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Melbourne Institute Nowcast of Australian GDP & Dating the Business Cycle

October 2020

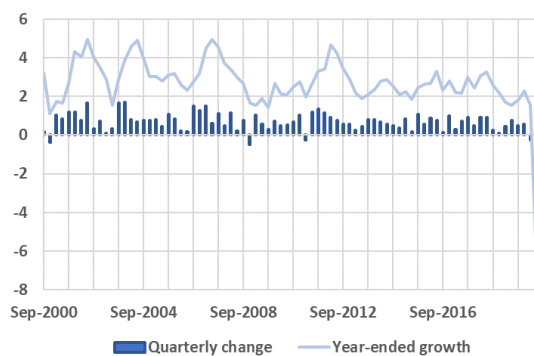
Melbourne Institute Nowcast of Australian GDP & Dating the Business Cycle

Released October 30, 2020

GDP contracted by 7 per cent in the June quarter of 2020

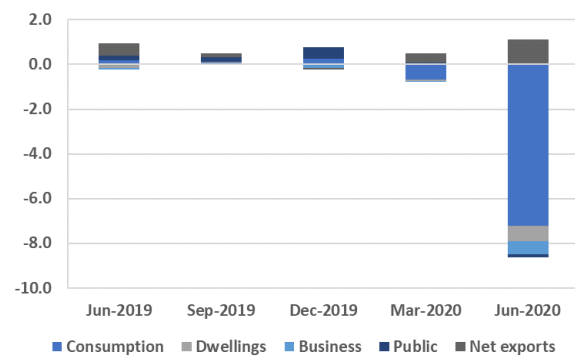
On September 2, the ABS reported that GDP contracted by 7 per cent in the June quarter of 2020, giving an annual growth rate of -6.3 per cent and marking it the worst quarter in recorded history. According to the ABS, household consumption fell by an unprecedented amount, detracting 6.7 percentage points from GDP. Public expenditure and net exports contributed positively to growth. The next release of the National Accounts, covering the September quarter, will be on December 2, 2020.

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



Source: ABS, up to Jun quarter 2020.

Figure 2: Contributions to GDP Growth (ppt)



Source: ABS, up to Jun quarter 2020.

Second nowcast for September Quarter GDP (released in October 2020)

GDP growth is projected to be 1.7 per cent in the September quarter, giving a year-ended growth rate of -5.2 per cent. This compares to last month's September quarter nowcast of 1.3 per cent for the quarter. The nowcast reflects the on-going effects of COVID-19 on economic activity and is consistent with a gradual rebound from the record fall in Q2. Our third and final nowcast for Q3 will be in November.

Continued improvement in hours worked and elevated retail spending have contributed positively to this month's GDP growth nowcast for the September quarter. However, the unemployment rate remains high and business credit conditions are weakening, posing risks for growth in Q4.

Risks to the outlook

The Monthly Activity Index continues to suggest that the recession stemming from the COVID-19 shock is short by Australian standards, with falls in output particularly concentrated in April and May. While the nowcast is for 1.7 per cent in the September quarter as a whole, the Activity Index points to some loss of momentum occurring throughout the quarter. As noted above, some of the partial indicators also point to downside risks existing for Q4. These data, however, obviously predate the removal of the lockdown restrictions in Melbourne.

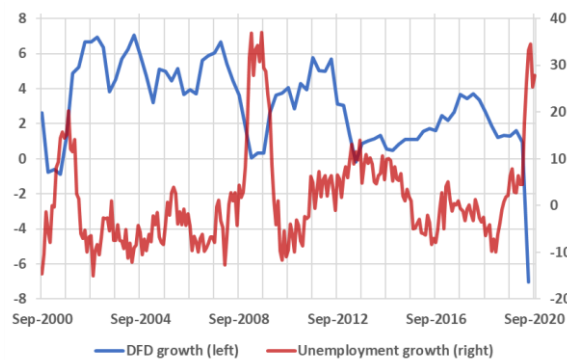
Also, while a short recession necessarily implies output growth to occur in *both* the September and December quarters, it does not mean that the recovery from this deep sharp recession will be rapid.

The unemployment rate remains high, although hours worked improves further¹

The unemployment rate remained at 6.9 per cent in September while the number of unemployed ticked up by 2 per cent from August to 28 per cent in September. Both the unemployment rate and the number of persons unemployed are down from their respective peaks in July. Nevertheless, grim unemployment conditions have become a drag on the growth of domestic final demand (DFD), which fell by a large 7 per cent in the June quarter (Figure 3). The growth rate of the number of unemployed remained a primary negative contributor to the GDP growth in the September quarter.

