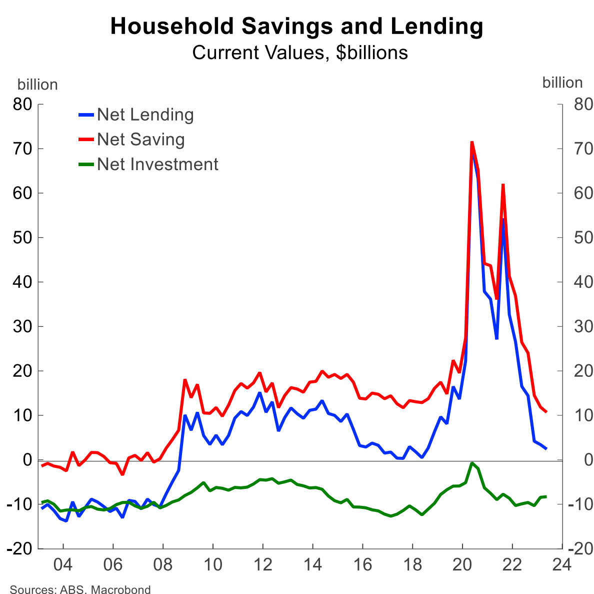
Data Snapshot

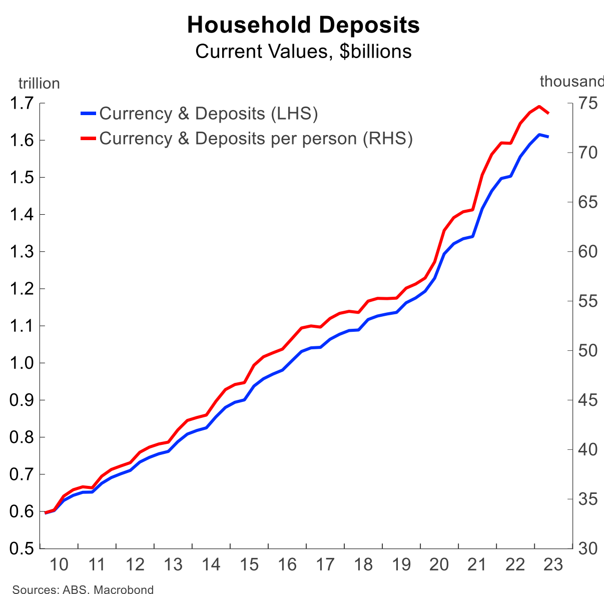
Thursday, 28 September 2023

Finance and Wealth

Household Deposits Drop for First Time In 16 Yrs

- **Households are generating enough income to finance total expenditure - net lending declined over the quarter to be broadly flat - or around $2 billion from more than $70 billion in 2022. It is the lowest level since June 2018.**
- **At the same time the stock of household deposits declined by $6.0 billion over the June quarter, the first quarterly decline since June quarter 2007 - or in 16 years.**
- **Why has this occurred? Elevated cost of living pressures and higher interest rates are putting pressure on household budgets and households have had to dip into deposits. But not all households. Some pockets of households are generating more than enough revenue to finance spending.**
- **What are the implications? Households must adjust! The sector cannot keep running down deposits to fund spending. It may also mean the cash flow channel of monetary policy becomes more potent as the financial position of households comes under pressure.**
- **This adjustment can occur by reducing expenditure and/or increasing income. Households have already started to reduce spending with consumption per person falling over the past three quarters. Income can only increase in a sustainable way through higher productivity.**
- **Governments used the balance sheet to support incomes through the pandemic. Increased spending and constrained supply resulted in high inflation. To sustain the higher level of spending, productivity needs to increase – there's no such thing as a free lunch.**





Households

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At the same time the stock of household deposits declined by $6.0 billion over the June quarter, the first quarterly decline since June quarter 2007.

Why has this occurred? Elevated cost of living pressures and higher interest rates are putting pressure on household budgets and households are having to dip into deposits. But not all households, with some pockets of households generating more than enough revenue to finance spending. It leaves the household sector as a whole break even over the June quarter.

