Media release

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Leading Index loses some ground but growth still above trend

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 +1.43% in February to +0.69% in March.

Westpac's Chief Economist, Bill Evans, commented, "The growth rate in the Leading Index remains in positive territory signalling above trend growth over much of the remainder of 2018. Drivers of the slowdown in the month have been from the domestic components – a slowing labour market; and some weakness in housing while rising short term interest rates have reflected liquidity pressures from global markets.

"Westpac's own forecast for growth in 2018 is 2.7%, around trend, and therefore somewhat weaker than is currently implied by the Leading Index.

"It appears likely that the Reserve Bank will lower its upbeat 3.25% growth forecast for 2018. The latest minutes from the Board refer to growth as "expected to exceed potential growth" (consistent with the signal from the Leading Index). However, with potential growth at 2.75% we expect the RBA will lower its growth forecast for 2018 to 3.0%.

"Looking through the 'choppy' profile in recent months, the Leading Index growth rate has lifted slightly over the last half year from 0.54% in October to the 0.69% in March. The main components driving the improvement have been a turnaround in commodity prices, measured in AUD terms (+0.58ppts) and a lift in US industrial production (+0.44ppts). These positives have been partially offset by weaker reads from aggregate monthly hours worked (–0.45ppts); a narrowing yield spread due to rising 90-day bill rates (–0.24ppts) and renewed slippage in dwelling approvals (–0.19ppts). The contributions from other components (S&P/ ASX 200; Westpac-MI Consumer Sentiment expectations index; and Westpac- MI Unemployment Expectations index) have been largely unchanged.

"The effects of those components of the Index which are directly impacted by overseas conditions have been mixed with commodity prices and US industrial production supportive being partly offset by rising short term interest rates. Domestic factors, covering the labour market and housing have been dilutive.

"The Reserve Bank Board next meets on May 1. There is very little chance of a rate move resulting from that meeting.

"In the April minutes the Board noted "members agreed that it was more likely that the next move in the cash rate would be up rather than down".
Markets have gradually pushed back the timing for that move until mid-2019. Only around six months ago markets anticipated nearly two moves by end 2018.

"Westpac has consistently been of the view that rates will remain on hold through both 2018 and 2019," Mr Evans said.

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