ACCESS ECONOMICS

business outlook

September 2008

Will the China domino fall?

Access Economics' Business Outlook

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STOP PRESS

❑ *Business Outlook* initially went to the printer less than a day ahead of the collapse in confidence in the global financial system. There have since been huge reactions from policymakers (interest rate cuts, emergency liquidity and funding measures) and from markets (a despairing dive). The same day saw the release of the latest Australian consumer confidence measure, which showed shoppers curling into the foetal position amid headlines that spoke not merely of the potential for Australian recession, but also of the potential for global depression.

❑ Bugger. *Business Outlook* was predicated on two key caveats – first, that China's economy did not join the walking wounded and, second, that Australian consumers did not lose heart. Both caveats are now in play. Our response has been to include this *Stop Press* so as to update you on where developments may now take the economy relative to the detailed commentary and forecasts in this current issue. We've also made partial changes to our forecasts, and minimal changes to the words which originally went to the printer (though the latter remain mostly unchanged). A full update for you will come with the next quarterly release of *Business Outlook*.

❑ One of the authors of *Business Outlook* was in the US Capitol when the House of Representatives voted down the initial US bailout plan. It was immediately obvious that global confidence would tank – and tank it has. The wheels of global commerce are oiled by the banking system, but the latter has shut up shop for now, leaving policymakers desperately trying to fill the gap by various emergency measures. **By definition those measures will fail**. **Governments and central banks just don't have the dollars to turn around markets in full retreat**. Once cracked, confidence is hard to repair. **Equally, however, current conditions are temporary**. At some stage markets in general and credit markets in particular will become less panicked, and the wheels of commerce will start to turn once more. That is why Access Economics takes some of the current pronouncements (of recession at home and depression abroad) with a grain of salt. However, the longer it takes markets to get their mojo back, the worse the short term outlook becomes for both Australia and the world.

❑ **We urge you not to overreact on your outlook for the economy**. Businesses and governments make their biggest mistakes amid both booms and busts. Over the last two years we consistently warned current conditions were not sustainable: for many businesses, they were simply too good. Equally, **current conditions are so dire they too cannot last too long, especially in credit markets**. And don't forget one simple but important point. Today's crisis is a hit to demand, not supply. The potential for economies to produce is driven by the number and quality of workers here and around the world, as well as the plant and equipment they have to work with. Neither element of that production potential has been damaged by today's crisis. Financial meltdowns have a history of weighing on confidence (and hence demand) for well over a year. But they will ultimately go away, allowing demand to lift back towards supply.

❑ **That doesn't say Australia is not at major risk. It is. But our risk focuses more on commodity markets** rather than financial markets (or credit markets in particular). As Access Economics has also stressed in recent years, Australia's national income has been massively pumped up by a surge in commodity prices. If those commodity prices reverse fast – an increasingly likely scenario – then a number of businesses and all governments can be entitled to fear the next few years. Keep watching China and commodity prices, particularly coal and iron ore prices. If the latter pair of prices fall out of bed, then so will Australia's short term fortunes.

❑ To date the slowdown in Australia's economic growth has been centred in consumer spending and housing construction, as they are very sensitive to interest rates and to the broader availability of credit, as well as to confidence. Interest rates are now lower, but confidence is too, and that is enough for us to expect that consumer spending and housing construction may be even weaker in the next little while. Rather more worryingly, fading prospects for the growth of emerging economies in general (and China in particular) may combine with difficulty in obtaining credit and an expected sag in business confidence to put a notable dent into what had been this nation's growth ace: business investment. The latter doesn't and won't turn on a dime, but it may well go from a key support to the overall growth outlook to something rather more modest.

❑ There may be little change elsewhere to the Australian growth outlook – government spending will continue unabated and, even amid rapidly gathering global gloom, export volumes should still lift. The latter is an important point, and one that many commentators may miss. When it comes to exports, our risk is lower prices rather more than it is lower quantities. The world will still want Australian industrial commodities in particular, but will pay us less than we'd like for them. Yet, with consumers cowed and business investment moving on to the back foot, GDP growth in Australia will be less than we had originally forecast in this edition of *Business Outlook*. The following report therefore contains updated forecasts – both tables and charts.

❑ Sectoral growth drivers are also switching. We had already made a point of that in the words you see in the publication here. However, the import of recent days means a rather larger and faster switch in the sectoral drivers has already occurred. Neither exchange nor interest rates are the negative they once were. And China is no longer the positive it once was. The impact of that is likely – on current developments – to be a narrowing of recent growth differentials rather than a reversal of them, though the latter now looks more of a possibility than it has done for years. After all, and even amid the rapid blooming of global gloom, Australian manufacturers and tourism operators will benefit from the impact on them of today's changed circumstances.

❑ **Global growth is also under the gun**. Just how much it is under the gun is unclear, but the longer the current crisis lasts, the worse it will be for global growth. Access Economics has long noted the importance of China in particular to local prospects. As we note yet again in the current edition of *Business Outlook*, *"to repeat an old refrain, Australia is fine while China is fine. Or, to sit that on its head, if China stops being fine, then Australia runs the risk of being buggered. Is there a risk that China won't be fine? You bet there is."* Well, that risk has just worsened again. Notably so. It won't be clear for some months yet just how much trouble China is (or isn't) in, but chances are that its growth will take a larger hit than earlier expected. We have therefore revised down our estimate of China's GDP growth in 2009 to 7.4% in the following report.

❑ Turning to other elements of the forecasts, **inflation is likely to be a little worse than initially forecast**. Again, we have adjusted the forecasts in the attached. However, the change is minimal – with inflation expected to be a little faster in the short term as the $A's fall from grace pressures retail pricing more than the souring economy reduces demand-driven inflation risks. Keep an eye on import prices in particular.

❑ On the outlook for interest and exchange rates, clients know we have long forecast a sharp fall in both, but we didn't foresee the extent of the financial firestorm of recent weeks. We see the Reserve Bank cutting cash rates to 5% in coming months as it takes out further insurance to avoid Australian economic growth getting caught up in the global maelstrom. Note that forecast assumes a weaker China rather than a flattened one. Were the latter to occur, then the RBA would drop rates even further still. The $A went from dicing with parity to cellar dweller in very short order, dropping well below the US 72 cents it has averaged since the $A first floated a quarter of a century ago. We don't see the $A fading too much further again over the next year, but the caveat to that is very much China's outlook – the worse that China (and commodity prices) look, then the lower the $A will go.

- The job market has been Australia's star performer for a long time. The accompanying forecasts here expected it to stay that way. We haven't had time to revisit those forecasts, but our earlier hopes for continuing outperformance on the labour market front are fading. The performance of job markets may yet still beat the forecast Treasury made last May, but there is now no certainty of that.

- The first signs of difficulties ahead are there to be seen. Commodity prices have fallen notably already. And although that is not yet true of coal and iron ore prices, steelmakers around the world are complaining that the current price for their product is barely ahead of the cost of making it. That suggests both (a) the mothballing of steel expansions and (b) price falls ahead for coal and iron ore in the contracts to run from April 2009. And rumours are rife of buyers of iron ore starting to request delays to their deliveries – an ominous sign. Meantime, the price of aluminium has fallen so much that Alcoa has just shelved all non-essential capex – a reminder of the (eventual) vulnerability of Australia's record pipeline of construction work yet to be done.

- Access Economics already had a sombre view of commodity price prospects, so the recent ructions on markets don't particularly affect our view on the outlook for the balance of payments. However, as Australia's economics lesson back in 1986 (during the days of the 'banana republic') remind us, 'the J-curve' effect sees the current account deficit get worse before it gets better. We import a bit more than we export, so a drop in the $A will tend to add more to the cost of imports than it saves us through higher export earnings. That said, a couple of years from now the lower $A will be starting to show up in healthier external accounts for Australia.

- And as for public sector accounts, they too remain in the thrall of commodity prices. If the latter tumble, then Australia's Federal fiscal surplus will be at risk of melting. That may not happen as fast as Lehmann Brothers bit the dust, but it would happen. (And Australians may then regret the years of big public spending and free-wheeling tax cuts which preceded it.)

Access Economics
October 2008

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EXECUTIVE SUMMARY

❑ An accelerating credit crisis and (what were until recently) eye watering commodity prices have seen weakness proliferate around **the globe**, with economies contracting across the Eurozone (including in each of Germany, France, Italy and Denmark), in Japan, in Canada, and in NZ, while UK growth has stalled. The US is still growing, but its economy will be shrinking soon too, and China will slow more than earlier expected. Although interest rates and commodity prices (including oil prices) are now lower, the globe is slowing rapidly, and 2009 will be a rather weaker year than 2008 – much weaker, if the Chinese domino falls. We expect China to slow to 7-8% growth in 2009. If it ends up less than that, then today's ugliness could become even uglier.

