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SA Economic Outlook

Summary

- The South Australian economy has been through challenging times in recent years. Unfortunately, good news has remained scarce and economic growth has been disappointing. The South Australian economy grew at just 1.3% in 2013-14, following growth of 0.9% in 2012-13.
- Confidence has been lacking in the South Australian economy. The closure of car manufacturing and the possibility that the Federal government will buy submarines from Japan rather than have them built locally in South Australia have been 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 other capital cities including Sydney and Melbourne. We expect further modest gains in house prices as the extended period of low interest rates should continue 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.

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

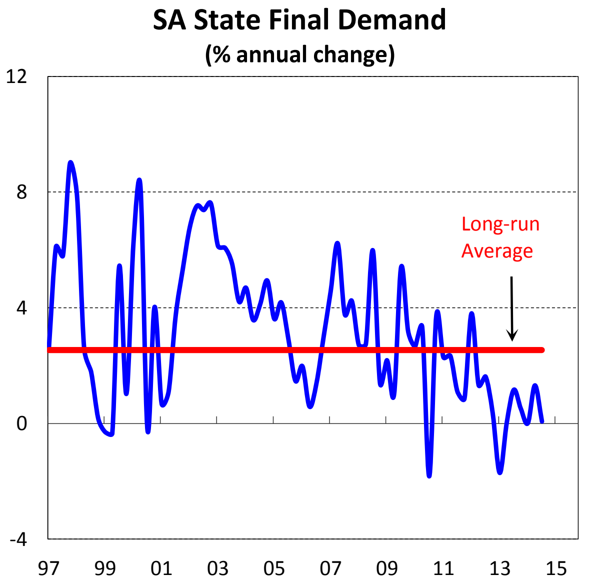
The South Australian economy has been through challenging times in recent years. Some issues include the shelving of BHP's Olympic Dam Expansion Project and the announcement by Holden to cease production in 2017. Unfortunately, good news has remained scarce and the latest blow is the possibility that the Federal Government will buy a new fleet of submarines from Japan instead of having them built in South Australia.

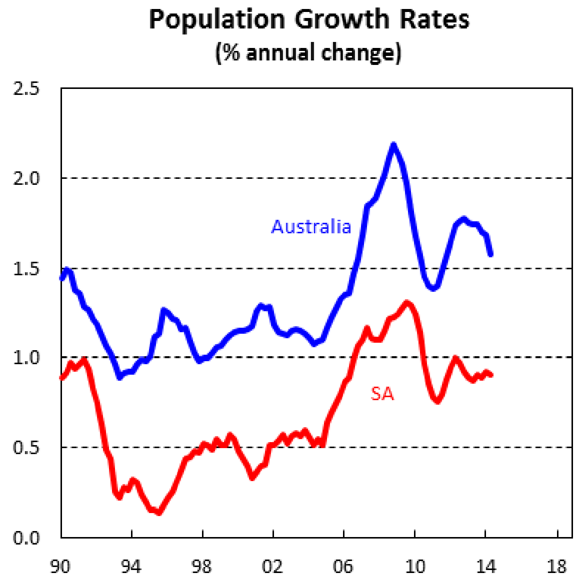
The Gross State Product (which is the State equivalent for GDP, published annually) has been disappointing in recent years. The South Australian economy grew at just 1.3% in 2013-14, following growth of 0.9% in 2012-13.

There are positives for the State, including a now weaker Australian dollar. The exchange rate has fallen over 20% against the US dollar and over 15% in trade-weighted terms since early 2013. This 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.

Recent data suggests that the South Australian economy is still struggling. State final demand is lacklustre, and barely grew at 0.1% in the year to the September quarter. The weak momentum in the State economy suggests that South Australia will continue to grow at a pace well below its long-run average.

Fragile confidence and relatively weak population growth also point to further weakness in the South Australian economy. However, there will be ongoing support from low interest rates, and a weaker Australian dollar.





