Wednesday, 23 March 2016

QLD Economic Outlook

Summary

- The pace of Queensland's economic growth slowed sharply in 2014-15, despite an improvement in Queensland's net exports, as private and government investment both declined. Gross State Product in Queensland grew at just 0.5% in 2014-15.

- The good news is we expect economic growth in Queensland to pick up in coming years. We have forecast stronger economic growth this financial year, with the improvement reflecting higher export volumes. Gross State Product is expected to increase by 3.5% in 2015-16.

- The outlook is not without its risks, however, with the forecast for stronger economic growth in 2015-16 dependent on commodity prices, particularly the price of LNG. Business investment has fallen significantly in Queensland in recent years, reflecting the end of the mining investment boom. That trend is expected to continue this year as large LNG projects move from construction to production.

- Prospects for industries outside of resources are improving, if only gradually. The lower Australian dollar (compared to several years ago) has boosted prospects in industries including tourism.

- Household spending growth in Queensland was relatively lacklustre in the December quarter. It seems unlikely that consumer spending will pick up significantly in the near-term. While solid jobs growth is supportive for spending, subdued wage growth and concerns about the economic outlook could continue to weigh on consumers.

- The pace of Brisbane house price growth has been one of the fastest of all the capital cities, behind Melbourne and Sydney. The outlook for Queensland's housing market, however, is muted. While historically Brisbane dwelling prices would tend to follow those of the larger capital cities, the Queensland economy faces a number of challenges which are likely to limit growth in house prices. Greater housing affordability in Queensland, however, is a positive sign for housing demand as is population growth.

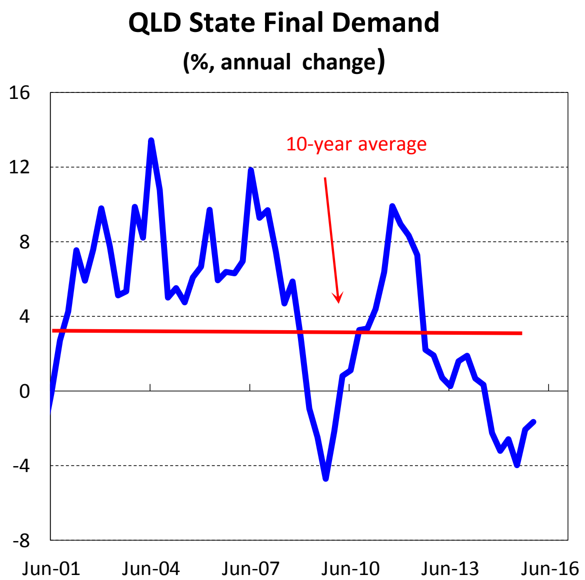
- The labour market in Queensland has grown at a solid pace over the past year. Queensland's labour market is now the second fastest of all the States (behind NSW). As a trend, the State's unemployment rate stood at 5.9% in February, down from 6.6% a year earlier.

