3. Domestic Economic Conditions

In 2015/16, output in Australia grew at around central estimates of the economy's potential rate of growth (Table 3.1; Graph 3.1).[1] Growth was supported by a significant increase in resource exports, consistent with new capacity coming online. At the same time, there were further large falls in mining investment. The transition of economic activity towards the non-mining sector has continued, as reflected in strong growth in dwelling investment and public demand and further growth in household consumption. Nominal income rose at a modest pace in 2015/16, mainly owing to the decline in commodity prices and low wage growth. However, commodity prices have risen over the course of 2016 and the terms of trade have increased of late following four years of significant declines.

The unemployment rate has declined a little further over recent months. While this suggests that labour market conditions have continued to improve,

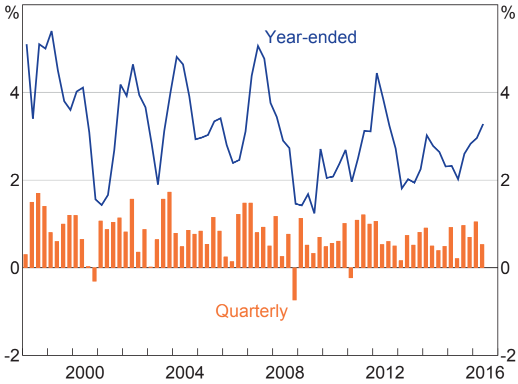
Table 3.1: Demand and Output Growth
Year average, per cent

	2015/16	2014/15
GDP	2.8	2.4
Domestic final demand	1.2	1.1
– Private demand[(a)]	0.6	1.2
– Consumption	2.9	2.6
– Dwelling investment	9.8	7.8
– Mining investment	–27.5	–20.1
– Non-mining investment[(a)]	1.0	6.9
– Public demand[(a)]	3.5	0.6
Change in inventories[(b)]	–0.1	0.3
Exports	6.7	6.7
Imports	–0.3	1.2
Mining activity	–2.0	–3.4
Non-mining activity	3.5	3.4
Nominal GDP	2.3	1.7
Real gross domestic income	0.6	0.1

(a) RBA estimates
(b) Contribution to GDP growth
Sources: ABS; RBA

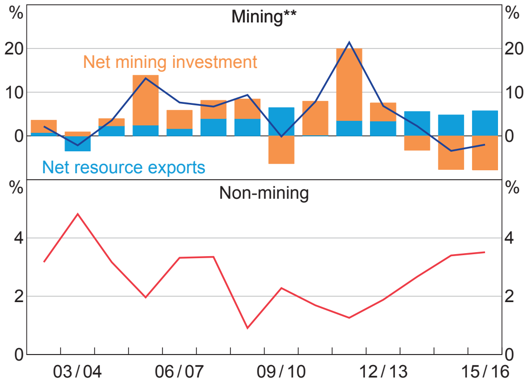
1 Although the 2015/16 annual national accounts (shown in Table 3.1) contain the most recent data on GDP, the June quarter 2016 national accounts, which were released prior to the annual national accounts, contain the most recent data on quarterly movements in GDP.

Graph 3.1
GDP Growth



Source: ABS

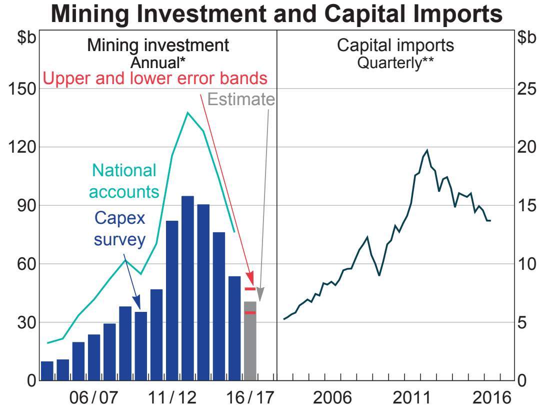
Graph 3.2
Mining and Non-mining Activity*
Year-average growth



* Mining and non-mining activity estimated by the RBA
** Components are contributions to year-average mining activity growth; contribution from mining inventories omitted

Sources: ABS; RBA

Graph 3.3
Mining Investment and Capital Imports



* Current prices
** Chain volume; reference year 2013/14

Sources: ABS; RBA

some other labour market indicators have been less positive. Employment growth has moderated from its strong pace last year and full-time employment has declined over the course of this year. In line with that, the underemployment rate has remained elevated over the past year or so. Together with low wage growth, this suggests that there is more spare capacity in the labour market than implied by the unemployment rate.

