

STATE HANDBOOK: VICTORIA



National
Australia
Bank

MARCH 2017

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KEY POINTS:

The Victorian economy gains further momentum as its population surges

CHART 1: STATE GSP GROWTH FORECASTS

Annual growth

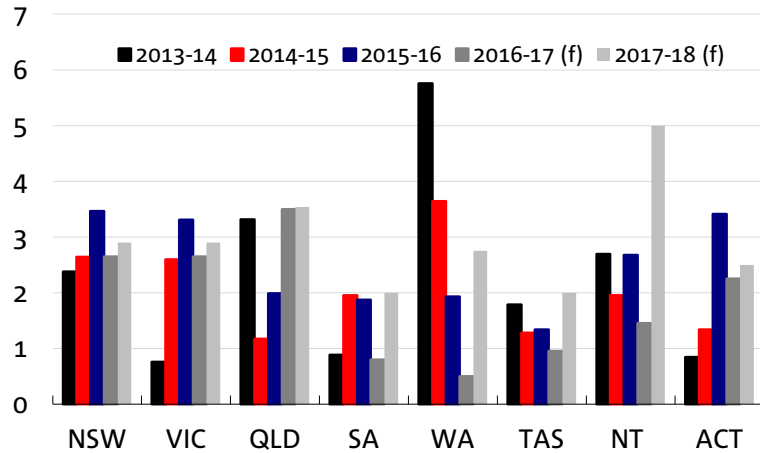
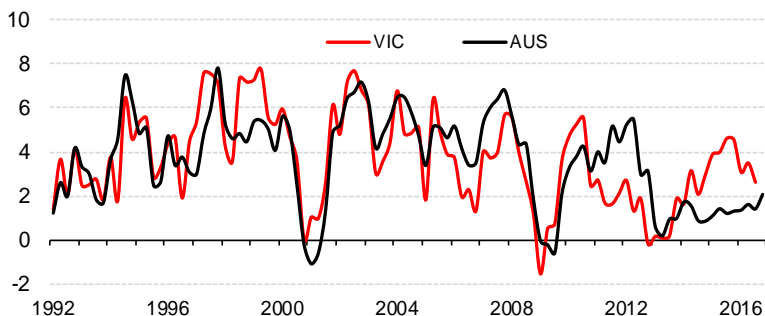


CHART 2: STATE FINAL DEMAND

Per cent (%)



Source: ABS and NAB Group Economics

- The Victorian economy performed strongly in 2015-16, with GSP rising by 3.3% (which was in line with our forecast), supported by strong dwelling investment and household consumption. This in turn reflected the resilience of the housing market which achieved its fourth consecutive year of price growth in 2016, while exceptionally strong population and employment growth also contributed to the state's output. The housing construction pipeline is at a historically high level, suggesting that dwelling investment will remain high in 2017 but with less scope to contribute to GSP growth. Although building approvals have weakened, high population growth and planning for new Melbourne suburbs suggest a solid outlook for Victorian dwelling investment. The overall level of construction activity of the state will be supported by the large infrastructure investment by the Victorian government in the Western Distributor and Metro Tunnel projects. Meanwhile, household consumption appears to have lost some momentum more recently. Business conditions have been more favourable than the national average and Victorian labour market has held up better than most states, although an elevated underutilisation rate indicates an ample amount of spare capacity. **We forecast Victorian real GSP growth to be around 2½% in 2016-17 and slightly stronger at 2.9% in 2017-18. The unemployment rate is forecast to be little changed at 5.7% by mid-2017 and to remain near that rate by mid-2018.**
- The recent improvement in the Victorian economy was relatively broad-based. In terms of GVA by industry, property services was the best performer in 2015-16, rising by 11% in the year, followed closely by the construction sector at 10%. Meanwhile, agriculture and mining were the weakest. According to more timely data from our business surveys, the construction and transport sectors enjoy the strongest conditions at present, and there are tentative signs of improvement in mining presumably due to the recent recovery in commodity prices. **Victorian household consumption growth has eased somewhat in recent quarters, but is overall still reasonably robust on the back of strong population growth, although sustained weakness in wages growth is weighing on its outlook.** Generally, consumers remain cautious, with our NAB Consumer Behaviour Survey showing that overall consumer spending preferences remain geared towards essential items.
- The Victorian labour market remains reasonably robust despite a sharp deceleration in part-time job creation, as a rotation towards full-time jobs helps to keep employment growth at a relatively steady level. However, the elevated underutilisation rate suggests little upward wage pressure. The imminent closures of the Toyota and Ford plants this year are expected to cost around 3,500 direct manufacturing jobs, plus some indirect job losses through parts suppliers. The impending closure of the Hazelwood power station will exacerbate the economic situation in the LaTrobe Valley. Population growth in Victoria continues to surge ahead that of all other states and territories, rising by 2.1% in the year to June quarter 2016, compared to 1.4% nationally.
- That said, **business investment growth has remained stubbornly weak despite low borrowing costs and improved economic conditions.** The relatively higher capacity utilisation rates of Victorian firms compared to the national average are nevertheless a sign that business activity in the state is relatively healthy. **Victorian services exports appear to have benefited disproportionately from a lower AUD compared to goods exports and are likely to grow further,** indicated by the continuous rise in the number of student visas granted by the government. Meanwhile goods exports have largely stagnated since mid-2015, partly reflecting the structural decline in the manufacturing sector.

IN FOCUS:

Contribution by dwelling investment to GSP expected to weaken in 2016-17

- Victorian dwelling investment surged in 2015-16, rising by 11% in annual growth terms and contributing 0.7 pts to GSP growth in the year (Chart 3). However, the level of dwelling investment has trended broadly sideways since then.
- Leading indicators of construction activity, particularly commencements, have moderated at high levels in recent months (Chart 4), and there are signs that the construction pipeline peaked in the middle of 2016. However, the pipeline remain long in historical terms (Chart 5).
- Our latest NAB Business Survey indicates that the business conditions and confidence of the Victorian construction sector also stabilised in broadly positive territory during 2016 (Chart 6). Recent announcements of new suburban developments to the north, west and south-east of Melbourne are another reason to believe that the Victorian construction industry will remain busy in the medium term.
- Although dwelling investment may contribute much less to GDP growth in 2016-17 than in the previous two years, the level of construction is expected to remain high.

