

State Update: South Australia – January 2016

NAB Group Economics



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Key points

- SA's economic performance continues to be at the bottom of the pack, challenged by unfavourable demographic factors, weak commodity prices, as well as the long-term structural decline of its manufacturing base. It also lacks the industry mix and job opportunities to draw workers back to the state as the national economy rebalances towards non-mining activity, although the lower AUD is supporting tourism arrivals and expenditure. Below-average population growth, combined with high unemployment, is in turn creating very limited demand and price impetus for residential property. The imminent end to car manufacturing activity in 2017, a challenging outlook for the defence and mining sectors, as well as the upcoming closure of the Port Augusta power stations and Leigh Creek coal mine, also constitute headwinds to the state's industrial activity. As a result, business conditions remain tepid, with the retail sector the rare bright spot. We expect the SA economy to grow by 1.7% in 15-16 before rising to 1.8% 16-17, with unemployment rate expected to gradually fall from 7.6% in 15-16 to 7.4% in 16-17.
- The Federal Government has announced plans to build \$40 billion worth of new surface ships for the navy in South Australia from 2018 onwards. It is also highly likely that at least 8 out of 12 submarines from the navy's next fleet will be built there although the timing remains uncertain. The scheduled completion of the Royal Adelaide Hospital late this year suggests that there could still be a public spending gap next year before the commencement of the former project. Meanwhile, the services and construction industries have grown in importance in terms of their contribution to SA's economic activity and employment since the mid 2000s.
- Residential property prices in Adelaide and regional SA have largely flat-lined and are increasingly falling behind the national average. The average regional house price for 2015 looks set to dip below the level seen in the previous year. A gradually rising dwellings to population ratio also suggests limited support for house prices going forward.
- Supported by surprisingly resilient wages growth, household consumption is a standout contributor to SA's recent economic performance, with retail spending and household expenditure growth maintaining strong momentum. Consumers are also seemingly more optimistic, demonstrated by their increased propensity towards discretionary spending. This is despite generally weak labour market conditions as SA continues to experience the highest unemployment rate across the states and territories.
- Business conditions continue to be unremarkable in SA, characterised by lower capacity utilisation, weak business investment and an elevated office vacancy rate. That said, capital expenditure expectations for buildings and structures do suggest an uplift in 2015-16.
- In terms of goods exports, the value of SA's mineral shipments in 2015 were dealt a significant blow by the sharp retreats in commodity prices since late 2014. This was only partially offset by stronger wine exports. Meanwhile, a lower AUD is delivering dividends to the state's services sectors through higher international student enrolments and overall tourism expenditure, although a more pronounced global slowdown than currently forecast is a downside risk.

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Chart 1: State GSP Growth Forecasts

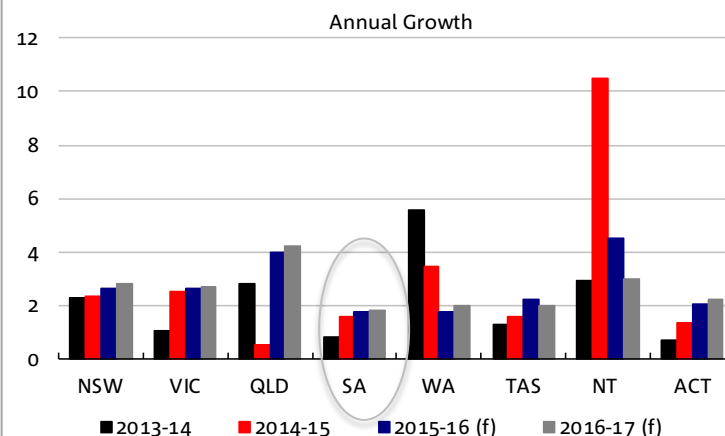
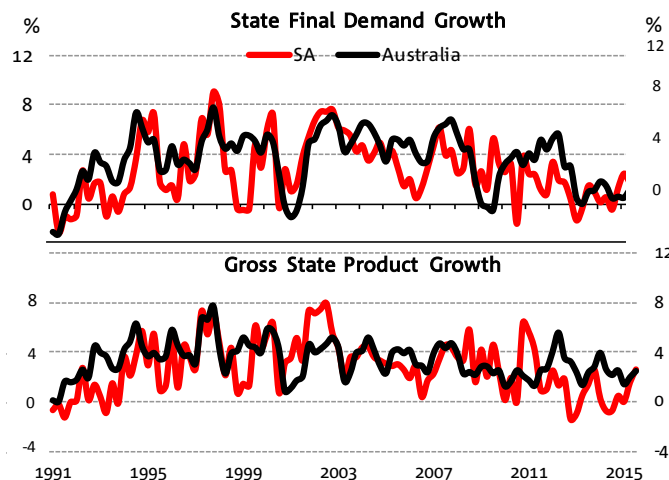


Chart 1: State Final Demand and GSP Growth* (y/y%)



*NAB Estimate Sources: ABS; NAB Economics

In Focus: A slowing and ageing SA population poses a challenge to the housing market

- South Australian population growth has moderated notably since late 2009, largely driven by lower net overseas migration and continuous net outflow of interstate migration. The SA population as a share of the Australian population has continued its structural decline (Chart 3).
- More importantly, SA population continues to age relative to the national average (Chart 4).

- SA manufacturing employment enjoyed a revival in 2013 and 2014, supported largely by a increase in food and beverage manufacturing jobs. However, the revival proved to be short-lived (Chart 5).
- Slowing population is one of the main factors weighing on the Adelaide housing market. Combined with more dwellings being constructed in 2015, the dwellings to resident population ratio has resumed an upward trend, which could be a detractor to price growth in the near-term (Chart 6).

