Tuesday 5 May 2015

ACT Economic Outlook

Summary

- Although the economy of the ACT has diversified over time, it remains heavily influenced by the government sector. The Federal government is the major employer and its purchasing activities impact upon local businesses. The ACT government is also a major employer and controls the release of development land through the ACT Land Development Agency.
- Cutbacks to the public service have dampened consumer confidence in the ACT but it is believed that the worst of the cuts are over. Low interest rates will provide support to consumer spending in the ACT.
- The economy grew at just 0.7% in 2013-14, a step down from the 2.4% growth in 2012-13, and well below the long-run average growth rate of 2.9%. More recent data shows that State final demand is suggesting that growth will remain modest in the current financial year.
- House prices in the ACT rose 1.3% in the year to April. This is less than the 8.3% increase seen on average across the major capital cities. Prices of apartments in the ACT have fallen 2.1% over the year compared to rise of 5.6% across Australia. The decline in unit prices reflects greater supply and modest demand following public sector job cuts.
- Retail spending has witnessed a pickup in the early months of 2015, and points to a further modest improvement in consumer spending in the first half of the year**.** For the year to February, retail sales in the ACT were up 4.4%, compared to an increase of 4.3% Australia-wide.
- A mid-year review of the 2014-15 ACT Budget has revealed an increase in the originally estimated Budget deficit of $332.8 million to $770.5 million driven mostly by the impact of the Asbestos Eradication Scheme. The review estimates that the ACT budget will return to surplus in 2017-18.
- Apart from the light rail project, there are few, if any other major new projects in the ACT engineering construction pipeline. The $600 million Capital Metro light rail project appears to be on track despite some concerns that funding for the reconstruction of the ACT's asbestos related homes might delay its progress. The project has the potential to underpin construction work in the ACT for several years.
- Low interest rates and modest population growth should support consumer demand in the ACT. A plateau in residential construction and the gradual completion of existing major construction projects are expected to hold activity back. However, the health and education sectors are also expected to provide support for the commercial construction sector over the next eighteen months. Positive but sub-trend growth is expected over the next two years.

Economic Growth

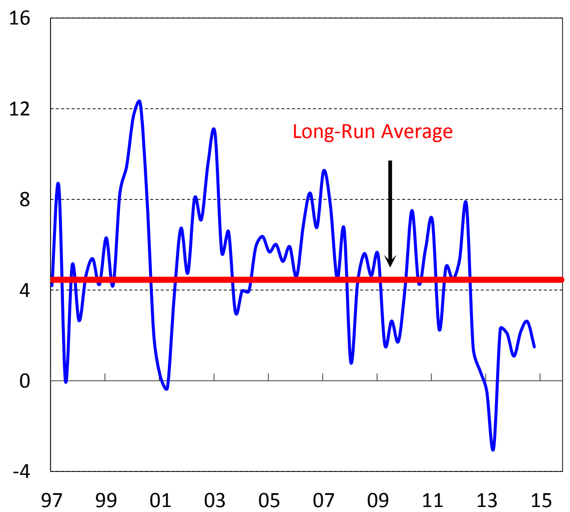
Economic growth in the ACT has been below par in recent times. As the economy is heavily tied to the government sector, public sector job cuts have weighed on economic activity. The cuts to jobs are flowing through to other areas, such as consumer spending. Moreover, the pullback in the public sector has coincided with a downturn in other private sector activity. The housing market in the ACT is moderating at a time when it is strengthening in other States. Meanwhile, business investment has been lacking given a narrowing pipeline of major projects.

The economy grew at just 0.7% in 2013-14, a large step down from the 2.4% growth in 2012-13, and well below the long-run average growth rate of 2.9%. More recent data shows that State final demand is suggesting that growth will remain modest in the current financial year. State final demand grew at an average quarterly pace of 0.6% over the second half of 2014, while annual growth slowed to 1.5% in the year to the December quarter. This annual pace is well below the long-run average of 4.3%, but it was above the Australia-wide annual growth in domestic final demand of 1.2%. Soft domestic demand is occurring across Australia.

