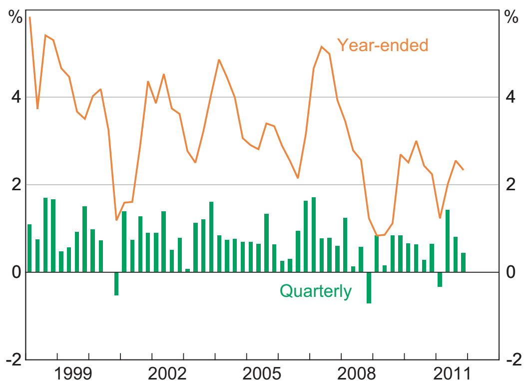
3. Domestic Economic Conditions

Output grew at a below-average pace of 2.3 per cent over 2011, as the surge in mining investment was offset by softer growth in other parts of the economy (Graph 3.1, Table 3.1). With work under way on a number of large-scale mining projects, investment in the mining sector is estimated to have grown by more than 60 per cent over 2011; close to half of this is estimated to have been imported. Household consumption grew at an around trend pace, supported by growth in household incomes. However, the high level of the exchange rate, along with weaker international conditions, weighed on other parts of private demand, and public demand also declined.

The available partial indicators and liaison suggest that the domestic economy has been growing at a modest pace in early 2012. Measures of business and consumer sentiment remain around, or a little below, long-run average levels. Employment growth picked up modestly in the March quarter, but outside of the mining industry, growth in labour demand remains subdued. Conditions faced by non-mining firms are soft, with the exception of those servicing the mining sector. Indicators of future building activity remain at low levels, while the high level of the exchange rate continues to weigh on import-

Graph 3.1
GDP Growth



Source: ABS

Table 3.1: Demand and Output Growth
Annualised, per cent

	January–June 2011	July–December 2011
Domestic final demand	4.2	4.7
– Private demand	4.9	7.3
– Public demand	2.0	–3.6
Change in inventories[(a)]	0.6	–0.2
GNE	5.3	4.2
Net exports[(a)]	–1.9	–0.6
GDP	2.2	2.5
Nominal GDP	7.4	3.8
Real GDI	5.7	2.0

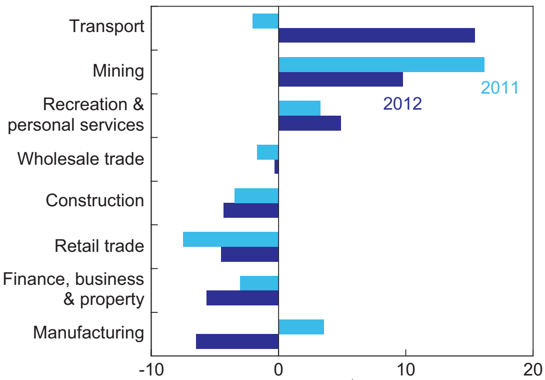
(a) Contribution to GDP growth
Source: ABS

competing and exporting firms across a range of industries (Graph 3.2). Mining production was temporarily disrupted in early 2012 by a range of factors including adverse weather. Nevertheless, work has continued on the very large pipeline of committed mining projects, with the most recent ABS capital expenditure survey providing further evidence of very strong investment intentions in 2012/13.

Graph 3.2

Business Conditions by Industry

Deviation from industry average since 1989, March quarter



Sources: NAB; RBA

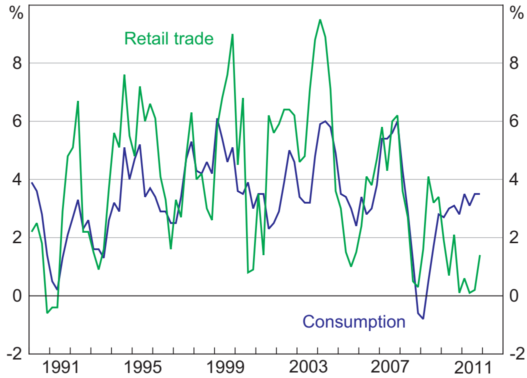
Household Sector

Consumer spending grew by around 3½ per cent over 2011, supported by income growth and notwithstanding a decline in wealth and confidence over the year. Data from the national accounts show that growth in total consumption was considerably stronger than growth in retail trade volumes over 2011, which accounts for around one-third of consumption (Graph 3.3). This reflected stronger growth in spending on household services and spending by Australians overseas. Consumer spending grew at around the same pace as household disposable income over 2011, implying a largely unchanged household saving ratio of around 9–10 per cent of income (Graph 3.4). In real terms, household disposable income grew by 3¼ per cent over 2011 as average growth in labour income offset soft growth in interest receipts and dividends and a decline in small-business income.

