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Growth rate of the Leading Index is recovering slowly

- 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 1.6% in May 2012, below its long term trend of 2.6%. The annualised growth rate of the Coincident Index, which gives a pulse of current activity, was 4.2%, well above its long term trend of 3.1%.

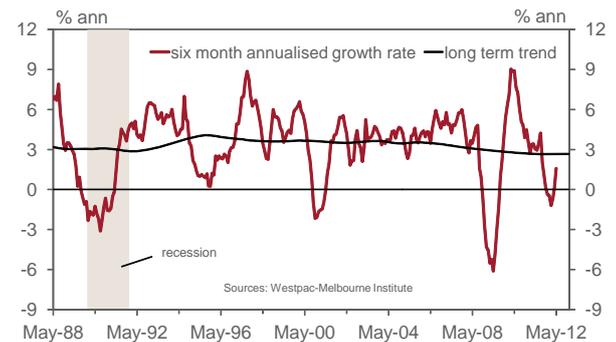
While the growth rate remains well below long term trend it is the fastest since September last year and is indicating that, while moderate, growth in the second half of 2012 and into 2013 will adopt an improving tempo. Westpac expects that growth in the second half of 2012 will be around an annualised pace of 3% whereas growth in 2013 should lift to an around trend 3.5%.

That profile presumes further interest rate relief through the second half of 2012 although the current disposition of the monetary authorities appears to be to sit tight for the next few months in the wake of the surprisingly strong surge in growth in the first quarter of 2012. That print was driven by a surge in real consumer spending partly resulting from the near deflationary conditions which operated during the quarter. “Apart from mining other sources of spending - residential housing and business investment were soft and reliably in line with the signals from the Leading Index in 2011.

Since December 2011 the growth rate in the Index has increased from -0.4% to 1.6%. The contributors to the improved growth performance were: dwelling approvals (+1ppt); materials prices (+0.6ppts); the share price Index (+0.3ppts); overtime worked (+0.3ppts); the real money supply (+0.2ppts); and productivity (+0.1ppts). Offsetting that improvement were corporate profits (-0.4ppts) and US industrial production (-0.2ppts). The dominant contribution from dwelling approvals was between April and May when approvals jumped 27.3% - with about three quarters of this due to a spike in ‘high-rise’ approvals and disruptions in WA a sharp reversal is likely in June. As such, the improvement in the Leading Index growth rate is somewhat more tentative than the figures suggest.

The level of the Index increased from 280.3 in April to 282.5 in May. Two of the four monthly components of the Index increased (real money supply increased by 1.4% and dwelling approvals increased by 27.3%). The other monthly components were down - the share price Index by 7.3% and US industrial production by 0.1%.

Westpac-MI Leading Index



The level of the Coincident Index rose from 276.8 in April to 277.6 in May. All three monthly components rose in May- retail trade (0.3%); employment (0.3%) while the unemployment rate increased from 5% to 5.1% (a negative for the overall Index). Over the last six months the growth rate in the Coincident Index has increased from 2.9% (below trend) to 4.2% (above trend). Almost 50% of this growth improvement has been due to employment growth.

The Reserve Bank Board next meets on August 7. It is clear from the minutes of the Board meeting on July 3 that the Board is in a ‘wait and see’ mode. Despite our own scepticism, the Board was clearly impressed by the 1.3% surge in GDP growth in the March quarter. As indicated by the rise in employment, which is key to the increase in the Coincident Index, the Board describes the labour market conditions as “relatively favourable”. We believe that there is already a case for financial conditions to ease further given our outlook for a rise in the unemployment rate; inflation near the bottom of the Board’s target zone; and a world economy that is likely to remain quite threatening. However it will clearly take time to convince the Board of our view.

Consequently we do not expect another rate cut until the December quarter.

Bill Evans, Chief Economist



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