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QLD Economic Outlook

Summary

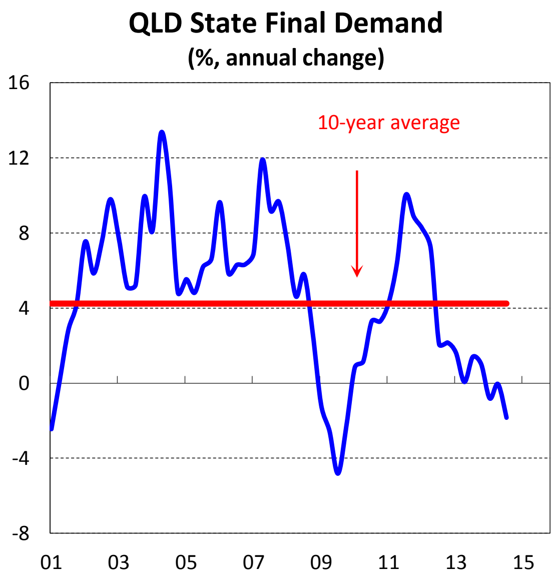
- Queensland's economy had been one of the outperforming States in recent years, reflecting the boom in resources investment. However, activity decelerated significantly in 2013-14, with mining investment now declining and subdued government spending.
- Growth in Queensland is expected to remain below its long-run average in 2014-15 as mining investment declines more sharply. However, solid growth is forecast for 2015-16. Exports will provide a large contribution to growth, particularly in the second half of 2015 as LNG exports ramp up.
- The significant drop in commodity prices in recent times will pose a major challenge for Australia and Queensland. It further confirms that mining investment will decline more sharply, and income from commodity exports will be less than previously anticipated. However, prospects for industries outside of mining 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.
- Household spending growth stalled in the September quarter in Queensland, after a gradual pick up through late 2013 and early 2014. While low interest rates have boosted consumer spending, soft growth in incomes may be limiting the ability of consumers to lift their spending.
- The upswing in the Australian housing market continues, although the pace of growth in house prices nationally has eased. House price growth in Sydney and Melbourne leads the way, but Brisbane house price growth outpaces that of the other capital cities. The relative affordability of Brisbane in comparison to Sydney and Melbourne suggests dwelling price growth has further to run there and the recent interest rate cut from the Reserve Bank of Australia and the prospect of another cut in coming months will be supportive for the Queensland property market.
- Employment has grown moderately in Queensland, but growth has not been strong enough to prevent the unemployment rate from rising. The unemployment rate has gradually risen to 6.5% over the past year, in trend terms. There is a risk that the unemployment rate could edge higher.

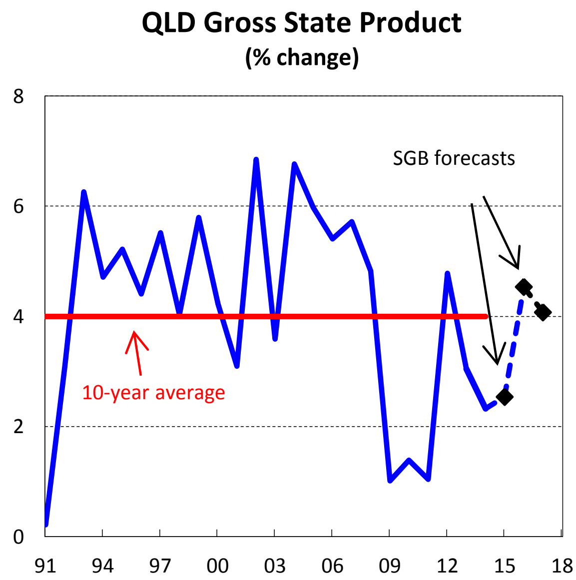
Percentage Shares of the Economy*		
Industries	**QLD**	**Australia**
Construction	11.4	9.4
Mining	10.8	9.6
Health care and social assistance	8.3	7.6
Manufacturing	7.2	7.5
Public administration and safety	6.7	6.3
Transport, postal and warehousing	6.7	5.6
Financial and insurance services	6.6	9.9
Professional, 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 economy had been one of the outperforming States through the mining investment boom. However, activity decelerated significantly in 2013-14. Gross State Product in Queensland grew at 2.3% in 2013-14 after growth of 3.0% in 2012-13. The pace of growth has is now below the long-run average growth rate of 3.6%. The drop in activity within mining investment and subdued public spending has weighed on growth in the Sunshine State.