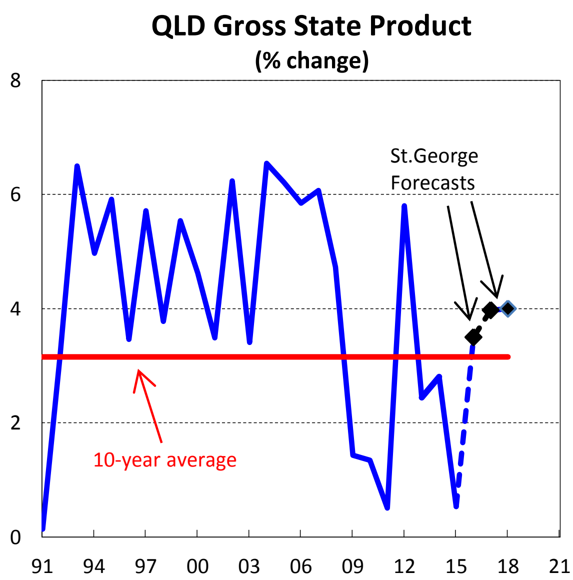
Percentage Shares of the Economy*		
Industries	**QLD**	**Australia**
Construction	12.2	9.1
Mining	8.9	10.2
Health care and social assistance	8.0	7.6
Manufacturing	7.7	7.3
Financial and insurance services	7.3	10.1
Public administration and safety	6.6	6.1
Transport, postal and warehousing	6.4	5.4
Professional, scientific and technical services	5.6	7.0
Retail trade	5.4	5.2
Wholesale trade	5.3	4.8
Education and training	5.3	5.5
Electricity, gas, water and waste services	4.4	3.2
Rental, hiring and real estate services	3.3	3.3
Accommodation and food services	2.8	2.8
Agriculture, forestry and fishing	2.8	2.6
Administrative and support services	2.6	3.1
Information media and telecommunications	2.4	3.4
Other services	2.3	2.2
Arts and recreation services	0.7	0.9

** Share of gross value added less ownership of dwellings 2014-15; Source: ABS, St.George*

Economic Growth

The pace of Queensland's economic growth slowed sharply in 2014-15, despite an improvement in Queensland's net exports, as private and government investment both declined. Gross State Product in Queensland grew at just 0.5% in 2014-15, down from growth of 2.8% in 2013-14. The pace of growth is below the 10-year average of 3.2%.



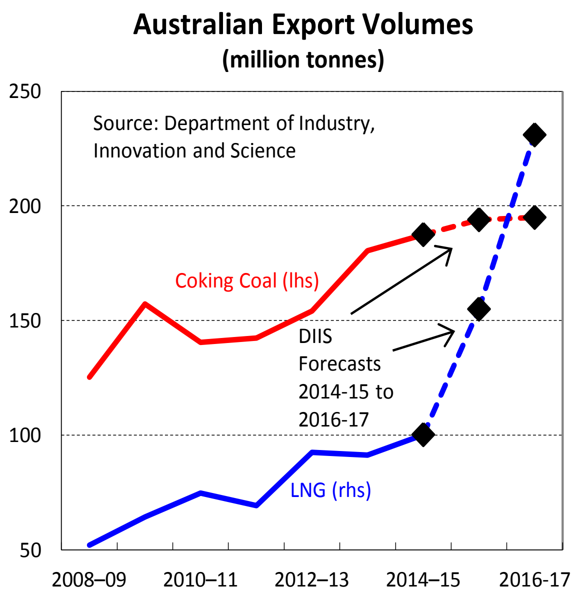


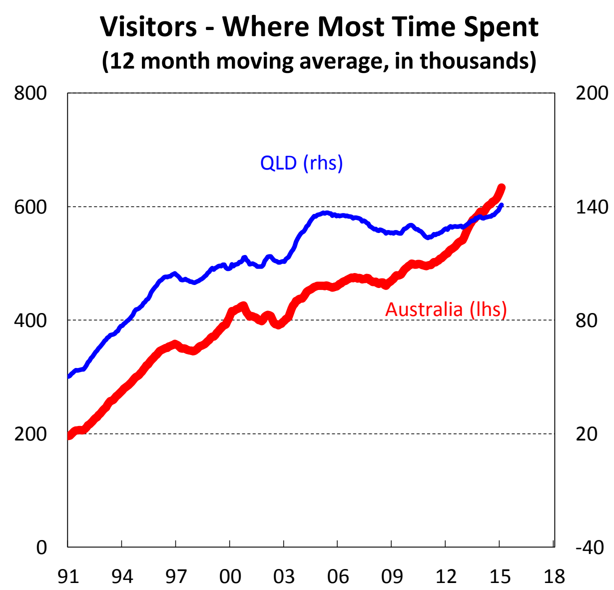
More recent data suggests business investment has weakened further since June 2015 and remains a drag on economic growth. State final demand provides a more up-to-date snapshot of economic activity in Queensland. Keep in mind, however that State final demand doesn't include exports which are expected to provide support to Queensland's bottom line as completed resource projects ramp up production. State final demand in Queensland edged up 0.1% in the December quarter 2015, the first quarterly increase in six quarters. For the year to the December quarter, State final demand remains in negative territory, falling 1.7%.

