2. Domestic Economic Conditions

Growth in the Australian economy has slowed over recent quarters. Domestic demand was unchanged in the December quarter as investment declined and household consumption growth weakened, despite higher population growth over this period. Timely indicators suggest domestic activity remained subdued in the March quarter as higher interest rates and cost-of-living pressures continued to weigh on demand. The balance between labour demand and supply has improved somewhat as labour demand has moderated and labour supply has been boosted by a sharp recovery in net arrivals from overseas. Nevertheless, the labour market remains tight, with many firms continuing to find it challenging to hire workers. Sentiment in the housing market has improved and housing prices have stabilised following a large decline over the past year.

The labour market remains tight …

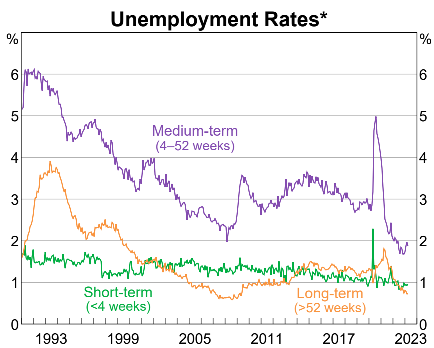
The unemployment rate remains around its 50-year low of 3½ per cent and is around multi-decade lows in most states. It has been steady around these levels since mid-2022, abstracting from the recent monthly variability that largely reflected changes to seasonal patterns. The medium-term unemployment rate – a measure of cyclical unemployment that has historically had the closest relationship with wages growth – has ticked up slightly in recent months but remains very low. The long-term unemployment rate is close to its lowest level in recent decades (Graph 2.1). Job vacancies have declined since mid-2022, but there are still nearly as many vacancies as there are unemployed people.

Broader measures of underutilisation have also remained around multi-decade lows (Graph 2.2). The decline in underemployment over recent years has been driven by firms responding to strong demand by increasing the hours of their workforce; many previously part-time employees have shifted into full-time work. Full-time employment has accounted for all the growth in employment since the onset of the pandemic (Graph 2.3).

… but the balance between labour demand and supply has improved

Demand for labour has eased but remains high. Employment growth has moderated following the rapid growth observed as the economy reopened. Timely indicators of labour demand, such as job advertisements, have moderated since mid-2022; however, they remain much higher than prior to the pandemic (Graph 2.4). Hiring intentions by firms in the Bank's liaison program have eased over recent quarters.

Graph 2.1

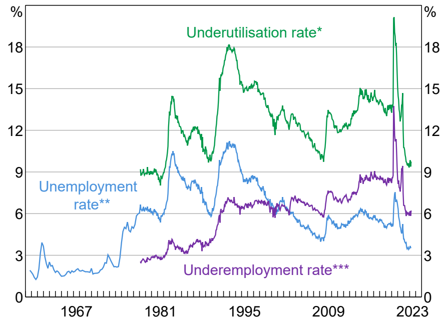


* Seasonally adjusted by the RBA.
Sources: ABS; RBA

Graph 2.2

Labour Underutilisation

Per cent of labour force



* Sum of the unemployment and underemployment rates.

** Quarterly data from 1959 to 1964 are spliced from historical national accounts data.

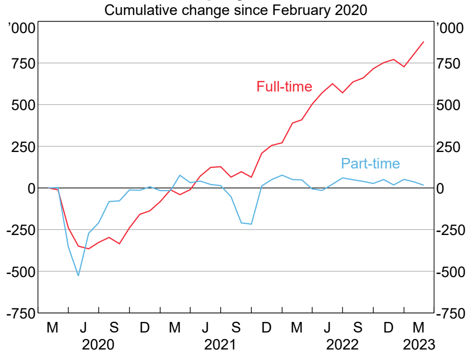
*** Employed people who want, and are available, to work more hours.

Sources: ABS; RBA

Graph 2.3

Employment

Cumulative change since February 2020



Source: ABS

Labour supply has continued to pick up recently. The working-age population has grown strongly over the past year as arrivals from overseas have increased to around pre-pandemic rates and fewer people than usual have departed the country (Graph 2.5). International student and working holiday maker arrivals have returned to around pre-pandemic levels; though some of these people are excluded from the working-age population measure, they have nonetheless contributed to an easing in labour shortages and turnover rates in some sectors. Despite growing supply, a lack of suitable labour remains a constraint for many firms. The strong labour market and ongoing demand for labour has supported the participation rate remaining near its record high in recent months.

