October 2018

Australian Households

What is CommBank data telling us?

Australian households are a source of economic stability and risk
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CommBank's balance sheet provides some interesting insights
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A new measure of satisfaction adds a quality metric to the debate
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The insights uncovered by analysis of our data by Chief Economist, Michael Blythe, have implications for policymakers, individuals and industries from industrials and logistics through to real estate.

CommonwealthBank of Australia

The big picture

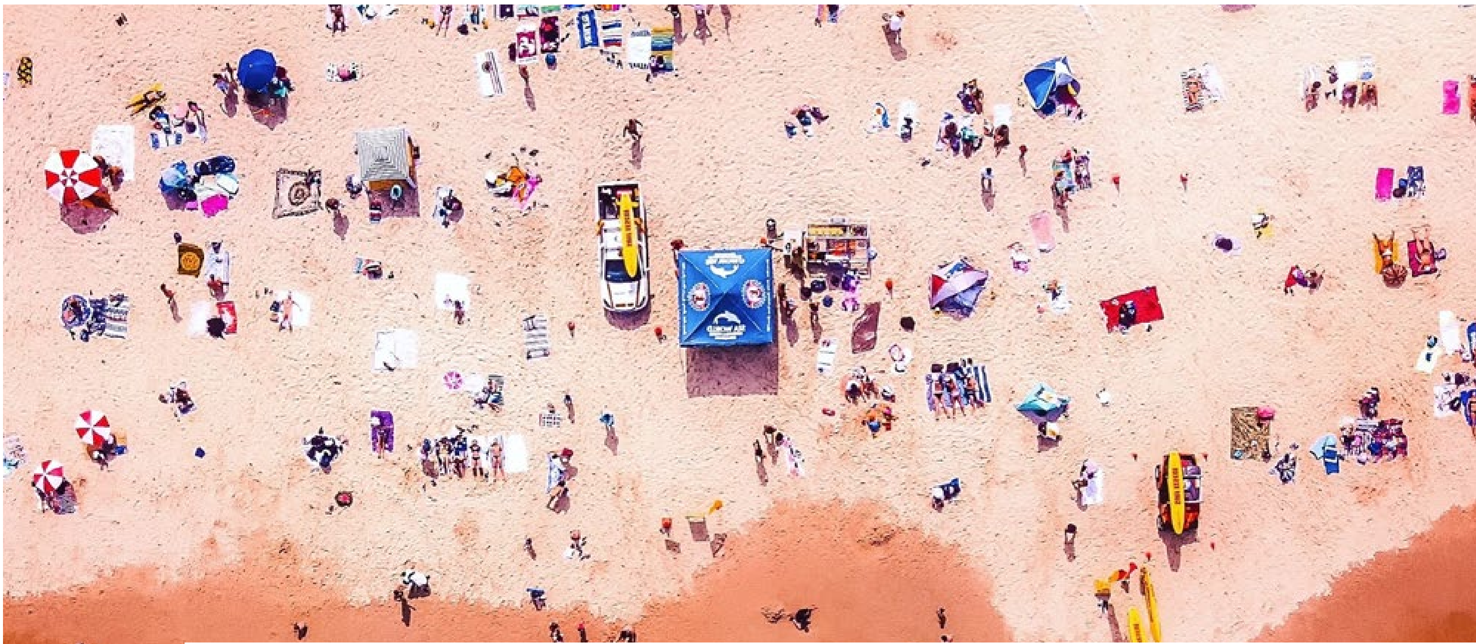
Households are the dominant part of the Australian economy:

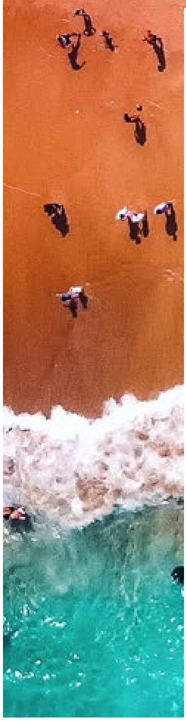
56%	Over the past decade consumer spending accounted for 56% of all economic activity.
5%	Household dwelling investment accounted for a further 5% of economic activity.
73%	Household primary income (excluding transfers such as taxes and welfare payments) represents 73% of national income.
70%	Households provide 70% of all income tax revenues and make a significant additional contribution via other taxes such as the GST, stamp duties and council rates.
44%	The household capital stock is equivalent to 44% of the total and households are, arguably, the ultimate owners of the business and government capital stock as well.

