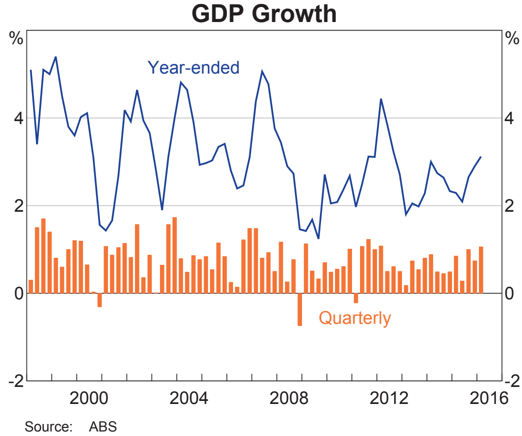
3. Domestic Economic Conditions

Activity in the Australian economy grew by more than 3 per cent over the year to the March quarter, above estimates of the economy's potential rate of growth (Graph 3.1). GDP growth in the March quarter was stronger than expected, largely as a result of a significant expansion in the volume of resource exports, which benefited from unusually favourable weather conditions (Table 3.1). Indications are that growth in the June quarter was moderate. National income has been growing at a modest pace, owing to the decline in the terms of trade and low inflation.

The strong contribution of resource exports to GDP growth over the past year was offset by a further large fall in mining investment, such that mining

Graph 3.1
GDP Growth



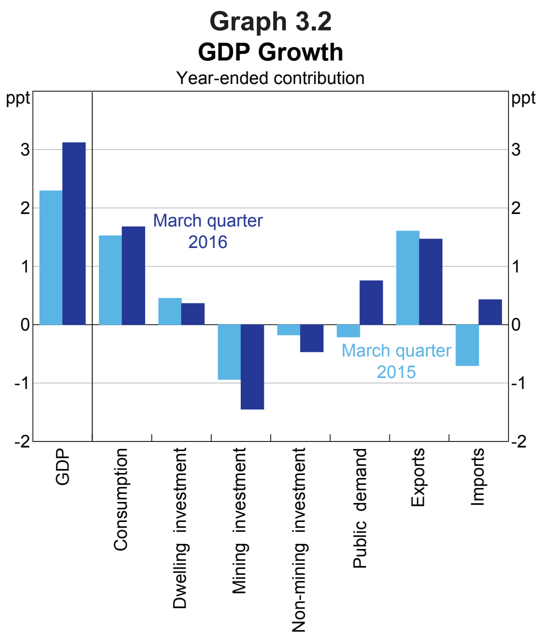
Source: ABS

Table 3.1: Demand and Output Growth
Per cent

	March quarter 2016	December quarter 2015	Year to March quarter 2016
GDP	1.1	0.7	3.1
Consumption	0.7	0.8	3.0
Dwelling investment	1.4	2.8	7.0
Mining investment[(a)]	–2.5	–9.6	–26.7
Non-mining investment[(a)]	–3.7	1.0	–4.7
Public demand	0.6	1.4	3.5
Exports	4.4	0.4	6.6
Imports	-0.8	0.5	–2.0
Mining activity[(a)]	4.8	–3.7	0.7
Non-mining activity[(a)]	0.4	1.5	3.6
Nominal GDP	0.5	0.4	2.1
Real gross domestic income	0.5	0.1	0.6
Memo: Terms of trade	–1.9	–3.4	–11.5

(a) RBA estimates
Sources: ABS; RBA

activity was little changed (Graph 3.2). Meanwhile, non-mining activity has been growing at or above a trend pace for some time. Low interest rates and the depreciation of the exchange rate since early 2013 have supported this rebalancing, with solid growth evident in consumption, dwelling investment and most export categories. Public demand has also grown at a solid pace. However, non-mining business investment has declined, subtracting a little from growth.



