

7.1 ECONOMIC CONDITIONS

Overview

The outlook for the ACT economy in 2011-12 remains generally positive, with the Territory having experienced some of the highest levels of economic growth in the country over the last year.

The ACT economy is expected to continue to grow due to the strong labour market conditions, solid population growth and a robust housing market. Economic growth, however, is forecast to moderate in 2011-12.

The economic growth prospects for the Territory in 2010-11 improved since the time of the 2010-11 Budget, mainly due to stronger investment expenditure and public consumption, but Commonwealth fiscal consolidation is expected to weigh on economic activity in 2011-12.

Commonwealth Government consumption expenditure plays a key role in the Territory's economic performance. A moderation in the Territory's State Final Demand (SFD) growth is expected in 2011-12, as the Commonwealth repairs its budget position and possibly diverts expenditure to re-building efforts following the recent natural disasters.

Growth in SFD and employment are expected to be well below their long-run average levels in 2011-12, as public consumption declines and private consumption and total investment grow at a below-trend pace.

Following the natural disasters in Australia, New Zealand and Japan, geopolitical tensions in the Middle East and North Africa (particularly Libya) and ongoing concerns about the sustainability of public finances in a number of European countries, the outlook for economic activity both globally and nationally are marked by elevated uncertainty. National and global economic growth is nevertheless expected to proceed at an above-trend pace in 2011-12. The latest data on output reflect that divergences in growth patterns across countries and regions prevail. Global inflationary pressures are picking up, fuelled in particular by higher commodity prices.

The medium-term outlook for national Gross Domestic Product (GDP) growth remains positive, underpinned by prospects of strong growth in mining investment and continuing high commodity prices. Recent natural disasters have, however, changed the near-term profile of GDP growth, with slower growth expected in 2010-11 due to a loss in production, but stronger growth expected in 2011-12 as rebuilding gets underway.

The Outlook for the ACT Economy

The prospects for the **ACT economy** in 2011-12 are generally positive with the Territory having experienced some of the highest levels of economic growth in the country over the last year. However, the fiscal consolidation by the Commonwealth Government is expected to have a significant impact on the Territory's economy.

This is reflected in the forecasts for economic growth in the ACT, as measured by SFD, which is forecast to moderate in 2011-12. The key economic aggregates for the ACT are summarised in Table 7.1.1.

Table 7.1.1
Economic Forecasts, Year-Average Percentage Change

	Actual	Forecasts ¹	
	2009-10	2010-11	2011-12
ACT			
Gross State Product	0.9	2¾	2¼
Employment	1.2	2½	¾
State Final Demand	1.4	4	1¾
Consumer Price Index	2.1	2½	3
Wage Price Index	3.5	3¾	3½
Population ²	1.8	1½	1½
Australia			
Gross Domestic Product ³	2.3	3¼	3¾

Notes:

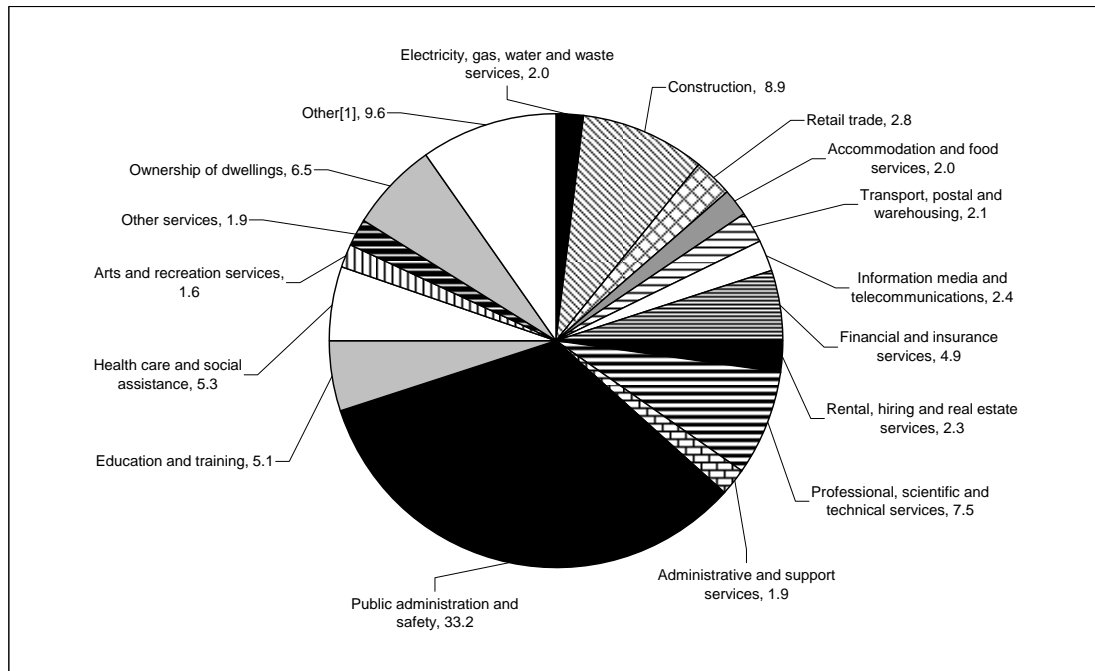
1. Forecasts are rounded to a ¼ of a percentage point to reflect the relative level of accuracy used in forecasting economic parameters. This is standard forecasting practice used by governments throughout Australia.
2. The population forecasts reflect Chief Minister's Directorate estimates. The forecasts 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. Previous ACT Budget papers used a 31 December estimate to represent the average population for the financial year.
3. Commonwealth Government 2010-11 Mid-Year Economic and Fiscal Outlook (MYEFO) forecasts for 2010-11 and 2011-12.

Economic growth in the ACT in 2011-12 is expected to be constrained by Commonwealth spending restraint. The increasing interest rate environment has affected spending as consumers remain cautious. Further increases in interest rates will also affect SFD and the broader economy.

However, the local residential property market is expected to continue to perform at a high level, with turnover remaining at the current levels, and price growth moderating following the very strong growth outcome in 2009-10.

Gross State Product (GSP), the Australian Bureau of Statistics' (ABS) headline measure of the ACT economy, is forecast to grow by 2¼ per cent in 2011-12. On the expenditure side, the growth in GSP will be supported by private consumption and total investment.

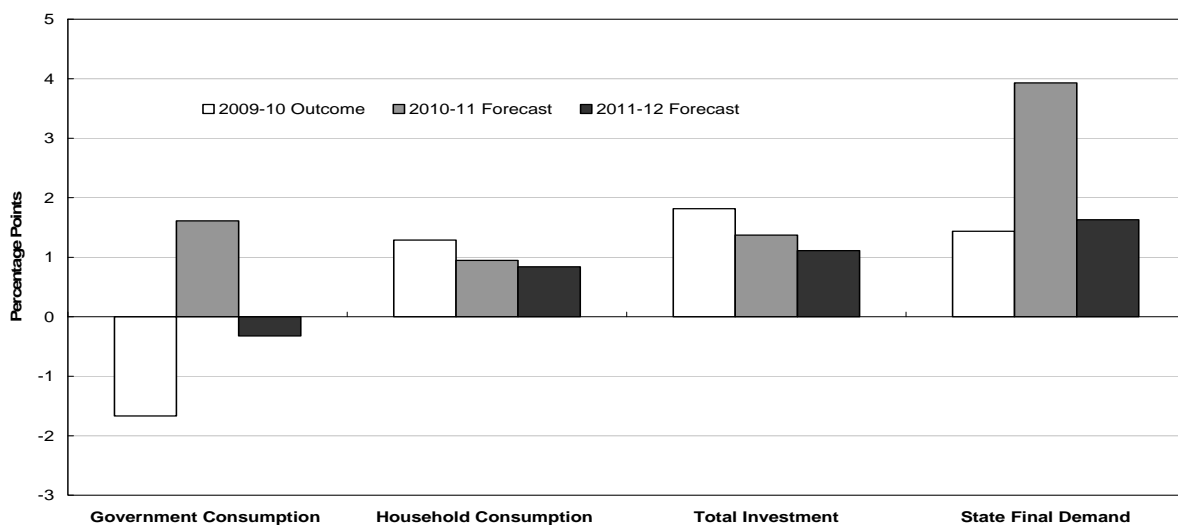
Figure 7.1.1
Share of Gross State Product 2009-10 Current Price Industry Value Added



