MELBOURNE INSTITUTE
Applied Economic & Social Research

Monthly Bulletin of Economic Trends: Households and Household Saving

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Housing and households

- **Consumption and savings:** *Key economic drivers such as household disposable income and consumption growth weaken further.*
- **First home owner activity rises:** *As investor activity declines, first home owner activity is now at its highest level since 2012.*
- **The changing housing landscape:** *An increasingly greater proportion of households are sensitive to housing costs, with ramifications for consumption growth.*
- **Outlook:** *Survey data suggests a growing proportion of consumers believe that house prices will rise over the next 12 months.*

Table 1: Outlook for Australia[1]

	Actual				Forecasts				Actual	Forecast
	2018	2018	2018	2019	2019	2019	2019	2020	Calender Year	
	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	2018	2019
Economic Activity										
GDP	3.1	2.8	2.4	1.8	1.5	1.7	2.2	2.5	**2.8**	**1.8**
	(0.9)	(0.3)	(0.2)	(0.4)	(0.5)	(0.5)	(0.7)	(0.6)		
Household Consumption	2.9	2.6	2.0	1.8	1.2	1.3	1.5	1.8	**2.6**	**1.4**
	(0.8)	(0.3)	(0.4)	(0.3)	(0.2)	(0.4)	(0.6)	(0.6)		
Private Dwellings	5.1	7.1	3.5	-3.1	-6.6	-8.8	-7.5	-6.6	**4.7**	**-6.5**
	(1.7)	(0.7)	(-2.9)	(-2.5)	(-2.0)	(-1.8)	(-1.5)	(-1.5)		
New Business Investment	3.7	-1.5	-1.2	-1.3	0.4	3.5	4.7	5.7	**1.4**	**1.8**
	(-0.5)	(-1.7)	(0.3)	(0.6)	(1.2)	(1.4)	(1.5)	(1.5)		
Domestic Final Demand	3.2	2.8	2.4	1.6	1.4	1.5	1.7	2.3	**2.9**	**1.6**
	(0.6)	(0.5)	(0.4)	(0.1)	(0.4)	(0.5)	(0.7)	(0.6)		
Imports of Goods & Services	6.7	1.9	1.2	-0.5	-0.6	1.3	1.5	2.2	**3.9**	**0.4**
	(0.6)	(-1.4)	(0.4)	(-0.1)	(0.5)	(0.5)	(0.6)	(0.6)		
Exports of Goods & Services	4.9	3.9	4.8	1.7	1.6	2.4	3.6	3.2	**5.0**	**2.3**
	(1.3)	(0.0)	(-0.5)	(1.0)	(1.1)	(0.8)	(0.7)	(0.6)		
Inflation & Financial Market										
Underlying inflation[2]	1.7	1.7	1.8	1.6	1.6	1.5	1.4	1.5	**1.8**	**1.5**
	(0.5)	(0.4)	(0.5)	(0.3)	(0.4)	(0.3)	(0.4)	(0.4)		
Headline Inflation	2.1	1.9	1.8	1.3	1.6	1.4	1.3	1.7	**1.9**	**1.4**
	(0.4)	(0.4)	(0.5)	(0.0)	(0.6)	(0.3)	(0.4)	(0.4)		
90-day Bill Rate[3]	2.0	2.0	2.0	1.9	1.3	1.3	1.3	1.3		
Trade Weighted Index[4]	62.5	62.6	62.0	60.9	60.2	60.2	60.2	60.2		
$A/$US rate (100)[4]	0.77	0.73	0.73	0.72	0.70	0.70	0.70	0.70		
Labour Market										
Unemployment Rate[4]	5.4	5.2	5.0	5.0	5.1	5.2	5.3	5.2	**5.3**	**5.2**
Employment Growth Rate[5]	2.7	2.4	2.3	2.3	2.5	2.3	2.0	1.8	**2.7**	**2.3**
	(0.4)	(0.6)	(0.7)	(0.6)	(0.6)	(0.4)	(0.4)	(0.4)		
Participation Rate[4]	65.6	65.5	65.6	65.7	65.9	65.9	65.8	65.7	**65.6**	**65.8**
Wage Price Index	2.1	2.3	2.3	2.3	2.3	2.1	2.1	2.1	**2.2**	**2.2**
	(0.6)	(0.6)	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)		

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* 26/8/2019.

