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Melbourne Institute Nowcast of Australian GDP

August 2023

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Released 24 August 2023

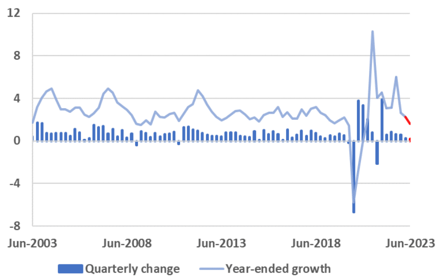
June quarter – third and final nowcast

- The Australian economy grew by a soft 0.2 per cent in the March quarter, to be 2.3 per cent higher over the year.
- We have revised up our nowcast to 0.2 per cent (previously 0.1 per cent) (Figure 1). This reflects that while falling commodity prices have weighed on the value of exports, higher export volumes now appear likely to contribute sizably to output growth. We anticipate that domestic demand stagnated in the June quarter, with the trade sector supporting overall growth. This nowcast corresponds to year-ended growth falling to 1.6 per cent.
- The official June quarter GDP data will be released by the ABS on Wednesday 6 September.
- The level of activity in the Australian economy appears strong – the unemployment rate is very low, the NAB Monthly Business Survey measure of capacity utilisation is above its average level – but growth is weak. the Westpac-Melbourne Institute Leading Index points to this extending into 2024.

Wages growth lower than expected, but productivity important for the rate outlook …

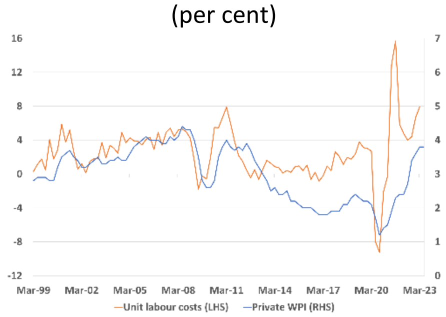
- The Wage Price Index increased by 0.8 per cent in the June quarter, less than expected by many economists, to be 3.6 per cent higher over the year (Figure 2). Wages growth was stronger in the private sector (0.8 per cent) than the public sector (0.7 per cent), although the latter was the strongest outcome since early 2013.
- Focussing on the private sector, in the June quarter a lower proportion of jobs reported a wage change, but those that did change increased hourly wages on average by a strong 4.5 per cent.
- The Wage Price Index is akin to the CPI for goods and services in that it effectively is for a bundle of jobs – it attempts to control for changes in the composition of the labour force etc. Consequently, it partially abstracts from productivity growth. Alternatively, unit labour costs are average labour costs adjusted for average labour productivity. Unit labour costs recently have been growing very strongly, reflecting both robust wages growth and productivity in Australia falling.
- Australian consumer prices are typically modelled as being a mark up on costs – namely unit labour costs and import prices. Consequently, strong growth in unit labour costs, also else equal, boosts inflation. While the lower-than-expected outcome for the Wage Price Index was encouraging, the outcome for unit labour costs in the June quarter – which will be released with GDP early next month – will be important for the inflation and interest rate outlook. It is likely to be strong again.
- The recent depreciation in the A$ will boost import prices, although the lag with which it then flows through to consumer prices can be substantial. Alternatively, a depreciation is quickly reflected in petrol prices, which in July were also pushed higher by increases in crude oil. The RBA focusses on underlying inflation, which often abstracts from the direct inflationary impacts of petrol prices.
- The RBA in their recent forecasts anticipate that the unemployment rate will rise to 3.9 per cent by late this year and further in 2024. Such increases are broadly consistent with the weak growth outlook and if they do not eventuate – the labour market has displayed surprising resilience in 2023 to date to the interest rate hikes – it would place further upward pressure on interest rates.

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



Sources: ABS, up to March quarter 2023, and MI.

Figure 2: Unit Labour Cost and Wages Growth
(per cent)



Source: ABS and RBA.