Graph 3.3

Household Spending

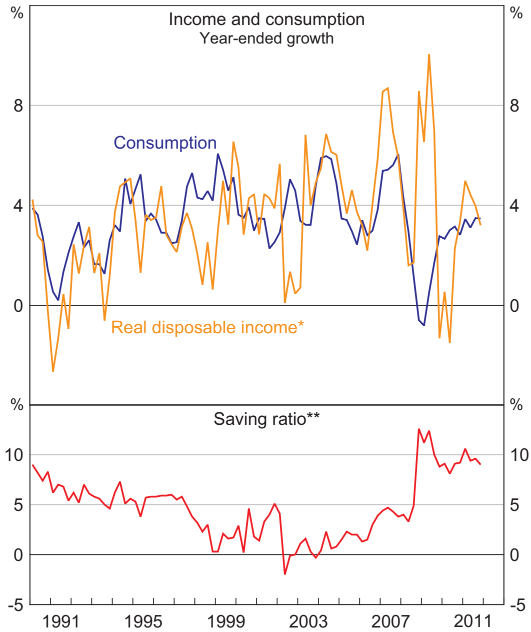
Year-ended growth



Source: ABS

Graph 3.4

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

** Net of depreciation

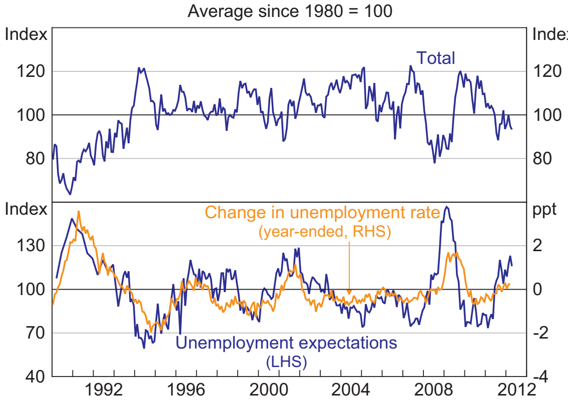
Sources: ABS; RBA

The pace of growth in consumer spending eased in the December quarter, and the available indicators suggest that the expansion in the March quarter was also modest. The value of retail sales increased slightly in January and February, while motor vehicle sales to households declined in the March quarter. Among goods retailers, spending in department stores and clothing, footwear & accessories outlets weakened over 2011 – to some extent reflecting competition from offshore online retailers – but appears to have picked up somewhat in recent months.

While the empirical relationship between consumption growth and consumer sentiment is relatively weak, the softer pace of growth in household spending in recent months is consistent with survey measures, which suggest that consumer sentiment is a little below long-run average levels. In particular, households' assessments of their own current and future personal finances are at low levels, weighed down by soft conditions in the labour market, with concerns about unemployment remaining elevated (Graph 3.5). Confidence is also likely to have been diminished by a decline in net wealth over the year, notwithstanding an estimated small rise in the March quarter as strong growth in financial assets was offset somewhat by a fall in dwelling prices.

The return of the saving ratio over recent years to levels that existed prior to the 1990s has contributed to strong growth in deposits, with household deposits increasing by 9 per cent in 2011. Credit growth has also fallen in recent years, from an annual rate of around 15 per cent during the mid 2000s to

Graph 3.5
Consumer Sentiment
Average since 1980 = 100



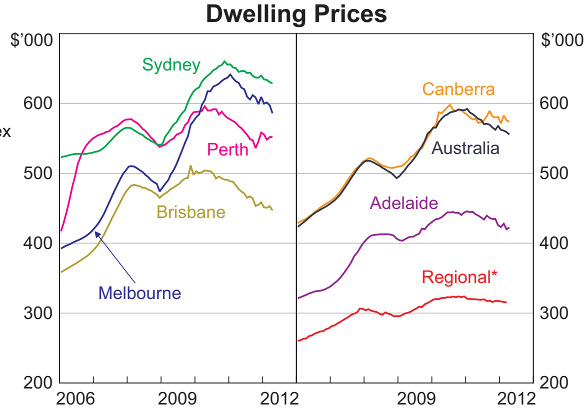
Sources: ABS; Melbourne Institute and Westpac

around 5 per cent recently, which is slightly slower than nominal income growth. Demand for housing finance has eased in recent months, following a rise in loan approvals in late 2011. This increase was largely driven by first home buyers responding to some stamp duty exemptions in New South Wales that expired on 31 December 2011.