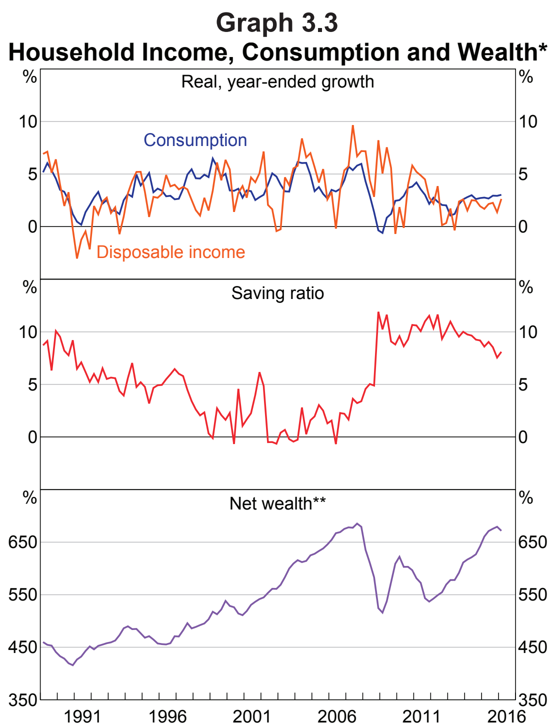
Sources: ABS; RBA

The unemployment rate has been steady at around 5¾ per cent. Employment growth has moderated somewhat since the start of 2016, following strong outcomes late last year. Average hours worked has declined a little and employment growth over recent months has been concentrated in part-time jobs. Indicators of future employment growth have been mixed of late. There is still evidence of spare capacity in the labour market, including low wage growth. While the protracted period of low wage growth has allowed for more employment than otherwise, it has also constrained growth in nominal household income in recent years.

Household Sector

Household consumption continued to grow at around its decade-average pace in early 2016. Low interest rates, employment gains and growth in household wealth have supported consumption in a period of below-average income growth. The saving ratio has declined further in line with the gradual trend of recent years (Graph 3.3). Consumption growth has remained strong in states with relatively little exposure to the resources sector, such as New South Wales and Victoria, but has been comparatively weak in the resource-rich states of Queensland and Western Australia.

Timely indicators of household consumption growth were mixed in the June quarter. Households' perceptions of their own finances have been above average in recent months, despite relatively weak income growth, and consumers' unemployment



* 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; saving ratio is net of depreciation

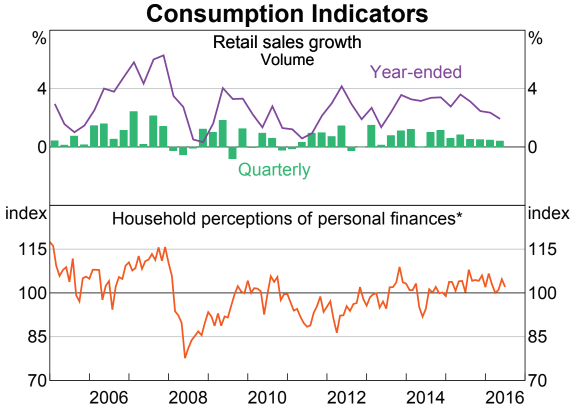
** Per cent of annual household disposable income, before the deduction of interest payments

Sources: ABS; RBA

expectations are lower than in recent years. However, retail sales volumes increased at a slightly slower pace than in the March quarter (Graph 3.4).

A range of indicators suggest that conditions in the established housing market have eased this year from very strong conditions over recent years. Housing prices were little changed in the June quarter according to most published measures (Table 3.2; Graph 3.5). In contrast, the headline CoreLogic measure of housing prices recorded very strong growth in April and May in a number

Graph 3.4
Consumption Indicators

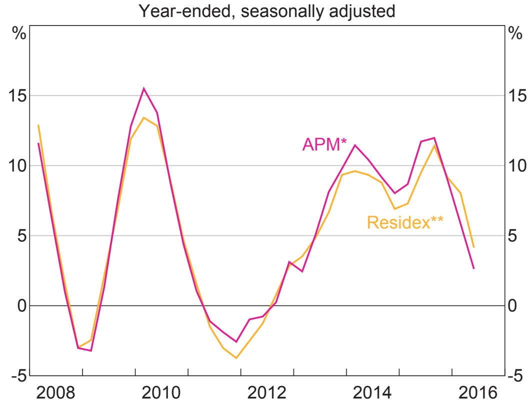


* Average of the ANZ-Roy Morgan and Westpac-Melbourne Institute consumer sentiment measures of respondents' perceptions of their personal finances relative to the previous year; average since 1980 = 100

