

3. Domestic Economic Conditions

Growth in the Australian economy remained a bit below average over 2014, and looks to have continued at a similar pace in early 2015 (Graph 3.1; Table 3.1). Dwelling investment has grown strongly over the past year and growth of household consumption picked up towards the end of 2014. In contrast, non-mining business investment has been subdued, although many of the conditions typically associated with stronger investment are in place. Activity in the mining sector has continued to expand, with strong growth of resource exports more than offsetting large declines in mining investment. Public demand was unchanged over 2014, consistent with fiscal consolidation by state and federal governments. Nominal GDP growth has been relatively weak, in line with the declines in the terms of trade.

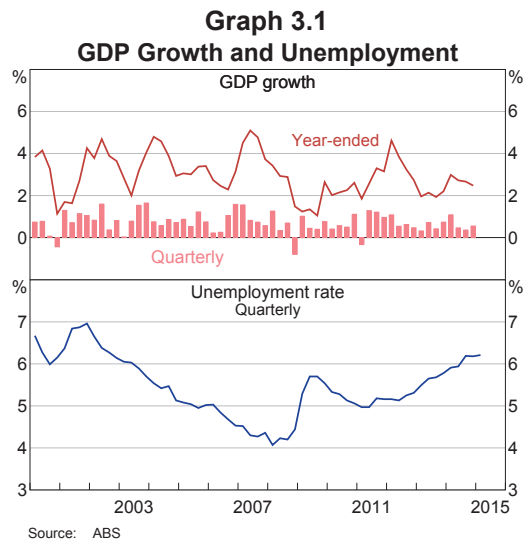


Table 3.1: Demand and Output Growth
Per cent

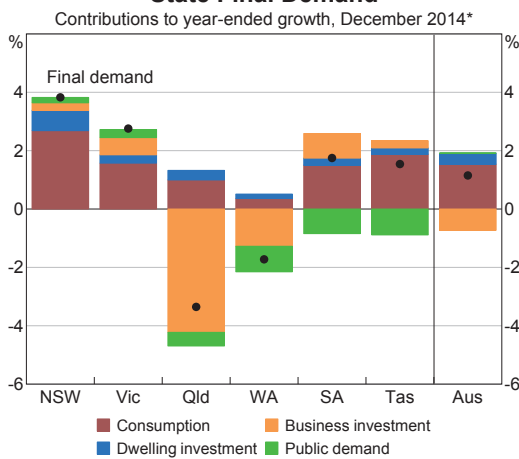
	December quarter 2014	September quarter 2014	Year to December quarter 2014
GDP	0.5	0.4	2.5
Consumption	0.9	0.6	2.8
Dwelling investment	2.5	-1.2	8.1
Mining investment ^(a)	-4.8	-5.0	-13.3
Non-mining investment ^(a)	1.9	0.6	2.0
Public demand	0.3	-1.0	0.0
Exports	1.0	3.6	7.2
Imports	-2.5	-0.7	-2.6
Nominal GDP	0.6	-0.1	1.7
Real gross domestic income	0.2	-0.4	0.1

(a) RBA estimates
Sources: ABS; RBA

There is general evidence of spare capacity in the labour market. However, recent trends appear to have been a little better over the past six months than earlier indicated, following recent data revisions. Leading indicators of labour demand continue to suggest modest employment growth over the coming quarters.

Low interest rates have been supporting economic activity across the country. Dwelling investment and consumption, the sectors of the economy most sensitive to changes in interest rates, contributed to growth in all states over 2014 (Graph 3.2). Outside New South Wales and Victoria, growth has been constrained by a decline in public demand and, in Queensland and Western Australia, large declines in mining-related business investment.

Graph 3.2
State Final Demand



* Contributions may not sum as ownership transfer costs are excluded
Sources: ABS; RBA

Household Sector

Conditions in the housing market remain strong overall, although there is considerable variation across regions. Growth of household consumption looks to have been around its average pace recently, having picked up over the past couple of years.

