2. Domestic Economic Conditions

The Australian economy staged a strong recovery in late 2021 and timely indicators suggest economic activity has remained resilient to the Omicron outbreak and the east coast floods in early 2022. The underlying strength in the economy has been particularly evident in the labour market, where conditions are the most robust in many years. Strong labour demand and fiscal measures are supporting growth in household income, although recent large increases in food and energy prices are having a significant negative impact on household budgets. More broadly, the increase in commodity prices following Russia's invasion of Ukraine has boosted national income, mainly in the form of elevated profits for companies in the resources sector and higher government tax revenue.

Labour market conditions are the tightest they have been in a long time …

The unemployment rate declined to 4 per cent in March – as low as in 2008 and, prior to that, the mid-1970s – amid strong labour demand (Graph 2.1). This demand has been met by firms increasing both headcount and hours of existing staff, which has seen other measures of spare capacity (such as heads- and hours-based underutilisation rates) also decline to levels not seen for many years (Graph 2.2). Labour underutilisation has declined across most industries and has been particularly notable in industries where employment has grown strongly (such as professional services) and those reporting labour supply shortages (such as hospitality). There are also signs that wages growth is picking up in response to this tightening in labour market conditions (see chapter on 'Inflation').

Overall, the supply of labour has been responsive to the strong demand for labour; the

Graph 2.1

Unemployment Rate*

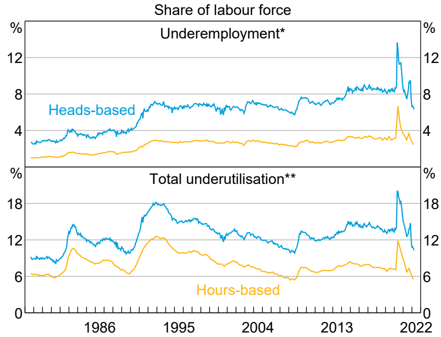
* Data are quarterly to February 1978 and monthly thereafter.

Source: ABS

Graph 2.2

Labour Underutilisation Rates

Share of labour force



* Full-time workers on part-time hours for economic reasons and part-time workers who would like, and are available, to work more hours.

** The underutilisation rate adds together the unemployment and underemployment rates.

Sources: ABS; RBA

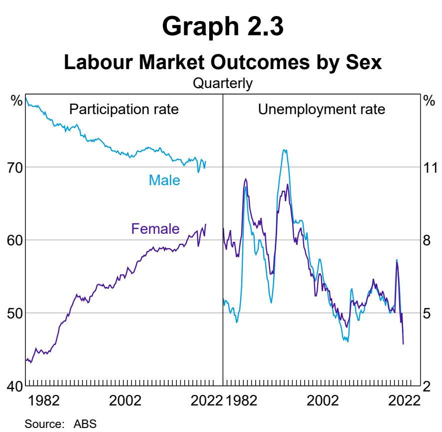
participation rate increased to a record high of 66.4 per cent in March, and the employment to working age population ratio also increased to a historically high level. This is in contrast to the experience of some other advanced economies, such as the United States and the United Kingdom, where the participation rate remains materially below pre-pandemic levels.

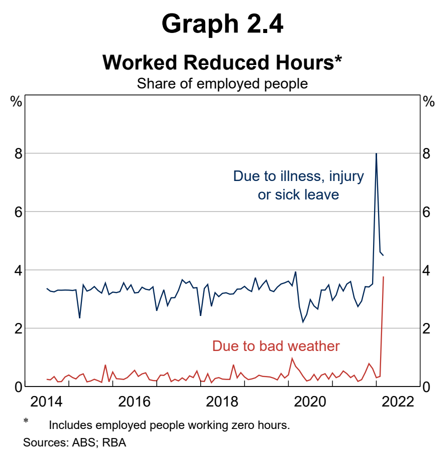
The increase in the participation rate in Australia has been largely driven by strong female participation, which has risen by 1 percentage point since February 2020 to a record high (Graph 2.3). Female employment has grown by 4 per cent over this period, which has seen the female unemployment rate decline to its lowest level since the mid-1970s. By contrast, the male participation rate is near its pre-pandemic level and, while still strong, male employment growth has been around half that for females. The relative strength in female labour market outcomes is partly due to robust growth in employment in a number of industries that employ a larger share of female workers, including the healthcare & social assistance industry.

