Data snapshot

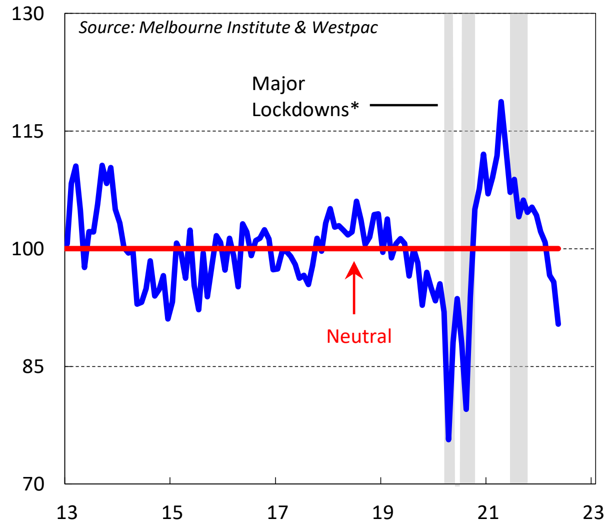
Bank of Melbourne

Wednesday, 11 May 2022

Consumer Sentiment
Household Budget Worries Intensify

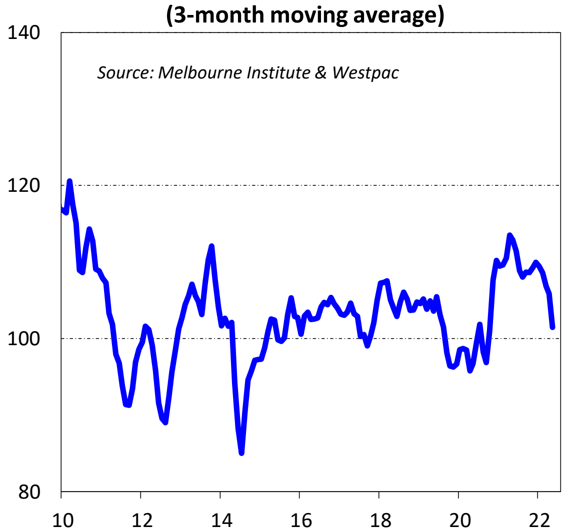
- **The Westpac-Melbourne Institute consumer sentiment index fell for a sixth consecutive month, dropping 5.6% to 90.4 in May. The result marks the largest one-month fall in sentiment since August 2020, when Melbourne was in its second lockdown.**
- **Consumers are increasingly concerned about the rising cost of living as annual headline inflation in the first quarter of 2022 printed at the fastest pace in over two decades. The survey also captured the Reserve Bank's (RBA) first interest rate hike since 2010.**
- **The combination of rising interest rates and high inflation is unsettling consumers. Consumers with a mortgage are facing a reduction in their disposable incomes as borrowing costs rise, while they are getting less bang for their buck as their purchasing power is eroded by higher prices.**
- **Across the states, Tasmania and Queensland experienced the steepest drop in sentiment in May. NSW, WA, Victoria and SA also experienced a fall in confidence in the month.**
- **Consistent with rising housing affordability constraints and the commencement of the RBA's rate hike cycle, the time to buy a dwelling index fell a further 1.6% to 77.5. The index is at its lowest level since April 2008, in the midst of the RBA's last rate hike cycle.**
- **Consumers face a mixed picture. The strong jobs market and the large saving buffers accumulated by households will support spending this year. However, rising inflationary pressures and expectations of further rate hikes are likely to continue to weigh on sentiment.**

Consumer Sentiment Index



National Lockdown 2020, VIC's 2nd lockdown & Delta Lockdowns

Family finances next 12 months
(3-month moving average)



Consumer confidence fell for a sixth consecutive month in May, hitting a 21-month low. The Westpac-Melbourne Institute consumer sentiment index fell 5.6% to 90.4 in May, from 95.8 in April. A value below 100 indicates the pessimists outweigh the optimists. The result marks the largest one-month fall in sentiment since August 2020, when Melbourne was under harsh lockdown restrictions following its second wave of COVID-19 infections.

