Wednesday, 28 October 2015

NSW Economic Outlook

Summary

- There continues to be a positive outlook for the NSW economy. NSW benefits significantly from low interest rates, with the low Aussie dollar also lending a helping hand.
- While NSW may have felt like it was standing on the sidelines in the mining investment boom, the ongoing transition in Australian economic growth to other sectors is a boon for NSW. We expect solid economic growth in coming years.
- The residential housing market in NSW has remained vigorous this year, driven by low interest rates, a rising population and foreign demand. The debate surrounding strong growth in house prices has heated up recently, particularly given a lift in interest rates from the banks. There are tentative signs that investor demand has cooled slightly.
- Dwelling price gains in Sydney in the year ahead seem likely to be more moderate than those seen over the past twelve months, given the strong run up in prices over recent years.
- Above average levels of building approvals will ensure healthy levels of home construction in NSW this year. These will help boost economic activity and ease the undersupply of housing in the State.
- The outlook for engineering construction is positive, boosted by a solid pipeline of road and rail infrastructure by the NSW State Government.
- The NSW labour market is in relatively good shape (considering economic growth remains below trend). The NSW labour market has continued its strong run of job growth, with the pace of growth picking up in recent months. Greater job security for those employed is supportive of consumer spending, although lacklustre wages growth limits consumer spending power.

Economic Growth

There continues to be a positive outlook for the NSW economy, which benefits significantly from the low interest rate environment, with the low Aussie dollar also lending a helping hand. Demand for housing has risen sharply as a result, and Sydney's housing market has become a widely discussed topic. Rising house prices have in turn helped to support the economy through residential construction and consumer spending and this has been reflected in a pick-up in employment growth in NSW.

Percentage Shares of the Economy*		
Industries	**NSW**	**Australia**
Financial and insurance services	15.1	9.9
Professional, scientific and technical services	8.7	7.5
Manufacturing	8.4	7.5
Health care and social assistance	7.5	7.6
Construction	6.2	9.4
Public administration and safety	6.1	6.3
Education and training	5.6	5.4
Transport, postal and warehousing	5.5	5.6
Retail trade	5.3	5.3
Wholesale trade	4.8	4.6
Information media and telecommunications	4.6	3.3
Administrative and support services	4.2	3.3
Rental, hiring and real estate services	3.9	3.2
Mining	3.2	9.6
Accommodation and food services	3.2	2.7
Electricity, gas, water and waste services	2.9	3.2
Other services	2.3	2.1
Agriculture, forestry and fishing	1.5	2.7
Arts and recreation services	1.2	0.9

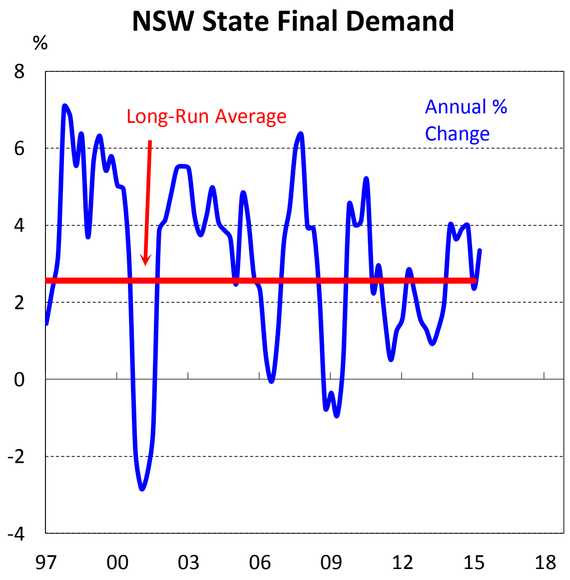
** As % of GSP and GDP less ownership of dwellings 2013-14*
Source: ABS, St.George

