

# State Update: New South Wales – September 2015

## NAB Group Economics



National  
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Bank

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## Key points

- **NSW state final demand is forecast to be robust, while export demand will remain subdued before slowly improving over coming years. Consequently, Gross State Product (GSP) growth is expected to remain solid at just below 3% in 2015-16 and 2016-17 (Chart 1).** Further out, there is a risk that rising interest rates (from late 2016) will weigh more heavily on NSW given its relative debt levels.
- State final demand growth has been stronger in NSW than the national aggregate (Chart 2). This is consistent with the Australian economy's transition away from the mining boom towards more diverse drivers of economic growth. However, subdued conditions in other states and internationally are expected to weigh on the traded sector, although AUD depreciation should be helping. Improvements in state domestic demand have largely stemmed from residential markets, buoyed by low interest rates, population growth, undersupply and strong investor demand.
- Dwelling investment has picked up sharply on the back of higher property prices. **The elevated stock of residential projects will sustain growth in dwelling investment for some time to come.** Chronic under-supply of housing and strong price growth validates these high levels of residential investment in Sydney, although the potential for oversupply in the apartment market has risen. The NAB Residential Property Survey suggests sentiment in NSW remains solid. However, growing supply and a tightening of investor credit will take some steam out of the market.
- **Spill-over effects from the residential market are being felt elsewhere.** The boost to household wealth has been good for consumption, although the positive momentum slowed somewhat in late 2014/early 2015. Consumer activity lifted again more recently, but this is partly a reflection of Federal Budget incentives for small business. With interest rates expected to remain low and lower oil prices assisting disposable income, consumption growth should improve further, although subdued wages growth and consumer confidence will remain a constraint.
- **The labour market has improved notably in Greater Sydney, but continues to look soft in the rest of NSW.** The NAB Business Survey suggest that labour intensive (non-mining) sectors of the economy are gaining momentum, which should continue to drive employment growth. However, additional labour supply (returning from the mining states) is expected to keep falls in the unemployment rate relatively modest. **The unemployment rate is forecast to drift downwards toward 5½% by mid-2017.**
- **Conditions are gradually improving for business and investment, while public infrastructure spending will provide key support to the local economy over coming years.** Both business conditions and confidence have steadily improved in NSW and spare capacity has been tightening, but high 'hurdle rates' remain a constraint on investment. Consequently, investment intentions and non-residential building approvals remain subdued (although some major projects have been approved in areas such as health). Business conditions have been particularly solid in service sectors, which appear to be seeing some benefit from AUD depreciation – short-term arrivals and international education enrolments have been picking up.

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Chart 1: State GSP Growth Forecasts

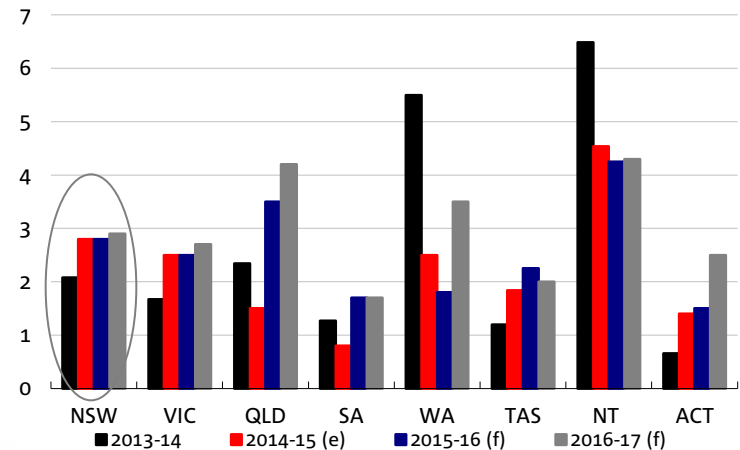
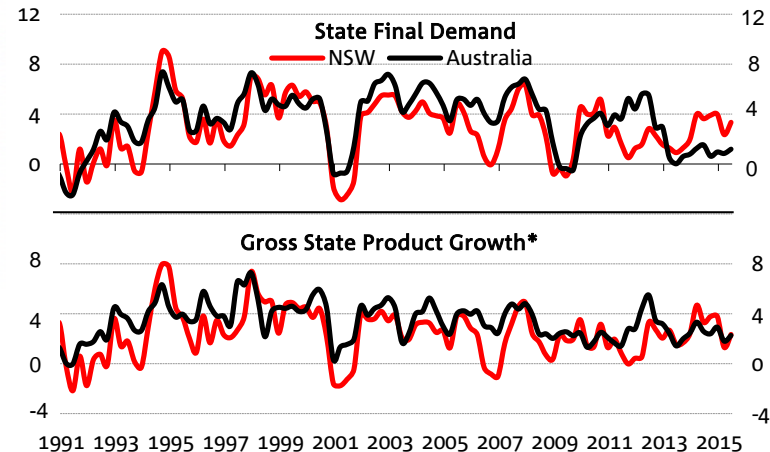


Chart 2: State Growth



1991 1993 1995 1997 1999 2001 2003 2005 2007 2009 2011 2013 2015

\*NAB Estimate

Sources: ABS; NAB Economics



# In Focus: Impacts of the housing market boom

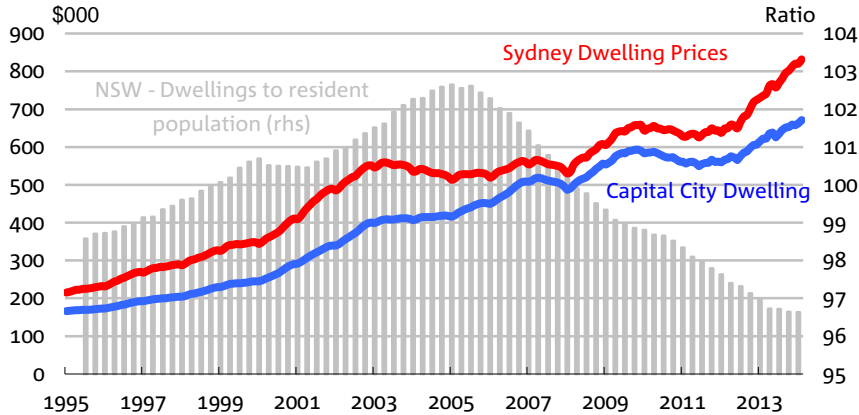
The NSW housing market is performing extremely well, especially given the patchy (albeit improving) economic context. House prices have increased 18.4% over the year to July and show very little sign of slowing (Chart 3).

Falling rental yields and higher price-to-income ratios (towards record highs) are raising concerns of a looming market correction (Chart 5). The measures, however, fail to account to improved borrowing power due to lower interest rates. Accounting for this suggests prices are not yet significantly overvalued.

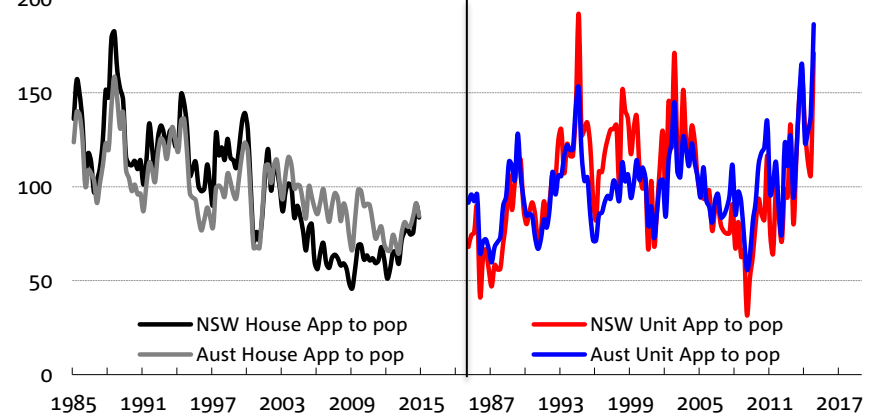
Housing supply is responding to prices. Chronic under-supply in Sydney would appear to justify such high rates of construction, although the ratio of apartment approvals to population may indicate some potential over-supply for that market in the near term – suggesting down price pressure from supply will be more pronounced in the apartment market (Chart 4).

