Bulletin

18 November 2020

Leading Index prints record rebound in growth

- **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 –0.47% in September to +3.25% in October.**

This is the first positive, above trend, growth rate since November 2018. It is also the strongest seen since the early 1980s. That said, it mainly reflects the severity of the preceding contraction which saw the index growth rate drop to an extreme low of –5.5% in April. Indeed, the level of the Index has still not fully recouped the sharp decline seen during COVID lockdowns earlier in the year.

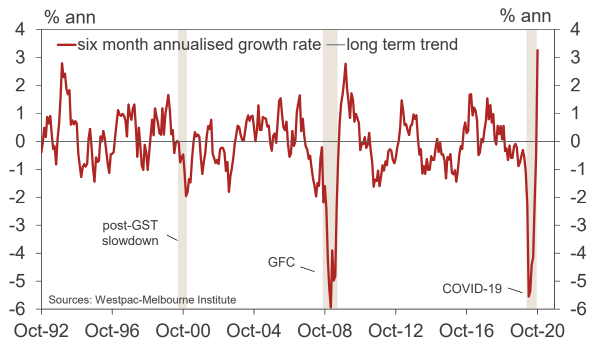
This and previous developments in the Index are consistent with Westpac's view that growth in the Australian economy will be significantly above trend in both the September and December quarters (around an 8% annualised pace). We note that recently other forecasters, including the Reserve Bank, have moved to adopt a similar view.

That momentum will slow in 2021 as the sharp initial improvement in activity due to the easing of domestic restrictions ends. The challenge to growth momentum will emerge from the June quarter as JobKeeper supports are removed, temporary loan repayment deferrals continue to roll off and other temporary measures to cushion the impact of the COVID shock have been removed.

But, as has been the case throughout this economic cycle, developments on the health front will continue to dominate. Notably, recent reports indicating earlier than expected progress around vaccines suggest these could provide a significant and welcome boost that offsets the expected 'soft patch' in the June/September quarters of 2021.

The Leading Index growth rate has risen an extraordinary 8.63ppts since May, easily the biggest turnaround in the history of the measure, eclipsing the 6.48ppt turnaround coming out of the GFC in 2009 and a 7.22ppt rebound in the mid-1970s. Two components have driven the bulk of the gain – US industrial production (+5.47ppts); and aggregate monthly hours worked (+2.69ppts). Both are cycling out of major disruptions from COVID-related lockdowns six months ago (note that the headline measure is a six- month annualised growth rate, so this impact is now falling into the base of the calculation). Other components have seen more mixed developments over the same period: the S&P/ASX 200 adding +0.75ppts and a rally in the Westpac-MI CSI expectations index adding +0.34ppts, but the yield spread, commodity prices (measured in AUD terms) and dwelling approvals all detracting marginally (–0.62ppts on a combined basis). The contribution from the Westpac-MI Unemployment Expectations index is broadly unchanged.

Westpac-MI Leading Index



Note that the October reading likely overstates the pace of ongoing momentum. Components such as industrial production and hours worked will clearly settle back to more moderate contributions as direct COVID-related disruptions drop out of the picture.

The Reserve Bank Board next meets on December 1. The minutes of the November meeting along with a recent speech from the Governor emphasise a significant pivot in the Board's approach to monetary policy. The labour market now takes centre stage.

Consistent above trend growth will be required to lower the unemployment rate and deliver a 'tight labour market'. For the meetings over the course of the first half of 2021 the Board will be focussed on assessing the impact on the economy of their Quantitative Easing program.

That is scheduled to be completed by June next year and with ample flexibility on its balance sheet it is not surprising that the minutes conclude that "the Board is prepared to do more if necessary.

Bill Evans, Chief Economist

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