2. Domestic Economic Conditions

Economic activity bounced back strongly in the December quarter, supported by a recovery in consumption and investment following the easing of activity restrictions related to the outbreaks of the Delta variant of COVID-19. The labour market had also snapped back by December, with employment a little higher and the unemployment rate lower than pre-Delta levels. Leading indicators of labour demand suggest that underlying labour market conditions remain strong.

The emergence of the highly transmissible Omicron variant saw a substantial escalation in cases of COVID-19 in most states and territories in December and January. This led to disruptions in some industries – including retail, hospitality, health and goods distribution – because of employee illness and isolation requirements. There has also been increased precautionary behaviour on the part of consumers related to health considerations. However, initial indications are that the impact of Omicron on economic activity has been much smaller than previous waves of COVID-19. The high rates of vaccination among the adult population, as well as the rollout of booster shots, have been effective in limiting the incidence of severe illness. Consequently, there have been less restrictions on activity than in earlier outbreaks.

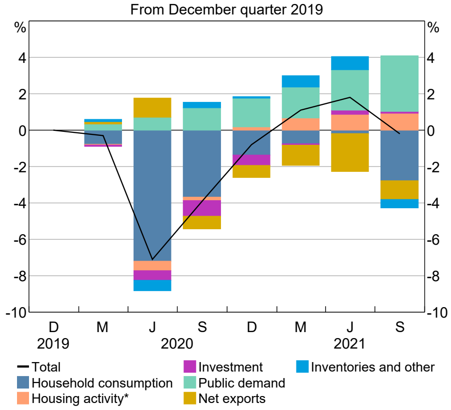
Restrictions weighed on domestic demand in the September quarter …

The Australian economy contracted by 1.9 per cent in the September quarter – one of the largest quarterly declines on record (Graph 2.1). Restrictions on activity led to a very sharp decline in state final demand in New South Wales, and to a lesser extent in Victoria. Elsewhere, in states without activity restrictions, state final demand continued to increase strongly. As in earlier lockdowns, household consumption of discretionary services – such as travel and restaurant meals – bore the brunt of the contraction (Graph 2.2). Business and dwelling investment were resilient as restrictions on construction were less binding than expected, and businesses viewed the disruptions as temporary. Resource exports increased, while imports of consumption goods fell sharply as lockdowns weighed on domestic demand and supply disruptions affected the availability of some goods, particularly motor vehicles.

Graph 2.1

GDP – Cumulative Contribution to Change

From December quarter 2019



* Dwelling investment and ownership transfer costs.

Sources: ABS; RBA

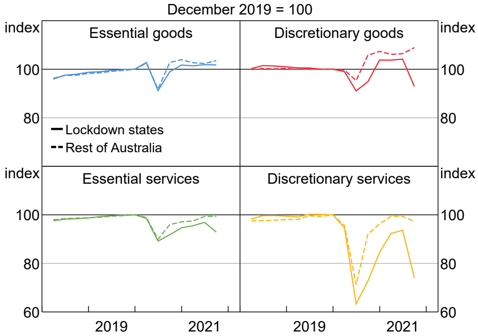
… but consumer spending rebounded sharply in the December quarter

Economic activity bounced back in the December quarter as restrictions were eased. Household spending increased as consumption opportunities broadened, with retail sales values growing by 9 per cent in the quarter (Graph 2.3). Consistent with the patterns observed following previous reopenings, spending at clothing & footwear shops, department stores and cafés & restaurants increased sharply, while food sales declined slightly. A strong recovery in spending on discretionary services such as entertainment and travel was also underway in the December quarter.