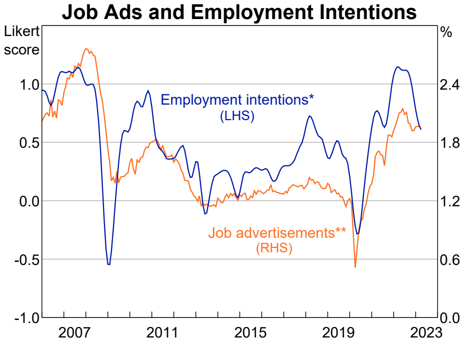
Actual and expected job mobility remains higher than prior to the pandemic but has declined in recent months. In most industries, job mobility has returned to around long-run averages; the main exception is health care, where job mobility remains elevated. Overall, job turnover continues to be driven by people looking for a better job or a change (Graph 2.6).

Domestic activity growth continued to moderate in late 2022 …

Growth in the Australian economy slowed to a below-trend rate of 0.5 per cent in the

Graph 2.4

Job Ads and Employment Intentions



* Over the year ahead; smoothed using a 13-month Henderson trend.

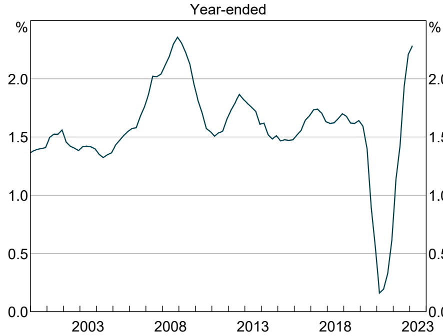
** As a share of the labour force.

Sources: ABS; Jobs and Skills Australia; RBA

Graph 2.5

Working-age Population Growth*

Year-ended



* Population aged 15 years and over.

Source: ABS

December quarter after solid growth through the middle of 2022 (Graph 2.7). While an increase in tourists and international students boosted exports a little in the quarter, growth in domestic final demand stalled – recording its weakest outcome outside of lockdowns since 2014. Investment declined and household consumption growth was much slower than in previous quarters. The bounce-back from pandemic-related restrictions had mostly run its course by late last year and higher interest rates, high inflation and declining wealth were dampening demand in the private sector. Partial indicators suggest domestic activity remained subdued in early 2023, as rising interest rates and cost-of-living pressures continued to weigh on demand.

Real output growth in the second half of 2022 was broadly in line with population growth, implying little growth in GDP per capita (Graph 2.8). In nominal terms, the economy continued to grow strongly in the December quarter, reflecting strong growth in domestic prices and a small rise in the terms of trade.

… as growth in household consumption slowed

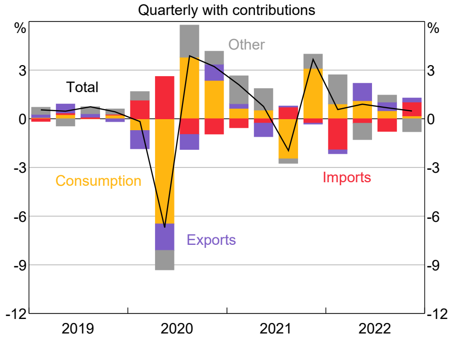
Household consumption growth slowed over the second half of 2022, with growth of 0.3 per cent in the December quarter (Graph 2.9). Slower growth reflected both underlying headwinds to consumption and the fading of the bounce-back from pandemic-related restrictions. In levels terms, household consumption per capita is close to its pre-pandemic trend and, other than international travel, both goods and services consumption are back to around trend (Graph 2.10). The consumption of discretionary goods – including clothing and footwear, and household goods – has declined, but there was continued steady growth in discretionary services categories such as transport and, hotels, cafes and restaurants.