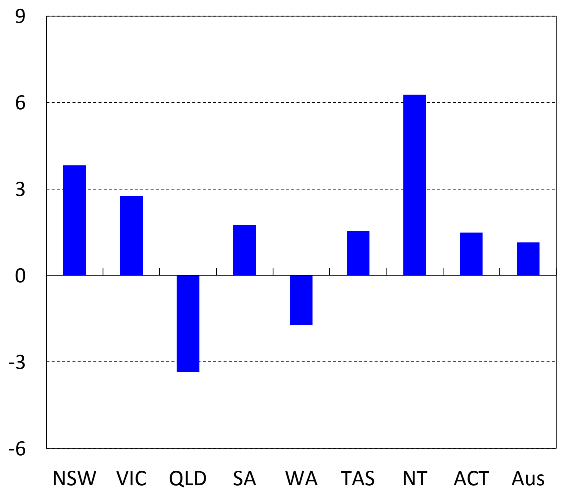
Further tightening measures are in prospect in this year's Federal Budget and would likely continue to weigh on confidence and growth. While this impact will be felt across the nation, the ACT is more sensitive to federal policy decisions. However, the Government has hinted that the bulk of job cuts announced have already occurred, and that further "major changes" are unlikely. There are also some early signs that confidence is starting to return among consumers and the business sector and that spending is gradually improving. Low interest rates are likely to be supportive of growth in the territory. That said, activity within housing and business investment is likely to remain below par.

On balance, we expect that ACT will grow at a modest pace over the next few years. (See page 8 for detailed economic forecasts).

ACT State Final Demand
(% annual change)



State Final Demand
(annual % change, Q4 2014)

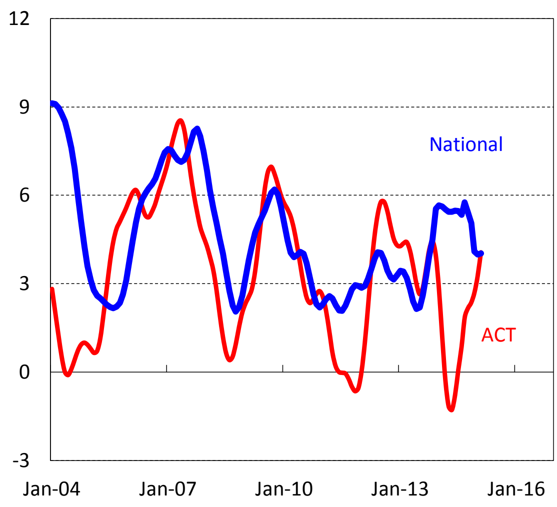


Percentage Shares of the Economy*		
Industries	**ACT**	**Australia**
Public administration and safety	34.5	6.3
Construction	11.3	9.4
Professional, scientific and technical services	10.0	7.3
Education and training	7.9	5.4
Health care and social assistance	6.9	7.6
Financial and insurance services	4.0	9.9
Electricity, gas, water and waste services	3.3	3.1
Accommodation and food services	3.2	2.8
Retail trade	3.2	5.3
Rental, hiring and real estate services	2.9	3.3
Transport, postal and warehousing	2.8	5.3
Information media and telecommunications	2.2	3.3
Other services	1.9	2.1
Administrative and support services	1.7	3.3
Arts and recreation services	1.7	0.9
Wholesale trade	1.3	4.6
Manufacturing	1.2	7.4
Mining	0.1	9.9
Agriculture, forestry and fishing	0.1	2.7

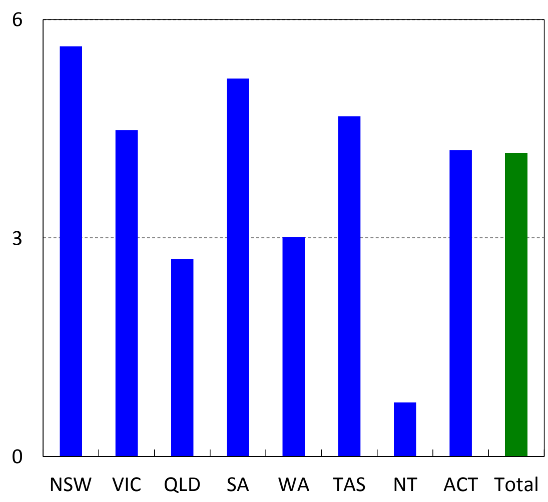
** As % of GSP and GDP less ownership of dwellings 2013-14*

Source: ABS, St.George

Value of Retail Sales
(trend, annual % change)



Retail Sales by State
(Feb 2015, annual % change)



