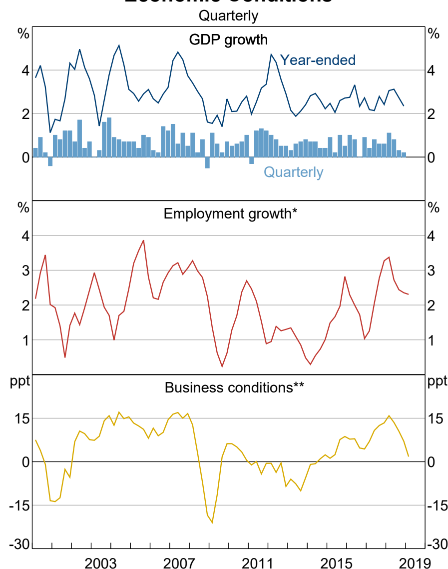
2. Domestic Economic Conditions

Growth in the Australian economy slowed in the second half of 2018 (Graph 2.1). This largely reflected slower-than-expected growth in consumption, although a number of temporary factors have also weighed on growth in recent quarters. Partial indicators of domestic economic activity suggest growth was moderate in the first quarter of 2019. Employment growth has remained solid in recent months and the unemployment rate has been stable after declining by more than expected over 2018.



The domestic economy slowed over the second half of 2018 …

GDP increased by 0.2 per cent in the December quarter and by 2.3 per cent over 2018 (Table 2.1). Growth in household consumption remained soft in the December quarter, and dwelling investment declined sharply. Both these components of domestic demand are likely to have been affected by persistently slow growth in household incomes and declining housing prices. Temporary factors, including weakness in mining sector activity and the effect of the drought on the farm sector, also contributed to slower GDP growth in the second half of 2018. In contrast, public demand and non-mining investment grew relatively strongly in the quarter and over the year.

… while employment growth has been resilient

Although GDP growth has moderated, employment has continued to expand by enough to reduce spare capacity in the labour market over the past year. This pattern of weaker growth of economic activity and resilient labour markets has also been evident in a number of other advanced economies. In Australia, a decrease in GDP growth is typically associated with employment growth also decreasing in the same period or sometime within the following nine months, but it is also not unusual for trends in GDP growth and the labour market to diverge for sustained periods.

Employment grew by 0.6 per cent in the March quarter to be 2½ per cent higher over the year

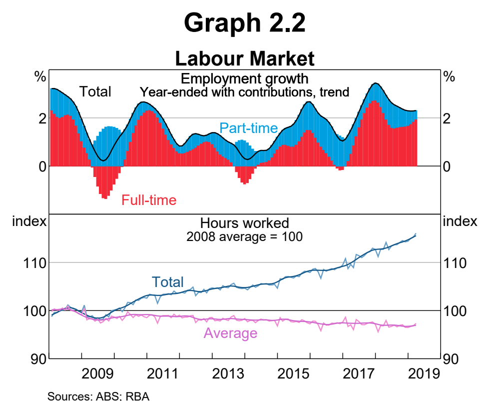
Table 2.1: Demand and Output Growth
Per cent

	December quarter 2018	September quarter 2018	Year to December quarter 2018
GDP	0.2	0.3	2.3
Domestic final demand	0.3	0.5	2.5
– Consumption	0.4	0.3	2.0
– Dwelling investment	–3.4	0.5	2.5
– Mining investment[(a)]	–5.5	–8.0	–13.5
– Non-mining investment[(a)]	2.4	0.8	4.0
– Public consumption	1.8	1.2	5.6
– Public investment	0.8	7.4	8.7
Change in inventories[(b)]	0.2	–0.3	0.0
Exports	–0.7	–0.1	4.7
Imports	0.1	–1.0	1.5
Mining activity[(a)]	–2.5	–2.6	0.3
Non-mining activity[(a)]	0.6	0.7	2.6
Farm GDP	–4.0	–2.4	–5.8
Non-farm GDP	0.3	0.3	2.5
Nominal GDP	1.2	1.0	5.5
Terms of trade	3.2	0.8	6.1

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

(Graph 2.2). This is above the rate of growth in the working-age population. Full-time employment has accounted for most of the growth over the year, partly driven by a pick-up in the rate at which workers are moving from part-time to full-time hours. Average hours worked have been relatively stable over the past year despite the relative strength in full-time employment growth; this is partly because fewer full-time workers are working more than 45 hours per week.

The employment growth over 2018 was largely in three industries: health care & social assistance; construction; and professional, scientific & technical services (Graph 2.3). These industries make up around 30 per cent of total employment. Continued strong growth in health-related jobs reflects both longer-term trends, such as the ageing of the population, as



well the rollout of the National Disability Insurance Scheme (NDIS) across Australia. Construction employment growth has been supported by both residential and non-residential construction activity. Growth in professional, scientific & technical services employment has been broad based across occupations.