A range of timely indicators suggest that household consumption growth remained subdued in the March quarter. Growth in

Graph 2.7

GDP Growth

Quarterly with contributions

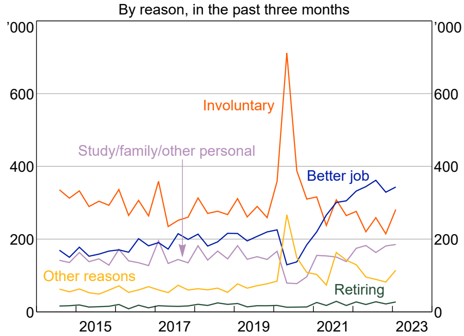


Sources: ABS; RBA

Graph 2.6

Job Turnover*

By reason, in the past three months



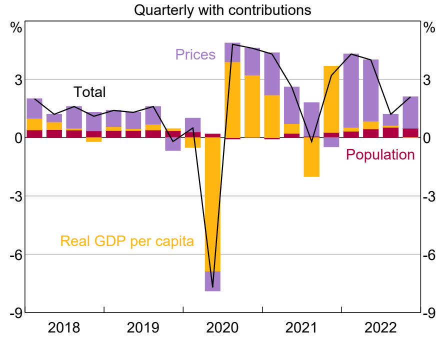
* This includes people currently measured as employed, unemployed or not in the labour force.

Sources: ABS; RBA

Graph 2.8

Nominal GDP Growth

Quarterly with contributions



Sources: ABS; RBA

nominal retail sales values has continued to slow; this slowing was broadly based but was particularly pronounced in discretionary goods categories such as household goods and clothing and footwear (Graph 2.11). Retail prices increased in the March quarter, and the volume of retail sales is estimated to have continued to decline. These data are consistent with information from the Bank's liaison program that spending has continued to moderate and retail volumes have declined since the start of the year (see Box A: Insights from Liaison). Preliminary estimates suggest that spending on international travel increased a little in the March quarter following a weak December quarter outcome, to remain well below its pre-pandemic trend.

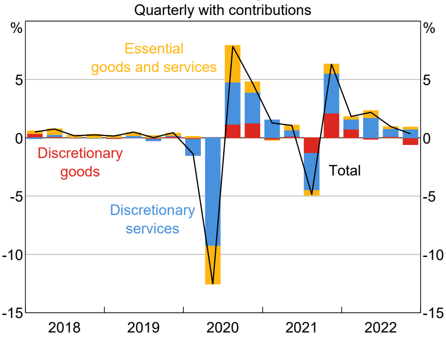
There are continued headwinds to household spending

Slower household income growth, higher cost of living and lower household wealth have all weighed on household spending. Household income growth slowed over the second half of 2022 as strong growth in labour income was offset by higher net interest payments and tax payable. Small business income declined over the year, as did social assistance payments – although the latter was at least partly due to more people gaining employment. The household saving ratio declined further in the quarter, to be a little below the average level that prevailed prior to the pandemic (Graph 2.12).

