

3. Domestic Economic Conditions

The Australian economy expanded at a below-trend pace over the year to the June quarter, as growth was weighed down by a fall in mining investment, moderate growth of household consumption and ongoing fiscal restraint (Graph 3.1, Table 3.1). After growing very strongly over recent years, mining investment is estimated to have fallen by around 10 per cent over the first half of 2013, although it remains at a high level. Non-mining investment also appears to have declined a little over this period, with businesses generally reluctant to take on new risks. Growth in household consumption has been below average, in line with soft labour market conditions and moderate growth in household income. Public demand declined over the past year, consistent with ongoing fiscal restraint at state and federal levels of government. In contrast, growth in dwelling investment has picked up as conditions in the housing market have strengthened. Also,

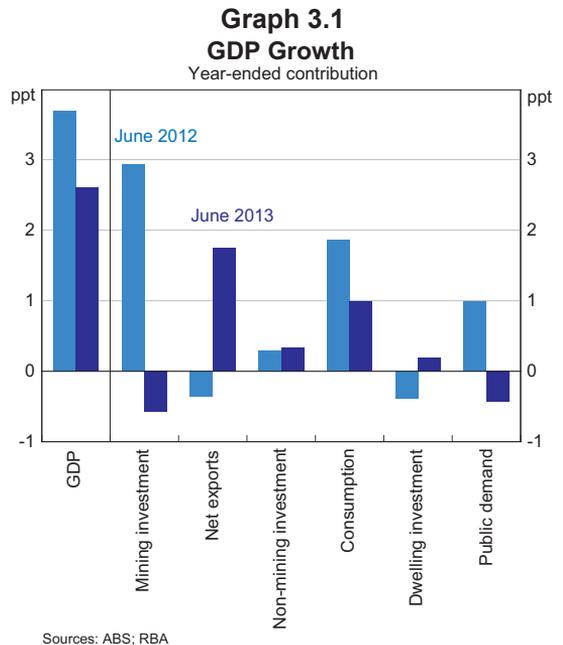


Table 3.1: Demand and Output Growth
Per cent

	June quarter 2013	Year to June quarter 2013
Domestic final demand	0.3	0.6
– Private demand	0.0	1.3
– Public demand	1.6	-1.8
Change in inventories ^(a)	0.2	-0.1
Gross national expenditure	0.6	0.5
Exports	1.3	6.4
Imports	1.6	-1.8
GDP	0.6	2.6
Nominal GDP	0.9	3.0
Real gross domestic income	0.6	1.5

(a) Contribution to GDP growth
Sources: ABS; RBA

resource extraction and exports have continued to grow, particularly of iron ore, as more mining projects move into the production phase.

More recently, partial indicators and liaison suggest that growth in economic activity has continued at a below-trend pace, although indicators of confidence and housing market conditions have picked up. Survey-based measures of current business conditions have been below average for some time. Consistent with this, non-mining investment is expected to remain subdued in the near term, with firms' surveyed capital expenditure intentions consistent with a small fall in 2013/14 as a whole. Mining investment is expected to continue to decline over the period ahead from the current high level. Growth in household consumption appears to have remained below trend in the September quarter, although some indicators have been a bit more positive recently. Indicators of business and consumer confidence have risen in recent months to above-average levels, although it is too early to know whether this pick-up will be sustained. Housing turnover and prices have also increased strongly, and dwelling investment continues to pick up.

Household Sector

Growth in household consumption was below average over the year to the June quarter, consistent with soft labour market conditions and relatively moderate growth in household income. The saving ratio remained within its range of recent years at around 10 per cent (Graph 3.2). Growth in consumption has been weak for most categories of discretionary spending, although it has been somewhat stronger for some non-discretionary items such as food, health and some financial services. Purchases of motor vehicles have flattened out, following strong growth in recent years as the high level of the exchange rate led to attractive offers for consumers.

