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The Leading Index surges

- The six month annualised growth rate in the Westpac-Melbourne Institute Leading Index, which indicates the likely pace of economic activity relative to trend three to nine months into the future, jumped from +0.66% in November to +1.41% in December.

This is a very strong above trend reading and, following the solid results in October and November, points to solid above trend growth in the early part of 2018. However, in our view there are still key negatives around housing, household incomes and the consumer which are likely to challenge the sustainability of any upswing in 2018.

The Index has recovered from the slow patch in June/ August, and, for this month at least, is above the levels it enjoyed over the six months to May when the average growth rate reading was a solid +1.12%.

In July, the growth rate printed -0.06% compared to December's reading of +1.41%.

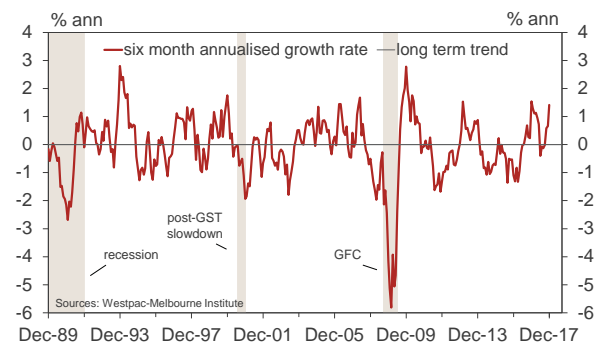
The main component contributions to the lift over this period have been: commodity prices in AUD terms (+0.65ppts); dwelling approvals (+0.20ppts); the Westpac-MI Consumer Sentiment expectations Index (+0.29ppts); the Westpac-MI Unemployment Expectations Index (+0.06ppts); a steeper yield curve (+0.06ppts); and the S&P/ASX200 Index (+0.12ppts); as well as US industrial production (+0.11ppts).

Only aggregate monthly hours worked (-0.02 ppts) detracted from growth over the period.

The boost to growth shows a healthy mix of both international and domestic factors providing further confidence around the near term outlook.

The Reserve Bank Board next meets on February 6. In the minutes to the December Board meeting the Board noted that: "How far and when stronger conditions in the economy and labour market feed into higher wage growth and inflation remained important considerations in shaping the outlook". The Bank's own underlying inflation forecasts are currently 1.75% in 2018 and 2% in 2019. It expects wages growth to increase gradually over the next year. Prospects for an imminent rate move are very small.

Westpac-MI Leading Index



However markets and most commentators, partly reflecting signals like the current reading of the Index are expecting rates to start increasing in the second half of 2018.

Westpac has a more patient view. Rates are expected to remain on hold in both 2018 and 2019

Bill Evans, Chief Economist

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