

Media release

16 December 2009

Strict Embargo 10:30am

Leading Index growth rate continues to climb

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 6.7% in October well above its long term trend of 3.1%. The annualised growth rate of the Coincident Index was 0.7%, below its long term trend of 2.8%.

Westpac's Chief Economist, Bill Evans, commented, "We continue to be surprised by the pace of recovery in the growth rate of the Leading Index. Over the last six months, growth has accelerated from –5.3% in May to the current 6.7%. As discussed last month this rapid turnaround represents the fastest reversal in the growth rate of the Leading Index since the economy bounced out of recession in the mid 1970's.

"This sharp recovery in the growth rate is consistent with Westpac's view of the economic outlook. In through the year terms we expect the growth rate of domestic demand to bounce back from around 1% in 2009 to 4½% in 2010. That will be supported by much stronger momentum in consumer spending; dwelling construction and business investment. The recovery in GDP growth will be more subdued (2% to around 3¼%) as the major supporters of growth in 2009 – inventories; government spending and net exports begin to fade in 2010.

“The components of the Leading Index that explain the sharp movement in the growth rate of the Leading Index from –5.3% in May to the October print of 6.7% are: US industrial production (3.4 ppt's); industrial commodity prices (3 ppt's); productivity (2.6 ppt's); the share price index (1.7 ppt's); dwelling approvals (1 ppt); domestic labour market conditions (0.8 ppt's) and real corporate profits (0.7 ppt's). These gains were partially offset by a contracting effect from the real money supply – partly reflecting credit conditions.

“The level of the Leading Index rose by 1 point (0.4%). Two of the four monthly components of the Index fell in October – the share price Index (down by 2.1%) and dwelling approvals (down by 0.7%). One component rose (US industrial production rose by 0.1%) and the real money supply was unchanged.

“The Reserve Bank Board next meets on February 2. The minutes from the December meeting where, as expected, the Board decided to raise the overnight cash rate by a further 0.25% indicate that the Board now believes there has been a material increase in the cash rate and that it has more flexibility going forward. This suggests to us that at the time of the December meeting it expected that a pause might be appropriate for the next meeting. With no January meeting scheduled and the data flow (including the buoyant signal from the Leading Index) indicating that growth prospects continue to improve we expect that the Board will choose to raise rates again by 25 bp's at the February meeting. However, with the Board also indicating in the minutes that it has no intention of moving rates to contractionary settings we recognise that a pause is likely for much of 2010. That will probably come from around mid year by which time

the overnight cash rate is likely to have reached 4.5% from its current level of 3.75%”.

Mr Evans said.

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