Leading Index drops below 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, dropped from +0.05% in May to –0.33% in June.

Westpac Chief Economist, Bill Evans, commented, “This is the first below trend reading since September last year and the weakest index growth rate since July 2017.

“The Leading Index growth rate has now slowed by just over 1ppt since the start of the year, swinging from a comfortably above trend pace to back below trend.

“The comfortably above trend pace persisted through January to April; slowed in May; and has now moved below trend in June. We will need further confirmation of this below trend movement to be comfortable that the Index has now shifted to a below trend signal for the growth outlook for the remainder of 2018 and into 2019. Certainly that below trend profile for the remainder of 2018 and 2019 accords with Westpac’s current growth forecasts.
“All components have contributed to this slowdown over the course of 2018 (from positive 0.68% in January to a negative 0.33% in June – a deterioration of 1.01ppts over the year).

“The biggest drags have come from: a turnaround in the previously positive contribution from the Westpac-MI Unemployment Expectations Index (–0.26ppts); reduced support from commodity prices, measured in AUD terms (–0.21ppts); and a deepening contraction in dwelling approvals (–0.2ppts).

“The index growth rate has also seen reduced positive contributions from the Westpac Melbourne Institute CSI expectations index (–0.13ppts); the S&P/ASX200 (–0.10ppts) and a turnaround in the yield spread (–0.10ppts).

“Aggregate monthly hours worked was a slightly larger drag on the index (a further -0.1ppts) while US industrial production contributed slightly less to growth (-0.1ppts).

“These developments are particularly interesting given that over the last year or so most of the movements in the index have been explained by international factors - commodity prices; US industrial production and the yield curve. As noted, this recent slowdown has been significantly influenced by domestic components.

“The Reserve Bank Board next meets on August 7. The minutes of the July board meeting, which were released on July 17, confirm that the Bank expects that the next move in the cash rate is more likely to be an increase rather than a decrease but progress is likely to be gradual.
“With the Bank expecting growth in 2018 and 2019 to be comfortably above trend we assess that the Board’s current expectations for policy are still different to Westpac’s views.

“We continue to expect that the cash rate will remain on hold throughout both 2018 and 2019”, Mr Evans said.

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