

# Consumer Sentiment surges

- **The Westpac–Melbourne Institute Index of Consumer Sentiment increased by 5.6% in January from 113.8 in December to 120.1 in January.**

This is a very strong result. The Index is seasonally adjusted and therefore takes account of traditional January optimism. Nevertheless it is still above its level of last September prior to the Reserve Bank's record three consecutive rate increases over the three months from October to December.

In other convincing evidence that households appear to have comfortably absorbed the higher interest rates we note that the confidence of those respondents who currently hold a mortgage has reached its highest level since 1994 when we first collected data using categories defined by home ownership. These categories of the Index are not seasonally adjusted but suffice to note that the rise in the confidence of those respondents with a mortgage was up 16.7% in January compared to the average rise in January of 8.6%.

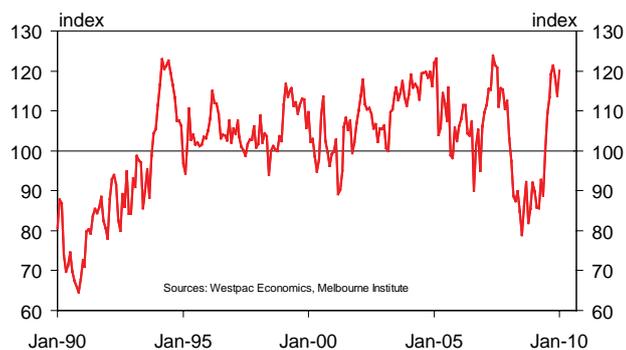
Clearly a major source of relief for households was the absence of a further rate increase. With no meeting of the Board of the Reserve Bank in January the record run of three consecutive monthly increases in interest rates was interrupted. The share market also supported confidence with a rise of 4.2% although petrol prices did increase by a solid 4.4%.

However it is likely that the most important fillip to confidence in the month was the continuation of positive surprises on the employment situation. Last week it was reported that the national unemployment rate had surprisingly fallen from 5.6% to 5.5% in December. An additional 35,000 jobs had been created in the month and the media is now speculating that the unemployment rate has peaked. Westpac certainly holds that view.

Supporting the importance of the jobs market in buoying confidence we note that over the course of 2009 the Westpac–Melbourne Institute measure of how households assess their job security has improved substantially.

Four of the five components of the Index increased in January. All components are seasonally adjusted. Assessments of "Family finances compared to a year ago" increased by 5.2%; expectations about family finances "over the next 12 months" increased by 10.5%. Expectations for "Economic conditions over the next 12 months" rose by 6.8% although expectations for "economic conditions over the next 5 years" fell by 2.1%. Opinions on whether it is a "good time to buy a major household item" rose by 7.7%.

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The Reserve Bank Board next meets on February 2. The evidence from this survey; the labour market; and recent trends in retail sales indicates that the Bank will be keen to move monetary settings back to a level where interest rates are no longer stimulatory for the economy. A recent speech from an RBA official indicated that such a level for their overnight cash rate might be expected to be around 4.5% compared to the current 3.75%. Accordingly we expect to see another rate hike of 0.25% to be announced by the Bank on February 2 with the likelihood of another two increases of 0.25% each by June

**Bill Evans**, Chief Economist