2. Domestic Economic Conditions

Australia's economic recovery had been stronger than earlier expected, prior to the recent outbreaks of COVID-19. GDP had exceeded its pre-pandemic level and the unemployment rate declined further over the June quarter to be below its level prior to the pandemic. The broad-based rebound in private domestic demand has been supported by accommodative fiscal and monetary policy, and timely indicators suggest growth in private demand remained strong in the June quarter.

The recent lockdowns in several states will weigh heavily on activity and the labour market in the September quarter. The Australian Government and state and territory governments have introduced substantial additional fiscal measures to support households and businesses through this period. The near-term outlook is highly uncertain and largely dependent on health outcomes; however, past experience of these events, both in Australia and elsewhere, suggests the negative effects on the economy will be temporary. Beyond the near term, the outlook is a little stronger than expected at the time of the previous *Statement*. The closure of the international border and other pandemic-related disruptions will continue to have a significant effect on some parts of the economy (see 'Economic Outlook' chapter).

The economy recovered to above pre-pandemic levels in the March quarter

The Australian economy grew by 1.8 per cent in the March quarter, to be around 1 per cent above its level at the end of 2019 (Graph 2.1). Both public demand and housing activity were above pre-pandemic levels, and household consumption had almost reached its pre-pandemic level. Growth in the quarter was broad based across expenditure components. A large increase of firms' inventories significantly contributed to growth in the quarter, as supply constraints eased and firms restocked to meet ongoing strong demand. The terms of trade increased to their highest level in nearly a decade, supporting business profits and government revenues.

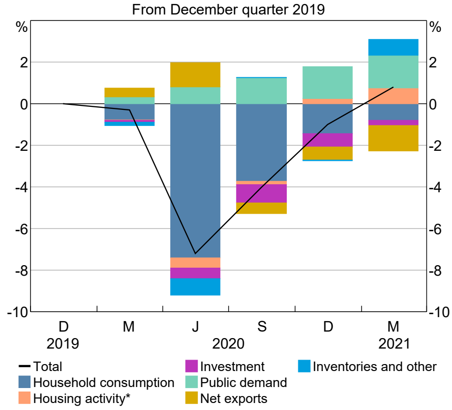
The effect of recent outbreaks and accompanying restrictions is expected to be temporary

From late May, community transmission of the virus resulted in the reintroduction of strict containment measures and border restrictions in several states (Graph 2.2). Localised population

Graph 2.1

GDP – Cumulative Contribution to Change

From December quarter 2019



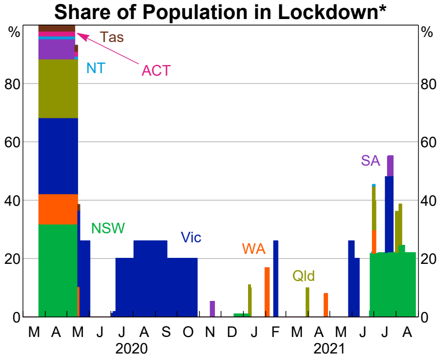
* Dwelling investment and ownership transfer costs

Sources: ABS; RBA

mobility, which is a timely indicator of economic activity, declined sharply following the 2-week lockdown in Victoria in late May, but bounced back after restrictions were eased (Graph 2.3). In response to the increase in COVID-19 cases in New South Wales from late June, the state government reintroduced stay-at-home orders in Greater Sydney and surrounding areas, comprising around a quarter of the Australian population. Mobility indicators declined in Greater Sydney as restrictions were progressively tightened. Shorter lockdowns were also introduced in Victoria and South Australia in July and in south-east Queensland in early August.

Graph 2.2

Share of Population in Lockdown*



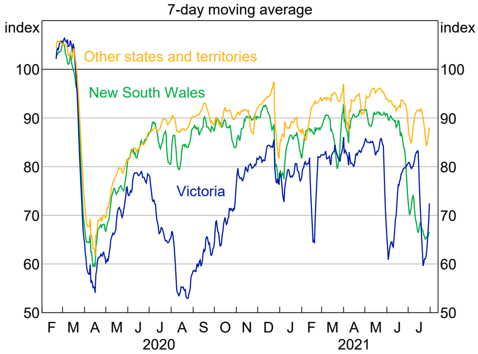
* Population estimated using statistical area that most closely corresponds to announced lockdown area