There was a strong increase in the number of people with a second job (defined as jobs worked by people in addition to their first job) over 2018. These second jobs are around 7¼ per cent of total filled jobs in the economy. Secondary jobs are most often in the household services sector, such as the health care & social assistance and education industries, and in the administrative & support services industry. It is common for secondary jobs to be in the same industry as the first job. Less timely data suggest that secondary job holders are more likely to be female, in professional occupations, and receiving relatively low incomes from their first job.

By state, employment growth has been concentrated in New South Wales and Victoria over the past year. Employment is historically high as a share of the working-age population in both states, even though population growth has remained strong. In contrast, in other states employment has been broadly unchanged or trended lower as a share of their working-age populations, consistent with relatively more subdued economic conditions across those states.

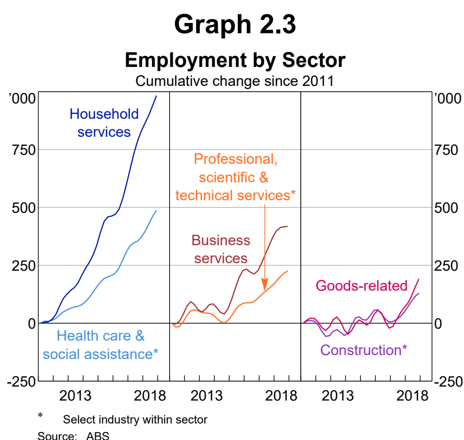
The unemployment rate has declined but some spare capacity remains

After declining by 0.6 percentage points over 2018, the unemployment rate was little changed in the March quarter at 5 per cent (Graph 2.4). This is the lowest level since mid 2011 and lower than expected a year ago. The share of underemployed workers – who want and are available to work additional hours – has also declined a little. As a result, a broader measure of labour market underutilisation, which captures both the hours sought by the unemployed and the additional hours that underemployed people would like to work, declined over the past year, and is also around its lowest rate since 2011. The labour force participation rate was little changed over the past year at just under 66 per cent of the working-age population, which is around historical highs.

Graph 2.3

Employment by Sector

Cumulative change since 2011



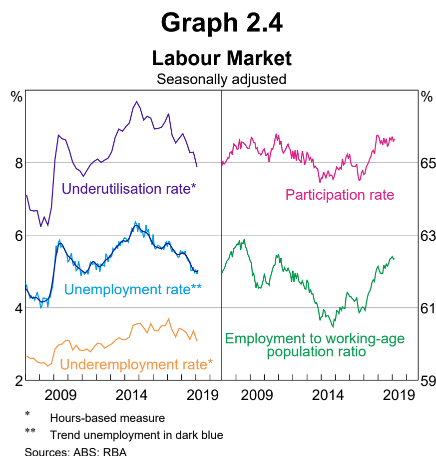
* Select industry within sector

Source: ABS

Graph 2.4

Labour Market

Seasonally adjusted



* Hours-based measure

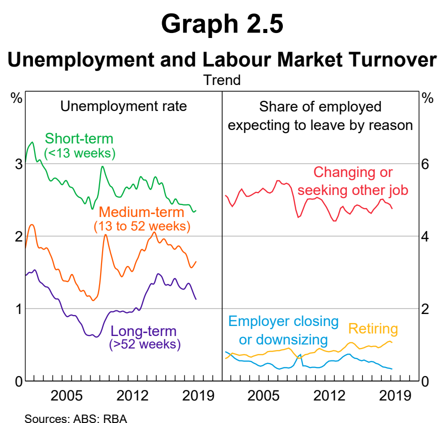
** Trend unemployment in dark blue

Sources: ABS; RBA

A number of other indicators suggest that labour market conditions remain positive and that spare capacity is being absorbed. There has been a notable decline in the rate of medium-term unemployment (between 13 weeks and one year; Graph 2.5). The share of the labour force that has been unemployed for over a year has also started to decline, having been little changed for a number of years. The trend unemployment rates for most age groups have declined over the past year. The youth unemployment rate (workers aged between 15 and 24 years) has declined notably to 11½ per cent; this rate tends to be more sensitive to economic conditions than the unemployment rate of other age groups.

Despite the decline in the unemployment rate over the past year, it is likely that the labour market still has some capacity to absorb additional labour demand before anything more than gradual upward pressure is generated for wage and price inflation. This judgement is based on the historical behaviour of wage and price inflation, as well as the Bank's estimates that, as in a number of other economies, the rate of unemployment consistent with full employment has trended down over several decades.

