

3. Domestic Economic Conditions

Recent economic data and liaison suggest that conditions continue to vary significantly across industries. The mining-related parts of the economy are performing strongly, with a number of large-scale mining projects underway and the terms of trade at very high levels. Overall, domestic demand continues to grow at a solid pace, although the high level of the exchange rate, fading impetus from Australian Government spending programs and changes in household spending and borrowing behaviour continue to weigh on activity in a number of industries. As has been the case in many other countries, the volatility in global financial markets resulted in noticeable declines in measures of consumer and business confidence in July and August, although confidence has since partially recovered.

GDP increased by 1.2 per cent in the June quarter to be up by 1.4 per cent over the year (Graph 3.1). For 2010/11 as a whole, GDP increased by 2.1 per cent, with the wet weather estimated to have subtracted around ½ percentage point from growth over this period (Table 3.1). Despite the large upswing in investment, mining sector activity is estimated to have grown below the pace of earlier years due to the flood-related decline in coal production and exports (Graph 3.2).¹ Growth in the non-mining part of the economy is estimated to have been below trend at around 1¼ per cent. Overall growth in labour productivity remains subdued, despite the strong growth in the capital stock, although recent

outcomes have been affected by the disruptions in coal production (Graph 3.3).

**Graph 3.1
GDP Growth**

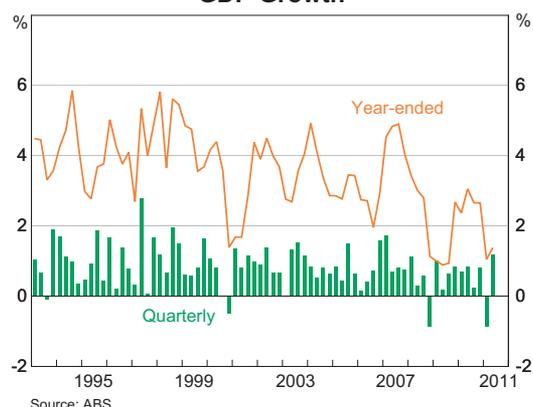


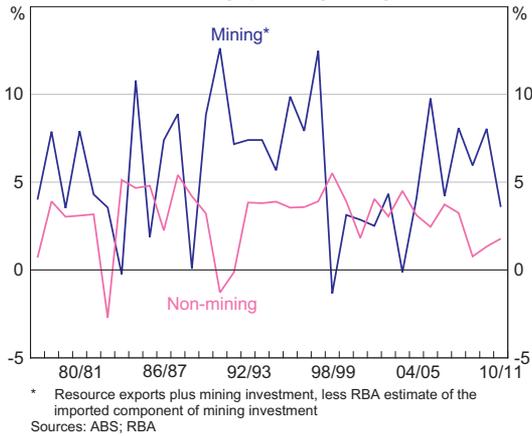
Table 3.1: Output and Factor Input Growth
Year-average, per cent

	2010/11
Domestic final demand	3.5
– Private demand	2.8
– Public demand	2.6
Change in inventories ^(a)	0.7
GNE	4.2
Net exports ^(a)	-2.0
GDP	2.1
Nominal GDP	8.3
Labour input	3.2
Capital stock	3.8

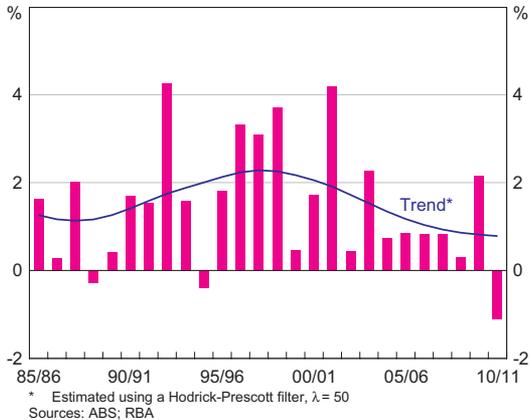
(a) Contributions to GDP growth
Source: ABS

¹ Mining output is estimated using the volume of resource exports and mining investment less its imported component. For more details, see 'Box B: Measuring the Mining and Non-mining Sectors' in the August 2011 Statement.

