

Media release

20 May 2009

Strict Embargo 10:30am

Consumer Sentiment loses ground

The Westpac Melbourne Institute Index of Consumer Sentiment fell by 4.3% in May from 92.7 in April to 88.8 in May.

Westpac Chief Economist, Bill Evans, commented, "The key factor behind the fall in the Index would have been consumers' assessments of the Federal Budget which was released prior to the survey being conducted. Our records indicate that this is the second biggest fall in the Index following the release of a Budget in the last ten years. In fact the only larger fall occurred in May 2006 when the Index fell by 6.4% although we expect that the principal reason behind that fall was the surprise rate hike by the RBA in the week prior to the release of the Budget. That rate hike was the first since December 2004 and signalled the beginning of a new cycle of rate hikes. As such it is reasonable to exclude 2006 from the sample and observe that the Index has shown its most negative response to a Budget in the last ten years. That result is probably not so surprising given the difficult economic circumstances in which the Budget has been framed. The fall, while large for a recent post Budget period, is not particularly significant in the context of the volatility we have seen over the last decade.

“The level of the Index remains very disappointing. Despite considerable improvement in financial markets and offshore sentiment the Index is only 2.3% above its average for the December and March quarters which are accepted as the low points for the world economy.

“There are other secondary factors unrelated to the Budget which should be taken into account when assessing this result. On the negative side it is reasonable to have expected some statistical offset to the sharp 8.3% increase in the Index last month. There may also have been some disappointment that the Reserve Bank held rates steady at their May Board meeting. However, on the positive side, we saw a 8% increase in the Australian dollar and a 3% rise in the Australian share market. Over the month there has been a discernible improvement in sentiment both towards global financial markets and prospects for the global economy. Unlike Australia, we saw improvements in the Consumer Sentiment Indexes in the US; the UK; Europe and Japan.

“Clues as to why consumers may have reacted negatively to the Budget may be found in the various age and income stratifications. Confidence of people in the centre age group (25–44) fell by 7.4%. Confidence of those in the upper income range (over \$60k) fell by 6.5% and for those earning less than \$40k the Index fell by around 5%.

“Amongst the components of the Index we saw large falls in those categories associated with consumers' assessments of their own financial position. "Family finances vs a year ago" was down by 7% and "Family finances over the next 12 months" fell by 7.3%. It is reasonable to conclude that consumers did not see the Budget as a positive for their own

finances and are focussing on the temporary nature of the fiscal handouts and the apparent limited scope for further fiscal stimulus over the years ahead.

“The short term economic outlook ("economic conditions over the next 12 months") was unchanged whereas "economic conditions over the next 5 years" was down by an extraordinary 13.6%. This is the second largest fall in this relatively stable component in the last ten years and probably indicates that consumers have been unnerved by the sharp rise in the government's deficit and the associated ballooning of the national debt. In contrast there was a 7.3% increase in the component, "whether it is a good time to buy a major household item". Consumers are clearly responding to the current improvement in their cash flow from the fiscal stimulus and rate cuts but concerns about their overall finances (and the likely future deterioration) may constrain their spending activities.

“The Reserve Bank Board next meets on June 2. While the possibility of cutting rates will once again be vigorously discussed we expect that the Bank will choose once again to hold rates steady. However, that doesn't signal the end of the rate cutting cycle. The sharp increase in the national debt and associated deterioration in the federal government's balance sheet will constrain the government's flexibility to pursue further substantial discretionary fiscal stimulus. That puts the emphasis back on to monetary policy which will need to be seen to be responding when the unemployment rate tracks from 5.5% to 8.25% (government's forecast) over the course of the next twelve months. We envisage that the Bank will resume cutting rates in August with a target to reduce the overnight rate by a further 1% through to end 2009”.

Issued by: Westpac Banking Corporation

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 11 May to 17 May. 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.