Victorian Economic Outlook

Summary

- The Victorian economy has performed well over the past couple of years. The combination of low interest rates and a still-low Australian dollar has provided support to some of Victoria’s key industries.

- Consumer spending in Victoria grew at a solid pace of 3.3% in the year to the March quarter, which was above the 10-year average of 2.6%. Low interest rates, strength in the housing market and an improving labour market are all providing support to consumer spending.

- The upswing in Melbourne’s housing market has cooled from its earlier pace, however, it remains one of the stronger performing housing markets of all the capital cities. In the year to July, dwelling prices in Melbourne rose by 7.5%.

- In Victoria, business investment has weakened in recent quarters, following stronger growth previously. While the outlook nationally for business investment remains subdued, in Victoria the outlook is more solid.

- Job growth in Victoria has been solid in recent months, improving in step with a pickup in economic activity. In the year to July, Victoria’s labour market added 93k jobs. The closure of the local car industry will have a negative impact on the labour market, however, other industries will continue to experience moderate growth in jobs.
The Victorian economy has performed well over the past couple of years. The combination of
low interest rates and a still-low Australian dollar has provided support to some of Victoria’s key industries. This boosted economic growth in Victoria in 2014-15. Gross State product rose by 2.5% in 2014-15, which was the fastest annual pace of growth in four years, and well up on the 1.0% pace of economic growth recorded in 2013-14 and 2012-13. The pace of growth was exceeded only by Western Australia and Northern Territory, and was even a touch stronger than economic growth in NSW (2.4%). We estimate growth in gross State product rose to 3.0% in 2015-16.

State final demand was softer in the March quarter, rising by just 0.1%, however, this follows average growth of 1.2% in each of the previous five quarters. For the year to the March quarter, State final demand rose 3.2%, down from 4.8% in the year to the December quarter, but still comfortably above the long-term average growth of 2.6%.

Although economic growth in Victoria has improved, there remain some headwinds that face the economy. Victoria’s economy has benefited from high levels of residential building activity, but these will have to slow at some point. Additionally, the end of car manufacturing will impact activity and jobs in the State. Running counter to these headwinds, however, is the low Australian dollar and low interest rates. These factors are lending strong support to economic activity, particularly in the service sector and will continue to do so throughout 2016. Additionally, strong population growth in Victoria will support economic growth. Victoria’s population rose by 1.9% in the year to the December quarter 2015 (the latest available data), which was the fastest among the States and territories.

Gross State product is expected to grow by 2.75% in 2016-17, before rebounding to 3.00% in 2017-18. This is equal to growth we expect to see for 2015-16. Over the forecast period, growth in gross State product in Victoria is expected to be above its long-run average. (Please see page 9 for more detailed forecasts).

**Consumer Spending**

Consumer spending in Victoria grew at a solid pace of 3.3% in the year to the March quarter, which was above the 10-year average of 2.6%. Low interest rates, strength in the housing market and an improving labour market are all providing support to consumer spending. However, slower growth in incomes suggests that consumer spending will continue to grow at a moderate pace over the medium-term.

Within household spending, annual growth was strongest for electricity, gas & other fuel (6.8%), clothing and footwear (6.0%), food (5.9%), communications (5.5%) and insurance & other financial services (4.8%). Spending on cigarettes & tobacco fell (-10.2%) in the year to the March quarter.

Retail spending data points to a moderation in the pace of growth in consumer spending in Victoria in recent months. Growth stood at 4.0% in the year to June, which is below the long-term average of 4.4%.

New motor vehicle sales have been strong in Victoria, with a record number of new vehicles sold in Victoria in the year to July 2016.
With official interest rates already at record lows and expected to fall further, consumer spending in Victoria is likely to remain supported. An elevated level of consumer confidence in Victoria provides an encouraging sign for consumer spending in coming months.

