MELBOURNE INSTITUTE
Applied Economic & Social Research

Melbourne Institute Nowcast of Australian GDP

January 2024

THE UNIVERSITY OF MELBOURNE

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Released 25 January 2024

December quarter – second nowcast

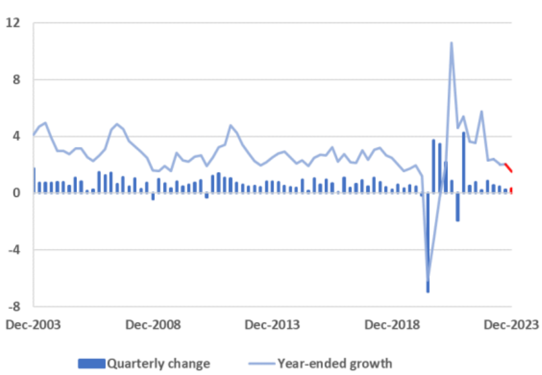
- The Australian economy grew by 0.2 per cent in the September quarter (2.1 per cent year-ended).
- Our second nowcast for growth in the December quarter is for growth of 0.3 per cent, which corresponds to year-ended growth slowing to be 1.5 per cent (Figure 1). This is unchanged.
- The official December quarter GDP data will be released by the ABS on Wednesday 6 March 2024.

Inflation outlook for 2024

- Key to the Reserve Bank's interest rate decisions in 2024 is the outlook for inflation.
- Their most recent forecasts – released in November last year – has underlying inflation declining from 5.2 per cent in the September quarter – to 3.3 per cent, still be above the target, late this year.
- The most recent partial data for underlying inflation have been mixed. The ABS Monthly CPI Indicator declined to 4.6 per cent in November, whereas the timelier Melbourne Institute (MI) Monthly Inflation Gauge showed a pick-up in December to 5.2 per cent.
- Two important determinants of inflation are unit labour costs - productivity-adjusted wages – and import prices. In the long run unit labour costs are roughly 4 times as important as import prices.
    - **Unit labour costs:** These grew by a strong 6.9 per cent year-ended in the September quarter (Figure 2), with productivity growth declining by 2.5 per cent.
        - The Productivity Commission argue that the pandemic resulted in 'productivity bubble', with labour temporarily moving from low-productivity sectors (e.g. services due to lockdowns), to high-productivity sectors. Productivity then fell as this was unwound. Nevertheless, before the pandemic Australia's productivity performance had been disappointing. This seems likely to continue in 2024.
        - Wages growth, using the Wage Price Index (WPI), was 1.3 per cent in the September quarter (4 per cent year-ended). As the WPI is partially productivity-adjusted, this is very strong. As the labour market currently is tight, but cooling (see below), and will cool further in 2024, nominal wages growth will remain high, but gradually moderate.
    - **Import prices:** In the September quarter these were 2.8 per cent lower than a year ago. This reflects that the war in Ukraine increased energy prices in 2022, combined with diminished supply-chain issues and efforts to lower inflation globally. While benign import prices may continue, a risk is that conflict in the Middle East leads to supply-chain issues re-emerging.
- The MI consumer expected inflation rate fell in December and maintained this fall in January.
- Inflation appears likely to moderate further in 2024 but be above the RBA's target. A period of tight monetary policy is necessary to constrain inflation, and therefore rates may be unchanged for a considerable period. Any measures to address the severe cost of living pressures faced by many households will need to be carefully designed so as to not require monetary policy to react.

Figure 1: GDP Growth

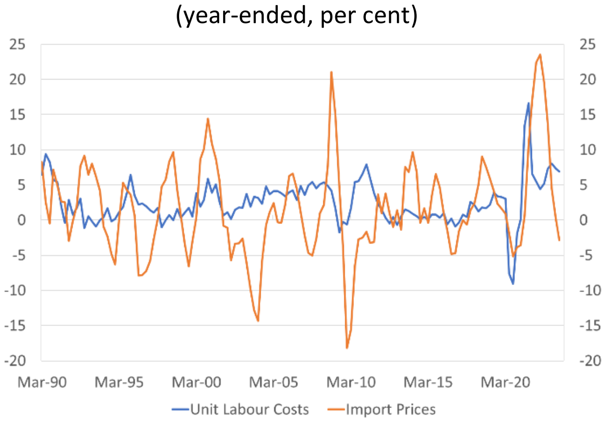
(chain volume, per cent)



