Wednesday, 21 October 2015

QLD Economic Outlook

Summary

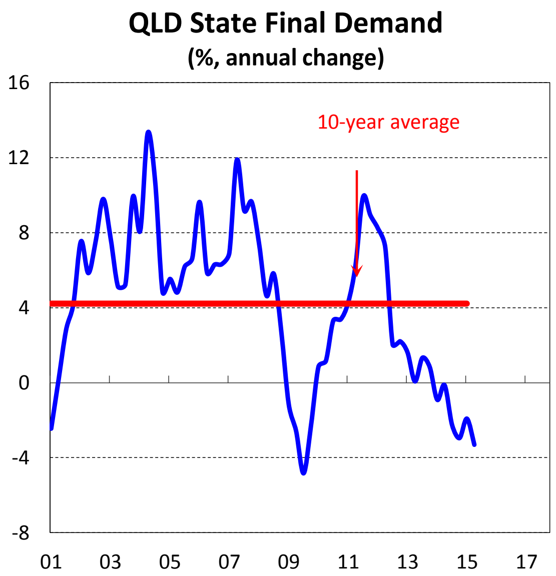
- Queensland's resources-boom induced growth hit a speed hump in 2013-14, with resource-related investment now declining and subdued government spending.
- Growth in Queensland is expected to remain below its long-run average in 2014-15 (data to be released later this year) as investment declines more sharply. However, growth is expected to improve in 2015-16, although the contribution of exports to growth is dependent on the outlook for export prices, particularly LNG prices.
- The significant drop in commodity prices in recent times has weighed on economic growth in Queensland. Lower commodity prices have dampened the outlook for business investment. The fall in coal and oil prices (which impact LNG) over the past year have already had an impact and will continue to do so over the coming year.
- Prospects for industries outside of coal and LNG are improving, if only gradually. The lower Australian dollar is seeing confidence return to the tourism industry.
- Low interest rates and the weaker Australian dollar are providing support to household spending although slow wages growth is limiting the ability of consumers to lift their spending.
- Australia's housing upswing has waned in recent months and that trend will likely continue. House prices should still register growth this year, albeit it at a slower pace. Dwelling prices in Brisbane have lagged behind Sydney and Melbourne, as is traditionally the case.
- Employment has grown at a moderate pace in Queensland, allowing the unemployment rate (in trend terms) to ease to 6.3%. This is an improvement, although it remains slightly above the national unemployment rate.

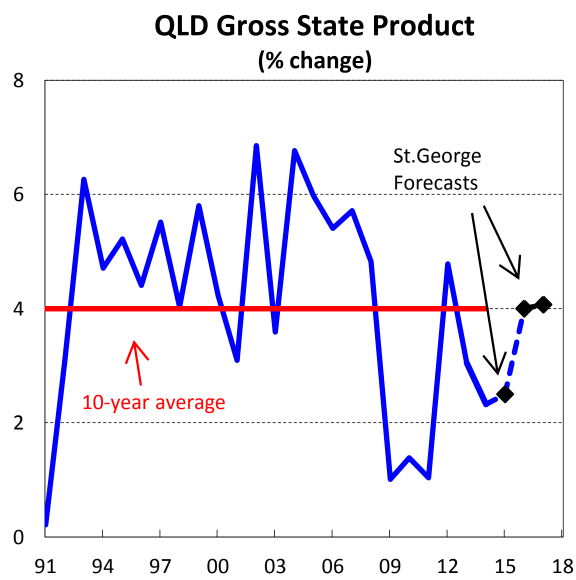
Percentage Shares of the Economy*		
Industries	**QLD**	**Australia**
Construction	11.4	9.4
Mining	10.8	9.6
Health care and social assistance	8.3	7.6
Manufacturing	7.2	7.5
Public administration and safety	6.7	6.3
Transport, postal and warehousing	6.7	5.6
Financial and insurance services	6.6	9.9
Professional, scientific and technical services	5.9	7.5
Wholesale trade	5.6	4.6
Retail trade	5.3	5.3
Education and training	5.2	5.4
Electricity, gas, water and waste services	3.7	3.2
Rental, hiring and real estate services	3.2	3.2
Accommodation and food services	3.0	2.7
Agriculture, forestry and fishing	2.7	2.7
Administrative and support services	2.5	3.3
Other services	2.3	2.1
Information media and telecommunications	2.2	3.3
Arts and recreation services	0.7	0.9

** Share of gross value added less ownership of dwellings 2013-14; Source: ABS, St.George*

Economic Growth

Queensland's resources-boom induced growth hit a speed hump in 2013-14, with mining investment declining and subdued government spending. Gross State Product in Queensland grew at 2.3% in 2013-14 after growth of 3.1% in 2012-13. The pace of growth has is now below the long-run average growth rate of 3.6%. The 2014-15 Gross State Product figures are due later this year and we expect growth of 2.5%.



