2. Domestic Economic Conditions

The recovery in the Australian economy is well underway. The lifting of restrictions in Victoria has contributed to a further improvement across a range of indicators of economic activity. Employment has recovered faster than previously expected and has supported growth in household spending. Extraordinary policy measures have continued to support household and business cash flow and balance sheet positions.

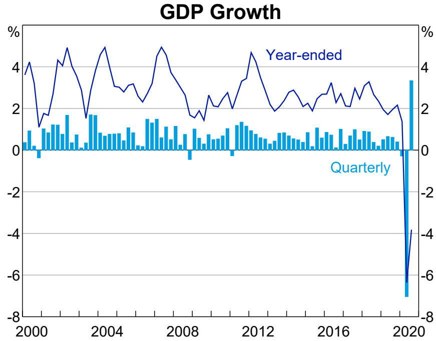
Nevertheless, conditions in parts of the private economy remain weak. Firms' reported investment intentions across most industries are sharply lower than before the pandemic. While some businesses have been able to adapt their activities, those in a number of industries such as the arts, hospitality and tourism continue to be significantly affected by the disruptions induced by the pandemic. The recovery in New South Wales and Victoria has been more restrained than elsewhere, due to mobility restrictions and the larger effect on these states of international border closures. Full-time employment is still well below pre-pandemic levels and the unemployment rate remains much higher than a year ago. As set out in the 'Economic Outlook' chapter, the recovery will depend on health outcomes and the ability of households and businesses to adjust through a period where some temporary support measures are unwound.

Economic activity rebounded over the second half of 2020 at a faster pace than expected

The Australian economy rebounded by 3 per cent in the September quarter, following a 7 per cent contraction in the June quarter (Graph 2.1). The main contributor to growth in the September quarter was household consumption, which increased by 8 per cent, supported by growth in household income, the lifting of restrictions and a reduction in precautionary behaviour. Public investment and dwelling investment increased but business investment declined in the quarter. Indicators of economic activity have, for the most part, picked up since September, and GDP growth is expected to have been solid in the December quarter, underpinned by the continued recovery in household consumption.

Graph 2.1

GDP Growth



Source: ABS

Employment has recovered to near pre-pandemic levels

Employment increased by 280,000 people in the December quarter to be a little below its February 2020 level. Much of the increase in recent months has been in Victoria, where employment rebounded as restrictions in that state eased, while employment in other states has continued to recover at a more moderate pace (Graph 2.2). Nationally, total hours worked remain a little below their pre-pandemic level, both because the number of people in employment is yet to fully recover and some workers are yet to see their weekly hours return to previous levels (Graph 2.3). The large increase in the number of employed people working zero hours for economic reasons in the initial phase of the pandemic has mostly unwound as activity has picked up. Improved economic conditions have also supported a recovery in average hours worked, to be near pre-pandemic levels.

The number of people employed part time has returned to its pre-pandemic level, but full-time employment has only partially recovered; there were around 125,000 fewer full-time workers in December 2020 compared with February (Graph 2.4). The recovery in part-time work has been fairly widespread across industries, with the level of part-time employment in most industries back to, or above, pre-pandemic levels; the accommodation & food services industry is a notable exception (Graph 2.5). The fall and subsequent recovery in part-time employment was unusually large compared to the experience of previous labour market slowdowns, reflecting the larger share of part-time workers in industries most affected by activity restrictions. Employment is yet to fully recover in industries that were most affected by restrictions on activity, whether directly (such as many household services industries) or indirectly as suppliers. For example, although manufacturing was less directly constrained by activity restrictions, employment in this industry in November was well below its level in February; around two-thirds of these employment losses were in food product manufacturing, where around 40 per cent of industry output is supplied to domestic hospitality services or is exported.