Consistent with a long period of economic expansion, the share of employed persons expecting to leave their employer over the next year because the employer was closing or downsizing has continued to trend lower. The share of employed persons expecting to leave their current employer voluntarily over the period ahead has declined a little recently. The slow rate of voluntary job turnover is likely to be contributing to low wages growth.



Leading indicators suggest some near-term moderation in employment growth

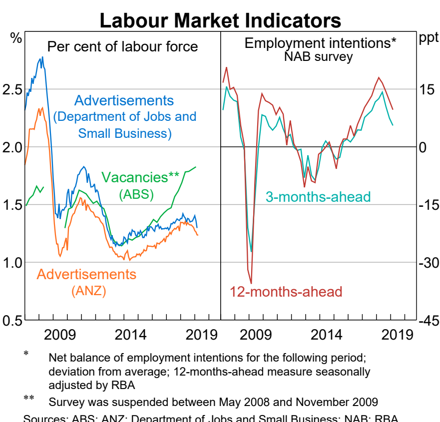
There continue to be mixed signals from the different leading indicators of labour demand. Job vacancies have continued to increase and are at a record high as a share of the labour force (Graph 2.6). In recent quarters there has been particularly strong growth in vacancies in the health care and construction industries. Business employment intentions remain above average according to the NAB quarterly survey and the Bank's liaison program. However, the rate of increase in vacancies has slowed since the first half of 2018 and hiring intentions have declined more recently. The number of job advertisements has also declined in recent months. Overall, the leading indicators point to a moderation in employment growth in the near term.

Household income growth has remained low, which remains a key source of risk for the economic outlook

Growth in household disposable income slowed to 2 per cent over the year to the December quarter 2018, well below its long-run average (Graph 2.7). Labour income grew by 4.3 per cent through 2018, reflecting the ongoing strength in labour market conditions. Growth in non-labour income was subdued. The drought has led to falls in farm sector unincorporated profits.

Softer conditions in the residential construction sector and slower housing turnover are also likely to have weighed on income growth for unincorporated businesses that support activity in the housing market. Strong growth in households' tax payments has subtracted from growth in disposable income over recent years.

Consumption growth has remained stronger than income growth in recent years and the household saving ratio has declined as a result (Graph 2.8). The prospect of continued low growth in household disposable income remains a key risk to the outlook for household consumption, especially given high levels of household debt and the need to service that debt.



* Net balance of employment intentions for the following period; deviation from average; 12-months-ahead measure seasonally adjusted by RBA

** Survey was suspended between May 2008 and November 2009

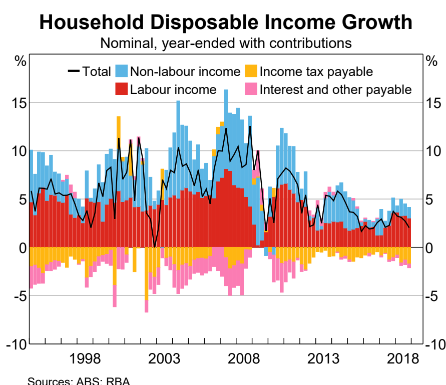
Sources: ABS; ANZ; Department of Jobs and Small Business; NAB; RBA

Housing prices have declined further

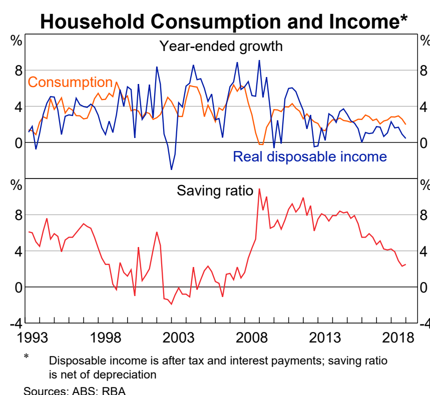
Established housing prices have continued to decline in Sydney, Melbourne and Perth; they are down by around 3 per cent since the previous *Statement* and are around 10 per cent lower over the past year (Graph 2.9; Table 2.2). While the pace of decline in some large cities appears to have moderated somewhat, housing price declines have become more widespread geographically since the start of 2019; prices have contracted a little in most other capital cities and in a larger number of regional areas. Capital city housing prices have now retraced to mid 2016 levels but remain 15 per cent higher than five years ago.

Other indicators of housing market conditions have generally remained weak in recent months. Vendor discounts and days on the market have remained elevated and housing turnover has continued to decline. In contrast, Sydney and Melbourne auction clearance rates have increased over 2019, although they remain low, as do auction volumes (Graph 2.10).

