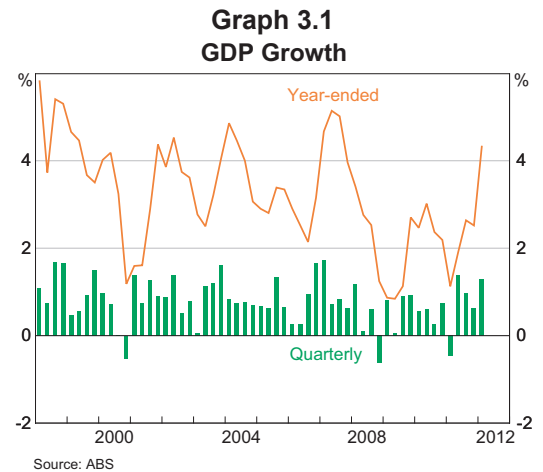


### 3. Domestic Economic Conditions

The latest information suggests that, since mid 2011, the Australian economy had been expanding at a stronger pace than had previously been indicated by the available data. GDP growth in the second half of 2011 was revised higher to be around trend. In the March quarter, GDP increased by 1.3 per cent driven by strong growth in household consumption and the ongoing surge in mining investment. Over the year, GDP was 4.3 per cent higher, in part reflecting the recovery of coal production following the flood-related disruptions in early 2011 (Graph 3.1, Table 3.1). Growth in national income has been softer, owing to falls in commodity prices and the terms of trade, which peaked in the second half of 2011 (Graph 3.2). Conditions continue to vary across industries, with the buoyant mining sector spurring activity in some industries, while the high exchange rate and weak conditions in the housing market weigh on activity in some others. Nonetheless, business surveys suggest

that the variation in conditions across industries is not unusually large by historical standards.

Recent data suggest that the economy continued to expand in the June quarter, although at a more moderate rate than in the March quarter. Retail and



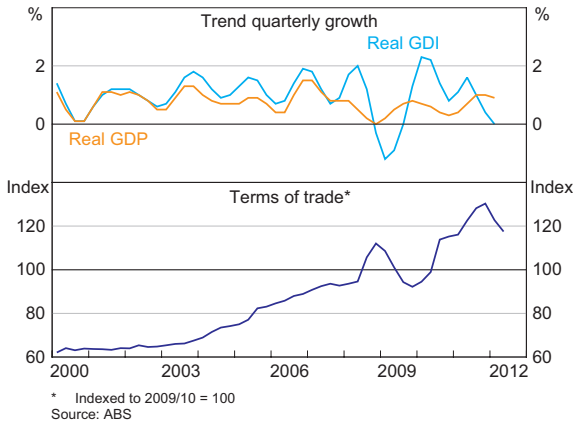
**Table 3.1: Demand and Output Growth**  
Per cent

	March quarter 2012	Year to March quarter 2012
Domestic final demand	1.8	5.0
– Private demand	2.2	6.7
– Public demand	0.3	–0.4
Change in inventories <sup>(a)</sup>	–0.1	0.5
Gross national expenditure	1.7	5.5
Net exports <sup>(a)</sup>	–0.5	–1.3
GDP	1.3	4.3
Nominal GDP	0.3	4.6
Real gross domestic income	0.2	3.5

(a) Contribution to GDP growth  
Source: ABS

**Graph 3.2**

**Gross Domestic Product and Income**



motor vehicle sales data indicate that household spending has continued to increase at an around average pace, while employment growth picked up in the June quarter. Growth in mining investment remains strong, with the commencement and approval of more projects in recent months sustaining the very large stock of work in the pipeline. Iron ore exports have recovered, following cyclone-related disruptions in the March quarter, although coal exports have fallen sharply. At the same time, slower global growth has contributed to continued falls in commodity prices. Surveys and liaison suggest that investment intentions in the non-mining sector have softened. Housing construction is likely to have fallen further in the June quarter, although the recent pick-up in building approvals points to some increase in residential construction activity in the second half of the year.

