

15 June 2022

Inflation and rate hikes drag sentiment towards historic lows

- **Sentiment falls 4.5% to 86.4 in June, hit by inflation concerns and 50bp rate hike.**
- **Homebuyer sentiment nearing Global Financial Crisis lows.**
- **House Price Expectations cooling rapidly, especially in NSW and Victoria.**
- **Most consumers expect mortgage rates to rise more than 1% by June 2023.**
- **Labour market confidence holds at relatively strong levels.**

The Westpac Melbourne Institute Consumer Sentiment fell 4.4% in June from 90.4 in May to 86.4 in June.

On June 7, the Reserve Bank announced a 50bp increase in the cash rate which was passed on in full by the banks.

This read is even weaker than we had expected.

Over the 46-year history of the survey, we have only seen Index reads at or below this level during major economic dislocations. The record lows have been during COVID-19 (75.6); the Global Financial Crisis (79.0); early 1990s recession (64.6); the mid-1980s slowdown (78.7) and the early 1980s recession (75.5). Those last three episodes were associated with high inflation; rising interest rates; and a contracting economy – a mix that may be threatening to repeat.

The survey detail shows a clear picture of a slump in sentiment being driven by rising inflation; an associated lift in interest rates; and a loss of confidence around the economic outlook, both here and abroad.

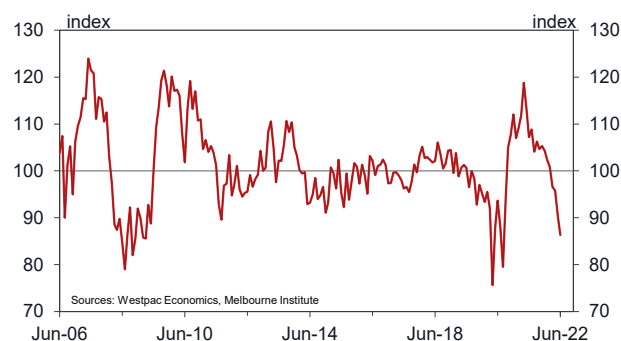
Every three months we ask respondents about their news recall on specific topics. By far the highest recall in June was around news on inflation – nearly 60% of respondents noted news on this topic. This compares to 43% for ‘economic conditions’, 24% for ‘interest rates; and 23% for ‘international conditions’.

This is a particularly high level of recall for ‘inflation’ news – second only to a 62% read just prior to the Global Financial Crisis and compared to a long run average of just 12%. Not surprisingly, 84% of those recalling inflation news assessed it as unfavourable. This compares to 71% for ‘interest rate’ news; 85% for news on ‘international conditions’; and 78% for news on ‘economic conditions’.

There has been a steady increase in the proportion of consumers who expect significant increases in interest rates over the next 12 months. In June, 58% of respondents expected rates to increase by more than 1% over the next year. That compares with 50% in May, 36% in April and 30% in March. Notably, this share jumped to 65% amongst those surveyed following the RBA’s 50bp rate hike.

Inflation and interest rate concerns have taken a toll on the sub-indices that assess family finances and the near-term economic outlook.

Consumer Sentiment Index



The ‘finances compared to a year ago’ sub-index dropped 7% to 74.0 while the ‘finances, next 12 months’ sub-index fell 7.6% to 86.2.

The level of the ‘finances next 12 months’ sub-index is particularly noteworthy. Unlike other sub-indices this one is lower than during the 2008-09 Global Financial Crisis (GFC) – 18% below the average during that period. Enduring high inflation and rising interest rates appear to be a much more concerning prospect for finances than the credit market dislocations and global growth collapse seen during the GFC.

Around the economic outlook, moves were more mixed, the ‘economic outlook, next 12 months’ sub-index is down by 7.2% to 83.8 but the ‘economic outlook, next 5 years’ sub-index is holding up surprisingly well, edging 2.1% higher to 98.1.

