Media release

18 February 2015

Strict Embargo 10:30am

Leading Index growth rate below trend for twelfth consecutive month

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 lifted from –0.57% in December to –0.27% in January.

Westpac's Chief Economist, Bill Evans commented, "Growth in the Index has now been below trend for twelve consecutive months. That signal continues to point to below trend growth for much of 2015. That outlook accords with Westpac's own forecasts with our expectation that growth through most of 2015 will be running at around a 2.75% pace, below the trend growth pace of around 3.25%. That forecast is based around another 0.25% rate cut over the next few months and an Australian dollar which will bottom at around USD 0.75 by mid-year.

"The Reserve Bank recently revised its own growth forecasts to be broadly in line with our own 'below trend' view. The Bank expects growth through 2015 at 2.25%-3.25% (2.75% mean) on the assumption of an Australian dollar averaging USD 0.78 and a further interest rate cut of 0.25% being delivered at least by May.

“The Bank does not release its detailed forecasts but the expected profile is likely to be in line with our own views that the annual pace of growth in consumer spending will lift from 2.5% in 2014 to 3% in 2015; business investment growth will contract for yet another year, dragged down by the ongoing contraction in mining investment, but export growth will continue at a solid 7-8% pace.

“However, as indicated by the Bank’s wide forecast range, there is considerable uncertainty around the growth outlook for 2015 with risks generally to the downside.

“The deviation in the growth rate of the Index relative to trend has narrowed from –1.01% to –0.27% (+0.74ppts) over the last six months. The major contributors to this improvement have been: commodity prices (+0.60ppts); dwelling approvals (+0.28ppts); and the Westpac MI CSI Expectations Index (+0.19ppts). Partially offsetting those improvements have been the ASX200 (–0.14ppts); the Westpac MI Unemployment Expectations Index (–0.05ppts); aggregate monthly hours worked (–0.05ppts); and the yield spread (–0.07ppts).

“The Reserve Bank Board next meets on March 3. On December 4 last year Westpac forecast consecutive February and March rate cuts for 2015. The February cut has been delivered but the Bank’s February Board minutes that were released on February 17 indicate a possible reluctance for consecutive moves. We still believe that a cut in March is the best policy to support domestic demand and maintain downward pressure on the AUD and this outcome remains our forecast.

"However a decision by the Board to delay the next cut to April or May to assess the immediate impact of the February cut on the housing market is a reasonable prospect. The important point ,as signalled by the below trend growth in the Leading Index, is that the Australian economy needs more stimulus and the Reserve Bank, with ample scope to cut (by world rather than historical standards) should be acting accordingly", Mr Evans said.

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