❑ Consumers are taking a back seat, but businesses and governments are still spending, and exports are lifting. Moreover, interest rates, petrol prices and the $A are all off their highs. As that unholy trinity cut into domestic demand in the first place, the loosening of that noose suggests some of the negatives in play may soon pass their worst. Provided confidence doesn't fall too much further, that points to the potential for recovery in consumer spending and housing construction through 2009. Australian **output growth** will get worse before it gets better, but it may trough by mid-2009, and then spend 2009-10 regathering some speed amid lower interest rates and improving export volumes. The biggest question marks over the outlook still revolve around prospects for China and commodity prices.

❑ **Inflation** is still a problem, but it may not stay that way. That's the very punt the Reserve Bank is making by reversing course – it thinks there is enough slowdown in the system to bring inflation back to heel. We agree, to the point that (as we've forecast for a while), we see underlying inflation back under 3% by late 2009, well before the RBA forecasts it there. But the inflation challenge is changing shape too – demand pressures may be less of a threat, but labour cost pressures remain higher than would be consistent with falling inflation rates and, boosted by a weaker $A and rising costs out of China, non-oil import prices are about to loom as the biggest threat that they've been since early this decade.

❑ **Interest rates** will fall from here – both globally and locally. Gathering global gloom means the policy switch from fears about inflation to fears about growth will spread rapidly through the world. The Reserve Bank's move to cut cash rates to 6% came earlier than expected, though given the collapsing confidence in markets and continuing pressure on credit spreads further cuts are likely from here. Targeting lower mortgage interest rates will help to offset the relapse in consumer confidence in the wake of recent market mayhem. Lower interest rates and falls in commodity prices have seen the $A slump sharply back well below the US 72 cents it has averaged since first floating.

❑ Past commodity booms saw Australian families, businesses and governments spend up during the good times. And, oops, we've done it again. With coal and iron ore prices through the roof, that won't stop Australia coming close to a **trade** surplus this year. Yet, as history repeats, the current account deficit will shift to a higher average plateau now that commodity prices are falling back once more.

❑ Forward indicators of **job growth** (such as job ads) have tanked, and the Reserve Bank has added its own sombre employment and unemployment forecasts to echo those that Treasury released some months back. Yet great profits have made workers a bigger bargain than ever before. Despite recent market mayhem and the effect of that on confidence, there remains a chance that job growth will beat Treasury's expectation of a slowing to 80,000 job gains in the year to mid-2009.

❑ As commodity prices turn, the **fiscal** bonanza of recent years will start to reverse. Commodity prices have underpinned lax spending by the Feds and some States, and have paid for a series of personal income tax cuts (with more already promised). They have also let populism run rife – 'the surplus is big, why can't pensions go up?' But the party could be pooped as commodity prices turn. So if you want to know what Federal and State fiscal policies will do, then keep watching coal and iron ore prices.

❑ Recent years have seen an increasingly consistent split through Australia's industrial landscape. **Sectors** for whom China is a customer have grown fast and have made big bucks, shrugging off the jump in the costs arising from tight capacity constraints, as well as negatives such as higher interest rates and the higher $A. For other sectors, however, China has been more a competitor than a customer, and/or the mix of high interest and exchange rates has proved all-too-toxic. The 'two-speed economy' has been splitting further apart as a result, though it is clear that some major drivers of that long-running split are changing course. In particular, interest rates are now heading down rather than up, the $A has shed a lot of excess weight (and remains a likely loser of more altitude over the next year or two) and, related to that, a bunch of commodity prices are well off their peaks. That changes the sectoral balance. However, while coal and iron ore prices remain at their current heady heights, this reversal of fortunes is likely to narrow growth differentials rather than reverse their polarity (mining and engineering will remain strong, while much of manufacturing will still grow slowly), though these forecasts point to further changes over time which should continue to narrow growth differentials.

❑ Among the **States and Territories**, the resource States are still stomping all over the performance of the weaker States, with NSW's economy in almost as much trouble as its politicians. However, although it may take a couple of years to become notable, the necessary pre-conditions to narrow that performance gap between those with and without mineral riches are now evident. Commodity prices have fallen, and so too have both interest and exchange rates. That combination reduces the attractiveness of the resource States on the one hand, and on the other hand also reduces some of the pressures on those States with big mortgages and even bigger manufacturing sectors.

❑ Latest data from **NSW** look gothic in their horror. Yet the cavalry is coming. Interest and exchange rates have fallen, and they'll fall further. Petrol prices are off their peaks. And, in the biggest positive of all, everybody in NSW now realises the State faces a genuine crisis.

❑ **Victoria** is slowing – slightly. Confidence has cooled, retailers are on the ropes, the credit crunch will be bad news for business services, and lingering pressure on manufacturers means Premiers (past and present) are asking for Canberra's help to prop up weak industries.

❑ **Queensland's** growth took a knock from flooded coal mines, but population gains are picking up pace once more, leaving the Sunshine State growing by an extra 100,000 residents next year, a key positive for retail and housing construction, the centre of its current slowdown.

❑ **South Australian** growth is solid in part as its economy is more resilient to interest rates than is the rest of Australia. Retail remains remarkably strong, as do car sales, suggesting the smaller debts among SA families helped them to stare down the evils of high interest rates.

❑ Disrupted gas supplies hurt **WA**, but its growth is still accelerating. It isn't financial markets that WA need fear, but commodity markets. Our mantra that the State is fine while China is fine remains true in spades (and in diamonds, gold, iron ore and gas …). A China stumble would (eventually) hit hard.

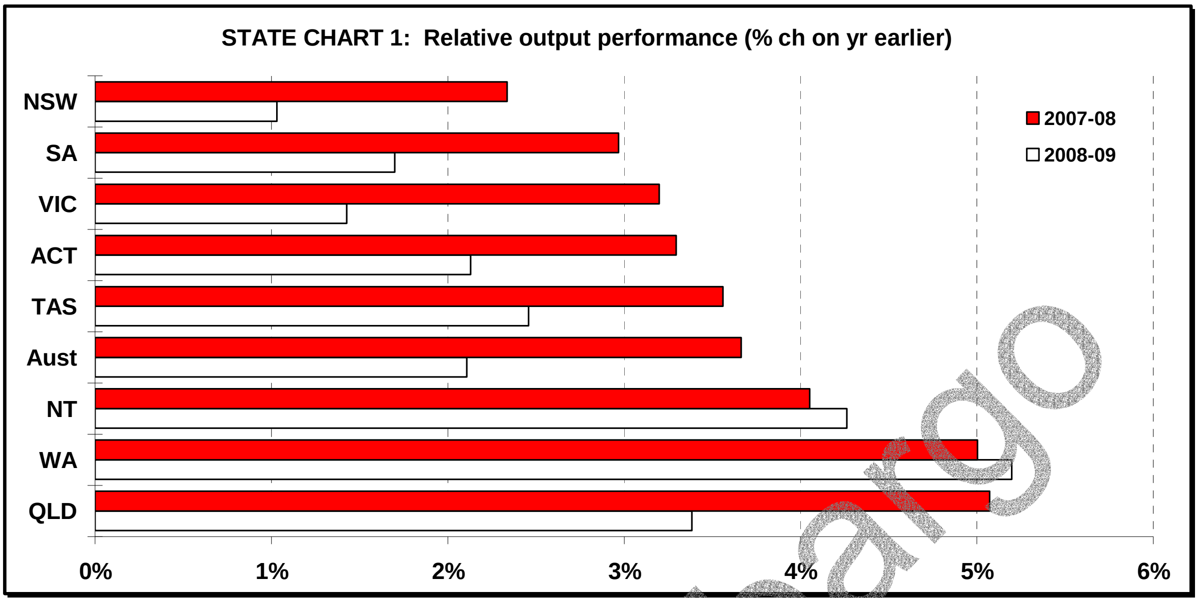
❑ **Tasmania's** economic momentum remains very healthy – which is all the more good news given that Gunns looks like a goner. It looks as if the Gunns pulp mill is now less than likely to go ahead, raising growth challenges for a small State lacking economies of scale.

❑ The **Northern Territory's** economy has navigated some tricky shoals, and is still in pretty good shape. Population growth is still accelerating; unemployment is back near record lows, and there is talk of a second LNG plant in Darwin. That would be very good news.

❑ The **ACT** has been slowing for a while, as its big mortgage belt is smarting amid high interest rates, and its commercial construction sector has completed some of the bigger jobs around town. The upshot is that most demand indicators are signalling at least amber.

STATE BY STATE COMMENTARY

There is considerable variation in history and prospects across Australia's regional economies. The ***Business Outlook*** examines the outlook for each of the States and Territories.



State Chart 1 shows output growth in 2007-08 and 2008-09, ranked on 2007-08 growth.

– The resource States are still stomping all over the weaker States, with NSW's economy in almost as much trouble as its politicians. It may take a year or two to become notable, yet that gap between those with and without mineral riches may shrink. Commodity prices have fallen, as have interest and exchange rates. That reduces the attractiveness of the resource States, and reduces pressures on States with big mortgages and bigger manufacturing sectors.