(Source: ABS)

Households are traditionally net savers. They are an important source of funding for the government, business and the financial system:

- Bank deposits now represent 60% of overall bank funding and within that mix household deposits are 42% of the total. *(Source: APRA)*
- Australian superannuation fund assets are equivalent to 148% of GDP. They are the world's sixth-largest pool of pension fund assets. *(Source: RBA)*





Households are also an important influence on economic policy. The Reserve Bank of Australia (RBA), for example, is required to run monetary policy “to ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia”. The impact of interest rate changes on household cash flows is one of the main transmission mechanisms for monetary policy. Governments like to hand out tax cuts. And personal benefits payments account for some 27% of government spending.

Households are a source of stability in the Australian economy. Consumer spending is one of the least variable components of GDP growth. The tendency of households to “smooth” consumption through variations in savings rates helps. A reduction in the household savings rate over the past few years, for example, has allowed consumer spending to defy the weakness in household income growth.

> **“Getting the household story right is critical to determining the direction of the Australian economy and understanding the risks and issues we face.”**
>
> **Michael Blythe**
> **Chief Economist, CommBank**

Insights from CommBank data flows

Clearly what is happening in the household sector is crucial to understanding the economy more broadly and in assessing any emerging risks.

The Commonwealth Bank is particularly well placed to obtain in-depth insights into a range of economic and financial issues. We are one of the largest financial services organisations in the country, with over 16 million customers trusting us with their banking needs.
While we don't cover the entire economy, Commonwealth Bank of Australia has visibility over a large share of all financial transactions in the Australian economy every day. We generate a vast array of data on financial transactions, savings and spending patterns. Our combined data sources give us a unique perspective on areas of topical interest.

We have already used our data to analyse household debt risks and issues (see The household debt "crisis" – what is CommBank data telling us?). We are now broadening out that analysis into what that data can tell us about Australian household incomes, spending and wealth. And we look at how satisfied Australian households are with the quality of life over and above the base financial calculations.

Our analysis is drawn from a sample of more than 2.5 million Commonwealth Bank of Australia households and information on spending through credit cards, EFTPOS, direct debit and BPAY transactions.

The average household

Our sample data shows that the average Australian household is composed of 2.40 people. Most (1.80 people) are in the productive group aged 18-64 years that drives economic activity and generates income.

The data also highlights an emerging demographic risk. The number of people aged over 65 years (0.31 people per household) now exceeds those aged less than 18 years (0.29 people). A rising dependency ratio highlights the need to boost productivity, labour participation, income and savings over the medium term. And the need to ensure that our fiscal position is sound.

Beyond the demographics, Australian households, on average, are in a position that would please the fictional Mr Micawber. His recipe for happiness was to keep spending below income.

And Australian households are achieving this:

- The average household has a gross income of close to $90,000 per annum, pays tax of $14,500 and spends (excluding rent and mortgage payments) around $57,000 each year.
- Rent ($6,000 per annum) or mortgage payments ($4,900 per annum) take part of the surplus but the average household remains a net saver overall.

Note that housing costs are much higher for those that rent or have a mortgage than for the average household. The average payment for those who actually rent is $21,000 per annum while payment for those that actually have a mortgage is $23,500 per annum.

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Sources of household income

Salaries remain the major source of income for the average household.

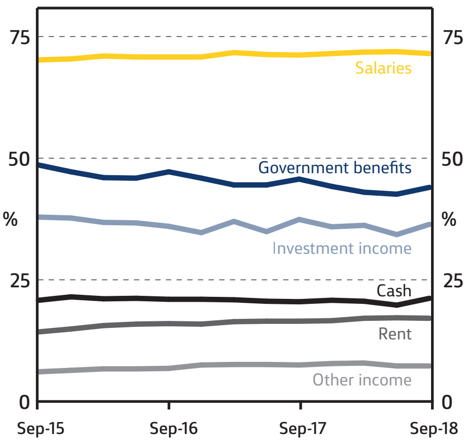
That share of households receiving a salary has edged higher over the past few years to 71% due to the improvement in the labour market. Government benefits and investment income are significant income drivers but their importance has declined in recent years:

- A strong labour market has reduced unemployment benefit payments.
- A government focus on containing welfare payments has also contributed.
- Low interest rates have reduced the importance of investment income.

