Domestic Economic Conditions

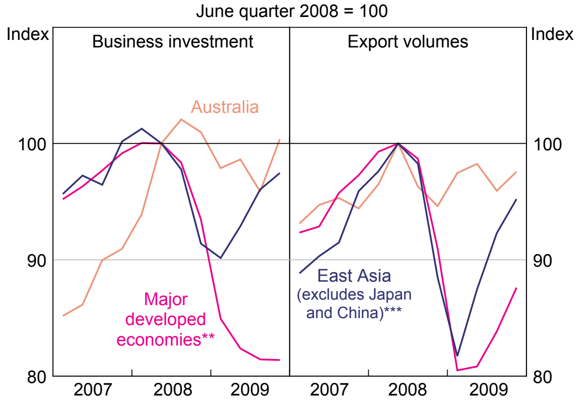
The Australian economy continues to recover from what turned out to be a relatively mild downturn. Over the past 18 months or so, activity has been supported by stimulatory settings of fiscal and monetary policy, high population growth, strong trade links with Asia and a sound financial system. Compared with the experience elsewhere in the developed world, business investment is at high levels and exports held up well through the financial crisis (Graph 30). Over 2009, GDP is estimated to have increased by 2.7 per cent (Table 7), a considerably stronger outcome than expected a year ago, with the result that the economy starts this expansion with less spare capacity than earlier thought likely.

A range of indicators suggests that the expansion has continued into 2010, although as is typical, conditions vary across sectors of the economy. Surveys indicate high levels of confidence in the future of the economy, although there appears to be a degree of caution in the spending plans of

Graph 30

Business Investment and Export Volumes*

June quarter 2008 = 100



* Weighted using GDP at market exchange rates
** Includes Canada, euro area, Japan, the UK and US; euro area business investment includes public investment
*** Export volumes also excludes Hong Kong and Singapore
Sources: ABS; Eurostat; IMF; RBA; Thomson Reuters

Table 7: Demand and Output Growth

Per cent

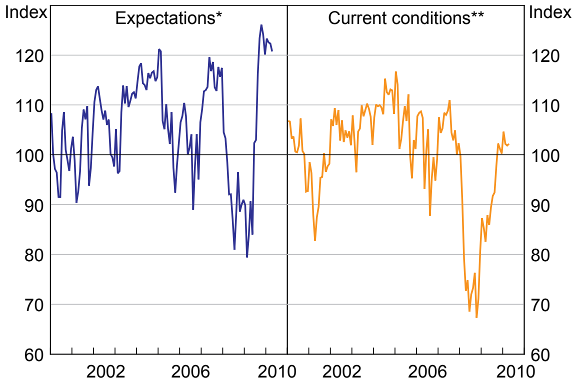
	December quarter 2009	Year to December quarter 2009
Domestic final demand	2.0	3.3
– Private demand	1.5	2.1
– Public demand	3.8	7.7
GNE	2.1	4.5
Net exports[(a)]	–1.3	–0.5
Statistical discrepancy[(a)]	0.0	–1.4
GDP	0.9	2.7

(a) Contribution to GDP growth
Source: ABS

Graph 31

Consumer Sentiment

Long-run average = 100

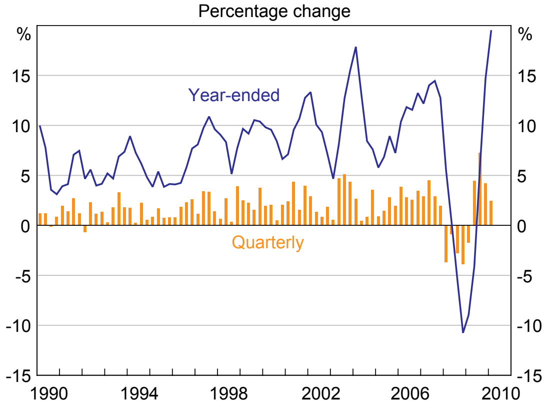


* Average of future personal finances and future economic conditions indices
** Average of current personal finances and buying conditions indices
Sources: Melbourne Institute and Westpac; Roy Morgan Research

