WESTPAC
Coast-to-Coast March 2023.

AUSTRALIA AND
THE GLOBAL ECONOMY

WESTPAC INSTITUTIONAL BANK

CONTENTS

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Overview

States

Australian economy, downside surprises on activity and wages

Over the past month, key updates on the Australian economy for the December quarter – the Wage Price Index (WPI) and economic activity in the national accounts – both provided downside surprises. The WPI printed a quarterly rise of 0.8% compared to market forecasts of 1%; and economic activity lifted by 0.5% in the period compared to market forecasts of 0.8%.

The measures of wage pressures in the national accounts also confirmed the benign signal from the WPI, although a sharp deterioration in productivity saw unit labour costs surge by 7% for the year, highlighting the inflation risk from wider labour costs. Inflation indicators in the national accounts were also strong, confirming that inflation was far too high in late 2022.

Strikingly, the December quarter National Accounts raised alarm bells about household finances and revealed weak domestic demand conditions as high inflation and higher interest rates impact. The RBA Governor has talked about the 'narrow path' that would rein in inflation while keeping the economy on an even keel. The national accounts highlighted the many risks associated with this narrow path.

Domestic demand was flat in the quarter, the weakest outcome since June 2014 (outside of the lock-down quarters during 2020 and 2021). The stalling of domestic demand was associated with consumer spending growth slowing from 1.0% for the September quarter to only 0.3%. The flat result for wider domestic demand came from: a decline in home building activity on an unfolding downturn in renovations work, –0.9%; a dip in business investment, –0.8%; and a cresting of public demand at a high level, edging 0.2% higher.

We have also seen stresses in the US banking system with the failure of three regional banks. Looking forward this is likely to lead to a significant lift in regulation of regional banks, resulting in a tightening of credit conditions in the US and other regions where the market fears similar developments. That development is likely to see a flatter profile for the federal funds rate, although "sticky" inflation and tight labour markets are unlikely to allow rate cuts in the US before 2024. Australian banks do not have the regulatory issues faced by the US, but global confidence is likely to be another headwind for the Australian economy. We do not expect to see the Reserve Bank cutting rates before the first quarter of 2024 in response to the very weak demand conditions we expect across the Australian economy.

These powerful headwinds to growth are triggering a broad based slowdown, not only across segments of domestic spending but also across each of the state economies - pointing to a likely broadly based downturn in 2023, as we discuss in this Report. In the December quarter state final demand contracted across NSW (–0.1%), Qld (–0.3%) and SA (–0.2%). A flat result was posted by Tasmania, while WA and Victoria eked out small gains, +0.1% and +0.2%, respectively.

The slowing of consumer spending growth nationally was despite a significant fall in the household savings rate from 7.1% to 4.5%, which effectively 'freed up' $9bn of spending capacity – compared to an increase in actual spending of around $6bn. In other words, spending would have fallen if households had not opted to put less of their income towards savings.

The household sector across the nation faced some extraordinary pressures during the period. Nominal disposable income contracted by 0.7% in the December quarter, weighed down by a 7.4% lift in tax payments and a 22.4% increase in interest payments – the latter to an all-time high in dollar terms ($25.2bn). The increase in tax payments partly reflects rising employment and rising wages but there is a considerable base effect coming from an unusually small increase in the September quarter (partly affected by the Low and Middle Income Offset which lowered tax payments in the September quarter). The fall in real wages (inflation at 7.8% in 2022 compared to wages growth of 3.3%) contributed to a record fall in real disposable income of 2.2% (outside the volatile pandemic period).

The interaction between negative real wages growth; rising tax and interest payments; labour income growth; and the draw-down in excess savings will dictate household incomes and spending over 2023 and 2024 – and in turn, the path of growth in the overall economy. While Westpac was surprised by scale of the contraction in real incomes in the December quarter, we see this development as broadly consistent with our long held downbeat outlook for consumer spending in 2023 and 2024.

We expect the contraction in real wages to end in 2023 but with very little in the way of gains – wages and inflation both tracking 4% in 2023, and 3.2% and 3% respectively in 2024. However, with slower employment gains in 2023 and 2024 total labour income growth will be much weaker. Meanwhile there will be more pressure from rising rates near term, with two 25bp hikes already passed and another two expected by mid year. Rates are forecast to fall by 100bps in 2024.

Consumer spending is likely to continue drawing support from a lower savings rate, which is expected to settle at around 2% by the end of 2024. This represents a partial draw-down on the reserve accumulated during the pandemic. We expect households to draw down around $50bn in 2023 and $70bn in 2024 out of the $300bn in excess savings that has been accumulated.

In summary, slowing employment growth; low confidence; drags from higher tax payments and interest costs will weigh heavily on the household sector over 2023 and 2024. Cyclical offsets to these negative forces as we move through 2023 and 2024 will be: stability in real wages and the capacity to draw down on excess savings balances.

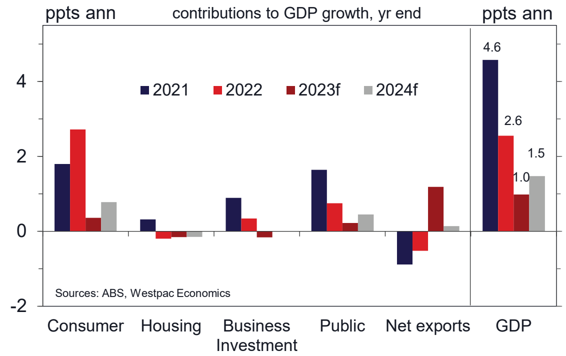
We have not materially lowered our growth forecasts for consumer spending in 2023 and 2024 despite the alarming signal around household finances. Our already very modest forecasts for consumer spending growth have been trimmed from 1% to 0.7% in 2023 and from 2% to 1.5% in 2024.

These adjustments see our GDP growth forecast hold at 1% for 2023 and trimmed from 2.0% to 1.5% for 2024. Other important developments remain largely unchanged – equipment investment down by 6.5% in 2023 and 3% in 2024; dwelling investment down 3.2% in 2023 and 2024; while net exports contribute 1.2ppts to growth in 2023 (upgraded from 1ppt) and 0.1ppt in 2024.

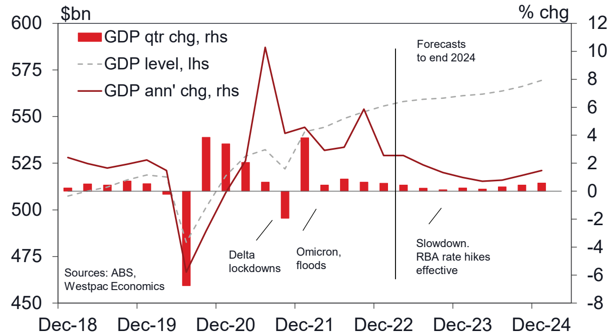
Bill Evans, Chief Economist Westpac Group

Australian Economic Outlook

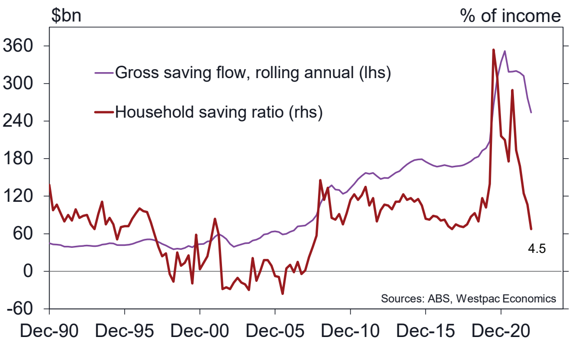
Australia: the growth mix



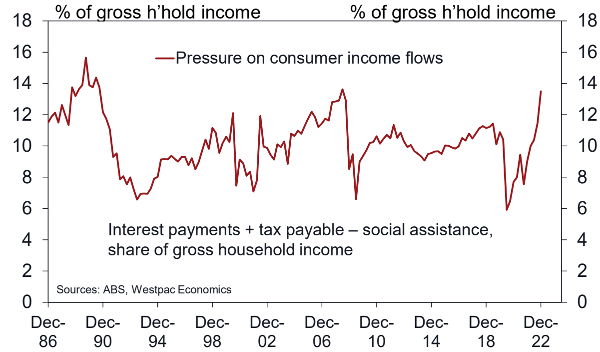
Australian economy: sharp slowdown in 2023



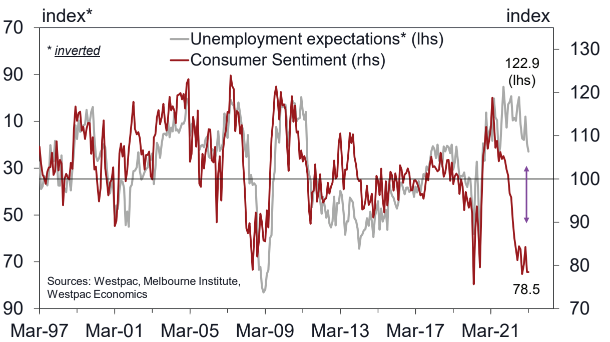
Household saving ratio and gross saving flow



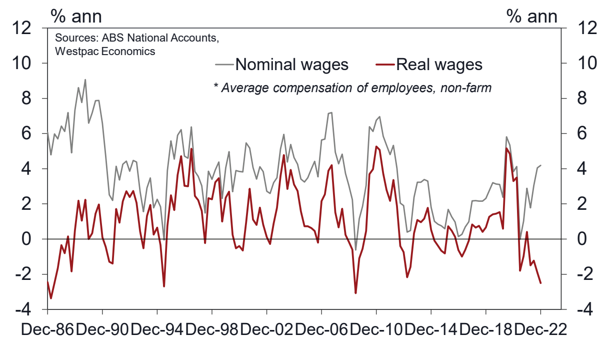
Pressure on consumer income flows



Consumers: Sentiment & unemploy' expectations



Wages – inflation squeeze



Broad based slowdown …

Final domestic demand: across the states

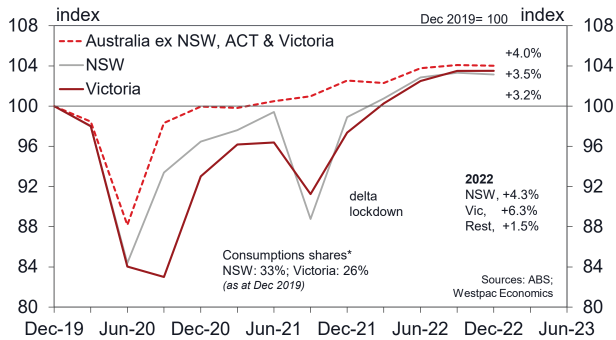
The Australian economy ended 2022 on a softer note, amidst a slowdown triggered by high inflation, rapid RBA rate increases and moving beyond the reopening post delta.

These dynamics will shape a sharp economic slowdown in 2023, albeit cushioned by households sizeable savings buffer, plus a boost from a lift in population growth on the reopening of the national border.

