

STATE UPDATE: QUEENSLAND

JULY 2016



CONTENTS

2		Key points
3		In Focus: Strong economic growth but incomes to remain weak
4		Labour market
6		Demographics
7		Consumer and household sector
8		Business sector
9		Residential property
11		Tourism
12		Trade
13		Fiscal outlook & semi market

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KEY POINTS

CHART 1: STATE GSP GROWTH FORECASTS

%, annual growth

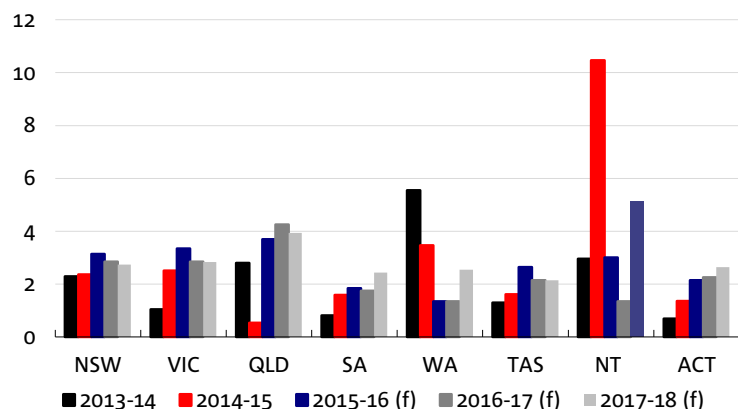
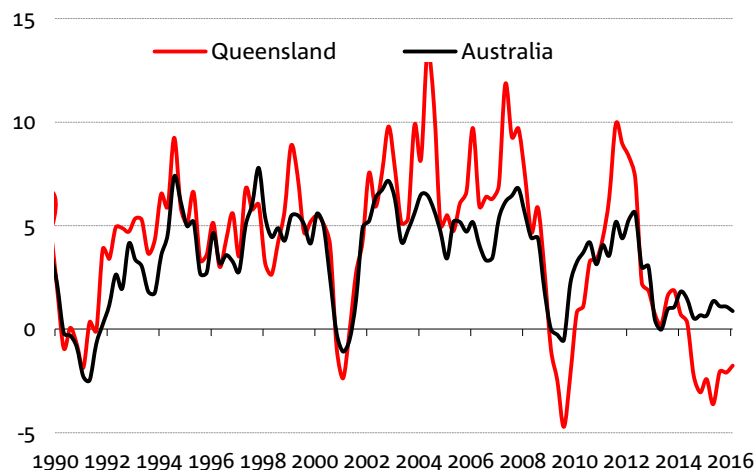


CHART 2: STATE FINAL DEMAND GROWTH

%



Source: ABS and NAB Group Economics

- Queensland's real gross state product is expected to grow solidly on the back of strong LNG exports and tourism, expanding by 3% in 2015-16 and 4% in 2016-17 respectively, and by a lesser 4% in 2017-18 as LNG exports flatten off from a high level. State final demand, however, will continue to contract as mining investment tapers off. In addition, while growth in real output accelerates, **income levels in the state will remain subdued**, as the combination of lower commodity prices and a soft labour market limit both corporate profits and labour income growth, which in turn is negatively affecting government revenue. The economic transition post the mining investment boom is also producing differing growth results across regions, industries and occupations. South-east Queensland with its larger population base and more diverse economy is outperforming, while mining regions are struggling.
- **The labour market transition is perhaps the biggest challenge currently facing the state.** A large number of high-paying mining, construction and professional services jobs have disappeared, and are slowly being replaced by services sector jobs, which often are part-time and lower paid. While the unemployment rate is trending down, it masks the problem of lower average wages, as well as a falling participation rate as discouraged workers leave the labour force, further compounding the problem of falling income levels. While the number of jobs is increasing healthily in south east Queensland, for the rest of the state it is on the decline. The mining regions, in particular, are struggling with elevated unemployment. The soft labour market has also resulted in slower population growth, with both net international and interstate migration slowing. Many young working aged people are heading to the southern states for better employment opportunities.
- The disparity is also evident in the residential sector. Brisbane and the Gold Coast in particular have attracted significant new dwelling investment, as higher yields and low interest rates are supporting investor demand from both interstate and overseas. They have also enjoyed higher price growth, while house price growth has been negative in most of regional Queensland. **While new dwelling investment is expected to add to the state's economic growth**, the concentration of large numbers of medium to high density dwellings in the Brisbane CBD and the Gold Coast poses a potential risk for prices and might hamper further investment.
- **Tourism is another bright spot.** Rising income levels in Asia will continue to see international visitor numbers grow. The lower AUD is also improving Australia's cost competitiveness, and visits from interstate holidaymakers will increasingly replace mining-related travel and contribute to the state's exports growth.
- Apart from LNG, **export growth in Queensland's other key commodities is expected to be low to moderate.** Coal and copper prices have fallen significantly but have shown signs of stabilising. Beef exports will decline from last year's highs while farmers rebuild herd levels.
- Overall, real economic growth will be positive on the back of strong LNG exports, supported by dwelling investment and tourism. The labour market transition will continue to pose challenges for income levels, household consumption and population growth.

LNG EXPORTS TO DRIVE ECONOMIC GROWTH BUT INCOMES TO REMAIN WEAK

Queensland's three large LNG projects have all commenced exporting in 2016, adding significantly to the state's exports and overall economic growth.

However, lower global oil prices, to which the LNG contracts are linked, will weigh on associated income and government revenue. The prices of other key Queensland commodities have also fallen significantly, including coking and thermal coal and copper. While net exports are expected to drive the state's positive economic growth in real terms, income and nominal GDP growth will be lower.

CHART 3: FORECAST LNG EXPORTS

(revised contract based phasing)

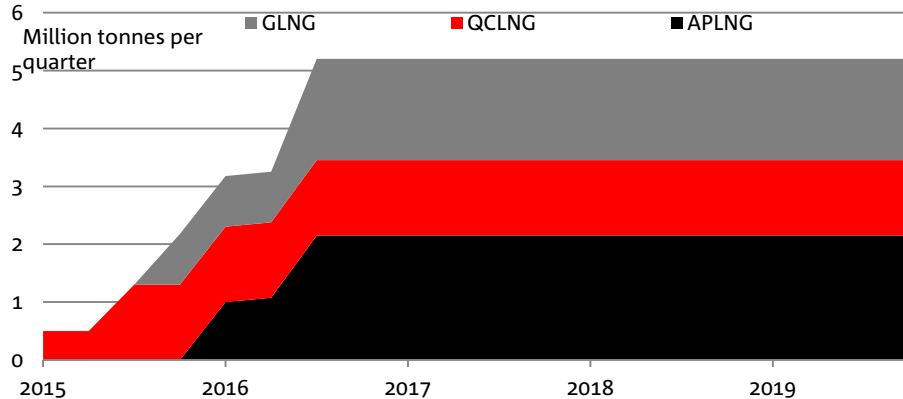
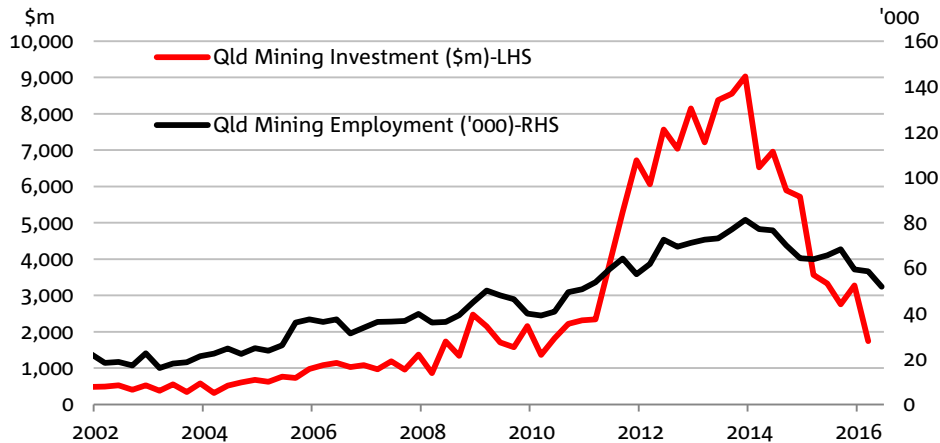


CHART 4: MINING INVESTMENT & EMPLOYMENT



Source: Energy Publishing, Bloomberg, BITRE, ABS, NAB Economics

The soft labour market post the mining boom is also limiting income growth, with average compensation per employee showing negative year-on-year growth and falling behind the national average. Lower income levels will limit household consumption growth, although improved tourism activity should support the retail and hospitality sectors.

Dwelling investment is adding support to the economy, however this has been concentrated in south east Queensland and especially in medium to high density dwellings. Outside the southeast, dwelling approvals have been on the decline.

