Message to doomsayers: moderate GDP growth keeps recession at bay

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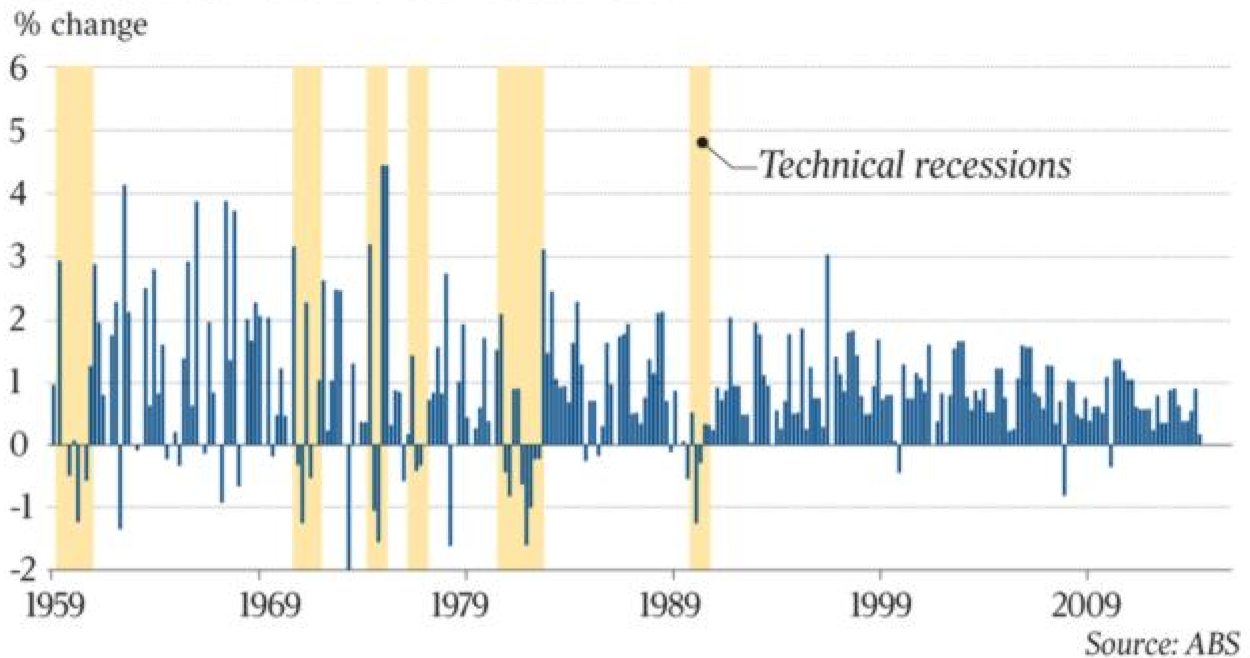

Australia's technical recessions. *Source:* TheAustralian

We often hear that Australia hasn't experienced a recession for 25 years. That's true if the claim relates, as it usually does, to a "technical recession" — two or more successive declines in our quarterly real GDP.

Recently, some commentators have been suggesting we're again on the brink of recession. But what is a recession? Does it only occur when there are successive quarterly falls in real GDP? And what are the risks of Australia tipping into an early recession, even if a broader definition is used? My chart shows the occasions on which Australia has experienced successive declines in quarterly GDP since quarterly national accounts were first compiled in 1959. (The graph also earns its keep by showing how quarter-by-quarter fluctuations in economic activity in this country became milder following the float of the Australian dollar in 1983).

But there are problems with this conventional listing of Australia's recessions. It omits two extremely painful slumps in business activity and confidence in 1974 and 2008. And it categorises as recessions the barely-noticed slowdowns of 1975, 1977 and 1980.

A commonsense approach would define a recession as having most or all of the following features: a jump in unemployment; a noticeable decline in business activity; a sharp fall in business confidence; a drying up of credit; and an increase in business failures.

Using this broader approach, Australia has experienced just six recessions in the past 70 years:

● 1952, following the end of the Korean War boom and the “horror” budget;

● 1961, brought on by the credit squeeze (and widely thought at the time as marking the end of Australia’s post-war prosperity);

● 1974, caused by the global oil shock and the shortcomings in the economic management of the Whitlam government;

● 1982, the mildest of our post-war recessions;

● 1991, the slump that contributed to the sharp drop in inflation;

● 2008/09, during the bleak days of the global financial crisis — and, despite initial fears of -financial meltdown and global depression, the contraction in Australia’s GDP was brief and our commodity prices surged.

Commentators and investors predicting an early recession fear the impact on the lacklustre Australian economy of: a hard landing for the Chinese economy; the slump in the average price of our export commodities; the risks of global deflation; the steep decline in capital spending by mining companies; the cautious behaviour of consumers; and prospects of a weakening in average house prices will run out of puff.

The commentators and investors who put a low probability on recession in the next year or two can point to: the big measures China has already taken to avoid collapses in property or spending; the boost to exports, including exports of services from the weaker Australian dollar; the trim inventories and the disciplined borrowings of most companies; the stronger-than-expected growth in jobs; and increased spending on infrastructure, particularly in NSW.

My guess is we’ll avoid recession in the next year or two. Instead, prospects are for modest to moderate growth in GDP (of two to 2.25 per cent) in 2016, with growth a notch higher in 2017. However, our lower commodity prices and depreciated currency will likely keep average incomes flat over the next year.

The implications for investment markets are these:

● Economic data on the Chinese economy will need to be closely watched.

● Corporate profits will likely expand, but more slowly than the average of analysts’ forecasts is currently suggesting.

● Our sharemarket seems well-placed to move modestly higher, but stock selection will be the key.

● Inflation is likely to remain mild, but maybe not as close to zero as is factored into bond yields — which at time of writing were 2.6 per cent on a ten-year bond.

● Our cash rate is likely to stay at its current level of 2 per cent for another year or so even as the US cash rate is raised.

● The average house price is more likely to stabilise than either continue its climb or suddenly dip.

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