Nevertheless, strength in the residential market is having a positive flow-on effect to the broader economy, namely consumption (Chart 6).

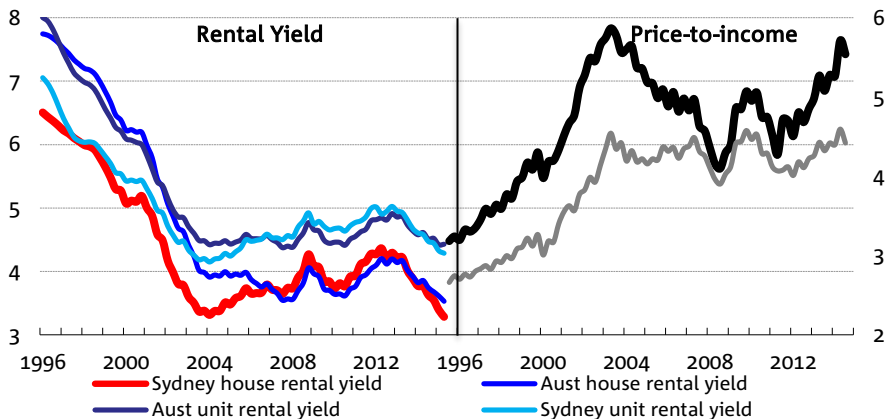
### Chart 3: House prices and under-investment in dwellings



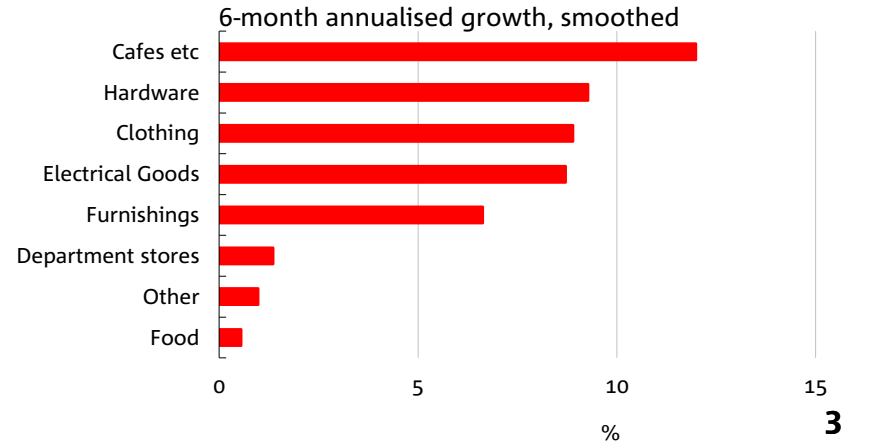
### Chart 4: Approvals relative to population growth (LRA = 100)



### Chart 5: Rental yields & price-to-income ratio



### Chart 6: NSW Retail sales growth by category





# Wealth effects helping to offset weak income growth, supporting consumption

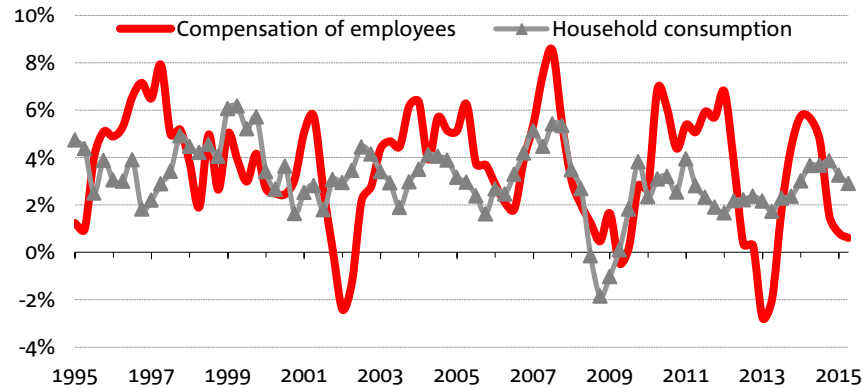
Labour income growth in NSW has remained relatively subdued, reflecting the degree of spare capacity in the labour market and well contained expectations for inflation (Chart 7).

Despite this, wealth effects from higher house prices helped to support retail sales growth, although the impetus appeared to slow from late 2014 (Chart 9). Consumer activity appears to have picked up again in recent months – in part reflecting Budget initiatives for small business.

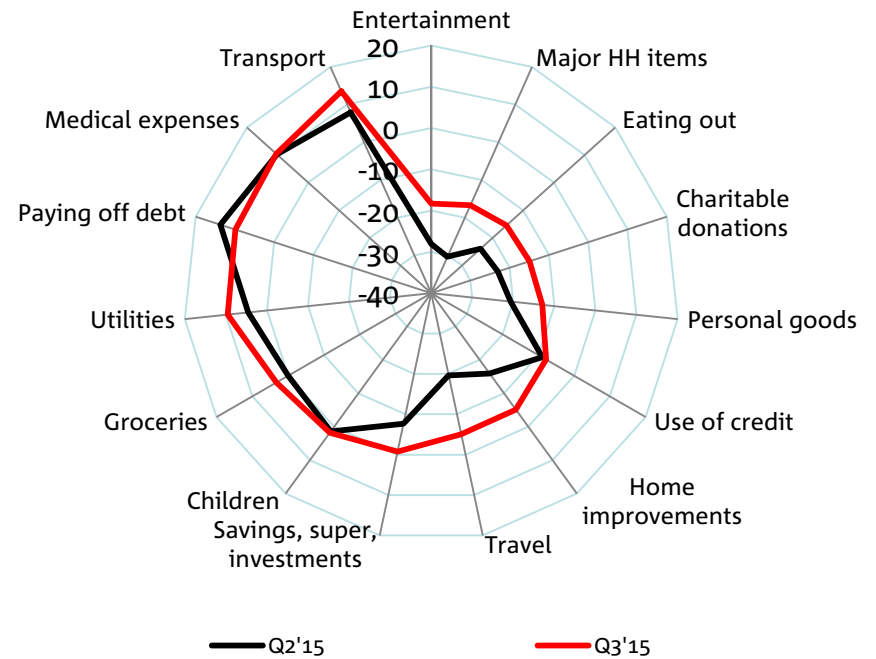
The Q3 2015 NAB Consumer Anxiety Survey showed some improvement, but continues to highlight a number of challenges for consumers. Despite enjoying the wealth effects from rising house prices, consumers continue to report a high degree of caution in relation to their spending behaviours.

In Q3 2015, households still showed preference towards conservative spending (eg. paying down debt), but were more inclined to spend on non-discretionary items as well, such as travel and eating out (Chart 8).

