

State Update: Victoria – September 2015

NAB Group Economics



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Key points

- **A rebalancing of national growth towards the large non-mining states has witnessed a pick-up in the momentum of Victorian economic activity over 2014 and 2015-to-date.** This is reflected in the improved performance by the state's traditional growth drivers of household consumption and dwelling investment. Victorian business conditions have embarked on an upward trend since mid-2013 to be the strongest (in trend terms) of all mainland states in recent months. Nonetheless, the labour market remains generally weak, with unemployment rate expected to moderate only slightly in the medium term. We forecast Victorian real GSP growth to be around 2½% in 2015-16 and will pick up slightly to 2¾% in 2016-17. Correspondingly, the unemployment rate is forecast to fall marginally to 6.2% by 16-17, from 6.4% in 14-15.
- **The large share of services in the Victorian economy suggests that the state is well-positioned to take advantage of the lower AUD in its tourism and education exports sectors. Foreign student numbers as indicated by student enrolments picked up strongly in 2014 and 2015 to-date, with 2015 numbers expected to come close to the historical record in 2009.** Meanwhile, anecdotal evidence from our NAB Monthly Business Survey and aviation statistics also suggest that inbound tourism to Victoria from domestic and foreign sources have continued to improve, with a major-step up in the latter since the beginning of this year.
- **Supported by low interest rates and strong asset price growth, Victorian household consumption has grown steadily since early 2013, only to trail behind NSW, and more recently, Tasmania.** Improved consumer optimism is also evident in a falling household saving ratio and a greater propensity by consumers in undertaking discretionary spending, with our Consumer Anxiety Survey showing that Victorian consumers are now more likely to spend on travelling, eating out and charitable donations.
- **Notwithstanding some improvements in employment since late 2014, the unemployment and underutilisation rates remain elevated.** This provides very little impetus to wages growth for the state, which is at historically low levels and among the weakest across jurisdictions. As a result, there are significant downside risks to consumption growth in the medium-term. The relatively high unemployment rate in Victoria could also be partly attributable to the strong growth in its labour force which was in turn brought about by a recovery in net overseas migration and net inflow of interstate migration. Victoria now has the highest population growth across all states and territories.
- **Dwelling investment is a standout sector of the economy, marked by record levels of dwelling approvals.** The construction pipeline is largely constituted of apartments and units, in turn spurred by solid growth in Victorian house prices over last few years, with Melbourne prices now around 20% higher than its recent trough in 2012. House price growth expected to moderate.
- **Meanwhile, business investment growth has remained modest despite low borrowing costs and improved business conditions, following a period of stagnation since the GFC.** Our research suggests that firms' hurdle rates to undertake investment continue to be significantly higher than their borrowing rates, and firms are likely to require further improvements in business conditions before entering into an expansionary investment mode. Capex expectations for the state point to flat spending in both machinery & equipment and buildings & structures for 2015-16 and 2016-15.
- **Victorian exports are expected to be robust in the near term, driven by strong education and rural commodity exports which are in turn supported by a lower AUD.**

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Chart 1: State GSP Growth Forecasts (Annual % ch)

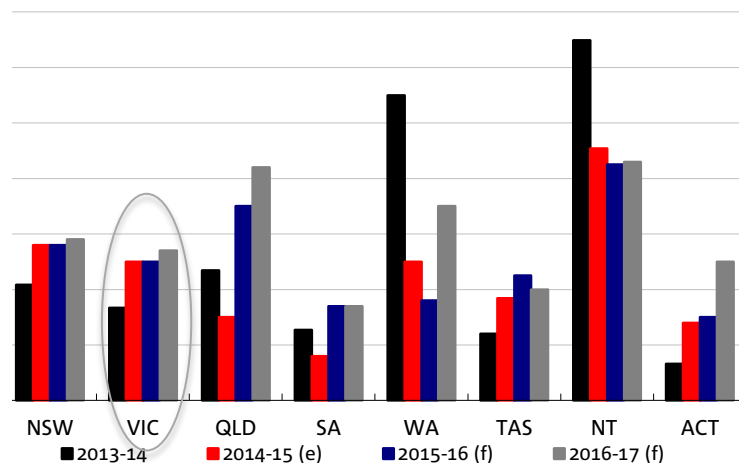
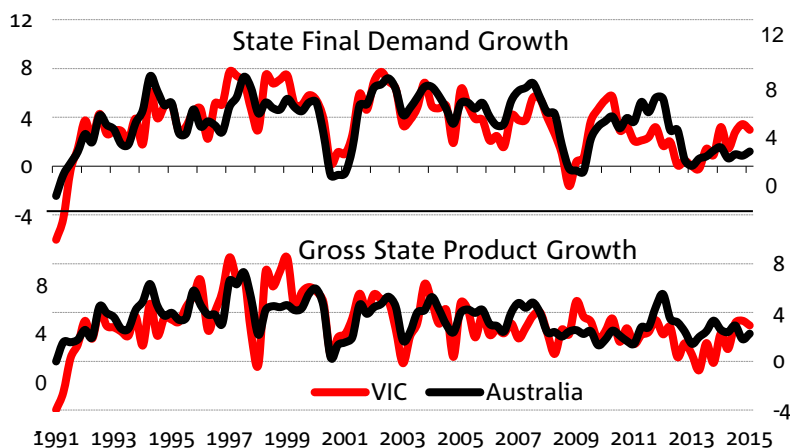


Chart 2: State Final Demand and Gross State Product* (y/y%)



Source: ABS, NAB Group Economics Note: * GSP have been estimated



In Focus: A rebalancing national economy sees workers returning to Victoria

- Victorian population growth continues to outpace the other states, driven by strong net overseas and interstate migration (Chart 3).
- Dwelling investment in Victoria has picked up strongly in 2013 and 2014, marked by record-levels of residential approvals, with the construction pipeline mainly constituted of multi-unit dwellings (Chart 4).

- Despite some recent improvement, the Victorian labour market is still weak overall, marked by an elevated unemployment rate and a high level of spare capacity (Chart 5).
- A rebalancing towards non-mining activity points to the Victorian services sectors generally outperforming traditional sectors in confidence and conditions, according to NAB Business Survey. Construction conditions and confidence are also very strong on the back of robust housing activity (Chart 6).