Sources: ABS; RBA; state and territory governments

Graph 2.3

Population Mobility*

7-day moving average



* Average from 3 January to 6 February 2020 = 100

Sources: Google LLC (2021), 'Google COVID-19 Community Mobility Reports', viewed 5 August 2021. Available at <https://www.google.com/covid19/mobility/>; RBA

The recent outbreaks of the Delta variant of COVID-19 and accompanying lockdowns will depress economic activity, especially in the September quarter, and temporarily reverse the improvement in the labour market. Output in the September quarter is now expected to contract by at least 1 per cent – instead of rising by a similar amount as expected prior to the lockdowns – with some but not all of the decline recovered in the December quarter (assuming limited further lockdowns). The main effects for the economy are through a reduction in household consumption. Household spending has declined through June and July. Information from the Bank's business liaison program and high-frequency payments data suggest the decline in spending has been broadly in line with the declines seen in earlier extended lockdowns. Spending on services has fallen and there has been an increase in food purchases and online activity, although these have only partly offset the decline in non-food sales.

Construction in Greater Sydney, south-east Queensland and South Australia has also been affected as a result of restrictions on activity and, in the case of Greater Sydney, ongoing restrictions on worker mobility and activity in a number of local government areas of concern. Information from the Bank's liaison program suggests that construction activity in Greater Sydney is likely to suffer from further delays in coordinating the deliveries of materials and rescheduling of subcontractors as they adjust to the recent pause in activity and ongoing restrictions.

Substantial fiscal support from the federal and state governments, including increased COVID-19 disaster relief payments, business support grants and tax relief, has been made available to businesses and workers in areas affected by longer lockdowns. Lockdowns are expected to result in a decline in employment in the September quarter, but the effects on the labour market are expected to be temporary, consistent with the forecast rebound in activity later in the year. The experience domestically and internationally over the past year has shown that economic activity recovers quickly following the removal of containment measures.

Employment increased further, alongside an increase in labour force participation

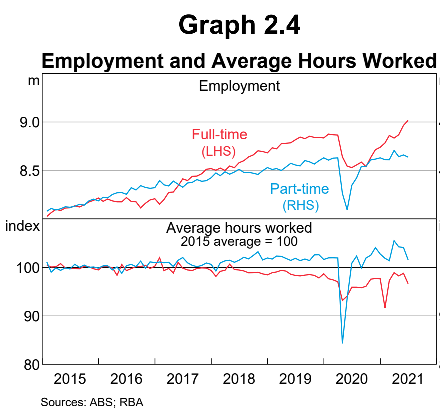
Employment increased by over 110,000 people over the June quarter, to be 1.2 per cent above its February 2020 level. Full-time employment accounted for all of this increase (Graph 2.4). The recovery in employment since 2020 has occurred alongside an upwards trend in average hours for both full-time and part-time employees. There was a drop in average hours in June due to activity restrictions in Victoria in response to a COVID-19 outbreak; for the most part, lockdowns have been accommodated through a reduction in employees' hours, rather than a reduction in employment. This suggests that underlying demand for labour remained resilient and that firms have generally been able to adjust to periods of disruption when they are expected to be short-lived.

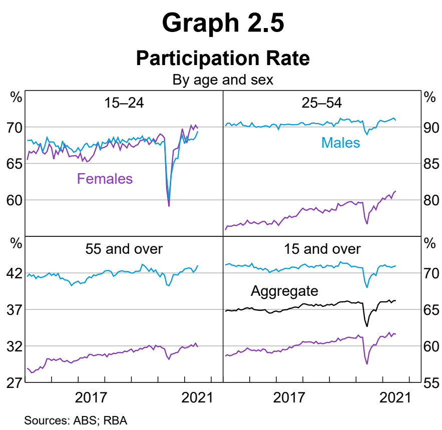
The sustained strength in labour market conditions has encouraged more people to seek employment, and labour force participation has increased above pre-pandemic levels for all age cohorts (Graph 2.5). Female participation has increased the most, in part reflecting strength in employment in industries that tend to have higher shares of female workers, such as healthcare. Since February 2020, female employment increased by around 90,000 people, compared to an increase of around 65,000 for male employment.

While employment is now higher than its pre-pandemic level in most industries, it is yet to fully recover in areas of the economy that continue to be the most affected by COVID-19 restrictions, such as hospitality, air travel and education. The hospitality industry also tends to employ a relatively high share of workers on temporary visas. Closed international borders have contributed to reported labour supply shortages; the number of people in Australia on a visa with working rights has declined by over 250,000 since March 2020 (Graph 2.6).