Sources: ABS; ANZ-Roy Morgan; RBA; Westpac and Melbourne Institute

Graph 3.5
Growth in National Housing Prices

Year-ended, seasonally adjusted



* APM is a quarterly stratified median price index

** Residex is a quarterly repeat sales price index

Sources: APM; RBA; Residex

of cities, to be more than 5 per cent higher over the June quarter. Recent information suggests that the strong increases reported by CoreLogic were overstated as a result of methodological changes affecting growth rates for the June quarter. The most recent data suggest that housing prices declined in most capital cities in July.

Other timely indicators of conditions in the established housing market continue to point to weaker conditions than last year. Auction clearance rates and the number of scheduled auctions

Table 3.2: Housing Prices

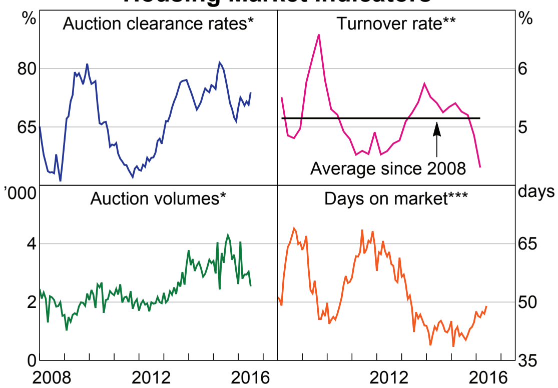
Percentage change, seasonally adjusted

	APM *Stratified median*		Residex *Repeat sales*	
	June quarter 2016	Year to June quarter 2016	June quarter 2016	Year to June quarter 2016
Sydney	0.0	1.0	–0.1	3.7
Melbourne	3.2	8.6	–1.3	9.2
Brisbane	1.7	2.0	0.9	3.5
Adelaide	–2.2	2.2	0.5	2.1
Perth	0.3	–3.4	–0.2	–3.8
Canberra	2.0	2.6	0.5	4.3
Hobart	1.4	4.6	–1.5	2.1
Darwin	–	–	–0.5	–4.5
Australia[(a)]	**0.8**	**2.6**	**–0.1**	**4.1**

(a) Capital cities only
Sources: APM; RBA; Residex

are lower than a year ago and there has been a large decline in the number of transactions in the housing market, which is reflected in the turnover rate (Graph 3.6). In the private treaty market, the discount on vendor asking prices has been little changed of late, but the average number of days that a property is on the market has increased from the lows of last year.

Graph 3.6
Housing Market Indicators

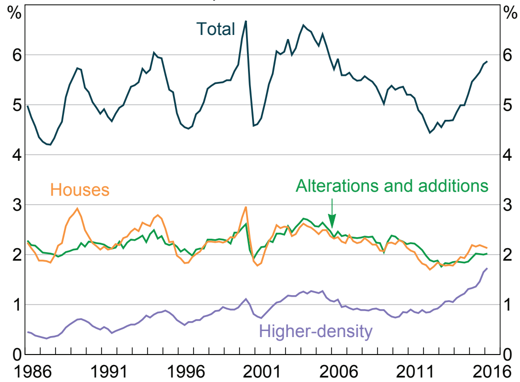


* Average of Melbourne and Sydney
** Share of dwelling stock, annualised
*** Capital city dwelling stock weighted median for private treaty sales only
Sources: ABS; APM; CoreLogic; RBA; Real Estate Institute of Victoria

Total housing loan approvals have been little changed in recent months. Meanwhile, housing credit growth has been steady in the first six months of the year but slower than in 2015, consistent with a relatively low level of turnover and the tightening of lending standards towards the end of 2015 (see 'Domestic Financial Markets' chapter for further details on the developments in housing finance).

