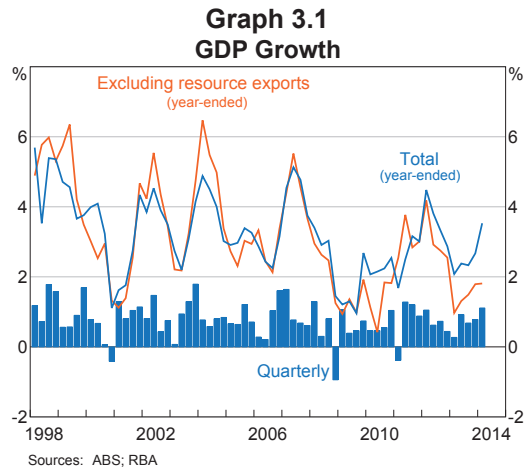


3. Domestic Economic Conditions

Growth of the Australian economy picked up over the second half of 2013 and early 2014, driven in part by a large increase in resource exports, although some timely indicators point to more moderate growth in recent months (Graph 3.1; Table 3.1).

GDP growth was particularly strong in the March quarter as a large amount of new mining capacity came on line and mining activity was less disrupted by weather conditions than typically occurs during Australia’s summer months. Growth of GDP excluding resource exports has picked up over the course of the past year but remains subdued. In the March quarter, mining investment is estimated to have fallen sharply and public demand declined, consistent with fiscal consolidation at the state and federal levels of government. Growth of household consumption also slowed after having picked up steadily through 2013. Nonetheless, there were



further tentative signs of somewhat stronger growth of non-mining activity. The recovery in dwelling investment gathered pace and non-mining business investment is estimated to have increased a little.

Table 3.1: Demand and Output Growth
Per cent

	March quarter 2014	December quarter 2013	Year to March quarter 2014
GDP	1.1	0.8	3.5
Domestic final demand	0.3	0.2	1.6
– Private demand	0.5	0.0	1.8
– Public demand	-0.3	0.9	0.8
Change in inventories ^(a)	-0.6	0.3	-0.7
Gross national expenditure	-0.3	0.5	0.9
Exports	4.8	1.1	10.4
Imports	-1.4	-0.6	-2.2
Nominal GDP	1.1	1.6	4.9
Real gross domestic income	0.8	1.0	2.5

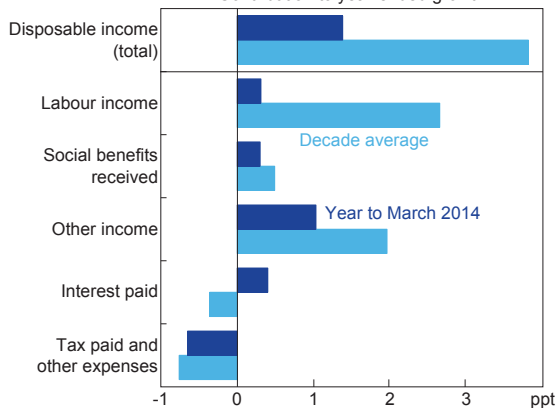
(a) Contribution to GDP growth
Source: ABS

Some labour market indicators have improved a little this year, but overall conditions remain subdued. Subdued wage and general domestic cost pressures are consistent with a degree of spare capacity in labour and product markets.

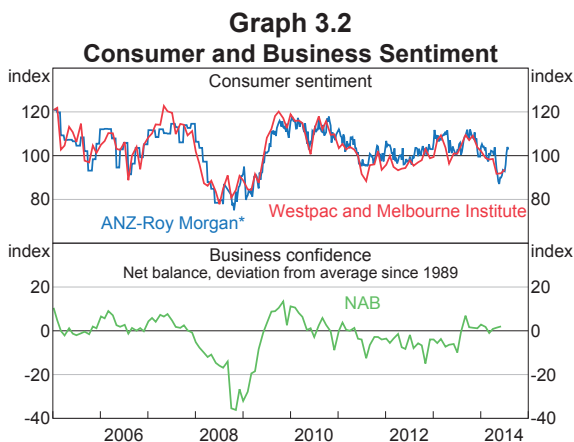
Recent economic indicators and information obtained through the Bank's business liaison suggest that GDP growth moderated in the June quarter. Export volumes eased from the high level of the March quarter and indicators of household demand softened; retail sales volumes were little changed in the quarter, measures of consumer sentiment had fallen to below-average levels and growth of household wealth appears to have been a little less rapid than the pace recorded over 2013. Growth of business investment and public demand is likely to have remained subdued. Nonetheless, surveys suggest that business conditions and confidence remain around long-run average levels, supported in part by the recovery in dwelling construction, and more timely measures of consumer confidence have rebounded to be above average levels (Graph 3.2).

(Graph 3.3). The slow growth largely reflected weakness in labour income, consistent with subdued labour market conditions. There was a small boost to disposable income from lower interest payments as banks' average lending rates declined (for more detail, see the 'Domestic Financial Markets' chapter).