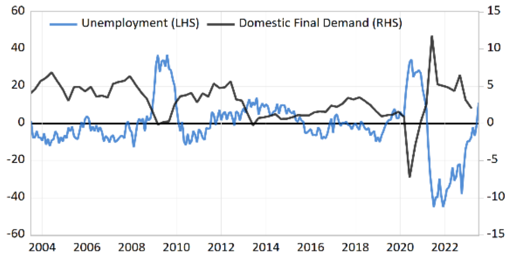
Unemployment rate increases, but shifting seasonal patterns a possible contributing factor …[1]

In July the unemployment rate increased to 3.7 per cent, up from 3.5 per cent. The ABS, however, noted that July includes school holidays and there appears to be some, possibly related, shifts in the seasonal pattern of employment. Consequently some of this rise in the unemployment rate could be unwound in August.

The nowcasting model contains two labour market indicators. The first is year-ended growth in unemployment (Figure 3). This has now turned positive, for the first time since late 2020. While the rise in July may be overstated, its central message is that domestic demand growth is likely to be very weak, which is consistent with other indicators. The sharp tightening of monetary policy, and households subsequently curtailing consumption, is an important contributing factor. The second labour market indicator included is monthly growth hours worked. This was 0.2 per cent in July (Figure 4), and a strong 5.2 per cent over the year.

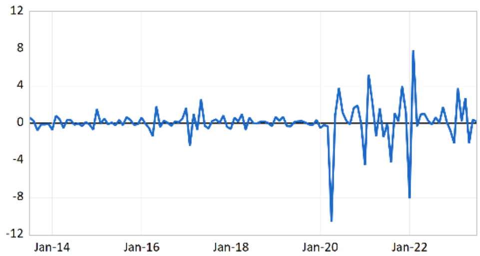
The Westpac-Melbourne Institute Unemployment Expectations Index provides a timely measure on how households view the outlook for the labour market. In August it fell, signalling that households overall became more optimistic about the outlook, although it remains around 23 per cent higher than a year ago.

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



Source: ABS, up to July 2023 (unemployment).

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



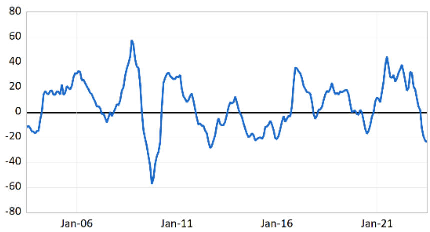
Source: ABS, up to July 2023.

Commodity prices fall further, but net exports likely to contribute to output growth…

The RBA Index of Commodity Prices in A$ fell by 2.9 per cent in July (Figure 5), with lower export prices for the bulk commodities (particularly coal) an important contributing factor. In the June quarter it fell by nearly 11 per cent; as commodity prices drive export prices, the terms of trade appear to have declined substantially. While we expect output to have grown slightly in the quarter, the fall in the terms of trade means national income is likely to have decreased.

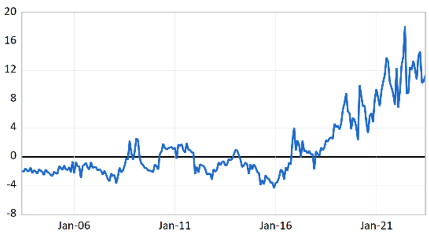
The trade balance increased in June (Figure 6), with the fall in the value of imports outpacing that in exports. Turning to the quarter, the value of exports fell by around 3.7 per cent, substantially less than the decline in commodity prices, pointing to strong growth in volumes. The value of imports grew by 0.6 per cent in the quarter, with import prices likely to have increased by a similar amount. Overall, it appears that net exports will make a substantial contribution to growth, unlike domestic demand.

Figure 5: Commodity Prices
(year-ended growth, per cent)



Source: RBA, up to July 2023.

Figure 6: Trade balance
($ billion)



Source: ABS, up to June 2023.

[1] Our nowcasting 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.