The slower growth in housing debt has been associated with weakness in the housing market. Weak demand has been reflected in a fall in Australian capital city dwelling prices of around 6 per cent since their peak in early 2011 and low housing turnover (Graph 3.6, Table 3.2). Notwithstanding this, it appears that in recent months dwelling prices might have been declining at a slower rate. With declines in dwelling prices, the ratio of dwelling prices to income is back around its 2002 level.

In contrast to dwelling prices, the various measures of rents grew by 4 to 5 per cent over the year (Graph 3.7). Reasonably strong rental growth, together with falling dwelling prices, has lifted rental yields to around ½ percentage point above their mid-2000s level. Rental vacancy rates have been around 2 per cent since 2009, above the very low levels seen in 2006–2008 but still low by historical standards.

Graph 3.6
Dwelling Prices



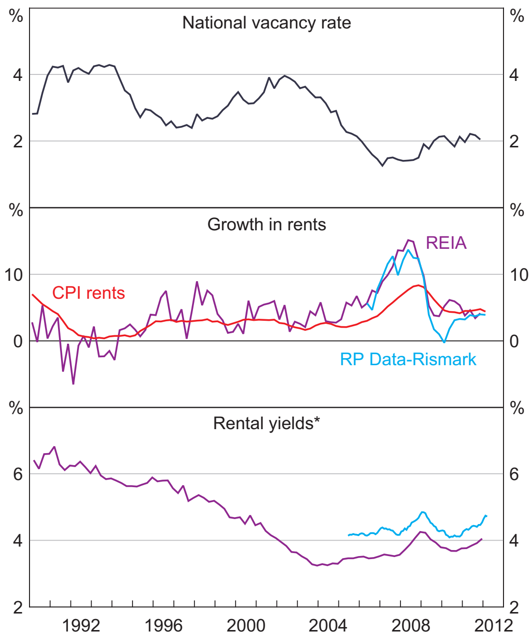
* Excluding apartments; measured as areas outside of capital cities in mainland states
Sources: RBA; RP Data-Rismark

Table 3.2: National Housing Price Growth
Per cent

	6 months to September 2011	6 months to March 2012	Year to March 2012
Capital cities			
ABS[(a),(b)]	–2.9	–1.7	–4.5
APM[(b)]	–2.4	–0.1	–2.5
RP Data-Rismark	–2.6	–1.9	–4.4
Regional areas			
APM[(b)]	–0.9	0.9	0.0
RP Data-Rismark[(a)]	–0.6	–0.8	–1.4

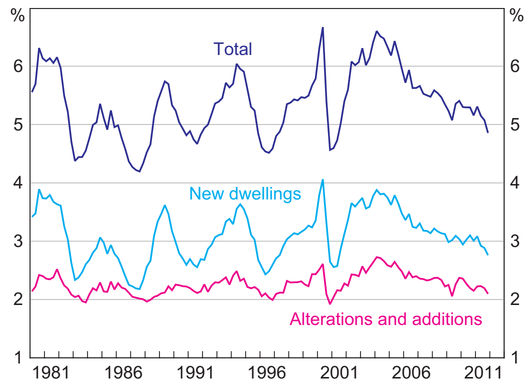
(a) Detached houses only
(b) Quarterly measures
Sources: ABS; APM; RBA; RP Data-Rismark

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

Graph 3.8
Private Dwelling Investment
Share of nominal GDP

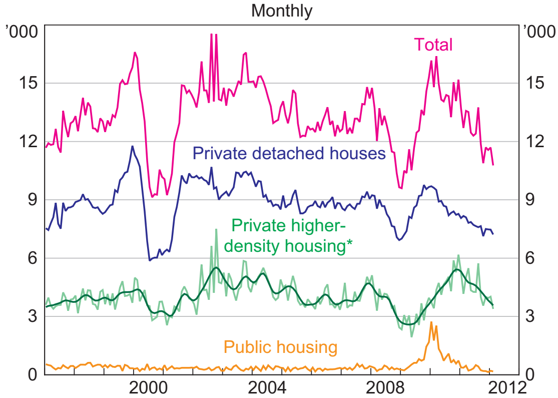


Source: ABS

Residential building activity fell over 2011 to be around the lows of some earlier cycles in dwelling investment (Graph 3.8). The weakness in residential building activity reflects a number of factors. According to liaison, declines in established dwelling prices have made households reluctant to commit to new contracts to build. Also, in recent years, the lengthy planning processes and arrangements for infrastructure provision have increased the cost of new dwellings. A range of initiatives have been undertaken by state governments to address these issues, including reviews of planning systems, the release of infrastructure plans and caps on infrastructure charges.

