BULLETIN

24 May 2023

Leading Index points to weakness extending into 2024

- **Leading Index growth rate remains stuck firmly below trend at –0.78%.**
- **Ninth consecutive negative print.**
- **Slowdown in 2023 now looks set to carry into 2024.**
- **Components show weakness shifting from financial conditions to construction and commodity sectors.**

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, declined to –0.78% in April from –0.69% in March.

The Leading Index has recorded below-trend growth for a ninth consecutive month, indicating the slowdown that began late last year is likely to extend through to the end of 2023 and into early 2024.

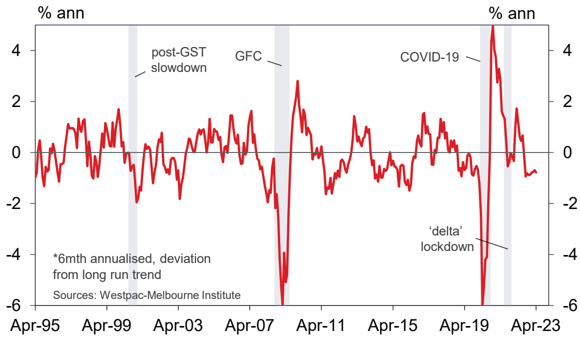
Westpac expects growth of just 1% in 2023 with this lacklustre performance continuing in 2024 which is expected to show only a slight lift to 1.5%. The Reserve Bank expects a similar, but slightly firmer, profile with growth forecast to slow to 1.2% in 2023, lifting to 1.7% in 2024. In both cases, activity contracts in per capita terms.

The Leading Index growth rate is largely unchanged over the last six months, improving very slightly from –0.82% in October to –0.78% in April.

Component-wise, the main improvements have been from: equity markets, a 6.5% recovery in the ASX200 adding 0.27ppts to the index growth rate; a stabilisation in the Westpac-MI CSI expectations index at low levels (adding a further 0.24ppts); and a steadier yield gap as the pace of interest rate tightening has slowed (adding 0.14ppts). Note that the momentum shifts here are mostly about the absence of further weakening rather than an outright improvement.

These shifts have been offset by a significant deterioration in dwelling approvals, which fell 20%qtr in the March quarter (taking –0.27ppts off the index growth rate), and commodity prices, which are down just over 10% from their October peaks in AUD terms (taking a further –0.21ppts off the index growth rate). Other components have shown little or no shift in momentum over the last six months.

Westpac-MI Leading Index



The Reserve Bank Board next meets on June 6. We expect it to leave rates on hold ahead of critical updates on inflation and the state of the economy.

The minutes to the Board's May meeting show the surprise move to raise rates by a further 25bps was a 'finely balanced' decision. The Board is clearly uneasy about risks to what is already a slow and narrow path back to low inflation. While recent updates on wages and labour market conditions may have allayed fears a little, the Board will be keen to see much clearer progress on inflation, and confirmation of both slowing consumer demand and a softening labour market.

Our central view is that this should emerge in coming months. But until then, meetings will continue to be 'live' and policy decisions 'finely-balanced'.

Matthew Hassan, Senior Economist

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