Graph 32

Household Net Worth*

Percentage change

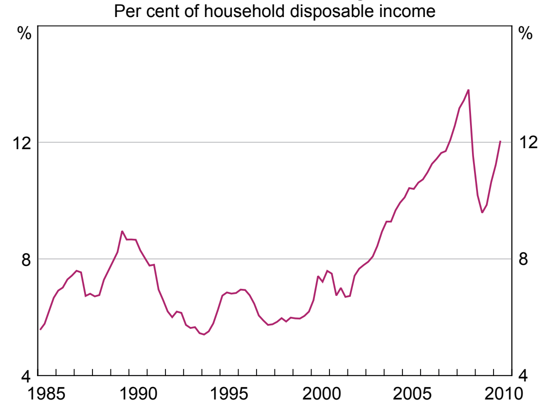


* RBA estimate for March quarter 2010
Sources: ABS; RBA

Graph 33

Household Interest Payments*

Per cent of household disposable income



* Excludes unincorporated enterprises. Income is before the deduction of interest payments. RBA estimates for March and June quarters 2010.
Sources: ABS; RBA

consumers and of businesses outside of the mining sector. The effect of the fiscal measures on activity is declining, with private demand expected to strengthen over the period ahead. The outlook for the resources sector is very positive, with rises in commodity prices and the terms of trade boosting domestic incomes and underpinning a further increase in mining investment.

Household Sector

Households appear to be quite optimistic about the future, and particularly the outlook for the economy (Graph 31). This is consistent with recent increases in wealth and solid employment growth. Household net worth is estimated to be around 20 per cent higher than its trough in March 2009, driven by solid growth in equity and property prices (Graph 32). While households are confident about the future, this appears to have had only a limited effect on spending recently. This apparent caution is reflected in consumers' survey responses about current conditions, which remain close to their long-run average.

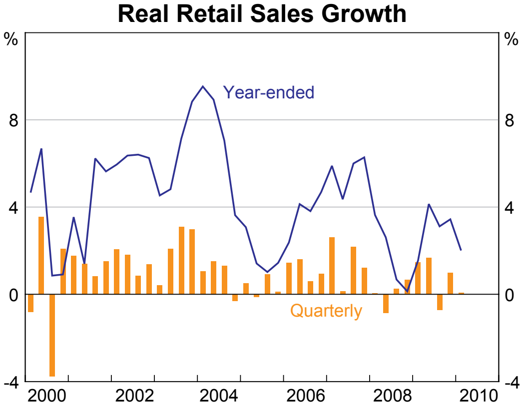
The increase in mortgage rates to more normal levels over the past half year is resulting in a significant increase in household interest payments (Graph 33). Based on the current level of mortgage rates, the ratio of interest payments to household disposable income is estimated to have increased by 2½ percentage points since mid 2009, although it remains below its peak of 13.8 per cent in September 2008.

The volume of retail sales increased by 0.1 per cent in the March quarter to be 2 per cent higher over the year (Graph 34). The recent modest growth is likely to partly reflect the unwinding of the effects of the stimulus payments, which prompted some households to bring forward the purchase of durable goods into the first half of 2009 (Graph 35). A similar pattern can be seen in the number of overseas trips taken by residents, which rose sharply in mid 2009 in response to low airfares and the appreciation of the exchange rate. In contrast, some other components of consumption have grown relatively strongly over the past year after weakness in 2008, particularly cafes and restaurants and purchases of motor vehicles.

The recovery in dwelling construction activity continues, with total building approvals in March around their highest level since 2003. After rising by close to 50 per cent over 2009, the number of private house building approvals has flattened out in recent months, partly reflecting the reduction in government grants to first-home buyers and the gradual removal of the earlier monetary stimulus (Graph 36). In contrast, private apartment approvals appear to be gradually picking up from their earlier very low levels. The increase has been concentrated in low-rise developments where business liaison is pointing to some improvement in access to construction finance, while high-rise apartment approvals remain weak (Graph 37). There is also a boost to dwelling investment from the almost 20 000 new homes being built under the Federal Government's Social Housing Initiative.

Housing prices have risen strongly over the past year or so, reflecting both supply- and demand-side factors. Over the past 15 months, capital city housing prices have risen by an average of around 1 per cent a month, to be 15 per cent above their trough in late 2008 (Graphs 38 and 39, Table 8). In the first three months of this year, the pace of growth was particularly strong in Melbourne and Sydney, though it tended to ease in the other capital cities, especially in Perth and Brisbane. Consistent with these trends,

