19 February 2025

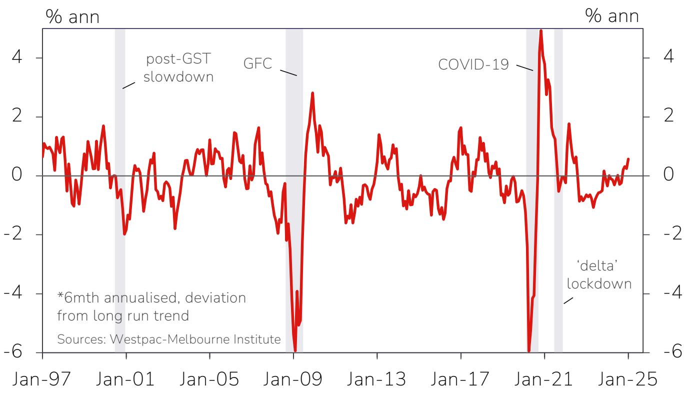
WESTPAC-MI LEADING INDEX BULLETIN

Latest insights into economic momentum

Key points

- Leading Index growth rate lifts to 0.58%, a 2½ year high.
- Above-trend momentum is becoming more convincing.
- Reads point to a gradual recovery rather than a sudden surge.
- All components contributing positive to growth signal.

Westpac-MI Leading Index



Leading Index shows economy gaining traction

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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, lifted to 0.58% in January from 0.24% in December.

The Westpac-Melbourne Institute Leading Index of Economic Activity is designed to assist in identifying turning points in the economy. The index combines variables that reflect different aspects of the economy into a single index that generally produces a more reliable cyclical indicator than any single component taken individually. The Leading Index of Economic Activity provides advance information on the state of the economy and gives early warnings of cyclical turning points.

The start of 2025 has seen a continued improvement in Australia's growth pulse. The latest rise in the Leading Index growth rate takes it to the strongest pace since July 2022, when the RBA was raising interest rates aggressively in response to a surge in inflation that was also weighing heavily on household finances. While the above trend growth pulse is becoming firmer and more convincing it is still not particularly strong. It remains more consistent with a gradual recovery than a sudden surge.

Westpac expects GDP growth to show a gradual improvement over the course of 2025, reaching 2.2%yr by year-end, a material improvement on the dismal 0.8%yr pace seen over the year to September 2024 but still a lacklustre result.

The detail is becoming more convincing. As noted, the Index growth rate has lifted to a 2½ year high. The positive, above-trend, signal has now been sustained for four consecutive months. This follows soft, mostly below-trend reads over the twelve months to September 2024, and materially weaker reads over the twelve months prior to that. The signal shows growth headwinds have dissipated, with a modest tailwind now evident.

The component breakdown shows the lift is mainly coming from an improvement in the Australian consumer, expected support from lower interest rates, a more positive tone around dwelling construction, and a stabilisation in commodity prices that has been augmented by a lower Australian dollar. Notably, all eight components of the Leading Index are contributing positively to the six-month annualised growth rate – the first time we have seen a consistent above-trend signal since June 2021."The Leading Index growth has lifted from +0.02% in July to +0.58% currently. Component-wise, over half of the 0.56ppt lift has come from commodity prices, which have lifted growth by 0.31ppts. This reflects a mix of moderating declines in global prices and a lower Australian dollar. Australia's commodity prices declined 3.4% over six months to January, the pace of falls slowing from an 11% decline over the first half of last year. A lower currency meant prices in AUD terms have risen over the last six months.

Other components have seen more mixed shifts, but mostly positive shifts over the last six months. An improvement in consumer unemployment expectations and a recovery in consumer expectations more generally have added 0.27ppts to growth. A firmer tone to dwelling approvals and a widening yield spread (a signal that broadly implies financial markets expect activity to pick up) have also added another 0.18ppts. This was partially offset by a moderation in aggregate hours worked, which took 0.2ppts off the headline growth rate. A rising sharemarket has also contributed positively although the pace of gains in the S&P/ASX200 has not changed over the last six months, meaning the contribution to the Index growth rate is also unchanged.

The Reserve Bank Board next meets on March 31–April 1. The Board decided to cut the cash rate by 25bps at its February meeting but made it clear in communicating the move that further easing is far from assured. The latest Leading Index update shows the Australian economy is seeing a modest lift in momentum. That is broadly consistent with both the Westpac and RBA outlook. As such, policy decisions will be shaped by inflation outcomes and assessments of the extent of slack across the domestic economy – the labour market in particular. While we expect that to draw further policy easing over the course of 2025, the case is unlikely to be convincing enough for the RBA Board to move again at its next meeting.

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