

Global Economics Comment: Is Poor Economic Sentiment Really About the Economy?

- Consumer sentiment remains very weak despite solid economic fundamentals, including a healthy labor market, a booming stock market, and solid consumer spending and GDP growth. This divergence is visible globally, but especially in the US.
- There are several reasons for this divergence. Cross-country relationships confirm that high price levels are lowering sentiment, while amplified political biases have led to sharp shifts after recent global elections that brought change in political leadership. But the weakness in sentiment is also quite broad. Sentiment remains below 2019 levels for all groups in the US even after stratifying by wealth, income, generation, social media use, political party, and homeownership.
- One explanation for these patterns is that people have generally become more downbeat on the state of the world for reasons unrelated to the economy. Consistent with this explanation, overall happiness levels deteriorated sharply in 2020 and have yet to recover, despite people's assessment of their financial situation only deteriorating modestly. While there are several plausible explanations for this shift, lower happiness is more strongly correlated with lower confidence in societal and government institutions since the pandemic.
- These results suggest that low reported economic sentiment likely reflects a more fundamental, downbeat assessment of the state of the world rather than the economy. Consumer sentiment may therefore not improve for the foreseeable future even if the economy continues to outperform and, as a result, will likely remain a less useful tool for predicting economic dynamics.

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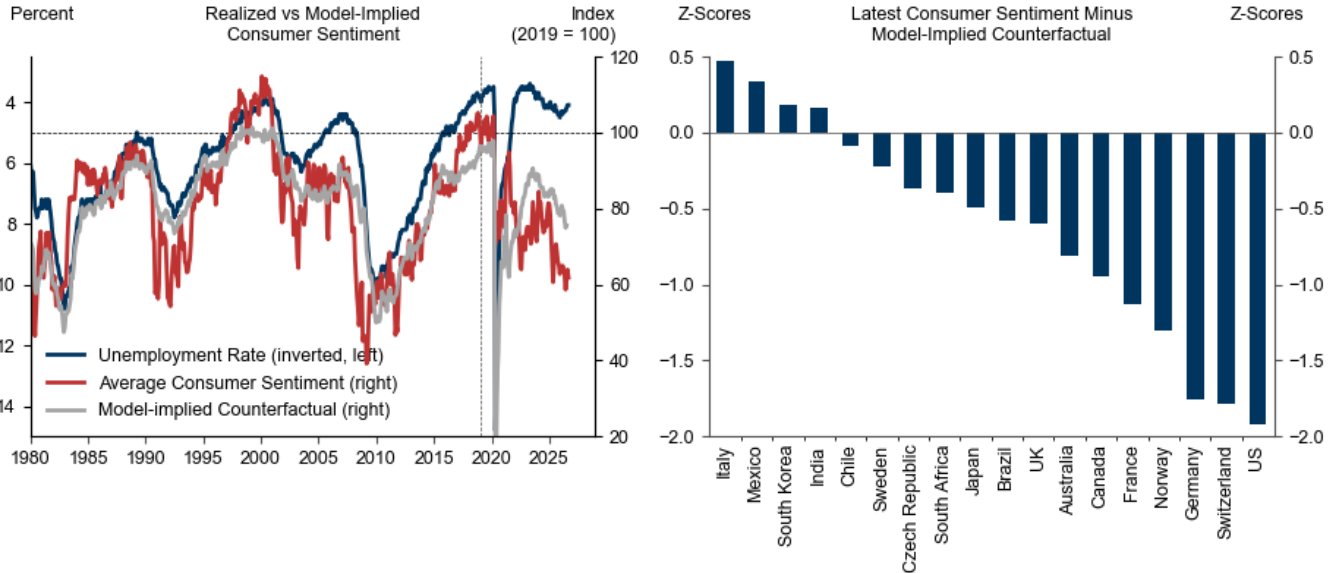
Is Poor Economic Sentiment Really About the Economy?

Consumer sentiment fell sharply in 2020 and remains depressed despite solid economic fundamentals, including a healthy labor market, a booming stock market, and solid consumer spending and GDP growth.