Source: ABS Cat No. 5220.0 'Other' includes Agriculture, forestry and fishing industry, Mining industry, Manufacturing industry, Wholesale trade industry and Taxes less subsidies on products.

State Final Demand growth is forecast to moderate to 1¾ per cent in 2011-12. The forecast growth reflects contributions from household consumption and total investment, partly offset by a negative contribution from public consumption. Constrained Commonwealth Government expenditure and moderate investment and private consumption growth are expected to lead to below-average SFD growth in 2011-12. Contributions to SFD from the various components of the economy are shown in Figure 7.1.2.

Figure 7.1.2
Contributions to Growth in ACT State Final Demand



Source: ABS Cat No. 5206.0 and ACT Treasury calculations.

Government consumption expenditure is forecast to decline in 2011-12. Fiscal consolidation efforts will constrain public consumption growth as the Commonwealth Government seeks to return its budget to surplus by 2012-13. It is expected there will be additional pressure on the Commonwealth Budget due to weaker economic growth in the short term as a result of the recent natural disasters and the impact on revenue from the appreciation of the Australian dollar. Spending in flood and cyclone affected regions will also add to budgetary pressures.

Household consumption expenditure growth is expected to moderate in 2011-12 in an environment of higher interest rates. However, the ACT's strong labour market, relative job security, higher than average wages and solid population growth will continue to support consumer spending.

Total investment growth is expected to be one of the main contributors to growth in economic activity in both 2010-11 and 2011-12. Although investment growth over the next two years is expected to be lower than in 2009-10, the level of spending is nevertheless expected to remain high as a proportion of SFD.

Dwelling investment growth was strong in 2009-10, led by an increase in first home buyers and supported by low interest rates. This high level of investment is expected to continue, underpinned by the current strength of the housing market, employment and population growth. However, further increases in interest rates will place some downward pressure on dwelling investment in 2011-12.

The ACT Government continues to implement policies to improve housing affordability in the Territory. The residential land release program outlines the Government's plan to release 5,500 residential dwelling sites in 2011-12, with a total of 18,500 over the next four years.

There are a number of major construction projects underway, including expansion of the Canberra Airport, the new ASIO Facility, the enlargement of the Cotter Dam and building works at Canberra Hospital, along with other components of the Government's capital works program, that will support **non-dwelling construction** in 2011-12.

Public investment growth is expected to moderate in 2011-12 from the high growth levels recorded in 2009-10 and 2010-11. Expenditure in 2010-11 remains at high levels due to both ACT Government and Commonwealth Government investment.

ACT **employment growth** is forecast to ease in 2011-12 consistent with moderating economic growth.

Population growth of 1½ per cent is projected in 2010-11 and each of the forward years. This is slightly stronger than the historical long-run average of 1¼ per cent. These projections take into account Estimated Resident Population data, as released by the ABS, as well as the most recent local age-specific assumptions on fertility, mortality and migration. It is expected that the ACT's population growth will be predominantly influenced by a natural increase and net overseas migration, with net interstate migration projected to have little effect on overall population growth.

Labour Market

The labour market in the ACT performed well throughout 2010-11 relative to other jurisdictions and the long run average. For 2011-12, the labour market is well positioned with high levels of participation and full-time employment, and the demand for labour remaining strong as indicated by the number of job vacancies as a ratio of labour force.