Graph 3.3
Real Household Disposable Income*
Contribution to year-ended growth



* Household sector includes unincorporated enterprises
Sources: ABS; RBA



* Rescaled to have the same average as the W-MI index since 1996
Sources: ANZ-Roy Morgan; NAB; Westpac and Melbourne Institute

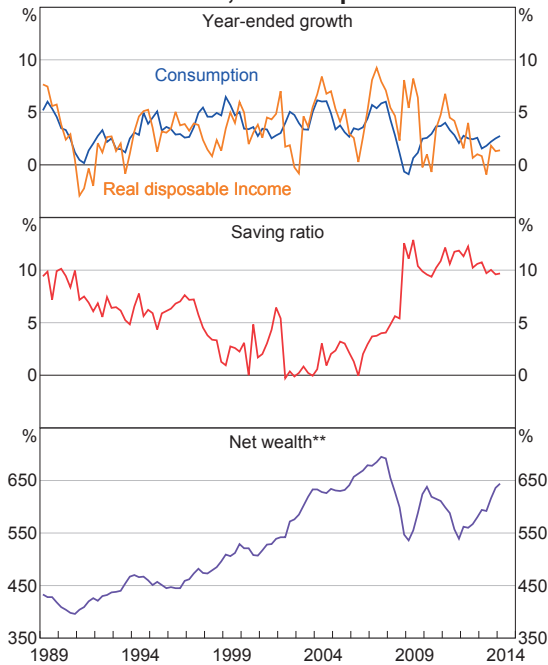
Household Sector

Growth of real household disposable income has slowed considerably in recent years. Over the year to the March quarter, it grew by 1½ per cent, compared with around 4 per cent over the past decade

After picking up steadily through 2013, the pace of household consumption growth slowed a little in the March quarter 2014. Still, consumption grew faster than income over the year, which was accompanied by increases in wealth driven by higher dwelling and equity prices (Graph 3.4). Accordingly, the household saving ratio has declined somewhat, but remains much higher than in recent decades.

More recent data suggest that consumption growth was moderate in the June quarter, with retail sales volumes declining by 0.2 per cent (Graph 3.5). The largest fall occurred in clothing retailing, where unseasonably mild weather conditions reportedly weighed on sales of winter apparel. Also, measures of consumer sentiment had fallen markedly in May to below-average levels. However, the weekly measure of consumer sentiment rebounded sharply in late July and is now above average levels (see Graph 3.2). In contrast to softer retail sales growth, motor vehicle sales to households have picked up in recent months after some weakness around the turn of the year.

Graph 3.4
Household Income, Consumption and Wealth*

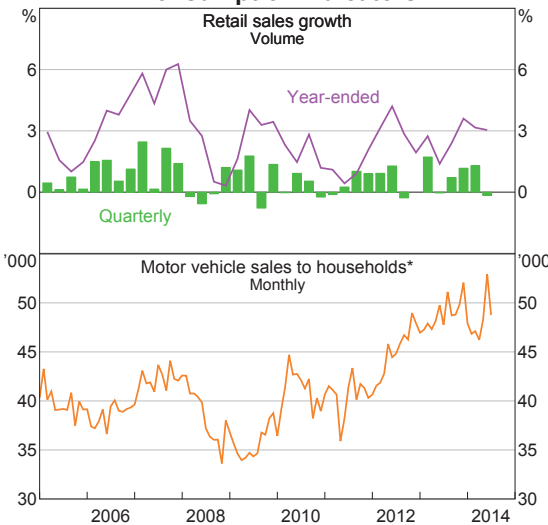


* Household sector includes unincorporated enterprises; disposable income is after tax and interest payments; income level smoothed with a two-quarter moving average between March quarter 2000 and March quarter 2002; saving ratio is net of depreciation

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

Sources: ABS; RBA; RP Data-Rismark

Graph 3.5
Consumption Indicators

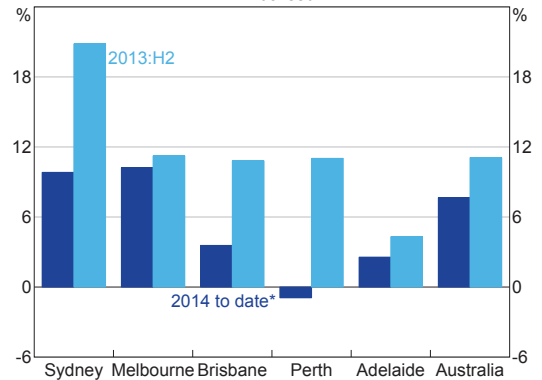


* Seasonally adjusted by the RBA

Sources: ABS; FCAI/VFACTS; RBA

Household wealth has grown strongly over the past 18 months or so, buoyed by higher housing and equity prices and ongoing saving by households, although more recently growth has eased a little (see Graph 3.4). In most of the capital cities, housing price inflation was less rapid over the first half of 2014 than it was over the latter part of 2013 (Graph 3.6; Table 3.2). While prices appear to have levelled out in Perth and Adelaide, growth has remained relatively strong in Sydney and Melbourne. Surveys indicate that, compared with earlier in the year, fewer households expect housing prices to rise over the next 12 months, and households view buying conditions for dwellings as less favourable than they did a year ago.

