State Economic Report

Wednesday, 16 July 2014

QLD Economic Outlook

Summary

- Queensland's economy has been one of the stronger performers in recent years, reflecting the boom in resources investment. Additionally, there remains a significant amount of activity still underway in the development of LNG projects. However, Queensland is not immune from falling mining investment which will pose a drag on growth.
- Growth prospects for the Queensland economy are mixed in comparison to earlier years, and we expect growth to continue to slow moderately. However, Queensland's economic outlook should be put into context. We expect growth of 3.0% in 2014-15, which is still forecast to be among the highest across all States.
- A sharp fall in coking coal prices has spelled difficult times for the coal industry and Queensland. Coal mine closures, job cuts and other cost cutting by producers have received significant attention in recent months and the news has been detrimental to confidence. The impact on demand and the job market remains uncertain.
- While it is a challenging time for the coal sector, Australian production continues to increase reflecting the completion of new capacity. Indeed, export earnings from coking coal are still expected to increase in both 2013-14 and 2014-15 as higher production more than offset lower prices. Exports are also set to gain as the production and export of LNG gather pace in coming years. The long-term outlook for Queensland's commodity exports is promising given the ongoing urbanisation of emerging economies and rising wealth of Asia.
- A recovery in Queensland's housing market is taking hold and we expect it to gain traction this year. Dwelling price growth in Brisbane should narrow their gap with growth in prices in Sydney and Melbourne. Housing construction is starting to pick up and there is further room for expansion. Rising house prices and low interest rates should be supportive of consumer spending.
- We expect the drag from mining investment to be offset by growth in exports, dwelling investment and consumption. In addition, a more upbeat tourism sector and a smaller drag from the public sector will be supportive of Queensland's economy.
- The Gold Coast Commonwealth Games in 2018 will provide a boost to economic activity through the construction of new infrastructure and should help lift employment and tourism.
- The release of the Brisbane City Council's City Centre Master plan 2014 provides support for long-term growth for the City of Brisbane through lifting its standing in arts, culture, entertainment and dining.

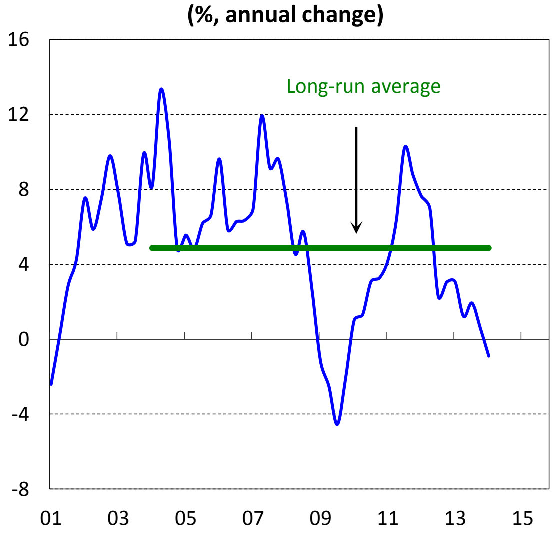
Percentage Shares of the Economy*		
Industries	**QLD**	**Australia**
Mining	12.0	11.2
Construction	10.3	8.8
Health care and social assistance	8.0	7.4
Manufacturing	8.0	7.9
Transport, postal and warehousing	6.5	5.6
Public administration and safety	6.4	6.0
Wholesale trade	6.1	4.9
Retail trade	6.1	5.3
Financial and insurance services	6.0	9.3
Professional, scientific and technical services	6.0	7.7
Education and training	5.0	5.3
Rental, hiring and real estate services	3.3	3.0
Agriculture, forestry and fishing	3.1	2.4
Administrative and support services	2.9	3.4
Electricity, gas, water and waste services	2.9	2.9
Accommodation and food services	2.7	2.7
Information media and telecommunications	2.1	3.1
Other services	2.0	2.0
Arts and recreation services	0.7	0.9

