

# Media release

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## **Consumer sentiment continues to rise**

The Westpac–Melbourne Institute Index of Consumer Sentiment rose by 1.7% in October from 119.3 in September to 121.4 in October.

Westpac's Chief Economist, Bill Evans, commented, "This rise is significant since the survey follows the Reserve Bank's decision to raise interest rates by 0.25%. However the result should come as no surprise. Evidence from the last tightening cycle, which began in May 2002, points to sentiment being resilient to rises while rates remain very low. For example, following the first rate hike in 2002, when the Reserve Bank raised rates from 4.25% to 4.5%, the Index fell by a modest 1.1%. The follow up move from 4.5% to 4.75% the next month actually saw a modest improvement in the Index of 0.5%.

"Over that previous period the standard variable mortgage rate was increased from 6.05% to 6.55%. In the current cycle the standard variable mortgage rate has been increased from 5.8% to 6.05%. As such, it seems unlikely that the next 0.25% increase in the mortgage rate, which Westpac expects to follow the next Board meeting of the Reserve Bank on November 3, will have any marked impact on sentiment.

“In the last tightening cycle, sentiment only started to respond adversely to interest rate increases once the standard variable mortgage rate exceeded 6.55%. The consecutive 0.25% increases in November and December 2003, which pushed the standard variable rate from 6.55% to 7.05%, saw a cumulative fall in sentiment of 5.2% while the next move in March 2005, which pushed the standard variable rate to 7.3%, saw a 15.5% collapse in sentiment. Subsequent increases over the next three years saw falls in sentiment averaging 8.5% following the move.

“Back in 2003 household debt to income ratios were around 130% compared to the current ratio of around 155%. Higher debt levels are likely to make households even more sensitive to increases in the standard variable rate. It is reasonable to expect that once the Reserve Bank's overnight cash rate starts exceeding 3.5% we will start to see sentiment responding adversely to rate hikes.

“Of course, interest rates are not the only factor affecting sentiment. In that regard, other developments were all supportive of sentiment. Since the last survey the share market has risen by 7.2%, petrol prices have fallen by 7.5%, and the Australian dollar has increased a further 7.5% to be 50% above its lows of around a year ago.

“The resilience of the labour market has also been buoying sentiment. The surprise fall in the unemployment rate from 5.8% to 5.7% in September strengthened households' convictions that their jobs are safe. Indeed some commentators have been speculating that the unemployment rate may have peaked although that is not Westpac's view.

“Last month we noted the sharp divergence between improvements in the Expectations Index and the Current Conditions Index. The Expectations Index rose by 1.1% while the Current Conditions Index was up by 2.7% in October. The Expectations Index is now at its

highest level since the survey was first produced in 1975. These stellar expectations are not matched by households' assessments of current conditions. While solid, this Index is well below previous peaks.

“This raises some doubt about the extent to which the upbeat mood feeds through to actual spending. In the past, high levels of overall consumer sentiment have usually led to 'booming' consumer demand but have had a more even mix of expectations and current conditions. Being optimistic about the future but still somewhat constrained financially may mean consumers remain more cautious, something echoed by the lingering risk aversion evident in their attitudes towards savings.

“The news on housing was mixed. We saw an 11% fall in households' assessments of whether now is a good time to purchase a house to the lowest level since November 2008. However, our subsidiary question on the outlook for house prices showed very buoyant expectations. Of those respondents with an opinion, 74% expected prices to rise compared to 53% when we last surveyed this issue in July.

“Both components of the Index which assess current conditions increased. Opinions on "Family finances compared to a year ago" improved by 4.2% while views on whether now is a good or bad "time to buy major household items" increased by 1.6%. Households were particularly confident about the near term economic outlook. Opinions on "Economic conditions over the next 12 months" rose by 5.7% although those on the five year economic outlook fell by 2.6%. Expectations for "Family finances over the next 12 months" rose by 0.5%.

“The Reserve Bank Board next meets on November 3. We expect the Board to raise the overnight cash rate by 0.25% and indicate in the associated statement that more rate

hikes are likely. As discussed earlier, we would not expect the next rate hike to damage sentiment although subsequent moves are likely to see sentiment turning down”, 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 5 October to 11 October. 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.