2. Domestic Economic Conditions

Australian economic activity was resilient to the disruptions caused by the Omicron outbreak of COVID-19 and the east coast floods in the first half of 2022. Growth in domestic demand was robust in the March quarter and timely indicators suggest momentum was sustained in the June quarter. The labour market is tight and full-time employment growth has been strong. Labour supply has been responsive to robust labour demand and the participation rate is at a record high. Measures of spare capacity in the labour market have declined to their lowest levels in decades and many firms are finding it challenging to hire workers. Strong labour demand is supporting household income. However, the headwinds to growth in activity are strengthening. Households' budgets have come under increasing pressure from rising prices, particularly for food and energy, and higher interest rates. Consumer sentiment has deteriorated sharply since the start of the year. Housing prices have begun to decline alongside weaker activity in the established housing market, rising interest rates and the expectation of further increases in the cash rate. Shortages of materials and labour are an ongoing challenge for some residential and infrastructure investment projects.

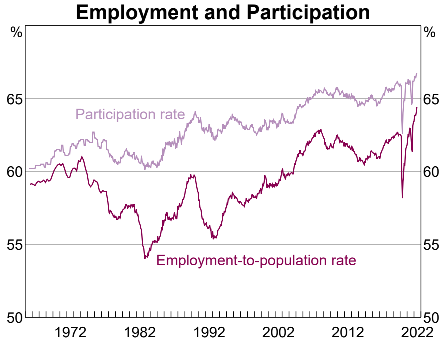
Demand for labour is strong

Employment has grown strongly in recent months, with the employment-to-population ratio reaching a record high level of 64.4 per cent in June (Graph 2.1). Employment increased by an average of 51,000 people per month over the past three months, compared with an average of 21,000 in the 12 months to February 2020, despite population growth being lower than before the pandemic.

Leading indicators suggest that demand for labour will remain strong in the months ahead. Job vacancies and advertisements are at very high levels and there are nearly as many vacancies as there are unemployed people (Graph 2.2).

Graph 2.1

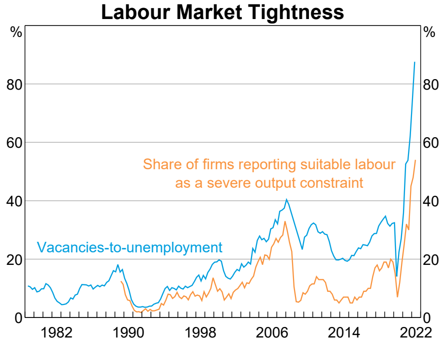
Employment and Participation



Source: ABS

Graph 2.2

Labour Market Tightness



Sources: ABS; NAB

The supply of labour has increased in response …

Labour force participation increased to a record high of 66.8 per cent in June. The rise in participation since the onset of the pandemic has been broadly based, and particularly strong for females and for people of both sexes aged 15–24 years and 55–64 years (Graph 2.3). In recent months, the youth participation rate reached its highest level since the mid-1990s. The participation rate of young people is more responsive to demand for labour than other age groups because they are less likely to be the primary income earner in their household. Further, youth employment tends to be concentrated in industries that are more sensitive to general economic conditions, such as accommodation & food services and retail trade.

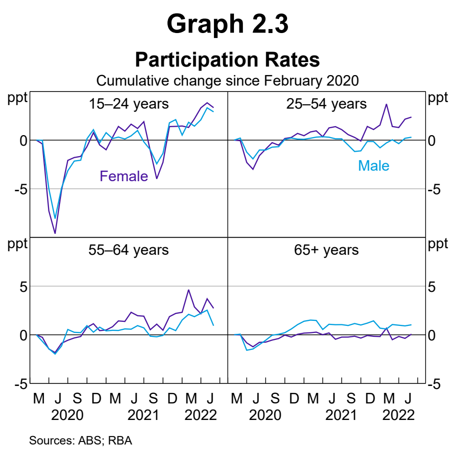
… but labour market spare capacity has reached its lowest levels in decades