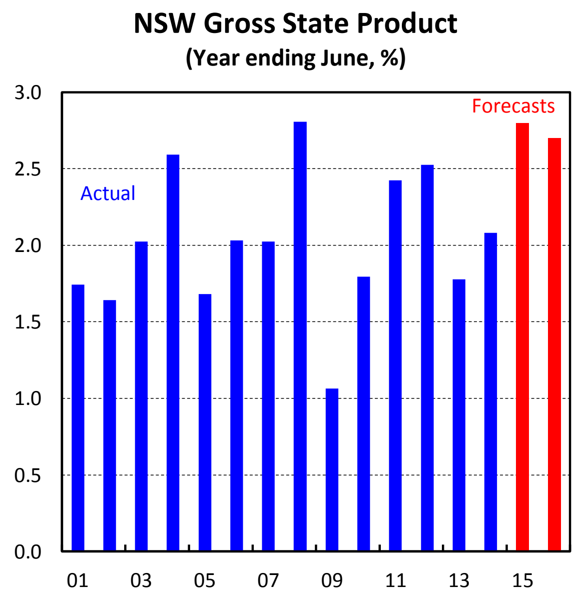
In 2013-14, the NSW economy grew by 2.1%, just above the 10-year average of 2.0%, and appears on track for stronger growth in coming years (with gross State product for 2014-15 due for release later this year).

State final demand grew at the solid pace of 0.9% in the June quarter for annual growth of 3.3%, which is well above the long-term average of 2.6%. This is expected to remain solid in coming quarters.

NSW is experiencing a lift in retail spending, strong levels of residential construction and there is a strong pipeline of investment projects. Low interest rates and rising house prices are supporting growth in the State. Tourism, international education, wealth management and agribusiness have been considered as potential areas of strong growth. Many of these sectors have a strong presence in the NSW economy and NSW has the potential to take advantage of these key growth areas.

While NSW may have felt like it was standing on the sidelines in the mining investment boom, the ongoing transition in Australian economic growth to other sectors is a boon for much of NSW.





Consumer Spending

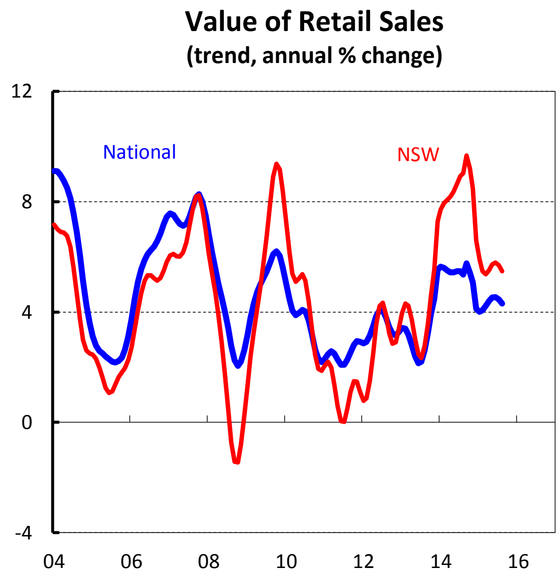
The pace of growth in retail sales in NSW has slowed from the 9%-plus growth experienced in the second half of last year. However, with growth of 5.5% in the year to August in trend terms, growth in NSW retail sales is above its long-term average and compares favourably to the other States and territories.

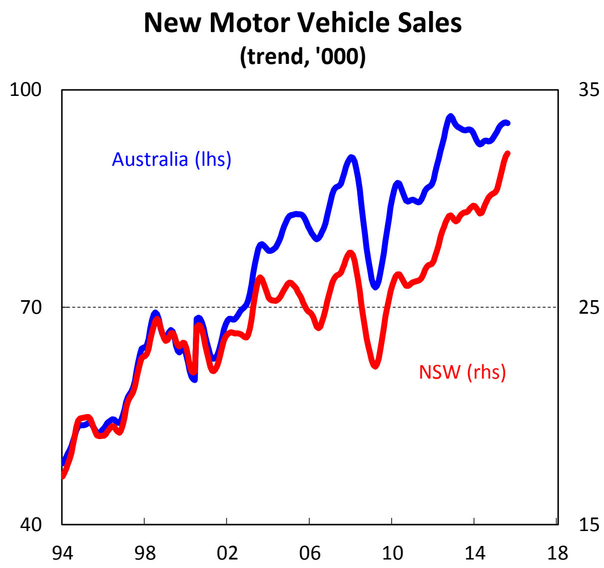
Low interest rates have had a greater impact in NSW where house prices and mortgages are largest. Interest rates should remain historically low over the coming year. The labour market is in relatively good shape (considering economic growth remains below trend). Greater job security for those employed is supportive of consumer spending, although lackluster wages growth limits consumer spending power. A positive wealth effect from rising house prices has been supportive for consumer spending, particularly in NSW where house price gains have outpaced other States and territories. As house price gains level off over the coming year, the impact of this will lessen.

