

Media release

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Leading Index points to slowing growth

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 +0.83% in April to +0.11% in May.

Westpac Senior Economist, Matthew Hassan, commented, “The Leading Index points to slowing growth over the second half of 2018. The May update is the weakest since September last year and while the index growth rate still indicates that momentum is running slightly above trend, there has been a clear shift lower in the first half of 2018.

“Latest national accounts figures show the Australian economy growing at an above trend 3.1% pace over the year to March. That is broadly consistent with the stronger growth pulse we saw in the Leading Index through much of 2017. While that pulse carried into the first few months of 2018 it has faded noticeably since February.

“The Leading Index growth rate has now slowed 1.31ppts since peaking at 1.42% in December. Domestic components account for most of the turnaround, with material shifts in every component: dwelling approvals (–37ppts); monthly hours worked (–28ppts); the Westpac Melbourne Institute CSI expectations index (–25ppts); and the Westpac-MI Unemployment Expectations Index (–21ppts). On a combined basis,

domestic components are now showing a below trend growth pulse for the first time since April last year.

“Components that reflect a mixture of domestic and international forces – namely the yield spread between short and long term interest rates, and the S&P/ASX 200 – have also contributed to the slowdown since December (–0.07ppts and –0.15ppts respectively).

“The continued above trend reading on the Index growth rate overall is now entirely due to continued strength in ‘international’ components. While largely unchanged on six months ago, the signals from both US industrial production and commodity prices (valued in Australian dollar terms) remain solidly positive.

“The Reserve Bank Board next meets on July 3. Recent commentary has reaffirmed the Bank’s central case view that growth will hold above 3% in 2018 and 2019. While the latest Leading Index update continues to show above trend momentum, there has been a clear slowing. Moreover, the component mix shows momentum could easily slip below trend if we see any weakening in the supportive contributions from global growth and commodity prices.

“Westpac continues to expect growth to moderate from here, to a trend 2.7% over 2018, and a below trend 2.5% in 2019, led by softening domestic drivers but with easing commodity prices in the mix as well. Accordingly, we continue to expect the RBA to keep the cash rate firmly on hold both this year and next”, Mr Hassan said.

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