Monday, 7 November 2016

South Australian Economic Outlook

Summary

- The South Australian economy faces challenges in the year ahead but should be aided by the low interest rate environment and by the weaker Australian dollar. In 2014-15, the South Australian economy grew by 1.6%. It is expected to have grown 1.5% in 2015-16. The outlook for 2016-17 is for continued modest growth of around 1.25%.
- The closing of the car industry in South Australia late next year will represent a significant negative for South Australian manufacturing. This will be offset to some extent by defence manufacturing in the State. The weaker currency has lifted the competitiveness of the manufacturing sector, as well as agriculture, tourism and international education.
- Population growth, a driver of growth in the larger States, has been soft in South Australia, commodity prices have fallen and the ageing population has slowed growth in the labour force.
- House prices in Adelaide have grown only modestly through the year to September. House prices are up 2.7% for the year to September 2016, while unit prices slipped 0.2%, according to CoreLogic.
- Business investment in South Australia has been lacklustre in recent years. The size of the declines in business investment in South Australia has, however, been less dramatic than in some of the resource States.
- Despite some dour headlines, the labour market in South Australia has picked up over the year. Employment rose by 1.8% in the year to September 2016. This is above growth in employment nationally of 1.4% over the same period.

Percentage Shares of the Economy*		
Industries	**SA**	**Australia**
Health care and social assistance	10.4	7.6
Manufacturing	8.7	7.3
Financial and insurance services	8.6	10.1
Construction	7.2	9.1
Public administration and safety	7.2	6.1
Education and training	5.9	5.5
Agriculture, forestry and fishing	5.8	2.6
Retail trade	5.8	5.2
Transport, postal and warehousing	5.8	5.4
Professional, scientific and technical services	5.5	7.0
Wholesale trade	5.4	4.8
Mining	4.8	10.2
Electricity, gas, water and waste services	4.2	3.2
Administrative and support services	3.2	3.1
Accommodation and food services	2.7	2.8
Information media and telecommunications	2.7	3.4
Rental, hiring and real estate services	2.6	3.3
Other services	2.6	2.2
Arts and recreation services	1.0	0.9

** share as % of Industry gross value added less ownership of dwellings*

Source: ABS, St.George Bank

Economic Growth

The South Australian economy faces challenges in the year ahead but should be aided by the low interest rate environment and by the weaker Australian dollar. An injection of larger GST payments under the latest revenue sharing arrangements will help as should the boost to confidence from long-term defence contracts.

In 2014-15, the South Australian economy grew by 1.6%. It is expected to have grown 1.5% in 2015-16. Over the past 10 years, which includes the GFC, the South Australian economy has averaged growth of 2.0% compared to the national average of 2.8%.

The outlook for 2016-17 is for continued modest growth of around 1.25%.

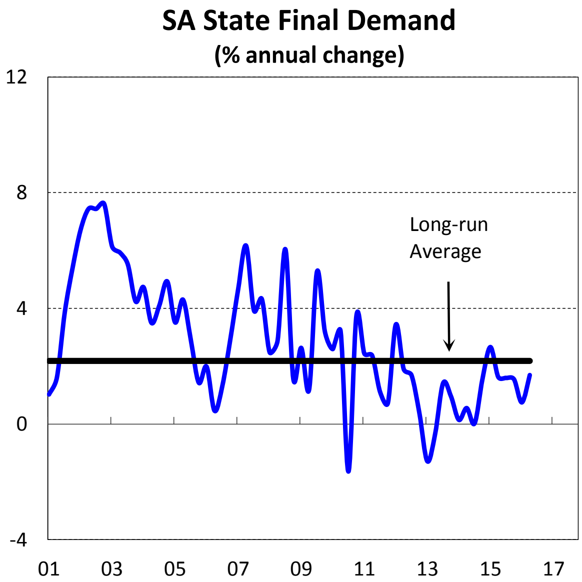
The challenges facing elements of the South Australian economy are well known. Many of them stem from global factors and the impact of the strong Australian dollar between from 2011 to 2014. The high AUD hurt the manufacturing sector and did nothing to assist the automotive sector. Population growth, a driver of growth in the larger States, has been soft in South Australia, commodity prices have fallen and the ageing population has slowed growth in the labour force.