Labour underutilisation has declined to below its pre-pandemic level

The unemployment rate decreased to 4.9 per cent in June, to be 2½ percentage points below its recent peak and a little below its February 2020 level. The decline in the unemployment rate over recent months was faster than expected, in part due to stronger employment outcomes and a more muted





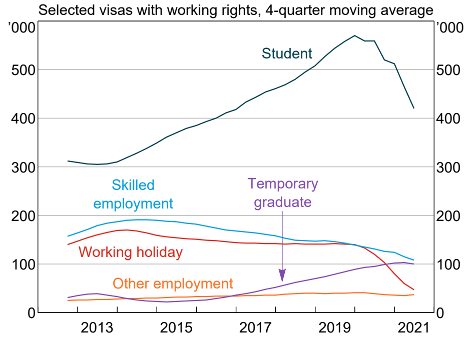
impact from the end of JobKeeper than anticipated at the time of the previous *Statement*.

Other indicators also point to a further reduction in labour market spare capacity. The heads-based underemployment rate was 7.9 per cent in June, around its lowest level since 2014 (Graph 2.7). Hours-based measures of underutilisation – which reflect the additional hours that unemployed and underemployed people would like to work – also declined, consistent with the upwards trend in average hours worked since last year.

Graph 2.6

Temporary Visa Holders in Australia

Selected visas with working rights, 4-quarter moving average

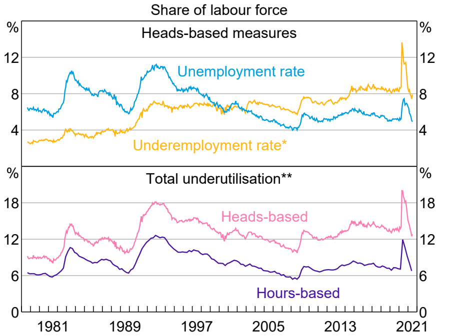


Sources: Department of Home Affairs; RBA

Graph 2.7

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

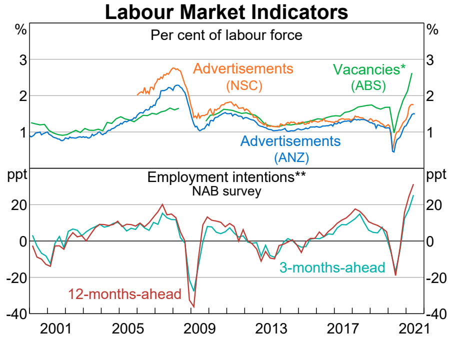
Leading indicators of the labour market have been strong

Forward-looking employment indicators were very positive ahead of the extended lockdown in Greater Sydney, pointing to strong underlying momentum in the labour market (Graph 2.8). In May, job vacancies were at a record high relative to the size of the labour force, reflecting the refilling of a large number of jobs lost throughout the pandemic, new hiring in parts of the economy experiencing strong demand, and Australia’s closed international borders that have reduced the availability of workers on temporary visas.

The strength in leading indicators of labour demand is consistent with information from the Bank’s liaison program – a majority of firms intend to increase headcount over the coming months and very few plan to reduce headcount. There were increased reports of labour availability concerns over the June quarter, but these still generally relate to difficulties finding workers with specific skills that are in high demand – particularly in residential construction and in the resources sector in Western Australia.

Graph 2.8

Labour Market Indicators



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

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

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

The labour market recovery supported household income and consumption in the first half of the year

Nominal household disposable income increased by 1 per cent in the March quarter to be 6 per cent above its pre-pandemic level (Graph 2.9). Lower social assistance payments were offset by growth in labour and financial income in the quarter. Labour income is expected to have increased further in the June quarter, alongside the strength in the labour market.

Household spending continued to support the economic recovery in the first half of the year. Consumption increased by 1.2 per cent in the March quarter, supported by greater opportunities to spend on discretionary services as restrictions were unwound. Discretionary goods consumption remained elevated (Graph 2.10). Timely indicators suggest spending was growing at a similar pace in the June quarter, prior to recent lockdowns coming into effect. Retail sales values grew 1.4 per cent in the June quarter, but declined by 1.8 per cent in the month of June. Sales declined sharply in New South Wales and Victoria, where spending was affected by lockdowns during that month (Graph 2.11).

