Monday, 17 August 2015

SA Economic Outlook

Summary

- The South Australian economy has been through challenging times in recent years and challenges remain on the road ahead. The South Australian economy grew at just 1.3% in 2013-14, although we expect growth picked up to 1.5% in 2014-15. Modest growth of 1.25% is expected for 2015-16.
- Confidence has been lacking in the South Australian economy. The demise of car manufacturing and uncertainty over the future of defence manufacturing in South Australia were the latest blows. A pickup in activity will require a positive shift in the mood of consumers and businesses.
- House prices in Adelaide have grown modestly, although the pace of growth has lagged behind growth in several other capital cities. We expect only modest gains in house prices in the year ahead as the extended period of low interest rates continues to support demand from both owner occupiers and investors.
- The weak momentum in the State economy suggests that South Australia will continue to grow at a pace well below its long-run average. We expect further modest growth in coming years. Relatively weak population growth, a lack of confidence and the impending end of car manufacturing in South Australia suggests that economic growth will continue to lag behind other States.
- There are still positives for the State, including a now weaker Australian dollar. Its decline will help support manufacturing, agriculture, tourism and education, which are key sectors of South Australia's economy. Low interest rates will also continue to support housing and consumption in the State.
- The South Australia 2015-16 Budget was somewhat radical and aimed at increasing business investment. A cornerstone of the Budget was reform to stamp duty.

Percentage Shares of the Economy*		
Industries	**SA**	**Australia**
Health care and social assistance	10.1	7.6
Manufacturing	8.9	7.5
Financial and insurance services	8.3	9.9
Construction	7.8	9.4
Professional, scientific and technical services	6.9	7.5
Public administration and safety	6.7	6.3
Agriculture, forestry and fishing	6.5	2.7
Education and training	6.1	5.4
Retail trade	5.6	5.3
Transport, postal and warehousing	5.1	5.6
Wholesale trade	4.9	4.6
Electricity, gas, water and waste services	4.6	3.2
Mining	4.1	9.6
Administrative and support services	3.0	3.3
Accommodation and food services	2.8	2.7
Information media and telecommunications	2.6	3.3
Other services	2.6	2.1
Rental, hiring and real estate services	2.5	3.2
Arts and recreation services	1.0	0.9

** share as % of Industry gross value added less ownership of dwellings Source: ABS, St.George Bank*

Economic Growth

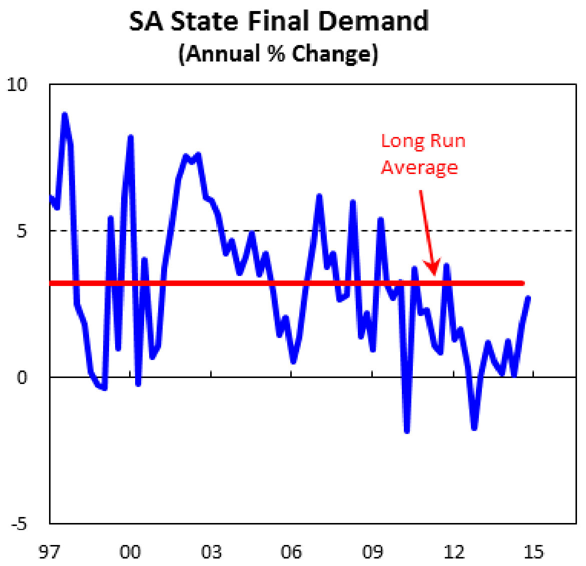
The South Australian economy has been through challenging times in recent years. Some issues include the loss of car manufacturing and uncertainty over the future of defence manufacturing.