Graph 3.6
Housing Price Growth
Annualised



* Data are to July

Sources: RBA; RP Data-Rismark

Other indicators of conditions in the established housing market remain strong overall. The time taken to sell properties and the average size of vendor discounts are at low levels, and auction clearance rates are above average, albeit not as high as late last year. Turnover appears to have increased a bit in the June quarter, though is still a little below average.

The nationwide rental vacancy rate has been little changed over recent quarters at a relatively low level, but conditions in the rental market appear to have generally eased (Graph 3.7). Rent inflation has declined to its slowest pace since the mid 2000s.

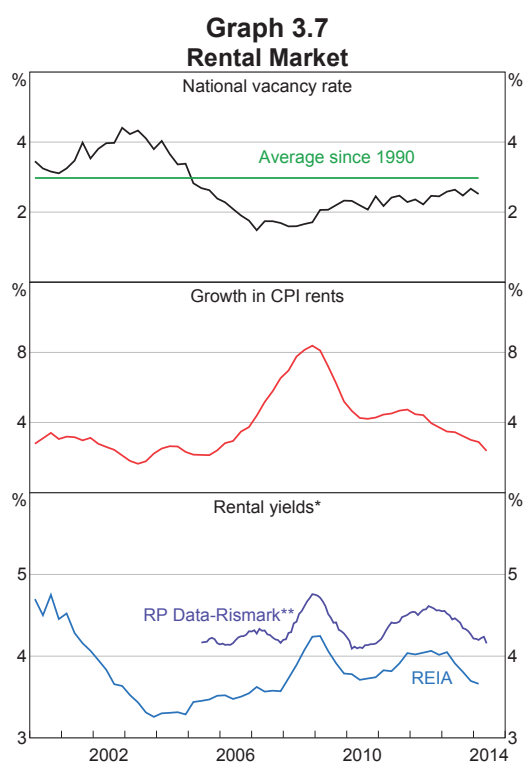
Table 3.2: Housing Price Growth
Per cent

	3 months to June 2014	3 months to March 2014	Year to June 2014
<i>Capital cities</i>			
APM ^(a)	2.1	1.9	10.1
RP Data-Rismark	1.4	2.3	10.3
<i>Regional areas</i>			
APM ^(a)	0.6	1.2	4.6
RP Data-Rismark ^(b)	0.0	0.3	3.3

(a) Quarter-on-quarter growth rate

(b) Detached houses only

Sources: APM; RBA; RP Data-Rismark



* REIA series uses an unmatched sample of rents and prices;
RP Data-Rismark series uses a matched sample

** Seasonally adjusted by the RBA

Sources: ABS; RBA; REIA; RP Data-Rismark

Combined with strong growth of housing prices over the past year or so, rental yields have fallen to around their average of the past decade.

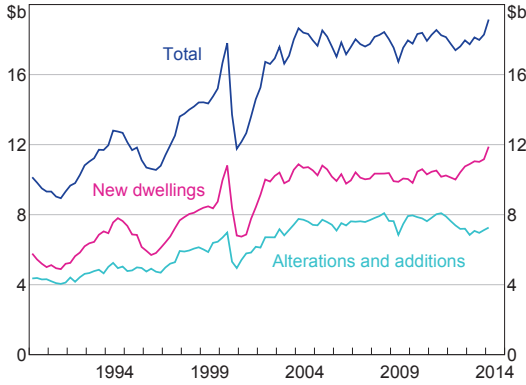
A strong recovery in dwelling investment is well under way, driven by low borrowing rates, growth

of housing prices, significant population growth and a retargeting of government assistance for first home buyers to new homes. Dwelling construction increased by almost 5 per cent in the March quarter to be 8 per cent higher over the year, as the substantial pick-up in residential building approvals over 2013 continued to flow through to activity (Graph 3.8). The increase was driven by a rise in new dwelling construction, particularly for higher-density dwellings. Alterations and additions activity also increased a little in the March quarter, after an extended period of weakness.

More recently, residential building approvals have declined a little in trend terms, but remain at a high level consistent with further growth of dwelling investment (Graph 3.9). The recent trend decline owes mostly to a decline in higher-density approvals from the very high levels seen in late 2013. Approvals for detached houses have trended higher in all mainland states over the past couple of years, notwithstanding a recent decline in South Australia.

