

4.1 ECONOMIC CONDITIONS

Background

Over recent months there have been increasing signs that a recovery from the global slowdown that began in the middle of 2000 is underway. Consumer and business confidence has begun to strengthen particularly in the United States and Europe, supported by a number of Asian countries. Recent forecasts by the International Monetary Fund (IMF) project global growth in 2002 at 2.8%, up from the 2.5% recorded in 2001. This is expected to strengthen to 4.0% in 2003 as the recovery in the majority of the major advanced economies really takes hold.

Throughout the global downturn the Australian economy consistently defied expectations. Over 2001, the Australian economy grew by 4.1%, outperforming the OECD and many of the other advanced industrialised economies. The domestic resilience was driven primarily by the lowest interest rates in 30 years. The low interest rates and the government's First Home Owners Grant (FHOG) scheme prompted a strong recovery in housing activity which, in tandem with other policy measures, contributed to a strong upturn in consumer spending.

The outlook for the Australian economy remains positive, with growth of between 3 and 4 per cent forecast over the next few years. Although activity in the residential construction industry is set to ease with rising interest rates and the removal of the additional first home buyers grant, business investment is expected to become the key driver of the national economy in anticipation of an expanding external sector. Investment in minerals appears to have already begun while investment in manufacturing is likely to pick up as firms seek to boost capacity after running inventories to very low levels.

Although the ACT should enjoy positive economic conditions throughout this period, the absence of export oriented mining and manufacturing sectors is likely to result in ACT growth lagging national growth.

Table 4.1.1
Economic Forecasts

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
	(Actual)	(Forecast)	(Forecast)	(Forecast)	(Forecast)	(Planning)
(Average annual growth)						
Percentage change on previous year ^a						
Gross State Product	3.4	3.0	3.1	3.0	3.0	3.0
Gross Domestic Product ^b	1.9	3.75	3.75	3.5	3.5	3.5 ^c
Employment Growth	2.7	0.0	1.0	1.2	1.0	1.0
Consumer Price Index	6.1	2.75	2.75	2.5	2.5	2.5
State Final Demand	1.5	4.1	2.8	2.9	3.6	3.6
Population ^d	1.0	0.8	0.8	0.9	0.9	0.9

- (a) Based on original data currently available, with financial data expressed in real terms. Percentage changes are expressed in year average or year total terms unless otherwise indicated.
- (b) Commonwealth Treasury estimates.
- (c) ACT Treasury planning assumption.
- (d) As at June each year.

State Final Demand

State Final Demand (SFD) represents expenditure in the ACT economy. It includes expenditure on goods and services sourced from outside the ACT (imports) and changes in the level of inventories. It is a measure of demand rather than production, comprising Household Final Consumption, Public Final Consumption, and Private and Public Investment.

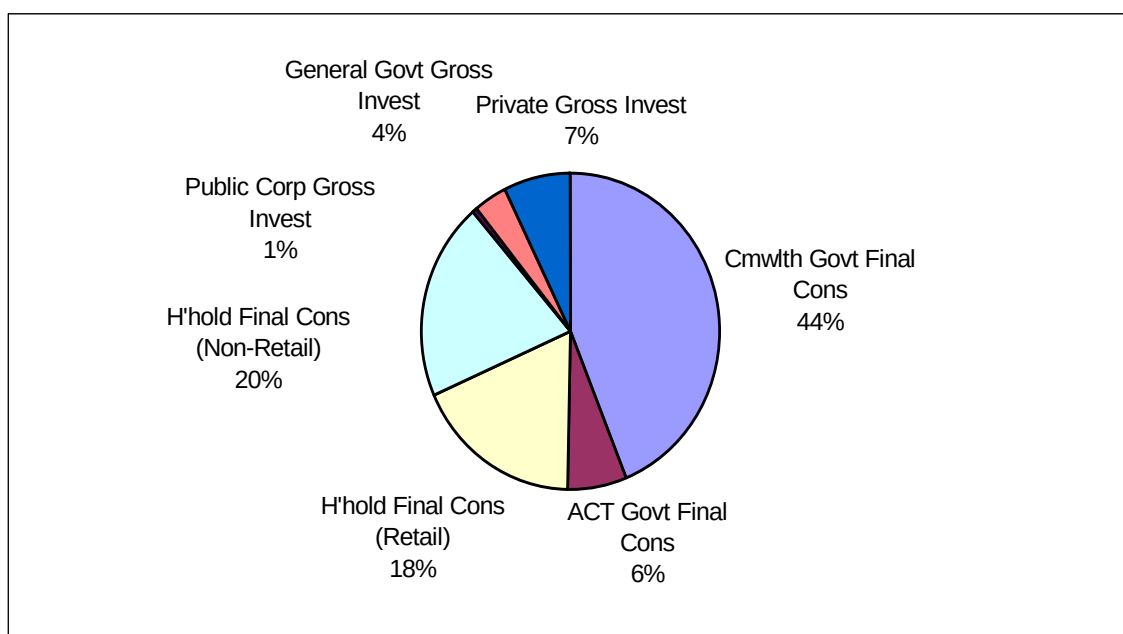
In 2000-01, SFD amounted to \$19,757m for the ACT. This represented approximately 3.1% of the national total. In absolute terms, this was higher than the NT and Tasmania and, in per capita terms, was the highest of all States and Territories.