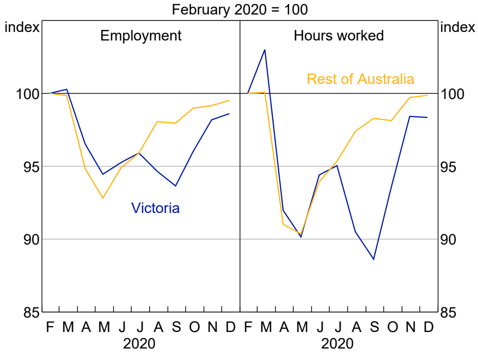
Unemployment has declined but remains high

The unemployment rate was 6.6 per cent in December, down from its peak of 7.5 per cent in July 2020 (Graph 2.6). The decline in the unemployment rate has been faster than expected at the time of the previous *Statement on Monetary Policy*, reflecting a stronger-than-

Graph 2.2

Employment and Hours Worked

February 2020 = 100

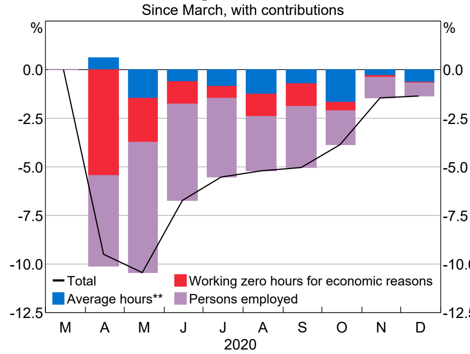


Sources: ABS; RBA

Graph 2.3

Cumulative Change in Total Hours Worked*

Since March, with contributions



* Total hours worked each week; seasonally adjusted

** Excluding people working zero hours for economic reasons

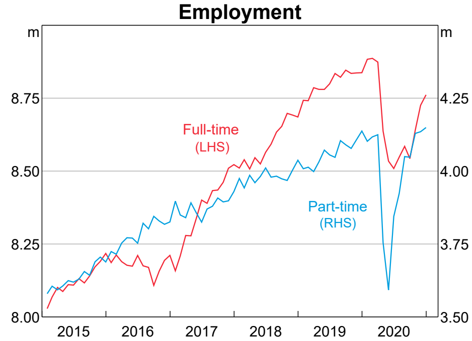
Sources: ABS; RBA

anticipated recovery in activity and employment in the December quarter. Growth in employment was greater than the increase in labour market participation, which has been boosted by the return of individuals who had temporarily exited the labour force in the first phase of the pandemic. The participation rate in December reached a historic high of 66.2 per cent; it was near or above pre-pandemic levels in all states.

Despite improving labour market conditions, there were still over 900,000 people unemployed in December, around 220,000 more than in February 2020. Broader indicators of spare capacity in the labour market have reversed much of the increases recorded in mid 2020, but remain elevated. The heads-based underemployment rate – which measures the share of full-time workers working reduced hours for economic reasons and part-time workers willing and available to work more hours – was 8.5 per cent in December, around its pre-pandemic level. The rate of labour market underutilisation – which adds together unemployed and underemployed people – was around 15 per cent in December, still well above pre-pandemic levels.

