

STATE HANDBOOK: VICTORIA



National
Australia
Bank

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KEY POINTS:

Victoria the fastest growing state

CHART 1: STATE GSP GROWTH FORECASTS

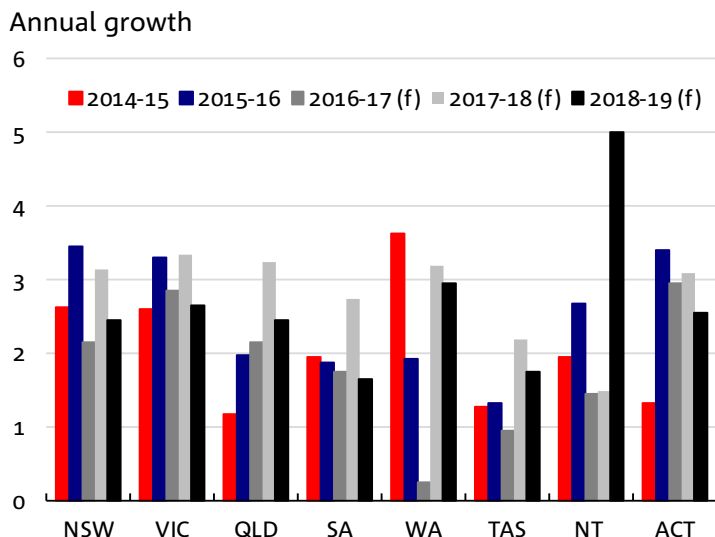
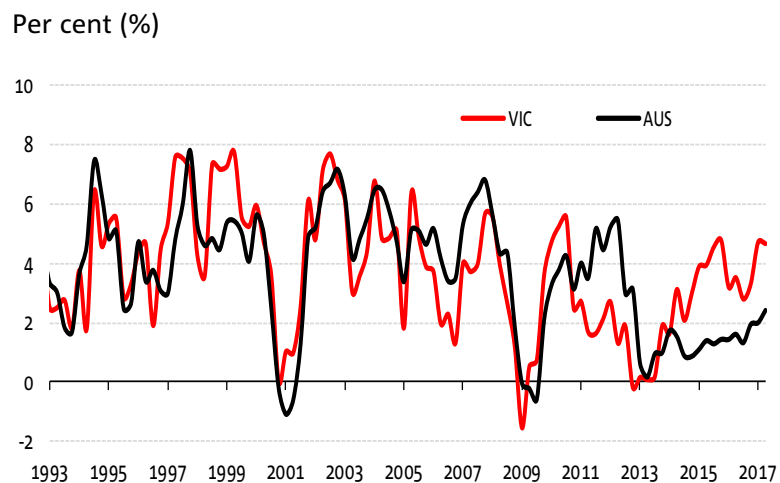


CHART 2: STATE FINAL DEMAND



- Victoria's diverse industry base and strong population growth have underpinned above-national-average economic growth in recent years. Strong labour market conditions in the state have attracted large numbers of interstate as well as overseas migrants. Consumption growth has also been robust, consistent with the improving labour market and strong population growth. Despite the structural decline in manufacturing, overall business conditions remain positive and business investment has been on the rise. Government infrastructure investment is also at historically high levels. **We expect Victoria to be the fastest growing state in 2017-18, with GSP growth increasing from an estimated 2.9% in 2016-17 to 3.3% in 2017-18 (driven by stronger labour market, business investment and government investment). GSP growth will then normalising to 2.7% in 2018-19. The unemployment rate is forecast to decline to 5.8% in 2017-18 and then 5.4% in 2018-19.**
- Jobs growth overall has been strong in Victoria, despite some setbacks and regional differences. However, underemployment remains an issue, perhaps explaining the slow wages growth. The Hazelwood power plant shutdown early this year has negatively affected the La Trobe Valley, where unemployment rate remains high despite government efforts to revive its economy. Following the Ford plant closures late last year, Toyota closed its Altona factory in October, making 2500 workers redundant. Finding full time employment has been challenging for these laid off workers, and while some have secured employment in other industries, the hours and pay tend to be lower. Many of the newly created jobs have been in lower paid services industries which tend to be part time as well. As the economy transitions, some higher-paying jobs are expected to be created in advanced manufacturing, health, education and financial services, which could support average wages.
- The stronger labour market overall has also seen the participation rate rise to record levels, resulting in an increase in the unemployment rate despite employment gains. Victoria's population has been growing strongly, thanks to its economic outperformance. While net overseas migration has contributed the most to population growth, Victoria has also experienced the highest net interstate migration across all jurisdictions since 2013. Better employment opportunities will continue to attract migration.
- Consumption growth has been strong as a result of population growth and rising employment. However, subdued wages growth, high household indebtedness and subdued consumer sentiment will remain a constraint on consumption growth, as it will nationwide.
- Residential investment has increased significantly and contributed to the state's GSP growth. While the construction pipeline remains strong, recent data suggests the level of dwelling investment might have peaked. With support from dwelling investment waning, business investment has been increasing steadily, amidst positive business conditions and confidence. Non-dwelling construction, especially of offices, has been on the rise. The government sector has also committed to significant infrastructure investment, estimated at around \$9.6 billion a year over the next four years, a level much higher than the during the previous decade. This will remain at a high level in the next three years, although the contribution to growth (based on the current pipeline of projects) is smaller from 2018-19.
- Wheat production and exports have enjoyed a good season in 2016-17 due to favourable weather conditions. The forecasts assume a return to average seasonal conditions in 2017-18. Services exports, especially education and tourism, are forecast to continue to grow strongly.

IN FOCUS:

Residential construction peaking with services exports to grow further

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. However, the level of dwelling investment has trended broadly sideways since then.

Leading indicators of dwelling construction activity, particularly commencements, have moderated from high levels in recent months, suggesting that the construction pipeline peaked in the middle of 2016. However, the pipeline remains high in historical terms and there is a longer lead time between approvals and completions thanks to the larger share of apartment projects. This suggests that the dwelling

CHART 3: PERCENTAGE POINT CONTRIBUTION OF DWELLING INVESTMENT TO GSP

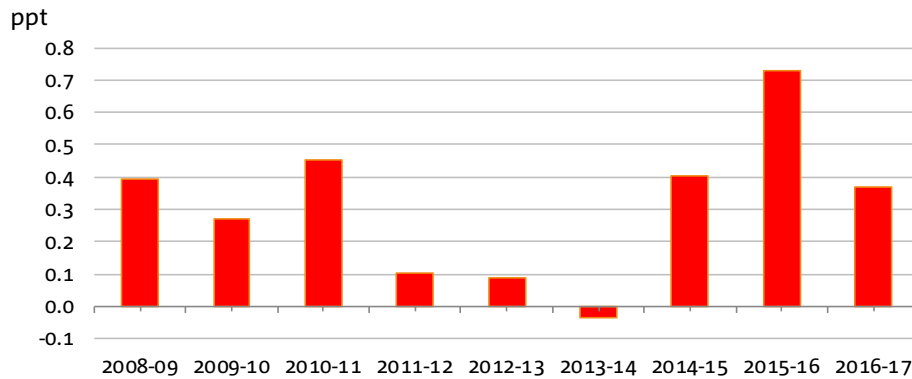
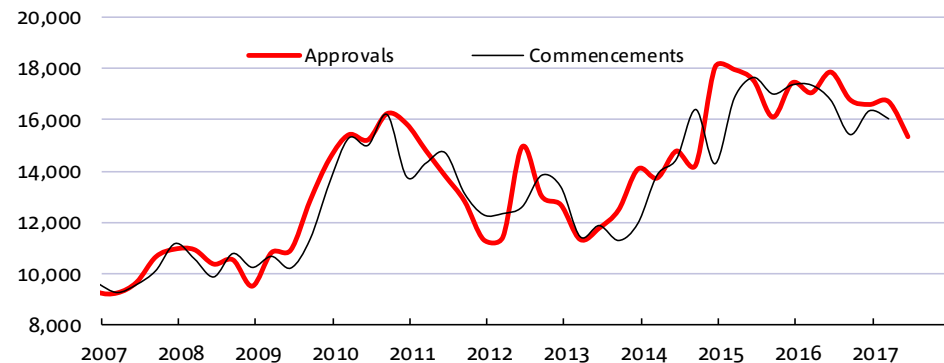


CHART 4: NUMBER OF DWELLING APPROVALS AND COMMENCEMENTS



Source: ABS, NAB Group Economics

construction cycle will be more elongated, and support dwelling construction at a high level for some years (although the contribution to growth will be smaller).

With the contribution from dwelling investment waning, services exports are expected to continue to grow and contribute to Victoria's GSP growth. Rising income levels in Asia, Australia's relative political and social stability and the anticipated depreciation in the AUD will all help attract international students and visitors. Victoria remains the second most popular destination for students and short term visitors after New South Wales.

