

Monthly Bulletin of Economic Trends: Economic Activity in the Major States

October 2018

Released at 11AM on 25 October 2018

Economic Activity in the Major States

- **June-2018 State Accounts:** *Victoria led the pack while activity in Western Australia held steady*
- **NSW and VIC house prices:** *more declines to come?*
- **NSW and VIC dwelling construction activity:** *a soft or a hard landing?*
- **Outlook:** *Weaker activity across the board*

Table 1: Outlook for Australia¹

	Actual				Forecasts				Actual	Forecast
	2017	2017	2018	2018	2018	2018	2019	2019	Financial Year	
	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	2017/18	2018/19
<i>Economic Activity</i>										
GDP	2.7	2.4	3.2	3.4	3.3	3.3	2.9	2.7	2.9	3.0
	(0.7)	(0.7)	(1.1)	(0.9)	(0.6)	(0.7)	(0.7)	(0.7)		
Household Consumption	2.7	3.0	3.2	3.0	3.0	2.4	2.6	2.6	3.0	2.6
	(0.6)	(1.1)	(0.5)	(0.7)	(0.6)	(0.6)	(0.7)	(0.7)		
Private Dwellings	-2.7	-4.8	1.9	3.8	5.0	4.2	0.1	-2.1	-0.5	1.7
	(-1.7)	(0.3)	(3.6)	(1.7)	(-0.6)	(-0.5)	(-0.5)	(-0.5)		
New Business Investment	8.7	6.9	4.5	4.1	2.0	2.7	3.2	4.9	6.0	3.2
	(3.2)	(0.3)	(0.7)	(-0.2)	(1.2)	(1.0)	(1.2)	(1.4)		
Domestic Final Demand	3.6	3.4	3.7	3.4	3.2	2.9	2.7	2.9	3.5	2.9
	(1.0)	(0.9)	(1.0)	(0.6)	(0.7)	(0.7)	(0.7)	(0.7)		
Imports of Goods & Services	8.3	7.3	6.0	6.2	5.3	4.9	4.6	5.6	6.9	5.1
	(2.3)	(1.7)	(1.7)	(0.4)	(1.4)	(1.3)	(1.4)	(1.4)		
Exports of Goods & Services	5.1	0.2	4.9	3.7	4.1	7.0	5.2	5.4	3.4	5.4
	(1.0)	(-1.5)	(3.0)	(1.1)	(1.4)	(1.3)	(1.3)	(1.3)		
<i>Inflation & Financial Market</i>										
Underlying inflation ²	1.8	1.8	1.9	1.9	2.0	2.1	2.1	2.2	1.9	2.1
	(0.4)	(0.4)	(0.6)	(0.5)	(0.5)	(0.5)	(0.5)	(0.6)		
Headline Inflation	1.8	1.9	1.9	2.1	1.9	1.8	1.9	2.1	1.9	1.9
	(0.6)	(0.6)	(0.4)	(0.4)	(0.5)	(0.5)	(0.5)	(0.6)		
90-day Bill Rate ³	1.7	1.7	1.8	2.0	2.0	2.0	2.1	2.1		
Trade Weighted Index ⁴	66.5	64.7	64.2	62.5	62.6	61.8	61.8	61.8		
\$A/\$US rate (100) ⁴	0.79	0.77	0.77	0.77	0.7	0.72	0.72	0.72		
<i>Labour Market</i>										
Unemployment Rate ⁴	5.5	5.5	5.5	5.4	5.3	5.3	5.2	5.2	5.5	5.3
Employment Growth Rate ⁵	2.8	3.3	3.4	2.7	2.5	2.1	1.9	1.9	3.0	2.1
	(0.8)	(0.8)	(0.7)	(0.4)	(0.6)	(0.4)	(0.5)	(0.4)		
Participation Rate ⁴	65.3	65.5	65.7	65.6	65.7	65.6	65.5	65.4	65.5	65.6
Wage Price Index	2.0	2.1	2.0	2.1	2.2	2.3	2.3	2.3	2.1	2.3
	(0.5)	(0.6)	(0.5)	(0.6)	(0.5)	(0.6)	(0.5)	(0.6)		

1: Actual in black and forecasts in blue; values in parentheses are quarterly growth rates. 2: As measured by the Reserve Bank's trimmed mean measure of inflation. 3: Average over last month in quarter. 4: Average of 3-months in the quarter. 5: Calculated from quarterly employment numbers that are averaged over the 3 months in the quarter.