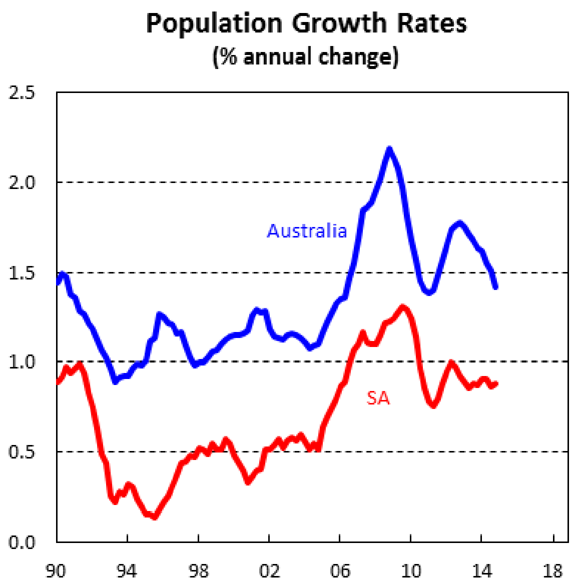
The Gross State Product (which is the State equivalent for GDP, published annually) has been disappointing in recent years. The South Australian economy grew at just 1.3% in 2013-14, following growth of 0.9% in 2012-13. Growth most likely improved slightly in 2014-15, but remained below trend.

Since early 2013, the exchange rate has fallen 29% against the US dollar and 21% in trade-weighted terms. This decline will assist manufacturing, agriculture, tourism and education, which are key sectors of the economy. Low interest rates will also support housing and consumption as would more certainty over the future of the defence industry.

The most recent national accounts data suggests that the impact of the lower Aussie dollar has begun to pay dividends. State final demand (which excludes imports and exports) rose 0.8% in the March quarter 2015, following growth of 0.3% in the December quarter 2014. For the year to the March quarter, South Australian State final demand lifted to 2.7%, from 1.8% in the year to the December quarter. This is above the 10-year average of 2.3%.

Fragile confidence and relatively weak population growth will, unfortunately, keep a lid on growth in the South Australian economy. However, there will be ongoing support from low interest rates, and a weaker Australian dollar.





We expect GSP growth in 2014-15 was 1.5% while growth in 2015-16 is forecast to be 1.2%. For 2017-18 growth close to 2.0% is forecast. This pattern reflects ongoing modest, but below trend, growth. (See page 8 for further details).

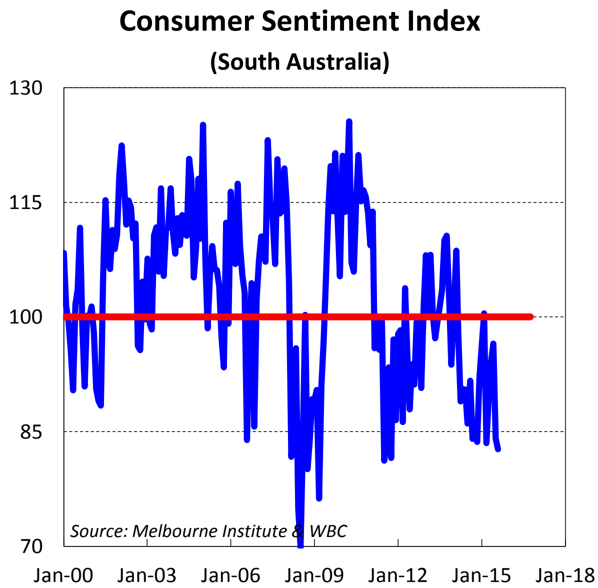
Consumer Spending

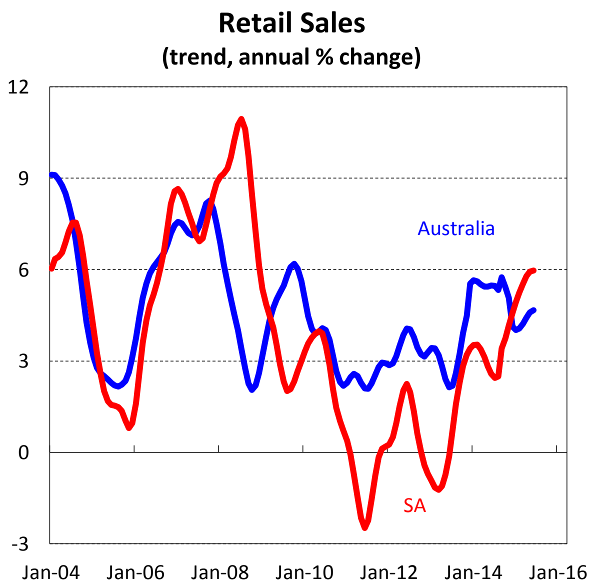
Consumer spending is gaining traction in South Australia, thanks to an extended period of low interest rates. Growth has edged up to an annual pace of 3.0% in the year to the March quarter. It was the fastest pace of growth in over four years, and above the long-run average of 2.1%.