We expect further modest growth of 1.5% in 2014-15 and 1.9% in 2015-16. This reflects a gradual improvement, although growth is expected to remain below trend. (See page 7 for further details).

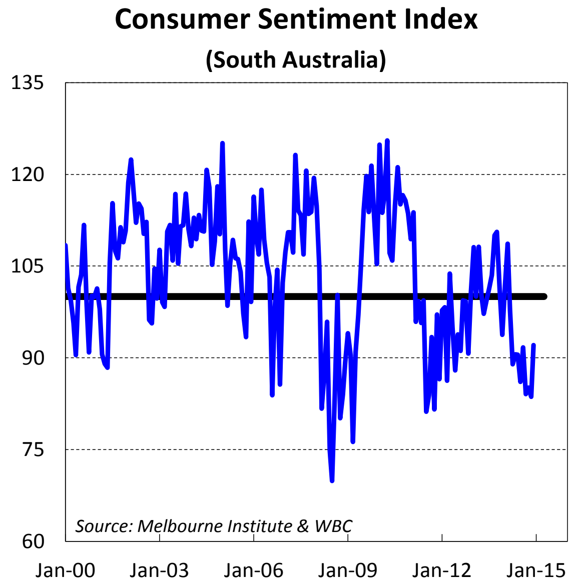
Consumer Spending

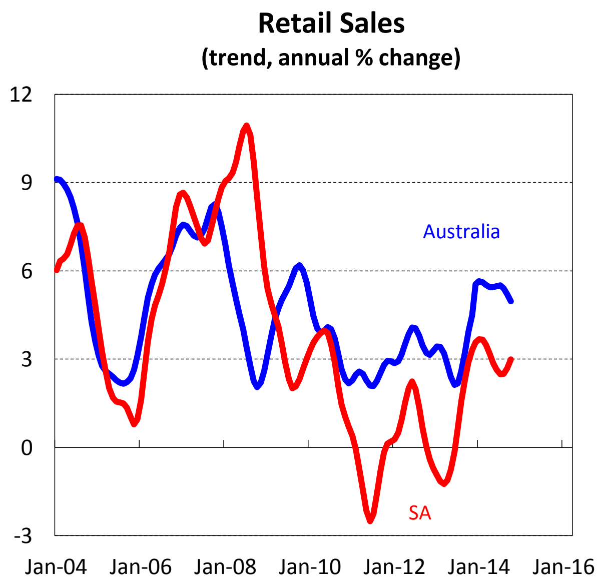
Consumer spending is gaining traction in South Australia, thanks to an extended period of low interest rates. Growth has edged up to an annual pace of 1.1% in the year to the September quarter. It was the fastest pace of growth in two years, but it remains well below the long-run average of 2.1%.

There are however, signs that consumer spending is picking up further in South Australia. Retail spending grew at an annual pace of 4.8% in October, the strongest in over five years. The pace of retail spending growth is now above its long-run average.

A key risk that could derail a recovery in spending is weak confidence. The consumer sentiment survey from the Westpac-Melbourne Institute indicates that consumers in South Australia remain pessimistic. The index has now been below 100 for 10 consecutive months. In December, it was at 92.1, although it was up from a low of 83.7 in November. Consumers in South Australia are slightly more optimistic than Australia-wide, where the index was at 91.1.

Nonetheless, consumers have been pessimistic for some time, and it appears that this has not yet translated into materially weaker spending. Low interest rates should continue to support consumer spending, although only modest growth is in prospect unless the mood of consumers turns around. Weak income growth is also likely to continue to hold back consumers.