Graph 2.4

Employment

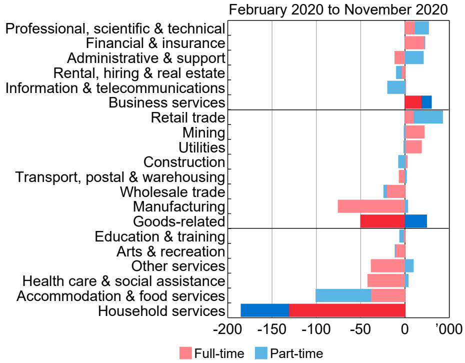


Source: ABS

Graph 2.5

Cumulative Change in Employment by Industry*

February 2020 to November 2020



* Darker colours indicate cumulative change in employment by sector

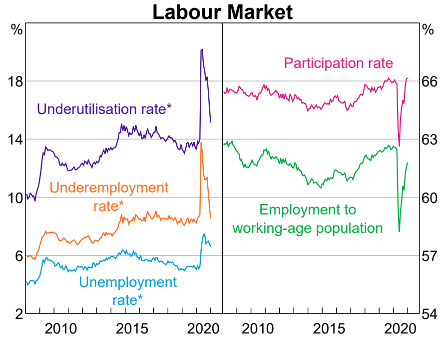
Sources: ABS; RBA

Leading indicators of labour market demand continue to recover

Forward-looking indicators of employment such as job advertisements and vacancies have continued to improve in recent months. Job advertisements remain below peaks seen in recent years, while vacancies are now above pre-pandemic levels (Graph 2.7). Survey indicators of employment intentions have picked up strongly since mid 2020. Information from business liaison also suggests improved employment expectations, although the outlook is mixed across industries. Some firms in restriction-affected industries, such as tourism and education, still expect to reduce employment over the year ahead. In the construction sector, near-term employment intentions in apartment and non-residential construction are also subdued, but employment in detached home

Graph 2.6

Labour Market



* Heads-based measure

Sources: ABS; RBA

construction has been strong, especially in Western Australia. The outlook for employment in infrastructure-related businesses is picking up as projects get underway.

Liaison information suggests that firms that are no longer eligible for JobKeeper payments are generally finding demand has recovered sufficiently to maintain or increase staffing levels. Firms that expect to remain eligible for JobKeeper have typically experienced a fall in revenue due to the restrictions in Victoria in the second half of 2020, or are in industries that are more affected by domestic and international travel restrictions.

Containment measures introduced over late December had a limited effect on activity

Several states experienced community outbreaks of COVID-19 over recent months stemming from returned overseas travellers. A rapid and targeted response by state authorities brought these outbreaks under control without affecting activity materially. A mix of short localised lockdowns, mandated use of masks, reductions in gathering sizes, intensive contract tracing by health authorities and restrictions on movement across state and territory borders were implemented. While indicators of mobility declined, particularly in Sydney, part of this was probably seasonal and movement of people remained higher nationally relative to the earlier outbreaks in 2020. Surveyed measures of consumer and business confidence also held broadly steady and remain around long-run averages (Graph 2.8).

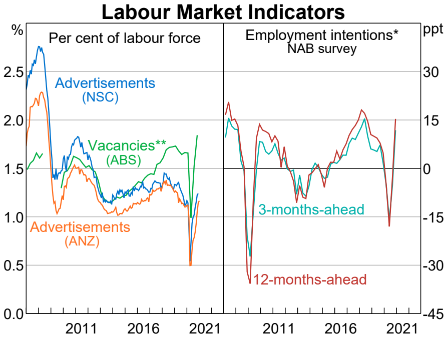
Household spending increased

Household consumption recovered strongly over the second half of 2020, but remained below its pre-pandemic level. Timely indicators suggest household spending increased in the December quarter, supported by favourable health outcomes, an improvement in labour market conditions, a return of consumer sentiment to around pre-pandemic levels and policy measures that have boosted household cash flow. The categories of spending that were most constrained by activity restrictions earlier in the year rebounded quickly as social distancing restrictions were eased, such as cafes & restaurants and clothing & footwear (Graph 2.9). Sales of household goods remain elevated, having benefited from the substitution from services where consumption possibilities are still constrained.

Information from liaison suggests that the recent domestic COVID-19 outbreaks had only a

Graph 2.7

Labour Market Indicators



* Net balance for the following period; deviation from average; 12-months-ahead measure seasonally adjusted by the RBA

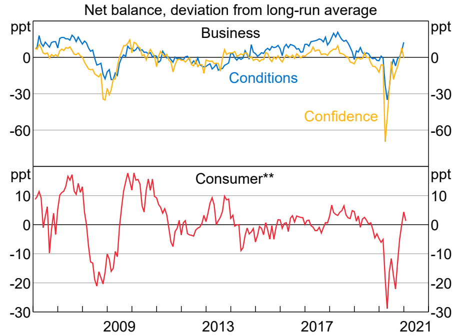
** Survey was suspended between May 2008 and November 2009

