Thursday, 26 May 2016

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NSW Economic Outlook

Summary

- The NSW economy has become one of the star-performing States within Australia. It has escaped much of the pain from the downturn in mining investment occurring in other States and has benefited greatly from low interest rates and a lower Australian dollar. This boost is evident in the strong housing market, the lift in tourist numbers and their flow on effects to businesses and the labour market.
- While the NSW economy isn't quite booming, economic growth in 2014-15 was the fastest in four years. We expect a solid outcome of 3.0% in 2015-16, which should result in a further gradual reduction in the unemployment rate. In following years, however, we expect growth to moderate as the housing market cools and as growth in dwelling investment slows.
- While housing should get another leg up from the recent reduction in official interest rates, we expect conditions in the housing market should continue to moderate. Residential construction activity is likely close to a peak although activity should remain at an elevated level over the course of the year.
- Much like the rest of Australia, the recovery in business investment has been uneven. However, prospects for a pickup in investment spending are continuing to improve. Business surveys indicate that conditions are at above-average levels and capacity utilisation is close to its highest levels since late 2007. There is also a healthy amount of work in road and rail infrastructure, largely driven by public works.
- The NSW labour market has been much stronger than expected. In 2015, it added more jobs than any other year on record. Job growth has since eased and will likely continue to moderate in coming months. The unemployment rate has fallen from its recent peak of 6.3% to sit at 5.3%. We expect that the job growth will be sufficient to see the unemployment rate gradually improve over the coming year or two.

Economic Growth

The NSW economy has become one of the star-performing States within Australia. It has escaped much of the pain from the downturn in mining investment occurring in other States and has benefited greatly from low interest rates and a lower Australian dollar. This boost is evident in the strong housing market, the lift in tourist numbers and their flow on effects to businesses and the labour market.

However, while NSW is now on the right side of Australia’s multi-speed economy, economic growth in the First State isn’t booming. In 2014-15, the NSW economy grew just 2.4%.

That said, economic growth in 2014-15 was the fastest in four years, and close to the 20-year average. Moreover, we expect a solid outcome of 3.0% in 2015-16, which could result in a further slight reduction in the unemployment rate.

