

Media release

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Surge in Leading Index supports Near Term Growth Outlook

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 0.00% in November to 1.28% in December.

Westpac's Chief Economist, Bill Evans, commented, "This marks the fifth consecutive month where the growth rate in the Index is at or above trend. That followed a period of fifteen consecutive months where the growth rate had been below trend. That sustained period of below trend growth in the series had been pointing to the weakness we have seen in the economy in the September quarter (although no lead indicator could have prepared us for a negative growth print)" Mr Evans said.

"However, the run of five consecutive above or at trend readings is signalling a better outlook for the first half of 2017. In particular, whereas over the September- November period the Index had been losing momentum, albeit still in positive territory, the December result represents a very strong rebound.

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Westpac is comfortable with its forecast of 3% growth through 2017. That growth rate is above trend and consistent with the positive leads from the Index over the last five months.

“Our growth concern is further out. Prospects for growth in 2018 look less encouraging. Housing construction is likely to be contracting through 2018 while export growth will slow and the terms of trade are likely to be falling, slowing nominal income growth. Prospects for an offsetting boost from household spending and business investment are not encouraging.

“The Leading Index growth rate has lifted over the last six months from a minus 0.08% in July to the current 1.28%. Over that period the key drivers of that improvement have been international developments. Rising commodity prices (0.72 percentage points); the steepening of the yield curve (0.66 percentage points) and US industrial production (0.06 percentage points) have played the dominant roles.

“On the other hand, the domestically based confidence; and housing market components have been the drag. Dwelling approvals (minus 0.17 percentage points); Westpac-MI CSI Expectations index (minus 0.07 percentage points) and Westpac-MI UE index (minus 0.05 percentage points) have all subtracted from growth.

“The labour market component (aggregate monthly hours worked) contributed 0.28 percentage points over the six months.

“The share market, which tends to reflect both domestic and offshore factors subtracted 0.07 percentage points from growth over the period.

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“The key components of the Index which are driving its current strength are implying that a strong boost to the terms of trade from rising commodity prices and an accommodative monetary policy can be expected to boost spending in the near term. A clearer pass through from those components to the domestic components, in particular confidence, will be required before we can expect a sustained boost to growth lasting more than the next 6-12 months.

“The Reserve Bank Board meets on February 7. The most recent Board minutes for the December meeting emphasised the concern the Board has with balancing the risks around financial stability and the possible need to further support a deteriorating economy. A reasonable interpretation of this discussion is that the “hurdle” to further cutting rates is high. In addition, the minutes put a positive spin on the current economic outlook – consumer spending passing through a soft patch; non mining investment being a bit stronger than the most recent capital expenditure survey indicates; the fall in the unemployment rate being consistent with the hours worked data; and the drag from mining investment likely to ease markedly in 2017.

“These sentiments are certainly consistent with our long held view that rates are likely to remain on hold over the course of 2017,” Mr Evans said.

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