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

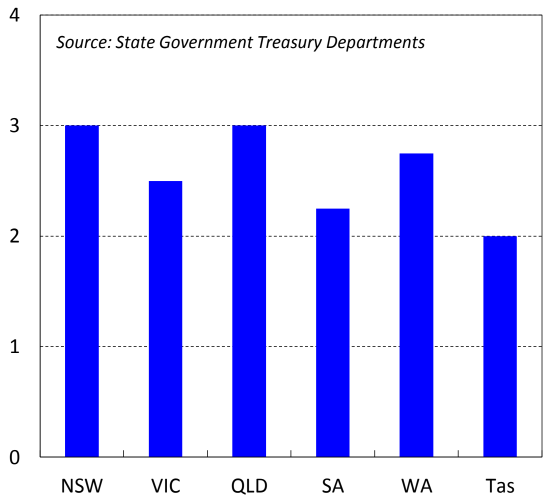
Economic Growth

Queensland's economy has been one of the outperforming States in recent years, reflecting the boom in resources investment. Gross State Product (which is the State equivalent for GDP, published annually) grew at a solid 3.6% pace in 2012-13. Huge LNG projects in development have been the major drivers of economic activity in Queensland. Further, the large scale of these projects will mean that activity will remain at an elevated level.

QLD State Final Demand
(%, annual change)



State Growth Forecasts 2014-15
per cent



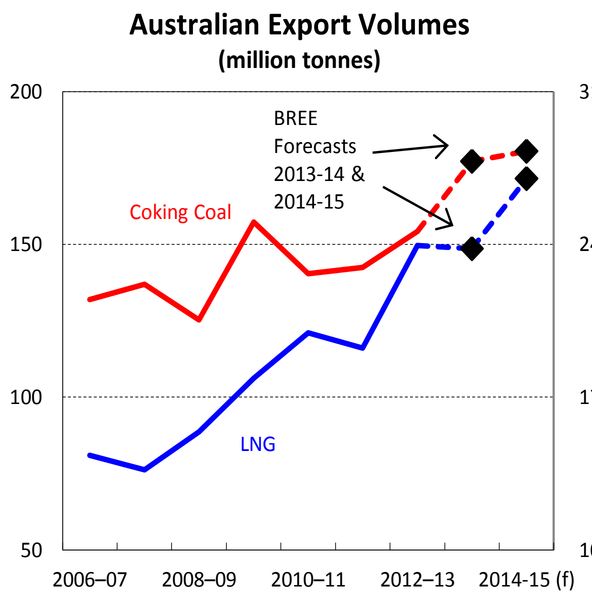
However, while Queensland should witness a less pronounced drop in mining investment activity than Western Australia, Queensland is not immune to the drag on growth from falling mining investment. The peak in investment spending has now most likely passed. State final demand has weakened, for two consecutive quarters, and declined 0.9% in the year to the March quarter. Declining business investment has driven the weakness in Queensland's demand, although a recovery in housing and consumer spending has been a partial offset.

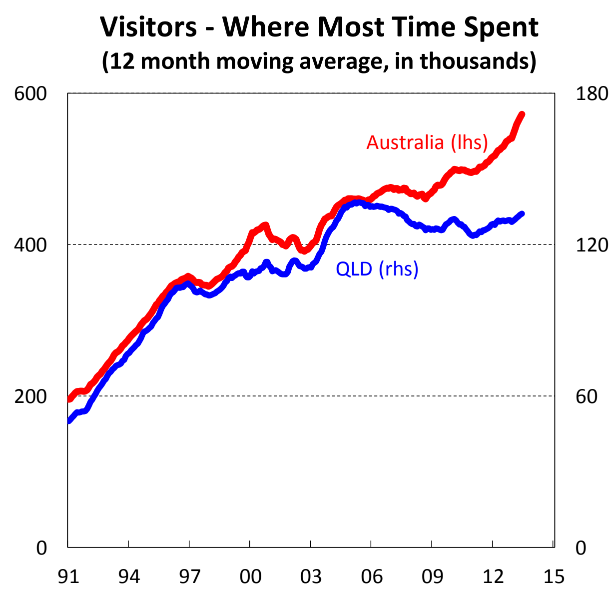
Additionally, a sharp fall in coking coal prices has spelled difficult times for the coal industry and Queensland. The spot price for coking coal fell just below US$106 per metric tonne in March. Prices have since recovered to just above US$110 a metric tonne, but they remain more than 13% lower than a year ago. Coal mine closures, job cuts and other cost cutting by producers have received significant attention in recent months and the news has been detrimental to confidence.

