

3. Domestic Economic Conditions

In 2013/14, the Australian economy grew in year-average terms at a pace that was a bit below trend (Table 3.1).¹ Exports made a large contribution to growth, supported by ongoing capacity expansion in the resources sector, particularly for iron ore (Graph 3.1). Dwelling investment strengthened markedly relative to a year earlier, supported by low interest rates and rising housing prices, and growth of consumption picked up. However, business investment fell in 2013/14, reflecting the fact that non-mining businesses have remained reluctant to increase their investment and mining investment has been declining. Public demand made a positive contribution to growth.

Labour market conditions remain subdued. The unemployment rate has risen a little over the past six months and growth in wages is low. Leading indicators of labour demand have picked up since the beginning of the year and point to modest employment growth over coming months.

Timely economic indicators and liaison suggest that GDP growth is likely to have been a little below trend in the September quarter, with growth of exports and non-mining activity offsetting a decline in mining investment. Retail sales growth has strengthened of late, though measures of consumer confidence remain at or below average. Survey measures of business conditions and confidence are close to their long-run averages.

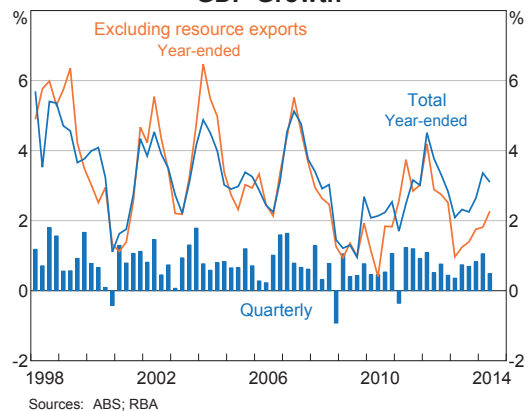
¹ The 2013/14 annual national accounts contain the most recent data on GDP. The June quarter 2014 national accounts, which were released prior to the annual national accounts, contain the most recent data on quarterly movements in GDP.

Table 3.1: Demand and Output Growth^(a)
Year average, per cent

	2013/14
GDP	2.5
Domestic final demand	1.2
– Private demand	0.9
– Consumption	2.2
– Dwelling investment	4.7
– Business investment ^(b)	-4.8
– Public demand ^(b)	1.5
Change in inventories ^(c)	-0.4
Gross national expenditure	0.8
Exports	5.8
Imports	-2.1
Nominal GDP	4.1
Real gross domestic income	1.7

(a) Based on 2013/14 release of the annual national accounts, rather than the June quarter 2014 release
 (b) Excludes net purchases of second-hand assets
 (c) Contribution to GDP growth
 Sources: ABS; RBA

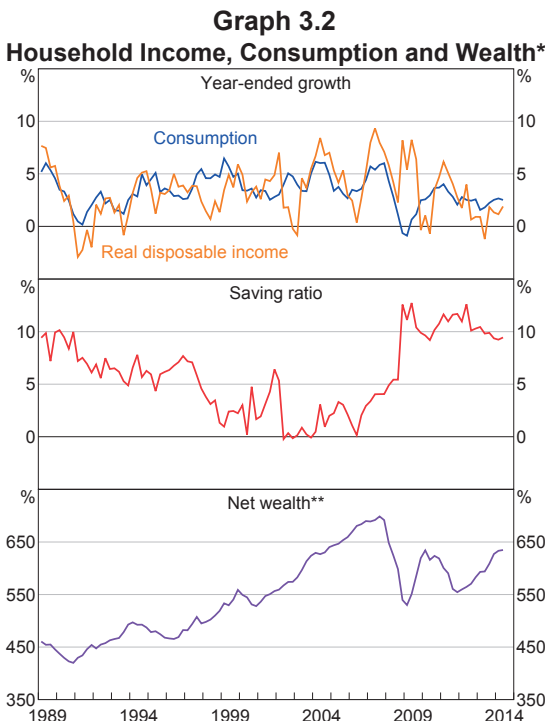
Graph 3.1
GDP Growth



Household Sector

Household consumption increased at a moderate pace over the first half of 2014, reflecting the net effect of low growth in income on the one hand and very low interest rates and strong increases in wealth on the other (Graph 3.2). Real household disposable income grew at well below its decade-average pace over the year to June, mostly as a result of subdued growth in labour income.

