

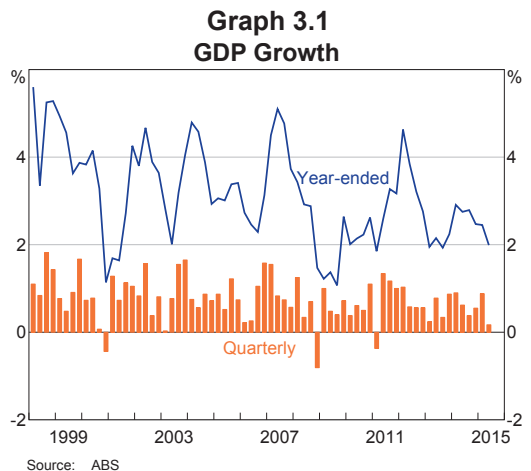
3. Domestic Economic Conditions

As expected, growth of the Australian economy eased in the June quarter, following strong growth in the previous quarter (Graph 3.1).¹ The weakness in the June quarter partly reflected temporary weather-related disruptions to resource exports. Indications are that growth picked up in the September quarter, aided by a rebound in resource exports.

National accounts data suggest that the Australian economy has expanded at a below-average rate in recent years (Table 3.1). Commodity prices and the terms of trade have fallen over this period, partly unwinding the earlier large increases. This has been accompanied by a depreciation of the exchange rate from historically high levels. Much of the expansion in production capacity for iron ore and coal has now occurred, and resource exports have risen significantly. Further large rises are in prospect as exports of liquefied natural gas (LNG) ramp up. Public demand has been little changed.

Income per capita has declined somewhat in recent years, as the decline in the terms of trade has been only partly offset by improvements in productivity (see the 'Price and Wage Developments' chapter). Population growth has also slowed. These factors have restrained growth in consumption and dwelling investment.

At the same time, however, there is further evidence that activity is rebalancing away from the resources sector toward non-resources sectors, particularly services (Graph 3.2; also see 'Box C: Developments by



Sector'). Very low interest rates continue to support growth in dwelling investment and consumption. The depreciation of the exchange rate has supported exports, especially in the services sector, and imports of capital goods and services have declined further. Non-mining investment, however, has been weak for some time. Overall, GDP growth in 2014/15 was at the lower end of the Bank's forecast range from a year ago, but the forecast error was small in the context of the usual wide range of forecast uncertainty.

Although GDP growth has been below average, employment growth has strengthened to be a little above average over much of the past year. This partly reflects an improvement in the demand for labour in the services sector. The protracted period of low wage growth may also have encouraged firms to employ more people than otherwise. At the same time, growth in labour supply has increased, despite lower population growth, through an increase in

¹ Although the 2014/15 annual national accounts (shown in Table 3.1) contain the most recent data on GDP, the June quarter 2015 national accounts, which were released prior to the annual national accounts, contain the most recent data on quarterly movements in GDP.

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

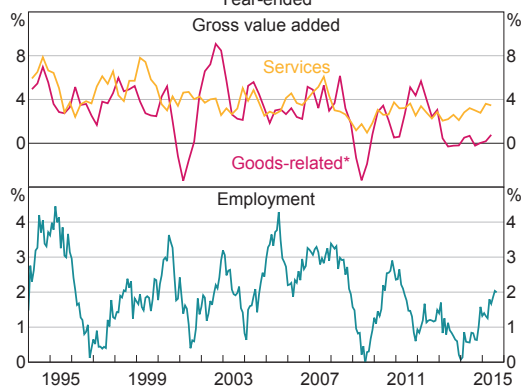
	2014/15	2013/14
GDP	2.3	2.5
Domestic final demand	0.7	1.3
– Private demand ^(a)	0.8	1.6
– Consumption	2.5	2.6
– Dwelling investment	8.3	5.1
– Mining investment ^(a)	-17.3	-8.5
– Non-mining investment ^(a)	1.1	-0.1
– Public demand ^(a)	0.0	0.4
Change in inventories ^(b)	0.2	-0.2
Exports	6.5	5.8
Imports	-0.1	-1.8
Nominal GDP	1.6	3.9
Real gross domestic income	0.0	1.7

