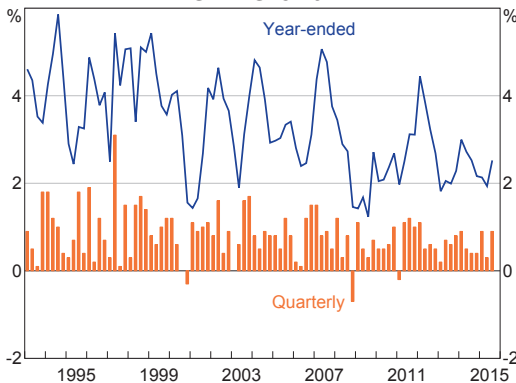


3. Domestic Economic Conditions

Growth in the Australian economy appears to have remained a bit below average over 2015 (Graph 3.1). Strong growth in the September quarter was driven by a rebound in resource exports, after weather-related disruptions in the June quarter. Indications are that the pace of growth in the December quarter was below average.

Graph 3.1
GDP Growth



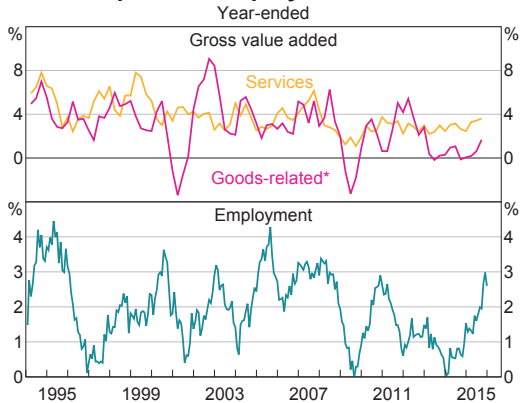
Source: ABS

The economy continues to be affected by a range of different forces. Low interest rates are supporting growth in household consumption and dwelling investment, and the depreciation of the exchange rate has helped to improve the competitiveness of Australian producers. This is particularly apparent in the services sector, where Australia's exports of services have grown, while imports of services have fallen noticeably over the past couple of years. At the same time, non-mining investment has remained subdued and mining investment has been declining sharply, as the significant

expansion in Australian mining production capacity – prompted by the earlier strength in commodity prices – reaches completion (Table 3.1). This has facilitated a significant increase in resource exports, although resource companies' earnings are being adversely affected by the large decline in commodity prices.

Economic activity has generally strengthened in non-resource sectors. Growth in output has been strongest in the services sector (Graph 3.2). An increase in the provision of services, particularly household services, generally requires less investment and more labour than an increase in the output of goods-related industries, which are generally more capital intensive. Hence, the relatively strong growth in the production of services may help to explain why employment growth has been strong even though GDP growth overall has been below average.

Graph 3.2
Output and Employment Growth



* Excluding mining

Sources: ABS; RBA

Table 3.1: Demand and Output Growth
Per cent

	September quarter 2015	June quarter 2015	Year to September quarter 2015
GDP	0.9	0.3	2.5
Consumption	0.7	0.6	2.7
Dwelling investment	0.9	0.4	10.3
Mining investment ^(a)	-9.7	-12.4	-28.9
Non-mining investment ^(a)	-2.2	3.5	-0.1
Public demand	-1.0	2.3	2.2
Exports	4.6	-3.3	6.5
Imports	-2.4	0.1	-1.2
Nominal GDP	0.8	0.2	2.2
Real gross domestic income	0.3	-0.5	0.2