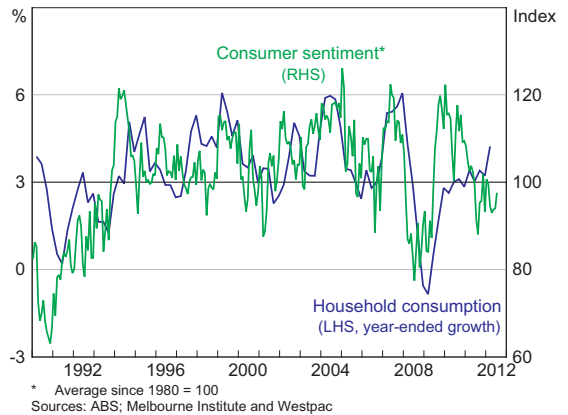
**Household Sector**

Household consumption increased by 1.6 per cent in the March quarter and by 4.2 per cent over the year, somewhat stronger than expected. In contrast, survey measures of consumer sentiment remained a little below their long-run average over this period (Graph 3.3). Recent growth has been broad based across both goods and services, following a period of relatively stronger growth in services consumption. The data indicate that the strong growth in

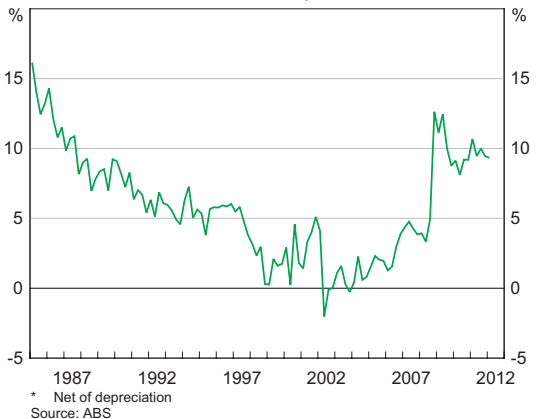
consumption volumes partly reflects falls in some retail prices. Discounting in many parts of the retail sector appears to have been driven by increased competition, including from overseas and domestic online sellers, and by consumers being more value conscious. Ongoing growth in household disposable income has allowed households to increase consumption while maintaining a saving ratio of around 10 per cent of income, well above the levels recorded in the 1990s and early 2000s (Graph 3.4).

Indicators suggest that consumer spending has retained considerable momentum in the June quarter. Growth in the volume of retail sales remained above its pace of late 2011, sales of motor vehicles

**Graph 3.3**  
**Consumer Sentiment and Consumption**



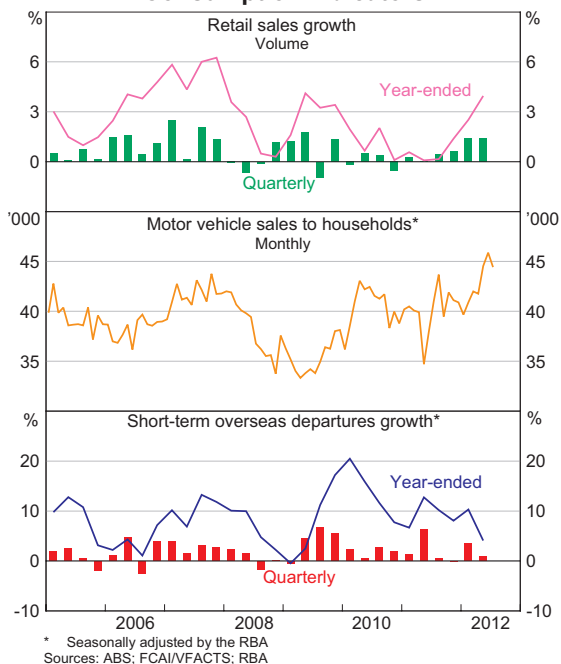
**Graph 3.4**  
**Household Saving Ratio\***  
Per cent of household disposable income



to households increased strongly and the number of Australians travelling overseas has continued to increase over recent months (Graph 3.5). The Bank's liaison suggests that various government payments made to households through May and June had a noticeable effect on sales at some retailers.