According to the Westpac-Melbourne Institute survey, consumer sentiment for Victoria was at 104.0 in August, after dipping to 99.1 in July. The reading is now back above 100 (where it has been in three out of the past four months), signaling optimists outweigh pessimists in Victoria.

Soft income growth, however, remains a key risk to the outlook for household spending. The level of household savings remains high, suggesting consumers could draw down on their savings for spending, while income growth remains subdued. For this to occur, however, requires a sustained lift in confidence and expectations of an ongoing improvement in the labour market.

**Housing**

The upswing in Melbourne’s housing market has cooled from its earlier pace, however, it remains one of the stronger performing housing markets of all the capital cities. In the year to July, dwelling prices in Melbourne rose by 7.5%, which was above the national average of 6.1%. In July, the annual pace of dwelling growth in Melbourne slipped behind that of Sydney (at 9.1%), after leading the pace of dwelling price growth among the capital cities for six months. The moderation in dwelling price growth in Melbourne is a welcome sign that growth is returning to a more sustainable pace.

Owner occupier demand for housing has remained solid, supported by low interest rates. Lending to owner occupiers in Victoria rose 12.4% in the year to June, the fastest pace of growth among the States and territories. The number of new owner occupier loans in Victoria has been above its long-run average for 13 consecutive months.

While investors continue to be an important force in the Melbourne housing market, growth in this sector has moderated. Investor home loans made up 37.4% of all home loans by value in June, down from November, down from a peak of 45.6% in May 2015. Measures by APRA to
temper growth in investor housing demand have impacted the market. Interest rates remain close to record lows, however, helping to drive demand.

- **Rental Markets**

Rental markets have been near balanced over the past two years in Melbourne, which is somewhat surprising given the high level of building activity across the State. In the December quarter the rental vacancy rate rose to 3.1% and held at that level in the March quarter of this year. Vacancy rates at 3.0% generally signal a balanced rental market.

Moreover, rents have continued to increase modestly. In the March quarter, rents for three-bedroom houses rose at an annual rate of 2.7%, although this was the slowest pace of growth in a year. Rents for two-bedroom units lifted 2.6% in the year to the March quarter, down from growth of 4.3% in the year to the December quarter.

The slower lift in rents and the increase in the rental vacancy rate to just above 3% suggest Melbourne’s rental market is now well supplied. Strong population growth continues to support demand for housing. As more supply comes onto the market, however, growth in rents is expected to slow.

- **Dwelling Investment**

Dwelling investment in Victoria grew at an annual rate of 7.2% in the year to the March quarter. This was the slowest pace of growth in five quarters, but remains high on a longer historical comparison. Residential construction continued to contribute to economic growth in Victoria in the March quarter.

Home building activity in Victoria is expected to remain strong for some time. In the year to June, approvals for the building of new apartments in Victoria rose 43.3%.
Residential building has been elevated in Victoria for many years, allowing demand for new dwellings to be satisfied, so that the market is close to balanced currently. There remains, however, a solid pipeline of new projects, which will increase the supply of apartments in Victoria in coming years.

The rate of growth in rents has slowed, while the rental vacancy rate has edged higher. This is likely to intensify as more apartments become available to rent. The pace of growth in house prices has moderated in recent months and as more supply comes onto the market in Victoria, this trend will gain momentum.

On a positive note, however, Victoria’s population growth is buoyant and we expect official interest rates to fall further, which should support the housing market.

Business Investment

At the national level, business investment has been in decline for the past three years. While mining investment has fallen sharply, capital expenditure in the non-mining sector nationally has also been under pressure and is now lower than it was in 2011. According to the ABS capital expenditure survey of business investment intentions, non-mining investment Australia-wide is set to decline in 2015-16 and soften further in 2016-17.

In Victoria, business investment has weakened in recent quarters, following stronger growth previously. In the year to the March quarter, business investment slipped 1.3%. While this is disappointing, it is well above the national decline in business investment over the same period of 13.0%. While the outlook nationally for business investment remains subdued, in Victoria the outlook is less so.

