3. Domestic Economic Conditions

A recovery in economic activity is underway across the country, but is proceeding at an uneven pace. Some industries remain constrained by mandated and voluntary social distancing, particularly in hospitality and tourism, while some other industries are feeling the effects of the broader economic downturn. The recovery has also varied across the country. The recent outbreak in Victoria and the associated strict lockdown measures induced a temporary setback there, but the economic recovery has continued elsewhere. Nationally, more than half of the employment lost in the initial downturn has been regained, but significant spare capacity remains in the labour market.

This recovery follows the biggest peacetime contraction in the Australian economy since the early 1930s. The national accounts confirmed that the Australian economy contracted by 7 per cent in the June quarter, the largest decline since the quarterly accounts began in 1959. The decline in GDP was immense, but less severe than in many other advanced economies because health outcomes here were less severe and policy support was substantial.

The near-term economic outlook will depend significantly on health outcomes, the prevention of the spread of the virus, and advances in medical treatment. The substantial policy stimulus implemented by the Australian and state governments and the Bank has played an important role in supporting the economy and will continue to do so. Policy measures introduced since the start of the pandemic have helped to keep employment relationships intact and have also increased the financial buffers of many households and businesses; an increase in financial buffers is an unusual outcome during an economic downturn. Measures introduced by the Bank have supported financial market functioning and the flow of credit, and reduced interest rates for borrowers. All these measures will encourage a swifter recovery. While earlier fiscal measures were centred on supporting incomes and retaining jobs, recent announcements have been more targeted towards stimulating private demand, which had taken a significant hit because of the pandemic. It is also likely that the disruption to how businesses and households operate, work and consume will lead to some structural change in the economy and entail a period of adjustment. More generally, and as set out in the 'Economic Outlook' chapter, a high degree of uncertainty will be a feature of the outlook for some time.

Domestic COVID-19 cases have fallen significantly

Most states have recorded a small number of new daily COVID-19 cases over recent months, but many of these have been returned travellers in hotel quarantine and there have been few instances of local transmission that are not linked to known contacts. The number of daily domestic COVID-19 cases over recent months has largely reflected case numbers in Victoria; these have declined significantly, from an average of around 270 in July to below 5 in late October, and local transmission has fallen to a few cases per fortnight (Graph 3.1).

Since August, state governments outside of Victoria have generally made targeted adjustments to social distancing restrictions in response to local outbreaks, and have also announced plans to ease restrictions further if health outcomes allow it. Even so, some restrictions are likely to remain in place for some time, possibly until a vaccine becomes widely distributed.

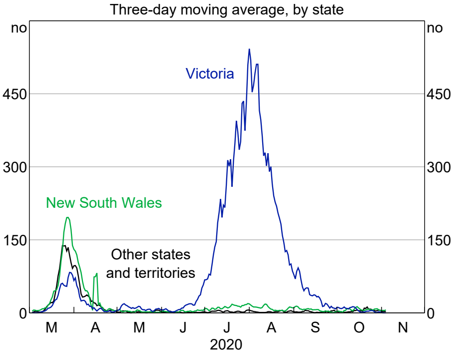
Restrictions in Melbourne have begun to be lifted under the Victorian Government's 'roadmap' for reopening the economy in steps, which seeks to balance reopening the economy and containing the virus. The first target was met in late September, a touch ahead of schedule, and restrictions were relaxed slightly. The next, more substantive, step of reopening started in late October. The last step of the plan, which would bring restrictions on activity in the state broadly in line with other parts of the country, is conditional on reaching a target of no new locally acquired cases in a 14-day period.

Over recent months, individuals have also voluntarily adjusted their behaviour in response to concerns about the spread of the virus. Reflecting a combination of mandated and voluntary responses, indicators of mobility dipped around July and August (Graph 3.2). Given the lockdown measures in Victoria, there was a marked fall in mobility in Melbourne; there was a shallower but still noticeable dip in Sydney, while the other capital cities appeared to have been less affected. Indicators of mobility, outside of Melbourne, have been relatively steady or declined a little over the past month or so and remain below their level at the start of the year in all states. Survey measures of business sentiment have continued to pick up over recent months, while measures of consumer sentiment increased sharply following the release of the Australian Government Budget (Graph 3.3).