CHART 5: IMPLIED PRICES, KEY QUEENSLAND EXPORTS

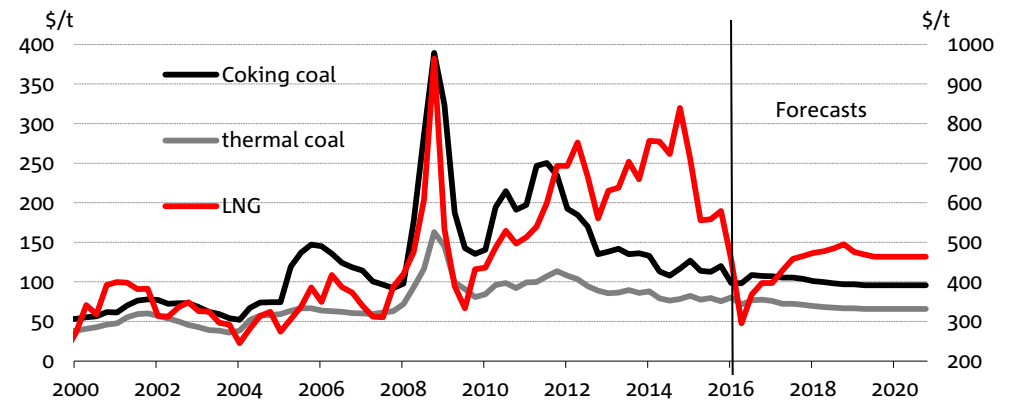
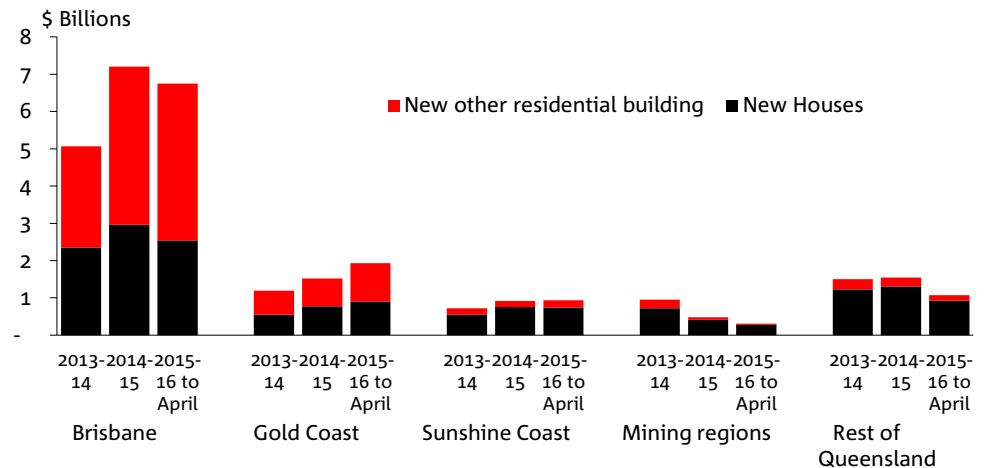


CHART 6: VALUE OF BUILDING APPROVALS BY REGION



LABOUR MARKET (1)

Labour market transitions away from mining-related industries and regions

The labour market in Queensland is in a difficult period of transition post the mining boom which provided many high-paying mining and construction jobs. While the number of employed people has been rising and the unemployment rate trending lower, the details reveal a bleaker picture:

1. The lower unemployment rate can be largely attributed to a falling participation rate, which blurs the picture of still soft labour market conditions.

CHART 7: LABOUR PARTICIPATION RATE, %

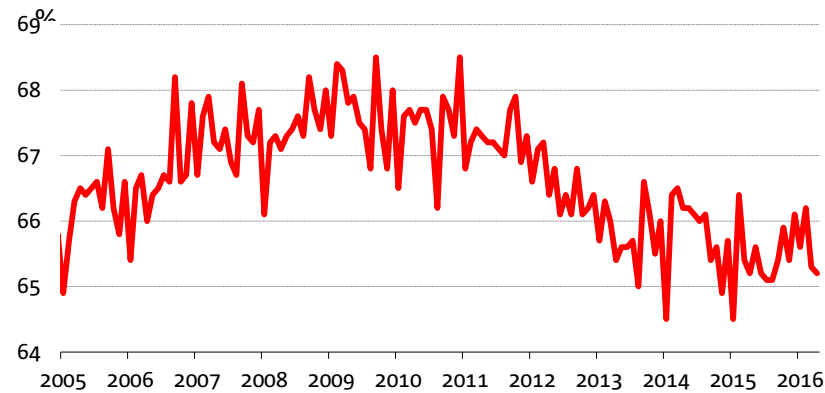
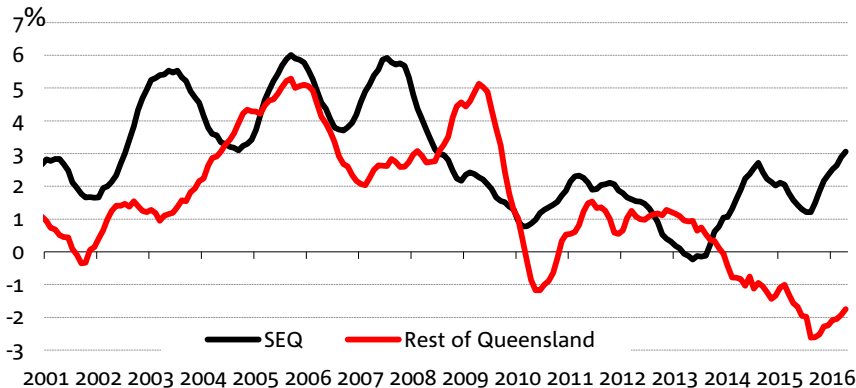


CHART 8: EMPLOYED PERSONS BY REGION

12-month rolling sum, YoY % growth



Source: ABS

2. The disparity between regions: most of the new jobs are being added in south east Queensland while the rest of the state including the mining regions are struggling with their less diverse economies.

3. While new jobs are being added, they are mostly part time jobs while full time employment growth has been stagnant. This in turn means the average earnings are falling.

CHART 9: FULL TIME VERSUS PART TIME EMPLOYMENT

12-month rolling sum

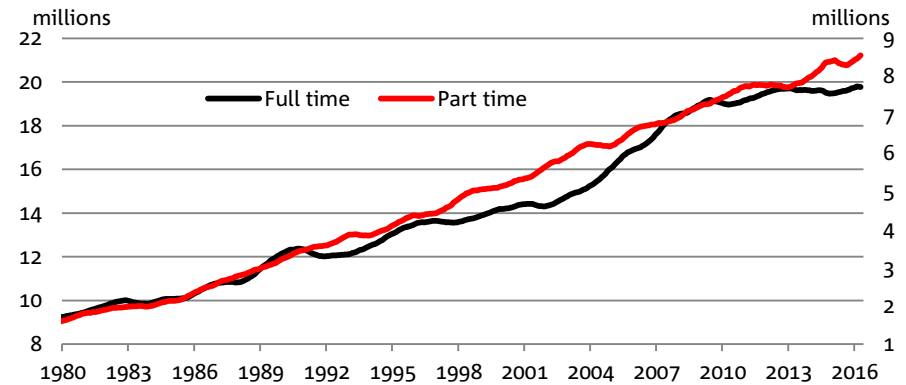
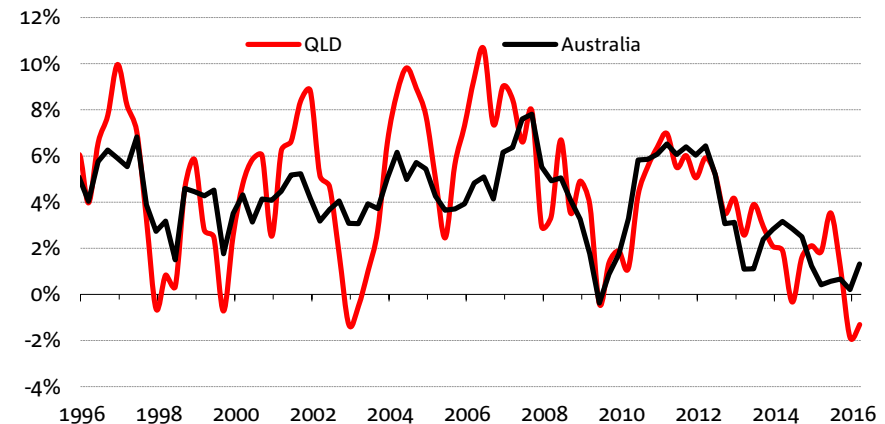


CHART 10: AVERAGE COMPENSATION PER EMPLOYEE, YOY GROWTH



LABOUR MARKET (2)

Labour market transitions away from mining-related industries and regions

4. Workers previously in full-time, higher paid employment in mining and construction are having to opt for lower paid jobs in services industries.

In the past 12 months, the hospitality and construction industries saw the biggest job losses. Many workers have finished their employment as three large scale LNG projects complete their construction. While surging dwelling investment in south East Queensland has created some construction jobs, this has not been enough to offset the decline in mining-related construction.