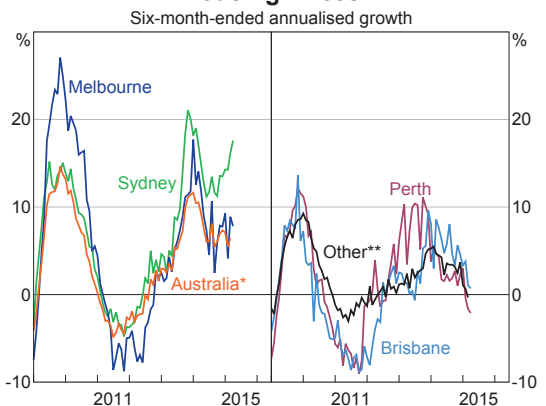
Looking through the monthly volatility, the pace of national housing price inflation has been little changed over the past year or so at around

8 per cent, which is above the growth rate of household incomes. Price increases and auction clearance rates have been particularly strong in Sydney and, to a lesser extent, Melbourne (Graph 3.3). Outside these cities, conditions in established housing markets have been fairly subdued; price growth has declined across much of the country over the past six months and prices have even fallen a little in some regions more recently. Other non-price indicators, including the average size of vendor discounts and the time taken to sell properties, also suggest that conditions in the established housing market have been weaker outside Sydney, although there can be seasonal adjustment issues with these measures around the turn of the year (Graph 3.4).

The nationwide rental vacancy rate has been gradually drifting higher since the mid 2000s. Accordingly, growth of rents has slowed. Combined with higher housing prices overall, this has resulted in rental yields continuing to fall.

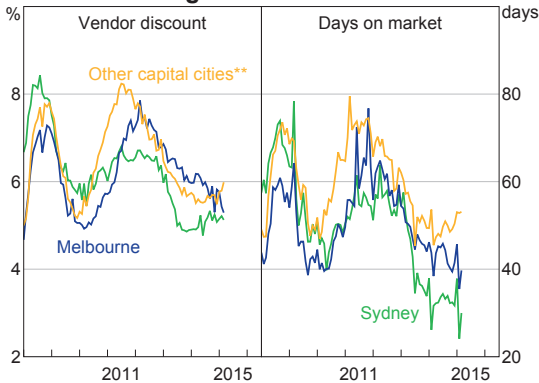
Consistent with low interest rates and relatively strong population growth, dwelling investment has continued to grow rapidly. Over 2014, dwelling investment increased by 8 per cent and, despite being a small share of the economy, contributed nearly ½ percentage point to GDP growth. The

Graph 3.3
Housing Prices



* Excludes apartments outside of capital cities
 ** Includes houses and apartments in Adelaide, Canberra, Darwin and Hobart and regional houses
 Sources: ABS; CoreLogic RP Data; RBA

Graph 3.4
Housing Market Indicators*



* Seasonally adjusted; capital city dwelling stock weighted median, private treaty sales only

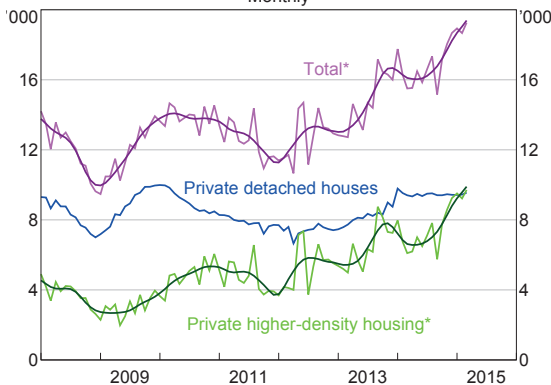
** Excludes Hobart

Sources: CoreLogic RP Data; RBA

increase has been driven by a strong pick-up in the construction of higher-density dwellings, particularly along the eastern seaboard. Dwelling approvals data suggest that further increases in higher-density construction are in prospect in the near term and that detached housing construction is likely to remain at a high level (Graph 3.5; for further details, see 'Box C: The Cycle in Dwelling Investment').

