Westpac Coast-to-Coast March 2019

An update on Australia's state economies

Westpac Institutional Bank

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Australian economy

This GDP print for the December quarter of 2018 shows the Australian economy having slowed in the second half of 2018 from a 4% annualised pace in the first half to a 1% annualised pace in the second half. The challenge for the Reserve Bank will be to credibly maintain its GDP growth forecasts at 3% in 2019 and 2.75% in 2020. Expecting a lift in the growth momentum from 1% to 3% could only really be justified if the economy was expecting to benefit from a significant stimulus. But global growth is slowing; the residential construction cycle has clearly turned; the AUD remains in a stable range; monetary policy is on hold and fiscal policy will continue to be constrained by the perceived need of both political parties to predict a surplus in 2019/2020.

Consequently the Reserve Bank is likely to see the need to further revise down its growth forecasts when it announces its revised forecasts with the May Statement on Monetary Policy. Those are likely to have an upper bound of 2.75% in 2019 and 2.5% in 2020. That is a "trend" forecast for 2019 and slightly below trend in 2020. Such forecasts are likely to still be assessed as consistent with steady policy with a clear "easing" bias.

With the residential construction cycle now turning down; business investment mixed; the savings rate now edging up; and house prices and new lending contracting, prospects for being able to maintain those forecasts in August look bleak. We expect by the August Statement on Monetary Policy the growth forecasts for both 2019 and 2020 will have both fallen below potential (2.75%); probably not to Westpac's current forecasts of 2.2% in both years but sufficiently below trend to invalidate any forecast of a falling unemployment rate and solid wages growth.

In such circumstances, with 150bps of "flexibility" the RBA is expected to cut the cash rate by 25bps to 1.25% and follow that up with a second cut of 25bs in November recognising confirmation of persistent below trend growth. Under such a benign growth outlook it will also be necessary to further push back on the expected timing of the return of underlying inflation into the 2-3% target band. This expected scenario is consistent with Westpac's forecast for two rate cuts in August and November.

There were a number of significant developments in the GDP report. Firstly we saw an extension of the contraction in new dwelling construction from the September quarter following a particularly strong first half. Westpac expects this is the start of a long run of falls in residential construction reflecting the downturn in dwelling approvals and an expected further contraction as tight funding conditions and falling house price expectations deter both demand and supply of new construction.

Secondly, we saw a second particularly weak print on consumer spending (0.4% following 0.3%) reflecting weak income growth and some early signs of a negative wealth effect as the savings rate lifted from 2.3% to 2.5%. Wages growth is lifting only very slowly while employment growth is expected to slow in 2019 as political uncertainty, global tensions around trade, and softening demand weigh on business employment and investment intentions. There are lags but the tepid growth in the second half of 2018 is likely to weigh on employment growth in 2019.

There is also likely to be a further wealth effect on consumption as the impact of falling house prices on household balance sheets plays out. Evidence of a wealth effect during the boom period for house prices is apparent in the 1.7–1.9ppt fall in the savings rate in NSW and Victoria. We expect this to gradually unwind over 2019 and 2020 restraining annual consumption growth to 2.0% in both 2019 and 2020 with an expected lift in the savings rate from 2.5% to around 5% by end 2020. That rise in the savings rate and associated low consumption growth is the main factor behind the expected soft GDP growth outlook.

House prices will be important in 2019. Even though prices have fallen by 13.2% from their peak in Sydney and 9.6% in Melbourne, these adjustments follow cumulative increases of 75% and 58% respectively over the previous five years. Affordability is still stretched in both cities. Unlike previous cycles where affordability was improved through sharp reductions in interest rates and relatively firm income growth, the necessary restoration of affordability in this cycle will need to come from prices. We estimate that further falls of up to 10% through 2019 and 5% in 2020 will be required to restore affordability given limited interest rate flexibility and a restrictive credit environment. In previous housing downturns interest rates played a critical role in restoring affordability. With the RBA cash rate already down at 1.5% there is very limited scope, even if the monetary authorities felt so inclined, for interest rate cuts to perform that traditional role.

There are also challenges with an entrenched low inflationary environment. On a calendar year basis headline inflation has been below the RBA's 2–3% target range since 2013. The concern is that such a protracted period of low inflation is impacting expectations. Our forecasts indicate that headline and core inflation will not reach 2% until June 2020. The RBA recently pushed back its forecast for underlying inflation to reach 2.25% from 2019 to 2020.

On the positive side, government infrastructure spending continues to lift with overall government spending up 6% in 2018. The mining investment contraction has bottomed out and there is some evidence of a likely modest lift in mining investment emerging during 2019. Services exports are booming. Education exports are up 15% in 2018 while total services exports lifted by 9.7%. Overall net services exports contributed nearly 0.5ppts to GDP growth.

As discussed, household income growth is expected to slow. We expect jobs growth of 1.3% in 2019 down from 2.2% in 2018. Wages growth is lacklustre, partly because considerable labour market slack remains. The underemployment rate is forecast at 8.5% by end 2019, largely unchanged since end 2014. Accordingly wages growth is expected to remain sluggish – this has been the case even in NSW where unemployment has fallen to 4.3%.

Bill Evans, Chief Economist

Australian economic outlook

Chart 1.

Real GDP: abrupt slowdown in 2018 H2

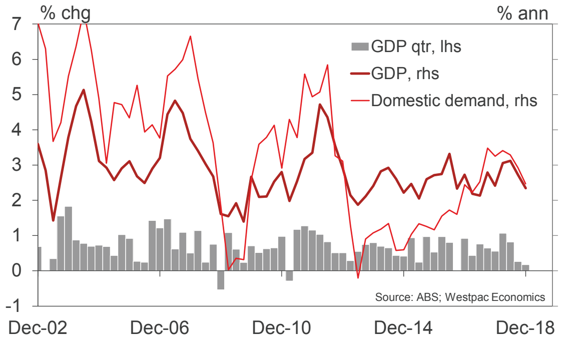


Chart 2.

Australia: the growth mix

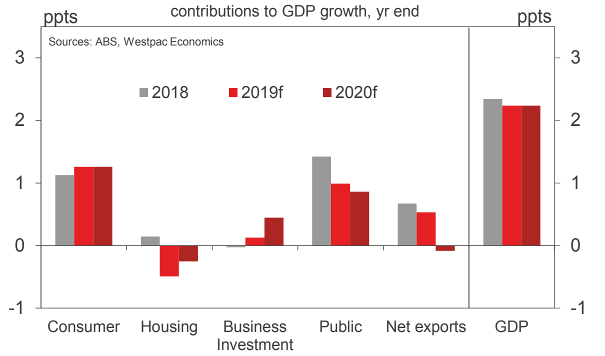


Chart 3.

Consumer spending: stuck in the slow lane

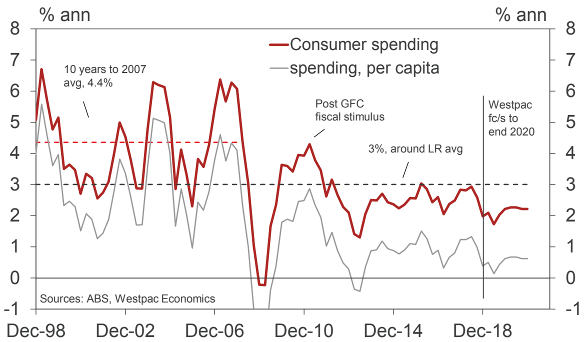


Chart 4.

Dwelling approvals: collapse late in 2018

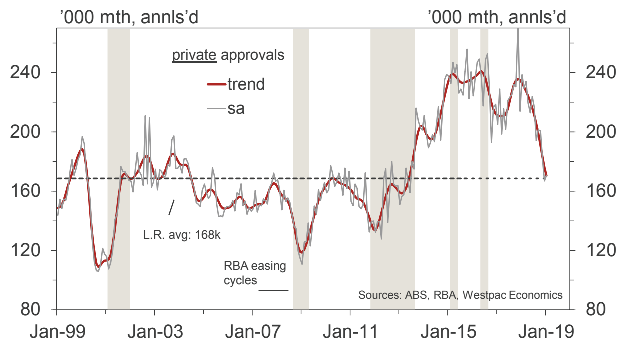


Chart 5.

Public infrastructure: strong upswing

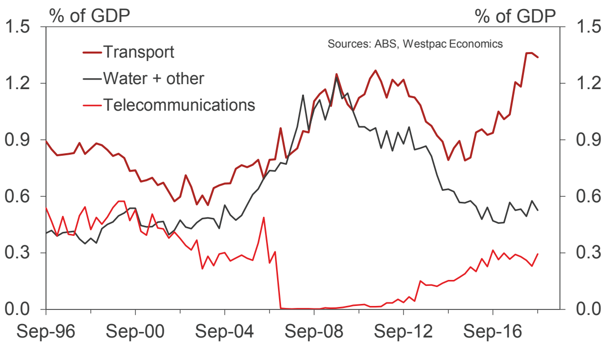
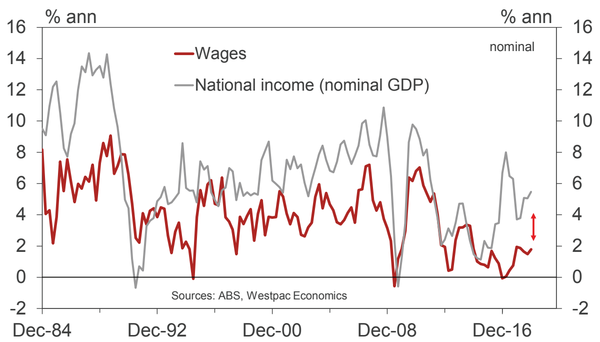


Chart 6.

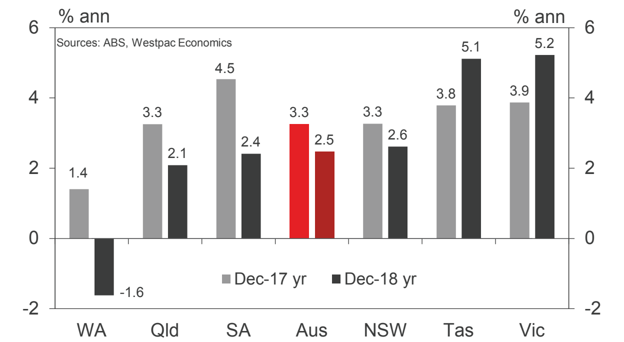
National income strength, wages still sluggish



Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

States overview

Domestic final demand



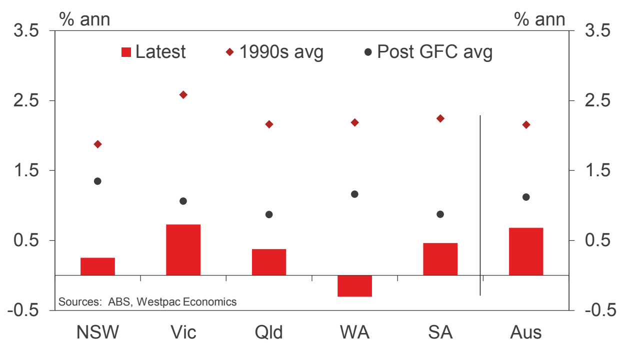
The Australian economy lost momentum in 2018, with domestic demand growth slowing to 2.5% from 3.3% in 2017.