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– Disrupted gas supplies hurt **Western Australia**, but growth is still accelerating anyway. It isn't financial markets WA need fear, but commodity markets. Our mantra that the State is fine while China is fine remains true in spades (and in diamonds, gold, iron ore and gas …).

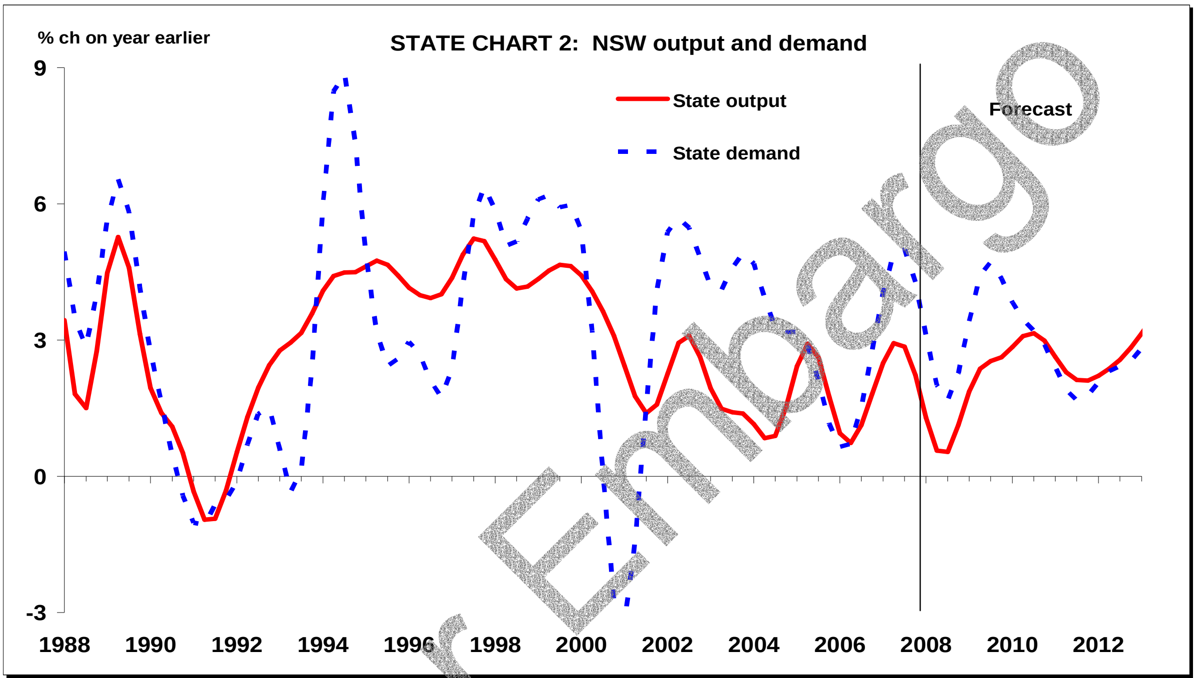
– **Tasmania's** economic momentum remains very healthy – which is all the more good news given that Gunns looks like a goner. It looks as if the Gunns pulp mill is now less than likely to go ahead, raising growth challenges for a small State lacking economies of scale.

– The **Northern Territory's** economy has navigated some tricky shoals, and it is still in pretty good shape. Population growth is still accelerating, unemployment is back near record lows, and there is talk of a second LNG plant in Darwin. That would be very good news.

– The **ACT** has been slowing for a while, as its big mortgage belt is smarting amid high interest rates, and as its commercial construction sector has completed some of the bigger jobs around town. The upshot is that most demand indicators are signalling at least amber.

New South Wales

New South Wales has been suffering more trials than Job. Pretty much anything that could go wrong, has gone wrong. We've laboured this list before, but it is impressively depressing nonetheless. High interest rates hit hardest in the State with the biggest mortgages, seeing retail spending shrink fast. The global credit crunch combined with the earlier home-grown increase in interest rates to drive trucks over the State's financial sector – a particular problem given Sydney is home to half of Australia's financial institutions. Population growth is poor, and the combination of high interest rates, poor population growth and few short term prospects of capital gains have seen an utter rout in the pace of housing construction in the State. And, with everything else going on, businesses aren't investing much in NSW.

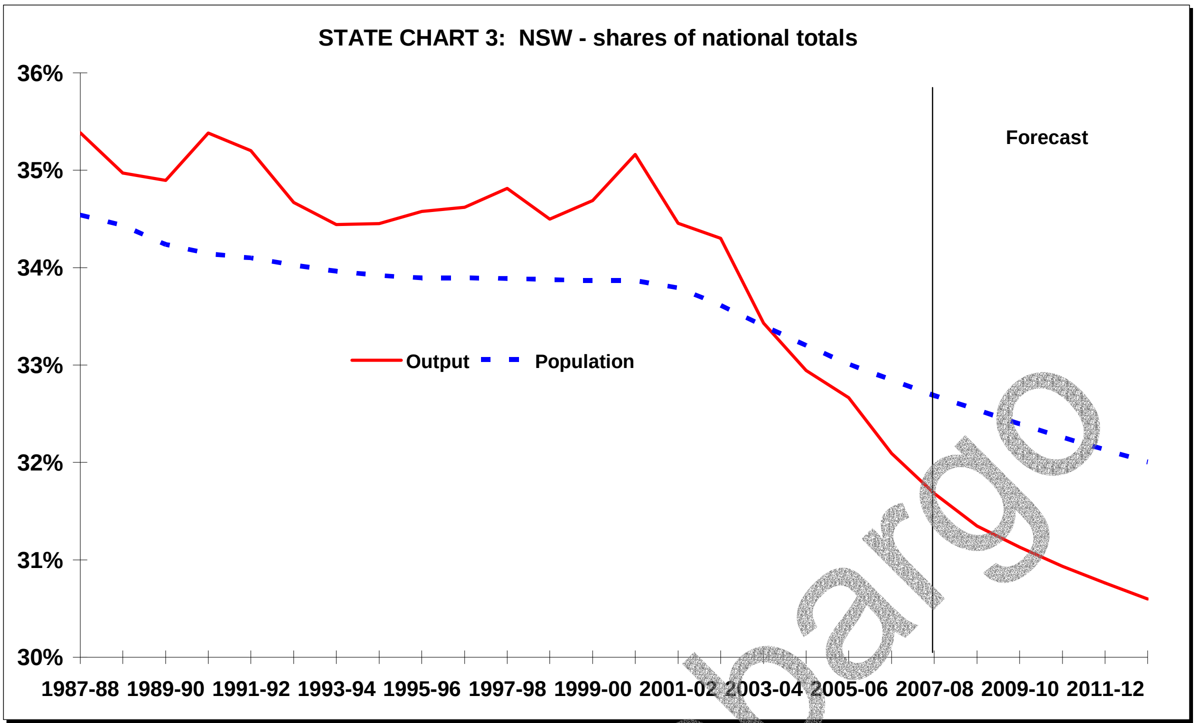


To make it worse, NSW is not merely suffering these negatives, it lacks many of the positives seen elsewhere. Despite NSW's coal, the positives felt by resource rich regions are mostly bypassing NSW, leaving it grappling with the side-effects of the commodity boom (high interest rates and a high $A, with the latter hurting NSW's manufacturers, and its tourism sector). Tourism looks particularly dire, while sightings of Macquarie Bank executives in big spending mode at harbourside eateries are now as rare as sightings of the Tasmanian Tiger.

Latest data look gothic in their horror. Nationally, the weakness in retail and in housing construction is being offset by strength in business investment and in exports. But in NSW those weak areas (retail and housing construction) are made even weaker by NSW's extreme sensitivity to interest rates. And those stronger areas (investment and exports) are missing in action in a State economy that lacks resource strengths and is increasingly viewed with a jaundiced eye by a sceptical business sector. Job vacancies are fading, and the State seems to have cemented in an unemployment rate a half percentage point above the national average.

Like it or not, Michael Costa told it like it was as he waved the Treasurer's role goodbye. Moreover, both sides of politics have their policy response to the current crisis wrong. In the usual kneejerk reaction of politicians looking to paper over the cracks in the State's fiscal finances, the latest focus is on canning capex while restricting the cutbacks to recurrent spending. As Homer would say, *D'Oh*. For a State suffering from infrastructure failures, to reduce spending on the likes of the transport system doesn't strike us as particularly bright.

After all, inadequate infrastructure was one of the many reasons why – as State Chart 3 shows – NSW's share of Australia's economy has fallen so spectacularly in the first place.



Nor does how NSW got its budget in this fix strike us as particularly bright. It was never NSW's failure of its 1970s style privatisation debate on electricity assets which was make or break for the State Budget. (The reason for selling the electricity sector was never the money that would bring in. Rather, it was a judgement call on who could better run these businesses – the private or public sector. We have few doubts as to the answer to that.)