Sources: ABS; ANZ; NAB; National Skills Commission (NSC); RBA

Graph 2.8

Business and Consumer Sentiment*

Net balance, deviation from long-run average



* Latest observations are December 2020 for business confidence and conditions and January 2021 for consumer confidence

** Average of Westpac–Melbourne Institute and ANZ–Roy Morgan surveys

Sources: ANZ–Roy Morgan; NAB; RBA; Westpac–Melbourne Institute modest effect on overall household spending. Consumption patterns are likely to have shifted a bit in those states that recently imposed tighter mobility restrictions. For example, spending on discretionary services and travel declined a little, while sales of household goods and food increased, consistent with households spending more time at home.

Temporary policies have boosted household cash flow but support is moderating

Nominal household disposable income increased by 3½ per cent in the September quarter, to be 8 per cent higher in year-ended terms; this is the strongest growth in nearly a decade (Graph 2.10). The JobKeeper program continued to support household cash flow, as did the recovery in economic activity and the labour market. Social assistance payments remained elevated. Towards the end of the year, tighter eligibility requirements for several policies took effect and the early superannuation withdrawal scheme concluded. Partly offsetting this, tax cuts brought forward in the Australian Government Budget took effect from October and pensioners and some other households have begun to receive two further Economic Support Payments, each valued at $250.

The household saving rate rose sharply early on in the pandemic because income increased and consumption declined. The household sector is estimated to have accumulated buffers of around $200 billion over the June and September quarters, or around 15 per cent of pre-pandemic annual income. The saving rate edged a bit lower but remained very high at close to 20 per cent in the September quarter (Graph 2.11). The pattern of consumption over recent quarters suggests restrictions on activity and strong health incentives to avoid some types of consumption have been primary drivers of the increase in household saving. Income uncertainty has also contributed to some extent, especially for those households whose income was most affected by the pandemic.

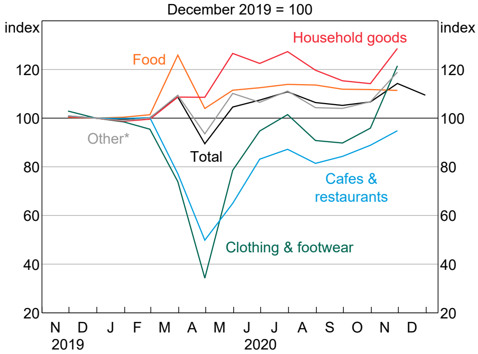
Conditions in the established housing market have strengthened …

Housing prices nationally increased by 3 per cent over the past year (Table 2.1). This was despite Sydney and Melbourne recording price declines following the onset of the pandemic. In recent months, housing prices have increased in all capital cities, although prices remain below their previous peaks in several cities (Graph 2.12).

Graph 2.9

Retail Sales Values

December 2019 = 100



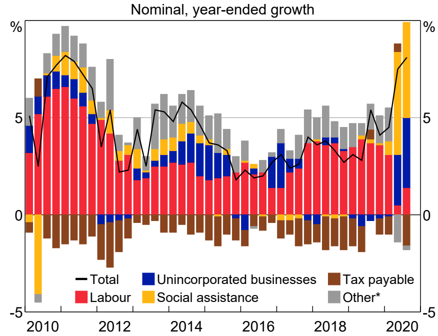
* Includes department stores and other retailing

