



18 March 2026

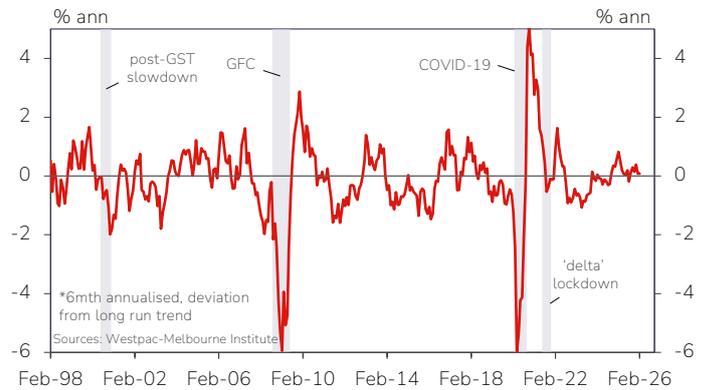
WESTPAC-MI LEADING INDEX BULLETIN

Latest insights into economic momentum

Key points

- Leading Index growth rate unchanged at +0.08% in February.
- Softer financial components offset by higher commodity prices, hours worked.
- Rate hikes, Middle East conflict starting to impact but likely more to come.

Westpac-MI Leading Index



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Leading Index holds slightly above trend for now



Matthew Hassan
Head of Australian Macro-Forecasting

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, held at +0.08% in February, unchanged from January but down from more firmly positive reads seen late last year.

Momentum remains a touch above average in early 2026 but is likely to drop in coming months as the RBA's latest interest rate hike impacts and we start to see the fuller effects from conflict in Middle East. Westpac expects the combination to see Australia's GDP growth slow to 2% this year, a material weakening on last year's 2.5% pace and one that we see as below trend for Australia. While there are some hints of this in the February Leading Index read, these signals should become much clearer as we move into March and April.

The Leading Index growth rate has moderated slightly from +0.13% in September to a +0.08% in February. The main drivers have been developments in financial markets. A cooling sharemarket has seen the contribution from the S&P/ASX200 component shift from +0.19ppts to flat with current readings suggesting this will become an outright drag on the Index growth rate next month.

Over the same period, the yield spread – the gap between the 10yr government bond rate and the 90-day bank bill rate – has widened at a slower pace, mainly reflecting the impact of RBA rate hikes on short term interest rates. The shift has taken 0.09ppts off the growth rate since September. With the RBA hiking interest rates by another 25bps at its March meeting, this also looks set to become an outright drag next month.

The main offsetting positive since September has been from commodity prices. A 13% rally in prices in USD terms since September has been muted somewhat by a higher AUD but still resulted in a 4% gain in local currency terms that has added 0.13ppts to the Leading Index growth rate. The sharp spike in global energy prices (and relatively steady AUD) since February 28 means this component is likely to make a more positive contribution next month.

Across the remaining components, the contribution from aggregate hours worked has added 0.09ppts a well but the contributions from other components have been essentially unchanged since September. Developments around both interest rates and the Middle East conflict also look likely to have a more pronounced drag on these components in the next month, particularly those based on Consumer Sentiment.

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 Reserve Bank Monetary Policy Board (MPB) next meets on May 4–5. While the latest Leading Index update shows momentum still slightly positive, the detail suggests its susceptible to a weakening near term as the RBA's March interest rate hike and the full effects of the conflict in the Middle East come through. For the MPB, the main focus will continue to be on inflation and how the balance of risks – between slower growth and higher energy costs – affect inflation expectations. Another 25bp rate hike looks likely to come at the May meeting.



Corporate Directory

Westpac Economics / Australia

Sydney
Level 19, 275 Kent Street
Sydney NSW 2000
Australia

E: economics@westpac.com.au

Luci Ellis
Chief Economist Westpac Group
E: luci.ellis@westpac.com.au

Matthew Hassan
Head of Australian Macro-Forecasting
E: mhassan@westpac.com.au

Elliot Clarke
Head of International Economics
E: eclarke@westpac.com.au

Sian Fenner
Head of Business and Industry Economics
E: sian.fenner@westpac.com.au

Justin Smirk
Senior Economist
E: jsmirk@westpac.com.au

Pat Bustamante
Senior Economist
E: pat.bustamante@westpac.com.au

Mantas Vanagas
Senior Economist
E: mantas.vanagas@westpac.com.au

Ryan Wells
Economist
E: ryan.wells@westpac.com.au

Illiana Jain
Economist
E: illiana.jain@westpac.com.au

Neha Sharma
Economist
E: neha.sharma1@westpac.com.au

Luka Belobrajdic
Economist
E: luka.belobrajdic@westpac.com.au

Westpac Economics / New Zealand

Auckland
Takutai on the Square
Level 8, 16 Takutai Square
Auckland, New Zealand

E: economics@westpac.co.nz

Kelly Eckhold
Chief Economist NZ
E: kelly.eckhold@westpac.co.nz

Michael Gordon
Senior Economist
E: michael.gordon@westpac.co.nz

Darren Gibbs
Senior Economist
E: darren.gibbs@westpac.co.nz

Satish Ranchhod
Senior Economist
E: satish.ranchhod@westpac.co.nz

Paul Clark
Industry Economist
E: paul.clarke@westpac.co.nz

Westpac Economics / Fiji

Suva
1 Thomson Street
Suva, Fiji

Shamal Chand
Senior Economist
E: shamal.chand@westpac.com.au



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