A long time ago, Access Economics pointed out that, absent Victoria, Australia virtually didn't have a recession in the early 1990s. You could say much the same about NSW today. The rest of Australia hasn't slowed much, but NSW has hit the wall. Yet the cavalry is coming. Interest rates have fallen, and they'll fall further. The exchange rate has fallen, and we think it will eventually fall further too. Petrol prices are off their peaks. And, in potentially the biggest advantage of all, everybody in NSW now realises that this is a genuine crisis. So far the latter realisation hasn't translated into better policymaking, but history provides the firm lesson that having the punters aware that "something needs to be done" is a necessary (but not sufficient) condition for the better policies to actually occur.

Investment spending has two components, housing and business. The latter has two **construction** components. The first is engineering construction (covering industrial and resource construction in mining and downstream processing) plus engineering work on roads, utilities and the like; and the second is non-residential or commercial building, usually encompassing construction of factories, shopping malls, business estates, schools and the like.

Interest rates are particularly central. The pace of **housing** construction in NSW has fallen so far and so fast that the only work left being done in the State is being handled by two blokes, a ute and a kelpie. Nationally, housing starts have dropped by about one-seventh since early 2004. However, NSW has accounted for a remarkable two-thirds of the national fall. That suggests there's only one way to go for a sector which, in normal times, counts for 5-6% of the State's economy. A rental vacancy rate of a bare 1% backs that view. As these forecasts show, Access Economics doesn't think NSW's recovery is here yet. It has been delayed once more by the unkindly hand of Fate. But it will get better from here. At some stage NSW becomes a turnaround story – perhaps a substantial turnaround. That day grows ever closer.

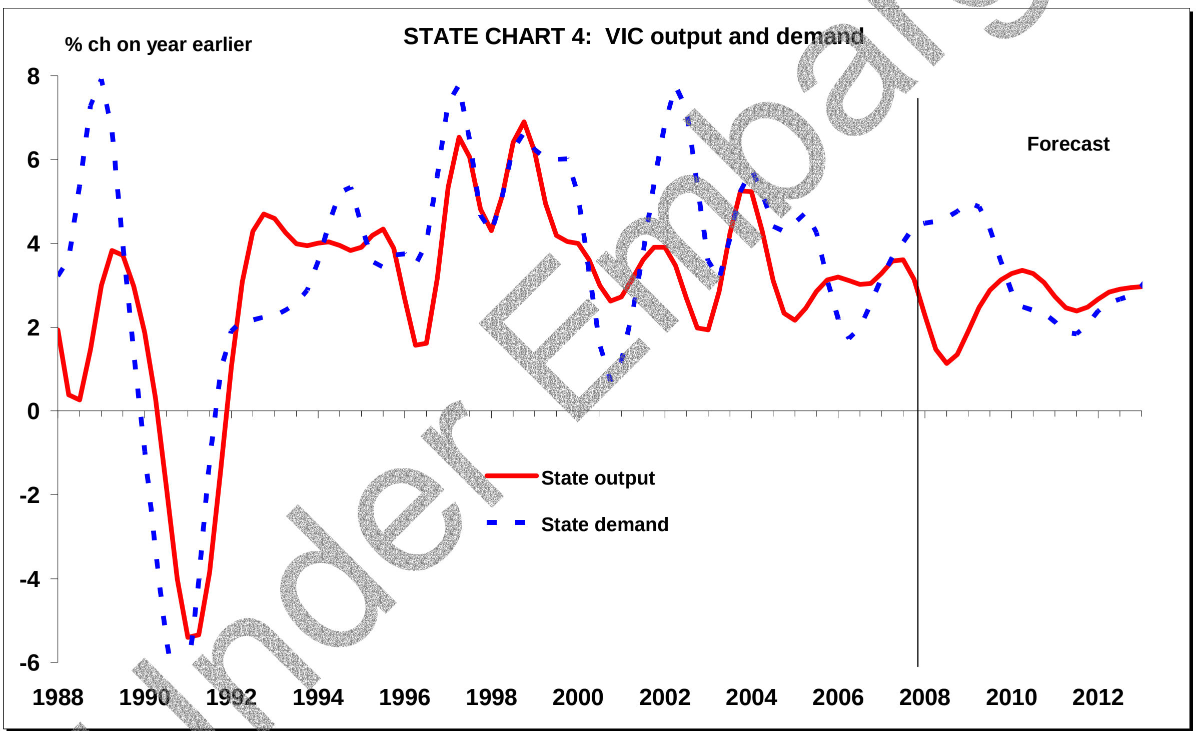
Engineering work has lifted thanks to water, power and rail projects. That may not last given the Government's intent to scale back capex, but there are major projects underway including the $1.9 billion desal plant at Kurnell and rail upgrades. The coal terminal off Newcastle has a $900 million upgrade, while a new international terminal and runway at Sydney Airport are underway. Mining projects are dominated by coal. Felix Resources is developing the Moolarben underground coal mine near Mudgee at a cost of $350 million, while Xstrata's Bulga coal mine development is also underway near Singleton. Projects in planning include Newcrest Mining's $550 million extension of the Ridgeway gold mine near Orange and BlueScope's $370 million relining of a blast furnace at Port Kembla, while Alkane Exploration is finalising a feasibility study on a gold mine development near Parkes. In other sectors, Visy Industries is spending $550 million upgrading its pulp and paper mill at Tumut.

State table 1		Forecasts 2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
NEW SOUTH WALES							
Gross State product	Constant price ($m)	328,334	331,719	340,231	350,354	357,994	367,743
	% change	2.3	1.0	2.6	3.0	2.2	2.7
New South Wales as a share of Australian output %		31.7	31.3	31.1	30.9	30.8	30.6
Nominal gross State product	$m	352,783	375,216	392,414	406,823	426,480	452,753
	% change	6.1	6.4	4.6	3.7	4.8	6.2
Real final demand	Constant price ($m)	332,779	340,555	355,301	365,947	372,742	382,123
	% change	4.3	2.3	4.3	3.0	1.9	2.5
Private consumption	Constant price ($m)	200,687	203,194	210,300	218,820	224,579	229,299
	% change	3.3	1.2	3.5	4.1	2.6	2.1
Private housing investment	Constant price ($m)	15,548	16,326	18,672	18,695	18,680	20,282
	% change	-2.0	5.0	14.4	0.1	-0.1	8.6
Private commercial construction	Constant price ($m)	14,647	14,591	15,755	15,790	14,989	14,494
	% change	8.3	-0.4	8.0	0.2	-5.1	-3.3
Private equipment investment	Constant price ($m)	24,762	25,287	25,475	24,857	24,526	24,686
	% change	19.3	2.1	0.7	-2.4	-1.3	0.7
International exports	Constant price ($m)	31,251	31,704	35,380	39,248	43,607	48,417
	% change	2.6	1.4	11.6	10.9	11.1	11.0
International imports	Constant price ($m)	80,635	93,439	103,614	106,849	113,470	122,185
	% change	12.3	15.9	10.9	3.1	6.2	7.7
Industrial production	Constant price ($m)	44,735	45,591	46,934	48,261	49,341	50,443
	% change	-1.4	1.9	2.9	2.8	2.2	2.2
Retail turnover	Constant price ($m)	74,421	74,076	76,220	79,611	80,891	82,739
	% change	4.3	-0.5	2.9	4.4	1.6	2.3
International tourist arrivals	Persons ('000s)	2,182	2,279	2,243	2,332	2,471	2,624
	% change	0.2	4.4	-1.6	4.0	5.9	6.2
Total population	Persons ('000s)	6,937	7,009	7,080	7,150	7,218	7,288
	% change	1.1	1.0	1.0	1.0	1.0	1.0
Population aged 15 and over	Persons ('000s)	5,605	5,678	5,750	5,820	5,888	5,955
	% change	1.3	1.3	1.3	1.2	1.2	1.1
Employment ('000s)	Persons ('000s)	3,397	3,451	3,525	3,603	3,647	3,710
	% change	2.3	1.6	2.1	2.2	1.2	1.7
Unemployment	Persons ('000s)	164	171	180	177	185	192
Unemployment rate	%	4.6	4.7	4.8	4.7	4.8	4.9
Consumer Price Index	1989-90 = 100	160.9	168.4	173.3	177.7	182.3	187.0
	% change	3.0	4.7	2.9	2.5	2.6	2.5
Average Weekly Earnings	$	913.50	941.43	986.78	1,025.65	1,068.70	1,120.03
	% change	2.6	3.1	4.8	3.9	4.2	4.8
Labour Price Index	Level	116.20	121.45	127.60	132.85	138.45	145.13
	% change	3.8	4.5	5.1	4.1	4.2	4.8
Base year for real data is 2005-06							

Commercial work is being underpinned by retail and office projects, but approvals in other sectors are more modest, and work may slow through 2009. There is a long term upgrade to the Royal North Shore Hospital in Sydney, while a $480 million redevelopment of the Sydney Uni campus is also underway and is due to be completed in 2010. An industrial estate is being developed at the former ABC studios site in Sydney's North Shore, while Multiplex has a $360 million office tower at King Street Wharf. Liverpool Hospital is receiving a $390 million redevelopment, while the State Government is constructing a jail at Cessnock which will now be completed in 2012 (and cost $300 million after a cost revision). Planned projects include the 'Civic Place' redevelopment in Parramatta, which has retail, commercial and residential components. Approval has been granted and work starts shortly. Westfield plans a $600 million redevelopment of the Centrepoint, Skygarden and Imperial Arcade buildings on Pitt St. in the CBD, while Investa will spend $500 million redeveloping Kindersley House on Bligh Street in Sydney. Elsewhere a number of upgrades are taking place at regional hospitals, including a new centre at the John Hunter Hospital in Newcastle.