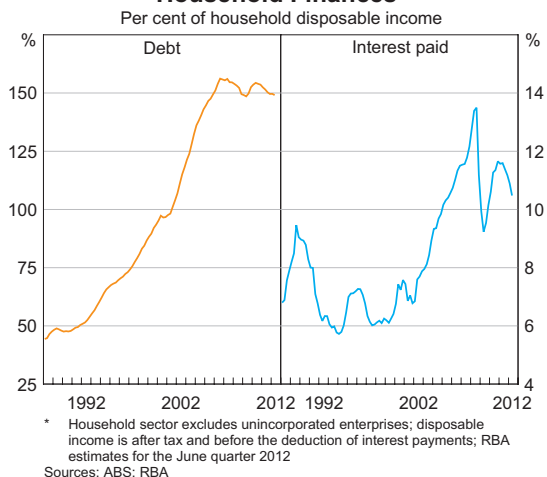
Over recent years, households have been saving at a higher rate and increasing their borrowing at a slower rate. Household debt grew at around the same pace as household income over the March quarter, leaving the ratio of debt to income at around 150 per cent; debt continued to grow at a moderate rate in the June quarter (Graph 3.6). Lower average interest rates over the March quarter resulted in a fall in household interest payments as a share of income, to around 11 per cent. Interest payments are estimated to have fallen further in the June quarter, broadly in line with the reductions in the cash rate in May and June. Interest receipts by the household sector have not fallen as much as payments due to a smaller fall in deposit rates than in borrowing rates as well as deposits growing faster than debt.

**Graph 3.5**  
**Consumption Indicators**



**Graph 3.6**

**Household Finances\***



Household net worth was 2½ per cent lower over the year to the March quarter, driven by lower dwelling prices, offset somewhat by growth in household financial assets. Net worth is expected to have fallen slightly in the June quarter, as a result of small falls in asset prices.

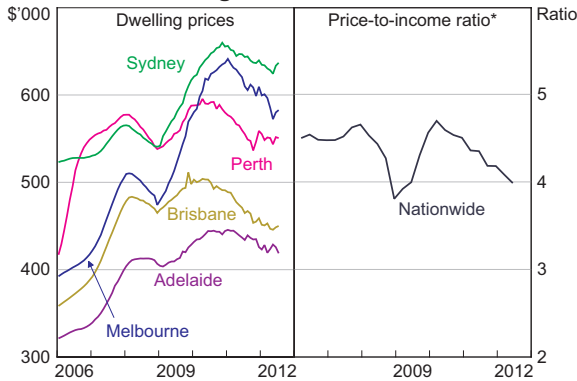
Australian capital city dwelling prices have fallen by around 6 per cent since their peak in early 2011 (Graph 3.7, Table 3.2); given continued growth in incomes, the ratio of dwelling prices to income has declined consistently over the past two years. In recent months, however, dwelling prices have picked up a little in most capital cities. Demand for housing finance has remained moderate, although there are differences across states, with the value of housing loan approvals growing strongly in Western Australia over the past year. Housing turnover has remained close to the low level of the early 1990s.

Growth in rents has continued to outpace overall inflation. This is consistent with vacancy rates, which nationwide remain low by historical standards at around 2 per cent (Graph 3.8).

Residential construction activity fell further in the March quarter, but there are signs from a number of indicators that activity may start to pick up in the second half of this year. Building approvals increased

**Graph 3.7**

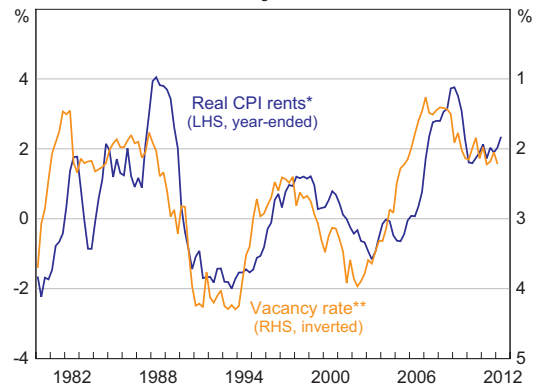
**Dwelling Prices and Income**



\* Average dwelling prices to average household disposable income (before the deduction of interest payments); RBA estimate for the June quarter 2012  
Sources: ABS; RBA; RP Data-Rismark

**Graph 3.8**

**National Vacancy Rates and Rents**



\* Calculated as the CPI measure of rents relative to underlying inflation  
\*\* Seasonally adjusted by the RBA  
Sources: ABS; RBA; REIA

in the June quarter, underpinned by a sharp rise in approvals for higher-density housing (Graph 3.9). Approvals for detached houses have been affected by temporary disruptions in Western Australia associated with the introduction of a new building approvals process.

Falls in mortgage interest rates and higher rental yields have increased the attractiveness of new housing investment, although falls in dwelling prices

appear to have been weighing on demand for new housing. Changes to state government housing initiatives are likely to have a mixed effect on national demand for new housing in coming quarters, with some initiatives having recently expired (such as the First Home Bonus scheme in Victoria) and other new policies taking effect (including the First Home Owner Grant (New Homes) scheme in New South Wales).

