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Monthly Bulletin of Economic Trends: Households and Household Saving

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Housing and households

- **Consumption and savings:** *Household saving rates continue to decline and are approaching pre-GFC levels.*
- **Housing lending slows significantly:** *Annual growth in housing finance falls to its lowest level since 2010.*
- **Housing market uncertainty:** *The proportion of consumers anticipating large house price falls increases, although buying sentiment is still relatively weak.*
- **Outlook:** *Housing markets to continue favouring buyers in the near-term.*

Table 1: Outlook for Australia[1]

	Actual				Forecasts				Actual	Forecast
	2017	2017	2018	2018	2018	2018	2019	2019	Financial Year	
	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	2017/18	2018/19
Economic Activity										
GDP	2.7	2.5	3.2	3.4	3.3	3.3	2.9	2.7	**2.9**	**3.0**
	(0.7)	(0.7)	(1.1)	(0.9)	(0.6)	(0.7)	(0.7)	(0.7)		
Household Consumption	2.7	3.0	3.2	3.0	3.0	2.4	2.6	2.6	**3.0**	**2.6**
	(0.6)	(1.1)	(0.5)	(0.7)	(0.6)	(0.6)	(0.7)	(0.7)		
Private Dwellings	-2.3	-4.3	2.2	3.8	5.0	4.2	0.1	-2.1	**-0.2**	**1.7**
	(-1.7)	(0.3)	(3.6)	(1.7)	(-0.6)	(-0.5)	(-0.5)	(-0.5)		
New Business Investment	8.7	6.9	4.5	4.1	2.0	2.7	3.2	4.9	**6.0**	**3.2**
	(3.2)	(0.3)	(0.7)	(-0.2)	(1.2)	(1.0)	(1.2)	(1.4)		
Domestic Final Demand	3.6	3.4	3.7	3.4	3.2	2.9	2.7	2.9	**3.5**	**2.9**
	(1.0)	(0.9)	(1.0)	(0.6)	(0.7)	(0.7)	(0.7)	(0.7)		
Imports of Goods & Services	8.3	7.3	6.0	6.2	5.3	4.9	4.6	5.6	**6.9**	**5.1**
	(2.3)	(1.7)	(1.7)	(0.4)	(1.4)	(1.3)	(1.4)	(1.4)		
Exports of Goods & Services	5.1	0.2	4.9	3.7	4.1	7.0	5.2	5.4	**3.4**	**5.4**
	(1.0)	(-1.5)	(3.0)	(1.1)	(1.4)	(1.3)	(1.3)	(1.3)		
Inflation & Financial Market										
Underlying inflation[2]	1.8	1.8	1.9	1.9	1.8	1.9	1.9	2.0	**1.9**	**1.9**
	(0.4)	(0.4)	(0.6)	(0.5)	(0.4)	(0.5)	(0.5)	(0.6)		
Headline Inflation	1.8	1.9	1.9	2.1	1.9	1.8	1.8	2.0	**1.9**	**1.9**
	(0.6)	(0.6)	(0.4)	(0.4)	(0.4)	(0.5)	(0.5)	(0.6)		
90-day Bill Rate[3]	1.7	1.7	1.8	2.0	2.0	2.0	2.1	2.1		
Trade Weighted Index[4]	66.5	64.7	64.2	62.5	62.7	61.8	61.8	61.8		
$A/$US rate (100)[4]	0.79	0.77	0.77	0.77	0.73	0.72	0.72	0.72		
Labour Market										
Unemployment Rate[4]	5.5	5.5	5.5	5.4	5.2	5.2	5.2	5.2	**5.5**	**5.2**
Employment Growth Rate[5]	2.8	3.3	3.4	2.7	2.5	2.1	1.9	1.9	**3.0**	**2.1**
	(0.8)	(0.8)	(0.7)	(0.4)	(0.6)	(0.4)	(0.5)	(0.4)		
Participation Rate[4]	65.3	65.5	65.7	65.6	65.6	65.6	65.5	65.4	**65.5**	**65.5**
Wage Price Index	2.0	2.1	2.0	2.1	2.2	2.3	2.3	2.3	**2.1**	**2.3**
	(0.5)	(0.6)	(0.5)	(0.6)	(0.5)	(0.6)	(0.5)	(0.6)		