The strong growth in net household wealth over the past two years largely reflects increases in housing prices. Higher equity prices have also contributed (see the 'Domestic Financial Markets' chapter for more details). The strong growth in net wealth is consistent with consumption growing faster than income and, hence, the gradual decline in the saving ratio recorded over the past couple of years.



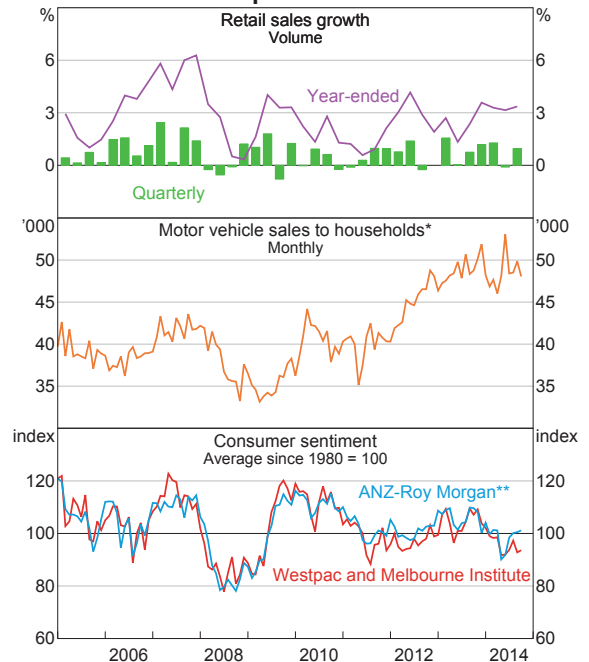
* Household sector includes unincorporated enterprises; disposable income is after tax and interest payments; income level smoothed with a two-quarter moving average between March quarter 2000 and March quarter 2002; saving ratio is net of depreciation

** Per cent of annual household disposable income, before the deduction of interest payments

Sources: ABS; RBA

Timely consumption indicators are consistent with moderate household consumption growth. Retail sales volumes increased by 1 per cent in the September quarter and liaison points to a further increase in October (Graph 3.3). Motor vehicle sales to households have remained at a high level recently. While retail and motor vehicle sales broadly correspond to the consumption of household goods (as measured in the national accounts), around two thirds of total household consumption is accounted for by services. There are fewer timely indicators for consumption of household services, although it tends to be less volatile than household goods consumption. Measures of consumer sentiment have diverged in recent months to be at or below average levels.

Graph 3.3
Consumption Indicators



* Seasonally adjusted by the RBA

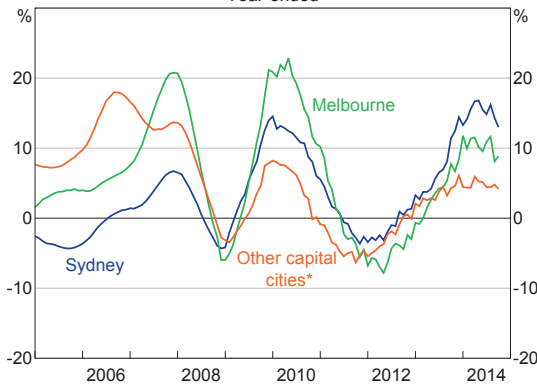
** Rescaled to have the same average as the W-MI index since 1996

Sources: ABS; ANZ- Roy Morgan; FCAI/FACTS; RBA; Westpac and Melbourne Institute

Nationwide housing prices increased by around 2 per cent over the three months to October. This is slower than the rapid pace observed in late 2013, but faster than recent growth in household income. Housing price inflation over the past year has been

