



## NSW – Economic Overview

- Recent economic growth measures have NSW performing relatively well compared to the other States.
- Comparatively weak residential construction activity over the past five years is a negative, and it may not change.
- Jobs and non-residential construction activity have been robust.
- State government financial outcomes have been relatively sound, debt is under control and the AAA rating is stable.
- Growth should moderate in the coming year as households react to expected higher interest rates.

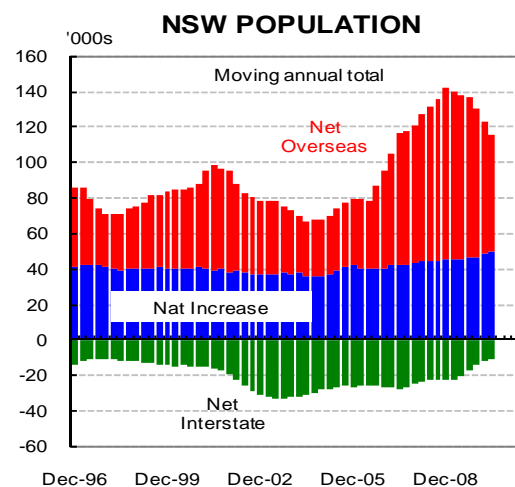
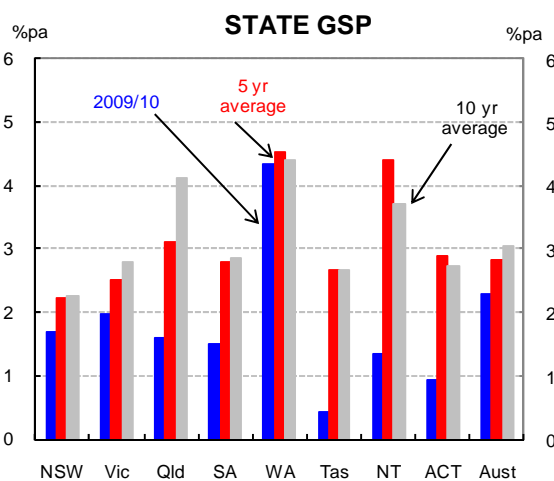
### Summary

This note concentrates on economic issues. The recent data on jobs and spending has NSW performing relatively well. In our view it is likely to resume its longer term growth rate of Gross State Product (GSP) of 2¼%pa over the next few years.

The economic positives for NSW flow from its size – it represents just under one third of the nation's GDP and population – its strong export outcomes and its status as a financial and professional services centre. These factors are not likely to change in the medium term. They can and should be exploited further.

In terms of NSW's economic outlook there needs to be a focus on areas where its economic performance must be significantly better. One of them, in our view, is new residential construction. Strong population growth, mainly through higher immigration, has not been matched by sufficient new residential construction through the metropolitan and regional areas. The result is relatively highly priced housing and strong growth in residential rents. NSW households end up spending proportionately more on housing services. It means less for consumption, investment and saving. Another negative is the underperformance in transport planning and delivery. It is becoming an issue for the companies that want to invest, expand and provide the new jobs.

The financial position of the NSW Government was updated in the mid year review and is given in Table 2. The public sector is forecast to run small operating surpluses over the next few years. The revenue position, and outlook, has been greatly assisted by comparatively strong jobs growth lifting payroll tax and a healthy turnover in the housing market adding to stamp duties. NSW has a small net debt position of around \$12bn or just under 3% of Gross State Product. The international ratings agencies have NSW classified as AAA and stable, the highest rating. Fortunately NSW, like the other States and Territories, avoided the recessions that gripped other developed nations and caused significant increases in public sector debt levels.