Chart 3: Population Growth Drivers in Victoria in 2014

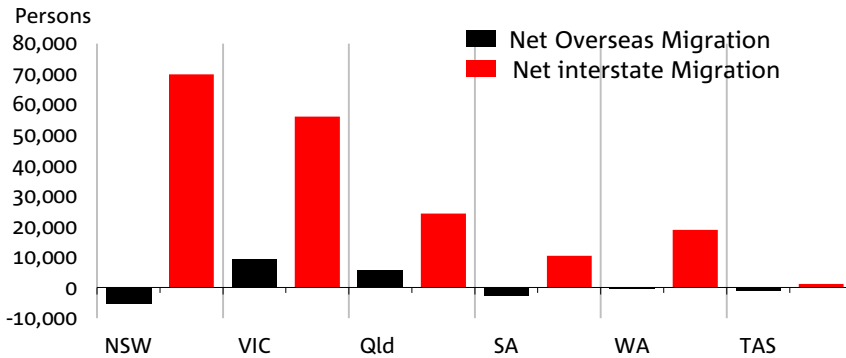


Chart 4: Residential Building Approvals and Construction Pipeline

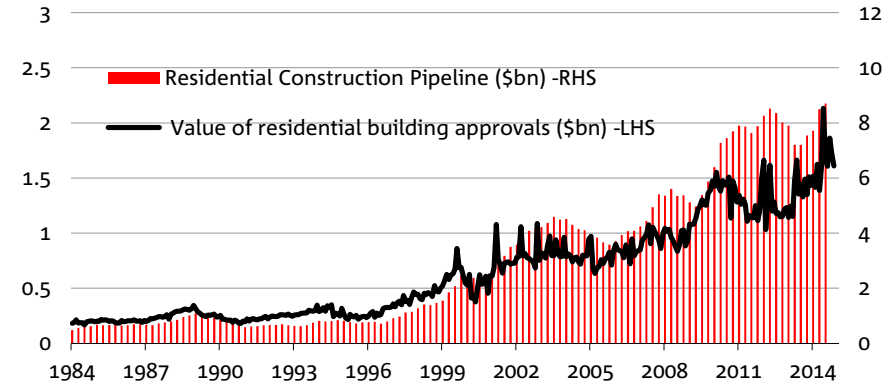


Chart 5: Unemployment and Underutilisation Rates

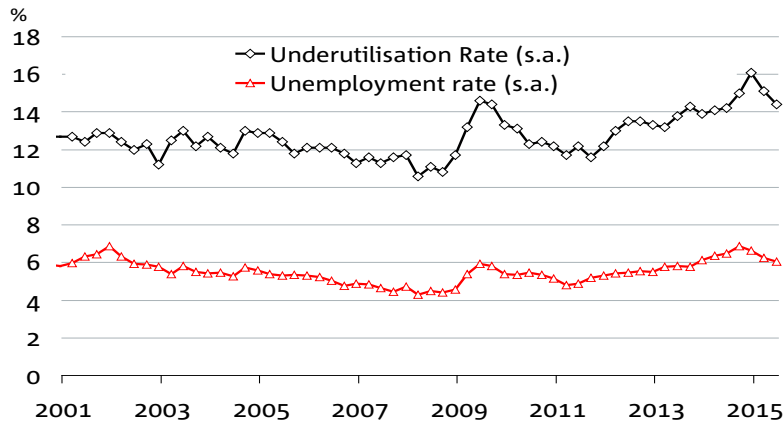
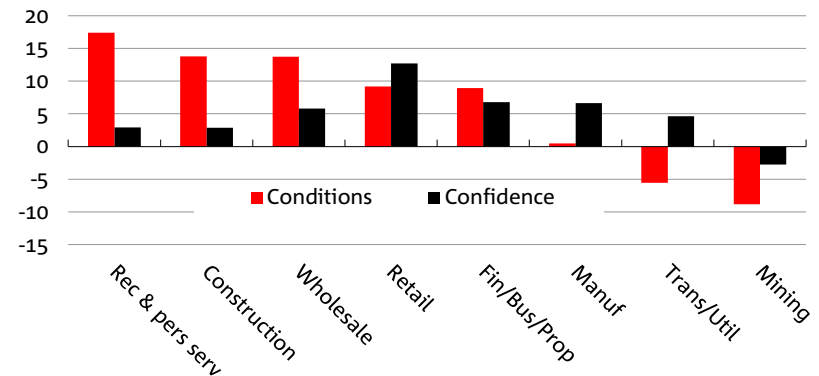


Chart 6: VIC Business Conditions and Confidence by Industry (net balance)





Consumption is holding up, but unlikely to be sustained under weak wages growth

- Household consumption growth has gained pace markedly since early 2013 despite worsening wages growth, potentially reflecting the stimulatory effects from low interest rates and strong house price growth (Chart 7 and Chart 9).
- Retail sales have been relatively resilient (Chart 9).
- According to our Consumer Anxiety Survey, Victorian consumers are increasingly inclined to undertake discretionary spending in items such as home improvements, travel and eating out, which suggests that they have become less cautious in general (Chart 8).

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

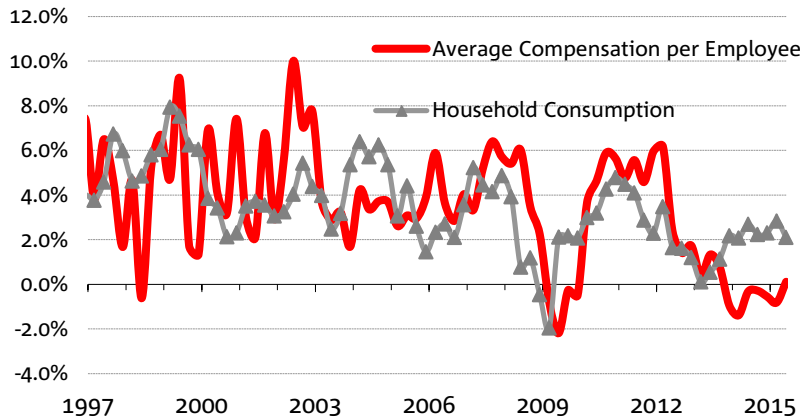


Chart 9: Vic Retail Turnover and Melbourne House Price Growth

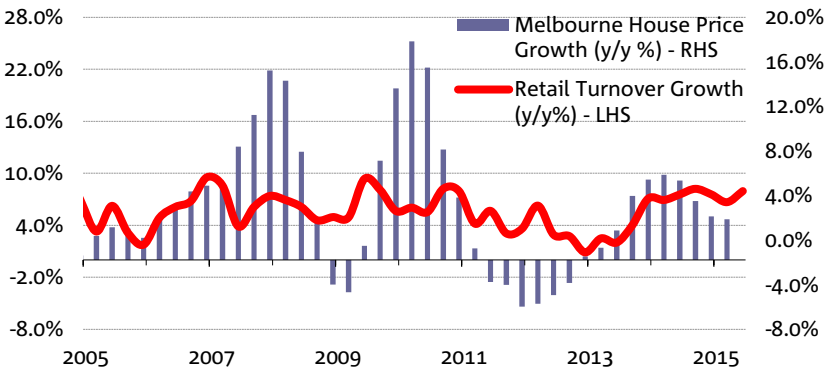
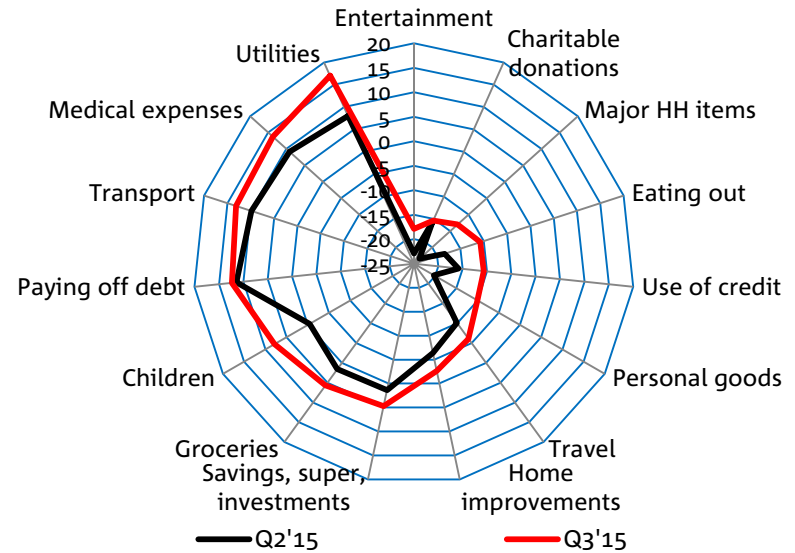