Rental vacancy rates in December 2018 were below their long-run average in most cities



Sources: ABS; RBA



* Disposable income is after tax and interest payments; saving ratio is net of depreciation

Sources: ABS; RBA

Table 2.2: Growth in Housing Prices
Percentage change to April 2019, hedonic

	Three-month-ended[(a)]	Year-ended	Fall since peak[(b)]	Growth over previous 5 years
Sydney	–2.9	–10.9	–15	21
Melbourne	–2.5	–10.0	–11	24
Brisbane	–1.4	–1.9	–2	9
Perth	–2.9	–8.3	–18	–18
Adelaide	–0.2	0.3	–1	12
Canberra	–0.1	2.5	na	23
Hobart	0.0	3.8	na	35
Darwin	–3.9	–7.1	–28	–28
8 Capital City Aggregate	–2.5	–8.4	–10	15
Regional	–1.4	–2.6	–3	12
National	–2.2	–7.2	–8	14

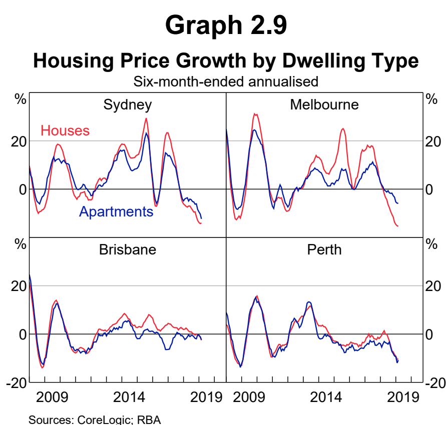
(a) Seasonally adjusted by the RBA

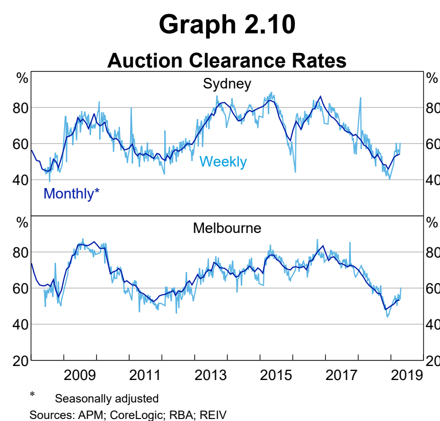
(b) Fall since peak for each city

Sources: CoreLogic; RBA

(Graph 2.11). In contrast, rental vacancies in Sydney have risen, particularly in regions where the supply of new apartments has increased significantly, and advertised rents in Sydney have declined over the past year. Following a sharp decrease in the vacancy rate in Perth, advertised rents have increased over the past year.

Declines in housing prices drove a fall in household net wealth in the second half of 2018 (Graph 2.12). Although further declines in housing prices since the start of 2019 will have weighed further on household net wealth, this should be partially offset by growth in the value of financial assets because equity prices have increased in recent months. As discussed in the



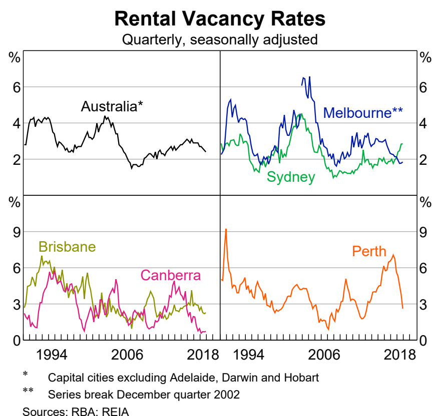


'Domestic Financial Conditions' chapter, growth in household credit has slowed further.

Growth in household spending on discretionary consumption has slowed

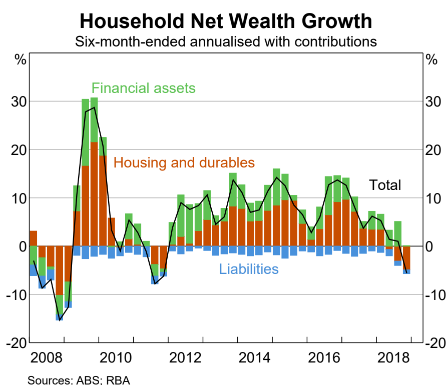
Household consumption growth slowed over 2018, to be 0.4 per cent in the December quarter and 2 per cent in year-ended terms (Graph 2.13). Consumption growth slowed most noticeably for discretionary items that tend to have the strongest relationship with housing-related activity, such as furnishing & household equipment. Contacts in the Bank's liaison program have also noted that the deterioration in housing market conditions is weighing on consumption. Growth in other types of discretionary consumption, such as eating out and recreational activities, has also slowed. In contrast, consumption of 'essential' items continued to grow at a steady pace in the December quarter.