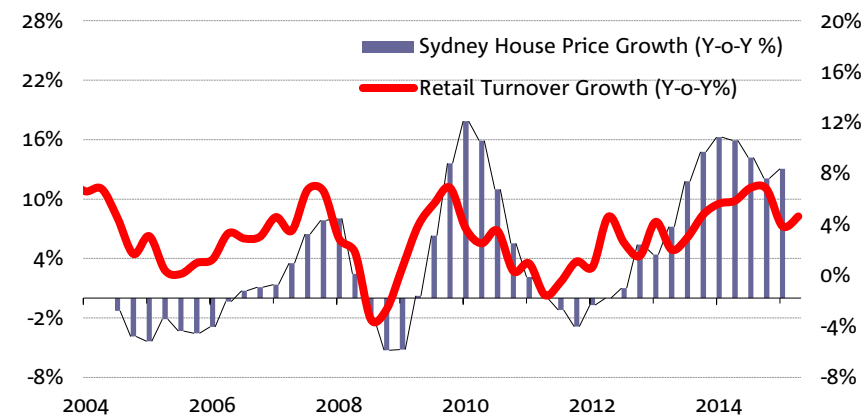
### Chart 7: Average Compensation and Household Consumption Growth (YoY)



### Chart 8: NAB Consumer Anxiety Survey – spending behaviour (net balance index)



### Chart 9: Retail Turnover and House Price Growth





# Business environment improving (outside of mining), but firms still reluctant to invest

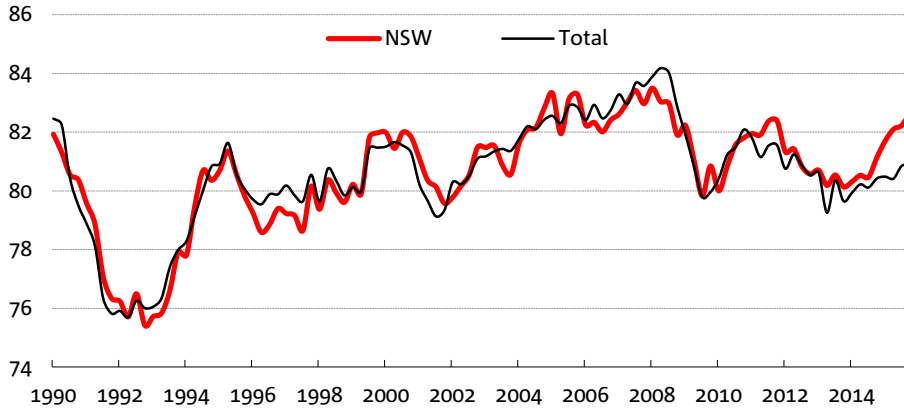
According to the monthly NAB Business Survey, capacity utilisation of businesses in NSW has steadily improved over the past 12-months, and is well above the national average (Chart 10). This trend is consistent with a trend improvement in business conditions in the state, which along with Victoria, has tended to outperform the other mainland states (Chart 11).

Tighter capacity (labour & capital) is a positive indication for wages and investment in the state.

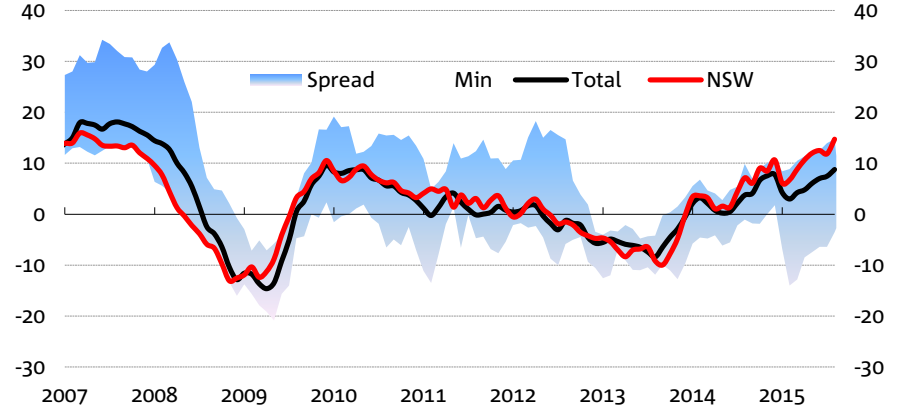
However, measures of investment intentions are mixed. Expectations from the NAB Business Survey are looking reasonably robust (Chart 12), while ABS capex expectations remain relatively muted (slide 6). Firms appear reluctant to invest in the current business environment, demanding high rates of return (hurdle rates) before committing to new projects.

Services sectors have consistently shown the best business conditions in the NAB Survey, but confidence has been more mixed – retail confidence has been a standout post the Federal Budget in May (Chart 13).

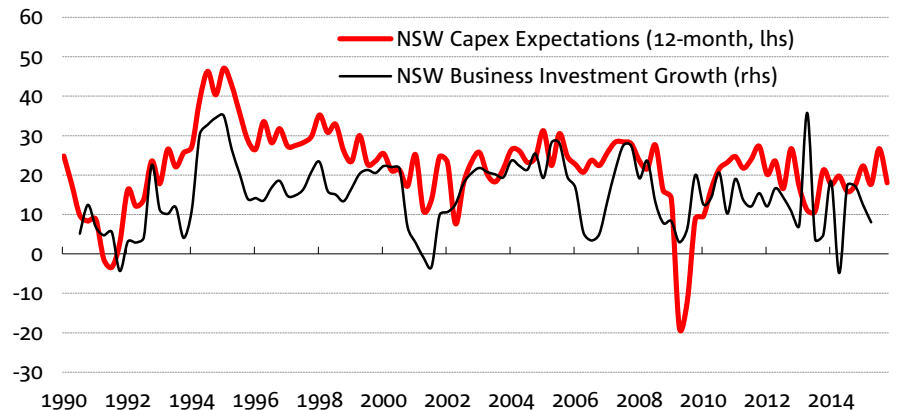
### Chart 10: NAB Business Survey – Capacity Utilisation



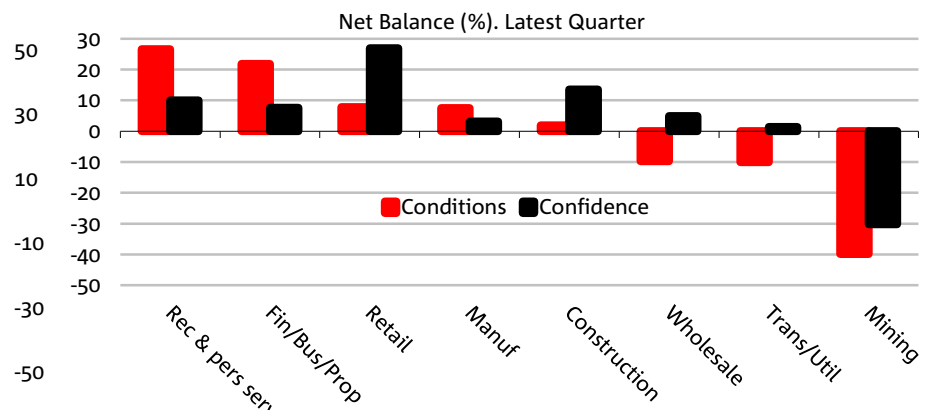
### Chart 11: Spread in NAB Business Conditions



