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Applied Economic & Social Research

Melbourne Institute Nowcast of Australian GDP

July 2022

THE UNIVERSITY OF MELBOURNE

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Released 28 July 2022

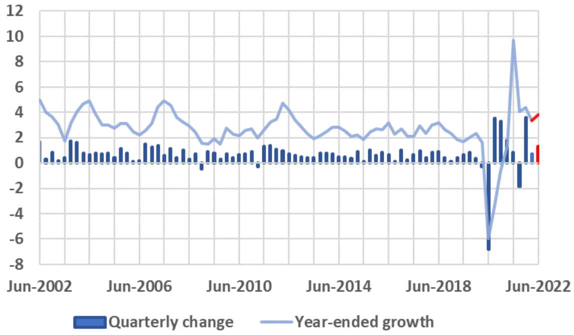
June quarter GDP – second nowcast

- The Australian economy grew by 0.8 per cent in the March quarter (Figure 1), weighed down by the Omicron outbreak and floods in Brisbane and Sydney. Growth was underpinned by household consumption and the public sector; over the year it was 3.3 per cent.
- Drawing on timely monthly indicators, our second nowcast for June quarter growth is 1.3 per cent, taking year-ended growth to 3.8 per cent (Figure 1). This nowcast mainly reflects data up to May.
- Our nowcast is an upwards revision by 0.3 percentage points from last month. Strong labour market data, nominal retail sales and business credit growth are important factors contributing to our nowcast. Alternatively, a likely downturn in residential construction is weighing on it.
- The official June quarter GDP data will be released by the ABS on Wednesday 7 September.

Strong inflation in the June quarter

- Like many nations, inflation in Australia has increased sharply this year. This includes underlying measures, which the Reserve Bank of Australia (RBA) typically focus upon. Trimmed-mean inflation increased by a strong 1.5 per cent in the June quarter, to be 4.9 per cent higher over the year.
- Inflation in Australia, unlike in many nations, is only available at a quarterly frequency. Consequently the Melbourne Institute produces the Inflation Gauge, which is a monthly measure to provide a more timely read on the state of inflation. It is produced by collecting prices from web sites (web scraping) and other sources and is calculated in a similar manner to the official CPI.
- The trimmed-mean Inflation Gauge, similar to the official data, was particularly strong in June - at levels last seen prior to the Global Financial Crisis (Figure 2). Its July reading is available next week.
- There are multiple reasons why inflation has been so strong this year. One factor is that the war in Ukraine has boosted petrol and gas prices, with the latter also affecting electricity prices. Secondly, the Australian economy rebounded from the COVID-related disruptions faster than most economists, including the RBA, anticipated. This has resulted in labour shortages in some sectors.
- The strength in inflation has implications for nowcasting. For example, many monthly indicators of the real economy are nominal, and higher-than-normal inflation makes it more difficult to determine what they imply about economic activity. This point is returned to later below.
- High inflation typically also signals that the economy is operating above capacity, that is, a positive output gap exists. This is complicated by international factors, such as oil prices, and fluctuations in the exchange rate, which can also sizably influence inflation.
- The RBA is responding to the current high inflation by rapidly unwinding the extraordinary policy settings it put in place during the pandemic and further substantial increases are expected soon.

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



Sources: ABS, up to March quarter 2022, and Melbourne Institute.

Figure 2: Inflation Gauge: Trimmed-Mean
(year-ended, per cent)

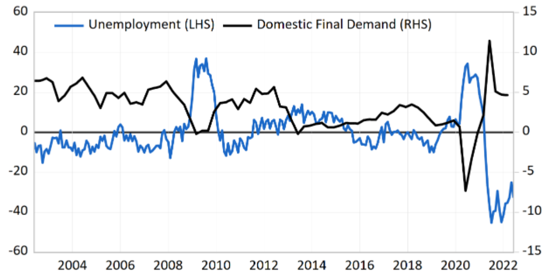
Source: Melbourne Institute, up to June 2022.

Unemployment rate at its lowest level since 1974…[1]

In June the unemployment rate decreased by 0.4 percentage points, reaching 3.5 per cent, its lowest level since 1974. The participation rate increased slightly, and at 66.8 per cent is at a particularly high level by historical standards. Not all developments in the labour market were positive though; the underemployment rate – which counts people that are employed but are working less hours than they desire – increased by 0.4 percentage points, although this was from a particularly low level.

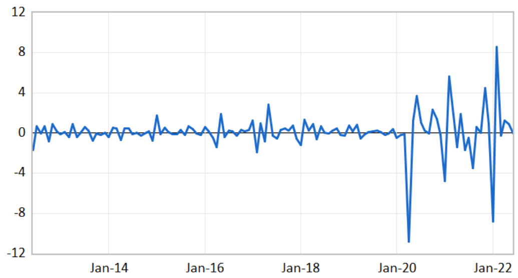
The two labour market indicators included in the nowcasting model are year-ended growth in unemployment and monthly growth in hours worked. Unemployment continues to point to strong domestic final demand growth (Figure 3); alternatively, hours worked is more sanguine (Figure 4). It is important to note that labour market indicators often lag the business cycle, and as the RBA tightening phase commenced in May it is too early for it to have had a large impact on these series.

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



Source: ABS, up to June 2022 (unemployment).

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



Source: ABS, up to June 2022.

