National Australia Bank

State Economic Update – March 2013

NSW

The outlook for NSW has softened since our last update, partly reflecting a sharp reduction in public investment. While mining investment provides an additional source of growth for NSW, it makes up only a relatively small share and recent weakness in activity in the coal industry is likely to weigh on investment in 2013. Nonetheless, mild activity in the NSW consumer sectors has helped to lower unemployment, which should assist growth over 2013, while a softening in the AUD and rising international student enrolments may help support services trade over coming quarters. While tightness in the housing market and declining affordability appear to be contributing to a rise in net outflow of persons from NSW, it does appear to have sparked increased activity in dwellings investment. The NSW economy should strengthen as the upswing in housing investment becomes more entrenched, although growth is likely to remain below trend in 2012-13.

Victoria

The Victorian economy slowed throughout 2012, with subdued investment and consumption expenditure contributing to a 0.1% decline in SFD over the year. Victoria's housing market is lagging behind other states due to the unwinding of previous exceptional dwellings growth over 2009 and 2010. In addition, Victoria's housing market is better supplied and this is likely to soften dwelling investment over the medium term. As a consequence of a softer outlook for housing, Victorian households appear more cautious, keeping the consumer sectors downbeat. This combined with the relatively small presence of mining in this state is likely to contribute to a higher rate of unemployment over the year ahead, though increases in labour productivity as a result of previous structural adjustment (due to the high AUD) should provide some offsetting strength. Overall, lower borrowing rates should eventually work to boost household spending, which should see growth in Victoria improve gradually over 2012-13, albeit remain subdued.

Queensland

A general softening in minerals and energy prices and the deferral of some marginal mining projects have contributed to a marked deceleration in Queensland's growth over 2012. Reflecting the slowing pace of the mining investment boom, Queensland's non-residential investment pipeline has fallen recently. Furthermore, downgrades to the outlook for growth in Australia's major trading partners – the US and Europe – have subsequently weakened demand from Asia, causing further deterioration in the state's trade balance. While dwelling investment has consistently struggled to keep pace with rapid population growth in Queensland in recent years, government initiatives taken to strengthen first home buyer demand may help to promote increased dwellings investment in coming quarters. The outlook for Queensland remains better than the national average, although the weakness in labour intensive parts of Queensland may keep the unemployment rate elevated for some time, keeping the risks to this economy to the downside.

Western Australia

Growth in the Western Australian economy continues to surpass growth in all other states, with SFD increasing by 14% through 2012, supported by solid growth in private business investment. Household consumption growth was supported by the state's strong population growth, as well as the high AUD, which has increased the purchasing power of the domestic consumers. While Western Australia's non-residential investment pipeline has fallen significantly, the pipeline remains elevated. Labour market conditions are strong, largely supported by exceptional growth in mining-related investment. However, as labour intensive mining investment growth slows in coming quarters, so too will the economy.

South Australia

Conditions in the South Australian economy remain subdued, with SFD deteriorating into the final quarter of 2012, growing by just 0.3% over the year. South Australia continues to struggle under the weight of the still elevated AUD, which is weighing particularly heavily on the non-mining trade-exposed and retail sectors. With South Australia's Olympic Dam expansion now unlikely to proceed in the near to medium term and with little other mining capital expenditure in the pipeline, economic growth in South Australia is likely to remain subdued through 2012-13.

Tasmania

The Tasmanian economy is underperforming relative to the rest of Australia. SFD contracted by 4.6% over 2012 and the combination of slowing population growth and the restructuring of some sectors of the economy, including manufacturing and forestry, provides little upside to the near-term outlook for this state. While the outlook for a softening AUD should be supportive for trade dependent sectors, uncertainty about job security is likely to keep consumer caution at the fore, while government fiscal tightening will continue to weigh more heavily in Tasmania than elsewhere (due to public demand accounting from more than 30% of SFD). Growth is likely remain subdued over 2012-13.

State Forecasts				
	Gross State Product		Unemployment Rate	
	Annual % change		Average rate	
	12/13f	13/14f	12/13f	13/14f
NSW	1.8	2.3	5.2	5.8
VIC	1.5	2.0	5.7	5.8
QLD	3.3	3.0	6.0	6.3
SA	1.8	2.0	5.8	6.0
WA	6.0	4.0	4.2	4.8
TAS	0.5	1.0	7.0	7.0
Australia	2.7	2.6	5.5	5.8

Source: NAB Economics

State conditions converge as weakness infiltrates previously strong performers

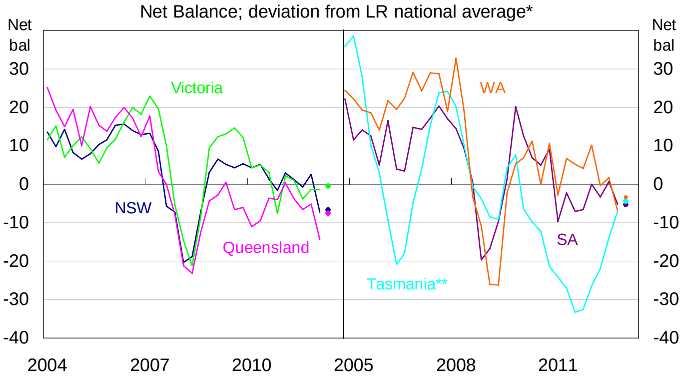
The NAB Quarterly Business Survey showed a sharp deterioration in activity in the December quarter 2012, with business conditions falling to their weakest level since June quarter 2009. The disparity between business conditions that became increasingly pronounced following the GFC has narrowed over recent quarters; however, the convergence of conditions readings largely reflects a weakening in previously stronger performing industries and regions, suggesting that weakness elsewhere is spreading. The survey highlights a marked deterioration in conditions in the resource-rich Western Australian and Queensland states over 2012, consistent with a general softening in minerals and energy prices and the deferral of some marginal mining projects, which are likely to have had flow on impacts to supporting industries. Conditions also weakened notably in NSW – while this may partly reflect weakness in the coal industry, it is possible that external financial troubles in the US (eg. the 'fiscal cliff' which was still unresolved at the time the survey was conducted), and worries about the outlook for global growth were having a material impact on the financial sector, which is a major industry for the NSW economy. Conditions remained poor in Victoria and South Australia. Business conditions in Tasmania continued to strengthen in the December quarter, after reporting extremely weak activity over 2011, though overall activity was still poor (care should be taken when interpreting these data due to small sample size).

