2. Domestic Economic Conditions

Economic activity declined sharply in the September quarter due to the effect of health-related restrictions on private domestic demand in some states. GDP is forecast to have fallen by around 2½ per cent in the quarter, with a large decline in private consumption and investment partly offset by growth in public demand and a rebound in exports. Hours worked fell sharply in lockdown-affected states between June and September, but job attachment appears to have been maintained even as measured employment dropped.

Fiscal measures supported household and business income in areas affected by lockdowns, along with ongoing assistance from monetary policy. As restrictions ease, fiscal and monetary policy support will help to re-establish the momentum in the economy that was evident prior to the recent Delta outbreaks. Consistent with this, consumer and business sentiment has held up, as have forward-looking indicators of labour demand. Information from the Bank's liaison program suggests that many businesses have viewed the recent setback to activity as temporary and have maintained staff levels and investment plans.

Conditions vary considerably around the country and across industries. Economic activity has remained firm in states without major Delta outbreaks. Consumer spending was at a high level in Queensland, South Australia and Western Australia, and surveyed business conditions remained relatively strong in these states. Timely measures suggest that a rebound in activity is now well underway in the Australian Capital Territory, New South Wales and Victoria as key vaccination rate thresholds have been met and restrictions on activity have been eased substantially. However, conditions remain subdued in parts of the economy more heavily affected by the pandemic, such as the tourism, transport, education and arts and recreation sectors, and their recovery is likely to take longer.

Domestic demand had strong underlying momentum prior to the recent outbreaks …

The Australian economy grew by 0.7 per cent in the June quarter, led by a strong increase in domestic final demand. The major components of domestic demand had recovered to be close to, or above, their pre-pandemic level in the quarter (Graph 2.1). The external sector subtracted from growth, driven by a fall in resource export volumes because of temporary production disruptions. Imports of intermediate and capital goods grew strongly as firms continued to respond to tax incentives for investment. The strong underlying momentum in the domestic economy was maintained in the September quarter in states not affected by extended restrictions on activity.

… but restrictions in the September quarter weighed heavily on activity

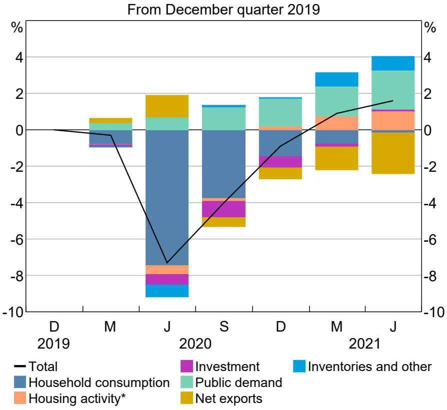
A sharp rise in COVID-19 case numbers in New South Wales and Victoria led to stay-at-home orders being extended for longer than had been announced at the time of the previous *Statement*. Around half of the Australian population were under significant restrictions for most of the September quarter (Graph 2.2). GDP is forecast to have fallen by around 2½ per cent in the quarter. The largest effects will, once again, have been on private consumption and investment, as observed in the June quarter of 2020 when national lockdowns were in effect.

In contrast to the lockdowns in 2020, measures of business and consumer sentiment have held up well in recent months. Information from the Bank's liaison program suggests that businesses have viewed the recent setback as temporary and anticipate a strong recovery in activity. Further, population mobility – a timely measure of economic activity – has increased strongly in New South Wales and Victoria (Graph 2.3).

Graph 2.1

GDP – Cumulative Contribution to Change

From December quarter 2019

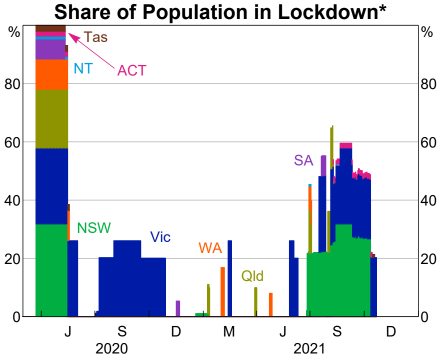


* Dwelling investment and ownership transfer costs

Sources: ABS; RBA

Graph 2.2

Share of Population in Lockdown*



* Population estimated using statistical area that most closely corresponds to announced lockdown area

