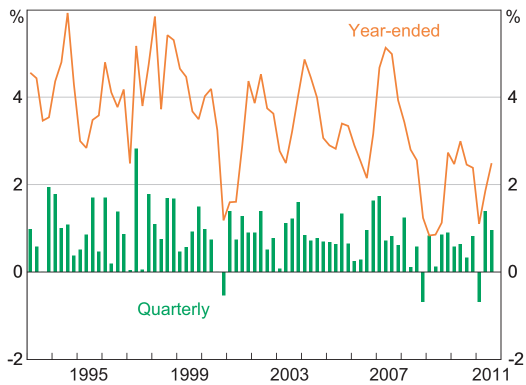
3. Domestic Economic Conditions

Output growth in the Australian economy is estimated to have been a little above trend over the second half of 2011, largely reflecting very strong growth in mining investment and the ongoing recovery in mining production from the extreme weather events earlier in the year (Graph 3.1, Table 3.1). National income was also boosted by higher commodity prices, with the terms of trade reaching their highest level on record in the September quarter. The outlook for mining investment remains very strong, with further announcements of new projects over recent months. In contrast, conditions are more subdued in some other industries, as the high level of the exchange rate, tight credit conditions for some sectors, the decline in public investment and changes in household spending behaviour continue to weigh on activity in the manufacturing, building construction and retail industries. More broadly, measures of consumer and business sentiment are around or a little below long-run average levels, in part reflecting concerns about developments overseas. The unemployment rate has been around 5¼ per cent in recent months, after increasing in mid 2011.

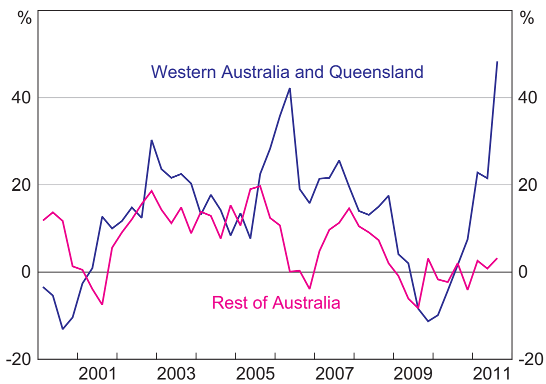
The variation in conditions across industries is also seen in regional outcomes. In resource-rich Western Australia and Queensland, demand is being driven by very strong growth in mining investment (Graph 3.2). Consistent with firm labour market outcomes, consumer spending has also been strong in Western Australia. In contrast, in the rest of Australia domestic demand has increased only modestly in recent quarters.

Graph 3.1
GDP Growth



Source: ABS

Graph 3.2
Business Investment Growth by State
Year-ended



Sources: ABS; RBA

Table 3.1: Demand and Output Growth
Per cent

	September quarter 2011	Year to September quarter 2011
Domestic final demand	2.1	4.6
– Private demand	3.6	6.7
– Public demand	–2.8	–1.9
Change in inventories[(a)]	–0.8	0.2
GNE	1.2	4.7
Net exports[(a)]	–0.6	–2.7
GDP	1.0	2.5
Nominal GDP	1.6	6.1

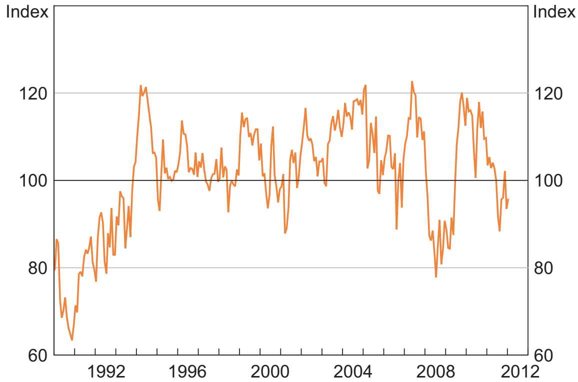
(a) Contribution to GDP growth
Source: ABS

Household Sector

Over the year to the September quarter, consumer spending grew at an around trend pace and broadly in line with growth in disposable incomes. More recently, the available indicators suggest the pace of consumer spending has moderated, with growth in retail sales volumes and motor vehicle sales slowing in the December quarter. While consumer confidence has recovered somewhat following the sharp decline in mid 2011, it remains below its long-run average (Graph 3.3). Sentiment is likely being affected by developments overseas, falls in asset prices and the softening in labour market conditions over 2011. Indeed, the proportion of household survey respondents recalling overseas news and news related to economic conditions rose sharply in December.

