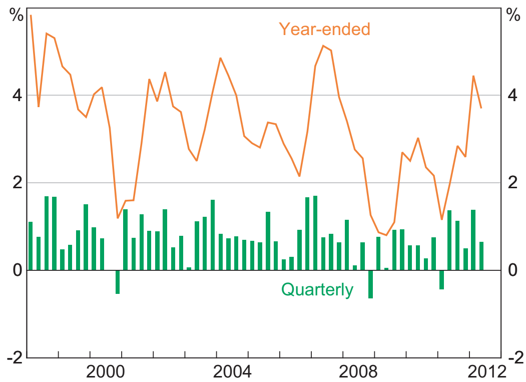
# 3. Domestic Economic Conditions

GDP grew at an above-trend pace over the year to June, though growth in the June quarter itself was slower but still not far from trend pace (Table 3.1; Graph 3.1). Over the year, the strength reflected the surge in mining investment and strong growth in household consumption while non-mining investment remained weak. In the June quarter, both consumption and business investment growth slowed from the rapid pace seen in the March quarter. Over the past year, falls in the terms of trade have weighed on growth in national income.

The latest information suggests that GDP growth in the September quarter was moderate. Consumer spending overall appears to have grown at around the same rate as in the June quarter. After picking up earlier in the year, employment growth softened in the September quarter, which is likely to have weighed on the growth of incomes and spending.

Mining investment appears to have continued to grow at a strong pace in recent quarters. Work underway on over $180 billion of committed liquefied natural gas (LNG) projects is continuing, although there are concerns about delays in terms of

**Graph 3.1**
**GDP Growth**



Source: ABS

**Table 3.1: Demand and Output Growth(a)**
Per cent

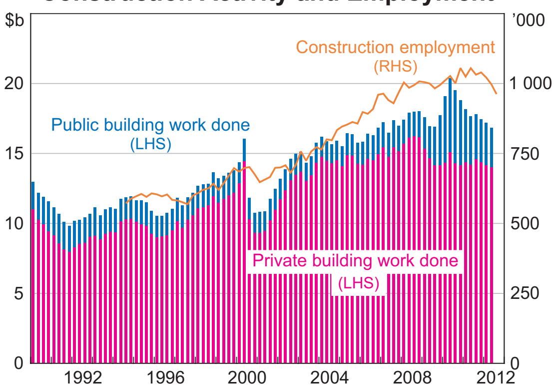
| | June quarter 2012 | March quarter 2012 | Year to June quarter 2012 |
|---|---|---|---|
| Domestic final demand | 0.9 | 2.1 | 5.8 |
| – Private demand | 0.4 | 2.4 | 6.8 |
| – Public demand | 2.3 | 1.2 | 2.7 |
| Change in inventories(b) | –0.3 | 0.0 | –0.3 |
| Gross national expenditure | 0.6 | 2.0 | 5.4 |
| Net exports(b) | 0.3 | –0.4 | –0.8 |
| GDP | 0.6 | 1.4 | 3.7 |
| Nominal GDP | 1.0 | 0.4 | 3.2 |
| Real gross domestic income | 0.6 | 0.4 | 2.1 |

(a) Based on the June quarter 2012 national accounts release, rather than the 2011/12 annual national accounts
(b) Contribution to GDP growth
Source: ABS

the rate of progress on some projects. The declines in iron ore and coal prices since earlier in the year have affected the outlook for mining investment over the next few years. Mining companies have announced both a scaling back of investment intentions and plans to restrain spending where possible to preserve cash flows. The terms of trade have continued to decline; in the September quarter they are estimated to have been around 13 per cent below the peak reached a year earlier.

At the same time, investment intentions outside of the mining industry remain relatively subdued. The elevated level of the exchange rate, and weak housing market activity, are still weighing on the outlook for some sectors. In particular, the construction industry has shed labour as the boost from spending on government-funded projects unwinds, and activity in private building construction remains weak (Graph 3.2). Leading indicators do, however, provide tentative signs of a recovery in residential building.

