7.1 ECONOMIC CONDITIONS

Overview

The ACT economy is expected to continue to experience positive conditions throughout the forecast period. In 2007-08, the economy is forecast to expand on the basis of solid growth in both household consumption expenditure and Australian Government expenditure. The level of private investment in the Territory is forecast to remain high in 2007-08, but a lower rate of growth is expected compared to the record high rate recorded in 2005-06. The ACT unemployment rate is expected to remain around record low levels and employment growth in 2007-08 is forecast to ease. Labour supply constraints are likely to persist into 2007-08.

The Outlook for the ACT Economy

The prospects for the **ACT economy** remain positive in 2007-08. Demand conditions are expected to remain strong, although growth will moderate somewhat from the high levels experienced in 2005-06 and so far in 2006-07. There will be some easing of supply constraints, but they will remain a key limitation on the prospects for the ACT economy.

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[(a)]		Projections [(b)]		
	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
ACT						
State Final Demand	5.3	4	4	4¾	4¾	4¾
Employment	1.6	3	1½	1½	1½	1½
Population	0.9	1 ¼	1 ¼	1	1	1
Consumer Price Index	3.6	2 ¾	2 ¾	2½	2½	2½
Wage Price Index	4.1	4	4	4	4	4
Australia						
Gross Domestic Product[(c)]	2.9	2½	3 ¾	3	3	3
Memorandum item[(d)]						
ACT Gross State Product	3.4	2½	2½	2½	2½	2½

Notes

(a) Forecasts and projections 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.

(b) Projections are based on long-run averages and are provided for planning purposes only. They do not reflect an expectation (forecast) of actual outcomes.

(c) Australian Government forecast, 2007-08 Budget, May 2007.

(d) The measure of production in the ACT economy, Gross State Product (GSP), is presented as a memorandum item, consistent with advice from the Australian Bureau of Statistics (ABS) that users should exercise caution when using estimates of real growth in the GSP measure for economic analysis, and consistent with the ABS labelling the real estimates of GSP as 'experimental'. The ABS estimates of real growth in GSP are derived indirectly. The method involves deriving a price deflator from the best possible nominal and real estimates of expenditure (SFD) that encompass as much as possible of GSP. This deflator is then applied to current price income estimates of GSP. Given these measurement issues, the ABS is currently developing estimates of GSP using the production approach. The ABS believes that better quality real estimates of GSP can be produced using this approach.

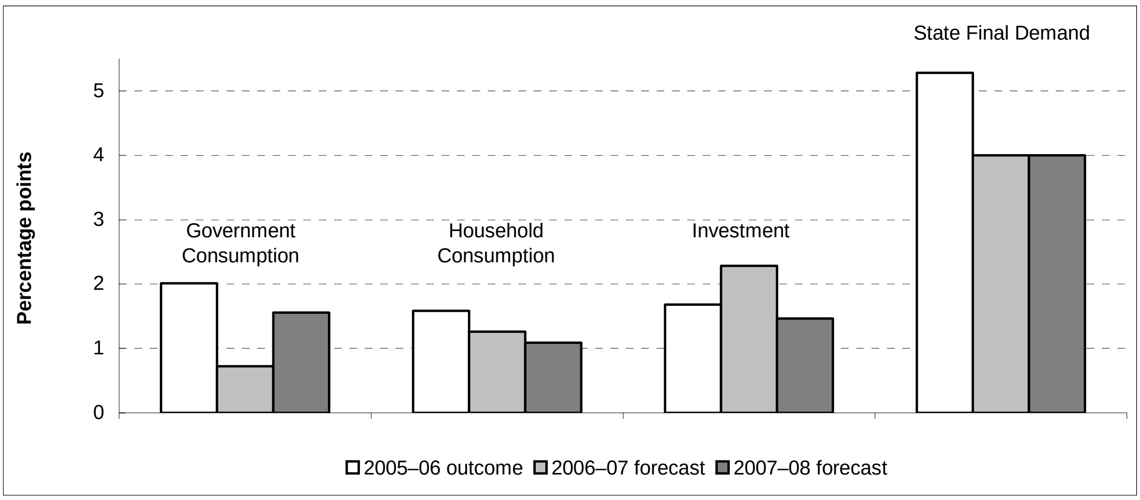
The Australian Government forecasts the national economy to strengthen in 2007-08. These forecasts are for Gross Domestic Product to grow at 3¾ per cent on the basis of improved performance from the rural sector, consistent with the assumption of a return to more normal seasonal conditions and the expectation of solid growth in consumption and investment. Exports are expected to grow in 2007-08, with the economy reaping the benefits flowing from increased business investment in recent years, although growth in business investment is forecast to moderate. The Australian Government expects productivity growth to improve and the prices of volatile items (such as petrol, fruit and vegetables) to moderate, allowing inflation to approach the middle of the Reserve Bank of Australia's (RBA) monetary policy target band of between two and three per cent in 2007-08.

Economic growth in the ACT is expected to remain broadly in line with the national average. While still constrained by supply, the ACT is expected to experience income and employment growth, driven substantially by Australian Government expenditure in the ACT, which in turn will encourage household consumption growth in 2007-08.

Gross State Product (GSP), the Australian Bureau of Statistics headline measure of the ACT economy is forecast to grow at around its historic average of 2½ per cent throughout the forecast period. However, there can be a significant divergence between actual economic activity and that measured by GSP. For this reason, the ABS advises that users exercise caution when using GSP estimates for economic analysis, as they may not provide an accurate picture of the ACT economy.