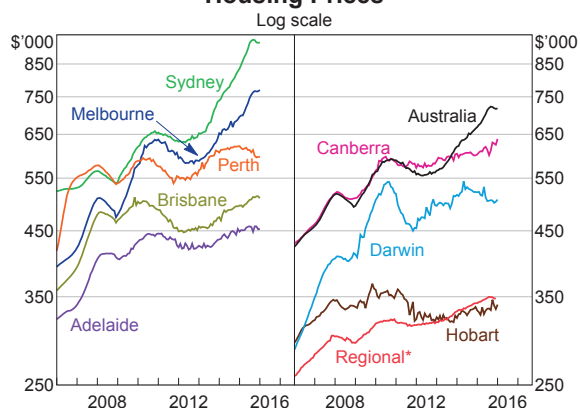
(a) RBA estimates
Sources: ABS; RBA

Strong employment growth has also been supported by a protracted period of low wage growth which, along with the exchange rate depreciation, may have encouraged firms to employ more people than otherwise. At the same time, growth in the supply of labour has increased through a rise in the participation rate, notwithstanding lower population growth. The unemployment rate declined to around 5¾ per cent in late 2015, having been within a range between 6 and 6¼ per cent since mid 2014. Nevertheless, there is evidence of spare capacity in the labour market, as the unemployment rate is still above recent lows, the participation rate remains below its previous peak and wage growth continues to be low.

Household Sector

Conditions in the established housing market have eased in recent months. National housing prices have declined slightly from their September 2015 peak, following strong growth earlier in 2015 (Graph 3.3). Auction clearance rates, which are another timely gauge of housing market conditions, have also declined from very high levels to be around their long-run averages (Graph 3.4).

Graph 3.3
Housing Prices



* Excluding apartments; measured as areas outside of capital cities in mainland states

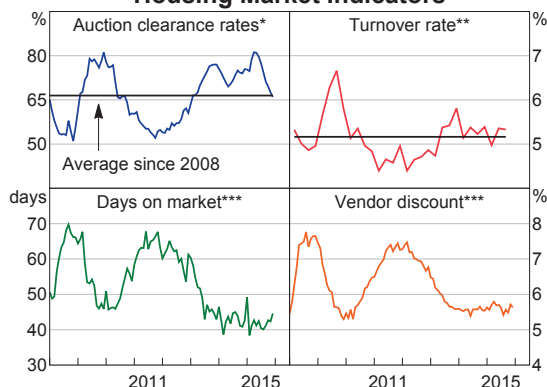
Sources: CoreLogic RP Data; RBA

However, some other indicators – including turnover rates, days on market and the eventual discount on vendor asking prices – have been little changed.

The easing in housing market conditions has been most pronounced for detached houses in Sydney and Melbourne, where earlier price growth had been strongest, and in Perth, where prices have been declining since early 2015. Until recently,

Graph 3.4

Housing Market Indicators



* Average of Melbourne and Sydney
 ** Share of dwelling stock, annualised
 *** Capital city dwelling stock weighted median for private treaty sales only; vendor discounts reflect average difference between the original listing price and the final selling price
 Sources: Australian Property Monitors; CoreLogic RP Data; RBA; Real Estate Institute of Victoria

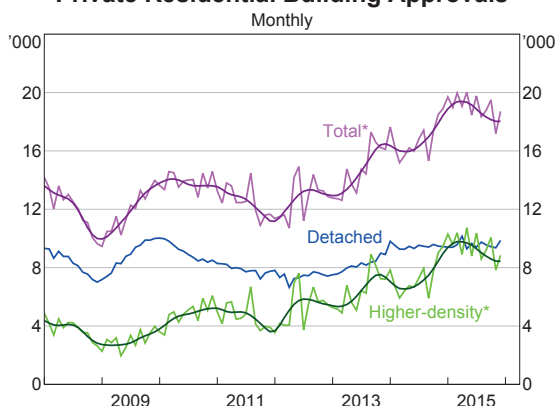
growth of national apartment prices had been noticeably slower than that of detached housing prices, reflecting large increases in higher-density housing supply over recent years, especially in Melbourne. The increase in supply over recent years, partly in response to strong investor demand, has been associated with a gradual increase in the nationwide rental vacancy rate. Rental yields remain low by historical standards.

Dwelling investment grew strongly over the year to the September quarter, supported by low interest rates and the significant increase in housing prices over the past several years. Building approvals have been on a downward trend over the course of the past year, driven by fewer higher-density approvals, but remain at a high level (Graph 3.5). Some other forward-looking indicators of dwelling investment, such as new construction loan approvals, have picked up a little in recent months.