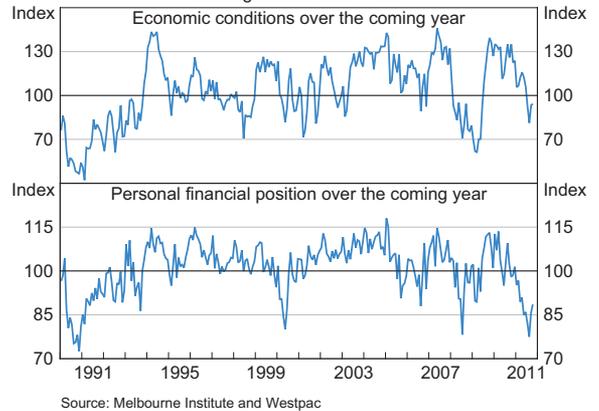
Graph 3.2
Mining and Non-mining Activity
 Year-average percentage change



Graph 3.3
Labour Productivity Growth
 All industries



Graph 3.4
Consumer Sentiment
 Average since 1980 = 100



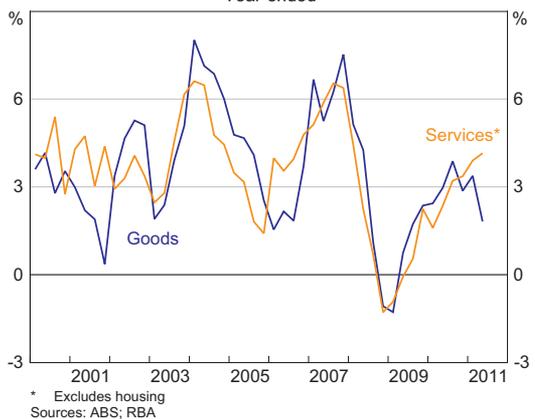
Household Sector

Both household consumption and borrowing continue to grow at rates broadly in line with incomes, but below the average rates of the past decade. Recently, consumer confidence has been affected by events abroad, as well as a range of other factors, with consumers' expectations for their personal finances over the coming year falling sharply from the start of 2011 although recovering somewhat in recent months (Graph 3.4). Household spending on most types of goods, including clothing and electronics, has been relatively soft, with

retailers reporting that larger-than-normal discounts have been required to stimulate sales (Graph 3.5). In contrast, other parts of household spending have been stronger: sales of motor vehicles have bounced back following a supply shortage caused by the Japanese earthquake, and there has been very strong growth over the past year in overseas travel. Consumption of a range of other services has also grown strongly over the past year, although liaison with service providers suggests that there has been some moderation in spending over recent months.

Real household disposable income is estimated to have increased by around 5 per cent over the year to the June quarter, mostly reflecting solid

Graph 3.5
Household Consumption Growth
 Year-ended

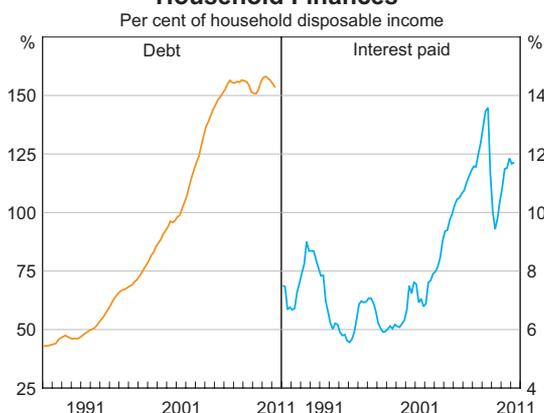


growth in labour income. In contrast, household net worth is estimated to have fallen by 2½ per cent over the September quarter to be 3 per cent lower over the year. The decline over the quarter reflects a fall in both the value of financial assets and house prices. At around 10 per cent, the household saving ratio remains well above the average level of the past two decades and more in line with levels of earlier decades. The household debt-to-income ratio declined over the quarter, but has remained between 150 and 160 per cent since 2006 (Graph 3.6). The interest burden was broadly unchanged over the year.