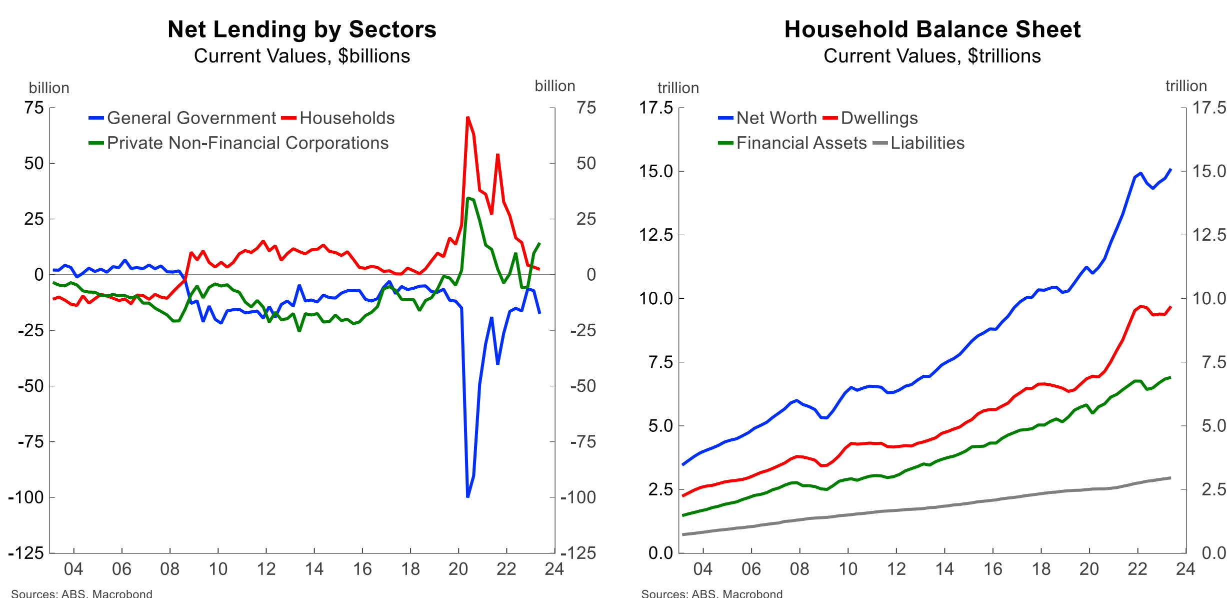
The June quarter National Accounts showed that net savings had fallen. Today's outcome shows that these savings were just enough to cover spending on investment.

What are the implications?

Households must adjust! The sector cannot keep running down savings to fund expenditure. It may also mean the cash flow channel of monetary policy becomes more potent as the financial position of households comes under pressure.

This adjustment can occur either through further falls in spending or higher growth in income. Households have already started to adjust, with per capita consumption falling over the December 2022, March 2023, and June 2023 quarters.

If households want to maintain higher standards of living, productivity needs to increase. Increasing incomes and spending without productivity growth will only further fuel inflation. These adjustments will take time.



Is the monetary policy transmission mechanism changing?

More Potent Cash Flow Channel

During this adjustment phase, the net financial position of households could continue to deteriorate. Empirical research shows that household cash flow and spending become more sensitive to interest rates when the sector experiences a deterioration in its net financial position – an insight the Reserve Bank (RBA) Board will need to consider going forward.

For example, in recently published research, the RBA found that the impact of changes in interest rates on cash flow is around 20 times larger for households that are net borrowers compared with households that are net lenders. This impact is even larger for “liquidity constrained” households – that is, households that do not save out of their current income.

In addition, the RBA also found that the change in consumption spending resulting from a change in cash flow (the so called “marginal propensity to consume”) is five times larger for households that are net borrowers compared with net lenders. Again, it is even higher for liquidity constrained households.

Therefore, as the net financial position of households deteriorates and households continue to borrow to finance expenditure, aggregate spending will become more sensitive to interest rates – either as more households become liquidity constrained or more households become net borrowers.

