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QLD Economic Outlook

Summary

- Queensland's economy is still going through a tough ride, as major mining projects continue to wrap up. Of the major LNG construction projects that have been underway in the State, most have been completed and are all due to wrap up this year. The drag on GSP growth has been most pronounced over the last two years, even as exports are beginning to provide a significant contribution to growth. The Queensland economy grew 2.0% in 2015-16 after growth of 1.2% in 2014-15.

- It is however, more likely that Queensland will post much stronger headline growth rates in coming years. While the downturn in mining construction has a bit further to run, the worst of the drag is likely over. Moreover, as projects are moving from the construction to the production phase, production is ramping up at major LNG facilities and exports will provide a significant contribution to growth. We expect that Queensland's economy will grow at a healthy 3.4% in 2016-17.

- A rebound in commodity prices, particularly for coking coal, is a major positive for Queensland and export incomes. However, there are concerns that the recent rally in prices is unsustainable.

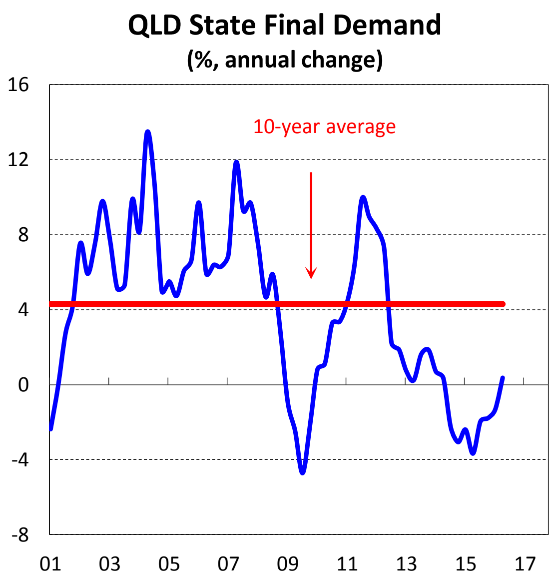
- The expected pickup in GSP growth however, masks some underlying weakness that still exists in the economy reflecting the effect of the mining construction downturn. Population growth is well down from its recent peak and household spending is still being weighed down by weak wage growth and a significant softening in labour market conditions over the past year.

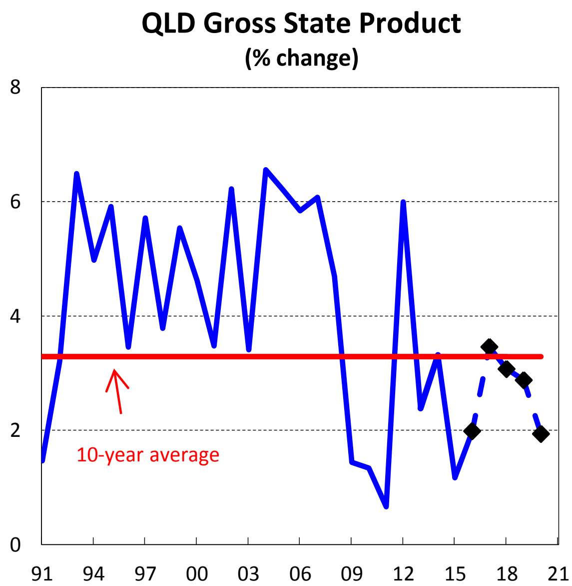
- Dwelling investment has been a key contribution to growth in recent years, as low interest rates support housing demand and construction. While residential construction will likely maintain at a high level over the next 12 to 18 months, it may have already peaked or could peak over the next few months.

- The relative affordability of Brisbane housing should provide major support for dwelling prices. In comparison to Sydney, Brisbane prices are at their largest discount since 2003, and may bring potential residents north. However, the surge in residential construction in recent years will likely put a lid on prices.