Chart 3: SA Share of Aus Population and Growth in Migration

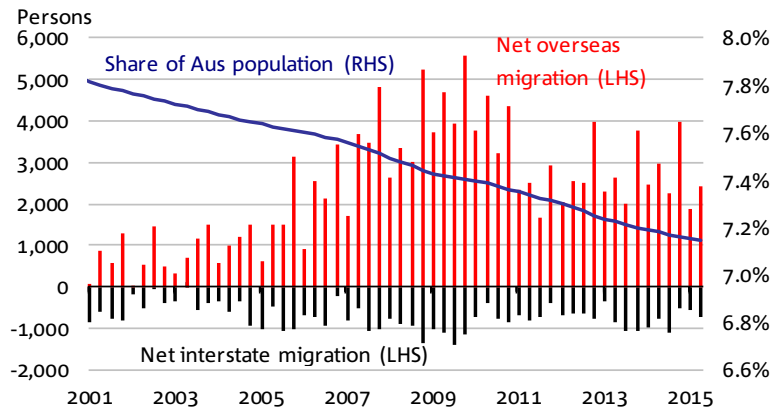


Chart 4: Age distribution of South Australian population

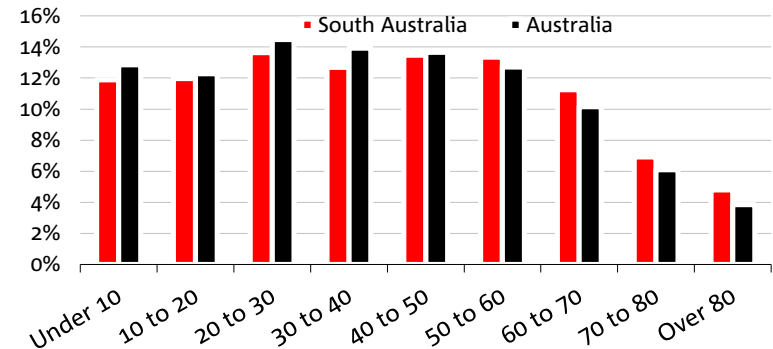
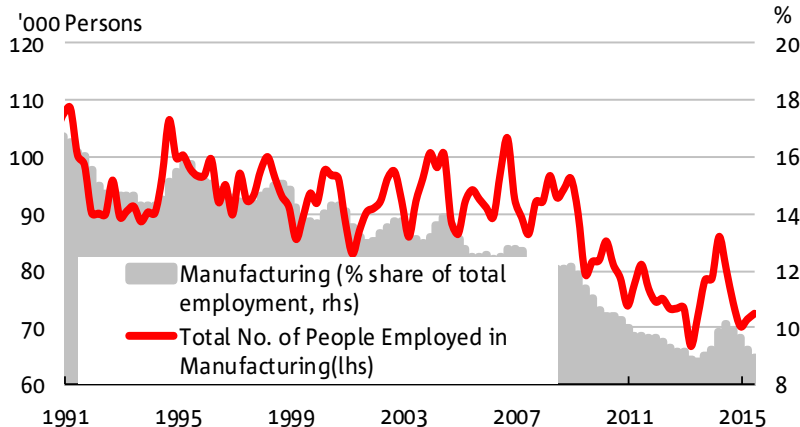
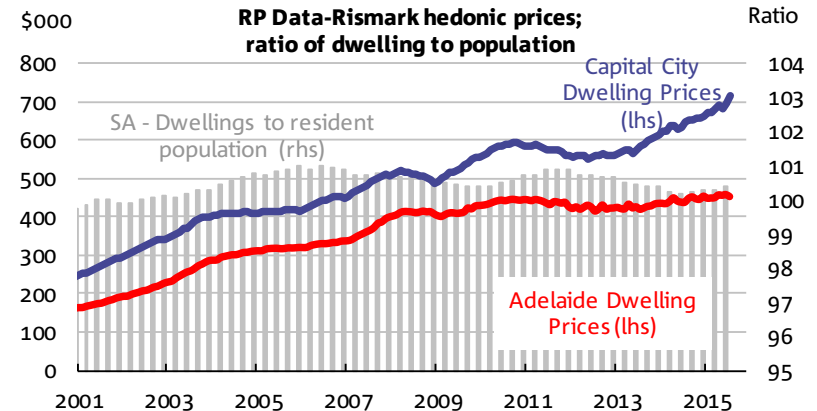


Chart 5: Manufacturing Employment



Source: ABS, NAB Group Economics

Chart 6: Adelaide House Prices and Dwellings to Population Ratio



Consumer and household sector showing momentum despite languishing house price growth

- Wages growth in SA has been relatively resilient, which has flowed into stronger household consumption (Chart 7).
- As a result, retail spending growth remains resilient. Meanwhile SA house price growth has also gained traction in recent months, albeit from low levels still (Chart 9).
- On the back of sustained wages growth, there is evidence that SA consumers have gradually become more optimistic. Based on our survey, consumers are showing increasing inclination to spend on discretionary items such as home improvements, major household items and travel, although they continue to place a strong priority on long-term financial objectives of savings, super and investments; children; medical expenses; as well as paying down debt. (Chart 8).

Chart 7: Average Compensation of Employees and Household Consumption Growth (v/v%)

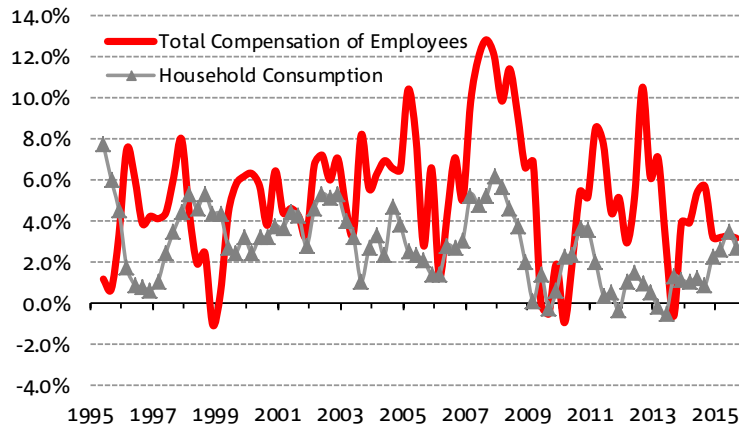


Chart 9: Retail Turnover and House Price Growth

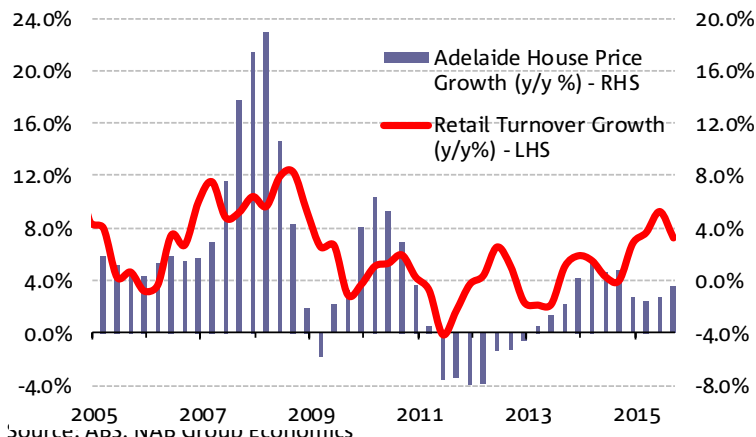
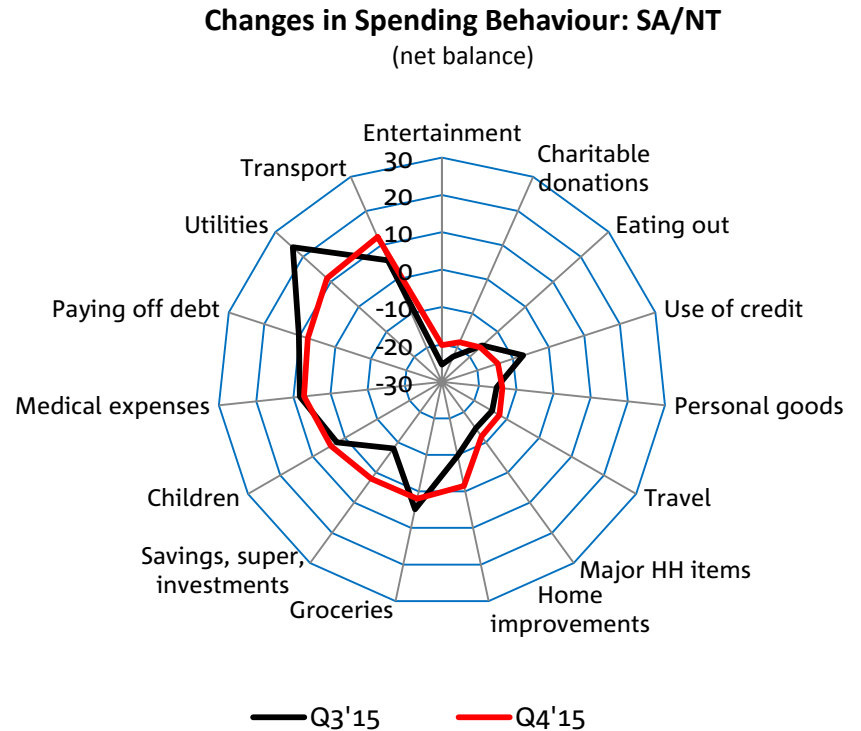