Graph 3.1

Confirmed COVID-19 Cases in Australia

Three-day moving average, by state

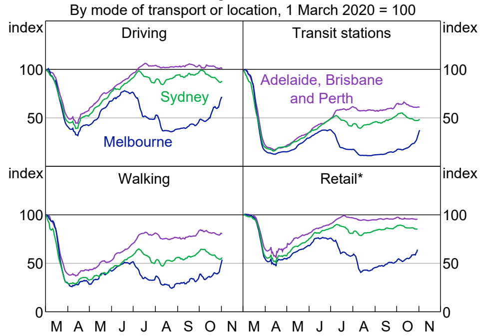


Sources: covidlive.com.au; government health departments; RBA

Graph 3.2

Mobility Indicators

By mode of transport or location, 1 March 2020 = 100



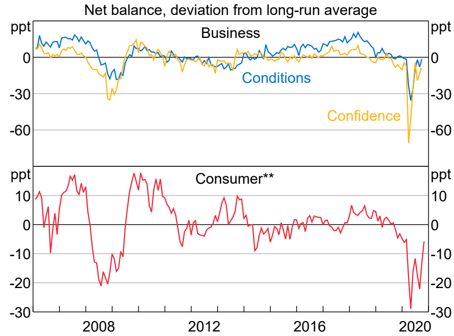
* Retail data are state based

Sources: Apple; Google LLC (2020), 'Google COVID-19 Community Mobility Reports', available at https://www.google.com/covid19/mobility/ viewed on 4 November 2020; RBA

Graph 3.3

Business and Consumer Sentiment*

Net balance, deviation from long-run average



* Latest observations are September 2020 for business confidence and conditions and October 2020 for consumer confidence

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

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

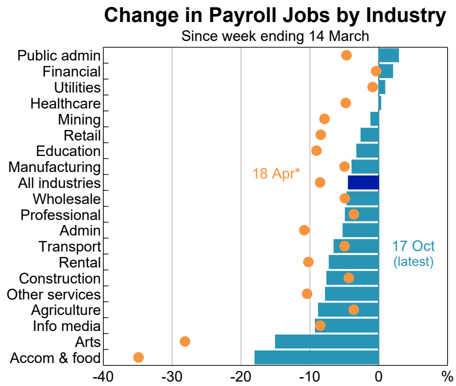
Employment was quick to rebound initially, but the improvement has slowed more recently

Employment and hours worked remain well below their pre-pandemic levels, as does activity. The initial recovery in employment was faster than had been earlier expected, but the pace of improvement has slowed since August. This slowing at the national level has been partly driven by developments in Victoria; between July and September employment there decreased by 2.2 per cent while increasing by 1.9 per cent in the rest of Australia (Graph 3.4). Timelier payroll data indicate that the number of payroll jobs nationally are a bit lower than they were in August.

Labour market conditions initially improved quickly once health-related restrictions started to be eased from May. Of the 870,000 employment losses between March and May, about half have since been recovered, but employment in September was still 3.3 per cent lower than in March. Increases in employment have been broad based across industries, although the number of payroll jobs remains below pre-pandemic levels in most cases (Graph 3.5).

Consistent with the increase in employment, total hours worked nationally have recovered about half of their initial fall; the recovery has been stronger outside of Victoria but hours worked remain well below their previous level (Graph 3.4). Average hours worked have almost fully recovered for part-time workers, as activity has picked up in industries that employ a relatively large share of part-time workers, such as hospitality. However, average full-time hours have recovered only about half of their initial fall (Graph 3.6). In September, around 900,000 employees were working reduced hours for economic reasons, over half of whom were full-time workers. The number of people working reduced hours has steadily fallen in recent months in most states and is around half the number in April, but has remained elevated in Victoria.

