

# Industry brief: consumer trends

## Consumer incomes, sentiment and expenditure

28 March 2006

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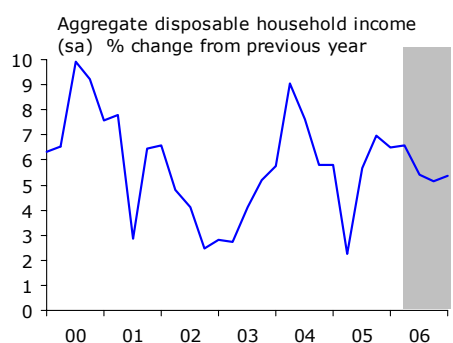
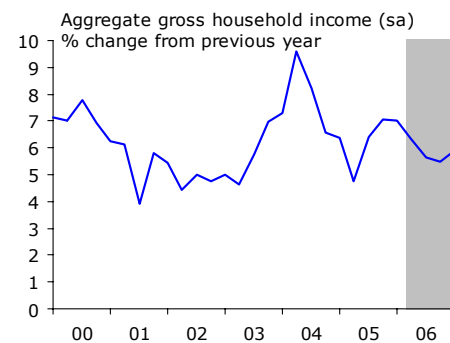
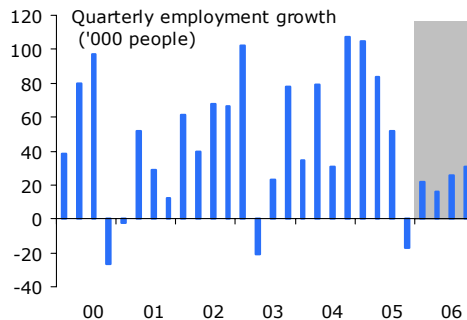
This brief is part of a series analysing current trends in Australian consumer spending preferences and patterns. The last issue was released in Oct. 2005.

Economics@ANZ publishes separate industry briefs twice yearly on retail sales (March and September) and new motor vehicle sales (February and August).

## Consumer income trends

Australian households appeared relatively prosperous at the start of 2006. Employment was holding steady (the decline over the last few months of 2005 had been reversed by February 2006) and unemployment was hovering around 5.2% — close to the lowest level in 30 years. Annual gross household income averaged around \$94,300 and disposable household income averaged \$69,350.<sup>1</sup> Average ordinary time earnings for full time employees were \$1,026 per week, or \$53,352 per year.<sup>2</sup> Other household income is derived from returns on investments (mainly in the form of rents and dividends).

### Employment is steady and real household incomes are growing nicely



Sources: ABS 5206.36; ABS 6202.0; Economics@ANZ

<sup>1</sup> Economics@ANZ. Excludes interest. Assumes an estimated 8.1 million residential dwellings in 2005.

<sup>2</sup> ABS 6302.02, seasonally adjusted. Average earnings for all employees (full time, part time and other) was \$808.60 per week, or \$42,047.20 per year, in Dec 2005.

In 2006, we expect employment to increase by around 1.1% (compared to 3.2% in 2005) and the unemployment rate to move closer to 5.4%, as the domestic economy moves down a gear from the property-driven pace of 2004-05. With an otherwise healthy economy and no fall in employment, aggregate household income is expected to grow by 5.5% and aggregate disposable income by 5.2% in 2006 — well above GDP and inflation (CPI), both anticipated to grow by just under 3%.

### Consumer sentiment trends

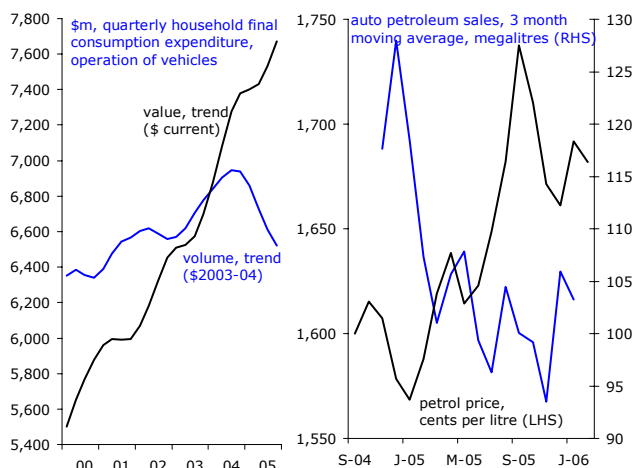
In 2005, the key drivers of consumer sentiment and spending were petrol prices and house prices. Other direct influences included interest rate adjustments (earlier in 2005), solid employment growth, a strong dollar (which reduced the cost of imported consumer goods) and a general bias toward 'cocooning' — that is, holidaying near home and spending at home.