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

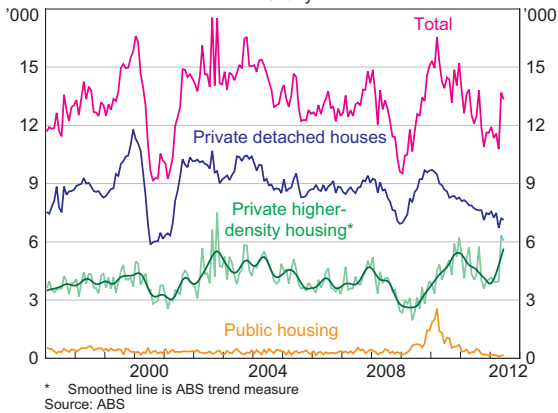
	3 months to March 2012	3 months to June 2012	Year to June 2012
<b>Capital cities</b>			
ABS <sup>(a), (b)</sup>	-0.1	0.5	-2.1
APM <sup>(b)</sup>	0.9	0.0	-1.1
RP Data-Rismark	-1.6	-0.6	-3.6
<b>Regional areas</b>			
APM <sup>(b)</sup>	1.1	1.9	1.8
RP Data-Rismark <sup>(a)</sup>	-0.1	-1.6	-2.2

(a) Detached houses only

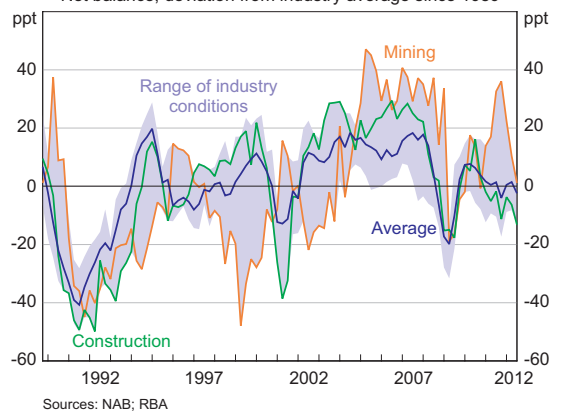
(b) Quarterly measures

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

**Graph 3.9**  
**Residential Building Approvals**  
Monthly



**Graph 3.10**  
**Business Conditions by Industry**  
Net balance, deviation from industry average since 1989

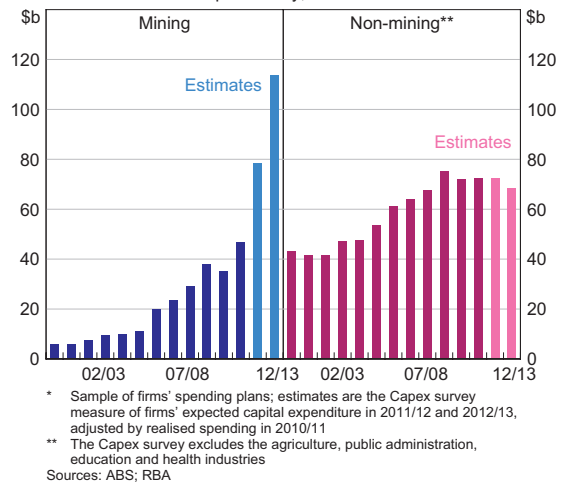


## Business Sector

Survey measures of business conditions softened a little over recent months, but are still around long-run average levels (Graph 3.10). Differences in conditions across industries continue to be broadly consistent with the ongoing structural changes affecting the Australian economy. The mining and transport industries report the strongest conditions, reflecting the continuing boom in mining investment, while conditions remain weak in large parts of the construction, manufacturing and retail industries. Nevertheless, the variation in business conditions across industries has been somewhat narrower over the first half of the year than historical norms.