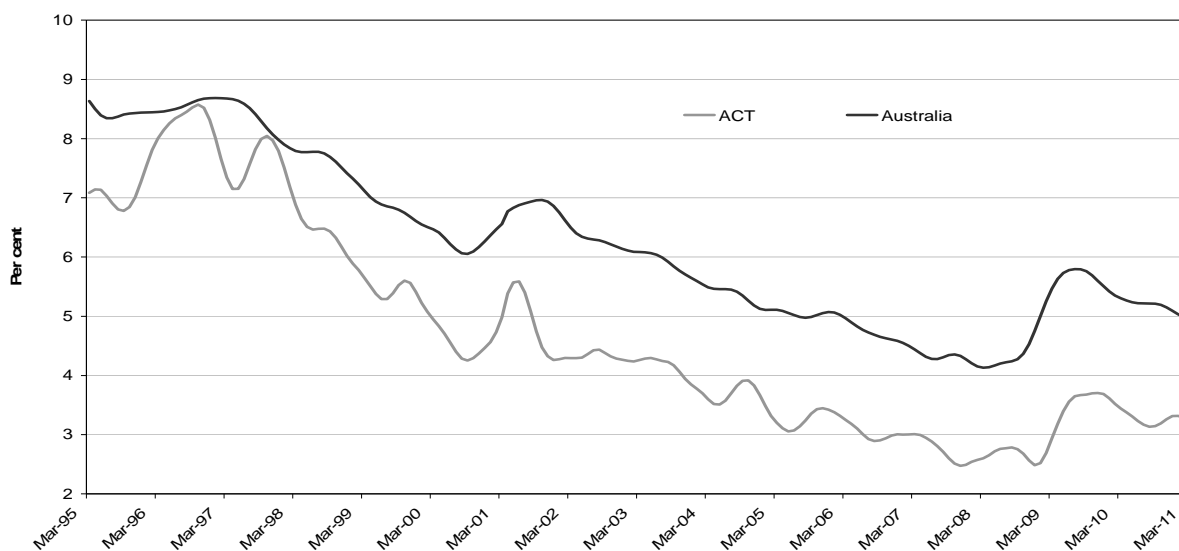
Due to these conditions, employment growth in 2011-12 is expected to remain positive, but a forecast moderation in economic activity and slowing population growth means the elevated levels of employment growth experienced in 2010-11 may not be sustained.

Employment

Employment growth in the ACT is forecast to moderate from 2½ per cent in 2010-11 to ¾ per cent in 2011-12, below its long run average. This is due to a mix of factors including the stronger than expected recovery in employment growth over the past year, the expected moderation in population growth, further tightening in monetary policy and Commonwealth fiscal consolidation.

Nationally, the unemployment rate has reduced from the levels recorded during 2009 to around 5 per cent. Leading indicators support the Commonwealth's forecast for the national unemployment rate to fall further to 4½ per cent by the June quarter 2012.

Figure 7.1.3
Unemployment Rate, ACT and Australia
Monthly Trend Data



Source: ABS Cat No. 6220.0

Labour Costs

Wages, as measured by the Wage Price Index (WPI), are forecast to grow by 3¾ per cent in 2010-11 and 3½ per cent in 2011-12 in the ACT. This is slightly lower than the average growth rate of around 4 per cent in the last five years.

Wages growth picked up over the second half of 2010, consistent with the strengthening in private sector labour market conditions. Over the year to the December quarter 2010, wages growth in the ACT was 3.7 per cent, slightly lower than the 3.8 per cent growth rate recorded nationally. However, taking inflation into account, growth in real wages over this period in the Territory remained slightly higher than that recorded nationally.

Labour supply constraints and a continued steady demand for labour in the ACT are expected to put some upward pressure on wages growth in the short to medium term in some select industries experiencing skills shortages, while overall downward pressures are to be anticipated from some areas of public service.