More recent monthly data show that state business conditions improved a touch in early 2013, though they remain poor overall. Much of the improvement appears to have reflected better conditions in the professional services sectors, assisted by the rally in equity prices since mid-November. Furthermore, it appears that lower borrowing rates are beginning to provide support to the consumer dependent sectors, including retail, recreation & personal services and wholesale. If this trend continues, we would expect to see further improvements in conditions of the more consumer dependent states, including Victoria, NSW and South Australia. Consistent with the general improvement in state conditions in early 2013 business confidence has also strengthened across all of the states in more recent months, though much of this appears to have been driven by external factors (including equity markets and a generally better outlook for the global economy).

Graph 1

Quarterly NAB Business Conditions Index

Net Balance; deviation from LR national average*

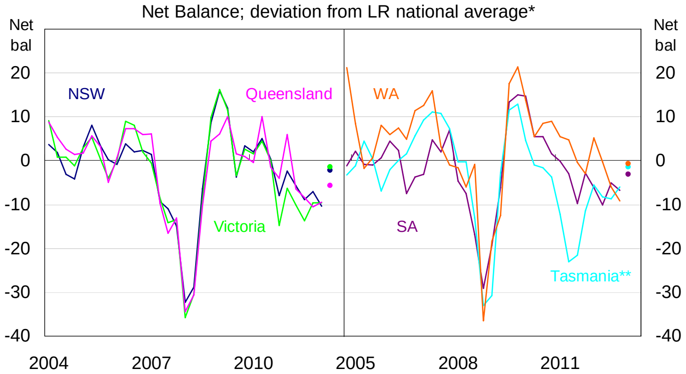


* Deviation from national average since Sep 1989. Data are seasonally adjusted. Dots represent March quarter 2013 estimates from NAB monthly business survey.
** Data have been trended using 5-term Henderson trend (due to small sample size)

Graph 2

Quarterly NAB Business Confidence Index

Net Balance; deviation from LR national average*



* Deviation from national average since Sep 1989. Data are seasonally adjusted. Dots represent March quarter 2013 estimates from NAB monthly business survey.
** Data have been trended using 5-term Henderson trend (due to small sample size)

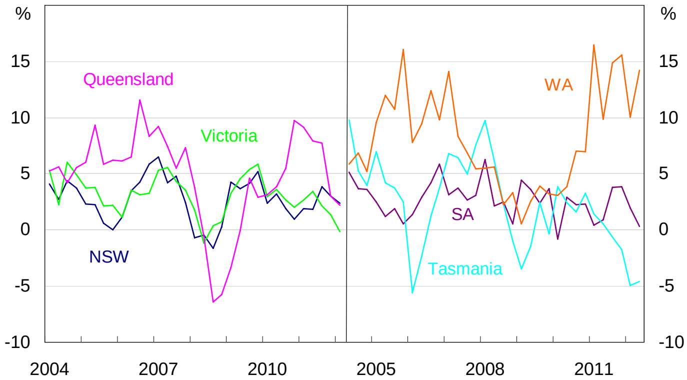
Households still cautious, keeping spending behaviour relatively subdued

Domestic final demand in Australia softened to 3½% over 2012, compared to growth of 4½% over 2011. Growth was particularly subdued in the second half of 2012, with the 6-monthly annualised pace falling to just 0.6%. Contributing to the recent weakness in demand has been the very subdued pace of private consumption expenditure, which makes up almost 55% of total final demand. Through the year growth in household final consumption expenditure growth was particularly weak in Tasmania, while Queensland, Victoria, NSW and South Australia all experienced fairly mild growth. Growth in Western Australia bucked the trend, with household consumption growth continuing at a relatively solid pace over the year.

