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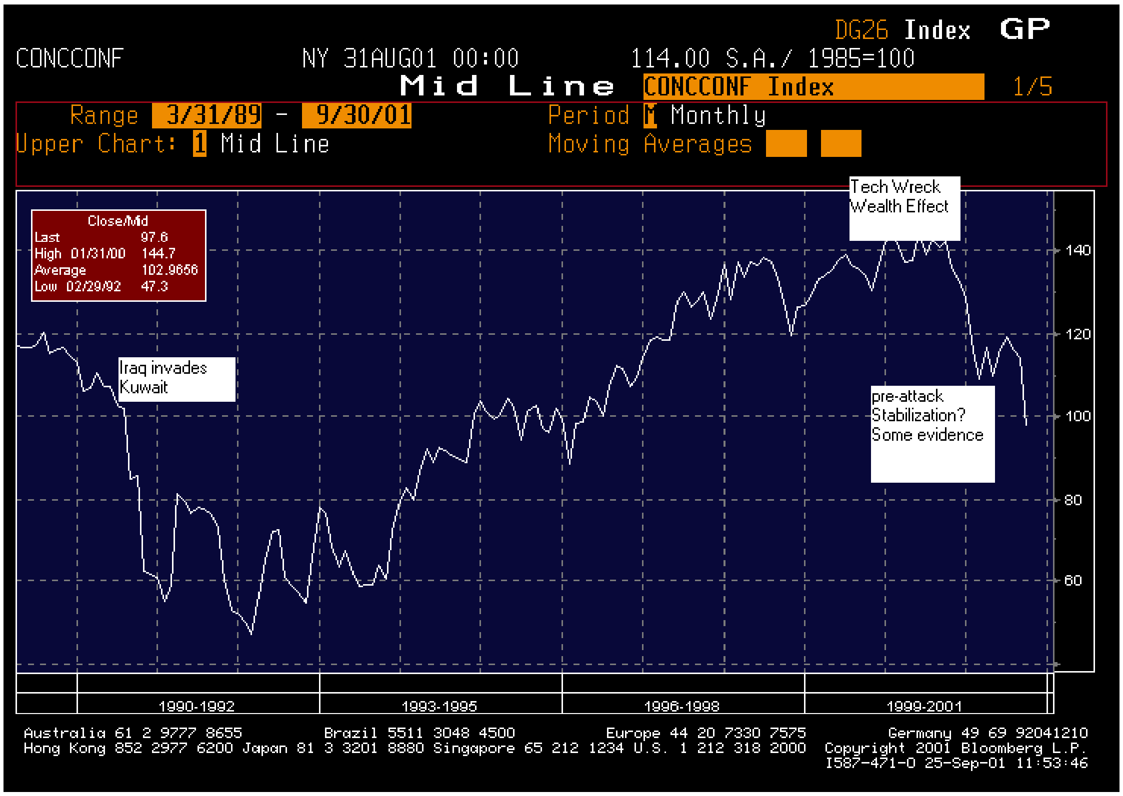
## Post Attack Economics:  Consumer Confidence Falls Sharply

The Conference Board reports today confirmed the shock to consumer expectations as measured by in the overall index and the forward expectations and current situation components.  There is some




**Consumer Confidence 1990-2001**

evidence that prior to the Attack, confidence had begun to stabilize, although clearly it was at best fragile. One difficulty in making historical comparisons is that the 1993—mid 2000 period (often referred to as “The Long Boom”) created huge optimism in the job market and hopes promised by the technology boom.  Confidence soared to record levels reflecting those trends.  The Conference Board data are likely to provide good directional indicators but are less likely to give us accurate metrics for forward developments on a month-to-month basis.  Looking back to the pre-Gulf war period, we note that confidence had begun to slide ***prior to the Iraqi invasion*** and slid abruptly following the invasion.  A rally in confidence occurred after the U.S. bombing of Iraq began in January 1991. The U.S. has yet to respond.  Will the consumer respond similarly?

Prior to the Attack, consumer confidence had already begun to sag in QIV2000 although by QII2001, some stability had retuned.  Starting from historically high levels, it was difficult to gauge whether the consumer would “fail,” and analysts have had varied opinions on that subject.  Nonetheless, consumer spending averaged some 2.5% growth prior to the attack. This was lower than 2000, but even those levels did not imply negative real growth in the overall economy.

