State Economic Outlook

Wednesday, 23 November 2016

NSW Economic Outlook

Summary

- The NSW economy has become one of the star-performing States within Australia. While it didn't enjoy as much upside from the mining investment boom, it did avoid the hangover which plagued some of the resource States. NSW has benefited greatly from low interest rates and a lower Australian dollar.
- In 2015-16, the NSW economy grew at its fastest pace since 1999-00. With growth of 3.5%, the NSW economy was the fastest growing in Australia. We expect economic growth in NSW to remain solid in 2016-17.
- The housing market has been a key area of strength for NSW. Two interest rate cuts from the RBA have supported the housing market this year, and should continue to provide a boost. Dwelling investment is expected to continue to contribute to economic growth, although at a declining pace. Dwelling price growth is likely to moderate, however, as supply ramps up this year and next.
- In recent years, low interest rates, rising house prices and an improving jobs market supported consumer spending in NSW. Growth in consumer spending remains solid, but has eased somewhat, with weak growth in incomes keeping a lid on consumers' appetites for additional spending.
- The positive outlook for NSW has led to an increase in business investment growth. Low interest rates, a low Australian dollar and strong conditions in the housing market have been supportive of private business investment. There has been a healthy amount of activity within commercial construction and the government has added to economic growth in NSW with increased infrastructure spending.
- Job growth in NSW has waned this year. New jobs continue to be created, but at a much slower pace. Job creation in recent years has outpaced growth in the labour force, resulting in a steady decline in the unemployment rate. The NSW unemployment rate held at 4.9% in October, down from 5.5% a year earlier.

Economic Growth

The NSW economy has become one of the star-performing States within Australia. While it didn't enjoy as much upside from the mining investment boom, it did avoid the hangover which plagued some of the resource States. NSW has benefited greatly from low interest rates and a still-low 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.

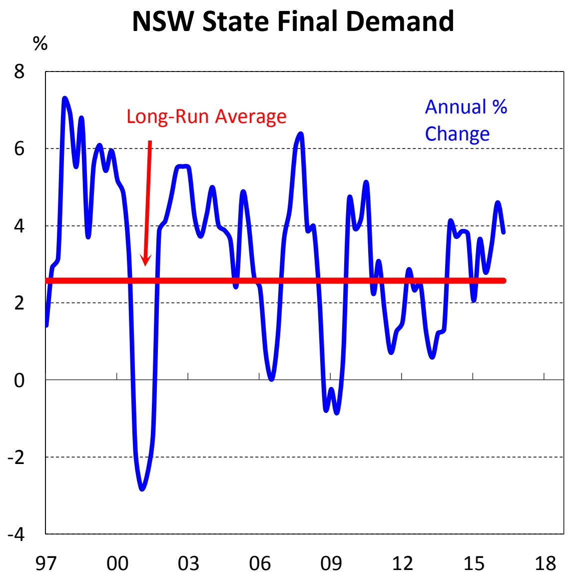
In 2015-16, the NSW economy was the fastest growing in Australia, at 3.5%, up from growth of 2.6% in 2014-15. This was the fastest growth since 1999-00 and well above the 20-year average of 2.5% in NSW. We expect another solid outcome of 2.75% in 2016-17.

