Media release

19 December 2018 **Strict Embargo 10:30am**

Leading Index bounces back

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, rose from +0.10% in October to +0.43% in November.

Westpac Chief Economist, Bill Evans, commented, "This latest lift in the Index growth rate comes as a surprise but does not override the general message from the Index over most of 2018.

"Over the seven months from October last year to April this year the growth rate averaged 0.89%. In the seven months since April the growth rate has averaged only 0.24% – a clear step down.

"Those readings to April were consistent with the strong, above trend momentum in the official growth figures that showed the Australian economy growing at a 3.8% annualised pace in the first half of 2018. The September quarter national accounts revealed a marked step down in the growth rate printing only 0.3%. Accordingly, Westpac expects that the growth momentum in the second half of the year will slow to 2% - lower than indicated by the Leading Index but certainly consistent with the step down in average growth over the last seven months.

“The growth pace in 2019 is expected to fall from the annual rate in 2018 of 3.0% to 2.6%, both rates well short of the Reserve Bank’s current outlook of 3.5% in 2018 and 3.25% in 2019.

“We expect the Bank will revise down those forecasts when the February Statement on Monetary Policy is released on February 8.

“Factors that we anticipate will be important headwinds for growth going forward are: an uncertain outlook for the consumer with ongoing weak wages growth; falling property prices in Sydney and Melbourne and a very low savings rate pointing to limited capacity for households to maintain current spending momentum. We also expect a slowdown in jobs growth as both political uncertainty and global volatility weigh on firms’ employment decisions through the first half of 2019.

“The growth rate in the Index has been choppy and while we have seen an overall downtrend the movement between June and November was a significant lift from –0.12% in June to +0.43% in November.

“Seven of the eight components have contributed to the lift but three shifts have driven the bulk of the 0.55ppt gain: a reduced drag from dwelling approvals (+0.23ppts); a pick-up in aggregate hours worked (+0.18ppts); and an improvement in the Westpac-MI Consumer Unemployment Expectations Index (+0.16ppts). A further 0.22ppt combined boost from US industrial production, commodity prices, the Westpac-MI Consumer Expectations Index, and a slight narrowing in the yield spread, has been negated by a significant drag from a declining sharemarket, the S&P/ASX 200 component effectively taking 0.24ppts of the headline growth rate since June.

“The Reserve Bank Board next meets on February 5. The minutes of the December Board meeting indicated that the Board has become somewhat less confident about the economy.

“Of most interest in the minutes was a more detailed explanation of the prospects for the consumer. In the past, the outlook for the consumer was described as a source of uncertainty. In the minutes, the issues around slow income growth, high debt levels and falling house prices are explained as being a combination of factors which are posing downside risks to the outlook for the consumer. This issue is critical to the Bank’s central view because trend growth in consumption is likely to be necessary to sustain the above trend growth which the Bank acknowledges will be necessary to further reduce the unemployment rate and lift wages growth.

“Readers will be aware that Westpac in its standard 2–3 year forecast horizon has consistently called the cash rate on hold since the last rate cut in August 2016. Markets are finally closely embracing our view that rates will be on hold in 2019 and 2020”, Mr Evans commented.

Issued by: Westpac Banking Corporation

Bill Evans

Chief Economist

Westpac Banking Corporation

Ph: (61-2) 8254 8531

Dr. Tim Robinson

Melbourne Institute

Ph: (61-3) 83442325