

SOUTH AUSTRALIAN OUTLOOK

Friday, 4 May 2012

Summary:

- The South Australian economy has moderated over the second half of 2011. State final demand edged up 0.2% in the December quarter, taking the annual rate to -0.6%, the weakest annual pace in more than 12 years. A weak housing market and heightened consumer caution are impacting negatively on economic activity in South Australia.
- Although declining as a proportion of the South Australian economy, the manufacturing sector remains an important part and has been stung by the strength of the Australian dollar. Other export-orientated industries in South Australia are also likely to have been impacted, including the education sector and South Australia's wine industry.
- South Australia has not yet joined the ranks of the resource-rich States of Western Australia and Queensland but there is significant mining potential that can be tapped. The possibility for growth in mining in South Australia has greatly boosted expenditure on mineral exploration. Business investment in South Australia grew at a reasonable annual pace of 5.9%, supported by mining, but it lags behind growth Australia-wide.
- The impact of householder caution is more pronounced in South Australia than other States. Consumer spending and the housing market have been weaker than nationally. Uncertainty about the global growth outlook and concerns about the job market might prolong the caution, although the RBA's decision to cut the cash rate by 50 basis points in May could help support confidence and spending.
- The outlook for the housing market is mixed for South Australia. Uncertainty about the growth outlook and slowing population growth will weigh on housing demand. South Australia is also not facing a housing shortage, which is providing a floor for house prices in some other States. However, there have been tentative signs of stabilisation in house prices early this year. There has also been an encouraging pick up in first home buyer demand in South Australia, which is important in driving a recovery in housing. Adelaide also remains one of the most affordable capital cities to purchase or rent.
- There remain some challenges for the South Australian economy in the near term, including ongoing household caution and slowing population growth. Meanwhile, the high Australian dollar is likely to continue to weigh on South Australia's manufacturing sector and other export oriented sectors outside of mining. The uncertain global backdrop further provides a risk to the South Australian and Australian economy.
- The outlook for South Australia, however is quite positive, but hinges greatly on whether the highly publicised Olympic Dam expansion project will go ahead. It is estimated that this expansion could cost up to \$30 billion and would provide a massive boost to spending on capital equipment and infrastructure. Longer term it will also provide a significant boost to employment and economic activity and export potential. The project has received government approval and is awaiting the final investment decision from the BHP Billiton Board due mid this year.

Percentage Shares of the Economy*		
Industries	Australia	SA
Manufacturing	8.2	12.3
Financial and insurance services	9.7	10.3
Construction	7.7	8.2
Health care and social assistance	5.8	7.9
Public administration and safety	4.9	6.3
Agriculture, forestry and fishing	2.4	6.2
Professional, scientific and technical services	6.6	6.0
Transport, postal and warehousing	5.1	5.8
Retail Trade	4.4	5.7
Education and training	4.5	5.6
Wholesale Trade	4.2	4.8
Mining	7.2	4.7
Electricity, gas, water and waste services	2.2	3.2
Information media and telecommunications	3.2	2.9
Accommodation and food services	2.3	2.5
Administrative and support services	2.4	2.3
Other services	1.7	2.3
Rental, hiring and real estate services	2.0	2.0
Arts and recreation services	0.8	1.0

* as % of Industry gross value added, excluding ownership of dwellings Source: ABS, BankSA

Economic Growth

South Australia's growth profile, as measured by State final demand weakened in the second half of 2011. State final demand edged up just 0.2% in the December quarter, after slumping 1.9% in the September quarter. Despite the decline in economic growth in South Australia in the December quarter, it still outpaced growth in Victoria, Tasmania and Western Australia. For the year to December, South Australia's economic growth has contracted 0.6%, the weakest annual growth rate in more than 12 years.

Although South Australia has significant mining potential to tap which includes BHP Billiton's massive Olympic Dam project, some of the headwinds that are affecting Australia are deeply impacting on South Australia. The high Australian dollar is weighing on the manufacturing sector, which remains an important part of the South Australian economy and continues to comprise a large share of gross State product (GSP), 12.3% as of June 2011. Other export orientated sectors, such as South Australia's wine industry and growing international student market have also been affected by the exchange rate.

