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Melbourne Institute Nowcast of Australian GDP & Dating the Business Cycle

August 2020

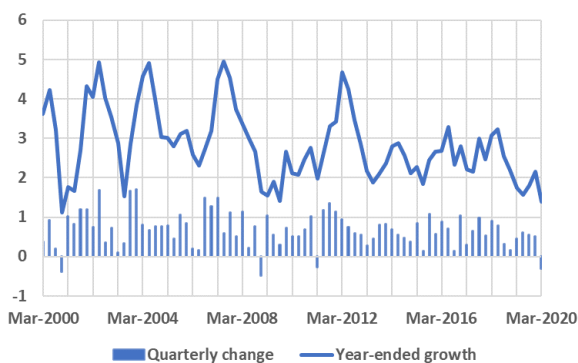
Melbourne Institute Nowcast of Australian GDP & Dating the Business Cycle

Released August 28, 2020

GDP contracted by 0.3 per cent in the March quarter of 2020

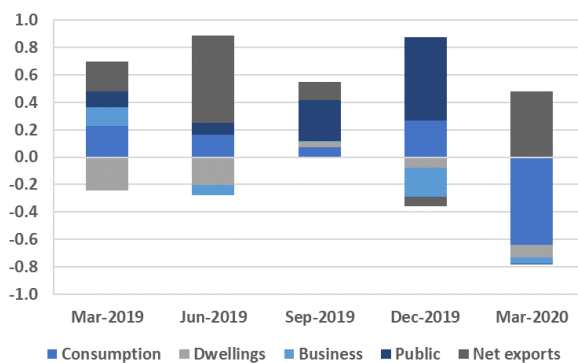
On June 3, the ABS reported that GDP contracted by 0.3 per cent in the March quarter of 2020, giving an annual growth rate of 1.4 per cent.¹ According to the ABS, public expenditure and net exports contributed positively to growth, with negative contributions from private consumption and investment. The next release of the National Accounts, covering the June quarter, will be on September 2, 2020.

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



Source: ABS, up to Mar quarter 2020.

Figure 2: Contributions to GDP Growth (ppt)



Source: ABS, up to Mar quarter 2020.

Third and final nowcast for June Quarter GDP (released in August 2020)

GDP growth is projected to be -3 per cent in the June quarter, giving a year-ended growth rate of -2.3 per cent. This is the third and final nowcast for Q2. The nowcast reflects the significant downturn associated with COVID-19 on Q2 GDP growth. Our first nowcast for Q3 will be in September.

Weakness in labour market conditions, non-food retail sales and trade were the primary contributors to the negative June-quarter nowcast. Notwithstanding recent improvement, hours worked remains well below its value at the same time last year. The annual growth rate of the number of unemployed has also increased for a fifth consecutive month. Conversely, relatively strong business and housing credit during Q2 have contributed positively to the nowcast.

Some encouraging aspects, despite the expected sharp fall...

While economic activity is nowcast to have declined sharply in the June quarter overall, one encouraging aspect is that our estimates of monthly activity point to this being mainly in April. Activity appears to have recovered somewhat in May, and to have declined only relatively modestly in June. The latter may reflect the tightening of COVID-related policies in Melbourne occurring from the second half of June onwards. This raises the question of whether another fall will occur in the September quarter. Some timely indicators, such as the Westpac-Melbourne Institute Consumer Sentiment Index, have declined, although this was concentrated in expectations about future, rather than current, conditions.

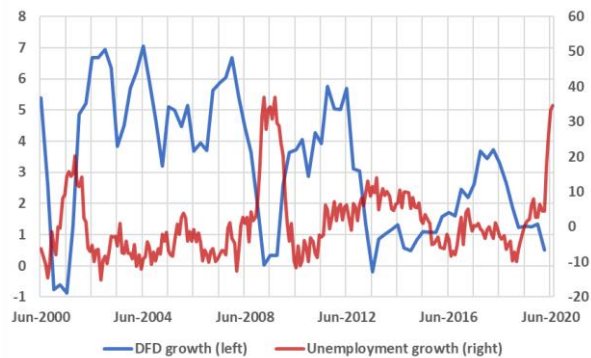
¹ Our third nowcast (of negative 0.2 per cent) for the March quarter was released in May 2020.

