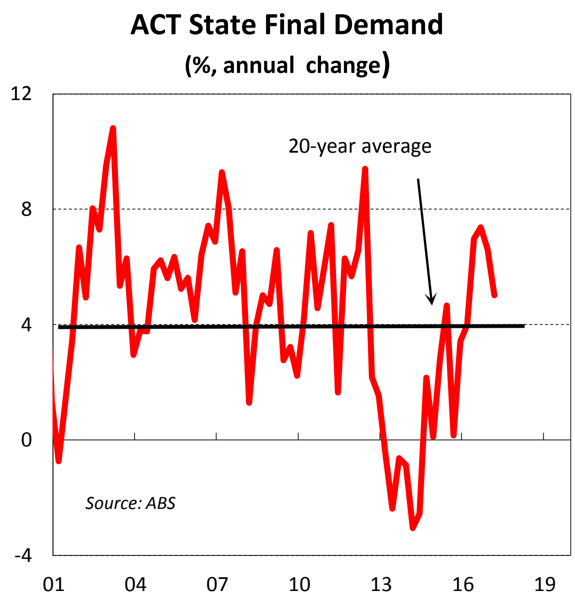
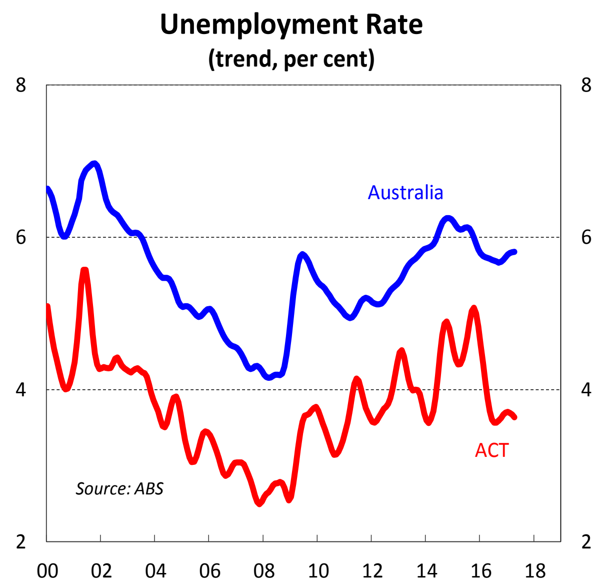
Thursday, 15 June 2017

ACT Economic Outlook

Summary:

- The outlook for economic growth in the ACT remains positive and will continue to benefit from low interest rates, a lower Australian dollar and no further cuts to government staff.
- Canberra is also benefiting from a demographic dividend. The city is attracting net interstate migration, especially from Sydney where dwelling prices are higher. Not surprisingly, population growth has picked up again and is approaching the 400,000 mark.
- Canberra is also benefiting from capital spending; a notable project is the Capital Metro, already underway and giving the local economy a boost. Some housing market indicators have cooled, but demand should remain solid given healthy job gains and the growth in the population.
- The ACT Budget was delivered last week. New Budget measures announced do not significantly alter the outlook for the ACT economy.





Key Points:

Economic activity remains strong in the ACT. **State final demand** grew at an annual pace of 5.0% in the year to the March quarter 2017. This compares favourably to national domestic demand growth of 1.7% in the year to the March quarter. ACT was the fastest growing economy, excluding the Northern Territory.