CHART 3: PERCENTAGE POINT CONTRIBUTION OF DWELLING INVESTMENT TO GSP

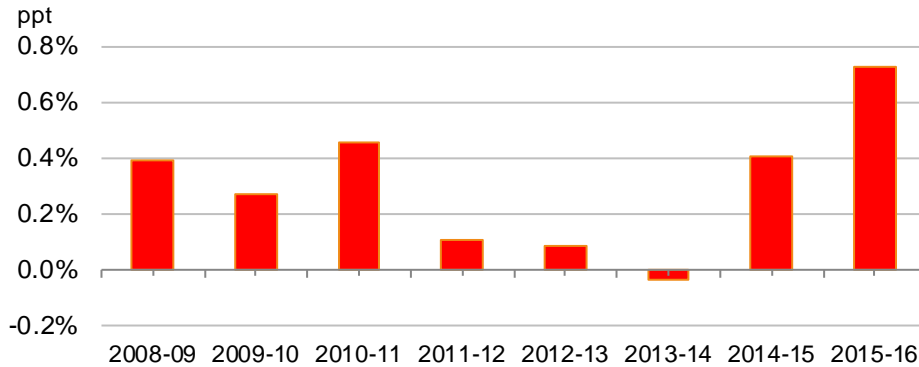


CHART 4: NUMBER OF DWELLING APPROVALS AND COMMENCEMENTS

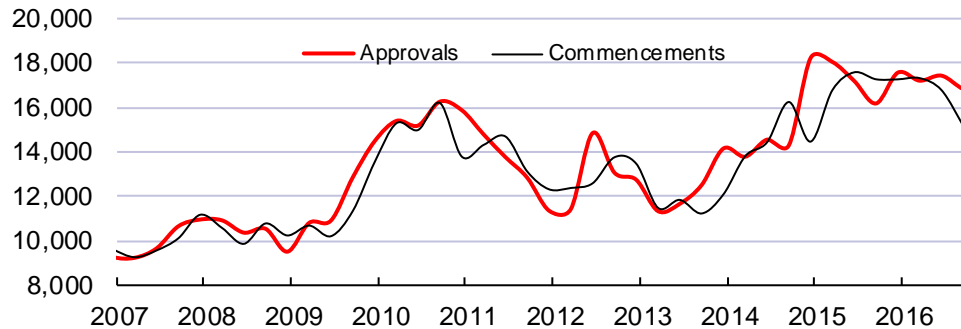


CHART 5: VALUE OF DWELLING APPROVALS AND PIPELINE
\$billion

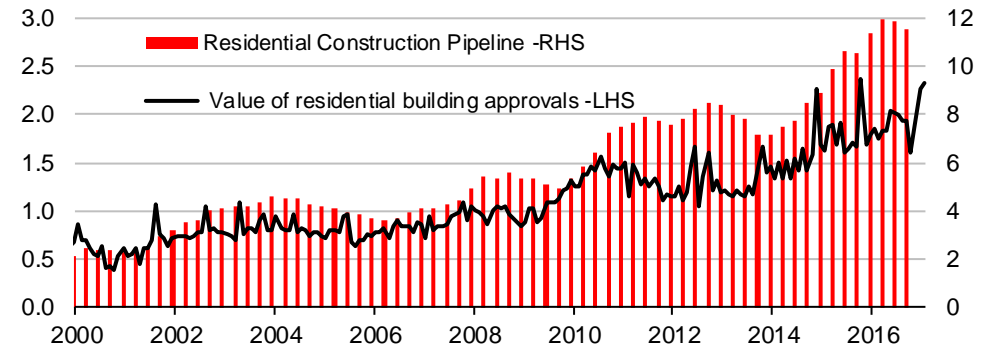
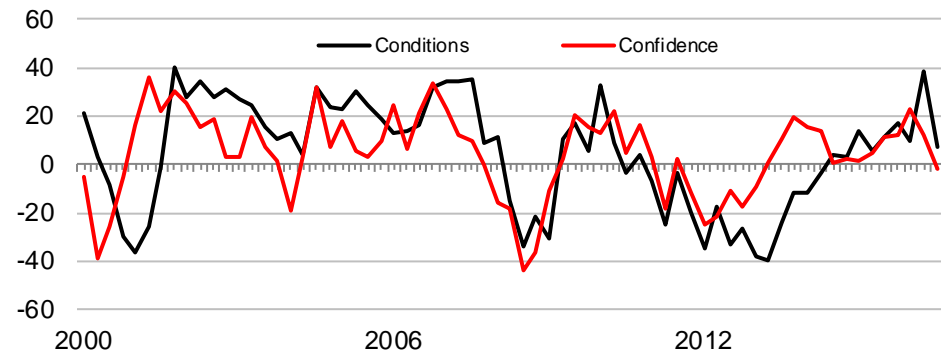


CHART 6: CONSTRUCTION BUSINESS CONDITIONS AND CONFIDENCE
Net balance



CONSUMER AND HOUSEHOLD SECTOR:

Consumption growth showing signs of easing but remains robust overall

- Nominal household consumption growth has lost some momentum in recent quarters, partly because of a lower rate of price inflation but growth in payrolls (wages and employment) remains supportive (Chart 7). After adjustment for inflation, consumer spending was a little more than 3% higher than a year ago.
- Retail sales growth has moderated notably since early this year, with the fading positive impetus from the housing market likely a factor (Chart 8).
- Based on our survey, consumers continue to practise high caution in their spending preferences, characterised by a strong inclination to spend on “essential” goods and services, including utilities, medical expenses and transportation, and less on discretionary items such as travel, personable goods and charitable donations (Chart 9).

CHART 7: TOTAL COMPENSATION OF EMPLOYEES AND NOMINAL HOUSEHOLD CONSUMPTION GROWTH

Year-on-year percentage growth

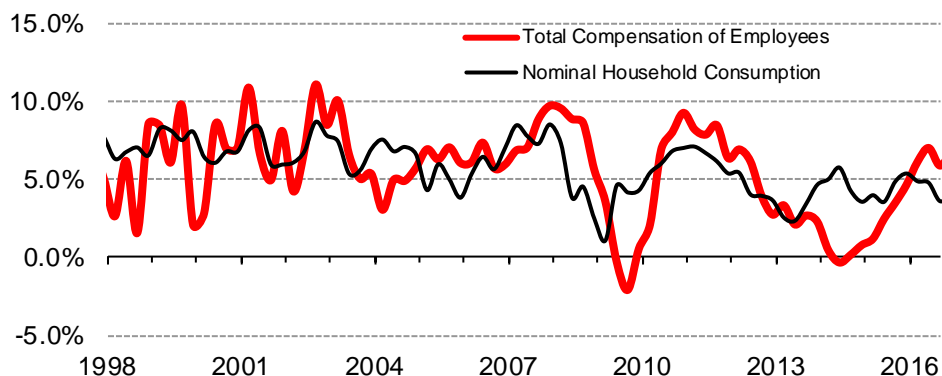


CHART 8: RETAIL TURNOVER AND HOUSE PRICE GROWTH

Year-on-year percentage growth

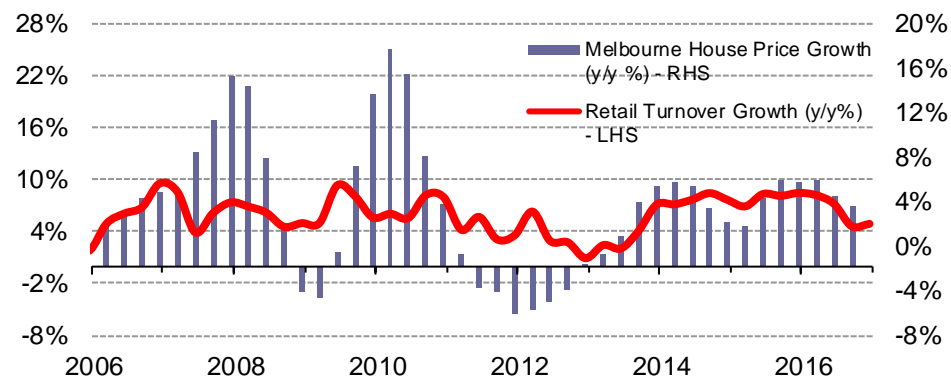
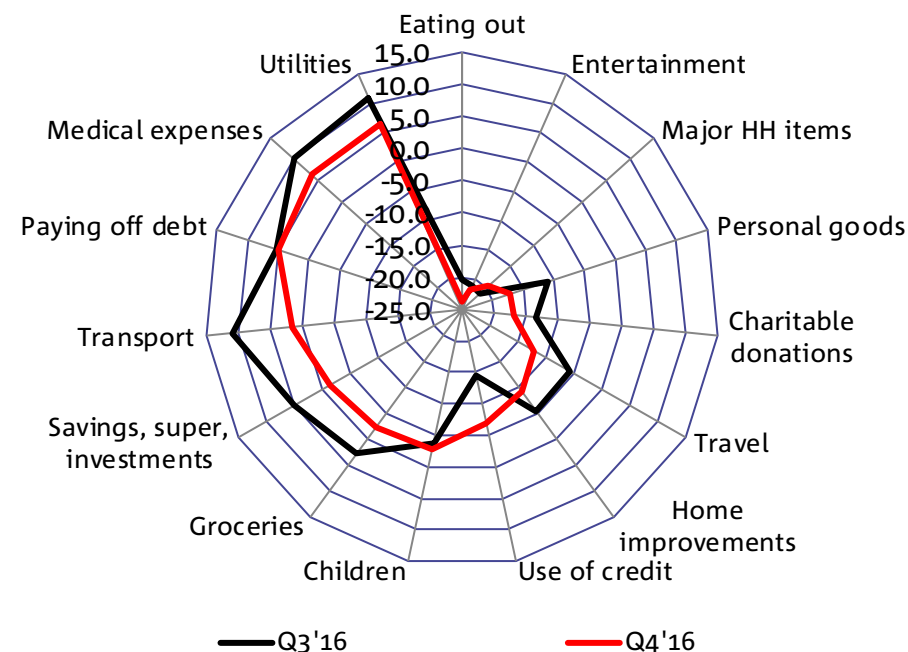


CHART 9: NAB CONSUMER ANXIETY SURVEY - CONSUMER SPENDING PREFERENCES

Changes in Consumer Spending Preferences (net balance)



NAB CUSTOMER SPENDING BEHAVIOURS:

Spending growth in Melbourne and regional areas broadly similar

NAB's customer transaction data allows for a more granular look at spending behaviours across regions in Victoria.

By individual postcode, spending growth in Melbourne over the year was fastest in StKilda East (15.4%) followed by Heatherton (14.3%), Hampton Park and Clayton. In regional Victoria, growth was fastest in Rapunyah (almost 40%) followed by Beulah (37.1%), Walpeup and Nyah.

[Customer spending on Accommodation, Cafes, Pubs & Restaurants was fastest in both Sydney Metro (13.8%) and NSW Regional areas (17.4%).]