The saving rate remained elevated in the March quarter. This largely reflected ongoing restrictions on households' ability to consume some types of services, even as growth in household income and wealth remained robust.

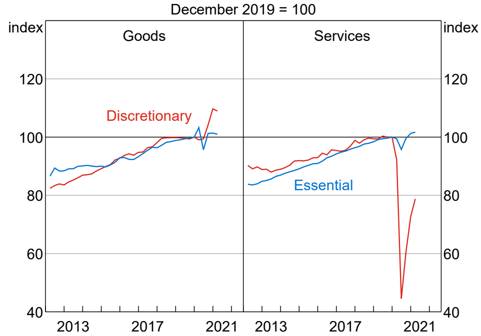
Conditions in housing markets remained strong

Housing prices increased by 6 per cent in the June quarter (Graph 2.12) (Table 2.1). Strong price growth continued through July, including in Sydney, such that national housing prices were around 15 per cent higher than the start of the year. Demand for housing remained strong nationally with turnover remaining around its highest level in more than a decade. Owner

Graph 2.10

Household Consumption

December 2019 = 100

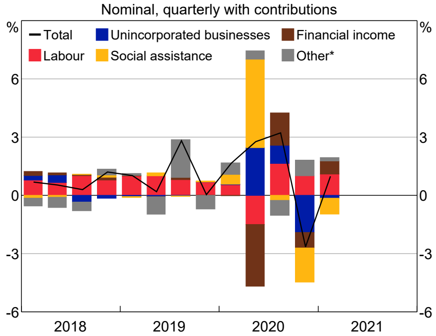


Sources: ABS; RBA

Graph 2.9

Household Disposable Income Growth

Nominal, quarterly with contributions



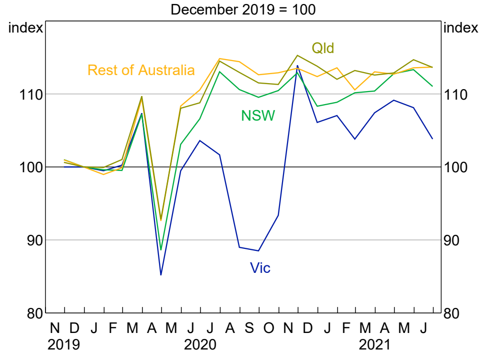
* Includes rent, tax payable, interest payable and other

Sources: ABS; RBA

Graph 2.11

Retail Sales Values

December 2019 = 100



Sources: ABS; RBA

Table 2.1: Housing Price Growth

Percentage change, seasonally adjusted

	July	June	May	April	Year-ended	Past 5 years
Sydney	2.3	2.8	3.0	2.2	18.2	30
Melbourne	1.9	1.9	2.0	1.3	10.4	25
Brisbane	2.1	2.2	2.1	1.7	15.9	21
Adelaide	1.9	1.9	1.7	1.8	15.7	24
Perth	0.8	0.6	1.3	0.7	10.8	–6
Darwin	1.8	1.0	2.9	2.4	23.4	–2
Canberra	2.5	2.7	2.0	1.8	20.5	45
Hobart	2.0	3.0	2.9	1.2	21.9	66
Capital cities	2.0	2.2	2.4	1.7	15.1	24
Regional	1.9	2.2	2.0	1.8	19.6	30
Australia	2.0	2.2	2.2	1.7	16.1	25

Sources: CoreLogic; RBA

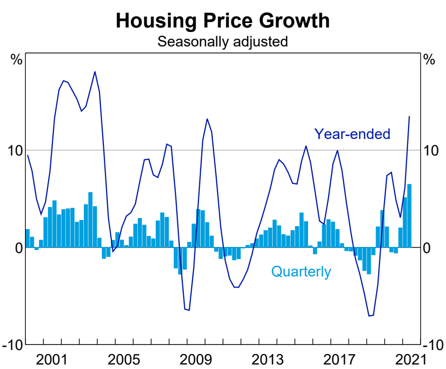
occupiers accounted for a large share of housing loan commitments in the past year, but investor activity has picked up over recent months (see 'Domestic Financial Conditions' chapter). Housing price growth has moderated a little since the reintroduction of stay-at-home orders in Sydney, and auction market withdrawals have increased.