The Omicron outbreak and the east coast floods have temporarily affected labour supply. Similar to previous outbreaks of COVID-19, reduced hours rather than headcount has been the primary way the labour market has adjusted to disruptions from Omicron. However, in contrast to previous outbreaks, people have mostly still been paid for these unworked hours. The number of employed people working fewer or zero hours due to 'illness, injury or sick leave' remained elevated in March but was well below its January peak (Graph 2.4). Information from the Bank's liaison program suggests that most firms were able to manage staff absenteeism in the past few months without material disruptions to operations. The heavy rain and floods in New South Wales and Queensland from late February onwards also saw a much higher-than-usual number of people working reduced hours due to bad weather in March.

… and forward-looking indicators of labour demand remain strong

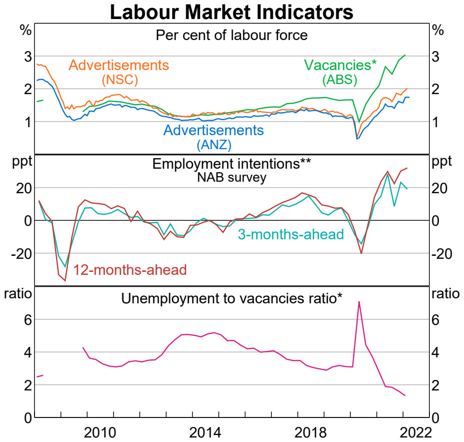
Leading indicators of labour demand point to a further tightening in the labour market in the period ahead (Graph 2.5). The ratio of the number of unemployed people to the stock of vacancies fell further in February to a record low of around 1½ unemployed persons per vacancy. Job advertisements also remained elevated in recent months and point to continuing strong growth in employment. Around three-fifths of firms in the Bank's liaison program intend to increase headcount over coming months (and most firms intend to increase wages, see





discussion below), while very few intend to reduce headcount. Most firms continue to report issues with labour availability in parts of their operations, although only a few have reported such issues across their entire workforce. Liaison information suggests that the reopening of international borders has not yet materially improved labour availability in sectors that tend to hire workers on temporary visas. While net overseas arrivals are picking up slowly, the numbers remain well below pre-pandemic levels, particularly for international students and working holiday makers who are often employed in the hospitality, administration & support and agriculture industries.

Job mobility remains high relative to the decade leading up to the COVID-19 pandemic, and has returned to levels that were common prior to the global financial crisis. The increase in the number of people switching jobs over the past year reflects some catch-up in planned job changes that were put on hold during the pandemic; however, it is also partly due to increased competition for workers. In response to elevated turnover, some firms in the Bank's liaison program reported having raised the wages of existing employees to meet increases in corresponding market salaries. Workers remain upbeat about the employment outlook, with the share of employees expecting to change jobs over the next year rising in recent months (Graph 2.6). The increase in expected job mobility has been primarily driven by full-time workers, particularly in higher-skilled occupations.



* ABS Vacancies Survey was suspended between May 2008 and November 2009.

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

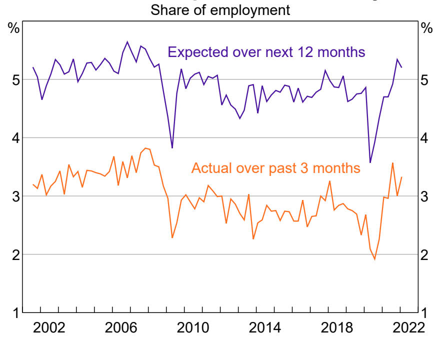
Sources: ABS; ANZ; NAB; National Skills Commission (NSC); RBA

Household income continues to be supported by the strong labour market

Household income has grown strongly during the pandemic but declined slightly in the December quarter as the tapering of fiscal measures, such as COVID-19 support payments, offset growth in labour income (Graph 2.7). Household income is expected to increase in the March quarter supported by strength in the labour market, with tax receipts indicating continued strong growth in labour income. Government disaster payments and resource company dividends from high commodity prices are also expected to contribute to higher household income.

