

State Update: Victoria – January 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.** This is reflected in the improved performance of household consumption and dwelling investment. However, positive impetus from the housing market is likely to fade in the medium term. Victorian business conditions have eased from their recent peak in mid-2015 but remain amongst the best – performing across states. The labour market has shown further improvement, although unemployment and underutilisation rates are still elevated by historical comparisons. We forecast Victorian real GDP growth to be around 2.6% in 2015-16 before picking up slightly to 2.7% in 2016-17. Correspondingly, the unemployment rate is forecast to fall marginally to 5.9% by 16-17, from 6.1% in 2015-16.
- **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 enrolments have picked up strongly, with 2015 numbers expected to surpass the historical record in 2009.** A sharper global slowdown, particularly in Asia, than currently forecast however presents a downside risk. Meanwhile, the NAB Monthly Business Survey and aviation statistics also suggest that inbound tourism to Victoria from domestic and foreign sources have continued to improve. Despite the slowing rate of AUD depreciation, the lag in transmission from a weaker currency into activity suggests these sectors are likely to continue to benefit in 2016. **Supported by low interest rates and strong asset price growth, Victorian household consumption growth has mostly outpaced income growth since late 2013.** That said, recent data suggests that wages growth has also gained traction. Improved consumer optimism is also evident in a falling household saving ratio and a greater propensity by consumers to undertake discretionary spending, with our Consumer Behaviour Survey showing that Victorian consumers are now more likely to spend on home improvements, travelling and charitable donations.
- **The Victorian labour market saw further improvements in Q4 2015, with full-time jobs making up most of the new jobs created.** That said, unemployment and underutilisation rates remain elevated. **The imminent closures of Toyota and Ford plants by 2017 are expected to shed around 3,500 direct manufacturing jobs, although indirect job loss through parts suppliers could be much larger.** The relatively high unemployment rate in Victoria is also partly attributable to the strong growth in its labour force brought about by net overseas migration and interstate migration. Victoria now has the highest population growth across all states and territories.
- **Dwelling investment has been a major contributor to the economy, marked by record levels of dwelling approvals. A large construction pipeline will continue to provide positive impetus to growth for the state in 2016, but a slowing housing market points to downside risks in dwelling and possibly consumption activity in the medium term.** The construction pipeline is largely constituted of apartments and units, in turn spurred by solid growth in Victorian house prices over last few years.
- **Meanwhile, business investment growth has remained modest despite low borrowing costs and improved business conditions.** 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 sustained improvements in business conditions before entering into an expansionary investment mode.
- **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.**

Contact

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

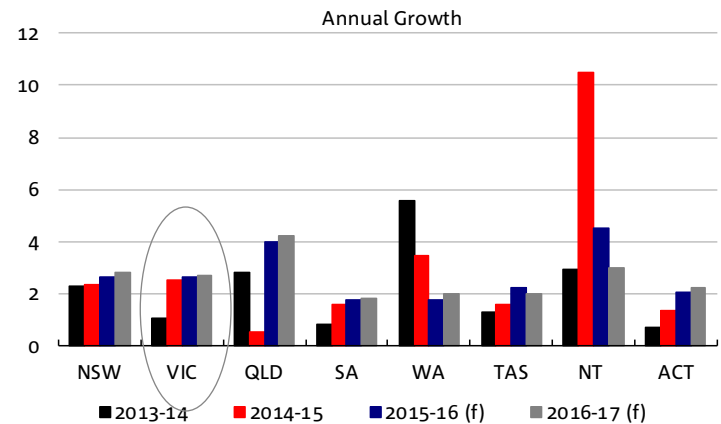
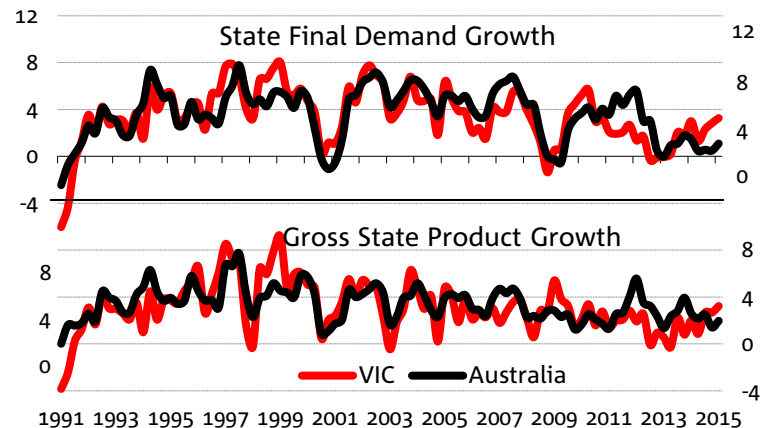


Chart 2: State Final Demand and Gross State Product* (y/y%)



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



In Focus: A rebalancing national economy supports recovery in the labour market

- Victorian population growth continues to outpace the other states, driven by strong net overseas and interstate migration (Chart 3).
- There was evidence that the Victorian labour market improved further in Q4 2015, marked by a recovery in full-time jobs after a strong spurt in part-time jobs growth (Chart 4). Within part-time employment, foreign-born workers account for close to 60% of the growth over 12 months to November 2015. This could be partly attributable to participation in the labour force by international students (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 continue to be strong from robust pipeline activity but confidence is weaker from lower house price growth expectations (Chart 6).

Chart 3: Population Growth Drivers in Victoria in the year to Jun 15

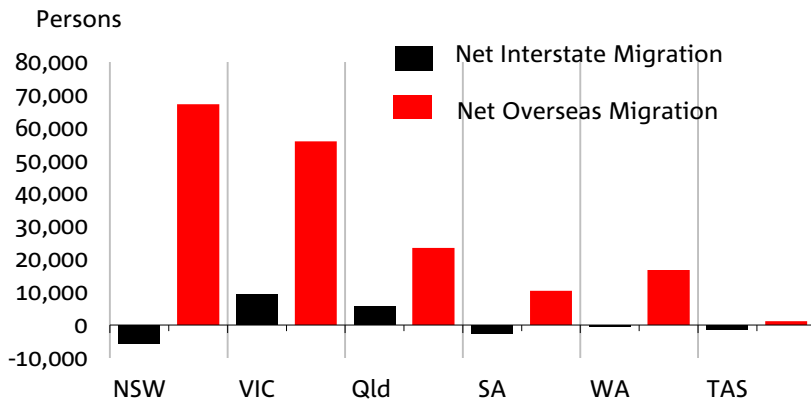
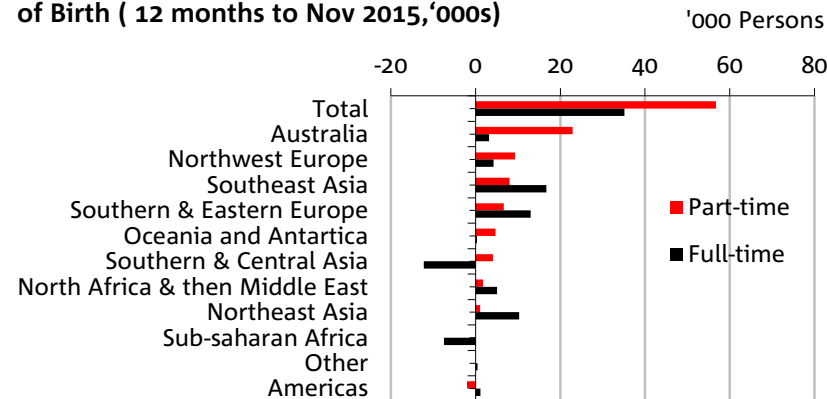