While it is a challenging time for the coal sector, Australian production is still increasing, reflecting the completion of new capacity. In Queensland, these have included Caval Ridge, Daunia, Baralaba expansion, North Goonyella Mine and Middlemount, and have offset the closures of unprofitable mines such as Glencore Xstrata's Ravensworth underground mine. Indeed, export earnings from coking coal are still expected to increase in both 2013-14 and 2014-15, as higher production more than offsets lower prices.

Exports are also set to be boosted as the production and export of LNG gather pace in coming years. Queensland's Curtis LNG is expected to begin production in December 2014 and Gladstone LNG is due to come online in the June quarter 2015.

A mixed outlook is reflected in our expectation for growth to slow in 2014-15, but Queensland's outlook should be put into context. We expect growth of 3.3% in 2013-14 and 3.0% growth of 2014-15, which is forecast to be among the highest across all States. Growth outcomes however, are below Queensland's long-run average growth rate of 4.0%. Queensland Treasury expect gross State product to expand by 3.0% in both 2013-14 and 2014-15.

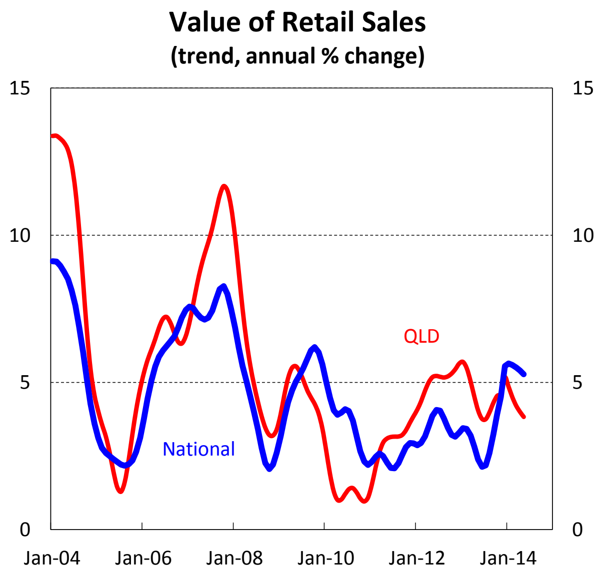


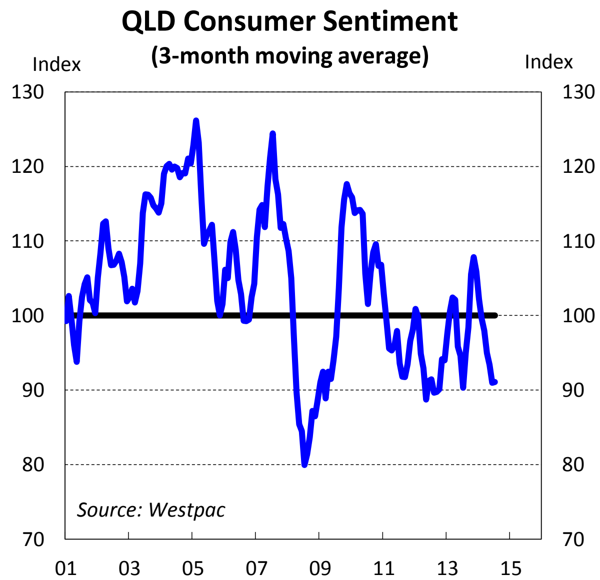


While business investment will detract from growth, a pickup in consumer spending, a recovery in dwelling investment and strong export growth will continue to support Queensland's economy this year. Fiscal consolidation will continue to be a drag on growth, but less so than in previous years. Additionally, an array of infrastructure spending funded by the State and the Commonwealth will be supportive of growth in the State.