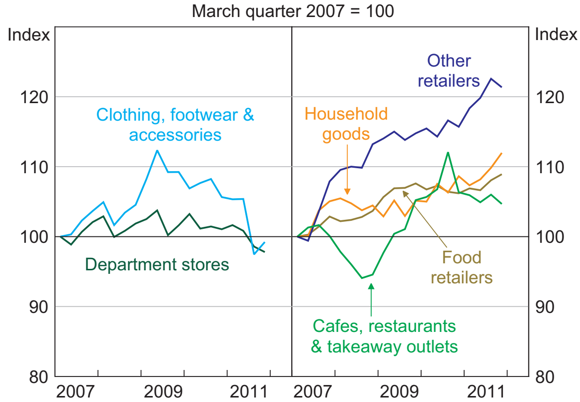
Consumer spending on goods has generally been quite weak over the past year, particularly spending in department stores and on clothing, footwear & accessories (Graph 3.4). While there are no official data on the total value of online purchases, there is some evidence that online purchases of goods have grown strongly over the past year. The value of international electronic purchases – which includes payments made by Australians travelling overseas as well as online purchases from overseas merchants – increased by 6 per cent over the year to November,

Graph 3.3
Consumer Sentiment
Average since 1980 = 100



Source: Melbourne Institute and Westpac

Graph 3.4
Retail Sales Volumes
March quarter 2007 = 100



Source: ABS

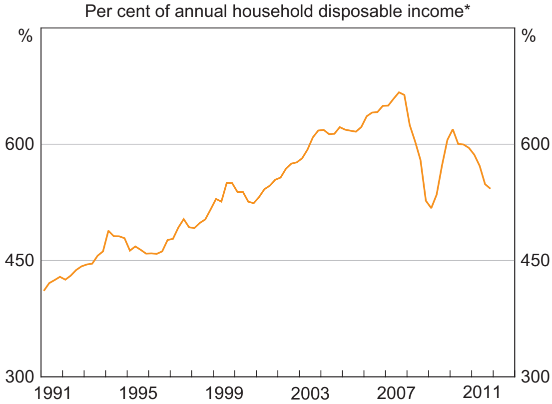
although online purchases remain a small share of total retail purchases.[1] Growth in spending on services has been stronger than that on goods, with services consumption up around 4 per cent over the year to the September quarter.

Household wealth is estimated to have grown slightly in the December quarter, but was around 2½ per cent lower over the year, with a 3½ per cent fall in average dwelling prices more than offsetting a small rise in the value of financial asset holdings over the year. The ratio of net wealth to household disposable income was just under 5½, after having been over 6½ in late 2007 (Graph 3.5).

In contrast to wealth, incomes have been growing strongly. Real household disposable income increased by 2.1 per cent in the September quarter to be 4½ per cent higher over the year, with nominal incomes almost 7 per cent higher over the year (Graph 3.6). Households have continued to devote a significant portion of their income to rebuilding assets and paying down debt – the household saving ratio has been around 10 per cent over the past three years and well above levels recorded in the 1990s and early 2000s. With income growing a little faster than debt, the household debt-to-income ratio has declined somewhat, although it remains high by historical standards (Graph 3.7).

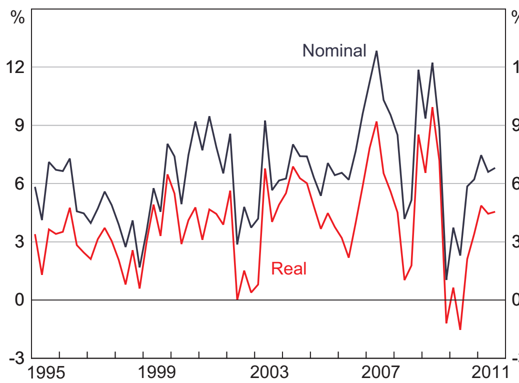
Australian capital city dwelling prices declined a little through most of 2011, although there were some tentative signs of stabilisation towards the end of the year. Prices were around 3½ per cent lower over the year and fell by around ½ per cent in the December quarter (Graph 3.8, Table 3.2). Brisbane, Perth and

Graph 3.5
Household Net Worth
Per cent of annual household disposable income*



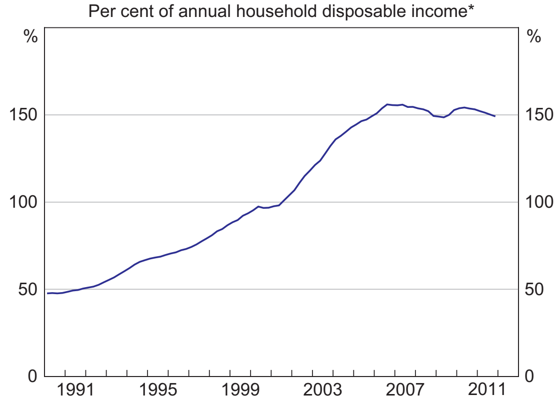
* Household sector includes unincorporated enterprises; disposable income is after tax and before the deduction of interest payments; RBA estimate for December quarter 2011
Sources: ABS; RBA; RP Data-Rismark

Graph 3.6
Household Disposable Income Growth*
Year-ended



* Household sector includes unincorporated enterprises; disposable income is after tax and interest payments; income level smoothed with a two-quarter moving average between March quarter 2000 and March quarter 2002
Source: ABS

Graph 3.7
Household Debt
Per cent of annual household disposable income*



* Household sector excludes unincorporated enterprises; disposable income is after tax and before the deduction of interest payments; RBA estimate for December quarter 2011
Sources: ABS; RBA