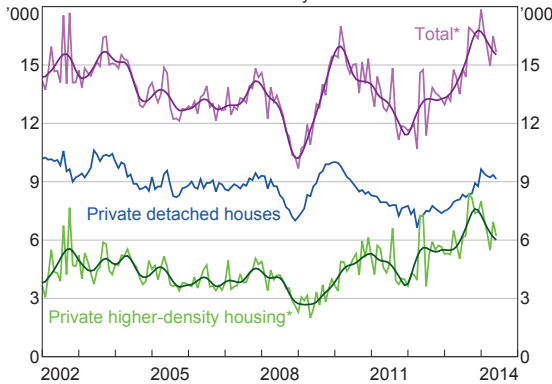
Other timely indicators of housing construction also point to a sustained recovery in dwelling investment. Loan approvals for new dwellings remained at a high level in May and first home owner grants for new dwellings have increased by 22 per cent over the past year (Graph 3.10). Liaison reports indicate that demand for new dwellings remains firm, with ongoing strong demand by foreign buyers for inner-city apartments, particularly in Melbourne.

Graph 3.8
Private Dwelling Investment
Chain volume,* quarterly



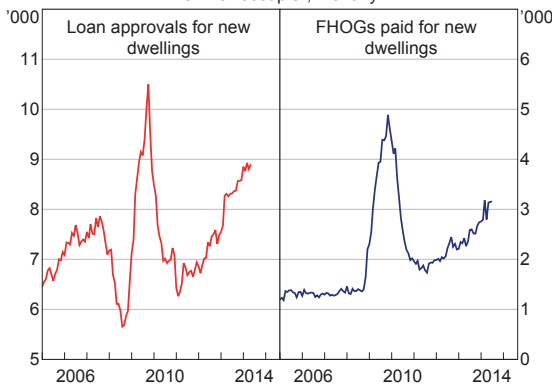
* 2011/12 prices
Source: ABS

Graph 3.9
Private Dwelling Approvals
Monthly



* Smoothed lines are ABS trend measures
Source: ABS

Graph 3.10
Indicators of Dwelling Investment*
Owner-occupier, monthly

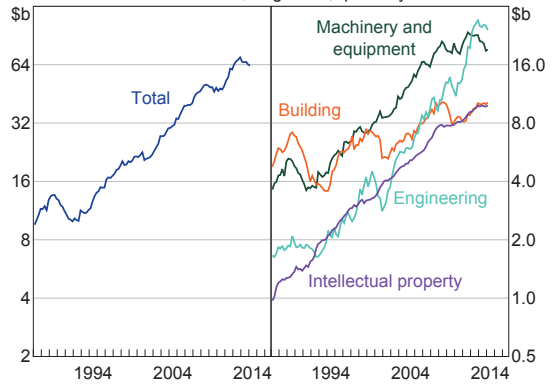


* Includes both new construction and newly erected dwellings
Sources: ABS; NSW Office of State Revenue; RBA

Business Sector

Business investment has continued to decline from its late 2012 peak as the investment phase of the mining boom is unwinding (Graph 3.11). By component, engineering construction fell in the March quarter, while non-residential building and machinery and equipment investment both increased a little. Over the past year, machinery and equipment investment has fallen by 10 per cent. Non-mining investment is estimated to have increased in the March quarter, although the increase only partly offset the fall in mining investment.

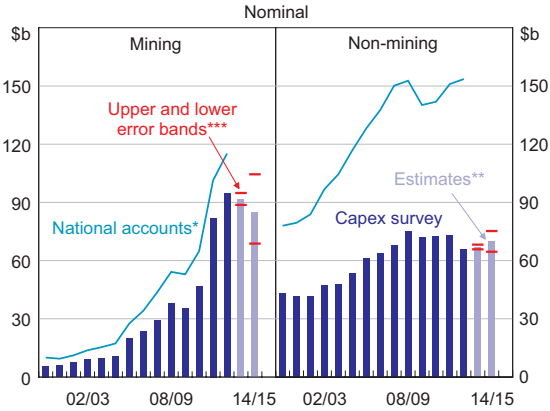
Graph 3.11
Private Business Investment
Chain volume,* log scale, quarterly



* 2011/12 prices; excluding cultivated biological resources
Sources: ABS; RBA

Both the ABS capital expenditure (Capex) survey and the Bank's liaison indicate that mining investment has passed its peak and is expected to fall sharply over the next couple of years (Graph 3.12). Investment intentions in the mining industry for 2013/14 were revised lower in the March quarter Capex survey. More importantly, the survey points to a sizeable decline in mining investment in 2014/15, although the Capex survey's estimates of investment intentions are less precise this far out. The Bank's liaison suggests the potential for a sharper decline than indicated by the Capex survey.