Sales in some sectors have been very strong. In the year to August, spending on electrical and electronic goods rose 17.4% and spending on hardware, building and garden supplies retailing rose 15.8%, likely reflecting the impact of the stronger housing market. Other sectors not directly related to the housing sector have also shown strong gains, including sales of footwear and other personal accessories (up 18.5%). Spending on takeaway food services continues to grow, rising 12.6% in the year to August. These sectors have likely benefited from low interest rates. The worst performing sector over the year to August was newspaper and book retailing (-10.6%), possibly reflecting competition from online and offshore providers.

The overall strength of retail spending in NSW is exemplified by the real quarterly volume of sales i.e. sales adjusted for inflation. Retail sales volumes rose 4.6% in the year to the June quarter in NSW, which is well above the long run average of 2.9%.

Sales of motor vehicles are a significant portion of consumer spending. NSW has seen strong growth in vehicles sales since 2011 with the monthly average of sales rising from 26,315 in 2011 to 31,169 during 2015 so far, hitting a record high in June 2015. Over the twelve months to August, NSW motor vehicle sales have increased 6.7%, compared to 2.1% nationally.





Consumers have been relatively upbeat in NSW according to the Westpac-Melbourne Institute survey of consumer sentiment. The index for NSW has hovered around 100 for the past four months, and at a reading of 101.7 in October, signals consumers are slightly more optimistic than pessimistic. This compares favourably to consumer sentiment Australia-wide, which has loitered below 100 for four consecutive months. The buoyant housing market, improvement in the labour market and the low interest rate environment are helping to boost the mood of NSW residents.

Looking ahead, it seems likely that interest rates will remain low, construction levels will remain firm in NSW and the labour market is likely to remain solid, giving some support to consumer spending in the year ahead. Growth in consumer spending, however, is likely to be capped by slow wages growth, lower population growth and easing growth in house prices.

Housing

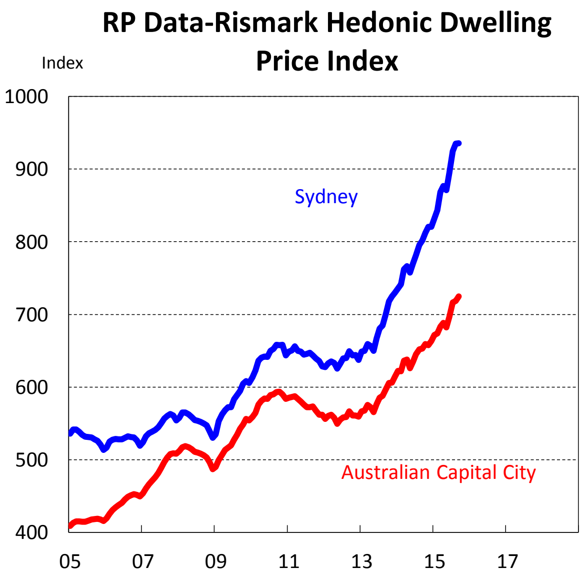
The residential housing market in NSW has remained vigorous this year, driven by low interest rates, a rising population and foreign demand. Sydney has the highest house prices and largest mortgages of all capital cities. As such, the NSW housing market has been the greatest beneficiary of historically low interest rates.