Nationwide housing prices are estimated to have fallen by around 1¼ per cent in the September quarter and by 3½ per cent over the year (Table 3.2). Brisbane and Perth have been the weakest markets over the year, with prices in these cities falling by around 5 per cent (Graph 3.7). Auction clearance rates are below decade-average levels in Sydney and Melbourne. Demand for housing finance has been subdued since the beginning of the year, although the value of loan approvals has picked up a little in recent months. While housing turnover rose in the June quarter, it remains at quite a low level.

Graph 3.6

Household Finances*



Graph 3.7

Dwelling Prices

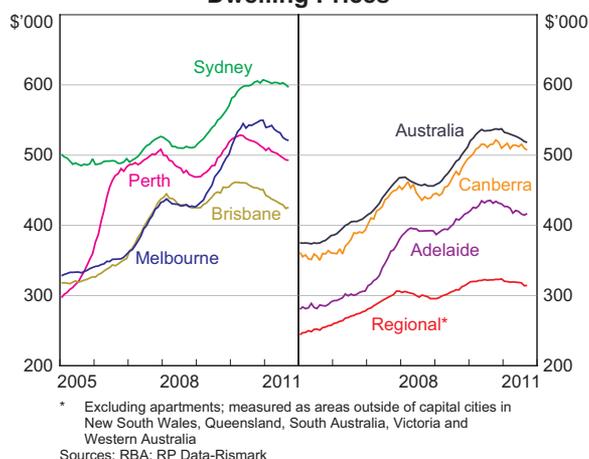


Table 3.2: National Housing Price Growth
Per cent

	3 months to June 2011	3 months to September 2011	Year to September 2011
Capital cities			
ABS ^{(a)(b)}	-0.5	-1.2	-2.2
APM	-2.2	-0.9	-4.3
RP Data-Rismark	-0.9	-1.3	-3.4
Regional areas			
APM ^(b)	0.1	-1.1	-1.8
RP Data-Rismark ^(a)	-0.1	-1.3	-2.4

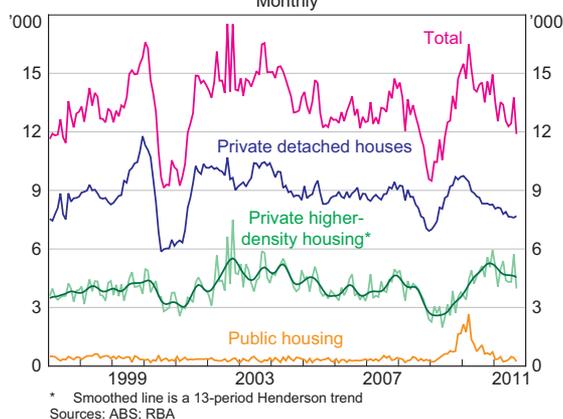
(a) Detached houses only

(b) Quarter-on-quarter growth rate

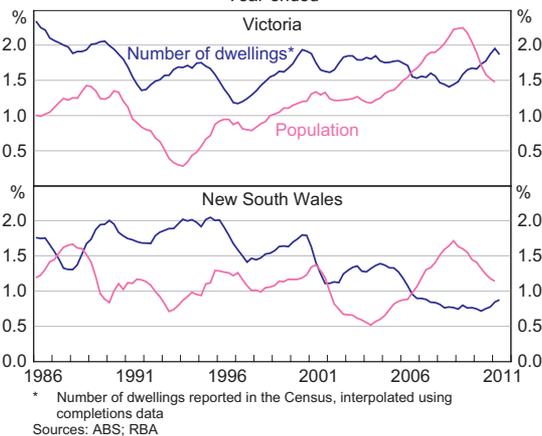
Sources: ABS; APM; RBA; RP Data-Rismark

Indicators of dwelling investment have softened over the year, with builders reporting that households are cautious about committing to contracts. However, there are divergences in the level of activity by type of building and state. While the number of building approvals for detached houses has fallen since late 2010 to relatively low levels, the number of approvals for higher-density housing (mainly apartments) has been higher than over recent years (Graph 3.8). Growth in the dwelling stock is currently quite strong in Victoria, reflecting growth in the building of apartments. In contrast, the growth in dwellings in New South Wales has been soft, and well below the rate of population growth (Graph 3.9).