Given these powerful headwinds, the slowdown in activity evident in the December quarter was broadly based across the economy and broadly based across the states. These December quarter developments foreshadow a sharp slowdown in 2023.

State final demand contracted in the December quarter across NSW (–0.1%), Qld (–0.3%) and SA (–0.2%). A flat result was posted by Tasmania, as it was nationally, while WA and Victoria eked out small gains, +0.1% and +0.2%, respectively.

Consumer spending per capita

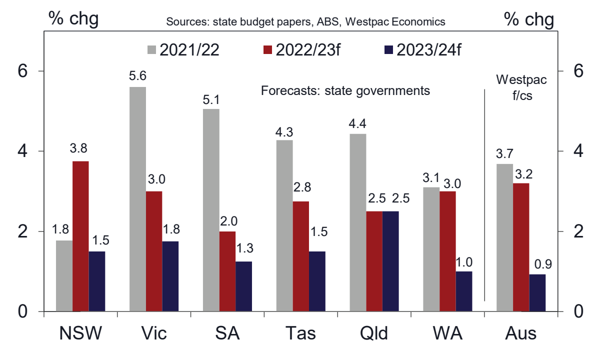


Consumer spending, accounting for a touch over 50% of the economy, slowed appreciably in the December quarter as households across the nation came under pressure. Nationally, consumer spending grew by a tepid 0.3% in the period, slowing from 1.0% and 2.2% in the two quarters prior.

That slowing in consumer spending partly reflected moving beyond the post delta rebound – a dynamic which had underpinned very strong outcomes over the first half of 2022 for NSW, the ACT and Victoria. In the December quarter, consumer spending was flat in Qld, SA and Tasmania, made small gains in NSW and Victoria (but declines in per capita terms) but showed strength in mining WA, +1.6%qtr.

Nationally, home building activity and business investment both declined in the December quarter. These results were mirrored in most states: housing down in NSW, Vic, SA, and Tas; business investment was broadly flat to down everyone (except Victoria).

Growth outlook by state: GSP



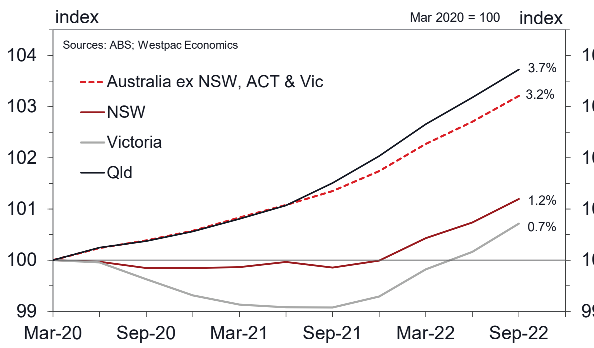
Another development associated with the loss of momentum in the economy is the cresting of public demand – as the spike in COVID-19 related spending unwinds. This dynamic is most apparent in NSW and Victoria (impacted by delta lockdowns). Since Q1 2022, public demand nationally is lower by –0.1%, while in Victoria it is down by –2.5% and in NSW is up by only 0.4%.

Westpac Economics is forecasting output growth nationally to slow to a well below trend 1% for 2023. In year average terms, we expect growth to moderate from the 3.7% outcome for 2021/22 to 3.2% for 2022/23 and then slow abruptly to around 1% for 2023/24. State government forecasts, which have been on the cautious side recently (a reflection of the pandemic era) tend to be more optimistic on prospects for the 2023/24 year. The weighted average forecast for the period is 1.6%.

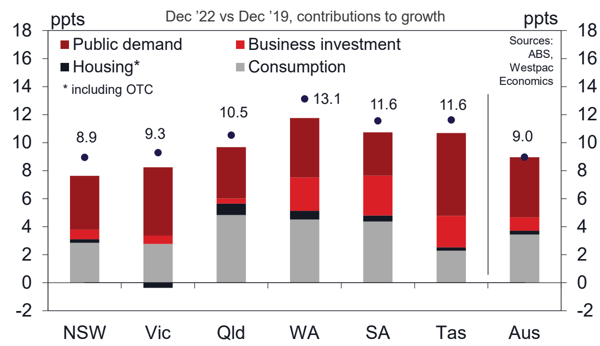
We also note that prospects for domestic demand are weaker than this – with net exports set to be a positive for growth, in part because of the boost to service exports from the recovery in international student numbers and holiday arrivals, supported by the lower Australian dollar.

... sharp downturn in 2023

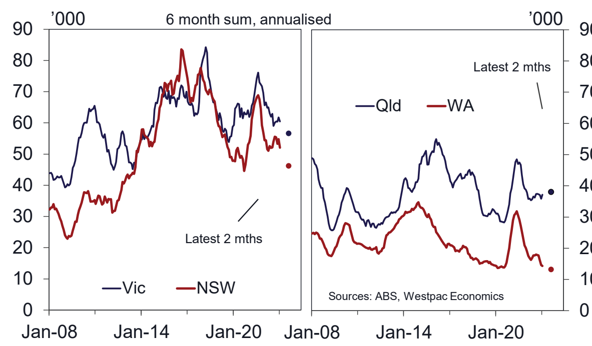
Population trends



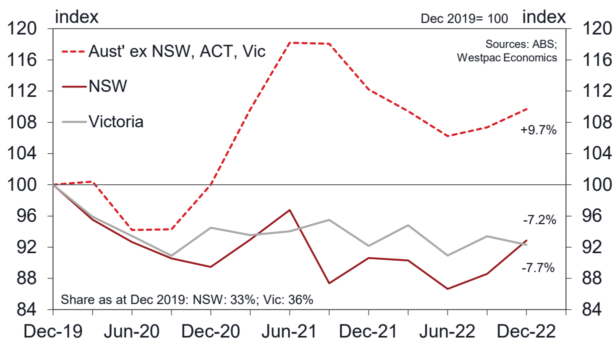
State final demand: vs pre covid



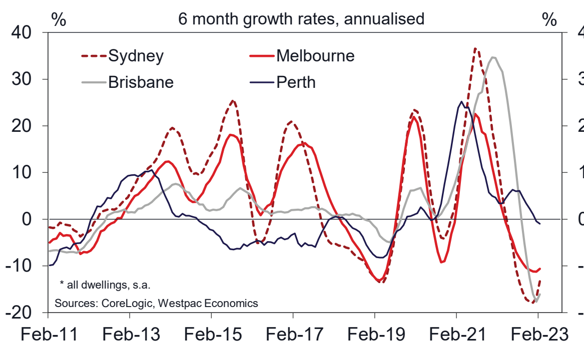
Dwelling approval downturn continues



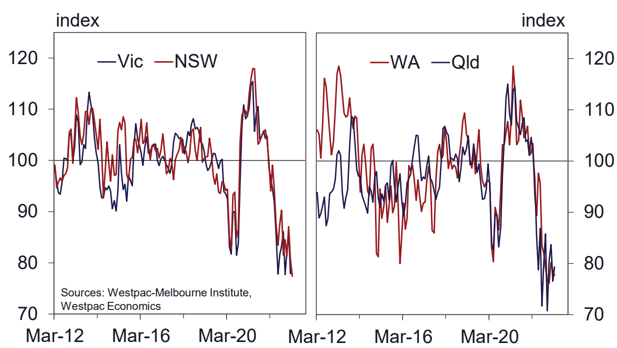
New home building activity



Dwelling prices: well off highs (ex Perth)



Consumer sentiment



States looking towards net zero …

Reducing greenhouse gas emissions is central to addressing the threats posed by climate change. The Australian government set out revised Paris Agreement commitments in June last year that target a reduction in emissions to 43% below 2005 levels by 2030 and to net zero by 2050. Needless to say this will require significant adjustment across much of the economy. This article looks at how emissions, targets and challenges compare across Australia's states.

Target-wise, all states have committed to achieve net zero emissions by 2050. Notably, Tas has already been achieving net zero since 2015, due to an increase in carbon 'sinks' relating to the reduction in native forest harvesting. Most state interim targets are also broadly consistent with the 43% target nationally: NSW aiming for a 70% cut in emissions by 2035; Vic and SA aiming for a 50% cut by 2030; and Qld aiming for a 30% reduction by 2030. WA is the main exception with its interim target aiming to reduce emissions from government operations only (including publicly-owned electricity generators) by 80% of 2020 levels by 2030 – this equates to a 6% reduction in state-wide emissions vs 2020 levels which is a 2% decline relative to 2005 levels.

Looking at trends in emissions over time, most states have achieved material reductions in emissions over the last decade. If we exclude the COVID-affected read in 2020, emission declines over the ten years to 2019 range from –13% in Qld to –17% in NSW, –20% in SA and –35% in Vic (although compared to the 2005 'baseline', SA has seen the largest cumulative reduction of –35%). WA is again a notable contrast with relatively little change showed in emissions over the years, the energy requirements of a strongly growing mining sector clearly a factor. More generally, some of the variation in trends across states will reflect differences in underlying growth. Population gains for example have been much slower in SA (+10% over 10yrs) compared to the other major states (+17% on a combined basis over the same period).

Breaking down the emissions rate per capita by state and again looking at pre-pandemic levels in 2019, WA and Qld stand out as the highest emitters (at 35 and 32.3 tonnes of CO_2-eq per person respectively) the high concentration of mining production clearly a factor. In terms of the mix, emissions associated with electricity generation were the largest contributor in all states, accounting for 60% of emissions in NSW and Qld, 72% in Vic, 76% in WA and a noticeably lower 45% in SA. Other emissions showed a fairly similar mix across states, transport as the second highest source of per capita emissions, agriculture and land use the next biggest in most states (Tas's land use carbon 'sink' again a notable exception), and emissions from industrial processes a little more prominent in NSW.

The detailed state comparison of emissions highlights the role natural endowments play in dictating a state's dominant industries and hence the level and sectoral shares of emissions. The 'mining states' of Qld and WA clearly have more intensive energy requirements for production. Conversely, states with more developed service sectors such as NSW and Vic tend to have lower requirements.

Natural endowments also account for some of the major variations in the composition of electricity generation by state. Those with abundant supplies of cheap fossil fuels tend to use these more heavily while those with other forms of generation more readily available, particularly hydro, have a mix with much lower emissions. Again looking at 2019 data, the larger states rely more strongly on non-renewable sources for electricity generation, renewables accounting for just 10% of generation in WA, 13% in Qld, 19% in NSW and, 21% in Vic. SA and Tas have much higher shares at 50% and 94% respectively – SA having a relatively high concentration of wind and solar generation and Tas getting over 40% of its electricity from hydro.

Coal generation accounts for a particularly high share in NSW, Vic and Qld. Interestingly, Vic's heavier reliance on brown coal, which produces more emissions than black coal due to its higher moisture and lower carbon content, largely negates the higher share of gas and renewables in its generation mix compared to NSW with similar total emissions per capita from electricity across the two states.

