

Media release

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Growth Rate of the Leading Index Continues to Plunge

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 –5.1% in February well below its long term trend of 2.9%. The annualised growth rate of Coincident Index was 0.7%, also well below its long term trend of 3.4%.

Westpac's Chief Economist, Bill Evans, commented, "The rate of deterioration of the growth rate of the Leading Index is truly remarkable. For some months the Index has been signalling that the Australian economy will enter a recession. The consistent run of negative reads for the growth rate is comparable with Australia's previous recessions which began in 1961, 1974, 1982, and 1990.

"A comparison with the last recession, which we no doubt recall the most clearly, is disturbing. During that recession the annualised growth rate of the Index remained negative for 20 consecutive months, reaching its low point of –3.4% after 12 months. In this cycle the growth rate first went negative in October last year and deteriorated to –5.1% in this February reading. During that earlier recession the low point for the Australian economy was 1991 when the economy contracted by 1.3%. Westpac is currently forecasting that the Australian economy will contract by 1% in 2009 which we expect to be the low point of the cycle. The current rapid deterioration in the growth rate of the Leading Index points to downside risk for that forecast.

“Our current view is that despite concerning signals from the Leading Index, this current recession will be less damaging than the one in the early 1990's. That view is clearly supported by the much more pre-emptive monetary and fiscal policy approach taken in this recession relative to the last one. However, global economic conditions are much more concerning this time than in the early 1990's. The low point of world growth in that period was 1.5% in 1991 whereas we expect the world economy to actually contract by 1% in 2009 – the first contraction since World War 2.

“These qualifications nevertheless emphasise that both monetary and fiscal policy still have much more work to do. It would be a mistake for the monetary and fiscal authorities to assume that enough work has been done given this extremely dangerous global economic environment.

“Over the last five months the annualised growth rate of the Leading Index has fallen from 0.5% in September to –5.1% in February. Of the 8 components of the Leading Index the major contributors to the 5.6ppt fall in the growth rate were: overtime worked (–1.4ppts); US industrial production (–1.1ppts); commodity prices (–0.9ppts); productivity (–0.8 ppts); share prices (–0.7ppts); corporate profits (–0.7ppts); and dwelling approvals (–0.1ppts). The 20% surge in share prices in March can be expected to be supportive of the Index in March but there is no comparable optimism about any of the other components, especially the component associated with the labour market.

“The level of the Leading Index fell by 0.8 points (–0.3%) in February. Two of the four monthly components rose in February. Real money supply was up 1.2% and dwelling approvals rose 7.8%. The all ordinaries index fell 5.5% while US industrial production

was down by 1.5%. Three of the four quarterly components – overtime worked, corporate profits and productivity – all detracted from the Leading Index in February.

“The level of the Coincident Index fell by 1.1 points (0.5%). The fall of 2.2% in real retail trade and rise in the unemployment rate from 4.8% to 5.2% were the most important factors behind the weakness in the Index. The sharp 1.1ppt fall in the growth rate of the Index over the month was largely explained by retail sales (–0.6ppts) and the unemployment rate (–0.4ppts).

“The Reserve Bank Board next meets on May 5. Despite the clear message from the Leading Index that more work needs to be done with monetary policy, we expect the Bank will decide to hold steady in May. With the Bank having already cut rates by 425bp since September we assess that the likely low point in the cycle will be 2% – only 1% below the current level. Given the importance of rate cuts in boosting confidence, we expect the Bank will see the need to have ample capacity to be cutting rates through the second half of 2009. The economic case for cutting rates further is undeniable. The issue is really only about tactics.” Mr Evans said.

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