Victoria

Victoria is slowing. Small business confidence has been crushed, retailers are on the ropes, and job vacancies are fading. Yet despite those negatives, so far Victoria is still waving rather than drowning. The State has long been a standout success given the hand dealt to it. Lacking the resource riches seen to the north and west, it has managed to grow at comfortable rates across a time when the same has definitely not been true of its close comparator, NSW.



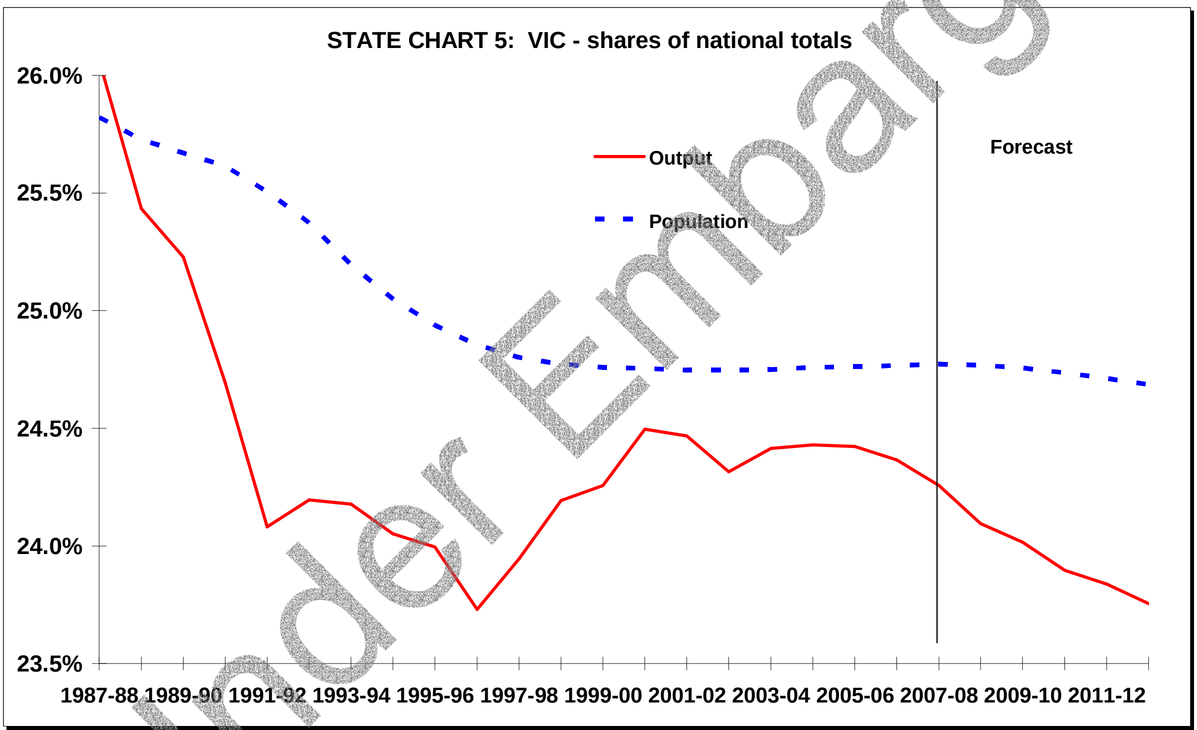
Or, in other words, the State has prospered when key positives were better in the rest of Australia. Yet current conditions pose even bigger challenges. They arise not merely because prospects are better elsewhere, but also because the negatives are now bigger in Victoria. The side effects of a commodity boom include high interest rates, high exchange rates and high commodity prices (and hence high manufacturing input costs, including the cost of oil). That combination poses challenges for a State with Victoria's degree of manufacturing focus.

Moreover, although the global credit crunch might have hit financial firms hardest, chances are that the effects of that are still spreading to firms in the business services sector, where Victoria has very strong representation. What started as bad news for banks and brokers is morphing into bad news for accountants and lawyers. Indeed, that process has already begun. Parts of Melbourne's CBD have thrived on the pace of corporate deal-making in recent years, and the latter is on the back foot and set to remain there for at least a year or more. That suggests the bad news from the credit crunch for the State's economy may be yet to peak.

Moreover, even though interest and exchange rates and commodity prices are all off their highs, the lingering pressures on the State's manufacturers are very considerable. A number have buckled and broken in the last couple of years, and it would be a mistake to suggest they are out of the woods yet. Indeed, the cries from Victorian Premiers (past and present) asking for Canberra's help to prop up fading industries is a pointer as to the pressures still evident.

Further, forward indicators for job growth have gone on the blink in more recent months, while population growth – although it remains magnificent – is no longer continuing to rise, and chances are that the State's next step in the pace of demographic destiny is downward.

Yet there are important positive factors for the State here too. The pipeline of construction work yet to be done (especially in commercial work) remains bloody beautiful. Indeed, the pace of construction in the State almost matches that seen in the resource stars. And housing construction continues to prosper at a time when, in much of the nation, it is in dire straits. Moreover, the State Government has been more willing to spend on infrastructure than some of its peers, meaning the pace of government spending continues to support the economy too.



The resultant contrast with NSW is remarkable. At some stage NSW stops being a disaster zone run by a bunch of Keystone cops and starts to be a more serious competitor. The past period of outperformance in the State's economy may then see an echo in a matching period of underperformance. Having said that, we think that some of the market share lost by NSW to Victoria will be permanent rather than temporary. That relatively optimistic view is embedded in State Charts 4 and 5. And, at some stage, the combination of lower interest and exchange rates will be a more marked benefit for the State – that will simply take more time.

In a nation of **housing** activity downturns, Victoria is better positioned than most, with the State's population growth still motoring along comfortably – so comfortably, in fact, that Victorian housing demand ranks well against both that of larger NSW and that of faster-growing Queensland. That said, the pent-up demand for housing evident in much of the rest of the nation is present in Victoria as well, with current housing starts still falling behind the need for them. It will take time for the turnaround to be evident (new starts are still falling), but that does point to better news ahead for the pace of housing construction in Victoria.

State table 2		Forecasts 2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
VICTORIA							
Gross State product	Constant price ($m)	251,366	254,955	262,471	270,653	277,408	285,495
	% change	3.2	1.4	2.9	3.1	2.5	2.9
Victoria as a share of Australian output %		24.3	24.1	24.0	23.9	23.8	23.8
Nominal gross State product	$m	266,741	283,737	297,294	308,612	324,351	344,108
	% change	7.9	6.4	4.8	3.8	5.1	6.1
Real final demand	Constant price ($m)	255,661	267,469	278,000	284,576	290,348	298,299
	% change	4.2	4.6	3.9	2.4	2.0	2.7
Private consumption	Constant price ($m)	148,562	150,958	157,146	164,267	169,181	173,244
	% change	3.6	1.6	4.1	4.5	3.0	2.4
Private housing investment	Constant price ($m)	15,159	16,093	17,513	17,126	16,934	18,237
	% change	4.4	6.2	8.8	-2.2	-1.1	7.7
Private commercial construction	Constant price ($m)	15,645	18,954	18,224	17,169	16,713	16,253
	% change	22.1	21.2	-3.9	-5.8	-2.7	-2.8
Private equipment investment	Constant price ($m)	19,943	22,001	22,473	21,395	21,187	21,426
	% change	2.5	10.3	2.1	-4.8	-1.0	1.1
International exports	Constant price ($m)	20,370	20,217	22,252	24,612	27,513	30,506
	% change	-1.2	-0.7	10.1	10.6	11.8	10.9
International imports	Constant price ($m)	57,384	67,404	74,610	76,935	81,872	88,338
	% change	11.2	17.5	10.7	3.1	6.4	7.9
Industrial production	Constant price ($m)	40,418	41,302	42,534	43,480	44,425	45,314
	% change	-1.3	2.2	3.0	2.2	2.2	2.0
Retail turnover	Constant price ($m)	54,610	54,181	56,016	58,939	60,741	62,382
	% change	2.4	-0.8	3.4	5.2	3.1	2.7
International tourist arrivals	Persons ('000s)	982	1,011	1,030	1,073	1,146	1,231
	% change	2.2	2.9	1.9	4.2	6.8	7.4
Total population	Persons ('000s)	5,257	5,335	5,411	5,483	5,552	5,621
	% change	1.6	1.5	1.4	1.3	1.3	1.2
Population aged 15 and over	Persons ('000s)	4,274	4,346	4,417	4,484	4,547	4,609
	% change	1.8	1.7	1.6	1.5	1.4	1.4
Employment ('000s)	Persons ('000s)	2,630	2,653	2,700	2,756	2,788	2,834
	% change	2.8	0.9	1.8	2.1	1.2	1.7
Unemployment	Persons ('000s)	125	126	135	131	135	138
Unemployment rate	%	4.5	4.5	4.8	4.6	4.6	4.6
Consumer Price Index	1989-90 = 100	159.6	166.7	171.7	175.8	180.7	185.3
	% change	3.6	4.4	3.0	2.4	2.8	2.5
Average Weekly Earnings	$	863.13	900.10	944.80	982.28	1,023.98	1,074.05
	% change	3.4	4.3	5.0	4.0	4.2	4.9
Labour Price Index	Level	116.05	121.55	127.83	133.10	138.73	145.45
	% change	3.8	4.7	5.2	4.1	4.2	4.8
Base year for real data is 2005-06							