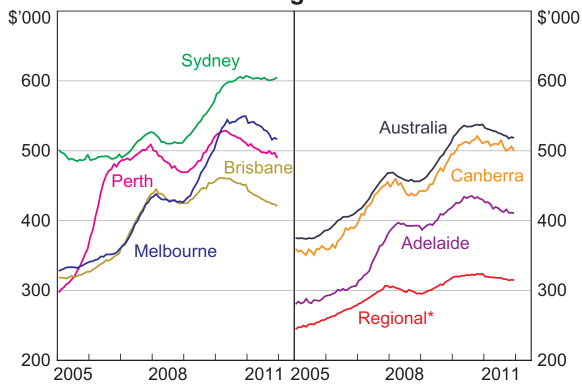
1 Internet purchases from local retailers are included in ABS data. Internet purchases from overseas are not included in ABS retail trade data, and only internet sales valued at more than $1 000 are included in ABS imports and consumption data in the national accounts. See 'Box B: Online Spending by Households', *Statement on Monetary Policy*, February 2011.

Melbourne were the weakest markets, down by around 4 to 6 per cent over the year; prices in Sydney were broadly unchanged over the year. The values of properties in more expensive suburbs have tended to fall by more than those in less expensive suburbs over the past year, although they also rose by more in earlier years, while house prices have tended to fall more than apartment prices.

The various measures suggest that average nationwide rents have increased by around 4 to 5 per cent over the past year, implying a rise in rental yields, in contrast to the fall in yields that has occurred over much of the past 15 years (Graph 3.9). Rental vacancy rates, at around 2.2 per cent nationwide (based on the REIA survey data), are low by historical standards. The vacancy rate is estimated to be lowest in Sydney.

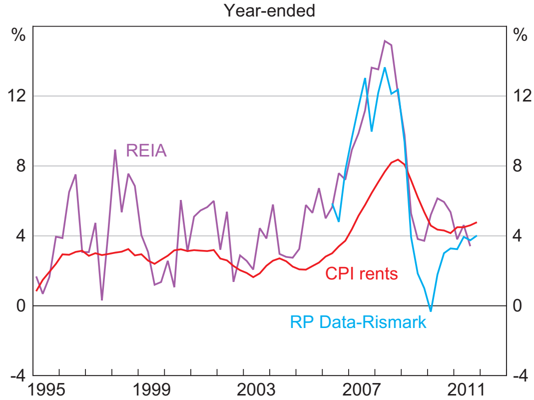
Residential building activity was very soft in 2011, with new home building remaining at low levels, and little growth in spending on alterations and additions. The weakness has partly reflected the earlier pull-forward of demand from the boost to grants to first home buyers in 2009, as well as lower expectations about capital gains from housing. As a result, growth in the dwelling stock has been soft in most of Australia; Victoria is the exception, reflecting significant apartment building over the past year (Graph 3.10). While private residential building approvals remain around 14 per cent below their decade average, some

Graph 3.8
Dwelling Prices



* Excluding apartments; measured as areas outside of capital cities in New South Wales, Queensland, South Australia, Victoria and Western Australia
Sources: RBA; RP Data-Rismark

Graph 3.9
Growth in Rents
Year-ended



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

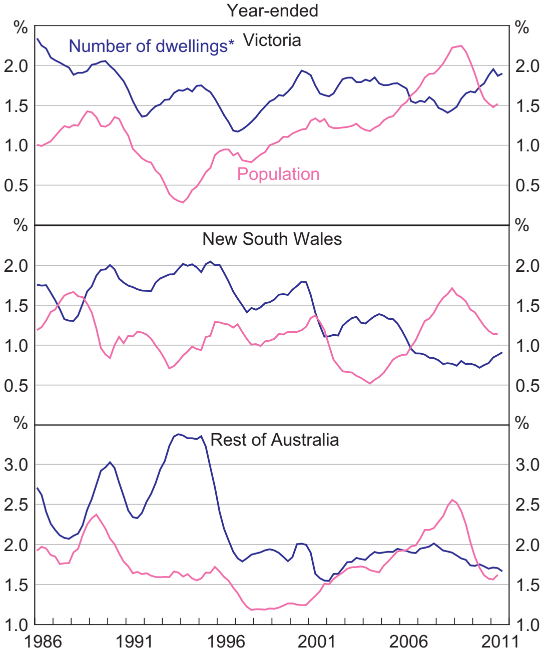
Table 3.2: National Housing Price Growth
Per cent

	3 months to September 2011	3 months to December 2011	Year to December 2011
Capital cities			
ABS[(a),(b)]	–1.9	–1.0	–4.8
APM[(b)]	–1.5	–0.2	–2.8
RP Data-Rismark	–0.8	–0.5	–3.6
Regional areas			
APM[(b)]	–1.5	–0.5	–2.2
RP Data-Rismark[(a)]	–0.5	–0.5	–2.9

(a) Detached houses only
(b) Quarter-on-quarter growth rate
Sources: ABS; APM; RBA; RP Data-Rismark

