

Box D

Recent Developments in Capacity Utilisation

Judgments about the extent of spare capacity in the economy have an important bearing on the outlook for inflation. In general, if an economy has considerable underutilised capacity, inflationary pressure will be lower than if it is operating at a high level of capacity utilisation. The level of capacity utilisation also affects firms' investment and employment decisions, as firms operating close to full capacity are more likely to invest in additional capital and employ more workers, particularly if output prices and profitability are rising. While the amount of spare capacity in an economy is not directly observable, a number of business surveys publish aggregated measures of firm-level capacity utilisation, which are helpful for gauging the balance of supply and demand in the Australian economy (Graph D1).

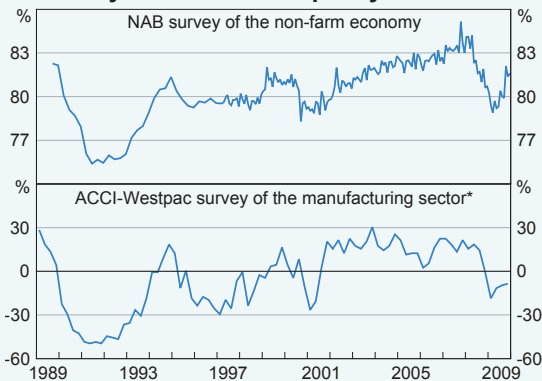
Typically, these surveys ask businesses a question like 'at what level of output is your company

currently operating?' The NAB survey also asks firms about the extent to which their output is being constrained by the availability of capital, labour and intermediate inputs. The responses suggest that the availability of labour is an important driver of overall trends in capacity utilisation while, perhaps surprisingly, premises and plant have tended to be a significantly less important factor over the past 15 years (Graph D2).

For much of the past decade, capacity utilisation – as measured by various business surveys – rose steadily, reaching unusually high levels. For example, in late 2007 the NAB measure was at its highest level in the two-decade history of the survey, with most industries experiencing high levels of capacity utilisation (Graph D1). Firms responded to this tight capacity by significantly increasing demand for labour and investment spending. Alternative measures of spare capacity in the economy, such as

Graph D1

Survey Measures of Capacity Utilisation

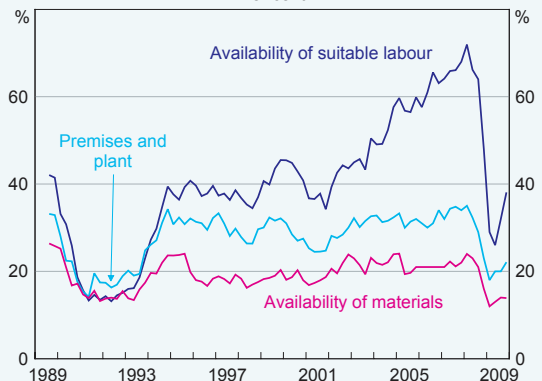


* Net balance; deviation from long-run average
Sources: ACCI-Westpac; NAB; RBA

Graph D2

Constraints on Output*

Per cent



* Per cent of firms reporting a minor or significant constraint
Source: NAB

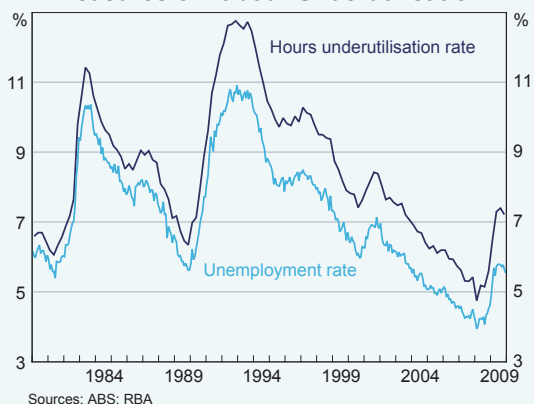
measures of labour underutilisation, also suggested a significant tightening in resource utilisation in the period to early 2008 (Graph D3).¹

As economic activity slowed over 2008, capacity utilisation declined, with measures suggesting it fell modestly below its long-run average to be roughly in line with the levels recorded during the relatively mild 2000–01 downturn. While a particularly sharp fall was recorded for the manufacturing sector, consistent with the weakness in global demand for manufactured goods, utilisation in the construction and services sectors remained at relatively higher levels, reflecting the overall resilience of domestic demand (Graph D4).

From around mid 2009, measures of capacity utilisation began to recover, and are now back above long-run average levels. Initially, this was driven by a pick-up in the manufacturing and construction sectors, though a number of services sectors have also reported increased capacity utilisation in recent months. This is consistent with survey measures indicating that firms have stronger hiring and investment intentions, and with the improvement in business sentiment more generally. Overall, these measures suggest that the economy starts the cyclical upswing with considerably less spare capacity than earlier thought likely. ↗

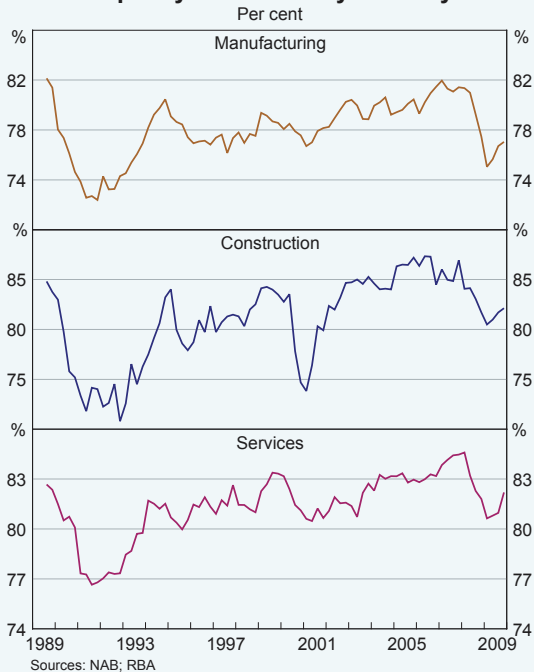
Graph D3

Measures of Labour Underutilisation



Graph D4

Capacity Utilisation by Industry



¹ The labour underutilisation rate accounts for both unemployed persons as well as those workers who would like to work more hours. A more detailed discussion can be found in the November 2004 *Statement*, 'Box B: Indicators of Labour Market Tightness', pp 35–36.