Chart 8: NAB Consumer Anxiety Survey - Consumer Spending Behaviour





Victorian business conditions outperforming other states

- According to the monthly NAB Business Survey, business conditions (in trend terms) in Victoria, together with NSW, have been among the top performing since late 2014 (Chart 10).
- Capacity utilisation of businesses in Victoria has been relatively stable in the last year, but fell marginally below national average recently despite the upward trend in business conditions (Chart 10). This partly reflects the relatively high slack in the Victorian labour market at the moment.

- Business investment growth in the state remains anaemic, although there are some tentative signs of some upward momentum since mid-2014. This coincides with a pick-up in the 12-month capex expectations index in the NAB Business Survey (Chart 12).

Chart 10: Spread in NAB Business Conditions (3-month-moving average, net balance)

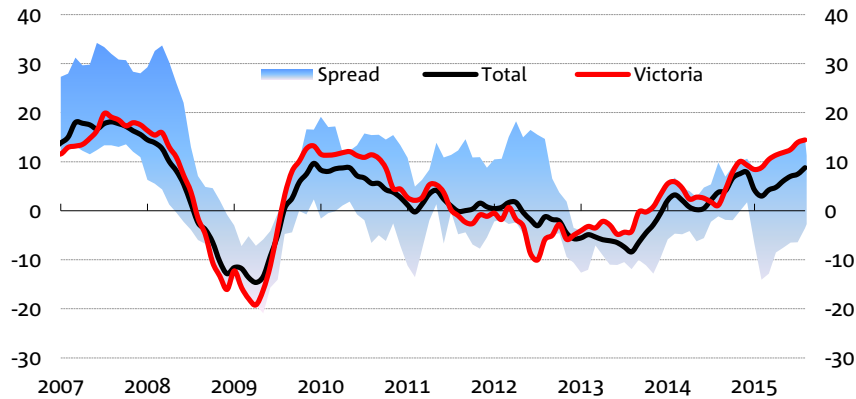


Chart 11: NAB Business Survey – Capacity Utilisation (%)

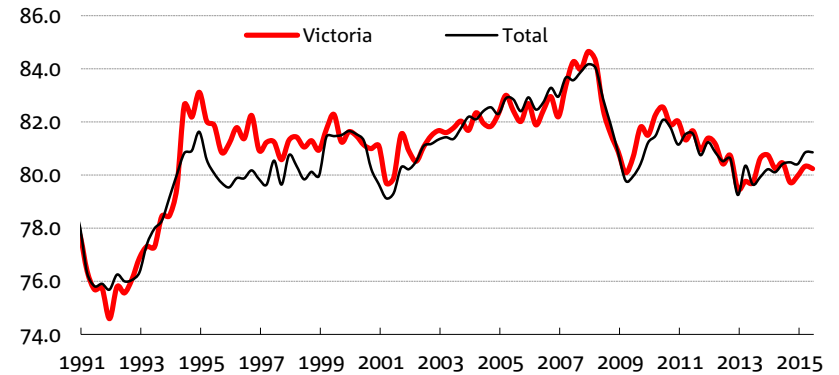
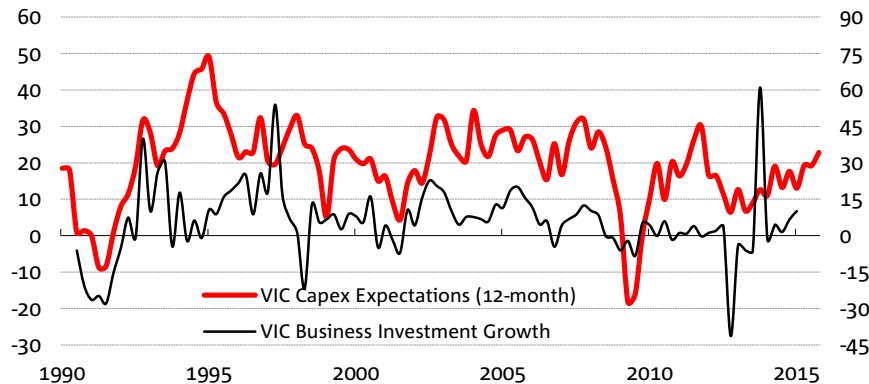


Chart 12: NAB Survey Capex Expectations & Private Business Investment Growth





Investment in commercial property stagnates, while capex expectations stay flat

- After an initial recovery in the aftermath of GFC, non-residential building approvals have been tracking sideways for the last four years, except for the “Other” category which has shown some upward momentum since 2013. The latter mainly includes hotels and other forms of recreational accommodation (Chart 13).
- After a period of moderation, office vacancy rates have started creeping upwards again in Q2 this year, which portends softer approvals in the near to medium term (Chart 15).
- Commercial property investment appetite remains subdued despite low borrowing costs and generally improving business conditions and confidence as reported in the NAB Business Survey (Chart 14)
- Business investment appetite remains restrained among firms in Victoria, evident in their relatively flat capital expenditure expectations in buildings & structures and machinery and equipment in over the next 12 months (Chart 16).

