Monday, 26 May 2014

SA Economic Outlook

Summary

- The South Australian economy is facing challenging economic conditions. Economic growth will likely remain modest over the coming year, but there is prospect for improvement. Consumption and the housing sector are responding well to low interest rates. Manufacturers, tourism, education and agriculture should also be supported by a weaker Australian dollar. However, relatively slow population growth will continue to be a drag on the South Australian economy.
- South Australia has received some big blows in recent times. The shelving of the Olympic Dam expansion project was a disappointment, and more recently, the announcement by Holden to cease production in 2017 was another. While the loss of local car manufacturing poses challenges particularly for regions and jobs tied to the sector, car manufacturing, including parts and related sectors comprises a small fraction of South Australia's economy.
- The potential job losses from the departure of car manufacturing are significant, more than 1% of South Australia's labour force in a worst case scenario. However the scale of this challenge needs to be put into context. In the year to February, the manufacturing sector in South Australia added more than twice the jobs that could potentially be lost in a worst-case scenario. A lower currency is likely to be bigger offsetting impact than the departure of car manufacturing on the South Australia job market.
- Holden and Olympic Dam have not been helpful for confidence, and private sector investment has consequently been lacklustre. Fortunately, public sector works are partially filling the void in both non-residential construction and infrastructure spending.
- The recovery in dwelling prices in Adelaide has lagged behind other capital cities across Australia, but has recently started to catch up. Dwelling prices have now surpassed their 2010 peak and residential construction is gaining traction. We expect further gains in house prices this year, and dwelling investment to provide a healthy contribution to South Australia's growth.
- Growth is expected to remain modest in South Australia, but we expect a gradual pickup this year and next. This improvement reflects a pickup in residential construction, consumer spending, and a healthy contribution to growth from net exports.

Percentage Shares of the Economy*		
Industries	**SA**	**Australia**
Manufacturing	9.6	7.9
Health care and social assistance	9.2	7.4
Construction	8.6	8.8
Financial and insurance services	8.5	9.3
Public administration and safety	6.8	6.0
Professional, scientific and technical services	6.1	7.7
Education and training	6.0	5.3
Retail trade	5.9	5.3
Agriculture, forestry and fishing	5.6	2.4
Transport, postal and warehousing	5.4	5.6
Wholesale trade	5.1	4.9
Mining	4.8	11.2
Electricity, gas, water and waste services	4.0	2.9
Administrative and support services	3.2	3.4
Information media and telecommunications	3.0	3.1
Accommodation and food services	2.8	2.7
Rental, hiring and real estate services	2.2	3.0
Other services	2.2	2.0
Arts and recreation services	1.0	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 in recent years. The shelving of the Olympic Dam Project and the more recent announcement by Holden to cease production in 2017 are some disappointing blows for the State. These are reflective of some broader challenges that are facing the entire country- the manufacturing sector on the squeeze and mining investment set to decline significantly.

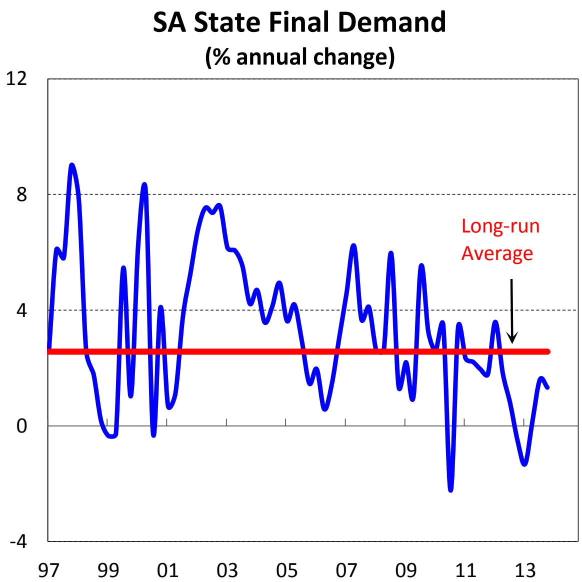
South Australia (along with Victoria) has borne the brunt of the difficulties within manufacturing. There are long-term structural changes at work, particularly for local car manufacturing, although the high Australian dollar has exacerbated recent troubles. Agriculture, tourism and education sectors are also affected by the high exchange rate and are important parts of South Australia’s economy.