Household consumption growth has picked up over the past couple of years, supported by low interest rates, rising household wealth, above-average population growth and, more recently, lower

Graph 3.5
Residential Building Approvals
Monthly

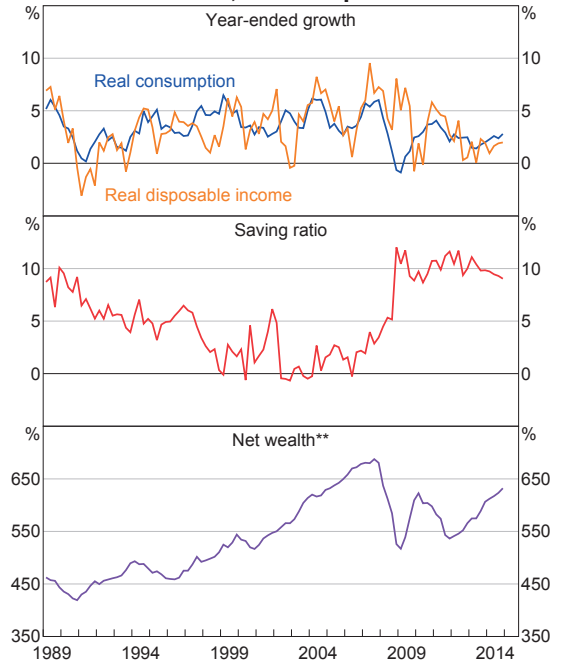


* Smoothed lines are 13-period Henderson trends

Sources: ABS; RBA

petrol prices. Consumption growth has been a little stronger than the growth of labour income, which has been relatively slow, and the saving ratio has declined a little (Graph 3.6).

Graph 3.6
Household Income, Consumption and Wealth*



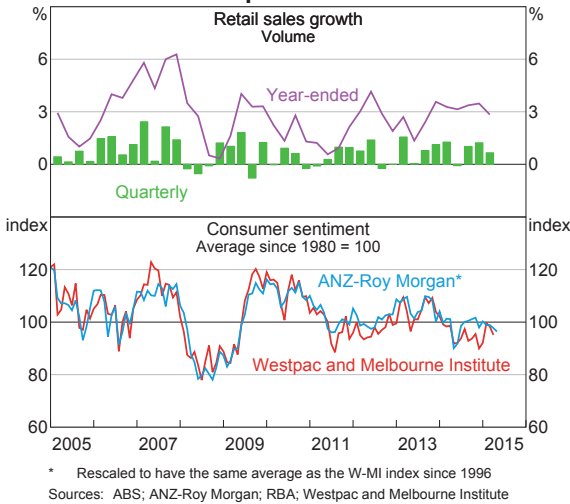
* Household sector includes unincorporated enterprises; disposable income is after tax and interest payments; income level smoothed with a two-quarter moving average between March quarter 2000 and March quarter 2002; saving ratio is net of depreciation

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

Sources: ABS; RBA

Recent indicators suggest that household consumption grew at an around-average pace in the March quarter. Retail sales volumes increased by 0.7 per cent in the quarter and, as has been the case since mid 2014, growth was concentrated in discretionary spending on items such as durable goods and spending in cafes and restaurants (Graph 3.7). Motor vehicle sales to households remain at high levels. Measures of consumer sentiment are a little below their long-run averages and consumers' unemployment expectations remain elevated.

Graph 3.7
Consumption Indicators



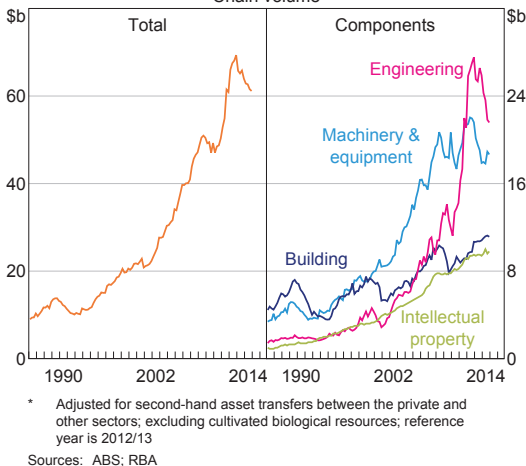
completed and very few new projects are expected to go ahead, particularly given the substantial fall in commodity prices, which has reduced the incentive to invest in new projects.

The latest estimates derived from the ABS capital expenditure (Capex) survey imply that the value of mining investment could decline by over 10 per cent in both 2014/15 and 2015/16, although there is considerable uncertainty around these estimates and the Bank's liaison points to an even larger fall (Graph 3.9). Indeed, the pace of the decline in mining investment could be greater than had previously been anticipated if declines in commodity prices place further pressure on mining sector profitability, particularly in the oil and gas sectors. Mining sector profits fell by 17 per cent over 2014.