The resilient Australian dollar, however, poses some uncertainty for the traded sector. Tourism is also impacted by the exchange rate, although visitor arrivals have been increasing in recent years. Tourist numbers have likely been helped by the Australian dollar's decline since early 2013, and the 2018 Commonwealth Games in the Gold Coast should help boost arrivals.

A key uncertainty is how significantly the struggles within Queensland's coal industry will damage economic growth. The industry is facing substantial competitive pressures given the surge in global supply and sharp fall in prices. However, the long-term outlook for Queensland's commodity exports is promising given the ongoing urbanisation of emerging economies and rising wealth of Asia.





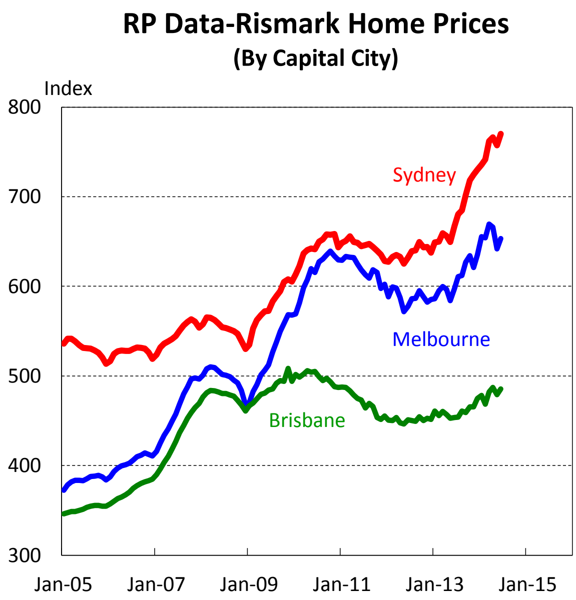
Consumer Spending

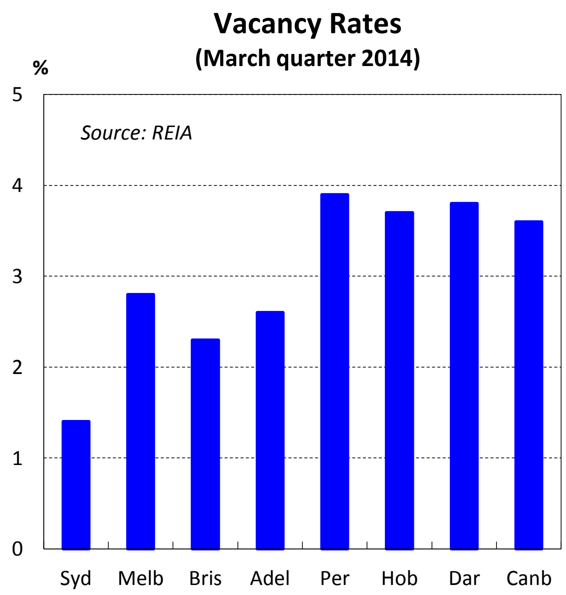
Household spending has gradually picked up in Australia and Queensland, reflecting the impact of low interest rates and rising household wealth. Annual growth in Queensland's household consumption lifted from 2.0% in the year to the March quarter 2013 to 2.8% in the year to the March quarter 2014. Growth in household consumption is below the long-run average, but is equal to growth Australia-wide.