CHART 5: NUMBER OF STUDENT VISAS GRANTED FOR VICTORIA-BOUND INTERNATIONAL STUDENTS

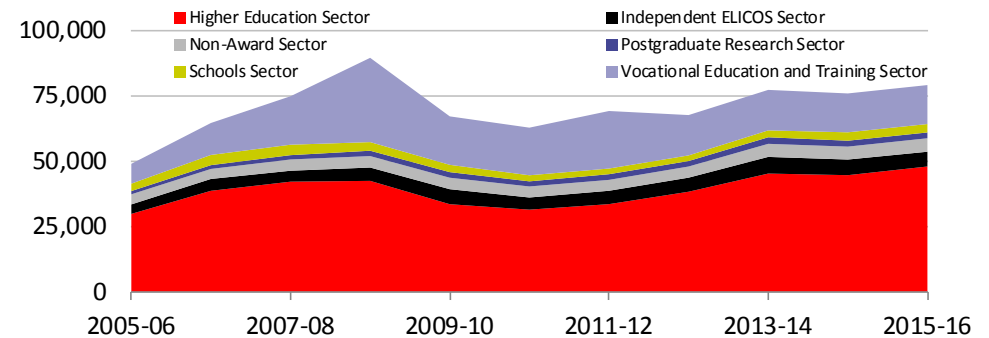
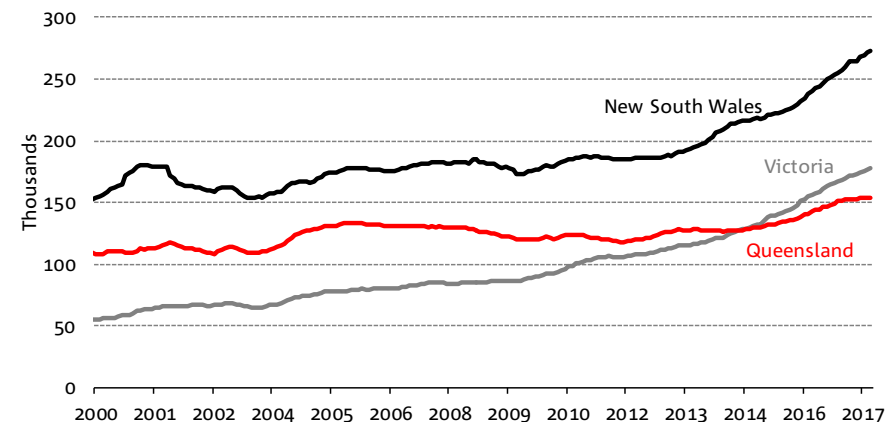


CHART 6: SHORT TERM VISITORS, STATE WHERE SPENT MOST TIME
12 month moving average



LABOUR MARKET (1):

Victorian labour market conditions have become more benign

Victoria has enjoyed superior growth in employment, and while it has eased back somewhat, it remains above the national average rate. Improved job opportunities have resulted in a steady rise in the participation rate. Combined with strong population growth, and slightly slower employment growth, the unemployment rate has risen slightly in recent months to 6.1%.

There are significant divergences across regions and industries however. The population centres of Melbourne and Geelong tend to provide more employment opportunities and have lower unemployment.

CHART 7: EMPLOYED PERSONS

Year on year growth, %, seasonally adjusted

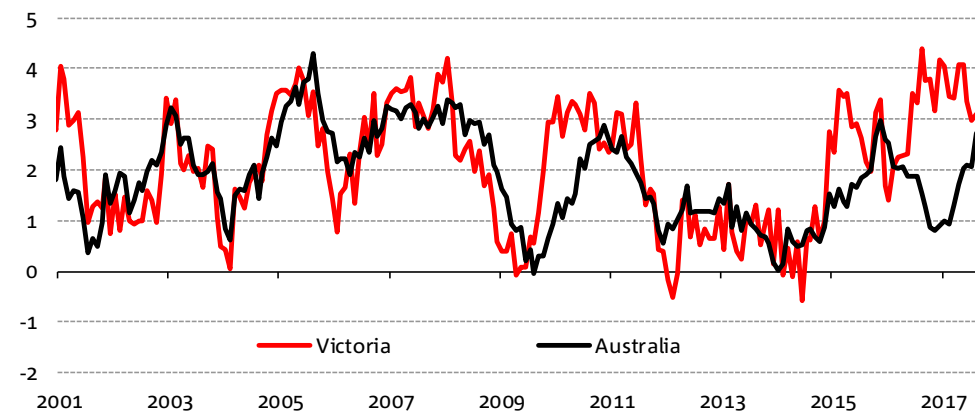
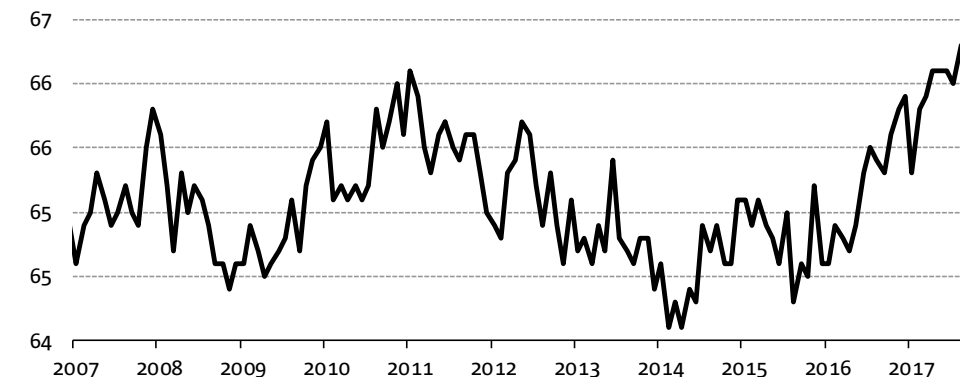


CHART 8: PARTICIPATION RATE

%



Source: ABS, NAB Group Economics

The unemployment rate in Geelong rose following the closure of the Ford plant in late 2016, but its growing population and increased dwelling activity have absorbed some of the unemployment. On the other hand, the Latrobe Valley remains more affected by the shutdown of the Hazelwood power station and associated job losses.

Toyota also closed its plant in Altona in October 2017, making 2500 workers redundant. The Australian Manufacturing Workers Union estimates only half of the 600 workers laid off by Ford in 2016 have found employment so far. Those who have often have to settle for lower paid part time work.

CHART 9: UNEMPLOYMENT RATE BY REGION

%, seasonally adjusted

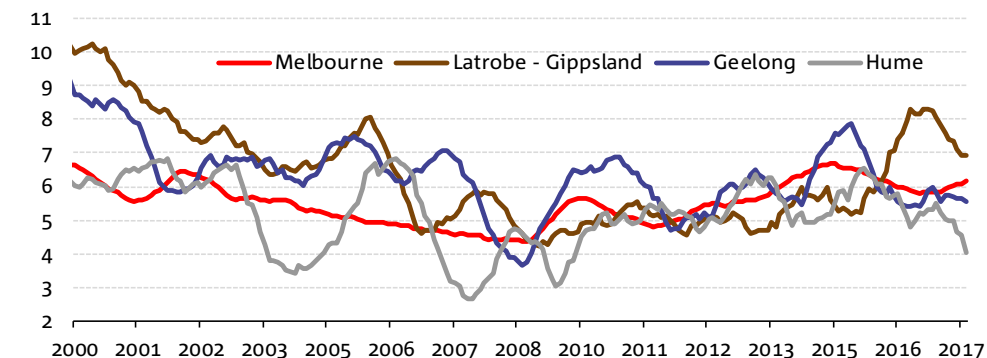
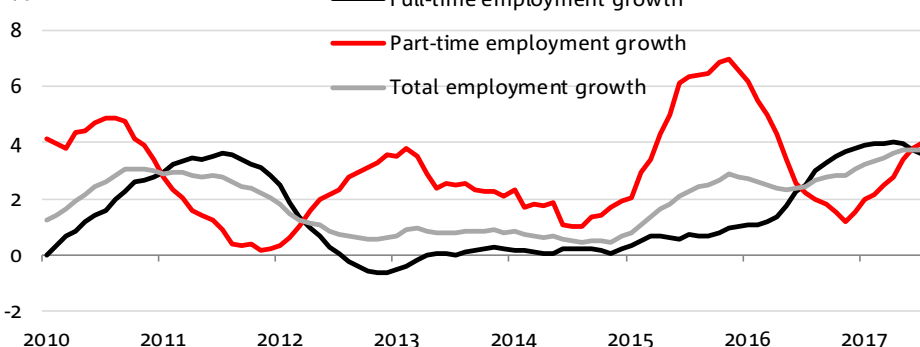


CHART 10: EMPLOYMENT GROWTH

%



LABOUR MARKET (2):

Services sector driving jobs growth

The Victorian labour market is transitioning away from traditional manufacturing and mining, towards services jobs, which can be more part-time and lower paid. Wages growth and labour productivity as a result have been subdued.

The strong education and health sectors have created many jobs. The growing population and Victoria's increasing popularity among international visitors have also seen more jobs added in hospitality.