The reduced importance of government benefits has contributed to the improvement in the Budget bottom line. The underlying Budget deficit for 2017/18 was $8 billion lower than expected as recently as May 2018. Most of that improvement came from an undershoot on the spending side of the equation – notably in the social security and welfare function.

Some income sources have increased in importance. Investor interest in the housing market means more households now receive rental income. "Other" income has also lifted. This lift reflects the growing importance of the "gig economy" (as proxied by transactions through Uber, Airbnb, PayPal etc).

Sources of Household Income
(% of households receiving)



Source: CommBank

Household wealth

The housing market is also a significant driver of household wealth:

- Housing accounts for 74% of wealth (based on deposits, housing, equities).
- The average household has assets of $274,000.

Rising house prices meant that growth in CommBank's wealth proxy outstripped income and spending for much of the period since 2015. However, falling house prices now mean that wealth is declining.

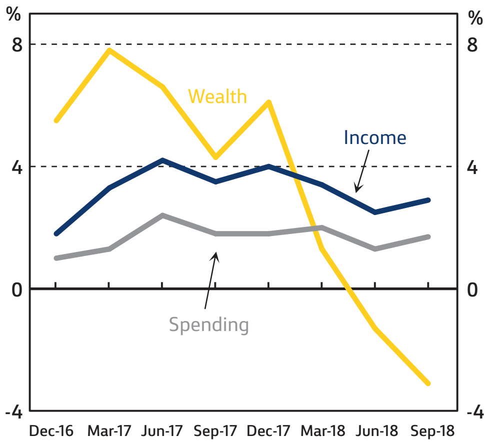
Part of that housing wealth is funded by debt. And the average household has $103,000 worth of debt on the liabilities side of the balance sheet. Higher borrowing means that the household debt:income ratio has lifted.

But rising house prices mean that the ratio of household assets:liabilities is also higher.

Changes to household balance sheets have produced some negative developments as well. Rising household debt has increased the sensitivity of the household sector to interest rate changes.

Higher debt levels mean that any given change in interest rates will have a bigger impact on household cashflows than previously. A proxy for the household debt service ratio based on our sample remains low. But the ratio has crept a little higher over the past couple of quarters. So there is a downside risk for consumer spending as interest rates move higher.

CommBank Household Indicators
(annual % change)



Source: CommBank

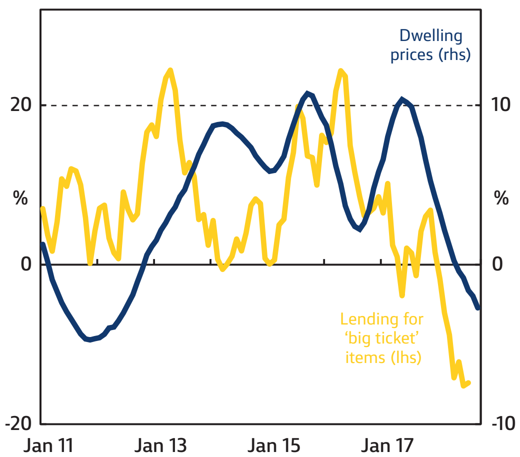
> “We spend much time debating fiscal and monetary policy. But wages policy should be on the agenda as well.”
>
> **Michael Blythe**
> **Chief Economist, CommBank**

The other spending-related issue is the risk of a negative “wealth effect” from falling house prices. Borrowing to buy “big ticket” items (such as cars) should give an indication of any wealth effect.

As shown in the chart below, there was some evidence of a positive wealth effect in 2015-16. But this did not continue through the latter stages of the housing price boom. A turn down in borrowing commenced well before the turn in the dwelling price cycle. This limited borrowing response on the way up and early retracement means the risks of an accelerating negative wealth effect now are reasonably low.

A bigger risk may come from the rollover of Interest-only loans into Principal & Interest loans. This rollover means the typical loan repayment increases by 30-40%. In an environment of subdued income growth, any rise in mortgage payments reduces household spending power.

CommBank’s Consumer Lending & Wealth
(smoothed annual % charge)



Source: CommBank / CoreLogic

Salaries may be the dominant contributor to household income. But they have grown at a subdued pace over the past few years. Combined with the squeeze on government benefits, our data presents a pretty modest picture of household spending power.

These observations underline the critical importance of getting the economic and policy backdrop right and why the recent personal income tax cuts should be welcomed.

The correct environment will see jobs growth continue, labour market slack diminish and wages eventually respond. Tax cuts, while small, will help at the margin.

