BULLETIN

20 December 2023

Leading Index ticks into positive

- **Leading Index growth rate lifts to +0.30%.**
- **November marks the first positive, above-trend read since mid-2022.**
- **Some of the surprise up-tick appears to be due to temporary factors.**
- **Underlying momentum is shifting as policy tightening slows but more consistent with stabilisation than the beginning of a cycle upturn.**

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, rose to +0.30% in November from –0.39% in October.

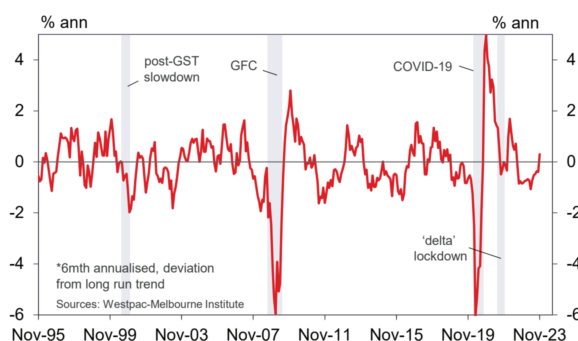
The Leading Index growth rate's surprise lift into positive territory breaks a run of fifteen consecutive negative, below-trend reads. While this points to an improvement in momentum, the November read was affected by one-off boosts that are likely to drop out in coming months. The underlying picture is still of an improvement but one that looks to be more consistent with stabilisation than the beginning of a clear cyclical upturn.

There is now little doubt about the economy's weak performance. The recently released September quarter national accounts showed GDP growth slowing to 2.1%yr with gains over the first nine months of 2023 tracking a 1.6% annual pace. That is materially below 'trend' which should be well above 3%yr given current strength in population growth. The Leading Index picked the slowdown clearly, swinging to negative in August 2022 and staying there through to October 2023. Despite the latest up-tick, recent reads suggest the below-trend growth pace will carry into the first half of 2024.

As noted, there were some one-off boosts flattering the Index growth rate in November. Dwelling approvals jumped 7.5% in the latest month due mainly to a spike in 'high rise' approvals that is almost certain to unwind. There was also a sharp widening in yield spreads through October-November, led by a surge in US bond yields, that has since unwound. Some of the Index growth rate's lift is also due to a stabilisation in hours worked as a choppy April-May period drops out of the calculation. Yet stable hours worked hardly represent positive conditions when the working-age population is growing as strongly as it has.

However, even allowing for these transitory effects, underlying momentum still looks to have improved. Excluding the latest lift in dwelling approvals and yield spreads still leaves the Index growth rate about flat – a material improvement on the consistent reads in the –0.5% to –1% range over the twelve months to August.

Westpac-MI Leading Index



In most cases the underlying dynamic appears to be of a stabilisation rather than a gathering upturn. Components like consumer sentiment and dwelling approvals are settling at weak levels after having declined sharply in response to surging inflation, a rising tax take and sharply higher interest rates. Industrial production and labour markets are also still seeing the delayed effects of the policy cycle. And while market measures – the S&P/ASX 200 and the yield spread (and, to some extent, commodity prices) – may be starting to anticipate a policy easing cycle, this effect was fairly muted in November.

Looking back over the last six months, nearly all components have contributed to the improved Index growth rate, which has lifted 1.31ppts from –1.01% in May to +0.3% currently. The biggest contributions have come from a widening yield spread (adding +0.58ppts to the headline growth rate); firming commodity prices, measured in AUD terms (+0.37ppts); and dwelling approvals (+0.29ppts). However, there has also been some support from a stabilisation in the Westpac-Melbourne Institute Unemployment Expectations Index (+0.15ppts) and a lift in the S&P/ASX200 (+0.05ppts).

The Reserve Bank Board next meets on February 5-6. Recent updates show markedly weaker conditions domestically, particularly for the household sector. This will make the Board more cautious about any additional interest rate tightening. Growth is weak and while the latest Leading Index update suggests we may be starting to see a stabilisation, this weakness looks likely to extend into the first half of next year. The Board will still be wary of any upside risks on inflation but, barring a truly disastrous December quarter CPI update, it is likely to leave policy unchanged in February.

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