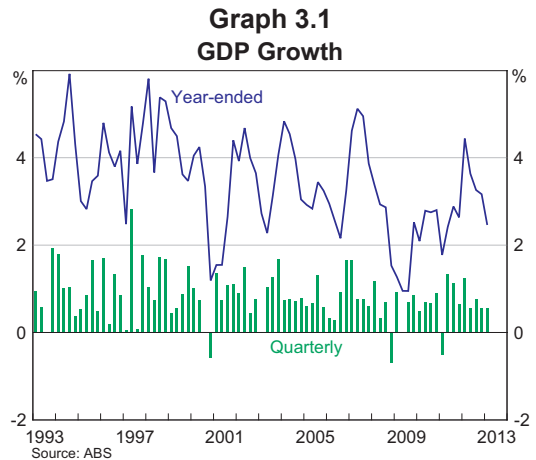


3. Domestic Economic Conditions

Growth of the Australian economy was a little below trend over the year to the March quarter, while timely indicators suggest that economic activity continued to grow at a similar pace in the June quarter (Graph 3.1, Table 3.1). Measures of consumer sentiment have fallen back to around average levels after picking up earlier in the year, and retail sales and the Bank’s liaison provide little indication of a pick-up in consumption growth after weaker-than-expected growth in the March quarter. The labour market continues to be somewhat subdued, consistent with survey-based measures of business conditions, which remain below average. Indeed, non-mining business investment continues to be weak and while mining investment remains at a high level, it is expected to decline over the next few years. In contrast, residential building approvals have continued to pick up, consistent with a recovery in



dwelling investment. Available data also indicate that growth in export volumes was strong over the first half of the year.

Table 3.1: Demand and Output Growth
Per cent

| | March quarter 2013 | Year to March quarter 2013 |
|--------------------------------------|--------------------|----------------------------|
| Domestic final demand | -0.3 | 1.1 |
| – Private demand | -0.7 | 2.1 |
| – Public demand | 1.4 | -1.9 |
| Change in inventories ^(a) | -0.4 | -0.9 |
| Gross national expenditure | -0.6 | 0.3 |
| Exports | 1.1 | 8.1 |
| Imports | -3.5 | -3.2 |
| GDP | 0.6 | 2.5 |
| Nominal GDP | 1.3 | 3.0 |
| Real gross domestic income | 1.1 | 1.0 |

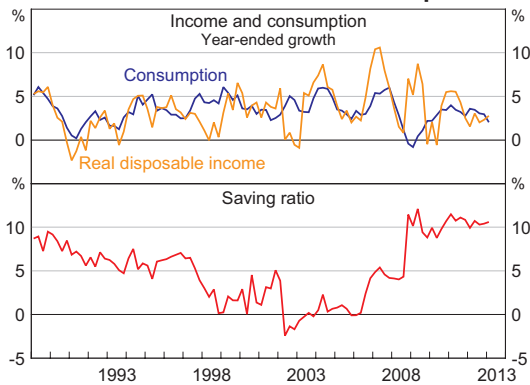
(a) Contribution to GDP growth
Source: ABS

Household Sector

Growth in household consumption has slowed over the past year, as below-average income growth and softer labour market conditions appear to have been weighing on households' willingness to spend. With consumption continuing to increase in line with incomes, the household saving ratio has remained steady at around 10 per cent of income (Graph 3.2). This is well above the levels seen in the 1990s and 2000s, but less than the rate of saving that prevailed up to the mid 1980s. Household net worth has continued to increase in recent quarters and is estimated to be almost 9 per cent higher over the year to June. This has been driven by increases in equity and dwelling prices, as well as ongoing saving by households (Graph 3.3).