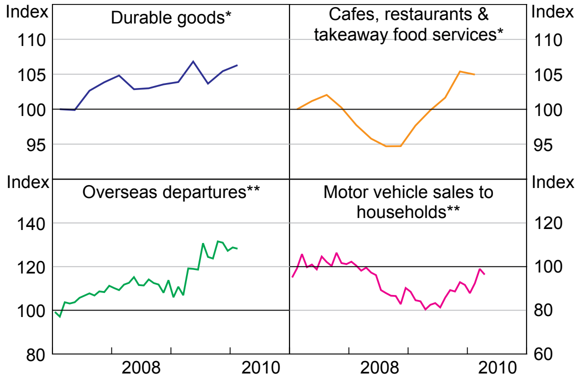
Graph 34
Real Retail Sales Growth



Source: ABS

Graph 35
Consumption Indicators

March quarter 2007 = 100



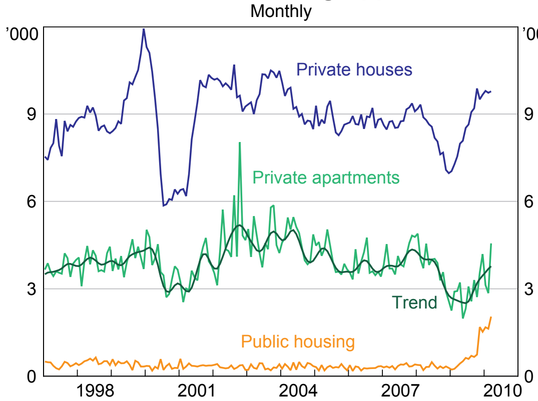
* Quarterly volume of retail sales; durable goods includes clothing, footwear & accessories, household goods and spending at department stores

** Monthly number; overseas departures are short term by residents

Sources: ABS; VFACTS

Graph 36
Residential Building Approvals

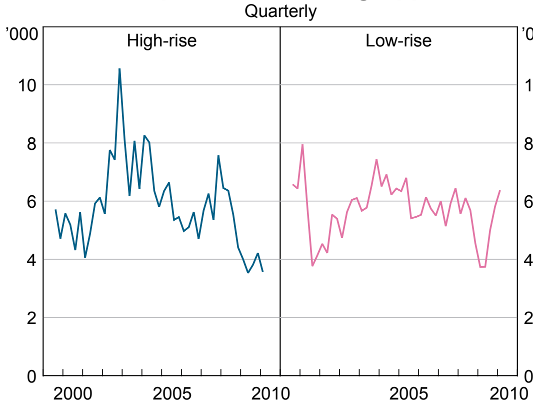
Monthly



Source: ABS

Graph 37
Private Apartment Building Approvals*

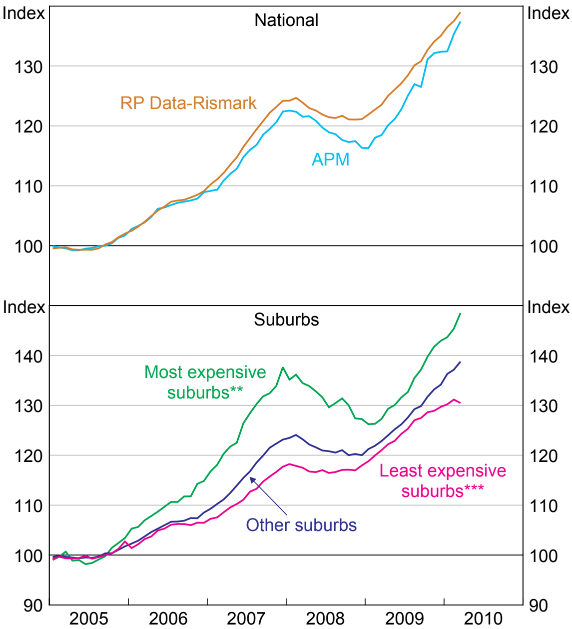
Quarterly



* High-rise buildings have three or more storeys

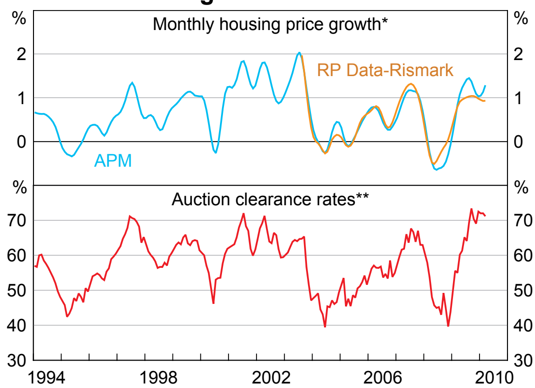
Sources: ABS; RBA

Graph 38
Capital City Housing Prices*
2005 = 100, seasonally adjusted



* Weighted average of houses and apartments in capital cities
** Most expensive 20 per cent of suburbs
*** Least expensive 20 per cent of suburbs
Sources: APM; RBA; RP Data-Rismark

Graph 39
Housing Market Indicators



* Capital cities; 13-period Henderson trend
** Dwelling stock-weighted nationwide measure
Sources: APM; RBA; REIV; RP Data-Rismark

auction clearance rates – which are a timely indicator of housing market conditions – have been around historically high levels since late last year, particularly in Melbourne, Sydney and Canberra.