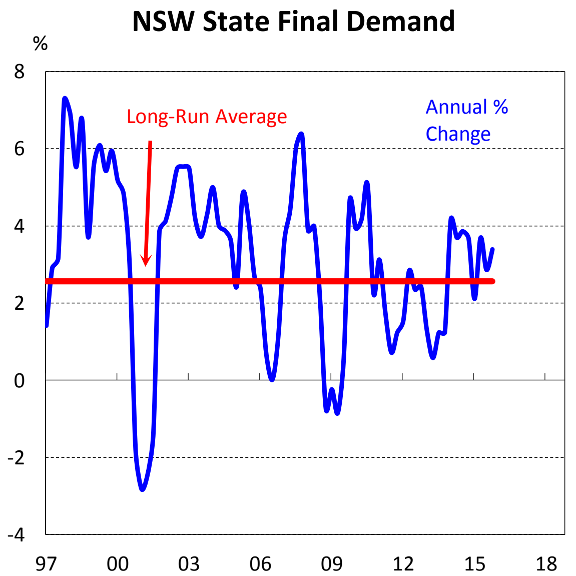
Percentage Shares of the Economy*

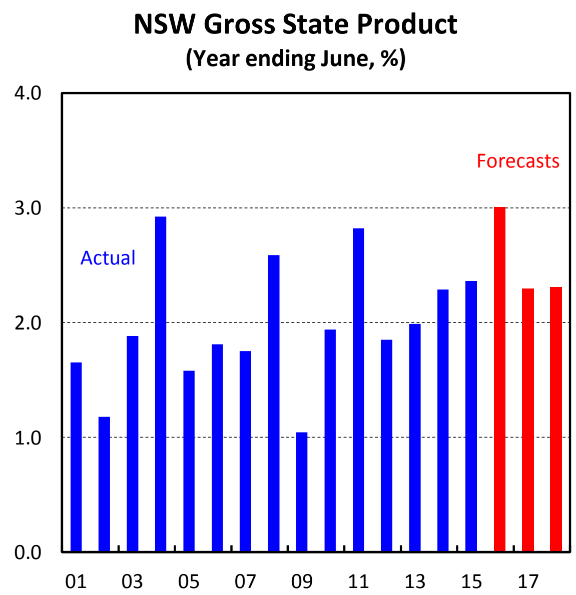
Industries	NSW	Australia
Financial and insurance services	15.0	10.1
Professional, scientific and technical services	8.3	7.0
Health care and social assistance	7.8	7.6
Manufacturing	7.4	7.3
Construction	6.6	9.1
Public administration and safety	6.0	6.1
Education and training	6.0	5.5
Retail trade	5.5	5.2
Wholesale trade	5.3	4.8
Transport, postal and warehousing	5.1	5.4
Information media and telecommunications	4.9	3.4
Rental, hiring and real estate services	3.9	3.3
Administrative and support services	3.7	3.1
Accommodation and food services	3.5	2.8
Mining	2.8	10.2
Electricity, gas, water and waste services	2.8	3.2
Other services	2.5	2.2
Agriculture, forestry and fishing	1.6	2.6
Arts and recreation services	1.2	0.9

** As % of GSP and GDP less ownership of dwellings 2014-15*
Source: ABS, St.George

The wide range of positives should continue to underpin a healthy amount of activity in NSW. Low interest rates will further support activity in the housing market and consumer spending. There is a healthy pipeline of transport infrastructure driven by the public sector. While growth in business investment has been lacking, businesses are reporting their best conditions in years. All of these factors should support employment and population growth and continue to see the NSW as one of the better performing State economies in the near term.

In following years, however, we expect growth to moderate as the housing market cools and as growth in dwelling investment slows.





Consumer Spending

Over the past few years, rising house prices, low interest rates and more recently, an improving labour market have been supportive factors for consumer spending in NSW. These factors continue to support household consumption. However, growth in consumer spending (adjusted for inflation) in NSW has softened over the past year from a recent peak of 4.1% in the year to the December quarter 2014 to an annual pace of 3.2% in the December quarter 2015.

Retail spending in the early part of 2016 confirms that this more moderate pace of spending is continuing. Annual growth in retail spending in March stood at 4.7%, down from a near double-digit pace in mid-2014.

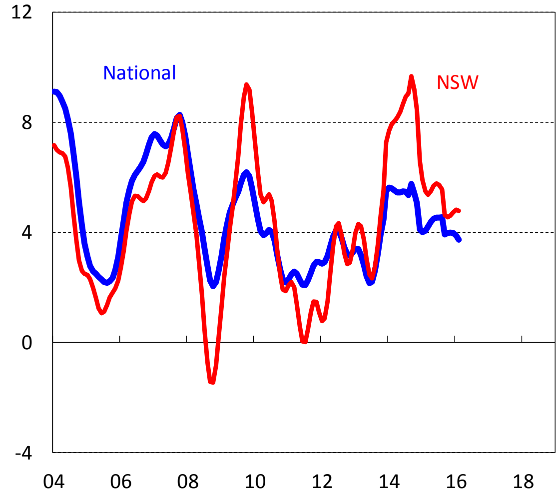
The softer pace of spending can be partially attributed to some easing conditions in the housing market. Additionally, weak growth in incomes is also limiting the ability for any further pickup in household spending.

Nonetheless, consumer spending is still growing close to its long-run average. Moreover, a growth rate of spending significantly above the pace of growth in incomes was never going to be sustainable.

