2. Domestic Economic Conditions

The Australian economy grew by 0.4 per cent in the September quarter and by 1.7 per cent in year-ended terms (Graph 2.1; Table 2.1). A number of factors have weighed on growth over the year. Households have been going through a period of adjustment to the prolonged period of low income growth, which has contributed to weak consumption growth. Following the earlier decline in housing prices, dwelling investment is currently in a downswing phase of the cycle. Mining investment is passing through a trough and is expected to contribute to growth in coming quarters. Other forms of business investment have been subdued. The farm sector has contributed to the downturn because of the ongoing effects of the drought and, more recently, bushfires (see 'Box B: Macroeconomic Effects of the Drought and Bushfires'). Working in the other direction, export growth was relatively strong over 2019 and supported growth in the economy.

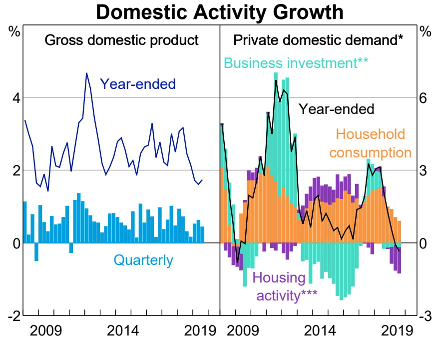
Employment grew more strongly than output over 2019, despite some moderation in employment growth in the December quarter. Private domestic demand is expected to strengthen in the second half of 2020. The most recent leading indicators suggest that mining and dwelling investment will turn around in 2020 (see 'Economic Outlook' chapter). Consumption growth is expected to gradually pick up. The bushfires and coronavirus will weigh on growth in the near term, but the effects are expected to be temporary.

Household consumption growth has been weak …

Household consumption was broadly flat in the September quarter and year-ended growth slowed to 1.2 per cent (Graph 2.2). This was the slowest rate of growth in consumption in a decade. The downturn in the housing market, which reduced households' wealth, and the extended period of weak growth in household income have contributed to the slowdown in consumption growth since mid 2018. The pick-up in the household saving ratio in the September quarter and the increase in household payments on mortgages in the December quarter are consistent with more subdued consumption growth being partly explained by households adjusting their behaviour after lowering their expectations about future income growth (see 'Domestic Financial Conditions' chapter).

Graph 2.1

Domestic Activity Growth



* Contributions to year-ended growth in bars
** Adjusted for second-hand asset transfers to the public sector
*** Dwelling investment and ownership transfer costs
Sources: ABS; RBA

Table 2.1: Demand and Output Growth

Per cent

	September quarter 2019	June quarter 2019	Year to September quarter 2019	Share of GDP
GDP	0.4	0.6	1.7	100
Domestic demand	0.2	0.3	0.9	98
– Consumption	0.1	0.3	1.2	56
– Dwelling investment	–1.7	–3.7	–9.6	6
– Mining investment	–7.8	3.7	–11.2	3
– Non-mining investment	–0.4	–1.5	1.1	9
– Public consumption	0.9	2.5	6.0	19
– Public investment	3.8	–1.5	0.6	5
Change in inventories(a)	0.1	–0.4	–0.3	n/a
Exports	0.7	1.3	3.3	24
Imports	–0.2	–1.1	–1.5	22
Mining activity(b)	0.7	1.7	2.3	15
Non-mining activity(b)	0.4	0.4	1.7	85
Farm GDP	–1.4	–0.2	–5.9	2
Non-farm GDP	0.5	0.6	1.9	98
Nominal GDP	1.1	1.5	5.5	n/a
Terms of trade	0.4	1.4	7.8	n/a

(a) Contribution to GDP growth

(b) RBA estimates

Sources: ABS; RBA

Consumption per person declined over the year, and the weakness in spending was broadly based by state. Following a period of weak growth in discretionary consumption, growth in spending on essential items has also slowed. In the September quarter, growth in the consumption of services slowed noticeably, reflecting less spending on transport services and at hotels, cafes & restaurants, which each declined by around 1 per cent in the quarter. Goods consumption remained subdued.

More recent data suggest that household spending remained subdued in the December quarter. Retail sales volumes increased by 0.5 per cent in the quarter, but were only 0.4 per cent higher over the year. Sales volumes of food contracted further in the quarter as ongoing strong price pressures from the drought weighed on volumes. Retail sales values growth was relatively strong in the month of November, because of the increasing popularity of the 'Black Friday' sales. The subsequent decline in monthly sales values in December is the result of purchases being brought forward to Black Friday. The effects of bushfires and associated poor air quality was evident in a decline in sales at cafes & restaurants in New South Wales in December. Motor vehicle sales to households have continued to decline over recent months.