Lending data suggest that investor loan approvals and credit growth have moderated since the first half of 2015. This is consistent with lenders' actions in 2015 to increase interest rates and introduce measures to strengthen their non-price lending terms, particularly for investors, in response to

Graph 3.5

Private Residential Building Approvals



* Smoothed lines are ABS trend measures
 Source: ABS

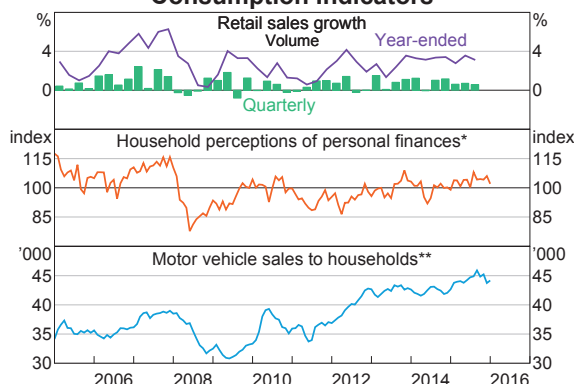
actions undertaken by the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC).¹ Growth in lending to owner-occupiers has increased such that aggregate housing credit growth has stabilised at around 7½ per cent (see the 'Domestic Financial Markets' chapter for further details on the developments in housing finance).

Consumption growth increased in the September quarter, to be close to its decade average in year-ended terms. Timely indicators of consumption suggest that this pace of growth has been sustained more recently. Growth in the value of retail sales was around average in late 2015 and the Bank's liaison with retailers suggests that sales conditions have improved more recently. Also, motor vehicle sales to households were strong in 2015 and households' perceptions of their own finances remain a little above average (Graph 3.6).

Household consumption growth has been supported by low interest rates, increasing employment and, to some extent, increased household wealth. However, growth in labour income has remained relatively subdued (Graph 3.7). The household saving rate has declined

¹ For further details on actions undertaken by APRA and ASIC, see RBA (2015), 'Box B: Responses to Risks in the Housing and Mortgage Markets', *Financial Stability Review*, March, pp 45–47.

Graph 3.6
Consumption Indicators

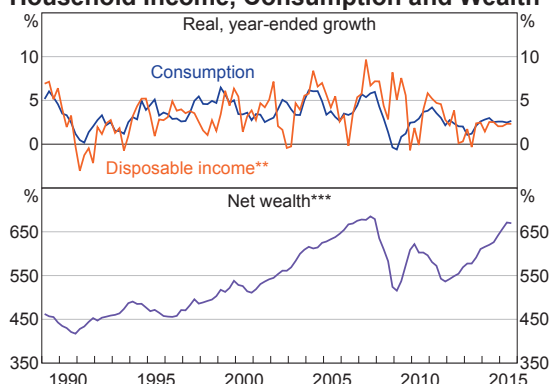


* Average of the ANZ-Roy Morgan and Westpac-Melbourne Institute consumer sentiment measure of respondents' perceptions of their personal finances relative to the previous year; average since 1980 = 100

** Three-month moving average

Sources: ABS; ANZ-Roy Morgan; FCAI/VFACTS; RBA; Westpac and Melbourne Institute

Graph 3.7
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

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

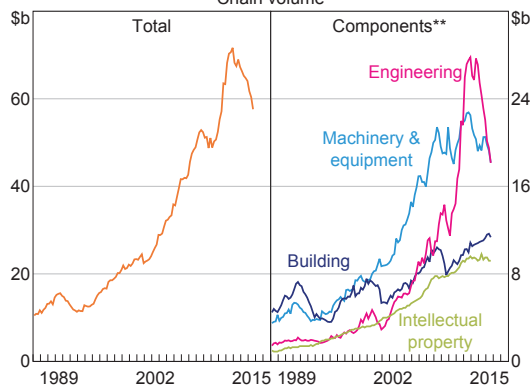
Sources: ABS; RBA

gradually over the past few years, and it remains at a relatively high level (see 'Box B: The Household Saving Ratio').