Weaker improvement in hours worked and continuing deterioration in the number of unemployed²

The unemployment rate remained at 7.5 per cent in July, while the monthly growth rate in the number of unemployed ticked up by 2 per cent to 35 per cent in July. This value is getting close to the GFC record set in March 2009. Worsening unemployment has become a drag on the growth of domestic final demand (DFD) (Figure 3) and remains a negative contributor to the Q2 quarter nowcast.

The improvement in hours worked lost momentum in July, with the monthly growth of hours worked falling back from 4 per cent in June to 1 per cent in July. This setback is likely to reflect the re-introduction of the lockdown in Victoria (and concerns over the re-emergence of the virus) on the labour force. Overall, hours worked in July was still 5 percent below its value in July 2019.

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



Source: ABS, up to Jul 2020.

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



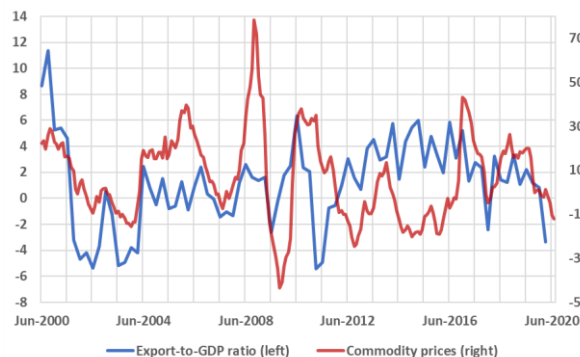
Source: ABS, up to Jul 2020. Note: Starts in Jun 2015 to reflect recent volatility.

Negative contribution from trade

Commodity prices seem to be free falling in recent months with the growth rate of the index of commodity prices falling by 5, 10, and 12 per cent in May, June and July respectively. This decline is observed in all categories, but particularly in rural and bulk commodities. Commodity prices continue to be a negative contributor to the Q2 nowcast.

The trade balance in June also contributed negatively to the June quarter GDP growth, falling heavily since March. Overall, trade has contributed negatively to the Q2 nowcast.

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



Source: ABS, up to Jul 2020.

Figure 6: Trade balance
(\$ billion)



Source: ABS, up to Jun 2020.

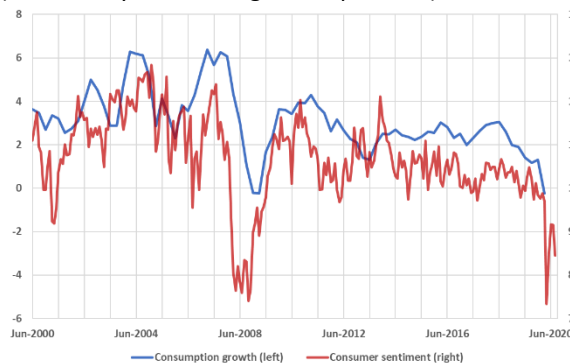
² Our nowcast model uses monthly information regarding labour market conditions, housing and business lending, retail sales, housing approvals, consumer expectations, trade conditions and commodity prices to gauge current economic conditions. **We note that the nowcast is currently in the experimental stage.**

Consumer sentiment rebounded in May and June but weakened again in July and August

Consumer sentiment experienced a severe dip in April but rebounded over May and June. The rebound, which resulted in a positive contribution to the nowcast from consumer sentiment, is likely to be partially associated with support stemming from packages such as JobKeeper and JobSeeker, in addition to the possibility that the effects of the Coronavirus have not been as severe as initially expected. This is one of the reasons for our nowcast being on the optimistic side. Most recently, however, weak consumer sentiment in July and August suggest continued weakness in economic growth for Q3.

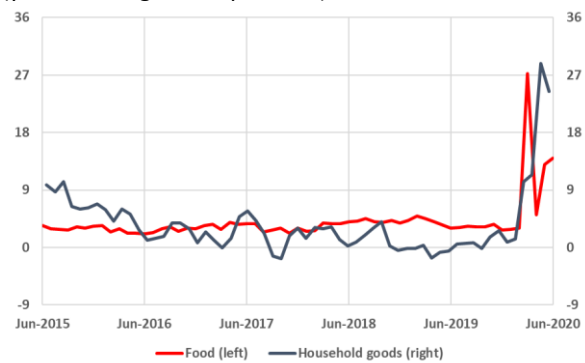
Following a sharp fall in April, food-related retail sales have improved in recent months. Accordingly, food-related spending has contributed positively to the nowcast for Q2. In contrast, non-food retail spending dipped in July, thereby contributing negatively to the Q2 nowcast.