Table 2: Key statistics for households

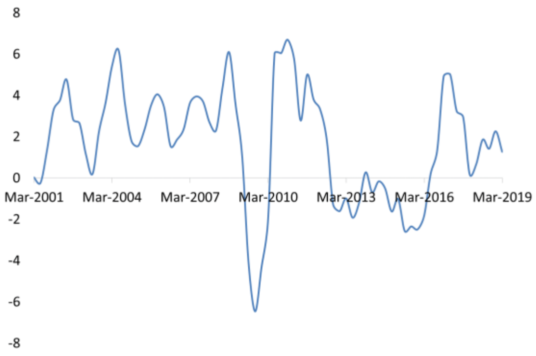
	Dec 2017	Mar 2018	Jun 2018	Sep 2018	Dec 2018	Mar 2019	Jun 2019	Fiscal Year 16/17	17/18
General									
Household consumption %pa	2.8	2.9	2.9	2.6	2.0	1.8	--	2.4	2.8
Disposable income %pa	0.1	0.6	1.8	1.3	2.1	1.3	--	3.6	1.3
Savings ratio	4.2	3.9	2.9	2.3	2.5	2.8	--	4.9	3.8
Household debt to income ratio	186.9	187.7	188.9	188.6	189.4	189.7	--	181.8	187.4
Consumer sentiment	103.3	103.0	102.1	100.5	104.4	98.8	100.7	98.7	101.6
Housing									
House prices %pa	5.0	2.0	-0.6	-1.9	-5.1	-7.4	-7.6	7.9	3.7
Housing debt to income ratio	138.0	138.5	139.3	139.4	140.1	140.1	--	133.8	138.2
Housing interest payments to income ratio	7.2	7.3	7.4	7.5	7.6	7.6	--	7.0	7.3
Housing finance %pa	-1.3	-5.2	-5.1	-10.1	-15.8	-15.3	-14.6	4.5	-2.5
Dwellings financed by first home buyers %	17.9	17.4	18.1	18.0	17.7	18.0	19.5	13.8	17.7
Consumer dwelling index	100.6	104.5	105.7	103.5	110.3	116.6	116.9	100.7	101.5
Wealth ratios									
Household assets to income	961.7	955.1	957.0	952.5	930.9	927.0	--	926.9	955.2
Housing assets to income	529.6	526.2	519.5	511.2	499.2	483.5	--	506.3	524.2
Household financial assets to income	402.6	400.0	409.1	413.5	404.4	416.5	--	390.2	401.8

* Values in blue are estimates.

Household income growth continues to be weak

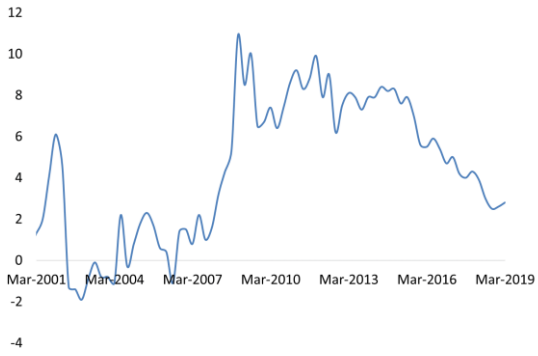
- In last month's MBET, we saw that March quarter State Final Demand (SFD) grew in three out of the five mainland states. Queensland recorded the strongest quarterly SFD growth of 0.5 per cent, followed by NSW (up 0.4 per cent) and Victoria (up 0.2 per cent). In contrast, SFD declined in South Australia (down 0.2 per cent) and Western Australia (down 0.3 per cent). However, much of the growth in Queensland and NSW was influenced by public investment which grew by 7.5 per cent and 3.2 per cent respectively. Meanwhile, public investment declined by 2.3 per cent in Victoria.
- Overall, aggregate consumption growth in the March quarter was subdued, consistent with the moderate demand growth observed across the major states. Annual aggregate consumption grew by 1.8 per cent in the first quarter, after growing by 2.0 per cent and 2.6 per cent in the preceding two quarters. March growth in household consumption was well below the average observed in both the 17/18 fiscal year (2.8 per cent), and the 16/17 fiscal year (2.4 per cent) (Table 2).
- Growth in per capita disposable income continued its weak run in the March quarter, rising by a disappointing 1.3 per cent compared to 2.1 per cent in the December 2018 quarter. This is consistent with the average growth observed in the 17/18 fiscal year (1.3 per cent), but significantly lower than the 3.6 per cent average growth observed in the 16/17 fiscal year (Figure 1). As noted previously, the absence of any meaningful wage growth is a key issue. Notwithstanding low inflation, weak growth in wages is a drag on both disposable income and household spending. This is particularly important for discretionary spending.
- The household savings rate increased slightly in the March quarter, rising from 2.5 per cent to 2.8 per cent. However, in line with the weak growth for disposable income, a clear downward trend is evident in the savings rate which appears to be moving towards pre-GFC levels. Accordingly, the current savings rate is well below the 3.8 per cent observed over the 17/18 fiscal year and the 4.9 per cent in the 16/17 fiscal year (Table 2).
- To better appreciate the magnitude of the decline in the savings rate, Figure 2 shows the household savings rate since 2000. After spiking in 2008 and remaining at elevated values until about 2015, it has since declined significantly. At present, there is little evidence to suggest that this downward trend will change in the short to medium term. Some of this decline is expected (as it represents a shift away from the spike observed during the peak of the GFC). However, it is likely that the current primary factor driving the decline is not related to falling risk aversion but to weak growth in household income which curbs the capacity of households to save.