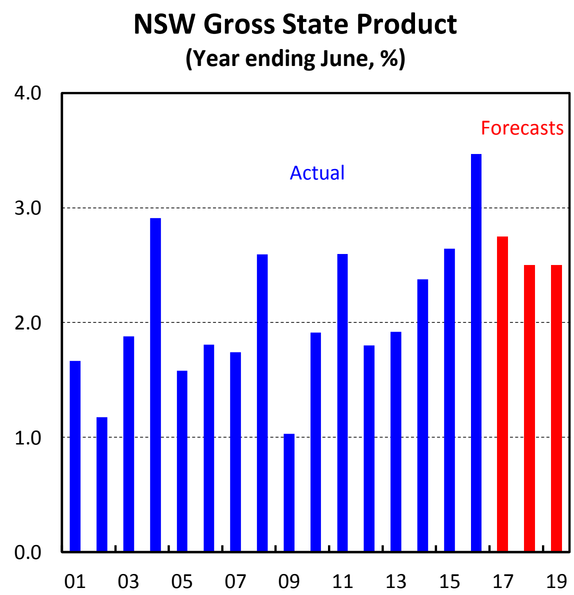
Percentage Shares of the Economy*

Industries	NSW	Australia
Financial and insurance services	15.4	10.4
Professional, scientific and technical services	8.8	7.4
Health care and social assistance	7.8	8.0
Construction	7.2	9.6
Manufacturing	7.1	7.1
Public administration and safety	6.2	6.5
Education and training	5.8	5.6
Wholesale trade	5.3	4.7
Retail trade	5.2	5.1
Transport, postal and warehousing	5.1	5.6
Information media and telecommunications	4.7	3.4
Rental, hiring and real estate services	4.2	3.6
Administrative and support services	3.7	3.2
Accommodation and food services	3.3	2.8
Electricity, gas, water and waste services	2.8	3.1
Other services	2.4	2.1
Mining	2.3	8.2
Agriculture, forestry and fishing	1.6	2.6
Arts and recreation services	1.2	1.0

** As % of GSP and GDP less ownership of dwellings 2015-16*
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 solid pipeline of infrastructure, driven by the public sector. Meanwhile, business investment has picked up in NSW. These factors should support the labour market and should continue to see the NSW economy outperform the national average over the coming year.





Consumer Spending

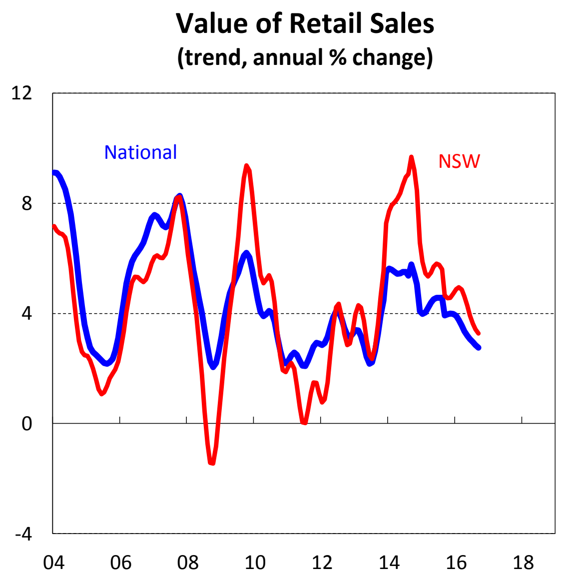
In recent years, low interest rates, rising house prices and an improving jobs market supported consumer spending in NSW. Growth in consumer spending has eased, but still remains solid. Weak growth in incomes appears to have kept a lid on consumers' appetites for additional spending.

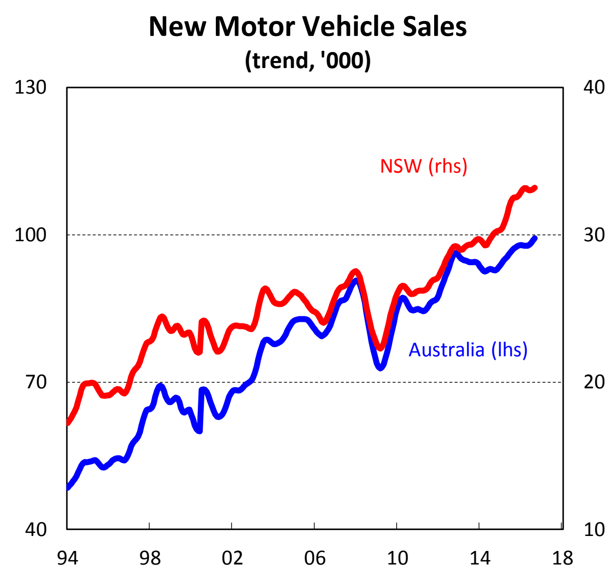
Following strong growth in 2014, the pace of growth in consumer spending has softened. Consumer spending rose by 3.6% in the year to the June quarter, still comfortably above the long term average growth of 2.8%, but below a recent peak of 4.1% in the year to the December quarter 2014. Over the year to the June quarter, spending on clothing & footwear (9.7%), electricity, gas & other fuels (7.2%), hotels, cafes and restaurants (5.8%) and communications (5.4%) has grown strongly.

Growth in retail sales, which covers a narrower array of items than consumer spending, has been lacklustre over the past year. Retail sales in NSW rose by 3.9% in the year to September, which is a slower pace of growth than in 2013 and 2014 and below the long-term (10-year) average of 4.5%. It is however, slightly above national growth of 3.3% in the year to September. Growth in retail sales has moved closer to growth in wages, reflecting consumers' reluctance to dip too far into savings to fund spending growth.