In 2006, the factors affecting consumers' disposable incomes and attitudes to spending will include: on-going high petrol prices; another round of income tax cuts flagged in last year's Budget taking effect from July (perhaps with further tax cuts to be announced in this year's Budget); rising childcare costs (in many locations); slower employment growth; and a weaker dollar.

### Petrol prices

The big story for consumer sentiment in 2005 was petrol prices. Metropolitan petrol prices peaked at around 127 cents per litre in September 2005 — 27% higher than a year earlier (monthly weighted average). Petrol sales (in megalitres) fell immediately in response, but only by 7.8% on the same month of 2004. Petrol sales slowly climbed back up in late 2005, but remained significantly below sales levels of a year earlier. Total automotive petrol sales ended 3% lower in 2005 than in 2004. By January 2006, monthly petrol sales were still 2% lower (by volume) than in January 2005.

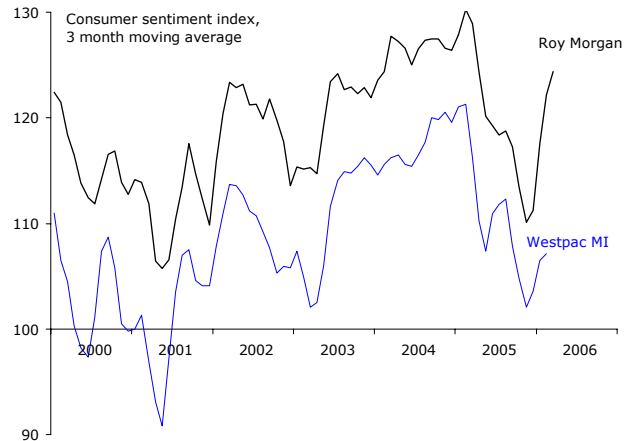
#### Petrol — spending more but buying less



Sources: ABS 5206.0 (trend); DITR; Motormouth

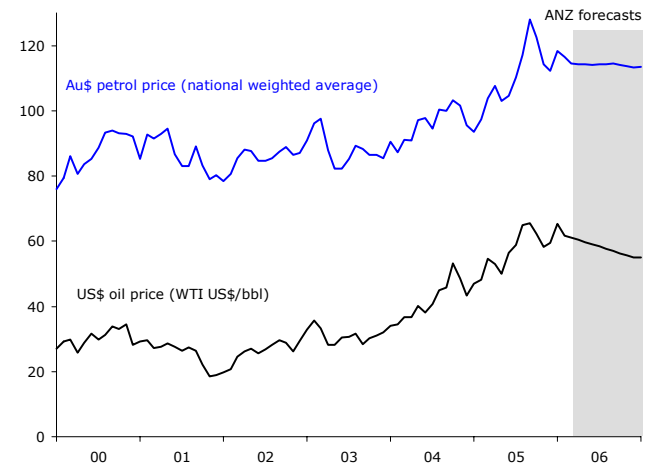
At a national level, 2005's petrol price increases meant that households spent 4% more on operating their cars (the main cost component of which is fuel) in nominal terms, but they bought 6% less in real terms (that is, household expenditure adjusted for inflation of the cost of running a car), in the December quarter of 2005 than they did in the same quarter of 2004.

### Consumers are recovering from the price shock



Sources: Roy Morgan; Westpac Melbourne Institute

### Fuel prices will stay relatively high in 2006



Sources: Datastream; Motormouth; Economics@ANZ

2005's petrol price rises were immediately mirrored in equally sharp drops in consumer sentiment, certain categories of retail spending and large car purchases.<sup>3</sup> This pessimism, however, proved to be temporary. By early 2006, petrol prices had eased somewhat and consumers were beginning to look up (if not yet spend up) again. Both the Westpac MI and Roy Morgan monthly consumer sentiment surveys showed rising confidence in the first two months of 2006. The Sensis quarterly survey showed consumer confidence (in household and personal finances for the next year) moving back to a net positive balance in Feb. 2006 (56%), from a