Chart 8: NAB Consumer Anxiety Survey - Consumer Spending Preferences



SA business conditions the weakest of all states, offering little impetus to business investment

- According to the monthly NAB Business Survey, capacity utilisation of businesses in SA has been on a downward trajectory since 2011 to be notably below national average (Chart 10). This trend is consistent with lower business conditions in the state, which had been the weakest across all mainland states since late 2014 (Chart 11).
- Business investment growth in SA remains subdued, with weaker capex expectations for the next 12 months suggesting little upside impetus for 2016. This is likely to reflect a shrinking manufacturing base and weakness in commodity prices (Chart 12).
- Services and traditional business sectors alike are plagued by weak business conditions, with the construction industry faring the worst (Chart 13).

Chart 10: NAB Business Survey – Capacity Utilisation

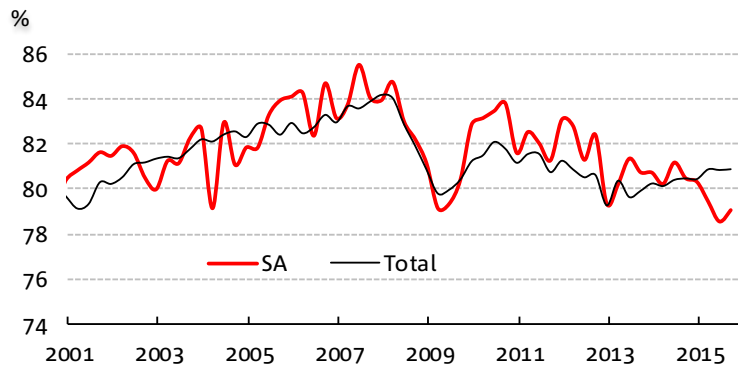


Chart 12: NAB Survey Capex Expectations & Private Business Investment Growth

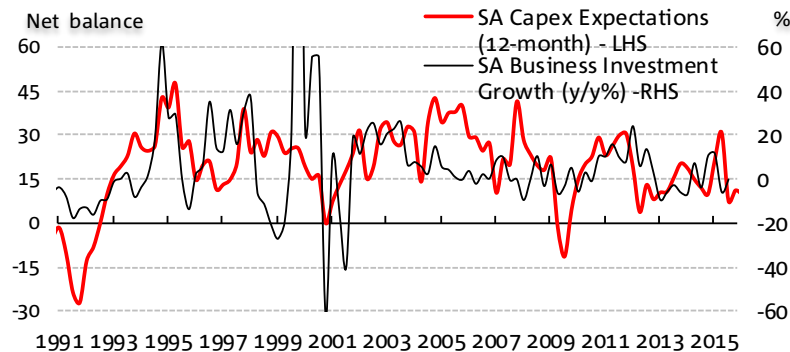


Chart 11: Spread in NAB Business Conditions (net balance , 3-month-moving average)

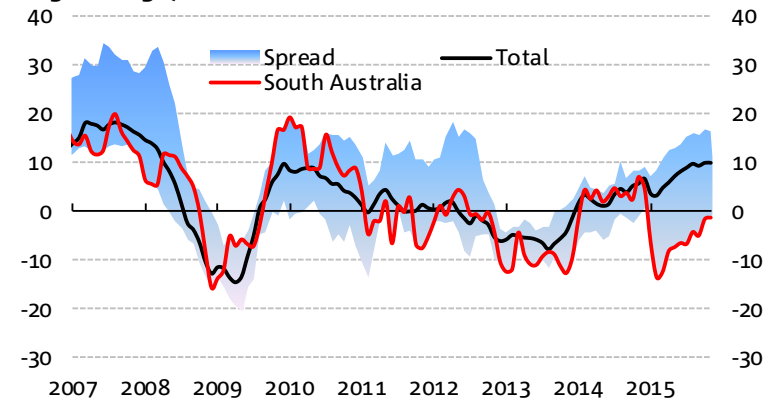
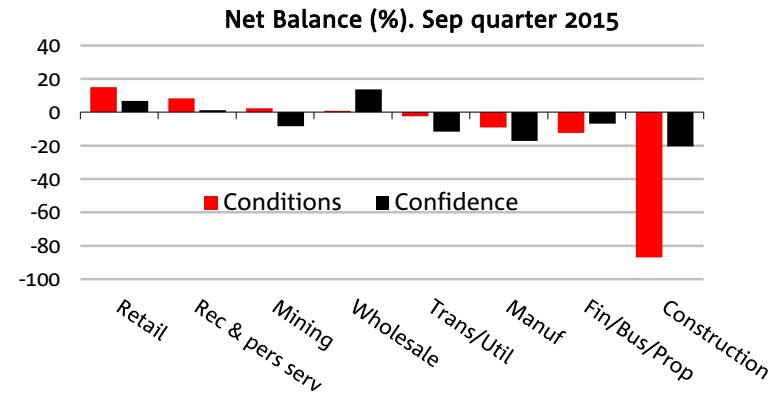


Chart 13: SA Business Conditions & Confidence by Industry



Commercial property/non-residential investment tracking at low levels, but capex expected to lift

- Reflecting the soft appetite for business investment, non-residential building approvals have been tracking at low levels, except for “Retail/Wholesale” which benefits from a surge in consumer activity (Chart 14).
- Rising office vacancy rates and low levels of office building approvals signal a substantial amount of spare capacity in the sector (Chart 15).
- That said, expected capital expenditure (capex) is higher for buildings and structures in 2015-16, while planned spending on machinery and equipment is expected to remain at similar levels to previous years (Chart 16).