Sources: ABS; RBA

Graph 2.10

Household Disposable Income

Nominal, year-ended growth



* Includes financial income, interest payable and other smaller components

Sources: ABS; RBA

Table 2.1: Growth in Housing Prices

Percentage change, seasonally adjusted

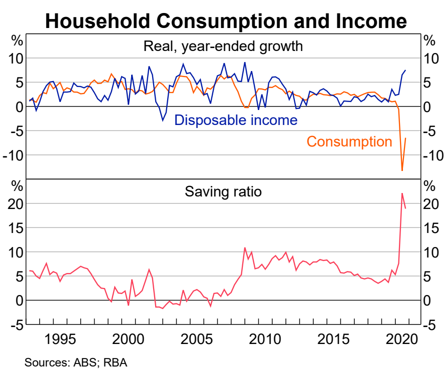
	January	December	November	October	Year-ended	Past five years
Sydney	0.3	0.6	0.4	0.0	2.0	11
Melbourne	0.4	0.6	0.3	–0.6	–2.1	15
Brisbane	0.8	0.9	0.3	0.3	4.0	9
Adelaide	0.8	0.8	0.9	0.9	6.5	14
Perth	1.3	1.0	0.9	0.6	3.4	–13
Darwin	2.0	2.1	1.8	0.9	11.4	–17
Canberra	1.2	0.8	1.1	0.9	8.5	28
Hobart	1.1	0.7	1.0	0.6	6.8	48
Capital cities	0.5	0.8	0.5	0.0	1.7	10
Regional	1.3	1.4	1.2	0.8	7.9	17
Australia	0.8	0.9	0.6	0.1	3.0	11

Sources: CoreLogic, RBA

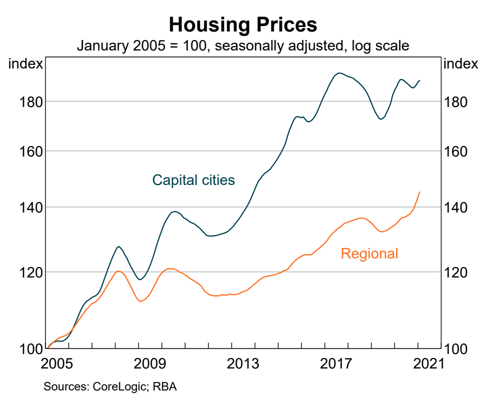
Housing price increases in regional Australia outpaced growth in the capital cities over the second half of 2020. Prices for houses have also increased by more than prices for units in recent months. Non-price indicators, including housing turnover, increased further towards the end of the year. Auction clearance rates increased in December in Sydney and Melbourne and auction volumes also increased. Lending data indicated that owner-occupiers accounted for a large proportion of recent housing purchases, supported by very low interest rates and policies to support first home buyers (see 'Domestic Financial Conditions' chapter).

Rental market conditions for owners of apartments in Sydney and Melbourne are weak, but conditions for houses have generally strengthened across most cities and regional areas. Advertised rents for units in Sydney and Melbourne have continued to decline over the past 6 months, while rents for houses in both cities increased a little (Graph 2.13). In December the rental vacancy rate declined noticeably in Sydney and edged down in Melbourne, though

Graph 2.11



Graph 2.12



they remained elevated in both cities (Graph 2.14). By contrast, vacancy rates in Perth declined to near-record lows and rents increased strongly, partly reflecting the limited supply of new rental stock. Some rental markets outside the capital cities remained tight. Advertised rents grew more strongly in regional New South Wales, Queensland and Victoria than in the capital cities of these states, in part driven by strong demand from households relocating from the capital cities.

… and detached housing construction activity has increased

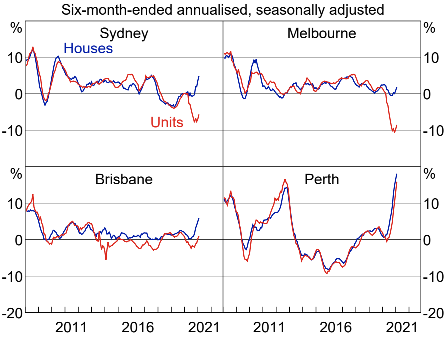
Building approvals for detached dwellings increased strongly over the second half of 2020 to be around their highest level on record (Graph 2.15). Approvals for alterations & additions also increased sharply in New South Wales and Queensland. Strong demand from owner-occupiers, particularly first home buyers, has been encouraged by policy support, including low interest rates and the Australian Government's HomeBuilder scheme. Sales of new homes increased sharply in December as buyers sought to secure the full $25,000 HomeBuilder Grant by signing contracts before the end of the month. Greenfield land sales remained elevated in the December quarter, driven by a surge in sales in Melbourne, while sales in other capital cities eased a little. Almost all detached home builders in the Bank's liaison program report that their construction pipelines are 'full' well into 2021, with activity expected to peak in the middle of 2021; extensions to deadlines for construction commencement for government grants has helped to extend the order book for builders.