Activity rebounded in the December quarter as consumption opportunities broadened …

The Australian economy grew by 3.4 per cent in the December quarter as household consump-



Sources: ABS; RBA

tion rebounded sharply following the easing of Delta-related restrictions (Graph 2.8). The increase in household consumption was broad based, but was particularly pronounced for discretionary goods and services. With higher consumption and lower income, the household saving ratio declined to 13½ per cent in the December quarter; this ratio is below the peak seen earlier in the pandemic but is still more than twice that typically observed in the years prior to 2020.

Public consumption was little changed after a large increase in the September quarter of 2021, while business, dwelling and public investment declined. Ongoing capacity pressures in the construction sector and supply chain issues contributed to the weak outturns for investment. In addition, the effect of tax incentives on growth in business investment may have waned over time. Net trade subtracted a little from growth in the December quarter; exports declined due to maintenance and weather disruptions in the resources sector, while a smaller decline in imports was driven by lower capital and consumption goods.

… but supply shocks temporarily slowed domestic activity growth in the March quarter

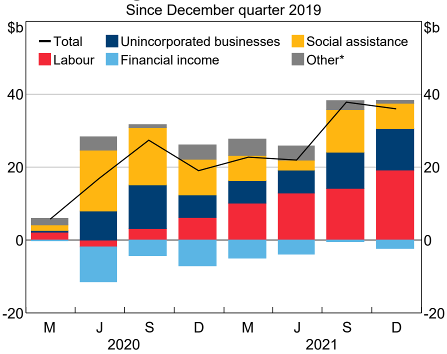
The Omicron outbreak experienced throughout the country and flooding in New South Wales and Queensland weighed on economic activity in the March quarter. However, the effect of these supply shocks should be limited and temporary. While labour shortages related to employee illness and isolation requirements have caused disruptions in some industries, timely indicators suggest that the impact of Omicron on domestic activity has been much less than that seen during earlier outbreaks. And, while the economic effect of the floods is substantial in the geographic areas directly affected by the devastation, it will be less evident in economy-wide data. Over time, government support and reconstruction efforts will also add to spending.

Domestic demand has been underpinned by household spending, which has remained resilient despite recent increases in the cost of living. Households increased their expenditure on discretionary goods and services as restrictions on activity were lifted in late 2021, particularly in hospitality and tourism (Graph 2.9). Retail sales values grew strongly in the March quarter. However, information from

Graph 2.7

Change in Household Income

Since December quarter 2019



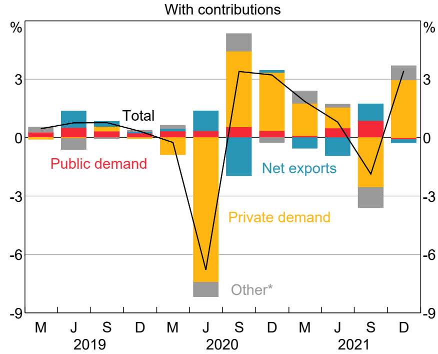
* Includes rent, tax payable, interest payable and other.

Sources: ABS; RBA

Graph 2.8

Quarterly GDP Growth

With contributions



* Includes change in inventories and statistical discrepancy.

Sources: ABS; RBA

retailers in the Bank's liaison program suggests that price increases contributed significantly to the increase in sales values as firms responded to the persistence and magnitude of cost increases (see chapter on 'Inflation'). Rising prices were also likely to have contributed to the decline in consumer confidence to below its long-run average, and are expected to weigh on consumption in the period ahead.

Supply chain disruptions and rising costs have weighed on business investment …

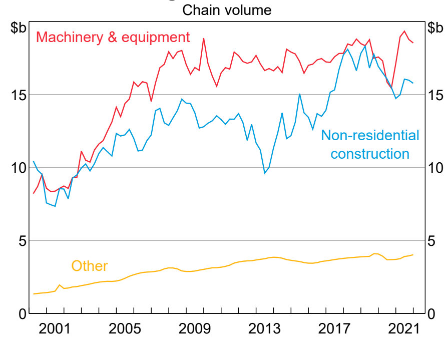
The strong upswing in non-mining business investment that had been underway in the first half of 2021 paused over the second half of the year. After a lockdown-affected September quarter, non-mining business investment declined a little further in the December quarter (Graph 2.10). Machinery & equipment investment declined, after earlier strong growth in response to tax incentives from the Australian Government that brought forward some investment. Imports of capital goods also slowed alongside ongoing supply chain disruptions. The earlier rebound in non-residential construction paused as some large projects finished, and costs increased amid broader capacity pressures in the construction industry. Nevertheless, surveyed measures of investment intentions have continued to highlight a positive backdrop for business investment. The ABS Capital Expenditure survey, conducted in January and February this year, indicated that both mining and non-mining business investment are expected to increase in the 2021/22 financial year (Graph 2.11).

