Leading Index gradually normalising

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, rose from -4.42% in July to -2.56% in August.

The components of the Index that explained the bulk of the improvement over the month were Consumer Sentiment, Unemployment Expectations and dwelling approvals.

These signals are broadly consistent with Westpac’s view that growth in the September quarter will be a solid 1.8% despite an expected 4% contraction in Victoria, which accounts for around 25% of national economic activity.

Our upgraded September quarter growth profile has meant a somewhat moderated pace in the December quarter from 2.8% to 2.2% as the expected recovery pace in Victoria is downgraded from 6% to 4%.

These forecasts are more optimistic than those provided by the Reserve Bank on August 6. Their forecasts imply growth in the second half of 2020 of 1.3% compared to our forecast of 4%.

Not surprisingly, the Bank has a much higher unemployment rate forecast for the end of 2020 at 10% compared to the Westpac forecast of 7.7%.

While the Leading Index growth rate has continued to improve from the extreme low set in April, it remains below the pace immediately prior to Australia’s nationwide lockdown. The current growth rate is 0.29ppt lower than in March. Component-wise, the main source of additional drag is coming from monthly hours worked (-0.82ppt); US industrial production (-0.76ppt); and commodity prices (-0.35ppt). These shifts have been mostly offset by more positive contributions from other components including: the S&P/ASX 200 (+0.66ppt); the Westpac-MI Unemployment Expectations Index (+0.54ppt); the Westpac-MI Consumer Expectations Index (+0.39ppt); and the yield spread (+0.22ppt).

Note that the big negative shock that accompanied the COVID outbreak back in March-April will start cycling out of the six-month growth rate calculation in coming months. Indeed, all else being equal, the growth rate will swing into solid positive from September on as the extreme weakness in March-April moves into the base of the calculation.

The Reserve Bank Board next meets on October 6 – the same day as the evening announcement of the Federal Budget.

Yesterday we saw the Minutes of the September Board meeting. There has been some market speculation that the Board is set to cut the overnight cash rate from 0.25% to 0.1%.

Westpac expects that such an option will remain under consideration but there appears to be no urgency. The Board noted that “the cash rate had remained very low at around 13 basis points, and investors expected it to remain at that level for some time”. The discrepancy between the ‘official’ cash rate and the market rate reflects liquidity conditions in financial markets.

Looking forward it appears that the Reserve Bank will be focussed on supporting government bond markets, including the borrowings of state and territory governments, as it continues to promote stimulatory fiscal policies to boost Australia’s growth rate.

In that regard, no doubt, the Bank will be expecting an expansionary Budget from the Federal authorities on October 6.

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.