Chart 14: Non-residential Building Approvals (\$ millions)

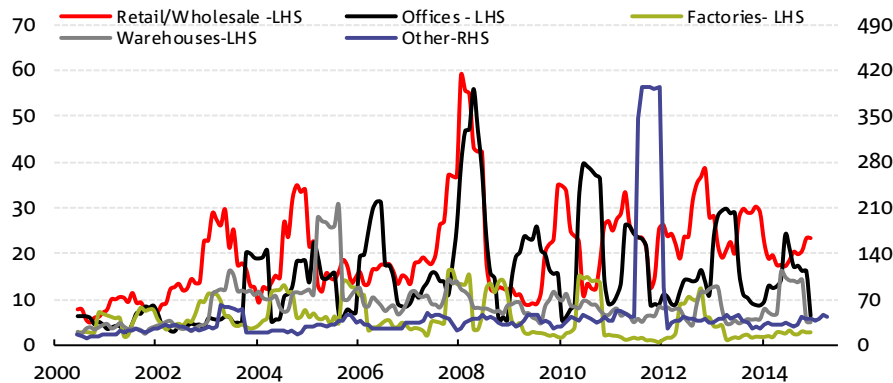


Chart 15: Office Approvals and Vacancy Rates

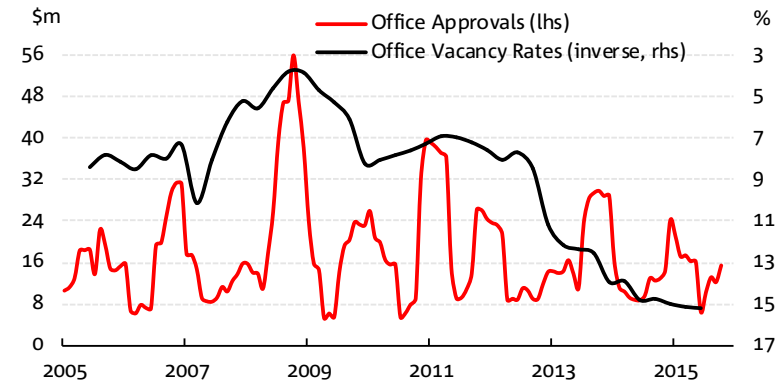
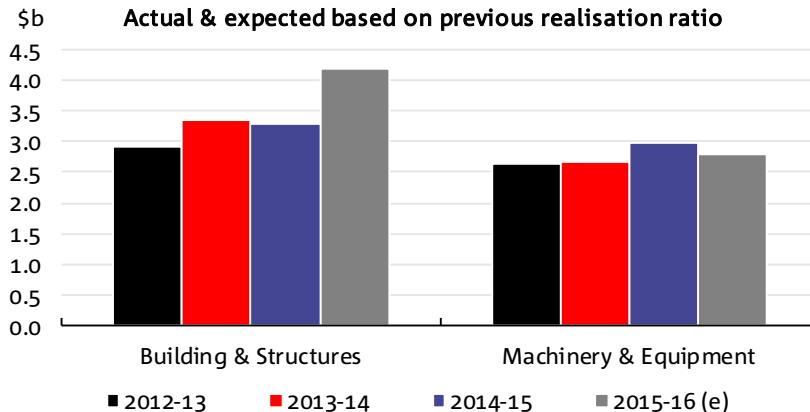


Chart 16: SA Capital Expenditure & Expectations



SA residential property prices expected to ease further

- The SA residential property sector remains subdued, characterised by low levels of approvals and commencements (Chart 22), as well as modest residential property price growth in the last five years. Regional house prices have started to contract since the start of this year (Chart 23).
- SA residential property price growth by sub-region in Adelaide suggests that eastern Adelaide leads in capital growth for houses while southern Adelaide dominates in the unit segment (Chart 24).
- Results from the latest NAB Property Survey reveal expectations by industry participants that SA/NT house prices will continue to contract in the short and medium term (Chart 25).

Chart 22: SA Residential Approvals & Commencements

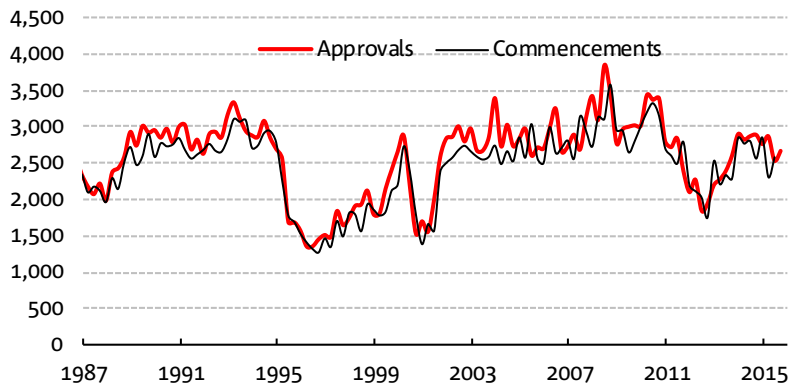


Chart 24: Adelaide - Median Property Price Growth (year to Q3 2015)

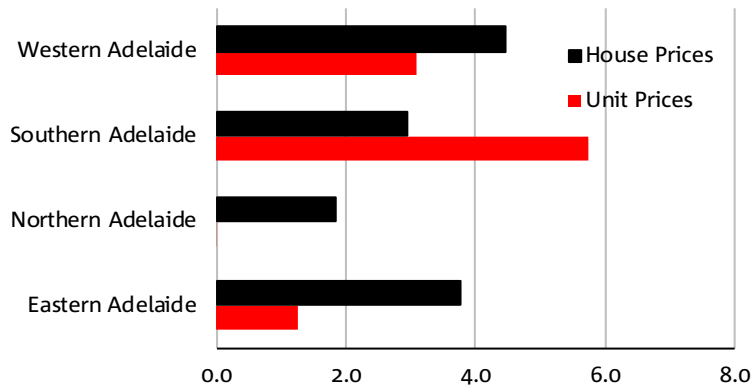


Chart 23: SA Residential Property Price Growth (v/v%)

