Queensland Economic Update

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Powering business potential

Chamber of Commerce & Industry Queensland

Business confidence is improving across the state as improved prices for major export commodities, low interest rates and a growing pipeline of infrastructure projects are lifting business optimism.

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Queensland Economic Developments

The Queensland economy is still on the long term path to recovery. However, in recent months economic conditions across the state have hit a bump.

The latest data was again mixed. Weaker construction activity and retail trade for the March quarter points to a weak result for state final demand when the data is released in June. The impact of Cyclone Debbie will also impact on the state final demand result. Meanwhile, the Pulse survey shows business confidence across the state is improving as is employment activity.

Business confidence as measured by the twelve-month outlook of the Queensland economy recorded a substantial increase in the March quarter 2017, rising to 49.4, the highest since December 2014. While confidence has improved, the Pulse Index is still below the neutral level of 50 and indicates business sentiment remains slightly pessimistic. The last time businesses were positively confident about the outlook for the Queensland economy was in 2014.

Since the last economic update, there have been several key data releases which help inform the likely stance of the RBA on monetary policy over the medium term.

The Consumer Price Index rose 2.1 per cent in the year to March 2017, at the lower end of the RBA's target range of 2-3 per cent, while the core measures of inflation remain below 2 per cent. Given the soft rate of wages growth as well as strong competition in the retail sector, inflation appears well contained. Combined with below trend growth for the national economy, CCIQ expects interest rates to remain on hold throughout 2017.

The 2017-18 Federal Budget brought forward spending on the government's $50 billion infrastructure package, although the details have not yet been revealed. The budget projects a return to surplus by 2020-21 with a range of measures to raise government revenues rather than continue the cost cutting approach which had stalled in the Senate. New spending initiatives were paired with revenue raising measures to neutralise the impact on the budget bottom line.

Stronger funding for infrastructure in Queensland will be necessary to offset the expected declines in the construction sector. Weaker activity in the residential and non-residential sectors were behind the declining construction levels in the past quarter, where apartments represented the largest decline, falling 21.7 per cent in the quarter.

During March, monthly retail sales in Queensland weakened further by 0.4 per cent (in trend terms). However, in annual terms, retail turnover is 2.0 per cent higher than the same period twelve months ago. Without stronger wages growth, retail spending is unlikely to grow at a rate much faster than inflation.

Pulse Index

49.4%

Highest level of confidence since 2014

Source: CCIQ

Federal Budget

37.6bn

Budget deficit in 2016-17

Source: Treasury Budget Papers

QUEENSLAND ECONOMY: KEY ECONOMIC INDICATORS

Indicator	Latest Release	Rate	Change
State Final Demand	Dec (Q)	0.4%	↑
CCIQ Pulse Survey 12 Month Outlook	Mar (Q)	49.4	↑
Unemployment Rate (Trend)	Apr (M)	6.4%	–
Building Approvals	Apr (M)	-19.9%	↓
Retail Trade	Mar (M)	2.0%	↑
Construction Activity	Mar (Q)	-1.0%	↓
Consumer Price Index	Mar (Q)	1.8%	↑
Exchange Rate (A$ - US$)	Apr (M)	74.8	↓

Construction Activity

-1.0%

Annual fall in total construction activity

Source: ABS 8755.0

Retail Trade

2.7%

Annual retail sales growth (trend)

Source: ABS 8501.0

Business Conditions

- **Pulse survey** of business conditions at highest level since 2014.
- **Construction activity** weaker during March quarter.
- **Building approvals** trending down led by apartments segment.

Labour Force

- **6.4% unemployment rate** which is above the national rate.
- **Employment levels** and participation rate rising.
- **Underemployment falling** despite increase in part time jobs .

Queensland Economic Overview

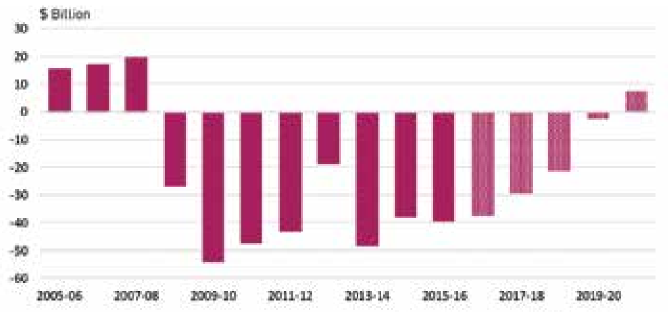
12 Month Outlook

- **Business sentiment** and confidence is building.
- **Residential construction** to weaken although offset to a degree by infrastructure spending.
- **Employment growth** to gather momentum.

Graph 1 - Other Dwellings Constructions ('000)

Source: ABS

Graph 2 - Budget Balance



Source: Commonwealth Budget Papers

Building Approvals

-19.9%

Annual fall in total building approvals

Source: ABS 8731.0

Unemployment Rate

6.4%

Employment and participation levels rising

Source: ABS 6202.0

CCIQ Economic Update Full Report

1. Pulse Index

Business confidence as measured by the Pulse twelve-month outlook of the Queensland economy recorded a substantial increase in the March quarter 2017, rising to 49.4, the highest since December 2014.