Graph 2.9

Household Consumption Growth

Quarterly with contributions

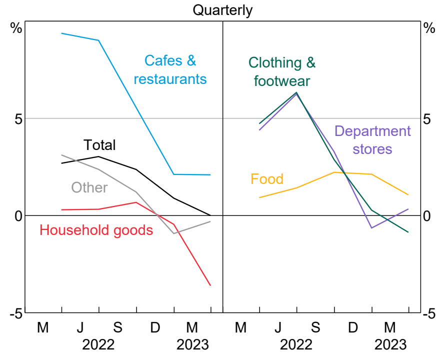


Sources: ABS; RBA

Graph 2.11

Growth in Retail Sales Values

Quarterly

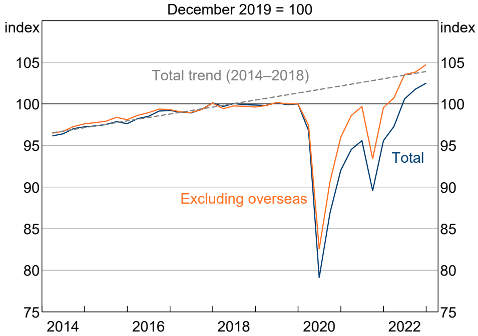


Sources: ABS; RBA

Graph 2.10

Services Consumption per Capita

December 2019 = 100

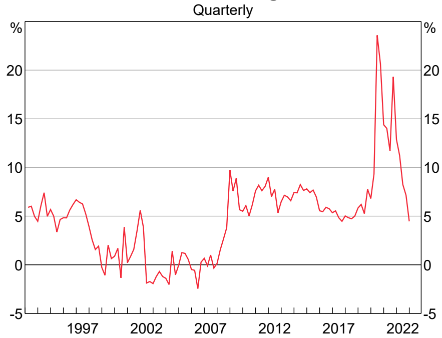


Sources: ABS; RBA

Graph 2.12

Household Saving Ratio*

Quarterly



* Saving as a share of disposable income; net of depreciation.

Sources: ABS; RBA

While slow growth in incomes represents a headwind to spending growth, this is partly mitigated by the distribution of employment income growth. The tight labour market has especially benefited lower income people, who tend to spend more of each extra dollar than those on higher incomes. Analysis of administrative employment data suggest that earnings growth in the year to the December quarter of 2022 was faster for lower income workers than higher income workers. Several factors are likely to have contributed to this. Previously unemployed people who gain employment typically benefit the most from strong labour market conditions. The significant reduction in underemployment has benefited lower income workers proportionately more than higher income workers. And wages growth has been relatively strong in lower skilled occupations (see Chapter 4: Inflation).

However, there are a number of other headwinds for household consumption growth. Adjusted for inflation, household disposable income declined by 3 per cent over 2022 (Graph 2.13). While that decline largely reflects rising consumer prices, higher taxes as a share of income have also contributed as gross nominal incomes have risen relative to income tax thresholds. Higher net interest payments are expected to put increasing pressure on household budgets as fixed-rate loans expire and cash rate increases are passed through to borrowers' payments with a lag (see Chapter 3: Domestic Financial Conditions). Real household net wealth also decreased by 10 per cent over 2022, driven by lower housing prices.

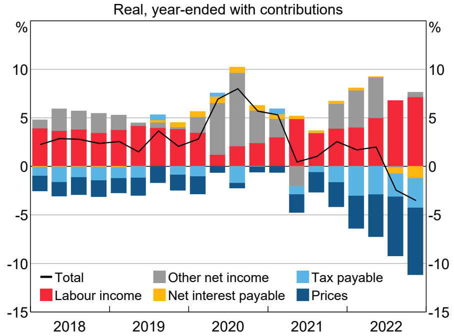
The extent to which these headwinds translate into continued subdued growth in consumption depends on how much households draw on their accumulated savings to smooth through current financial pressures. Many households have built up extra savings in recent years. In aggregate, households saved around an additional $300 billion during the pandemic, relative to pre-pandemic trends – equivalent to around 20 per cent of annual disposable income. A large share of this additional savings is relatively liquid and reflected in higher bank deposits (including offset accounts) (Graph 2.14). However, some of the additional savings have flowed into assets that are less readily available to support household consumption in the near term, such as superannuation accounts and spending on home renovations.

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

Graph 2.13

Household Disposable Income Growth

Real, year-ended with contributions

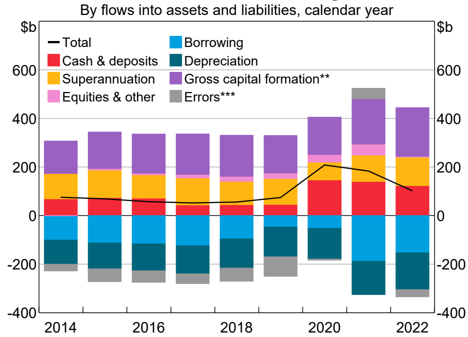


Sources: ABS; RBA

Graph 2.14

Household Net Saving*

By flows into assets and liabilities, calendar year



* Excludes valuation effects.

** Change in inventories less net capital transfers plus gross fixed capital formation.

*** Errors are the difference between the income account and financial account measures of net saving.

Sources: ABS; RBA

pandemic. Sentiment has been particularly weak for households with a mortgage on their home (Graph 2.15).

