

State Update: South Australia – September 2015

NAB Group Economics



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Key points

- The South Australian economy continues to underperform relative to the national average, failing to benefit significantly from the mining boom, while simultaneously lacking the right industry mix and job opportunities to draw workers back to the state as the national economy rebalances towards non-mining activity. This is reflected in a slowing population growth and the high unemployment rate of the state, which in turn is creating a very limited demand and price impetus for residential property. As a result, business conditions remain tepid, although there are some tentative green shoots emerging from the retail space. We expect the SA economy to grow by 1.7% in 15-16 and 16-17 and is not sufficient to prevent a rise in the average unemployment rate to 7.6% in 15-16 and 7.7% in 16-17.
- The structural decline of the manufacturing sector in the state is ongoing, but has shown signs of moderation in recent times. However, this decline is expected to gain pace upon the exits by Holden and Toyota in 2017. The Federal Government has announced plans to build \$40 billion worth of new surface ships for the navy in South Australia from 2018 onwards, but there continue to be uncertainties in whether the navy's next fleet of submarines will be built there. As such, there could be a gap in public spending in the near term after the completion of the Royal Adelaide Hospital next year. Meanwhile, services and construction industries have grown in importance in terms of their contribution to SA's economic activity and employment since the mid 2000s.
- The above is accompanied by population growth that is consistently below the national average and of an ageing profile, which has weighed on business and housing activity. Residential property prices in Adelaide and regional SA have largely flat-lined and are increasingly falling behind the national average. Since December last year, house prices growth in regional SA has started to contract. 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.
- Household consumption is a bright spot for the SA economy, with retail spending and household spending in general continuing to improve, although a high level of consumer caution is still evident, with consumer anxiety high compared to the national average (despite some improvement). This is despite generally weak labour market conditions, as SA overtook Tasmania since the start of this year as the state with the highest unemployment rate. However, a rising participation rate potentially flags a turnaround in underlying labour market conditions. Business conditions continue to be unremarkable in the state, characterised by lower capacity utilisation, weak business investment and an elevated office vacancy rate. That said, capital expenditure expectations for buildings and structures do suggest an uplift in 2015-16.
- Tax reform measures announced in the 2015-16 Budget are expected deliver almost \$670 million in tax reductions over the four years to 2018-19, mostly in the form of tax exemptions and cuts benefitting businesses. These will provide the much needed stimulus to revitalise the SA economy.

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Chart 1: State GSP Growth Forecasts

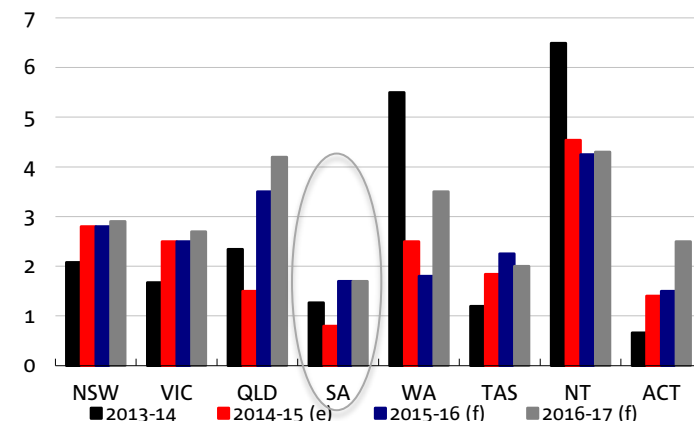
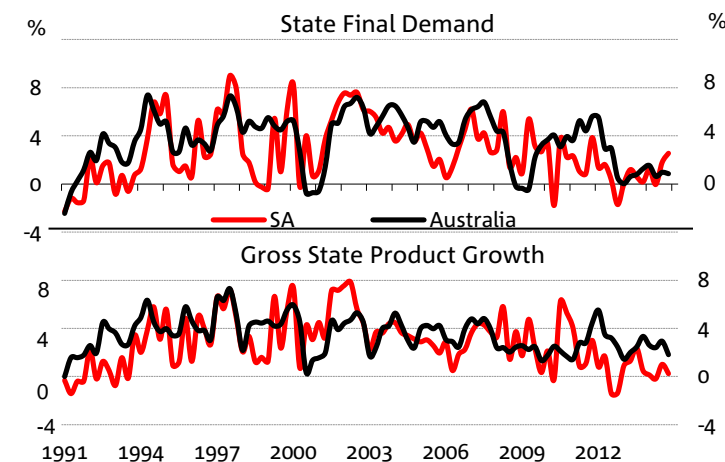


Chart 1: State Final Demand and GSP Growth* (y/y%)



In Focus: A slowing and ageing SA population poses a drag on the housing market

- South Australian population growth has moderated notably since late 2009, largely driven by lower net overseas migration and continuous net outflow of interstate migration. The SA population as a share of the Australian population has continued its structural decline (Chart 3).
- More importantly, SA population continues to age relative to the national average (Chart 4).
- SA manufacturing employment enjoyed a revival in 2013 and 2014, supported largely by a increase in food and beverage manufacturing jobs. However, the revival proved to be short-lived (Chart 5).
- Slowing population is one of the main factors weighing on the Adelaide housing market, but a falling dwellings to population ratio suggests some upside risks to prices in the medium term (Chart 6).