CHART 10: GREATER MELBOURNE METRO AREA

Year-ended growth to Q4 2016

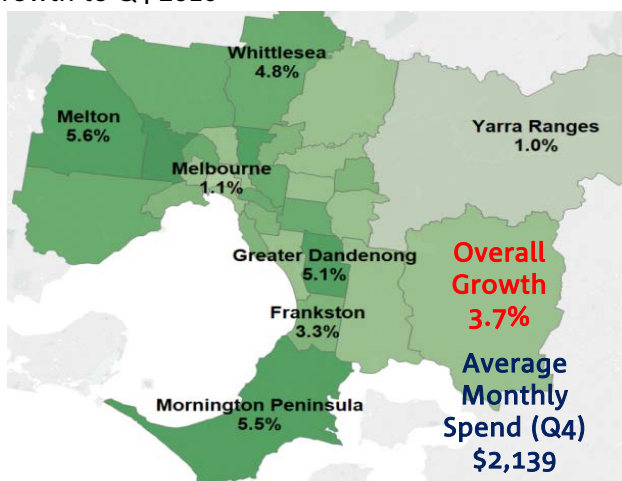


CHART 11: REGIONAL VIC (EX METRO)

Year-ended growth to Q4 2016

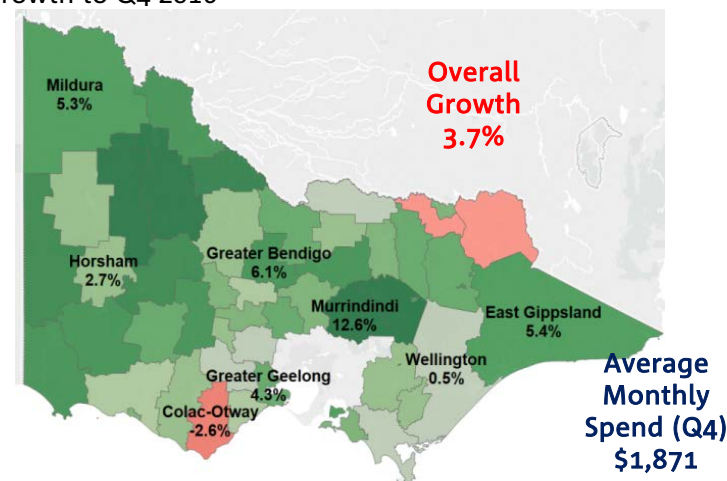


CHART 12: TOP 20 GROWING METRO POSTCODES FOR SPENDING

Top 20 Postcodes by Spend Growth: Melbourne Metro
(Q4 2016 spend value on Q4 2015 spend value)

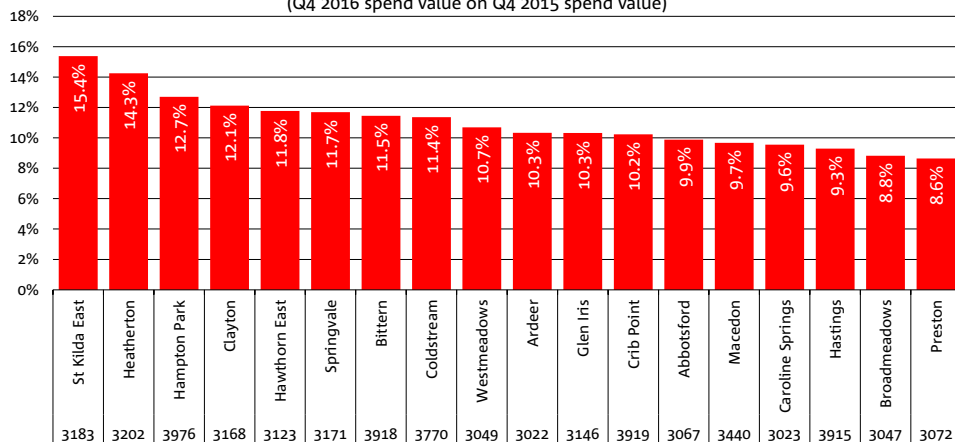
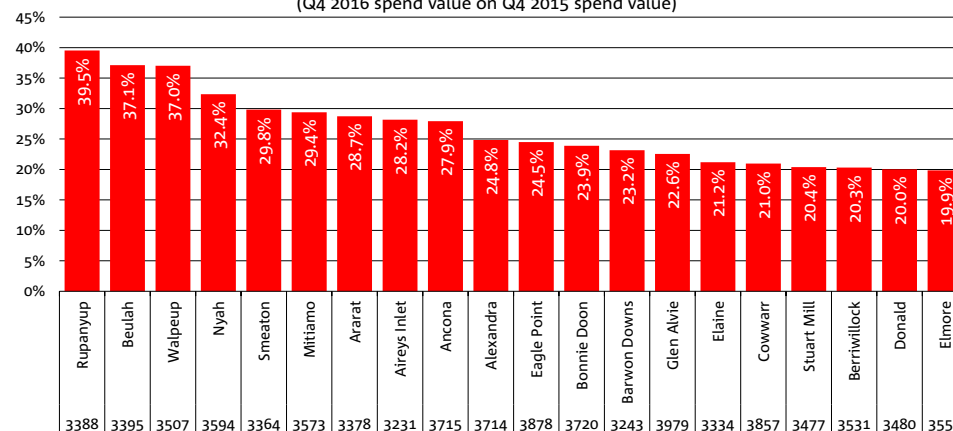


CHART 13: TOP 20 GROWING REGIONAL POSTCODES FOR SPENDING

Top 20 Postcodes by Spending Growth: VIC Regional
(Q4 2016 spend value on Q4 2015 spend value)



BUSINESS SECTOR:

Victorian business conditions easing but remain above the national average

- According to the monthly NAB Business Survey, Victorian business conditions (in trend terms) have improved slightly since late 2016 and continued to be above their long-term average and the national average (Chart 10).
- Capacity utilisation has softened recently, in line with national trends, but remains above the national average (Chart 11).
- Victorian business investment has been broadly stable during 2016. However the 12-month capex expectations index in the NAB Business Survey remains historically high, suggesting that business investment appetite by firms could be increasing (Chart 12).
- The NAB Business Survey reveals that business conditions are, on balance, positive in all industry sectors except retail (Chart 13).

CHART 14: SPREAD IN NAB BUSINESS CONDITIONS

Net balance, 3-month-moving-average

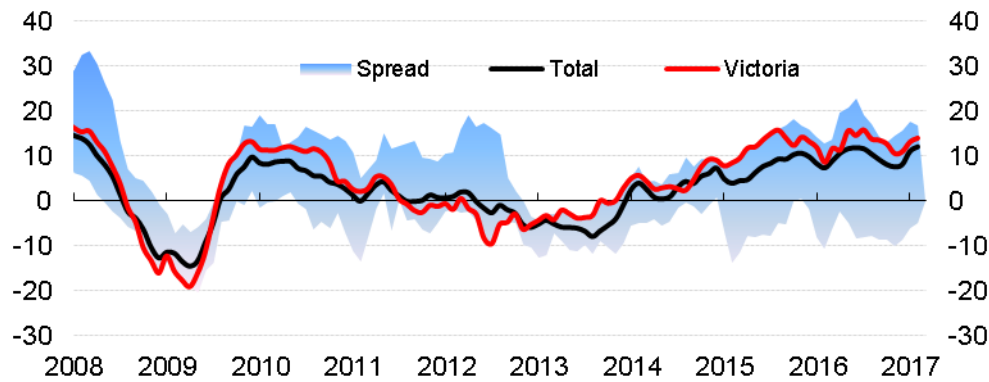


CHART 15: NAB BUSINESS SURVEY – CAPACITY UTILISATION

Per cent of total capacity (%)