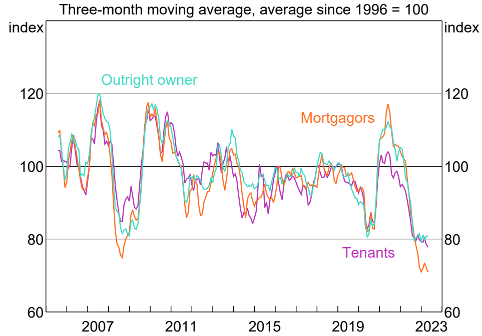
The outlook for business investment remains positive but has softened

Business investment decreased in the December quarter but remained around 3 per cent higher over 2022 (Graph 2.16). Non-residential construction investment has been supported by a significant pipeline of projects and an easing of materials supply constraints. Investment in machinery and equipment declined in the quarter, but remained at an elevated level, as firms in some industries sought to expand capacity following an extended period of above-average capacity utilisation.

Graph 2.15

Consumer Sentiment by Tenure

Three-month moving average, average since 1996 = 100

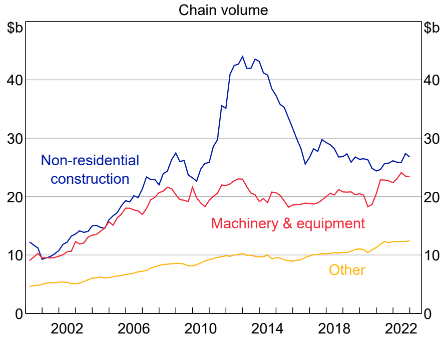


Sources: RBA; Westpac–Melbourne Institute

Graph 2.16

Private Business Investment

Chain volume



Sources: ABS; RBA

Survey measures of investment intentions, business conditions and information from liaison generally point to a positive outlook for business investment, although the outlook has softened. Business conditions generally remained around or above their long-run averages in the first part of 2023, although some indicators of business sentiment have since declined (Graph 2.17). The December quarter ABS Capital Expenditure Survey showed that, in aggregate, firms increased their expectations for investment in the 2022/23 financial year (Graph 2.18). The first estimate for the 2023/24 financial year also showed that firms intend to increase their nominal investment compared with the current financial year, though this may partly reflect higher input costs. Information from the Bank's liaison program suggests that some firms anticipate delays to investment projects resulting from labour shortages, and some smaller firms are focusing on conserving liquidity rather than investing.

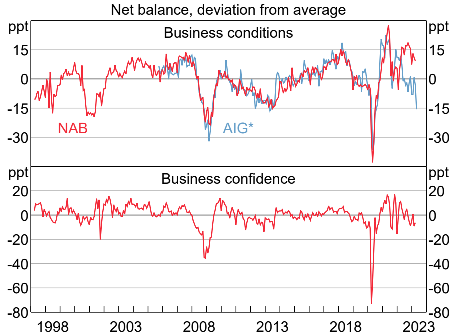
Demand for new dwellings has fallen considerably

Dwelling investment decreased in the December quarter of 2022, to be around 4 per cent lower than a year earlier (Graph 2.19). While constraints on the supply of materials

Graph 2.17

Business Sentiment

Net balance, deviation from average



* AIG series prior to January 2020 is fitted values from regression between the legacy and current AIG series; rescaled to have the same standard deviation as the unadjusted NAB measure since 2005.

Sources: AIG; NAB; RBA

have eased, poor availability of skilled tradespeople has continued to limit the pace at which firms have been able to work through the large pipeline of residential construction.

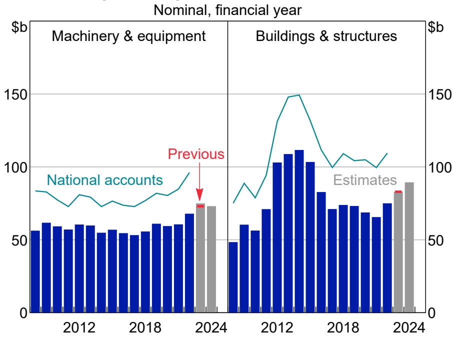
Looking beyond the pipeline of approved dwellings to be built, demand to purchase new detached housing remained exceptionally weak in early 2023. This reflects a range of factors, including higher costs of land and construction, falling established home prices (making them a more attractive alternative to building a new home) and poor buyer sentiment stemming from construction delays and builder insolvencies. Indicators such as building approvals, greenfield land sales and new home sales have declined to be around their lowest levels in at least a decade and some liaison contacts have reported that pre-construction cancellations have increased (Graph 2.20). Recent weakness in demand for new detached dwellings is expected to weigh on dwelling investment once the backlog of dwelling construction is worked through. Information from liaison suggests that investor demand for new higher density housing has also been low, despite an increase in rental yields on units.