Real household disposable income increased by 2 per cent over the year to the June quarter, around half the average annual rate of growth over the past

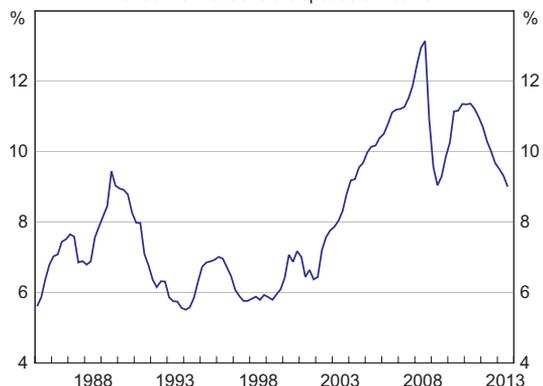
two decades. Growth in labour income has been particularly soft, held down by weak employment growth and slower wage inflation. Interest payments as a share of disposable income are estimated to have fallen by a further 1 percentage point over the past year to 9 per cent owing to lower interest rates (Graph 3.3).

Graph 3.2
Household Saving Ratio*
Per cent of household disposable income



* Net of depreciation
Source: ABS

Graph 3.3
Household Interest Payments
Per cent of household disposable income*

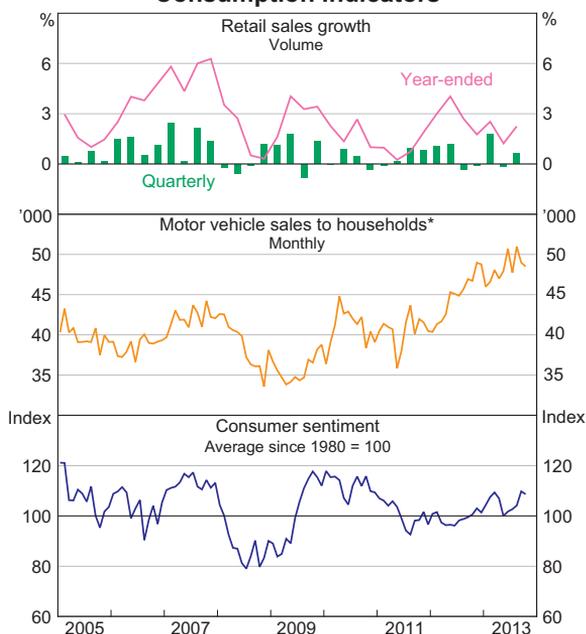


* Excludes unincorporated enterprises; income is before the deduction of interest payments; RBA estimate for September quarter 2013
Sources: ABS; RBA

Growth of household consumption appears to have been moderate in the September quarter. Retail sales volumes increased by 0.7 per cent, with prices little changed overall (Graph 3.4). Sales at retailers of clothing, footwear & accessories, food-related items

and household goods increased, while department store sales declined. Growth in the value of retail sales picked up as the quarter progressed. There were reports from liaison of further improvement of sales in October. In contrast, motor vehicle sales have been little changed since earlier in the year. Over recent months, survey measures of consumer sentiment have risen to well above average levels, and consumers' concerns about future conditions in the labour market have moderated, although they remain somewhat elevated.

Graph 3.4
Consumption Indicators

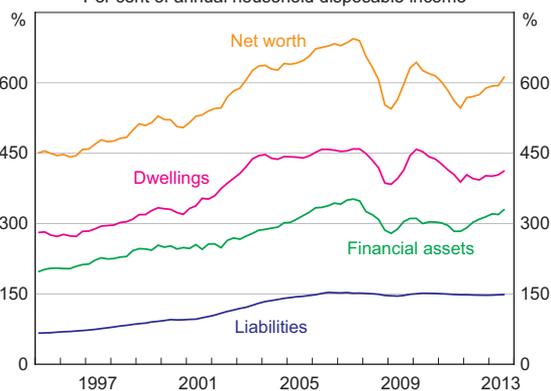


* Seasonally adjusted by the RBA
Sources: ABS; FCAI/FACTS; Melbourne Institute and Westpac; RBA; Roy Morgan Research

Improved sentiment in the household sector may in part reflect strong growth in household net worth, which is estimated to be 10 per cent higher over the year to September 2013 (Graph 3.5). This increase has been driven by higher equity and housing prices. Housing prices have risen strongly in recent months, with nationwide prices increasing by around 2¾ per cent over the September quarter and 5½ per cent over the past year (Graph 3.6, Table 3.2);