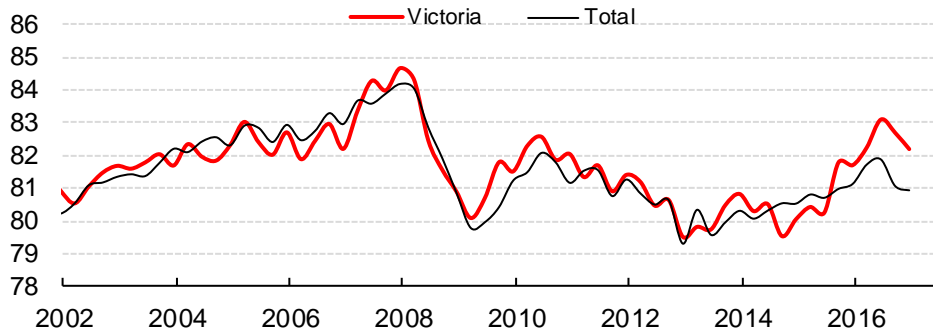


CHART 16: NAB SURVEY CAPEX EXPECTATIONS & PRIVATE BUSINESS INVESTMENT GROWTH

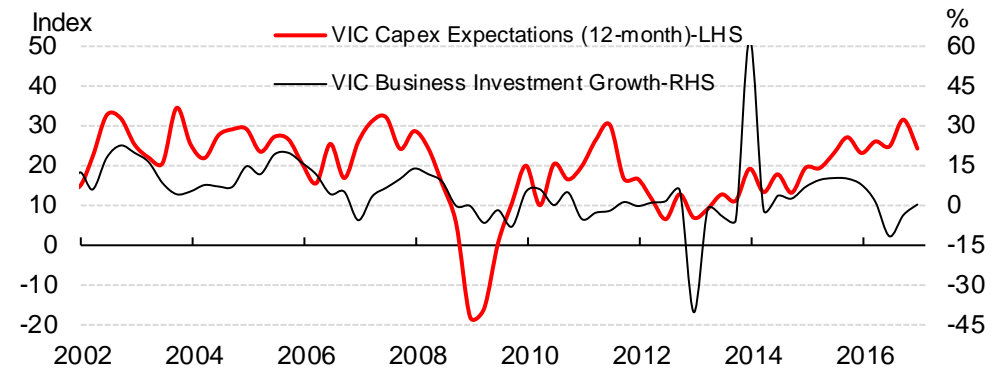
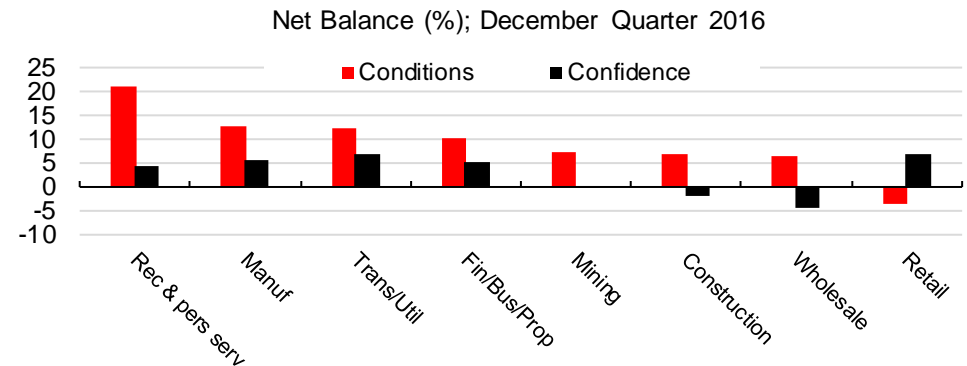


CHART 17: BUSINESS CONDITIONS AND CONFIDENCE BY INDUSTRY

Net balance



COMMERCIAL PROPERTY/NON-RESIDENTIAL INVESTMENT:

Business investment outlook mixed, despite robust business conditions

- The outlook for Victorian business investment is showing tentative signs of improvement. Non-residential building approvals for offices have picked up strongly since mid-2016, while the building approvals for “Other” (which mainly includes hotels and other forms of recreational accommodation) are also showing a mild upward trend (Chart 14).
- Office vacancy rates have eased moderately from the recent peak in 2014, driven by fewer office approvals in 2015-16 and more robust demand for office spaces (Chart 15).
- The expected capital expenditure in buildings & structures for 2016-17 looks to be weakening from the actual expenditure in 2015-16, while machinery and equipment capex is expected to be broadly unchanged (Chart 16).

CHART 18: NON-RESIDENTIAL BUILDING APPROVALS

Million dollars

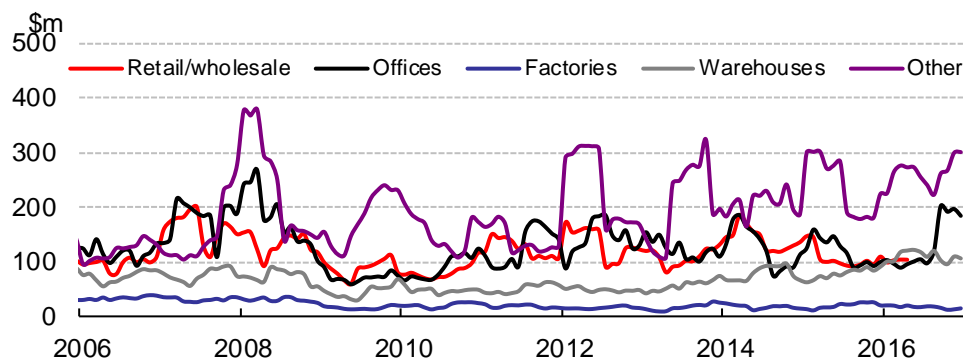


CHART 20: VIC CAPITAL EXPENDITURE & EXPECTATIONS

Actual & expected based on previous realisation ratio

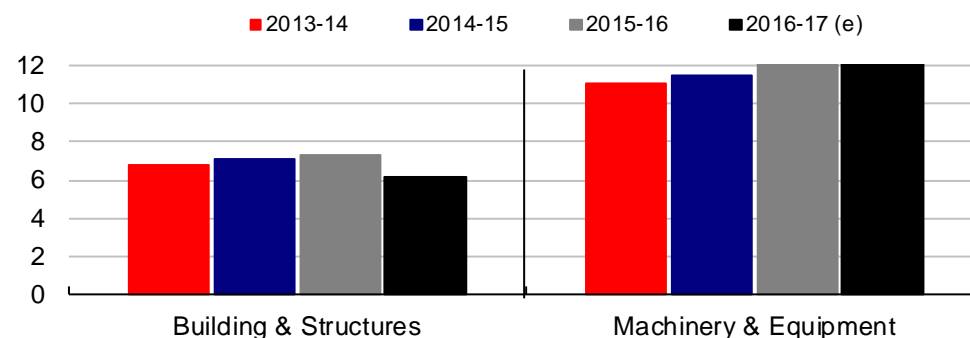
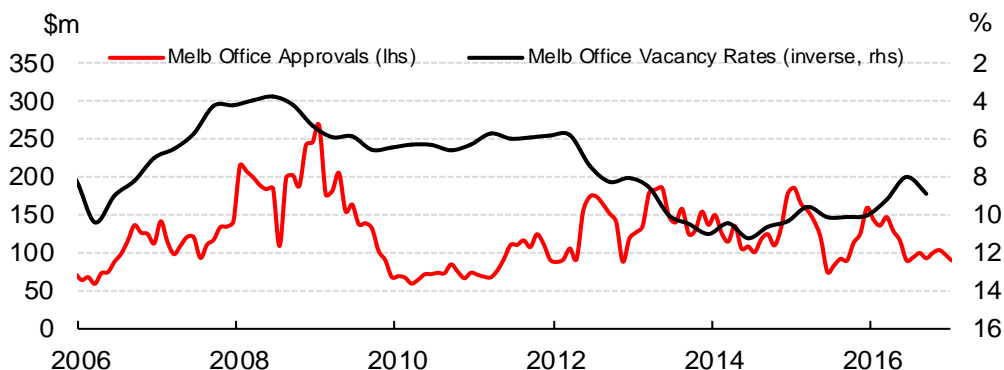


CHART 19: OFFICE APPROVALS AND VACANCY RATES



DWELLING INVESTMENT:

Dwelling investment accelerates from a record residential construction pipeline

- The value of residential construction pipeline appears to have passed its peak (Chart 17). We expect the contribution from construction activity to GSP growth to start tapering off but high approvals suggest building work to remain high.
- The Melbourne house price-to-income ratio has reached a historical high level on the back of the housing boom since late 2013. This in turn has depressed rental yields to historical lows (Chart 18).
- The strength in Victorian dwelling approvals, and subsequently commencements and construction activity, has been largely driven by a surge in unit applications, with the Victorian unit commencements to population ratio now at more than twice its long-run level (Chart 19).