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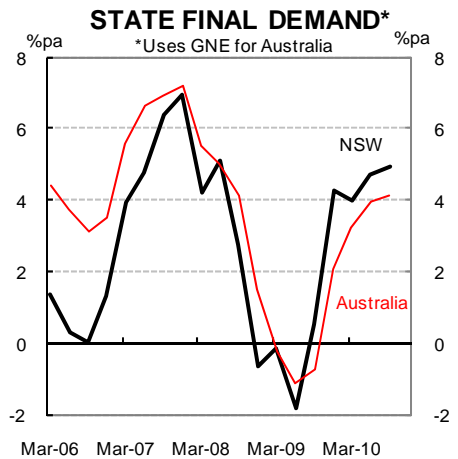
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**Growth and construction**

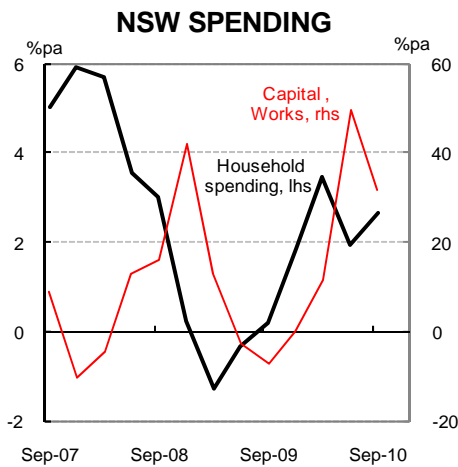
NSW grew by 4.9% in year to September.

The main quarterly measure of State growth, real State Final Demand (SFD) has NSW expanding by a strong 4.9% over the year to September. That's well above its average for the past five years of 2.7%. The SFD data corresponds to the national Gross National Expenditure series. GNE for Australia has averaged 3.7% over the past five years. So, NSW tends to average weaker spending growth than the national figure. The "miners", Queensland, Western Australia and the Northern Territory, have much higher growth than NSW and Victoria, and lift the national outcomes.



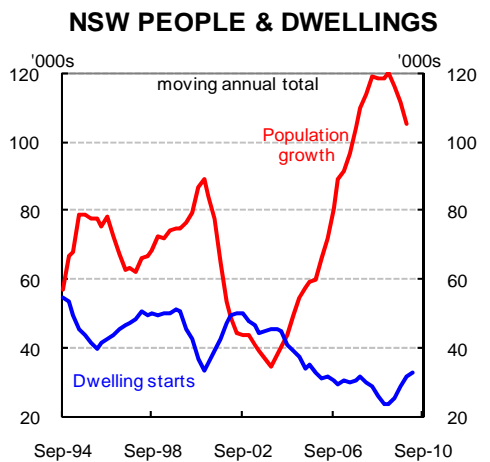
NSW recovered more quickly.

NSW has recovered a shade more quickly than the national economy since the North American Financial Crisis (NAFC). It appears to be related to much lower mortgage rates for households which released more funds to be spent elsewhere. Direct Government handouts to households also lifted their spending. NSW non-residential construction rose strongly over 2009 and 2010, driven mainly by federally funded construction of school and health buildings.



Residential construction weaker.

Residential construction in NSW was relatively weak for a prolonged period following the 2000 Olympics. Since 2003 stronger population growth has accentuated the undersupply of new dwellings nationally and particularly in NSW. Residential rents have been rising by more than five percent per year over that period as demand grew. The recent pick-up in NSW residential construction will peak soon, judging by the approvals data. Forecast higher interest rates will also be a negative for new construction.



Undersupply of dwellings.

It is difficult to see the undersupply of new dwellings in NSW being overcome, especially in the inner-city areas. Local residents, and most local councils, make it difficult to bring on new medium density apartments. The result is likely to be above-inflation growth in rents. We expect jobs growth to stay relatively firm in the major cities over the next few years. Business surveys indicate that demand for labour should remain an issue for the next few years. Demand for rental dwellings is forecast to remain relatively firm.



**Retail and car sales**

Retail spending volatile over past year.