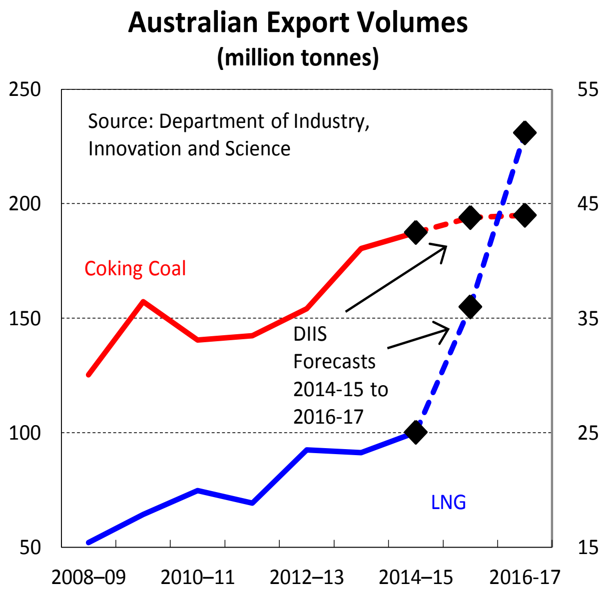


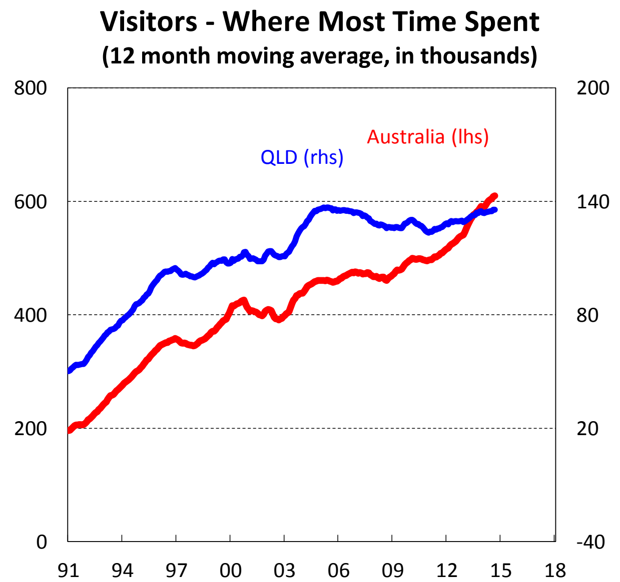
More recent data suggests that the downturn in business investment is accelerating, and is providing a bigger drag on growth. State final demand in Queensland contracted 0.8%, the fourth consecutive quarterly decline. It has contracted 3.3% in the year to the June quarter, the lowest annual growth since the September quarter 2009 in the aftermath of the GFC. Remember, however, that State final demand data does not include exports, which would boost Queensland's bottom line as projects from the resource based investment boom come on line and begin production.

As new projects have moved into the production phase, resource based investment has slumped sharply, although not unexpectedly. Curtis Island LNG began production in December 2014, Gladstone LNG began this month and the Australia Pacific LNG plant is scheduled to go into production in coming weeks. In Queensland, three major LNG projects have boosted economic activity in recent years. The remaining project have is due for completion this year, which will leave resources based investment severely reduce compared to the hive of activity seen in recent years.

The solid increase in the volume of LNG exports will be a major driver of growth for Queensland, although prices are likely to weigh on values. The significant drop in commodity prices in recent times will pose a major challenge for Queensland and Australia. Coal and oil prices have fallen significantly over the past year, indicating that mining investment will continue to decline further from here and that less income will be gained from commodity exports.

