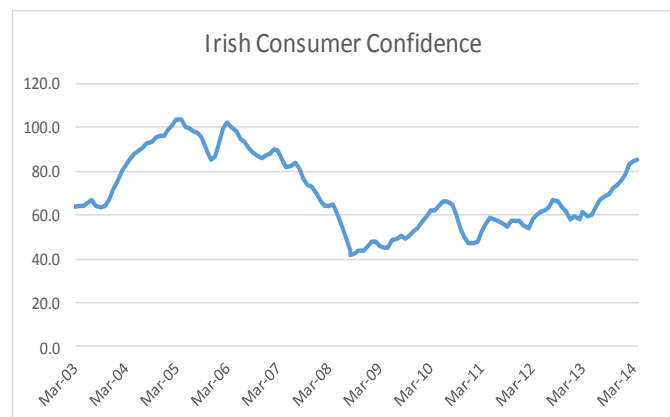
15 May 2014

Irish consumer confidence, as measured monthly by the ESRI/KBC index, has risen sharply over the past year and is now back at levels last seen in early 2007, i.e. before the financial crisis and subsequent plunge in Irish employment and economic activity. The economic situation in Ireland has certainly improved of late but the scale of the change appears at odds with the buoyant confidence readings and is difficult to explain.

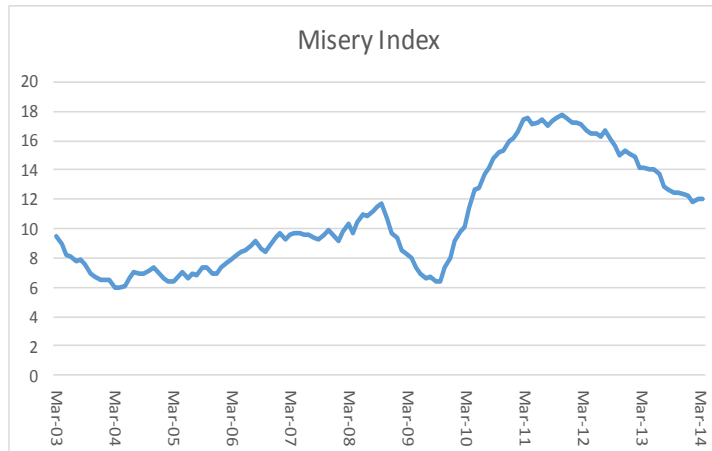
The index is compiled from a telephone survey of households and is based on a number of questions involving the respondents own economic situation and perceptions of the broader economic backdrop. The series is volatile and is best viewed as a three-month moving average and on that basis over the past decade has ranged from over 100 (during 2004 and 2005) to around 40, the low recorded in mid-2008. Confidence subsequently picked up to a high of 66 in mid-2010 before plunging back below 50 around the bail-out and entry of the Troika later that year. A slow and uneven recovery ensued but the past twelve months has seen a marked acceleration, with the index currently standing at 85 from around 60 in the spring of last year.

As noted, this is now at levels last seen some seven

years ago but the economic backdrop then was very different. The economy was at full employment, for example, with the unemployment rate at 4.5% against 11.7% now, although the latter has fallen from a peak of over 15%. Inflation was much higher back then, at around 5%, as against the current 0.3%, but the Misery index (the sum of the unemployment rate and the inflation rate) was still lower, at 9.6 versus 12 today. Wages were also growing strongly in 2007, by 5% per annum, in contrast to the falls recorded in recent years, and of course disposable income has also been hit by tax increases since 2008.



The index is thought to have a close relationship with retail sales and consumer spending but again the picture is very different in the two periods; real personal consumption was growing at an annual rate of some 7% in the first quarter of 2007 but the most recent figure, for the final quarter of 2013, showed a 1.1% fall in consumption. Spending probably turned positive again in the first quarter of this year but most forecasters envisage a 2% rise in 2014 at best, far below the pace recorded when confidence was last at similar levels.



It may well be that the index is responding in an exaggerated manner to specific variables, such as the rise in house prices (which is not positive for everyone), or simply reflecting relief that the economic situation is not as dire as was the case in 2008-2010, and that the economic outlook, although still cloudy, is at least somewhat clearer than appeared at the worst of the crisis. It is also possible that the consensus is wrong and spending will surprise to the upside so supporting the confidence index as a useful forward indicator of consumption. Time will tell on that issue but it does seem clearer that another observed relationship involving the index has indeed broken down, at least for now- the correlation between consumer confidence and support for the government. In general, strong readings in confidence tended to go hand in hand with strong support for the sitting government, as captured by opinion polls, but that relationship appears to have well and truly splintered of late , as the confidence surge over the past year has not translated into a boost for the government in the polls.