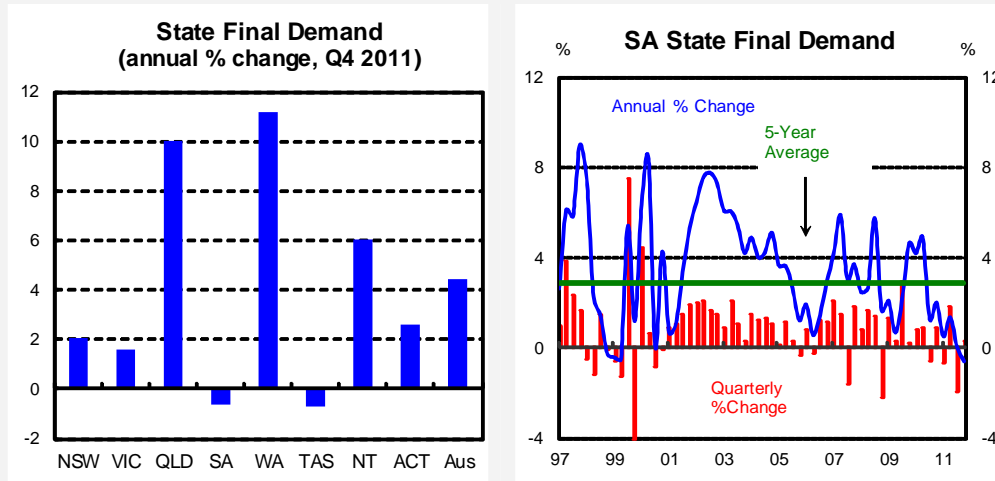
Dwelling investment and household consumption have also been softer than other States, reflecting greater caution amongst householders.

The annual growth rate of -0.6% is well below the domestic final demand reading of 4.4% for the national economy.

Note that ideally, gross state product (GSP) would be used to assess broad economic growth, which includes inventories and net exports, but the data is not available quarterly.

Exports have grown at a strong pace, with volumes rising by 8.6% in the year to December. Exports have been supported by favourable growing conditions for grains and ongoing solid demand from Asia for commodities. South Australia's largest exports in 2010-11 include wheat, copper, alcoholic beverages, copper ores & concentrates and iron ore & concentrates.

Import growth has also been solid and is outpacing export growth. In the year to December, imports rose by 12.7%.



The South Australian Treasury expects economic growth in 2011-12 of 2.25%, slightly below than growth of 2.4% recorded in 2010-11. Forecasts have been downgraded slightly from May last year reflecting weaker expected growth for Australia and more subdued conditions for consumer spending and the non-mining sectors of the economy. However, the South Australian Treasury expects South Australian growth to pick up to 3.00% in 2012-13, above long-run average growth of 2.7%.

Business Investment

The still-strong terms of trade in Australia are expected to continue to support private business investment over the coming year.

Nationally, businesses raised capital expenditure by 30% in the year to December, although growth in capital expenditure retraced slightly in the December quarter last year. It is estimated businesses intend to increase spending by approximately 36% in 2011-12 and again in 2012-13 (according to the most recent survey from the ABS).

Business investment in South Australia in 2011 was strong, likely benefiting from South Australia's growing mining sector. After falling 7.2% in the September quarter, business investment rose 3.1% in the December quarter. For the year, business investment in South Australia rose 5.9%, although this was well below the growth of 19.6% seen nationally over the same time frame.

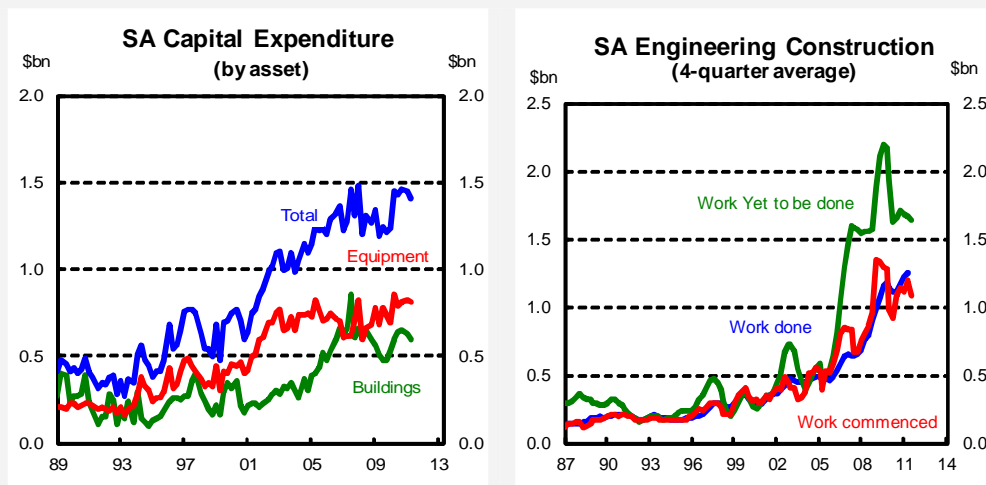
The potential for mining in South Australia has greatly boosted expenditure on mineral exploration (excluding petroleum), which rose by 51.4% in the year to December 2011. This compares with annual growth of 42.4% Australia-wide.