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



Source: ABS

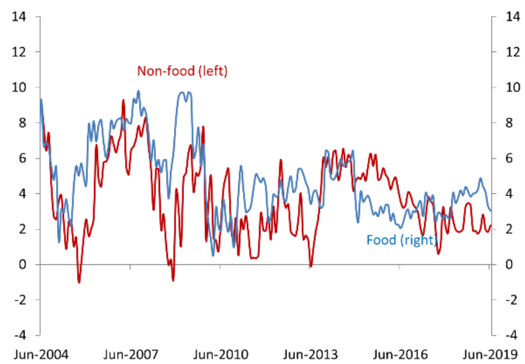
Figure 2: Savings ratio



Source: ABS

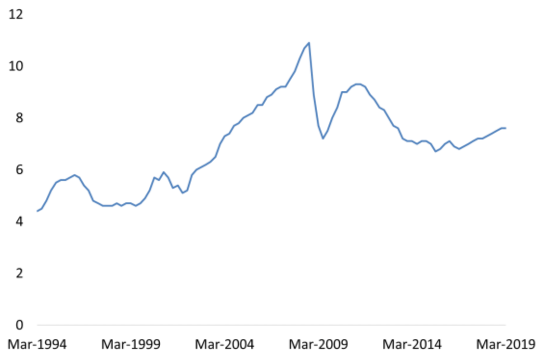
- Figure 3 depicts annual growth in food and non-food retail spend since 2004. Historically, both have moved in a fairly similar fashion. Two key properties are observable in the data. First, there is a clear decline in the growth rate of retail spend generally (at least relative to the value observed from 2004 up until the onset of the GFC). Second, there appears to be a greater divergence between the two growth rates from about 2013 onwards. Initially, non-food spend outpaced food related spend. From 2017, a shift appears away from non-food retail spend towards food-related retail spend. Thus far in 2019, annual growth in food retail trade has been growing at approximately double the rate of non-food retail spend (with an average annual growth rate of 4.0 per cent, as compared to 2.1 per cent for non-food retail spend).
- Housing interest payments as a share of disposable income have continued their slow but steady rise, as Figure 4 shows. This is consistent with the observed rise in the housing debt to income ratio, which is now at 140.1 relative to 133.8 during the 16/17 fiscal year (Table 2). At the same time, steadily falling housing prices have curbed household wealth (Figure 5), leading to meaningful falls in housing asset to income ratios (although these have been partially offset by a recent rise in financial markets). These trends suggest that the recent rate cuts have been sensible, particularly since they will reduce pressure on interest payments in the short to medium term (leading to a likely divergence – at least in the short term - between the above indicators of household financial conditions).
- The Melbourne Institute's consumer sentiment survey indicates that sentiment is subdued. Figure 6 shows a relatively volatile level of movement in consumer sentiment in the past few months. After rising in November and December 2018, to about 104), sentiment has fallen over the course of 2019 and was recorded at 96.5 in July. This is below the benchmark level of 100, indicating that the proportion of people that are pessimistic exceeds those that are optimistic. It remains to be seen whether recent rate cuts will be able to shift sentiment.

