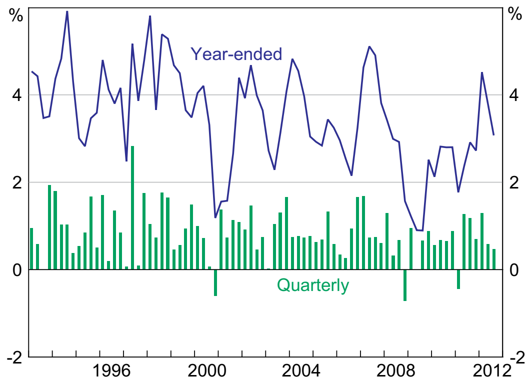
3. Domestic Economic Conditions

The latest national accounts indicate that the Australian economy grew at around trend pace over the year to the September quarter, although growth was lower in that quarter (Graph 3.1, Table 3.1). Public demand weakened, consistent with fiscal consolidation. Growth in consumption spending also slowed somewhat following very strong growth earlier in the year, in line with some moderation in labour income. In contrast, there was a moderate pick-up in housing construction activity. Growth in mining investment remained strong, although it appears to be slowing and the peak in spending is expected to occur within the year. At the same time, investment intentions in the non-mining sector remain subdued.

More timely information suggests that growth in economic activity picked up in the December quarter from the midyear slowdown. Housing construction continued to increase gradually and trade data imply that resource exports increased strongly towards the end of the year.

Graph 3.1
GDP Growth



Source: ABS

Table 3.1: Demand and Output Growth
Per cent

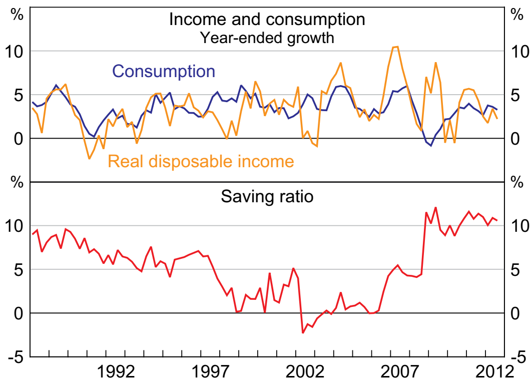
	September quarter 2012	June quarter 2012	Year to September quarter 2012
Domestic final demand	0.2	0.8	3.7
– Private demand	1.7	0.3	4.6
– Public demand	–4.8	2.5	0.6
Change in inventories[(a)]	0.3	–0.3	0.4
Gross national expenditure	0.5	0.4	4.1
Net exports[(a)]	0.1	0.3	0.3
GDP	0.5	0.6	3.1
Nominal GDP	0.2	1.0	1.9
Real gross domestic income	–0.4	0.4	–0.1

(a) Contribution to GDP growth
Source: ABS

Household Sector

Growth in household spending slowed in the second half of 2012 from the strong pace recorded earlier in the year. With household consumption growing broadly in line with income, the household saving ratio has remained relatively steady at around 10 per cent of income, which is similar to the rate of saving in the 1980s and well above the levels prevailing during the 1990s and 2000s (Graph 3.2).

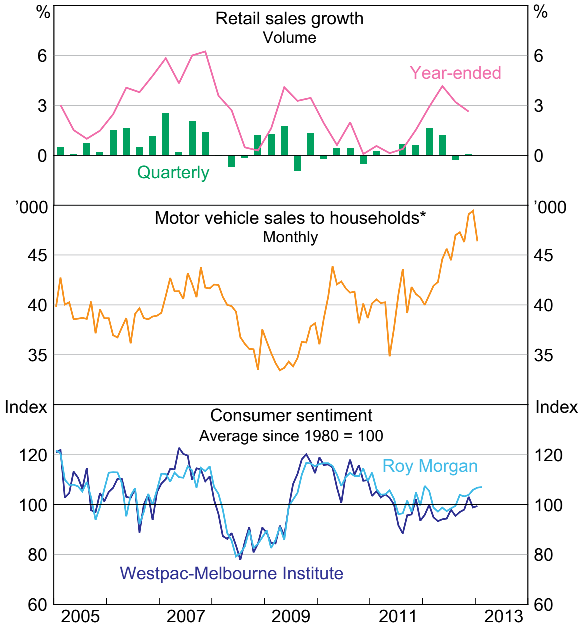
Graph 3.2
Household Income and Consumption*



* 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
Sources: ABS; RBA

Growth in the volume of retail sales – which primarily captures sales of goods – slowed in the second half of last year (Graph 3.3). Retail sales were little changed in the December quarter, with food and department stores recording sales growth while other retailers experienced falls. In contrast to retail sales, motor vehicle sales to households rose strongly in the December quarter, continuing the strong growth in the previous two quarters. Despite a decline in January, motor vehicle sales were still about 15 per cent higher over the year. The high value of the Australian dollar, along with sales incentives by manufacturers, has kept motor vehicle prices little changed. Measures of consumer sentiment have remained at or even slightly above long-run average levels in recent months.