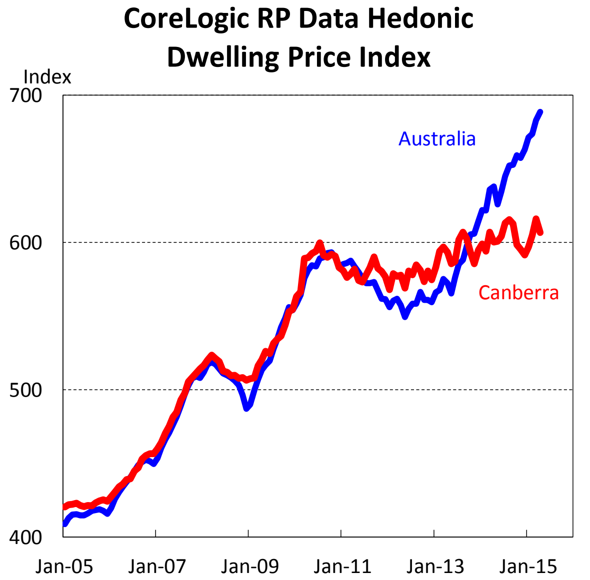
Consumer Spending

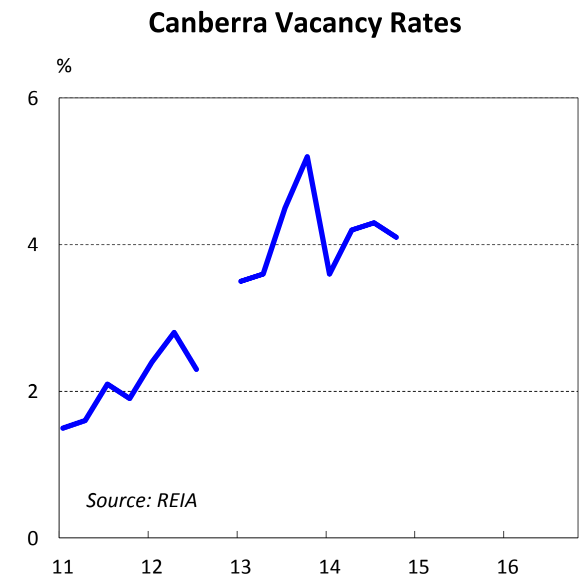
Consumer spending has been weak in the ACT, reflecting a softer labour market and subdued consumer confidence. Annual growth was at just 0.2% in the year to the December quarter. Nonetheless, consumption improved in the second half of 2014, after contracting earlier in the year.

Retail spending has witnessed a pickup in the early months of 2015, and points to a further improvement in consumer spending in the first half of the year. Annual growth (in trend terms) picked up to 4.1% in February, the strongest in 15 months and above its long-run average of 3.8%. Low interest rates and lower petrol prices are likely supporting consumer spending in the ACT.

The question is whether this strengthening in consumer spending can be sustained.

Australian consumer sentiment has been below average for the past year. Sentiment saw a peak with the election of the Coalition government in September 2013 but has broadly declined since then. The latest reading of the Westpac-MI consumer sentiment index was 96.3 and below the 100-benchmark indicating that more consumers are pessimistic than optimistic. There is a risk that still subdued readings of consumer sentiment will temper a recovery in consumer spending. The Westpac-MI index of consumer sentiment does not have a separate measure for the ACT.





Housing

Canberra dwelling prices have recovered from a dip in prices towards the end of 2014 but fell 1.5% in the month of April. CoreLogic RP Data dwelling prices were 1.1% higher than a year ago. Canberra dwelling prices have continued to underperform capital city prices Australia-wide. By comparison, the average of Australian capital cities grew at an annual pace of 7.9% in April, largely driven by prices in Sydney.

Prices of houses in Canberra have performed relatively better than units. House prices were up

1.3% in the year to April while unit prices have fallen 2.1%.

