2. Domestic Economic Conditions

The Australian economy had substantial momentum over the first half of 2022 and timely indicators suggest growth held up into the September quarter. The labour market is currently very tight. Employment growth has been minimal since the middle of the year as many firms are finding it challenging to hire workers. Labour demand is strong, although there are signs it is easing slightly. Some parts of the economy have faced disruptions from adverse weather events and shortages of materials, but this has not weighed materially on investment intentions or perceptions of business conditions. While strong labour market conditions are supporting household incomes, household budgets are under increasing pressure from rising prices and higher interest rates. Housing prices have continued to decline since their peak in April this year.

The labour market is tight and employment growth has slowed

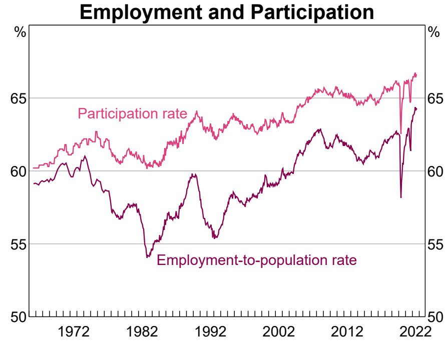
The labour market remains tight. The employment-to-population ratio and the participation rate are near record highs (Graph 2.1). The number of employed people in Australia is 4½ per cent higher than in February 2020, driven entirely by full-time employment. However, there was almost no employment growth in the September quarter.

Spare capacity in the labour market is at multi-decade lows. The unemployment rate has remained around 3½ per cent in recent months, while the heads-based underutilisation rate has been little changed at around 9½ per cent. Medium- and long-term unemployment rates have also remained steady (Graph 2.2). The medium-term unemployment rate, which is more representative of cyclical unemployment and so tends to be the most relevant for wages growth, is around its lowest level since the series began in 1991.

Hours-based measures of underutilisation are also at historically low levels as strong labour demand over the past year has been met

Graph 2.1

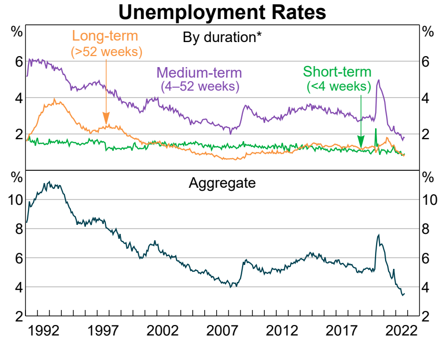
Employment and Participation



Source: ABS

Graph 2.2

Unemployment Rates



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

through an increase in hours of existing workers, including via part-time workers moving into full-time employment and a greater number of people holding multiple jobs. However, average hours worked have remained below their mid-2021 level amid elevated rates of sick leave and annual leave (Graph 2.3). Only a small number of firms in the Bank's liaison program have reported increasing headcount or the hours of existing staff to deal with high levels of sick leave this year. At the margin, the recent reduction in sick leave could alleviate some of the labour shortage pressures being experienced by firms.

Indicators of labour demand have started to moderate in recent months but remain at high levels

Most measures of job advertisements and vacancies have stabilised or declined a little in recent months and fewer firms in the Bank's liaison program plan to increase their headcount. Nonetheless, there are roughly as many vacancies as there are unemployed people and more than half of all firms in business surveys report that finding suitable labour is a significant constraint on activity (Graph 2.4). As a result, there is likely to be less scope for further growth in employment in the period ahead.

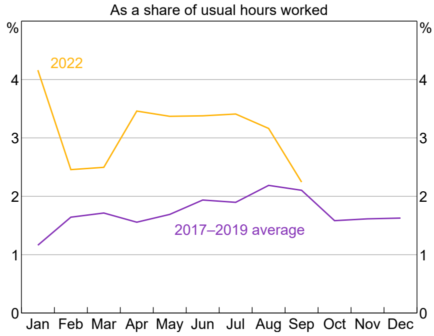
Job vacancies remain particularly high in industries most reliant on migrants for their workforce, such as accommodation & food services. While overseas arrivals and departures have increased since the reopening of the international border, the number of international students in the country remains well below pre-pandemic levels. Liaison suggests that the border reopening has not materially improved labour availability to date, in part because of delays in visa processing.