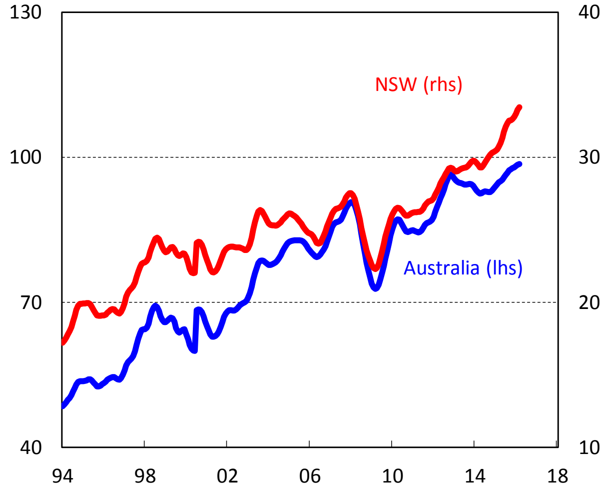
We still think that household consumption will grow at a moderate rate. There are a range of factors which will continue to support spending. Although some heat has come out of the housing market, particularly in Sydney, there remains a great deal of activity within the construction sector. This should prop up spending in those areas relating to home improvements. Indeed, areas such as hardware, building and garden supplies continue to witness double-digit annual growth. Ongoing low interest rates can also help finance spending in other areas. Most notably, the purchase of vehicles has been the strongest growth category of household spending.

A healthy labour market in NSW as well as relatively firm population growth also supports the view that consumer spending will grow moderately. Low interest rates and the low Australian dollar will continue to be major positives for the NSW economy, jobs and spending.

Value of Retail Sales
(trend, annual % change)



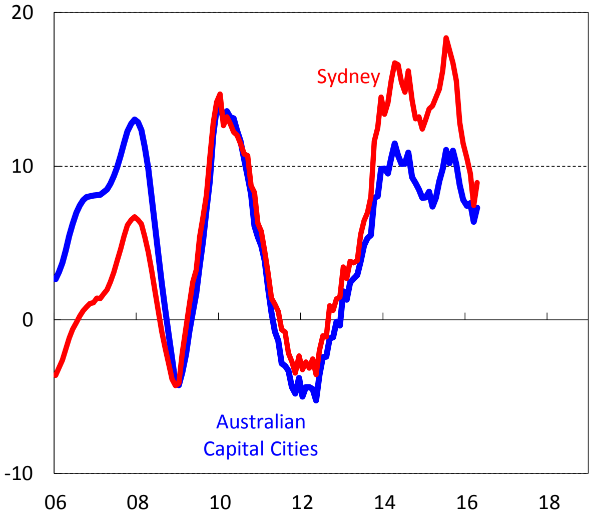
New Motor Vehicle Sales
(trend, '000)



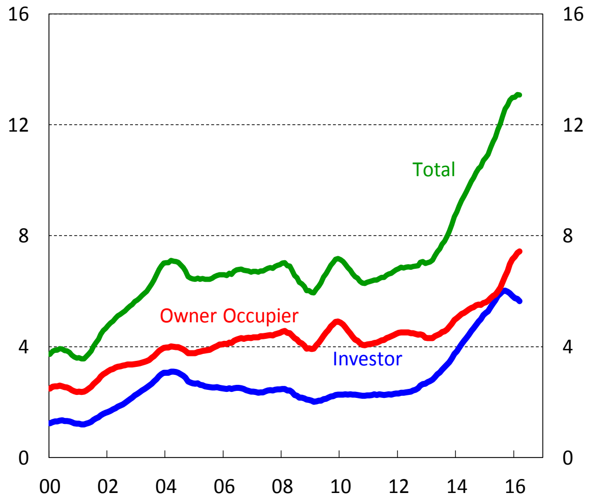
The extent to which consumer spending can grow at a pace beyond the pace of income growth will depend largely on how comfortable consumers will feel about reducing their level of savings, and this in turn will depend on confidence.

Consumers have generally been more optimistic in NSW, likely reflecting the strong lift in house prices over recent years and the relatively firm conditions within the State economy. The Westpac-Melbourne Institute survey of consumer sentiment for NSW has largely held above 100 over the past year, indicating more optimism than pessimism among consumers. The index stood at 109.9 in May following the RBA move to cut official interest rates by 25 basis points. It remains to be seen whether the easing conditions in the housing market, jitters in global financial markets at the turn of the year or worries regarding the state of the global economy are unnerving consumers enough to negatively impact spending. However, there are enough positives in NSW, including a relatively healthy labour market, low interest rates and solid activity in the housing market, which should keep consumer spending ticking along reasonably well.