State Final Demand (SFD) is expected to show growth of 4 per cent in 2007-08. This reflects solid growth in Australian Government outlays in the ACT, private consumption and housing investment. Offsetting these factors, business investment is forecast to ease in 2007-08 from the high growth rates experienced in 2005-06 and in 2006-07 to date. Contributions to SFD from the various components are shown in Figure 7.1.1.

Figure 7.1.1
Contributions to Growth in ACT State Final Demand



Source: ABS, Cat. No. 5220.0 and ACT Treasury estimates

Government consumption expenditure, particularly that of the Australian Government, is a key determinate of economic activity in the ACT. Following modest growth in Australian Government consumption expenditure in the ACT in 2006-07 to date, growth in outlays is forecast to increase in 2007-08.

Private consumption expenditure in the ACT is expected to continue to grow at around long-run average rates. Consumption is being driven by growth in real wages and population, but these factors are likely to be offset by subdued growth in household wealth as real house price growth moderates. The contractionary nature of current monetary policy settings and the risk of further upward movements in interest rates are expected to further dampen consumption.

The general outlook for the ACT **labour market** remains positive across the forecast period. Employment in the ACT is expected to ease in 2007-08 to the long run average growth rate of 1½ per cent from the above-average growth of 3 per cent expected in 2006-07. A forecast population growth rate of 1¼ per cent, as well as a high participation rate, is expected to generate employment growth. However, a continued shortage of suitably skilled workers is likely to constrain employment growth in key industry sectors in 2007-08.

Although the outlook for **private investment** in 2007-08 remains strong, growth is forecast to slow from the significant acceleration experienced in 2005-06, and to date in 2006-07.

Businesses in the ACT are optimistic, buoyed by strong consumer demand. Investment is running at high levels, while growth in business credit remains strong, adding weight to the prospects for further increases in **business investment** over the forecast period.

Non-dwelling construction growth is forecast to gradually ease from the 2005-06 record levels of activity that had not been experienced since the investment growth that occurred with the construction of new Parliament House. The volume of non-dwelling construction activity undertaken in the ACT in 2005-06 was 85 per cent higher than that of the previous year. This high growth has been largely driven by the expansion in the number of Australian Government public servants working in the ACT and the demand for new office buildings to replace older leased offices. As the work started in recent years is completed, and the number of new projects falls, non-dwelling construction is expected to moderate significantly as a driver of private investment.

The outlook for ACT **dwelling investment** is for modest growth, as the market continues its consolidation after the downturn following the national housing boom in the early part of the decade. A large number of residential blocks are earmarked for release during the final quarter of 2006-07 and throughout 2007-08. This additional land supply, combined with housing affordability policy measures announced in April 2007, is expected to remove some of the pent up demand for housing and stimulate dwelling investment in 2007-08.

For the established **housing market**, residential property **turnover** is expected to experience moderate growth, consistent with a degree of easing of supply constraints, while real property **prices** are similarly expected to rise at modest rates in 2007-08.

Population growth over the forecast period is expected to be 1¼ per cent, above long-run average growth of 1 per cent. A sustained period of recruitment activity by Australian Government agencies is contributing to this above-average population growth.

A change in Australian Government outlays is the most significant **risk** to the ACT's economic forecasts. The potential for a change of budget policy arising from the upcoming federal election magnifies this risk in the short term. In addition, there is the possibility that consumption, investment and employment growth will be affected during the election period due to lower levels of activity in many Australian Government departments.

Finally, although **interest rates** are expected to remain relatively stable over the forecast period, further sustained rises in interest rates would negatively impact on private consumption and investment in the ACT, particularly given the build-up in household debt in recent years.

Labour Market

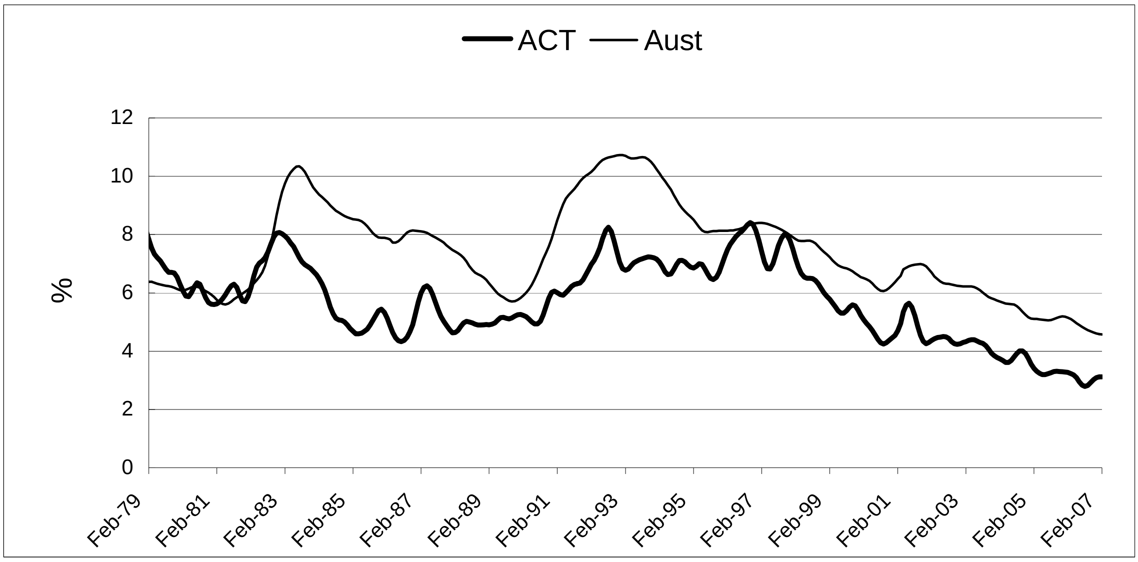
The ACT labour market is expected to remain strong over 2007-08, despite some sectors being constrained by skills shortages. Strong demand for labour is expected to keep the trend unemployment rate well below the national rate and the labour force participation rate around record highs.