Graph 2.2

Household Consumption

December 2019 = 100

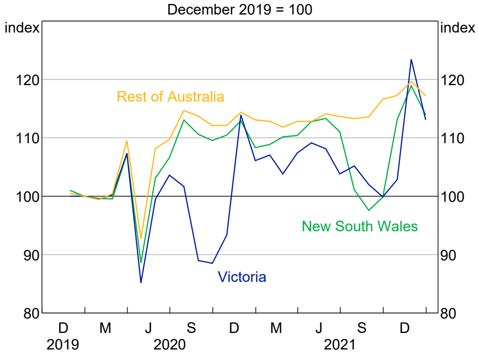


Sources: ABS; RBA

Graph 2.3

Retail Sales Values

December 2019 = 100



Sources: ABS; RBA

High-frequency indicators suggest the emergence of the Omicron variant began to affect economic activity from around the turn of the year. Population mobility – a timely indicator of economic activity – declined a little more through January than was seen this time last year (Graph 2.4). Information from the Bank's business liaison program and other timely indicators suggest that spending on a range of discretionary goods and services declined in January, particularly in hospitality and tourism, but the overall impact on consumer spending has been much smaller than during periods of lockdown. Consumer sentiment has declined a little to be around its long-run average (Graph 2.5). Business confidence declined in December, but measures of business conditions were little changed over recent months and remain broadly around average levels.

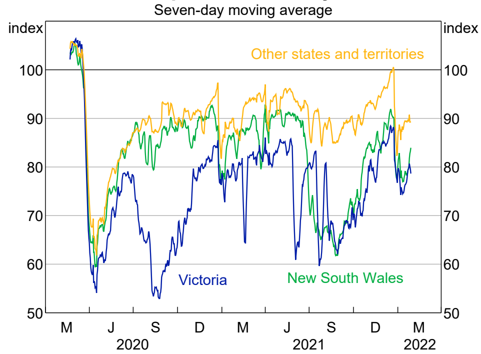
The labour market rebounded rapidly following the easing of lockdown restrictions

Employment and hours worked in December had recovered to be a little above levels seen prior to the Delta outbreak in mid-2021 (Graph 2.6). The snap back in labour market conditions was strong in contact-intensive industries in lockdown-affected states.

Graph 2.4

Population Mobility*

Seven-day moving average



* Google mobility; average from 3 January to 6 February 2020 = 100.

Sources: CEIC Data; RBA

Participation rates increased sharply in these states as people returned to their previous jobs, or took up or began searching for new employment opportunities. Outside of lockdown-affected states, labour market outcomes were relatively stable during the second half of 2021.

The labour market was able to recover quickly because many people who exited employment during the Delta outbreak remained connected, or 'attached', to their employers (that is, they were stood down without pay rather than retrenched) (Graph 2.7). Firms in the Bank's liaison program reported that they were reluctant to lay off staff in response to the Delta outbreak because of difficulty attracting suitable labour prior to the lockdowns and expectations that the disruptions would be relatively short lived.

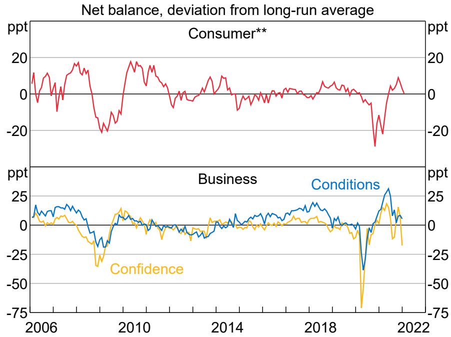
The unemployment rate declined to 4.2 per cent in December, following a period of volatility during the Delta outbreak. The measured unemployment rate did not give a clear indication of changes in labour market conditions for much of the second half of 2021 because of the effects of lockdowns and the lifting of restrictions. An alternative measure of spare capacity that captures flows into and out of the labour force as well as those working zero hours (either for economic or for 'other' reasons) declined to 5.2 per cent in December; this followed a peak of 11.7 per cent in August (Graph 2.8). Other measures of labour market spare capacity have also declined. The heads-based underemployment rate fell to 6.6 per cent in December – its lowest level since November 2008.

Worker absences due to Omicron-related illness and isolation requirements are expected to contribute to a sharp decline in total hours worked in January, with firms in the Bank's liaison program reporting elevated levels of

Graph 2.5

Consumer and Business Sentiment*

Net balance, deviation from long-run average



* Latest observation December 2021 for business confidence and conditions, and January 2022 for consumer confidence.

