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Media release

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Consumer optimism fades

The Westpac Melbourne Institute Index of Consumer Sentiment declined 2.3% to 103.6 in August from 106.1 in July.

Westpac Chief Economist, Bill Evans, commented, “The consumer mood deteriorated in August, giving back about half of the surprisingly strong gains seen in June and July. Those gains look to have been partly a positive response to the tax cuts announced in the May Budget, which passed into legislation in June, the first round of cuts coming into effect in July. The June-July gains also came against a backdrop of adverse developments on the global trade front and an emerging price correction in the Sydney and Melbourne housing markets.

“Despite the latest decline, the Index is still in positive territory overall, 5.5% above the average in 2014 to 2017. August marks the ninth successive month that the Index has been above the 100 level, indicating optimists outnumber pessimists, a clear turnaround on the twelve months in which 11 out of 12 readings were below 100.

“Reduced rate rise fears may also have contributed to the lift in sentiment since earlier in the year. Every six months we gauge respondents’ outlook for interest rates. Back in February, 58% of respondents expected rates to rise over the next year down slightly from 61% in August 2017. The proportion fell further to just below 50% in August 2018.

"All index components recorded declines in August, but the biggest falls were around expectations for the economy: the 'economic outlook, next 12 months' sub-index down 4.9% and the 'economic outlook, next 5yrs' sub-index down 3.1%. Both sub-indexes recorded strong gains last month. Despite the August pull-back, both 'economic outlook' sub-indexes remain well above their levels a year ago and 9-10pts above their long run averages.

"Consumer views around family finances showed a milder pull back in August but remain weaker overall. The 'finances vs a year ago' sub-index dipped 0.5% and the 'finances, next 12 months' sub-index declined 1.1%. Both remain 1-2pts below their long run averages. Household budgets have come under persistent pressure from a range of factors, including: slow growth in wages, rising electricity and petrol costs, and declining house prices.

"Consumers remain relatively downbeat on spending. The 'time to buy a major household item' sub-index declined 1.7%, giving up all of last month's firming. At 122.4, the sub-index is 5ppts below its long run average and well below the levels associated with buoyant spending conditions.

"Consumer views on unemployment continue to soften, pointing to a shift in labour market conditions. The Westpac Melbourne Institute Unemployment Expectations Index rose 2.8% to 129.3 and has now risen 7.2% from its February low (recall that higher reads mean more consumers expect unemployment to rise in the year ahead). The Index, which can also be viewed as a measure of consumers' sense of job security, is now back near its long run average levels, suggesting consumers expect little change in the unemployment rate over the next 12mths. That would in turn imply a continuation of the slower employment gains seen since the start of the year with employment growth over the first half of 2018 more in line with growth in the working age population. Whether the shift marks a more sustained turning point in the labour market – something that has been seen during the lead in to the last two Federal elections – remains to be seen.

“Consumer views around housing improved in August. The ‘time to buy a dwelling’ index posted a solid 5.5% gain and is now up 15.1% on a year ago and over 20% from its mid-2017 low. At 108.8, the index is at its highest level since September 2016. However, it remains well below the long run average of 120. The biggest lifts over the past year have been in Sydney and Melbourne where markets have seen significant price declines. Despite this, the average ‘time to buy a dwelling’ sub-indexes for these cities over the last three months has still been more subdued (102 and 101 respectively compared to 105.8 nationally). The easing rate rise fears evident in consumers’ mortgage rate expectations would have undoubtedly contributed to this lift in housing sentiment.

“Consumer expectations for house prices stabilised in August. The Westpac Melbourne Institute Index of House Price Expectations edged 0.3% higher to 112.8 in August. That followed a sharp 13.1% drop over the previous two months. Expectations showed solid gains in NSW and Vic (both up 4.8%), the states that had led the declines in June-July (down 22% and 23% respectively).

“The Reserve Bank Board next meets on September 4. Last week the Bank released its latest Statement on Monetary Policy which provided an update on its forecasts. Of most interest was a downward revision to the Bank’s inflation forecast for 2018 from 2.25% to 1.75%. If correct that would mark five consecutive years when headline inflation has printed below the bottom of the Bank’s 2-3% target band.

“The Reserve Bank still expects inflation to lift to 2.25% by 2020 and anticipates that the next move in the cash rate will be up. An obvious headwind to the Bank’s plan to move inflation back into the target zone is the impact that five years of underperformance in inflation will have on households’ and firms’ expectations. Lower expectations will make it that much more difficult to lift inflation back into the band. Price expectations impact households' wage expectations and claims, while firms’ pricing decisions are also influenced by expectations.

“Certainly it will be quite some time before the Bank has a case to adjust the cash rate.

“Westpac reaffirms its view that rates will remain on hold in both 2018 and 2019”, 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 6 August to 11 August 2018. The data have been weighted to reflect Australia's population distribution.