Employment

Following expected strong employment growth of around 3 per cent in 2006-07, on the back of intense recruiting activity by the Australian Government and to a lesser extent the private sector, employment growth for 2007-08 is forecast to moderate to the long term average growth rate of 1½ per cent. The unemployment rate is at historically low levels – currently averaging a trend rate of 3 per cent for 2006-07. With skills shortages continuing to pose significant challenges for employers, and demand for labour expected to remain strong, unemployment is expected to remain, between 2½ per cent and 3½ per cent during 2007-08. Given that the ACT is near full employment, the contribution to employment growth is expected to come from increases in participation, as new workforce entrants tend to move directly into employment.

At the national level, employment has grown faster than that forecast by the Australian Government in the Federal Budget of 2006-07, but the Australian Government expects this to moderate to 1½ per cent in 2007-08. Although the national unemployment rate is expected to rise over the forecast period from its current 30-year low, a slightly softer national labour market is expected to provide only a limited incentive for interstate migration to the ACT, allowing only a minor easing of the tight ACT labour market.

Figure 7.1.2
Trend Unemployment Rate, ACT and Australia (Monthly Data)



Source: ABS Cat No. 6202.0

Labour costs

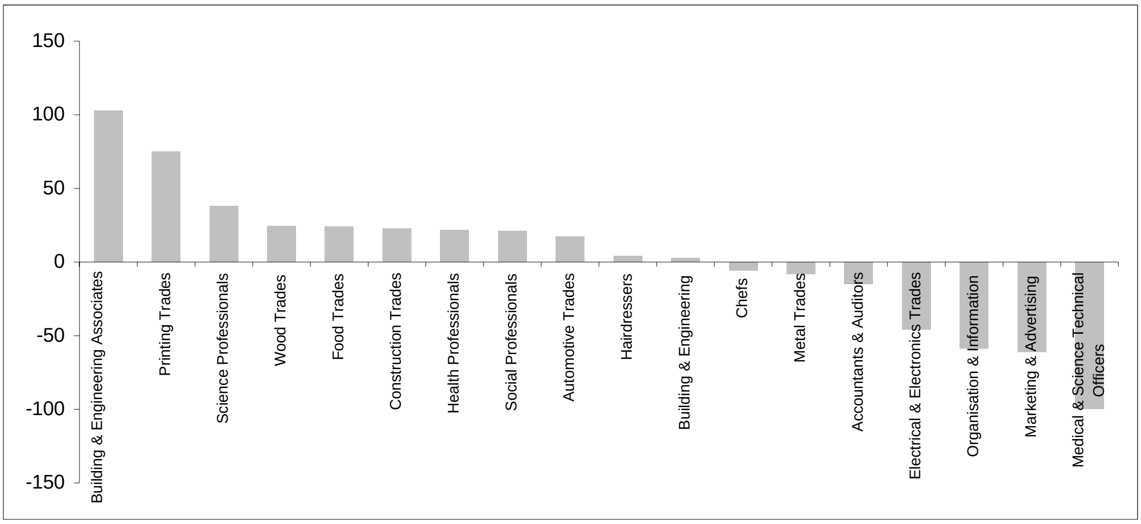
Wages growth, as expressed by the Wage Price Index (WPI), is forecast to grow at 4 per cent in both 2006-07 and 2007-08. Given labour supply constraints and a continued demand for labour, there is upside risk to wages growth over the short term, especially in many services industries that may be experiencing skills shortages. This risk may be magnified in the ACT due to its tighter labour market.

For the year to the December quarter 2006, annual average WPI growth was 4 per cent per annum, equal to the 4 per cent per annum recorded nationally. Taking inflation into account, growth in real wages over this period was 0.9 per cent in Canberra, higher than the 0.7 per cent recorded nationally. Public sector wages in Canberra grew at an annual rate of 4.4 per cent for the year ending the December quarter 2006 — faster than the 3.5 per cent wages growth recorded in the private sector.

Skilled vacancies in the ACT

One indicator of the strength of demand for labour, and the persistence of skills shortages, is the Department of Employment and Workplace Relations (DEWR) index of skilled vacancies, which counts the skilled vacancies in the major newspapers each month. In the year to March 2007 (Figure 7.1.3), the ACT recorded an increase in advertised vacancies, with eleven of the eighteen occupational groups surveyed by the DEWR index recording higher vacancy levels over the year. The largest rises were recorded for Building and Engineering Associate Professionals, Printing Trades and Science Professionals.

Figure 7.1.3
Skilled Vacancies – ACT annual change (%) – March 2007



Source: DEWR Vacancy Report March 2007

Skills shortages are a nation-wide problem. With national employment rising steadily, and the ACT economy experiencing employment growth in an environment of high participation rates and moderate population growth, skills shortages are expected to persist throughout 2007-08.