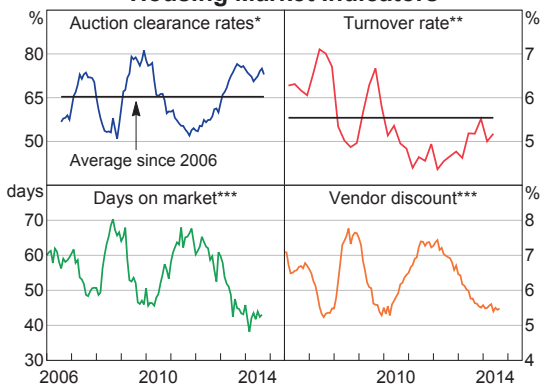
highest in Sydney and Melbourne, where investor demand has been particularly strong (Graph 3.4). Non-price indicators also remain consistent with strong conditions in the established housing market. Auction clearance rates remain at above-average levels and average days on market and vendor discounts remain at very low levels (Graph 3.5). The increase in housing prices has been associated with an increase in the value of loan approvals and housing turnover, although not by as much as would be expected based on earlier episodes of strong housing market conditions (see 'Box A: Housing Prices, Turnover and Borrowing').

Graph 3.4
Housing Price Growth
Year-ended



* Weighted by share of dwelling stock
Sources: ABS; RBA; RP Data-Rismark

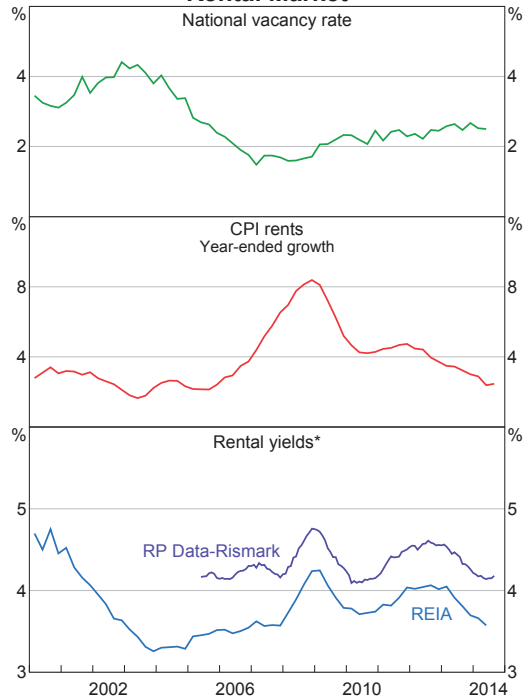
Graph 3.5
Housing Market Indicators



* Average of Melbourne and Sydney
** Share of dwelling stock, annualised
*** Capital city dwelling stock weighted median, private treaty sales only
Sources: Australian Property Monitors; RBA; Real Estate Institute of Victoria; RP Data-Rismark

The nationwide rental vacancy rate was little changed in the June quarter and remains a little above the level of recent years (Graph 3.6). Consistent with this, rental price inflation has slowed over the past year, which, combined with the faster pace of housing price growth, has resulted in further declines in rental yields.

Graph 3.6
Rental Market



* REIA series uses an unmatched sample of rents and prices; RP Data-Rismark series uses a matched sample and has been seasonally adjusted by the RBA

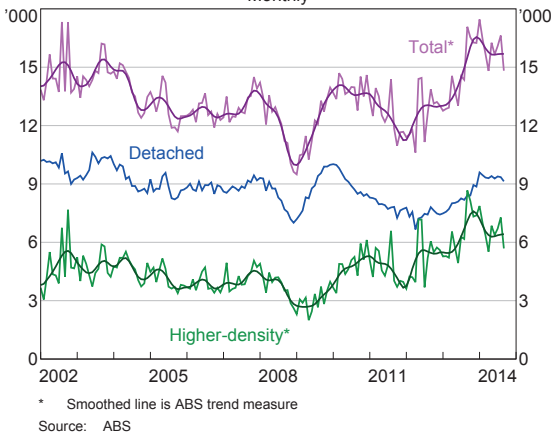
Sources: ABS; RBA; REIA; RP Data-Rismark

Dwelling investment continues to grow strongly, supported by low interest rates, strong population growth and rising housing prices. There has been a strong rise in construction activity for both detached and higher-density housing. In contrast, alterations and additions activity declined over the year to June and remains relatively low.