Graph 3.2

Household Income and Consumption*

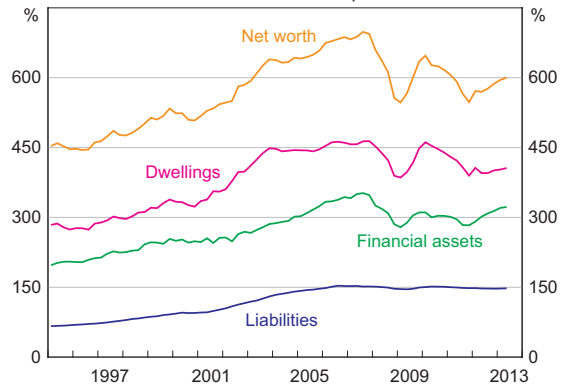


* Household sector includes unincorporated enterprises; disposable income is after tax and interest payments; income level smoothed with a two-quarter moving average between March quarter 2000 and March quarter 2002; saving ratio is net of depreciation
Sources: ABS; RBA

Retail sales volumes were unchanged in the June quarter, suggesting that growth in the consumption of goods remained below average (Graph 3.4). Clothing, footwear & accessories retailers and cafes, restaurants and takeaway stores posted modest sales growth, but this was offset by falls in sales at department stores and household goods retailers. Retail sales values were also broadly unchanged in the quarter, as were prices. Information from the Bank's liaison suggests that growth in retail sales remains relatively weak. Survey measures of

Graph 3.3

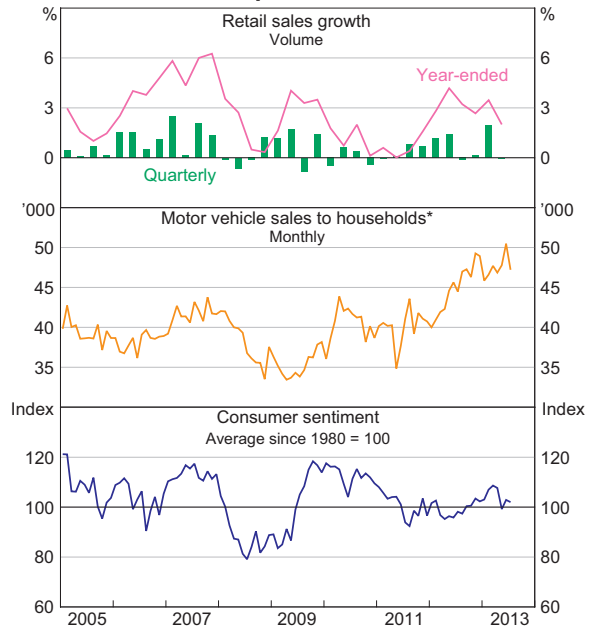
Household Wealth and Liabilities*



* Household liabilities exclude the liabilities of unincorporated enterprises; disposable income is after tax and before the deduction of interest payments; RBA estimates for June quarter 2013
Sources: ABS; RBA; RP Data-Rismark

Graph 3.4

Consumption Indicators



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

consumer sentiment declined from above average in the first quarter to around average, and consumers' concerns about future conditions in the labour market remain elevated. In contrast, sales of motor vehicles to households increased by 3½ per cent in the June quarter, supported by ongoing discounting,

although sales fell in July. Reported buying conditions for dwellings remain favourable, with measures of sentiment regarding the housing market supported by the low level of interest rates.

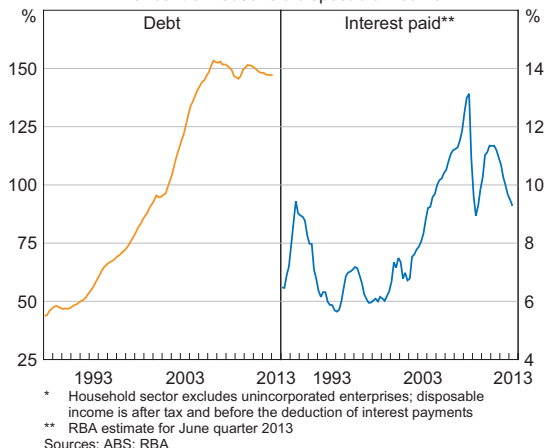
Real household disposable income (after interest payments) increased by 2¾ per cent over the year to the March quarter. Growth in labour income was weak (as wage growth slowed) and growth in income from household assets was subdued. Interest payments are estimated to have declined to 9¼ per cent of household disposable income in the June quarter from 11¼ per cent two years earlier as a result of lower average interest rates. Household debt has continued to grow in line with nominal incomes, with debt as a share of household disposable income steady at a little below 150 per cent (Graph 3.5).