The rise in housing prices reflects a number of fundamental factors including the improved outlook for economic growth and the strong rate of population growth as well as supply-side problems, which have constrained home-building in recent years. Traditionally, the rate of home-building has exceeded the rate of population growth. However, over the past year, the population growth rate of a little over 2 per cent has been well in excess of the 1.4 per cent growth in the number of dwellings

Table 8: National Housing Price Growth
Per cent

	December quarter 2009	March quarter 2010	Year to March quarter 2010	Trough-to-latest
Capital cities				
ABS(a)	5.1	4.8	20.0	20.0
APM	4.9	2.9	15.7	15.7
RP Data-Rismark	2.9	3.6	12.6	14.5
Regional areas				
APM	4.2	1.1	11.0	11.6
RP Data-Rismark(a)	2.3	0.6	6.3	6.7

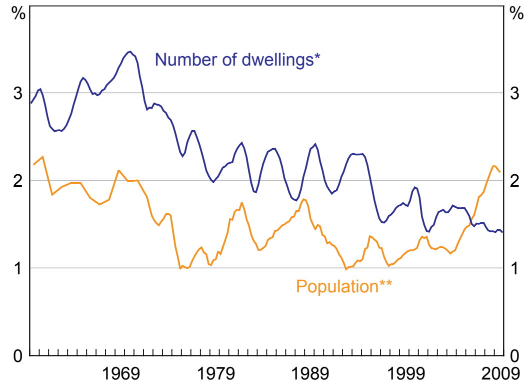
(a) Detached houses only
Sources: ABS; APM; RBA; RP Data-Rismark

(Graph 40). This reversal is evident across all mainland states.

Growth in housing prices has been apparent for both houses and apartments, both within and outside the major capitals, and across both more- and less-expensive suburbs in the capital cities. Following a modest decline in nationwide dwelling prices in 2008, the pick-up in dwelling prices was initially strongest in the least-expensive suburbs, which may have been most sensitive to low mortgage rates and the increase in grants for first-home buyers (Graph 38). The rise in dwelling prices has been strongest in Victoria, where state government supplements to first-home buyer grants, which continue to apply, have been among the largest (Graph 41).

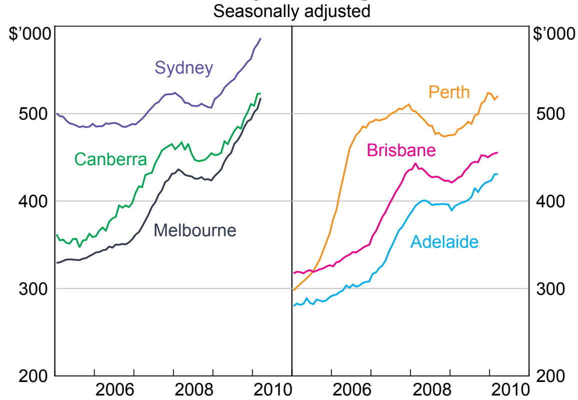
The continuing buoyancy in the established housing market has been somewhat at odds with recent developments in housing finance, which has traditionally been a good indicator of housing market conditions. Housing loan approvals have declined by around 15 per cent since their peak in September last year. This divergence might be partly explained by shifts in the composition of transactions in the housing market. For example, with the recent easing of first-home buyer demand there has been a large decline in turnover in lower-priced suburbs. This may help explain the fall in loan approvals as first-home buyers are more likely than other buyers to use debt to purchase dwellings: household surveys indicate that around 90 per cent of purchases by first-home buyers involve a mortgage, while for repeat buyers only around 65 per cent of housing sales involve a mortgage. Overall, the divergence between aggregate nationwide loan approvals and housing prices remains something of a puzzle, although the developments in housing finance across the states appear to be broadly consistent with developments in prices, with loan approvals strongest in Victoria, which has also had the strongest housing market (Graph 42).