Forward-looking indicators continue to point to above-average growth in dwelling investment. Building approvals have been at a high level since late 2013, with some volatility reflecting movements

in the higher-density component (Graph 3.7). Building approvals for detached dwellings have been little changed since March. Loan approvals for new dwellings have increased by 8 per cent over the year to August and the number of first home owner grants (FHOGs) paid for new dwellings has continued to trend higher in all states, increasing by 34 per cent over the past year (Graph 3.8).

Graph 3.7
Private Dwelling Approvals
Monthly



Graph 3.8
Indicators of Dwelling Investment*
Owner-occupier, monthly

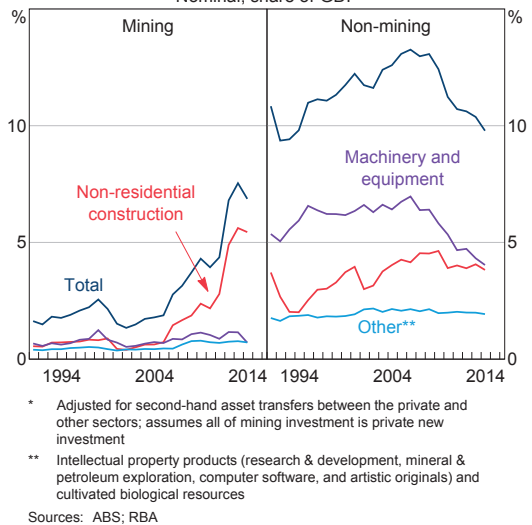


Business Sector

Mining investment declined by 7 per cent in 2013/14 as further progress was made on existing large mining projects but few new projects got

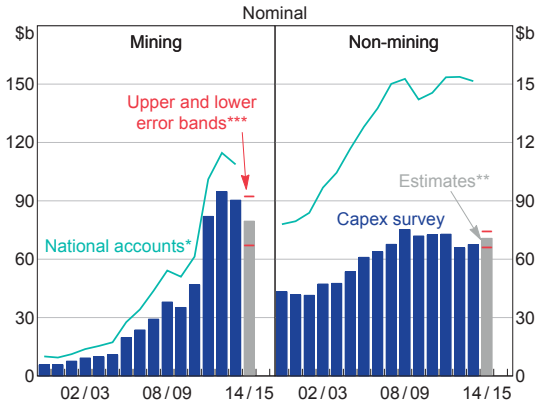
underway (Graph 3.9). This subtracted around ½ percentage point from GDP growth in the year, although the effect on domestic activity is lower after taking account of the imported content of mining investment. Since its peak in mid 2012, the decline in mining investment has been driven by falls in investment in both machinery & equipment and buildings & structures; resource exploration activity remained largely unchanged over that period. The latest estimate derived from the ABS capital expenditure (Capex) survey suggests that a further fall in mining investment is in prospect in 2014/15, led by a sharp decline in building & structures investment (Graph 3.10). The Bank's liaison also points to larger declines in mining investment over the next couple of years than have been seen to date.

Graph 3.9
Private Business Investment*
Nominal, share of GDP



Non-mining investment declined a little in real terms in 2013/14, and is very low as a share of nominal GDP relative to history. Subdued non-mining investment in recent years is consistent with modest growth in demand, spare capacity, the still high level of the exchange rate and firms' low appetite for risk. Nevertheless, over the past year or so there has been a gradual increase in the pace of economic activity outside of the mining sector and there are indications that non-mining investment will pick up in the next year. The latest estimates derived