### Chart 12: NAB Survey Capex Expectations & Private Business



### Chart 13: NSW Business Conditions & Confidence by State





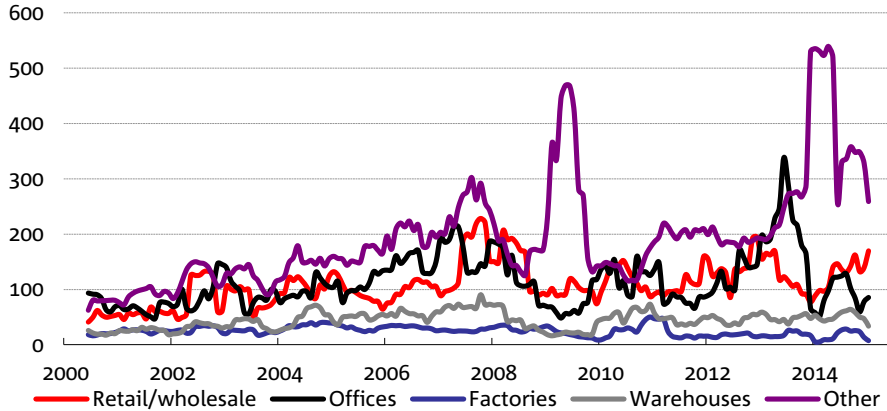
## Business reluctant to invest, although some large projects still in the pipeline

Reflecting firms reluctance to commit to new investment, non-residential building approvals have been relatively muted compared to the trends seen in the residential sector (Chart 14). However, some very large projects – such as the \$6bn Barangaroo project – will help support construction activity in the near-term.

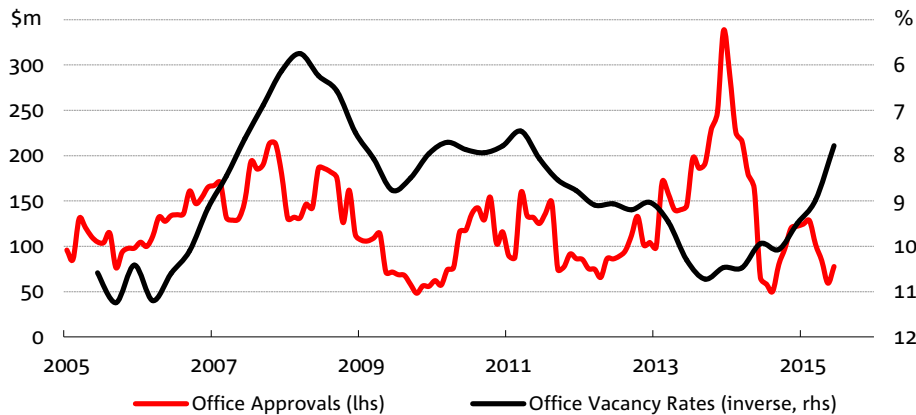
Falling office vacancy rates are consistent with an apparent improvement in office (and other commercial property) markets according to NAB Commercial Property Survey (Charts 16 & 17).

Expected capital expenditure (capex) by businesses (according to the ABS survey) suggests that spending on buildings and structures in NSW is likely to remain relatively flat in the next 12 months, while planned spending on machinery and equipment is expected to improve moderately (Chart 15). Part of the subdued outlook is explained by the continuing contraction of mining investment.

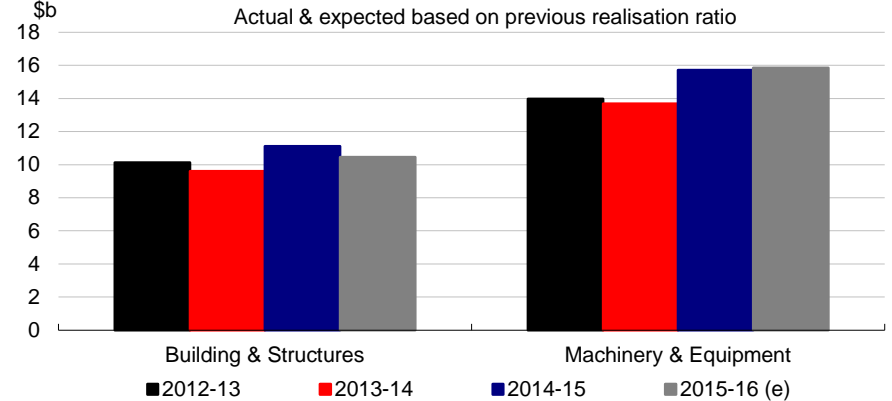
**Chart 14: Non-residential Building Approvals (\$ millions)**



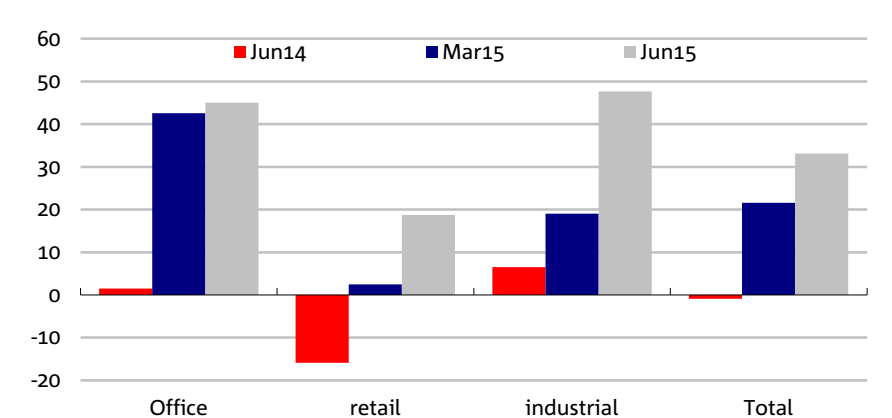
**Chart 16: NSW Office Market Conditions**



**Chart 15: NSW Capital Expenditure & Expectations**



**Chart 17: NAB Commercial Property Index - NSW**





# Strong employment growth despite elevated unemployment rate

Labour market conditions vary considerably across the state. While conditions appear to be improving around Greater Sydney, regional areas continue to look relatively weak (Chart 18).

Aggregate job growth has been strong in NSW, with 118k jobs created over the year to July 2015 – the strongest gain in around 7 years. However, solid population growth and a rising participation rate meant that the unemployment rate has remained near its recent peak (at 6%, Chart 20).

In the last 12 months to June 2015, most of the jobs created were in construction – consistent with the large residential construction pipeline – and the services sectors. Unsurprisingly, job losses have been largest in public administration and mining, consistent with fiscal restraint, a deterioration in coal markets and falls in mining investment (Chart 19).