The slowdown was evident across four of the six states, namely: the mining states of WA and Qld; as well as NSW and South Australia. Only the power house economies of Victoria and Tasmania bucked the trend, with annual growth actually picking up in 2018, to exceed a brisk 5%.

It was a soft end to the year, with domestic demand nationally expanding by only 0.3% in Q4. Weakness was particularly apparent in NSW and WA, where state final demand contracted, by -0.1% and -0.3%, respectively.

The new home building cycle turned in mid-2018, swinging from strong gains to sizeable declines. This general pattern was evident across most states. Qld was weaker, with falls throughout most of the year. In Victoria and Tasmania, activity posted a strong gain for the year but the cycle appears to be turning down, particularly in Victoria.

Consumer spending, per capita

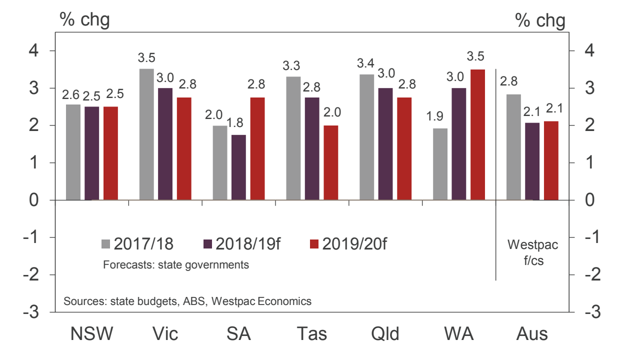


Consumers reined in their spending in 2018, feeling the pressure from weak wages growth, high debt levels and falling house prices. These challenging dynamics are particularly apparent in NSW, where a strong upswing in house prices has given way to a sizeable pull-back. WA households, after the end of the mining investment boom, are also under pressure.

Nationally, consumer spending per capita grew by only 0.4% in 2018, including a flat second half of the year. In NSW and WA, per capita spending contracted in the second half of 2018, a -0.3% and a -0.2% respectively.

Government spending, in the form of public demand, is a bright spot, expanding by a brisk 6% in 2018, directly adding 1.4ppts to activity nationally. Health and transport infrastructure spending are key priorities. Annual growth in excess of 6% is evident right across the eastern states (Qld, NSW, Victoria and Tasmania). Spending was more modest and volatile in SA and WA during 2018.

Growth outlook by state: GSP



With the Australian economy rapidly losing momentum, and dim prospects of a near-term rebound, the growth forecasts of the official family are likely to be downgraded - spanning the RBA, the Federal Treasury and the state budget papers.

Westpac Economics expects output growth nationally to be 2.1% in the 2018/19 financial year and holding at that pace in 2019/20, representing a slowing from 2.8% in 2017/18.

The state budgets, on a weighted average basis, expect output growth to be 2.8% in 2018/19 and 2.7% in 2019/20. These forecasts (including the pre-election update in NSW) were released ahead of the weak December quarter national accounts.

Downside risks are across the mining and non-mining states. As noted above, conditions have already slowed in Qld, WA and in NSW. Key to the loss of momentum are housing and the consumer - with these broad dynamics evident across each of the mainland states.

States overview

Chart 1.

State jobs markets

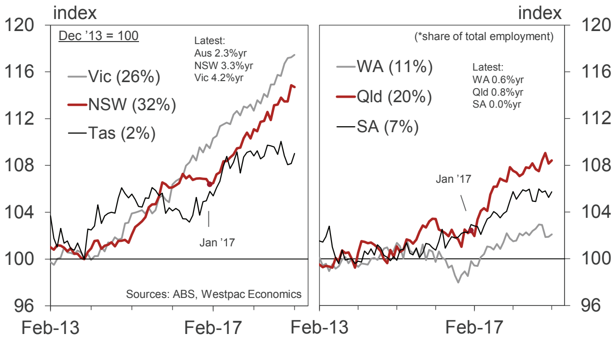


Chart 2.

State final demand, contributions

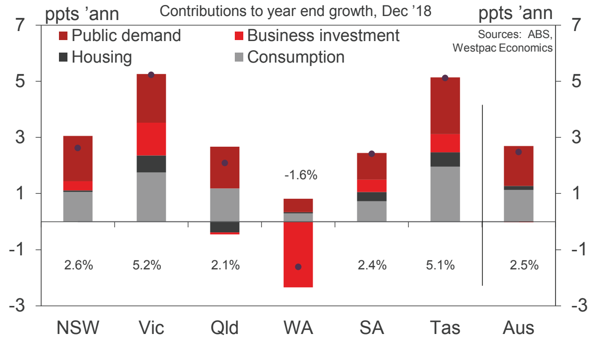


Chart 3.

Dwelling prices: housing markets cool

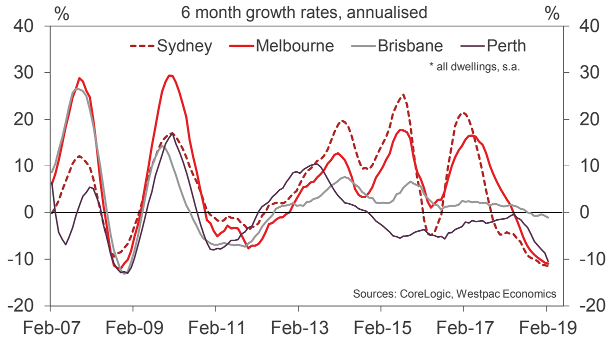


Chart 4.

Dwelling approvals: downtrend across states

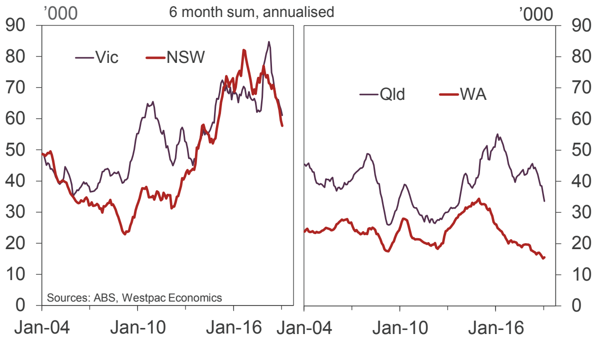


Chart 5.

Strong population growth: 1.6% nationally

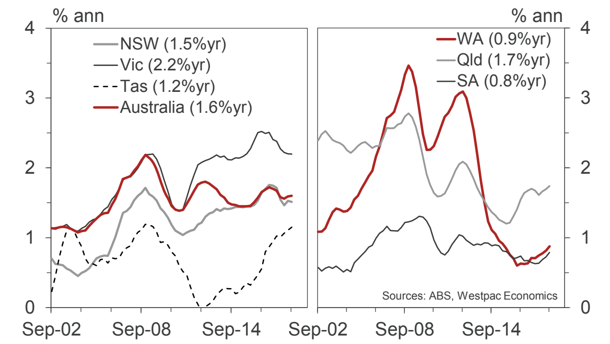
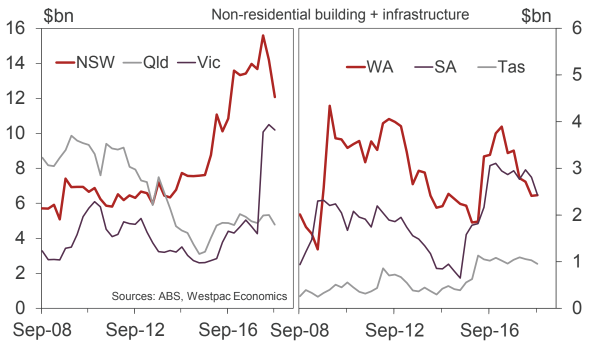


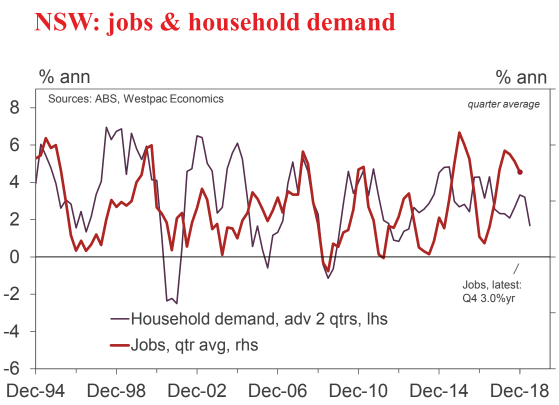
Chart 6.

Public construction work pipeline: surging



Employment and activity: a state view

Chart 1.



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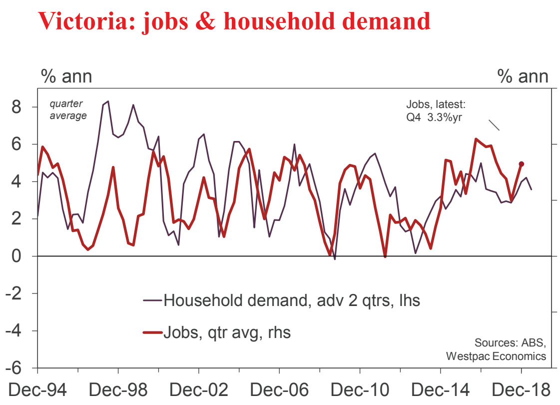

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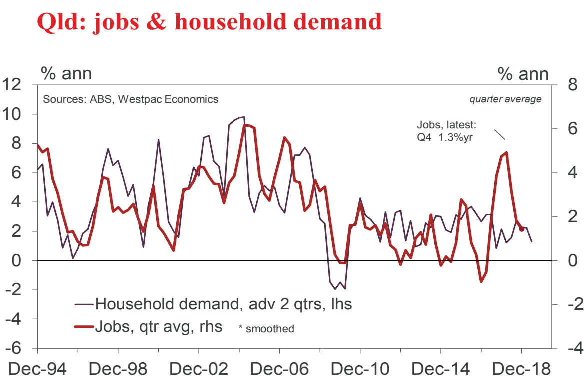

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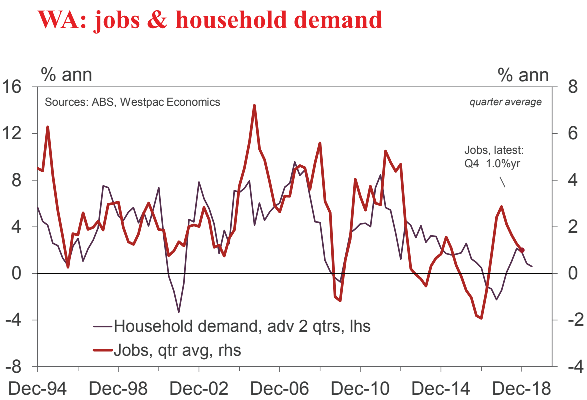

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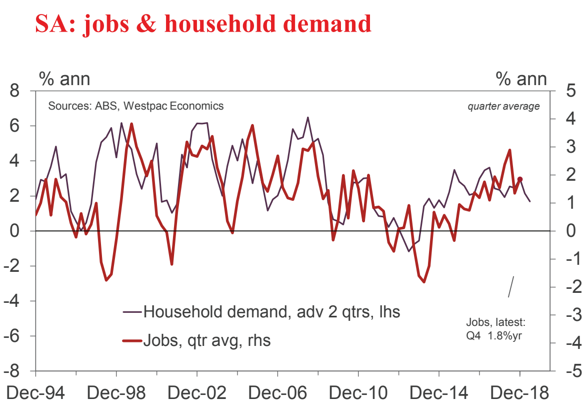
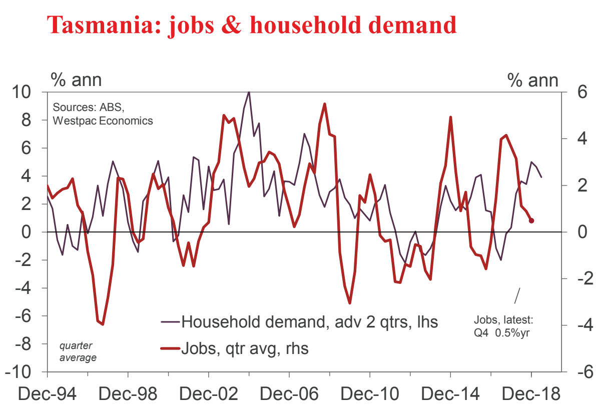


Chart 6.