(a) RBA estimates

(b) Contribution to GDP growth

Sources: ABS; RBA

Graph 3.2
Output and Employment Growth
Year-ended



* Excluding mining

Sources: ABS; RBA

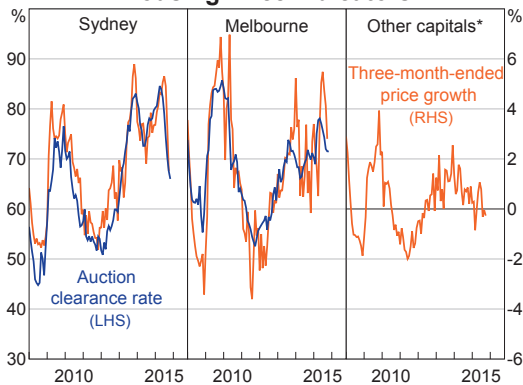
the participation rate. The recent increases in labour demand and supply have been broadly offsetting, and so the unemployment rate has been little changed at relatively high levels, consistent with a degree of spare capacity in the labour market.

Household Sector

Low interest rates continue to support prices and activity in the housing market, although conditions vary widely across market segments. Household consumption growth remains below average, but has picked up relative to a couple of years ago.

Housing price growth has remained elevated for some time now. This has been driven by developments in Sydney and Melbourne, although auction clearance rates and price growth in these cities have declined over the past few months (Graph 3.3). There has been little evidence of price pressures in other regions. Lending data suggest that the level of investor demand remains strong, although there have also been signs of moderation in this market segment of late, as loan approvals appear to have declined. The slight easing in housing market conditions is consistent with lenders taking steps to strengthen their lending standards in response to supervisory actions undertaken by the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments

Graph 3.3
Housing Price Indicators



* Weighted average of Adelaide, Brisbane, Canberra, Darwin, Hobart and Perth

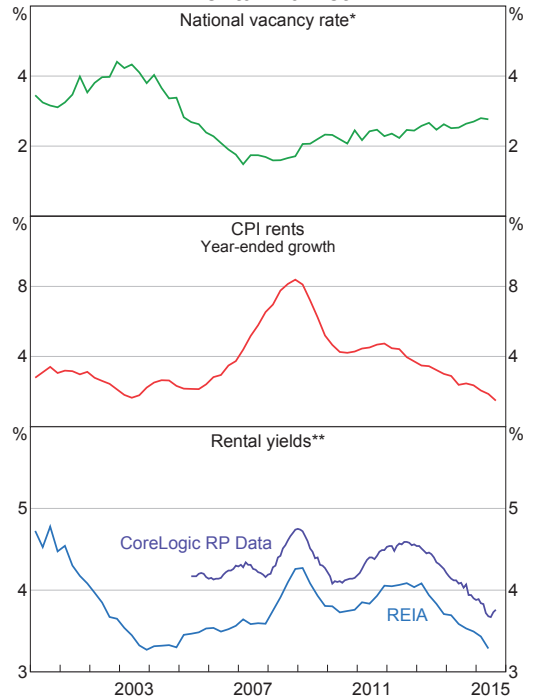
Sources: Australian Property Monitors; CoreLogic RP Data; RBA; Real Estate Institute of Victoria

Commission (ASIC).² More recently, many lenders have announced further increases to their interest rates on mortgages.

Prices of detached houses have been growing more rapidly than apartment prices, consistent with large increases in higher-density supply in recent years. An increase in supply in the rental market has been associated with a gradual increase in the nationwide vacancy rate and a decline in rent inflation and rental yields (Graph 3.4).

Dwelling investment grew strongly over the year to the June quarter, consistent with low interest rates and the associated strength in housing prices. While dwelling investment is expected to continue to grow over the period ahead, forward-looking indicators provide mixed signals about the strength of that growth. For example, building approvals remain at high levels, particularly in regions where housing price growth has been most rapid (Graph 3.5). However, residential land sales have moderated and liaison suggests that there are land supply constraints for detached housing in some parts of the country. To the extent that land supply constrains the growth of detached housing, this could encourage more renovation activity, which has been at relatively low levels over the past couple of years.