Measures of consumer sentiment have also declined over recent quarters (Graph 2.3). Headline consumer sentiment tends to decline during the first few months following the start of an interest rate easing phase, with sentiment and monetary policy both responding to the same news (Graph 2.4). Households' views on economic conditions have also deteriorated since the middle of 2019, which is consistent with the slowing in private demand, and their expectations for the longer-run economic outlook having been revised lower. However, households' views on their current personal financial situation, which historically have tended to be more indicative of actual spending decisions, have not changed much over the past six months.

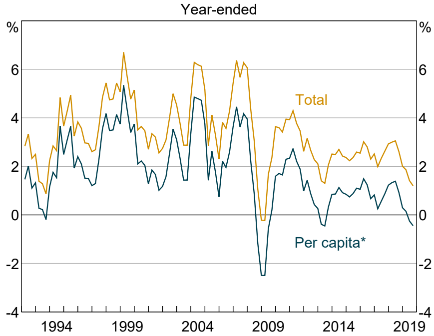
… following a prolonged period of low growth in household disposable income …

Growth in nominal household disposable income has been low for more than five years, reflecting subdued growth in wages, weak growth in a number of other sources of household non-labour income and strong

Graph 2.2

Household Consumption Growth

Year-ended



* Based on population forecasts for June and September 2019

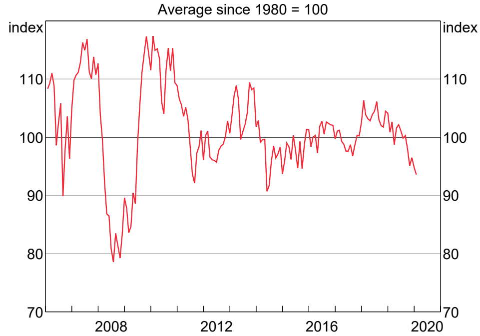
Sources: ABS; RBA

growth in tax payments (Graph 2.5). Household disposable income growth picked up noticeably in the September quarter to a little over 5 per cent in year-ended terms, largely driven by eligible households receiving the low- and middle-income tax offset payments in that quarter and by lower interest payments from the recent reductions in the cash rate. While wages growth remained subdued, growth in employment supported growth in labour income, which was 1.1 per cent in the September quarter. Non-labour income growth remained modest, which partly reflected lower income to

Graph 2.3

Headline Consumer Sentiment*

Average since 1980 = 100



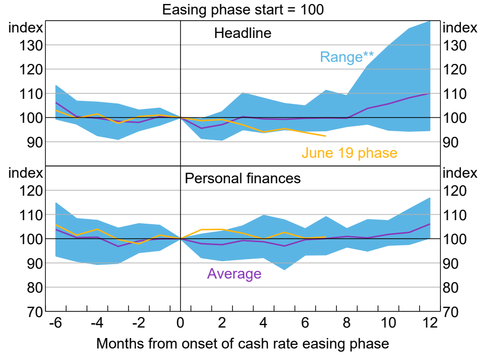
* Mean of Westpac–Melbourne Institute and ANZ–Roy Morgan surveys' deviations from average

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

Graph 2.4

Consumer Sentiment during an Easing Phase*

Easing phase start = 100



* Mean of Westpac–Melbourne Institute and ANZ–Roy Morgan consumer sentiment measures

** Covers five easing phases beginning 1996M7, 2001M2, 2008M9, 2011M11 and 2015M2

Sources: ANZ–Roy Morgan; RBA; Westpac–Melbourne Institute self-employed farm and construction-related workers.

The household saving ratio increased in the September quarter, to 4.8 per cent (Graph 2.6). While household disposable income was boosted by the tax offset and lower interest rates, this did not contribute much to consumer spending in the quarter.

