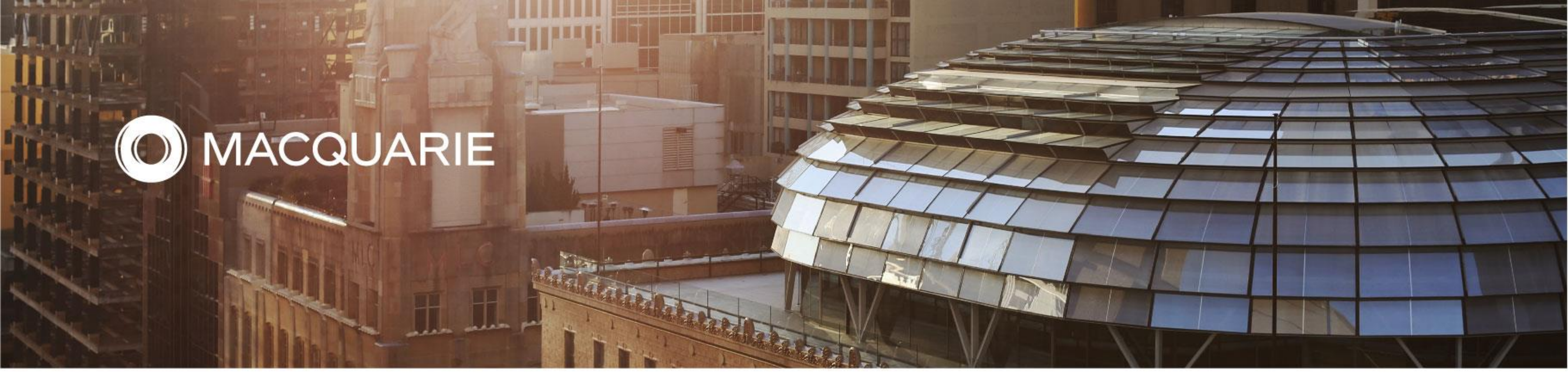


Australian Consumer Outlook

Demand to be a casualty in the fight against inflation

- Macquarie's Macro Strategy team expects consumption growth to slow into 2H22 as real household disposable income faces headwinds from high inflation, rising interest rates and weaker employment outcomes.
- Domestic spending has, so far, been relatively unscathed – rescued by a still elevated household savings ratio that has cushioned the impact of falling real disposable income amid high inflation and rising interest rates. However, this appears to be as good as it gets.
- Macquarie is confident that growth in consumer spending will slow materially due to a combination of factors:
  - The erosion of the 'savings cushion' (net household saving ratio) as the monetary policy tightening cycle deepens
  - Falling "wealth effects" (i.e. falling housing prices) and weaker housing activity dampening consumer demand
  - Increasing household interest-servicing debt burdens weighing on real household disposable income
  - Modest support for aggregate consumption from recovering population growth.

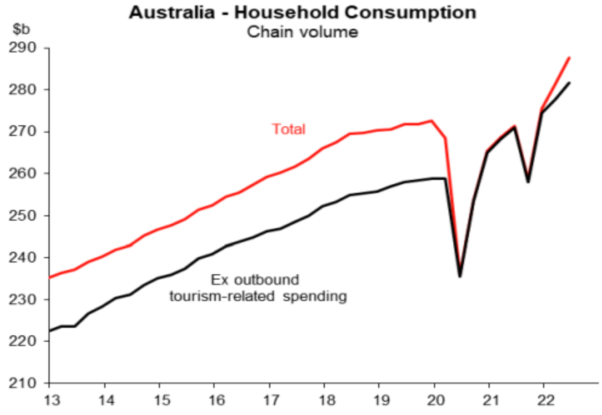
This is a summary of a recent report from Macquarie's Macro Strategy team "Aussie Consumer Outlook - Demand has to slow, but how much?".

Now is likely as good as it gets

Despite what is undeniably a deteriorating domestic economic growth backdrop, the near-term outlook for household consumption has remained solid. Domestic spending has, so far, been relatively unscathed – rescued by a still elevated household savings ratio that has cushioned the impact of falling real disposable income amid high inflation and rising interest rates.

Indeed, consumer spending has rebounded strongly after being severely depressed from COVID restrictions, with per capita consumption having rebounded above pre-COVID levels. In particular, discretionary goods consumption has been exceptional, benefitting from COVID-related demand for anything home-related, depressed spending on services, fiscal stimulus, and a stimulus boost to housing-related demand. This appears to be reversing now as services spending rebounds, with travel-related spending still to recover to pre-COVID norms.