Chart 18: Unemployment rate by region, % nsa

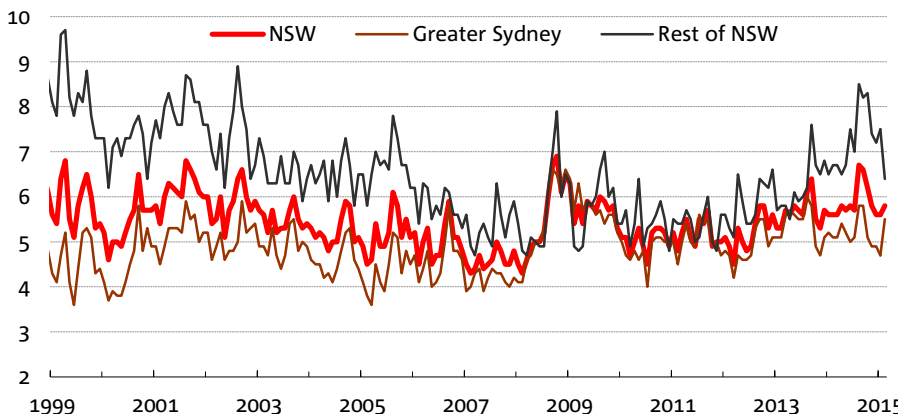


Chart 20: Unemployment rate & NAB capacity utilisation rate

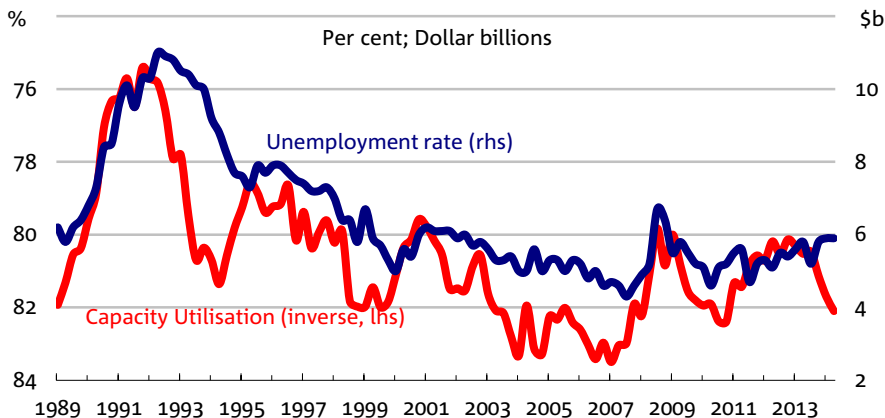
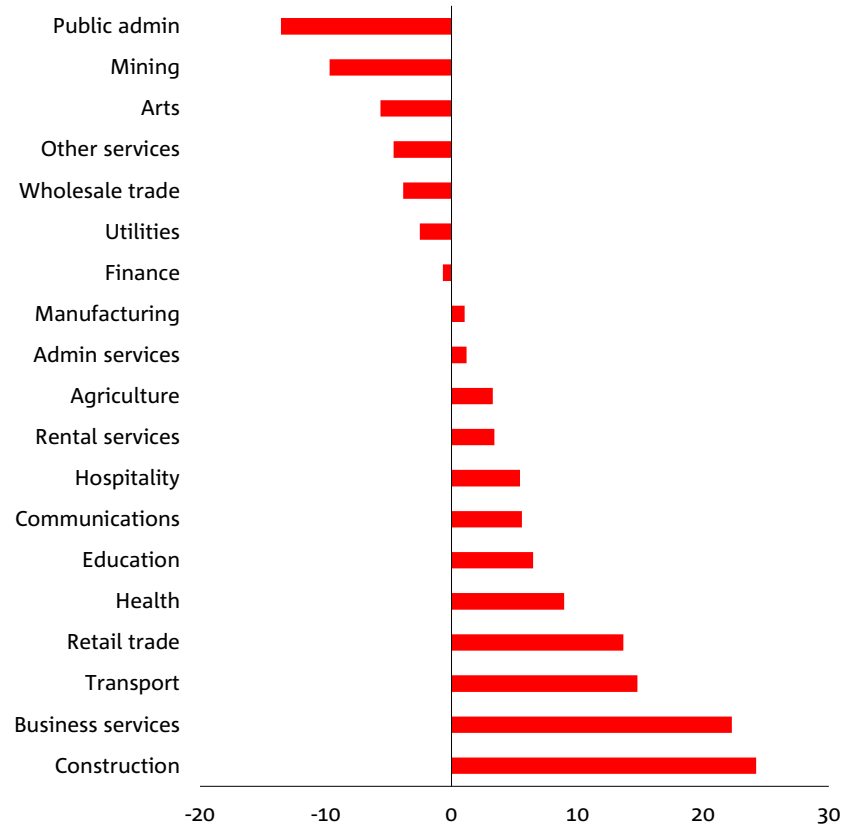


Chart 19: Change in employment by industry, last 12 months, NSW, '000





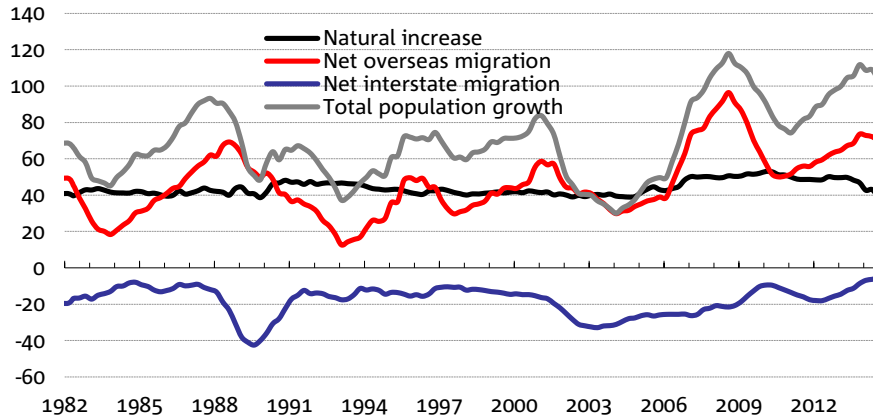
# Demographic trends turning more positive as mining investment boom winds down

Since peaking in 2009, NSW population growth has slowed, but much more modestly than in other (especially non-mining) states. The slowdown has largely been driven by net overseas migration and natural increases. In contrast, net interstate migration continues to slow as the mining boom unwinds (Chart 21).

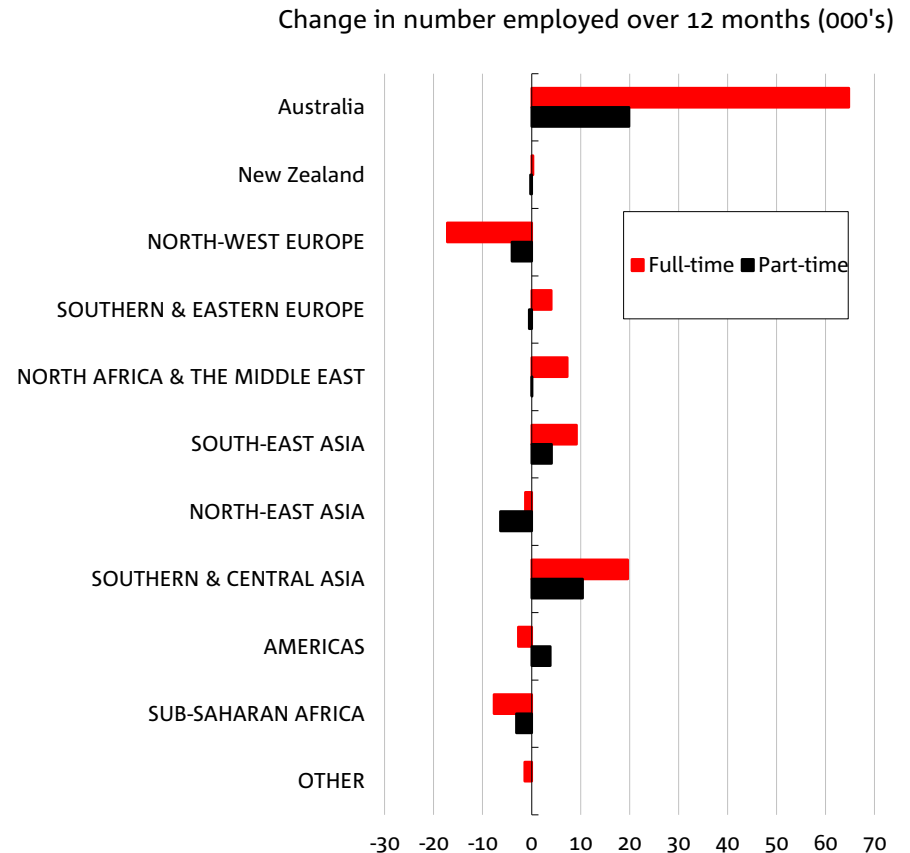
After lagging behind for more than a decade, NSW population growth is now consistent with national average levels (Chart 23).