As new projects have moved into the production phase, resource-based investment has slumped sharply, although not unexpectedly. The Queensland LNG industry is transitioning from construction to production. Curtis Island LNG began production in December 2014, while Gladstone LNG and the Australia Pacific LNG project began production in 2015.

The solid increase in the volume of LNG exports from these completed projects will be a major driver of growth for Queensland, although prices are likely to weigh on values. The significant drop in commodity prices in recent times will pose a major challenge for Queensland and Australia. The oil price has fallen by around 60% over the past two years. Although the oil price has edged up from its lows earlier this year, it remains below US$40 per barrel. This weighs on export earnings from LNG (with the still-low Australian dollar buffering the impact somewhat) and putting pressure on the profitability of LNG businesses, potentially reducing the viability of further business investment in the industry.

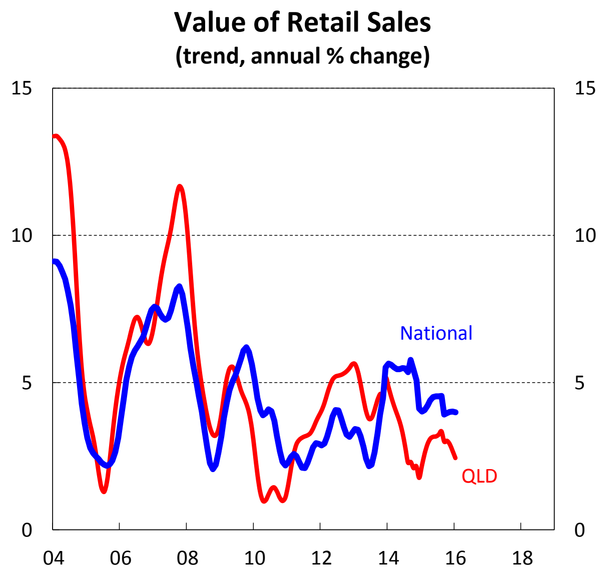
The price of Queensland's other major export, coking coal, has also declined over the past year, reflecting slowing demand for steel making in China. Despite falling prices and the closure of some producers, the production of Australian coking coal (the bulk of which is within Queensland, in the Bowen Basin) is expected to increase this year according to the Department of Industry, Innovation and Science's Resources and Energy Quarterly in December. Increased production at new and existing operations is expected to more than offset mine closures in Australia.