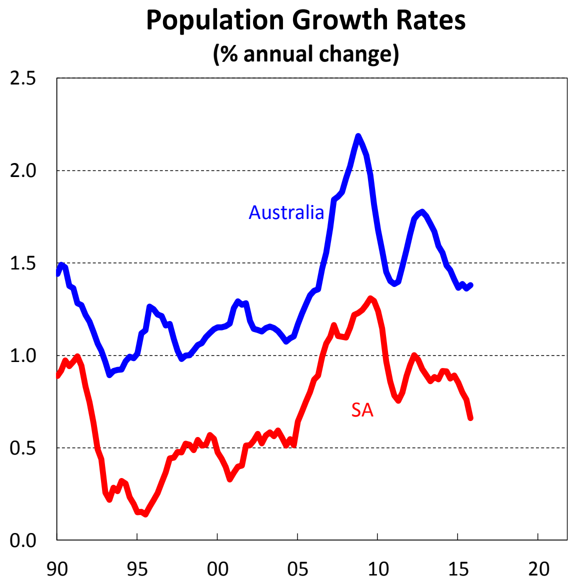
The closing of the car industry in South Australia late next year will represent a significant negative for South Australian manufacturing. This will be offset to some extent, however, by the much publicized construction of submarines, frigates and offshore patrol vessels in South Australia which will help boost economic growth, down the track.

What is the outlook for economic activity in South Australia? For the State as a whole it is not as dour as many make out but neither is it sparkling. Since early 2013, the exchange rate has fallen 28% against the US dollar and 19% in trade-weighted terms.

The weaker currency has lifted the competitiveness of manufacturers, the agricultural sector and other exporters. It is also lifting activity in the tourism and international education industries. Ongoing and new road and rail projects should also help lift the level of activity over the next 18 months.

The most recent national accounts data suggests that the impact of the lower Aussie dollar is paying dividends. State final demand (which excludes imports and exports) rose by 0.6% in the June quarter 2016, following growth of 0.3% in the March quarter 2016. For the year to the June quarter, South Australian State final demand rose 1.7%. While this is below the 10-year average of 2.1%, it is an improvement on recent quarters.





Consumer Spending

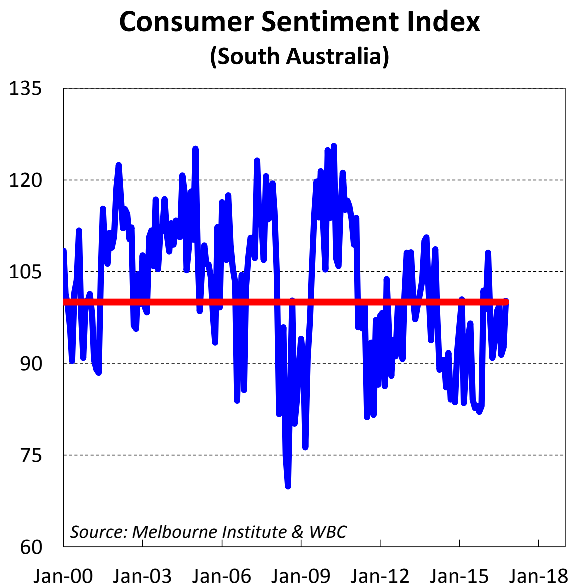
Consumer spending in South Australia (which includes retail spending, new car sales and spending on items such as education, insurance and other services) accelerated in 2015 and has maintained a solid pace of growth so far this year. In the year to the June quarter, consumer spending rose 2.6%. This was above its 10-year average of 2.2%, and the seventh consecutive quarter of above average growth. It remains below the national average pace of household spending, which was at 2.9% in the year to the June quarter.