CoreLogic - RP Data Dwelling Prices
(% annual change)



NSW Housing Finance
(By value 12-Month Moving Average, $bn)



Housing

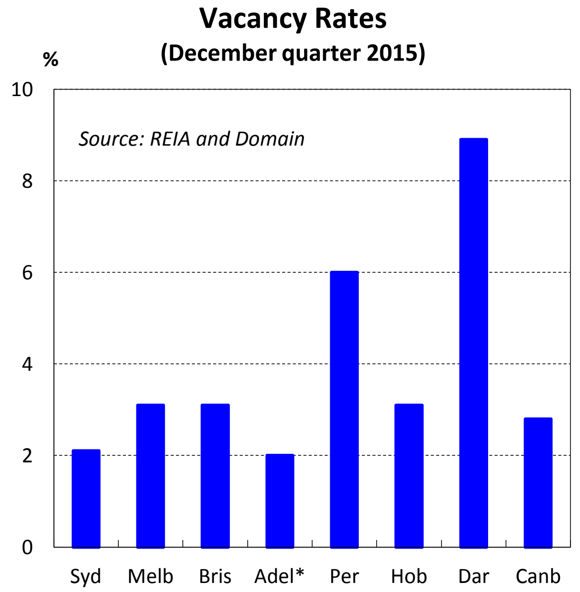
The housing market has been a key area of strength for NSW. Prices have continued to head north – dwelling prices were 8.9% higher in the year to April according to RP Data Core Logic, although price growth has eased from the 18.4% annual surge in July of last year.

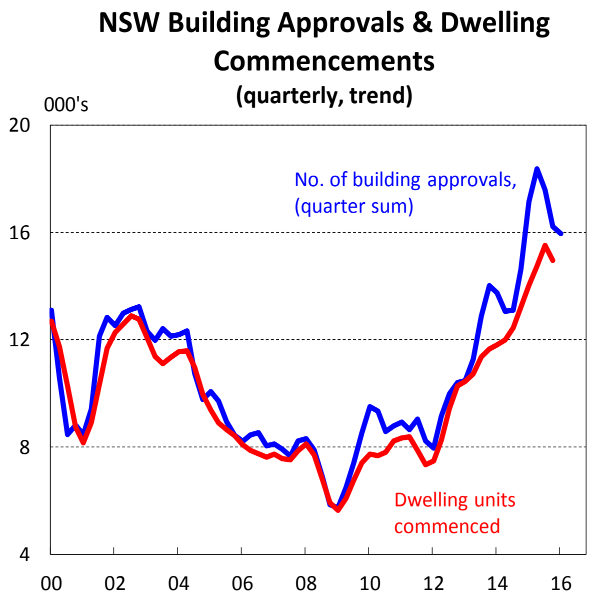
Housing is set to gain another leg up after the RBA cut the cash rate to 1.75% in May, and there is the prospect of another cut to official interest rates. Nonetheless, a further moderation in house price growth is expected to continue. Auction clearance rates are down from their peaks, lending growth has softened and the measures by APRA to keep a lid on home lending to investors appear to have done their job.

Housing is becoming increasingly less attractive for investors. Rental yields have fallen to new lows as growth in dwelling prices has outpaced growth in rents. Median weekly rents rose 2.2% in the year to the December quarter for a 3 bedroom house and 4.0% for a 2 bedroom unit according to the REIA. Meanwhile, vacancy rates are edging higher, lifting 0.4 percentage points over the year although they continue to suggest that rental markets are tight (well below 3% at 2.1%).

We expect these factors to continue to cap investor housing demand, which have been a large proportion of the market. The strong gains in Sydney dwelling prices are unlikely to be repeated anytime soon. Nonetheless, there are plenty of positives which will continue to support activity. Low interest rates and solid population growth will continue to underpin demand and some further growth in prices, but at a more moderate pace.

The upswing in dwelling prices attracted the highest levels of residential construction on record in NSW last year. Moderating price growth and building approvals down from their peaks suggest that further strong gains are unlikely, although activity should remain at an elevated level over the course of the year.