Business Sector

Private business investment fell by 5 per cent in the September quarter and by 11 per cent over the year (Graph 3.8). In year-ended terms, the decline

Graph 3.8
Private Business Investment*



* Adjusted for second-hand asset transfers between the private and other sectors; reference year is 2013/14

** Excluding cultivated biological resources

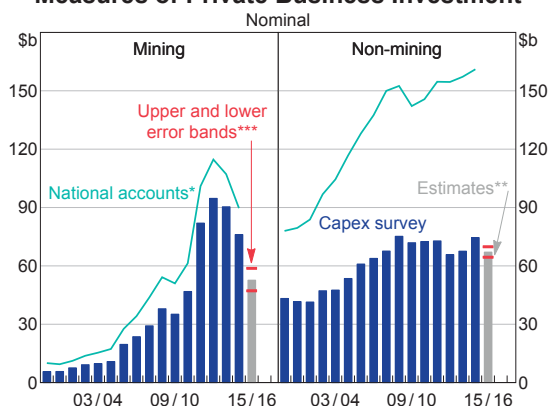
Sources: ABS; RBA

was led by a sharp fall in mining investment, while non-mining investment is estimated to have been little changed.

The large decline in mining investment since its peak in mid 2012 reflects the completion of several large-scale resource projects. Mining investment is still expected to decline further over coming years, as few new projects are likely to commence. The fall in commodity prices over recent years has reduced profits and the incentive to invest in the mining sector. The ABS capital expenditure (Capex) survey of investment intentions and the Bank's liaison point to a sharp fall in mining investment in 2015/16 (Graph 3.9). The subtraction from GDP from lower mining investment is expected to peak this financial year.

Non-mining investment has been weak for some time and indicators of investment intentions suggest that it will remain subdued in the near term. The latest Capex survey continues to imply that non-mining investment will fall in 2015/16, while non-residential building approvals remain at relatively low levels, consistent with weak underlying conditions in the commercial property market. The Capex survey, however, does not cover a large share of non-mining investment that is included in the

Graph 3.9
Measures of Private Business Investment

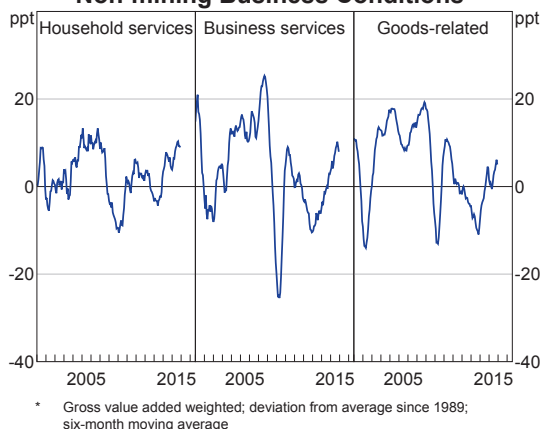


* Adjusted for second-hand asset transfers between the private and other sectors; excluding cultivated biological resources
 ** Estimates are firms' expected capital expenditure, adjusted for the past average difference between expected and realised spending
 *** Error bands are based on the root mean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

national accounts, such as investment in agriculture, education, health care and intellectual property. Although the Bank's liaison suggests that investment intentions in these sectors are generally more positive than elsewhere, non-mining investment is still expected to be subdued in aggregate in the near term.

Nevertheless, a number of factors supportive of non-mining investment remain in place. Interest rates are very low, the Australian dollar has depreciated over the past few years and non-mining company profits increased over 2015. Consistent with this, survey measures of business conditions in non-mining sectors are clearly above average, particularly in the services sectors, but also in the goods-related sectors more recently (Graph 3.10). Business credit growth has also picked up over the past year.

Graph 3.10
Non-mining Business Conditions*

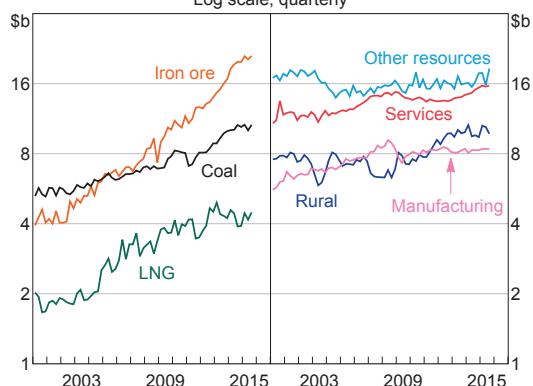


* Gross value added weighted; deviation from average since 1989; six-month moving average
 Sources: ABS; NAB; RBA

External Sector

Export volumes rose by 6 per cent over the year to the September quarter, led by strong growth in resource exports, particularly iron ore (Graph 3.11). Exports of iron ore are expected to continue to grow over the next couple of years, albeit at a slower pace than over the past few years, as production from the larger, low-cost producers continues to expand. Liquefied natural gas (LNG) exports are expected to increase substantially over the next few years as a number of LNG projects currently under construction begin production.