Employment by industry: NSW in focus

Labour market trends have come into sharp focus against the backdrop of weaker activity data.

In the year to the December quarter 2018, employment numbers increased by 2.4% nationally. This is a robust pace, comfortably outstripping population gains of 1.6%.

Arguably, the job numbers describes a more upbeat economy than the national accounts, which report that output grew by 2.3% over this period.

Switching to hours worked - a more appropriate guide to activity - sheds some light on this apparent tension. Hours worked grew by a less impressive 1.6% in 2018, broadly consistent with output growth, and representing a sharp slowing from a 3.2% increase in hours worked in 2017.

At a state level, the NSW jobs market stands out as ripe for a correction in 2019.

Employment in NSW grew by a brisk 3.0% in the year to the December quarter 2018. However, state final demand growth has moderated to 2.6%, down from close to 4.0% earlier in the year, and household demand growth has eased to only 1.7%. Again, hours worked are less impressive at only 1.5% for 2018. This helps to explain the lack of strength in wage incomes in the state, which is constraining household's spending power.

NSW employment trends by industry highlight that job gains in 2018 were concentrated in professional business services; construction; finance; retail; and real estate - together accounting for 95% of the total increase. The housing downturn points to jobs growth slowing in 2019.

Chart 1.

NSW: employment and hours worked

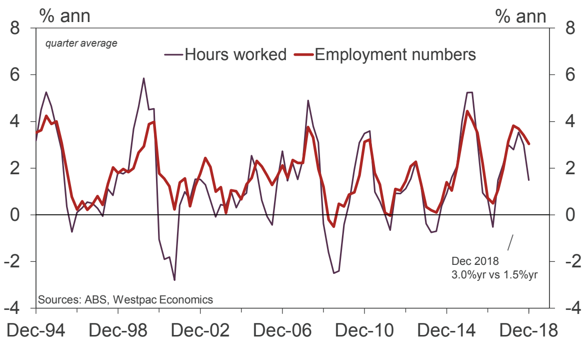


Chart 2.

NSW employment by sector

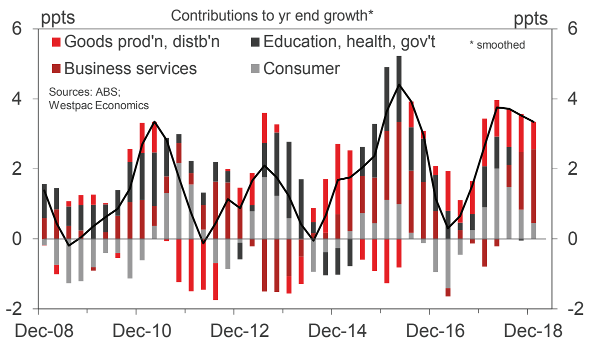


Chart 3.

NSW: employment by sector

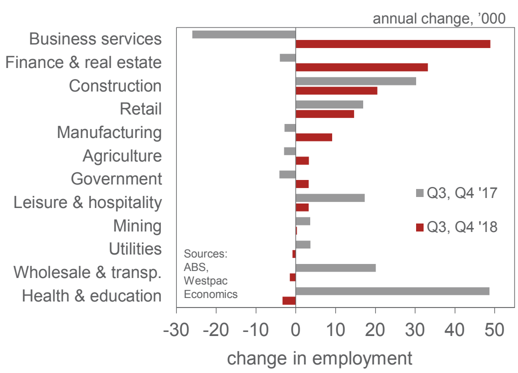
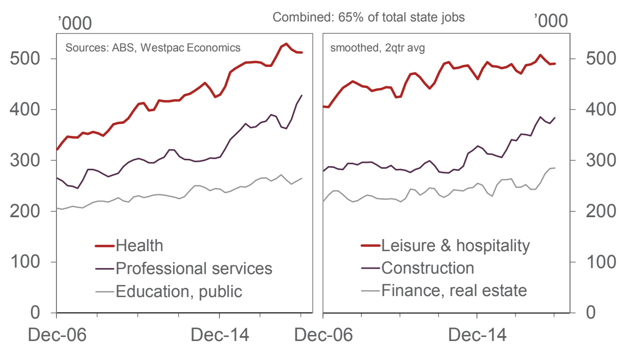


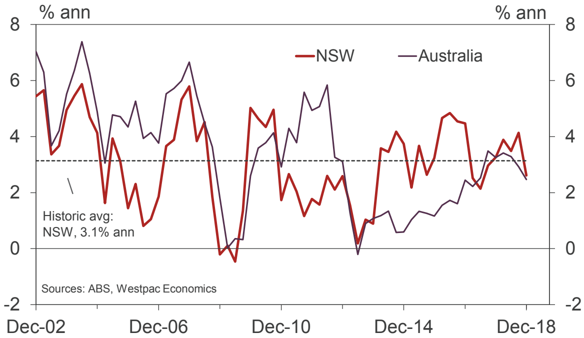
Chart 4.

NSW: employment trends



NSW: conditions slow ...

NSW state final demand slows



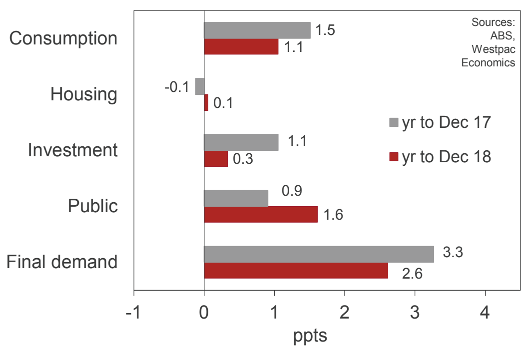
The NSW economy ended 2018 on a soft note, with state final demand contracting by 0.1%.

For the year as a whole, state final demand growth slowed to a below trend 2.6%. That follows a relatively strong run for the four years 2014 to 2017, when state demand grew by an average of 3.7% per year, including a 3.3% rise in 2017.

The downturn of the housing sector, as well as weak wages (average earnings), is key to this loss of momentum.

The recent new home building upswing in NSW was by far the strongest of any of the states, with activity increasing by 126% over the six years to end 2017. In 2018, work grew by a further 7.6% in the first half of year, but that was fully reversed by a 7.3% decline over the second half. Further falls are in prospect, with approvals now around 30% below the peak of late 2017. Rental vacancy rates have increased in Sydney, but are not particularly high by historical standards, as supply largely catches up with demand.

NSW: contributions to state final demand

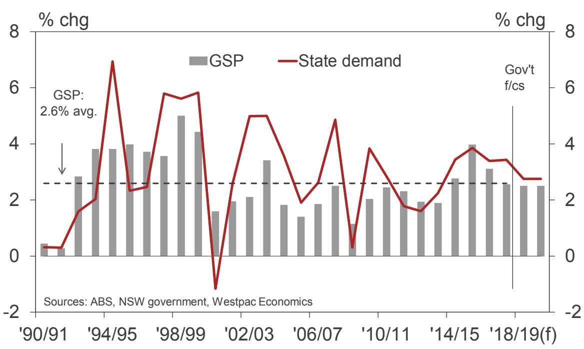


Dwelling prices in Sydney have also turned, with a sizeable pull-back following a very strong run (up 70% in four and half years). Prices have fallen by 13% since the peak of mid-2017, with downward pressure continuing in 2019, to be back at late 2015 levels.

The 2018 year was a particularly challenging one for NSW households. Wages, or average earnings, growth is weak; debt levels are high; house prices are falling; and much of regional NSW is experiencing severe drought.

Against this backdrop, consumer spending hit the wall in the second half of 2018. Per capita spending contracted by 0.3% over this period. That was the weakest of any of the states, even below a -0.1% for WA. By way of context, outcomes during the height of the GFC were considerably weaker, with per capita spending contracting by 1.9% in a six month period.

NSW economic performance & outlook



The people of NSW are set to go to the polls on March 23 (for a state poll) and likely in May (for the Federal poll).

In the pre-election state budget update, the growth forecasts for 2018/19 were downgraded by 0.25%. The risks to these figures are, arguably still tilted to the downside. Notably, the budget update was released on March 5, a day before the weak December quarter national accounts.

Significantly, the period of above trend output growth for the state has passed, now that the housing sector has turned and turned down sharply.

GSP grew by 2.8% in 2014/15, 4.0% in 2015/16 and 3.1% in 2016/17 - three consecutive years of above trend growth. In 2017/18 growth moderated to 2.6%, in line with the long-run average. The budget update anticipates growth will be 2.5% in both 2018/19 and 2019/20, with state final demand growth at 3.0% this year (down from 3.4% in 2017/18) and then 2.75% in 2019/20.

… led by housing and the consumer

Chart 1.

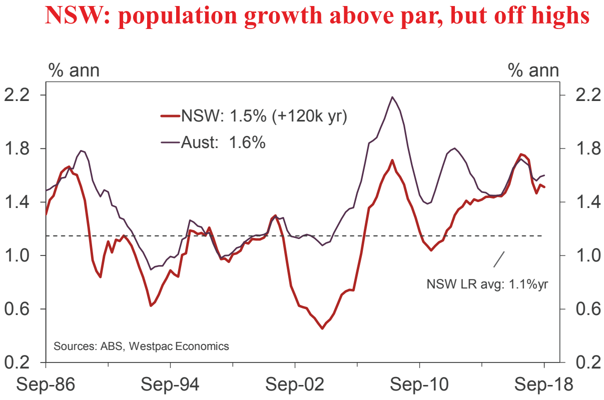


Chart 2.

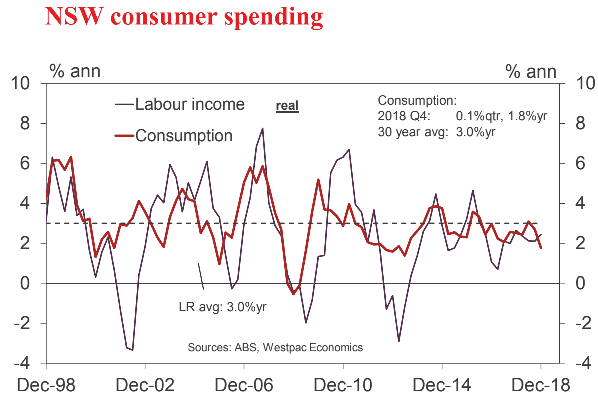


Chart 3.

