2. Domestic Economic Conditions

The Australian economy has been growing at a below-trend rate over recent times. This largely reflects that consumption growth has been weighed down by a period of low growth in household income and declining housing prices. By contrast, labour market outcomes have been generally strong. In the June quarter, employment continued to grow faster than the working-age population and labour force participation rose to a record level, but the unemployment rate increased. Economic growth is expected to gradually strengthen. Partial indicators suggest economic growth was firmer in the June quarter partly because of stronger growth in resource exports.

Employment growth has been strong …

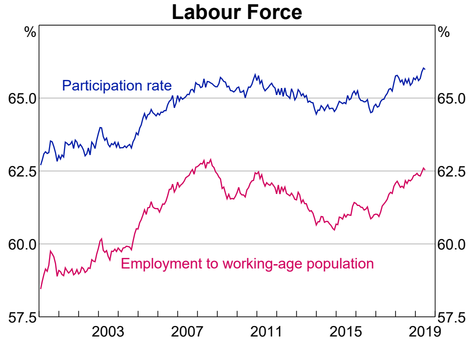
Employment growth has remained strong at 2.6 per cent over the year to the June quarter. Growth in employment has exceeded population growth and the share of the working-age population employed is close to a record-high level (Graph 2.1). In the June quarter, the bulk of growth was in part-time employment, though full-time employment has accounted for most of the growth over the past year. Strong labour demand has been met recently by an increase in labour supply that has seen the participation rate increase further to a record-high level. More people are entering the workforce as opportunities arise, particularly young people and women aged 25–45 years; older workers are also retiring later than in the past (Graph 2.2).

Victoria and New South Wales continue to account for a higher-than-average share of employment growth. Employment has outpaced the relatively strong working-age population growth in both states over the past year, whereas the employment to working-age population ratio has declined in Queensland.

By industry, education and health care & social assistance have been a consistent source of

Graph 2.1

Labour Force

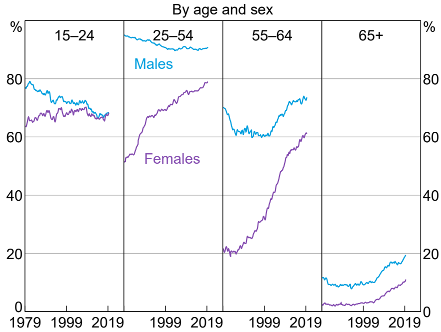


Source: ABS

Graph 2.2

Participation Rate

By age and sex



Sources: ABS; RBA

employment growth (Graph 2.3). This reflects longer-term trends in demand in the economy, especially for health-related jobs as the population ages and the National Disability Insurance Scheme (NDIS) is rolled out across Australia. While employment in professional, scientific & technical services has picked up in recent quarters, there has been little employment growth elsewhere in the business services sector over the past year. Despite the recent moderation in residential building activity, employment in the construction industry has continued to rise, though at a slower pace than a year ago.

… but the unemployment rate has increased

The unemployment rate increased to 5.2 per cent in the June quarter (Graph 2.4). This followed a period over late 2018 and early 2019 during which the unemployment rate was stable at around 5 per cent. The share of underemployed workers – who want and are available to work additional hours – also increased in the June quarter. As a result, a broader measure of labour market underutilisation, which captures both the hours sought by the unemployed and the additional hours that underemployed people would like to work, has increased in recent months but remains slightly lower than it was a year ago. Unemployment rates have increased across most states in recent months, with Western Australia a notable exception.

It remains likely that the labour market can absorb additional labour demand before anything more than gradual upward pressure is generated for wage and price inflation. Estimates of the unemployment rate associated with full employment are subject to considerable uncertainty. However, given that wage and price inflation have been lower than past relationships would have suggested, it is likely that this rate has trended down recently, to perhaps be around 4½ per cent, although uncertainty around any estimate of full employment is high.