Graph 3

Real State Final Demand

Year-ended percentage change

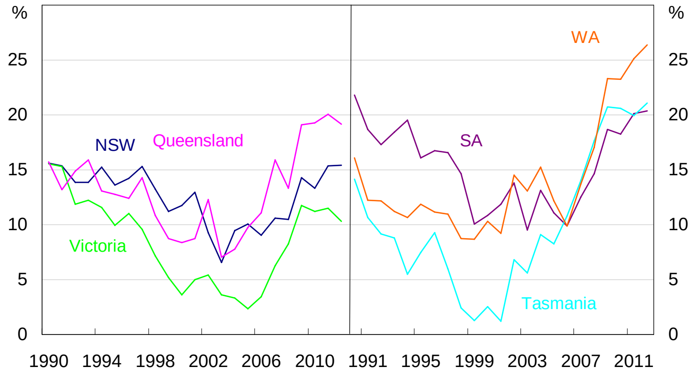


Sources: ABS; NAB

Graph 4

Household Savings*

Proportion of gross disposable income



* Includes consumption of fixed capital

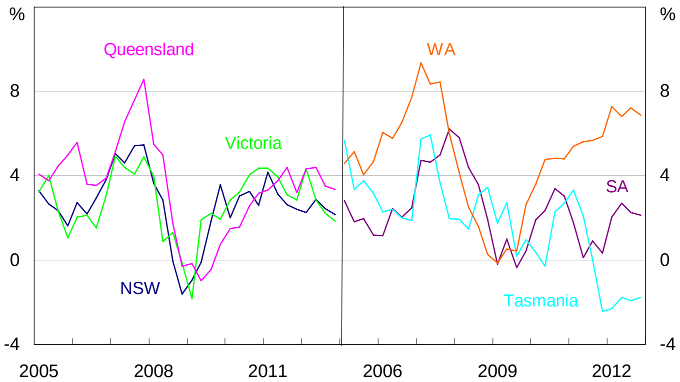
Sources: ABS; NAB

Consumer caution has remained a prominent theme since the onset of the global financial crisis (GFC), when households re-assessed their spending behaviours in order to help de-leverage their balance sheets. As a result households are now saving a much larger proportion of their disposable income than they were prior to the GFC, and it is clear that this has weighed heavily on consumption growth. While interest rates have fallen since late 2011, in effect lowering the rate of return available to households on their savings, this does not appear to have discouraged households from continuing to save. Rather, the general uncertainty about the near-term outlook for the Australian economy, which is undergoing significant adjustment as the mining boom evolves from the investment phase to the production phase, appears to be weighing on confidence, which is keeping households cautious. More certainty about the economic outlook may be expected to see households relax their savings patterns, which could help to strengthen household consumption growth. The rise in household saving as a proportion of disposable income has been broad-based across states, though it has been particularly pronounced in Western Australia, where household income growth has run well ahead of consumer spending, despite the strength of the latter (see below).

Graph 5

Real Household Final Consumption Expenditure

Year-ended percentage change

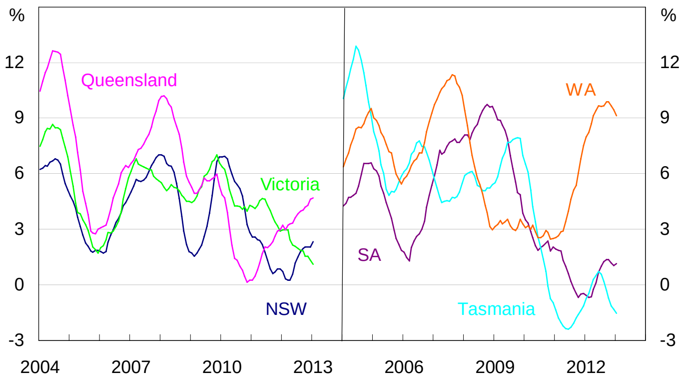


Sources: ABS; NAB

Graph 6

Retail Sales Growth

Annual average percentage change



Source: ABS

The savings patterns of individual states as well as the general strength of each economy are strong determinants of consumption behaviours. Household consumption expenditure growth in Western Australia has been particularly marked over recent years (averaging an annual pace of 4¾% per year since 2007), reflecting the state's strong population growth and labour market conditions, as well as the high AUD, which has increased the purchasing power of domestic consumers. In contrast, household consumption in Tasmania has been poor reflecting the generally weak state of this economy, with soft labour market conditions and income growth. Household consumption growth in the other states has been broadly similar over recent quarters. Retail sales, which account for approximately one third of total household consumption expenditure, have exhibited similar trends to consumption growth across the states.

Public Sector Investment Makes Way for Private Investment

Commonwealth and State Government's intent to bring their Budget balances into surplus continues to constrain growth in public sector demand. Public capital investment across the states has generally declined over 2012 as Commonwealth fiscal spending on infrastructure has unwound. Western Australia and Victoria are the two exceptions, where growth surged over 2012, although public investment growth in Victoria appears to have been artificially boosted by the transfer of effective ownership of the Wonthaggi desalination project to Melbourne Water, estimated to be worth around $5 billion. Public investment spending was cut back most significantly in NSW over 2012, while it was marginally lower in South Australia and Queensland.

Underlying Gross Fixed Capital Formation - 2012*

	Year-average percentage change					
	NSW	VIC	QLD	SA	WA**	TAS
Private	3.2	3.3	10.3	1.6	24.6	-9.9
Public	1.3	-20.6	-0.2	3.4	9.8	-15.5
Total	**2.8**	**-0.4**	**8.2**	**2.0**	**23.2**	**-11.4**

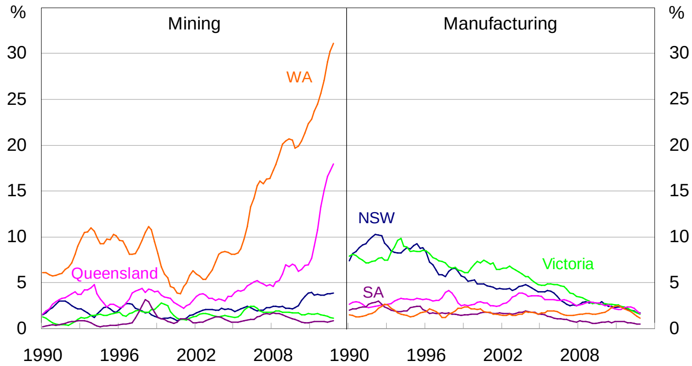
* Abstracting from asset sales between sectors
** Actual: underlying not available from ABS
Sources: ABS; NAB

Capital investment has expanded rapidly over much of the past decade, resulting in a broad-based increase in capital expenditure as a share of state final demand across the Australian states (see Graph). While mining investment continues to contribute to growth in private business investment, the peak in mining investment is quickly approaching and concern about the capacity of the non-mining sector to compensate for the end of the mining investment boom is increasing. The mining sector in WA currently accounts for almost 31 per cent of total capital expenditure in Australia, while the Queensland mining industry accounts for close to 18 per cent, which are their highest shares in recent history (see Graph). Thus, the imminent unwinding of mining investment will no doubt have significant implications for growth in these states. Aside from mining, there has been a clear step down in investment in the steadily declining manufacturing sector, which has come under increased pressure from the still high AUD as well as competition from the emerging economies of Asia. Overall, the outlook for business investment has softened, but given the magnitude of resource projects currently committed, particularly liquefied natural gas (LNG) projects, mining investment is expected to remain at an elevated level for a couple of years, which will continue to support investment growth over the forecast horizon.