1: Actual in black and forecasts in blue; values in parentheses are quarterly growth rates. 2: As measured by the Reserve Bank's trimmed mean measure of inflation. 3: Average over last month in quarter. 4: Average of 3-months in the quarter. 5: Calculated from quarterly employment numbers that are averaged over the 3 months in the quarter. *Prepared by G. Lim and S. Tsiaplias, Macroeconomics@MI. Data in this report were finalized on 19/11/2018.*

Table 2: Key statistics for households

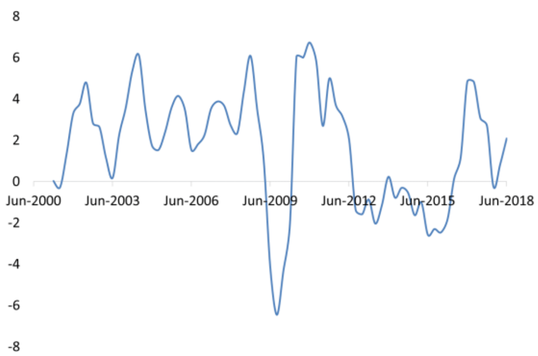
	Mar 2017	Jun 2017	Sep 2017	Dec 2017	Mar 2018	Jun 2018	Sep 2018	Fiscal Year 16/17	Fiscal Year 17/18
General									
Household consumption %pa	2.3	2.7	2.7	3.0	3.2	3.0	-	2.6	3.0
Disposable income %pa	4.8	3.1	2.7	-0.3	0.8	2.1	-	3.5	1.3
Savings ratio	3.9	2.5	2.4	2.4	1.6	1.0	-	3.8	1.9
Household debt to income ratio	183.1	186.9	187.0	188.1	189.6	190.5	-	182.4	188.8
Consumer sentiment	99.7	96.2	97.9	103.3	103.0	102.1	100.5	98.7	101.6
Housing									
House prices %pa	10.2	10.2	8.3	5.0	2.0	-0.6	-2.1	7.9	3.7
Housing debt to income ratio	134.6	136.9	137.7	139.0	140.1	140.7	-	134.1	139.4
Housing interest payments to income ratio	7.0	7.2	7.3	7.2	7.4	7.5	-	7.0	7.3
Housing finance %pa	1.3	2.1	4.8	4.7	2.5	0.4	-7.7	-0.9	3.1
Dwellings financed by first home buyers %	13.5	14.9	17.4	17.9	17.4	18.1	18.0	13.8	17.7
Consumer dwelling index	99.6	90.9	95.2	100.6	104.5	105.7	103.5	100.7	101.5
Wealth ratios									
Household assets to income	940.9	955.9	956.3	971.2	962.6	965.4	-	930.4	963.9
Housing assets to income	514.8	527.8	526.9	534.3	527.7	522.7	-	508.4	527.9
Household financial assets to income	395.7	397.7	398.9	406.5	404.4	412.3	-	391.5	405.5

* Values in blue do not include (unavailable) data for September 2018 and are therefore estimates.