Despite recent decreases in housing prices relative to income and increased rental yields, forward-looking indicators suggest that there is little prospect of an imminent recovery in housing construction. Approvals for new dwellings have continued to trend downwards in early 2012, especially for higher-density housing (mainly apartments) (Graph 3.9). This follows the run-up in approvals in 2010 that was concentrated in Victoria. Approvals for detached houses are at low levels in all mainland states, notwithstanding a recent increase in Queensland that can be partly attributed to the state government's Building Boost Grant for new dwellings.

Graph 3.9
Residential Building Approvals
Monthly



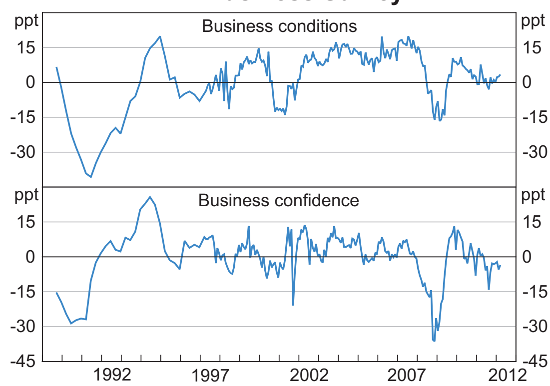
* Smoothed line is a 13-period Henderson trend
Sources: ABS; RBA

Business Sector

Survey measures of business conditions are generally around long-run average levels, but remain below the higher levels that prevailed through much of the 2000s (Graph 3.10). The strength of activity continues to vary across industries, with mining firms and firms servicing the mining sector experiencing strong conditions, while conditions remain weak in parts of the construction, retail, and manufacturing industries. Survey measures also suggest that conditions have softened in the business services sector since mid 2011, consistent with low turnover in property markets and general weakness outside of mining and related activities.

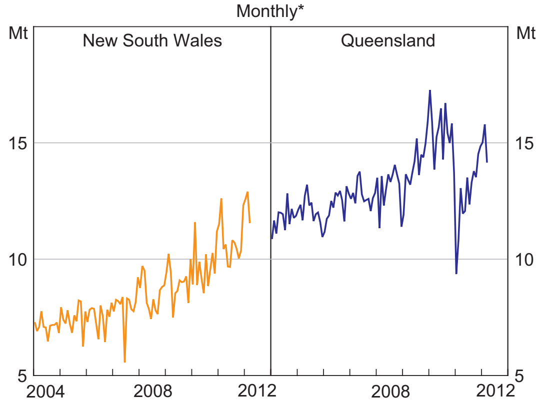
Resource exports grew modestly over the year to December 2011, as solid growth in iron ore exports was partially offset by declines in coal, oil and, to a lesser extent, liquefied natural gas (LNG) exports (for more detail, see 'Box C: Resource Exports in 2011'). More recently, coal export volumes are estimated to have increased in seasonally adjusted terms in the March quarter (Graph 3.11). However, wet weather in New South Wales and Queensland, a shortage of explosives at some coal mines due to the temporary closure of Orica's Ammonia Plant in Newcastle, and industrial action at the BHP Billiton Mitsubishi Alliance mines have all affected coal production to some extent. Iron ore production was adversely affected by cyclone activity in the March quarter, with exports likely to have fallen in the quarter. Over the next few years, both iron ore and coal production and exports are expected to grow strongly due to significant expansions to mines and transport infrastructure.