CHART 11: CHANGES IN EMPLOYMENT BY INDUSTRY

12-month to August 2017 ('000)

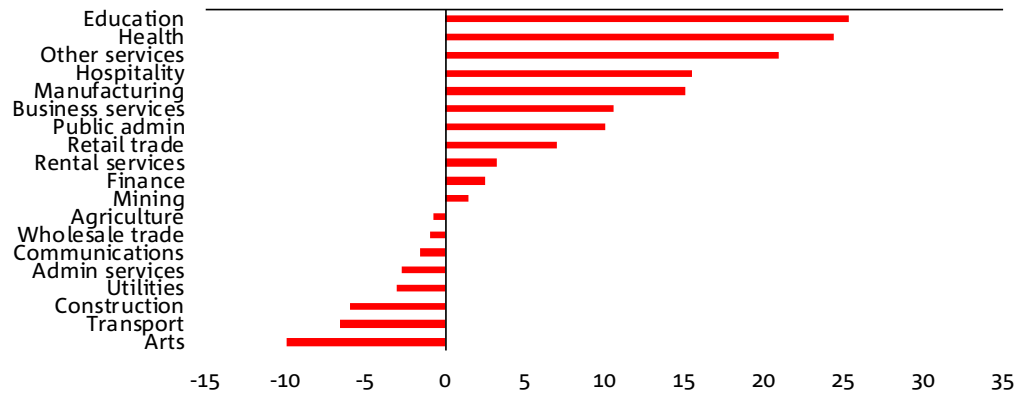
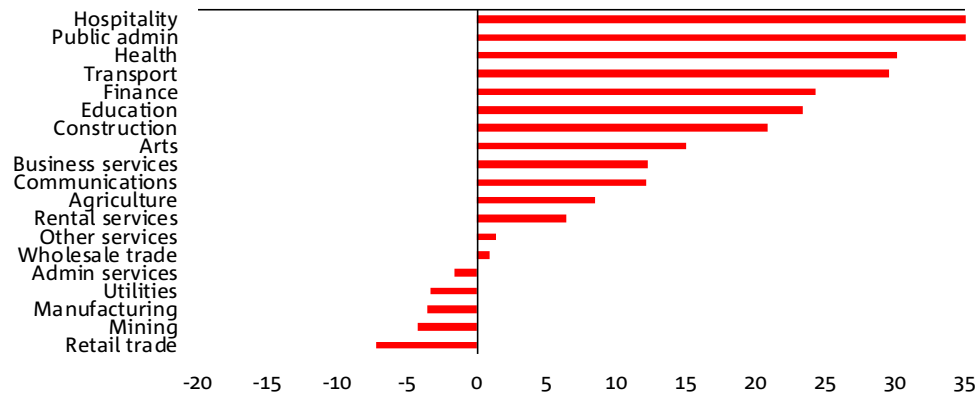


CHART 12: CHANGES IN EMPLOYMENT BY INDUSTRY

Three years to August 2017 ('000)



Source: ABS, NAB Group Economics

However, the local manufacturing base is seeing the creation of some high end manufacturing jobs, for example in car design rather than car manufacturing. Victoria's strong expertise in health, higher education and finance could also see the creation of higher paying professional jobs, supporting average wages growth.

Forward indicators including the NAB Business Survey continue to point to further improvements in the labour market.

CHART 13: AVERAGE COMPENSATION OF EMPLOYEES

Year on year % change

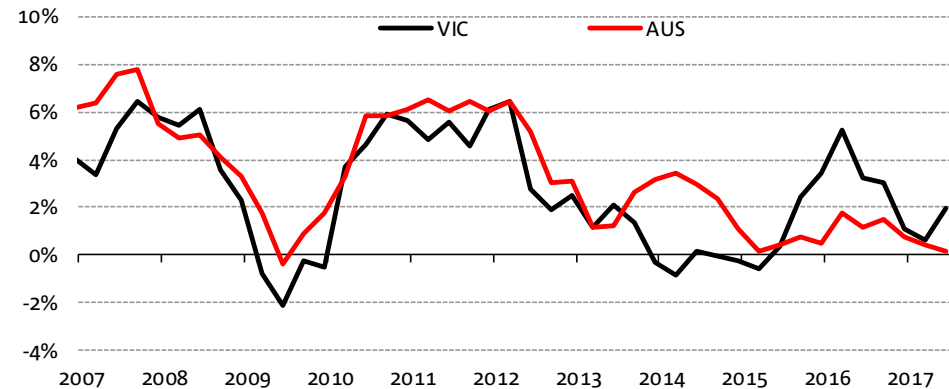
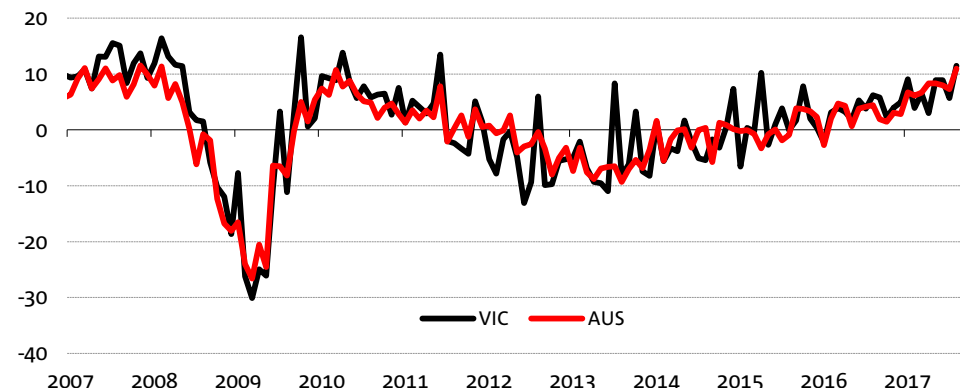


CHART 14: NAB BUSINESS SURVEY EMPLOYMENT CONDITIONS

Index, seasonally adjusted



DEMOGRAPHICS:

Strong migration drives population growth

Victoria has enjoyed the fastest population growth in the country for some time. In the 12 months to March 2017, Victorian population increased by nearly 150,000 persons. Most of the new Victorians were overseas migrants, followed by interstate migrants.

The education sector continues to attract large numbers of international students, mostly to the higher education sector. Victoria received the second largest number of international students after New South Wales, and well ahead of Queensland. The forecast depreciation of the AUD, combined with the stability in Australia, will continue to attract international students.

Net interstate migration to Victoria has also been growing strongly. It overtook Queensland in 2013 and has been recording the highest net interstate migration since then. Better employment opportunities in Victoria, in a time of mining downturns in WA and QLD, continue to attract interstate migrants.

It is worth noting around two-thirds of these new arrivals were aged 15 to 44 years, significantly higher than its share in the total population.

CHART 15: VIC AND AUS POPULATION GROWTH

Year-ended growth (%)

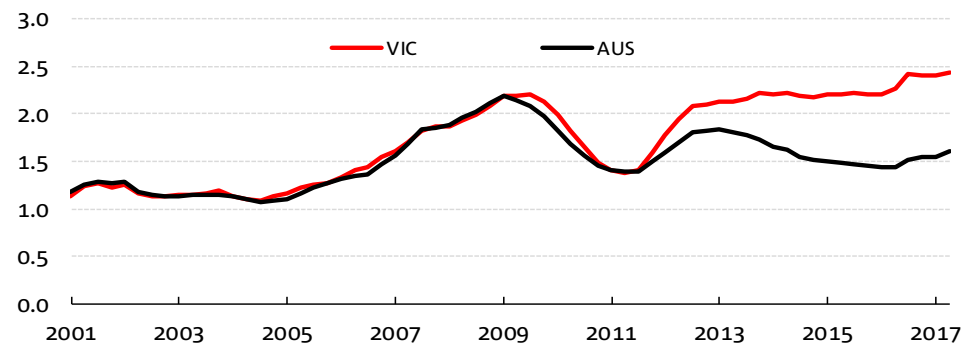
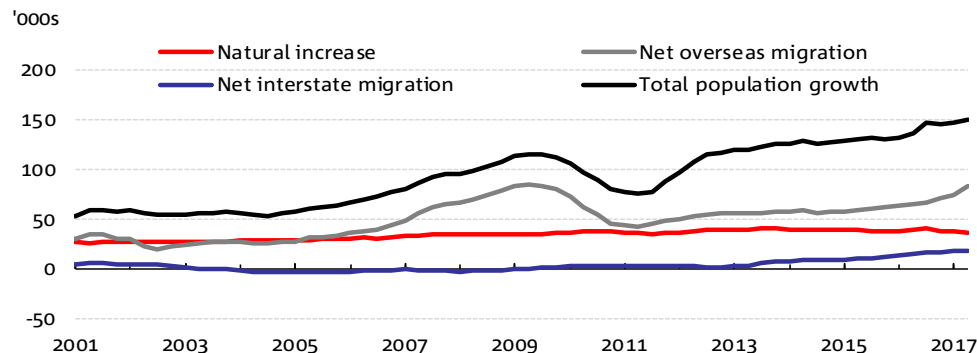


CHART 16: POPULATION GROWTH DRIVERS (000S, OVER THE YEAR)

Persons ('000 over the year)