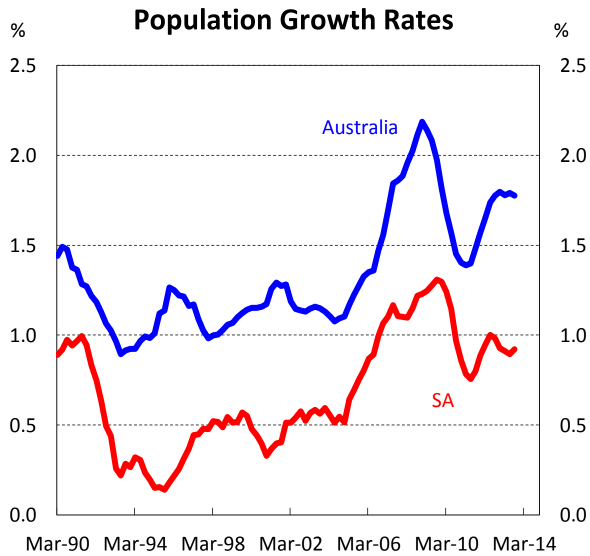
Gross State Product (which is the State equivalent for GDP, published annually) has slowed over the past two years and underperformed the nationwide outcomes. The South Australian economy grew by 1.8% and 1.3% in 2011-12 and 2012-13, respectively.

More recent data is promising, and there are early indications that an improvement is in prospect. State final demand grew 1.3% in the year to the December quarter. The pace of growth in final demand has improved from a year ago when it was in decline, although growth in South Australia remains below par.

Low interest rates are boosting housing and consumption, but they lag behind other States. Although the Australian dollar is high by historical standards, it remains lower than what it was in early 2013. Additionally, the drag on the State economy from weaker mining investment will be minimal since mining investment did not reach the same heights of other States. Another positive is export growth (in goods), at 19.9% in the year to the December quarter, which was at its fastest pace in 2½ years.

Nonetheless, the headwinds that have faced South Australia will continue to bite. Holden's announcement will put a dent in jobs and confidence in the economy, although car manufacturing including parts and related sectors comprises a small fraction of South Australia's economy. South Australia's weak population growth (at 0.9%) has also been a hindrance and sits well behind the national growth rate (1.8%) and growth rates of other States.





We expect growth to gradually pickup in 2013-14 and 2014-15 to 1.8% and 2.1% respectively, reflecting the supportive impact of lower interest rates and a weaker Australian dollar. (See page 8 for further details).

