Monday, 25th August 2014

ACT Economic Outlook

Summary

- The economy of the ACT is 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.
- Planned cutbacks to the public service have dampened consumer confidence in the ACT. While short-term 'pain' is expected, growth in the population and the public service over time suggests that the medium term outlook for consumer spending in the ACT remains positive.
- Growth in State final demand in the ACT has been lacklustre over the past year. State final demand declined in the December quarter last year and in the March quarter this year. For the year to March, State final demand in the ACT contracted by 1.4%.
- House prices in the ACT rose 1.7% in the year to July. This is less than the 10.3% increase seen on average across the major capital cities. Prices of apartments in the ACT have risen 4.1% over the year compared to 9.4% across Australia. The more modest growth reflects a better balance of supply and demand as well as some uncertainty among prospective buyers.
- Retail sales have been soft in the ACT, declining for six consecutive months. For the year to June, retail sales in the ACT were down 2.3%, compared to an increase of 5.5% Australia-wide.
- The 2014-15 ACT Budget has moved from surplus to deficit over the past five years. The ACT government expects the budget to return to surplus in 2017-18, two years later than previously expected.
- While there is a handful of engineering construction projects currently underway, most of which are due for completion by 2016, there is little in the way of new projects in the pipeline. The Capital Metro light rail project, worth around $600 million, remains under discussion with preliminary work under way.
- Low interest rates should continue to 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, new ACT government projects, if they all proceed, should help to counteract the decline in existing projects. Positive but sub-trend growth is expected over the next two years.

Economic Growth

Economic growth in the ACT is likely to be modest over the next two years. Public sector job cuts and spending cuts will fall more heavily on the ACT than other States and territories. This, in conjunction with a decline in major engineering and commercial construction projects, will weigh on economic activity in the ACT. Low interest rates and steady population growth will help support the economy, however, economic growth in the ACT is likely to remain modest.

In addition to the potential fiscal tightening measures from this year's Federal Budget, there is the damage to confidence, which will likely be felt more acutely in the ACT. The economic impact of this decline in confidence is more difficult to quantify.

State final demand in the ACT has contracted for two consecutive quarters, declining 0.2% in the March quarter, following a 0.4% contraction in the December quarter of last year. For the year to the March quarter, State final demand in the ACT fell 1.4%, compared to growth in domestic final demand Australia-wide of 1.6% in the year to the March quarter.

Percentage Shares of the Economy*

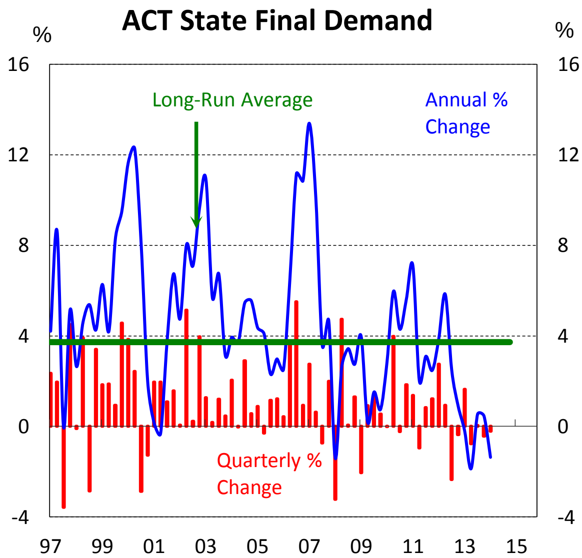
Industries	ACT	Australia
Public administration and safety	33.3	6.0
Construction	11.3	8.8
Professional, scientific and technical services	11.1	7.7
Education and training	7.6	5.3
Health care and social assistance	6.7	7.4
Financial and insurance services	4.1	9.3
Retail trade	3.3	5.3
Accommodation and food services	3.1	2.7
Electricity, gas, water and waste services	2.9	2.9
Rental, hiring and real estate services	2.7	3.0
Transport, postal and warehousing	2.6	5.6
Other services	2.5	2.0
Information media and telecommunications	2.2	3.1
Administrative and support services	2.1	3.4
Wholesale trade	1.5	4.9
Arts and recreation services	1.5	0.9
Manufacturing	1.3	7.9
Mining	0.1	11.2
Agriculture, forestry and fishing	0.1	2.4