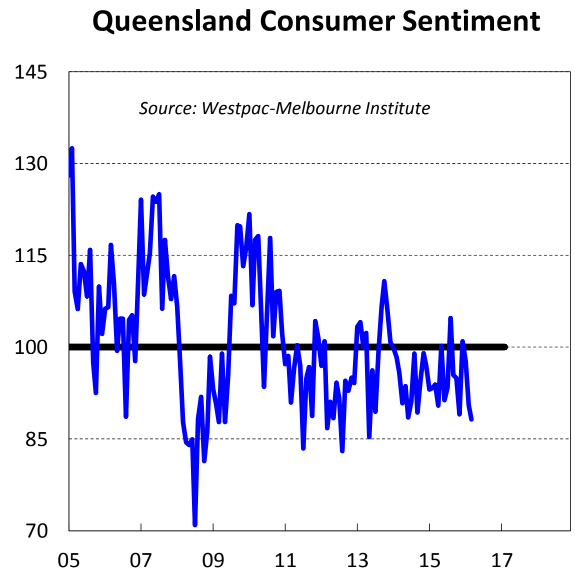




Exports are set to contribute significantly to growth in Queensland in coming years. However, downward pressure on commodity prices will continue to weigh on the mining sector and incomes more generally. A major positive is that there is increasing support to growth from the weaker Australian dollar (compared to several years ago) and low interest rates. These will assist Queensland's tourism sector and consumer spending. Overseas visitors to Queensland have been gradually increasing, although to a lesser extent that to other States. Overseas tourist arrivals to Queensland increased 10.8% in the year to January. Overseas arrivals to Queensland have now been surpassed by overseas visitors to Victoria, with arrival numbers to New South Wales still in the lead. Additionally, Queensland continues to experience its worst drought on record, with 86 percent of the State drought-declared. This continues despite a better start to the year for some drought-declared areas which received welcome rainfall.

We expect that Queensland's economy will grow at 3.5% in 2015-16, with the pickup in growth reflecting higher export volumes. The lower Australian dollar will provide a boost to other exports, with tourism and international education faring better. However, further weakness in domestic demand is expected in Queensland, with State final demand expected to contract by 1.5% in 2015-16, after contracting 3.0% in 2014-15 (Please see page 9 for further details on forecasts).





Consumer Spending

While consumer spending is rising in Queensland, the pace of growth is lackluster. Household spending growth in Queensland rose 0.5% in the December quarter, for the third consecutive quarter. For the year to the December quarter, household consumption expenditure rose 2.6%, which is below the long-term average of 3.3% growth. Low interest rates and the weaker Australian dollar (compared to two years ago) are providing support to household spending although slow wages growth is limiting the ability of consumers to lift their spending.

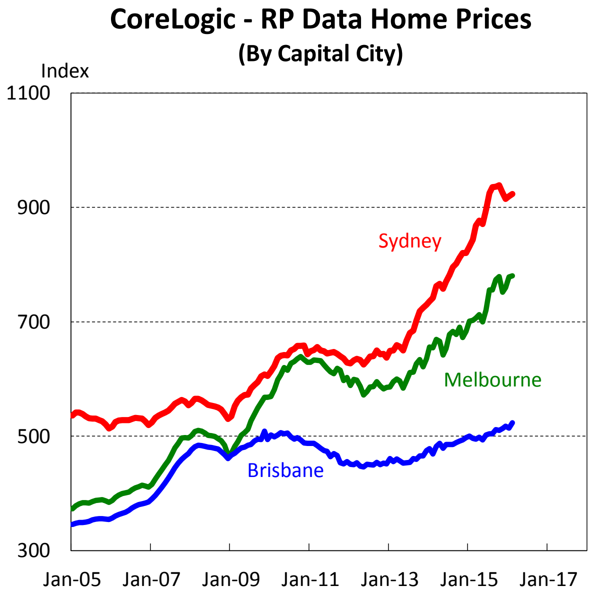
For the year to the December quarter, the strongest growth in household consumption in Queensland was in clothing & footwear (6. 8%), followed by health (7.5%) and communications (5.5%).

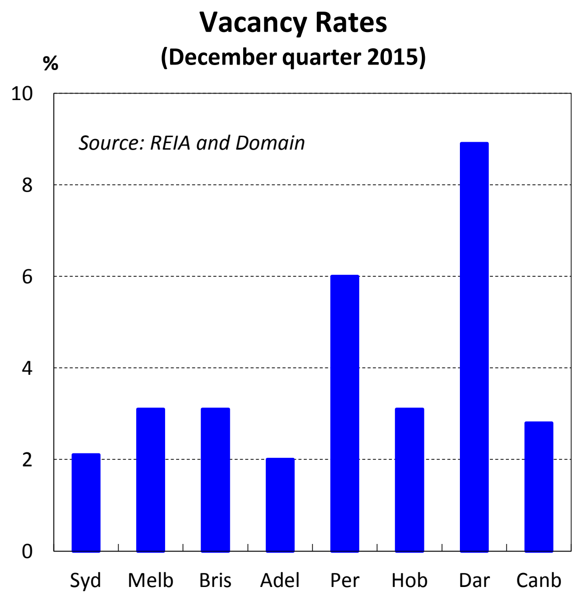
Retail sales in Queensland rose 2.1% in the year to January. This is below the long-term State average of 4.6% and below the current pace nationally of 4.0%, suggesting Queensland's retail sales are lagging, reflecting slower income growth in the State.