Graph 3.3
Consumption Indicators

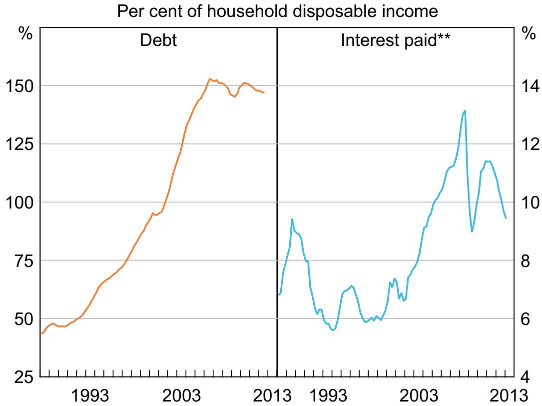


* Seasonally adjusted by the RBA
Sources: ABS; FCAI/VFACTS; Melbourne Institute and Westpac; RBA; Roy Morgan Research

Real household disposable income grew by around 2 per cent over the year to the September quarter, supported by modest growth in wages and salaries. Lower average interest rates reduced households' interest payments to 10 per cent of household income, down from 11¼ per cent a year earlier (Graph 3.4). Interest payments are estimated to have continued to decline in recent months, given reductions in the cash rate in October and December. Household debt has grown at an annual rate of around 4 per cent, broadly in line with growth in nominal income. As a result, debt as a share of household disposable income has remained steady at a little below 150 per cent of income.

After having fallen over much of 2011, household net worth is estimated to have increased by around 10 per cent over 2012 (Graph 3.5). The increase has been driven by strong growth in the value of financial assets and moderate increases in dwelling prices, coupled with relatively subdued growth in household debt.

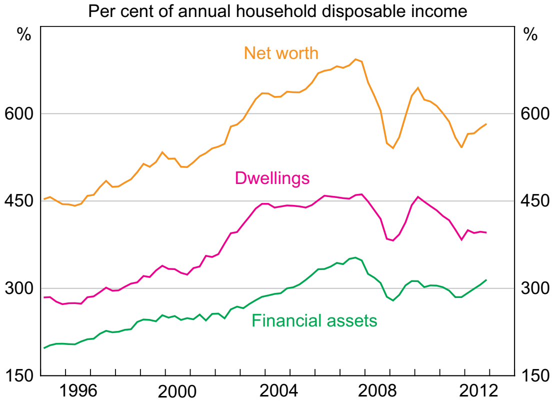
Graph 3.4
Household Finances*
Per cent of household disposable income



* Household sector excludes unincorporated enterprises; disposable income is after tax and before the deduction of interest payments
** RBA estimates for December quarter 2012 and March quarter 2013
Sources: ABS; RBA

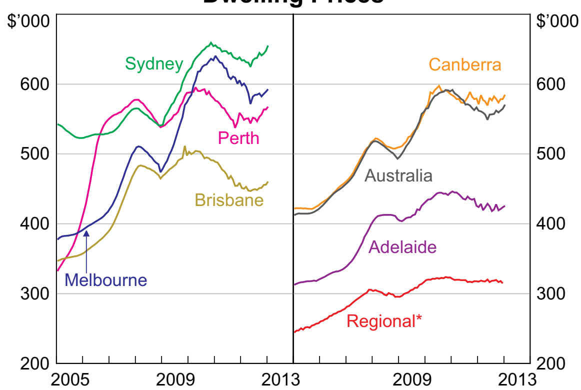
Australian capital city dwelling prices have risen by 4 per cent since their trough in mid 2012 (Graph 3.6, Table 3.2). Recent price rises have been relatively broad based, with all state capitals recording higher prices over the three months to January. Some other indicators also point to a strengthening in the established housing market. Auction clearance rates in Sydney and Melbourne have continued to rise from their lows in late 2011 and early 2012. Private sector surveys indicate that, on balance, households expect house prices to rise further over the year ahead. Housing loan approvals increased moderately over the second half of 2012, underpinned by loans to investors and repeat buyers, although they were little changed relative to the outstanding stock of housing credit.

