

6.1 ECONOMIC CONDITIONS

Overview

Economic growth in the ACT is forecast to recover somewhat in 2009-10 following the moderation in growth in 2008-09.

The global financial crisis has had a major impact on economies throughout the world. The full scope and scale of the crisis is difficult to identify, and the timing of the recovery is similarly difficult to predict. This significantly increases the uncertainty associated with economic forecasting in the near term.

Governments throughout the world have been swift in their policy responses to the global financial crisis. In Australia, the Commonwealth Government implemented a \$10.2 billion fiscal stimulus package in December 2008 and followed that with an additional \$42 billion package in February 2009 that concentrates predominately on infrastructure spending. Locally, the ACT Government introduced a third appropriation Bill of \$25 million. The Reserve Bank of Australia began an unprecedented loosening of monetary policy dropping the target interest rate by 425 basis points in eight months. While governments and central banks have been using policies to increase disposable incomes, consumption and investment have yet to respond, predominately due to the combination of low business and consumer confidence and the substantial falls in wealth experienced in the last half of 2008.

Although the ACT unemployment rate is expected to rise as a lagged response to the moderating economy in 2008-09, it is still expected to remain relatively low compared with unemployment rates across Australia.

The Outlook for the ACT Economy

The prospects for the **ACT economy** in 2009-10 overall look better as demand conditions are expected to regain some strength following the weakness of 2008-09. However, weakness is expected to continue to some extent in response to the global financial crisis with growth forecast to remain below the long-term trend.

The key economic aggregates for the ACT are summarised in Table 6.1.1.

Table 6.1.1
Economic Forecasts, Year-average percentage change

	Actual	Forecasts(a)		Projections (a) (b)		
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
ACT						
Gross State Product	2.5	1	½	3	3	3
Employment	1	¾	½	1¾	1¾	1¾
State Final Demand	2.2	¾	2	5	5	5
Consumer Price Index	3.6	3½	1¾	2½	2½	2½
Wage Price Index	4.1	3¾	3½	4	4	4
Population(c)	1.3	1¼	1	1	1	1

Australia

Gross Domestic Product ^(d)	3.7	1	$\frac{3}{4}$	3	3	3
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Notes:

- Forecasts and projections are rounded to a $\frac{1}{4}$ 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.
- Projections are based on long-run averages and are provided for planning purposes only. They do not reflect an expectation (forecast) of actual outcomes. Projections have been updated to reflect changes in the long-run trends.
- For population forecasts, the 31 December estimate is used to represent the average population for the financial year. As such, the forecast growth is based on the growth from one December to the next, rather than 'year average' as with all other forecasts.
- Commonwealth Government forecasts are provided in the 2008-09 Updated Economic and Fiscal Outlook published in February 2009.

The global financial crisis dominates the international economic environment and the outlook remains uncertain. In its latest forecast for world economic growth, the International Monetary Fund (IMF) has again revised its growth projections downward. Global economic activity is now projected to contract by 1.3 per cent in 2009, before recovering gradually in 2010.

The global financial crisis has had a clear impact on the Australian economy. In the last official update, the Commonwealth Government lowered its forecasts for the national economy. GDP was expected to remain positive in 2009-10, with $\frac{3}{4}$ per cent growth, but employment growth was forecast to be negative with the national unemployment rate expected to rise to 7 per cent by June 2010. Recent announcements by the Commonwealth would, however, suggest that there will be a downward revision to GDP and an upward revision to unemployment as part of the 2009-10 Commonwealth Budget. It would appear a recession is almost certain.

In the ACT in 2009-10, the economic picture is likely to be primarily influenced by lower interest rates and the relative job security enjoyed by ACT residents as well as the financial crisis and its impact on confidence, asset prices and credit availability.

The ACT is a particularly interest rate sensitive jurisdiction. Part of the slowdown in 2008-09 was a response to the high interest rate environment in Australia until late 2008. As interest rates were lowered, the typical rebound in consumption and investment has been dampened due to the continued effects of the global financial crisis on household wealth and consumer confidence. With a likely stabilisation in household wealth as 2009 progresses, the historically low interest rates should reinvigorate confidence within the ACT economy.