Prices of Queensland's other major export, coking coal, has also declined over the past year, reflecting slowing demand for steel making in China. The price has stabilised in recent months following the closure of some producers, resulting in a more balanced market. However, the risk of a further drop in prices remains. Despite falling prices and the closure of some producers, the production of Australian coking coal (the bulk of which is within Queensland) is expected to increase this year according to the Department of Industry, Innovation and Science's Resources and Energy Quarterly in September. Increased production at existing operations is expected to more than offset mine closures in Australia.

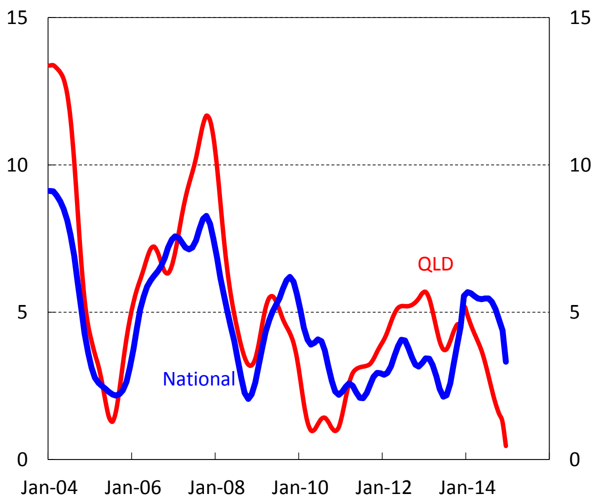




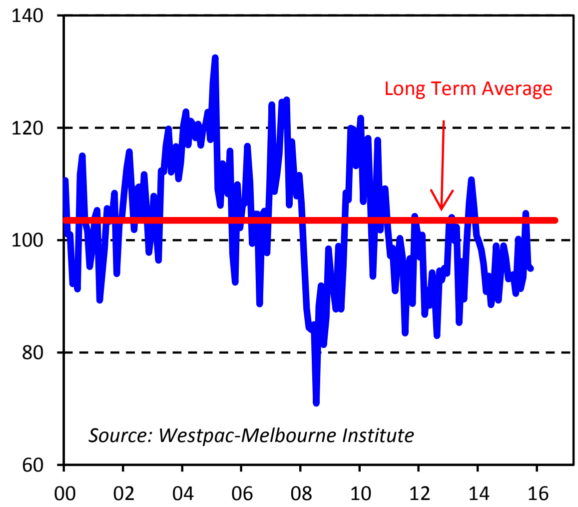
Exports are set to contribute significantly to growth in Queensland in coming years. However, downward pressure on commodity prices will continue to weigh on the mining sector and incomes more generally. A major positive is that there is increasing support to growth from the weaker Australian dollar and low interest rates. These will assist Queensland's tourism sector, housing and consumer spending. Overseas visitors to Queensland have been gradually increasing, although to a lesser extent that to other States. Overseas arrivals to Queensland have now been surpassed by overseas visitors to Victoria. Additionally, Queensland continues to experience its worst drought on record, with 80 percent of the State drought-declared.

We expect that Queensland's economy will grow at 4.0% in 2015-16, with the pickup in growth reflecting higher export volumes. The lower Australian dollar will provide a boost to other exports, with tourism and international education faring better. However, domestic demand in the Queensland economy is expected to be subdued, with State final demand expected to only increase by 0.5% in 2015-16, after contracting 2.6% in 2014-15. (Please see page 9 for further details on forecasts).

Value of Retail Sales
(trend, annual % change)