Transitioning electricity generation towards lower-emitting renewable sources is clearly key to achieving Australia's Paris targets. According to BloombergNEF Australia had $5.6bn worth of renewables investment underway in 2019, or 0.4% of GDP. That looks to be a higher rate than in the US (0.26% of GDP), the UK (0.19%), Japan (0.32%) and India (0.3%) but well behind the global leader at the moment, China (0.58% of GDP or $83.4bn). That said, investment is likely to rise sharply from here, particularly in the US where the Inflation Reduction Act passed in 2022 has provided $67bn in funding and a range of other incentives to encourage clean energy investment.

Domestically, more specific data on the project pipeline shows renewables projects are dominating in the electricity generation space, accounting for all major projects in NSW, Qld, WA and Tas, 96% of work in Vic and 82% in SA (all figures as at December 2022). If we include projects outside of the generation space (mostly hydrogen-related), as at December, Qld had the highest level of renewables investment at $36.6bn while NSW and WA followed closely behind at $27.9bn and $19.7bn respectively. Note that the pipeline is categorised into three groups: 'under construction', 'committed' and 'under consideration/possible'. Across the states, definite projects made up 38% of the pipeline in Qld and 26% in NSW, 27% in Vic, but only 8% in WA and SA. A significant proportion of 'under consideration' and 'possible' projects clearly need to proceed for investment to ramp up.

Large-scale investment will clearly be central to lowering emissions. However, small-scale shifts by individual consumers and businesses will also play a part in reducing emissions. On this front, two key areas of change – the take-up of small-scale solar generation, and of electric vehicles (EVs) – show a wide variation in performance to date.

Small-scale solar PV energy generation has risen strongly across all states, in most cases nearly tripling over the six years to 2019. In terms of generation per 100,000 persons, WA and Qld have the highest rates of use with 83GwHs and 65GwHs respectively compared to 33GwHs in NSW and 29GwHs in Vic. Variations will reflect differences in climate across states – the 'sun-belt' across Qld and WA particularly suited to solar generation.

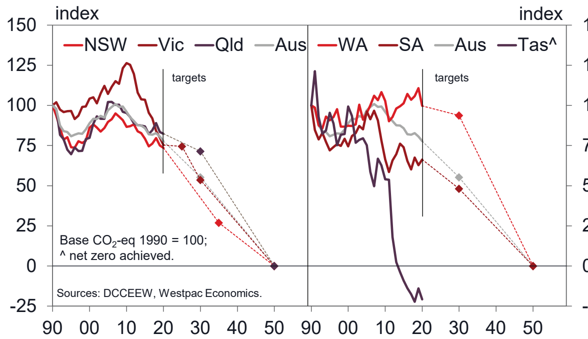
The take-up of EVs has been noticeably slower. While sales are rising sharply, they remain relatively small. BloombergNEF figures indicate there were 39k EV sales in Australia in 2019, accounting for about 5% of all vehicle sales (state data on take-up is not available). That is comparable to the 5.8% share in the US but well behind the 22% of sales in China and 23% in Europe where EVs account for over half of new sales for some 'early adopters' such as the Netherlands, Sweden and Norway. Aside from direct policies, the lack of charging infrastructure looks to be large factor behind the slow take-up of EVs in Australia. And of course, transitioning electricity generation to lower emissions is a key prerequisite for enhancing the degree to which EVs reduce aggregate greenhouse gas emissions.

Overall, despite a clear down-trend in emissions the change required to achieve our obligations under the Paris Agreement still looks formidable. Starting points and conditions differ state-by-state but most face significant challenges with a clear need to accelerate both large-scale investment and small-scale shifts.

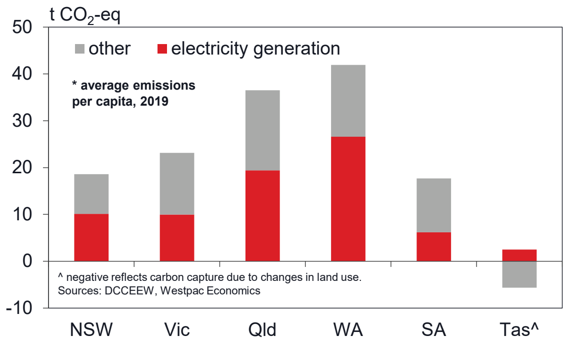
Matthew Hassan, Senior Economist and **Rea Dcosta,** Graduate

... facing a formidable challenge

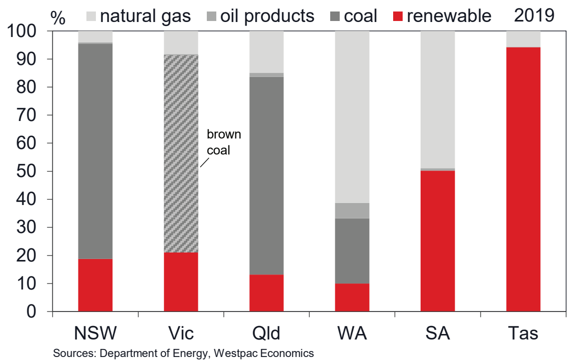
Greenhouse gas emissions and targets: by state



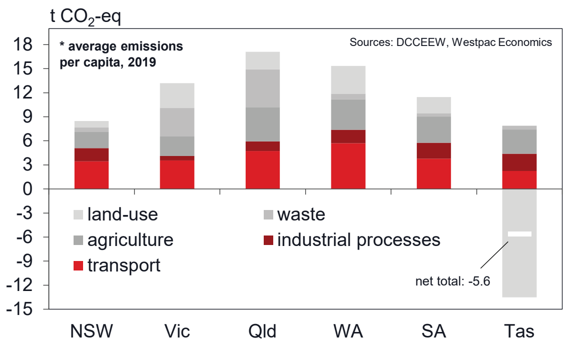
Emissions: electricity and other sources



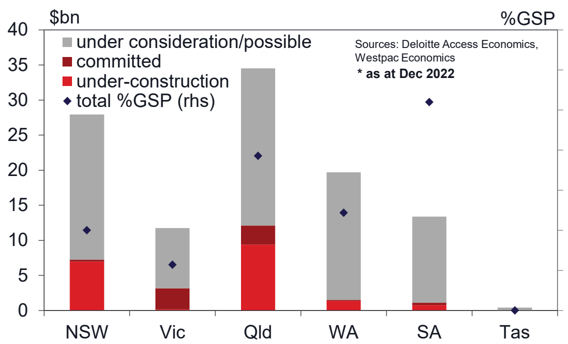
Electricity generation by source



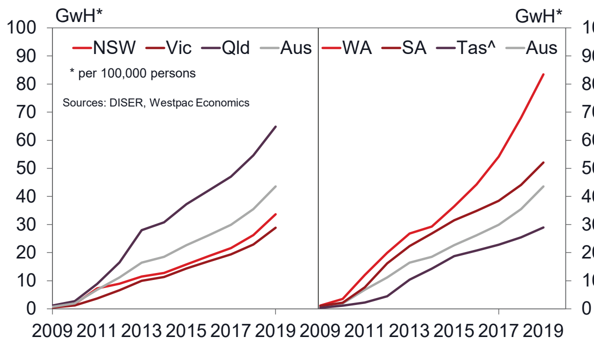
Emissions excl. electricity: components



Renewables investment projects

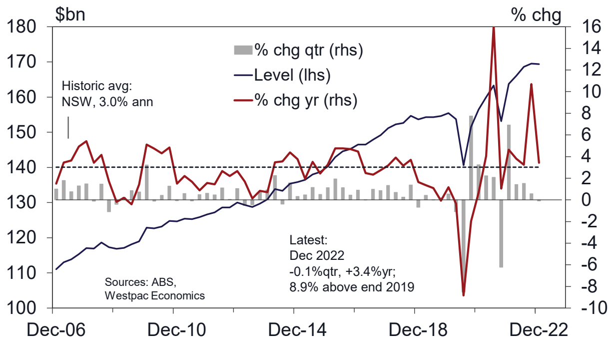


Small-scale solar PV generation: by state



Moving beyond delta rebound ...

NSW demand: beyond post delta rebound

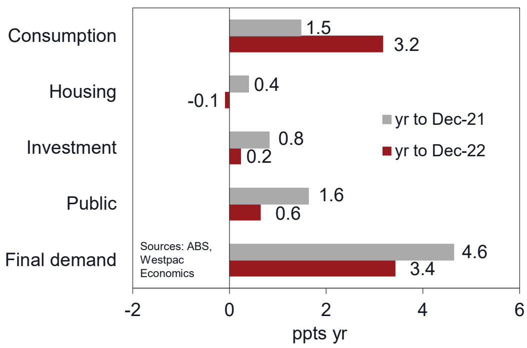


The NSW economy is in transition, moving beyond the post delta rebound, and facing intensifying headwinds of high inflation and rapid fire RBA rate hikes. Household balance sheet strength (with a very large saving buffer and an unemployment rate at historic lows) will cushion the downturn.

Against this backdrop, it was a flat end to calendar 2022, with state final demand edging 0.1% lower – a result broadly in line with the flat outcome nationally.

From mid-to-late-2021 to around mid-2022, the key growth drivers of the NSW economy were consumers spending more freely on services (the reopening from the delta lockdown) and public demand (boosted by a spike in COVID-19 related spending). However, those growth drivers have faltered, contributing to that flat end to 2022. Public demand is cresting at a high level, as the spike in COVID-19 spending unwinds. In the year to March 2022, public demand grew by 8.5%, but is only 0.4% higher since then.

NSW: contributions to state final demand

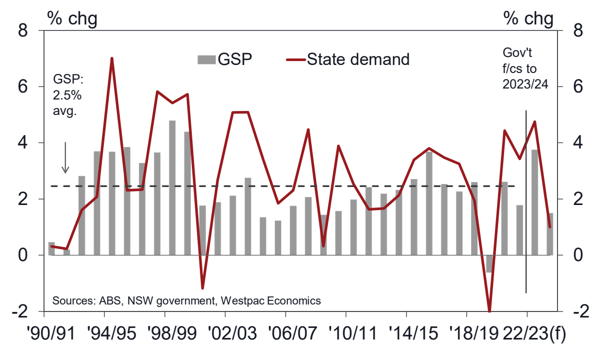


Consumers are cutting back and increasingly more selective in their spending choices in response to the intense pressures on household income. Overall consumer spending grew by an anaemic 0.2% in the December quarter, after slowing to a rise of 0.8% in September. The spending mix included a further rise in hospitality in the final quarter of 2022 (albeit a modest +1.7%), but other goods and service fell, –0.6%, while recreation and culture is down almost 5% since June.

Housing was generally a source of weakness in 2022, including a December quarter outcome of –1.2%qtr, and –1.6%yr. Home renovations, a key growth driver from mid-2020 to 2021 Q3 (up 45%), is now in a downturn, declining by 6.3% in 2022.

Business investment ended 2022 on a softer note as well, down by –1.1%, to be only 0.3% higher since June 2021. While equipment spending has moved higher, in response to limited capacity, the bounce since mid-2021 appears to have been capped by increasing uncertainty around the outlook.