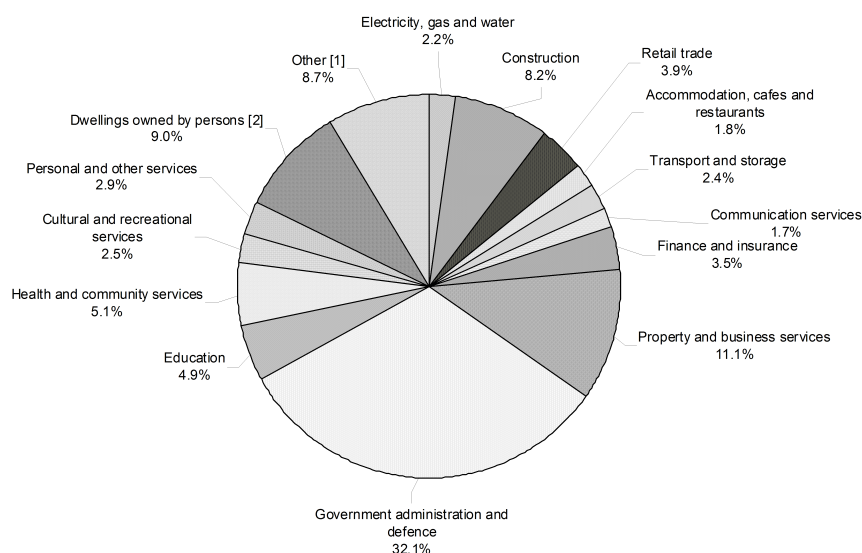
Commonwealth Government consumption expenditure has long been a significant contributor to the ACT's economic growth. However, with the ongoing effects of last year's tight Commonwealth budget, including the increased efficiency dividend limiting Commonwealth Departmental budgets, the contribution of government consumption to the ACT's growth in 2009-10 is expected to be relatively weak. Changes in Commonwealth Government employment are, however, still expected to contribute positively to overall employment growth in the ACT.

Changes in Commonwealth Government outlays place significant **risk** on the ACT's economic forecasts. These economic forecasts are based on the announced Commonwealth budget position as published in its 2008-09 Budget and subsequent updates. The uncertainty and lower confidence arising from the ongoing global financial crisis also brings risks to the

ACT's economic forecasts. The rapid cuts in official interest rates will take time to reach maximum effectiveness in the domestic economy. This delay is being exacerbated by reductions in asset prices. An assumed stabilisation in asset prices underlies the economic forecasts.

Gross State Product (GSP), the Australian Bureau of Statistics' headline measure of the ACT economy, is forecast to grow at ½ per cent in 2009-10. On the expenditure side, the growth in GSP will be primarily supported by private consumption. However, as a large proportion of household consumption items are imported into the ACT, a growing household consumption base, all else equal, will generally not be reflected in GSP growth to the same extent as it will be in State Final Demand.

Figure 6.1.1
Share of Gross State Product 2007-08
Current Price Industry Value Added

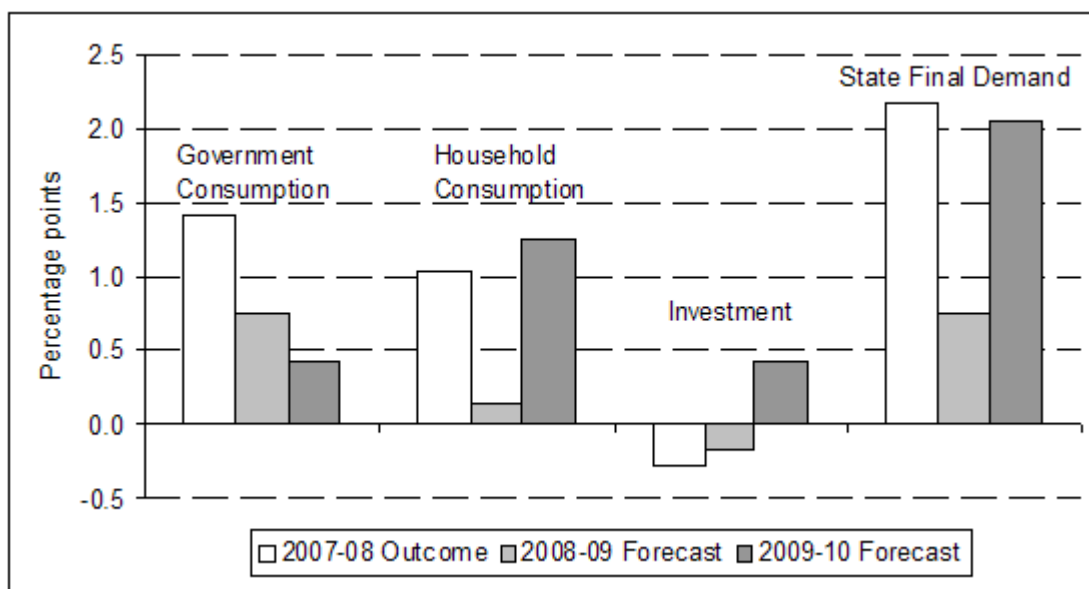


Source: ABS Cat. No. 5220.0

1. 'Other' includes Agriculture, forestry and fishing industry, Mining industry, Manufacturing, Wholesale trade and Taxes less subsidies on products.
2. This industry values the services provided by dwellings to renters and owner-occupiers. Rent is imputed for owner-occupied dwellings to enable the services provided by those dwellings to be treated consistently with the marketed services provided to tenants by rented dwellings.