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

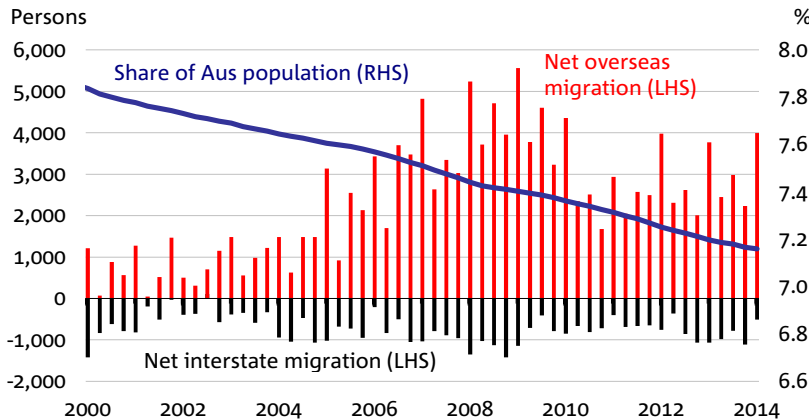


Chart 5: Manufacturing Employment

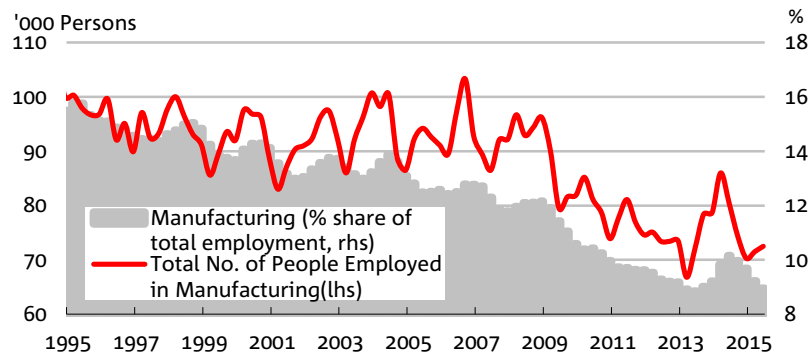


Chart 4: Age distribution of South Australian population

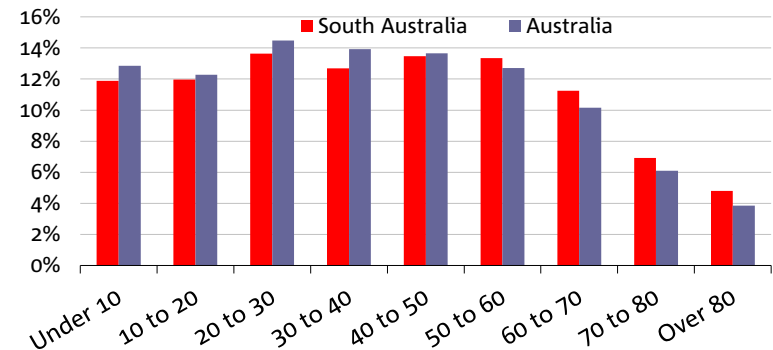
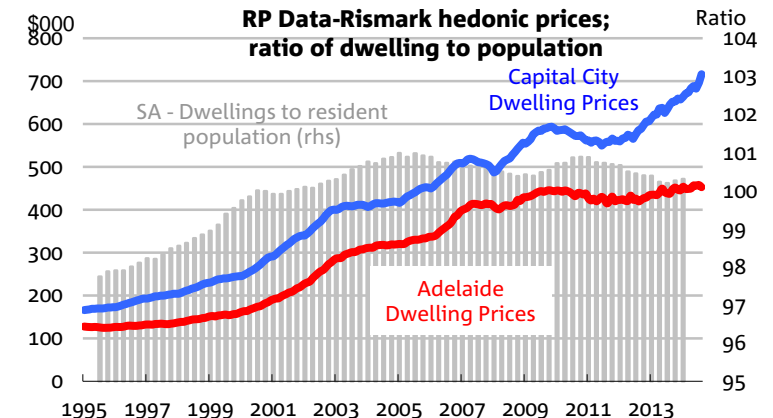


Chart 6: Adelaide House Prices and Dwellings to Population Ratio



Consumer and household sector showing momentum despite languishing house price growth

- Wages growth in SA has been relatively resilient, which has flowed into stronger household consumption (Chart 7).
- This is evident in a pick-up in retail spending growth, while house price growth appears to be losing momentum (Chart 9).
- Despite an improvement in consumer spending, consumers generally continue to exhibit a certain level of caution, as evident in their preferences to spending on essential items and paying down debt (Chart 8).

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

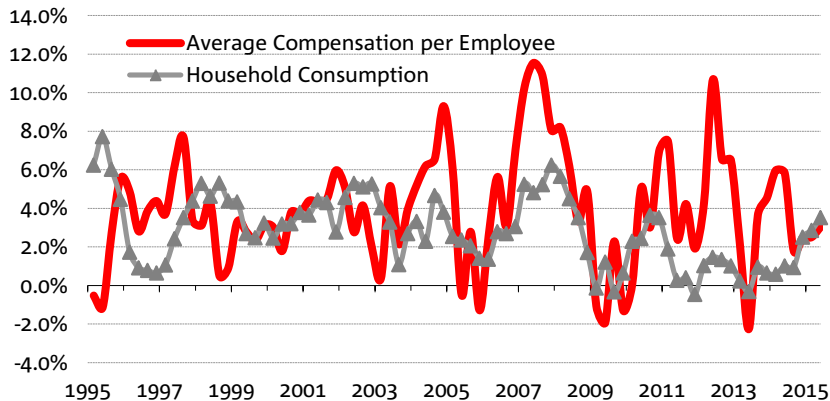
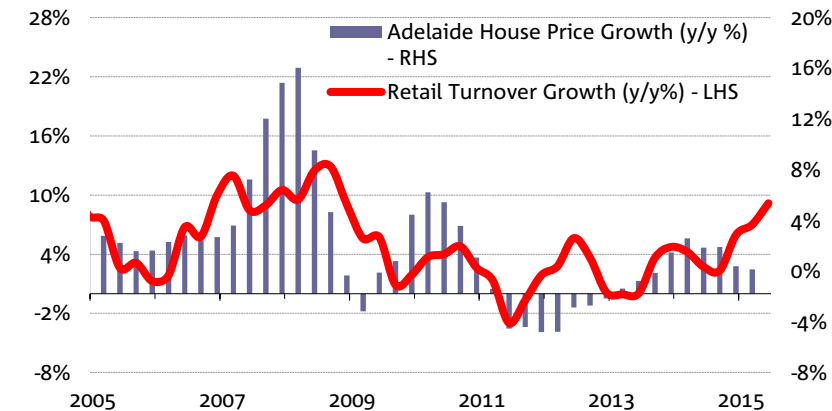
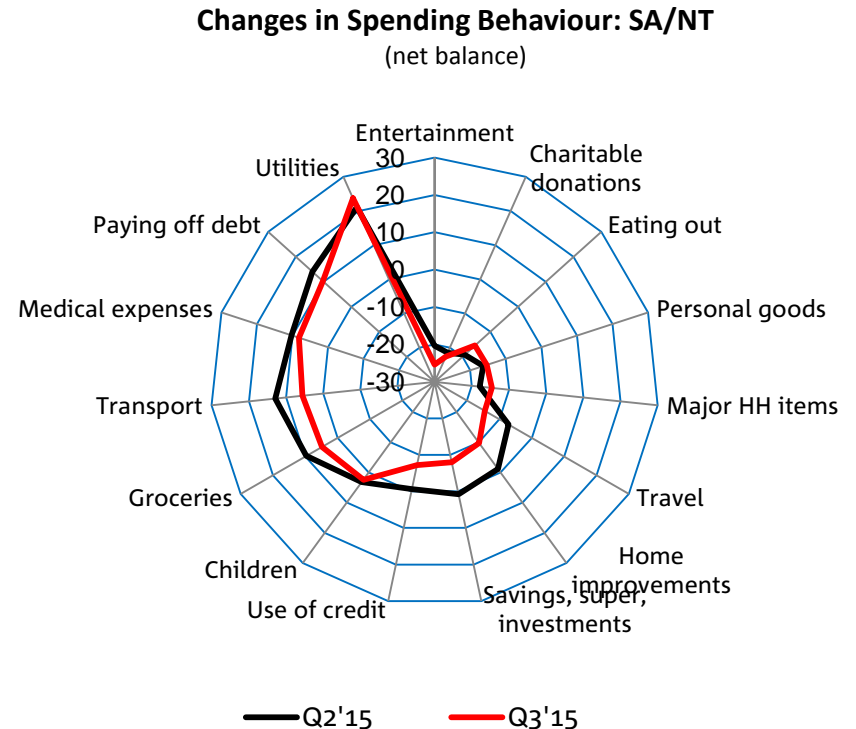


