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Leading Index stabilises

- **Leading Index growth rate steadies to -0.01%.**
- **Growth drags dissipating but momentum to remain soft in 2024.**
- **Improving signal mainly coming from equities, hours worked.**
- **Brief 'tailwind' from commodity prices has disappeared.**

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, improved slightly to -0.01% in April from -0.08% in March.

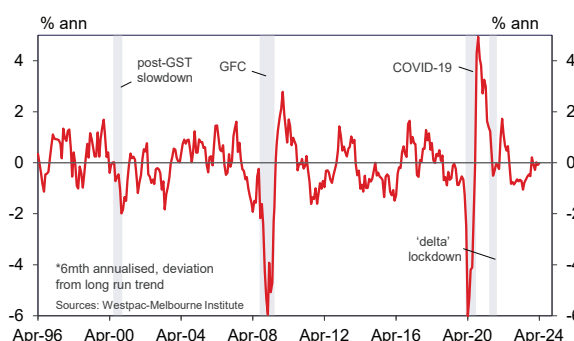
The Leading Index is again showing signs of some stabilisation in growth momentum. That is broadly consistent with the notion that the main negatives over the last two years – the combined drag on household incomes from sharply higher living costs, interest rate rises and a surging tax take – are starting to dissipate. The last six months has already seen a material moderation in inflation and the end to the RBA's rapid series of interest rate rises. Coming months will see the Stage 3 tax cuts provide additional relief for household incomes, a prospect that is already supporting consumer sentiment a little.

Despite these shifts, Westpac expects the associated improvement in growth to be fairly muted, with GDP forecast to rise at a 1.9% annual pace over the second half of the year, up on the 1.3% pace over the first half of the year. This is still below trend for Australia which, with some moderation in population growth, is likely to be around 2.5%yr.

The improved signal from the Leading Index over the last six months reflects a rally in equity markets and a less negative tone from labour markets and consumer sentiment.

The Leading Index growth rate has lifted just over half a percentage point since October from -0.53% to around flat currently. The two main components driving the lift have been: the S&P/ASX200, which has risen 13% from its October lows, adding +0.37ppts to the index growth rate; and aggregate monthly hours worked, which have been volatile month to month but posted a cumulative 1.8% rise over the same period (adding another +0.33ppts to the Index growth rate). Slight improvements in the Westpac-MI Unemployment Expectations Index, US industrial production and the Westpac-MI Consumer Sentiment Expectations Index have also given some support at the margin (adding +0.23ppts to growth on a combined basis).

Westpac-MI Leading Index



These shifts have been partially offset by a narrowing yield spread as long-term bond rates have tracked back from last year's highs and short-term rates have nudged slightly higher. That shift has lowered the index growth rate by -0.44ppts.

Notably, a sizeable positive contribution from commodity prices in recent months has now unwound. This component is now exerting a slight drag on the overall index growth rate, similar to the picture back in October.

The Reserve Bank Board next meets on June 17-18. We expect it to again leave the official cash rate unchanged. While the Board remains vigilant towards further upside surprises on inflation, it is wary of 'noise' in the price data and comfortable that the wider picture of weakening demand coming more into line with supply remains consistent with moderating domestic inflation over the medium term. The latest Leading Index suggests momentum will improve a little over the course of this year but remain at or slightly below par. Both the monthly inflation update, due later today, and the March quarter national accounts, due in early June, are expected to be consistent with the Board's base-case view.

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