Domestic consumer spending has recovered strongly

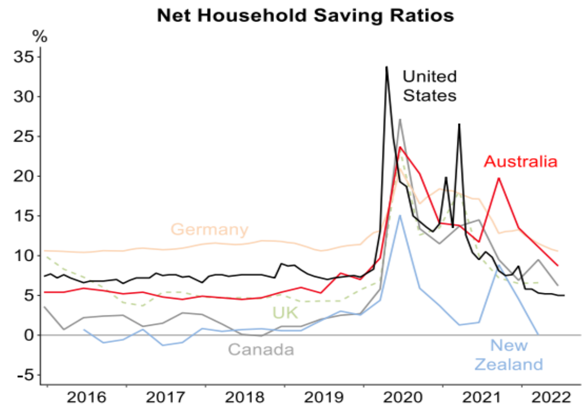


Source: ABS, Macquarie Macro Strategy, September 2022

…but a sharp slowdown is coming

However, this is likely to be as good as it gets. Beyond the near-term, Macquarie's Macro Strategy team expects consumption growth to slow into 2H22 for the following reasons:

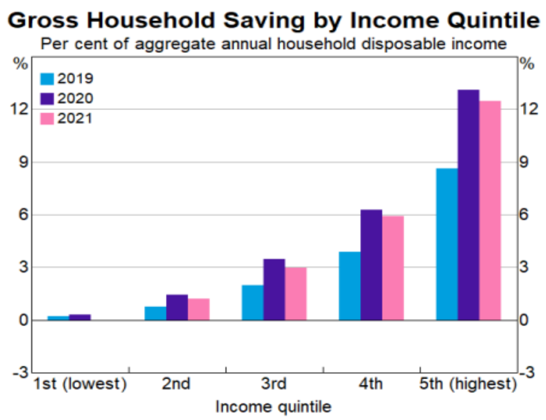
Domestic household savings ratio is expected to follow other countries down



Source: ABS, Macquarie Macro Strategy, September 2022

1. The erosion of the savings cushion: Although the household saving rate in Q2 (8.7%) remained above the pre-COVID average (6.5%), the RBA estimates that around 80% of this has been accumulated by households in the top 40% of the income distribution. While these households account for a high share of consumer spending, they are also less likely to be liquidity constrained and more likely to treat this 'excess' saving as an improvement in wealth rather than for spending.

Excess savings from COVID has been largely in higher income households

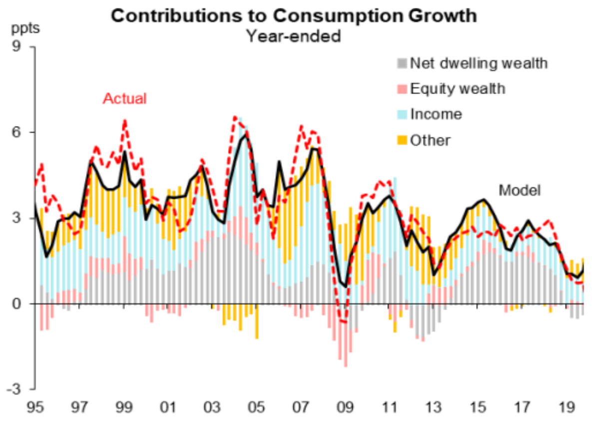


Source: ABS, RBA, Roy Morgan, Macquarie Macro Strategy, September 2022

The 'optimal' degree to which monetary policy will need to dampen consumer spending to bring inflation back to the RBA's target bands remains unknown and the risk that policy is tightened too much, at least temporarily, is real. While it is too early for the increase in interest rates to have had much impact on household cash flows, the degree of monetary tightening will, in turn, have a significant bearing on consumer spending and household disposable income moving forward.

2. Falling wealth and weaker housing activity: Studies have suggested that "wealth effects" on consumption can be asymmetric, with falling housing prices having a disproportionately large effect on consumer spending. For example, during the most recent period of falling housing prices (late-2017 to mid-2019) where prices fell more than 8%, consumption growth slowed sharply and by more than consensus at the time, with durables consumption categories the most susceptible (vehicles, furnishing, clothing).

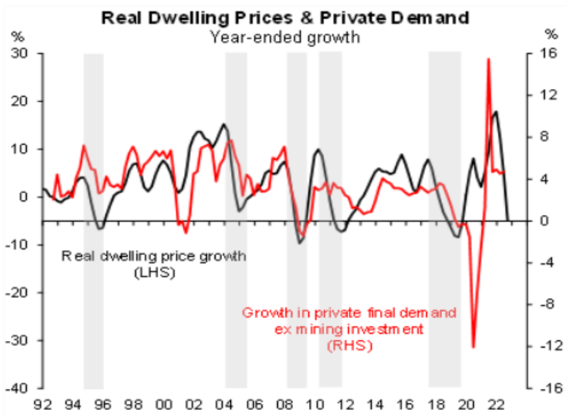
Weaker housing wealth has historically been correlated with weaker consumer spending growth



Source: ABS, RBA, Macquarie Macro Strategy, September 2022

Housing turnover has already fallen 20% from its peak at end-2021 (highest peak since 2004), with further declines anticipated. Additionally, house prices are forecast to fall by ~15% from peak to trough. If history is any guide, consumer spending and growth in aggregate private demand will likely feel the hit soon.