Components of State Final Demand

The largest component of ACT SFD is Government Final Consumption Expenditure (GFCE). GFCE is current expenditure by general government bodies on services to the community such as defence, education, and public order and safety. Because these are provided free of charge or at charges which cover only a small proportion of costs, the government is considered to be the consumer of its own output. This output has no directly observable market value, and so it is valued in the national accounts at its cost of production.

GFCE comprises 50% of total SFD, with the bulk of this being consumption by the Commonwealth (44%) and the remainder being expenditure by the ACT government (6%). Obviously, GFCE is a significant influence on the level of SFD.

Figure 4.1.1
Components of ACT State Final Demand, June 2001



Sources: ABS Cat No 5220.0 Table 13 and ACT Treasury estimates

The second largest component of SFD is household final consumption expenditure (HFCE), which makes up 38% of total SFD. HFCE measures recurrent expenditure by households and

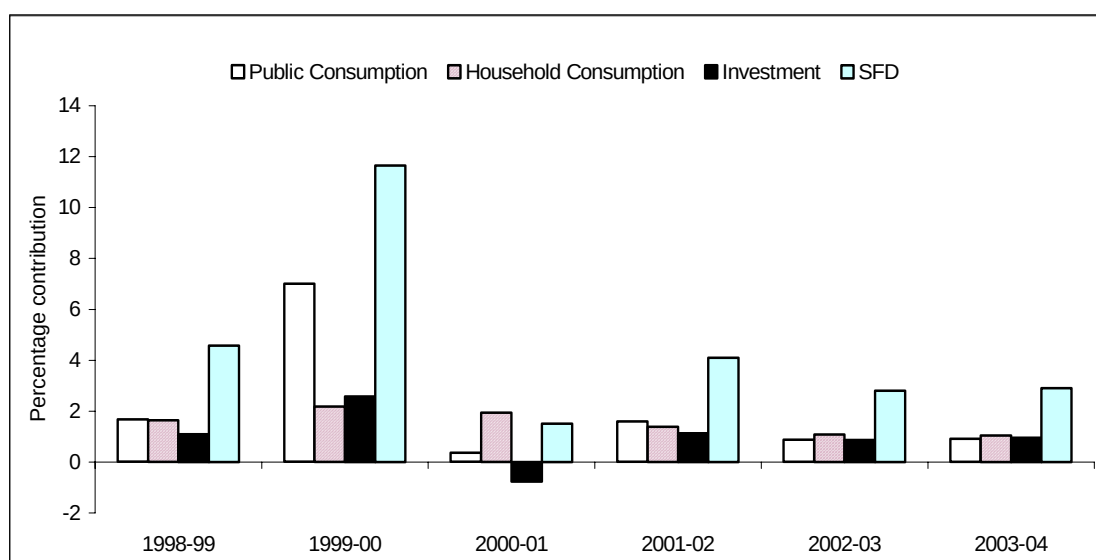
non-profit institutions serving households. HFCE is a large aggregate covering a wide range of goods and services. Just over half of HFCE is expenditure on non-retail goods such as utilities, transport, health and education. The remainder is expenditure on retail goods such as food, alcohol and tobacco, furnishings and other household equipment. HFCE tends to be a relatively stable source of demand with households adjusting their savings and credit levels to adjust for short-term economic impacts.

The remaining components of SFD relate to Gross Fixed Capital Formation (GFCF) or investment in assets. GFCF is the value of acquisitions less disposals of new or existing fixed assets. Capital formation is undertaken by the private sector, the government sector, and by public corporations. It includes expenditure on dwellings, non-dwelling construction and plant and equipment. Notwithstanding its relatively small contribution to SFD, investment is traditionally highly volatile and consequently has a disproportionate influence in percentage movements.

Contributions to SFD

In 2000-01, ACT SFD grew by 1.5% – the highest of all Australian states and territories. Growth in Public Final Consumption was 0.7%, while Household Final Consumption grew at 5.4%. Household Final Consumption was the main driver of SFD growth during 2000-01, contributing 1.9% points to the 1.5% growth in SFD. This was followed by Public Final Consumption which contributed a further 0.3% points. The result was offset by a decline in investment of 0.8% points.