But more action would help. The tax cut agenda could be brought forward. And we have argued for some time now that we should be thinking about wages policy as well as the more traditional monetary and fiscal policies.

The Fair Work Commission has taken a step in that direction via above-average increases to the minimum wage over the past two years. Increases of about 3.5% per annum in 2017 and 2018 were notably above the 2.5% rises of preceding years and well above economy-wide wages growth closer to 2% per annum.

Household spending

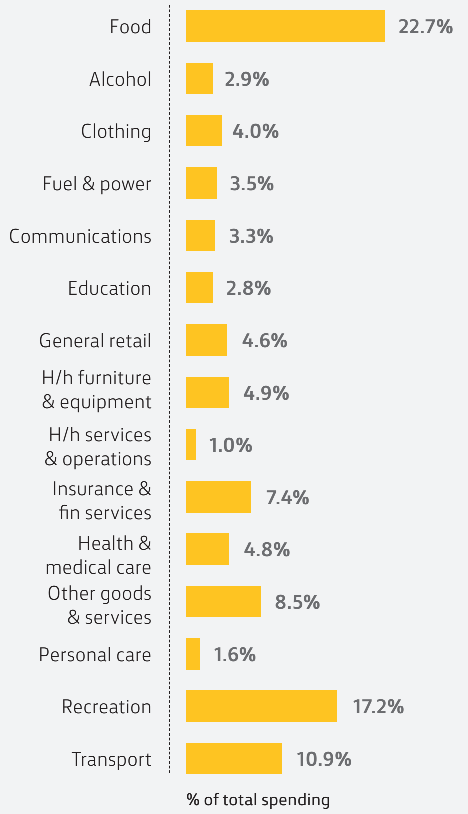
These recent increases in the minimum wage are delivering additional spending power to the group most likely to use that benefit. Households in the lower part of the income distribution spend a larger share of their income.

Another potential approach with some attractive features is offered by the reported Japanese proposals to cut company taxes. But only for those companies lifting wages and capex.

CommBank's indicators confirm the relatively weak consumer spending pulse of recent years. But there are some other features of interest:

- It is difficult to define what "essential" spending is. Many, for example, would argue mobile phones are essential! But the traditional essentials of food, clothing and shelter remain a significant share of the average household spend. That share stands at around one-third.
- Beyond the essentials, the next largest share of spending (around 17%) is on recreation. This large share, second only to food, underlies the relatively comfortable position occupied by the average household.
- Nevertheless, our earlier report on household debt revealed households had a negative view of their personal circumstances. The gap between perception and reality at least partly reflects the largish share of the "pain" spend within the overall mix. The pain spend consists of any items we have to buy but not necessarily enjoy paying for such as petrol, school fees, health insurance and utilities. It represents 17-18% of the overall consumer mix.
- Spending shares have remained relatively constant over the past few years. A slightly larger share of spending is going on food, transport and recreation. The offsetting reduction was in retail-related spending.

The 'Average' Household
(spending shares as at Q3 2018)



Source: CommBank

Have households missed out?

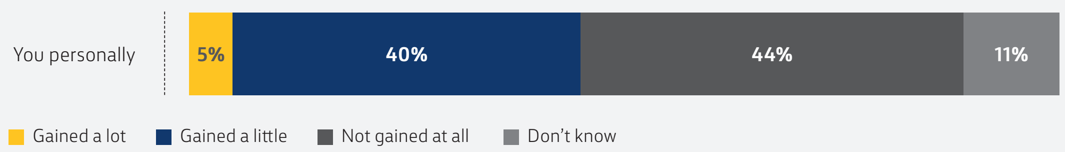
The general message from the traditional economic indicators – income, wealth and spending – is that the average Australian household is travelling quite well. But surveys here, and overseas, reveal that many households think they have missed out.

A recent CEDA (Committee for Economic Development of Australia) study on attitudes to economic growth and development, for example, shows that 44% of individuals believe they have not gained anything from Australia's exceptional 27-year run of uninterrupted economic growth. And a further 40% think they have gained only a little.

One implication is that household satisfaction depends on more than just the hard-edged financials.

> **"There is a disconnect between Australia's strong economic track record and the community's sense of having shared in this growth. The results remind us that the community assesses the benefits of sustained economic growth based largely on their current circumstances and whether they feel like they are getting ahead."**
>
> **Jarrod Ball**
> **Chief Economist, CEDA**

Who has benefited by 26 years of growth?