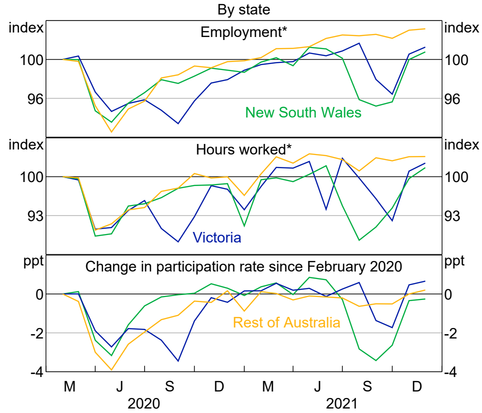
** Average of Westpac–Melbourne Institute and ANZ–Roy Morgan surveys.

Sources: ANZ–Roy Morgan; NAB; RBA; Westpac–Melbourne Institute

Graph 2.6

Labour Market Outcomes

By state



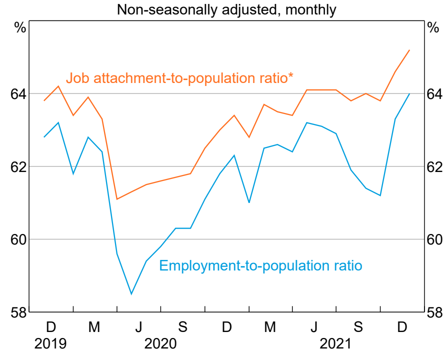
* February 2020 = 100.

Sources: ABS; RBA

Graph 2.7

Labour Market Outcomes

Non-seasonally adjusted, monthly



* Share of the population reporting that they have a job they are connected to (whether currently in that job or temporarily absent).

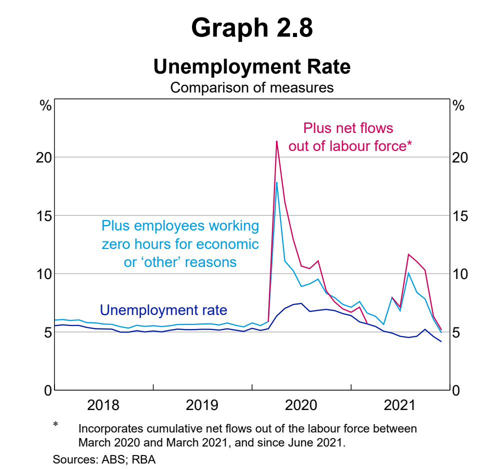
Source: ABS

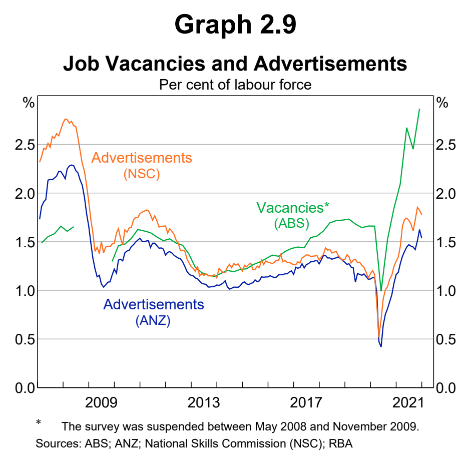
absenteeism. Some firms in the accommodation, hospitality and retail sectors have reported around 15–30 per cent of staff were temporarily unavailable due to illness or isolation requirements. This decline in hours is expected to be short lived and smaller than observed during the national lockdowns in 2020.

A range of indicators of labour demand remain strong

Leading indicators of labour demand suggest that labour market conditions were strong at the end of 2021 (Graph 2.9). Job vacancies as a share of the labour force reached a record high in November, with around one in five businesses reporting at least one vacancy – almost double the rate seen prior to the pandemic. Job vacancies were particularly strong in Western Australia, where the job vacancy rate far exceeded that observed during the mid-2000s mining boom. In aggregate, job vacancies were well above pre-pandemic levels in all industries, particularly in those most affected by lockdowns and border closures, such as accommodation & food services and arts & recreation. Job advertisements have also remained elevated. Consistent with this, information from the Bank's liaison program continues to suggest that around half of all firms intend to increase headcount over coming months and very few firms expect to reduce headcount. Firms continue to report difficulties finding workers for a range of roles, including in the construction, professional services, agricultural and hospitality sectors.