Mining Activity

Activity in the mining sector declined in 2015/16, as the fall in mining investment was only partly offset by strong increases in resource exports (Graph 3.2). Mining activity is expected to expand as the drag from mining investment wanes over the next year or so and exports of liquefied natural gas (LNG) continue to ramp up. Further growth in iron ore export volumes is also likely, supported by increased production from Australia's large low-cost producers.

Mining investment has fallen significantly since its peak in 2012/13, from 9 per cent of GDP to about 4½ per cent in 2015/16 (Graph 3.3). Further declines are expected as work on LNG facilities continues to decline and few new projects are expected to commence. However, the largest subtraction of mining investment (net of imports) from GDP growth looks to have already occurred; the ABS capital expenditure (Capex) survey of investment intentions and Bank liaison point to a smaller subtraction in 2016/17.

Overall economic conditions remain relatively weak in Western Australia and, to a lesser extent, Queensland. The earlier large falls in commodity prices from their peak in 2011 exerted a significant drag on growth in output and income in those states. The increase in commodity prices over 2016 to date represents a marked change from previous years. If sustained, higher commodity prices will provide some support to growth in nominal income, but are not expected to lead to much additional mining investment over the next couple of years.

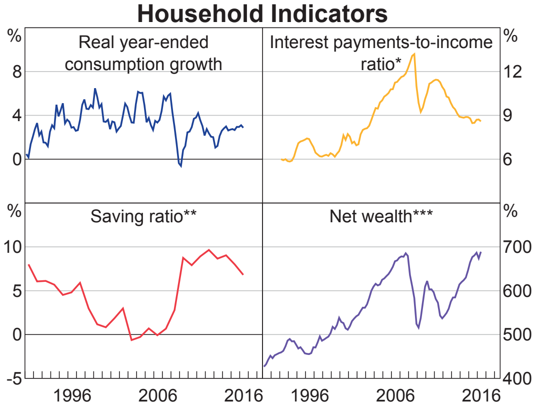
Non-mining Activity

Growth in non-mining activity has picked up over recent years, supported by low interest rates and the depreciation of the exchange rate since early 2013 (Graph 3.2). In 2015/16, non-mining activity increased by a little more than its average rate.

Household sector

Consumption growth has continued to be supported by low interest rates, rising household wealth and further increases in employment, although wage growth has been subdued. The household saving ratio has declined gradually, but remains at a relatively high level compared with outcomes over recent decades (Graph 3.4).

Graph 3.4
Household Indicators



* Excludes unincorporated enterprises
** Net of depreciation
*** Per cent of annual household disposable income before the deduction of interest payments
Sources: ABS; RBA

In 2015/16, growth in household consumption was close to its decade-average rate. However, growth was more moderate in the June quarter, owing to a decline in the consumption of goods; consumption of services grew at a similar pace to recent quarters. The weakness in goods consumption was consistent with subdued growth of retail sales in the June quarter. Growth in the value of retail sales remained modest early in the September quarter, potentially signalling further weakness in goods consumption. On the other hand, households' perceptions of their own finances have been above average for some time and increased in the September quarter.

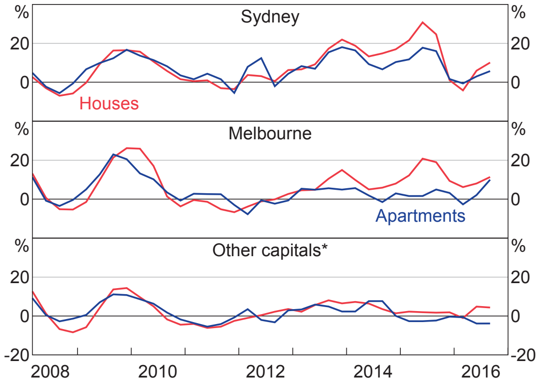
There is some uncertainty about the likely strength of consumption growth over the period ahead. If weak growth in household income persists, households may restrain growth in future consumption, which would imply a more modest decline in the household saving ratio than has been observed in the past few years.

Housing price growth and auction clearance rates have risen in Sydney and Melbourne recently, although the number of auctions held remains lower than a year ago (Graph 3.5; Graph 3.6). In the private treaty market, the average discount on vendor asking prices has decreased slightly, but the average number of days that a property is on the market has increased from the lows of last year, mainly reflecting developments outside Sydney and Melbourne. Housing loan approvals have edged higher over recent months, driven by investor lending, and growth in lending to investors for housing has picked up to be close to that for owner-occupiers (see 'Domestic Financial Markets' chapter for further details on housing finance).