CHART 21: VALUE OF DWELLING APPROVALS AND PIPELINE

\$billion

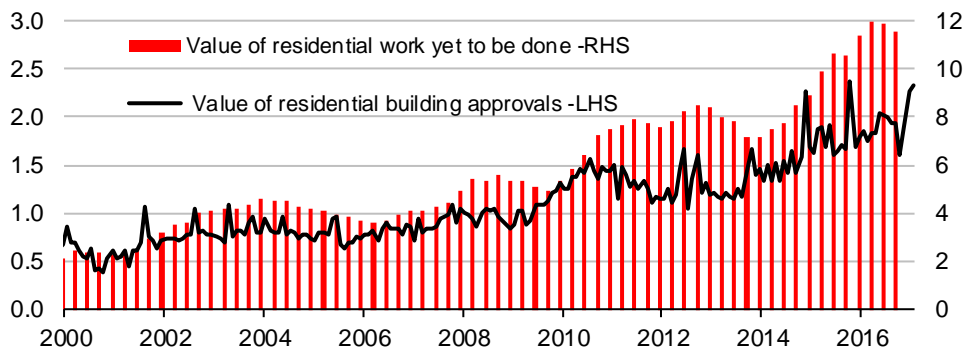


CHART 23: VIC HOUSE AND UNIT COMMENCEMENTS TO POPULATION RATIO

Long-run Average =100

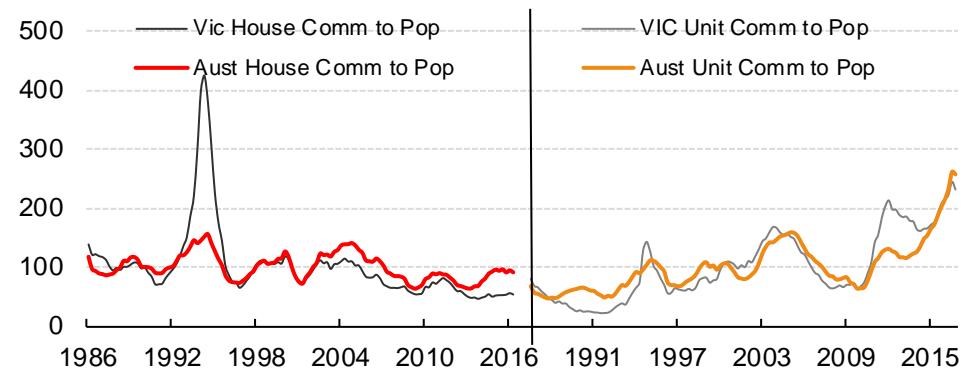
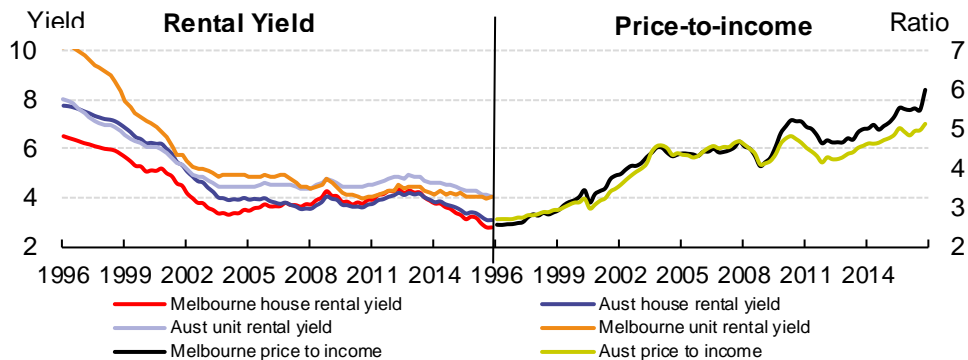


CHART 22: VIC RENTAL YIELDS (%) AND PRICE-TO-INCOME RATIOS



Source: ABS, NAB Group Economics

RESIDENTIAL PROPERTY:

Victorian house price outlook improves

- Melbourne house price *growth* has accelerated since the spring season of 2016, while that of units and regional houses have turned lower (Chart 20).
- VIC residential property price growth by sub-region in Melbourne suggests that Greater Dandenong City, Southern Melbourne and Northern Middle Melbourne led capital growth for houses in the 12 months to Q3 2016, while Yarra Ranges Shire and Eastern Outer Melbourne dominated the unit segment (Chart 21).
- In regional Victoria, property prices in the Gippsland and Mallee regions were the strongest, while those in the Wimmera region contracted slightly (Chart 27).

CHART 24: VIC RESIDENTIAL PROPERTY PRICE GROWTH

Year-on-year growth (%)

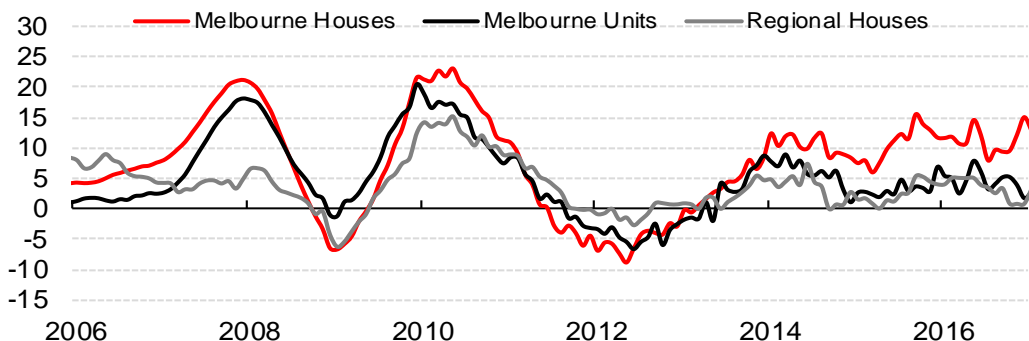
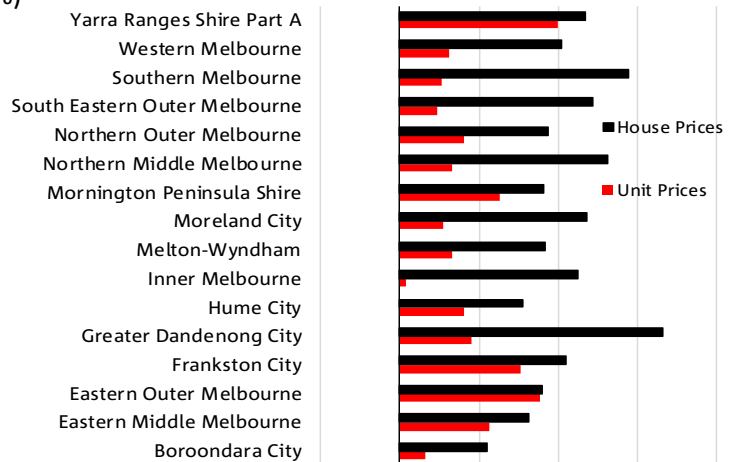


CHART 25: MELBOURNE - MEDIAN PROPERTY PRICE GROWTH (YEAR TO Q3 2016)

Year-on-year growth (%)



- According to the NAB Property Survey, industry professionals expect VIC property prices to pick up pace in the near to medium term, and consistently outperform the national average (Chart 22). NAB Economics however expects some moderation in the pace of house price growth through 2017 and a small fall in unit/apartment prices, although the recent cut to stamp duty for some first home owners and current strong momentum in the market suggests upside risk. Please refer to our housing price forecasts on page 15.

CHART 26: NAB PROPERTY SURVEY – HOUSE PRICE EXPECTATIONS

Quarterly growth (%)

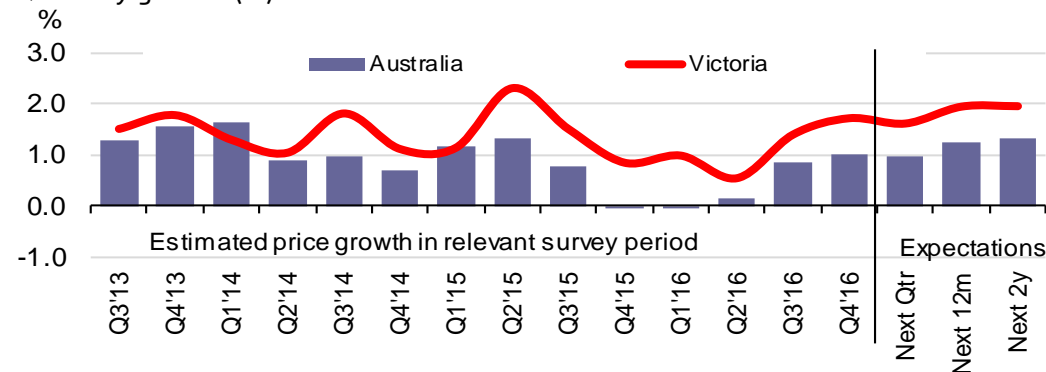


CHART 27: REGIONAL VICTORIA - MEDIAN PROPERTY PRICE GROWTH (YEAR TO Q3 2016)

Year-on-year growth (%)