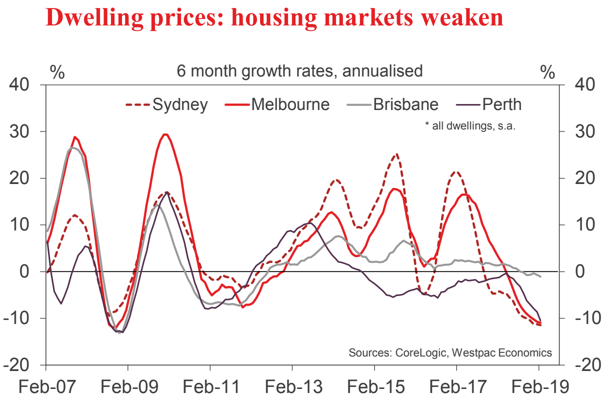
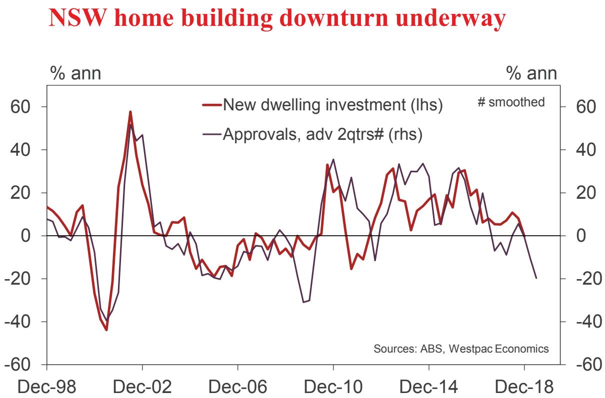


Chart 4.



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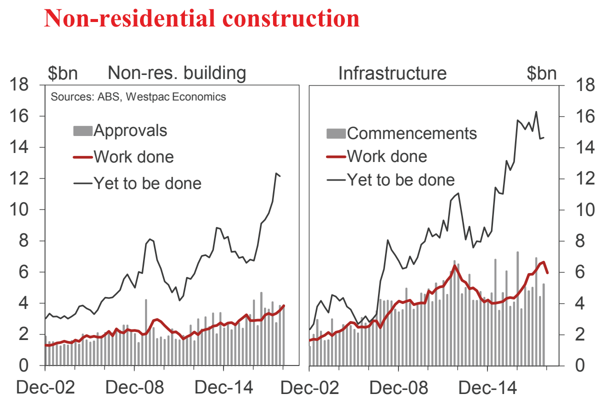

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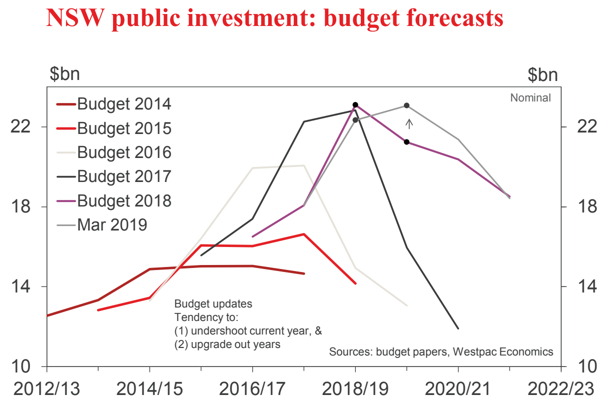

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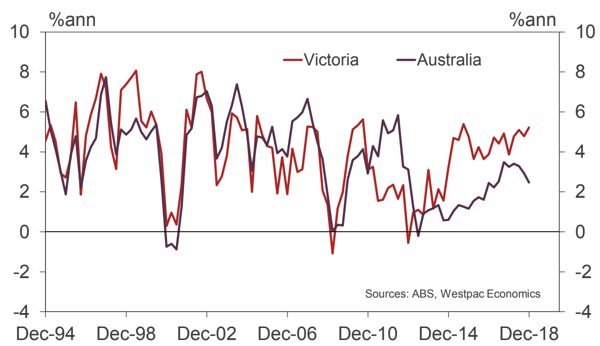
Victoria: momentum holding for now ...

Victorian state demand: well above trend growth

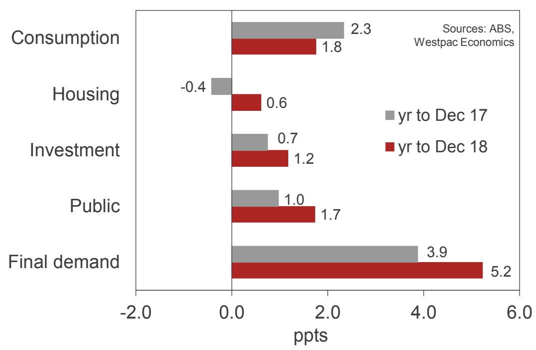


Victoria's economy posted strong growth in 2018 but with an uneven performance over the year that points to key drags emerging around housing and the consumer. Momentum outside of these sectors still looks positive with significant support still coming from population growth, government spending, non residential building, infrastructure work and services exports.

Household incomes have also recorded better gains than in other states, with employment growth again picking-up and notable support coming from a lift in wages growth (a key contrast with NSW in particular).

The state economy's resilience will be tested in 2019 and 2020 as declines in dwelling construction and spillovers from Melbourne's housing market correction starts to have more effect. A slowdown in annual growth already looks inevitable, the main question being around the quantum of the moderation.

Vic: contributions to state final demand

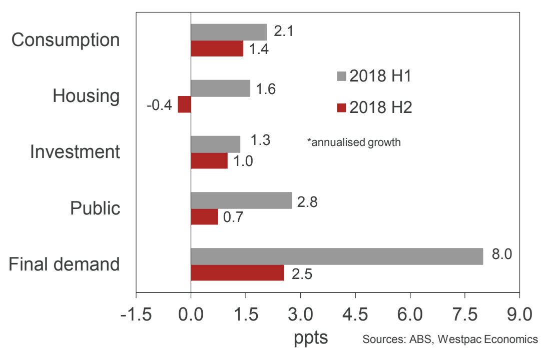


Victorian state final demand had a very strong first half of 2018 – growth tracking an 8% annualised pace – but an abrupt slowdown to a 2.5% pace over the second half. Growth for the full year came in at 5.2%, double the 2.5% pace seen nationally and lifting rather than slowing.

A slowdown in consumer demand and a turnaround in dwelling investment accounted for most of the moderation over the second half of the year. That said, both components continue to perform relatively well with annual growth in consumption sustaining at 2.9% for the year (considerably better than the 2.0% pace nationally and the 1.8% pace in NSW). Likewise, the decline in dwelling investment in Vic over the second half of the year was at about half the pace seen in NSW.

The forward view for housing remains downbeat, dwelling approvals falling a further 12% over the last quarter of 2018 and the Melbourne price correction deepening in recent months. The drag from new dwelling construction and spillover effects on consumer demand look set to continue.

Vic: contributions to state final demand



Household incomes remain relatively well supported. Job growth re-accelerated over the second half of 2018, despite the demand slowdown. The state's trend unemployment rate dropping to 4.5%. Wages have also picked up, tracking at 2.7%yr vs 2.2%yr across the rest of Australia. To the extent that this carries into 2019, the combined support for income should mean Vic has greater capacity for income gains to mitigate the effect of house price declines on spending.

Vic is the clear standout on investment outside of housing. Public investment is up 20%yr and 72% since Q3 2014's low. Business investment meanwhile is 11% higher than end-2017, and up 34% from end-2013. Behind that headline gain is a surge in engineering construction, 33%yr, with non-residential construction also supportive, 7.6%yr – the pipeline still looking strong for both. Equipment investment has also been robust, up 6.3%yr, but may see some softening in the face of slowing demand. Population growth and services exports remain key supports justifying both this investment and further growth.

... but housing downturn starting to bite

Chart 1.

Victorian labour market

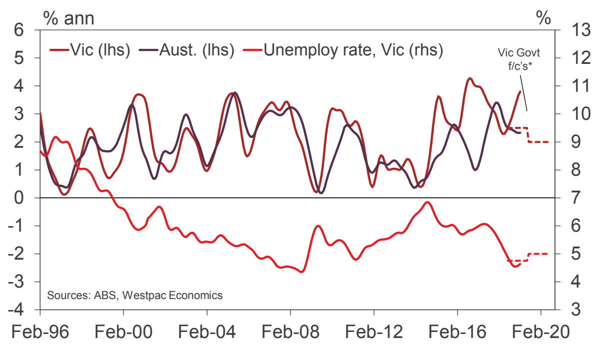


Chart 2.

Vic household income & spending well balanced

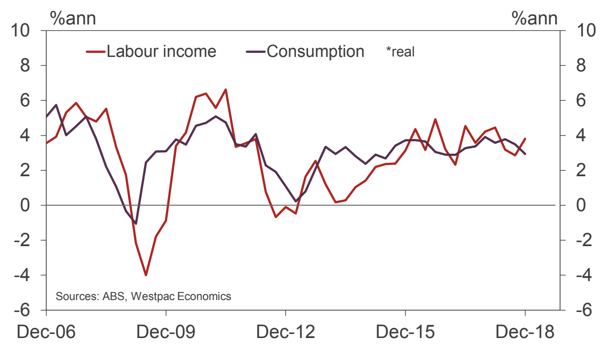


Chart 3.

Dwelling approvals: Vic

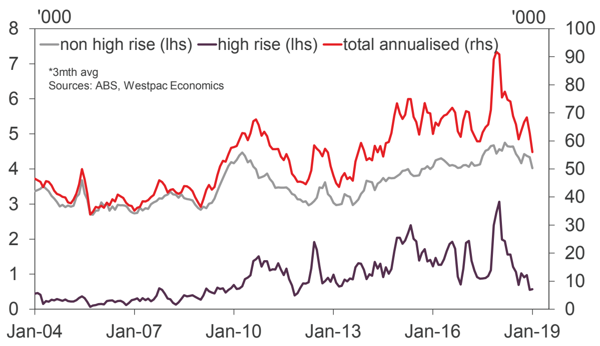


Chart 4.

Melbourne house prices

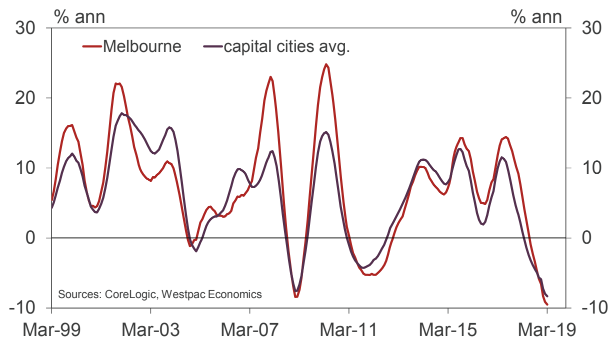


Chart 5.