Chart 13: Non-residential Approvals

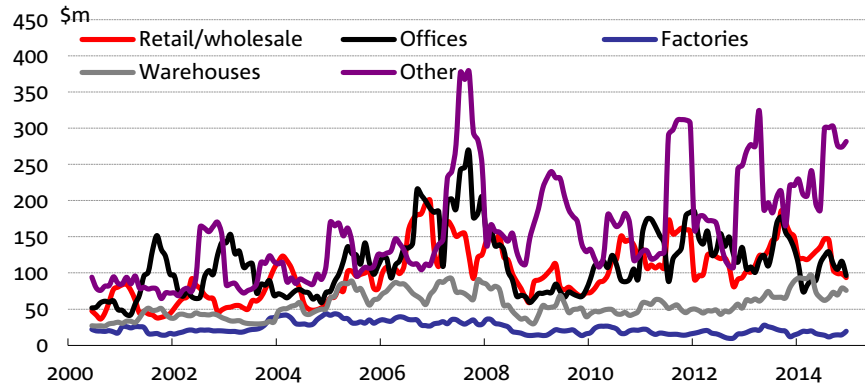


Chart 14: NAB Commercial Property Survey (Index)

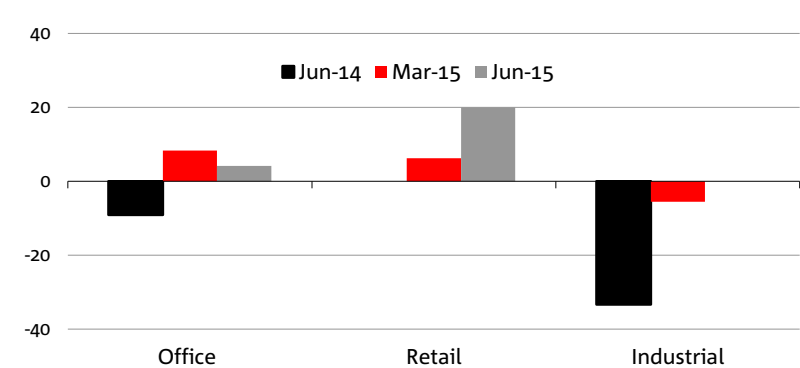


Chart 15: Office Approvals and Vacancy Rates

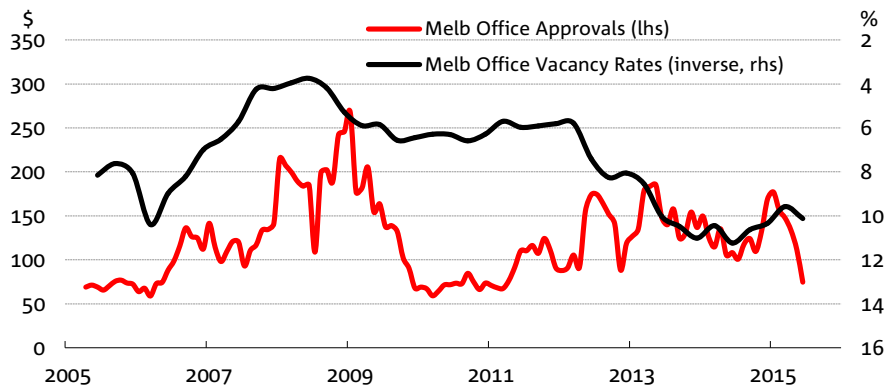
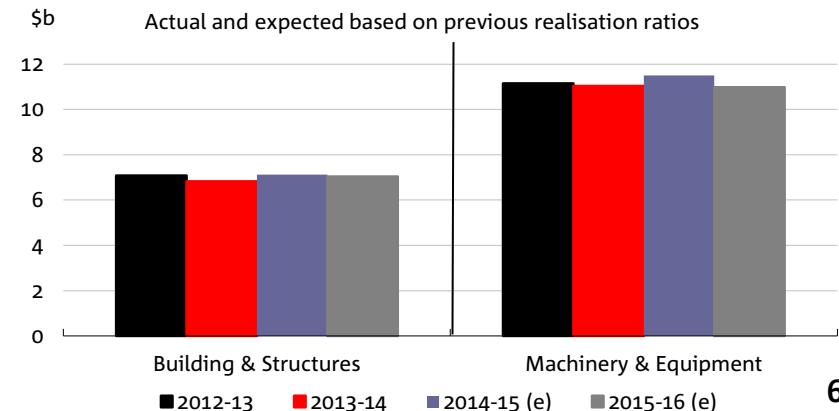


Chart 16: VIC Capital Expenditure & Expectations





Unemployment rate in Victoria remains elevated with plenty of spare capacity

- Despite recent improvements in the labour market, Victorian unemployment rate remains at elevated levels (Chart 17). Employment growth since late 2014 has been largely characterised by a strong increase in part-time jobs rather than full-time jobs (Chart 18), therefore the true extent of excess capacity in the labour market has not been fully captured by a falling unemployment rate.

- Within part-time employment, foreign-born workers account for close to three quarters of the growth over 12 months to July 2015. This could be partly attributable to participation in the labour force by international students (Chart 19).
- In the last 12 months to June 2015, most of the jobs created were in the services sectors, although the retail sector cut back on hiring substantially over the period. The more traditional sectors of manufacturing, transport and utilities continued to experience steady job losses (Chart 20).

Chart 17: Monthly unemployment rate

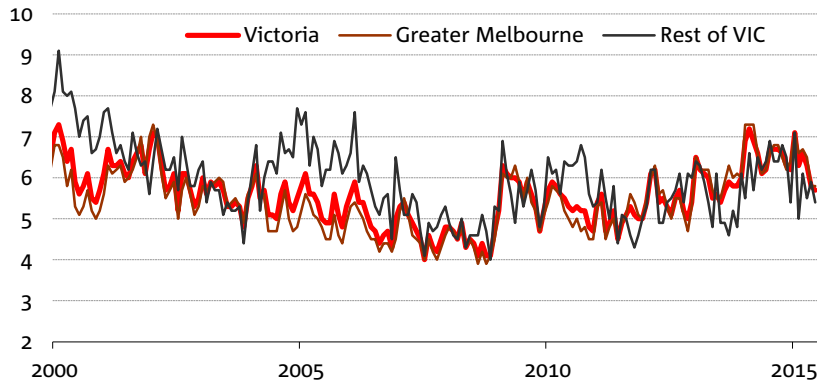


Chart 18: Full-time and part-time employment growth (12-mth rolling growth %)

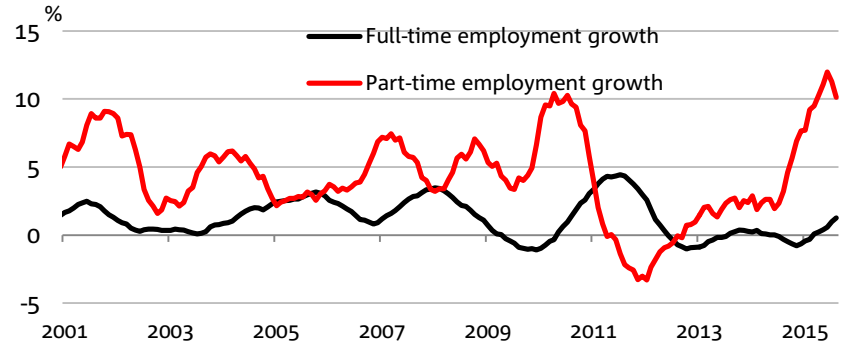


Chart 19: Part-time Employment by Country of Birth ('000s) (over 12 months to July 2015, 000)