Graph 3.8
Residential Building Approvals
Monthly



Graph 3.9
Dwelling and Population Growth
Year-ended

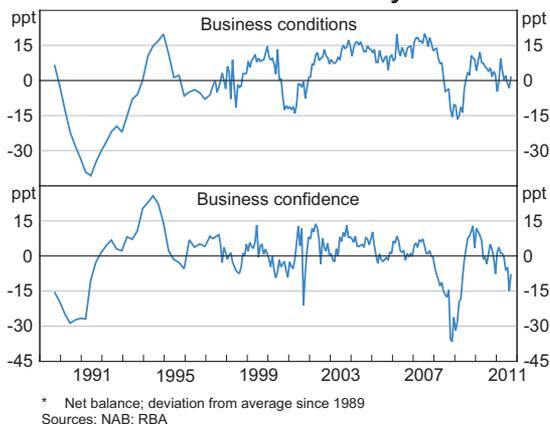


Business Sector

Measures of business confidence have fallen noticeably recently, notwithstanding a partial recovery in September (Graph 3.10). However, most measures of business conditions remain around average levels, with the main exception being the Sensis survey of smaller- and medium-sized firms. There continue to be large differences in conditions across industries, with the retail, manufacturing and construction sectors all experiencing considerably weaker trading conditions than firms exposed to the mining boom; conditions in service industries remain around average (Graph 3.11). Business investment grew by 10 per cent over the year to the June quarter, driven by a 25 per cent rise in engineering construction activity, which was largely mining-sector related.

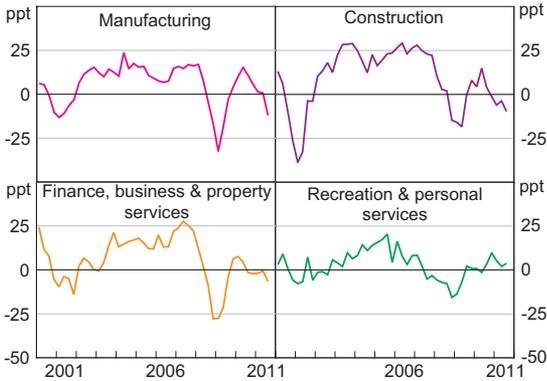
Firms exposed to the mining sector continue to experience strong conditions. Despite recent declines, commodity prices remain at elevated levels, supporting mining profits. Mining production is continuing to recover from the adverse weather earlier in the year. Iron ore exports have rebounded strongly to record-high levels, boosted by capacity expansions (Graph 3.12). However, coal production in Queensland remains constrained by restrictions on removing water from flood-affected mines,

Graph 3.10
NAB Business Survey*



Graph 3.11

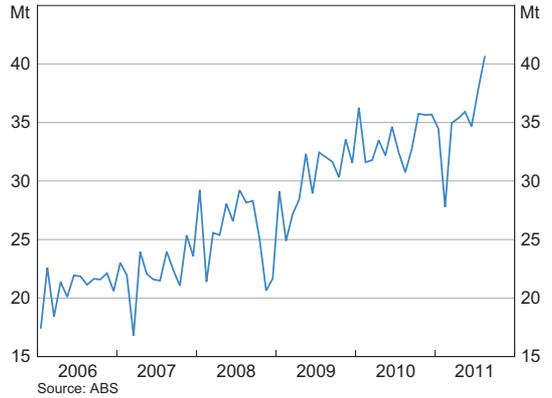
Business Conditions – Selected Industries*



