Media release

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Leading Index growth rate drops

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 +0.42% in November to –0.27% in December.

Westpac Chief Economist, Bill Evans, commented, "This latest print for the Index growth rate extends a period of choppy performance. Last month we were surprised with the lift in the growth rate to +0.43% (revised back to +0.42%) and the specific print for December is more in line with our own growth expectations.

"However despite these choppy results the major trend is consistent with our view that growth has slowed from a solid above trend pace to at or below trend going forward.

"Over the eight months from September 2017 to April 2018 the growth rate averaged +0.78%. In the eight months since April the growth rate has averaged only +0.16% – 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 around an annualised pace of 4% in the first half of 2018. The September quarter national accounts revealed a marked step down in the growth rate printing only 0.3%, an annualised pace of just above 1%. Accordingly, Westpac expects that the growth momentum for the full second half of last year will come in at 2% – lower than indicated by the Leading Index but certainly consistent with the step down in average growth over the last eight months.

“The growth pace in 2019 is expected to fall from the annual rate in 2018 of 3.0% to 2.6%, both rates are well short of the Reserve Bank’s current outlook of 3.5% in 2018 and 3.25% in 2019, set out in its November Statement on Monetary Policy.

“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, indicating a negative wealth effect, and a downturn in the residential construction cycle.

“We also expect a slowdown in jobs growth and investment spending as both political uncertainty and global volatility weigh on firms’ employment and investment decisions.

“While the Index growth rate has been choppy month to month, it has shown a significant deterioration over the last six months, declining from 0.59% in July to –0.27% in December.

“Four of the eight components have contributed to the fall: the S&P/ASX200 (-0.41ppts); dwelling approvals (-0.35ppts); hours worked (–0.25ppts) and the Westpac-MI Consumer Sentiment Expectations Index (–0.15ppts).

“Partially offsetting those sharp falls were: the Westpac-MI Unemployment Expectations index (+0.19ppts); the yield spread (+0.06ppts) and commodity prices (+0.03ppts). There was no change in the contribution from US industrial production.

“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.

“A likely more downbeat assessment of the consumer and the housing construction cycle are significant factors behind our assessment that the Bank will lower its growth forecasts for 2018 and 2019 in the February Statement that will be released three days after this Board meeting.

“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. We continue to call rates on hold in 2019 and 2020”, Mr Evans commented.

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