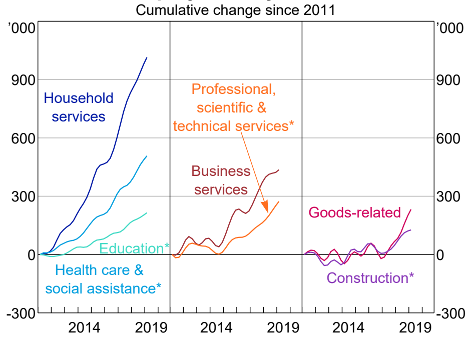
Leading indicators suggest employment growth will moderate

Forward-looking indicators of labour demand have moderated since mid 2018 (Graph 2.5). Job vacancies declined slightly in the three months to May, but remain at a high share of the labour force. Vacancies in health care continue to increase strongly, in line with the strength in the employment data for this industry. By contrast, vacancies in construction and several other industries have declined this year. Measures of job advertisements have declined further in

Graph 2.3

Employment by Sector

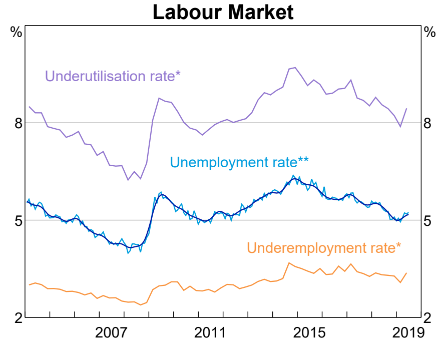
Cumulative change since 2011



* Select industry within sector
Source: ABS

Graph 2.4

Labour Market



* Hours-based measure
** Trend unemployment in dark blue
Sources: ABS; RBA

Table 2.1: Demand and Output Growth

Per cent

	March quarter 2019	December quarter 2018	Year to March quarter 2019	Share of GDP 2017/18
GDP	0.4	0.2	1.8	100
Domestic final demand	0.1	0.4	1.6	99
– Consumption	0.3	0.4	1.8	56
– Dwelling investment	–2.5	–2.9	–3.1	6
– Mining investment[a]	–1.8	–7.4	–10.6	3
– Non-mining investment[a]	1.2	2.5	1.4	10
– Public consumption	0.8	2.0	5.1	19
– Public investment[a]	0.4	1.0	7.2	5
Change in inventories[b]	–0.1	0.2	0.0	n/a
Exports	1.0	–0.5	1.7	22
Imports	–0.1	0.4	–0.5	–21
Mining activity[a]	0.9	–2.6	–1.6	13
Non-mining activity[a]	0.3	0.6	2.3	87
Farm GDP	–0.2	–5.2	–6.8	2
Non-farm GDP	0.4	0.3	2.0	98
Nominal GDP	1.4	1.2	4.9	n/a
Terms of trade	3.1	3.0	6.1	n/a

(a) RBA estimates

(b) Contribution to GDP growth

Sources: ABS; RBA

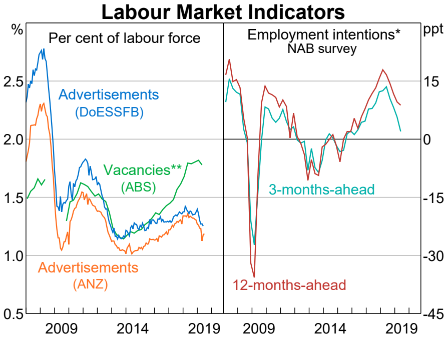
recent months, though the timing of public holidays and the federal election can account for some of the weakness in April and May. Employment intentions in the NAB survey and the Bank's liaison program have moderated, but remain above long-term averages.

Growth in the domestic economy remained subdued in the March quarter

Real GDP increased by 0.4 per cent in the March quarter to be 1.8 per cent higher over the year (Table 2.1; Graph 2.6; Graph 2.7). Subdued growth in income and lower housing prices in recent years continued to weigh on growth in consumption. There were also further declines in dwelling investment. Public demand remained strong. Elevated infrastructure spending has been a recent feature of both public and private investment; non-mining business investment added modestly to growth in the March quarter though mining investment subtracted from it. That GDP growth has been subdued despite strong employment growth implies very weak growth in labour productivity: there has been little growth in non-farm labour productivity over the past three years.