Graph 7

Capital Expenditure by Industry by State*

Proportion of total Australian capital expenditure, annual sum



* Data not available for Tasmania
Sources: ABS; NAB

The shifting phases of the mining boom

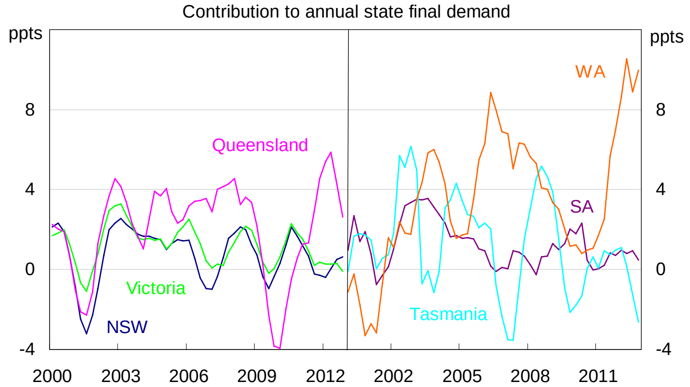
The non-residential investment pipeline reached a turning point in mid-2012, reflecting the significant amount of mining construction taking place, combined with a slowing stream of project commencements, with many of the 'mega' mining projects already underway. Much of the reduction in the non-residential investment pipeline has occurred in Western Australia and Queensland; nonetheless, the pipeline in these states remains somewhat elevated at around one year and two months long, and together makes up around 85% of the total Australian pipeline. Looking ahead, iron ore investment in the near term, which mainly presides in Western Australia, should remain strong given much of the spending is already committed. However, new iron ore developments are likely to proceed at a slower pace than previously anticipated. The non-mining states are not expected to make a significant contribution to future non-residential investment given already low capacity utilisation and soft demand.

The Australian Bureau of Resources and Energy Economics (BREE) released its updated listings of major mining projects at the end of 2012, which showed there were 98 advanced resource and energy projects under way or committed as at October 2012, representing $260.8 billion or 18% of GDP. This figure is largely made up of LNG projects, including Gorgon, Wheatstone and Ichthys, reflecting the shift in demand towards lower greenhouse gas emitting energy internationally. South Australia's Olympic dam mine expansion is excluded from these figures; this project was delayed and is unlikely to proceed in the near term (the South Australian government granted a four year extension to the indenture agreement). While the value of committed projects in the pipeline remains large, it has been in decline, suggesting that the peak in mining investment is approaching. The shift from investment to production and exports will have important implications for output growth and employment.

Graph 8

Investment Expenditure*

Contribution to annual state final demand

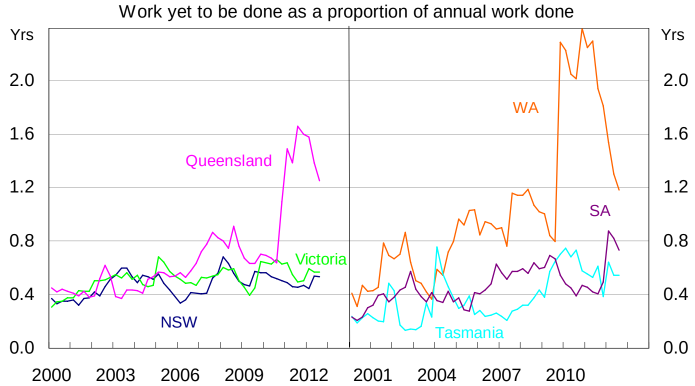


* Gross fixed capital formation
Sources: ABS; NAB Group Economics

Graph 9

Non-residential Investment Pipeline*

Work yet to be done as a proportion of annual work done



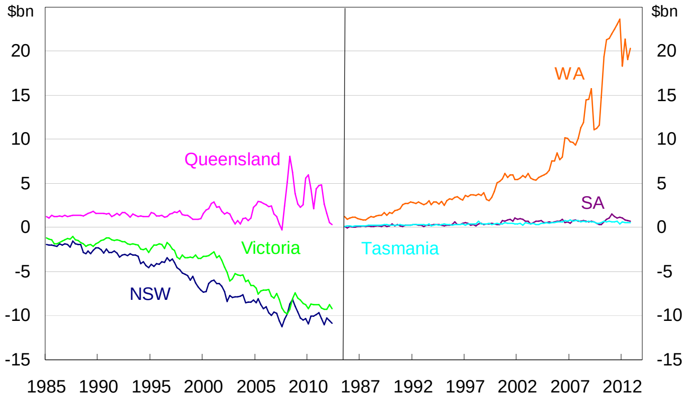
* Calculated as the sum of non-residential building and engineering construction
Sources: ABS; NAB

Nominal net international trade continuing to weaken across states

While down from their recent peak, nominal net exports in Western Australia remain at elevated levels and continue to easily outperform the rest of the country, helped by the fact that China is Western Australia's largest trading partner – accounting for close 46% of the state's exports in 2011-12. Looking ahead, expansions in production capacity are expected to be the key driver of export volumes over coming years, rather than fluctuations in external demand. Elsewhere, nominal trade balances have continued to deteriorate, particularly in Queensland, where weak coal exports have contributed an $11 billion deterioration in the nominal trade balance in 2012 compared to in 2011. While export conditions have weakened more recently, the fiscal expansion and easing in monetary policy implemented by major central banks (US, Europe and Japan) through the course of 2012 is expected to boost growth into 2013, which should flow through to strengthened export demand in the industrialising Asian economies. South Australia and Tasmania have continued to struggle under the weight of an elevated AUD, while in Victoria and NSW, trade balances have deteriorated significantly in recent years. Exports in commodities continue to dominate trade patterns while rural exports have lifted considerably over the past year or so, in line with improved conditions.

