

MELBOURNE INSTITUTE
Applied Economic & Social Research

Monthly Bulletin of Economic Trends: Households and Household Saving

February 2018

Outlook for Australia¹

	Actual				Forecasts				Actual	Forecast
	2016 Dec	2017 Mar	2017 Jun	2017 Sep	2017 Dec	2018 Mar	2018 Jun	2018 Sep	Financial Year 2016/17	2017/18
<i>Economic Activity</i>										
GDP	2.4 (0.9)	1.8 (0.4)	1.9 (0.9)	2.8 (0.6)	2.9 (0.9)	3.2 (0.7)	2.8 (0.5)	2.9 (0.7)	2.0	2.9
Household Consumption	2.7 (0.9)	2.1 (0.4)	2.4 (0.8)	2.2 (0.1)	2.2 (0.8)	2.4 (0.6)	2.2 (0.6)	2.6 (0.6)	2.4	2.2
Private Dwellings	7.8 (2.6)	-0.3 (-3.4)	-2.3 (-0.5)	-2.3 (-1.0)	-5.2 (-0.4)	-2.4 (-0.5)	-2.6 (-0.7)	-2.3 (-0.7)	2.6	-3.1
New Business Investment	-6.2 (1.8)	-0.8 (3.0)	1.4 (0.5)	7.5 (2.0)	5.1 (-0.5)	2.5 (0.5)	2.5 (0.5)	1.5 (1.0)	-4.0	4.4
Domestic Final Demand	2.3 (1.0)	2.2 (0.7)	2.4 (0.8)	3.2 (0.6)	2.8 (0.7)	2.8 (0.7)	2.6 (0.6)	2.7 (0.7)	2.1	2.8
Imports of Goods & Services	3.2 (2.4)	8.7 (2.7)	6.5 (0.5)	7.7 (1.9)	7.1 (1.8)	6.0 (1.7)	7.2 (1.6)	6.8 (1.5)	4.8	7.0
Exports of Goods & Services	7.8 (2.7)	3.3 (-1.6)	5.3 (3.3)	6.4 (1.9)	6.2 (2.5)	10.4 (2.3)	8.7 (1.7)	8.2 (1.5)	5.4	7.9
<i>Inflation & Financial Market</i>										
Underlying inflation ²	1.6 (0.5)	1.8 (0.5)	1.8 (0.5)	1.8 (0.4)	1.8 (0.4)	1.8 (0.5)	1.7 (0.5)	1.8 (0.5)	1.7	1.8
Headline Inflation	1.5 (0.5)	2.1 (0.5)	1.9 (0.2)	1.8 (0.6)	1.9 (0.6)	2.0 (0.6)	2.4 (0.5)	2.3 (0.6)	1.7	2.0
90-day Bill Rate ³	1.8	1.8	1.7	1.7	1.7	1.7	1.7	1.9		
Trade Weighted Index ⁴	64.7	66.1	64.5	66.5	64.7	64.7	64.7	64.7		
\$A/\$US rate (100) ⁴	0.74	0.76	0.75	0.79	0.77	0.77	0.77	0.77		
<i>Labour Market</i>										
Unemployment Rate ⁴	5.7	5.8	5.6	5.5	5.5	5.3	5.2	5.2	5.7	5.4
Employment Growth Rate ⁵	0.9 (0.2)	1.1 (0.5)	1.9 (1.0)	2.6 (0.8)	3.2 (0.8)	3.4 (0.7)	2.8 (0.4)	2.4 (0.5)	1.4	3.0
Participation Rate ⁴	64.7	64.7	65.0	65.3	65.5	65.5	65.6	65.5	64.8	65.5
Wage Price Index	1.9 (0.5)	1.9 (0.6)	1.9 (0.5)	2.0 (0.5)	2.0 (0.5)	2.0 (0.5)	2.1 (0.6)	2.2 (0.6)	1.9	2.0

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 finalized 20 Feb 2018.