The household savings conundrum

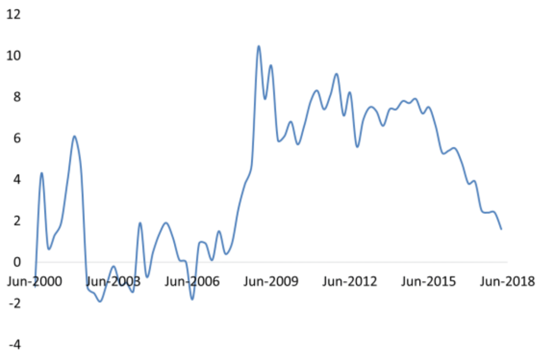
- In last month's MBET we saw that State Final Demand (SFD) rose across all five major states in the June quarter. Final demand grew particularly strongly for Victoria (+5.2% in annual terms and 1.2% for the quarter) and South Australia (+3.7% annually and +1.3% quarterly). Annual growth was reasonable for NSW and Queensland (approx. 3.5%), although growth over the quarter was weak (0.3% and 0.1%). As in previous quarters, Western Australia continues to lag the other states.
- In line with the results for the major states, aggregate consumption exhibited reasonable growth in the second quarter, albeit falling slightly from an annual growth rate of 3.2% in March to 3.0% in June. With the observation of June's result, our overall forecast of stronger consumption growth in 17/18 was confirmed with fiscal year growth of 3.0% compared to 2.6% for the 16/17 fiscal year (Table 2).
- As previously noted, however, there are a number of warning signs regarding household consumption growth in the short to medium term. Although disposable income growth has risen in the past two quarters (from a decline of 0.3% in December 2017), overall growth continues to remain relatively weak. In this respect, June's 2.1% annual growth is well below the 3.1% observed in the same quarter during 2017 (and the 4.8% observed in March 2017) (Figure 1).
- In line with the relatively weak growth of disposable income, the household savings rate has continued to decline. In June, the savings ratio fell further from 1.6 to 1.0. Over the course of the 17/18 fiscal year, the savings ratio fell to 1.9 which is well below the 3.8 observed in the 16/17 fiscal year (Table 2).
- Figure 2 shows a downward trend in the savings ratio commencing in 2015. Since then, the ratio has fallen from around 6 to its current value of 1. After spiking during the GFC, the post-GFC savings ratio hovered between 6 and 8 per cent until 2015. In the absence of any contrary evidence regarding household savings behaviour, it appears likely that the ratio will approach its pre-GFC value of approximately zero in the next few quarters.
- The decline in the savings rate is concerning if it is driven by constraints on household spending, rather than an amelioration of uncertainty and fear. In this respect, the combination of fairly persistent weak growth in household disposable income (Figure 1) and a downward trend in savings suggest that the decline is linked to household spending constraints. To examine this issue further, we consider the breakdown of retail spend by food and non-food items. Although imperfect, this breakdown provides a useful approximation of the extent to which household spend is allocated to 'needs' rather than 'wants'.

Figure 1: Household disposable income (per capita annual growth)



