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Melbourne Institute Nowcast of Australian GDP & Dating the Business Cycle

July 2020

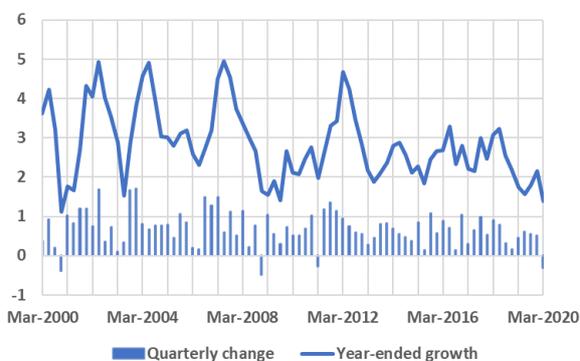
Melbourne Institute Nowcast of Australian GDP & Dating the Business Cycle

Released July 31, 2020

GDP contracted by 0.3 per cent in the March quarter of 2020

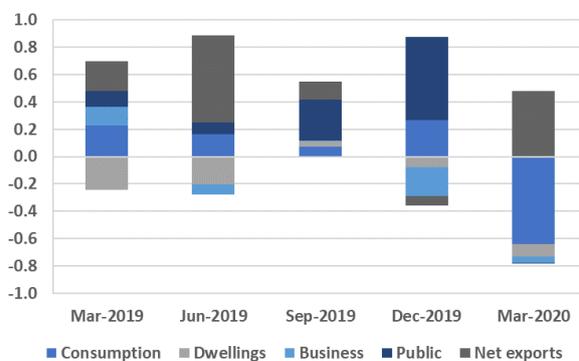
On June 3, the ABS reported that GDP contracted by 0.3 per cent in the March quarter of 2020, giving an annual growth rate of 1.4 per cent.¹ According to the ABS, public expenditure and net exports contributed positively to growth, with negative contributions from private consumption and investment. The next release of the National Accounts, covering the June quarter, will be on September 2, 2020.

Figure 1: GDP Growth (chain volume, per cent)



Source: ABS, up to Mar quarter 2020.

Figure 2: Contributions to GDP Growth (ppt)



Source: ABS, up to Mar quarter 2020.

Second nowcast for June Quarter GDP (released in July 2020)

GDP growth is projected to be -3.0 per cent in the June quarter, giving a year-ended growth rate of -2.3 per cent. The second nowcast continues to reflect the downturn associated with COVID-19 on Q2 GDP growth. Our third and final nowcast for Q2 will be in August.

Labour market conditions and retail sales were the primary contributors to the negative June-quarter nowcast. Despite an improvement in June, hours worked remains well below its value at the same time last year, with the unemployment rate also continuing to rise. Commodity prices and housing approvals also contributed negatively to the Q2 nowcast. Conversely, business lending and consumer sentiment have improved in recent months, although further evidence is required to support a sustained improvement.

Considerable Volatility in the Australian Economy

Economic activity is estimated to have fallen substantially in April, following a decline in March. While some recent partial data for June have been positive, such as the pick-up in hours worked, our estimates point to activity strengthening earlier in May, which was when restrictions began to be eased. Subsequently it appears activity fell in June, but this will be clearer once more partial data become available. Policies were tightened in Victoria from around the 20th of June, and the lockdown reintroduced late in the month. In all, the recent period has been one of considerable volatility in activity in the Australian economy. Looking through this, it is clear that we are currently in a recession.

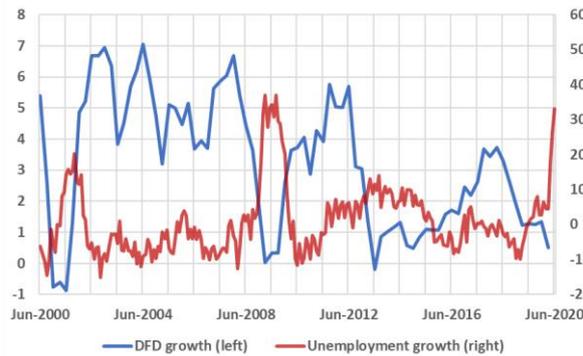
¹ Our third nowcast (of negative 0.2 per cent) for the March quarter was released in May 2020.