Job mobility remains higher than in the years preceding the pandemic, and is around the levels seen prior to the global financial crisis. The pick-up in job mobility since the onset of the pandemic continues to be driven by people wanting a better job or a change; the number of workers switching jobs for this reason has increased much faster than the number who report planning to do so, suggesting that some workers are taking advantage of attractive job offers even though they had not been actively looking for a new role. Changes in mobility have been mixed across industries. Job mobility in health care and professional services has declined after being elevated for most of the pandemic, while the job mobility rate in some business services has increased notably (Graph 2.5).

Graph 2.3

Hours Not Worked Due to Sick Leave*

As a share of usual hours worked

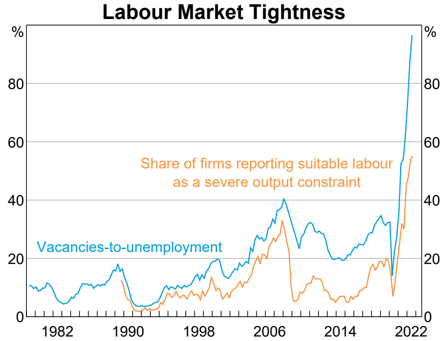


* Non-seasonally adjusted.

Sources: ABS; RBA

Graph 2.4

Labour Market Tightness



Sources: ABS; NAB

Economic activity had strong momentum in the June quarter

The Australian economy grew by 0.9 per cent in the June quarter and by 3.6 per cent over the year. In the quarter, growth in household consumption was strong as spending on discretionary services, such as hotels & restaurants and overseas travel, continued to recover from the restrictions and international border closures that were in place during the pandemic (Graph 2.6). Household spending on goods was little changed in the June quarter but remained at an elevated level. Strong growth in consumption saw the household saving ratio decline further to be closer to, but still above, the levels that prevailed prior to the pandemic (Graph 2.7).

Growth in GDP was also boosted by a rebound in exports, following earlier production disruptions in the resources sector. By contrast, construction activity declined because of ongoing material and labour shortages, illness-related absences and weather-related disruptions. Public demand was broadly flat in the June quarter, but remained at a high level as a share of GDP.

The terms of trade rose strongly to a historical high, providing a substantial boost to national income –mainly in the form of higher profits for companies in the resources sector and higher tax revenue. Nominal GDP increased by 12 per cent over the year, close to its fastest growth rate in over 30 years, underpinned by the record terms of trade, strong growth in domestic prices and solid growth in the real economy (Graph 2.8).

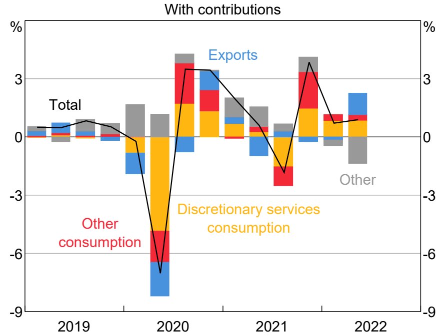
Household spending has grown solidly in recent months

A range of timely data sources suggest that growth in real household consumption was solid in the September quarter, but has slowed a little from the strong pace recorded around the middle of the year. Household spending growth was supported by continued recovery in

Graph 2.6

Quarterly GDP Growth

With contributions

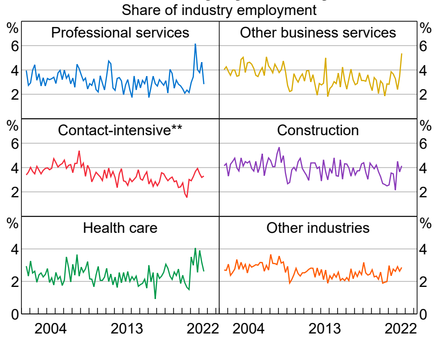


Sources: ABS; RBA

Graph 2.5

Job Mobility by Industry*

Share of industry employment



* Based on the industry of new job.