Graph 3.10
Private Business Investment



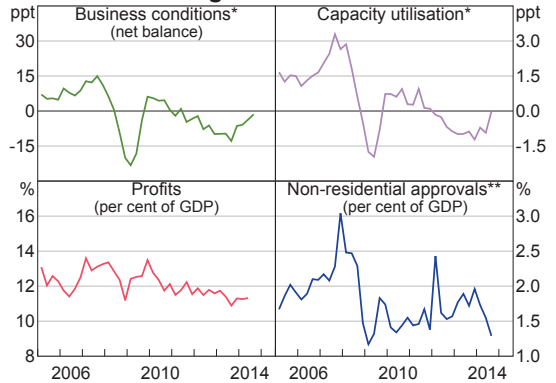
* Adjusted for second-hand asset transfers between the private and other sectors; excluding cultivated biological resources
 ** Estimates are firms' expected capital expenditure, adjusted for the past average difference between expected and realised spending
 *** Error bands are based on the root mean square error of each adjusted estimate compared with the final outcome for investment in each year
 Sources: ABS; RBA

using the Capex survey point to modest growth in non-mining investment in 2014/15, led mainly by a pick-up in machinery & equipment investment. Survey measures of non-mining business conditions and confidence have increased over the past year and are around average levels (Graph 3.11). Survey measures of capacity utilisation have risen since early 2013 to be around long-run average levels. Business surveys also suggest that investment intentions in the non-mining sector have increased to around average levels. The stock of work yet to be done on large non-residential building projects has increased further over the past year or so and will support activity in the near term. However, non-residential building approvals have trended lower since the start of the year to relatively low levels and office vacancy rates have been increasing. This is consistent with weak underlying conditions in the commercial property market.

Farm Sector

The Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) forecasts that farm production will fall by 5 per cent in 2014/15 (Graph 3.12). This reflects expectations of crop

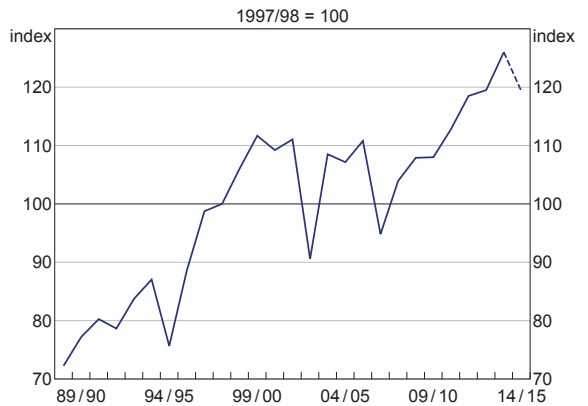
Graph 3.11
Non-mining Business Indicators



* Investment share weighted; deviation from average since 1989; three-month moving average
 ** RBA forecast for the September quarter 2014
 Sources: ABS; NAB; RBA

and livestock production declining from relatively high levels in 2013/14. The Bureau of Meteorology calculates that there is a 50 per cent chance of an El Niño weather pattern developing over coming months and rainfall is likely to be below average over much of Australia for the remainder of 2014. This follows below-average rainfall in much of Queensland, New South Wales and south west Western Australia over the past year.

Graph 3.12
Volume of Farm Production*

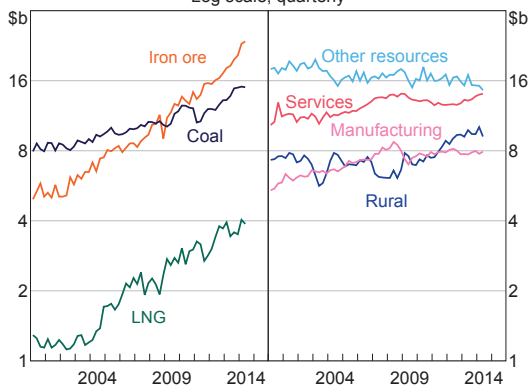


* The solid line represents ABARES' estimate while the dotted line represents ABARES' 2014/15 forecasts
 Source: ABARES

External Sector

Export volumes grew at an above-average pace over the first half of 2014, driven by bulk commodities (Graph 3.13). A decline in the level of overall exports in the June quarter partly reversed strong growth in the March quarter. Service export volumes increased a little over the first half of the year, reflecting increases in exports of education, tourism and 'other' services (which include financial and other business services). In the September quarter, resource exports look to have grown at an above-average pace, supported by a higher volume of exports from existing mines and ongoing capacity expansions.

