

CHAPTER 1

ECONOMIC PERFORMANCE, OUTLOOK AND STRATEGY

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1.1 OVERVIEW

The ACT economy remains resilient. In the face of the challenges posed by the Commonwealth Government's spending cuts and downsizing of the Australian Public Service, the ACT economy, as measured by State Final Demand (SFD), grew by 1.9 per cent in the 2014 calendar year. This is despite a slight fall in employment and a net interstate migration outflow. An expected slight pickup in growth in the second half of 2014-15 lifts forecast growth in State Final Demand to 2¼ per cent for the 2014-15 financial year.

The economic outlook for the ACT in 2015-16 is expected to improve moderately. The ACT Government's own infrastructure and capital program will stimulate activity in the short to medium term. The lifting of the Commonwealth Government's hiring freeze as well as the *Jobs and Small Business Package* and the *Families Package* in the 2015-16 Commonwealth Budget, are also expected to help boost confidence in the ACT economy.

A low interest rate environment will also support the ACT economy.

National economic conditions remain challenging as the source of growth transitions to non-mining sectors. Resource exports, dwelling and non-mining investment, and an improvement in household consumption are expected to underpin economic growth, noting that the Australian economy is currently growing at a slightly below-trend pace.

The International Monetary Fund notes that global economic activity has improved moderately in 2015, with a slight acceleration expected in 2016. The momentum of recovery in advanced economies, led by the United States, is expected to support much of the expected global growth. China's transition away from investment toward consumption-led growth will provide opportunities for the ACT economy, given the ACT's strength in high value service exports.

Overall, lower energy prices are predicted to underpin global growth. Lower than forecast inflation rates in many economies are expected to provide central banks with further opportunities to support demand through ongoing accommodative monetary and fiscal policy settings.

1.2 NATIONAL AND GLOBAL ECONOMIC OUTLOOK

Australian Economy

The Australian economy continues to grow at below-trend pace, as commodity prices and resource-related investments continue to decline noticeably. Non-mining led business investment has also remained subdued over the last year, despite government moves to rebalance the Australian economy after the end of the mining led investment boom.

However, supportive monetary policy has seen stronger growth in dwelling investment over the past six months. In addition, the resource cycle is moving from investment to production with noticeable increases in export volumes.

Household consumption has also gained momentum, in part as a result of interest rate cuts by the Reserve Bank of Australia (RBA). Despite consumer sentiment remaining subdued, retail sales data indicates growth in household consumption has continued in the early months of 2015.

There are also signs of improvement in labour market conditions. Employment growth has improved over recent months, the participation rate has picked up slightly, and the unemployment rate has remained at around 6.2 per cent since July 2014.

Consumer price inflation has slowed substantially over the past year, reflecting in particular significant declines in global oil prices and general deflationary pressures around the world. Measures of underlying inflation continue to remain within the RBA's target band. Wage cost pressures remain subdued, both in the private and public sectors, consistent with spare capacity in the labour market.

Despite the decline in commodity prices putting pressure on high-cost producers of iron ore and the coal sector, resource exports continue to increase. Non-mining business investment continues to remain subdued, albeit in the presence of positive conditions for a recovery. Looking forward, resource exports are expected to continue to support economic growth. However, resource exports remain susceptible to external shocks, in particular from lower international commodity prices and the economic performance of key trading partners.

Key risks to the Australian economy continue to exist from the rate of decline of mining investment and the impact of lower commodity prices. The Australian Prudential Regulation Authority and the RBA have also warned of the risks involved in rapid house price growth in a number of Australian cities. Lower than expected global growth is also a potential risk to economic growth nationally.

World Economy

The growth prospects for the global economy have improved, with better than expected economic growth recorded in advanced economies in 2014 helping to offset growth that was below expectations in developing economies. Significant decreases in oil prices have been positive for global growth, in particular for advanced economies, while country specific factors such as movements in exchange rates and the further easing of monetary policy have also contributed to improved economic performance.

Global economic growth is expected to remain at a relatively moderate rate in 2015, with a slight acceleration expected in 2016. Lower energy prices are predicted to underpin growth, and lower than forecast inflation rates in many economies are expected to provide central banks with further opportunities to support demand through ongoing accommodative monetary and fiscal policy settings.

Growth in the **United States** was stronger than expected in 2014, as a result of strong domestic consumption, driven by improved levels of consumer confidence, lower oil prices and steady income growth. Above trend growth is expected to continue in 2015 and 2016. This will be driven by increased domestic demand, supported by lower energy prices, low levels of inflation, and improvements in the housing market.

Gradual economic recovery has continued in **Europe**, driven by increased household consumption, higher consumer and business confidence, and an improving labour market. Moderate levels of growth are expected in 2015 and 2016, supported by ongoing monetary stimulus and lower oil prices. However, the ongoing risk of financial market instability and decreasing productivity growth represent continuing challenges.

Following a recession in mid-2014, **Japan** has experienced improved economic conditions in recent months. Economic growth is expected to gradually improve in 2015 and 2016, supported by increased wages growth driven by tight labour market conditions, ongoing stimulatory fiscal and monetary policy settings, and the positive impact of lower oil and commodity prices. However, the impact of the ever increasing public debt burden will remain a challenge for the country.

Economic growth in **China** has continued to ease as a result of slowing domestic demand, with the Chinese Government reducing its Gross Domestic Product growth target for 2015 to about 7 per cent from around 7.5 per cent. The slowdown in economic growth from previous very high levels is being driven by weakness in the property market and softening conditions in the industrial and financial sectors. Ongoing structural reforms aimed at rebalancing the economy toward consumption driven growth and stimulus measures focussed on the property market, are expected to help support economic growth in China in the medium term, although risks remain around possible asset price bubbles. Overall, this transition is likely to provide significant opportunities for the ACT region in terms of the supply of high value-added products and services.

1.3 ACT ECONOMIC OUTLOOK

Recent Economic Developments

Economic growth in the Territory, as measured by State Final Demand (SFD), was 1.9 per cent in 2013-14. Year-average growth to the December quarter 2014 remained at this rate, but is expected to pickup slightly in the second half of 2014-15, to record growth of 2¼ per cent for the financial year.

Gross State Product is also forecast to increase slightly, from the 0.7 per cent recorded in 2013-14 to 1¼ per cent in 2014-15.

Employment in 2014-15 is expected to decline by ¼ of a percentage point. The lower than expected employment result was partially due to larger than expected Australian Public Service (APS) job cuts in 2014-15. The employment result was also negatively affected by slowing activity in labour intensive sectors, such as accommodation and food services related sectors.

Inflationary pressures have been well contained in 2014-15, due to the effects of lower oil prices and general deflationary conditions. The Consumer Price Index is expected to grow by 1¼ per cent in 2014-15 and the Wage Price Index by 1¾ per cent over the same period.

Population growth continues to remain below trend, with annual population growth of 1.2 per cent through-the-year to 30 September 2014.

