Westpac Institutional Bank

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Leading Index lifts back above trend

The six month annualised deviation from trend growth rate in the Westpac–Melbourne Institute Leading Index , which indicates the likely pace of economic activity three to nine months in the future, lifted from –0.02% in March to +0.43% in April.

Westpac Senior Economist, Matthew Hassan commented, “The lift is a positive sign after persistently weak, below trend readings throughout 2014 and a dip back into slight negative territory in March. It suggests the Australian economy has regained some momentum although the growth pulse is still not particularly strong.”

“The Leading Index growth rate has been above trend for three of the first four months in 2015. That compares favourably to 11 out of 12 months in 2014 that were materially below trend. However, at 0.43%, the growth rate in April is still well below the 0.78% average pace in 2013 and lacklustre by historical standards.

“The Index growth rate has now swung from 0.43% below trend in November 2014 to 0.43% above trend in April. Nearly all components have contributed to the 0.86ppt turnaround although in some cases this has been through a reduced drag rather than an outright positive contribution.

“The main drivers have been improved reads on aggregate monthly hours worked (+0.44ppts); the ASX200 (+0.24ppts) and dwelling approvals (+0.23ppts). Recent improvements in consumer sentiment have also given a lift with the Westpac MI Consumer Sentiment Expectations Index adding 0.15ppts and the Westpac MI Unemployment Expectations Index adding a further 0.10ppts to the Index growth rate. There were also slight positives from a narrowing yield spread and a reduced drag from falling commodity prices (measured in AUD terms).

“Notably, the global growth pulse has become a less positive influence with the contribution to the Leading Indicator growth rate from the US industrial production component swinging from +0.26ppts in November to –0.19ppts in April.

“The component mix raises questions about how well the newfound above-trend growth pulse will be sustained. In particular, the support from improved consumer sentiment largely reflects the direct initial boost from RBA interest rate cuts in February and May and a better than feared Federal Budget. With interest rates now likely on hold and the Government potentially facing more opposition to its Budget measures from a hostile Senate, these positives could dissipate in coming months. Meanwhile both equity markets and commodity prices remain under pressure with the AUD continuing to provide little buffer to external weakness.

“The Index rose 0.11% in the April month, from 98.06 to 98.17, but components were quite mixed. On the plus side: the Westpac-MI Consumer Expectations index surged 10%; the Westpac-MI Unemployment Expectations index fell 5.8% (indicating an improved outlook for unemployment); dwelling approvals rose 2.8%; and aggregate monthly hours worked rose 1.1%. On the down side: the ASX 200 fell 1.7% in the month; US industrial production was down 0.3%; and commodity prices fell 3.6% in AUD terms.

“The Reserve Bank Board next meets on June 2. Having cut rates at its previous meeting in May there is little to no chance that the Bank would move again in June.

“The minutes from the May Board meeting highlight that the Bank is relying on an ongoing boost to household expenditure to encourage businesses to invest and employ, setting the economy on a path to at or above trend growth in 2016. The Leading Index shows the Bank’s moves in February and May have helped lift momentum but that the growth pulse is still not convincing. Our view, for now, is that the most likely scenario is for an extended period of steady rates although the risks to growth remain skewed to the downside”, Mr Hassan said.

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