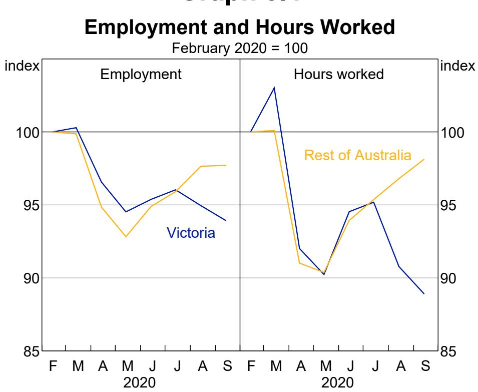
Graph 3.5



* The lowest weekly value of the aggregate payroll jobs index

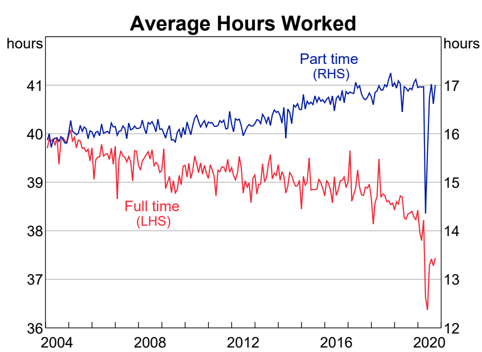
Sources: ABS; RBA

Graph 3.4



Sources: ABS; RBA

Graph 3.6



Sources: ABS; RBA

Unemployment and other measures of underutilisation remain high

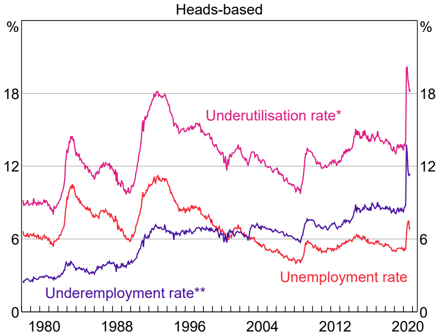
The unemployment rate increased from 5.2 per cent in March to 6.9 per cent in September (Graph 3.7). The rise in unemployment has been smaller than initially expected, in part because much of the labour market adjustment to the downturn was through employees working fewer hours while retaining their jobs, rather than becoming unemployed. The retention of employees during this period has been strongly underpinned by the JobKeeper program. Consistent with many employees working fewer hours, broader indicators of spare capacity in the labour market remain high. The heads-based underemployment rate was around 11½ per cent in September, having declined a little from its highest ever rate in April. Hours-based measures of underutilisation – which reflect the additional hours that unemployed and underemployed people would like to work – have also declined from their recent peaks, but remain elevated. The number of people working zero hours for economic reasons in September 2020 was still around four times as high as in September 2019.

Another key driver of the smaller-than-expected increase in the measured unemployment rate since the pandemic began has been a sharp decline in labour market participation. In particular, of those people who lost employment, a large share exited the labour force (at least temporarily); in many cases these people were able to access government income support programs (such as JobSeeker) that were expanded in response to the pandemic. Although the number of people outside the labour market has been steadily declining over recent months, there are still more than 200,000 people who left the labour force early in the pandemic and are yet to return, most of whom are in Victoria. As restrictions continue to ease, it is likely that more people will look to re-enter the labour force, encouraged by increasing employment opportunities and tighter JobSeeker eligibility criteria (JobSeeker mutual obligation requirements for recipients outside of Victoria were reinstated in August). To help gauge the effect of these various factors, the ABS provides some alternative measures of unemployment that include employees working zero hours and those employees who moved out of the labour force in March and are yet to return; these measures have declined in recent months but remain elevated (Graph 3.8).

Graph 3.7

Labour Underutilisation Rates

Heads-based



* Sum of the unemployment and underemployment rates

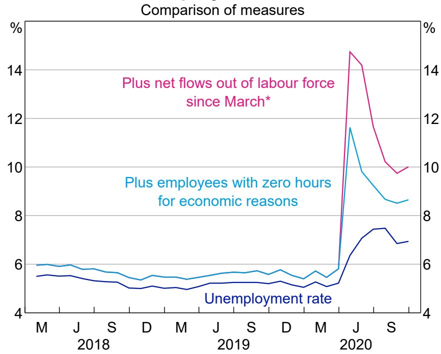
** Full-time workers on reduced hours for economic reasons and part-time workers who would like, and are available, to work more hours

Sources: ABS; RBA

Graph 3.8

Unemployment Rate

Comparison of measures



* 'Effective unemployment rate' used by government

Sources: ABS; RBA

The jobs outlook remains subdued, but is improving

Forward-looking indicators of employment such as job advertisements and vacancies have picked up since May, but remain lower than their pre-pandemic levels (Graph 3.9). Surveys and information from business liaison indicate that employment intentions have improved but remain subdued, and are mixed across industries. An elevated share of firms still expect to reduce headcount over the year ahead, but an increasing number of firms report that they expect to lift headcount or reinstate regular hours, contingent on continued improvement in business conditions. Contacts expecting to remain eligible for the JobKeeper extension tend to be exposed to travel or tourism, or have experienced significant revenue loss because of the restrictions in Melbourne.

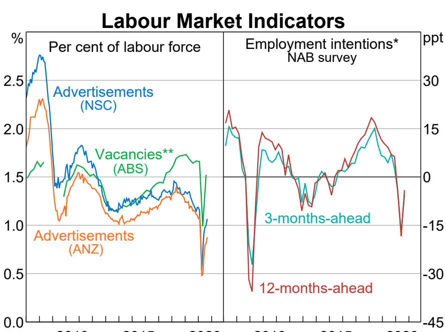
The Australian Government Budget contained further substantial fiscal support for the economy …

Following the outbreak of the pandemic, the Australian and state governments announced fiscal policy measures aimed at limiting the contraction in activity and large-scale losses of employment. The initial packages of fiscal support from the Australian Government were centred on the JobKeeper program, cash flow support for businesses and increased social assistance payments. State and territory governments also provided support to households and businesses, mainly in the form of relief from taxes and fees and increased funding of public services.

More recent policies announced in the 2020/21 Australian Government Budget, released in early October, were targeted at supporting the recovery. The measures included bringing forward tax cuts to households and expanding and extending depreciation allowances to encourage business investment (Graph 3.10). Additional expenditure on infrastructure was also announced.