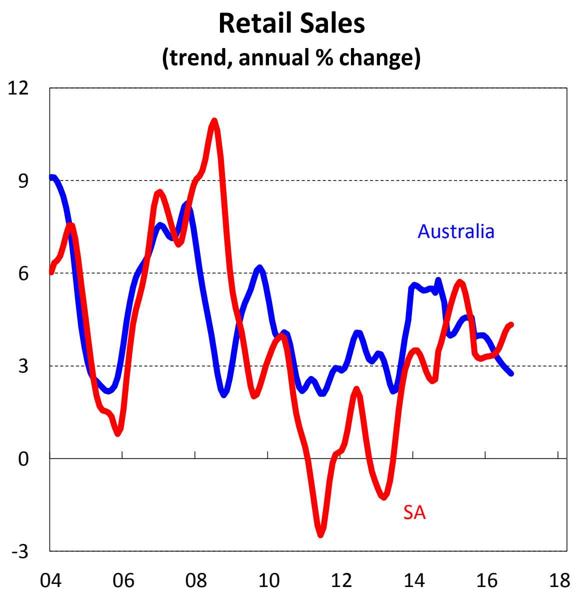
Retail sales in South Australia rose 4.4% in the year to September. This is above the 10-year average of 3.7% and above the national average retail sales growth of 3.3% in the year to September.

New motor vehicle sales in the year to September jumped 10.3%, although these numbers are volatile. Over the past three years, new motor vehicle sales in South Australia have averaged over 5800 per month. In September, new motor vehicle sales in South Australia were at their highest since January 2013.

Consumer sentiment in South Australia has been mostly soft for the past two years, but with occasional spikes in optimism (see chart below). A reading of 100 indicates that those who are optimistic about their household financial situation are balanced by those who are pessimistic.

In October, consumer sentiment in South Australia rose above 100, for the first time since February. The RBA's two rate cuts in May and August this year are likely providing some support for consumer sentiment, and consumer spending in South Australia.





Housing

House prices in Adelaide have grown only modestly through the year to October. House price are up 2.7% for the year to October 2016, while unit prices slipped 0.2%. According to Corelogic, the median house price in Adelaide is $437,500, while the median price for a unit is $355,000. Dwelling prices in regional South Australia are reported to have slipped 0.2% in the year to September 2016. The easing in unit and regional house prices is not good news for home owners and their consumer spending. For potential first home buyers, however, the news is encouraging, with affordability less challenging than in some of the other States.

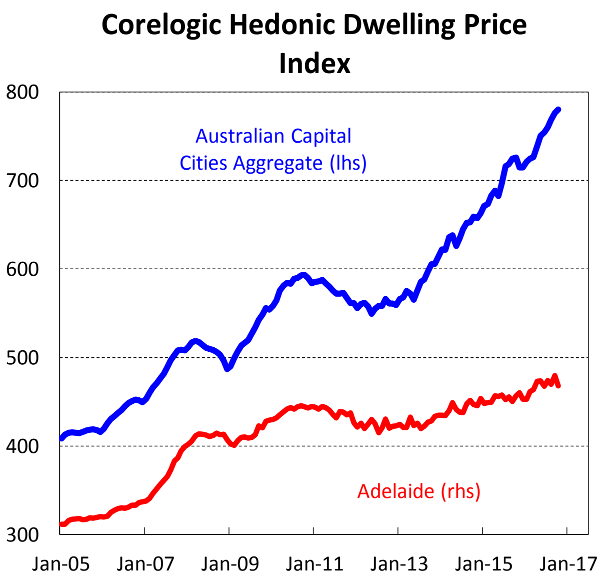
Demand for owner occupier loans continues to lift, although the pace of growth has moderated. The number of new home loans in South Australia rose 3.9% in the year to August, down from a recent peak of 15.9% growth in the year to May 2016. Demand remains solid, however, reflected in auction clearance rates. In October, the auction clearance rate in Adelaide averaged 71.2%, up from an average of 63.5% over the past three years.