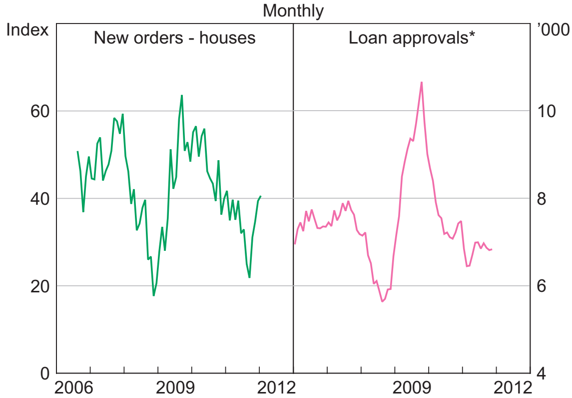
other timely indicators of home building activity have increased modestly in recent months, albeit from a low level (Graph 3.11). The HIA-AIG Performance of Construction Index new orders series for houses has risen since October and first home buyer grants for new dwellings increased modestly in the second half of 2011.

Graph 3.10
Dwelling and Population Growth
Year-ended



* Number of dwellings reported in the Census, interpolated using completions data
Sources: ABS; RBA

Graph 3.11
Indicators of Dwelling Investment
Monthly



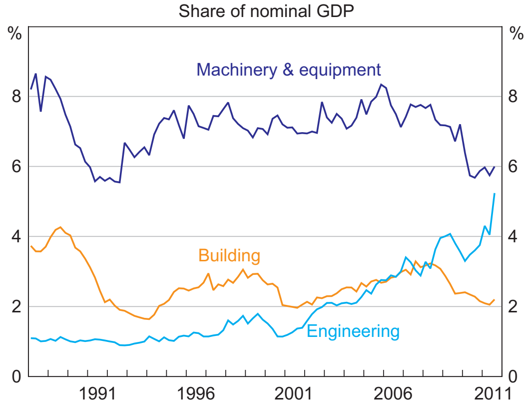
* Includes newly constructed dwellings and dwellings in the process of construction
Sources: ABS; AIG; HIA

Business Sector

Business investment rose very strongly in the September quarter, mainly reflecting engineering work on large mining projects (Graph 3.12). Over the year to the September quarter, mining investment is estimated to have increased by more than 50 per cent. The sharp upswing in mining investment continues to drive very strong growth in capital imports, which rose by around 40 per cent over 2011 (for further details on the impact of mining investment on Australia's imports, see 'Box C: Imports and Investment').

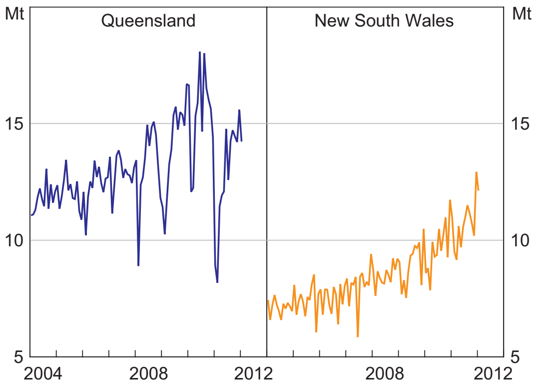
Mining production and exports also grew strongly over the second half of 2011, owing in part to a recovery in coal production in Queensland after flooding earlier in that year. Coal exports from Queensland have risen significantly since early 2011, but remain below pre-flood levels as some mines are still inundated (Graph 3.13). While recently there has been significant rainfall in Queensland's coal-producing regions, mining companies have not yet reported material disruptions to coal production, although the situation is still developing. Heavy rainfall in New South Wales over recent months has caused some loss of production. Iron ore exports have risen rapidly since mid 2011, by around 15 per cent, underpinned by capacity expansions and

Graph 3.12
Business Investment Components*
Share of nominal GDP



* Excludes second-hand asset transfers between the private and other sectors
Source: ABS

Graph 3.13
Coal Shipments*
Monthly



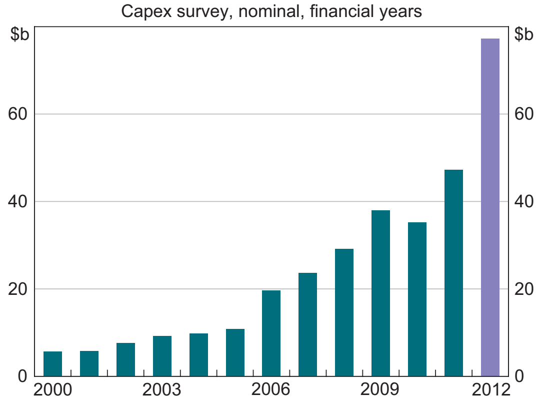
* Non-seasonally adjusted
Sources: RBA; various port authorities

efficiency improvements by some of the major producers.

The outlook for mining investment remains very positive, with the ABS capital expenditure survey of firms' spending plans pointing to a large rise in mining sector investment in 2011/12 (Graph 3.14). Consistent with this, there have been further announcements of large-scale projects in recent months, including the approval of the US$34 billion Ichthys liquefied natural gas (LNG) project, which will transport gas by pipeline from the Browse Basin off the coast of Western Australia to Darwin. The huge amount of investment in LNG production facilities that is currently under way will drive a subsequent surge in LNG exports; the Pluto project is expected to begin production around March this year, with other large projects expected to come online from late 2014. The outlook for iron ore and coal exports also remains strong. Investment in mine, rail and port infrastructure projects is expected to result in a significant increase in coal production in coming years. Large expansions in iron ore capacity are also in the pipeline.

