

Media release

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Surprisingly modest fall in Consumer sentiment

The Westpac–Melbourne Institute Index of Consumer Sentiment fell by 3.8% in December from 118.3 in November to 113.8 in December.

Westpac's Chief Economist, Bill Evans, commented, "This is a surprisingly modest fall in the Index given recent developments on interest rates. On December 1, the Reserve Bank raised the overnight cash rate by 25 bp's for an unprecedented third consecutive month and most banks increased their variable mortgage rates by more than the 25 bp's. The standard variable mortgage rate has now increased to between 6.5% and 6.75% compared to around 5.75% as recently as September. Over that period the Index has fallen by 4.7% from its near record highs.

"We expected that there was a real possibility that the Index would fall much more sharply than the 3.8% which it has registered. Note that after the RBA tightened by 25 bp's in March 2005 the variable mortgage rate was increased to 7.3% from 7.05% and the Index fell by a massive 15.5%. Each subsequent increase in mortgage rates over the course of 2006 and 2007 generally saw "double digit" falls in the Index. With households now holding even more debt relative to their incomes we expect that we must be getting close

to levels of the variable mortgage rate where households will become much more sensitive than is currently the case.

“A closer inspection of the components of the Index shows that those folks holding a mortgage have responded much more negatively to the rate increases than those who are not holding a mortgage. Confidence amongst those with a mortgage fell by 8.9% while Confidence of those who are renting actually increased by 1.6% while those wholly owning their homes registered a fall of 4.1%.

“Other positive factors are clearly supporting the Confidence of those households who are not borrowers. The share market rose by 2.4%; the Australian dollar was slightly higher; and petrol prices were broadly stable (up by 0.7%). However, encouraging news on the labour market was probably the most important offset to the news on interest rates.

Following the stunning increase of 40,000 jobs in September it was reported that a further 25,000 new jobs had been created in November despite market forecasts for job losses. Supporting this view was the "News Heard Index" which, surprisingly, showed that more households recalled news on the state of the economy than on interest rates.

Their assessment of the news on interest rates was decidedly pessimistic but the assessment of news stories on the economy was still comparatively upbeat.

“All components of the Index fell in December although the assessment of Current Conditions (down by 2.1%) was more resilient than Expectations (down 4.9%)”.

Responses on “Family finances compared to a year ago” (down 1.9%); “whether now is a good time to buy a major household item” (down 2.3%) and “the five year economic outlook” (down 1.4%) were all quite modest falls. Households are more concerned about

the near term. Responses on "Family finances over the next 12 months" (down 6%) and "economic conditions over the next 12 months" (down 7.2%) were both much weaker.

“However retailers should derive considerable comfort from the relatively modest fall of only 2.3% in the "time to buy a major household item" component.

“The interest rate increases clearly affected Sentiment towards housing with the "Time to Buy a Dwelling" Index down by a relatively modest 12.3% since September although, surprisingly, the Index actually increased by 2.5% over the month. For households it appears that optimism about house prices may be offsetting any concerns about interest rates as far as housing is concerned. This broader optimism is supported by the 2.9% increase in households' sentiment towards purchasing a motor vehicle over the month.

“With rising deposit interest rates banks have increased their attraction to savers. The proportion of those respondents nominating banks as the wisest place for savings increased from 26.7% to 29%. This increase is likely to reflect higher rates rather than risk aversion. The proportion of households indicating that the wisest place for savings is to pay down debt fell from 25.5% in September to 20.7% in December. Real estate preferences increased from 15.6% to 18.5% also supporting the view that rising house price expectations have more than offset the impact of higher interest rates.

“The Reserve Bank board does not meet again until February 2. The Governor's last Statement indicated that the Board would most likely have paused if there had been a meeting in January. With the scheduled pause in January it appears likely that the Bank will opt to raise the overnight cash rate by 25 bp's on a fourth occasion in February. The

evidence from this survey is that households overall are coping relatively well with the interest rate increases to date. Optimism about house prices and jobs are partially offsetting the impact of rate hikes on Consumer Sentiment. We have little doubt that we are nearing a point where the level of the variable mortgage rate will start to elicit a much more negative response across all households but the evidence from this survey is that we are not there yet”, Mr Evans said.

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Further information:

Bill Evans	Guay Lim	Michael Chua
Chief Economist	Melbourne Institute	Melbourne Institute
Westpac Banking Corporation	Ph: (61-3) 8344 2146	Ph: (61-3) 8344 2144
Ph: (61-2) 8254 8531		

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 30 November to 6 December. 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.