BULLETIN

22 March 2023

Leading Index negative for seventh consecutive month

- **Leading Index growth rate holds at a weak –0.94%.**
- **Seventh consecutive negative print, pointing to below-trend growth in 2023.**
- **Westpac expects weakness to extend into 2024, more negative reads likely.**
- **Both domestic and international factors behind the subdued print with notable drags from: hours worked; softening confidence in the labour market; falling commodity prices; and declining US industrial production.**

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 slightly to –0.94% in February from –1.04% in January.

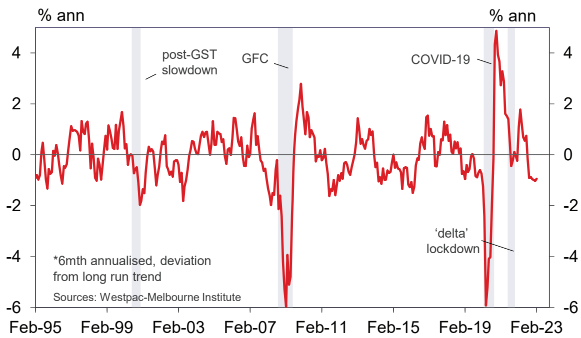
This marks the seventh consecutive month that the growth rate has been negative. The Index continues to point to below-trend growth over the next 3-9 months. This is broadly in line with Westpac's forecast that growth in the Australian economy will be only 1% in 2023. The slowdown reflects the lagged effects of rising interest rates; a deep shock to real wages; a bottoming-out of the savings rate and falling house prices.

Recent developments in the global banking system are unlikely to significantly impact Australia's financial system but will be a further headwind for the major advanced economies, particularly through a reduction in credit availability and knock to confidence. This, in turn, will have indirect implications for Australia's growth prospects.

These factors are expected to extend into 2024 which is expected to show a second consecutive year of below-trend growth – at around 1.5%. Accordingly, despite already registering seven consecutive months of negative growth, the Leading Index is likely to continue recording negative prints through much of 2023.

The Leading Index growth rate has seen a sharp turnaround from +0.75% in July last year to the current -0.94%. The main components driving the deterioration have been: a slowdown in aggregate hours worked (accounting for –0.63ppts of the weakening); falling commodity prices in AUD terms (–0.45ppts); a downturn in US industrial production (–0.37ppts), and softening consumer expectations for unemployment (–0.28ppts). There have also been some additional drag from a narrowing in the yield spread (–0.13ppts); and a softening in dwelling approvals (-0.1ppts). These negatives were partially offset by a reduced drag from the Westpac-MI CSI expectations index (+0.18ppts); and a lift in equity markets (+0.09ppts), both of which look likely to be short-lived given recent developments in global financial markets.

Westpac-MI Leading Index



The Reserve Bank Board next meets on April 4. Westpac expects that the Board will decide to pause the tightening cycle for the first time since it began raising rates in May last year. Softer-than-expected prints for economic activity; monthly inflation; and wages growth are highlighting the cumulative impact of rising rates and cost of living shocks and improved prospects for a moderation in inflation. Policy is now firmly in restrictive territory, indicating that the rapid pace of tightening over the previous year can slow.

The minutes from the March RBA meeting indicate that the Board intends to consider a pause at its April meeting. This is an unusual step. Along with the evidence of slowing in the domestic economy, caution around developments in global financial markets will also be a factor in the Board's decision.

We do not expect that a decision to pause in April will mark the end of the cycle. New information will be available for the May Board meeting, particularly around inflation and the staff's revised economic forecasts. We expect this to indicate the need for a further response from the Board, with a final 0.25% increase in the cash rate in May marking the end of tightening cycle.

Bill Evans, Chief Economist

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