Graph 3.12
Measures of Private Business Investment

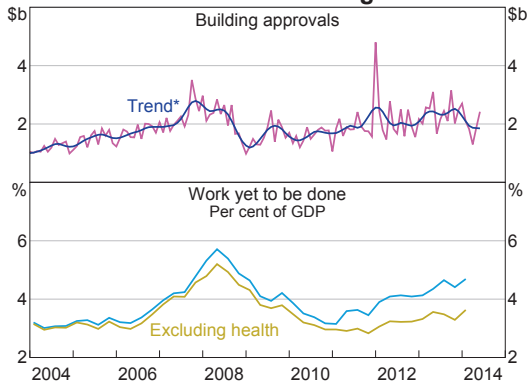


* Adjusted for second-hand asset transfers between the private and other sectors; excluding cultivated biological resources
 ** Estimates are firms' expected capital expenditure, adjusted for the past average difference between expected and realised spending
 *** Error bands are based on the root mean square error of each adjusted estimate compared with the final outcome for investment in each year

Sources: ABS; RBA

For non-mining investment, the Capex survey is pointing to a small pick-up in investment in 2014/15, almost entirely in buildings and structures. Other data on the outlook for investment in non-mining buildings and structures have been mixed. Non-residential building approvals have trended down since the start of the year, after growing over the past few years (Graph 3.13). The downward trend in approvals is consistent with underlying conditions in the commercial property market, where vacancy rates are above their decade averages and rental

Graph 3.13
Private Non-residential Building Construction



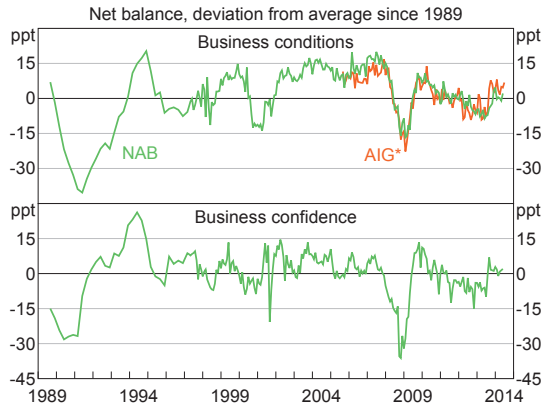
* 13-period Henderson trend

Sources: ABS; RBA

yields are below their historical averages. Even so, the elevated stock of work yet to be done flowing from prior approvals suggests that non-residential building investment will rise in coming quarters.

After picking up from below-average levels last year, business sentiment has remained around its long-run average level over the past few months (Graph 3.14). Survey measures of capacity utilisation are around average levels, although the Bank's liaison suggests that firms are reluctant to invest until they see a sustained period of strong demand.

Graph 3.14
Business Sentiment



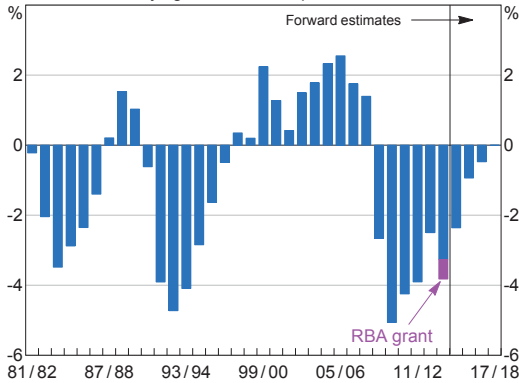
* Weighted average of AIG's Performance of Construction, Performance of Manufacturing and Performance of Services Indices, scaled to have the same mean and standard deviation as the NAB Business Conditions Index from 2005

Sources: AIG; NAB; RBA

Government Sector

Recent federal and state budgets call for ongoing fiscal consolidation over coming years (Graph 3.15). The planned consolidation is similar in size to previous episodes of fiscal tightening and will restrain aggregate demand as in the past. In 2014/15, the consolidated deficit is expected to narrow to around 2½ per cent of GDP, and progressively lower deficits are planned for subsequent years. The consolidated budget is scheduled to return to a balanced position by 2017/18, though there remains a level of uncertainty around which new policy initiatives will be legislated.

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



* Combined Australian Government, state and territory budget balances based on 2014/15 budgets or mid-year reviews as available; 2013/14 remains an estimate