Queensland Consumer Sentiment



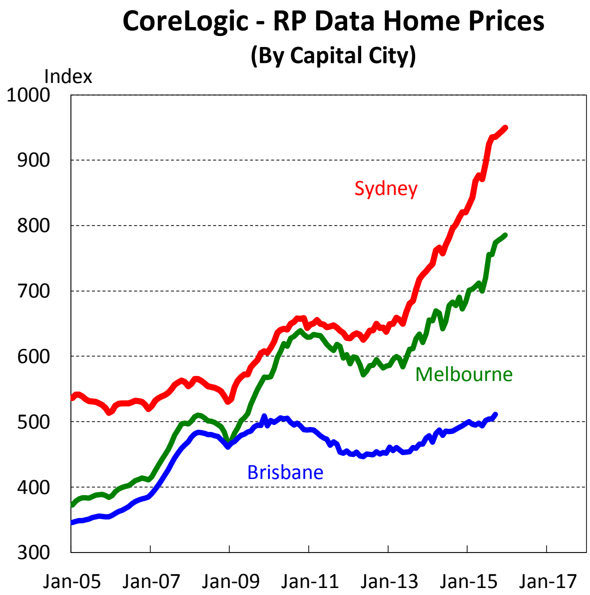
Consumer Spending

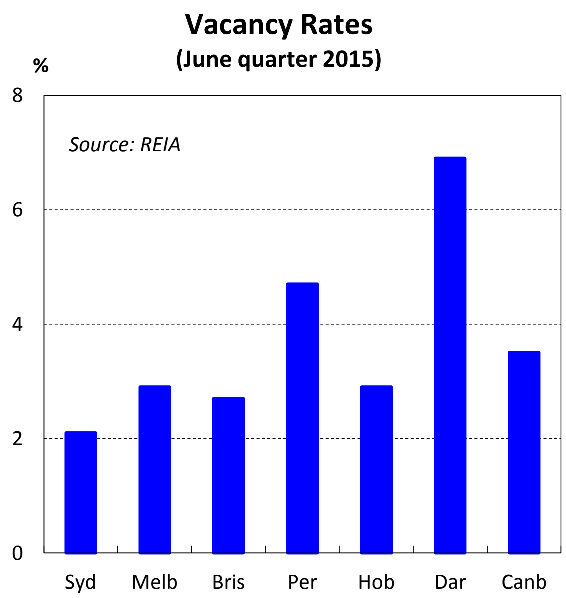
Household spending growth in Queensland was relatively lackluster in the June quarter, rising 0.6% in real terms, following growth of 1.1% in the March quarter. For the year to the June quarter, household spending rose 2.8%, the strongest since December 2012. Low interest rates and the weaker Australian dollar are providing support to household spending although slow wages growth is limiting the ability of consumers to lift their spending.

For the quarter, the strongest growth in household consumption was in health (3.2%), communications (2.0%) and clothing and footwear (1.7%). In Queensland, consumption was boosted by vehicle purchases (10.7%) and communications (7.2%) over the year to the June quarter.

It seems unlikely that consumer spending will pick up significantly in the near-term. Subdued wage growth and concerns about the economic outlook could continue to weigh on spending. Indeed, the consumer sentiment index by the Westpac-Melbourne Institute has been below 100 for 19 out of the last 22 months, indicating pessimists outweigh optimists. The index was at 94.9 in October, down from 95.5 in September.

Low interest rates will however continue to support modest growth in household consumption over the medium term.





Housing

Australia's housing upswing has waned in recent months. That trend will likely continue, although house prices should still register growth this year, albeit it at a slower pace. Dwelling prices in Brisbane have lagged behind Sydney and Melbourne, as is traditionally the case. According to CoreLogic – RP Data, Brisbane dwelling prices grew at an annual pace of 4.6% in September, down from a recent peak of 7.0% in June last year. This compares to national capital city dwelling price growth of 11.0% in the year to September, reflecting faster-paced growth in Sydney and Melbourne, with slower growth in other capital cities. Dwelling price growth in Brisbane continues to outpace the other capital cities (apart from Sydney and Melbourne). Contraction within the mining/resources construction sector and softer population growth will limit gains but low interest rates should help maintain demand.

Lending for owner occupiers in Queensland fell 0.7% in the year to August. This is below the national average of 8.8% over that period. Investor lending for housing was up 32.4% in the year to July but this is down on the 45.4% annual growth rate seen in March. These numbers are volatile. In July, investor loans comprised 39.0% of total lending for housing in Queensland. This is well up on the levels of around 25% seen in early 2009 but has been relatively stable over the past few years. This is much lower than the proportion of investors in NSW (at above 45%).

- Rental Markets

Brisbane has witnessed subdued growth in rents over the past year. Rents for a 3-bedroom house and for a 2-bedroom "other" dwelling in Brisbane rose 1.4% in the year to the June quarter. Low vacancy rates in Brisbane suggest that rental markets remain tight. The vacancy rate in Brisbane stood at 2.7% in the June quarter and is the second lowest among all capital cities, after Sydney. Vacancy rates below 3% are indicative of strong demand for rental accommodation.