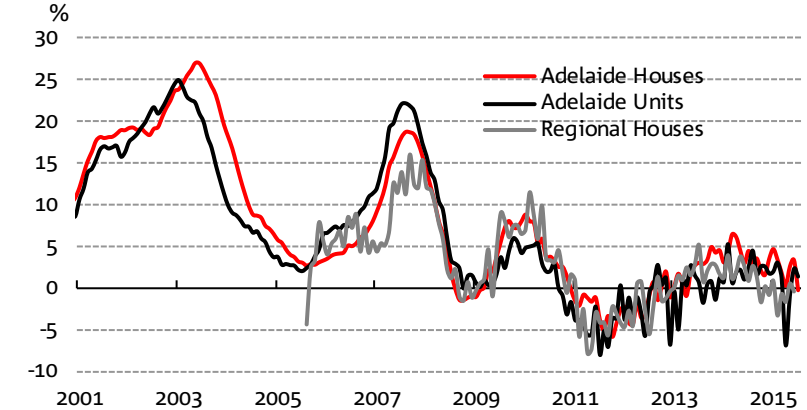
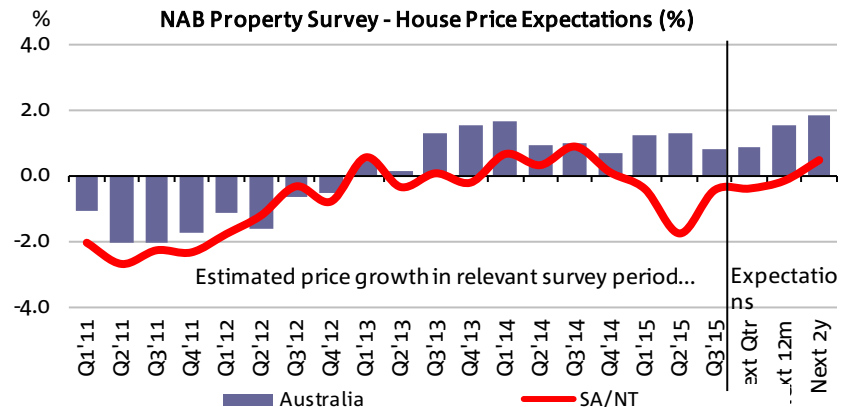


Chart 25: NAB Property Survey – House Price Expectations (%)



SA services and agricultural exports

- The SA tourism sector have shown signs of picking up since 2013, with accommodation takings turning the corner and bed vacancy rate relatively stable around the 37% mark. A lower AUD is expected to see a higher level of inbound tourism into SA from international and domestic sources.
- International student enrolments in SA, an indicator for foreign student numbers, have picked since 2014, but our estimate for 2015 suggests that enrolments will still be below the peak recorded for 2010 (Chart 32). Education is the largest services export category for SA (Chart 34).

- Weaker global commodity prices have dented the value of SA agricultural and mining exports in 2013-14, despite relatively robust production volumes (Chart 33). More recent anecdotal data suggests that SA agricultural exports, especially wines, have picked up this year on the back of Australia's Free Trade Agreements with Japan and Korea and a depreciation in the AUD.

Chart 31: SA Accommodation Takings and Bed Vacancy (4 qtr-rolling average)

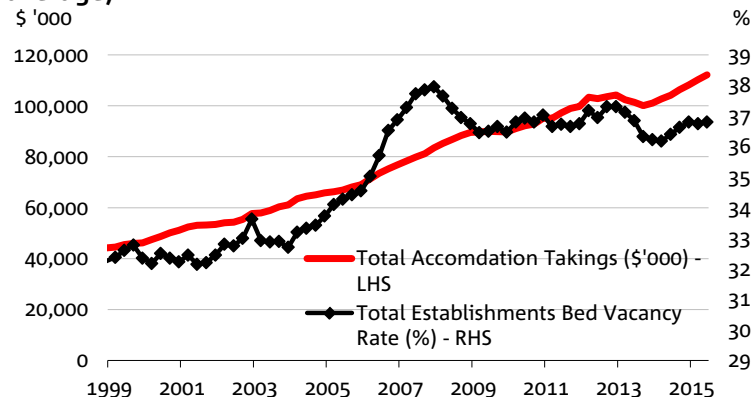


Chart 32: International Student Enrolments

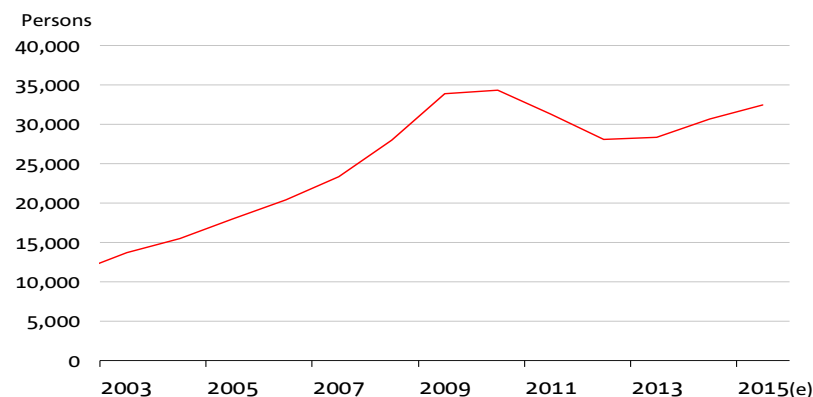


Chart 33: Value of South Australian Goods Exports by Industry

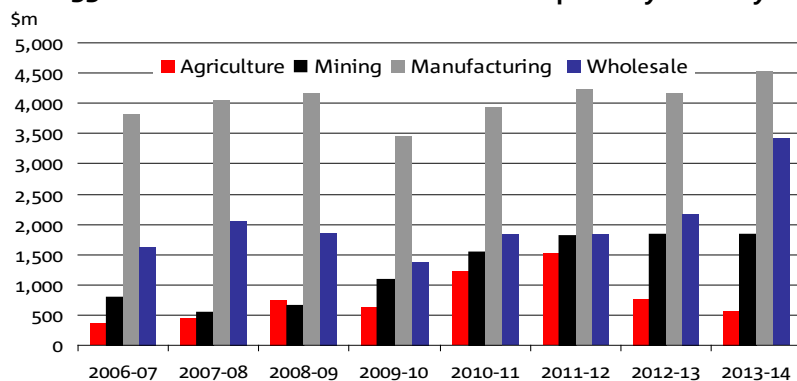
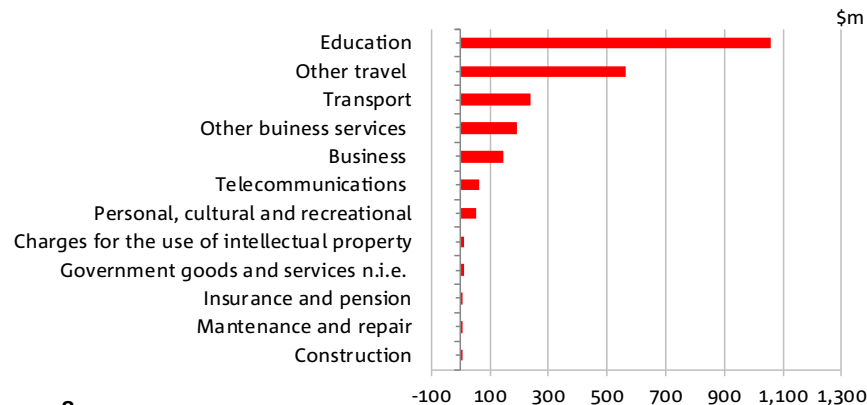


Chart 34: Value of SA Services Exports by Sector in 2014



SA's labour market continues to underperform other states

- Labour market conditions in SA have experienced a broad-based deterioration since 2012 and are among the weakest across states (Chart 17).
- The state has overtaken Tasmania to record the highest unemployment rate among all states and territories since the start of this year. However, a rising SA unemployment rate has been accompanied by a higher participation rate which potentially signifies a turnaround in labour market conditions (Chart 18).