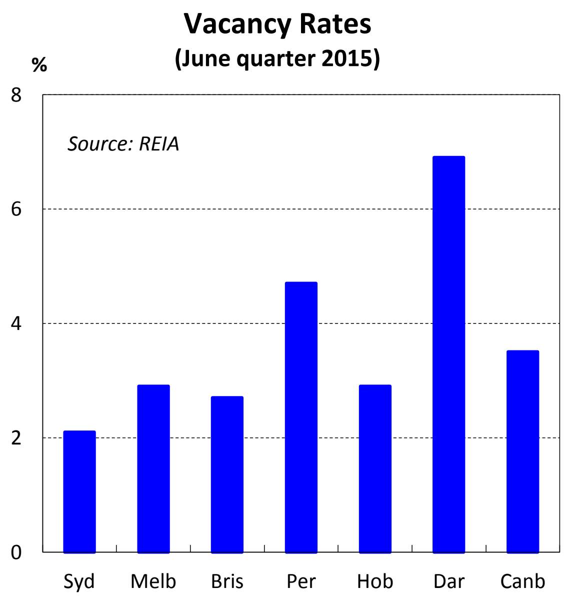
According to RP Data Corelogic, Sydney dwelling prices were up 16.7% in the year to September. Although this is down from a cyclical peak of 18.4% in the year to July 2015, it remains strong and lifted from an increase of 13.7% in the year to January. While strong growth in house prices provides a positive wealth effect for home owners, the impact on non-owners is negative and the standout growth in certain markets has complicated the Reserve Bank of Australia's job.

The debate surrounding strong growth in house prices has heated up recently, particularly given a lift in interest rates from the banks. Concerns had particularly centred on lending to investors and there is now some tentative evidence that APRA's measures are working and that growth in bank lending to investors is slowing.

There has been a significant shortfall in dwellings in NSW in recent years, impacting prices, with the negative impact being felt strongly by those endeavouring to enter the market. While the recent surge in residential construction will only partially dent the shortfall, we have seen a move in the right direction. In the year to the June quarter 2015, there were almost 53.6k new homes built in NSW. This is greater than the needs of NSW's new population over the year to the March quarter 2015. The population in NSW rose by 101.1k in the year to the March quarter 2015 (with around 2.6 people per household according to the 2011 Census). However, considering that dwellings in NSW have been in shortage for many year, due to rapid population growth and weak home building, there remains a shortage. While home construction has accelerated in the past three years and surpassed recent population growth, there remains an overhang from previous years. Hence, the shortage and hence the upward pressures on prices.

These factors would suggest that house prices in Sydney are not primed for a large fall in the near-term, although a levelling off in growth is likely. Evidence of tempering demand includes the auction clearance rate in Sydney, which has fallen to 63.7% in the latest week, from a recent high of 89.7% in late April.





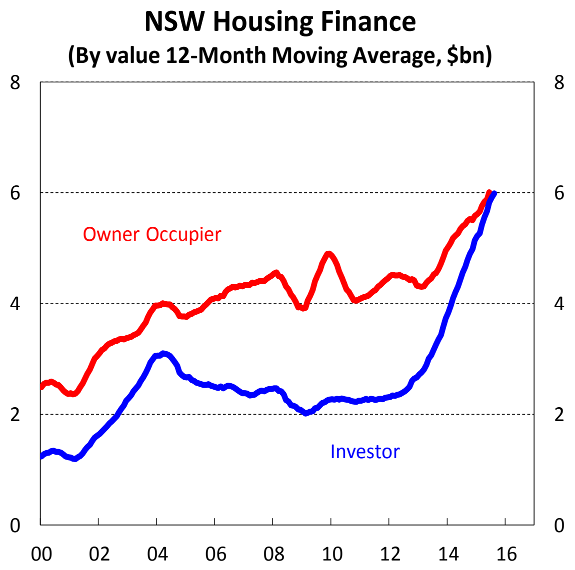
The shortage of housing has contributed to low rental vacancy rates in Sydney. Vacancy rates have risen over the past year, but rental markets remain tight. The Sydney vacancy rate stood at 2.1% in the June quarter 2015, and continued to be the lowest vacancy rate of all the capital cities. This was up from 1.9% in the March quarter and 1.7% in the December quarter last year. However, the vacancy rate remains very low, given vacancy rates below 3% are indicative of tight rental markets and strong demand for rental accommodation (although below 2% is considered very tight). Sydney median weekly rents for 3-bedroom houses in the year to the June quarter 2015 lifted 2.2% to $460, while rents for 2-bedroom other dwellings rose 1.0% to

