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Melbourne Institute Nowcast of Australian GDP & Dating the Business Cycle

February 2021

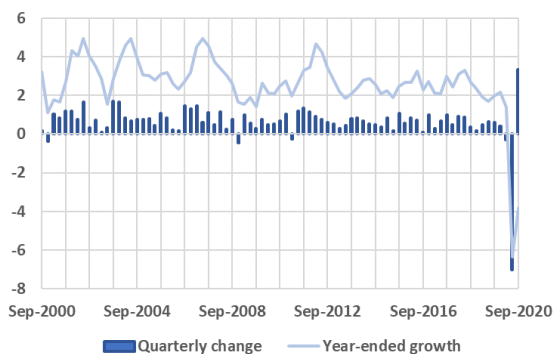
Melbourne Institute Nowcast of Australian GDP & Dating the Business Cycle

Released February 25, 2021

GDP grew by 3.3 per cent in the September quarter of 2020

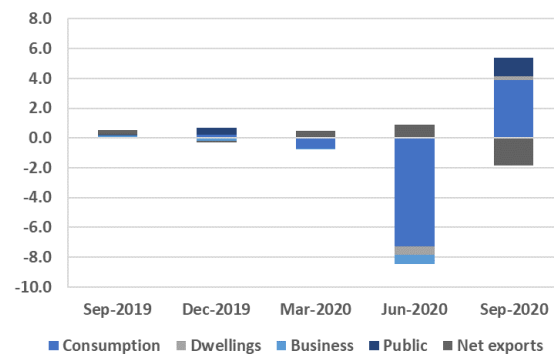
On December 2, the ABS reported that GDP grew by 3.3 per cent in the September quarter of 2020, giving an annual growth rate of –3.8 per cent and showing signs of recovery. According to the ABS, household consumption rebounded in the third quarter as restrictions eased, contributing 4 percentage points to GDP. Public expenditure continued to support growth, while net exports subtracted 1.9 percentage points from GDP. The next release of the National Accounts, covering the December quarter, will be on March 3, 2021.

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



Source: ABS, up to Sep quarter 2020.

Figure 2: Contributions to GDP Growth (ppt)



Source: ABS, up to Sep quarter 2020.

Third and final nowcast for December Quarter GDP (released in February 2021)

GDP growth is projected to be 1.6 per cent in the December quarter, giving a year-ended growth rate of negative 2.7 per cent. The nowcast for Q4 reflects the easing of restrictions on households and business activities, although we note the on-going uncertainty of COVID-19 on economic activity. In March 2021, the first nowcast for Q1-2021 will be released.

Strong housing market conditions, relatively strong data for hours worked and improvement in consumer sentiment up to December contributed positively to the third GDP growth nowcast for Q4. We note, however, that uncertainty about international economic conditions and the domestic labour market (including the removal of JobKeeper), in addition to extremely weak business credit conditions, pose risks for growth during 2021.

Uncertainty exists about the momentum in the economy

The Monthly Activity Index suggests that the economy, after growing strongly in November as the lockdown was relaxed in Victoria, may have lost some momentum. Activity is estimated to have declined slightly in early 2021, although this is only based on limited data (mainly the Westpac-Melbourne Institute Consumer Sentiment Index) and will be revised as more data become available.

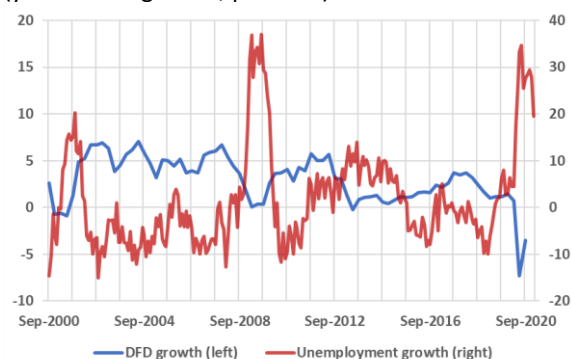
Looking further forward, growth in the Westpac-Melbourne Institute Leading Index alternatively has remained very strong recently and is considerably above its trend. This suggests that above-trend growth is likely to occur in the next 3 to 9 months, which is necessary to reduce the spare capacity that exists and to lower the unemployment rate, which despite recent falls remains elevated.