Notwithstanding the recent strengthening in housing market conditions in Sydney and Melbourne, overall conditions in the established housing market have eased relative to mid last year. Housing price inflation remains below the peaks in 2015. Housing credit growth is lower than a year ago, consistent with the tightening in lending standards since then and lower turnover. Tighter lending standards have been reflected in the declining share of interest-only loans over the past year and a decrease in new lending with loan-to-valuation ratios greater than 90 per cent.[2] Moreover, much of the increase in credit is being used to finance new housing construction rather

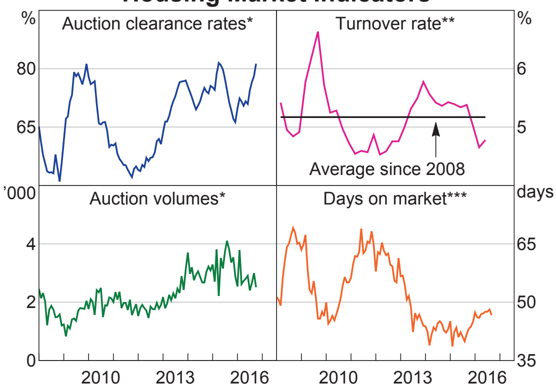
2 See RBA (2016), *Financial Stability Review*, October, pp 18–19.

Graph 3.5
Housing Price Growth by Dwelling Type
Six-month-ended annualised, seasonally adjusted



* Dwelling stock weighted average of Adelaide, Brisbane and Perth
Sources: APM; RBA

Graph 3.6
Housing Market Indicators



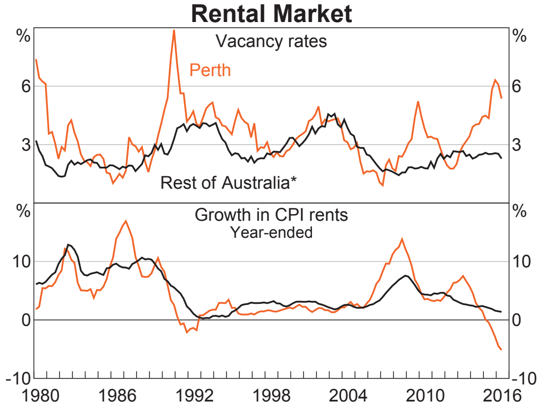
* Average of Melbourne and Sydney
** Share of dwelling stock; annualised
*** Capital city dwelling stock weighted median for private treaty sales only
Sources: ABS; APM; CoreLogic; RBA; Real Estate Institute of Victoria

than consumption (in contrast to the experience of the early 2000s).

Private dwelling investment continued to grow at an above-average rate in 2015/16. Residential building approvals remain well above their long-run average, driven by higher-density approvals, and there is a significant amount of work in the pipeline. That work is expected to support a high level of dwelling investment for some time, although the rate of growth in dwelling investment is expected to decline over the forecast period.

In some residential markets, such as apartment markets in inner-city areas of Melbourne and Brisbane, there are concerns that the significant new supply of dwellings in the pipeline will outpace growth in demand for housing and place downward pressure on rents and prices. This in turn could increase the risk of off-the-plan purchases failing to settle.[3] While there are reports of some settlement delays and settlement failures, liaison suggests that so far the incidence of these is not higher than usual (although there looks to have been a slight rise in settlement delays for some foreign buyers). In Western Australia, over recent years population growth has declined, the unemployment rate has increased, household income growth has moderated and yet dwelling completions have been high. This has led to a sharp rise in rental vacancy rates and a noticeable decline in rents and prices in Perth (Graph 3.7). Rent growth in the rest of the country has declined to low levels, but vacancy rates have been generally steady and relatively low.

Graph 3.7
Rental Market



* Capital cities only; excludes Adelaide from March quarter 2015
Sources: ABS; RBA; REIA

3 If the buyer is unwilling or unable to settle the purchase of the property, the deposit is forfeited and the property developer can resell the property. See RBA (2016), 'Box B: The Housing Market', *Statement on Monetary Policy*, August, pp 42–44; RBA (2016), *Financial Stability Review*, October p 17.

