more give, less take

NAB State Economic Handbook

by NAB Economics & NAB Interest Rate Strategy

April 2015

National Australia Bank

Overview:

- Economic profile – the Australian economy is facing some significant headwinds, although there are pockets of the economy that are performing well. The Q4 national accounts continue to show a domestic economy struggling to offset the impact of falling mining investment. While investment in dwellings is improving the boost to consumption is likely to fade (recent soft retail sales) with on going caution in consumer attitudes.
- At the same time falling iron ore and non rural commodity prices have significantly reduced income flows. GDP growth for 2014-15 is forecast to remain below trend at 2.3%, with the labour market expected to deteriorate further – unemployment rate to hit 6.7% by end 2015. Lower oil prices and interest rates should provide a kick to growth in 2015-16 – GDP growth of 3.0% -- although this is softer than previously expected due to weaker expectations for non mining investment, the potential of a sharper fall in mining investment, and renewed consumer caution as unemployment continues to rise. In 2017 GDP could be around 3% and unemployment 6% by the end of the period
- Budget positions – improving but focus remains on reducing expenditure as Commonwealth terminates/modifies some payments to states. Variation to GST relativities in light of significant drops in commodity prices will have significant implications for state revenues. The Commonwealth has announced a White Paper on Reform of the Federation and White Paper on Tax Reform.
- Credit ratings of most states and territories are seen to be stable but there remains much uncertainty around funding infrastructure spend and potential implications for budgets.
- States are well through funding programs for 2014-15 but the market know believes that issuance in 2015-16 will be greater than previously forecast.
- Semi-government bonds have been under pressure since the Queensland election and at least until the state budgets are released this pressure may persist. The semi-benchmark curve is likely to remain steep and we see value in 2019-21 part of the curve.

Contents

Overview: State Economies

The divergence between mining and non-mining state economies continues, although with mining investment now winding down it is the major non-mining economies that are starting to outperform. Although strong export performance in the mining states – as mining projects become operational – is contributing to Gross State Production (GSP) in the mining states, the rebalancing back towards the non-mining states has become apparent in domestic demand. Over 2014, real state final demand (SFD) growth was strongest in NSW and Victoria, while WA and Queensland were in decline. Strong performance in residential property markets and better consumption contributed to the outcome, although both retail sales and property prices have lost some momentum more recently. Nevertheless, higher housing prices, low interest rates and an undersupply has encouraged a surge of residential construction approvals that should contribute notably to growth this year – particularly in NSW and Victoria.

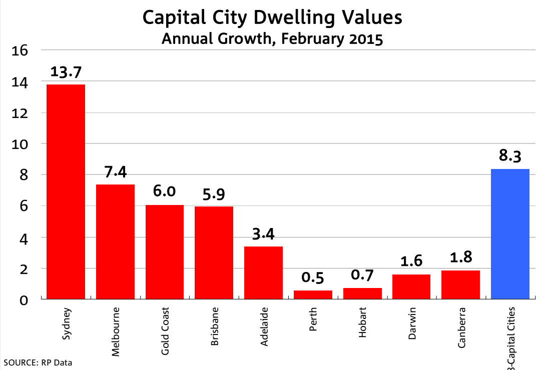
Various surveys conducted by NAB Economics provide a timely read on state economies and sectors. The NAB Business survey indicates that firms in NSW and Victoria are facing more favourable business conditions (in terms of sales, profits and employment), but confidence levels tend to be more varied. Meanwhile, consumers appear to be most anxious in Victoria – despite reasonable economic performance – while Tasmanian consumers are slightly more relaxed. Finally, the property surveys show conditions softening, especially in the mining state of WA (see p3-5).

As a result of less mining investment, GSP growth in WA and Qld is expected to be slower this year and next, than in 2012-13 – growth in exports will be partly offsetting against soft domestic demand. Growth in NSW and Victoria should be supported by residential construction, while consumption and business investment will gradually improve as well. South Australia and Tasmania will likely lag due to headwinds (eg. auto industry closures) and less favourable residential market fundamentals.

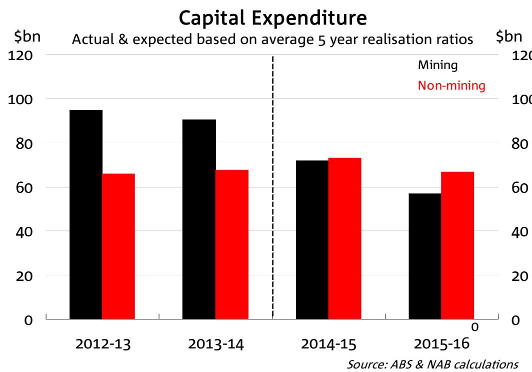
NAB growth and unemployment rate forecasts for the states

	Gross State Product YoY			Unemployment Rate		
	14/15f	15/16f	16/17f	14/15f	15/16f	16/17f
NSW	2.7	2.8	2.7	6.2	6.3	6.3
VIC	2.2	2.4	2.6	6.7	6.7	6.4
QLD	2.5	5.6	4.2	6.6	6.7	6.1
SA	1.6	2.0	2.0	7.0	7.6	7.2
WA	2.3	2.3	3.3	5.6	6.5	6.0
TAS	1.5	1.7	1.7	6.9	6.7	6.6
Australia	2.3	3.0	3.0	6.3	6.6	6.2

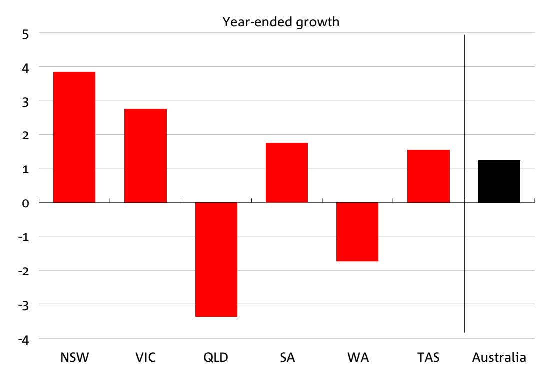
Capital city property prices growth



Mining capex in decline

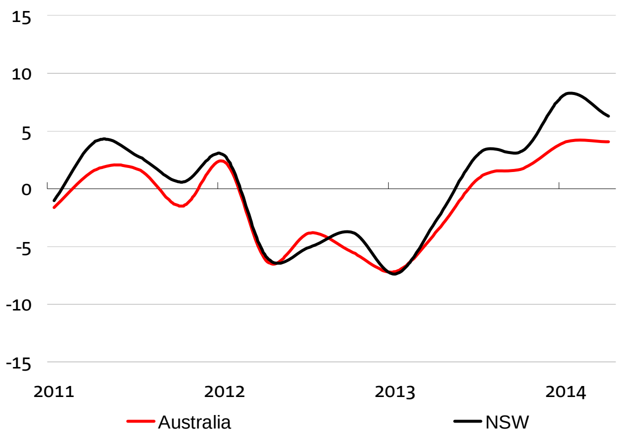


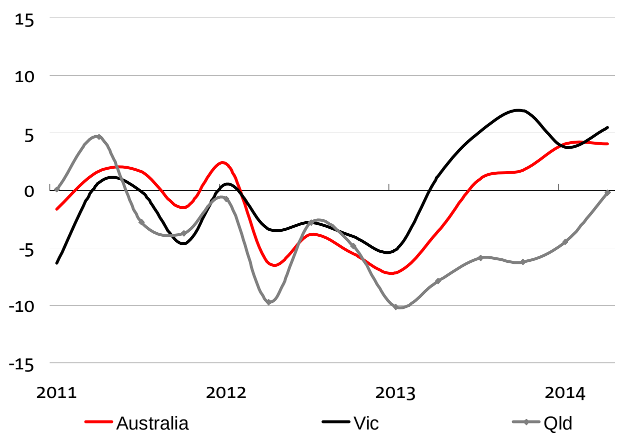
Real SFD Growth

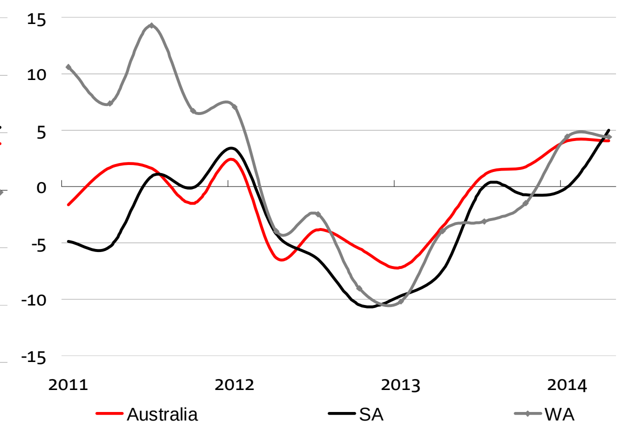


NAB State Economic Indicators - Summary

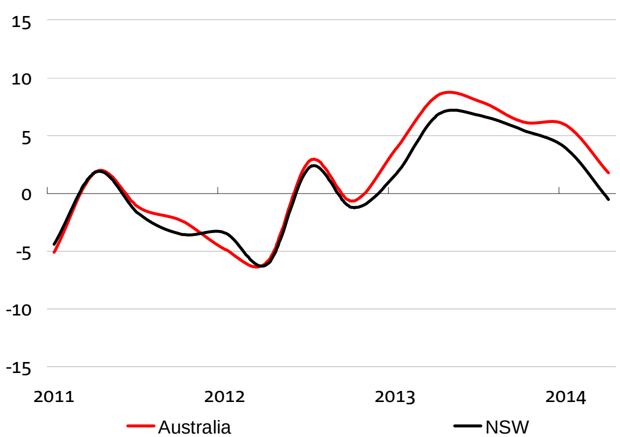
Business Conditions by State (net balance, sa)

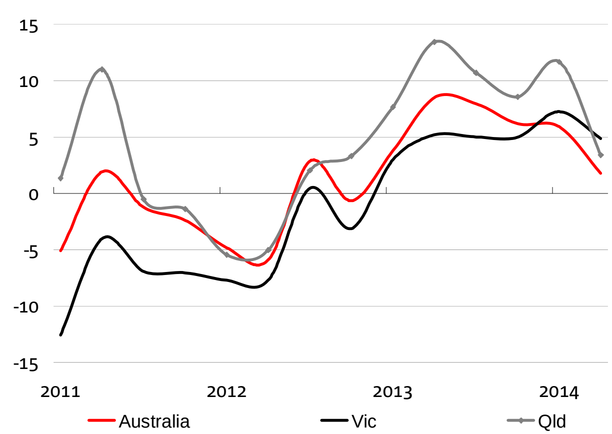


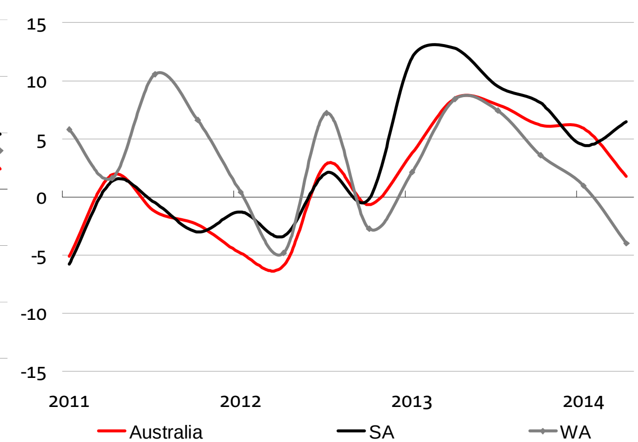




Business Confidence by State (net balance, sa)

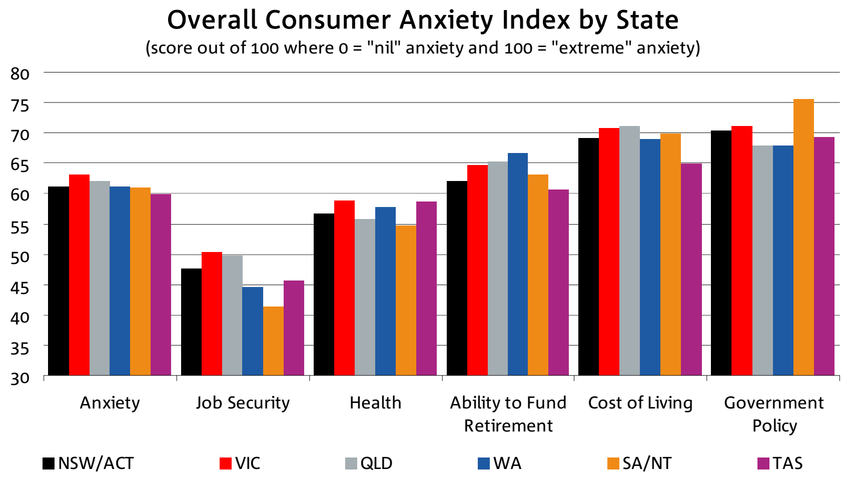




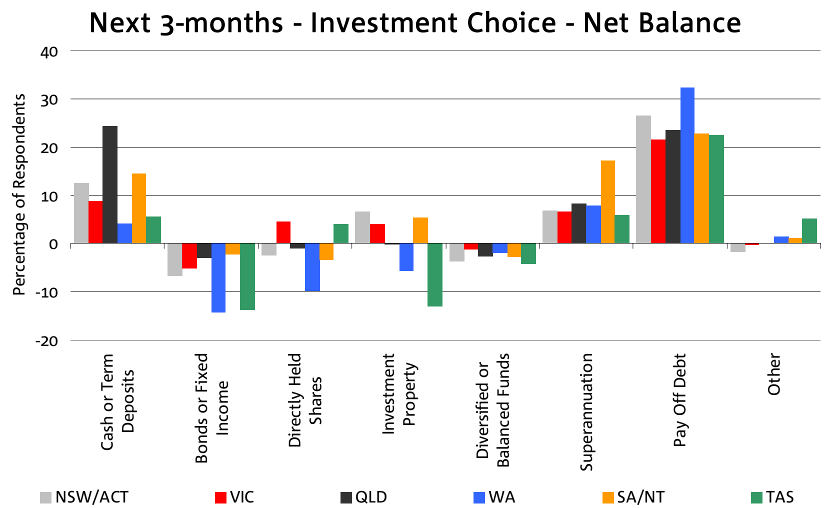


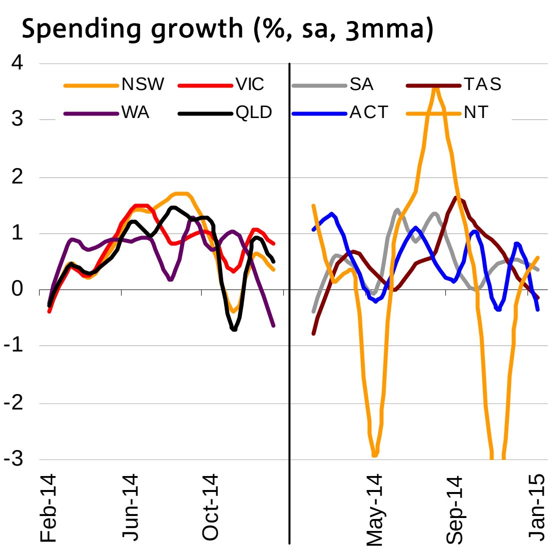
NAB State Economic Indicators - Summary

NAB Consumer Anxiety Index

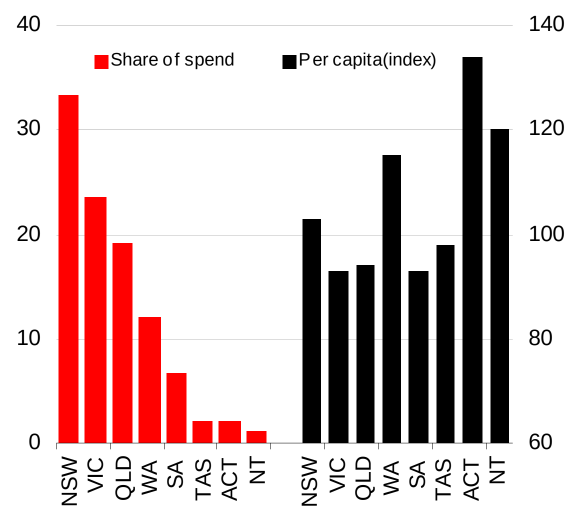


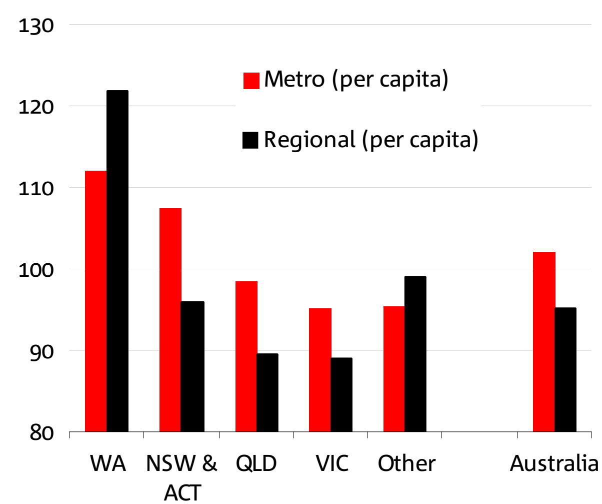
NAB Wealth Survey





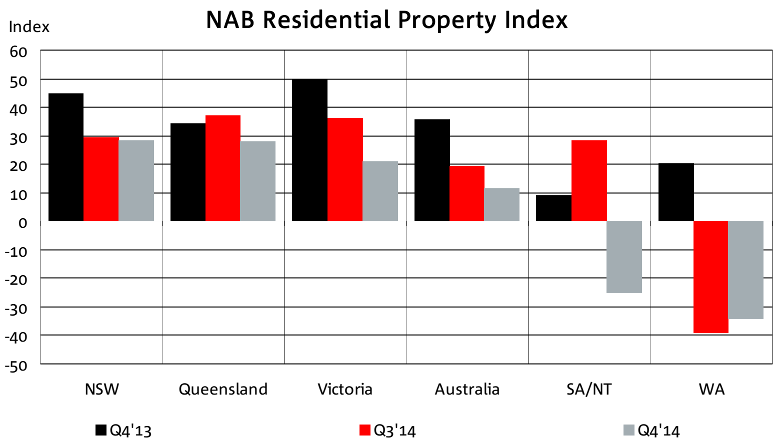
NAB Online Retail Spending Index

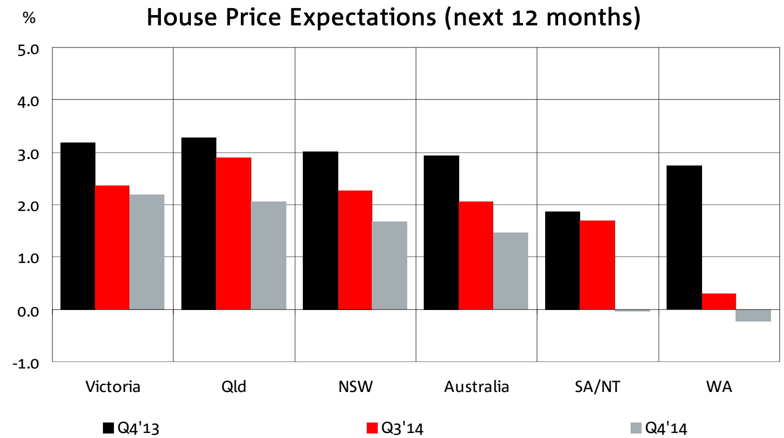




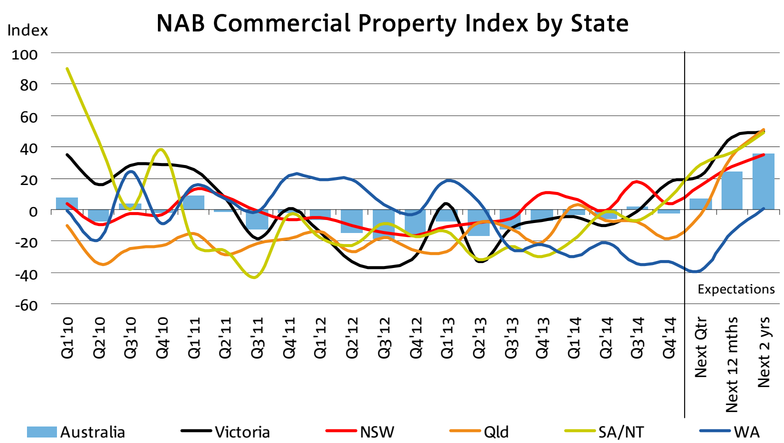
NAB State Economic Indicators - Summary

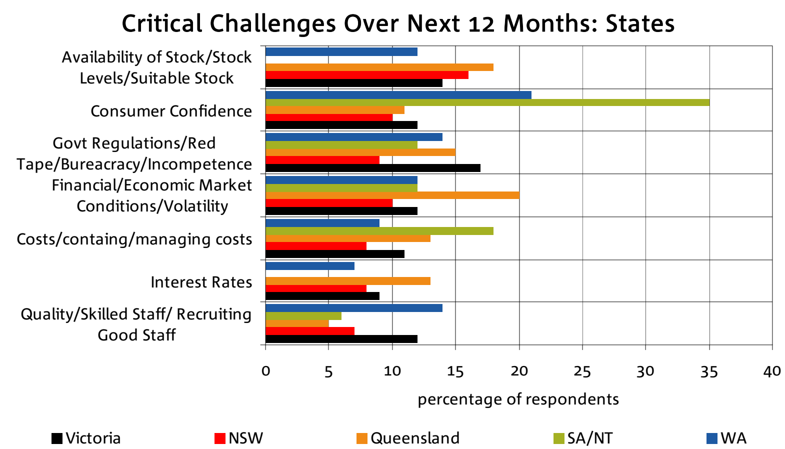
NAB Residential Property Survey





NAB Commercial Property Survey





Overview: State Fiscal Positions

- Based on current projections, a majority of state budget positions (ex NSW and Victoria) expect to be in deficit in 2014-15. Nevertheless, outside of WA and NT, the remaining states anticipate a significant turnaround in their budget positions based on an expected improvement in the economy (supporting revenues) and expenditure restraint. In the forward estimates, all states except for Tasmania are forecast to be in surplus by 2017-18.
- Surpluses are generally achieved via a combination of revenue and expenditure measures. However, revenue is also reliant on expectations for increases in consumer spending and property prices (contributing to land taxes), while mining states are anticipating a boost to revenue from increased commodity production in the out years. While the uncertainty behind these expectations varies, they all carry budgetary risks.
- Mining revenues are less than expected – with renewed focus on other sources of revenue (such as Goods and Services Tax (GST)), but spending cuts are unavoidable. For example, the WA government downgraded its revenue estimates by a hefty $5 billion over the forward estimates period (2014-15 to 2017-18), including a downward revision of $1.6 billion in the current financial year alone.
- For example, the volatility in GST allocation to states, based on the shares determined by the federal body of Commonwealth Grants Commission (CGC), is expected to favour mining states in 2015-16 given the sharp falls in commodity prices in recent months. This will serve to divert GST revenue away from non-mining states, including Victoria, to the mining states of Western Australia and Queensland for which mining royalties are negatively impacted by weaker commodity prices.

General government operating balance

AUDbn	2013-14	2014-15f	2015-16f	2016-17f	2017-18f
NSW	-2.5	0.3	0.4	1.1	1.0
VIC	0.9	1.1	2.2	2.4	2.4
QLD	-2.3	-0.1	3.1	3.1	3.0
SA	-1.2	-0.2	0.3	0.7	0.9
WA	0.2	-1.3	-0.9	0.3	1.3
TAS	-0.4	-0.1	-0.1	-0.1	-0.1
NT	-0.4	-0.6	-0.1	0.0	0.0

Distribution of GST revenue

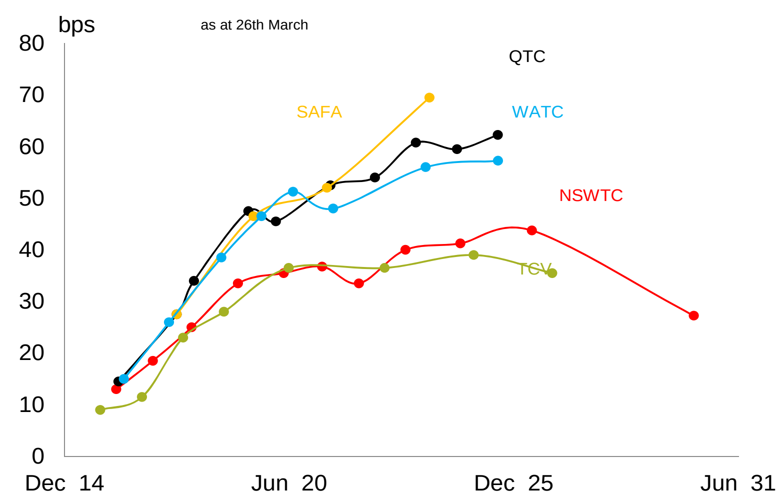
State or Territory	Share if GST were distributed on an equal per-capita basis (A)	2014-15 relativity (B)	2014-15 actual GST share after adjusting by the relativity ©
NSW	32.0%	0.97500	31.2%
VIC	24.9%	0.88282	22.0%
QLD	20.3%	1.07876	21.9%
WA	11.2%	0.37627	4.2%
SA	7.1%	1.28803	9.2%
TAS	2.2%	1.63485	3.6%
ACT	1.6%	1.23600	2.0%
NT	1.0%	5.66061	5.9%

Semi-Government Market Overview:

- Expected deterioration in budget positions for both the Commonwealth and states has raised the prospect of bond supply being greater in the forward estimates than previously projected. For now though this appears to be having a bigger impact on the performance of semi-government bonds.
- This under-performance is in part being driven by concerns around credit ratings (at least for Queensland where the market had ahead of the election being looking at prospect of an upgrade) but more so, where demand comes from.
- Bank balance sheets remain the dominant players in the semi-government market whereas for ACGBs it remains offshore. For the later, the search for yield has and is likely to continue to maintain reasonable demand. In terms of bank balance sheets, level of asset swap margins will continue to impact the extent to which semis can compress relative to benchmark.
- The widening in semi spreads began in January as (among other things) we saw SSA/semi switching but gathered momentum following the Queensland election. The longer end of the semi curve has been hardest hit but essentially semi-benchmark spreads (across the curve) are back out at the wides seen in October last year. QTC paper is trading out at new wides for the year.
- Until state budgets are released (Victoria is the first to be handed down on 5th May, Qld budget will not be out until Jul 14th) pressure in semi spreads may prevail.
- For now spread curves (ie 3y-10y) are likely to remain under some steepening pressure.
- The 2019-21 part of the curve, however, is seen to offer value as the 3y-5y part of the spread curve is steep. The non AAA states offer greater pick up but until budgets are released much uncertainty remains.
- Until we see more clarity around state budget positions and funding of infrastructure projects our preference is to hold AA in the front of the curve and AAA from the belly to longer end.