Contacts in the Bank's liaison program have noted that some firms are experiencing cash flow issues and insolvencies have risen in the construction industry over the past year. This is because of the lengthening in detached dwelling completion times, along with substantial increases in construction costs and firms still working through fixed-price contracts signed prior to these increases.

Graph 2.18

Capital Expenditure Intentions*

Nominal, financial year



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

Sources: ABS; RBA

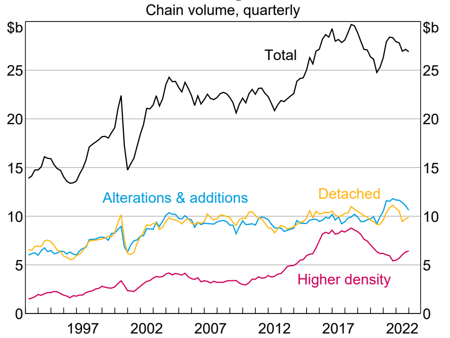
Housing prices have stabilised …

National housing prices have stabilised in recent months, as indicated by a range of data sources, following a decline of around 8 per cent since their peak in April 2022 (Graph 2.21). Prices remain 16 per cent above their pre-pandemic level. Strong underlying fundamentals for housing, such as population and income growth, have offset the effects of the higher cost of credit on housing prices nationally. The

Graph 2.19

Private Dwelling Investment

Chain volume, quarterly

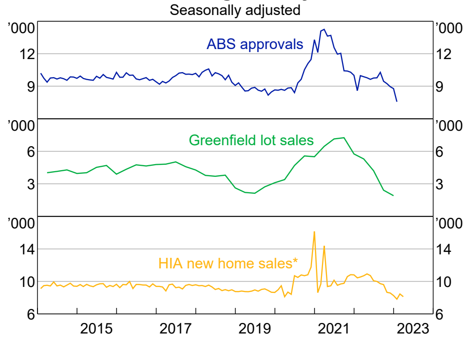


Sources: ABS; RBA

Graph 2.20

Detached Housing Activity Indicators

Seasonally adjusted



* Detrended and rescaled to have the same mean as ABS approvals.

Sources: ABS; HIA; RBA; Research4

Table 2.1: Growth in Housing Prices

Per cent, seasonally adjusted

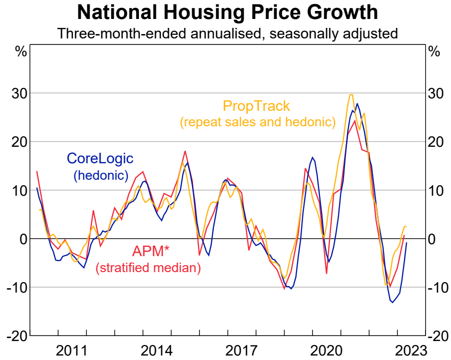
	April	March	February	Since recent peak	Year-ended	Since Feb 2020
Sydney	0.7	0.7	0.1	–12	–11	11
Melbourne	–0.1	0.1	–0.6	–10	–9	1
Brisbane	–0.3	–0.6	–0.4	–11	–10	26
Adelaide	–0.1	–0.2	0.1	–2	1	42
Perth	0.1	0.4	–0.4	–0	1	25
Darwin	–1.3	–0.7	–0.2	–3	–0	29
Canberra	–0.5	–0.8	–0.5	–10	–9	25
Hobart	–0.1	–1.0	–1.7	–13	–13	20
Capital cities	0.3	0.2	–0.3	–9	–8	12
Regional	–0.4	–0.4	–0.6	–8	–7	31
National	0.1	0.0	–0.4	–8	–8	16

Sources: CoreLogic; RBA

combination of stronger demand, limited supply of properties and changes in the interest rate outlook has led to an earlier stabilisation in housing prices than expected by many market commentators; if maintained, this stabilisation will support the outlook for household wealth and consumption (see Chapter 5: Economic Outlook).