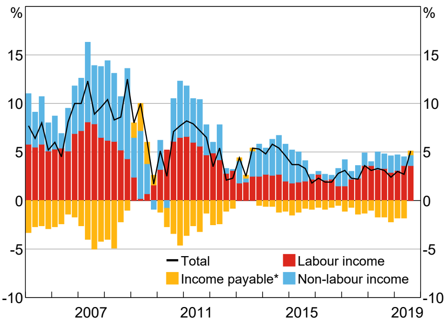
… but conditions in the established housing market strengthened further

The turnaround in the established housing market has become more widespread geographically over recent months. Nationally, prices have increased by around 4 per cent since the previous *Statement on Monetary Policy* and are close to their previous peak in mid 2017

Graph 2.5

Household Disposable Income Growth

Year-ended with contributions

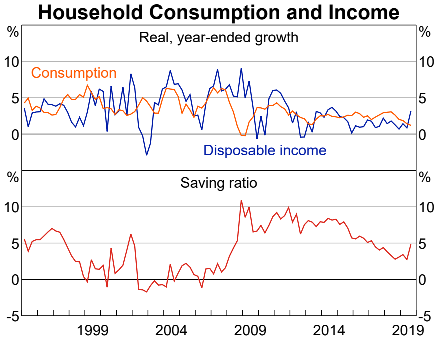


* Includes tax and interest payments

Source: ABS

Graph 2.6

Household Consumption and Income



Sources: ABS; RBA

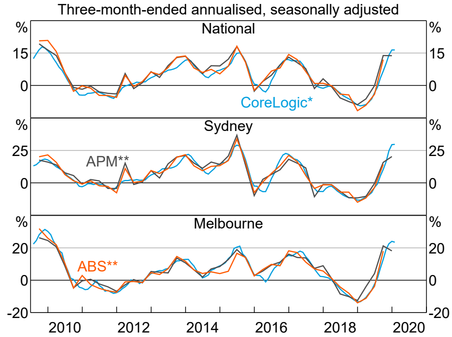
(Graph 2.7; Table 2.2). Housing price growth has picked up in most capital cities and in regional Australia over recent months. It is likely that lower interest rates have contributed to the turnaround in housing markets, but the large variation in housing prices across the country over recent years suggests other fundamentals such as population growth, incomes and supply-side constraints remain important drivers.

Other indicators of conditions in established housing markets have also strengthened in recent months (Graph 2.8). Auction clearance rates picked up further towards the end of 2019 in both Sydney and Melbourne, as did the number of auctions held in both cities. New residential listings have increased, as the rise in prices has encouraged sellers to enter the market. The housing turnover rate has increased notably since the middle of 2019, albeit from very low levels. Although recent observations of turnover are subject to large revisions, the increase in turnover is consistent with the historical relationship with housing prices as well as partial indicators of market activity. Since the previous *Statement*, the share of households that are expecting housing prices to rise over the coming year has increased further.

Graph 2.7

Housing Price Growth

Three-month-ended annualised, seasonally adjusted



* Hedonic home value index

** Stratified median index; national indices only include the capital cities

Sources: ABS; APM; CoreLogic; RBA

Table 2.2: Growth in Housing Prices[(a)]

Percentage change, hedonic

	January	December	November	October	Year-ended	Past five years
Sydney	1.5	2.2	2.9	1.4	7.9	24
Melbourne	1.7	1.7	2.0	1.8	8.2	32
Brisbane	0.5	0.7	0.6	0.6	1.1	10
Adelaide	0.3	0.3	0.3	0.3	0.4	11
Perth	0.2	0.0	0.1	–0.3	–5.7	–20
Darwin	0.0	–0.4	–0.7	–0.3	–8.1	–30
Canberra	0.4	0.2	1.0	0.4	3.1	23
Hobart	0.8	0.2	2.1	0.5	5.0	45
Capital cities	1.2	1.4	1.9	1.2	5.2	18
Regional	0.5	0.4	0.4	0.3	0.4	13
Australia	1.0	1.3	1.6	1.0	4.1	17