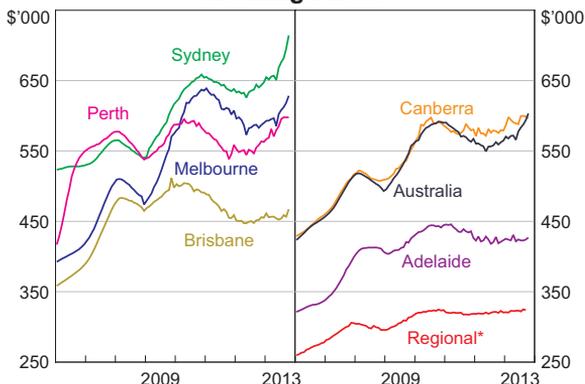
prices picked up further in October. Over the three months to October, housing price inflation was particularly marked in Sydney, with prices rising by more than 5 per cent. Melbourne also recorded a strong increase and prices in Brisbane have started to pick up. While housing prices in Sydney and Perth have surpassed their peaks of 2010, the ratio of nationwide prices to household income remains below the levels seen over much of the past decade. Other indicators point to strong conditions in the established housing market; auction clearance rates remain elevated, while the degree of vendor discounting and the average time taken to sell a

Graph 3.5
Household Wealth and Liabilities*
Per cent of annual household disposable income



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

Graph 3.6
Housing Prices



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

Table 3.2: Housing Price Growth
Per cent

	3 months to September 2013	3 months to June 2013	Year to September 2013
Capital cities			
ABS ^{(a),(b)}	1.9	2.7	7.6
APM ^(b)	1.9	2.4	7.0
RP Data-Rismark	2.8	1.1	5.5
Regional areas			
APM ^(b)	1.3	0.5	3.4
RP Data-Rismark ^(a)	0.2	0.1	0.8

(a) Detached houses only

(b) Quarter-on-quarter growth rate

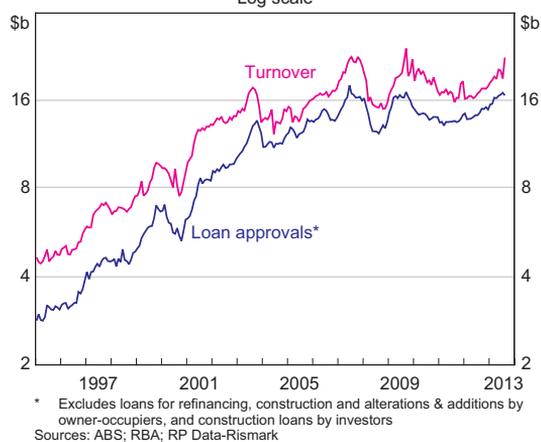
Sources: ABS; APM; RBA; RP Data-Rismark

property have both fallen substantially and are now close to their lowest levels in nearly a decade. Surveys indicate that households view buying conditions for dwellings as favourable and expectations of future housing price growth have increased. Turnover in the housing market, as a share of the housing stock, has risen from relatively low levels over the past two years. This higher turnover can be expected to boost demand for a range of services including real estate, legal and financial services.

Demand for housing finance has risen as the value of housing turnover has increased (Graph 3.7). Nonetheless, housing loan approvals remain relatively low as a share of household debt and so household debt has continued to grow broadly in line with nominal incomes (see the 'Domestic Financial Markets' chapter for further details).

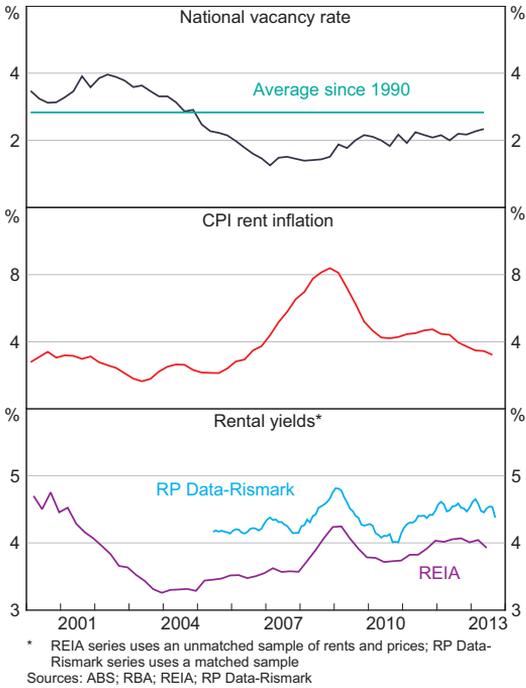
In contrast to the market for established dwellings, conditions in the rental market appear to have eased slightly in recent quarters from the relatively tight position a year ago. The nationwide rental vacancy rate increased a little in the June quarter to around 2¼ per cent, but is still below the long-run average (Graph 3.8). Rent inflation has slowed to around 3¼ per cent annually, although this is still above CPI inflation and rental yields remain higher than the average of the past decade.