Chart 9: Retail Turnover and House Price Growth



Source: ABS, NAB Group Economics

Chart 8: NAB Consumer Anxiety Survey - Consumer Spending Preferences



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

- According to the monthly NAB Business Survey, capacity utilisation of businesses in SA has been on a downward trajectory since 2011, and fell below the national average recently (Chart 10). This trend is consistent with lower business conditions in the state, which had been the weakest across all mainland states since late 2014 (Chart 11).
- Business investment growth in SA remains subdued, despite reasonably robust capex expectations for the next 12 months. This is likely to reflect a shrinking manufacturing base and lacklustre commercial property performance (Chart 12).
- Services and traditional business sectors alike are plagued by weak business conditions, with the wholesale industry faring the worst, likely a reflection higher import costs due to a depreciated AUD (Chart 13).

Chart 10: NAB Business Survey – Capacity Utilisation

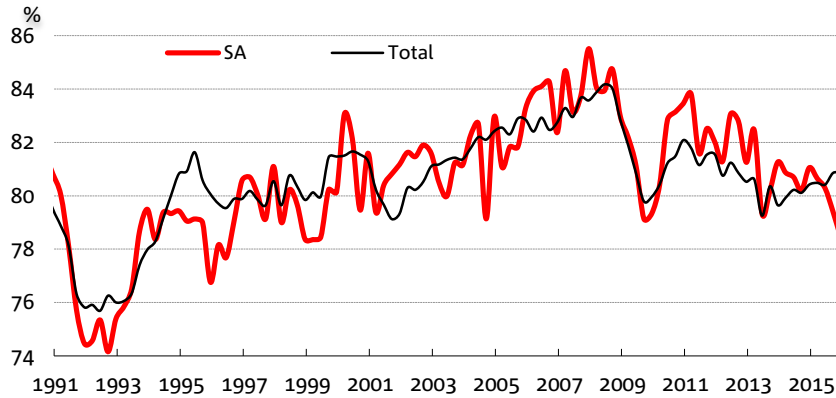
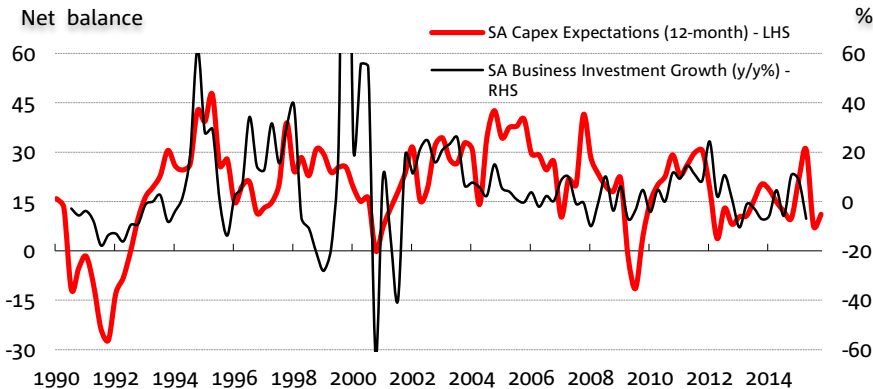


Chart 12: NAB Survey Capex Expectations & Private Business Investment Growth



Source: ABS, NAB Group Economics

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

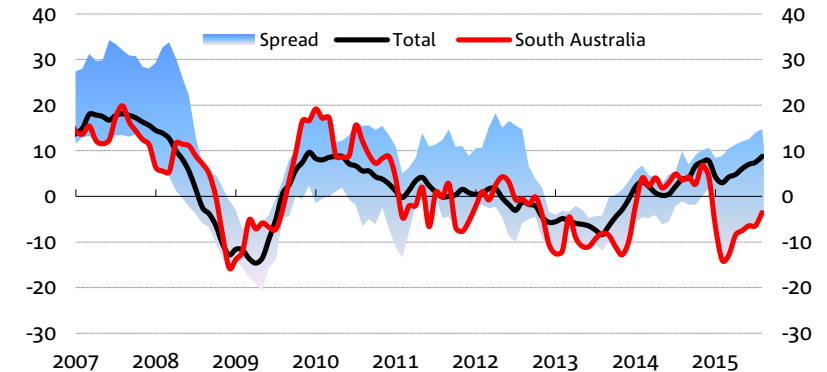
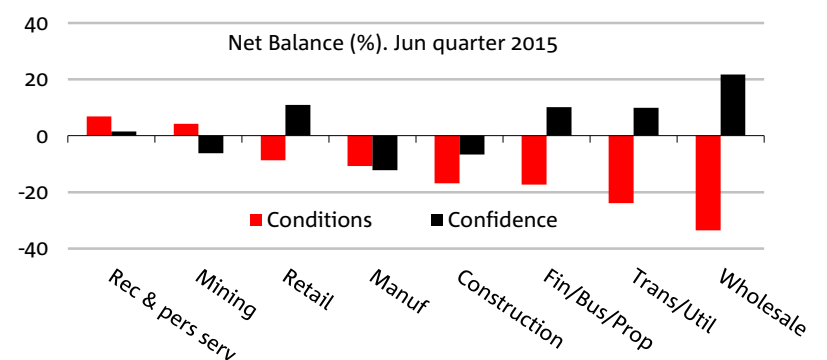


