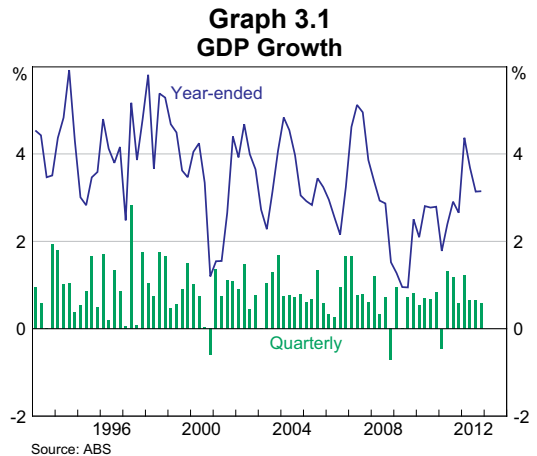


3. Domestic Economic Conditions

The Australian economy expanded at an around trend pace over 2012, although growth was slower in the second half of the year than in the first half (Graph 3.1, Table 3.1). Growth in consumption spending slowed somewhat in the latter part of the year and there was a very large fall in recorded public demand over the same period. Resource sector (mining) investment remained at a very high level, although growth slowed. In contrast, resource export volumes grew strongly in the last months of the year and dwelling investment began to recover after declining over 2011/12. Growth in national income was weak over 2012, reflecting a decline in the terms of trade.

The latest partial indicators and liaison suggest that growth in economic activity may have picked up slightly in the March quarter. Despite recent growth in employment remaining moderate, growth



in consumer spending looks to have increased, consistent with stronger consumer sentiment and rising asset prices. Dwelling investment is likely to have risen further in the quarter, while growth in

Table 3.1: Demand and Output Growth^(a)
Per cent

	First half 2012	Second half 2012
Domestic final demand	6.4	0.6
– Private demand	5.8	4.1
– Public demand	8.0	–10.4
Change in inventories ^(b)	–0.7	0.0
Gross national expenditure	5.6	0.6
Net exports ^(b)	–0.4	1.7
GDP	3.8	2.5
Nominal GDP	3.2	0.8
Real gross domestic income	1.3	–1.0

(a) Growth over two quarters, annualised

(b) Contribution to GDP growth

Source: ABS

mining investment is likely to have continued to slow. Surveys suggest that business conditions and capacity utilisation generally remained a little below long-run averages in the early part of 2013. Non-mining investment is expected to remain subdued in the near term, although firms' surveyed capital expenditure intentions point to a gradual pick-up in the second half of this year and into the next.

Household Sector

Growth in household consumption slowed in the second half of 2012, in line with somewhat subdued conditions in the labour market. The saving ratio remained at around 10 per cent of income, which is similar to the rate of saving in the mid 1980s and well above the levels prevailing during the 1990s and 2000s. Growth of household debt, at around 4 per cent over 2012, is broadly in line with growth in income. Consequently, the ratio of debt to income has been little changed, at close to 150 per cent.

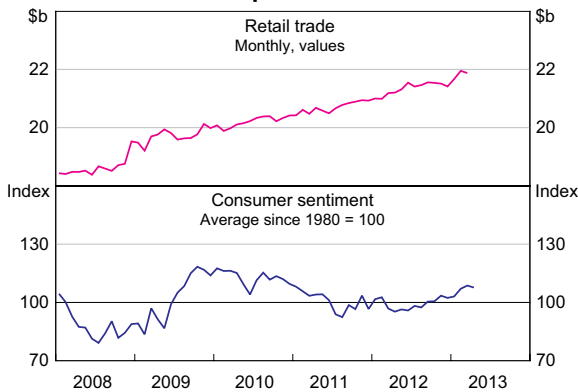
Indications are that growth in household consumption strengthened in the early months of 2013. After having slowed considerably late last year, the value of retail sales – which primarily captures sales of goods – picked up strongly in the March quarter, to be 3¾ per cent higher over the year (Graph 3.2). Growth in the quarter was broad based, with sales increasing for all categories of retailers. The volume of retail sales also grew

strongly, and by a little more than values as retail prices fell slightly in the quarter. Information from the Bank's liaison suggests that retail sales rose further in April. The strengthening in sales growth this year coincided with consumer sentiment being above average levels. Consumers' expectations of unemployment have also fallen from recent peaks, while reported buying conditions for dwellings and motor vehicles remain around their highest levels for a decade. Consistent with this, motor vehicle sales to households have remained at a high level in early 2013; although sales fell over the four months to April, they were 10 per cent higher than a year ago. The high value of the Australian dollar, along with continued strong competition, has kept motor vehicle prices low and helped to stimulate sales.