A component of business investment which has seen strong growth nationally is engineering construction. Engineering construction growth has moderated in South Australia over the past few quarters. It rose 14.3% in the December quarter 2011, partly recovering from a 29.7% drop in the September quarter, but was down 4.1% in the year to December.

Prospects for engineering construction and therefore business investment largely hinge on the well-publicised Olympic Dam expansion project. The South Australian and Federal governments have approved the expansion, with the board of BHP Billiton due to make its final decision on the project in the middle of this year. The cost of the project is estimated by market analysts to be around \$30 billion, and would lead to a marked upgrade of our

forecasts for growth in South Australia for the out years, via lifting business spending and employment.

Other projects in South Australia include the \$1.8 billion desalination plant at Port Stanvac (due to be completed by the end of this year) along with a number of other transport projects. The \$840 million South Road upgrade program is underway and the \$812 million South Road Superway is establishing a north-south corridor between the Port River Expressway and Regency Road. The \$546 million Northern Expressway project is also underway and the \$460 million Gawler rail line electrification, as part of the wider rail revitalisation project is still underway.



Non-residential building construction however is providing near-term support to business investment. Construction for non-residential buildings lifted by 24.8% in the year to December 2011. Non-residential commencements have surged, with projects being led by the \$1.75 billion New Royal Adelaide Hospital project. According to BIS Shrapnel, this will help lift non-residential commencements of 128% in 2011-12. Non-residential commencements are however expected to fall sharply in 2012-13 after the temporary spike this fiscal year.

Consumer Spending

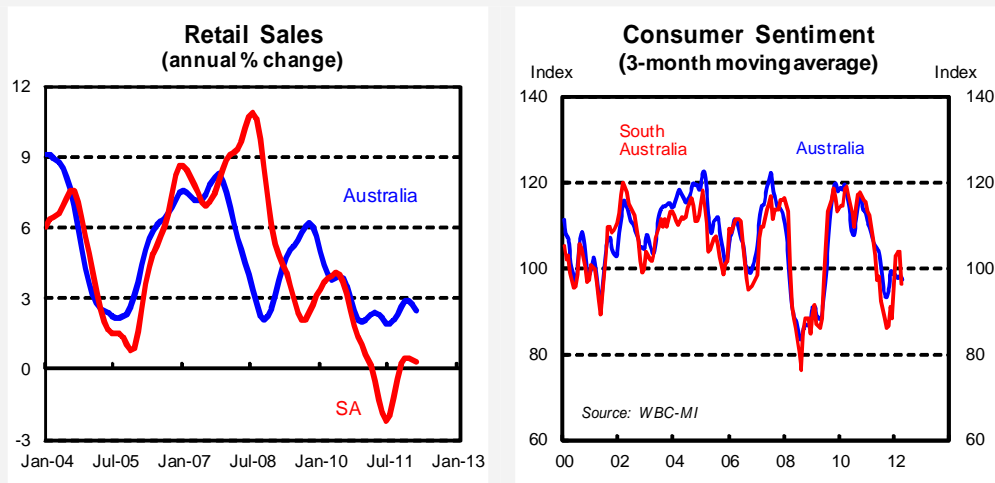
Consumer spending has been weak in South Australia. Household final consumption expenditure rose by just 0.9% in the year to December 2011, much weaker than the long-run average of 2.8% for South Australia and growth of 3.5% nationwide.