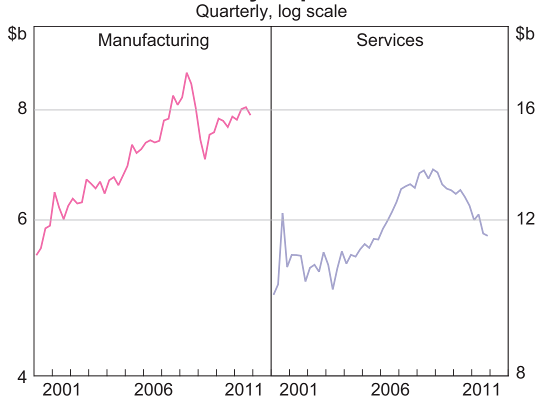
In contrast, conditions remain subdued in some other areas of the economy. The ABS capital expenditure survey points to little growth in non-mining sector investment over the remainder of 2011/12. The high level of the Australian dollar continues to restrain activity in trade-exposed industries such as manufacturing, tourism and education. Services exports have fallen by around 15 per cent since their peak in 2008 and have continued to trend lower (Graph 3.15). Education exports, especially to India, have fallen particularly sharply, due to both the high exchange rate, which has made education in Australia more expensive, and the tightening of access to student visas. Manufacturing exports also remain well below their peak recorded prior to the global financial crisis, with exports of road vehicles and beverages (including wine) particularly weak. Firms in some of these sectors are facing some

Graph 3.14
Mining Capital Expenditure*
Capex survey, nominal, financial years



* Sample of firms' spending plans; latest estimate for 2011/12 adjusted for historical realised spend
Sources: ABS; RBA

Graph 3.15
Non-commodity Export Volumes*
Quarterly, log scale



* RBA estimate for December quarter 2011; 2009/10 prices
Sources: ABS; RBA

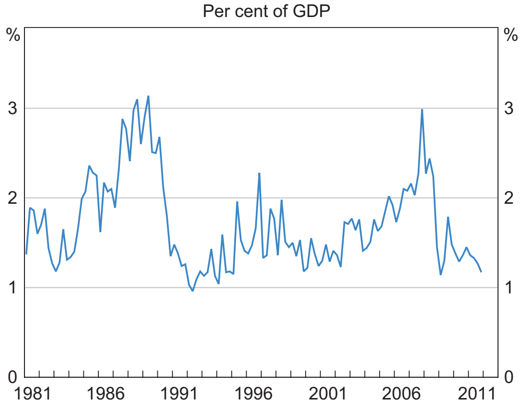
difficult adjustments as they respond to the higher exchange rate.

Measures of conditions within the construction sector are well below average, reflecting weak demand for residential and non-residential building as well as tight credit conditions. The value of private sector non-residential building approvals remains at well below average levels (Graph 3.16).

In the property market, the national CBD office vacancy rate ticked down in the December quarter, to 7.2 per cent, a little below its decade average. Vacancy rates fell in the quarter in Brisbane, Canberra, Melbourne and Perth, with the vacancy rate in Perth now at 2½ per cent, down from 7½ per cent a year ago. Nationwide office capital values are estimated to have risen by 6 per cent over the year to the December quarter, with values in Perth and Sydney showing the strongest growth. In contrast, retail property vacancy rates rose over 2011 in line with the subdued trading conditions faced by retailers (Graph 3.17). This deterioration in the retail market has seen rental growth slow.

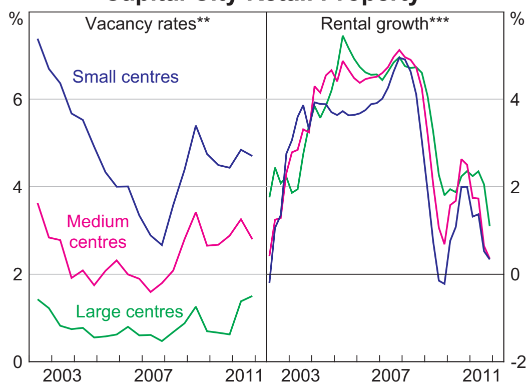
Overall, company profits grew by 5½ per cent in the September quarter to be 11½ per cent higher over the year. Non-mining profits grew by 7 per cent in the quarter to be equivalent to 12½ per cent of GDP, in line with the decade average. Robust profit growth has seen internal funding generated by businesses rise to its highest level as a share of GDP in over 20 years (Graph 3.18). Internal funding now accounts for around 70 per cent of total business funding, compared with around 35 per cent in the mid 2000s when businesses were much more reliant on externally sourced funding, and in particular debt funding. This increased reliance on internally generated funds reflects both a reduced appetite for debt among corporates and, for some sectors, more restricted access to debt.