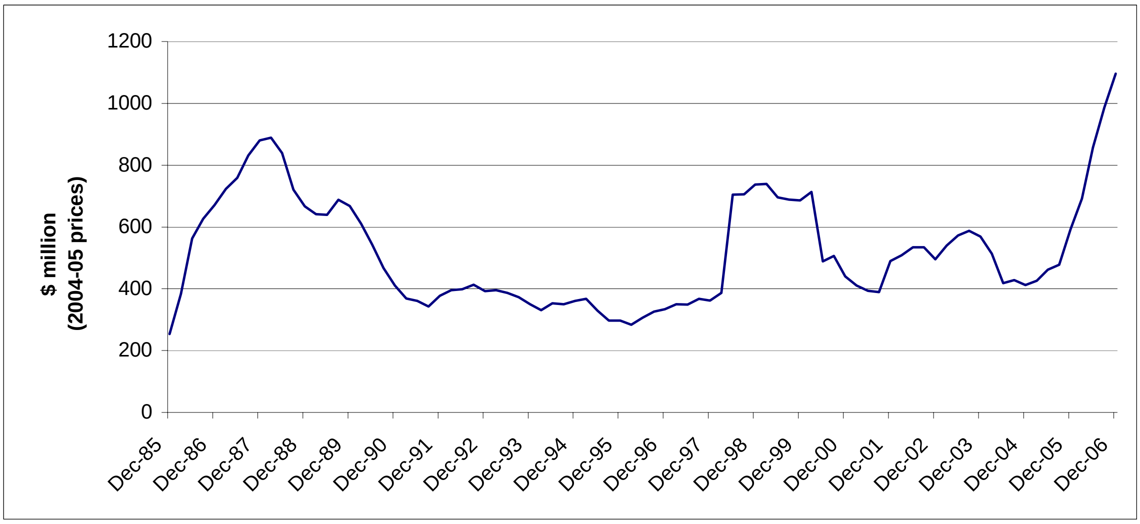
Short-term skills shortages can, in part, be attributed to the cyclical point of the labour market. That is, as the ACT approaches supply capacity constraints and the demand for labour keeps increasing, shortages can be expected while the market takes time to adjust wages, which in turn attracts more people to obtain the relevant skills through appropriate training. Training may take some time however, causing short-term shortages. Medium-term skills shortages relate to the provision of education in the key areas of need. Longer-term skills shortages relate to demographic trends such as the ageing of the population, which will result in a smaller workforce as ageing workers retire and there are relatively less young workers to replace them.

Investment

Non-Dwelling Construction

The volume of ACT non-dwelling building work done in 2006 was $1.1 billion, almost three times higher than the $412 million recorded in 2004 (in price adjusted terms). This surge in non-dwelling building construction has been unprecedented in the Territory’s history, even eclipsing the activity associated with the construction of the New Parliament House in the late 1980’s. Both the development of new office blocks, created mainly to accommodate the expanding Australian Government workforce, and new retail complexes, have sustained this growth.

Figure 7.1.4
Volume of ACT non-dwelling construction
Annual original data



Source: ABS Cat. No. 5206.0

Non-dwelling construction remains strong so far in 2006-07, with very high levels of non-dwelling building work expected to be maintained during this period, although at a growth rate lower than that attained during 2005-06. It is likely that the level of non-dwelling construction activity will decline in 2007-08, with the associated potential for negative growth a possibility as activity returns to more normal levels.

Offsetting this moderation in non-dwelling investment in 2007-08 is the forecast for sustained growth in business investment and dwelling investment. Growth in household incomes, a stable macroeconomic environment, and the prospects for an increased availability of land for development provide a basis for future business expansion and dwelling construction.

Housing market

The ACT housing market is expected to experience moderate growth over the forward estimates, consistent with a buoyant labour market and continued household income growth. Property turnover, while growing only modestly in 2006-07, is expected to rise in 2007-08 in line with the release of new land and units over the forecast period. House prices are set to record modest real growth in 2007-08.

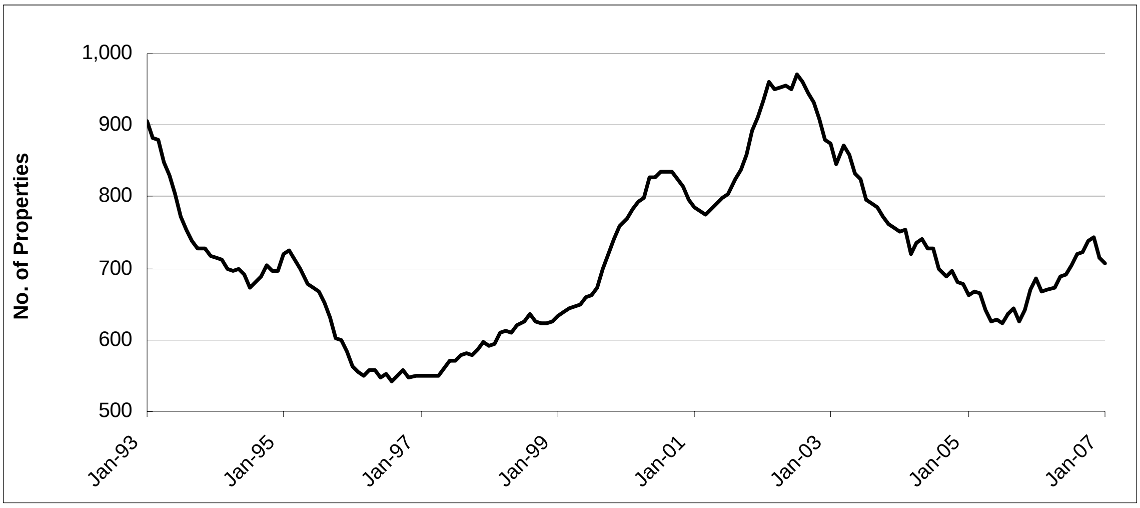
The growth observed in the housing market since mid-2004 has followed a more sustainable and steady pattern than that apparent during the housing boom period of 2000 to 2003. Owner-occupier housing turnover will rise, as more land is released and investors are expected to increasingly enter the market in 2007-08 as rental returns improve relative to other investments.