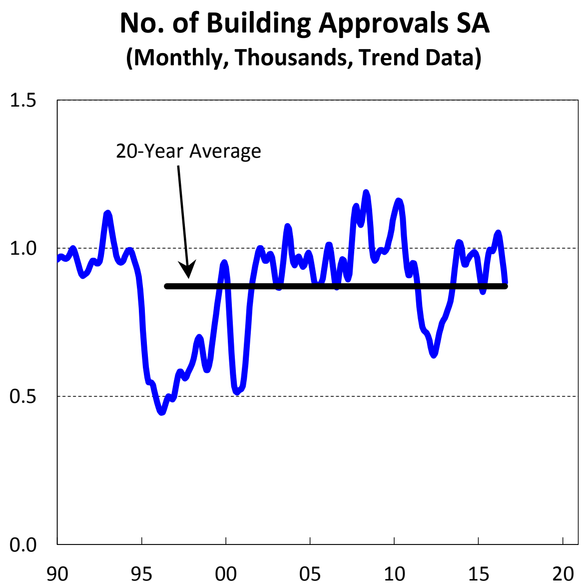
- **Dwelling Investment**

Construction of new dwellings continues at a pace that appears to be in excess of population growth requirements. Over the year to the June quarter 2016, more than 10,800 new dwelling constructions were commenced in South Australia. At the same time the population rose by 11.1k. With an average of 2.4 people per dwelling, that implies an underlying need for around 4,625 new dwellings per year.

It is possible that changing demographics have reduced the number of persons per dwelling; however, housing forecasters BIS Shrapnel suggest that by 2017; South Australia will have a surplus of around 5,700 dwellings. While this sounds large, the last census told us that in 2011, South Australia had 727,676 private dwellings of which 83,777 were unoccupied (holiday homes, homes for lease, newly constructed).

The mix of slower population growth, creeping excess supply and soft growth in prices suggests that residential construction activity will be muted over the next 12-18 months.





- **Rental Markets**

The value of investor loans for housing has fallen Australia-wide over the year to July. Measures by APRA to curb investor lending appear to be impacting demand, as well as tighter lending standards from lenders. Demand from investors in South Australia has been volatile, having increased 18.2% in the year to August, after falling 6.4% in the year to July. According to CoreLogic, gross rental yields for houses in Adelaide have edged lower in recent years, easing to 3.9% in September. Gross rental yields on units in Adelaide are attractive on a national comparison and have remained fairly stable in recent years, at 4.7% in September.

The median weekly rent for a 3-bedroom house in Adelaide is $340, while the median weekly rent for 2-bedroom 'other dwellings' (mostly units) rose to $290 per week, according to the Real Estate Institute of Australia. Rental vacancy rates remained tight in Adelaide at 1.7% for houses and 2.2% for units, according to Domain.

- **Housing Outlook**

With population growth, economic growth and wages growth all soft, dwelling prices in South Australia are not expected to see the sort of gains witnessed in Sydney and Melbourne recently. Dwelling prices rose 10.2% in Sydney and 9.0% in Melbourne in the year to September. Concerns around the labour market and reduced population growth are keeping a lid on demand for Adelaide housing, while new housing supply continues to come on line.

We expect the pace of growth in dwelling prices in Adelaide to remain modest in coming months. Low interest rates will help support demand for housing, but the pace of growth in house prices is likely to be moderate.

Business Investment

Business investment in South Australia has been lacklustre in recent years. The size of the declines in business investment in South Australia has, however, been less dramatic than in some of the resource States. Private business investment in South Australia has fallen 25.0% from its peak in the March quarter 2012. Nationally, private business investment has declined 27.4% from its peak in June 2013. Private business investment comprises as slightly smaller part of the South Australian economy (11.2% of State final demand), than it does for the national economy (13.1% of domestic demand).

Private business investment in South Australia has weakened over the last three quarters. For the year to the June quarter, business investment fell 16.4% in South Australia. This was weaker than nationally, where business investment declined 14.3% in the year to the June quarter.