State credit ratings and outlook		
State	**S&P**	**Moody's**
NSW	AAA/Stable	Aaa/Stable
VIC	AAA/Stable	Aaa/Stable
QLD	AA+/Stable	Aa1/Negative
SA	AA/Stable	Aa1/Stable
WA	AA+/Stable	Aa1/Stable
TAS	AA+/Stable	Aa1/Negative
NT	--	Aa1/Negative

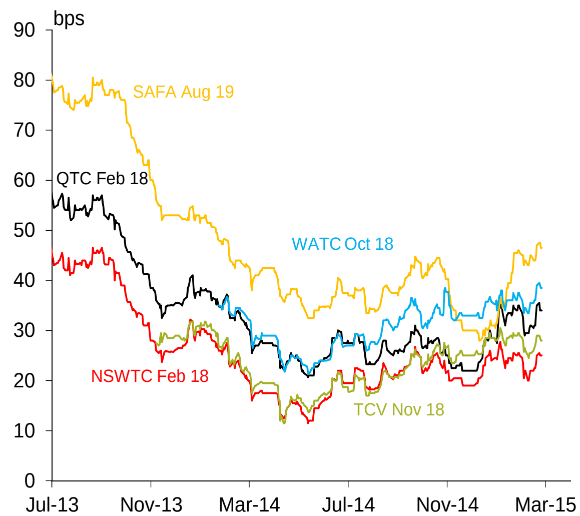
Spread to benchmark curves



Source: NAB

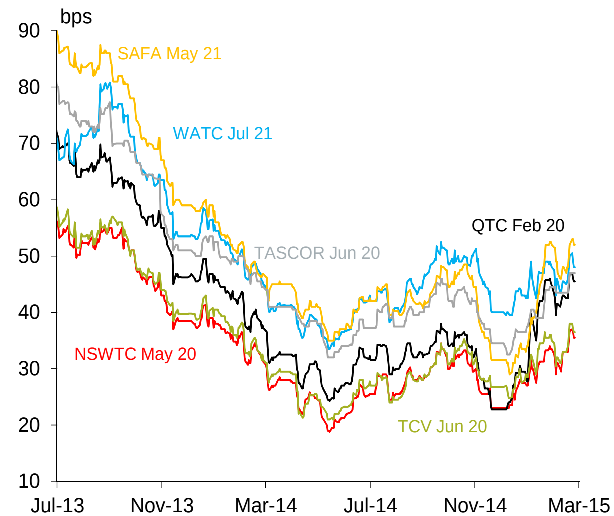
Chart Relativities

3y spread to benchmark



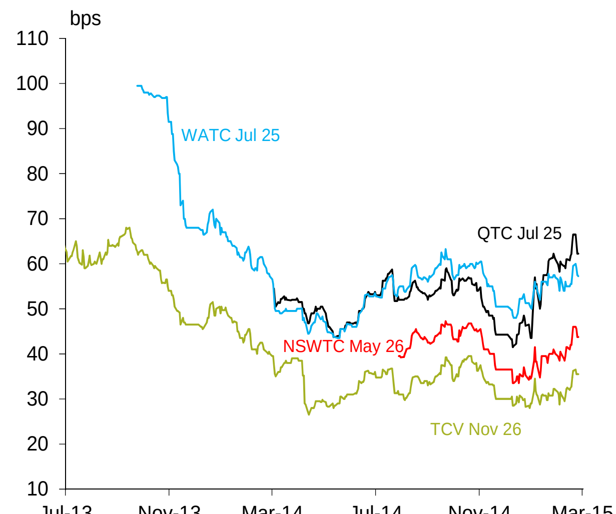
Source: NAB

5y spread to benchmark



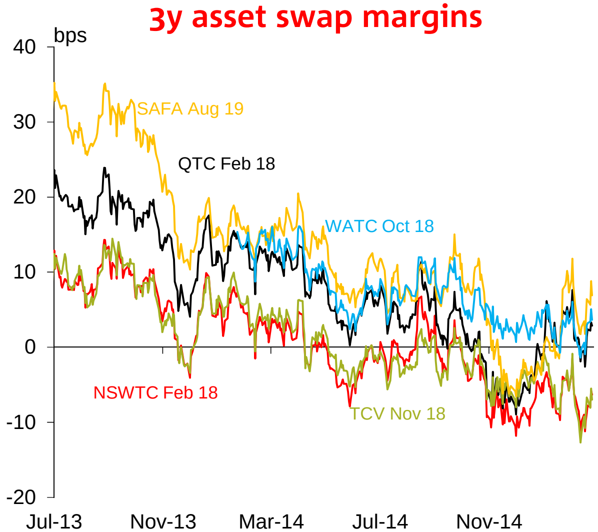
Source: NAB

10y spread to benchmark



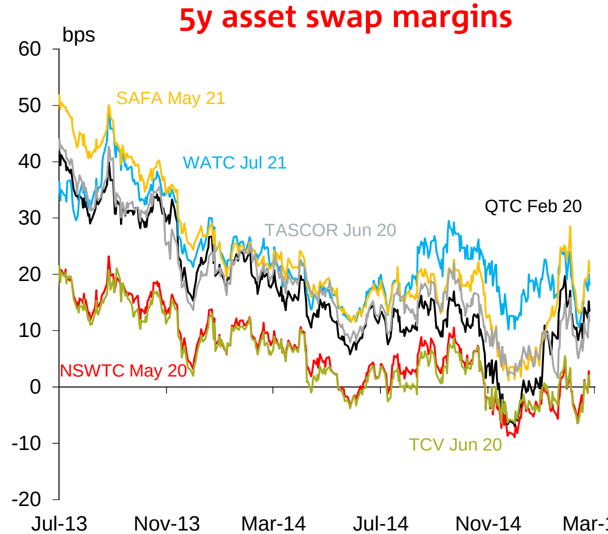
Source: NAB

3y asset swap margins



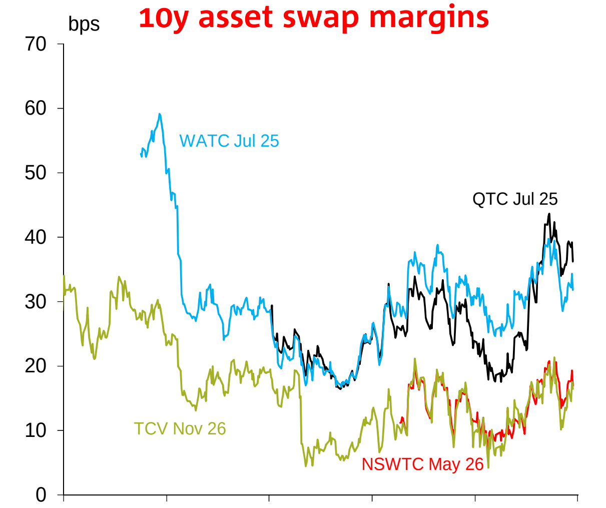
Source: NAB

5y asset swap margins



Source: NAB

10y asset swap margins

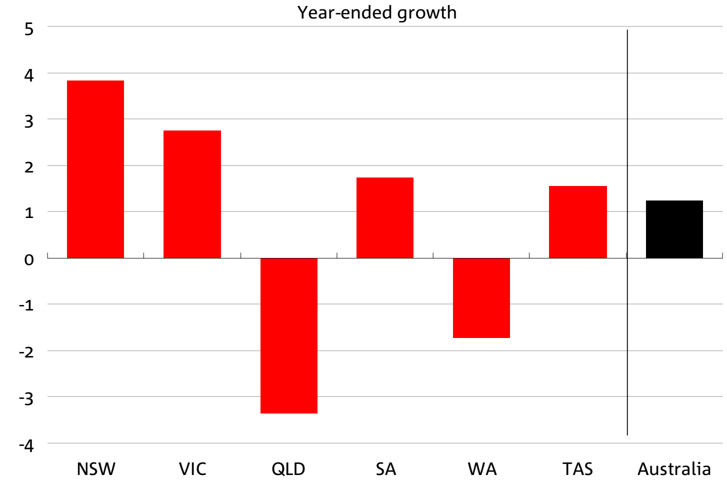


Source: NAB

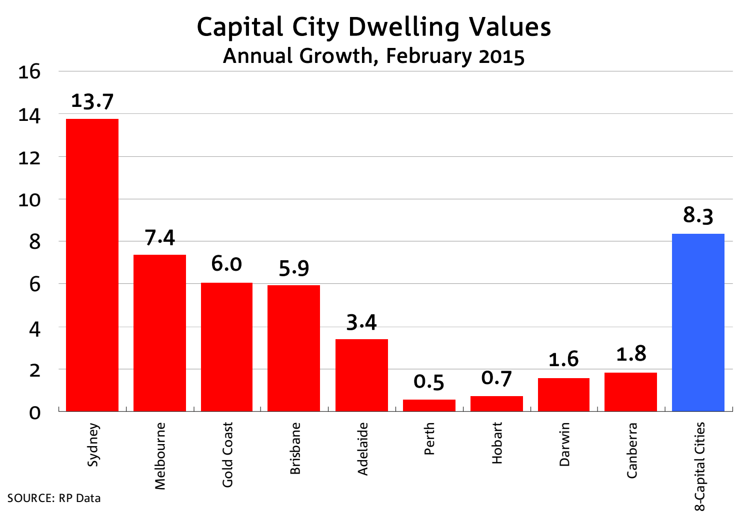
State Details: New South Wales

- Australia's largest state economy has outperformed over 2014, supported by the positive impetus stemming from residential markets. Low interest rates, solid population growth, undersupply and a rise in investor demand, has made residential property markets a standout for the NSW economy.
- The boost to household wealth has had flow on effects for consumption during 2014, although numerous headwinds saw retail spending slow late in the year and into 2015. Nevertheless, interest rates are expected to remain low, which along with lower oil prices and AUD depreciation, should spark a more broad based recovery in 2015-16. Conditions are gradually improving for business investment, while public infrastructure spending will provide key support to the local economy over coming years – putting aside potential financing hurdles.
- ***Our forecast is for NSW Gross State Product (GSP) growth to lift closer to trend at around 2¾% in 2014-15 and 2015-16 (following growth of just 2.1% in 2013-14). However, further out there is a risk that rising interest rates (from late 2016) will weigh heavily on NSW given its relative debt levels.***

Real Gross SFD Growth

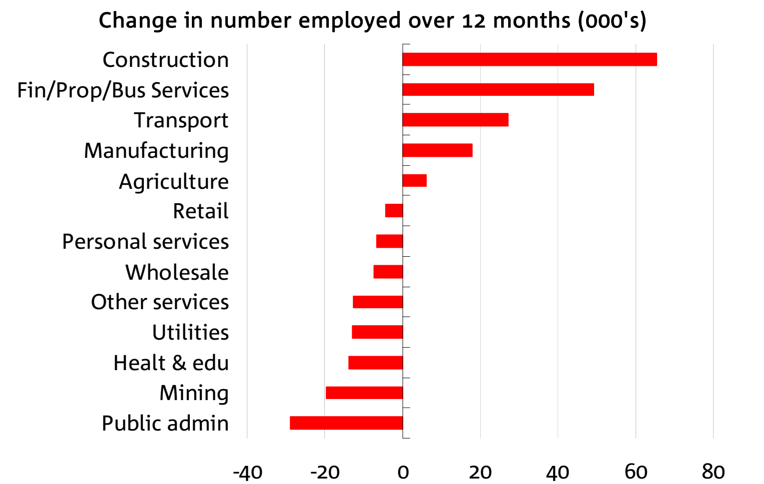


NSW property prices a standout



SOURCE: RP Data

Employment up most in real estate related sectors



Source: ABS, NAB Economics

State Details: NSW retail sales and wage growth

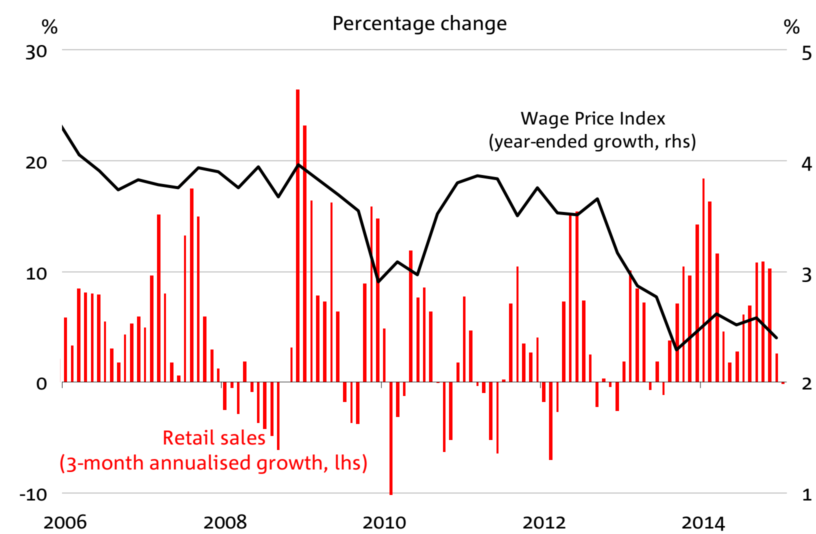
- Consumption made the largest contribution to NSW State Final Demand (SFD) in the year up to Q4 2014. Household consumption contributed 2.3 ppt to annual growth of 3.8% over the period. The notable improvement in consumer spending over 2014 came on the back of the surge in residential property prices that has helped drive household wealth in the state higher and boost demand for household goods. This included a spike in the purchase of electrical and electronic goods, which has been largely attributed to the new iPhone release and may prove to be temporary.

- Indeed, after recovering nicely from a post budget hit to consumer spending, retail sales appear to have slowed notably late in the year (Graph). The slowdown in retail sales largely reflects weaker sales of household related items, following the strong growth of prior months. However, retail volumes continued to grow strongly in Q4 2014, suggesting that slowing retail sales are at least partly due to heavy discounting and other dis-inflationary pressures, such as falling petrol prices.

- Nevertheless, a soft labour market and shaky confidence has been (and will continue to be) a major constraint on household spending, and with some of the heat coming out of the housing market, a slowdown in retail spending is to be expected. With lesser support from the housing market, additional catalysts are needed to break the consumer caution and invigorate spending. Low interest rates and petrol prices – along with continued, albeit more moderate growth in house prices – should assist household finances and encourage additional spending on discretionary items. An eventual improvement in the economy will also feed into wages, which have shown close to zero real growth.

NSW retail spending by type

Retail turnover and wage growth

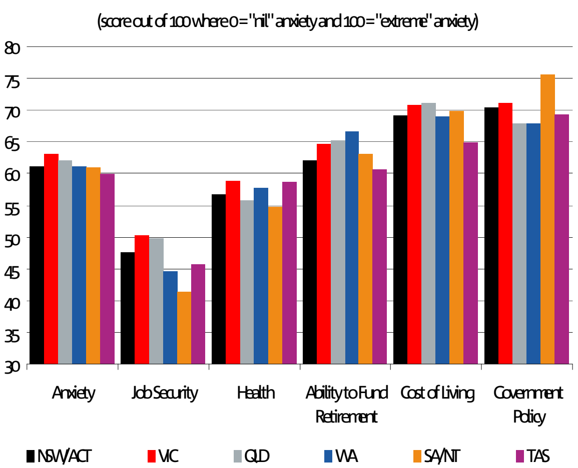


Source: ABS; NAB

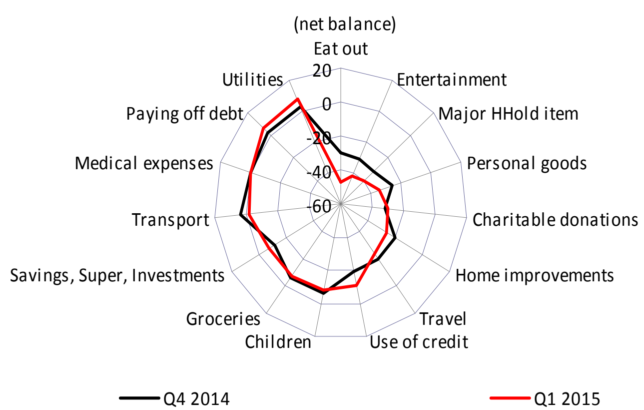
State Details: NSW consumer anxiety and spending behaviour

- The NAB Consumer Anxiety Index shows that NSW consumers have become slightly less anxious over the past couple of quarters. NSW was no longer the most anxious state in Q1 2015, although this is largely a reflection of higher anxiety in other states. Anxiety levels in NSW are largely a reflection of uncertainty over government policy, followed by cost of living pressures. Concern over job security ranks lowest and showed improvement in Q1, despite an unemployment rate that is trending higher, while attitudes towards job security in all other states deteriorated.
- Other measures of consumer anxiety were also soft in late 2014, but lower oil prices and an interest rate cuts have brought about a spike in the early 2015. However, with fundamental headwinds remaining – household debt, housing affordability, political uncertainty – it is unclear how long this can be sustained. The federal and state budgets could pose an additional challenge if additional cost savings measures are introduced. For example, public administration shed the most jobs in NSW over the past year. These factors continue to be reflected in consumer spending behaviour in NSW. Consumers have been holding back on discretionary spending to concentrate on essential items such as utilities, transport, medical etc. In the March quarter NSW consumers indicated even less inclination to spend on eating out, entertainment and major household items, although they pointed to slightly higher use of credit (Chart).
- ***NAB economics forecast labour markets to remain soft nationally as the labour intensive mining boom winds up and workers return to non-mining states in search of employment. Although the residential construction sector and improved demand for labour in professional services will help to soak up the employment overhang (assisted by public infrastructure investments in later years – see below), the unemployment rate is forecast to stay elevated close to 6¼ (worse than the state treasury forecast of 5½-5¾%).***

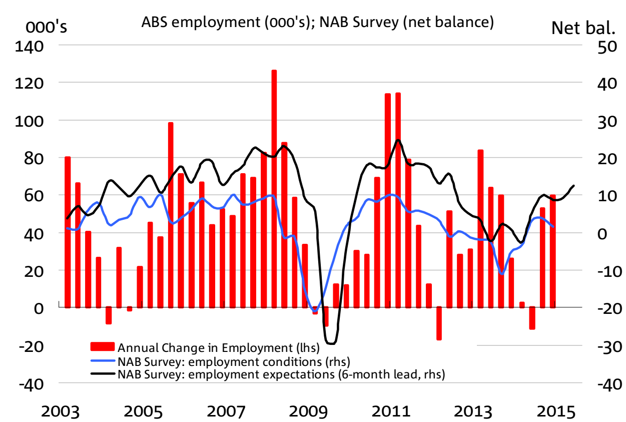
NAB Consumer Anxiety Index



NSW: Changes in spending behaviour



Employment conditions



Sources: ABS; NAB

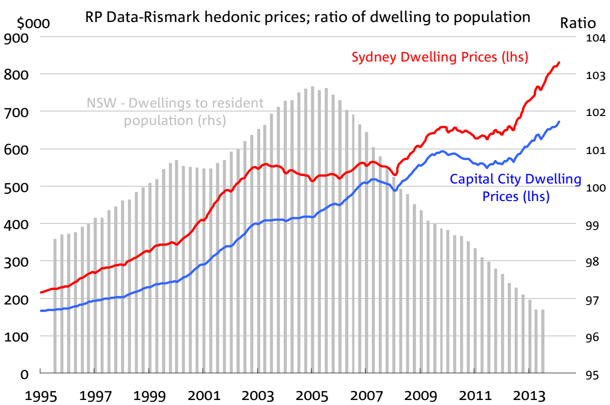
State Details: NSW residential property sector

- A major source of momentum in NSW has been the strength in residential property markets, underpinned by the underinvestment in housing supply that has occurred over the past 5-10 years (see the first chart below). Population growth in NSW has been incredibly strong, driven by overseas immigration, while interstate outward migration – which has been a long running feature in NSW -- has slowed. New housing supply has failed to keep pace with this growth, demonstrated by the consistent decline in the ratio of dwellings per resident population, which has fallen to its lowest level in decades. However, with affordability remaining an issue for many first home buyer owner occupiers, much of the demand has stemmed from investors – including foreign buyers. Consequently, house prices growth in Sydney has been the strongest of the capital cities, encouraging a flood of housing investment.

- Residential building approvals rose by about a third over 2013 and remained elevated during 2014 (the value of residential buildings approved in December was 10½% higher than a year earlier). These high levels are contributing to a solid pipeline of residential construction work to be done, increasing nearly 50% over the past 2½ years to about $9.2 billion – more than 3% of SFD. Given current rates of construction in NSW, this pipeline is enough to support construction activity for more than 7 months with no new projects approved (an unlikely negative outcome given the current momentum and record low interest rates). However, given the high concentration of construction in multi-storey (4 storeys or more) apartments, accounting for around a third of approvals last year, lag times for construction activity could potentially be significant.

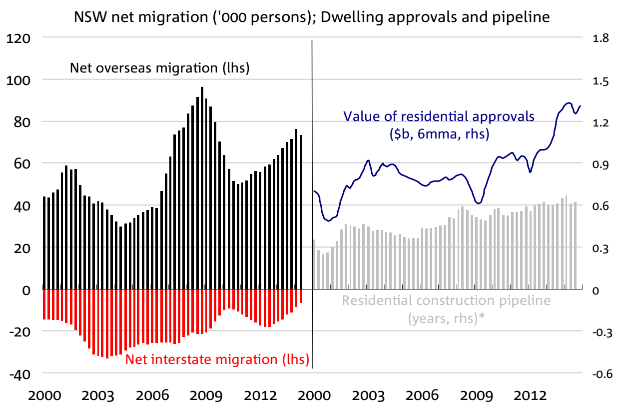
- ***Looking forward, the NAB Residential Property Survey suggests some mixed demand signals in Q4 across buyer types – resident investors and owner occupiers lifted, while FHB investors and foreign buyers softened. In terms of the market fundamentals, deteriorating affordability, highly leveraged households and rising unemployment/low wage growth will continue to provide headwinds to the housing market, but low interest rates, a falling AUD (assisting foreign affordability) and a medium term economic improvement indicate ongoing positive growth. NAB are forecasting Sydney residential property prices to rise further, albeit at a softer pace (4.1% over 2015 and 2.3% over 2016), helping to underpin solid residential construction activity ahead.***

Residential property sector



Sources: ABS; RP Data-Rismark

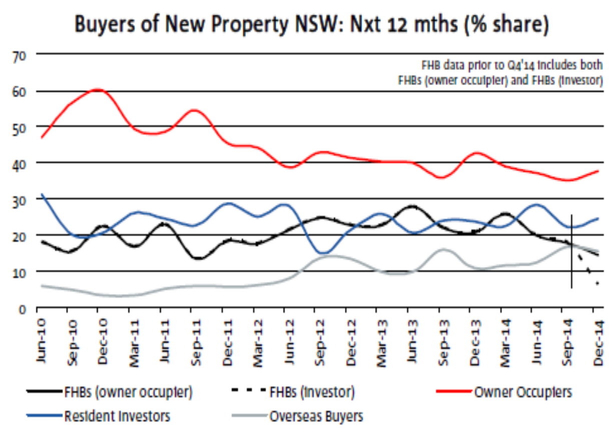
Residential property sector



* Ratio of work-yet-to-be-done to annualised work done

Source: ABS; NAB

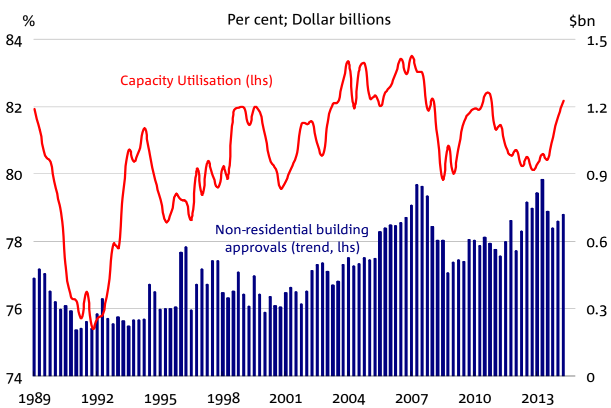
NAB residential property survey



State Details: NSW commercial property sector

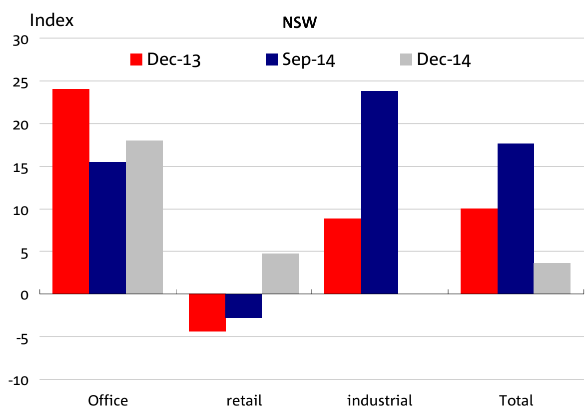
- Spare capacity in NSW appears to have tightened in late 2014, suggesting that fundamentals have become a little more favourable for business investment. With little support coming from the mining sector, largely due to tough conditions in coal markets, non-mining investment needs to pick up in order to fill the gap. Certainly, non-dwelling investment made a positive contribution to GSP in 2014, but a much more pronounced lift is needed. After accounting for asset sales, the contribution was skewed a little more towards private, rather than public investment, in 2014. Annual average growth in private investment in 2014 was -0.8%, as opposed to an underlying rise of 3.9%.
- Non-residential activity has not been as vigorous as the residential sector, but building approvals have started to lift again from the mid year slowdown. Additionally, the NAB Business Survey shows that conditions have improved for more business investment in NSW. Capacity utilisation is back to around its highest level since 2010, and is not far from its pre-GFC peak. In combination with low interest rates and gradually rising equity prices, firms should be starting to look to invest. However, investment intentions for the next 12 months from our survey have not shown any significant improvement. This suggests other factors are still limiting firms 'animal spirits', making them reluctant to expand operations. Similarly, the ABS Capital Expenditure Survey showed that investment intentions for non-mining firms (at the national level) were disappointing, pointing to a decline in 2015/16.
- In terms of non-dwelling building investment, the most recent NAB Commercial Property Survey suggested that sentiment in NSW deteriorated in the final quarter of 2014. This was particularly apparent in the industrial sector, which deteriorated sharply, while office and retail actually saw some improvement – consistent with a lower reported vacancy rates in offices and improved confidence among retailers.
- This is broadly reflected in firms reported intentions for upcoming developments. The number of developers in NSW planning to start new developments in the industrial sector dropped of in Q4, and is now below the levels reported at the same time in 2013. In contrast, the shift to positive sentiment by retail developers has coincided with a ramping up of plans to start new developments. For offices, however, commencement intentions eased slightly in Q4 despite a moderate improvement in sentiment.

Non-res. approvals & capacity utilisation



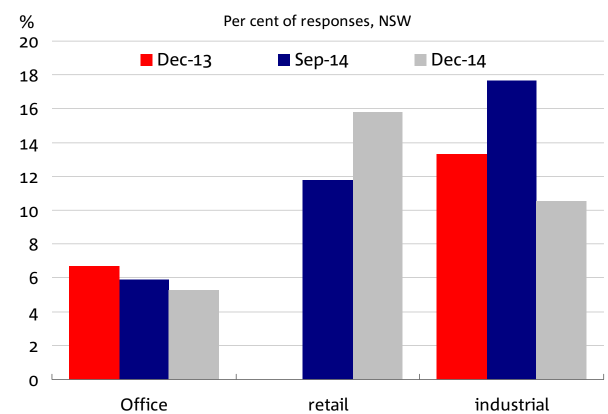
Sources: ABS; NAB

NAB Comm. Prop. Index - Sentiment



Source: NAB Economics

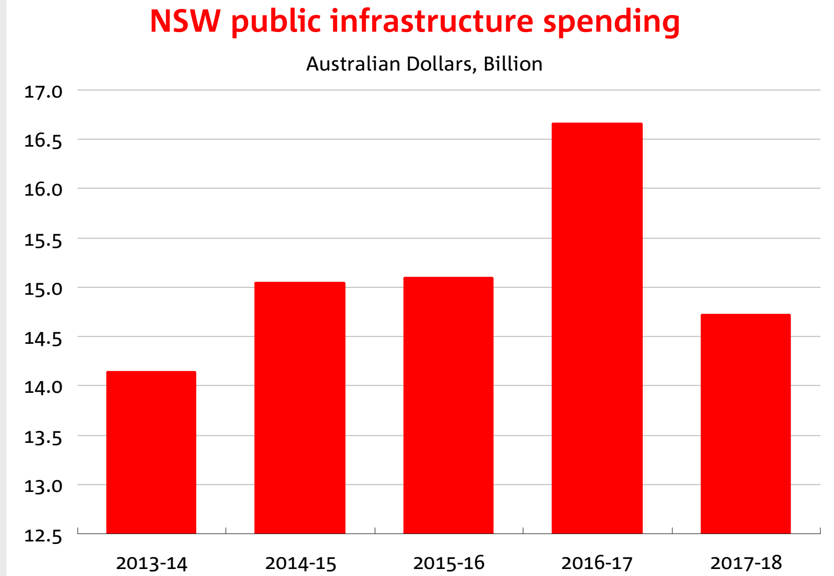
Development Commencement Intentions



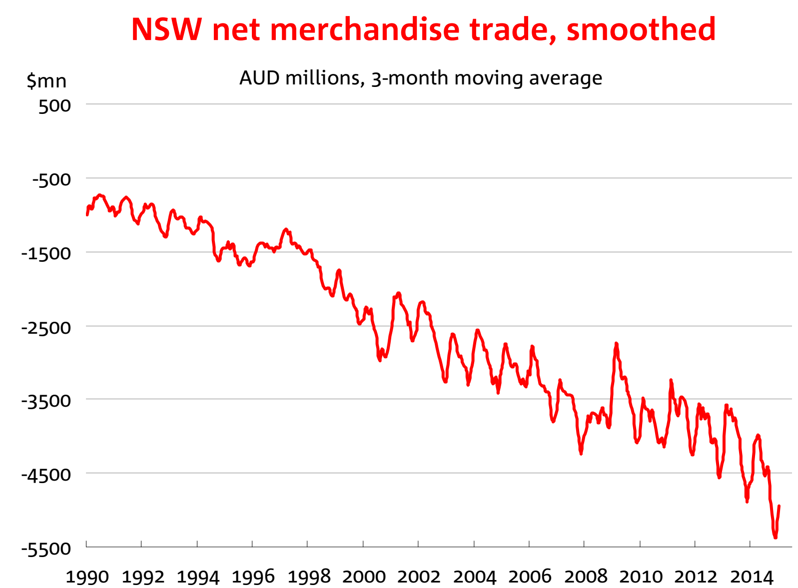
Source: NAB Economics

State Details: NSW public infrastructure spending and net trade

- The state budget anticipated some $61.5 billion to be spent on public infrastructure projects over 4 years ($25 billion earmarked for road and rail projects). In the mid-year budget review, capital expenditure was forecast to be $733 million higher than at Budget, most of which is due to new spending initiatives. The NSW government also has a proposed capital investment program ('Rebuilding NSW') that is not included in the Half-Yearly Review as it is to be funded by proceeds from the proposed 49% lease of NSW electricity network businesses. The program is valued at $20 billion. In addition, $4.9 billion in approved reservations for the 'Restart NSW' fund, have not been included.
- High levels of state public investment will be an important source of growth, activity and jobs over coming years. Public infrastructure construction tends to be highly labour intensive, so the direct impact on the local economy will be quite apparent – past NSW Treasury analysis shows that the initial impact from $1m in infrastructure spend is around 4 full time jobs (10 jobs when second round effects are accounted for) depending on various assumptions. With $11.5 billion to be spent on infrastructure in 2014-15, this could contribute around 46k jobs to the economy.
- NSW net export performance remains relatively poor given the ongoing difficulties in coal markets, weakness from interstate demand and significant (although moderating) headwinds from the AUD. Imports have also shown solid growth, in line with better consumer demand over 2014. Fewer capital imports by the mining sector and some assistance from an anticipated depreciation of the AUD (forecast to drop to USD 0.73 by early 2016) will provide some support to the state's exporting industries, but is unlikely to significantly reverse the trend because of softer commodity demand (coal is NSW largest export) and unfavourable climate conditions for rural exports. Timely data on merchandise trade suggest that the trade deficit continued to deteriorate heavily over 2014. Nevertheless, major service exports like education related travel and tourism stand to benefit from both the lower AUD and recent Free Trade Agreements with Japan and China.



Source: NSW State Budget 2014/15



Sources: ABS; NAB

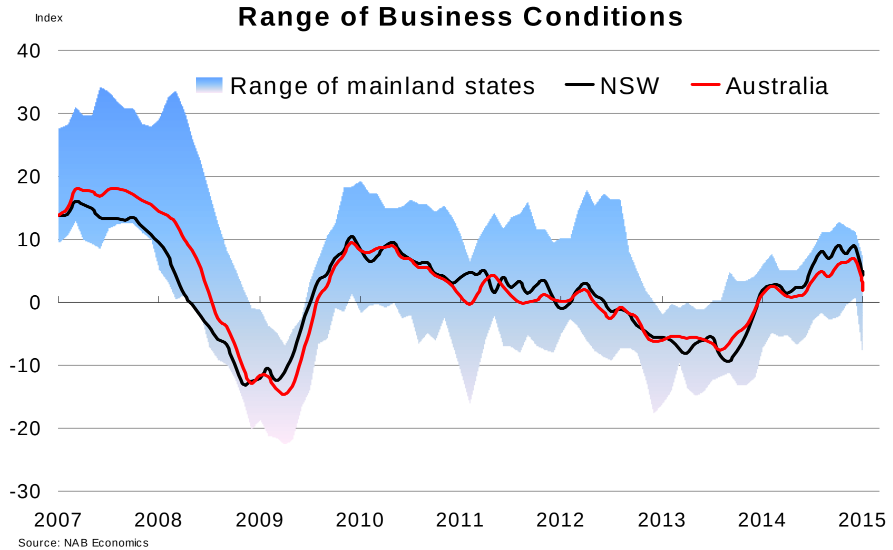
State Details: NSW Business Survey

- Results from the NAB Business Survey generally support the notion that the NSW economy is heading into a services led recovery, despite firm's responses on actual activity remaining relatively subdued – especially outside of the service sectors. Despite easing recently, the business conditions index for NSW (a summary of trading conditions, profitability and employment) has remained in mildly positive territory over 2014 and is also above the national average.

- However, some of the leading indicators from the business survey are mixed for the NSW economy. Forward orders continue to be very soft, having been negative for four of the last six months. The wholesale sector – often considered a bellwether industry for the broader economy – is also showing soft conditions and confidence levels (see the bottom chart). Similarly, while confidence levels reported by firms in NSW have been relatively positive, they have eased considerably from the post-Federal election highs of 2014 (confidence in NSW is only third highest among the mainland states). Capacity utilisation is a relative bright spot, lifting sharply over 2014 to 81.8% in trend terms, slightly above the long run average. Consequently, firm's capital expenditure index lift into positive territory over the same period and has held there.