CHART 11: CHANGE IN EMPLOYMENT BY INDUSTRY

last 12 months to May-16, Queensland, '000

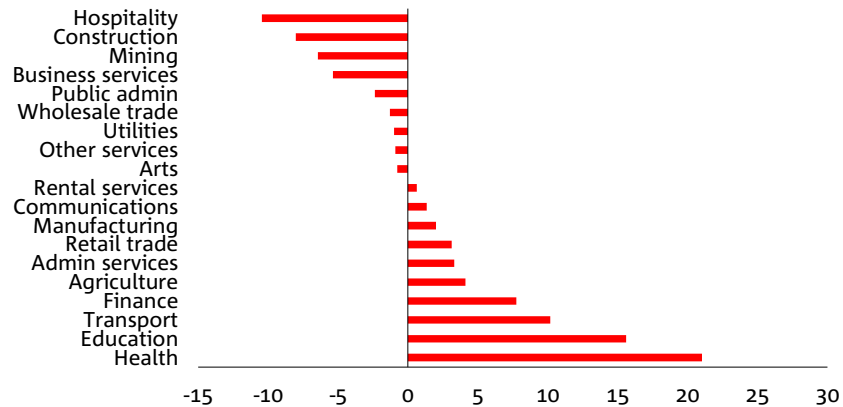
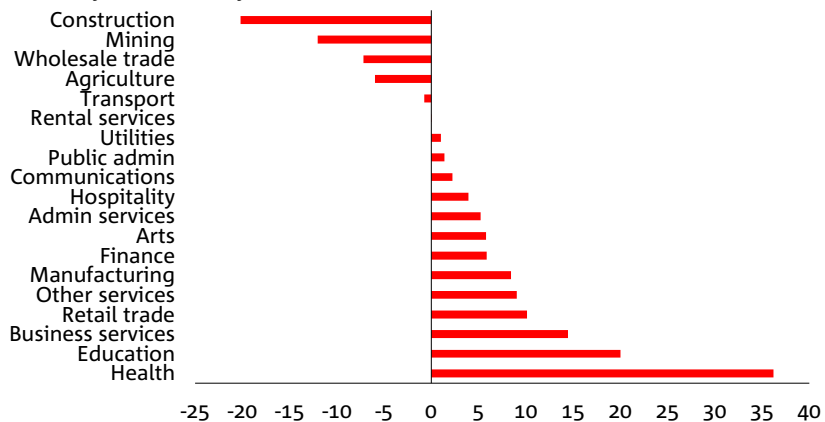


CHART 12: CHANGE IN EMPLOYMENT BY INDUSTRY

last 3 years to May-16, Queensland, '000



Source: ABS

As a result of the shifts towards lower paid services jobs and part time work, labour income growth has been subdued despite improving employment numbers and the falling unemployment rate. This will in turn negatively affect consumer sentiment and household consumption growth.

CHART 13: WAGE PRICE INDEX, YOY GROWTH, %

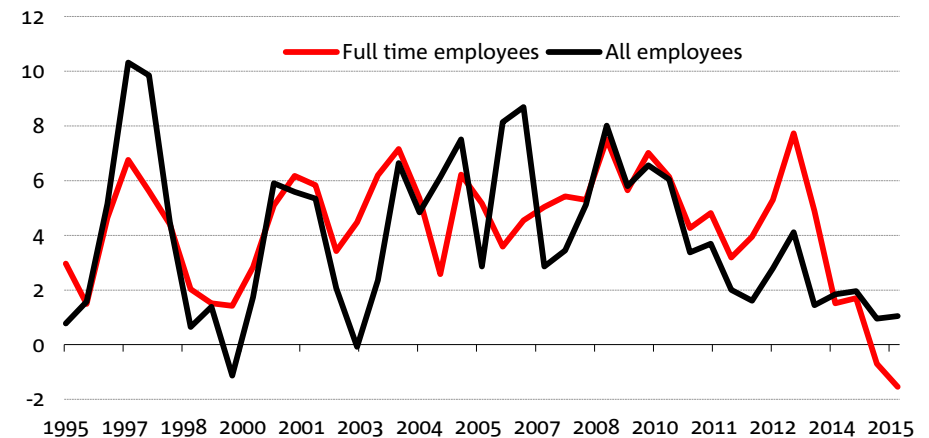
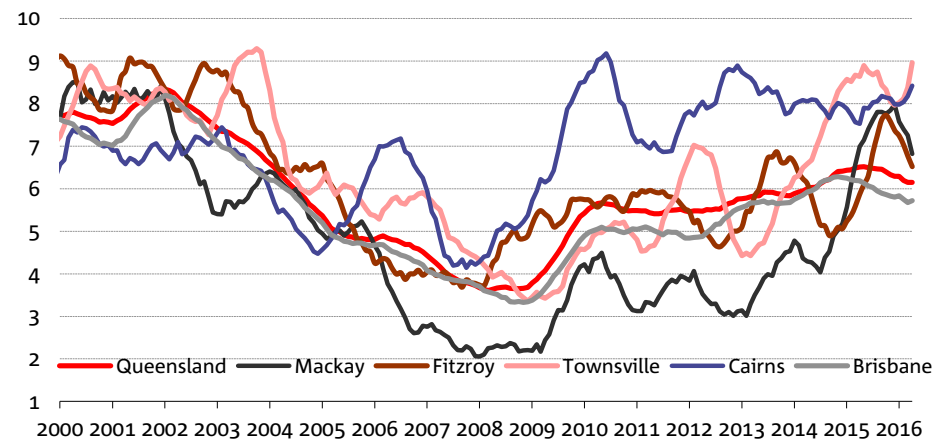


CHART 14: UNEMPLOYMENT RATE, SELECTED REGIONS

12-month moving average, %



POPULATION

Population growth slows as employment prospects weaken

Population growth continues to slow in Queensland, and has now fallen below the national average. The fall in net overseas migration has been the biggest detractor from the population growth. A large number of temporary visas were issued for the construction of large resource projects, the completion of which reduced demand for these workers. Net interstate migration has also slowed significantly. Weaker jobs prospects has resulted in more interstate emigration, although net interstate migration remains positive overall.

What is more worrying is perhaps the emigration of young people, in search for better opportunities in the southern states. In particular, the proportion of 20 to 39 year olds as a share of the population has declined significantly compared to the national average.

Previously the most popular interstate migration destination, Queensland has now been overtaken by Victoria.

CHART 15: POPULATION GROWTH, QUEENSLAND AND AUSTRALIA

%, year on year

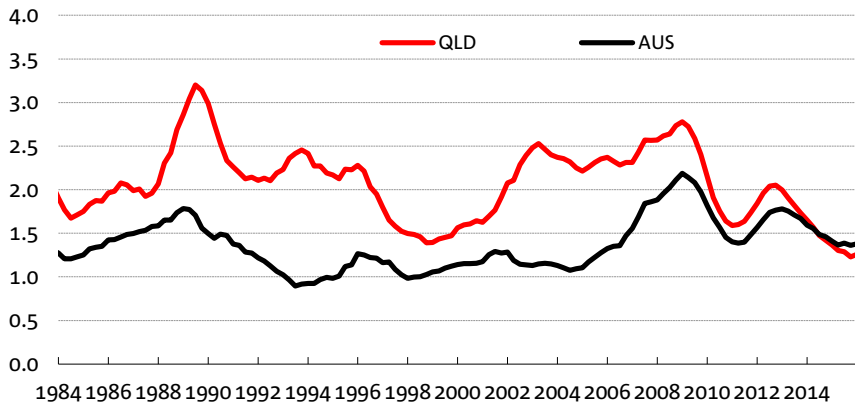
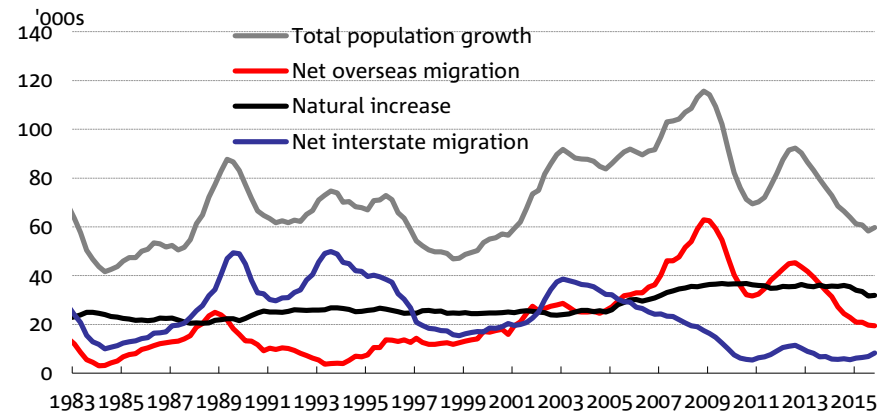