Consumption of some services including recreation, education and healthcare, which have been supportive of consumer spending nationwide, are growing at a softer pace in South Australia. Some discretionary areas of consumer spending have been quite weak, including clothing & footwear and furnishings & household equipment.

Retail spending which is a large component of overall household consumption, has also been weak in South Australia. Retailing is a weak spot in the economy nationally but again the South Australian economy has witnessed softer growth in retailing compared with the national average. Retailing in South Australia rose a subdued 0.4% in the year to February, compared to an increase of 2.0% nationally over the same period. This compares to long-run average growth of 5.0% in South Australian retail sales.

Soft growth in consumer spending is likely reflective of weaker consumer sentiment in South Australia. The Westpac-Melbourne Institute measure of consumer sentiment in South Australia has generally trailed behind the index for Australia over the past year. However, there was an encouraging bounce in sentiment in April in South Australia. The index currently

sits at 103.8 in South Australia compared with an index reading of 94.5 for Australia. This suggests South Australian consumers are more optimistic than Australia wide and that optimists currently outweigh pessimists in South Australia. This bounce may have reflected expectations ahead of the RBA decision to cut rates in May, but the index has been very volatile in South Australia in recent months.



Consumer spending is likely to remain soft in the near term given that factors worrying consumers are likely to linger for some time. Uncertainty regarding the global economy remains and soft job growth is likely to keep consumers sidelined. However, the Reserve Bank's decision to cut the cash rate by 50 basis points cut should help provide some support to confidence and spending.

Housing

House prices nationally and in South Australia have softened since early 2011. House prices in Adelaide fell 3.8% in the year to March 2012, but they are beginning to outperform other States. House prices in Australia fell by 4.5% over the same period according to data from the Australian Bureau of Statistics (ABS).

Other house price data tells a similar story. According to RP Data-Rismark, dwelling prices in Adelaide fell 4.2% in the year to April, while dwelling prices for Australia-wide (8-capital city aggregate) fell 4.5% in the year to April. An index measuring house prices for the rest of South Australia is also weaker and down 4.4% in year to April.

The moderation in property prices in South Australia partly reflects the unwinding of stimulus measures including the FHOB (first home owners' boost), which has impacted South Australia more than other States.

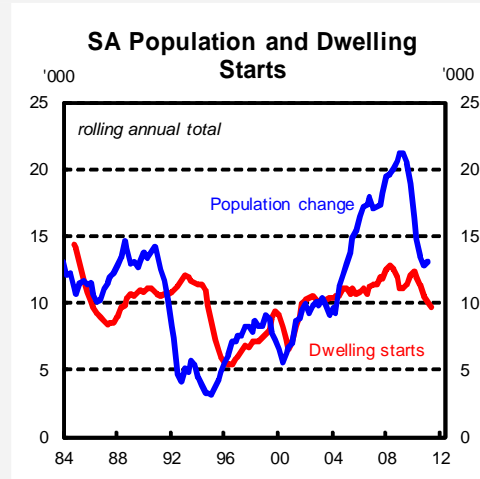
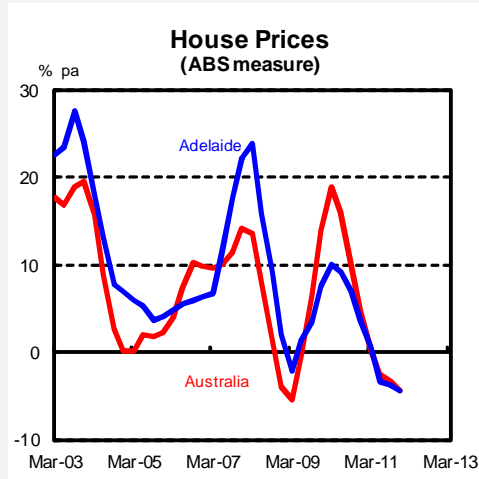
Slowing population growth in South Australia, a trend also occurring Australia wide, is one factor that is dampening demand for housing. Annual population growth in South Australia is estimated to have slowed to 0.8% in the June quarter 2011 from a peak of 1.3% in the March quarter 2010. This compares to estimated annual population growth of 1.4% Australia-wide in the September quarter 2011.