Graph 10

Nominal Net Exports

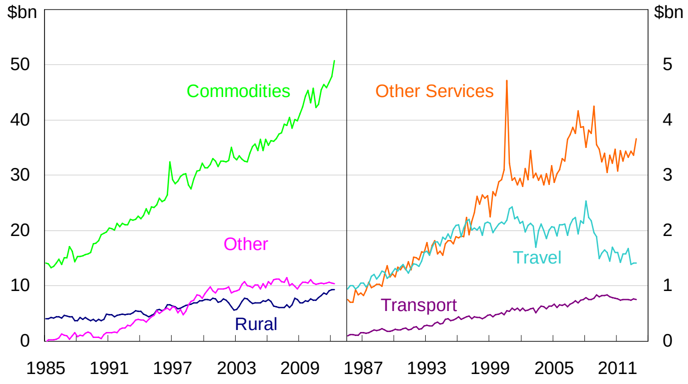


Sources: ABS; NAB Group Economics

Graph 11

Goods & Services Exports

Chain Volume Measures (reference year 2010-11)



Sources: ABS; NAB Group Economics

While Victoria and NSW typically have large trade deficits in merchandise goods, it is services trade that generally drives export performance within these states, accounting for around two thirds of total exports. According to balance of payments data, Australian services exports rose by 0.8% over 2012, with a large decline in transport services more than offset by rises in travel and other services. With the AUD beginning to soften and international student enrolments on the rise, it is possible that Victoria and NSW may benefit from improved net services trade over coming quarters.

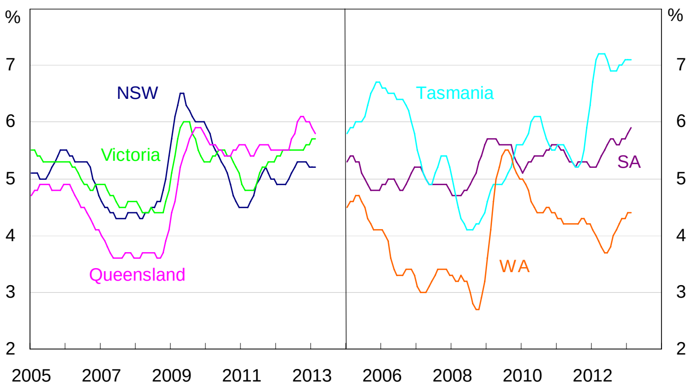
Labour market conditions resilient but expected to soften

The unemployment rate has risen across the majority of states over the past six months or so, though relatively stronger activity in the NSW and Queensland consumer sectors appears to be helping to lower unemployment in these states, keeping the national rate broadly unchanged at around 5.4%. The increase in the trend unemployment rate has been particularly concerning in Tasmania, currently trending at a little above 7%, with the labour market particularly weak in the north west of Tasmania, which has been negatively affected by the decline in the manufacturing sector. While the unemployment rate in WA has risen by almost 1 ppt over the past year, it remains very low relative to rates across the rest of the country – at close to 4½% – suggesting that capacity pressures may continue to be a cause for concern over the year ahead. Unemployment rates in the remaining states are currently between 5% and 6%. Interestingly, growth in average monthly hours worked is declining across all states (except for NSW and WA), suggesting employers have maintained their preference for reducing hours rather than heads.

Graph 12

Unemployment Rate

Trend

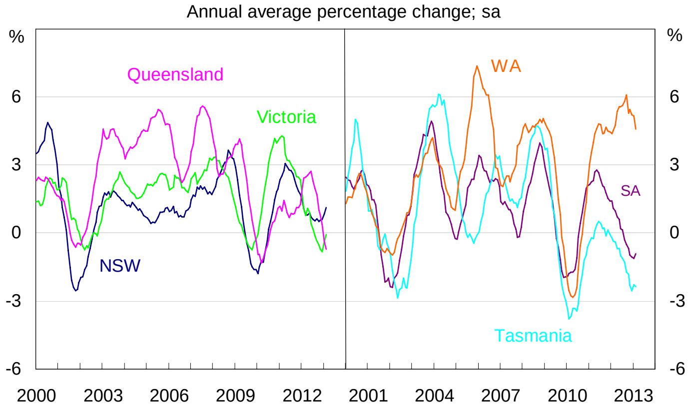


Sources: ABS; NAB

Graph 13

Aggregate Monthly Hours Worked

Annual average percentage change; sa

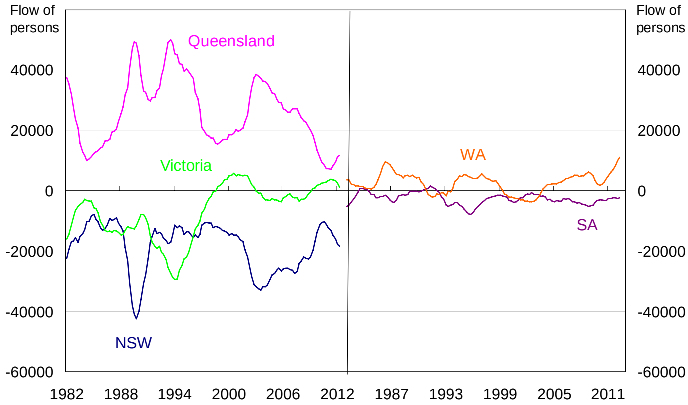


Sources: ABS; NAB

Labour market indicators generally point to a moderation in employment growth – largely reflecting the frictional impact the structural adjustment in the Australian economy is having on hiring – although indicators have improved a little over recent months. Employment growth is expected to soften after resource investment growth reaches its peak and growth in domestic demand moderates, with the slowing in growth to be especially apparent in the resource rich states. We see the unemployment rate rising to around 5¾% by mid 2013, up from its current trend rate of 5½%. The higher rate of unemployment is likely to be particularly apparent in the non-mining states – Tasmania, SA, Victoria and, to a lesser extent, NSW, although the weakness in labour intensive parts of Queensland may also keep the unemployment rate high in this state for some time.