NSW economy: looming downturn



Ahead of the state election, the economic forecasts were refreshed in December (the half yearly budget review) and again in February (the pre-election document). The growth outlook has been downgraded, marked lower in response to a more aggressive RBA tightening cycle.

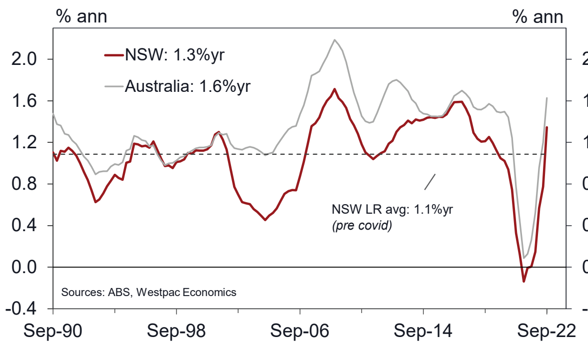
State final demand growth is now expected to slow from 4.75% this year (downgraded from 5.5%) to a below trend 1% in 2023/24. Output growth is a forecast 3.75% this year (down from 4.25%) slowing to 1.5% next year (from 2.75%) - with exports to be a positive for growth.

Activity in the state will be cushioned by the ongoing recovery in international student numbers and international tourists, with the national border having reopened in February 2022. The Australian dollar trading below the US70¢ mark is also a positive, making Sydney and NSW and more attractive, competitive destination.

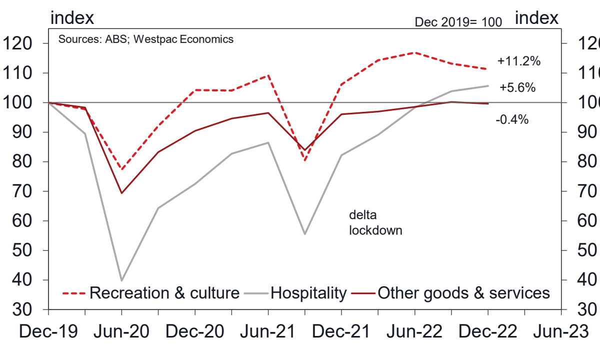
Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

... sharp slowdown in prospect, RBA rate hikes biting

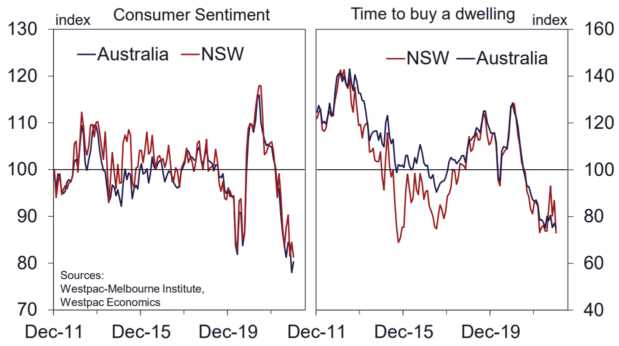
NSW population growth rebounds, to above par



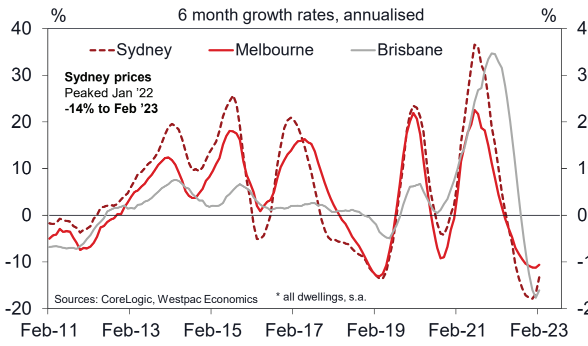
NSW: consumer spending trends



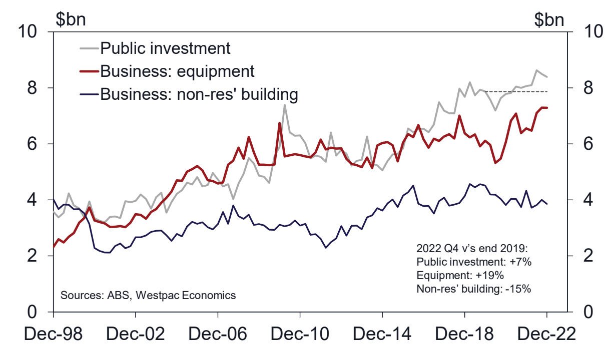
Consumer confidence: deeply pessimistic



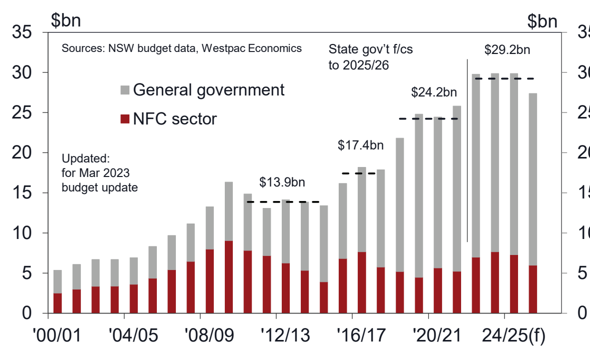
Sydney dwelling prices: well off highs



Investment cycles

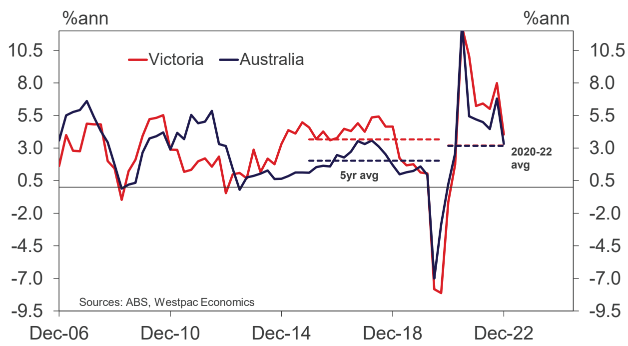


NSW government capital expenditure



A mixed performance, activity slowing ...

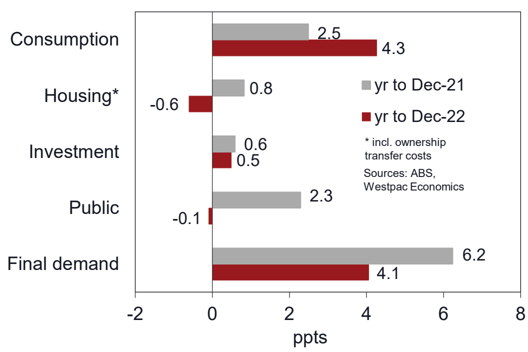
Victorian demand: post-delta rebound ends



Vic's strong-but-brief post-COVID rebound has given way to a more mixed performance since mid-2022, rapid interest rate rises weighing heavily on the consumer and housing-related demand while broader activity finds support from a resurgence in net migration inflows. As noted previously, the state is more sensitive than others to both of these drivers.

State demand stalled over the second half of 2022, annual growth slowing abruptly. However, this only captures domestic drivers, excluding the impact on activity from the resurgence in exports such as education and tourism. Labour markets arguably provide a better gauge of wider activity. Here, growth in employment and hours worked both suggest momentum has held up better, albeit with a slowdown in early 2023 suggesting rate rise impacts are starting to outweigh the boost from export sector rebounds.

Vic: contributions to state final demand

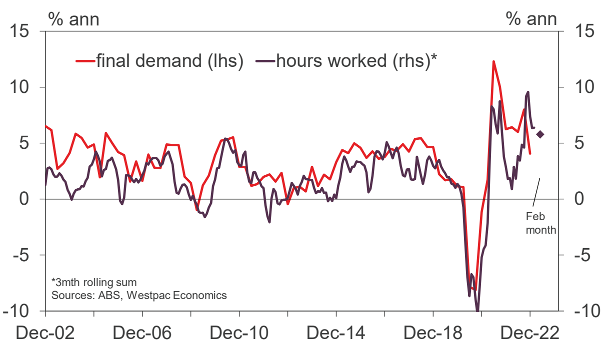


State final demand rose just 0.2% in Q4 after a flat Q3 but a strong first half that still saw an annual gain of 4.1%yr. The bulk of the slowing came from an abrupt deceleration in consumer spending, from a rollicking 12.6% annual pace in H1 to a 3.7% annual pace in H2 that included a sub-2% annual pace in the final quarter. Notably, growth in labour incomes has been much more subdued, stalling flat in real terms in the final quarter.

Housing activity has also turned down, new dwelling investment contracting 2.8% over H2 2022 led by a big 11.2% drop in renovation activity. Prices and turnover have also seen material corrections albeit with price declines showing tentative signs of slowing in recent months.

Vic business investment was broadly flat over H2 2022 to be up 4.7%yr. The detail shows a 14% surge in non-res construction more than offsetting a 2.5% decline in equipment investment. Tight capacity and labour shortages remain significant issues.

Victoria: final demand and hours worked

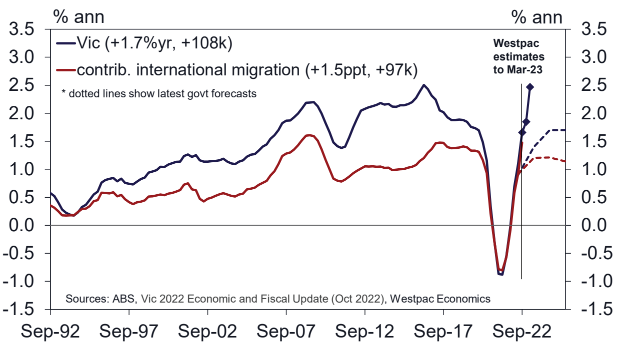


The broader pipeline of non-res construction remains positive with a large round of public works giving a big boost to infrastructure works. There is now over $25bn in infrastructure work in the pipeline, the commencement of Melbourne's massive North-East link – featuring 6.5kms of tunnels – nearly doubling work yet to be done in Q4. The project is part of the $90bn of transport projects being conducted under the state government's 'Victoria's Big Build' scheme.

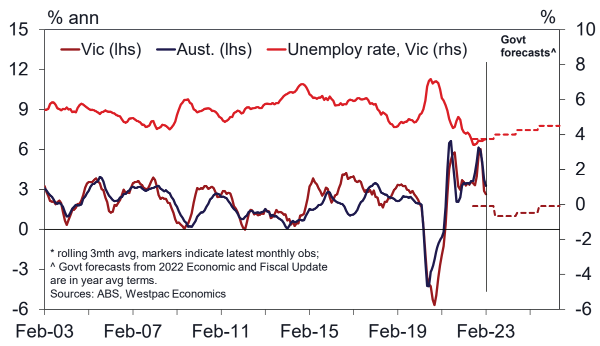
As noted, a resurgence in migration inflows is shaping as a key support to activity. ABS estimates show population growth lifting back to 1.7%yr in Q3 with other indicators including monthly arrivals and departures, and labour force population estimates, suggesting annual growth is likely to hit 2.5%yr in early 2023, well above the state government's forecasts of 1.4%yr. Foreign student higher education commencements rose nearly 60%yr in 2022 and look set to push higher in early 2023. The burst is also apparent in labour supply with employment growth still tracking a robust 2.6%yr annual pace but unemployment holding at 3.7% rather than declining.