The upswing in dwelling investment, particularly the construction of high-density dwellings, has continued, supported by low interest rates and earlier increases in housing prices (Graph 3.7). Residential building approvals are lower than their peak of mid 2015 but remain at high levels. Indeed, building approvals have continued to exceed completions, resulting in the number of dwellings under construction or yet to be completed reaching historically high levels. The work in the pipeline is

Graph 3.7
Dwelling Investment
Current prices, share of GDP

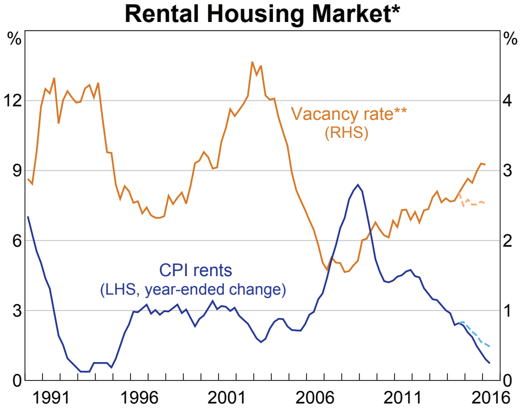


Sources: ABS; RBA

sufficient to underpin dwelling investment activity for the next couple of years (see 'Box B: The Housing Market').

Conditions in the rental market have continued to soften over the past year. The aggregate rental vacancy rate has drifted higher to be close to its longer-run average of around 3 per cent and rental inflation is around multi-decade lows, having eased across most capital cities (Graph 3.8). The Perth rental market is particularly weak, reflecting the slowing in population growth combined with ongoing additions to the housing supply.

Graph 3.8
Rental Housing Market*

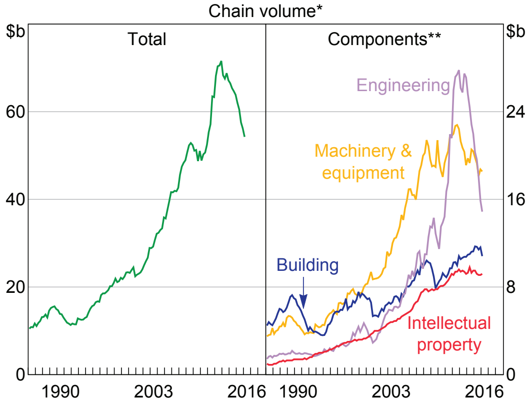


* Dotted lines exclude Perth
** Excludes Adelaide from March quarter 2015
Sources: ABS; RBA; Real Estate Institute of Australia

Business Sector

As expected, private business investment declined further in the March quarter and fell by 13 per cent over the year (Graph 3.9). The decline in the quarter was led by falls in engineering (which was largely related to the decline in mining investment) and building construction.

Graph 3.9
Private Business Investment
Chain volume*



* Adjusted for second-hand asset transfers between the private and other sectors; reference year is 2013/14

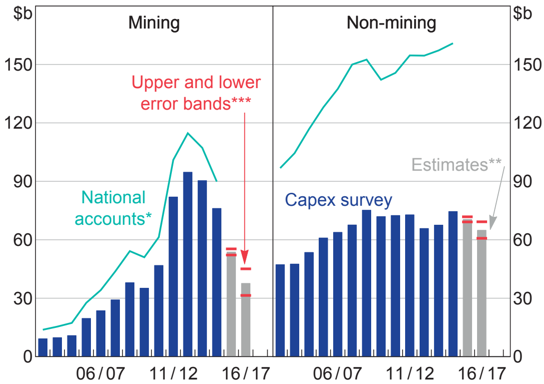
** Excluding cultivated biological resources

Sources: ABS; RBA

Mining investment has fallen by around 45 per cent since its 2012 peak and is expected to fall further over the next couple of years as few new projects are expected to commence. The ABS capital expenditure (Capex) survey of investment intentions and Bank liaison suggest there will be a further large fall in mining investment in 2016/17, although the largest subtraction from GDP growth is likely to have occurred in 2015/16 (Graph 3.10).