Surging prices continue to take a heavy toll on spending intentions. The ‘time to buy a major household item’ sub-index fell 3.3% to 89.5 – weaker reads have only ever been seen during the onset of the COVID pandemic, the GFC and the early 1990s recession.

Despite this collapse in consumer sentiment, Westpac is still constructive on the near-term outlook for consumer spending. The main drivers are a continued post-COVID reopening and the freeing-up of savings, with important support coming from strong labour markets.

High confidence in the labour market is still very clear in our June survey. The Westpac-Melbourne Institute Unemployment Expectations Index remains at very low levels, falling marginally from 109.6 in May to 108.5 in June (a decline means more respondents expect the unemployment rate to fall – an improved outlook). The Index is still 16% below its long run average of 130.

The same cannot be said for confidence around housing which has seen a further significant deterioration.

Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

The 'time to buy a dwelling' index fell 3.1% from 77.5 in May to 75.1 in June – a new post-GFC low. The index reflects deteriorating affordability which had been due to rising prices but is now being affected by actual and expected rises in interest rates.

A deep chasm has opened between males and females on this topic, with index reads of 85.8 (up 1.1%) for males and 64.7 (down 8.6%) for females. This disharmony does not bode well given that house purchases are usually the most important single spending decision for many families.

House price expectations continue to cool rapidly. The Westpac Melbourne Institute Index of House Price Expectations fell by 8.4% from 121.4 to 111.1. The Index is still above 100, indicating that more respondents expect prices to rise than fall. However, the picture across states varies. In NSW the Index fell by 11.2% to 103.8 while in Victoria it fell by 9.9% to 101.50. It looks likely that pessimists will soon hold sway in both states. In contrast, optimism still abounds in Queensland where the state index rose 3.1% to 124.5.

The wedge between males and females is also apparent on house price expectations, if not quite as severe (115.2 vs 107.2).

Consumer risk aversion has also intensified. Our June survey included updates on our 'wisest place for savings' questions which is run every three months. Safe or defensive options are now heavily favoured with a further rise in the proportion of consumers nominating 'bank deposits', and 'pay down debt'. Indeed, just over 64% of consumers nominated debt repayment or capital protected options, up from 59% in March and near the extreme high of 65.5% seen during the GFC. Conversely, very few consumers favour riskier options, only 8% nominating 'real estate' and 8% nominating shares.

The Reserve Bank Board next meets on July 5. The best policy in a tightening cycle is to move quickly in the early stages of

the cycle when interest rates are clearly below neutral and the risk of over-tightening is moderate. It is also important to signal, as early as possible, to economic agents that the Bank is committed to containing inflation.

We saw a 50bp move in June from 0.35% to 0.85% and we expect another 50bp move in July. That would see not only the emergency cuts in 2020 being withdrawn but also most of the 75bp of cuts made in 2019, when the Board became frustrated with its inability to lift inflation back to within the 2-3% target band.

As we have seen with today's survey, high inflation has become the major challenge for the Australian economy. The RBA needs to normalise policy quickly to begin to address this very disturbing challenge. Another 50bps in July will be a further decisive step in this process.

Bill Evans, Chief Economist, ph (61-2) 8254 8531

Consumer Sentiment – June 2022

Item	avg*	Jun 2020	Jun 2021	May 2022	Jun 2022	%mth	%yr
Consumer Sentiment Index	101.4	93.7	107.2	90.4	86.4	-4.5	-19.5
Family finances vs a year ago	89.2	77.0	89.6	79.6	74.0	-7.0	-17.3
Family finances next 12mths	107.4	105.3	107.3	93.3	86.2	-7.6	-19.7
Economic conditions next 12mths	91.1	77.2	108.7	90.4	83.8	-7.2	-22.8
Economic conditions next 5yrs	92.0	102.4	114.0	96.2	98.1	2.1	-13.9
Time to buy a major household item	126.2	106.3	116.5	92.6	89.5	-3.3	-23.2
Time to buy a dwelling	117.9	107.6	96.1	77.5	75.1	-3.1	-21.8
Unemployment Expectations Index	129.5	127.2	108.4	109.6	108.5	-1.0	0.1
House Price Expectations Index	126.8	80.6	157.8	121.4	111.1	-8.5	-29.6

Source: Westpac-Melbourne Institute.