Sources: ABS; RBA; state and territory governments

Lockdowns temporarily interrupted further improvement in the labour market …

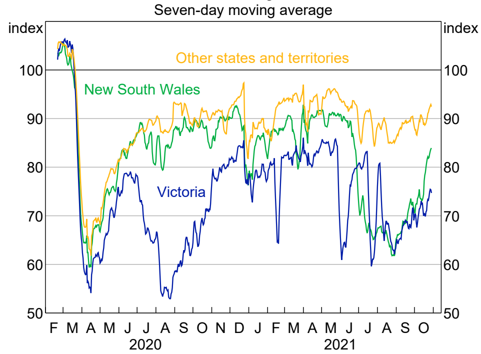
There were large disruptions to the labour market in recent months. A significant number of workers were on reduced hours or stood down in those parts of the economy most affected by lockdowns. Total hours worked fell by 3 per cent from June to September, and employment decreased by 2 per cent (around 280,000 people). Although a very large number of people have been affected, in aggregate these disruptions were not as severe as the sharp drops in total hours and employment that occurred in the initial phases of the pandemic in 2020 (Graph 2.4).

The effects on the labour market have been greatest in New South Wales and Victoria; elsewhere, the labour market has been more resilient. Similar to lockdowns in 2020, industries that recorded the largest declines in employment during recent months tended to be contact-intensive, such as accommodation & food and retail (Graph 2.5). Employment has been more resilient in industries in the business

Graph 2.3

Mobility*

Seven-day moving average



* Google mobility; average from 3 January to 6 February 2020 = 100

Sources: CEIC Data; RBA

services sector, as well as manufacturing and healthcare.

There was a marked decline in the rate of labour market participation in recent months, from 66.2 per cent in June to 64.5 per cent in September. Although measured employment declined, many of the people recorded as 'not employed' maintained some degree of job attachment to their employers, and were not actively searching for a new job given they anticipated returning to their previous employment. For other people who were not employed, lockdowns reduced the availability of new employment opportunities; search requirements for JobSeeker eligibility were also suspended in COVID-19 hotspot areas. Lower participation more than offset the effect of the fall in employment on the headline unemployment rate, which declined from 4.9 per cent in June to 4.6 per cent in September. An alternative measure of spare capacity that captures employed people working zero hours due to economic or 'other' reasons, as well as net flows out of the labour force, was 11 per cent in September (Graph 2.6).

… but underlying conditions in the labour market are strengthening again

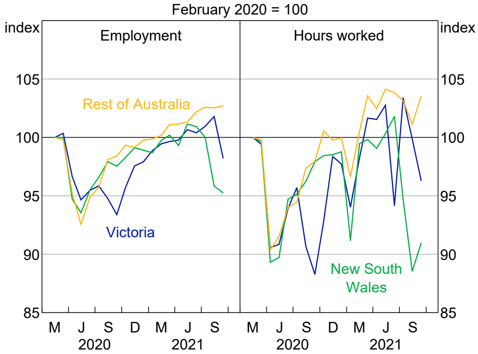
Forward-looking indicators of labour demand point to a strong recovery in the labour market over coming months (Graph 2.7). Timely data on job advertisements showed a strong increase in hiring intentions in New South Wales and Victoria from the latter half of September, ahead of the easing of lockdown restrictions. Hours worked also picked up in New South Wales in September. Liaison over recent months suggested that firms affected by lockdowns were reluctant to lay off staff given reported labour shortages and strong labour demand prior to the lockdowns.

Involuntary job turnover picked up sharply at the onset of the pandemic, and one in five people who left or lost their job over the year to February 2021 were retrenched (Graph 2.8). By

Graph 2.4

Employment and Hours Worked

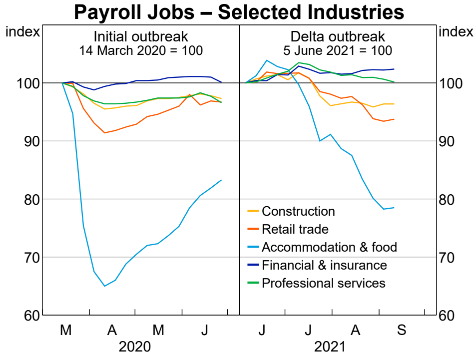
February 2020 = 100



Sources: ABS; RBA

Graph 2.5

Payroll Jobs – Selected Industries

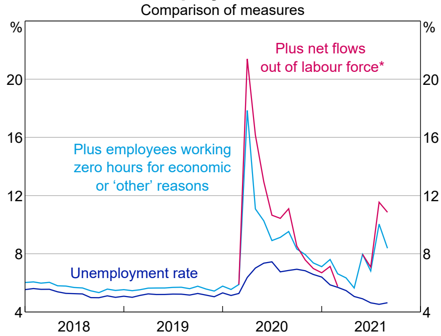


Sources: ABS; RBA

Graph 2.6

Unemployment Rate

Comparison of measures



* Incorporates cumulative net flows out of labour force between March 2020 and March 2021, and since June 2021