Graph 2.5

Labour Market Indicators



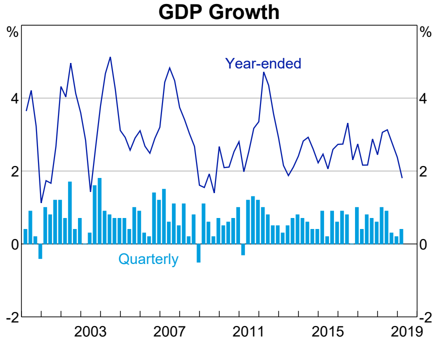
* Net balance for the following period; deviation from average; 12-months-ahead measure seasonally adjusted by the RBA

** Survey was suspended between May 2008 and November 2009

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

Graph 2.6

GDP Growth

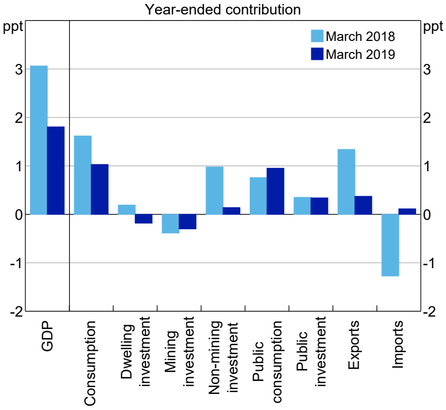


Source: ABS

Graph 2.7

GDP Growth

Year-ended contribution



Sources: ABS; RBA

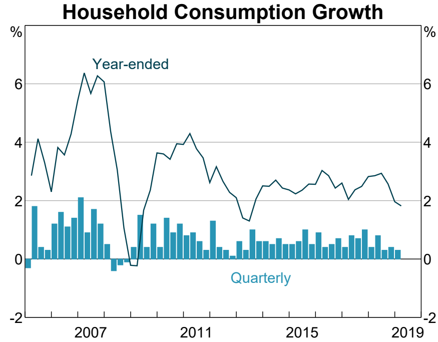
Growth in household discretionary spending slowed further

Household consumption grew by 0.3 per cent in the March quarter to be 1.8 per cent higher over the year, the slowest rate of growth in several years (Graph 2.8). In addition to subdued income growth, weak housing market conditions have contributed to the slowdown in consumption. The slowdown in consumption growth in recent quarters has been more pronounced for discretionary items, particularly those typically associated with housing turnover and household wealth (Graph 2.9). By category, year-ended growth has eased the most since mid 2018 for furnishing & household equipment and sales of new cars.

More recent indicators suggest household consumption growth remained soft in the June quarter. Retail sales volumes grew by 0.2 per cent over the year to the June quarter, the slowest rate of growth since the early 1990s; sales of household goods and at food retailers declined over the year. Information from the Bank's business liaison program has indicated that strong price rises for meat and vegetables during the first few months of 2019, as a result of supply shortages associated with the drought, contributed to reduced sales volumes for food. Sales of new cars to households declined in the June quarter and remained much lower than a year ago. Households' sentiment about the

Graph 2.8

Household Consumption Growth



Source: ABS

economic outlook has declined in recent months but sentiment towards their current finances has improved; both measures are close to their long-run average.

Non-labour sources of income continued to weigh on household income growth

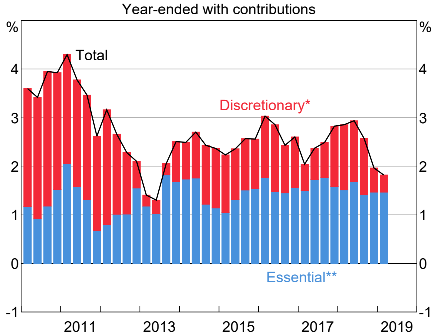
Household disposable income grew by 0.8 per cent in the March quarter and growth remained subdued in year-ended terms at 2.3 per cent (Graph 2.10). Growth in labour income supported household disposable income growth in the March quarter, consistent with strong employment growth. Non-labour income declined by 0.3 per cent in the March quarter, however, and year-ended growth slowed to 1.5 per cent. Income from unincorporated businesses declined in the quarter and over the year because of lower residential construction activity, lower turnover in the housing market and weakness in the farming sector (Graph 2.11). Growth in other forms of non-labour income, such as social assistance and rental income, also remained low. Strong growth in household tax payments of 7.6 per cent over the year to the March quarter has weighed on disposable income growth, although these tax payments declined slightly in the March quarter. Nominal income growth was a little faster than growth in household consumption spending, so the household saving ratio increased for the second consecutive quarter.

Year-ended growth in disposable income is expected to remain subdued in the June quarter, before picking up over the second half of 2019. The reductions in the cash rate in June and July and application of the low- and middle-income tax offset will boost disposable income in the September quarter.

