2. Domestic Economic Conditions

The Australian economy expanded strongly over 2022. After the initial impetus from reopening in early 2022 had passed, activity continued to grow at a solid pace over the second half of the year. The strong expansion supported large gains in employment, and measures of spare capacity in the labour market have been broadly steady at around multi-decade lows. Labour demand is strong, though it has moderated a little in recent months. Some of the demand for labour has been met by a sharp recovery in net arrivals from overseas, which is helping to alleviate shortages in some areas. Even so, the labour market remains tight and many firms continue to find it challenging to hire workers. The strong labour market continues to support growth in household incomes, as more people have jobs and others are receiving higher wages. At the same time, rising interest rates and living costs are reducing real spending power. Along with further declines in housing prices, this is weighing heavily on consumer sentiment and demand to purchase new housing. Timely indicators suggest consumption growth has slowed in recent months.

Strong labour demand continues to support growth in employment

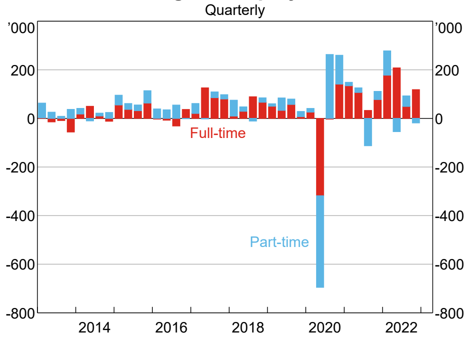
Employment continued to increase in the second half of 2022, though not as rapidly as in the first half of the year when the economy was reopening (Graph 2.1). Monthly employment growth averaged 29,000 over the last three months of 2022, compared with 21,000 in the 12 months prior to the onset of the COVID-19 pandemic, driven by full-time employment. Employment data for the June and September quarters were recently revised up.

Job advertisements and vacancies remain at high levels despite having moderated in recent months (Graph 2.2). This is consistent with strong employment intentions reported by firms in the Bank's liaison program and business surveys.

Graph 2.1

Change in Employment

Quarterly

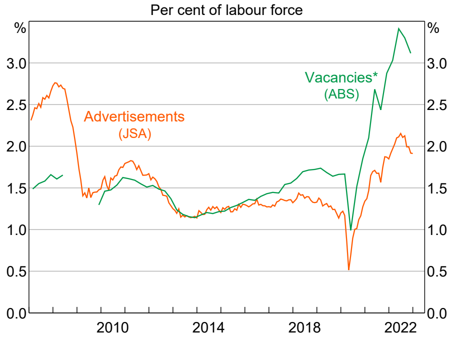


Sources: ABS; RBA

Graph 2.2

Job Vacancies and Advertisements

Per cent of labour force



* The survey was suspended between May 2008 and November 2009.

Sources: ABS; Jobs and Skills Australia (JSA); RBA

Labour supply has risen to meet some of this strength in demand …

Strong demand for labour has encouraged more people to enter the labour force over the past year, with the participation rate and employment-to-population ratio both around record highs. Much of this increase has been driven by young people and females; youth participation is around its highest rate in recent decades, while female participation rates are also around record highs (Graph 2.3).

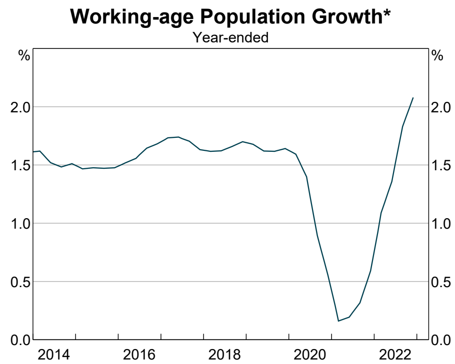
In the second half of 2022, higher labour supply was also supported by a strong pick-up in net arrivals from overseas. An increase in the arrival of international students and low levels of departures have seen the working-age population grow faster than before the pandemic (Graph 2.4). The return of working holiday makers has also helped to alleviate labour shortages in some areas.

Average hours worked has increased to be around pre-pandemic levels in recent months (Graph 2.5). This largely reflects the uptake of full-time hours by more workers in a tight labour market, as well as workers taking less sick leave. In line with the strength in employment growth, total hours worked has grown strongly.