Chart 5: Part-time and Full-time Employment Growth by Country of Birth (12 months to Nov 2015, '000s)



Source: ABS, NAB Group Economics

Chart 4: Monthly Employment Change

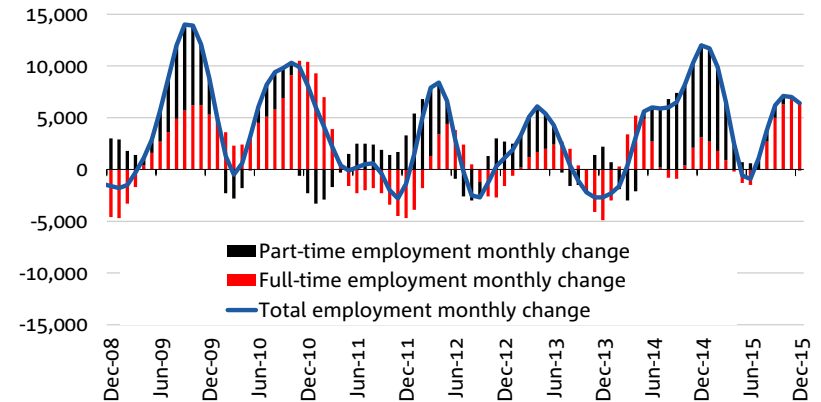
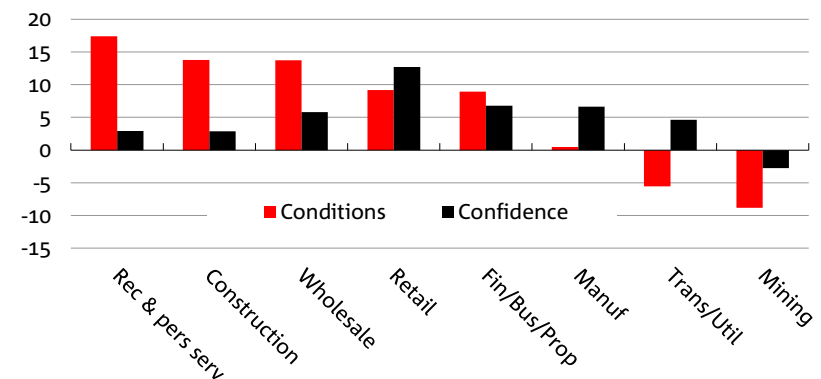


Chart 6: VIC Business Conditions and Confidence by Industry (net balance)





Consumption is holding up, supported by strong employment growth

- Household consumption growth has held up on the back of strong employment growth, with further evidence that wages growth is gaining momentum as well (Chart 7 and Chart 9).
- Retail sales have also been relatively resilient, possibly a reflection of the wealth effects from a robust housing market (Chart 9).
- According to our Consumer Behaviour Survey, Victorian consumers are increasingly inclined to undertake discretionary spending in items such as home improvements, travel and charitable donations, which suggests that they have become less cautious in general (Chart 8).

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

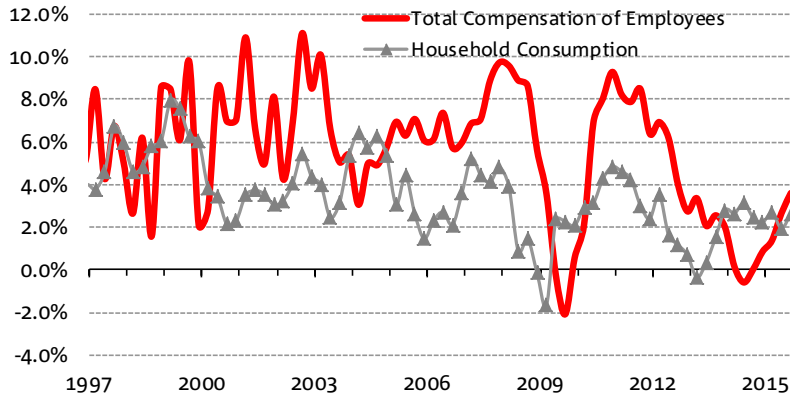
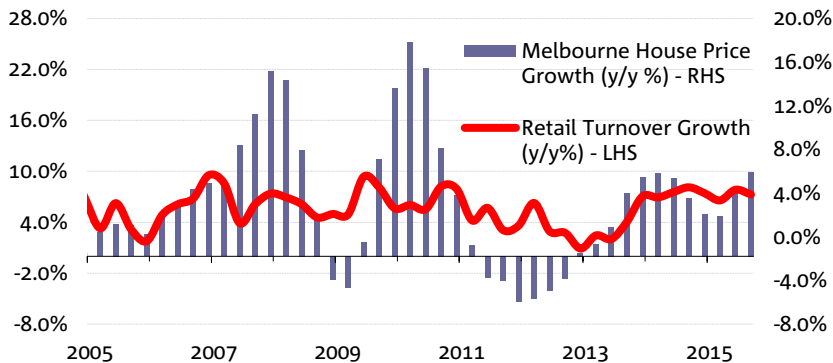
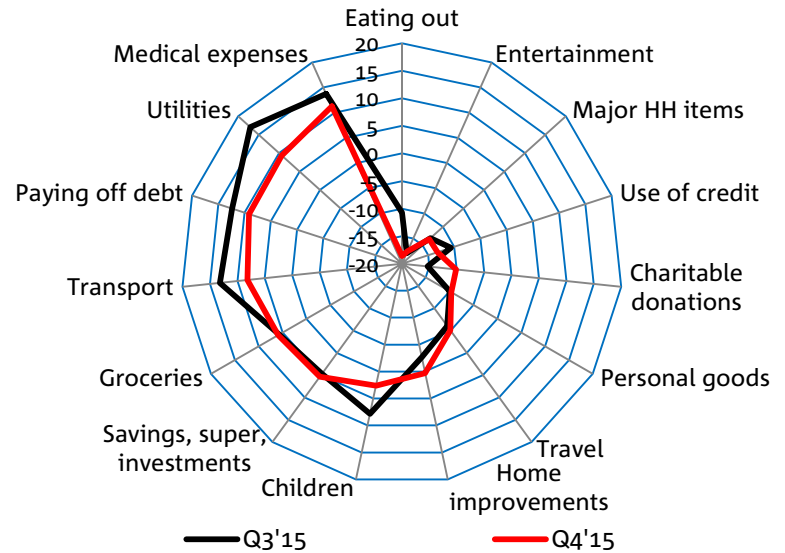


