

Media release

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Consumer Sentiment soars as economy ‘escapes’ recession

The Westpac–Melbourne Institute Index of Consumer Sentiment rose by 12.7% in June from 88.8 in May to 100.1 in June.

Westpac Chief Economist, Bill Evans, commented, "This is a truly remarkable result. It is the second largest recorded increase in the Index since the survey began in 1974 and the largest increase in the last 22 years.

"It is very likely that the dominant factor behind this extraordinary rise was the release of the March quarter national accounts last Wednesday which registered a small but nevertheless positive growth rate for the Australian economy in the March quarter following the contraction in the economy in the December quarter. That result was widely hailed in the media as indicating that Australia had avoided a recession (defined as two consecutive quarters of negative growth).

"From the consumer's perspective that was extremely encouraging news since they had already benefited from a 385 bp cut in the variable mortgage rate; and around \$14 bn of direct government transfers with another \$5bn to come. The unemployment rate had

actually fallen in April to 5.4% so on the assumption that Australia had avoided a recession and the worst had passed, consumers have become much more confident.

“The significance of the word "recession" to consumers was previously highlighted in March 2001 when the Index fell by 13.2% following the release of the December quarter 2000 national accounts which showed negative growth and was hailed in the media as portending a recession. The Index snapped back with an 11.6% jump when March quarter data showed the economy rebounding.

“However, we warn that the positive reaction in June is probably premature. The March quarter national accounts still portrayed a very weak economy with domestic spending falling by 1% – the sharpest fall since December quarter 2000. Overall GDP growth was positive because imports contracted by an extraordinary 7.0% allowing net exports to contribute 2.2 pts to GDP growth and ensuring a positive result. We expect this net export effect to partially reverse in the next two quarters with GDP registering consecutive negative quarters of growth a re-establishing the "recession" label. This points to a potential negative shock to sentiment when the June quarter GDP figures are released in September.

“Other factors would also have contributed to this stunning result. Driven by the consistent improvement in financial assets particularly global share markets (Australia's market is up by 26% since the March low and 5% since the last Survey) Consumer Sentiment has been on the rise in most of the major economies. The latest reading from the US showed a 5.5% increase – taking the gains from the low in February to 22%.

“The Index is now at its highest level since January 2008 when the unemployment rate was 4.3% and the economy was growing at a 4% pace.

“Since the authorities started providing the economy with stimulus (when the Reserve Bank unexpectedly cut rates by 0.25% on September 3) the Index had only increased by around 3% despite the record monetary and fiscal stimulus. That was undoubtedly because consumers accepted that the stimulus would be associated with a recession threatening jobs and financial welfare. With those concerns apparently allayed in the eyes of consumers (optimists now slightly outnumber pessimists) this surge in the Index can be seen as a delayed response to the significant stimulus over the last 9 months. If as we expect we are likely to see substantial increases in the unemployment rate over the next 12 months then, as we saw in the early 1990's, consumer sentiment will remain under considerable downward pressure.

“Four of the five components of the Index increased. These increases were led by economic expectations with "economic conditions over the next 12 months" up by 37%; "economic conditions over the next 5 years" up by 20.2%. Assessments of family finances were also strong with "expectations of family finances over the next 12 months" up by 11.1% and "family finances vs a year ago" up by 8.1%. The only component that fell was "time to buy major household items" which was down by 1.6%.

“Overall the "Current Conditions" Index was up by only 2.2% compared with 20.7% for the Expectations Index. That emphasis on expectations is similar to the recent result we saw for the US Index when Expectations were up by 10.0% and current conditions fell by 0.9%.

“We are of the view that the "Current Conditions" is a more reliable indicator of the likely outlook for consumer spending. In that regard it is significant that the one component of the Index which fell was the one most closely correlated with overall consumer spending – "Time to buy major household items". That is a major qualification of the reliability of this movement in the Index for predicting consumer spending.

“Our assessment that averting a recession was the main driver of the result is supported by the News Heard Index. This Index showed that 77.5% of respondents recalled news items on Economic Conditions with the next highest categories being "Interest rates" on 23.9% and "International Conditions" on 19.2%. There was a sharp improvement in respondents assessments of all those categories compared to the last measure in March.

“With purchases of housing and motor vehicles seen as the most cyclical components of expenditure there was further good news on "Time to Buy a Dwelling" and "Time to Buy a Car" indices. The former is up 2.5% since March and now 80% since last June. The car industry would be buoyed by an 8.7% increase in that Index since March and a 51% increase since last June.

“The increase in Confidence has encouraged respondents to raise the risk profile of their investments. The proportion of respondents who assessed banks as the wisest place for their savings fell by 5.7 ppts from 32.8% in March to 27.1%. In contrast, the proportion of respondents who favoured shares increased by 5.6 ppts from 6.7% in March to 12.3%.

“The Reserve Bank Board next meets on July 7. Westpac has assessed for some time that the Bank is unlikely to deliver on its easing bias in the near future. This result only strengthens the case for rates to remain on hold. Uncertainties associated with the sustainability of the current stability in the global financial system; the outlook for the Australian labour market; the potential for ‘recession’ to be resurrected in the media's coverage; and pressures on banks' funding costs will encourage the Bank to maintain its easing bias for some time to come”.

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Survey interviews are conducted by **OZINFO** Research on the telephone using trained interviewers. Telephone numbers and the household respondent are selected at random. This latest survey is based on 1200 adults aged 18 years and over, across Australia. It was conducted in the week from 1 June to 7 June. The data have been weighted to reflect Australia's population distribution. Copyright at all times remains with the Institute of Applied Economic and Social Research.