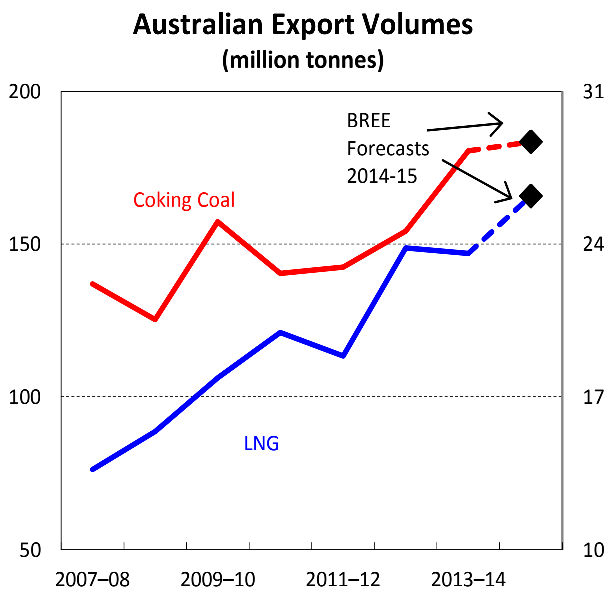
More recent data suggests that the downturn in business investment is accelerating, and is providing a bigger drag on growth. State final demand in Queensland contracted 1.4% in the September quarter, and contracted 1.8% over the year.

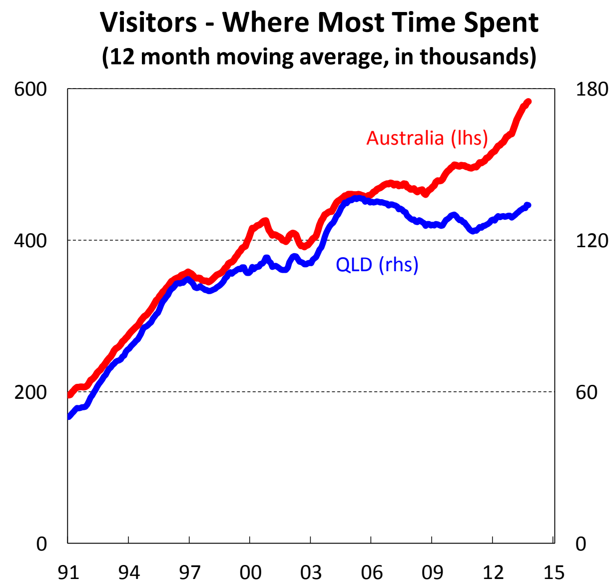
The significant drop in commodity prices in recent times will pose a major challenge for Queensland and Australia. It confirms that mining investment is set to decline more sharply, plus less income will be gained from commodity exports.

In Queensland, major LNG projects have been propping up economic activity. These include the $24.7bn Australia Pacific LNG project, the $20bn Curtis Island LNG project and the $16bn Santos project off Gladstone. The Curtis Island and Gladstone projects are approaching completion. While this means that mining investment will drop significantly further, exports are set to surge. The first shipment of gas left Curtis Island at the beginning of the year, while production at Gladstone is expected to commence the middle of this year.

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. LNG prices have been relatively stable in recent months, but there are downside risks to the price of LNG. LNG prices do not move directly with oil prices, but the recent sharp fall in oil prices could push prices lower later this year. Additionally, the increase in Australian supply could add to downward pressure on prices.

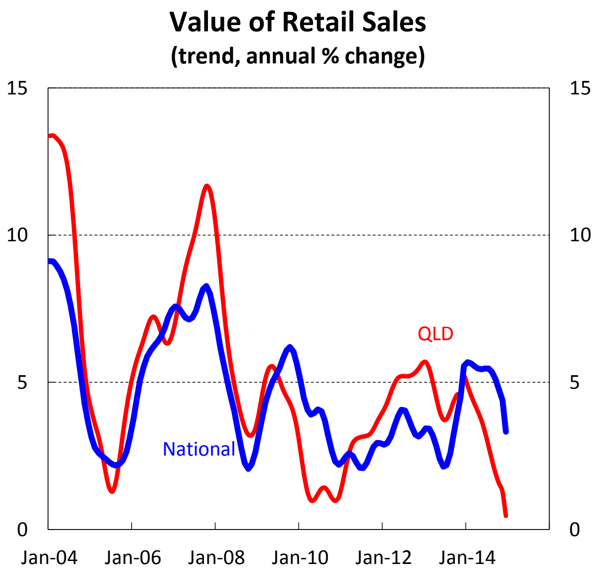
Prices of Queensland's other major export, coking coal, has been relatively stable after dropping sharply in early 2014. The closure of unprofitable mines has resulted in a more balanced market, suggesting that prices should continue to be relatively stable. However, the risk of a further drop in prices 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 Bureau of Resources & Energy Economics (BREE). Production from new projects has more than offset mine closures in Australia.