Source: ABS, NAB Group Economics

CHART 17: NUMBER OF STUDENT VISAS GRANTED FOR VICTORIA-BOUND INTERNATIONAL STUDENTS

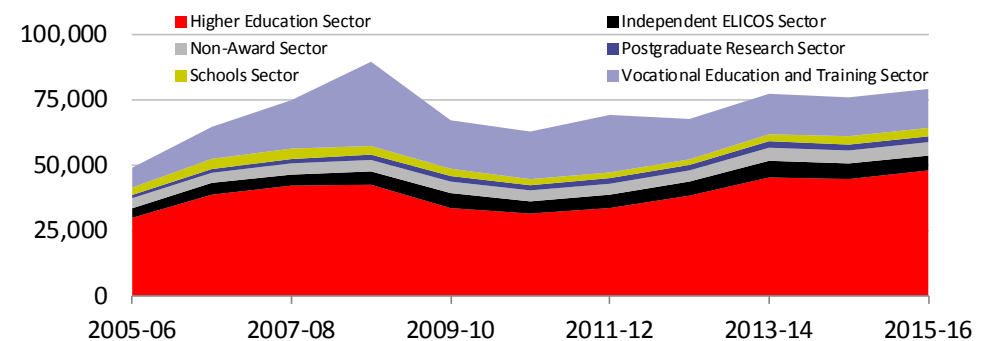
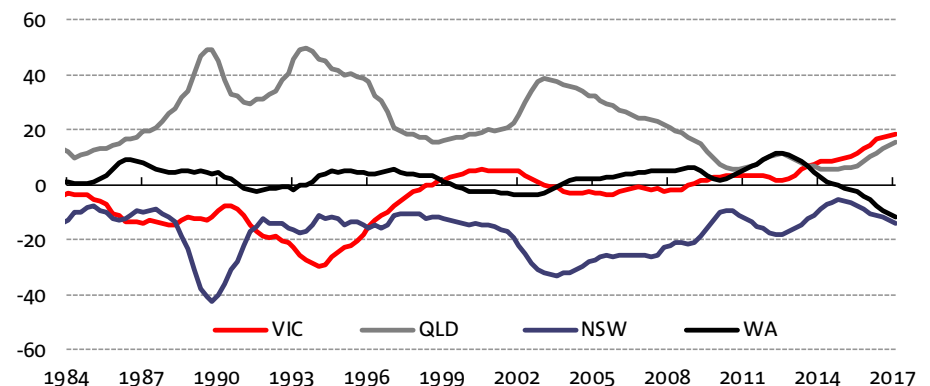


CHART 18: NET INTERSTATE MIGRATION

Persons ('000, over the year)



CONSUMER AND HOUSEHOLD SECTOR:

Consumption growing with population and employment

Strong population and employment growth has translated to higher employee earnings (compensation of employees in Chart 7), which have driven strong aggregate household consumption growth. However, subdued wages growth means consumption per capita growth has been more limited. The wealth effect from rising house and equity prices has also supported retail sales growth, which turned up again 2017, although high house prices may be constraining spending for those saving for a home deposit. High household indebtedness could limit spending growth going forward, particularly as interest rates rise.

According to the NAB Consumer Anxiety Survey, consumers remain cautious, preserving their spending power on essentials including utilities and medical expenses, while cutting back on discretionary spending on personal goods, charitable donations and entertaining. Noticeably, household expected utilities to take up a larger portion of their spending in Q2, reflecting the surge in utility prices.

CHART 19: TOTAL COMPENSATION OF EMPLOYEES AND NOMINAL HOUSEHOLD CONSUMPTION GROWTH

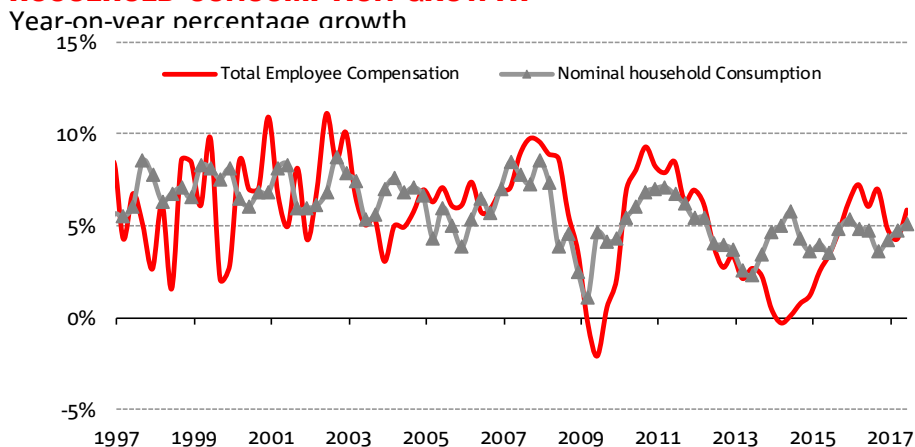


CHART 20: RETAIL TURNOVER AND HOUSE PRICE GROWTH

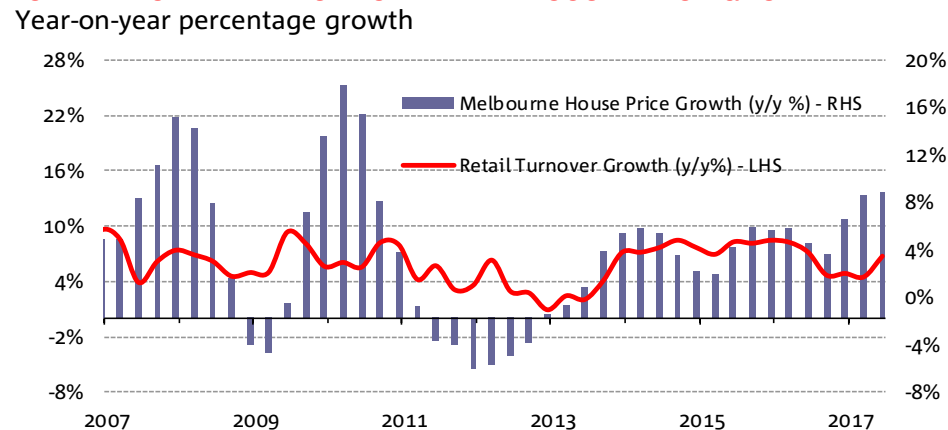
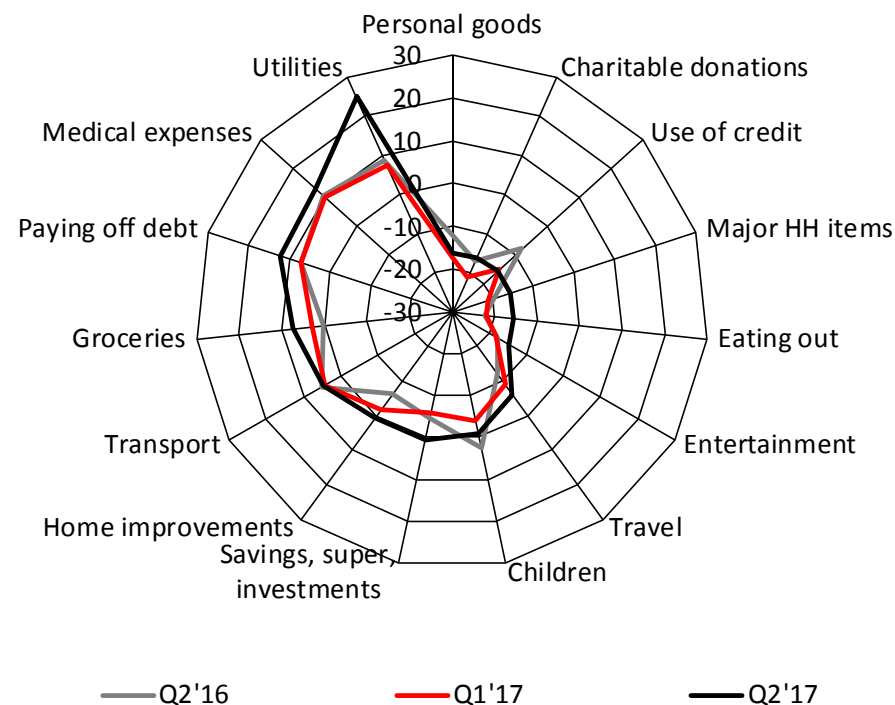


CHART 21: NAB CONSUMER ANXIETY SURVEY - CONSUMER SPENDING PREFERENCES

Changes in Consumer Spending Preferences (net balance)



NAB CUSTOMER SPENDING BEHAVIOURS:

Faster spending growth in Victoria regions than Melbourne

Customer spending in regional VIC (ex metro) grew 5.2% y/y in Q2 2017, from 4.1% y/y in Q1 2017, and ahead of Melbourne metro (4.1%).

Average spending increased \$51 to \$1,866 but was below Melbourne metro (up \$60 to \$2,080).

Spending growth was fastest for Arts & Recreation (32.7%), Wholesale Trade (31.4%) and Accommodation & Food Services (12.5%).

Customer spending on Education & Training (-3.2%), Transport, Postal & Warehousing (-0.3%) and Healthcare & Social Assistance Trade (-0.3%) fell.