Graph 3.10
NAB Business Survey*



* Net balance; deviation from average since 1989
Sources: NAB; RBA

Graph 3.11
Coal Shipments
Monthly*



* Seasonally adjusted by the RBA
Sources: ABS; RBA; various port authorities

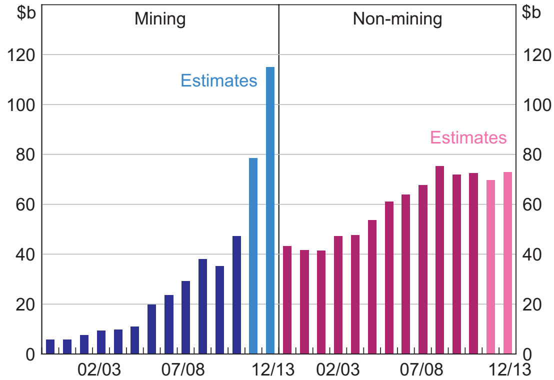
The outlook for investment in the mining sector remains extremely strong. The ABS survey of firms' capital expenditure plans points to very large rises in mining investment in 2011/12 and 2012/13 (Graph 3.12). Construction is continuing on numerous large LNG projects, valued at around $165 billion in total, while investment in iron ore and coal mines and related infrastructure also remains strong. As a result, mining investment is projected to rise to around 9 per cent of GDP in 2012/13.

Conditions in some other parts of the economy are subdued, and investment intentions in the non-mining sector remain weak. The capital expenditure survey points to little change in non-mining investment in 2011/12 and 2012/13, while survey measures of investment intentions generally remain well below average levels.

Following a large spike in non-residential building activity in the September quarter 2011, conditions in this sector have been much more subdued. The national CBD office vacancy rate was unchanged in the March quarter at 7.2 per cent, a little below the decade average. The office vacancy rate is likely to remain around this level over the next few years, with demand for, and supply of, new office space both relatively muted. This is consistent with forward-looking indicators of office building activity, with approvals remaining low as a share of GDP (Graph 3.13).

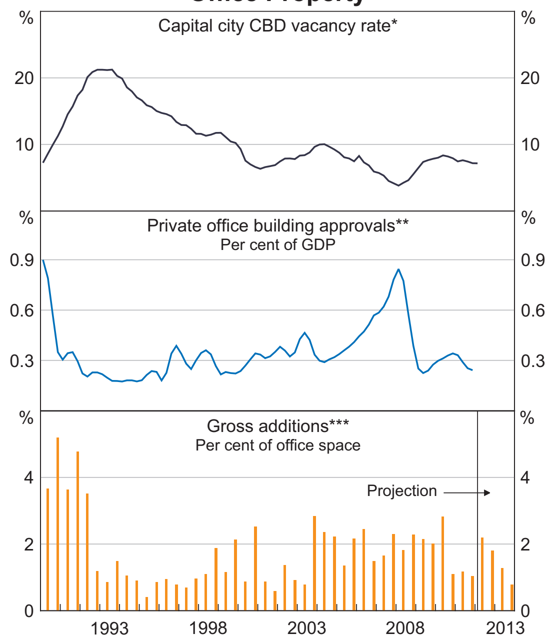
The divergence in conditions between the mining and non-mining sectors is also evident in company profits. Mining profits remain at a high level relative to GDP, not far below historical highs (Graph 3.14). In contrast, non-mining profits as a share of GDP are a little below the decade average, with profit results mixed among industries; manufacturing profits in 2011 were down by 12 per cent from 2010, with profits as a share of GDP slightly below the previous trough of late 2008.

Graph 3.12
Capital Expenditure*
Capex survey, nominal



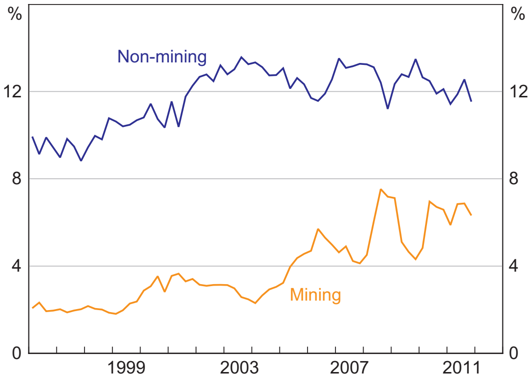
* Sample of firms' spending plans; estimates are the Capex survey measure of firms' expected capital expenditure in 2011/12 and 2012/13, adjusted by realised spending in 2010/11
Sources: ABS; RBA

Graph 3.13
Office Property



* Excluding Darwin and Hobart, quarterly
** Trend, quarterly
*** Capital city CBDs, half yearly; gross of withdrawals
Sources: ABS; Jones Lang LaSalle Research; Property Council of Australia; RBA