The mining investment boom ushered in higher interest rates and a stronger Australian dollar, than would have otherwise been the case. These factors weighed heavily on the non-resource States and were a significant factor behind the deterioration in South Australia's manufacturing sector.

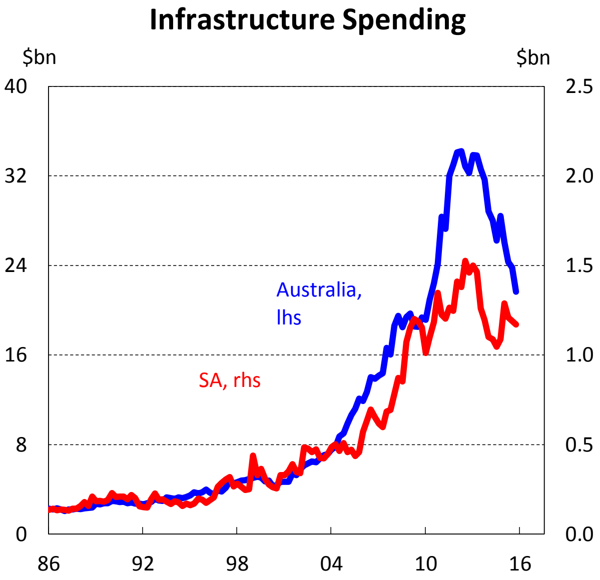
That contraction in the South Australian manufacturing sector over recent years will be a negative for future engineering construction. While there remain projects in the pipeline, including the $4.5bn Central Eyre iron ore project and the $3.2bn Arckaringa coal project, the future of these projects is still uncertain. The $514mn upgrade of the Port Pirie smelter is due for completion in 2017.

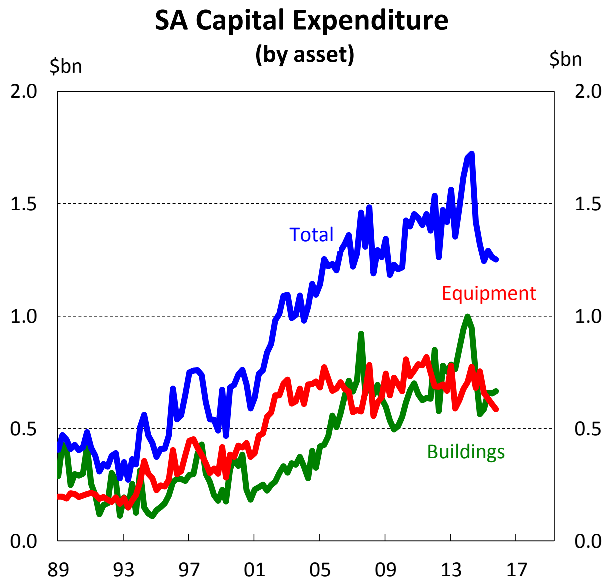
In recent times, the public sector has supported activity, and helped make up for the lack of private sector activity, with government investment rising for three consecutive quarters. Spending on roads will help boost South Australia's economic growth in coming years. The South Road upgrade is worth $90mn.

The Budget announcement by the State Government that it will remove most business stamp duties should be supportive of business investment.

Within non-residential construction, publicly funded health projects include the new Royal Adelaide hospital, which at a value of $2.34bn is the world's third most expensive building, and the redevelopment of Lyell McEwin hospital, worth more than $300 mn, continue lead the way in activity.

Outside of healthcare, activity is limited, dampened by uncertain demand. However, the expansion of the Adelaide Convention Centre and the Westfield Marion Shopping Centre are underway. A pickup in retail activity and the still low Australian dollar should boost longer term prospects for commercial construction.





The level of confidence within South Australia is a key factor in the outlook for business investment within the non-mining sector. Business confidence in South Australia has improved recently according to the BankSA State Monitor. The business confidence index rose to 103.1 in July, from 99.9 in February. It has moved to above a reading of 100, indicating optimists outweigh pessimists.