Graph 3.7
Housing Turnover and Loan Approvals
Log scale

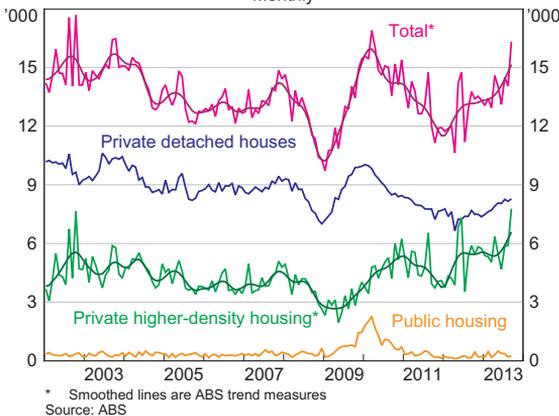


Dwelling investment increased over the past year, despite a pause in growth in the first half of 2013, which mirrored an earlier softer patch in building approvals. Forward-looking indicators point to a resumption of growth from the second half of 2013. The number of private residential building approvals rose by 9 per cent in the September quarter (Graph 3.9). Detached house approvals have been rising since late last year after an extended period of weakness, with strong growth in New South Wales and Western Australia; approvals have stabilised at a relatively low level in Victoria following very strong activity in 2009 and 2010. Higher-density approvals,

**Graph 3.8
Rental Market**



**Graph 3.9
Residential Building Approvals**
Monthly

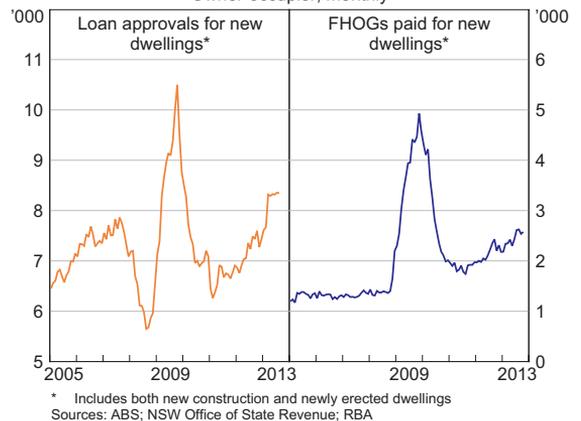


which tend to be volatile, increased strongly in the September quarter, buoyed by approvals in New South Wales and Victoria. Approvals for high-rise developments in inner-city areas have increased strongly in these states since around 2009, notwithstanding some moderation in Victoria more recently. Liaison contacts have noted the increasing

presence of overseas buyers and developers for high-rise developments in inner-city areas, although survey evidence suggests that the share of overseas buyers in the housing market overall is little changed. In aggregate, building approvals are expected to increase further over the period ahead, aided by a continued recovery in the established housing market, relatively high rental yields, low lending rates and government support to first home buyers that is increasingly directed towards purchases of newly built, rather than existing, dwellings.

Other timely indicators of housing construction also suggest that a sustained recovery in activity is under way. Loan approvals for new dwellings are 12 per cent higher than at the beginning of the year, while first home owner grants (FHOGs) for new dwellings have risen by 18 per cent over the same period (Graph 3.10). Rising house prices and the increase in housing turnover is also expected to underpin a pick-up in renovation activity.

**Graph 3.10
Indicators of Dwelling Investment**
Owner-occupier, monthly

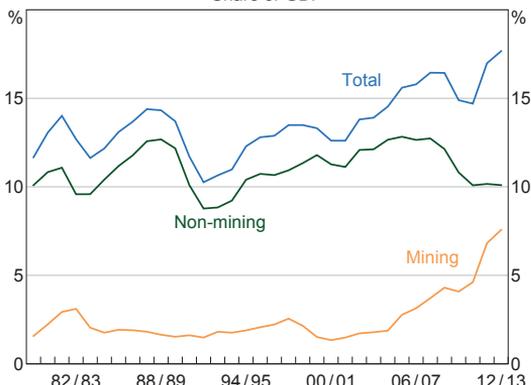


Business Sector

Total business investment has been very high as a share of economic activity, with mining investment estimated to have peaked at around 7½ per cent of GDP in 2012/13 (Graph 3.11). However, in recent quarters, mining investment is estimated to have declined, with public announcements by resource

companies and the Bank's liaison both signalling that the investment phase of a number of mining projects is beginning to wind down. This contributed to a decline in total business investment over the first half of the year (Graph 3.12).

