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Leading Index slips, growth momentum remains well below trend

The six month annualised deviation from trend growth rate of the Westpac Melbourne Institute Leading Index which indicates the likely pace of economic growth three to nine months into the future declined from –0.49% in November to –0.61% in December.

Westpac’s Senior Economist Matthew Hassan commented, “The Leading Index has now registered below trend growth in eleven of the last twelve months. Official figures show GDP growth recorded a lacklustre 2.5% pace in the first nine months of 2014. Based on the Leading Index, the Australian economy looks set to continue recording below trend growth well into 2015.”

“The Leading Index growth rate improved slightly over the second half of 2014, from –0.77% in July to –0.61% in December. Component-wise, the composition of that weakness has also remained largely the same. Back in July, the main negatives were from the RBA commodity price index (–0.80ppts), the yield gap (–0.32ppts) and aggregate monthly hours worked (–0.22ppts). December shows a very similar picture with the same three components contributing –0.22ppts, –0.35ppts and –0.39ppts respectively. Note that the reduced drag from falling commodity prices is mainly due to a lower exchange rate with this component measured in AUD terms. The reduced
drag from commodity prices and a more positive contribution from dwelling approvals (+0.19ppts) have been offset by weaker contributions from the ASX 200 (–0.23ppts), hours worked (–0.17ppts) and US industrial production (–0.15ppts). There has been little change in the contribution from other components over the last six months.

“For the December month in isolation, the Index was unchanged at 97.89 with half of the components improving and half deteriorating. The positives came from the ASX (up 1.8%); the RBA commodity price index in AUD terms (up 1.1%); dwelling approvals (up 7.6%); and the Westpac-Melbourne Institute Unemployment Expectations Index (down 5.5% indicating an improved outlook for unemployment). The negatives were from the Westpac-Melbourne Institute Consumer Expectations Index (down 0.3%); US industrial production (down 0.1%); the yield spread (narrowing 0.3ppts) and aggregate monthly hours worked (down 0.5%).

“The Reserve Bank Board next meets on February 3. While market pricing is only giving a one in four chance of a February interest rate cut, Westpac's view is that the case for lower rates is strong. The December Leading Index adds to this, showing growth momentum remains weak. With commodity prices continuing to fall in 2015, incomes and confidence remain under pressure. We expect the December quarter inflation report due out later today will show sufficient scope for the RBA to cut rates with a February move seen as more attractive for the Bank given that it coincides with a full Statement on Monetary Policy and a full revision to its forecasts.”, Mr Hassan said.

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