Approvals for higher-density dwellings have remained very low nationally. Developers in the liaison program report that sales of off-the-plan apartments remain weak, citing buyer preferences for established or recently completed properties, rental income uncertainty weighing on investor demand and an absence of foreign buyers. Some developers reported that they had delayed commencements of planned projects, and they expect demand for

Graph 2.13

Advertised Rents Growth

Six-month-ended annualised, seasonally adjusted

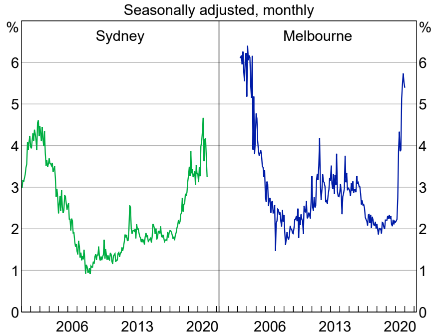


Sources: CoreLogic; RBA

Graph 2.14

Rental Vacancy Rates

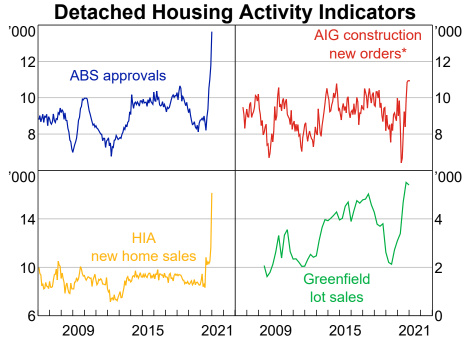
Seasonally adjusted, monthly



Sources: RBA; REINSW; REIV

Graph 2.15

Detached Housing Activity Indicators



* Rescaled to have the same mean and variance as ABS approvals

Sources: ABS; AIG; HIA; RBA; Research4

higher-density apartments to remain low for the foreseeable future. This is consistent with the sharp reduction in net overseas migration, contributing to the slowest rate of population growth in a century, and a shift in buyer preferences towards detached housing.

State budgets imply a strong increase in public investment

Health and other pandemic management spending over recent quarters contributed to a 6 per cent increase in public demand over the year to the September quarter. Public investment was unchanged over the year, although most states released budgets since the previous *Statement* that foreshadow a large increase in investment spending over the next few years. Projects flagged by state government budgets included large and small infrastructure projects and the construction of social housing.

The consolidated deficit of the Australian and state governments is expected to peak at just under 15 per cent of GDP in 2020/21 (Graph 2.16). Improved economic conditions over the second half of 2020 contributed to a revision to the expected Australian Government Budget deficit, from around 11 to 10 per cent of GDP, in the mid-year budget update. Projections from the Australian and state treasuries suggest that the consolidated deficit will decline sharply after 2020/21, reflecting the expiry of income support measures such as JobKeeper and improved economic conditions.