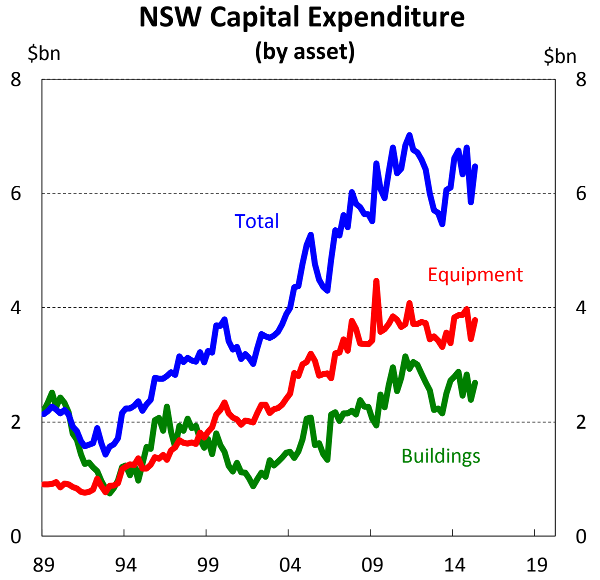


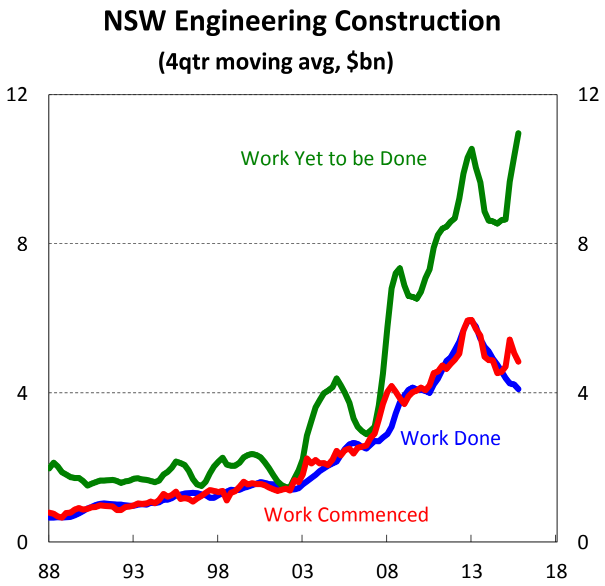


Softer growth suggests that residential construction will have a smaller positive impact on economic growth than previously. However, the high level of activity should assist in making up for the shortfall in homebuilding in earlier years.

Business Investment and Infrastructure Spending

Conditions are supportive for a recovery in business investment. Low interest rates, a low Australian dollar and strong conditions in the housing market should help flow through to stronger activity in other areas including investment spending. Indeed, there has been a healthy amount of activity within commercial construction and infrastructure spending.





However, while prospects remain positive, business investment has hit a bit of a lull. Business spending in NSW has softened over the past year after firmer growth over 2014 and early 2015. In the December quarter 2015, business investment was just 1.5% higher than a year ago. This isn't a bad result relative to the sharp falls in Queensland and Western Australia where major mining projects are approaching completion. However, the recovery in non-mining investment, which was supposed to help fill the hole left by mining investment, has been uneven across Australia. NSW has been no exception.

That said, there is a healthy amount of work underway and in the pipeline, largely driven by public works. Within engineering construction activity, work yet to be done hit nearly $11bn in the year to the December quarter 2015, the highest on record for NSW. A sizeable proportion of projects continue to be within transport infrastructure. Work has begun on WestConnex, NorthConnex and the CBD and South East Light Rail project. Work also continues on the Sydney Metro North West rail link.