The supply of properties newly listed for sale had been around the top end of the range of the past few years, although listings have declined over the past month alongside restrictions on activity in some markets (Graph 2.13). Total listings declined further as properties have continued to clear quickly from the market, indicating that demand has remained strong relative to the volume of properties listed for sale.

Rental market conditions have tightened across most of the country

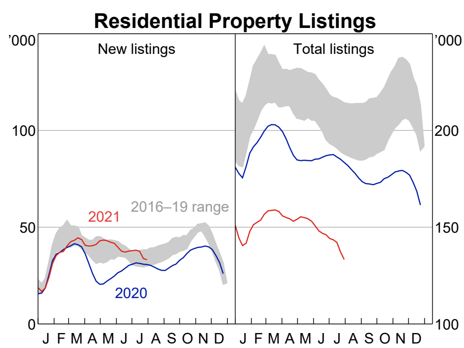
Advertised rents for houses have increased substantially since the September quarter last year. In regional areas and smaller cities, growth

Graph 2.12



Sources: CoreLogic; RBA

Graph 2.13



Sources: CoreLogic; RBA

in rents has been strong and vacancy rates remain very low (Graph 2.14). Rental conditions in apartment markets in Sydney and Melbourne began to stabilise, and demand picked up following the earlier decline in rents; advertised unit rents remain 8 per cent below pre-pandemic levels in Melbourne and 2 per cent below in Sydney. As part of their response to the outbreak in Greater Sydney, the New South Wales Government introduced a short-term eviction moratorium for rental arrears for tenants who have been significantly affected by the lockdown. Rental yields have declined in much of the country as advertised rents have continued to be outpaced by housing prices.

Housing investment is supporting economic growth

Dwelling investment increased in all states over the first half of the year, supported by fiscal and monetary policy. Construction of new houses and renovations drove a 6½ per cent increase in investment in the March quarter. Approvals for houses and alterations & additions declined in the June quarter from record high levels as the effect of HomeBuilder waned, though approvals remain well above pre-pandemic levels (Graph 2.15). Underlying demand for new dwellings remains strong, with low interest rates and robust growth in housing prices supporting approvals. Notwithstanding the temporary disruptions to construction activity in some states, the large pipeline of work to be completed on approved projects will also continue to support construction activity over the coming year.

Business investment increased faster than expected

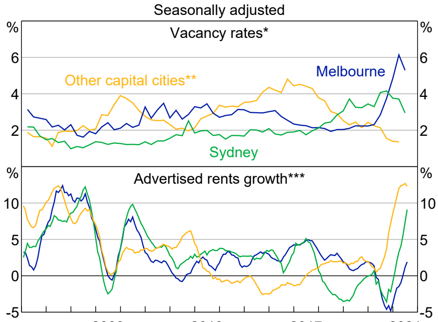
Business investment recovered more quickly than expected after falling sharply at the onset of the pandemic. Private non-mining business investment increased by 4 per cent in the March quarter. The increase was underpinned by strong machinery & equipment investment, particularly in the manufacturing, construction, retail and agriculture sectors (Graph 2.16). Firms have responded to the tax incentives for investment from the Australian Government, the rapid recovery in domestic activity and strong growth in profits over the past year. These factors, together with further increases in surveyed measures of business conditions and capacity utilisation, are likely to have continued to support machinery & equipment investment in the June quarter (Graph 2.17).

In contrast to the rapid recovery in machinery & equipment investment, private non-residential construction investment declined by more than

Graph 2.14

Rental Market Indicators

Seasonally adjusted

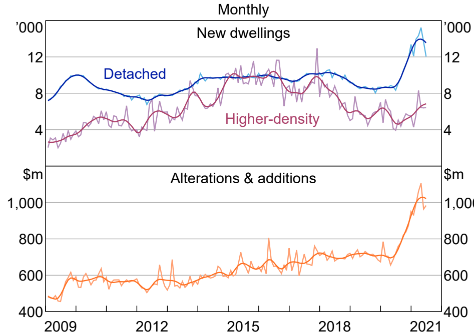


* Quarterly; includes a June quarter estimate for Melbourne and Sydney
** Dwelling stock weighted; vacancy rate excludes Adelaide
*** 6-month-ended annualised
Sources: CoreLogic; RBA; REIA; REINSW; REIV

Graph 2.15

Private Residential Building Approvals*

Monthly



* Smoothed lines are 13-period Henderson trends
Sources: ABS; RBA

expected in the March quarter (Graph 2.18). This partly reflected lower investment in sectors that have been adversely affected by the pandemic, such as office buildings and retail property (see 'Box B: COVID-19 and Commercial Property in Australia'). However, forward-looking indicators, such as building approvals and measures of investment intentions from the ABS Capital Expenditure (Capex) survey, have picked up significantly from last year. Building approvals for industrial buildings have increased. This is consistent with information from the Bank's liaison program of demand for warehouses in response to the shift towards online retailing during the pandemic (Graph 2.19).