Graph 3.16
Private Non-residential Building Approvals*
Per cent of GDP



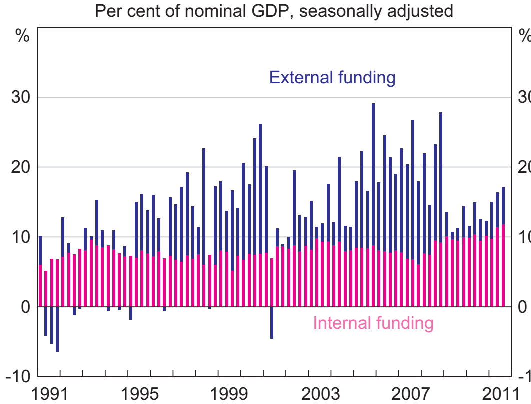
* RBA estimate for December quarter 2011 GDP
Sources: ABS; RBA

Graph 3.17
Capital City Retail Property*



* Speciality stores in surburban shopping centres
** Half-yearly
*** Year-ended, quarterly
Source: Jones Lang LaSalle Research

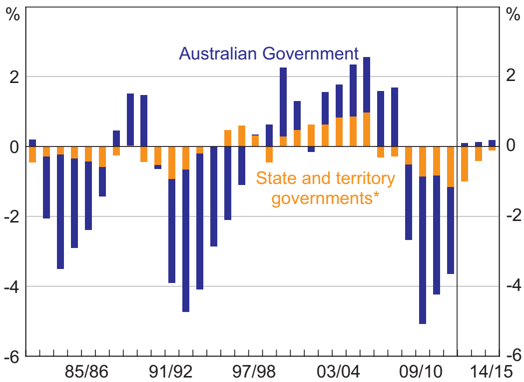
Graph 3.18
Business Funding
Per cent of nominal GDP, seasonally adjusted



Sources: ABS; RBA

Government Spending

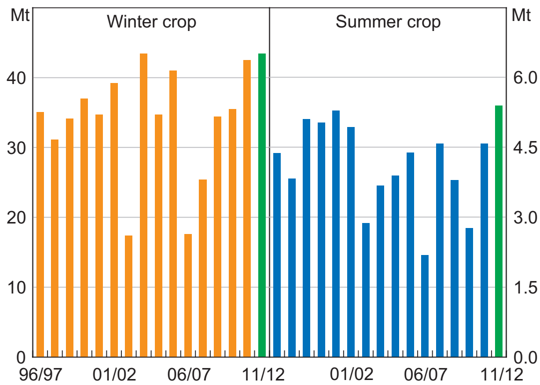
Public demand contracted over 2011 as spending associated with the earlier fiscal stimulus was completed. In the November Mid-year Economic and Fiscal Outlook, the Australian Government budget position was forecast to move from a deficit of 2.5 per cent of GDP in 2011/12 to a small surplus in 2012/13 (Graph 3.19). The consolidated budget position for the states is expected to be a deficit of 1.1 per cent of GDP in 2011/12, with a narrowing of the deficit forecast over coming years. The forecast combined state and federal deficit for 2011/12 was revised upwards, reflecting weaker-than-expected growth and falls in asset prices weighing on tax receipts, and new government payments to households and businesses announced as part of the Government's Clean Energy Future package.



* 2011/12 mid-year updates; 2011/12 budgets for ACT and Tasmania
Sources: ABS; Australian Treasury; state and territory treasuries

Farm Sector

Conditions in the farm sector mostly remain favourable. Rural exports increased strongly over 2011, with large winter and summer crops resulting in a significant increase in exports of grain and cotton. With relatively high prices for rural commodities, real farm income has also been at high levels. Looking ahead, the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) expects the recently harvested winter crop and current summer crop to both surpass previous records, ensuring rural exports remain high (Graph 3.20). The recently harvested wheat crop is estimated to be a little over 28 million tonnes, underpinned by a doubling in wheat production in Western Australia following last season's drought-affected crop. Spring rainfall across most wheat-growing regions in the eastern states improved yields, but heavy rain in both Western Australia and parts of the eastern states late in 2011 caused some crop damage and quality downgrades. Cotton production is also expected to reach record levels, driven by relatively high prices and the increased availability of irrigation water, although recent rain has caused some crop damage. ABARES' forecast of gross farm production, which includes both crops and livestock, has been revised up to growth of 4 per cent in 2011/12, following a rise of just under 7 per cent in 2010/11.



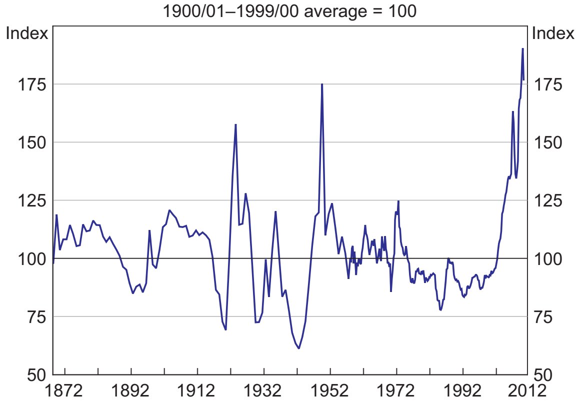
* ABARES forecasts for 2011/12
Source: ABARES

External Sector

Australia's trade surplus reached a 40-year high as a ratio to GDP in the September quarter, reflecting large increases in bulk commodity contract prices. More recently, a decline in iron ore and coal prices has resulted in a smaller trade surplus as well as a fall in the terms of trade from their record level (Graph 3.21). Solid growth in export volumes has been outstripped by more rapid growth in import volumes, reflecting the appreciation of the Australian dollar and the sharp upswing in mining investment (for further details on Australia's imports, see 'Box C: Imports and Investment'). In line with these developments, the current account deficit, which had narrowed significantly over the past few years, is likely to have widened towards the end of 2011.