... as stalling state demand outweighs service exports surge

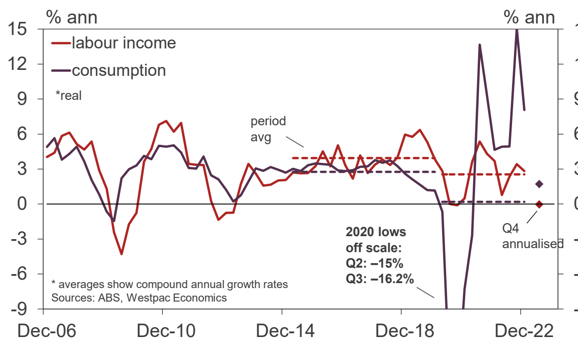
Vic's popn growth: outstripping expectations



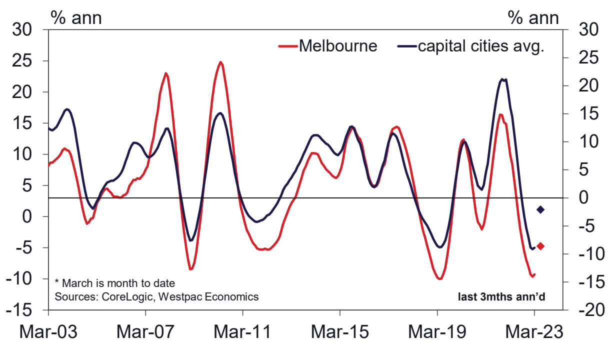
Victoria: jobs growth and unemployment



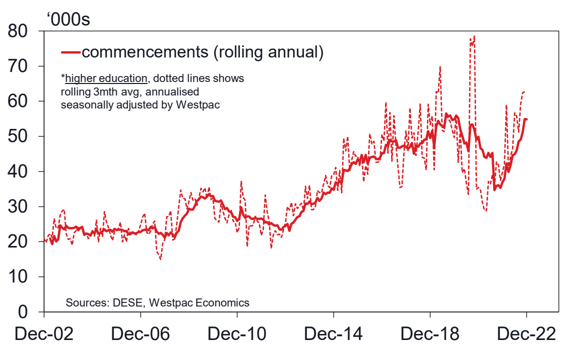
Vic households: incomes and spending



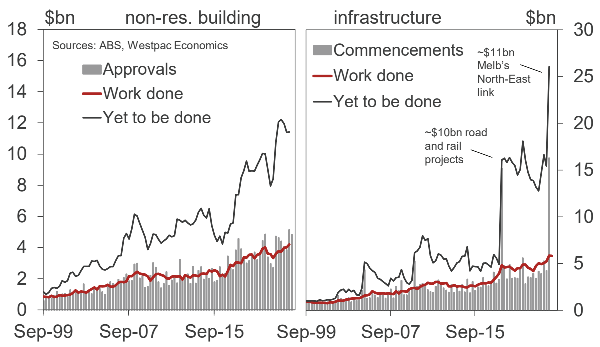
Melbourne house prices



International students: Victoria

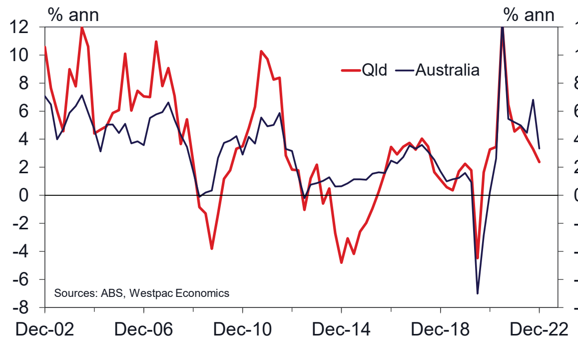


Vic's non-res construction pipeline



Headwinds beginning to impact ...

State final demand: Qld vs Australia



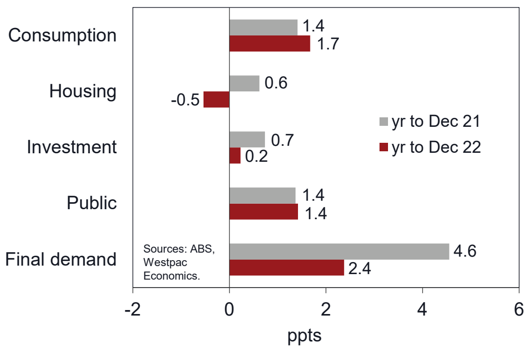
Queensland's state economy was the weakest across the nation in Q4 and 2022, state final demand contracting 0.3% in the quarter to be up only 2.4%yr. Having avoided the brunt of the 'delta' outbreak, state growth in Queensland is still ahead of NSW and Victoria, up 10.5% compared to December 2019.

Underlying these results was a patchy performance across Queensland's economy, reflective of the broadening headwinds not only facing the state but also the nation as a whole.

Consumption stalled in Q4 (–0.1%) as households directed spending away from discretionary items such as furniture & household equipment (–4.1%qtr) towards essentials, like food (+3.9%qtr) and rent & dwelling services (+0.8%).

Dwelling investment meanwhile eked out a modest gain after a challenging year (+1.4%qtr; –9.5%yr), with a lift in new housing construction (+3.9%qtr) providing an offset to the lasting weakness in renovation activity (–1.3%qtr; –14%yr).

Qld: contributions to state final demand

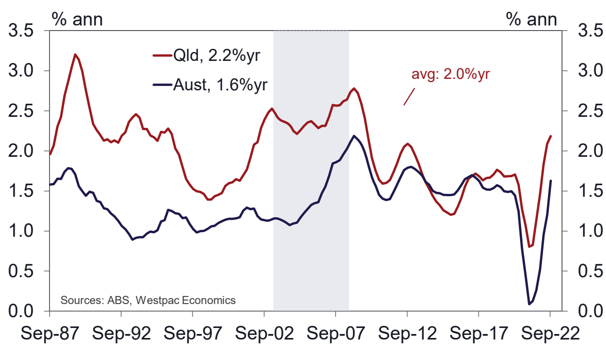


The sizeable pipeline of residential investment projects can provide some level of support over the medium-term, especially given the surge in net migration (see below), but the outlook for the housing market certainly remains difficult.

Queensland's property market is in a sharp slowdown. At –13%, the three-month annualised pace of price declines is the most severe across the major eastern states, while lower turnover and downbeat sentiment offers little reprieve for in near-term as the full impact of interest rate increases continues to crystalise. The extremely tight supply-demand balance may offer some underlying support to prices once current headwinds fade.

New business investment in Queensland also throttled back in Q4 after a robust year of gains (–4.1%qtr; +2.0%yr). Weakness was broadly-based in the quarter, with declines across non-residential construction (–4.3%qtr), equipment investment (–5.8%qtr) and engineering construction (–5.1%qtr).

Pop. growth rebound above national average



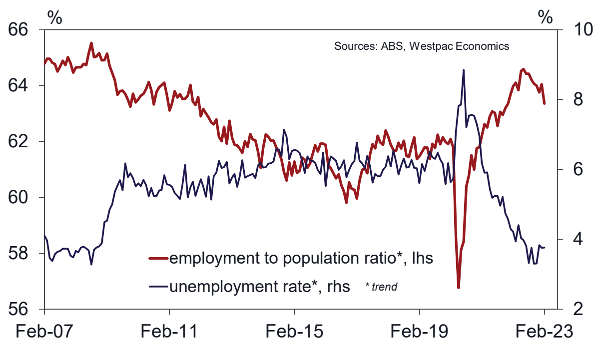
Government consumption provided necessary support to households in Q4, rising 1.2% on the state government's cost-of-living rebate and increased social benefits. Public investment was meanwhile more tepid in the quarter, up only 0.6%.

While the broader outlook for 2023 is certainly challenging for both households and businesses, the recovery in net migration and population growth should serve as a key positive for Queensland into the longer-term.

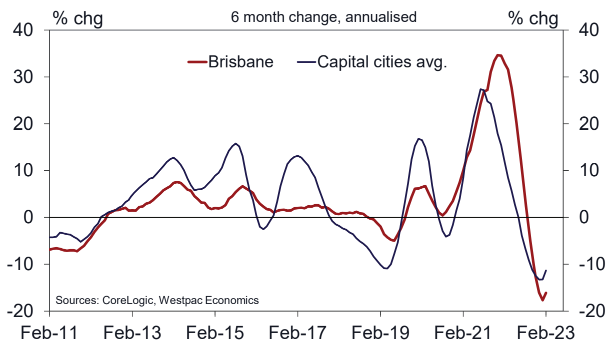
Indeed, Queensland remains the clear front-runner nationally, annual population growth now at 2.2%yr, in excess of the state's long-run average and well above the national average of 1.6%yr. Underlying this, net overseas migration printed a stellar +15.4k in Q3 2022, just shy of the state's Q3 record of +15.8k in 2008. Interestingly, net interstate migration away from NSW/Victoria to Queensland is still presenting as a strong contributor to population growth, highlighting the emerging opportunities to be found in Queensland once current headwinds fade.