More recent data is suggesting that consumer spending could be hitting a softer patch. Queensland retail spending declined for two consecutive months to May and annual growth slipped from a peak of 5.4% in the year to January to 3.4% in the year to May. Retail spending growth is also lagging behind annual growth in Australia at 4.6% in May.

A pause in a consumer spending recovery could reflect a sharp downturn in confidence in the wake of the Federal Budget. In Queensland, consumers have turned increasingly pessimistic this year according to the Westpac-Melbourne Institute Survey on consumer sentiment. The index for Queensland stood at 91.1 in July, and has been below 100 (indicating more consumers are pessimistic than optimistic) for all of 2014. Further, Queenslanders have been more pessimistic than Australia-wide for nine out of the last ten months.

Pessimism within the State does not bode well for the consumer spending outlook. The difficulties within the coal industry and potential impact on Queensland's labour market may continue to weigh on consumer sentiment and spending. However, low interest rates should continue to support gains in house prices and the share market. This boost to household wealth suggests to us that any pullback in spending should be temporary and the recovery in consumer spending witnessed earlier in the year should resume later this year.





Housing

An upswing in the housing market is underway across Australia, supported by a lengthy period of low interest rates. Dwelling prices in Brisbane have lagged behind Sydney and Melbourne, which traditionally occurs but growth is picking up, suggesting prices are playing some "catch up'. Brisbane dwelling prices grew at an annual pace of 7.0% in June, the strongest in 4½ years.

- **Rental Markets**

Brisbane has witnessed modest growth in rents over the past year. Rents for a 3-bedroom house and for a 2-bedroom "other" dwelling in Brisbane rose 2.7% in the year to the March quarter. Low vacancy rates in Brisbane suggest that rental markets remain tight and point to upward pressure on rents. The vacancy rate in Brisbane stood at 2.3% in the March quarter and is one of the lowest among all capital cities. Vacancy rates below 3% are indicative of strong demand for rental accommodation.

- **Dwelling investment**

The lift in house prices is resulting in a recovery in dwelling investment in Queensland, which lifted 9.1% in the year to the March quarter. Strong growth in building approvals points to a further pickup in dwelling construction and suggests that residential housing activity will support economic activity in Queensland. In the year to May, residential building approvals rose by 30.2%, and the number of approvals is now just sitting above its long-run average.

The pipeline of new dwellings is a welcome development after a long period of underbuilding in Queensland.

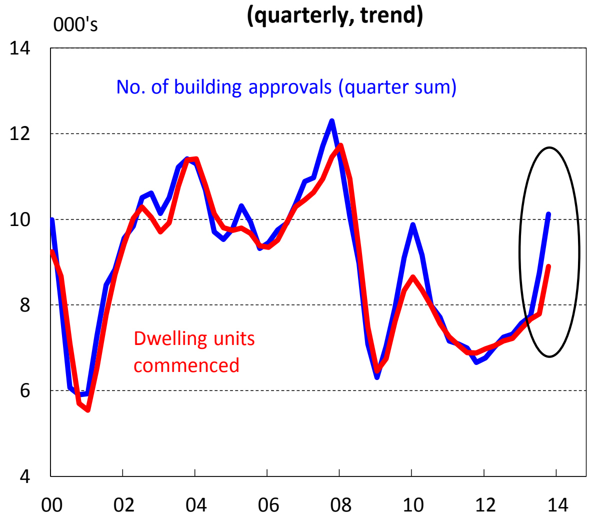
Outlook

The outlook for Queensland's housing market is promising. We expect further moderate growth in Queensland dwelling prices, and for the gap to close between Brisbane and the larger capital cities. The relative affordability of Brisbane in comparison to Sydney and Melbourne also suggests there is potential for dwelling prices to rise further.

