Leading Index signals above trend growth

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 +0.63% in September to +0.43% in October.

Westpac's Chief Economist, Bill Evans, commented, “The October reading is the third consecutive above trend result and follows fifteen months of persistent below trend reads. Although the growth rate has slowed a little, it is still a clear positive signal for the near term economic outlook. That signal is broadly consistent with Westpac's forecast for growth to hold around a 3% pace over the course of this year and to lift to 3.3% in 2017.

“Westpac has recently lifted its growth forecast for 2017 from 3% to 3.3%. That reflects the recent improvement in the terms of trade following the sustained boost in bulk commodity prices; a more confident assessment of the sustainability of the residential construction cycle and continuing evidence of a strong outlook for growth in both resource and services exports.”
“The Leading Index growth rate has lifted over the last six months from a 0.34% below trend reading in May to the current 0.43% above trend result.

“Offshore factors continue to dominate the sources of improvement in the Index. Of the net 77 basis points in improvement over the last six months, three of the four externally driven components contributed 90 basis points – commodity prices (45 basis points); US industrial production (25 basis points); and a steepening yield curve (25 basis points). The other component of the Index which is heavily influenced by global forces (ASX 200) actually subtracted 8 basis points from the overall movement over the six months. Of course we can expect another story in November following the post-election boom in the share market.

“Contributions from the domestic components of the Index were mixed over the six month period. Aggregate hours worked have improved, contributing 31 basis points to the lift. However, confidence measures have weighed on the Index. The Westpac-MI Consumer Expectations Index subtracted 14 basis points and the Westpac-MI Unemployment Expectations Index subtracted 13 basis points. A slowdown in dwelling approvals has also seen this component subtract 13 basis points.

“The Reserve Bank Board next meets on December 6. There is virtually no chance of a policy move coming from that meeting. The minutes from the November meeting signalled that the Bank is in a ‘wait and see’ mode. There was an air of uncertainty around both the housing market and the labour market. Considerable time will be required before the picture around both becomes clearer. From our perspective we expect stability in the housing market and some gradual pick-up in labour market conditions as stronger overall growth lifts it out of the current ‘slow patch’.
“Consequently, we expect that a central bank, which must be questioning the effectiveness of yet more monetary stimulus, will be unlikely to see the need to adjust policy throughout the entire run of 2017” Mr Evans said.

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