Percentage Shares of the Economy*		
Industries	**QLD**	**Australia**
Construction	12.8	10.9
Health care and social assistance	8.8	7.4
Mining	8.2	6.9
Manufacturing	7.4	6.3
Financial and insurance services	7.0	6.0
Public administration and safety	6.8	5.8
Transport, postal and warehousing	6.6	5.6
Education and training	5.5	4.6
Retail trade	5.5	4.6
Professional, scientific and technical services	5.2	4.4
Wholesale trade	5.1	4.3
Electricity, gas, water and waste services	3.8	3.2
Rental, hiring and real estate services	3.6	3.1
Administrative and support services	2.9	2.5
Agriculture, forestry and fishing	2.9	2.5
Accommodation and food services	2.8	2.4
Other services	2.2	1.9
Information media and telecommunications	2.1	1.8
Arts and recreation services	0.7	0.6

** Share of gross value added less ownership of dwellings 2015-16; Source: ABS, St.George*





Economic Growth

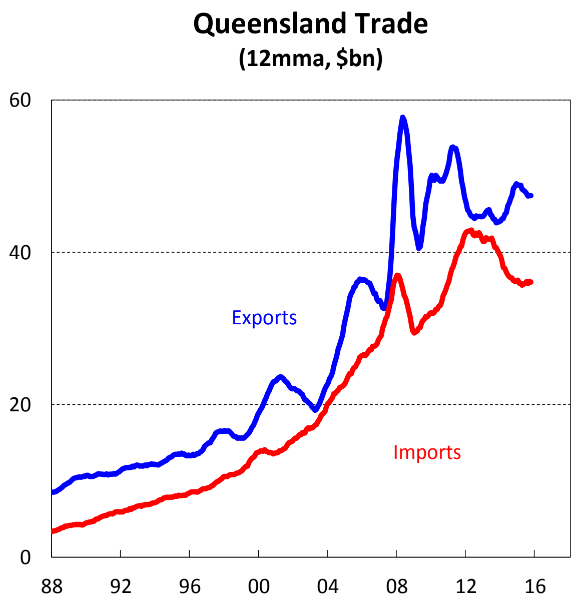
Queensland's economy is still going through a tough ride, as major mining projects continue to wrap up. Of the major LNG construction projects that have been underway in the State, most have been completed and are all due to wrap up this year. The drag on GSP growth has been most pronounced over the last two years, even as exports are beginning to provide a significant contribution to growth. The Queensland economy grew 2.0% in 2015-16 after growth of 1.2% in 2014-15.

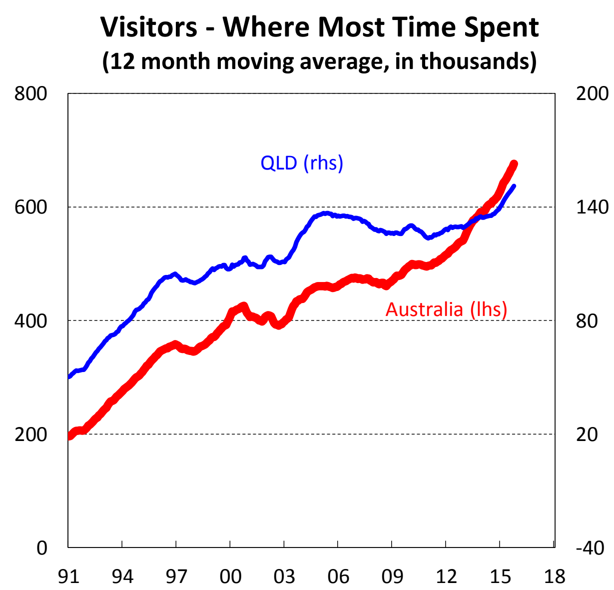
It is however, more likely that Queensland will post much stronger headline growth rates in coming years. While the downturn in mining construction has a bit further to run, the worst of the drag is likely over, particularly in comparison to other States such as Western Australia. Moreover, as projects are moving from the construction to the production phase, production is ramping up at major LNG facilities and exports will provide a significant contribution to growth. Indeed, Australia-wide export volumes grew 47% in 2015-16 and are estimated to increase another 41% in 2016-17 according to the Department of Industry, Innovation and Science, where a sizeable portion will come from Queensland.

The income gains from exports are another promising signal for Queensland given that commodity prices have recovered over recent times. In particular, coking coal prices have surged over 200% since the middle of this year. Oil prices have also recovered from their recent lows in January, and point to some improvement in the contract prices of LNG over coming months.