<sup>3</sup> Economics@ANZ *Motor Vehicle Outlook*, February 2006 and *Industry Brief: Retail Trade*, March 2006. [www.anz.com/go/economics](http://www.anz.com/go/economics)

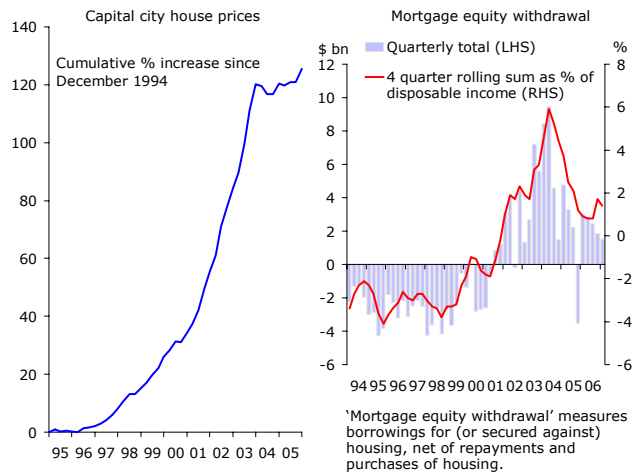
net negative balance (44%) in Nov. 2005 (the first net negative sentiment recorded in this survey).<sup>4</sup>

While consumer sentiment appears to have recovered, actual spending may take longer, due to petrol's real and ongoing impact on household disposable incomes. We expect oil and petrol prices to ease only slowly in 2006. Despite consumers' best efforts to reduce their fuel consumption, higher fuel prices will continue to eat into disposable incomes and discretionary spending.

### House prices

The second big influence on consumers in 2005 was the end of the housing price boom in most parts of Australia. While flat or declining house prices have helped to improve affordability for first home-buyers, they have also reduced the extent to which existing home-owners are prepared to draw down their equity in their homes to fund retail, leisure and other spending. Home-owners in many urban locations have now moved into a 'balance sheet consolidation' phase and are borrowing less against their real estate assets (for non-housing purposes) than they did from 2003 to 2005.

#### Established house prices and mortgage equity withdrawals have peaked in most locations



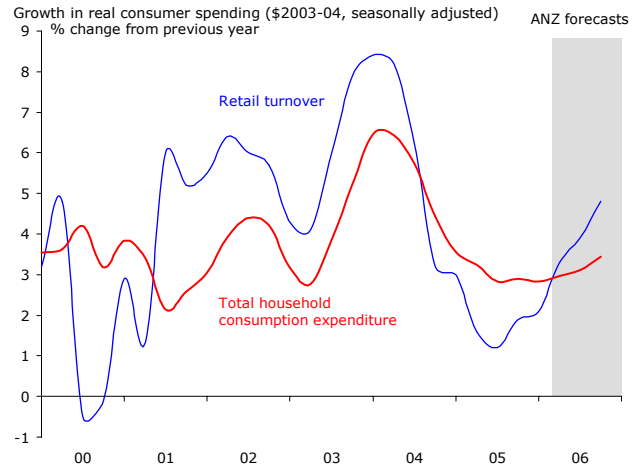
Sources: ABS; RBA; Economics@ANZ

The exceptions to this trend are Perth and Darwin, which (together with some regional centres in Queensland) are currently in the midst of a belated property price boom, fuelled in part by the international surge in demand for mineral resources. Elsewhere in Australia, some locations (such as inner Sydney) which hit their price peak early may already have reached the bottom of the current price cycle and be ready to start swinging up again soon. Low residential vacancy rates and solid underlying demand indicate that house prices are unlikely to languish for too long.<sup>5</sup>

## Consumer spending trends

Both real household expenditure and real retail turnover decelerated (that is, the growth rate slowed but stayed positive) in 2005, after a period of particularly strong growth over the preceding two years. Real annual retail turnover growth slowed from a peak of 8.4% in March 2004 to just 1.9% in December 2005 (3.4% in nominal terms due to moderate inflation in the December quarter).