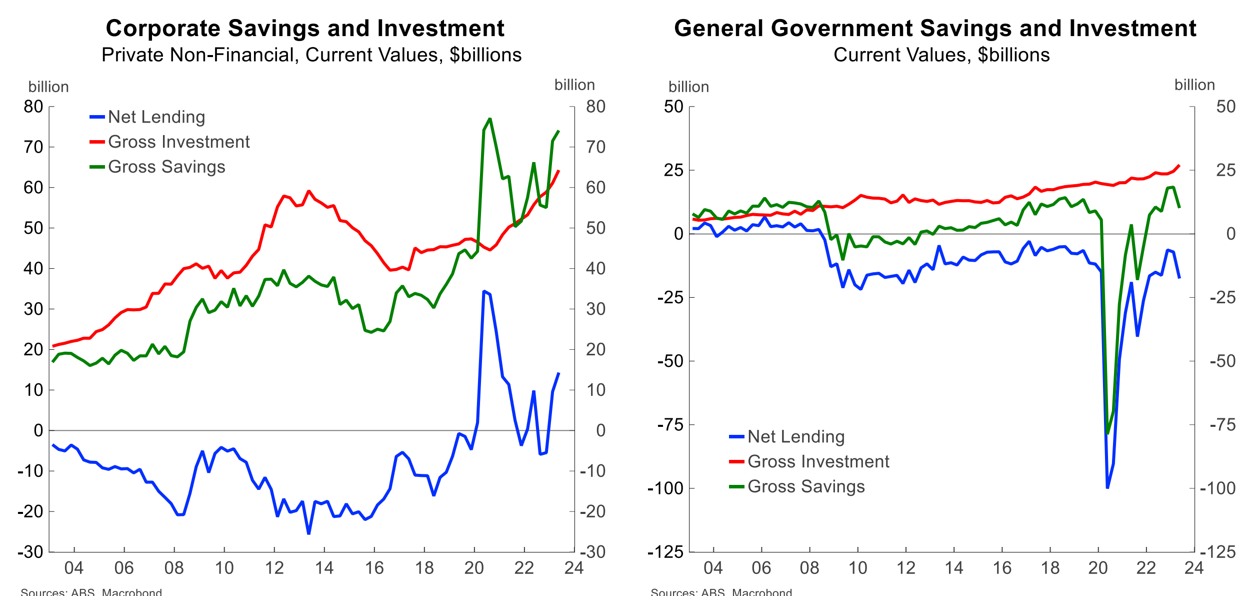
The RBA has also estimated that around 15% of households with variable rate mortgages (or more than 300,000 households) will have negative cash flow and become liquidity constrained with a cash rate of 3.60% - these population estimates are likely to be larger given the cash rate is currently at 4.10% and the research was done at 3.60%.

How much more sensitive? That will depend on how much the net financial position of households deteriorates and will need to be considered with partly offsetting changes, such as a more muted wealth channel.

Muted Wealth Channel

Household wealth has stabilised, after falling since the June quarter 2022. Household wealth has grown by 2.6% over the June quarter 2023. Amazingly, household wealth is around 1.1% higher than the previous peak recorded in the March quarter 2022.

The modest upturn in house prices has led to an increase in the value of dwellings by 3.3% over the June quarter to be broadly in line with the peak in the March quarter 2022. An increase in the value of dwellings means that the wealth channel of monetary policy may have become more muted, when compared with previous cycles.



The corporate sector

In normal times, corporations borrow to invest in machinery and equipment, property, and human

capital to produce a value add.

During the pandemic, the incomes and gross savings of private corporations was supported through government programs. During this time, there was also a moderation in investment such that the sector became a net lender for the first time since 1993. The corporate sector has continued to be a net lender on the back of resilient demand conditions.

General government

The Commonwealth government and the commodity rich state governments are likely to record budget surpluses in the 2022-23 fiscal year. This will help the general government sector shift from being a net borrower to a net lender.

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