Vic's non-res construction pipeline soars

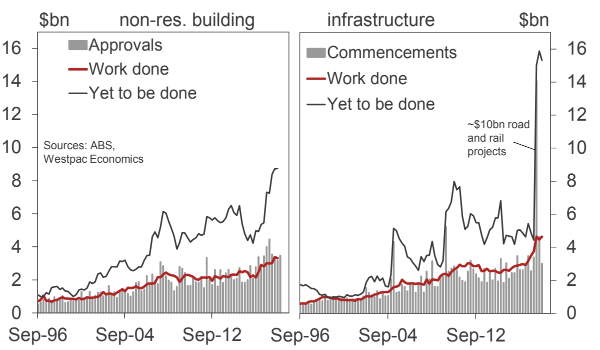
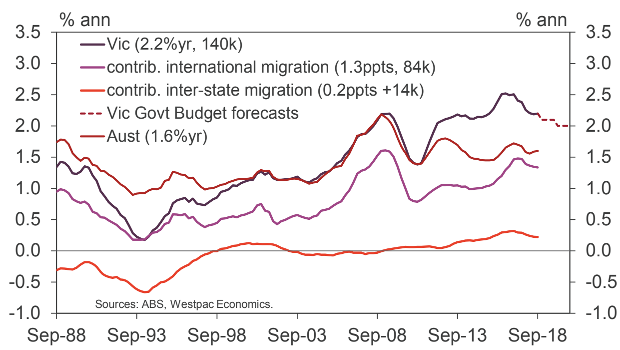


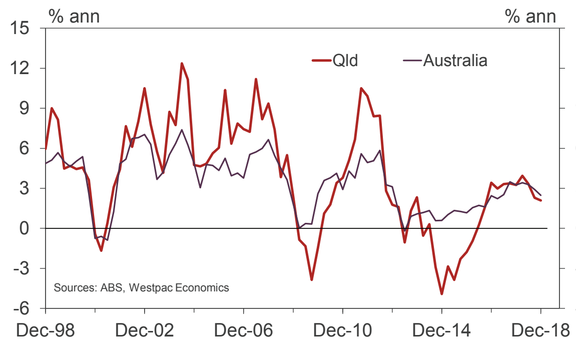
Chart 6.

Vic's population growth



Queensland: construction turning lower ...

Qld domestic demand has moderated

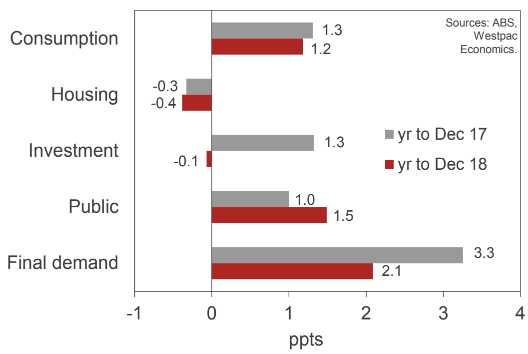


Qld state demand recovered 0.9% in the December quarter following a 0.2% contraction in Q3. In 2018, through the year demand growth was only 2.1%, or +0.4% in per capita terms, leaving Qld as the 2nd slowest state for the year.

The slowdown is driven by a decline in private construction across housing, non-residential and engineering. Additionally, the ongoing drought continues to present difficulties. At the start of 2019, twenty-three councils and five part council areas were drought declared - over half of the total state by land area.

With harsh weather continuing in 2019 - both drought and floods - and the construction cycle turning lower, a risk for the Qld economy centres on lower output growth feeding into the labour market. Employment slowed through the second half of 2018 but the unemployment rate held steady with the participation rate coming off. That will not continue indefinitely and unemployment will rise if support for growth is not found.

Qld: contributions to state final demand

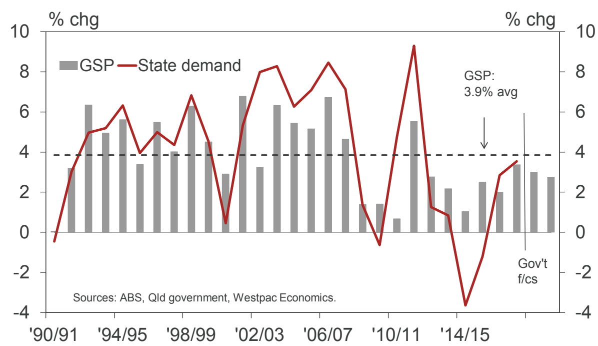


Housing construction is weak, falling 5.7% in Q4 to be 6.7% lower over 2018. Activity post the Brisbane apartment boom is subsiding, and now with housing price growth flat-lining following the downturn in Sydney and Melbourne, there is little encouragement for development. That said, Qld prices did not surge like the other two states, and is seeing solid population growth of 1.7%yr, largely due to housing affordability.

Housing aside, the slowdown is acutest in non-residential building which fell 9.2% in Q4 and is down 22.2% annually. Engineering construction is also muted, up only 1.6% over the year with new mining projects concluding. Equipment investment remains on a robust uptrend but will likely see spill-overs from the reduced construction activity.

A more positive dynamic is seen in public investment, up 2.0% in Q4 and 11.7% over the year. The pipeline is strong on the back of the State government's $46bn infrastructure program over the next four years.

Qld economic performance & outlook



As with Australia in aggregate, Qld consumer spending has been modest. While Q4 posted a solid 0.7% gain, that follows previous subdued results and left annual consumption growth at 2.1%, just below the national average of 2.3%. Consumer spending is hampered by nationwide factors relating to low household income growth and high debt, but an additional weight on the Qld consumer are signs of a worsening labour market.

State-wide employment growth has drifted below working age population growth. Jobs increased by a modest 0.8% in the year to February 2019, compared to the 4.3% surge during 2017. Despite this, the trend unemployment rate dipped to 5.7% in February as fewer people looked for work.

But with Qld's population growth tracking at 1.7%yr, the uptrend in the size of the labour force will eventually resume. As such, output growth will need to be supported back to trend to sustain a balanced labour market.

... raises risks for labour market

Chart 1.

Qld net migration has rallied off historic lows

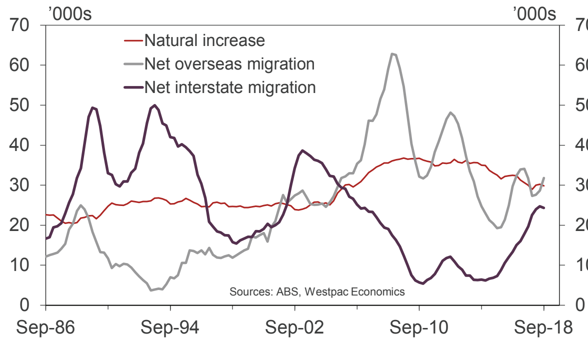


Chart 2.

Qld: employment's share of population slips

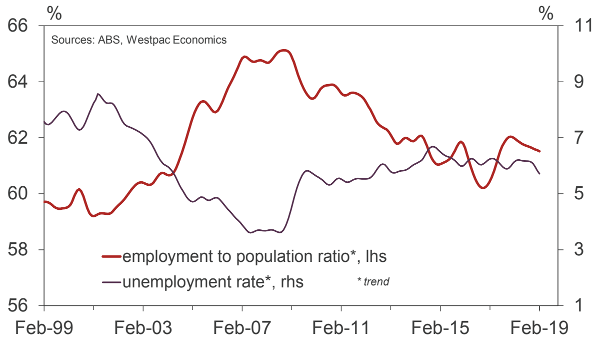


Chart 3.

Qld: Labour income and consumption

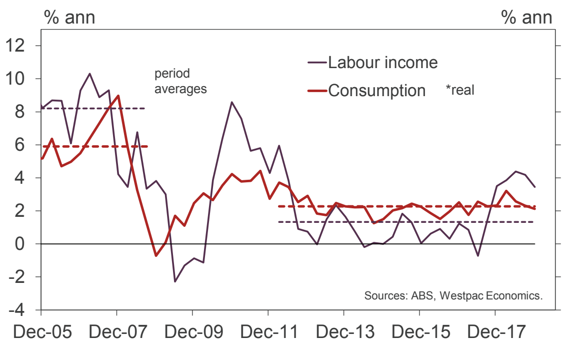


Chart 4.

Qld dwelling approvals are declining

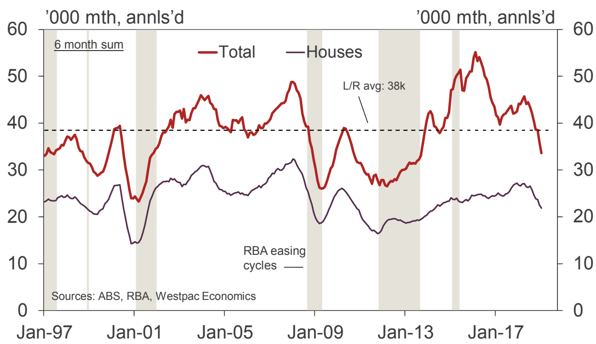


Chart 5.

Consumer & business confidence ease back

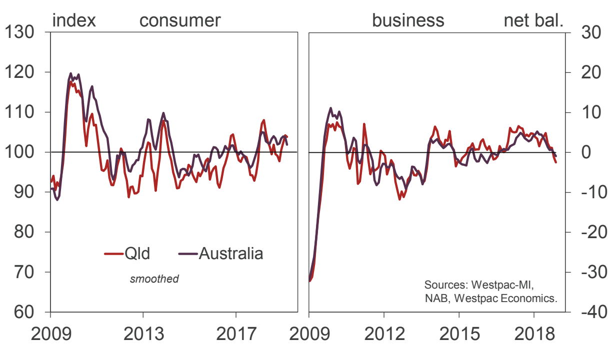
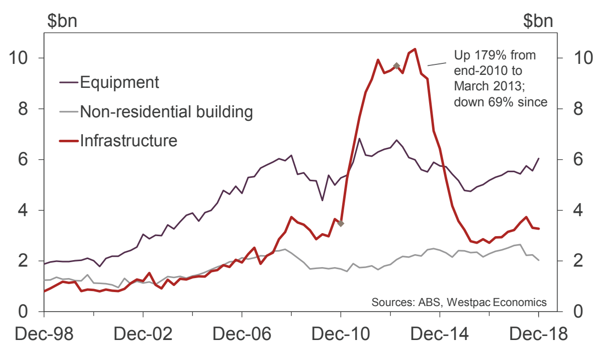


Chart 6.

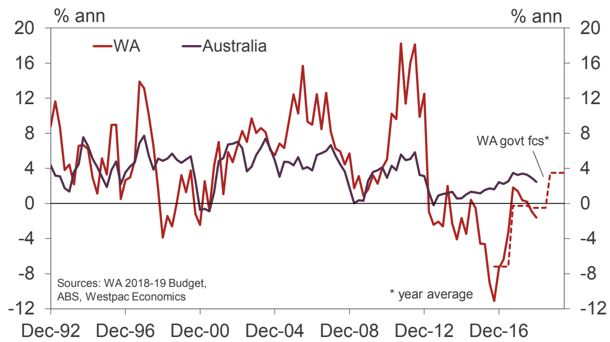
Qld business investment: in modest uptrend



Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

Western Australia: recovery stalls ...