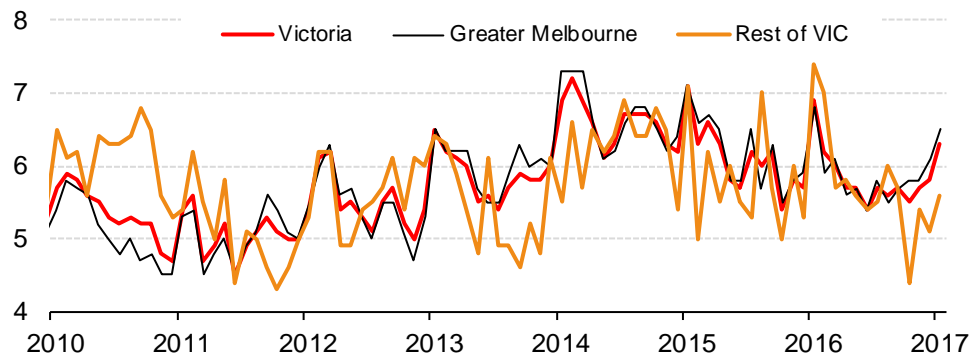
LABOUR MARKET:

Victorian labour market conditions have become more benign

- The Victorian unemployment rate appears to have turned up in recent months after a period in decline since late 2014, largely reflecting a steady rise in the participation rate against a backdrop of steady employment growth (Chart 24). Employment growth in recent months has been largely characterised by a rotation towards full-time jobs away from part-time ones (Chart 25). An acceleration in full-time job creation, combined with an upward trend in the participation rate, suggest that labour market conditions in Victoria are improving.

CHART 28: VIC UNEMPLOYMENT RATE BY REGION

Per cent of labour force (%)



- That said, there remains a significant amount of excess capacity in the labour market as indicated by the still-elevated level of the underutilisation rate (Chart 26).
- In the 12 months to November 2016, most of the additional jobs created were in the health, construction and hospitality sectors (Chart 27). Meanwhile, job losses in manufacturing and mining appear to have eased somewhat. The communications sector was the worst performer over the period by shedding close to 6k jobs.

CHART 30: UNEMPLOYMENT AND UNDERUTILISATION RATES

Per cent of labour force (%)

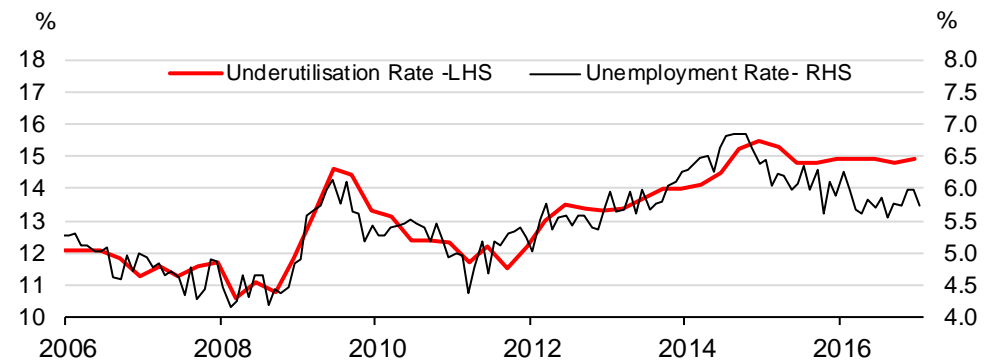


CHART 29: FULL-TIME AND PART-TIME EMPLOYMENT GROWTH

12-month rolling growth (%)

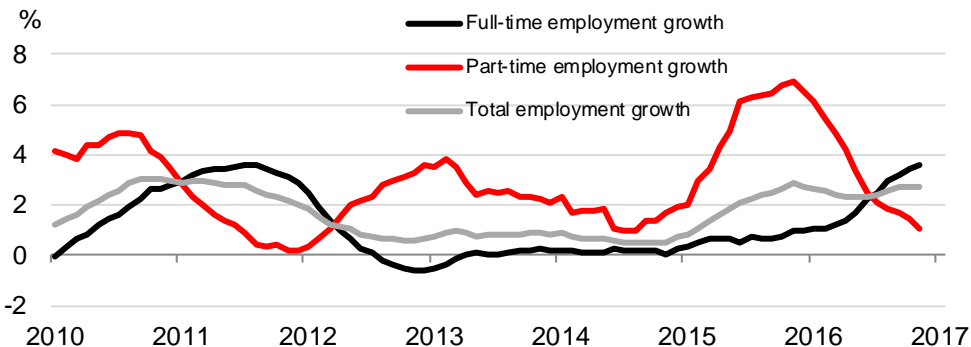
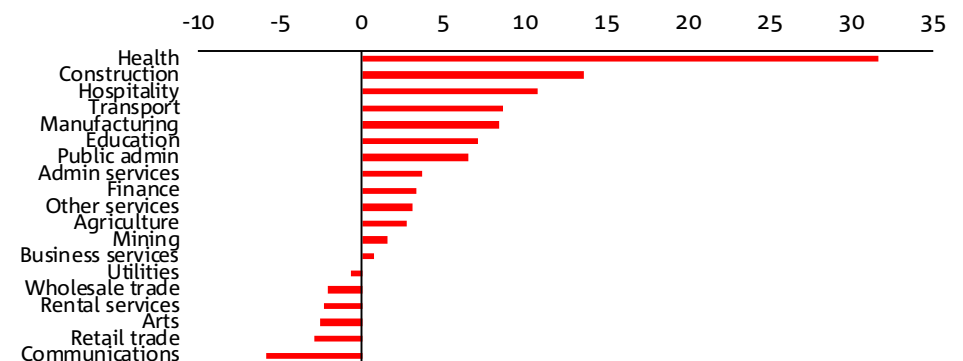


CHART 31: 12-MONTH CHANGE IN EMPLOYMENT BY INDUSTRY TO NOV-16

Thousand persons ('000)



DEMOGRAPHICS:

Victorian population growth surged ahead of the national average

- Victorian population growth accelerated in H1 of 2016 and increased its lead over other states and territories (Chart 28). Victorian population growth, at 2.1% over the year to Q2 2016, was significantly higher than the national average of 1.4% over the same period.
- In terms of the components of population growth, net interstate migration constituted slightly more than half of the total increase, while natural increase accounts for around a third. Meanwhile, the contribution from net interstate migration has risen steadily over the last few years (Chart 29).
- A gradual recovery in the number of international students, as indicated by the rising trend in the number of visas granted for Victoria-bound international students since 2012-13, has been partly responsible for propping up net overseas migration into the state (Chart 30).

CHART 32: VIC AND AUS POPULATION GROWTH

Year-ended growth (%)

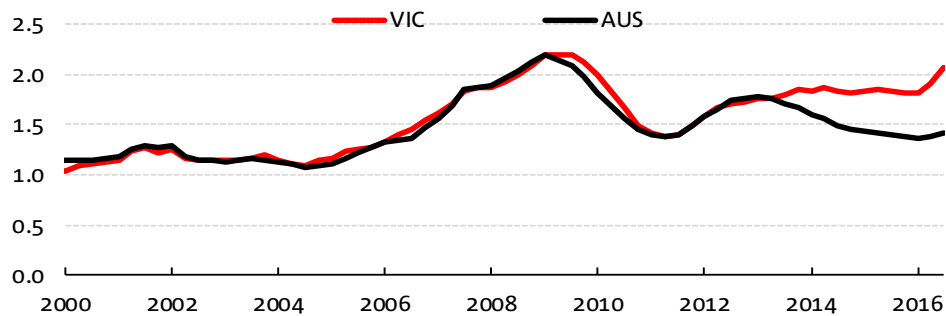
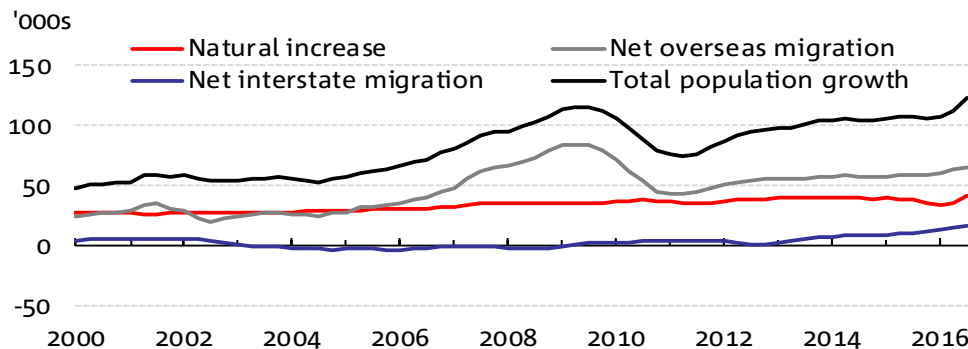


CHART 33: POPULATION GROWTH DRIVERS (000S, OVER THE YEAR)