Graph 3.4
Rental Market

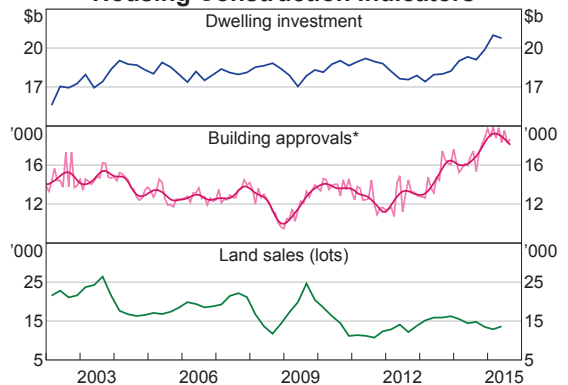


* Excludes Adelaide from March quarter 2015

** REIA series uses an unmatched sample of rents and prices; CoreLogic RP Data series uses a matched sample and has been seasonally adjusted by the RBA

Sources: ABS; CoreLogic RP Data; RBA; REIA

Graph 3.5
Housing Construction Indicators



* Smoothed line is the ABS trend measure

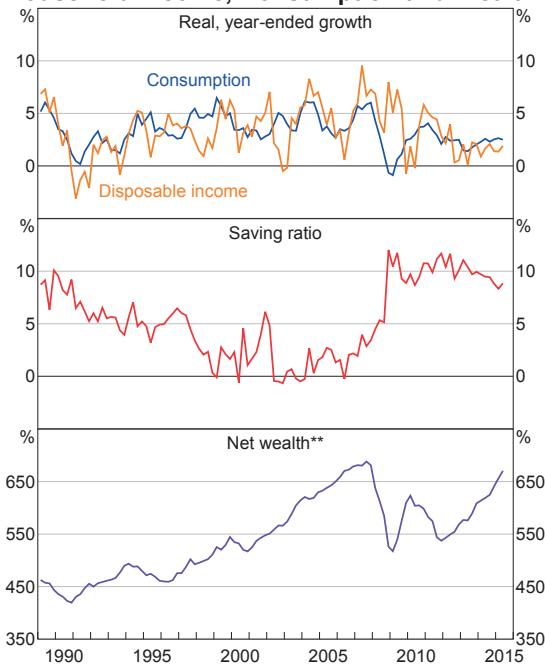
Sources: ABS; Housing Industry Association

2 For further details on supervisory actions undertaken by APRA and ASIC, see RBA (2015), 'Box B: Responses to Risks in the Housing and Mortgage Markets', *Financial Stability Review*, March.

Household consumption growth remains below average, but has picked up relative to a couple of years ago, aided by very low interest rates and rising wealth (Graph 3.6).³ Consumption growth has outpaced growth in household disposable income – which has been low by historical standards – and the saving ratio has declined gradually from relatively high levels.

Timely indicators of consumption have been generally positive, although they typically have had only a modest correlation with aggregate consumption growth. Retail sales volumes increased by 0.6 per cent in the September quarter (Graph 3.7).

Graph 3.6
Household Income, Consumption and Wealth*



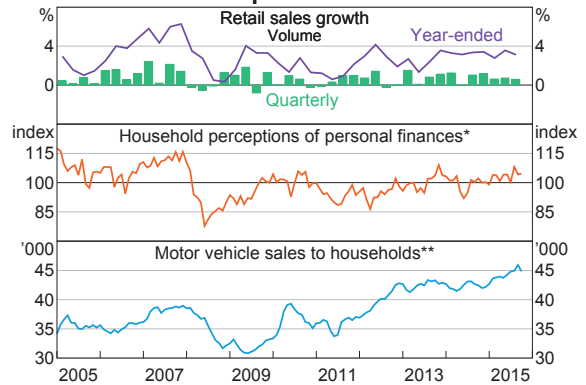
* Household sector includes unincorporated enterprises; disposable income is after tax and interest payments; income level smoothed with a two-quarter moving average between March quarter 2000 and March quarter 2002; saving ratio is net of depreciation

** Per cent of annual household disposable income, before the deduction of interest payments

Sources: ABS; RBA

3 Recent estimates suggest that the direct effect of housing price growth on consumption is quite small, although indirect effects – for example, via expectations of future income growth – could be important. See Gillitzer C and JC Wang (2015), 'Housing Wealth Effects: Evidence from New Vehicle Registrations', RBA Bulletin, September, pp 13–20.