Nonetheless, there are concerns that the recent rally in prices is unsustainable. Economic activity in China has stabilised which has allayed earlier concerns of a hard landing. While recent stimulus measures will support demand for commodities, there remain long-term structural issues in regards to industrial overcapacity and elevated levels of corporate debt. China’s property market is beginning to slow and this could present some downside risk to commodity prices.

The fall in the Australian dollar since 2013 has also been a major boost for exports, especially for Queensland’s tourism industry. Inbound tourists who spent most of their time in Queensland have increased after lagging behind some other States in recent years. There have been some benefits in the form of prospective investment within tourism which include resort developments. Adding to the range of positives is that Queensland is no longer in drought, which would further add to export capacity in the rural sector.





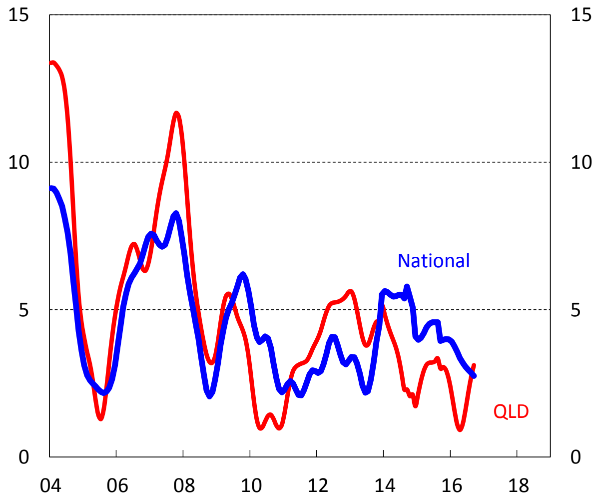
We expect that Queensland's economy will grow at a healthy 3.4% in 2016-17, as exports continue to provide a strong contribution to growth. The lower Australian dollar will also further provide a boost to other exports including tourism and international education. The lessening drag from the mining investment downturn is also a key positive for the outlook. There are however, downside risks in coming years as housing construction is close to a peak, although the slowdown in population growth could be close to stabilising. (Please see page 9 for further details on forecasts).

Consumer Spending

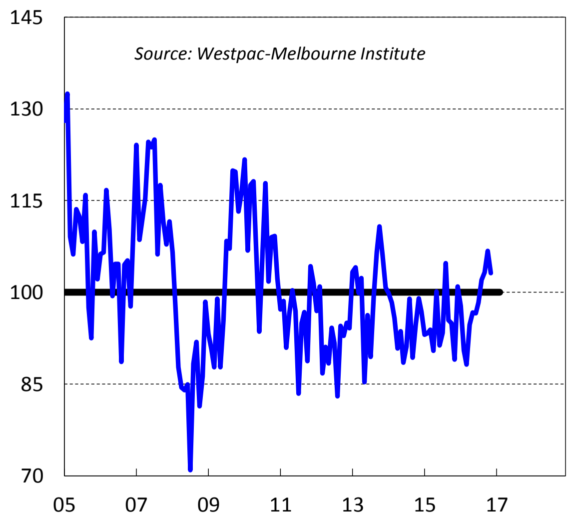
The mediocre pace of growth in consumer spending is continuing in Queensland. Household spending grew 1.9% in the year to the June quarter, which was the slowest in nearly two years, and below the 10-year average of 3.1%. Soft wage growth has continued to limit growth in consumer spending, and a recent slowdown in Queensland's labour market may have also had an impact.

However, there has been some better news in Queensland retailing over recent months. Retail

Value of Retail Sales
(trend, annual % change)



Queensland Consumer Sentiment



spending in Queensland grew at 4.0% in the year to September 2016, picking up from 2.9% annual growth in the year to September 2015.

As the downturn from mining investment continues to ease, the associated job losses and population slowdown should also lessen and become less of a drag on consumer spending. There also continues to be support from low interest rates.

That said, household spending and retailing continue to grow well below their long-run averages. Some further improvement is possible, as the State benefits from the lower Australian dollar which is boosting Queensland's tourism sector.