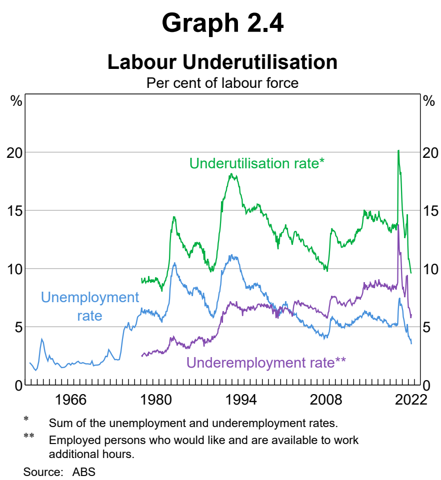
The labour market has continued to tighten in recent months amid strong labour demand. The unemployment rate fell to a near 50-year low of 3.5 per cent in June and the heads-based underutilisation rate declined to 9.6 per cent – the lowest rate since 1982 (Graph 2.4). Medium- and long-term unemployment rates have declined further in recent months; the medium-term unemployment rate, which is typically more representative of cyclical unemployment and so tends to be the most relevant for wages growth, is at its lowest level since the series began in 1991.

Hours-based measures of underutilisation have also declined to multi-decade lows as firms respond to demand by increasing the hours of existing staff. Many previously part-time employees have shifted into full-time work. Full-time employment in June was 7 per cent higher than its February 2020 level, while part-time employment was 0.6 per cent lower (Graph 2.5). The increased share of work that is full time has contributed to a rise in average hours worked to around pre-pandemic levels. This is despite an elevated number of employed persons continuing to work fewer-than-usual hours due to illness.

Hiring workers is becoming more challenging in the tight labour market

Hiring intentions reported by firms in surveys and the Bank's liaison program remain strong. However, firms have also reported that finding suitable labour is a significant constraint on activity, with some expressing concerns about achieving their desired increases in headcount in the tight labour market. Firms have





responded to labour availability issues by offering higher wage increases for specific workers, emphasising non-wage remuneration, and hiring less-experienced or less-qualified staff than previously.

Job vacancies remain high in most industries, including those that rely heavily on migrants for their workforce, such as accommodation & food services. Although permanent and long-term migration flows have largely returned to pre-pandemic levels, arrivals of students and working holidaymakers remain low, suggesting that vacancies may remain elevated for some time. Information from the Bank's liaison program suggests that labour availability is yet to improve meaningfully following the reopening of the international border; some firms have attributed this to delays in visa approvals.

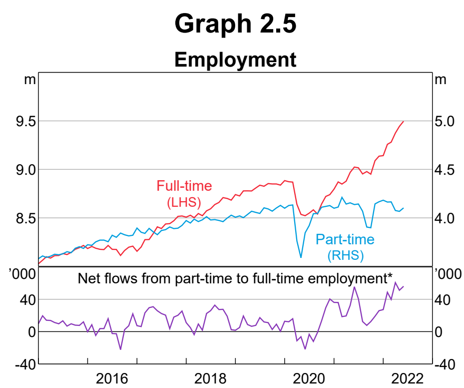
Job mobility remains higher than in the years preceding the pandemic in a range of industries and the number of people moving for a better job or because they want a change has continued to increase (Graph 2.6). However, overall job mobility has declined a little in recent months, particularly in professional services where mobility has returned to its long-run average. This is consistent with the earlier increase in mobility being largely a catch-up on job changes that were put on hold during the pandemic. While job mobility in health care remains well above its long-run average, the number of people in health care expecting to change jobs in the next 12 months has declined to around average levels.

