MELBOURNE INSTITUTE
Applied Economic & Social Research

Monthly Bulletin of Economic Trends: Households and Household Saving

May 2019

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Housing and households

- **Consumption and savings:** *Household consumption growth weakens, while disposable income growth and saving rates exhibit a moderate pick-up.*
- **House prices decline sharply:** *Housing markets are weak across Australia, with house prices and finance falling and housing debt and interest payments rising.*
- **Housing market and interest rates:** *Low inflation raises calls for a rate cut, which would further reduce the probability of any further house price depreciation.*
- **Outlook:** *Survey data suggests many consumers now believe that the worst of the housing downturn has been observed.*

Table 1: Outlook for Australia[1]

	Actual				Forecasts				Actual	Forecast
	2018	2018	2018	2018	2019	2019	2019	2019	Calender Year	
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	2018	2019
Economic Activity										
GDP	3.1	3.1	2.7	2.3	1.8	1.6	1.9	2.3	**2.8**	**1.9**
	(1.1)	(0.8)	(0.3)	(0.2)	(0.6)	(0.6)	(0.5)	(0.5)		
Household Consumption	2.8	2.9	2.6	2.0	2.0	1.5	1.7	1.8	**2.6**	**1.8**
	(0.4)	(0.9)	(0.3)	(0.4)	(0.4)	(0.4)	(0.5)	(0.5)		
Private Dwellings	2.9	5.2	7.1	2.5	-1.7	-4.5	-5.9	-3.8	**4.4**	**-4.0**
	(3.4)	(2.2)	(0.5)	(-3.4)	(-0.8)	(-0.8)	(-1.0)	(-1.3)		
New Business Investment	4.6	3.9	-0.7	-0.2	-0.1	1.5	4.3	5.3	**1.9**	**2.7**
	(0.9)	(-0.4)	(-1.3)	(0.7)	(1.0)	(1.2)	(1.4)	(1.6)		
Imports of Goods & Services	6.2	6.7	2.4	1.5	1.0	1.4	3.5	4.4	**4.1**	**2.5**
	(1.8)	(0.6)	(-1.0)	(0.1)	(1.2)	(1.1)	(1.0)	(1.0)		
Exports of Goods & Services	6.5	4.9	4.0	4.7	1.8	1.7	2.5	3.9	**5.0**	**2.5**
	(4.1)	(1.3)	(-0.1)	(-0.7)	(1.2)	(1.2)	(0.8)	(0.6)		
Inflation & Financial Market										
Underlying inflation[2]	1.8	1.8	1.8	1.8	1.6	1.5	1.7	1.8	**1.8**	**1.6**
	(0.6)	(0.4)	(0.4)	(0.4)	(0.3)	(0.4)	(0.5)	(0.5)		
Headline Inflation	1.9	2.1	1.9	1.8	1.3	1.5	1.5	1.5	**1.9**	**1.5**
	(0.4)	(0.4)	(0.4)	(0.5)	(0.0)	(0.5)	(0.5)	(0.5)		
90-day Bill Rate[3]	1.8	2.0	2.0	2.0	1.8	2.0	2.0	2.0		
Trade Weighted Index[4]	64.2	62.5	62.6	62.0	60.8	60.6	60.6	60.6		
$A/$US rate (100)[4]	0.77	0.77	0.73	0.73	0.71	0.70	0.70	0.70		
Labour Market										
Unemployment Rate[4]	5.5	5.4	5.2	5.0	5.0	5.0	5.1	5.1	**5.3**	**5.1**
Employment Growth Rate[5]	3.4	2.7	2.4	2.3	2.2	2.1	1.8	1.6	**2.7**	**1.9**
	(0.7)	(0.4)	(0.6)	(0.6)	(0.6)	(0.3)	(0.3)	(0.4)		
Participation Rate[4]	65.7	65.6	65.6	65.6	65.7	65.6	65.5	65.4	**65.6**	**65.6**
Wage Price Index	2.1	2.1	2.3	2.3	2.2	2.3	2.3	2.3	**2.2**	**2.3**
	(0.5)	(0.5)	(0.6)	(0.5)	(0.5)	(0.6)	(0.6)	(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, S. Tsiaplias and J. Wang, Macroeconomics@MI. Data in this report were finalized on* 27/5/2019.