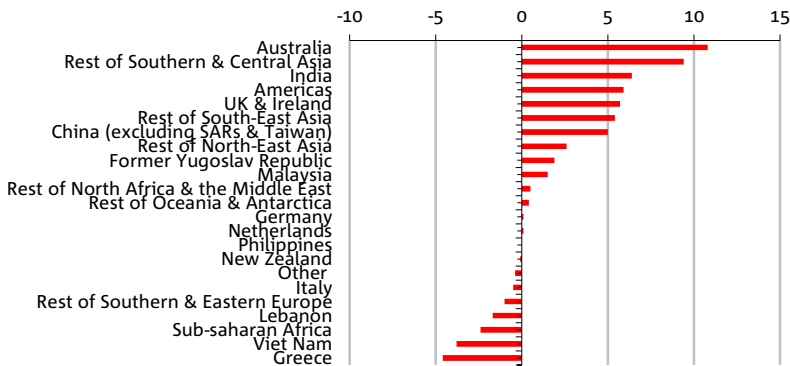
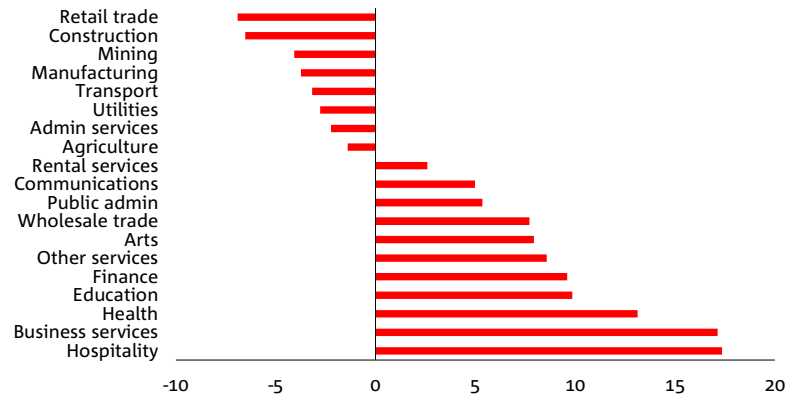


Chart 20: 12-month change in employment by industry to Jun-15 ('000s)





Victoria now enjoys the highest population growth in Australia

- Victorian population growth has been tracking at historically elevated levels, overtaking WA as the fastest growing among all states and territories in December 2014 (in year-ended terms). All three components of population growth: natural increase, net overseas migration and interstate migration contributed positively to growth over the last few years, but more recently net interstate migration has been particularly resilient from the repatriation of some workers from the mining states (Chart 21).
- Since early March, Victorian population growth has consistently outperformed the national average (Chart 22). A strong pick-up in the number of international students, as indicated by student enrolment data for 2014 and 2015 to-date, has been partly responsible in propping up net overseas migration into the state (Chart 22).

Chart 21: VIC Population Growth Drivers ('000s, over the year)

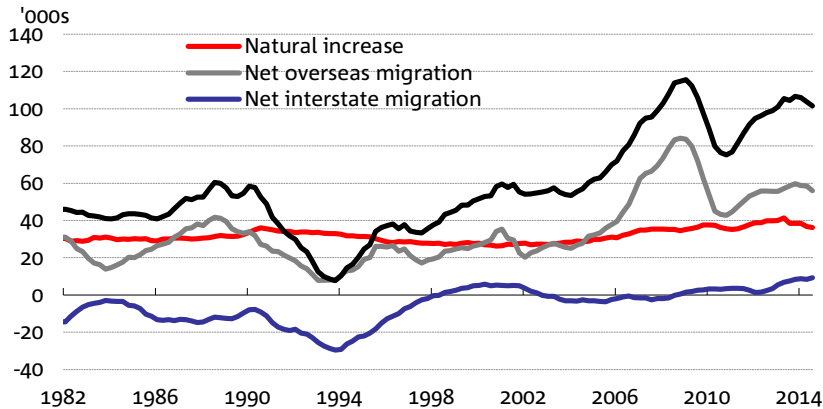


Chart 22: VIC and AUS Population Growth

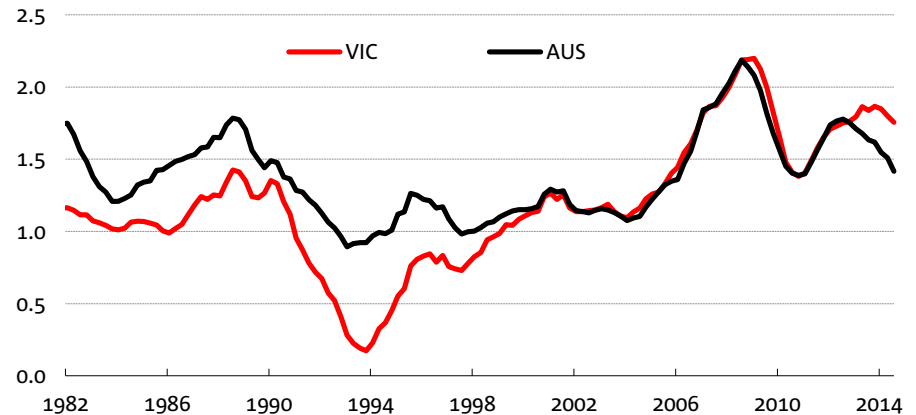
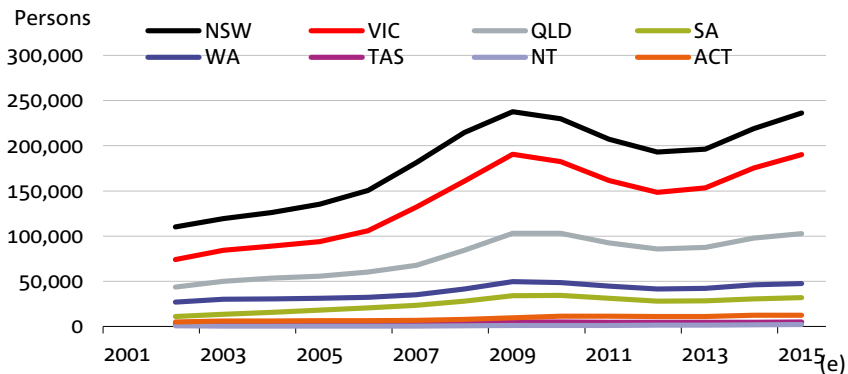


Chart 22: International student enrolment numbers by calendar year



Source: ABS, Australian Education International NAB Group Economics



Dwelling investment is one of the main drivers of Victorian growth

- As of late last year, Victorian residential approvals and commencements have surpassed the previous records set in 2010 (Chart 21).
- Strong house price growth in the past two years against a backdrop of weak wages growth had resulted in a steady rise in the price-to-income ratio, as well as a decline in rental yield (Chart 23).
- The strength in dwelling approvals has been largely driven by a surge in unit applications, as a large number of apartment/unit projects were given the green to go ahead light by the previous Liberal government (Chart 22).