Population trends are consistent with observations from the labour market. While employment growth in NSW has improved notably, it appears that domestic workers have largely satisfied the growing demand (Chart 22).

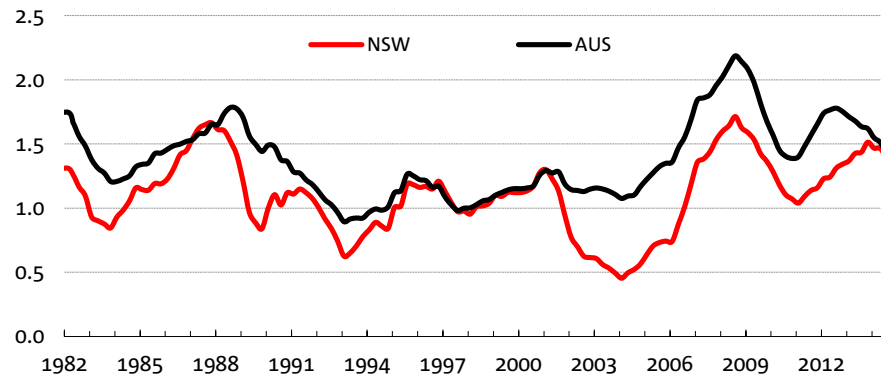
### Chart 21: NSW Population growth (000s, over the year)



### Chart 22: NSW Employment by country of birth



### Chart 23: NSW Population growth (year-ended growth)







# Residential property market a stand out, but momentum likely to slow

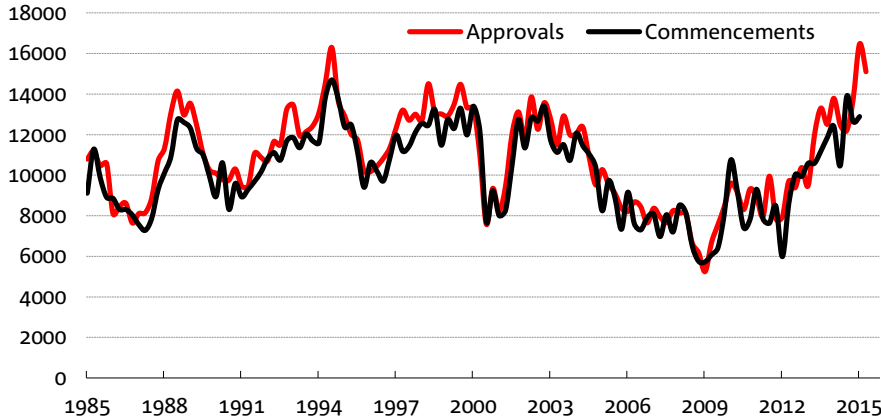
The NSW residential property sector remains very strong, supporting high levels of approvals and commencements, as well as the rapid pace of residential property price growth (Chart 24).

The NAB Property Survey suggest the market will continue to perform well in the near-term, although the pace of price growth is likely to slow (Chart 26).

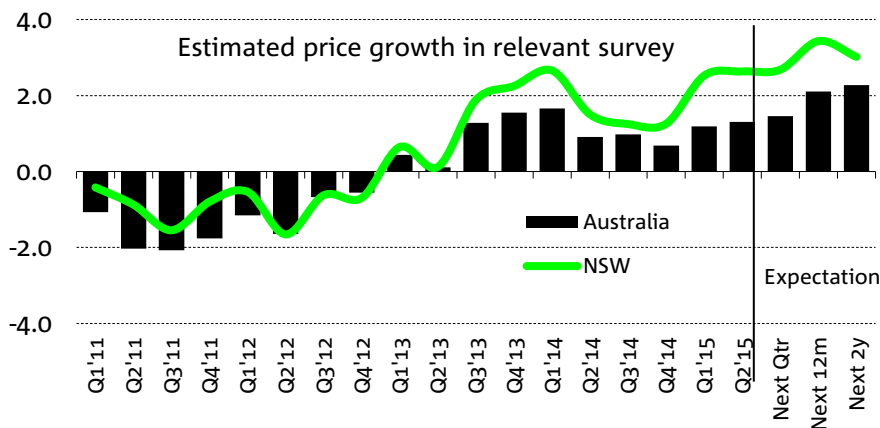
Price growth has varied across property types and regions, although all have generally performed reasonably well (Chart 25). Price growth is particularly strong in Sydney houses, followed by units. Growth has been more subdued for regional houses, but has still risen by more than 5% over the year to July.

Residential property price growth by sub-region in Sydney suggests fairly consistent capital growth for both houses and units across regions (Chart 27).

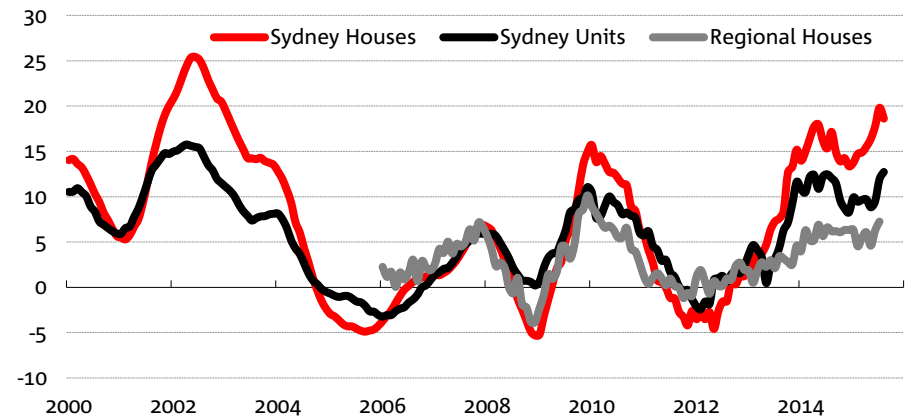
**Chart 24: NSW Residential Approvals & Commencements**



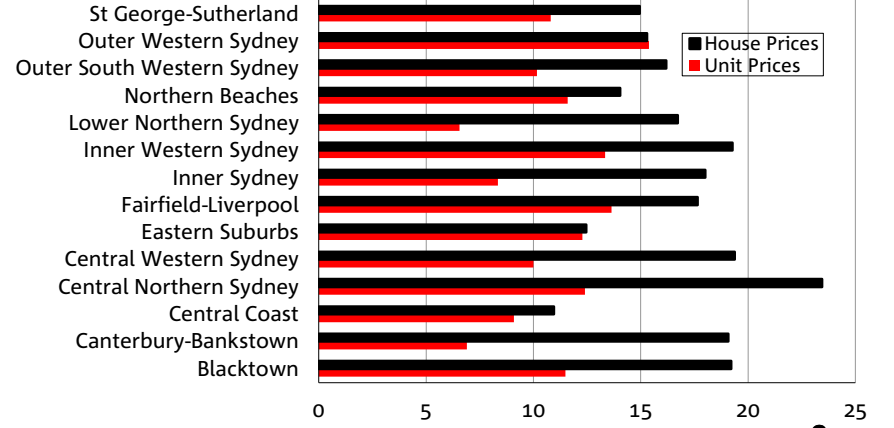
**Chart 26: NAB Property Survey – House Price Expectations (%)**



**Chart 25: NSW Residential Property Price Growth**



**Chart 27: Sydney - Median Property Price Growth (year to Q1 2015)**





# Fiscal position helped by residential transfer duties. Extensive infrastructure investment pipeline

The State Budget for NSW continues to anticipate an operating surplus going forward. While the surplus has been boosted by a restructuring of transport assets, the surplus excluding the restructuring for 2014-15 and 2015-16 is still up from the 2014-15 Budget (Chart 28).