While Australia's aggregate trade balance remains close to record highs, this masks diverging trends in goods and services trade (Graph 3.22). While the balance on goods trade has shifted to surplus recently, in part reflecting the very high level of commodity prices, a sizeable deficit in services trade has emerged. The latter trend has been driven largely by the increase in Australia's exchange rate over recent years, coupled with strong growth in Australian incomes. Overseas travel is now more affordable for Australians, leading to a strong increase in tourism-related services imports. In contrast, services exports have fallen over recent years.

Graph 3.21
Terms of Trade*
1900/01–1999/00 average = 100

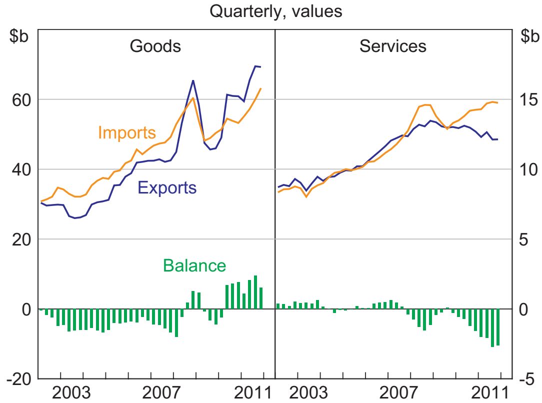


* Annual data to 1958/59, quarterly data thereafter with dates referring to December quarter; RBA estimate for December quarter 2011
Sources: ABS; RBA

Labour Market

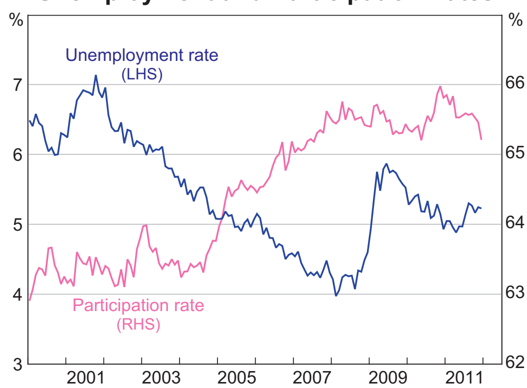
The unemployment rate has remained around 5¼ per cent in recent months, although employment growth has been soft and the participation rate is estimated to have fallen in December (Graph 3.23). Growth in total employment remains patchy, with mixed employment outcomes across industries and little net employment growth over 2011. Some of the weakness in employment likely reflects the effect of earlier pre-emptive hiring that supported above-trend employment growth in 2010. Recent business liaison has indicated that some firms have become more cautious about hiring new workers in the absence of clear indications of a pick-up in demand. Growth in total hours worked has been stronger than employment growth over the year, suggesting firms have been meeting additional labour needs via increases in average hours rather than hiring additional workers (Graph 3.24).

Graph 3.22
Goods and Services Trade Balances*
Quarterly, values



* RBA estimates for December quarter 2011
Sources: ABS; RBA

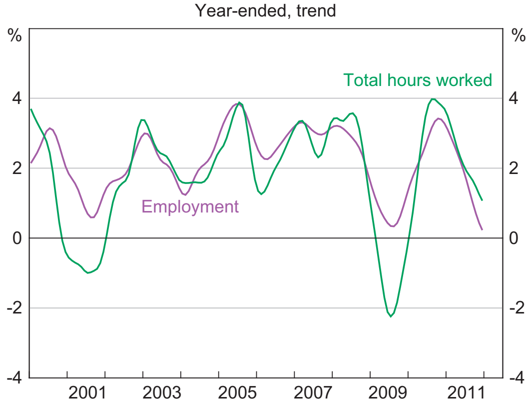
Graph 3.23
Unemployment and Participation Rates