… but the labour market remains tight

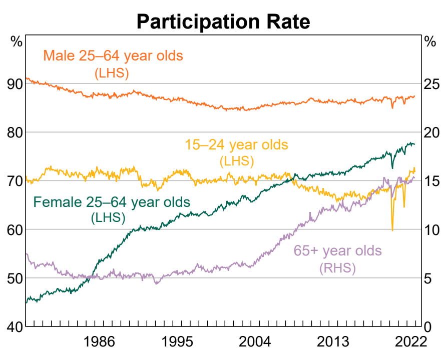
Spare capacity in the labour market is at multi-decade lows. The unemployment rate remained around 3½ per cent in late 2022 – its lowest level in nearly 50 years, with youth unemployment around its lowest level in over 40 years (Graph 2.6). In December, the unemployment rate was below 4 per cent across all states for the first time in the history of the (monthly) data (Graph 2.7). Broader measures of underutilisation have also declined to multi-decade lows as firms have responded to high demand by increasing the hours of existing staff; many previously part-time employees have shifted into full-time work.

Graph 2.4



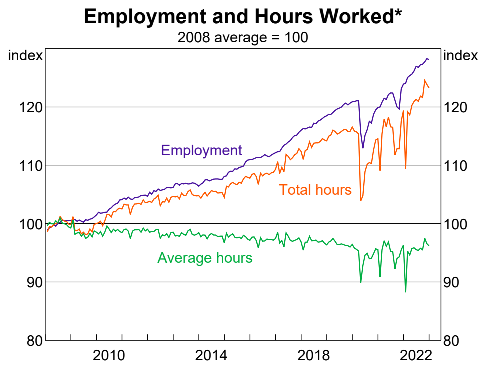
* Population aged 15 years and over.
Sources: ABS; RBA

Graph 2.3



Sources: ABS; RBA

Graph 2.5



* Seasonally adjusted.
Sources: ABS; RBA

Finding suitable labour remains a challenge for many firms and the tightness in the labour market is underpinning wages growth. There are almost as many vacancies as there are unemployed people and the proportion of firms in business surveys that report finding suitable labour as a significant constraint remains very high (Graph 2.8). Job mobility continues to be higher than in the years preceding the pandemic, and is around the levels seen prior to the global financial crisis, driven by people wanting a better job or a change. A small but growing number of contacts in the Bank's liaison program have reported some easing in labour shortages, partly reflecting the recent increase in net arrivals from overseas.

Economic activity grew solidly in the September quarter

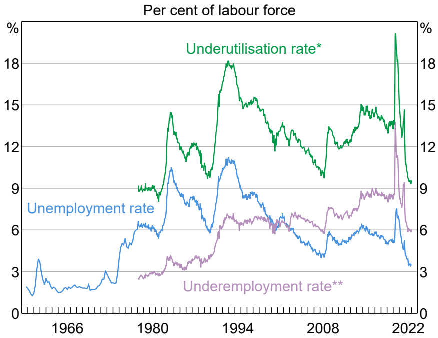
The Australian economy grew by 0.6 per cent in the September quarter (Graph 2.9). Growth in household consumption was strong, underpinned by the ongoing rebound in spending on international travel and other discretionary services. The household saving ratio declined further as a result, to be closer to, but still slightly above, the average levels that prevailed prior to the pandemic (Graph 2.10).

GDP growth was boosted by strength in exports in the September quarter, reflecting strong growth in services and rural exports. Dwelling and business investment also rebounded modestly, reflecting an easing of materials

Graph 2.6

Labour Underutilisation

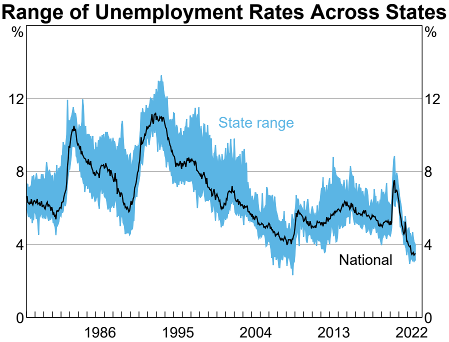
Per cent of labour force



* Sum of the unemployment and underemployment rates.
** Employed people who want, and are available, to work more hours.
Source: ABS