Recent survey's have seen consumers become increasingly concerned about the rising cost of living, which quickly superseded pandemic developments as the key driver sentiment. These concerns were compounded when headline annual inflation printed at 5.1% in the first quarter of 2022 – the fastest pace in over two decades. In addition, inflation expectations – as measured by the Melbourne Institute – rose to a more than 9½ year high of 5.2% in April.

However, hotter-than-expected inflation was not the only catalyst for the sharp decline in sentiment in May. The survey was undertaken between 1 and 5 May and therefore captured the Reserve Bank's (RBA) first interest rate hike in more than a decade. At its May meeting, the RBA increased the cash rate target by 25 basis points to 0.35%, a bigger move than the 15 basis point hike expected by markets. The RBA also flagged further rate hikes on the horizon and suggested a cash rate somewhere between 1.50% and 1.75% by the end of 2022 would be 'plausible'.

The combination of cost-of-living pressures and the expectation of rising interest rates is unsettling consumers. Wages growth has not kept pace with the uplift in inflation, meaning consumers purchasing power is being eroded. In other words, households are getting less bang for their buck. Plus, indebted households are sensitive to higher rates, as higher borrowing costs can eat into disposable incomes. Indeed, 77% of respondents expect mortgage rates to rise over the next 12-months (70% in April), while 52% expect rates to rise by more than 1% over the same period (34% in April). Households without buffers or with slim buffers, and with higher mortgages relative to their incomes, will be more sensitive to higher rates.

However, these pressures will be cushioned by the extraordinary amount of savings accumulated during the pandemic and relatedly, the repayment buffers which indebted households have run up. The RBA found the median excess payment buffer for owner-occupiers with a variable-rate loan was equivalent to around 21 months' worth of scheduled payments in February 2022, up from around 10 months' worth at the start of the pandemic. Reflecting this, confidence among mortgagee's only declined 2.9% compared to the broader fall of 5.6%.

The survey detail shows the extent to which these factors weighed on confidence in May. Four of the five sub-indices declined in the month and all five sub-indices reported a value below 100.

Consistent with the pressures on budgets, the decline was led by the outlook for personal finances. Households' expectations for their finances over the next 12 months fell 11.2% to 93.3, the largest monthly fall since May 2014. Family finances vs a year ago edged up 0.3% to 79.6. Meanwhile, expectations for economic conditions over the next 12-months and 5-years tumbled 5.8% and 4.1%, respectively, falling to their lowest level since the second half of 2020.

The 'time to buy a major household item' sub-index, indicates that the commencement of the interest rate hiking cycle and surging inflation are beginning to dampen consumer's spending appetites. The sub-index shed 5.7% in May, falling to 92.6, its lowest level since August 2020.

Across the states, Tasmania (-19.2%) and Queensland (-11.7%) experienced the steepest drop in sentiment in May. Confidence in Tasmania dropped to its lowest level since April 2020, just after the pandemic first swept Australia. NSW (-4.7%), WA (-4.1%), Victoria (-2.7%) and SA (0.4%) also experienced a fall in confidence in the month. Confidence remains strongest in NSW and Victoria.

Consistent with rising affordability constraints in the housing market and the commencement of the RBA's rate hike cycle, the time to buy a dwelling index fell a further 1.6% to 77.5. The 'time to buy a dwelling' index has fallen 41.3% since its peak in November 2020 and is at its lowest level since April 2008, in the midst of the RBA's last rate hike cycle. The house prices expectations index also declined in May, tumbling 9.4% in the month to 121.4. However, the reading over 100 suggests that most respondents still expect an increase in dwelling prices over the next year.

Outlook

Consumers face a mixed picture. There are more Australians than ever before in a job and the unemployment rate is at its lowest level in almost 50-years, plus households have accumulated large saving buffers. These factors will support spending this year. However, rising inflationary pressures and expectations of further rate hikes are headwinds.

Notably, the RBA does not expect inflation to return to its 2-3% target band until midway through 2024. Plus, the central bank has forecast headline inflation to continue to rise to a peak around 6% in the second half of this year. It is on this backdrop that we expect the RBA to continue to hike the cash rate over the course of 2022 to 1.75% by the end of the year.

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