The recovery in the established housing market has continued, with prices rising further (Graph 3.6, Table 3.2). Housing prices are now 6½ per cent above their 2012 trough. In recent months, prices in most state capitals have increased. Auction clearance rates also remain at high levels. The demand for housing finance has continued to strengthen, consistent with rising dwelling prices and lower interest rates, with the value of housing loan approvals rising at an annualised pace of 25 per cent over the past 6 months. This strong growth in loan approvals and the slow pace of growth in overall household debt implies that households with existing debt

Graph 3.5

Household Finances*

Per cent of household disposable income



Graph 3.6

Housing Market



Table 3.2: National Housing Price Growth

Per cent

| | 3 months to June 2013 | 3 months to March 2013 | Year to June 2013 |
|--------------------------------|-----------------------|------------------------|-------------------|
| Capital cities | | | |
| ABS ^{(a),(b)} | 2.4 | 0.8 | 5.1 |
| APM ^(b) | 2.6 | 0.5 | 4.9 |
| RP Data-Rismark | 1.0 | 1.1 | 3.8 |
| Regional areas | | | |
| APM ^(b) | 0.6 | 0.2 | 1.6 |
| RP Data-Rismark ^(a) | -0.7 | 0.7 | 0.5 |

(a) Detached houses only

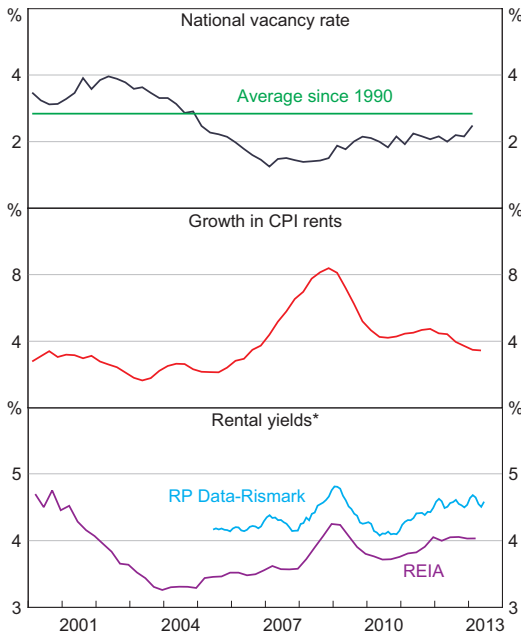
(b) Quarter-on-quarter growth rate

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

are paying down their debt more quickly (see the 'Domestic Financial Markets' chapter).

Nationwide, the rental vacancy rate increased in the March quarter to 2½ per cent, a little above the rate that has prevailed over recent years but still below its longer-run average (Graph 3.7). While the growth in rents has slowed, it continues to exceed general inflation and rental yields remain elevated relative to recent history. The growth of rents has been particularly strong in Perth over the past year and rental yields there are elevated. Given a more subdued economic outlook in Western Australia and a weakening labour market, conditions in the Perth market may soften in the period ahead.

**Graph 3.7
Rental Market**



* REIA series uses an unmatched sample of rents and prices; RP Data-Rismark series uses a matched sample
Sources: ABS; RBA; REIA; RP Data-Rismark

Residential construction activity was unchanged in the March quarter, with further strong growth in new building activity offset by a decline in activity for alterations and additions. Nonetheless, overall activity in the sector is more than 4 per cent higher than in mid 2012. The weakness in alterations and additions for much of the past year is a little unusual

given the pick-up in housing prices and new building activity. However, a continued recovery in the established housing market is expected to support an increase in alterations and additions activity. Moreover, forward-looking indicators point to an ongoing recovery in dwelling investment; loan approvals for new dwellings were almost 15 per cent higher over the year, while first home owner grants (FHOGs) for new dwellings also picked up, driven by particularly strong growth in New South Wales and Western Australia (Graph 3.8).