Graph 3.11
Export Volumes*
Log scale, quarterly



* Reference year is 2013/14
 Sources: ABS; Department of Industry, Innovation and Science; RBA

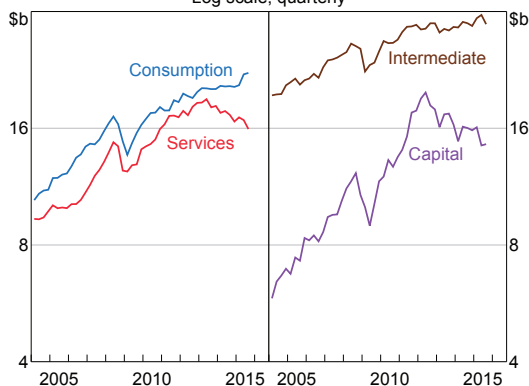
In contrast, significant falls in coal prices and the relatively high cost of some Australian production suggest that further substantial growth in coal exports is unlikely.

Service exports have also grown over recent years, aided by improved competitiveness associated with the depreciation of the Australian dollar. Tourism, education and business service exports have all expanded. In contrast, manufactured exports have been subdued.

Import volumes declined modestly over the year to the September quarter (Graph 3.12). Service imports have declined noticeably over the past couple of years, in particular tourism and business services. This decline is consistent with the depreciation of the exchange rate, which has encouraged Australians to switch some of their expenditure to domestic producers for such services. Capital imports have also fallen as construction of many of the import-intensive, large-scale mining projects has approached completion. Consumption imports, which tend to be less sensitive to exchange rate movements than service imports, have increased over the past year.

Graph 3.12
Import Volumes*

Log scale, quarterly

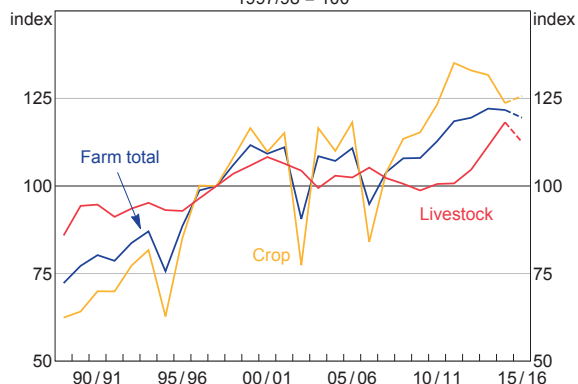


* Reference year is 2013/14
Source: ABS

Farm Sector

The Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) expects the volume of farm production to decline modestly in 2015/16 (Graph 3.13). A decline in livestock production due to herd rebuilding is expected to more than offset a small increase in crop production. El Niño conditions, which are typically associated with lower rainfall, are expected to ease in the first half of 2016.

Graph 3.13
Farm Production Volumes*
1997/98 = 100



* Dashed lines represent 2015/16 forecasts; 2014/15 data are estimates
Source: ABARES

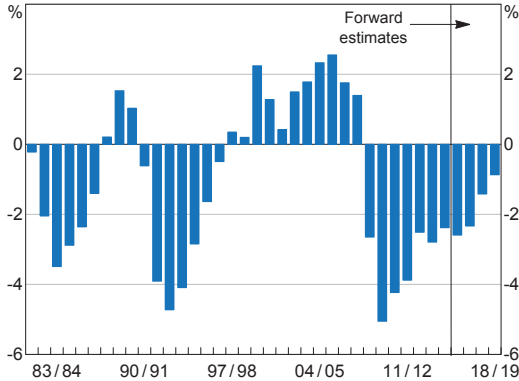
Government Sector

The Australian Government's Mid-Year Economic and Fiscal Outlook, together with recent state budget updates, continues to imply fiscal consolidation over coming years, albeit at a slower pace than previously expected (Graph 3.14). The consolidated budget deficit in 2015/16 is expected to be around 2.6 per cent of GDP. The decline in commodity prices has lowered federal and state revenues while transfer duty receipts are higher in New South Wales and Victoria.