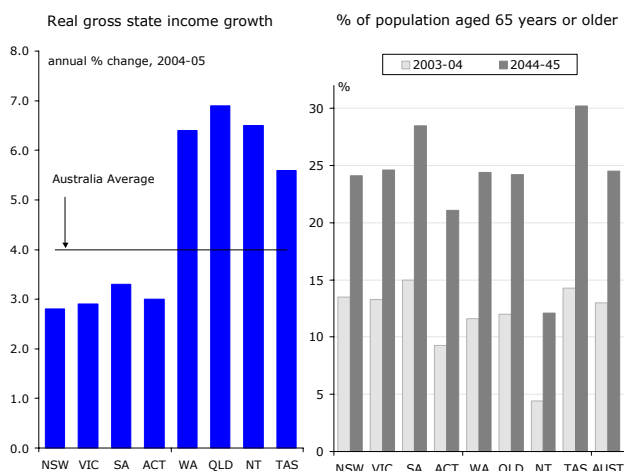
### Household spending will accelerate again in 2006



Sources: ABS 5206.0, 8501.01 (CVM sa); Economics@ANZ

Retail figures for January 2006 suggest that spending growth may be picking up again. With continuing growth in real household incomes and tax cuts from July, consumer spending growth should accelerate by late 2006. We expect household consumption to grow by around 2.5%, and retail spending by around 3.5% p.a. in 2006.

### Australia's states have different growth paths



Sources: ABS; Productivity Commission

There will, however, be noticeable differences in consumer spending between states, in line with differences in their current economic performance and demographic trends. WA, NT and, to a lesser extent, Qld are currently benefiting from mining and property booms and can expect stronger consumer activity as a result.

<sup>4</sup> The quarterly *Sensis Consumer Report* commenced in May 2004.

<sup>5</sup> Economics@ANZ, *Property Outlook*, Dec 2005.

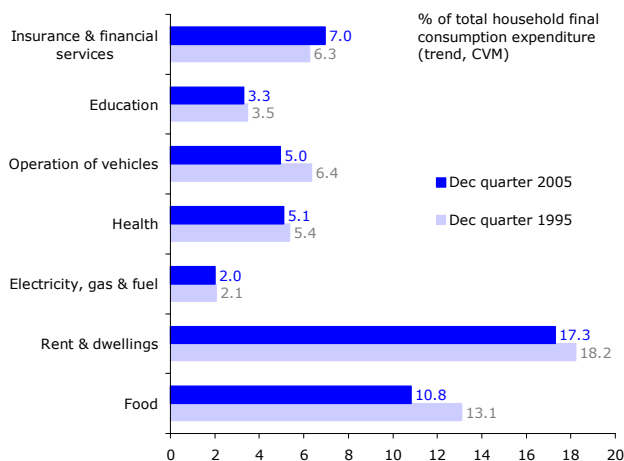
Tasmanian state income has also been growing at an above average rate, due to increased property values and growth in agriculture, forestry, mining, tourism and other specialized industry pockets.

Consumption patterns will also reflect demographic differences, with a younger population in the NT and ACT and an older (and more rapidly ageing) population in SA and Tasmania. As a broad generalization, older populations tend to buy fewer retail goods and to consume a different mix of goods and services than younger people.

## Essential expenditure

In December 2005, a lower proportion of national household consumption expenditure went on essentials (such as rent, food, utilities and health services<sup>6</sup>) than it had a decade earlier — leaving a higher proportion of expenditure for discretionary items. Despite higher fuel prices, the proportion of household expenditure devoted to the operation of private vehicles (the main cost component of which is fuel) also declined over the decade.

### Smaller proportion of expenditure for essentials



Source: ABS 5206.20 (CVM trend)

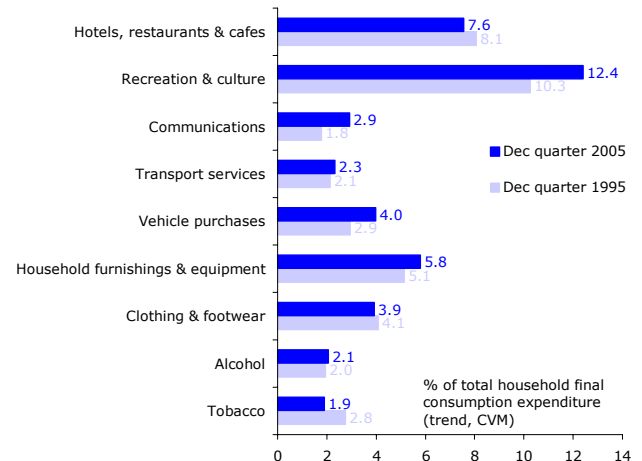
One of the few exceptions to this pattern has been insurance and financial services (which most people would regard as essential rather than discretionary), which have taken a larger share of household expenditure through insurance, credit, investment and other products. This is consistent with the story of growing average household wealth and affluence arising from the property price boom, higher and more widespread share ownership and continuous economic growth over the past decade.