Table 2: Key statistics for households

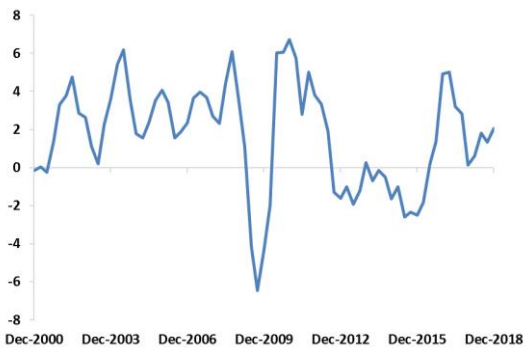
	Sep 2017	Dec 2017	Mar 2018	Jun 2018	Sep 2018	Dec 2018	Mar 2019	Fiscal Year 16/17	Fiscal Year 17/18
General									
Household consumption %pa	2.5	2.8	2.8	2.9	2.6	2.0	--	2.4	2.8
Disposable income %pa	2.8	0.1	0.6	1.8	1.3	2.1	--	3.6	1.3
Savings ratio	4.1	4.2	3.9	2.9	2.3	2.5	--	4.9	3.8
Household debt to income ratio	186.0	186.9	187.7	189.0	188.7	189.6	--	181.8	187.4
Consumer sentiment	97.9	103.3	103.0	102.1	100.5	104.4	98.8	98.7	101.6
Housing									
House prices %pa	8.3	5.0	2.0	-0.6	-1.9	-5.1	-8.3	7.9	3.7
Housing debt to income ratio	137.0	138.0	138.5	139.3	139.5	140.2	--	133.8	138.2
Housing interest payments to income ratio	7.2	7.2	7.3	7.4	7.5	7.6	--	7.0	7.3
Housing finance %pa	1.5	-1.4	-4.9	-5.1	-10.0	-15.6	--	4.5	-2.5
Dwellings financed by first home buyers %	17.4	17.9	17.4	18.1	18.0	17.7	--	13.8	17.7
Consumer dwelling index	95.2	100.6	104.5	105.7	103.5	110.3	116.6	100.7	101.5
Wealth ratios									
Household assets to income	947.2	962.1	955.7	957.8	949.9	927.9	--	927.0	955.7
Housing assets to income	521.3	529.7	526.3	519.7	507.9	495.3	--	506.3	524.3
Household financial assets to income	395.9	403.0	400.4	409.6	414.2	405.3	--	390.3	402.2

* Values in blue are estimates.