Figure 4.1.2
Contributions to changes in SFD

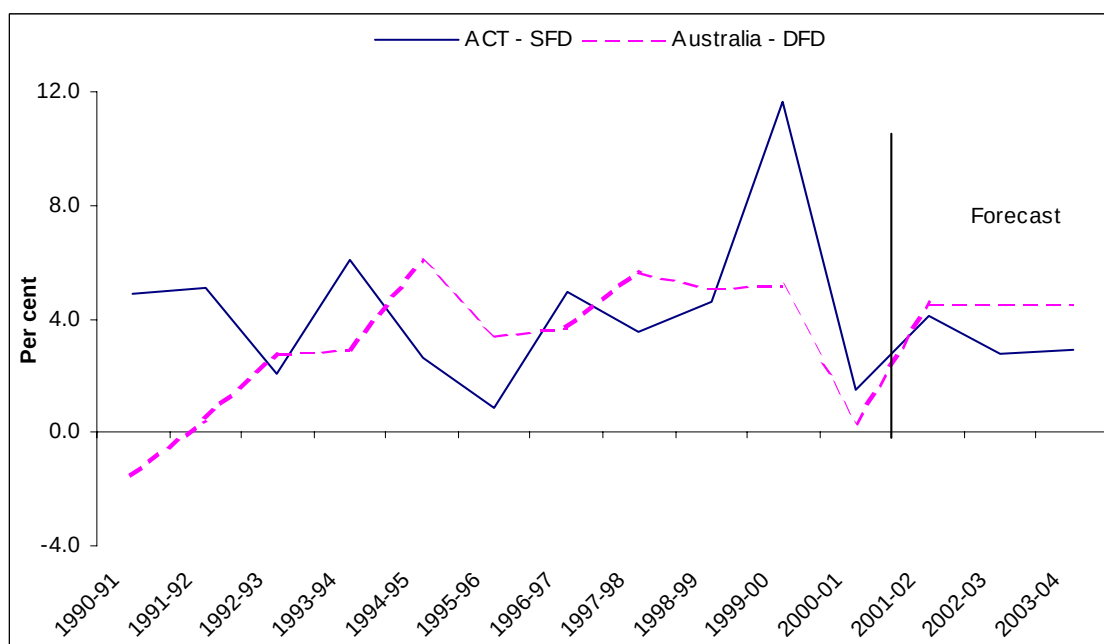


Source: ABS Cat No 5220.0 Table 3

Outlook for SFD

SFD for 2001-02 is now expected to grow by 4.1%, exceeding the 3.0% forecast in last year's Budget. Domestic Final Demand (DFD), the national analogue to SFD, is now forecast to grow by 4.5% after being revised upward from 3.75% in the recent Commonwealth Budget.

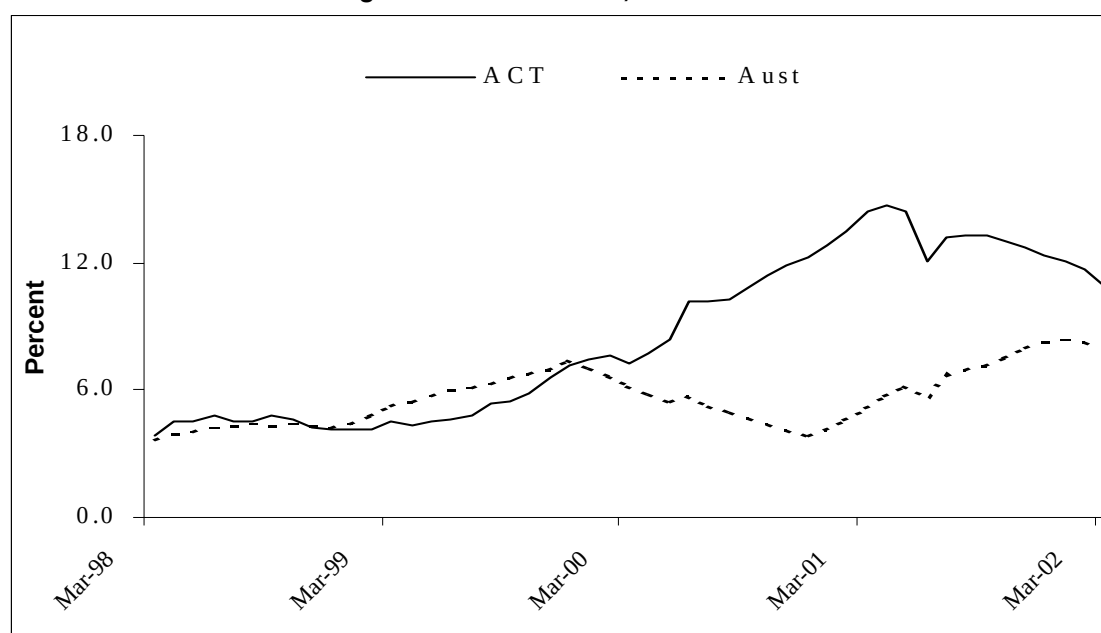
Figure 4.1.3
Annual growth in demand, ACT and Australia



Source: ABS Cat No 5220.0 Table 3

There are three key drivers of the increase in SFD in 2001-02. Firstly, household consumption has been stronger than originally thought as consumers have taken advantage of lower real interest rates and substantially increased their use of revolving credit. In the first nine months of the current financial year, use of revolving credit in the ACT has increased by 6.6% in year to date terms. Household consumption will moderate as interest rates rise and consumption associated with housing investment declines.