CHART 16: QUEENSLAND POPULATION GROWTH

(000s, over the year)



Source: ABS

CHART 17: SHARE OF POPULATION AGED 20 TO 39

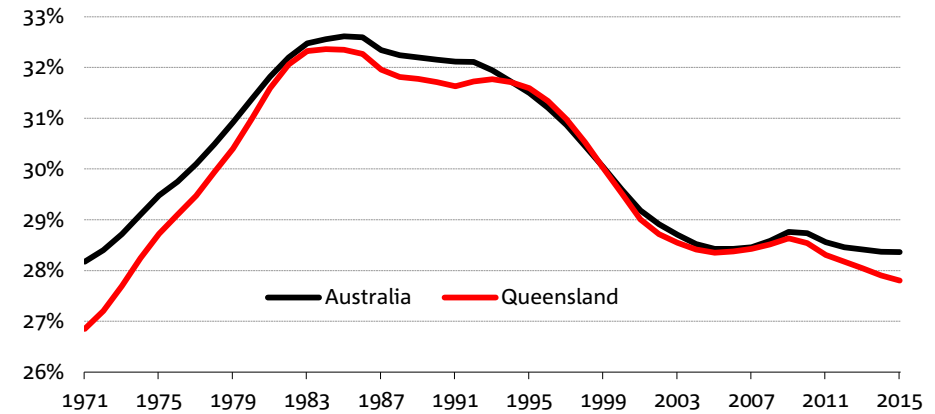
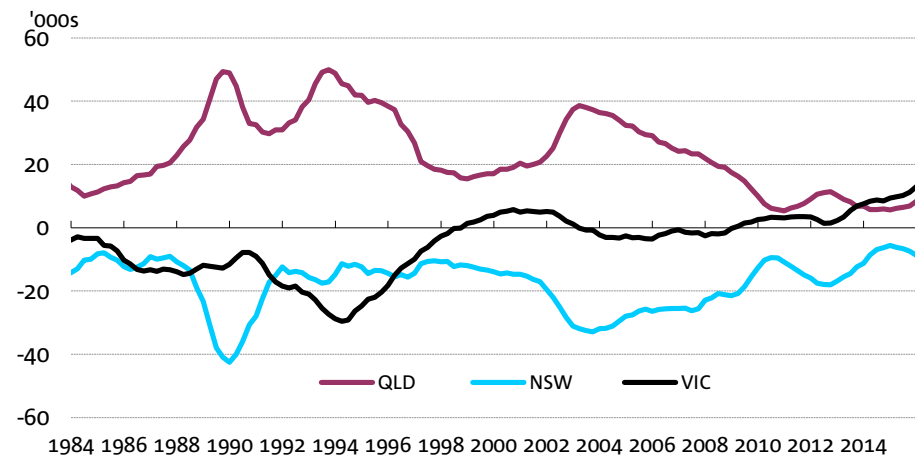


CHART 18: NET INTERSTATE MIGRATION

(000s, over the year)



HOUSEHOLD CONSUMPTION

Household consumption growth to remain limited

Household consumption growth remains subdued, limited by both weak income growth and slower population growth. Their combined negative effects more than offset the supportive effects of low interest rates and rising house prices. Retail turnover and hospitality spending, however, should be more supported by tourism activity.

Consumer sentiment has improved somewhat, possibly due to higher house prices, however remains below average.

The latest Q2 NAB Consumer Anxiety Survey shows that households remain cautious in a soft labour market and weak income growth environment. More people plan to pay off debt and only increase spending on essentials like medical expenses, transport and utilities while cutting back on home improvements and travel.

CHART 19: TOTAL EMPLOYEE COMPENSATION & HOUSEHOLD CONSUMPTION

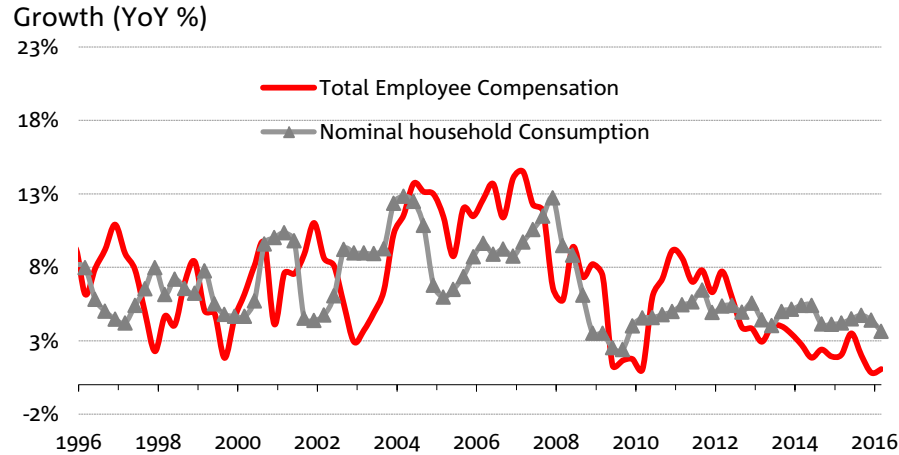
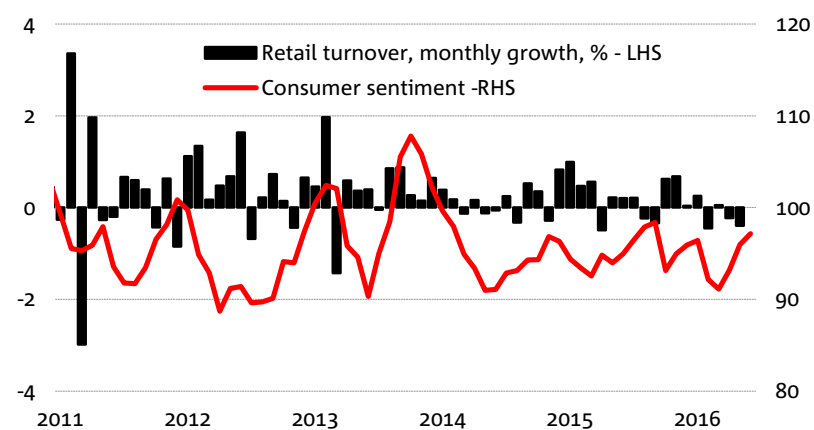
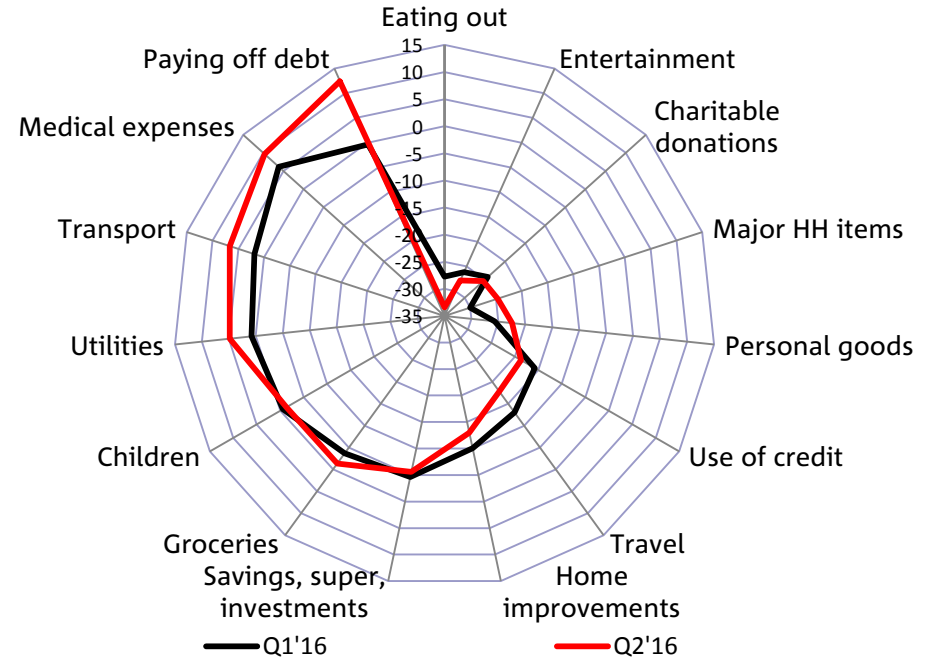


CHART 20: RETAIL TURNOVER GROWTH AND CONSUMER SENTIMENT



Source: ABS, NAB Consumer Anxiety Survey

CHART 21: CHANGES IN SPENDING BEHAVIOUR, NET BALANCE



BUSINESS SECTOR

On a slow recovery post mining investment boom

Business investment has fallen significantly post the mining investment boom. The prospects for new mining investment have been limited by lower commodity prices and subdued global demand. While the low interest rate and low exchange rate environment is providing support for non-mining business investment, the recovery process has been gradual.

Business conditions in Queensland as measured by the NAB Business Survey are catching up but still lagging behind the national average.