Chart 17: Unemployment Rate by Region

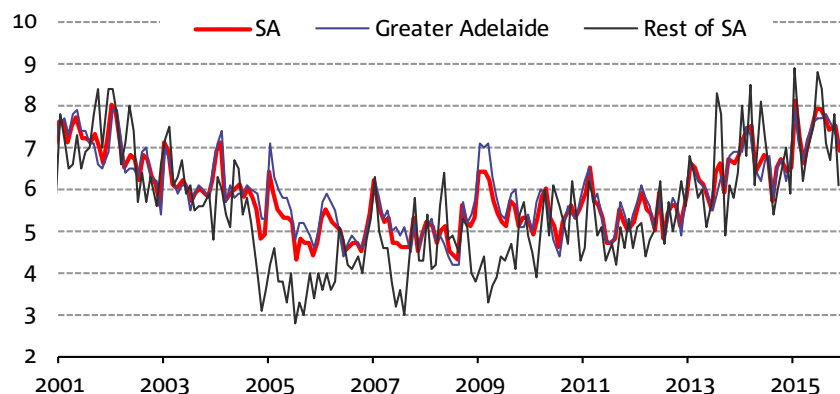
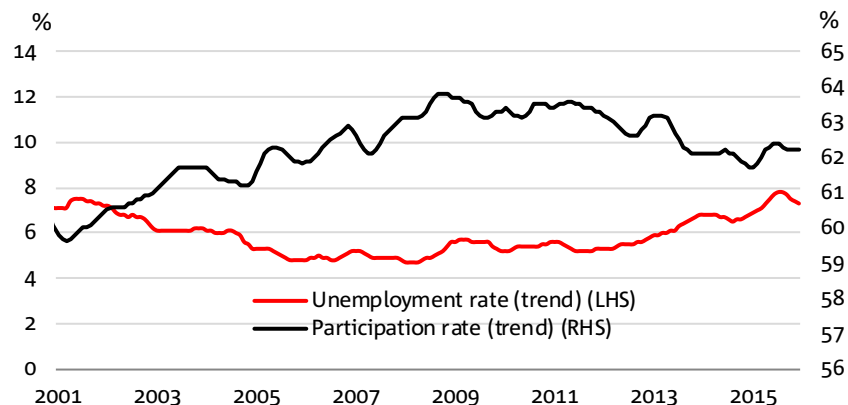


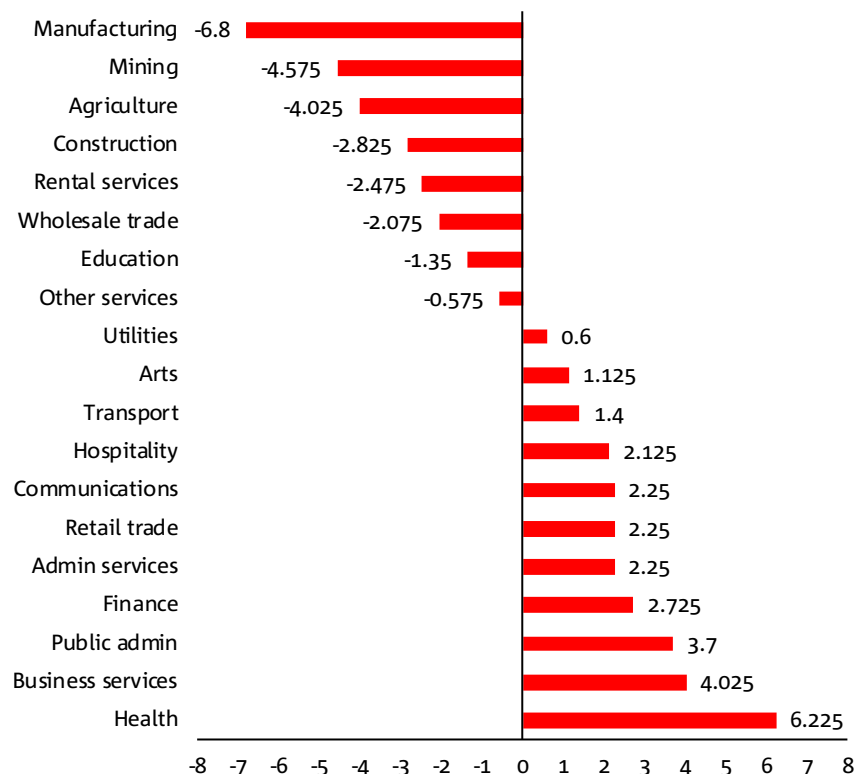
Chart 19: SA Unemployment & Participation Rates



Source: ABS, NAB Group Economics

- In the 12 months to May 2015, most of the jobs created were in services sectors, while the more traditional sectors of manufacturing, wholesale and mining continued to experience job losses (Chart 18).

Chart 18: Change in employment by industry, last 12 months to November 2015, SA, '000s



SA share of Australian population continues its structural decline

- Since peaking in 2009, SA population growth has slowed notably on the back of lower net overseas migration and a sustained outflow of interstate migrants (Chart 20).
- SA population growth continues to track significantly below national average levels (Chart 21), which entrenches the sliding trend in its share of the Australian population, currently at around 7.2% from just under 9% in the early 1990s.

Chart 20: SA Population Growth Drivers ('000s, over the year)

