12 June 2019

Sentiment dips as economy concerns outweigh policy boost

- **The Westpac-Melbourne Institute Index of Consumer Sentiment dipped 0.6% to 100.7 in June from 101.3 in May.**

This is a disappointing result given the cut in official interest rates this month and suggests deepening concerns about the economy have outweighed the initial boost from lower rates. Indeed, the Reserve Bank's move was widely anticipated and may well have 'franked' these concerns which would have solidified further following the disappointing national accounts figures released a day later. The March quarter GDP update showed growth slowing to just 1.8% at the start of the year, the slowest pace since the GFC in 2009 and a full percentage well below 'trend' of 2.75%.

Moves in the component indexes support this interpretation. The biggest decline was in the sub-index tracking expectations for the 'economy, next 12mths' which dropped 4.7% to be back in slightly pessimistic territory. In contrast, the 'finances, next 12mths' sub-index caught a decent 3.1% rise. That was despite the 'finances vs a year ago' sub-index weakening 2.4%, the mix implying that household finances remain under pressure but are expected to improve as lower interest rates and income tax relief comes through. Interestingly, the sub-index tracking longer term expectations for the economy showed a slight 1% improvement.

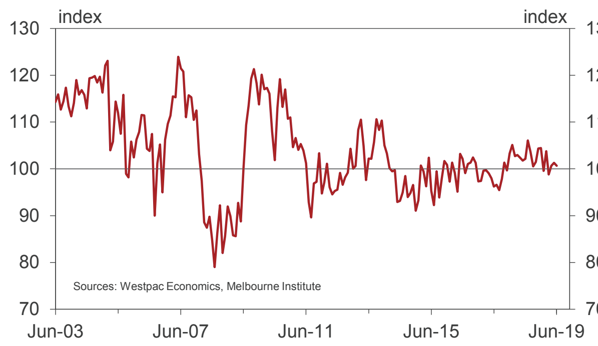
Attitudes towards spending were largely unchanged with the 'time to buy a major household item' sub-index dipping 0.2% to 115.5. The index has been stuck in a tight range well below the long run average of 127. With readings on current finances also weak this suggests consumer spending is likely to remain weak near term.

Responses over the survey week show a marked drop-off after the Reserve Bank's official rate cut. Responses collected before the June 4 decision had a combined index read of 106.8. Those collected after had a combined read of 95.5, with daily results showing a further softening after the weak GDP report.

The sub-group detail points to several factors affecting different consumer segments. The surprise Federal election result on May 18 produced a strong rise in sentiment amongst Coalition voters, up 7.5% in the month, but an even sharper decline amongst ALP voters (–9.9%). The associated change in outlook for tax policy around investor housing also produced a strong lift in sentiment amongst consumers with an investment property (+9.5%) and likely contributed to a fall in sentiment amongst renters (–5.3%). In contrast, sentiment amongst the mortgage belt showed a 2.8% rise, the gain reflecting the cut in interest rates but a more muted response than in previous cuts (sentiment in this segment surged 7% and 15% following the previous cuts in 2016).

Responses to additional questions on news recall provide some additional pointers to the factors influencing sentiment. The highest recall was for news on 'economic conditions' (31%); 'interest rates' (29%); and 'Budget and tax' (20%). Notably news around all three topics was assessed as less negative than in March, the last time these questions were run. There was a particularly sharp turnaround in 'Budget

Consumer Sentiment Index



and tax' news which was viewed as deeply negative in March but a slight positive in June – the personal income tax cuts announced in the April Budget and the Federal election result likely contributors. It should be noted that while Consumers Sentiment has dipped in this latest month, it is still 1.9% above its March level.

Consumer confidence in the labour market faltered again in June. The Westpac-Melbourne Institute Unemployment Expectations Index recorded a 5.1% rise, reversing all of the previous month's decline (recall that higher readings indicate that more consumers expect unemployment to rise in the year ahead). Expectations have been volatile in 2019 suggesting labour market conditions may be shifting. NSW and Vic showed particularly sharp rises in June, both up 7.9%. That said, the Index levels in these states and nationally are still slightly better than average.