**Graph 3.2**
**Construction Activity and Employment**



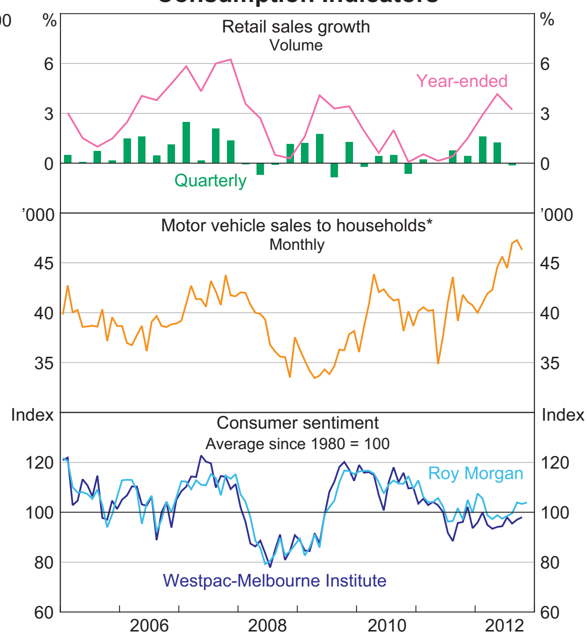

Source: ABS

## Household Sector

Consumer spending increased strongly in early 2012, in line with income growth associated with stronger employment growth. Consumption growth slowed in the June quarter from the very strong growth in the March quarter and was supported by various government payments to households made in May and June associated with the introduction of the carbon price and assistance for families with school-age children. Growth in spending on goods was noticeably stronger than on services, reflecting a reversal of the trend seen through much of 2011. In line with this pattern of spending, the volume of retail sales – which primarily captures sales of goods – increased quite rapidly over the first half of this year (Graph 3.3). Sales volumes improved for most types of retailers, although for some this was driven by aggressive discounting earlier in the year. While estimates suggest that online spending by Australian households at both domestic and overseas retailers is only a small fraction of total consumption, it is growing rapidly and so it may have weighed on sales for some other retailers in recent years.

Most indicators suggest that growth in consumption spending continued in the September quarter, but at a pace slightly below trend after the unusual strength earlier in the year, as the impetus to sales from heavy discounting in early 2012 and the government payments to households in the previous quarter unwound. At the same time, growth in labour income is likely to have been reduced

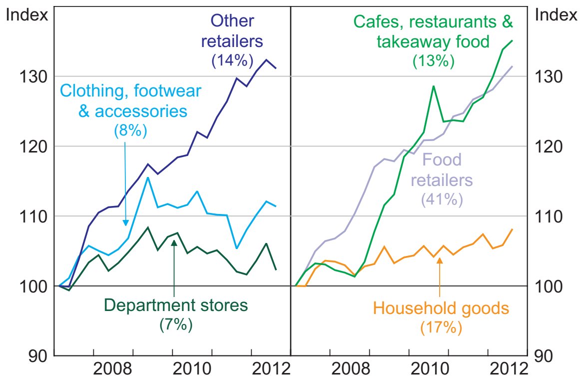
**Graph 3.3**
**Consumption Indicators**




* Seasonally adjusted by the RBA
Sources: ABS; FCAI/VFACTS; Melbourne Institute and Westpac; RBA; Roy Morgan Research

by slower growth in employment and a decline in average hours worked. The value of retail sales grew moderately in the September quarter, underpinned by growth at food-related and household goods retailers (Graph 3.4). However, this reflected higher prices in the quarter, with the volume of retail sales falling slightly. Sales of motor vehicles to households continued to rise in the September quarter. Consumer survey respondents report that now is a good time to purchase a motor vehicle, perhaps as the high level of the exchange rate has made imported vehicles more affordable than in the past. Indeed, the recent strength in car sales has been driven by sales of imported vehicles, with sales of domestically produced vehicles declining over the past six months.

**Graph 3.4**
**Retail Sales Values***
March quarter 2007 = 100

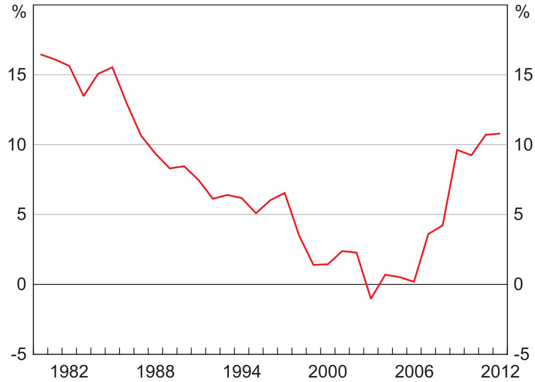



* Numbers in brackets are shares of total retail sales
Source: ABS

Over the past few years, growth in consumption was broadly in line with household income growth. Consequently, the household saving ratio remained at around 10 per cent of disposable income (Graph 3.5).