Prepared by G. Lim and V. Nguyen, Macroeconomics@MI. Data in this report were finalized on 19/10/2018.

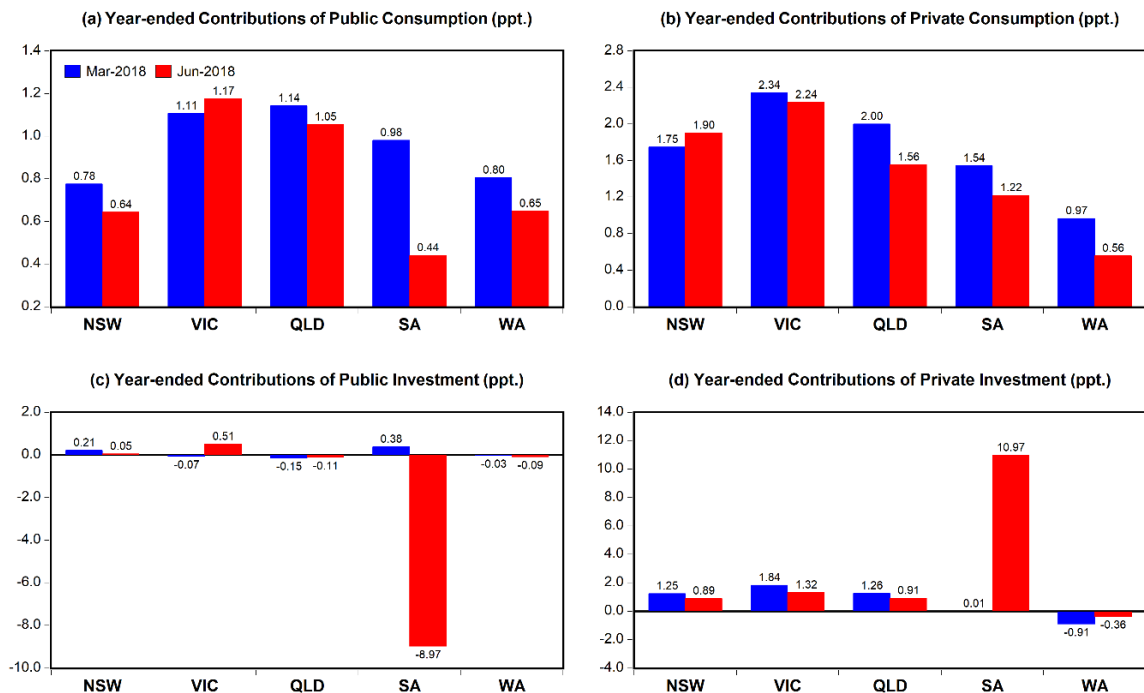
Table 2: Actuals and Forecasts for Major States