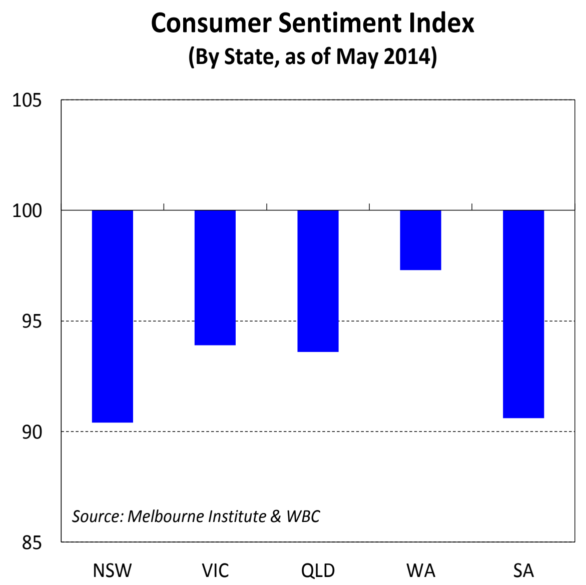
Consumer Spending

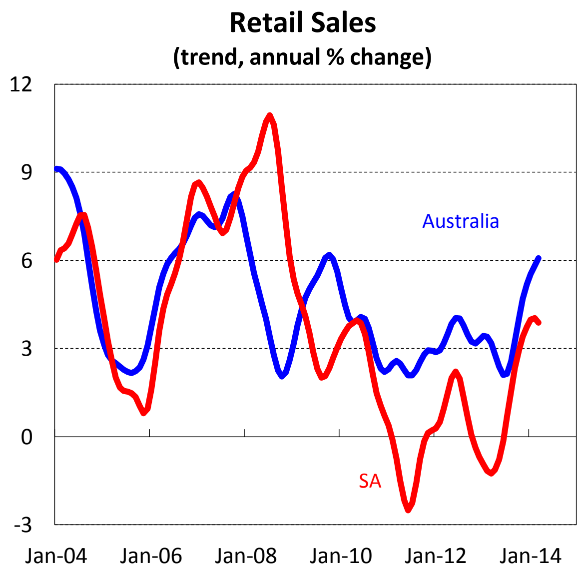
Consumer spending started to improve in South Australia towards the end of last year, lifting from an annual pace of just 0.1% in the year to the June quarter 2013 to 1.4% in the year the December quarter. This rate of growth remains well below the long-run average of 2.3% and the growth Australia wide. However, there signs that consumer spending has firmed in South Australia early this year.

Retail spending is gaining traction in South Australia. Annual growth stepped up 3.1% in March, just below the long-run average of 3.5% but a vast improvement on the contraction witnessed over the same period a year ago.

There remains a risk that consumer spending will be dented by the Federal Budget proposals announced in early May, which have already weighed on consumer sentiment. The consumer sentiment index from the Westpac-Melbourne Institute is suggesting consumers in South Australia are downbeat. The index was 90.6 as of May, well below 100 suggesting pessimists outweigh optimists. South Australian consumers were among the most pessimistic across all States.

While consumer spending might be dampened, we do not expect that the recovery will be derailed. The impact of lower interest rates and higher asset prices should continue to support spending over the medium term.