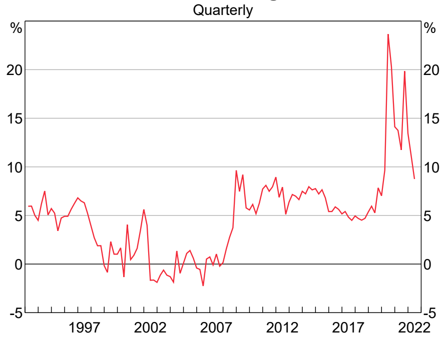
** Includes accommodation & food services, arts & recreation and retail trade.

Sources: ABS; RBA

Graph 2.7

Household Saving Ratio*

Quarterly



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

Sources: ABS; RBA

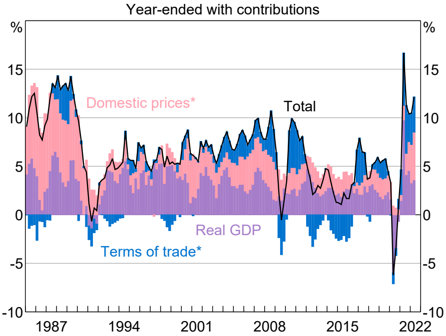
spending on discretionary services, such as hospitality and travel. Retail sales values grew by 2.3 per cent in the quarter, underpinned by a further recovery in spending at cafes & restaurants and at department stores. A significant share of this increase reflected strong growth in retail prices, though volumes are estimated to have also risen (Graph 2.9).

These data are consistent with information from retailers in the Bank's liaison program that suggests spending growth slowed a little recently (see 'Box A: Insights from Liaison'). Liaison contacts suggest that retail sales values continued to grow in October.

Graph 2.8

Nominal GDP Growth

Year-ended with contributions



* RBA estimates.

Sources: ABS; RBA

Headwinds to household spending are strengthening

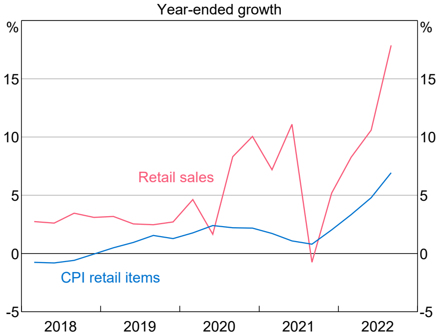
Nominal household disposable income (after taxes and interest payments) grew by 1 per cent in the June quarter despite a small increase in net interest payments by households. In aggregate, the value of household interest payments is larger than the value of interest receipts as the household sector holds more interest-bearing debt than interest-earning assets. Net interest payments will therefore continue to weigh on household disposable income growth in the quarters ahead, as cash rate increases since May 2022 are passed through to lending rates and fixed-rate loans expire (see chapter on 'Domestic Financial Conditions').

Household budgets are also under increasing pressure from rising prices. Rising consumer prices continued to outpace growth in overall household disposable income, leading to a decline in real (inflation-adjusted) disposable income in the June quarter (Graph 2.11). Real household net wealth also decreased by around 5 per cent in the quarter – the largest quarterly fall since 2008 – as both housing and financial wealth declined. Nevertheless, real household net wealth remained around 20 per cent above its pre-pandemic level, while real household disposable income was 7 per cent higher.

Graph 2.9

Nominal Retail Sales and Prices

Year-ended growth

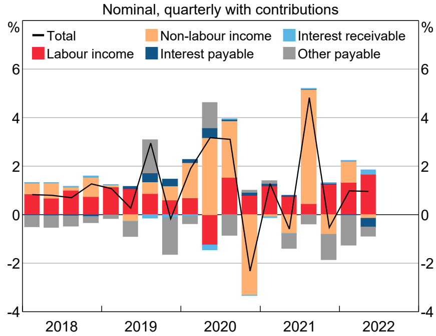


Sources: ABS; RBA

Graph 2.10

Household Disposable Income Growth

Nominal, quarterly with contributions



Sources: ABS; RBA

These pressures on household budgets from rising costs of living and increased interest rates have contributed to a sharp decline in consumer sentiment, which is around the lows observed at the onset of the pandemic and during the global financial crisis. These factors are expected to weigh on household consumption in the period ahead (see chapter on 'Economic Outlook').