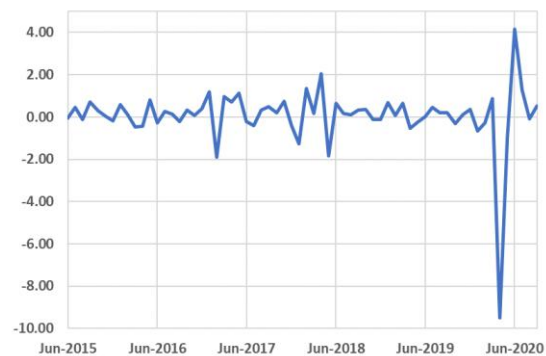
Hours worked improved further in September, with a positive 0.5 per cent rate of monthly growth. The growth rate of hours worked has remained a positive contributor to the September nowcast. However, hours worked in September was still 5 per cent below its value in September last year.

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



Source: ABS, up to Sep 2020.

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



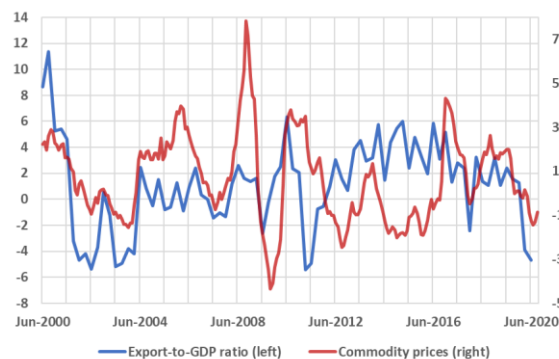
Source: ABS, up to Sep 2020. Note: Starts in Jun 2015 to reflect recent volatility.

Commodity prices have temporarily stabilised, imports rise

The index of commodity prices seems to have stabilised temporarily in September, although it is still 9 per cent lower than the level in the same month last year. The negative growth rate of the index of commodity prices was largely the result of non-rural commodities. Consistent with the recent declines in the commodity price index, the exports to GDP ratio fell by 5 per cent over the year to June.

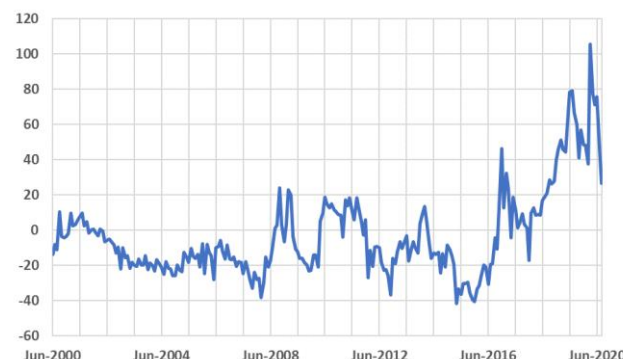
The net trade surplus shrank in September, due mainly to an increase in imports of goods. Overall, trade remains a negative contributor to the September nowcast.

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



Source: ABS, up to Sep 2020.

Figure 6: Trade balance
(\$ billion)



Source: ABS, up to Aug 2020.

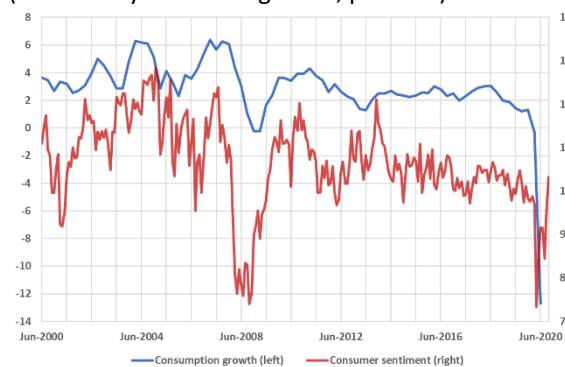
¹ Our nowcast model uses monthly information regarding labour market conditions, housing and business lending, retail sales, housing approvals, consumer expectations, trade conditions and commodity prices to gauge current economic conditions. **We note that the nowcast is currently in the experimental stage.**

Consumer sentiment improves

The seasonally-adjusted current conditions component of consumer sentiment increased by 7 per cent in October, following a 14 per cent improvement in September. This follows a fall of 8 per cent in August and flat sentiment in July. Importantly, the value of the sentiment index in October exceeded 100 for the first time since November 2019, indicating that the number of optimists is greater than the number of pessimists. The results suggest that consumers are cautiously optimistic about economic conditions for Q3 and Q4.