Demand for housing finance has remained broadly unchanged as a share of credit; over the past six months, the value of housing loan approvals has risen by around 5 per cent (annualised), driven by owner-occupiers. These new loans have been sufficient to keep aggregate outstanding housing debt growing broadly in line with household incomes despite some increase in loan prepayments

**Graph 3.5**
**Household Saving Ratio***
Per cent of household disposable income

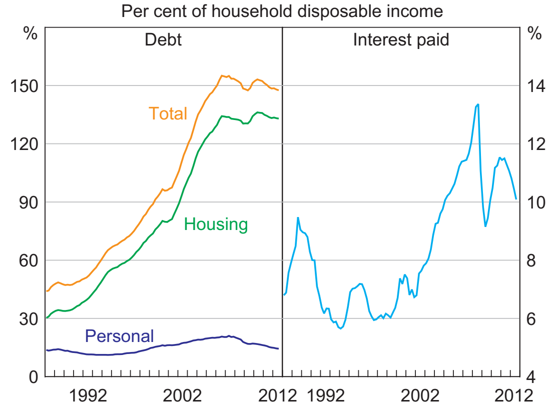



* Net of depreciation
Source: ABS

(Graph 3.6). The growth of overall household debt has slowed from an annual rate of 5 per cent a year ago to around 4 per cent currently, largely reflecting the increase in prepayments of housing loans and the decline in personal debt outstanding. Lower average interest rates over the June quarter resulted in a fall in households' interest payments as a share of income. Interest payments are estimated to have fallen further following the reduction in the cash rate in October.

Household net worth in the June quarter was about 2 per cent lower than a year earlier, reflecting lower average dwelling prices and higher liabilities,

**Graph 3.6**
**Household Finances***
Per cent of household disposable income




* Household sector excludes unincorporated enterprises; disposable income is after tax and before the deduction of interest payments; RBA estimates for the September quarter 2012
Sources: ABS; RBA

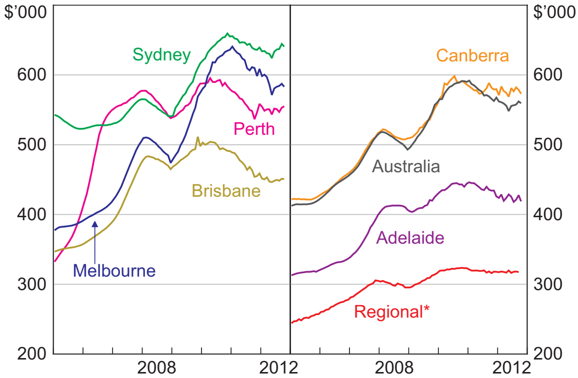
offset somewhat by an increase in financial asset holdings. Net worth is, however, estimated to have risen strongly in the September quarter driven by a rebound in equity and dwelling prices.

Australian capital city dwelling prices have risen by around 2 per cent since their May 2012 trough, although they are still around 5 per cent below their January 2011 peak (Table 3.2; Graph 3.7). Recent price rises have been broad based, with prices in almost all state capitals increasing since May. Despite the increase in dwelling prices, and an increase in auction clearance rates, housing turnover has remained close to the low level of the early 1990s.

Rents have continued to grow strongly, with rental vacancy rates around 2 per cent and remaining near their historical lows. Nationwide, rents have increased by around 4 per cent over the past year. Given more modest growth in house prices, average rental yields have risen to almost 5 per cent, from around 4½ per cent a year ago. Perth in particular has seen very strong growth in rents.