Sources: ABS; RBA

contrast, the number of people leaving their jobs for voluntary reasons declined at the start of the pandemic, consistent with workers delaying job changes in the face of heightened uncertainty. Turnover has picked up in recent months; unlike last year, the recent increase in people leaving their jobs was driven by voluntary reasons, with the most common reason being to get a better job or because they wanted a change.

Strong underlying labour market conditions have also supported further increases in labour market participation over the past 18 months, notwithstanding the temporary effects of the recent lockdowns. Increases in participation by female workers reflects strength in industries that tend to have a higher share of female workers, such as health care (Graph 2.9). Labour force participation for older workers has also picked up from its level just prior to the pandemic, in contrast with the declines in participation observed in other advanced economies such as the United States.

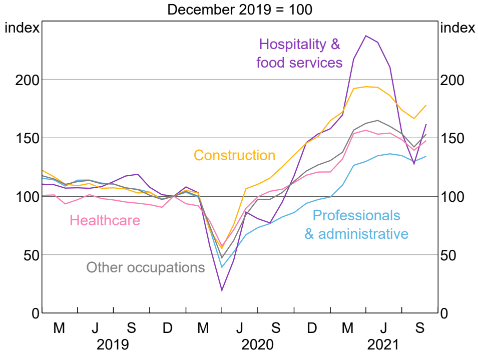
Household consumption fell sharply in the September quarter, but is now recovering …

Timely mobility and spending data, as well as information from the Bank's liaison program, suggest that household spending increased through September and October, following a large fall over the previous three months. There was a substantial decline in spending in New South Wales and Victoria in response to tighter restrictions on activity during the Delta outbreak (Graph 2.10). Spending remained elevated in states less affected by restrictions. The categories of spending that declined most sharply were, similar to last year, clothing & footwear and in contact-intensive industries, such as discretionary services (Graph 2.11). Conditions have been particularly challenging for smaller firms. Household expenditure on travel and holidays remained well below pre-pandemic levels, even in the states with relatively few

Graph 2.7

Job Advertisements by Occupation

December 2019 = 100

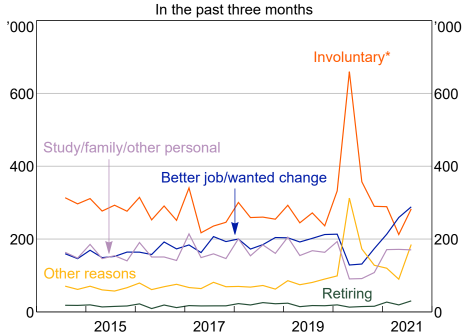


Sources: National Skills Commission; RBA

Graph 2.8

Reasons People Left/Lost Jobs

In the past three months



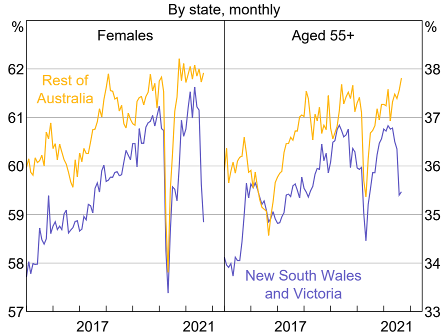
* Includes retrenched, made redundant, dismissed, temporary/seasonal job ended, ill health and closed down own business

Sources: ABS; RBA

Graph 2.9

Participation Rates

By state, monthly



Sources: ABS; RBA

restrictions on activity, weighing heavily on the tourism sector.

… as fiscal measures have supported household and business incomes

Household disposable income is expected to have increased in the September quarter, after declining slightly in the June quarter. Labour income declined over this period, driven by a decline in employment and hours worked. But, in aggregate, this is likely to have been more than offset by higher social assistance income following the reintroduction of payments provided by the Australian Government and state and territory governments in response to the lockdowns, similar to those provided in 2020. The household saving ratio is expected to have increased sharply in the September quarter as consumption opportunities were limited, particularly for discretionary services (Graph 2.12).