Victoria was among the “non-resource” States which missed out on the benefit from the mining investment boom. Similarly, Victoria is having an easier time than some of the other States as
mining investment declines nationally. Low interest rates and the still-low currency are helping businesses. Strong population growth should also help underpin demand.

According to the NAB survey, conditions among businesses in Victoria eased to 8 in July. Capacity utilisation for Victoria rose to 82.6% in Q2, above the long-term average of 80.9%.

Nationally, business surveys point to an improvement in business conditions in the services sector over the past year, although in the June quarter, that improvement partially reversed. The services sector is benefitting from low interest rates and the depreciation of the currency since 2013. Growth in the services sector is reflected in the labour market, with many of the new jobs created in Victoria in the past year in the services sector.

The lower Australian dollar has had a positive impact on Victorian businesses in many industries, including the tourism industry. Overseas visitors to Victoria rose 12.4% in the year to June 2016. The number of overseas visitors to Victoria overtook those going to Queensland in 2015, putting Victoria in second place behind NSW.

The near-term pipeline for both engineering and commercial construction remains promising. Within engineering construction, work is underway on the $1.3bn project to widen the CityLink and Tullamarine Freeways and in 2018 work is due to resume on the $5.5bn Western Distributor road project. The State government is also planning $11bn towards underground rail tunnels and new stations across Melbourne CBD.

Within commercial construction, a healthy level of office projects is in the pipeline or under way including the 80 Collins Street Office Tower, development at Collins Square and the Wesley Church Site Office Development.

Labour Market

Job growth in Victoria has been solid in recent months, improving in step with a pickup in economic activity. In the year to July, Victoria’s labour market added 93k jobs. For the year to July, employment in Victoria rose by 3.2%, which was the strongest annual pace of growth of all
the States.

In July Victoria’s workforce participation rate lifted to 65.3%, up from 64.9% a year earlier. The unemployment rate lifted to 5.9%, from 5.7% in June, but remains well below the unemployment rate of 6.4% a year earlier.

By industry, some of the largest job gains for Victoria in the year to May were in the services sector, with healthcare & social assistance (51.8k) delivering the largest number of new jobs. This was followed by construction (25.4k), agriculture, forestry & fishing (24.6k) and retail (10.1k). The largest job losses were in manufacturing (-13.1k) reflecting the impact of the stronger Australian dollar in previous years, including the challenges within the car manufacturing industry and the long-run structural decline in manufacturing across Australia.

There remain downside risks to the employment outlook, including the closure of the local car industry, which will impact Victoria. Other industries, however, will continue to experience moderate growth in jobs. The improving economic outlook, record low interest rates and the still low Australian dollar (compared to 2013) will support jobs growth.

### Unemployment Rate (trend, per cent)

![Unemployment Rate Chart](chart1)

### VIC Annual Employment Change (thousands)

![VIC Employment Change Chart](chart2)

#### State Budget

The Victorian Government expects an operating surplus of $2.9bn in 2016-17, with surpluses expected to continue over the Budget forecast period (which is out to 2019-20).

In its 2016-17 Budget, the Victorian government announced new spending on rail and road infrastructure, including $3bn for the Melbourne Metro Rail and $7bn for the Western Distributor Project. Other infrastructure spending included school infrastructure worth $924m. There was also an extra $1.63bn for hospitals, ambulances and health programs.
**BankSA Forecasts**

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<th>Economic Indicators, % Change</th>
<th>2015-16 (f)</th>
<th>2016-17 (f)</th>
<th>2017-18 (f)</th>
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<td>Wage Price Index</td>
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*Source: BankSA*  *actual figures*

We expect that the pace of growth in Victoria will ease to 2.75% in 2016-17, before rebounding to 3.00% in 2017-18. Low interest rates, robust population growth and the low Australian dollar (compared to 2013) should continue to provide support to the broader Victorian economy over the next few years.
Contact Listing

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