Non-mining business sector

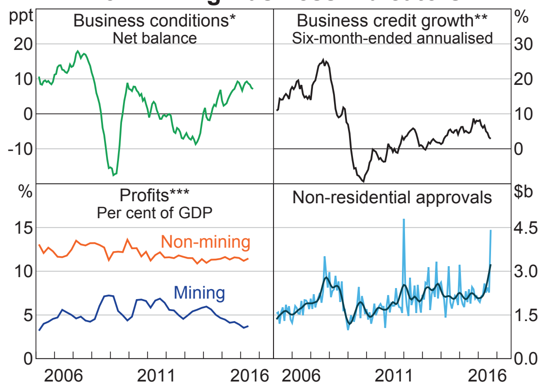
Revised data in the annual national accounts suggest that non-mining business investment has been on an upward trend for the past few years, after declining in 2012/13, although growth was modest in 2015/16. The rise in non-mining investment is consistent with the pick-up in non-mining activity over recent years, which has been supported by low interest rates and the earlier depreciation of the exchange rate.

Indicators such as the ABS Capex survey suggest that non-mining business investment is likely to be subdued in 2016/17. However, the Capex survey only covers about half of the non-mining business investment captured by the more comprehensive national accounts measure; it does not cover certain industries, such as some service industries that have had relatively strong investment outcomes over recent years, nor does it measure investment in intangible capital such as software, which has also grown relatively strongly. Private non-residential building approvals have picked up of late, reflecting increases in New South Wales and Victoria, although work yet to be done (as a share of GDP) has been on a downward trend for the past two years or so.

By state, the Capex survey suggests that the weakness in non-mining investment has been most evident in Western Australia and Queensland, where the downturn in the terms of trade and mining investment have had a large, direct effect on demand. In contrast, non-mining business investment appears to have increased somewhat in New South Wales and Victoria, which are less exposed to the mining sector and where economic conditions have improved over the past couple of years.

Survey measures of business conditions in the non-mining sectors have been above average for some time (Graph 3.8). Survey measures of profitability are at above-average levels, although the ABS measure of non-mining company profits has been little changed as a share of nominal GDP. Business credit growth has moderated recently, although this partly reflects a reduction in the growth of credit extended to mining-related firms.

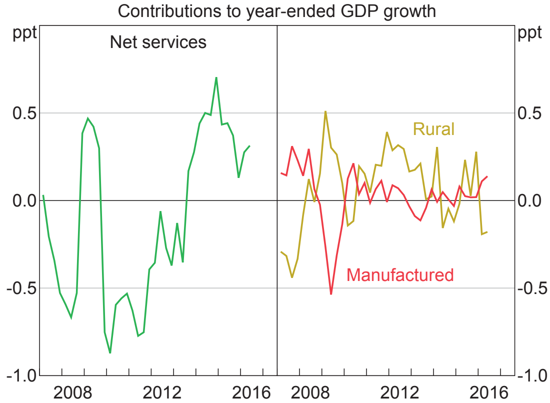
Graph 3.8
Non-mining Business Indicators



* Deviation from long-run average; gross value added weighted; three-month moving average
** Business credit includes mining and non-mining industries
*** Inventory valuation adjusted gross operating profits
Sources: ABS; APRA; NAB; RBA

The depreciation of the exchange rate since early 2013 has supported growth in non-mining exports. Net service exports have made a significant contribution to GDP growth over this period, with tourism, education and business services exports all expanding (Graph 3.9). Manufactured exports have picked up since the beginning of 2016, following several years of little change. Rural exports, most notably wheat and beef, have declined in the year

Graph 3.9
Non-mining Exports
Contributions to year-ended GDP growth



Sources: ABS; RBA

to date. The global stock of wheat is at a historically high level resulting in low wheat prices, while Australian beef supply has been tightening as farmers rebuild their herds.

Government sector

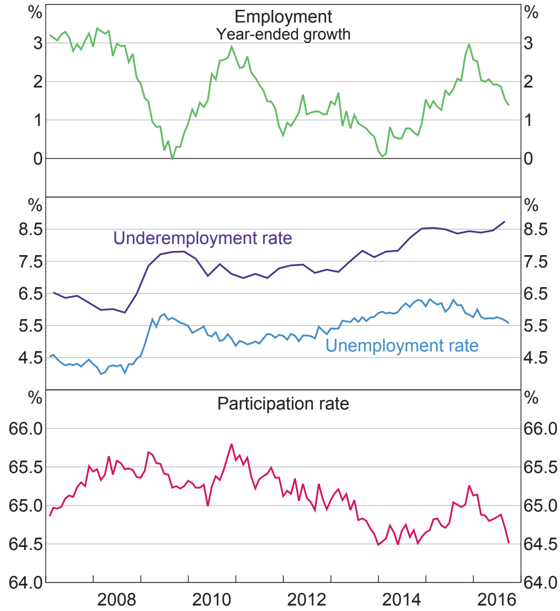
Public demand has contributed strongly to growth over the past year, in part reflecting an increase in infrastructure investment in New South Wales and Victoria. Federal and state budgets suggest that the consolidated deficit will widen a little in 2016/17 to around 3 per cent of GDP. Deficits are expected to be progressively lower over subsequent years and the consolidated deficit is forecast to return to a balanced position by around 2019/20.