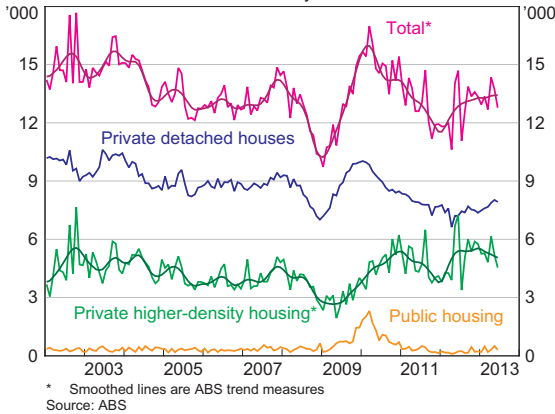
**Graph 3.8
Indicators of Dwelling Investment**



* Includes both new construction and newly erected dwellings
Sources: ABS; NSW Office of State Revenue; RBA

The number of private residential building approvals rose by 4 per cent in the June quarter and the trend measure is around 15 per cent higher than at the 2011 trough (Graph 3.9). Detached housing approvals have started to recover after a lengthy period of weakness, while approvals for higher-density housing have moderated somewhat from their recent high levels. The Bank's business liaison suggests that demand for new housing has improved over recent months, particularly in New South Wales. The increase in total building approvals is expected to continue, aided by an ongoing recovery in the established housing market, relatively high rental yields, low borrowing rates and government support to first home buyers (which in most states has now been directed towards purchases of newly built homes rather than existing dwellings).

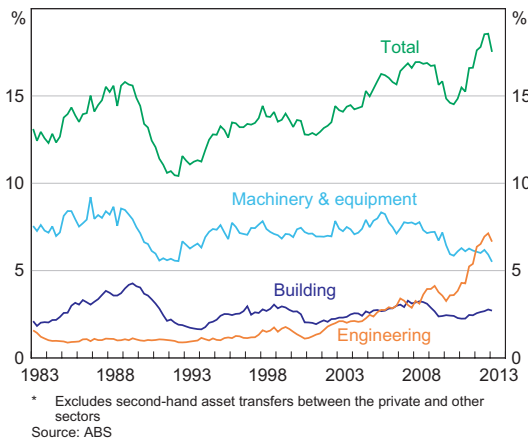
Graph 3.9
Residential Building Approvals
Monthly



Business Sector

While business investment remains high as a share of the economy, it declined in the March quarter, with estimates of mining and non-mining investment lower. Both engineering construction and machinery & equipment investment decreased noticeably (Graph 3.10). These developments are consistent with the fall in capital imports as well as information from both public announcements by resource companies and the Bank's liaison signalling that the investment phase of a number of mining projects is beginning to wind down. While it is difficult to know for certain, it may well be that mining investment has peaked.

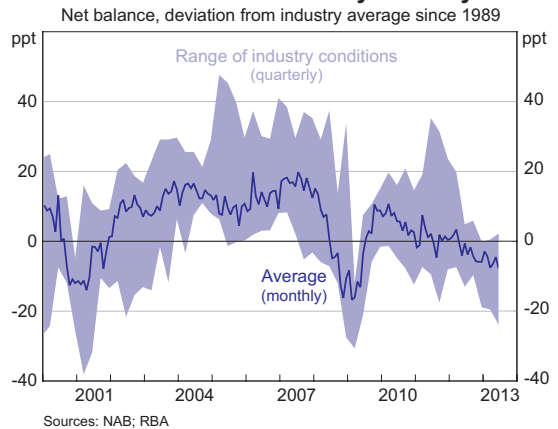
Graph 3.10
Business Investment*
Share of GDP