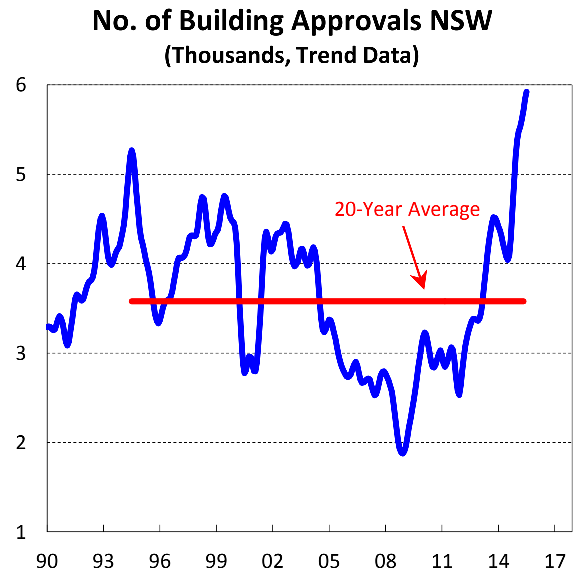
$500 (although this was down from $520 in the March quarter).

Investor demand for housing in NSW has picked up strongly in the past three years suggesting that investors have been encouraged by attractive rental yields, a low interest rate environment and rising house prices, although yields have fallen recently. Tight rental markets continue to suggest strong demand for rental accommodation. The Australian Prudential Regulation Authority (APRA) placed additional restrictions on growth in lending to investors in December last year, and there are tentative signs this is having an impact on investor demand. Loans to property investors in NSW rose 17.7% in the year to August, however, this is down from 40.2% growth in the year to May. Investor loans made up 43.9% of all property lending in August, down from more than 50% a few months earlier.

Owner-occupier demand for housing remains strong and the number of owner occupier loans rose 19.0% in the year to August, to its highest since July 2003. This is up from annual growth of 3.8% in the year to August 2014.

Rising prices and changes to State government policy have held back the reported number of first-home buyers in NSW. First-home buyers in NSW as a percentage of all dwellings financed were 12.2% in August 2015, which is not far above the record low of 9.3% in July 1991. While affordability remains an issue for first home buyers, it is likely some first-home buyers have become housing investors and do not appear in 'first-home buyer' statistics, thus 'muddying' the statistics.





Dwelling price gains in Sydney in the year ahead seem likely to be more moderate than those seen over the past twelve months, given the strong run up in prices over recent years. While demand remains strong, investors are seeing yields decline as prices rise and the short-term outlook for capital gain appears less certain than a year or two earlier.

Above average levels of building approvals will ensure healthy levels of home construction in NSW this year, which will help boost economic activity and ease the undersupply of housing in the State.

Business Investment and Infrastructure Spending

Private capital expenditure has strengthened over the past year. In NSW private capex is up 10.0% over the year to the June quarter, in contrast to the 10.5% decline nationally over the same period. Over the year to the June quarter, in addition to dwelling investment, non-dwelling construction and investment in machinery and equipment have supported economic growth.

Overall business investment in NSW (which is more broad than capital expenditure) weakened by 3.5% in the year to the June quarter. This was driven by a decline in new engineering construction, which fell 26.9% in the year to the June quarter and is down 48.4% from a recent peak in September 2012. The outlook for engineering construction in NSW, however, is looking more promising.

A weak recovery in non-mining investment across Australia poses some concern for business spending in NSW. However, there are a healthy number of projects that will keep activity at an elevated level, including commercial construction and infrastructure projects.