... ahead of a challenging 2023

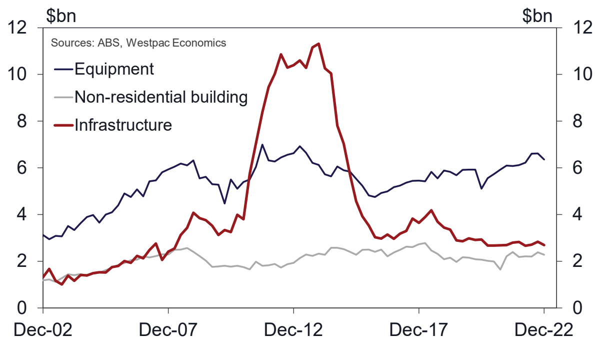
Qld labour market in robust health



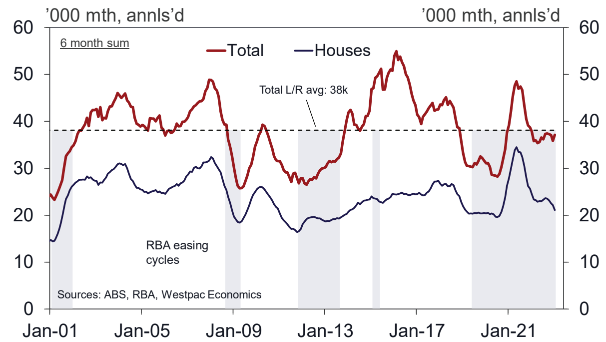
Brisbane housing market correction deepening



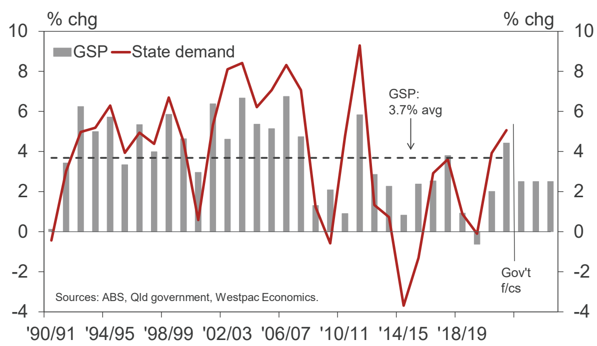
Qld business investment has been supportive



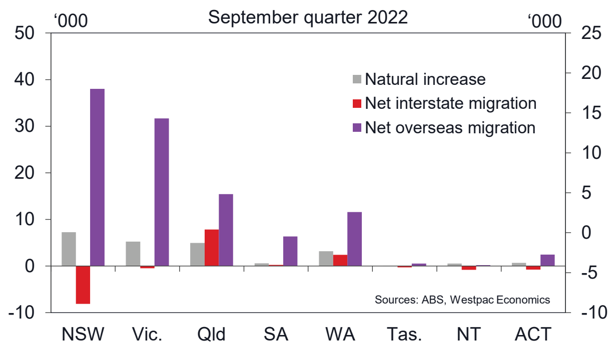
Dwelling approvals: supply limiting new pipeline



Qld economic performance & outlook

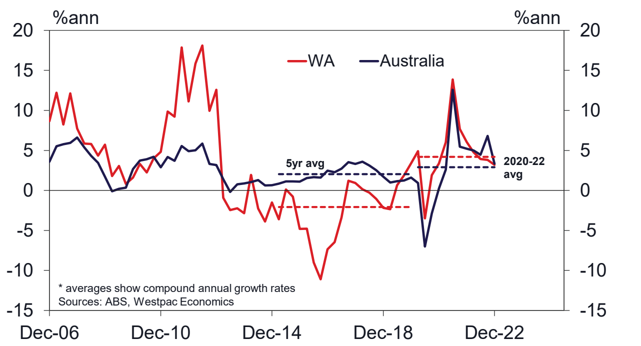


Promising return of overseas migration



Growth moderates ...

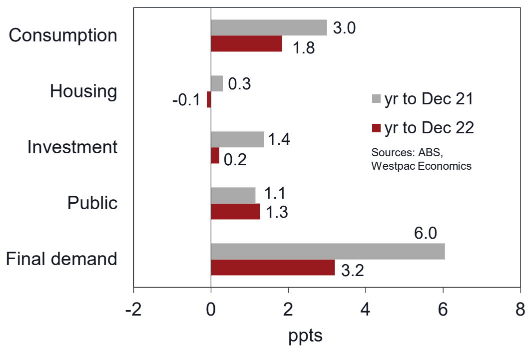
State final demand: WA vs Australia



The WA economy has moderated over the last year, led by a cooling across most components of private demand. Growth is now broadly in line with the rest of Australia, WA having outperformed significantly during the COVID period, due in large part to the state managing to avoid significant virus outbreaks. The slowdown in 2022 reflects several factors, including COVID disruptions to operations early in the year, high inflation and rising interest rates weighing on consumer demand and the housing sector.

The state looks more evenly poised than the major eastern states heading into 2023. While inflation and rate rises are set to put more pressure on consumers and housing activity, both look less susceptible to weakness than inter-state peers. Conditions remain relatively buoyant across WA's large mining sector, albeit with a mixed performance for prices and with investment still fairly subdued. Meanwhile the state government has ample scope to provide policy support to growth if required.

WA: contributions to state final demand

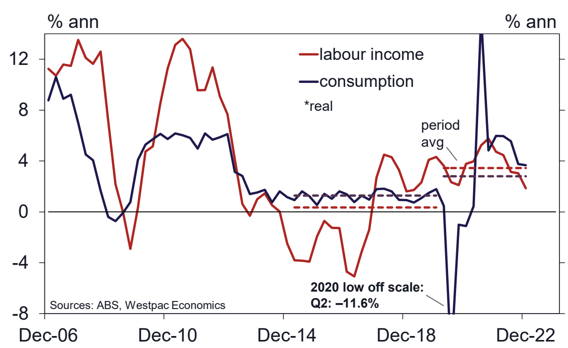


State demand tracked a choppy path in 2022, a 1.1% mini-burst in Q3 followed by a near-flat 0.1% gain in Q4. Annual growth moderated to 3.2%yr, in line with the pace nationally but a solid result given the absence of the 'post-COVID reopening dynamics' that drove above-trend gains in other states.

Consumer spending posted a surprisingly strong 1.6%qtr gain in Q4, significantly outperforming the 0.3% gain seen nationally. One notable point of difference here is around the drag coming from rising electricity and gas costs – whereas these have risen sharply in the major eastern states (up 15-20%yr in many cases), they have been relatively stable in WA (+2.5%yr). Households in WA also look to be carrying less leverage than interstate peers.

Housing activity posted a surprising finish to 2022, an 8% bounce in new dwelling investment more than offsetting a dip in renovations. The lift came despite weak reads on approvals, which still suggest there are more declines to come near term.

WA households: incomes and spending



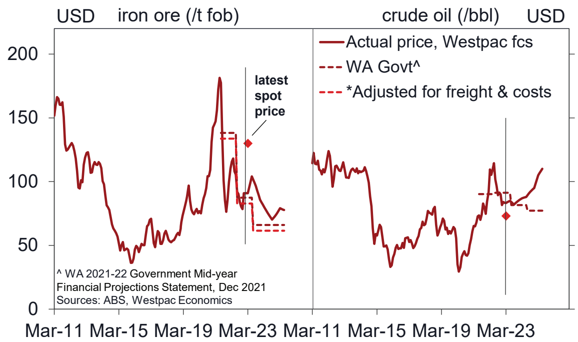
Business investment softened slightly over the second half of 2022, weaker equipment investment partially offset by a gain in non-res construction. The project pipeline has lifted over the last year led by a 30% rise in infrastructure work (some of which is likely to be price-driven). Even still, the total value of work is barely a third of the peak seen during the mining boom.

Public demand has also been choppy in 2022 but around a stronger underlying up-trend – Q4 down 2.4%qtr but still up 4.9%yr. The state government is now running consistent actual and projected budget surpluses, allowing it to start paying down the public debt amassed during the mining bust years, and giving some scope to provide fiscal support if needed.

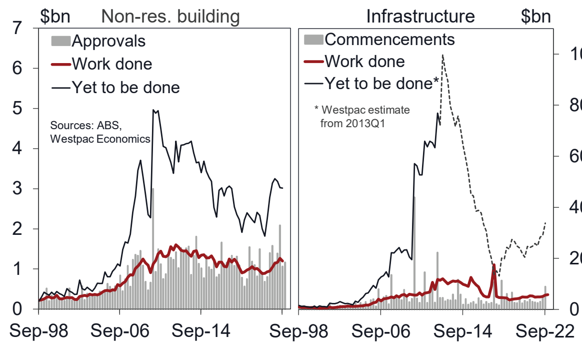
Labour markets confirm the slowdown, growth in both employment and hours worked both moderating materially since mid-2022. Unemployment remains relatively low, wages growth lifting to around 4%yr.

... but looks more evenly poised than in other states

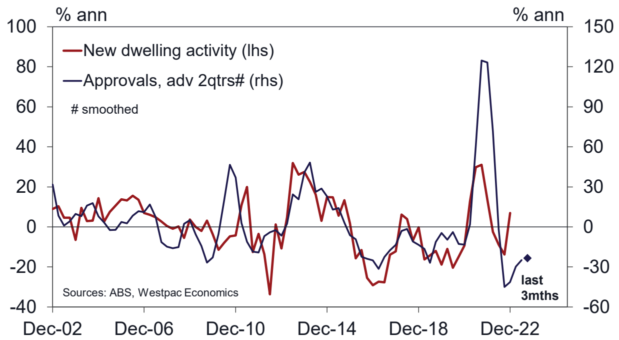
Commodity prices: iron ore & crude oil



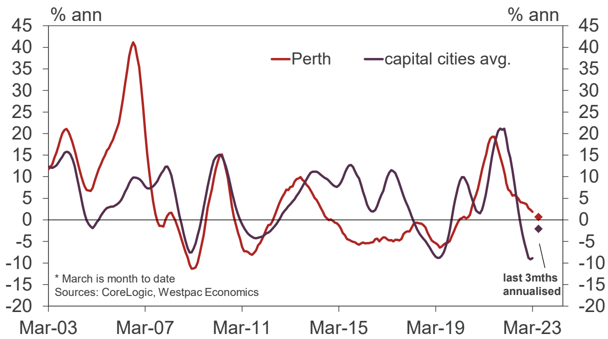
Construction pipeline



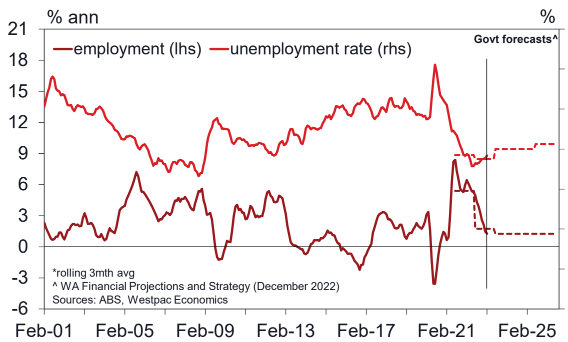
New dwelling inv. cycling big HomeBuilder surge



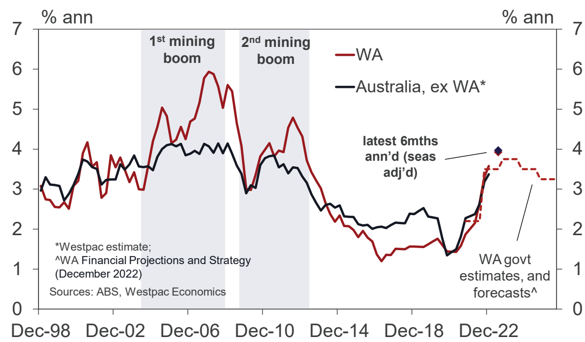
Perth house prices: milder correction



WA labour market

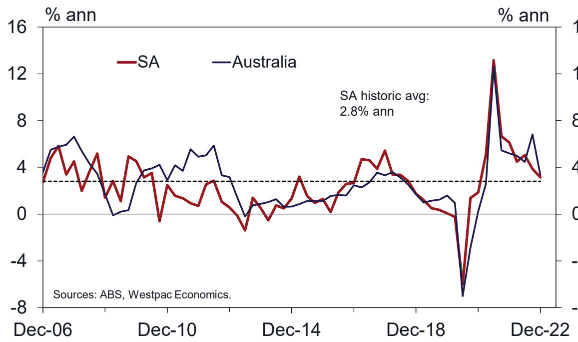


WA wages growth lifting



A soft finish …

State final demand: SA vs Australia

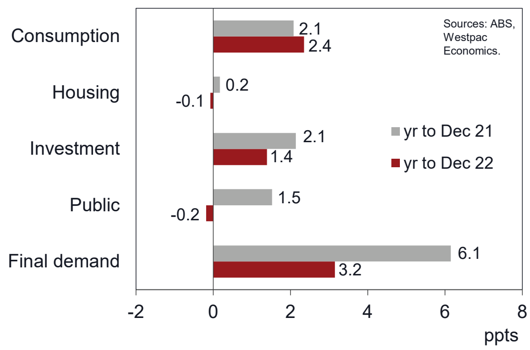


South Australia finished the year on a bleak note, state demand declining 0.2% in Q4. While this does follow a period of strong growth over H1 2022 – activity up a robust 3.2% for the year – the impact from building headwinds is clearly materialising.