Graph 2.9

Household Consumption Growth

Year-ended with contributions



* Includes furnishing & household equipment, clothing & footwear, recreation & culture, motor vehicles, alcohol & tobacco, air & water transport, hotels, cafes & restaurants, and 'other goods and services'

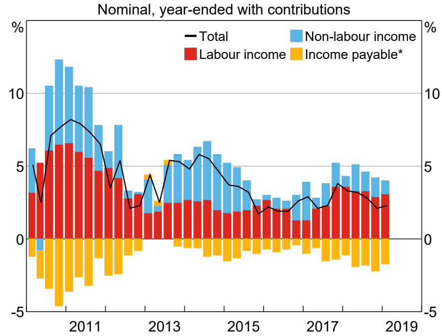
** Calculated as a residual; includes categories such as food, housing, health, education and utilities

Sources: ABS; RBA

Graph 2.10

Household Disposable Income Growth

Nominal, year-ended with contributions



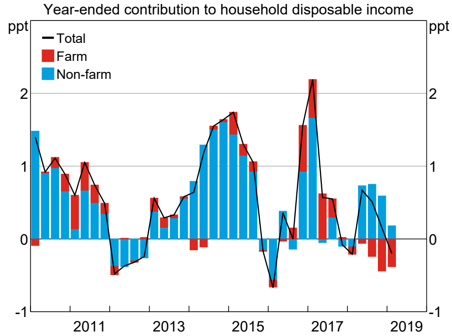
* Includes tax and interest payments

Sources: ABS; RBA

Graph 2.11

Unincorporated Business Income

Year-ended contribution to household disposable income



Sources: ABS; RBA

Dwelling investment continued to decline

Private dwelling investment declined by 2.5 per cent in the March quarter and by 3.1 per cent over the year (Graph 2.12). The quarterly decline was broad based across dwelling investment types. The pipeline of work to be done remains at a high level, particularly for higher-density projects in New South Wales and Victoria, though it has declined in most states (Graph 2.13). The number of dwellings in the pipeline is expected to continue to fall as completions outpace approvals. Residential building approvals declined further over May and June, to be more than 20 per cent lower over the year.

Conditions in the earlier stages of residential property development remain weak. Contacts in the Bank's liaison program indicate that demand for new houses and apartments has remained around the low levels of late 2018. Given this, the typical lags between the sale and construction of new dwellings imply that the decline in dwelling investment will continue for some time, despite the recent signs of stabilisation in the established housing market.

Established housing markets appear to have stabilised

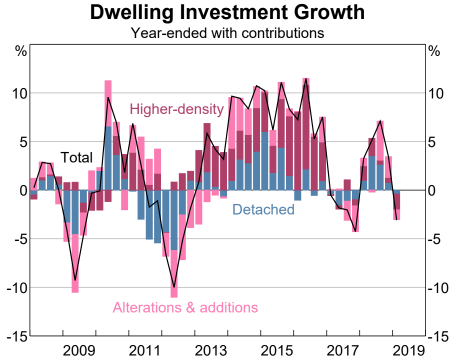
Conditions in a number of housing markets have stabilised recently, following the removal of uncertainty that preceded the federal election, APRA's announcement of proposed changes to mortgage serviceability requirements and the lowering of the cash rate. After declining for more than a year, established prices in Sydney and Melbourne increased slightly over recent months (Table 2.2; Graph 2.14). Auction clearance rates have strengthened further in Sydney and Melbourne on low auction volumes (Graph 2.15). The share of households expecting further price declines has eased in recent consumer surveys.

Conditions remain subdued in established housing markets outside Sydney and Melbourne, though they have recovered a little in most capital cities and some regional areas more recently. Prices increased in July in Brisbane, following declines for most of the past year. The size of price declines in some other areas, including Perth, have moderated in recent months.

Rental vacancy rates were below their long-run average in the March quarter in most cities (Graph 2.16). The Perth rental market has tightened since mid 2017; vacancy rates have fallen and advertised rent inflation has turned

Graph 2.12

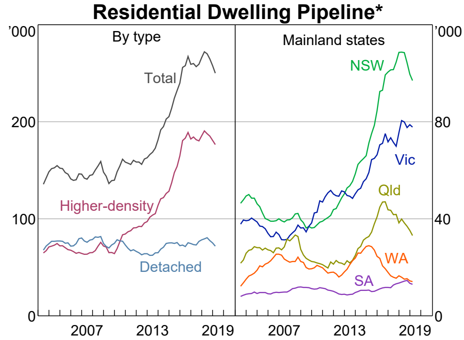
Dwelling Investment Growth



Sources: ABS; RBA

Graph 2.13

Residential Dwelling Pipeline*



* Includes dwellings approved but not yet commenced and private dwellings under construction