Income pressures ease slightly, although sentiment is subdued

- In last month's MBET we observed an improvement in the level of consumer sentiment across major states following the favourable income tax cuts and tax-relief measures proposed in the 2019/20 Federal Budget. Readings of the Westpac-Melbourne Institute Consumer Sentiment Indexes showed a marked increase in the sentiment recorded for NSW, VIC, QLD and WA following the April budget as compared to the surveyed sentiment immediately prior to the budget.
- The Westpac-Melbourne Institute Expectations Index shows that much of the positive impact of the budget on consumer sentiment was through the expectations channel. The upcoming survey readings will reveal whether the positive impact is sustainable or a short-lived response.
- Household overall consumption growth continued its relatively weak run in the December quarter. Annual aggregate consumption grew by 2.0 per cent in the last quarter, after growing by 2.9 per cent in the June quarter and 2.6 per cent in the September quarter. This growth is consistent with the weak demand growth observed across the major states in the December quarter. It is also below the weak average growth (of 2.4 per cent) observed over the 16/17 fiscal year (Table 2).
- Per capita disposable income grew by a relatively strongly rate of 2.1 per cent in the December quarter, exceeding the growth seen in any of the preceding four quarters since December 2017. The average growth rate of per capita disposable income over the calendar year of 2018 has been 1.5 per cent, slightly higher than the average over the 17/18 fiscal year (1.3 per cent) but still below the average growth in the 16/17 fiscal year (3.6 per cent) (Figure 1). Overall, the soft growth in disposable income over the past year is likely due to the absence of meaningful wage growth. Weak wage growth has been a drag on both disposable income and household spending (particularly non-food spend, as discussed on the next page).
- In line with the growth in disposable income during the December quarter, the household savings rate increased slightly in the December quarter (by 2.5 per cent) relative to its previous value of 2.3 per cent. The savings rate, however, is still below the average growth observed in the last two fiscal years – being 4.9 per cent for 16/17 and 3.8 per cent for 17/18 (Table 2). Despite the slight pick-up in the December quarter, the savings rate is likely to continue its post-2014 downward trend.

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



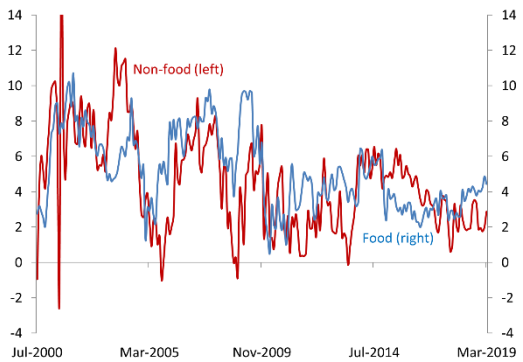
Source: ABS

Figure 2: Savings ratio

Source: ABS

- Figure 3 depicts annual growth in food and non-food retail spend since mid-2010. The figure show an shift away from non-food retail spend towards food-related retail spend from about 2017. Annual growth in food retail trade (from 2017 onwards) has been growing at approximately double the rate of that of non-food retail spend.
- Housing interest payments as a share of disposable income have continued to rise steadily, as Figure 4 shows. This is consistent with the observed rise in the housing debt to income ratio (Table 2). Both interest payments and debt appear to have imposed significant liquidity constraints on households.
- To make matters worse, steadily falling housing prices will curb household wealth (Figure 5). The joint presence of tighter constraints on borrowing and falling housing prices suggests that housing interest rate pressures will continue to rise as the housing market continues to cool down.
- The Melbourne Institute's consumer sentiment survey indicates that sentiment is somewhat subdued. Figure 6 shows a relatively volatile level of movement in consumer sentiment in the past few months. After rising to 104.4 in December, sentiment fell back to 98.8 in March, before rising again (albeit moderately) to 101.3 in May. Despite the recently observed increase in disposable income, the volatility in household sentiment reflects the presence of generally weak household conditions.

Figure 3: Retail trade (annual % growth)