Chart 9: Vic Retail Turnover and Melbourne House Price Growth



Source: ABS, NAB Group Economics

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).
- The sustained strength in Victorian business conditions is finally showing through a notable upward trend in capacity utilisation (Chart 10).
- Business investment growth in the state has also shown signs of picking up of late. This coincides with a pick-up in the 12-month capex expectations index in the NAB Business Survey (Chart 12).
- The NAB Business Survey also reveals that services sectors in Victoria such as financial, business and property; retail; as well as recreational and personal services are outperforming the traditional sectors (Chart 13).

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

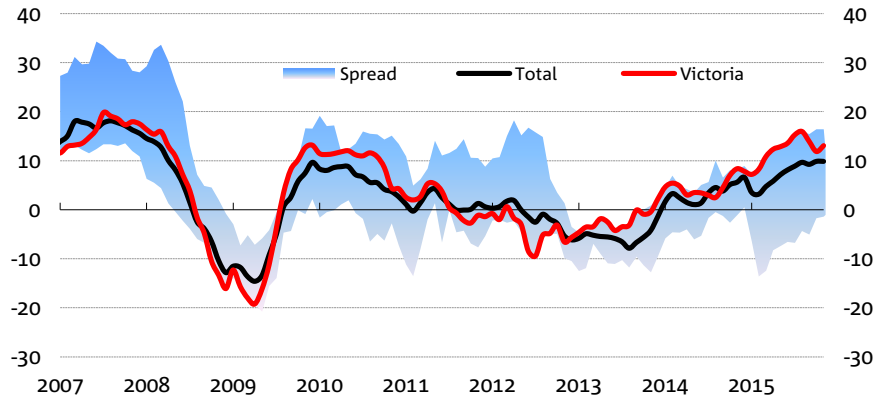


Chart 11: NAB Business Survey – Capacity Utilisation (%)

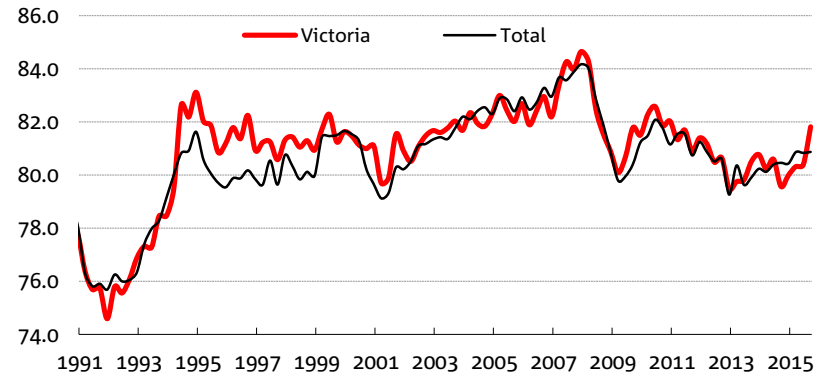


Chart 12: NAB Survey Capex Expectations & Private Business Investment Growth

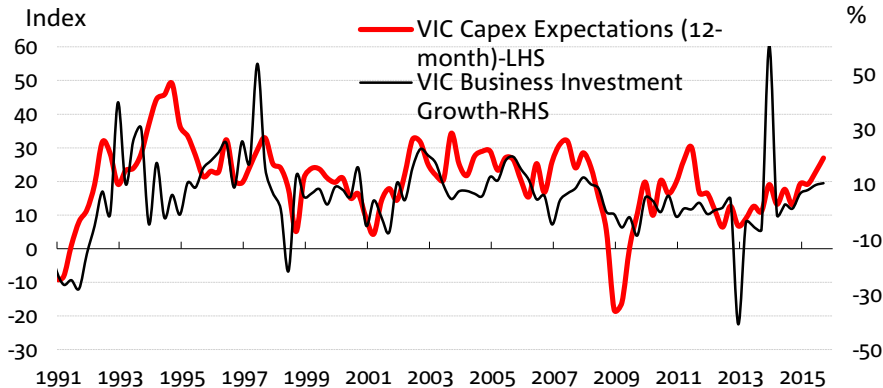
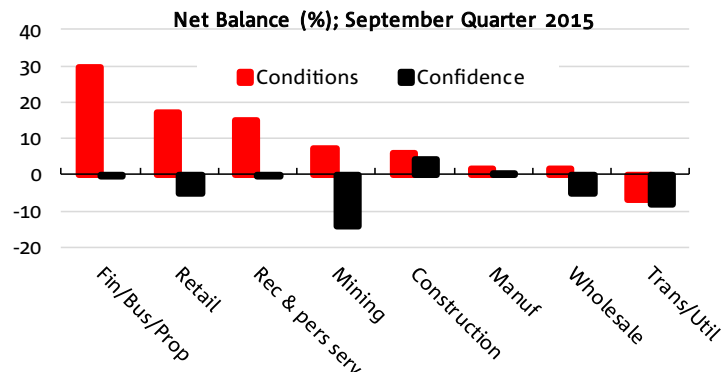


Chart 13: VIC business conditions and confidence by industry(%)





Business investment outlook remains subdued, despite improving business conditions

- The outlook for Victorian business investment remains subdued, despite generally improving business conditions and confidence as reported in the NAB Business Survey. 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”, and to a lesser extent, “Warehouses” categories which have shown some upward momentum. “Other” mainly includes hotels and other forms of recreational accommodation (Chart 13).
- Office vacancy rates are stabilising around the 10% mark, driven by fewer office approvals in 2015 (Chart 15). Commercial property investment appetite remains subdued despite low borrowing costs.
- Business investment appetite remains restrained among firms in Victoria, evident in their relatively flat capital expenditure expectations in buildings & structures and machinery and equipment for 2015-16 (Chart 16). This reflects firms’ significantly higher hurdle rates for investments relative to borrowing rates.