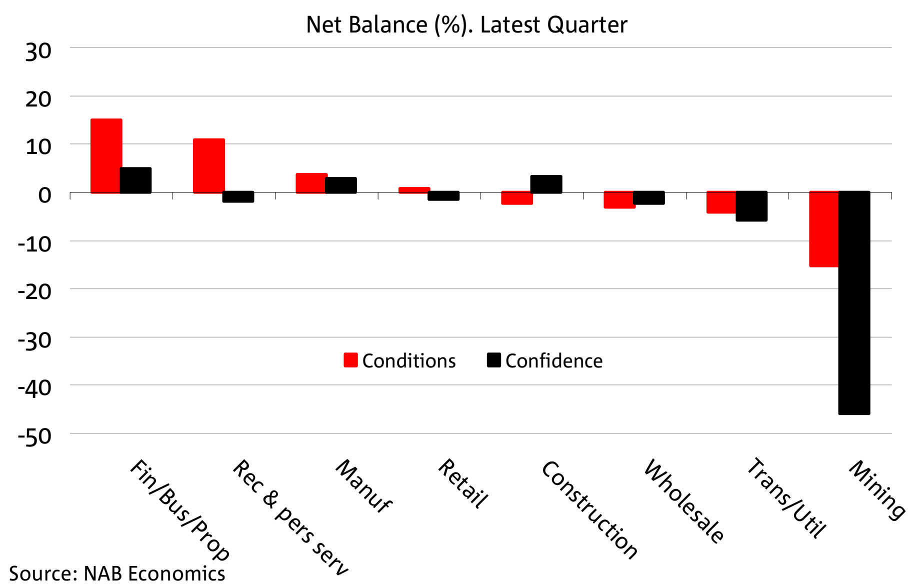
- By industry, business conditions are generally looking best in the services industries, which are particularly prominent industries in NSW. In spite of soft conditions, construction firms in NSW are cautiously optimistic (see the bottom chart) – a trend that is even more apparent in the more timely monthly survey, which also shows a similar story for retail.

NSW business conditions relative to state spread



Source: NAB Economics

NSW business conditions and confidence by industry



Source: NAB Economics

NSW – Budget and issuance update

Capital city	Sydney
Government	Liberal-National Party
Next election	March 2019
Rating and outlook	Moody's Aaa/Stable S&P AAA/Stable
Website	www.nsw.gov.au

- **Budget position** The NSW Governments mid year budget review (MYBR) showed an improved budget position for 2014-15 with a small surplus now estimated (vs previous estimate of deficit). The improved position has been driven by a stronger-than-expected property market which has boosted forecast revenues. While forward estimates will continue to benefit from the property market, payroll tax is now estimated to be lower as are mining royalties. The Government will use some of the improved budget position to fund infrastructure projects – including Newcastle Revitalisation Program. The net debt position has also improved– driven by the better budget position but also the sale of Macquarie Generation assets.
- **Credit rating** On October 15th S&P revised NSW rating outlook from negative to stable. NSW holds a AAA stable outlook rating with both S&P and Moody's.
- **Issuance profile** Following the updated MYBR, NSWTC revised its 2014-15 issuance program lower by AUD900m. This reflected proceeds from the sale of Delta Electricty Colongra power station and some small reductions in funding needs from other clients. Following the issue of the new nominal 2026 bond line NSWTC has no further plans to issue a new benchmark line before June 30. Given issuance to 23rd Jan, NSWTC estimates it has another AUD2.05bn of bonds to issue. The funding profile for forward estimates shows a gradual decline in issuance. With the LNP re-elected at the March 28 election, this funding profile is likely to be lower as the state progresses with planned asset leases.

NSW General Government Operating Balance

$ millions	2013-14	2014-15	2015-16	2016-17	2017-18
FY13-14	-1,890	-563	157	535	
FY14 MYBR	-2,546	-1,051	-323	320	
FY 14-15		-283	660	2,155	1,666
FY15 MYBR		272	402	1,096	1,038

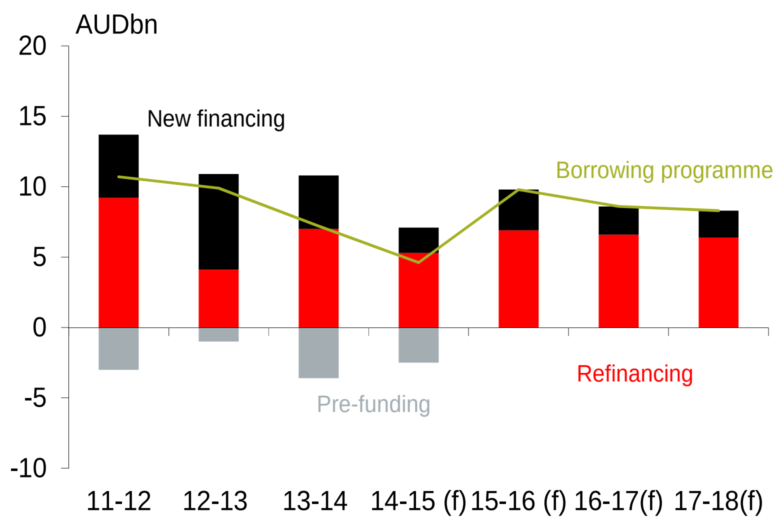
Source: NSW State Budgets papers

NSW Non-financial Public Sector net debt

$ billions	2013-14	2014-15	2015-16	2016-17	2017-18*
FY13-14	48	54	58	62	
FY14 MYBR	47	52	57	61	
FY14-15	40	46	50	53	54
FY15 MYBR		42	46	50	51

Source: NSW State Budgets papers

NSW Borrowing Program



Source: NSWTcorp

State Details: Victoria

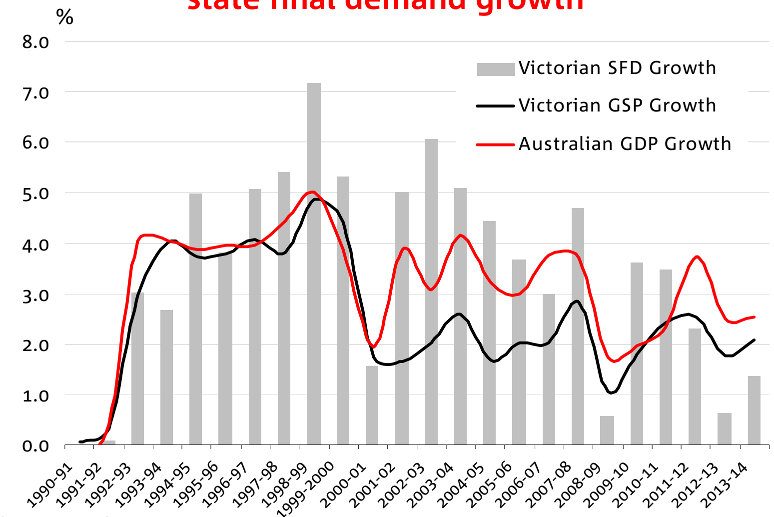
- Victoria is Australia's second most populous state and likewise has the nation's second largest economy. Victoria's economy is relatively diversified, with its manufacturing base experiencing a structural decline in the last few decades while the services sector burgeoned. The imminent end of car manufacturing activity by Ford and Toyota over 2016 and 2017 is likely to accentuate this trend.

- Since 2006, the Victorian economy has consistently performed below the national average, albeit positive still, as robust mining activity in Western Australia and Queensland began to drive Australian GDP growth. Combined with a disproportionately strong population growth, Victoria's gross state product (GSP) per capita in real terms, which is a measure of the standard of living, fell in 2013-14. Unemployment rate has been on a rising trajectory since 2011 but appears to have improved slightly in recent months and now stands at 6.3% (trend) and 6.0% (seasonally adjusted) – the second lowest state in Australia after Western Australia.

- In the latest *Budget Update* released under the newly elected Labor government, the projected surplus is revised slightly upwards for 2014-15 but downwards for those in the forward estimates period, relative to the *Pre-Election Budget Update*. However, consistently robust forecasted surpluses ranging from 1.1 to 2.4 million dollars suggest that Victoria's AAA credit rating with a stable outlook is unlikely to face any significant downgrading pressure in the medium term.

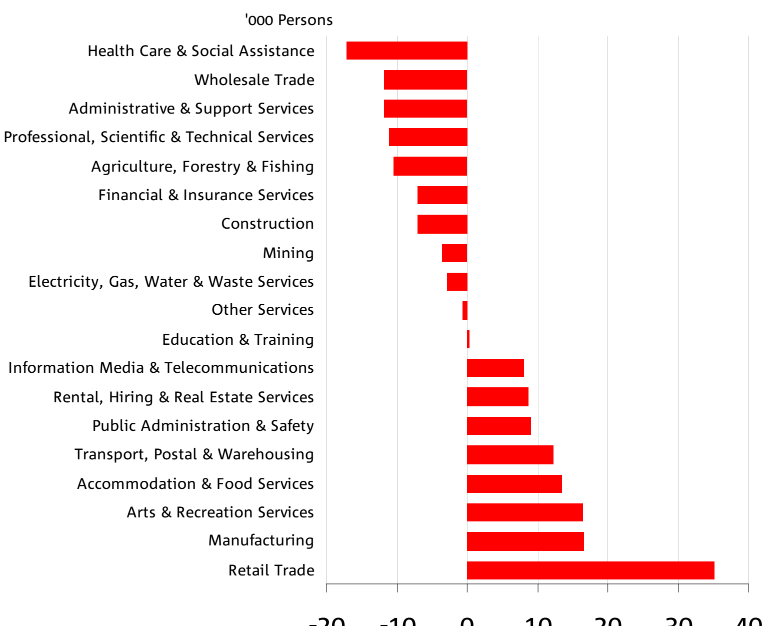
- *Looking ahead, a buoyant outlook for the residential and commercial property sectors suggests that dwelling and business investment could make a more positive contribution to growth, which will be further aided by robust population growth driven predominantly by net overseas migration. However, a weak labour market characterised by high unemployment rate and soft wages growth point to stagnating and even falling standards of living. Hence household consumption is likely to be constrained. Uncertainty in the Victorian fiscal environment associated with the imminent dumping of the East West Link project and volatility in GST revenue also weighs on government infrastructure spending prospects. As such, NAB forecasts Victorian GSP growth to be 2.2% and 2.4% in 2014-15 and 2015-16 respectively, before rising to 2.6% in 2016-17.*

Vic real gross state product and state final demand growth



Source: ABS

Change in employment by industry 12 months to Dec 14



Source: ABS

State Details: Vic industry contribution, GSP and population growth

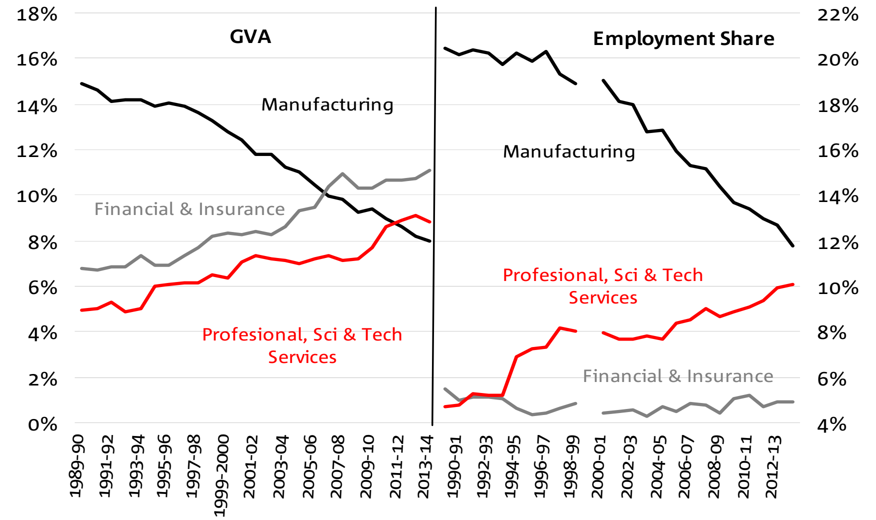
- The structural decline in Victoria's manufacturing activity, while having started since the 1970s, gained pace since late 1990s as the concentration of global manufacturing shifted increasingly to Asia. Relative to Australia, Asia enjoys the competitive advantages of having a lower cost base and proximity to an expansive rising middle-class consumer market.

- As a result, the output contribution by the manufacturing sector to the Victorian economy has fallen from almost 15% in 1990 to be around 8% in recent years. Meanwhile, higher value-adding services industries, in particularly professional, scientific, financial and insurance services, rose in prominence.

- However, manufacturing continues to be the single largest source of full-time employment by industry for the state, followed by construction and retail, employing about 240,000 people. As such, the expected winding down of the car manufacturing and aluminium industries is expected to exert a disproportionate effect on the labour market.

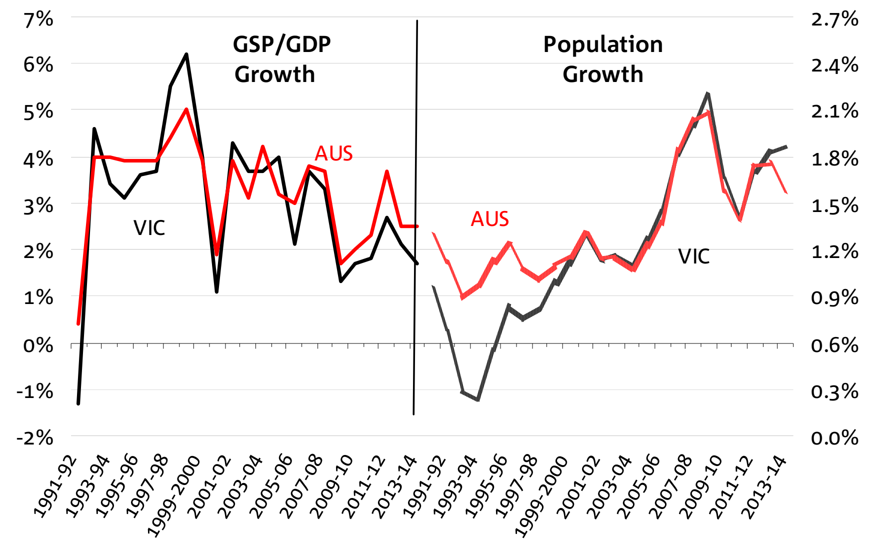
- Consistently lower-than average growth rates since mid-2000s and disproportionately strong population growth in Victoria in recent years, have weighed on the labour market and average income growth. Victoria's real gross state income per capita, which takes into account the effects of changes in terms of trade on the purchasing power of residents, contracted by 0.5% in 2013-14, the only second contraction since the inception of the series published by the Australian Bureau of Statistics in 1992-93.

Selected industries by share of total industry gross value added and full-time employment (CVM)



Source: ABS

Real gross state product and population growth



Source: ABS

State Details: Vic population and labour market

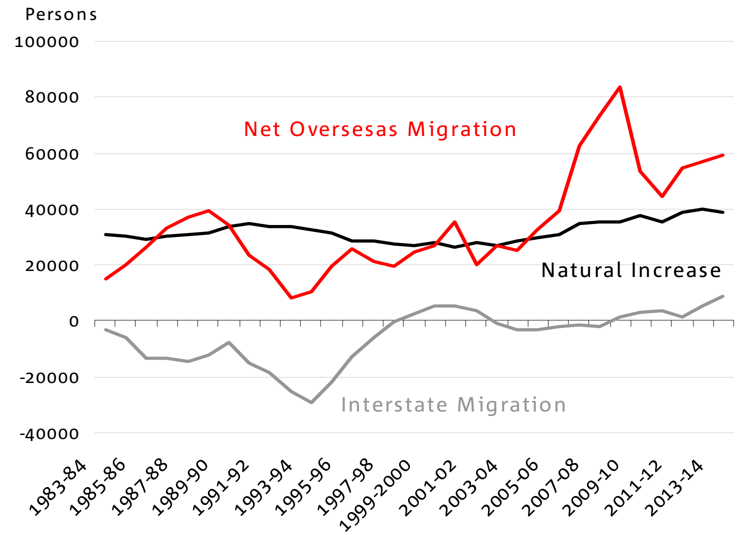
- Between the two most populous capitals, Melbourne population growth continues to outpace Sydney in absolute terms and growth rates. Since 2008, Melbourne population outpaced Sydney across all age groups, and is on track to be Australia's largest city by the middle of the century if current trends continue.

- Since hitting the most recent trough in 2010-11, net overseas migration to Victoria has gained steadily to be just under 60,000 in 2013-14, accounting for 28% of all overseas arrivals to Australia. Interstate migration also surged in 2013-14 by more than 60% to be around 8800 persons. This is largely driven by the suite of measures introduced by the Department of Immigration and Multicultural and Indigenous Affairs in October 2013 to simplify the process for student visa application resulted in pick-up in student numbers in recent years.

- Soft state final demand growth, coupled with a growing labour force as a result of population growth have in turn introduced more slack in the labour market, with unemployment rate tracking upwards for more than 3 years since mid-2011; nonetheless it appears to have eased in recent months to be currently around 6.3% in trend terms.

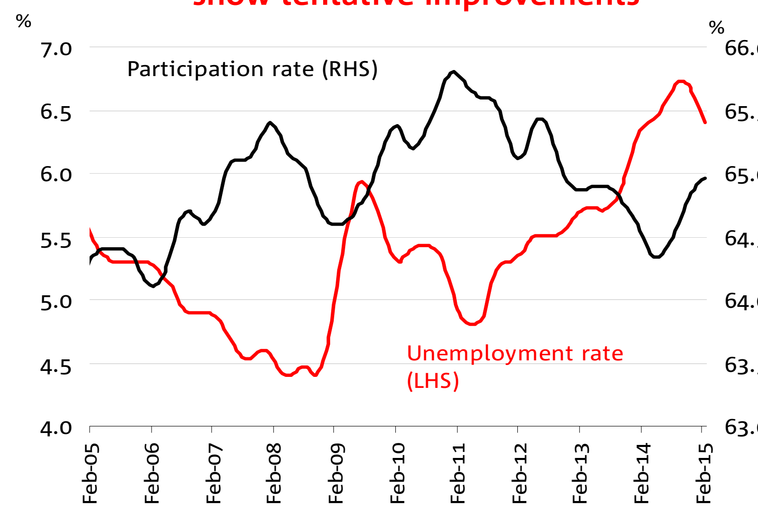
- Notwithstanding the volatility in labour force data at the state level, weak labour market fundamentals and a rising participation rate suggest that the moderation in unemployment rate is likely to be a short-lived phenomenon, and is expected to rise further in the coming months. NAB forecasts Victorian unemployment rate to average at 6.7% for both 2014-15 and 2015-16.

Victorian annual population growth by source - net overseas migration dominates



Source: ABS

Unemployment and participation rates (3mma) show tentative improvements

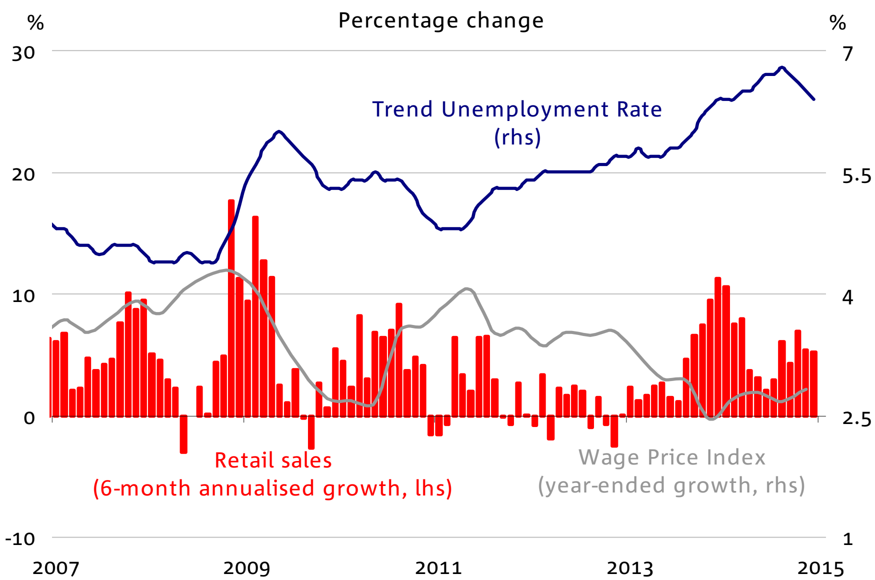


Source: ABS

State Details: Vic retail sales and consumer spending behaviours

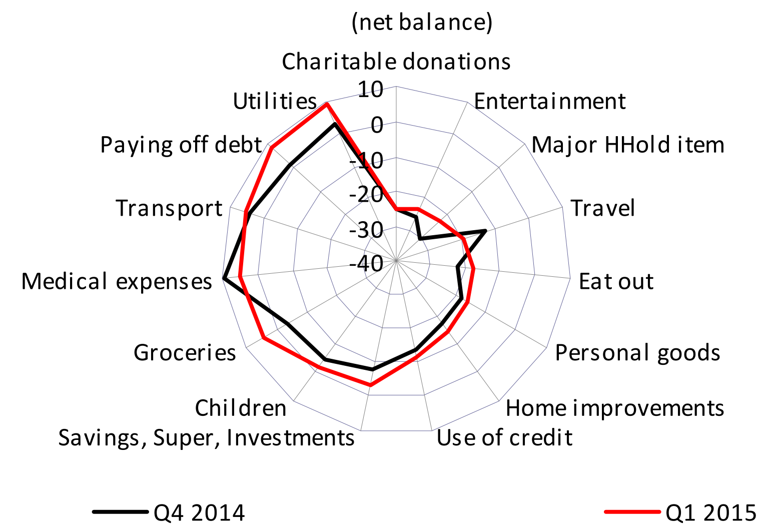
- Despite the apparent weakness in the labour market, Victorian retail sales has maintained reasonable growth, but is likely to have been underpinned by robust population growth rather than an increase in purchasing power of individuals.
- This observation is further supported by the fact that the growth in retail sales is largely accounted by strength in “essential goods” such as supermarket and grocery purchases and other necessary household items, while discretionary spending on clothing and footwear, household durables and most personal services have mostly stagnated.
- According to NAB’s Anxiety Report in Q1 2015, Victorian consumers at the individual level have indeed demonstrated ongoing caution in their spending inclinations in recent months, with respondents focussing more on things like paying down debt at the expense of buying major household items and eating out. Intentions regarding spending on essential items on the other hand generally rose in the quarter. The survey also shows that the anxiety of Victorian consumers lifted notably in the quarter, which included a deterioration in perceived job security – although uncertainty over government policy and cost of living are the biggest concerns.

Retail sales resilient on the back of strong population growth but wages growth stays low



Source: ABS; NAB

Consumers continue to focus on paying down debt and spending on essential items



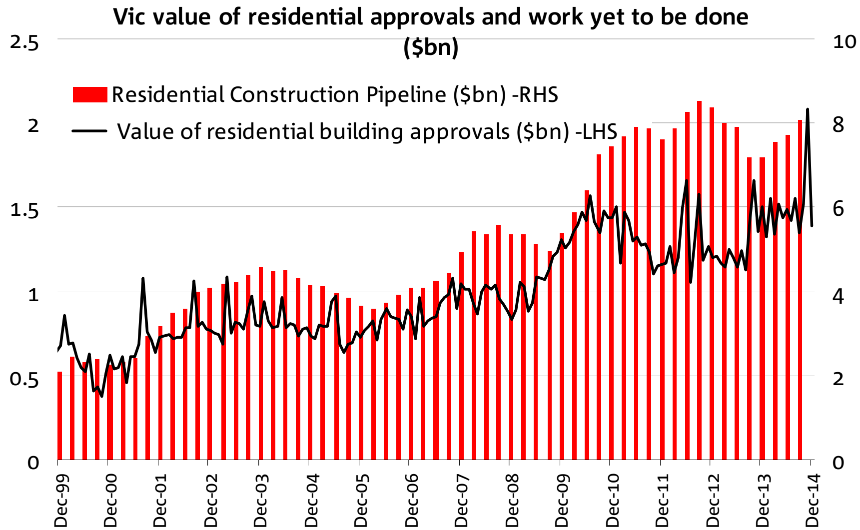
Source: NAB Group Economics

State Details: Victorian residential property sector

- In the real estate sector, the level of housing approvals and construction pipeline are playing an important role in supporting domestic activity. Corresponding to a year of strong housing demand and price growth in 2014, residential building approvals and construction pipeline have grown strongly over the year, with the former reaching unprecedented levels towards the end of last year. This suggests that the increases in housing supply in the coming months are likely to contain price growth in the state.

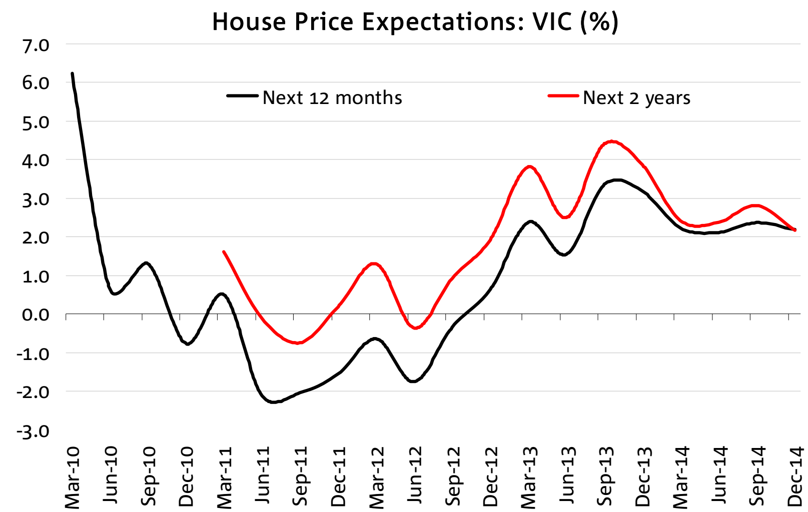
- Based on NAB's Residential Property Survey for the December quarter 2014, respondents consisting of mainly industry professionals: real estate agents, property developers and asset/fund managers, as well as market participants of owners and investors expect Victorian housing prices to slow to 2.2% in the next 1-2 years (down from 2.4% and 2.8% respectively). However, they are more optimistic about rent growth, expecting it to rise by 1.4% next year (1.2% in Q3) and 2% in the year after (1.4% in Q3). In terms of our own forecasts, NAB expects property prices in Melbourne to average growth of 2.7% and 2.3% in 2015 and 2016 respectively.

Victorian housing approvals have soared in recent months



Source: ABS

Housing sector professionals and participants lowered their price expectations for the coming months



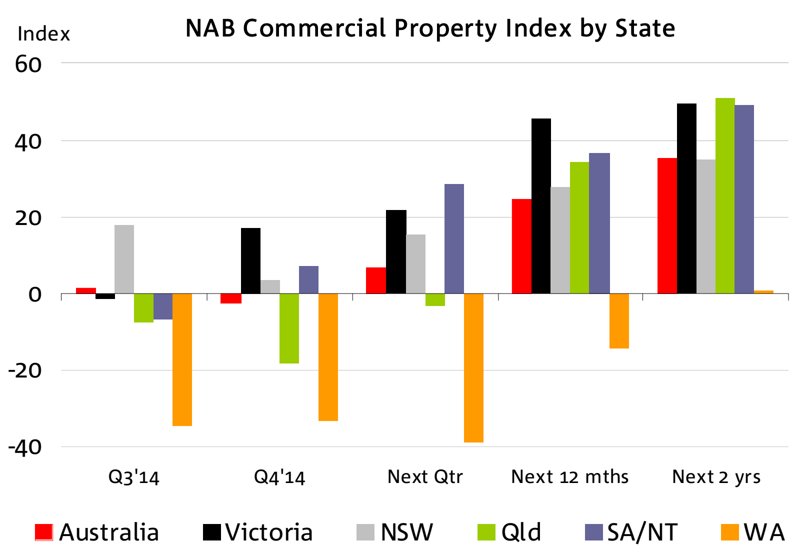
Source : NAB Group Economics

State Details: Victorian commercial property sector

- In terms of non-dwelling building investment, the most recent NAB Commercial Property Survey suggested that sentiment in Victoria improved markedly in the final quarter of 2014 to be the most optimistic amongst mainland states, and is expected to outperform other states' in a year's time as well.

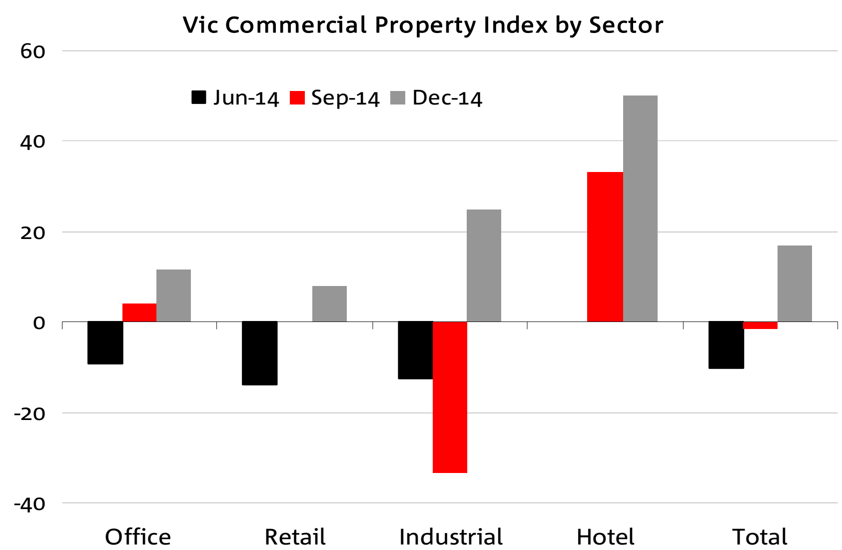
- By sector, the December quarter's results reflect buoyancy of confidence in the industrial and hotel properties, with the supply of the former having been constrained for some time and its vacancy rate expected to fall. The rebalancing of domestic activity towards business services from mining also saw confidence rising for office and retail spaces, meanwhile a strong pick-up in retail activity since mid-2013 in Victoria is also reviving interest in retail properties.