* Net balance; deviation from average since 1989
Sources: NAB; RBA

Graph 3.12

**Iron Ore Exports
Monthly**

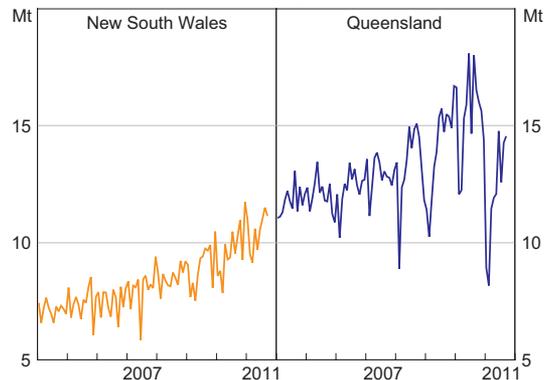


Source: ABS

with coal shipments in September still about 12 per cent below pre-flood levels (Graph 3.13). In total, coal exports are estimated to have subtracted around $\frac{3}{4}$ percentage point from GDP growth over the first half of 2011, with available data indicating a relatively modest contribution to growth in the September quarter. The Bureau of Meteorology's (BoM) latest analysis suggests that another La Niña event is developing, which increases the probability of above-average rainfall in the north and east of Australia over the summer. While this raises the prospect of further disruptions to coal production and exports, the BoM expects this La Niña event to be weaker than the one last year.

Graph 3.13

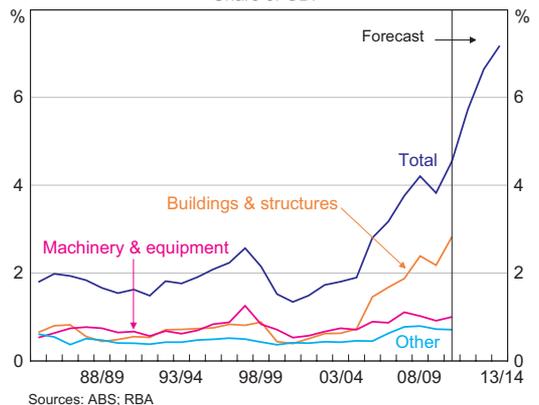
**Coal Shipments*
Monthly**



* Non-seasonally adjusted
Sources: ABS; RBA; various port authorities

Mining investment grew strongly over the first half of the year. Since the August *Statement*, a final investment decision for the Wheatstone LNG project has been announced, lifting the total value of LNG projects currently underway or committed to around \$146 billion (Table 3.3). With work done already at high levels, mining investment is likely to increase to around 7 per cent of GDP over the next few years (Graph 3.14). Consistent with the rise in mining-related investment, imports of capital goods have risen particularly strongly over the past year or so (see 'Box B: The Mining Sector and the External Accounts').

Graph 3.14
**Mining Investment
Share of GDP**



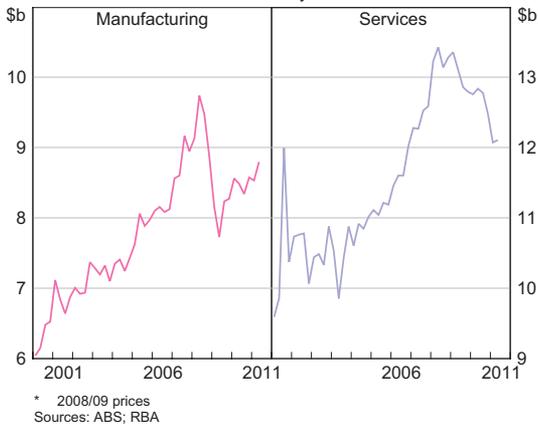
Sources: ABS; RBA

Table 3.3: Value of LNG Projects Under Construction in 2011^(a)
A\$ billion

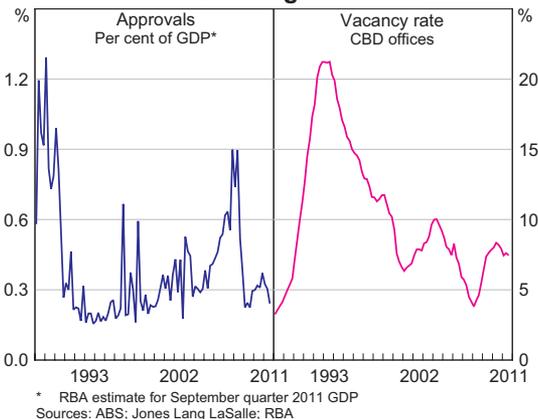
Gorgon	43
Wheatstone	28
Gladstone	16
Pluto	15
Queensland Curtis	15
Australia Pacific	14
Prelude (Floating)	12
North Rankin B	5
Total	146