In line with the above-average conditions reported by the mining industry, mining investment has grown strongly, by around 70 per cent over the past year. The outlook for mining investment remains strong, with the latest ABS survey of firms' capital expenditure plans (Capex) implying further rapid growth for 2012/13 (Graph 3.11). This is despite some mining companies adopting a more cautious approach recently to investment opportunities (to which they are not yet committed) given recent falls in commodity prices and the softer global economic outlook. Mining investment is expected to peak, however, over the next few years. Investment continues to be underpinned by construction on

**Graph 3.11**  
**Capital Expenditure\***  
Capex survey, nominal



a number of very large liquefied natural gas (LNG) projects, valued at around \$180 billion in total, including the second liquefaction train at the Australia Pacific LNG project in Gladstone, which was recently approved. Investment in mines and infrastructure for other commodities, such as iron ore and coal, also continues to grow rapidly. Given the import-intensive nature of mining investment, particularly for LNG projects that often involve large modular production plants built offshore, capital imports have also increased very strongly over recent years.

The outlook for non-mining investment remains quite weak, with investment intentions in a range of business surveys below long-run average levels. The ABS Capex survey also points to little growth in non-mining investment in 2012/13. In liaison, many firms indicate that they are slowing their investment spending in line with weaker cash flows and are becoming more selective about which projects to pursue, with many companies only prepared to spend on machinery and equipment investment to the extent necessary to offset depreciation.

Non-residential construction activity remains relatively subdued. Private building approvals have increased in the first half of the year but, generally, remain low relative to GDP. For offices, the national CBD office vacancy rate ticked up by about ¾ percentage point in the June quarter, to remain around its post-2000 average at just under 8 per cent. Capital city office vacancy rates generally remain around average, but have fallen over the past year in Perth to 3 per cent.

Company profits fell by 3 per cent in the March quarter, but were 6 per cent higher over the year. Non-mining profits rose by 9 per cent over the year, with considerable variation between industries. Mining profits slowed considerably over the December and March quarters but remained broadly unchanged over the year, and are well above their decade average as a share of GDP (Graph 3.12).

Following a period of deleveraging, business borrowing has picked up over the past few quarters. In conjunction with profits remaining at a high level, this leaves businesses well placed to increase investment when they see profitable opportunities.

## Farm Sector

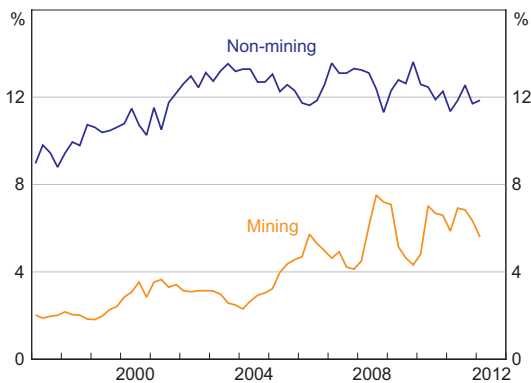
The outlook for the farm sector generally remains positive. The Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) forecasts the 2012 winter crop to remain at a high level by historical standards, albeit 15 per cent lower than the record 2011 crop. While recent increases in wheat prices are likely to support income growth, dry conditions in Western Australia may lower crop yields. The Bureau of Meteorology has suggested that there is a risk of an El Niño event developing this year, which is typically associated with below-average rainfall over parts of Australia, although water storage levels remain high in most regions after two years of good rainfall.

## External Sector

Export volumes declined in the March quarter, as cyclone-related disruptions to iron ore exports and a fall in rural exports (from recent high levels) offset a recovery in coal exports. Following earlier changes to student visa policies and the ongoing high level of the exchange rate, service exports continued to decline, though there are tentative signs that the value of service exports has stabilised (Graph 3.13). The volume of manufactured exports grew by nearly 5 per cent over the year to the March quarter, as declines in exports of construction-related materials have been more than offset by increased exports of specialised manufacturing products such as mining-related equipment. Nevertheless, the level of manufactured exports remains well below its 2008 peak.

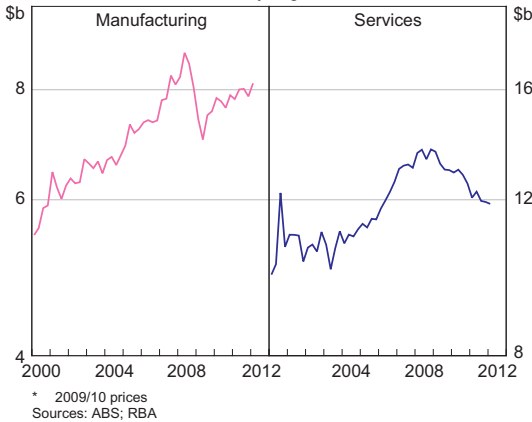
Iron ore exports rebounded in the June quarter, while coal exports declined (Graph 3.14). After returning to pre-flood levels earlier in the year, coal shipments from Queensland have fallen in part due to industrial