Sales of new motor vehicles fell 1.3% in the year to February in Queensland. The decline was led by sales of passenger vehicles which fell (-9.9%) in the year to February. Sales of 'other vehicles' (mostly commercial vehicles) rose 10.8% in the year to February, which is a positive sign for the commercial sector in Queensland, while sales of sports utility vehicles edged up 0.7% over that period.

It seems unlikely that consumer spending will pick up significantly in the near-term. While solid jobs growth is supportive for spending, subdued wage growth and concerns about the economic outlook could continue to weigh on consumers. The index of consumer sentiment in Queensland, produced by Westpac and the Melbourne Institute slumped in March, falling to a reading of 88.2, the lowest since May 2013 and well below the 100 level, signaling more consumers are pessimistic than are optimistic. The index nudged above 100 in December, but sentiment has since turned lower. A lack of confidence in the economic outlook could limit consumers' willingness to ease up on precautionary saving, in favour of spending.

Wages growth in Queensland was anemic at 2.0% in the year to the December quarter. This is the lowest annual growth since these records began in September 1998 and barely keeping pace with underlying inflation, also at 2.0%. It is also slightly below the Australian average wages growth of 2.1% in the year to December. Despite slow wages growth, ongoing low interest rates will continue to support modest growth in household consumption over the medium term.





Housing

Australia's housing upswing has waned in recent months, and this has been evident in Brisbane dwelling prices. Dwelling prices in Brisbane have lagged behind Sydney and Melbourne, as is traditionally the case. According to CoreLogic – RP Data, Brisbane dwelling prices grew at an annual pace of 5.5% in February, down from a peak of 7.0% in June 2014. This compares to national capital city dwelling price growth of 7.6% in the year to February. Most of the strength in the national average is being driven by Sydney and Melbourne, with Canberra house prices also showing reasonably solid growth. Contraction within the mining/resources construction sector and softer population growth will limit gains in Queensland but low interest rates should help maintain demand.

Lending for owner occupiers in Queensland rose 6.1% in the year to January, which is not far behind the national average of 7.3% growth over the same period. The value of lending for investor housing, however, declined 13.5% in the year to January. The decline in investor lending in Queensland was slightly less sharp than the decline in national investor lending. Australia-wide investor lending declined by 14.8% over the same period reflecting the implementation of new lending criteria by APRA. Investor loans in Queensland now make up a smaller proportion of the value of total loans in the State, at 31.8% in January, down from a recent peak of 39.6% in June last year.

- **Rental Markets**

Brisbane rents have grown slowly 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 December quarter. This is below the pace of both core and headline inflation, although dwelling price growth over the past year has convincingly outpaced inflation. The rental vacancy rate in Brisbane has edged higher in recent quarters, so that the rental market is no longer tight, although demand remains solid. The vacancy rate in Brisbane stood at 3.1% in the December quarter. 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 20.5% in the year to the December quarter. This reflects strength in new dwelling investment, as well as alterations and additions. Despite a decline of 38.3% in Queensland building approvals in the year to January, building approvals remain at a reasonably solid level.

