

Media release

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Surprise surge in Consumer Sentiment

The Westpac Melbourne Institute Consumer Sentiment Index increased by 9.3% in July from 100.1 in June to 109.4 in July

Westpac Chief Economist, Bill Evans, commented, "This is unquestionably a stunning result. My personal view had been that given that last month we saw the second largest increase in the Index since we started measuring the Index in 1974 any rise in July would have been a great result. The news on the variables that traditionally impact the Index had generally been downbeat. Despite this, sentiment has posted another strong gain with the Index now printing an increase of 23.2% over the last 2 months – the largest 2 month increase in the Index since the survey began in 1975. And it is the largest increase by a substantial margin. The second largest 2 month increase was 18.8% in March 1992 when households were finally convinced that the Australian economy was coming out of recession.

“This is now the highest level of the Index since December 2007. It is 38.5% above its level a year ago and at 109.4 optimists decisively out-number pessimists for the first time since December 2007.

“This rise is despite no boost from the traditional drivers of confidence – petrol prices actually increased by 3.6%; the Reserve Bank left rates on hold in June despite its maintaining its easing bias; we even saw one bank modestly raising mortgage rates despite no rate change from the Reserve Bank; the equity market rally has stalled since the last survey registering a modest fall of 3.6%; and the rise in the Australian dollar has been arrested. International news has been mixed. China's recovery has gathered pace but it has become apparent that market optimism about an early recovery in the major economies has been misplaced with global sharemarkets down by 3.7% since the last survey.

“Last month we indicated that a key explanation for the near record jump in the Index was the relief that households would have felt when reading that Australia had dodged a recession with the release of the March quarter national accounts. This is likely to have been a supporting reason behind the July result – with notable rises in sentiment towards the economic outlook. However, we suspect there have been other factors at work as well.

“Clearly we are dealing with much larger forces than the ones that typically drive confidence. The stand out force must be the huge financial handouts introduced by the Government to counter the global financial crisis. Note that the handouts came in two tranches. The first tranche of \$8.4bn was paid mainly to pensioners and carers in December and the second of \$12.7bn has been paid to low /medium income earners over

the March/May period. After Sentiment and spending failed to respond to the first tranche there was some criticism that the payments had been "wasted". In hindsight it appears that this first tranche may have been too narrowly based and that those receiving the payments were initially cautious given the avalanche of disturbing information associated with the global financial crisis. No such criticism can be levelled at the second tranche. It has now been almost fully disbursed and has resulted in an instant boost to retail sales and supported this surge in confidence.

“The unexpected resilience of the employment figures has also played a role. Households whose exposure to the sharemarket had been limited had expected that the major impact of the global financial crisis on their welfare would have been through the jobs market. However, over the last two months the unemployment rate has remained steady. It appears that firms which only a year ago were nominating a shortage of quality labour as the major constraint on their businesses are now hoarding labour. The lead indicators are suggesting that firms have sharply curtailed plans to employ new workers but the ongoing switch from full time to part time highlights firms' efforts to retain workers. Workers are feeling more secure in their jobs. As of June, the Westpac-Melbourne Institute measure of job security¹ has improved by 12% since its low in February, although it is still 20% lower than a year ago. We will release the latest update of this index tomorrow. The Consumer Sentiment Index is now at its highest level since December 2007 when the unemployment rate was 4.3% compared with the current reading of 5.7%.

“The success which the government’s stimulus package has achieved in boosting confidence will be a lesson to other governments including the US which have taken

¹ Westpac-Melbourne Institute Index of Unemployment Expectations.

different approaches in their stimulus packages. The key is not the direct impact of increasing spending capacity - even these two huge handouts still only represent 2% of GDP. The key is to restore confidence and this policy approach as the first stage of a comprehensive program seems to have been more successful than tax cuts or direct spending.

“The lift in Confidence appears to have spread to the housing market. In May we added a special question to the Survey asking households about their expectations for house prices. In May, only 32% of respondents expected house prices to rise over the next 12 months. In the July survey that proportion has increased to 52%. And the rise has not been due to over exuberant First Home Buyers. Respondents in the 35-54 age bracket have increased their confidence levels from 28% to 53%.

“Risks still remain. The handouts have now been curtailed. The second stage of the government's stimulus package - the \$14.7bn spending over 2009/10 mainly directed at schools is unlikely to have a similar impact on confidence. Meanwhile the unemployment rate is set to rise further (we expect it to reach 7.5% by year's end). Even if there are limited job reductions the lack of new hiring will mean the natural increase in the workforce will not be absorbed and the unemployment rate will rise. We still expect, despite an improving outlook for consumer spending, that second quarter GDP will print negative, reviving recessionary concerns. Evidence from the last recession points to confidence levels taking a solid hit once the unemployment rate starts to rise quickly.

“Four of the five components of the Index increased. In particular respondents were positive about the economic outlook. "Expected economic conditions over the next 12

months" increased by 19.6%; "Expected economic conditions over the next 5 years" increased by 15.7%. Assessments of their own finances were more subdued. "Family finances over the next 12 months" increased by 3%; "Family finances compared to a year ago" fell by 0.9%; "Whether now is a good time to buy major household items" increased by 9.5%. Note that this latter component actually fell last month by 1.6% despite the 12.7% rise in the overall Index. Research shows this component is a particularly reliable lead indicator of overall spending so its strong rise is a very encouraging point for retailers.

"Yesterday we saw the latest Statement from the Governor following the Reserve Bank's Board meeting in July. While maintaining the general sentiment, "some scope for further easing of monetary policy" the rhetoric in the Statement was substantially more up beat than in June. This print for the Index will encourage even more optimism from the Bank. Clearly it will be some months before a case can possibly be made to deliver on the easing bias. In these volatile times the situation can change rapidly with the labour market and the global economy being the most likely candidates. However we must say that the probability of the Bank acting on its bias has diminished markedly.", Mr. Evans said.

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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 29 June to 5 July. 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.