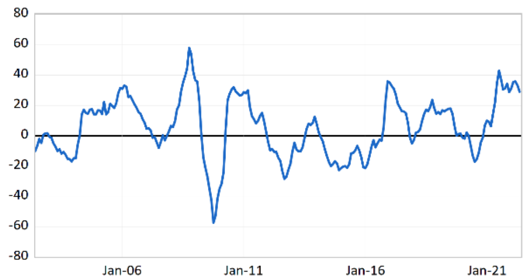
Commodity prices weaken, but remain strong

The RBA Index of Commodity Prices in A$ fell by 1.5 in June but remains more than 26 per cent higher than a year ago (Figure 5). Rural and base metal prices contributed to the fall. Spot prices for the bulk commodities, fell by more than 9 per cent, with concerns about economic activity in China and hence steel production, which uses iron ore and coking coal, a likely contributing factor. These falls in spot prices may well flow through to Australian export prices in coming months.

Crude oil prices have shown resilience to concerns about a sharp slowing in the global economy due to aggressive monetary policy responses in many nations to stem inflation.

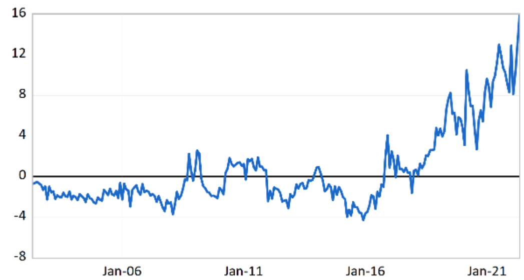
The trade surplus widened further in May (Figure 6), with growth in exports (particularly of coal and related products) outstripping growth in imports.

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



Source: RBA, up to June 2022 (commodity prices).

Figure 6: Trade balance
($ billion)



Source: ABS, up to May 2022.

[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 at recessionary levels

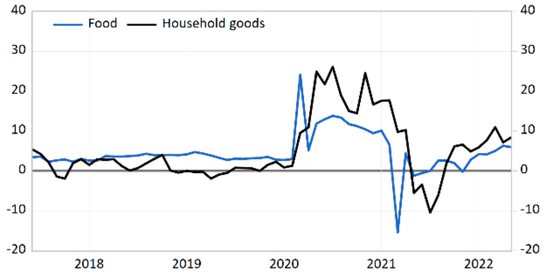
The value of retail trade posted another sizable increase in May (0.9 per cent), to be 10.4 per cent higher over the year. The nowcasting model focuses on two components of retail trade – food and expenditure on household goods, which grew more modestly in May (0.6 and 0.4 per cent) than some other industries – surprisingly department stores, but also cafes, restaurants and take-away food.

The ABS noted that part of the growth in the value of retail sales in May was due to higher prices, particularly for cafes etc. and food.

Consumer sentiment weakened further in July. The nowcasting model focusses on the Current Conditions Index, which is particularly weak (Figure 8). It is at levels only seen in the first wave of the pandemic, the GFC and the early 1990s recession. The component comparing family finances to a year ago is particularly weak – it is more than 23 per cent lower than a year ago.

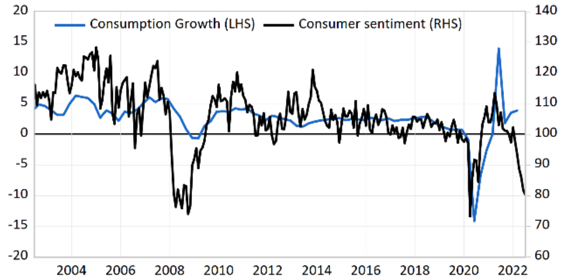
High inflation is one factor contributing to the current divergence between retail trade and consumer sentiment. It, together with the interest rate increases, is likely to be weighing on sentiment.

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



Source: ABS, up to May 2022.

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



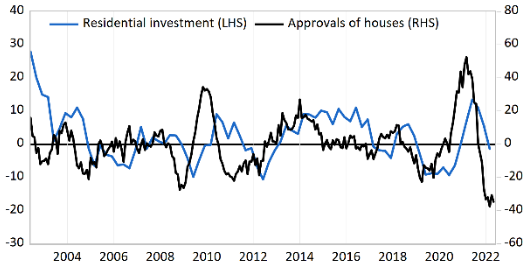
Source: ABS and Melbourne Institute, up to July 2022 (consumer sentiment).

Business credit growth strengthens further

Building approvals improved in May, with a strengthening in approvals for buildings other than houses (i.e. apartments). Approvals, however, are volatile; the nowcasting model focuses on those for houses, which remain well down on a year ago, signalling a likely further decline in residential investment (Figure 9). The other housing indicator included is housing credit growth, which is less closely tied to residential investment. The pace of its increase has moderated, and given the recent interest rate increases, is likely to decline in coming months.

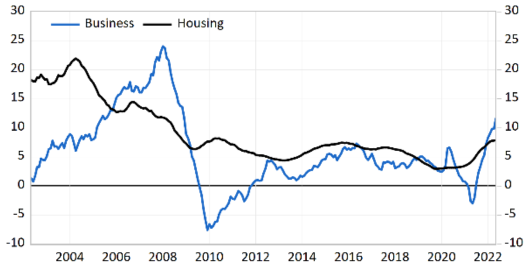
Business credit growth alternatively improved sizably in May and is well above the growth rates achieved in the last decade (Figure 10). The NAB Business survey reported a weakening in business confidence in June, but business conditions remained well above average.

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



Source: ABS, up to May 2022 (approvals).

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



Source: RBA, up to May 2022.

Next release: 25 Aug 2022.

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.

We note that the nowcast methodology currently is in an experimental stage.

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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