Media release

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Leading Index suggests growth a little less sluggish

- **Leading Index growth rate lifts to –0.2% in July from –0.4% in June.**
- **Momentum running below trend but not particularly weak.**
- **Detail shows main drag coming from financial conditions and labour market.**
- **GDP growth likely positive overall, close to flat in per capita terms.**

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 to –0.2% in July from –0.4% in June.

“The July update marks the seventh consecutive below-trend read on the Leading Index growth rate. That said, momentum has improved a touch since mid-year with the latest monthly read of –0.2% only marginally below ‘trend’. This compares with the two-year stretch of below-trend reads in 2022–24 which saw an average read of –0.4%, ranging as low as –1.0%. All up, the latest Leading Index points to an economy that is soft, but not particularly weak. GDP growth likely to still be positive overall in coming quarters but perhaps running close to flat in per capita terms.

“The detail shows the sub-trend Leading Index growth signal is mainly coming from financial conditions and the labour market. The headline growth rate of –0.2% reflects a –0.2ppt drag from ‘financial market’ components (the S&PASX200 and the yield spread) and a further 0.2ppt drag from ‘labour market’ components (total hours worked and consumer unemployment expectations). Contributions from other components are more mixed, with a slight drag from wider consumer sentiment and commodity prices but slightly bigger (but still small) positives from dwelling approvals and US industrial production.

“It’s a similar story when we look at how the signal has shifted since the start of the year. The Leading Index growth rate has slowed from –0.06% in January to –0.20% in July, a 0.14ppt deterioration. The single biggest component contributing to this has been the yield spread where sharply higher short-term interest rates, mainly due to the RBA cash rate increases, have driven an abrupt narrowing that has taken –0.33ppts off the Index growth rate. Labour market components have taken an additional 0.11ppts off the Index growth rate with a retracement in commodity prices (in AUD terms) taking off another 0.19ppts. Against this, the growth pulse has seen some modest support coming from US industrial production (+0.26ppts); dwelling approvals (+0.15ppts); and slightly less downbeat reads on the Westpac–MI Consumer Expectations Index (+0.07ppts).

“Stepping back, the component contributions and changes over the last six months have been relatively small by historical standards. Meanwhile, the most substantive change – the drag from an abrupt narrowing in the yield spread – has largely run its course with the RBA's shift from active monetary tightening to a 'hawkish hold' set to see a mechanical moderation in this specific drag in the months ahead. All else being equal that should see momentum improve a touch but, absent some other developments, the overall picture looks likely to be one of soft growth and an economy that is lacking direction either way.

"The Reserve Bank Monetary Policy Board next meets on September 28–29. We expect it to again leave the cash rate unchanged but reiterate that it is prepared to hike again if high inflation is showing signs of being more persistent. While not the Bank's primary consideration, the soft growth picture coming from the Leading Index and other measures will be of some comfort to the Board. On the one hand, it suggests demand is continuing to come more into line with supply capacity. However, the moderate slowing also points to an underlying resilience. Whether the pace of softening is enough to ensure a timely moderation in inflation back to the 2–3% target range is the key question," Mr Hassan commented.

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