The labour share of income has been relatively stable outside the mining sector

Despite solid growth in labour income, the labour share of income in the national accounts has declined in recent years. However, this is largely attributable to strong growth in mining profits, which has been driven by increases in the terms of trade. Excluding mining, the labour share of income has been little changed over the past decade, aside from during the pandemic when government subsidies temporarily boosted profits (Graph 2.12). Mining profits are expected to decrease over coming years as the terms of trade reverts to lower levels.

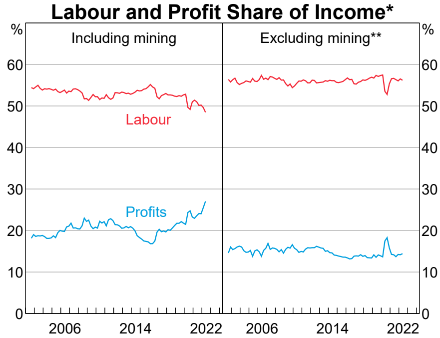
The outlook for business investment remains positive

Business investment was little changed in the June quarter. Growth in machinery and equipment investment remained elevated, as firms responded to strong demand (Graph 2.13). By contrast, non-residential construction investment declined as capacity constraints and adverse weather limited the pace at which work could be completed.

Survey measures of capacity utilisation and investment intentions point to a positive outlook for business investment. Non-mining capacity utilisation and business conditions

Graph 2.12

Labour and Profit Share of Income*



* Shares do not sum to 100 per cent due to the exclusion of gross mixed income, and the gross operating surplus of public corporations, financial corporations, general government and dwellings.

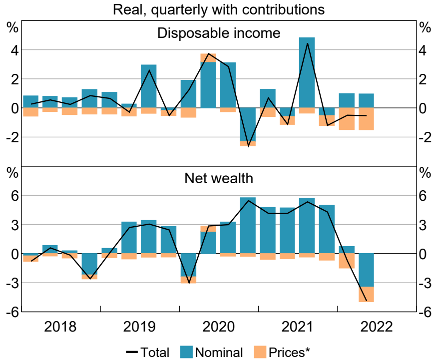
** Excluding mining sector profits and mining sector labour income.

Sources: ABS; RBA

Graph 2.11

Growth in Household Income and Wealth

Real, quarterly with contributions



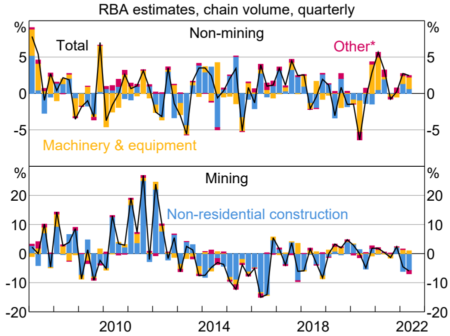
* Consumption deflator.

Sources: ABS; RBA

Graph 2.13

Private Business Investment Growth

RBA estimates, chain volume, quarterly



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

Sources: ABS; RBA

remain elevated; capacity utilisation was around its highest level in over three decades in September. Business confidence is around its long-run average, and liaison suggests that firms are generally optimistic about the longer term outlook for demand.

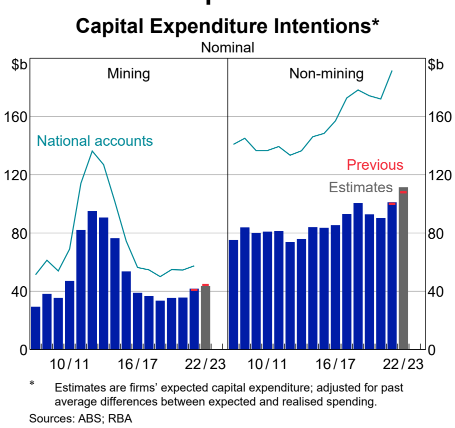
The ABS Capital Expenditure Survey showed that, in aggregate, firms increased their expectations for investment in the 2022/23 financial year, though this may partly reflect elevated input costs (Graph 2.14). Non-mining firms expected to increase investment in machinery and equipment, but revised their intentions for non-residential construction investment slightly lower compared with the previous survey, as capacity constraints and ongoing wet weather are expected to hamper the pace of construction work. Mining firms reduced investment intentions for the current financial year. Liaison suggests that planned investment by the mining industry will largely be to maintain production rather than to expand capacity. Mining firms are also returning much of the earnings arising from elevated commodity prices to investors, rather than reinvesting profits.

