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Melbourne Institute Nowcast of Australian GDP

March 2023

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March quarter – first nowcast

- The Australian economy grew by 0.5 per cent in the December quarter, and 2.7 per cent over the year.
- Drawing on timely monthly indicators, our final nowcast for the March quarter is for quarterly growth of 0.4 per cent (Figure 1). This corresponds year-ended growth easing to 2.6 per cent.
- The outlook for the Australian economy is weak. In the near term, the re-opening of the Chinese economy may result in net exports providing some buffer to weak domestic demand growth. However, whether it will continue to do so further out is uncertain. With monetary policy clearly contractionary, and cost-of-living pressures weighing on households, consumption growth – the largest component of output – is likely to slow further. Overall, the Westpac-Melbourne Institute Leading Index points to below-trend growth in the Australian economy occurring in the next 3 to 9 months. A per capita recession is likely.
- A new source of uncertainty is instability within regional U.S. banks weighing on U.S. economic growth. Nevertheless, the Federal Reserve recently tightened policy by a further 25 basis points.
- The official March quarter GDP data will be released by the ABS on Wednesday 7 June.

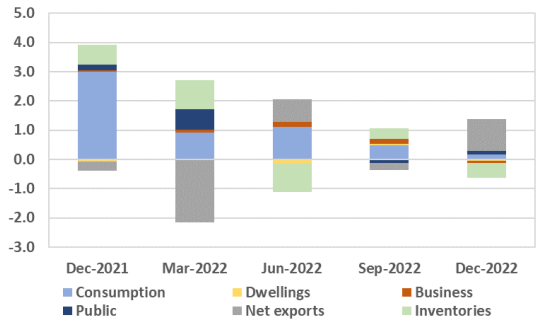
The Australian economy is slowing…

- In the December quarter growth in the Australian economy was underpinned by a positive contribution from net exports (1.1 percentage points; Figure 2). This contribution reflected both a lift in exports and a sizable fall in imports.
- An important determinant of imports growth is domestic demand, which was flat in the December quarter. Weak household consumption growth, as foreshadowed by the Westpac-Melbourne Institute Consumer Sentiment index, was a key factor in the weak demand. Consumption increased by only 0.3 per cent in the December quarter and contributed 0.2 percentage points to growth.
- Surprisingly new business investment fell by 0.8 per cent in the December quarter. As discussed later, while partial indicators for business investment generally remain at strong levels, some have weakened. Less surprising was a fall in residential investment, weighed down by the increases in interest rates. The biggest drag on growth, however, was a drawdown of inventories (0.5 percentage points).
- A period of below-trend growth is necessary to reduce inflation, and this will result in the unemployment rate increasing. Whether the increases in interest rates to date are sufficient to return inflation to the RBA's target in a timely manner is unclear. Monthly movements in the Melbourne Institute Inflation Gauge signalled that inflation has remained strong in 2023 to date; the less timely ABS Monthly CPI Indicator alternatively suggested a greater moderation may have occurred. Overall, given the contractionary effects on economic activity that the current level of interest rates is having, we believe the RBA can afford to wait and assess the incoming data, particularly the March quarter CPI, before deciding if going further is necessary.

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

Sources: ABS, up to December quarter 2022, and MI.

Figure 2: Contributions to Quarterly Growth
(percentage point)



Source: MI, ABS, calculations.

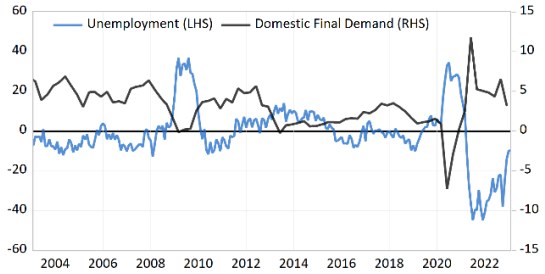
Labour market retraces last month's easing…[1]

In February the unemployment rate returned to 3.5 per cent, unwinding last month's increase, which the ABS had flagged was possibly due to atypical seasonal developments. The participation rate increased by 0.1 percentage points and is at a high level by historical standards.

The nowcasting model includes two labour market indicators. The first, namely year-ended growth in unemployment, was little changed and continues to point to robust domestic final demand growth. The second, monthly hours worked, was affected by more people than usual taking annual leave in January and rebounded strongly in February (Figure 4); in trend terms it grew only modestly.

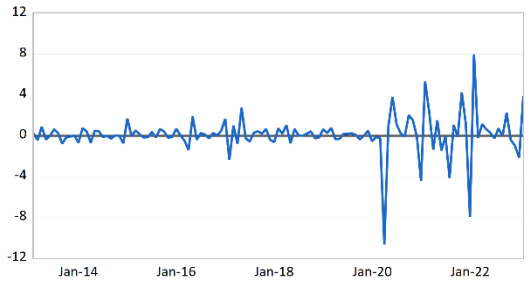
The Westpac-Melbourne Institute Unemployment Expectations Index is a more forward-looking indicator for the labour market. It increased by 2.9 per cent in March, signalling that more households expect unemployment to rise in the future.

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



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

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



Source: ABS, up to February 2023.

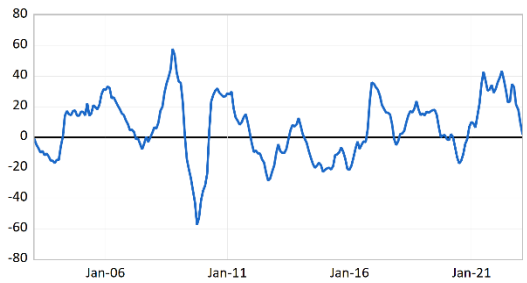
Commodity prices decline, with large falls in thermal coal prices …

The RBA Index of Commodity Prices in A$ fell by 1.3 per cent in February, with January also revised lower. While commodity prices remain at a high level by historical standards, they are now 3.8 per cent lower than six months ago, and little changed over the year (Figure 5).