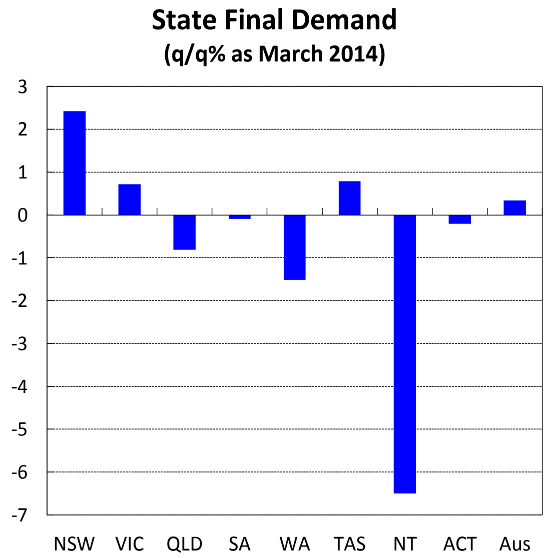
** As % of GSP and GDP less ownership of dwellings*

Source: ABS, St.George

Annual growth in ACT gross State product in 2012-13 was solid at 2.7%, however, this data is now somewhat dated. We will have a clearer picture of how the ACT economy is faring with the release of the 2013-14 gross State product in early September. At this stage we expect growth in 2013-14 to have been weaker at 2.3%.

(See page 8 and 9 for detailed economic forecasts).



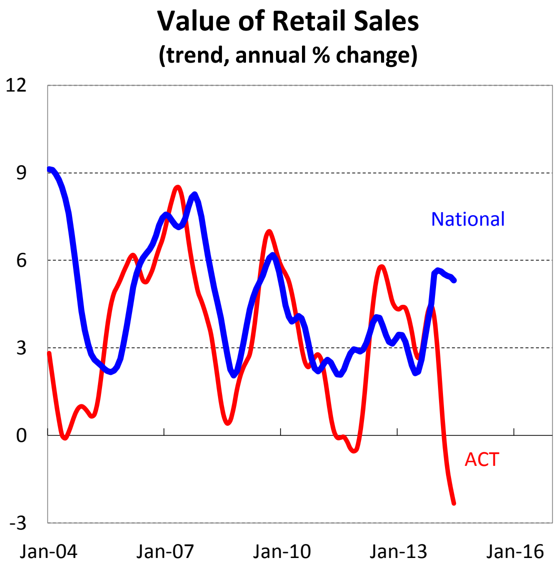


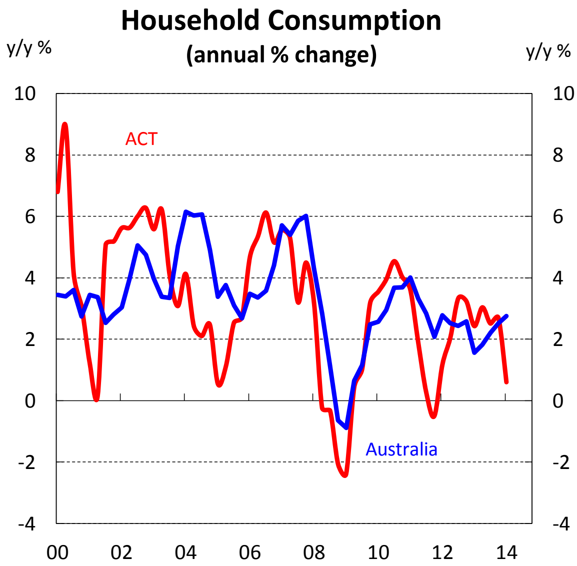
Consumer Spending

Consumer spending in the ACT has softened, with media coverage of the Federal Budget and uncertainty about the job market likely weighing on consumer's willingness to spend. In the March quarter, household consumption in the ACT fell 1.0%, with some discretionary areas of spending, including clothing and footwear (-5.3%), furnishings and household equipment (-5.4%), purchase of vehicles (-4.8%), recreation and culture (-1.7%) and hotels cafes and restaurants (-4.5%) showing declines.