Graph 3.14

Consolidated Budget Balance*

Underlying cash balance, per cent of nominal GDP



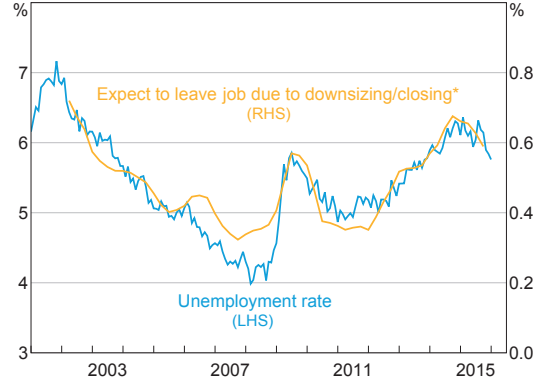
* Federal, state and territory governments, based on 2015/16 budgets and mid-year updates; excludes the effect of the federal grant to the RBA in 2013/14.

Sources: ABS; Australian Treasury; State and Territory Treasuries

Graph 3.16

Unemployment and Expectations

Per cent of labour force



* Four-quarter moving average; non-seasonally adjusted

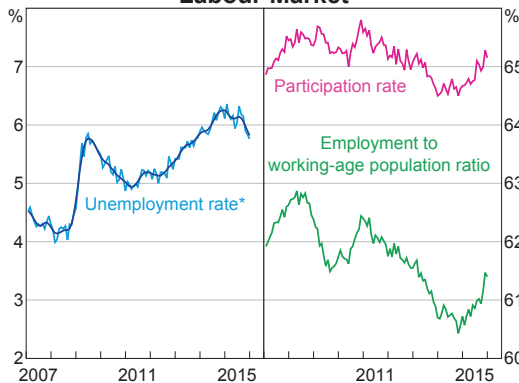
Sources: ABS; RBA

Labour Market

A range of indicators suggest that labour market conditions have improved over the past year. After little change since mid 2014, the unemployment rate declined to around 5¼ per cent in late 2015 (Graph 3.15). The number of unemployment benefit recipients as a share of the labour force, which tends to be less volatile than the unemployment rate, has also declined a little since the middle of 2015. In addition, the number of workers who expect to lose their jobs because their employer is likely to close or downsize in the year ahead has declined (Graph 3.16).

Employment growth strengthened over 2015 to be above its long-run average – even after taking into account changes in the labour force survey sample – consistent with the increase in measures of job vacancies and advertisements (Graph 3.17). The participation rate has also been increasing. This could be a response to higher labour demand, whereby individuals may have commenced work or are searching for work in response to improvements in employment prospects (the ‘encouraged worker’ effect). The Australian Government’s new employment services model, ‘jobactive’, introduced on 1 July 2015, may have also boosted the

Graph 3.15
Labour Market

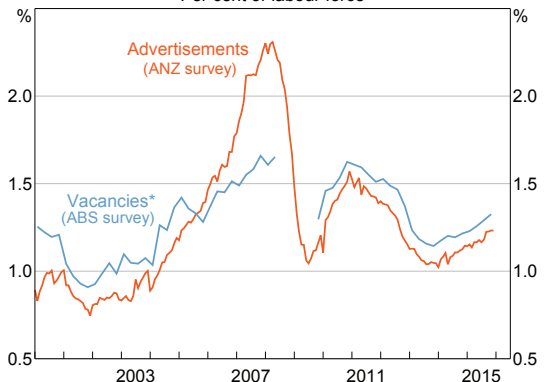


* Smoothed line is ABS trend measure

Source: ABS

Graph 3.17
Job Vacancies and Advertisements

Per cent of labour force



* This survey was suspended between May 2008 and November 2009

Sources: ABS; ANZ

participation rate by requiring more unemployment benefit recipients to search actively for work than in the past.