Economic Outlook for 2015-16

The key economic aggregates for the ACT are summarised in Table 1.3.1.

Table 1.3.1
Economic Forecasts, Year-Average Percentage Change

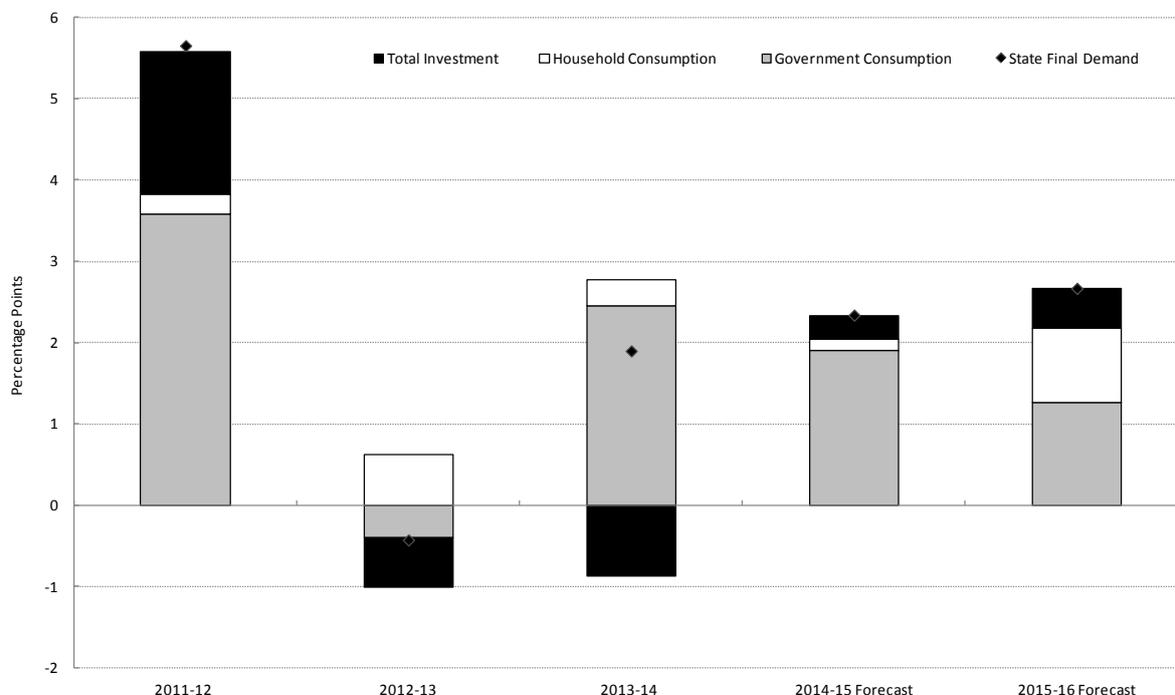
	Actual	Forecasts ¹	
	2013-14	2014-15	2015-16
ACT			
State Final Demand ²	1.9	2¼	2¾
Gross State Product ²	0.7	1¼	1½
Employment	-0.2	-¼	¾
Wage Price Index ³	2.4	1¾	2¼
Consumer Price Index	2.2	1¼	2
Population ⁴	1.2	1¼	1¼
Australia			
Gross Domestic Product ^{2,5}	2.5	2½	2¾

Notes:

1. Forecasts and projections are rounded to a ¼ of a percentage point to reflect the relative level of accuracy used in forecasting economic parameters.
2. Economic growth is forecast in real terms.
3. Total hourly rates of pay excluding bonuses.
4. The population forecasts are based on the rate of growth from the June quarter compared to the June quarter of the previous year, rather than 'year average' as with all other forecasts.
5. These are 2015-16 Commonwealth Budget forecasts for 2014-15 and 2015-16.

State Final Demand (SFD) is forecast to increase slightly to 2¾ per cent in 2015-16. The increase in demand is expected to be driven by a larger contribution from household consumption. Contributions to SFD growth from the various components are shown in Figure 1.3.1.

**Figure 1.3.1
Contributions to Growth in ACT State Final Demand**



Source: ABS Cat No. 5206.0; Chief Minister, Treasury and Economic Development Directorate.

Gross State Product (GSP) is forecast to grow by 1½ per cent in 2015-16, reflecting a forecast pickup in employment.

Government Consumption

Commonwealth Government consumption in 2014-15 was boosted by the front loading of job cuts in the APS, with redundancy packages adding to Commonwealth Government expenditure on wages and salaries. With job cuts expected to be minimal in 2015-16, together with continued fiscal restraint, Commonwealth Government consumption is expected to grow at a lesser pace in 2015-16. ACT Government consumption in 2014-15 is boosted by expenditure on the Asbestos Eradication Scheme, and is expected to reduce in 2015-16, while still remaining an important overall contributor to SFD growth.