Retail sales rose 6.1% in the year to June. The pace of annual growth in retail sales has lifted and is now well above the rate of a year ago (2.8% in the year to June 2014). It also remains well above the 10-year average of 3.6%.

A key risk for spending is ongoing weakness in confidence. The consumer sentiment survey from Westpac-Melbourne Institute indicates that consumers in South Australia remain pessimistic. After briefly rising above 100 (indicating optimism) in February, the consumer sentiment index for South Australia fell back sharply into pessimistic territory and was at 82.7 in August. This was the lowest reading in over three years. South Australian consumers are less optimistic than Australia-wide, where the index was at 99.5 in August.

Consumer spending has remained solid, with low interest rates providing support. However, slow income growth and lacklustre consumer confidence have capped spending growth.





Housing

House prices in Adelaide have grown modestly, although the pace of growth has lagged behind growth in several other capital cities including Sydney and Melbourne. In July, Adelaide dwelling prices rose at an annual pace of 3.4%, according to CoreLogic-RP Data. By comparison, dwelling prices Australia-wide grew at 11.1% over the same period.

- Dwelling Investment

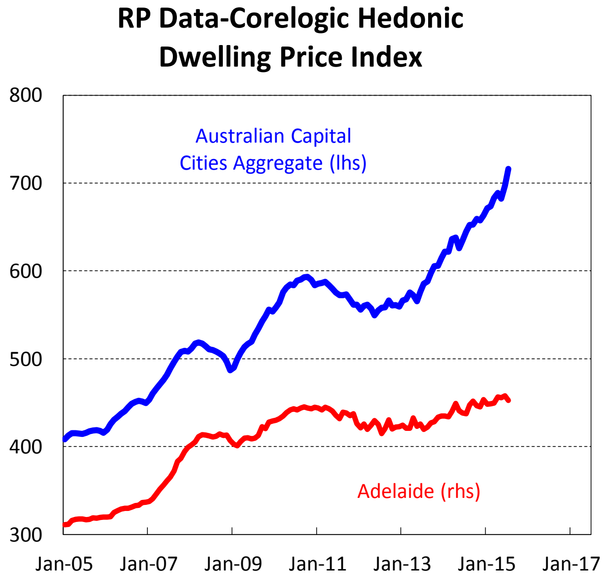
The modest gain in house prices along with low interest rates have supported a lift in residential construction. However, the residential construction pipeline has slowed, which will continue to impact residential construction activity in South Australia next year. Earlier strength in residential construction, low population growth and concerns about the outlook for jobs have likely been behind the lacklustre construction pipeline.