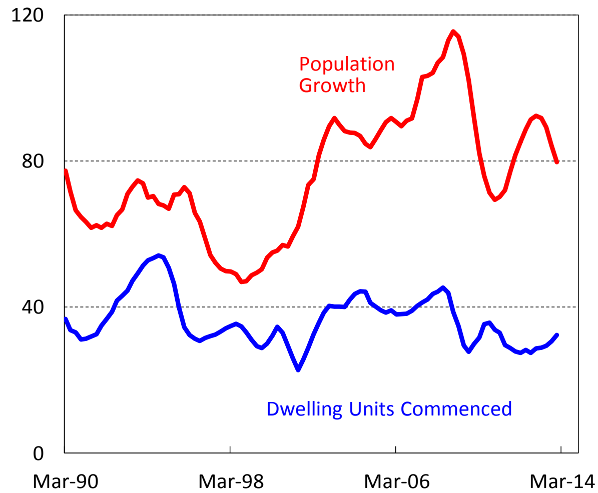
Queensland is one of the States where supply constraints exist given solid population growth and lacklustre building activity over the past decade. A pickup in residential construction in Queensland is in its early stages and further gains in residential property prices suggest there is room for stronger growth in dwelling investment.

Solid population growth is also supportive for housing demand, although Queensland's population growth has slowed from a peak of 2.1% annual growth in September 2012, to 1.7% in December 2013. The pace of Queensland's population growth is now in line with growth Australia-wide.

QLD Building Approvals & Dwelling Commencements
(quarterly, trend)



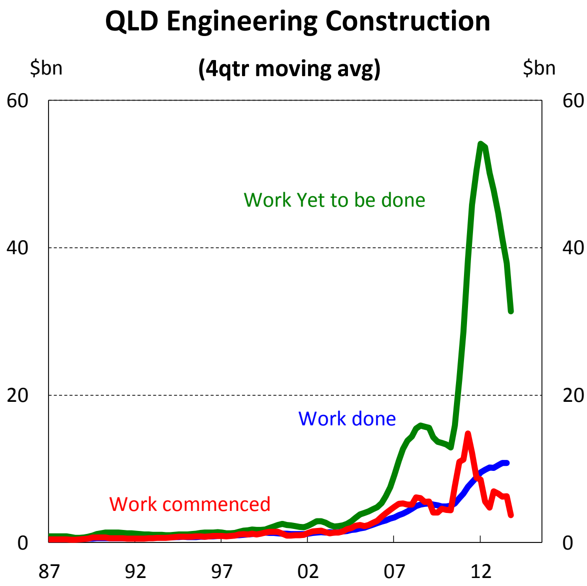
QLD Population & Housing
(rolling annual total, thousands)

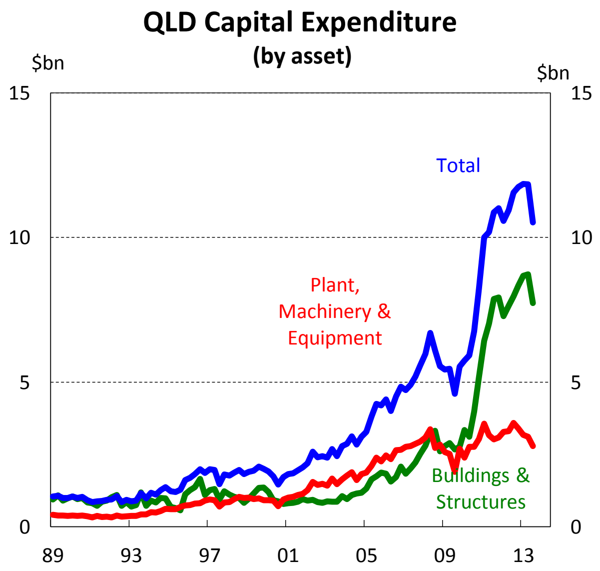


Additionally, The Brisbane City Council has recently released its City Centre Master Plan 2014 to prepare a strategy for managing expansion in Brisbane given it estimates Brisbane's economy will double over the next 20 years. The blueprint focuses on lifting Brisbane's standing in arts, culture, entertainment and dining and coincides with a shift towards greater higher-density living in the city. In other parts of Queensland, those areas tied to tourism should benefit from a revival in confidence in the industry. However, housing in coal-mining regions could come under pressure depending on the scale of job cuts and mine closures.