Chart 21: VIC Residential Approvals and Commencements

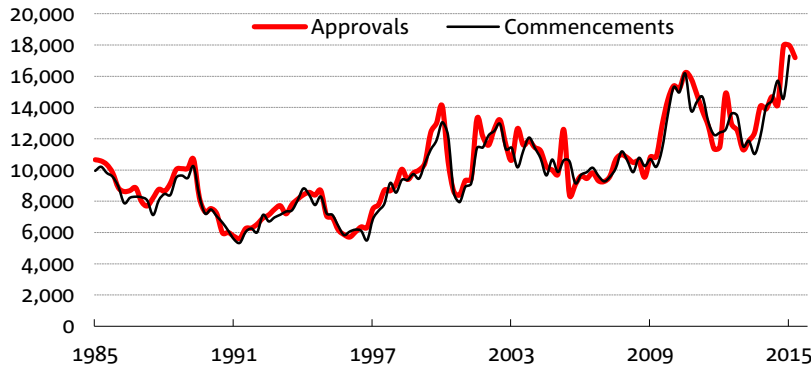


Chart 22: VIC House and Unit Applications to Population Ratio (LRA = 100)

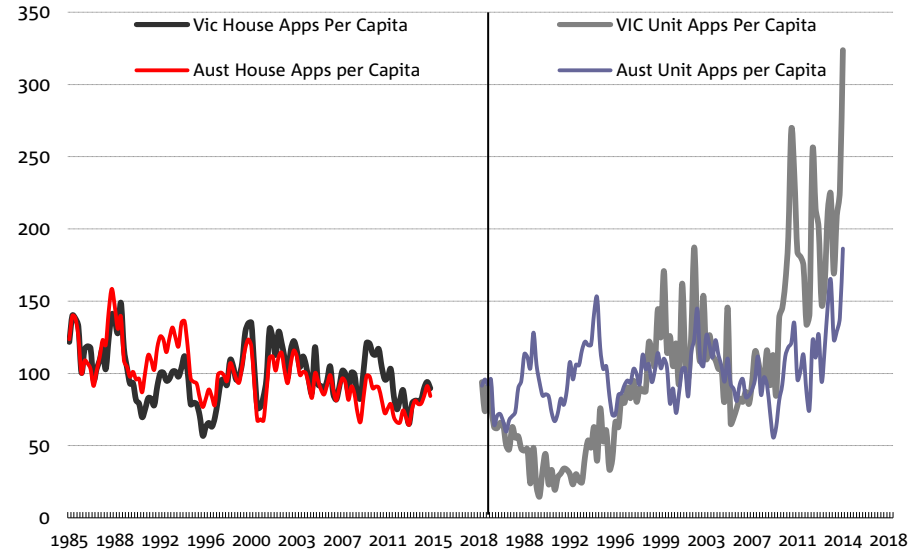
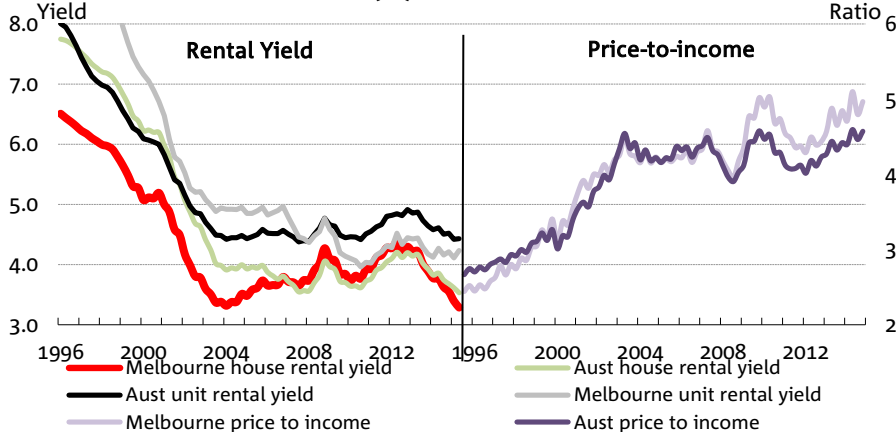


Chart 23: VIC Rental Yields (%) and Price-to-Income Ratios



Source: ABS, NAB Group Economics



Victorian house prices have surged in the last two years

- Melbourne houses have outperformed units and regional houses in terms of capital growth by a significant stretch in the current cycle (Chart 24).
- VIC residential property price growth by sub-region in Melbourne suggests that Eastern Middle Melbourne, Inner Melbourne and Moreland City led capital growth for houses in the 12 months to Q1 this year, while Eastern Middle Melbourne and Yarra Ranges Shire dominate in the unit segment (Chart 26).

- According to the NAB Property Survey, respondents consisting of industry professionals expect VIC property prices to follow a rising track in the near to medium term (Chart 25).
- In regional Victoria, Loddon and Mallee were the fastest growing regions for residential properties over the same period, while East Gippsland and Western District languished (Chart 27).

Chart 22: VIC Residential Property Price Growth (YoY %)

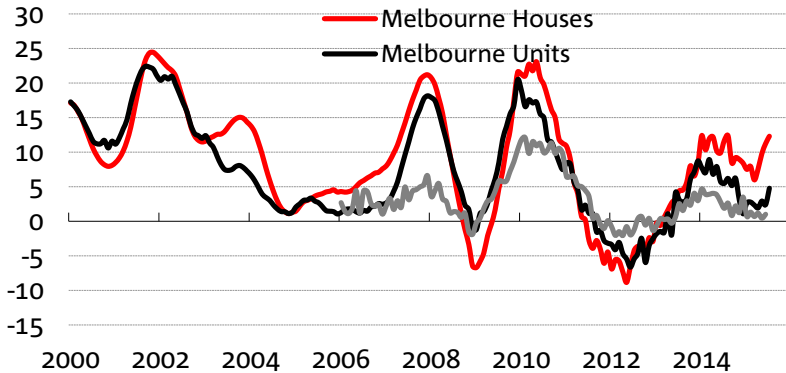


Chart 26: Melbourne - Median Property Price Growth (year to Q1 2015)