A positive sign for consumer spending is a pickup in consumer sentiment in recent months. The Westpac-Melbourne Institute index on consumer sentiment for Queensland has lifted to above 100 for four consecutive months, and stood at 103.2 in November.

Nonetheless, soft wage growth continues to put a lid on spending. Moreover, employment growth has weakened over the past year or so, which suggests that any significant pickup in household spending will require consumers to tap into their savings. An ongoing modest pace of consumer spending is the most likely scenario.

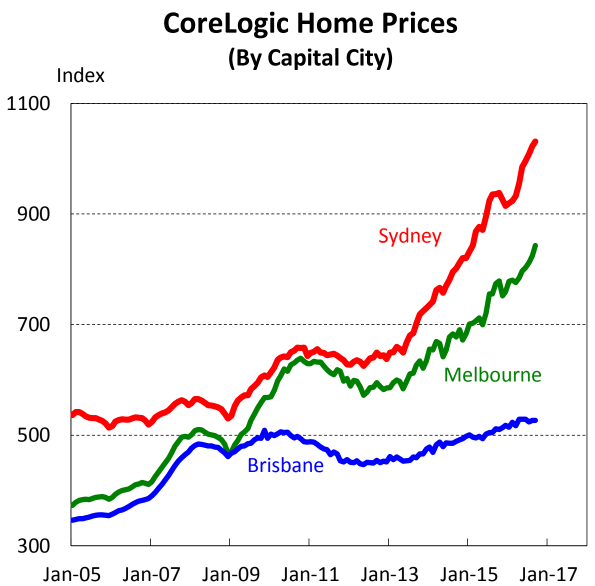
For the year to the June quarter, the strongest growth in household consumption in Queensland was electricity, gas & other fuel (8.1%), clothing & footwear (6. 1%) and communications (5.5%). Areas of weakness included the purchase of vehicles (-10.4%) and cigarettes & tobacco (-10.1%).

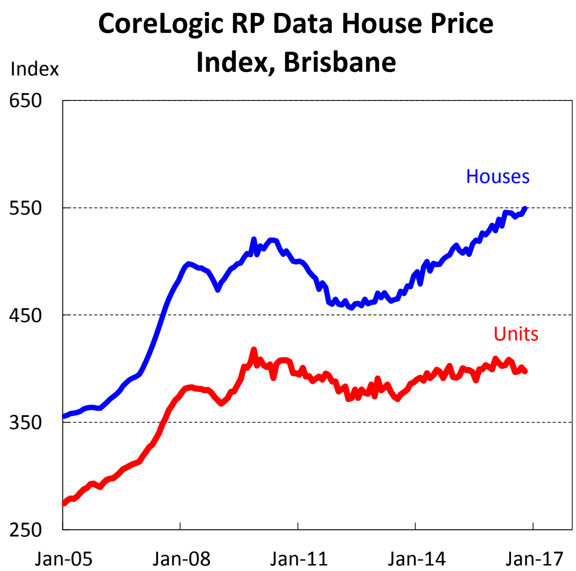
Housing

The price of housing has grown modestly over the past few years. In the year to October, Brisbane dwelling prices rose 4.1%, while Brisbane-Gold Coast prices rose 5.0% over the same period.

While low interest rates have helped to support price growth, gains have continued to lag behind Sydney and Melbourne, where annual growth stood in excess of 9% in October. In the past, strong gains in Sydney prices have tended to flow through to Brisbane. For example, the gain in Brisbane house prices over 2002 onwards followed the surge in Sydney occurring over the late 90s to early 2000s.

However, Brisbane does not appear to be tracking its Sydney or Melbourne counterparts to the same extent as in past housing cycles. Part of the reason is likely because the downturn in mining construction is weighing on jobs, incomes and population growth. It might still be the case that the relatively affordable homes in Brisbane will eventually draw potential residents to the Sunshine State from down South, although the recent surge in the new supply of residential apartments in the Brisbane CBD will likely prevent significant price gains. Indeed, unit price gains in Brisbane have begun to suffer as a result and declined 1.4% over the year to October. Houses in contrast, were up 4.7% over the same period.