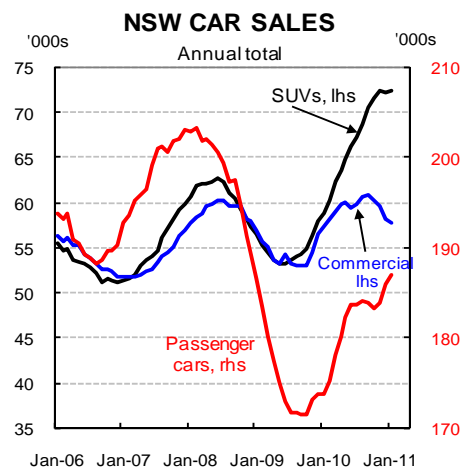
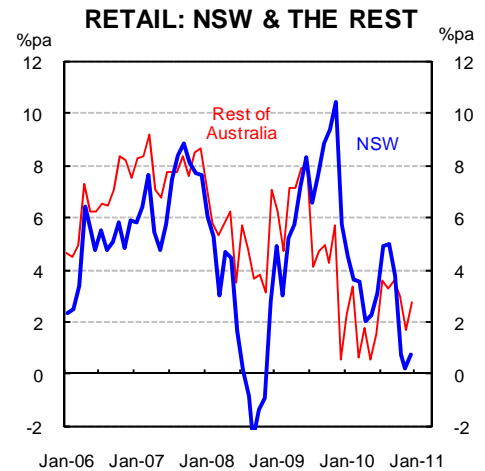
Retail spending in NSW has been more volatile than the national figures through the past year. Annual growth in NSW was significantly higher at the start of 2010. But ended lower. Even though NSW had enjoyed relatively stronger full-time jobs growth than the other States over the period. The non-retail part of NSW and national household spending figures is much stronger than traditional retail activity.

Services spending firm.

But it appears that higher outlays for services, like utilities, health, education, restaurants and mortgages, mean less funds are available for retail. But lower imported goods prices across retail, and other areas, might mean consumers can spend less on retail than previously. At the same time consumers have been saving more. Income and savings growth, on the ABS measures, has been relatively solid over the past year.

Strong AUD lowers imported car prices.

Car sales in NSW demonstrate the uneven pattern of household spending growth over the past year. In contrast to traditional retail, new car sales have been improving. They were helped by the Federal Government's investment allowance which boosted the commercial and SUV segments. Lately, passenger car sales have moved appreciably higher than a year ago. The strong Australian dollar (AUD) has helped to lift car sales. It has reduced imported car, and goods, prices. It could be that consumers are using the savings on imported goods to buy non-retail services.



**Resilient NSW labour markets**

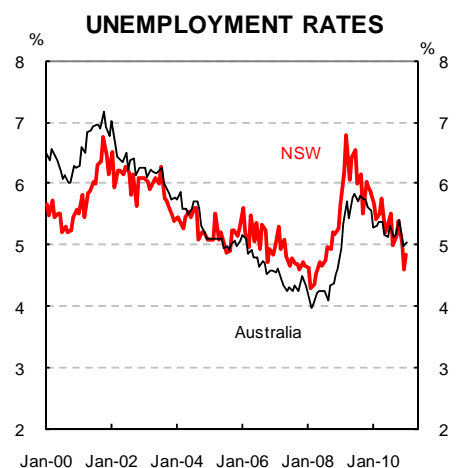
Jobs growth firm.

Underscoring the NSW economy's very solid performance in the wake of the NAFC has been the robust labour market conditions. From a cyclical low point of 4.2% in February 2008, NSW unemployment rose to 6.8% by March 2009 as the GFC impacted. However, by December 2010, NSW's unemployment rate had fallen to 4.6%. Further falls are likely in 2011 and 2012 as the national economy and NSW accelerate further.

Unemployment rate to fall.

So a NSW unemployment rate in the low 4s is probably not too far away. It will boost NSW consumer confidence and spending in the coming year. Over 2010 jobs growth was around 3.7% with 130k new jobs created (with nearly 100k of those jobs being full-time positions). Rebounding equity prices and superannuation balances should also help boost consumer spending later in H11 2011 and 2012.

The post NAFC aggressive stimulatory monetary and fiscal policies helped underpin NSW growth and helped boost business and consumer confidence over 2009 and 2010. In





2011 and 2012, we see NSW final demand accelerating further powered by revived consumer spending, strong dwelling and business investment as well as ongoing solid public infrastructure spending.