Residential construction activity is continuing to face capacity constraints

A number of factors have combined to slow the pace of residential construction since the start of 2022, including ongoing shortages of labour and materials, adverse weather conditions and illness-related absenteeism (Graph 2.15). The decline in activity in the June quarter was largest for the detached housing sector, reflecting that firms in this sector tend to be smaller project home builders and are more sensitive to supply chain issues affecting the availability of labour and materials. Consistent with this, average completion times rose by about a month in 2021/22. These delays, in combination with higher material costs, have reduced cash flows and contributed to rising insolvencies in the construction sector.

Demand for new detached housing has fallen considerably since the start of the year, due to rising interest rates, higher prices for land and construction alongside falling established home prices, and poor buyer sentiment arising from construction delays. Consistent with this, building approvals, new greenfield land sales and new home orders have all declined. Information from the Bank's liaison program suggests that demand for off-the-plan apartments has also softened of late. Nevertheless, the pipeline of work to be done remains

Graph 2.14



Graph 2.15

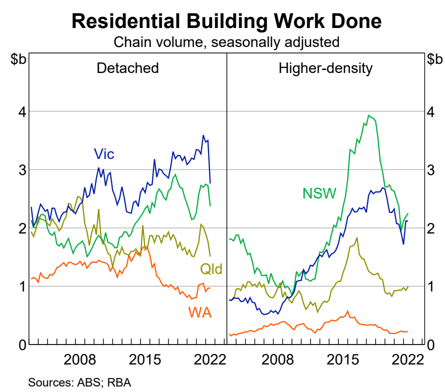


Table 2.1: Housing price growth

Percentage change, seasonally adjusted

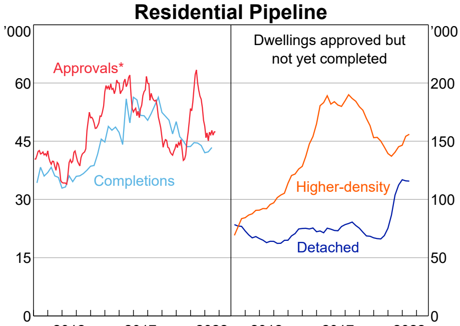
	October	September	August	July	Year-ended	Five-year growth
Sydney	−1.5	−1.7	−1.9	−1.9	−8.6	10
Melbourne	−1.0	−0.9	−1.0	−1.1	−5.6	4
Brisbane	−1.8	−1.3	−1.2	−0.5	8.4	36
Adelaide	−0.3	0.0	0.1	0.6	16.5	47
Perth	0.0	−0.1	0.1	0.5	4.0	18
Darwin	−0.5	−0.0	1.2	0.5	4.9	13
Canberra	−1.0	−1.5	−1.8	−1.3	1.0	44
Hobart	−1.1	−1.2	−1.4	−0.9	−1.0	52
Capital cities	−1.2	−1.2	−1.3	−1.1	−3.1	13
Regional	−1.3	−1.0	−1.1	−0.5	6.6	37
National	−1.1	−1.2	−1.2	−0.9	−0.9	18

Sources: CoreLogic, RBA

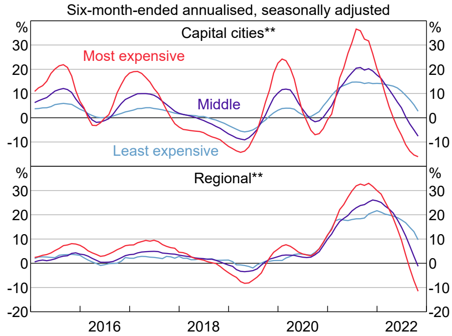
elevated, reflecting the delays associated with constructing the large number of dwellings approved during the pandemic (Graph 2.16).