State Final Demand (SFD) is forecast to grow at 2 per cent in 2009-10, an increase from the expected growth in 2008-09 but still below the long-term growth rate. The forecast growth in 2009-10 mainly reflects the contribution from the growth in household consumption. The main reason the forecast for SFD is below trend in 2009-10 is the relatively low growth in Commonwealth Government outlays in the ACT. Contributions to SFD from the various components are shown in Figure 6.1.2.

Figure 6.1.2
Contributions to Growth in ACT State Final Demand



Source: ABS, Cat. No. 5206.0 and ACT Treasury estimates

Government consumption expenditure, particularly that of the Commonwealth Government, is a key determinant of economic activity in the ACT. The Commonwealth’s 2008-09 Budget (and subsequent updates) forecast very moderate government expenditure growth in 2008-09, including a significant efficiency dividend imposed on all Commonwealth Government agencies, and a further moderation in the growth of Commonwealth Government outlays in 2009-10. Nonetheless, the weakness in Commonwealth Government consumption is not expected to result in a net reduction in Commonwealth employment in the ACT. A reallocation of resources between programs is the most likely outcome of efficiencies at the Commonwealth level. Government consumption expenditure in the ACT is expected to be the lowest contributor to SFD growth. The Commonwealth Government stimulus packages, although significant, largely comprise cash transfers and investment, and will not contribute to the Government consumption component of SFD growth.

Growth in household consumption expenditure in the ACT is expected to improve in 2009-10 as significantly lower interest and inflation rates combine with relative job security in the ACT to restore consumer confidence and maintain strong disposable income growth. This follows an easing in retail sales over the last two years, initially due to the high levels of interest rates, and more recently due to a significant fall in consumer confidence and lower household wealth as a result of the global financial crisis.

Investment is forecast to rebound following negative growth in 2007-08 and 2008-09. Private investment is expected to grow in 2009-10 with increased dwelling investment offsetting an easing in non-dwelling construction. Partly offsetting the forecast rise in private investment is a small fall in public sector investment attributable to the Commonwealth Government.

The outlook for ACT **dwelling investment** is for solid growth. Increased land supply has played an important role in meeting the demand for new dwelling investment. The Commonwealth Government’s temporary tripling of the First Home Owners Grant for the construction of new houses and the low interest rate environment are working to increase demand for new dwellings. Although the boost to the First Home Owners Grant expires on

30 June 2009, contracts signed up until this date will almost certainly lead to dwelling investment extending well into 2009-10. The low interest rate environment is likely to also restore confidence in the wider housing market which, along with increased land supply, should provide a healthy boost to dwelling construction for non-first home buyers. As a result, residential property **turnover** is expected to rebound and experience moderate growth, following the downturn in 2008-09, while real property **price** growth is expected to be positive in 2009-10.

Non-dwelling construction growth is expected to ease in 2009-10, although overall construction is expected to remain at high levels. Non-dwelling construction in 2009-10 will be underpinned by a number of large commercial developments. These include the Australian National University Exchange, Section 63, and new offices to house the Australian Security Intelligence Organisation and the Office of National Assessments, as well as the Commonwealth Department of Environment and Water Resources.

Public investment is expected to remain at high levels in 2009-10 despite easing in 2008-09. The ACT Government investment in infrastructure will continue at a record high level. A significant amount of investment is also expected to flow to the ACT as part of the Commonwealth Government's \$42 billion *Nation Building and Jobs Plan*. In 2009-10 alone, the ACT's share of Commonwealth Government investment expenditure resulting from the Plan is expected to be in the order of \$210 million. This should help to support the level of Commonwealth Government investment in the ACT which has moderated recently.

ACT **labour market** activity is forecast to ease in 2009-10 due to the lagged effect of moderating economic activity in 2008-09. Significantly lower interest rates and reductions in employee working hours are expected to support employment, with growth moderating only slightly compared to that recorded in 2008-09.

Population growth in 2009-10 is expected to be 1 per cent, in line with the longer-run average. Natural increase and net interstate migration rates are forecast to make positive contributions to the population growth. In periods of economic downturn in the past, net interstate migration into the ACT has been relatively strong. These factors will nevertheless be partially offset by net overseas migration which is likely to be a negative contributor to growth, as a result of the proposed reductions in the skilled migration program.

Labour Market

Further moderation in employment growth is forecast for 2009-10 due to the lagged impact of moderating activity in 2008-09. Trend unemployment is expected to increase from the historical lows experienced in late 2008, but to remain below the long-term average for the ACT and to be comparatively much better than other jurisdictions.