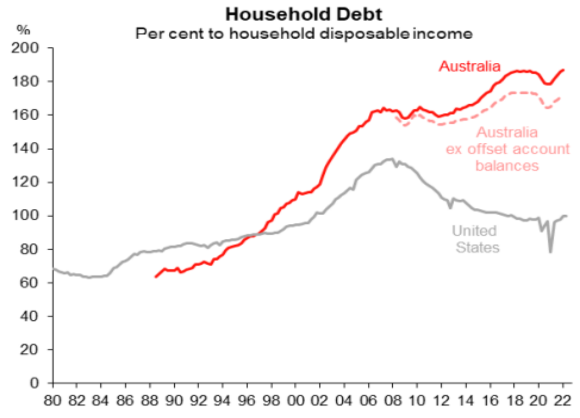
Broader private demand growth has historically weakened amid declining dwelling price growth



Source: ABS, CoreLogic, Macquarie Macro Strategy, September 2022

3. Consumer sensitivity to higher interest rates: Around 75% of Australian households have some form of debt, whether it is an outstanding owner-occupier mortgage or investment property loan. The high debt-to-income ratio of Australian households and the relatively high share of variable-rate mortgages means that Australian household disposable income is more sensitive to changes in interest rates, particularly compared with US households.

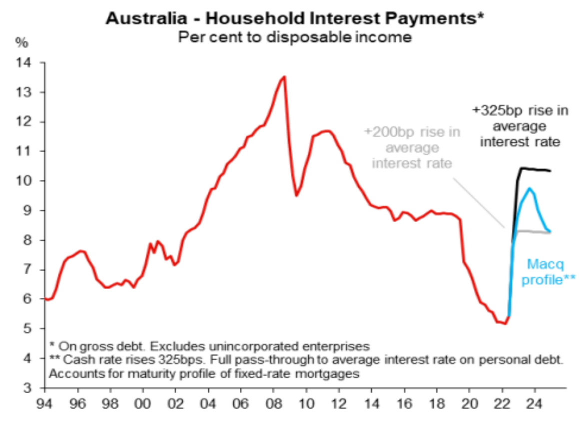
Australia's household debt burden is significantly higher than global counterparts



Source: ABS, CoreLogic, Macquarie Macro Strategy, September 2022

Recent and prospective increases in interest rates will push the household interest-servicing burden higher. While there is currently a high share of outstanding housing loans on fixed interest rates (~35%), around 60% of these will start to reset from 2H23 which would see broader household debt rise by 4.25-4.5% of income, assuming full pass-through to variable mortgage rates. This would see overall household interest burdens to peak at their highest levels in around a decade, further weighing on (real) household disposable income.

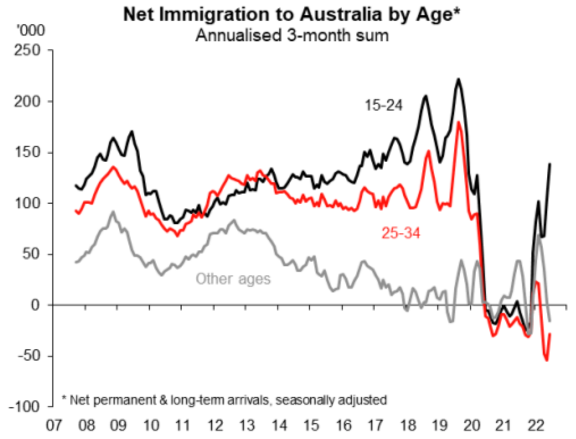
Australia's household debt burden to rise materially through 2023 as rate rises pass through



Source: ABS, CoreLogic, Macquarie Macro Strategy, September 2022

4. Only modest support expected from population growth: The sharp slowdown of domestic population growth due to COVID border closures has weighed on aggregate consumer spending growth. Encouragingly, population growth is now recovering amid a pick-up in net immigration, however, while Macquarie expect further improvement, population growth is not expected to settle back to pre-COVID rates anytime soon. Further, with a large portion of the increase in net immigration attributable to the return of international students, support to aggregate consumption growth is expected to be more modest than if the increase in net immigration was more evenly spread across age groups.

Recent pick-up in net immigration has been skewed towards younger age groups



Source: Department of Home Affairs, Macquarie Macro Strategy, September 2022

Macquarie WM Investment Strategy Team

This report was finalised on 30 September 2022.

Recommendation definitions (Macquarie Australia/New Zealand)
Outperform – return >3% in excess of benchmark return
Neutral – return within 3% of benchmark return
Underperform – return >3% below benchmark return

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