*avg over full history of the survey, all indexes except 'time to buy a dwelling', 'unemployment expectations' and 'house price expectations' are seasonally adjusted

The survey is conducted by OZINFO & DYNATA. Respondents 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 6 June to 9 June 2022. 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.

Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

© Copyright 2022 Westpac Banking Corporation

Things you should know.

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ('Westpac').

Disclaimer

This material contains general commentary only and is not intended to constitute or be relied upon as personal financial advice. To the extent that this material contains any general advice, it has been prepared without taking into account your objectives, financial situation or needs, and because of this, you should, before acting on it, consider the appropriateness of the advice, having regard to your objectives, financial situation and needs, and, the disclosure documents (including any product disclosure statement) of any financial product you may consider. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This material may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Country disclosures

Australia: Westpac holds an Australian Financial Services Licence (No. 233714). This material is provided to you solely for your own use and in your capacity as a client of Westpac.

For XYLO Foreign Exchange clients: This information is provided to you solely for your own use and is not to be distributed to any third parties. XYLO Foreign Exchange is a division of Westpac Banking Corporation ABN 33 007 457 141 and Australian credit licence 233714. Information is current as at date shown on the publication. This information has been prepared without taking account of your objectives, financial situation or needs. Because of this you should, before acting on this information, consider its appropriateness, having regard to your objectives, financial situation or needs. XYLO Foreign Exchange's combined Financial Services Guide and Product Disclosure Statement can be obtained by calling XYLO Foreign Exchange on 1300 995 639, or by emailing customer@xylo.com.au.

New Zealand: In New Zealand, Westpac Institutional Bank refers to the brand under which products and services are provided by either Westpac or Westpac New Zealand Limited ("WNZL"). Any product or service made available by WNZL does not represent an offer from Westpac or any of its subsidiaries (other than WNZL). Neither Westpac nor its other subsidiaries guarantee or otherwise support the performance of WNZL in respect of any such product. The current disclosure statements for the New Zealand branch of Westpac and WNZL can be obtained at the internet address www.westpac.co.nz. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QFE Group Financial Advisers Act 2008 Disclosure Statement at www.westpac.co.nz.

China, Hong Kong, Singapore and India: This material has been prepared and issued for distribution in Singapore to institutional investors, accredited investors and expert investors (as defined in the applicable Singapore laws and regulations) only. Recipients in Singapore of this material should contact Westpac Singapore Branch in respect of any matters arising from, or in connection with, this material. Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking licence and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activities. This material is intended only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking and Insurance Regulatory Commission (CBIRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

UK: The contents of this communication, which have been prepared by and are the sole responsibility of Westpac Banking Corporation London and Westpac Europe Limited. Westpac (a) has its principal place of business in the United Kingdom at Camomile Court, 23 Camomile Street, London EC3A 7LL, and is registered at Cardiff in the UK (as Branch No. BR00106), and (b) authorised and regulated by the Australian Prudential Regulation Authority in Australia. Westpac is authorised in the United Kingdom by the Prudential Regulation Authority. Westpac is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons.

Disclaimer continued overleaf

Disclaimer continued

Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for “eligible counterparties” and “professional clients” as defined by the rules of the Financial Conduct Authority and is not intended for “retail clients”. With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation(EU) 596/2014).

Investment Recommendations Disclosure

The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

- I. Chinese Wall/Cell arrangements;
- II. physical separation of various Business/Support Units;
- III. Strict and well defined wall/cell crossing procedures;
- IV. a “need to know” policy;
- V. documented and well defined procedures for dealing with conflicts of interest;
- VI. reasonable steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

U.S.: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission (“CFTC”) as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC (“WCM”), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 (‘the Exchange Act’) and member of the Financial Industry Regulatory Authority (‘FINRA’). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.