**Graph 3.12**  
**Private Non-financial Corporation Profits\***  
 Share of nominal GDP

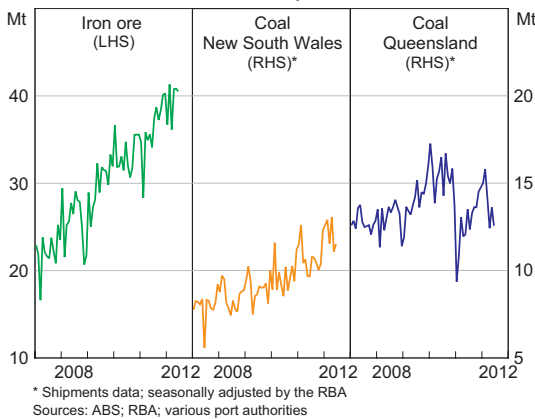


\* Gross operating profits; inventory valuation adjusted  
 Sources: ABS; RBA

**Graph 3.13**  
**Non-commodity Export Volumes\***  
 Quarterly, log scale



**Graph 3.14**  
**Bulk Commodity Exports**  
 Monthly



action at the BHP Billiton Mitsubishi Alliance mines. Coal shipments from New South Wales have also declined in recent months, in part due to the impact of wet weather and some planned maintenance. The first shipment from the Pluto LNG project occurred in the June quarter.

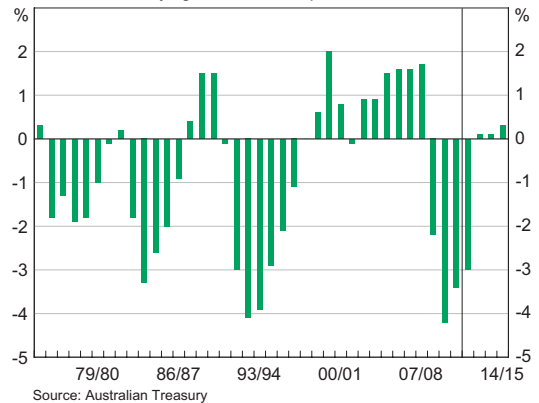
Growth in imports volumes over the first half of 2012 appears to have slowed from the rapid pace over 2011. The surge in mining investment to date has been accompanied by a sharp increase in the volume of capital equipment imports, with close to half of mining investment estimated to have been

imported. Growth in the volume of consumption imports has been less pronounced, and has been around its long-run average over the first half of the year.

## Government Sector

Australian Government and state budgets point to a significant overall fiscal consolidation over the coming two years. In the May Budget, the Australian Government budget balance was forecast to shift from a deficit of 3 per cent of GDP in 2011/12 to a surplus of 0.1 per cent of GDP in 2012/13 (Graph 3.15). At face value, this turnaround in the budget position would have a very large contractionary impact on the economy, but various publicly available estimates suggest that the impact on the economy is likely to be considerably less than this. In part, this reflects a shift in the timing of some payments from the 2012/13 fiscal year into 2011/12 and, to a lesser extent, the nature of the reductions in expenditure, including cuts in offshore spending. A range of estimates suggests that, in isolation, the Australian Government budget may subtract around  $\frac{3}{4}$ – $1\frac{1}{2}$  per cent from growth in real GDP in 2012/13. The consolidated state budgets also point to a tightening in fiscal policy in 2013/14.

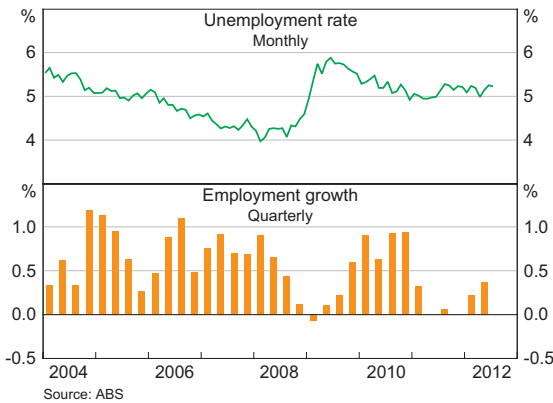
**Graph 3.15**  
**Australian Government Budget Balance**  
 Underlying cash balance, per cent of GDP