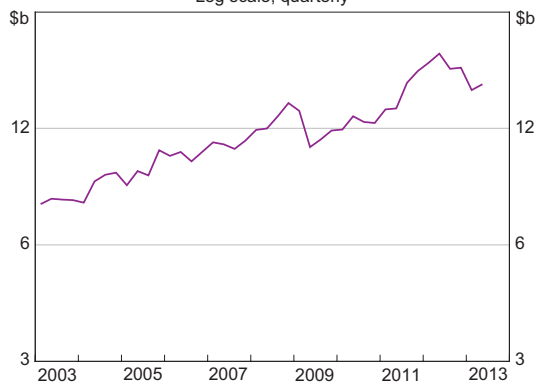
Business profits recovered somewhat in the March quarter after falling in 2012, in part reflecting a short-lived increase in the spot price of iron ore around the beginning of the year. The overall decline in prices for bulk commodities over the past year and a half has led to an increased focus on managing costs in the mining sector, particularly in the coal industry. Profit growth in the non-mining sector varied considerably across industries in the March quarter, but was positive overall. The recent depreciation of the exchange rate should provide some support to profits in the trade-exposed sectors, both resource and non-resource.

Indicators suggest that business conditions in the June quarter remained below their long-run average levels. Survey-based measures of business conditions have been mixed in recent months, but remain a little below long-run average levels across almost all industries (Graph 3.11). Surveys and the Bank's liaison suggest that weak domestic demand still remains a key concern for businesses, although the recent depreciation of the Australian dollar, along with the effects over time of stimulatory monetary policy settings, should work to support business conditions. In addition, the declines in bulk commodity prices over the past year are weighing on sentiment in the mining sector. Available data indicate that capital import values in the June quarter were around 17 per cent lower than their peak a year ago, consistent with weakness in investment (Graph 3.12).

Graph 3.11
Business Conditions by Industry
Net balance, deviation from industry average since 1989



Graph 3.12
Capital Import Values*
 Log scale, quarterly

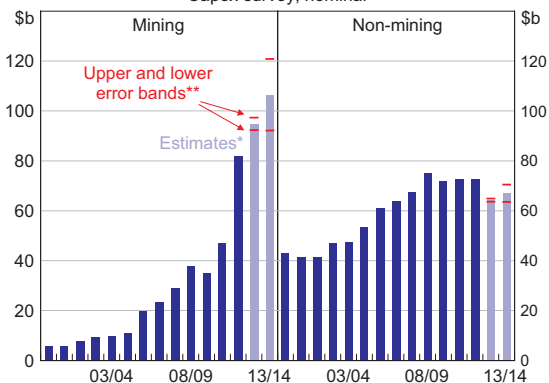


* June quarter 2013 observation based on monthly data
 Source: ABS

Despite the softness in some near-term indicators of business investment, the latest ABS capital expenditure (Capex) survey suggests that investment will grow in 2013/14 (Graph 3.13). However, care is needed in interpreting these estimates as the coverage of non-mining investment excludes some types of investment and important sectors such as agriculture, forestry & fishing and health care & social services (see 'Box A: Measuring Business Investment'). Moreover, intentions in the Capex survey tend to be subject to a degree of uncertainty, the more so for the mining sector. At odds with other information, these data imply that the increase in investment in 2013/14 is likely to be largest in the mining sector, with further growth in building and structures offsetting falls in machinery and equipment investment.

For the parts of the non-mining sector that the Capex survey covers, it also suggests an increase in investment spending in 2013/14. Meanwhile, some indicators of private non-residential building investment have strengthened. Building approvals have trended higher so far in 2013, after being boosted in early 2012 by two large healthcare projects (Graph 3.14). However, office vacancy rates have also risen over the past year, partly reflecting cost-cutting by companies providing services to the resources sector. The Bank's liaison also points to weak demand for office space, with this weighing on development activity in the sector.