As well as disaster payments to support household income, government assistance packages included direct support to business through grants and payroll tax deferrals, which have supported the cash flow of businesses.

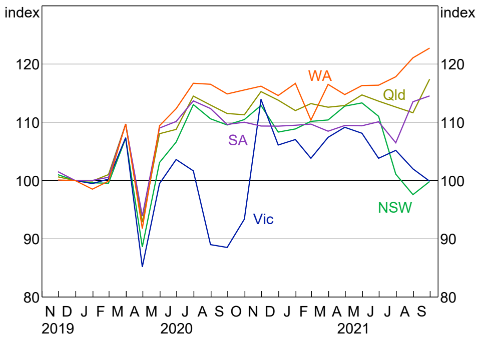
The Delta outbreak temporarily weighed on business investment

Non-mining business investment rose strongly prior to the 2021 lockdowns. Machinery & equipment investment increased to be well above its pre-pandemic level, supported by strong growth in profits throughout the pandemic, the rapid recovery in domestic activity and the Australian Government's tax incentives for investment (Graph 2.13). Non-mining non-residential construction activity had also turned around in the first half of the year, reflecting growth in investment in renewable energy projects and logistics buildings such as warehouses. Mining investment was little changed in June, as firms did not adjust capital

Graph 2.10

Retail Sales Values

December 2019 = 100

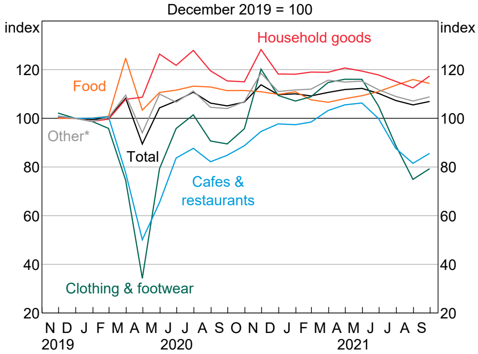


Sources: ABS; RBA

Graph 2.11

Retail Sales Values

December 2019 = 100



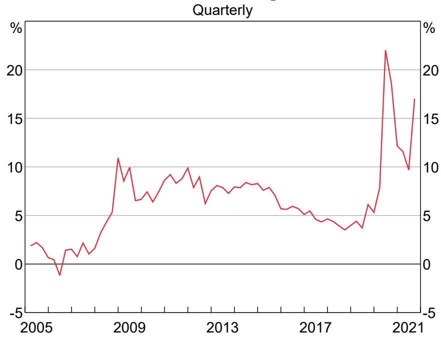
* Includes department stores and other retailing

Sources: ABS; RBA

Graph 2.12

Household Saving Ratio*

Quarterly



* Estimate for the September quarter 2021; saving as a share of disposable income, net of depreciation

Sources: ABS; RBA

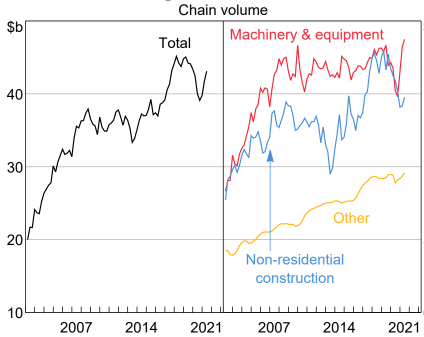
expenditure plans despite high commodity prices.

Investment activity, particularly construction, was disrupted during the September quarter as states with large outbreaks of the virus placed restrictions on construction site activity. As a result, business investment is expected to have contracted sharply in the September quarter. However, a range of partial indicators suggest that this will be a temporary setback, and that business investment will regain its positive momentum following the lifting of restrictions in states affected by outbreaks. Non-mining firms upgraded their investment expectations in the most recent ABS Capital Expenditure (Capex) survey, conducted in July and the first half of August. Many firms in the Bank's liaison program have remained optimistic about the outlook in recent months and have generally not cancelled capital expenditure plans. That said, the impact has been highly varied across firms of different sizes and operating in different industries. Firms in the construction sector have indicated there could be scope to catch up on missed non-residential construction work. Surveyed measures of business conditions declined from the very strong levels seen in the first half of the year, but remain broadly around average as business confidence rebounds, particularly in New South Wales (Graph 2.14).