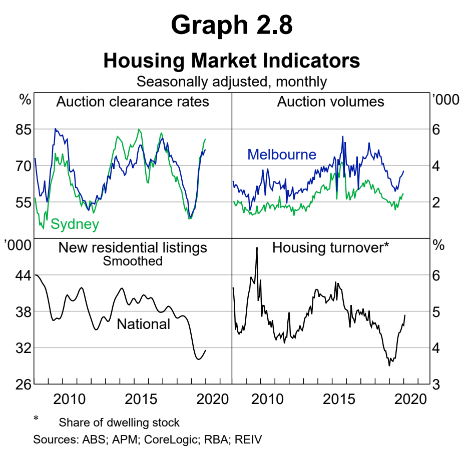
(a) Seasonally adjusted by the RBA

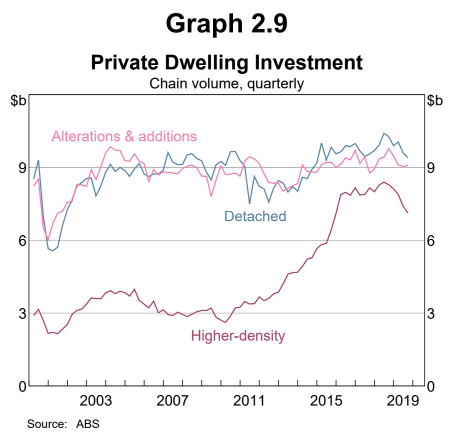
Sources: CoreLogic; RBA

However, dwelling investment continued to decline

Dwelling investment declined in the September quarter, for both detached housing and higher-density housing (Graph 2.9). Dwelling investment has subtracted 0.6 percentage points from GDP growth over the year. A bit over half of the decline over the year reflected the decline in activity in New South Wales, where detached activity fell by 15 per cent and higher-density activity fell by 23 per cent.

Dwelling investment is expected to continue to decline in the near term. Leading indicators nonetheless point to activity stabilising later in 2020, consistent with the strengthening in the established housing market feeding into building activity with a lag. Private residential building approvals increased a little towards the end of 2019 and developers in the Bank's liaison program have reported an increase in sales activity in recent months, albeit from a low base. Greenfield land sales also increased in the second half of 2019.





Consistent with the turnaround in established markets over recent months, spending on costs involved with transferring properties such as stamp duties and fees paid to real estate agents and lawyers (known as 'private ownership transfer costs') increased by 4.5 per cent in the September quarter. This contributed 0.1 percentage points to quarterly GDP growth after having subtracted 0.3 percentage points from growth over the year to June.

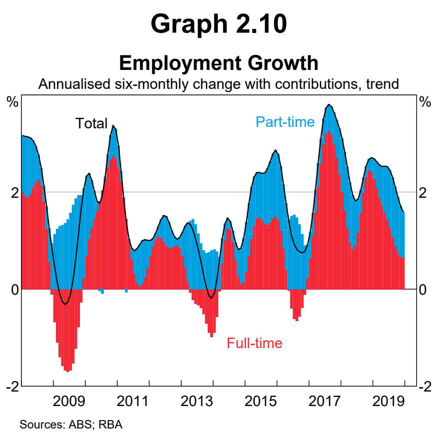
Employment growth remained firm over the year …

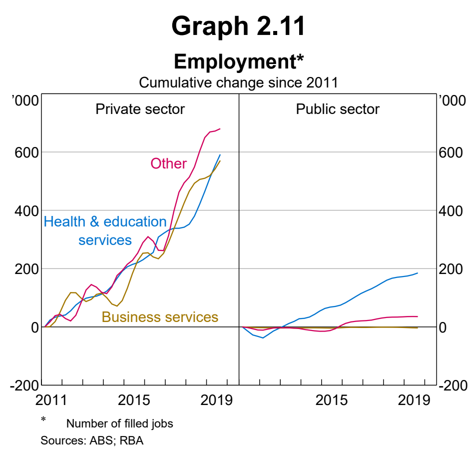
Employment growth moderated to 0.3 per cent in the December quarter, but remains 2.1 per cent higher over the year, and the ratio of employment to the working-age population remains close to its record high levels. After a decline in October, employment increased in November and December. All of the growth in the quarter was in part-time employment, which follows a year of strong full-time employment growth (Graph 2.10).

Less-timely data for the September quarter showed continued strong employment growth in the health care & social assistance and education & training industries. The increase in health-related employment appears to have been fairly broad based but, in recent years, growth has been particularly pronounced for aged & disability carers and nurses. This reflects both the ageing of the population and the rollout of the National Disability Insurance Scheme (NDIS). The rate of job creation over the past year has been high in business services and, in particular, in segments of the professional, scientific & technical services industry, such as IT-related business services. However, employment in construction and retail trade declined over the year, reflecting the slowing in residential building activity and subdued retail conditions. Information from the liaison program suggests employment intentions for residential construction firms have stabilised after weakening for over a year.

Over the past few years, jobs growth has been concentrated in the private sector, rather than the public sector (Graph 2.11).[1] However, some of the growth in private sector employment over this period has been a result of government spending. For example, in health and education services over three-quarters of new jobs have been private sector jobs, although higher government spending may have funded around one-quarter of all additional jobs created by private firms in these industries.

