

Media release

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Leading Index continues to signal weakness ahead

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 –1.2% in December, well below its long term trend of 3.5%. The annualised growth rate of the Coincident Index was 3.3%, well up on its November read of 2.4% but mainly due to the fiscal policy-induced jump in December retail sales with growth still below its long term trend of 3.7%.

Westpac Senior Economist, Matthew Hassan commented, "Despite some modest upward revisions, the growth rate in the Leading Index remained in negative territory for the second consecutive month. In the past this has been a useful indication of a likely recession in Australia."

"Australia has experienced three recessions since 1965 – defined as a contraction in economic activity over the course of a year. These were in the mid 1970s, the early 1980s and the early 1990s. On each occasion we saw the growth rate in the Leading Index turn negative about a year before a recession was confirmed. There have only been two occasions in which the growth rate in the Index turned negative but the economy avoided a full-blown recession – in the mid-80s and in 2000-01. And even these episodes saw a notable weakening in economic activity, including a quarterly

decline in GDP, a slowdown in through the year growth to around 1% and significant falls in domestic demand in through the year terms.”

Mr Hassan said “The growth rate in the Leading Index has fallen sharply from the 4.5% registered in July to December’s read of –1.2%. Seven of the eight components of the Index contributed to this fall. Amongst the domestic components, the main contributions have come from: dwelling approvals (–0.9ppt); share price index (–0.7ppt); overtime worked (–0.3ppt); productivity (–0.7ppt); and corporate profits (–1ppt). Deteriorating conditions abroad have also been a major factor with the US industrial production component detracting –2.3ppts.”

“The level of the Leading Index fell by 0.8 pts (–0.3%). This fall was mainly explained by a 2% fall in US industrial production in December.”

“Growth in the Coincident Index jumped from November to December but mainly due to the fiscal policy-induced surge in December retail sales. The level of the Coincident Index rose by 1.6 points with real retail trade adding +1.0ppt compared to a +0.2ppt contribution in November. Other components were mostly unchanged. The Government’s \$8.7bn in fiscal payments to households in December were a key factor in the retail jump, although indications suggest the bulk of the cash was either saved or used to pay down debt.”

Mr Hassan noted “The divergence between the Leading and Coincident Indexes echoes recent results from the Westpac-Melbourne Institute Consumer Sentiment Survey which has seen a steady improvement in consumers’ assessment of current conditions but a sharp deterioration in their expectations for the year ahead. In both cases, the improvement in measures of the current situation reflect the direct impact of substantial policy easing – particularly the major boost to household incomes and

spending from the \$8.7bn in fiscal payments that went out in December. However with this boost dropping out in coming months, the improvement in current measures will clearly be difficult to sustain.“

“The Reserve Bank Board next meets on March 3. We expect it to further reduce rates with the overnight cash rate eventually moving to 2% by mid-2009”, Mr Hassan said.

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