Graph 2.13

Non-mining Business Investment

Chain volume



Sources: ABS; RBA

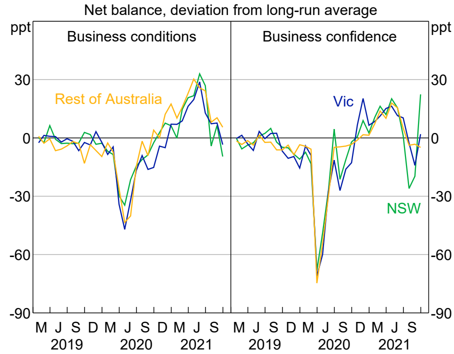
Public investment growth has increased and is supporting the domestic economy

The June quarter saw the fourth consecutive increase in public investment, supported by road and rail infrastructure construction. Growth has been particularly strong at the state and local government level, and that has been the main contributor to public investment growth in recent quarters (Graph 2.15). A very large pipeline of public capital expenditure works will support public investment for several years and is contributing to the demand for construction materials and labour.

Graph 2.14

Business Sentiment

Net balance, deviation from long-run average

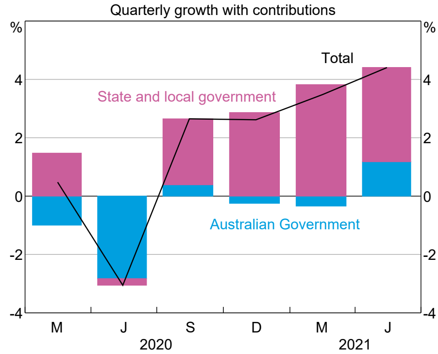


Sources: NAB; RBA

Graph 2.15

Public Investment*

Quarterly growth with contributions



* Includes public corporations; adjusted for second-hand asset transfers between the public and other sectors

Sources: ABS; RBA

Public consumption remains elevated as share of GDP. Spending on government responses to the Delta outbreak and the accelerated rollout of COVID-19 vaccines will have contributed to public consumption growth at both the federal and state levels in the September quarter.

The outlook for residential construction activity remains strong but may be subject to capacity constraints

There is a large pipeline of almost 250,000 dwellings to be completed over coming years (Graph 2.16). Approvals for new detached housing have decreased since HomeBuilder program applications concluded in March 2021, but remain above pre-pandemic levels. Approvals for alterations & additions have increased strongly over the past year. The increase in renovation activity has occurred as many households spend more time at home and have had reduced consumption options due to lockdowns and border restrictions. The construction of high-density dwellings continues to support investment as the pipeline of projects is worked through.

Capacity constraints have begun to slow the delivery of this large pipeline of approved dwellings. In the June quarter, dwelling investment grew modestly and the ratio of work completed to work yet to be done declined, consistent with the impact of capacity constraints. Capacity utilisation for the construction sector in the June quarter was at a high level (Graph 2.17). The cost of building materials has also risen. In the September quarter, restrictions on workers attending construction sites in New South Wales and Victoria delayed work on dwelling investment projects. Information from the Bank's liaison program suggests these disruptions have delayed building activity by a few months, with limited scope to make up for these delays because of capacity constraints.

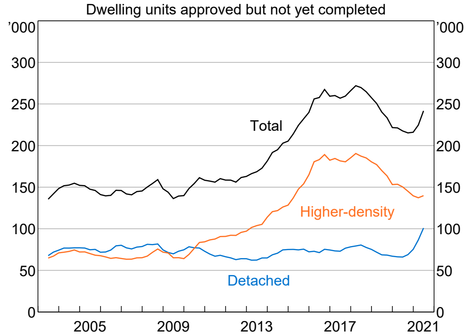
Housing price growth remains strong in most markets

Housing prices have grown rapidly over 2021 across Australia (Table 2.1). Median housing prices have reached new highs in most capital cities (Graph 2.18). Demand for housing has been strong from owner-occupiers, including first home buyers, and investors (see chapter on 'Domestic Financial Conditions'). Price growth has been strongest for detached dwellings and in regional areas over the past year. Restrictions introduced in response to the Delta outbreak, including on open inspections, temporarily weighed on housing market activity, particularly in Melbourne. However, new listings and auction market activity rebounded quickly