Residential construction activity continued to decline over the first half of the year, to reach low levels as a share of GDP. There are tentative signs, however, that demand for new housing is beginning to improve as falls in mortgage interest rates, higher rental yields and the recent turnaround in established housing prices have increased the attractiveness of new housing investment. Building approvals appear to have reached a trough mid year, supported by a pick-up in higher-density housing (Graph 3.8). While approvals for detached houses have increased by less than total building approvals, typically it can take several quarters for falls in interest rates to spur recovery in this market. In addition, uncertainties in Western Australia associated with the introduction of a new building approvals process are yet to be fully resolved. Loan approvals to owner-occupiers for new construction have increased over 2012, although investor loan approvals for new construction remain subdued (Graph 3.9). Among owner-occupiers, first home buyer demand has increased noticeably, with first home owner grants (FHOGs) for new dwellings increasing quite strongly over the past six months.

**Graph 3.7**
**Dwelling Prices**




* Excluding apartments; measured as areas outside of capital cities in mainland states
Sources: RBA; RP Data-Rismark

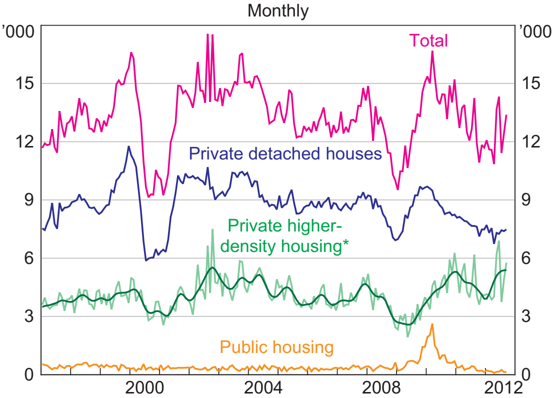
**Table 3.2: National Housing Price Growth**
Per cent

| | 3 months to June 2012 | 3 months to September 2012 | Year to September 2012 |
|---|---|---|---|
| **Capital cities** | | | |
| ABS[(a), (b)] | 0.6 | 0.3 | 0.3 |
| APM[(b)] | –0.2 | –0.4 | –0.3 |
| RP Data-Rismark | –0.6 | 1.2 | –1.3 |
| **Regional areas** | | | |
| APM[(b)] | –1.0 | –0.1 | –0.3 |
| RP Data-Rismark[(a)] | –0.4 | 0.4 | –0.3 |

(a) Detached houses only
(b) Quarter-on-quarter growth rate
Sources: ABS; APM; RBA; RP Data-Rismark

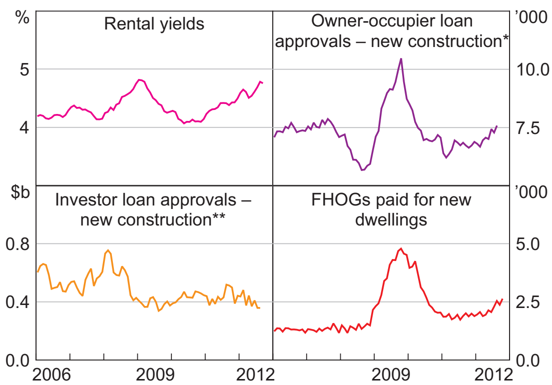
While this partly reflects demand in Victoria being brought forward owing to the expiry of the First Home Bonus scheme, the increase in assistance to first home buyers purchasing new dwellings in New South Wales and South Australia may support demand in the period ahead.

**Graph 3.8**
**Residential Building Approvals**
Monthly




* Smoothed line is ABS trend measure
Source: ABS

**Graph 3.9**
**Indicators of Dwelling Investment**

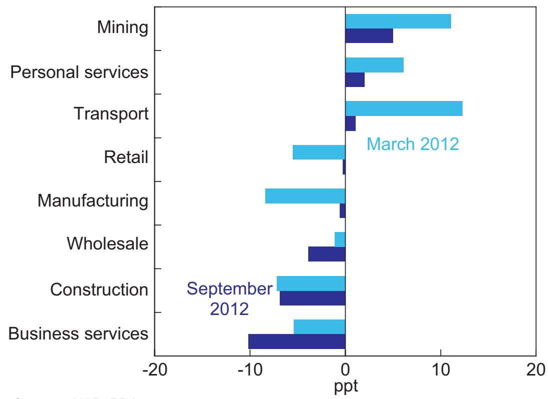



* And newly erected dwellings
** 3-month moving average
Sources: ABS; NSW Office of State Revenue; RBA; RP Data-Rismark

## Business Sector

Private sector surveys and liaison with firms suggest that business conditions remain close to their longer-run average, albeit quite a bit softer than the buoyant conditions seen through much of the 2000s. Across industries, a notable change over the past six months has been the large fall in conditions in the mining and transport industries (Graph 3.10). The business services sector has also seen declines while conditions have improved for retail and manufacturing. Business services and building construction continued to report weaker-than-average conditions.