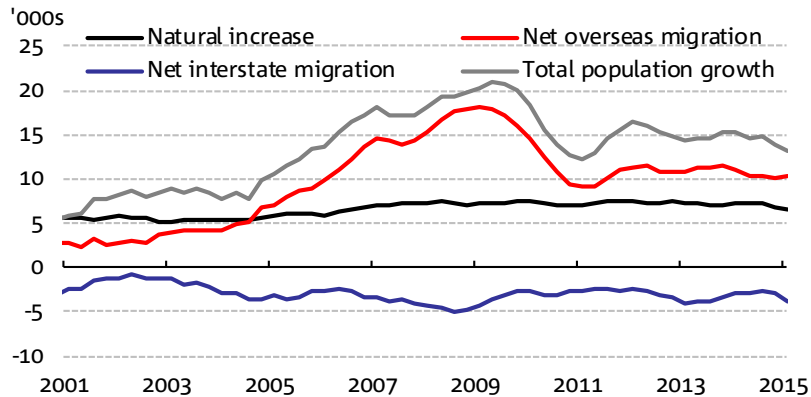
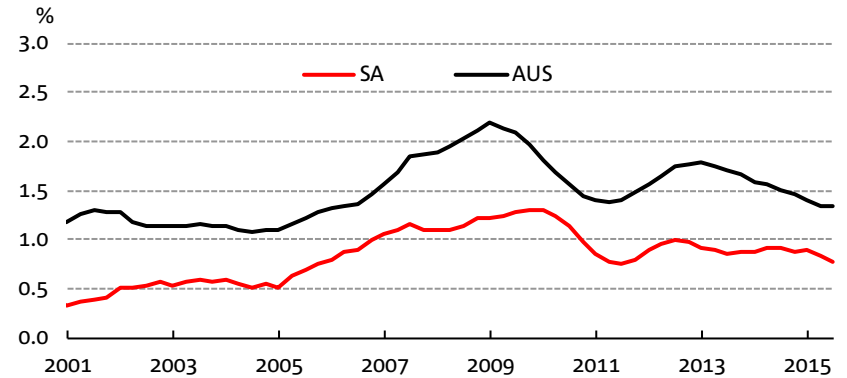


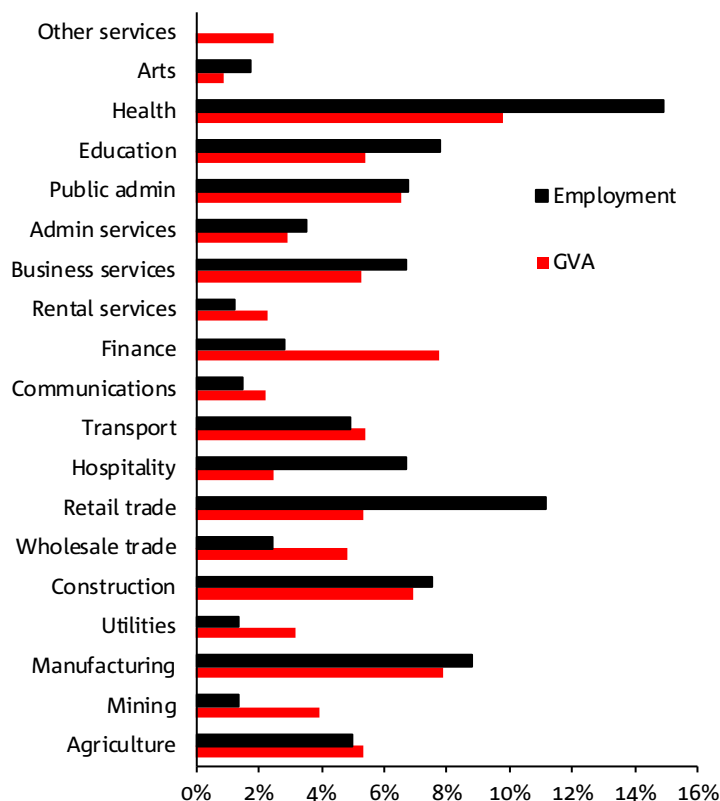
Chart 21: SA Population Growth (y/y%)



Services sectors are gaining prominence in output and employment shares over manufacturing

- The top three sectors in SA by output share are health services, manufacturing and finance & insurance services. The former overtook manufacturing as the largest industry by gross value added in 2008-09 and the largest employer in 2006-07 (Chart 26).
- By employment share, manufacturing (9%) is ranked third behind health and social services (15%) and retail trade (11%).
- China and the ASEAN bloc are the main trading partners for SA (Chart 27 & 28).
- SA's top commodity exports include iron ore and concentrates (\$1.6bn), wheat (\$1.4bn) and alcoholic beverages (\$1.2bn). Meanwhile, SA imports mainly refined petroleum (\$0.9bn), vehicle parts and accessories (\$0.6bn) and goods vehicles (\$0.4bn) from other countries (Chart 29 & 30).

Chart 26 : Composition of employment & GVA



Tables 27 & 28: Top SA export destinations and import source countries, 2014-15

Value of exports (\$m)			Value of imports (\$m)		
1	China	2248	1	ASEAN	1909
2	ASEAN	2027	2	China	1598
3	US	1669	3	EU	1334
4	EU	1331	4	US	815
5	India	762	5	Singapore	730
6	Japan	475	6	Japan	550
7	UK	447	7	Korea	484
8	New Zealand	424	8	Germany	263
9	HK	240	9	New Zealand	209
10	HK	240	10	UK	193
11	Taiwan	224	11	Taiwan	119
12	Singapore	129	12	HK	31
13	Germany	63			

Tables 29 & 30: Major SA export and import goods, 2013-14

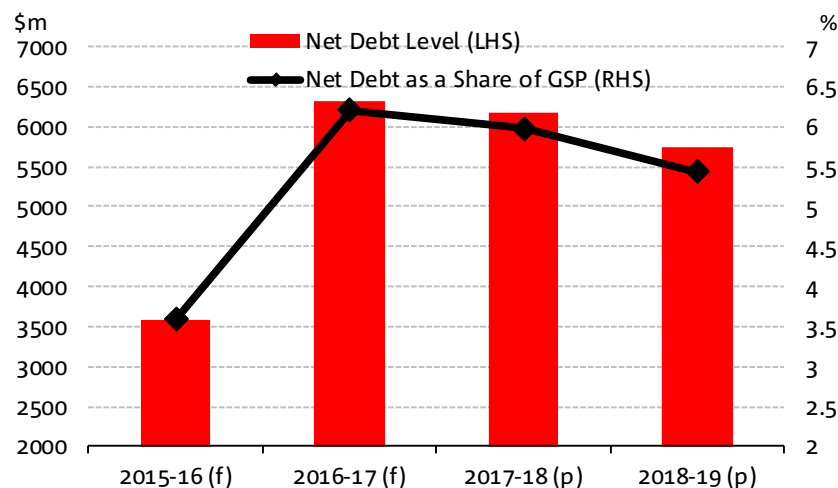
Major exports, goods, 2013-14			Major imports, goods, 2013-14		
	A\$m			A\$m	
Iron ores & concentrates	1,596		Refined petroleum	902	
Wheat	1,370		Passenger motor vehicles	643	
Copper	1,171		Vehicle parts & accessories	420	
Alcoholic beverages	1,154		Goods vehicles	282	
Copper ores & concentrates	830		Power generating machinery & part	257	

SA General Government debt level expected to pick up in the short term on tax cut measures

- The SA general government has significantly revised its forecast net debt for 2015-16 downwards by \$652m from the 2015-16 Budget estimate of \$4.2b. This primarily reflects higher dividends from MAC to the Highways Fund due to stronger-than-expected investment returns in 2014-15 (Chart 34). Despite consistent downgrades across the forward estimates period, net debt is still expected to peak in 2016-17 due to the commercial acceptance of the new Royal Adelaide Hospital.