Figure 4.1.4
Annual growth in retail trade, ACT and Australia



Source: ABS Cat No 8501.0 Table 13

Secondly, public consumption, which is predominantly Commonwealth Government expenditure, is also forecast to increase in 2001-02. Outlays were originally forecast to increase by 2.2% in 2001-02, but this figure has subsequently been revised upward to 3.1%. Growth in outlays is forecast to moderate to 1.7% in 2002-03 and 1.8% in 2003-04.

Finally, private investment in 2001-02 is expected to rebound strongly supported by dwelling investment as a consequence of lower interest rates and the First Home Owners Scheme. Building approvals are up 48% in year to date average terms while the value of housing finance commitments is up 22% in year to date average terms. Leading indicators suggest a slowing in dwelling construction during 2002-03.

In 2002-03, growth in SFD is forecast to slow to 2.8% as higher interest rates and reduced public expenditure impact on demand.

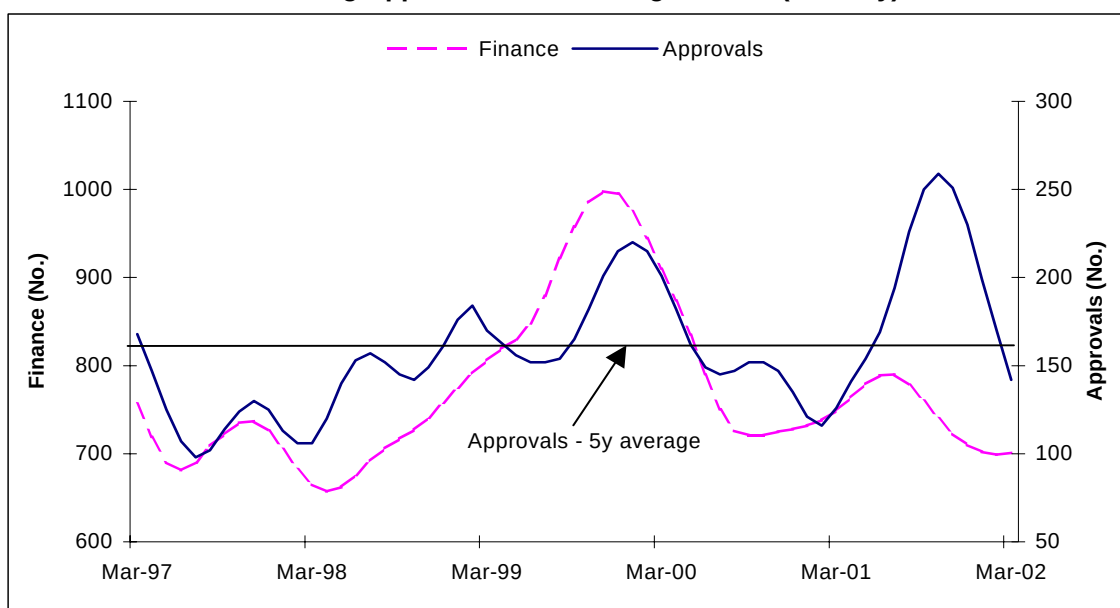
Private Investment

As outlined above, private investment is expected to increase in 2001-02 as a result of lower real interest rates and the continuation of the First Home Owners Grant. The components of private investment are discussed in detail below.

Dwellings

Dwelling investment has been highly volatile over the past 3 years. This has been the combined influence of the introduction of the GST, the provision of the FHOG and declining interest rates. Dwelling investment slumped sharply in 2000-01, falling by 30.3% over 1999-00 levels. All major indicators of building activity fell significantly. Dwelling approvals fell by 22.5%, dwelling commencements fell by 33.6%, and housing finance commitments fell by 19.7%.

Figure 4.1.5
Building Approvals and Housing Finance (Monthly)



Sources: ABS Cat Nos 8731.0 Table 7 and 5609.0 Table 3

The substantial falls in all the leading indicators came as a result of the introduction of the GST. Homeowners brought forward construction in anticipation of increases in building costs when the GST was introduced in July 2000.

The housing market has shown remarkable activity during 2001-02. This is a direct consequence of lower real interest rates and the FHOG Scheme. The latter in particular has contributed to higher than expected price rises with the median price in December 2001 reaching \$210,000. This is nearly 25% higher than December 1999 levels.

Prices are expected to level off and possibly decline further out as the FHOG is reduced for newly constructed dwellings, real interest rates increase and the supply of dwellings returns to more sustainable levels.