Victorian commercial property outlook most optimistic among mainland states



Source: NAB Group Economics

Industrial and hotel properties driving Victorian commercial property confidence

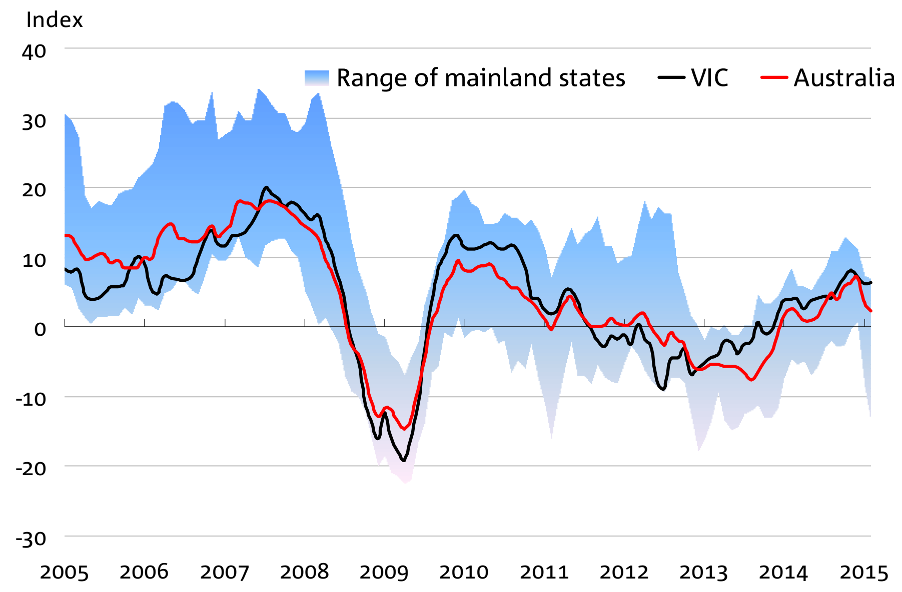


Source: NAB Group Economics

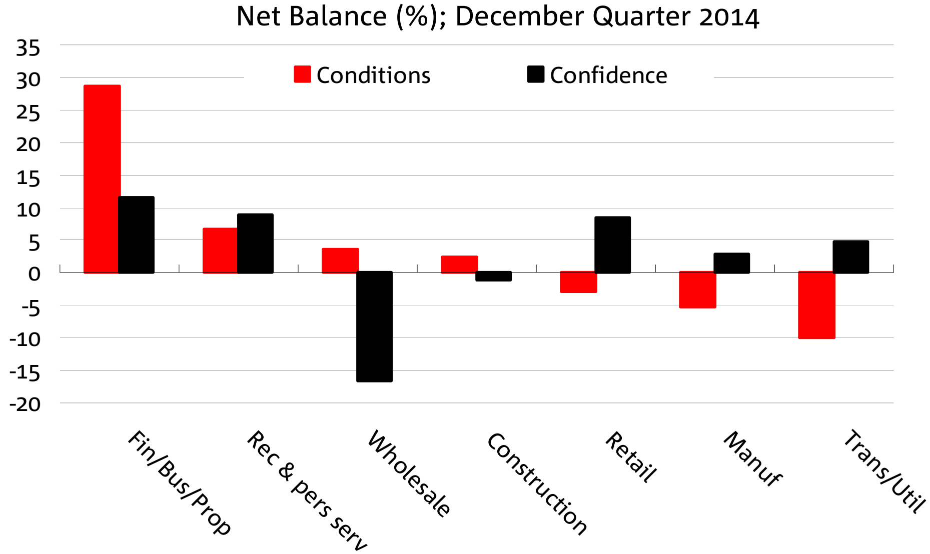
State Details: Vic Business Survey

- Results from the NAB Business Survey show that while Victorian business conditions have tracked slightly above national average most of the time since early 2013, Victorian businesses are generally less optimistic for the next three months than their interstate counterparts.
- According to the results for the December quarter, business conditions were reported to be stronger in the services sector of finance, business and property, recreation and personal services and wholesale businesses. Confidence for the next three months is less rosy for these businesses, with wholesale reporting the weakest confidence presumably reflecting a significantly softer AUD which ramps up import costs.
- Conversely, retail, manufacturing as well as transport and utilities businesses report lacklustre conditions, but are more optimistic about the next three months. The finance, business and property sector in particular reports confidence at +11.6 (seasonally adjusted), reflecting the buoyancy in housing market activity since late 2013.

Victorian business conditions relative to state spread



Victorian business conditions and confidence by industry



State Details: State finances and infrastructure projects

- The *2014-15 Victorian Budget Update* released by the then newly elected Labor government in December 2014 continued to forecast strong budget surpluses over the forecast period, with surplus in 2014-15 tipped to reach $1.1 billion, before increasing to $2.4 billion by 2017-18. These results are on balance slightly weaker (apart from 2014-15 surplus which experienced at $49m upgrade) than the forecasts in the *2014-15 Budget* under the Liberal Government and the Pre-Election Budget Update.
- The results primarily reflect the deferral of Commonwealth co-payments to the East West Link (which is intended to be scrapped by the Labor Government) and additional allocation of funding to prison and youth justice beds, First Home Owner Grants, and a reduction in projected GST revenue.
- While Victoria's fiscal position is strong compared to a number of other states and is not under immediate threat for its triple-A rating to downgraded, there are a number of risks to the outlook. The most prominent one being the Labor's government's election commitment not to proceed with the East-West Link project which could potentially involve a sizeable amount of compensation to the consortium estimated at around AUD1bn. Secondly, the increased volatility in Goods and Services Tax (GST) allocation to states, based on the shares determined by the federal body of Commonwealth Grants Commission (CGC), in the wake of sharp falls in commodity prices in recent months.

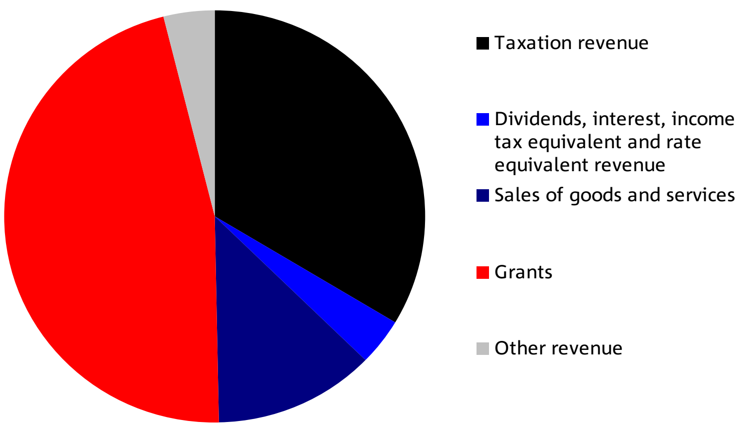
Infrastructure investment

- The *2014-15 Victorian Budget Update* saw the newly elected Labor government back away from the East West Link project but maintain its key asset election commitments to fund the removal of 50 level crossings, the Melbourne Metro Rail and West Gate Distributor projects. So far an additional $166m have been allocated to these priorities in 2014-2015, but additional funding are likely to be allocated once there is more clarity around how the Commonwealth funding earmarked for the East West Link could be reallocated for the state government's new infrastructure priorities as discussions with the Commonwealth government continue.

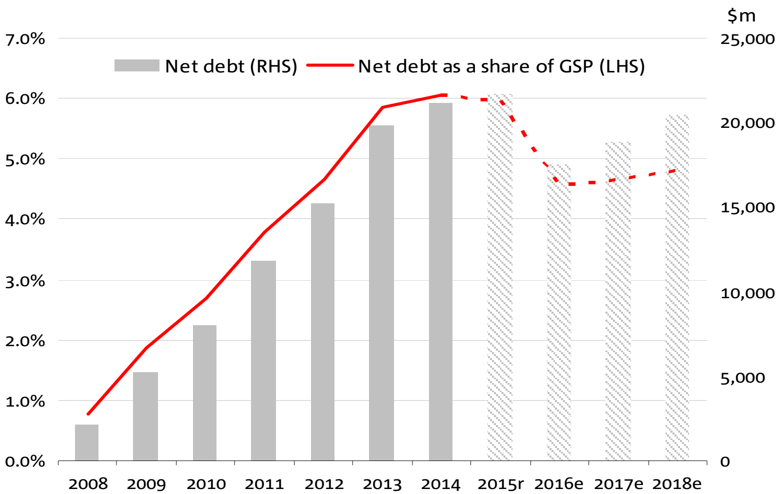
Net debt

- As a result of additional funding commitments for previously unfunded prison and youth justice beds, lower GST revenue and a lower projected nominal GSP, net debt as a percentage of GSP is projected to peak at a higher level than the *2014 Pre-Election Budget Update*.

Victorian government revenue by source



Net debt level and net debt as a share of GSP as at 30 June - state of Vic



Victoria – Budget and issuance update

Capital city	Melbourne
Government	Labor Party
Next election	November 2018
Rating and outlook	Moody's Aaa/Stable S&P AAA/Stable
Website	www.vic.gov.au

- **Budget position**. The newly elected Victorian Labor Government is focused on maintaining an operating surplus (while still funding election commitments), maintaining AAA credit rating and keeping debt levels low. The slight downgrade in forecast operating surplus provided in the MYBR reflects unfunded expenditure associated with expansion of Victoria's prison and lower GST revenue. The Government has begun early implementation of policy initiatives made at the November 2014 election but these are funded through reprioritisation of existing funding and the release of discretionary contingencies. The Government is not proceeding with the East West Link (a policy decision of the previous Government).
- **Credit rating** Victoria has a AAA credit rating with stable outlook from both Moody's and S&P. The stable outlook reflects the view that Victoria will continue to demonstrate fiscal discipline and success in executing its financial strategy.
- **Issuance profile** TCV's funding program has not changed from that announced after the release of the 2014-15 budget. There may be some tweaking following the decision not to proceed with the East West Link but essentially TCV plans to issue AUD5.7bn in 2014-15 of which AUD3.3bn is new money. The big impact to TCV's funding is in 2015-16 given the privatisation of Port of Melbourne.

Victorian General Government operating balance

$ millions	2013-14	2014-15	2015-16	2016-17	2017-18
FY13-14	225	399	1,928	2,547	
FY14 MYBR	222	911	2,052	2,719	
FY15	935	1,327	3,030	3,183	3,330
FY15 MYBR		1,142	2,198	2,414	2,444

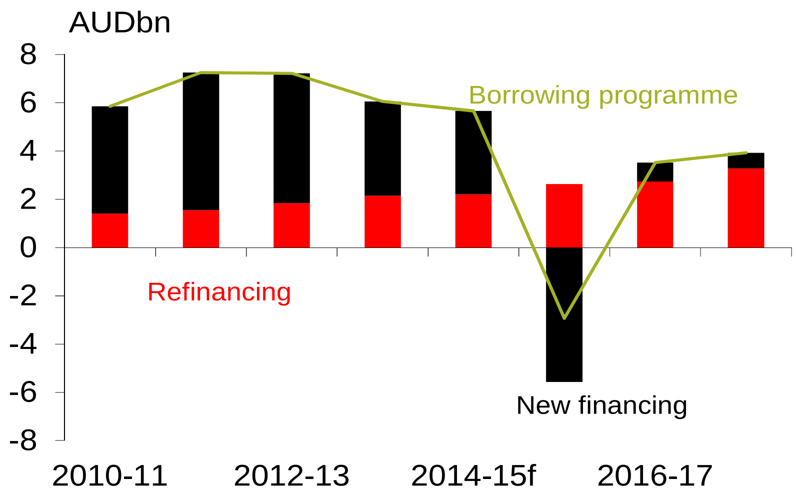
Source: Victorian budget papers

Victorian Non-financial Public Sector net debt

$ billions	2013-14	2014-15	2015-16	2016-17	2017-18
FY13-14	39	42	42	41	
FY14 MYBR	39	41	41	40	
FY15	37	40	35	36	37
FY15 MYBR		38	34	35	37

Source: Victorian budget papers

TCV borrowing program

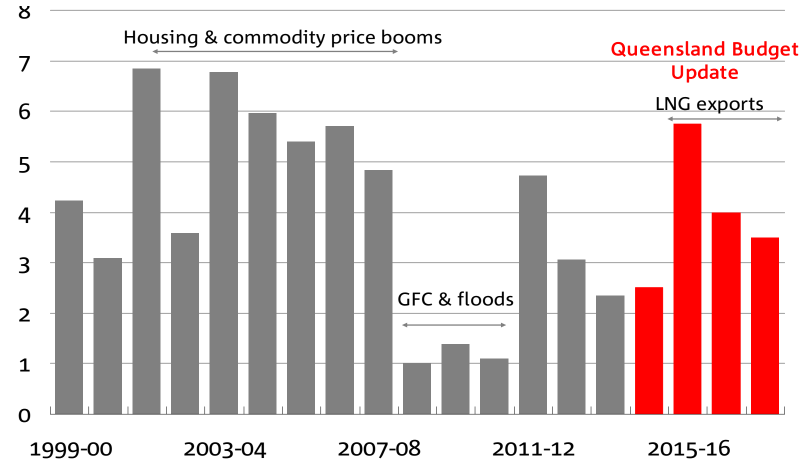


Source: TCV

State Details: Queensland

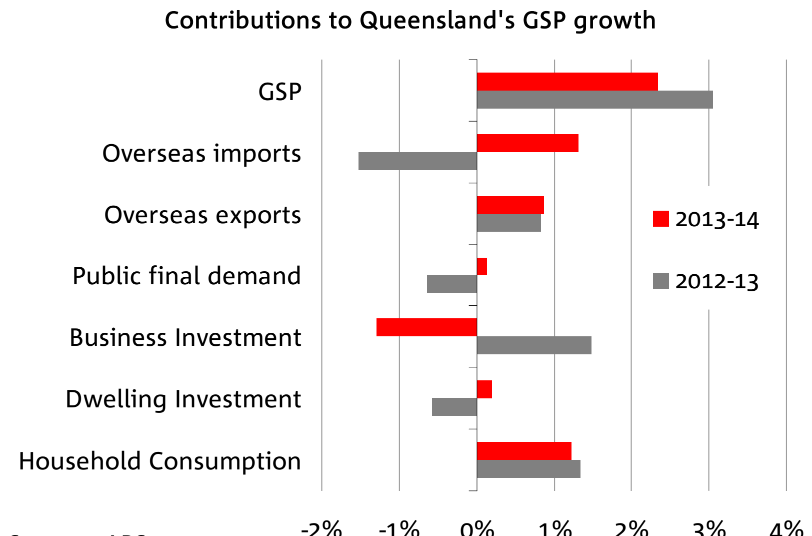
- Strong business investment has driven Queensland's superior economic growth over the past few years, but the level of investment has begun to decline and Queensland's economy is now facing a period of transition. As the large liquefied natural gas (LNG) projects are nearing completion and move to the less labour intensive operations phase, economic and jobs growth is slowing down. In 2013-14, Queensland's economic growth slowed to 2.3% from 3.1% in 2012-13, slightly below the national average of 2.5%. The ramp-up of LNG exports will continue to drive Queensland's economic growth in the next few years while household consumption and dwelling investment recover to long-run average levels.
- A number of coal projects were completed in 2013-14 and with the construction of three large scale LNG projects winding down, overall business investment in Queensland fell by 5.6% in the year, making it the biggest detractor to GSP growth. This also means fewer machinery and equipment imports, with imports falling by 7.2%, contributing 1.3% to the overall GSP growth. Household consumption also contributed 1.2% to overall growth while dwelling investment and public final demand started making small positive contributions.
- *Looking ahead, a strong contribution to GSP from net exports, as gas production ramps up, will help to drive stronger growth from 2015. However, the downturn in mining investment and commodity prices will continue to pose significant headwinds – keeping growth in state final demand (SFD) soft and the labour market weak. Public spending is also expected to be restrained to help reduce state debt, although we need to wait until the next budget to gauge the new Labor Government's strategy for improving the budget position. Lower interest rates and AUD depreciation will help the state economy transition through the end of the mining boom (with particular support for dwelling construction, as well as agricultural and tourism/education related service exports), but severe job shedding from the mining sector and a somewhat resilient (albeit slowing) population growth will see the unemployment rate hover around 6½%. Our forecast is for Queensland Gross State Product (GSP) growth to lift to around 2½% in 2014-15 before jumping to around 5½% in 2015-16 on the back of strong net exports. This is broadly consistent with the forecasts provided in the state budget.*

Real gross state product growth



Sources: ABS, Queensland 2014-15 Budget and Mid Year Fiscal and Economic Review

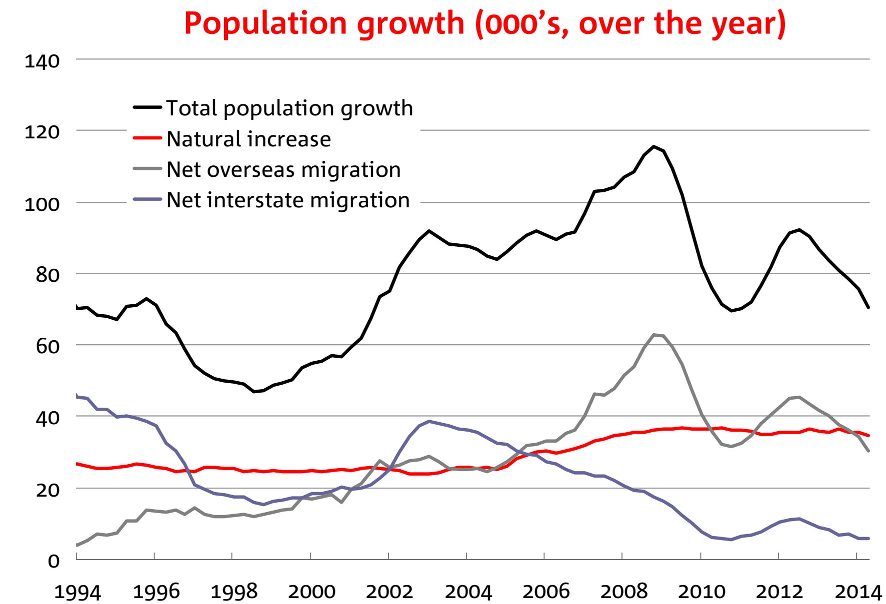
Contribution to GSP (%)



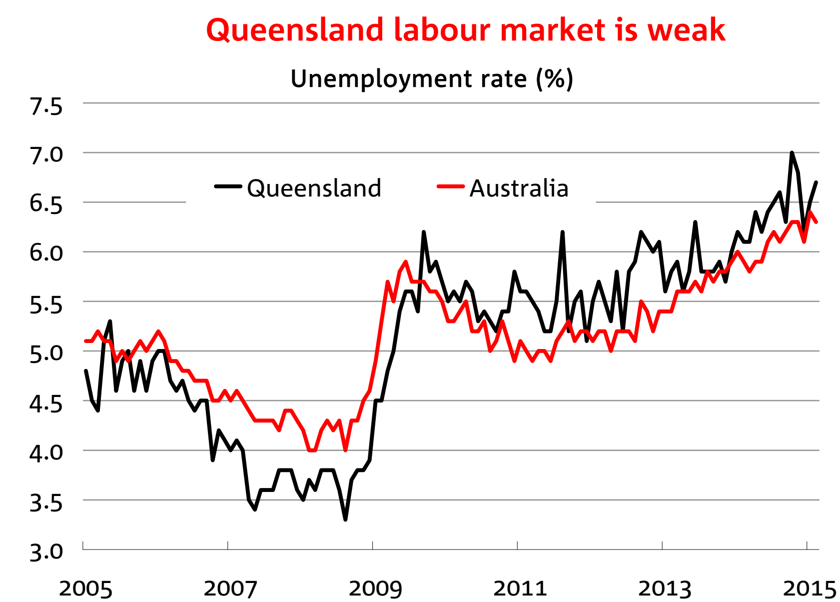
Sources: ABS

State Details: Qld population and labour market

- Population growth in Queensland has been trending lower since 2012, with lower inflows from both net interstate and overseas migration. It partly reflects a slowdown in the influx of workers in relation to the resources investment boom.
- Nationally, net overseas migration is forecast to increase gradually in 2014-15 by the Department of Immigration, however it is unclear what share of that will come to Queensland. A potential source of support to interstate migration moving forward is the relative affordability of property prices compared to Victoria and New South Wales. However, the number of employer sponsored visas will continue to decline, as the construction of large mining projects finish and lower commodity prices depress new investments. Overall, Queensland is unlikely to enjoy the unprecedented population growth it had in previous years.
- Population growth has been slowing and employment has not kept up in pace. Queensland's unemployment rate has been creeping up, as the ending of the mining investment boom coincides with fiscal consolidation at the state and federal levels which resulted in job losses in mining and related construction and engineering services as well as public administration. Proposed federal funding cuts are likely to impact Queensland's first and fifth largest employing industries, health and education, while the third largest employer construction faces an ever depleting pipeline of mining investment – although increased activity in dwelling construction will help to offset. Other large employers including retail trade and hospitality are still battling with cautious consumers and sluggish spending. Overall, labour market conditions will remain subdued until business investment picks up and household consumption improves.



Source: ABS

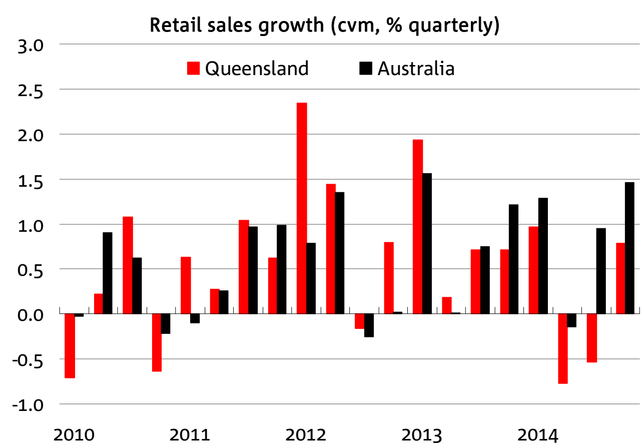


Source: ABS 6202.0

State Details: Qld consumer sentiment and spending

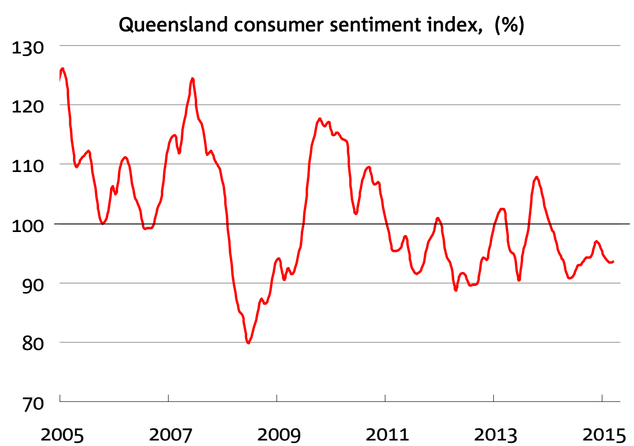
- Soft population and employment growth has been reflected in consumer spending over much of 2014. Household consumption growth softened around mid-year, as income growth was constrained by weak labour market conditions and a falling terms of trade. Growth in retail sales volumes, a partial indicator of movements in household consumption, also lagged behind that of Australia for six consecutive quarters – despite a pick-up in Q4 2014. Consumer sentiment is up from last years lows, but remains subdued. This is despite rising property and share prices adding to household wealth, as well as relief to some household finances from the recent cut to interest rates and lower oil prices.
- NAB's own measure of consumer anxiety is also elevated, and Queensland consumers appear to be second most anxious among states. Queensland consumers are among the most concerned over cost of living, job security and ability to fund retirement, but are less anxious over health relative to most other states. However consumers seem to be taking these concerns in their stride, with individuals' spending behaviour painting a more mixed picture. Consumers have been holding back on discretionary spending to concentrate on essential items, but since Q4 2014 respondents reporting an inclination towards spending more on discretionary items has increased (but is still soft), particularly in the areas of personal goods, charity and major household items (Chart).
- *Looking ahead, oil prices are expected to remain at relatively low levels, which along with low interest rates, should provide a boost to the household budget. However, with slower population growth and still weak employment market, the recovery in household consumption will be gradual. The unemployment rate is forecast to stay elevated close to 6½%, before showing some improvement in 2016/17 (worse than the state treasury forecast of 5¼-5½%).*

Retail sales growth trailing national average



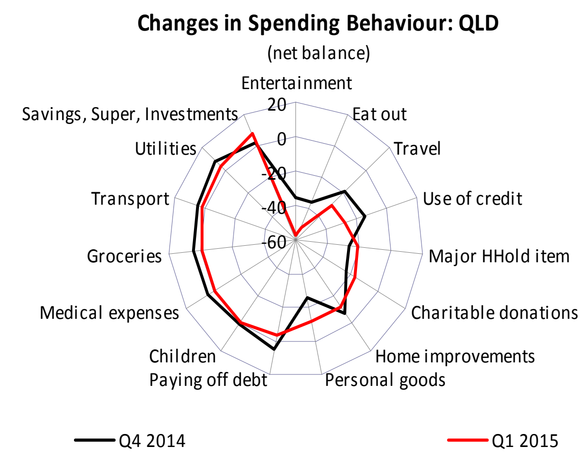
Sources: ABS 8501.0

Consumer sentiment weak



Source: Datastream

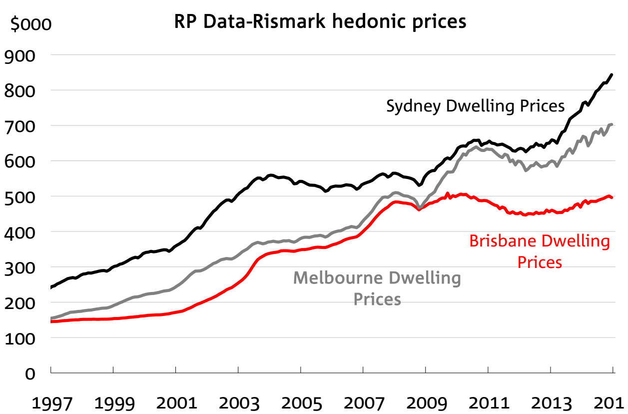
Positive signals from discretionary spending



State Details: Qld residential property sector

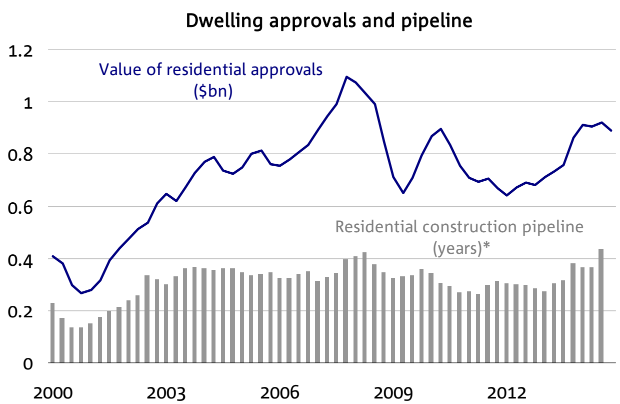
- In 2013-14, dwelling investment grew by 4.5%, after six consecutive years of decline. The low interest rate environment and relative affordability of Brisbane housing compared to Sydney and Melbourne will likely see investment in dwelling improve further. With the large scale mining projects nearing completion, wage pressure in the construction industry may also come down, which could assist residential activity.
- Residential construction activity is already responding to the return of prices to their previous peaks. Building approvals have held up at elevated levels, pushing up the pipeline of work to close to a 6-month volume at current rates of construction. Construction activity has been strongest in the medium and high-density segments. However, an expectation for more subdued population growth will be a constraining factor.
- *Looking forward, the NAB Residential Property Survey suggests some mixed demand signals in Q4 across buyer types – both overseas and resident investors and owner occupiers eased, while FHB (first home buyers) owner occupiers lifted despite wide-held concerns over affordability for this segment. In terms of market fundamentals, relative affordability compared to other big eastern markets will be favourable for Brisbane prices, but slowing mining investment and elevated unemployment will have significant implications for markets in certain areas. Low interest rates, a falling AUD (assist foreign affordability) and a medium-term economic improvement indicate ongoing positive growth. NAB is forecasting Brisbane residential property prices to rise further, albeit at a softer pace (5.7% over 2015 and 3.8% over 2016), helping to underpin solid residential construction activity ahead.*

Property prices on the rise, but less than other cities



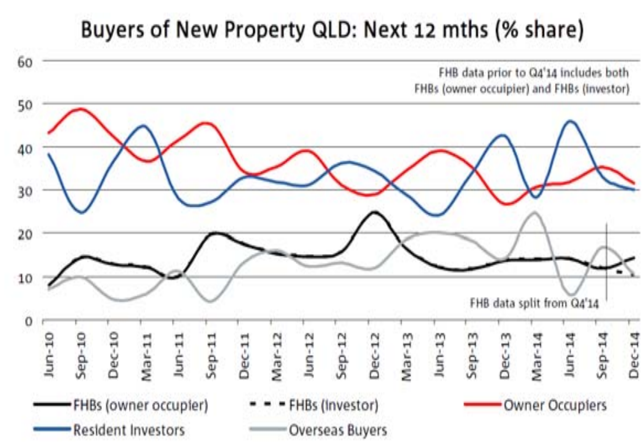
Sources: RP Data-Rismark

Residential construction responding to stronger market conditions



* Ratio of work-yet-to-be-done to annualised work done
Source: ABS; NAB

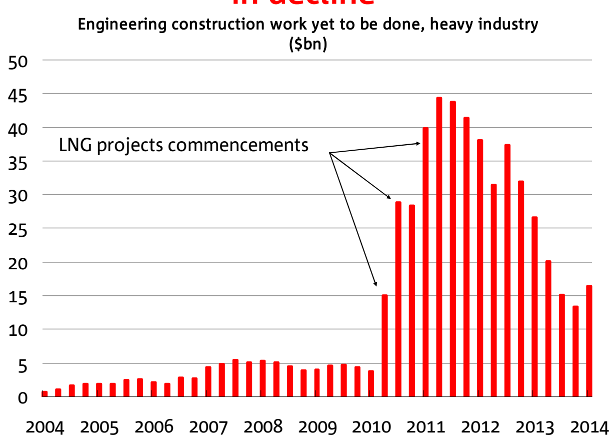
Qld residential property sector



State Details: Qld business investment

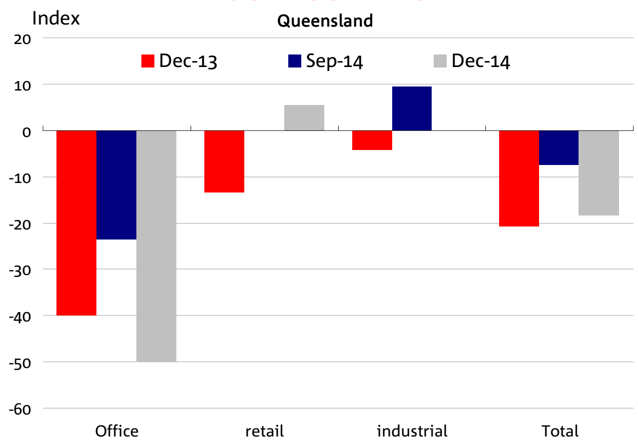
- Queensland has enjoyed unprecedented levels of business investment, as a result of high commodity prices, the building of new mines and especially the construction of three large LNG projects. The combined capital expenditure of these LNG projects exceeds $60 billion, resulting in total non-dwelling construction more than doubling over the three years to 2012-13. Business investment grew annually by 22.0%, 38.5% and 6.6% respectively in the three years to 2012-13 contributed half of Queensland's total GSP growth in 2012-13.
- However, with many coal projects completed and construction of the major LNG projects coming to a close, business investment dropped by 5.6% in 2013-14, detracting 1.3% from total economic growth. Lower commodity prices also mean no significant new projects have commenced elsewhere in the resources sector. As a result, mining investment will continue to fall. Non-mining investment will lift slowly, but subdued levels of capacity utilisation and non-residential approvals suggest this will not prevent further falls in near term investment.
- Data from the quarterly NAB Business Survey shows firms' capital expenditure intention for the next 12 months is showing signs of improvement. The sustained low interest rate environment and lower Australian dollar will prove favourable to some sectors including retail and tourism, however the lower commodity prices will keep mining investment depressed for some time yet. As a result, the recovery in business investment will be slow to come.
- In terms of non-dwelling building investment, the most recent NAB Commercial Property Survey suggested that sentiment in Queensland deteriorated in the final quarter of 2014. This was particularly apparent in the office sector, which deteriorated sharply, while industrial softened also. In contrast, retail actually saw some improvement – consistent with lower reported vacancy rates in retail and positive confidence among retailers (see below).
- This is broadly reflected in firms reported intentions for upcoming developments. The number of developers in Queensland planning to start new developments in the industrial sector dropped in Q4. In contrast, the shift to positive sentiment by retail developers has coincided with a ramping up of plans to start new developments. For offices, commencement intentions lifted slightly in Q4, despite a drop in sentiment, and is higher than a year earlier.

