Media release

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Leading Index pulls 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, fell from +1.39% in December to +0.73% in January.

Westpac's Chief Economist, Bill Evans, commented, "This is a full reversal of the strong 0.7ppt jump we saw last month. Most of the volatility in the Index over the last two months can be explained by dwelling approvals. After contributing 0.33ppts to growth in December, approvals fell sharply in January to subtract 0.21ppts points from growth.

"Nevertheless the Index is still registering a comfortably above trend reading and, following the solid results in October and November, points to above trend growth in the early part of 2018.

"However, in our view there are still key negatives around housing, household incomes and the consumer that are likely to challenge the sustainability of any upswing in 2018".

“The Index has recovered from the slow patch in June -August, although it remains below the high levels seen over the six months to May last year when the average growth rate reading was a solid +1.15%.

“In August, the growth rate printed –0.12% compared to January’s reading of +0.73%.

“The main component contributions to the lift over this period have been: commodity prices in AUD terms (+0.80ppts); the Westpac-MI Consumer Sentiment expectations Index (+0.21ppts); the Westpac-MI Unemployment Expectations Index (+0.14ppts); a steeper yield curve (+0.05ppts); and the S&P/ASX200 Index (+0.16ppts); as well as US industrial production (+0.24ppts).

“Only dwelling approvals (–0.27ppts) and aggregate monthly hours worked (–0.45ppts) detracted from growth over the period.

“The boost to growth shows a healthy mix of both international and domestic positives providing further confidence around the near term outlook.

“The Reserve Bank Board next meets on March 6. In a speech on February 8 the Governor concluded: “The Reserve Bank Board does not see a strong case for a near-term adjustment in monetary policy”.

Clearly there will be no policy change at the March meeting.

“Through 2017 Westpac has argued for rates to remain steady in 2017–2019. The Reserve Bank expects to make some progress in reducing unemployment and having inflation return to the midpoint of the target range. However, based on its most recent forecasts, released on February 9, that progress is expected to be painfully slow.

Underlying inflation is expected to reach only 2%, the bottom of target range, through 2019 and the unemployment rate is expected to fall from 5.5% to 5.25% (compared to an estimated full employment rate of 5.0%) by end 2019.

“While we are less optimistic about the unemployment rate and the growth outlook the Bank’s forecasts are not entirely out of line with our own view and, arguably, consistent with a steady cash rate over the next two years”, said Bill Evans.

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