Housing prices have declined further …

National housing prices declined in October, to be 5 per cent lower than the peak in April, alongside rising interest rates and a deterioration in market sentiment; nevertheless, prices are still around 20 per cent higher than at the onset of the pandemic (Table 2.1). Prices have declined across most market segments and geographic areas over recent months and – as is typical of housing price cycles in Australia – especially so in the most expensive segments of the Sydney, Melbourne and Brisbane markets (Graph 2.17). Auction clearance rates and turnover in most capital cities have declined since the beginning of the year, and survey expectations of housing price growth remain low.



* Rolling three-month sum.
Sources: ABS; RBA



* Least expensive (5th–25th percentiles), middle (25th–75th percentiles), most expensive (75th–95th percentiles).
** Capital cities price indexes are for the eight capital cities and regional prices are for the rest of Australia.
Sources: CoreLogic; RBA

… and the rental market is very tight

Rental vacancy rates have declined in most capital cities and regional areas since the beginning of the year (Graph 2.18). Declines have been largest in Melbourne and Sydney, particularly in the inner and middle suburbs of Sydney, to be around their longer run average levels. In other capital cities, vacancy rates are at or around historical lows. Growth in advertised rents (for new leases) has been strong as a result; CPI rent inflation, which measures rent increases for all leases, has risen in recent months. Recent flooding is expected to place short-term pressure on rental markets and temporary accommodation in flood-affected communities.

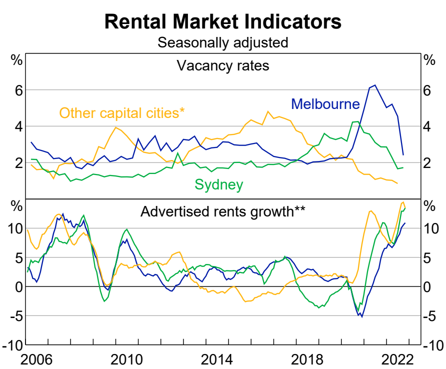
Despite the tightness in the rental market and rising rents, average household size has declined to a low level relative to the past quarter-century (Graph 2.19). This suggests the demand for additional space during the pandemic has endured so far, which in turn could be contributing to tight conditions in the rental market. The increase in net immigration following the reopening of the international border is also likely to increase rental demand, particularly in Sydney and Melbourne.

Public consumption remains elevated

In the June quarter, a sharp decline in real public consumption offset growth in public investment, as the previous quarter's high level of spending in response to the floods and the pandemic was unwound. Public consumption nonetheless remains at a high level compared with the pre-pandemic period as a share of nominal GDP, supported by public spending programs such as the National Disability Insurance Scheme (Graph 2.20). A strong pipeline of infrastructure projects is expected to support public investment going forward, though labour shortages and elevated capacity utilisation in the construction sector are expected to hamper the pace of work.

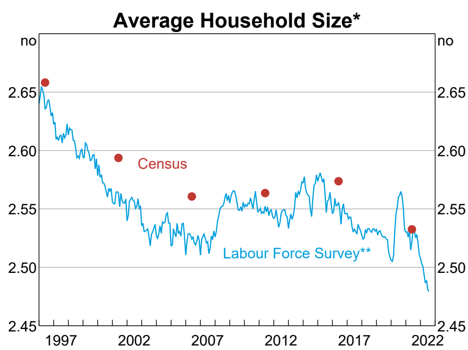
The Australian Government Budget October 2022–23 revealed a large upgrade to expected receipts over the next two years, owing to higher commodity prices and the stronger-than-expected labour market. The upgrade to receipts is expected to reduce the budget deficit relative to the estimates in the March Budget (Graph 2.21). Additional funding for aged care and payments to reduce the cost of child care were mostly offset by policies that increase tax revenue.