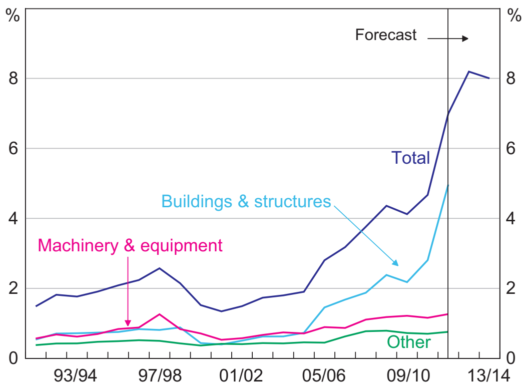
**Graph 3.10**
**Business Conditions by Industry**
Deviation from industry average since 1989; quarterly




Sources: NAB; RBA

Weaker conditions in the mining industry are consistent with the recent falls in iron ore and coal prices, which have prompted a reassessment of mining investment projects that have been under consideration. Lower prices have reduced mining companies' cash flows and reduced their appetite for investment spending. Sentiment has also been weighed down by the high exchange rate and rising cost pressures. As a result, a number of large uncommitted projects have been deferred, companies are slowing the pace of spending on some committed projects, and some older, higher-cost coal mines have been closed. Liaison with the industry suggests that exploration and feasibility work outside the petroleum sector has been scaled back significantly, partly reflecting reduced access to funding for junior miners. There are also signs that plans for spending on machinery and equipment have been pared back. Despite these developments, investment in the coming year is still expected to rise, underpinned by construction on a number of very large LNG projects. LNG investment continues to ramp up as these projects have not been adversely affected by the shift in sentiment elsewhere in the resources sector. Nevertheless, there is uncertainty about the timing of work for some LNG projects. Overall, after surging by around 55 per cent in 2011/12, mining investment looks set to rise further (albeit at a slower rate), and the level of investment in the mining sector is expected to peak some time during 2013 (Graph 3.11).

**Graph 3.11**
**Mining Investment**
Share of GDP



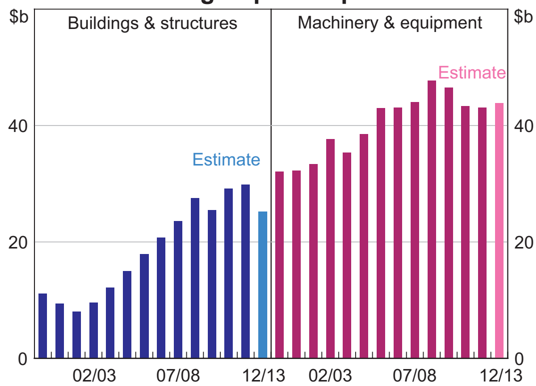

Sources: ABS; RBA

Outside the mining industry, investment intentions remain relatively soft. After little change in 2011/12, the latest ABS survey of firms' capital expenditure plans (Capex) points to a decline in nominal non-mining investment in 2012/13 (Graph 3.12). Machinery and equipment investment is expected to be broadly unchanged this financial year, although motor vehicle purchases by businesses – which account for around one quarter of total machinery and equipment investment – have been relatively strong since June. Spending on buildings and structures is expected to remain subdued, with private non-residential building approvals, while volatile, little changed overall over the past six months.

Approvals for new office construction have also been relatively stable over the past six months and industry estimates point to a slowing in new office supply in 2013 (Graph 3.13). CBD office vacancy rates rose slightly in most capital cities in the September quarter. The vacancy rate for cities overall remains around 8 per cent, slightly above the average over the past decade.