Other Buildings and Structures

Investment expenditure on other buildings and structures decreased by 29.1% in 2000-01, once again as a result of the introduction of the GST. While it is difficult to forecast non-residential construction activity in the ACT, investment is expected to improve in 2001-02 in line with improvements in other areas of the construction sector.

Proposed and continuing major capital projects include:

- The Queanbeyan bypass;
- The Barton Highway duplication;
- Maintenance of the National Museum;
- Upgrading the Australian Institute of Sport; and
- Kingston Foreshore Development Project.

Machinery and Equipment

Investment in machinery and equipment increased by 12.2% in 2000-01, but was well down on the 1999-00 figure of 48.6% growth. Machinery and equipment investment is expected to continue growing in line with local business confidence and the continuing development of export markets. However, the factors driving national investment growth, expected growth in global demand for resources and manufactures, are less significant for the ACT. Hence, investment growth is forecast to be less than that expected nationally.

Intangible Fixed Assets

Growth in investment in intangibles slowed in 2000-01 increasing by 18.5%, after growing by 29.4% in 1999-2000. This growth should be maintained over the medium term, reinforced by the growth of high technology businesses in the ACT.

Economic Growth

Gross State Product (GSP) is an income-based measure of economic activity that is produced by summing household income and profits from businesses. Growth in ACT GSP has been volatile due to the relative narrowness of the ACT economic base compared to the national economy.

In 2000-01, GSP amounted to \$13,087m for the ACT. This represented approximately 2.0% of the national total. In absolute terms, this was higher than the NT and Tasmania and, in per capita terms, was the highest of all states and territories.

Components of GSP

The largest component of GSP in the ACT is Compensation of Employees, which accounts for about 61% of GSP. Compensation of Employees consists of the value of entitlements earned by employees from their employers for services rendered during the accounting period. It covers wages and salaries received by employees in cash and in kind, changes in provisions for future employee entitlements, and employers' social contributions.

The second largest component of GSP is Gross Operating Surplus (GOS), which accounts for about 31% of GSP. Gross Operating Surplus measures the surplus accruing from processes of production before deducting any explicit or implicit interest charges, land rent or other property incomes payable on the financial assets, land or other tangible non-produced assets required to carry on the production. Importantly, the majority of public sector production is attributed on output value equivalent to its input costs and, therefore, does not contribute to GOS.

The final component of GSP is taxes less subsidies on production and imports, which accounts for the remaining 8% of GSP. Taxes on production and imports include the GST (from 1 July 2000), wholesale sales taxes (prior to 1 July 2000), excise taxes, payroll taxes, land taxes, local government rates, motor vehicle registration charges paid by businesses, and customs duties. Subsidies are unrequited payments that government make to resident producers or importers on the basis of the levels of their production activities or the quantities or values of the goods or services which they produce, sell or import. Examples include export incentive grants, dairy industry stabilisation payments, the phosphate fertiliser bounty, and the Tasmanian freight equalisation scheme.

Outlook for GSP

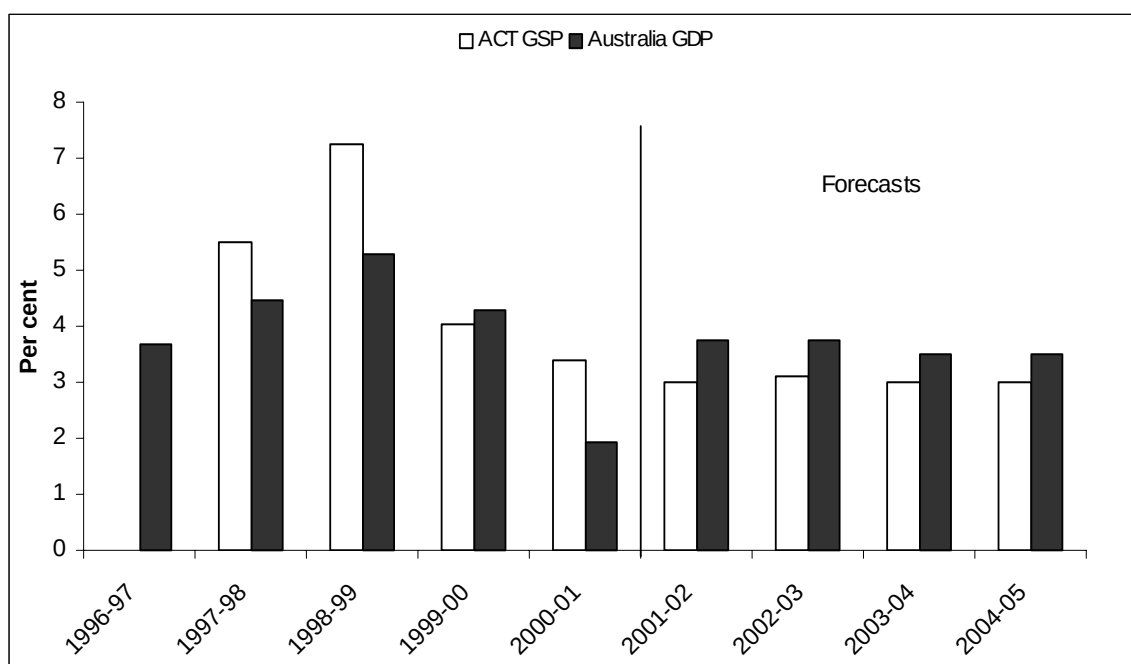
Over the 12 months ending in June 2001, ACT GSP grew by 3.4%, while nationally Gross Domestic Product (GDP) grew by 1.9%. The outlook for GSP remains positive with GSP forecast to grow by 3.0% in 2001-02, although this is down on the 4.6% forecast in last year's Budget.