The left chart of [Exhibit 1](#) shows that the average of the University of Michigan's consumer sentiment and The Conference Board's consumer confidence measures currently stands well below the level implied by the current US unemployment rate, headline inflation, and wealth-to-income ratio. And while the underperformance is particularly pronounced in the US, the right chart of [Exhibit 1](#) shows that sentiment is currently below model-predicted levels in almost all DMs.

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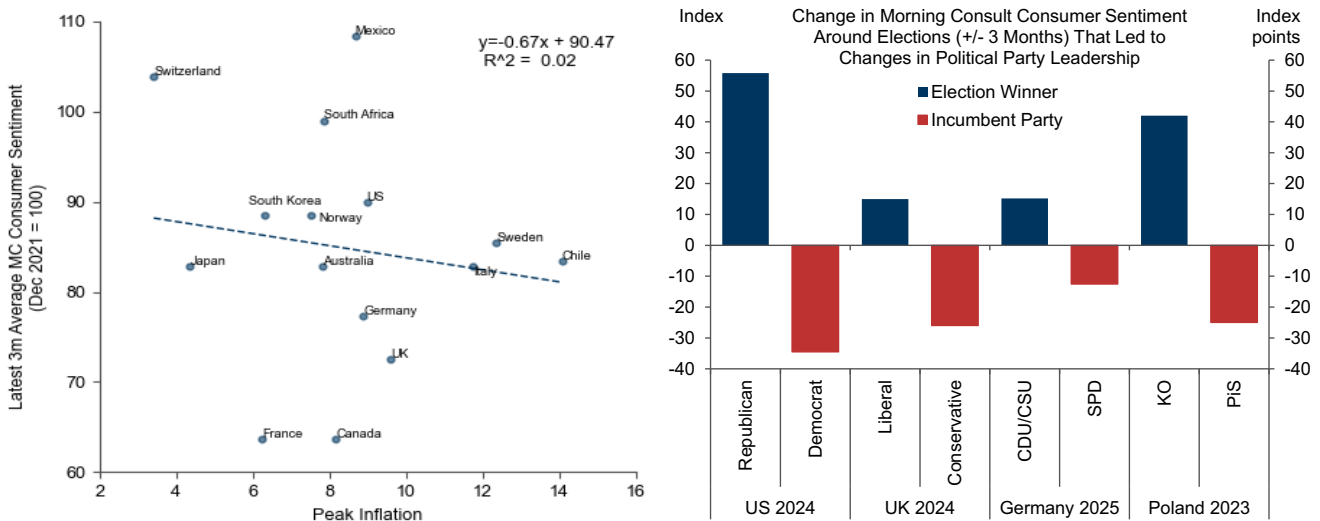
Exhibit 1: Consumer Sentiment is Notably Lower than Implied by Economic Fundamentals Across Major Economies



Source: The Conference Board, University of Michigan, Haver Analytics, Goldman Sachs Global Investment Research

There are several well-established reasons for this divergence. Intuitively, after scatter-plotting the peak year-over-year headline inflation rate during the pandemic against its latest 3m average consumer sentiment score from Morning Consult, we find that the rise in price levels due to the post-pandemic inflation surge appears to be weighing on consumer sentiment across countries. Furthermore, political biases have led to sharp shifts after recent global elections that brought change in political leadership (these biases became amplified in the US after a switch to online data collection in the UMich sentiment survey).

Exhibit 2: Sentiment Remains Depressed in Countries That Experienced More Extreme Pandemic Inflation; Political Biases Are Visible Around Recent Global Elections that Brought Change in Political Leadership