Retail sales volumes, which exclude the impact of inflation, paint a more subdued picture. In NSW, retail sales volumes rose just 1.7% in the year to the September quarter, down from annual growth above 6% in late 2014. NSW retail sales volumes are growing more strongly, however, than the national average, which rose 1.2% in the year to the September quarter.

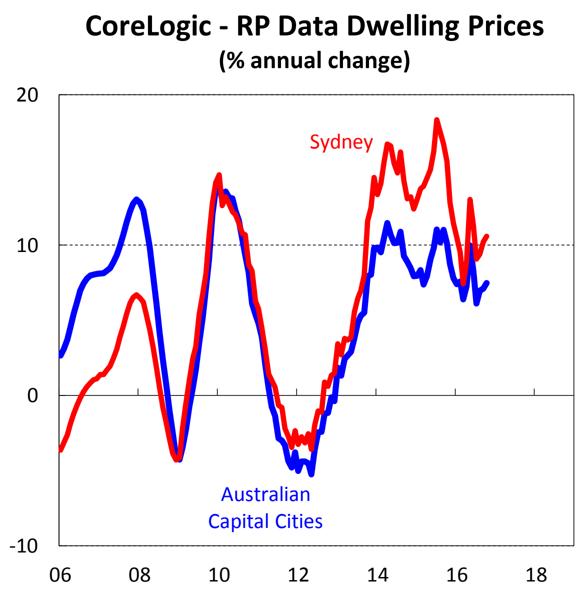
We expect household consumption to grow at a moderate rate over the coming year. Low interest rates remain conducive to spending, while firm population growth in NSW will support demand. While the housing market has come off the boil nationally, the construction pipeline in NSW remains strong, suggesting ongoing activity in the home improvements sector.

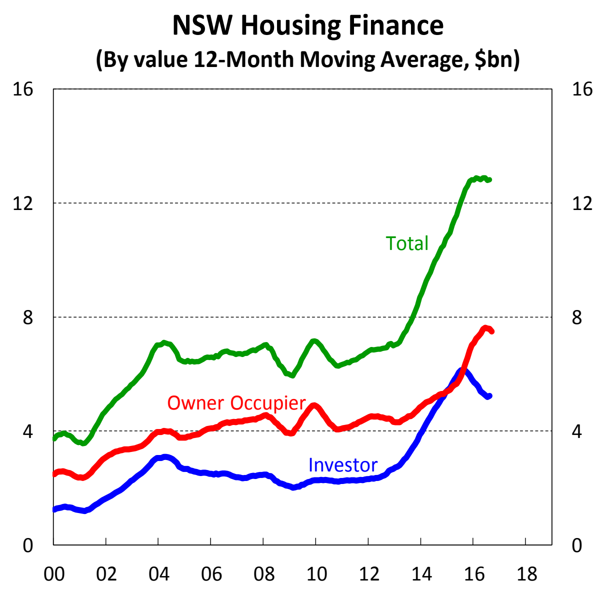




The extent to which consumer spending can grow at a pace beyond the pace of income growth will depend largely on how comfortable consumers will feel about reducing their level of savings, and this in turn will depend on confidence.

Consumers have been quite optimistic in NSW. 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 103.6 in November. The strength in consumer sentiment likely reflects relatively firm conditions within the State economy. Low interest rates, the continuing solid lift in house prices in NSW, the relatively healthy labour market and the still low Australian dollar should continue to support consumer sentiment in the State.





Housing

The housing market has been a key area of strength for NSW. Prices have continued to gain ground in Sydney – dwelling prices were 10.6% higher in the year to October according to Core Logic, although price growth has eased from the 19.8% annual surge in July of last year.

Auction clearance rates in Sydney remain strong, averaging 81.3% in October. Despite this, lending for housing has softened over the past year in NSW. The number of owner occupier loans has declined 9.2% in the year to September in NSW. After a period of weakness, however, the value of new loans to investors in NSW rose 13.7% in the year to September. The value of all new loans (to owner occupiers and investors) in NSW fell 2.8% in the year to September.

After weakening in the first half of this year, investor lending appears to be having a resurgence of late. APRA measures to curb lending to investors had an impact, but even lower official interest rates and continuing price gains in Sydney have supported investor demand.