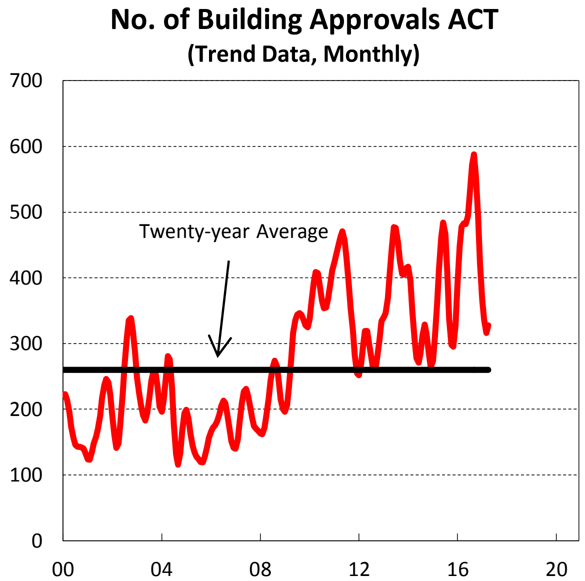
The **gross state product** measure includes the impact of international trade but this data is available only annually. In 2015-16, gross state product rose by 3.4%. Another solid result is expected for 2016-17.

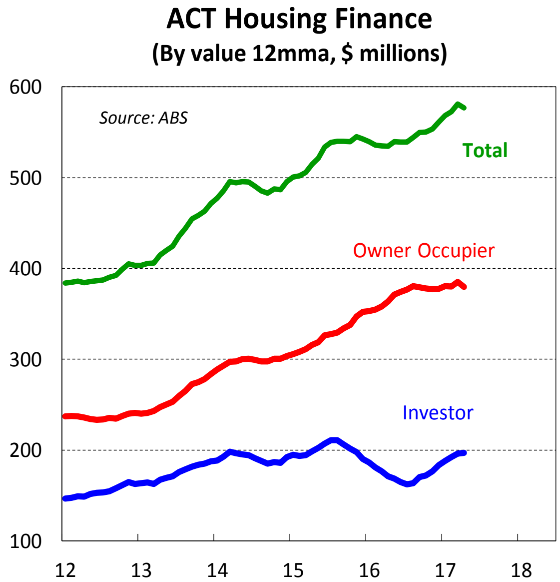
This year's **Federal Budget** continued to delay budget repair. This indicates that public sector will not be facing a squeeze from spending cuts and efficiency dividends, which will be supportive of economic growth in the ACT in the near term.

The Federal government has resumed hiring and the impact of previous hiring freezes in the public service is wearing off. This is providing support to both the housing market and retail spending. A net increase in federal government staff is expected for 2017/18.

The Capital Metro light rail project is now underway and should provide a boost to the ACT economy. The $700 million City to Gungahlin corridor is expected to be operational in 2019.

Last year, direct international flights to and from Singapore and Wellington were announced for Canberra. By mid 2018, direct international flights to and from Doha will commence. These are expected to inject income into the ACT economy and support the **tourism** and business sector.





The **housing market** has been a key factor in propping up the ACT economy over the past year. Dwelling prices in Canberra are growing at a moderate pace. Unit prices rose by 8.1% in the year to May 2017. House prices grew at a more moderate 5.5% in the year to May 2017. It is the first time annual unit price growth has outpaced that of house prices since August 2015. Canberra is expected to record a small oversupply of dwellings this year. However, the replacement of asbestos-affected homes (i.e. Mr Fluffy effect) removes some supply. Low interest rates and firm job growth are helping to support the housing market. 'Mr. Fluffy' relocations and foreign buying is also placing upward pressure on prices. Moreover, recently announced cuts to stamp duty for buyers of new properties below the $700,000 threshold will also help underpin demand.

Home lending has decreased in recent months, echoing the move nationally. The range of measures introduced by authorities in recent months to cool the housing market is beginning to hit lending. The number of **owner occupier home loans** fell by 4.4% in the year to April, while the value of those loans has declined by 6.4% in the ACT. The value of **investor loans** was 5.0%

higher in the year to April, although the annual pace has decelerated in recent months, from a cyclical high of 54.3% in the year to December 2016.