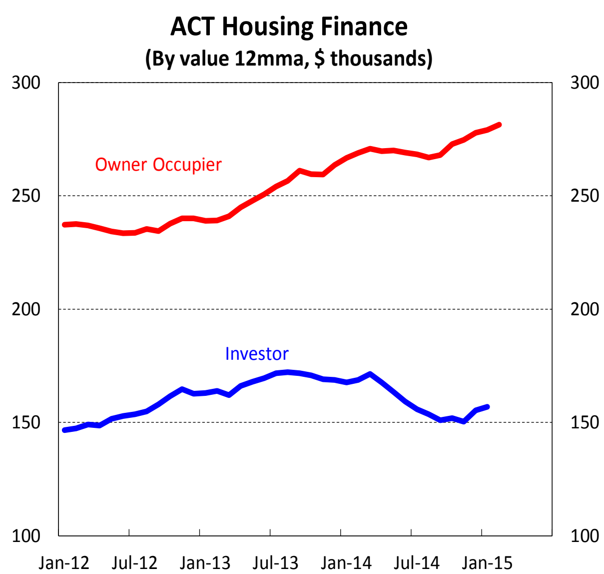
The growth in house prices is an encouraging sign that some confidence is returning to the market. Indeed, home lending has picked up in recent months, particularly among owner occupiers. However, Canberra house prices are likely to continue to trend sideways as they have done over the past few years. Low interest rates will provide support, but there are factors which are weighing on demand.

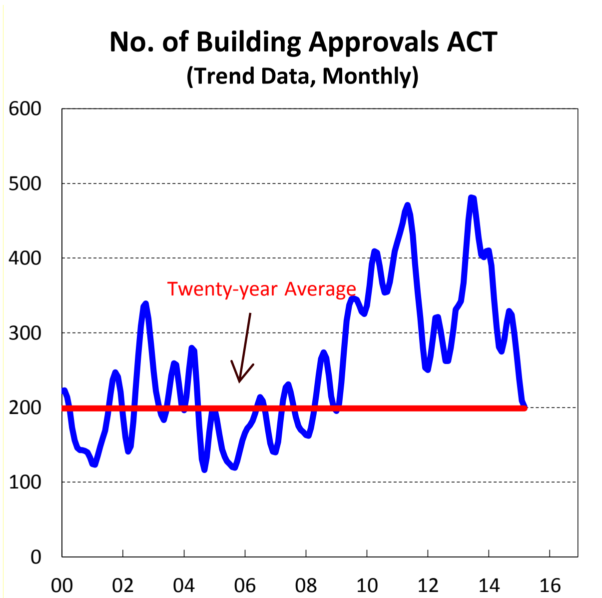
The decline in unit prices likely reflects a mix of increased supply and softer demand following public sector job cuts.

A slowdown in ACT population growth is likely keeping a lid on demand for housing. After annual population growth of 2.0% in in September 2012, the pace of growth slowed to 1.2% in September 2014. Much of the weaker growth in population is due to residents moving interstate, which has gathered pace over the past two years. This boils down to the labour market, where public job cuts have become increasingly evident in recent data.

A period of historically high residential building activity over the past five years has also raised concerns of oversupply, particularly at a time when demand appears to be waning. Rising vacancy rates also suggest demand for rental accommodation is softening.

Vacancy rates in the ACT rose from 3.6% in the March quarter 2014 to 4.1% in the December quarter 2014, according to the Real Estate Institute of Australia. Vacancy rates in 2011 and 2012 were consistently below 3.0% but rose to 5.2% in the December quarter 2013. The vacancy rate in Canberra is exceeded only by those of Darwin (5.4%) and Perth (4.2%) and may be indicative of an oversupply of rental accommodation.