**The Attack generated an abrupt change in consumer attitudes and we should expect that to be** reflected

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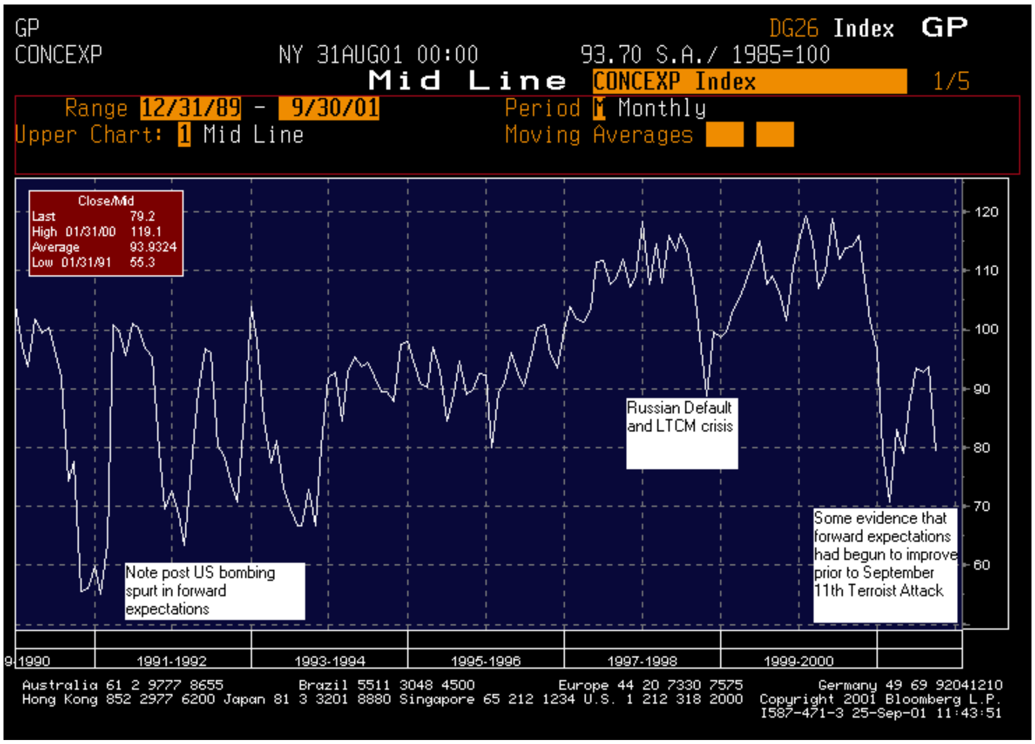
in reduced purchases of consumer durables as well as a retrenchment in leisure and travel activities. The data on buying intentions, while showing declines, indicate only modest drops, smaller than the worst anticipations. This shows up in both intentions for home and auto purchase. At the time of the survey, consumers may have been still evaluating whether this was a singular episode or the beginning of an entirely new era for the U.S.




**Consumer Expectations**

Clearly, there has been a sharp impact on forward expectations of consumers, but translating that decline into declines in purchases of specific durables and non-durables may be subject to more than the usual uncertainty. A comparison of the buying intentions data for homes and automobiles indicates poor month-to-month correspondence. Auto sales, for example, have shown spurts of growth earlier in the year and a slower pace later in the year. Home sales have been very brisk—at near record levels---while the 'intentions' data series show a high degree of month-to-month volatility of intentions. Of course, the record declines in interest rates may have proven to be a significant incentive that is masked by 'intentions' sampling. Anecdotal reports released since the Attack point to significant declines in actual new car sales and recent auto industry forecasts show sharply lower sales volumes are anticipated.

There may be two offsets to this apparent drop: (1) the possible increase in recreational driving as a substitute for air travel---particularly if consumers see the Attack as indicative of more dangerous air travel in the future and (2) the possibility that gasoline prices may drop significantly due to the recent drop in crude oil prices. At best, however, this would seem to offer only a modest offset to the likely decline in consumer incomes as unemployment rises.