Sources: ABS; RBA

Table 2.2: Growth in Housing Prices
Percentage change, seasonally adjusted

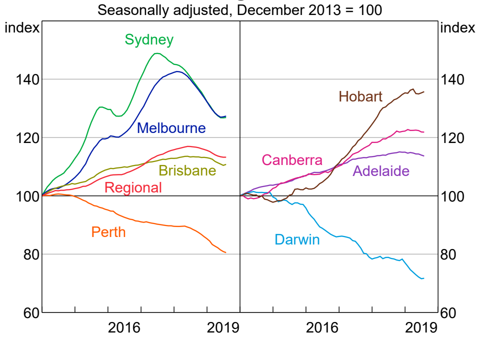
	July	June	May	April	Year-ended	Growth over previous five years
Sydney	0.1	0.0	–0.5	–0.7	–9.0	18
Melbourne	0.2	0.1	–0.5	–0.6	–8.2	24
Brisbane	0.3	–0.4	–0.4	–0.4	–2.4	7
Adelaide	–0.3	–0.3	–0.0	–0.3	–0.8	10
Perth	–0.4	–0.7	–0.9	–0.6	–8.9	–20
Darwin	0.2	–0.8	–1.1	–1.1	–8.7	–29
Canberra	0.0	–0.4	–0.1	0.1	1.1	22
Hobart	0.3	0.3	–0.1	–1.1	2.8	36
Capital cities	0.1	–0.1	–0.4	–0.6	–7.3	13
Regions	0.0	–0.1	–0.2	–0.4	–3.0	11
National	0.1	–0.1	–0.4	–0.6	–6.4	13

Sources: CoreLogic; RBA

positive. Sydney rental vacancy rates remain an outlier and have risen further, particularly in areas where the supply of new apartments has increased significantly; advertised rents have declined over the past year.

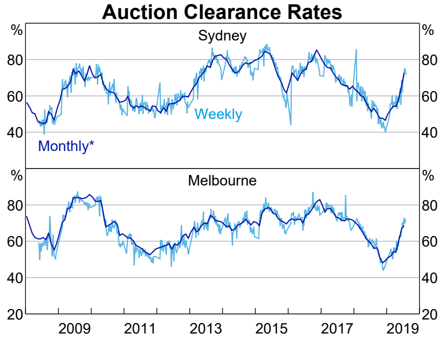
Despite some stabilisation in established market conditions, housing market turnover remains around its lowest level in recent decades. The decline in housing market turnover led to a sharp decline in the national accounts measure of private ownership transfer costs in the March quarter, which subtracted 0.2 percentage points from quarterly GDP growth. Private ownership transfer costs measure the services associated with buying housing, including costs such as fees and commissions paid to real estate agents, auctioneers and lawyers and stamp duty. This component will be less of a drag on GDP growth as turnover in the housing market stabilises.

Graph 2.14
Housing Prices
Seasonally adjusted, December 2013 = 100



Sources: CoreLogic; RBA

Graph 2.15
Auction Clearance Rates



* Seasonally adjusted
Sources: APM; CoreLogic; RBA; REIV

Household net wealth was unchanged in the March quarter because declines in housing prices were offset by an increase in financial wealth. In the June quarter, equity prices increased further and declines in housing prices were smaller, which should have supported growth in household net worth.

Public demand has supported economic growth

Strong growth in public demand has continued the recent trend of contributing a larger share of economic growth as private demand has slowed (Graph 2.17). Public demand increased by 0.8 per cent in the March quarter to be 5.5 per cent higher over the year. Growth in public consumption was driven by ongoing federal government spending on social benefits to households, reflecting the rollout of the NDIS and increased spending on the Pharmaceutical Benefits Scheme. Public investment, which includes spending on infrastructure and public buildings across all levels of government, grew strongly over the year.

The projections for the underlying cash balance across the latest consolidated government budgets is mostly unchanged since last year's updates. The underlying cash deficit is expected to be around 1 per cent of GDP in 2018/19 and 2019/20. After this, the reduction in the consolidated deficit is expected to occur more gradually than the contraction that occurred in 2017/18. The federal government cash balance is projected to be in surplus by 2019/20, while the deficit of the states and territories is projected to peak this year (Graph 2.18).