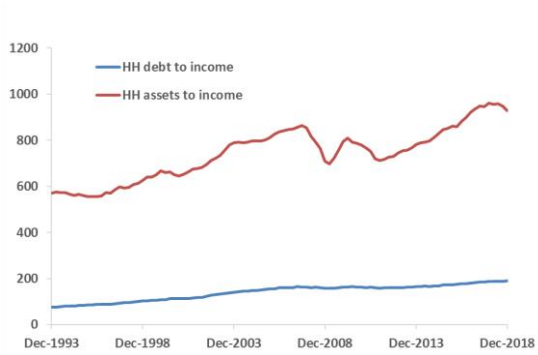


Source: ABS

Figure 4: Housing interest payments to disposable income ratio

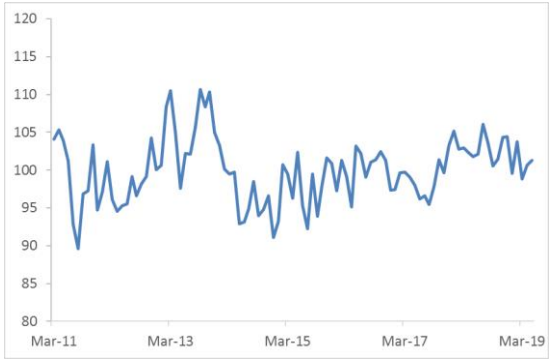
Source: RBA

Figure 5: Household debt and asset ratios



Source: RBA

Figure 6: Consumer sentiment

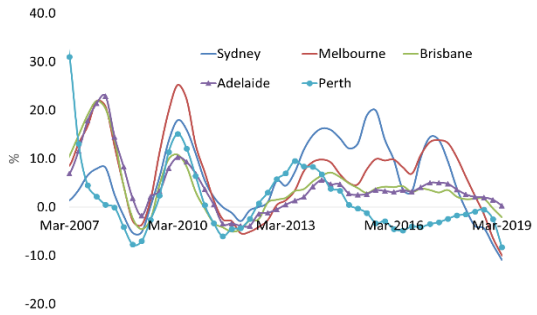


Source: MI

First home buyer activity continues to be sluggish

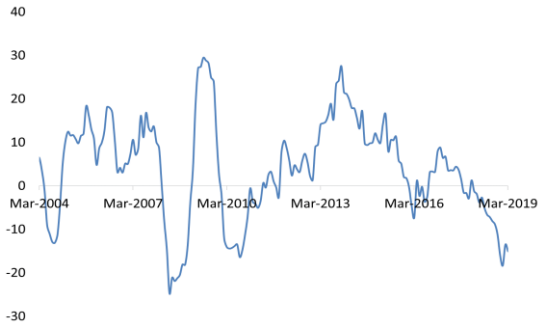
- Although auction clearance rates fell to below 50 per cent in the Melbourne and Sydney markets in the latter half of 2018, clearance rates in the two major cities now appear to be at around 55 per cent, albeit on relatively low volumes. A difficulty in assessing these values, however, is that the reporting rate for auction results during downtimes tends to be lower than that during normal. Further evidence is therefore required before the current rates can be treated as indicative of an improvement in underlying conditions.
- Figure 7 shows a common downward trend in housing growth across Australia. Annual growth in house prices for Sydney, Melbourne, Brisbane and Perth is negative, whilst growth in Adelaide is flat. Sydney and Melbourne appear to have fallen by around 10 per cent in annual terms, with Perth falling by approximately 8 per cent (thereby continuing its persistent run of falling property prices from mid-2015).
- In line with the decline in housing transaction volumes, housing finance is at its lowest level of annual growth since the sharp drop observed during the GFC (Figure 8). It is notable that this decline has not been driven by major changes in financial economic conditions, with interest rates remaining low and employment conditions relatively strong.
- Amidst declining house prices, and in the backdrop of the 2017 stamp duty exemptions in NSW and Victoria, first home buyer activity over the course of 2019 seems to have increased in NSW and South Australia, although a fall was observed in both states during the March quarter (Figure 9). First home owner activity seems to have plateaued in Victoria and Queensland at a little under 20 percent of all housing transactions.
- The Melbourne Institute's House Price Expectations Index gauges suggests that consumers do not expect house prices to rise in the interim. In May, the proportion of consumers expecting house prices to rise by 0 to 10 per cent continued its downward trend, with only about 1 in 5 consumers expecting a price rise over the next year (Figure 10).

Figure 7: House prices (annual percentage change)



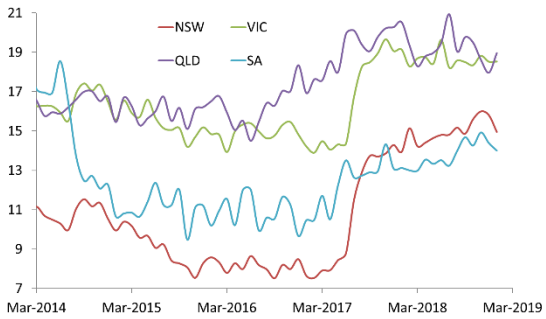
Source: MI.