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

Figure 2: Inflation Determinants

(year-ended, per cent)



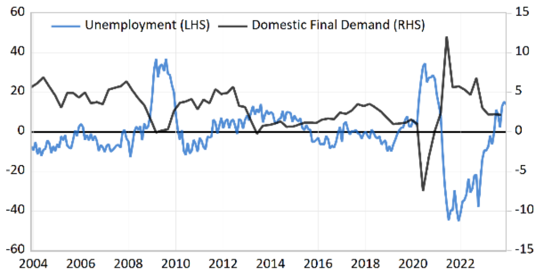
Sources: RBA, and ABS.

Labour market: tight, but cooling…[1]

The unemployment rate was unchanged at a low 3.9 per cent in December. This was despite a large 0.5 per cent decrease in employment. The reconciliation is that the participation rate fell from 67.3 per cent - which was very high by historical standards – to 66.8 per cent. The ABS noted that changes in seasonal patterns may have affected employment in the last few months of 2023; this is likely due to the rising prominence of Black Friday sales. The nowcasting model includes year-ended growth in unemployment, which edged higher and is pointing to very weak domestic demand growth (Figure 3).

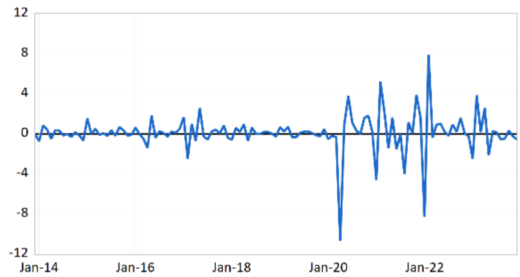
The cooling in the labour market is apparent in aggregate hours worked. These fell by 0.5 per cent in December (Figure 4). While they remain 1.2 per cent higher than a year ago, hours worked clearly have lost momentum since mid-2023.

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



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

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



Source: ABS, up to December 2023.

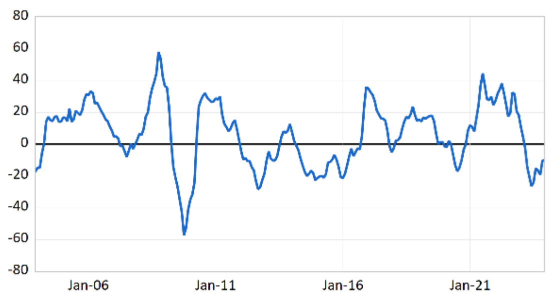
Commodity prices continue to edge higher…

The RBA Index of Commodity Prices in A$ increased by 0.3 per cent in December. Prices were around 9.5 per cent higher than in mid-2023, but lower than a year ago by a similar amount (Figure 5). In the December quarter prices rose 4.5 per cent, suggesting that the terms of trade may have improved.

Higher export prices for the bulk commodities were one factor which contributed to the increase in December. However, this may not be maintained; in January the spot price for iron ore initially rose further, but subsequently the sluggish Chinese economy appears to have resulted in this being more than unwound.

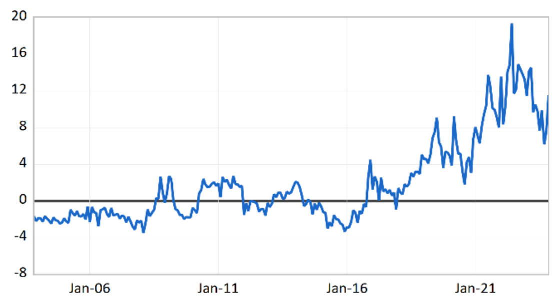
The goods trade surplus increased strongly in November (Figure 7). While the value of exports did increase, due to growth in coal and related products, the fall in the trade surplus primarily reflected a decline in the value of imports. All major categories of imports fell, but the main contributor was a decline in the value of consumption imports due to non-industrial transport equipment. The trade data are volatile and don't always map well into their expenditure counterparts; nevertheless, the fall might reflect soft discretionary expenditure by households going forward.

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



Source: RBA, up to December 2023.

Figure 6: Goods Trade balance
($ billion)



Source: ABS, up to November 2023.