Figure 3: Retail trade (annual % growth)



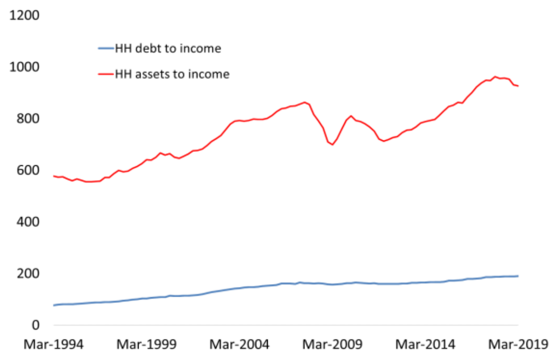
Source: ABS

Figure 4: Housing interest payments to disposable income ratio



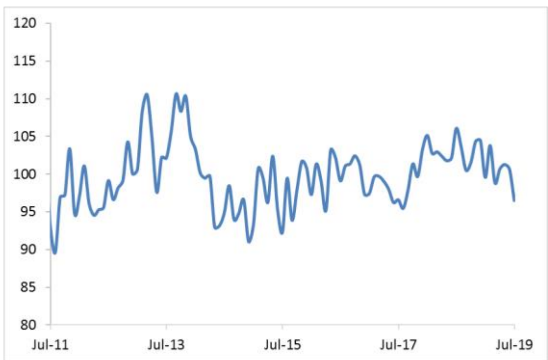
Source: RBA

Figure 5: Household debt and asset ratios



Source: RBA

Figure 6: Consumer sentiment

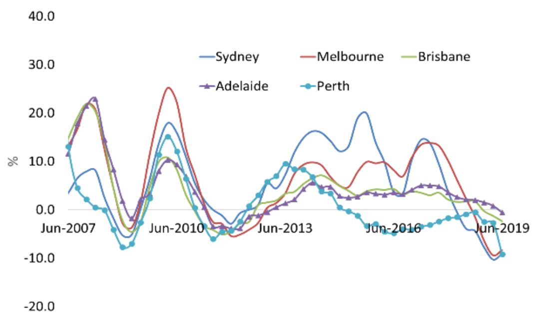


Source: MI

Housing markets likely to have seen their worst, first home buyer activity on the rise

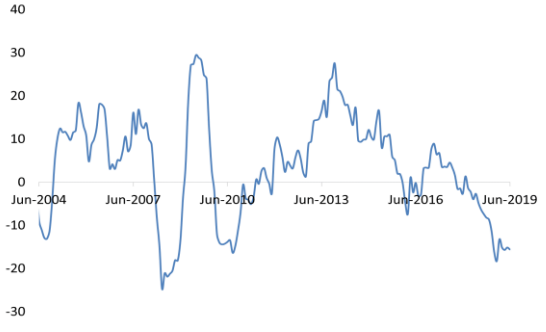
- In May's MBET it was noted that auction clearance rates in the two major cities had risen to about 55 per cent, albeit on relatively low volumes. Since then, clearance rates have continued to rise to approximately 65 per cent. By comparison, in the latter half of 2018 clearance rates had fallen to well below 50 per cent in the Melbourne and Sydney markets. Although clearance rates have risen, volumes continue to be well below those observed in recent years suggesting that underlying market conditions are still relatively weak
- Figure 7 shows a common downward trend in housing growth across Australia. Annual growth in house prices has fallen for all major cities. Recent data suggest that the Sydney and Melbourne markets fell by around 10 per cent (in annual terms) in the March quarter, and by a slightly smaller amount in the June quarter (indicating that the worst of the declines may have been observed in early 2019).
- In line with the decline in housing transaction volumes, annual growth in housing finance remains at levels not seen since the sharp drop observed during the GFC (Figure 8). Recent data, however, suggests a possible bottoming out with June quarter growth rising to -14.6 per cent (from -15.8 and -15.3 in the preceding two quarters). Recent rate cuts should lead to at least some improvement in housing finance growth rates.
- The decline in house prices, and curbing of investor credit, has led to a significant rise in first home buyer activity over the past few months (Figure 9). The proportion of first home owners is about 17 per cent in NSW and 21 per cent in Victoria (with investor activity declining, first home buyer proportions in NSW and Victoria are now at their highest levels since 2012).
- Consistent with the increase in first home buyer activity, the Melbourne Institute's House Price Expectations Index gauges shows a sharp fall in the proportion of consumers expecting house prices to fall over the next 12 months. Accordingly, the number of consumers expecting prices to stay the same or to rise by up to 10 per cent has risen sharply (Figure 10).