Figure 8: Housing finance (annual percentage change)



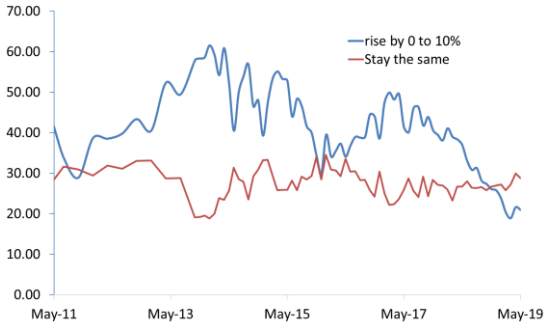
Source: ABS.

Figure 9: Proportion of first home buyers



Source: ABS.

Figure 10: House price expectations

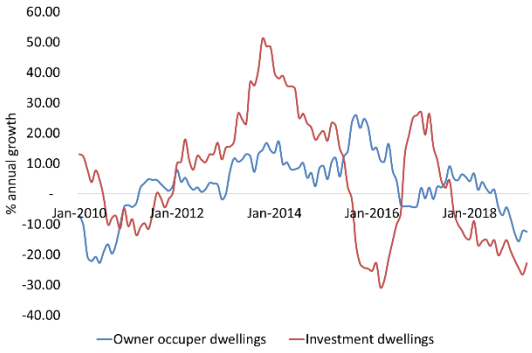


Source: ABS. CoreLogic.

Rate cuts and house prices

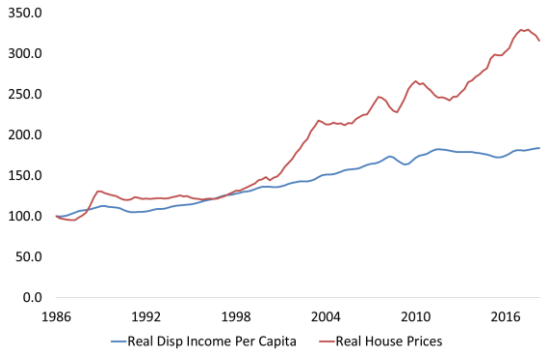
- Inflation has remained relatively weak in recent quarters. In the March quarter, the CPI grew by 0.0 per cent, for an annual inflation rate of 1.3 per cent. The trimmed mean and weighted median inflation rates, which attempt to minimize the impact of extreme price changes, also show that annual inflation grew by somewhere between 1.2 per cent and 1.6 per cent in the March quarter. A key factor in these measures, however, is that petrol prices were low for the first half or so of the quarter.
- The presence of low inflation, and low wages growth, have raised the possibility of a rate cut. In this respect, it is interesting to consider the possible ramifications of a rate cut for the housing market. There is some evidence suggesting that lower interest rates increase the probability of unstable housing markets, although the mechanism for this is unclear. One possibility is the nonlinear demand for housing when credit is cheap and readily available.
- In the aftermath of the federal election, key Labour party policies relating to negative gearing and capital gains tax will no longer be relevant in the short term. These policies are likely to have had a negative marginal effect on house prices, thereby exacerbating the current downturn. In their place, the Liberal party has proposed a $500 million scheme whereby eligible first-home buyers, with at least a 5 per cent deposit for a home, will be able to qualify for a loan (and avoid paying the usual mortgage insurance required for relatively high LVR borrowers).
- Polices with lottery-type characteristics such as the mortgage guarantee scheme are unlikely to have any meaningful impact on housing markets (or to benefit the majority of younger buyers). The more likely outcome is that they may prop up demand for lower-end and/or higher-density dwellings, generating demand for developers who are trying to offload stock at the tail end of the previous boom.
- In the absence of any major housing policy, the impact of any rate cut will not have to considered in the context of fiscal policies aimed at curtailing investor activity. As such, a string of rate cuts, which will reduce further reduce the cost of credit, may well curb the current negative growth observed in lending to households, which is negative for both owner-occupier related lending and lending for dwelling investments (Figure 11).
- Given that rates are already extremely low, it seems unlikely that a shift in the stance of monetary policy will result in any significant house price appreciation (instead, they will probably minimize the probability of any additional falls). In such a scenario, house prices will continue to be high, particularly when compared to real household disposable income which has been relatively flat in recent years (Figure 12).