The net fiscal impact of the Australian Government Budget on the economy is equivalent to around 7 per cent of GDP in 2020/21. This is mostly reversed over subsequent years. The fiscal deficit of the Australian Government is expected to increase to 11 per cent of GDP in 2020/21, as a result of the significant fiscal support provided by COVID-19 stimulus policies and the decline in revenue alongside the decline in activity. This represents the largest

Graph 3.9

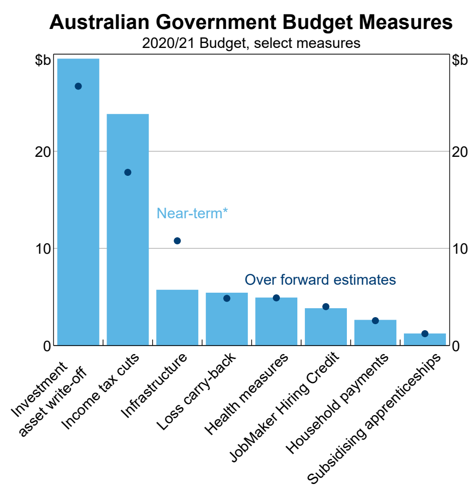


* Net balance for the following period; deviation from average; 12-months-ahead measure seasonally adjusted by the RBA

** Survey was suspended between May 2008 and November 2009

Sources: ABS; ANZ; NAB; National Skills Commission (NSC); RBA

Graph 3.10



* Cost over the next two financial years, except for the investment asset write-off and loss carry-back, which shows the cost over 2021/22 and 2022/23

Source: Australian Treasury

peacetime Australian Government fiscal deficit observed in Australia. By 2023/24, the deficit is expected to have declined to 3 per cent of GDP; at that time, new policy measures would no longer be contributing to the deficit, which would be driven instead by general government spending and automatic stabilisers such as ongoing elevated unemployment benefit payments and reduced taxation revenues. While Australian Government debt has increased due to spending measures and lower revenue, interest payments are still expected to decline as a share of GDP over the forecast period, reflecting the decline in interest rates to historically low levels (Graph 3.11).

As well as supporting households and businesses by adjusting taxes and transfers, the Australian and state governments have added to demand directly by the provision of public goods and services. Public consumption increased by 3 per cent in the June quarter, and was the main source of expenditure growth in the economy, led by state and local government spending. Public investment is likely to increase over coming quarters as 'shovel ready' projects get underway.

… and policy measures have continued to support household cash flow

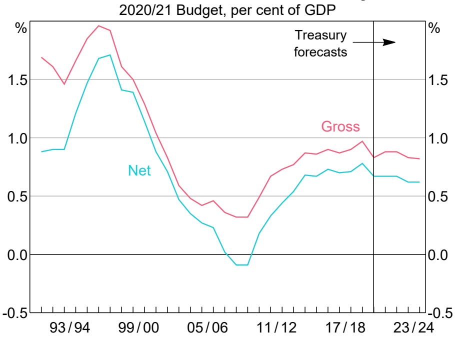
Policy measures have provided significant support to household cash flow. As a result, household disposable income increased in the June quarter, despite the large contraction in economic activity, and is expected to have increased further in the September quarter (Graph 3.12). Income support has mostly come from the JobKeeper program, which increased unincorporated business income and supported labour income, and from the temporary increase in social assistance payments. Eligibility for JobKeeper was tightened in late September and payments were reduced, in particular for part-time workers. (For a discussion of income support policies in other economies, see 'Box A: Income Support Policies for Advanced Economies during the COVID-19 Pandemic'.)

Household cash flow has been further boosted for those households who made early withdrawals from superannuation since April; these withdrawals have totalled $35 billion, equivalent to around 10 per cent of quarterly household disposable income. In aggregate, the increase in cash flow from these sources has been partly offset by a decline in other income, partly driven by a fall in financial income alongside steep declines in equity prices earlier in the year.

Graph 3.11

Australian Government Interest Payments

2020/21 Budget, per cent of GDP

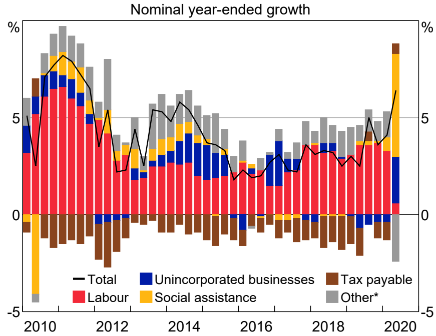


Source: Australian Treasury

Graph 3.12

Household Disposable Income

Nominal year-ended growth



* Includes financial income, interest payable and other

Sources: ABS; RBA

The Australian Government Budget included policies that will provide additional support to many households in 2020/21. In addition to bringing forward tax cuts, the low and middle income tax offset will continue to be available for this financial year. These measures are expected to reduce household income tax by around $24 billion over the next two years, mostly concentrated in 2021/22. Pensioners and some other households will also receive two $250 payments, to be paid from November 2020 and early 2021, in addition to the two payments of $750 received earlier this year.

