Media release

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Growth in Leading Index remains below trend

The six month annualised deviation from trend growth rate of the Westpac Melbourne Institute Leading Index which indicates the likely pace of economic growth three to nine months into the future rose from –0.15% in February to –0.09% in March.

Westpac's Chief Economist, Bill Evans commented, "This is the second consecutive month where the 6 month annualised growth rate in the Index has fallen below trend. The Index had been growing above trend during the period January 2013 to January 2014 but had been below trend in all but two months between October 2010 and December 2012. That signal during that 2010 – 2012 period was consistent with below trend growth in 2011 and 2012.

"Through the year GDP growth in 2011, 2012 and 2013 has been remarkably stable at around 2.8% – certainly below 'trend' for the Australian economy. However, growth in 2011 and 2012 was being boosted significantly by mining investment (new engineering construction surged 47% and 37% respectively) whereas in 2013 mining investment became a drag on growth (new engineering construction declined 5%).

“Our estimates of mining equipment investment tell a similar story – up 42% and 27% respectively in 2011 and 2012, and down by 40% in 2013.

“Consequently the more upbeat signal from the Index in 2013 is likely to be consistent with a better performance, generally, in the non-mining sectors. There was certainly clear evidence of that in consumer spending which lifted from a 2.3% annualised growth pace in the first half of 2013 to a 3% annualised growth pace in the second half.

“The above trend growth rate of the Index right through 2013 is pointing to a continuation of a generally improved growth momentum in the non-mining sector in the first half of 2014. Westpac's forecasts are generally in line with that expectation but the loss of momentum in the Index in recent months is disturbing for the non-mining sector in the second half of 2014. To date Westpac is not forecasting that loss of momentum in the second half of 2014 so we will be monitoring developments around the current signals from the Index with great interest over the next few months.

“As discussed the Index has slowed markedly from the above trend pace of late last year. Since October the Index has slowed from 1.21ppts above trend to 0.09ppts below trend. Major contributors to that slowdown were: the yield spread (0.5ppts); the Westpac -MI Consumer Sentiment Expectations Index (0.37ppts); dwelling approvals (0.24ppts); the Westpac-MI Unemployment Expectations Index (0.22ppts); the RBA Commodity Price Index (0.1ppts). Partially offsetting these reductions was an increase of 0.14ppts from aggregate monthly hours worked.

"The overall level of the Index fell from 98.41 in February to 98.38 in March. Four components of the Index improved – the Westpac-MI Consumer Expectations Index rose by 2.63%; US industrial production rose by 0.16%; aggregate monthly hours worked rose by 0.5%, and the Westpac-MI Unemployment Expectations Index fell 3.28% (declines in this Index indicate an improved outlook for unemployment). On the other hand the ASX Index fell by 0.19%, commodity prices by 2.61%, dwelling approvals by 5.16%; and the yield spread narrowed by 0.05ppts.

"The Reserve Bank board next meets on May 6. On March 17 Westpac revised its forecast for the overnight cash rate to no change until the second half of 2015. Previously we had expected rates to fall further over the course of the second half of 2014. We therefore do not expect the board to change rates at its upcoming meeting. Even if the signal from the Index that growth can slip below trend in the second half of 2014 proves to be reliable monetary policy will now be focussed on the growth outlook for 2015. The Reserve Bank is currently forecasting growth at 3.5% in 2015 – above trend. It will need to see the emergence of sustained below trend growth in 2014 with little prospect of a lift in 2015 before it would contemplate lower rates. The modest below trend growth in the Index is, at this stage, insufficient evidence to prompt the Bank to make such a call," Mr Evans said.

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