Media release

17 September 2014

Strict Embargo 10:30am

Leading Index growth rate stays 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 fell from –0.75% in July to –0.90% in August.

Westpac's Chief Economist Bill Evans commented, "This is the seventh consecutive month where the growth rate in the Index has been below trend. The index continues to indicate that we can expect growth in the Australian economy to stay below trend in the second half of 2014 and into 2015".

"That view is consistent with the revised forecasts recently released by the Reserve Bank of Australia in its August Statement on Monetary Policy. While the Bank forecasts using ranges, an analysis of the mid points of these ranges indicates that its forecasts imply that the growth 'pace' of the Australian economy is likely to have slowed to 2% (annualised) in the second half of 2014. It has also lowered its forecast (mid-point) for 2015 from 3.25% to a below trend 3%. Growth momentum in the first half of 2015 is forecast to lift from 2% to 3% (still below trend).

"Westpac is more optimistic around the growth outlook than the Reserve Bank. Consistent with the signal from the Leading Index we expect below trend growth in the second half of 2014 but at a 3% annualised pace rather than the 2% implied by the Reserve Bank. In particular we are expecting the pace of consumer spending in the second half to lift from 2% (annualised) in the first half of 2014 to 3% in the second half. That more positive consumer outlook is expected to strengthen further in the first half of 2015, reaching a 3.5% annualised pace. That is consistent with our slightly more upbeat view on the first half of 2015 than implied by the index. We expect that growth momentum in the economy can lift to a trend 3.25% pace in the first half of 2015.

“Over the last six months the index’s growth rate has remained at a below trend growth pace. However, the components of the index which have been driving this below trend pace have evolved. In March, when the Index’s growth rate was 0.04% below trend, the key drivers were: the Westpac –MI Consumer Sentiment Expectations index (–0.21ppts); the Westpac MI Unemployment Expectations index (–0.17ppts) and RBA commodity price index in AUD (–0.20ppts). Offsetting those negative effects were dwelling approvals (0.21ppts) and US industrial production (0.23ppts). The yield spread; aggregate hours worked and the ASX 200 all had minimal impact on the growth rate.

“In August the growth rate in the Index has fallen further below trend to –0.90%. The major contributors are now: commodity prices (–0.64ppts); yield spread (–0.31ppts); Westpac – MI Consumer Sentiment Expectations Index (–0.11ppts) and dwelling approvals (–0.13ppts) .Offsetting those drags on growth are US industrial production (0.14ppts) and the Westpac – MI Unemployment Index (0.14ppts). Neither the ASX 200 nor aggregate monthly hours worked had a notable impact on the growth rate.

“Overall we can conclude that commodity prices have intensified their drag on the growth rate; the slowdown in dwelling approvals has led to a reversal in the effect which that series is having on the index; consumers are less nervous around the labour market; and the flattening of the yield curve has become a drag on growth.

“The changed contribution from the yield spread has resulted from a flattening of the yield curve. A fall in long rates which is not matched by lower short rates indicates that the stance of monetary policy may have tightened. Of course the yield curve, in particular the long end of the curve, is capturing both domestic and international influences. Since August the yield curve has steepened by around 30bps pointing to an easing in the assessed policy stance.

“We do not expect to see the Reserve Bank changing rates anytime over the next year. Indeed, the Bank once again confirmed its intentions in its September board minutes for a period of stability in rates. Westpac expects that, with our expectation of a more favourable economic environment than is anticipated by the Reserve Bank, the next move in rates will be a tightening but not until the second half of 2015, with August currently appearing to be the date for the first move”, Mr Evans said.

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