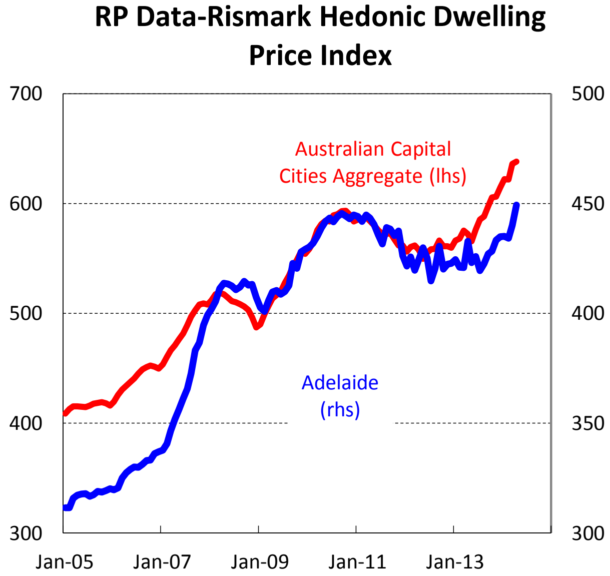
Housing

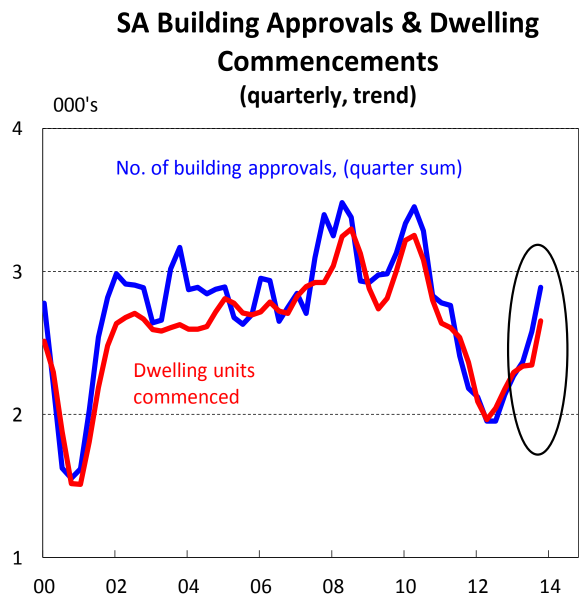
Adelaide dwelling prices rose by 2.1% in the month of April and by 3.8% in the year to April, according to RP Data-Rismark. Prices have now surpassed their previous peak in 2010. The recovery in dwelling prices in Adelaide has lagged behind other capital cities across Australia, but has recently started to catch up. By comparison, dwelling prices for the Australian capital city average rose 11.5% in the year to April.

- Dwelling Investment

Gains in house prices, although modest, have assisted in supporting activity in residential construction. Dwelling units commenced grew at 12.5% in the year to the December quarter 2013, and leading indicators suggest that solid growth is set to continue into 2014. Dwelling approvals in South Australia grew at a solid 34.1% in the year to March.

In addition to low interest rates, incentives by the South Australian State government to boost residential construction have had a positive impact. Some of these measures have been scaled back, but the recovery in residential construction should continue. The Housing Construction Grant, $8.5k for all home buyers purchasing a new home, ended on 31 December 2013. Meanwhile, full concessions from stamp duty on a new apartment or substantially refurbished apartment (in certain areas of South Australia, including the Adelaide city council area) will become a partial concession from 1 July 2014. A change to the eligibility to the First Home Owner Grant (FHOG) to only apply to newly constructed homes from 1 July 2014, should divert first home buyer demand towards new homes, and further support residential construction. This measure, however, has proved to have a negative impact on overall first home buyer demand in other States.





- **Rental Markets**

Residential rents have continued to witness growth in Adelaide with median weekly rents for a 3 bedroom house growing at an annual rate of 1.6% in the year to the December quarter and 3.7% in the year for a 2 bedroom "other" dwelling. The residential rental market remains close to balanced. The most recent data shows that the vacancy rate rose to 3.1% in the December quarter, which is also equal to the average over the past two years in Adelaide.

- **Housing Outlook**

An extended period of low interest rates point to further gains in house prices in South Australia but the size of the gains will be tempered by slower population growth and a softer labour market in comparison to other States. Additionally, the relatively softer pace of population growth combined with a lift in residential construction activity suggests that the housing shortage witnessed across the country is likely to be less evident in South Australia.

Business Investment

Business investment has been weak in South Australia. Mining investment is weakening from its heights of a few years ago, while non-mining investment has been slow to pick up. Business investment in South Australia fell 4.0% in the year to the September quarter, the second consecutive quarter of annual decline.

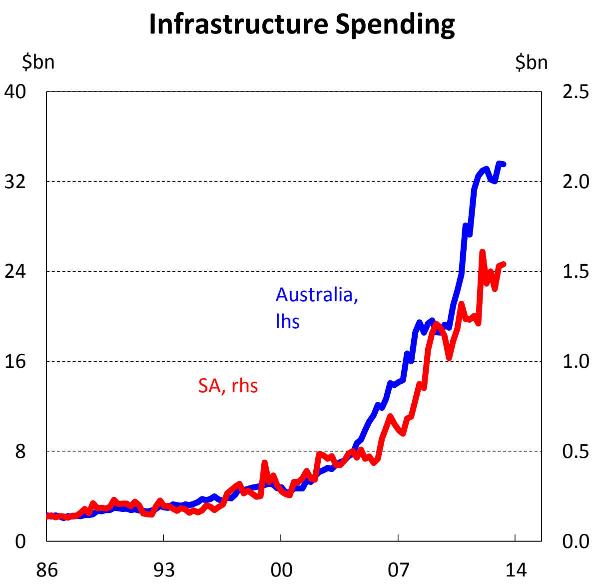
While private sector works have been in the doldrums, the public sector has helped to fill the gap in both non-residential construction and the engineering construction.