Chart 13: Non-residential Approvals

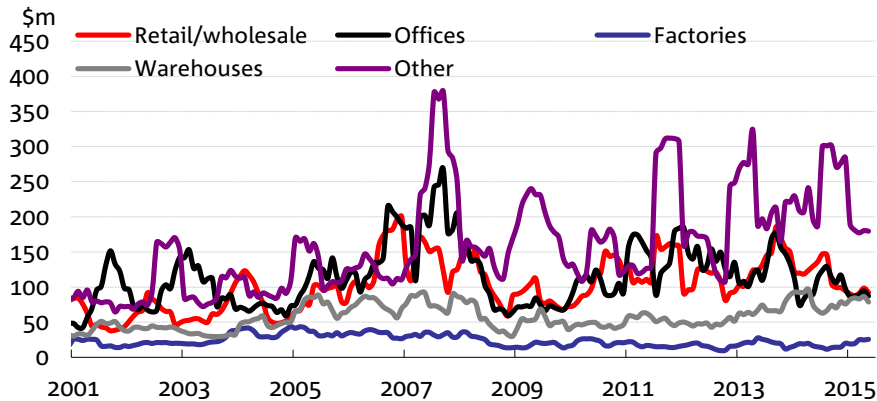


Chart 14: NAB Commercial Property Survey (Index)

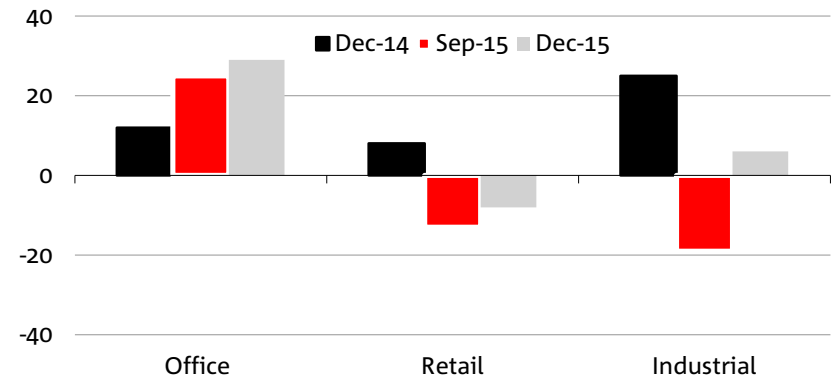


Chart 15: Office Approvals and Vacancy Rates

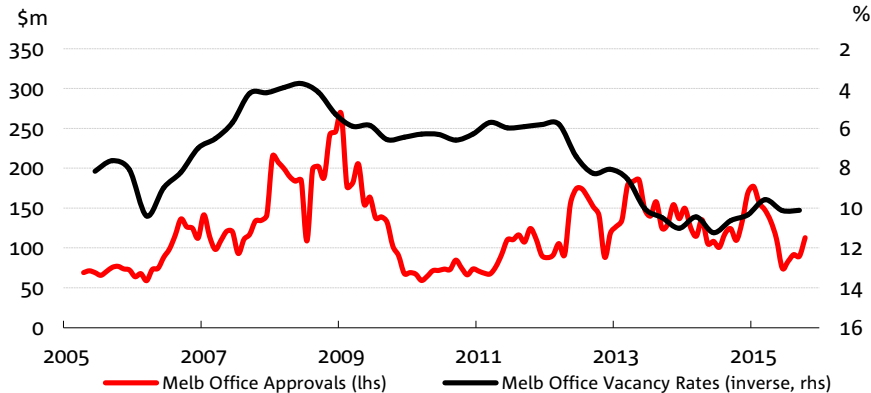
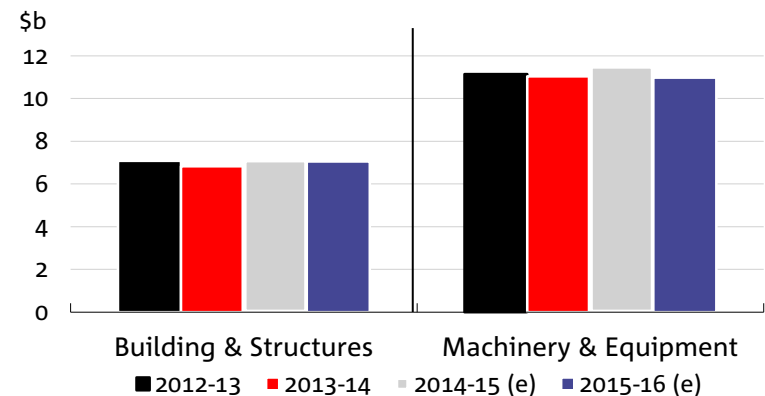


Chart 16: VIC Capital Expenditure & Expectations





Dwelling investment continues to be strong, but positive impetus from construction likely to fade in the medium term

- The value of residential construction pipeline is at record-high, spurred by strong dwelling approvals. However, the latter appears to have peaked, with the result for November showing a sharp retracement (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 number of dwelling approvals and work-yet-to-be-done

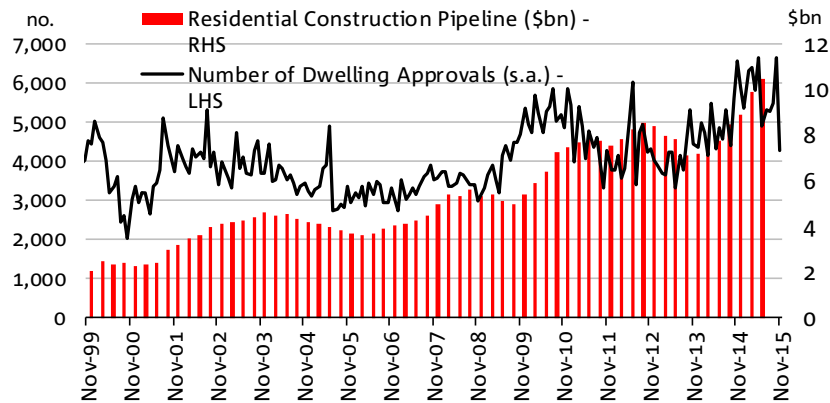


Chart 22: VIC House and Unit Applications to Population Ratio (LRA = 100)