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



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

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



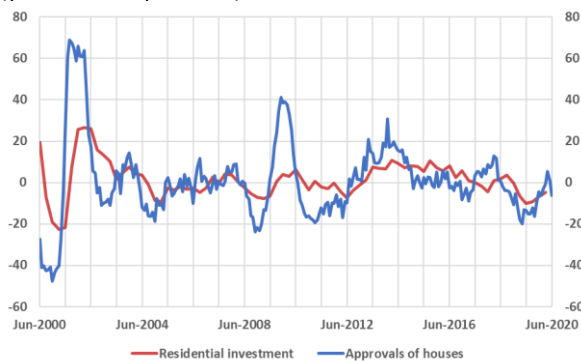
Source: ABS, up to Jun 2020. Note: Starts in Jun 2015 to better reflect recent volatility.

Dwelling approvals fall in June

Growth in dwelling approvals fell by over 6 per cent in year-ended terms during June thereby contributing negatively to the current nowcast. This followed stronger dwelling approval numbers in April and May. Overall, there is significant volatility in dwelling approval growth rates and this is consistent with a high level of uncertainty about short-term housing market conditions.

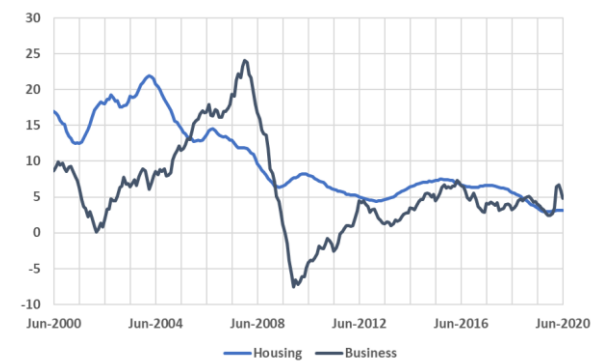
In March and April, the annual growth rate of business lending more than doubled relative to the average rate of growth observed in the first two months of 2020. We had posited that this was temporary and largely attributable to borrowing in order to cover short-term expenses during the downturn. In this respect, annual growth in business lending fell in May and June. Overall, the contribution of lending conditions is negligible this month.

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



Source: ABS, up to Jun 2020.

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



Source: ABS, up to Jun 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.³

The Monthly Activity Index is constructed so that at the quarterly frequency, it coincides with the 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.⁴

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. Australia is now in a recession, with the peak in economic activity having occurred in February 2020.

An aspect to note is that the fall in activity is estimated to be concentrated in two months, namely March and April. These falls are very sharp by historical standards. While Australian recessions historically have an average length of 3 quarters, it is possible that the current one may be shorter-output may cease to fall in consecutive months. This, however, does *not* mean the recovery will be rapid. Where one dates a recovery as starting from is highly uncertain at present and will become clearer as time passes and more data are available. The second wave in Melbourne obviously is currently weighing on growth; it and the recent experience of New Zealand highlight how rapidly a situation can escalate. This will probably remain the case until a vaccine is discovered.

A recession is not yet evident in the official ABS data (presented in Tables 2 and 3) as these are at quarterly frequency, and we will not obtain the June GDP figures until early September.

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)
Apr-1977	Jan-1975 Dec-1977	8	27		35
Feb-1982	Jan-1983	11	50	58	61
Mar-1990	May-1991	14	86	97	100
May-2000	Dec-2000	7	108	122	115
Feb-2020		<i>Ongoing</i>	230	237	
Average		9	102	129	128

Note: The average durations are rounded to full months. Includes the ongoing phase. Sample is 1974:09- 2020:08.

³ 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.

⁴ 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
			<i>ongoing</i>		
Average durations		3	28	34	20
Standard deviations		2	36	39	8

Note: The average durations and standard deviations are rounded to full quarter. Includes the ongoing phase. Sample is 1959:Q3 – 2020:Q1.

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
			<i>ongoing</i>		
Average durations		4	15	20	20
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:Q1.

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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