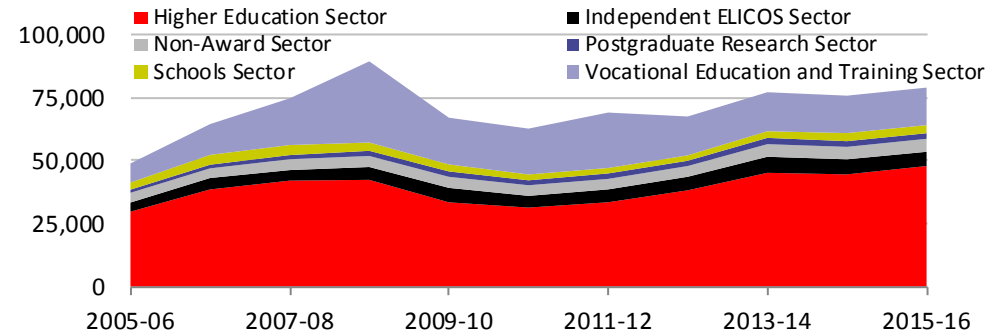
Persons ('000 over the year)



Source: ABS, NAB Group Economics

CHART 34: NUMBER OF STUDENT VISAS GRANTED FOR VICTORIA-BOUND INTERNATIONAL STUDENTS

No. of visas



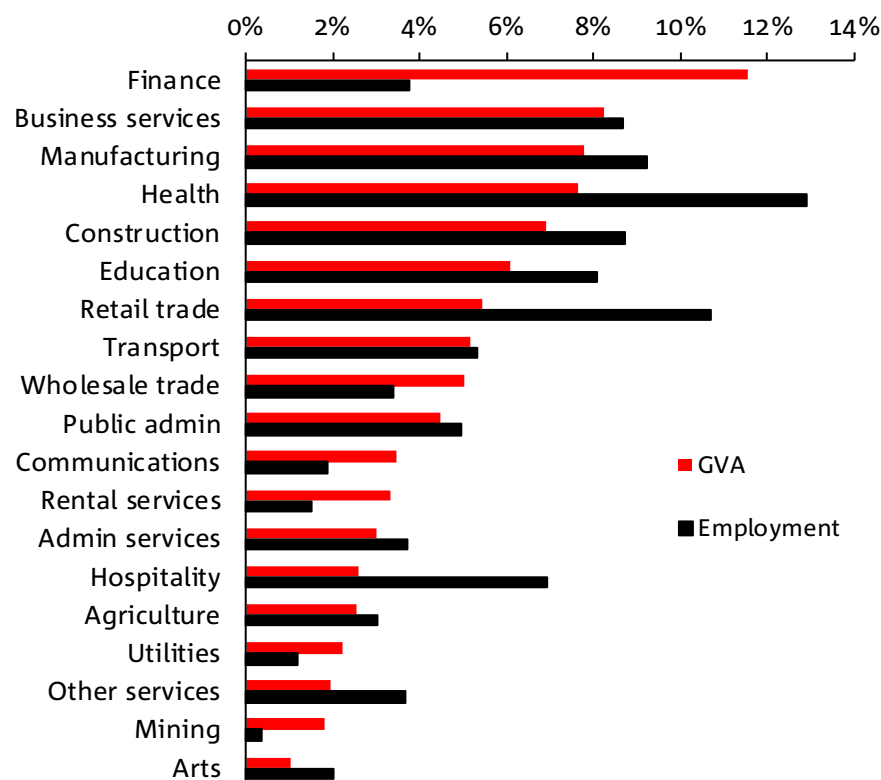
ECONOMIC STRUCTURE AND TRADE

Services sectors are the biggest contributors to production and employment

- In 2015-16, financial and business services continued to account for the largest shares of gross value added (GVA) production by industry in Victoria, with finance and business services accounting for 11.6% and 8.2% of total GVA output respectively, while there has been a gradual decline in the share of manufacturing to 7.8%. The large increase in employment by the healthcare sector in the year to November 2016 took its share of total employment to 12.9%, while the share of retail fell moderately to 10.7% over the same period (Chart 31).
- China maintains its position as Victoria's largest trading partner in terms of exports and imports, although the total value of trade between the state and China has slowed since mid-2016. The value of Victorian goods exports to China in the year to November 2016 was \$4.8 billion, which was equivalent to only around 27% of total imports from China (Tables 32 & 33). Top Victorian goods exports include wool, beef and passenger motor vehicles, while crude imports, passenger vehicles and refined petroleum represent its top three imports (Tables 34-35).

CHART 35 : COMPOSITION OF VIC EMPLOYMENT & GVA

Percentage share (%)



TABLES 36 & 37: TOP VIC EXPORT DESTINATIONS AND IMPORT SOURCE COUNTRIES, 12 MONTHS TO DEC 2016

Million (\$m)

Value of exports (\$m)		Value of imports (\$m)	
1	China	4785	17972
2	ASEAN	3600	14956
3	US	2841	10972
4	New Zealand	2060	7780
5	EU	1462	4692
6	Japan	1381	4617
7	Singapore	932	2573
8	Korea	906	2060
9	HK	744	2009
10	India	549	1487
11	Taiwan	467	1345
12	UK	317	213
13	Germany	266	

TABLES 38 & 39: TOP VIC MERCHANDISE EXPORTS AND IMPORTS

Major exports, goods, 2014-15		Major imports, goods, 2014-15	
	A\$m		A\$m
Wool & other animal hair (incl tops)	1,528	Passenger motor vehicles	5,983
Beef	1,498	Crude petroleum	4,832
Passenger motor vehicles	1,433	Refined petroleum	1,922
Meat (excl beef)	1,368	Goods vehicles	1,740
Milk, cream, whey & yoghurt	1,166	Vehicle parts & accessories	1,471

FISCAL OUTLOOK

General government surpluses mostly revised lower over the forward estimates

- Relative to the *2016-17 State Budget*, the Victorian government has revised its projected operating surpluses significantly lower in most years over the forward estimates, largely reflecting additional expenses associated with the funding of new government initiatives such as assistance to the Latrobe Valley, improving ambulance response time and responses to homelessness. Victoria's general government sector surplus is now forecast to be \$1.7 billion in 2016-17, compared to \$2.9 billion at Budget time. Consequently, net debt figures have been revised higher across most years in the forward estimates period, both in absolute terms and as a share of GSP (Chart 36).
- Relative to the *2016-17 State Budget*, the Victorian state revenue outlook for the budget and forward estimates period has improved, with the overall revenue (see Chart 37) expected to grow at an average rate of 4.2% annually compared to the projected growth of 3.4% at Budget time. Growth in state taxation revenue is expected to be exceptionally strong in 2016-17 at 8.7%, reflecting one-off factors such as the receipt of pre-paid port license fees associated with the leasing of the Port of Melbourne, as well as a pick-up in property tax revenue on the back of strong property price growth.

CHART 40: VIC NET OPERATING BALANCE

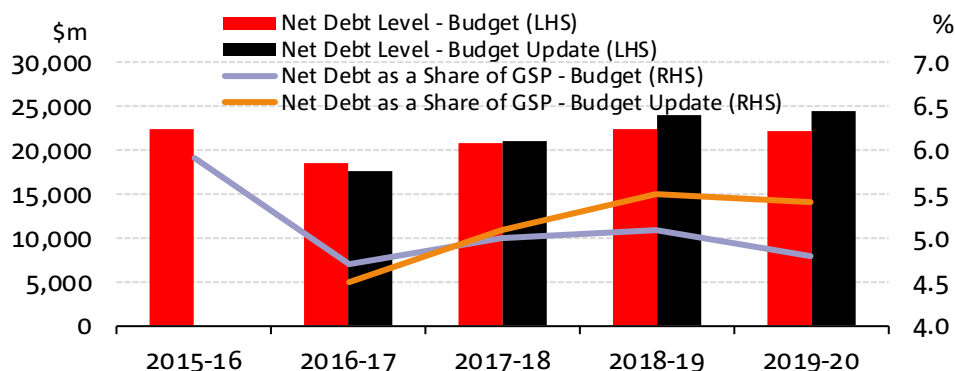
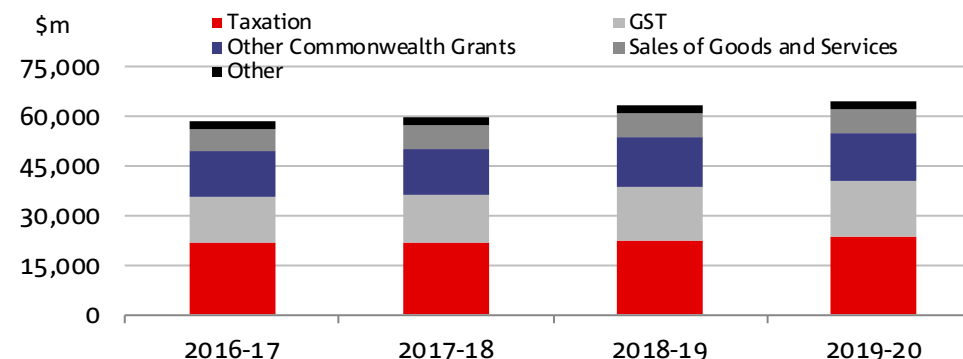