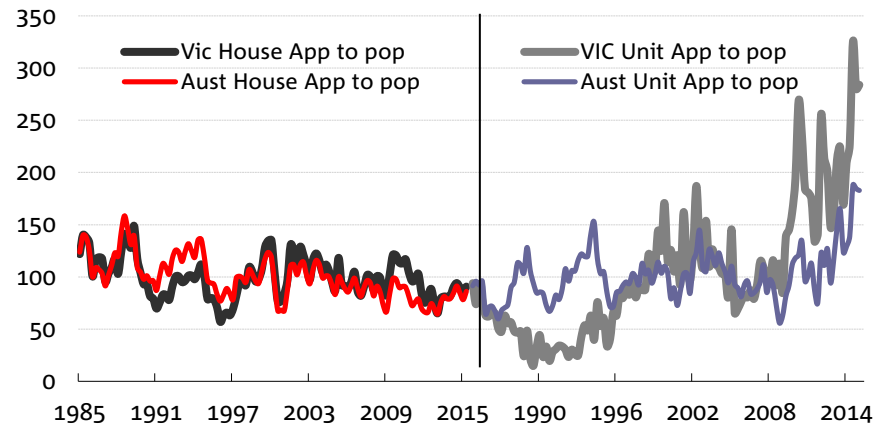
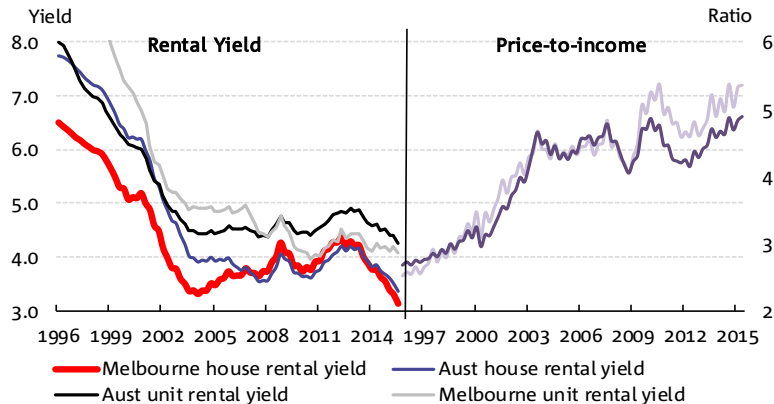


Chart 23: VIC Rental Yields (%) and Price-to-Income Ratios





Unemployment rate in Victoria remains elevated with plenty of spare capacity

- Victorian unemployment rate is on a downward trend, supported by reasonably strong employment growth (Chart 17). Employment growth since late 2014 has been largely characterised by a strong increase in part-time jobs, although there are signs that full-time jobs have gained traction since H2 2015 (Chart 18). As such, the true extent of excess capacity in the labour market has not been fully captured by a falling unemployment rate, with the underutilisation rate still high (Chart 19).
- In the 12 months to November 2015, most of the jobs created were in the services sectors, except for retail and admin services. Somewhat surprisingly, manufacturing employment increased over the period, while mining and construction continued to shed jobs (Chart 20).

Chart 17: Monthly unemployment rate

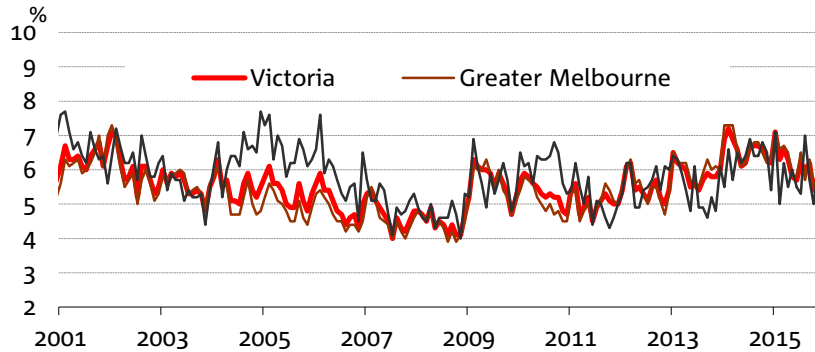


Chart 18: Full-time and part-time employment growth (12-mth rolling growth %)

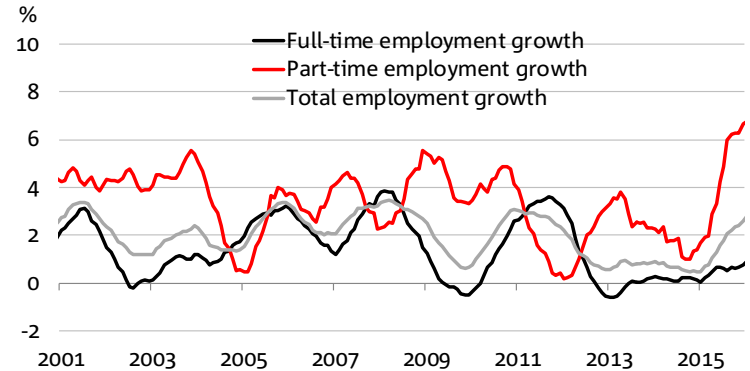


Chart 19: Unemployment and Underutilisation Rates

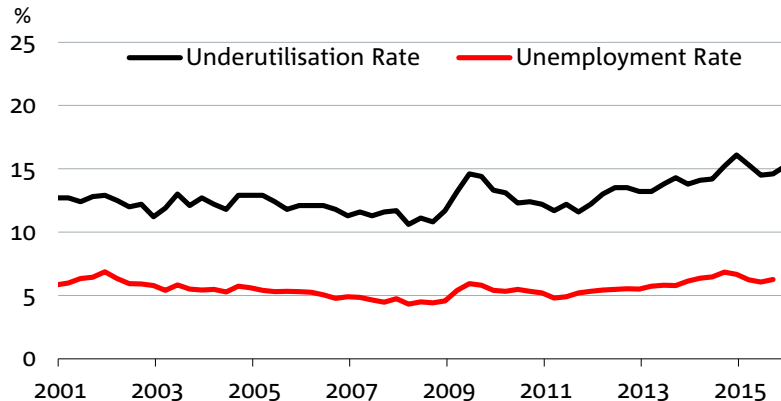
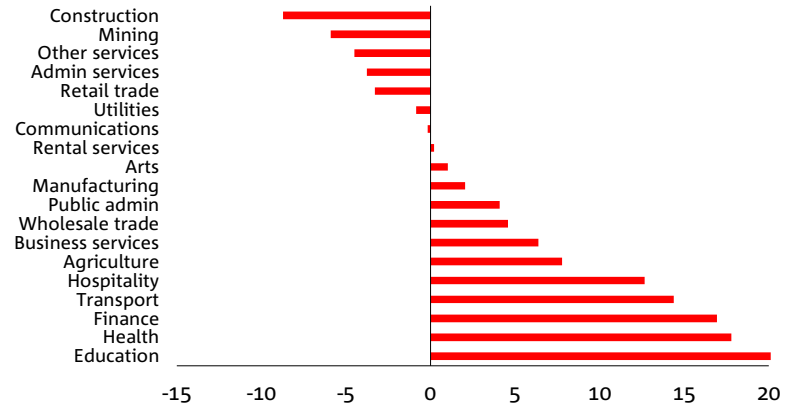


Chart 20: 12-month change in employment by industry to Nov-15 ('000s)