Upward revisions to revenues in 2014-15 reflect higher-than-expected residential transfer duty, the re-profiling of Commonwealth grants, and higher distributions from the Public Non-Financial Corporation sector. Revenue growth is expected to moderate in coming years due to a change in GST relativities and falling CNP payments.

The NSW government remains focused on expense restraint. Expenses for 2014-15 are expected to come under Budget by \$311 million, while expense growth over coming years is expected to average 2.8%.

Nevertheless, there continues to be an extensive infrastructure investment plan in NSW, which will help to drive support to the local economy over coming years. The 2015-16 Budget includes \$68.6b committed to infrastructure projects over the four years to 2018-19 (across both GG and PNFCs). Much of this relates to previously announced transport projects.

Chart 28: NSW net operating balance & transfer duty revenue (% of GSP)

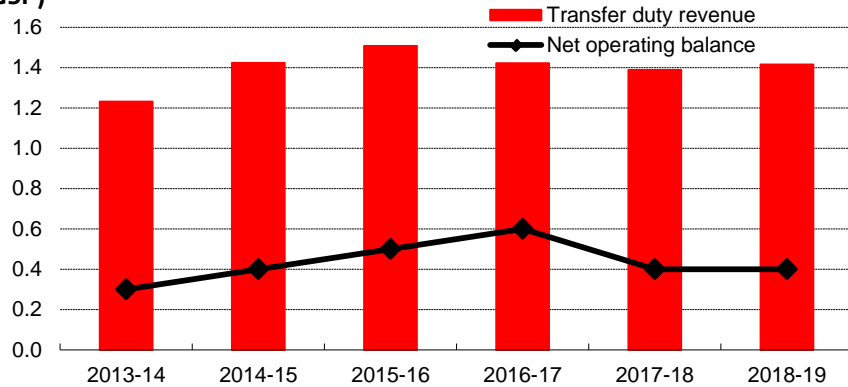


Chart 30: NSW state capital spending by function

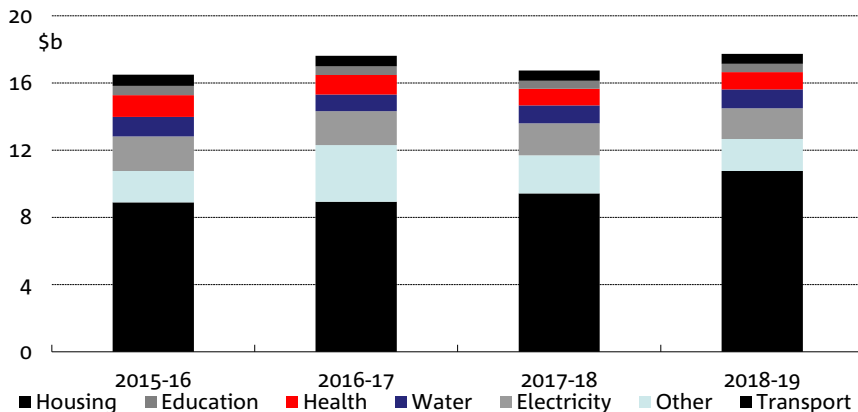
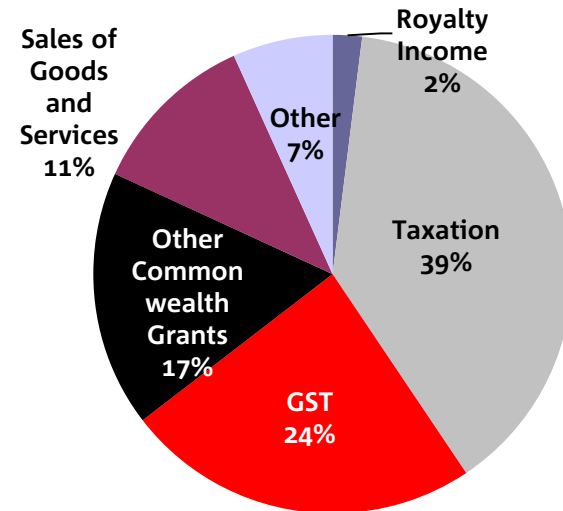


Chart 29: NSW Composition of state revenues



Sources: NSW State Budget; NAB Economics



## Net debt to rise but manageable; borrowings to decline with sale of 'poles and wires'

NSW net debt is being impacted by asset sales where the initial reduction in net debt position (as proceeds are included) is unwound as these are reinvested into capital expenditure. Current estimates do not include proceeds from the partial lease of electricity network.

NSWTC plans to issue AUD7.3bn in 2015-16, comprising AUD5.1bn of refinancing and AUD2.2bn of new borrowings. NSWTC forecasts issuance to average AUD7bn over the forward estimates. Projections do not include retirement of debt from the lease of poles and wires.

The AAA rating with stable outlook was unaffected by the 2015-16 budget. S&P noted that budgetary performance will be slightly weaker due to the softer revenue growth profile. Projections for budgetary performance and debt are consistent with AAA rating.

In 2015-16 NSWTC plans to issue AUD4-5bn of fixed rate benchmark lines and AUD1-2bn of FRNs. With legislation limiting NSWTC to only lend to entities that are 100% owned, the sale of 'poles and wires' will reduce borrowings by AUD15.7bn (currently at AUD50bn).