The combination of slowing population growth and higher than average dwelling commencements over most of the 2008-10 period suggests that the undersupply of housing that exists nationally is less evident in South Australia. Indeed, BIS Shrapnel estimates that South Australia had a slight oversupply of 2200 dwellings in 2011, and a small oversupply is expected to continue over 2012 and 2013.

Dwelling commencements have fallen over the past year, in response to slowing population and moderating house prices. Residential construction has been weak across the country, including South Australia. Sluggish growth in house prices suggests that the outlook for residential construction is likely to remain subdued. Further, unlike some other States, South

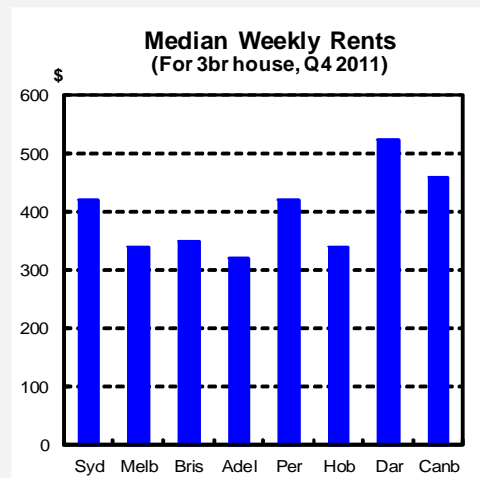
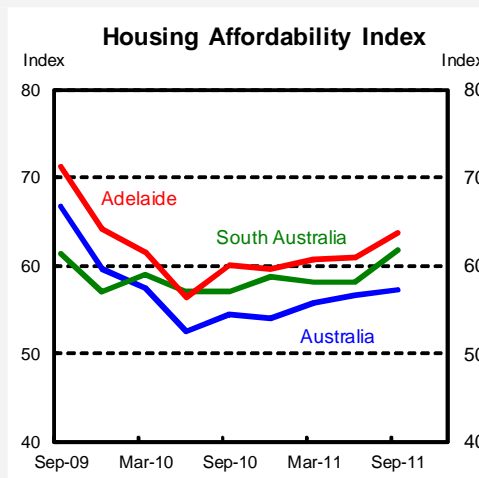
Australia does not face the same shortfall in the supply of housing. Therefore, a stronger boost to housing demand is likely required before residential will pick up once again. Leading indicators such as building approvals also suggest that the outlook for residential construction is likely to remain weak. Building approvals fell 28.1% in the year to February and has been in double-digit decline in 10 of the past 12 months.

There are however, some positives for the South Australian housing market. There are tentative signs of stabilisation in the housing market in Adelaide and Australia early this year. In the three months to April, RP Data-Rismark dwelling prices in Adelaide are 0.7% higher. This compares to a 0.3% increase over the same period for Australia.



A slight improvement in home loan demand is also encouraging. New owner- occupier home loans have risen for two consecutive months to be higher 3.7% in the year to February. Although the pace of growth is not overly strong, there has been a pick up in first home buyer demand, which has been a trend seen nationally.

First home buyers have increased to 15.3% as a proportion of all owner occupier loans and the proportion of first home buyers has steadily increased from a low of 12.6% in April 2011. First home buyers are important in driving a recovery in housing, as it provides additional housing demand and a market for existing home owners to sell their properties to upgrade. Rate cuts from the Reserve Bank (RBA) in November and December have helped support housing demand, while the 50 basis point cut to the cash rate from the RBA in May could help boost confidence further.



According to the HIA housing affordability index in Q4 2011, Adelaide is the third most affordable capital city in Australia after Hobart and Brisbane. Adelaide is also the cheapest capital city to rent in Australia. The median weekly rent for a three-bedroom house is \$320 per week, while the rent for two-bedroom other dwellings stands at \$270 per week according to the Real Estate Institute of Australia. Relatively higher vacancy rates in Adelaide, which stood at 3.4% in the December quarter, and a more balanced supply and demand outlook, suggest that housing is likely to remain affordable over the near-term for South Australia.

The high standards of living and the huge potential for economic growth through mining are strong supportive factors for the South Australian housing market over the long-term.

