Data snapshot

Bank of Melbourne

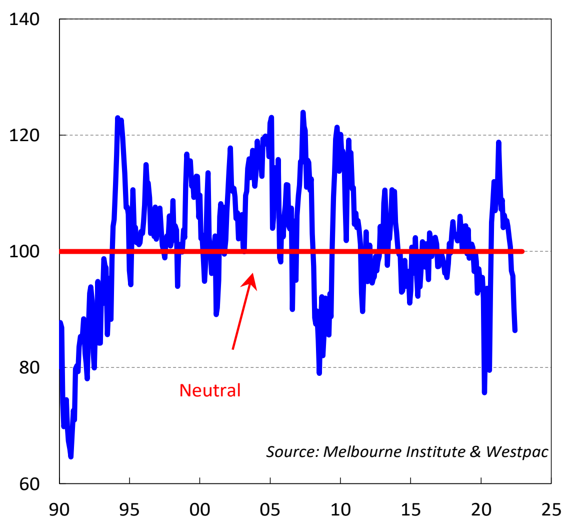
Wednesday, 15 June 2022

Consumer Sentiment

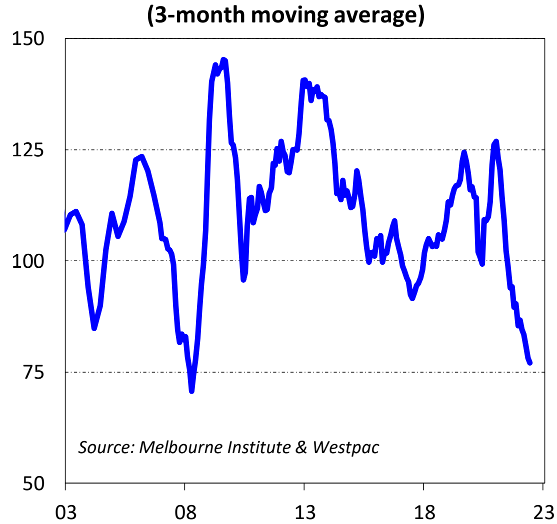
0.5% Hike Spooks Consumers Further

- **Consumer confidence dropped 4.5% in June to 86.4, its lowest level in 22 months, following the Reserve Bank's (RBA) 50 basis point rate hike on 7 June. The index is approaching lows recorded during previous crises, highlighting the extent of the concern amongst households.**
- **In April 2020, the index fell to 75.6 as COVID-19 swept the country. During the Global Financial Crisis (GFC) in July 2008, the index fell to 79.0. The index hit a record low of 64.6 in November 1990 during the 'recession we had to have'.**
- **Reflecting concerns over household budgets, the biggest drag on sentiment were measures of personal finances. Expectations for the economic outlook over the next year also deteriorated.**
- **Rising rates are weighing on the housing market outlook. The 'time to buy a dwelling' index fell 3.1% to 75.1, its lowest level since the GFC. A growing share of households are expecting a sizeable increase in interest rates over the next year.**
- **The results were mixed across the states in June. Declines in sentiment in NSW, Victoria and Queensland were partly offset by improvements in sentiment in the remaining states.**
- **Business confidence remains buoyant but optimism has waned recently. And there is a risk that weak consumer sentiment bleeds into business confidence, particularly for smaller-sized businesses.**
- **Spending has bounced back strongly from lockdowns. However, the significant hit to consumer confidence over recent months points to downside risks to the outlook for consumer spending. Indeed, we could see a loss of momentum in spending growth later this year.**

Consumer Sentiment Index



Time to Buy a Dwelling Index
(3-month moving average)



Consumer confidence dropped 4.5% in June to 86.4, its lowest level in 22 months. This marks the seventh consecutive month the index has declined, as households grow increasingly worried about rising inflation and interest rates. A value below 100 indicates the pessimists outweigh the optimists.

The index is approaching lows recorded during previous periods of crisis, highlighting the extent of the concern amongst households. For comparison, in April 2020, the index fell to 75.6 after COVID-19 swept the country. During the Global Financial Crisis (GFC) in July 2008, the index fell to 79.0. The index hit a record low of 64.6 in November 1990 during the 'recession we had to have'.

Meanwhile, data released yesterday indicated that business confidence remained buoyant but optimism has waned recently. And there is a risk that weak consumer sentiment bleeds into business confidence, particularly for smaller-sized businesses.