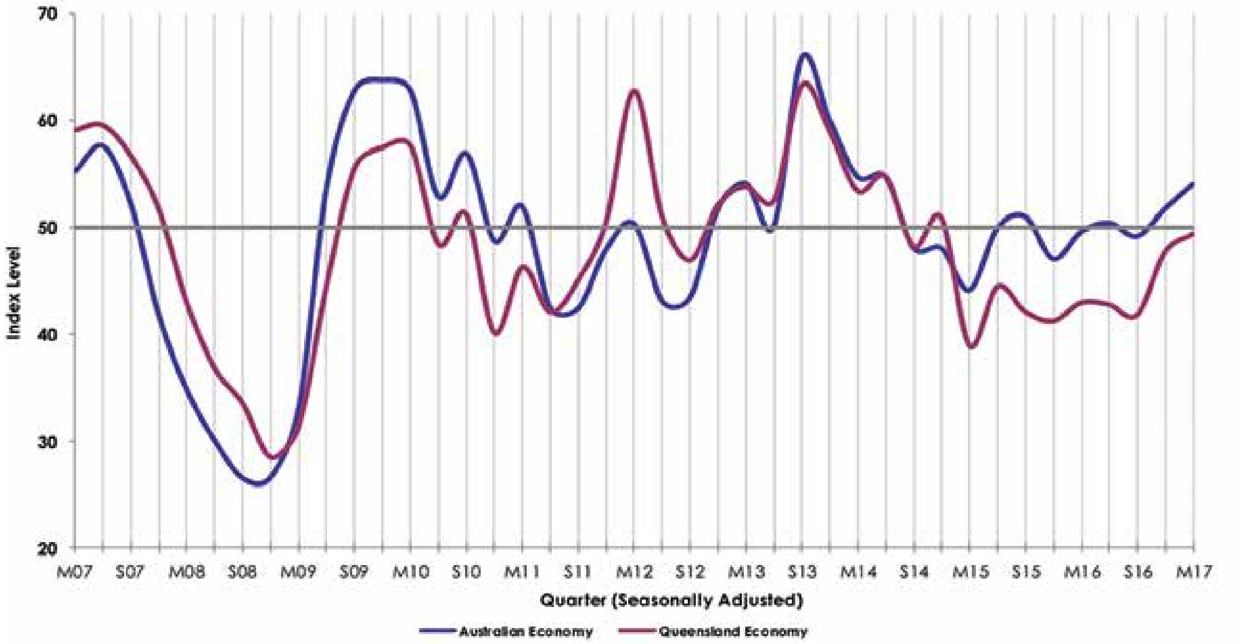
While confidence has improved, the Pulse Index indicates business sentiment remains slightly pessimistic – sitting below the neutral level of 50. The last time businesses were confident about the outlook for the Queensland economy was in 2014.

The catalyst for this lift in confidence is the improving Queensland economy which has been underpinned by strengthening economic data.

Improved prices for major export commodities, low interest rates and a solid pipeline of infrastructure expenditure have been key positives for the Queensland economy across the past quarter, translating into a more positive outlook from the small business community. These factors saw the proportion of pessimists drop by 10 per cent over the past year. The factors weighing on down on positive sentiment included the continued uncertainty and apprehension regarding the global political climate, international markets, high unemployment, increased operational costs and reduced customer demand.

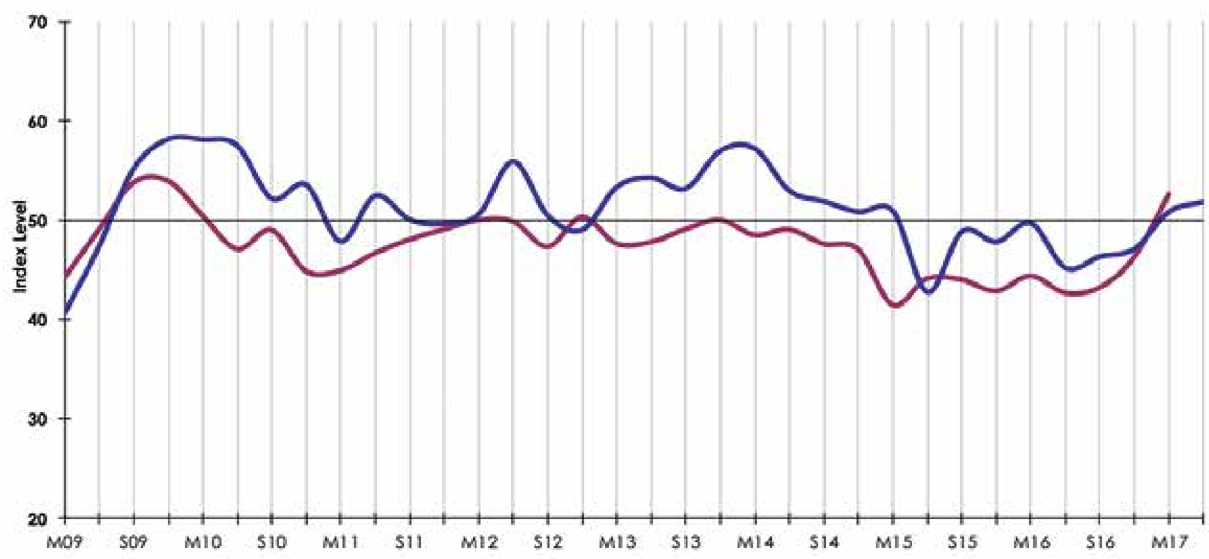
Additional improvements in General Business Conditions and Sales and Revenue were seen across small business as they reported higher levels of profitability, capital expenditure and employment levels compared to the December quarter. As Queensland small businesses invest in their own operations, it encouragingly points to further upward momentum through the remainder of 2017.