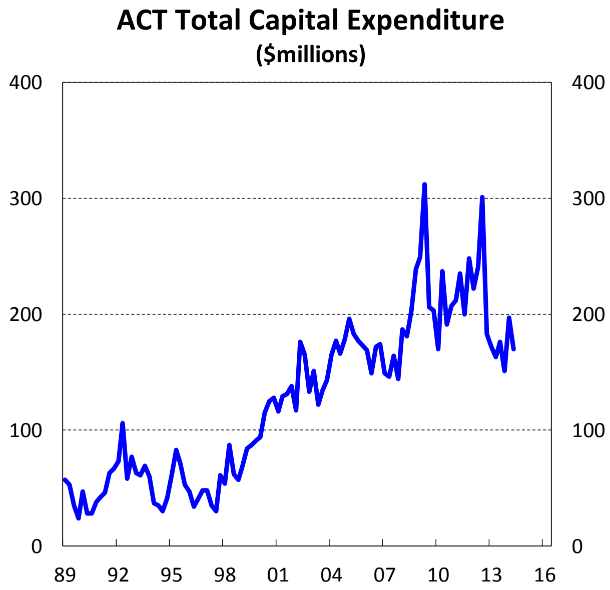


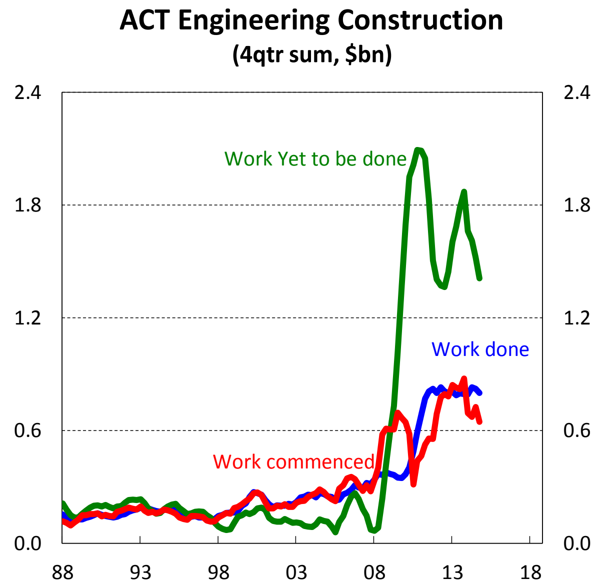
Rising vacancy rates have translated to falling rents. Median rents for a three-bedroom house declined 3.4% over the year to December quarter 2014, while for a two-bedroom ‘other dwelling’ (apartments) rents declined 7.3% over the same period.

Falling rents and rising vacancy rates provide some unfavourable conditions for investors, and unsurprisingly, demand for investor lending has been subdued despite a pick up towards the end of last year.

Further, the underperformance in dwelling prices has resulted in weakening activity within residential construction. Building approvals have trended downwards in the ACT and are now back to their long-run average, and point to some weakness in residential construction. There has been some relatively recent but unfortunate news which should support activity. Over time the reconstruction of around 1000 'Mr Fluffy/asbestos' affected homes will support the residential construction sector.

While the recent recovery in dwelling prices and an uptick in home lending is encouraging, dwelling prices and residential activity will likely remain subdued this year, as weak job prospects and slowing population growth weigh on demand. Nonetheless low interest rates should provide support and keep a floor under prices and activity.





Business Investment

Business investment in the ACT has been flat in recent quarters and the annual pace went backwards in the December quarter, falling 2.0%.

The $600 million Capital Metro light rail project appears to be on track despite concerns that funding for the reconstruction of the ACT's asbestos related homes might delay progress. The project has the potential to underpin construction work in the ACT for several years.

Apart from the light rail project, there are few, if any other major new projects in the ACT engineering construction pipeline.

Within other non-residential building activity, construction work continues at the Australian National University's business and research precinct, a $50 million hotel at Canberra airport and on the IKEA store at Majura Park. The health and education sectors are also expected to provide support for the commercial construction sector over the next eighteen months with projects including the University of Canberra Public Hospital and a new CIT Campus in

Tuggeranong.

Labour Market

The ACT labour market has continued to weaken over the past year. In trend terms, a net 2,300k jobs were lost in the year to March, or 1.1% of ACT's labour force. It was the largest percentage annual decline since March 1997.

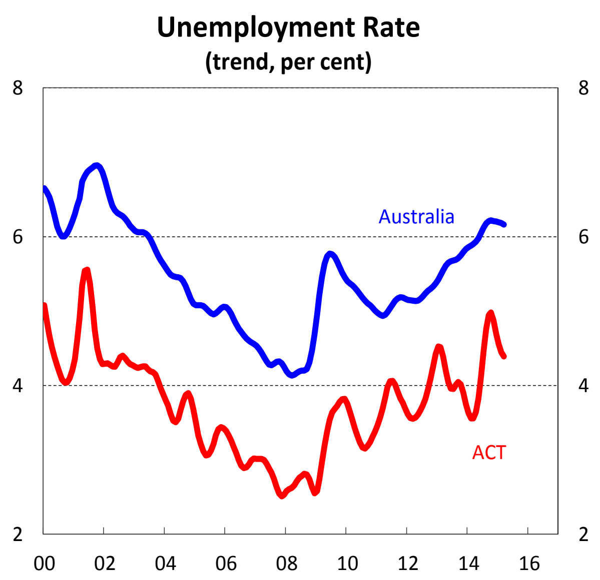
Unsurprisingly, the bulk of job losses are occurring in the public sector. In the year to February, the most job losses were in public administration & safety (-6.6k), followed by accommodation & food services (-3.3k) and administrative & support services (-2.8k). These losses were partially offset by job gains in construction (+3.7k), arts & recreation services (+2.8k) and electricity, gas, water & waste services (+1.5k).