Graph 2.16

Residential Pipeline*

Dwelling units approved but not yet completed

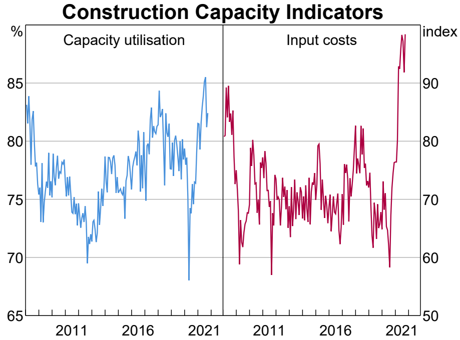


* Private and public sector

Sources: ABS; RBA

Graph 2.17

Construction Capacity Indicators



Sources: AIG; NAB; RBA

Table 2.1: Housing Price Growth

Percentage change, seasonally adjusted

	October	September	August	July	Year-ended	Past five years
Sydney	1.5	1.8	1.8	2.2	25.2	29
Melbourne	0.7	1.0	1.5	1.6	16.4	24
Brisbane	2.4	1.7	2.1	2.1	22.3	28
Adelaide	1.8	1.9	2.0	1.9	20.1	30
Perth	0.0	0.4	0.7	0.8	16.4	9
Darwin	0.4	0.2	0.5	1.4	19.3	0
Canberra	1.9	1.9	2.1	2.6	25.5	53
Hobart	1.9	2.4	2.4	2.2	28.1	72
Capital cities	1.3	1.5	1.7	1.9	20.8	25
Regional	1.8	1.8	2.0	1.9	24.3	36
Australia	1.5	1.6	1.7	1.9	21.6	27

Sources: CoreLogic; RBA

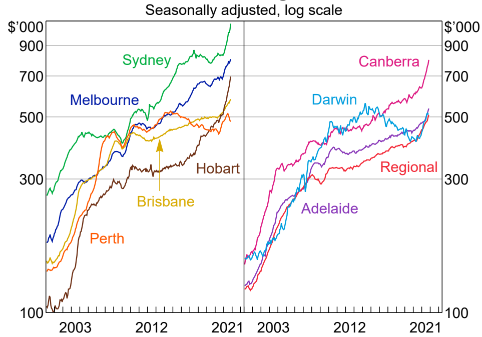
following the easing of restrictions in Sydney and Melbourne.

Advertised rents have increased strongly over the past year. The strongest increases were recorded in the smaller capital cities and regional areas, where changes in the pattern of internal migration during the pandemic have contributed to demand (Graph 2.19). The weakness in population growth resulting from the closure of the international border reduced rental demand in large capital cities, and advertised rents for units remain below their pre-pandemic level in Melbourne and around their pre-pandemic level in Sydney. However, advertised rents for units in major capital cities have increased over recent months as vacancy rates have declined. Rental yields have fallen over the past year because advertised rents growth has been outpaced by housing price growth.

Graph 2.18

Median Housing Prices

Seasonally adjusted, log scale

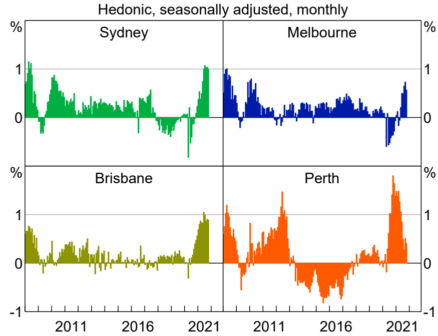


Sources: CoreLogic; RBA

Graph 2.19

Advertised Rents Growth

Hedonic, seasonally adjusted, monthly



Sources: CoreLogic; RBA

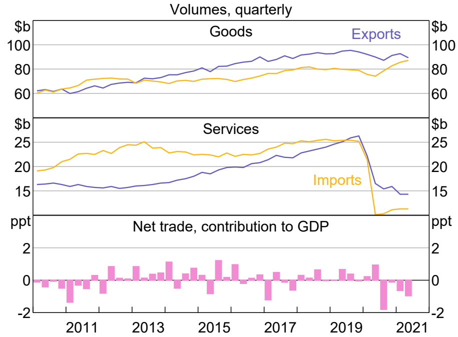
Resource export volumes have begun to recover after temporary disruptions weighed on production

Partial data and information from the Bank's liaison program indicate that resource export volumes began to recover in the September quarter, as maintenance and weather-related issues that affected June quarter exports were resolved (Graph 2.20). Rural exports have increased further over recent months. The near-term outlook for the rural sector remains favourable because of improved growing and pasture conditions, as well as strong global demand for grains, meat and wool. Trade in services remained low in the September quarter because of ongoing restrictions on international travel. The trade surplus reached a record level in August supported by high prices for some key Australian export goods, notably coal and LNG.

Graph 2.20

Trade in Goods and Services

Volumes, quarterly



Sources: ABS; RBA