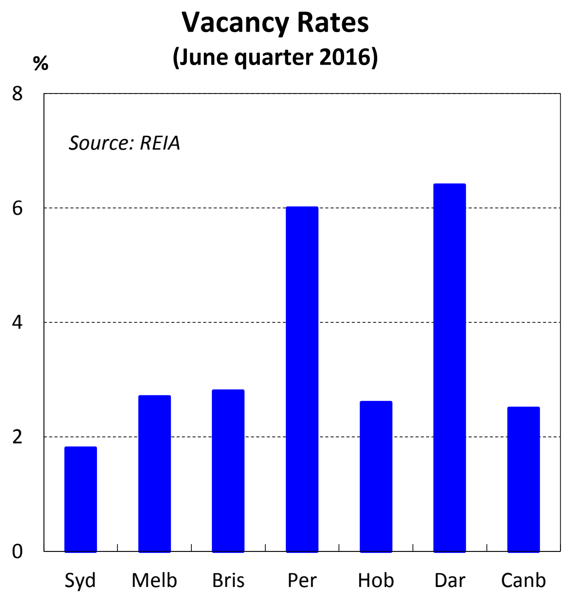
Rental yields have fallen to new lows as growth in dwelling prices has outpaced growth in rents. Median weekly rents rose 6.7% in the year to the June quarter for a 3 bedroom house and were unchanged for a 2 bedroom unit, compared to a year earlier, according to the REIA. Meanwhile, vacancy rates remain very low, falling 0.3 percentage points over the year, to 1.8% in Sydney, suggesting the rental market is very tight (as indicated by a rental vacancy rate below 2%).

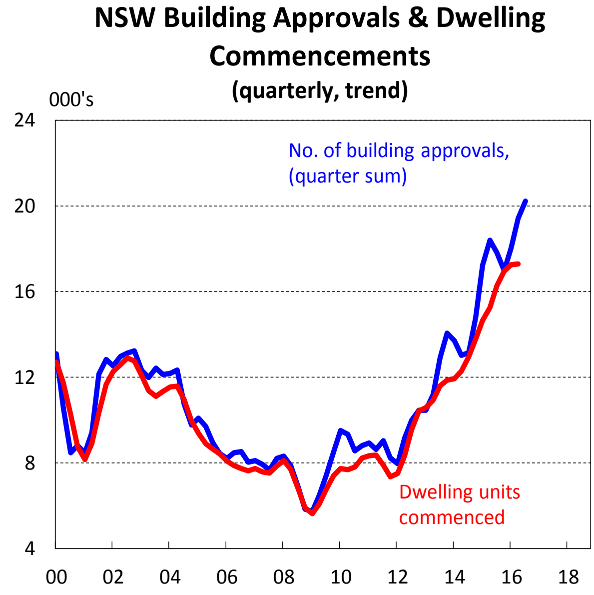
Two interest rate cuts from the RBA have supported the housing market this year, and should continue to provide a boost. Dwelling price growth is likely to moderate, however, as supply ramps up this year and next. The pipeline of apartment construction is robust, suggesting an increase in the supply of apartments over the next two years. Meanwhile, the supply of houses with proximity to the CBD is likely to decrease, as these residences continue to be bought by developers for apartment construction.

Overall, approvals of new houses are flat, rising just 0.1% in the year to September, in trend terms. Residential building approvals in NSW increased 17.1% over the year to September, in trend terms. The increased supply is being driven by the apartments segment, with trend building approvals rising 28.8% in the year to September.

While some other capital cities are likely to face a growing oversupply of apartments, the situation in Sydney is less severe. While current levels of dwelling construction in NSW exceed new demand, there is a level of pent-up demand, following years of undersupply. This pent-up demand will help to absorb the new supply, to a point.

We expect dwelling price growth to moderate further over the coming year, with apartment prices bearing the brunt of the slowdown in price growth in Sydney. Demand for housing is likely to remain elevated compared to units, particularly if the stock of established houses coming to market remains subdued. There are plenty of positives which will continue to support activity. These include low interest rates, firm population growth and reasonable job creation.