Graph 40
Dwelling and Population Growth
Year-ended



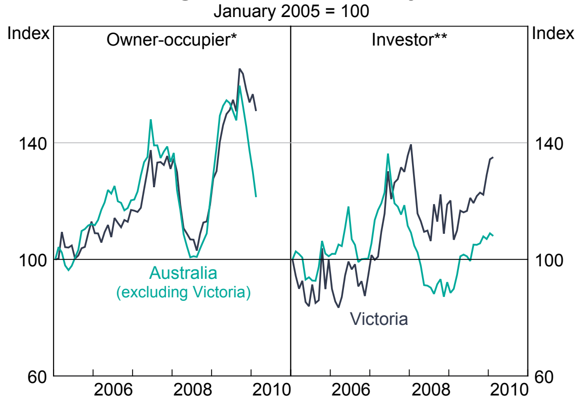
* Number of dwellings reported in the Census, interpolated using completions data
** Data are annual to 1972 and quarterly thereafter
Sources: ABS; RBA

Graph 41
Capital City Housing Prices
Seasonally adjusted



Sources: RBA; RP Data-Rismark

Graph 42
Housing Loan Approvals by State
January 2005 = 100



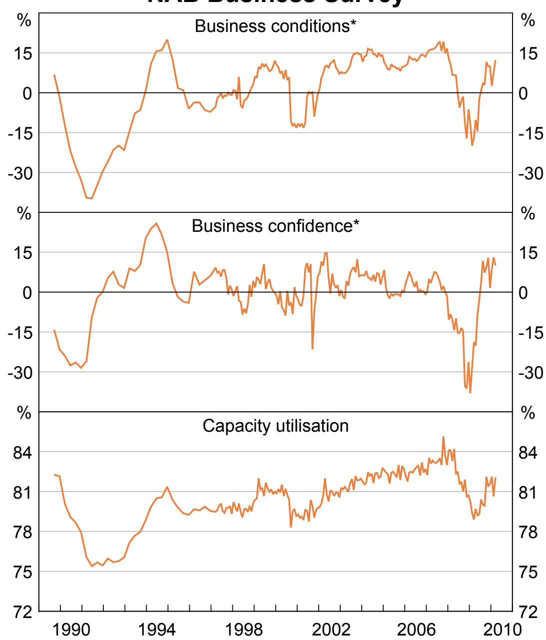
* Net of refinancing
** Excludes investor approvals for new construction and by 'others'
Sources: ABS; RBA

Business Sector

Surveys report that conditions and confidence in the business sector remain above long-run average levels after rising strongly through 2009, while measures of capacity utilisation are around average levels (Graph 43). These patterns are reasonably consistent across sectors, although confidence in the mining sector is particularly high. Business profits recovered in late 2009 and the very large increases in bulk commodity contract prices will provide a boost to profits over coming quarters.

While firms have a fairly optimistic view of the future, outside of the mining sector they remain cautious in their spending plans. There was strong growth in business investment in the December quarter, but this was partly in response to the temporary tax concessions for new tangible assets. In particular, sales of motor vehicles to businesses, which typically comprise around one-quarter of machinery and equipment investment, rose strongly in the December quarter, but have since eased to be 4 per cent lower in the four months to April.

Graph 43
NAB Business Survey



* Net balance; deviation from long-run average
Sources: NAB; RBA

The outlook for mining-sector investment has strengthened over the past year, underpinned by further large increases in bulk commodity prices and an expectation that demand for raw materials from China and other emerging economies will grow solidly in the medium term. Mining investment is at a historically high level, well above the peaks of previous mining booms in the early 1980s and the late 1960s and early 1970s, supported by large projects in the oil and gas, coal and minerals sectors (Graph 44). Construction work on the $43 billion Gorgon liquefied natural gas (LNG) project commenced in the December quarter and there are a number of other significant projects currently in the advanced stages of planning, including additional LNG projects on the North-West Shelf off the coast of Western Australia and coal-seam methane projects in Queensland. There are also a number of large iron-ore projects being developed in the Pilbara and other areas of Western Australia, and coal supply expansions in the Bowen Basin in Queensland and the Hunter Valley in New South Wales. This large pipeline of work is expected to result in a further substantial increase in mining investment over coming years.

In contrast to the mining sector, commercial property development remains weak, with the value of private non-residential building approvals (excluding educational facilities) at around its lowest level as a share of the economy since the early 1990s (Graph 45). This has reflected both weak demand for office and industrial property, with vacancy rates rising over the past year, and a reduction in the supply of credit to many property developers (Graph 46). Over recent months, however, office and industrial property capital values and rents have stabilised as the economy has improved. While commercial property construction remains weak, overall non-residential building activity is being supported by public spending on educational facilities. Construction of educational facilities by both the public and private sectors rose strongly in the second half of 2009, although it is expected to subtract from growth over 2010 as projects are completed.