Labour force participation has increased significantly over recent years, but declined a little in the December quarter. The increase in participation has been most pronounced for





females aged between 25 and 54 and older workers of both sexes (Graph 2.12). Increases in labour force participation rates have also been largest in the tighter labour markets in the south-eastern states, as strong demand for labour encouraged more people to enter or defer leaving the workforce.

Leading indicators of employment growth are mixed

Leading indicators of labour demand have been a bit mixed (Graph 2.13). Indicators of job advertisements fell over the second half of 2019. Employment intentions in the NAB survey and the Bank's liaison program have generally moderated over recent months, but remain positive. In contrast, job vacancies increased a little over the three months to November but remain a bit lower than one year ago. Taken together with the modest growth in domestic activity over the second half of 2019, it is expected that employment growth will remain moderate over the first half of 2020, but pick up thereafter.

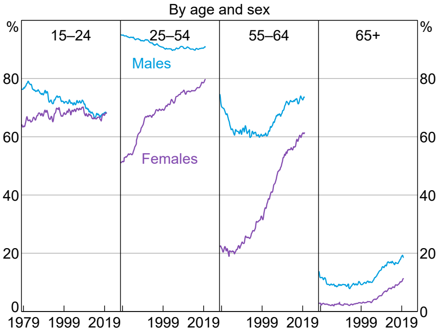
Spare capacity remains in the labour market

The unemployment rate declined a little in the December quarter, but has remained in the 5–5¼ per cent range since April 2019 and is slightly higher than it was one year ago (Graph 2.14). The slight decline in recent months reflects a noticeable fall in the unemployment rate for females. In contrast, the unemployment rate for males has been broadly unchanged since April 2019, which is likely to reflect weaker demand for residential construction workers. The share of underemployed workers – who want and are available to work additional hours – was broadly unchanged over 2019. However, a broader measure of underutilisation that captures both the number of hours of work sought by the unemployed and the additional hours that the underemployed would like to work has decreased slightly over the past year.

Graph 2.12

Participation Rate

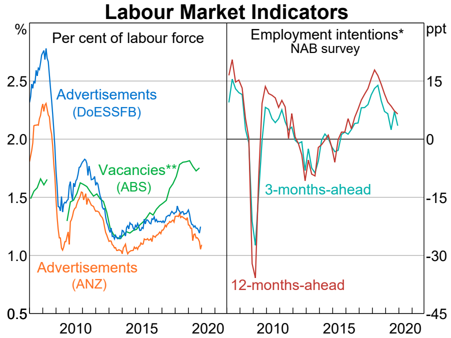
By age and sex



Sources: ABS; RBA

Graph 2.13

Labour Market Indicators



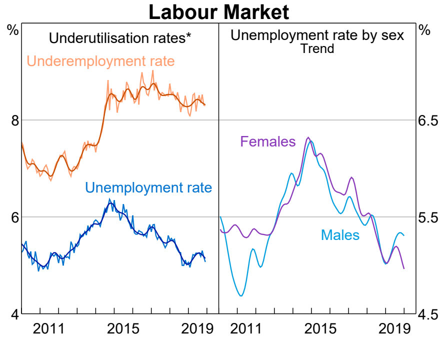
* Net balance for the following period; deviation from average; 12-months-ahead measure seasonally adjusted by the RBA

** Survey was suspended between May 2008 and November 2009

Sources: ABS; ANZ; Department of Employment, Skills, Small and Family Business (DoESSFB); NAB; RBA

Graph 2.14

Labour Market



* Heads-based measures; trend rates in darker shade

Source: ABS

Over the past year or so, unemployment rates have increased or remained stable across most states (Graph 2.15). In Western Australia the unemployment rate has trended gradually lower as labour market conditions in the state have tightened. The aggregate unemployment rate remains above estimates of full employment, meaning that the labour market has capacity to absorb additional labour demand before anything more than gradual upward pressure is generated for wage and price inflation.

Business investment growth has been subdued

Business investment was a little lower over the year to the September quarter because declines in mining investment more than offset modest growth in investment by the non-mining sector (Graph 2.16). Mining investment has been passing through a trough; work on new LNG facilities declined over the year, while capital expenditure picked up for other projects. Slower domestic demand has weighed on non-mining investment. Forward-looking indicators and business liaison suggest that business investment growth is likely to pick up over the coming year, led by mining investment.