- **Dwelling investment**

The lift in house prices in recent years is resulting in a recovery in dwelling investment in Queensland, which lifted 6.8% in the year to the June quarter. Although dwelling investment fell 4.8% in the June quarter, this followed growth of 12.2% in the March quarter. High levels of building approvals indicate a healthy pipeline for dwelling investment. In the year to July, Queensland building approvals rose 2.2%.

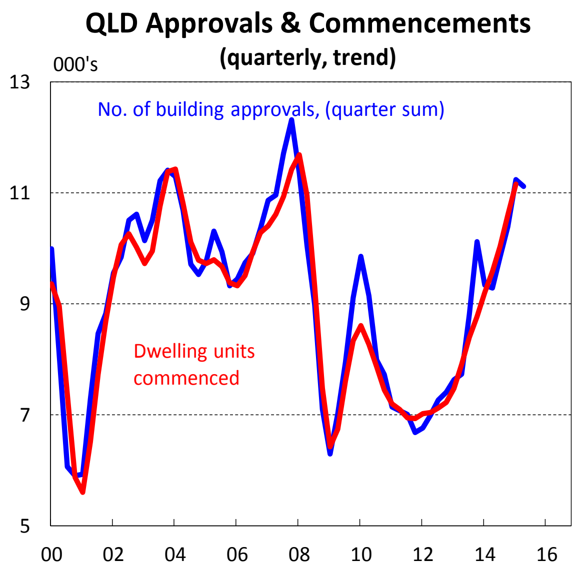
Outlook

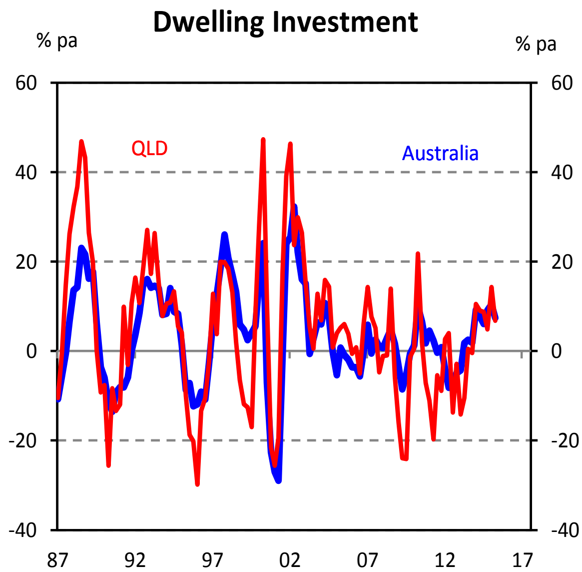
The outlook for Queensland's housing market is muted. While historically Brisbane house prices would tend to follow those of the larger capital cities, the Queensland economy faces a number of challenges which are likely to limit growth in house prices. The relative affordability of Brisbane in comparison to Sydney and Melbourne, however, suggests Brisbane dwelling price growth has further to run.

House prices have had a strong run over the past year, with interest rate cuts in February and May supportive of demand. Recent measures to tighten lending requirements and lift interest rates for investors, in an effort to meet APRA requirements, could help to slow the pace of growth in house prices nationally.

Queensland is one of the States where demand for housing has exceeded supply given solid population growth and lacklustre building activity over the past decade. While Queensland's population growth has slowed from a peak of 2.1% annual growth in September 2012 to 1.3% in March 2015, excess demand is expected to continue this year. The pace of Queensland's population growth is now below the 1.4% annual growth Australia-wide.

Property prices in Queensland are generally expected to strengthen over the coming year, although the performance of property prices will vary by area. The Australian dollar has fallen 10.2% in trade-weighted terms over the past year. This will boost the tourism industry in Queensland. Those residential areas closely tied to tourism should benefit from a revival in confidence in the industry. Recent sharp declines in commodity prices will impact on the profitability of mining companies and lead to cost cutting, including job cuts and mine closures. The lower coal and oil prices (impacting LNG prices) will impact Queensland particularly and property in associated areas may come under downward pressure.