Despite some weakness in consumption in the December quarter, consumption imports were boosted by motor vehicle imports, which increased by almost 14 per cent over 2012. Consumption imports grew in the March quarter, once again reflecting growth in motor vehicle imports.

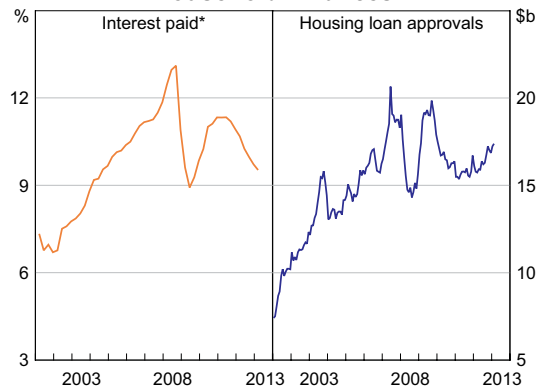
Reductions in interest rates late last year have lowered households' interest payments further, to around 9½ per cent of household disposable income in the March quarter, close to the lowest share of income in recent years (Graph 3.3). There are signs of an increasing appetite for borrowing in the household

Graph 3.2
Consumption Indicators



Sources: ABS; Melbourne Institute and Westpac; Roy Morgan Research

Graph 3.3
Household Finances



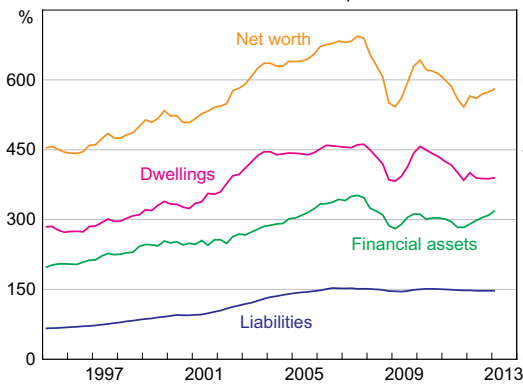
* Per cent of household disposable income; household sector excludes unincorporated enterprises; disposable income is after tax and before the deduction of interest payments; RBA estimate for March quarter 2013
Sources: ABS; APRA; RBA

sector, with approvals for both housing and personal loans increasing over recent months, although loan approvals to first home buyers remain subdued (see the 'Domestic Financial Markets' chapter for details).

Sentiment in the household sector has been boosted by strong growth in household net worth over the past year, driven by large rises in equity prices and moderate dwelling price inflation (Graph 3.4). Household net worth grew by 1½ per cent in the December quarter to be around 9 per cent higher over the year, and is estimated to have risen by a further 3 per cent in the March quarter.

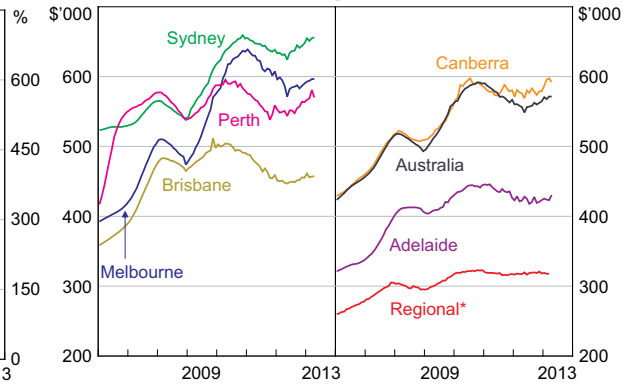
The improvement in conditions in the established housing market since mid 2012 has continued in early 2013 (Graph 3.5, Table 3.2). Australian capital city dwelling prices rose by around 1 per cent over the three months to March and are around 4 per cent above their low point of mid 2012. Price rises have been relatively broad based, with most state capitals recording increases over the first few months of the year. Auction clearance rates have also increased substantially over the past year, and are now well above average in Sydney and around average levels in Melbourne.