Modest house price growth, rising incomes and the ACT Government's Housing Affordability initiatives will support continued interest by first home buyers during 2007-08.

Turnover of new and established dwellings

In 2006-07, residential property turnover has been hindered somewhat by supply constraints and contractionary monetary policy. However, with supply expected to increase in 2007-08, housing turnover is forecast to be driven by employment growth and improved population growth in the Territory. The associated employee job security that arises from low unemployment in the ACT also supports sustained demand for housing. It is expected that strong rental returns, together with low rental vacancy rates, will support investor interest in 2007-08, although in the longer term, the Australian Government changes to superannuation policy may result in a movement away from property within investor's portfolios.

Figure 7.1.5
ACT Residential Turnover, 12 Month moving average,
Monthly original data



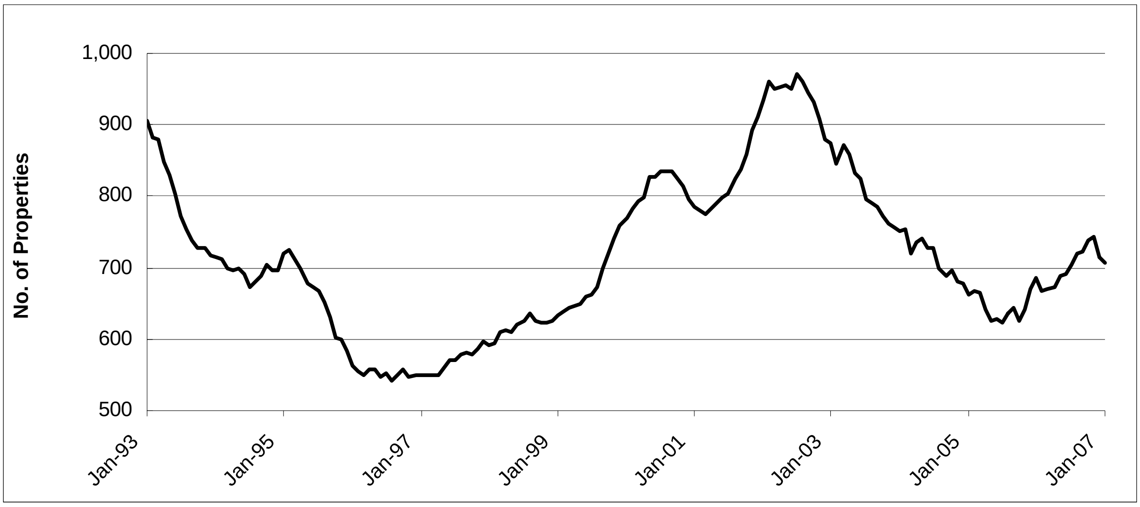
Source: ACT Planning and Land Authority

Price movements

Due to the relatively tight ACT housing market, it is expected that residential property prices will experience growth above that observed within the economy as a whole in 2007-08. Despite the housing market now tracking at more stable levels, than in recent years, real price growth has continued, albeit at lower rates. As with housing turnover, supply constraints, population growth and wage growth are contributing to house price growth. However, the impact of the 2006 interest rate rises and the prospect of significant land release over the forecast period are expected to have a moderating effect on house price growth across the forward estimates.

Figure 7.1.6

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, which provides approximately 26,000 dwellings for rent. The rental vacancy rate in the ACT, at 1.6 per cent in December 2006, is comparable with the vacancy rates experienced nationally and indicative of a national trend away from investment in rental properties.

While the demand for rental accommodation is expected to persist over the forecast period, supply pressures may ease with new units and land expected to become available by 2007-08.

In the short term, however, tight vacancy rates are expected to continue to push up rents in the ACT. In the longer-run, upward pressure on rents may persist through continued growth in household incomes, improved population growth, and moderate real growth in house prices. While good rental returns are expected to maintain investor interest, changes to superannuation policies announced by the Australian Government and the continued strength of the share market may act to dampen this interest in the longer-run.

Consumer prices and interest rates

Consumer prices

Due to competition within global goods and capital markets, continued wage pressures have seen only a limited flow on to consumer prices. Should this continue, and with the prospect of prices for volatile items stabilising, growth in the Consumer Price Index (CPI) should be constrained within the RBA's target band for inflation of 2-3 per cent by 2007-08. As such, CPI is forecast to grow at 2¾ per cent in 2007-08.

In the medium to long-term, imported manufactured goods will continue to have a deflationary effect on prices, as global competition in production of these goods intensifies and high commodity prices keep the Australian dollar at high levels. Offsetting this somewhat is the risk that, should drought conditions persist into 2007-08 and beyond, increases in the prices of domestically sourced agricultural products will add to inflation.

Consumer prices in Canberra in 2005-06, as measured by the CPI, were heavily influenced by prices growth in volatile items such as petrol (following international oil price rises) and fruit and vegetables (following drought conditions and Cyclone Larry's destruction of the Queensland banana plantations in early 2006). With these prices now falling to more normal levels, inflation forecasts show a slowdown across the forecast period. The CPI grew at 3.6 per cent in Canberra in the year-to-date to the March quarter 2007, slightly above the 3.4 per cent CPI growth recorded nationally.