Pipeline of Qld mining investment in decline



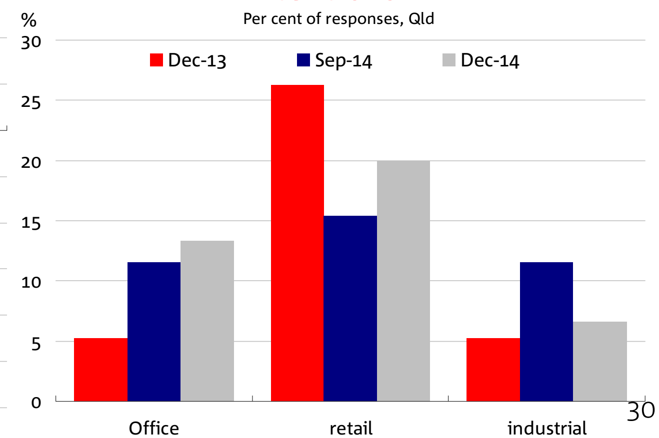
Source: ABS 8762.0

NAB Commercial Property Index - Sentiment



Source: NAB Economics

Development Commencement Intentions

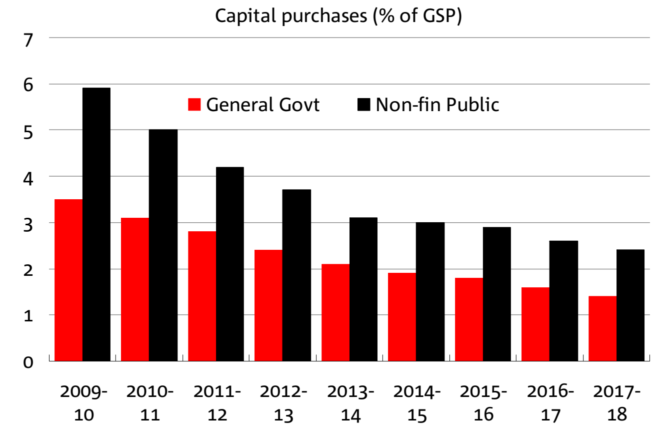


Source: NAB Economics

State Details: Qld commodities and public sector

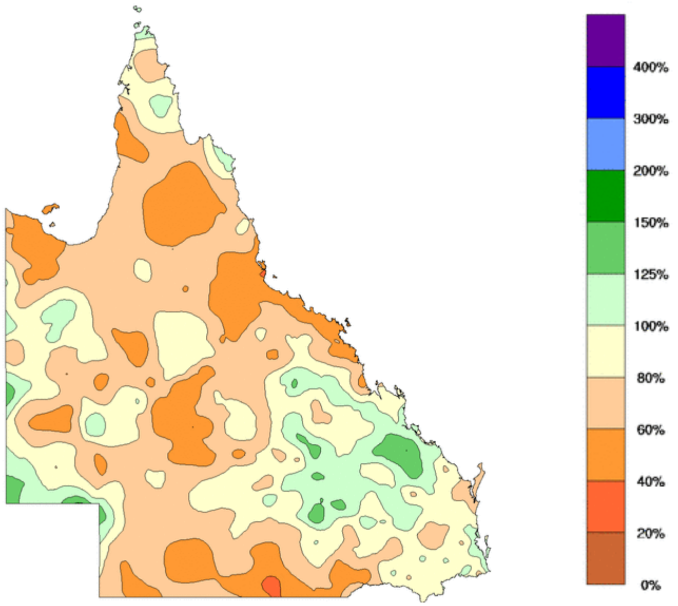
- As a result of state and federal fiscal tightening, real public final demand (the sum of federal, state and local government consumption and investment) was forecast to decline over the three years to 2015-16, before returning to modest growth in subsequent years. Note that these numbers are based on the previous government policies. Potential changes to the asset recycling strategy could potentially see the profile of public demand change considerably.
- Having endured drought conditions for much of 2014, large parts of Queensland, with the notable exception of Cape York, enjoyed decent rainfall in December 2014 and January 2015. February and March rainfall has been more disappointing however, and parts of Queensland (particularly western Queensland) remain in drought. While The Bureau of Meteorology's rainfall outlook for April to June 2015 forecasts above average rainfall much of the state, it may be too late for an adequate finish to the wet season.
- Cattle prices jumped in early January in response to rainfall but began to ease in February as dryer conditions returned. While prices remain at elevated levels compared to last year, they remain under pressure from mixed rainfall conditions. Overall, drought conditions remain an ongoing risk in Q2 2015 and beyond.
- In 2013-14, Queensland's saleable coal production reached 226 million tonnes, up 9.5% from the previous year. Export volumes were 206 million tonnes, up 14.5%. However due to lower prices, total export values were only up 6.2%, to be AUD $25 billion. The declines in coking coal prices seem to have stabilised somewhat while thermal coal prices continue to fall. Prices are expected to remain subdued as weaker-than-expected global growth and China's efforts to address pollution will keep demand growth soft.
- BG Group's QCLNG has shipped its first cargo of LNG to Asia in January, with the other two projects GLNG and APLNG starting shipping later this year. The prices for LNG exports are likely to be lower than expected, lowering company profits and taxation revenues for the government. The LNG prices are linked to oil prices, which have declined to six-year lows. Most of the exports are headed to Japan and the Japan LNG price has fallen to USD $13.4/mmbtu in February 2015 from $16.1 in June 2014. With gas prices forecast to remain low, the prospect for new LNG projects is highly unlikely.

Public sector to reduce capital purchases



Source: MYFER

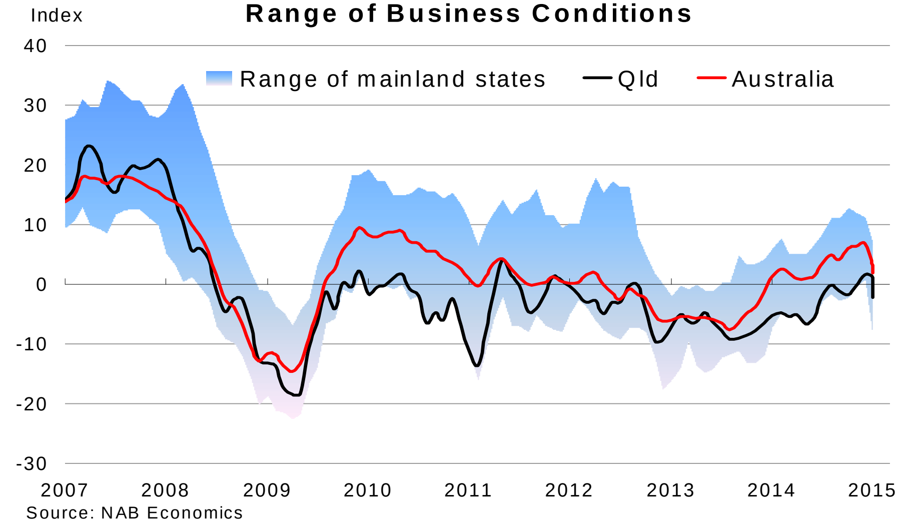
Qld rainfall (percentage of mean) 1 October 2014 to31 March 2015



State Details: Qld Business Survey

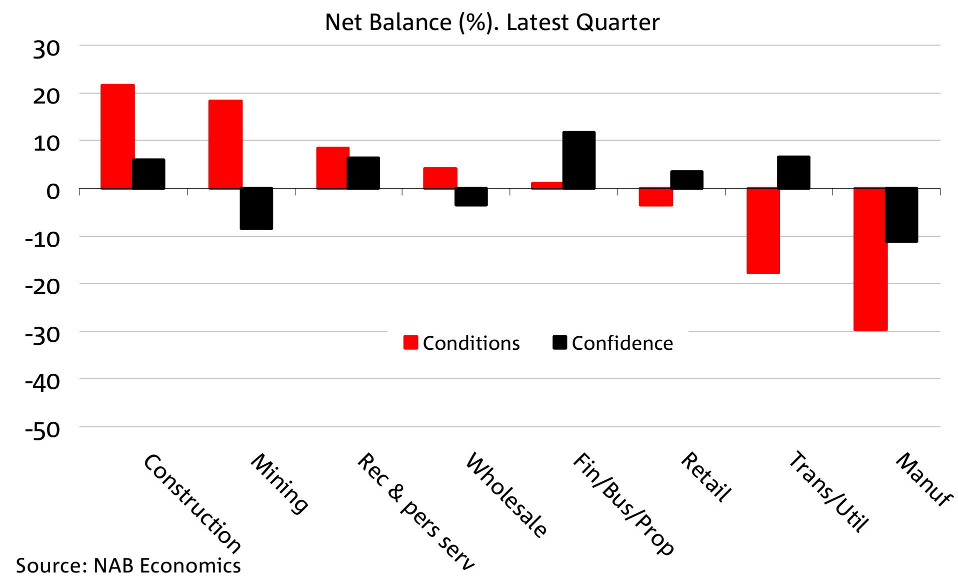
- The NAB Business Survey indicates business conditions in Queensland have been lagging behind the national average since the Global Financial Crisis, although the gap has been closing more recently. Prior to the GFC, businesses in Queensland reported strong conditions as the state enjoyed high commodity prices, rising house prices and household consumption. From early 2010, a series of natural disasters including floods and cyclones hit the state, which shut down mines and affected a wide range of businesses. Business conditions shifted back into positive territory in late 2014, assisted by AUD depreciation, a break in drought conditions, improving residential markets, and somewhat more stable coal prices.
- The December 2014 survey results show business conditions varied significantly across industries, while the variation in confidence was marginally lower. Conditions were particularly positive in construction and (surprisingly) mining, which likely reflects solid residential construction activity, AUD depreciation and the commencement of production from completed mining projects. In contrast, manufacturing remains the weakest industry (in both conditions and confidence) despite a boost to export competitiveness from AUD depreciation. Transport/utilities is also weak, but lower energy prices may be supporting confidence in the industry.

QLD business condition relative to state spread



Source: NAB Economics

QLD business conditions and confidence by industry



Source: NAB Economics

Queensland– Budget and issuance update

Capital city	Brisbane
Government	Labor Party
Next election	2018
Rating and outlook	Moody's Aa1/Negative S&P AA+/Stable
Website	www.qld.gov.au

- **Budget position** *Note that the budget numbers mentioned here are based on the previous Governments policies*. The mid-year budget review (MYBR) showed a small deterioration in the operating balance although debt levels were lowered due to expenditure control and a lower debt level for 2013-14. Back in 2012-13 a new fiscal strategy was implemented to control expenditure and improve the deficit and debt positions. Saving measures totalled AUD7.8bn over the 2012-13 to 2015-16 period. As the table opposite highlights the Government estimated a return to surplus in 2015-16 despite revenue sources expected to fall by AUD5.9bn. Note that these estimates did not include potential asset sales.
- A weaker outlook for coal (and gas) prices will have an impact on royalty revenue in Queensland. The budget assumptions for hard coking coal prices ($140, $150 & $156 per tonne over 2015-16, 2016-17 and 2017-18) are higher than NAB's forecasts ($120, $130 and $150), although this is largely offset by NAB's assumption of greater AUD depreciation.
- **Credit rating** S&P sees Queensland's budgetary performance as weak while the debt burden is forecast to peak at 156% of operating revenues in fiscal 2015 before declining due to improved operating balances and slower capital expenditure growth. S&P's estimate of Queensland's adjusted operating balance as % of adjusted operating revenues is well below that estimated using the budget numbers (see chart). The positive rating outlook reflects the view that the state's financial management would remain strong (in particular expense management) working to take the budget position back to surplus. Downward pressure on the rating would be seen if operating expenditure grew faster than operating revenues.
- **Issuance profile** QTC's funding program was reduced by AUD1bn following the MYBR (ie program reduced from AUD13bn to AUD12bn). QTC is around 75% through its 2014-15 funding program. Issuance fiscal year to date has been focused in Oct 15, Sep 17, Jul 23 bond lines.

Queensland General Government Operating Balance

$ millions	2013-14	2014-15	2015-16	2016-17	2017-18
FY13-14	-3,760	2,091	2,043	1,713	
FY14 MYBR	-3,769	1,910	2,026	1,474	
FY 14-15	-2,298	188	3,188	3,534	2,968
FY15 MYBR		-64	3,078	3,120	3,011

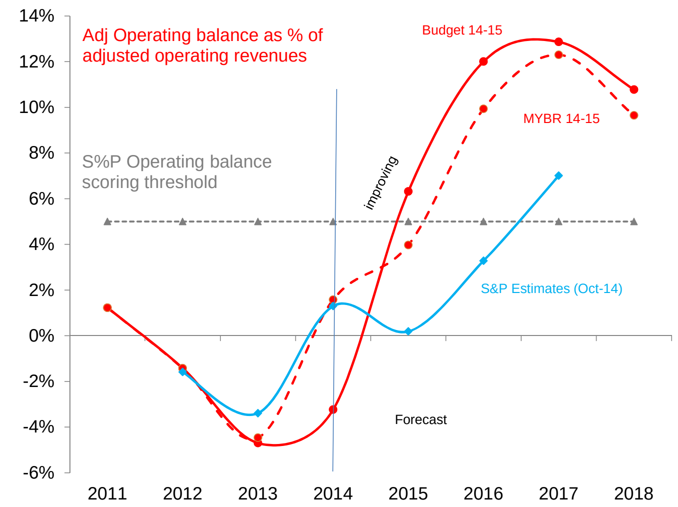
Source: Qld State Budgets papers

Queensland Non-financial Public Sector net debt

$ billion	2013-14	2014-15	2015-16	2016-17	2017-18
FY13-14	40	42	42	41	
FY14 MYBR	39	41	41	41	
FY14-15	38	42	42	41	41
FY15 MYBR		38	38	38	38

Source: Qld State Budgets papers

Queensland Non-financial Public Sector net debt



Further thoughts on QTC

- In its latest update on Queensland (released in October 2014) S&P focused on expenditure management, stating that a focus on this should lead to a stabilisation of the states high debt burden through the end of the forecast period. It suggested that ‘downward ratings pressure would occur if the state allowed operating expenditures to grow faster than its operating revenues, resulting in operating deficits and larger after-capital account deficits, further increasing its debt burden’.
- Based on the mid-year budget papers (which did not include proceeds from potential asset sales but is based on LNP policies) Queensland could be described as a solid AA credit rating. With the Queensland Labor Government now in power asset sales/leases are out of the question. This poses questions around how the state will repay its debt. We will have to wait till the new government hands down its budget (which is likely to be some months away) to see if the Labor Government is focused on the credit rating and will work on improving the budget position or not. Recall Queensland moved from AAA rating to AA+ in February 2009.
- Market pricing would suggest that the market is concerned about the later (and so potential risk of credit rating downgrade). The uncertainty around the incoming Queensland government and their policies has seen QTC bonds trade above WATC (both hold AA credit rating) on a zero coupon, maturity matched basis (see table). QTC longer dated paper is currently trading around 25bps above TCV paper and 21bps above NSWTC.
- In the current environment QTC 10y paper offers value when trading closer to 30bps over NSWTC and TCV. For the 5y maturity value is seen in the 15-20bps area – currently trading 13bps over NSWTC and 11bps over TCV. Near 10bps 3y QTC paper starts to offer value – currently 8.7bps above NSWTC and 6.2bps over TCV.
- Given how flat the curve is and risks around Queensland’s budget, for now we see value in moving out of QTC 20/22 paper and into 2018.

Zero coupon maturity matched analysis - as at 26th March 2015

	QTC vs NSWTcorp			QTC vs TCV			WATC vs QTC		
Period	**3y**	**5y**	**10y**	**3y**	**5y**	**10y**	**3y**	**5y**	**10y**
6 Month ago	1.0	5.3	14.4	6.1	7.5	17.1	3.8	2.0	5.6
3 Month ago	1.8	2.9	11.8	0.1	1.4	15.4	5.5	9.1	8.4
1 Month ago	9.1	14.1	23.9	9.8	13.7	28.7	-0.8	-5.0	-3.5
1 Week ago	8.2	12.6	22.1	8.6	13.7	27.7	1.4	-3.8	-5.5
Current	9.8	13.3	22.3	10.1	13.4	28.7	-0.5	-3.2	-6.5

State Details: South Australia

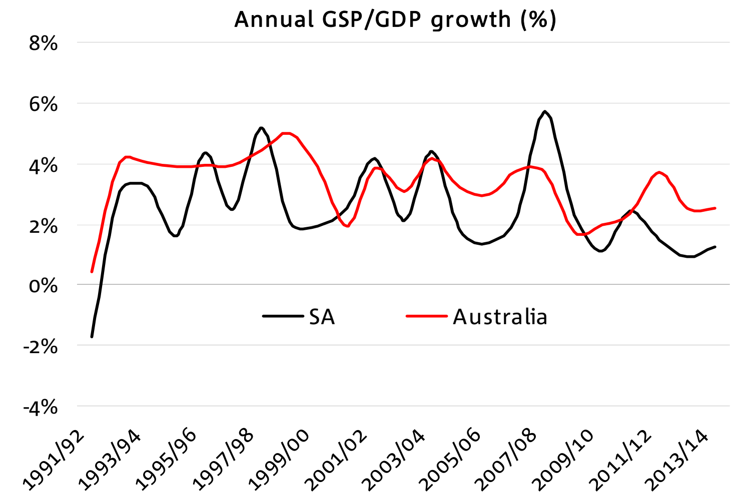
- The South Australian economy has consistently underperformed in recent years, failing to benefit significantly from the mining boom, while simultaneously lacking the right industry mix to weather the headwinds from an elevated AUD and rising input costs.

- Similar to the case of Victoria, the structural decline of the manufacturing sector is ongoing in South Australia but at a slower rate, with the pending exits by Holden and Toyota in 2017 expected to accelerate this trend. Food products, auto vehicles and their affiliated parts suppliers represent the top three employing sub-sectors in the manufacturing industry and the winding down of the latter two is likely to have a non-negligible job loss impact. The latest announcement by the federal government not to proceed with the legislation to cut the automotive transition scheme by $500 million before 2017 suggests that the easing in manufacturing activity could be more gradual than previously anticipated.

- Meanwhile, services and construction industries have grown in importance in their contribution to SA's economic activity and source of employment. The healthcare and social services sector overtook manufacturing as the largest industry by gross value added in 2008-09 and the largest employer in 2006-07. Other services sectors such as finance and insurance, as well as professional, scientific and technical services also rose in prominence since the early 2000s. By employment share, manufacturing (9%) is now currently ranked third behind healthcare and social services (16%) and retail trade (11%).

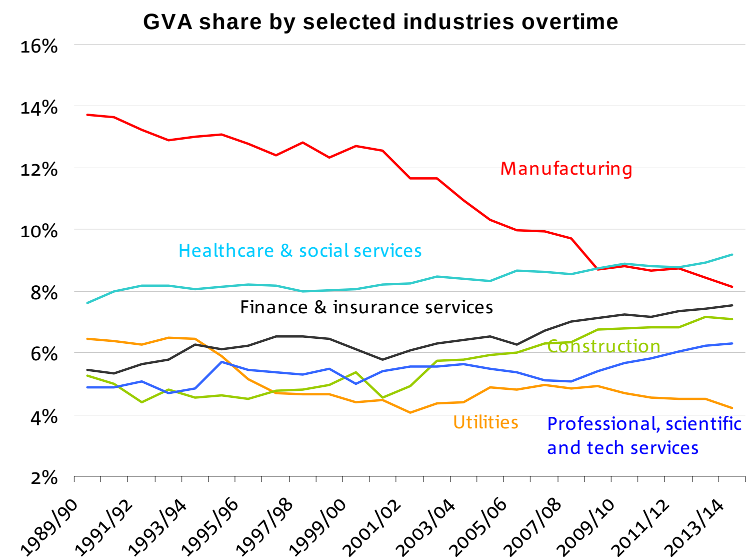
- *Reflecting the lack of economic momentum in the state, South Australia has the highest unemployment rate of any state or territory, with trend unemployment standing at 7% in February 2015, well above the national average of 6.3%. More worryingly, this is against a downward trend in labour force participation. We expect that GSP growth in SA will lift in 2014-15 to a sub-trend rate of around 1.6% -- from 1.3% in 2013-14. This is weaker than that forecast in the 2014-15 state mid-year budget review. Sub-trend growth and the contraction of the manufacturing industry will keep spare capacity and the unemployment rate elevated.*

South Australian GSP growth lacking momentum



Source: ABS

Healthcare and social services now the largest industry in SA



Source: ABS

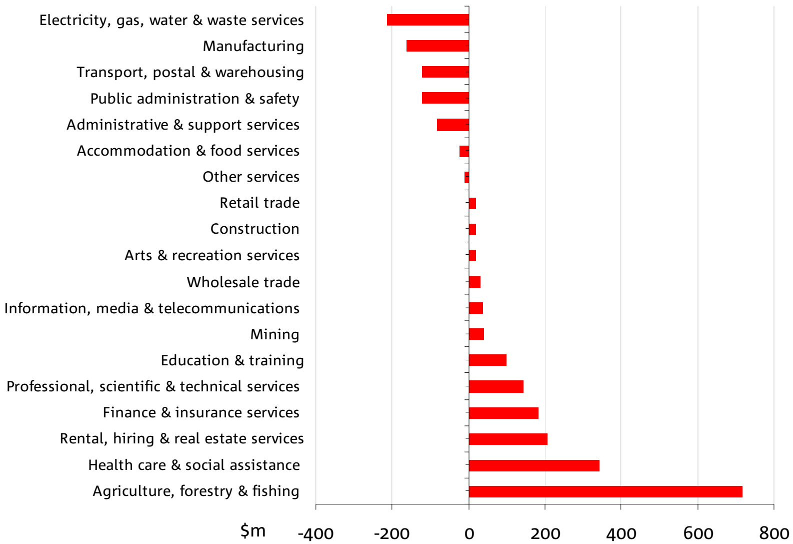
State Details: SA – further industry details

- South Australia's higher dependence on manufacturing has seen the state's economy come under pressure from an elevated AUD and long term structural decline of the sector. Car manufacturing in general, and Holden's operations at Elizabeth in particular, is in the process of winding down in advance of the end of local operations in 2017. With car manufacturing declining, the SA Government has sought to promote defence manufacturing, especially shipbuilding. The shipyards at Osborne in Adelaide's northern suburbs constructed the Collins Class submarine in the 1990s and early 2000s and currently see the assembly of three Hobart Class air warfare destroyers. Construction of the air warfare destroyers likely to be nearing completion in five years, and if no further major contracts are forthcoming, it is likely that shipbuilding activity will decline. The Australian Government's evaluation process for new submarines does not include a bidder proposing local construction for the vessels.

- SA also has a disproportionately large share of agriculture activity relative to national average, and its share has been on an upward trend since the early 2000s on the back of an Asian-led rise in demand for Australian agricultural commodity exports. SA agriculture is focussed on grain, although horticulture, beef, lamb, wool and dairy are also important. Wheat, which is by far the single biggest agricultural commodity in SA, has largely recovered from the millennium drought. A bumper wheat harvest in 2013-14 helped boost the agri sector to be the strongest industry contributor to growth (see top chart). While ABARES estimates SA wheat production to fall by 9.3% in 2014-15, it is still expected to be around 30% higher than the 10 year average to 2013-14. Against falling international wheat prices since the second half of 2014, we expect the falling AUD to provide some support to domestic prices for the coming season.

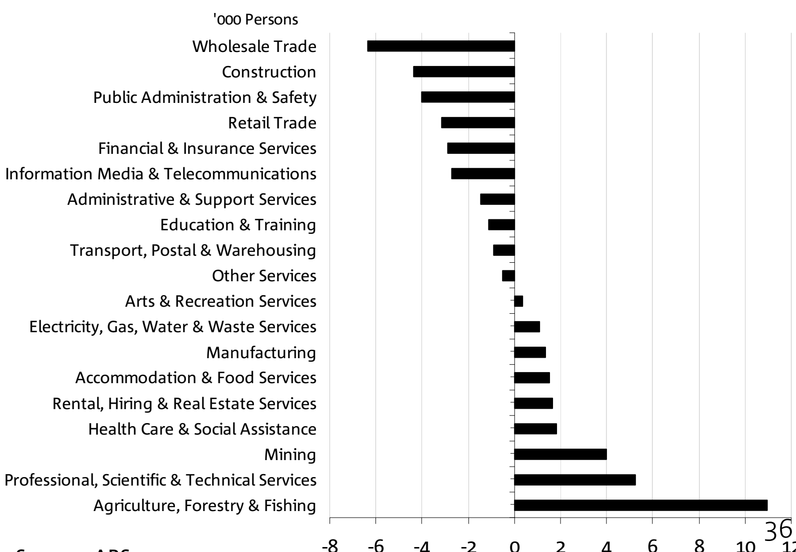
- Consistent with its position as the best performer by output, it also created the highest number of additional jobs compared to all industries in the year, notwithstanding a large share of them being part-time in nature. Reflecting the high-growth trajectory of the minerals mining industry, job growth in the sector is reasonably robust as well. On the contrary, the traction in construction and retail industries, which have been growing quite strongly in the past decade, appear to have lost some steam based on the high number of job cuts. Perhaps not surprisingly, wholesale trade shed the most positions in 2013-14 as manufacturing continues to shrink.

Growth in output level by industry in 2013-14 ($m)



Source: ABS

Growth in employment by industry in 2013-14 ('000 positions)



Source: ABS

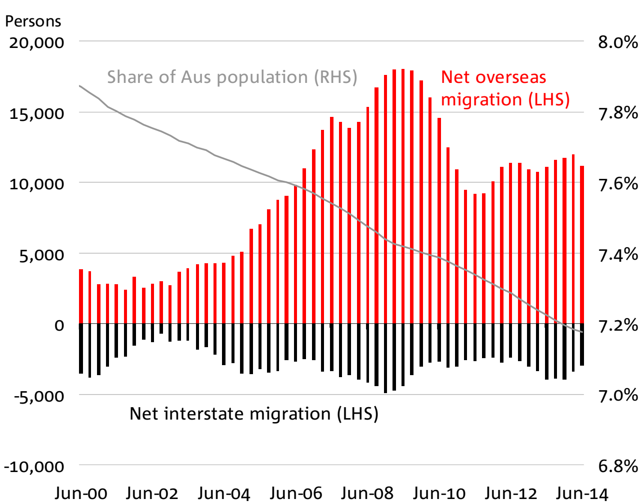
State Details: SA population and labour market

- Despite a reasonable pick-up in net overseas migration since mid-2000s that outweighs outflow of residents interstate, SA's population growth has consistently fallen below the national average for well over the past three decades. As a result, SA's share of Australian population has been on a irreversible decline since then, from accounting for close to 9% in the early 1980s to be slightly above 7% in 2014. And similar to Tasmania, its population is ageing, with relatively smaller shares of children and young adults, and significantly higher shares of adults above 50.

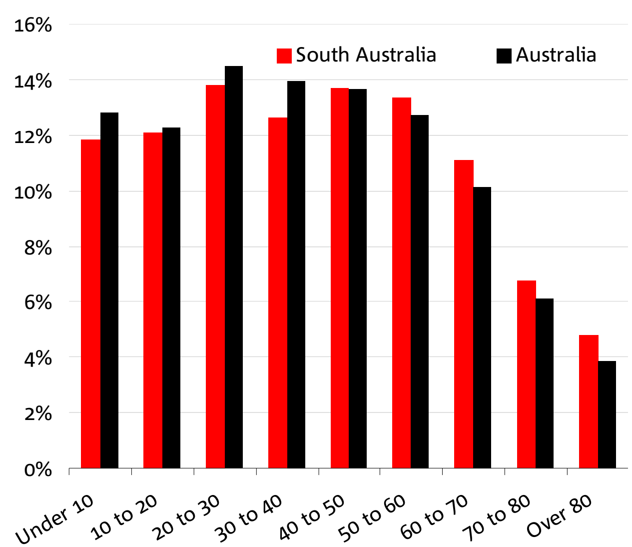
- This ageing profile mirrors the laborious transition of SA's industry mix dominated by traditional auto and food manufacturing industries to higher-value yielding high-tech manufacturing and services industries. The shift in focus by the SA state government to defence manufacturing is an attempt to leverage on the existing manufacturing infrastructure and skill base in SA, however the lumpy nature of these projects suggest that they are not easily sustainable and likely to introduce significant cyclical movements in the labour market.

- Reflecting an economy with weak industrial fundamentals and an ageing population, SA unemployment has been trending upwards since 2012, and worryingly, accompanied by a falling participation rate. This partly reflects the effect of the relatively higher share of baby boomers hitting retirement ages; as well as the lack of good-quality jobs for adults of productive ages, resulting in more and more discouraged workers leaving the workforce.

