

Media release

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Leading Index points to lift in momentum

The six month annualised growth rate in the Westpac-Melbourne Institute Leading Index, which indicates the likely pace of economic activity relative to trend three to nine months into the future, rose from +0.15% in August to +0.58% in September.

Westpac's Chief Economist, Bill Evans, commented, "The September reading is the second consecutive above trend result and follows fifteen months of persistent below trend reads. It is the strongest growth rate recorded since December 2013 and a clear positive signal for the near term economic outlook. That signal is broadly consistent with Westpac's forecast for growth to hold around a 3% pace over the course of both this year and next.

"The Leading Index growth rate has lifted sharply over the last six months from a 1.18% below trend reading in April to the current 0.58% above trend result. While all components have contributed to the improvement the main lift continues to come from 'offshore developments'. Nearly two thirds of the gain has come from the combination of: a rally in commodity prices (+0.51ppts); a modest recovery in US industrial production (+0.40ppts) and globally-driven improvements in financial conditions reflected in the sharemarket (+0.20ppts) and the yield spread (+10ppts) components.

“That said, we continue to see some improvement in in local components as well with a notable positive from stabilising labour market conditions (aggregate hours worked contributing +0.40pts) and modest support from consumer sentiment and dwelling approvals (contributing +0.15ppts on a combined basis).

“The Reserve Bank Board next meets on November 1. A significant number of commentators have been predicting a rate cut in November and a few weeks ago markets had been giving around a 50% probability to a move. We were never convinced that the inflation report which is due to be released on October 26 would provide the case for a cut. In fact, with a 0.3%qtr reading for underlying inflation dropping out, it seems likely that the September quarter report will actually show that annual underlying inflation has lifted.

“It has also become clear that ‘financial stability’ concerns will be given considerable weighting in policy deliberations. In his maiden speech this week Governor Lowe clearly stated these had already factored in recent policy decisions and would continue to be given prominence. With Sydney house prices having been reported to have lifted by 3.5% and Melbourne by 5% in the last three months the risks of further boosting housing with another rate cut will be a significant consideration for the Board.

“Indeed while we give little probability to a further rate cut at the next meeting our assessment of the growth outlook, including the shape of the construction cycle, points to rates remaining on hold for the foreseeable future”, Mr Evans said.

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