Data snapshot

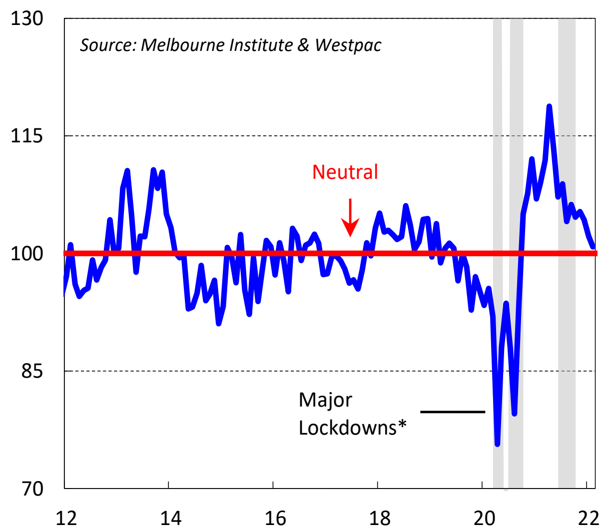
Wednesday, 9 February 2022

Consumer Sentiment

Focus Swings From Virus to Rates & Prices

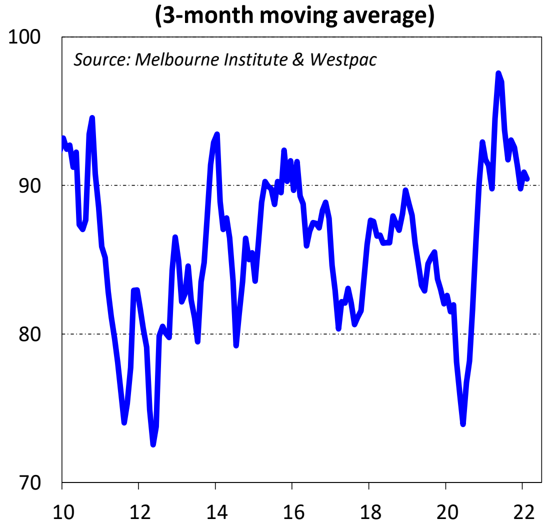
- **Consumer sentiment, as measured by Westpac and the Melbourne Institute, fell 1.3% to 100.8 in February. The index has fallen for three consecutive months since the emergence of the Omicron variant. It is down 4.3% since November 2021. The index is now at its lowest level since September 2020.**
- **Cost-of-living pressures appear to have taken a toll on confidence, which was also dented by growing prospects of interest rates rises on the horizon. These factors overshadowed falls in COVID-19 cases following a peak in mid January and a rosier view of the economic outlook.**
- **Despite the fall, the index remains above 100, as optimists continue to outweigh pessimists. Encouragingly, households are more upbeat about the economic outlook, consistent with the expectation that Omicron disruptions won't derail the recovery.**
- **Sentiment fell in Victoria (-7.7%), NSW (-5.7%), and WA (-1.5%). Pessimists now outweigh optimists in Victoria and NSW. Sentiment rose in Tasmania (8.5%), Queensland (1.6%) and SA (1.1%) after declining in January.**
- **The time to buy a dwelling index fell by 2.4% to 84.9. The prospect of interest rate increases on the horizon is likely weighing on sentiment for prospective purchasers. In February, 66% of respondents expected interest rates to move up over the next year, up from 55% in January.**
- **Consumer spending is expected to rebound strongly, supported by pent-up demand, a large war chest of savings, a strong labour market, and robust asset prices. However, inflationary pressures and higher interest rates may pose headwinds for some households.**

Consumer Sentiment Index



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

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



Consumer sentiment, as measured by Westpac and the Melbourne Institute, fell 1.3% to 100.8 in February. The index has fallen for three consecutive months since the emergence of the Omicron variant. It is down 4.3% since November 2021. The index is now at its lowest level since September 2020.

Cost-of-living pressures appear to have taken a toll on confidence, which was also dented by growing prospects of interest rates rises on the horizon. These factors overshadowed falls in COVID-19 cases following a peak in mid January and a rosier view of the economic outlook.

Inflation has been more elevated than previously expected, as demonstrated by the strong CPI outcome for the December quarter, released in late January. Growing inflationary pressures have been driven by high fuel prices and supply-chain disruptions, which pushed up goods prices and the cost of building new homes.

Relatedly, the Reserve Bank Governor has conceded that rate hikes in 2022 are “plausible”. This marks a considerable shift for the central bank, which in the not-too-distant past was maintaining that it did not expect rates would rise until 2024. As a result, some households could be facing higher mortgage rates sooner than they expected. The survey period coincided with this change in guidance from the central bank.

Despite the fall, the index remains above 100, as optimists continue to outweigh pessimists. Across the country, sentiment fell in Victoria (-7.7%), NSW (-5.7%), and WA (-1.5%). Victoria and NSW more than reversed the increases they experienced in January. Pessimists now outweigh optimists in Victoria and NSW as sentiment has fallen below 100 in both states. Sentiment rose in Tasmania (8.5%), Queensland (1.6%) and SA (1.1%) after declining in January.

The drop in confidence follows a fall in the weekly Roy Morgan measure, which declined from 101.8 to 99.9 in the week ending 6 February.

The fall in sentiment was driven by a decline in views around family finances. The ‘family finance last 12 months’ sub-component dropped 9.3% and the ‘family finance next 12 months’ sub-component was down 1.2%. These drops may reflect cost-of-living pressures (petrol prices, in particular, have increased sharply in recent months), and the prospect of higher interest rates. Additionally, the ‘current conditions’ sub-component fell 4.5%, perhaps reflecting some lingering effects from disruptions to income as millions of people were required to isolate during the Omicron outbreak.

Encouragingly, households are more upbeat about the economic outlook, consistent with the expectation that Omicron disruptions won’t derail the recovery. The ‘economic conditions next 12 months’ and ‘economic conditions next 5 years’ sub-components rose by 2.5% and 1.5%, respectively.

The unemployment rate fell to a 13 year low of 4.2% in December. This demonstrated the strong momentum that was evident in the labour market prior to the Omicron outbreak. The outbreak is expected to result in a fall in hours worked, however, the impact on employment levels is expected to be more limited. The strength seen was also reflected in the consumer sentiment survey. The unemployment expectations index fell to 102.8, its second lowest level since February 2011. This suggests that consumers expect the labour market to continue to strengthen and for unemployment to continue to fall. We expect the unemployment rate to have a ‘3’ at the front of it by the end of 2022. This is a rate that has not been sustained consistently since the 1970s.

The time to buy a dwelling index fell by 2.4% to 84.9. The prospect of interest rate increases on the horizon is likely weighing on sentiment for prospective purchasers. In February, 66% of respondents expected interest rates to move up over the next year, up from 55% in January. However, despite expectations of future rate rises, house price expectations for the next year still rose 8.7%.

Outlook

Consumer spending makes up more than 50% of economic activity in Australia and is expected to rebound strongly. Spending is expected to be supported by pent-up demand, a large war chest of savings, a strong labour market, and robust asset prices. However, inflationary pressures and higher interest rates may pose headwinds for some households.

We expect the economy to recover strongly after the temporary impacts from the Omicron variant. The labour market is forecast to continue to improve and unemployment is expected to fall below full employment over 2022. These factors are expected to support a lift in wages growth as the economy grows above its trend rate of growth and lead the RBA to deliver the first rate hike in August 2022.

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