Hours worked improved, although the unemployment rate continues to deteriorate²

The unemployment rate continued to rise, from 7.1 per cent in May to 7.5 per cent in June. The monthly growth rate in the number of unemployed reached 33 per cent, closing in on the GFC record set in March 2009. Worsening unemployment has become a drag on the growth of domestic final demand (DFD) (Figure 3) and remains a negative contributor to the Q2 quarter nowcast.

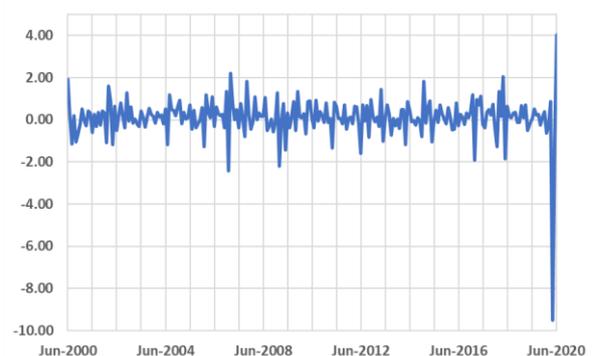
Hours worked, however, improved in June, with the monthly growth of hours worked turning from negative to positive (from -9 and -1 per cent in April and May to +4 per cent in June). This is likely to reflect the gradual relaxation of social distancing policies on the labour force (before the re-introduction of the lockdown in Victoria). Despite the improvement, however, hours worked in June was 5.6 percent below its value in June 2019.

Figure 3: Unemployment and DFD
(year-ended growth, per cent)



Source: ABS, up to Jun 2020.

Figure 4: Growth of hours worked
(monthly, per cent)



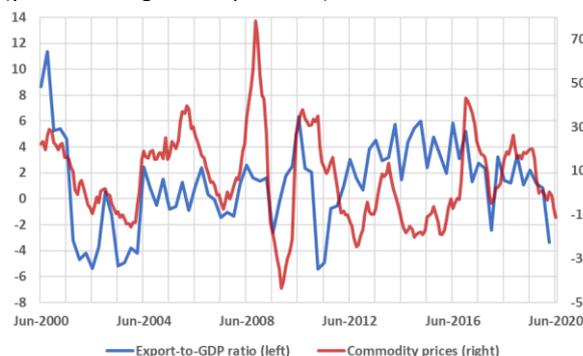
Source: ABS, up to Jun 2020.

Negative contribution from commodity prices

The index of commodity prices fell by 11 per cent in June, yet another dive from the 7 per cent decrease in May, reflecting the sharp falls in all the commodity price categories in June, including rural and non-rural commodities, especially bulk commodities. The contribution of commodity prices to the Q2 nowcast was negative in July.

The trade balance in May appears to have stabilised slightly above its April level albeit only by a moderate amount. Overall, trade contributed negatively to the second nowcast of the June quarter.

Figure 5: Commodity Prices and Export-to-GDP Ratio
(year-ended growth, per cent)



Source: ABS, up to Jun 2020.

Figure 6: Trade balance
(\$ billion)



Source: ABS, up to May 2020.

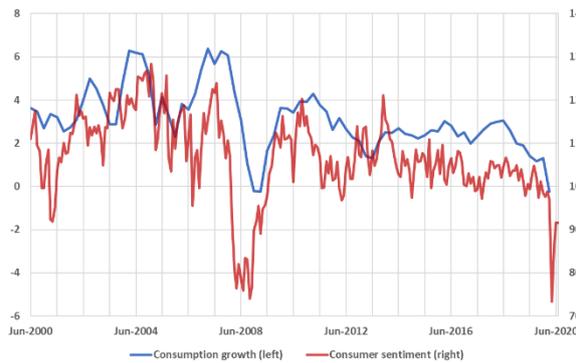
² Our nowcast model uses monthly information regarding labour market conditions, housing and business lending, retail sales, housing approvals, consumer expectations, trade conditions and commodity prices to gauge current economic conditions. **We note that the nowcast is currently in the experimental stage.**

Consumer sentiment improved in May

Although consumer sentiment fell heavily in April, it partially rebounded in May (rising by more than 12 percentage points). The improvement in May is likely associated with the support stemming from fiscal stimulus packages such as JobKeeper and JobSeeker. This improvement contributed positively to the June nowcast, and is partially responsible for our nowcast being at the optimistic end of the forecast spectrum.