The primary cause for the downgraded forecast is lower than expected employment growth during 2001-02. The 2001-02 Budget forecast employment growth of 1.3% however, based on data to April 2002, zero employment growth is now expected on a year-on-year average basis. With real wages now expected to increase by 0.5 % in 2001-02, the contribution of compensation to wage and salary earners to GSP growth is now expected to be negligible.

Given the downgraded forecast for employment, the bulk of the contribution to increased GSP is now set to come through increases in GOS and taxes less subsidies on production and imports. The prospects for profits remain sound in the ACT with business expectations revealing that the majority of businesses are positive about the ACT economy, employment, sales and profits. It is therefore expected that growth in GOS will contribute approximately 2.4% points to GSP, with the remaining 0.6% to come from increases in taxes less subsidies.

The rate of economic growth is forecast to increase marginally next year to 3.1% led by a small recovery in employment and higher growth in real wages.

Figure 4.1.6
Change in GSP/GDP, ACT and Australia



Sources: ABS Cat Nos 5220.0.40.001 and 5204.0, ACT Treasury and Commonwealth Treasury forecasts.

Business Confidence in the ACT

As mentioned above, business confidence remains strong in the ACT. In the most recent Yellow Pages Business Index (May 2002), a net balance of 69% of Small to Medium Businesses (SMEs) in the ACT were confident about business prospects over the next 12 months. This was the highest figure amongst the Australian states and territories and 2 percentage points higher than the February 2002 figure for the ACT.

The Yellow Pages results supported the April 2002 Chamber of Commerce and Industry quarterly Business Expectations Survey. The survey found that 50% of ACT businesses expect an improvement in conditions in the April 2002 quarter – an increase on the 48% in the January quarter.

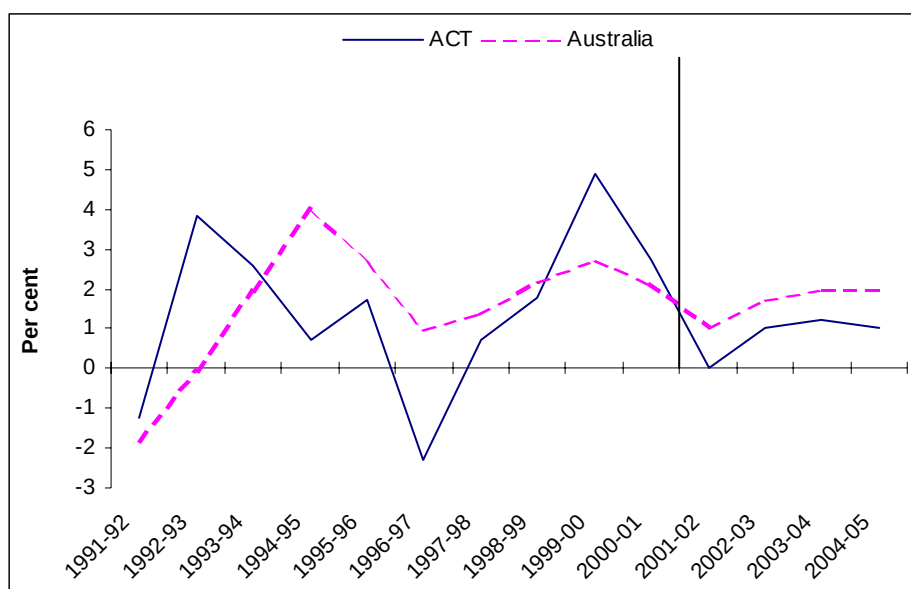
Employment

Employment in the ACT grew by 2.7% in 2000-01 in year average terms, reaching record levels in the process. The first eleven months of 2001-02 have seen employment decrease by 1.0% in average terms and the extent of this decline means that employment levels are not expected to grow in year average terms this financial year.