Housing price growth has been led by Sydney recently, driven by increases in the more expensive segments of the market. Housing prices continued to decline in most other areas,

Graph 2.21



* Quarterly; capital cities only.

Sources: APM; CoreLogic; PropTrack; RBA

although the pace of decline has slowed further in most capital cities (Graph 2.22; Table 2.1). Housing market activity has picked up in recent months, as measured by auction clearance rates and housing turnover, but remains well below levels seen at the start of 2022. Survey measures of housing price expectations have also increased.

… and the rental market remains very tight

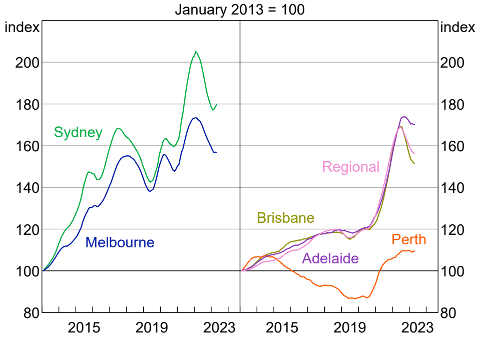
Rental vacancy rates have declined in most capital cities and regional areas over the past year. Declines have been largest in Melbourne and Sydney, where vacancy rates are now below long-run average levels (Graph 2.23). In other capital cities, vacancy rates are at historical lows. Stronger population growth has added to the demand for rental properties. The average household size has increased slightly in capital cities in recent months and has been increasing for some time in regional areas, where rental markets have been tighter for a longer period; this reverses a small part of the declines in average household size seen since the onset of the COVID-19 pandemic (Graph 2.24).

Growth in advertised rents (for new leases) has been strong, although the pace of growth has eased in recent months in some areas (Graph 2.25). In most states, rents growth in capital cities has been outpacing growth in regional areas. Rents have grown more strongly for units than houses, and rental yields for units have increased to be above pre-pandemic levels for most states.

Graph 2.22

Housing Prices

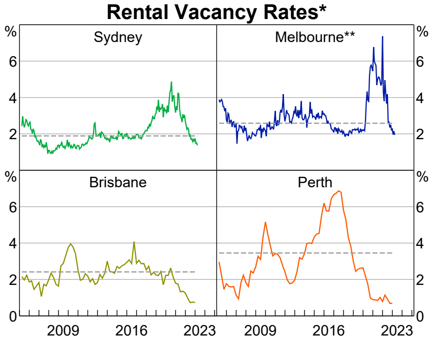
January 2013 = 100



Sources: CoreLogic; RBA

Graph 2.23

Rental Vacancy Rates*



* Data is monthly for Sydney and Melbourne, and quarterly for Brisbane and Perth; dashed lines represent historical (2005- 2019) averages.

** Linear interpolation made for March 2021 observation to smooth one-off spike.

Sources: RBA; REIA; REINSW; REIV

Public demand remains elevated

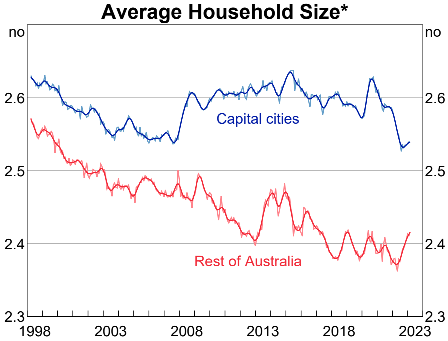
Public consumption as a share of nominal GDP remains high compared with the pre-pandemic period, supported by public spending programs such as the National Disability Insurance Scheme and aged care (Graph 2.26). A strong pipeline of infrastructure projects is expected to support public investment going forward, though ongoing labour and materials shortages may limit the pace at which work can be completed.