The Omicron outbreak affected many businesses over recent months (Graph 2.12). Around 20 per cent of firms surveyed in each of the first few months of 2022 reported being affected by COVID-19-related employee absences, while around 40 per cent experienced supply chain disruptions. Despite this, and in contrast to declining consumer sentiment, surveyed

Graph 2.10

Non-mining Business Investment

Chain volume

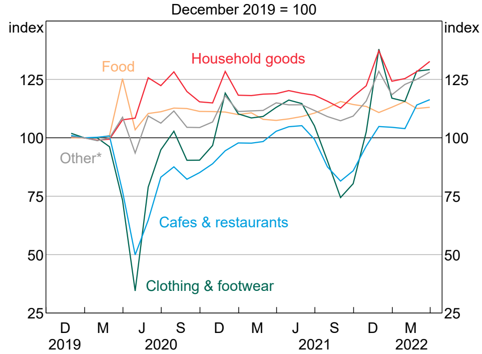


Sources: ABS; RBA

Graph 2.9

Retail Sales Values

December 2019 = 100



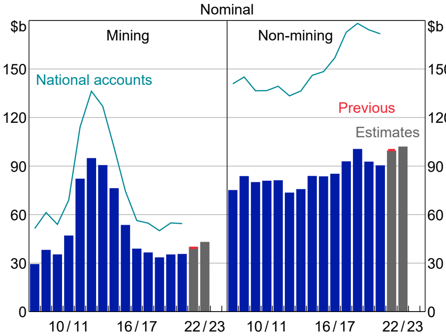
* Includes department stores and other retailing.

Sources: ABS; RBA

Graph 2.11

Capital Expenditure Intentions*

Nominal



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

Sources: ABS; RBA

measures of business conditions and confidence increased in recent months and remained above their long-run averages. The increase reflected a rebound in activity in services-related industries and continued strong demand in goods-related industries.

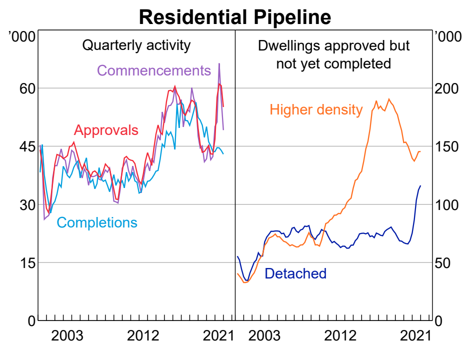
… and the pace of new housing construction has slowed

Demand for new housing and renovations has been strong over the past two years, reflecting 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. There remains a large pipeline of residential construction work, but the pace of delivery has slowed recently due to supply bottlenecks (Graph 2.13). Construction activity declined in the December quarter, with builders in the Bank's liaison program reporting that construction times in most states are around three months longer than average due to shortages of materials and labour. Capacity utilisation in the construction sector is well above average, consistent with the sector operating at close-to-peak capacity. Widespread rainfall along the east coast and absenteeism due to the Omicron outbreak will have further weighed on construction activity in the March quarter. New home sales and greenfield land sales indicate demand for new housing has eased but remains above pre-pandemic levels.

Housing price growth has slowed, but conditions vary across the country

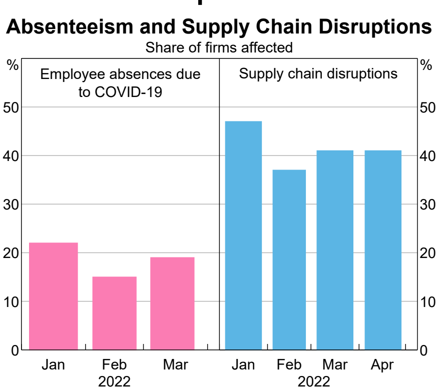
Housing price growth has eased at the national level over recent months following strong gains throughout 2021 (Graph 2.14). Prices have been declining a little in Sydney and Melbourne alongside falling auction volumes and clearance rates in these cities (Table 2.1). Survey measures of housing price growth expectations have also begun to ease from high levels. In most other capital cities and regional areas, price growth has moderated but remains strong, supported by a very low number of properties available for sale (Graph 2.15).