Suncorp CCIQ Pulse Index



Source: CCIQ

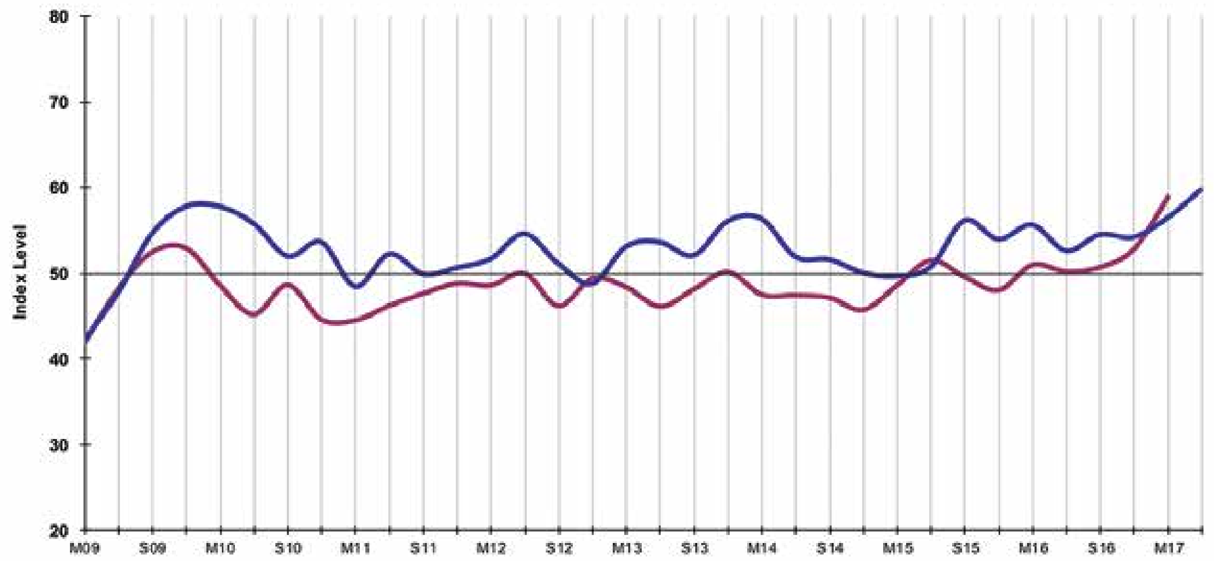
General Business Conditions Pulse Index



Quarter (Seasonally Adjusted) —— Current —— Forecast

Source: CCIQ

Sales & Revenue Pulse Index



Quarter (Seasonally Adjusted) —— Current —— Forecast

Source: CCIQ

2. Federal Budget

The 2017-18 Federal Budget was heavily focused on investment in infrastructure and education. The budget also mapped a new path to surplus with a range of measures to raise government revenues rather than continue the cost cutting approach which had stalled in the Senate.

Although the government has announced new spending measures, the Budget has forecast that expenditure will remain on hold at around 25 per cent of GDP through the forward years. Essentially government spending is on track to grow at the same rate as the economy. The key to returning to surplus is through higher revenues. Tax receipts were projected to rise from $406 billion in 2016-17 to $526 billion in 2020-21. As a proportion of GDP, this is expected to rise from 23.2% to 25.4% over the outlook period.

Behind the tax revenue receipts was a forecast acceleration in GDP growth, with LNG exports a significant contributor in the short-term. If all goes to plan, the Federal Government is looking at a Budget surplus of $7.4 billion in 2020-21. In order to achieve these targets, the government is banking on a range of new revenue measures which are projected to raise $18 billion over the forward estimates. Such initiatives include:

An increase to the Medicare Levy

The levy will rise from 2 per cent to 2.5 per cent of taxable incomes generating $8.2 billion in revenue over the forward estimates.

A new Major Bank Levy

A 6 basis points charge on the five biggest banks is expected to raise $6.2 billion by 2020-21.

A new Skilling Australians Fund Levy

Increased and new fees imposed on businesses employing foreign skilled workers are projected to raise $1.2 billion.

Tightening Capital Gains Tax discounts for foreign investors

Projected to save the government $580 million.

Restricting deductions for investment properties

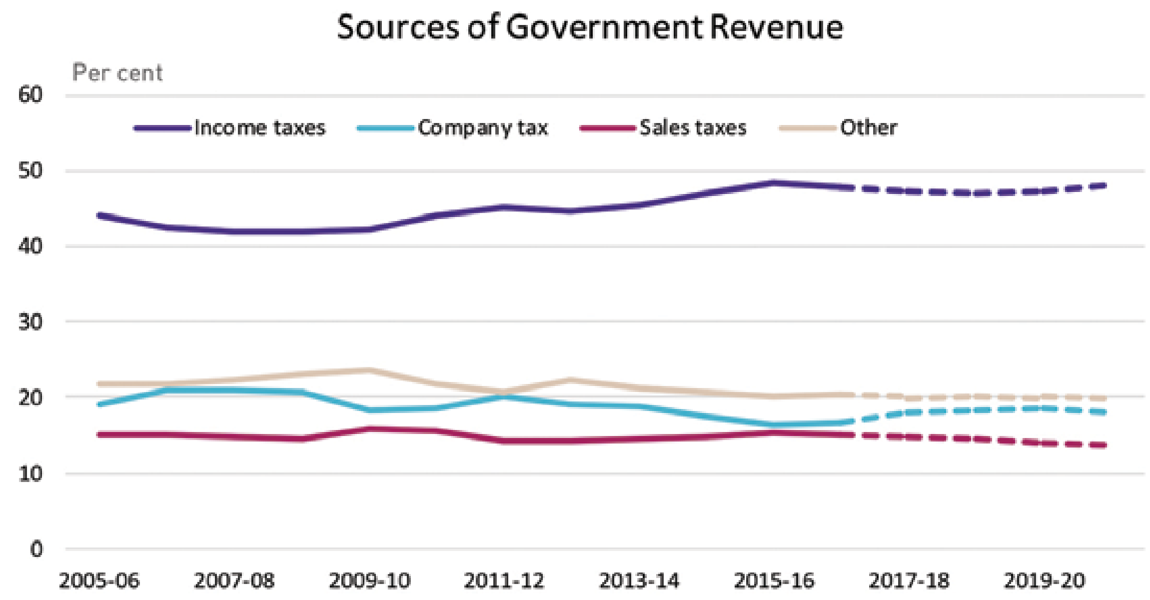
Tightening on allowable deductions including the removal of travel deductions ($540 million) and limiting depreciation deductions ($260 million).