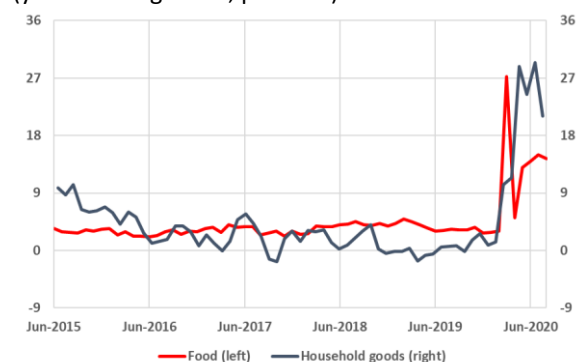
Recently announced retail trade data for August indicate a moderation in the rate of annual growth for non-food related retail spending. Annual growth in food related spending during August, however, remained similar to values observed in June and July. Notwithstanding the moderation in non-food related spending, the rate of annual growth remains elevated and will likely continue to decline to normal rates of growth in the coming months.

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



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

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



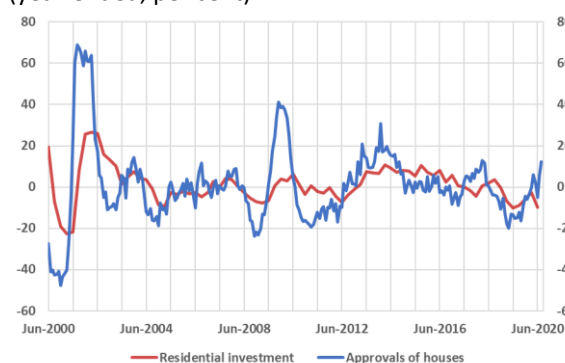
Source: ABS, up to Aug 2020. Note: Starts in Jun 2015 to better reflect recent volatility.

The growth rate of dwelling approvals continues to improve

Annual growth in dwelling approvals was over 12 per cent in August and over 5 per cent in July. Notwithstanding the historical volatility in dwelling approval growth rates, recent values indicate better than expected housing conditions. In August, the number of dwelling approvals was the highest since January 2019.

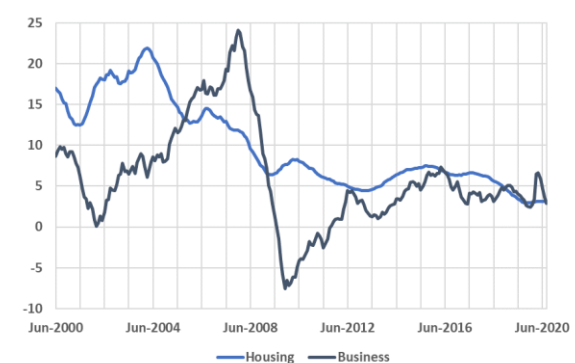
Housing credit has also maintained a relatively stable growth rate in recent months, exceeding three per cent in every month during 2020. On the other hand, after a short-lived spike in March and April, annual growth in business credit has fallen back to the weak levels observed in the second half of 2019, raising concerns about future investment conditions.

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



Source: ABS, up to Aug 2020.

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



Source: ABS, up to Aug 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.²

The Monthly Activity Index is constructed so that at the quarterly frequency, it coincides with the log of 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.³

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. Akin to the official ABS data (shown in Table 2) the Monthly Activity Index indicates that the Australian economy is currently in a recession. There is little change in these business cycle dates compared to those reported last month.

Our nowcasts and the Monthly Activity Index continue to suggest that the recession is short and sharp by historical standards, with a substantial fall in output of nearly 3 per cent in April. As discussed previously, for the official quarterly data to also suggest a shorter-than-average recession – that is, the trough to occur in the June quarter – it is necessary for output to also grow in the December quarter. Of course, both the Monthly Activity Index and GDP data are subject to data revisions and this may influence the dating of the business cycle.

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)
Sep-1981	Jan-1975	20	80		100
Mar-1990	May-1983	15	82	102	97
Mar-2020	Jun-1991	2	345	360	347
	May-2020		<i>Ongoing</i>		
Averages		11	128	231	181
Standard deviations		8	149	182	143

Note: The average durations are rounded to full months. Includes the ongoing phase. Sample is 1974:09- 2020:10.

² 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.

³ 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
Dec-2019		<i>ongoing</i>	114	118	
Average durations		3	15	34	34
Standard deviations		2	8	38	37

Note: The average durations and standard deviations are rounded to full quarter. Includes the ongoing phase. Sample is 1959:Q3 – 2020:Q2.

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
Dec-2019		<i>ongoing</i>	4	6	
Average durations		4	16	22	19
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:Q2.

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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