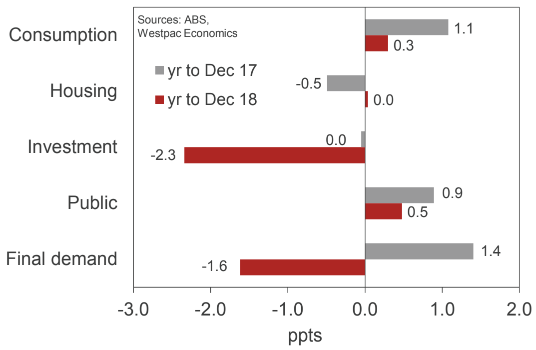
WA state demand: deep contraction ends



WA's recovery from the mining-driven recession in 2015-17 has lost its way with more signs that growth in the state is stalling. Final demand slipped back into contraction over the second half of 2018 - albeit partly due to one last drop in mining investment. The state's labour and housing markets are also looking decidedly weaker. Recent commodity price gains offer some hope but this may do little to help households facing into a renewed slowing in income growth and house price declines impacting already battered balance sheets.

After rising 1.4% in 2017, state final demand has declined in three of the past four quarters to be down 1.6%yr for 2018 as a whole. Sharp falls in Q1 and Q4 were driven by business investment – dented by the final let down in the mining investment boom that has been unwinding since 2012 with the recent completion of major gas projects. However, other components – dwelling investment, public demand, and slowing consumer spending – have also contributed to the weak picture over the last year.

WA: contributions to state final demand

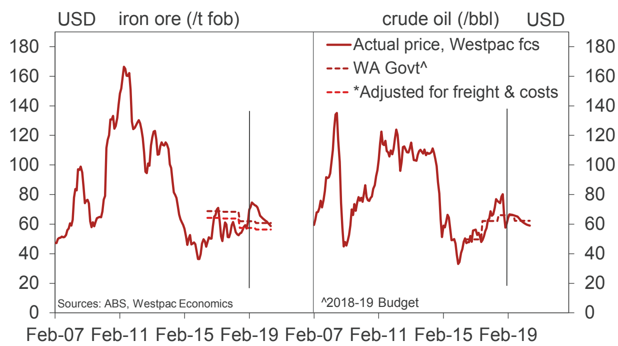


Housing investment looks set for further weakness. Despite already being down 31% from its peak in Q3 2015, approvals fell sharply over the second half of 2018 and are pointing to a further 20-25% decline in investment over 2019. Rising renovation work has provided some offset over the past year, although this was coming off a large contraction in 2017 and may come under pressure from weak incomes.

A renewed decline in Perth dwelling prices will put additional pressure on dwelling construction and consumer spending via household balance sheets. After very nearly stabilising in early 2018, Perth prices have again moved sharply lower, down 8% over the year to February. Having already endured five years of declining prices, state household balance sheets are in poor condition to begin with.

Deteriorating labour market conditions pose an additional threat. After an initial strong jobs rebound in 2017, +3.7%, annual jobs growth has moderated to 0.6% currently. The trend unemployment rate is elevated at 6.2%.

Commodity prices: iron ore & crude oil



The combined effect of slower job gains and still anaemic wages growth has undermined household incomes with growth in aggregate real labour income slowing back to just 1.9%yr. These are clearly challenging times for WA households, particularly those sitting on little or no housing equity and potential job loss, and it is hardly surprising that growth in consumption has slowed back to just 0.6%yr – less than a third of the national result.

The main near term hope is improving conditions for the state's mining sector. Prices have again outperformed expectations, particularly for iron ore, and while the 'pass through' to household incomes may again be muted, some modest lift in mining investment and employment, coupled with a boost to state government revenues could provide some uplift to state demand. However, that may be slow to materialise and in the mean time, the weaknesses evident in housing, the labour market and the state's household sector may be the more dominant forces.

... and growth may be hard to restart

Chart 1.

Jobs market: recovery slows after initial rebound

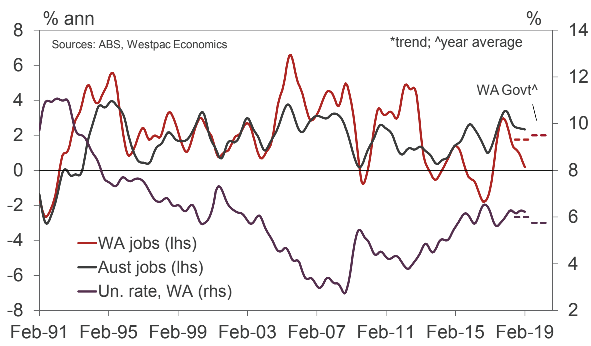


Chart 2.

WA households: incomes improve, spending slows

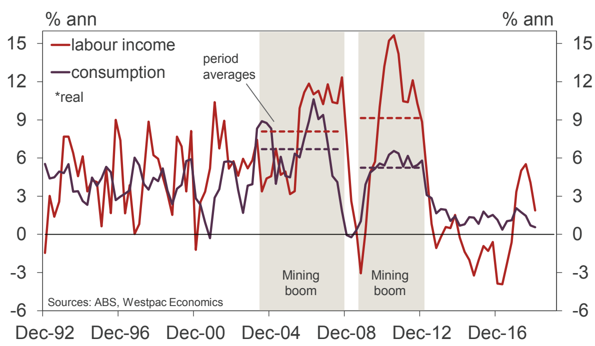


Chart 3.

House prices: Perth declines re-accelerate

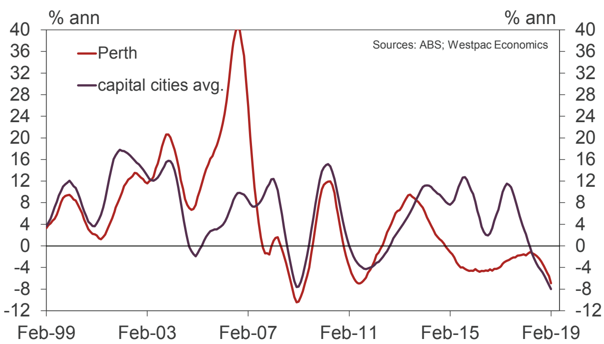


Chart 4.

New home building: further falls coming through

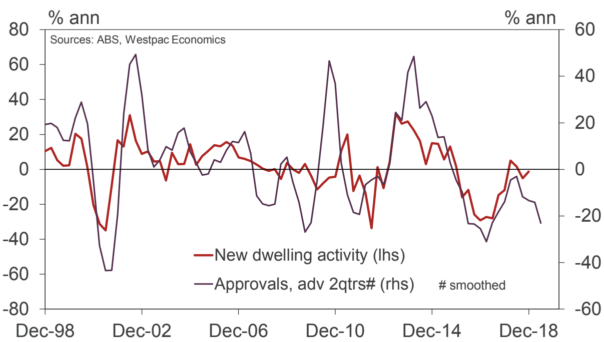


Chart 5.

Government demand & wage spend

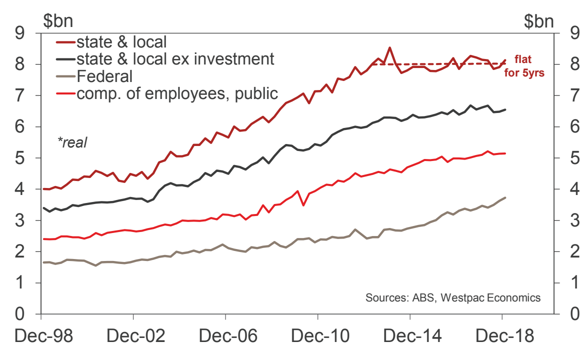
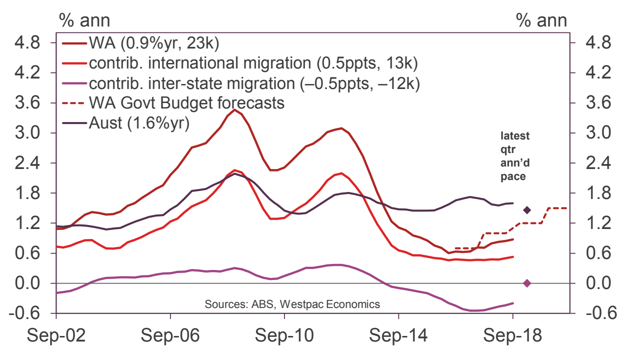


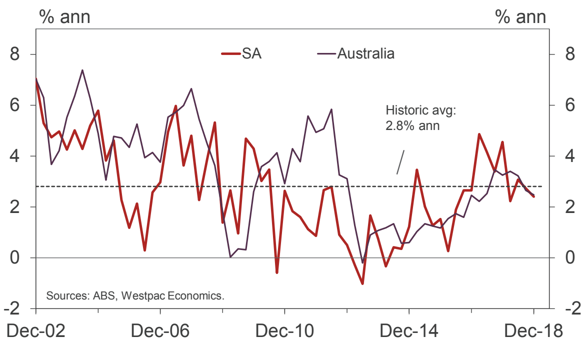
Chart 6.

WA's population growth



South Australia: investment uptrend is ...

State final demand growth around average

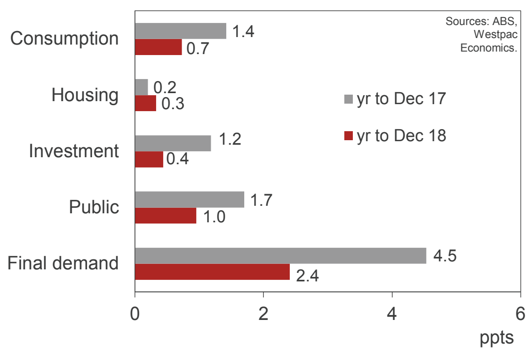


South Australia state demand rose 0.8% in the December quarter 2018, following a gain of just 0.2% in September. The update wrapped up a choppy calendar year, with through the year state demand growth tracking at a moderate 2.4%. That result is broadly in line with the national average of 2.5%.

Yet, in per capita terms, SA annual demand growth outpaced the national average, 1.7% to 0.9%. In one sense that underscores a better productivity outcome, but it is also reflective of SA's relatively slow population growth.

An associated consequence of the latter is a more fragile consumption profile. As SA employment growth stalled through the second half of 2018, the drag on incomes saw annual household consumption growth slow to 1.3%, against the national average of 2.0%. For now, this is being offset by other spending, namely investment, with a number of projects still in the pipeline.

SA contributions to state final demand

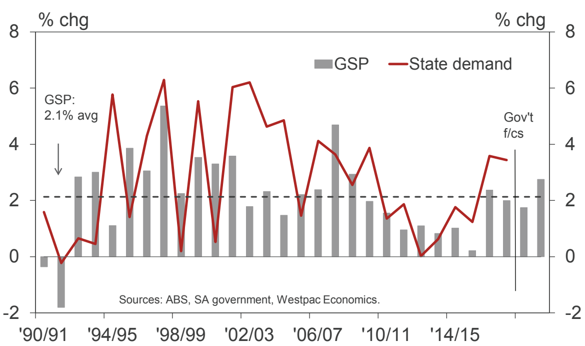


Public investment grew 8.3% in annual terms in Q4, but note that a number of projects recently reached completion, skewing the number higher. Ahead, the $1.8bn new Women's and Children's hospital is a major planned development - expected to be completed in 2024.