Strong labour market conditions continue to support household income

Household income increased by around 4 per cent over the year to the March quarter, to be more than 10 per cent higher than at the beginning of the pandemic. This was supported by strong growth in labour income as employment increased over this time (Graph 2.7). Timely indicators point to further strong growth in labour income in the June quarter, while social assistance payments have been supported by the indexation of these payments to inflation as well as additional 'cost of living' payments to welfare recipients.

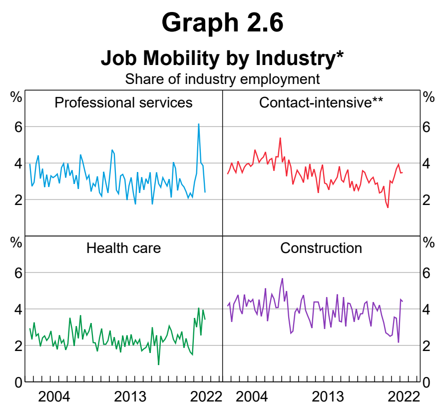
Activity in the March quarter was resilient to the Omicron outbreak and east coast floods …

The Australian economy grew by 0.8 per cent in the March quarter as domestic activity proved resilient to the Omicron outbreak and the flooding in New South Wales and Queensland that occurred throughout this period



* Three-month rolling average.

Sources: ABS; RBA



* Based on the industry of new job.

** Includes accommodation & food services, arts & recreation and retail trade.

Sources: ABS; RBA

(Graph 2.8). The Omicron outbreak dampened activity a little, but was much less disruptive than previous waves of COVID-19 because of high vaccination rates and the absence of lockdowns. Growth in household consumption led the increase in domestic demand as discretionary spending continued to recover from prior restrictions and the full reopening of the international border enabled a pick-up in travel spending. Higher consumption saw the household saving ratio decline in the March quarter; however, at over 11 per cent, the saving ratio remained well above its average level in the years leading up to the pandemic (Graph 2.9).

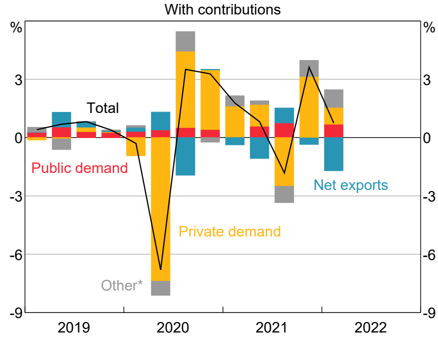
Public consumption increased strongly in the March quarter supported by pandemic and flood-related spending. Dwelling investment fell as materials and labour shortages constrained activity, but business and public investment increased. Net trade subtracted from growth in the March quarter; exports declined due to production disruptions in the resources sector, while imports grew strongly as firms filled order backlogs and rebuilt inventories.

… and the domestic economy retained its strong momentum in the June quarter

Timely indicators suggest that domestic demand increased strongly in the June quarter, driven by growth in household consumption. Retail sales volumes increased by 1.4 per cent in the June quarter, driven by discretionary goods and services consumption at cafes & restaurants, clothing & footwear shops and department stores (Graph 2.10). Information from retailers in the Bank's liaison program suggests retail sales values have remained at a high level in recent months, though price increases have made a larger contribution for some retailers as they pass on cost increases.

Graph 2.8

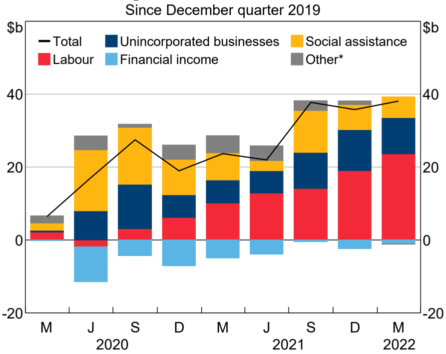
Quarterly GDP Growth
With contributions



* Includes change in inventories and statistical discrepancy.
Sources: ABS; RBA

Graph 2.7

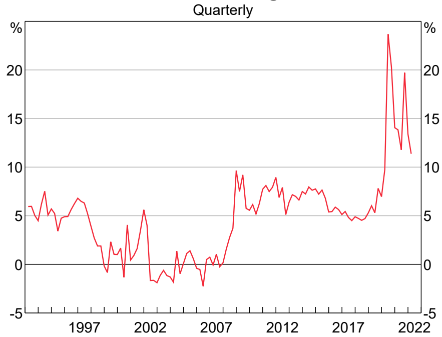
Change in Household Income
Since December quarter 2019