Graph 3.4
Household Wealth and Liabilities*
Per cent of annual household disposable income



* Household liabilities exclude the liabilities of unincorporated enterprises; disposable income is after tax and before the deduction of interest payments; RBA estimates for March quarter 2013
Sources: ABS; RBA; RP Data-Rismark

Graph 3.5
Dwelling Prices



* Excluding apartments; measured as areas outside of capital cities in mainland states
Sources: RBA; RP Data-Rismark

Table 3.2: National Housing Price Growth
Per cent

	3 months to December 2012	3 months to March 2013	Year to March 2013
Capital cities			
ABS ^{(a), (b)}	2.0	0.1	2.6
APM ^(b)	1.9	0.9	2.4
RP Data-Rismark	0.3	1.2	2.4
Regional areas			
APM ^(b)	0.9	1.6	1.8
RP Data-Rismark ^(a)	-0.5	-0.1	0.1

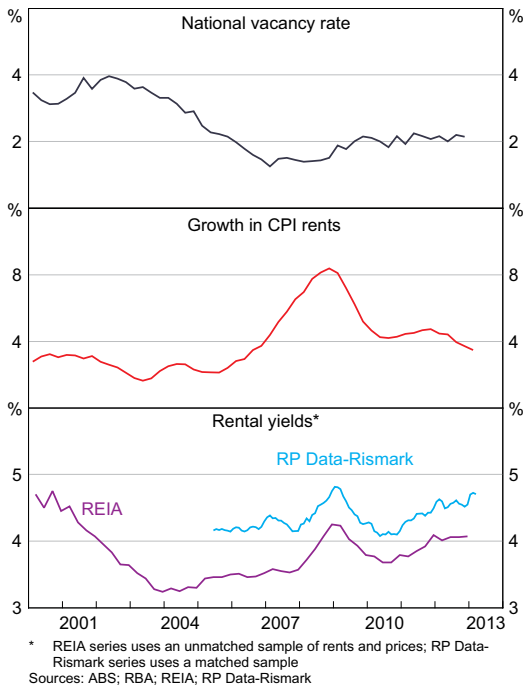
(a) Detached houses only

(b) Quarter-on-quarter growth rate

Sources: ABS; APM; RBA; RP Data-Rismark

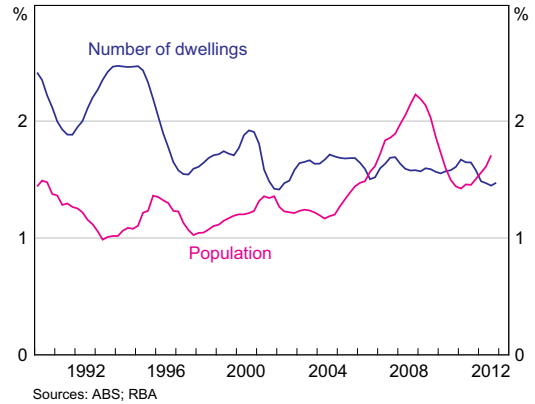
The pick-up in dwelling prices is likely to have been supported by the relatively tight rental market. Nationwide, rental vacancy rates in the December quarter were a little over 2 per cent, around where they have been for the past 3½ years and quite a bit lower than their average over the 1990s and early 2000s (Graph 3.6). In line with relatively low vacancy rates, rents have been rising at an annual rate of around 4 per cent for some time and rental yields are around their highest levels for several years. Rental yields and growth in rents are particularly high in Perth, and to a lesser extent in Sydney, while the rental market is a little softer in Adelaide and Melbourne.