Graph 3.7
Consumption Indicators



* Average of the ANZ-Roy Morgan and Westpac-Melbourne Institute consumer sentiment measure of respondents' perceptions of their personal finances relative to the previous year; average since 1980 = 100

** Three-month moving average

Sources: ABS; ANZ-Roy Morgan; FCAI/VFACTS; RBA; Westpac and Melbourne Institute

Measures of consumer sentiment are around their long-run averages and sentiment regarding households' own finances has been more positive.⁴ Motor vehicle sales to households have been on an upward trend over the past year, although they have been volatile of late.

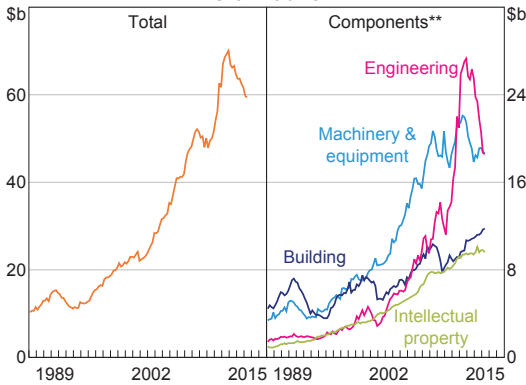
Business Sector

Private business investment declined slightly in the June quarter, to be around 6 per cent lower in 2014/15 (Graph 3.8).

Mining investment peaked in mid 2012 at around 8 per cent of nominal GDP. It has since fallen to around 5 per cent of GDP, reflecting the completion of large-scale projects and a lack of new projects as the decline in commodity prices over recent years has reduced the incentive for new investment. The ABS capital expenditure (Capex) survey and the Bank's liaison point to further substantial declines in mining investment (Graph 3.9). The expectation is that it will fall to below 3 per cent of GDP by the end of 2017 (see the 'Economic Outlook' chapter). Mining sector profits fell by 27 per cent over the

4 For more information on the relationship between measures of consumer sentiment and aggregate consumption growth, see Wang JC and L Berger-Thomson (forthcoming), 'Consumer Sentiment Surveys', RBA Bulletin, December.

Graph 3.8
Private Business Investment*
Chain volume

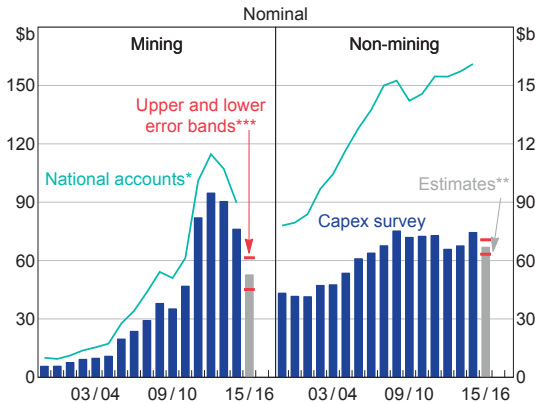


* Adjusted for second-hand asset transfers between the private and other sectors; reference year is 2012/13

** Excluding cultivated biological resources

Sources: ABS; RBA

Graph 3.9
Measures of Private Business Investment
Nominal



* Adjusted for second-hand asset transfers between the private and other sectors; excluding cultivated biological resources

** Estimates are firms' expected capital expenditure, adjusted for the past average difference between expected and realised spending

*** Error bands are based on the root mean square error of each adjusted estimate compared with the final outcome for investment in each year

