

## SA Economic Outlook

### Summary

- The South Australian economy has been through challenging times, with its key manufacturing sector facing a squeeze from the high Australian dollar. The housing market has been more sluggish than other parts of the country. Additionally, mining has yet to gain a major foothold in South Australia and has not benefited from the height of the investment boom to the same extent as some other States.
- House prices in South Australia and nationally have stabilized over the past year, although the recovery in South Australia has been less pronounced in comparison to other States. We continue to expect further recovery in housing this year, and an improvement in residential construction.
- There remain downside risks and uncertainty for the outlook. Soft employment growth suggests that consumption growth is unlikely to pick up significantly. Additionally, given mining investment is approaching or passed its peak, resource investment is also set to wind back in South Australia. Confidence among consumers and businesses remain subdued according to the BankSA State Monitor, which may continue to restrain consumption, investment and employment.
- We expect that growth will improve, and South Australia's outlook is appearing more positive. Lower interest rates are helping to support the housing sector. Additionally, the recent fall in the Australian dollar will provide some welcome relief for South Australia's manufacturing sector, and other export oriented sectors including education, tourism and agriculture.

Percentage Shares of the Economy*		
Industries	SA	Australia
Manufacturing	10.9	8.6
Financial and insurance services	10.0	11.1
Health care and social assistance	8.1	6.9
Construction	7.7	8.7
Agriculture, forestry and fishing	6.6	2.7
Public administration and safety	6.6	5.7
Retail trade	5.8	5.1
Professional, scientific and technical services	5.7	7.5
Mining	5.7	11.3
Transport, postal and warehousing	5.6	5.7
Education and training	5.5	4.9
Wholesale trade	5.2	5.1
Information media and telecommunications	3.2	3.3
Electricity, gas, water and waste services	3.1	2.7
Accommodation and food services	2.7	2.7
Administrative and support services	2.4	2.7
Other services	2.1	2.1
Rental, hiring and real estate services	2.0	2.4
Arts and recreation services	0.9	0.9

\*share as % of Industry gross value added less ownership of dwellings Source: ABS, BankSA

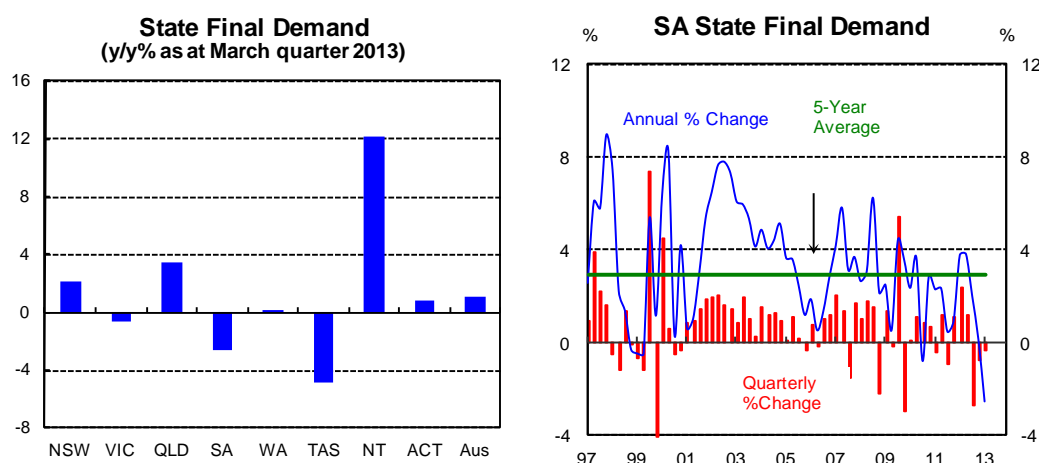
## Economic Growth

The South Australian economy has been through challenging times, with its key manufacturing sector facing a squeeze from the high Australian dollar. The housing market has been more sluggish than other parts of the country. Additionally, mining has yet to gain a major foothold in South Australia and has not benefited from the height of the investment boom to the same extent as some other States.

Reflecting the headwinds facing the State, State final demand in South Australia has contracted for three consecutive quarters to the March quarter 2013. In the year to the March quarter 2013, State final demand contracted 2.5%.