Graph 3.14
Private Non-financial Corporation Profits*
Share of nominal GDP

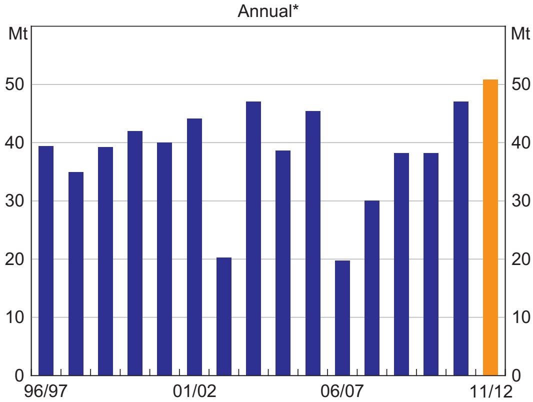


* Gross operating profits; inventory valuation adjusted
Sources: ABS; RBA

Farm Sector

After growing by around 6 per cent over 2010/11, farm production is expected to have grown by around 4 per cent over 2011/12 according to the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES). The strong performance of the farm sector reflects record crop production, and coincides with above-average rainfall in the cropping regions in the eastern states due to the La Niña weather system and favourable climatic conditions in Western Australia (Graph 3.15). Above-average rainfall has replenished subsoil moisture and increased the availability of irrigation water and should provide further support to crop yields in the near term. Overall, the prospects for the farm sector generally are positive (see 'Box D: Conditions in the Farm Sector').

Graph 3.15
Crop Production
Annual*



* ABARES forecast for 2011/12
Source: ABARES

External Sector

Exports in 2011 were much weaker than had been anticipated, growing by 1 per cent over the year. While rural exports grew strongly, in line with farm production, resource exports increased only slightly. This was largely due to the weakness in coal exports as the recovery following the Queensland floods was more protracted than expected (for further discussion, see 'Box C: Resource Exports in 2011'). Furthermore, the high level of the exchange rate and softer trading partner growth weighed on the growth of other exports. Manufacturing export volumes fell slightly, while services exports fell further over 2011 to be back around their 2006 levels, with the change to student visa policies, and the high exchange rate, contributing to the sharp decline in recent years. In early 2012, export volumes have been affected by the disruptions to coal and iron ore production reflecting adverse weather and some other factors.

Imports grew by 13 per cent over the year to December 2011, reflecting very strong growth in mining investment and the appreciation of the exchange rate.

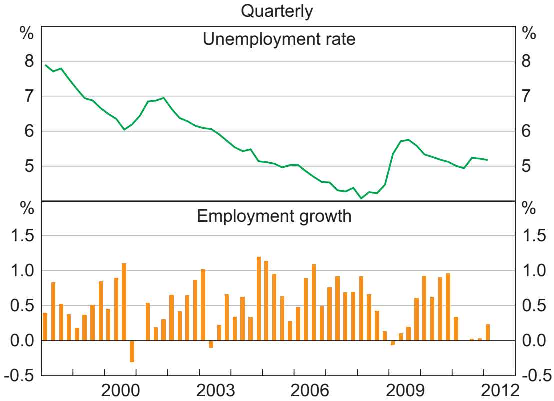
Labour Market

There was modest employment growth in the March quarter, but the unemployment rate remained around 5¼ per cent with the participation rate declining slightly (Graph 3.16). Although employment growth picked up in the quarter, average hours worked fell, suggesting that growth in aggregate demand for labour remains subdued (Graph 3.17). Overall, the decline in the participation rate over the past year, and weakness in average hours worked more recently, suggest that there has been some increase in spare capacity in the labour market despite the unemployment rate remaining broadly unchanged since mid 2011.

The slower employment growth over the past year followed a period of rapid hiring in 2010, possibly as firms prepared for an anticipated increase in domestic demand growth. However, the slower employment growth also masks the effect of structural change as the mining sector grows in relative importance and other sectors adjust to the high level of the exchange rate and softness in some components of domestic activity. According to the Bank's liaison program, outside of the mining industry, weaker-than-expected demand has led employers to be more cautious about hiring new staff. Moreover, in the parts of the economy most adversely affected by the forces of structural change, many firms have reduced employment to contain costs and improve productivity. In contrast, the outlook for employment remains buoyant in industries and regions directly linked to the mining boom.

