2. Domestic Economic Conditions

The strong recovery in the Australian economy and the labour market has continued. Low infection rates, substantial fiscal and monetary policy support and a lift in confidence have boosted the recovery. Household spending, dwelling investment and exports have all contributed to the snap back in activity. Employment has also bounced back, to be above its pre-pandemic level, and the unemployment rate has declined significantly from its peak in July 2020. Policy measures are supporting the economic recovery, but a rebalancing of public and private demand is underway. The outlook is stronger than expected at the time of the previous *Statement*, but it remains uneven as the pandemic continues to weigh on parts of the economy (see the 'Economic Outlook' chapter).

The economy expanded by 3.1 per cent in the December quarter, to be 1.1 per cent smaller than at the end of 2019 (Graph 2.1). Growth in the quarter was broad based across expenditure components. The terms of trade increased by around 5 per cent over the December quarter, to their highest level in nearly a decade, supporting business profits and government revenues.

Timely indicators of economic activity suggest that GDP returned to its pre-pandemic level in the March quarter. Overall household and business balance sheet positions are stronger than prior to the pandemic. The vaccine rollout is progressing, with around 2½ million doses administered so far. However, activity still remains below where it would have been without the pandemic and conditions in some parts of the private economy remain weak.

Some industries, including tourism and educational service providers, continue to be affected by the international border closure. Growth in the Australian population has slowed significantly, but the effect this is having on the economy is being offset by the considerable support from policy measures (see 'Box C: International Border Closures, Slower Population Growth and the Australian Economy'). Given virus cases remain high globally and new strains are circulating overseas, it could be some time before the border is reopened fully.

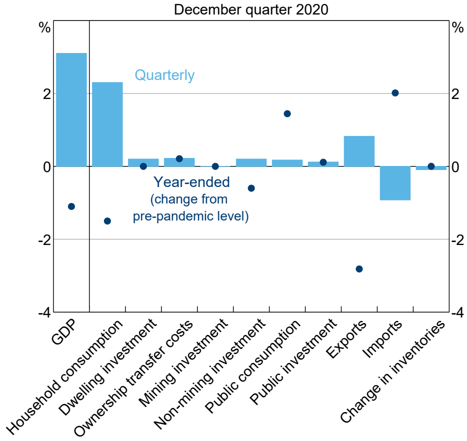
Spare capacity in the labour market has declined faster than expected

The unemployment rate has declined rapidly over recent months to reach 5.6 per cent in March. This is almost 2 percentage points below

Graph 2.1

Contribution to GDP Growth

December quarter 2020



Sources: ABS; RBA

the peak in July last year, but ½ percentage point above the pre-COVID level (Graph 2.2). The decline in the unemployment rate has been faster than expected at the time of the previous *Statement*, as activity and employment have grown more strongly than anticipated.

Other labour market measures also indicate that spare capacity has reduced further, with the underemployment rate now back around its pre-pandemic level, and the number of people working reduced hours for economic reasons also falling to around pre-pandemic levels. Labour force participation has strengthened, and the participation rate increased to a record high 66.3 per cent in March. Available information suggests that the end of the JobKeeper program in March has had only a muted effect on employment so far.

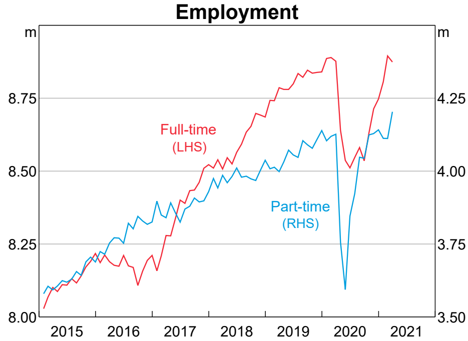
The recovery in employment has been broad based

The number of people in employment increased by almost 200,000 between December and March, surpassing the pre-COVID level of employment and taking the employment-to-population ratio back to around 62½ per cent. The initial phase of the recovery in employment was largely driven by increases in part-time employment (Graph 2.3). However, as the recovery has progressed the flow from part-time to full-time employment has increased, as is typically observed in labour market recoveries; full-time employment has now recovered to around its pre-pandemic level. Employment growth has been widespread across states in recent months.