There is hope however, that the outlook is more positive. After being hard hit by the Australian dollar's strength over the past few years, the AUD's recent fall will provide some welcome relief for the manufacturing sector and other export-oriented sectors in South Australia including education, tourism and agriculture. The Australian dollar (in trade-weighted terms) has fallen more than 9 per cent from its recent peak reached in April this year. That said, the Australian dollar will need to stay lower for longer to have a lasting positive impact on these industries. Lower interest rates will also provide support, particularly for South Australia's housing and retailing sectors.

Although the level of investment in mining has been quite low in South Australia, there remains potential for growth in mining over the long-term. Olympic Dam remains a prospective project and there are large scale mineral deposits in South Australia.



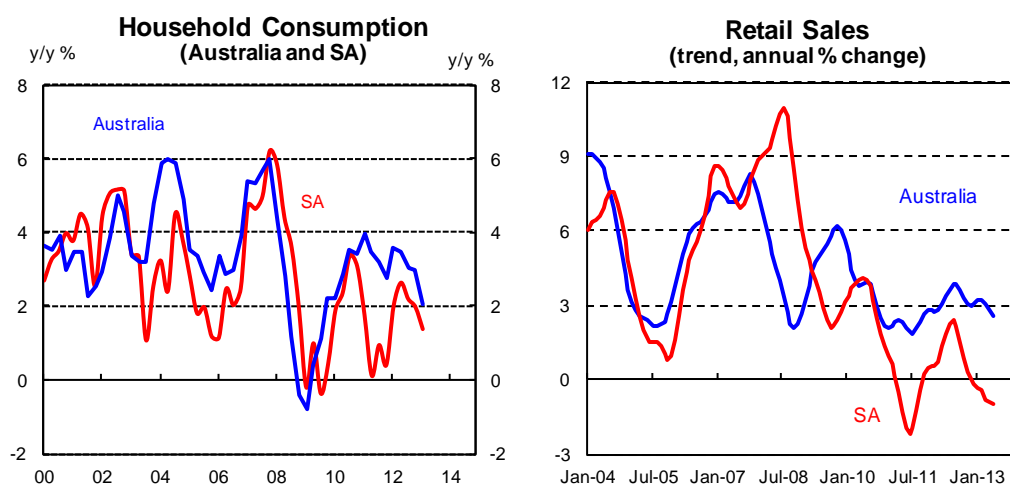
After posting growth of 2.1% in 2011-12, the South Australian Treasury expects economic growth of 1.25% in 2012-13. It expects growth to then pick up to 2.5% in 2013-14. Our growth forecasts are lower, reflecting weak State demand over the three quarters to Q1 2013, and we expect growth of 0.1% in 2012-13. However, we also expect growth to pick up in 2013-14, to 1.5%, reflecting the impact of lower interest rates and a weaker Australian dollar. (See page 8 for further details).

### Consumer Spending

Consumer spending has softened in South Australia, slowing to an annual pace of 1.4% in the year to the March quarter 2013. This is well down from a peak of 2.6% in the year to June 2012. Annual growth in the March quarter was the weakest annual pace since 2011. The rate of growth remains well below the long-run average of 2.4% and the growth Australia wide.

Retailing, a large component of household consumption, has been particularly weak, and has declined 1.0% in the year to May. Household spending on services, including health, insurance & other financial services has fared better, witnessing growth of 7.9% and 5.4% in the year to the March quarter respectively.

Soft job growth is likely keeping a lid on spending, despite lower interest rates, and may continue to dampen consumer spending in the near-term. The BankSA State Monitor survey in May is pointing to a drop in consumer confidence, which fell to its lowest level since the survey began in late 1997. The survey noted that 68% of people were positive about their household situation, down from 72% in February. The index, however, at 100.7 in May, is indicating that optimists just slightly outweigh pessimists. In contrast, another measure of consumer confidence, from the Westpac-Melbourne Institute is suggesting consumer confidence in South Australia has improved. The index rose to 99.3 in June, a 2.2% increase from May and up 13.0% over the year to June. However, the Westpac-Melbourne Institute measure remains below 100, indicating that sentiment remains fragile and points to modest growth in consumer spending.



## Housing

House prices in South Australia and nationally have stabilized over the past year, helped by interest rate cuts since November 2011. However, the evidence of improvement in the Adelaide housing market is less pronounced, and it has underperformed the market Australia-wide.