In February the spot price for thermal coal, which is used for electricity generation, fell sharply from exceptionally high levels stemming from the war in Ukraine. This fall is yet to be reflected in the average export prices received by Australian exporters for the bulk commodities, which increased slightly in February. Consequently, further falls in commodity prices appear likely in coming months.

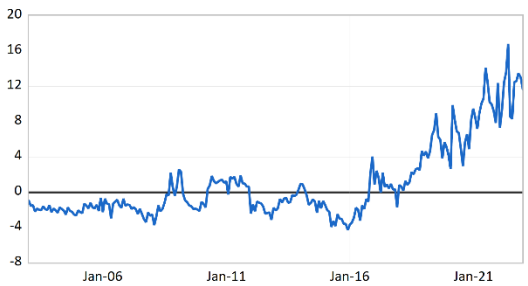
The trade surplus declined again in January (Figure 6), reflecting growth in the value of imports, particularly of consumption and capital imports. The value of exports increased modestly, with service exports continuing to recover, although they still remain below their pre-COVID level.

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



Source: RBA, up to February 2023.

Figure 6: Trade balance
($ billion)



Source: ABS, up to January 2023.

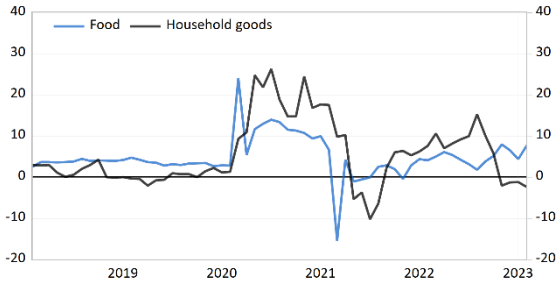
[1] Our nowcasting model uses monthly information regarding labour market conditions, housing and business lending, retail sales, housing approvals, consumer expectations, trade conditions and commodity prices to gauge current economic conditions.

Consumer sentiment unchanged, remaining at an exceptionally weak level …

The Westpac-Melbourne Institute Consumer Sentiment Index was unchanged in March, but nearly 19 per cent lower than a year ago. Current conditions, which the nowcasting model focusses on, eased due to a weakening in whether it is a good time to buy major household items (Figure 8). The Current Conditions index, weighed down by the hikes in interest rates, is signalling a very weak outlook for consumption. Alternatively, the Expectations Index improved slightly, reflecting increased optimism about economic conditions in five years outweighing greater pessimism about the year ahead.

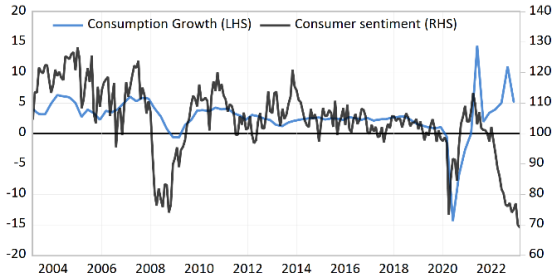
Retail trade grew by a subdued 0.2 per cent in February. While this follows strong growth in January, that was influenced by changing seasonal patterns relating to the increasing importance of Black Friday sales and overall we believe retail trade growth to be slowing. The nowcasting model focuses on two components of retail trade, and these are providing divergent signals; year-ended growth of spending on food increased in February, whereas it remained negative for household goods (Figure 7).

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



Source: ABS, up to February 2023.

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



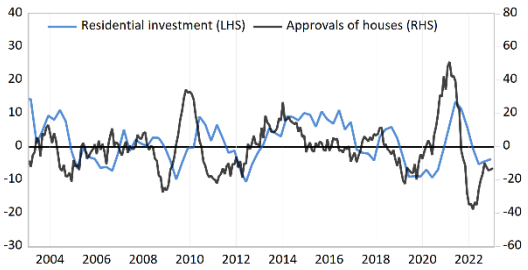
Source: ABS and Melbourne Institute, up to March 2023 (consumer sentiment).

Credit growth continues to ease…

Dwelling approvals fell sharply in January. On a monthly basis approvals are volatile, and in trend terms a slowing is clearly evident since mid last year. The nowcasting model focuses on approvals for houses; these are 12 per cent lower than a year ago (Figure 9). This suggests that negative year-ended residential investment growth is likely in the March quarter, however, given the falls that have already occurred that could correspond to modest growth in the quarter. Nevertheless, it is clear that a sustained upswing in residential investment growth is highly unlikely. The nowcasting model also includes a second indicator, namely year-ended growth in housing credit. Unsurprisingly, given the increases in interest rates, this slowed further in January (Figure 10).

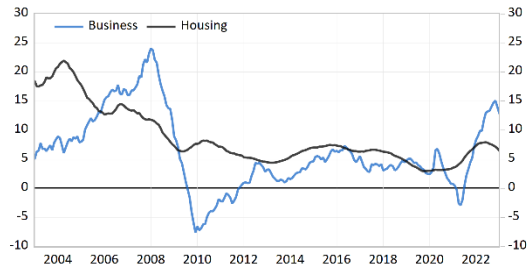
Business credit growth eased in January but remained strong (Figure 10). Similarly business conditions, as reported by the NAB Monthly Business Survey, remained at well above-average levels. The more forward-looking business confidence measure fell and is much weaker. Capacity utilisation also declined but remains at a high level. Overall, while the outlook for business investment is uncertain, it appears unlikely to make a sizable contribution to output growth in the March quarter.

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



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

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



Source: RBA, up to January 2023.

Next release: 27 April 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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