CHART 22: GREATER MELBOURNE METRO AREA

Year-ended growth to Q2 20167

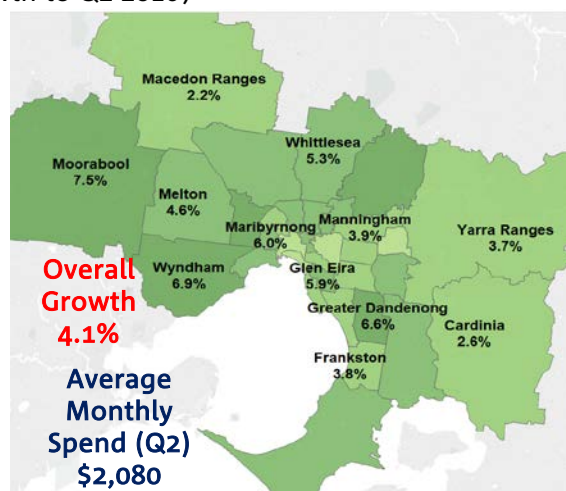


CHART 24: REGIONAL VIC (EX METRO)

Year-ended growth to Q2 2017

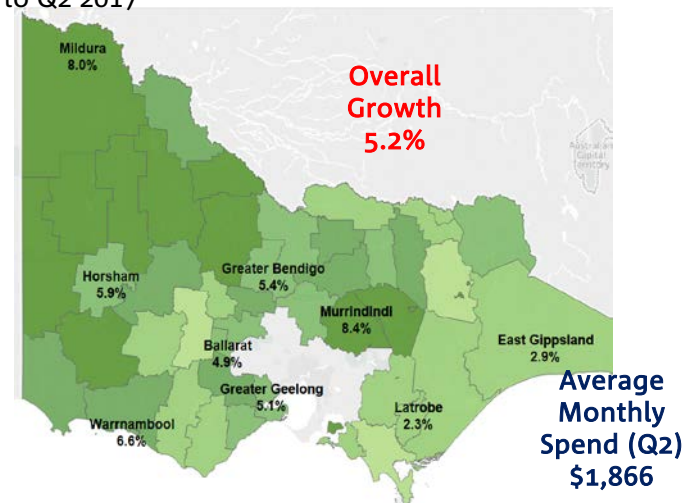


CHART 23: TOP 20 GROWING METRO POSTCODES FOR SPENDING

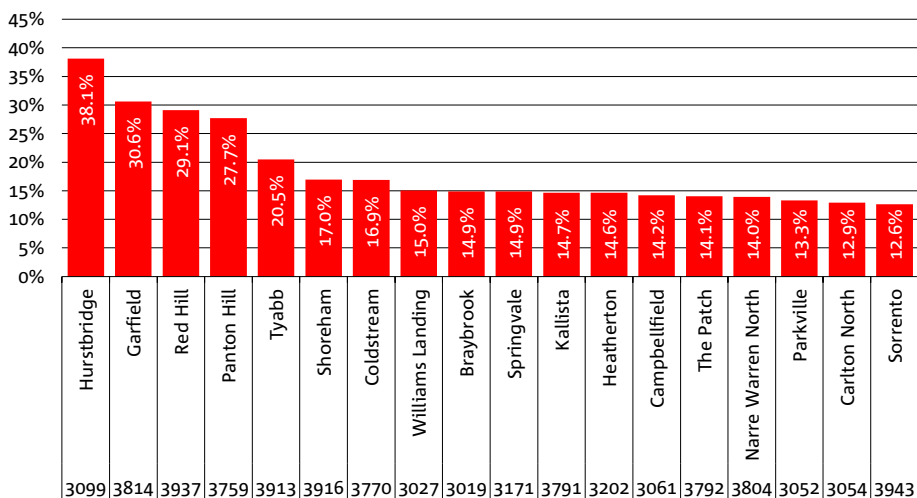
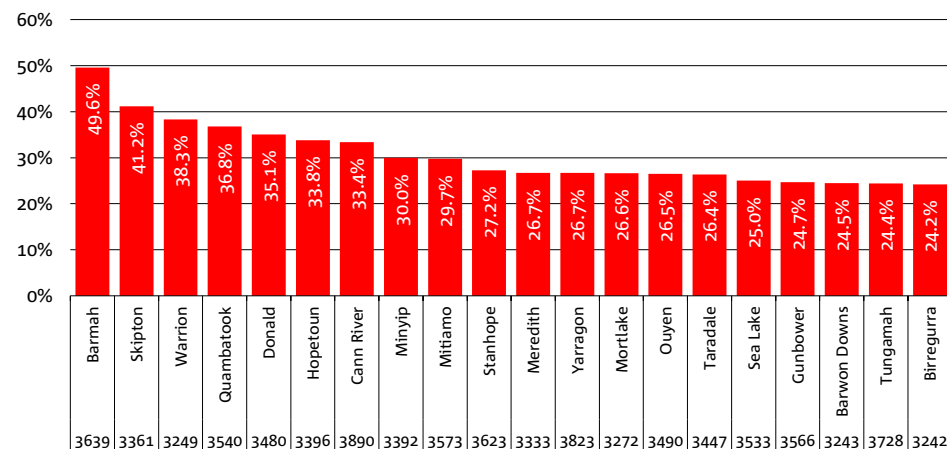


CHART 25: TOP 20 GROWING REGIONAL POSTCODES FOR SPENDING



BUSINESS SECTOR:

Victoria continues to lead national business conditions

According to the monthly NAB Business Survey, Victorian business conditions continued to improve and outperform the national average.

The capacity utilisation rate has fallen somewhat but remains at a high level, well above the national average and its own long run average.

Business investment in Victoria has been rising steadily, and capital expenditure expectations continue to suggest increased investment activity according to the NAB Survey (Chart 16 and the ABS, Chart 20 on page 10) . With manufacturing in

decline, investment in machinery & equipment has been flat for some years. However, non-dwelling building investment has been increasing steadily, as has investment in intellectual property as the state moves towards higher end services and product offerings.

By Industry, most industries reported positive business conditions in Q2 except for construction and wholesale, although construction confidence was very positive.

CHART 26: SPREAD IN NAB BUSINESS CONDITIONS ACROSS STATES

Net balance, 3-month-moving-average

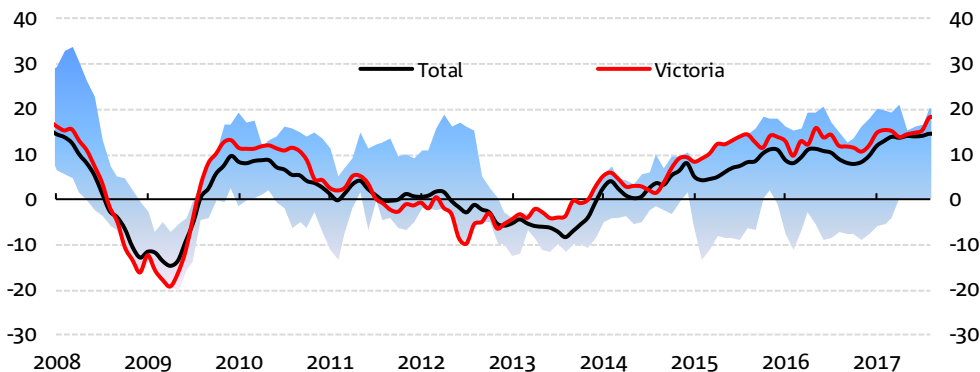


CHART 27: NAB BUSINESS SURVEY – CAPACITY UTILISATION

Per cent of total capacity (%)

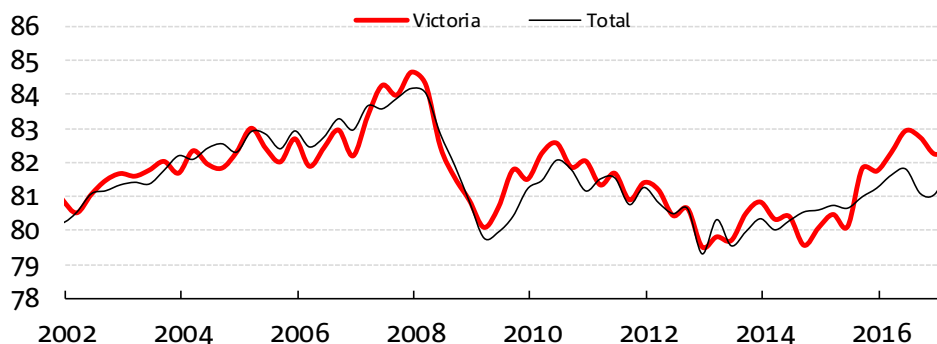


CHART 28: NAB SURVEY CAPEX EXPECTATIONS & PRIVATE BUSINESS INVESTMENT GROWTH

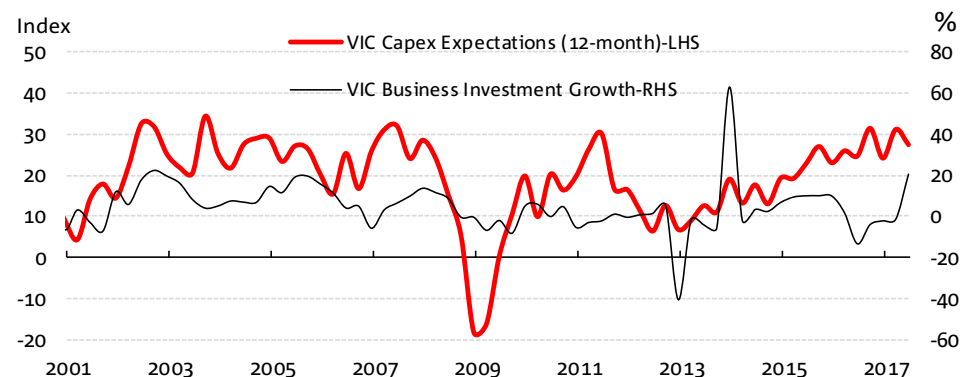
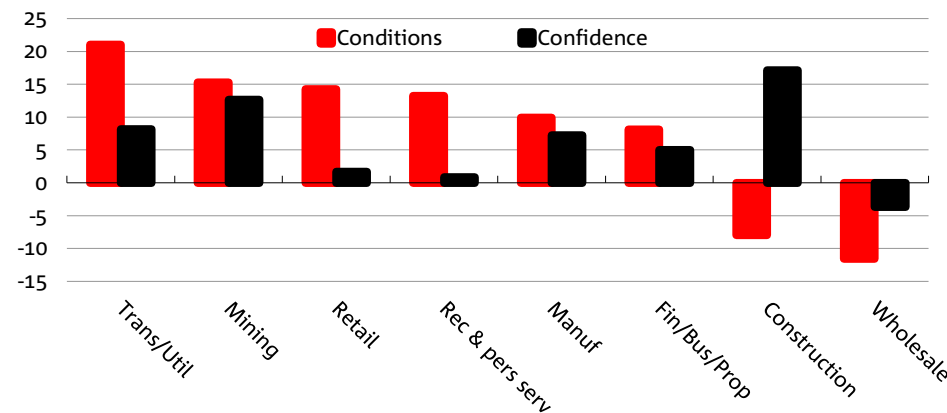


CHART 29: BUSINESS CONDITIONS AND CONFIDENCE BY INDUSTRY

Net balance, June 2017



NON-RESIDENTIAL INVESTMENT:

Office approvals rise with falling vacancy

Non-residential building approvals have also risen along with the residential construction boom. Office approvals, in particular, have risen as office vacancy rates continue to fall.

