Media release

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Leading Index growth rate continues to fall

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 –0.29% in December to –0.43% in January.

Westpac Chief Economist, Bill Evans, commented, "As discussed last month, despite some choppiness, the major trend is consistent with our view that growth has slowed from a solid above trend pace to one that is at or below trend going forward.

"Over the eight months from September 2017 to April 2018 the growth rate averaged +0.78%. In the nine months since April the growth rate has averaged only +0.10% – 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%. Westpac expects that the growth momentum for the full second half of last year will come in at around 1.5% – well below trend and 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 2.7% to 2.6%.

“This slowing growth environment is clearly emphasised by the Reserve Bank’s growth revisions in its February Statement on Monetary Policy where it lowered its growth forecast for 2018 from 3.5% to 2.75% and the 2019 forecast from 3.25% to 3.0% - still notably above trend and well above Westpac’s forecast.

“We note that the Bank has, in particular, recognised a negative wealth effect impacting consumers as house prices fall, particularly in Sydney and Melbourne, while the residential construction downturn has deepened.

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

“The Index growth rate has shown a significant deterioration over the last six months, declining from +0.17% in August to –0.43% in January.

“Four of the eight components have contributed to the fall: the S&P/ASX200 (–0.36ppts); dwelling approvals (–0.35ppts); US industrial production (–0.24ppts) and aggregate monthly hours worked (–0.05ppts).

“Partially offsetting those sharp falls were: the Westpac-MI Unemployment Expectations index (+0.15ppts); the yield spread (+0.02ppts); commodity prices (+0.17ppts) and the Westpac MI CSI expectations index (+0.07ppts).

"The Reserve Bank Board next meets on March 5. The minutes of the February Board meeting confirmed that the Board now sees the risks around the cash rate outlook as being more evenly balanced than had been the case in 2018 when it expected that the next move would be an increase.

"The policy outlook is firmly linked to progress in reducing the unemployment rate and moving the inflation rate back into the 2–3% policy band.

"The risks around the outlook centre on the household sector and dwelling investment. The Bank remains generally comfortable with the outlook for business investment; government spending and external conditions.

"Clearly, developments in the housing market, particularly in Sydney and Melbourne, are attracting considerably more attention from the Bank than we had seen in the minutes of meetings held in 2018. In particular, the Bank's current position that the effect of recent price falls on overall economic activity was expected to be relatively small is noted. However, in a very significant warning around the policy outlook, the February minutes state "if prices were to fall much further, consumption could be weaker than forecast, which would result in lower GDP growth, higher unemployment and lower inflation than forecast".

"The minutes note that financial market pricing implied that the Australian cash rate was expected to remain unchanged for a considerable period with some expectation of a decrease by late 2019.

"Over most of last year when markets; the RBA, and most economists were forecasting higher rates, Westpac's view was consistently that rates would remain on hold in 2019 and 2020. That was largely because our growth, inflation and employment forecasts did not justify higher rates. As discussed, our current forecasts remain lower than those of the RBA and we therefore expect that, over time, the RBA will further revise down their forecasts.

"However we do not think that those downward revisions will be sufficient to trigger a rate cut. As usual, our forecasts will continue to be reviewed", Mr Evans commented.

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