According to RP Data-Rismark, dwelling prices in Adelaide edged up 0.2% in the year to June 2013, while the Australia-wide capital-city-average gained 3.8% over the same period. However, there has been an improvement in Adelaide. A year ago, the annual rate of decline for Adelaide dwelling prices was -2.4%.

ABS data also points to a sluggish housing market in Adelaide, although recent data has been improving. In the year to the March quarter, Adelaide house prices edged up 0.9%, while Australian house prices rose 2.6% in the year to the March quarter.

Slower population growth and a softer labour market in comparison to other States have likely contributed to the weaker housing story in South Australia.

### - Dwelling Investment

Weak house prices have translated into very subdued residential construction activity in South Australia. Dwelling investment fell 13.9% in the year to the March quarter 2013, an improvement on the -15.5% annual rate in the year to the December quarter 2012, which was the weakest annual growth in more than eleven years. Residential construction has yet to recover after Government stimulus measures were withdrawn in 2010-11.

Although residential building has been weak, South Australia is not facing the same shortfall in the supply of housing like other States. This has been thanks to an extended period of strong building activity in the early 2000s. Additionally, a pullback in migration flows has dampened the underlying demand for housing in South Australia.

There is however, some good news for South Australia's residential construction industry given conditions have improved. The trend in building approvals in South Australia has risen over the

past year, albeit from very low levels, and for the year to May was running at an annual rate of 21.0% in trend terms. Lower interest rates and stabilizing house prices may have assisted in halting the slide in residential construction.

New incentives by the South Australian State government should also assist in boosting residential construction. The Housing Construction Grant, worth \$8500, came into effect from 15 October 2012 and is available for all home buyers purchasing or building a new home (up to a market value of \$400 000 and phasing out at \$450 000). There are also concessions from stamp duty on a new apartment or substantially refurbished apartment on contracts entered into from 31 May 2012 in certain areas of South Australia, including the Adelaide city council area.

#### - Rental Markets

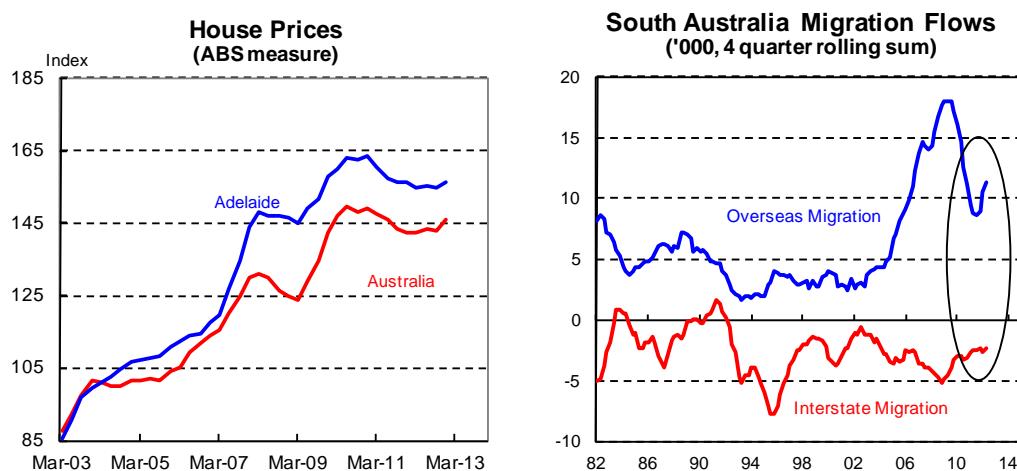
Rental markets improved in recent months across most capital cities including Adelaide. According to the Real Estate Institute of Australia (REIA), median weekly rents for a three-bedroom houses rose 1.5% and two-bedroom “other dwellings” rose 1.8% in the year to the March quarter 2013. Adelaide’s vacancy rate was at 3.0% in March 2013, where a vacancy rate below 3% indicates ‘strong demand’ for rental accommodation.

Rent in Adelaide is the second most affordable among all capital cities, just behind Hobart.

#### - Housing Outlook

The lower interest rate environment provides the ideal conditions for further recovery in housing. Rate cuts since November 2011 should continue to have a positive impact on the housing market as we progress through the remainder of 2013. The government incentives suggests that housing construction will continue to improve from very low levels of activity, although it is unlikely to return to levels witnessed in earlier years anytime soon.