Employment

The global economic downturn has inevitably impacted on the Australian labour market, and thus the ACT labour market. However, rather than immediately shedding staff, as has been common in past economic slowdowns, some employers may be more cautious in relation to downsizing workforces. In response to difficulties many businesses had in securing skilled

workers in the first place, some businesses may attempt to cope with the downturn by reducing overtime or working hours, with the expectation that a recovery is not far away.

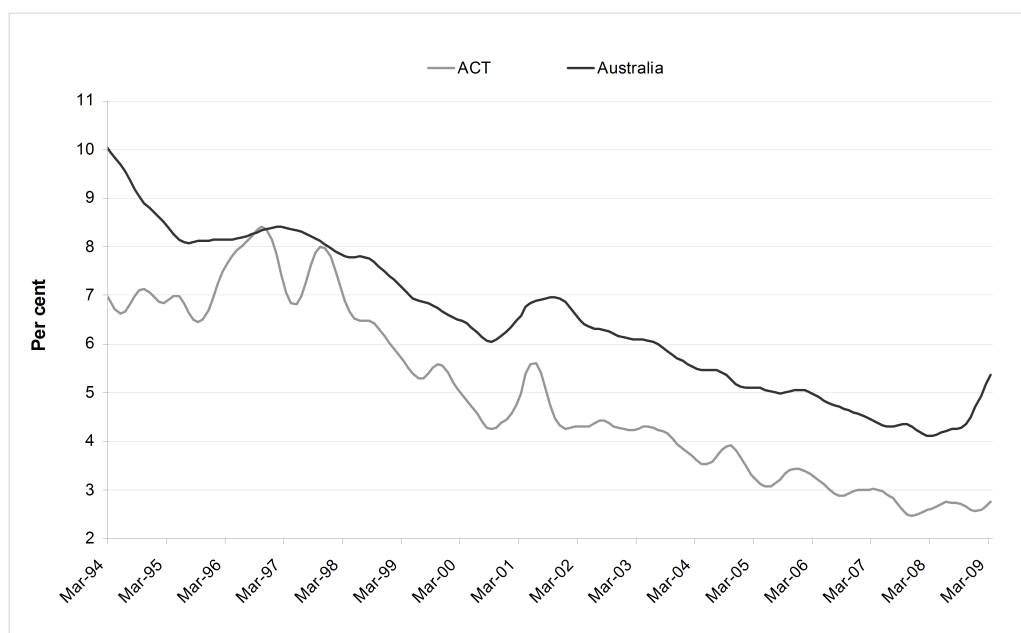
Employment growth is forecast to moderate from $\frac{3}{4}$ per cent in 2008-09, to $\frac{1}{2}$ per cent in 2009-10, below the long-term average rate of $1\frac{3}{4}$ per cent. The easing in employment growth in 2009-10 is a result of the lagged impact of moderating economic activity in 2008-09. However, the significantly lower interest rate environment should once again begin to support growth in employment towards the latter half of 2009-10.

The ACT unemployment rate is at historically low levels. Over the last 15 years the unemployment rate in the ACT has gradually trended down, consistent with the pattern recorded across Australia. However, over the three months to March 2009, the unemployment rate in the ACT has edged slightly higher, while the national rate has rapidly increased (see Figure 6.1.3). This is possibly due to major job losses across Australia occurring in industries in which the ACT has little or no exposure, namely the finance, mining and manufacturing industries; and employers in the ACT being more reluctant to shed staff having been through a period of acute skills shortages.

Regardless, the ACT unemployment rate is estimated to increase from the current rate of 2.8 per cent to around 3 per cent at the end of June 2009 and further to $3\frac{1}{2}$ per cent at the end of June 2010. This estimate is consistent with the forecasts for economic activity over the period and is based on the assumption of a constant labour force participation rate. The ACT unemployment rate is expected to remain below its long-term trend as well as the national rate.

At the national level, the Commonwealth Government in the Updated Economic and Financial Outlook (UEFO), published in February 2009, has revised down the forecast for employment growth to a fall of $\frac{3}{4}$ per cent in 2009-10, with a corresponding and significant rise in unemployment to 7 per cent.

Figure 6.1.3
Trend Unemployment Rate, ACT and Australia (Monthly Data)



Labour costs

Wages growth, as expressed by the Wage Price Index (WPI), is forecast to grow at 3½ per cent in 2009-10, representing a moderation from the forecast growth of 3¾ per cent in 2008-09. The forecast reflects moderating demand for labour, rising unemployment and lower inflation. The relative job security offered to many employees in the ACT may also place downward pressure on wages.

Over the year to the December quarter 2008, WPI growth was 3.7 per cent, lower than the 4.3 per cent recorded nationally. Taking inflation into account, growth in real wages over this period was largely flat in Canberra, lower than the around 0.6 per cent real growth recorded nationally.