Tightening laws around tax avoidance by multinationals

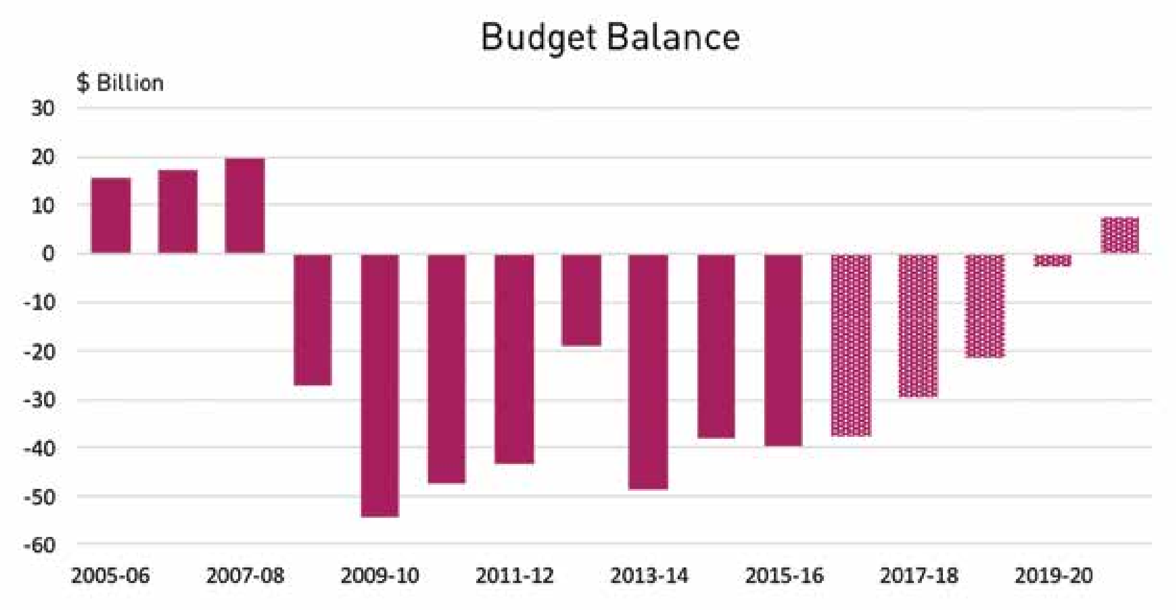
Treasury has not yet specified the additional revenue to be raised.

Past budgets have displayed a poor track record of forecasting the economic variables which underpin the budget revenue calculations. The main issue has been the assumption of a return to long-term averages for a range of economic indicators. Those assumptions have proven to be quite optimistic as the adverse impact of the end of the mining investment boom has weighed down on the economy.

The economic assumptions underpinning this Budget appear reasonable and offer more conservative projections than those of last year. However, there is no doubt that there will need to be a slice of luck for the budget to return to surplus.



Source: Commonwealth Budget Papers



Source: Commonwealth Budget Papers

> **"There will need to be a slice of luck for the budget to return to surplus by 2020/21"**

Steven Gosarevski
CCIQ, Economist & Data Analyst

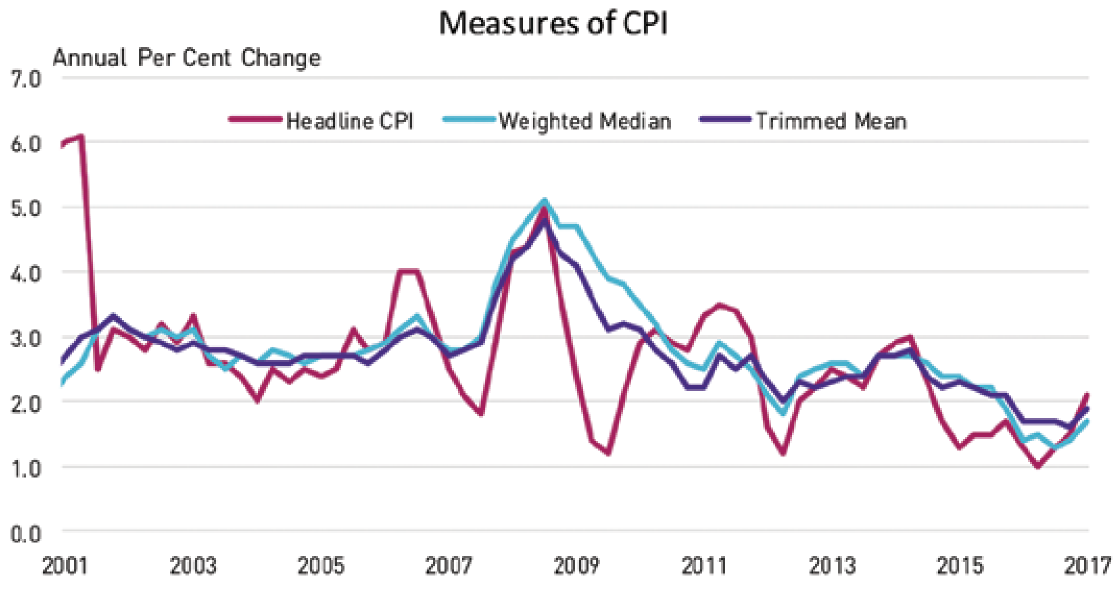
3. CPI, Wages and Monetary Policy

Since the last economic update, there have been several key data releases which help inform the likely stance of the RBA on monetary policy over the medium term.

The Consumer Price Index rose 2.1 per cent in the year to March 2017, the first time the CPI was back within the RBA's target range of 2-3 per cent since September 2014. The Brisbane based measure of inflation was slightly lower at 1.8 per cent.

While the headline rate of inflation at the national level has moved back into the lower end of the target range, the core measures of inflation – the Weighted Median and Trimmed Mean - remain below 2 per cent.

These measures of core inflation represent the underlying trend increase in prices and are calculated by stripping out the most volatile items in the basket of goods used to calculate the CPI. Forecasts of future CPI are based on the core measures of inflation and are currently indicating a benign outlook for price growth.