“Other” building approvals (which mainly include hotels and other forms of recreational accommodation) have also increased strongly as the state welcomes more interstate and international migrants and tourists.

The expected capital expenditure in machinery & equipment for 2017-18 looks to be weakening from the actual expenditure in 2016-17, while buildings & structures capex is expected to increase further.

The NAB Commercial Property Survey also confirms the strong sentiment in the office space, with office property conditions surging in Q2, reaching around 60 index points.

CHART 30: NON-RESIDENTIAL BUILDING APPROVALS

Million dollars

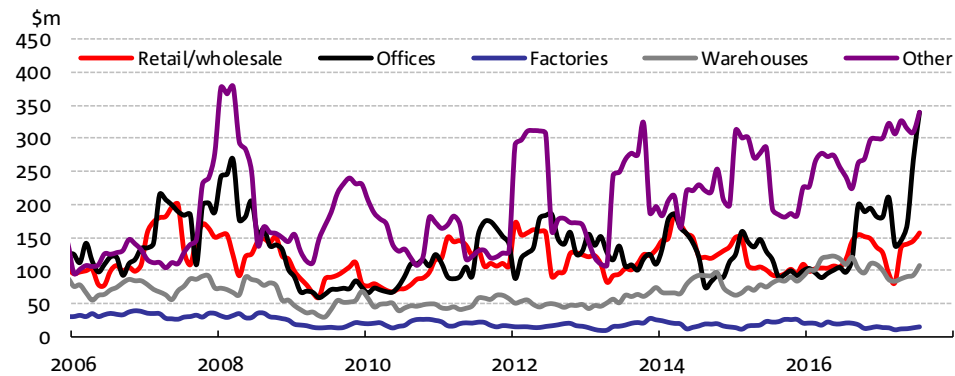


CHART 31: OFFICE APPROVALS AND VACANCY RATES

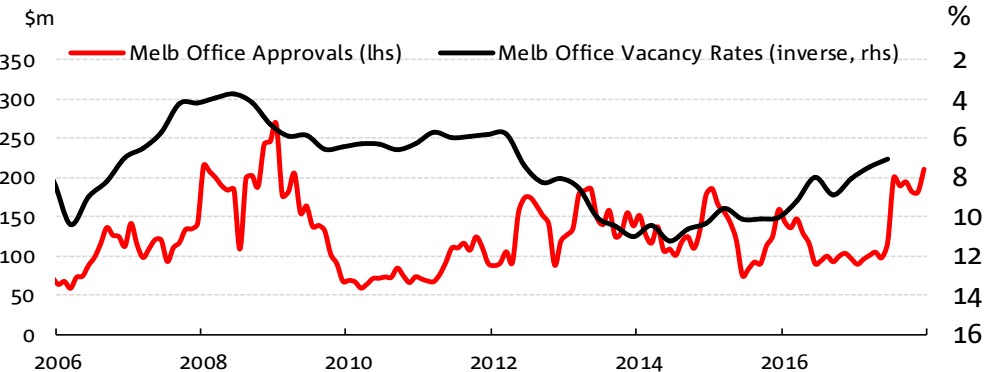


CHART 32: VIC CAPITAL EXPENDITURE & EXPECTATIONS

Actual & expected based on previous realisation ratio

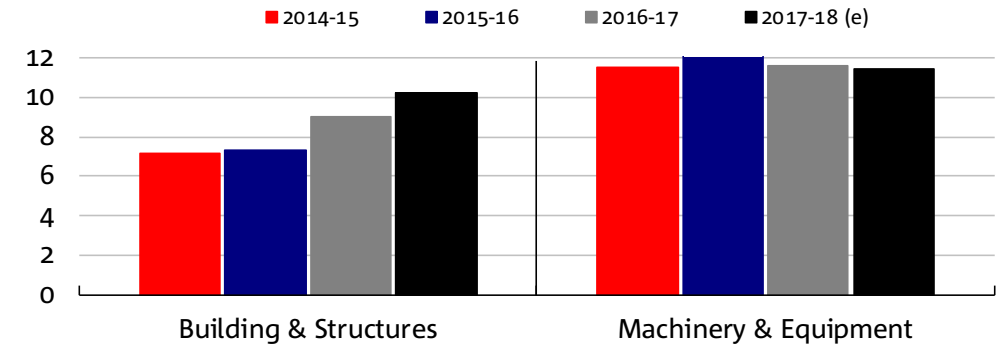
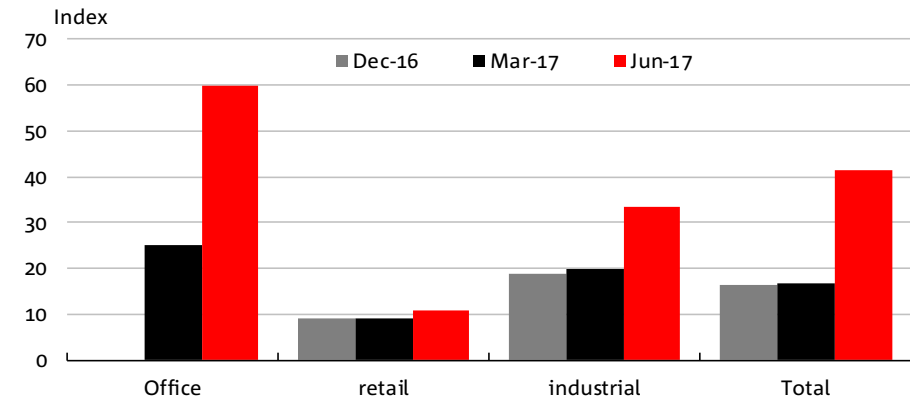


CHART 33: NAB COMMERCIAL PROPERTY INDEX



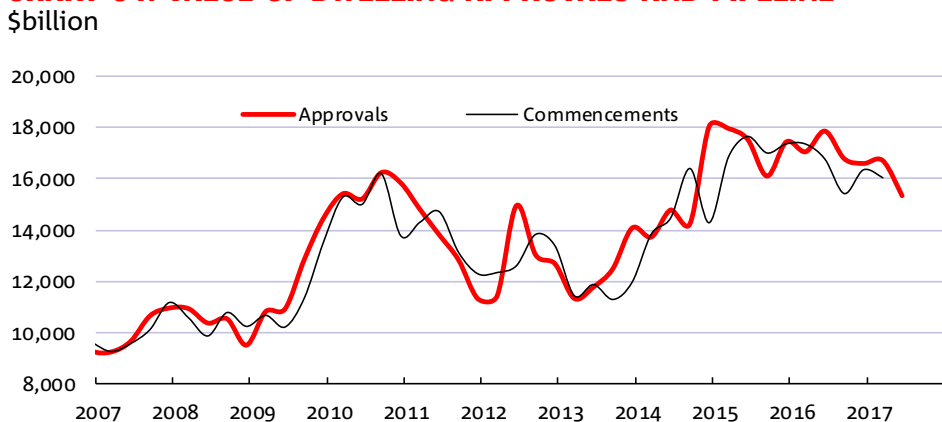
DWELLING INVESTMENT:

Dwelling investment boom seems to have passed its peak

The value of the residential construction pipeline appears to have passed its peak. Therefore we expect the contribution from construction activity to GDP growth to start tapering off, although the high level of approvals suggest building work will remain high.

The strength in Victorian dwelling approvals, and subsequently commencements and construction activity, has been largely driven by a surge in unit/apartments, with the unit commencements to population ratio now at more than twice its long-run level.

CHART 34: VALUE OF DWELLING APPROVALS AND PIPELINE



New houses under construction compared to population growth, on the other hand, remains below its historical average. As a result, price growth for houses has been superior to that for units/apartments. Price growth for units/apartments in the CBD and some outer suburbs have been zero or negative.

Going forward, the NAB Residential Property Survey shows Victorian house price growth is expected to fall below the national average.