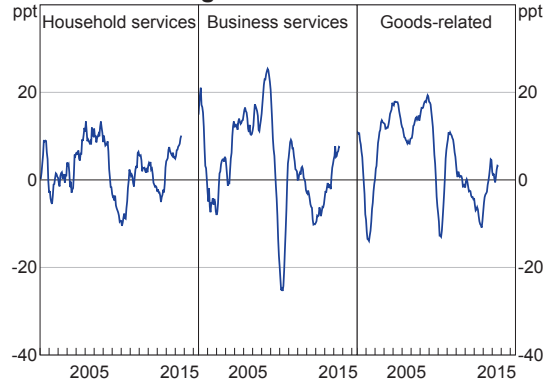
Sources: ABS; RBA

year to the June quarter, consistent with lower commodity prices.

Non-mining investment has been weak for some time in real terms and indicators of investment intentions suggest that it will remain subdued over the next few quarters. The latest Capex survey continues to imply that non-mining investment will fall in 2015/16. However, the Capex survey does not cover a large share of non-mining business

investment that is included in the national accounts, such as investment in agriculture, education and healthcare. Nor does it capture investment in intangible items (which tends to grow at a steady pace). Non-residential building approvals remain at relatively low levels, consistent with weak underlying conditions in the commercial property market. At the same time, very low interest rates and the depreciation of the exchange rate over the past year or so have supported demand, and survey measures of business conditions in the non-mining sectors are clearly above average levels, particularly in the services sector (Graph 3.10). However, parts of the services sector tend to be less intensive in their use of capital, so the improvement in conditions there has been reflected in higher employment growth more than investment at this stage. Non-mining company profits have increased in line with nominal GDP.

Graph 3.10
Non-mining Business Conditions*



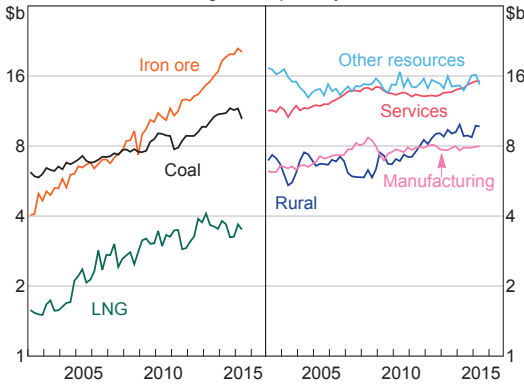
* Gross value added weighted; deviation from average since 1989; six-month moving average

Sources: ABS; NAB; RBA

External Sector

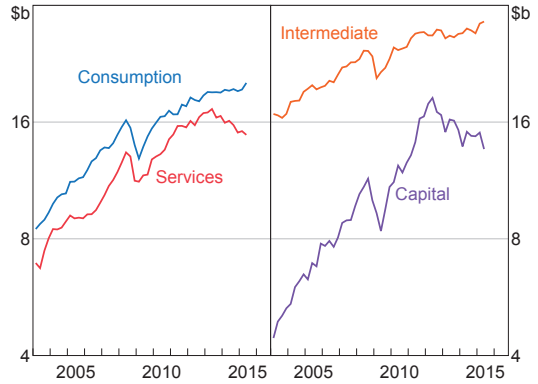
Export volumes rose by around 6 per cent in 2014/15, despite a sharp contraction in the June quarter as unfavourable weather conditions affected resource exports (Graph 3.11). In that quarter, coal exports were impaired by the floods in the Hunter Valley, while exports of LNG were affected by temporary shutdowns of some plants, owing to planned maintenance and some unplanned power

Graph 3.11
Export Volumes*
Log scale, quarterly



* Reference year is 2012/13
Sources: ABS; Department of Industry, Innovation and Science; RBA

Graph 3.12
Import Volumes*
Log scale, quarterly



* Reference year is 2012/13
Source: ABS

outages. Exports of bulk commodities are expected to continue to grow over the next couple of years, although the pace of growth is likely to slow. LNG exports are expected to increase substantially over the next couple of years as a number of LNG projects commence production, but some large LNG projects will start production a bit later than previously thought.