Engineering work is starting to struggle to compete with the boom States. Victoria's share of engineering work has fallen notably in recent years as high commodity prices sent dollars north and west, while the high $A saw manufacturing investment slide. The recent fall in the $A should help lift to activity. Work underway includes upgrading the arterial link from the West Gate Bridge to the Monash Freeway, the dredging of Port Philip Bay to allow larger container ships into Melbourne, a low-emission coal fired power plant in the Latrobe Valley, and the conversion of open channels to pipelines in the Wimmera-Mallee. Lihir Gold is developing an underground gold mine at Ballarat, while minor road projects are underway throughout Melbourne. Planned projects include the second stage of the Turrum oil and gas field project, an upgrade to an aluminium smelter in Portland, a desalination plant in Gippsland and a gas-fired power station near Orford in the State's west.

Engineering may be struggling, but **commercial** activity isn't, with a lift in office, health and accommodation approvals suggesting the pipeline of work continues to expand. Work under construction includes a $1.1 billion redevelopment of the Royal Children's Hospital, to be completed by 2011. Meanwhile ANZ is spending $620 million on a new 10 storey building on Collins St. in Melbourne and Westfield is upgrading Doncaster Shoppingtown at a cost of $600 million. A new convention centre is underway in Melbourne at a cost of $370 million and will be completed shortly, while $320 million is being spent on redeveloping the Edwin Flack field near Olympic Park. The $220 million 'CGU Tower' is underway at the corner of

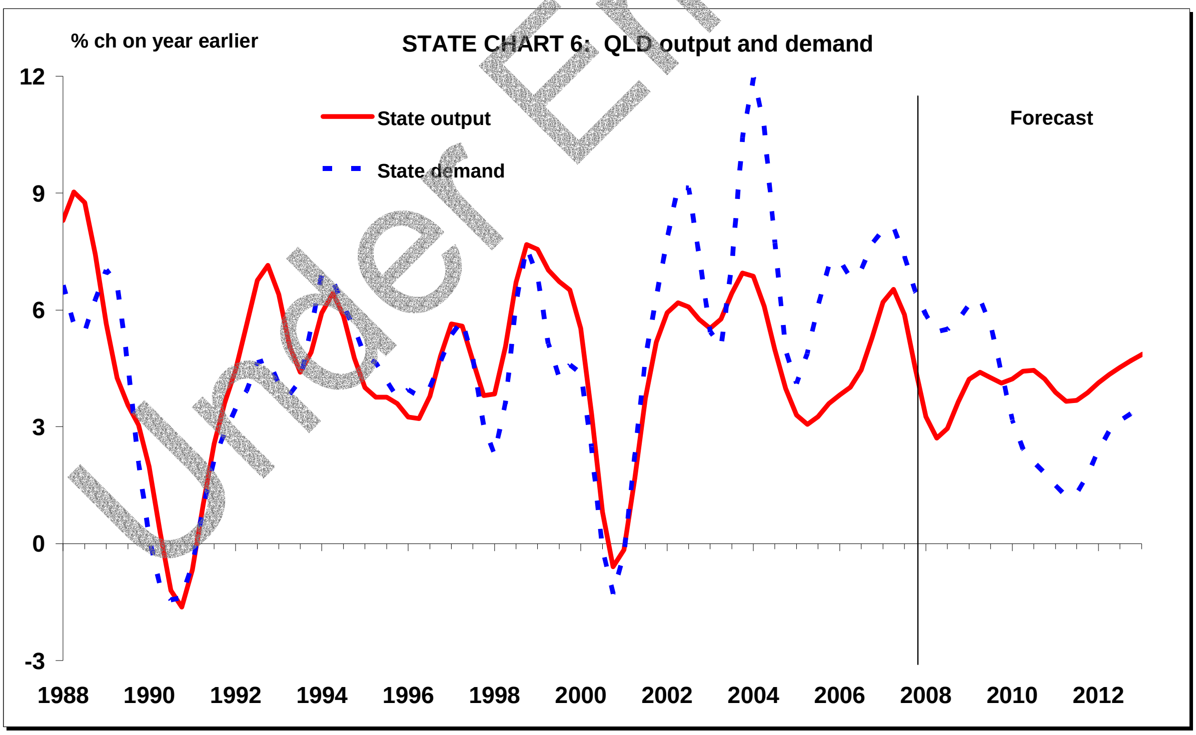
Bourke and William Streets in Melbourne, while other offices are underway at Docklands. A $170 million retail/commercial redevelopment is taking place on the site of the Fishmarkets on the Yarra, while DJs are spending $85 million redeveloping their Bourke Street store.

Queensland

Queensland remains on the right side of Australia's 'two speed economy'. It is true that the State's growth has slowed notably, that consumers are cautious, that the rate of construction of housing has dropped back, and that renovations are remarkably rare in a State that is otherwise still healthy. However, despite those setbacks, Queensland's economy is set to grow strongly, bouncing back from the Bowen Basin flooding which took key coal mines off line for a time earlier in 2008 (and which is responsible for a chunk of the recent slowdown).

Resources remain the brightest star in the State's firmament. Past commodity price increases set off a chain reaction from boardrooms to bankers and from bean counters and brokers to engineers and architects. The result has been a surge in engineering construction demand in the State which is still building in size despite the sobering falls in some commodity prices seen more recently. That leaves a huge wave of 'committed' projects coming down the construction pipeline identified in Access Economics' *Investment Monitor*.

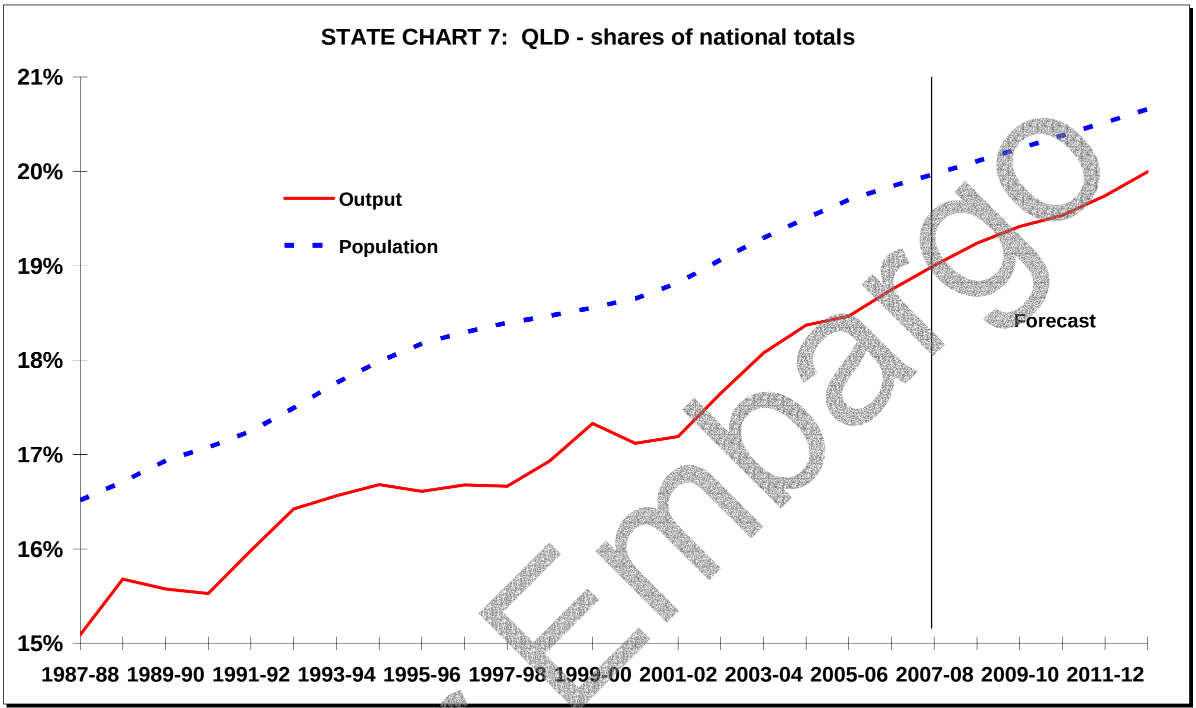
We remain concerned (even 'gravely' concerned) by the potential for commodity prices to fall back further. For Queensland, the make or break commodity is coal. Spot coal prices are still trading above the current contract prices. The bad news is they have already fallen notably. Where that latter move eventually ends up will be vital to Queensland's longer term outlook.