Source: ABS

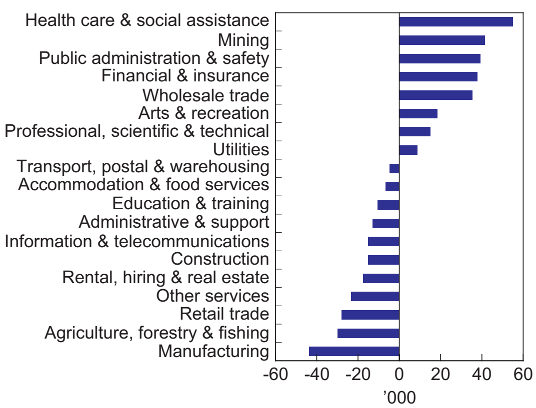
The slowdown in the pace of employment growth is evident across most industries, with a number of industries experiencing a decline over the year to November (the latest available data). In part this reflects structural adjustment to the resources boom and the accompanying high exchange rate. Employment has been particularly weak in the manufacturing and agriculture, forestry & fishing industries (Graph 3.25). Other industries recording declines in employment include construction and retail trade. Although there are no official industry employment data for December, the weakness in part-time employment in the monthly data suggests that retailers did not hire as many additional staff in the peak pre-Christmas period as normal. In contrast, employment growth in other industries such as health care & social assistance and financial & insurance services has been relatively solid, and employment in public administration & safety also increased strongly. Despite its small size, rapid growth in mining industry employment again made a sizeable contribution to aggregate employment growth over the year.

Graph 3.24
Growth in Labour Input
Year-ended, trend



Source: ABS

Graph 3.25
Employment Growth
Year to November 2011

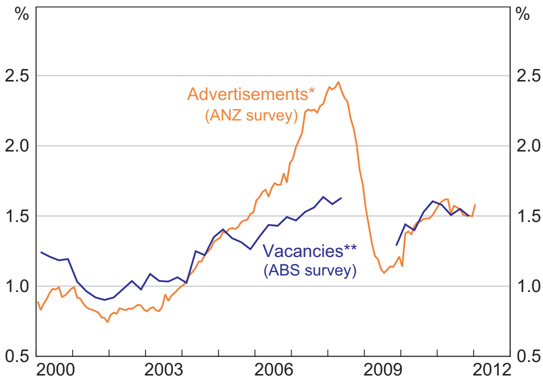


Source: ABS

Forward-looking indicators of labour demand point to modest employment growth in coming months. Both the ABS measure of job vacancies and ANZ's job advertisements series fell in the December quarter, although advertisements picked up in January and the vacancy rate remains at a high level (Graph 3.26). The decline in vacancies is consistent with reports from liaison of continued caution by firms in their hiring intentions and the below-average intentions reported by manufacturing firms in the ACCI-Westpac survey. The Bank's liaison with firms suggests that the share of firms expecting to increase employment declined over 2011 and the share expecting to decrease employment rose. A number of large employers in the finance and manufacturing industries have also recently announced job losses associated with business restructures.

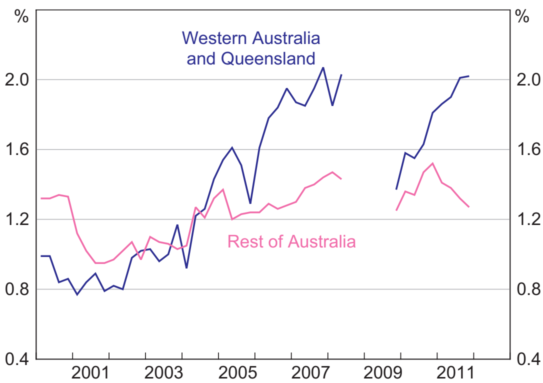
The relatively high level of vacancies and low unemployment rate indicate that despite the moderation in labour demand over the past year, labour market conditions remain reasonably tight. Nationally, the ratio of vacancies per unemployed worker is around 0.3, which is well above the long-run average. The level of vacancies is particularly high in Western Australia where the vacancy rate has continued to rise over the past year, in part owing to the very rapid pace of growth in vacancies in the mining industry. The vacancy rate has also been rising in Queensland, which has relatively high exposure to mining activity; in contrast, vacancies have been declining in other states over the past year (Graph 3.27).

Graph 3.26
Job Vacancies and Advertisements
Per cent of labour force



* RBA estimate of labour force for January 2012
** This survey was suspended between May 2008 and November 2009
Sources: ABS; ANZ

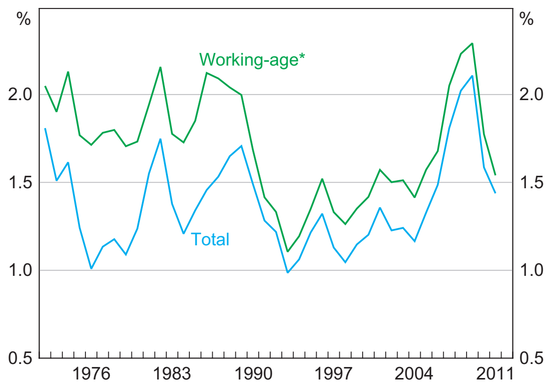
Graph 3.27
Job Vacancies*
Per cent of labour force



* Seasonally adjusted by RBA; this survey was suspended between May 2008 and November 2009
Sources: ABS; RBA

Growth in the labour supply eased over 2011 in line with slower growth in the working-age population and the recent fall in the participation rate (Graph 3.28). The latest ABS population estimates for the year to June 2011 confirm that the rate of population growth has slowed significantly in recent years as a result of a decline in net immigration and a slight slowing in natural increase.

Graph 3.28
Population Growth
Year to June



* 15 years and over
Source: ABS