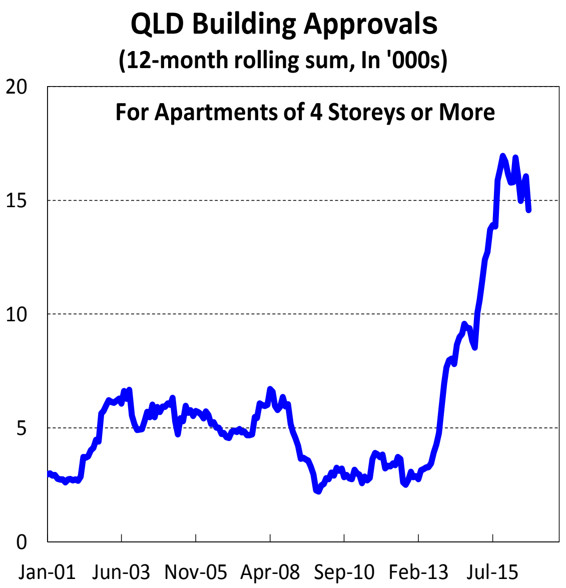
- **Rental Markets**

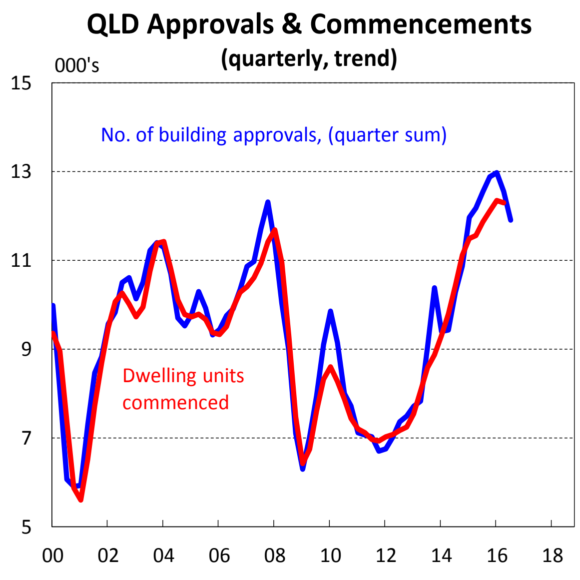
The stream of new dwellings has resulted in vacancy rates edging higher over recent years. According to REIA, vacancy rates stood at 2.8% in the June quarter, up slightly from 2.7% a year ago. While the current vacancy suggests that rental markets are close to balanced, there is a risk that they will lift further, which would raise some concerns regarding oversupply of rental accommodation. Indeed, while broader vacancy rates for Brisbane suggest little sign of excess rental stock, vacancy rates in the CBD and some surrounding suburbs are higher.

Rising vacancies point to a high risk of falling rents. However, most recent data is suggesting that rents in Brisbane have continued to grow, although at a modest pace. For a 3-bedroom house rents grew 1.3% in the year to the June quarter and for a 2-bedroom "other" dwelling, rents grew 1.4% in the year to the June quarter.

Dwelling investment

Along with the national trend, residential construction in Queensland is growing at a very strong pace. In the year to June, dwelling investment grew 12.8%, and will likely maintain at a high level over the next 12-18 months. The number of building approvals remains elevated, although residential construction may have already peaked or could peak over the next few months. Construction is generally concentrated in apartments, and there are growing concerns over an emerging oversupply within the Brisbane CBD.





Outlook

In the near-term, the modest price gains are likely to continue given interest rates remain at historically low levels. The relative affordability of Brisbane should provide major support for dwelling prices. In comparison to Sydney, Brisbane prices are at their largest discount since 2003, and this may bring potential residents north.

However, the surge in residential construction in recent years will likely put a lid on prices. Moreover, population growth has slowed thanks to the downturn in mining construction in the State. Annual population growth has weakened from a peak of 2.1% in September quarter 2012 to 1.3% in the March quarter 2016, although the slowdown in population growth appears to have stabilized in recent times. It is possible that population growth is beginning to respond to the relative affordability of housing in the State.