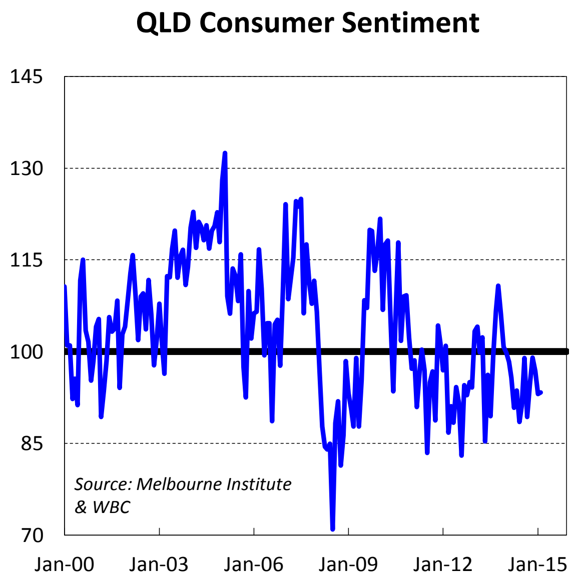




Exports are set to contribute significantly to growth in Queensland in coming years. However, downward pressure on commodity prices will continue to weigh on the mining sector and incomes more generally. A major positive is that there is increasing support to growth from the weaker Australian dollar and low interest rates. These will assist Queensland's tourism sector, housing and consumer spending. Visitor arrivals to Queensland have been gradually increasing, although to a lesser extent that to other States.

We expect that Queensland's economy will grow at 2.5% in 2014-15, and below its long-run average. The accelerating downturn in mining investment is expected to weigh on growth. Additionally, household spending growth is expected to be modest. However, exports are set to increase in coming years and are expected to provide a large contribution to growth, particularly from 2015-16 as LNG exports ramp up. The lower Australian dollar will also provide a further boost to other exports, and support Queensland's tourism sector. A pickup in growth is in prospect over 2015-16 and 2016-17. (Please see page 9 for further details on forecasts).





Consumer Spending

Household spending growth in Queensland stalled in the September quarter, after a gradual pick up through late 2013 and early 2014. Annual growth slowed from 2.3% in the year to the June quarter to 1.7% in the year to the September quarter. While low interest rates have boosted consumer spending, soft growth in incomes may be limiting the ability of consumers to lift their spending.

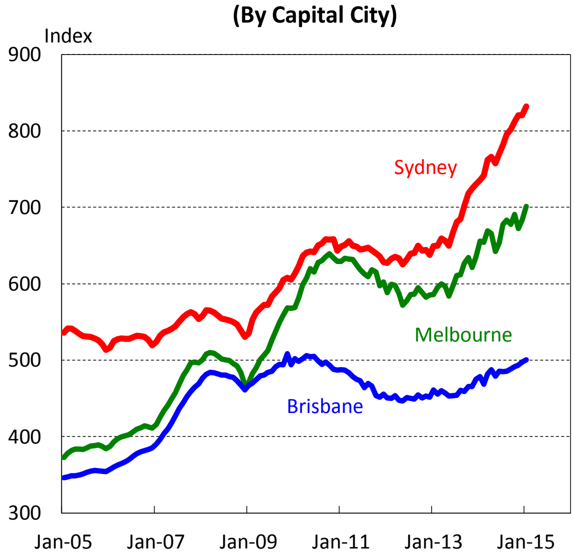
Queenslanders have increased their spending, mostly on services. In the year to September, household spending was strongest on hotels, cafes & restaurants (9.3%), communications (7.0%) and insurance & other financial services (5.9%).

More recent data could suggest that household consumption may have picked up again towards the end of 2014. Retail sales (in volumes) grew 0.8% in the December quarter, the strongest outcome in three quarters. Retail spending is a large component of overall household consumption. Annual growth in retail sales volumes however, remains soft at an annual pace of 0.4%.