The consumer sentiment survey captured the response of households to the 50 basis point rate hike from the Reserve Bank (RBA) on 7 June – the second consecutive hike and the biggest move in 22 years. Accordingly, a growing share of households are expecting a sizeable increase in interest rates over the next year. In June, 58% of respondents expected interest rates to increase by more than 1% in the next 12 months. Only 30% of households expected such an increase in March.

Plus, cost-of-living pressures are biting. Annual headline inflation printed at 5.1% in the first quarter of 2022 – the fastest pace in two decades – and is widely projected to rise further. We expect inflation will peak around 6.5-7.0% later this year. Consumers are being hit by higher grocery bills and higher prices at the petrol pump – despite the 22.1 cent cut to the fuel excise announced in the Federal Budget. Additionally, a rise in wholesale energy prices is likely to flow through to consumers in the coming months, adding to pressures.

Consistent with the strain on household budgets, the biggest drag on the headline reading was the 'family finances over the next 12 months' subindex which fell 7.6% to 86.2. This is the lowest reading in 8 years. 'Family finances vs a year ago' also fell 7.0% to 74.0. Expectations for economic conditions over the next year deteriorated further, although expectations for economic conditions over the next five years edged up slightly. The 'time to buy a major household item' index extended declines, indicating that cost-of-living pressures appear to be hitting consumers' willingness and/or ability to spend. All five of the sub-indices are below their respective long-run averages, except for 'economic conditions over the next five years'.

The results were mixed across the states. Declines in sentiment were recorded in June in Queensland (-7.5%), New South Wales (-7.1%) and Victoria (-6.7%), perhaps pointing to more nervousness about higher interest rates in these states. In contrast, there was an improvement in sentiment in the smaller states of Tasmania (14.6%), WA (9.3%) and South Australia (5.4%). Regardless, sentiment is below 100 in all states, indicating the pessimism is widespread across the country.

Rising rates are weighing on the outlook for the housing market, which was already losing momentum ahead of the RBA's rate hikes. The 'time to buy a dwelling' index, a measure of homebuyer sentiment, fell 3.1% to 75.1, its lowest level since April 2008. The metric is now approaching the record low of 67.1 from February 2008. The index has steadily declined since reaching in a peak in November 2020, as housing affordability became increasingly stretched. Although, housing market sentiment is now also being impacted by the increases in the cash rate, and expectations of significant further tightening.

Sentiment has soured across renters, mortgagees and outright owners, sitting well below the long-run average amongst all cohorts. Sentiment amongst tenants edged slightly higher to 87.0 in June. Meanwhile, sentiment amongst mortgagees fell in the month to 87.5. The divergence perhaps reflects that renters are less directly impacted by higher rates than mortgagees. Sentiment amongst outright owners also fell to 84.5. Sentiment amongst mortgagees and outright owners may also be hit by a projected decline in dwelling prices in the coming period.

The house price expectations index dropped a further 8.5% in June to 111.1, the fourth consecutive monthly decline in the series, which is now down 28.6% on its level from February. However, at a level over 100, the index continues to indicate that a majority of respondents expect dwelling prices to increase. The index is lowest in NSW and Victoria, where dwelling prices have already begun to decline in the capital cities. The index is higher in the smaller states of Queensland, South Australia and Western Australia, where dwelling price growth has held up in recent months, as buyers are attracted to the relatively more affordable property in these states.

The unemployment index edged down 1.0% to 108.5 in June – a decline indicates more respondents expect the unemployment rate to fall. The index is well below its long-run average of 129.4. The labour market remains very tight – with the unemployment rate near a 48-year low of 3.9% in April – and leading indicators point to further jobs growth in the months ahead.

Outlook

The economic recovery has been underpinned by a rapid rebound in consumer spending, boosted by pent-up demand, elevated savings and the booming jobs market. However, a number of growing challenges are hitting the hip pocket of households. We expect inflation to rise further and that the Reserve Bank will continue hiking the cash rate to peak around 2 to 2.5% in the first half of 2023.

The significant hit to consumer confidence that has played out over recent months points to downside risks to the outlook for consumer spending, particularly discretionary spending. Indeed, we could see a loss of momentum in spending growth later this year.

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