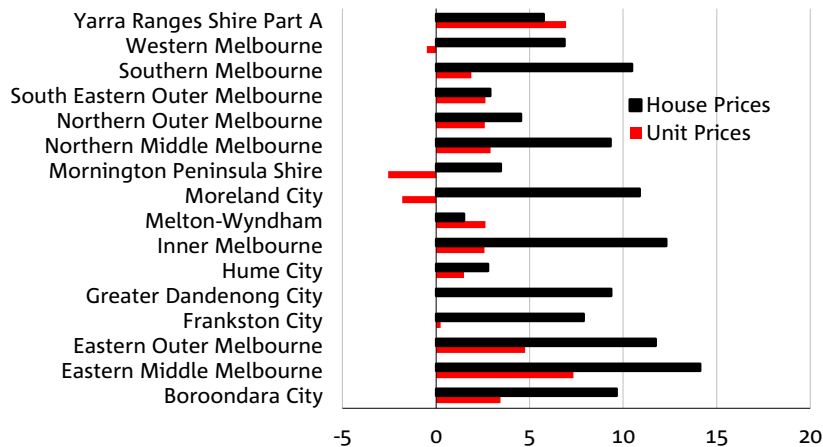


Chart 25: NAB Property Survey – House Price Expectations (%)

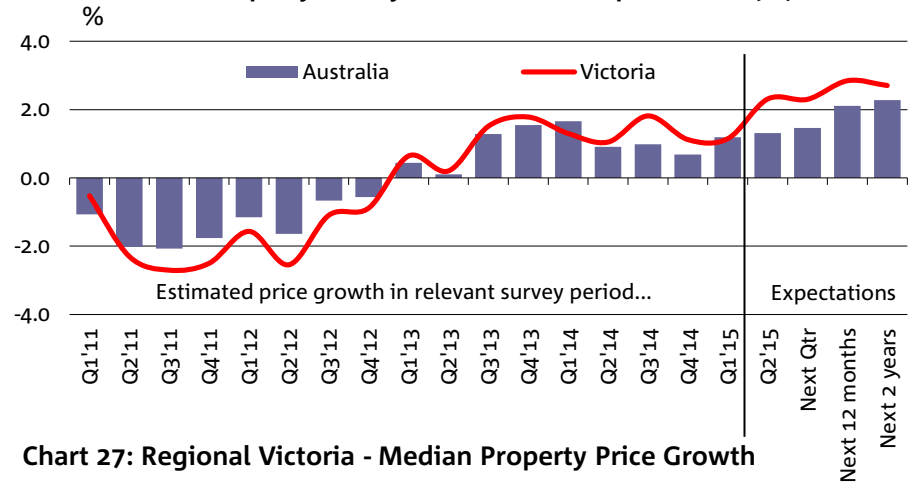
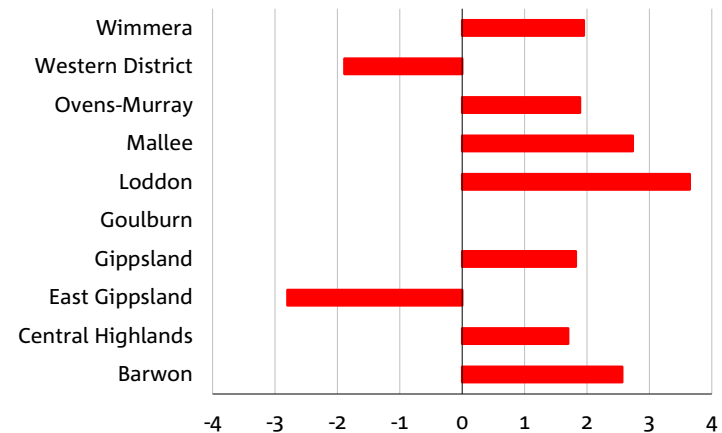


Chart 27: Regional Victoria - Median Property Price Growth (year to Q1 2015)



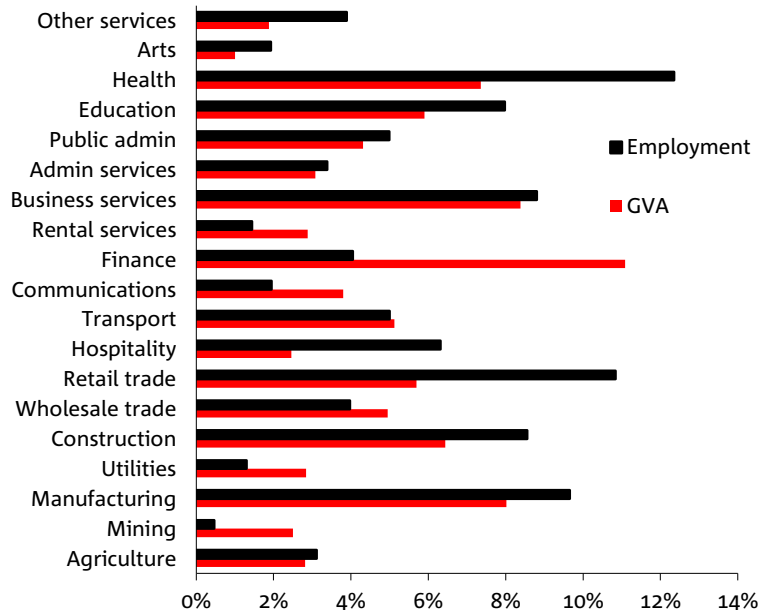


Services sectors are the biggest contributors to production and employment

- The services sectors continued to dominate output shares by industry in 2013-14, with finance and business services accounting 11% and 8.5% respectively, ahead of the traditional industry pillar manufacturing at 8%. The largest employing industries over the same period were healthcare (12%), retail trade (12%) and manufacturing (10%) (Chart 28). The ongoing structural decline in the latter will see its importance in output and employment diminish gradually overtime.

- China is Victoria's largest trading partner in exports and imports. Victorian goods exports to China fell marginally in 2014-15 to \$4.3 billion (Tables 29-30). Top Victorian goods exports include dairy products, passenger vehicles and wool, while crude imports, passenger vehicles and refined petroleum represent its top three imports (Tables 31-32).

Chart 28: Composition of Employment and Gross Value Added by Industry



Source: RP Data, ABS, NAB Group Economics

Tables 29-30: Top Victorian Goods Export Destinations and Import Source Countries, 14-15; Tables 31-32: Major Victorian Export and Import Goods

Value of exports (\$m)		Value of imports (\$m)			
1	China	4320	1	China	16320
2	ASEAN	3776	2	EU	12967
3	US	2702	3	ASEAN	12168
4	New Zealand	1950	4	US	8275
5	Japan	1721	5	Japan	4183
6	EU	1328	6	Germany	3864
7	Korea	893	7	New Zealand	2621
8	Singapore	866	8	Korea	1975
9	HK	678	9	UK	1892
10	India	553	10	Singapore	1664
11	Taiwan	502	11	Taiwan	1329
12	UK	291	12	HK	492
13	Germany	239			

Tables 31-32: Major Victorian Export and Import Goods

Major exports, goods, 2013-14		Major imports, goods, 2013-14	
	A\$m		A\$m
Milk, cream, whey & yoghurt	1,377	Crude petroleum	6,666
Passenger motor vehicles	1,349	Passenger motor vehicles	5,693
Wool & other animal hair (incl tops)	1,317	Refined petroleum	2,517
Meat (excl beef)	1,175	Goods vehicles	1,640
Wheat	1,027	Vehicle parts & accessories	1,440



Victorian government predicts strong surpluses in the coming years

- The general government sector operating surplus is estimated to be \$1.2 billion in 2015-16, growing to \$1.8 billion in 2018-19, reflecting slower growth rate of expenses (Chart 33).