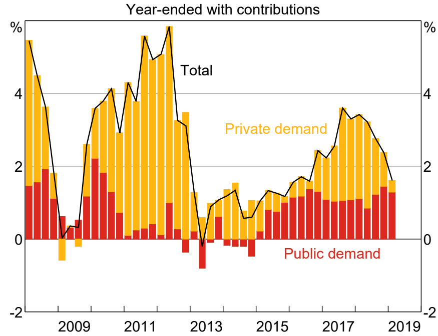
Infrastructure investment has been strong

Investment in infrastructure has picked up over recent years (Graph 2.19). This has been led by both public and private investment in transport infrastructure in metropolitan areas. There has also been a large increase in electricity-related

Graph 2.17

Domestic Final Demand Growth*

Year-ended with contributions



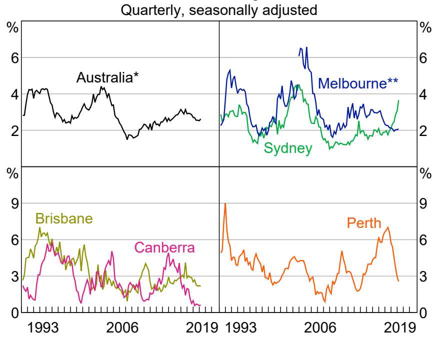
* Adjusted for second-hand asset transfers between the public and other sectors

Sources: ABS; RBA

Graph 2.16

Rental Vacancy Rates

Quarterly, seasonally adjusted



* Capital cities excluding Adelaide, Darwin and Hobart

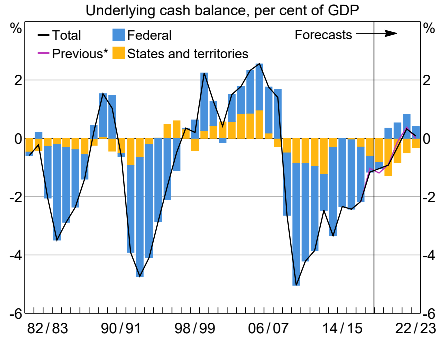
** Series break December quarter 2002

Sources: RBA; REIA

Graph 2.18

Consolidated Government Balance

Underlying cash balance, per cent of GDP



* Updated 2018/19 budgets; includes federal mid-year economic and fiscal outlook

Sources: ABS; Australian Treasury; RBA; State and territory budgets infrastructure spending, particularly private-sector renewable energy projects. The pipeline of infrastructure work yet to be done suggests the level of activity will remain elevated in coming years, supported by roads and electricity (particularly renewables) projects.

Growth in other non-mining investment has slowed over the past year

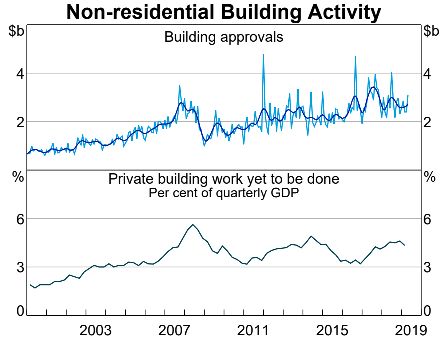
Non-mining investment apart from infrastructure remains elevated, but has been growing slowly over the past year. In particular, growth in non-residential building investment has slowed, after a period of strong growth over 2017 and the first half of 2018. However, building approvals remain around their average since 2016 and the stock of work yet to be done on private non-residential buildings remains elevated, reflecting work underway on offices, warehouses and other commercial buildings (Graph 2.20).

Investment in machinery & equipment and other assets has also been growing at a subdued pace (Graph 2.21). In contrast, firms' investment in computer software has increased steadily in recent years. Investment intentions for 2019/20 reported by non-mining firms in the Australian Bureau of Statistics (ABS) Capital Expenditure (Capex) survey suggest capital expenditure on machinery & equipment investment will ease; that said, early estimates of capital expenditure have historically been subject to a large degree of uncertainty.

Consistent with the slower growth outlook for non-mining business investment, survey measures of expected capital expenditure and business conditions have eased since early 2018 and remain close to average for most industries; conditions are more subdued in the retail and transport & utilities industries (Graph 2.22). By contrast, non-mining profits increased strongly in the March quarter and should support conditions for firms to invest.