The faster-than-expected increase in employment has been assisted by the ongoing easing of activity restrictions. Strong demand has also pushed employment beyond its pre-pandemic levels in a number of industries, including retail and professional services (Graph 2.4). In contrast, hospitality employment remains well below its pre-pandemic level, and employment in parts of the economy dependent on international visitors and students (for example, tourism and tertiary education) is also yet to recover fully.

Graph 2.3

Employment

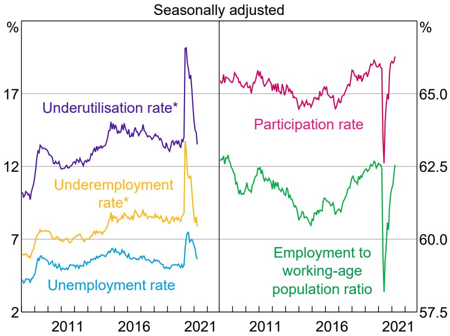


Sources: ABS; RBA

Graph 2.2

Labour Market

Seasonally adjusted



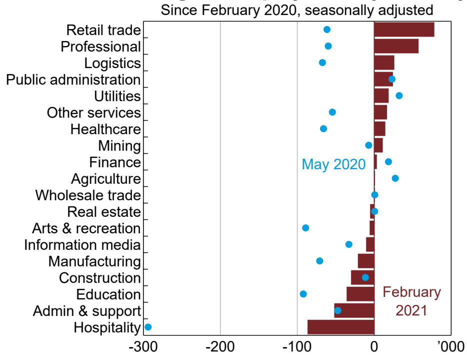
* Heads-based measure

Sources: ABS; RBA

Graph 2.4

Change in Employment by Industry

Since February 2020, seasonally adjusted



Sources: ABS; RBA

Leading indicators of labour demand suggest the near-term outlook for employment is strong

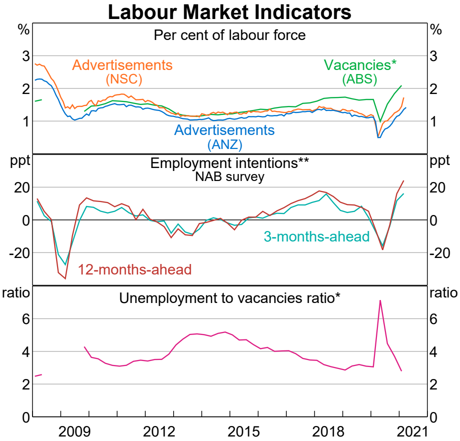
The withdrawal of JobKeeper at the end of March is likely to result in some job losses over the course of the June quarter. However, these job losses are expected to be more than offset by demand for labour elsewhere in the economy. In particular, forward-looking indicators suggest strong demand for labour over coming months. As a share of the labour force, job vacancies and advertisements are at historically elevated levels and employment intentions have continued to pick up (Graph 2.5). A number of factors have been contributing to this, including a return to more usual patterns of job turnover, the re-filling of positions that were cut during the pandemic, 'catch-up' of hiring that was put on hold last year, and new hiring in parts of the economy experiencing strong demand.

Vacancies are high in most industries, including those where employment is still below pre-pandemic levels and in industries where employment has risen over the past year (Graph 2.6). A high level of vacancies points to a positive near-term outlook for employment growth in these industries.

Indicators of near-term labour demand are consistent with information from the Bank's business liaison program. Around half of the Bank's liaison contacts expect to increase headcount over the year ahead, with only 10 per cent expecting to decrease headcount (Graph 2.7). This is partly due to firms that reduced headcount over the past year not anticipating a need for further reductions, and partly because firms that have recently expanded headcount are also expecting to increase headcount further.