Graph 2.7

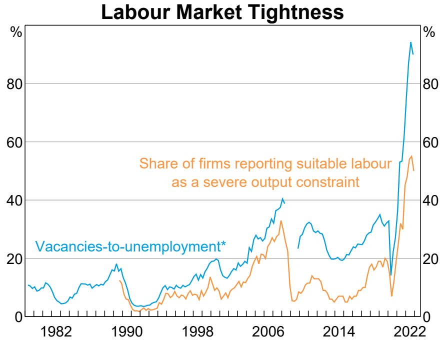
Range of Unemployment Rates Across States



Sources: ABS; RBA

Graph 2.8

Labour Market Tightness

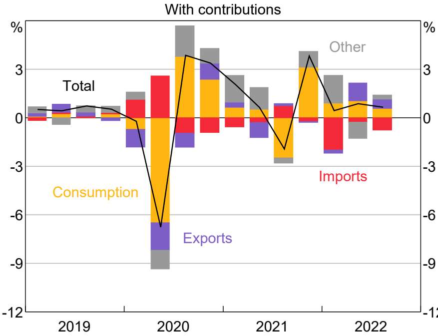


* The ABS vacancies survey was suspended between May 2008 and November 2009.
Sources: ABS; NAB; RBA

Graph 2.9

Quarterly GDP Growth

With contributions



Sources: ABS; RBA

shortages and fewer weather-related disruptions. Strong demand for overseas travel by Australians and the filling of order backlogs resulted in strong growth in imports.

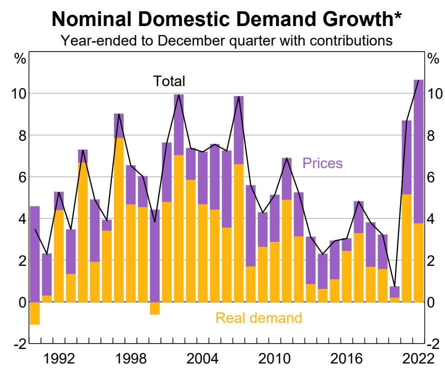
In nominal terms, domestic final demand continued to grow strongly in the September quarter, underpinned by solid growth in real demand and strong growth in domestic prices. Total nominal demand in the economy remained elevated, having grown well above its pre-pandemic trend rate over the year (Graph 2.11). Growth in nominal GDP was more subdued in the quarter. This reflected a 6.6 per cent decline in the terms of trade, albeit from historically high levels, due to an increase in import prices and a decline in commodity export prices.

Household spending growth has moderated …

Household consumption increased by 1.1 per cent in the September quarter (Graph 2.12). This was a slower pace than earlier in the year, but higher than the pre-pandemic average. The solid growth in the quarter reflected a continued recovery in international travel. Australians' spending overseas rose sharply, with travel imports increasing by around 65 per cent, to be around 60 per cent of pre-pandemic levels. Spending overseas underpinned strength in consumption of discretionary services – such as transport, and hotels, cafes and restaurants – which increased by 3.4 per cent in the quarter.

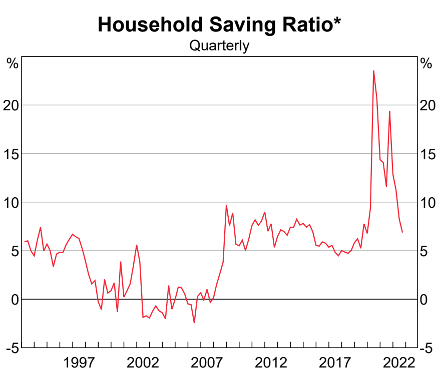
A range of timely indicators suggest that growth in real household spending continued to moderate in the December quarter. Growth in retail sales values slowed, with declines in household goods, department stores, and clothing and footwear (Graph 2.13). Retail prices increased strongly and the volume of retail sales declined in the quarter. This weakness was concentrated in discretionary goods categories and was partially offset by solid growth in spending on food and at cafes and restaurants.

Graph 2.11



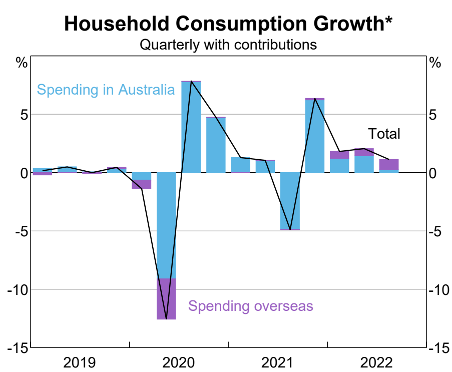
* Estimates for December quarter 2022.
Sources: ABS; RBA

Graph 2.10



* Saving as a share of disposable income; net of depreciation.
Sources: ABS; RBA

Graph 2.12



* Household consumption in the national accounts measures spending by Australian residents.
Sources: ABS; RBA

These data are consistent with information from the Bank's liaison program that spending continued to moderate in the December quarter (see 'Box B: Insights from Liaison'). Following strong growth in the September quarter, trade data suggest that spending by Australians overseas was broadly steady in the December quarter.