Graph 3.13
Capital Expenditure Intentions
 Capex survey, nominal

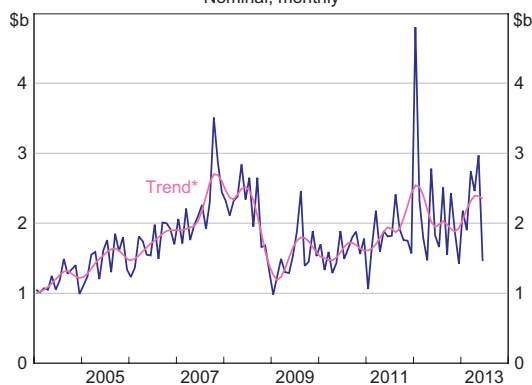


* Estimates are firms' expected capital expenditure in 2012/13 and 2013/14, adjusted for the past average difference between expected and realised spending

** Error bands are based on the mean absolute error of growth rate for each estimate of investment intentions compared with the final outcome for investment in each year

Sources: ABS; RBA

Graph 3.14
Private Non-residential Building Approvals
 Nominal, monthly



* 13-period Henderson trend
 Sources: ABS; RBA

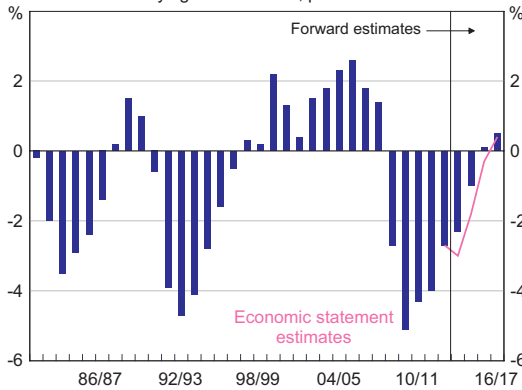
Government Sector

The Australian Government budget and recent state budgets pointed to ongoing fiscal consolidation at all levels of government (Graph 3.15). Taken together, the budgets had a relatively small reduction in the aggregate budget deficit in 2013/14, with most of the adjustment planned for 2014/15 and 2015/16.

The Australian Government's recent economic statement contained updated expenditure and revenue profiles, and proposed policy measures,

with the implication that the consolidated budget deficit would widen a little in 2013/14, with a greater reduction in the aggregate deficit over the following years.

Graph 3.15
Consolidated Budget Balance*
 Underlying cash balance, per cent to GDP



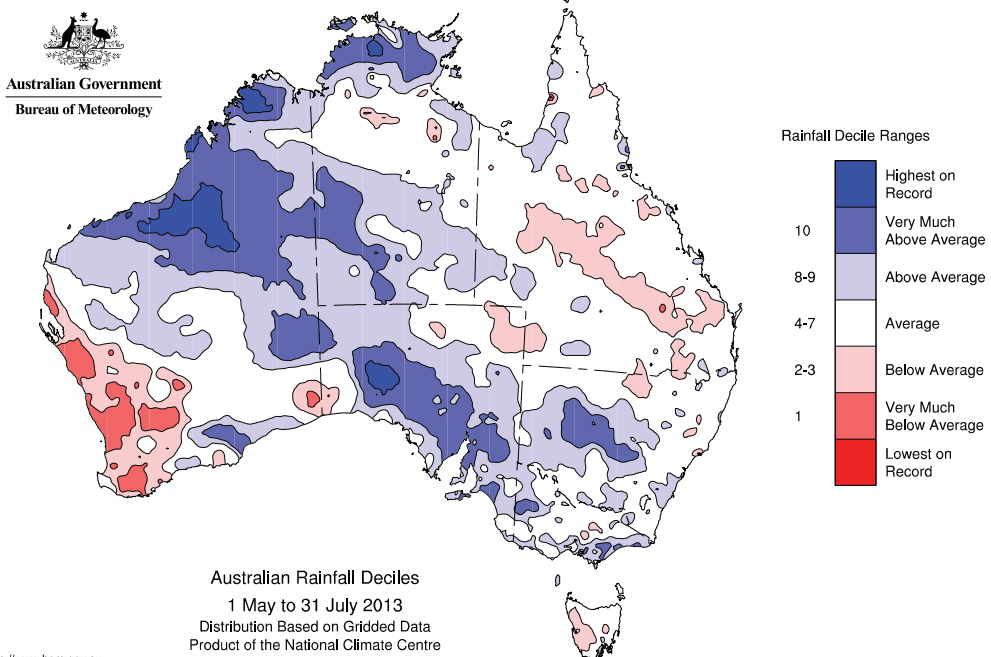
* Combined Australian Government, state and territory budget balances based on 2013/14 budgets or mid-year reviews as available; 2012/13 remains an estimate
 Sources: Australian Treasury; state and territory treasuries