Business Investment

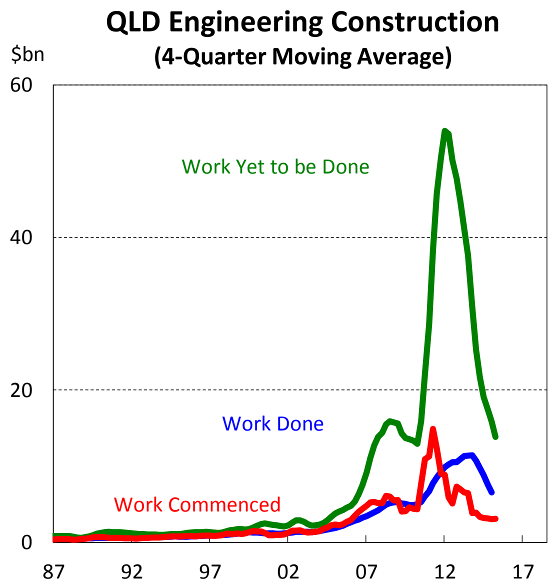
The downturn in mining investment has continued to weigh on business spending in Queensland. The major LNG projects which have been the massive driver of business investment have mostly completed across Queensland, which means that the worst of the drag on economic growth has passed.

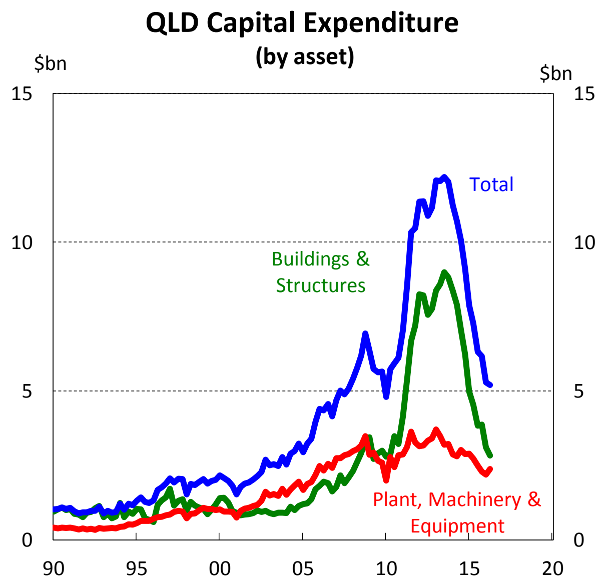
That said, business investment is still in contraction, declining 16.6% in the year to June quarter 2016. This pace of decline is still an improvement from the 29.1% contraction in the year to the June quarter 2015.

The rate of decline should continue to ease as the final stages of major projects wrap up. While we are not expected to see much growth in coming years, there are limits to how much further business investment can drop - total capital spending in Queensland is down at levels not seen since 2007.

Engineering construction has accounted for the bulk of the weakness within business investment. In the year to the June quarter, the value of engineering construction contracted 21.3%, which takes into account the completion of the Curtis Island project and the Gladstone LNG, while the Australian Pacific LNG has moved into its production phase.

There are also number of coal projects, including Byerwen, Grosvenor and Eagle Downs which are set complete construction next year. However, beyond these projects the pipeline is looking more uncertain. The Adani Carmichael coal mine would be the largest prospective project, and would be one of the world's largest. It has cleared most legal obstacles and Adani has announced it would start construction in the third quarter of 2017. That said, financing remains a hurdle, although the rebound in coal prices improves prospects for this project and other mines. Other potential projects include an $8.3bn Galilee Coal project and a $4.2bn Kevin's Corner project.





The good news for Queensland business investment lies in the potential for spending within tourism. The lower Australian dollar has resulted in a lift in tourist numbers and with it, a relatively healthy pipeline of tourism projects. Major projects include the Arlie Beach resort and the Great Keppel Island resort redevelopment, although these are still in the early stages of development. The originally proposed $8.1bn Aquis casino and resort in Cairns has been scaled back to a still large $2.0bn hotel, apartment and villa complex.