There has been a slight pick up in net interstate migration (and net overseas migration) in Western Australia in response to exceptionally strong growth in mining-related investment in the resource-rich state, which has tightened labour market conditions markedly. During the past decade, there has been a general decline in net interstate migration to Queensland, though the flow has picked up a little more recently, while net outflow of persons from NSW has picked up recently, perhaps partly in response to declining housing affordability. Victoria continues to benefit from a marginally positive inflow of net interstate migration. While not shown on the chart (due to data volatility), Tasmania is experiencing a significant out flow of migration as workers are encouraged into the mining states. This is having a negative impact on some Tasmanian industries, and is partly responsible for the underperformance of this state relative to the rest of the country.

Graph 14
Annual Net Interstate Migration



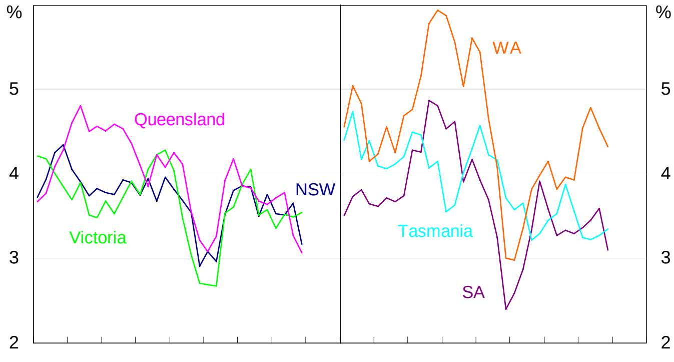
Sources: ABS; NAB

Wage pressures contained easing, consumer price inflation under control

Soft labour market conditions and excess spare capacity have contributed to a general decline in wages growth over the second half of 2012 across the states. The wage price index, which measures the cost of a unit of labour, rose by 3.4% over 2012, which was the softest outcome in 2½ years. The only two states that did not report a decline in wages growth over the second half of 2012 were Victoria and Tasmania, were growth was broadly unchanged (from a relatively subdued level) over the second half of the year. While wages growth has certainly softened in the resource-rich Western Australian economy, it is much higher than in any other state reflecting the relative strength of this economy, and is likely to remain of concern in 2012-13 due to already tight labour market conditions. Wage pressures are generally expected to soften over the forecast horizon, due to expected softness in employment growth and increasing unemployment as the economy transitions from the labour intensive mining investment phase to the capital intensive mining production phase.

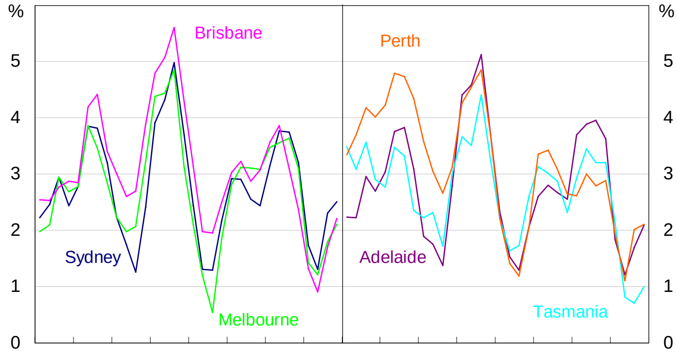
While consumer price inflation picked up across the states over the second half of 2012, much of this was due to the introduction of the carbon tax as well as some impact from means testing of the private health insurance rebate, and is expected to be only temporary. Underlying measures of (national) inflation were much less subdued, running at around 2¼% in the December quarter, largely reflecting continued strength of the Australian dollar together with a weakening economy and price discounting. The weaker activity outlook for the domestic economy is expected to help contain inflation to below 3% over the forecast horizon, even when the impact of carbon pricing is taken into account. Inflationary pressures are fairly similar across the states, with all of the states experiencing fairly soft labour market conditions and similar capacity pressures relative to their averages. However, the recent surge in equity prices and signs of a strengthening housing market, which both contribute to increased wealth, may assist consumer spending in coming quarter. This, together with a depreciating exchange rate may place upwards pressure on price inflation over the year ahead. Nonetheless, labour market conditions are expected to worsen as the mining boom shifts from the labour intensive investment phase to the capital intensive exports phase, which should help to keep overall inflation pressures contained.