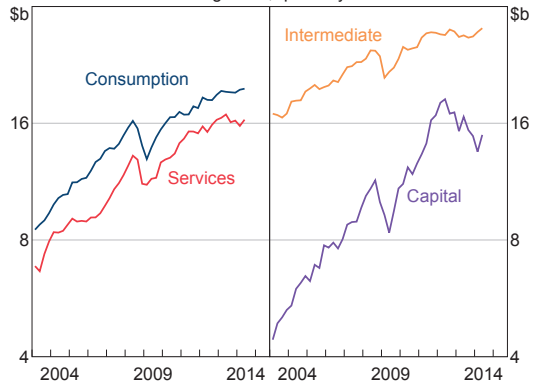
Graph 3.13
Export Volumes*
Log scale, quarterly



* 2011/12 prices
Sources: ABS; BREE; RBA

Import volumes grew strongly in the June quarter, led by capital imports, although growth was broad-based across all components (Graph 3.14). However, imports are lower than a year ago, consistent with moderate growth in domestic spending, partly as a result of the decline in mining investment. The depreciation of the exchange rate since early 2013 may also have weighed on imports.

Graph 3.14
Import Volumes*
Log scale, quarterly



* 2011/12 prices
Source: ABS

Labour Market

Labour market conditions remain subdued. The monthly labour force data have been especially volatile of late and affected by some measurement issues related to seasonality. On revised estimates, employment appears to have increased by around 1 per cent since the turn of the year, which is somewhat below population growth (Graph 3.15). The unemployment rate has risen over the past six months to 6.2 per cent. The participation rate has been little changed over that period.

Graph 3.15
Labour Market

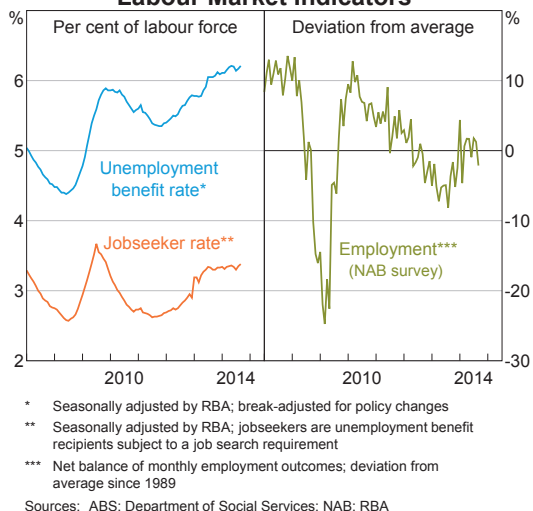


Source: ABS

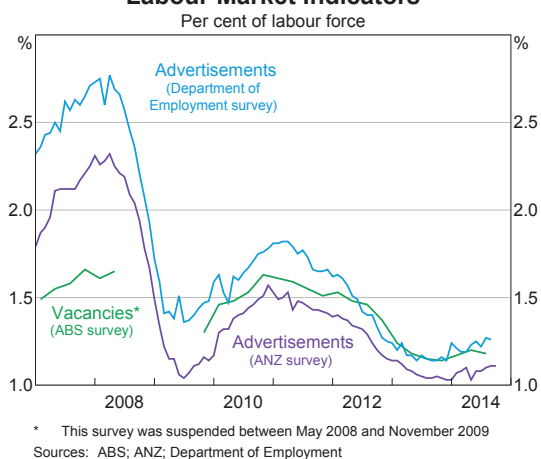
Meanwhile, the number of people collecting unemployment benefits and subject to a job search requirement has stabilised (as a proportion of the labour force) over the course of this year, after having increased over the preceding two years (Graph 3.16). Similarly, business surveys indicate that monthly employment outcomes have been close to long-run average levels over 2014 to date, and reports from the Bank's liaison suggest that employment intentions are higher than they were a year ago. Also, the leading indicators of labour demand have generally improved since last year (Graph 3.17). The ABS measure of job vacancies has increased since its trough at the end of 2013, while measures of job advertisements have also trended higher over the course of the year.