Housing-related sentiment showed a clear response to the lowering in interest rates although again some of the gains were more muted than seen in past rate cuts. In particular, the 'time to buy a dwelling' index posted a 1.8% rise to 116.9, a rise but a subdued once compared to the 10%+ gains recorded following the previous cuts in 2016. Some of this likely reflects the mixed effects from the Federal election and rate move on views across different sub-groups – assessments amongst consumers with an investment property surged 8.5% but assessments amongst renter households dropped 8.7%.

Where policy changes have generated by far the biggest shift is around expectations for house prices. The Westpac-Melbourne Institute Index of House Price Expectations Index posted a spectacular 22.7% gain in June, moving from deep negative territory of 89.4 to a clear positive read of 109.7. This is the highest level since August 2018 but still well below the long run average read of 126. All states recorded sharp rises and net positive reads over the 100 mark. Overall, the mix suggests consumers see policy shifts as a clear positive for the price outlook but a much more mixed result for buyers in terms of affordability.

Responses to additional questions on the 'wisest place for savings' show a slight easing in risk aversion although it remains very high by historical standards. Consumers still heavily favour 'safe options', 64% nominating deposits, superannuation or paying down debt as the best place for savings. The proportion favouring real estate nudged up, but only slightly from 9% to 10% (still near historical lows). Likewise, the proportion favouring shares lifted from 7% to 10%. Despite the slight shift, the mix still points to risk that households increase savings rates further in the months ahead.

The Reserve Bank Board next meets on July 2. The initial sentiment reaction to the June rate cut will be somewhat disappointing for the Bank. It comes after a disappointing March quarter national accounts update that means the Bank will need to make a further downgrade to its growth forecasts. The case for further policy easing remains clear. We continue to expect a further 25bp cut to be delivered in August, the timing allowing the Bank to make a fuller assessment of the impact of its initial move and to provide a complete set of updated forecasts with its August Statement on Monetary Policy.

The labour market will remain a key focus for the policy profile. Westpac's more downbeat view on this front points to a further 25bp cut in November taking the cash rate to 0.75%.

Matthew Hassan, Senior Economist

Consumer Sentiment – June 2019

	avg*	Jun 2017	Jun 2018	May 2019	Jun 2019	%mth	%yr
Consumer Sentiment Index	101.5	96.2	102.1	101.3	100.7	-0.6	-1.4
Family finances vs a year ago	89.4	81.4	86.7	85.3	83.2	-2.4	-4.1
Family finances next 12mths	107.7	102.8	105.0	103.8	107.0	3.1	2.0
Economic conditions next 12mths	91.0	91.3	101.5	104.2	99.3	-4.7	-2.2
Economic conditions next 5yrs	91.3	88.6	95.0	97.3	98.2	1.0	3.4
Time to buy a major household item	127.3	117.1	122.4	115.8	115.5	-0.2	-5.6
Time to buy a dwelling	119.6	90.9	105.7	114.9	116.9	1.8	10.6
Unemployment Expectations Index	130.0	140.3	126.9	120.9	127.0	5.1	0.1
House Price Expectations Index	126.4	133.6	119.9	89.4	109.7	22.7	-8.6

Source: Westpac–Melbourne Institute

*avg over full history of the survey, all indexes except 'time to buy a dwelling', 'unemployment expectations' and 'house price expectations' are seasonally adjusted

Survey interviews are conducted by OZINFO Research on the telephone using trained interviewers. Telephone numbers and the household respondent are selected at random. This latest survey is based on 1200 adults aged 18 years and over, across Australia. It was coducted in the week from 3 June to 7 June 2019. The data have been weighted to reflect Australia's population distribution. Copyright at all times remains with the Melbourne Institute of Applied Economic and Social Research.

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