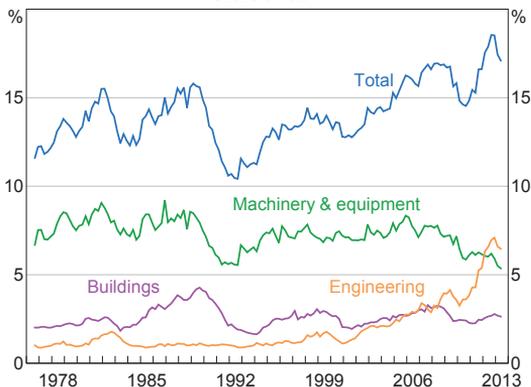
Graph 3.11
Private Business Investment*
Share of GDP



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

Sources: ABS; RBA

Graph 3.12
Business Investment*
Share of GDP



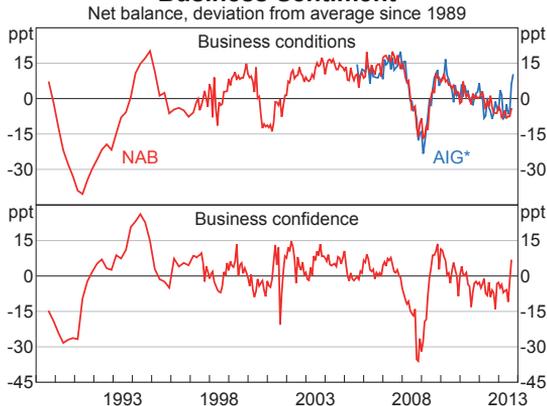
* Adjusted for second-hand asset transfers between the private and other sectors, excluding cultivated and biological resources

Sources: ABS; RBA

Non-mining investment remains low as a share of GDP. Contributing factors appear to be the subdued demand faced by non-mining firms and a reluctance of firms to take on new risks. Survey-based measures of business conditions have been weak for some time, although they have shown improvement

recently (Graph 3.13). Measures of business confidence have improved markedly over recent months, although it is too soon to know whether this will be sustained and lead to an increase in employment and investment.

Graph 3.13
Business Sentiment
Net balance, deviation from average since 1989



* Weighted average of AIG's Performance of Construction, Performance of Services and Performance of Manufacturing indices, scaled to have the same mean and standard deviation as the NAB Business Conditions Index.

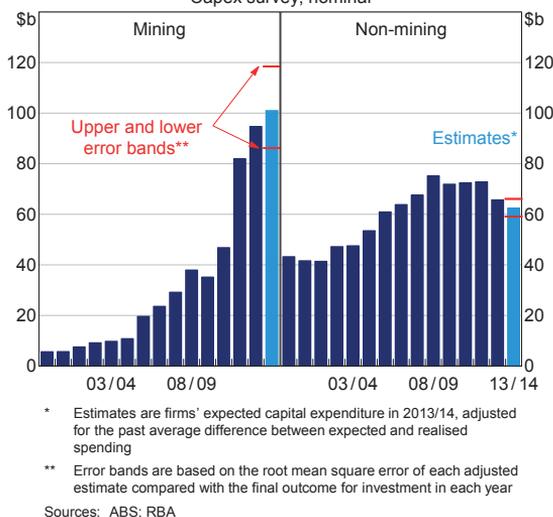
Sources: AIG; NAB; RBA

The ABS capital expenditure (Capex) survey for the June quarter (which predates the recent pick-up in business sentiment) continues to suggest that non-mining investment covered by the survey will decline in 2013/14 (Graph 3.14). However, in coming years non-mining investment not covered by this survey – such as investment in agriculture, forestry & fishing and healthcare & social services – is expected to grow faster than investment included in the Capex survey, particularly in the healthcare industry. The Capex survey provides more comprehensive coverage of mining investment, although it tends to be a less accurate guide than it is for the non-mining component. The survey suggests that mining investment will increase in 2013/14. However, public statements by mining companies and the Bank's liaison imply that mining investment will decline in 2013/14.