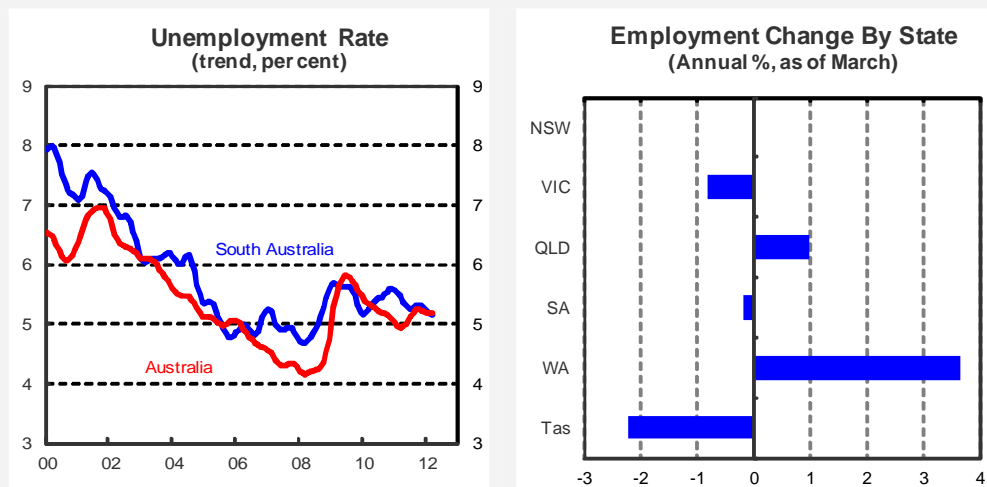
In a report published by the Economic Intelligence Unit in August 2011, Adelaide was ranked among the most favourable top ten cities in the world to live in (with a ranking of equal eighth). In arriving at the scores, cities were assessed in terms of their stability, healthcare services, culture & environment, education and infrastructure.¹

The near-term outlook for housing is mixed. Slowing population growth, uncertainty about the global economic outlook and concerns about the job market will weigh on housing demand over the near term. However, rate cuts from the RBA and relatively affordable housing in Adelaide are positives for the housing market.

Labour Market

Job growth has been soft in Australia and in South Australia. Annual employment growth in South Australia stood at -0.2% in the year to March, compared with 0.3% growth nationally. South Australia has lost a net 1.5k jobs in the year to March, and sits behind Western Australia, Queensland and NSW.

Despite net job losses over the past year, South Australia's unemployment rate has remained low at 5.2%, equalling the national rate. This trend partly reflects a gradual decline in the participation rate over the past year or so.



The breakdown of employment by industry suggests that the job market has been affected by the soft housing market and cautious behaviour by consumers. The construction industry lost a net 7.2k jobs in the year to February, while accommodation & food services lost 8.4k. Administrative & support services (-7.8k) also lost jobs in the year to February. Industries that gained the most jobs in South Australia included agriculture, forestry & fishing (12.9k) which is benefiting from favourable growing conditions, followed by finance & insurance services (7.0k) and other services (5.6k).

Leading indicators of employment – namely job advertisements – continue to point to a soft pace of job growth. Further, ongoing uncertainty regarding the global economic outlook will

likely keep firms hesitant in taking on new workers.

Manufacturing jobs in South Australia have declined as a proportion of total jobs over the past two decades, but the sector remains a large employer within the State economy. It currently employs 9.4% of the South Australian labour force, behind a number of service sectors. Healthcare & social assistance is South Australia's largest employer (12.9%) followed by retail trade (11.7%).

BankSA Forecasts

Economic Indicators, % Change				
	2009-10	2010-11	2011-12 (f)	2012-13 (f)
Gross State Product	1.20	2.40	1.50	1.80
State Final Demand	4.00	1.30	0.20	2.50
Employment	0.90	1.80	0.50	1.40
Unemployment Rate	5.30	5.40	5.30	5.50
Adelaide CPI	2.20	3.20	2.80	2.50
Wage Price Index	2.80	3.50	3.50	3.60

Source: BankSA

South Australian Treasury expect gross State product to expand by 2.25% in 2011-12 and 3.00% in 2012-13. Our forecasts are lower reflecting a soft State final demand outcome for Q4 2011 and continued weakness in certain areas of the economy. In addition, the South Australian Treasury has taken into account some of the potential impact of the Olympic Dam expansion project. Confirmation from the BHP Billiton board to approve the project could subsequently lead to a significant upgrade to our forecasts for growth and employment.

Footnotes:

1. Economic Intelligence Unit, The Liveability Survey, August 2011

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