Chart 13: SA Business Conditions & Confidence by Industry



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

- Reflecting the soft appetite for business investment, non-residential building approvals have been tracking at low levels, except for a spike in “other” investment in 2011 resulting from the approval of the Olympic Dam expansion project. This project was eventually shelved by BHP in 2012 on the back of falling commodity prices (Chart 14).
- Rising office vacancy rates and low levels of office building approvals signal a substantial amount of spare capacity in the sector (Chart 15).
- That said, expected capital expenditure (capex) is higher for buildings and structures in 2015-16, while the planned spending on machinery and equipment is expected to remain at similar levels to previous years (Chart 16).

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

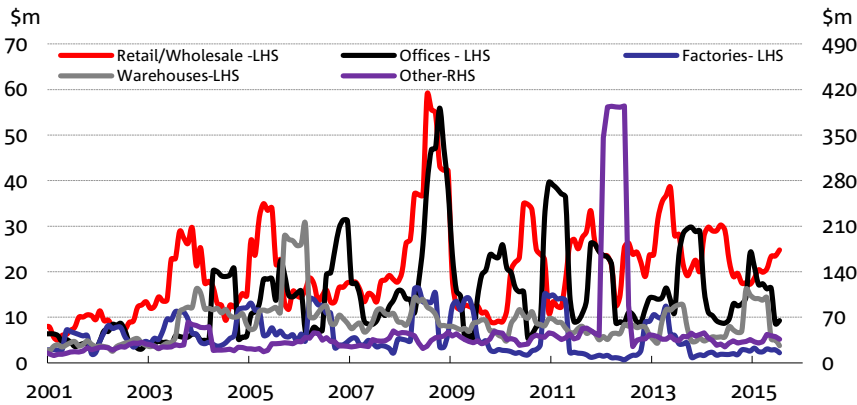


Chart 15: Office Approvals and Vacancy Rates

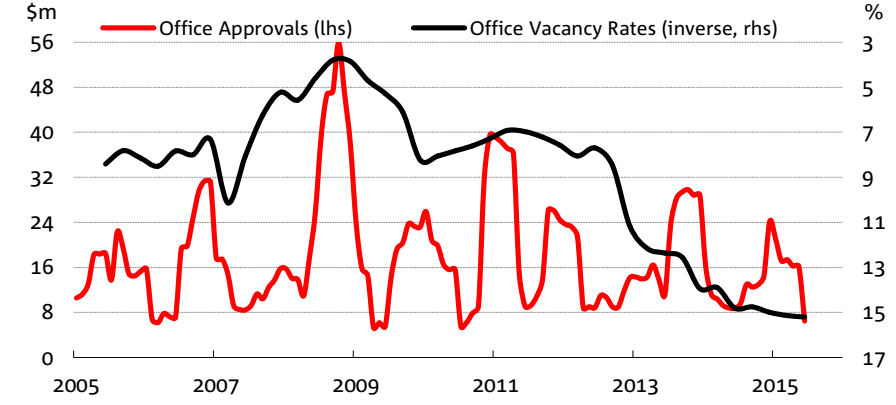
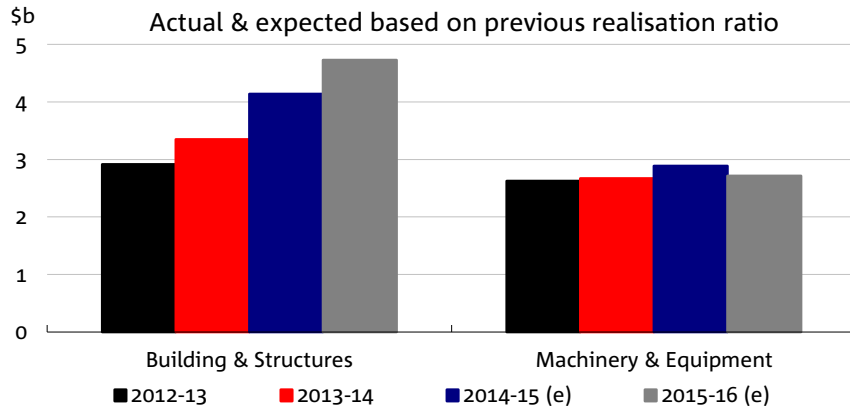