CHART 22: BUSINESS CONDITIONS (NET BALANCE) & SPREAD

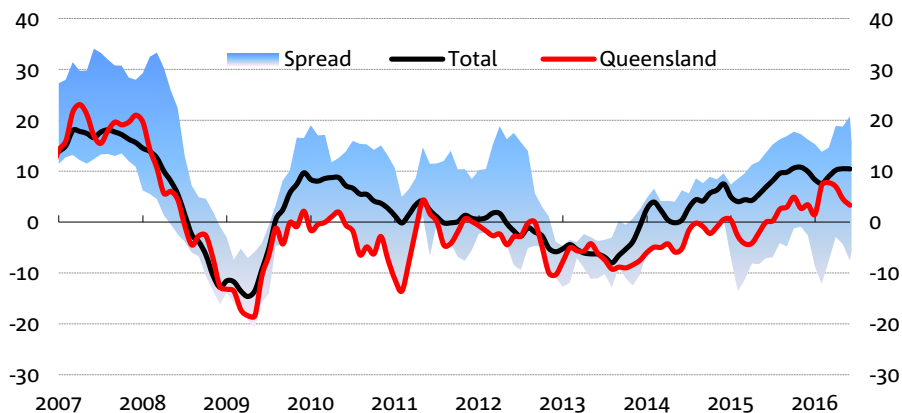
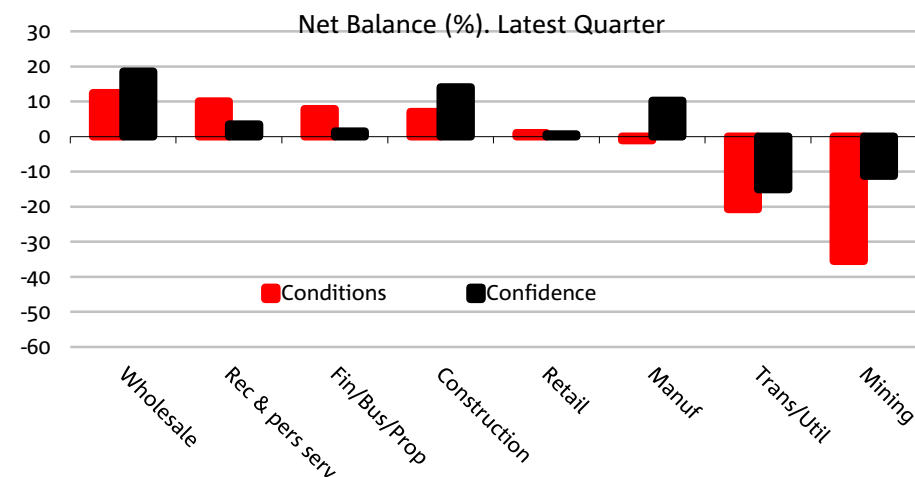


CHART 23: NAB BUSINESS SURVEY INDUSTRY RESULTS



Source: ABS, NAB Business Survey

Conditions have improved in the services sectors while mining conditions remain very negative. Confidence, on the other hand, has been more upbeat.

Following strong growth in the past year, non-residential building approvals have moderated.

While capacity utilisation has improved significantly, it remains below average and recent completed construction could see spare capacity increase again, especially in the commercial office space.

CHART 24: NON-RESIDENTIAL BUILDING APPROVALS

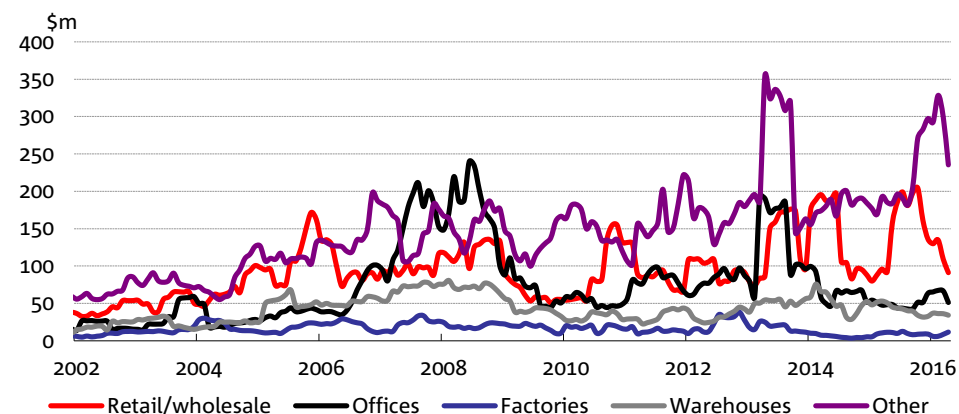
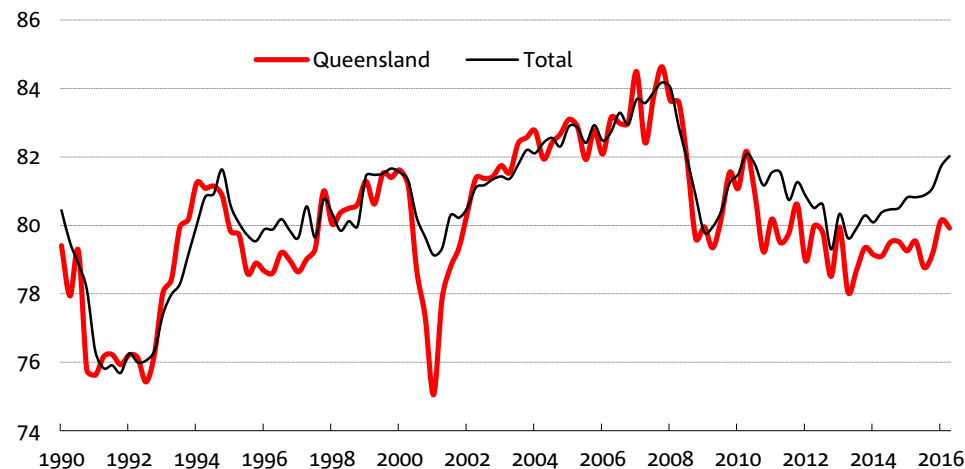


CHART 25: NAB BUSINESS SURVEY - CAPACITY UTILISATION (%)



DWELLING INVESTMENT

Strong dwelling investment growth supported by higher yields and low interest rates

Brisbane has enjoyed better rental yields and better affordability compared to Sydney and Melbourne. Combined with low interest rates, this has supported strong dwelling investment.

Rising dwelling approvals have helped increase the dwellings to population ratio in Queensland, while lowering the rental yield for both houses and units. The price-to-income ratio has also ticked up, which could limit further acceleration in price growth.

CHART 26: QUEENSLAND DWELLINGS TO POPULATION & DWELLING PRICES

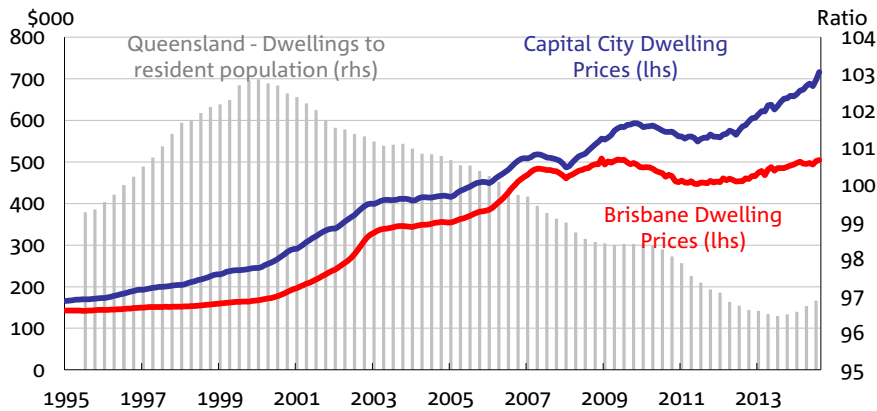
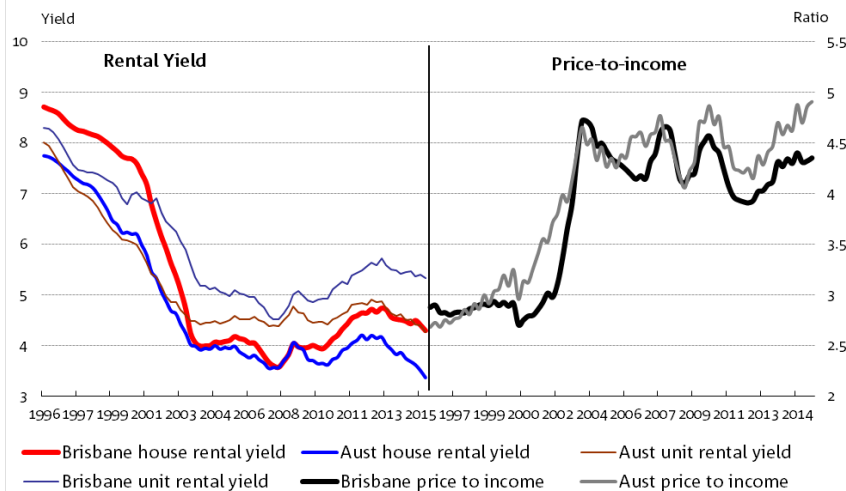


CHART 27: RENTAL YIELDS AND PRICE TO INCOME RATIOS



Source: ABS, RP Data

Most of the work yet to be done is in high density units and apartments rather than houses. As a result, while the house approvals to population ratio in Queensland remains below the national average, the unit approvals to population has quickly caught up.