For now, however, output growth looks set to motor through a global downswing (see State Chart 6). Population growth is picking up pace once more, leaving the Sunshine State with the remarkable knowledge that it will see an extra 100,000 residents in the coming year – a key positive for retailing and housing construction, the centre of the current slowdown.

Moreover, the last issue of *Business Outlook* went out of its way to make the point that the State's tourism operators were being slowly toasted by a combination of factors, notably the strength of the $A. The fall in the latter in the last few months therefore counts as a major positive for this important sector, and indeed for the State as a whole. More broadly, swings in the $A will help to moderate the boom/bust impact of commodity price cycles – just as the State never tasted the full force of rising global prices for commodities due to an increase in the $A, the current fall in the Pacific peso takes a lot of pressure off.

Outside of resources, the State's south east corner (from Noosa to Brisbane down to Tweed Heads) is hurting from high interest rates. The turn in the latter is good news, but it merely reduces the pressure on this part of the State rather than eliminating it.



The latest lift in population gains suggests that the tough times for **housing** construction in the Sunshine State won't last for too long. After all, it comes atop what was already a lack of supply of housing in the State, even if the pent-up demand in Queensland is only a fraction of that in NSW. Although housing starts are still relatively flat – having been flattened by the pain of mortgage interest rates in recent times – this sector should find itself back on the road to recovery some time in the first half of 2009. When it does so, it will return to being (as usual) a growth driver for the wider Queensland economy.

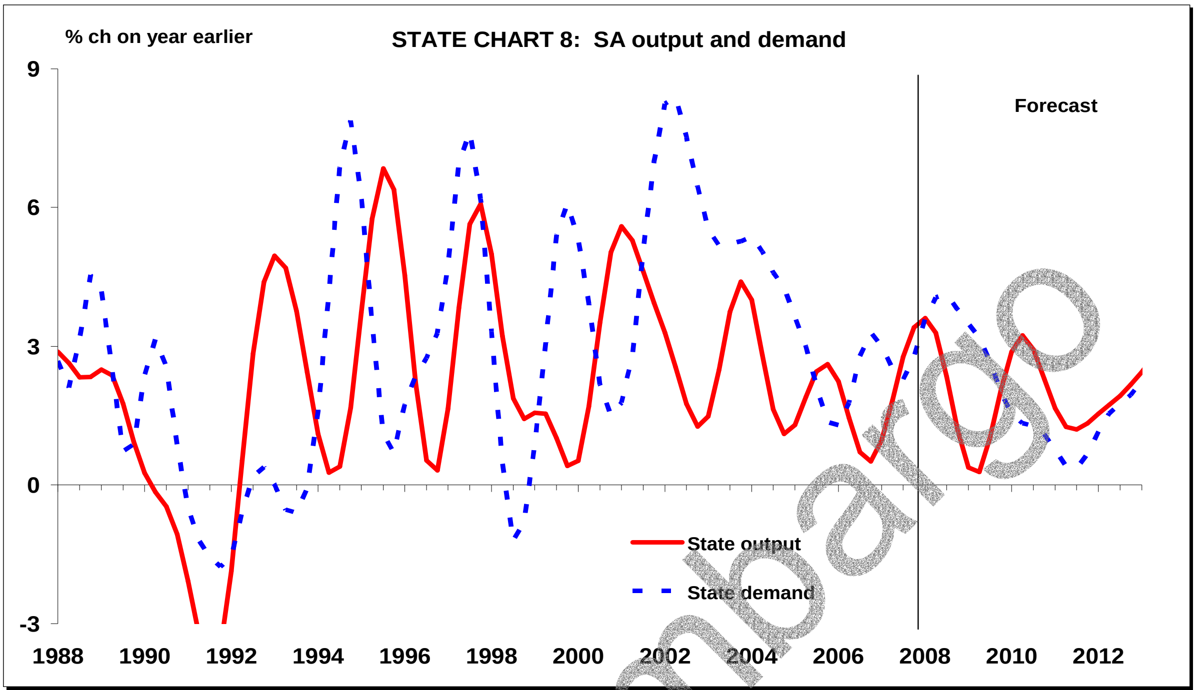
Engineering has lifted strongly amid high commodity prices. That has seen the State's share of national engineering work rise notably, with heaps of projects still yet to get underway. Major works under construction include the $3 billion Ipswich Motorway and the $2 billion first stage of the North South Bypass Tunnel. Other road projects include the $1.9 billion duplication of the Gateway Bridge in Brisbane, the $810 million northern busway project linking Enoggera Creek and Aspley, and construction of the $420 million Tugun to Tweed Heads bypass on the Pacific Motorway. And the State has turned on the waterworks, including the $2.5 billion construction of a dam on the Mary River south of Gympie and a $1.2 billion desalination plant at Tugun on the Gold Coast. Wyaralong Dam is also underway southwest of Brisbane. Mining projects are generating big dollars too. Rio Tinto is spending $950 million developing the Clermont coal mine, due to be completed by end-2010, while Anglo Coal is developing the Lake Lindsay coal mine at a cost of $690 million and Kagara Zinc is developing a gold mine in the State's north at a cost of $60 million. There are some large projects in planning, including Chalco's $3 billion plan to develop the Aurukun bauxite deposits and construct an alumina refinery at Cape York, while a $1.2 billion nickel and cobalt mine is being planned for Gladstone. Other projects in planning include the $2 billion Northern Link road project and the construction of a coal terminal at the Port of Gladstone.

It may be lagging its engineering counterpart, but **commercial** approvals remain high having jumped in mid-2005. Projects underway include upgrades to the Supreme and District Courts in Brisbane and Austcorp's 'Vision' project on the corner of Margaret and Mary Streets in Brisbane. The latter includes substantial retail and commercial components as well as some residential facilities and is due for completion in 2010. Leighton is constructing a $360 million, 33-storey office tower on George Street in Brisbane, while outside of Brisbane the Ryan Group is wrapping up construction on a new shopping centre at Bundaberg. The Townsville Corrective Centre is being expanded at a cost of $143 million, while the redevelopment of the Southbank Institute of TAFE is being completed. A new State Tennis Centre is under construction at Tennyson at a cost of $82 million and is due to be completed in mid-2009, while redevelopments of the Prince Charles Hospital in Brisbane and the Townsville General Hospital are underway.

State table 3		**Forecasts**					
		2007-08	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**2012-13**
QUEENSLAND							
Gross State product	Constant price ($m)	196,918	203,580	212,189	221,237	229,735	240,308
	% change	5.1	3.4	4.2	4.3	3.8	4.6
Queensland as a share of Australian output %		19.0	19.2	19.4	19.5	19.7	20.0
Nominal gross State product	$m	210,159	230,434	243,104	257,661	275,407	295,581
	% change	7.5	9.6	5.5	6.0	6.9	7.3
Real final demand	Constant price ($m)	217,098	229,681	240,874	245,627	249,711	257,812
	% change	6.6	5.8	4.9	2.0	1.7	3.2
Private consumption	Constant price ($m)	111,756	115,704	120,563	126,463	130,913	134,894
	% change	4.4	3.5	4.2	4.9	3.5	3.0
Private housing investment	Constant price ($m)	16,532	17,480	18,732	18,051	17,869	19,328
	% change	-0.4	5.7	7.2	-3.6	-1.0	8.2
Private commercial construction	Constant price ($m)	14,297	18,727	19,514	17,816	16,365	15,902
	% change	8.3	31.0	4.2	-8.7	-8.1	-2.8
Private equipment investment	Constant price ($m)	19,634	20,932	22,178	21,484	21,063	21,456
	% change	15.1	6.6	6.0	-3.1	-2.0	1.9
International exports	Constant price ($m)	37,511	42,548	47,189	52,818	59,319	66,277
	% change	2.4	13.4	10.9	11.9	12.3	11.7
International imports	Constant price ($m)	31,488	36,232	40,457	42,132	45,184	49,216
	% change	15.4	15.1	11.7	4.1	7.2	8.9
Industrial production	Constant price ($m)	37,390	39,667	41,400	43,085	44,864	46,790
	% change	4.9	6.1	4.4	4.1	4.1	4.3
Retail turnover	Constant price ($m)	47,189	48,272	49,725	52,144	53,994	55,795
	% change	5.5	2.3	3.0	4.9	3.5	3.3
International tourist arrivals	Persons ('000s)	1,579	1,678	1,767	1,865	1,999	2,148
	% change	-2.6	6.3	5.3	5.5	7.2	7.4
Total population	Persons ('000s)	4,238	4,331	4,424	4,517	4,610	4,704
	% change	2.2	2.2	2.1	2.1	2.1	2.0
Population aged 15 and over	Persons ('000s)	3,389	3,474	3,559	3,643	3,726	3,808
	% change	2.5	2.5	2.4	2.4	2.3	2.2
Employment ('000s)	Persons ('000s)	2,160	2,216	2,285	2,347	2,392	2,447
	% change	3.0	2.6	3.2	2.7	1.9	2.3
Unemployment	Persons ('000s)	83	95	107	111	121	130
Unemployment rate	%	3.7	4.1	4.5	4.5	4.8	5.1
Consumer Price Index	1989-90 = 100	164.8	173.7	178.6	182.9	188.2	192.9
	% change	4.1	5.4	2.8	2.4	2.9	2.5
Average Weekly Earnings	$	832.13	877.08	923.75	962.85	1,005.18	1,055.38
	% change	2.1	5.4	5.3	4.2	4.4	5.0
Labour Price Index	Level	118.08	123.53	130.13	135.65	141.48	148.43
	% change	4.2	4.6	5.3	4.2	4.3	4.9
Base year for real data is 2005-06							