Income support has enabled a swift rebound in spending since restrictions were lifted

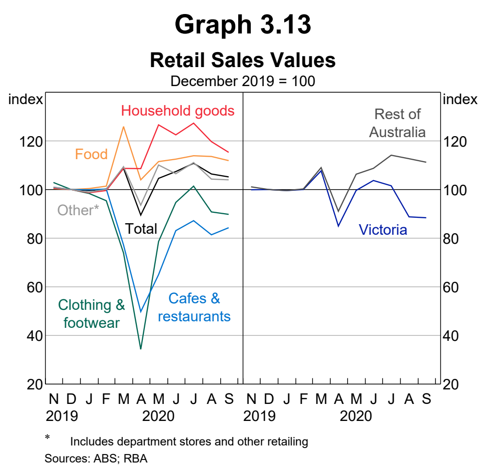
A range of partial indicators suggest household spending has partly recovered over the past six months, supported by the easing in restrictions on activity and policies to support household cash flow. After declining by 13 per cent over the first half of the year, household consumption is forecast to increase by close to 10 per cent over the second half.

Consumption patterns have shifted considerably as households and retailers have adjusted to restrictions. Sales of household goods and food remained elevated in September. Spending at cafes & restaurants improved but remained below its pre-COVID level (Graph 3.13). Online retail sales continued to grow strongly in recent months, to account for more than 10 per cent of total retail sales. Sales of motor vehicles also increased strongly in many states.

Spending on discretionary services has remained weak compared with other types of consumption, although there are signs of improvement in some areas as restrictions ease. For example, payments data and information from the Bank's liaison program point to an increase in domestic travel spending from its trough in the June quarter. Some of this expenditure is likely to be instead of overseas travel, as spending by Australians travelling overseas typically accounts for around 5 per cent of consumption.

The prevalence of the virus and the accompanying activity restrictions weighed heavily on household spending in Victoria in the September quarter. Retail sales fell sharply in August, and information from the Bank's liaison program indicates that store closures severely impacted sales growth in Melbourne. Retailers anticipate that conditions will improve substantially alongside health outcomes and as trading restrictions are eased over coming months.

The increase in household income and contraction in consumption in the June quarter meant the household saving rate increased sharply to 20 per cent, the highest it has been since 1974 (Graph 3.14). Much of the increase in the saving rate was due to restrictions on household activity and reduced opportunity to consume in the quarter, but precautionary savings by some households concerned about future income would also have contributed. Some survey indicators suggest that households in most income brackets had a higher rate of saving over recent quarters; but that is likely to obscure some significant variation within each group. Households are expected to consume a



larger share of their income as opportunities to spend increase and household income declines alongside the tapering in fiscal policy support.

Housing market conditions across the country are uneven

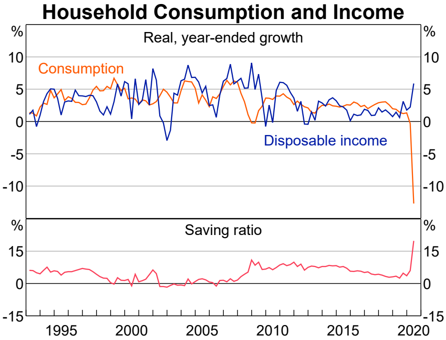
Housing prices in Melbourne and Sydney have declined since the August *Statement*, while prices have increased in the other capital cities and regional Australia (Graph 3.15). New listings have increased in most cities since August, but remain a little below average for this time of year (Graph 3.16). The exception was Melbourne, where new residential property listings fell sharply because of the restrictions that were in place, but rebounded strongly in October as restrictions on in-person auctions and inspections were lifted. Auction clearance rates declined in September to below 40 per cent in Melbourne, and many scheduled auctions were withdrawn, but recovered to around 60 per cent in October. Auction clearance rates in Sydney have increased to around 70 per cent over the same period, and auction volumes have been around average.

Rental vacancy rates remain elevated in Sydney, and have increased further in Melbourne (Graph 3.17). Advertised rents in Sydney and Melbourne have declined, driven by apartment rents. By contrast, vacancy rates have declined and rents have increased strongly in Perth, where lower dwelling investment in previous years has limited the supply of new rental stock. More generally, lower rental income could present cash flow challenges for some property investors if weak rental market conditions continue, and may also weigh on investor demand for new properties.

Policy is supporting detached housing construction

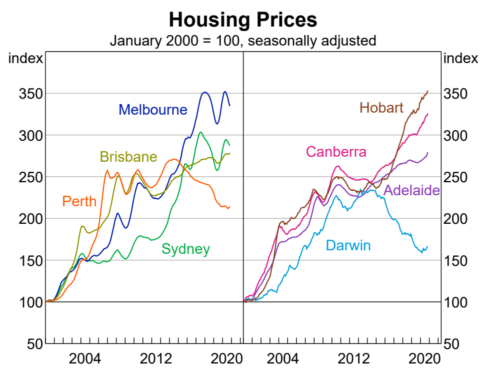
Fiscal and monetary policy measures are supporting conditions for detached residential construction in the near term. Building approvals for detached dwellings rose strongly over the September quarter (Graph 3.18). Survey measures of new orders for detached homes

