

Media release

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Leading Index slowing down

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 1.6% in November 2011, below its long term trend of 2.9%. The annualised growth rate of the Coincident Index which gives a pulse of current activity was 3.0%, around its long term trend of 3.1%.

Westpac Chief Economist, Bill Evans, commented, "The growth rate in the Index has slowed from the 4.5% which was reported for August and is now well below trend. It appears that the boost to above trend growth we saw in July and August has quickly faded and the outlook has evolved into a "below trend" story.

"This message is consistent with Westpac's own forecasts for 2012. We are currently forecasting growth in 2012 of 3% which is slightly below trend growth for the economy. However, we see that profile in two stages with growth in the first half near a 2 to 2.5% annualised pace to be followed by growth in the second half around a 3.5% to 4% annualised pace. As discussed, a read on the Leading Index for November 2011 is giving us information which is focussed around the first half of 2012 and the below trend read on the Index for November is consistent with our own expectations.

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“The Leading Index provides little insight into our more optimistic views on growth in the second half of 2012. Our reasons for a stronger growth profile in the second half of 2012 revolve around the likely lagged impact on the economy of the recent rate cuts more of which are expected for the first half of 2012; the expected impact of a switch from tightening to easing policy in China; and monetary authorities adopting aggressive quantitative easing policies in both Europe and the US.

“Over the last six months the growth rate in the Index has decreased slightly from 2.9% to 1.6%. The components of the Index derived from the national accounts contributed more positively to growth over the period – corporate profits (+0.2ppts) and productivity (+0.4ppts). US industrial production also added +0.2ppts to the Index growth rate. However, these positives were more than offset by bigger drags from manufacturing prices (–0.8ppts); the all ordinaries index (–0.5ppts); and overtime worked (–0.7ppts). The remaining components: dwelling approvals and real money supply, were broadly unchanged.

“The level of the Index fell 0.5 points from 282.2 in October to 281.7 in November. Three of the monthly components fell – real money supply (–0.2%); US industrial production (–0.7 %); and the all ordinaries index (–4.1%). Dwelling approvals rose by 8.4% following two large falls of 10% and 14.2% in October and September, respectively.

“The Board of the Reserve Bank next meets on February 7. Since the last Board meeting in December we have seen ongoing deterioration in the labour market while financial and economic conditions in Europe remain fragile. We expect the Board to cut the overnight cash rate by a further 0.25% to 4% completing three consecutive meetings when the overnight cash rate has been reduced. Even at 4% there is scope

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for the Board to go further given the benign outlook for inflation. Indeed, we expect a follow up move in May”, Mr Evans said.

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