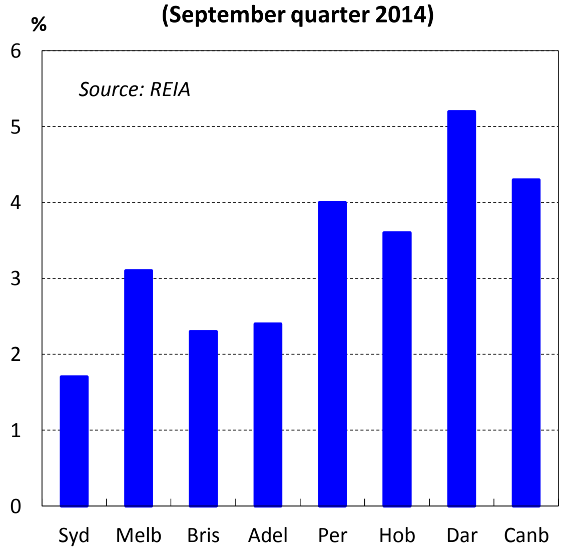
Subdued consumer confidence however, is suggesting that consumers are unwilling to lift spending significantly in the near-term. Unlike some other States, consumer sentiment in Queensland failed to improve much after the RBA rate cut in February and the large drop in petrol prices. The Westpac-Melbourne Institute index of consumer sentiment for Queensland was at a reading of just 93.3 in February, and has remained below 100 for 14 consecutive months. Queenslanders are also more pessimistic than Australia-wide.

The entrenched pessimism and softer growth in incomes suggest that consumer spending is unlikely pick up significantly. However, the extended period of low interest rates should support modest growth in household consumption over the medium term.

RP Data-Rismark Home Prices
(By Capital City)



Vacancy Rates
(September quarter 2014)



Housing

Australia's housing upswing has waned in recent months and 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. Brisbane dwelling prices grew at an annual pace of 4.6% in January, down from a recent peak of 7.0% in June last year. This compares to national capital city dwelling price growth of 8.0% in the year to January, reflecting faster-paced growth in Sydney and Melbourne. Dwelling price growth in Brisbane continues to outpace the other capital cities (apart from Sydney and Melbourne). The outlook for Queensland property is for modest growth this year. The interest rate cut in February and expectations of another cut in coming months are likely to boost demand and affordability for property buyers.

- **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 September 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 September 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 10.6% in the year to the September quarter. High levels of building approvals earlier last year point to further strength in dwelling construction in the early part of this year, although the recent slowing in building approvals suggests this strength in dwelling investment will taper later this year. In the year to December, Queensland building approvals fell 5.7%.

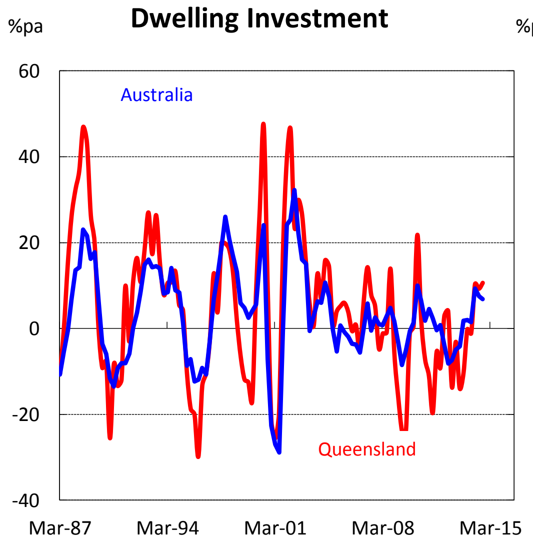
Outlook

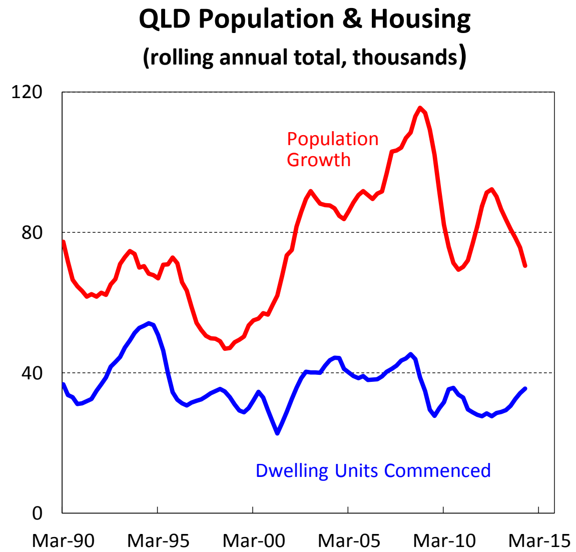
The outlook for Queensland's housing market is promising. We expect further moderate growth in Queensland dwelling prices, and for the gap to close between Brisbane and the larger capital cities. The relative affordability of Brisbane in comparison to Sydney and Melbourne also suggest Brisbane dwelling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

Housing affordability nationally has improved with an interest rate cut in February this year and another one likely in coming months. This should help boost housing demand and drive house price growth during 2015.