Sources: Australian Treasury; State and Territory Treasuries

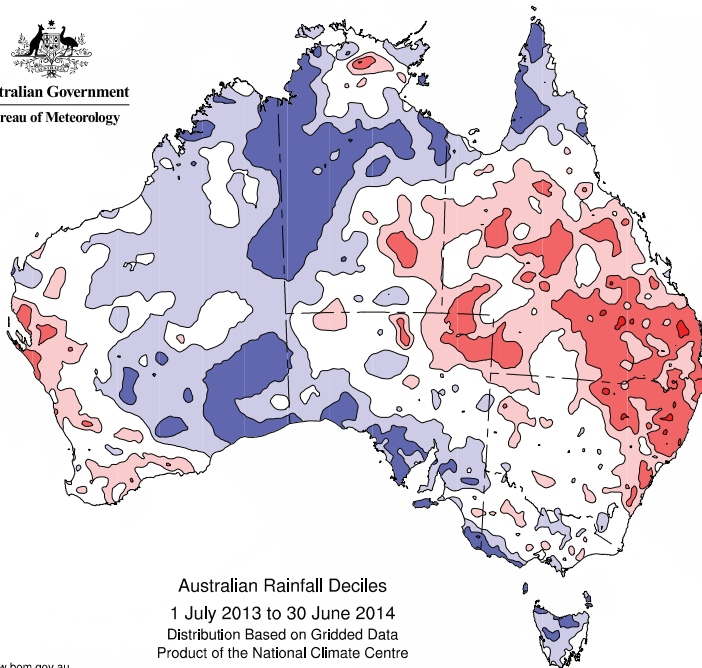
Farm Sector

Farm production is estimated to have risen by 6 per cent in 2013/14 according to the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES). This increase reflected a strong wheat crop in Western Australia and increased slaughtering of livestock as a result of a lack of rain in Queensland and northern New South Wales (Graph 3.16). ABARES expects farm production to fall in 2014/15 as livestock producers begin to rebuild stock numbers and as wheat yields return to more normal levels.

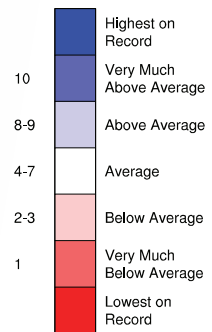
The Bureau of Meteorology currently estimates that there is a 50 per cent chance of El Niño conditions developing in 2014, which are associated with below-average rainfall over southern and eastern inland areas and above-average daytime temperatures

Graph 3.16
Australian Rainfall
 1 July 2013 to 30 June 2014


 Australian Government
 Bureau of Meteorology



Rainfall Decile Ranges



Australian Rainfall Deciles
 1 July 2013 to 30 June 2014
 Distribution Based on Gridded Data
 Product of the National Climate Centre

<http://www.bom.gov.au>

© Commonwealth of Australia 2014, Australian Bureau of Meteorology ID code: AWAP

Issued: 21/07/2014

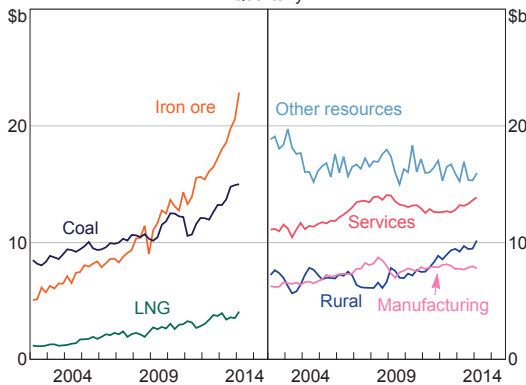
Source: Bureau of Meteorology

over the southern part of Australia. The effect of El Niño conditions on crop production is not clear, as it depends on the intensity and timing of rainfall.

External Sector

Resource exports made a strong contribution to GDP growth over the year to the March quarter, led by expansions in production and export facilities for iron ore and, to a lesser extent, for coal (Graph 3.17). In the quarter, resource exports contributed 0.9 percentage points to GDP growth, although some of this reflected the temporary effect of favourable weather conditions. While ongoing expansions to capacity are expected to lead to increases in iron ore and coal exports over the next year, the pace of growth in these exports is expected to slow noticeably. The first of the liquefied natural gas (LNG) projects currently under construction is also expected to begin production around the turn of the year. Manufacturing exports were little changed over the past year, as the still high level of the exchange rate continues to weigh on the sector. At the same time, however, there has been a broad-based increase in services exports, including in tourism, education-related services and other services (such as financial services). Rural exports increased sharply in the March quarter, led by wheat exports from Western Australia.

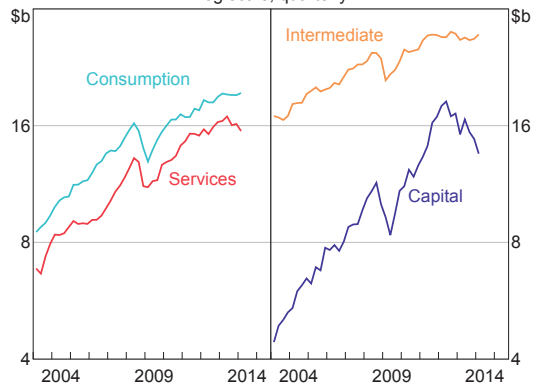
Graph 3.17
Export Volumes*
Quarterly



* 2011/12 prices
Sources: ABS; BREE; RBA

Imports fell in the March quarter and over the year (Graph 3.18). This primarily reflected a decline in capital goods imports, with liaison suggesting that the import-intensive phase of LNG investment is now unwinding. Recent Bank estimates suggest that imports have accounted for somewhere between one-third and one-half of mining investment in recent years and the import intensity of the LNG investment projects under way is expected to decline over the next few years.