The revised outlook for 2001-02 is a considerable downward revision on last year's budget estimate of 1.3%, due to a large number of unforeseen events impacting on the ACT employment market in the last nine months. The collapse of Ansett and HIH, as well as the events of September 11 and the associated downturn in the global economy have all played a part in destabilising ACT employment. These events coincided with a Federal Government election that usually results in a period of subdued activity as well as less business trips to the ACT. The decline in employment, understandably, has occurred mainly in the tourism and hospitality industries.

Although employment is now not expected to grow on average in the current year, increases in employment over recent months suggest the general employment outlook remains positive. Consequently, employment in 2002-03 is expected to recover and grow at 1.0%, and is forecast to remain at or around this rate of growth for the next few years. The outlook reflects a return to more normal conditions, however, employment will remain dependent on public expenditure growth.

Figure 4.1.7
Annual Employment Growth, ACT and Australia



Sources: ABS Cat No 6202.0 Tables 8h and 8I, Commonwealth Treasury MYEFO 2001-02 and ACT Treasury forecasts

Wages

Historically, Average Weekly Earnings (AWE) for the ACT have been significantly higher than those for Australia overall. This is due to the different pattern of occupational employment in the ACT which tends towards relatively high skilled occupations.

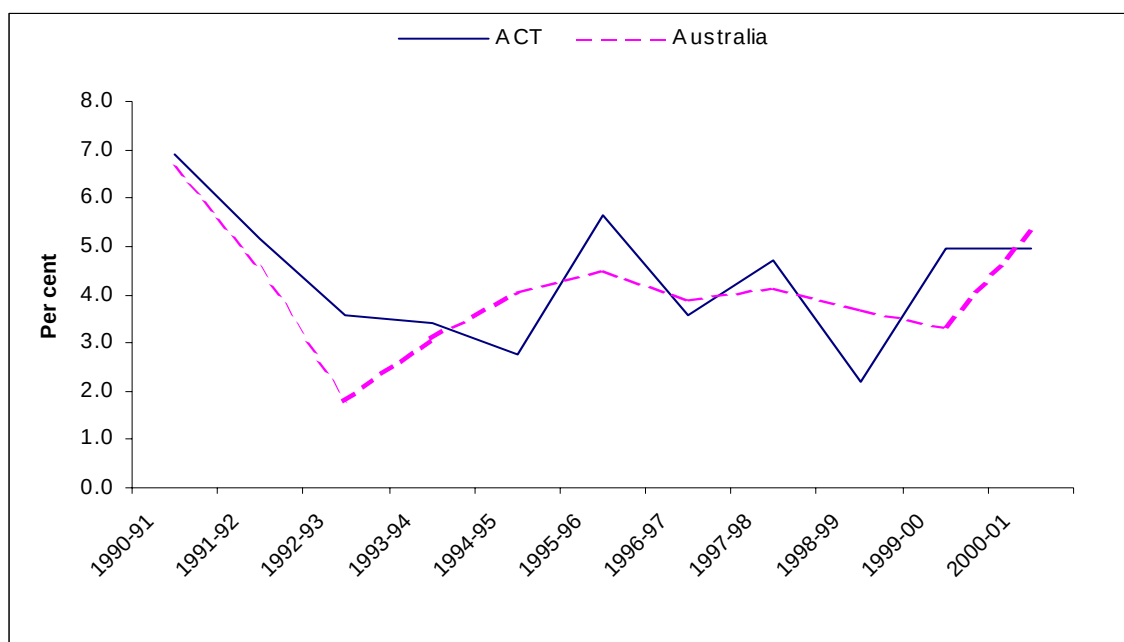
AWE in the ACT have risen steadily since February 1999. In February 2002, ACT Full-time Adult Ordinary Time Earnings (FTAOE) were \$951.50 per week, up 1.1% on the previous quarter and well above the Australian average of \$860.40.

Movements in average weekly earnings tend to broadly reflect changing labour market conditions in the Territory with a marked reduction in wages growth associated with the period of reduced employment growth during the later half of the 1990s. The softening in wages growth over the last 12 months supports the lower than expected employment outcome for the ACT for 2001-02.

Real wages growth in the ACT in 2002-03 is expected to increase to around 1.5% as employment prospects in the Territory begin to improve.

The combination of modest employment growth and wages growth will contribute around 2.0% to GSP in 2002-03. The remaining growth will come mainly from business profits.