Queensland is one of the States where demand 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 1.5% in June 2014, excess demand is expected to continue this year. The pace of Queensland's population growth is now slightly below the 1.6% 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 7.5% 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 pressure.



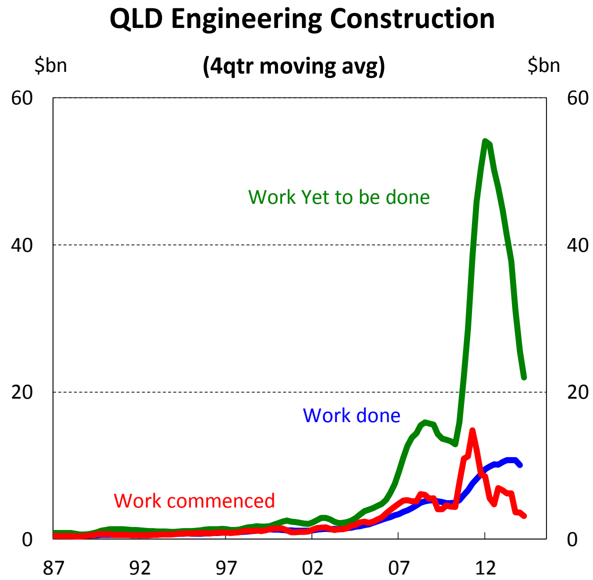


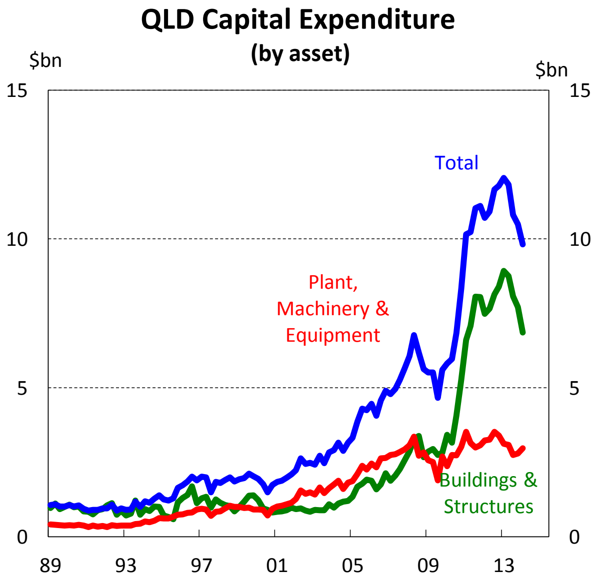
Business Investment

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 September quarter, business investment contracted 16.8% in Queensland. It was the weakest result since the December quarter 2009.

In the near-term, there is significant work underway in three major LNG projects, including Origin's $24.7bn Australia Pacific LNG development near Gladstone, the $20bn Curtis Island LNG project and Santos's $16bn coal seam facility at Gladstone. However, these projects are due for completion this year.

The drop off in activity once these mega projects wrap up will be a major test for Queensland and Australia. 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.



