

FINANCIAL FAQs

CONSUMERS DISCOURAGED BY GAS PRICES

With retail gasoline prices jumping more than 50 cents in the past two months, consumers' views about the current economic situation plunged in early May at the fastest rate in at least 28 years, researchers at the University of Michigan said Friday.

The University of Michigan consumer sentiment index fell to 79.0 in May -- it's the lowest level since October's 74.2 reading -- from 87.4 in April. The big drop came in the current-conditions index, which plunged 13 points to 96.2, the biggest one-month decline since the University of Michigan switched to a monthly survey in 1978, outpacing the previously steepest 10.7-point decline in November 1981.

This is expected to put a serious crimp in consumer spending, as higher interest rates had already begun to squeeze consumers' pocketbooks. The Prime Rate is up to 8 percent after Wednesday's Federal Reserve rate hike of one-quarter. The Prime Rate, which is the index used by most consumer loans, has now risen 4 percent since June 2004.

This is reflected mainly in the shrinkage of consumer debt. The Federal Reserve reported that revolving and non-revolving consumer debt (excluding mortgages) had risen just 2.75 percent in the first quarter. Revolving (credit card) debt actually shrank over that time. This is in contrast to the 7 percent annual increase in borrowing that occurred during the 2001 recession and later.

In May, more consumers mentioned high gasoline prices when asked about recent developments than at any other time since the sentiment survey began being taken on a quarterly basis more than 50 years ago, the researchers said. And the largest proportion in 25 years said high gasoline prices were reducing their standard of living.

Impact on economy

So far, the jump in gasoline prices has had only a minor impact on economic growth and consumer spending. In April, retail sales increased 0.5%, but most of the increase was due to higher gas prices. Excluding gasoline sales, retail sales increased 0.1%.

The current conditions index has fallen as many as 10 points several times: once after Hurricane Katrina in September 2005; once in the depths of the 1991 recession; once after Saddam Hussein captured Kuwait in 1990; once during the 1981 recession; and once in 1980, just after hostages were taken at the U.S. Embassy in Tehran. Consumer sentiment has fallen in four of the past five months after peaking at 91.5 in December. When gas prices fall, the index rises, but when gas prices soar, confidence suffers.

Consumers are also downbeat about the near-term economic outlook. The expectations index, reflecting views about the next six months, fell to 68.0 from 73.4 -- also the lowest level since October. Meanwhile, consumers' expectations for inflation in the next year jumped from 3.3% to 3.9%. But expectations over the next five years were unchanged at 3.1%.

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