CHART 28: VALUE OF WORK YET TO BE DONE BY DWELLING TYPE

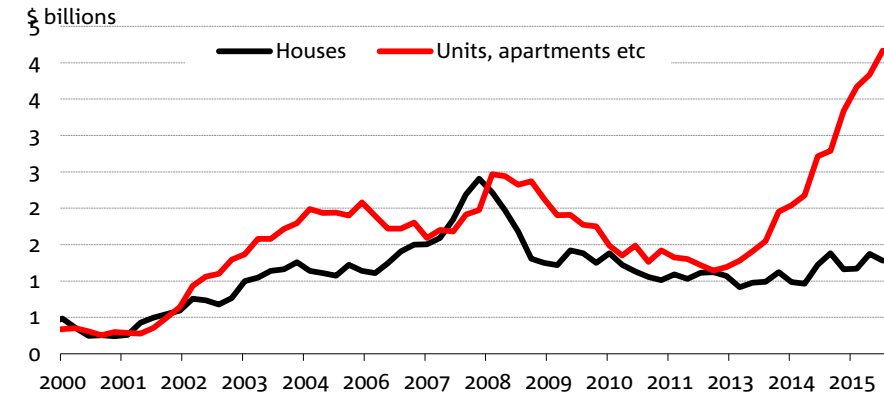
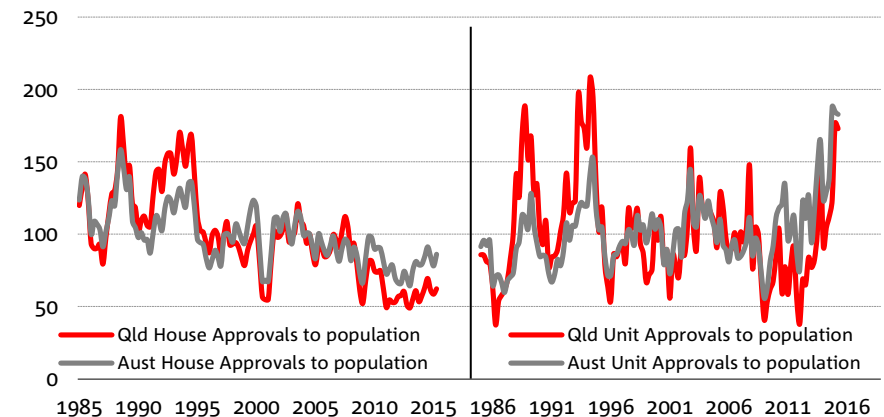


CHART 29: BUILDING APPROVALS RELATIVE TO POPULATION
(Long-run average = 100)



HOUSING

Price differentials across regions while significant apartment supply could dampen prices

Looking across the state, most of the new building approvals have been in units and apartments and concentrated in Brisbane and the Gold Coast. On the other hand, building approvals in mining regions have declined significantly.

The divergence in growth across Queensland regions has shown up in property prices as well. While houses and most units enjoyed positive price growth across Brisbane, in areas outside the south east, house price has suffered negative growth.

CHART 30: VALUE OF BUILDING APPROVALS, BY REGION

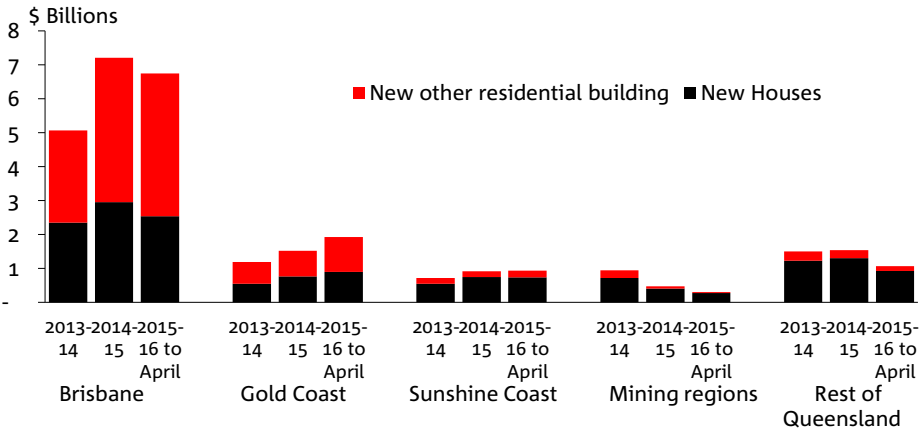
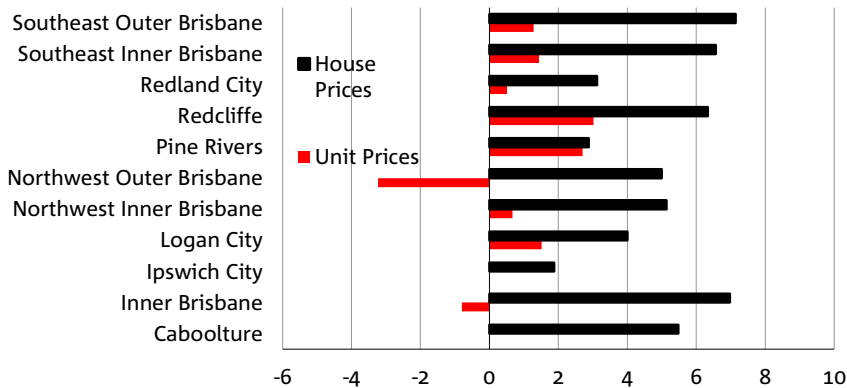


CHART 31: BRISBANE - MEDIAN PROPERTY PRICE GROWTH (year to Q1 2016)



Source: ABS, RP Data, NAB Residential Property Survey

The Q1 NAB Residential Property Survey shows most respondents expect house price growth in Queensland to continue and lead the national average. However, risks remain around the price outlook for units and apartments, especially in the Brisbane CBD, where significant building has been occurring.

NAB forecasts the Brisbane hedonic house prices will rise by 4.0% and 1.9% in 2016 and 2017 respectively, whereas unit prices will rise by a lesser 1.7% in 2016, before falling 1.8% in 2017.

CHART 32: REGIONAL QUEENSLAND - MEDIAN HOUSE PRICE GROWTH (year to Q1 2016)

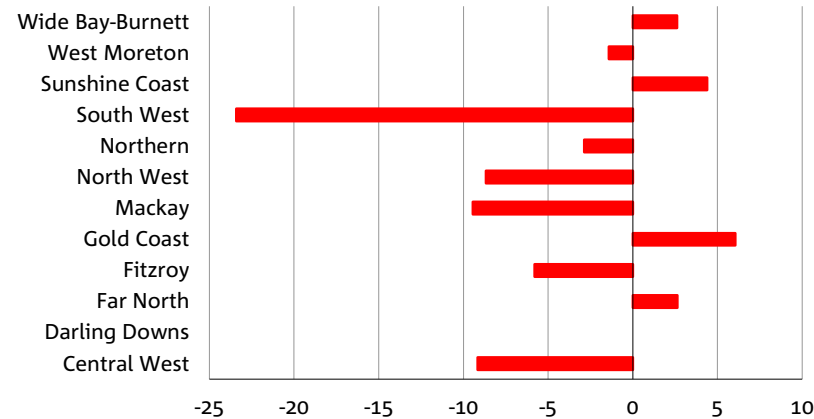
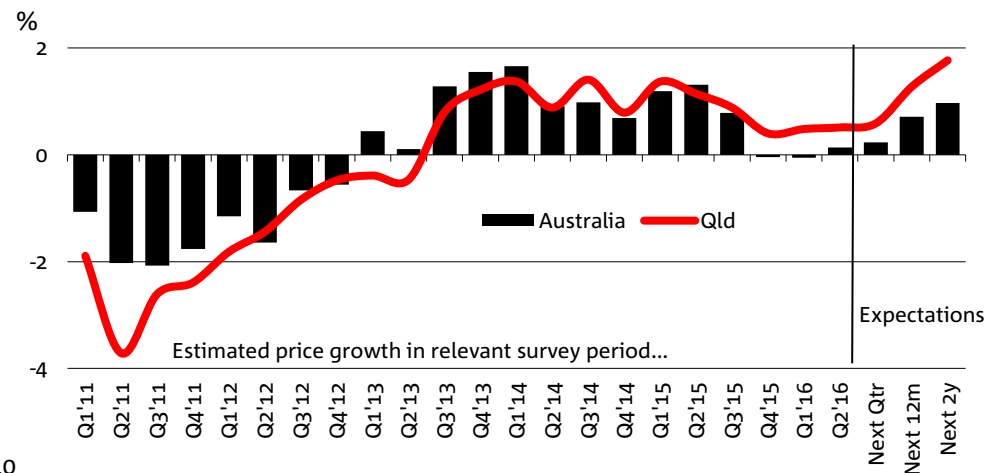


CHART 33: NAB RESIDENTIAL PROPERTY SURVEY - HOUSE PRICE EXPECTATIONS (%)



TOURISM

Tourism to improve as the lower currency provides help

While mining-related travel has declined sharply, both domestic and international tourism to Queensland have been improving, thanks to a lower AUD and rising income levels in Asia.