Private business investment has also been robust. Though down 1.5% in Q4, annual growth is 4.0%. Equipment investment is on a moderate trend and the level of engineering construction work is particularly elevated. Electricity generation has expanded with SA a net exporter of surplus electricity for the first time in the past ten years. In 2019, work is scheduled to be completed for the $450mn Lincoln Gap Wind Farm and the $400mn Bungala Solar project. Further down the pipeline are the $1.5bn Ceres Wind Project and the $1.0bn Riverland Solar project.

The housing investment picture is mixed. New dwelling construction is up 2.2% annually but the approvals pipeline is not encouraging. However, renovation activity has been strong of late, +14.8% in yearly terms.

SA economic performance & outlook



Regarding housing prices, Adelaide has started to follow the Sydney and Melbourne downturn. Based on CoreLogic data, house prices are now slightly down from where they were six months ago.

Weakness here also coincides with a softening in SA's labour market. Since mid-2018, employment has flat-lined and the trend unemployment rate has drifted higher, rising from 5.6% to 5.9%. With wage inflation still subdued at 2.3%, annual average 2018 nominal labour income growth was just 2.0% - a shift lower from 2017's 3.8% pace.

As SA's population growth is only 0.8%yr, household income growth is more reliant on wage gains. But with the unemployment rate now moving in the wrong direction, the lack of capacity pressure in the labour market is not conducive with a wages uplift. As such, maintaining solid spending growth in other parts of the economy is integral to get the unemployment rate down, wages up and the consumer moving again.

… offsetting fragile consumption growth

Chart 1.

South Australia: choppy demand profile

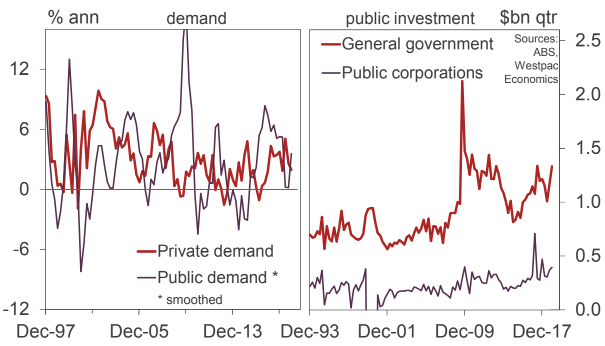


Chart 2.

A moderate uptrend in business investment

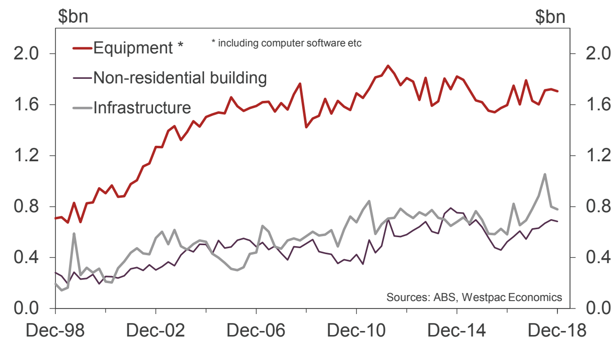


Chart 3.

Adelaide house price growth turns flat

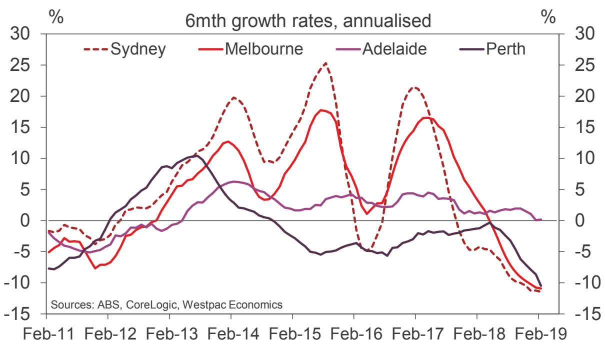


Chart 4.

Dwelling approvals: SA vs Australia

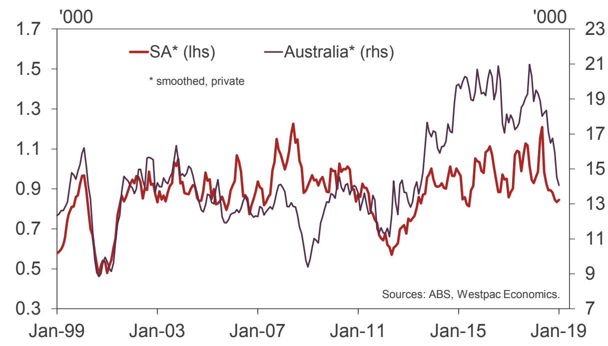


Chart 5.

SA jobs growth has cooled

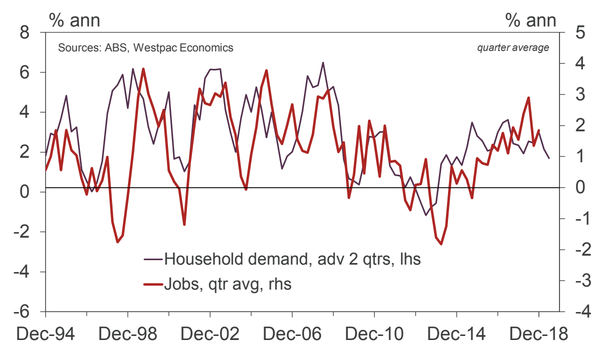
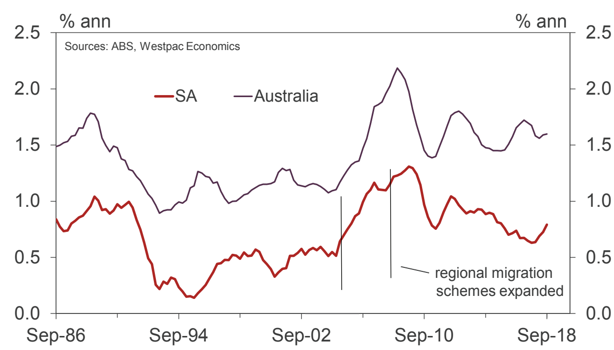


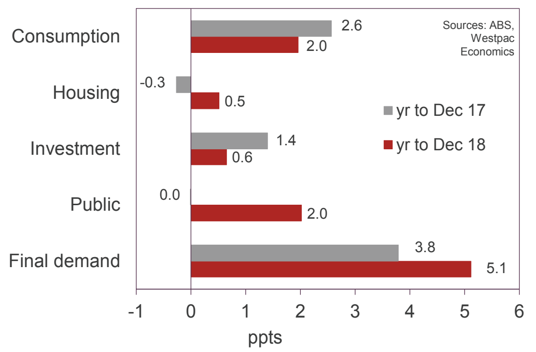
Chart 6.

Weak population growth a lasting concern



Tasmania: 2018, a stellar year ...

Tasmania: contributions to state demand

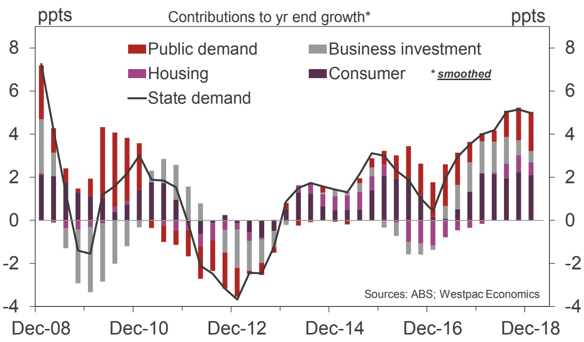


The 2018 year was a stellar one for the Tasmanian economy. The state was a hive of activity, with state final demand increasing by a break-neck 5.1% - only edged out by Victoria (at 5.2%). On a per capita basis, it's no contest, with Tasmania at 4.0% and daylight second. The current growth pace is the strongest since 2008, ahead of the GFC impact.

The strength in activity was broadly based across sectors, led by home building and government spending. This was supportive of rising business investment (+7.3%yr following a 17.8% rise in 2017) and brisk consumer spending (+3.3%yr, or +2.2%yr per capita).

The housing sector has enjoyed a strong upswing. State population growth has accelerated to 1.2%, in line with historic highs and double the long-run average. Vacancy rates are relatively tight in the Hobart market. Home building activity grew by almost 15% in 2018, directly adding 0.5ppts to activity.

Tasmanian state demand

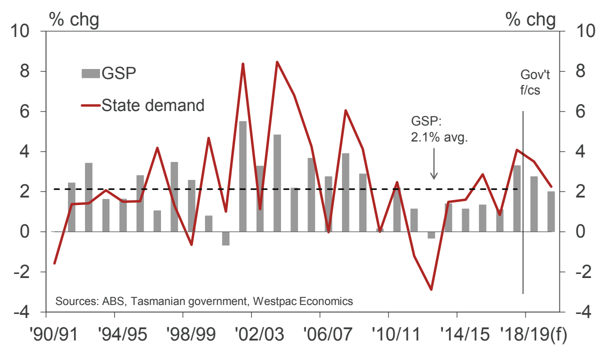


Looking ahead, the housing sector may be less supportive of growth in 2019. New home building activity may have peaked, recording a near 9% fall in Q4 and with approvals consolidating of late. House prices, while still up of late, have been more volatile.

Government spending, in the form of public demand, grew by 7.6% in 2018, directly adding 2ppts to activity. The outlook is for further upside but growth at this pace is unsustainable. Public investment, while volatile, trended higher over the past two years and new projects have been added to the investment pipeline.

The low Australian dollar and strong demand from the Asian region and the mainland has provided a major boost to the Tasmanian economy. Goods export earnings (including seafood, paper and mining) in 2018 rose by 14%, building on a 24% increase in 2017 - fully reversing the sharp trend decline from end 2007 to 2016.

Tasmanian economic performance & outlook



International service export volumes have also performed well, to be 28% higher in the December quarter 2018 than they were two years earlier. Tourist arrivals from the mainland is another area of strength, encouraging additional investment in the tourism sector.

The Tasmanian government understandably upgraded the 2018/19 growth forecasts in the January budget update. Output growth for this year was upgraded by 0.5% to 2.75% and state demand by 0.25% to 3.5%. The expectation that growth will slow but still be above trend in 2018/19 appears to be a reasonable one.

Beyond this year, the growth path is uncertain. Housing is likely to moderate, public demand growth may lose momentum and business investment can be volatile. Exports will likely remain a growth driver, supported by a low Australian dollar. The state budget figures from 2019/20 are projections, assuming output growth is around trend at 2.0% and that state demand expands by 2.25%.

… but growth likely to moderate in 2019

Chart 1.

Tasmania: domestic demand accelerates

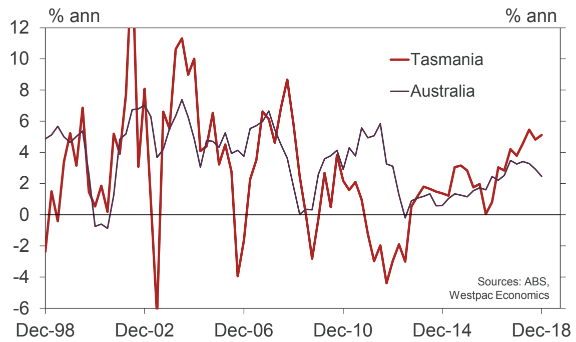


Chart 2.