Graph 2.5

Labour Market Indicators



* ABS Vacancies Survey was suspended between May 2008 and November 2009

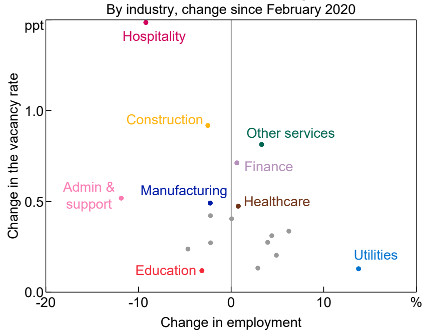
** Net balance for the following period; deviation from average; 12-months-ahead measure seasonally adjusted by the RBA

Sources: ABS; ANZ; NAB; National Skills Commission (NSC); RBA

Graph 2.6

Vacancies and Employment

By industry, change since February 2020

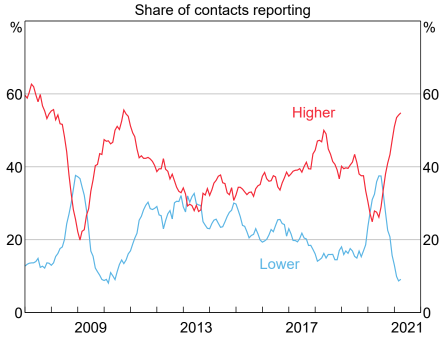


Sources: ABS; RBA

Graph 2.7

Employment Intentions*

Share of contacts reporting



* Over the year ahead; 7-month centred moving average

Source: RBA

Consumption patterns are rebalancing

Household consumption continued to recover over recent months. Timely indicators suggest that spending returned quickly to previous levels after short lockdowns in several states earlier this year. After the initial rebound during the second half of 2020, the recovery in consumption is expected to have continued at a more moderate pace in the March quarter, leaving it a little short of its pre-pandemic level.

As restrictions on activity have been lifted, consumption patterns for many items have started to return to their pre-pandemic shares (Graph 2.8). Reversing earlier shifts in spending behaviour, household spending on food and alcohol to be consumed at home has declined as a share of consumption over recent quarters and spending on discretionary services, such as eating out, entertainment and domestic travel, has increased. However, some consumption patterns will take longer to shift back towards pre-pandemic norms. For example, spending on transport services remains subdued, particularly in the case of public transport. In part this reflects many employees continuing to work from home for at least part of their working week.

The earlier large boost to household income has partially unwound …

There have been large quarterly changes in household income during the pandemic. After receiving a significant boost from government transfers through the middle of 2020, nominal household income declined by 3.1 per cent in the December quarter (Graph 2.9). The decline in social assistance in the quarter reflected a reduction in the value of pandemic-related support payments and a tightening of eligibility requirements, as well as lower unemployment. Financial income also declined. By contrast, labour income increased by 1.4 per cent, supported by the recovery in the labour market. Over the first half of 2021, fiscal transfers have declined further with the expiry of the Coronavirus Supplement and the JobKeeper program but, because employment has recovered strongly, household income is expected to have been broadly unchanged.

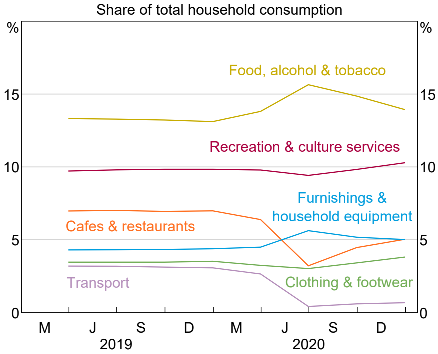
… but the household sector accumulated extra savings over the course of the pandemic

Following a large increase in saving through the middle of last year, the household saving ratio (net of depreciation) declined 7 percentage points in the December 2020 quarter to 12 per cent. This still high rate of saving is

Graph 2.8

Expenditure on Selected Items

Share of total household consumption

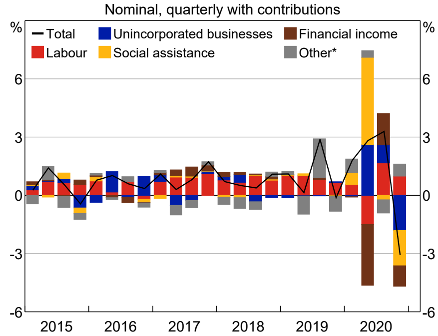


Sources: ABS; RBA

Graph 2.9

Household Disposable Income Growth

Nominal, quarterly with contributions



* Includes rent, tax payable, interest payable and other

Sources: ABS; RBA

consistent with activity restrictions in place at the time. The rate of household saving is expected to decline further over the coming year as uncertainty recedes and opportunities to consume become more available. Some households may also opt to draw down on a portion of their savings accumulated over 2020. All household income groups saved more than usual over 2020, but the bulk of the additional savings were accumulated by the top 40 per cent of the income distribution (Graph 2.10). This is in line with the experience of some other advanced economies.