Graph 3.18
Import Volumes*
Log scale, quarterly

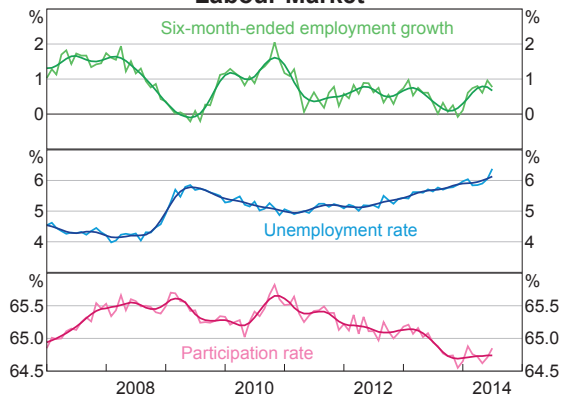


* 2011/12 prices
Source: ABS

Labour Market

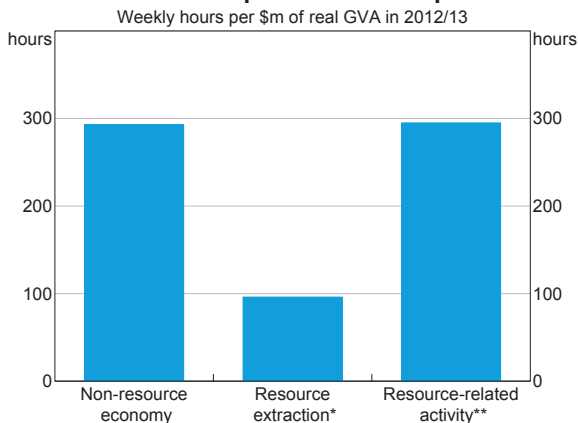
Some labour market indicators have improved a little this year, but overall conditions remain subdued. Employment has grown by around 1 per cent over 2014 to date, roughly keeping pace with population growth (Graph 3.19). The pick-up in employment growth since the beginning of the year is consistent with the improvement in economic activity since early last year. The strong growth in the extraction of resources is not likely to have added very much to the demand for labour, given that resource extraction is more capital intensive than production in the

Graph 3.19
Labour Market*



* Smoothed lines are 13-period Henderson trends
Sources: ABS; RBA

Graph 3.20
Labour Requirement of Output



* Includes mineral and gas extraction, and resource-specific manufacturing
** Includes investment that supports future production of resources as well as the provision of intermediate inputs used in the current production of resources

Sources: ABS; RBA

non-resource economy and typically requires only around one-third of the labour input (Graph 3.20).¹

The participation rate appears to have stabilised, fluctuating around its current level for the past few quarters, after declining from late 2010. Much of the earlier decline in the participation rate is likely to have reflected cyclical factors, although structural forces – including the ongoing effect of the ageing of the population – may have also had a significant effect.

Despite the improvement in some indicators, the unemployment rate has continued to rise since the start of the year. However, there has been significant monthly volatility of late. This may in part reflect a notable change to the definition of unemployment in the month of July, as well as unusually large effects from rotation of the survey sample.

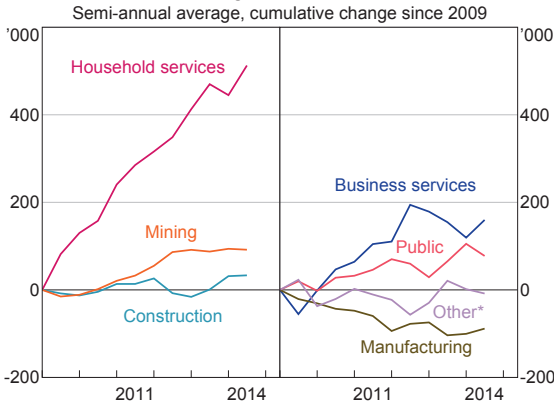
More generally, there remains a degree of spare capacity in the labour market. The unemployment rate is around its highest level since the early 2000s and the participation rate is around its lowest level of the past eight years. Total hours worked are currently only a little higher than their level two years ago despite strong growth of the population. Broader

measures of underemployment have also continued to rise in recent quarters, as there has been an increase in the prevalence of part-time workers that are seeking to work additional hours.

By industry, employment outcomes reflect the changing composition of economic activity. Employment in the household services sector has continued to exhibit a strong upward trend; gains in the health and education industries have accounted for the bulk of employment growth in this sector (Graph 3.21). Business services employment has retraced some of its recent decline; information from the Bank's liaison program suggests that strength in the residential and commercial property markets is stimulating demand for labour in the professional and real estate industries. Meanwhile construction employment has trended higher over the past year, consistent with growth in residential building activity. Mining employment has been relatively stable over the past two years, as the investment phase of the mining boom gives way to the production and export phase. Manufacturing employment has been little changed of late but remains on a gradual declining trend over the longer term.