* Includes rent, tax payable, interest payable and other.
Sources: ABS; RBA

Graph 2.9

Household Saving Ratio*
Quarterly



* Saving as a share of disposable income; net of depreciation.
Sources: ABS; RBA

Households are facing rising cost-of-living pressures, while higher interest rates are putting increased pressure on some household budgets. These developments have contributed to a sharp decline in consumer sentiment, which is now back around levels observed during the onset of the pandemic and the global financial crisis (Graph 2.11).

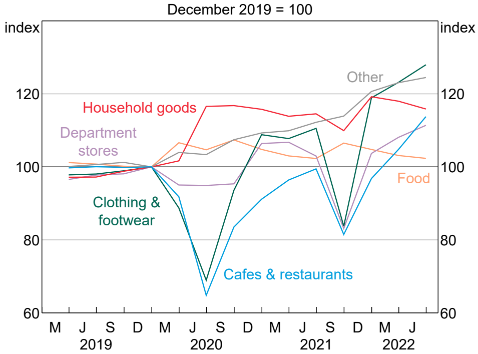
The outlook for business investment is positive …

Business investment has grown by more than 10 per cent since its trough in mid-2020, underpinned by non-mining machinery and equipment investment (Graph 2.12). However, business investment remains below its pre-pandemic level as a share of GDP, reflecting lacklustre outcomes in other components. Non-residential construction investment has been hampered by supply chain issues, severe weather and capacity constraints. Growth in mining investment has also been subdued, despite very high prices for a range of commodities; this is consistent with information from the Bank's liaison program that suggests firms have been undertaking investment to sustain their level of production, rather than to expand capacity.

Survey measures of capacity utilisation and investment intentions point to a positive outlook for business investment. Non-mining capacity utilisation remained around its highest level in over three decades in June. The ABS Capital Expenditure Survey showed that firms have increased their expectations for investment in the 2022/23 financial year (Graph 2.13), a trend that has been broadly based across most industries. Information from the Bank's liaison program suggests firms remain optimistic about the longer term outlook for demand. However, some of the recent increase in investment spending intentions also reflects cost pressures, as a growing number of firms have noted that rising material and construction costs are

Graph 2.10

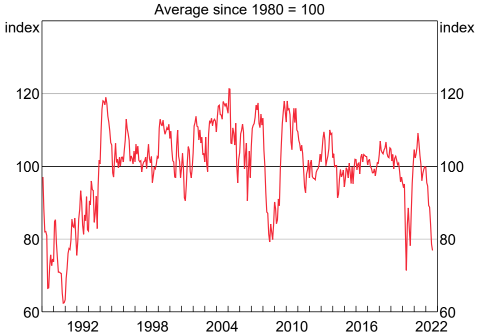
Retail Sales Volumes
December 2019 = 100



Sources: ABS; RBA

Graph 2.11

Consumer Sentiment*
Average since 1980 = 100

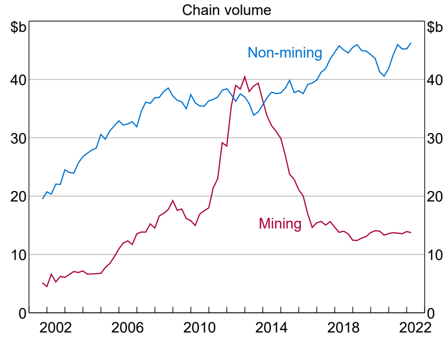


* Mean of Westpac–Melbourne Institute and ANZ–Roy Morgan surveys' deviations from average.