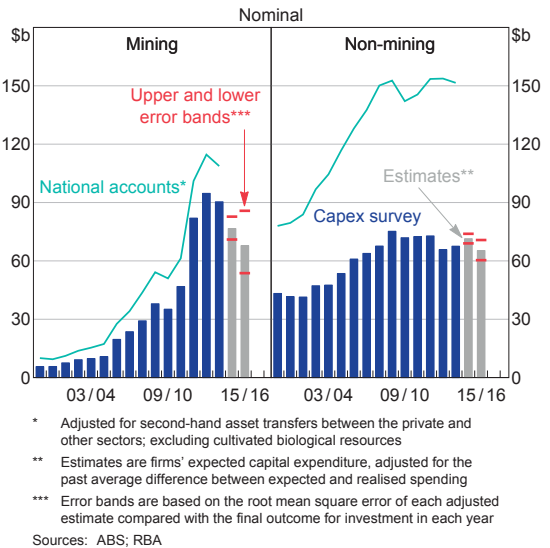
Business Sector

Private business investment continued to decline in the December quarter and was 4 per cent lower over the year (Graph 3.8). Over 2014, mining investment declined sharply while non-mining investment growth was subdued. The decline in mining investment since its peak in mid 2012 reflects the completion of large-scale iron ore, coal and liquefied natural gas (LNG) projects. The decline is expected to continue over coming years as existing projects are

Graph 3.8
Private Business Investment*
Chain volume



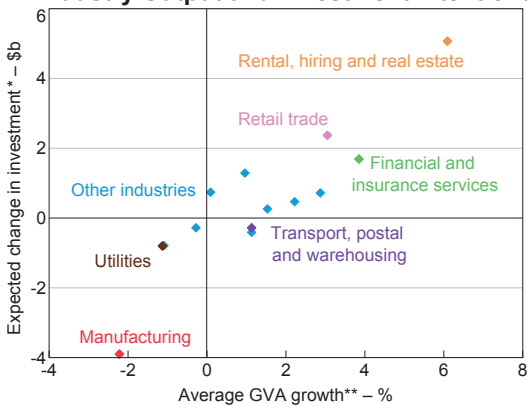
Graph 3.9
Measures of Private Business Investment
Nominal



Non-mining investment has been subdued over recent years and the data suggest that this will continue for some time. The latest Capex survey implies that any recovery in nominal non-mining investment in 2014/15 will be reversed in 2015/16. The survey suggests that the weakness in non-mining investment intentions is being driven by industries that have been experiencing subdued output

growth in recent years, such as the manufacturing industry (Graph 3.10). In contrast, industries that have been experiencing better conditions over recent years, such as the retail trade and rental, hiring & real estate industries, have recorded positive investment intentions. The estimates of capital expenditure intentions from the Capex survey are, however, subject to significant uncertainty, especially those further out. Moreover, the survey does not cover a large share of non-mining investment that is included in the national accounts, such as in agriculture, education and health care. Nor does it capture investment in intangible items (which tends to grow at a steady pace).

Graph 3.10
Industry Output and Investment Intentions

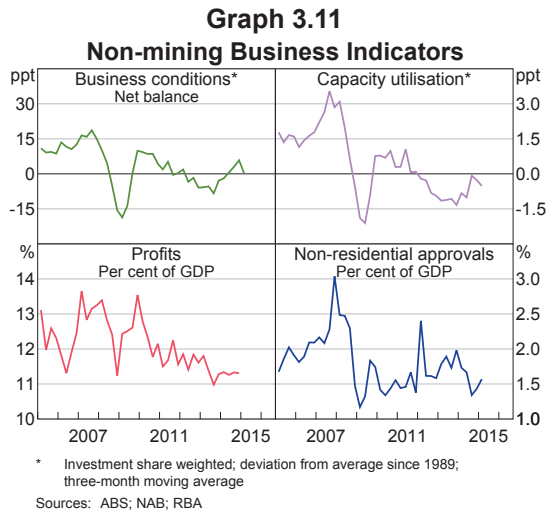


* Average nominal investment implied by the Capex survey in 2014/15 and 2015/16 less average nominal investment in 2012/13 and 2013/14 from the national accounts

