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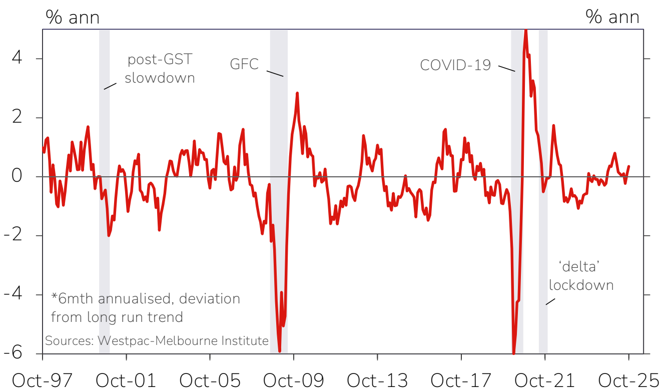
WESTPAC-MI LEADING INDEX BULLETIN

Latest insights into economic momentum

Key points

- Leading Index growth rate lifts to 0.35%, moving into slightly positive territory.
- Increase marks a step-up from around-trend readings over past six months.
- Recent surge in consumer expectations played a big role.

Westpac-MI Leading Index



Leading Index moves further into positive territory

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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, moved into slightly positive territory in October, lifting to +0.35% in October from +0.10% in September.

After oscillating around a zero reading for the past six months, the Leading Index has built up some momentum heading into year-end, with the October update pointing to growth running at a slightly above-trend pace in early 2026. While the growth signal is not particularly strong, it is consistent with Westpac's view that activity will continue to pick up steam over the rest of this year and into next, with GDP growth forecast to rise from 1.8%yr currently to 2.4%yr over 2026. Westpac views this as roughly around-trend, with the current slightly-above-trend momentum evident in the Leading Index expected to encounter some headwinds as we enter the new year.

Some of the improvement compared with six months ago relates to the heightened uncertainty at that time, following US President Trump's announcement of 'reciprocal' tariffs. Earlier above-trend momentum largely evaporated as a result, but since then the Leading Index growth rate has lifted +0.19ppts.

The drivers of this improvement were centred on three components. Firstly, the recent surge in the Westpac–MI Consumer Expectations Index, which resulted in the first net positive reading on consumer sentiment in nearly four years, flipped it from acting as a drag on momentum to contributing positively (adding +0.19ppts). Secondly, the S&P/ASX200 remained a key positive as share markets continued to trade well above April's lows (adding +0.17ppts). Thirdly, growth in hours worked continued to make a modest contribution (adding +0.07ppts).

The contributions from these components could be at risk of shrinking over the months ahead as we move past the 'Liberation Day' period as the base of comparison. Consumer expectations have been volatile month-to-month lately and this could continue. It is also worth noting that the S&P/ASX200 has sold off significantly so far this month. If share prices are sustained at these levels in the rest of November, its positive contribution this month could unwind.

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.

Recent gains were tempered by a deterioration in consumer expectations for jobs (detracting –0.17ppts) and a smaller contribution from US industrial production (detracting –0.08ppts). Other components have seen relatively small shifts over the past six months, with a small lift in dwelling approvals and a slightly wider yield spread being broadly offset by a shrinking drag from commodity prices in AUD terms.

The Reserve Bank Monetary Policy Board next meets on December 8–9. In recent communications, the Board acknowledged some of the recent upside surprise in inflation was due to temporary factors, although there is some concern that it could be persistent. With policy still at mildly restrictive levels, the Board can afford to keep the cash rate at current levels while it assesses the inflation trend for a couple more quarters without too much of a risk to activity, as is already being foreshadowed by a lift in the Leading Index growth rate. Westpac expects the cash rate to remain on hold until mid-2026, by which time the expected easing in inflation should be more evident. This would enable cash rate cuts in May and August, bringing monetary policy back to broadly neutral levels.

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