Victoria now enjoys the highest population growth in Australia

- Victorian population growth continues to be the fastest among all states and territories (in year-ended percentage terms), albeit at a slowing rate.
- Since late 2013, growth in net overseas migration has moderated significantly nationally as the mining boom unwinds, albeit to a lesser extent in Victoria. Growth in natural increase has also slowed, but this is offset by particularly strong net interstate migration as some workers from the mining states return to the larger states (Chart 21).
- Since March 2013, 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)

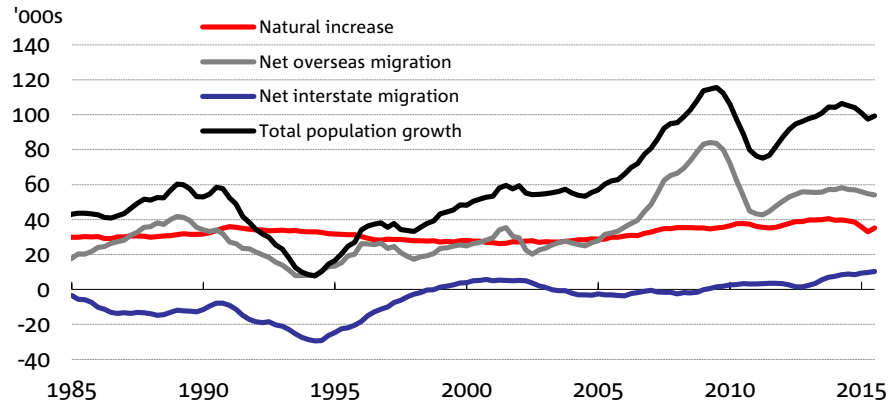


Chart 22: VIC and AUS Population Growth

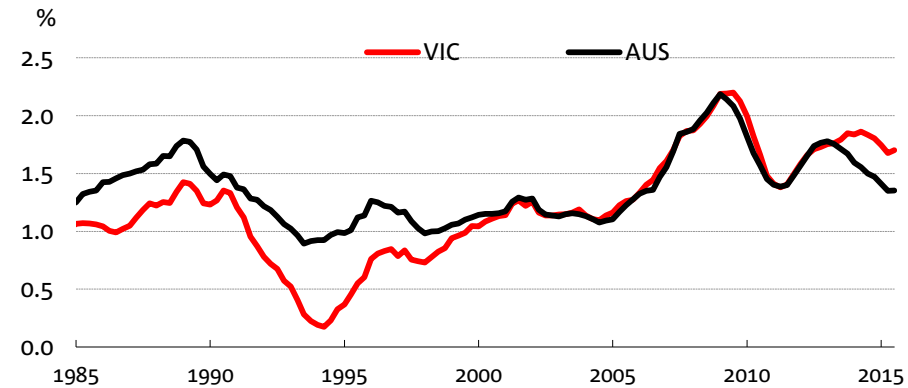
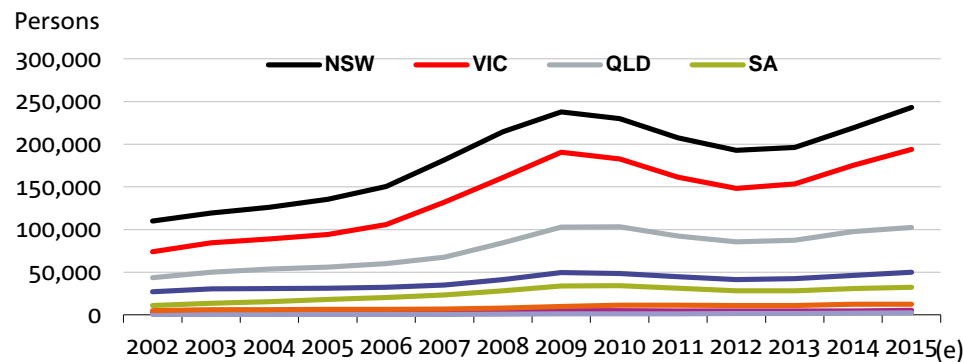


Chart 22: International student enrolment numbers by calendar year





Victorian house price outlook remains relatively resilient, despite cooling clearance rates

- 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, Boroondara City, Inner Melbourne and Eastern Outer Melbourne led capital growth for houses in the 12 months to Q3 2015, 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). Please refer to our house price forecasts in the *Overview* pack.
- In regional Victoria, Mallee and Ovens-Murray were the fastest growing regions for residential properties over the same period, while Gippsland and East Gippsland languished (Chart 27) .

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

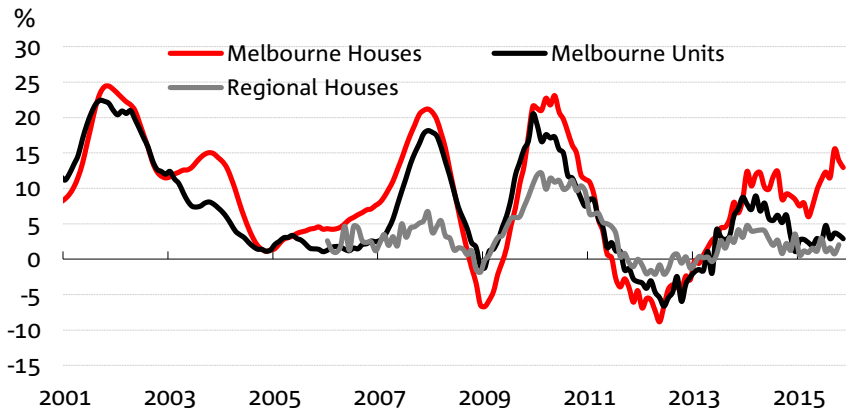


Chart 25: NAB Property Survey – House Price Expectations (%)



Chart 26: Melbourne - Median Property Price Growth (year to Q3 2015)