Mining investment increased in the March quarter, supported by a strong rise in machinery & equipment investment, and is at its highest level since 2017. The Capex survey measures of investment intentions point to further increases in mining investment in the 2021/22 financial year. The intended projects are primarily to replace existing capacity, rather than to expand capacity (Graph 2.20).

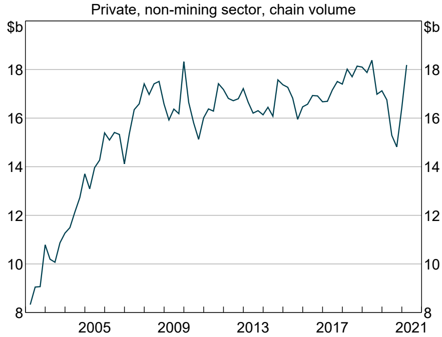
Goods trade continues to recover …

The value of goods exports has grown strongly since the middle of last year, mainly because of higher iron ore prices (Graph 2.21). The value of goods imports recovered its pre-pandemic level in March, underpinned by higher volumes as the strong domestic recovery drew in imports. By

Graph 2.16

Machinery & Equipment Investment

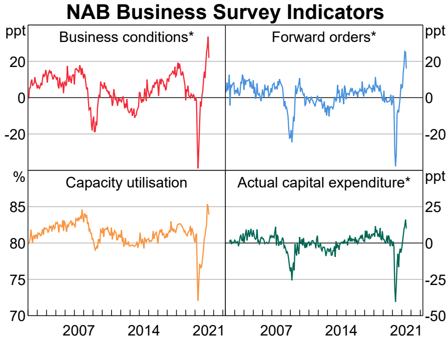
Private, non-mining sector, chain volume



Sources: ABS; RBA

Graph 2.17

NAB Business Survey Indicators



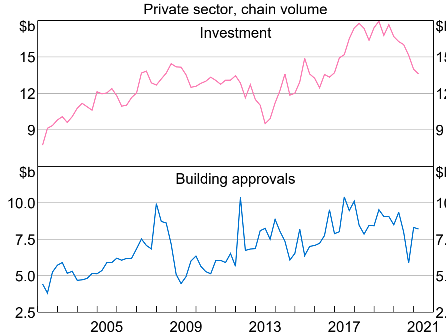
* Net balance; deviation from long-run average

Sources: NAB; RBA

Graph 2.18

Non-residential Indicators

Private sector, chain volume

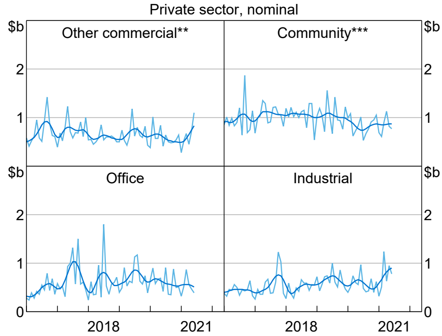


Sources: ABS; RBA

Graph 2.19

Non-residential Building Approvals*

Private sector, nominal



* Smoothed lines are 13-period Henderson trends

** Retail & wholesale and transport facilities

*** Religious, health, entertainment and education facilities

Sources: ABS; RBA

contrast, services trade remains at subdued levels due to ongoing restrictions on international travel. The rebound in prices of key Australian export goods has driven recent increases in the trade surplus, which reached a record level in June.

… with further increases in rural and resource exports …

Growth in rural and resource exports supported export volumes in the March quarter. Rural exports grew by 14 per cent, led by cereals, as grain exporters continued to operate at capacity following the strong winter crop harvest. Improved pasture conditions and the recovery in the global economy have also supported exports for higher-value products such as meat and wool.

Resource export volumes increased in the March quarter, driven by record iron ore export volumes as producers took advantage of high prices. Partial trade data suggest that iron ore export volumes declined in the June quarter because of additional maintenance activity and weather-related disruptions in April. Nonetheless, iron ore exports are expected to remain around capacity in the near term, supported by high prices and robust demand from China.