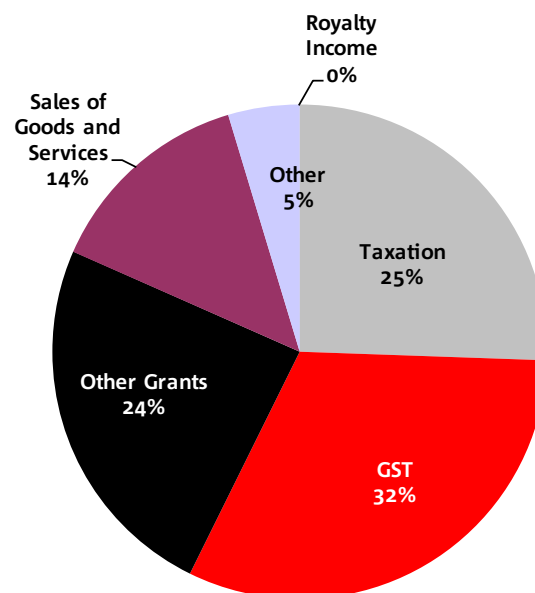
Relative to Budget, total taxation revenues have been revised down in all years, mainly due to revisions to payroll tax, gambling tax and insurance duty. Meanwhile, GST grants have been revised up for the forward estimates period reflecting changes to SA's expected share of the GST pool. GST is the single largest source of revenue for the state at 32%(Chart 35).

Chart 34: SA Net Operating Balance



Note: f= forecast; p= projection

Chart 35: SA Composition of State Revenue



Net debt projections revised lower as is new borrowings

- The improvement in the net debt position in 2015-16 is largely due to the dividend payment from MAC to the Highways Fund. This has been driven by stronger than expected investment returns in 2014-15. Net debt is expected to peak in 2016-17 (due to the commercial acceptance of the new Royal Adelaide Hospital) (Chart 36).
- Feeding the new budget forecasts into the credit matrix shows only minor changes to the outlook for the states budget performance (Chart 37).
- SAFA updated its funding program for 2015-16 following the release of the MYBR. Given the dividend payment from the Motor Accident Commission, client funding has been revised from AUD0.4m to AUD0.1m, and reducing the overall funding program from AUD4.2bn to AUD3.7bn. Fiscal year to date SAFA has issued AUD1bn of its revised AUD1.5bn of term funding (or 67%) (Chart 38). The remaining AUD500m of term funding will go across a variety of maturities. The maximum amount of outstanding in each bond line will be capped at AUD2bn. As at the end of 2015 SAFA's bonds outstanding stood at AUD14.97bn which is AUD0.75bn above levels as at end June 2015 (Chart 39).

Chart 36: South Australia Non-Financial Public Sector net debt

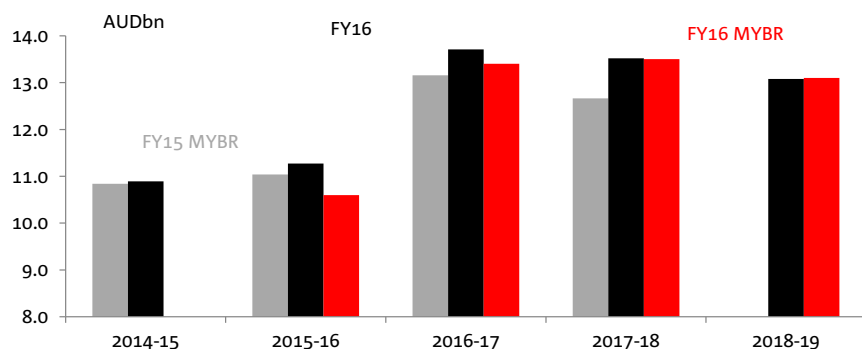


Chart 38: SAFA borrowing programme

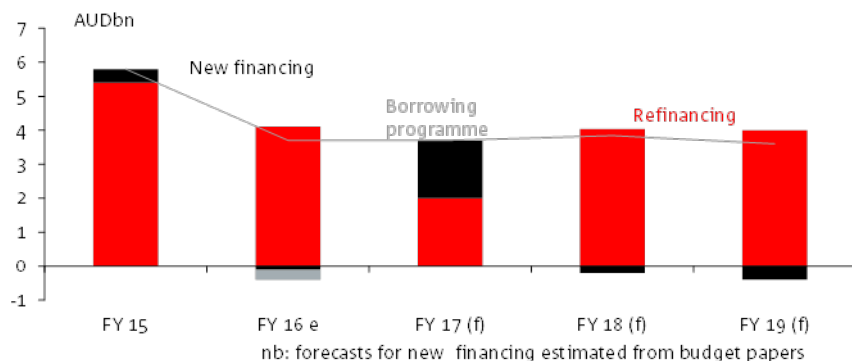


Chart 37: S&P credit metric: Budget Performance

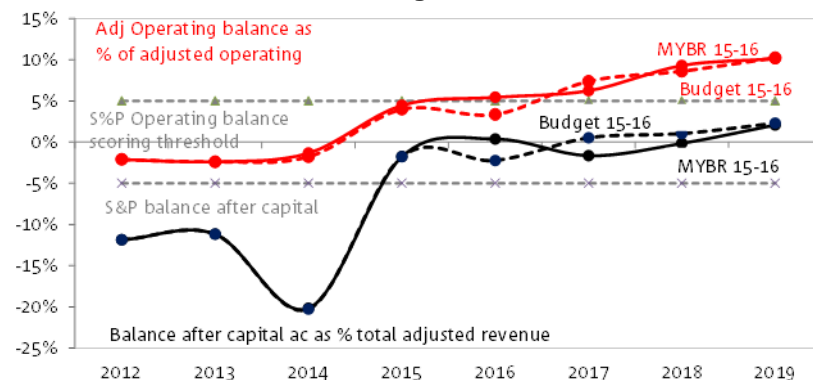
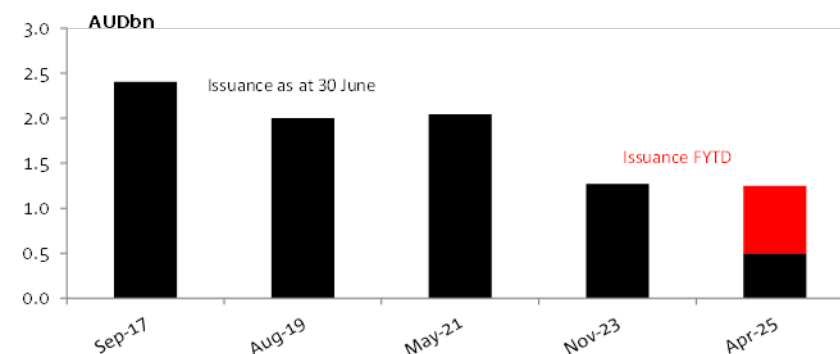


Chart 39: SAFA term bonds outstanding as at July 2015



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