Investment

Housing market

The ACT housing market is forecast to recover somewhat from the forecast weakness of 2008-09. This is in response to lower interest rates, the Commonwealth Government's stimulus packages, and the relative job security afforded to many ACT employees. First home buyers are likely to be one of the main drivers of this recovery, at least initially.

Property turnover is forecast to grow modestly in 2009-10 following the expected fall in 2008-09. House prices are forecast to return to modest real price growth in 2009-10 following the weakness of 2008-09.

First home owner activity is expected to continue to pick up in the early part of 2009-10. As 2009-10 progresses, investors are expected to increasingly return to the housing market as rental returns and capital appreciation improve relative to other investments.

Turnover of new and established dwellings

Underlying demand for residential property has been weak for most of 2008-09 (see Figure 6.1.4). The risk of this occurrence was highlighted in the 2008-09 Budget. It was initially a result of the high interest rate environment in the early part of the year, and later in response to the global financial crisis.

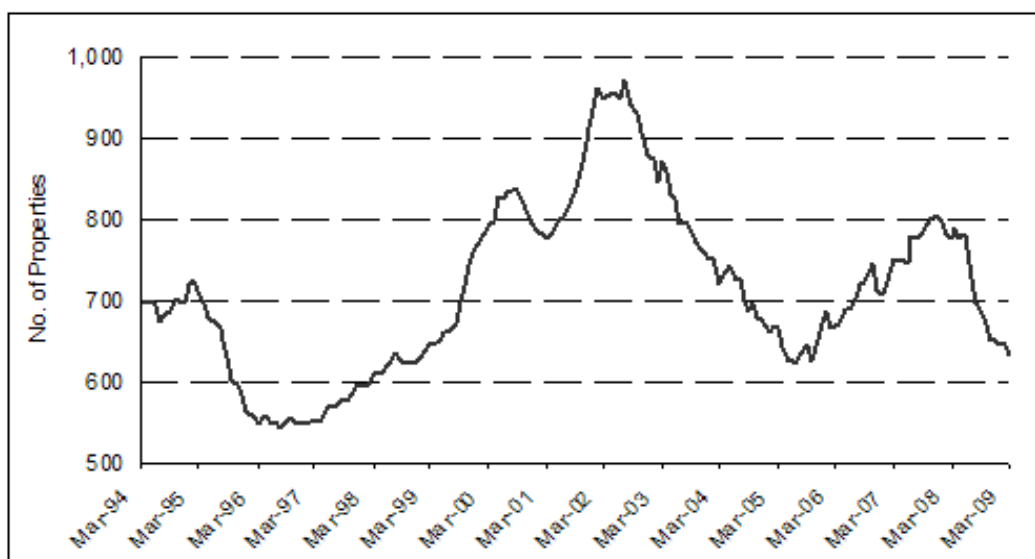
Moving forward, demand for residential property is likely to return, initially from first home buyers, then from second and subsequent owner-occupiers, and later into the year from investors. Second and subsequent owner-occupiers are likely to drive the market in 2009-10 as lower interest rates, relatively high levels of job security and a stabilisation in wealth levels all combine to inject confidence back into the housing market.

The first home owners segment of the market is particularly sensitive to interest rate movements and with rates at 49 year lows, it is expected to provide an ongoing boost. This boost will be supported by the ACT Government's Housing Affordability initiatives and accelerated land release program which will assist in the supply of low cost housing options.

The last year has not been particularly conducive to housing investment, with falling house prices and uncertainty in financial markets reducing the growth in financing from housing investors. However, with sharemarket returns likely to remain low until the global economy recovers, and as confidence in the housing market grows, the relative attractiveness of the ACT's housing market will improve. As such, investors are expected to increasingly contribute to the rise in turnover later in 2009-10.

However, there remains a risk that financial market volatility could lead to ongoing easing in the levels of personal wealth and a subsequent further moderation in demand for housing.

Figure 6.1.4
ACT Residential Turnover, 12 Month Moving Average,
Monthly Original Data



