

## The Importance of Tracking Consumer Confidence

The vitality of the residential real estate market is influenced by three main factors: 1) performance of the labour market; 2) changes in mortgage rates; and 3) consumer confidence. This last factor reflects consumers' perceptions about current and future economic conditions. In Canada, the Conference Board of Canada publishes an index that measures these perceptions using a monthly survey among households from different provinces across the country. The survey consists of four questions regarding households' views about the labour market, their personal finances and their feelings about making a major purchase. This last aspect is particularly relevant for forecasting the evolution of the real estate market, as households are asked to answer the following question: "In your opinion, is now a good time to make a major purchase, such as a home<sup>1</sup>?". Here, we are interested in the proportion of households that responded affirmatively to this question. For example, in April 2011, 52 per cent of Québec households felt that it was a good time to make a major purchase, while in the last recession this proportion had fallen to less than 25 per cent.

### Consumer Confidence and Home Sales in Québec

The Index of Consumer Confidence is an important indicator of the evolution of MLS<sup>®</sup> sales in the short term. When consumers are optimistic about the economy, they are more likely to make a major purchase, such as a home or other big-ticket item. We will now analyze the relationship between the proportion of Québec households that feel that now is a good time to make a major purchase (sub-index Q4)<sup>2</sup>, such as a home, and the number of residential sales in the province of Québec for the period from January 2007 to April 2011. The chart below shows the evolution of the confidence sub-index Q4 (blue dotted line) and the number of residential sales<sup>3</sup> (red line) in Québec. There were several fluctuations in this period, due to the recession. The proportion of Québec households that felt it was a good time to make a major purchase, which reached 54.5 per cent in December 2007, fell dramatically in 2008 and reached a low of 24.8 per cent in December. One year later, in December 2009, consumer confidence had almost fully recovered (49.3 per cent). MLS<sup>®</sup> sales followed almost the exact same trend during this period. It is clear from the chart that changes in consumer confidence and residential sales are closely linked. In the next section, an analysis of the correlation between the two variables will enable us to prove this point, while allowing us to make a small distinction.

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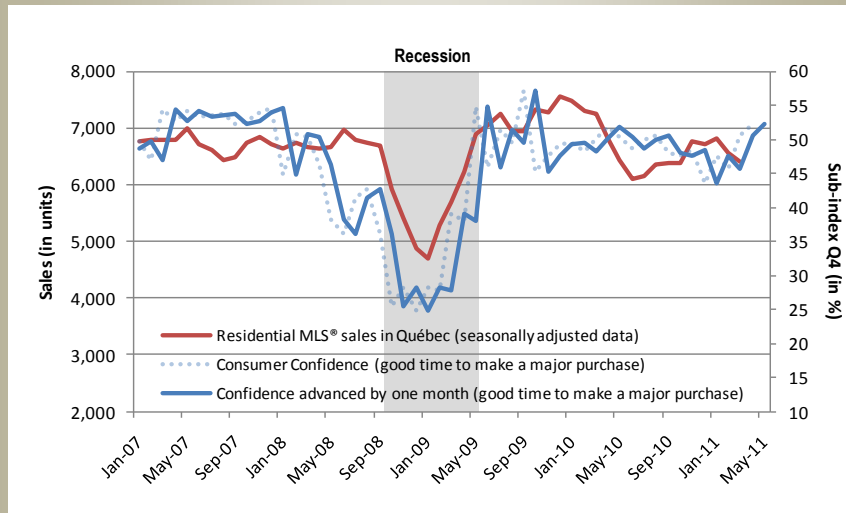
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<sup>1</sup> For more information about the Index of Consumer Confidence, [click here \(see page 2\)](#).

<sup>2</sup> This proportion corresponds to question 4 on the survey conducted by the Conference Board of Canada.

<sup>3</sup> Seasonally adjusted data from The Canadian Real Estate Association (CREA).

## Consumer Confidence and Residential MLS® Sales in Québec



Source: CREA and Conference Board of Canada

### Measuring the Relationship Between Consumer Confidence and Residential Sales

The degree by which changes in the two variables are related can be determined by a statistical measure called the correlation coefficient<sup>4</sup>. It has a value of between - 1 and + 1. The coefficient is positive when two variables move in the same direction, and it is negative when they move in opposite directions. Also, the closer the coefficient of correlation is to 1, the stronger the relationship between the two variables<sup>5</sup>.

Thus, the correlation between MLS® sales and the confidence sub-index Q4 is indeed high, but this correlation increases (+ 0.68) when we examine the confidence level in a given month and residential sales in Québec the following month. We therefore advanced the consumer confidence index by one month<sup>5</sup> on our chart (solid blue line) in order to better observe the relationship. The correlation coefficient decreases for any other period analyzed<sup>7</sup>.

In the case of consumer confidence and residential sales in Québec, the correlation is at its highest when we shift the confidence variable by one month.

<sup>4</sup> To learn more about the correlation coefficient, [click here](#).

<sup>5</sup> A coefficient of 1 means a perfect correlation.

<sup>6</sup> The data on confidence is advanced by one month, meaning that, in the chart, the data corresponding to sub-index Q4 for January 2007 is actually that of December 2006, data for February 2007 is actually that of January 2007, etc.

<sup>7</sup> More specifically, the correlation between a high proportion of households that think now is a good time to make a major purchase for a given month and the level of residential sales two months later is + 0.63. The correlation decreases to + 0.52 when compared with residential sales three months later, and to + 0.39 when compared with sales four months later.

Thus, in the case of consumer confidence and residential sales in Québec, the correlation is at its highest when we shift the confidence variable by one month. This means, for example, that the value of the consumer confidence index of February is most strongly correlated with the MLS® sales of March. This is very useful in that movement in the confidence index for a given month will generally give us a good idea of the movement of residential sales for the following month. In general, a decrease in residential sales will be preceded by a drop in consumer confidence the month before.

Caution must be taken, however. A correlation does not imply a cause-and-effect relationship. A correlation that exists between confidence (sub-index Q4) and the number of residential sales the following month does not necessarily mean that an increase in Québec consumer confidence will result in an increase in residential sales in Québec. One or several other factors may be causing the synchronized movement of confidence and sales. For example, an increase in employment level may lead to an increase in both confidence and residential sales. Similarly, a decrease in mortgage rates may push consumer confidence upwards and can also translate into more residential sales.

Nevertheless, the relationship observed between the two variables suggests that the evolution of the confidence sub-index Q4 gives us a good idea of the MLS® sales performance of the following month. Thus, to understand the performance of the real estate market, it is important to follow the evolution of consumer confidence. Interested readers can do so by subscribing to the economic news produced by the Québec Federation of Real Estate Boards, by clicking [here](#).

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