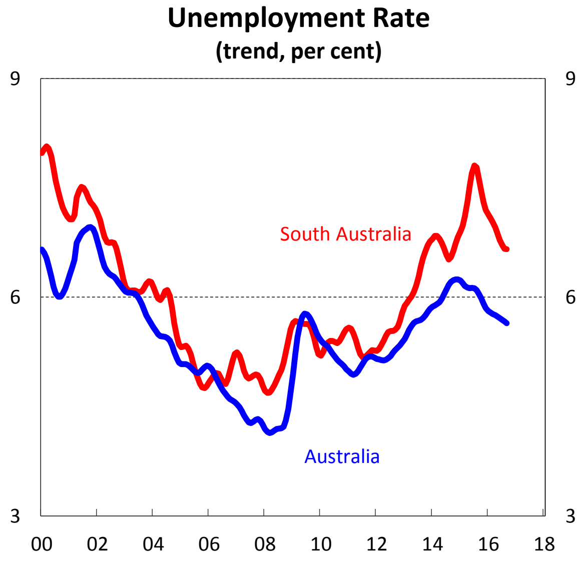
State Budget

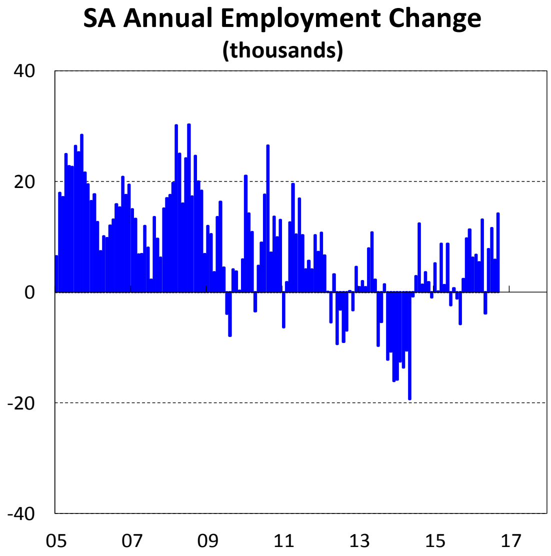
The 2016-17 State Budget predicts a surplus of $254 n for 2016-17. This is little changed from an estimated surplus of $258mn in 2015-16. This was the first surplus in seven years, with the improvement coming courtesy of a larger dividend from the South Australian Motor Accident Commission. The 2016-17 State Budget indicated the government expects surpluses to continue over the forward estimates to 2019-20.

The Budget included an extension to the small business payroll tax rebate for four years, new job creation grants for businesses and an extension of the off-the-plan apartment stamp duty concession for 12 months. The 2016-17 State Budget included an infrastructure spend of $1.8bn, up from an estimated $1.2bn in 2015-16. Spending on health facilities over the next four years will be worth $3.2bn, including the new Royal Adelaide Hospital, as well as $2.0bn spending in partnership with the Federal Government, on North-South Corridor projects.

Labour Market

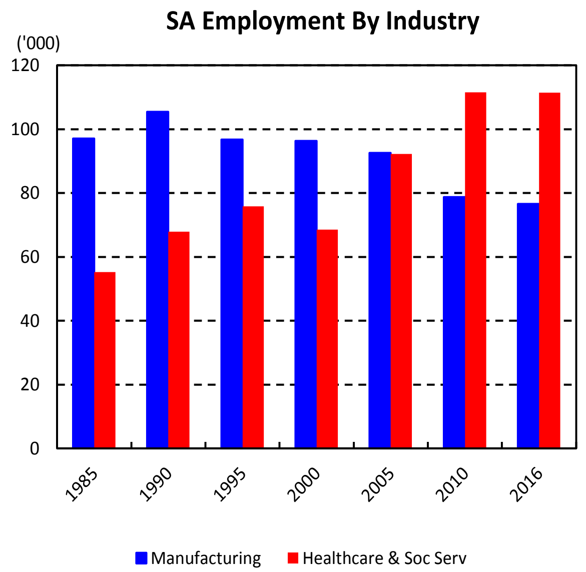
Despite some dour headlines, the labour market in South Australia has picked up over the year. Employment rose by 1.8% in the year to September 2016. This is above growth in employment nationally of 1.4% over the same period and a turnaround from the decline of 0.7% in employment in South Australia in the year to September 2015. According to the ABS, the unemployment rate has fallen from 7.6% in September 2015 to 6.7% in September 2016. Over the year to September 2016, 14,200 jobs were created. The national unemployment rate stood at 5.6% in September.