(a) US dollar-denominated project values converted to Australian dollars at US\$1.03
Sources: RBA; publicly available information

Graph 3.15
Non-commodity Exports*
Quarterly



Graph 3.16
Office Building Indicators



The high level of the exchange rate is having a contractionary effect on a number of non-mining industries, particularly manufacturing and some service industries, including tourism and education. Manufacturing and services exports remain well below their pre-crisis levels; exports of education-related services have been particularly weak over the past year, partly reflecting tighter access to student visas (Graph 3.15). The Bank's liaison suggests that the high level of the exchange rate is leading to a re-evaluation of business strategies in parts of the manufacturing industry, with some firms investing in capital equipment to remain competitive, while other firms are restructuring or closing facilities.

Activity in the non-residential building sector remains subdued, reflecting only modest growth in tenant demand and the unwinding of the government stimulus. While there has been some overall improvement in credit conditions facing developers, conditions remain tight, particularly for small to mid-tier firms. The value of non-residential building approvals has increased since 2009, but remains at low levels as a share of GDP. In the office market, with little new supply, the national CBD office vacancy rate ticked down in the September quarter to be around its decade average (Graph 3.16). Vacancy rates in Canberra, Melbourne and Perth fell in the quarter, with Perth recording a particularly large decline, while vacancy rates in Adelaide, Brisbane and Sydney rose slightly. National prime CBD office capital values are estimated to have risen by 7 per cent over the year to September, with values in Perth and Melbourne showing the strongest growth.

Overall, investment intentions outside the mining sector generally remain subdued; the ABS capital expenditure survey points to soft growth in non-mining investment in 2011/12, while business survey measures suggest non-mining investment intentions have softened, but remain above 2009 levels. Reports from liaison suggest that some firms have become more cautious in investing in additional capacity prior to clear signs that demand is strengthening.

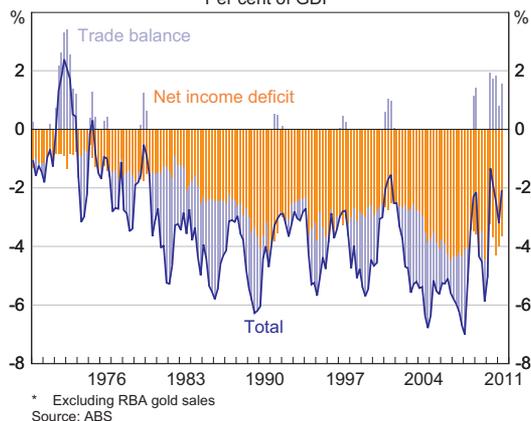
Farm Sector

Exports of rural commodities have risen strongly over the past year and are expected to remain at high levels, as large winter and summer crops boost grain exports. The Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) estimates a large winter crop in 2011, with production only slightly less than last year's bumper harvest. While some parts of NSW and southern Queensland have suffered from below-average rainfall, winter crop production in Western Australia is expected to recover strongly after experiencing drought last year. Summer crop production is also forecast to remain around decade highs in 2011/12, with elevated prices and the increased availability of irrigation water expected to underpin a record cotton crop. ABARES forecasts gross farm production, which includes both crops and livestock, to increase by 2½ per cent in 2011/12, which is a slight downward revision from earlier forecasts.

