

16 September 2015

Leading Index slows well below 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, decreased from **-0.40% in July to -1.14% in August.**

The economy seems to be losing momentum as we move through 2015. In the first four months of 2015 the average growth rate of the Leading Index was 0.16% above trend. That seemed to be a welcome lift in momentum from the second half of 2014 when the average growth rate was 0.67% below trend. However in the last four months the growth rate has slowed from 0.03% below trend to 1.14% below trend.

This emerging below trend growth profile for the economy is certainly in line with our own views. Note that the June quarter national accounts confirmed that Australia's six month annualised growth slowed to a 2.1% pace in the first half of 2015 with our forecast for the second half of a still below trend 2.5%. Looking further out we expect growth in 2016 of 2.7% (recently revised down from 3.0%).

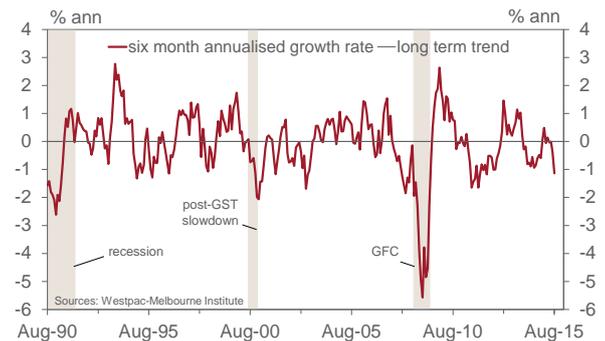
With trend growth in the economy now likely to be nearer 2.75% than 3% our forecast for GDP growth in 2016 of around trend growth looks a little vulnerable based on this recent print from the Leading Index. The Leading Index gives us a guide into the likely momentum in the economy through the second half of 2015 and into 2016. Today's print points to a likely 'below trend' start to next year.

Key factors behind our current expectation of a modest lift in the growth pace in 2016 are: a lift in consumer spending growth from 2.5% in 2015 to 2.9% in 2016; a modest improvement in non-mining investment spend largely offsetting a sharper slowdown in mining investment and an increased contribution from net exports (adding 1.3ppts to GDP growth, up from 0.8ppts in 2015). These positive factors will be partly offset by a much smaller contribution to GDP growth from dwelling investment as the residential building boom reaches its peak.

Over the last six months the six month annualised growth rate has slowed from being 0.06% below trend to 1.14% below trend. Key drivers of this slowdown have been: S&P/ASX 200 (-0.74ppts); dwelling approvals (-0.20ppts); aggregate monthly hours worked (-0.20ppts); the Westpac-MI Consumer Expectations Index (-0.17ppts); commodity prices in AUD terms (-0.17ppts); US industrial production (-0.08ppts); and the Westpac-MI Unemployment Expectations Index (-0.07ppts).

"Partly offsetting these factor has been the yield curve which has added 0.53ppts. This effect has come about despite some recent flattening of the yield curve as the short end of the curve begins to doubt the need for a near term rate cut.

Westpac-MI Leading Index



The recent sell off in the sharemarket has been particularly important in explaining the sharp fall in the growth rate between July and August. Of the 0.74ppt fall in the growth rate between July and August, 0.46ppts came from the sharply lower S&P/ASX 200.

The Reserve Bank Board next meets on October 6. There is little chance that the Board will decide to change policy settings. Policy will now be focussed on the growth outlook for 2016. This print of the Leading Index is casting some early doubt around the Bank's forecast of 3% growth for 2016. However the Bank is still expecting that the unemployment rate has stabilised despite growth in 2015 likely to be in the 2-2.5% range. A particularly important point here is that the make-up of growth seems to be more 'jobs intensive' than we may have expected, with the lift from dwelling construction, household expenditure and net services exports being particularly important.

The Board is very likely to await more evidence around the labour market and specifically the beneficial impact on the jobs market resulting from the sharp fall in the Australian dollar before it moves again.

At Westpac we do not expect any further rate movements before 2017.

Bill Evans, Chief Economist



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