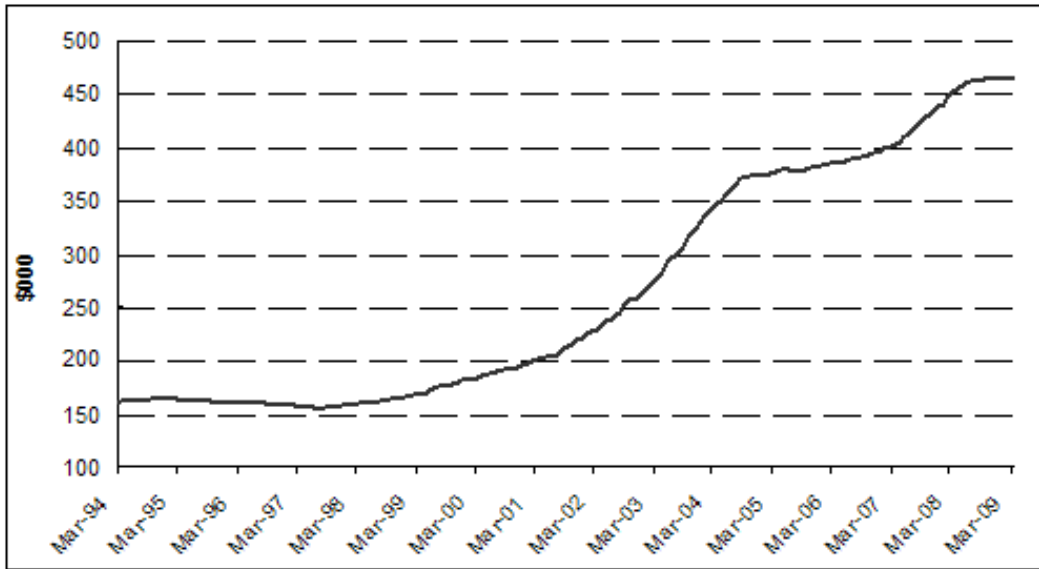
Source: ACT Planning and Land Authority

Price movements

House prices moderated in 2008-09 in response to the combination of high interest rates, uncertainty arising from the global financial crisis, which impacted on confidence and therefore demand, as well as ACT Government housing affordability initiatives (see Figure 6.1.5). Towards the end of 2008, conditions became quite favourable for first home buyers. Typically, this cohort are purchasers of lower priced housing. Subsequently the pick up in demand from first home buyers has exacerbated the downward pressure on average price of house sales.

As confidence returns to the housing market, the pent up demand from strong population growth in recent years is expected to place upward pressure on house prices in 2009-10. The likely return of investors later in the year should provide an environment where all segments of the housing market — first home buyers, second and subsequent purchasers and investors — are all actively involved at some point. This combination is expected to restore real house price growth especially while interest rates remain at historical lows.

Figure 6.1.5
ACT Residential Property Average Price, 12 Month Moving Average,
Monthly Original Data



Source: ACT Planning and Land Authority

Rental Market

Small investors dominate the private rental market in the ACT, who at the time of the 2006 Census of Population and Housing, provided approximately 23,000 dwellings for rent. The weekly rent for a three-bedroom house in Canberra in the year to December 2008 rose by 6.8 per cent, the lowest annual increase of all states or territories.

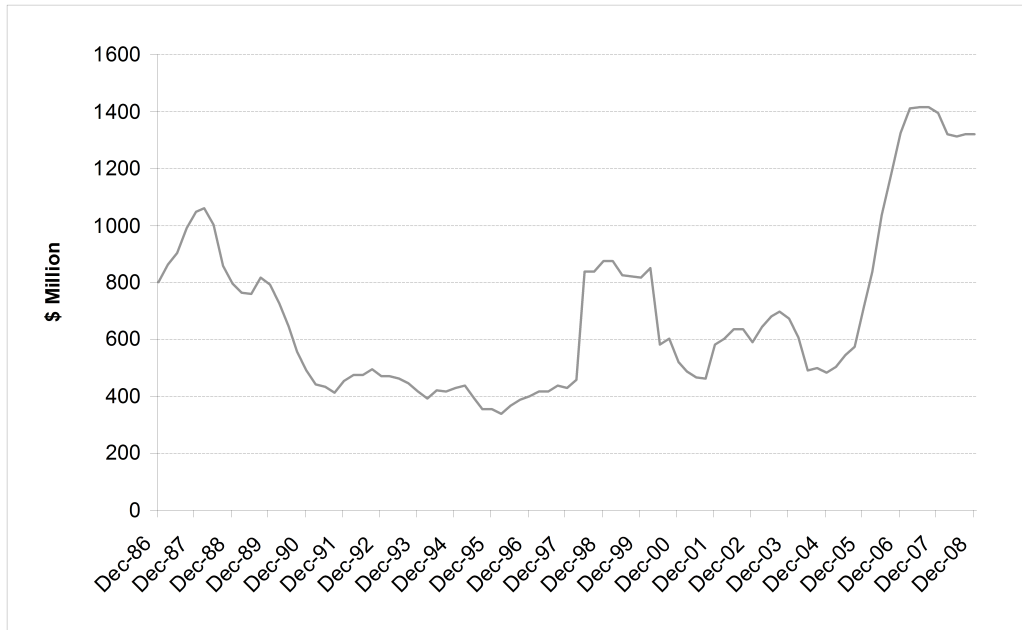
The rental vacancy rate in the ACT, at 2.3 per cent in December 2008, is lower than the 2.6 per cent in December 2007 and also below the ten-year average of 2.7 per cent. The declining vacancy rate indicates a tight rental market, which is consistent with the fall in finance for housing investment in the past year. However as the property market becomes more attractive, relative to other investment opportunities, investor activity is expected to increase. This is likely to result in an increase in the supply of rental accommodation and thereby limit upward pressure on rental prices beyond 2009-10.