Business investment has declined further

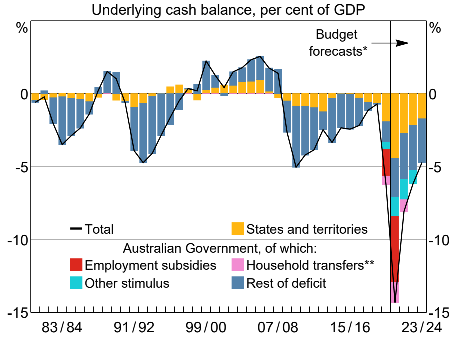
Private non-mining business investment declined by a further 4 per cent in the September quarter, to be 13 per cent lower over the year (Graph 2.17). Heightened restrictions in Victoria constrained non-residential construction activity in the quarter, but by less than anticipated. Machinery & equipment investment fell further, to be its lowest level since 2006. The decline in machinery & equipment investment was significant but smaller than had been expected, leading to a more moderate fall in non-mining investment overall.

Firms' expectations for investment increased off a very low base in the most recent ABS Capital Expenditure (Capex) survey (Graph 2.18). In particular, non-mining firms anticipate a more moderate decline in machinery & equipment investment this financial year than had previously been expected. The Capex survey, conducted in October and November, was the first since the announcement of expanded tax incentives for investment by the Australian Government. The increase in business profits over recent quarters will also help to support the

Graph 2.16

Consolidated Government Finances

Underlying cash balance, per cent of GDP



* Forecasts from latest budgets or budget updates

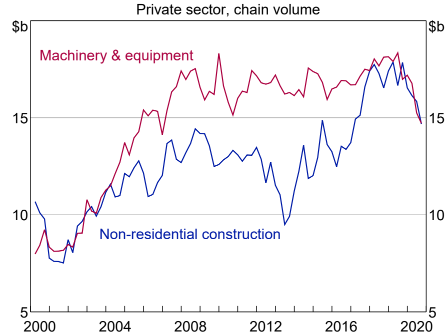
** Includes household income tax changes from 2020/21 budget

Sources: ABS; Australian Treasury; RBA; state and territory budgets

Graph 2.17

Non-mining Business Investment

Private sector, chain volume

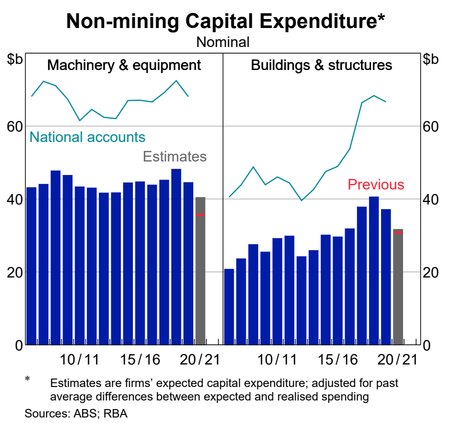


Sources: ABS; RBA

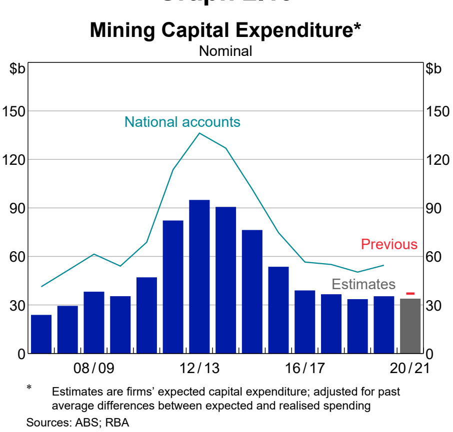
outlook for investment as activity continues to recover. Expectations for non-residential construction by non-mining firms remain weak, consistent with the low level of building approvals in the second half of 2020.

Mining investment declined by 5 per cent in the September quarter, but was moderately higher over the year. Information from liaison and company reports continue to suggest that investment will be supported by work on iron ore and coal projects this financial year. However, spending will likely be more modest than was previously anticipated, with the Capex survey indicating that some firms have scaled back their investment intentions (Graph 2.19).