Coal exports rose modestly in the March quarter. Although coal exports to China have been minimal for most of the year, this has been broadly offset by higher demand from other markets, including India and Japan, reflecting the ongoing recovery in global demand (Graph 2.22). Partial trade data suggest maintenance activity will weigh on coal exports in the June quarter.

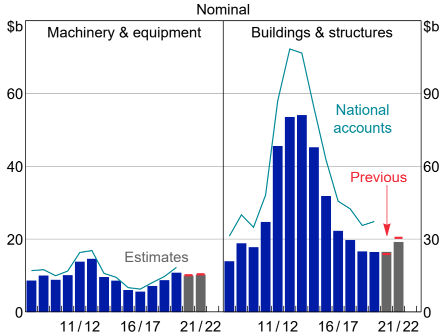
… and a continued recovery in imports supported by strong domestic demand

Goods import volumes continued to increase strongly in the March quarter, in line with the recovery in domestic activity. Capital goods imports, particularly of machinery and industrial

Graph 2.20

Mining Capital Expenditure*

Nominal



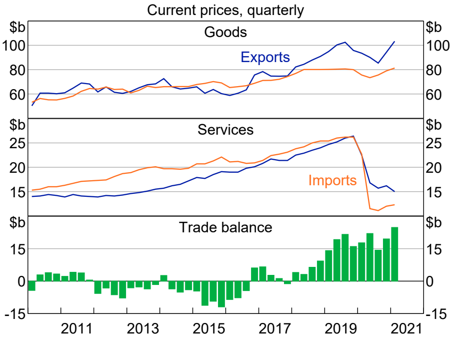
* Estimates are firms' expected capital expenditure; adjusted for past average differences between expected and realised spending

Sources: ABS; RBA

Graph 2.21

Trade in Goods and Services

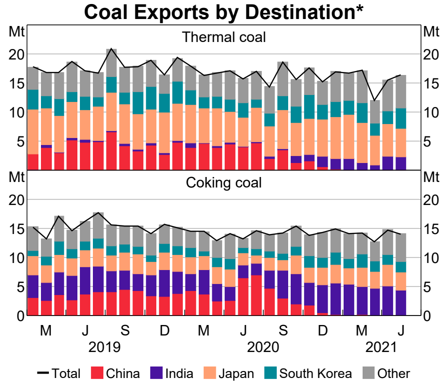
Current prices, quarterly



Source: ABS

Graph 2.22

Coal Exports by Destination*



* Seasonally adjusted by the RBA

Sources: ABS; RBA

equipment, have been supported by tax incentives from the Australian Government. The recovery in activity should have further supported import volumes in the June quarter, though global production and shipping disruptions weighed on imports of several key categories of goods, including motor vehicles. Services import volumes are around half of their 2019 levels and are unlikely to materially increase until the international border reopens.

Public demand continues to support activity

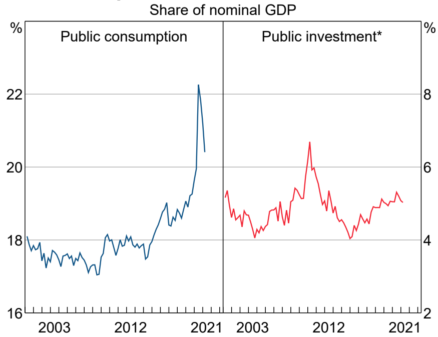
Extraordinary policy support has underpinned the economic recovery and public demand remains a relatively large share of economic activity (Graph 2.23). However, growth in public spending has slowed over the past year and public consumption declined in the March quarter. Recent federal and state government budgets included new spending, supported by higher revenue from the stronger-than-expected rebound in economic activity and higher commodity prices. These programs will support public consumption over coming quarters.

Federal and state government budgets over the past year have also included significant commitments of public investment in infrastructure. While public investment increased for the third consecutive quarter in March – and is expected to have increased further in the June quarter – the pace of growth has been slower than foreshadowed by government budgets. Information from the Bank's liaison program suggests that the rollout of these large investment programs may be delayed further, with ongoing reports of administrative challenges in awarding public construction contracts and constraints on the availability of materials, equipment and labour.

Graph 2.23

Components of Public Demand

Share of nominal GDP



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

Sources: ABS; RBA