

11 July 2023

## Consumer sentiment fails to respond to the RBA's pause

- **Westpac-Melbourne Institute Consumer Sentiment rises by 2.7% to 81.3.**
- **A significant reported fall in inflation looks to have boosted confidence.**
- **Consumers remain wary about the interest rate outlook despite RBA's pause.**
- **Index remains in deeply pessimistic territory.**
- **Sustained lift only likely if inflation is much lower and rates are firmly on hold.**
- **Housing market sentiment lifts, albeit with buyer attitudes still very downbeat and price expectations rising at a slower pace.**
- **Confidence in the labour market steady around long run average levels.**

**The Melbourne Institute of Consumer Sentiment index rose by 2.7%, from 79.2 in June to 81.3 in July.**

Sentiment remains at the deeply pessimistic levels that have prevailed for just over a year now. The Index plunged 17% over the first half of 2022 and has barely budged since then, holding in the very weak 78-86 range. Even with the latest modest lift, the Index is still firmly in this range and 3% below its level of a year ago.

The main drags on sentiment throughout this period of depressingly low consumer sentiment have been the surging cost of living and sharply higher interest rates. Our research suggests inflation has been the more dominant factor.

As such, the key driver of this month's lift is likely to have been the reported easing in the ABS monthly inflation indicator, from 6.8% in April to 5.6% in May.

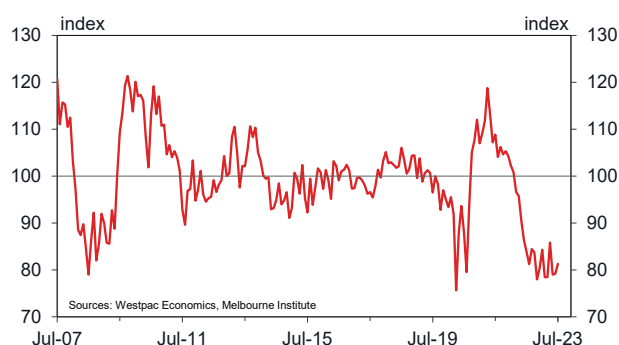
This is backed by responses over the course of survey week which suggest the RBA Board's decision to pause in July did nothing to boost confidence.

Sentiment was considerably more buoyant ahead of the RBA decision, with an index read of 88, up 11.2% on June. Presumably this captured the full effect of the better news on inflation which had printed in the previous week.

Post RBA responses showed a combined index read of 77.9, down 11.6% on the pre-RBA sample and down 1.6% on the June read. As discussed, the total sample for the week resulted in an overall lift of 2.7%.

The weaker post-RBA sentiment read is surprising but is in line with the last time the RBA opted to pause back in April. That decision also followed an improved inflation read for the month of February (a drop from 7.4% to 6.8%), which was reported in the week prior to the survey. While sentiment posted a 9.4% gain for April as a whole, it declined 7.3% between the pre- and post-RBA samples.

### Consumer Sentiment Index



Even judged by the full July sample result, the RBA's decision to pause in July does not appear to have resonated with consumers.

Notably, most commentators described the RBA's July decision as a temporary pause. Consumers agree with most expecting interest rates to move higher over the next year.

In fact, consumers are slightly more hawkish on the interest rate outlook than they were during the RBA's previous pause. Back in April, just over 23% of consumers surveyed after the RBA decision expected rates to be unchanged or lower over the following 12 months, while just over a third expected rates to increase by 1% or more. Despite rates being 0.5% higher in July, only 14% of consumers expect rates to be unchanged or move lower while 41% are bracing for a further big rise.

In summary, the responses suggest consumers are still clearly very nervous about the outlook for interest rates, particularly with the previous pause in April having been a 'false dawn'.

The key message is that sentiment is probably not going to stage a sustained lift from current deeply pessimistic levels until inflation is much lower and interest rates are firmly on hold.

The component sub-indexes showed the July gain was broadly based but offset by a weaker assessment of current finances.

The 'family finances vs a year ago' sub-index fell 4.9% to 62.2, returning to the extremely weak level seen in February. The detail shows the decline was led by consumers on lower incomes and renters which more than offset a slight improvement for mortgagors (albeit from a weaker starting point than other sub-groups).

Near term expectations showed the biggest gains in July. The 'family finances, next 12 months' sub-index surged by 6.8% to 89.7 and the 'economic outlook, next 12 months' sub-index rose 5.4% to 81.4. However, both sub-indexes are coming off bigger 10-12% falls over the previous two months. The July gain only clawed back part of the drop.