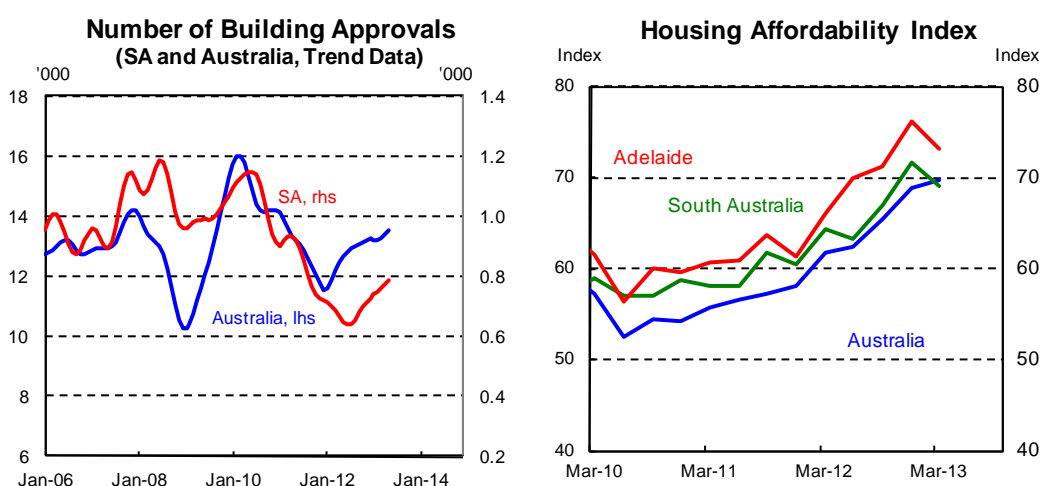
Further, a recent pick up in population growth should also be supportive of house prices. South Australia’s population grew 1.0% in the year to the September quarter. This was up from a 0.6% annual pace in the year to September 2011, although it was below the 1.7% annual growth recorded Australia-wide.



Concerns about the outlook for employment and a general reluctance to take on new debt, however, are likely to limit house price gains in Adelaide. This is particularly so given that South Australia's job market has been softer than in some other States.

Nonetheless, we continue to expect further recovery in housing this year, albeit this is likely to be less pronounced than other States. Adelaide remains the fourth most affordable housing market among all capital cities behind Hobart, Canberra and Brisbane according to the HIA/CBA housing affordability index, although affordability in Adelaide deteriorated in the March quarter this year.

South Australia enjoys high living standards. In a report published by the Economic Intelligence Unit in August 2012, Adelaide was ranked the equal fifth most livable city in the world. In arriving at the scores, cities were assessed in terms of their stability, healthcare services, culture & environment, education and infrastructure. Adelaide's ranking was an improvement on 2011, with Adelaide's score boosted by new infrastructure.

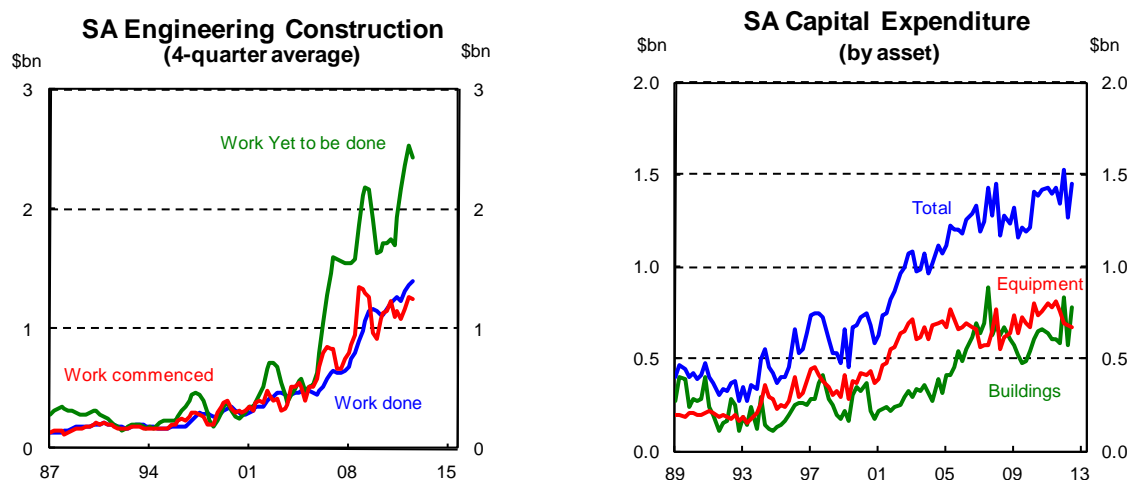


## Business Investment

Growth in business investment has slowed across Australia, as mining investment approaches a peak, and this has also occurred in South Australia. In the year to the March quarter, business investment declined 8.3%, the weakest in three years.