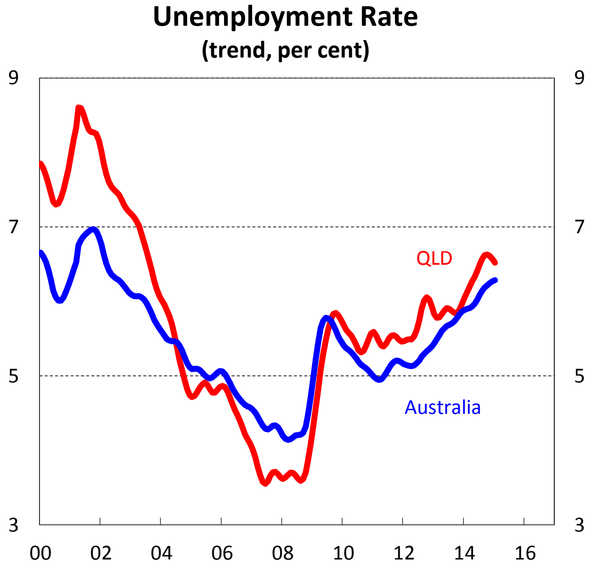


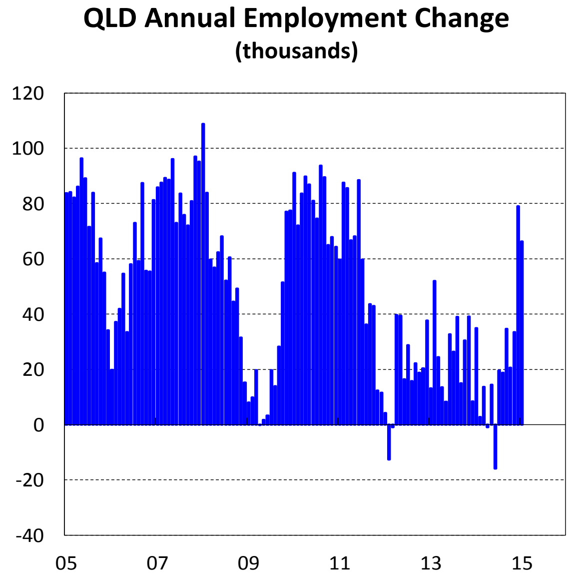
The downturn in mining investment is likely to be a drag on commercial construction, which has benefited from the strong lift in incomes and resources activity. There is work currently underway within the healthcare sector, including the Sunshine Coast University hospital ($1.8bn) and the new children's hospital in Brisbane ($1.4bn), although the overall pipeline is at risk of shrinking in line with the decline in mining construction.

Prospects for industries outside of mining 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 is planned to be built in two stages over 10 years at a cost of over $8bn. The project is currently "on hold" pending probity checks and license requirements. Redevelopments for various island resorts are also on the cards including a $600mn revamp at Great Keppel Island.

There are also major transport projects supported by the public sector. These include the $1.7bn 'Legacy Way' project and the $1.1bn Morton Bay Rail link. Time will tell if the incoming government will support further infrastructure spending. The newly instated Labor government has said it will announce its Building Queensland infrastructure plan. There will also the ongoing infrastructure construction required for the 2018 Gold Coast Commonwealth Games.

This year, business investment is likely to decline more sharply in 2014-15 as mining projects come to completion. While this fall in investment should detract significantly from growth, the boost in production capacity should see one of the drivers of growth shift further towards exports.





State Government Policy

A newly elected minority Labor Government headed by Premier Annastacia Palaszczuk had been light on detail in regards to new policies prior to the election. A clearer picture should develop over coming months. An encouraging development is the establishment of "Building Queensland" a new infrastructure planning body, to be set up within 12 months.

Labour Market

The labour market in Queensland has grown moderately over the past year, adding 34.3k jobs over the year to January. As a trend, the unemployment rate stood at 6.5% in January. This was unchanged from six months ago in July, but higher than the 6.0% trend unemployment rate recorded in January 2014. It also sits above the trend Australian unemployment rate of 6.3%.

Most jobs in Queensland were created in accommodation & food services (40.3k) followed by professional, scientific & technical services (35.9k) and other services (10.6k). Jobs were lost in manufacturing (-38.1k) and retail trade (-28.5k). The mining industry also lost jobs (17.0k) as activity in mining investment winds down.

The industry breakdown suggests that an array of non-mining industries, mainly services, is supporting employment growth in Queensland. Nonetheless, employment within the mining industry and other jobs linked to the large projects underway, are at risk of declining further. While the impact to growth will be offset by a surge in production and exports, this is generally viewed as less labour-intensive than the investment activity in past years. This would suggest that the unemployment rate in Queensland could edge higher.

St.George Banking Group Forecasts

Economic Indicators, % Change				
	2013-14	2014-15 (f)	2015-16 (f)	2016-17 (f)
Gross State Product	2.30	2.50	4.50	4.10
State Final Demand	0.30	0.40	1.60	2.60
Employment	1.80	0.40	1.70	2.50
Unemployment Rate (year average)	6.00	6.60	6.50	5.60
Brisbane CPI	2.80	2.10	2.20	2.50
Wage Price Index	2.70	2.60	2.70	3.20

Source: St.George Banking Group

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