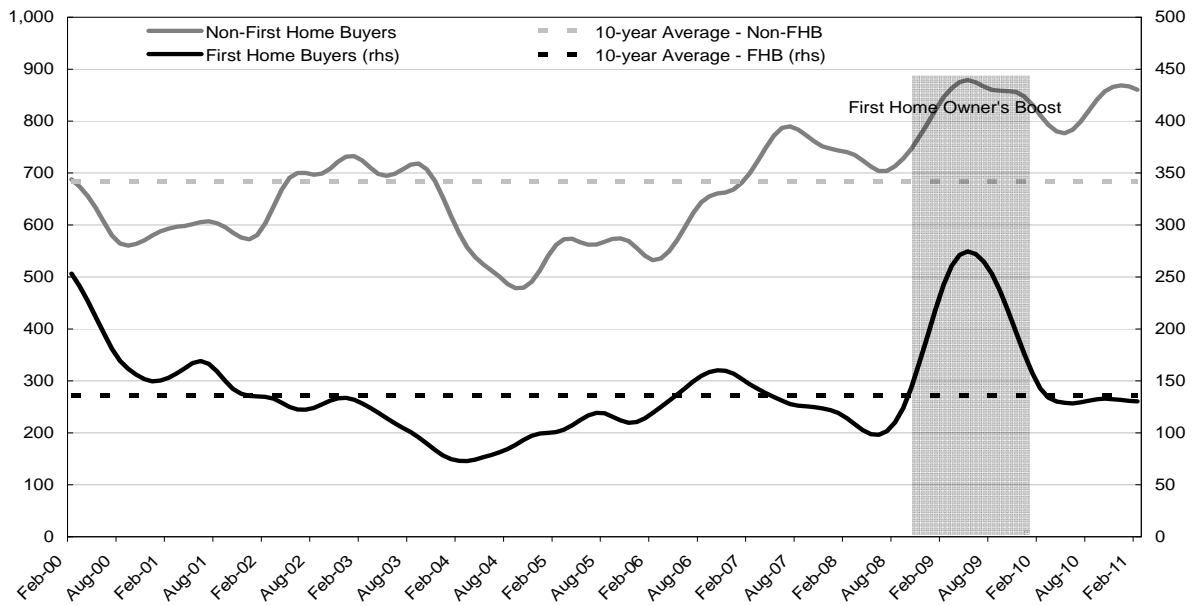
Investment

Housing Market

The ACT housing market continued to perform well in 2010-11, with a range of indicators remaining above their long-run average levels. This was underpinned by relatively low interest rates, and strong population and employment growth. On the supply side, dwelling commencements and dwelling completions reached record levels.

In 2011-12, the growth in the housing market is forecast to moderate due to an environment of increasing interest rates, and increased supply. The level of first home buyer activity has now returned to long-run average levels following the peak supported by housing stimulus measures (see Figure 7.1.4). However, non-first home buyer activity still remains at high levels and is well above its long-term average. The combination of a tight rental market, gains in house prices, population growth and a strong labour market provide a favourable property investment environment.

Figure 7.1.4
ACT Number of Housing Finance Commitments for Owner Occupation, Monthly Trend Data