The recent improvement in labour market conditions has been broad based across age groups and genders. The youth unemployment rate fell noticeably over 2015, although it remains relatively high. The improvement in conditions has been concentrated in the eastern states and in service industries. Unemployment rates in New South Wales, Victoria and Queensland declined over the year, while Western Australia's unemployment rate rose, reflecting Western Australia's greater exposure to the resources sector.

Strong growth in household services employment was underpinned by a large increase in health & social assistance employment (Graph 3.18). The Bank's liaison suggests that this partly reflects increased demand for aged and home-based care services as the population ages, as well as hiring by early childhood centres ahead of the increase in required staff-to-child ratios that came into effect on 1 January 2016.

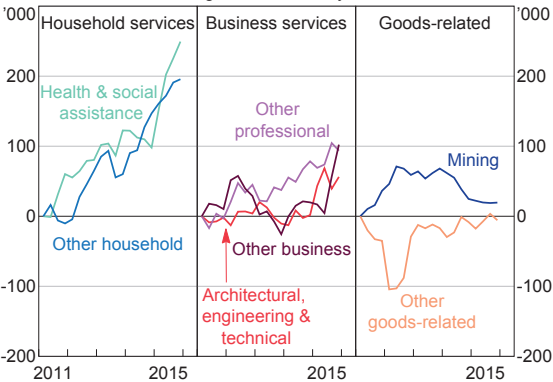
Business services employment growth has been relatively broadly based. Employment in a range of business services industries has been assisted by the depreciation of the Australian dollar and subsequent increase in net exports of business services.

Employment in architecture, engineering & technical services has also been supported by government infrastructure projects and the strength in residential building activity. In other professional services, such as legal & accounting and computer system design, employment has also increased. According to the Bank's liaison, this may reflect broader demand from firms for IT-related investment to improve productivity and reduce costs.

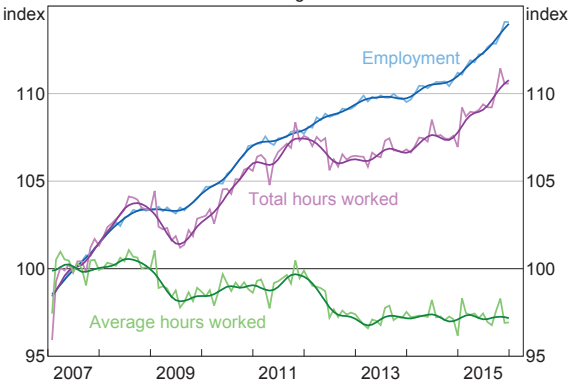
In contrast, goods-related employment overall remained weak. Mining employment declined slightly over 2015, after a sharp fall in 2014. Employment in manufacturing declined further over the year, while retail employment increased. Employment was little changed in a number of other goods-related industries.

As discussed earlier, the concentration of employment growth in labour-intensive service sectors, such as household services, may help to explain why employment growth over 2015 was above average even though GDP growth was not. The changing composition of employment towards services over the past year does not appear to have been associated with a substantial change in job characteristics, such as hours of work or entitlements. Average hours worked have been little changed for the past three years (Graph 3.19). Even though the household services sector

Graph 3.18
Employment by Industry and Sector
Change since February 2011



Graph 3.19
Employment and Hours Worked*
2007 average = 100



has historically had a higher share of part-time and casual employees, much of the increase in employment over 2015 has been concentrated in full-time work and in industries that do not have a particularly high proportion of casual employees. For example, employment has grown strongly in health and professional services; the share of employees without leave entitlements in these industries is relatively low and broadly similar to manufacturing and wholesale trade, where employment outcomes have been weaker (Graph 3.20).

Notwithstanding the improvements in the labour market over the past year, there is still evidence of spare capacity. The unemployment rate remains above lows of recent years, as does the rate of underemployment. Wage growth continues to be low (see ‘Price and Wage Developments’ chapter). While the participation rate has risen of late, it remains below its previous peak in late 2010. ❖