Health insurance has also seen a number of significant government policy and subsidy changes, plus price rises, over this period. These have affected household uptake and expenditure on this key insurance sector product.

## Discretionary spending

The proportion of total household expenditure going to most categories of discretionary goods and services increased in the decade from 1995 to 2005. Expenditure on some categories — including hotels, restaurants & cafes and recreation & culture — tend to fluctuate more than others.

### Higher proportion of expenditure going on cars, phones & recreation



Source: ABS 5206.20 (CVM trend)

Within the hotels and licensed clubs sector of retail turnover, the proportion spent on gambling increased from 36% in 2003 to 40% in 2005. Gambling turnover has been edging up, but it remains a small component of total national retail spending (3.3% in 2003 and 3.7% in 2005). Gambling turnover as a proportion of retail turnover largely reflects state gaming policies — it is highest in NSW and lowest in WA (where there are no poker machines outside that State's only casino).<sup>7</sup>

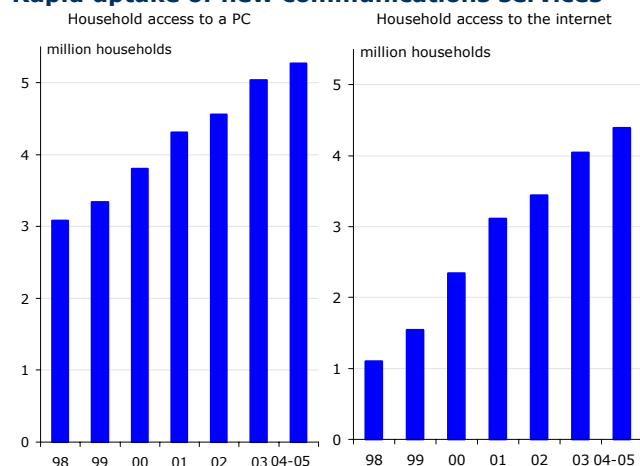
The one discretionary product category showing a continuous long-term decline is tobacco. This trend is largely due to conscious health and social policies and is set to continue. Smoking will be banned from an increasing number and variety of locations (including gaming venues) across most states.

The discretionary categories that have had the largest growth in their share of national household expenditure over the last decade have been vehicles, communications and recreation & culture. Car prices have come down significantly over this period due to tariff changes, a rising Australian dollar and stiff international competition in the automotive industry. Australians have responded by purchasing new cars in record numbers — 788,343 new passenger cars and SUVs in 2005<sup>8</sup> — and are spending more of their income on them as a result.

<sup>6</sup> Health insurance is included in 'insurance and financial services'. These data do not include public expenditure on health or other services.

<sup>7</sup> Gambling turnover includes TAB, Kino, bingo, poker machine and other electronic gaming transactions. ABS 8501.0.55.003, Feb 2006.

<sup>8</sup> Economics@ANZ, *Motor vehicle outlook*, Feb 2006.

**Rapid uptake of new communications services**

Source: ABS 8146.0

Communications (including phones, mobile phones and internet services) and recreational & cultural services have also seen significant growth in their share of household expenditure. These services are characterised by rapid technological development and rapid uptake of new products by consumers. Many new communications products have in turn begat (or enabled) more new products and services.

Technological development has also meant significant convergence and connection between these established categories of expenditure. For example, a pay-per-view film downloaded from the internet and viewed on a home screen would require expenditure across communications, entertainment and household equipment categories. Such a product may be replacing a more traditional entertainment experience (such as going to a cinema) or it may be providing an additional service.

## Summary

In 2006, Australian employment is expected to remain relatively stable, while real household incomes will continue to quietly increase.

In 2005, the issues of most immediate concern to Australian consumers were petrol prices and house prices. While concern over these has dissipated, they will remain an important influence on consumer sentiment and discretionary spending preferences through 2006. Due to the general health of the Australian and wider global economies, high oil prices haven't caused the widespread inflation that some people feared. The core inflation rate has stayed within the RBA target band (under 3%) and is expected to stay there for the time being.

Other factors will influence individuals' spending preferences to a greater or lesser degree. Tax cuts to be implemented from July 2006 will provide a discretionary spending boost for everyone.

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