Source: CEDA

The CommBank Household Satisfaction Index

The Organisation for Economic Co-operation and Development (OECD) has conducted surveys on what individuals actually value in driving their level of satisfaction. (You can add your preferences to the OECD's database by clicking here).

The surveys show that material conditions are part of the mix. So income, wealth, jobs and housing do matter. But a range of other influences are important in determining the quality of life. These include health, work-life balance, education, social connections and civic engagement.

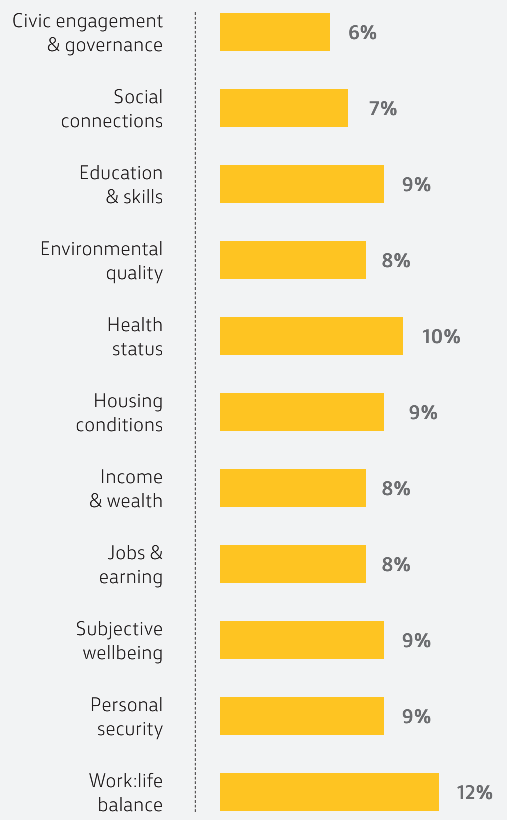
The chart shows what is important for Australians. At the top of the list is work:life balance, health, education and life satisfaction. It is only after that point that the traditional wellbeing measures of housing, income and jobs start to register.

There are many similarities between what Australians see as important for satisfaction with other countries and regions. But what does stand out on a global comparison is how we value work:life balance more highly. Land of the long weekend indeed!

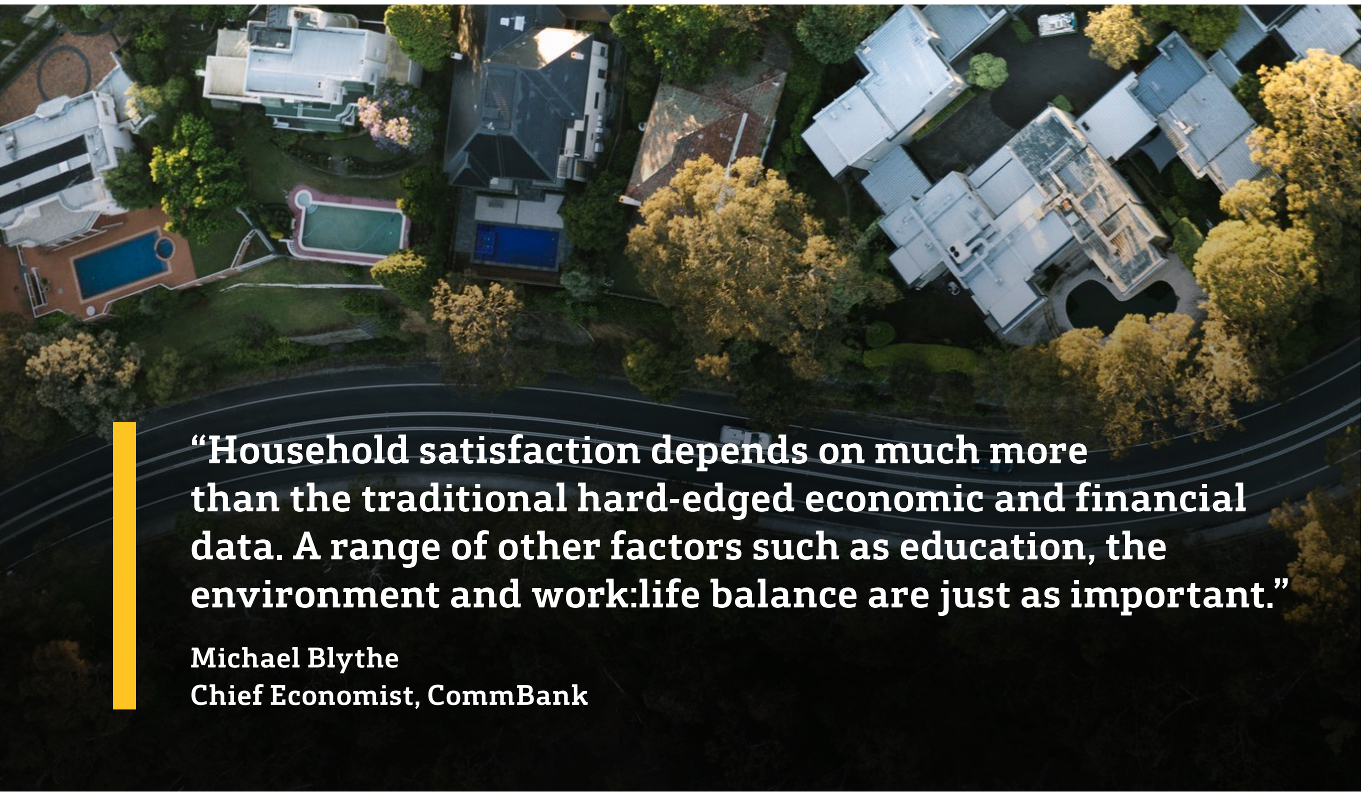
There are also some variations within the average picture:

