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## Leading Index still well above trend

- **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, fell from 3.83% in January to 2.64% in February.**

The growth rate in the Index continues to hold comfortably in positive territory indicating that growth through much of 2021 will be above trend. That outlook is consistent with Westpac's views.

Indeed, we recently lifted our growth forecast for 2021 to 4.5% from 4.0% – well above trend.

From our perspective the key driver of growth in 2021 will be the household sector as a sharp fall in the currently elevated savings rate will free up considerable funds to support strong consumer spending.

Accumulated savings from 2020 will allow households to lower their savings rate but that will only happen if there is the desire to lift spending. Ten-year highs in the Westpac Melbourne Institute Index of Consumer Sentiment supplemented by a booming housing market and further reopening of the domestic economy as vaccine rollouts take effect will set the scene for the expected boost to spending.

That will be despite a modest contraction in real household disposable income as the withdrawal of government support programs and modest wages growth weigh on incomes.

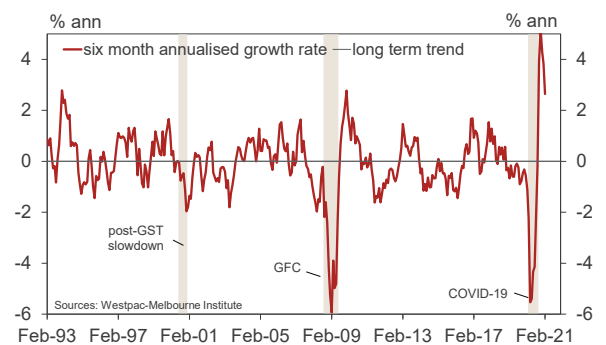
With the economy only contracting by 1.1% in 2020, the strong 1.6% growth we expect in the March quarter, which is consistent with the signals from the Leading Index in the second half of 2020, will see activity returning to-pre pandemic levels during the March quarter.

Over the last six months the growth rate in the Index has lifted from -0.2% to 2.64%.

The recovery in the growth rate continues to be dominated by international factors – US industrial production and commodity prices. Of the 2.84ppts recovery in the Index US industrial production contributed 1.12ppts while commodity prices contributed 1.01ppts. Other positive contributors were hours worked (0.72ppts); dwelling approvals (0.4ppts); and the yield curve (0.04ppts).

Offsetting those gains were the Westpac-Melbourne Institute Consumer Expectations Index (-0.2ppts); the Westpac-Melbourne Institute Unemployment Expectations Index (-0.14ppts) and the ASX/S&P 200 (-0.13ppts).

### Westpac-MI Leading Index



The Reserve Bank Board next meets on April 6. Policy is expected to remain on hold for the next few months before the Board decides whether to extend its Yield Curve Control (YCC) policy to a longer bond than the current April 2024 bond.

Westpac expects that the Bank's forecasts for inflation; wages growth; and the unemployment rate will not make a credible case that by the first half of 2024 the economy will reach the conditions necessary to justify a rate increase.

Accordingly, there will be full justification for the Board extending the targeting program to the November bond signalling that on current forecasts the Bank does not expect to be raising the cash rate until very late in 2024 at the earliest.

**Bill Evans**, Chief Economist



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