Figure 7: House prices (annual percentage change)



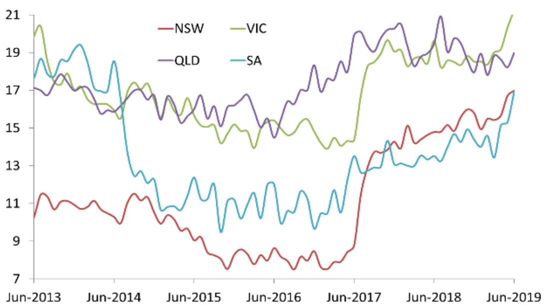
Source: ABS. CoreLogic.

Figure 8: Housing finance (annual percentage change)



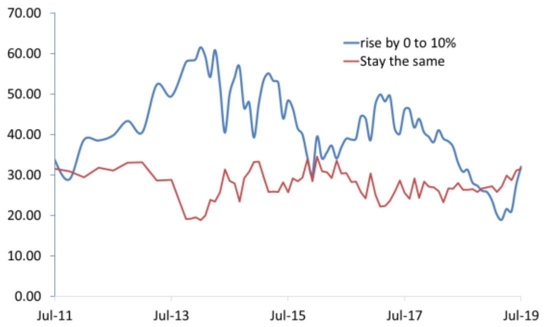
Source: ABS.

Figure 9: Proportion of first home buyers



Source: ABS.

Figure 10: House price expectations

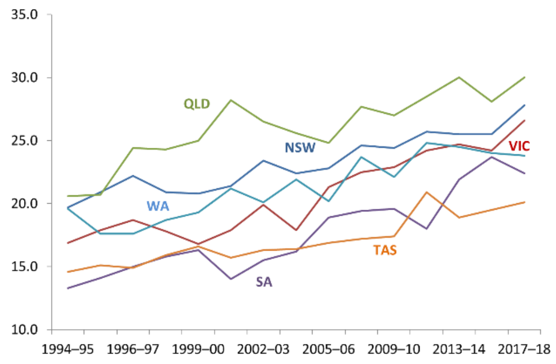


Source: MI.

How has the housing landscape changed over the past 25 years?

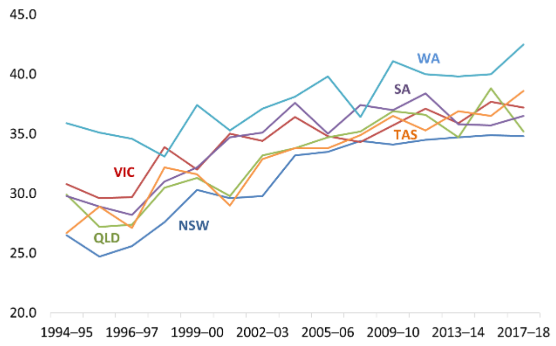
- In the lead-up to the recent Federal election, there was significant discussion regarding the price of housing access and the on-going suitability of tax breaks for housing. Labour party policies focused on the cutting back of negative gearing for new investors, while the Liberal party proposed a small-scale scheme whereby eligible first-home buyers, with at least a 5 per cent deposit for a home, would be able to qualify for a loan.
- Amidst this discussion, and in light of the continued presence of relatively high house prices (notwithstanding the declines over the past year), recent data released by the ABS allows us to examine trends in the general housing landscape over the past 25 years thereby providing some useful context for the broader discussion on housing affordability.
- Figure 11 shows how the proportion of households that are renters has changed since 1994. Key historical differences (such as the presence of a relatively high proportion of renters in Queensland) continue to be observed. In all states, however, there is an obvious positive trend in rental proportions. In the two largest states, the proportion of renters has increased by an average of 0.4 percentage points per annum over the past 25 years, from about 18 per cent of households in 1994/95 to 27 per cent in 2017/18.
- An even clearer positive trend is observed in the proportion of households with a mortgage. Figure 12 shows a comparably small level of variation in mortgage proportions across the states, in addition to a strong positive trend. As is the case with rental proportions, certain key features – such as the relatively high proportion of mortgagors in Western Australia – are persistently observed in the data. On average, the proportion of mortgagors has risen from about 30 per cent of households to approximately 38 per cent of households.
- The substantial increases in renter and mortgagor proportions indicate that a record proportion of households are now facing significant housing-related costs. To better understand this, note that housing costs (on average) for owners without mortgages constituted a relatively negligible 3 per cent of gross household income in 2017/18. In contrast, average housing costs for renters or mortgagors were about 17 per cent of gross household income.
- For many households, an increasingly greater proportion of overall household expenditure is therefore being allocated to housing costs. This is likely to have influenced (and will continue to influence) household expenditure on goods other than housing, particularly goods of a discretionary nature which are typically curtailed to pay for housing costs. This is also consistent with recent trends in retail spend data showing that food-related expenditure is relatively high compared to non-food expenditure.