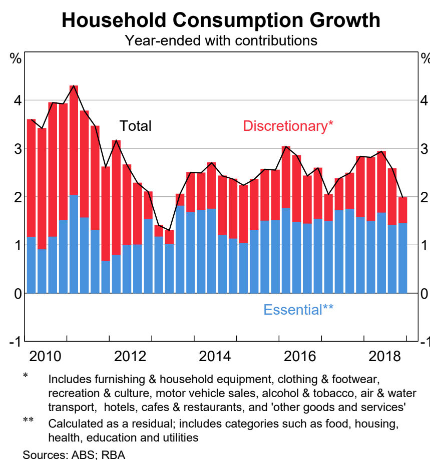
More recent indicators suggest household consumption growth has remained soft in recent months. Retail sales volumes contracted slightly in the March quarter, reflecting a broad-based slowing in growth across categories and states. Sales of new cars to households have increased a little since the start of the year, but remain much lower than a year ago. Households' sentiment towards their own finances has declined over the past year to be below their long-run average level.



Dwelling investment is likely to have passed its peak for this cycle

Dwelling investment declined sharply in the December quarter, and looks to have peaked in the September quarter 2018 (Graph 2.14). Investment in both new dwellings and alterations & additions declined by similar magnitudes. Most of the decline in investment





in new dwellings was accounted for by higher-density investment in New South Wales and detached dwelling investment in Queensland.

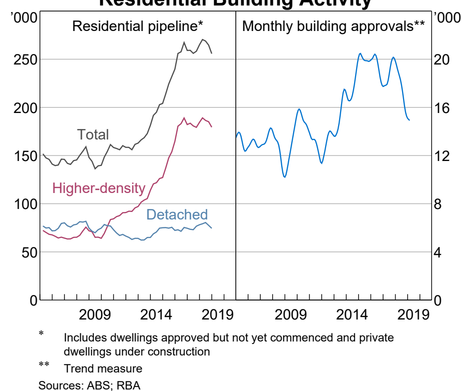
Leading indicators suggest the level of dwelling investment will decline markedly over coming years, although it is difficult to assess the timing of this decline. The pipeline of work to be done remains very large, which should continue to support a high level of dwelling investment in the near term, particularly in Sydney and Melbourne (Graph 2.15). This is consistent with information from firms in the Bank's liaison program that expect construction activity to remain elevated for the next few quarters. However, commencements of new dwelling projects fell sharply in the December quarter. Building approvals have been trending lower for more than a year and imply a much lower level of activity once the current pipeline of work is completed.

Public demand has been robust …

Public demand was 6.3 per cent higher over 2018, and accounted for around half of the growth in domestic final demand over the year (Graph 2.16). Public consumption grew strongly, led by increased spending on the NDIS, aged-care services and other health benefits. Growth in public investment was also strong, in part due to continued investment in infrastructure.

… accompanied by stronger tax revenue

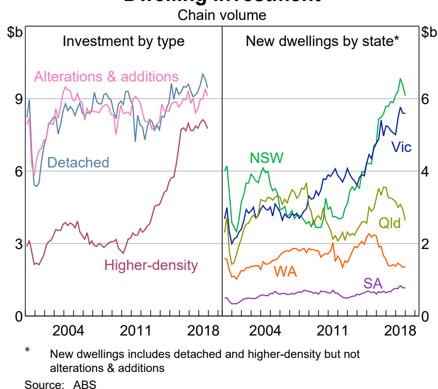
Taxes on household income grew by almost 10 per cent over the year to the December quarter 2018, reflecting very strong growth in tax payments in the June and September quarters, which has weighed on household disposable income growth. The relatively strong growth in household income tax revenue in recent years is likely to have reflected a number



* Includes dwellings approved but not yet commenced and private dwellings under construction

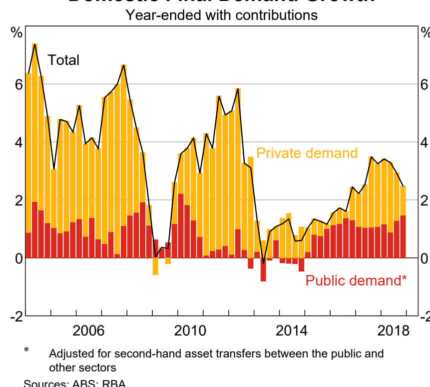
** Trend measure

Sources: ABS; RBA



* New dwellings includes detached and higher-density but not alterations & additions

Source: ABS



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

Sources: ABS; RBA

of factors, including improved compliance, smaller claims for deductions and increased capital gains tax payments. Household income tax revenue as a share of nominal GDP was 12.1 per cent in the December quarter 2018, up from 11.7 per cent a year earlier (Graph 2.17). Corporate income tax revenue as a share of GDP has also increased in recent years, in part because of higher commodity prices increasing corporate profits. Stronger growth in tax revenue has supported an improvement in the financial position of the government sector.