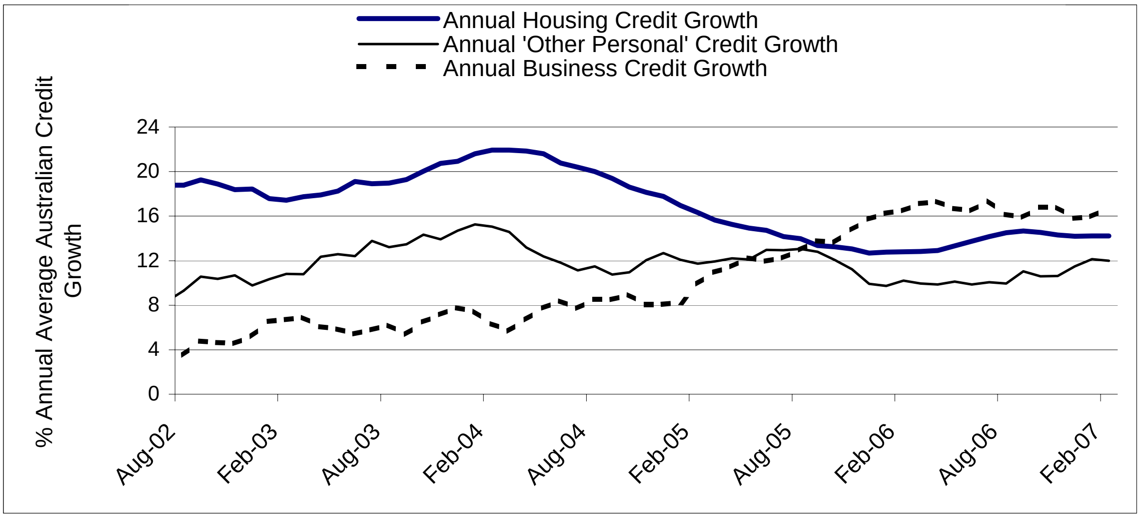
Interest Rates

The RBA raised the cash interest rate target by 0.25 percentage points on 2 August and again on 8 November 2006, taking the target rate to 6.25 per cent. These rises followed the 0.25 percentage point increase in May 2006. In explaining the rises, the RBA cited the continued expansion in the world economy, strengthening domestic demand and tight labour market conditions contributing to inflation.

The 2006 interest rates rises have led to monetary policy being contractionary. This view is supported by the yield curve remaining inverted (ie. short term rates are higher than long term rates). At current levels interest rates can be expected to have a moderate influence on business investment, household spending and economic growth in the ACT in 2007-08.

Credit growth, particularly business credit, has been strong over the past year. While the growth in demand for housing credit has eased following interest rate rises, growth in other personal household credit has risen in recent months.

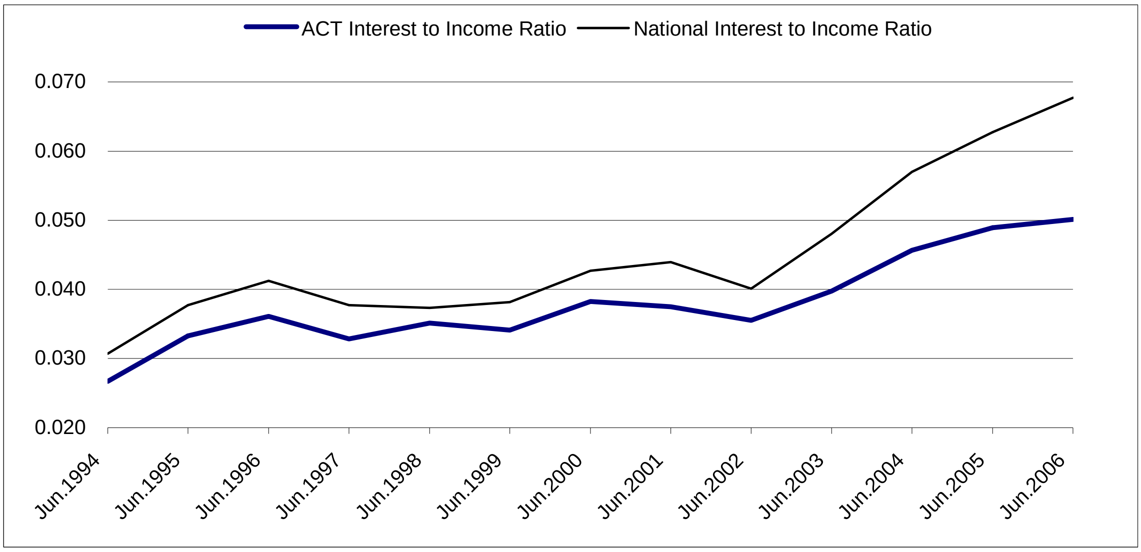
Figure 7.1.7
Australian Annual Growth in Credit



Source: RBA

ACT households continue to display a willingness to carry high levels of debt compared to other jurisdictions. This primarily reflects the higher average income levels and debt servicing ability of ACT households. While not insensitive to interest rate increases, the higher debt servicing capacity of ACT households is likely to lessen the relative economic impacts of interest rate rises. 2005-06 saw a relative improvement in the ability of ACT households to service their interest liabilities compared to Australian households overall.

Figure 7.1.8
Interest to Income Ratios



Source: ABS Cat No. 5220.0

The ACT Population: Current Trends and Future Implications

ABS estimates indicate that over the past decade the ACT usual resident population has grown steadily, from just over 308,000 in 1996 to around 329,000 in 2006. Over this period, natural increase (birth minus deaths) accounted for 9.2 percentage points of growth and overseas migration a further 0.8 percentage points. Net interstate migration detracted from population growth by 3.6 percentage points.

Between 2001 and 2006, the usual resident population of the ACT increased by 9,500, or three per cent. This represents an average annual growth rate of 0.71 per cent. However, the official ACT Estimated Resident Population (ERP) estimates do not include the Territory's growing number of seasonal and itinerant workers, who, at least temporarily, live and work in the ACT but report their place of usual residence outside the ACT. While the size of this sector of the population in the ACT is not known with any certainty, anecdotal feedback from key industry sectors such as the Australian Public Service and the construction industry, indicate that it is likely to be significant.