	Actual				Forecasts				Calendar Year	
	Sep 2017	Dec 2017	Mar 2018	Jun 2018	Sep 2018	Dec 2018	Mar 2019	Jun 2019	Actual 2017	Forecast 2018
NEW SOUTH WALES										
<i>State Final Demand</i>	2.8 (0.8)	3.1 (1.3)	4.0 (1.0)	3.5 (0.3)	3.1 (0.5)	2.9 (1.1)	2.7 (0.8)	2.5 (-2.3)	2.8	3.4
<i>Consumption</i>	2.8 (0.6)	2.8 (1.1)	2.9 (0.6)	3.2 (0.8)	3.1 (0.5)	2.9 (0.9)	2.7 (0.5)	2.8 (-1.9)	2.6	3.0
<i>Employment</i>	1.9 (0.9)	3.1 (1.1)	3.8 (0.6)	3.7 (1.1)	3.4 (0.6)	3.0 (0.7)	2.8 (0.4)	2.5 (-1.6)	1.6	3.5
<i>Unemployment</i>	4.8	4.7	5.0	4.8	4.6	4.7	4.9	4.9	4.8	4.8
VICTORIA										
<i>State Final Demand</i>	5.2 (1.1)	4.2 (0.4)	5.2 (2.5)	5.2 (1.2)	4.5 (0.4)	4.3 (0.1)	4.1 (2.3)	3.9 (1.0)	4.6	4.8
<i>Consumption</i>	3.6 (0.8)	4.1 (1.3)	4.0 (0.7)	3.8 (0.9)	3.6 (0.6)	3.5 (1.2)	3.2 (0.5)	3.1 (0.8)	3.6	3.7
<i>Employment</i>	3.3 (0.5)	2.9 (0.6)	2.7 (0.4)	2.0 (0.5)	2.6 (1.2)	2.7 (0.7)	2.5 (0.2)	2.3 (0.2)	3.5	2.5
<i>Unemployment</i>	6.1	5.8	5.5	5.3	4.7	4.8	4.8	4.9	6.0	5.1
QUEENSLAND										
<i>State Final Demand</i>	3.5 (0.8)	3.5 (1.4)	4.2 (1.0)	3.4 (0.1)	3.0 (0.4)	2.7 (1.1)	2.5 (0.8)	2.7 (0.3)	3.3	3.3
<i>Consumption</i>	2.7 (0.6)	2.6 (1.1)	3.6 (0.8)	2.8 (0.3)	2.5 (0.4)	2.6 (1.2)	2.7 (0.9)	3.0 (0.5)	2.5	2.9
<i>Employment</i>	3.9 (1.7)	4.8 (0.8)	4.9 (0.7)	3.1 (-0.1)	1.8 (0.5)	1.6 (0.5)	1.5 (0.6)	1.6 (-0.0)	2.5	2.9
<i>Unemployment</i>	5.9	5.9	6.1	6.2	6.1	6.4	6.3	6.3	6.1	6.2
SOUTH AUSTRALIA										
<i>State Final Demand</i>	3.9 (0.5)	5.3 (1.4)	2.9 (0.4)	3.7 (1.3)	3.4 (0.3)	3.0 (1.0)	3.0 (0.4)	2.9 (1.2)	4.5	3.2
<i>Consumption</i>	2.0 (0.2)	2.8 (1.2)	2.7 (0.3)	2.1 (0.4)	2.1 (0.2)	2.3 (1.4)	2.5 (0.4)	2.5 (0.5)	2.6	2.3
<i>Employment</i>	1.9 (1.0)	1.5 (0.1)	2.3 (1.3)	2.8 (0.4)	1.2 (-0.6)	1.3 (0.1)	1.2 (1.3)	1.2 (0.3)	1.5	1.9
<i>Unemployment</i>	5.9	6.0	5.9	5.6	5.6	5.7	5.7	5.4	6.3	5.7
WESTERN AUSTRALIA										
<i>State Final Demand</i>	2.0 (1.2)	1.7 (0.6)	0.8 (-1.2)	0.8 (0.2)	0.6 (1.1)	0.7 (0.7)	0.9 (-1.0)	1.0 (0.3)	-1.5	0.7
<i>Consumption</i>	1.2 (0.5)	2.1 (0.5)	1.8 (0.0)	1.0 (0.1)	1.1 (0.5)	1.3 (0.7)	1.6 (0.3)	1.9 (0.3)	1.2	1.3
<i>Employment</i>	2.5 (0.6)	2.9 (0.4)	2.1 (-0.0)	1.6 (0.6)	1.2 (0.2)	1.0 (0.2)	1.2 (0.2)	1.4 (0.8)	1.3	1.5
<i>Unemployment</i>	5.6	6.1	6.2	6.3	6.1	6.4	6.4	6.4	5.9	6.3