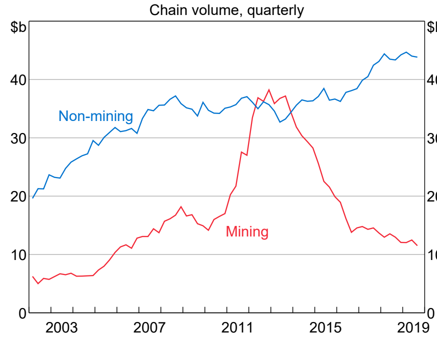
Total mining investment declined by 11 per cent over the year to the September quarter, because less construction work associated with the wind-down of the remaining LNG projects more than offset further growth in machinery & equipment investment (Graph 2.17). Despite the decline in the quarter, the Australian Bureau of Statistics (ABS) Capital Expenditure (Capex) survey continues to suggest that mining investment will increase in 2019/20, although there may be some quarterly volatility. Information from the Bank's liaison program and company announcements also suggest that resource firms are likely to increase investment over the next couple of years to sustain and, in some cases, expand production.

Private non-mining business investment grew by around 1 per cent over the year to the

Graph 2.16

Private Business Investment*

Chain volume, quarterly



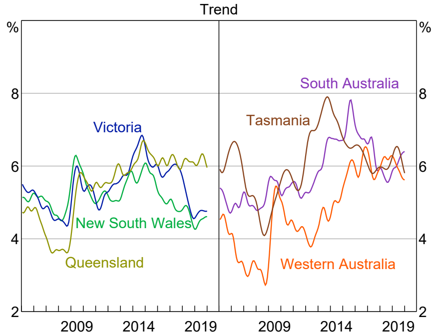
* RBA estimates of new investment

Sources: ABS; RBA

Graph 2.15

Unemployment Rates by State

Trend

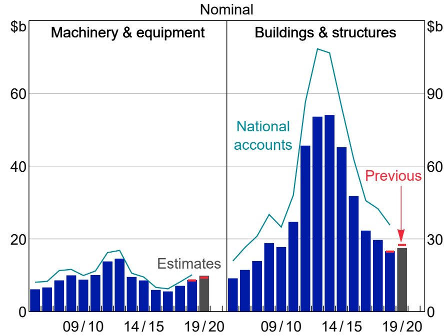


Source: ABS

Graph 2.17

Mining Capital Expenditure*

Nominal



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

Sources: ABS; RBA

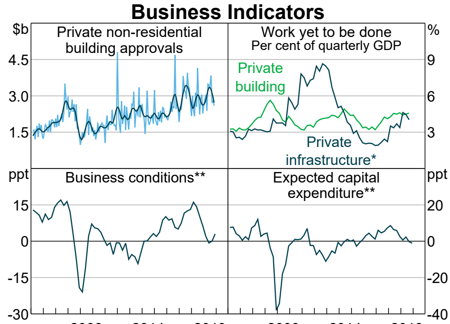
September quarter (Graph 2.18). Within this, machinery & equipment investment declined by 5 per cent over the year; slower consumption and dwelling investment are likely to have contributed to this weakness, with investment in industries exposed to those sectors being particularly soft. In contrast, non-residential construction grew by 6 per cent in the year to the September quarter, led by construction of commercial and industrial buildings, as well as work on infrastructure-related projects, particularly roads.

Forward-looking indicators of non-mining investment are mixed and on balance suggest that growth is likely to remain subdued over the next few quarters (Graph 2.19). On the one hand, there appears to be a reasonable amount of non-residential construction work in the pipeline. Non-residential building approvals have overall been solid in recent quarters, despite easing at the end of 2019, leading to an increase in the pipeline of work yet to be done; the pipeline of private infrastructure work yet to be done also remains elevated, despite easing recently.

On the other hand, investment intentions for 2019/20 reported by firms in the Capex survey would suggest a weaker near-term outlook for non-mining business investment than was previously expected; investment in both machinery & equipment and in buildings & structures is expected to decline (Graph 2.20). By industry, firms in retail, wholesale and construction expect investment to decline in 2019/20; this might be a reaction to recent weakness in consumption and residential construction activity (Graph 2.21). Expectations are more mixed among firms in service-related industries; utilities (including renewables) and rental, hiring & real estate firms expect investment to expand further in 2019/20, while firms in other service industries expect investment to decline. However, the Capex survey does not cover all industries or all types of investment.