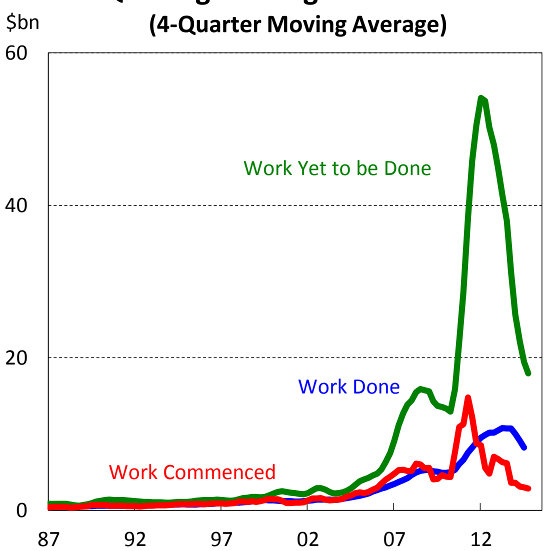
Business Investment

Business investment has weakened further in Queensland, as more projects approach completion, and lower commodity prices have reduced the attractiveness of new investment. In the year to the June quarter, business investment contracted 27.4% in Queensland. It was the weakest result since these records began in 1985.

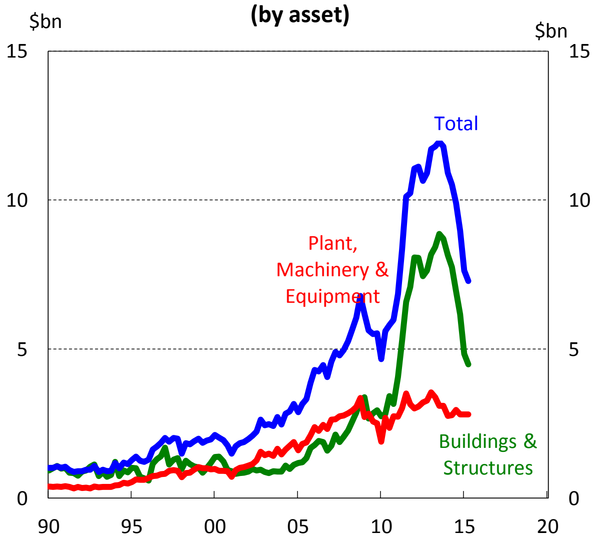
The decline in business investment has been led by the resources sector. Major LNG projects in Queensland, which have boosted engineering construction in recent years, have now reached or are close to completion. Engineering construction work done in Queensland fell 16.7% in the March quarter, which was the sixth consecutive quarterly decline. For the year to the March quarter, engineering construction work done declined 38.5% in Queensland.

While the value of resources related investment has declined, the fall in commodity prices has reduced the feasibility of new mining projects suggesting that the slowdown in activity is set to become more acute. The proposed Adani Carmichael mine would be Australia's largest coal mine (and one of the largest in the world). While this mine has the potential to stem some of the downside in resource related investment, the challenges the mine faces suggest that counting on it is a stretch too far at this stage.

QLD Engineering Construction
(4-Quarter Moving Average)



QLD Capital Expenditure
(by asset)



The downturn in resources related investment is likely to be a drag on commercial construction, which has benefited from the strong lift in incomes and resources activity. There is work currently underway within the healthcare sector, including the Sunshine Coast University hospital ($1.8bn) although the overall pipeline has shrunk in line with the decline in resources related construction.

Prospects for industries outside of resources are improving, if only gradually. The lower Australian dollar is seeing confidence return to the tourism industry - the biggest project in the pipeline is the Aquis resort complex near Cairns, which was planned to be built in two stages over 10 years at a cost of around $8bn. Although the project has stalled, the developer and government are hoping to continue negotiations, pending probity checks and license requirements. Other casinos are undergoing redevelopment, including $2bn for the Queen's