Graph 3.5
Household Wealth*
Per cent of annual household disposable income



* Household sector includes unincorporated enterprises; disposable income is after tax and before the deduction of interest payments; RBA estimates for December quarter 2012
Sources: ABS; RBA; RP Data-Rismark

Graph 3.6
Dwelling Prices



* Excluding apartments; measured as areas outside of capital cities in mainland states
Sources: RBA; RP Data-Rismark

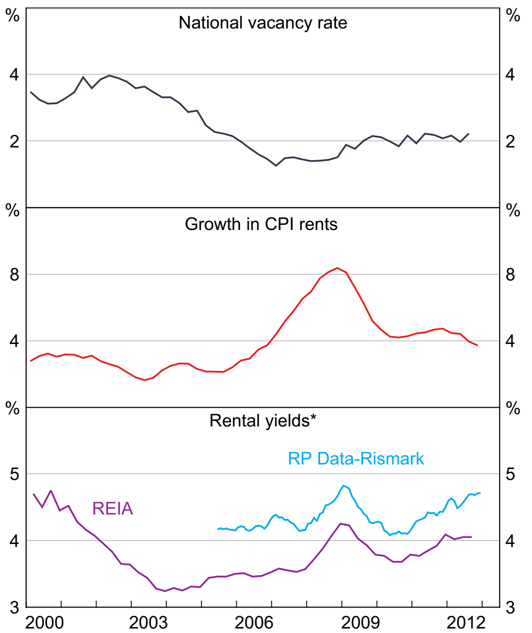
Table 3.2: National Housing Price Growth
Per cent

	3 months to September 2012	3 months to December 2012	Year to December 2012
Capital cities			
ABS[(a), (b)]	–0.1	1.6	2.1
APM[(b)]	–0.5	1.8	2.1
RP Data-Rismark	1.0	0.4	–0.4
Regional areas			
APM[(b)]	–0.3	0.9	1.3
RP Data-Rismark[(a)]	0.9	–1.3	–0.7

(a) Detached houses only
(b) Quarter-on-quarter growth rate
Sources: ABS; APM; RBA; RP Data-Rismark

Residential vacancy rates remain relatively low at around 2 per cent, contributing to rents growing faster than inflation and rising rental yields (Graph 3.7). Nationwide, rents are growing at an annual rate of around 4 per cent. With rents growing faster than dwelling prices over the past year, nationwide gross rental yields have increased to 4¾ per cent (and as high as 5½ per cent in Perth).

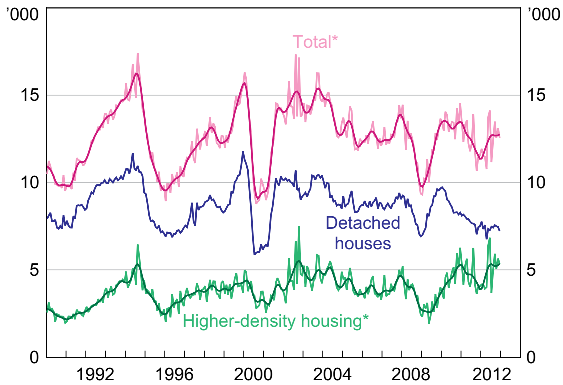
Graph 3.7
Rental Market



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

After falling over 2011/12, residential construction activity is estimated to have picked up in the second half of 2012. As a share of GDP, and relative to population growth, however, investment in new dwellings remains subdued. Forward-looking indicators point to a recovery in dwelling investment over the period ahead. Building approvals and loan approvals for new dwellings rose over 2012, as falls in interest rates, higher rental yields, and improved conditions in the established housing market have increased the attractiveness of new housing investment (Graph 3.8). A number of state governments have changed the nature of their support to first home buyers, emphasising purchases of new homes rather than existing homes. Over the year, first home buyer demand improved noticeably notwithstanding some decline more recently; the number of first home owner grants for new dwellings was almost 20 per cent higher in the three months to January compared with a year earlier.