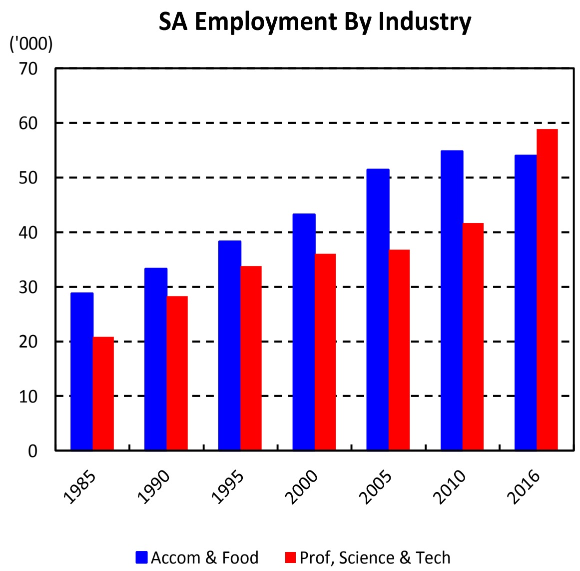




While the labour market remains relatively soft, it is also changing shape. The number of workers in the manufacturing sector has fallen by 20.5k since 1985 but the number of workers in the health & social services sector has risen 56.1k. Similarly the number of workers in the wholesale trade sector has fallen 4.5k, but the number in the professional, technical & scientific services sector has risen by 38.0k. There have also been solid increases in retail trade (35.6k), public administration & safety (32.5k), accommodation & food services (25.2k) and education & training (19.5k).

The healthcare & social assistance industry is already the largest employer in South Australia, representing over 14% of the workforce. Over the August quarter, however, in South Australia, the Australian Bureau of Statistics reports the healthcare & social assistance industry shed the most jobs, with a decline of 9.6k, followed by the transport, postal & warehouse industry (-4.0k). The professional, scientific & technical industry added the most jobs (4.4k), followed by manufacturing (3.9k), in the August quarter. Over the year to the August quarter, manufacturing (6.8k) added the largest number of jobs, followed by wholesale trade (6.6k) in South Australia. Job losses were heaviest in transport, postal & warehousing (-10.3k), followed by healthcare & social assistance (-5.0k).





Looking ahead, we expect the labour force to continue changing shape. The still-low AUD should assist sectors such as agriculture, international education, manufacturing and tourism. The ageing population will see ongoing growth in the healthcare and social services sector.

St.George Forecasts

Economic Indicators, % Change					
	2015-16 (actual)	**2016-17 (f)**	**2017-18 (f)**	**2018-19 (f)**	**2019-20 (f)**
Gross State Product, constant prices	1.50*	1.25	2.00	2.00	2.00
State Final Demand	1.40	1.60	1.70	2.10	2.20
Employment	0.60	1.20	1.00	1.00	1.00
Unemployment Rate	7.30	6.90	6.70	6.80	6.80
Adelaide CPI	0.90	1.75	2.00	2.00	2.25
Wage Price Index	2.30	2.20	2.50	3.30	3.30

Source: St.George Banking Group *forecast

We expect an improvement in South Australia's economy so that economic growth lifts to around the trend rate in South Australia, towards the end of the forecasting period. The adjustment within the manufacturing industry and relatively weak population growth are key risks to the outlook. However, the economic outlook in South Australia is improving. Low interest rates are supporting economic growth in the State. Businesses are seeing the benefits flow from the lower Australian dollar and growth in Asia. Agriculture, tourism, education and healthcare are the areas expected to see growth.

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