

25 January 2023

Leading Index continues to signal weak growth

- The growth rate in the Leading Index held at a weak **-0.96%**.
- That points to below trend growth in the first half of 2023.
- Rising short term interest rates are weighing on the Index.
- These effects are slightly offset by ongoing confidence in the labour market.
- Confidence measures, while very low, have recently stabilised.

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, was **-0.97%** in December, largely unchanged on the **-0.96%** read in November.

December marks the fifth consecutive month that the growth rate has been negative.

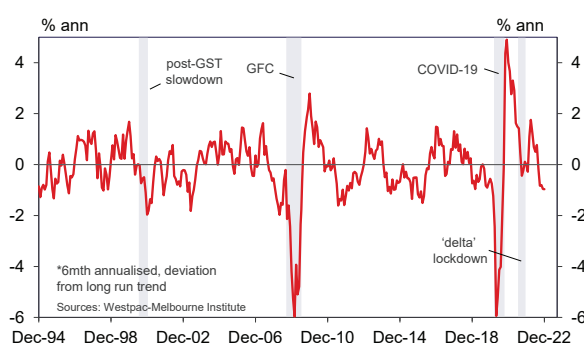
The Index continues to point to below-trend growth in the first half of 2023. Westpac concurs with that view although we expect the slowdown in the Australian economy in 2023 to be more apparent in the second half of the year when growth is forecast to stagnate after running at a 2% annual pace in the first half.

The key driver of the slowdown will be the consumer as elevated interest rates and negative real wages growth take their toll on spending.

However, there is unusual uncertainty around this outlook, particularly with respect to the household sector where large excess savings accumulated during the pandemic are providing a buffer against rising interest rates and cost of living pressures, especially for households in higher income groups.

The Leading Index growth rate has seen a sharp turnaround over the last six months, going from running 0.5% above trend in June to 0.97% below trend in December. Two components account for all of the 1.47ppt swing: the yield spread, which has seen a sharp narrowing as policy tightening has driven up short term rates while long term rates have steadied (-0.88ppts); and commodity prices, which have seen a significant reversal in AUD terms (-0.79ppts).

Westpac-MI Leading Index



Additional drags from weakening US industrial production (-0.25ppts) and dwelling approvals (-0.18ppts) have been more than offset by a rally in Australia's sharemarket (+0.39ppts) and a modest improvement in the Westpac Consumers Expectation Index (+0.27ppts).

The slight positive contributions from the remaining labour-market-related components - the Westpac Consumer Unemployment Expectations Index and aggregate monthly hours worked - have been largely unchanged since mid-2022.

Overall, the components paint a picture of clear drags on growth coming from abroad and the RBA's interest rate tightening but with support coming from a slight lift in confidence and the continued stability in local labour markets.

The Reserve Bank Board next meets on February 7.

Current measures of inflation indicate that the challenge for the Board to achieve its objective of bringing inflation back into the target band of 2-3% remains formidable.

The case for a further rate increase of 0.25% at the February meeting seems clear.

Bill Evans, Chief Economist

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