** Average annualised growth in real gross value added (GVA) over 2012/13 and 2013/14

Sources: ABS; RBA

Non-mining company profits grew in line with nominal GDP over 2014 and survey measures of business conditions are around average levels (Graph 3.11). In contrast, survey measures of non-mining capacity utilisation and the more forward-looking NAB business confidence measure are a bit below their long-run average levels. While a large stock of work yet to be done will support non-residential building investment for a time, non-residential building approvals will need to rise from their relatively low levels for this to be sustained. The



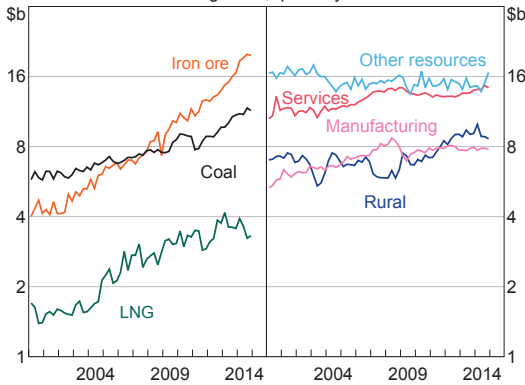
current level of approvals is consistent with weak underlying demand for space in the commercial property market.

At the same time, many of the conditions that are typically associated with stronger investment are in place. Finance is readily available at low cost and business credit growth has increased over the past year or more. Domestic demand growth has picked up and is likely to be supported in the period ahead by relatively strong population growth, low interest rates, low oil prices and the exchange rate depreciation. The Bank's liaison suggests that a sustained pick-up in demand is required to spur growth of business investment.

External Sector

Export volumes rose by 7 per cent over 2014, contributing 1½ percentage points to GDP growth. The increase was driven by strong growth of resource exports, particularly iron ore, reflecting further expansions to extraction, processing and transport facilities (Graph 3.12). Exports of coking and thermal coal also rose over the year. While exports of bulk commodities are expected to continue to grow over the next couple of years, given existing commitments to expand capacity, the pace of growth is expected to slow and a sustained period of low commodity

Graph 3.12
Export Volumes*
Log scale, quarterly

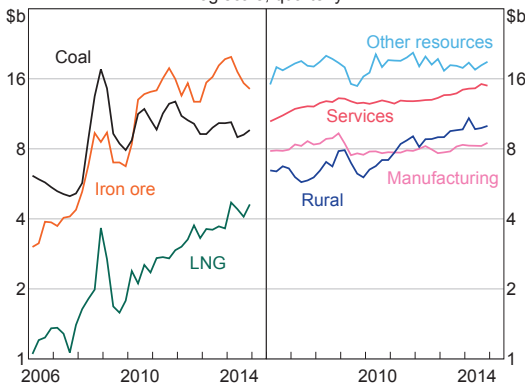


* Reference year is 2012/13
Sources: ABS; Department of Industry and Science; RBA

prices could prompt some curtailment of existing supply by higher-cost producers (see 'International Economic Developments' chapter). In contrast, LNG exports are expected to increase substantially over the next couple of years as a number of projects currently under construction begin production.

Service exports have grown over the past couple of years, driven by tourism, education and business services exports and supported by the depreciation of the exchange rate. The value of service exports in total is currently worth a little more than iron ore exports, given the sharp decline in the price of that commodity (Graph 3.13). In contrast, manufactured

Graph 3.13
Export Values
Log scale, quarterly

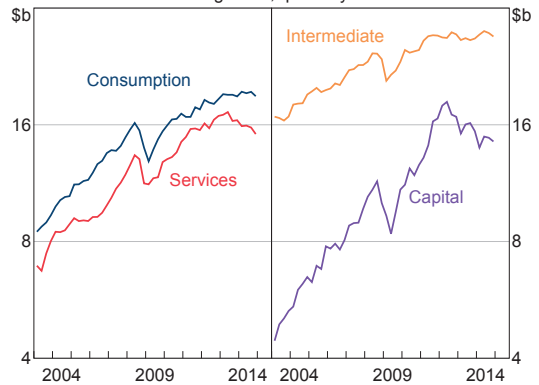


Sources: ABS; Department of Industry and Science; RBA

exports have remained subdued for some time and, so far, have not responded to the exchange rate depreciation by as much as might be expected based on historical behaviour.