Labour market

The unemployment rate continued to decline in the September quarter and is a bit more than half a percentage point below its peak in mid 2015 (Graph 3.10). While the unemployment rate has declined more quickly than had been expected a year ago, other indicators paint a more mixed picture and are consistent with some moderation in labour market conditions over the course of this year.

In particular, following strong growth in late 2015, employment growth has slowed to a more modest pace and the increase in employment since then has been in part-time jobs (See 'Box B: Trends in Part-time and Full-time Employment'). Also, the underemployment rate – which captures employees who are available and would like to work more hours – has picked up a little over the past year and remains elevated. The pick-up in underemployment has been driven by males, while underemployment has been little changed for females. This difference may reflect the loss of full-time jobs in industries that tend to hire a larger share of males, such as mining, manufacturing and utilities. Moreover, the participation rate has declined a little of late, mostly because of a decline in male participation.

Graph 3.10
Labour Market

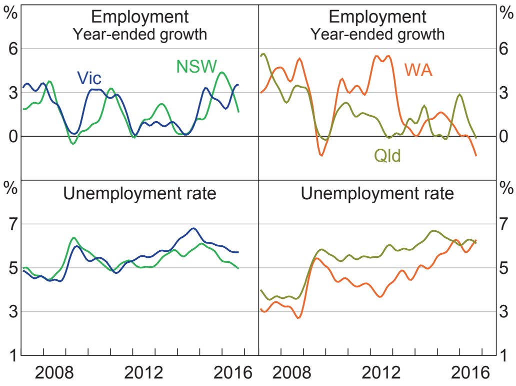


Source: ABS

Differences in the labour market across states are consistent with the rebalancing of economic activity from mining to the non-mining sectors. Although most new jobs created this year have been part-time, total employment has grown in New South Wales and Victoria, been subdued in Queensland and declined in Western Australia (Graph 3.11). Over the past two years, the unemployment rate has declined in all states except Western Australia, where it has increased noticeably. A sharp slowing in net interstate and overseas immigration to the resource-rich states has assisted adjustment to slowing growth in labour demand and helped to limit the rise in unemployment rates in Queensland and Western Australia.

By sector, household services has been the most important contributor to employment growth over the past couple of years. Within that sector, there have been further increases in employment in the health and education industries and, more recently, employment growth in the accommodation & food industry has increased, possibly reflecting a

Graph 3.11
Labour Market by State
Trend

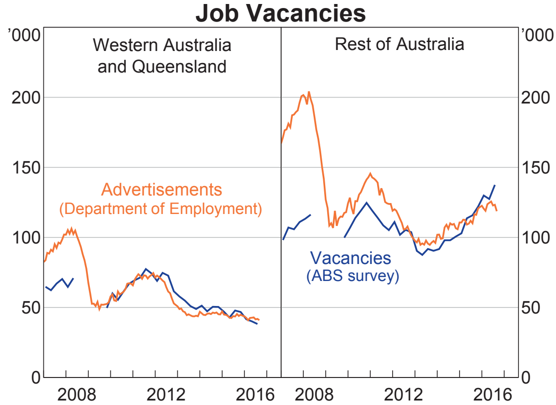


Sources: ABS; RBA

boost in demand owing to the earlier depreciation of the exchange rate. Within the goods sector, construction employment has grown strongly for several years, owing to the pick-up in residential construction activity, which has offset the decrease in employment associated with the decline in mining-related construction work. Mining employment is now back to around 2011 levels.

Overall, forward-looking indicators of labour demand point to continued moderate growth in total employment in the near term. Job vacancies have increased steadily in the non-resource states, but remain subdued in the resource-rich states, indicating that the divergence in employment outcomes between the states is likely to continue for a time (Graph 3.12). Although reductions in mining-related employment associated with falls in mining investment appear to be largely complete, there are likely to be some further job losses over the next couple of years associated with the completion of LNG projects. The degree of excess capacity in the construction industry in Western Australia is unlikely to abate over the next year or so. ✠

Graph 3.12
Job Vacancies



Sources: ABS; Department of Employment; RBA