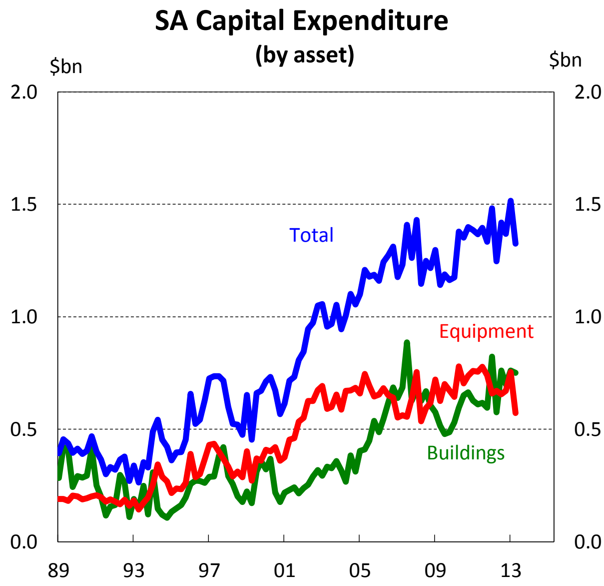
Non-residential construction continues to be supported by large publicly funded health projects including the new Royal Adelaide hospital and redevelopments of Lyell McEwin hospital and the

Queen Elizabeth hospital. State funding is also continuing to contribute through the building of a manufacturing hub at the Tonsley Park site and the redevelopment of the Adelaide Festival Centre.

As reflected in the leasing market, non-residential demand in Adelaide appears to be in for another quiet year. We expect leasing activity to remain subdued during 2014. Incentives and vacancy rates rose last year.

Within engineering construction activity, road and rail projects are dominating in South Australia. These include the South Road Superway project and the revitalisation project of the Noarlunga Line within rail.





The mining sector is continuing to react to the gradual decline in commodity prices. There are few major resource and mineral projects to note, and the pipeline has continued to fade. As of October, the Bureau of Resources and Energy Economics (BREE) reported $5.5bn worth of feasible projects but only one project, the Four Mile uranium project in the northern Flinders Ranges, worth around $100mn at the committed stage of development. There were no new projects progressing to the committed stage since April.

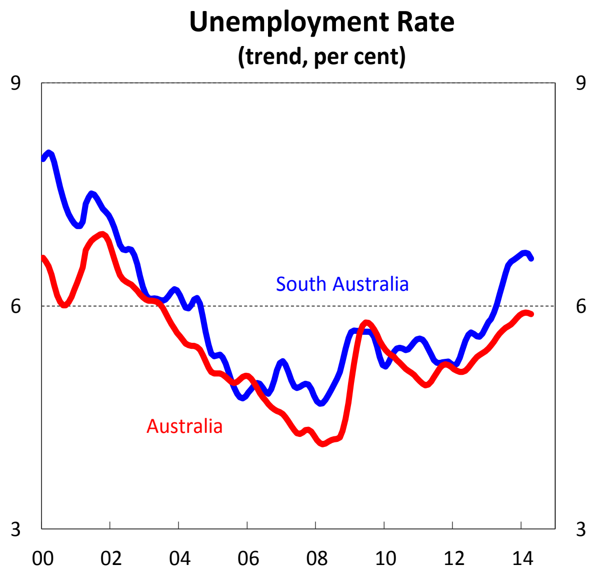
A lift in business confidence will likely be necessary before the private sector starts picking up its investment spend. The BankSA business monitor in February highlighted uncertainty among businesses following the announcements of closures by car manufacturers and ahead of the Federal Budget. While some measures in the Federal Budget should be supportive of South Australian businesses, such as the proposed company tax cut, the cuts to income support for households could dampen consumer spending and therefore demand.