¹ Differences in the labour input requirement, as measured here, will also capture the impact of differences in average hours worked across industries. See Rayner V and J Bishop (2013), 'Industry Dimensions of the Resource Boom: An Input-Output Analysis', RBA Research Discussion Paper No 2013-02.

Graph 3.21
Employment Growth



* Includes agriculture, forestry & fishing; electricity, gas, water & waste services; retail trade; transport, postal & warehousing; and wholesale trade

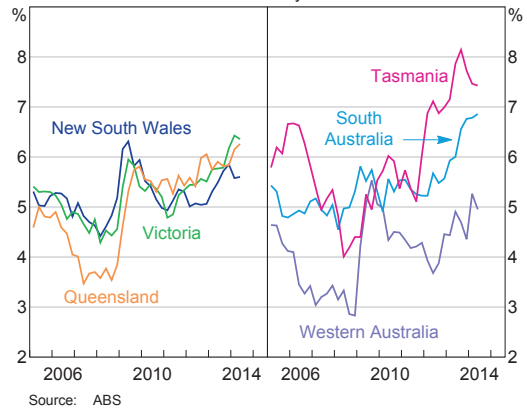
Source: ABS

Much of the increase in aggregate employment since the beginning of the year has been driven by New South Wales and Queensland. While the unemployment rate has increased in Queensland, this has been accompanied by a notable pick-up in the state's participation rate, perhaps suggesting that workers previously discouraged by poor job prospects may have resumed searching for work (Graph 3.22). The unemployment rate in Western Australia has also risen over the past two years, but remains low relative to other states. In Victoria, the unemployment rate remains relatively elevated. Labour market conditions remain generally subdued in South Australia and Tasmania, although the unemployment rate in Tasmania has declined somewhat from its peak around a year ago.

Nationally, the pace of population growth remains relatively strong by historical and international standards, notwithstanding a slight slowing in net overseas migration over the year to the December quarter. The composition of this growth across the states has shifted somewhat, possibly in response to changes in the pattern of demand across industries and regions. In particular, population growth has slowed in the mining-intensive states of Western

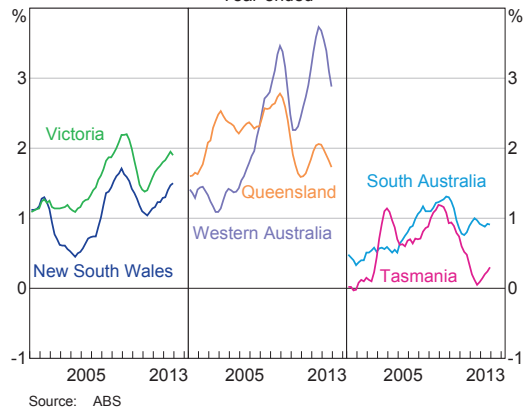
Australia and Queensland, but has accelerated in New South Wales and Victoria (Graph 3.23). Much of this shift is due to changes in net overseas migration, while net interstate migration has exhibited a similar, but more muted, pattern. Overseas migration may be particularly helpful in adjusting to changing patterns of labour demand; just as migrants were drawn to the resource-related regions and occupations in Western Australia and Queensland during the mining investment boom, they are now being drawn to the relatively stronger performing states of New South Wales and Victoria.

Graph 3.22
Unemployment Rates by State
Quarterly



Source: ABS

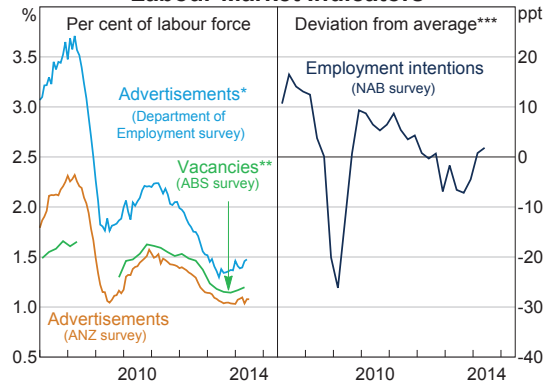
Graph 3.23
Population Growth by State
Year-ended



Source: ABS

Forward-looking indicators of labour demand have generally improved since last year. However, overall they remain at low levels, consistent with only moderate employment growth over the coming months. The ABS measure of job vacancies has increased over the past few quarters, while some measures of job advertisements have also trended higher despite some mixed outcomes of late (Graph 3.24). Business survey measures of hiring intentions have improved over recent months, to be slightly above their historical average. Reports from the Bank’s liaison suggest that businesses’ employment intentions have been little changed over recent months, but have improved since a year ago. ✎

Graph 3.24
Labour Market Indicators



* Adjusted by the department for the effect of MyCareer’s offer of free job advertising from July 2013; the adjusted data may understate recent improvements in job advertisements

** This survey was suspended between May 2008 and November 2009

*** Net balance of employment intentions for the following quarter; deviation from average since 1989

Sources: ABS; ANZ; Department of Employment; NAB; RBA