By sector in ACT, the strongest gains in household spending were in electricity, gas and other fuel (4.8%) and health (3.7%).

For the year to the March quarter, growth in household consumption slowed to 0.6%, from 2.4% a year earlier.





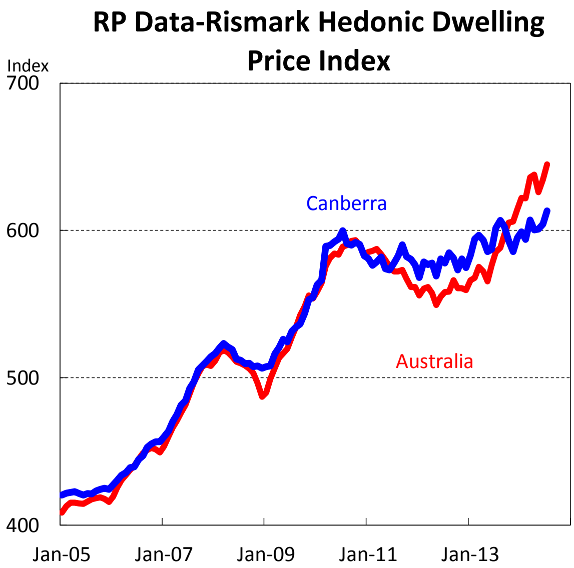
Retail sales have been soft in the ACT, declining for six consecutive months. For the year to June, retail sales in the ACT were down 2.3%, compared to an increase of 5.5% Australia-wide.

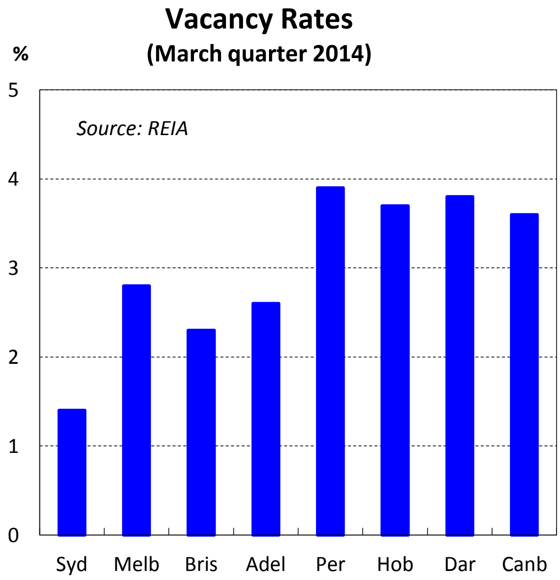
Australian consumer sentiment has declined in recent months, following the release of the Federal Budget, although it was already at fragile levels prior to this. In the year to July, Westpac-MI consumer sentiment fell 7.1% with a reading of 94.9 well below the 100-benchmark, indicating more Australian consumers are pessimistic than optimistic. The decline in consumer sentiment has taken a toll on retail sales in recent months, and it appears that this is exemplified in the ACT, where the job uncertainty from the Federal Budget is also likely to have weighed on consumers.

Housing

Dwelling price gains in Canberra have been more subdued than in other Australian capital cities. Canberra dwelling prices have risen 1.9% in the year to July, compared to a 10.2% increase for the capital city average over the same period. In other data ABS dwelling prices in Canberra rose 0.8% in the June quarter. Annual growth in dwelling prices at 2.2% in Canberra, is the slowest of all the capital cities, according to the ABS measure.

The soft growth in house prices reflects concerns about the outlook for employment, following the Federal Budget. Low interest rates remain a supportive factor for the ACT housing market, given Canberra home owners have the highest proportion of mortgages of all the States and territories.