Source: ABS

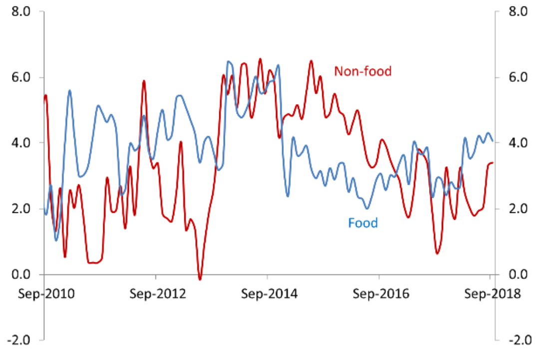
Figure 2: Savings ratio



Source: ABS

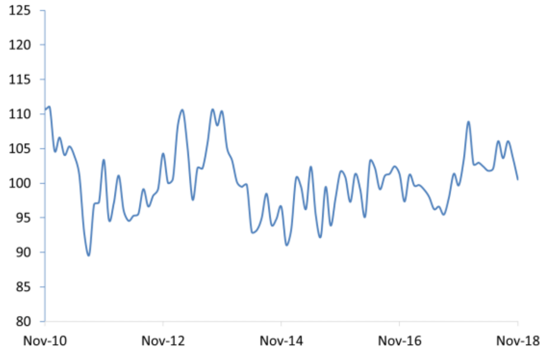
- The overall trends of food and non-food retail spend are presented in Figure 3. The figure shows a broad decline (from about 2015 onwards – about the same time the savings rate commenced its downward decline) in the proportion of retail spending allocated to non-food items. In recent months, this negative trend appears to have given way to greater volatility. In contrast, retail spend on food has been stable, and slowly rising in the past year or so.
- The breakdown suggests that the falling savings rate is attributable to both a normalisation of savings following the GFC-related spike and to the presence of liquidity constraints, with the latter likely to be the more dominant factor of the two in recent months. This interpretation is supported by the relatively flat consumer sentiment over the course of 2018, which fell slightly from 103.0 in March, to 102.1 in June and 100.5 in September (Figure 4, Table 1).
- Information that is indirectly related to spending constraints can also be gleaned from key ratios regarding household assets and debt. Figure 5 shows an abatement of the rapid rise in the assets to income ratio attributed to falling house prices, with Figure 6 showing that (even in the absence of changes to the cash rate) tighter lending conditions are leading to a gradual rise in the ratio of housing interest payments to household income.
- Given that banks will continue to pass-on any increases in credit costs, and that monetary policy will eventually enter a tightening phase, the housing interest payments to household income ratio will continue to increase over the medium term. Similarly, the assets to income ratio will probably experience significant headwinds, with the housing assets to income ratio likely to continue falling. Even in the June quarter, the assets to income ratio would have fallen were it not for unexpectedly strong financial market conditions. Nevertheless, this does not present any concerns for overall financial stability with household assets comfortably covering debt levels.

Figure 3: Retail trade (annual % growth)



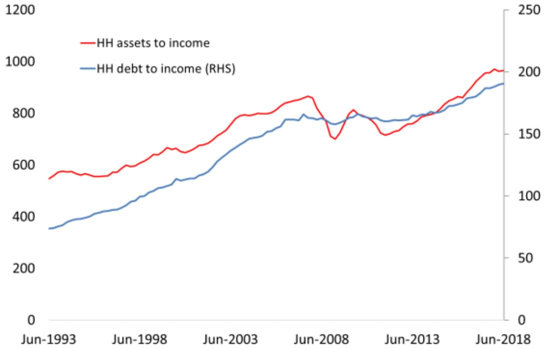
Source: ABS.

Figure 4: Consumer sentiment index



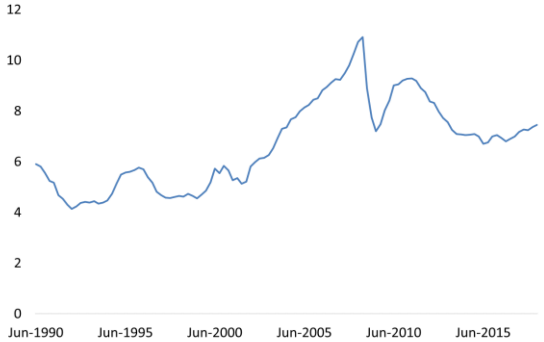
Source: MI

Figure 5: Household debt and asset ratios



Source: RBA.