Sources: ANZ–Roy Morgan; RBA; Westpac–Melbourne Institute

Graph 2.12

Private Business Investment*
Chain volume



* New investment.

Sources: ABS; RBA

increasing the nominal value of capital investments.

… but housing construction has been impeded by supply constraints and bad weather

A number of factors – including government policy measures, low interest rates and an apparent shift in preferences towards more space as people spent more time at home during the pandemic – supported demand for new housing and renovations over the past few years. The increase in detached housing approvals in 2021 resulted in a large pipeline of residential construction work (Graph 2.14). This pipeline will sustain construction activity even as demand for new housing eases, as indicated by new home sales, greenfield land sales and dwelling approvals.

The pace of construction activity has been constrained by supply chain issues, and capacity utilisation within the industry has been elevated for some time. Information from the Bank's liaison program suggests there have been shortages and significant cost increases for labour and materials. Construction delays have been exacerbated by widespread rainfall along the east coast and absenteeism due to the Omicron outbreak. Rising costs have compressed margins on fixed-price contracts, with some firms expecting more insolvencies in the industry.

Housing prices are declining nationally, but conditions vary across the country

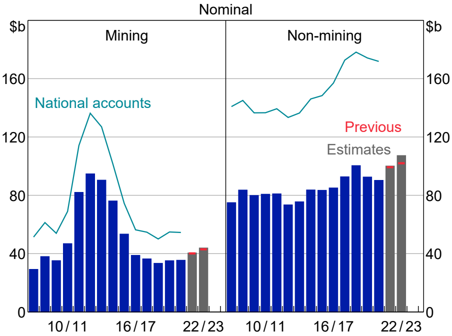
Housing prices have declined in a number of markets in recent months as interest rates have increased and market sentiment has deteriorated. Price declines have been largest in Sydney and Melbourne (Graph 2.15; Table 2.1). In these cities, auction volumes and clearance rates have declined, and the number of properties currently listed for sale is above average (Graph 2.16). Survey-based measures of housing price expectations and housing turnover have also declined since the beginning of the year. In some other capital cities housing price growth has slowed but remains positive, supported by a very low number of properties listed for sale.

Advertised rents in most states rose strongly over the first half of 2022, consistent with low vacancy rates and strong growth in household income (Graph 2.17). Vacancy rates in Sydney and Melbourne have declined recently, particularly in Sydney's middle-ring suburbs. In other capital cities, vacancy rates remain around historical lows. Strong growth in rents for newly rented properties supported a modest pick-up in overall rents paid in the Consumer Price Index

Graph 2.13

Capital Expenditure Intentions*

Nominal



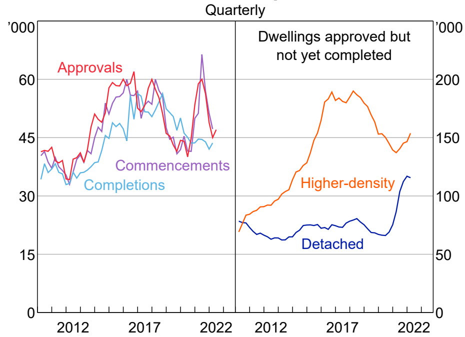
* Estimates are firms' expected capital expenditure; adjusted for past average differences between expected and realised spending.