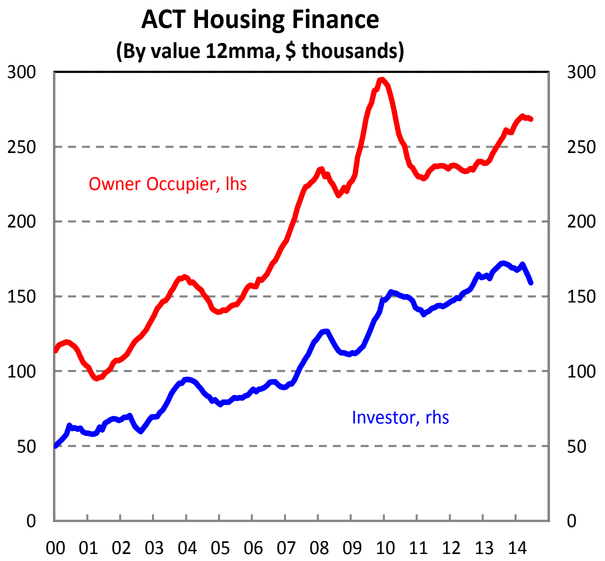
Population growth slowed in the ACT in 2013, from a recent peak of 2.0% in mid-2012, to 1.6% in the year to December 2013. This is slightly below the Australian average population growth of 1.7%, but indicates that population flows have been robust and remain supportive of the ACT housing market. There is a risk that population growth in the ACT slows in the near-term.

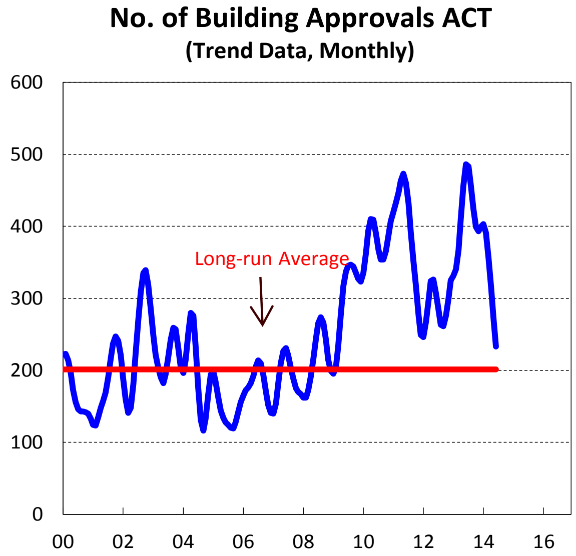
The rental vacancy rate in Canberra has risen over the past year, to reach 3.6% in the March quarter according to the REIA. This compares to the weighted average vacancy rate for Australian capital cities of 2.4% in the March quarter. It suggests that demand for rental accommodation in Canberra is not strong (as a rental vacancy rate below 3% would suggest) and is indicative of a slight oversupply of rental accommodation.

The modest demand for rental accommodation in Canberra has weighed on rents over the past year. Median weekly rents in Canberra for three-bedroom houses have declined 4.3% in the year to the March quarter, while rents for 2 bedroom ‘other dwelling’ fell 6.8% over that period.

Investor demand in Canberra has softened, with investor housing finance falling almost 25% in the year to June 2014. This likely reflects weaker rental markets and uncertainty about the outlook for employment in Canberra.

Owner-occupier demand in Canberra has been stronger than investor demand, although it softened in June, so that owner-occupier housing finance declined 4.8% in the year to June. First home buyers in the ACT, as a proportion of all housing finance, were 12.8% in June. This represents a decline over the past couple of years, as changes to the first home owners grant in the ACT weighed on demand. From September 2013, the grant rose from $7,000 to $12,500, although only new properties, off-the-plan properties or substantially renovated properties are now eligible and not established properties.





Canberra's housing market faces concerns of oversupply. These concerns have intensified given the sale of four greenfield residential development sites worth nearly $19m. An increased supply of new residential construction could weigh on dwelling prices in the ACT.

Dwelling price gains in Canberra are likely to grow at a subdued pace this year, as the impact of low interest rates runs its course and job uncertainty continues to weigh on would-be buyers. That being said, residential building activity has picked up, indicating that low interest rates and stabilising house prices have helped to spur life into residential construction. Investment in new dwellings rose 8.2% in the year to the March quarter. Building approvals in the ACT have been more subdued than in most other States and territories, suggesting the upturn in residential construction activity will slow in the second half of this year.