Chart 16: SA Capital Expenditure & Expectations



Labour Market

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

Chart 17: Unemployment Rate by Region

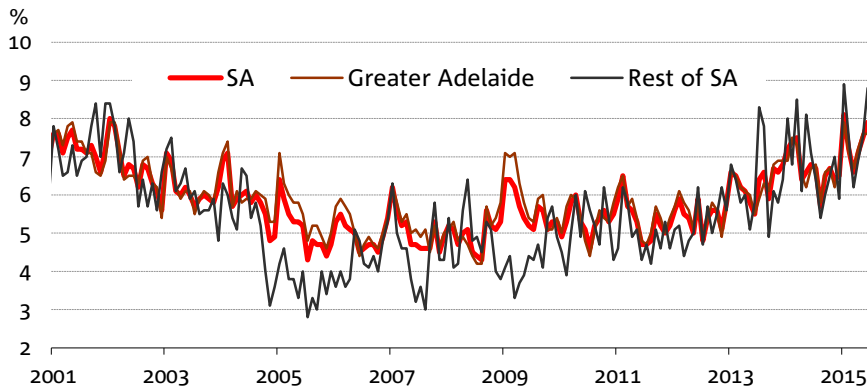
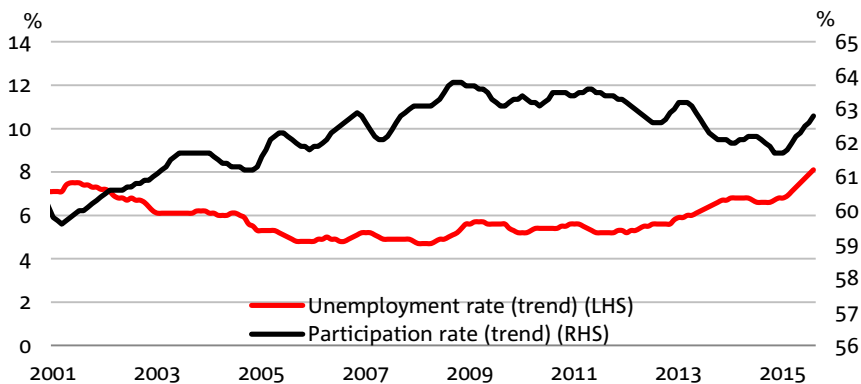


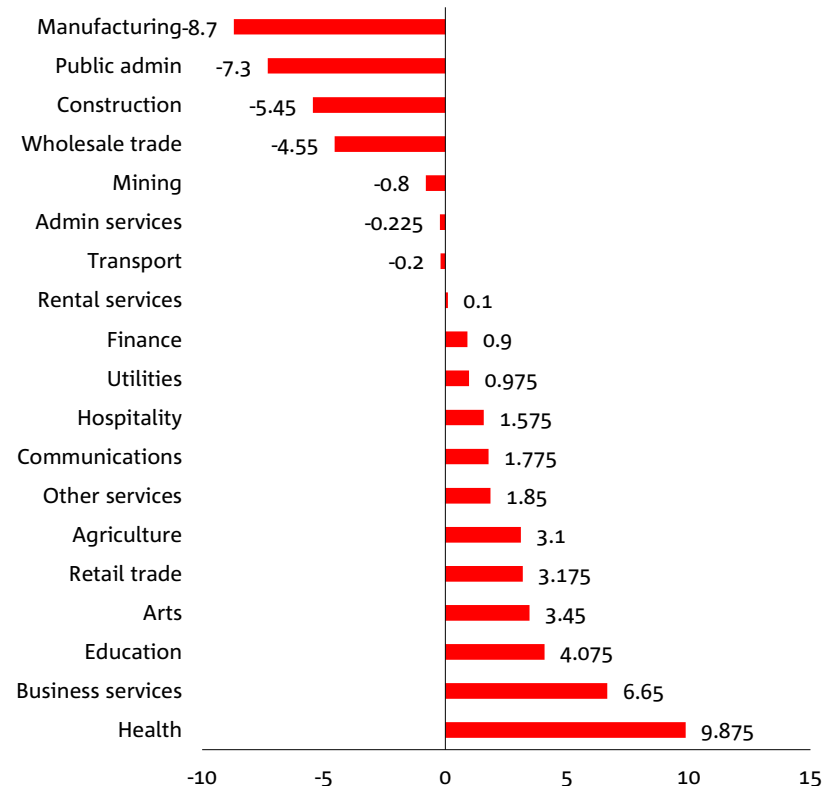
Chart 19: SA Unemployment & Participation Rates



Source: ABS, NAB Group Economics

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

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



SA share of Australian population continues its structural decline

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

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

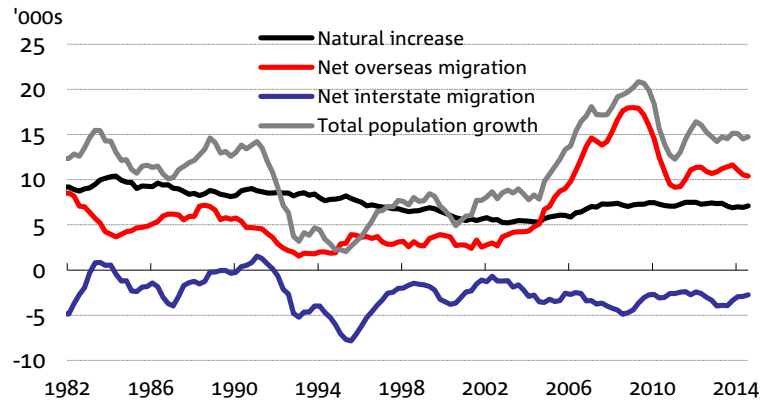
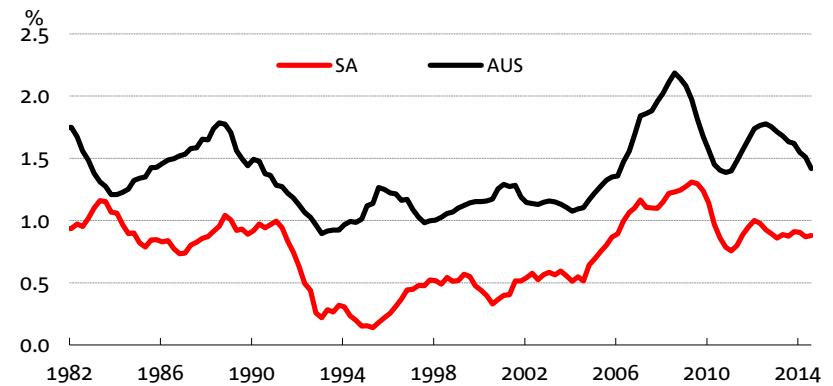


Chart 21: SA Population Growth (y/y%)



SA residential property prices expected to ease further

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

Chart 22: SA Residential Approvals & Commencements

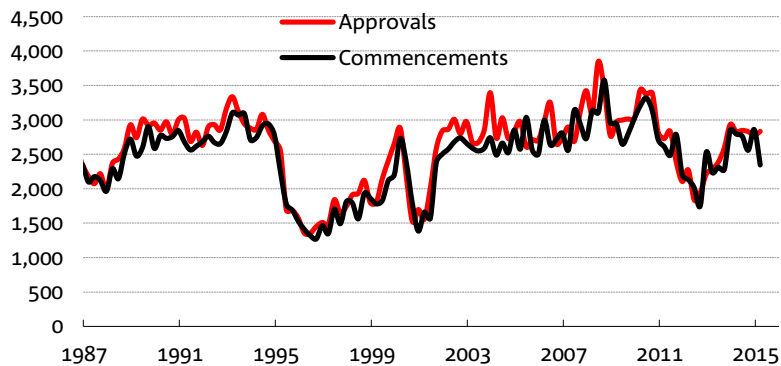


Chart 23: SA Residential Property Price Growth (y/y%)