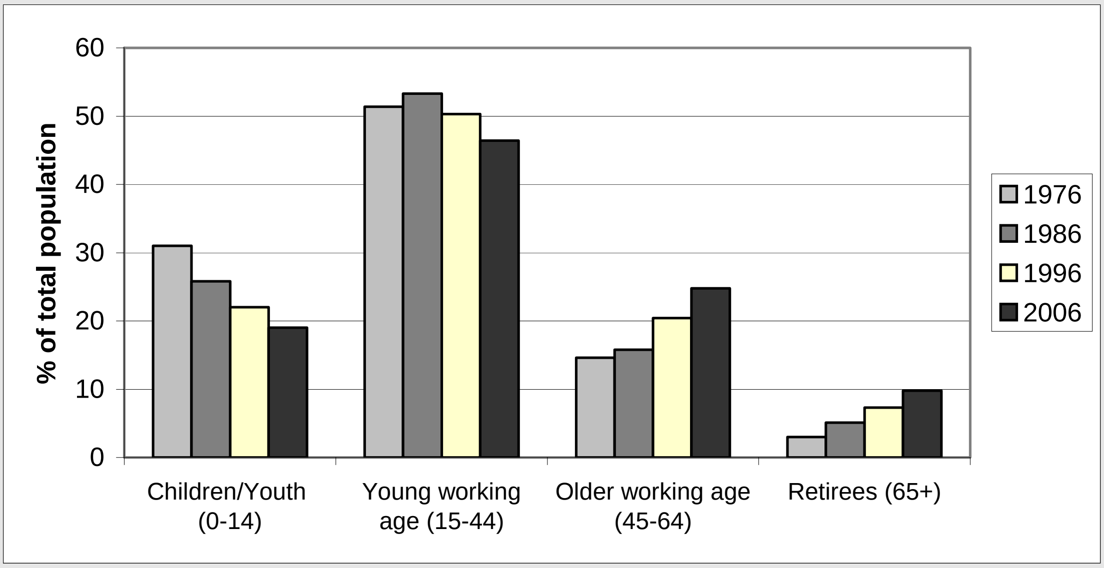
In estimating the ERP, the Australian Bureau of Statistics uses Medicare records and long term trends which are benchmarked to the National Census of Population and Housing. The ERP for the ACT has been historically underestimated, in part due to many new arrivals to the Territory not updating address details in their Medicare records. This under-reporting of ACT population figures has financial repercussions for the ACT, and inhibits the Government's decision making and future planning ability. The ACT Government, in cooperation with the ABS and Medicare, has recognised this issue and provided funding in this Budget for an advertising campaign aimed at encouraging ACT residents to update their Medicare records.

Ageing of the ACT Population

Over the past three decades, the ACT population has aged markedly. In 1976, 82.4 per cent of the ACT population was aged below 45 years. However, by 2006, this percentage had fallen to 65.3 per cent. This process of demographic ageing is graphically illustrated in Figure 7.1.9. The obvious structural change is the increasing numbers of middle-aged and older adults relative to children.

While these changes have been occurring over time, in the period 2001 to 2006, significant increases occurred among the older working age (up by 7,500 or 10.1 per cent) and retirees (up by 5,000 or 18.2 per cent). The ageing of the ACT population has been amplified by a decline among children and youth (down by 2,900 or -4.5 per cent).

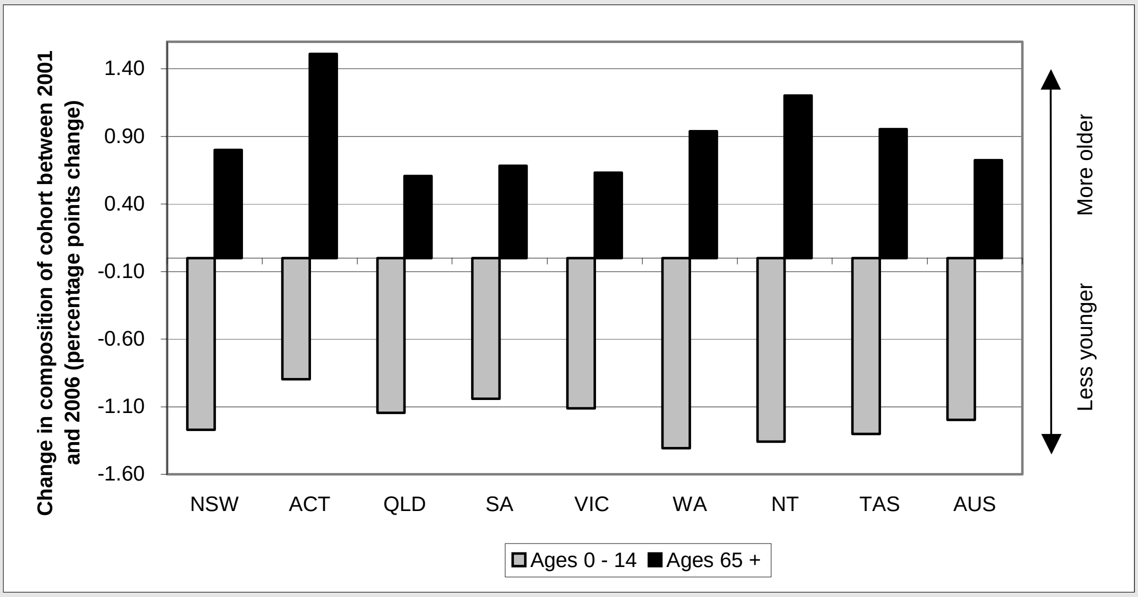
Figure 7.1.9
Age structures of the ACT Usual Resident Population, 1976-2006



Source: ABS Cat No. 3105.0

While a changing ageing pattern is evident throughout Australia, the segment of the population aged 65 and over as a proportion of the total population, has risen more markedly in the ACT than for any other jurisdiction since 2001. The ageing of the ACT's population is accentuated by the fact that the proportion of the population aged between 0-14 has fallen since 2001, albeit at a slightly lower rate relative to other states and territories.