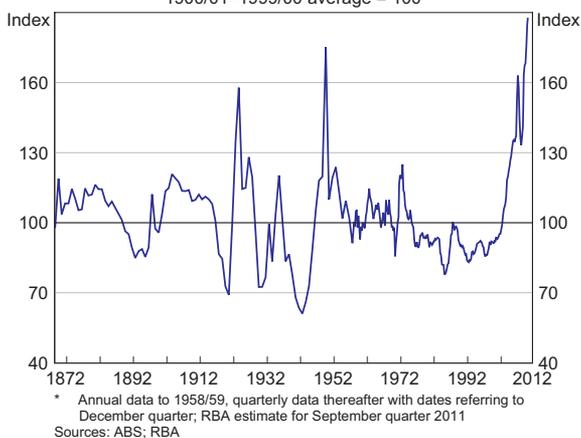
External Sector

Large increases in bulk commodity contract prices over the year to September have significantly boosted Australia's export revenues. Growth in import volumes has remained strong through 2011, reflecting solid domestic demand growth and higher import penetration, as the high Australian dollar has lowered the relative price of imports. Capital imports have risen particularly strongly over the past year or so, in line with the sharp upswing in mining investment. Overall, the trade surplus is currently around its highest level as a share of GDP since the early 1970s (for further details on the impact of the mining sector on the trade balance, see 'Box B: The Mining Sector and the External Accounts'). The current account deficit has also narrowed, to around 2 per cent of GDP, which is well below the average of the past two decades (Graph 3.17). Higher commodity prices have also lifted the terms of trade to their highest level on record, although some decline appears to be now underway (Graph 3.18).

Graph 3.17
Current Account Balance*
Per cent of GDP



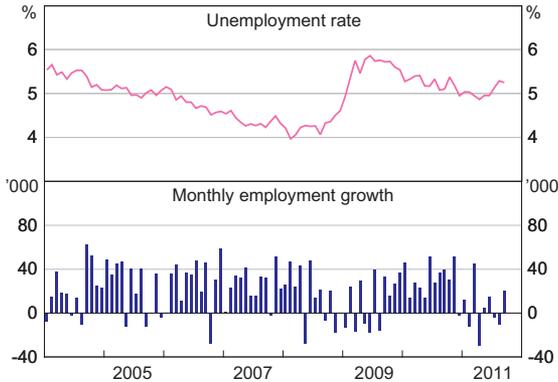
Graph 3.18
Terms of Trade*
1900/01–1999/00 average = 100



Labour Market

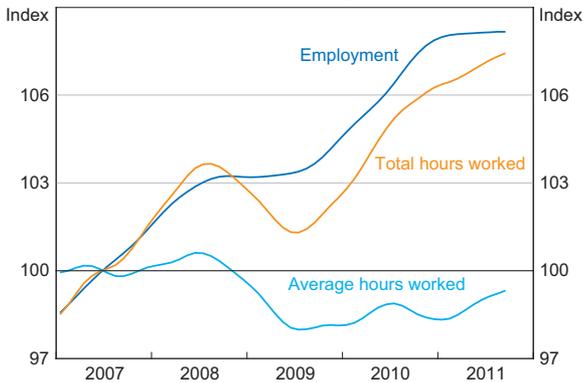
After remaining around 5 per cent over the first half of 2011, the unemployment rate has picked up in recent months, to 5.2 per cent in September, with little net employment growth over the past few quarters (Graph 3.19). While there has been a slowing in employment growth, total hours worked are estimated to have grown at a stronger pace, with a modest pick-up in trend average hours worked (Graph 3.20). The stronger growth in hours worked compared with employment is in contrast with developments in the second half of 2010 when

