Media release

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Leading Index growth rate firmly in negative territory

“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 –0.37% in January to –0.56% in February.

“The Index has now registered three consecutive months in which the growth rate has been negative. This is a strengthening signal that growth through the first two to three quarters of 2019 is likely to be below trend.

“The signal from the Index is certainly consistent with the weak momentum in the second half of 2018 revealed in the print of the December quarter national accounts. In the second half of 2018 growth momentum slowed to an annualised pace of 1% from a 4% pace in the first half of the year.

“Westpac expects growth in the Australian economy in 2019 to be around 2.2% – significantly below trend which is generally assessed as 2.75%.

“Key to the ongoing slow growth will be a challenged consumer as households adjust to much slower wages growth than anticipated and falling house prices. That will be supplemented by a continuation of the contraction in residential house building activity that appears to have begun in the September quarter of 2018.

“We have consistently highlighted these risks which are likely to coincide with a slowdown in jobs growth and investment spending as both political uncertainty and global volatility weigh on firms’ employment and investment decisions.

“The Index growth rate has shown a significant deterioration over the last six months, declining from +0.47% in September to –0.56% in February. Five components have driven the deterioration: US industrial production (–0.31ppts); the S&P/ASX200 (–0.30ppts); the Westpac-MI Unemployment Expectations index (–0.22ppts); the yield spread (–0.19ppts); and dwelling approvals (–0.10ppts).

“The only component providing a partially offset is the commodity prices in Australian dollar terms (+0.12ppts). The contribution from the remaining components – monthly hours worked and the Westpac MI CSI expectations index – has been largely unchanged.

“The Reserve Bank Board next meets on April 2. The minutes of the March Board meeting highlight the importance of data releases going forward with the key issue being the “tension” between soft activity indicators and strong labour market data. It will take time for the Bank to resolve those tensions but we expect that by the August meeting the case for lower rates will be clear.

“At present the Bank is forecasting growth of 3% in 2019 and 2.75% in 2020. The signals, some of which are discussed in this release, are pointing to much slower growth. We expect the Bank's growth forecasts to be lowered in both May and August with the forecasts in August being consistent with the need for easier policy. Westpac expects rate cuts of 25 basis points in both August and November", Mr Evans commented.

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