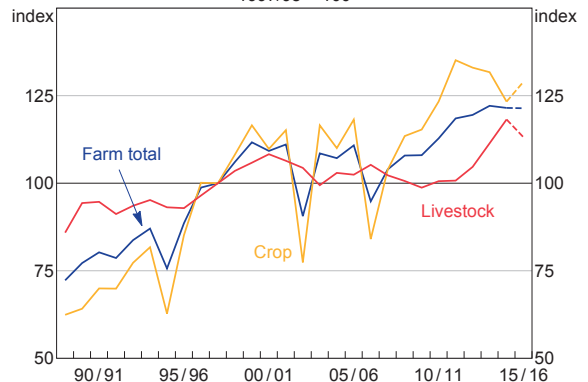
The depreciation of the Australian dollar has provided support to exports. Service exports have grown particularly strongly over the past couple of years, with strong growth in tourism, education and business service exports. Over 2014/15, net service exports contributed more to GDP growth than iron ore exports, the first time this has happened in six years. In contrast, manufactured exports have been little changed for some years.

Import volumes were little changed in 2014/15. Consistent with the depreciation of the exchange rate, service imports declined as expenditure appears to have been switched to domestically produced services, particularly for travel (Graph 3.12). Capital imports have also fallen, as construction of many of the import-intensive, large-scale mining projects approaches completion. Consumption and intermediate imports, which tend to be less sensitive to the exchange rate than service imports, have increased over the past year.

Farm Sector

The Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) expects the overall volume of farm production to be little changed in 2015/16, as an increase in crop production is expected to offset a decline in livestock production (Graph 3.13). The Bureau of Meteorology expects an El Niño event to continue until early 2016. El Niño is typically associated with below-average rainfall over eastern Australia, although there is substantial variation in El Niño events and their impact on crop production.

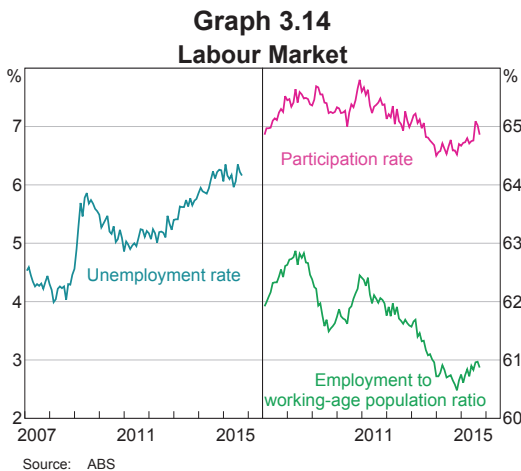
Graph 3.13
Farm Production Volumes*
1997/98 = 100



* Dashed lines represent 2015/16 forecasts; 2014/15 data are estimates
Source: ABARES

Labour Market

Employment growth has increased over the past year and outpaced growth in the population (Graph 3.14). The improvement has partly reflected a shift in the composition of activity toward more labour-intensive services sectors (see 'Box C: Developments by Sector'). In addition, wage growth has declined by more than expected based on its historical relationship with the unemployment rate. This flexibility may have encouraged firms to employ more people than would otherwise have been the case (see the 'Price and Wage Developments' chapter).



At the same time, labour supply growth has also increased, despite lower population growth, as the participation rate has trended higher. The increase in participation could be a response to higher labour demand if individuals have commenced work, or searching for work, in response to perceived improvements in employment prospects (this is known as an 'encouraged worker' effect). The Australian Government's new employment services model, 'jobactive', introduced on 1 July, may have also boosted the participation rate by requiring

more unemployment benefit recipients to search actively for work than in the past.⁵