Housing

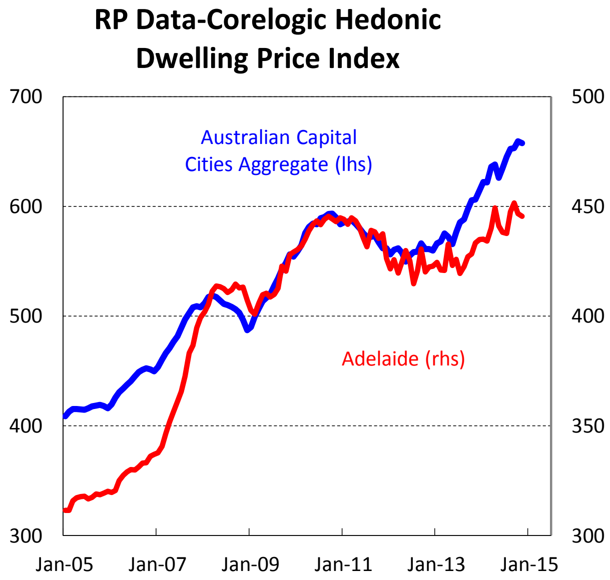
House prices in Adelaide have grown modestly, although the pace of growth has lagged behind growth in other capital cities including Sydney and Melbourne. In November, Adelaide dwelling prices rose at an annual pace of 2.8%, according to CoreLogic-RP Data. By comparison, dwelling prices Australia-wide grew at 8.5% over the same period.

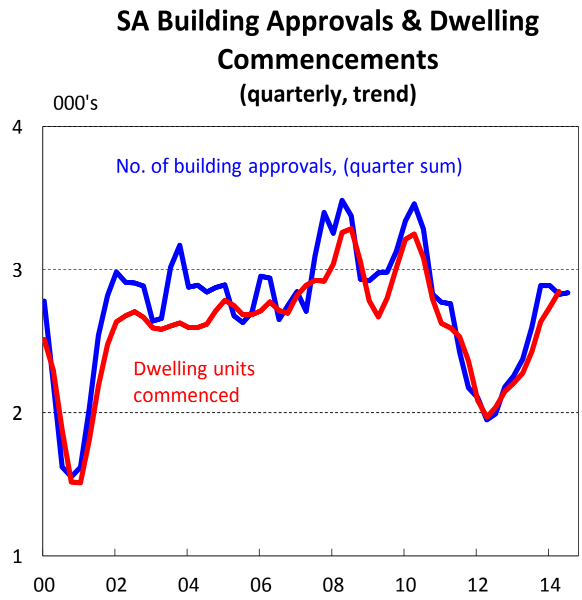
- **Dwelling Investment**

The modest gain in house prices along with low interest rates have supported a lift in residential construction, although it appears that activity is beginning to stabilise at a level close to its long-run average over the past year. This suggests that dwelling investment is providing less of a contribution to GSP growth than in earlier years.

A range of incentives by the South Australian State government, which are being phased out, may have pulled forward demand for newly constructed homes. 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.

Notwithstanding the impact of State government incentives, further gains in house prices should keep residential construction activity at 'goldilocks' levels – not too hot, not too cold. A positive from this development is that South Australia is unlikely to suffer much supply overhang which could exaggerate swings in house prices down the track.





- **Rental Markets**

While investor activity is not as strong as in Sydney and Melbourne, loans to investors in South Australia are still increasing at a healthy rate. An extended period of low interest rates combined with relatively high gross rental yields in Adelaide suggest that housing investment could be attractive for investors in South Australia. According to CoreLogic RP Data, rental yields stood at 4.9% for units and 4.2% for houses as of November.

Residential rents have continued to grow modestly in Adelaide. Median weekly rents for a 3 bedroom house grew at an annual rate of 4.7% in the year to the June quarter and 1.8% in the year for a 2 bedroom “other” dwelling. Vacancy rates were at 2.5% in the June quarter, which suggests there is strong demand for rental accommodation.

- **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 remained broadly steady at just above 30% of loans. The more restrained investor interest in South Australia is one factor behind the underperformance of Adelaide house prices.