Chart 31: NSW Non-Financial Public Sector net debt

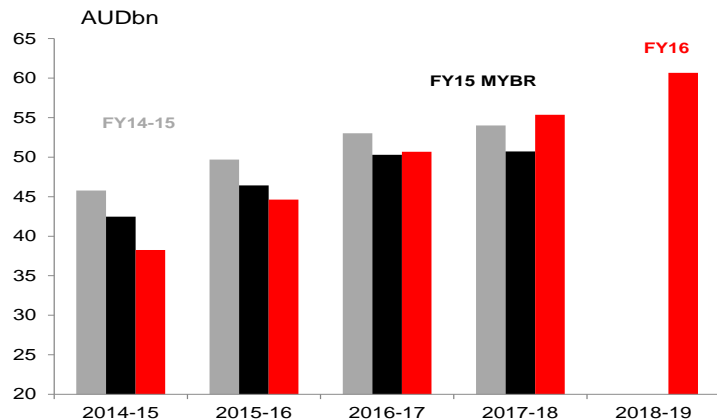


Chart 32: S&P credit metric: Operating balance as % of revenue

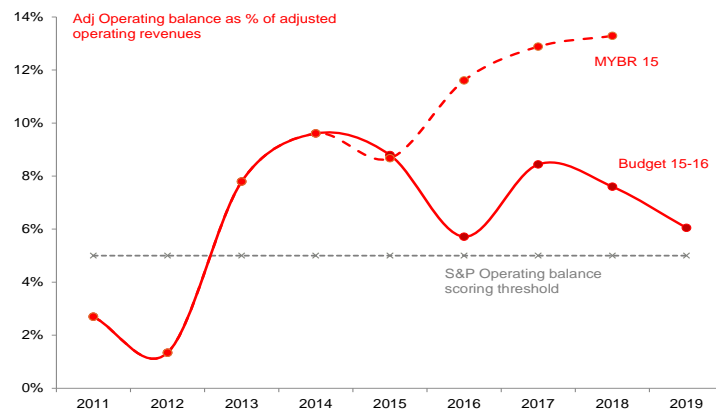


Chart 33: NSWTC borrowing programme

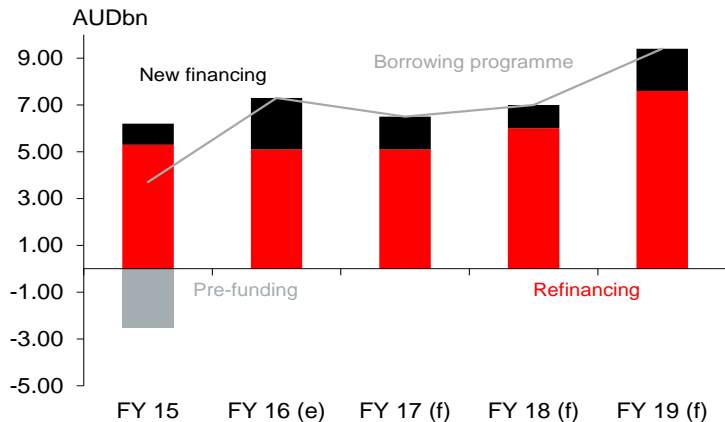
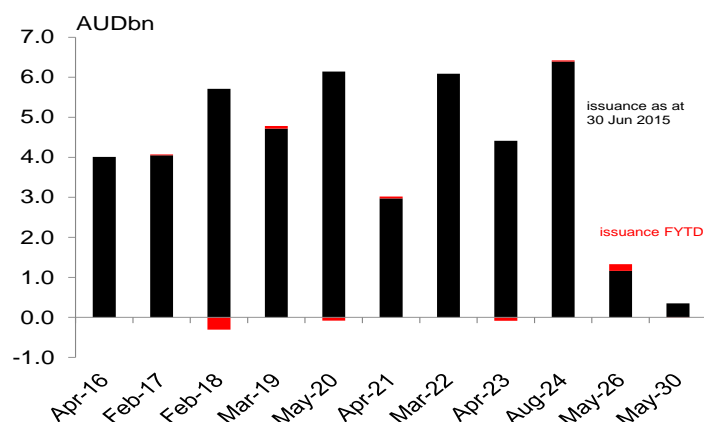


Chart 34: NSWTC term bonds outstanding as at early Aug 2015



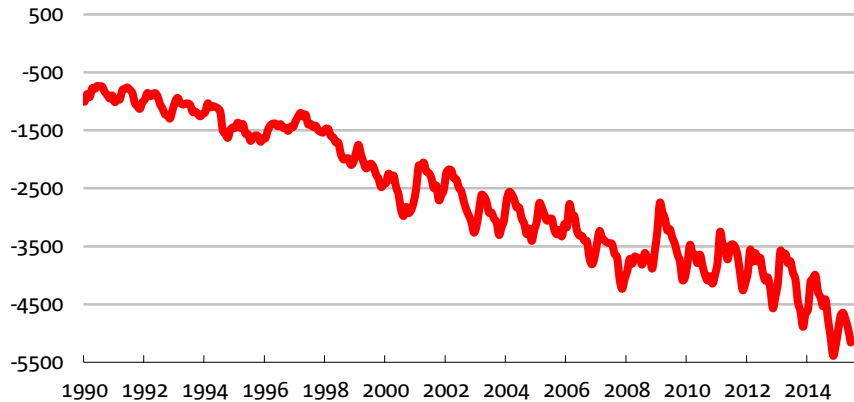


## Net exports still subdued, but AUD depreciation is starting to help export demand

Soft economic conditions interstate and internationally has kept demand for NSW exports relatively subdued. Meanwhile, moderate improvement in domestic demand has supported imports, weighing on the state's net trade position (Chart 35).

Nevertheless, AUD appreciation is starting to have an impact on export demand, particularly for services such as tourism. Short-term visitor arrivals to NSW have been steadily increasing (Chart 36).

Chart 35: NSW Net Trade (AUD millions, 3mma)



Top export destinations, NSW, 12-month average to May 2015

Value of exports (\$m)		Value of imports (\$m)			
1	Japan	9289	1	China	27084
2	China	5723	2	EU	19264
3	ASEAN	3592	3	ASEAN	13013
4	Korea	3292	4	US	11245
5	US	2880	5	Japan	6318
6	Taiwan	2164	6	Germany	5004
7	New Zealand	2044	7	Korea	4849
8	EU	1783	8	Singapore	2965
9	India	1327	9	UK	2780
10	HK	730	10	New Zealand	2473
11	UK	681	11	Taiwan	2111
12	Singapore	452	12	HK	518
13	Germany	128			

Chart 36: Short-term visitors – state where most time spent

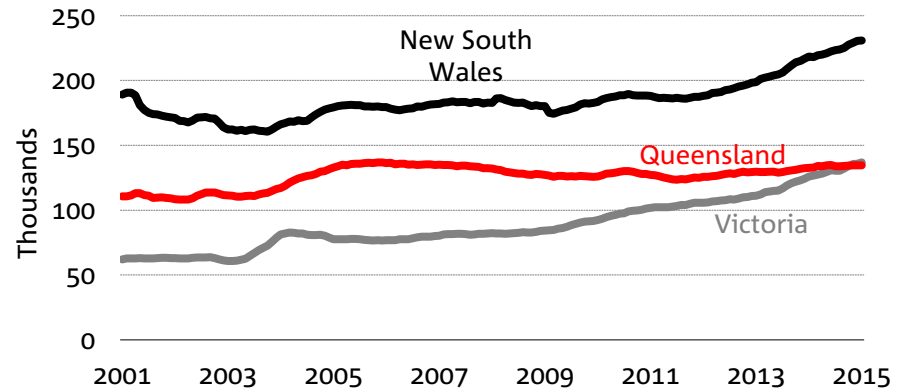
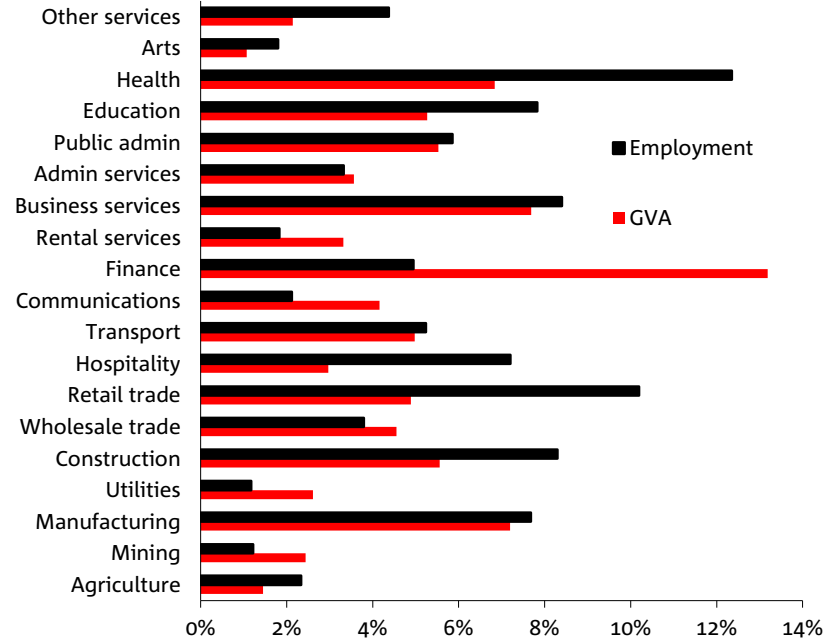


Chart 37: Composition of employment & GVA



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