

# Media release

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## **Modest fall in Consumer Sentiment Index reflects continuing caution on rates**

The Westpac–Melbourne Institute Consumer Sentiment Index fell by 2.6% in February from 120.1 in January to 117 in February.

Westpac's Chief Economist, Bill Evans, commented, “The fall in the Index is a little surprising. Households received a very welcome surprise in February when, despite strong media and market speculation to the contrary the Reserve Bank decided not to raise the overnight cash rate.

“However, the level of the Index remains very high. It is still 2.9% above the December 2009 reading; 3.2% above the reading of 6 months ago and 15.2% above its long term average.

“While recognising that rates were held steady in February households do not expect rates to have peaked. A special question in the February survey on consumers' expectations for mortgage interest rates supports this view. An overwhelming 93% of consumers expect rates to rise over the next 12 months with over 60% expecting an increase of more than

1%. This is consistent with the reasonable commentary on the RBA's rate decision, which emphasised that rates were still likely to rise further over the course of the year. Indeed the Governor's Statement was quite explicit on that point.

“This caution on interest rates is probably best reflected by the response of those folks who currently hold a mortgage where their confidence fell by considerably more than those respondents who wholly own their homes or who rent.

“Other factors which are likely to have unnerved respondents were the adverse developments in the global economy. These included news that the Chinese authorities unexpectedly moved to slow their economy; the emergence of further sovereign risk concerns in Europe and four consecutive loss weeks on the US share market. Not surprisingly these developments affected Australia's financial markets. Since the last Sentiment survey the Share Price Index has fallen by around 8% and the Australian dollar was down by 6.5%.

“Respondents would have been buoyed by lower petrol prices. Petrol prices are down by 4% since the last survey. Because there has only been a 3 week break since the last survey there has been no fresh news on the labour market. We suspect the surprisingly strong 5.6% increase in the Index last month was largely driven by the further reported fall in the unemployment rate in January.

“With such significant falls in the share market and caution about interest rates it does not surprise that the components of the Index which experienced the largest falls related to respondents' views on their own finances. Responses to "Family finances compared to a

year ago" fell by 5.4% while the 12 month outlook for finances deteriorated by 4.6%. Expectations for "Economic conditions over the next 12 months" fell by 0.8% and the 5 year outlook for economic conditions improved by 1.6%. Responses to "Whether now is a good time to buy a major household item" fell by 4.1% to remain above the long term average of 127.8 (though only by a modest 2.6%).

"The Reserve Bank Board next meets on March 2. The surprise decision to put rates on hold in February has convinced markets that the Bank will pause again in March. The Governor's Statement indicated that the Bank planned to raise rates further but the February pause indicated they see less urgency. In the Bank's Statement on Monetary Policy the most prominent downside risk to their upbeat growth outlook was nominated as "a significantly slower recovery in the world economy than currently expected". Recent global developments will highlight the need for caution. For us the key is that the Bank is still forecasting that growth will return to trend in 2010 and 2011. That indicates the need to restore the overnight cash rate to around "neutral" which we assess as 4.5%. Until that objective is achieved we expect that each Board meeting will be a close call although the period when rates are increased at consecutive meetings appears to have passed. The March meeting will mark three months since the last move and the Bank will have had sufficient time to assess the impact of the rate increases in the final months of 2009. Despite current market sentiment a return to stability in global economic conditions over the next three weeks could still see the Bank opting for another increase in March", 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 1 February to 7 February 2010. 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.