… and there are several headwinds slowing household spending

Nominal household disposable income grew by 1.6 per cent in the September quarter, driven by growth in labour income. The tight labour market has especially benefited lower income households. The latest available data (which are for the year to August 2022) suggest that earnings growth has been faster for lower income than higher income individuals. The low unemployment rate also means that a greater number of lower income people now have a job. Lower income households tend to spend more of each extra dollar of income than higher income households, which should support aggregate consumer spending. Many households also built up large financial buffers during the pandemic period, including through offset accounts. Additional savings accumulated by households since the beginning of the pandemic are estimated to amount to close to $300 billion, equivalent to around 20 per cent of annual disposable income.

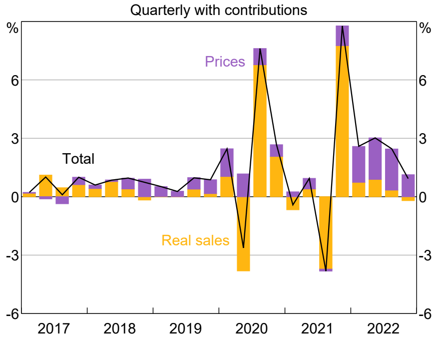
However, there are a number of headwinds for consumption growth. Inflation remains high, with strong growth in prices in the September quarter causing real household disposable income to decline by ½ per cent, to be 2½ per cent lower over the year (Graph 2.14). Real household net wealth also decreased by around 4 per cent in the quarter, driven by lower housing prices, which will be a further drag on consumption growth in the period ahead. Alongside inflationary pressures, higher net interest payments are expected to put increasing pressure on household budgets as cash rate increases are passed through to lending rates and fixed-rate loans expire (see chapter on 'Domestic Financial Conditions').

The pressure on household budgets from higher interest rates and inflation have contributed to a sharp decline in consumer sentiment, which is around the lows observed at the onset of the pandemic and during the global financial crisis (Graph 2.15). The decrease in sentiment has been most pronounced for the one-third of households with a mortgage.

Graph 2.13

Nominal Retail Sales Growth

Quarterly with contributions

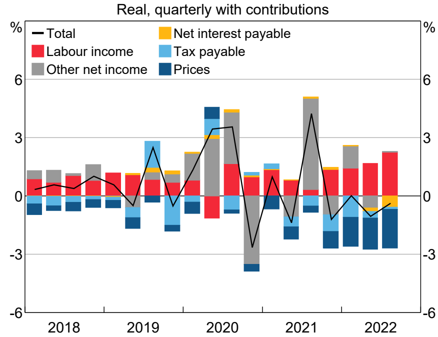


Sources: ABS; RBA

Graph 2.14

Household Disposable Income Growth

Real, quarterly with contributions



Sources: ABS; RBA

The outlook for business investment remains positive

Business investment increased by around 4 per cent over the year to the September quarter (Graph 2.16). Non-residential construction investment grew alongside increased project commencements as constraints on materials availability eased a little, though building work done remains below pre-pandemic levels. Investment in machinery and equipment also increased, supported by the agricultural, mining, and transport, postal and warehousing industries.

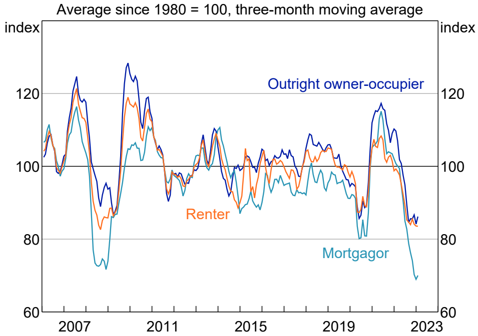
Survey measures of business sentiment have softened in recent months (Graph 2.17). Business conditions and capacity utilisation have declined, but remain well above their long-run averages.