Tasmania: population growth at historic highs

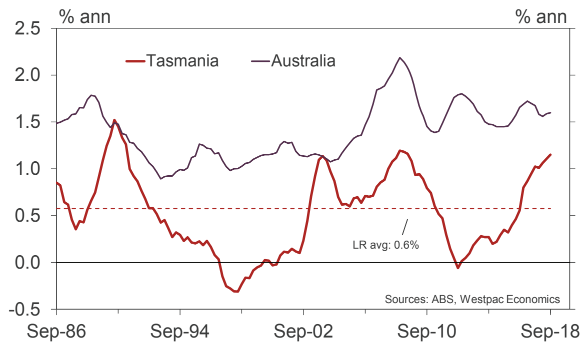


Chart 3.

Hobart house prices: begin to cool

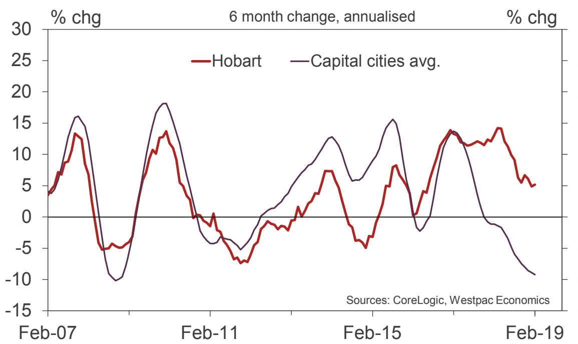


Chart 4.

Private new home building: at a peak?

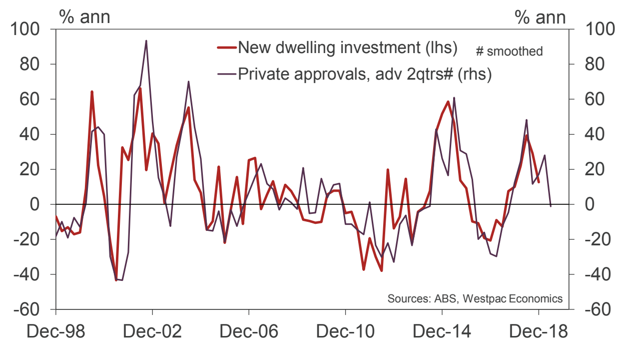


Chart 5.

Tasmania: employment at high levels

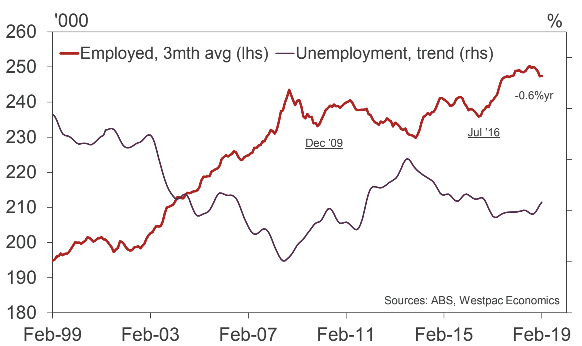
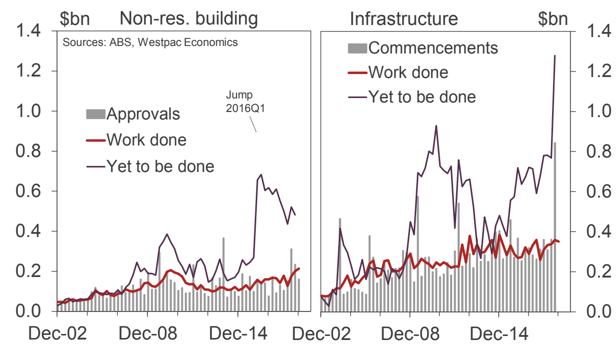


Chart 6.

Non-residential construction: sizeable pipeline



Summary indicators

Chart 1.

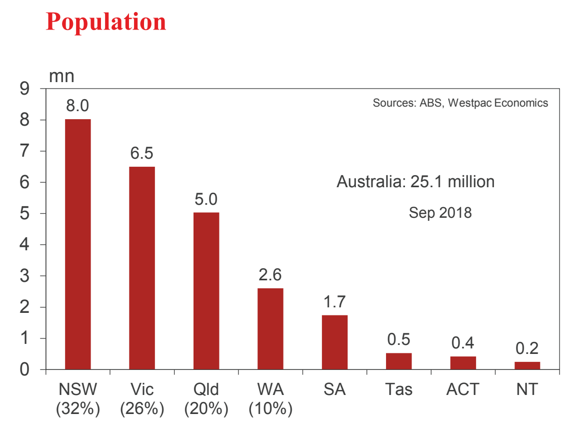


Chart 2.

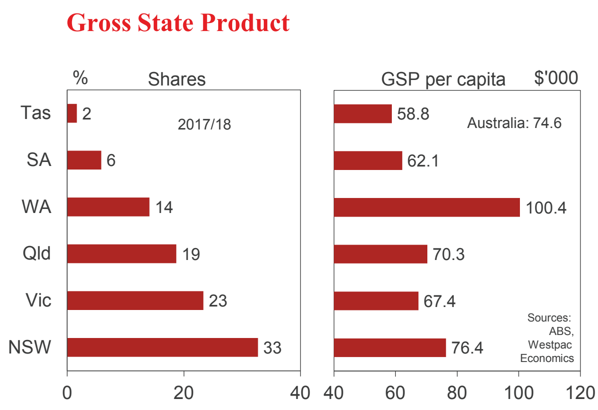


Chart 3.

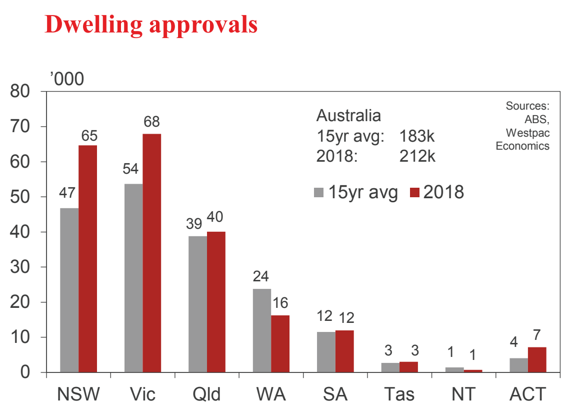
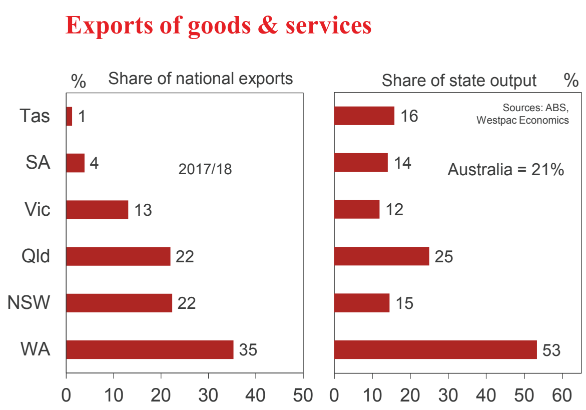


Chart 4.



Industry mix: share of gross value add

	Australia	NSW	Vic	Qld	WA	SA	Tas	NT	ACT
Agriculture	2.7	1.9	2.4	3.3	2.4	5.4	9.5	3.3	0.1
Mining	8.2	3.3	0.8	10.1	31.2	3.9	4.4	14.1	0.1
Manufacturing	6.2	5.9	7.6	6.4	5.2	6.8	6.6	4.3	1.1
Construction	8.3	7.9	8.3	9.2	8.8	7.3	6.3	13.1	6.9
Transport, utilities	7.6	7.5	8.1	8.8	5.9	8.4	7.5	5.8	4.3
Wholesale, retail	8.7	9.0	10.1	8.5	6.5	10.3	8.2	5.6	4.6
Health, social assistance	7.5	6.5	8.2	7.7	5.9	10.2	13.0	7.8	12.4
Education	5.0	4.8	5.5	5.2	3.7	6.1	6.5	5.4	6.1
Household services	5.3	5.5	5.3	5.8	4.0	5.7	5.6	6.2	4.9
Finance	9.4	12.7	11.5	6.6	4.4	8.0	7.9	2.8	3.4
Business services	16.6	20.3	18.4	14.3	10.9	13.1	10.5	7.7	19.2
Public administration	5.5	4.7	4.7	5.6	4.2	5.7	5.3	14.0	28.9
Ownership of dwellings	9.0	10.0	9.1	8.5	6.9	9.2	8.8	10.1	8.1

Sources: ABS, Westpac Economics. For the 2017/18 financial year.

Forecasts: state activity and employment

		2017/18	2018/19f		2019/20f	
		actuals	Govt f/cs	Westpac	Govt f/cs	Westpac
Australia *	GDP	2.8	2.8	2.1	2.7	2.1
	Employment	3.0	2.2	2.1	1.7	0.7
NSW	GSP	2.6	2.50	2.2	2.5	2.1
	Employment	3.1	2.75	3.0	1.5	0.8
Vic	GSP	3.5	3.00	2.8	2.8	2.4
	Employment	2.8	2.50	3.0	2.0	1.0
Qld	GSP	3.4	3.00	2.0	2.8	2.0
	Employment	4.2	1.50	1.0	1.8	0.6
WA	GSP	1.9	3.00	1.5	3.5	2.0
	Employment	2.3	1.75	0.5	2.0	0.6
SA	GSP	2.0	1.75	1.5	2.8	1.8
	Employment	2.2	1.50	0.6	1.0	0.5
Tasmania	GSP	3.3	2.75	2.8	2.0	1.8
	Employment	3.0	0.25	0.2	1.0	0.5

* Government forecasts for Australia are a weighted average of the state government forecasts.
State government forecasts are from the most recent state budget update.
Westpac's state numbers are calculated to be consistent with the national forecasts.

Gross State Product

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
NSW	2.4	2.3	1.9	1.9	2.8	4.0	3.1	2.6
Vic	2.9	2.0	1.1	2.4	3.1	3.5	4.0	3.5
Qld	0.7	5.5	2.8	2.2	1.0	2.5	2.0	3.4
WA	4.4	9.5	5.9	5.8	2.5	1.1	-1.8	1.9
SA	1.6	1.0	1.1	0.8	1.0	0.2	2.4	2.0
Tas	1.9	0.7	-0.2	1.1	1.0	1.7	1.5	3.3
Australia	2.5	3.9	2.6	2.6	2.3	2.8	2.3	2.8

Sources: ABS, Westpac Economics * GSP estimates are only on an annual basis. The 2017/18 update was released in November.

Employment

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
NSW	2.5	0.6	1.7	0.5	1.3	3.8	1.1	3.1
Vic	2.8	1.0	1.2	0.9	2.4	2.7	4.0	2.8
Qld	1.8	1.3	0.2	1.3	0.2	1.7	0.2	4.2
WA	3.4	4.0	2.8	–0.1	1.0	–0.4	–0.9	2.3
SA	1.5	0.5	0.1	–1.3	0.4	0.5	1.4	2.2
Tas	1.3	–1.3	–1.0	–0.4	2.8	–0.2	0.8	3.0
Australia	2.4	1.2	1.2	0.5	1.2	2.3	1.5	3.0

Sources: ABS, Westpac Economics

Notes

Notes

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