Graph 2.19

Business Indicators

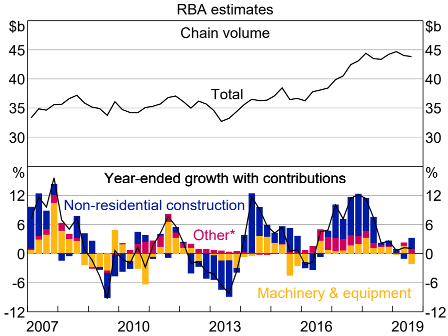


* Excludes resources and other heavy industry
** Non-mining; NAB survey; net balance, deviation from long-run average
Sources: ABS; NAB; RBA

Graph 2.18

Private Non-mining Business Investment

RBA estimates

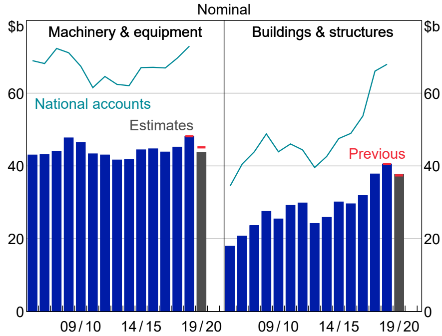


* Includes cultivated biological resources (mainly livestock, vineyards and orchards), computer software, research & development and artistic originals
Sources: ABS; RBA

Graph 2.20

Non-mining Capital Expenditure*

Nominal



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

Survey measures of business conditions and expected capital expenditure remain around long-run average levels, but well below their high levels in early 2018. Strong growth in non-mining profits over the past year should support conditions for firms to invest.

Public demand remained strong

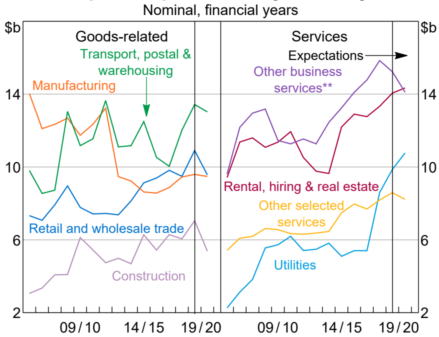
Ongoing growth in public demand provided an offset to the weakness in private demand over the past year (Graph 2.22). Public demand increased by 1.5 per cent in the September quarter to be 5 per cent higher over the year. Defence spending, partly related to purchases of defence assets and training exercises undertaken in the quarter, accounted for about one-third of public demand growth. Over the year, public consumption grew strongly, underpinned by spending on defence and social assistance benefits, such as the NDIS. Public investment picked up in the quarter, but this followed weak growth in previous quarters.

The strong growth in public spending over recent years has been accompanied by stronger growth in tax revenue, although revenue collected from households declined in the September quarter due to implementation of the low- and middle-income tax offset (Graph 2.23). Stronger growth in tax revenue has contributed to the trend reduction in the underlying cash deficit in the consolidated set of government budgets over recent years. Recent updates to state and federal budgets indicate that the reduction in the consolidated cash deficit of the government sector will continue over coming years. Over recent months both the federal and some state governments have announced additional expenditures in response to the bushfires, which is expected to boost public demand in the near term.

Graph 2.21

Capital Expenditure by Industry*

Nominal, financial years



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

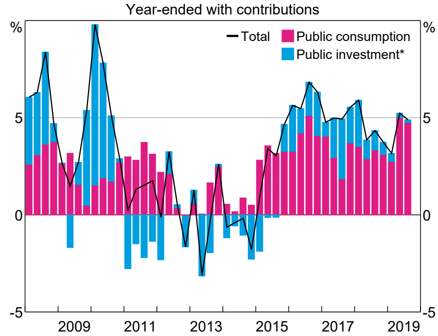
** Includes information media & telecommunications, finance & insurance, and professional, scientific & technical services

Sources: ABS; RBA

Graph 2.22

Public Demand Growth

Year-ended with contributions



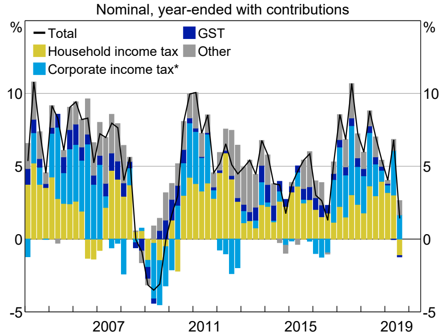
* Adjusted for second-hand asset transfers between the public and other sectors