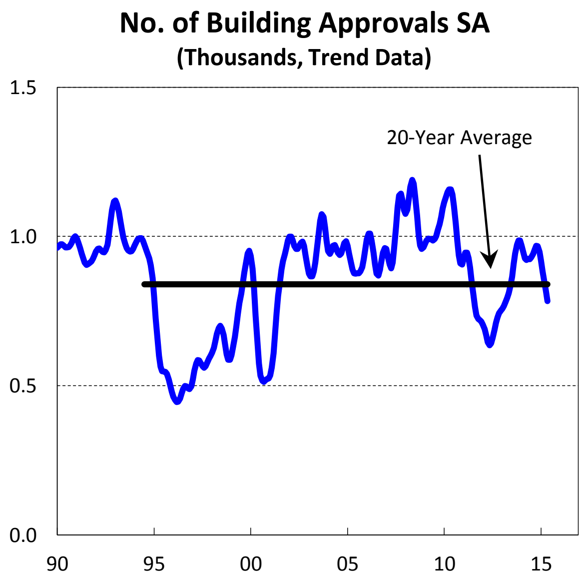
The winding back of Government incentives is a possible factor behind the slower outlook for residential construction. As of 31 December 2013, a housing construction grant of $8500 with the purchase of a new home ended. Stamp duty concessions on the purchase of a new or substantially refurbished apartment within a defined area were also available until 30 June 2014. Partial concessions are still available for contracts entered into between 1 July 2014 and 30 June 2016. The First Home Owner Grant (FHOG) of $15000 is still available for the purchase of a new dwelling.

- Rental Markets

Loans to investors in South Australia have shown a solid increase in the first half of this year, although not to the degree witnessed in Sydney and Melbourne. Low interest rates together with relatively high gross rental yields and greater affordability in Adelaide have driven investor interest in South Australia. According to CoreLogic RP Data, rental yields stood at 4.7% for units and 4.2% for houses as of July.

Residential rents have continued to grow modestly in Adelaide. Median weekly rents for a 3 bedroom house grew at an annual rate of 3.3% in the year to the March quarter and 1.8% in the year for a 2 bedroom "other" dwelling. Vacancy rates were at 2.8% in the December quarter 2014 (which is the most recent data), suggesting there is strong demand for rental accommodation, with the rental market 'tight'.





- **Housing Outlook**

Unlike in NSW and Victoria, investor demand in South Australia is not surging ahead of owner occupiers. The proportion of investor loans has averaged 32.5% of all loans by value, over the past year. The more restrained investor interest in South Australia is one factor that has held back growth in Adelaide dwelling prices and seen them grow at a more moderate pace, compared to those in Sydney and Melbourne.

We expect only modest gains in house prices in the year ahead. House price gains in Adelaide are likely to continue to lag behind capital cities in several other States, and will be tempered by slower population growth, the softer labour market in comparison to other States and concerns about the outlook for jobs. An extended period of low interest rates should support demand from both owner occupiers and investors, but the pace of growth in house prices likely to remain slow.

Business Investment

Business investment in South Australia has been lacklustre in recent years, although, it has picked up over the past year. In the March quarter, according to the Australian Bureau of Statistics, capital expenditure by businesses rose 1.1% from a year ago.

The contraction in the manufacturing sector over recent years will be a negative for future engineering construction. Additionally, the recent fall in commodity prices may weigh on projects in the pipeline. However, the value of investment projects in the pipeline has some momentum and projects underway include the $514mn upgrade of the Port Pirie smelter.

In recent times, the public sector has supported activity, and helped make up for the lack of private sector activity. The Budget included $165 million spending on roads.

The manufacturing industry in South Australia was dealt another blow recently, with the Federal Government hinting that it might allow its next fleet of submarines to be built offshore. However, it is estimated that even if the next submarine fleet is sourced outside of Adelaide, two-thirds of the costs associated with outfitting and maintaining those submarines will occur in Australia, with South Australia receiving a substantial share.

The decline in defence projects in South Australia, resulting in a much-publicised "Valley of Death" for the industry, has led to it being thrown a life-line, with the recent announcement of continuous ship construction in South Australia. This will start with offshore patrol vessels in 2018 and frigates in 2020. These projects are expected to be worth $39 billion over time.