Non-Dwelling Construction

The volume of ACT non-dwelling construction work done in 2008 was \$1.3 billion, in price adjusted terms (see Figure 6.1.6), the second highest calendar year level recorded in the ACT. The continued high level of non-dwelling construction is still expected to contribute strongly to overall investment in 2009-10.

The global financial crisis presents a risk to the investment outlook with some proposed projects cancelled or delayed in the past several months as credit conditions tightened. Nevertheless, non-dwelling construction is likely to continue at high levels in 2009-10 given the projects already underway and the strong likelihood of a number of other high value projects in the near future. Viable commercial property projects should benefit from the Commonwealth's Australian Business Investment Partnership which is aimed at providing liquidity support to the commercial property sector.

Figure 6.1.6
Volume of ACT non-dwelling construction
Annual original data



Source: ABS Cat. No. 5206.0

Consumer prices and interest rates

Consumer prices

Australia's inflation has been moderating in recent quarters after an extended period of rapidly rising prices. This is in response to weaker global growth and domestic demand, as well as the associated impact on commodity prices and interest rates. Two of the main items contributing to the moderation in inflation are items which had previously contributed to the rapidly increasing inflation rate, namely fuel prices and the cost of financial services (that is, changes in interest rates). Moderating wage pressures, as the national economy slows and unemployment rises, are likely to exert further downward pressure on inflation in 2009-10. The main upward driver to inflation in the short term is the significant depreciation of the Australian dollar, although this appears to have reversed to some extent recently. On balance, all these factors should combine to drive down inflation, as measured by the Consumer Price Index (CPI), to around 2 per cent, in through the year terms, in 2008-09 and 2009-10. This is at the lower bound of the RBA's inflation target of 2-3 per cent on average over the economic cycle.

Consumer prices in Canberra in 2007-08, as measured by the CPI, grew by 3.6 per cent. This was largely influenced by increases in the cost of fuel, financial services and housing related expenses. However, with the prices of fuel and financial services decreasing significantly in recent quarters the forecast CPI growth for 2008-09 has been revised down to 3½ per cent.

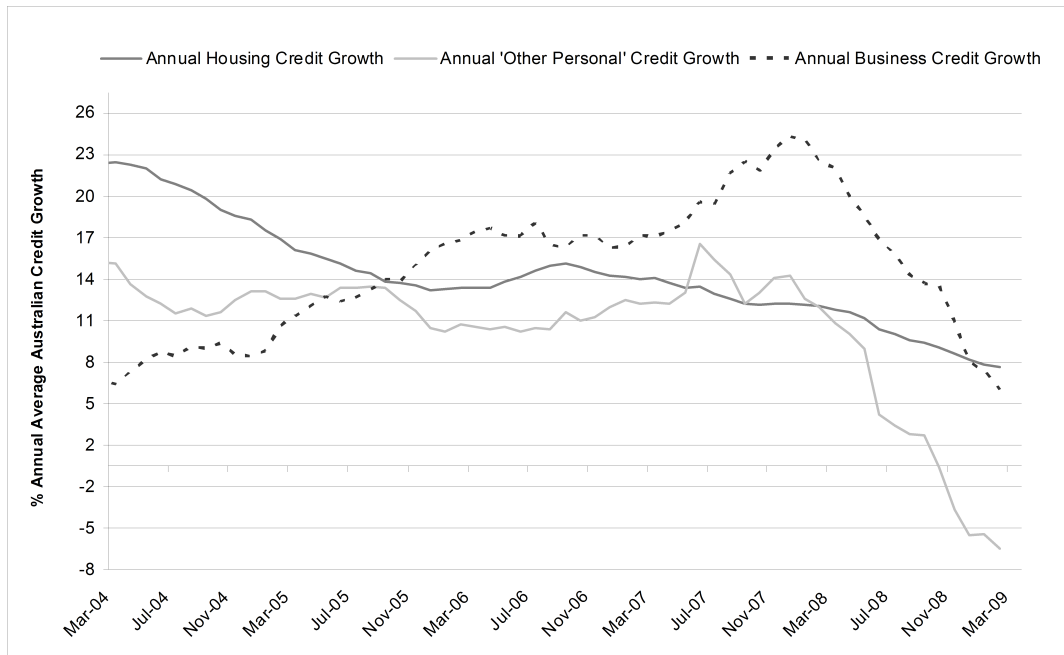
Interest Rates

The RBA has cut the official cash rate target by 4.25 percentage points since September 2008, taking the target rate to a 49-year low of 3 per cent.