The business sector as a whole is in a generally sound financial position, as reflected in reduced gearing ratios (see 'Box B: Listed Corporates' Gearing Ratios') and a low level of corporate insolvencies. Business borrowing has fallen sharply over the past year, largely due to a significant deleveraging of balance sheets and tighter lending standards. There are, however, signs this process is coming to an end, with business credit stable in the March quarter, and liaison with businesses indicating the availability of credit has improved somewhat in recent months (see also the 'Domestic Financial Markets' chapter).

Farm Sector

Farm production is expected to have increased slightly in 2009/10, with an increase in the wheat crop partly offset by a decline in dairy and wool production. The outlook for the period ahead appears largely favourable. Eastern cropping regions have received above-average rainfall in recent months as the El Niño weather pattern seen over the summer has abated, which has raised soil moisture levels and should support winter crop plantings. Floodwaters in late 2009 and February/March 2010 have boosted inflows to the Murray-Darling basin, which are now around historical averages for this time of year, improving water availability for irrigated crops.

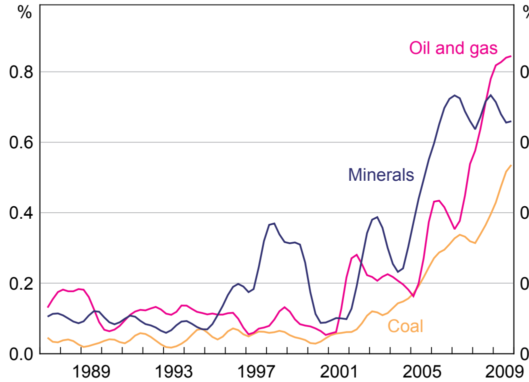
External Sector

Export volumes held up through the financial crisis, which was a considerably better outcome than for almost all major economies where exports suffered large falls in late 2008 and early 2009. More recently, demand for Australian exports of resource commodities has been strong, and prices for most commodities have risen significantly (Graph 47). While coal exports were affected by weather-related

Graph 44

Mining Engineering Work Done*

Per cent of nominal GDP

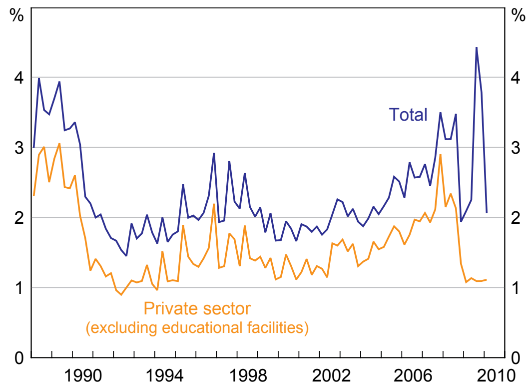


* 7-period Henderson trend
Sources: ABS; RBA

Graph 45

Non-Residential Building Approvals*

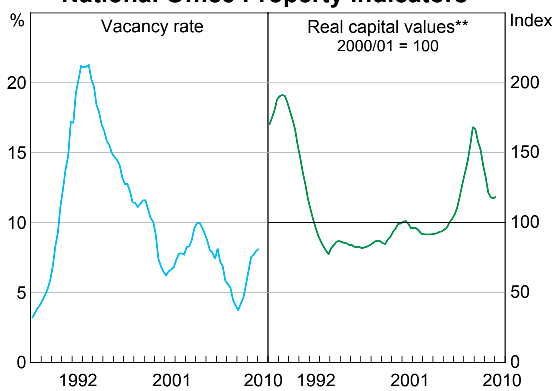
Per cent of nominal GDP



* RBA estimate for March quarter 2010 GDP
Sources: ABS; RBA

Graph 46

National Office Property Indicators*

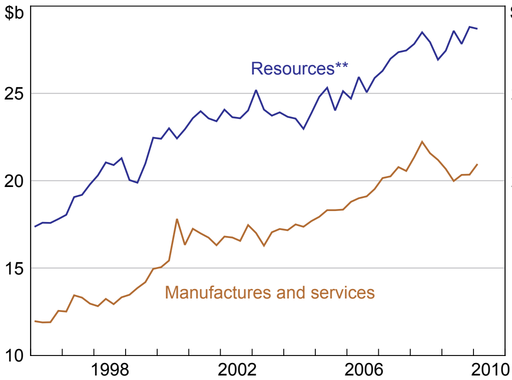


* Capital city CBDs (excluding Hobart and Darwin)
** Deflated by trimmed mean CPI
Sources: Jones Lang LaSalle; Property Council of Australia; RBA