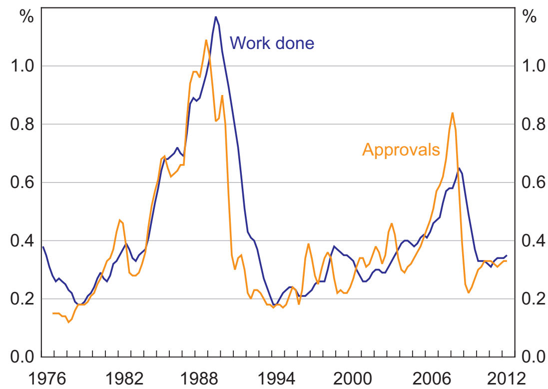
Company profits fell by 5 per cent over the year to June, driven by a 15 per cent fall in mining profits. Although lower than a few years ago, profits remain relatively high as a share of GDP. As discussed in the Domestic Financial Markets chapter, overall, businesses have high levels of internal funds and have also increased their use of external funding recently, indicating that they have adequate funding available for investment.

**Graph 3.12**
**Non-mining Capital Expenditure***




* Sample of firms' spending plans; estimates are the Capex survey measure of firms' expected capital expenditure in 2012/13, adjusted for historical realised spending; the Capex survey excludes the agriculture, public administration, education and health industries
Sources: ABS; RBA

**Graph 3.13**
**Office Construction**
Share of nominal GDP*




* 7-period Henderson trend
Sources: ABS; RBA

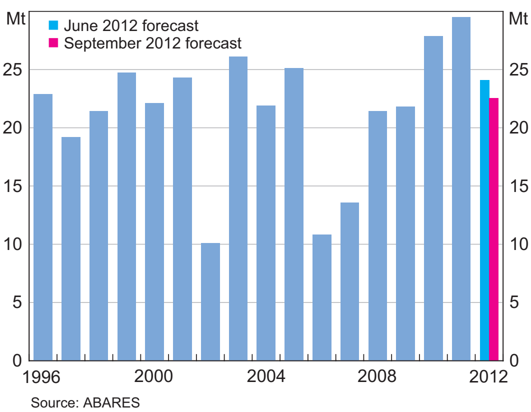
## Government Sector

In the October Mid-Year Economic and Fiscal Outlook (MYEFO), the Australian Government forecasts an underlying cash surplus of $1.1 billion (0.1 per cent of GDP) in 2012/13 – following an estimated deficit of 3 per cent in 2011/12 – and expects the budget position to remain in surplus in 2013/14. State and territory governments' budgets indicate a widening of their consolidated deficit position in 2012/13 and then a narrowing in subsequent years to be broadly in balance in 2014/15. Together, the federal and state budget outlooks imply a significant fiscal consolidation over the coming two years. Recent falls in public sector employment suggest that consolidation is having some dampening effect on activity.

## Farm Sector

Conditions in the farm sector are mixed. High prices for wheat and some other crops are supporting farm incomes. However, the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) has revised down its forecasts of the 2012 winter crop to levels that are around 20 per cent below the record crop achieved last year (Graph 3.14). This largely stems from below-average winter rainfall in Western Australia.