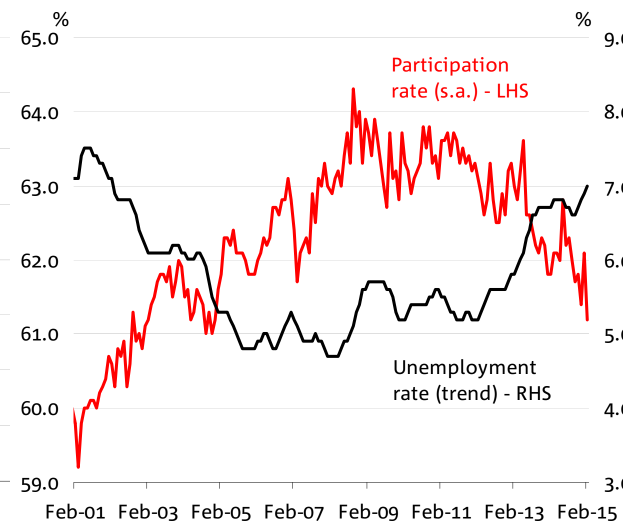
SA share of Aus population in a structural decline



SA population is ageing



Signs of discouraged job seekers on the rise



Source: ABS

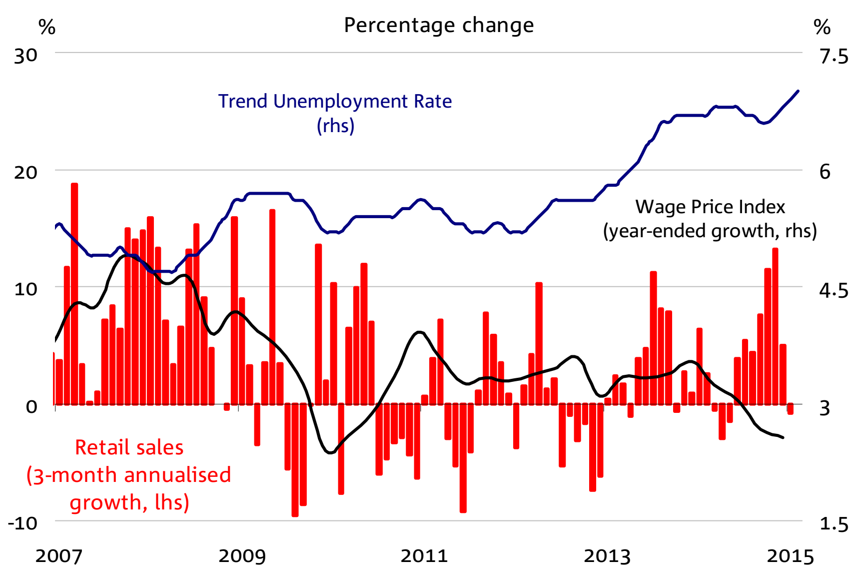
State Details: SA consumer spending behaviour and house prices

- Despite a deteriorating labour market marked by an upward trending unemployment rate and weakening wage growth, retail sales had been relatively resilient in the SA economy since 2013. This is predominantly due to a low base after retail turnover had largely stayed stagnant from early 2009 to mid-2013, before showing some signs of pick-up since then. However, the year-average growth in turnover of 3.4% for 2014 is significantly below the trend growth of around 6% in the five years before the GFC.

- Meanwhile, performance by the housing sector continues to be anaemic, with the average house prices in Adelaide being increasingly falling behind the national capital city average after a period of strong positive correlation for most of the 2000s. In 2014, house prices in Adelaide grew by 4% compared to the 9.8% recorded by the capital city average. That said, the falling ratio of dwellings to resident population suggests that supply-side fundamentals are tightening, and should act as a floor to prices going forward.

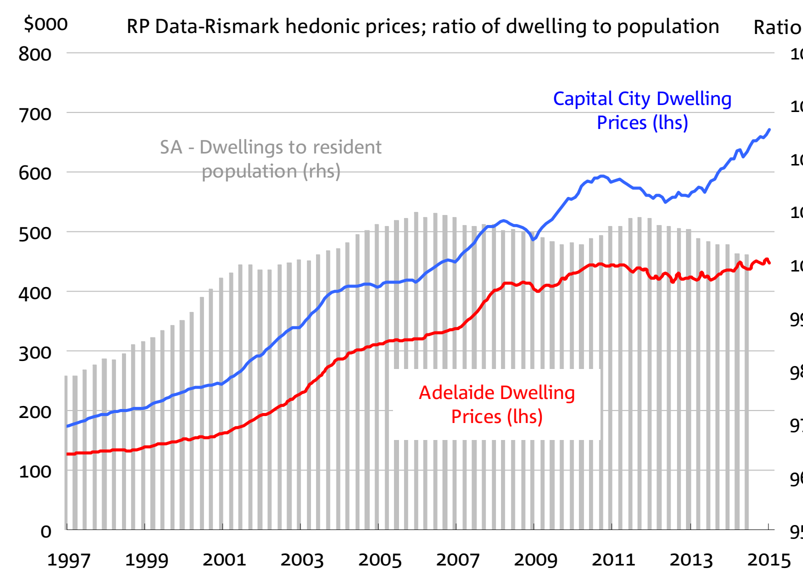
- ***In line with the expected slowing growth in housing markets across capital cities after a strong 2014, NAB forecasts Adelaide housing prices to rise by 2.1% and 2.2% in 2015 and 2016 respectively, compared to the capital-city average of 3.9% and 2.1% in the corresponding period.***

SA experiencing a tentative recovery in its retail sector despite soft labour market conditions



Source: ABS; NAB

Adelaide housing prices are increasingly lagging behind national average

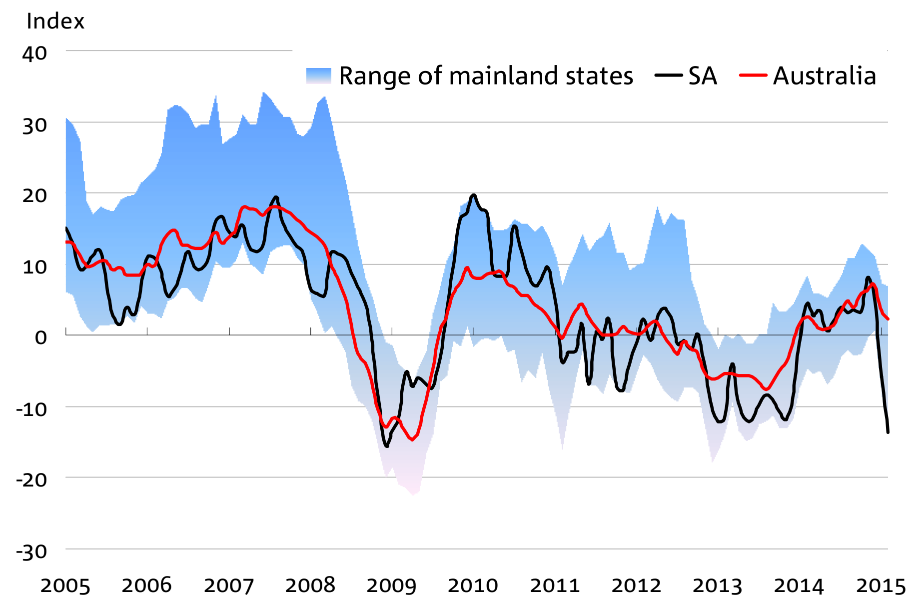


Sources: ABS; RP Data-Rismark

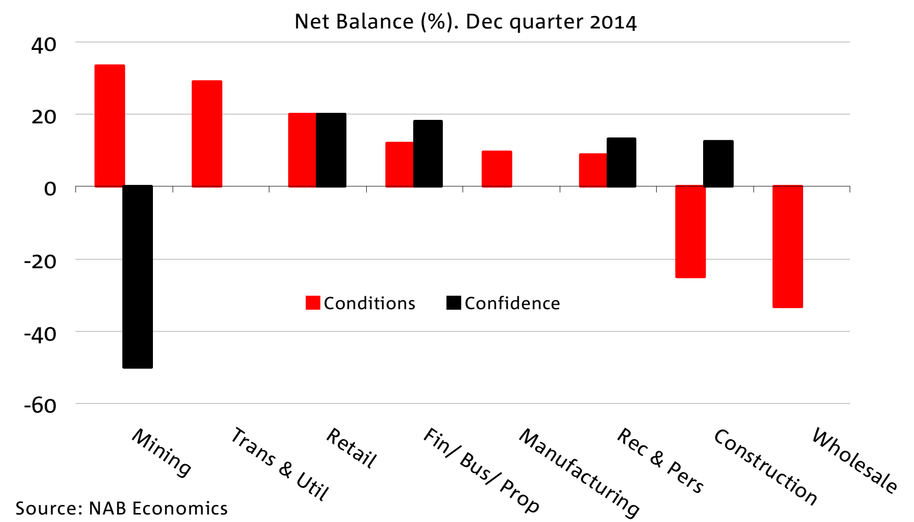
State Details: SA Business Survey

- As a testament to the lacklustre underlying industrial dynamics of the SA economy, NAB Business Survey shows that the overall monthly business conditions of the state has mostly underperformed against the national average since early 2011, and has deviated sharply from it in recent months to be the worst performing mainland state.
- Based on the results for the December quarter, business conditions were reported to be the strongest in mining, transport and utilities and retail, reaffirming the growing importance (albeit from a very low base) of the mining sector, improved retail spending, while cheaper oil prices have helped boost the transport and utilities sector by lowering input costs.
- Consistent with the employment data, poor conditions are reported by businesses in wholesale and construction, despite strong output contribution from the latter. The weak conditions in wholesale is a reflection of the spillovers from a contracting manufacturing sector, while a flat housing market is not providing much support to the construction pipeline.
- Meanwhile, confidence is soft for mining, transport & utilities as well as manufacturing. Sharply retreating commodity prices have contributed to a grim outlook for the mining sector, while long-term declining trends in the fundamentals for transport/utilities and manufacturing give businesses few reasons to be optimistic about the near-term future, despite positive current conditions.

SA business conditions relative to state spread



SA business conditions and confidence by industry



Source: NAB Economics

South Australia– Budget and issuance update

Capital city	Adelaide
Government	Labor Party
Next election	March 2018
Rating and outlook	Moody's Aa1/stable S&P AA/Stable
Website	www.sa.gov.au

- **Budget position** The South Australian mid year budget review (MYBR) showed a small improvement in 2014-15 budget position but a deterioration in 2015-16 and 2016-17 estimates. The net operating balance for 2014-15 is now forecast to be a $185 million in deficit, down from a forecast deficit of $479 million at *2014-15 Budget.* The primary driver of the lower deficit is was a payment of $852.9 million (not included in the above revenue write down) from the Motor Accident Commission (MAC) to the Highways Fund in December 2014. Combined with a delay in the Royal Adelaide Hospital project, the MAC payment allows the Government's fiscal targets to be met, including a net debt to revenue ratio below 35%.
- The State budget position is still forecast to be in surplus in 2015-16. The change in budget position in the outer years reflects a reduction in taxation revenue estimates, an increase in GST revenue grants and a reduction in Commonwealth Government grants. Note that net debt to revenue ratio is expected to remain below 35% across the forward estimates
- **Credit rating** South Australia has a credit rating of AA with stable outlook from Standard and Poor's and Aa1 stable outlook from Moody's. The AA rating reflects weak budgetary performance while it is seen to have a moderate debt burden. Reduction in debt levels is seen to come from improved operating balances, slower capital expenditure and a wind down of the state owned Motor Accident Commission (MAC). The stable outlook reflects the expectation that the state will achieve operating surpluses in the forward estimates.
- **Issuance profile** Following the MYBR SAFA revised its funding program lower by AUD200m (from AUD6bn to AUD5.8bn) reflecting lower client funding associated with the MAC return of capital. As at end 2014 SAFA had AUD1bn of funding left to complete. SAFA has around AUD500m bonds left to issue under its 2014-15 funding program.

South Australia General Government Operating balance

$ millions	2013-14	2014-15	2015-16	2016-17	2017-18
FY13-14	-748	-261	551	843	
FY14 MYBR	-955	-511	303	614	
FY 14-15	-1,232	-479	406	776	883
FY15 MYBR		-185	265	699	872

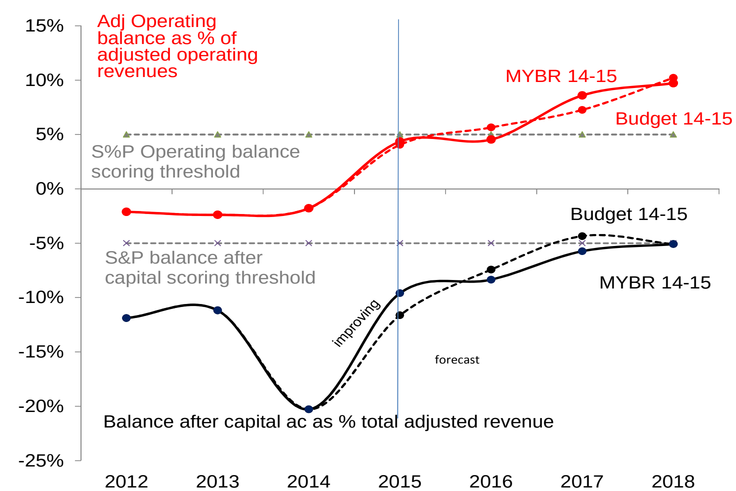
Source: SA State Budgets papers

South Australia Non-financial Public Sector net debt

$ billion	2013-14	2014-15	2015-16	2016-17	2017-18
FY13-14	11.1	11.3	13.7	13.1	
FY14 MYBR	10.8	11.1	13.7	13.1	
FY14-15	10.9	11.5	14.3	13.1	12.5
FY15 MYBR		10.8	11.0	13.2	12.7

Source: SA State Budgets papers

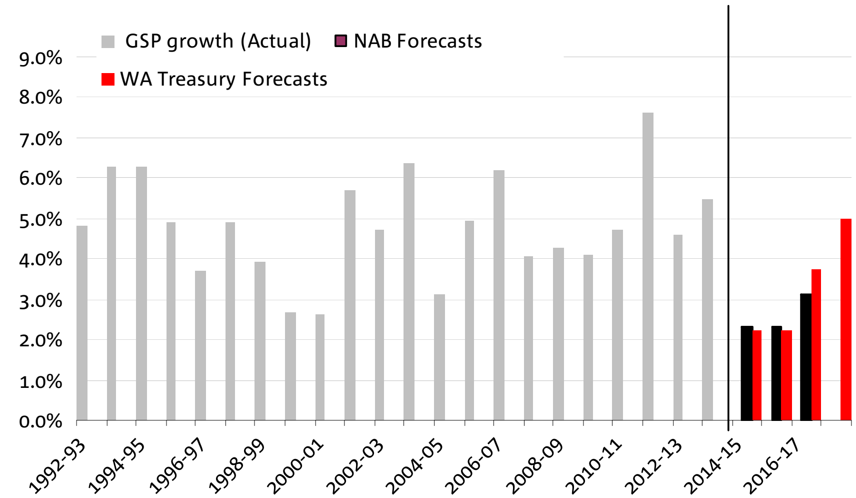
South Australia Budget Performance



State Details: Western Australia

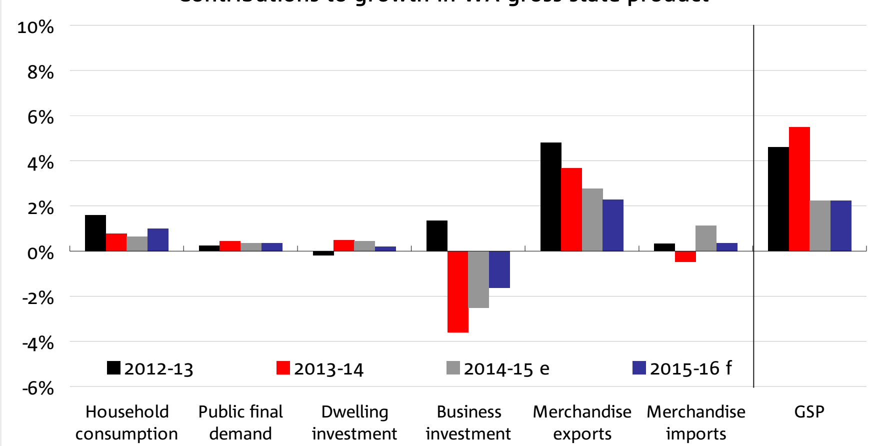
- Western Australia (WA) is the fourth largest state in Australia by population share (10%) but it has been punching above its weight in terms of contribution to GDP in the last decade on the back of a once-in-a-generation mining boom.
- WA's economic growth peaked in 2011-12 at 7.6%, driven largely by mining investment, before moderating to 5.5% in 2013-14. Despite a fall in growth rate, WA's share of Australia's GDP grew to the highest in history at 16.4%. It accounts for 43% of Australia's total exports and 47% of total goods exports. The top five exports from WA in 2013 were iron ore and concentrates (AUD 67.5bn), gold (AUD 13.4bn), natural gas (AUD 11.6bn), crude petroleum (AUD 8.4bn) and wheat (AUD 2.4bn).
- WA's mining-driven business investment peaked in 2011-12. Since then it entered into a transition from mining investments to production and exports which continued in 2014. The level of actual new mining capital expenditure remains resilient, only falling by a modest 0.4% in year average terms in 2014 relative to a year ago, largely driven by solid investments in buildings and structures.
- *While a surge in mineral production and exports from the newly completed projects will contribute to the state GSP growth over coming years, the fall in employment (from labour-intensive mine construction to less labour intensive operation) and lack of non-mining business investment are likely to constrain domestic demand and more than offset the positive impetus from exports. The sharp fall in iron ore prices towards the end of 2014 is also expected to put a material dent into the state government's coffers, which possibly limits public expenditure and consumption. Consequently, we expect GSP growth in WA to slow from over 5% in recent years, to around 2.3% in both 2014-15 and 2015-16, before an expected ramping-up in LNG exports in two years' time will lift growth rate closer to 3.3%. This is relative to the WA's Treasury forecasts of 2.25% for this financial year and next, followed by 3.75% in 2016-17. Correspondingly, the unemployment rate is expected to lift to an average of 5.6% in 2014-15 and 6.5% in 2015-16, but could be partly offset by some outward interstate migration.*

Real Gross State Product Growth



Source : ABS

Contribution to GSP (%)



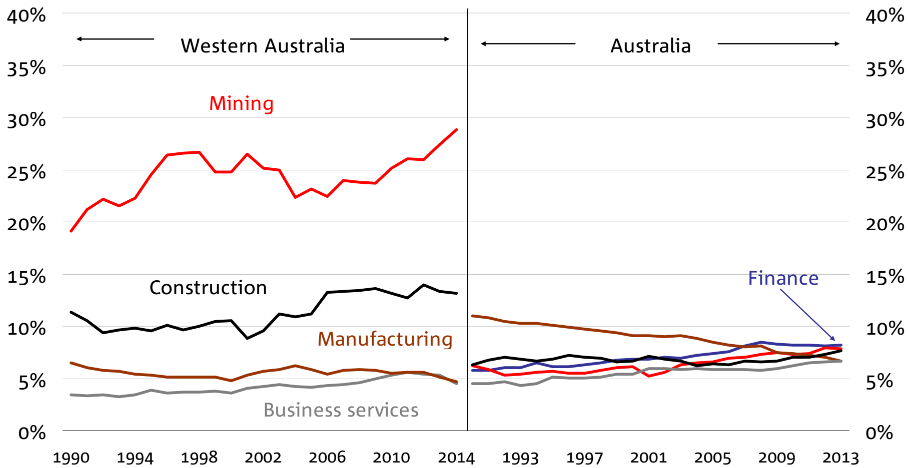
Note: 2014-15 are Western Australia 2014-15 Mid-Year Financial Projections Statement estimates

State Details: WA mining sector

- In line with the boom, the industry share of the mining sector in WA has risen steadily since mid-2000s, reaching a historical-high of 29% 2013-14. That compares to less than 10% for mining Australia-wide. The once-in-a-generation mining boom also drove growth in related industries including construction and manufacturing (through the downstream processing of minerals), bolstering construction's share of total economic output higher. Meanwhile manufacturing's share was held at a relatively steady level despite an overall shrinking manufacturing industry nationally.
- The level of mining capital expenditure has remained at more robust levels than anticipated in recent quarters, with the sharp slowdown associated "mining cliff" yet to materialise. This largely reflects a rapid running down of existing engineering construction pipeline, which is estimated to have fallen at a rate of a quarterly average of $4.3bn since December quarter 2012. If the current rate of depletion continues, the existing pipeline of engineering construction work is expected to be exhausted by September quarter this year. By then we can expect mining capital investment to decline at a more rapid rate. The steady falls in commodity prices over 2014 appear to have a hastening effect on the rate of engineering work done in WA, suggesting mining firms' eagerness in completing projects which have been committed in the quickest rate possible in a bid to defend market shares.
- Against the backdrop of low commodity prices and large investments in the sector coming to completion, the tide of new minerals and energy supply is expected to weigh on commodity prices and stifle new (mega) mining investment projects. Only one new major resource project had been announced in the second half of 2014.

WA's economy driven by the mining sector

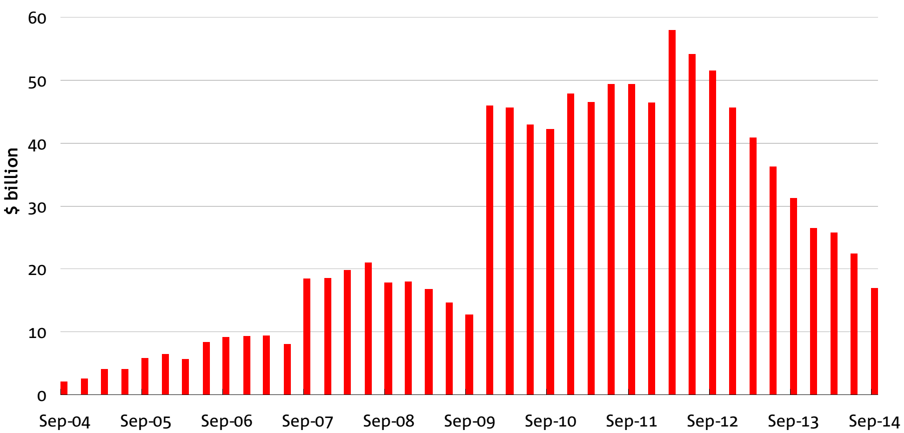
Industry's share of the economy, WA and Australia



Source: ABS

Engineering construction pipeline being run down at a rapid rate

Engineering construction work yet to be done, heavy industry, Western Australia

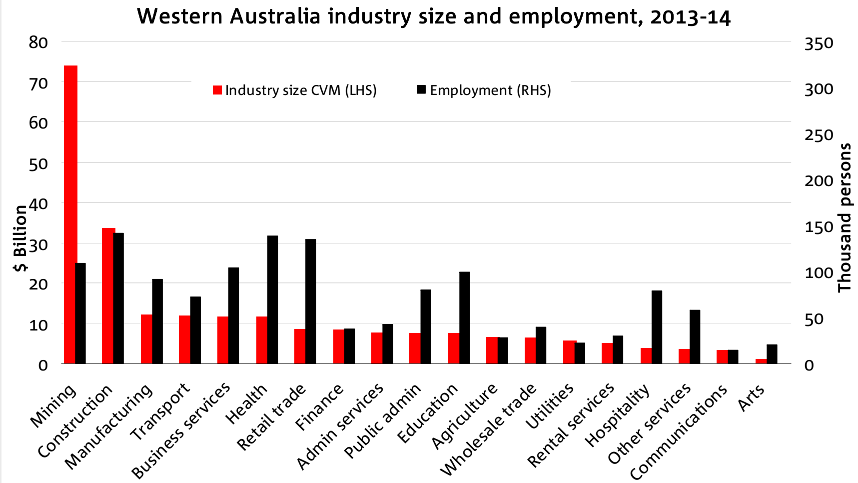


Note: Data after March 2013 are estimates
Source: ABS 8762.0

State Details: WA - Industry and population

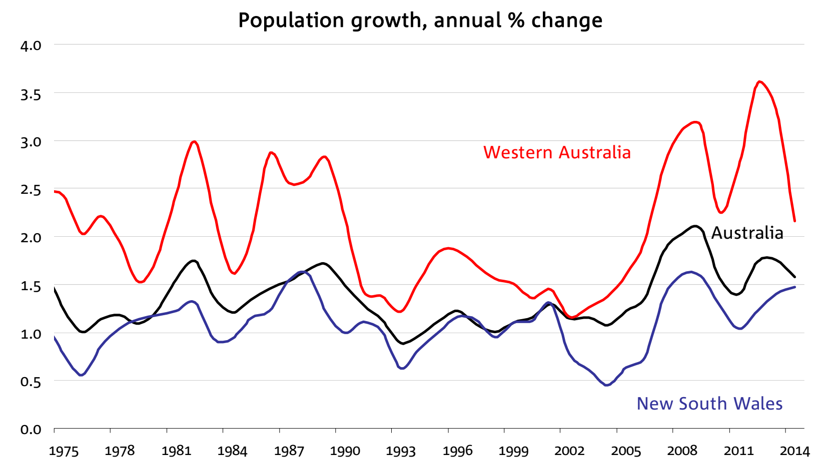
- As a sign of continued strength in construction activity, employment rose to record high in the sector over the 2013-14 financial year, while mining employment fell from its historical high in the previous year. While mining and construction sectors were major employing industries in 2013-14, services sectors, especially health, retail trade and business services, were also important employers.
- A rising demand for services in WA has largely been fuelled by a rapidly growing population, which has exceeded 2% annually since the mid-2000s to be well above national average. Since peaking at 3.6% in 2011-12, population growth has slowed considerably in the last two years to be at 2.2% in 2013-14. This highlights the transitory nature of the population composition of WA which predominantly tracks the rises and ebbs of the resource industry.
- The winding down of the mining industry against a strong growth in working-age population has served to exert downward pressure on the labour market. The trend unemployment rate for WA has risen steadily to 5.8%, up from a pre-GFC low of around 3.7%, and above the GFC high of 5.4%. Meanwhile wages growth has also embarked on a downward trajectory since mid-2012. That said, WA's current labour market conditions are still more robust than national average, bolstered by the construction and services sectors.
- ***Looking forward, the swift depletion rate of engineering pipeline constitutes non-negligible downside risks to WA's near-term labour market outlook, with the slack expected to arise from the construction and mining sectors unlikely to be absorbed readily by the non-mining sectors. NAB forecasts the unemployment rate in WA to average 5.6% in 2014-15 and peak at 6.5% in 2015-16, before improving to 5.5% in 2016-17 as the transition away from mining boom completes. The impact on population, spending behaviour and asset prices is expected to keep private household consumption's contribution to GSP very subdued.***

Non-mining sectors still big employers in WA



Sources: ABS

WA's population growth still above national average

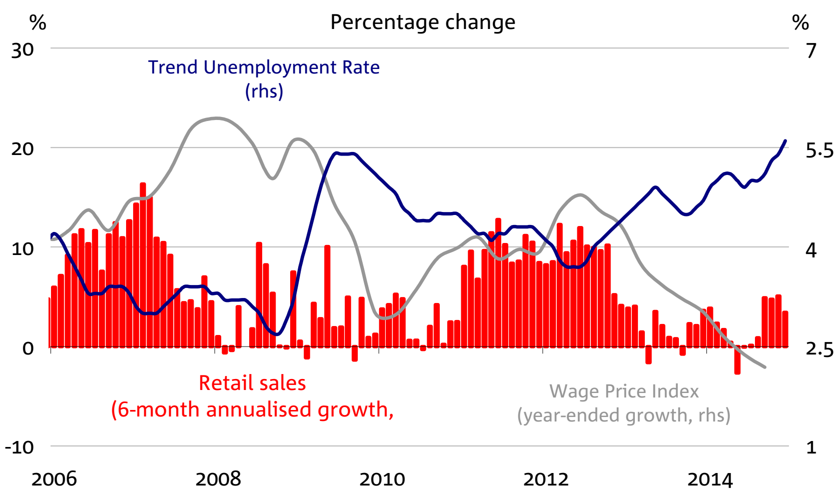


Source: ABS

State Details: WA retail sales and consumer spending preferences

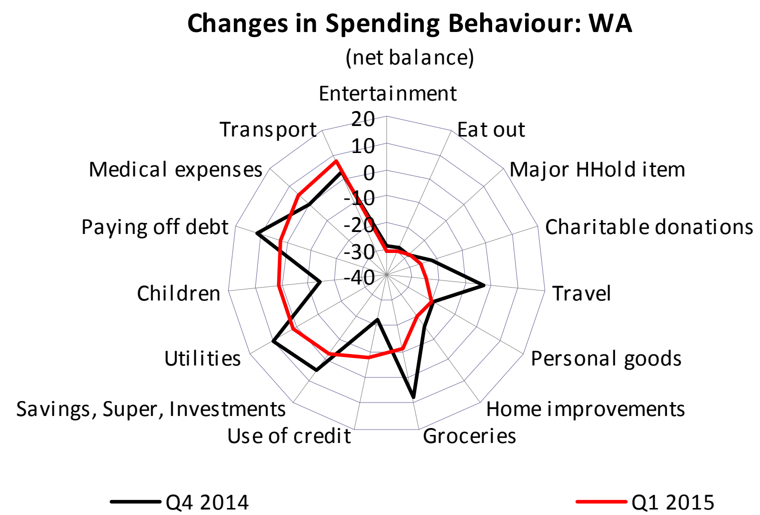
- Corresponding to a deteriorating labour market, discretionary consumer spending appears to have eased considerably since late 2012 based on retail sales data. Retail sales entered a period of strong recovery post-GFC but started to plateau off in late 2012. More recently, some tentative signs of a pickup in the sector have emerged, possibly pointing to the stimulatory effects of record low interest rates.
- Based on NAB's Consumer Anxiety Report, in recent quarters consumers in WA have reported a lower level of overall anxiety relative to the peaks of last year. However, consumers' spending behaviours continue to be relatively restrained, showing a higher inclination on optimising their long-term financial management strategies and spending on essential goods and services. A significantly larger share of respondents have cited that they are less inclined to set aside for eating out, entertainment and major household items, yet there was a notable improvement in the use of credit.
- ***Looking ahead, oil prices are expected to remain at relatively low levels, which along with low interest rates, should provide a boost to the household budget. However, with slower population growth and still weak employment market, the recovery in household consumption will be gradual.***

Retail sales in WA subdued in line with weak wages growth



Source: ABS; NAB

WA consumers continue to exhibit caution in their spending preferences

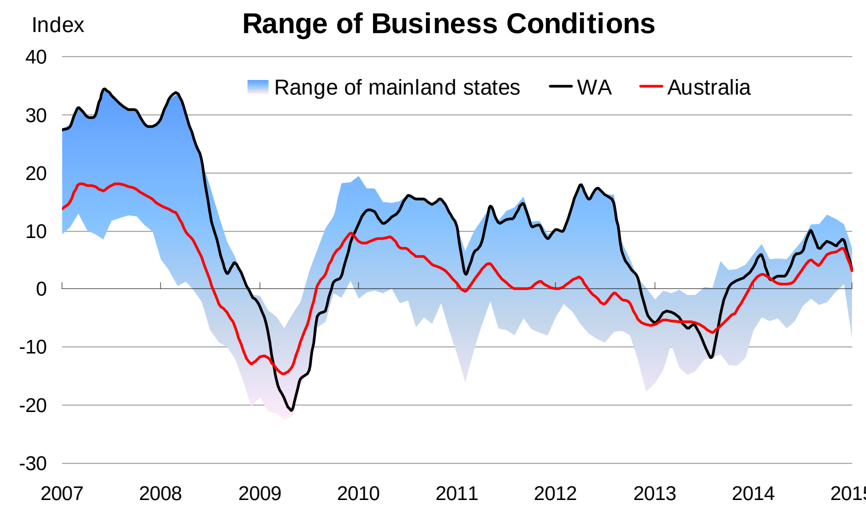


Source: NAB Group Economics

State Details: WA Business Survey

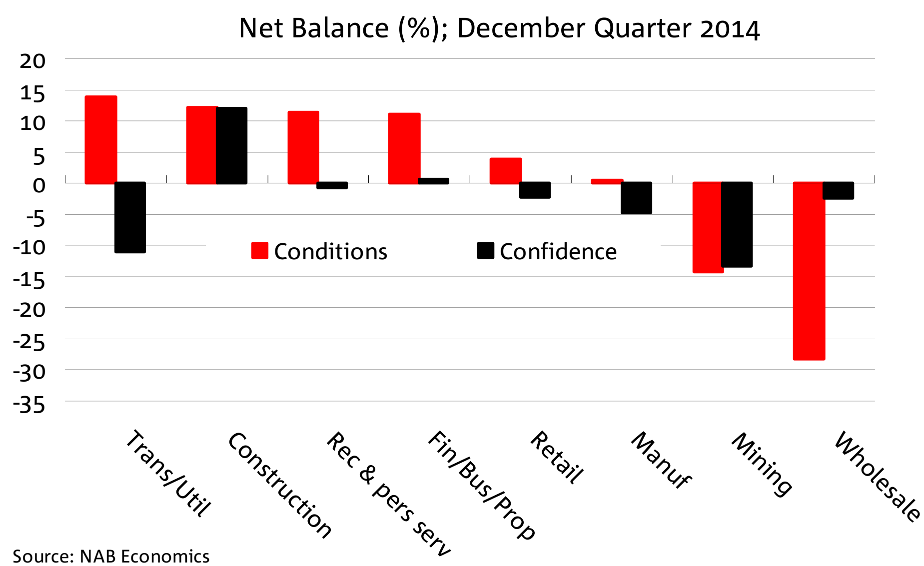
- Since our last report where we conjectured the growing importance of the construction and consumer sectors in WA's economic composition, business conditions (a summary of trading conditions, profitability and employment) in the former have improved markedly while those in the consumer sectors stayed relatively resilient.
- The strength in the construction sector reflects a combination of the robustness in activity both in engineering and dwelling construction.
- Furthermore, a number of the leading indicators from the business survey are foreshadowing a slowdown in the WA economy. Forward orders continue to be very soft and have been increasingly negative in the last three months.
- Capacity utilisation has also been flagging over the same period to be at 76.3%, well below its long-run average of 81.5%. Confidence levels reported by firms in WA have been deteriorating since November last year to be entrenched in negative territory.