Short-term international visitor numbers has been rising steadily, however the growth has lagged behind that for New South Wales and Victoria. Many overseas visitors are visiting family and friends, who are more likely to reside in the two bigger states.

CHART 34: NATIONAL TOURISM EXPORTS & THE AUSTRALIAN DOLLAR

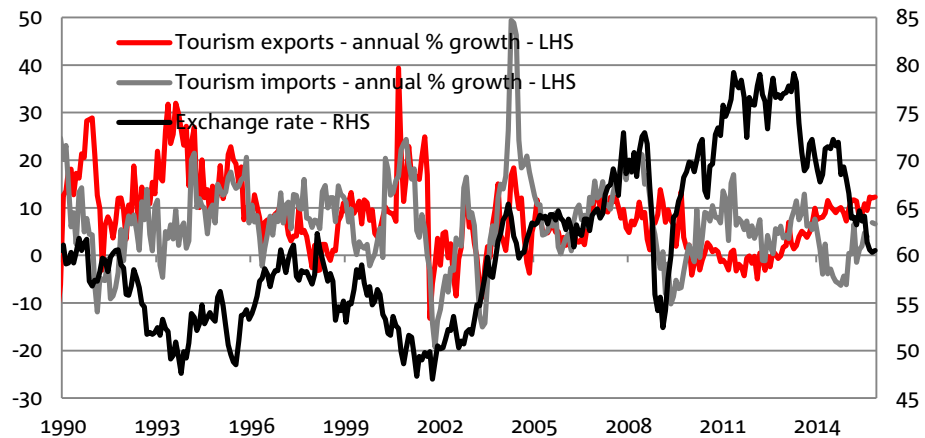
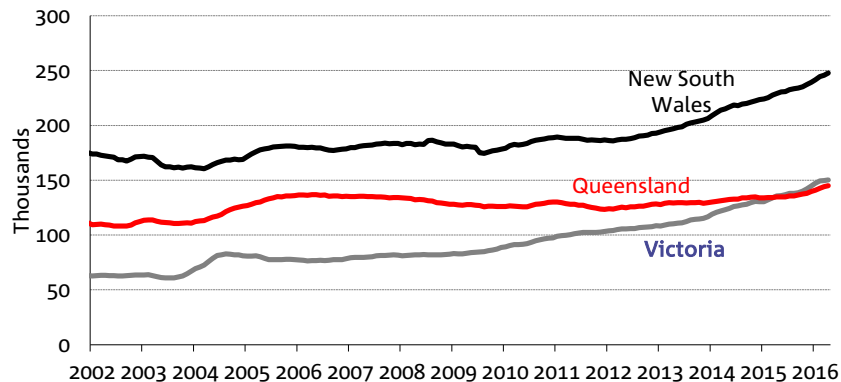


CHART 35: SHORT-TERM INTERNATIONAL VISITORS,

state where spent most time



Source: ABS, RBA, BITRE, NAB, Macrobond

International airport arrivals to the major tourist destinations of Brisbane, Gold Coast and Cairns have been on the rise. Hong Kong airlines commenced direct flights to the Gold Coast and Cairns this April, bringing in visitors from the region, especially mainland China.

On the domestic tourism front, Queensland does have its appeal and with the lower AUD making international travel relatively more expensive, we are likely to see more domestic visitors to Queensland.

CHART 36: INTERNATIONAL AIRPORT ARRIVALS, MONTHLY

EXPORTS

Weak export growth outside LNG

Apart from LNG, Queensland's other key exports are likely to experience little to moderate growth.

Coal export volumes are expected to grow moderately in 2016, while export values will decline due to lower prices. Weaker demand prospects from China will see little or no growth in coal exports going forward.

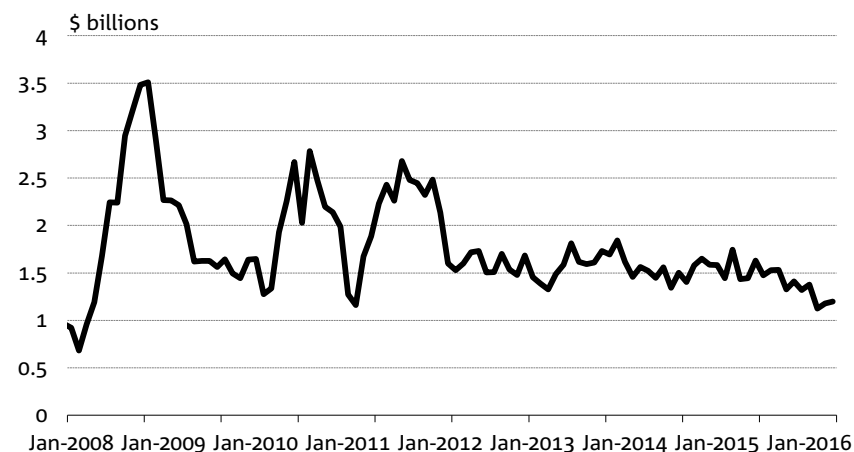
In addition, base metals exports are expected to fall in both 2015-16 and 2016-17 as major producers announce production cuts in the face of weaker global demand and falling prices.

CHART 37: QUEENSLAND'S MAJOR EXPORTS GOODS

Major exports, goods, 2014-15

	A\$m
Coal	18,353
Beef	4,947
Copper	2,272
Other ores & concentrates	2,109
Aluminium	1,140

CHART 38: QUEENSLAND COAL EXPORTS, VALUE



Source: ABS, DFAT

Beef exports surged in 2015 due to drought conditions and an undersupply in the US. With the US drought over, there is reduced export demand and domestic restocking has begun as herd levels were depleted significantly. As a result, beef production and exports are expected to continue to fall.

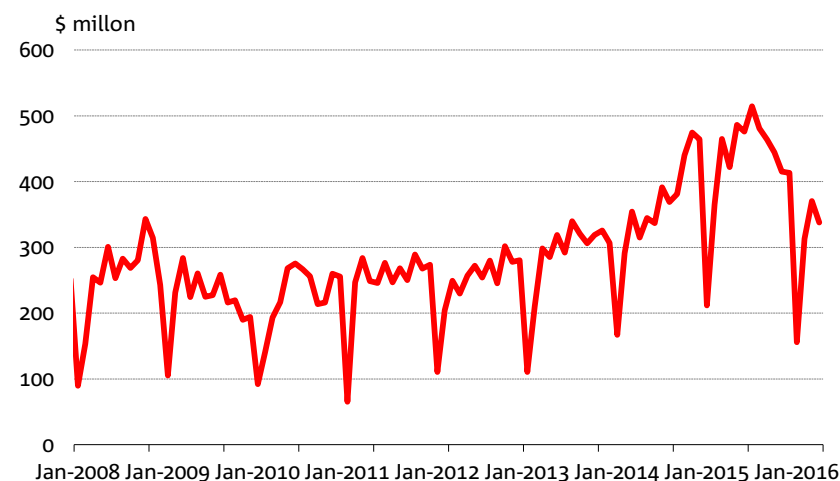
Imports growth is likely to remain subdued, as high levels of capital imports have fallen with the completion of the three LNG projects. The lower AUD will also limit consumption goods and services imports growth.

CHART 39: QUEENSLAND'S MAJOR IMPORTS GOODS

Major imports, goods, 2014-15

	A\$m
Crude petroleum	4,607
Refined petroleum	3,923
Passenger motor vehicles	3,790
Goods vehicles	1,689
Heating & cooling equipment	773

CHART 40: QUEENSLAND BEEF EXPORTS, VALUE



FISCAL OUTLOOK

Budget to remain in surplus but balances lowered

The state government has further revised down its net operating balance forecasts, since its mid year fiscal and economic review. The biggest revision was to 2015-16, due to the Commonwealth Government's decision to defer disaster recovery funding. For 2016-17 to 2018-19, royalty revenues were revised down significantly due to lower coal price and coal seam gas royalties assumptions.

Since the 2014-15 budget, royalty revenue has been revised down in each subsequent budget update by Queensland Treasury. Both coal price and oil price assumptions (to which LNG export prices are linked) have been revised significantly.