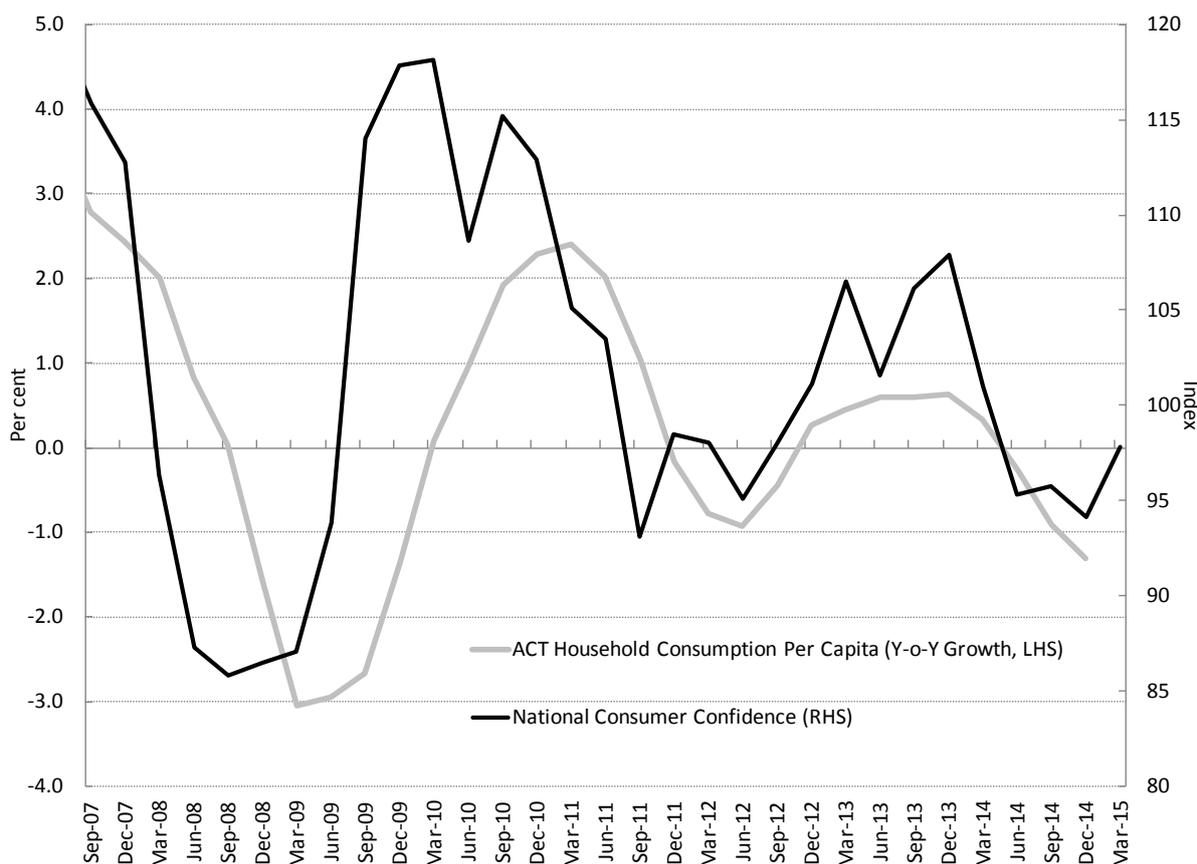
Household Consumption

Household consumption growth is forecast to pickup in 2015-16, as the local labour market stabilises after the recent Commonwealth job cuts. However, expectations on household income growth remain subdued and this, combined with continuing relatively low consumer confidence and below trend population growth, is expected to limit private spending growth in 2015-16, despite the impact of lower interest rates.

National consumer confidence has shown some improvement in early 2015, but still remains below long-run average levels. This improvement in confidence is expected to be reflected in the growth rate for overall household consumption per capita (Figure 1.3.2).

Job security is expected to continue to influence consumer confidence in the ACT. This may improve with the announcement in the 2015-16 Federal Budget of an end to the period of sharp contraction of the APS, including a relaxation of the hiring freeze from 1 July 2015.

Figure 1.3.2
Consumer Confidence and ACT Household Consumption Per Capita



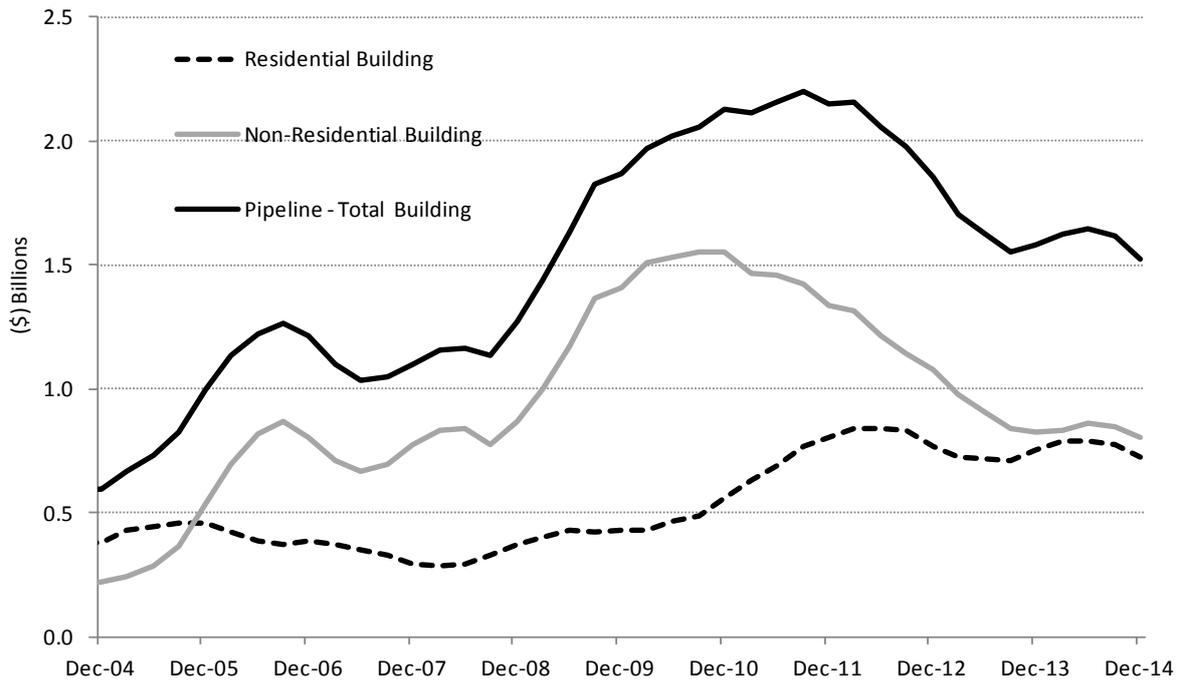
Source: ABS Cat No. 5206.0 and No. 3101.0; Westpac – Melbourne Institute Survey of Consumer Sentiment.

Investment

Total investment in the ACT is forecast to improve over the next two years.

Dwelling and non-dwelling investment is expected to play a key role in driving investment growth over the forward years. The December Quarter 2014 Building Activity Survey and Engineering Construction Activity Survey showed that the value of work in the pipeline remains at relatively high levels (Figure 1.3.3).

Figure 1.3.3
Real Value of Construction Work in the ACT Pipeline (Four-quarter Moving Average)



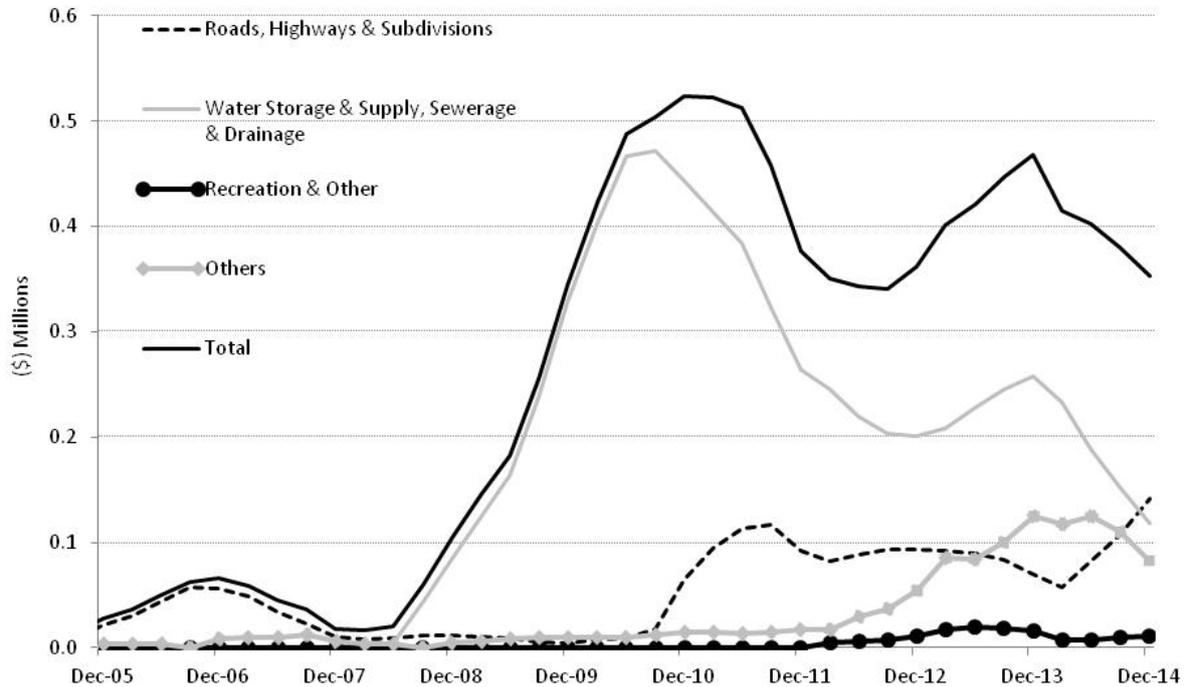
Source: ABS Cat No. 8752.0 and No. 8782.0.65.001; Chief Minister, Treasury and Economic Development Directorate.