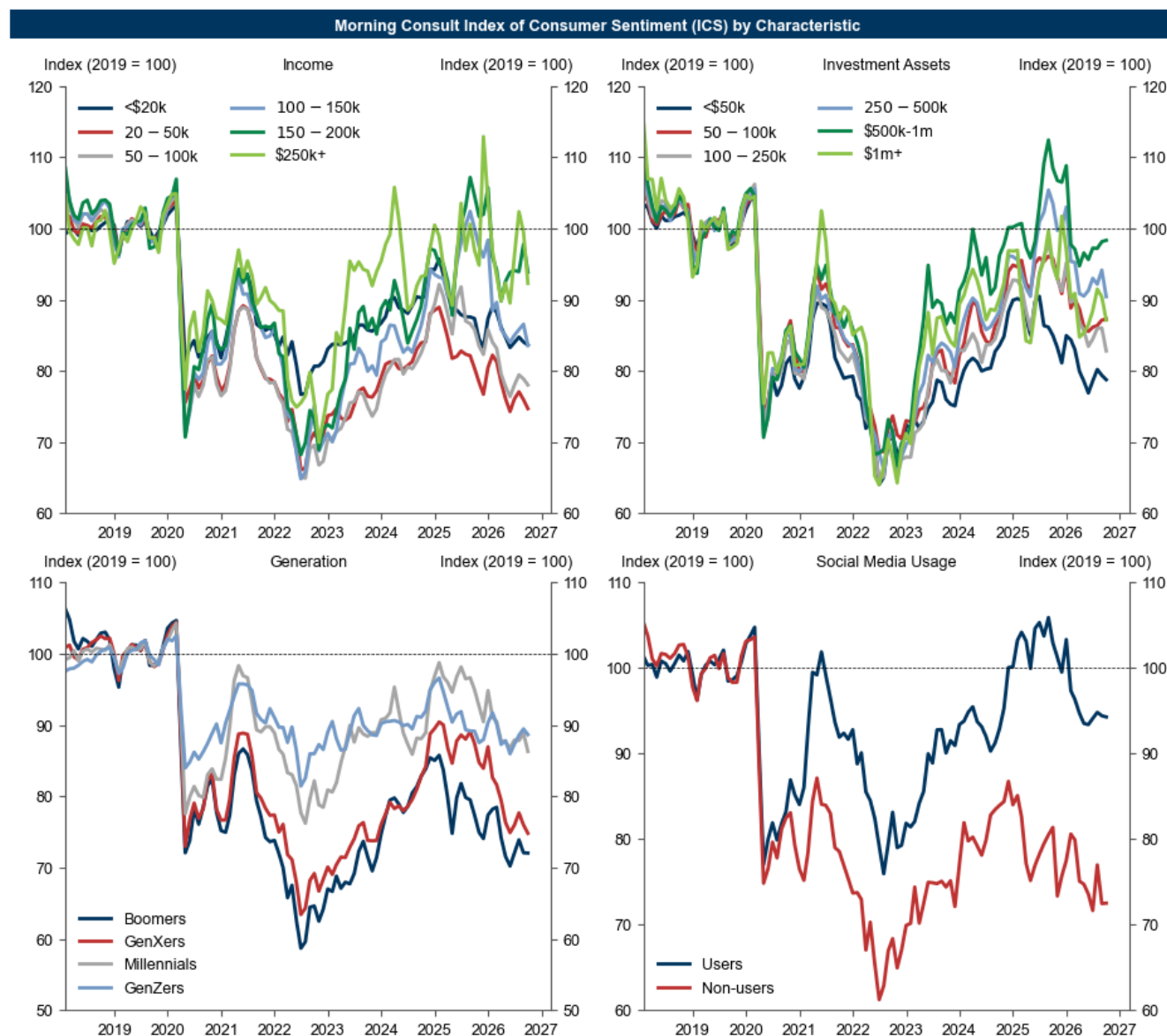
Source: Morning Consult, Goldman Sachs Global Investment Research

To help document the drivers of low sentiment, in [Exhibit 3](#) we use data from Morning Consult to compare sentiment trends across several different groups in the US. This exercise yields several striking patterns, some of which are surprising.

Intuitively, we find that sentiment has declined more and remained lower for lower-income (top left chart) and lower-wealth (top right chart) households. These patterns demonstrate that lower-socioeconomic households are disproportionately downbeat on the economy, consistent with narratives that that cost-of-living pressures and a K-shaped economy are weighing on sentiment.

