

Media release

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Leading Index improving

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 –3.3% in June well below its long term trend of 2.6%. The annualised growth rate of the Coincident Index was –0.7%, also below its long term trend of 2.9%.

Westpac's Chief Economist, Bill Evans, commented, "The pace of contraction of the growth rate of the Leading Index is easing considerably. Last month the growth rate registered minus 5.3% compared to the current measure of minus 3.3%. Clearly the lowpoint in the outlook for growth has been reached and steady improvement can be expected from here.

"Westpac expects year average growth in 2009 of 0.2% to be followed by growth of 1.8% in 2010. The recent surge in both business and consumer confidence places considerable upside risks to these numbers but the new dimension of a Reserve Bank that appears to be signalling plans to raise interest rates must temper the outlook. The resilience of confidence to the prospect of higher rates will be a key determinant of the growth outlook.

"Confidence measures do not figure directly in the components of the Leading Index. However the indirect effect is captured in a number of the components. The 2.8ppts improvement in the growth rate of the Index from its lowpoint of minus 6.1% in February to the current minus 3.3% is mainly explained by improvements in the share

market (1.8ppts), overtime worked (1.7ppts), corporate profits (0.8ppts) and dwelling approvals (0.6ppts). Falls in manufacturing prices continued to weigh on the growth rate, reducing it by a further 1.7ppts over the period. Improved confidence in the equity, labour and housing markets all contributed to the better performance of the Index.

“The level of the Leading Index increased by 1.8 points (0.7%). Three of the four monthly components increased with the all ordinaries index up by 3.6%, dwelling approvals rising by 9.3%, and the real money supply up by 0.5%. The international influence of US industrial production continued to weigh, although by a lesser extent, registering a 0.4% reduction. When growth in East Asia was mainly reliant on exports to the US, a US activity variable was a reasonable way of capturing the broader performance of Australia’s trading partners. However, since the growth momentum in East Asia has switched to domestic spending mainly due to Chinese stimulus policies, US industrial production is likely to be understating the external demand support for Australian growth.

“The Reserve Bank Board next meets on September 1. Recent statements from the Governor indicate that the Bank has adopted or is near to adopting a tightening bias. Markets expect the first rate hike as soon as October/November. Westpac’s bias has been for the Bank to hold off raising rates given that we still assess the current promising improvement in confidence to be fragile and an untimely rise in rates could significantly damage confidence. We believe the Bank may also be mindful of these risks and will therefore delay its first move until February next year, when the recent improvement in economic indicators has had time to consolidate.” Mr Evans said.

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