Conditions in the housing market have picked up strongly

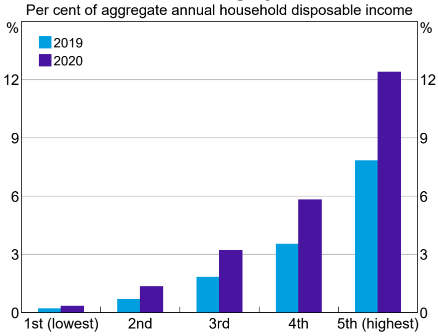
Following 3 per cent growth over 2020, housing prices increased by 5 per cent in the March quarter and strong price growth continued in April (Table 2.1). The broad-based nature of the upswing is in line with housing demand being supported by low interest rates, government support programs, a positive outlook for employment, potentially some pent-up demand during the pandemic and the increase in savings over 2020. Since the previous *Statement*, prices in Sydney and Melbourne have exceeded their previous peaks (in nominal terms) recorded in 2017 and 2020 respectively, and prices have continued to reach new highs in many smaller cities (Graph 2.11). Price growth for detached houses has continued to outpace units. Prices in all segments of the housing market have increased strongly, but price growth has been particularly strong for the most expensive properties in capital cities over recent months (Graph 2.12).

Other indicators also suggest that demand has been strong relative to the supply of housing available for sale. New residential listings have normalised over recent months to be a little above their levels from the past few years. But the stock of total listings in each month has been low, indicating that properties are being sold quickly. Auction volumes in Sydney and

Graph 2.10

Gross Household Saving by Income Quintile

Per cent of aggregate annual household disposable income

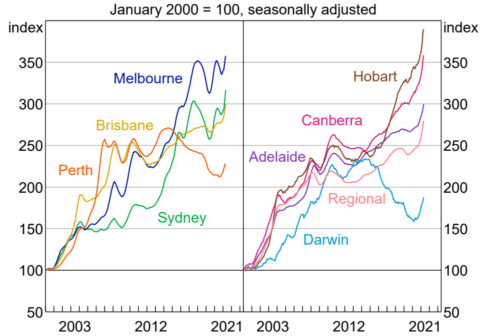


Sources: ABS; RBA; Roy Morgan Single Source

Graph 2.11

Housing Prices

January 2000 = 100, seasonally adjusted

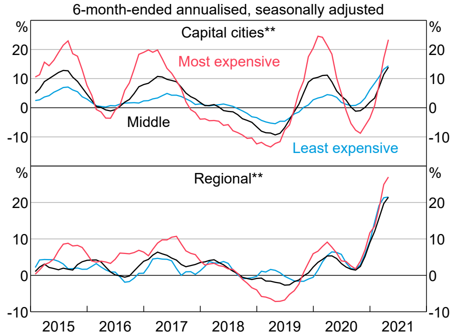


Sources: CoreLogic; RBA

Graph 2.12

Housing Price Growth by Dwelling Value*

6-month-ended annualised, seasonally adjusted



* Least expensive (5th–25th percentile), middle (25th–75th percentile), most expensive (75th–95th percentile)

** Capital cities price indexes are for the 8 capital cities and regional prices are for the rest of Australia

Sources: CoreLogic; RBA

Table 2.1: Housing Price Growth

Percentage change, seasonally adjusted

	April	March	February	January	Year-ended	Past five years
Sydney	2.4	3.4	2.1	0.4	7.5	23
Melbourne	1.2	2.2	1.7	0.2	2.2	22
Brisbane	1.6	2.2	1.3	0.9	8.3	14
Adelaide	1.8	1.5	1.0	0.9	10.3	18
Perth	0.5	1.4	1.2	1.2	6.7	–9
Darwin	2.3	1.6	1.1	2.1	15.3	–10
Canberra	1.6	2.8	1.7	1.4	14.2	36
Hobart	1.0	3.1	2.1	1.5	13.8	56
Capital cities	1.8	2.6	1.8	0.6	6.4	18
Regional	1.9	2.2	1.8	1.4	13.0	24
Australia	1.8	2.5	1.8	0.7	7.8	19

Sources: CoreLogic, RBA

Melbourne also increased to well above average levels and auction clearance rates remained high in recent months. Housing turnover has been around its highest level in several years. Demand for housing and credit over the past year has been primarily driven by owner-occupiers, including first home buyers. Investor activity has picked up a little recently, albeit from a low base.