In real terms, non-mining investment has been subdued for several years and indicators, such as the Capex survey, suggest that it will remain so for at least the next few quarters. The estimates from the Capex survey are, however, subject to considerable uncertainty. Moreover, the survey does not cover a large share of non-mining investment that is captured by the national accounts data, including investment in agriculture, education or healthcare, as well as intangible items, such as software

Graph 3.10
Measures of Private Business Investment
Nominal



* Adjusted for second-hand asset transfers between the private and other sectors; excluding cultivated biological resources

** Estimates are firms' expected capital expenditure, adjusted for the past average difference between expected and realised spending

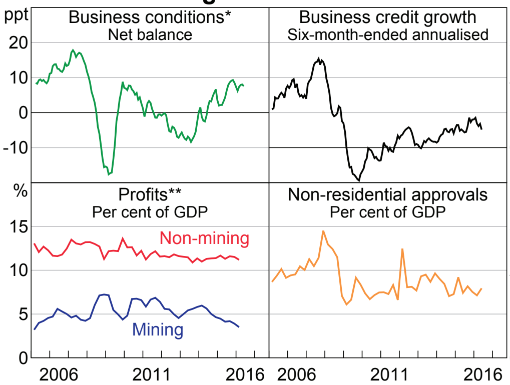
*** Error bands are based on the root mean square error of each adjusted estimate compared with the final outcome for investment in each year

Sources: ABS; RBA

development. Non-mining investment has been particularly weak in resource-rich states. In part, this is because many non-mining firms provide inputs and support to firms involved in either mining investment or resource extraction. More broadly, investment by non-mining firms is being adversely affected by weak demand growth overall in those states. In contrast, in New South Wales and Victoria, which are less resource intensive, the recovery in non-mining business investment appears to have begun, supported by very low interest rates and the depreciation of the Australian dollar over the past few years.

Although non-mining investment has been weak for some time, business surveys suggest that non-mining business conditions and capacity utilisation have been on an upward trend since 2013 and these survey measures are currently well above their long-term averages (Graph 3.11). Business credit growth has eased a little of late. At the same time, non-mining company profits have been little changed as a share of nominal GDP. While non-residential building approvals persist at relatively low levels, reflecting weak underlying conditions in the commercial property market, the Bank's liaison

Graph 3.11
Non-mining Business Indicators



* Deviation from long-run average; gross value added weighted; three-month moving average

** Inventory valuation adjusted gross operating profits

Sources: ABS; APRA; NAB; RBA

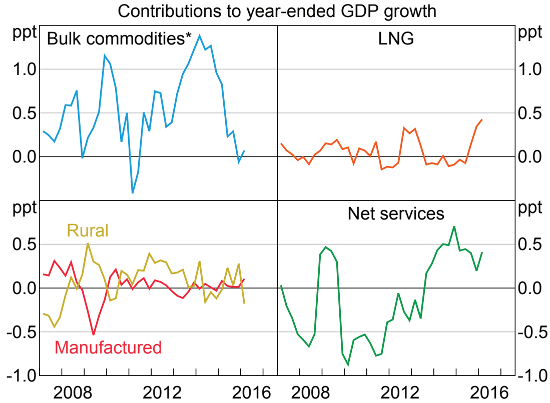
has suggested that the outlook for investment is relatively favourable in some commercial property sectors, including retail, hotels, student accommodation and aged care.

External Sector

Export volumes rose by 7 per cent over the year to the March quarter, largely driven by strength in resource and service exports (Graph 3.12). The ramp-up in liquefied natural gas (LNG) production has begun and LNG exports are expected to continue to grow rapidly over the next few years as further projects are completed. Both iron ore and coal exports grew strongly in the March quarter, supported by unusually favourable weather conditions. Looking ahead, iron ore export volumes are expected to be supported by increased production from Australia's large low-cost producers, while coal exports face headwinds from the relatively high cost of some Australian production and weak global demand. Net service exports have increased over the past year, although at a slower pace more recently, assisted by the improvement in competitiveness associated with the depreciation of the Australian dollar and relatively low labour cost growth; tourism, education and business service exports have all expanded.

Graph 3.12
Exports

Contributions to year-ended GDP growth



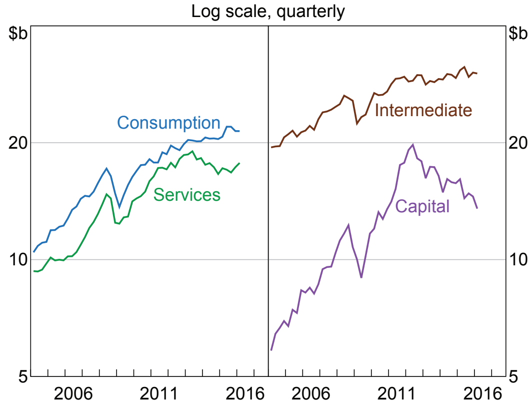
* Iron ore and coal

Sources: ABS; RBA

Import volumes decreased modestly over the year to the March quarter, reflecting declines in capital and intermediate imports (Graph 3.13). Imports of capital goods have been declining since 2012 when mining investment peaked.