Graph 3.19
Labour Market



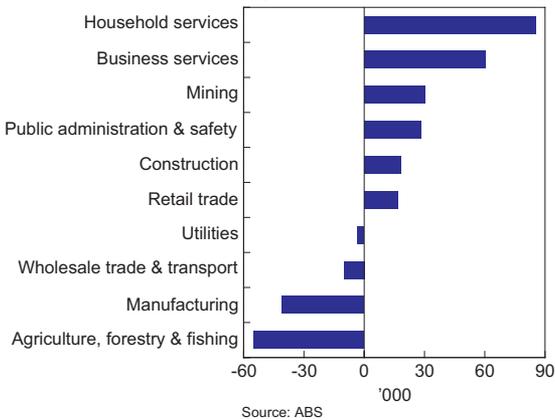
Source: ABS

Graph 3.20
Employment and Hours Worked
2007 average = 100, trend



Sources: ABS; RBA

Graph 3.21
Employment Growth
Year to August 2011, trend



Source: ABS

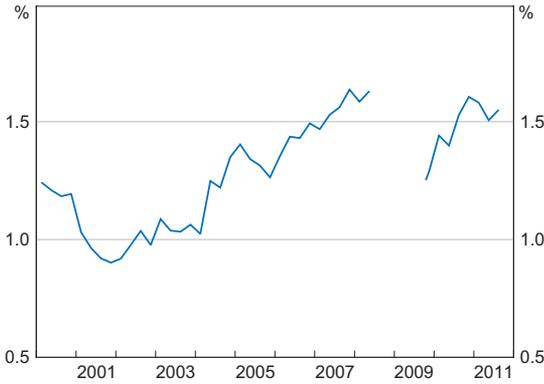
employment outpaced growth in hours worked. More recently firms appear to be making greater use of existing employees.

The slowing in employment growth has been broad based although there remains considerable divergence in the pace of employment growth across industries (Graph 3.21). Employment in the mining industry has grown by 14 per cent over the year, while manufacturing employment has fallen by around 5 per cent. Growth in services sector employment has slowed, although the large household and business services industries continue to make sizeable contributions to overall employment growth. Growth in business services employment has been supported by solid growth in employment in professional & scientific services and financial & insurance services. In the household services sector, growth in health care and hospitality employment remains firm but education employment has softened recently. The data on employment in agriculture, forestry and fishing have been very weak over the past year, which is difficult to reconcile with the generally positive conditions in the rural sector.

The slowdown in employment growth in the early part of the year was more pronounced than suggested by forward-looking indicators of labour demand such as job advertisements, vacancies and business surveys. These indicators have been mixed recently, though most are weaker than in early 2011. The ABS measure of job vacancies rose by 3.3 per cent over the three months to August and remains at a relatively high level (Graph 3.22). However, aggregate job advertisements, as reported by ANZ, have fallen in recent months and hiring intentions from business surveys eased in the September quarter, although they remain around average in the NAB survey.

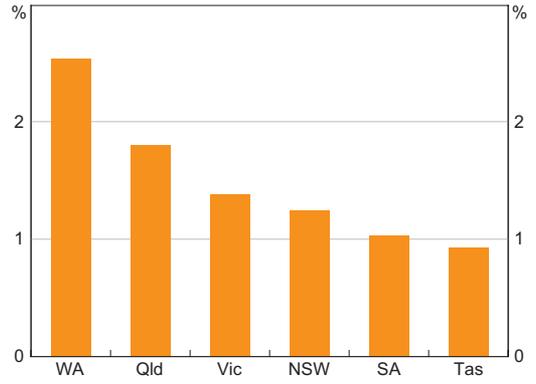
Consistent with the relative strength in the resources sector, the vacancy rate is high in Western Australia, where the unemployment rate has declined the most since the 2008/09 slowdown and the labour market is tightest (Graph 3.23). In most other states

Graph 3.22
Job Vacancies*
 Per cent of labour force



* This survey was suspended between May 2008 and November 2009
 Source: ABS

Graph 3.23
Job Vacancies by State
 Per cent of labour force



Source: ABS

the vacancy rate remains around the average of the past decade, with state unemployment rates generally clustered close to the national average.

Recent data confirm a slowdown in the trend growth of labour supply. This has been primarily due to slower population growth as a result of lower net migration (although the contribution of natural increase to population growth has also slowed in

recent years). The slowdown in net migration largely reflects lower arrivals of international students, who typically participate in the labour market as part-time workers. The recent slowing in labour force growth has also reflected a small fall in the participation rate, which had risen sharply in late 2010 when the labour market was more buoyant.