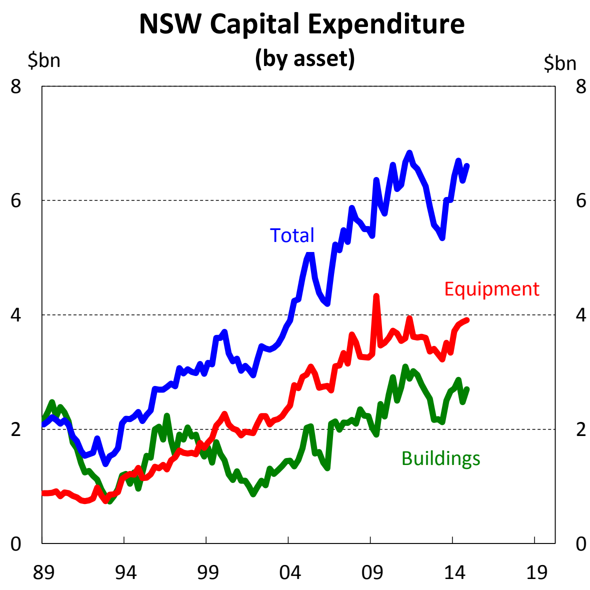
The most notable project within commercial construction continues to be Barangaroo, worth $6bn, which will underpin activity over the next few years. Other large projects include the Darling Harbour Live project, which includes the new Sydney Convention and Entertainment Centre worth $900mn and a new hotel worth $250mn.

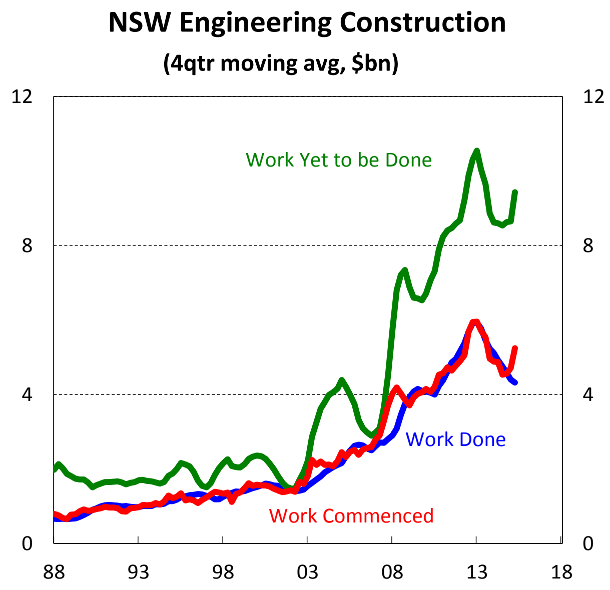
The 2015-16 NSW State Budget approved $5bn for hospital upgrades, redevelopments and expansions across the State, including the Blacktown, Mt Druitt and Lismore Hospitals. Much of the big money is within infrastructure spending or engineering construction. In the NSW State Budget, the State government allocated $68.6 billion in funding for infrastructure spending over the next four years. This will be spent on previously announced road and rail projects.

Transport projects include the $8.3bn North West Rail link. The WestConnex road project is the largest project in the pipeline, linking Sydney's M4 and M5 motorways through to the Sydney CBD and Sydney Airport. It is estimated to be worth around $15.4 billion. Work on Stage 1, which includes the M4 widening, has commenced, and will take around 10 years to deliver in 3 stages. In addition, planning and pre-works are underway for NorthConnex, which is worth $3 billion (and partly privately financed) and will link the M1 and M2.

Within the mining sector, falling commodity prices are taking their toll on the investment outlook. The pipeline of projects has continued to dwindle, according to official estimates. There were six mining projects at the committed stage of development as of April 2015 worth $2.5bn. This was down from seven projects worth $2.8bn in October 2014. These are projects which have received final investment approval or are currently under construction. The large fall in thermal coal prices and the risk that prices will remain muted suggests a weak outlook for future resources and energy projects within NSW.

New South Wales is expected to still fare relatively well as the pipeline of mining projects decline. The amount of investment outside of mining in New South Wales has historically been much larger than investment within the mining sector. Encouragingly, confidence among businesses in the State has improved, helped by low interest rates, a weaker currency and a more palatable Federal Budget this year. Confidence among NSW businesses is now at its highest since the record high reach in the December quarter 1994 and should support the medium-term outlook for investment.