The ACT Government's Asbestos Eradication Scheme is expected to support residential investment in 2015-16. Strong foreign buyer interest in new ACT housing construction is also expected to support ongoing investment.

Leading indicators in *engineering construction activity* continue to point to a high level of investment, although a downward trend has taken place in recent quarters (Figure 1.3.4). In this Budget, the ACT Government will invest \$208 million in New Capital Works in 2015-16, and \$459 million over four years. These projects are part of the Government's \$2.8 billion infrastructure program over the forward estimates.

Projects to commence within the next two years include the ACT Court Facilities Early Works, public housing renewal projects, duplication of major roads, and other ACT Government capital projects.

Figure 1.3.4
ACT Nominal Value of Engineering Construction Work Yet-to-be Done
(Four-quarter Moving Average)



Note: The "Others" category includes Bridges, Railways & Harbours, Electricity Generation, Telecommunications and Heavy Industry.
Source: ABS Cat No. 8762.0; Chief Minister, Treasury and Economic Development Directorate.

Total public sector investment (which consists of investment by the Commonwealth Government, ACT Government and Public Corporations) is forecast to contribute positively to total investment in the short term.

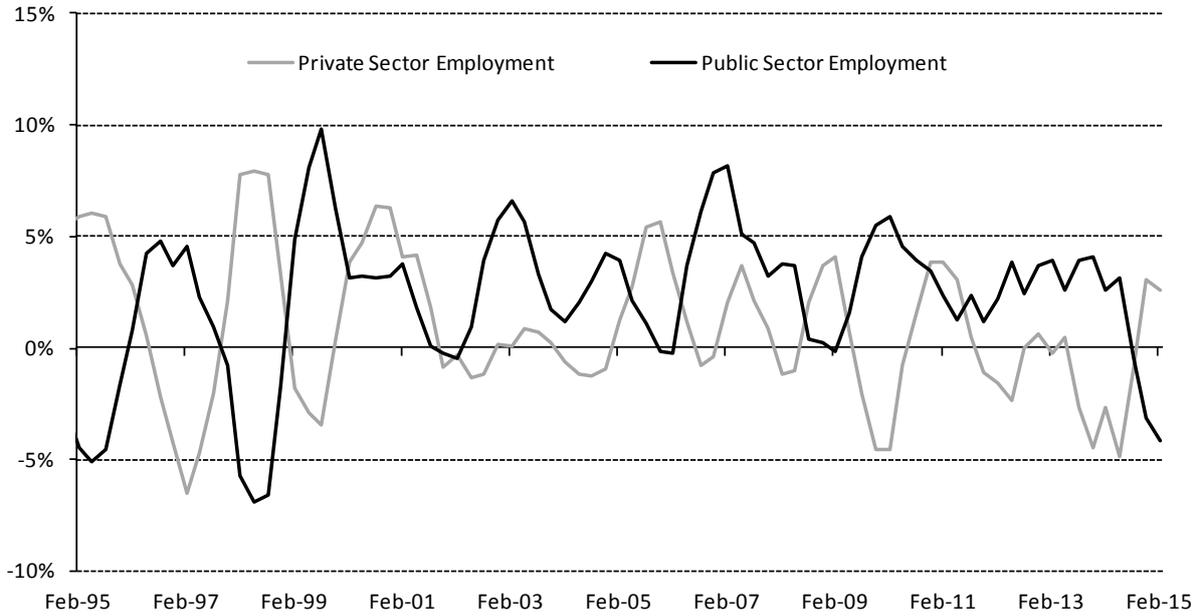
Labour Market

Employment in 2014-15 is expected to decline by $\frac{1}{4}$ of a percentage point, before growing at a below-trend pace of $\frac{3}{4}$ of a percentage point in 2015-16.

Employment in 2014-15 was negatively affected by larger than expected APS job cuts and slowing activity in labour intensive sectors such as the accommodation and food services sectors. The 2015-16 Commonwealth Budget noted that the average staff levels (ASL) in the general government sector Australia-wide in 2015-16 will be 15,165 lower than the ASL peak of 185,505 in 2011-12. The APS's Statistical Bulletin shows that APS job cuts were front loaded, with a reduction of 5,378 ACT jobs (14,414 nationally) through the 18 months to 31 December 2014.

While the broad employment picture in 2014-15 was affected by Commonwealth Government downsizing, a pickup in private sector employment has partially offset the impact of APS jobs cuts and restrictive hiring practices (Figure 1.3.5). The past few ACT Budgets have added employment through increased service delivery and construction of key projects. In addition, the relaxation from 1 July 2015 of the stringent restrictions on recruitment by Commonwealth Government departments should help support an improved labour market outcome in 2015-16.