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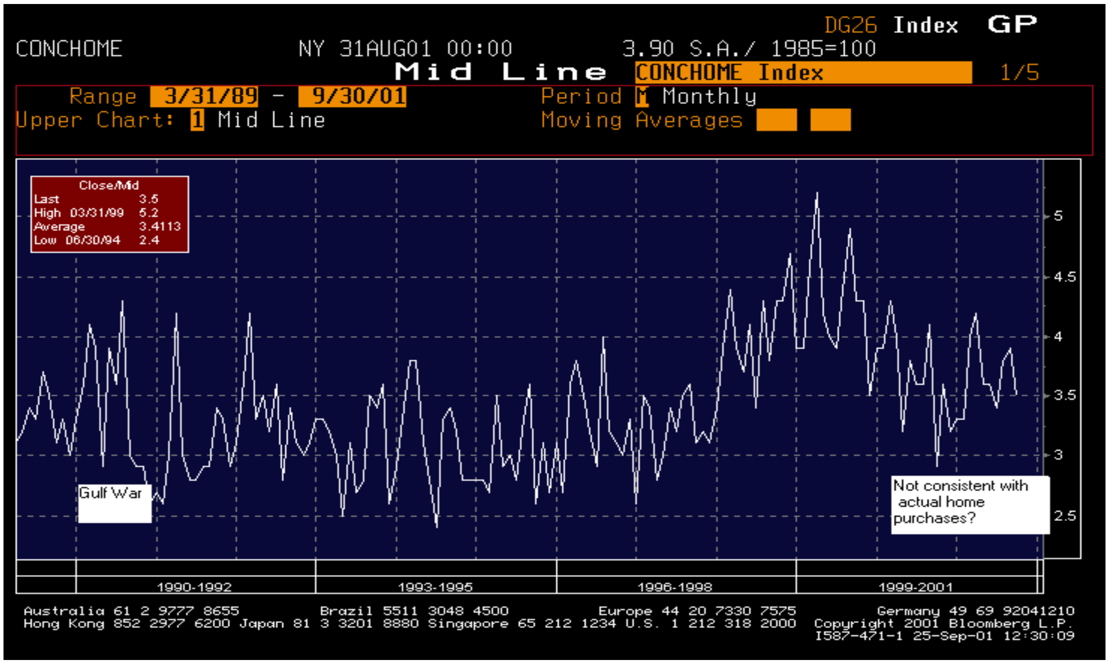
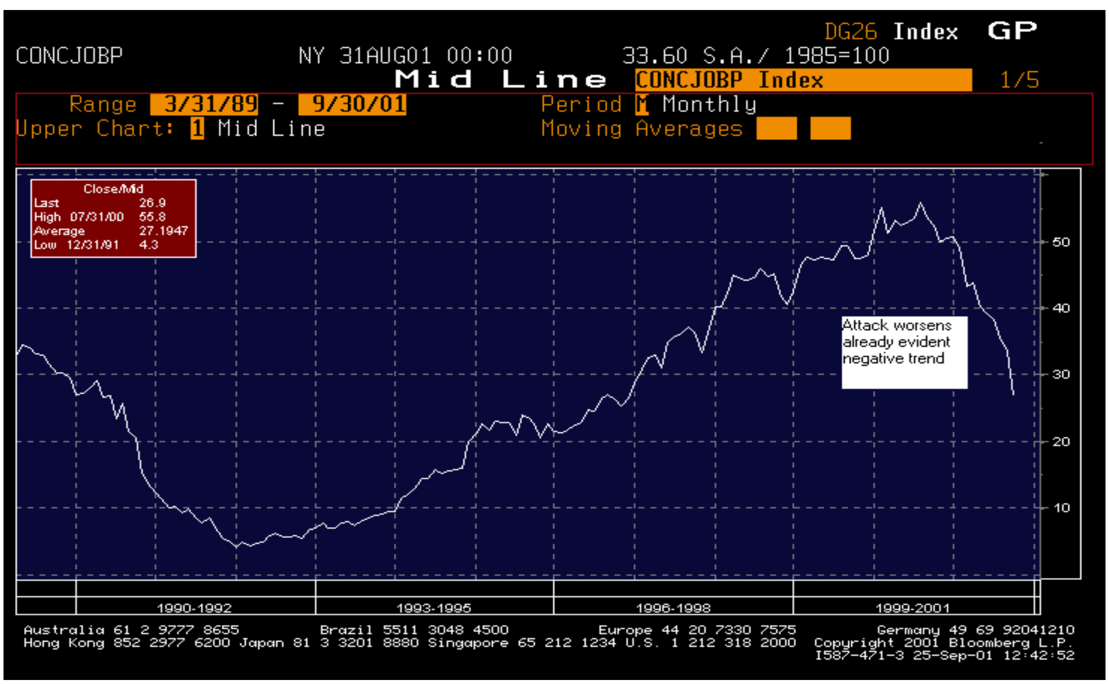