Sources: ABS; RBA

Graph 2.14

Residential Pipeline

Quarterly



Sources: ABS; RBA

Table 2.1: Housing Price Growth

Percentage change, seasonally adjusted

	July	June	May	April	Year-ended	Five-year growth
Sydney	−1.8	−1.5	−1.2	−0.6	1.6	15
Melbourne	−1.1	−0.9	−0.6	−0.2	0.3	10
Brisbane	−0.4	0.5	0.9	1.3	22.1	45
Adelaide	0.7	1.6	1.5	1.7	24.1	48
Perth	0.6	0.9	0.6	0.7	5.5	18
Darwin	0.2	0.6	0.5	0.4	5.3	9
Canberra	−1.3	0.5	−0.1	1.4	12.1	53
Hobart	−0.9	−0.4	−0.0	0.1	10.1	62
Capital cities	−1.1	−0.7	−0.5	−0.0	5.4	18
Regional	−0.5	0.4	0.6	1.2	17.0	44
National	−0.9	−0.5	−0.2	0.2	8.0	23

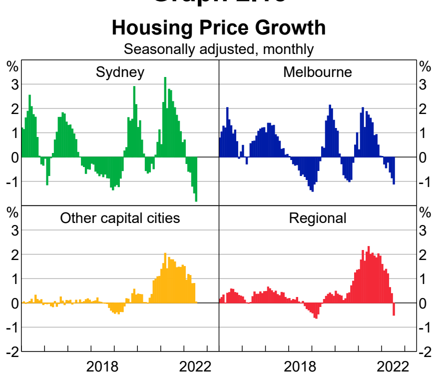
Sources: CoreLogic, RBA

(CPI) in the first half of the year. Rental yields have increased slightly across most states in recent months as growth in advertised rents has outpaced growth in housing prices.

Growth in public consumption has been strong

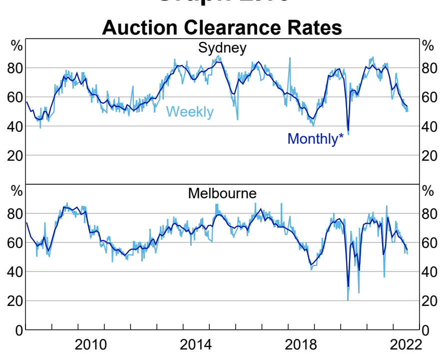
Public demand increased by 2.5 per cent in the March quarter, reflecting strong growth in public consumption as defence personnel were deployed to assist flood-affected communities throughout Queensland and New South Wales (Graph 2.18). Public consumption as a share of GDP remains at a very high level compared with the pre-pandemic period (Graph 2.19). By contrast, growth in public investment has been subdued over the past year or so. Public infrastructure projects have been delayed due to labour and materials shortages, alongside elevated capacity utilisation in the construction sector.

Graph 2.15



Sources: CoreLogic; RBA

Graph 2.16



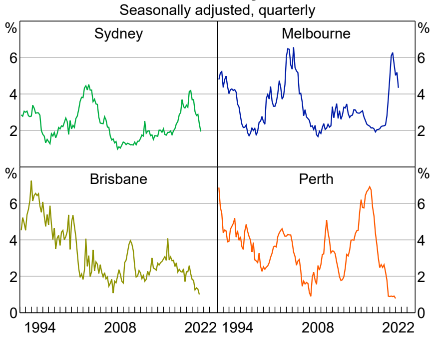
* Seasonally adjusted.

Sources: APM; CoreLogic; RBA; REIV

Graph 2.17

Rental Vacancy Rates

Seasonally adjusted, quarterly

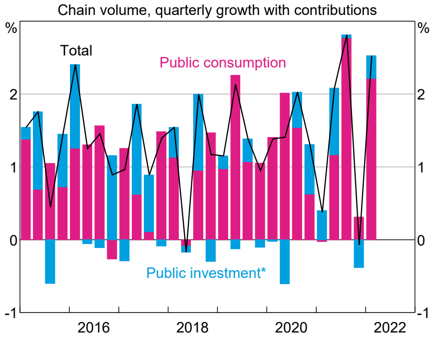


Sources: RBA; REIA; REINSW; REIV

Graph 2.18

Public Demand

Chain volume, quarterly growth with contributions



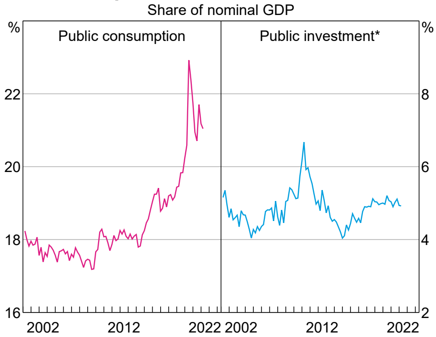
* Adjusted for second-hand asset transfers between public and other sectors.