Graph 3.8
Private Residential Building Approvals
Monthly



* Smoothed lines are ABS trend measures
Source: ABS

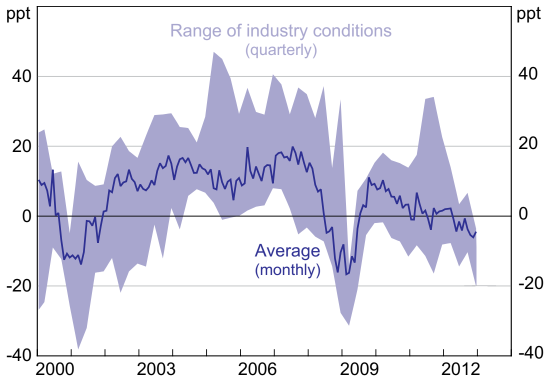
To date, the pick-up in building approvals has been concentrated in higher-density housing. In contrast, detached housing approvals are yet to show clear signs of recovery, but historical experience suggests that it can take some time for more favourable conditions to flow through to increased activity. Consistent with this, there are few reports from liaison of demand for new housing improving apart from in Western Australia.

Business Sector

Aggregate survey measures of business conditions are a little below their long-run average levels (Graph 3.9). In contrast to the situation earlier in 2012, surveys of business conditions are now below average across most industries. The decline in conditions has been particularly pronounced in the mining industry, consistent with the falls in commodity prices through much of 2012.

Graph 3.9
Business Conditions by Industry

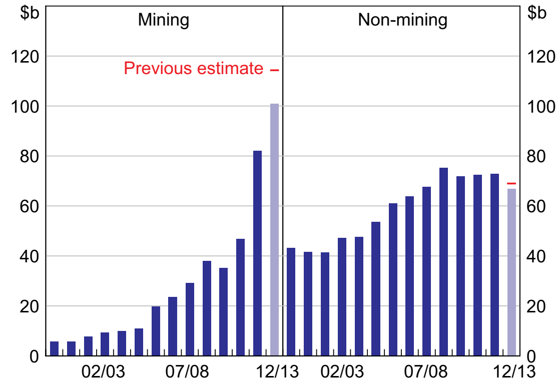
Net balance, deviation from industry average since 1989



Sources: NAB; RBA

Graph 3.10
Capital Expenditure Intentions

Capital expenditure survey, nominal



Sources: ABS; RBA

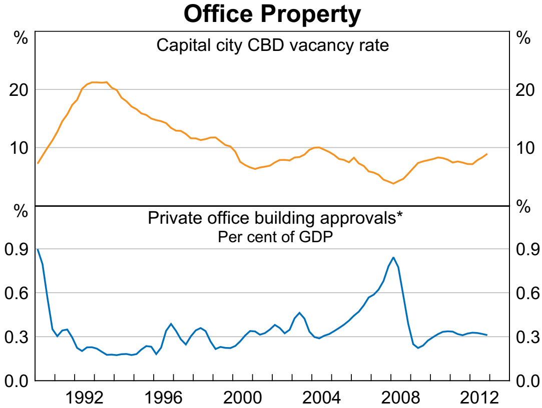
In line with mining firms' reassessment of conditions, their investment plans have been scaled back relative to earlier in 2012. In the latest ABS capital expenditure survey, expectations in the mining sector were revised down sharply for 2012/13, although expenditure is still expected to grow in the year (Graph 3.10). Large downward revisions were made to plans for both machinery & equipment investment and investment in buildings & structures. Liaison and company reports suggest that the largest revisions to investment intentions have been in the coal sector, where price declines have been more persistent and have also led to the closure of some higher-cost mines. Price declines for iron ore through the September quarter of 2012 had also prompted a reassessment of the viability of some projects and affected project financing, which contributed to some uncommitted projects being deferred. The sharp increase in the price of iron ore in recent months does not appear to have materially affected investment plans to date, in part because the general expectation is that prices will not be sustained at these levels. Nonetheless, given the magnitude of resource projects already committed, particularly liquefied natural gas (LNG) projects, mining investment is expected to remain at an elevated level for a couple of years.

Non-mining investment has declined as a share of economic activity over the past five years and the near-term outlook remains subdued, with business surveys indicating that investment intentions are still below average. According to the capital expenditure survey, machinery & equipment investment for 2012/13 is expected to remain at a similar level to investment in the previous two years. While there has been continued strength in motor vehicle sales to businesses, liaison suggests that some firms remain reluctant to invest except to cover depreciation, partly reflecting concerns about the strength of demand and general uncertainty about the economic outlook.