Over the four years to 2019-20, the Budget projects revenue growth to average 3.2%pa and expenses to average 2.9%pa.

CHART 41: NET OPERATING BALANCE

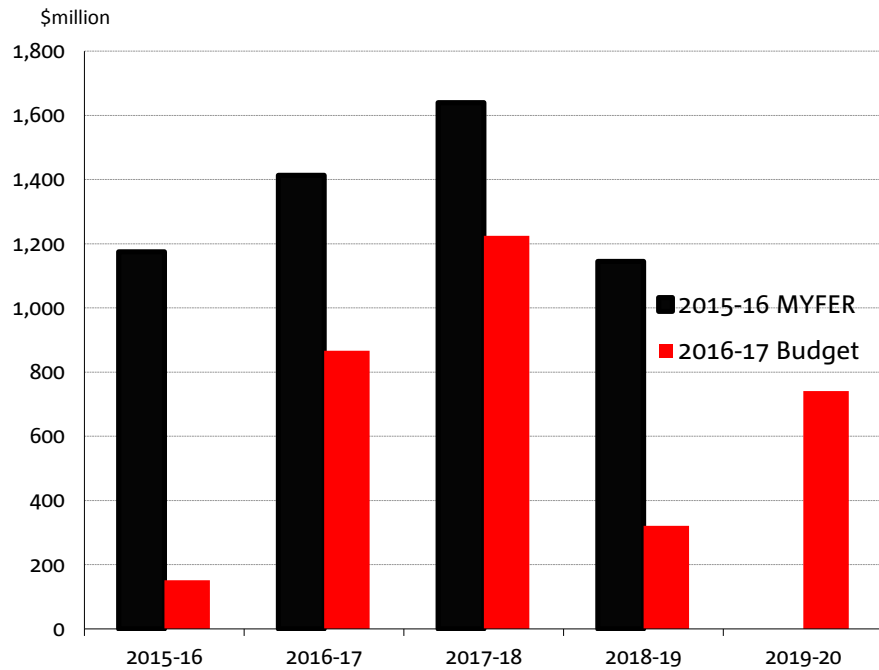
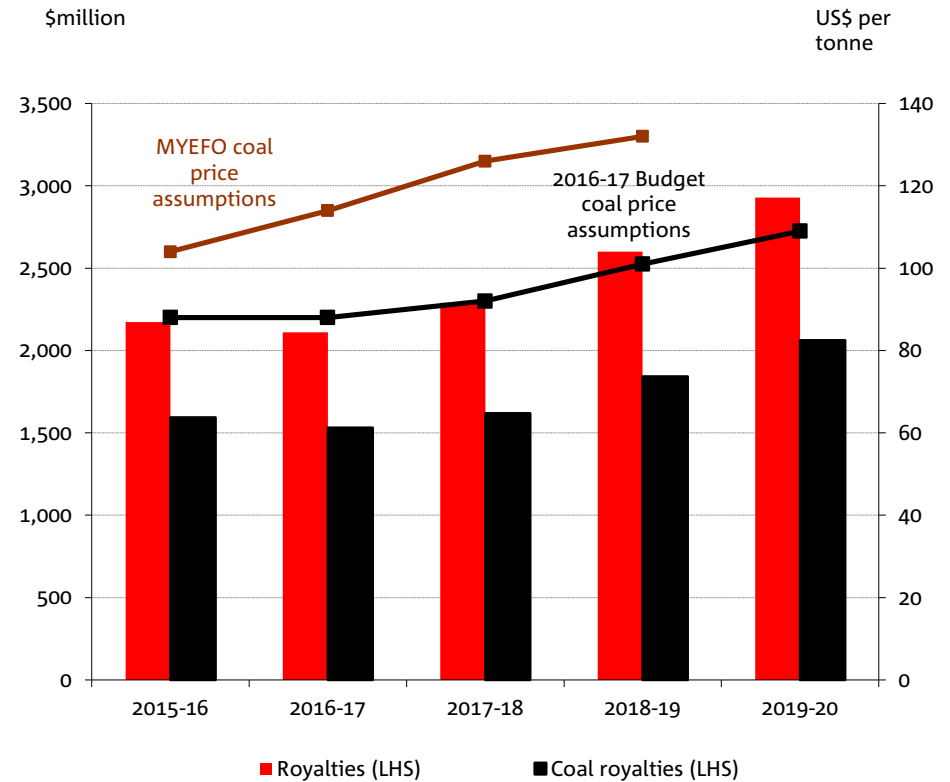


CHART 42: FORECAST ROYALTIES (TOTAL AND COAL) AND COAL PRICE ASSUMPTIONS



Source: Queensland 2016-17 Budget, 2015-16 Mid Year Fiscal and Economic Review, NAB Economics



NET DEBT AND BOND ISSUANCE

Ongoing fiscal deficits will keep net debt rising throughout the forecast period,

At the total state level, ongoing fiscal deficits will keep net debt rising throughout the forecast period, from \$40bn in 2015-16 to \$47.6bn by 2019-20. The key elements of the Government's Debt Action plan include repatriation of surplus funds from defined benefit scheme (total of \$4bn with \$2bn used to fund infrastructure and \$2bn to reduce net debt); use of surplus cash in government-owned corporations and regearing of government owned corporations.

QTC is rated Aa1 by Moody's with a negative outlook and the equivalent S&P rating of AA+, but with a stable outlook. Our own estimate of S&P's scoring methodology shows that QLD's key metrics remain consistent with a AA+ rating.

QTC estimates that it will borrow \$ 7.3bn of term debt in 2016-17. This comprises \$1.9bn of new funding and \$5.4bn of maturities. QTC will look to consolidate shorter maturities into longer to smooth and extend the maturity profile.

CHART 43: QLD NON-FINANCIAL PUBLIC SECTOR NET DEBT

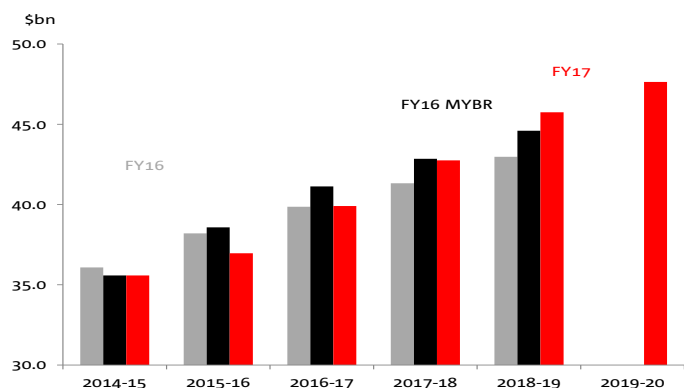


CHART 44: QTC BORROWING PROGRAMME

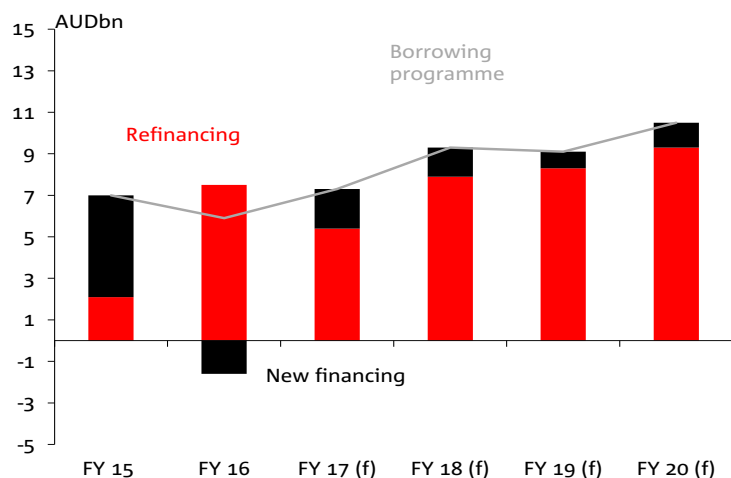


CHART 45: S&P CREDIT METRIC: TAX SUPPORTED DEBT/REVENUE

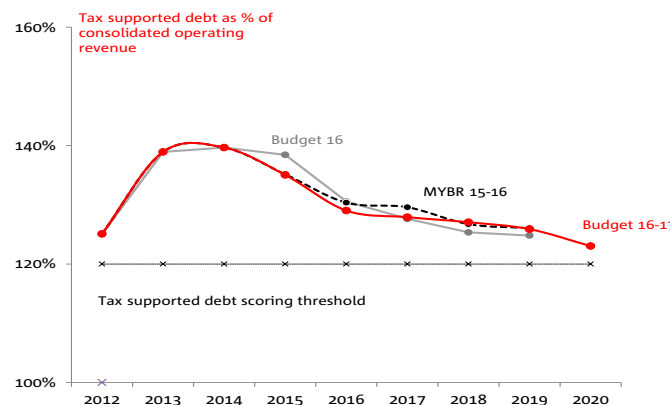


CHART 46: QTC TERM BONDS OUTSTANDING AS AT END JUNE 2016