Sources: ABS; RBA

Graph 2.23

Taxation Revenue Growth

Nominal, year-ended with contributions



* Only includes taxation of resident corporations

Source: ABS

There was broad-based growth in exports over the year

Resource export volumes increased by around 4 per cent over the year to September, led by LNG and condensate exports as the final LNG projects continued to ramp up production (Graph 2.24). Coal exports declined in the September quarter largely because of lower demand from India. Iron ore export volumes also declined in the quarter, partly affected by planned maintenance undertaken by the major miners, but this was more than offset by an increase in exports of other non-ferrous metal ores and minerals. Non-monetary gold exports increased strongly in the quarter; this can be volatile from quarter to quarter but grew by one-third over the year to September, supported by bullion demand from the United Kingdom. Resource exports are expected to grow further over 2020, as LNG exports continue ramping up. The outbreak of coronavirus poses some near-term risks to commodity exports, although current information suggests that any disruptions are likely to be temporary.

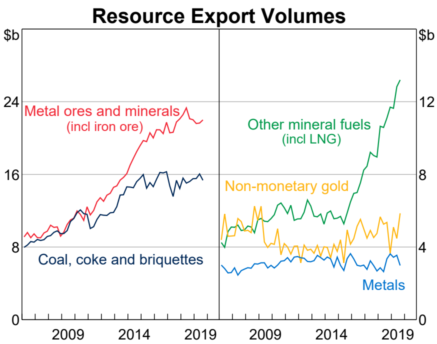
Australia's manufactured and service exports have continued to grow steadily in recent years, supported by the lower Australian dollar, growth in Australia's major trading partners and, in the case of service exports, an increase in student and visitor arrivals. Manufactured exports grew by 6 per cent over the year, led by continued growth in exports of professional & scientific instruments and medicinal & pharmaceutical products. Travel service exports also increased by around 6 per cent over the year to the September quarter 2019, underpinned by growth in education-related exports (Graph 2.25). However, as discussed further in the 'Economic Outlook' chapter, the outbreak of coronavirus is likely to adversely affect tourism and education exports in the near term.

Rural exports were 3 per cent lower in the September quarter, and are expected to decline further over 2020, in line with further declines in rural production associated with dry conditions; for further discussion see 'Box B: Macroeconomic Effects of the Drought and Bushfires'.

Import volumes declined modestly in the September quarter, consistent with a decline in private investment, which is a relatively import-intensive component of expenditure. Capital imports were particularly weak in the quarter, led by a continued decline in imports of industrial transport equipment. Partial data suggest that import volumes also declined in the December quarter.

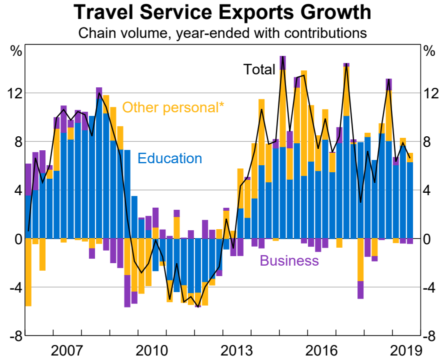
The trade surplus increased further in the September quarter to 4.2 per cent of nominal GDP (its highest share since 1959 when quarterly data began) because export values

Graph 2.24



Sources: ABS; RBA

Graph 2.25

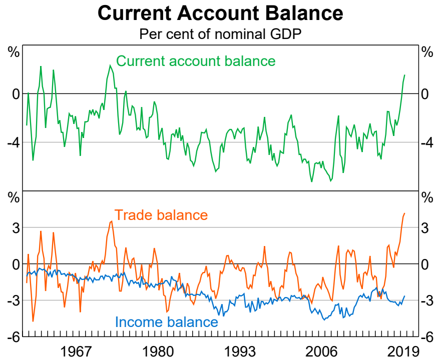


* Includes tourism

Sources: ABS; RBA

increased by more than import values (Graph 2.26). Partial trade data suggest that the trade surplus remained elevated in the December quarter. The increase in the trade surplus, alongside a narrowing in the net income deficit, resulted in a further increase in Australia's current account surplus, to around 1.6 per cent of GDP. ✠

Graph 2.26



Sources: ABS; RBA

Endnotes

[1] There is a discrepancy between the public and private employment split in the Labour Account data (which uses data gathered from businesses and households) and the Labour Force survey data (which relies upon data from households). The view of the Australian Bureau of Statistics is that the Labour Account data provides a more accurate account of which industry the job is actually in.