Non-residential building investment intentions also remain subdued, with building approvals declining over recent months. This largely reflects weakness in building approvals in the retail and wholesale sectors. Although the value of approvals for office buildings is largely unchanged over the past year, the outlook for the office market has weakened a little, with office vacancy rates rising modestly over the past six months in line with public sector job cuts and softer conditions across much of the economy (Graph 3.11). However, non-residential building investment is expected to continue to be supported by community-related projects that were approved in 2012, such as healthcare facilities, which are not captured by the capital expenditure survey (Graph 3.12).

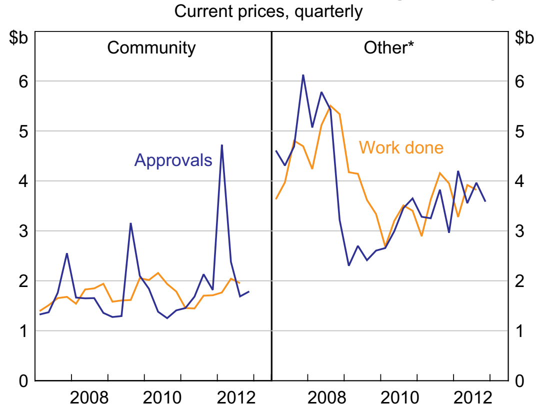
Company profits fell by around 10 per cent over the year to the September quarter, driven by a large fall in mining profits as a result of lower iron ore and coal prices. As discussed in the 'Domestic Financial Markets' chapter, the corresponding reduction in internal funding for the business sector as a whole is being offset by an increase in external funding, particularly non-intermediated funding, so the business sector still has adequate funds available for investment.

Graph 3.11
Office Property



* Trend, quarterly
Sources: ABS; Jones Lang LaSalle Research; RBA

Graph 3.12
Private Non-residential Building Activity
Current prices, quarterly

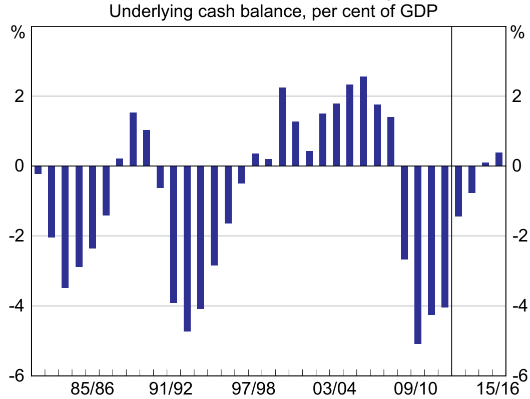


* Offices, other commercial buildings and industrial buildings
Sources: ABS; RBA

Government Sector

State government midyear budget updates suggest a small widening in the combined fiscal deficit of the states this financial year. Together, the latest available federal and state budget outlooks continue to imply a significant fiscal consolidation in the two years to 2013/14, although recent information suggests that the consolidation may not be as large in 2012/13 (Graph 3.13). Consistent with fiscal restraint, public demand declined by 5 per cent in the September quarter, driven by sizeable falls in public investment.

Graph 3.13
Total General Government Budget Balance*
Underlying cash balance, per cent of GDP



* Combined federal and state budget balances based on 2012/13 budgets or midyear reviews as available
Sources: ABS; Australian Treasury; state and territory treasuries

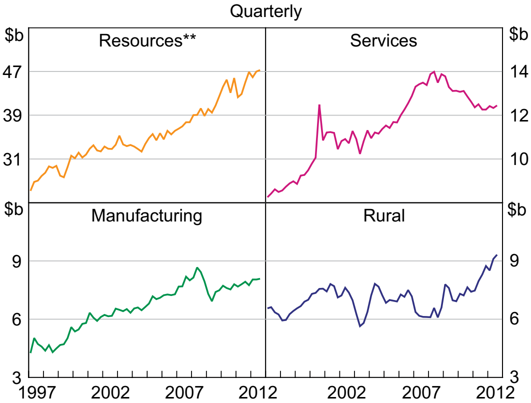
Farm Sector

Following two years with high production levels and high prices, the outlook for the farm sector has softened somewhat. Wheat prices have declined in recent months, but remain high by historical standards. The winter crop (which includes grains and oilseeds) is expected by the Australian Bureau of Agricultural and Resource Economics and Sciences to be around the average of the past decade. This is considerably smaller than the large 2011 crop as a result of below-average rainfall during the winter and spring of 2012 in most cropping regions. Recent flooding in Queensland and northern New South Wales has caused damage to crops and infrastructure in some horticultural regions and may temporarily boost prices for some food items.