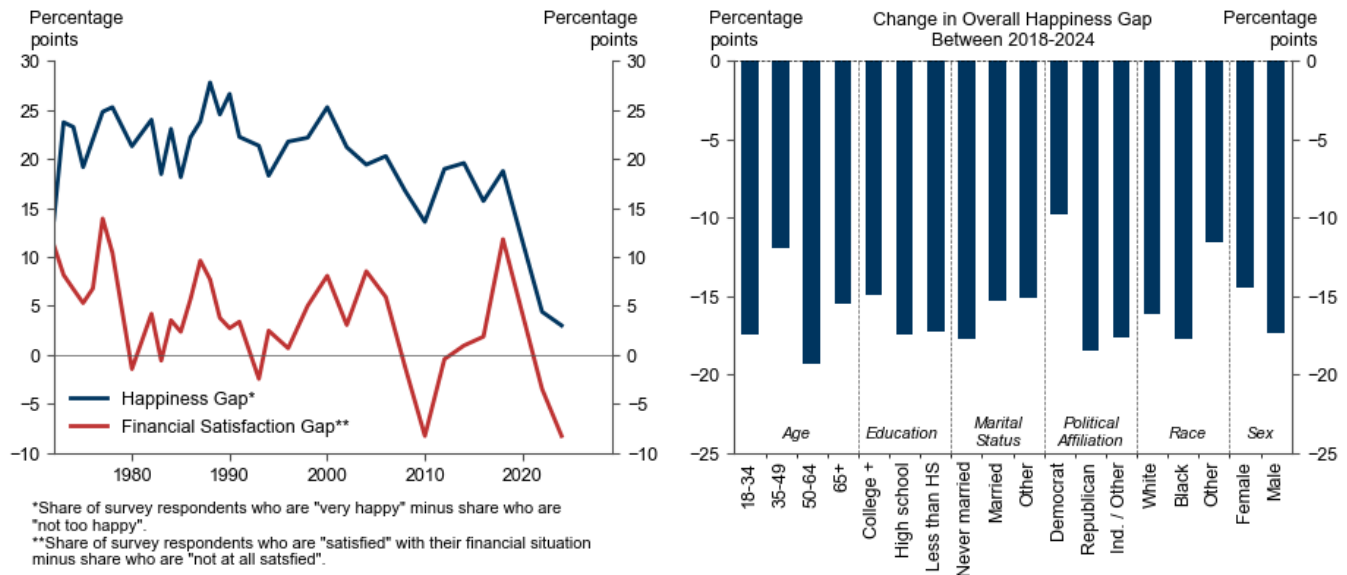
Less intuitively, we find that sentiment is lower for GenX and Baby Boomers than for Millennials and GenZ (bottom-left chart), a pattern that cuts against the common narrative that younger households disproportionately face sentiment headwinds from cost-of-living increases and AI-job-displacement (although it does align with longer-run trends showing that younger households are generally more optimistic on the economic outlook). Also on the less intuitive side, we find that sentiment is higher among social media users (bottom-right chart), and that this outperformance is robust after controlling for age effects (not shown). While academic research has found that social media usage has a negative effect on economic sentiment, this pattern suggests that the benefits from greater social engagement dominate any social media-induced headwinds.

Our key takeaway, however, is that the weakness in sentiment is quite broad. Sentiment remains below 2019 levels for all strata shown in Exhibit 3 (as well as combinations of these groups), and we also find that sentiment remains below 2019 levels for all political parties and for homeowners/renters. Simply put, it's hard to find a group that has positively revised their views on the economy since 2020.

Exhibit 3: Declines in Sentiment are Broad-based Across Demographic and Income Groups

Source: World Bank, Goldman Sachs Global Investment Research

One alternative explanation for weak sentiment recently proposed by UChicago economist Sam Peltzman is that people have generally become more downbeat on the state of the world for reasons unrelated to the economy. Indeed, survey data from the University of Chicago's General Social Survey (GSS)—which has been conducted every 2-4 years since 1972—shows a sharp decline in general happiness since 2020 that has yet to recover (left chart, Exhibit 4). This decline is outsized relative to the change in people's perception of their financial situation and is broad-based across all examined socioeconomic groups (right chart, Exhibit 4).