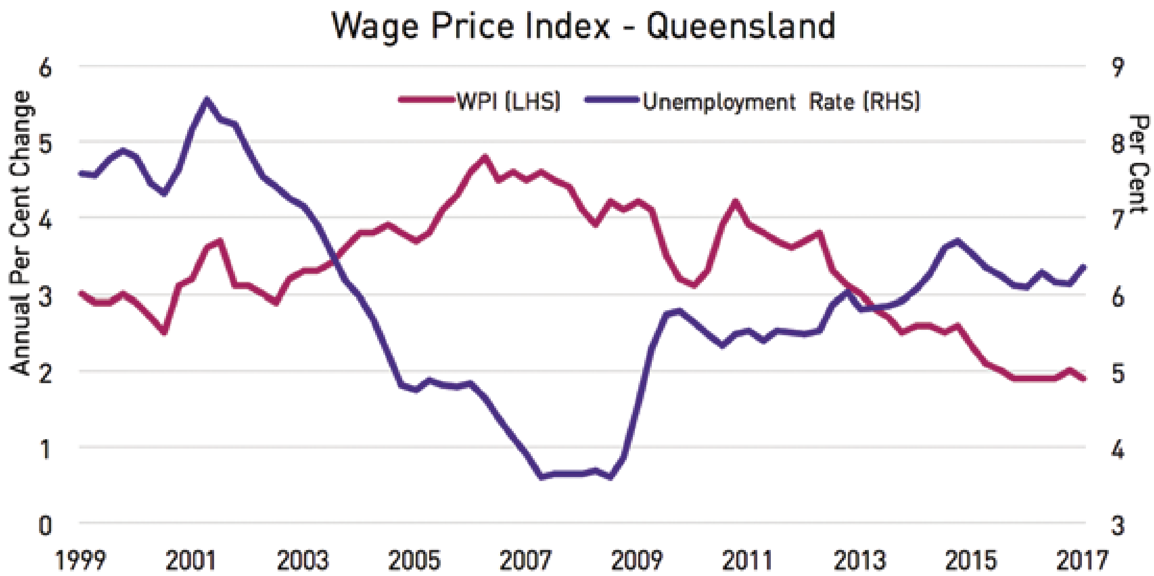
Source: ABS & RBA

The RBA has the view that underlying inflation is expected to increase gradually to 2 per cent in early 2018, with headline inflation contained to 2 to 3 per cent in period to June 2019. The growth in wages is a key factor with only moderate increases in unit labour costs expected to feed into the cost of goods and services. The RBA also cited retail competition and increased housing supply keeping rents down as factors to constrain inflation over the next two years.

Both the national and Queensland measures of the Wage Price Index rose 1.9 per cent in the year to March 2017. At the national level, real wages (adjusting for inflation) declined during the past year, while real wages in Queensland were marginally positive at 0.1 per cent.

Continued labour market weakness and a large degree of spare capacity have limited the scope of wage increases across the national jobs market. This is a function of both the elevated level of unemployment as well as underemployment of part time workers. The recent decline in company profits have also contributed to the weakness in wages growth.

The Reserve Bank anticipates a pick up for real wages growth during 2018 and 2019 with higher levels of expected inflation likely to contribute to wage pressures. Meanwhile, in the 2017-18 Federal Budget, Treasury forecast the Wage Price Index to grow at above 3 per cent from 2018-19, implying real wage growth of over 1 per cent annually over the same period.



Source: ABS

The RBA released in May its latest Statement of Monetary Policy which sets out its assessment of current economic conditions and the outlook for inflation. The RBA expects the economy to accelerate during 2018 which should stimulate employment growth and a rise in inflation activity toward 2019. Compared to the forecasts presented in the February statement, growth was marginally upgraded for 2018 with all other forecasts unchanged.

Given the soft outlook for growth in the short term and inflation being well contained, CCIQ expects interest rates to remain on hold through 2017. This assumes the dollar continues to support the economic transition towards balanced growth with a greater reliance on growth from the trade exposed sectors.

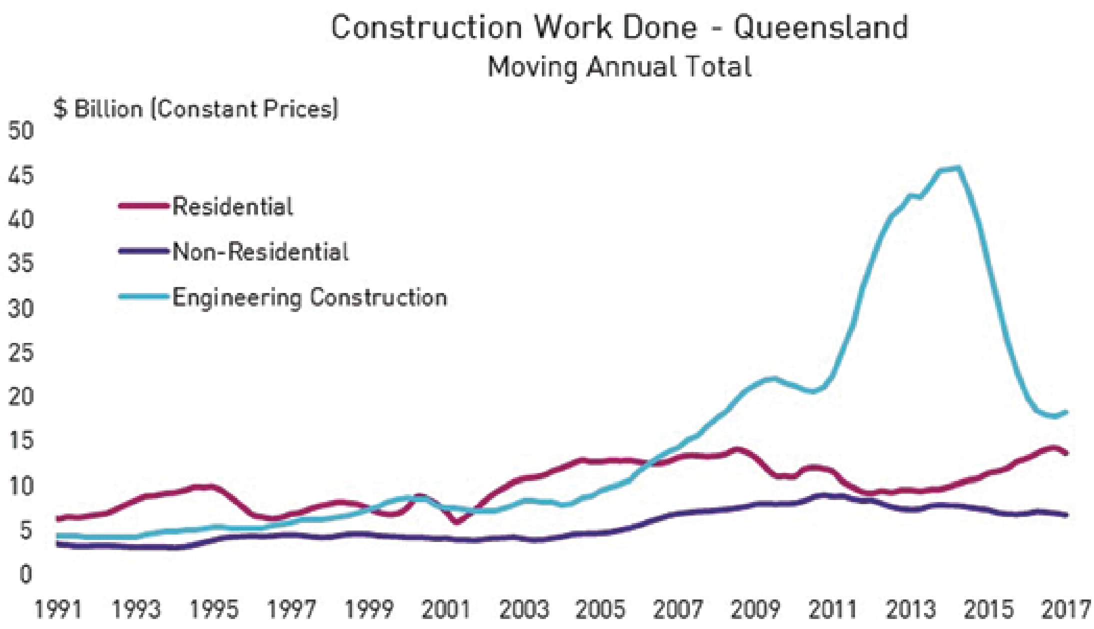
4. Construction Activity

The level of construction activity in Queensland fell 1.9 per cent during the March 2017 quarter to $9.4 billion, the lowest level of activity since 2007. Construction activity has declined over 40 per cent since 2014 after work peaked on the major LNG plants in Gladstone.