Figure 6: Housing interest payments to disposable income ratio

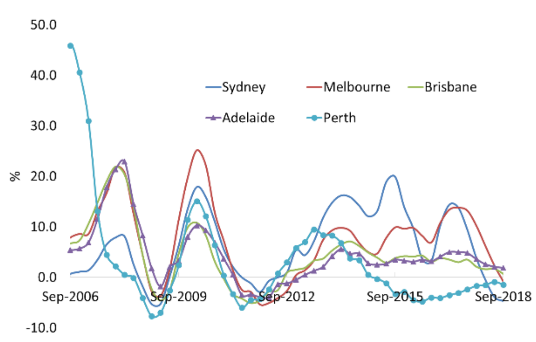


Source: RBA

The housing market continues its decline

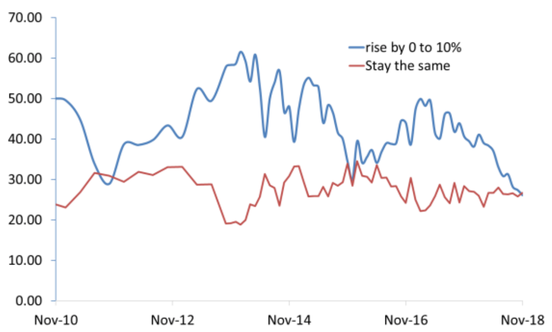
- In August's MBET we discussed recent research by Lim and Tsiaplias (2018) who examined the relationship between house prices and drivers such as interest rates.[1] The authors found that when interest rates fell below a certain threshold, the house price to income ratio was more likely to become unpredictable and unstable, potentially exhibiting periods of sharp changes and volatility.
- The authors also found that Australian housing markets are likely to exhibit greater sensitivity to factors such as housing supply, inflation and consumer expectations when interest rates are low. This can produce sharp changes in some cities but not in others.
- In recent months we have observed a sharp drop in auction clearance rates and a continued shift in pricing dynamics in favour of buyers rather than sellers. Clearance rates have fallen to below 50 per cent in the Melbourne and Sydney markets, with the overall clearance rate across major cities now at about 45 per cent. The overall clearance rate is now similar to the previous cyclical low in 2011 and likely to fall further.
- Figure 7 shows the annual growth in house prices for Sydney, Melbourne, Brisbane, Adelaide and Perth. Sydney and Melbourne have exhibited significant falls and are now in the negative range. The corresponding absence of any major falls in Brisbane, Adelaide and Perth is likely to be attributable to their already weak growth levels rather than any excess demand in those markets. Overall, the two-speed housing market observed in recent years appears to have converged to a single market exhibiting zero or negative growth.
- The Melbourne Institute's House Price Expectations Index shows that consumers are increasingly pessimistic about house price growth (Figure 8). In November, the proportion of consumers expecting house prices to rise by 0 to 10 per cent fell to approximately 1 in 4 consumers. At this time last year, 40 per cent of consumers were expecting house prices to rise between 0 and 10 per cent. November's value reflects a declining trend in house price optimism that commenced early this year. The current proportion of consumers expecting house prices to rise is at its lowest point since data collection began in 2009.
- Earlier commentary by some economists suggested that a house price decline would require some form of economic shock (in particular higher interest rates or a rise in unemployment). It is clear, however, that this reasoning was misguided. Notwithstanding relatively low interest rates and unemployment, both house prices and housing expectations have declined significantly.

Figure 7: House price changes (% annual)



Source: ABS.

Figure 8: House price expectations



Source: MI.

[1] Lim, G.C. and Tsiaplias, S. (2018). Interest Rates, Local Housing Markets and House Price Over-reactions, *Economic Record* 94(S1), pp. 33-48, https://doi.org/10.1111/1475-4932.12402.

First home buyers appear hesitant a one-off jump in activity

- The 2017 stamp duty exemptions announced by the Victorian and NSW governments produced an immediate jump in the proportion of first home owners in NSW and Victoria. Further information on this is available in the February and May issues of MBET. Although the stamp duty exemptions did not appear to produce a positive trend in the proportion of first home buyers, they did, however, lead to a positive jump in first home buyers. Most of the shift took place over July and August where the proportion of first home buyers rose by 4.1 per cent in NSW and 3.9 per cent in Victoria.

- In August's MBET it was noted that, notwithstanding weaker house prices and stamp duty exemptions, it was not clear that first home buyer activity would continue to rise. In particular, it was argued that significant house price depreciation would be required to induce any meaningful increase in first home buyer activity (over and above that stemming from existing first home owner stamp duty exemptions).