Graph 47

Export Volumes*

Quarterly

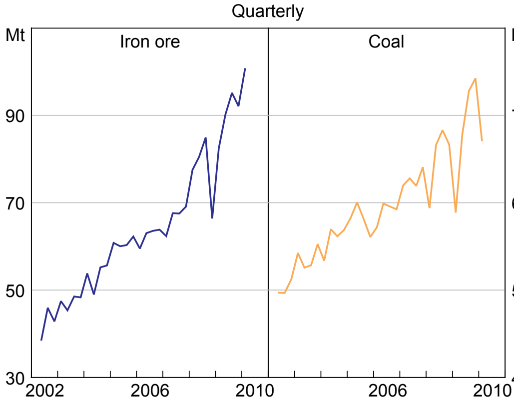


* RBA estimates for March quarter 2010
** Excludes RBA gold transactions
Sources: ABS; RBA

Graph 48

Resource Export Volumes

Quarterly

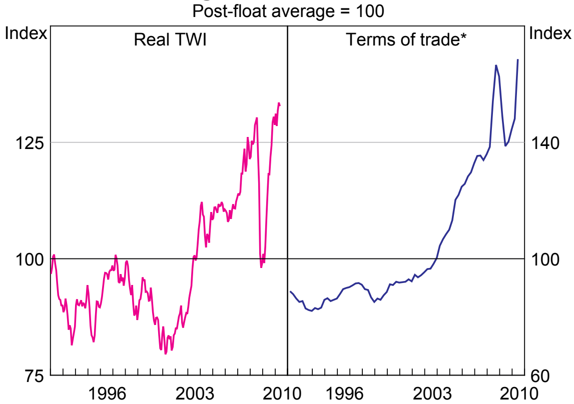


Sources: ABS; RBA

Graph 49

Real Exchange Rate and Terms of Trade

Post-float average = 100



* RBA estimates for March and June quarters 2010
Sources: ABS; RBA; Thomson Reuters

disruptions in the March quarter, iron ore and coal export capacity has increased as a result of the high levels of mining investment over recent years (Graph 48). Looking ahead, major investments in the resources sector – particularly for iron ore, coal and LNG – are expected to underpin solid growth in resource export volumes in coming years.

Manufactured exports remain well below their pre-crisis peak, although exports of motor vehicles have continued to recover. Slow non-commodity export growth partly reflects the dampening effect of the appreciation of the exchange rate.

Import volumes are estimated to have risen further in the March quarter, and have reversed almost all of the nearly 15 per cent fall that occurred between mid 2008 and early 2009. However, the pace of growth has slowed from the second half of 2009, as the effects of the inventory restocking and the rapid appreciation of the exchange rate during 2009 have begun to ease.

The terms of trade are estimated to have risen further in the March quarter. Looking forward, significant contract price increases in the June quarter are expected to see the terms of trade rise by around 20 per cent over 2010 – a significantly better outcome than was expected a year ago. Together with a recovery in global investor sentiment, this has contributed to the considerable appreciation of the exchange rate since early 2009, which in real terms is now around its highest level in the post-float period (Graph 49).

Labour Market

Conditions in the labour market have remained solid in the early part of 2010, following surprisingly strong employment growth in late 2009. After the large recorded increase in January, employment has grown more modestly in the past couple of months, although the full-time component continues to post solid gains (Graph 50). Aggregate employment is now 1½ per cent above its earlier peak in late 2008.

After falling to 5¼ per cent in January, the unemployment rate has been broadly unchanged in recent months and is ½ percentage point below its recent peak (Graph 51). A broader measure of labour underutilisation that includes the 'underemployed' – those workers who would like to work more hours – has also fallen since late 2009, but is still above pre-downturn levels. The recent decline in underemployment has been driven by a decrease in the number of full-time workers who are on reduced hours for economic reasons (such as insufficient work available), while the number of part-time workers who prefer more hours has remained elevated.

All states have recorded growth in employment in recent months. Since the trough in aggregate employment in mid 2009, employment growth in Victoria has been particularly strong. On an industry basis, employment growth has been concentrated in the services sector, particularly professional, scientific & technical services, as well as in wholesale trade and mining (Graph 52).