Job mobility remained at historically high levels in November and the share of workers expecting to change jobs in the next 12 months continued to increase. Elevated job mobility partly reflects workers catching up on planned job changes that had been put on hold due to disruptions associated with the pandemic, as well as workers feeling encouraged by stronger labour market conditions to change jobs. It also reflects labour market adjustments to the uneven effects of the pandemic on labour demand. High-skilled jobs in professional services sectors have experienced particularly sharp increases in job mobility since mid-2021, while job mobility rates in other sectors have remained in line with historical averages (Graph 2.10). Firms in the liaison program have also reported higher voluntary turnover in recent months, driven by a pick-up in staff leaving for higher pay, particularly in professional services and some construction and mining-related roles.





Fiscal measures supported household and business incomes during lockdowns

Household income increased in the September quarter, as fiscal measures such as the COVID-19 disaster payments provided strong support to household and small business incomes (Graph 2.11). These measures have been subsequently wound down as key vaccination rate thresholds were met. Strong growth in disposable income and a fall in consumption saw the household saving ratio increase to 20 per cent in the September quarter. Total additional savings accumulated by households during the pandemic are estimated to amount to more than $200 billion. Many households have also benefited from large increases in housing wealth as prices have risen (Graph 2.12).

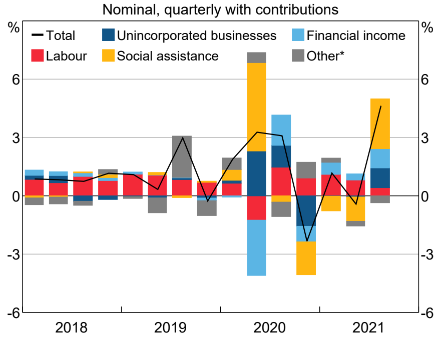
Business investment was resilient during the Delta outbreak

The decline in non-mining business investment in the September quarter was much smaller than expected at the time of the previous *Statement*, as many firms were able to adapt to lockdowns and other restrictions on construction activity. Non-mining business investment remained 2 per cent above its pre-pandemic level as the recovery in domestic demand and tax incentives from the Australian Government continued to underpin machinery & equipment investment. Non-residential construction increased, supported by renewable energy projects and new warehouses to facilitate the shift to online shopping (Graph 2.13). The Omicron outbreak is not expected to have significantly disrupted firms' longer-term investment plans, consistent with large firms' investment intentions having remained steady throughout the Delta outbreak in the second half of 2021.

Graph 2.11

Household Disposable Income Growth

Nominal, quarterly with contributions



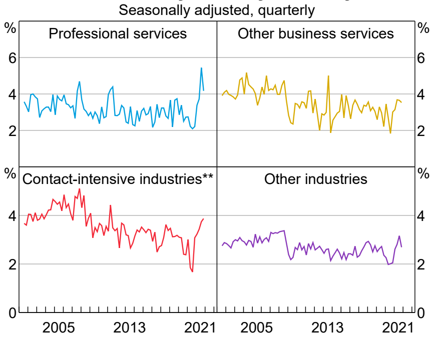
* Includes rent, tax payable, interest payable and other.

Sources: ABS; RBA

Graph 2.10

Job Mobility Rate by Industry*

Seasonally adjusted, quarterly



* Share of industry employment.

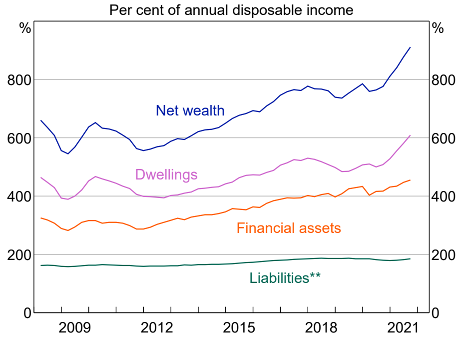
** Includes hospitality, arts & recreation and retail trade.

Sources: ABS; RBA

Graph 2.12

Household Assets and Liabilities*

Per cent of annual disposable income



* Disposable income before the deduction of interest payments.