Figure 4.1.8
Annual change in Average Weekly Earnings, ACT and Australia



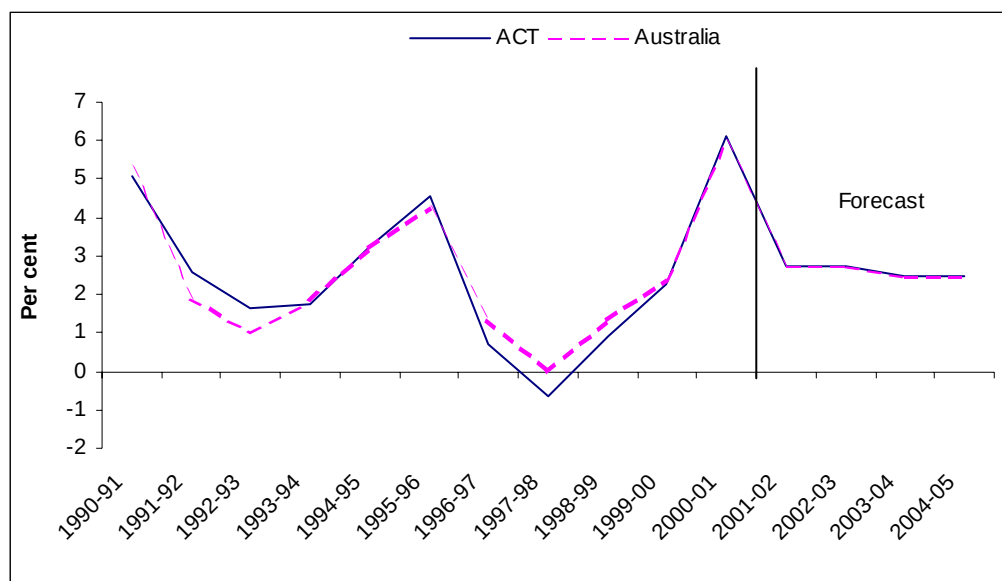
Sources: ABS Cat No 6302 Tables 2 and 12h

Prices

Price movements in Canberra closely follow national trends. After experiencing low rates of inflation during the later 1990s, the inflation rate spiked up to 6.1% in 2000-01 as a consequence of the introduction of *A New Tax System*.

The outlook for inflation is for a return to pre-GST levels with a 2001-02 forecast of 2.75%. Inflation is expected to remain at 2.75% in 2002-03 and then drop back slightly to 2.5% for the remaining forecast years.

Figure 4.1.9
Consumer Price Index, ACT and Australia



Sources: ABS Cat No 6401.0 Table 1a and Commonwealth Treasury

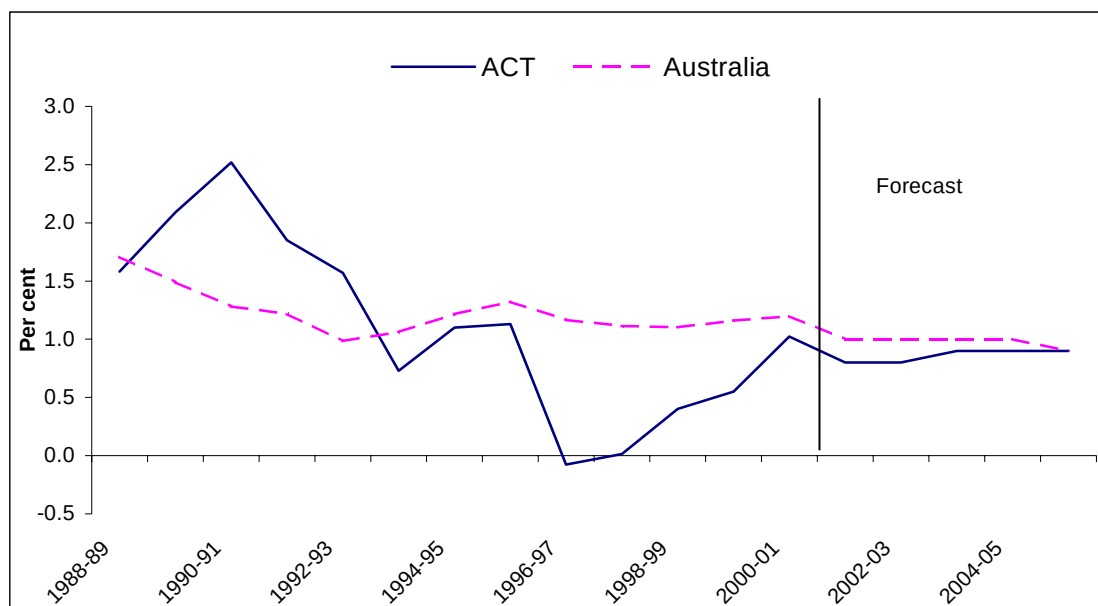
Population

Over the next few years net interstate migration to Canberra is expected to return to positive levels due to an expanding and more diversified economy and labour market which encourages more people to move to Canberra, and fewer to leave.

Population growth improved in 2000-01 (1.0%), due mainly to the return of slightly positive net migration to Canberra. This was much higher than the 0.6% growth experienced in 1999-00.

The ACT population is expected to increase by 0.8% in 2001-02 and 2002-03, compared with national growth of 1.0%.

Figure 4.1.10
Annual population growth, ACT and Australia



Sources: ABS Cat Nos 3101.0 and 3222.0 (Series 2), and Demographics ACT