Graph 3.14



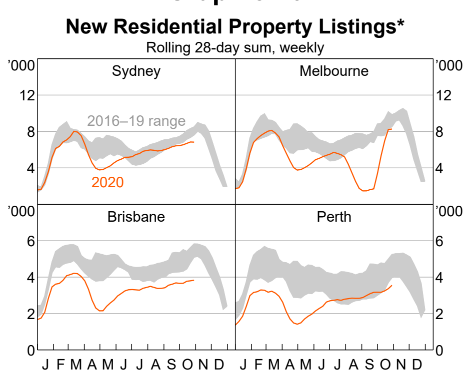
Sources: ABS; RBA

Graph 3.15



Sources: CoreLogic; RBA

Graph 3.16



* Properties advertised for sale across multiple sources or multiple times in the same 28-day period are only counted once

Sources: CoreLogic; RBA

have increased, although liaison has suggested that sales of greenfield land and new homes have moderated a little following a period of strong demand driven by policy measures, including the Australian Government's HomeBuilder scheme. Liaison indicated that the time limits to qualify for HomeBuilder have caused some builders to reach capacity for the remainder of the year. State government policies are also supporting demand, particularly in Western Australia. The value of large alterations & additions has also increased strongly in recent months.

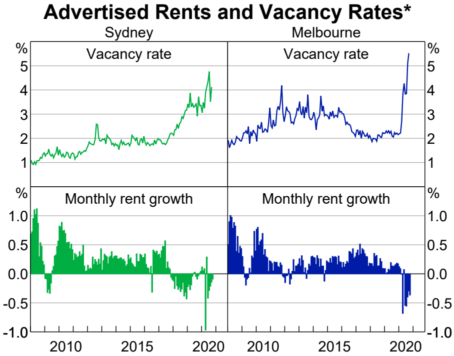
Construction activity in Melbourne was curtailed by limits on the number of workers allowed on construction sites and restrictions on movements between construction sites in August and September, and to a lesser extent in October. Victoria typically accounts for around one-third of national construction activity, so these restrictions weighed on dwelling and non-residential building investment in the September quarter.

Approvals for higher-density dwellings remain very low nationally. The strict timelines on the HomeBuilder scheme mean that higher-density construction projects are unlikely to qualify. Developers have reported that sales of off-the-plan apartments remained weak, with some developers delaying commencements of planned projects.

Forward-looking indicators for non-residential construction activity have weakened further; private non-residential building approvals have fallen significantly, and commencements of new private building projects fell in the June quarter (Graph 3.19). As the existing pipeline of commenced projects is worked through in coming quarters, non-residential construction activity is expected to fall. The pipeline of non-mining infrastructure work also eased further in the June quarter, led by renewable electricity projects.

Graph 3.17

Advertised Rents and Vacancy Rates*

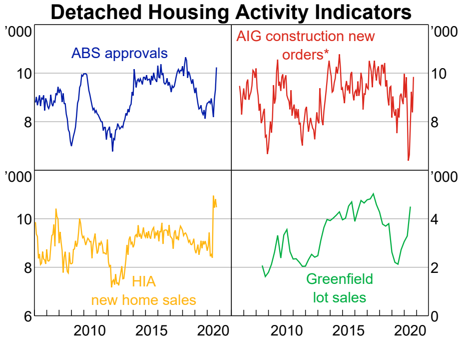


* Seasonally adjusted

Sources: CoreLogic; RBA; REINSW; REIV

Graph 3.18

Detached Housing Activity Indicators

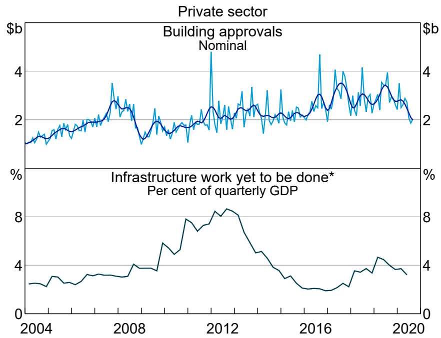


* Rescaled to have the same mean and variance as ABS approvals

Sources: ABS; AIG; HIA; RBA; Research4

Graph 3.19

Non-residential Construction Indicators



* Excludes resources and other heavy industry

Sources: ABS; RBA

Policy has also cushioned the decline in business investment

Non-mining business investment, including non-residential construction, fell by 5 per cent in the June quarter, to be 9 per cent lower over the year. While sharp, the fall in investment was smaller than had been expected. This was largely because the fall in machinery & equipment investment was moderated by a significant take-up of tax incentives for investment that were announced in March, such as the expanded instant asset write-off. Investment in computer software and research & development also fell in the quarter.