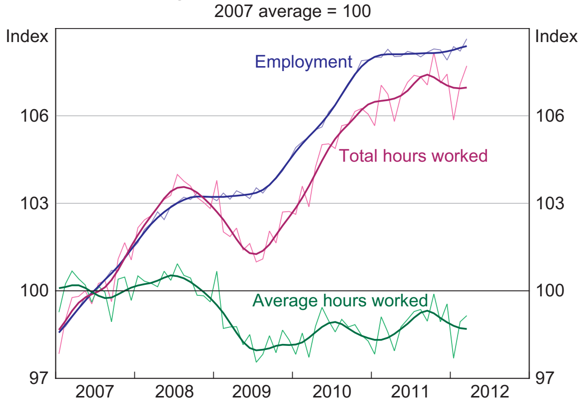
The industry employment data show that there have been job losses in a number of relatively large goods-related industries, including manufacturing, transport and retail trade, and also in the accommodation & food services industry, over the past year (Graph 3.18). Many firms in these industries, particularly in manufacturing and parts of tourism, have been exposed to heightened international competition as a result of the strong Australian dollar. In contrast, mining employment grew by more than 20 per cent over the year to the March quarter and contributed 0.4 percentage points to aggregate employment growth. Mining employment has expanded by over 40 per cent since late 2008, with mining employment picking up in all states and its share of total employment rising from about 1½ per cent to 2¼ per cent over this period (Graph 3.19). The pick-up in investment activity in the mining sector is also supporting construction employment, although total construction employment declined slightly owing to the drag on activity from the slowdown in residential and commercial construction activity. There were sizeable increases in health care and public administration employment.

Graph 3.16
Labour Market
Quarterly



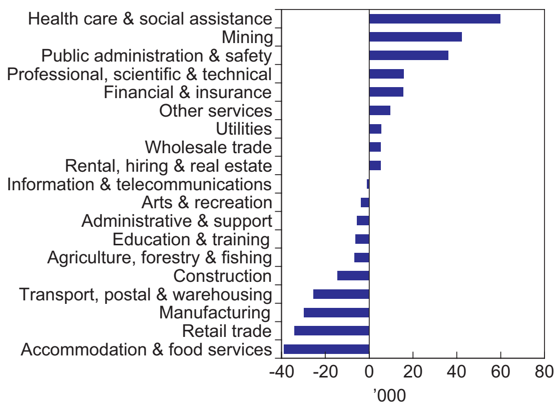
Source: ABS

Graph 3.17
Employment and Hours Worked*
2007 average = 100



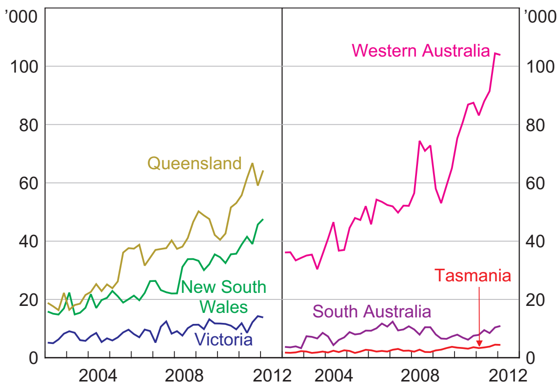
* Smoothed lines are 13-period Henderson trends
Sources: ABS; RBA

Graph 3.18
Contributions to Employment Growth
Year to February 2012, trend



Source: ABS

Graph 3.19
State Mining Employment*



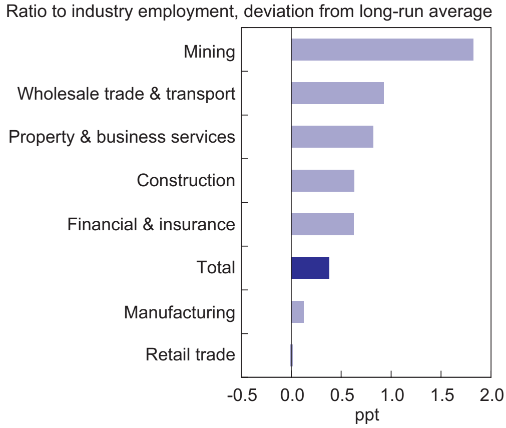
* Not seasonally adjusted
Source: ABS

The mixed developments in employment across industries are reflected in divergent employment trends across the states. Over the year, employment growth has been concentrated in Western Australia and Queensland, while employment has contracted in Victoria and Tasmania and has been broadly flat in the other states. The strength of employment growth in Western Australia primarily reflects the significance of mining in the state, with spillover effects to activity in non-mining industries also contributing to employment growth. While mining employment growth has also been strong in Queensland, employment is more diversified in the state and so this has been somewhat offset by weaker growth in other sectors. In contrast, employment has fallen in Victoria reflecting the relative significance of manufacturing and retail employment for that state. Nevertheless, the dispersion of unemployment rates across regions remains within its historical range.