**Graph 3.6
Rental Market**



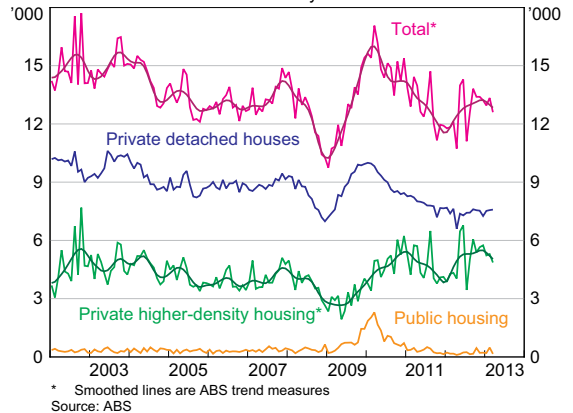
The tight rental market, together with rising dwelling prices and low lending rates, have contributed to a recovery in dwelling investment from relatively low levels. Over recent years, growth in the dwelling stock has been weak relative to growth in the population, which has picked up recently (Graph 3.7). After falling over 2011/12, residential construction

**Graph 3.7
Dwelling and Population Growth**
Year-ended



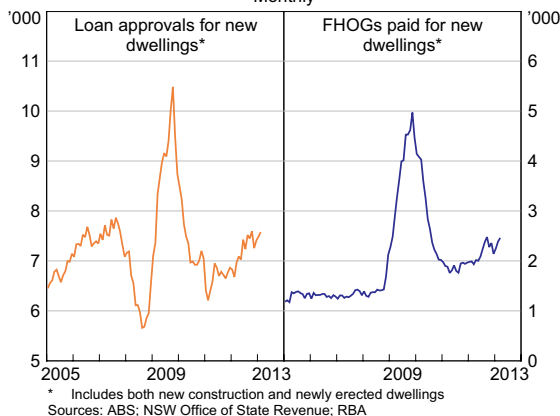
activity increased over the second half of 2012, to be 3 per cent higher than its trough in the June quarter 2012. The increase in private residential building approvals over the past year points to some further rise in activity in the near term, although approvals have eased a little recently (Graph 3.8). Unlike in previous upswings, however, the pick-up in building approvals to date has been concentrated in higher-density housing, notwithstanding a small fall over the past few months. Detached housing approvals are yet to show clear signs of recovery. There has also been notable variation across regions (for further details, see 'Box A: Regional Developments in Dwelling Approvals').

**Graph 3.8
Residential Building Approvals**
Monthly



A number of other forward-looking indicators point to a further recovery in dwelling investment over the months ahead. Notwithstanding a fall in late 2012, loan approvals – and first home owner grants – for new dwellings have increased over the past year or so (Graph 3.9). This has been particularly evident in recent months in Western Australia, New South Wales and Queensland. Activity in the latter two states appears to be benefiting from changes by state governments to direct their support for first home buyers towards purchases of new, rather than existing, dwellings. The Bank’s business liaison also suggests that demand for new housing is improving from low levels, with enquiries from prospective purchasers and visits to display homes increasing.

Graph 3.9
Indicators of Dwelling Investment
Monthly



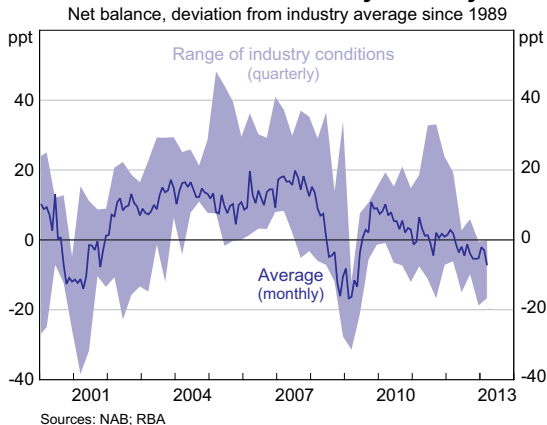
Business Sector

Growth in business investment eased in the December quarter, reflecting a fall in machinery and equipment investment and slower growth in engineering construction. Business investment, however, remained at an elevated level as a share of GDP, as further growth in mining investment largely offset weakness in non-mining investment. In line with some deterioration in survey measures of business conditions, company profits declined in the quarter. This was driven by a fall in mining profits as earlier falls in spot prices flowed through

to prices received by Australian exporters. Profits in the non-mining economy also declined slightly, particularly in the manufacturing and wholesale trade sectors. Indicators for the March quarter suggest that business conditions remained a little below their long-run average levels.