Graph 2.18



* Dwelling stock weighted; vacancy rate excludes Adelaide.
** Six-month-ended annualised.
Sources: CoreLogic; RBA; REIA; REINSW; REIV

Graph 2.19



* Number of persons usually resident in an occupied private dwelling; excludes visitor-only households and persons in non-private dwellings (e.g. hotels and hospitals).
** Estimated using Labour Force Survey microdata.
Sources: ABS; RBA

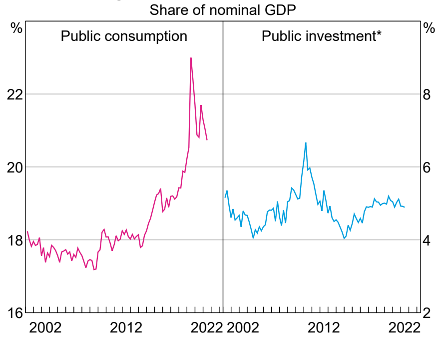
Exports remain at a high level …

Export values remained at a high level in the September quarter (Graph 2.22). Rural export values have continued to increase, reflecting strong domestic production and high prices amid tight global supply. Resource exports have been hampered by weather and maintenance disruptions after minimal disruptions in the June quarter. Combined with a sharp increase in import values due to strong demand for overseas travel and the filling of goods order backlogs, this has seen the trade surplus decline in the September quarter.

Graph 2.20

Components of Public Demand

Share of nominal GDP



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

Sources: ABS; RBA

… while services trade continued to grow

Trade in services continued to recover following the reopening of the international border for vaccinated travellers in late February. Both travel exports and imports rose in the June quarter, reaching 40 per cent of their pre-pandemic levels.

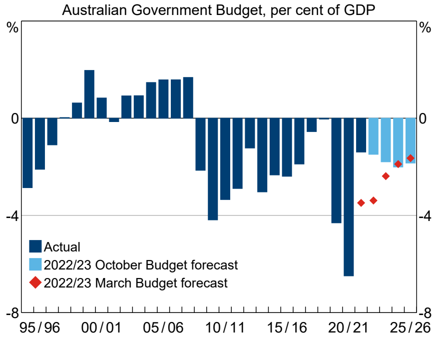
Partial data suggest imports increased in the September quarter, reflecting the strong demand for travel services. Short-term resident returns (an indicator for travel services imports) has grown rapidly over 2022 to date.

On the exports side, the number of visitors to Australia has recovered more slowly (Graph 2.23). Visa lodgement data suggest that foreign demand for education is strong, but student arrivals have been partially constrained by delays in visa processing following the reopening of borders. It will take at least two years for the number of international students in Australia – and so services exports – to recover to pre-pandemic levels.

Graph 2.21

Underlying Cash Balance

Australian Government Budget, per cent of GDP

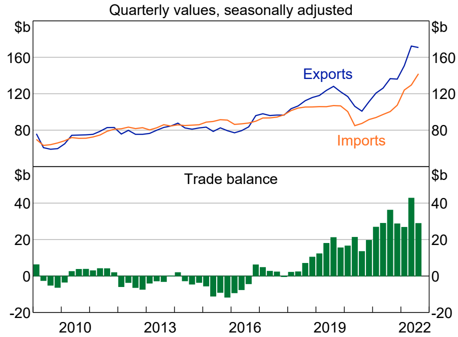


Sources: ABS; Australian Treasury; RBA

Graph 2.22

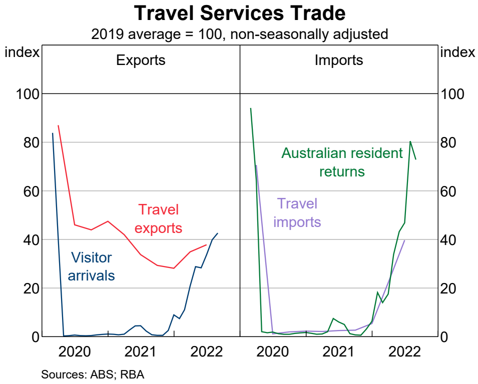
Trade in Goods and Services

Quarterly values, seasonally adjusted



Sources: ABS; RBA

Graph 2.23


Travel Services Trade
2019 average = 100, non-seasonally adjusted
index
Exports
Imports
index
100
80
60
40
20
0
Travel
exports
Visitor
arrivals
Australian resident
returns
Travel
imports
2020
2021
2022
Sources: ABS; RBA