Rental market conditions remain uneven

Rental markets tightened for both houses and apartments outside of Sydney and Melbourne in the first part of the year. Rents have grown very strongly in some parts of the country, particularly for houses, and vacancy rates outside of the two largest cities reached their lowest level in around a decade (Graph 2.13). The Melbourne and Sydney rental markets have been the outliers for most of the past year with both affected by lower net overseas migration. In Sydney, growth in advertised rents has recently turned positive, though vacancy rates remain elevated. Vacancy rates remain very high in Melbourne. Rental eviction moratoria concluded at the end of March, which may contribute to an increase in rents over the June quarter and increased vacancy rates.

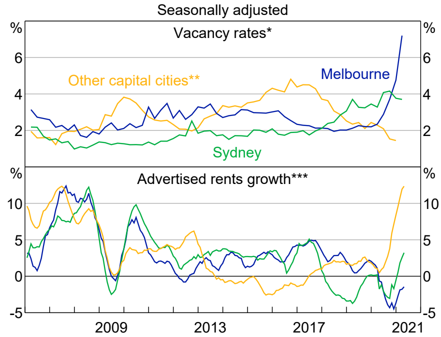
House construction and renovation activity has been boosted by policy support

Approvals for detached dwellings and alterations & additions increased to record-high

Graph 2.13

Rental Market Indicators

Seasonally adjusted



* Quarterly; includes a March quarter estimate for Melbourne and Sydney

** Dwelling stock weighted; vacancy rate excludes Adelaide

*** 6-month-ended annualised

Sources: CoreLogic; RBA; REIA; REINSW; REIV levels in the March quarter, which has boosted the pipeline of construction activity over 2021 (Graph 2.14). In addition to the support provided by low interest rates, this increase in approvals has been driven by HomeBuilder and other state-based grants; construction on many of the large number of projects being approved under these programs is only now commencing. Some construction firms in the Bank's business liaison program have been experiencing supply constraints that have led to cost pressures and some delays to construction timelines. Higher-density construction activity remained subdued in the March quarter. If the increase in approvals for higher-density projects in March is sustained, this will provide a boost to dwelling investment over coming years.

Policy support and a rebound in activity has supported business conditions

Business investment fell sharply through the middle of last year, as business sentiment collapsed and firms responded to weak demand and heightened uncertainty related to the pandemic. Policy support for firms then stabilised business conditions and appears to have brought forward the beginning of a recovery in business investment. In the recent period, surveyed business conditions have risen further to record-high levels, indicating that firms are growing more confident in the strength of the recovery.

Private non-mining business investment increased by 3 per cent in the December quarter, albeit from a low level (Graph 2.15). The increase was driven by machinery & equipment investment as firms responded to the tax incentives for investment from the Australian Government, as well as to the recovery in demand. Those factors, together with strong growth in profits and a reported increase in capacity utilisation and business confidence, should continue to support non-mining investment in the near term (Graph 2.16, Graph 2.17).

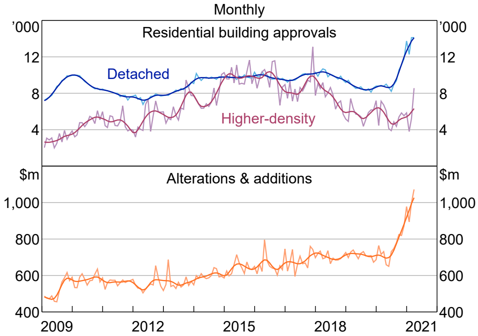
However, the recovery in non-mining investment is still at an early stage – it remains 7 per cent lower than before the pandemic. Non-residential construction investment continued to decline in the December quarter and the pipeline of work fell. The outlook is uneven across sectors, and investment may take longer to recover in those sectors that have been more negatively affected by the pandemic.