Table 1: Key statistics for households

	2016	2017	2017	2017	2017
	Dec	Mar	Jun	Sep	Dec
General					
Household consumption (% change p/a)	2.7	2.1	2.4	2.2	-
Disposable income (% change p/a)	5.5	4.6	2.8	2.9	-
Savings ratio	4.5	4.0	3.0	3.2	-
Household debt to income	182.2	184.3	187.9	188.4	-
Consumer Sentiment	97.3	99.7	96.2	97.9	103.3
Housing					
House Prices (% change p/a)	7.7	10.2	10.2	8.3	-
Housing debt to income ratio	133.2	134.5	136.8	137.5	-
Housing interest payments to income ratio	6.9	7.0	7.1	7.2	-
Housing finance (% change p/a)	-3.3	1.1	2.2	4.5	4.4
Dwellings financed by first home buyers (%)	13.8	13.5	14.9	17.4	17.9
Consumer dwelling index	102.9	99.6	90.9	95.2	100.6
Wealth ratios					
Household assets to income	924.2	940.5	951.1	952.1	-
Housing assets to income	504.3	514.4	522.6	521.8	-
Household financial assets to income	389.5	395.7	398.1	399.8	-

Sources: ABS, RBA , MI.

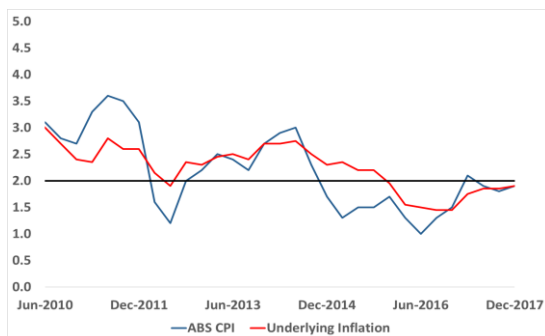
General conditions

- In January's MBET, we mentioned that September quarter state final demand for all the major state economies recorded positive growth. The Victorian economy recorded the strongest rate of growth (4.7 per cent), followed by South Australia (3.9 per cent), New South Wales (2.8 per cent) and Queensland (2.7 per cent). Western Australia recorded the lowest level of growth at 1.3 per cent. Overall, the economy grew by 2.8 per cent in the third quarter. Next month, the ABS will release the fourth quarter results.
- This month we focus on the household sector. Table 1 shows key statistics for households. Overall, consumption growth has remained fairly stable (albeit unremarkable) over the course of 2017 at a little over 2 per cent. However, in line with relatively strong employment conditions, we expect consumption growth to rise to 2.6 per cent in the December quarter.
- In per-capita terms, household conditions appear to have deteriorated over the course of 2017, with per-capita disposable income growth falling substantially. In this respect, in the June and September quarters of 2017, per-capita disposable income grew by a little under 3 per cent (as compared to 5.5 and 4.6 per cent in December 2016 and March 2017 respectively). Over the same period, household debt to income also rose slightly. However, we also observed a rise in consumer sentiment during the December quarter suggesting a perceived improvement in overall conditions.
- In terms of the housing market, house price growth has fallen steadily over the past 12 months. The ABS' residential property price index grew by over 10 per cent in the first and second quarters of 2017, falling to a (still relatively strong) 8.3 per cent in the third quarter. We anticipate that growth fell further in the December quarter.
- As house price growth has slowed, we have seen an increase in first home-buyer activity with first home buyers accounting for around 18 per cent of all dwellings financed in the final quarter of 2017 (relative to 14 per cent for the same quarter in the preceding year). We have also seen an increase in the growth rate of housing finance (which grew by 4.4 per cent in the December 2017 quarter, relative to a -3.3 per cent change for the same quarter in 2016) and an increase (albeit relatively small) in the ratio of housing debt to income.
- The Melbourne Institute's housing dwelling index - which measures whether households believe it is a good time to purchase a dwelling –improved in the December quarter of 2017. This follows a substantial decline in the index in June 2017 and is consistent with the recent fall in house price growth.
- In terms of overall housing wealth, the September quarter saw a slight increase in the ratio of household assets to disposable income relative to June 2017 (for both total assets and financial assets). However, as house price growth has slowed, the ratio of housing assets to income has also fallen slightly.

