

Media release

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Leading Index sustains recent lift in growth rate

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 1.36% in December to 1.30% in January.

Westpac's Chief Economist, Bill Evans, commented, "This marks the sixth 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).

"However, the run of six 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 and January results represent a very strong rebound.

"Westpac concurs with the forecast of the Reserve Bank of 3% growth through 2017. That growth rate is above trend and consistent with the positive leads from the Index over the last six months.

“Potential complications for this growth rate lie with the Australian dollar. Although the recent strength in the Australian dollar is entirely understandable given the recent surge in commodity prices, the intensity and timing of any boost to spending from the rising terms of trade is always uncertain. On the other hand a higher Australian dollar can be expected to challenge services and manufacturing export growth. For now our forecasts for commodity prices and the Australian dollar envisage that we are near the peaks although we do not expect much correction to commodity prices or the Australian dollar through the remainder of 2017.

“Certainly we have more concerns for growth beyond 2017. Prospects for growth in 2018 look discouraging. 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. Eventually, however, a substantial correction to the Australian dollar will provide considerable relief for growth prospects in 2019.

“The Leading Index growth rate has lifted over the last six months from a 0.28% in August to the current 1.30%. Over that period the key drivers of that improvement have been restricted to a narrow group of components. Rising commodity prices (0.82 percentage points); the steepening of the yield curve (0.51 percentage points); average monthly hours worked (0.38 percentage points) and US industrial production (0.01 percentage points).

“On the other hand there was considerable drag from the share market (ASX 200) (−0.29 percentage points); dwelling approvals (−0.25 percentage points); the Westpac

– MI Unemployment Expectations index (–0.14 percentage points) and Westpac MI Consumer Sentiment Expectations Index (–0.01 percentage points).

“As discussed above the steepening yield curve signals supportive monetary policy and the commodity prices are boosting incomes through the terms of trade.

“The Reserve Bank Board meets on March 7. Yesterday’s Board minutes for the February meeting confirmed the Board’s view that the economy is likely to grow by around 3% in 2017 and 2018. The assessment around the outlook for consumption growth was a little more subdued. However buoyant housing markets in both Sydney and Melbourne are continuing to weigh on their considerations. In addition a boost to activity and global confidence has brightened the near term outlook. Inflation is assessed to be gradually moving towards the Bank’s target zone while business investment prospects are improving.

“Westpac expects that cash rate will remain on hold through 2017 and 2018,” Mr Evans said.

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