The unemployment rate fell slightly in January, although hours worked also fell¹

The annual growth rate of the number of unemployed fell from 28 per cent in December to 20 per cent in January, with the unemployment rate sliding further from 6.6 per cent in December to 6.4 per cent in January. Nevertheless, unemployment conditions were still a drag on the growth of domestic final demand, which fell by 3.5 per cent over the year to the September quarter. The number of unemployed up to December remains a primary negative contributor to the Q4 nowcast.

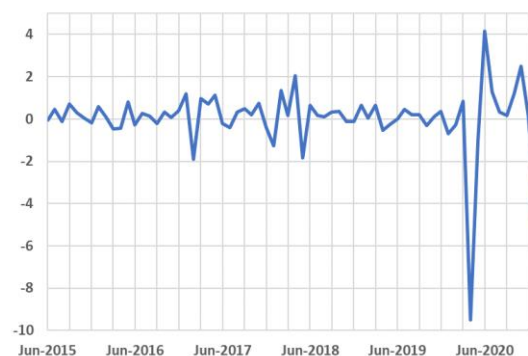
The monthly growth of hours worked fell by 4.9 per cent from December to January, widening the gap between its current value and the value observed in the same month last year (down by 5.7 per cent compared to January 2020). Overall, however, hours worked up to December was a primary positive contributor to the Q4 nowcast.

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



Source: ABS, up to Jan 2021.

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



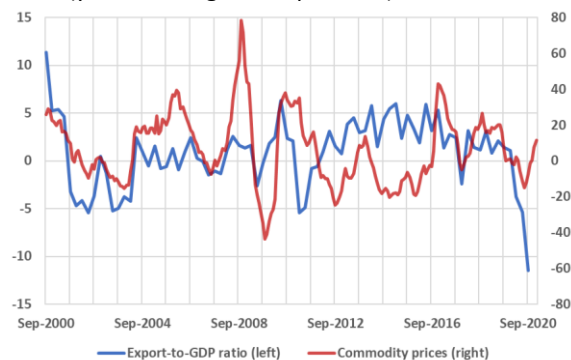
Source: ABS, up to Jan 2021.

Commodity prices improved further in January, while trade remains weak

The index of commodity prices rose further by 11.4 per cent over the year to January, due primarily to the large increase in bulk commodity prices (especially iron ore prices, which peaked again in January after reaching a nine-year high in December). The index of commodity prices up to December has finally made a positive, albeit small, contribution to the nowcast for Q4 and may push exports up further in the next quarter.

Net exports increased in December, resulting from both an increase in total exports and a decrease in total imports. Overall, the trade sector remains weak and the trade balance up to December contributed negatively to the final nowcast for Q4.

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



Source: ABS, up to Jan 2021.

Figure 6: Trade balance
(\$ billion)



Source: ABS, up to Dec 2020.

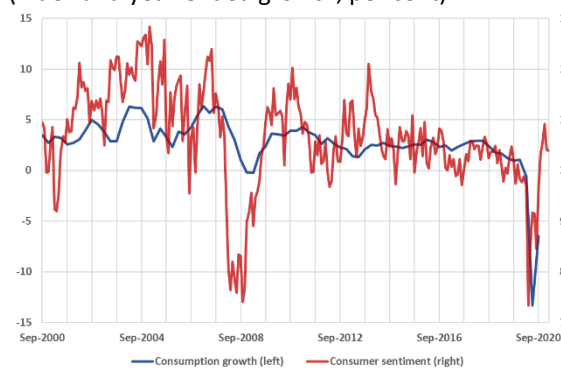
¹ Our nowcast model uses monthly information regarding labour market conditions, housing and business lending, retail sales, housing approvals, consumer expectations, trade conditions and commodity prices to gauge current economic conditions. **We note that the nowcast is currently in the experimental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

Consumer sentiment has weakened in the first two months of 2021

The seasonally adjusted current conditions component of consumer sentiment fell by 0.1 points in February, after falling by another 5.1 points in January. This is the second consecutive decline after a period of successive improvement from September to December. The number of optimists is now only slightly greater than the number of pessimists, suggesting that consumer spending looking forward to Q1 2021 may be weaker than expected.