CHART 41: COMPOSITION OF VIC STATE REVENUE FOR 2016-17

Percentage share (%)



SEMI GOVERNMENT AND CREDIT OUTLOOK

Victoria's AAA credit rating to be lowered in the event of Commonwealth downgrade

- The pushing out of the Port of Melbourne lease receipts by a year into 2016-17 results in a drop in General Government net debt from \$22bn in 2015-16 to \$18.6bn in 2017-18, before rising back to the current level. The broader NFPS measure of net debt falls from \$37bn in 2015-16 to \$34bn in 2016-17, before rising to \$39bn by 2019-20.
- Post the release of the 2016-17 budget S&P stated that there is no change to Victoria's AAA credit rating. We note it will be lowered if the Commonwealth's rating is changed.
- Post the budget TCV announced that total funding for FY 17 is a net repayment of \$1.5bn. This comprises \$3.6bn of short term debt repayment and \$2bn of long term borrowing requirement. The funding program is impacted by the long term lease of the Port of Melbourne.

CHART 42: VIC NON-FINANCIAL PUBLIC SECTOR NET DEBT

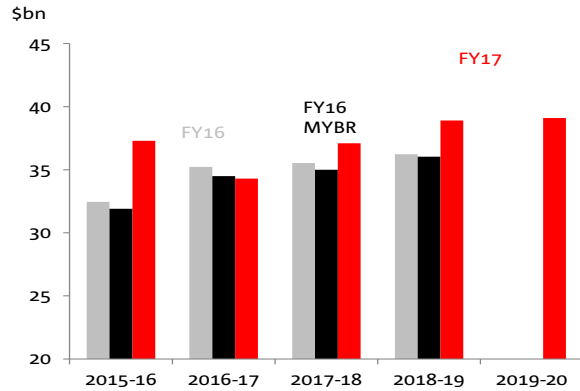
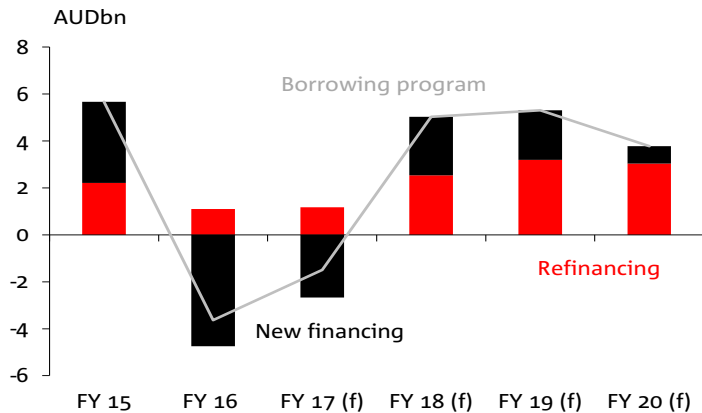
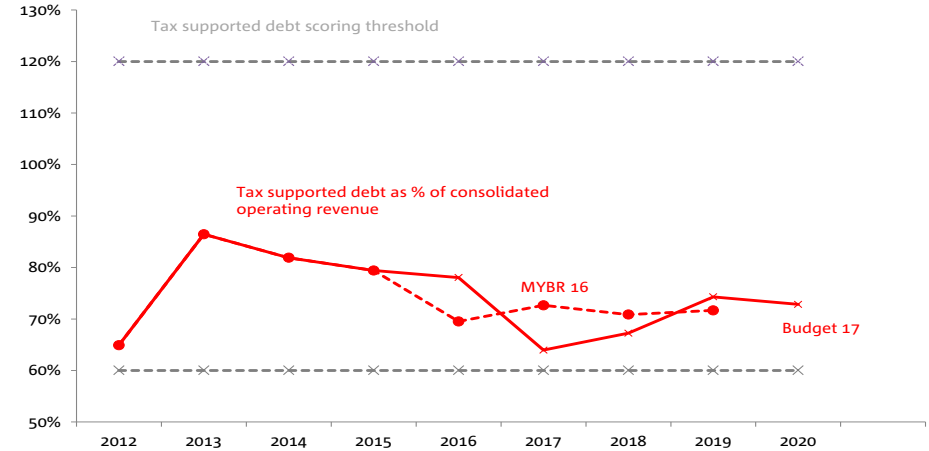


CHART 43: TCV BORROWING PROGRAMME



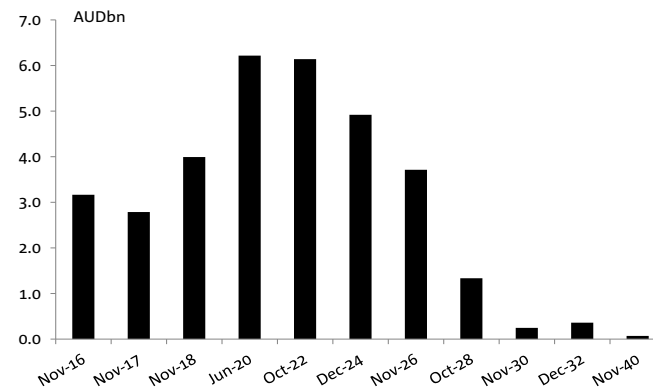
Source: Victorian budget paper, TCV

CHART 44: S&P CREDIT METRIC: OPERATING BALANCE AS % OF REVENUE



Source: Victoria's budget papers, NAB

CHART 45: CV TERM BONDS OUTSTANDING AS AT END JUNE 2016



FORECASTS BY STATE AND TERRITORY:

Victoria and NSW ahead of the pack

NAB's economic forecasts by state and territory are below. For a summary of the outlook by state, please see the [States Handbook – Overview](#) which contains links to the detailed handbook for each state and territory.

REAL GROSS STATE PRODUCT AND UNEMPLOYMENT RATE FORECASTS

Annual average

NAB growth and unemployment rate forecasts for the states

	Gross State Product YoY				Unemployment Rate			
	14-15	15-16	16-17f	17-18f	14-15	15-16	16-17f	17-18f
NSW	2.6	3.5	2.7	2.9	5.9	5.4	5.1	5.3
VIC	2.6	3.3	2.7	2.9	6.4	5.9	5.7	5.7
QLD	1.2	2.0	3.5	3.5	6.5	6.2	6.2	5.8
SA	2.0	1.9	0.8	2.0	6.9	7.3	7.0	7.0
WA	3.6	1.9	0.5	2.8	5.4	6.0	6.5	6.3
TAS	1.3	1.3	1.0	2.0	6.9	6.5	6.5	6.5
NT	2.0	2.7	1.5	5.0	4.2	4.2	4.0	4.8
ACT	1.3	3.4	2.3	2.5	4.5	4.5	4.3	4.3
Australia	2.4	2.7	2.1	3.0	6.2	5.9	5.7	5.7

HEDONIC HOUSE PRICE FORECASTS*

Through the year growth to Q4

	2013	2014	2015	2016	2017
Sydney	15.2	13.4	11.5	16.7	4.5
Melbourne	8.5	8.4	11.7	15.1	5.6
Brisbane	5.3	5.2	4.3	4.0	1.7
Adelaide	3.0	4.5	-0.3	4.5	1.5
Perth	10.2	2.1	-3.8	-4.4	-2.7
Hobart	2.9	3.3	-1.6	11.7	3.5
Cap City Avg	9.9	8.4	7.8	11.6	3.4

Source: ABS, CoreLogic/NAB Economics

HEDONIC UNIT/APARTMENT PRICE FORECASTS *

Through the year growth to Q4

	2013	2014	2015	2016	2017
Sydney	11.6	8.3	11.3	9.6	1.0
Melbourne	8.7	1.1	6.9	1.7	-2.7
Brisbane	3.5	1.2	1.8	-0.2	-1.8
Adelaide	0.6	2.5	1.4	1.1	0.7
Perth	6.3	1.9	-3.5	-3.2	-3.8
Hobart	-5.1	5.9	8.6	6.7	0.6
Cap City Avg	9.0	5.1	7.9	5.9	-0.8

SOURCE: CoreLogic, NAB Economics