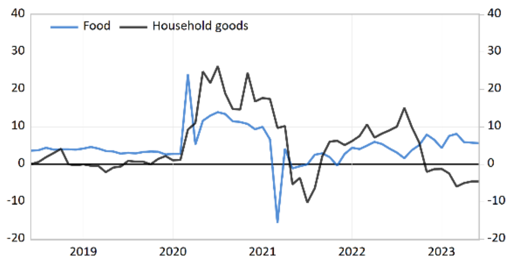
Consumer sentiment remains weak …

The Westpac-Melbourne Institute Consumer Sentiment Index edged lower in August, falling by 0.4 per cent.

The Nowcasting model focusses on the Current Conditions Index. This improved by 1.7 per cent in August, due mainly to a lift in the component measuring family finances relative to a year ago. This component, however, remains exceptionally weak; it is 10.8 per cent lower than a year ago and around 27 per cent below its average over the inflation-targeting period. This reflects the cost-of-living pressures facing many Australians, and points to a further slowing in consumption growth (Figure 8).

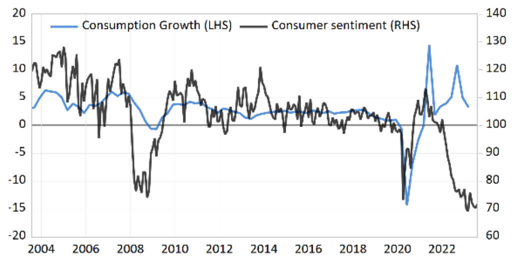
Retail trade turnover fell by 0.8 per cent in June but are 2.3 per cent higher over the year. The nowcasting model focusses on two sub-components, namely year-ended spending on food and household goods. These continue to have divergent implications for consumption growth, with spending on household goods weak (Figure 7). Turning to the quarter as a whole, retail trade volumes fell by 0.5 per cent. While retail trade is only one component of household consumption, it is another indicator pointing to a weak outcome in the June quarter.

Figure 7: Retail trade
(year-ended growth, per cent)



Source: ABS, up to June 2023.

Figure 8: Consumer Sentiment and Consumption
(index and year-ended growth, per cent)



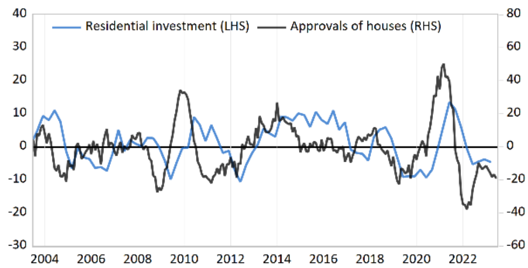
Source: ABS and Melbourne Institute, up to August 2023 (consumer sentiment).

Dwelling approvals partially retrace previous strength…

Dwelling approvals in June unwound some of their strong growth in May, with approvals for dwellings other than housings, such as apartments, falling substantially. Looking through the monthly volatility, dwelling approvals appear to be stabilizing, and increased by 6.2 per cent in the June quarter. Nevertheless, they remained considerably lower than a year ago, indicating that a small decline in residential investment is likely (Figure 9).

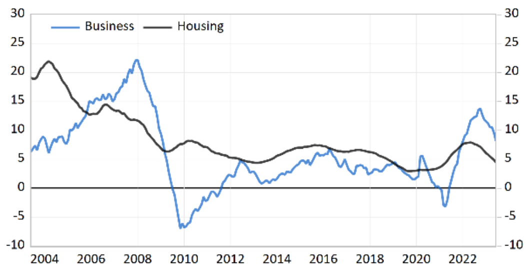
Dwelling credit growth, which is less closely tied to residential investment, eased in June. In year-ended terms it was 4.5 per cent, down from 6.1 per cent in January, with higher interest rates an important contributing factor (Figure 10). A similar slowing is evident in business credit growth. Alternatively, the NAB Monthly Business Survey reported that business conditions in July remained slightly above their long-run average level. It appears unlikely that business investment will contribute substantially to growth in June quarter.

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



Source: ABS, up to June 2023 (approvals).

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



Source: RBA, up to June 2023.

Next release: 28 September 2023.

Melbourne Institute Nowcast of Australian GDP

The Melbourne Institute Nowcast of Australian GDP 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.

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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