Graph 2.20

Non-residential Building Activity

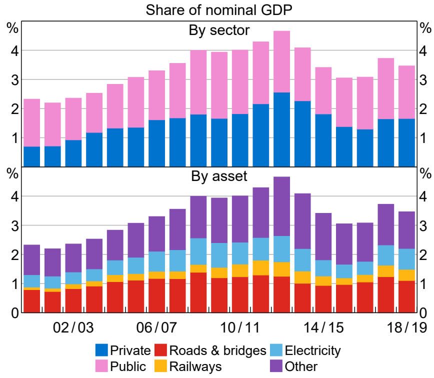


Sources: ABS; RBA

Graph 2.19

Infrastructure Work Done*

Share of nominal GDP



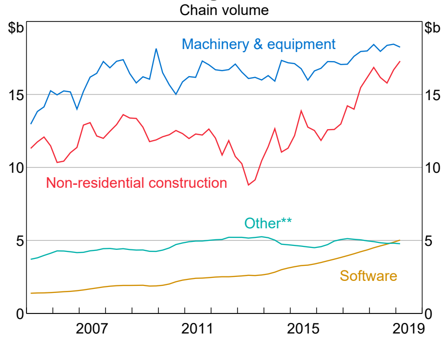
* Excludes explicitly identified resources and other heavy industry projects, but captures some resource-related work; 2018/19 includes projections for the June quarter

Sources: ABS; RBA

Graph 2.21

Non-mining Investment*

Chain volume



* RBA estimates of new investment

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

Sources: ABS; RBA

Mining investment and resource exports are expected to recover from recent soft outcomes

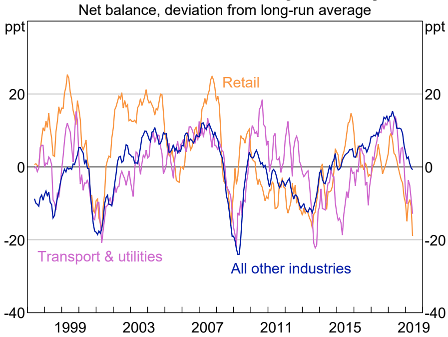
Mining investment declined further in the March quarter as construction on the remaining liquefied natural gas (LNG) projects continued to wind down. The decline in the quarter, taken together with the recent Capex survey for 2018/19, suggests that mining investment is around its trough (Graph 2.23). Information from the Capex survey for 2019/20, the Bank's liaison program and company announcements continue to suggest that mining investment will pick up gradually over the next year or so as mining firms invest to sustain production levels and, in some instances, expand productive capacity.

Resource export volumes were unchanged in the March quarter, as a strong rebound in non-monetary gold exports offset declines in other resource exports (Graph 2.24). Partial trade data suggest that resource exports should increase in the June quarter. Growth is expected to be led by LNG exports, as recently completed projects ramp up production, and iron ore exports as they recover from supply disruptions including Tropical Cyclone Veronica in late March. The strength in iron ore prices over recent months is not expected to affect resources sector activity directly, although there are likely to be spillovers to the broader economy from the boost to national income (for more discussion, see Box B: The Recent Increase in Iron Ore Prices and Implications for the Australian Economy).

Graph 2.22

Business Conditions by Industry*

Net balance, deviation from long-run average



* Three-month moving average

Sources: NAB; RBA

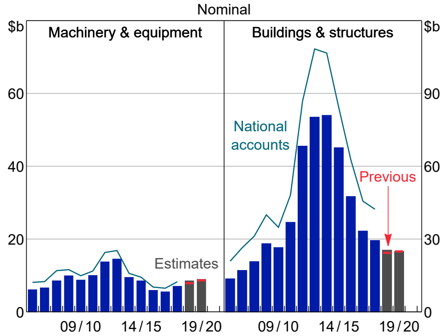
Drought conditions have weighed on the farm sector

Drought conditions have persisted across south-eastern Australia, although some regions have had rainfall in recent months, particularly South Australia, Victoria and southern New South Wales. Farm GDP has fallen by around 7 per cent since the middle of 2018, driven by lower crop production. With lower output and elevated input costs (including higher feed and water costs), nominal farm profits declined by 6 per cent in the March quarter, to be