Survey measures of investment intentions and information from liaison point to a positive outlook for business investment. The September quarter ABS Capital Expenditure Survey showed that investment intentions for the 2022/23 financial year remain higher than the 2021/22 financial year outcome, though this may partly reflect higher input costs (Graph 2.18). Most firms are reportedly continuing to pursue investment projects; however, information from the Bank's liaison program suggests that some firms anticipate project delays resulting from cost increases and difficulties securing labour.

Graph 2.15

Consumer Sentiment by Housing Tenure

Average since 1980 = 100, three-month moving average

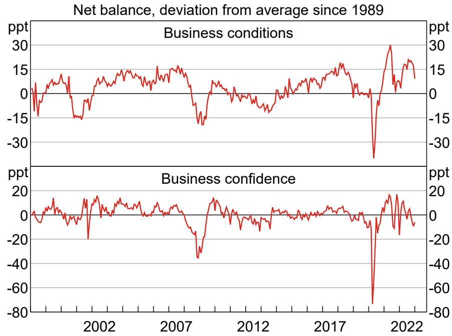


Sources: RBA; Westpac–Melbourne Institute

Graph 2.17

Business Sentiment

Net balance, deviation from average since 1989

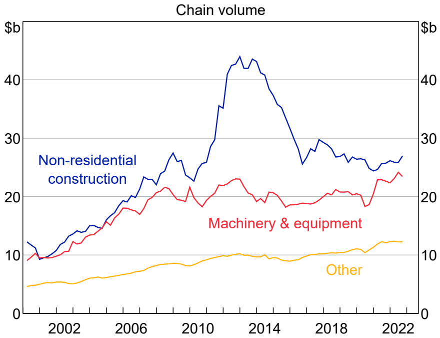


Sources: NAB; RBA

Graph 2.16

Private Business Investment

Chain volume

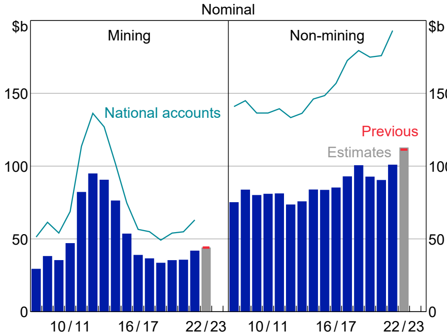


Sources: ABS; RBA

Graph 2.18

Capital Expenditure Intentions*

Nominal



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

Sources: ABS; RBA

Residential construction continues to face capacity constraints

Dwelling investment increased modestly in the September quarter of 2022, but remained 4 per cent lower than a year earlier (Graph 2.19). The increase reflected an easing of constraints on supply of materials and fewer adverse weather events compared with previous quarters. Dwelling investment increased in the higher density sector across most states and also in the detached sector, particularly in New South Wales and Victoria.

However, capacity constraints – particularly those arising from labour availability – continue to limit the pace at which work can be done. Builders in the Bank's liaison program have noted that detached dwelling completion times have lengthened significantly since 2020. These delays, along with substantial increases in construction costs, have contributed to reduced cash flow for some firms and increased insolvencies in the construction industry over the past year.

Demand to purchase new detached housing has fallen considerably in recent months. This reflects a range of factors, including rising interest rates, higher prices for land and construction, falling established home prices (making them a more attractive alternative to building a new home) and poor buyer sentiment stemming from construction delays. Building approvals – along with leading indicators of approvals, such as new greenfield land sales and new home orders – have all continued to decline.

Information from the Bank's liaison program suggests that demand for off-the-plan apartments has declined, particularly for first home buyers. Demand for new higher density housing from investors has also decreased, even though unit rental yields have risen since the start of the year and immigration is expected to support rental demand. Nevertheless, the pipeline of work to be done remains elevated, reflecting the large number of dwellings approved during the pandemic that have not yet been completed due to construction delays (Graph 2.20). This is expected to support construction activity for some time.