Graph 2.18



Graph 2.19



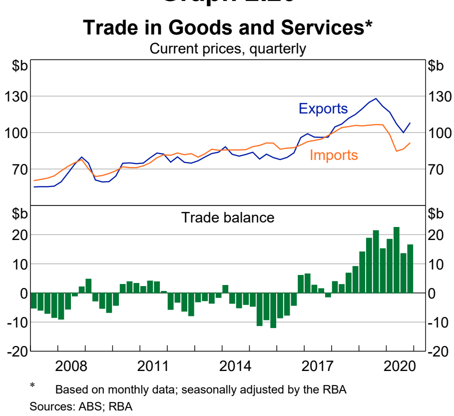
Trade in goods has picked up in recent months

The trade surplus narrowed significantly in the September quarter (Graph 2.20). Import volumes increased strongly, driven by imports of capital and consumer goods, consistent with the ongoing recovery in domestic spending. At the same time export volumes declined by around 3 per cent in the quarter, led by lower resource exports. Trade in services remained constrained by ongoing restrictions on international travel.

The trade surplus widened a little in the December quarter. Partial data suggest that trade in goods picked up over the period. Increased exports of machinery & equipment have supported growth in manufactured exports as global demand has improved. Rural exports have also increased, led by cereals after the drought broke in parts of Australia last year. The outlook for the rural sector remains favourable, with record crop production forecast by the Australian Bureau of Agricultural and Resource Economics (ABARES) as a result of good growing conditions associated with the La Niña event underway (Graph 2.21).

Resource export volumes also appear to have increased in the December quarter, although coal exports remained at low levels (Graph 2.22). Domestic coal production had been cut back in response to lower prices since the onset of the

Graph 2.20



pandemic. Prices have since recovered because a cold Northern Hemisphere winter has increased demand for thermal coal, and Indian steel production has recovered to pre-pandemic levels. But coal exports to China have fallen in recent months and could remain weak for some time because of ongoing uncertainty surrounding Chinese coal import policies and the bilateral trading relationship; any increase in coal exports will likely involve diverting these exports elsewhere.

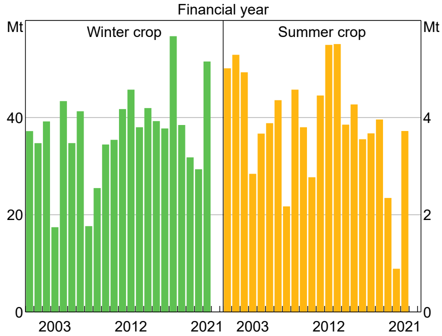
Partial trade data suggest that iron ore export volumes were little changed in the December quarter, as exports from Western Australia were affected by maintenance and weather-related port disruptions. Iron ore exports are expected to remain close to capacity as producers respond to high iron ore prices, which have been underpinned by strong Chinese steel production and constrained global supply. LNG exports look to have risen owing to increased energy demand from the cold Northern Hemisphere winter.

Goods imports have continued to increase in recent months in line with the recovery in domestic spending. Imports of consumption goods are well above their pre-pandemic level. Imports of passenger motor vehicles have driven the rebound, having increased in each of the last 6 months. Despite the strength in consumer goods imports, many retailers in the business liaison program report that inventories remain lower than ideal. Capital goods imports have also increased over recent months, especially imports of industrial transport equipment.

Graph 2.21

Australian Crop Production*

Financial year



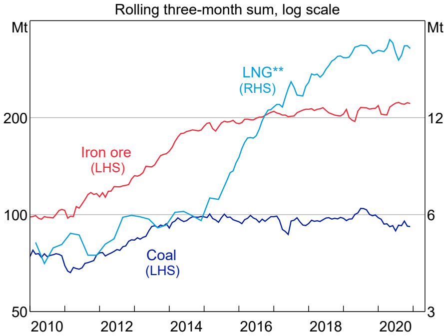
* Includes ABARES forecast for 2020/21

Source: ABARES

Graph 2.22

Resource Exports*

Rolling three-month sum, log scale



* Seasonally adjusted by the RBA

** Quarterly prior to September 2015

Sources: ABS; Department of Industry, Science, Energy and Resources; RBA