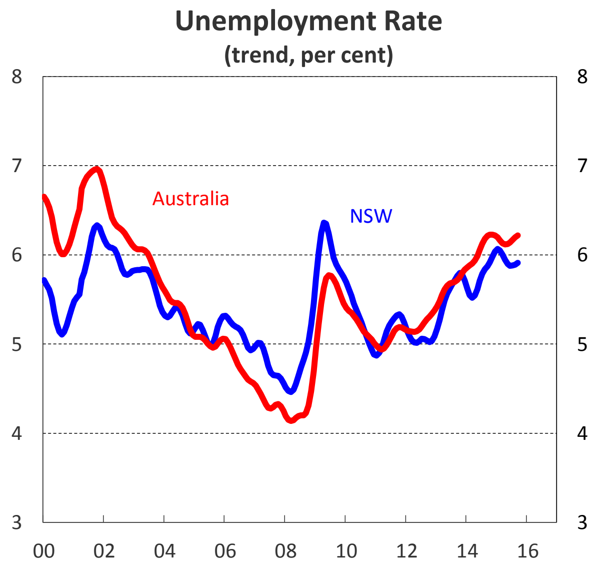
Labour Market

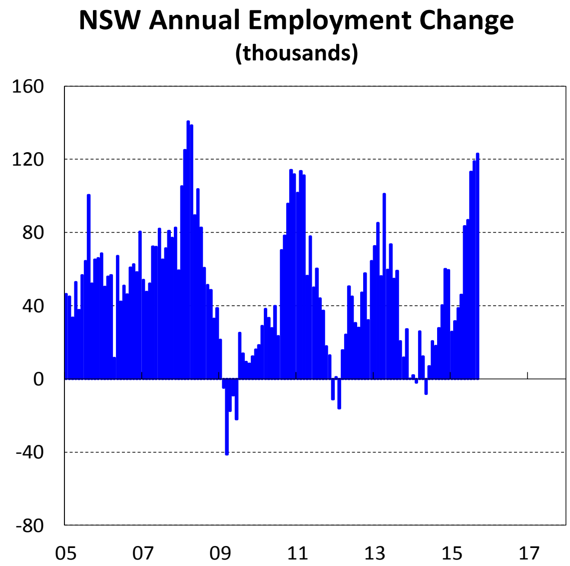
The NSW labour market continued its strong run of job growth, with the pace of growth picking up in recent months. In the year to September, the NSW economy added 123k jobs, the largest annual gain since April 2008. Jobs growth has lifted to 3.4% in the year to September, the highest since November 2010 and well above the 2.0% rate nationally. The good news on the employment front has lifted the NSW workforce participation rate to above 64% in recent months, although it still remains below that of many of the other States.

Solid job gains have resulted in the unemployment rate edging down from a recent peak of 6.2% in February to 5.9% in September, the lowest unemployment rates of all the States. It sits below the nationwide unemployment rate of 6.2%.

In the year to August in NSW, job gains have been concentrated in professional, scientific & technical services (50.8k), healthcare & social assistance (46.3k) and administrative & support services (20.2k). These services industries appear to be benefiting from low interest rates.

Strengthening activity within housing construction and a more promising outlook for investment in infrastructure, commercial construction and the services sector suggests that employment should continue to grow solidly.





St.George Banking Group Forecasts

The NSW economy is set for solid economic growth in coming years. Low interest rates and solid population growth are expected to support dwelling investment. Further private and public spending on road and rail infrastructure will ensure employment growth and retail spending remain strong over the coming year. We expect that NSW gross State product (GSP) will pick up to 2.8% in 2014-15 (with the data due for release later this year) and will reach 2.7% in 2015-16.

Economic Indicators, % Change (year average)				
	2014-15 (e)	2015-16 (f)	2016-17 (f)	2017-18 (f)
Gross State Product	2.80	2.70	2.70	2.60
State final demand	3.40	2.80	3.00	3.10
Employment	1.30	2.80	1.60	1.50
Unemployment rate (year average)	5.90	6.00	5.90	6.00
Sydney CPI	1.90	2.50	2.50	2.50
Wage Price Index	2.30	2.50	2.60	2.70

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