Non-mining investment, including spending on infrastructure, has supported growth

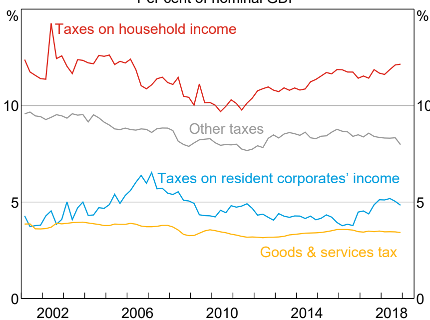
Private non-mining business investment grew by 2.4 per cent in the December quarter to be 4 per cent higher over the year (Graph 2.18). Growth in non-residential construction slowed over the year as building construction eased, but this was partly offset by growth in private infrastructure projects, including roads and renewable energy projects.

Leading indicators point to continued growth in non-mining business investment over the next year or so. The pipeline of work yet to be done on private infrastructure projects has remained elevated over the past year, supported by roads and electricity projects (Graph 2.19). Private non-residential building approvals remain around their average since 2016 and the stock of work yet to be done on private buildings has increased a little further, largely reflecting work underway on offices, short-term accommodation and warehouses. Survey measures of expected capital expenditure and business conditions remain at or above average levels, despite easing over the past year. Recent growth in non-mining profits should support conditions for firms to invest.

Graph 2.17

Taxation Revenue*

Per cent of nominal GDP



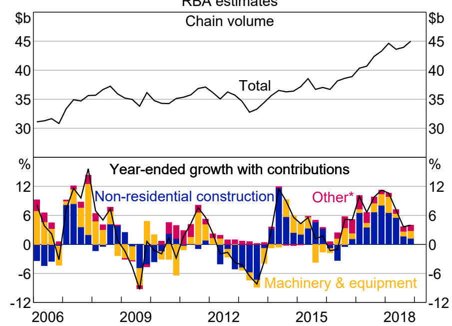
* National accounts basis; income includes capital gains

Source: ABS

Graph 2.18

Private Non-mining Business Investment

RBA estimates

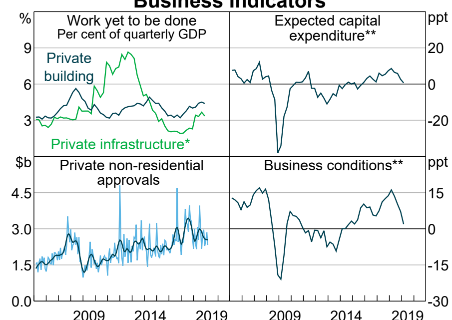


* Includes cultivated biological resources (mainly livestock, vineyards and orchards), computer software, research & development and artistic originals

Sources: ABS; RBA

Graph 2.19

Business Indicators



* Excludes resources and other heavy industry

** Non-mining; NAB survey; net balance, deviation from long-run average

Sources: ABS; NAB; RBA

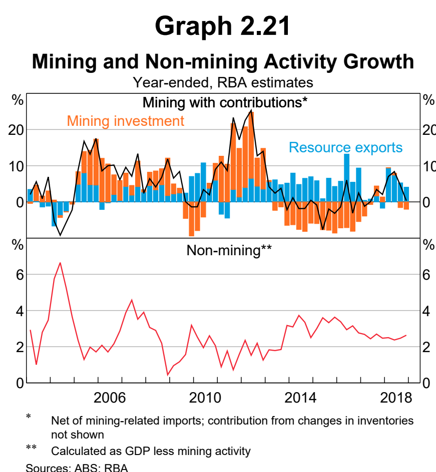
Investment intentions for 2018/19 reported by non-mining firms in the Australian Bureau of Statistics (ABS) Capital Expenditure (Capex) survey point to further growth in both machinery & equipment and buildings & structures investment (Graph 2.20). The first estimate of investment intentions for 2019/20 from the Capex survey suggest that firms expect investment in buildings & structures will increase modestly, while investment in machinery & equipment is expected to ease. However, the first Capex estimate has historically been subject to a large degree of uncertainty.

Mining investment and resource exports are expected to pick up

The mining sector weighed on GDP growth in recent quarters as mining investment declined further and growth in resource exports slowed (Graph 2.21).