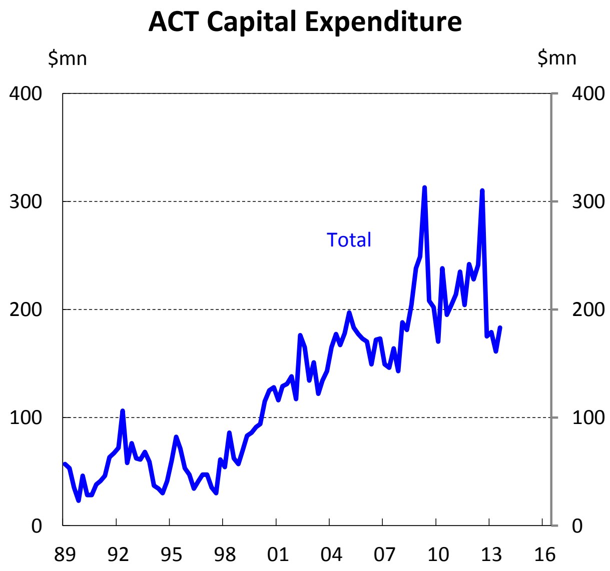
Business Investment

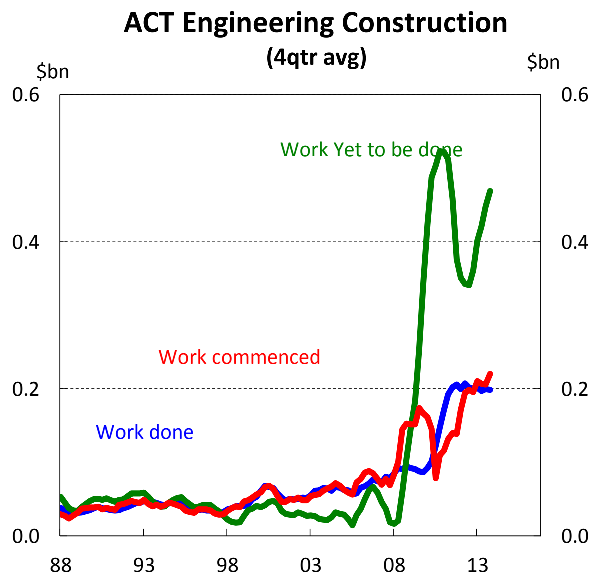
Business investment in the ACT has declined in five out of the past seven quarters. Business investment fell 8.1% in the March quarter, after declining 3.2% in the December quarter last year. For the year to the March quarter, business investment in the ACT has declined 30.0%.

While there is a handful of engineering construction projects currently underway, most of which are due for completion by 2016, there is little in the way of new projects in the pipeline. Activity in the engineering construction sector may be heading for a new low. The Capital Metro light rail project, worth around $600 million, remains under discussion with preliminary work under way. If it proceeds, it would underpin the ACT's engineering construction sector but may at some time place pressure on the ACT budget.

Public sector cutbacks and rising office vacancy rates are presenting little in terms of incentives for the ACT's commercial construction sector. Again there are few new projects in the pipeline, while a number of other projects are fast approaching their completion dates. The refurbishments at the ADFA Campus are almost done and upgrades to the Belconnen Markets are not far behind.

While private business investment is relatively subdued, the public sector is taking up some of the slack with projects including the University of Canberra Public Hospital and a new CIT Campus in Tuggeranong.





Labour Market

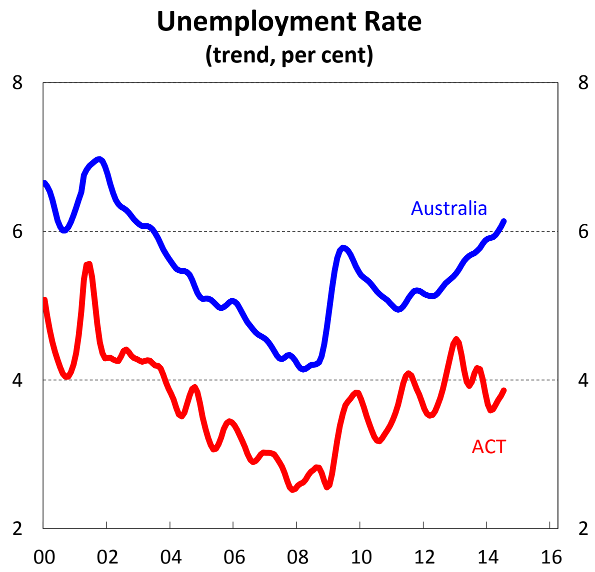
According to the Canberra based Australian Bureau of Statistics (ABS), the labour market in the ACT has picked up marginally the six months to July. In trend terms, 1000 jobs have been created and employment stands at an all-time record of 215,000. Of the total, 158,900 are full-time and 56,000 are part-time.