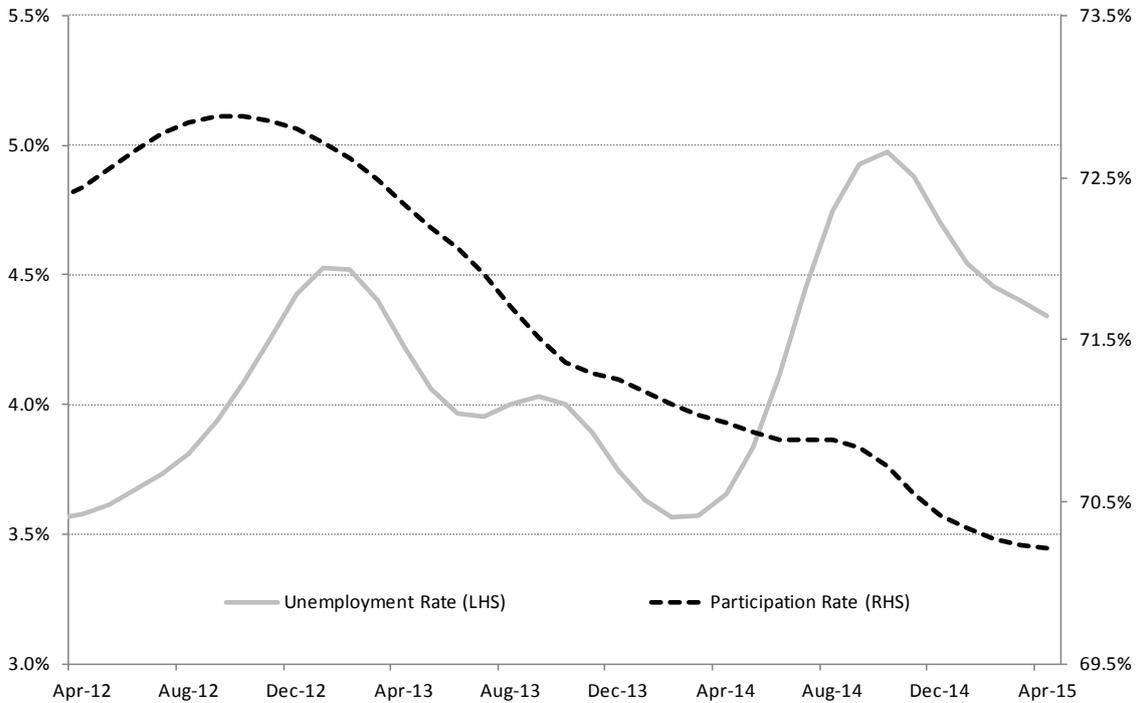
Figure 1.3.5
ACT Private and Public Sector Employment (Year-average change)



Source: ABS Cat. No. 6291.0.55.003.

Data from early 2015 has displayed initial signs of a turnaround in the labour market following softer outcomes through 2014. Employment levels in the ACT have improved and the unemployment rate has begun to decrease (Figure 1.3.6).

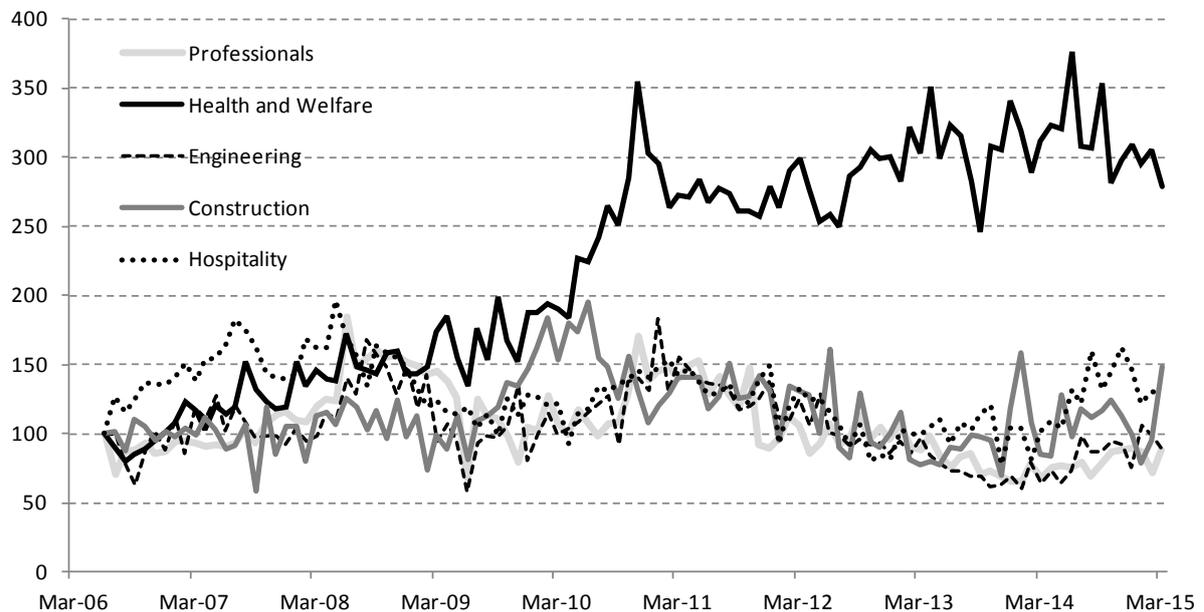
Figure 1.3.6
ACT Unemployment Rate and Participation Rate (Monthly Trend Data)



Source: ABS Cat No. 6202.0.

This outlook is also consistent with an upturn observed in leading employment indicators, albeit from very low levels. Year-on-year to March 2015, the Commonwealth Department of Employment's job vacancy report showed a 10.4 per cent increase in internet job vacancies in the ACT (Figure 1.3.7).

**Figure 1.3.7 Internet Job Vacancies Index by Sectors in the ACT
(Index: Jan 06=100 Seasonally Adjusted)**



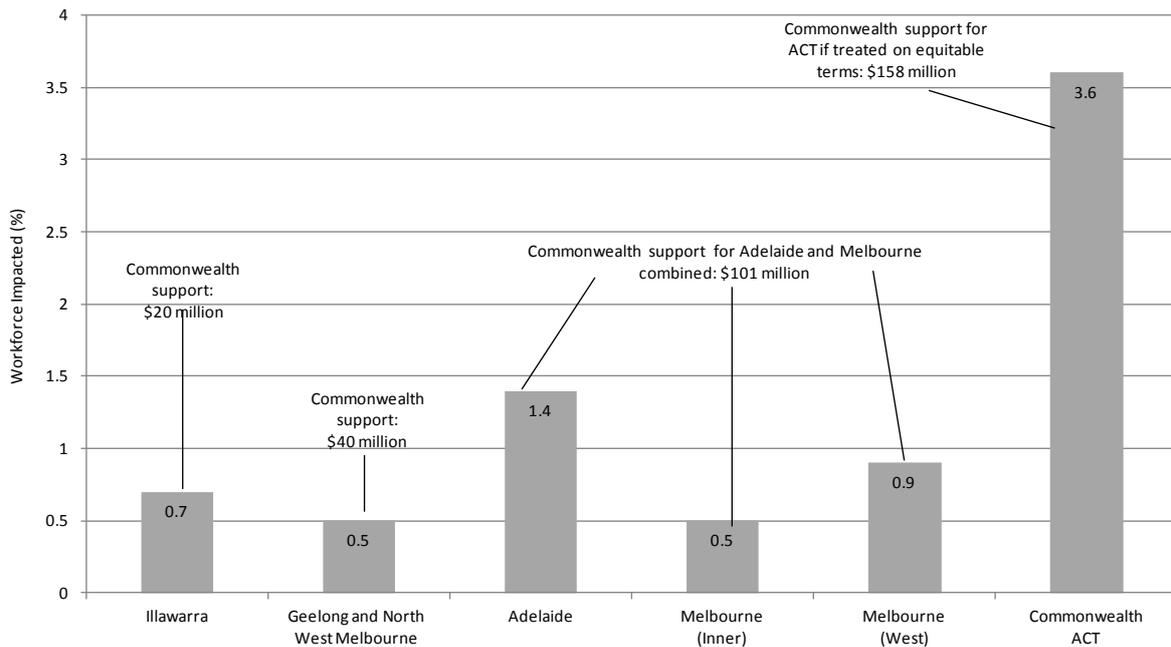
Source: Commonwealth Department of Employment.

