BULLETIN

20 July 2022

Leading Index growth rate slows in June

- **Growth rate slows to 0.40% from 0.56%.**
- **Still indicating above trend growth momentum near term.**
- **Slowing pace points to economic slowdown later in 2022.**

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, slowed to 0.40% in June from 0.56% in May.

The Leading Index's growth rate surged in February and March as the benefits to the economy from the reopening in the eastern states gained maximum momentum.

Since that time the growth rate in the Leading Index has been sliding.

The June Index is capturing the very early impact of central bank tightening cycles. Most notable for the Australian economy has been the Reserve Bank of Australia, where the first move was initiated in early May.

As the Reserve Bank extends and accelerates the pace of its tightening cycle, we can expect the growth rate in the Index to continue to ease.

The reading for June indicates above trend growth in the near term. We expect that as we move further into the three-to-nine-month 'window' growth prospects are going to falter.

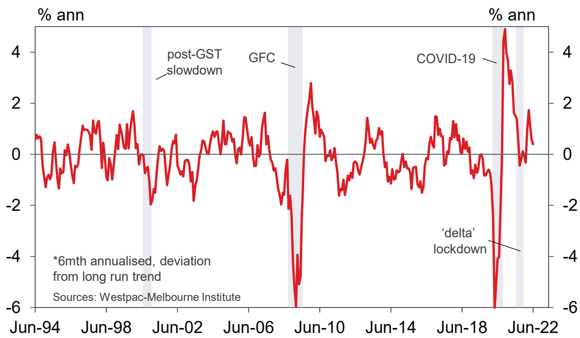
Westpac currently expects growth to slow from 4% in 2022 to 2% in 2023. That outlook is highly dependent on the profile for the Reserve Bank's tightening cycle.

In that regard, the Minutes from the July RBA Board meeting indicated that the decision to tighten by 50bps was taken with limited debate. That compared with the June meeting where there appeared to be a detailed discussion around the relative benefits of 25 or 50bps.

Despite the recent slowing, the Index growth rate is still up on the start of the year. The 0.40% read in June compares to a -0.33% in January. The main components driving that improvement have been: a rebound in hours worked coming out of omicron disruptions early in the year (adding +0.66ppts to the growth rate); a lift in commodity prices in AUD terms (+0.33ppts); a stabilisation in dwelling approvals (+0.17ppts); and steady gains in US industrial production (+0.10ppts).

These positives have been partially offset by a sharp weakening in sentiment-based components – the Westpac-MI CSI expectations index and the Westpac-MI Unemployment

Westpac-MI Leading Index



Expectations Index taking 0.18ppts and 0.24ppts off the index growth rate respectively – and a major sell-off in equities, the S&P/ASX 200 taking a further 0.14ppts off the index growth rate.

The Reserve Bank Board next meets on August 2. For some time, we have been predicting that the Board will opt for a fourth successive rate rise and a third successive cash rate increase of 50bps.

This marks a rapid re-tightening in policy. In 1994 the Board decided to increase the cash rate by 275bps in three meetings (spaced over five months) with two moves of 100bps and one of 75bps. Aside from that episode and a single 50bp increase during the 1999-2000 tightening, the current cycle is the first time the cash rate has been lifted by 50bps or higher since 1990.

The Board has indicated in the Minutes of the July meeting that "the level of interest rates was still very low for an economy with a tight labour market and facing a period of higher inflation."

The Board will still have four more meetings this year to reach its target cash rate without needing to revert to the more aggressive policies we have seen overseas from central banks that have a more limited number of meetings and economies that are less sensitive to the central bank's policy rate.

Bill Evans, Chief Economist

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