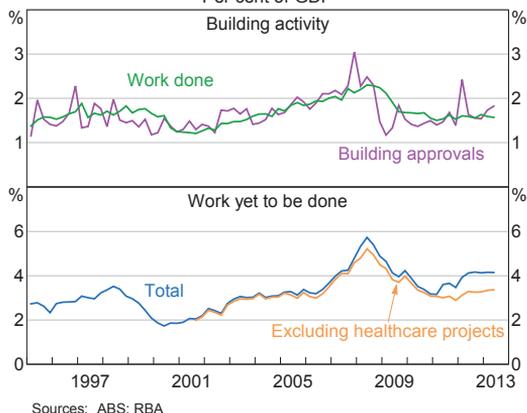
In contrast to the soft outlook for non-mining investment from the Capex survey, some forward-looking indicators of private non-residential building

investment have strengthened. Non-residential building approvals have moved higher since the start of the year and the stock of work yet to be done is at a relatively high level, boosted by large healthcare projects (Graph 3.15). However, indicators of current activity in the sector, including work done, remain subdued. Also, office vacancy rates have risen and rents for offices have declined over the past year, partly reflecting a focus on reducing costs by both companies providing services to the resources sector and some state governments.

Graph 3.14
Capital Expenditure Intentions
Capex survey, nominal



Graph 3.15
Non-residential Building Work
Per cent of GDP



Farm Sector

The Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) forecasts that farm production will increase by 1¾ per cent in 2013/14, owing to a larger wheat crop. This represents a slight downward revision from ABARES forecasts in June. Higher world prices for dairy products, wool and lamb, together with the depreciation of the Australian dollar since earlier in the year, are expected to more than offset the effect of lower world prices for most grains and oilseeds. Hence, prices received by farmers overall are forecast to increase by 2 per cent in 2013/14.

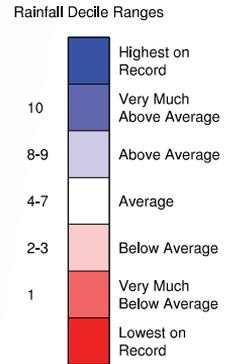
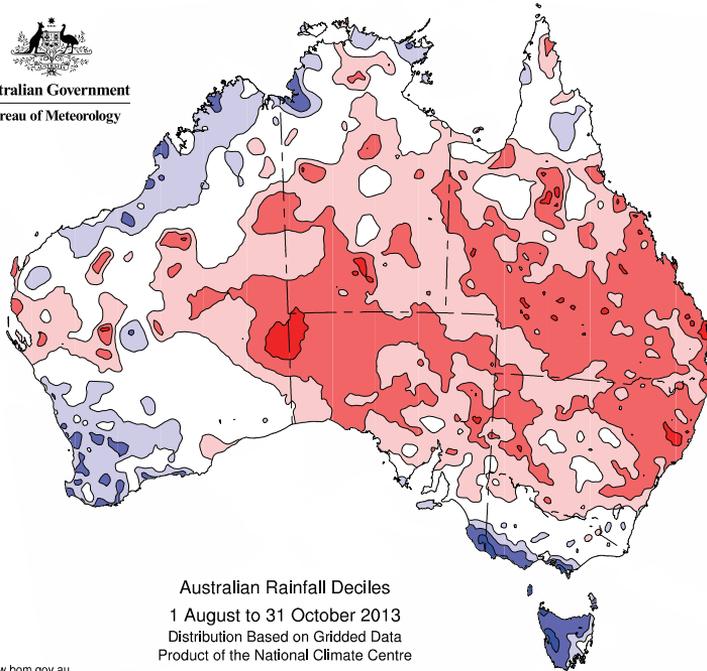
The approaching harvest of winter crops is expected to see a higher level of production across southern Australia as a result of the good growing conditions in the first half of the year. However, dry weather in northern New South Wales and Queensland is likely to have reduced the potential yield in these regions (Graph 3.16). In addition, dryer than usual conditions continue to place pressure on cattle producers to reduce stock levels in Queensland and the Northern Territory as a result of inadequate feed.

External Sector

Exports rose in the June quarter, underpinned by further growth in resource exports and a pick-up in rural exports (Graph 3.17). The strong growth in resource exports over the past couple of years reflects more supply coming on line as investment projects reach completion. Imports also grew modestly in the quarter, driven by a rebound in capital goods imports.