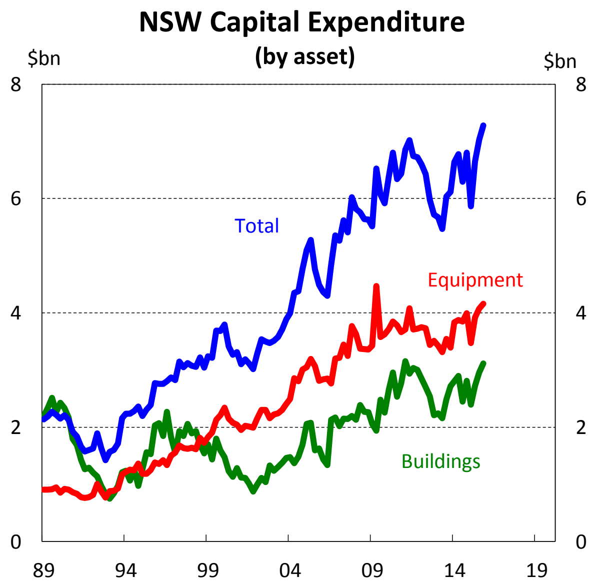


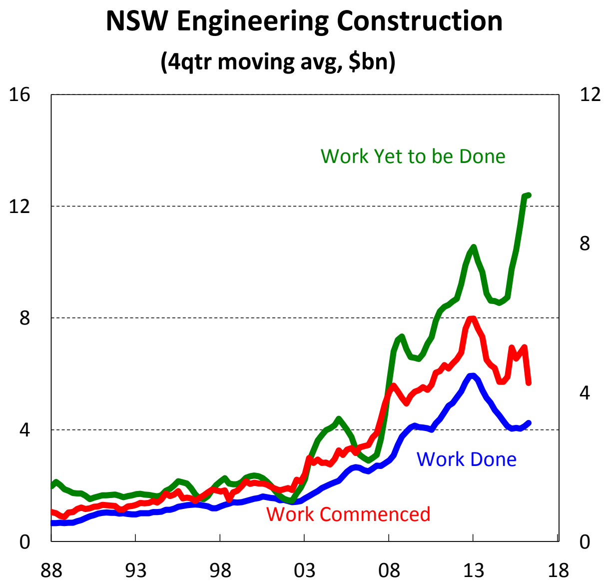


With residential building already at an elevated level, residential construction will have a smaller positive impact on economic growth than previously. However, the high level of activity should assist in making up for the shortfall in homebuilding in earlier years, adding to the supply of dwellings and assisting with affordability.

Business Investment and Infrastructure Spending

Strong economic growth and a positive outlook for NSW have led to an increase in business investment. Low interest rates, a low Australian dollar and strong conditions in the housing market have supported private business investment. There has been a healthy amount of activity within commercial construction. Additionally, government investment has been doing its share of the heavy lifting for the economy, with strong growth in infrastructure spending.





In the year to the June quarter 2016, business investment in NSW lifted 4.0%. This compares favourably to other States, including Western Australian, Queensland and South Australia, where business investment has continued to decline over the past year.

Infrastructure growth continues to support the NSW economy. There is a healthy amount of work underway and in the pipeline, largely driven by public works, particularly in transportation. Within engineering construction activity, work yet to be done hit a record high of $13.2bn in the March quarter 2016. This eased marginally to $12.7bn in the June quarter 2016, still at the second highest on record. A sizeable proportion of projects continue to be within transport infrastructure. Work continues on WestConnex, NorthConnex, the CBD and South East Light Rail projects and the Sydney Metro North West rail link.

There are also some noteworthy projects within commercial construction, although the pipeline is not as full as it was previously. The massive $6bn Barangaroo development, is ongoing and work will continue through to 2020. The Crown casino and hotel at Barangaroo, worth $2bn, was approved earlier this year. The Darling Harbour Live project worth around $2bn is due for completion soon, while the Royal North Shore Hospital upgrade is now complete.

For the broader business community, prospects for ongoing investment spending remain solid. Business surveys indicate that conditions in NSW have deteriorated a little over the past year, but business confidence has lifted somewhat. Capacity utilisation in NSW eased to 82.2% in the September quarter, but remains above its long-run average and equal to its level of a year earlier.