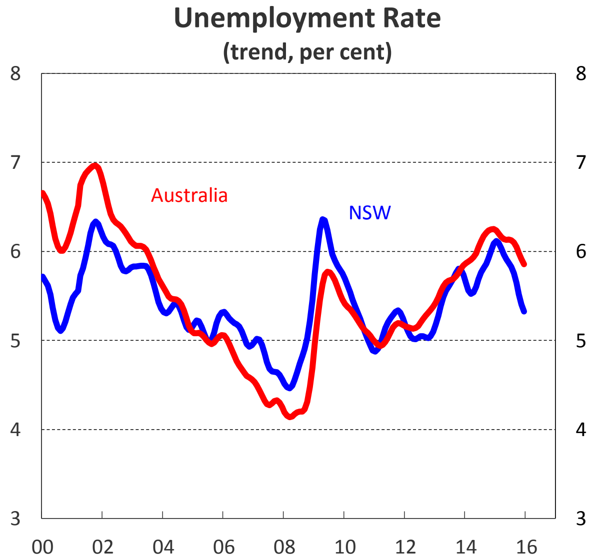
There are also some noteworthy projects within commercial construction. The largest, the $6bn Barangaroo development, is ongoing and work will continue through to 2020. An upgrade to the Royal North Shore hospital worth $1bn and the Darling Harbour Live project worth $2.5bn are also underway.

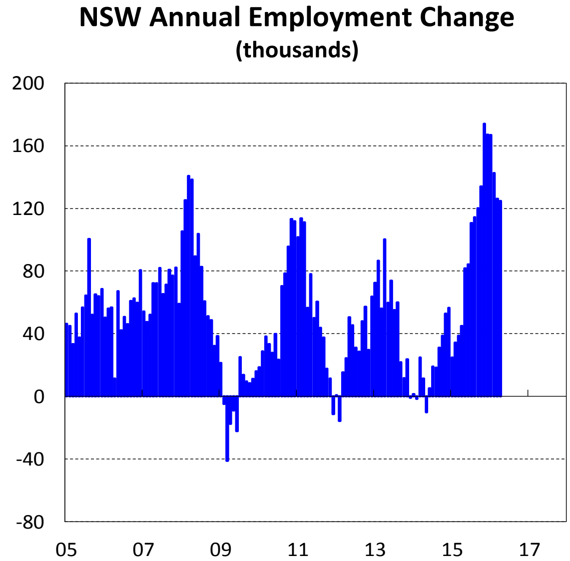
For the broader business community, prospects for a pickup in investment spending are continuing to improve. Business surveys indicate that conditions are at above-average levels and capacity utilisation is close to its highest levels since late 2007. In this environment, it would be reasonable to expect that in time, businesses will increase investment to meet demand and to replace ageing capital stock.

Labour Market

The labour market in NSW had a stellar run of job gains over 2015, adding a total of 167.1k jobs. That was the most jobs ever gained in a calendar year, or at least since 1979 when ABS data was collected.

In recent months, job growth has moderated but the annual pace of job gains in the year to April remained solid at 124.7k. The strength of job gains has resulted in the unemployment rate falling to 5.3% in April, down from a recent peak of 6.3% in February 2015.





A further moderation in job growth is likely in coming months. While the NSW economy is performing relatively well, the pace of economic growth has not been enough to justify the surge in jobs over the past year. Nonetheless, we expect that job growth will be sufficient to see the unemployment rate gradually improve over the coming year or two.

The strength of NSW's job market can be partly explained by stronger activity within services. Areas where job gains have been strongest in the year to February include professional, scientific & technical services (41.4k), administrative & support services (30.7k), retail trade (29.7k) and healthcare & social assistance (26.6k).

St.George Banking Group Forecasts

The NSW economy is on a solid footing, and continues to gain support from low interest rates, a low Australian dollar and relatively strong population growth. A healthy amount of activity in road and rail infrastructure and positive conditions in businesses further suggests that employment growth and spending will be well supported over the coming year. We expect that the NSW economy will grow at 3.0% in 2015-16, but slowing to 2.4% in 2016-17 reflecting easing growth in dwelling investment and a cooling housing market.

Please see detailed forecasts on page 8.

Economic Indicators, % Change (year average)				
	2014-15	**2015-16 (f)**	**2016-17 (f)**	**2017-18 (f)**
Gross State Product	2.40	3.00	2.40	2.20
State final demand	3.20	2.90	2.60	2.50
Employment	1.20	3.70	1.50	1.50
Unemployment rate (year average)	5.90	5.40	5.30	5.20
Sydney CPI	1.90	1.50	1.60	2.20
Wage Price Index	2.30	1.90	2.50	2.70

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