Figure 11: Proportion of households that are renters



Source: ABS.

Figure 12: Proportion of households with a mortgage

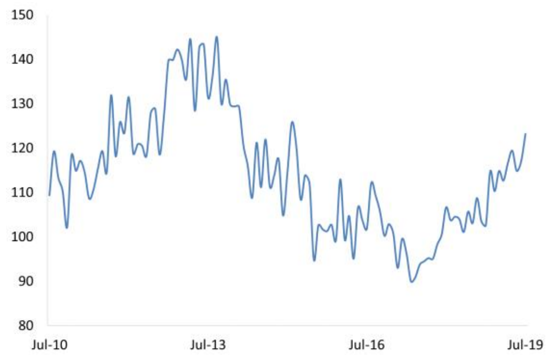


Source: ABS.

Looking forward…

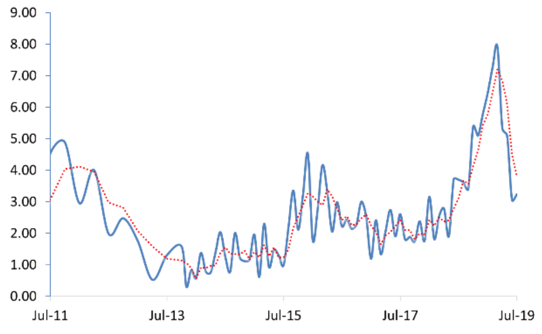
- In attempting to offset recent relatively low inflation and wages growth, the RBA has recently cut back its cash rate to 1 per cent. There is some evidence suggesting that lowering credit costs has historically been associated with an increased speculation in housing (and financial) markets, primarily by influencing the typical relationship observed between prices and fundamentals. In the current economic climate, however, a likely outcome of the recent easing is that it will curb any further house price depreciation that may otherwise have taken place. As such, house prices (and house price to income ratios) are likely to remain high. In such an environment, lending practices are particularly important for overall financial stability.
- In this respect, the relatively recent Banking Royal Commission was critical of Australian lending practices, particularly in terms of the financial arrangements and payment structures between lenders and brokers. These arrangements are important in maintaining a stable relationship between housing markets, credit levels and overall economic fundamentals. Although numerous recommendations were made regarding lending practices (which were, in principle, approved by both major parties), it remains to be seen how future legislation will interpret these recommendations.
- To get a better picture of future housing market conditions, we examine the Melbourne Institute's Dwelling Sentiment Index. This index is derived based on answers provided by consumers regarding whether they believe it is a good time to buy a dwelling. Figure 13 show that dwelling sentiment has improved in recent months, following a substantial period of decline. In May 2019, sentiment increased to a pre-election value of 114.9, considerably above the 101.1 observed in May 2018. This month, the index increased further to 123.2, and is now above its 5-year average of 106 and its overall average of 117 (since 1996). Overall, following on from the federal election and the recent rate cuts, sentiment appears to have improved by a substantial margin.
- In the previous editions of MBET, we 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 measure this, we used the Melbourne Institute's House Price Expectations Index and focused on the extent to which individuals expect house prices to fall by more than 10 per cent.
- In July 2019, a little over 3 per cent of consumers believed that house prices would exhibit annual falls of more than 10 per cent (Figure 14). This is considerably lower than the record 7 per cent of consumers who believed that house prices would exhibit 10+ per cent falls in February (or the 5 per cent in May). Although the proportion of consumers expecting large falls has declined, it is still greater than the historical average of about 2.5 per cent (or the 5-year average of 2.7 per cent). Overall, however, July's survey results indicate that many consumers believe that the worst of the housing market decline was observed in the first quarter of 2019.

Figure 13: Dwelling sentiment (Good time to buy a dwelling)



Source: MI.

Figure 14: 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				
	2019	2019	2019	2020	Calender Year
	Jun	Sep	Dec	Mar	2019
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		0.5	0.6	0.7	**0.4**

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