Graph 2.23

Mining Capital Expenditure*

Nominal

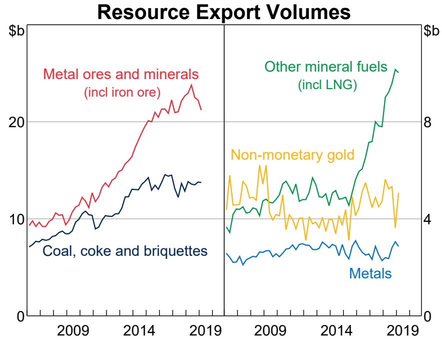


* Estimates are firms' expected capital expenditure; adjusted for past average differences between expected and realised spending

Sources: ABS; RBA

Graph 2.24

Resource Export Volumes



Sources: ABS; RBA

24 per cent lower than June quarter 2018. The most recent climate outlook published by the Bureau of Meteorology indicates that drier-than-average conditions are expected for large parts of the country over the next three months, which suggests further weakness in activity in the rural sector in coming quarters.

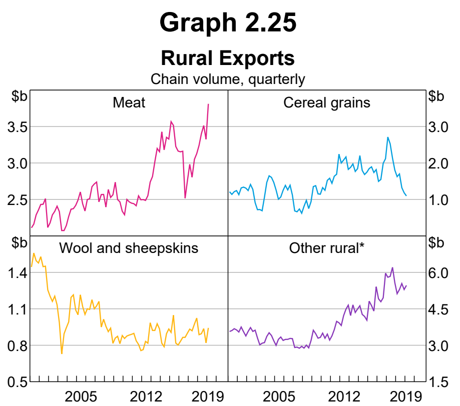
Rural exports increased solidly in the March quarter, because strong growth in meat exports more than offset continued weakness in cereal exports (Graph 2.25). Dry conditions have kept slaughter rates elevated over recent months and demand for meat products has been supported by strong overseas demand and a lower Australian dollar. Assuming that seasonal conditions gradually return to average over the next year or so, meat exports should ease from their elevated levels as producers focus on herd rebuilding.

Service and manufactured exports continue to grow steadily

Australia's service and manufactured exports have grown steadily over recent years, supported by the continued economic expansion in Australia's major trading partners and a modest depreciation of the Australian dollar. Increasing enrolments of overseas students and visitor arrivals should continue to support growth in service exports over the next couple of years. The importance of travel services to Australia's export base has increased considerably over the past two decades, from around half of total service exports in the early 2000s to around two-thirds more recently, with most of the increase driven by education-related travel exports (Graph 2.26).

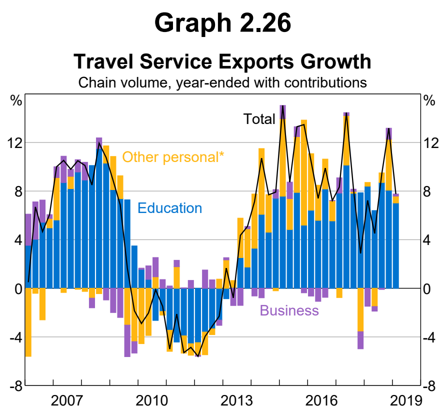
Growth in total import volumes has eased over the past year or so, alongside slower growth in both public and private investment, which are relatively import-intensive components of expenditure. Partial data suggest that import volumes declined modestly in the June quarter.

An increase in Australia's export volumes, higher export prices, and a modest decline in import volumes resulted in a further increase in the trade surplus in the March quarter, to its highest share of nominal GDP since the March quarter 1973 (Graph 2.27). Available data suggest another sizeable trade surplus is expected in the June quarter. The recent increases in the trade surplus have offset some widening in the net income deficit, leaving the current account deficit at its narrowest as a share of GDP since the late 1970s. The widening in the net income deficit over the past couple of years is consistent with a pick-up in dividend payments to non-residents because revenues in the largely foreign-owned mining sector have increased.



* Includes horticulture and dairy exports

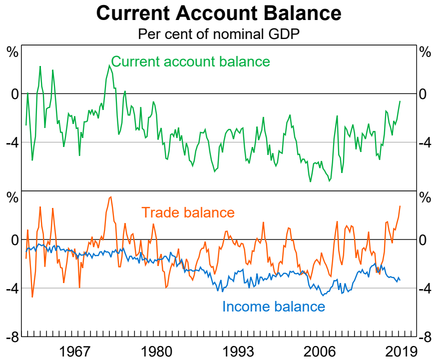
Sources: ABS; RBA



* Includes tourism

Sources: ABS; RBA

Graph 2.27



Sources: ABS; RBA