WA business conditions relative to state spread



Source: NAB Economics

WA business conditions and confidence by industry

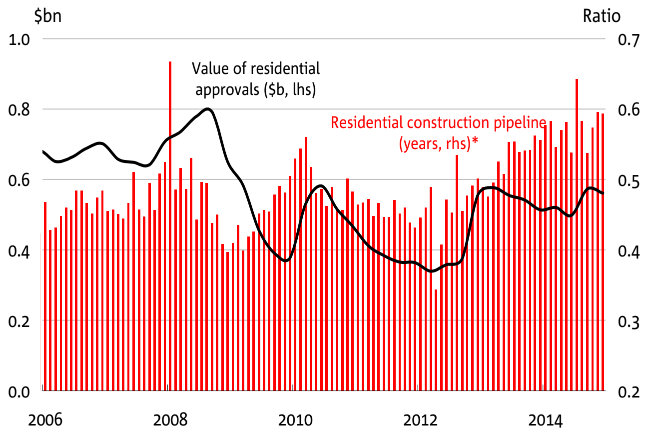


Source: NAB Economics

State Details: WA residential property sector

- While consumption is not offering much support to the overall domestic demand, WA has maintained a high level of residential building approvals since early 2013, although the momentum in the accumulation of residential construction pipeline is showing signs of tapering. Previously strong employment growth, higher rents and low interest rates contributed to higher housing demand and price growth, which triggered a significant positive response in housing approvals.
- However, Perth's housing market performance has diverged from the national trend throughout 2014 which was dominated by surging Sydney prices and to a lesser extent, Melbourne's. Perth's average house price only rose by 4.4% in 2014, compared to 9.7% nationally. This is partly driven by more housing supplies coming online while demand fundamentals have weakened on a softer labour market and population growth.
- Based on NAB's Residential Property Survey for the December quarter 2014, respondents consisting of mainly industry professionals: real estate agents, property developers and asset/fund managers, as well as market participants of owners and investors echoed the general weaker sentiments in the market, paring back their price expectations to -0.2% next year (0.3% in Q3) and 0.6% in the next year (1.2% in Q3). They also cited employment security as the biggest and most "significant" constraint to buying existing property. In the medium term, the large pipeline of dwelling construction is expected to counteract some of the drag from business investment; however given the small share of the dwelling investment sector in the state's economic activity, it will not be sufficient to offset the investment gap entirely. The increase in dwelling supply will also serve to cap the upward momentum for house prices in the near term. NAB forecasts Perth house price to grow modestly by 1.8% and 1.0% this year and next respectively.

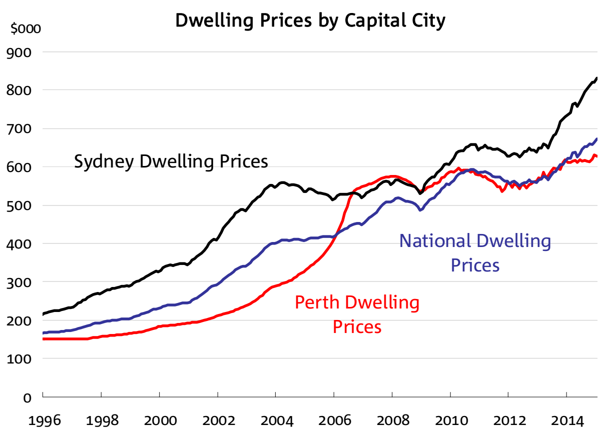
Dwelling investment a valuable contributor to activity



* Ratio of work-yet-to-be-done to annualised work done

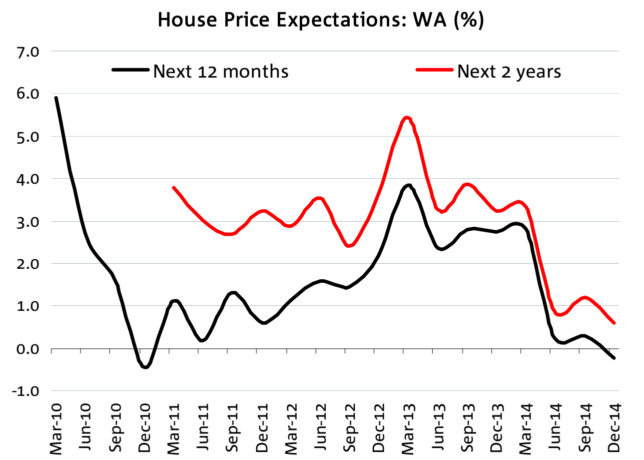
Source: ABS; NAB

Perth dwelling prices losing steam from a rising supply while demand fundamentals weaken



Sources: RP Data-Rismark

Housing sector professionals and participants pessimistic in their housing price expectations assessments



Source: NAB Group Economics

Western Australia– Budget and issuance update

Capital city	Perth
Government	Liberal-National coalition
Next election	March 2017
Rating and outlook	Moody's Aa1/Stable S&P AA+/Stable
Website	www.wa.gov.au

- **Budget position** The mid-year budget review (MYBR) highlighted the pressure the WA budget is under given the fall in the iron ore price and (near-term) decline in GST revenue. The end result was that the Government revised revenue estimates lower by AUD5bn over the forecast horizon (ie out to 2017-18). General government operating balance for 2014-15 was revised from a small surplus to a deficit of AUD1.3bn. With the iron ore price having declined another 10% since the MYBR, there is even more focus on saving measures but also a change in the GST distribution. Sensitivity analysis shows that for each $US1 per tonne increase/decrease in the price of iron ore, iron ore royalties change by ±$56m.
- Savings measures have included a 1,500 cut in public sector employees, trimming non-essential procurement expenditure by 15%, imposing an efficiency dividend requirements for general government agencies. A couple of revenue-raising measures: raising the exemption threshold of payroll tax scale from $800,000 to $850,000 and arranging for the payment of interim dividends from the energy sector, have also been introduced.
- **Credit rating**. WA's stable outlook by S&P is based on the view that the state would maintain operating surpluses. Pressure would be seen on the rating if WA 'recorded cash operating deficits without a sustainable plan to return to surplus'. WA's credit matrix deteriorated following the MYBR, most notably the debt burden. S&P's concern is if the tax supported debt as % of consolidated revenue were to move above 90%.
- **Issuance profile.** Following the MYBR WATC announced that its new money lending program included a AUD430m increase in borrowings. WATC is seen to be close to 70% through its 2014-15 funding program. WATC has focused issuance fiscal year to date in the WATC Oct 18, WATC Jul 20, WATC Jul 21 and WATC Oct 23 nominal benchmark lines and in FRN space issuance has been into WATC Mar-17 and WATC Nov 19 bonds.

WA General Government operating balance

$ millions	2013-14	2014-15	2015-16	2016-17	2017-18
FY13-14	386	-147	128	16	
FY14 MYBR	437	-124	263	10	
FY 14-15	183	175	5	50	283
FY15 MYBR		-1,287	-907	304	1,344

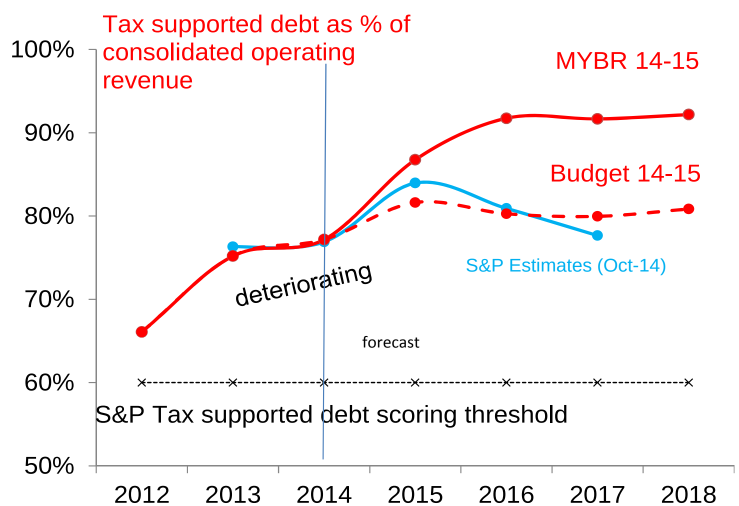
Source: WA State Budgets papers

WA Non-financial Public Sector Net Debt

$ billions	2013-14	2014-15	2015-16	2016-17	2017-18
FY13-14	36	39	42	46	
FY14 MYBR	34	38	41	43	
FY14-15	34	38	39	41	43
FY15 MYBR		38	41	44	47

Source: WA State Budgets papers

S&P key credit matrix for WA



Source: WA Budget papers, NAB

State Details: Tasmania

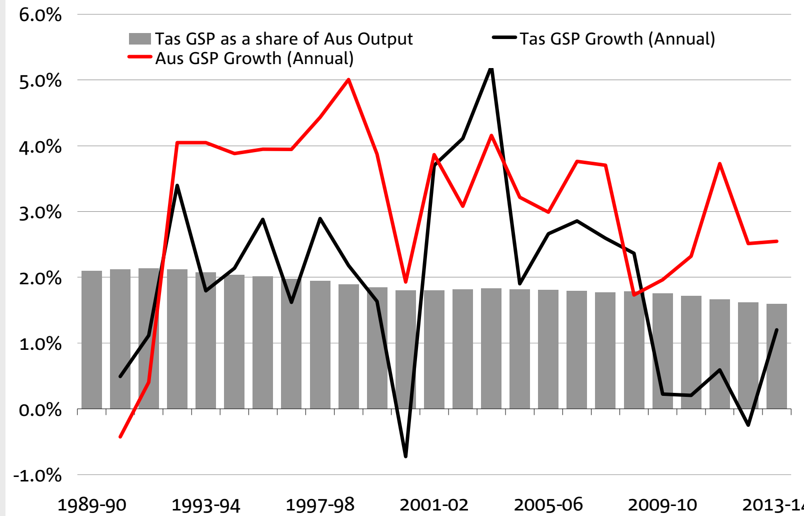
- Tasmania is an island state located south of the Australian mainland. It is Australia's smallest state, having a population of just over 500,000. This combination of remoteness and low population presents a number of economic challenges.

- Tasmania's annual GSP growth has mostly been below national average growth since the early 1990s, with the gap widening substantially in the post-GFC era. A sustained structural decline in manufacturing sector, one of its main traditional industry pillars, was further undermined by a strong AUD during the period, which weighed on its other main sectors of tourism and primary exports. As such, its output share in Australian production has been gradually eroded over time, from accounting for more than 2% in the early 1990s to just 1.6% in 2013-14.

- In 2013-14, Tasmanian GSP experienced a notable uptick to 1.2%, which partly reflects a lift in household final consumption and positive contribution from the balancing item that encapsulates interstate trade activity. The external sector was the biggest drag, with net exports falling by 20% year-on-year from lower export volume of copper ore exports due to the closure of a major mine and softer demand for zinc and aluminium commodities. A shrinking timber sector also generated a smaller exportable volume of woodchips.

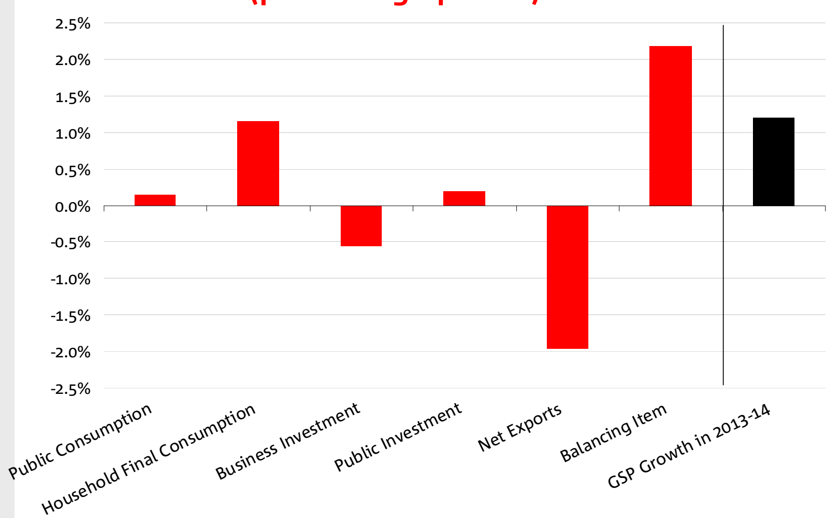
- ***A notably depreciated AUD since second half of 2014 is likely to be a key benefactor to the prospects of Tasmanian exports and tourism in the near term. Meanwhile, a falling unemployment rate alongside a rising participation rate suggest that the fundamentals in the Tasmanian labour market are gaining momentum. This is further supported by a slowing rate of interstate migration which point to a stabilising labour force. Stronger activity in dwelling construction is also expected to contribute positively to growth. However, a recovery in consumer spending is tentative at best at the moment, although consumer anxiety did improve a little in the latest NAB Consumer Anxiety Index. Given the above, we expect Tasmanian growth to pick up to 1.5% and 1.7% for 2014-15 and 2015-16 respectively, albeit still at sub-trend levels relative to history.***

Real Gross State Product Growth



Source:ABS

Contribution to GSP in 2013-14 (percentage points)



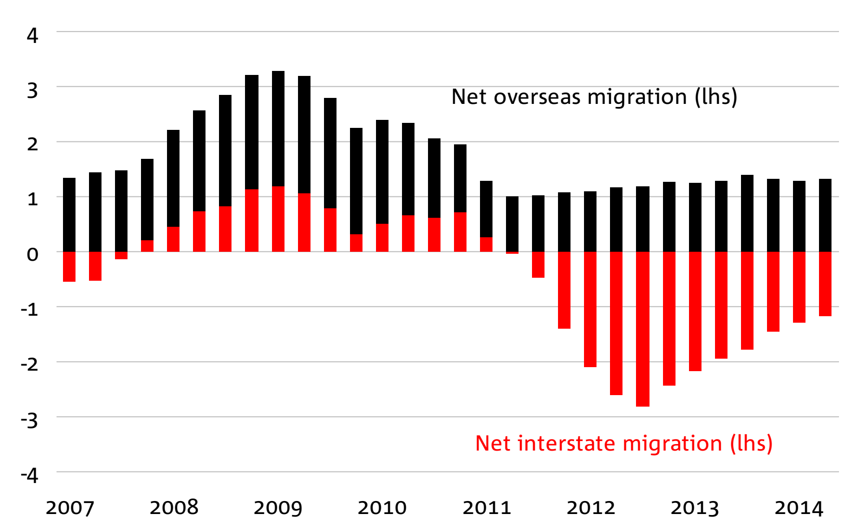
Source:ABS

State Details: Tas population

- Weak GSP growth over the post-GFC period (except for 2013-14) saw a reversal in the tide of interstate migration from net positive to negative, with the net outflow of Tasmanian residents to other states peaking in 2012 at around 5,200 people. This has moderated since, while net overseas arrivals remains at a relatively stable level. Combining the effects of both interstate and overseas migration, there had been a net drain in Tasmanian population in 2012 and 2013 due to migration flow. However, a pick-up in activity in 2013-14 helped to slow the interstate outflow, which is more than offset by net overseas migration, resulting in a net positive migration flow.

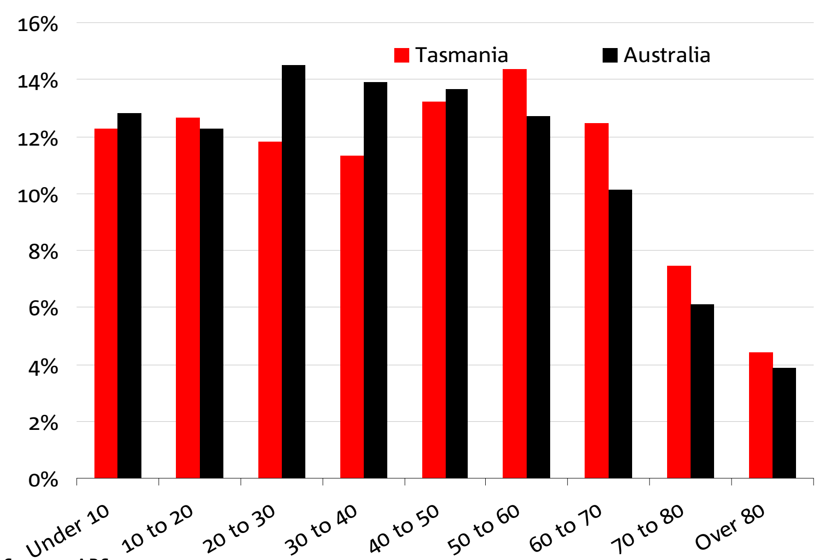
- Similar to the trends in output, Tasmania's share of Australian population is falling overtime, from 2.7% in the early 1990s to 2.2% in 2013-14. Its population is also older than the national average, with a notably smaller proportion of the population aged 20 to 40. Not only is the Tasmanian resident population ageing, it is growing at the slowest rate amongst all the states and territories – just 0.3% in 2013-14.

Net overseas and interstate migration – overall migration flow is marginally positive



Source: ABS; NAB

Contribution to GSP in 2013-14 (percentage points)



Source: ABS

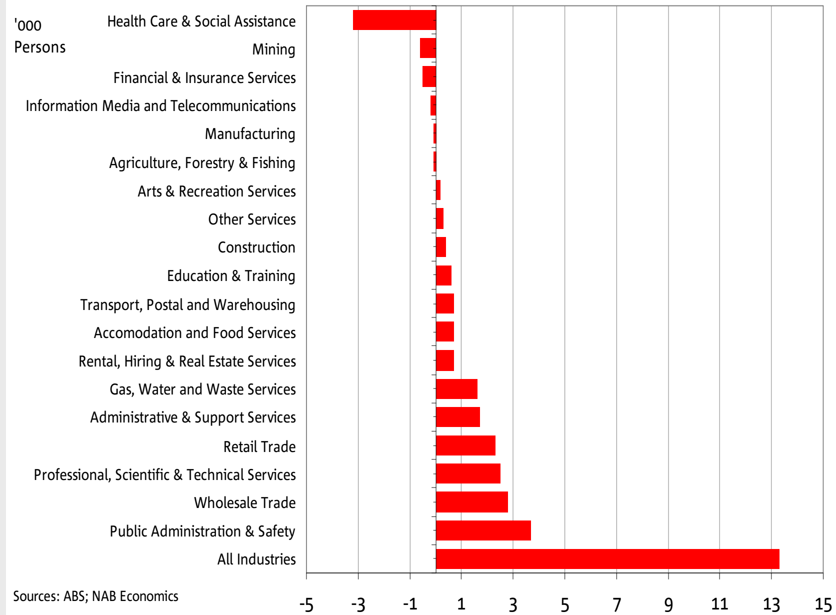
State Details: Tas labour market

- Slower economic growth saw the Tasmanian unemployment rate rise steadily in the aftermath of the GFC from 2008 to 2013 despite weak population growth over the period. It started trending downwards from its peak of 8.3% in August 2013 to be currently around 6.5%, which is second highest amongst all the states after South Australia.

- A moderation in the unemployment rate corresponded with a notable household spending-driven improvement in economic activity, partly reflected in the robust growth in retail sales in late 2013 and early 2014. That said, wages growth remains anaemic, although the slowdown appears to have stabilised and is expected to improve as employment growth picks up from a tentative recovery in the housing construction and tourism sectors.

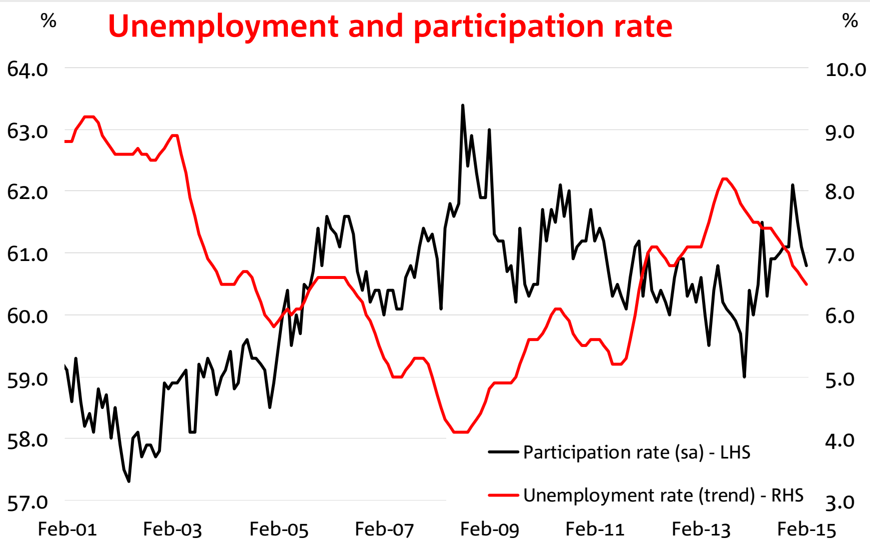
- Over the 12 months to December quarter 2014, the majority of jobs created in Tasmania were in the public safety and administration sector, followed by wholesale trade, professional/scientific and technical services as well as retail trade. Meanwhile, the traditional industrial strongholds of manufacturing, mining and agriculture, forestry and fishing have experienced either job cuts or zero job growth.

Employment by industry



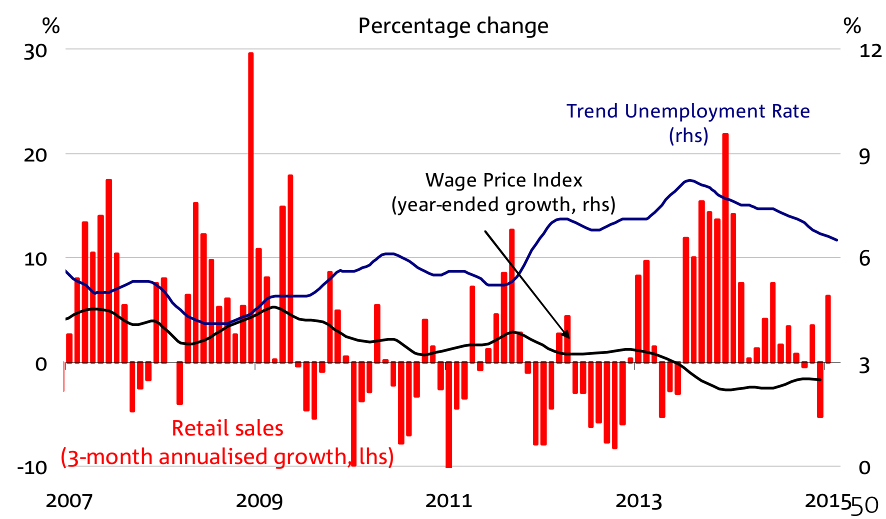
Sources: ABS; NAB Economics

Unemployment and participation rate



Source: ABS

Unemployment, wages growth & retail sales

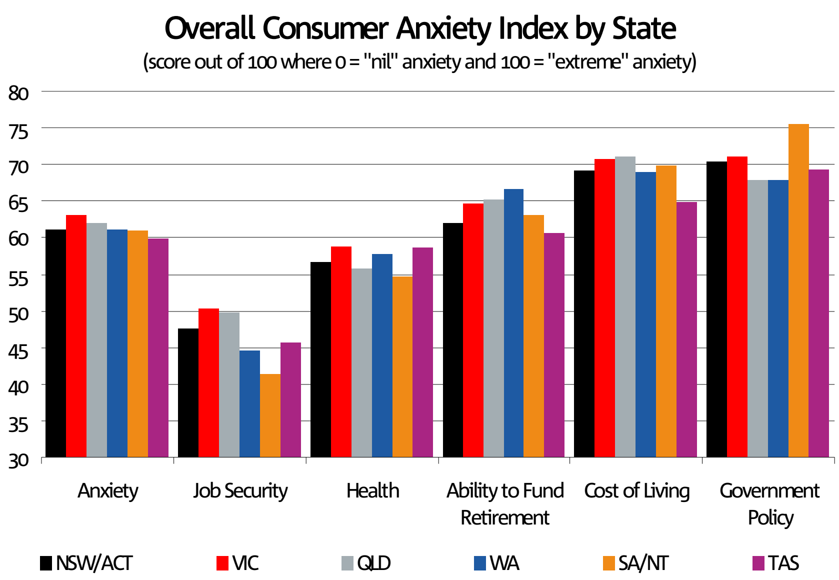


Source: ABS; NAB

State Details: Tas consumer anxiety and spending behaviours

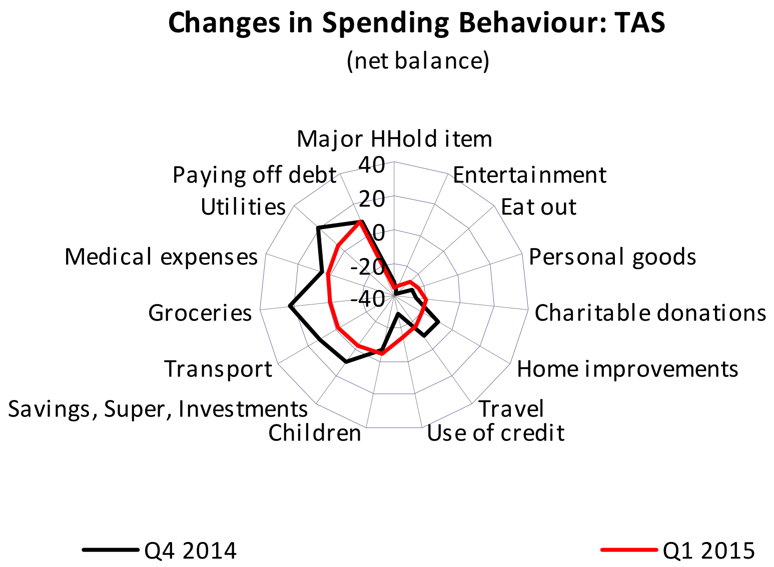
- Despite the overall weak income growth, the March quarter NAB Consumer Anxiety Index showed Tasmanian consumers to be the least anxious of all states. This is largely a reflection of worsening anxiety in other states and a notable pull back in concerns over the cost of living in Tasmania. In spite of the improvement in overall anxiety and a better trend in the states unemployment rate over recent months, concerns over job security actually lifted.
- Consumer behaviour in Tasmania continues to be cautious despite some improvements in Q1 2015. Similar to other states, survey respondents have shown to be more inclined towards spending on essential goods and services such as groceries, transport and utilities, while demonstrating more prudent intentions in longer-term financial management strategies to focus on savings, super and investment, as well as paying down debt. However, in the quarter, respondents suggested that they were pulling back slightly from this trend, although the big shift was more towards reining in spending on essential items rather than increasing outlay on discretionary items.

Tasmanian consumers experienced the lowest anxiety among all states in Q1



Source: NAB Group Economics

However, consumers remain cautious in their spending patterns



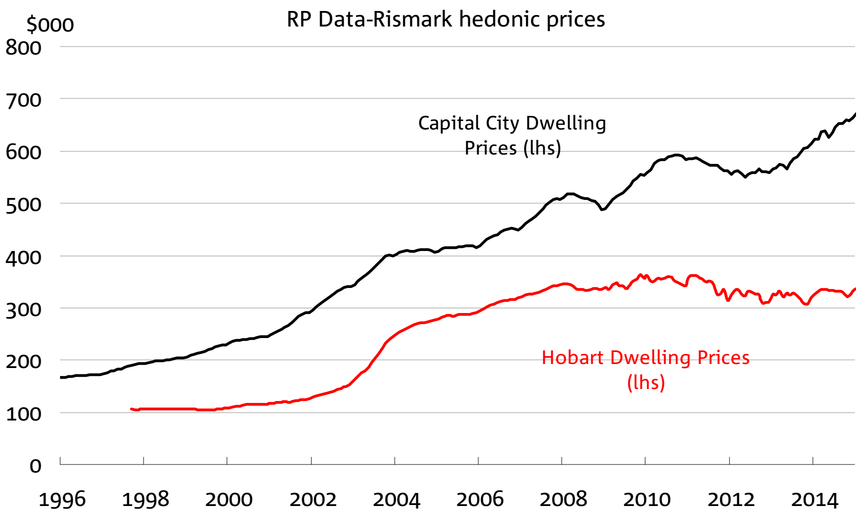
Source: NAB Group Economics

State Details: Tas housing market

- Unlike the mainland capital cities, Hobart house prices have been largely stagnant to mildly downward trending since 2008, with the median hedonic prices in Hobart now around half of the weighted average of all capital city prices. A continuous growth in housing supply over most of the 2000s combined with low population growth drove the dwelling to population ratio higher over time, to reach unprecedented levels in 2014 and constituted headwinds to house price growth over the period.