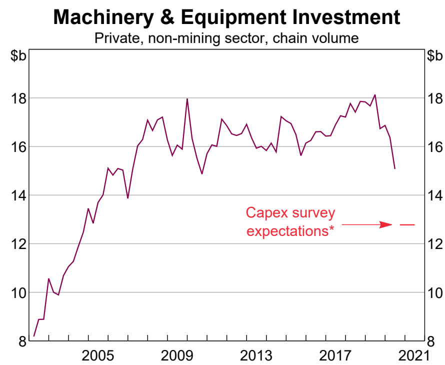
Firms' expectations for investment were little changed in the most recent ABS Capital Expenditure (Capex) survey, which was conducted in July and August. Firms continue to report that they will substantially reduce investment this financial year, including in machinery & equipment (Graph 3.20). All industries expect to reduce investment over the coming year (Graph 3.21). However, the Capex survey was conducted prior to the October Australian Government Budget, which expanded and extended tax incentives for business investment. These policies are expected to reduce the fall in machinery & equipment investment over the next two years by easing cash flow constraints (especially for small businesses) and encouraging firms to bring forward spending. Take-up of the policies is also expected to increase as the economic recovery continues and firms become more confident about future demand.

Mining sector investment increased by 1 per cent in the June quarter as work on replacement iron ore projects continued. Investment expectations from liaison and the Capex survey continue to suggest a modest increase in spending in the year ahead, driven by further work on iron ore and coal projects (Graph 3.22).

The pandemic has interrupted Australia's trade

Australia's trade in goods and services has fallen sharply since the outbreak of COVID-19 (Graph 3.23). Restrictions on international travel resulted in a collapse in exports and imports of tourism, education and passenger transport services. These are unlikely to recover until international travel restrictions are eased, which is assumed to take place around the end of 2021 (see 'Economic Outlook' chapter). At the same time, exports of resources and rural goods have

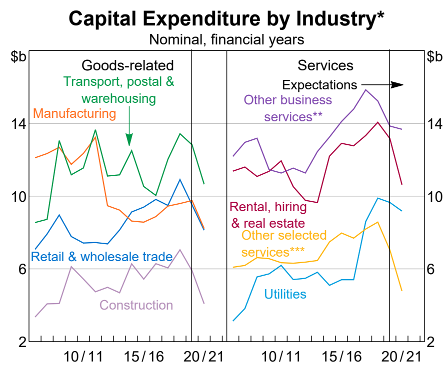
Graph 3.20



* Average real quarterly spending implied by firms' expectations; adjusted for past average differences between expected and realised spending, and deflated using RBA forecast for the implicit price deflator

Sources: ABS; RBA

Graph 3.21



* Non-mining industries included in the ABS capital expenditure (Capex) survey; expectations are firms' estimates of capital expenditure; adjusted for past average differences between expected and realised spending

** Includes information media & telecommunications, finance & insurance, and professional, scientific & technical services

*** Includes accommodation & food, administrative & support services, arts & recreation, and other services

Sources: ABS; RBA

declined, and imports of consumption and investment goods have fallen in line with weaker domestic demand. The decline in imports was larger than in exports over the first half of the year, so the trade surplus was higher on average. That said, the surplus has been generally narrower in recent months, driven by a pick-up in goods imports, which reflects the recovery in domestic demand.

Resource exports declined by around 2 per cent over the first half of the year. The decline was led by lower coal exports because global demand for coal has been weak and some producers scaled back production in response to lower prices (Graph 3.24). By contrast, iron ore export volumes increased further and reached a record level in the June quarter; producers sought to capitalise on higher iron ore prices. However, partial trade data and information from the Bank's liaison program suggest that iron ore export volumes declined in the September quarter as Australian firms undertook maintenance, and liquefied natural gas (LNG) export volumes were affected by extended maintenance at some LNG facilities and weak global demand. Coal exports also look to have declined further in recent months.

Goods imports were very weak in the June quarter, but have picked up more recently in line with the recovery in domestic demand. Imports of motor vehicles have recovered particularly strongly, following a pick-up in vehicle sales as a result of the significant take-up of tax incentives for investment in the June quarter.

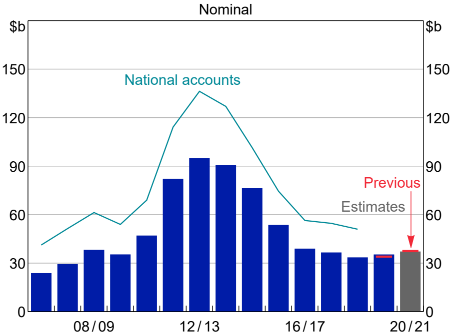
The outlook for the rural sector remains favourable

The Bureau of Meteorology has declared that La Niña is underway. This weather pattern typically results in above-average rainfall across eastern Australia during spring and summer; this generally provides favourable growing conditions for cereals, although it also increases the risk of flooding (Figure 3.1). At the same time, improved pasture conditions will continue to support farmers to further rebuild herds and

Graph 3.22

Mining Capital Expenditure*

Nominal



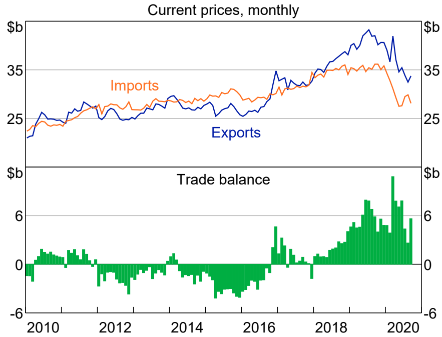
* Estimates are firms' expected capital expenditure; adjusted for past average differences between expected and realised spending