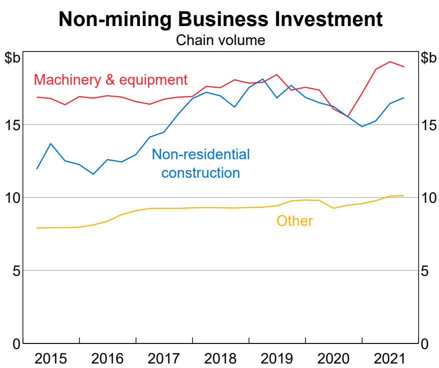
** Excludes unincorporated enterprises.

Sources: ABS; RBA

Public demand is providing strong support to the economy

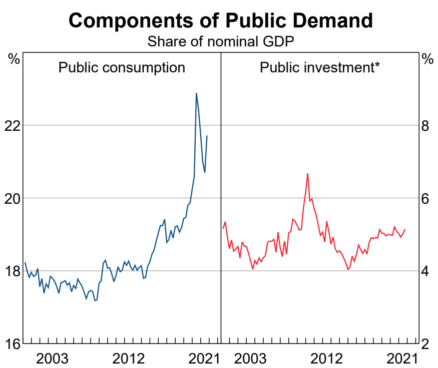
Public demand grew by 7 per cent over the year to the September quarter. Public consumption grew at its strongest quarterly rate in 25 years and remained at a very high share of nominal GDP. Recent increases have been driven by public health spending related to the Delta outbreak and the accelerated rollout of COVID-19 vaccines (Graph 2.14). Growth in public investment slowed as lockdowns and other restrictions on activity had some impact in the quarter. The pipeline of work to be done on public transport projects has increased substantially over the past year.

Graph 2.13



Sources: ABS; RBA

Graph 2.14



* Adjusted for second-hand asset transfers between the public and other sectors.

Sources: ABS; RBA

Recent federal and state government midyear budget updates included new spending, mainly health-related, alongside stronger-than-expected revenues. These budgets point to continued strong growth in both public consumption and public investment over coming quarters.

Residential construction was strong in 2021 despite disruptions from lockdowns

Dwelling investment was unchanged in the September quarter as renovation activity continued to expand and firms were largely able to adapt to restrictions on the construction of new dwellings in areas affected by the Delta outbreak. Alterations & additions have been supported by households' desire for extra space and increased savings accumulated during the pandemic. There is a large pipeline of residential construction work to be completed, with more than 120,000 new dwellings commenced across the June and September quarters (Graph 2.15). Building approvals have eased from the very high levels of early 2021 as the Australian Government's HomeBuilder scheme has now concluded; however, they remain above pre-pandemic levels. Information from the Bank's business liaison program suggests that detached housing projects are taking longer to complete than normal due to shortages of both workers and building materials.

Conditions in housing markets vary across the country

Housing prices increased by 22 per cent over 2021 (Graph 2.16). Housing price growth has been supported by low interest rates and the inherent inability of supply to respond immediately to increased demand. In recent months, housing price growth has moderated in Sydney, Melbourne and Perth from the high rates seen earlier in 2021; however, prices have continued to increase rapidly in some smaller

Table 2.1: Housing Price Growth
Percentage change, seasonally adjusted

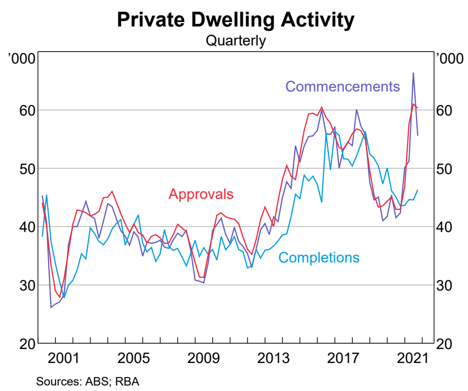
	January	December	November	October	Year-ended	Five-year growth
Sydney	0.7	0.7	1.1	1.4	25.5	27
Melbourne	0.1	0.0	0.4	0.7	14.9	22
Brisbane	2.5	2.6	2.7	2.5	29.2	38
Adelaide	2.3	2.2	2.2	1.8	24.8	38
Perth	0.3	0.3	–0.1	0.1	11.2	11
Darwin	0.3	0.4	–0.1	0.4	12.6	2
Canberra	1.9	1.2	0.8	2.0	25.5	56
Hobart	1.2	1.4	1.0	1.7	27.6	72
Capital cities	1.0	0.8	1.0	1.3	21.3	25
Regional	1.7	1.9	2.0	1.8	26.1	42
National	1.2	1.1	1.2	1.4	22.4	29