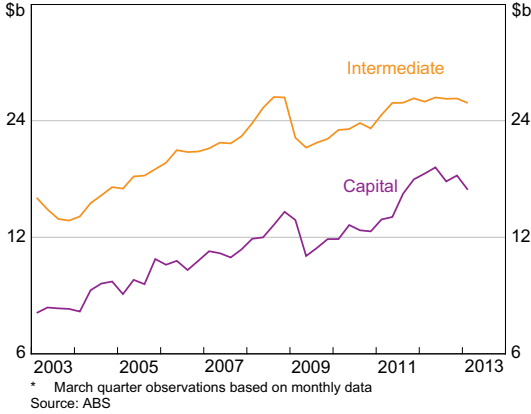
Following some improvement early in the year, survey measures of business conditions fell in March and remain somewhat below long-run average levels (Graph 3.10). In contrast, forward-looking indicators of business confidence have picked up recently to around average levels. Business surveys suggest that expectations of investment growth have also picked up a little, though they remain at low levels. Other timely indicators of near-term growth in business investment remain subdued. Capital imports have fallen and indicators of capacity utilisation are a little below long-run average levels. Liaison continues to suggest that the reluctance of some firms to invest reflects concerns about the strength of demand, general uncertainty about the economic outlook and a focus on containing costs.

Graph 3.10
Business Conditions by Industry
Net balance, deviation from industry average since 1989



In line with weaker demand from businesses, growth in imports eased in the second half of 2012, driven by declines in capital imports (Graph 3.11). The fall in capital imports in part owes to weakness in volatile components related to large ‘lumpy’ mining-related investment. Also, there has been little growth in

Graph 3.11
Import Values*
 Log scale, Quarterly

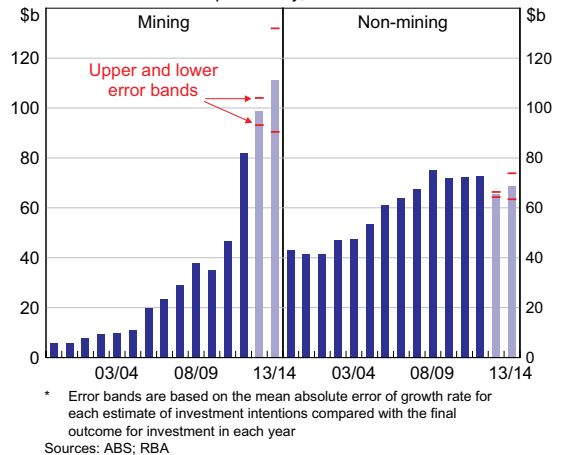


intermediate imports over the past year. Weakness in the growth in overall import volumes is estimated to have continued into the March quarter. This reflects both continued weakness in capital imports and falls in intermediate imports, although the latter largely reflects oil imports, which tend to be volatile.

As discussed in the 'Domestic Financial Markets' chapter, business funding has been subdued recently, consistent with the weakness in non-mining investment. Business credit has been little changed over the past six months, although there has been some growth in other debt funding. Growth in equity funding has been generally subdued recently, compared with above-average growth in late 2011 and early 2012. In contrast, internal funding has remained only a little below its decade average as a share of GDP, in line with developments in business profits. Overall, businesses appear to be in a position to fund additional investment, with large holdings of cash and other liquid assets on their balance sheets, and generally good access to external sources of funds.

Despite some weakness in the near-term indicators of business investment, the latest ABS capital expenditure (Capex) imply that investment is likely to grow in 2013/14 (Graph 3.12). These data actually suggest that the increase in investment may be largest in the mining sector, with further growth in building and structures offsetting falls in machinery and equipment investment. However, the early releases for the Capex survey tend to be a less reliable guide for mining investment than for non-mining business investment. Given the uncertainty around these estimates, and that information from company statements and the Bank's liaison suggest that mining companies have scaled back their investment intentions since the middle of last year, it seems likely that mining investment in 2013/14 will remain around current levels. This reflects the large stock of resource projects already committed to, which is expected to keep mining investment at an elevated level for some time.