Graph 15
Wage Price Index
Year-ended percentage change



Sources: ABS; NAB

Graph 16
Consumer Price Index
Year-ended percentage change

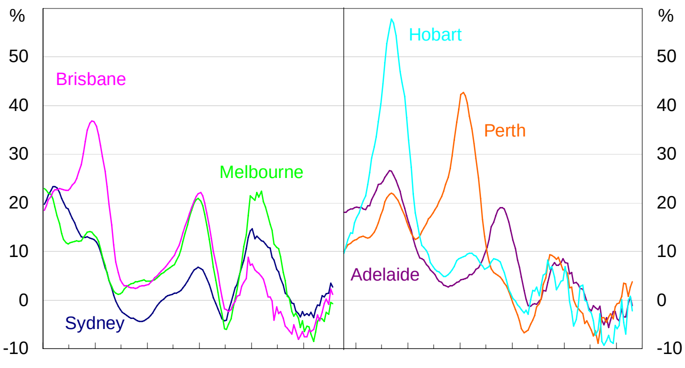


Sources: ABS; NAB

Housing market slowly stabilising and expected to strengthen further

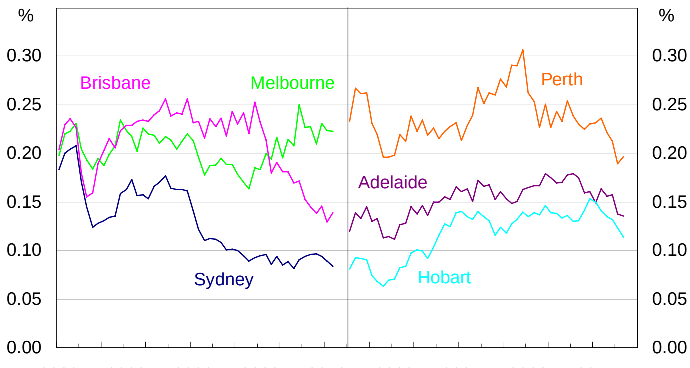
There appear to be green shoots emerging in the housing market, with most states beginning to see growth in dwellings prices following almost two years of annual declines. According to monthly RP Data Rismark data, average dwellings prices across Australia's capital cities rose by 1.3% over the year to February 2013 – the first positive growth outcome since May 2011 – though deviations in economic growth across the states has meant the recovery in the housing market has not been equal. Across the capital cities, the recovery in the housing market has largely been driven by the Perth and Sydney markets, where annual dwellings price growth first turned positive in September 2012. The residential property market in Perth has performed particularly well when compared to the other states, helped largely by a resource-led surge in population growth, tight rental market conditions, increased building approvals and first home buyer activity. The dwellings price recovery is taking longer in the other states, with Melbourne prices still declining in early 2013, while Adelaide and Hobart dwellings prices only recorded positive growth for the first time in January 2013. Nonetheless, the annual pace of growth has improved in all capital cities over recent months, supported by relatively low borrowing rates, growth in household incomes, sound underlying fundamentals and government initiatives in Queensland, South Australia and Tasmania taken to strengthen first home buyer demand.

Graph 17
RP Data House Prices
Year-ended percentage change



Sources: RP Data; NAB

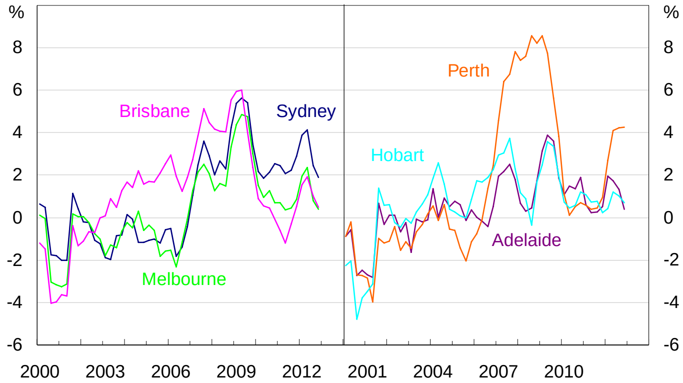
Graph 18
Dwelling Completions to Population Ratios
Average over quarter



Sources: ABS; NAB

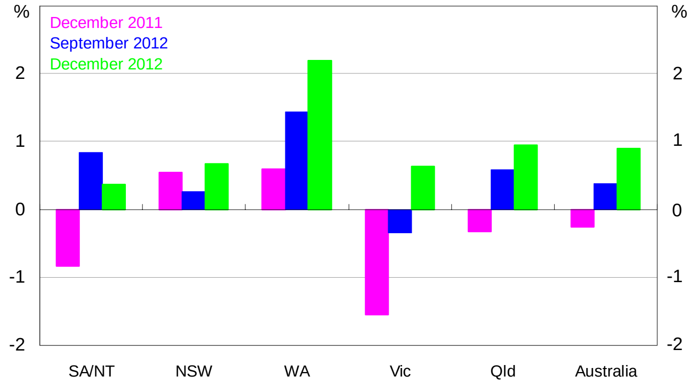
Despite improved conditions in the residential property market, the outlook for dwelling investment remains concerning. While ABS data show that prices for project homes rose by 1.4% over 2012, housing construction materials were shown to have increased by 1.2% over the same period, while hourly rates of pay for the construction industry were 3.5% higher over the year. Given that labour costs are a significant part of the overall cost of housing construction, these outcomes imply that cost pressures may prevent a meaningful lift in housing construction in the near term. Nonetheless, rising prices should eventually result in increasing dwelling investment. We are beginning to see signs that dwelling investment may be strengthening, with the ratio of dwelling completions to population showing signs of stabilising. However, not all is equal across states. According to this metric, the NSW and Tasmanian housing markets, already the tightest in the country, have tightened further, while dwelling investment in Queensland and to a lesser extent Western Australia has consistently struggled to keep pace with rapid population growth in recent years – albeit the ratio of dwellings construction to population has ticked up more recently. Conversely, the Victorian housing market is better supplied and this is likely to prevent an influx of dwelling investment in the near to medium term. We expect data to confirm that dwellings construction strengthened into 2013, consistent with the more recent decline in real rents, which has broadly softened over the second half of 2012, except for in Perth.

Graph 19
Real Rents
Year-ended percentage change



Sources: ABS, NAB

Graph 20
Expected House Price Growth
12 months ahead



Source: NAB Residential Property Survey

While underlying demand for housing appears to be improving, it is unlikely that we will see a solid upturn in house prices over 2013. Households remain cautious in their spending and borrowing behaviours, as reflected in soft credit lending, relatively low confidence and still high savings rates. All of this is likely to keep demand for housing somewhat contained. Furthermore, the outlook for a softening in domestic demand at the national level, below-trend growth in household consumption and an expected softening in labour market conditions is likely to keep buyers at bay. Nonetheless, interest rates are expected to remain below average levels for some time, which should encourage more buyers into the market.