Leading indicators suggest that these patterns of employment growth are likely to continue. While the ABS measure of job vacancies remains at a relatively high level – only a little below the peaks in 2008 and late 2010 when job creation was particularly strong – there are differences across industries and states. Vacancy rates are at very high levels for mining positions and above average for construction and property & business services roles but around average for other industries (Graph 3.20). Reflecting these industry patterns, the vacancy rate is particularly high in Western Australia but only moderately above average in the other states.

The ANZ measure of job advertisements has picked up in recent months. However, over the past year these leading indicators have tended to overestimate net employment growth, possibly because they do not account for the pick-up in job losses associated with increased structural change in the economy. Firms in a range of industries continue to indicate that they are cautious about hiring more staff, and some liaison contacts expect to reduce headcount. Overall, the vacancy data and survey measures continue to point to modest employment growth in the period ahead.

Graph 3.20
Industry Vacancies*
Ratio to industry employment, deviation from long-run average

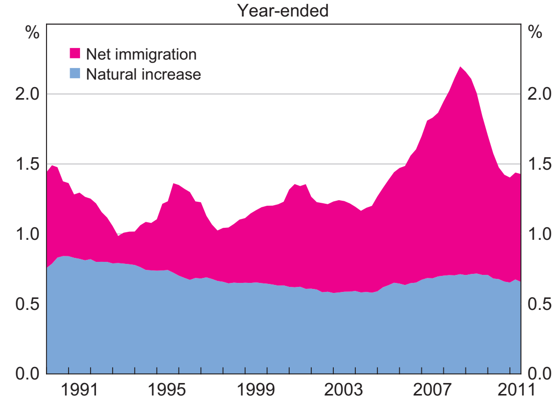


* As at February 2012; not seasonally adjusted
Source: ABS

Slower population growth and a decline in the participation rate have seen the growth of labour supply slow from the historically rapid pace in the late 2000s (Graph 3.21). Working-age population growth has slowed from a peak of around 2¼ per cent in late 2009 to around 1½ per cent. This reflects a sharp turnaround in net immigration associated with fewer international students in recent years, many of whom participate in the labour market on a part-time basis. The most recent data suggest that the number of international arrivals has stabilised and a gradual pick-up in net immigration is expected over the next few years as the number of student and worker arrivals picks up.

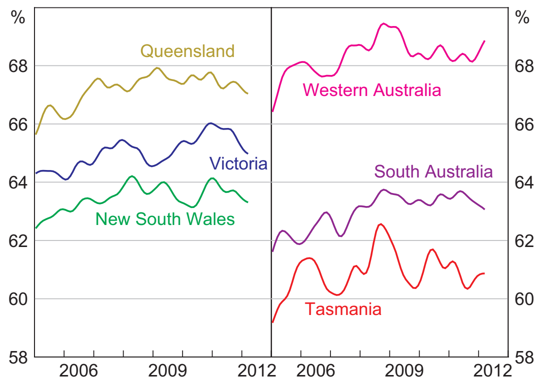
The decline in the labour market participation rate has also reduced the labour supply, although, in part, this is likely to be a response to softer labour demand over the past year and so could be reversed if faster employment growth encourages greater participation. The participation rate has declined by 0.6 percentage points since its record high in late 2010 to be a little below its average level since 2007. The cycle in the participation rate over the past two years has been most pronounced in New South Wales and Victoria, while participation in Western Australia has been trending upwards in recent months, broadly consistent with the strength of the respective state labour markets (Graph 3.22). Although the fall in the national participation rate implies a small increase in latent spare capacity in the labour market, it may also indicate a temporary fall in the economy's potential supply of labour as workers affected by structural change are likely to face a range of difficulties, including the need to retrain or relocate, before they can take advantage of employment opportunities in expanding industries or regions.

Graph 3.21
Population Growth
Year-ended



Source: ABS

Graph 3.22
State Participation Rates
Trend



Source: ABS