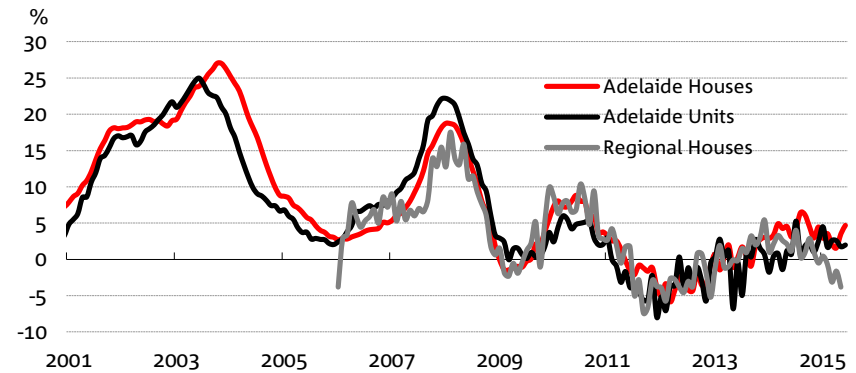


Chart 24: Adelaide - Median Property Price Growth (year to Q1 2015)

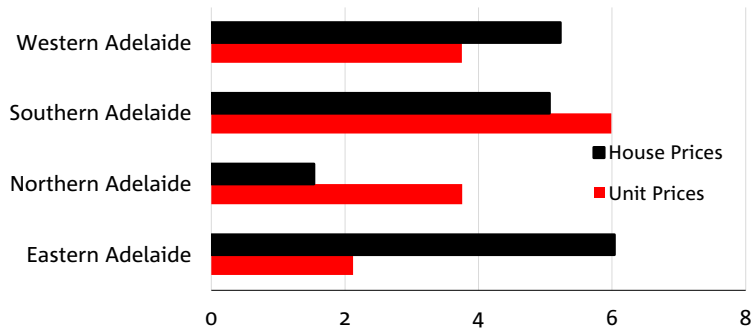
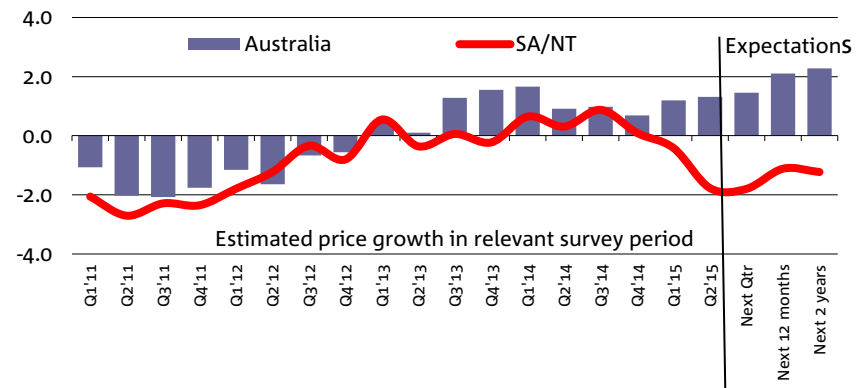


Chart 25: NAB Property Survey – House Price Expectations (%)

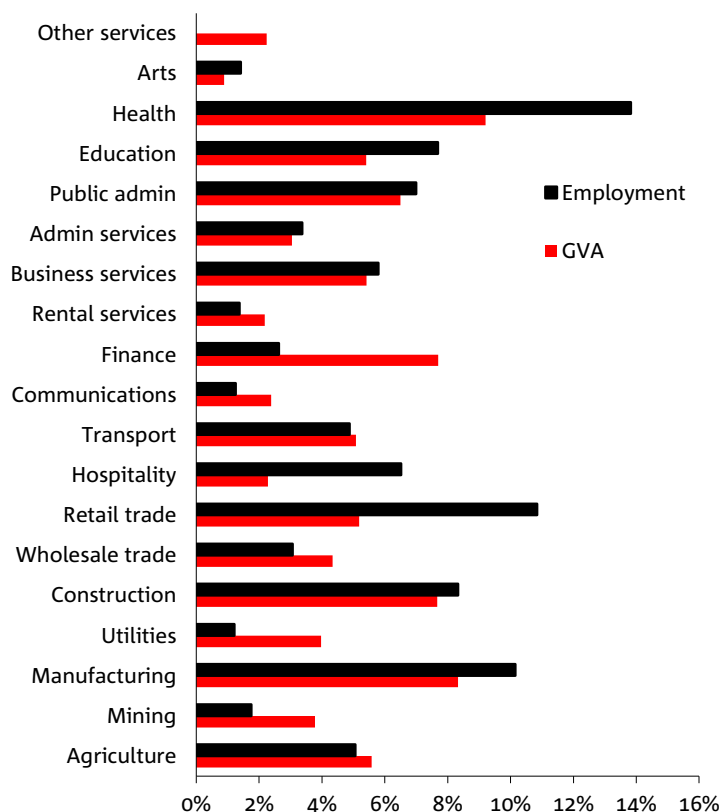


Services sectors are gaining prominence in output and employment shares over manufacturing

- The top three sectors in SA by output share are health services, manufacturing and finance & insurance services. The former overtook manufacturing as the largest industry by gross value added in 2008-09 and the largest employer in 2006-07 (Chart 26).
- By employment share, manufacturing (9%) is ranked third behind health and social services (16%) and retail trade (11%).

- China and the ASEAN bloc are the main trading partners for SA (Chart 27 & 28).
- SA's top commodity exports include iron ore and concentrates (\$1.6bn), wheat (\$1.4bn) and alcoholic beverages (\$1.2bn). Meanwhile, SA imports mainly refined petroleum (\$0.9bn), vehicle parts and accessories (\$0.6bn) and goods vehicles (\$0.4bn) from other countries (Chart 29 & 30).