**Home Purchasing Intentions**




**"Plentiful Jobs"**

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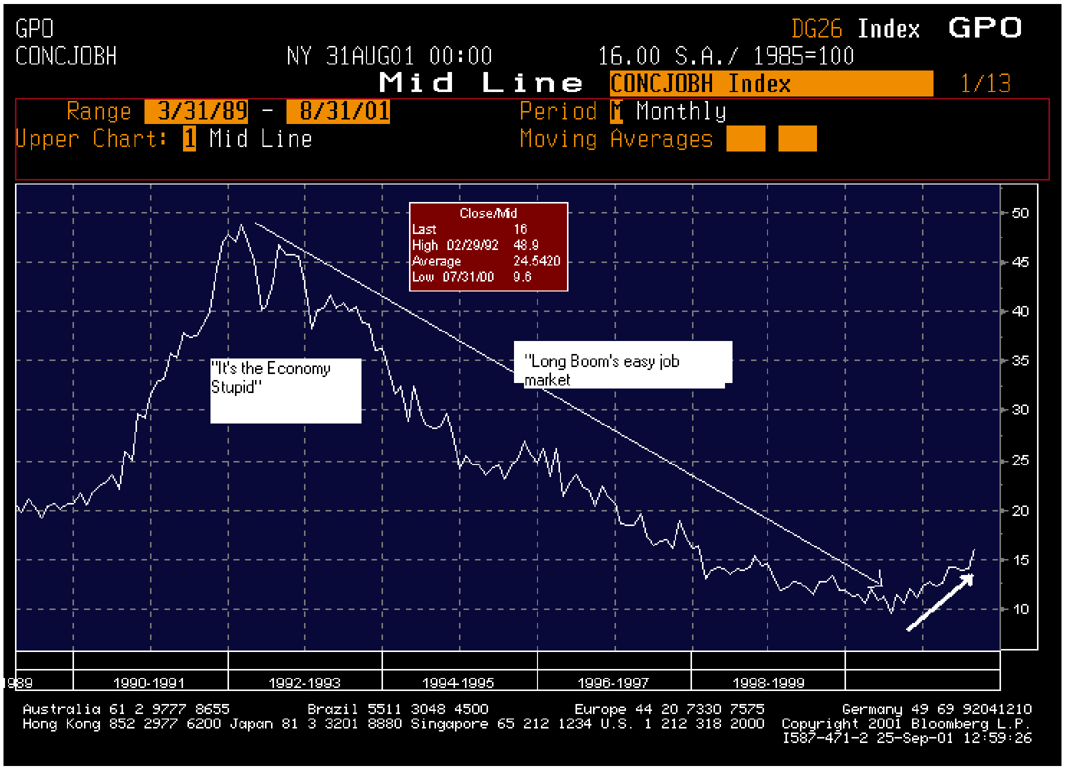


## "Jobs Harder to Find"

One of the legacies of the post Gulf war period was the **increased difficulty in locating jobs**. The peak measure registered by the Conference Board was in February 1992 and there was a double-dip in this measure during the summer election campaign. Monetary policy was easing, but in the judgment of the Bush campaign, not sufficiently fast. The Long Boom, as it has come to be known, began in the Clinton Administration. The "low" in 'Jobs Harder to Find' occurred in July 2000. Accelerated employment growth occurred much later during the Long Boom.

It is likely that this survey data does not totally reflect the post Attack environment. If so, it probably will understates true unemployment at this moment. **A quick and dirty regression of the total unemployment rate on the 'jobs harder to find' survey on data since QI 1989, however, shows a remarkably good fit. The regression equation predicts the current unemployment rate to be some 5.3% as compared to the last month's reading of 4.9%.**

Some forecasters now look for unemployment rates to soar well above the 6% (compared to the last reported level of 4.9%). Clearly, consumption is threatened and today's confidence surveys reflect those anxieties. It is the translation into jobs, however, that can haunt the economy and make the decline more serious.

**Monetary policy** has faced a huge difficulty in righting the investment boom collapse, but prior to the attack there was increasing evidence that the large drop in interest rates and abundant liquidity in the system would stabilize economic growth or at the least prevent a serious recession. The confidence of consumers has been severely eroded by the Attack. That makes two weak elements in GDP (investment and consumption), which guarantees more recession pressures. The issues now are 'how deep and how long?' The Fed will find all the evidence for an additional cut on October 2nd. The remaining issue is whether it is a 25 or 50 basis point cut. With an unclear dimension to changes in fiscal policy, and a clearly demonstrated ability and willingness to act on an inter-meeting basis, the Fed may choose to be modest in its decision on October 2nd. We will address this issue subsequently.