The *2015-16 Budget* outlook includes additional revenue measures consisting of a 3.0 per cent stamp duty surcharge to be applied to foreign buyers of residential real estate, and a 0.5 per cent land tax surcharge to absentee owners of property in Victoria. GST is the single largest source of Victorian government revenue in 2015-16 (Chart 34).

Chart 33: General Government Net Operating Balance

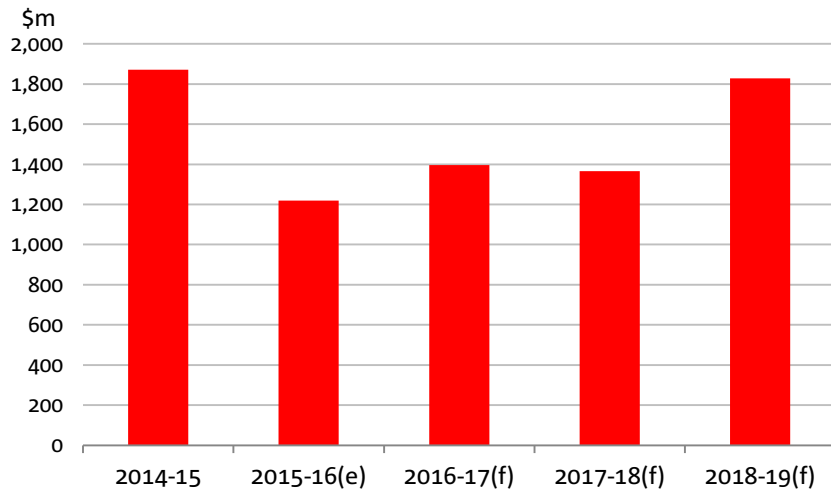
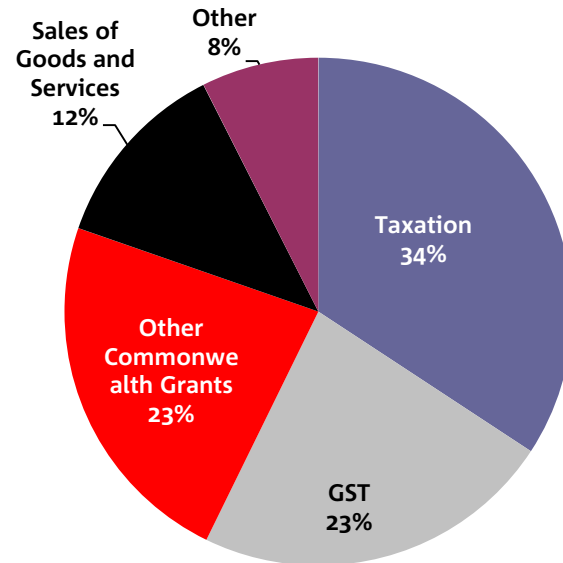


Chart 34: Sources of Victorian Revenue in 2015-16





Net debt position improving, borrowing programme remains low

- Provision of core services is not expected to add to Victoria’s debt burden. Net debt is projected to improve in the current fiscal year and stabilise through the forward estimates. Gross debt projected to peak at 80.7% of revenue in 2014-15 (Chart 35)
- TCV’s borrowing programme for 2015-16 is –AUD3.6bn of which there is AUD1.1bn of refinancing while new money comprises –AUD5.5bn for general government (impacted by the completion of Port of Melbourne lease) and AUD0.7bn for participating authorities (Chart 37).
- S&P affirmed Victoria’s AAA credit rating with stable outlook following the 2015-16 budget. Positives for the state are projected decline in total-tax supported debt as well as improvement in budget performance (Chart 36).
- The AUD1.9bn of funding will be predominantly focused in existing domestic benchmark lines while the proceeds from the Port lease will be used to reduce short-term debt. Remaining funds will be invested against future maturing TCV liabilities (Chart 38).

Chart 35: Victorian Non-Financial Public Sector net debt

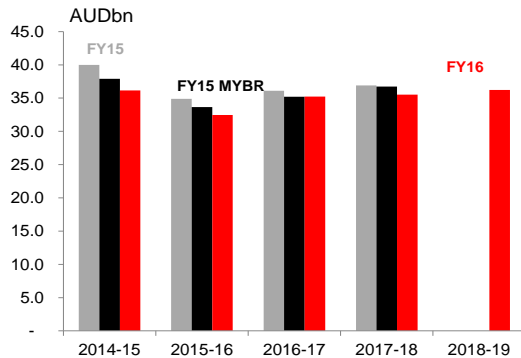


Chart 37: TCV Borrowing Programme

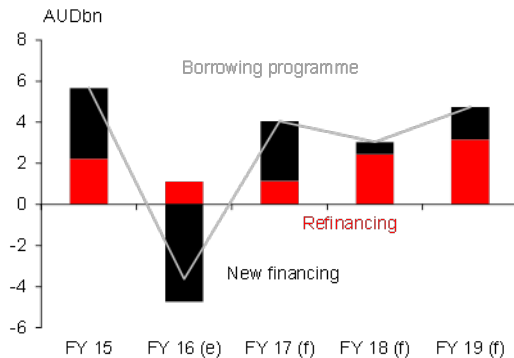


Chart 36: S&P Credit Metric: Tax Supported Debt

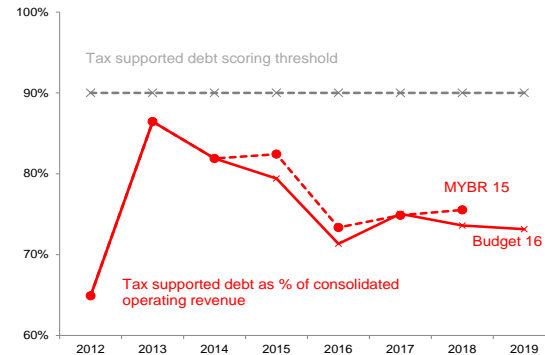
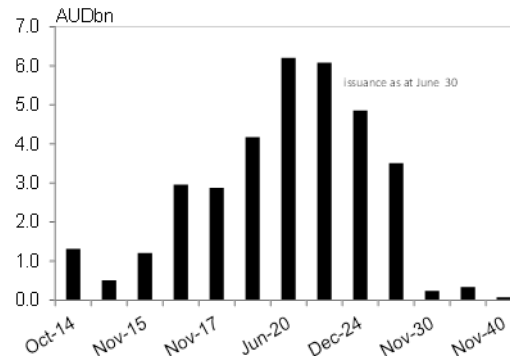


Chart 38: TCV Term Bonds Outstanding



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