Media release

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Consumer sentiment falls on ‘Brexit’ and election concerns

The Westpac Melbourne Institute Index of Consumer Sentiment fell by 3% in July from 102.2 in June to 99.1 in July.

Westpac’s Chief Economist, Bill Evans, commented, “With the major events of ‘Brexit’ and prolonged election uncertainty it is not surprising to see a fall in the Index. In fact, given these developments, this fall appears to be surprisingly modest.

“The survey was conducted over the period July 4 to July 7. By the time of the survey market volatility associated with ‘Brexit’ had largely settled down and media commentary was, correctly in my view, concentrating on the implications for the UK economy rather than the initial reaction which speculated on some disastrous contagion for the whole of Europe. However concerns would have lingered for many respondents given the blanket publicity which the ‘Brexit’ development received.

“On the other hand election uncertainty persisted throughout most of the survey period. Respondents would have been particularly unnerved about the prospect of an inconclusive election result given the experience during the last ‘hung’ Parliament in 2010 to 2013.

“Consequently, to see the Index fall by only 3%, back to its level of March 2016 and still 4.2% above its April level is encouraging. Since the end of the survey period we have seen some welcome political certainty with the prospect of a hung Parliament avoided. It is reasonable to speculate that had the survey been conducted over the last few days the results would have been more positive.

“Furthermore, we expect the Reserve Bank to move to cut rates again following its meeting on August 2. Following the cut in May the Index surged by 8.5% putting it firmly in positive territory above 100, indicating optimists outnumber pessimists. With the Index currently poised only slightly below 100 we can be reasonably confident that the Index will be back above a 100 next month despite having to negotiate two major shocks in ‘Brexit’ and election uncertainty.

“With a 3% fall in the overall Index it is not surprising that respondents were a little less confident around the labour market. The Westpac Melbourne Institute Index of Unemployment Expectations rose 1.9% in July but the Index is still 4% below its level in April and, most importantly, 8.0% below its level of a year ago. Our assessment of that Index is that it is indicating a steady improvement in the labour market.

“Reflecting market volatility and political uncertainty, both components of the Index that relate to households’ assessments of their own finances were weaker. The sub-index tracking assessments of ‘family finances compared to a year ago’ fell by 5.2% while the ‘family finances over the next 12 months’ sub-index fell by 2.7%.

“Concerns about the short term economic outlook intensified with the component ‘economic conditions over the next 12 months’ falling by 6.1% although the 5 year outlook was steady.

“The sub-index tracking vies on ‘time to buy a major household item’ fell by 1.5%.

“Over the last 12 months the overall Index has increased by a healthy 7.4%. However that improvement has been dominated by the ‘economic outlook’ components which have risen by nearly 20% on average whereas the ‘family finances’ components have only improved by an average of 2.4%. Respondents may be buoyed by reports of overall improving economic conditions but they are not feeling the same improvement in their own financial position, pointing to a less encouraging basis for boosting consumer spending than may be implied by the overall Index.

“Signals in the housing market were mixed. The ‘time to buy a dwelling’ index fell by 1.8% to 101.8. This Index has been markedly weaker since the middle of last year although there has been no sign of further deterioration in 2016. On the other hand respondents are regaining their confidence in the outlook for prices. The Westpac Melbourne Institute Index of House Price Expectations lifted by 4.3% in July to its highest level since August last year and up around 17.3% on the average of the last quarter of last year.

“The Reserve Bank Board next meets on August 2. We expect that it will decide to further reduce the overnight cash rate to 1.5%. This will follow the decision to lower rates by 0.25% at its Board meeting in May. Westpac had not expected that move because we underestimated the significance which the Board had read into the March quarter inflation report. On the basis of that report the Board lowered its forecasts of underlying inflation in 2016 from 2.5% to 1.5% and in 2017 from 2.5% to 2.0% – the bottom of the Bank's target range. We do not believe that it would have made such significant changes to its assessment of the inflation outlook without being prepared to cut rates further. Indeed its own forecast of 2% in 2017 incorporated the market forecast of a further rate cut.

"With the AUD lifting above USD0.76 and the inflation target at risk it seems a sensible policy option to cut rates further.

"However we are mindful that despite cutting rates the Board did not lower its growth forecasts indicating that the motivation behind the May decision was entirely around the need to credibly achieve the inflation target over the forecast period. Rigid adherence to that policy in future might be questioned particularly, as hinted at in this survey, if the rate cuts spill over into excessive exuberance in asset markets. Hence we expect that this cut will, most likely, be the last in the current easing cycle", Mr Evans said.

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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 conducted in the week from 4 July to 7 July 2016. The data have been weighted to reflect Australia's population distribution.