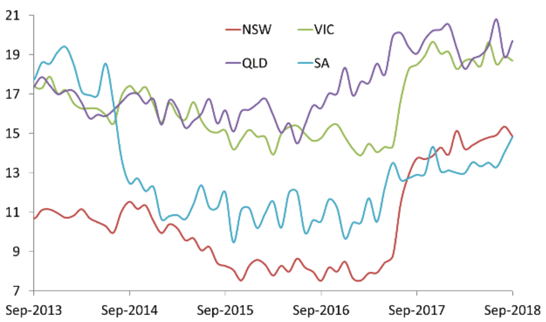
- Figure 9 shows the proportion of first-home buyers in NSW, Victoria, Queensland and South Australia. In September, the proportion of first home buyers in NSW fell slightly to 14.85 per cent (from 15.3 per cent in August), with the proportion in Victoria also falling from 18.9 per cent in August to 18.7 per cent in September. In contrast, first home buyer proportions rose in Queensland and South Australia to 19.8 and 14.1 per cent respectively (from their August values of 19.1 and 13.5 per cent).

- A critical issue in recent housing market activity, and the proportion of first home owners, is the extent to which banks are willing to lend for housing purposes. Table 1 indicates that annual growth in housing finance fell by 7.7 per cent in September. This is the largest fall since November 2010. It has yet to reach, however, the overall size of declines observed during the GFC and in the early 2000s suggesting that further tightening in the provision of housing finance should not be surprising (Figure 10).

- Given the declining growth in housing finance, and the additional restrictions that have been imposed on investment-related housing finance, one may expect owner-occupier activity to increase relative to investment activity. However, the proportion of housing finance provided to (non-development) investors rose from 29.5 per cent in July to 30.5 per cent in September. In contrast, the proportion of housing-finance provided to owner-occupiers (excluding refinancing) fell from July's 47 per cent to 45.5 per cent in September.

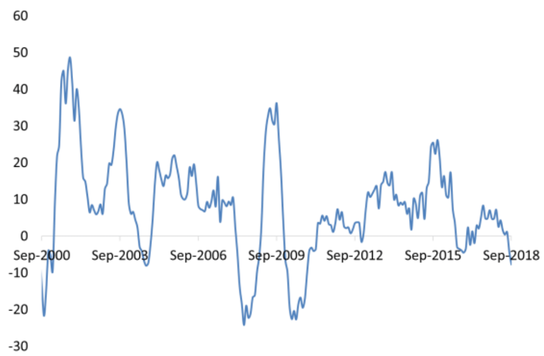
- The observed hesitance of owner-occupiers seems to be consistent, with both: (i) the August MBET's appraisal that housing prices continue to remain high for first-home owners, and (ii) the negative housing sentiment shared by consumers (Figure 8).

Figure 9: Proportion of first home buyers



Source: ABS.

Figure 10: Housing finance (annual percentage change)

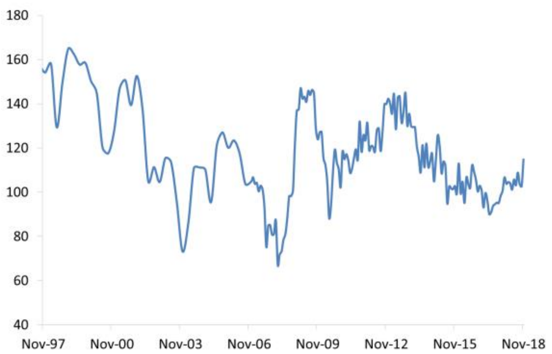


Source: ABS.