Employees experience a significant increase in their cost of living

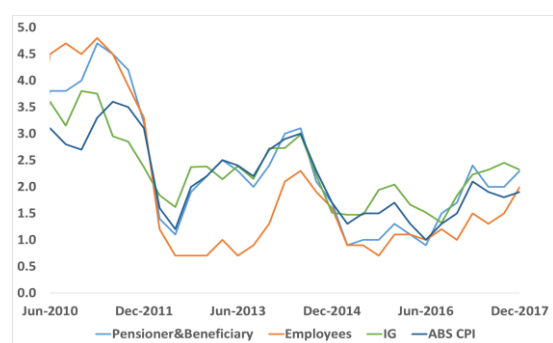
- Notwithstanding the reasonable growth observed for most of the states, aggregate inflation continues to be weak. The ABS recently released the December CPI, with quarterly inflation of 0.6 per cent and annual (headline) inflation of 1.9 per cent. The underlying measures of annual inflation were close to their headline counterpart at 1.8 per cent for trimmed mean inflation and 2.0 per cent for the weighted median (Figure 1).
- The inflation estimates were consistent with a recent pattern of flat (relatively weak) inflation, with headline inflation falling from 2.1 per cent in March 2017 to a little below 2 per cent in the following three quarters of 2017. We note that the Reserve Bank’s inflation target band is between 2 and 3 per cent.
- It is useful to compare the CPI with the ABS Cost of Living Indexes. The Cost of Living Indexes are designed to measure the (after-tax) purchasing power of different types of households. On the other hand, the CPI measures price inflation for a ‘typical’ household and is designed to reflect the household sector as a whole. A core difference between the two measures is that the living indexes incorporate changes in the amount of interest paid on mortgages (in addition to housing maintenance costs).
- Figure 2 shows a clear difference between the cost of living for employees and overall inflation as measured by the CPI. The figure also shows that inflation and the cost of living for non-employees (for example, pensioners) is relatively similar. This similarity is related to the general indexing of benefits and pensions. It is interesting to note that, notwithstanding flat inflation (and a flat cost of living for non-employees), there has been a relatively sharp increase in the cost of living for employees over the past year.
- In December 2016, the annual percentage change in the cost of living for employees was 1.0 per cent. Over the course of 2017, the annual percentage change in the cost of living for employees doubled to 2.0 per cent. We note that this positive trend in the cost of living for employees is consistent with the increase observed in the Melbourne Institute’s Inflation Gauge over this period.

Figure 1: Inflation (annual % change)



Source: ABS.

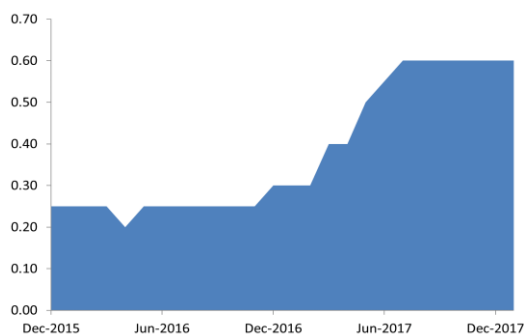
Figure 2: Cost of living (annual % change)



Source: ABS; MI. The IG variable is the based on the Melbourne Institute Inflation Gauge.

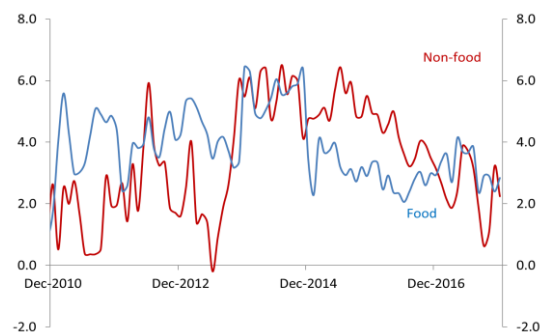
- Although the cost of living indexes do not account for investment items, it is interesting that the steep change in the cost of living for employees coincides closely with a period where the margins between investor lending rates and owner-occupier lending rates have also increased sharply (Figure 3).
- Note that the spread between investor and owner-occupier lending rates rose from 25 bps in October 2016 to a current spread of approximately 60 bps. This increase has been in response to changes imposed on the banking sector including the limiting of new interest-only home loans to 30 per cent of total housing loans, and an increase in bank equity to capital ratios.
- Although inflation has been relatively flat over the past year, we have observed an unusual amount of volatility in non-food retail spend during this period (Figure 4). The annual growth in non-food retail spend has exhibited sharp rises and falls over the past year (for example, annual growth of nearly 4 per cent in May 2017 compared to annual growth of a meagre 0.6 per cent in September 2017).
- The rise in the volatility of non-food retail spend does not appear to stem from changes in aggregate prices. To some extent, however, it may reflect the sharp rise in the cost of living for employees. In this respect, employees may be responding to uncertainty regarding the quantum of the increase in their cost of living by curbing non-food spend. Note that (by comparison to non-food spend) food-related retail spend has been fairly stable over the past year with average annual growth of around 3.2 per cent.