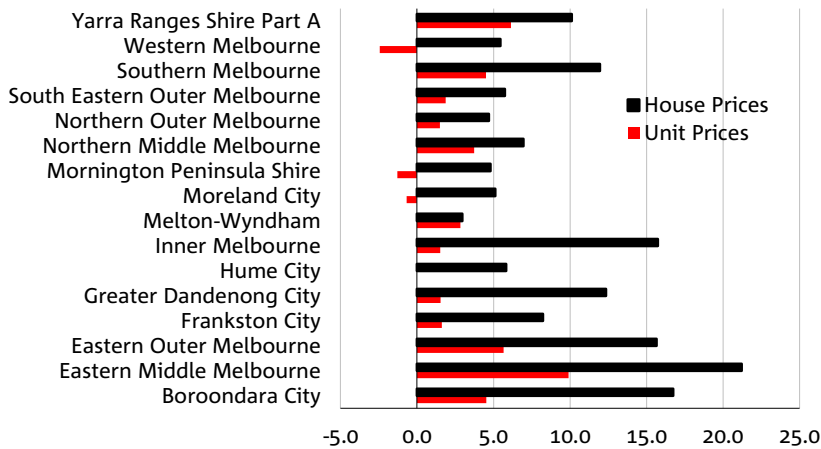
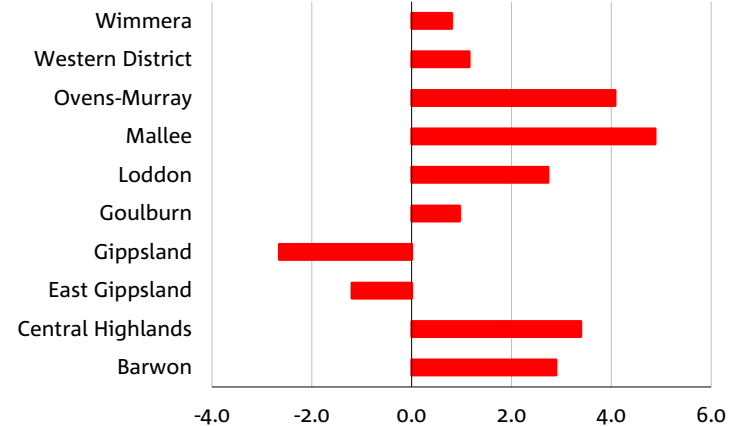


Chart 27: Regional Victoria - Median Property Price Growth (year to Q1 2015)



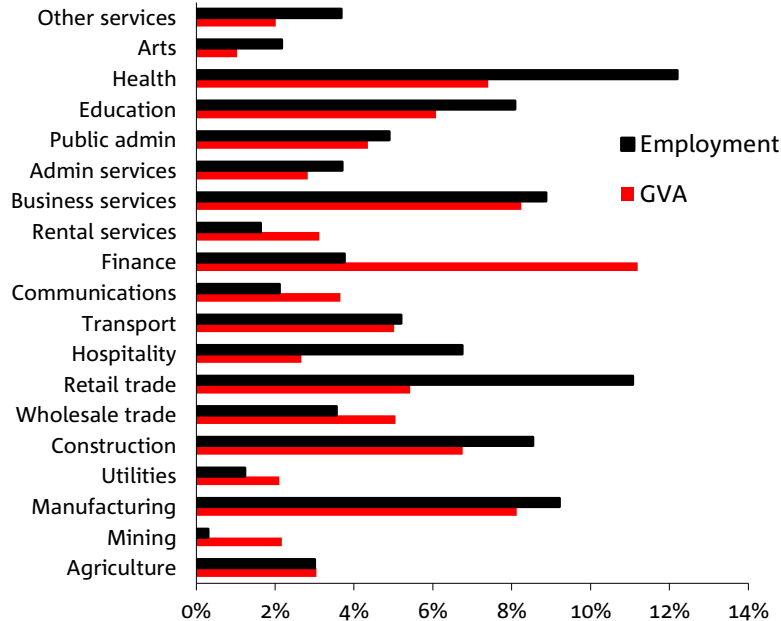


Services sectors are the biggest contributors to production and employment

- The services sectors continued to dominate output shares by industry in 2014-15, with finance and business services accounting 11.2% and 8.2% respectively, ahead of the traditional industry pillar manufacturing at 8%. The largest employing industries over the same period were healthcare (12.2%), retail trade (11.1%) and manufacturing (9.2%) (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 in the year to Nov 2015 was \$4.7 billion (Tables 29-30), but this represents only around a quarter of total imports from the country. 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



Note: Employment by industry data is for 2015 average; GVA by industry is for 2014-15 average

Source: RP Data, ABS, NAB Group Economics

Tables 29-30: Top Victorian Goods Export Destinations and Import Source Countries, 12 months to Nov 2015; Tables 31-32: Major Victorian Export and Import Goods

Value of exports (\$m)		Value of imports (\$m)	
1	China	4690	17660
2	ASEAN	3702	13539
3	US	2665	11907
4	New Zealand	1940	8676
5	Japan	1639	4452
6	EU	1519	4067
7	Korea	885	2595
8	Singapore	842	2123
9	HK	723	1961
10	India	524	1702
11	Taiwan	501	1409
12	UK	348	442
13	Germany	272	

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

- Relative to the *2015-16 Budget*, the general government sector operating surplus has been revised up by \$493 million in 2015-16, and by an average of \$314 million a year in 2016-17 and 2017-18. This largely reflects stronger than expected taxation revenue from stamp duty receipts and GST grants. The operating result for 2018-19 is expected to reduce by \$274 million largely due to removal of \$1.5 billion in previously expected for the former East West Link project (also removed from 2015-16 and 2016-17) by the Commonwealth Government.

Taxation revenue and GST grants is expected to make up close to 60% of the total Victorian government revenue in 2015-16 (Chart 34). There could be potentially large changes to the states' revenue mix as a result of the current federal government review of taxation arrangements, although no change is expected until after the upcoming federal election in late 2016 (2017 implementation at the earliest).

Chart 33: General Government Net Operating Balance

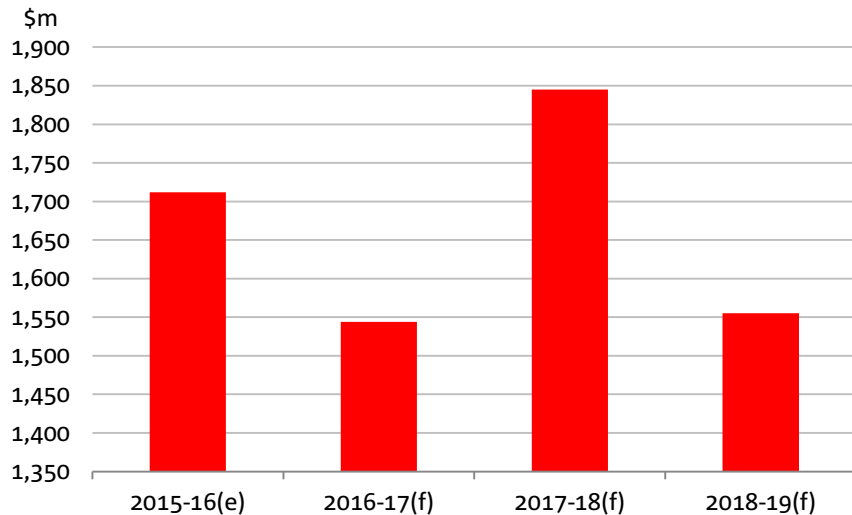
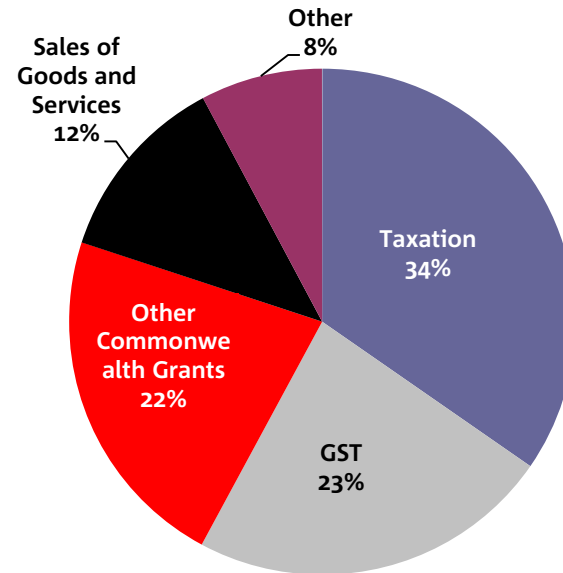