Business Investment

Business investment has been softening across Australia reflecting gradual decline in mining investment this year, and a more pronounced decline next year. In Queensland, business investment is weakening and fell by 12.1% in the year to the March quarter. It was the weakest result in almost four years.





Although investment is declining, there remains a high level of activity in Queensland. There are three major LNG projects currently underway, including Origin's $23bn Australia Pacific LNG development near Gladstone, the $19.6bn Curtin LNG project and Santos's $16.2bn coal seam facility at Gladstone. These large projects will support mining investment activity in the near-term. The Bureau of Resources and Energy Economics (BREE) is estimating $75bn worth of resource and energy projects at the committed stage as of April 2014, projects which are currently under construction or have received final approvals. Additionally, there is a sizeable $74bn worth of feasible projects, which mainly include coal projects and supporting infrastructure.

However, the number of committed mineral and resource projects in Queensland's pipeline is falling. Committed projects are down from $77bn in October 2013, and suggest that business investment will slide further. Additionally, the fall in coal prices and uncertainty regarding the outlook for LNG prices highlights a risk that many of the potential projects will not come on line.

The projected slowing in resources-related investment activity in coming years will also affect the commercial construction sector, which has been a notable beneficiary of the boom in resource-related activity in recent years.

We expect some short-term downward pressure on the commercial property rental market, primarily due to the slowdown in tenant demand from the government and resources sector. This trend is expected to continue throughout 2014. However, the broader service sector will help counteract the absence of high demand from the government and resources sector. While the leasing market across office, retail and industrial nationally and in Queensland is subdued, the investment market remains robust as investors chase yield.

In terms of construction, commercial property projects currently underway include the construction of two $650mn commercial office towers at 1 Williams Street and 480 Queens Street. Further down the pipeline is a plan for the $4.2bn Aquis resort complex near Cairns, a sign that tourism is looking more optimistic. Meanwhile, in the health sector there are the major publicly-funded projects of the Sunshine Coast University hospital ($1.8bn) and the new children's hospital in Brisbane ($1.4bn). There is also the ongoing infrastructure construction required for the 2018 Gold Coast Commonwealth Games.

We expect business investment will continue to decline in 2014-15 as projects come to completion. While this fall in investment should detract significantly from growth, the boost in production capacity should continue to see one of the drivers of growth shift towards exports.

The Queensland State Budget

The State government is estimated to post a deficit of $2.3bn in 2014-15, following an estimated deficit of $6.1bn in 2013-14. The fiscal consolidation by the State government will continue to be a drag on growth, although the contractionary impact should be less than in previous years. Queensland's fiscal position is the least attractive of all States and Queensland holds one of the highest net debts among States.

The public sector is helping to support infrastructure spending through a number of Federal and State funded projects. These include the $1.8bn Toowoomba Bypass projects, the $1.4bn Gateway North project, the $1.7bn 'Legacy Way' road project and the $1.3bn light rail network from Griffith University to Broadbeach.

A raft of new initiatives might also be announced ahead of State election due in mid-2015.