Weaker activity in the residential and non-residential sectors were behind the declining construction levels in the past quarter. In the residential segment, apartments activity had the largest decline, falling 21.7 per cent in the quarter. The construction of new detached house were down 7.5 per cent, while alterations and additions was weaker by 4.5 per cent.

The decline in residential construction activity could subtract over 0.5 percentage points from state final demand growth in the March quarter.

On a more promising note, engineering construction activity was stronger by 7.4 per cent in the quarter. Infrastructure construction has started to climb through the 2016-17 financial year with recent commencements data indicating the improvement is spread across both privately and publicly funded infrastructure.



Source: ABS

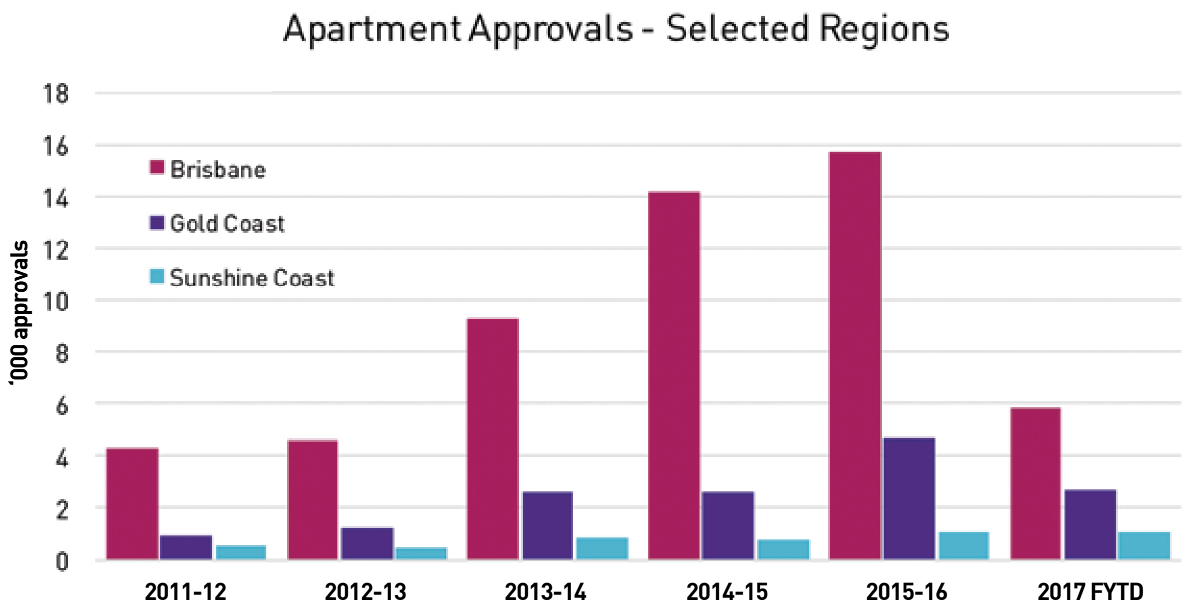
The tide has turned on the residential construction sector.

Apartment approvals have been trending lower since early 2016 and are down by almost 30 per cent in the year to March 2017. The large addition of new stock into the market along with regulatory measures to reduce speculative activity are impacting the segment. The collapse of several home and apartment building companies has further added to the concerns on the health of the housing market.

New commencements of detached houses have also slowed since early 2016. While new approvals are down by 2 per cent in the year to March, there has been a far more visible slowdown in recent months.

The large increase in apartments construction was concentrated in Brisbane, representing approximately 60 per cent of all apartment approvals in Queensland during 2015-16. In contrast, Brisbane only accounted for 17 per cent of all new housing approvals for the state.

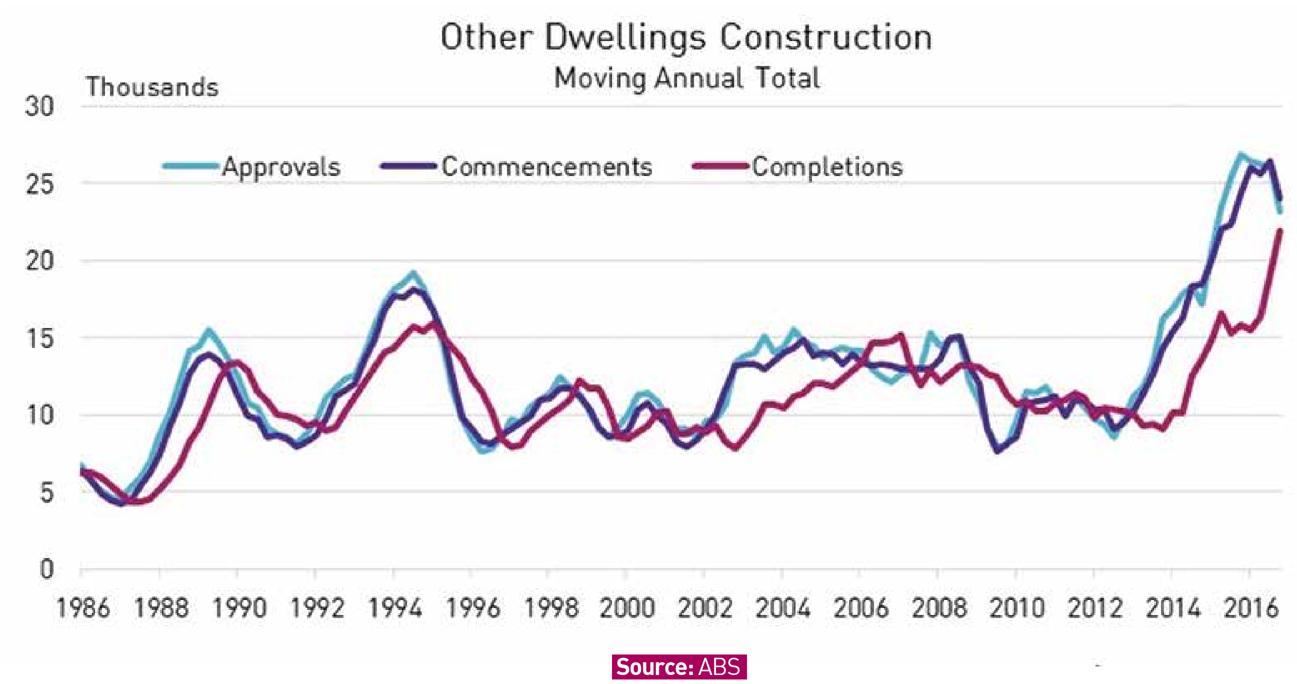
In a short period of time, apartment developments have surged across Brisbane, and to a lesser extent, the Gold Coast. Approvals in Brisbane more than trebled between 2011-12 and 2015-16 but have slowed sharply this financial year. Measures to slow and unwind potential risks in the market have started to take effect. In the nine months to March 2017, Brisbane apartment approvals are 45 per cent lower than the corresponding period last year.