Victoria led the pack while activity in Western Australia held steady

- The latest Australian Bureau of Statistics' National Accounts showed that State Final Demands (SFDs) grew in all five major states in the June quarter of 2018. VIC and SA recorded strong quarterly gains of 1.2% and 1.3%, respectively. Meanwhile, NSW, QLD and WA recorded much weaker growth of 0.3%, 0.1% and 0.2%, respectively. The strong growth in VIC this quarter was partly attributable to a strong increase in public investment while the strong quarterly growth in SA was driven by a strong increase in private investment.
- In year-ended terms, the economies of the major states recorded positive growth for the fourth consecutive quarter. VIC again led the growth pack with a robust SFD growth rate of 5.2%, followed by SA (3.7%), NSW (3.5%) and QLD (3.4%). The year-ended growth in WA SFD was steady at 0.8% in this quarter after slowing from 2.0% September 2017 to 0.8% in March 2018.
- Contributions to year-ended SFD growth (Figure 1) show that the strong SFD growth in VIC in the June quarter was attributable to solid growths in all of its major components. Specifically, VIC private consumption and investment together added 3.6 ppts to VIC year-ended SFD growth. Meanwhile, VIC public consumption and investment (recording year-ended growth rates of 6.9% and 11.1% - highest across the states) together added 1.7 ppts to VIC year-ended SFD growth.
- The declining trend in the year-ended SFD growth in WA appears to have eased this quarter, largely due to the declining negative influence from WA private investment (subtracting just 0.4 ppts from to WA year-ended SFD growth, as compared to 4.5 ppts in June 2017 and 10.1 ppts in June 2016). With the positive effects of the latest public infrastructure spend likely to kick in the September and December quarters, other things equal, growth in the WA economy is likely to improve gradually towards the end of 2018 and early 2019.

Figure 1: Contributions to year-ended growth in SFDs (percentage points)

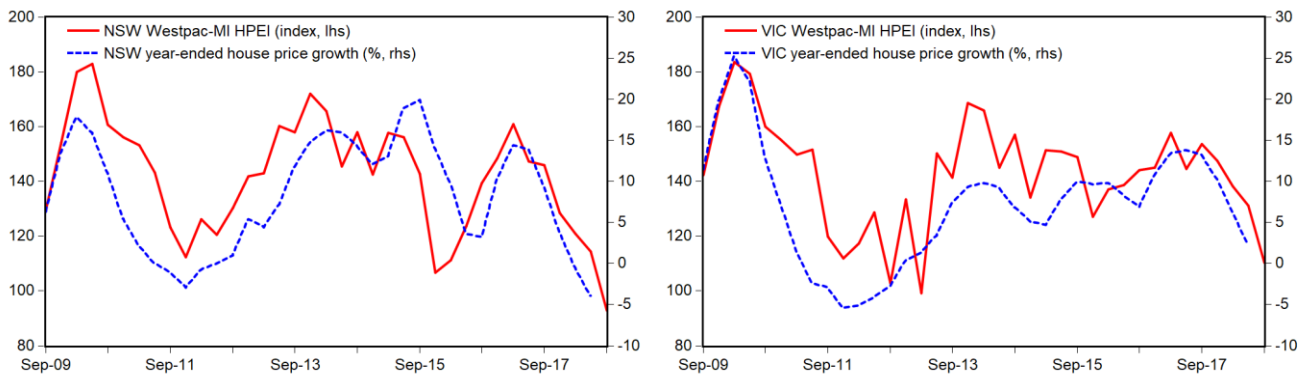


Source: Australian Bureau of Statistics (ABS).

NSW and VIC house prices: more declines to come?