The RBA has stated that it is concerned about the significant economic downturn as a result of the global financial crisis. The RBA has signalled its intention to keep reducing interest rates to assist in the recovery of the domestic economy.

National housing and other personal credit growth have been falling in 2008 (see Figure 6.1.10). This is most likely a response to the uncertainty in the current economic environment, resulting from the global financial crisis. Individuals are now diverting a greater share of their incomes to debt reduction and saving rather than consumption spending. The fall in business credit growth stems from a combination of an increasingly risk averse approach as business confidence falls and a lack of competition in business lending. Many businesses are reacting to the slowing economy by postponing or cancelling major capital expenditure. Other businesses which may be seeking to expand are finding it more difficult to access credit. At the same time that a number of foreign banks have exited the business lending market, the remaining lenders have tightened their lending criteria, particularly for new customers. This has meant that access to business credit, even for otherwise sound business operations, has been more difficult, especially for those businesses which were previously funded by foreign banks.

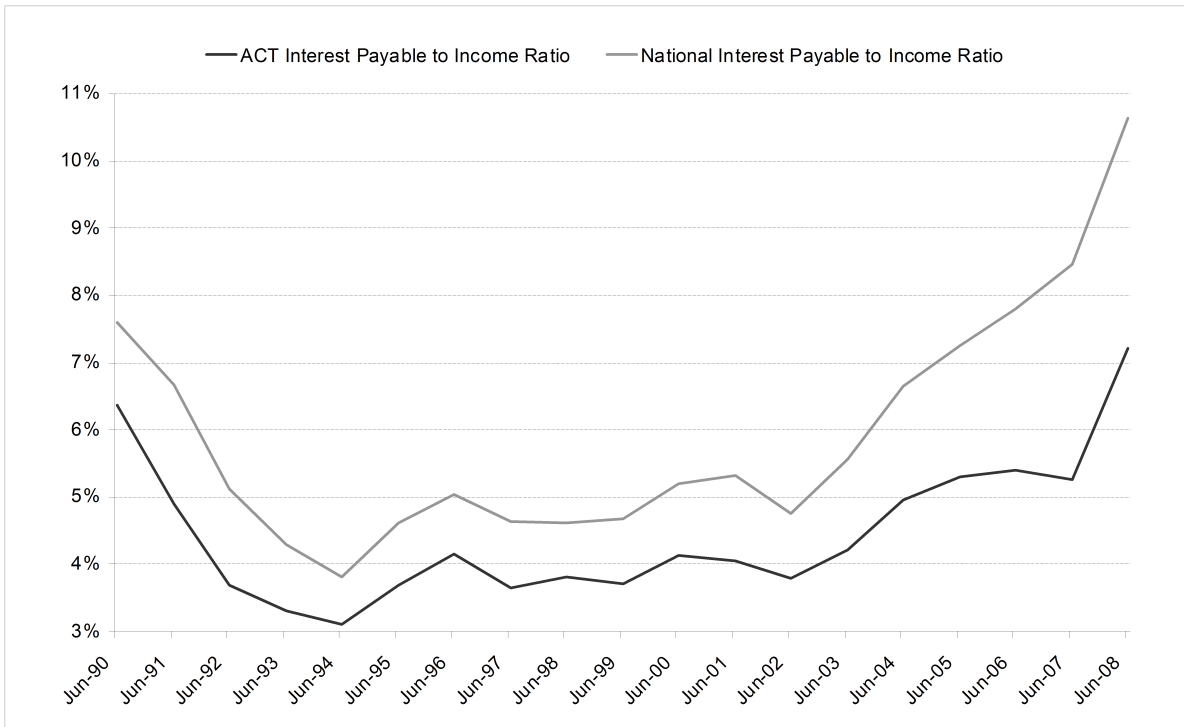
Figure 6.1.7
Australian Annual Growth in Credit



Source: RBA

Until the end of 2007-08 ACT households experienced increasing debt servicing costs, mainly as a result of high interest rates. Apart from a period between 2005 and 2007, this was consistent with the national trend. Since ACT households possess higher income levels than the rest of the nation, ACT households were in a much better position to service their interest liabilities compared to Australian households overall (see Figure 6.1.11). However, this data does not take into account the cumulative 4.25 percentage point interest rate cuts since September 2008 which would be expected to reduce the interest payable to income ratio for both Australia and the ACT.

Figure 6.1.8
Interest to Income Ratios



Source: ABS Cat No. 5220.0