**NSW Wages**

Despite strengthening NSW labour market conditions, the latest available data suggest that NSW's broad based wages remained modest and well in check. The QIII wage cost index (WCI) showed NSW total wage costs running at an annual 3.5% rate, a touch shy of the national rate of increase of 3.6%pa This was somewhat below the annual rates of 3.8-3.9%pa in Queensland, Western Australia, the ACT, and Northern Territory. Public sector wages growth is now marginally higher than for the private sector after a period of wider divergence.

**Sydney CPI**

In 2010, the All groups CPI rose in all capital cities. Sydney's CPI rose a relatively modest 2.4% in the year to QIV 2010, compared with the national annual rate of increase of 2.7%pa. The largest positive movement was recorded in Melbourne (+3.1%pa) and Brisbane (+3.0%pa) due to relatively higher increases in housing, alcohol and tobacco and transportation. Canberra (+2.1%pa) recorded the smallest positive movement. The most significant contributor to Sydney's lift in the CPI in QIV was the increase in house purchase prices (+1.1%). Rents also recorded increases in all cities, including Sydney. Falling clothes prices of 3.0% in Sydney in QIV helped offset the solid increases in house purchase prices and rental costs in Sydney – which reflects a significant shortage of dwellings versus demand in the emerald city.

**Population growth**

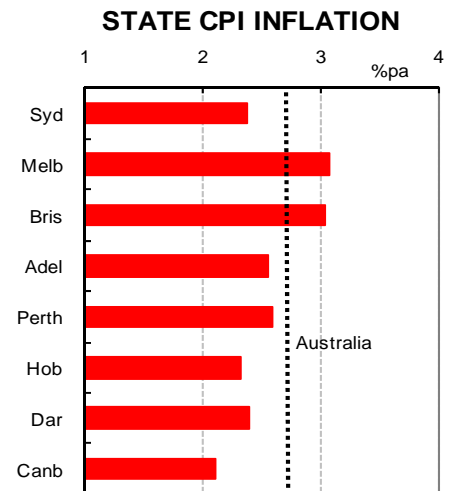
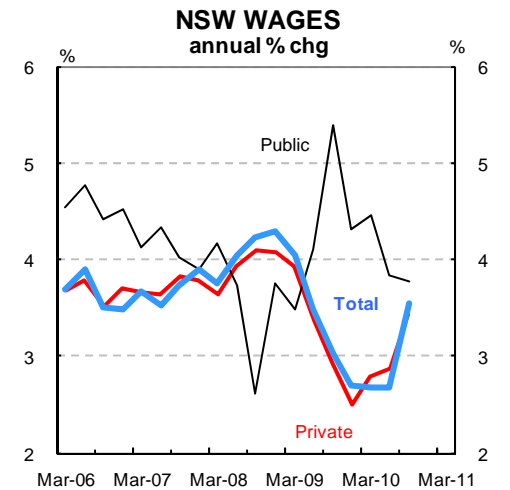
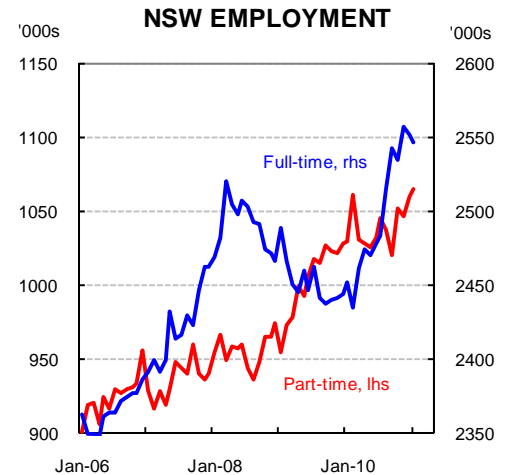
The latest comprehensive ABS population data (released for QII 2010) showed strong, albeit moderating, population growth figures across the states (including NSW) and the nation. NSW's population growth in the year to June 2010 was 1.5%. It also demonstrates one of the reasons why Australia avoided the housing market implosions and meltdowns that are still crippling the housing sectors in the advanced G 7 economies, and many of their economic satellites, particularly in Europe (i.e. Ireland and Spain).