Graph 3.13
Import Volumes*

Log scale, quarterly



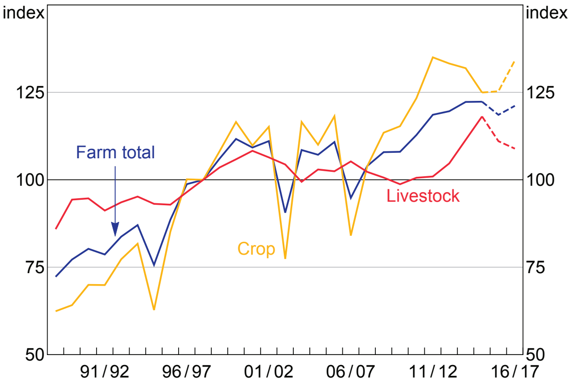
* Reference year is 2013/14

Source: ABS

Farm Sector

The Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) estimates that the volume of farm production declined modestly in 2015/16 (Graph 3.14). In recent years, farm production has been supported by strong growth

Graph 3.14
Farm Production Volumes*
1997/98 = 100



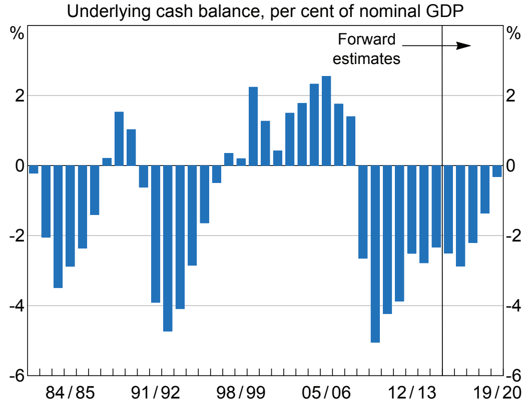
* Dotted lines represents 2015/16 and 2016/17 forecasts
Source: ABARES

in livestock production, but this is expected to have moderated in 2015/16 as herds were being rebuilt. Farm production volumes are forecast by ABARES to increase in 2016/17 as the ongoing decline in livestock production is expected to be more than offset by strong growth in crop production, given above-average rainfall at the start of the winter crop-planting season.

Government Sector

Recent federal and state government budgets suggest that the consolidated deficit will increase a little in 2016/17 to around 3 per cent of GDP, owing largely to lower revenue growth in the federal budget and higher capital expenditure by the New South Wales Government (Graph 3.15). Deficits are expected to be progressively lower over subsequent years; overall these deficits are slightly larger than previous budget estimates. The consolidated budget is expected to return to a balanced position by around 2019/20.

Graph 3.15
Consolidated Budget Balance*
Underlying cash balance, per cent of nominal GDP

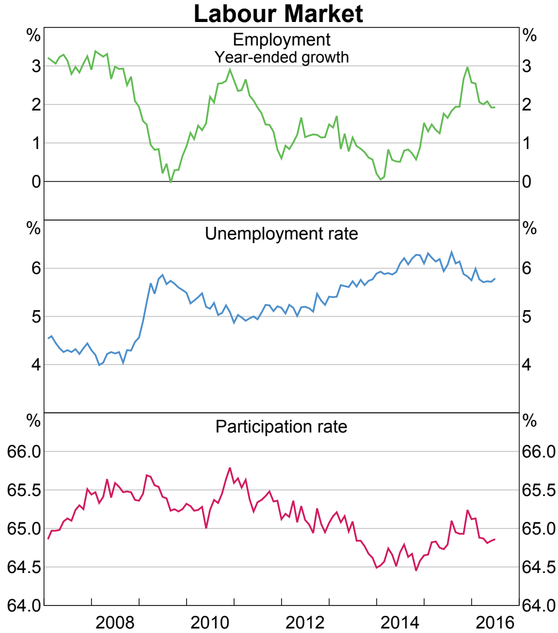


* Federal, state and territory governments, based on 2016/17 budgets; excludes the effect of the federal grant to the RBA in 2013/14
Sources: ABS; Australian Treasury; RBA; State and Territory Treasuries