In contrast, mining investment has remained relatively resilient during the pandemic and is 2 per cent higher in year-ended terms as firms undertook projects to replace existing capacity

Graph 2.14

Private Building Approvals*

Monthly



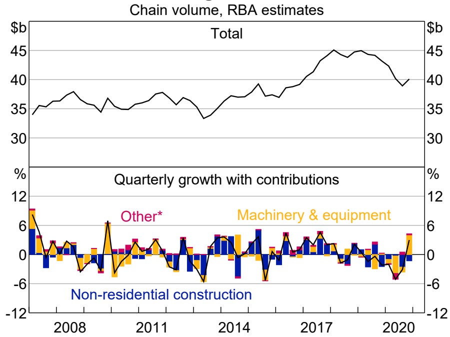
* Smoothed lines are 13-period Henderson trends

Sources: ABS; RBA

Graph 2.15

Private Non-mining Business Investment

Chain volume, RBA estimates



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

Sources: ABS; RBA

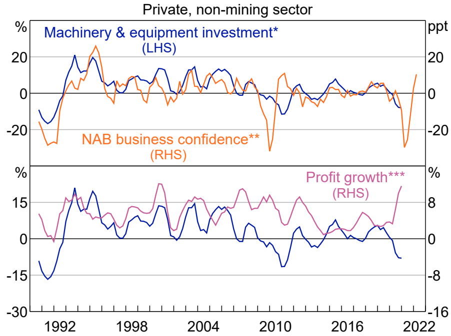
in the iron ore and liquefied natural gas (LNG) sectors.

Surveyed measures of investment intentions have increased from the low levels of mid 2020. The ABS Capital Expenditure (Capex) survey, which was conducted in January and the first half of February, indicates that both mining and non-mining business investment are expected to increase in the 2021/22 financial year (Graph 2.18). Higher current and expected oil prices have made some new LNG projects viable, while a large pipeline of renewable energy projects is expected to support non-mining business investment.

Graph 2.16

Business Confidence, Profits and Investment

Private, non-mining sector

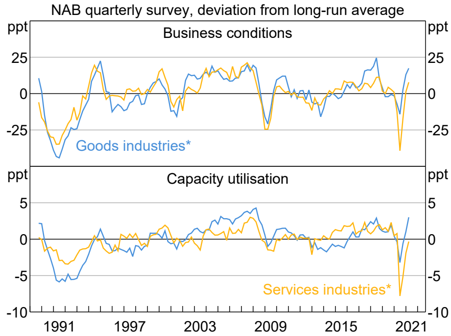


* Nominal; year-average growth; RBA estimates
** 3-month rolling average; lagged by 4 quarters; deviation from long-run average
*** Gross operating surplus; year-average growth
Sources: ABS; NAB; RBA

Graph 2.17

Business Sentiment

NAB quarterly survey, deviation from long-run average



* Goods industries include manufacturing, construction, wholesale, retail and transport & utilities; services industries include recreation & personal and finance, business & property; investment share weighted
Sources: NAB; RBA

Public demand continues to support growth

Health and other pandemic management spending contributed to a 7½ per cent increase in public consumption over the year to the December quarter 2020. Public investment also increased in 2020, but only modestly, reflecting a slower-than-expected rollout of the large capital expenditure programs announced across all levels of government. Information from the Bank's liaison program suggests that these delays in part reflect capacity constraints and approval processes.

As at March, the Australian Government's underlying cash deficit for the 2020/21 financial year to date was smaller than expected at the time of the Mid-year Economic and Fiscal Outlook (MYEFO) in December (Graph 2.19). Both higher receipts and lower payments, mostly reflecting the faster-than-expected rebound in activity and employment alongside higher commodity prices, contributed to a smaller deficit than previously foreshadowed.

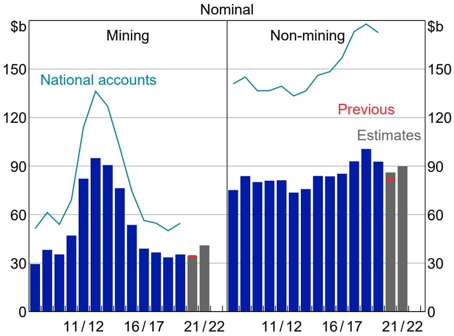
Rural and resource exports have increased strongly

Rural exports increased sharply in the December quarter following a strong harvest, and resource exports were also higher, contributing to a

Graph 2.18

Capital Expenditure Intentions*

Nominal



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

4 per cent increase in total export volumes. The domestic recovery continued to drive increases in import volumes, led by capital and consumer goods. Trade in services remained constrained by ongoing restrictions on international travel. The trade surplus increased in the December quarter, and growth in rural and resource export values continued to support the trade surplus over the March quarter (Graph 2.20). However, the value of both exports and imports remain below pre-pandemic levels as foreign and domestic demand continues to recover.