CHART 36: VIC RENTAL YIELDS (%) AND PRICE-TO-INCOME RATIOS

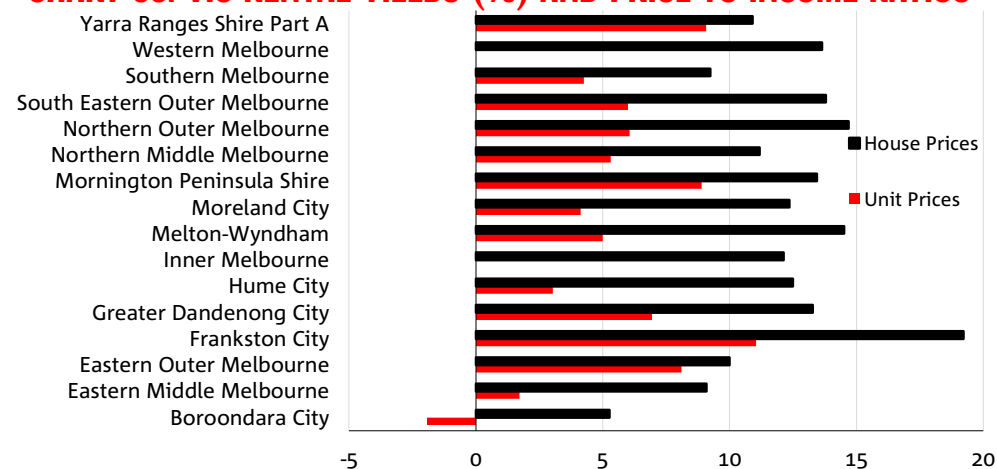


CHART 35: VIC HOUSE AND UNIT COMMENCEMENTS TO POPULATION RATIO

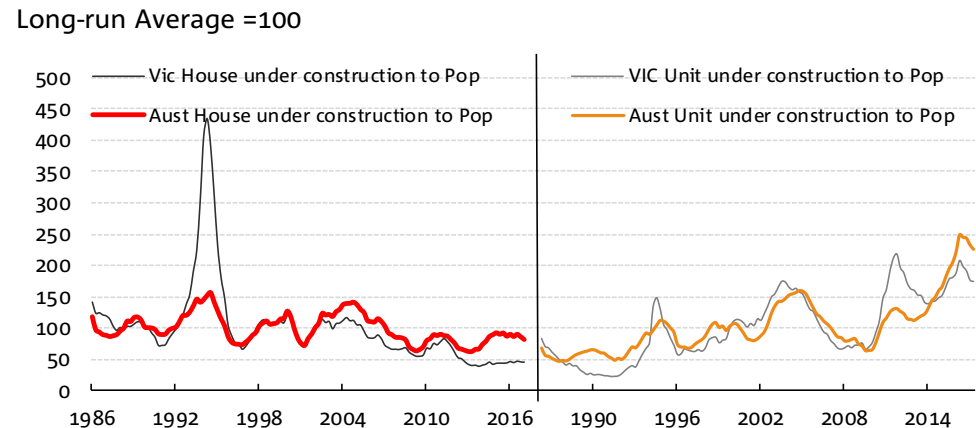
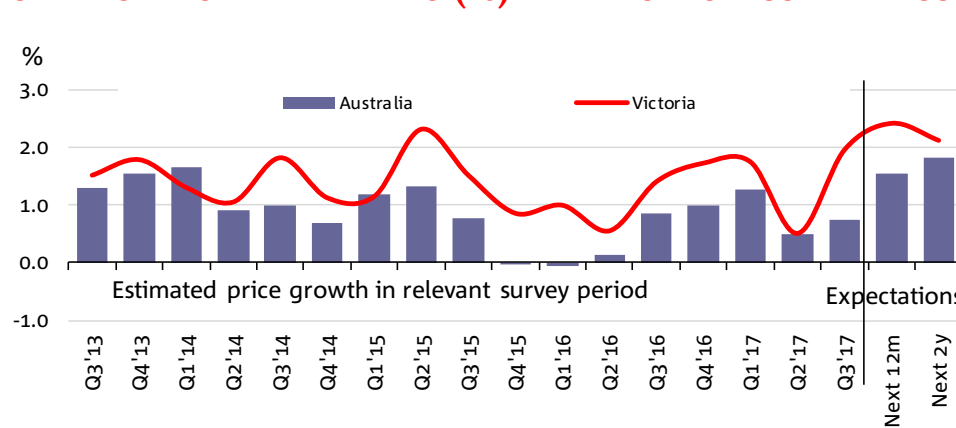


CHART 37: VIC RENTAL YIELDS (%) AND PRICE-TO-INCOME RATIOS



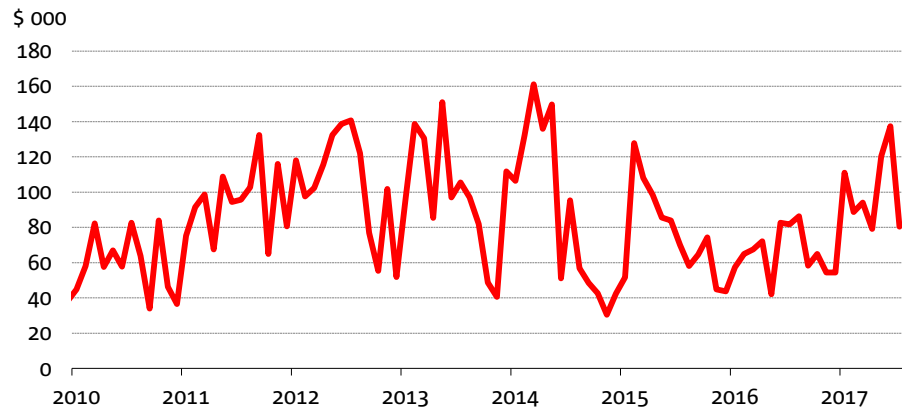
TRADE

Tourism and education to drive exports growth

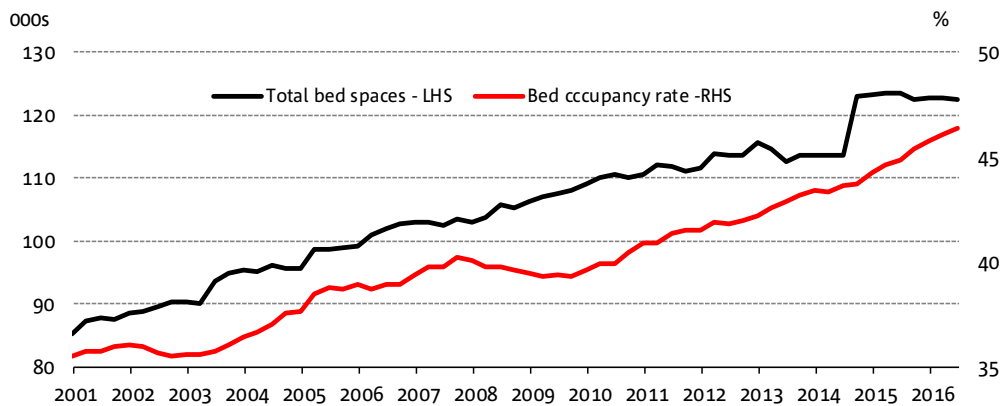
A record winter crop of 10 million tonnes (including 5.2 million tonnes of wheat) was produced in 2016-17, 190% higher than in 2015-16. As a result, cereal grain exports surged in 2016-17. This season has been mixed nationally, although Victoria has seen some of the best conditions. We expect Victorian winter crop production to be close to average in 2017-18. Dairy output fell in 2016-17 due to poor prices and very wet conditions in Northern Victoria. It may be difficult for dairy production to recover fully given the closure of two Victorian factories and a tough season in Gippsland. The beef industry faces the challenge of lower prices, although lamb and wool are performing well.

Services exports have been rising steadily, supported by rising income levels in Asia and a favourable AUD. International student and short term visitor numbers are expected to continue to rise, contributing to Victoria's exports growth. Interestingly, Victoria has overtaken Queensland as the second most popular destination for international short term visitors. Accommodation availability has also been improving with rising occupancy rates.

CHART 38 : VICTORIAN EXPORTS OF CEREAL GRAINS

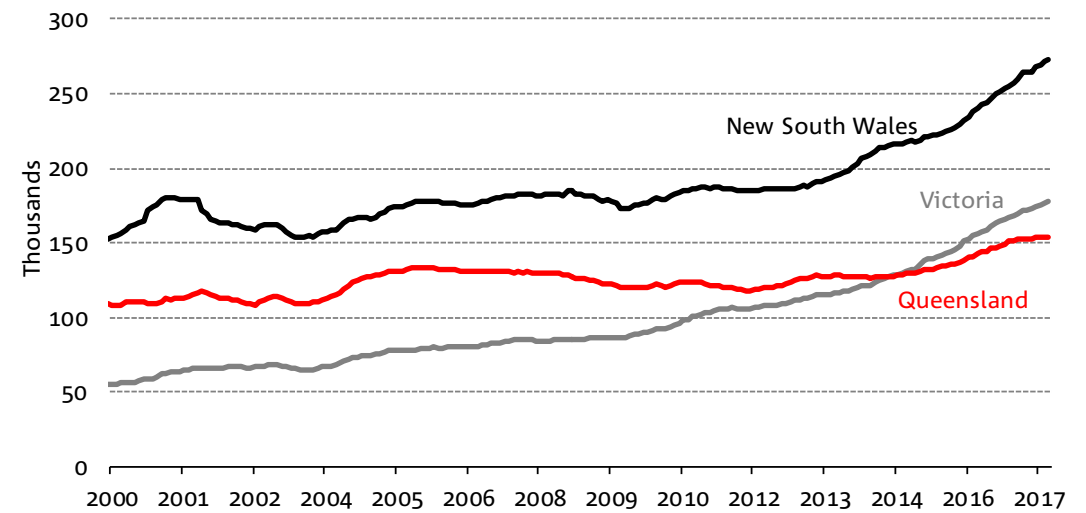


TABLES 39: TOURIST ACCOMMODATION



Source: ABS, NAB Economics

TABLES 40: SHORT TERM VISITORS, STATE WHERE SPENT MOST TIME
12 month moving average



FISCAL OUTLOOK

Forecast operating surplus with increased infrastructure investment

The state government is projecting net operating surpluses through the forward estimates period. Revenue growth is expected to average 3.7% a year over the next four years, exceeding average expense growth of 3.2% a year.