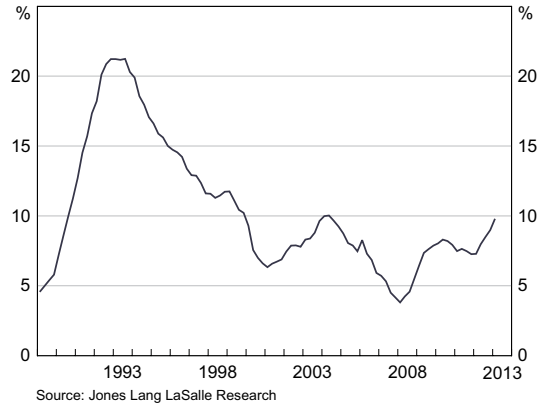
Graph 3.12
Capital Expenditure Intentions
 Capex survey, nominal



The Capex survey suggests that non-mining investment will increase in 2013/14, with growth in both machinery and equipment investment and buildings and structures investment. This expectation is also subject to a degree of uncertainty. Other indicators of private non-residential building investment, particularly for the near term, remain subdued. Building approvals have trended lower over much of the past year, although they were boosted in early 2012 by two large healthcare projects, which also account for much of the increase in the stock of work yet to be done (Graph 3.13).

Conditions in the office property market continue to weigh on non-residential building activity. While there was a large increase in office approvals in March, this was concentrated in Queensland. Vacancy rates in all major markets have increased over the past year, and the national vacancy rate is now 2½ percentage points above its decade average and at the highest level since mid 2004 (Graph 3.14). Conditions in other commercial property markets also remain subdued, with real rents little changed or lower over the past year.

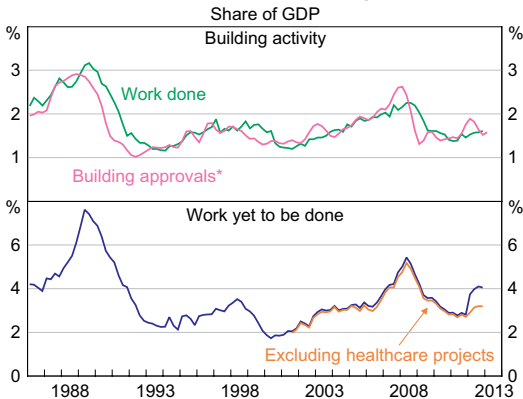
Graph 3.14
National Office Vacancy Rate
Excluding Darwin and Hobart



Farm Sector

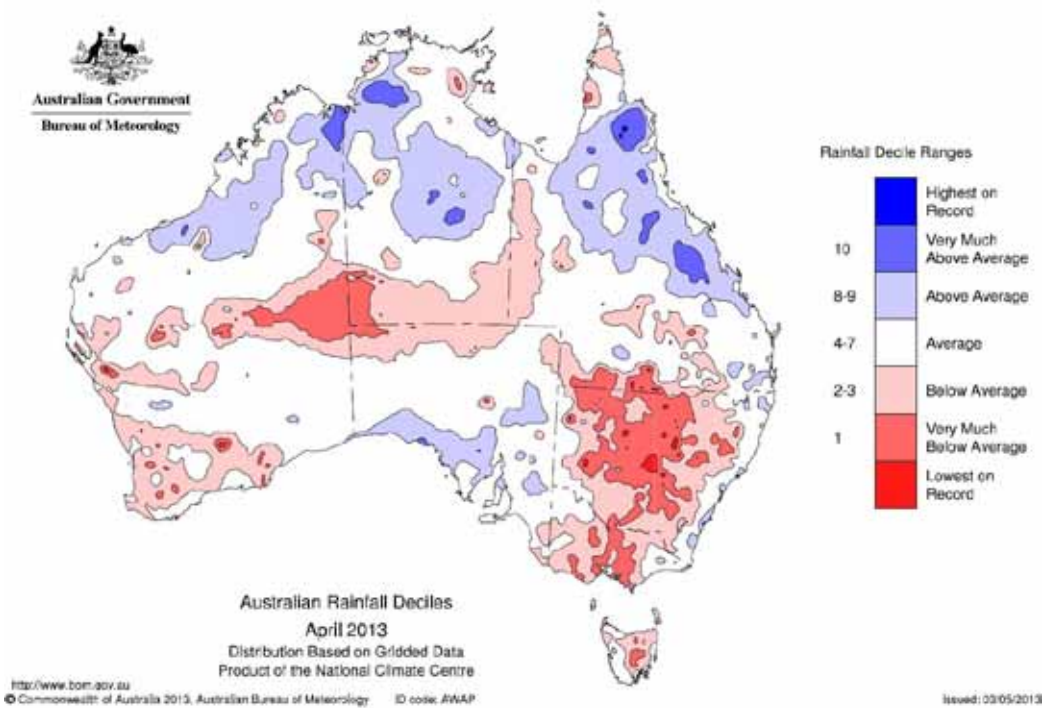
The Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) expects farm incomes to decline in 2012/13, but to remain at a high level by historical standards. The decline in incomes in the year reflects lower prices as well as a fall in crop production. Prices for livestock and livestock products (such as wool) are estimated to be 9 per cent lower in 2012/13. The winter crop in 2012 is expected to have been more than 20 per cent lower than the crop in 2011. Despite this fall, the 2012 winter crop is estimated to have been around the average level of the past decade, with the record crop of the previous year having been boosted by rainfall that was well above average. Currently, conditions in some cropping regions are dry, and rainfall in coming weeks will be necessary to enable successful sowing of the winter crop (Graph 3.15).