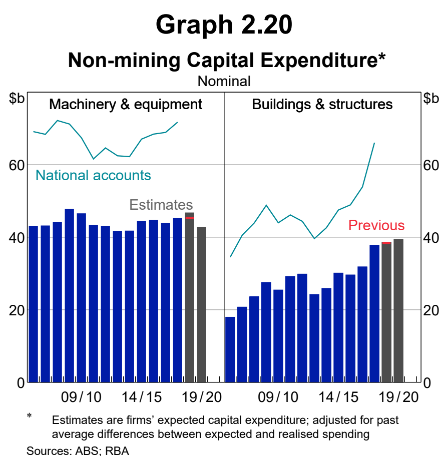
Mining investment declined in the December quarter as construction on the remaining liquefied natural gas (LNG) projects continued to wind down. The decline in the quarter, taken together with the recent Capex survey for 2018/19, suggests that mining investment is around its trough (Graph 2.22). Information from the Capex survey for 2019/20, the Bank's liaison program and recent company announcements suggest that mining investment will pick up gradually over the next year or so as mining firms invest to sustain production levels and, in some instances, expand productive capacity.

Resource exports have increased considerably in recent years because mining investment has increased productive capacity in this sector (Graph 2.23). In particular, LNG exports continue to grow strongly and are expected to increase further over the next year or so as production from the final LNG projects in Western Australia continues ramping up. However, aggregate



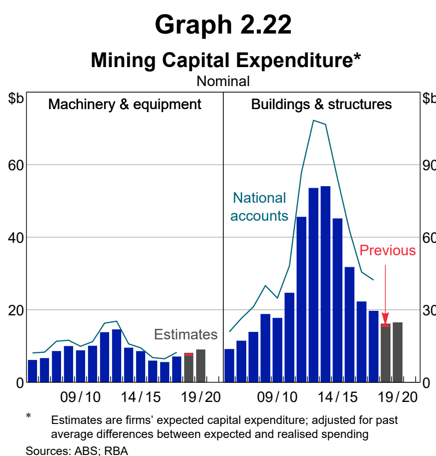
Graph 2.21
Mining and Non-mining Activity Growth

* Net of mining-related imports; contribution from changes in inventories not shown
** Calculated as GDP less mining activity
Sources: ABS; RBA



Graph 2.20
Non-mining Capital Expenditure*

* Estimates are firms' expected capital expenditure; adjusted for past average differences between expected and realised spending
Sources: ABS; RBA



Graph 2.22
Mining Capital Expenditure*

* Estimates are firms' expected capital expenditure; adjusted for past average differences between expected and realised spending
Sources: ABS; RBA

resource exports declined in the second half of 2018, in part reflecting supply disruptions to iron ore and a sharp decline in non-monetary gold exports. Partial trade data for the March quarter suggest that non-monetary gold exports, which can be volatile from quarter to quarter, are likely to have retraced much of their recent decline.

Iron ore exports are expected to have declined in the March quarter, largely because of disruptions arising from Tropical Cyclone Veronica affecting ports in Western Australia. Looking ahead, major miners have recently lowered their annual production guidance for iron ore, and export volumes are likely to pick up gradually over coming quarters. Coal exports have also been affected by weather-related disruptions in Queensland in recent months, which resulted in a port closure for a couple of weeks, and are expected to have declined a little in the March quarter. Increases in customs clearance times at some Chinese ports since early 2019 have added some uncertainty to the medium-term outlook for Australian coal exports.

Unfavourable weather conditions have weighed on the farm sector

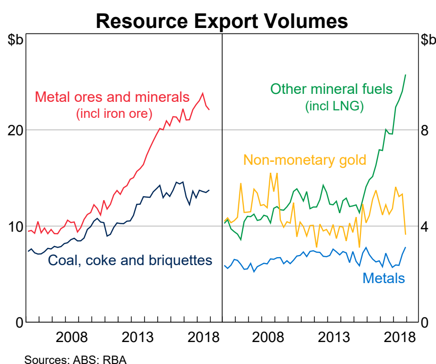
Over the past few quarters, drought conditions in south-eastern Australia and flooding in northern Queensland have adversely affected the rural sector, which has experienced lower crop production, large livestock losses and rising input costs. Since the middle of 2018, when drought conditions started intensifying, farm output has declined by around 6 per cent and farm profits (both incorporated and unincorporated business income associated with the farm sector) have declined by 26 per cent (Graph 2.24).

The unfavourable conditions have also weighed on rural exports. Cereal grain exports have continued to decline in recent quarters as drought conditions have both lowered crop production and seen more domestic production used for feed. In contrast, meat-related exports increased over the year to December 2018, reflecting both drought-induced herd reductions and strong overseas demand.