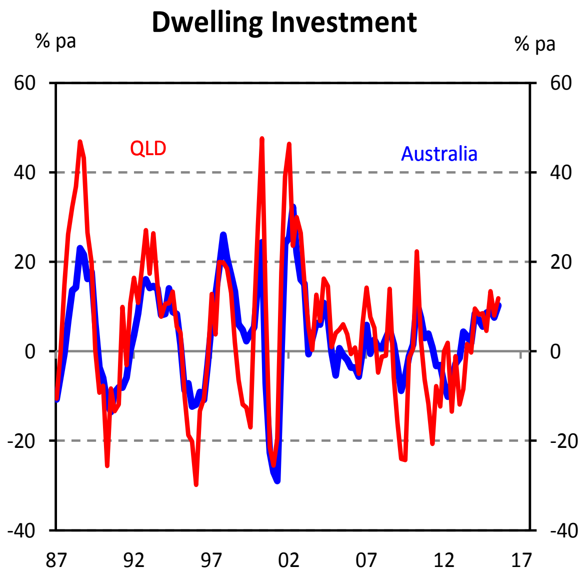
Outlook

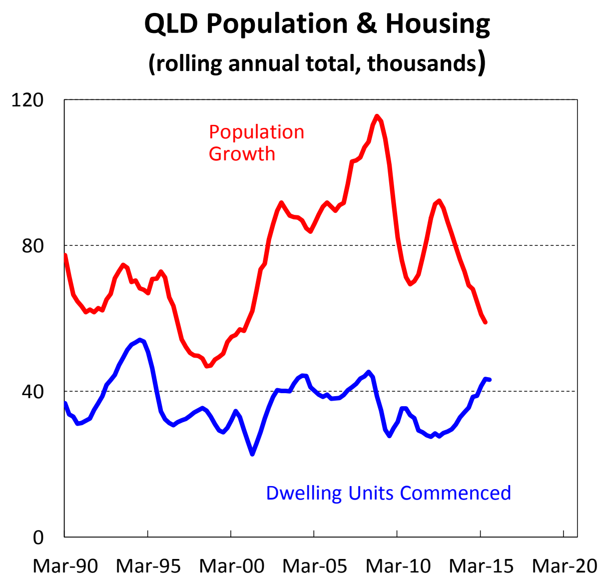
The outlook for Queensland's housing market is muted. While historically Brisbane dwelling prices would tend to follow those of the larger capital cities, the Queensland economy faces a number of challenges which are likely to limit growth in house prices. The relative affordability of Brisbane in comparison to Sydney and Melbourne, however, is expected to lend some support.

The pace of dwelling price growth in Brisbane has already slowed from last year's highs and we would expect this trend to continue. The strong run of dwelling price growth in recent years and slightly higher interest rates in response to APRA requirements are expected to further slow the pace of dwelling price growth this year.

Queensland is one of the States where demand for housing has exceeded supply, given solid population growth and lacklustre building activity over the past decade. However, dwelling investment has been strong over the past year, while population growth in Queensland has slowed. Queensland's population growth has slowed from a peak of 2.1% annual growth in September 2012 to 1.3% in June 2015. The pace of Queensland's population growth is below the 1.4% annual growth Australia-wide. The shortage of housing witnessed in Queensland over the past decade is expected to ease this year. This will limit the upside in house price growth for Queensland in 2016.

Property prices in Queensland are generally expected to strengthen moderately over the coming year, although the performance of property prices will vary by area. The Australian dollar has fallen 8.1% in trade-weighted terms over the past two years. This will assist the tourism industry in Queensland and may attract further foreign demand. Those residential areas closely tied to tourism should benefit from a revival in confidence in the industry. Recent declines in commodity prices will impact 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 further downward pressure.