Figure 3: Lending rate spread



Source: RBA. Difference between investor and owner-occupier standard variable lending rates.

Figure 4: Growth in retail spend (annual % change)

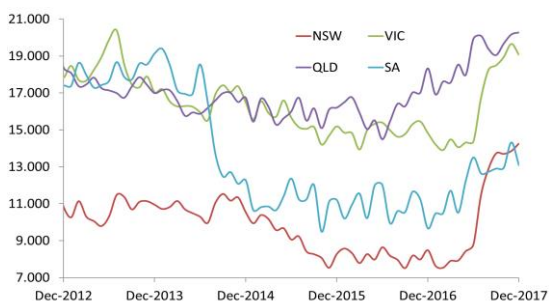


Source: ABS.

The housing market and stamp duty exemptions

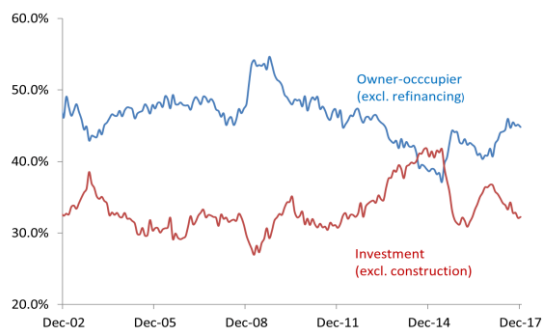
- In the November issue of MBET, we explored the ramifications of the stamp duty exemptions provided by the NSW and Victorian governments to first home buyers. It was suggested that the exemptions had been effective in increasing the proportion of first home buyers in both states. Given that we have now observed an additional three months of housing data, it is useful to examine whether the proportional increase in first home buyers has continued.
- Figure 5 shows the proportion of first home buyers in NSW, Victoria, Queensland and South Australia. The figure shows that the proportion (of first-home buyers) in NSW is now similar to that of South Australia, while the proportion in Victoria has now reached the level observed in Queensland.
- Figure 6 also shows a positive trend in the proportion of housing finance going to owner-occupiers rather than (non-development) investors. Investors are now responsible for approximately 30 per cent of housing finance, compared to an average of 41 per cent during FY14/15.
- We note, however, that the proportion of first home buyers in NSW and Victoria increased only slightly in the fourth quarter (by about 1.3 per cent versus approx. 0.6 per cent for Queensland and South Australia). It seems, therefore, that most of the gains stemming from the stamp duty exemptions were obtained in the immediate quarter following their introduction.
- In short, the exemptions appear to have produced a fast level shift in the proportion of first home owners in NSW and Victoria (of about 4.3 per cent for the former and 3.6 per cent for the latter) rather than a change in trend.
- Further data are, however, required to solidify this conclusion. As such, in the May edition of MBET we will be able to examine the impact of the exemptions on housing trends in more detail.

Figure 5: Proportion of first home buyers



Source: ABS.

Figure 6: Proportion of housing finance to owner-occupiers and investors



Source: ABS.

Precision of (year-end) Forecasts					
	2017	2018	2018	2018	Financial Year 2017/18
	Dec	Mar	Jun	Sep	
Australia					
<i>Economic Activity</i>					
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
<i>Inflation & Financial Market</i>					
Underlying Inflation		0.1	0.2	0.3	0.3
Headline Inflation		0.3	0.4	0.5	0.6
90 day bill		0.3	0.5	0.7	0.6
Trade Weighted Index		3.3	3.7	3.9	2.3
<i>Labour Market</i>					
Unemployment Rate		0.1	0.1	0.2	0.3
Employment		0.1	0.2	0.4	0.5
Participation Rate		0.1	0.2	0.3	0.3
Wage Price Index	0.5	0.5	0.6	0.7	0.4

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