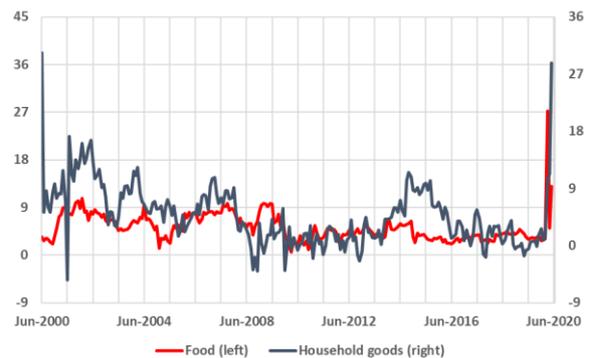
Food-related retail sales fell heavily in April, with annual growth of -22 per cent. Despite an improvement in May, food-related retail sales over the past few months has contributed negatively to the nowcast. In contrast, a similar drop was not observed for non-food retail sales in April. Non-food retail sales contributed positively (albeit, only by a moderate amount) to the June nowcast.

Figure 7: Consumer Sentiment and Consumption
(index and year-ended growth, per cent)



Source: ABS and Melbourne Institute, up to Jul 2020.

Figure 8: Retail trade
(year-ended growth, per cent)



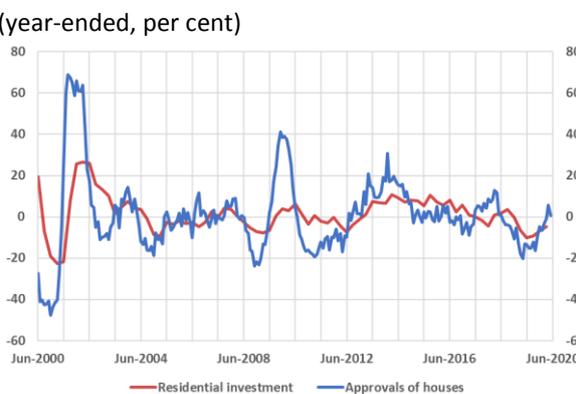
Source: ABS, up to May 2020.

Dwelling approvals wane

Despite an uptick in dwelling approvals for April, percentage growth in approval numbers again fell in May. The fall suggests considerable uncertainty about housing market conditions in the short term. In line with May's fall in dwelling approval growth, housing market activity contributed negatively to the current nowcast.

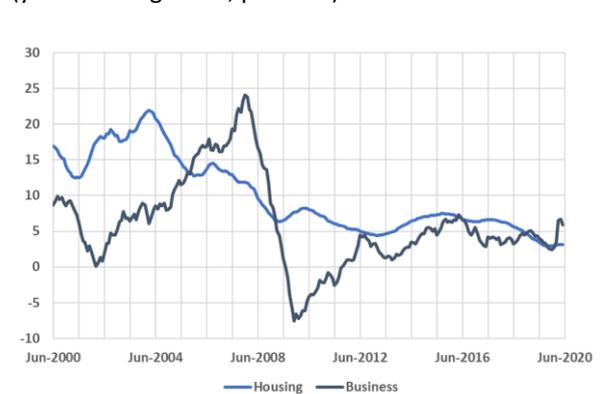
From March onwards, the annual growth rate of business lending has nearly doubled relative to the average rate of growth observed in the first two months of 2020. This is likely to be associated with a combination of fiscal stimulus and borrowing to cover expenses during the current downturn. Although it is not clear that business lending will continue to improve, the current increase in business lending contributed positively to the Q2 nowcast.

Figure 9: Dwelling Approvals and Residential Investment
(year-ended, per cent)



Source: ABS, up to May 2020.

Figure 10: Housing Credit and Business Credit
(year-ended growth, per cent)



Source: ABS, up to May 2020.

Dating the Australian Business Cycle

The Melbourne Institute uses a Monthly Activity Index, together with the nowcast and a rule to identify turning points, to date whether the Australian economy may be in a recession.³

The Monthly Activity Index is constructed so that at the quarterly frequency, it coincides with the real quarterly GDP to ensure that both data set exhibits similar turning points. Essentially our approach interpolates the quarterly values in history, guided by monthly partial indicators of the state of the economy.⁴

Table 1 identifies the turning points (as in peaks and troughs) and the periods of contractions and expansions in business cycle analysis using monthly data. Australia is now in a recession, with the peak in economic activity having occurred in February 2020.