The most recent climate outlook published by the Bureau of Meteorology indicates that around-average conditions are expected over the next three months across eastern and southern Australia. The 2018 *State of the Climate* report by the Bureau of Meteorology and the Commonwealth Scientific and Industrial Research Organisation presents evidence that seasonal variations in rainfall are occurring against the backdrop of a trend towards drier conditions in the south-west and south-east of

Graph 2.23

Resource Export Volumes

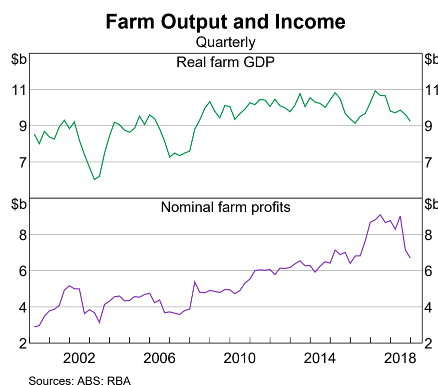


Sources: ABS; RBA

Graph 2.24

Farm Output and Income

Quarterly



Sources: ABS; RBA

the country, which will affect the farm sector over the longer term.

Service and manufactured exports continue to grow steadily

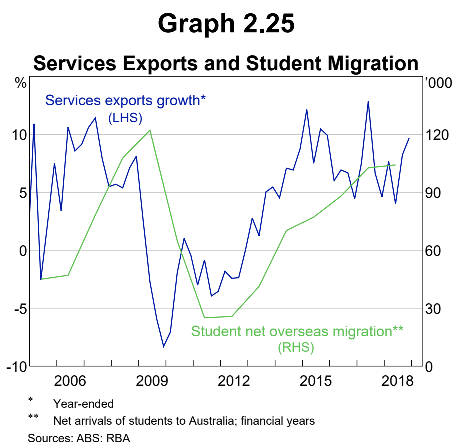
Service and manufactured exports have grown steadily over recent years, supported by the economic expansion in Australia's major trading partners and a modest depreciation of the Australian dollar. Increasing enrolments of overseas students and visitor arrivals should support growth in service exports over the next couple of years (Graph 2.25).

Import volumes increased a little in the December quarter, consistent with continued growth in investment (a relatively import-intensive component of expenditure) but growth in imports moderated over the year (Graph 2.26). Available indicators suggest import volumes are likely to have moderated further in the March quarter.

Higher export prices in the December quarter, which offset lower export volumes and a small increase in the value of imports, saw the trade surplus increase further to its highest level as a share of GDP in 45 years (Graph 2.27). Available data suggest another sizeable trade surplus is expected in the March quarter. Recent increases in the trade surplus have offset some widening in the net income deficit, leaving the current account deficit at relatively low levels. The widening in the net income deficit over the past couple of years is consistent with a pick-up in dividend payments to non-residents because revenues in the largely foreign-owned mining sector have increased. ✠

Graph 2.25

Services Exports and Student Migration



* Year-ended

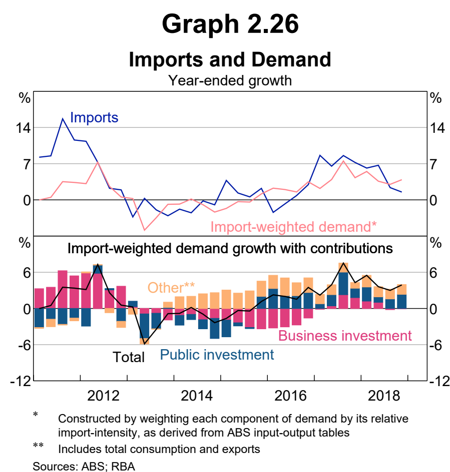
** Net arrivals of students to Australia; financial years

Sources: ABS; RBA

Graph 2.26

Imports and Demand

Year-ended growth



* Constructed by weighting each component of demand by its relative import-intensity, as derived from ABS input-output tables

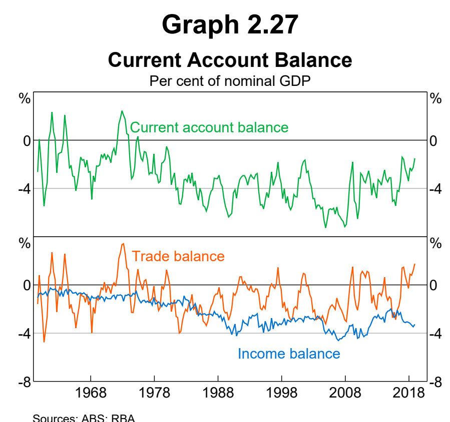
** Includes total consumption and exports

Sources: ABS; RBA

Graph 2.27

Current Account Balance

Per cent of nominal GDP



Sources: ABS; RBA