

Media release

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Surprising fall in Consumer sentiment

The Westpac Melbourne Institute Index of Consumer Sentiment fell by 8.3% in December from 103.4 in November to 94.7 in December.

Westpac's Chief Economist, Bill Evans commented, "The Index has now fallen to its lowest level since August this year when respondents were concerned that the Reserve Bank was preparing to raise interest rates while global financial markets had taken a tumble".

"On face value it should be a surprise that the Index has not risen following a second rate cut from the Reserve Bank (which was eventually passed on in full by the major banks to mortgage borrowers). However the history of previous easing cycles shows that rate cuts do not guarantee an improvement in sentiment.

"Since 1994 we have seen 20 rate cuts including last week's. On 12 occasions the Index has increased following the rate cut and on 8 occasions it has fallen. The likely explanation is that respondents' concerns over the reasons behind the rate cut may overwhelm the perceived benefits of the cut itself.

"For this survey we also ask respondents questions about those news items which they most recall and whether these items are perceived positively or negatively. When interest

rates are moving they typically capture considerable attention. For this survey news on interest rates was recalled by 31.5% of respondents whereas economic conditions attracted the attention of 60%; international conditions 55.6% and Budget and taxation 36.9%.

“The news on economic conditions; international conditions and Budget and taxation was considered the most negative since 2008/09. News on interest rates was the most positive since that period.

“Despite the positive perception of interest rates the confidence of respondents with a mortgage fell by 9.5%.

“Specific news which is likely to have unnerved respondents is the reported increase in the unemployment rate from 5.2% to 5.3% with a loss of 40,000 full time jobs. Of course, the constant stream of news on developments in Europe is also likely to have impacted respondents, while equity markets were volatile.

“Four of the five components of the Index fell in December. The sub-index tracking views on "economic conditions over the next 12 months" was down by 19.4%; while "economic conditions over the next 5 years" fell by 14.4%; "family finances compared to a year ago" fell by 8.6% although "expectations for family finances over the next 12 months" improved by 3%. The sub-index tracking views on "whether now is a good time to buy a major household item" fell by 3%.”

“Risk aversion increased markedly in this survey. When asked about "the wisest place for savings" 26.6% of respondents nominated "pay down debt". That was an increase from 18.7% in September. Since we started measuring that component in 1997 there has only

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been one higher measure, in March 2010. Only 6.6% of respondents nominated equities – the lowest percentage since 1993; while the 14% nominating real estate was, apart from 2008, the lowest since the survey began in 1974.

“Attitudes towards purchasing housing and motor vehicles also fell modestly. The index tracking views on "time to buy a house" was down by 1.9% while the index tracking views on "time to buy a Car" was down by 1%.

“The Reserve Bank Board next meets on February 7. After having cut rates in both November and December the decision to move will become progressively more difficult. However it is our view that rates are still slightly above neutral giving plenty of scope for more cuts. This read on Consumer Sentiment will be noticed by the Bank although it will also observe the resilience of overall consumer spending as measured by the national accounts despite generally poor prints for Consumer Sentiment in the second half of 2011.

“For us a very important signal from this survey is the heightened level of risk aversion. So far that high level of risk aversion and associated rise in the savings rate has not unduly constrained consumer spending due to strong labour income growth. Evidence from a weakening labour market is pointing to a slowdown in income growth which is likely to be associated with a softening of spending if savings rates do indeed remain high. That dynamic will have to feed into the Bank's growth outlook although as indicated by our "news heard" indexes respondents' and the Bank's own perceptions of overseas economic developments will continue to be a key driver of interest rate policy.

“We continue to expect that the Board will decide to further cut rates at its upcoming meeting on February 7”, 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 December to 11 December 2011. The data have been weighted to reflect Australia's population distribution. Copyright at all times remains with the Melbourne Institute of Applied Economic and Social Research.