Australia's (& NSW's) strong population growth in recent years and weak new residential construction over 2002 to 2009 resulted in a significant undersupply of dwellings. This undersupply has created pent-up demand pressures that were released as the RBA cut

Wages growth at 3.5%pa.

Sydney CPI at 2.4% in 2010.

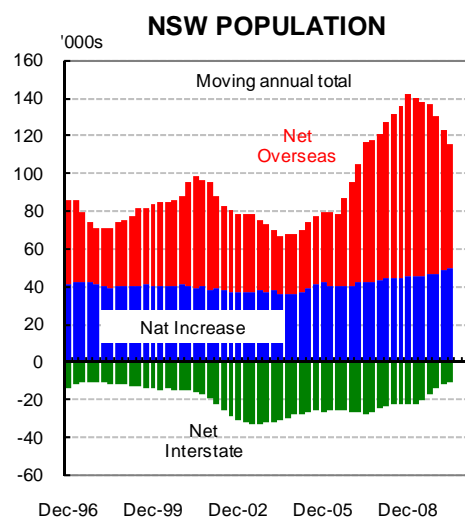
Population growth lifted by migration.





**Population and house prices.** interest rates through 2008 and 2009. So, while the US and UK witnessed 30% falls in house prices from 2007 to 2009 as their unemployment rates rose and the housing markets went into oversupply, Australian (and NSW) house prices recorded 20% rises. On our estimates, underlying annual housing demand is around 185-195k, while new construction has been accelerating in the past year, the gap between underlying demand and supply is still significant (around 30k).

**Net overseas migration to remain at high levels.** Net overseas migration was boosted substantially by the Federal Government from 2002 due to fears of widespread labour shortages which could lead to inflationary wages growth. The Global Financial Crisis (GFC) calmed these fears temporarily. But now the re-emergence of the mining boom will most probably require net overseas migration maintained around the 250k level in coming years. The major impact from this strong population growth will be ongoing upward pressures on housing costs via rising house prices and rents, especially in Sydney where vacancy rates are at record lows already.



**Table 1: NSW ECONOMIC PROJECTIONS**

CBA forecasts	2009-10 actual	2010-11f	2010-12f	Comment
Real Gross State Product (GSP)%	1.7	2¼	2¼	Growth around trend
Employment Growth % June	1.7	2.8	1¾	Jobs growth firm
Unemployment Rate % June	5.4	5¾	5½	Sliding unemployment rate
CPI (Sydney) %pa	2.9	2½	2¾	Moderate inflation
Wages Price Index %pa	3.0	3¼	3½	Wages growth edging higher
Exports \$bn annual	31.2	37	42	Exports rising
Dwelling starts, '000s annual	31.8	34	31	Dwelling construction modest
Population growth %pa June	1.5	1¼	1¼	Population growth moderate
CBA median house price Sydney \$000s	733	750	770	Subdued housing market

**Table 2: NSW FISCAL PROJECTIONS**

NSW Fiscal Projections	2008-09 Outcomes	2009-10 Estimates	2010-11 Estimates Mid Year	2011-12 Estimates	2012-13 Estimates
Total Revenue \$mn	49,663	56,333	56,535	60,030	62,260
Total Expenses \$mn	50,560	55,339	56,369	59,855	61,828
Operating Balance (GFS)\$mn	(897)	994	167	176	432
Fiscal Balance* \$mn	(3,275)	(3,267)	(4,346)	(2,478)	(1,675)
Net Debt \$mn	8,108	9,364	12,153	13,609	14,788
Net Debt % GSP	2.5%	2.3%	2.8%	2.9%	3.0%
Capital Works Spending \$bn	13.3	16.6	16.7	15.7	14.7

\* Net Lending/Borrowing including capital expenditures. Source: NSW Government, mid-year update.



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