Chart 26 : Composition of employment & GVA, 2013-14



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

| Value of exports (\$m) | | | Value of imports (\$m) | | |
|------------------------|-------------|------|------------------------|-------------|------|
| 1 | China | 2337 | 1 | ASEAN | 2057 |
| 2 | ASEAN | 1886 | 2 | China | 1486 |
| 3 | US | 1541 | 3 | EU | 1269 |
| 4 | EU | 1269 | 4 | Singapore | 948 |
| 5 | India | 819 | 5 | US | 853 |
| 6 | Japan | 524 | 6 | Japan | 532 |
| 7 | New Zealand | 454 | 7 | Korea | 476 |
| 8 | UK | 441 | 8 | Germany | 258 |
| 9 | HK | 252 | 9 | New Zealand | 216 |
| 10 | Korea | 225 | 10 | UK | 189 |
| 11 | Taiwan | 185 | 11 | Taiwan | 131 |
| 12 | Singapore | 120 | 12 | HK | 32 |
| 13 | Germany | 55 | | | |

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

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

SA services and agricultural exports

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

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

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

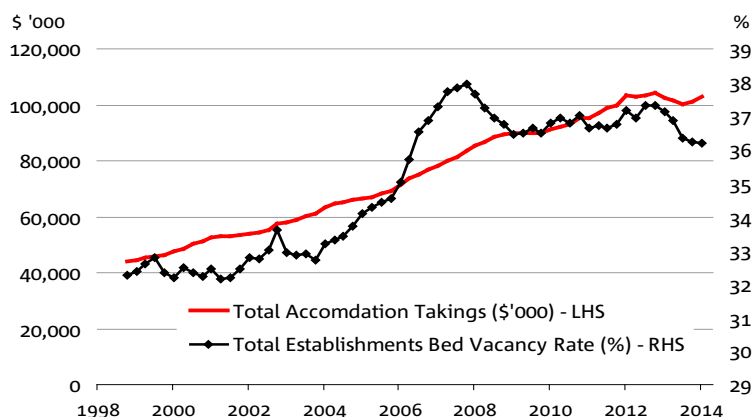
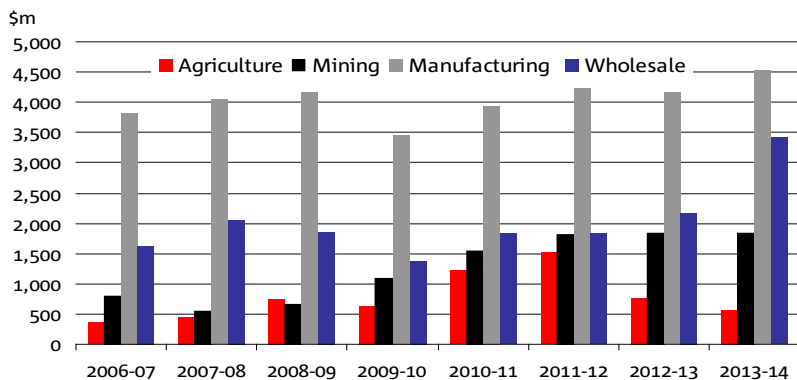
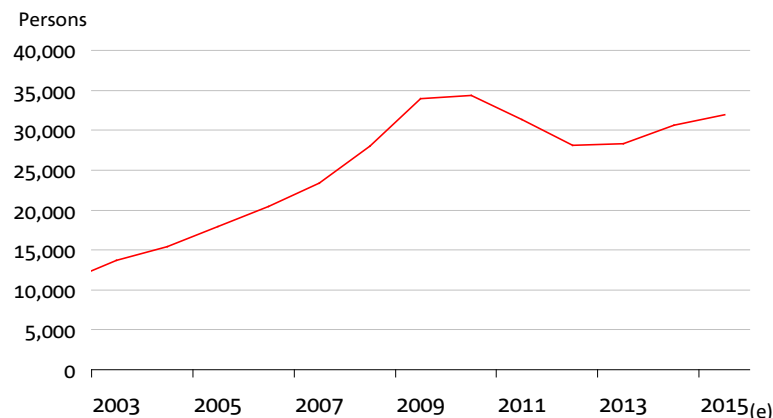


Chart 33: Value of South Australian Exports by Industry



Source: ABS, NAB Group Economics

Chart 32: International Student Enrolments



Note: Figures for 2015 are estimated based on monthly flows to Jun-15
Source: Australian Education International, NAB Group Economics

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

- The SA government has introduced some substantive tax cuts (estimated to be around \$670m over the forward estimates period) in the recent budget. They mainly involved providing tax cuts or exemptions for businesses, which will benefit SA's economy in the long term. This has an effect of lowering SA's net operating balance in the near term, while planned expenditure restraint in the out years will return the budget to surplus (Chart 34).
- Excluding the impact of policy measures introduced in the budget, the downward revisions to taxation revenue since the 2014-15 State Budget have been offset from 2015-16 by upwards revisions to GST revenue grants, the latter now being the largest source of state revenue at 32% (Chart 35).