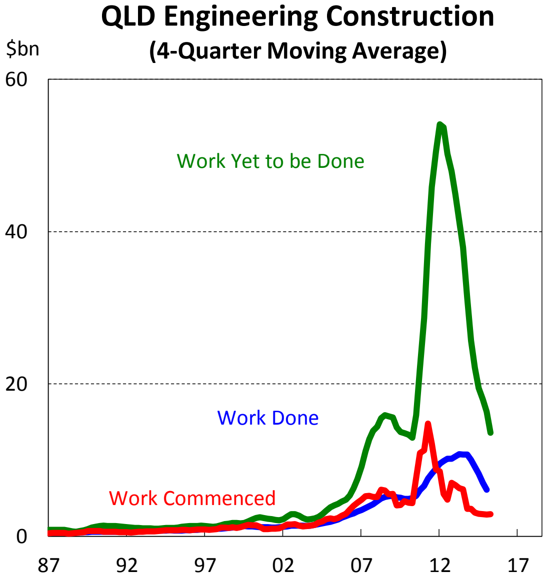


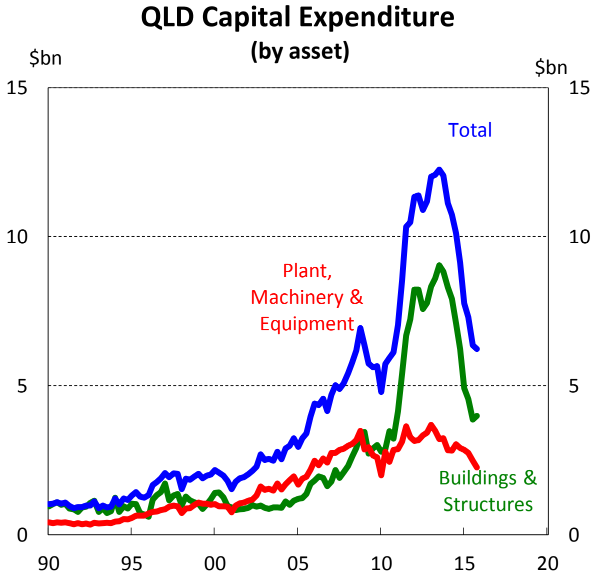
Business Investment

Business investment declined sharply in 2014-15 as mining projects came to completion. 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 December quarter, business investment contracted 26.2% in Queensland.

The decline in business investment has been led by the resources sector. Major LNG projects in Queensland, which have boosted engineering construction in recent years, have now reached or are close to completion. Engineering construction work done in Queensland fell 8.1% in the September quarter, which was the eighth consecutive quarterly decline. For the year to the September quarter, engineering construction work done declined 42.0% in Queensland.

While the value of resources related investment has declined, the fall in commodity prices has reduced the feasibility of new mining projects suggesting that the slowdown in activity is set to continue. The proposed Adani Carmichael mine would be Australia’s largest coal mine (and one of the largest in the world). The project is still being considered but faces considerable challenges, including legal challenges and further declines in coal prices. Another potential project, the China First Coal Project, is worth $6.4bn.





The pipeline of work in commercial construction has retreated in step with the downturn in resource-related investment, which had provided flow on impetus through strong incomes and activity. There still remain some projects underway including the Sunshine Coast University hospital ($1.8bn) due for completion in 2017 and the ICON Ipswich retail development, worth $1bn, due for completion this year.

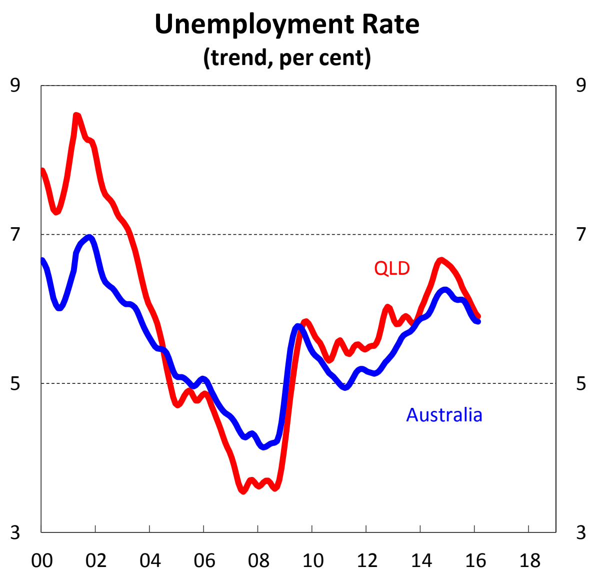
New projects in Queensland include the second stage of the Gold Coast Light Rail project worth $700mn. However, some projects were completed in the December quarter, including the $1bn Moura Link – Aldoga Rail project at the Wiggins Island Coal Terminal.