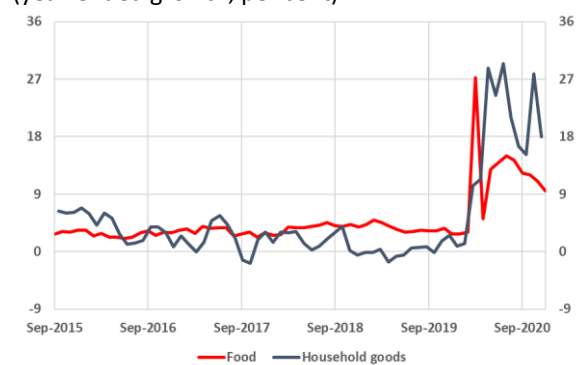
Annual growth in food-related retail trade data for December continued to moderate, with the rate of growth declining for a fifth consecutive month. This is, however, largely expected. Moreover, the annual growth rate of non-food related retail trade fell by nearly 10 per cent in December, after spiking to an annual growth rate of 28 per cent in the previous month, highlighting the significant uncertainty about non-food related retail spending in the short term.

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



Source: ABS and Melbourne Institute, up to Feb 2021.

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



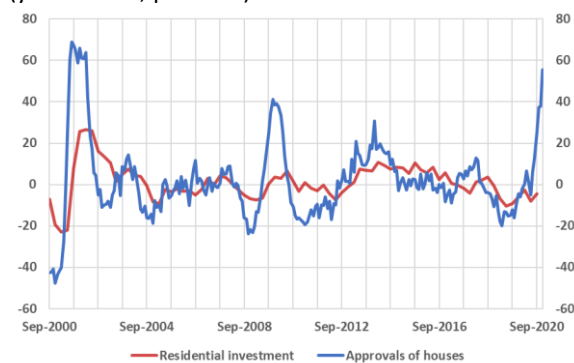
Source: ABS, up to Dec 2020.

Dwelling approvals reach record levels as business lending continues to wane

The housing market ‘boom’ continued in December with dwelling approvals rising for a sixth consecutive month. In December, approvals were 55 per cent greater than those observed December 2020. Moreover, the absolute number of approvals was at its highest on record. Clearly, housing activity has been a major positive factor in this month’s nowcast.

Housing credit data also improved in December, reaching an annual growth rate of over 3.5 per cent. This is the strongest annual improvement in housing credit since 2019. The sharp contrast between housing and business credit growth seen in recent months was also observed in December, with annual growth in business lending below 1 per cent for the second consecutive month. Growth prospects for investment in 2021 therefore continue to be poor.

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



Source: ABS, up to Dec 2020.

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



Source: ABS, up to Dec 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. Similar to the official ABS data (shown in Table 2), the Monthly Activity Index indicates that the Australian economy entered a recession in 2020. The dates presented are very similar to last month.

The business cycle dates continue to suggest that the COVID-19 recession only lasted 2 months, which is shorter than average. Confirmation that the recession has ended will occur when the December quarter GDP data is released early next month.

The COVID-19 recession, while short, was deep, even with the aggressive fiscal and monetary policy responses. The Reserve Bank has indicated that the cash rate will remain at essentially zero for several years. This is a reflection of the amount of slack that currently exists in the economy. It may also partially reflect the problem of inflation persistently undershooting the RBA's target that existed before COVID.

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	16	80	102	96
Mar-1990	Jan-1983		86		101
Mar-2020	Jun-1991		2		345
	May-2020		<i>Ongoing</i>		
Averages		10	130	231	181
Standard deviations		7	147	182	143

Note: The average durations are rounded to full months. Includes the ongoing phase. Sample is 1974:09- 2021:02.

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	38

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

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	2	4		6
Jun-1975	Dec-1975	2	6	8	8
Jun-1977	Dec-1977	7	15	17	22
Sep-1981	Jun-1983	4	9	16	13
Sep-1985	Sep-1986	2	5	9	7
Sep-1989	Dec-1991	9	5	7	14
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	13	18	21
Standard deviations		2	13	14	15

Note: The average durations and standard deviations are rounded to full quarter. Includes the ongoing phase. Sample is 1973:Q3 – 2020:Q3.

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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