Labour Market

Employment growth has moderated, following strong growth late last year (Graph 3.16). The unemployment rate has been steady at around 5¾ per cent, having fallen by around ½ percentage point over 2015. The participation rate has also been little changed in recent months, although it is lower than it was late last year.

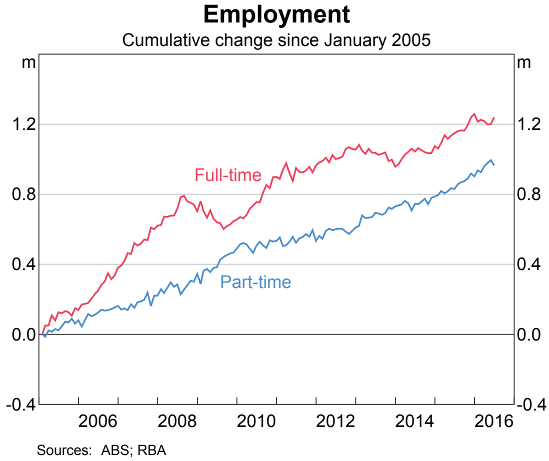
Graph 3.16
Labour Market



Source: ABS

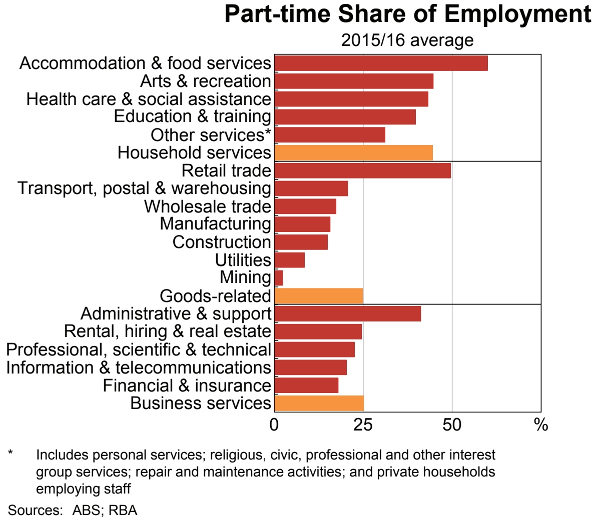
Over the course of 2016, employment growth has been concentrated in part-time jobs, while full-time employment has been little changed until very recently (Graph 3.17). The share of part-time employment has trended higher over a number of decades to be close to one-third of total employment. This reflects increased participation by females, as well as labour market reforms that have provided firms with greater flexibility to adjust working hours rather than headcount in response to changes in demand.[1]

Graph 3.17



More recently, the shift in the composition of employment growth towards part-time employment appears to reflect two factors. First, employment growth has been stronger in industries that tend to have a higher proportion of part-time jobs, such as household services (Graph 3.18). In part, this reflects solid growth in household consumption and a pick-up in tourism, but also longer-run trends, such as increasing demand for aged and home-based care services as the population ages. Second, the recent growth in part-time employment may reflect a cautious approach by firms to hiring and/or a means for them to increase their use of labour in a way that contains costs. In particular, the Bank's liaison suggests that a broad range of businesses are seeking greater flexibility from employees through the use of part-time or casual work or temporary contracts, to improve productivity and minimise their labour costs. This might help to also explain the increase in part-time employment relative to full-time employment in a range of industries in the business service and goods-related sectors. Meanwhile, both full-time and part-time construction employment have grown strongly, underpinned by elevated levels of residential construction activity.