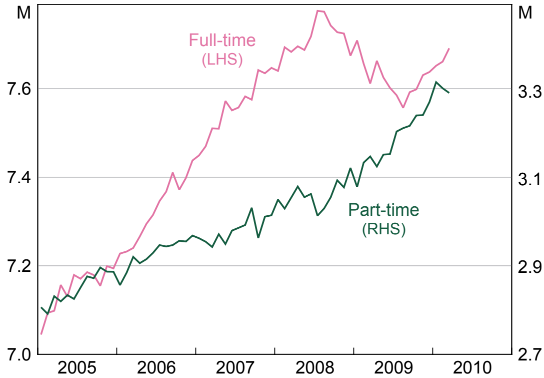
With much of the adjustment during the recent labour market downturn occurring via a reduction in average hours worked, it might have been expected that average working hours would have picked up before the number of people in employment. However, employment has grown at a solid pace over the past year, while average hours worked have remained subdued (Graph 53). The softness in average hours worked partly reflects the relatively strong growth in part-time employment since mid 2009; part-time employment has grown by over 4 per cent, while full-time employment has grown by 1¼ per cent. It also reflects that average hours worked by full-time employees are yet to retrace the declines recorded during the recent labour market downturn, when working hours were reduced in order to lower labour costs and preserve jobs.

Forward-looking indicators point to solid employment growth in coming quarters. Business survey measures of hiring intentions have risen in

Graph 50

Employment

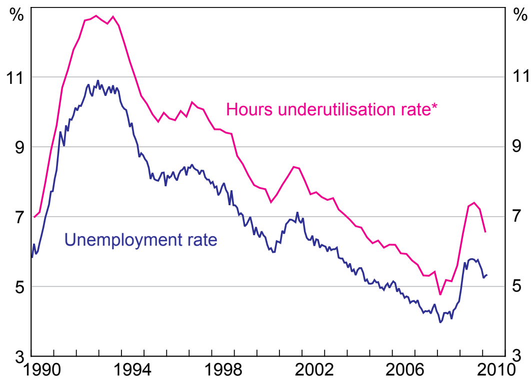
Number of persons



Source: ABS

Graph 51

Measures of Labour Underutilisation

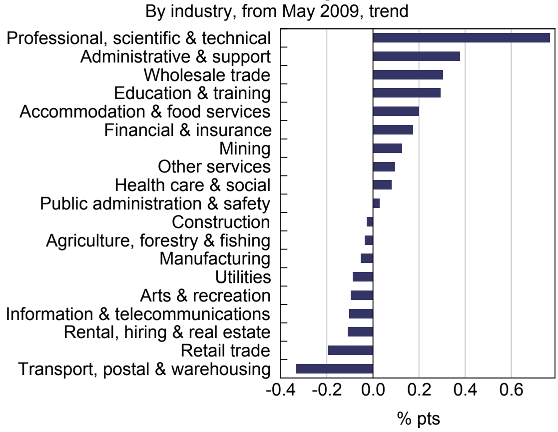


* Mid-month of quarter
Sources: ABS; RBA

Graph 52

Contribution to Employment Growth

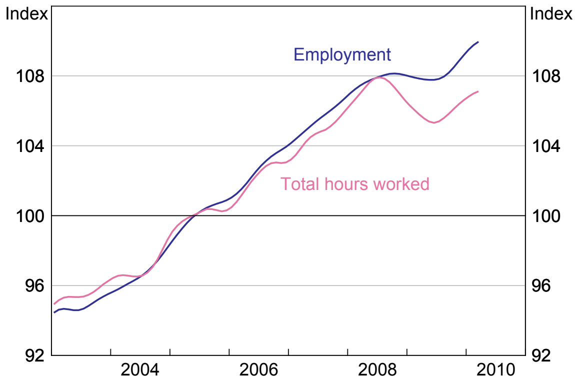
By industry, from May 2009, trend



Source: ABS

Graph 53

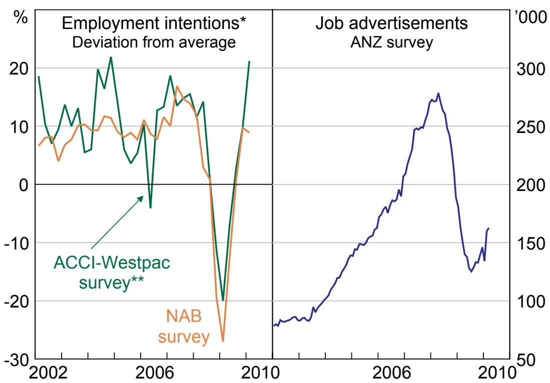
Employment and Hours Worked



Source: ABS

Graph 54

Labour Market Indicators



* Expectations for following quarter, net balance
** Seasonally adjusted by RBA
Sources: ACCI-Westpac; ANZ; NAB; RBA

recent months to above-average levels (Graph 54). The recently reinstated ABS survey of job vacancies posted a strong increase in the three months to February, although vacancies as a proportion of the labour force still remain below mid-2008 levels. Likewise, the ANZ measure of total job advertisements continues to trend upwards, but also remains well below its peak in mid 2008. Consistent with these data, households continue to expect less unemployment in a year's time.