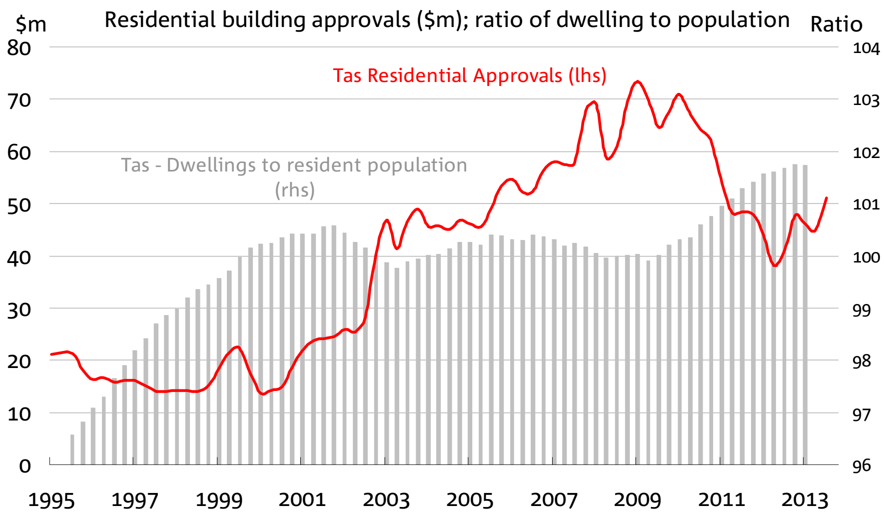
- A further pick-up in housing approvals since 2013 is expected to also be associated with looser supply fundamentals and thus expected to keep a lid on upward house price mobility in the near to medium term.

Hobart dwelling prices diverging from capital city average



Sources: ABS; RP DataRismark

Rising housing approvals portend greater housing supply and contained price momentum



Sources: ABS; RP Data-Rismark

Tasmania– Budget and issuance update

Capital city	Hobart
Government	Liberal Party
Next election	2018
Rating and outlook	Moody's Aa1/Negative S&P AA+/Stable
Website	www.tas.gov.au

Budget position

- The 2014-15 Tasmanian Revised Estimates report, which is the equivalent to the Budget Updates by other states, showed a marginal improvement in the State's financial position for 2014-15 since Budget, with a net operating deficit of -$299.9 million, compared to --$285.6m predicted during the Budget. Over the budget and the forward estimates period, an improvement of $23.3m have been included in the net operating balance, which primarily reflects changes in underlying parameters, as opposed to active state government's decisions. Some of these include an increase in expected GST repayments, stronger dividends from state-owned utility companies that offset lower returns from Hydro Tasmania etc, as well as lower superannuation interest expense reflecting the latest actuarial projection of the Government's defined benefit obligation
- Tasmania has not returned a budget surplus since 2009-10, however, general government net debt is forecast to diminish overtime to result in a positive equity of $ 74 million by 2017-18.

Credit rating

- Tasmania has a AA credit rating with stable outlook from S&P (Moody's rating is Aa1 with negative outlook). According to Standard and Poor's analysis, Tasmania's budget performance is strong but it has limited budget flexibility. In addition its unfunded superannuation liability is significant (at 70% of revenues). The stable outlook reflects the view that Tasmania will broadly achieve its budget cost savings and maintain constrained growth in spending.

Issuance profile

- Tascorp estimated that it would issue AUD900m in 2014-15 with funding raised via taps and existing hotstock lines.

Tasmania's General Government operating balance

$ millions	2013-14	2014-15	2015-16	2016-17	2017-18
FY13-14	-267	-165	-34	10	
FY 14 MYBR	-376	-261	-136	-131	
FY 14-15		-286	-125	-125	-118
FY 15 MYBR		-300	-81	-151	-100

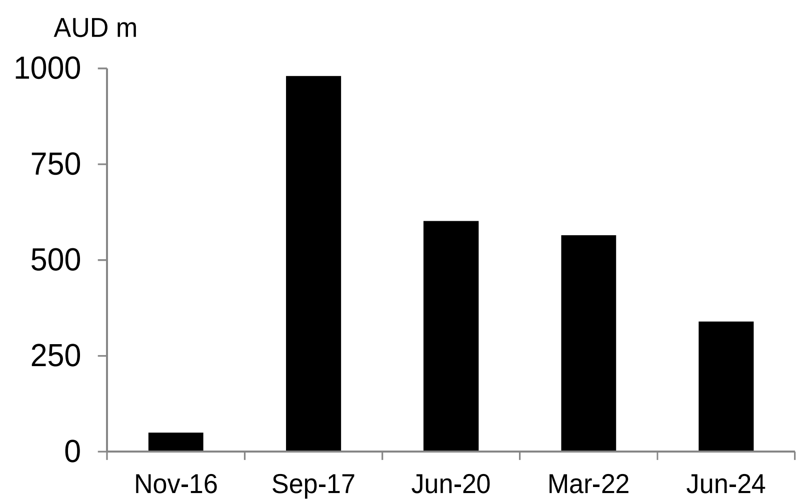
Source: Tasmania State Budgets papers

Tasmania's Non-financial Public Sector Net Debt

$ billions	2013-14	2014-15	2015-16	2016-17	2017-18
FY13-14	2.8	2.9	3.0	3.0	
FY 14 MYBR	2.3	2.3	2.5	2.5	
FY 14-15		2.3	2.5	2.7	2.8
FY 15 MYBR		2.1	2.4	2.5	2.5

Source: Tasmania State Budgets papers

Benchmark bonds outstanding



Source: Bloomberg

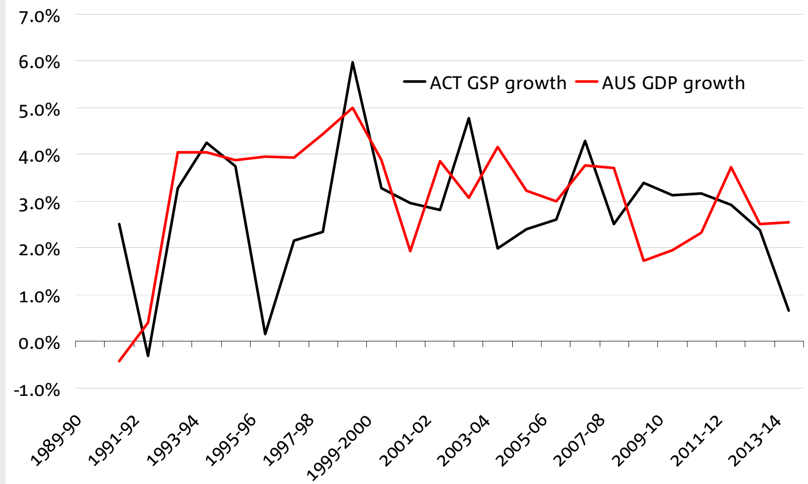
Territory Details: Australian Capital Territory

- The Australian Capital Territory (ACT) is a territory within New South Wales consisting of Canberra and a small rural surrounding area. With Canberra being the Commonwealth government's administrative and policy-making centre, ACT's industry composition is heavily skewed towards services, with gross value added by industry over-represented in public safety and administration ; professional, scientific and technical services; education and training; construction and to a lesser extent arts and recreational services as well as utility services relative to the Australian averages.

- Given its high concentration in services provision and small area size, ACT serves as an important services centre to its surrounding regions. According to the Commonwealth Grants Commission, the flow of ACT services to NSW residents significantly exceeds the flow in the opposite direction, which suggests that the city capital incurs a disproportionate amount of service delivery costs relative to its population share.

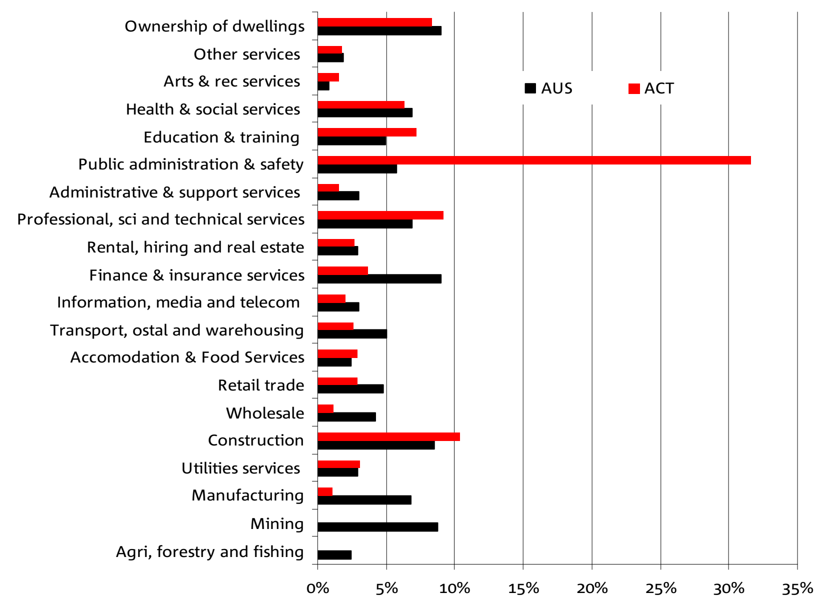
- Given the spill-over effects of the recent cuts in Australian Public Service (APS) employees onto consumer spending, labour market and the residential property sector, it is perhaps of no surprise that the aggregate growth for ACT has slowed notably in recent years. ACT's GSP growth slowed to 0.7% in 2013-14 from of its recent peak of 3.4% in 2008-09, which is below population growth. This necessarily means that GSP per capita, a measure of standard of living, has fallen. Part of the weakness of the ACT economy also reflects the slowing down of mining investment in WA and Queensland, which had the effect of bolstering Federal Government revenue significantly in the past, and subsequently led to increased spending in the national administration centre.

ACT vs AUS Growth



Source:ABS

ACT vs AUS GVA by industry

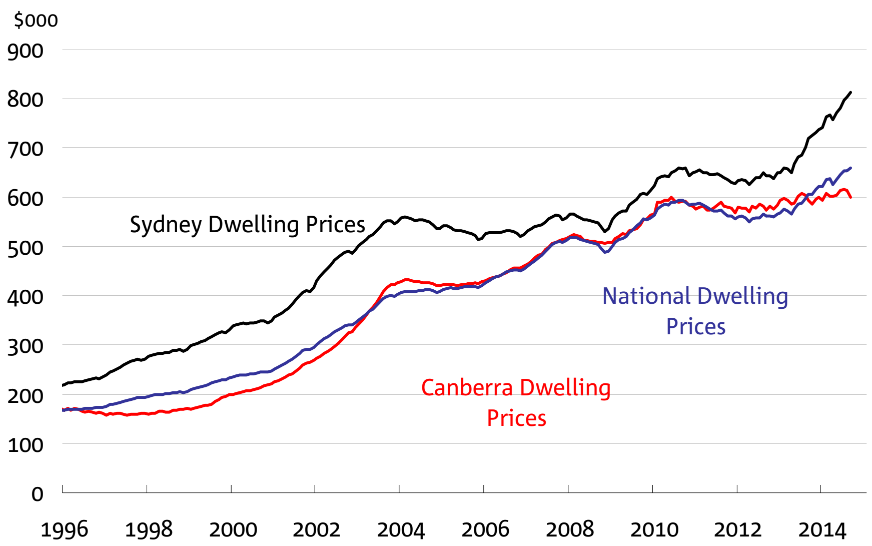


Source:ABS

Territory Details: ACT residential property sector

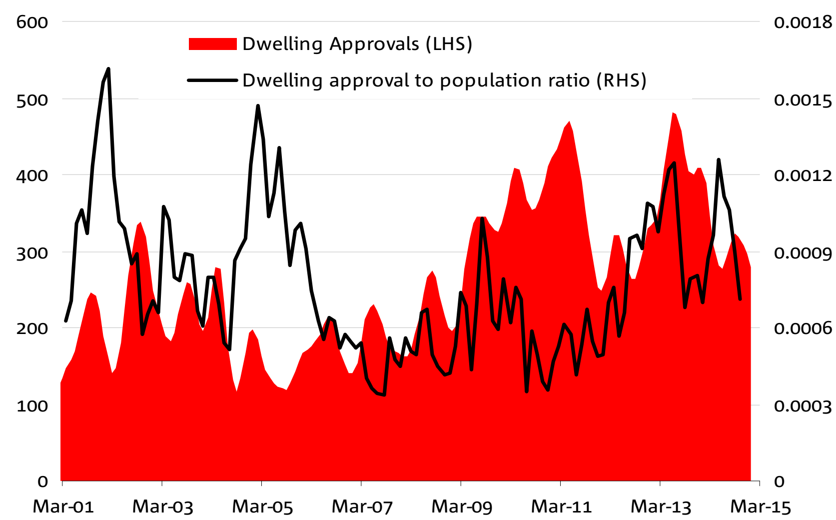
- Historically, comparatively strong earnings capacity by ACT residents had supported housing demand and kept prices elevated in Canberra for most of the 2000s. Canberra's average dwelling prices had grown largely in line with national average in the decade from 2003 to 2013, but the recent deterioration in its labour market conditions saw Canberra dwelling index increasingly fall behind national average.
- In the meantime, dwelling approvals have also trended downwards since its peak in June 2013 which indicates that a negative supply response is already occurring in the wake of stagnant prices. A tightening housing supply should provide a floor to prices going forward, when there appears to be a very limited upward impetus at this point in time given weak wages and population growth. As such, we expect the dwelling prices in ACT to record very gradual gains in the coming quarters.

Canberra, Sydney and national dwelling prices



Source: Australian Public Service Commission

ACT dwelling approvals number and dwelling approvals to population ratio



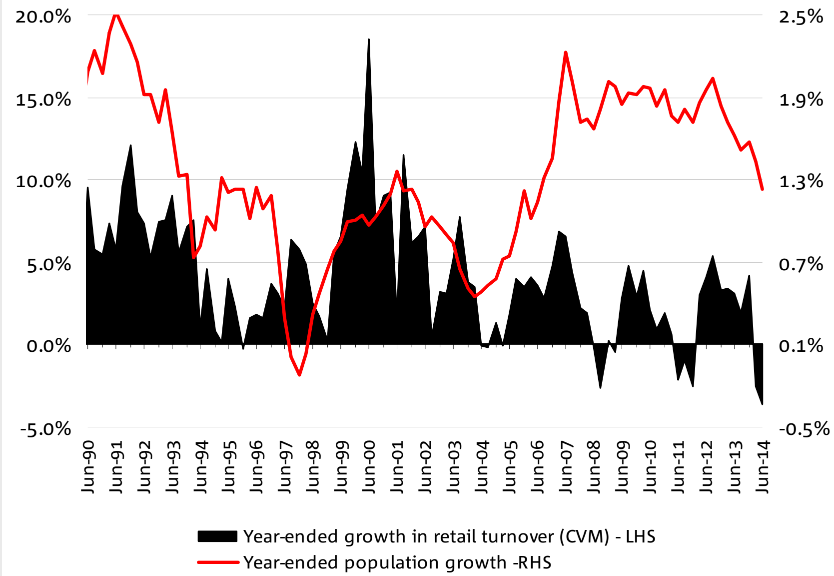
Source:ABS

Territory Details: ACT population growth

- With a high concentration of Commonwealth public service jobs and events located in ACT compared to other states/territory, its attracts a population that is exceedingly mobile, made up of young professionals make career-driven moves from interstate. As a result, ACT has an elevated rate of long-term migration and plenty of short-term cross-border movements at the same time. The level of population growth is thus highly sensitive to career prospects in the area, and has shown signs of moderation in recent times against the streamlining measures by the federal government.

- Year-ended population growth in ACT has slowed from a recent peak of 2% in September quarter 2012 to only 1.2% in June quarter 2014. Population growth in ACT is likely to continue to fall behind national average in the next few years, reflecting a relatively small component of interstate migration and a net outflow of interstate migration. The slowing in population growth in recent years had also coincided with an overall weaker retail spending.

Retail turnover and population growth



Source:ABS

Australian Capital Territory– Budget and issuance update

Capital city	Canberra
Government	Labor Party
Next election	October 2016
Rating and outlook	S&P AAA/stable
Website	www.act.gov.au

- **Budget position** The mid year budget review (MYBR) shows a deterioration in budget position for the current financial year and the next. The ACT budget fell into deficit in 2013-14 of $330 million. In its MYBR, the ACT government forecasts a deficit $770 million in 2014-15, which is a decline of $438 million compared to the estimate published at Budget time. This deterioration is due to the decision to implement a buyback scheme for ACT houses affected by loose-fill asbestos, which is estimated to have a net operating impact of $530.5 million over four years. The ACT Government fulfils the role of both a State and local government, and therefore is responsible for the provision of municipal services ordinarily provided by local councils in other parts of Australia. The net operating balance is projected to return to surplus by 2017-18.
- The ACT is the first State or Territory to commit to phasing out inefficient transaction based taxes, including stamp and insurance duties.
- **Issuance profile** ACT estimates its funding requirement for 2014-15 is around AUD565mn.

ACT General Government operating balance

$ millons	2013-14	2014-15	2015-16	2016-17	2017-18
FY 14 MYBR	-265	-127	-46	-23	
FY 14-15	-265	-333	-118	-26	77
FY 15 MYBR	-265	-770	-250	-23	80

Source: ACT budget papers

ACT General Non-financial Public Sector Net Debt

$ billions	2013-14	2014-15	2015-16	2016-17	2017-18
FY 14 MYBR	2.07	2.43	2.38	2.23	
FY 14-15	1.86	2.66	3.15	3.37	3.52
FY 15 MYBR		2.99	3.73	3.93	3.97

Source: ACT budget papers

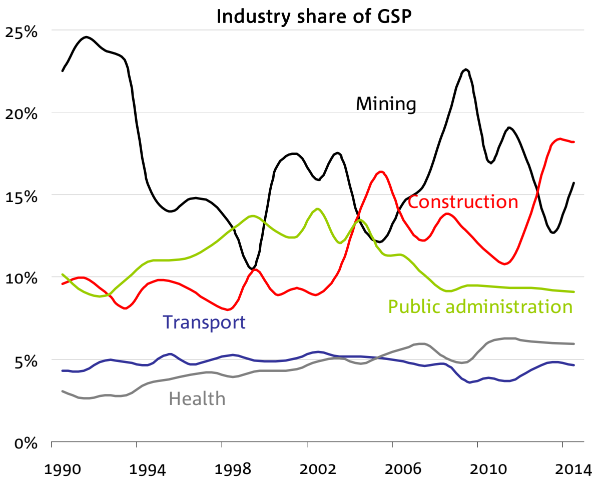
Territory Details: Northern Territory

- The economic structure of the Northern Territory is very different from that of other states and territories. Its high dependence on mining and mining-related construction and transport industries makes it highly prone to the cylical movements in the economy. The territory also has a large public administration and defence presence. In 2012-13, defence expenditure's share of NT's GSP was the highest among all jurisdictions. During times of strong commodity prices and mining investments, NT's economy tends to grow strongly, but can be more negatively affected in an event of a downturn. Due to the lack of diversity in its economic base, NT's economic growth rates can vary greatly from year to year.

- In recent years, gravity-defying commodity prices and unprecedented levels of business investment have driven NT's superior economic growth. At present, the mining landscape is dominated by the Ichthys LNG project -- currently under construction, the project will bring gas from the Browse Basin off the Kimberley coast onshore to an LNG processing facility in Darwin. Since construction began in 2012, business investment has skyrocketed from an average of 13% in 2010-11 to 36% in 2013-14.

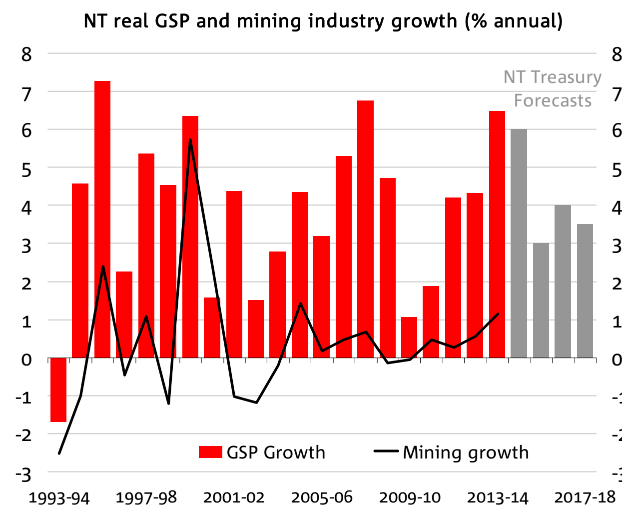
- Onshore engineering construction is expected to peak in 2014-15, supporting strong employment and economic growth during this period. Growth is expected to then ease in 2015-16, as the resource projects move from the labour and capital intensive construction phase to the operations phase, resulting in slower employment and economic growth, with only some offset coming from a ramp-up in export volumes.

Share of GSP by industry



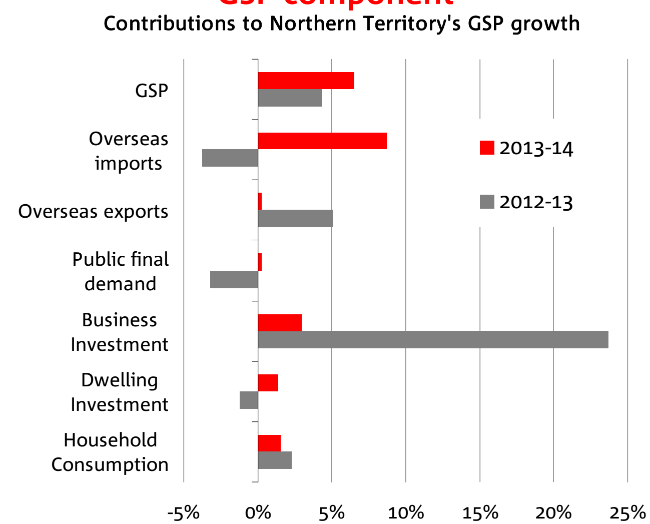
Source: ABS

GSP and mining growth



Sources: ABS, Northern Territory Government Budget 2014-15 and update

Contribution to growth by GSP component



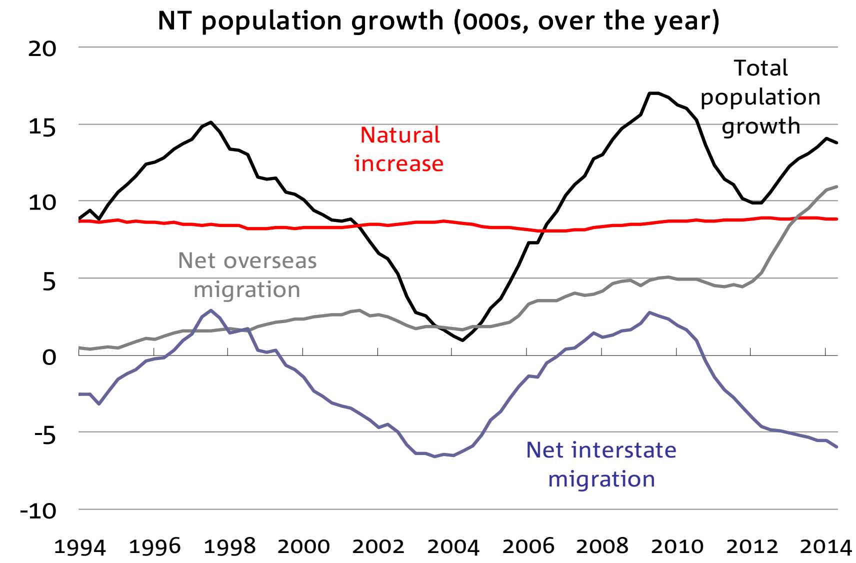
Sources: ABS

Territory Details: NT housing market and population

- Northern Territory has the smallest population and the third largest land mass of all Australian jurisdictions. Its population growth has been characterised by volatile net interstate migration, increasing overseas migration and steady natural increases. The resource projects have brought in large numbers of skilled workers from both overseas and interstate but as their construction winds up, NT's population growth is likely to slow.

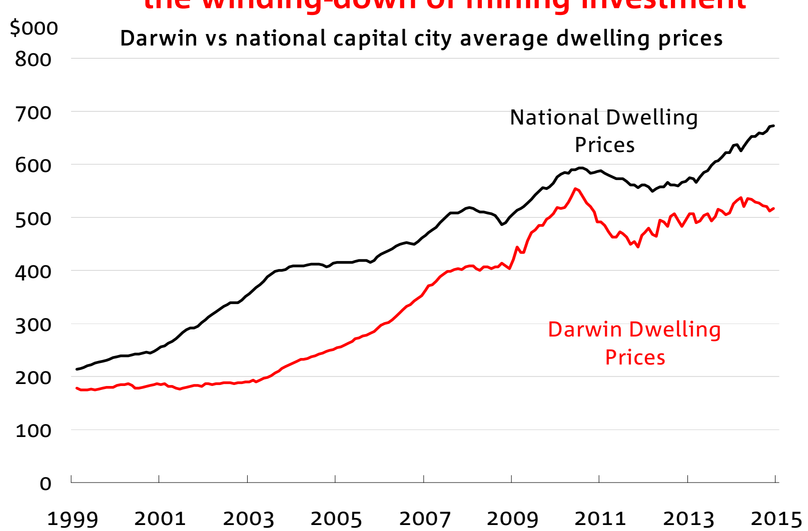
- Dwelling investment rose by a strong 39.4% in 2013-14, contributing 1.4 percentage points to the territory's overall 6.5% GSP growth. However as the large resource projects near completion, their labour requirement will decline, leading to slower population growth. Corresponding to a weaker population impetus, the value of residential approvals declined during 2013-14 while dwelling prices in Darwin have also started moderating.

Retail turnover and population growth



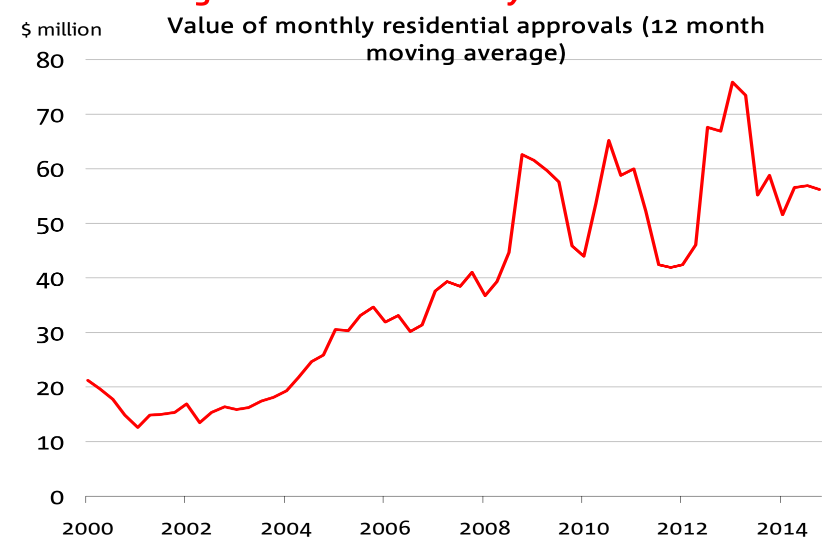
Source: ABS

Darwin dwelling prices showing fatigue from the winding-down of mining investment



Sources: RP Data-Rismark

Slowing residential approvals suggest weaker housing construction activity in the near future



Source: ABS

Northern Territory– Budget and issuance update

Capital city	Darwin
Government	Country Liberal Party
Next election	August 2016
Rating and outlook	Moody's Aa1/Negative
Website	www.nt.gov.au

- **Budget position** The Northern Territory (NT) mid year budget review (MYBR) shows a slightly better budget position from that delivered at the May Budget. This reflects increased GST and own source revenue. NT net debt is expected to plateau at around AUD3.7bn. Note that the non financial public sector operating balance is a more accurate measure given it includes Power and Water Corporation which is not self-supported. Government sector net operating balance is forecast to move to surplus in 2014-15, however the total fiscal balance remains in deficit and is forecast to increase over the forward estimates period.
- Commonwealth grants dominate the Northern Territory's revenue base. Around half of the Northern Territory Government's revenue comes from GST, compared to less than a quarter for Victoria. The Northern Territory is the only State or Territory not to levy land tax.
- The GST distribution system is designed to give States the same capacity to deliver services. The Northern Territory's high proportion of the population living in remote indigenous communities sees it receive more than 5 times its population share of GST, with indigenous and remote factors causing a redistribution of $1.5 billion to the Northern Territory in 2014-15.
- The Northern Territory's dependence on GST leaves it exposed to fluctuations in GST pool growth and its share of the pool. Should the Commonwealth Grants Commission change the GST allocation rules, the Northern Territory could stand to lose more than other jurisdictions.
- **Issuance profile** NT estimates its funding requirement for 2014-15 is AUD334mn.

NT Non-financial public sector operating balance

$ millons	2013-14	2014-15	2015-16	2016-17	2017-18
FY 14 MYBR	-1181	-349	-235	-175	
FY 14-15	-394	-667	-92	-53	-39
FY 15 MYBR		-605	-51	-43	4

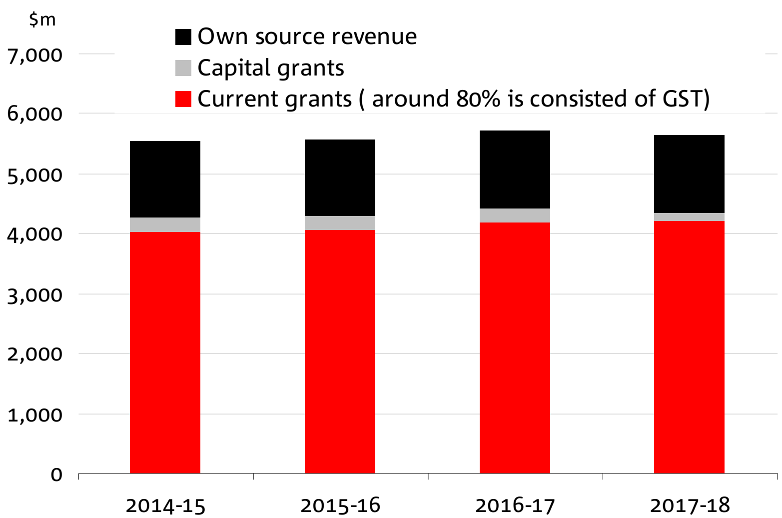
Source: Northern Territory

NT Non-financial Public Sector Net Debt

$ billions	2013-14	2014-15	2015-16	2016-17	2017-18
FY 14 MYBR	4.26	4.57	4.78	4.95	
FY 14-15	3.41	4.07	4.12	4.14	4.16
FY 15 MYBR		3.70	3.73	3.74	3.75

Source: Northern Territory

NT revenue by source



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