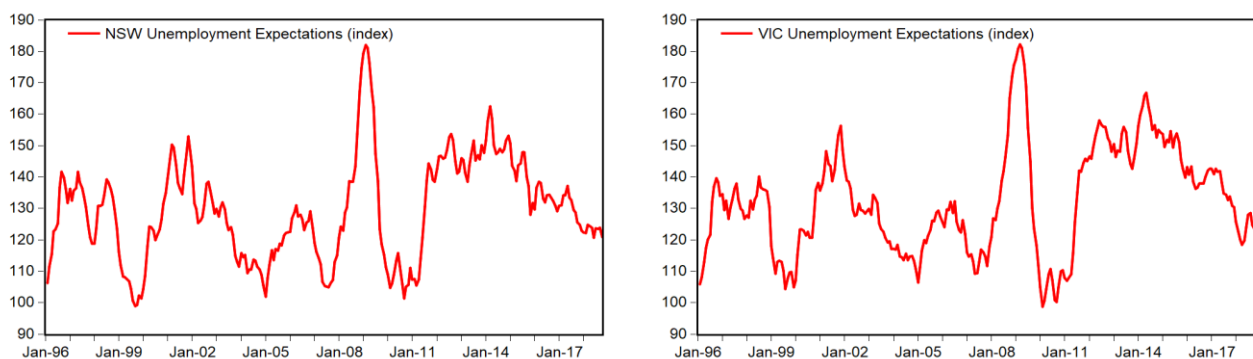
- The June-quarter Australian Bureau of Statistics' residential property price indexes showed that Sydney residential property price has declined for four consecutive quarters since September 2017, amounting to a fall of 3.9% over the period. Though a bit behind, Melbourne residential property price has also fallen for two consecutive quarters, by 0.6% in March and 0.8% in June.
- The declines in the house prices of these two major capital cities, to a large extent, have been foreshadowed by recent movements in the Westpac-Melbourne Institute House Price Expectations Indexes for NSW and VIC (they capture housing market sentiments, see Figure 2). The leading information from these Indexes indicate that house prices in Sydney and Melbourne are likely to decline further in the coming quarters.
- Given current low real wage growth, relatively high household debt levels, and tighter lending standards for home loans (especially, for investment properties), further declines are to be expected. Probably, the more important questions are "for how long?" and "by how much?"
- It appears that the weakening housing market sentiment in NSW and VIC is not a sign of an overall collapse in consumer confidence. The recent Westpac-Melbourne Institute Consumer Sentiment Survey indicates that, despite ongoing weaknesses in current family finances, consumers are still positive about future family finances, short-term economic conditions and future employment prospects. Figure 3 shows that NSW and VIC consumers are rather optimistic about future employment – in fact, they are at their most optimistic levels since 2011.
- To gauge 'how long' and 'by how much?' house prices will move, we turn to a quick review of the fundamentals - housing demand and supply.

Figure 2: NSW & VIC House Price Expectations



Source: Australian Bureau of Statistics (ABS) and Melbourne Institute (MI)

Figure 3: NSW & VIC Unemployment Expectations

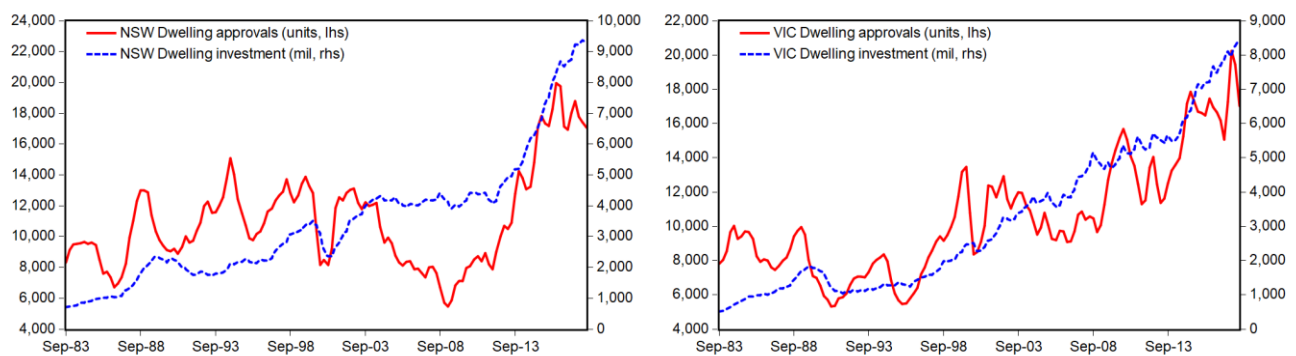


Source: Melbourne Institute

NSW and VIC housing construction activity: a soft or a hard landing?