Labour Market

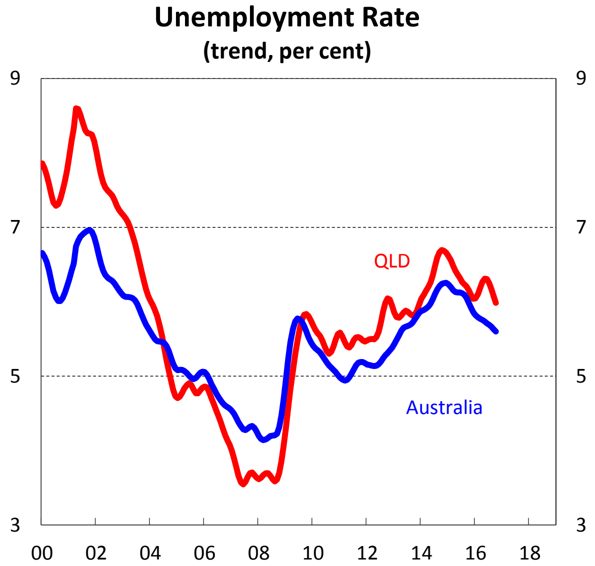
Queensland's labour market has softened considerably over 2016. Jobs have contracted in eight out of the last nine months, and led to a 46.0k contraction in the year to October. This was the weakest annual pace since data became available in 1979.

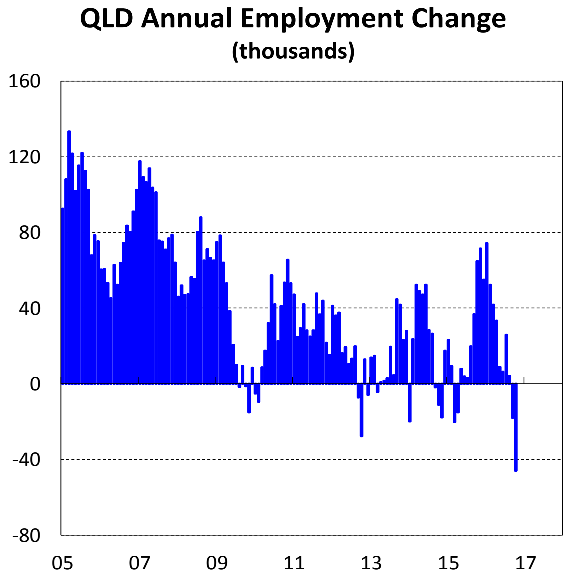
The current weakness in the labour market might reflect some pay back for much stronger job growth over 2015. While there are challenges for the Queensland economy, current conditions do not justify consistent job losses.

We would expect that in time, job growth should recover somewhat. The loss of mining construction jobs will dissipate, and improving prospects in the tourism sector should assist in supporting job growth.

The unemployment rate has not risen with the contraction in employment. The unemployment rate stood at 5.8% in October, which is down from 6.2% a year earlier. Additionally, Queensland's unemployment rate is only slightly higher than the national rate of 5.6%.

Falling workforce participation has been helped keep the unemployment rate lower than it otherwise would be. The participation rate in Queensland has fallen to 63.3% in October, the lowest in just over 13 years.





By industry, job gains reflected those sectors which have been performing well. Healthcare & social assistance (29.0k), construction (17.1k) and other services (9.1k) had the strongest job gains. The largest job losses were somewhat surprisingly in professional, scientific & technical services (-30.1k), while the decline in jobs in mining (-13.7k) and manufacturing (-10.3k) was in step with the completion of major resource projects and the structural decline of manufacturing.

The trend that develops over the next several months will provide a better gauge over the health of the labour market. We expect that the labour market will recover from recent job losses to a moderate pace of job growth.

St.George Banking Group Forecasts

Economic Indicators, % Change				
	2015-16	**2016-17 (f)**	**2017-18 (f)**	**2018-19 (f)**
Gross State Product	2.00	3.40	3.10	2.90
State Final Demand	-1.30	1.70	1.00	1.30
Employment	1.60	-0.80	1.40	1.40
Unemployment Rate (year average)	6.20	6.00	6.00	6.00
Brisbane CPI	1.60	1.70	2.10	2.20
Wage Price Index	2.40	2.10	2.00	2.30

Source: St.George Banking Group

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