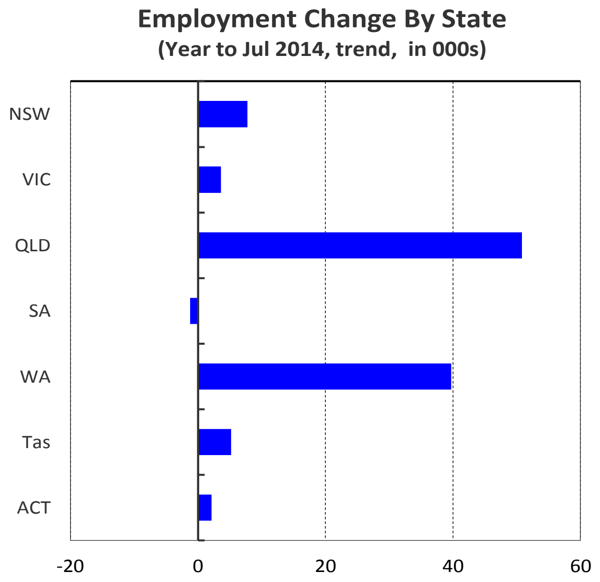
Despite the pick-up in jobs, the unemployment rate in the ACT has been climbing since May as growth in the labour force outpaces the growth in jobs. The ACT unemployment rate still remains low, however, with a trend rate of 3.9% in July, compared to a trend rate of unemployment of 6.1% nationally.

Cut-backs announced by the previous Federal government were expected to reduce the public service by around 14,500 people. The most recent Federal Budget saw that number increased by around 2,000. However, delays in the passage of the Budget through parliament, and possible amendments, suggest that the later number could be reduced.

While not all the reductions in public service numbers will occur in the ACT, the loss of public sector jobs (and the flow on effects throughout the economy) will dampen activity.

As of May 2014, 32.9% of the ACT workforce was employed in 'public administration and safety. This is well up on the 23% reported in the early 2000s but down on a recent peak of 34% in November 2013.





The 2014-15 ACT Budget

The ACT budgetary position has deteriorated over the past five years. From a surplus of $148 million in 2009-10, the budget has moved to an expected deficit of $333 million for 2014-15. Over that period net debt is estimated to have risen from negative $938 million (a surplus) to a debt of $1228 million.

The ACT government expects the Budget to return to surplus in 2017-18. The budget speeches of 2012-13 and 2013-14 expected a surplus to be achieved by 2015-16.

The reasons behind the 2014-15 Budget deficit include major spending on ACT infrastructure, reductions in earnings from financial investments, increased borrowing costs resulting from increased debt and substantial increases on supplies and services.

Infrastructure spending includes the Capital Metro light rail project, the University of Canberra Public Hospital and a new CIT Campus in Tuggeranong.

Despite concerns expressed by the Centre for International Economics that financing for the Capital Metro project places the ACT's financial position at risk, the rating agency, Standard and Poor's has said that it does not expect to downgrade the ACT government's triple-A rating.

St.George Banking Group Forecasts

Low interest rates should continue to 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, new ACT government projects, if they all proceed, should help to counteract the decline in existing projects.

The ACT Government is expecting marginally stronger Gross State Product (GSP) growth than our forecasts. They expect growth of 1.8% in 2014-15 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)				
	2013-14e	**2014-15 (f)**	**2015-16 (f)**	**2016-17 (f)**
Gross State Product	2.30	1.60	2.30	2.30
State final demand	-0.50	0.70	2.00	2.10
Employment	0.60	0.40	0.50	1.00
Unemployment rate (year average)	3.90	4.30	4.50	4.60
Canberra CPI	2.20	2.30	2.50	2.50
Wage Price Index	2.70	2.60	3.10	3.50

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