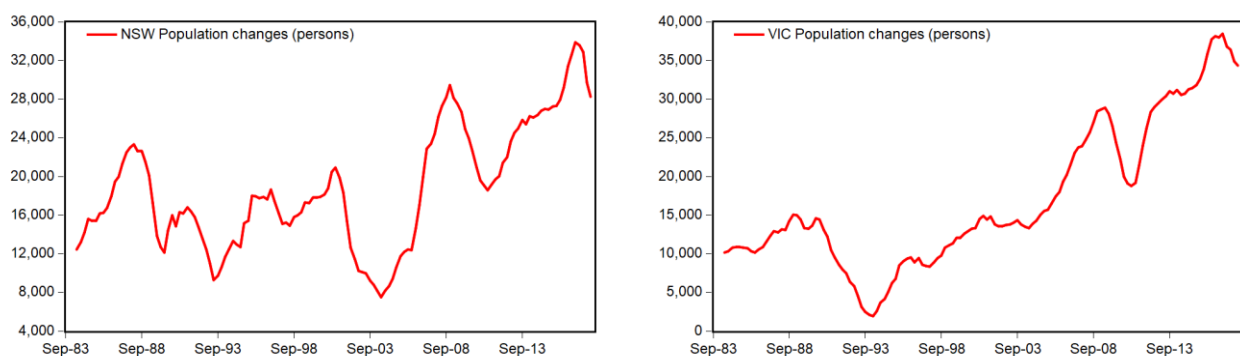
- Strong economic activity in housing construction sector has been key to strong economic activity in NSW and VIC over the past 5 years. While attracting investment and creating jobs, strong activity in housing construction has also been beneficial for economic activity in other sectors such as financial, real estate and insurance services as well as public sector revenue.
- Amid the declining house prices in Sydney and Melbourne, will housing construction activity follow suit? Figure 4 charts dwelling approvals and dwelling investment in NSW and VIC. It shows that they both have been at historic highs and appear to have reached their peaks.
- Investor activity, to some extent, may have contributed to the unprecedented level of housing investment and construction in NSW and VIC. However, the fundamental driver has been robust population growth in both states, spearheaded by overseas migration (nearly half of which are skilled migrants) over the last 10 years. Over this period, NSW population has added an average of 25,000 persons per quarter and VIC an average of 30,000 persons, or around a million each over 10 years (Figure 5). This strong population increase has underpinned strong demand for housing and hence strong housing activity and investment.
- The information from dwelling approvals indicates that housing investment and housing construction activity in NSW and VIC is likely to level off gradually over the next year or two. Beyond that, trends in population growth will have important implications, especially whether it will be a soft or a hard landing, for housing construction activity in both NSW and VIC.
- The key issues for policy-makers in NSW and VIC are to identify the next sources of growth should housing construction activity go south and to prepare for the next slowdown in population growth. Infrastructure spend and well-thought out urban planning are likely to be sound long-term investment.

Figure 4: NSW & VIC Housing Market Activity



Source: Australian Bureau of Statistics

Figure 5: NSW & VIC Population Increase



Source: Australian Bureau of Statistics

State Leading Indexes of Activity: Weaker activity across the board

- The latest Melbourne-Institute State Leading Indexes indicate that economic activity in NSW, VIC and SA is likely to be just below trend growth in late 2018 and early 2019. The contributions of components to growth in the Indexes in Table 3 suggest that weaker activity in NSW, VIC and SA mainly results from weaker household financial conditions and more moderate housing market activity. Specifically, in October, dwelling approvals and housing finance commitment subtracted 0.57 ppts from NSW growth, 0.59 ppts from VIC growth and 0.37 ppts from SA growth. In addition, weak consumer spending was the other major detractor from SA activity as retail trade subtracted 0.24 ppts from SA growth.
- Information from the Melbourne-Institute State Leading Indexes Activity suggests that activity in QLD and WA is likely to remain well below trend in the first half of 2019. As the result of weak economic activity, labour market conditions and household financial condition in these two major states have been sluggish, which have further weakened consumer spending. The decline in retail trades was the largest detractor from QLD and WA growth in October (subtracting 0.52 ppts and 0.62 ppts, respectively). While the recent depreciation of the AUD has benefited QLD and WA, downside risks are nonnegligible for QLD and WA.