We expect further modest gains in house prices as the extended period of low interest rates should continue to support demand from both owner occupiers and investors. House price gains in Adelaide are likely to continue to lag behind capital cities in other States, and will be tempered by slower population growth and a softer labour market in comparison to other States.

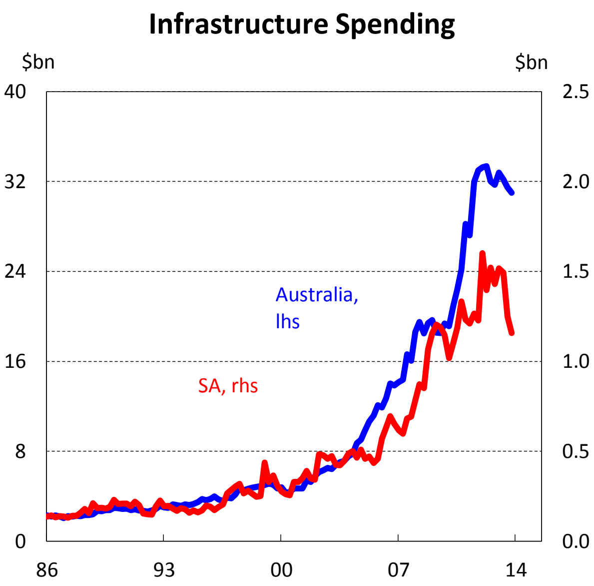
Business Investment

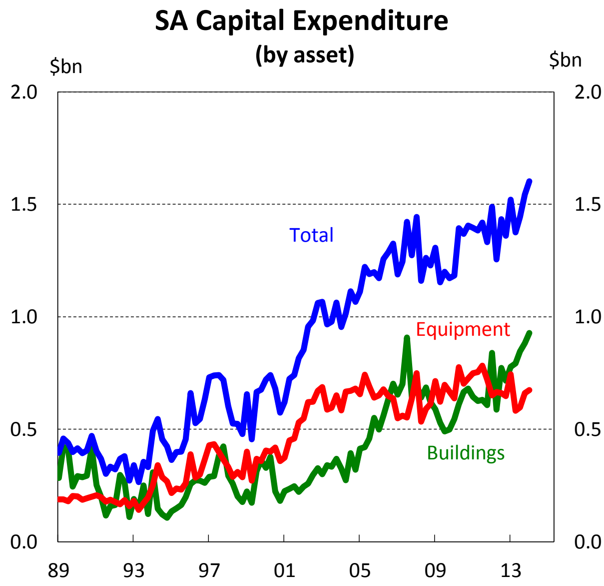
Business investment in South Australia has been lacklustre in recent years. Mining investment failed to take off despite the promise of becoming the next resource powerhouse. Further, non-mining investment has remained slow to pick up. In the September quarter, business investment fell 5.2% from a year ago.

Much of the weakness has come from engineering construction and infrastructure spending. However, the value of investment projects in the pipeline appears to be increasing. These include the $514mn upgrade of the Port Pirie smelter.

In recent times, the public sector has helped support activity, and helped make up for the lack of private sector activity. As part of the wider Rail Revitalisation program, Stage 2 of the electrification of the Gawler line has been announced and is expected to commence in 2017-18.

Within non-residential construction, publicly funded health projects including the new Royal Adelaide hospital and redevelopments of Lyell McEwin hospital and the Queen Elizabeth hospital, continue lead the way in activity. Within other sectors, the weak state of the job market has unfortunately translated into a soft outlook for commercial construction.