Recent trade data suggest that there was a large increase in iron ore export volumes in the September quarter. Strong growth in resource exports is expected to continue over the next couple of years. Manufactured goods export volumes are estimated to have grown in the September quarter. Import volumes appear to have declined, reflecting lower imports of services and capital goods.

Graph 3.16
Australian Rainfall
 1 August to 31 October 2013

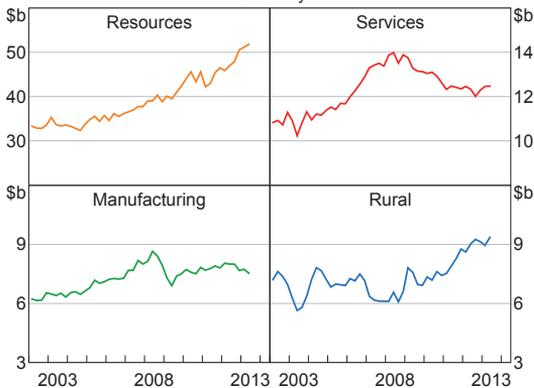


Australian Rainfall Deciles
 1 August to 31 October 2013
 Distribution Based on Gridded Data
 Product of the National Climate Centre

<http://www.bom.gov.au>
 © Commonwealth of Australia 2013, Australian Bureau of Meteorology ID code: AWAP
 Source: Bureau of Meteorology

Issued: 31/10/2013

Graph 3.17
Export Volumes*
 Quarterly



* 2010/11 prices
 Sources: ABS; RBA

Labour Market

Labour market conditions have remained soft in recent months, consistent with below-trend growth in the economy. The unemployment rate has trended higher since mid 2011 (see 'Box B: The Increase in the Unemployment Rate'; Graph 3.18). The participation rate, which had been little changed for more than a year, has declined quite noticeably over recent months, mainly due to a decrease in male participation. Also, employment has been little changed since earlier in the year and so the ratio of employment to the working-age population has fallen to its lowest level since 2005 (Graph 3.19).

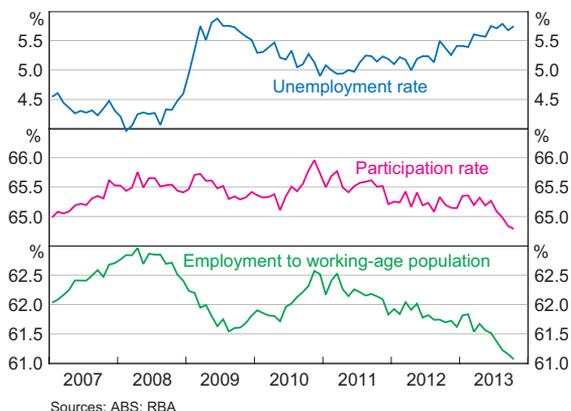
While employment growth has slowed to 0.8 per cent over the past year, in trend terms total hours worked increased by 1.6 per cent over the same period. This is consistent with reports from the Bank's liaison that some firms have sought to

contain costs by increasing the hours of existing employees rather than hiring new staff. Most recently, the increase in total hours worked might also reflect a shift in employment towards industries in which workers tend to work longer average hours. Despite the increase in hours worked, measures of underemployment – capturing employed workers who want to work more hours – have risen over recent months, reflecting an increase in the number of part-time workers looking for additional hours (Graph 3.20).

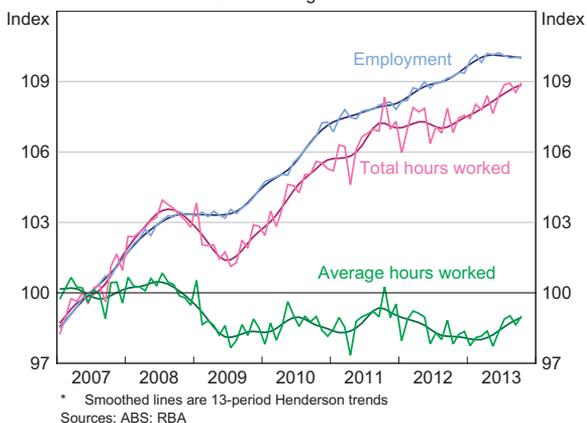
Unemployment rates have increased and participation rates have declined in most states over the past year (Graph 3.21). In New South Wales, employment has declined in recent months following relatively strong growth earlier in the year. Employment has been little changed in Victoria since the middle of the year. In contrast, employment growth in Queensland has been stronger since the middle of the year, while the state’s unemployment and participation rates have remained relatively stable. Consistent with the slowing in resource-related activity, the unemployment rate in Western Australia has increased from a very low level and the participation rate has declined noticeably over the past year. Labour market conditions in South Australia and Tasmania have also weakened over the same period.