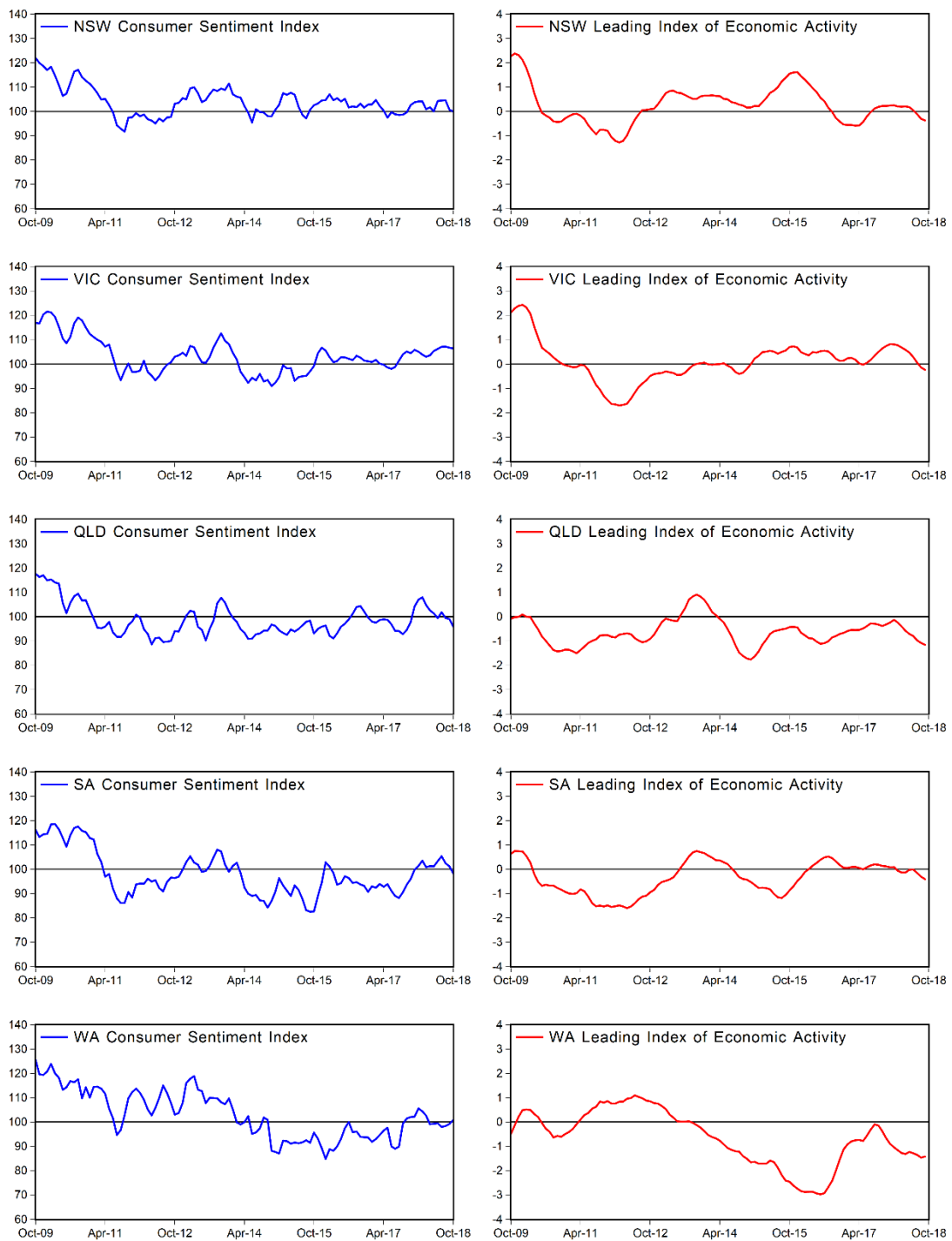
Table 3: Contributions of to Year-ended Growth in State Leading Indexes

	Sep-18	NSW	VIC	QLD	SA	WA
Monthly level		100.24	101.92	97.64	101.61	95.35
Monthly growth		-0.15	0.10	-0.07	0.00	0.07
Year-ended growth		-0.51	-0.27	-1.18	-0.45	-1.38
Westpac-MI CSI expectations index		-0.02	0.01	-0.01	0.03	0.01
Westpac-MI UE index		0.03	0.04	-0.03	0.14	0.04
Aggregate monthly hours worked		0.33	0.35	-0.34	0.05	-0.17
Retail trade		-0.09	0.04	-0.52	-0.24	-0.62
Dwelling approvals		-0.28	-0.34	-0.04	-0.11	-0.13
Housing finance commitment		-0.29	-0.25	-0.24	-0.13	-0.49
Westpac-MI current family finances index		-0.01	0.05	0.03	0.03	0.01
AUD/USD		-0.12	-0.12	0.15	-0.14	0.13
Yield spread		-0.06	-0.06	-0.12	-0.07	-0.11
RBA commodity prices AUD				-0.06		-0.05