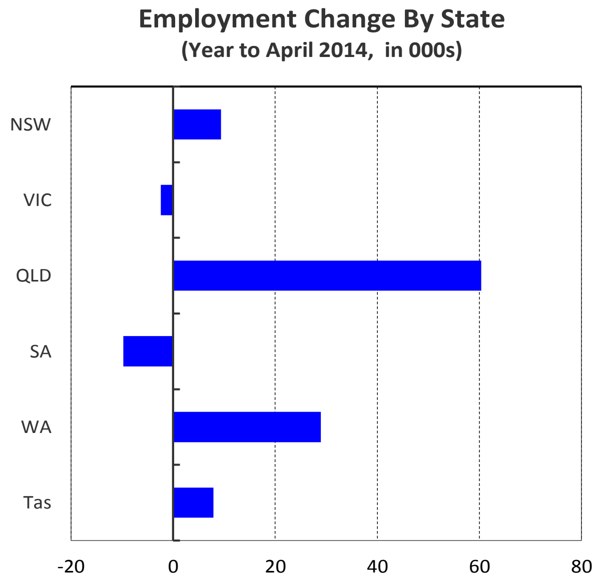
Nonetheless, a lower Australian dollar should be helpful for many businesses and could assist in the outlook for investment spending. The SA State Budget 2014-15 to be released on 19 June could also be an opportunity for the State Government to announce further infrastructure spending for South Australia.

South Australia's significant mining potential indicates that the long-term prospects for business investment growth remain promising. Despite the shelving of its expansion project, Olympic Dam is still resource-rich, and remains a potential source of investment, jobs and economic activity.

Labour Market

The labour market in South Australia has been weak over the past year and has lost 9.8k jobs in the year to April. The unemployment rate has also gradually risen over the past year from 5.9% a year ago to 6.3% in April, although it has recently fallen from the recent peak of 7.1% in March.





The loss of local car manufacturing poses challenges particularly for regions tied to the sector and will have implications for South Australia's labour market. Long-term structural factors are at play in local car manufacturing, although the strong AUD in recent years has exacerbated its woes. The worst-case scenario is that 9,000 jobs in the South Australian economy disappear while the best-case scenario (announced job cuts only) is 2,000 jobs will disappear.

The potential job losses are significant at more than 1% of South Australia's labour force. However the scale of this challenge needs to be put into context. In the year to February, the manufacturing sector in South Australia added more than twice the jobs that could potentially be lost in a worst-case scenario. Additionally, the most likely outcome will lie somewhere in between the best and worst case scenarios.

Somewhat surprisingly, manufacturing was the industry which added the most jobs over that period (+19.1k) perhaps suggesting a weaker Australian dollar is helping. Indeed, a lower currency is likely to be bigger offsetting impact than the departure of car manufacturing on South Australia job market. Agriculture, forestry & fishing added the second most jobs over the year, at 15.7k jobs. The two industries that were the weakest on the hiring front are education and wholesale trade.

BankSA Forecasts

Economic Indicators, % Change				
	2012-13	**2013-14 (f)**	**2014-15 (f)**	**2015-16 (f)**
Gross State Product, constant prices	1.30	1.80	2.10	2.20
State Final Demand	-0.20	1.00	1.90	2.00
Employment	0.10	-1.20	1.20	1.20
Unemployment Rate	5.70	6.60	6.30	6.10
Adelaide CPI	2.00	2.60	2.80	2.50
Wage Price Index	3.30	3.00	3.10	3.10

Source: BankSA

We expect an improvement in South Australia’s economy but for growth to remain modest in coming years. A pickup in dwelling investment, modest growth in consumer spending and positive contribution to growth from net exports should see growth gradually pick up in 2013-14 and 2014-15.

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