ACT residential vacancy rates have declined substantially from their peak in the December quarter 2013 of 5.2%. The vacancy rate stood at 2.2% in the December quarter 2016 and further highlights the reasonably healthy conditions in the housing market. With vacancies sitting comfortably below 3%, it signals a tight rental market and that there is strong demand for rental accommodation. The vacancy rate in the ACT is below that of all the other Australian capital cities except for Sydney (1.9%).

Turning to commercial property, Canberra's prime grade vacancy rate is lower than other **CBD office markets**. The vacancy rate for the CBD office market is declining, but it still sits above the long-run average. It is a two-tiered market in Canberra with the leasing market improving more so in the prime-grade office space. There is limited office supply (excluding airport), but new starts are expected, including at Constitution Place (due 2020). Investment returns in Canberra are lowly correlated with other CBD office markets, delivering portfolio diversification. This diversification attracts foreign investors and investment more generally.

The ACT **unemployment rate** (in trend terms) has fallen from a recent peak of 5.1% in October 2015 to 3.6% in April 2017. It is the lowest unemployment rate in trend terms, excluding the Northern Territory. In trend terms, a net 3,200 jobs were created in the year to April. In the year to February, job gains were in professional, scientific & technical (6.1k), accommodation & food services (2.5k), education & training (1.5k) and public administration & safety (1.2k). Job losses were steepest in financial & insurance services (-2.4k), healthcare & social assistance (-1.3k) and information, media & telecommunications (-1.2k).

Population growth has lifted in recent data with growth of 1.5% in the year to the September quarter, matching the national population growth rate. It was the strongest annual pace in a year and will support demand in the ACT economy. The size of the population is approaching 400,000.

The pace of **retail sales** has slowed sharply in the ACT mirroring the national trend. However, retail sales are growing more strongly than nationally, reflecting its firmer economic fundamentals. Annual growth stepped down to 3.7% in April, down from a recent peak of 8.0% in October 2016. It remains above the pace of annual retail sales growth Australia-wide which stood at 3.1%. Weak wages growth is constraining retail spending. Retailers also face the prospect of Amazon and Alibaba into Australia.

Building approvals in the ACT were elevated over much of 2016, averaging 490 approvals per month. The pace has cooled over 2017, with an average of 336 per month over the first four months, although this still remains above the long-term average. 'Mr Fluffy' affected homes continues to impact residential construction.

Engineering construction activity in the ACT is now being dominated by the Capital Metro light rail. This project is worth $700 million and takes up the bulk of engineering construction work in the ACT. According to the ABS, the total value of engineering work yet to be done in the ACT stood at just over $1 billion. Elsewhere, the the other noteworthy potential project is the $29 million Cotter Road duplication.

The outlook for **commercial construction** is improving. Work has begun on the expansion of Goodwin Village Farrer. The Australian National University is set to begin the redevelopment of Union Court and University Avenue worth $220 million later this year.

ACT Budget

The ACT Budget for 2017-18 was handed down last week on June 6 by ACT Treasurer Andrew Barr. A deficit of $83.4 million is forecast for 2017-18, after an expected $74 million deficit in 2016-17. A return to surplus is expected in 2018-19.

Some of the key announcements included:

- Cuts to discounts for households who pay rates upfront (ie delivering a rise in rates).
- Land tax on investors' properties extended to vacant housing.
- Stamp duty for buyers of new properties will be cut. For a house worth $700,000, stamp duty will be cut by $1,100, to $22,360. For commercial properties worth less than $1.5 million, stamp duty is halved this year and abolished in the next budget.
- Tax break for small and medium clubs.
- An increase in the building levy.
- Land release with 51,000 sqm of mixed-use space for the city and 77,000 sqm Canberra-wide.
- Major Canberra Hospital expansion to include new surgical, radiology and emergency centre.
- $85 million for new school facilities and tech.
- Infrastructure - work is to start on the Civic to Woden light rail, West Basin "activation" to encourage lakeside leisure, sport, business and housing, new roads include the Gundaroo Drive widening and Canberra Brickworks access road and around $30 million for new public housing

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