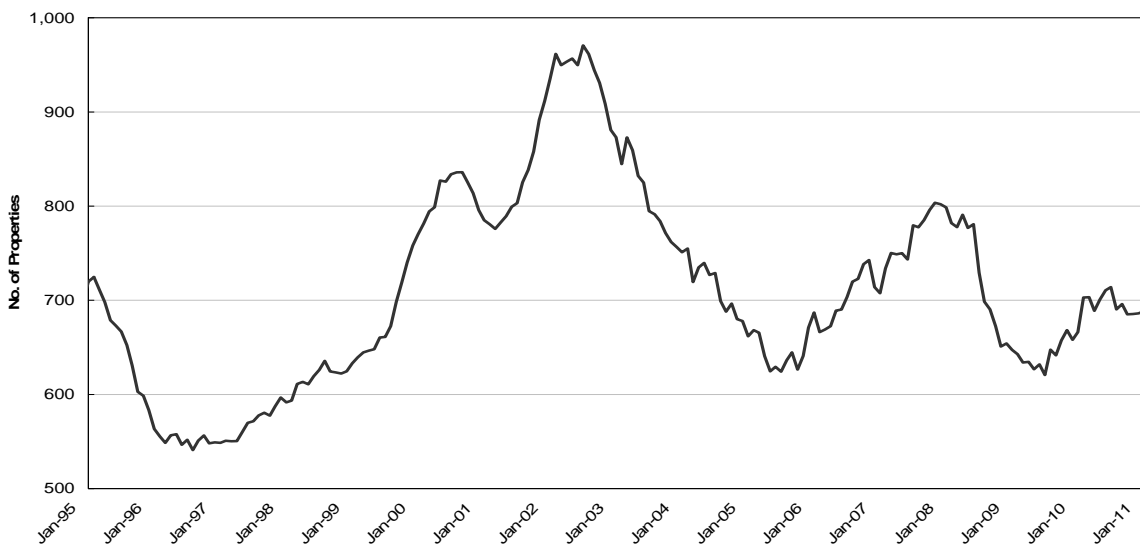


Source: ABS Cat No 5609.0 and ACT Treasury calculations.

Turnover of New and Established Dwellings

The turnover of new and established dwellings is forecast to remain largely at the 2010-11 levels, following the relatively high turnover growth experienced in 2009-10. This is primarily due to a change in the economic environment, in an outlook of increase in interest rates and the pull forward effect of stimulatory measures in 2009-10.

Figure 7.1.5
ACT Residential Turnover, 12-Month Moving Average, Monthly Original Data



Source: ACT Planning and Land Authority.

Price Movements

Growth in house prices remained strong in 2010-11 with a return to moderate levels towards the end of the year, partly due to increases in housing supply, and the effect of withdrawal of stimulus measures.

The Government's accelerated residential land release program is expected to continue to increase housing supply in the Territory. This is expected to place downward pressure on house prices. Dwelling prices are forecast to grow marginally in real terms.

Rental Market

The weekly rent for a three-bedroom house in Canberra in the year to the December quarter 2010 rose by 7.1 per cent, the second highest annual increase of all jurisdictions. The rental vacancy rate in the ACT, at 1.7 per cent in the December quarter 2010 was the third lowest in the country, indicating strong demand for rental properties.

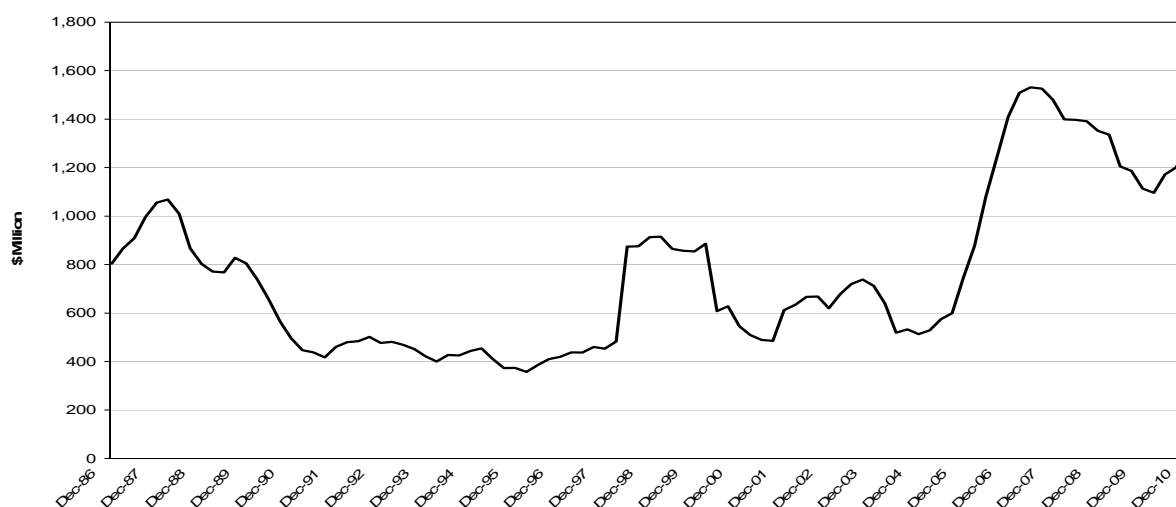
The rental market is expected to remain strong in 2011-12, however, increased housing supply is expected to ameliorate pressure on the rental market in the medium-term.