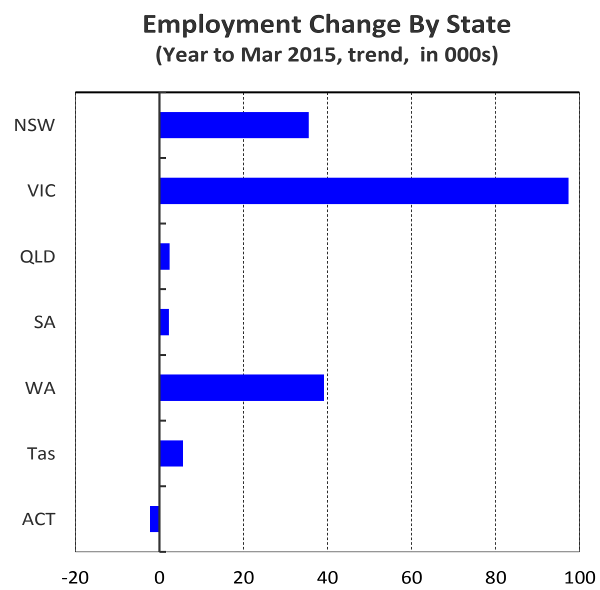
The loss of jobs has resulted in an increase in ACT's unemployment rate. In trend terms, it has lifted to 4.4% in March 2015 from 3.6% a year ago. Nonetheless, the unemployment rate continues to sit well below the national rate at 6.2%.

A positive for the ACT labour market is that the bulk of the public sector job cuts have likely passed. While more cuts to the public sector are possible, recent comments by the Federal Government suggest that further steep budget cuts are unlikely given that the government was approaching its 2017 target to remove 16,500 FTE (full-time equivalent) public service jobs.

That said, there is likely more weakness ahead for the ACT labour market. Pressure to further tighten the Federal Budget in the wake of falling commodity prices indicates that job growth in the public sector will continue to be muted, and could limit opportunities within the private sector. Additional labour demand within the public sector is likely to be met through contractors over the next few years.

The soft outlook for job growth could result in a further lift in the unemployment rate, although a slowdown in population growth would limit any rise.





The 2014-15 ACT Budget Review

The ACT budgetary position was reviewed in December. The original $332.8 million deficit estimated for 2014-15 has increased to $770.5 million driven mostly by the impact of the Asbestos Eradication Scheme. The review estimates that the ACT budget will return to surplus in 2017-18.

The net debt of the ACT government for 2014-15 has been revised upwards from 3.0% of Gross State Product at the time of the Budget to 4.0% at the review. This level is similar to that of South Australia and Western Australia at the time the review was undertaken. The net debt of the NSW government sat at 2.0% while for Victoria it was 6.0%. The ACT, NSW and Victoria continue to hold their AAA credit ratings.

New initiatives listed in the Budget review included $32.8 million of spending over four year for the Community Services Directorate to assist with the care of children and young people; $5.4 million over four years in costs associated with the demolition of the former Mental Health Psychiatric Unit at the Canberra Hospital and savings of $33 million over four years from general government spending with details to be provided in the 2015-16 Budget scheduled to be released on 2nd June.

St.George Banking Group Forecasts

Low interest rates and modest population growth should support consumer demand in the ACT. A plateau in residential construction and the gradual completion of existing major construction projects are expected to hold activity back. However, the health and education sectors are also expected to provide support for the commercial construction sector over the next eighteen months. Positive but sub-trend growth is expected for the ACT economy over the next two years.

The ACT Government is expecting marginally stronger Gross State Product (GSP) growth than our forecasts. They expect growth of 1.5% in 2015-16 and 2.5% in 2015-16. The ten year average of ACT's GSP growth is 3.1%.

St George Banking Group Forecasts:

Economic Indicators, % Change (year average)				
	2013-14	**2014-15 (e)**	**2015-16 (f)**	**2016-17 (f)**
Gross State Product	0.70	1.30	1.40	2.40
State final demand	1.90	1.50	1.90	2.50
Employment	-0.20	-0.90	0.30	1.00
Unemployment rate (year average)	3.80	4.70	4.60	4.60
Canberra CPI	2.20	1.20	2.20	2.50
Wage Price Index	2.80	2.00	2.50	2.90

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