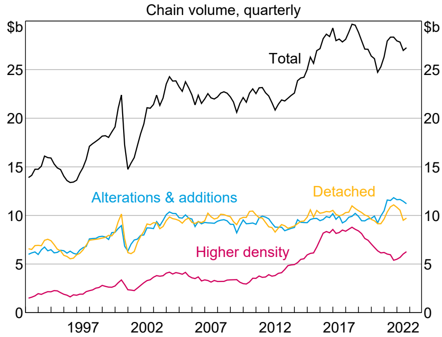
Housing prices have declined further …

National housing prices have declined by 8 per cent since their peak in April 2022, alongside rising interest rates and poor market sentiment. Price declines have been broadly based across most market segments and geographic areas, though the pace of decline has varied (Table 2.1; Graph 2.21). Housing market turnover has also declined in most capital cities over the past year. While survey measures of housing price expectations and

Graph 2.19

Private Dwelling Investment

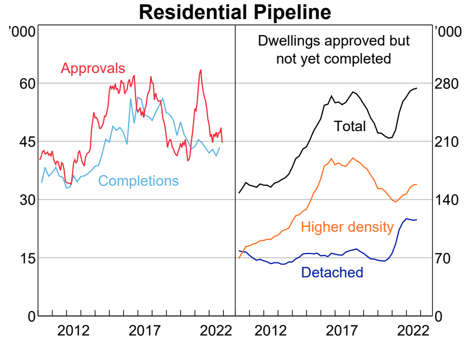
Chain volume, quarterly



Sources: ABS; RBA

Graph 2.20

Residential Pipeline



Sources: ABS; RBA

Table 2.1: Growth in Housing Prices

Percentage change, seasonally adjusted

	January	December	November	Since recent peak	Year-ended	Since Feb 2020
Sydney	−1.1	−1.2	−1.3	−14	−14	9
Melbourne	−1.2	−1.1	−0.9	−9	−9	1
Brisbane	−1.5	−1.8	−2.0	−10	−5	28
Adelaide	−0.7	−0.6	−0.5	−2	7	42
Perth	−0.4	−0.1	−0.0	−0	3	25
Darwin	−0.1	−0.4	0.4	−1	4	32
Canberra	−0.9	−0.8	−1.2	−8	−6	27
Hobart	−1.6	−1.6	−1.8	−10	−9	23
Capital cities	−1.1	−1.1	−1.1	−9	−9	12
Regional	−1.0	−1.2	−1.1	−6	−2	33
National	−1.1	−1.1	−1.2	−8	−7	16

Sources: CoreLogic, RBA

auction clearance rates have stabilised in recent months, these remain well below the levels seen at the start of 2022.

… and the rental market is very tight

Rental vacancy rates have declined in most capital cities and regional areas over the past year (Graph 2.22). Declines have been largest in Melbourne and Sydney, where vacancy rates are now around long-run average levels. In other capital cities, vacancy rates are at or around historical lows. Growth in advertised rents (for new leases) has been strong as a result, although the pace of growth has eased in recent months, particularly in regional areas (Graph 2.23). Rents have grown more strongly for units than houses, and rental yields for units have increased across most states recently.

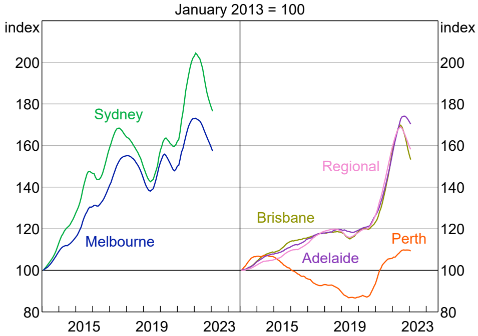
Public consumption remains elevated

Public demand was little changed in the September quarter; a decline in public

Graph 2.21

Housing Prices

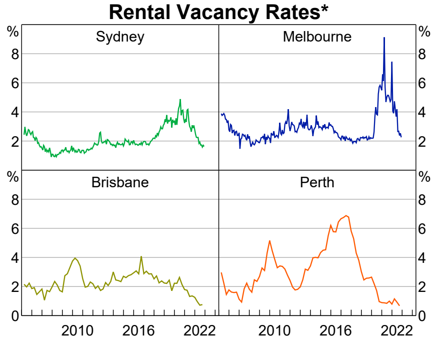
January 2013 = 100



Sources: CoreLogic; RBA

Graph 2.22

Rental Vacancy Rates*



* Data is monthly for Sydney and Melbourne, and quarterly for Brisbane and Perth.

Sources: RBA; REIA; REINSW; REIV

investment was offset by an increase in public consumption. Continued assistance for those affected by floods in Queensland and New South Wales supported public consumption, which remains at a high level compared with the pre-pandemic period as a share of nominal GDP (Graph 2.24). Public spending programs such as the National Disability Insurance Scheme also supported public consumption. A strong pipeline of infrastructure projects is expected to support public investment going forward, though ongoing labour and materials shortages may limit the pace at which work can be completed.

