Media release

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The Leading Index slows but growth still above trend.

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, fell from 0.51% in October to 0.11% in November.

Westpac's Chief Economist, Bill Evans, commented, "This marks the fourth consecutive month where the growth rate in the Index is above trend. That followed a period of fifteen consecutive months where the growth rate had been below trend. That sustained period of below trend growth in the series had been pointing to the weakness we have seen in the economy in the September quarter (although no lead indicator could have prepared us for a negative growth print).

"However, the run of four consecutive above trend readings is signalling a better outlook for the first half of 2017. Nevertheless, it is disappointing that the growth rate appears to, once again, be losing momentum. Westpac is still comfortable with its forecast of 3% growth through 2017. We struggle somewhat with the government's MYEFO forecast for 2016/17 which implies average quarterly growth of around 0.8% per quarter in the December (2016); March (2017); and June (2017) quarters. That growth pace would be around 0.5% above trend – a stretch particularly as we see the growth rate of the Leading Index slowing once again.

“The Leading Index growth rate has lifted over the last six months from a 0.12% below trend reading in June to the current 0.11% above trend result. Over that period the key drivers of that improvement have been international developments. Rising commodity prices (0.49 percentage points); the steepening of the yield curve (0.41 percentage points) and the lift in the share market (0.07 percentage points) have played the dominant roles.

“On the other hand, the domestically based confidence; and housing market components have been the drag. Dwelling approvals (minus 0.57 percentage points); Westpac-MI CSI Expectations index (minus 0.13 percentage points) and Westpac-MI UE index (minus 0.10 percentage points) have all subtracted from growth.

“The labour market component (aggregate monthly hours worked) contributed 0.07 percentage points over the six months. However, it was responsible for 0.41 percentage points of the net 0.40 percentage point fall in the growth rate between October and November.

“The Reserve Bank Board does not meet again until February 7 next year. Yesterday the Board minutes for the December meeting emphasised the concern the Board has with balancing the risks around financial stability and the possible need to further support a deteriorating economy. A reasonable interpretation of this discussion is that the “hurdle” to further cutting rates is high. In addition, the minutes put a positive spin on the current economic outlook – consumer spending passing through a soft patch;

non mining investment being a bit stronger than the most recent capital expenditure survey indicates; the fall in the unemployment rate being consistent with the hours worked data; and the drag from mining investment likely to ease markedly in 2017.

“These sentiments are certainly consistent with our long held view that rates are likely to remain on hold over the course of 2017,” Mr Evans said.

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