Looking forward…

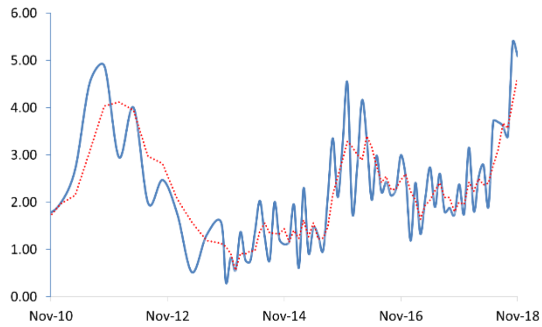
- The current decline in housing market activity indicates that, even in the absence of significant monetary policy tightening or a decline in labour market conditions, auction clearance rates and house prices can exhibit significant volatility.
- Housing finance growth has also declined, albeit not to the levels observed during the GFC. Furthermore, the distribution of housing related finance shows that the proportion of housing finance for owner-occupier refinancing is currently at its highest point since 2016 (at 21 per cent). This suggests that households are generally more interested in taking advantage of low interest-rate conditions than participating in the current housing market.
- To get a better picture of future housing market conditions, it is useful to consider the Melbourne Institute’s Dwelling Sentiment Index. This index examines directly whether households believe it is a good time to buy a dwelling. It therefore looks at both the price and non-price considerations of households.
- Figure 11 show a downward trend in dwelling sentiment from about 2012 to 2016 before plateauing. In recent months, however, dwelling sentiment has shown some signs of recovery. In November, the index rose to 114.8 compared to its value of 102.6 last month and 98.3 at this time last year. This suggests that consumers observe an improvement in buying conditions, at least relative to the conditions in recent years. Nevertheless, sentiment remains below its long-term average (approximately 117) and well below its previous high of 145 in September 2013.
- In August’s MBET we considered the stability of housing markets and argued that a useful forward-looking measure of housing market stability is to examine the extent to which consumers expect inordinate house price changes. To examine this, we use the Melbourne Institute’s House Price Expectations Index and focus on the extent to which individuals expect house prices to fall by more than 10 per cent.
- In August, around 3.7 per cent of survey respondents anticipated house prices to fall by more than 10 per cent. In October this proportion rose sharply to 5.4 per cent, before falling slightly in November to 5.1 per cent. Figure 12 shows that, in October and November, the number of individuals expecting significant (greater than 10 per cent) house price falls rose to their largest level since the House Price Index commenced in 2009.
- Despite the sharp rise in the proportion of consumers expected large price falls, dwelling sentiment is still muted (albeit rising). These two statistics suggest that further falls are required before buying conditions exhibit a material improvement. As such, housing markets are likely to continue favouring buyers in the short term.

Figure 11: Dwelling sentiment (Good time to buy a dwelling)



Source: MI.

Figure 12: Proportion of respondents expecting house prices to fall by more than 10 per cent



Source: MI. Red dashed line is 3-mth moving average.

Table 3: Precision of year-ended Forecasts for Australia

	Precision of (year-end) Forecasts				
	2018 Sep	2018 Dec	2019 Mar	2019 Jun	Financial Year 2018/19
	Australia				
Economic Activity					
GDP	0.6	0.9	1.1	1.2	**0.7**
Consumption	0.5	0.8	1.0	1.1	**0.7**
Dwelling	2.3	2.4	2.5	2.8	**1.9**
Business Investment	5.2	6.0	6.7	7.5	**4.6**
Import	2.5	4.2	5.8	6.6	**3.7**
Export	2.6	3.4	4.0	4.4	**2.9**
Inflation & Financial Market					
Underlying Inflation		0.2	0.3	0.4	**0.3**
Headline Inflation		0.4	0.5	0.7	**0.6**
90 day bill		0.3	0.5	0.7	**0.6**
Trade Weighted Index		3.3	3.7	3.9	**2.3**
Labour Market					
Unemployment Rate		0.1	0.2	0.3	**0.3**
Employment		0.2	0.4	0.5	**0.5**
Participation Rate		0.2	0.3	0.4	**0.3**
Wage Price Index	0.4	0.5	0.6	0.7	**0.4**

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