Exhibit 4: Overall Happiness Levels Have Declined Sharply Since 2020

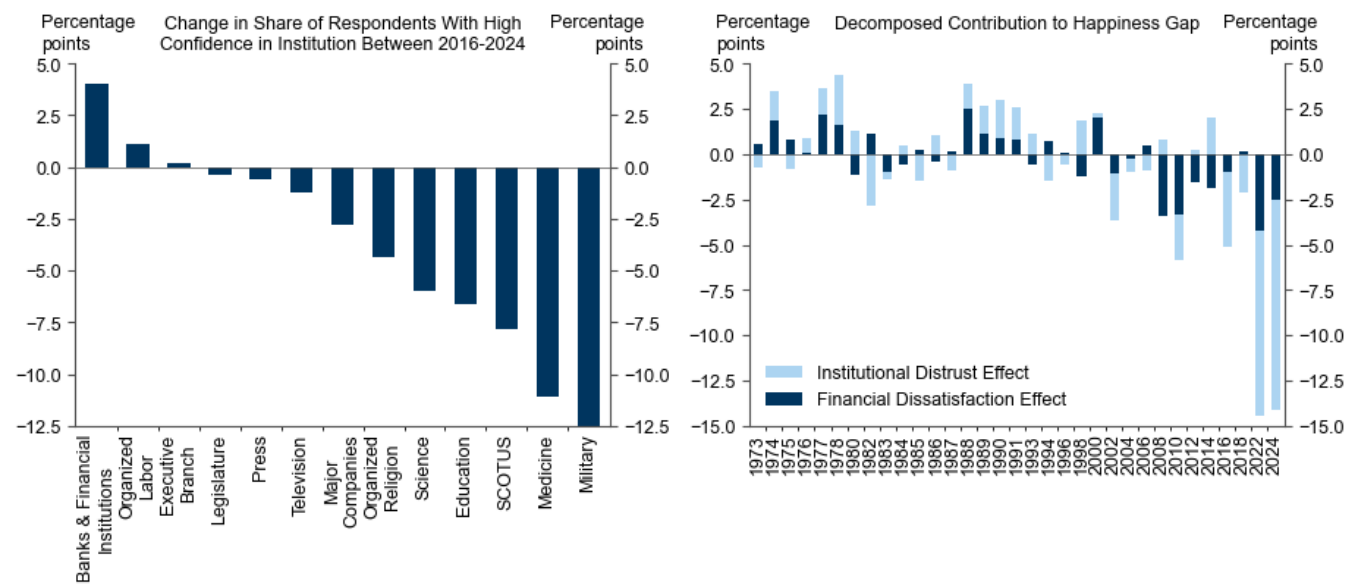
Source: University of Chicago, Goldman Sachs Global Investment Research

While there are several plausible explanations for the US population becoming more downbeat, the timing aligns with a perceived deterioration in societal and government institutions. The share of GSS respondents with “a great deal” of confidence has fallen for nearly all institutions since 2016 (left chart, [Exhibit 5](#)), with medicine and science, the military, education, and the Supreme Court seeing the largest declines.

While the declining confidence in US institutions is arguably a continuation of a long-run trend, it has increasingly correlated with lower happiness since 2020. To illustrate the strengthening relationship between declining institutional trust and happiness, we use the detailed survey microdata to construct an aggregate institutional distrust measure across the 13 institutions that respondents are asked about in the GSS. We then regress binary indicators of whether a respondent self-identified as being on this “institutional trust” proxy and use the regression results to decompose the happiness gap.

The results of this analysis are shown in the right chart of [Exhibit 5](#). We find that relative to historical averages, the decline in institutional trust explains a disproportionate amount of the decline in net happiness over the last few years. In contrast, the change in respondents’ perceived financial situations had a much smaller effect.

Exhibit 5: Falling Confidence in Societal and Government Institutions Since the Mid-2010s Has Contributed to the Happiness Decline



Source: University of Chicago, Goldman Sachs Global Investment Research

These results suggest that low reported economic sentiment likely reflects a more fundamental, downbeat assessment of the state of the world rather than the economy. Consumer sentiment may therefore not improve for the foreseeable future even if the economy continues to outperform, and, as a result, will likely remain a less useful tool for predicting economic dynamics.

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