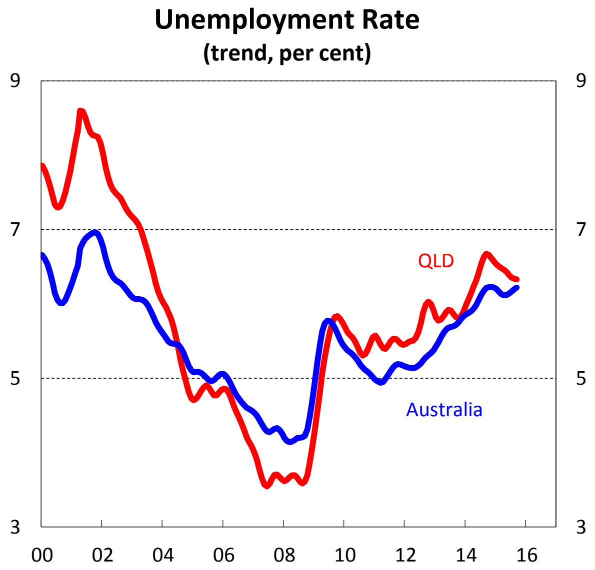
Wharf in Brisbane and $345mn for Jupiter's on the Gold Coast. Redevelopments for various island resorts are also on the cards including at Lindeman Island and Great Keppel Island.

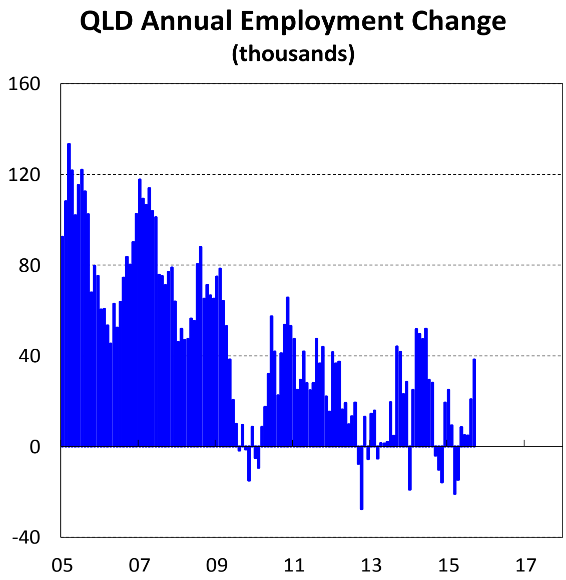
Business investment most likely declined sharply in 2014-15 as mining projects came to completion. While this fall in investment has detracted from growth, the boost in production capacity should see the drivers of growth shift further towards exports.

State Government Budget

The State Government provided extra funding for education and healthcare in addition to $10.1bn spending on infrastructure across Queensland. Nonetheless, a Budget surplus of $1.2bn is estimated for 2015-16 after an estimated $962mn surplus in 2014-15. Debt levels are expected to decline $9.6bn by 2017-18.

The Budget however, lacked any new major policy decisions. It also deferred a lift in the threshold for payroll tax which was promised by the former LNP Government to be lifted to $100k from July 2015.





Labour Market

The labour market in Queensland has grown at a moderate pace over the past year, adding 38.7k jobs in the year to September. Employment growth has lifted to 1.7% in the year to September, up from a -0.2% annual growth rate a year earlier. It is, however, still below the national employment growth rate of 2.0% in the year to September. As a trend, the unemployment rate stood at 6.3% in September, down from 6.7% a year earlier. It still sits slightly above the trend national unemployment rate of 6.2%, although it is moving in the right direction. The Queensland workforce participation rate of 65.5% is the highest of all the States, with the exception of WA.

The downturn in resource related investment is beginning to take a toll on Queensland's labour market. Construction employment fell 32.9k in the year to August, while mining employment fell 1.6k over the same period. Other industries where employment declined included accommodation & food (-13.2k) and other services (-8.4k). There were however, job gains in the year to August in education & training (17.1k), retail trade (12.6k) and public administration & training (8.9k).

Jobs linked to services should continue to grow moderately, although employment within the mining industry and other jobs linked to the construction of major projects will remain weak. A large amount of engineering construction activity is set to be completed this year, and efficiency gains will be the key focus for mining firms while commodity prices remain under pressure. This would suggest that the unemployment rate in Queensland could edge higher.

St.George Banking Group Forecasts

Economic Indicators, % Change				
	2014-15 (f)	**2015-16 (f)**	**2016-17 (f)**	**2017-18 (f)**
Gross State Product	2.50	4.00	4.10	4.10
State Final Demand	-2.60	0.50	3.00	2.80
Employment	0.20	1.20	1.30	1.50
Unemployment Rate (year average)	6.50	6.50	6.20	6.00
Brisbane CPI	1.90	2.30	2.50	2.50
Wage Price Index	2.40	2.50	2.80	3.00

Source: St.George Banking Group

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