Figure 11: Annual growth in lending to households



Source: ABS.

Figure 12: Income and house price growth



Source: ABS.

Looking forward…

- In February's MBET we noted the criticisms of Australian lending practices made in the Banking Royal Commission. We also noted that the major uncertainty associated with the Commission's recommendations is whether the proposed changes (particularly those pertaining to the remuneration structure of brokers) lead to effective new legislation that improves lending outcomes for consumers. This is largely a function of political will. In December 2018, APRA also removed its previous restriction on banks that limited new interest-only lending to 30 per cent of issued home loans.

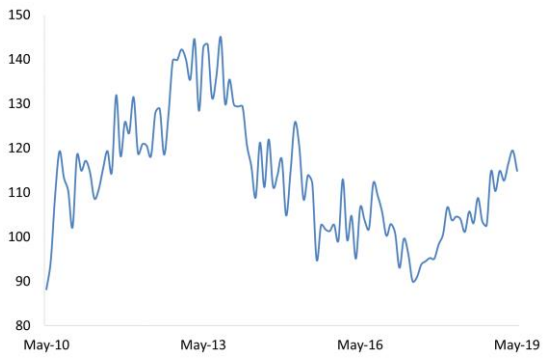
- To some extent, the government's new mortgage guarantee is at odds with the stability-focused measures above. The guarantee seems to be encouraging (or, at least, facilitating) first-home buyers to take on mortgages with an effective loan to valuation ratio of 95 per cent. It is difficult to see how this policy improves financial stability or encourages better lending standards.

- 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 relative dwelling sentiment has improved in recent months, following a substantial period of decline. In February 2019, the index was at 112, considerably above the 103.8 observed in February 2018. This month, the index increased further to a pre-election value of 114.9, although it remains below its long-term average of approximately 117. Overall, sentiment appears to be improving, although it will be interesting to examine how household sentiment changes next month following the re-election of the LNP.

- 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.

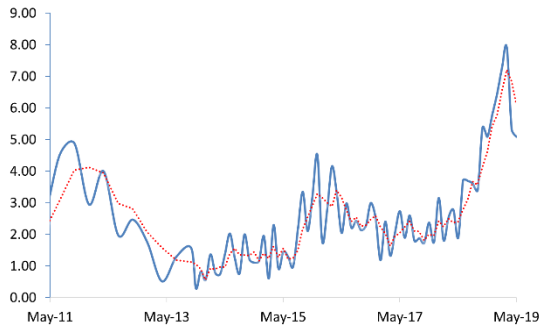
- In May 2019, about 5 per cent of consumers believed that house prices would exhibit annual falls of more than 10 per cent (Figure 14). This is considerably lower than the 7 per cent of consumers who believed that house prices would exhibit 10+ per cent falls in February (Figure 12). Nevertheless, the proportion is still substantially greater than the historical average of about 2.5 per cent. We note that February's proportion was the largest since the index commenced in 2009. Taken together, Figures 13 and 14 indicate that many consumers now believe that the worst of the housing market decline was observed in the March quarter.

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 Mar	2019 Jun	2019 Sep	2019 Dec	**Calender Year 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	0.4	0.5	0.6	0.7	**0.4**

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