Forecasts for Key Macroeconomic Variables in Major States

- We forecast year-ended growth in SFD to be strongest in NSW and VIC in the coming quarters, around 3% for NSW and just above 4% for VIC. Year-ended growth in QLD SFD is likely to be around 2.5% at the beginning of 2019 while year-ended growth in SA SFD is forecast to stabilise around 3% over the next four quarters. As for WA, we forecast its SFD's year-ended growth to gradually improve towards 1% over the next several quarters, due in part to substantial infrastructure spend.
- Labour market conditions are likely to be more moderate across major states with varying rates of employment growth, reflecting the varying conditions of the state economies. We forecast year-ended employment growth to be strongest in NSW and SA (just under 3%) over the next four quarters, followed by VIC (around 2.5%). Meanwhile, year-ended employment growth is likely to be weaker in QLD and WA (just above 1%) over the same period.

Figure 6: Consumer Sentiment Indexes and State Leading Index



Note: The figure plots the 3-month centered moving averages of the Westpac-Melbourne Institute Consumer Sentiment Indexes and the 3-month centered moving averages of the year-end deviation-from-trend growth of the Leading Indexes for NSW, VIC, QLD, SA and WA. Source: Melbourne Institute. The State Leading Indexes combine the latest information from consumer expectations on future activity and unemployment, current family finance, aggregate monthly hours work, retail trade, dwelling approvals, housing finance commitments, AUD/USD exchange rate, the yield spread and RBA's \$A commodity price index (for QLD and WA only).

Table 4: Precision of year-ended Forecasts for Australia and Major States

	Precision of (year-end) Forecasts				Financial Year 2018/19
	2018	2018	2019	2019	
	Sep	Dec	Mar	Jun	
Australia					
<i>Economic Activity</i>					
GDP	0.6	0.9	1.1	1.2	
Consumption	0.5	0.8	1.0	1.1	
Dwelling	2.3	2.4	2.5	2.8	
Business Investment	5.2	6.0	6.7	7.5	
Import	2.5	4.2	5.8	6.6	
Export	2.6	3.4	4.0	4.4	
<i>Inflation & Financial Market</i>					
Underlying Inflation	0.1	0.2	0.3	0.4	
Headline Inflation	0.3	0.4	0.5	0.7	
90 day bill		0.3	0.5	0.7	
Trade Weighted Index		3.3	3.7	3.9	
<i>Labour Market</i>					
Unemployment Rate		0.1	0.2	0.3	
Employment		0.2	0.4	0.5	
Participation Rate		0.2	0.3	0.4	
Wage Price Index	0.4	0.5	0.6	0.7	

	Precision of year-ended Forecasts				
	Sep-2018	Dec-2018	Mar-2019	Jun-2019	2018
NEW SOUTH WALES					
State Final Demand	1.2	1.4	1.5	1.6	1.3
Consumption	0.8	1.0	1.0	1.1	0.9
Employment		0.6	0.9	1.0	0.8
Unemployment		0.3	0.4	0.4	0.4
VICTORIA					
State Final Demand	1.3	1.5	1.6	1.6	1.4
Consumption	1.0	1.2	1.2	1.3	1.1
Employment		0.6	0.9	1.0	0.8
Unemployment		0.3	0.4	0.5	0.4
QUEENSLAND					
State Final Demand	2.1	2.5	2.8	2.9	2.3
Consumption	1.0	1.5	1.8	1.8	1.3
Employment		0.8	1.1	1.3	1.0
Unemployment		0.4	0.5	0.5	0.5
SOUTH AUSTRALIA					
State Final Demand	1.7	1.9	1.9	1.9	1.8
Consumption	0.9	1.1	1.3	1.3	1.0
Employment		0.8	1.0	1.1	1.0
Unemployment		0.4	0.5	0.6	0.5
WESTERN AUSTRALIA					
State Final Demand	3.4	3.8	4.0	4.0	3.6
Consumption	1.2	1.6	1.7	1.8	1.4
Employment		0.8	1.1	1.2	1.1
Unemployment		0.4	0.5	0.6	0.5

For more information about the Melbourne Institute,
see: <http://melbourneinstitute.unimelb.edu.au/>

For more information about Macro@MI and other Reports
see: <http://melbourneinstitute.unimelb.edu.au/research-programs/macroeconomics>

