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## Leading Index bottoms out well above 2020 lows

**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, was -0.5% in October, unchanged from September.**

The Index growth rate has now been in negative territory for two consecutive months. Given that our two major cities were locked down for most of the September quarter and into October the Index has held up quite well.

One key consideration has been that despite these lockdowns the rest of the country has been operating above trend. The global backdrop has also been much more supportive with US industrial production continuing to drive a strong recovery - in stark contrast to the major negative impact this was having on the Index in the June quarter last year.

Finally, while hours worked were a drag on the Index in September and October confidence measures and the sharemarket have held up well.

Westpac is expecting a solid recovery in the economy in the December quarter although we anticipate even faster growth in the first half of 2022 as the full effect of easing restrictions comes through locally and households, benefiting from strong balance sheets (both high savings and rising asset values) and rapid jobs growth, move to satisfy pent up demand for services.

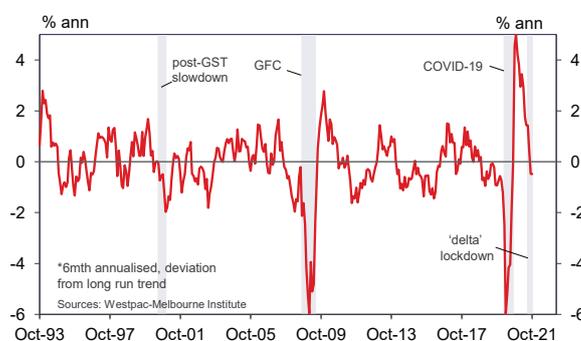
The Leading Index growth rate has fallen over the last five months, from 1.8% in May to -0.5% in October. Nearly all eight Index components have contributed to the 2.3ppt turnaround.

“The four biggest drivers have been: aggregate hours worked (-0.8ppts); dwelling approvals (-0.5ppts); commodity prices (measured in AUD terms, -0.4ppts); and US industrial production (-0.3ppts). There has also been some drag from the two financial market components: a sell-off in the ASX200 and the yield spread each taking 0.3ppts off the headline growth rate since May.

Confidence measures have been slightly more positive, the contribution from the Westpac-Melbourne Institute Consumer Expectations Index unchanged since May and an improvement in the Westpac-Melbourne Institute Unemployment Expectations Index adding 0.2ppts to the headline growth rate.

The Reserve Bank Board next meets on December 7. This meeting is not expected to yield any policy changes. For that we will have to await the meeting on February 1 next year.

### Westpac-MI Leading Index



That meeting will see the bond buying program reviewed along with a refreshed set of forecasts. Westpac expects the Board to scale back its purchases of bonds from \$4 billion per week to \$2 billion prior to the program winding up by mid-May.

The Governor continues to emphasise the Board's patience with respect to the timing of the initial rate increase. Westpac remains comfortable with our view that the bank's first move will come in February 2023 although markets are anxious for a mid-2022 move while the Governor himself is still open to waiting till 2024.

Much will depend on how wages growth evolves since achieving the inflation target without clear evidence that wages growth is lifting significantly will question whether any move back to the inflation target can be sustained.

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