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The 'economic outlook, next five years' sub-index posted a more muted 1.7% rise to 94.3.

The 'time to buy a major household item' sub-index, capturing attitudes towards major purchases, was up 3.1% but, at 78.8, is still holding around historically weak levels.

The Westpac-Melbourne Institute Unemployment Expectations Index was about steady in July, dipping 0.1% to 131.2. However, the measure continues to point to a loss of confidence around jobs. The index is up 32% since the interest rate tightening cycle began in May last year. The July read is again above long run averages (recall that higher index reads mean more consumers expect unemployment to rise in the year ahead).

The RBA's rate pause does look to have eased some of the pessimism around housing. The 'time to buy a dwelling' index lifted by 6.2% in July. However, at 76.4, pessimists still heavily outnumber optimists, with the index still in the extremely weak 70-80 range that has prevailed since early 2022.

Consumer expectations for house prices continue to lift. The Westpac Melbourne Institute House Price Expectations Index lifted by 1.8% to 149.3 – optimists outnumbering pessimists by more than five to one. The index has surged by 45% since February, although expectations appear to have stabilised at very high levels over the last three months.

The Reserve Bank Board next meets on August 1.

From Westpac's perspective the dataflow, balance of risks and shifting RBA priorities favoured a rate increase at the Board's July meeting. The Board instead chose to pause, to await further information including the quarterly inflation report for June and the staff's revised forecasts due in early August.

This was the same motivation behind the RBA Board's pause in April and would have been consistent with a pause in January (albeit with no meeting scheduled for that month), and the Board's decision in October last year which saw a surprise taper from 0.5% increments to 0.25%.

But of most significance is that the Bank believes that full employment is 4.5% – nearly 1ppt above the current level. Full employment is defined as the unemployment rate which is consistent with the Bank's inflation objective. By that measure, the labour market currently poses a significant threat to achieving that objective.

If, as we expect, annual underlying inflation prints around 6.1% for the June quarter, and the unemployment rate continues to hold well below full employment, the case for higher rates will be clear.

We expect the Board to lift the cash rate by 0.25% at both the August and the September Board meetings before a long pause. The first rate cut in the subsequent easing cycle is expected next May

**Bill Evans, Chief Economist, Westpac Group**

## Consumer Sentiment – July 2023

| Item                               | avg*         | Jul 2021     | Jul 2022    | Jun 2023    | Jul 2023    | %mth       | %yr         |
|------------------------------------|--------------|--------------|-------------|-------------|-------------|------------|-------------|
| <b>Consumer Sentiment Index</b>    | <b>101.0</b> | <b>108.8</b> | <b>83.8</b> | <b>79.2</b> | <b>81.3</b> | <b>2.7</b> | <b>-3.0</b> |
| Family finances vs a year ago      | 88.7         | 93.7         | 72.0        | 65.4        | 62.2        | -4.9       | -13.6       |
| Family finances next 12mths        | 107.0        | 109.9        | 86.2        | 84.0        | 89.7        | 6.8        | 4.1         |
| Economic conditions next 12mths    | 90.8         | 109.5        | 80.3        | 77.2        | 81.4        | 5.4        | 1.3         |
| Economic conditions next 5yrs      | 92.0         | 110.5        | 91.6        | 92.7        | 94.3        | 1.7        | 3.0         |
| Time to buy a major household item | 125.3        | 120.6        | 88.8        | 76.4        | 78.8        | 3.1        | -11.3       |
| Time to buy a dwelling             | 121.5        | 96.9         | 80.1        | 72.0        | 76.4        | 6.2        | -4.6        |
| Unemployment Expectations Index    | 129.2        | 109.6        | 109.8       | 131.3       | 131.2       | -0.1       | 19.6        |
| House Price Expectations Index     | 125.8        | 158.3        | 104.9       | 146.7       | 149.3       | 1.8        | 42.3        |
| Interest Rate Expectations Index   | 153.9        | n.a.         | 183.9       | 178.9       | 174.8       | -2.3       | -4.9        |

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

The survey is conducted by OZINFO & DYNATA. Respondents are selected at random. This latest survey is based on 1200 adults aged 18 years and over, across Australia. It was conducted in the week from 3 July to 6 July 2023. 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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