Services exports continue to grow as services imports stabilise

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 2.27). The trade surplus increased in early 2023, as export values rose and import values declined.

Graph 2.24

Average Household Size*



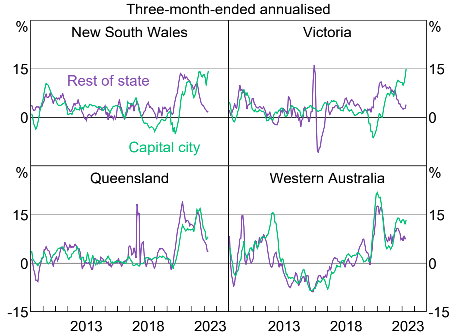
* Smoothed lines are 13-period Henderson trends.

Sources: ABS; RBA

Graph 2.25

Advertised Rents Growth*

Three-month-ended annualised



* Hedonic; seasonally adjusted.

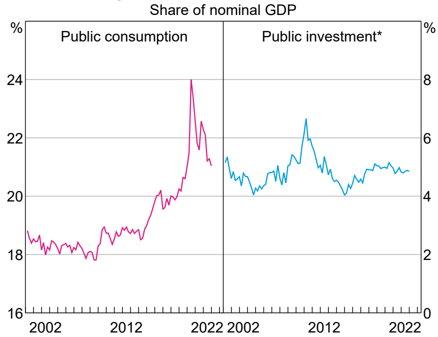
Sources: CoreLogic; RBA

Services export volumes grew in the December quarter, driven by the ongoing recovery in tourism and education exports. The number of overseas arrivals and the value of travel exports suggest that services export volumes continued to increase in the March quarter (Graph 2.28). Student visa grants have risen to their highest level in at least a decade, which should support a further increase in education exports over the first half of this year. Preliminary travel data suggests the level of Australians' overseas travel spending has remained broadly steady since mid-2022.

Graph 2.26

Components of Public Demand

Share of nominal GDP



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

Sources: ABS; RBA

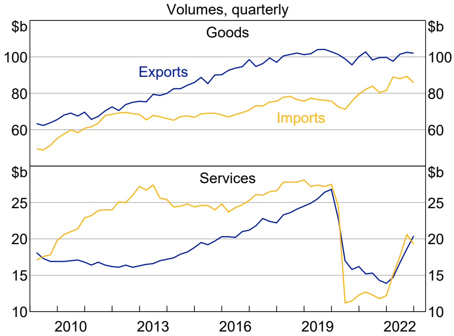
Goods export volumes were flat in the December quarter as increases in bulk commodities and manufacturing exports were offset by declines in rural exports and non-monetary gold. Partial data indicate a mixed start to 2023 for resource exports, with higher LNG exports offset by lower coal exports. Coal exports have been trending down since 2019 as producers have faced ongoing production issues. Coal exports to China resumed in the March quarter in small quantities. Rural exports declined in the December quarter, though levels remain elevated following favourable weather conditions and tight global supply. Rural export values declined further in the March quarter.

There were broad-based declines in goods imports volumes in the December quarter. Pandemic-related manufacturing disruptions in China drove a decline in capital goods. There was also a broad-based decline in the imports of consumption goods, though this was partly offset by a large increase in the imports of vehicles as supply chain disruptions eased in the quarter. Partial data for the March quarter have been volatile but indicate some recovery in the value of capital goods imports, which is consistent with reports from firms in the liaison program that supply chain disruptions have eased over the past year.

Graph 2.27

Trade in Goods and Services

Volumes, quarterly

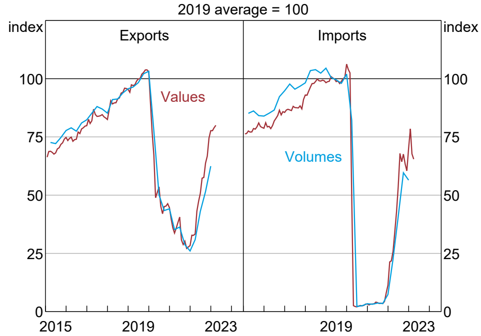


Sources: ABS; RBA

Graph 2.28

Travel and Passenger Transport Trade

2019 average = 100



Sources: ABS; RBA