Graph 3.13
Non-residential Building Work



* 7-period Henderson trend; RBA estimate for March quarter 2013
Sources: ABS; RBA

Graph 3.15
Australian Rainfall
 April 2013

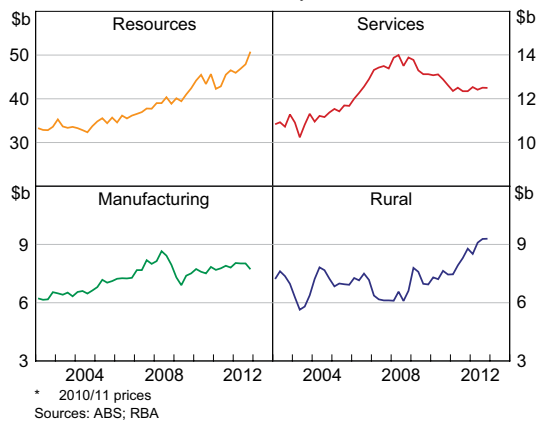


Source: Bureau of Meteorology

External Sector

Exports made a sizeable contribution to growth in the December quarter, largely reflecting strong growth in resource exports (Graph 3.16). Coal exports rose sharply owing to increased demand from China, in addition to a recovery from earlier supply disruptions to coking coal production. Iron ore export volumes also grew noticeably, as the utilisation of expanded mine, rail and port infrastructure increased. Outside of resource exports there was little growth. There was a broad-based decline in manufactured goods exports, while rural exports increased marginally, despite a fall in wheat exports, as wool and meat exports increased. Services export volumes were flat in the quarter, and were only slightly higher over the past year as declines in education-related exports have largely offset rises in tourism exports.

Graph 3.16
Export Volumes*
 Quarterly



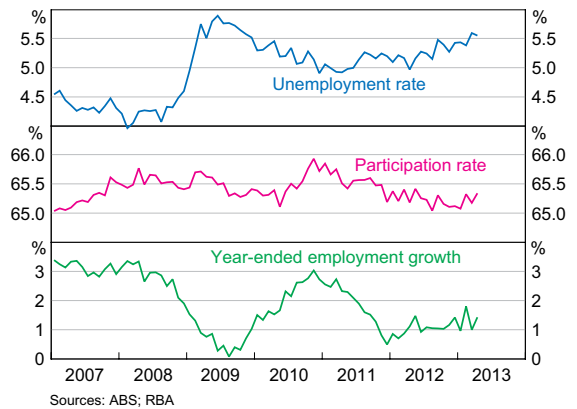
Export volumes are estimated to have grown moderately in the March quarter. Growth in resource exports appears to have slowed, reflecting both a fall in crude oil exports and more subdued growth in coking coal volumes due to floods in Queensland in early 2013, although the disruptions have been smaller than occurred in 2011. Iron ore exports are estimated to have increased at a pace similar to the past three quarters, as producers continue to ramp up production. Outside the resource sector, services exports appear to have grown in the quarter. The number of overseas arrivals has softened recently, although liaison suggests that tourism exports in 2013 are likely to continue to be boosted by growth in arrivals from China. Liaison also indicates that education exports have stabilised. Rural and manufactured exports appear to have been little changed in the quarter.