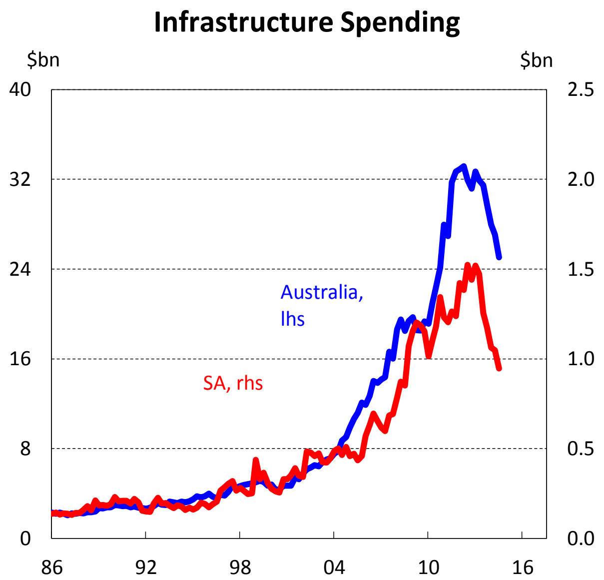
As parts of the manufacturing sector in South Australia are waning, what will fill the void in growth, jobs and investment? There are opportunities in South Australia, including growth in advanced manufacturing, food manufacturing, medical devices and aerospace manufacturing.

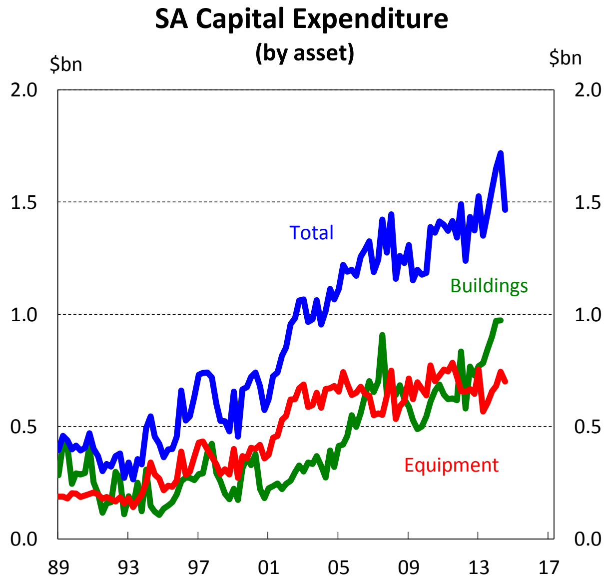
Examples of possible projects include the recent memorandums of understanding between a South Australia company and Indian companies to develop and manufacture solar products and metal recycling technology.

The Budget announcement by the State Government that it will remove business stamp duties, including on commercial property sales, should be supportive of business investment.

Within non-residential construction, publicly funded health projects including the new Royal Adelaide hospital and the redevelopment of Lyell McEwin hospital, continue lead the way in activity. The recent Budget also included a rehabilitation centre at Flinders Medical Centre, worth almost $160m.

Outside of healthcare, activity is limited, dampened by uncertain demand. However, a long-term project to develop an advanced manufacturing hub at Tonsley Park worth $1bn is progressing, and a redevelopment of the Rundle Mall in Adelaide was recently completed. A pickup in retail activity and the weaker Australian dollar should boost longer term prospects for commercial construction.





The level of confidence within South Australia is a key factor in the outlook for business investment within the non-mining sector. Unfortunately, business confidence in South Australia has deteriorated recently according to the BankSA State Monitor. The business confidence index fell to 100.7 in June, from 107.6 in February. It remains just above a reading of 100, indicating optimists marginally outweigh pessimists.