Commonwealth Assistance to Industry

The Commonwealth Government has provided no support to the ACT economy, despite the extent of the APS job cuts and the impact this had on the economy. By comparison, the Commonwealth Government has provided direct support to the industries or other regions impacted by significant change.

In response to the loss of approximately 6,600 direct jobs at Ford, Holden and Toyota, the Commonwealth Government committed approximately \$140 million in assistance programs. The closure of Blue Scope in Illawarra also attracted support of \$20 million for 1,000 direct job losses. On average, this is equivalent to approximately \$20,000 in Commonwealth funding per direct job loss. If treated on similar terms, the ACT economy would have been boosted by an injection of \$158 million (see Figure 1.3.8).

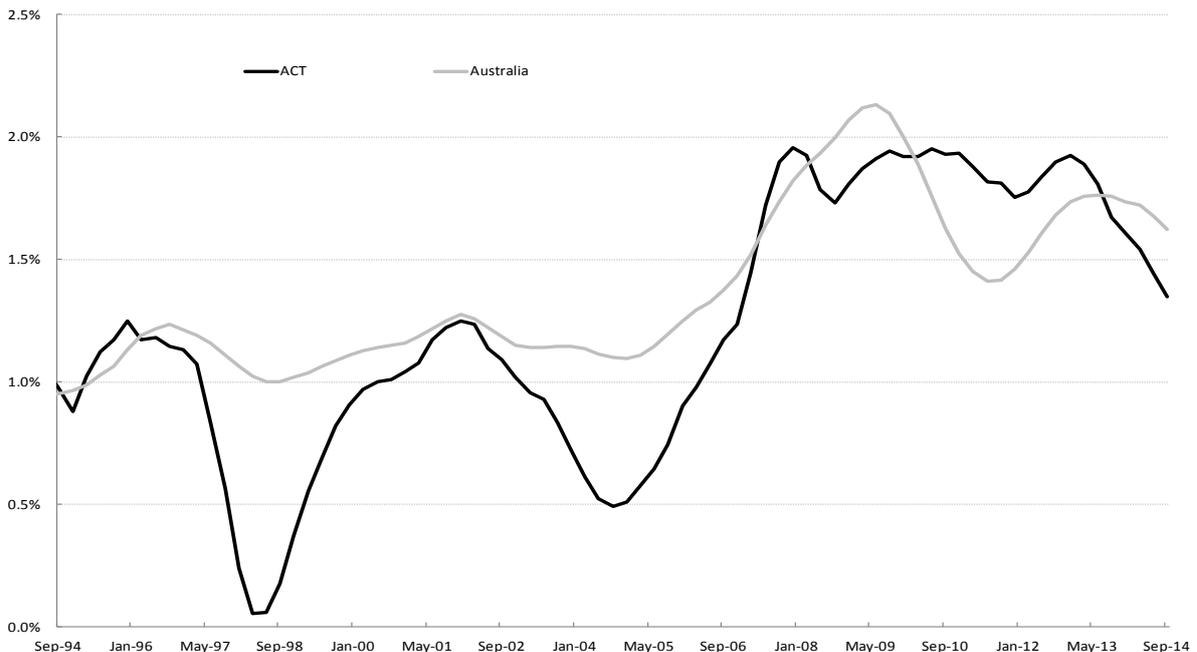
Figure 1.3.8 Commonwealth Assistance to Industry



Population

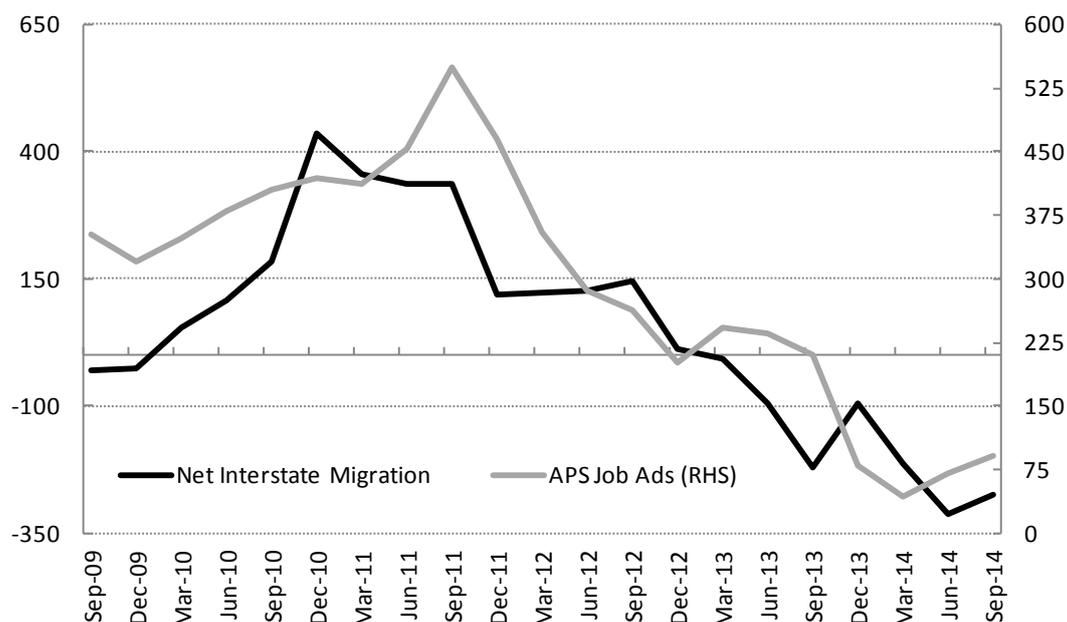
Population growth in the ACT continues to moderate, in line with the subdued economic environment in the Territory through the Commonwealth Government job cuts and fiscal consolidation. The slowdown (see Figure 1.3.9) has mainly been driven by net interstate migration, which recorded three consecutive quarters of outflow from the ACT between the March and September quarters of 2014, in line with the decline in APS job advertisements observed in the Territory (Figure 1.3.10).

**Figure 1.3.9
ACT Population, Through-the-Year Growth**



Source: ABS Cat No. 3101.0.

Figure 1.3.10 Net Interstate Migration and APS Job Ads, ACT Quarterly Original Data



Source: ABS Cat No. 3101.0 and APS Jobs website

Net overseas migration to the ACT has slowed somewhat, consistent with the overall national trend. However, inflows from international student numbers are expected to maintain some strength over 2014-15 and 2015-16. In addition, natural increases in the population are expected to continue to contribute positively to population growth.