Sources: CoreLogic; RBA

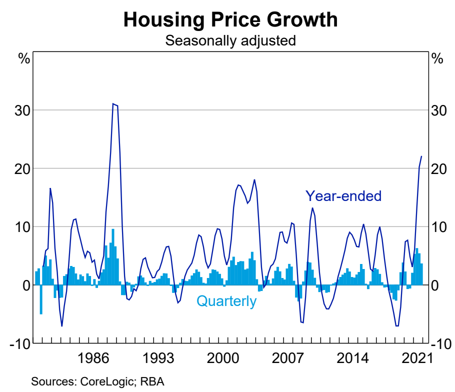
capital cities and regional areas (Table 2.1). During the pandemic, price growth for detached houses has been stronger than for apartments, partly reflecting changes in housing preferences. Housing turnover picked up strongly across most markets towards the end of the year, including in Sydney and Melbourne where restrictions on sales activity had weighed on turnover through the September quarter. Consequently, housing loan commitments are at an elevated level (see chapter on 'Domestic Financial Conditions'). The number of properties listed for sale had remained low in recent months as the rate of purchases outpaced new listings.

Advertised rents increased strongly over 2021, following earlier declines in some locations over 2020. Advertised rents have substantially outpaced increases in the CPI rents series (see chapter on 'Inflation'). That said, growth in advertised rents has eased in some capital cities over recent months. For a number of quarters,

Graph 2.15



Graph 2.16



the largest increases for advertised rents have been recorded in the smaller capital cities and regional areas, where vacancy rates are very low (Graph 2.17). Changes in the pattern of internal migration during the pandemic have contributed to demand in those areas. More broadly, survey data suggest that renters' average household size has declined since the onset of the pandemic, putting upward pressure on demand for rental properties. Growth in advertised rents has also been supported by the increase in household income and the declining availability of rental stock as listings have continued to decline in both capital cities and regional areas.

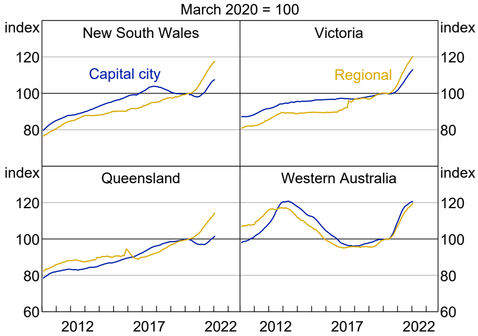
Production issues have weighed on resource exports

Partial data and information from the Bank's liaison program indicate that resource exports declined in the December quarter, as maintenance and wet weather weighed on production (Graph 2.18). Rural exports have continued to increase over recent months due to favourable growing and pasture conditions, as well as strong global demand for grains and meat. Trade in services remained depressed in the December quarter but is expected to increase as the international border is reopened to eligible travellers including Australian citizens and residents, students, skilled migrants and some tourists. The trade surplus has declined over recent months but remains elevated, supported by high prices for some key export goods, notably coal and LNG.

Graph 2.17

Advertised Rents

March 2020 = 100

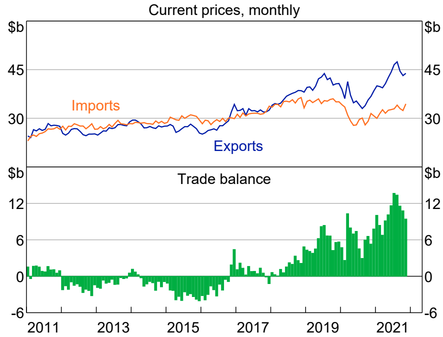


Sources: CoreLogic; RBA

Graph 2.18

Trade in Goods and Services

Current prices, monthly



Sources: ABS; RBA