

Media release

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Leading Index surges back to positive growth

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 1.7% in August just below its long term trend of 2.8%. The annualised growth rate of the Coincident Index was –0.1%, also below its long term trend of 2.8%.

Westpac's Chief Economist, Bill Evans, commented, "The pace of recovery in the growth rate of the Leading Index has been remarkable. The annualised growth rate has moved from –6.9% in May to today's print of 1.7% in August – an increase of 8.6 ppts.

"Following the two recessions Australia experienced in the early 1980's and 1990's the rate of recovery in the Index was not as steep.

"In the recovery in 1990/91 the growth rate improved by 4.5 ppt's over 9 months and in the 1982 recovery the growth rate improved by 6.6 ppts over 6 months. Growth increased from –0.9% in 1991 to 3.9% in 1992 while it accelerated from –2.5% in 1982 to 3.6% in 1983.

“The current sharp improvement in the growth rate of the Leading Index strongly supports the view that the Australian economy is moving onto a much stronger growth trajectory in 2010.

“It is certainly supportive of Westpac's forecast that GDP growth in Australia will increase from 1.5% in 2009 to 4% in 2010.

“The components of the Index that explain the sharp improvement in the growth of the Leading Index from its low point in May of –6.9% to the August print of 1.7% are: domestic labour market conditions (2.4 ppt's); US industrial production (2 ppt's); share prices (1.3 ppt's); corporate profits (1.3 ppt's); dwelling approvals (0.9 ppt's); manufacturing prices (0.6 ppt's); and productivity (0.6 ppt's). These contributions were partly offset by the real money supply which subtracted 0.4 ppt's from growth.

“These components are capturing the key themes behind the improving prospects for the economy in 2010 – global recovery; considerable improvement in prospects for the labour market; sharp improvement in financial markets; better outlook for corporate profits; resurgence in housing market; recovery in commodity prices; and improved productivity. The Index is also signalling the key risk for 2010 as global credit markets remain difficult and interest rates continue to rise both the demand and supply of credit are likely to be headwinds.

“The level of the Index rose by 2.8 points (1.1 %). That follows a 1.4% increase in the Index in July and a 1.1% increase in June – the largest percentage increase in the Index over three months since the early 1980's. Of the four monthly components of the Index three increased – share prices (up 5.5%); real money supply (up 0.1%); and US industrial production (up 0.8%) – dwelling approvals fell by 0.1%.

“The level of the Coincident Index rose by 0.1 points. Across the monthly components: real retail trade rose 0.6% and employment fell by 0.2%.

“The Reserve Bank Board next meets on November 3. Westpac expects that the Board will decide to raise rates again following the decision to begin the tightening cycle with an increase in rates of 0.25% at its meeting in October. The clear signal from today's print of the Leading Index points to significantly improving growth prospects in 2010 and a need to move rates away from the current highly expansionary setting. The issue for debate at the meeting should be whether the move is by 25 bp's or 50 bp's. Recent speeches and reports from the Bank indicate particular unease with the Bank's forecast that underlying inflation will move back from its current read of 3.9% to 2% by the end of 2010. The release of the September quarter inflation data on October 28 may show that the quarterly pace of underlying inflation has actually picked up. In those circumstances a decision to raise rates by 50 bp's in November would not surprise”. Mr Evans said.

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