This is most evident from the weakness in dwelling investment, down –1.7%yr at December. With falling rates of completion and commencement, new dwelling construction acted as a major drag on overall activity (–7.7%qtr; –3.0%yr), while renovation activity provided little support, stalling flat at year-end.

Arguably, prospects for South Australia's housing market remain comparatively more constructive. Recognising the state's very tight supply-demand balance and favourable affordability setting, the correction cycle and consequent negative wealth effect will likely be less severe for South Australian home-owners. This, in addition to the 10% gain in Adelaide's house prices in 2022 and the slowing pace of price declines so far in 2023, should provide some underlying support this year.

SA contributions to state final demand

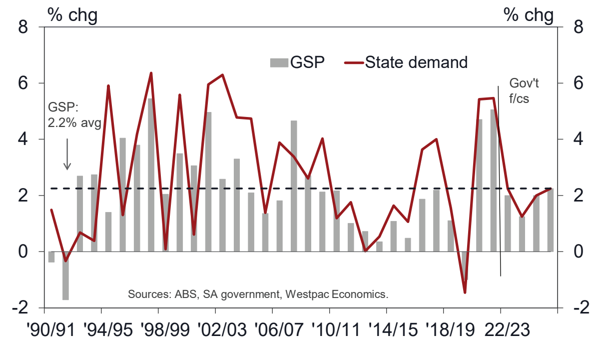


One of the key highlights for the South Australian economy in 2022 was new business investment, up 12.2%yr at December compared to the national average of just 3.1%yr. Most of this strength has been evident in equipment investment (+17.8%yr), though larger-scale investment in engineering projects and non-residential construction has also been greatly supportive.

Business investment did, however, stall in Q4 (–0.1%); and, as is the case across the rest of the nation, the cost of investment and uncertainty over the outlook is likely to hold back expansion. Down 16%yr after posting its sixth consecutive decline in Q4, public investment is also currently not providing reason for the private sector to commit to new capacity.

Highlighting the impact of financial conditions and uncertainty, household consumption fell flat in Q4 upon a broad-based moderation in discretionary spending, most notably across recreation & culture (+0.5%) and vehicle operations (–1.7%).

SA economic performance & outlook



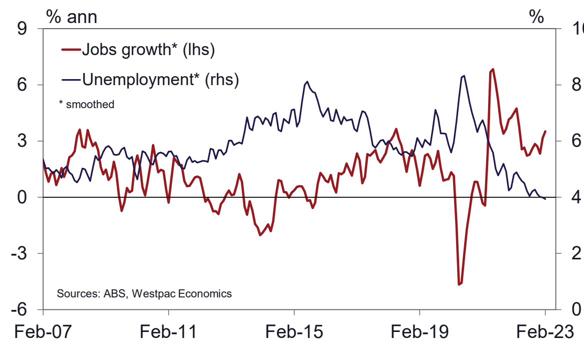
Public consumption was able to provide a partial offset in Q4, rising 1.6% together across state/local and national levels, primarily centred on social benefits and employee expenses.

It is promising to see labour market outcomes remain supportive so far in 2023. With monthly gains in employment being sustained over summer – something which all other states failed to achieve – South Australia's employment-to-population ratio shot to a record high of 61.4% in February and the state's unemployment rate fell to a new historic low of 3.8%.

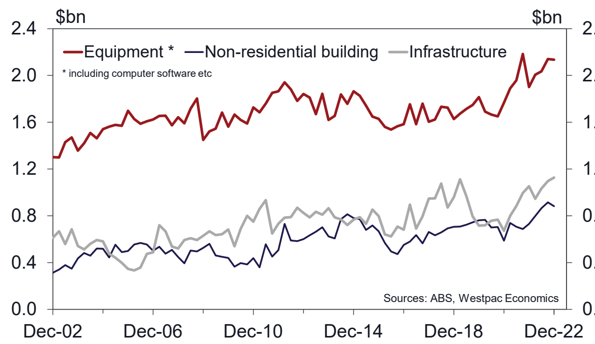
But like the rest of the nation, South Australia is facing a tough year ahead given the cumulative impact of the RBA's rapid tightening cycle is yet to fully impact. There are, however, areas in the state economy that can provide some level of underlying resilience. Most notably, a pursuit of productivity gains through public investment will not only better preserve gains made in the labour market over last year, but it will also establish a stronger base for recovery once headwinds begin to fade.

... to an otherwise constructive year

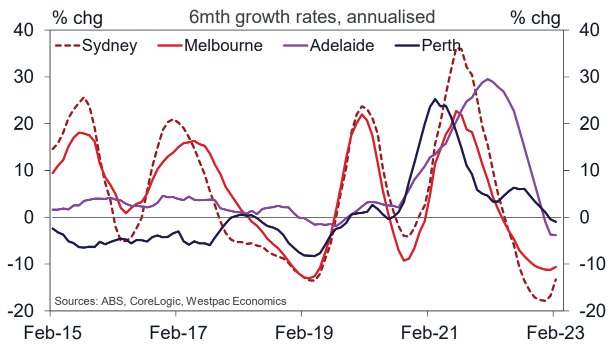
SA's labour market is tight



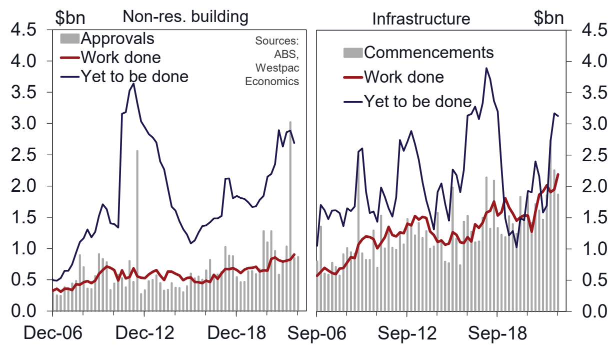
Business investment has strength



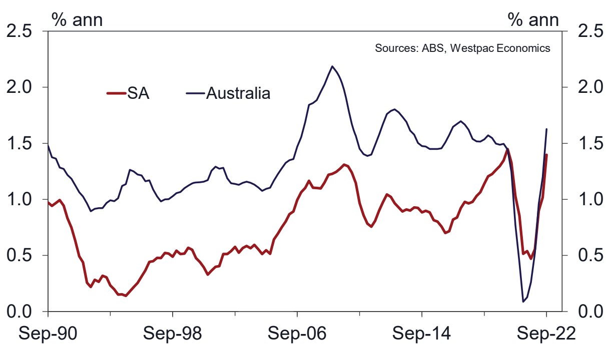
Home affordability in Adelaide's favour



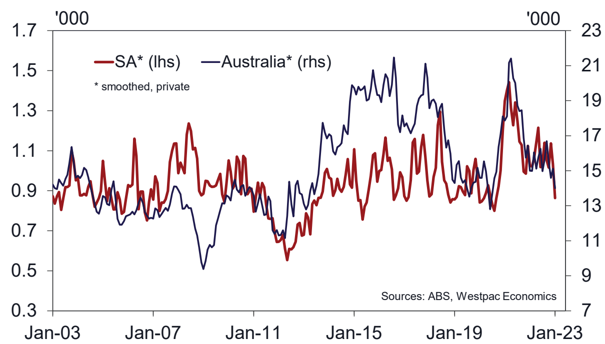
Construction benefitting from renewables



SA population growth beginning to recover

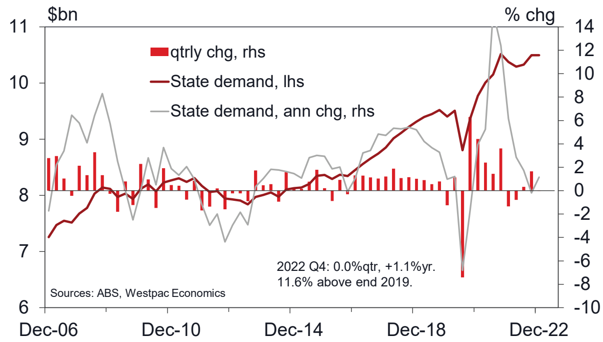


SA housing construction: pipeline positive



Spring bounce falters ...

Tasmania: flat end to 2022

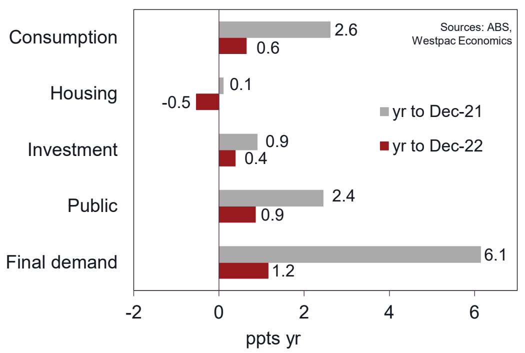


Tasmania's economy bounced into Spring, with state final demand expanding by a brisk 1.6% in the September quarter 2022 (albeit half of that was due to jump in equipment spending). That was followed by a consolidation in the December quarter, with demand flat in the period.

The flat end to 2022 mirrored that on the mainland, with the RBA's rapid fire interest rate rises, along with high inflation, squeezing households. Spending by Tasmanian households stalled in the December quarter, under the weight of these pressures, while nationally it grew by a tepid 0.3%.

Tasmania's housing sector is in a downturn, after a strong extended upswing from mid-2017 to September 2021. The let down effect post the HomeBuilder program and the adverse impact of sharply higher interest rates are apparent. In the December quarter, home building activity contracted by –5.9%, to be 11.3% lower over the year - the softest result of any of the states.