Sources: ABS; RBA

Graph 2.19

Components of Public Demand

Share of nominal GDP



* Adjusted for second-hand asset transfers between public and other sectors.

Sources: ABS; RBA

Resource exports have begun to recover following recent production issues …

Available data and information from the Bank's liaison program indicate that resource export volumes began to recover in the June quarter, following earlier declines because of protracted maintenance and weather-related disruptions. Rural exports have remained elevated over recent months, reflecting strong production and global demand.

Import volumes have been supported by the filling of order backlogs, a rebuilding of inventories and the international border reopening. In values terms, however, exports have increased by more than imports, reflecting high prices for some energy-related commodities such as coal, which has taken the trade surplus to record highs (Graph 2.20).

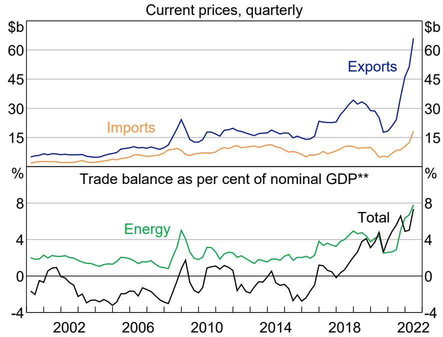
… while services trade has picked up

Trade in services has continued to pick up following the full reopening of the international border, with departures recovering more quickly than arrivals. The slow recovery in arrivals reflects limited inflows of students and tourists, in part because of recent COVID-19 outbreaks and travel restrictions in China (Graph 2.21). Student visa numbers have increased and liaison contacts in the education sector anticipate that

Graph 2.20

Australia's Energy Trade*

Current prices, quarterly



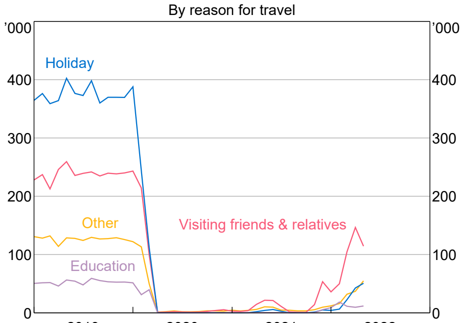
* Includes coal, coke & briquettes and other mineral fuels; seasonally adjusted by the RBA.

** Includes RBA nominal GDP forecast for June 2022.

Sources: ABS; RBA

student enrolments will continue to pick up over the second half of this year and into early 2023. However, it will take at least a few years before the number of international students in Australia recovers to around pre-pandemic levels (Graph 2.22).

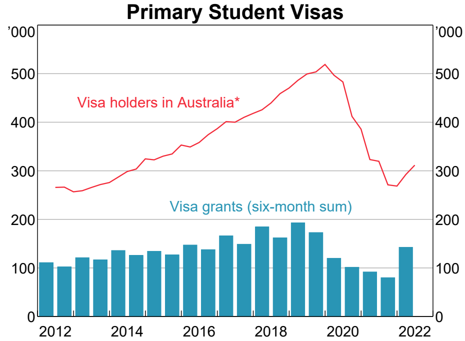
Graph 2.21



* Seasonally adjusted until March 2020; original data from April 2020 onwards.

Sources: ABS; RBA

Graph 2.22



* Seasonally adjusted until March 2020; original data from April 2020 onwards.

Sources: Department of Home Affairs; RBA