Farm Sector

The Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) estimates that farm production fell by 4¼ per cent in 2012/13, following the previous year's strong production. Farm production is forecast to pick up by 3 per cent in 2013/14, driven by the expectation of a larger wheat crop. Livestock production is also forecast to increase, with stronger demand for beef from emerging economies in the Middle East and Asian regions. Rural prices are forecast to ease in 2013/14 reflecting high levels of global crop production.

Recently, there has been above-average rainfall across much of South Australia, New South Wales and Victoria (Graph 3.16). This has boosted soil moisture for crops, many of which were planted when conditions were dry, and reports indicate that crops are germinating well. However, dryer than usual conditions continue across Queensland, forcing cattle producers to reduce stock levels as a result of inadequate feed.

Graph 3.16
Australian Rainfall
 1 May to 31 July 2013



<http://www.bom.gov.au>

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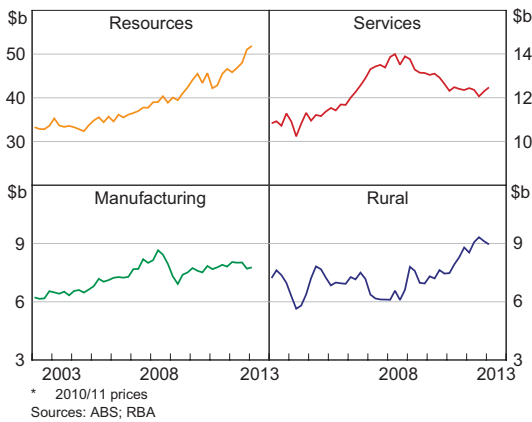
Source: Bureau of Meteorology

Issued: 01/08/2013

External Sector

Exports rose in the March quarter, underpinned by further growth in resource exports and a pick-up in services exports (Graph 3.17). The strong growth in resource exports over the past year has been the result of additional supply coming online as investment projects in the sector reach completion. In contrast, imports fell, driven by lower capital imports.

Graph 3.17
Export Volumes*
Quarterly



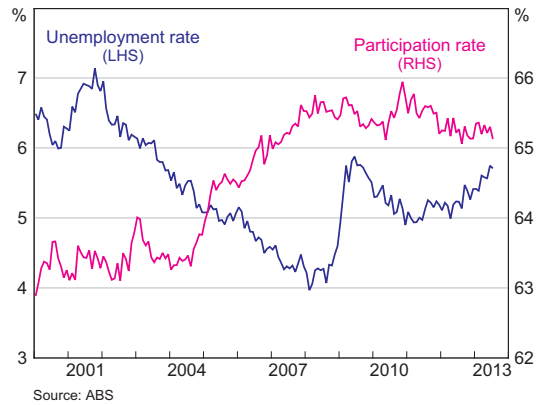
Based on more recent monthly trade data, iron ore export volumes are estimated to have increased in the June quarter, and strong growth in resource exports is expected over the remainder of 2013. Growth in service exports volumes is expected to be moderate in the June quarter given some softening in overseas arrivals, although arrivals from China have grown rapidly over the past year.

Labour Market

Labour market conditions remain somewhat subdued. The unemployment rate has increased a little further, with employment growth remaining below the growth of the working-age population, while the participation rate has been little changed over the past year or so (Graph 3.18).