Import volumes declined moderately over 2014, largely reflecting the fall in mining investment and the depreciation of the exchange rate (Graph 3.14). Capital imports have fallen over the past couple of years as construction on many of the relatively import-intensive, large-scale mining projects has approached completion. Service imports have also declined noticeably. In particular, imports of travel services have declined as the depreciation of the exchange rate has made overseas travel for Australian residents more expensive.

Graph 3.14
Import Volumes*
Log scale, quarterly

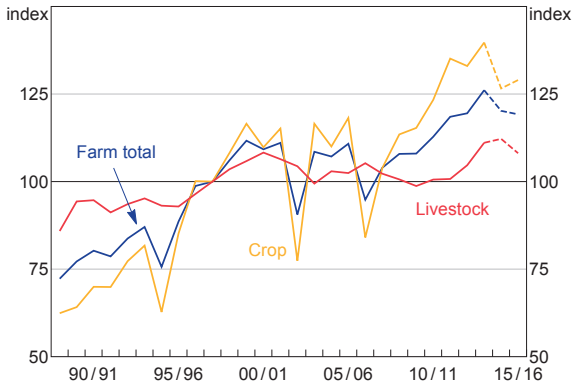


* Reference year is 2012/13
Source: ABS

Farm Sector

The Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) expects farm production volumes to decline by around 5 per cent in 2014/15, driven by generally dry conditions for winter crops (Graph 3.15). In contrast, livestock production is expected to rise marginally. ABARES is forecasting a small decline in farm production in 2015/16, as restocking is expected to hold back livestock production following a period of increased slaughter rates and high export demand. ABARES forecasts that the prices received by farmers will increase in both

Graph 3.15
Farm Production Volumes*
1997/98 = 100



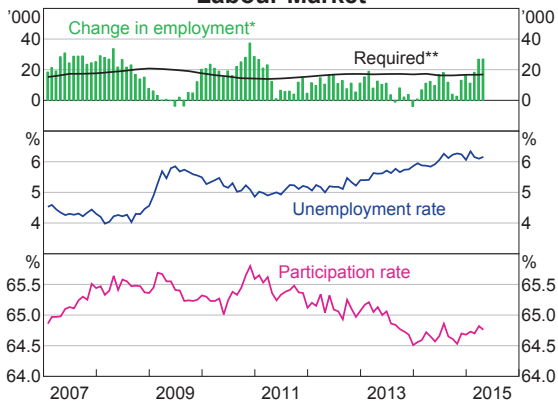
* Dashed lines represent ABARES forecasts for 2014/15 and 2015/16
Source: ABARES

2014/15 and 2015/16 due to higher world prices for livestock and assisted by the depreciation of the Australian dollar over the past year.

Labour Market

Recent data, including revisions to previously published figures, suggest that employment growth has picked up to be faster than population growth over the past six months or so (Graph 3.16). This growth has been accompanied by a rise in the participation rate and average hours worked. The unemployment rate has been broadly stable at around 6¼ per cent since mid 2014.

Graph 3.16
Labour Market



* Six-month-ended average

** Increase in employment required to keep the unemployment rate constant given growth in the working-age population, if the participation rate remains unchanged

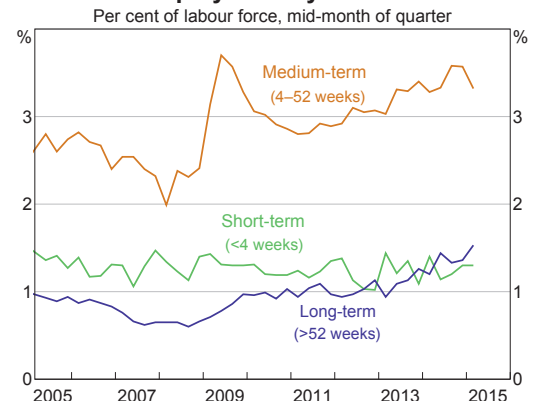
Sources: ABS; RBA

Despite these better trends of late, a broad range of indicators suggest that there is spare capacity in the labour market, including relatively slow growth in wages (see 'Price and Wage Developments' chapter). The unemployment rate remains elevated at around its highest level since the early 2000s. The number of unemployment benefit recipients as a share of the labour force also remains elevated, though it has not changed significantly over recent quarters, in line with the latest vintage of the labour force data. The participation rate is below its level of a few years ago and there has also been an increase in the number of employed people who are working fewer hours than they desire.