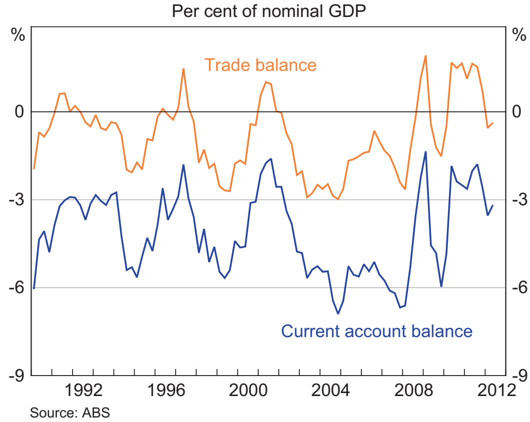
**Graph 3.14**
**Wheat Production**




## External Sector

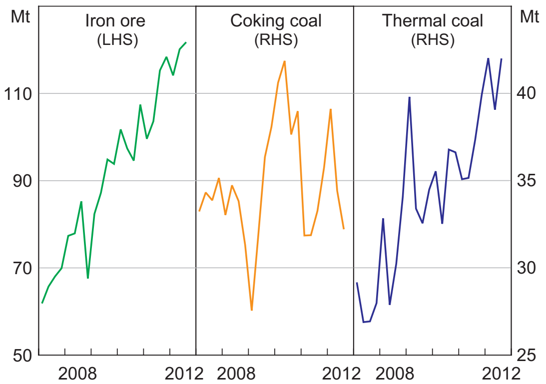
Export volumes rose in the June quarter, as strong growth in iron ore, gold and rural exports offset a fall in coal exports. The growth in iron ore exports reflected a recovery from the cyclone-related disruptions in the March quarter. Rural exports were supported by the continued drawdown of wheat stocks following large harvests in 2010 and 2011. Import growth was driven by capital goods related to ongoing resource investment. After posting surpluses in recent years, the trade balance has returned to a deficit in 2012 as prices received for bulk commodity exports have come off their peaks (Graph 3.15).

**Graph 3.15**
**Current Account Balance**
Per cent of nominal GDP




In the September quarter, export volumes are estimated to have increased moderately, while import volumes are estimated to have been unchanged. Iron ore export volumes appear to have increased in the quarter, while data on coal exports were mixed. Coking coal exports (primarily from Queensland) have declined, whereas there was modest growth in thermal coal exports (Graph 3.16). Liaison contacts suggest that global demand for coal has been weak. It is also likely that there has been some rebuilding of stockpiles following the end of industrial action at BHP Billiton Mitsubishi Alliance (BMA) mines. The earlier-than-expected closure of some older, higher-cost mines – in response to

## Graph 3.16
**Bulk Commodity Exports**
Quarterly




Sources: ABS; RBA

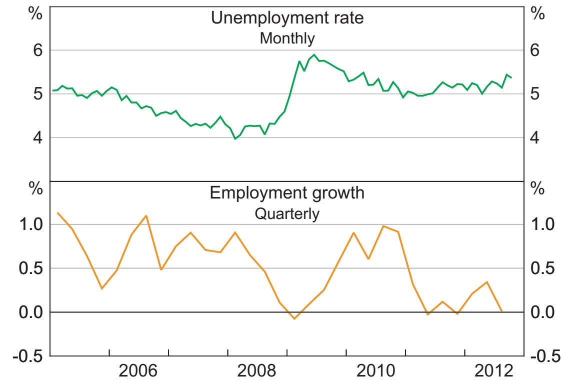
lower spot prices and concerns about high costs – has resulted in some cuts to employment in coal mining and related services. However, the impact on export volumes in the near term is expected to be limited as the mines being closed are generally small producers.

## Labour Market

Labour market conditions have softened in recent months, following signs of stronger growth in the first half of 2012. Employment growth slowed and the unemployment rate has risen slightly (Graph 3.17). In line with these softer outcomes, the participation rate and the employment-to-population ratio have both declined over the past year (Graph 3.18).

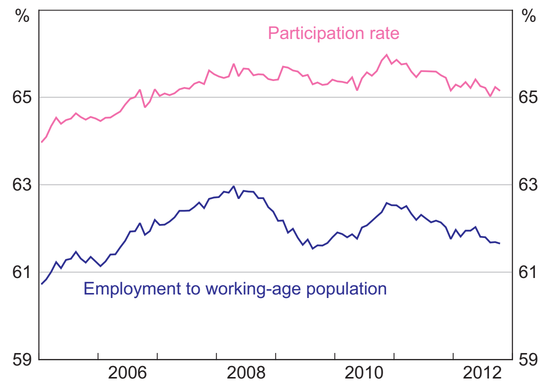
The Labour Force Survey data reveal a relatively wide dispersion of employment outcomes across different industries (Graph 3.19). Over the past year, most states have seen a particularly pronounced decline in demand for labour in the construction industry. Nationally, the slowdown in building activity has led to a decline in employment in construction of around 7 per cent. Falls in public administration employment have also been significant. Despite strong growth over the past year, mining employment recorded a small decline in the three months to August, its first quarterly decline since mid 2009. As discussed above, this reflects in part the closure of some older

