Leading Index continues to point to lack lustre growth

The growth rate in the Leading Index remains below zero, indicating momentum will track well below trend. In fact, the January print represents the fourteenth straight month that the Index growth rate has been negative. This has been consistent with the persistent below trend growth we have seen for the Australian economy.

This update points to weak underlying economic momentum continuing in the first half of 2020 and is consistent with Westpac’s view that underlying growth will remain around a 2% pace in the first half of 2020.

After taking into account our estimate for the impact of the coronavirus and the bushfires in the first quarter of 2020 we have revised down our forecast for growth to 0% in the March quarter from 0.5%. That is now estimated to be followed by a 0.8% (0.5% underlying) in the second quarter as the effects of the virus disruptions dissipate and some rebuild begins in the aftermath of the bushfires. Growth momentum is expected to lift in the second half as the rebuild from the bushfires comes through.

Overall, despite some significant redistribution of growth through the year we expect that growth in 2020 will hold around 2%, well below trend which we estimate as 2.75%.

The Leading Index growth rate has deteriorated over the last six months from -0.16% in August to the current -0.46%. The main driver of the 0.29ppt shift has been a weaker signal commodity prices, measured in AUD terms (+0.5ppt); with some additional drag coming from slower gains in the sharemarket (~0.11ppts); and softer reads around the Westpac-MI CSI expectations index (~0.04ppts) and US industrial production (~0.03ppts).

These negatives have been partially offset by a modest recovery in dwelling approvals (+0.19ppts); a modest widening in the yield spread (+0.14ppts); and slightly better signals around the labour market, aggregate monthly hours worked (+0.05ppts); and Westpac-MI UE index (+0.03ppts).

The Reserve Bank Board next meets on March 3. We expect the Board will decide to keep rates on hold at that meeting.

However we do expect further reductions in the cash rate over the course of 2020.

We note from minutes of the February Board meeting, which were released yesterday, that the Board discussed a further reduction in interest rates because prospects are for only gradual progress towards the Bank’s inflation and unemployment goals.

The decision to defer hinged largely around the benefits vs the risks of lower rates.

Those risks were around encouraging additional borrowing in the housing market. With housing credit growth benign and little evidence of loose lending practices it seems reasonable that any evidence that the gradual convergence towards the inflation and employment targets is not being achieved will result in further policy easing.

That profile remains Westpac’s view although we recognise that the risks are that this evidence may take more time to emerge than implied by our current forecast that the next cut in rates will be at the April Board meeting.

Bill Evans, Chief Economist
Disclaimer continued

Investment Recommendations Disclosure

The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

i. Chinese Wall/Cell arrangements;
ii. physical separation of various Business/Support Units;
iii. Strict and well defined wall/cell crossing procedures;
iv. a “need to know” policy;
v. documented and well defined procedures for dealing with conflicts of interest;
vi. reasonable steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

U.S.:

Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission (“CFTC”) as a Swap Dealer, but is neither registered as, nor affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC (“WCM”), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 (’the Exchange Act’) and member of the Financial Industry Regulatory Authority (’FINRA’). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.