Relative to last month the nowcast of a larger fall in the June quarter has resulted in the variance of the Monthly Activity Index increasing. A more volatile series means that negative growth rates, and hence the dating of recessions, are more likely. For example, the period in the early 2000s associated the collapse of the Dot-Com bubble and the introduction of the GST is now a recessionary period.

A recession is not yet evident in the official ABS data (presented in Tables 2 and 3) as these are at quarterly frequency, and we will not obtain the June GDP figures until early September.

Table 1: Monthly Business Cycle Dates

Peak	Trough	Contraction	Expansion	Cycle	
		peak to trough (months)	trough to peak (months)	peak to peak (months)	trough to trough (months)
Apr-1977	Dec-1977	8			
Feb-1982	Jan-1983	11	50	58	61
Jun-1990	May-1991	11	89	100	100
May-2000	Dec-2000	7	108	119	115
Feb-2020		<i>Ongoing</i>	230	237	
Average		9	102	129	128

Note: The average durations are rounded to full months. Includes the ongoing phase. Sample is 1974:09- 2020:07.

³ The rule is known as Bry-Boschan Quarterly (BBQ). See A. R. Pagan and D. Harding (2002) "Dissecting the cycle: a methodological investigation", *Journal of Monetary Economics*, 49(2), p. 365-381. Also see <http://www.ncer.edu.au/data/data.jsp>. The commonly quoted "two-quarters of negative growth" rule to define a recession is an approximate way of identifying turning points in the level of economic activity.

⁴ The data used are: the Westpac-Melbourne Institute Consumer Sentiment Index (time to buy a major household item and family finances versus a year ago); retail trade; the trimmed-mean CPI; the Melbourne Institute Inflation Gauge; monthly imports; the real and nominal trade-weighted exchange rate and aggregate hours worked. We construct the Monthly Activity Index from 1974:09 onwards due to availability of the monthly data. The MI Monthly Activity Index is currently still in development (particularly its open economy aspects).

Table 2: Real GDP Business Cycle Dates

Peak	Trough	Contraction	Expansion	Cycle	
		Peak to trough (quarters)	Trough to peak (quarters)	Peak to peak (quarters)	Trough to trough (quarters)
Mar-1961	Sep-1961	2			
Jun-1965	Mar-1966	3	15	17	18
Sep-1971	Mar-1972	2	22	25	24
Jun-1975	Dec-1975	2	13	15	15
Jun-1977	Dec-1977	2	6	8	8
Sep-1981	Jun-1983	7	15	17	22
Jun-1990	Jun-1991	4	28	35	32
			<i>ongoing</i>		
Average durations		3	28	34	20
Standard deviations		2	36	39	8

Note: The average durations and standard deviations are rounded to full quarter. Includes the ongoing phase. Sample is 1959:Q3 – 2020:Q1.

Table 3: Cycles in Real GDP per Capita

Peak	Trough	Contraction	Expansion	Cycle	
		Peak to trough (quarters)	Trough to peak (quarters)	Peak to peak (quarters)	Trough to trough (quarters)
	Jun-1974				
Jun-1975	Dec-1975	2	4		6
Jun-1977	Dec-1977	2	6	8	8
Sep-1981	Jun-1983	7	15	17	22
Sep-1985	Sep-1986	4	9	16	13
Sep-1989	Dec-1991	9	12	16	21
Jun-2000	Dec-2000	2	34	43	36
Dec-2005	Jun-2006	2	20	22	22
Mar-2008	Dec-2008	3	7	9	10
Jun-2018	Dec-2018	2	38	41	40
			<i>ongoing</i>		
Average durations		4	15	20	20
Standard deviations		2	12	13	12

Note: The average durations and standard deviations are rounded to full quarter. Includes the ongoing phase. Sample is 1973:Q3 – 2020:Q1.

Melbourne Institute Nowcast of Australian GDP & Dating the Business Cycle

The Melbourne Institute Nowcast of Australian GDP and the Monthly Index used to date the business cycle use monthly information regarding labour market conditions, housing and business lending, retail sales, housing approvals, consumer expectations, trade conditions and commodity prices in order to gauge current economic conditions.

We note that the nowcast and the dating methodology are currently in the experimental stage.

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For information on the data contained in the report contact the Melbourne Institute, The University of Melbourne, on (03) 8344 2196.

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