Chart 34: Sources of Victorian Revenue in 2015-16



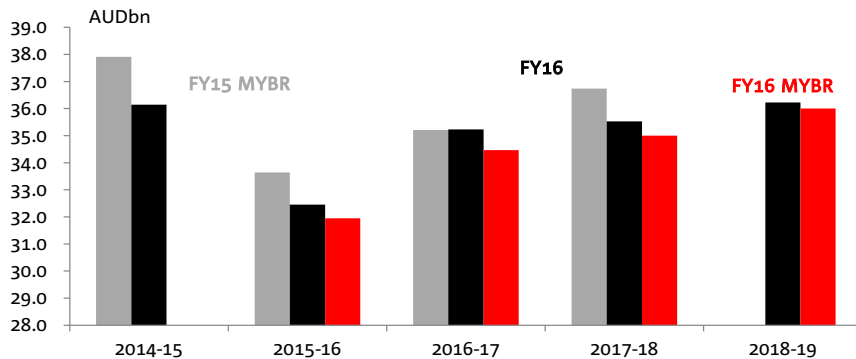
Net debt projections improve, borrowing programme remains low

The cost of providing additional core services is not expected to add to the State's debt burden with net debt projected to be 4.4% of GSP by June 2019. The Government is on track to fully fund its unfunded superannuation liability by 2035 (Chart 35).

S&P reaffirmed Victoria's AAA stable credit rating after the 2015-16 budget. Budgetary performance is expected to remain consistent with recent history while the projected decline in the state's total-tax supported debt is also noted as a positive for the state's credit rating (Chart 37).

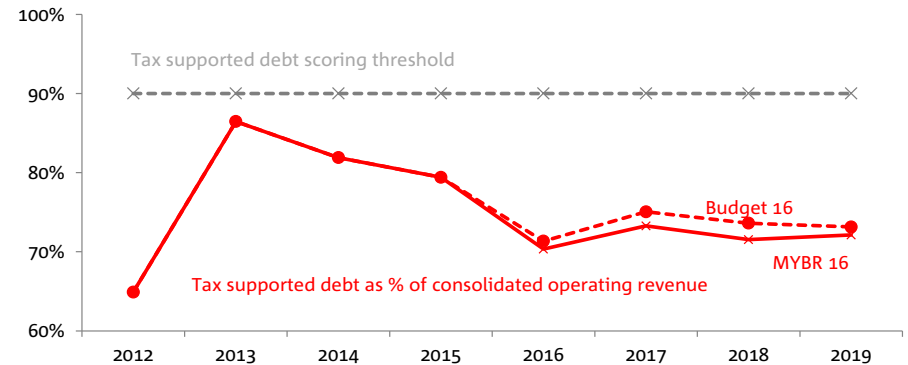
TCV's funding program is unchanged from budget time. The total program for 2015-16 is expected to be negative AUD3.6bn, comprising AUD1.1bn of refinancing and negative AUD4.7bn of new money (-AUD5.5bn of general government and AUD0.8bn of government business enterprises). Excluding maturities TCV has issued net AUD0.64bn of bonds fiscal year to date which includes syndication of new Oct 28 bond (issued AUD1bn) (Chart 36). As at end 2015 TCV's bonds outstanding totalled AUD32.1bn which is AUD0.8bn below levels as at end June 2015 (Chart 38).

Chart 35: Victorian Non-Financial Public Sector net debt



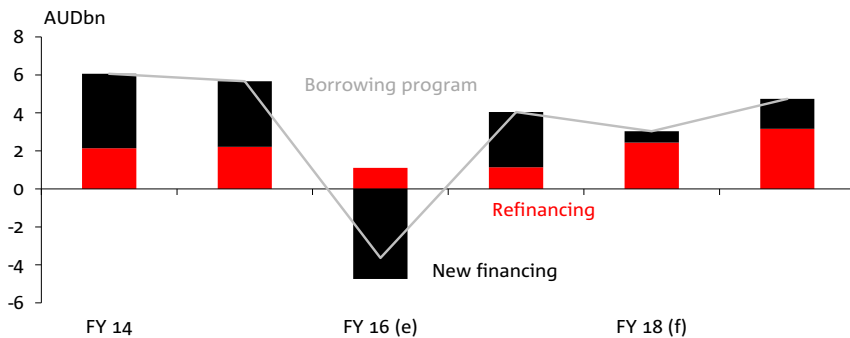
Source: Victorian budget papers

Chart 36: S&P credit metric: Tax supported debt



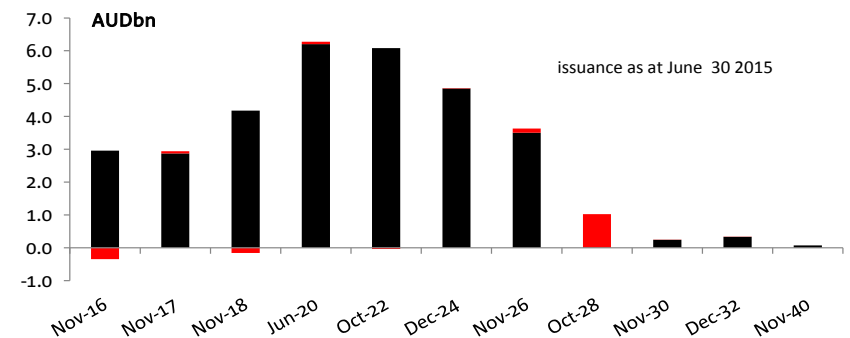
Source: Victorian budget papers, NAB

Chart 37: TCV borrowing programme



Source: TCV

Chart 38: TCV term bonds outstanding as at end 2015



13 Source: TCV

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