Tasmania: contributions to state demand



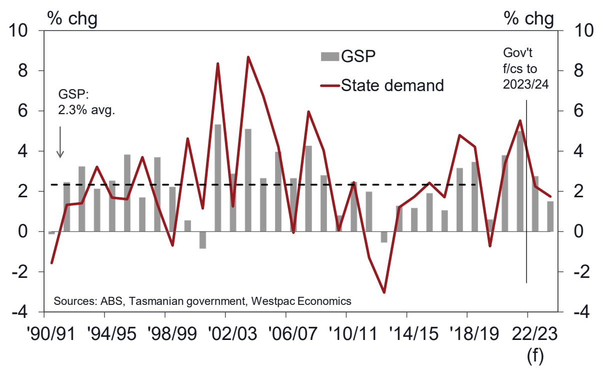
The housing downturn in Tasmania during 2022 was evident across new home building and renovations. Prospects are for the downturn to extend through 2023. Dwelling approvals have continued to track lower and sentiment on whether is it a good "Time to Buy a Dwelling" is particularly weak.

The investment story has been a positive one for Tasmania over recent years – thereby expanding the infrastructure base and helping to grow the productive capacity of the state.

Public investment has been on a strong upward over the past five years and remained at a high level in 2022, up 0.7% on the year prior and 36% higher than in 2015.

Business investment also remained elevated in 2022, albeit 2% below that in 2021, to be 39% higher than in 2015. Over this seven year period, business investment in Tasmania is a stand-out - with that +39% result by far the strongest of any of the states.

Tasmania economic performance & outlook



In mid-February, the state government refreshed their economic outlook and forecasts in the half yearly update.

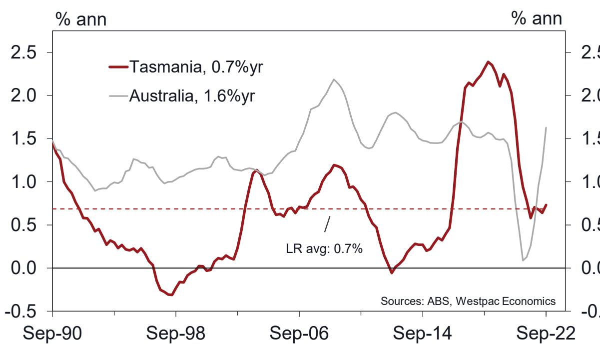
The government highlighted the particularly strong performance of Tasmania's economy over the past two financial years (2020/21 and 2021/22). The update confirmed the output growth forecast for 2022/23, at 2.75%, in light of the strong performance in the September quarter 2022.

However, the outlook for 2023/24 was downgraded, to a below trend 1½% for output growth and 1¾% for state demand, both marked lower from 3%. The RBA tightening cycle in response to inflation pressures has been more aggressive than originally anticipated – pointing to a prospective sharp slowdown.

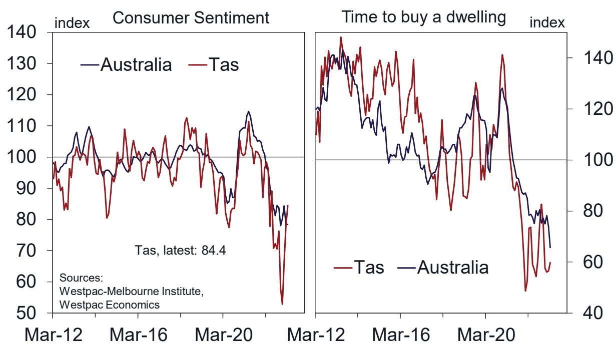
A positive for the outlook are prospects for service exports. With the reopening of the national border, along with increased travel by those on the mainland, there is scope for a further recovery in student numbers and tourist arrivals. Moreover, the move in the Australian dollar back below US70¢ makes Australia and Tasmania a competitive destination.

… outlook downgraded, service exports a bright spot

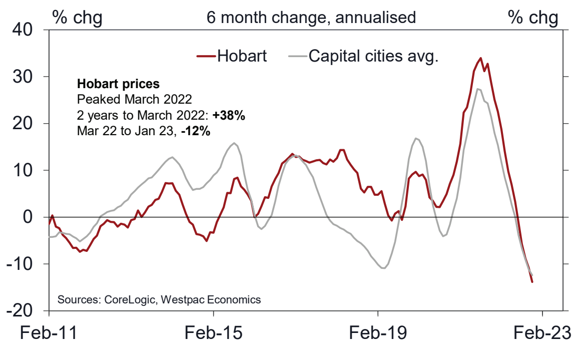
Tas population growth, consolidates



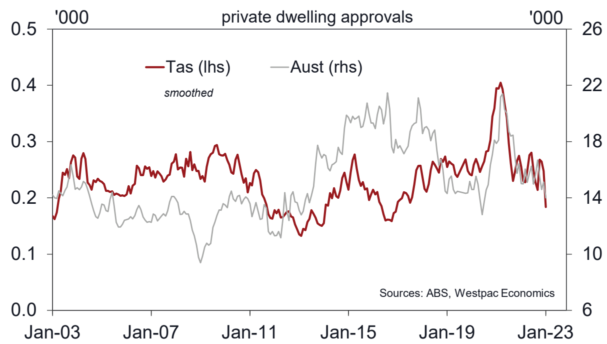
Tasmania, consumer confidence off lows



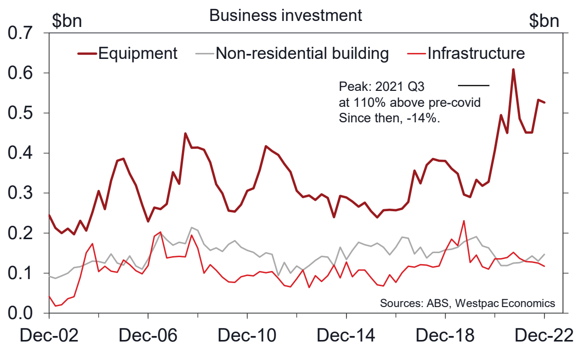
Hobart dwelling prices: pull-back



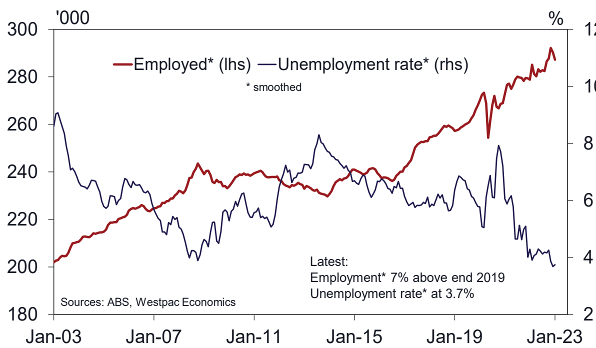
Dwelling approvals: downturn continues



Equipment spending, still elevated

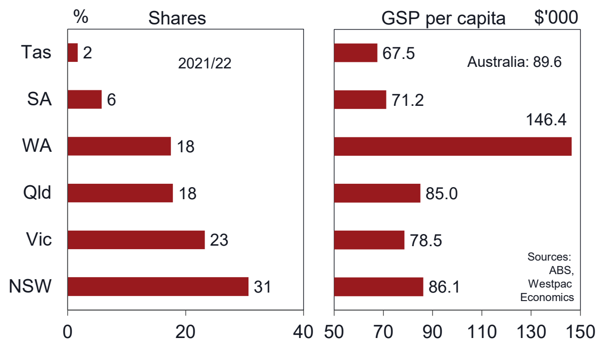


Tasmania: employment upward trend

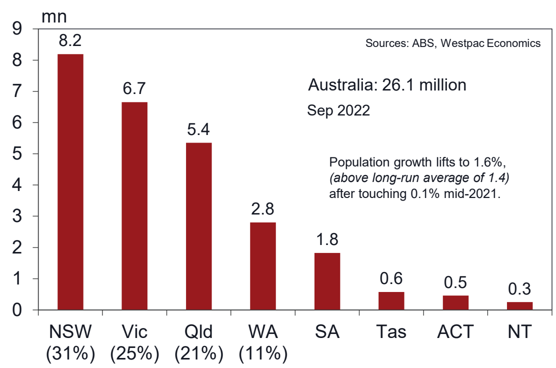


SUMMARY INDICATORS

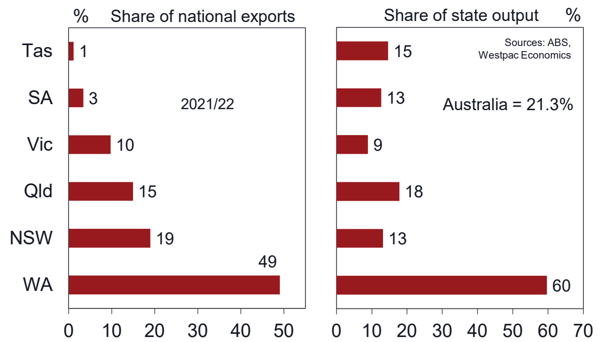
Gross State Product



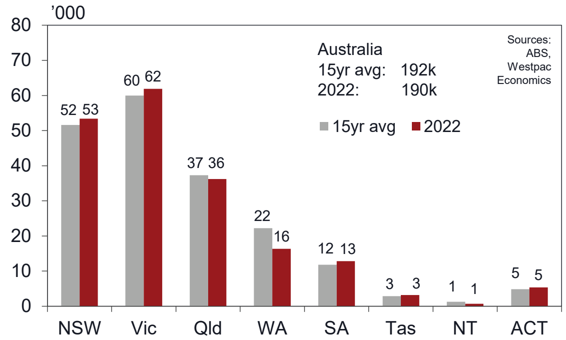
Population



Exports of goods & services



Dwelling approvals



Industry mix share of gross value add

	Australia	NSW	Vic	Qld	WA	SA	Tas	NT	ACT
Agriculture	2.6	1.9	2.4	2.9	2.1	5.6	11.2	3.7	0.1
Mining	10.6	2.3	1.1	11.0	42.5	3.6	4.0	25.6	0.1
Manufacturing	6.0	5.8	7.0	6.4	5.2	7.0	5.8	3.9	1.0
Construction	7.4	7.8	8.2	7.6	5.7	7.3	7.0	5.8	6.8
Transport, utilities	6.8	6.8	7.4	8.1	4.7	7.5	7.3	5.0	3.5
Wholesale, retail	8.8	9.6	10.5	8.6	5.4	10.2	7.7	6.3	4.7
Health, social assistance	8.2	7.6	8.8	9.2	5.5	11.0	13.9	8.4	9.5
Education	5.2	5.3	5.8	5.5	3.2	6.4	6.2	5.1	6.0
Household services	4.6	4.8	4.5	5.3	3.4	5.0	4.9	5.7	4.3
Finance	8.2	11.4	10.2	5.9	3.6	7.2	5.1	2.4	2.8
Business services	16.3	20.9	18.4	14.1	9.5	12.7	9.8	7.0	20.4
Public administration	5.9	5.1	5.6	6.0	3.4	6.4	7.1	12.4	32.0
Ownership of dwellings	9.4	10.8	10.0	9.4	5.7	9.9	10.1	8.6	9.0

Sources: ABS, Westpac Economics. For the 2020/21 financial year.

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