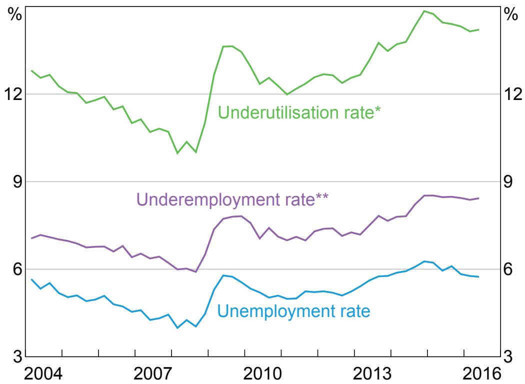
Graph 3.18



The unemployment rate remains at a level consistent with there being spare capacity in the labour market. Furthermore, the share of workers who would like to work more hours has been little changed over the past two years and is at a high level. That is, the underemployment rate (which captures the number of workers who would like more hours, as a share of the labour force) has not fallen by as much as the unemployment rate over the past year (Graph 3.19). Low growth in a range of wage measures is also consistent with a degree of spare capacity in the labour market. At the same time, low wage growth may enable firms to employ

1 Bishop J and M Plumb (2016), 'Cyclical Labour Market Adjustment in Australia', RBA *Bulletin*, March, pp 11–20.

Graph 3.19
Labour Underutilisation Rates
Per cent of labour force



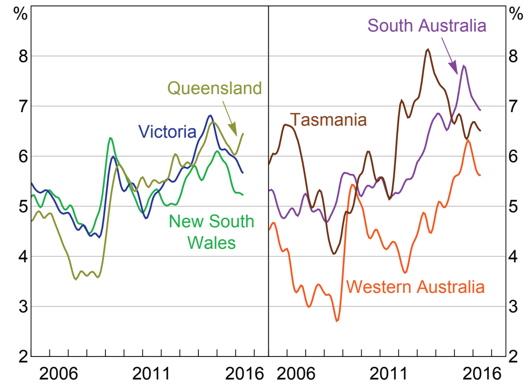
* Underutilisation rate is the sum of the underemployment and unemployment rates
** Full-time workers on reduced hours for economic reasons and part-time workers who would like, and are available, to work more hours
Source: ABS

more workers than would otherwise be the case (see 'Price and Wage Developments' chapter).

There appears to be somewhat less spare capacity in New South Wales and Victoria, where unemployment rates have declined noticeably over the past year and growth in full-time employment has been strongest (Graph 3.20). In contrast, Queensland's unemployment rate has ticked up recently and Western Australia's unemployment rate is much higher than it was a few years ago, although it is still a little below the national average. At the same time, population growth has moderated noticeably in the resource-rich states relative to the rest of the country, which has helped to limit the increase in their unemployment rates. Looking ahead, further mining-related job losses are expected as LNG-related construction projects reach completion.

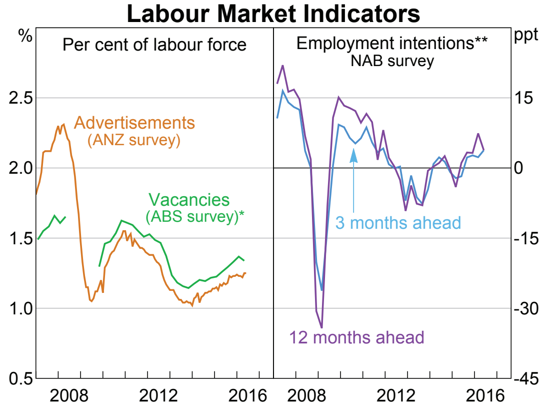
Indicators of future employment growth have been mixed over recent months, following strong gains over the preceding year. Job advertisements as a share of the labour force had been little changed for some time, but increased slightly over the past couple of months (Graph 3.21). In contrast, the job vacancy rate declined a little over the three months

Graph 3.20
Unemployment Rates by State
Trend



Source: ABS

Graph 3.21
Labour Market Indicators



* This survey was suspended between May 2008 and November 2009
** Net balance of employment intentions for the following period; deviation from average; 12-months-ahead measure seasonally adjusted by the RBA
Sources: ABS; ANZ; NAB; RBA

to May. This appears to be consistent with weaker employment growth in the business service and goods-related sectors compared with household services, for which vacancies have continued to increase. The NAB survey measure of firms' hiring intentions remains above average. Overall, these indicators suggest employment growth in coming months will be consistent with a stable unemployment rate. ✠