Sources: ABS; RBA

Graph 3.23

Trade in Goods and Services

Current prices, monthly

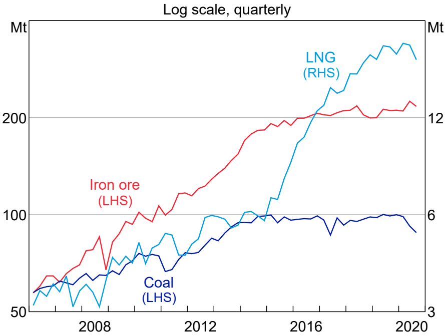


Sources: ABS; RBA

Graph 3.24

Resource Exports*

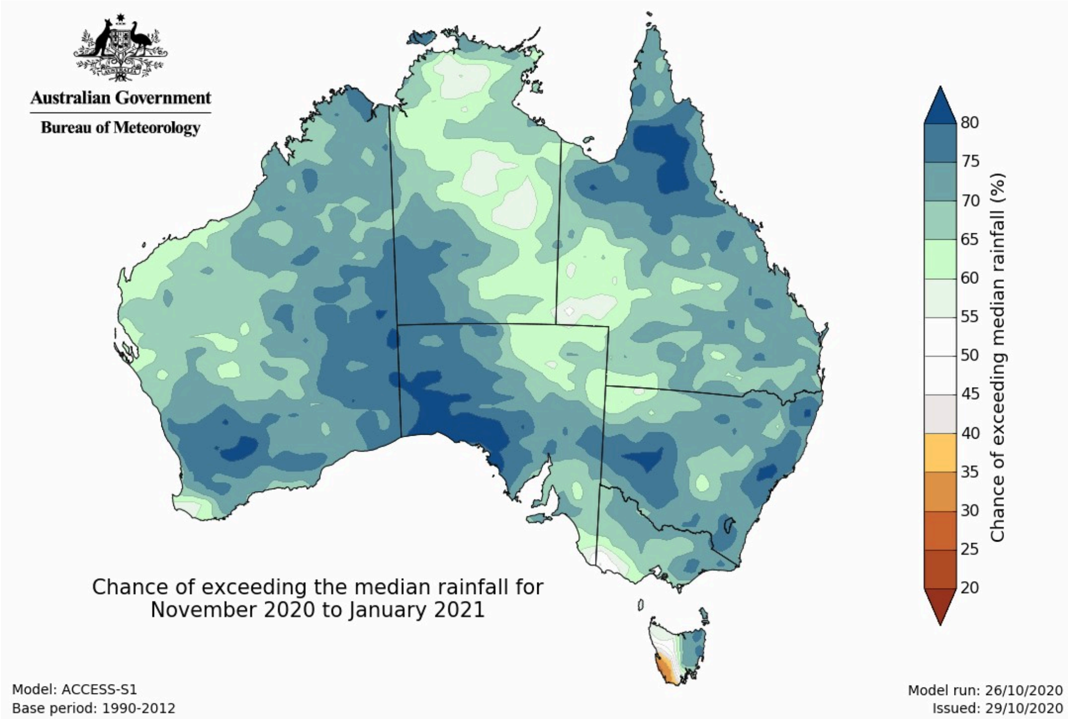
Log scale, quarterly



* Seasonally adjusted by the RBA

Sources: ABS; RBA

Figure 3.1 : Chance of Exceeding Median Rainfall



flocks, after the drought left the number of sheep and cattle in Australia at record lows. Accordingly, the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) expects crop production to increase strongly in 2020/21, while meat production is expected to decline (Graph 3.25).

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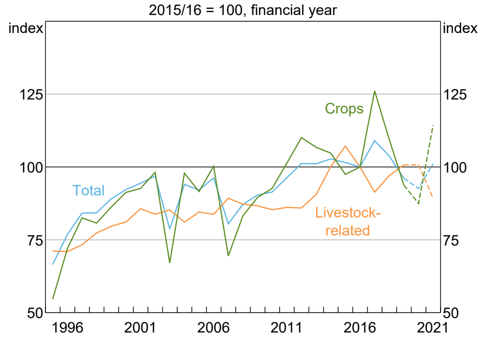
The pandemic has had a limited impact on agricultural production to date, although weaker demand has weighed on prices for some higher-value agricultural goods. Horticultural harvests later in the year could be affected by international and domestic border restrictions, which could disrupt the supply of labour, even with government exemptions to travel restrictions that would allow the movement of some agricultural workers across borders. Since the start of the year, Chinese authorities have

Graph 3.25

Farm Production Volumes*

2015/16 = 100, financial year



* Dotted lines represent ABARES' preliminary estimates for 2019/20 and forecasts for 2020/21

Sources: ABARES; RBA

introduced import restrictions and tariffs on certain agricultural exports from Australia; these will materially affect some sectors directly targeted by the measures. ✠