The pace of revenue growth in the near term is expected to ease as revenue from Victoria's land and property taxes moderates. Offsetting some of the weakness will be the strength in payroll tax revenue, as a result of a growing population and strong labour market.

GST revenue is expected to grow by an average of 6.9% per year from 2017-18 to 2020-21. This reflects an improvement in Victoria's share of the national GST pool, in part due to continued strong population growth relative to other states.

Government infrastructure investment is at historically high levels. Estimated investment for the next four years is at \$10.1, 9.8, 10.1 and 8.4 billions respectively, compared to an average of \$5.6 billion over the decade to 2016-17. Projects include the Metro Tunnel, the Level Crossing Removal Program, the West Gate Tunnel Project and the Western Suburbs Road Package.

CHART 41: GENERAL GOVERNMENT NET OPERATING BALANCE

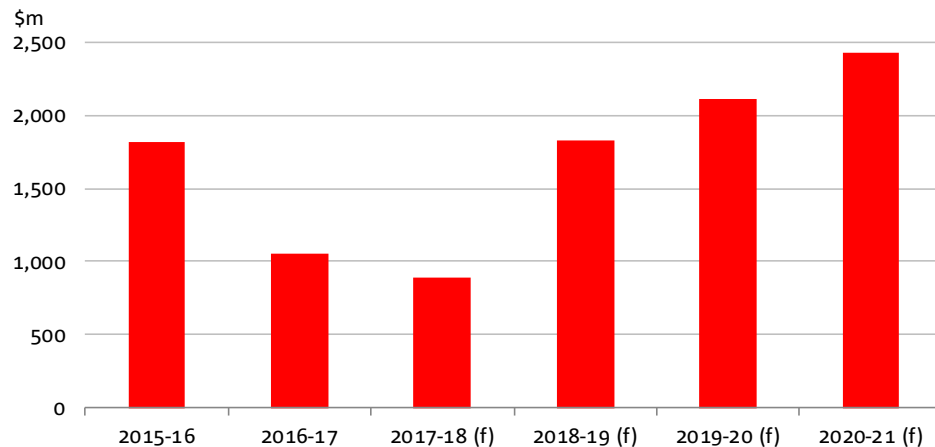
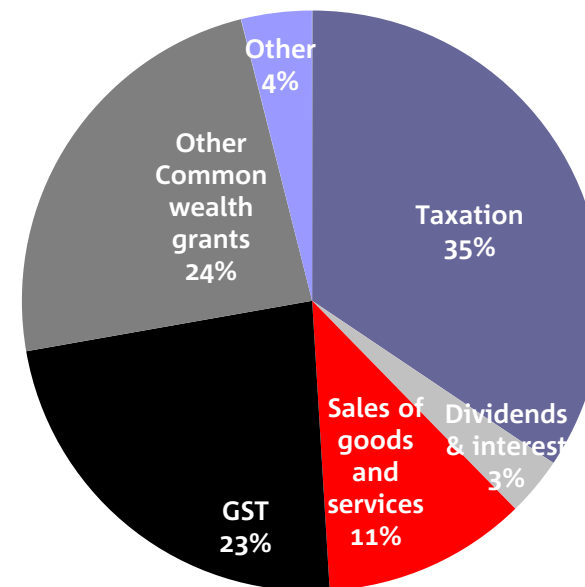


CHART 42: REVENUE BREAKDOWN, 2017-18

Percentage share (%)



SEMI GOVERNMENT AND CREDIT OUTLOOK

Issuance set to rise

Policy decisions at the general government level add to spending, but the biggest driver of increased borrowing is a pickup in infrastructure investment for a range of projects, including transport. Growth in debt is significant relative to earlier Budget forecasts.

For the first time in several years, TCV projects a significant pickup in net issuance. TCV issuance FY YTD is minimal, at just \$300m of an \$8.3bn total task.

Victoria is rated Aaa/stable from Moody's and AAA with a negative outlook from S&P. The state's budget performance is consistent with a AAA - the risk of a downgrade rests with S&P's view on the Commonwealth.

CHART 43: VIC NON-FINANCIAL PUBLIC SECTOR NET DEBT

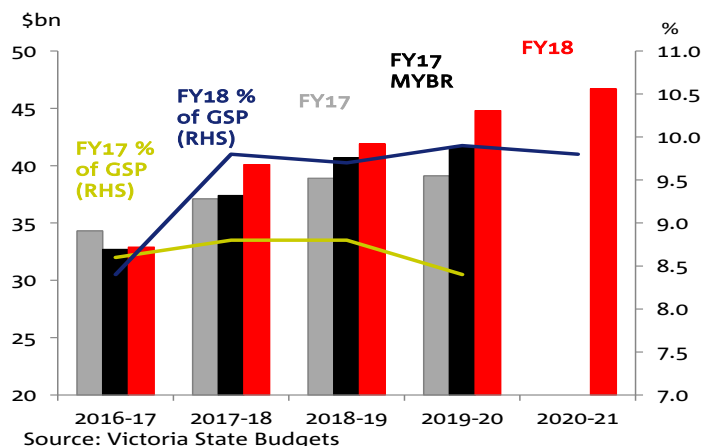
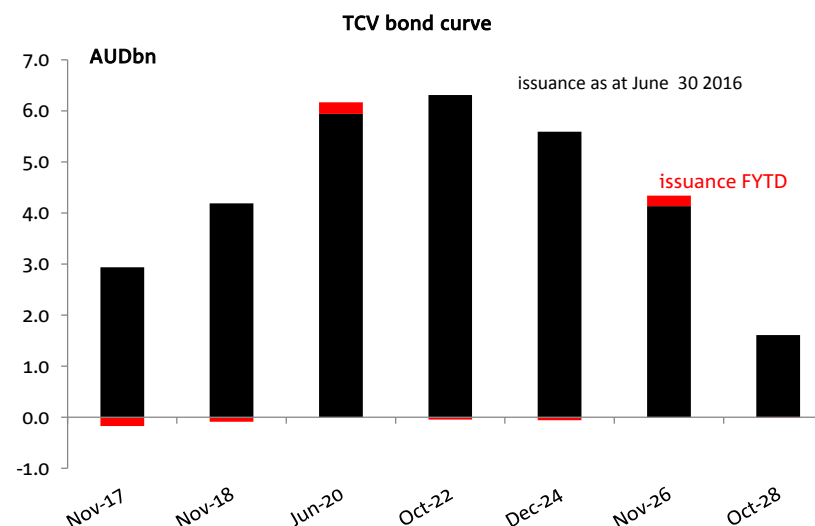


CHART 44: TCV BORROWING PROGRAM

TCV Issuance outlook (\$bn)	2017-18	2018-19	2019-20	2020-21
New Money	7.0	2.4	3.6	1.7
Maturities	1.4	2.3	3.1	3.2
Total	8.3	4.6	6.7	4.9

Source: TCV, Budgets, NAB

CHART 45: TCV TERM BONDS OUTSTANDING



Source: TCV

Source: TCV

FORECASTS BY STATE AND TERRITORY

Victoria to lead the pack in 2017-18, before growth moderates a little in 2018-19

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			
	15-16	16-17f	17-18f	18-19f	15-16	16-17	17-18f	18-19f
NSW	3.5	2.2	3.1	2.5	5.4	5.0	4.7	4.7
VIC	3.3	2.9	3.3	2.7	6.0	5.9	5.8	5.4
QLD	2.0	2.2	3.2	2.5	6.2	6.2	6.0	5.9
SA	1.9	1.8	2.7	1.7	7.3	6.7	6.5	6.5
WA	1.9	0.3	3.2	3.0	6.0	6.2	6.2	5.9
TAS	1.3	1.0	2.2	1.8	6.5	6.1	6.0	6.0
NT	2.7	1.5	1.5	5.0	4.2	3.5	4.0	4.2
ACT	3.4	3.0	3.1	2.6	4.5	3.8	4.8	4.8
Australia	2.7	2.0	3.2	2.5	5.9	5.7	5.4	5.3

HEDONIC HOUSE PRICE FORECASTS*

Through the year growth to Q4

	2015	2016	2017f	2018f	2019f
Sydney	15.5	10.7	5.1	3.7	3.0
Melbourne	15.8	9.5	8.6	5.5	3.4
Brisbane	6.9	2.7	3.1	1.9	1.2
Adelaide	3.8	3.8	3.4	1.7	1.7
Perth	-4.2	-2.9	-3.0	0.7	1.2
Hobart	7.0	9.6	10.0	4.9	1.7
Cap City Avg	11.2	7.3	4.6	3.4	2.5

HEDONIC UNIT/APARTMENT PRICE FORECASTS*

Through the year growth to Q4

	2015	2016	2017f	2018f	2019f
Sydney	13.1	5.8	5.9	0.5	0.6
Melbourne	7.5	4.7	6.4	1.2	-2.4
Brisbane	1.1	-3.0	-1.1	-1.8	-1.2
Adelaide	2.4	0.6	0.5	0.5	0.5
Perth	-2.8	-6.3	-1.9	0.4	0.7
Hobart	1.1	6.4	5.7	2.4	0.6
Cap City Avg	8.2	3.5	4.7	0.5	-0.3