Chart 34: SA Net Operating Balance

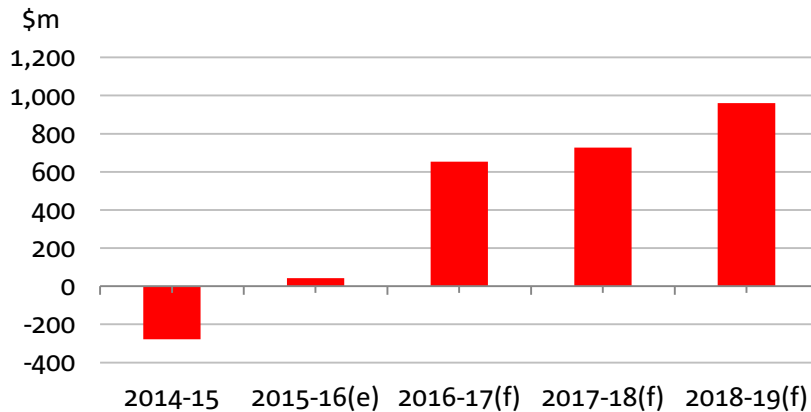
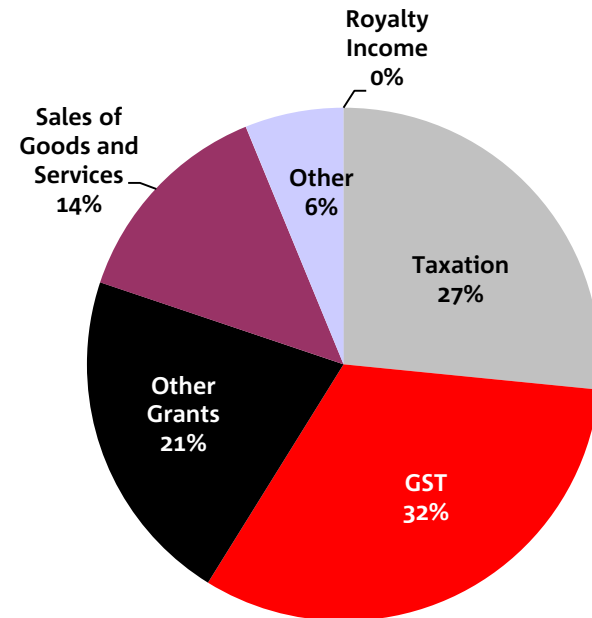


Chart 35: SA Composition of State Revenue



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

- Net debt is expected to rise over the next two years, peaking in June 2017, reflecting the recognition of the financial lease obligations for the Royal Adelaide Hospital (worth AUD2.8bn). The Government plans to fully fund defined benefit superannuation liability by 2034 (Chart 36).
- SAFA's borrowing programme for 2015-16 totals AUD4.2bn. Funding comprises AUD0.4bn of new loans, AUD2bn of refinancing and –AUD0.3bn of pre-funding. Fixed and FRN outstandings are estimated to be AUD14.4bn at Jun-16 and AUD16.1bn at Jun-17 (Chart 38).

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

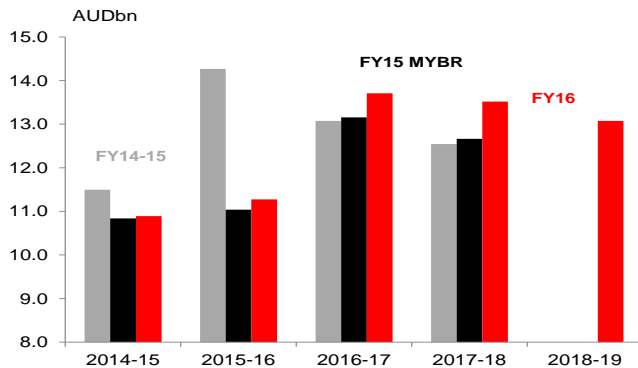
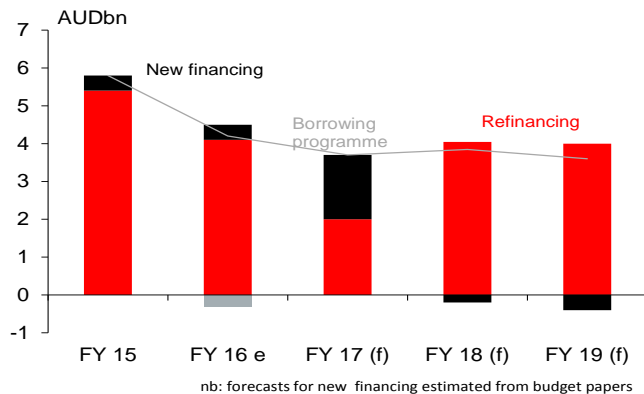


Chart 38 SAFA borrowing programme



Source: SAFA, SA Department of Treasury Finance

- South Australia's credit rating was not affected by 2015-16 budget. However, S&P noted that its projections for the states budget performance are more muted than those in the budget. The projected rise in tax supported debt in 2016-17 is within rating expectations (Chart 37).
- SAFA intends to refinance May 2016 FRN maturity via issuing into existing 2023 and 2025 lines and potentially creating new lines in 2022 and 2024. It has not been decided whether these new lines will be FRN or fixed (Chart 39)

Chart 37: S&P credit metric: Budget Performance

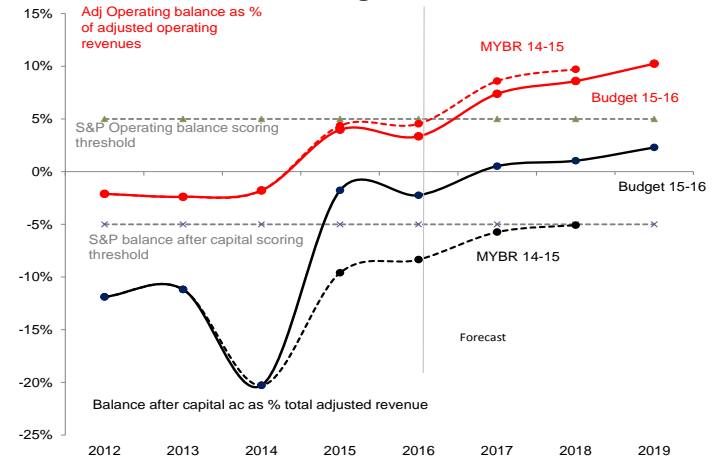
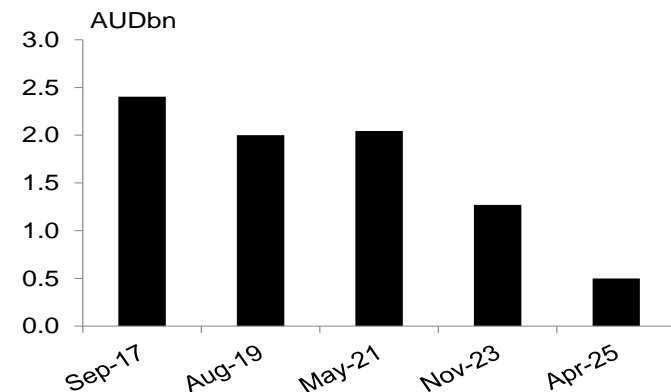


Chart 39: SAFA term bonds outstanding as at July 2015



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