Despite signs of stabilisation in a few indicators, there remains a degree of spare capacity in the labour market. The unemployment rate is around its highest level since the early 2000s, and above the level that statistical estimates suggest would be consistent with stable domestic inflationary pressures.² The participation rate is around its lowest level in the past eight years and average hours worked have declined a little in recent years. Consistent with this, cyclically sensitive components of unemployment, such as the medium-term unemployment rate and involuntary unemployment, have also increased (Graph 3.18). These provide some signal about the degree of spare capacity and account for much of the increase in the unemployment rate over the past few years. The youth unemployment rate, which is also sensitive to the business cycle, has increased by a bit more relative to the aggregate unemployment rate than it has in previous episodes. The employment-to-population ratio and participation rate for this age group have also fallen significantly in the current episode, alongside an increase in the proportion of young people attending full-time education. Long-term unemployment, which is likely to reflect more

Graph 3.16
Labour Market Indicators



Graph 3.17
Labour Market Indicators

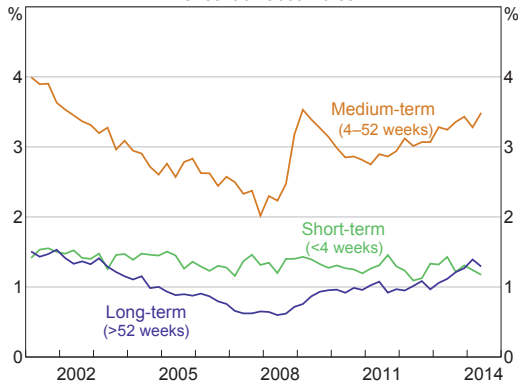


structural or enduring influences on unemployment, has increased since the beginning of 2013.

The change in the composition of economic activity away from the resources sector has been apparent in employment outcomes in recent quarters. Mining employment appears to have declined somewhat recently (Graph 3.19). Lower demand for construction

2 More detail is contained in Ballantyne A, D De Voss and D Jacobs (2014), 'Unemployment and Spare Capacity in the Labour Market', RBA Bulletin, September, pp 7–20.

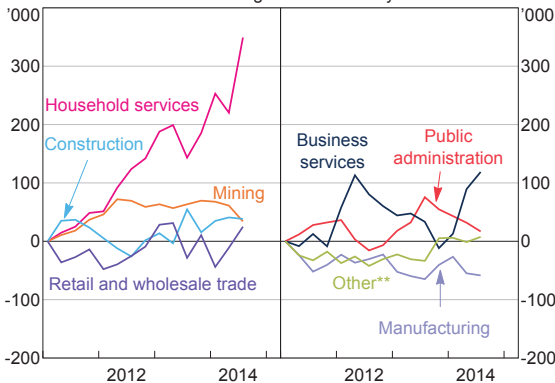
Graph 3.18
Unemployment by Duration*
 Per cent of labour force



* Unemployment spell ended with a period of work of one hour or more from July 2014 onwards, and two weeks or more prior to this; seasonally adjusted by RBA up to June quarter 2014 and non-seasonally adjusted data used for the latest quarter

Sources: ABS; RBA

Graph 3.19
Employment Growth by Industry*
 Cumulative change since February 2011



* Non-seasonally adjusted data used for the latest quarter

** Includes agriculture, forestry & fishing; transport, postal & warehousing; and electricity, gas, water & waste services

Source: ABS

workers in the resources sector appears to have been more than offset by increases in demand from other sources of construction employment. Hence, overall construction employment has increased since the beginning of the year, particularly in New South Wales, consistent with growth in construction activity. Liaison suggests that construction employment is likely to increase further over the year ahead. Meanwhile, business services employment has recovered to be close to its historical peak. Employment in household-focused industries has also increased. The household services sector has continued to experience strong employment growth, driven by the health and education industries. Employment in retail and wholesale trade has picked up. Alongside the changing patterns of labour demand across industries and regions, there has been a shift in the pattern of population growth at the state level. Both net overseas immigration and net interstate immigration have picked up in New South Wales and Victoria. In contrast, the pace of population growth has slowed from high levels in the resource-intensive states of Western Australia and Queensland. ❖