Labour Market

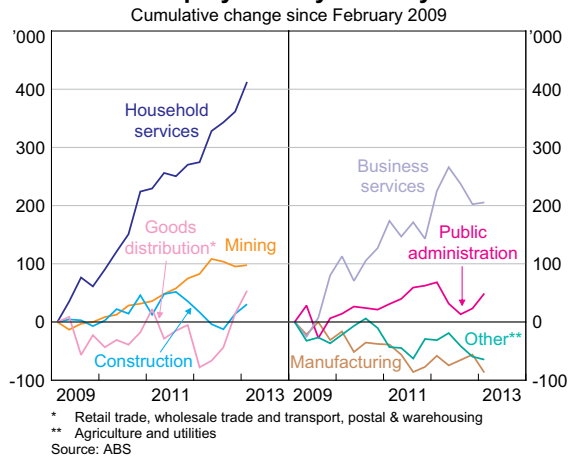
Labour market conditions have remained somewhat subdued over recent months. The unemployment rate has risen a little further and trend employment growth has remained below the rate of growth in the working-age population (Graph 3.17). After declining from its peak in late 2010, the participation rate has been broadly stable over the past year, owing to a stabilisation in the participation rate of prime-age males. Average hours worked have remained at a relatively low level and most of the increase in aggregate employment over the past six months can be attributed to growth in part-time employment.

There has been a further shift in employment growth away from mining and business services, with employment in these industries remaining below the peaks reached in 2012 (Graph 3.18). In contrast, the household services sector, which includes health care and education, has continued to make a significant contribution to aggregate employment growth. There has also been a pronounced rise in employment in the goods distribution sector

Graph 3.17
Labour Market



Graph 3.18
Employment by Industry



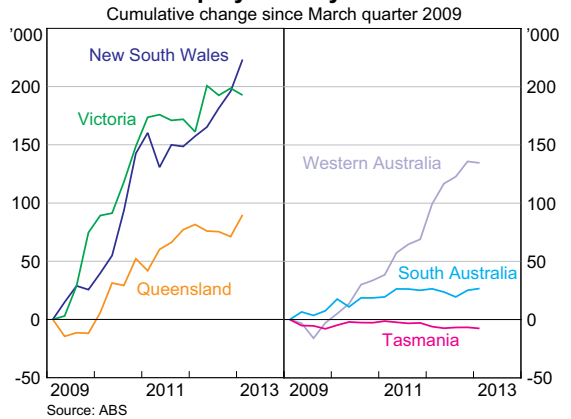
over the past year, driven by strong employment growth in the wholesale trade and transport, postal & warehousing industries. Over the six months to February, employment picked up in the construction industry, consistent with the beginning of a recovery in dwelling investment. The level of employment in manufacturing has been little changed over the past 18 months, after having declined by around 10 per cent over the preceding decade.

The pace of aggregate employment growth across the states has also been shifting (Graph 3.19). In Western Australia, employment growth has slowed

in recent months, reflecting the weaker conditions in the mining industry. Employment growth has continued to pick up in New South Wales, while labour market conditions in Queensland look to have improved after a period of weakness. Conditions have stabilised in South Australia, but remain subdued in Victoria and Tasmania.

Leading indicators of employment growth have been mixed recently, although they remain at relatively low levels (Graph 3.20). The quarterly ABS measure of job vacancies fell in the three months to February, to be around 18 per cent lower over the year. On the other hand, after pronounced declines in 2012, measures of job advertisements have been relatively stable since the start of the year. Business survey measures of hiring intentions remained at or slightly below average levels in the March quarter, while reports from the Bank's liaison suggest that firms remain cautious about hiring staff.

Graph 3.19
Employment by State



Graph 3.20
Labour Market Indicators