Graph 2.13



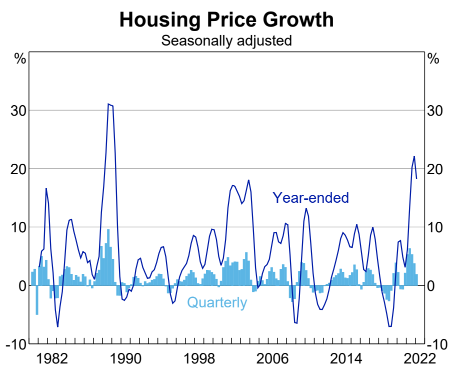
Sources: ABS; RBA

Graph 2.12



Source: ABS

Graph 2.14



Sources: CoreLogic; RBA

Table 2.1: Housing Price Growth

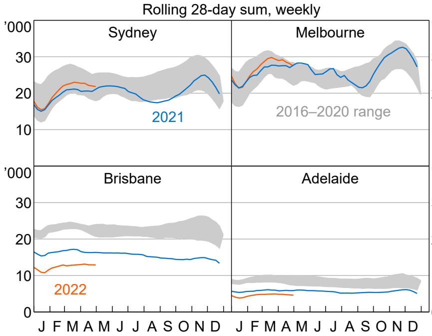
Percentage change, seasonally adjusted

	April	March	February	January	Year-ended	Five-year growth
Sydney	–0.4	–0.5	–0.3	0.7	15	22
Melbourne	0.0	–0.4	–0.2	0.0	8	17
Brisbane	1.7	1.7	1.7	2.4	29	45
Adelaide	1.7	1.9	1.8	2.2	26	44
Perth	1.0	0.4	–0.1	0.3	7	15
Darwin	0.5	0.4	0.7	0.4	9	4
Canberra	1.3	1.0	0.4	1.9	21	56
Hobart	0.1	0.4	0.9	1.1	21	69
Capital cities	0.2	0.1	0.1	1.0	15	22
Regional	1.3	1.4	1.4	1.6	24	46
National	0.5	0.4	0.4	1.1	17	27

Sources: CoreLogic; RBA

Growth in advertised rents has been strong in most states, reflecting low vacancy rates and strong income growth (Graph 2.16). Advertised rents in capital cities declined in the initial stages of the pandemic but are now significantly above pre-COVID-19 levels. Vacancy rates in Sydney and Melbourne declined recently, particularly in inner city suburbs, suggesting that strong advertised rent growth will persist in these cities. Over time, this will flow through to overall rents paid in those cities, which have been subdued for several years. In other capital cities, vacancy rates remain around historical lows despite reduced levels of overseas migration through the pandemic period. Recent flooding is expected to have placed additional short-term pressure on rental markets in affected regions in Queensland and New South Wales.

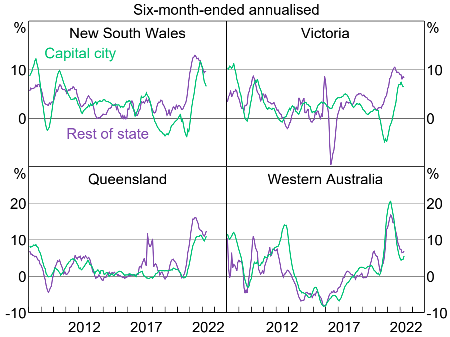
Graph 2.15



* Properties advertised for sale across multiple sources or multiple times in the same 28-day period are only counted once.

Sources: CoreLogic; RBA

Graph 2.16



* Hedonic; seasonally adjusted.

Sources: CoreLogic; RBA

Public spending continues to provide strong support for the economy

Public demand declined in the December quarter as an increase in state public consumption and investment was offset by a decline in federal consumption and investment expenditure. The increase in state public demand was driven by health measures and a pick-up in activity on key infrastructure projects. Public demand as a share of GDP remained at a very high level compared with the pre-pandemic period (Graph 2.17). The Australian Government Budget 2022–23 affirmed that federal government consumption and investment spending would remain at high levels in coming quarters. The Budget included a very large upgrade to realised tax revenue, as well as expected receipts over the forward estimates, supported by stronger economic and employment outcomes, and higher commodity prices. Only part of the upgrade in receipts was earmarked to support household incomes, with the remainder reducing the deficit over the forecast period (Graph 2.18).

