

# Economic research note

22<sup>nd</sup> January 2009

## Weak sentiment to subdue retail sales in 2009

- **Consumer sentiment, as measured by the Westpac-Melbourne Institute Consumer Sentiment Survey, fell 2.2% in January 2009 from its level in December 2008 falling 12.8% over the last year.**
- **The survey shows consumers are increasingly concerned over the outlook for economic growth and the labour market in Australia over 2009.**
- **With the labour market expected to deteriorate over the next six months there is unlikely to be any further substantial improvement in sentiment until 2H09.**

Consumer sentiment measures households' expectations about current and future economic conditions. As such it offers an insight into the likely strength of household consumption and retail sales. If the index is greater than 100 the outlook for households is positive.

### The data

In January 2009, the consumer sentiment index (as measured by the Westpac-Melbourne Institute Consumer Sentiment Survey) fell by 2.2% from 92.0 to 89.9. Over the year to January 2009, the index has fallen 12.8%. This is part of a longer decline in sentiment that began when the index peaked at 123.9 in May 2007. Since July 2008 sentiment has steadied though it remains well below the ten year average level of 107. This is seen in Figure 1.

Figure 1

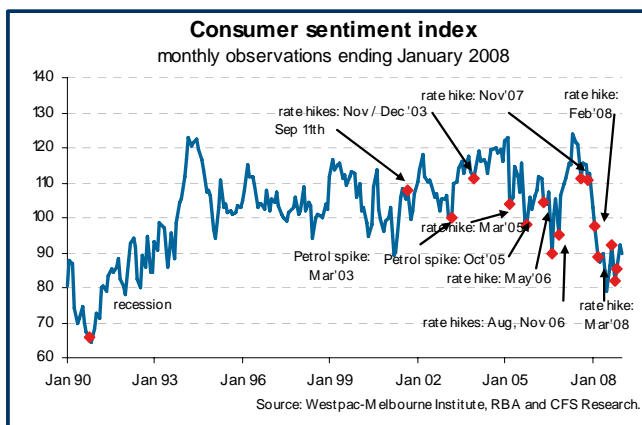
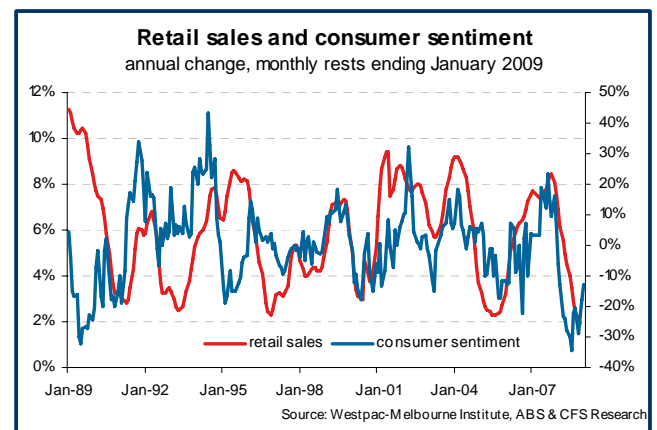


Figure 2



### Analysis

The collapse in consumer sentiment throughout 2007 and into 1H08 was due to aggressive monetary tightening by the Reserve Bank of Australia (RBA) and the onset of the global credit crisis. However, sentiment stabilised during 2H08, at least temporarily, despite ongoing falls in equity markets, as households reacted to dramatic cuts in interest rates and fiscal stimulus.

A strong positive correlation between retail sales and consumer sentiment appears to have emerged over the past ten years. This suggests that the current stability in sentiment should provide some support for retail sales in early 2009. This is shown in Figure 2. The weaker relationship between the two variables in the early to mid nineties reflects greater volatility in economic conditions characterised by pronounced interest rate cycles and substantial adjustments in the labour market.

The likelihood of further improvement in sentiment over the first quarter of 2009 seems low. Households will remain nervous as the labour market deteriorates CFS Research expects the labour market deterioration to result in a rise in

the unemployment rate in Australia to between 5% and 6% over 2009. (Please see [Labour market to deteriorate in 2009](#) for details.). This will offset the improvement in household finances associated with interest rate cuts. This is likely to result in subdued retail sales over 1H09.

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