

Media release

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Leading Index back below trend growth

The annualised growth rate of the Westpac–Melbourne Institute Leading Index, which indicates the likely pace of economic activity three to nine months into the future, was 2.6% in October 2011, below its long term trend of 3.0%. The annualised growth rate of the Coincident Index which gives a pulse of current activity was 3.5%, above its long term trend of 3.2%.

Westpac Chief Economist, Bill Evans, commented, "The growth rate in the Index has slowed from the 4.4% which was reported for August and is now back below trend. It appears that the boost to above trend growth we saw in July and August has quickly faded and the 'around trend' story which has been generally the case since the beginning of 2011 is now appropriate."

This message is consistent with Westpac's own forecasts for 2012. We are currently forecasting growth in 2012 of 3% slightly below trend growth for the economy.

"Over the last six months the growth rate in the Index has decreased slightly from 3.0% to 2.6%. The two components of the Index derived from the national accounts contributed more positively to growth over the period – corporate profits (+0.6ppts) and productivity (+0.5ppts). That improvement was complemented by overtime

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worked (0.3ppts). However, these positives were more than offset by bigger drags from manufacturing prices (-0.8ppts); the all ordinaries index (-0.5ppts) and dwelling approvals (-0.6ppts). The remaining components, US industrial production and real money supply, were broadly neutral.

“In November the Reserve Bank released its revised growth outlook for 2011; 2012 and 2013. In August it had been forecasting growth to be comfortably above trend. These forecasts have now been reduced to 1¾%; 4%; and 3¼% respectively. Those forecasts compare with Westpac's 2%; 3%; and 3½% respectively. With the exception of our view that 2012 will be a year of slightly below trend growth and the Reserve Bank expecting a robust above trend 4%, our forecasts are broadly in line.

“The level of the Leading Index rose from 281.8 to 282.2 (0.1%). Three of the four monthly components of the Leading Index rose in October: the real money supply (up 0.2%); US industrial production (up 0.7%); and the All Ordinaries Index (up 7.2%). Dwelling approvals declined sharply by 10.7%.

“The Reserve Bank Board next meets on February 7. The minutes of the December Board meeting where the Board decided to cut rates by 0.25% indicated that the key theme was the concern that sovereign credit and banking problems would weigh heavily on economic activity in Europe which continued to pose downside risks to the global economy and, consequently, Australia. There was also further recognition of the mixed outlook for Australia with housing; consumers; and employment all looking subdued. On the other hand business investment, particularly mining, looked robust. With prospects for Europe steadily deteriorating and the interest rate sensitive parts of the economy remaining weak we believe there is ample scope for a further rate cut in February”.

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