

Media release

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Leading Index points to continued economic contraction

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 –3.1% in January, a long way below its long term trend of 3.2%. The annualised growth rate of the Coincident Index was 1.8%, down half a per cent on its December read of 2.3% and also well below its long term trend of 3.5%, although still comfortably above zero.

Westpac Senior Economist, Matthew Hassan commented, "The Leading Index is now in deeply negative territory consistent with contracting economic activity. There are only four occasions in the 49 year history of the Index in which its growth rate has fallen below the current read: in the early 1960s, the mid-70s, the early 80s and the early 90s. Each of these was followed by recessions in the Australian economy."

Mr Hassan said: "This is the weakest read in the Leading Index since August 1990 when the six month growth rate fell to –3.4%. Back then the economy had already entered what went on to become a deep and long-lasting recession. The trend unemployment rate had risen 1.2ppts from its cyclical low and went on to climb a further 3.8ppts to a high of 10.7% over the following two years."

“Notably, the current deterioration in the Leading Index has happened over a much shorter timeframe. The August 1990 low came a full year after the Index’s growth rate first slipped below zero. The current cycle has already seen the growth rate collapse to a similar level, but in less than six months.”

“The annualised growth rate in the Leading Index has fallen 7.1ppts in five months, from the above trend 4% registered in August to –3.1% in January. The deterioration has come across six of the eight components. Amongst the domestic items, significant negative contributions have come from: falling corporate profits (–1.4ppt); slowing productivity growth (–1.4ppt); further falls in share prices (–1.1ppt); and a slide in dwelling approvals (–0.6ppt). The only positive contribution has been from higher overtime worked (+0.2ppt). Conditions abroad continue to have a major impact with the US industrial production component detracting –2.4ppts.”

“The level of the Leading Index fell by 0.6 pts (–0.2%) in the January month. Three of the four monthly components declined: share prices, US industrial production and dwelling approvals. Three of the four quarterly components fell in the December quarter: overtime, corporate profits and productivity.”

Mr Hassan noted: “Growth in the Coincident Index also fell in January but this was mainly due to a moderating boost from policy factors late last year. The level of the Coincident Index fell by 0.2 pts (–0.1%), with annualised growth slipping from 2.3% in December to 1.8% in January. One of the main movers was real household income which contributed +2.0ppts in January compared to +2.3ppts in the previous month. However, this is still well up from the +1.0ppt contribution this component made in August. The RBA’s aggressive rate cuts and \$8.7bn in fiscal payments have given a major boost to incomes over the last six months. Amongst the other components,

rising unemployment detracted -0.6 ppts in January compared to -0.3 ppt in December but others registered only marginal shifts.”

Mr Hassan said: “While the Leading Index continues to point to sharply weaker activity, the Coincident Index suggests a more moderate deterioration to date. The main reason for the wedge is the policy support to household incomes and retail trade. These two components combined have lifted the six month annualised growth rate in the Coincident Index by 2.1 ppts since August. Without this positive, growth on this measure would also have slipped into negative territory for the first time since 1991.”

“Indeed, more generally the policy response to date suggests the economy is not heading for a repeat of the early 1990s experience. Both monetary and fiscal policy has been eased aggressively and early. At the same time, Australia is not having to deal with the same sort of problems that badly undermined the banking system in the early 1990s – the sharply unwinding boom in commercial property in particular. ”

“The Reserve Bank Board next meets on April 7. We expect it to reduce the cash rate by another 25bps to 3% with the overnight cash rate eventually moving to 2% in the second half of 2009”, Mr Hassan said.

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