Production issues have weighed on resource exports …

Partial data and information from the Bank's liaison program indicate that resource export volumes have declined over recent months. Coal production in the March quarter was impacted by flooding in eastern Australia, while LNG production was affected by maintenance-related disruptions. Labour shortages due to Omicron-related staff absenteeism also affected production volumes, resulting in longer shipping queues at ports, particularly in the coal sector. Rural exports have continued to increase over recent months as ongoing favourable weather conditions have supported record grain harvests. Higher commodity prices have sharply increased the value of exports in recent months, boosting national income via higher profits in the resources sector. However, the trade surplus has trended downward since mid-2021, largely due to strong growth in import values (Graph 2.19).

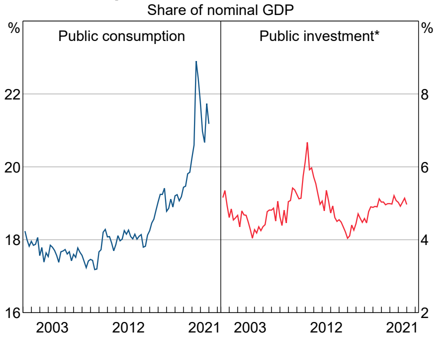
… while services trade has begun to recover

Trade in services has begun to recover following the full reopening of the international border for vaccinated travellers in February, which in turn followed the partial reopening to select eligible visa-holders in December (Graph 2.20). Education exports have increased as international students arrived for the first semester of 2022, though student visa numbers remain well below their pre-pandemic level.

Graph 2.17

Components of Public Demand

Share of nominal GDP



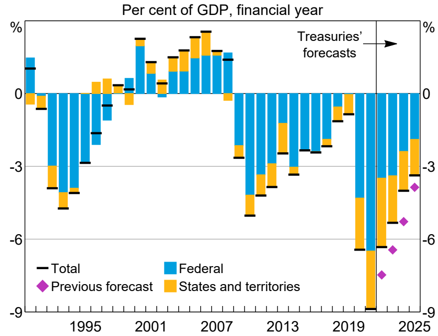
* Adjusted for second-hand asset transfers between the public and other sectors.

Sources: ABS; RBA

Graph 2.18

Consolidated Government Underlying Cash Balance

Per cent of GDP, financial year



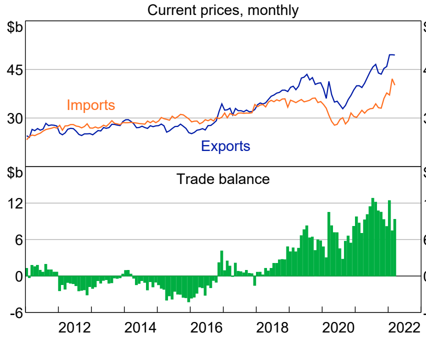
Sources: ABS; Australian Treasury; RBA; state and territory treasuries

Liaison contacts in the sector anticipate that student enrolments will continue to pick up in the second half of this year and in early 2023 but that it will take several years for enrolments to return to their pre-pandemic level. Travel imports have continued to recover following the commencement of unrestricted outbound travel for Australian citizens and permanent residents in November 2021.

Graph 2.19

Trade in Goods and Services

Current prices, monthly

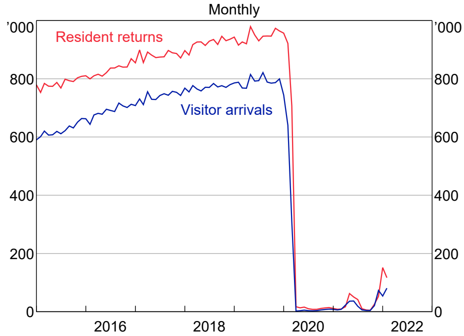


Sources: ABS; RBA

Graph 2.20

Short-term Visitor Arrivals and Resident Returns

Monthly



Sources: ABS; RBA