## Graph 3.17
**Labour Market**



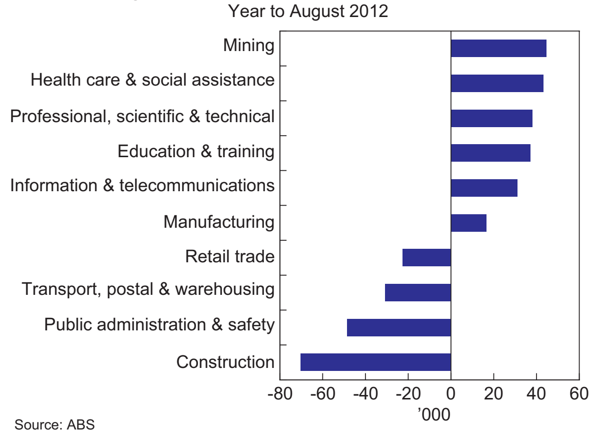

Source: ABS

## Graph 3.18
**Participation and Employment Rates**




Source: ABS

## Graph 3.19
**Employment Growth in Selected Industries**
Year to August 2012

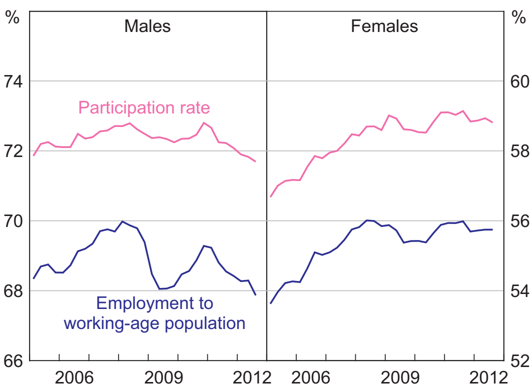



Source: ABS

coal mines, while the Bank's business liaison also indicates that some firms in the iron ore and coal industry are reducing employment more generally to contain costs. Employment growth has remained relatively strong in a number of business and household services industries, including professional services, health care and education. Recent data also suggest that manufacturing employment has increased slightly over the past year after falling sharply during the first half of 2011.

The weakness in overall employment growth has been especially pronounced among male workers. Total male employment has been little changed over the past two years, and the ratio of male employment to male working-age population has fallen to around the same level as its trough in mid 2009 (Graph 3.20). This has coincided with a decline in the participation rate of both prime working-age males and males aged 15 to 24 years. Consistent with this, employment has been particularly soft in male-dominated industries such as construction and transport, postal & warehousing. In contrast, female employment has grown in line with the female working-age population in recent years. Some of the recent weakness in youth employment may be due to ongoing softness in industries exposed to discretionary spending, such as retail trade and accommodation & food services, which tend to employ a higher proportion of younger workers.

**Graph 3.20**
**Labour Market Outcomes by Gender**

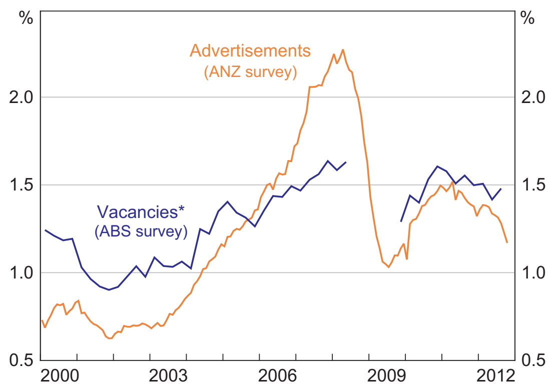


Source: ABS

Labour market conditions continue to vary across states. Trend employment growth has slowed in Western Australia and Victoria since earlier in the year. In Queensland, the level of employment has fallen since the start of 2012, while it appears to have stabilised in South Australia and Tasmania. Employment growth has picked up a little in New South Wales from the low levels seen earlier in the year.

Leading indicators of labour demand have generally remained subdued, and point to only modest employment growth in coming months. The ANZ job advertisements series fell for the seventh consecutive month in October, to be around 15 per cent lower over the year (Graph 3.21). In contrast, the ABS measure of job vacancies increased in the three months to August, though this only partly reversed a fall in the previous three months. Reports from the Bank's liaison suggest that businesses in many industries are cautious about hiring more staff. ✠

**Graph 3.21**
**Job Vacancies and Advertisements**
Per cent of labour force



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