Non-Dwelling Construction

The volume of ACT non-dwelling construction work done in 2010 was \$1.3 billion, significantly above the long-run average level. The 2010 volume of non-dwelling construction was around 17 per cent higher than the 2009 level and is expected to account for a significant share of overall investment in the remainder of 2011 and into 2012.

Following the global financial crisis, credit conditions for commercial property developments remain restrictive which, combined with higher office vacancy rates, have limited the appetite of developers to commence new projects. While there are still some downside risks, improved global economic prospects for 2011-12, combined with improving access to capital, should lead to a more positive environment for non-dwelling construction activity.

Figure 7.1.6
Volume of ACT Non-Dwelling Construction
Four-Quarter Moving Average



Source: ABS Cat No. 5206.0

Consumer Prices and Interest Rates

Consumer Prices

The Reserve Bank of Australia (RBA) has indicated that there is likely to be a temporary rise in the Consumer Price Index (CPI) inflation rate to around 3 per cent over the year to June 2011. The combined contributions to this outcome of the recent flooding and cyclone related events are expected to add up to about half a percentage point.

While upward pressure on wages, food, oil and utility prices are expected to flow through to higher consumer prices nationally, the strong Australian dollar is expected to, in part, place downward pressure on inflation.

In the year to the December quarter 2010, CPI grew by 2.1 per cent in Canberra, lower than the 2.7 per cent CPI growth recorded nationally. This was mainly due to lower growth in costs in Canberra compared to Australia for alcohol and tobacco, housing, education and transportation as well as a relatively larger decrease in the cost of clothing and footwear in Canberra.

Price declines in 2010 in consumer goods in Canberra such as clothing and footwear, furniture, audio, visual and computing equipment, sport and recreational equipment and toys, games and hobbies reflect the impact of the stronger Australian dollar, heavy discounting and tariff cuts in early 2010.

The CPI for Canberra is expected to grow by 2½ per cent in 2010-11, with growth accelerating further to 3 per cent in 2011-12.

Interest Rates

The RBA has gradually removed the monetary stimulus that was put in place during the global economic downturn against the backdrop of a strengthening domestic economy, increasing the official cash rate six times since October 2009, taking it to 4.75 per cent by November 2010. The Budget forecasts assume that the RBA will continue raising interest rates in 2011-12 as its approach would be to look through temporary effects caused by the recent natural disasters, focusing on the medium-term outlook for output and inflation.

Higher interest rates will have a downward influence on business investment, household spending and broader economic growth both in the ACT and nationally.

Forward Year Projections

Forward year projections are included in Table 7.1.2 below. Projections are based on long-run averages and are provided for planning purposes only, and do not reflect an expectation (forecast) of actual outcomes.

Table 7.1.2
Economic Projections, Year-Average Percentage Change

	Projections ¹		
	2012-13	2013-14	2014-15
ACT			
Gross State Product	3	3	3
Employment	1¾	1¾	1¾
State Final Demand	4¾	4¾	4¾
Consumer Price Index	2½	2½	2½
Wage Price Index	4	4	4
Population ²	1½	1½	1½
Australia			
Gross Domestic Product ³	3¼	3¼	3¼

Notes:

1. Projections are rounded to a ¼ of a percentage point to reflect the relative level of accuracy used in estimating economic parameters. This is standard practice used by governments throughout Australia.
2. The population projections reflect Chief Minister's Directorate estimates. The estimates 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 projections. Previous ACT Budget papers used a 31 December estimate to represent the average population for the financial year.
3. Commonwealth Government 2010-11 Mid-Year Economic and Fiscal Outlook (MYEFO) forecasts for 2010-11 and 2011-12.