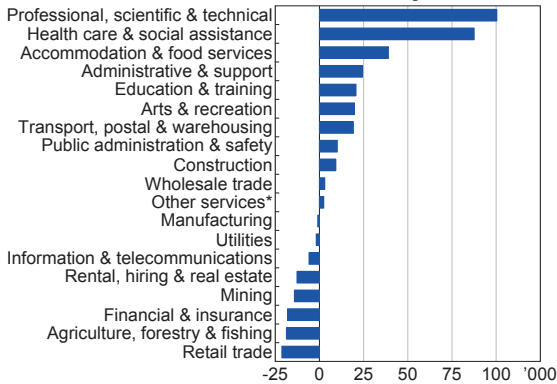
The increases in labour demand and supply over the past year or so appear to have been largely offsetting, such that the unemployment rate has been broadly stable in the range of 6–6¼ per cent over that period. This level of the unemployment rate and the low growth in wages suggest that there is still spare capacity in the labour market. The unemployment rate remains around its highest level since the early 2000s and the participation rate is still below its peak in late 2010. The more cyclically sensitive components of the unemployment rate, such as medium-term unemployment, remain elevated.⁶ The longer-term unemployment rate has also increased over time, which is likely to be a response to the prolonged period of weak labour market conditions. The extent of geographic or skills mismatches between workers and available jobs does not appear to have changed over recent years, since the relationship between the unemployment rate and the job vacancy rate has not shifted from its historical pattern. Similarly, measures of underemployment are elevated but broadly in line with what would be expected based on their relationship with the unemployment rate over the past decade.

The increase in employment growth this year has been broad based across services industries (Graph 3.15). In the household services sector, employment in health care & social assistance has risen substantially across all states. The Bank's business liaison suggests that this is being driven by a range of factors, including increased demand for aged and home-based care services owing to demographic factors. Employment in accommodation & food services has also increased

⁵ For a detailed explanation of the overlap between unemployment benefit recipients and the unemployment and participation rates, see ABS (2014) 'The Unemployed and Recipients of Government Unemployment Benefits – Differences Explained', Australian Labour Market Statistics feature article, July.

⁶ See Ballantyne A, D De Voss and D Jacobs (2014) 'Unemployment and Spare Capacity in the Labour Market', RBA *Bulletin*, September pp 7–20.

Graph 3.15
Employment Growth
Year to August 2015



* Includes personal services; religious, civic, professional and other interest group services; repair and maintenance activities; and private households employing staff

Source: ABS

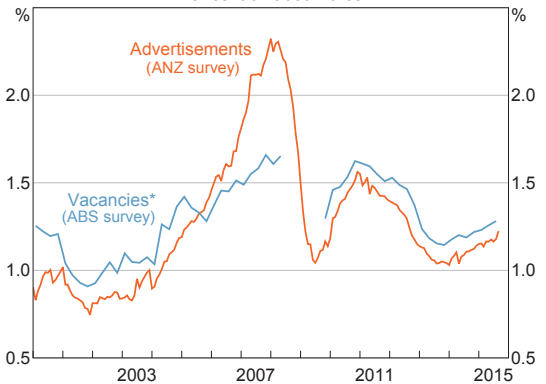
substantially, supported by the recovery in the domestic tourism industry following the exchange rate depreciation.

The increase in business services employment growth has been concentrated in professional, scientific & technical services in New South Wales and Victoria. This has been underpinned by architectural, engineering and technical services employment, which is likely to be associated with a wide range of activities including government infrastructure projects and residential construction projects. Employment in legal & accounting and computer system design has also increased, possibly reflecting broader demand from firms elsewhere to cut costs and improve productivity through IT-related investment. Some of this increase in business services employment may also be related to the improvement in business service exports following the exchange rate depreciation.

Employment in goods-related industries remains weak. Mining employment has declined since late 2013. Construction employment has been little changed over the past year as the decrease in labour demand associated with the decline in mining construction activity appears to have been roughly offset by the increase associated with residential building activity.

In line with the pick-up in employment growth, leading indicators of labour demand, such as the ANZ measure of job advertisements and the ABS survey of job vacancies, have been on an upward trend over the past couple of years (Graph 3.16). Employment intentions in the NAB survey suggest that firms' hiring intentions have picked up and are now around average. Recent outcomes for a range of forward-looking indicators suggest that employment is likely to continue to grow. ↘

Graph 3.16
Job Vacancies and Advertisements
Per cent of labour force



* This survey was suspended between May 2008 and November 2009
Sources: ABS; ANZ