- Men tend to give a higher weight to income. Women see community ties and work:life balance as more important.
- Older respondents value health, safety, housing and civic engagement relatively more highly. Younger respondents value life satisfaction, work:life balance, jobs and incomes more highly.

Australia: What's important
(% of total ratings)



Source: OECD



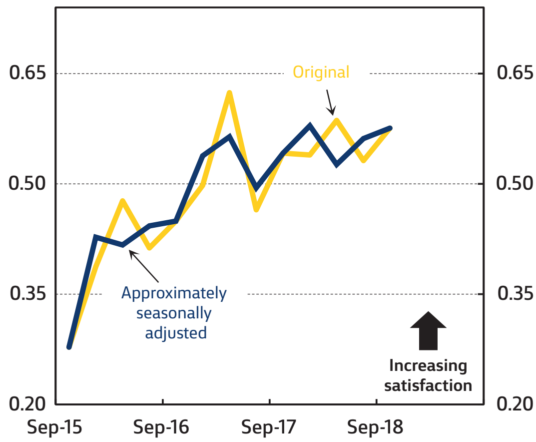
> **“Household satisfaction depends on much more than the traditional hard-edged economic and financial data. A range of other factors such as education, the environment and work:life balance are just as important.”**
>
> **Michael Blythe**
> **Chief Economist, CommBank**

Knowing what drives satisfaction is important. Trying to quantify satisfaction is a more difficult task. Nevertheless, the very granular data that we obtain on income, wealth and spending from CommBank household flows and other CommBank surveys provide a framework. The results are shown in the chart alongside. An approximate seasonal adjustment has been applied to allow for the fact that we appear to be more satisfied in “summer” than in “winter”.

CommBank’s Household Satisfaction Index (HSI) slowly improved up to early 2017 and has tracked sideway since. Readings a little above 0.5 suggest Australian households tend to be of the “glass half full” variety when assessing their level of satisfaction.

How could satisfaction be improved? Areas with low satisfaction scores include civic engagement, environment and education. So policies targeting improvements in those areas would help. But there is also a degree of self-validation evident. Scores for life satisfaction are low. Perhaps we should step back and smell the roses!

CommBank Household Satisfaction Indicator
(0= completely dissatisfied, 1=completely satisfied)



Source: CommBank

Sources & methodology

Our analysis of household activity is drawn from a sample of more than 2.5 million households who are CommBank customers.

This sample provides information on household structure, incomes and assets and liabilities. The spending activities of this group is tracked through credit card, EFTPOS, direct debit and BPAY transactions. Additional information is derived from other sources such as CoreLogic.

The hard economic data is leavened by information from a CommBank survey on consumer perceptions and sentiment.

Note that the data reflects the structure of CommBank's customer base and may differ from that of the population as a whole.

The CommBank HSI reflects measures of what Australian households view as important in determining their overall level of satisfaction. Proxies for these components are derived from CommBank's sample of household customers. The proxy measures are normalised in a way that gives a range of 0-1. A reading of "zero" indicates complete dissatisfaction. A reading of "one" means completely satisfied.

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