Source: ABS

This slowdown in apartment approvals combined with the growing number of project completions has led to a shrinking pipeline of dwellings under construction. This has manifested into a 21.7 per cent decline in other dwelling construction during the March 2017 quarter.

In the coming periods, we should see further falls in construction activity as the big glut of apartment commencements from 2016 work their way through to project completion. With the market awash with new stock and a stagnant outlook for prices, new project commencements have dropped sharply in recent month. This slowdown is expected to stabilise around the 14,000 dwelling units annually – around 45 per cent lower than the peak levels.



Source: ABS

> **"Measures to slow the apartment market and unwind risks have successfully reduced the number of new approvals."**

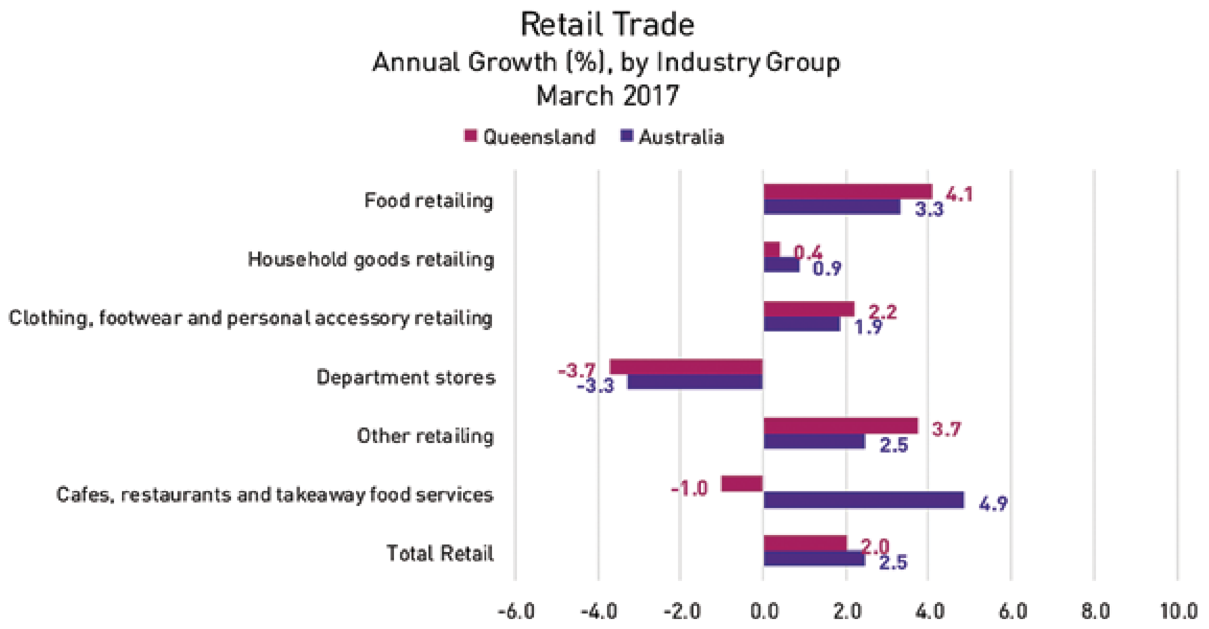
Kate Whittle - **CCIQ, State Manager of Advocacy**

5. Retail

During March, monthly retail sales in Queensland weakened further by 0.4 per cent (in trend terms) and is the fifth consecutive monthly decline stretching back to November 2016. In annual terms, retail turnover is 2.0 per cent higher than the same period twelve months ago.

Some of the decline can be attributed to the impact of severe Tropical Cyclone Debbie, while the weakness in the labour market continues to weigh on the retail sector. Jobs growth has been sluggish, while the growth in incomes have dropped to their slowest levels in decades.

Taking inflation into account, real wages have barely improved in the past year (up 0.1 per cent) which has led to greater consumer spending constraint in recent periods. This slowdown in spending is particularly evident in the discretionary retail categories such as Department Stores, Cafes, Restaurants & Takeaway Food Services, and Household Goods Retailing which have displayed the weakest growth across the retail segments.



Source: ABS

The March quarterly data release also showed the price of retail goods rose by 0.1 per cent over the previous quarter at both the state and the national level. The combination of weak consumption growth and increased competition (including the arrival of foreign retailers) has helped keep retail prices in check. Retail volumes (removing the impact of price increases) was also weak in Queensland, falling 1.0 per cent during the March quarter.