## Labour Market

While the monthly data are inherently volatile, since the start of the year there has been a modest recovery in the pace of employment growth, following little net growth in published employment over 2011 (Graph 3.16). Moreover, owing to problems with estimating population growth, it is likely that the employment data have understated recent growth (see 'Box E: Employment and Population Estimates' for more detail). Measures that are expressed relative to the size of the labour force, however, such as the participation rate and the unemployment rate, are relatively unaffected by these measurement issues. After falling in 2011, the participation rate and the ratio of employment to working-age population have tracked sideways in 2012 so far. Consequently there has been little change in the unemployment rate, which remains around 5¼ per cent. Despite the modest improvement in employment growth, aggregate labour demand remains affected by structural developments that are creating pressure for labour shedding in some industries, including retail trade and manufacturing.

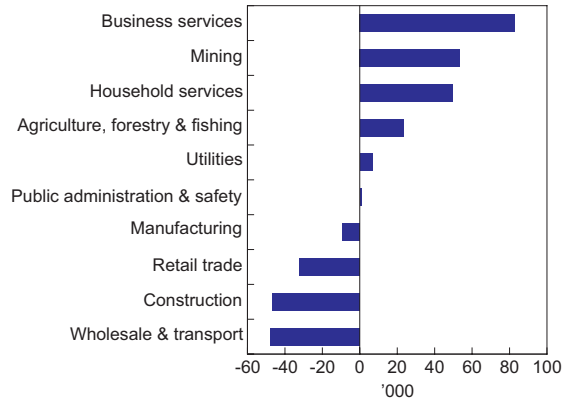
**Graph 3.16**  
**Labour Market**



Employment data by industry show that growth over the year has been underpinned by higher employment in a number of service industries and exceptionally strong growth in mining employment (Graph 3.17). Mining employment grew by more than 25 per cent over the year, and has expanded by

**Graph 3.17**

**Contributions to Employment Growth**  
Year to May 2012, trend



over 50 per cent since late 2008. The momentum in employment growth across most service industries, including business services, has picked up over the first half of 2012.

Employment outcomes remain relatively weak in a number of industries exposed to international competition that has been heightened by the strong Australian dollar, or facing patchy domestic demand. Even so, the pace of decline in manufacturing employment appears to have moderated in recent quarters. Weakness in residential and commercial construction activity has led to a fall in construction employment, despite the strength in mining-related construction. Employment has also declined in the retail sector over the past year, as the industry continues to adjust to slower sales growth since 2008. Consistent with this, in the Bank's business liaison program many firms in the parts of the economy most adversely affected by the forces of structural change report that they are reducing employment to contain costs and improve productivity.

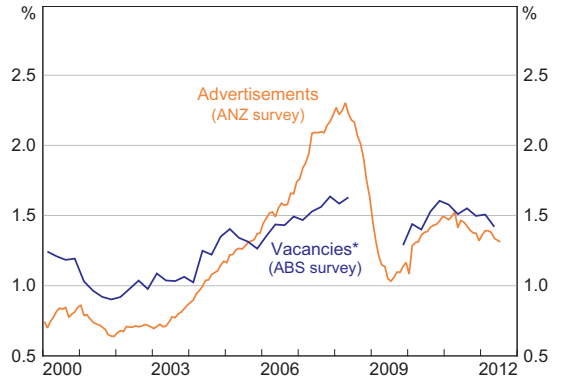
Labour market conditions also vary across the states, consistent with differences in industry composition. Over the year to the June quarter, Western Australia experienced rapid employment growth, reflecting the importance of the mining industry in the state. Over recent months, employment growth has picked up in New South Wales and Victoria, in part driven by



strong increases in business services. Labour market conditions have weakened in the other states, with employment falling in Tasmania and South Australia over the past year. In Queensland, strong employment growth in mining has been offset by weaker outcomes in other industries, leaving the level of employment unchanged over the year.

Leading indicators continue to imply modest growth in employment in the period ahead. ABS job vacancies and the ANZ advertisements measure have declined over recent quarters but nevertheless remain at relatively high levels (Graph 3.18). Survey measures of hiring intentions have also softened of late.

**Graph 3.18**  
**Job Vacancies and Advertisements**  
 Per cent of labour force



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