Consistent with the expected improvement in the housing market over 2013, the December quarter 2012 NAB Residential Property Survey has shown a gradual improvement in expectations of house prices by market participants over recent quarters. According to the survey, respondents expect house prices to lift over 2013, predicting 1½% growth in prices, with respondents now expecting prices to rise across all of the states. By state, respondents remained most bullish about Western Australia, predicting a 2.2% increase in prices. While this is consistent with our view for Western Australian dwellings price growth to continue to out-perform the national average over 2012-13, assisted by resource-led strength in population growth, tight rental market conditions, increased building approvals and first home buyer activity, price growth may ease a little in 2013-14 as the mining investment phase transitions into the production phase and this state's economy begins to slow. Expectations were a little softer for Victoria, at just 0.6%, with this market still lagging due to the unwinding of previous exceptional dwellings growth over 2009 and 2010. Expectations were broadly similar across the remaining states, ranging between 0.4% for SA/NT, and 0.9% for Queensland.

State government fiscal positions being squeezed

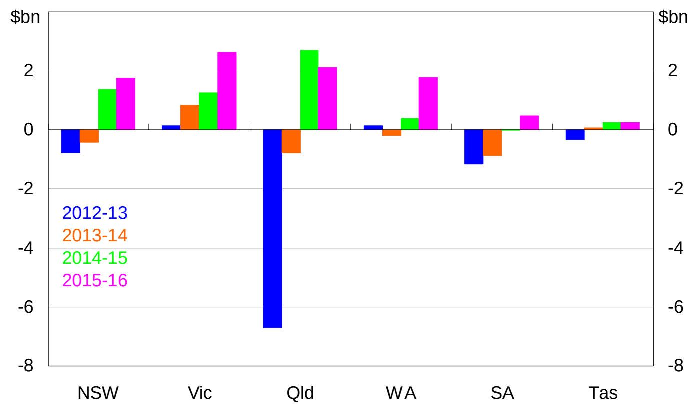
With the exception of Western Australia and Victoria, all of the state treasuries have revised down their 2012-13 estimates of GSP since Budget time. The downgrades largely reflect weaker than expected global economic conditions through the second half of 2012, which have weighed on the national economic growth outlook for Australia. Business confidence and conditions are weaker than implied by previous growth projections, and as a consequence, household consumption and dwelling investment have generally been revised lower. In SA, the delay in the proposed Olympic Dam mine expansion was largely responsible for a 1 ppt downward revision to GSP for 2012-13. The ¼ ppt downward revision to Queensland GSP growth largely reflects downgrades to the outlook for growth in its major trading partners – the US and Europe – and the subsequent flow on effect this has on Asian trading partners, while a general deterioration in international and Australian growth forecasts was responsible for the ¼ ppt downgrade to NSW GSP growth. In contrast, stronger than expected business investment and above-average population growth over the past year is largely responsible for the 1¼ ppt improvement in the outlook for 2012-13 in Western Australia, while in Victoria, increases in labour productivity as a result of structural adjustments have resulted in a ¼ ppt improvement in the 2012-13 outlook.

Consistent with a weaker national growth outlook for Australia and a general downgrade to state government revenue projections, the fiscal positions of state governments have come under increasing pressures since our last State Economic Update was released in October 2012. According to the 2012-13 Budget updates of the state treasuries, all states with the exception of NSW revised down their estimates of net operating balances for 2012-13. Softening revenues in some of the states partly reflects subdued expectations for GST revenue and land transfer duty as well as the impact of adjusted revenue allocation from the Commonwealth government as a result of recast population data arising from the 2011 Census. The outlook for expenses growth was generally better across the states, though much of this reflected the

Commonwealth government bringing forward grants into 2011-12. While the extension of first home buyer schemes in Queensland, South Australia and Tasmania have increased the outlook for expenses in those states, this has been partly offset by a general focus on reducing back office expenditure through wages policies and staff attrition, which has provided additional savings to most of the states. All state Budgets are also under pressure from increased spending in health. As a result of the downgrade to the state government fiscal outlooks, there has been a general deterioration in forecasts for general government net operating balances in 2012-13.

By state, Queensland expects its net operating deficit to deteriorate to $6.7 billion in 2012-13, largely reflecting revisions to royalty payments. The deficit is expected to narrow to $783 million in 2013-14 (compared to a previous expectation for a razor thin surplus), largely reflecting further downgrades to royalty payments as well as the shifting of natural disaster payments from 2013-14 into 2014-15. The net operating deficit in NSW improved to $776 million, reflecting the combination of lower superannuation expenses and delayed but increased Commonwealth roads payments – this has substantially worsened the estimate for 2013-14 to a deficit of $423 million. A deterioration in SA's net operating deficit to $1.17 billion in 2012-13 largely reflects the impact of spending carried over from 2011-12, as well as reductions in revenue and the adjustment of the Department for Health and Ageing's savings task. The South Australian government estimates a net operating deficit of $868 million in 2013-14. Victoria and Western Australia are the only two states forecasting a net operating surplus in 2012-13 ($137 million and $140 million respectively). In Victoria, the net operating surplus is projected to rise to $835 million in 2013-14, which is a little softer than the surplus estimated at Budget time, while the Western Australian government projects its net operating balance to deteriorate to a deficit of $187 million in 2013-14, reflecting a tighter revenue outlook. The Tasmanian government expects a net operating deficit of $327 million in 2012-13, which is worse than the deficit expected at the time of the Budget; the deterioration primarily reflects falling state taxation, mineral royalties and expenditure increases. Tasmania estimates its net operating balance to improve over the forward estimates, rising to a surplus of $71 million in 2013-14.

Graph 21
Net Operating Balance



Source: State Treasury mid-year Budget reviews

Composition of production

	2011/12 Share of State Production (%)						
	NSW	VIC	QLD	SA	WA	TAS	Australia
Agriculture	2	3	3	6	2	8	**3**
Mining	3	2	11	5	36	2	**10**
Manufacturing	8	9	8	10	5	9	**8**
Construction	6	6	9	7	12	7	**8**
Wholesale Trade	5	5	6	5	3	3	**5**
Retail Trade	4	6	5	5	3	6	**5**
Finance & Insurance	15	13	7	9	4	8	**10**
Property & Business	13	14	11	9	8	7	**12**
Other	43	42	41	43	26	50	**40**

Source: ABS

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