Weakness in business investment has been across engineering construction, buildings and capital equipment. Engineering construction fell from a peak of 64.0% annual growth in the year to the September quarter 2012 to an annual decline of 1.5% in the year to the March quarter 2013. Investment in machinery and equipment also weakened, falling 22.4% in the year to the March quarter 2013.

There remains a modest \$2.3bn worth of engineering construction in the pipeline. However, the pipeline of work is shrinking given a lack of major mining projects that have received final approval.



According to the Bureau of Resources and Energy Economics (BREE) mining projects at the “committed stage” (projects which have received the final go ahead) are worth just \$298 million and include Arrium’s Whyalla Port expansion and the Quasar Resources-Alliance Resources joint venture Four Mile uranium project.

In commercial construction, activity is continuing to be led by the \$1.8 billion Royal Adelaide Hospital, where work is expected to continue through to 2016. Abstracting from the Royal Adelaide Hospital, however, the near-term pipeline is limited, although there are a few major projects including the \$70 million Westfield West Lakes redevelopment and the \$175 million redevelopment of Skycity Casino. Difficulties in retail and manufacturing sectors and soft employment growth are weighing on office, retail and factory construction.

There is prospect for improvement in construction activity given the recent fall in the Australian dollar and lower borrowing costs, which should support economic activity. South Australia’s significant mining potential indicates that the long-term prospects for business investment growth remain promising. Despite the delay to its expansion project, Olympic Dam is still resource-rich, and remains a potential source of investment, jobs and economic activity.

### Labour Market

Job growth has been modest in Australia, and the South Australian labour market has been an underperformer. Annual employment in South Australia grew by 0.5% in the year to June 2013, softer than the 1.4% annual job growth nationally. The pace of job growth has been insufficient to prevent the unemployment rate rising from a cyclical low of 5.1% in January 2012 to 6.0% as at June 2013.

In the year to May 2013, most jobs were created in healthcare and social assistance (+18.2k), education and training (+9.2k) and transport, postal & warehousing (+6.3k). Most job losses have occurred in agriculture, forestry & fishing (-9.1k), professional, scientific & technical services (-8.9k) and accommodation and & food services (-7.2k).



Among other sectors, manufacturing has lost 1.4k jobs in the year to May, although the scale of decline has diminished. The construction industry is also improving in line with a stabilizing housing market, adding 5.1k jobs in the year to May.

Business confidence has remained subdued and suggests that firms have been concerned about the global outlook and the high Australian dollar. The BankSA State Monitor has reported a decline in confidence from 102.6 in February to 94.1 in May, and indicates that pessimistic business owners outweigh optimistic ones. Although uncertainties remain regarding the global economic outlook, lower interest rates should give some support for the South Australian economy. The recent decline in the Australian dollar provides a margin of relief for some of the South Australian industries struggling under the weight of the very high currency. Even given the Aussie dollar's recent fall, however, the currency remains at a reasonably high level and at this level will continue to thwart economic growth and employment gains in South Australia. Other leading indicators of employment, such as job advertisements, are also pointing to a soft pace of job growth.

### BankSA Forecasts

Economic Indicators, % Change				
	2011-12	2012-13 (f)	2013-14 (f)	2014-15 (f)
Gross State Product, constant prices	2.10	0.10	1.50	2.10
State Final Demand	2.10	-0.80	1.20	1.80
Employment	0.60	0.10	0.50	1.40
Unemployment Rate	5.30	5.70	6.20	6.00
Adelaide CPI	2.70	2.20	2.50	2.50
Wage Price Index	3.40	3.30	3.00	3.10

Source: St. George Banking Group

Weakness in State demand has resulted in a downgrade in our growth forecast for 2012-13 to 0.1%, slowing from 2.1% in 2011-12. An improvement in dwelling investment, modest growth in consumer spending and positive contribution to growth from net exports, however, should see growth gradually pick up in 2013-14 and 2014-15.



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