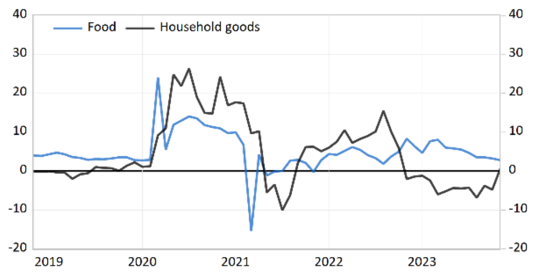
[1] Our nowcasting model uses monthly information regarding labour market conditions, housing and business lending, retail sales, housing approvals, consumer expectations, trade conditions and commodity prices to gauge current economic conditions.

Consumers are very pessimistic…

The Westpac-Melbourne Institute Consumer Sentiment Index, which has been weak since mid-2022, fell a further 1.3 per cent in January. The Current Conditions Index, which is included in the nowcasting model, fell 3.7 per cent, weighed down by a deterioration in family finances relative to a year ago. With households facing cost of living pressures due to high inflation and interest rate increases, responses about family finances were exceptionally weak. The Current Conditions Index suggests a further a weakening consumption growth may occur (Figure 8). The Expectations Index alternatively was unchanged in January, and 1.3 per cent lower than a year ago.

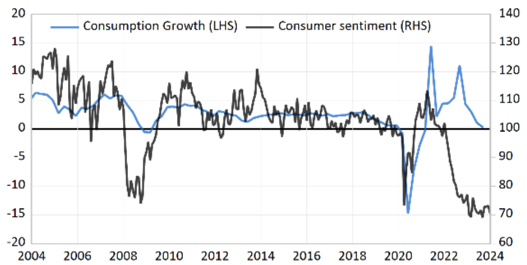
Retail trade increased by a strong 2.2 per cent in November. The ABS noted that in the past two years there may have been a change in the seasonal pattern of retail trade due to the increase popularity of Black Friday sales. The nowcasting model contains to sub-components of retail trade, with year-ended growth in household goods strengthening noticeably in November (Figure 7). The Westpac Card Tracker also displays volatility due to the sales, but they argue that abstracting from this the trend household spending is weak.

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



Source: ABS, up to November 2023.

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



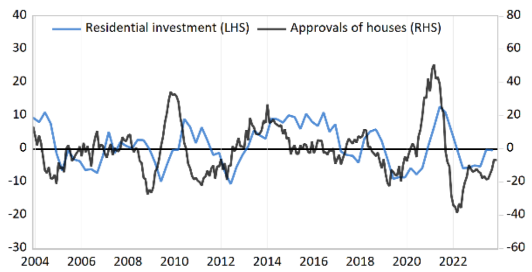
Source: ABS and Melbourne Institute, up to January 2024 (consumer sentiment).

Dwelling approvals improve and housing credit stabilizes…

Dwelling approvals increased by 1.6 per cent in November, due to higher approvals for dwellings other than houses, such as apartments. Looking through the volatility, trend approvals have been increasing since around April, but remain lower than a year ago. Approvals are now commensurate with moderate growth in residential investment (Figure 9), although it is unlikely to contribute significantly to output growth. Another positive development is that housing credit growth recently has stabilised. Credit, however, it is less closely tied to residential investment (Figure 10).

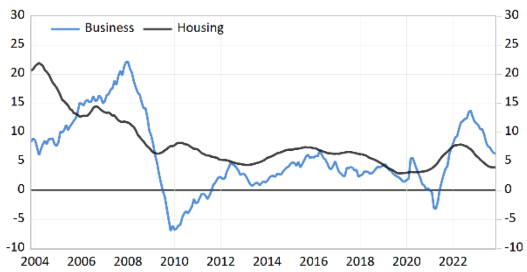
Business credit growth recently continued to weaken, although it remains higher than for much of the previous decade. In an environment of soft consumption growth non-mining investment is likely to also be subdued in the near-term. While the terms of trade may have increased in the December quarter, uncertainty over the outlook for the Chinese economy may weigh on mining investment. The December NAB Monthly Business Survey reported that capacity utilisation eased from a high rate.

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



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

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



Source: RBA, up to November 2023.

Next release: 29 February 2024.

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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