External Sector

Export volumes rose in the September quarter, with growth broadly based across all major categories of exports (Graph 3.14). The rise in resource exports was largely driven by mineral fuels exports, including LNG. Iron ore exports also rose, although volumes were disrupted by maintenance and expansion activities at Port Hedland. In contrast, coking coal exports declined, probably reflecting both weak demand and the industrial dispute at BHP Billiton Mitsubishi Alliance (BMA) mines early in the quarter. Services export volumes were supported by strong growth in tourism exports, and transport equipment drove growth in manufactured exports.

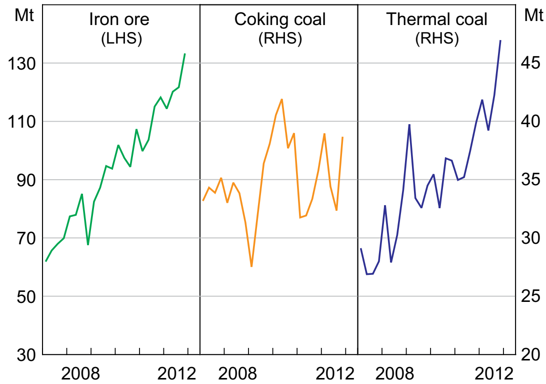
Graph 3.14
Export Volumes*
Quarterly



* 2010/11 prices
** Excludes RBA gold transactions
Sources: ABS; RBA

In the December quarter, indications are that export volumes increased strongly, underpinned by resource exports. Increased demand from China supported exports of iron ore and coking coal, with additional impetus to coking coal exports from the cessation of the BMA industrial dispute early in the September quarter (Graph 3.15). Thermal coal export volumes also increased noticeably in the quarter. Overseas arrivals continued to grow in the quarter, and liaison suggests that education exports have stabilised, after having declined since 2009. In contrast, rural export volumes are estimated to have fallen, owing to falls in wheat exports, which had grown rapidly through much of 2012 as inventories from the previous two large crops were drawn down in response to the high global price for wheat. Imports are estimated to have grown moderately in the December quarter.

Graph 3.15
Bulk Commodity Exports
Quarterly



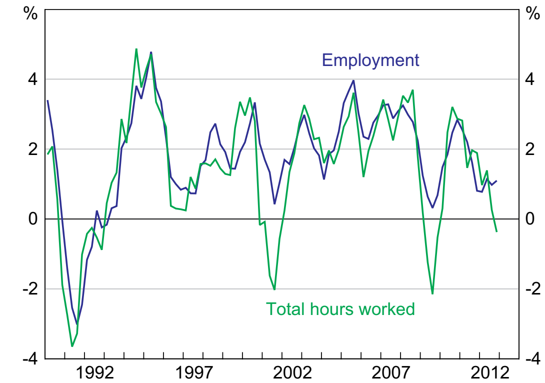
Sources: ABS; RBA

Recent bad weather in Queensland damaged rail infrastructure, which is likely to weigh on coal exports in the March quarter. However, the effect of this event on the State's coal industry is not expected to be as significant as that in 2011.

Labour Market

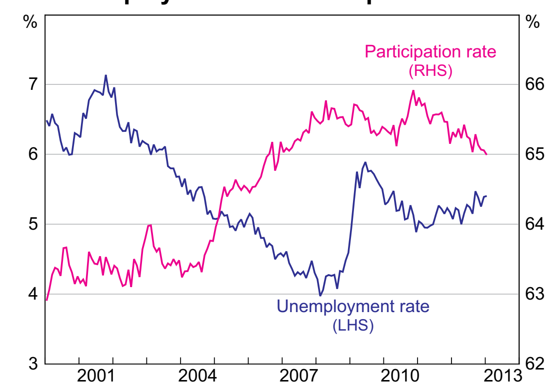
Labour market conditions have remained subdued in the past few months. In year-ended terms, employment growth has remained around 1 per cent since the middle of 2012, while total hours worked have not grown over the year (Graph 3.16). Consistent with this, a range of indicators suggest that there is increased spare capacity in the labour market. The unemployment rate trended gradually higher over the past year, while the participation rate has declined since the end of 2010, reflecting softer labour market conditions and ongoing structural developments in labour supply (Graph 3.17; see 'Box C: The Labour Force Participation Rate').