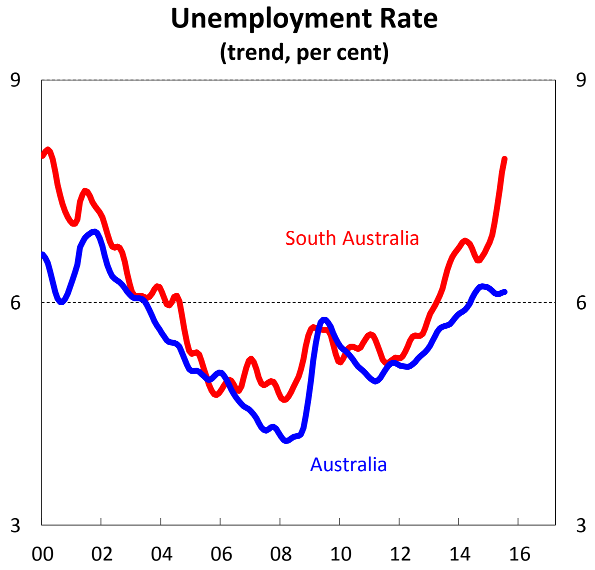
State Budget

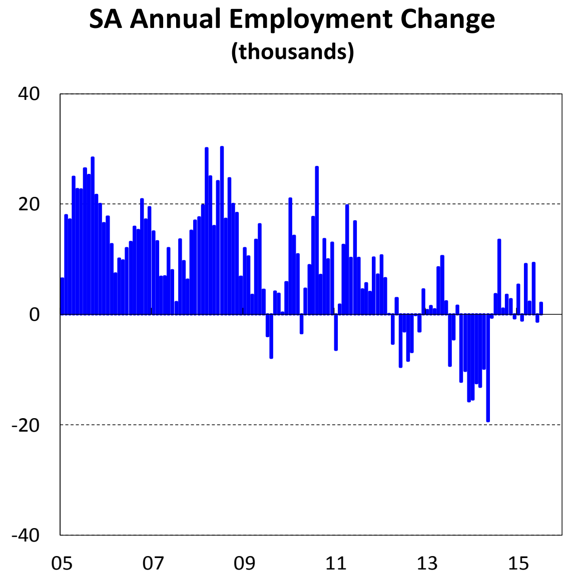
Following five consecutive years of Budget deficits, the latest South Australian Budget is predicting a surplus of $43m for 2015-16. The South Australia 2015-16 Budget was somewhat radical and aimed at increasing business investment. A cornerstone of the Budget was reform to stamp duty. This includes the abolition of stamp duty on non-real property transfers, which includes business transfers. Stamp duty on the sale of commercial property will also be abolished. These tax cuts are expected to stimulate economic growth over time.

Labour Market

The labour market in South Australia has been subdued in recent years. In the year to July, South Australia added 2.1k jobs. By comparison, 243.6k jobs were added nationally over the same period.

Ongoing softness in jobs growth has pushed the unemployment rate higher in trend terms, from 6.6% in July 2014 to 7.9% in July 2015, a 14-year high. This is the highest of all the States and well above the national unemployment rate of 6.3%. An increase in workforce participation has put upward pressure on the unemployment rate, with workforce participation rising to 62.4 in July, from 62.2 a year earlier. This is well below the national average workforce participation rate of 65.1%.





Most jobs were created in the arts & recreation sector in the year to May with 5.8k jobs added. This was followed by financial & insurance services (5.5k), information, media & telecommunications (5.3k) and transport, postal & warehousing (5.1k). Sectors which are facing challenges witnessed some job shedding. These included manufacturing and mining, which lost 7.8k and 5.2k jobs, respectively in the year to May.

BankSA Forecasts

Economic Indicators, % Change				
	2014-15 (est.)	**2015-16 (f)**	**2016-17 (f)**	**2017-18 (f)**
Gross State Product, constant prices	1.50	1.25	1.90	2.00
State Final Demand	1.50	1.60	1.70	1.80
Employment	0.40	0.50	0.50	1.00
Unemployment Rate	6.90	7.40	7.20	6.80
Adelaide CPI	1.60	2.50	2.50	2.60
Wage Price Index	2.60	2.20	2.50	3.30

Source: St.George Banking Group

We expect an improvement in South Australia’s economy but for growth to remain modest and below trend in coming years. The adjustment within the manufacturing industry and relatively weak population growth are key risks to the outlook. However, low interest rates and a weaker Australian dollar will be supportive for the South Australian economy.

Contact Listing

Chief Economist

Hans Kunnen
kunnenh@stgeorge.com.au
(02) 8254 8322

Senior Economist

Josephine Horton
hortonj@stgeorge.com.au
(02) 8253 6696

Senior Economist

Janu Chan
chanj@stgeorge.com.au
(02) 8253 0898