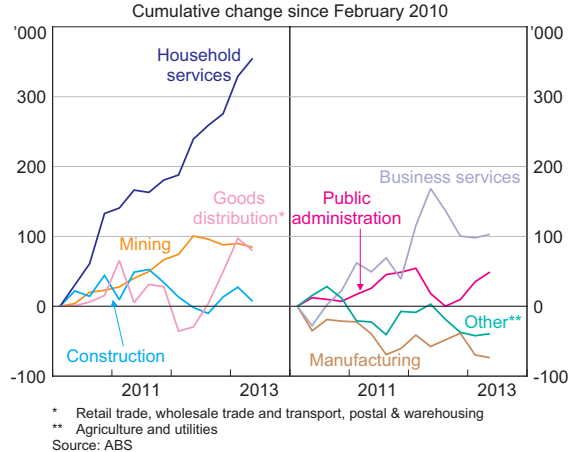
Labour market conditions in industries exposed to mining activity remain subdued, in line with reports that mining companies are seeking to contain

Graph 3.18
Unemployment and Participation Rates



costs and as mining projects move towards the less labour-intensive operational phase. The level of employment in both mining and business services has been broadly unchanged over the first half of the year, and remains below the levels reached in mid 2012 (Graph 3.19). Most of the fall in business services employment has been in New South Wales. In contrast, over the same period the household services sector (which includes health care, education and accommodation & food services) made substantial contributions to aggregate employment growth. Despite continued fiscal consolidation by state and federal governments,

Graph 3.19
Employment by Industry
Cumulative change since February 2010

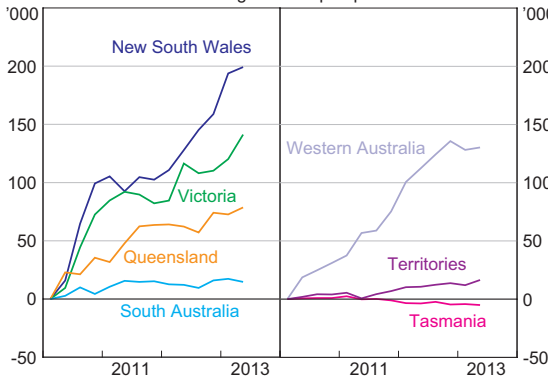


employment in public administration and safety is recorded as having increased over the past year, following declines in the first half of 2012. In contrast, employment in manufacturing has declined over the first half of the year, and is close to the levels of 18 months ago.

The pattern of employment growth across the states has shifted over recent months (Graph 3.20). Since the beginning of the year, employment growth has been stronger in Victoria and New South Wales, although it has slowed more recently in New South Wales. Consistent with the slowing growth in resource-related activity, employment in Western Australia has remained flat since the end of last year, and the unemployment rate has risen from a very low level. Labour market conditions are relatively subdued in Queensland and South Australia, while conditions remain weak in Tasmania.

Graph 3.20
Employment by State

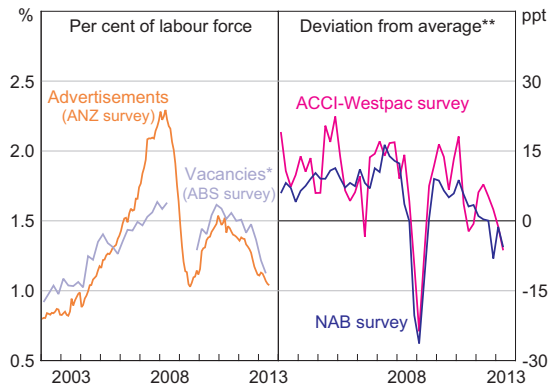
Cumulative change since April quarter 2010*



* Quarters end in October, January, April and July
Source: ABS

Indicators of labour demand have softened further and suggest that employment growth is likely to remain modest in the near term (Graph 3.21). The ABS quarterly measure of job vacancies fell in the three months to May, to be around 19 per cent lower over the year. Measures of job advertisements have also declined in recent months. Survey-based measures of businesses' employment intentions fell to below-average levels in the June quarter, while reports from the Bank's liaison suggest that firms remain cautious about hiring staff.

Graph 3.21
Labour Market Indicators



* This survey was suspended between May 2008 and November 2009
** Net balance of surveyed employment intentions for the following quarter; deviation from average since 1989
Sources: ABS; ACCI; ANZ; NAB; RBA; Westpac