Employment in mining and business services has been little changed over recent quarters and remains below the peaks of 2012, as the economy moves into the less labour-intensive production phase of the mining boom and businesses exposed to mining activity maintain their focus on containing costs (Graph 3.22). Employment in manufacturing has declined further, after stabilising somewhat in the past couple of years, and employment in the household services sector (which includes the health, education and hospitality industries) declined in recent months, following several years of strong growth (see ‘Box C: The Household Services Sector’). In contrast, construction employment has picked up over the past year or so; residential construction

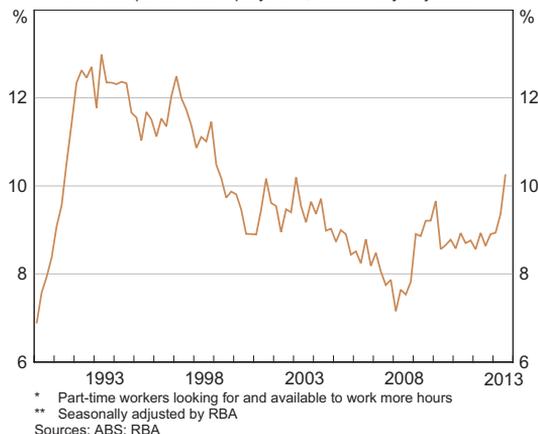
Graph 3.18
Labour Market



Graph 3.19
Employment and Hours Worked*
2007 average = 100



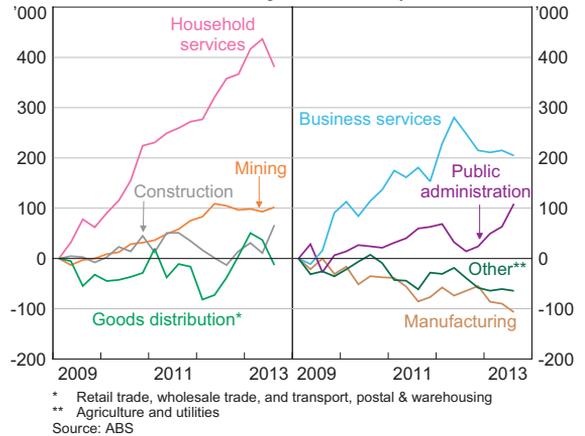
Graph 3.20
Underemployed Part-time Workers*
Share of part-time employment, seasonally adjusted**



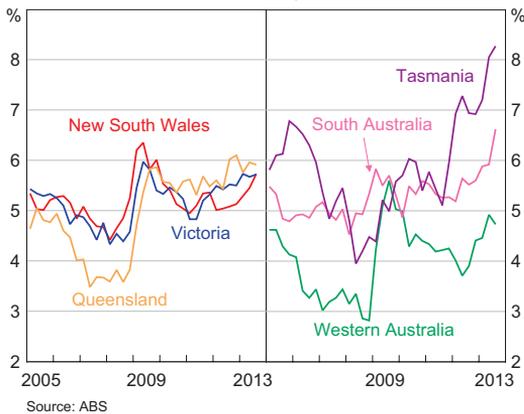
employment has been particularly strong in New South Wales, consistent with indicators of increased dwelling construction activity. Also, employment in public administration and safety is reported to have recovered in recent quarters after declining in 2012.

There have been tentative signs of stabilisation in most forward-looking indicators of employment growth in recent months, though they remain at low levels (Graph 3.23). The ABS quarterly measure of job vacancies rose over the three months to August but it is around 20 per cent lower over the year. The pace of decline in measures of job advertisements also appears to have eased in recent months. Business survey measures and the Bank's liaison with firms suggest that employment intentions remain at or below their historical average.

Graph 3.22
Employment by Industry
Cumulative change since February 2009



Graph 3.21
Unemployment Rates by State
Quarterly



Graph 3.23
Labour Market Indicators