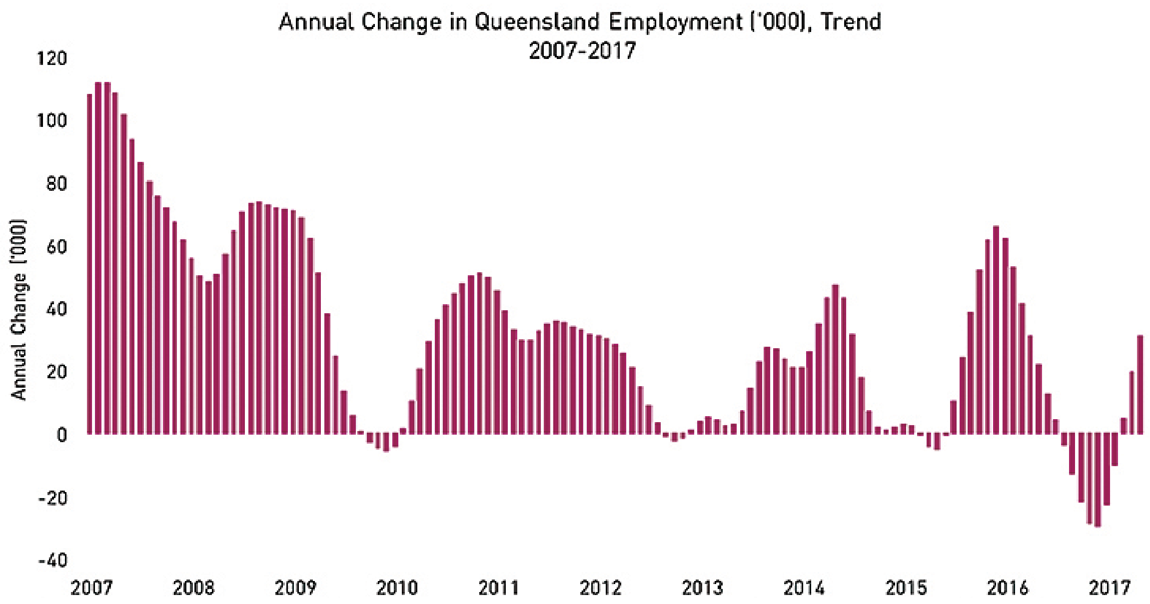
The outlook for retail spending appears to be quite soft in the short term. The current state of the jobs market and weak wages growth is likely to weigh on retail activity. The Pulse Survey showed an improvement in small business confidence however businesses are still marginally pessimistic – similar to measures of consumer confidence.

> **“Retail volumes fell during the March quarter, weighed down by weak employment and income growth.”**
>
> Kate Whittle - **CCIQ, State Manager of Advocacy**

6. Labour Force

The trend unemployment rate remained steady in April at 6.4 per cent with 6,600 jobs created during the month and 14,500 jobs over the past twelve months.

Although the number of jobs have increased in the past year, the total number of hours worked have dipped 0.4 per cent over the same period. This trend in the reduction of hours worked while total employment is rising reflects the increasing proportion of part-time jobs in the labour market.



Source: ABS

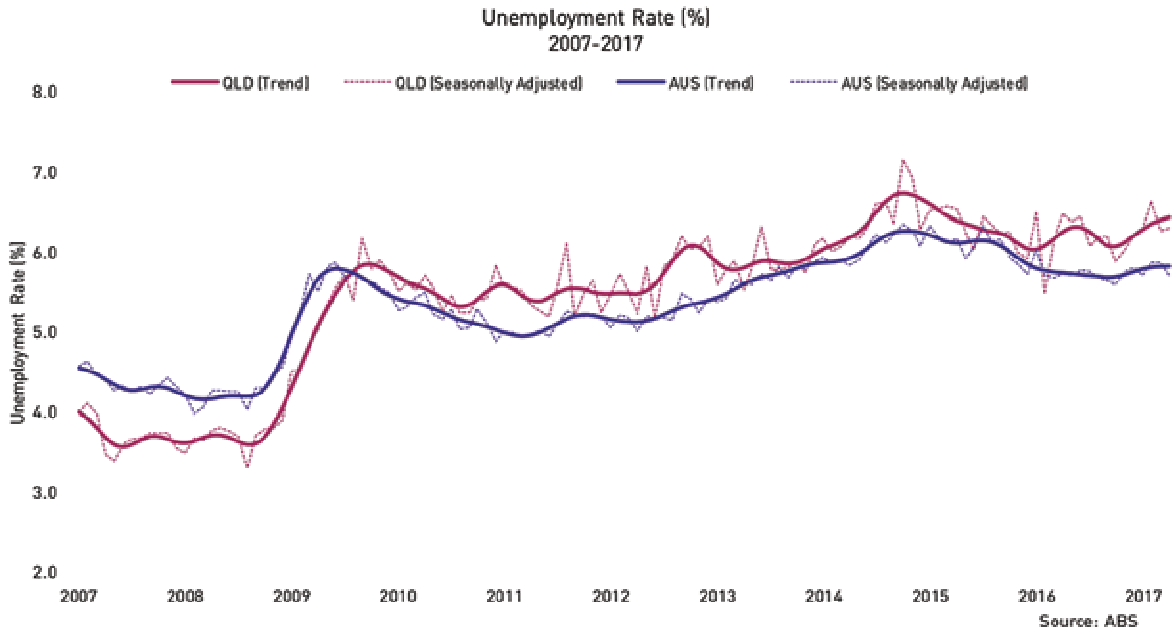
The monthly lift in trend jobs growth started late in 2016. Since November, 31,100 jobs have been added with 18,500 part-time roles created during this period. Despite the growth in new jobs created, unemployment levels have also increased during this period. This is due to a combination of increased population and higher participation levels which have increased the number of unemployed job seekers by 10,000.

The increased rate of participation is an encouraging sign for the labour market. As state final demand has stabilised and expanded in recent quarters, the increase in participation is an indication that discouraged workers are returning to the jobs market. So while the unemployment rate has ticked up to 6.4 per cent, there are some healthy signs for the jobs market.

Another promising sign is the reduction in the level of underemployment. Compared to twelve months ago, the number of underemployed workers has dropped by roughly 15,000. These reductions occurred across both categories of underemployment: people seeking more part-time hours and full-time employees who worked reduced hours.

Overall, the underutilisation rate (rate of unemployment and underemployment) has declined in the past year from 14.8 per cent in April 2016 to 14.0 per cent in April 2017.

Nevertheless, these levels of underutilisation are unacceptably high and more needs to be done to help stimulate activity.



"Despite the unemployment rate remaining steady, there are some healthy signs across the labour market"

Kate Whittle - **CCIQ, State Manager of Advocacy**

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