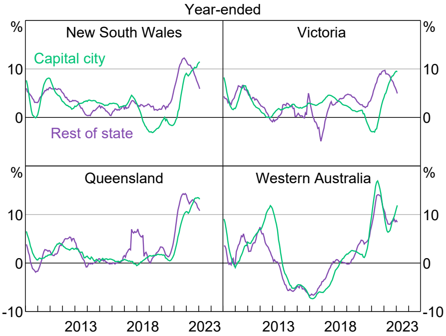
Services trade continued to drive growth in exports and imports

Export and import volumes have increased substantially since early 2022, driven by services trade, as students and tourists took advantage of the removal of travel restrictions (Graph 2.25). Across both inbound and outbound passengers, the number of those travelling for the purpose of visiting friends and relatives has recovered the fastest, though there has also been a sizeable increase in holidaymakers and students travelling to Australia (Graph 2.26). Despite the strong growth, travel services remain well below pre-pandemic levels.

Graph 2.23

Advertised Rents Growth*

Year-ended



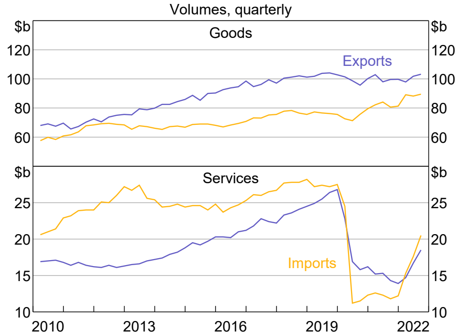
* Hedonic; seasonally adjusted.

Sources: CoreLogic; RBA

Graph 2.25

Trade in Goods and Services

Volumes, quarterly

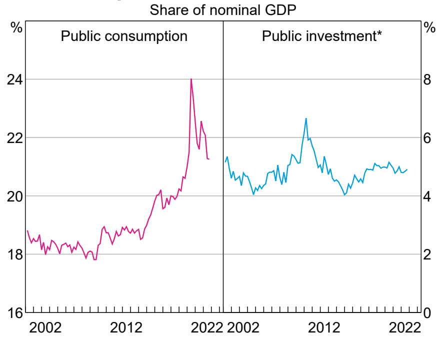


Sources: ABS; RBA

Graph 2.24

Components of Public Demand

Share of nominal GDP



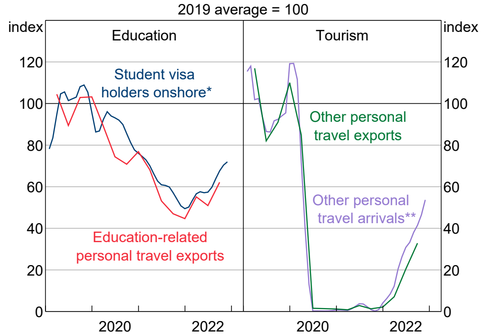
* Adjusted for second-hand asset transfers between public and other sectors.

Sources: ABS; RBA

Graph 2.26

Personal Travel Exports and Movements

2019 average = 100



* Three-month moving average.

** Includes holidaymakers and those visiting friends and relatives; three-month moving average.

Sources: ABS; Department of Education; Department of Home Affairs

Rural exports have increased strongly since early 2022, driven by ongoing favourable weather conditions and tight global supply. Consecutive record winter crops of wheat, combined with elevated prices due to persistent dry conditions in other major exporting nations and the war in Ukraine, have contributed to the historically high values seen in recent months. Despite devastating flooding in some areas of the eastern states, near-record production in other parts of the country has supported elevated levels of rural exports.

Resource export volumes were volatile over 2022 as weather and maintenance sporadically impacted production. Wet weather on the east coast was particularly disruptive for coal exports, while maintenance and industrial action led to a sharp fall in LNG exports in the September quarter. Partial data for the December quarter showed that bulk commodity exports increased. Information from liaison suggests bulk resource exports will not be impeded by record flooding in the Kimberley region.

Import volumes and values grew solidly in the September quarter, and continued to outpace growth in domestic final demand over 2022 as travel imports recovered. In the December quarter, import values declined due to declining oil prices and falling freight rates. The trade surplus increased in the December quarter, as export values rose and import values declined.