Rural export volumes increased by more than 20 per cent in the December quarter, led by cereals after the drought broke in parts of Australia last year. The near-term outlook for the rural sector remains favourable as exporters continue to operate at capacity following the second-highest winter crop harvest on record. Improved pasture conditions will support farmers in continuing to rebuild herds and flocks.

Resource export volumes increased by a little under 2 per cent in the December quarter, and look to have increased further in the March quarter. Partial trade data and information from the Bank's liaison program suggest that iron ore export volumes increased in the March quarter, because fewer weather-related disruptions occurred than is usual over this part of the cyclone season. This was partly offset by maintenance at some mines. Iron ore exports are expected to remain close to capacity as producers respond to decade-high iron ore prices and robust Chinese demand. LNG exports appear to have remained elevated in the March quarter, supported by strong global energy demand as economic activity recovers.

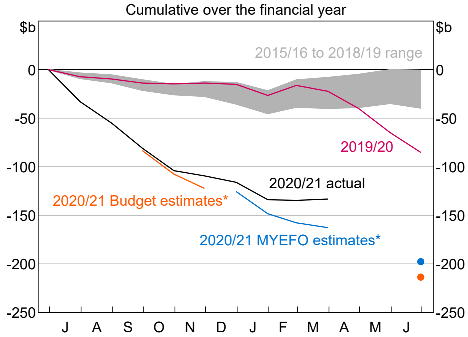
Coal exports to China fell to very low levels in the March quarter (Graph 2.21). However, over recent months this decline has been broadly offset by higher demand from other markets including India, Japan and South Korea as global energy consumption recovers and steel production exceeds pre-pandemic levels. Disruptions to coal mines and infrastructure in the Hunter region in New South Wales from flooding weighed on thermal coal exports in March, including to Japan and South Korea, with some disruptions continuing into April. The recent COVID-19 resurgence in India may weigh on coking coal exports in the near term.

Goods imports have grown strongly in recent months, consistent with the ongoing recovery in domestic demand. Imports of passenger motor vehicles continued to drive the rebound, with strength in sales to businesses supported by the tax incentives for investment from the Australian Government. Capital goods imports have also increased, especially machinery and industrial

Graph 2.19

Australian Government Underlying Cash Balance

Cumulative over the financial year



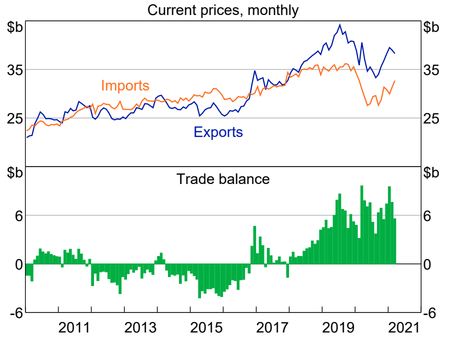
* Dots show end-of-financial-year estimates at the time of the Budget and MYEFO

Sources: Department of Finance; RBA

Graph 2.20

Trade in Goods and Services

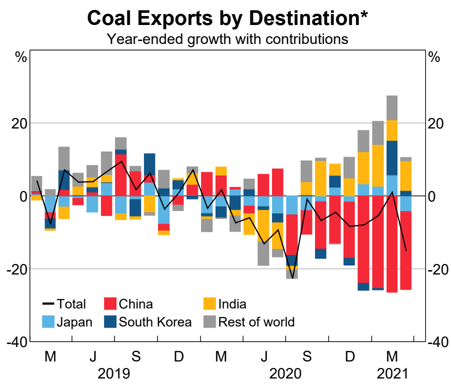
Current prices, monthly



Sources: ABS; RBA

equipment, supported by tax incentives and resurgent demand for agricultural equipment in response to improved farming conditions. ✠

Graph 2.21



* Seasonally adjusted by the RBA

Sources: ABS; RBA