Graph 3.16
Growth in Labour Input
Year-ended



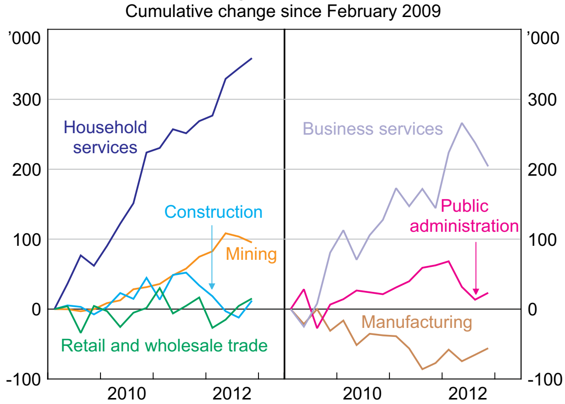
Source: ABS

Graph 3.17
Unemployment and Participation Rates



Source: ABS

Graph 3.18
Employment Growth
Cumulative change since February 2009



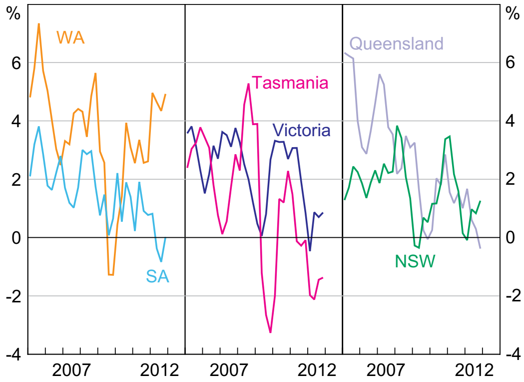
Source: ABS

Employment in the mining industry and the business services sector fell over the six months to November, following a period of strong growth (Graph 3.18). The fall in mining industry employment is consistent with reports in the second half of 2012 of some firms seeking to contain expenditure. In contrast, employment has increased in the manufacturing and retail trade industries in recent months, after falling in 2011. Employment in the construction industry declined over much of the year, consistent with weakness in building activity. Fiscal consolidation by state and federal governments has contributed to a decline in public administration employment over the year. In contrast, the household services sector, including the large healthcare and education industries, has continued to make significant contributions to aggregate employment growth.

Labour market outcomes continued to vary across states. In Western Australia, employment growth remained high (Graph 3.19). New South Wales and Victoria experienced modest employment growth, while employment growth in South Australia recovered somewhat more recently. In contrast, employment has remained subdued in Queensland and Tasmania. Although there is a relatively wide range of employment growth outcomes across states, the dispersion of unemployment rates across states and by region (based on ABS statistical local areas) are near their averages over the past decade. This is consistent with migration to regions with strong employment growth (including from overseas), as well as some adjustment of labour supply to regional labour market conditions.

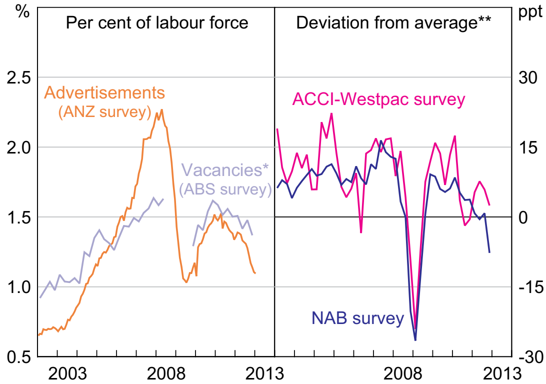
Leading indicators of labour demand have continued to soften and point to only modest employment growth in coming months (Graph 3.20). The ABS measure of job vacancies fell in the three months to November to be around 8 per cent lower over the year. Measures of job advertisements have been weaker, with the ANZ series around 18 per cent lower over the year to January. Business survey measures

Graph 3.19
Employment Growth by State
Year-ended



Source: ABS

Graph 3.20
Labour Market Indicators



* This survey was suspended between May 2008 and November 2009

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

Sources: ABS; ACCI; ANZ; NAB; RBA; Westpac

of hiring intentions also declined in the December quarter. Reports from the Bank's liaison suggest that businesses in many industries remain cautious about hiring staff.