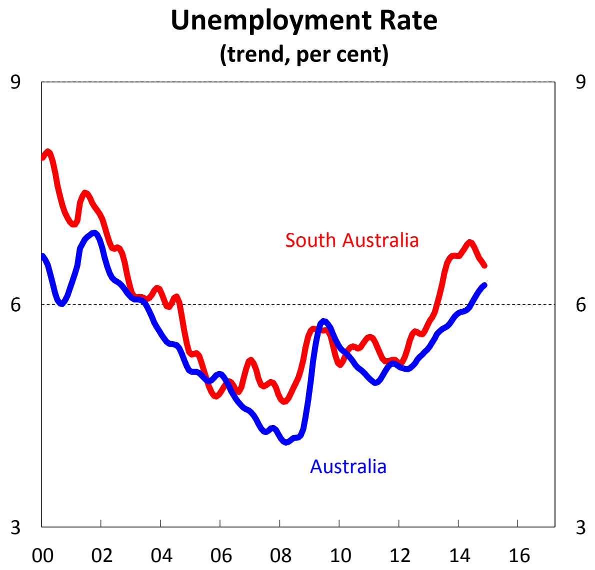
Falling commodity prices dim prospects for further investment within the mining sector and there remains little in the pipeline. A lift in non-mining business investment is needed to support growth across Australia and in South Australia.

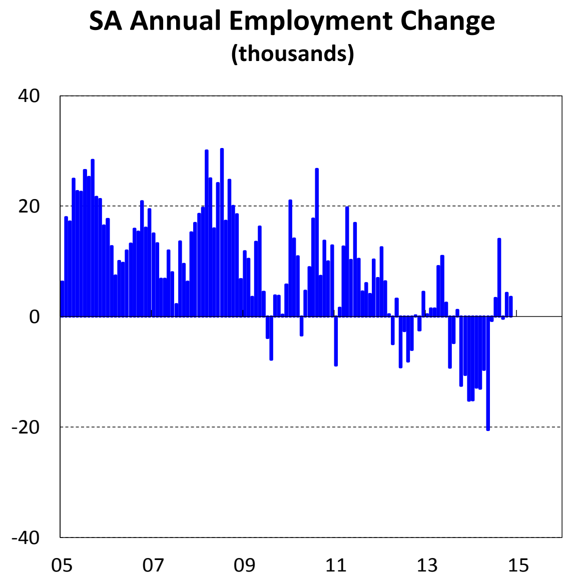
The level of confidence within South Australia will be a key factor in the outlook for business investment within the non-mining sector. Recently, business confidence in South Australia has lifted according to the BankSA State Monitor. The business confidence index rose to 105.8 in September, the highest in 12 months. Perceptions that business activity was picking up had increased, particularly among owners of SMEs. While the improvement in confidence is encouraging, a further lift will likely be necessary before a recovery in business investment takes hold.

Labour Market

The labour market in South Australia has been subdued in recent years, although conditions have significantly improved from around a year ago. In the year to November, South Australia added 3.6k jobs. By comparison, 10.5k jobs were shed over the same period a year ago.

The stabilization in the labour market has helped the unemployment rate edge lower over the past year from 6.8% in November 2013 to 6.6% in November 2014. However, a decline in workforce participation has also helped keep down the unemployment rate in South Australia, a trend which is occurring across the country.





Most jobs were created in the healthcare social assistance sector in the year to November with 8.2k jobs added. This was followed by arts & recreation services (6.4k), professional, scientific & technical services (4.4k) and accommodation & food services (4.3k). Sectors which are facing challenges witnessed some job shedding. These included manufacturing and public administration & safety, which lost 8.5k and 7.8k jobs, respectively in the year to November. Construction (-9.9k) however, lost the most jobs in South Australia.

BankSA Forecasts

Economic Indicators, % Change				
	2013-14	**2014-15 (f)**	**2015-16 (f)**	**2016-17 (f)**
Gross State Product, constant prices	1.30	1.50	1.80	2.10
State Final Demand	0.80	1.30	1.70	2.00
Employment	-1.30	0.60	1.20	1.20
Unemployment Rate	6.70	6.70	6.80	6.70
Adelaide CPI	2.60	2.00	2.50	2.50
Wage Price Index	3.30	2.60	2.50	2.80

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 car 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

Besa Deda
dedab@stgeorge.com.au
(02) 8254 8322

Senior 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