Considering the current trend by components of population, the ACT's population is forecast to grow by 1¼ per cent in 2014-15 and 2015-16 (Figure 1.3.9).

Housing Market

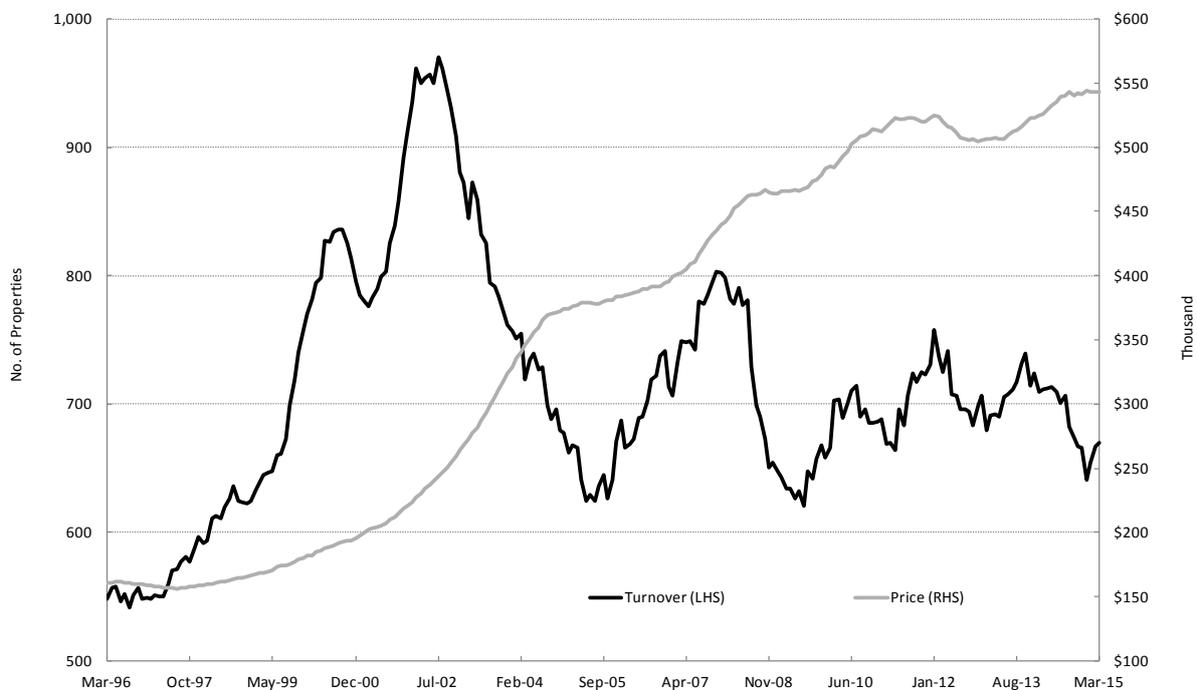
The ACT housing market experienced strong building activity in recent years, particularly in apartments and townhouses. This is in-line with the Government's land release program as well as other initiatives to improve housing affordability and to increase urban infill development.

Investment remains at high levels. However, reductions in some sectors have been recorded recently. Residential building commencements decreased by 9.4 per cent year-on-year to the December quarter 2014. Year-on-year to March 2015, the number of building approvals in the ACT in trend terms decreased by 36.8 per cent, driven mainly by a reduction in units, flats, apartments and townhouses.

The turnover in the established housing market has increased in recent months, driven mainly by owner-occupiers. Year-on-year to March 2015, the number of owner occupier housing finance commitments for established dwellings increased by 2.2 per cent in original terms.

House prices remain relatively subdued and are expected to remain so over the medium term (Figure 1.3.11). The latest Bendigo Bank Real Estate Market Facts report shows the median house price in Canberra increased by 1.9 per cent in the December quarter 2014 while the median price for other dwellings was flat. This was below the weighted average increase recorded for Australian capital cities over the same period (an increase of 3.5 per cent for houses and 2.5 per cent for other dwellings), and below the increases experienced in Sydney (4.5 per cent for houses and 3.7 per cent for other dwellings).

Figure 1.3.11
ACT Residential Property Turnover and Average Price, 12-Month Moving Average
Original Data



Source: Environment and Planning Directorate; Chief Minister, Treasury and Economic Development Directorate.

The housing market will continue to face short-term challenges as a consequence of the Commonwealth Government’s fiscal consolidation, although there continue to be positive factors for the housing market from solid overall economic fundamentals and favourable investment conditions driven by historically low interest rates and the ACT Government’s Land Release Program.

Consumer Price Inflation and Wages

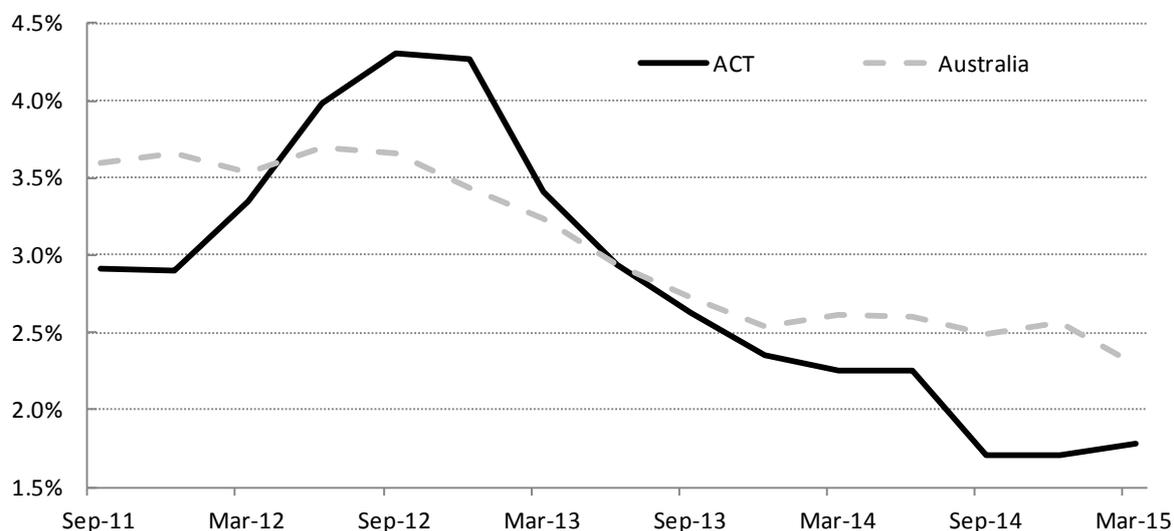
Consumer Prices

Inflationary pressures are expected to increase in 2015-16, albeit from current very low levels, as the impact of the depreciation of the Australian dollar places upward pressure on the price of tradable goods. Inflation is forecast to reach 2 per cent in 2015-16, which is at the lower bound of the inflation target of 2 to 3 per cent set by the Reserve Bank of Australia.