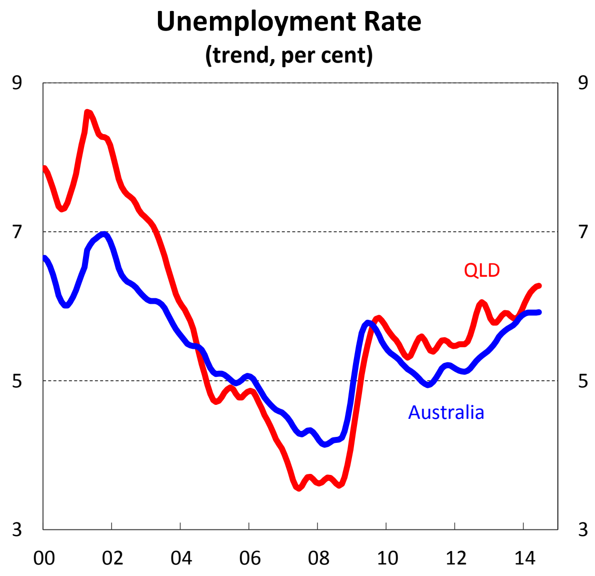
Labour Market

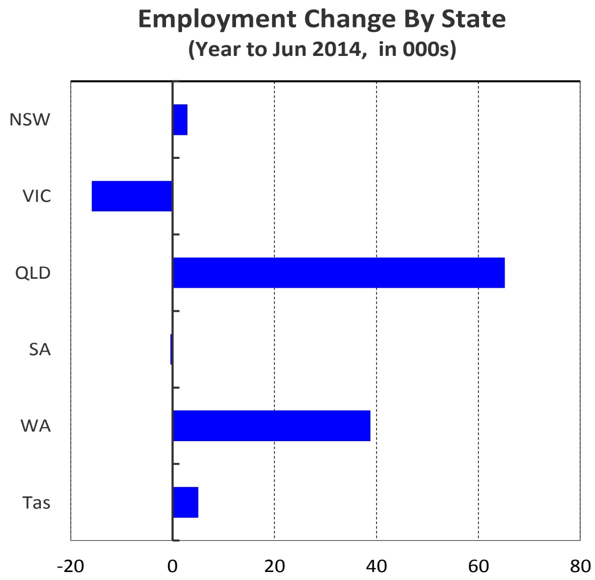
Queensland's labour market has been surprisingly buoyant and created more jobs in the past year than any other State. In the year to June, Queensland added 65.2k jobs. By comparison, Australia added 100.3k jobs over the same period (including those jobs created in Queensland). The strong job gains is probably due to some 'catch up' after weak job growth in earlier years.

The unemployment rate has edged higher in Queensland despite recent solid job growth. It stood at 6.3% in June, up from a recent low of 5.7% in November last year, and remains above Australia's unemployment rate of 6.0%.

Despite wide-spread publicised downsizing in the coal industry, mining employment actually increased 3.9k in the year to May. Most jobs were created in education (20.9k) followed by retail trade (20.6k) and healthcare & social assistance (19.9k). Jobs were lost in wholesale trade (-17.0k), agriculture (-11.1k) and transport, postal & warehousing (-8.5k).

The woes in the coal industry could weigh on employment in Queensland in coming months. However, a recovering housing market and improving conditions in other parts of Queensland's economy, such as tourism, point to moderate job growth over the medium-term.





St.George Banking Group Forecasts

Economic Indicators, % Change	2013-14 (f)	2014-15 (f)	2015-16 (f)	2016-17 (f)
Gross State Product	3.30	3.00	4.50	4.80
State Final Demand	0.20	0.50	2.70	3.00
Employment	2.00	1.70	2.50	2.50
Unemployment Rate (year average)	6.00	6.10	5.80	5.60
Brisbane CPI	2.80	2.70	2.70	2.50
Wage Price Index	2.70	2.90	3.30	3.50

Source: St.George Banking Group

Contact Listing

Chief Economist	Senior Economist	Senior Economist	Senior Economist
Besa Deda	Hans Kunnen	Josephine Horton	Janu Chan
dedab@stgeorge.com.au	kunnenh@stgeorge.com.au	hortonj@stgeorge.com.au	chanj@stgeorge.com.au
(02) 8254 3251	(02) 8254 8322	(02) 8253 6696	(02) 8253 0898