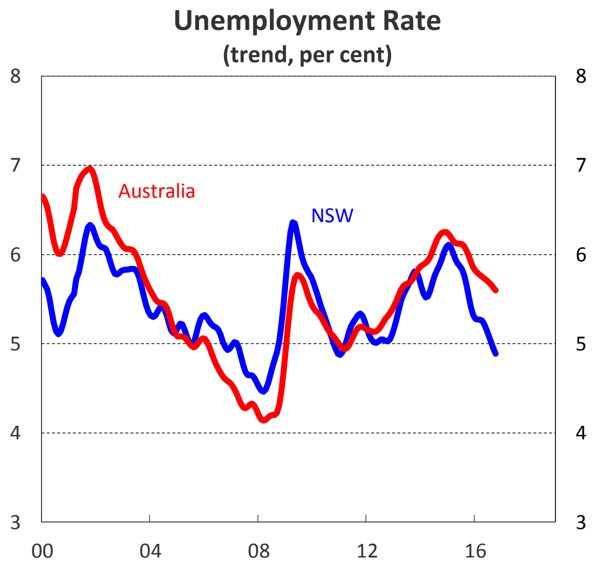
Labour Market

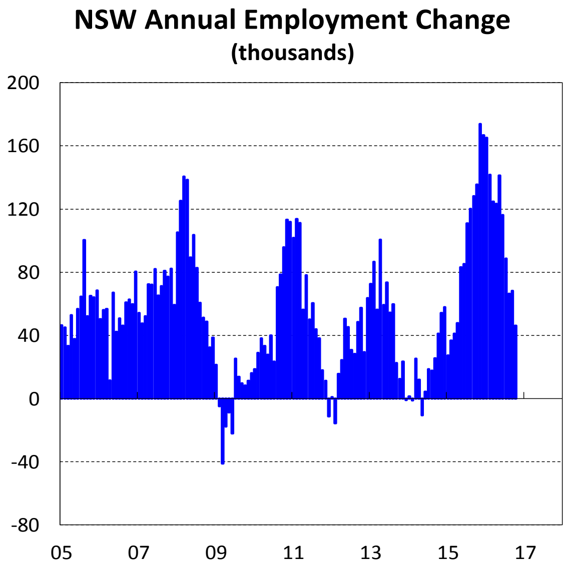
Jobs growth in NSW has slowed to a snail's pace so far this year, following robust growth last year. Last year 166.7k new jobs were created in the State (for an average of 13.9k jobs per month). So far in 2016, only 7.7k new jobs have been created (or an average of 0.8k jobs per month).

The annual pace of jobs growth was 46.1k in the year to October. That strength largely reflects stronger jobs growth in late 2015, which has petered out so far this year. In 2015, NSW had the strongest jobs growth of all the States, although in recent months, Victoria's labour market has claimed this honour.

Jobs growth in NSW slowed to 1.2% in the year to October, down from a recent peak of 4.8% in the year to November 2015. NSW jobs growth, however, remains above the national average (at 0.9%).

Despite lacklustre growth more recently, job creation in recent years has outpaced growth in the labour force, resulting in a steady decline in the unemployment rate. The NSW unemployment rate held at 4.9% in October, down from 5.5% a year earlier. It is well below the national unemployment rate of 5.6%.





The strength of NSW's job market can be partly explained by a boost to construction from new residential building, with 31.9k construction jobs created in NSW in the year to August (the latest available data). The services sector has also created jobs over the year to August, with strong growth in professional, scientific & technical services (26.0k), administrative & support services (21.9k) and public administration & safety (16.8k). By industry, job losses have been greatest in wholesale trade (-21.5k), retail trade (-19.7k) and manufacturing (-16.6k).

The NSW economy has been performing relatively well which should support demand for labour. The NSW labour market is expected to continue to add jobs at a moderate pace over the coming year, although we are unlikely to see a return to the strong jobs creation of 2015 in the near-term.

St.George Banking Group Forecasts

The NSW economy grew at a robust pace last year and solid growth is expected to continue over the next couple of years. The economy is expected to remain supported by low interest rates, a low Australian dollar and relatively strong population growth. Road and rail infrastructure spending should continue to support economic activity. We expect that the NSW economy will grow at 2.75% in 2016-17, but easing to 2.5% in 2017-18 and 2018-19 reflecting easing growth in dwelling investment.

Economic Indicators, % Change (year average)				
	2015-16	**2016-17 (f)**	**2017-18 (f)**	**2018-19 (f)**
Gross State Product	3.50	2.75	2.50	2.50
State final demand	3.70	3.00	2.50	2.50
Employment	3.80	1.50	1.50	1.50
Unemployment rate (year average)	5.40	5.30	5.10	5.10
Sydney CPI	1.50	2.00	2.20	2.20
Wage Price Index	2.10	2.30	2.70	2.70

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