Figure 7.1.10
Change in age cohort composition 2001 to 2006

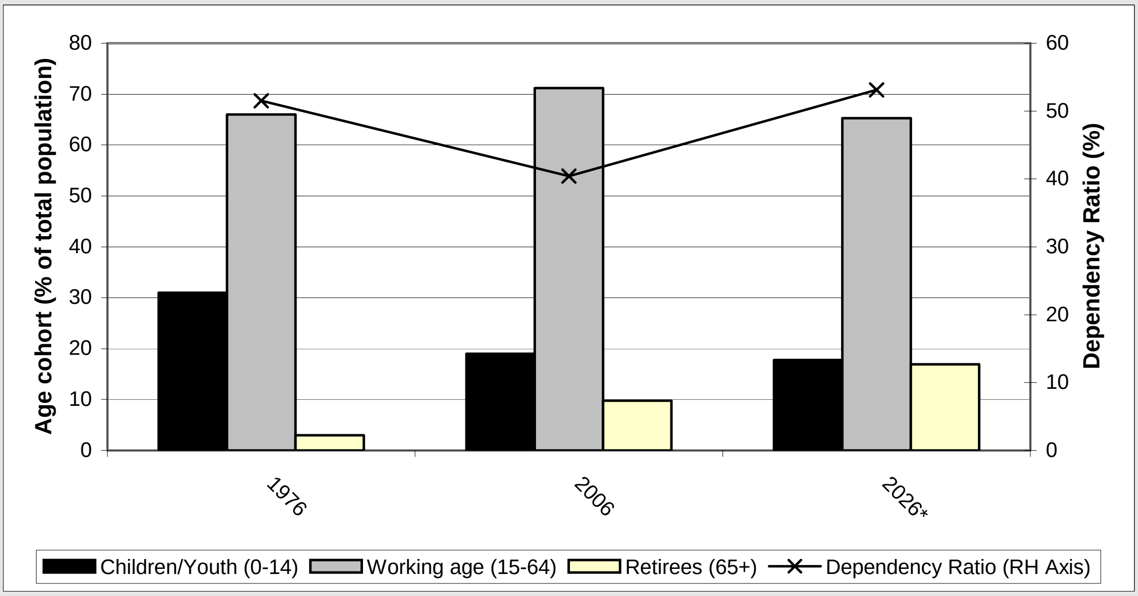


Source: ABS Cat. No. 3201.0

Given the entrenched pattern of demographic ageing in the ACT and with little prospect of a large net inflow of young people to the Territory, it is highly likely the ACT population will continue to age over the coming decades. Therefore, over the next two decades, demographic ageing has the potential to create a marked imbalance between the working and non-working population in the ACT, as smaller cohorts of younger workers replace large cohorts of older workers.

Figure 7.1.11 illustrates what would happen to the working-aged population in the ACT over the next two decades of the current pattern of demographic ageing were to continue. Although the working population is projected to grow in absolute terms by around 40,000, its size relative to the non-working population is projected to fall, as shown by the projected rise in the dependency ratio, which measures the proportion of the ACT non-working age to working age population.

Figure 7.1.11
Age structures and dependency ratios of the ACT population, 1976, 2006 and 2026* ERP



**ACT Treasury projections.*
Source: ABS Cat. No. 3201.0

Implications of Population Ageing

A long-term decline in the relative size of the ACT working population has the potential to create further labour shortages and place increased pressure on what is projected to be a relatively smaller cohort of younger workers. The ACT Government is positively addressing labour supply side constraints through initiatives such as the Skilled and Business Migration Program, Live in Canberra campaign and the establishment of the Skills Commission. Similarly, while government incentives to encourage mature-aged workers to remain in the labour force longer, may offset the loss of older cohorts from the labour force, increases in the mature-aged working population are unlikely to be sufficient to offset the expected fall in the participation rate over the coming decades. In addition, demographic ageing will impact directly on the composition and level of services required by the ACT community, with demand for health and aged care services expected to grow particularly strongly over the coming decades.

While the ageing of the ACT population poses challenges to the economy, a larger body of retired persons can effectively contribute to the ACT community through increasing levels of volunteer activity. Additionally, a decreasing mortality rate is partly symptomatic of improved health care and prevention, enabling an improved quality of life after retirement.

Nevertheless, the ACT Government, like all other Australian governments, will be confronted with significant policy challenges as a consequence of demographic ageing. Policies focusing on improving regulation and developing human capital will be needed to ensure that changes in the size and structure of the working population do not adversely affect labour force productivity and participation over the coming decades. The ACT Government has begun to address the ageing challenge through its participation in the Council of Australian Government's National Reform Agenda (NRA). Modelling by the Productivity Commission suggests that the NRA has the potential to overcome the negative economic impacts of ageing through a focus on health promotion and disease prevention, education and training, and work incentives. As such, reforms to disability care and support, increased expenditure on mental health, and an increased focus on the prevention of diabetes are examples of initiatives supported by the ACT Government in order to maximise labour participation in an environment of population ageing.