Chapter 3
Consumer Sentiment and Confidence during Post-Crisis 2008: A Panel Data Analysis

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ABSTRACT
This chapter attempts to find out the impact of recent recession on the consumption pattern through consumer confidence index (CCI) of selected developed and developing economies. This chapter examines how the macroeconomic variables like growth rate, inflation, unemployment rate and debt-GDP ratio etc. influence the consumer’s confidence during 1996-2012, in which the crisis occurred in 2008. Moreover, in this chapter we have explained the role of consumption sentiment in terms of consumer confidence regarding future expectation. Apart from that, from the panel data set of 11 countries, we have found that more or less all the economies including the United States have experienced downward movement of consumer’s confidence in the presence of the great recession of 2008-2009.

INTRODUCTION
Several authors have rightly pointed out that though economic recession is a part of a business cycle but it make itself an evil of own family. Historically it has been evidenced that economic activities like consumption pattern of households and investment confidence of the producers of an economy have been distorted due to a major economic slowdown. If we start with the great recession of 1930s as our base instance, we have found that such a recession marked the most severe and persistent decline in aggregate consumption during this period. In this context the second-worst collapse has been observed in the 1974-5 recession and it sustained for just one year. In contrast to the previous recessions the most current recession 2008-9 has been experienced most severe
and persistent decline in aggregate consumption\(^2\) since Second World War. All components and subcomponents of consumption declined during this period. Moreover, some of the authors have emphasized that the recovery path of consumption following the recent crisis has been uncharacteristically weak and they have also mentioned that persistence of weaknesses in the recovery path is reflected most in the subcomponents of nondurables and especially in services consumption\(^3\). Some of the authors have also claimed that recovery of consumption pattern from its lower trajectory becomes delayed mainly due to lack of consumers’ confidence regarding future.

Hence it become essential for us to integrate the issues related with consumers’ confidence and other important macroeconomic variables in the context of recent recession. The motivation behind this work has been generated from the facts that though their exists quite a few works in this line, but none of them have used the panel data of consumers’ confidence of developed and developing countries to discuss the impact of recent economic crisis on consumers’ confidence. In this paper we are trying to fill up the gap of the existing literature using panel data.

**BACKGROUND**

Economic theories recognize the importance of expectations for aggregate economic behaviour. Few influential economic thinkers of the past century attributed explicitly to the volatility of expectations as a crucial factor in explaining the existence and depth of business cycles. Keynes emphasized in the General Theory the importance of changes in expectations that are motivated by “animal spirits”, not by rational probabilistic calculation. In particular, entrepreneurs’ animal spirits related to their investment decisions were theorized of being a major determinant of economic fluctuations. Pigou (1927) also thought of business cycles as being largely driven by expectations. He stressed entrepreneurs’ errors of optimism and pessimism as key drivers of fluctuations in real activity. Expectations play an important role in modern state-of-the-art general equilibrium models. Expectations are almost universally modelled as formed according to the rational expectations hypothesis. As a result, at least in models with determinate equilibrium, errors (due to expectation) can be solved out as a function of fundamental shocks and they disappear as autonomous sources of dynamics. Hence, there is typically no scope for fluctuations in expectations in the spirit of those emphasized by Keynes, which are driven by animal spirits, market psychology, sentiment, or by any shift in expectation that cannot be reconnected to original structural disturbances. In this study, we focus on sentiment especially on consumer’s sentiment and also consumer confidence that is measured as consumer confidence index (CCI). Now, we discuss on consumer confidence.

**CONSUMER CONFIDENCE**

Consumer confidence is the degree of optimism on the state of the economy that consumers are expressing through their activities of spending and saving. The Consumer Confidence Index (CCI) is an important indicator which measures consumer confidence. Measurement is indicative of consumption component level of gross domestic product (GDP). Naturally CCI affects stock market. The US Federal Reserve looks at the CCI when determining interest rate changes, and it also affects stock market prices. There is huge variation in CCI in the country to country analysis. However, consumer confidence is a lead indicator of economic trends\(^4\). In simple terms, increased consumer confidence indicates economic growth in which consumers are spending money, indicating higher consumption. Decreasing consumer confidence implies slowing economic growth, and so consumers are likely