Wages

Wages growth is forecast to increase to 2¼ per cent in 2015-16, consistent with moderate consumer prices growth, spare capacity in the labour market, and public sector wage and cost containment by the Commonwealth Government (Figure 1.3.12).

Figure 1.3.12
Wage Price Index. Through-the-Year Growth
Original Data



Source: ABS Cat. No. 6345.0

Forward Year Projections

Forward year projection parameters are reflected in Table 1.3.2 below. Projections based on these medium-term assumptions are provided for planning purposes only and do not reflect an expectation (forecast) of actual outcomes.

Table 1.3.2
Economic Projections, Year-Average Percentage Change

	Projections ¹		
	2016-17	2017-18	2018-19
ACT			
State Final Demand ²	4	4	4
Gross State Product ²	2½	2½	2½
Employment	1½	1½	1½
Wage Price Index ³	3½	3½	3½
Consumer Price Index	2½	2½	2½
Population ⁴	1½	1½	1½
Australia			
Gross Domestic Product ^{2,5}	3¼	3½	3½

Notes:

1. Forecasts and projections are rounded to a ¼ of a percentage point to reflect the relative level of accuracy used in forecasting economic parameters.
2. Economic growth is forecast in real terms.
3. Total hourly rates of pay excluding bonuses.
4. The population forecasts are based on the rate of growth from the June quarter compared to the June quarter of the previous year, rather than 'year average' as with all other forecasts.
5. These are 2015-16 Commonwealth Budget forecasts.

1.4 ECONOMIC STRATEGY

Economic Strategy

The Government's economic strategy is to grow and continue to diversify the ACT economy, encourage job creation and support the community. The 2015-16 Budget builds on the efforts in 2014-15 and continues the Government's focus on these key principles.

There is no doubt the ACT economy has suffered under the Commonwealth Government's job cuts and spending cuts (see ACT Economic Outlook – Chapter 1.3). However, the policies in last year's Budget to invest in jobs and infrastructure have underpinned the ACT economy in these hard times.

The worst of the Australian Public Service job cuts and declines in Commonwealth spending appear to be behind us.

The Government will continue to use this budget to safeguard jobs for Canberra and grow our economy in 2015-16. Transforming Canberra through major infrastructure projects will generate jobs for Canberrans, stimulate the ACT economy, and help to reduce the impact of the past Commonwealth Budget contraction. Infrastructure investment will continue to play a key role in promoting economic stability in the ACT and generating longer-term economic benefits for the community. While the Government is unable to control expenditure decisions by the Commonwealth Government, we can improve the resilience of the ACT economy to the impacts of negative Commonwealth decisions.

Economic strategy – priority areas

Priority areas of the Government's economic strategy are: promoting key infrastructure development and urban renewal, encouraging business development and job creation, and continuing service provision with a focus on social inclusion.

Infrastructure

Our priority is to continue to build new infrastructure, and plan for the Canberra of tomorrow through major long-term projects.

Infrastructure investment is one of the best ways for governments to promote long-term improvements in productivity, by enhancing the efficiency with which private sector resources can be used. This drives growth and better living standards for the community.

Infrastructure investment is delivered by the construction sector, which accounts for over eight per cent of employment in the ACT. Growth in this sector has significant flow-on benefits for employment in a range of related professions such as architecture, engineering, law and finance.

The \$2.8 billion infrastructure program in the 2015-16 Budget builds on the investment announced in the 2014-15 Budget (refer to Infrastructure and Capital – Chapter 5).

Urban renewal

While new infrastructure is important in stimulating growth in our city, this Government is also committed to improving the infrastructure in Canberra's older suburbs. Urban renewal is an essential element of the Government's strategy to achieve better economic and social outcomes for the Territory. The Government, in this Budget, is establishing a comprehensive program of urban renewal across Canberra. The program will reinvigorate the Territory and support our economy through improved public housing, transport, access roads, pathways, local shops, and sport and community facilities.

An important aspect of the urban renewal strategy is the program of asset sales which commenced in 2014-15. This will allow the government to restructure our balance sheet and invest in productivity enhancing infrastructure. The asset sales program will also attract additional funding as part of the Commonwealth's Asset Recycling Initiative which provides incentive payments on proceeds of asset sales re-invested in productive infrastructure.

Business Development Strategy

This Budget commits \$6 million to *Confident and Business Ready – Business Development Strategy 2015*. The focus of this strategy is on creating the right business environment and using our competitive strengths to accelerate innovation and investment.

The strategy will build on the effective approaches we have pursued over the last three years to support innovation, investment and create and keep jobs in the ACT. We will continue to work with our business community and university sector to build a city with its own distinct economic identity for the future.

We will also continue to work with our regional neighbours to leverage and promote the size and diversity of economic opportunities that exist in the broader Canberra region, particularly in relation to the visitor economy.

Taxation reform

In support of its business development strategy, the Government is also continuing its agenda of taxation reform. The economy will benefit in the longer term from the transition to a more efficient and fairer taxation structure (see Taxation Reform – Chapter 6.2 for further information).

Access Canberra

Access Canberra is providing a new 'one-stop shop' to cut red tape and better connect Canberrans to government services. Access Canberra brings together ACT Government customer services, approvals and regulatory compliance activities. Access Canberra aims to make it easier for business to meet its regulatory requirements by streamlining processes and incrementally moving to a modern, risk-based approach to services and compliance. By adopting a customer-focus, Access Canberra will work with businesses to support and promote their ideas, encouraging growth and innovation.

Access Canberra will be a key party in delivering on the Government's red tape reduction agenda.

1.5 RISKS TO THE ECONOMIC OUTLOOK

The Australian economy is forecast to return to trend growth in 2016-17. Changes to the Australian and/or world economic growth path will have flow-on effects to the ACT economy. Of particular note is the impact of commodity prices on our national growth.

The large number of jobs cuts in the Australian Public Service, which occurred over the last 18 months, have had a significant negative impact on the local ACT economy. Given recent announcements by the Commonwealth Government, the risk of further cuts and hence damage to the local economy has abated, and somewhat reduces future risks to the ACT economy. This Budget assumes a return to moderate growth across the main economic indicators, but from a weakened base.

Although the risk of further job cuts appears to have fallen, the ACT economy still faces the prospect of lower than expected Commonwealth Government spending and continued Commonwealth Government wage restraint, which will affect income and associated household spending growth in the Territory. Other potential risks to the ACT economic outlook are slower than anticipated population, employment and price growth in 2015-16.

Business confidence is expected to improve; however, there is uncertainty as to the extent and pace with which that improvement will occur. A similar comment may be made in respect of consumer sentiment.

The *Jobs and Small Business Package* and *Families Package* in the Commonwealth Budget, which are expected to help boost the ACT economy, should partly offset these risks.

At the Territory level, the ACT Government's 2015 business development strategy, *Confident and Business Ready*, sets out a clear and positive plan to support our private sector as it continues to grow and develop over the next two years. The establishment of Access Canberra in 2014 will focus on streamlining processes for dealing with government, providing further support for local business.