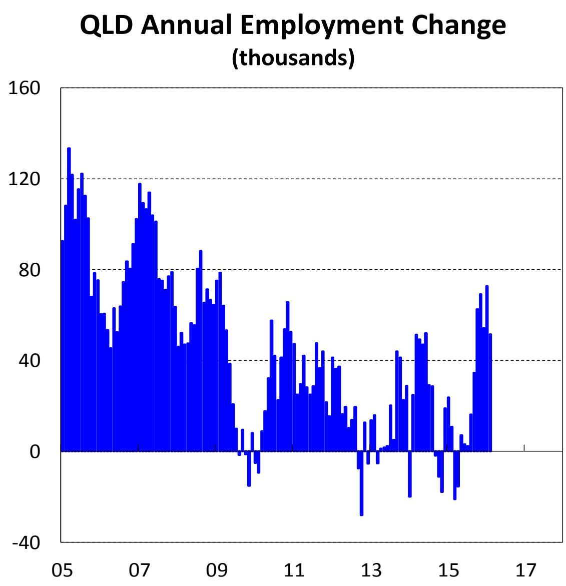
Prospects for industries outside of resources are improving, if only gradually. The lower Australian dollar is seeing confidence return to the tourism industry in Queensland, with major projects including the Aquis resort near Cairns (worth $8.2bn), the Airlie Beach resort and the Great Keppel Island resort redevelopment.

While overall business investment continues to decline in Queensland, strong mining investment in recent years has boosted the State's production capacity. This means despite likely further slowing in resource-related investment, exports will provide further support to growth in Queensland.

Labour Market

The labour market in Queensland has grown at a solid pace over the past year, adding 51.5k jobs in the year to February. The Queensland labour market has added jobs in six out of the past seven months, with a decline in jobs growth in February ending the recent strong run. Employment growth has eased in recent months to 2.2% in the year to February, although this is up from 0.5% growth a year earlier. Queensland's labour market is now the second fastest of all the States (behind NSW) and above the national average of 2.1% growth in employment in the year to February. In trend terms, the unemployment rate stood at 5.9% in February, down from 6.6% a year earlier. It sits slightly above the trend national unemployment rate of 5.8%, although it is moving in the right direction. The Queensland workforce participation rate of 65.4% is the highest of all the States, with the exception of WA.





In the year to November, the strongest job gains in Queensland were in manufacturing (68.3k), healthcare & social assistance (42.1k) and education & training (36.0k). Strength in manufacturing and education & training jobs, in particular, likely reflect to some extent the positive impact from the weaker Australian dollar in recent years.

The largest losses by industry were in construction (-14.1k), accommodation & food services (-11.3k) and professional, scientific & technical (-8.3k).

The performance of Queensland's labour market by industry is quite divergent, with the resource related investment downturn negatively impacting some industries, while the lower Australian dollar is proving a boon to others. This trend is expected to continue, with jobs growth in Queensland likely to continue to grow moderately.

St.George Banking Group Forecasts

St.George Banking Group Forecasts:

Economic Indicators, % Change	2014-15	2015-16 (f)	2016-17 (f)	2017-18 (f)
Gross State Product	0.50	3.50	4.00	4.00
State Final Demand	-3.00	-1.50	2.00	3.00
Employment	0.20	1.80	1.50	1.50
Unemployment Rate (year average)	6.50	6.00	6.00	6.00
Brisbane CPI	1.90	1.80	2.50	2.50
Wage Price Index	2.40	2.40	2.80	3.00

Source: St.George Banking Group

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