Much of the increase in the unemployment rate since mid 2011 can be attributed to the 'medium-term' unemployed (those who have been unemployed for between 4 and 52 weeks; Graph 3.17). However, the rate of long-term unemployment (those unemployed for more than a year) has also risen, consistent with the protracted period of subdued labour market conditions.

Across industries, recent employment outcomes have continued to reflect the shift in the composition of economic activity away from resource-related sectors. Employment growth over the past year has been concentrated in industries related to household consumption and residential

Graph 3.17
Unemployment by Duration*



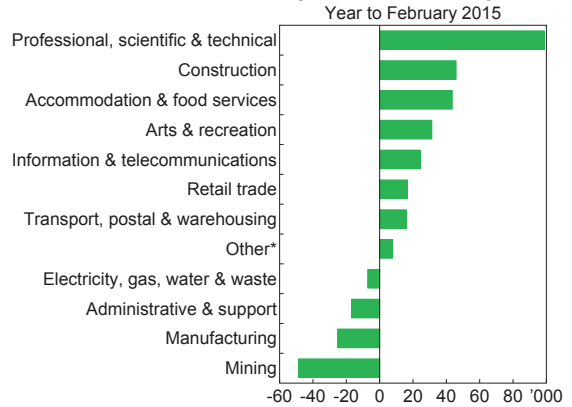
* Seasonally adjusted using ABS seasonal factors for aggregate unemployment rate

Sources: ABS; RBA

construction (Graph 3.18). Growth in professional, scientific & technical services has largely been driven by architectural, engineering & technical services, consistent with reports from the Bank's business liaison of strong demand for professional roles related to residential building activity. Total construction employment has increased over the past year, suggesting that the pick-up in residential construction employment has more than offset the decline in mining-related construction employment. The accommodation & food services and arts & recreation industries have also made significant contributions to recent employment growth. In contrast, employment has declined in the mining and manufacturing industries.

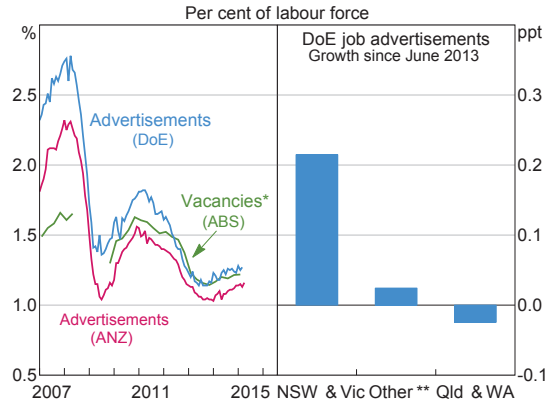
A number of forward-looking indicators of labour demand, such as job advertisements and vacancies, have been little changed over recent months at relatively low levels (Graph 3.19). Nevertheless, they remain higher than at the end of 2013 and, together with evidence from surveys and liaison, suggest modest employment growth over the coming months. The distribution of job vacancies across states also reflects the shift in economic activity away from the resources sector. Job advertisements and vacancies have increased relatively strongly as a share of the labour force in Victoria and New South Wales since 2013, while they have declined or been little changed in Queensland and Western Australia.

Graph 3.18
Employment Growth by Industry



* Includes agriculture, forestry & fishing; wholesale trade; financial & insurance services; rental, hiring & real estate services; public administration & safety; education & training; health care & social assistance; and other services
Source: ABS

Graph 3.19
Job Advertisements and Vacancies



* This survey was suspended between May 2008 and November 2009
** All other states and territories; territories seasonally adjusted by RBA
Sources: ABS; ANZ; Department of Employment (DoE); RBA