South Australia

South Australia is accelerating at a time Australia is slowing (see State Chart 8). That is not because SA is the next resource boom State. Although mineral exploration has picked up and SA has world class mineral deposits, South Australia is not the next Western Australia.



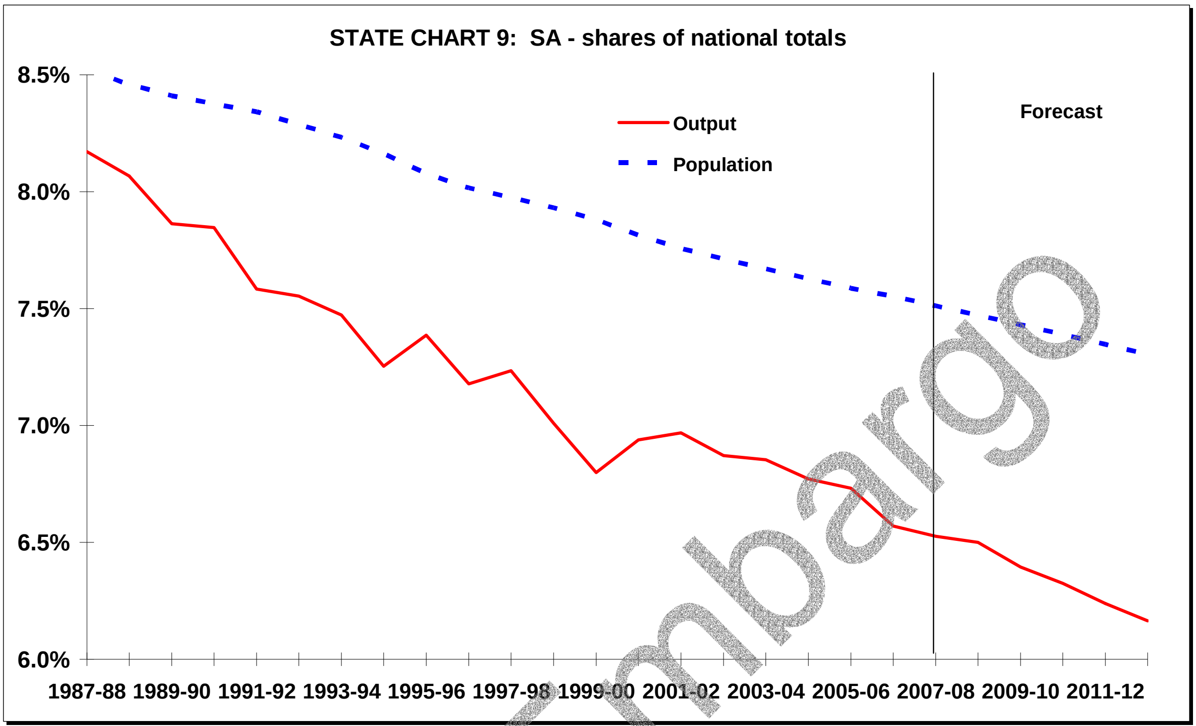
Rather, the State is outperforming because its economy is more resilient in the face of high interest rates than is the rest of Australia. Retail spending remains remarkably strong, as do car sales, suggesting the relatively smaller debts among South Australian families have helped them to stare down the evils of high interest rates. Similarly, housing prices might have jumped through 2007 and are still holding onto those gains, but those prices remain lower than in many of the other State capitals. That affordability lead is a key reason why housing finance is holding up, with approvals for home-building on the climb.

And a better year for rain means many South Australian farmers should see their output lift in 2008-09. The gains are expected to be concentrated in grains, with wheat output in the State almost half as high again as it was last year. A similar increase is also expected for canola output, while barley output may be a quarter higher than the drought-affected 2007-08 crop.

Yet the prolonged dry has cut deep into cattle numbers, with beef output in 2008-09 easing from last year due to the earlier fall in herd size. The State's wool output is still sliding too, reflecting the longer term fall in sheep numbers as the switch from flocks to crops rolls on. It is in irrigated crops where times are toughest. SA irrigators have slightly larger allowances this year, but inflows into the Murray-Darling basin are too weak to sustain much output.

So whereas much of Australia is seeing the pace of demand growth weaken for a bunch of reasons (most notably the spike in interest rates), the demand shock is smaller in South Australia than elsewhere, and the State's growth rate remains more than reasonable. Yet the structural challenges for the State continue to climb – demand might be holding up but supply isn't doing the same. Or, more accurately, the supply side potential of the rest of Australia's economy is growing at a faster rate than South Australia's. The share of State income being set aside to invest in business investment for the future is only two-thirds of the national rate, a poor share, and behind even that seen in NSW.

And population growth has been stuck at 1% since the second half of 2006 across a period in which it had been accelerating for Australia as a whole. Moreover, the State's older age profile means that weak population growth runs the risk of great supply shock for numbers of potential workers – if Adelaide's boomers retire, the ranks of those standing behind them look somewhat thinner than those seen in other States.



These are concerns for the longer term. Some of them are being addressed – despite recent falls in job vacancies, job growth remains more solid, and the only reason the unemployment rate is stuck half a percentage point above the national rate is because more South Australians are putting up their hands to participate in the job market. But structural weaknesses will ultimately swamp the demand cycle of the moment, leading to a continuation of the longer term trends that have driven South Australia's path (as seen in State Chart 9).

SA's **housing** starts just hit a 14-year high, propelled by the combination of 1% population growth and excellent housing affordability. Indeed, at these levels the earlier evidence of pent-up demand in the State may now be being eaten into – something that no other jurisdiction in Australia could claim at the moment. Equally, however, a moderate downswing also implies a matchingly moderate potential for upswing as mortgage interest rates fall from here through to end-2009. That points to a somewhat flatter profile for the outlook for housing construction in South Australia than is likely Australia-wide.

Engineering work has potential thanks to hefty mining exploration and some rich resource veins. But that's blue sky for now, with WA and Queensland still hogging the limelight, and SA engineering work has dropped to its lowest in two years. Oxiana's $1 billion gold and copper mine development at Prominent Hill is the largest project underway. It is due to be completed by late 2009. Other work includes the $560 million Gawler bypass on the Northern Expressway, while the second stage of Babcock & Brown's $400 million wind farm at Mount Gambier is now complete. The Christies Beach water treatment facility has a $270 million upgrade, while the Sturt Highway is getting a $160 million upgrade. Planned projects include a $420 million proposal by Iluka Resources to develop the Eucla Basin mineral sands project northwest of Ceduna. Meanwhile the big kahuna – the massive $6.3 billion uranium and copper mine expansion at Olympic Dam – is still dominating the pipeline, but work is not expected to begin before 2010. Meanwhile Protavia is planning to develop a $1.5 billion pulp mill near Penola, though the project is still awaiting planning approval.

State table 4		**Forecasts**					
		2007-08	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**2012-13**
SOUTH AUSTRALIA							
Gross State product	Constant price ($m)	67,632	68,780	69,895	71,640	72,600	74,092
	% change	3.0	1.7	1.6	2.5	1.3	2.1
South Australia as a share of Australian output %		6.5	6.5	6.4	6.3	6.2	6.2
Nominal gross State product	$m	74,987	79,884	82,251	85,802	89,587	93,952
	% change	7.0	6.5	3.0	4.3	4.4	4.9
Real final demand	Constant price ($m)	71,249	74,039	75,787	76,646	77,140	78,578
	% change	2.6	3.9	2.4	1.1	0.6	1.9
Private consumption	Constant price ($m)	42,439	43,200	43,487	44,362	44,905	45,371
	% change	4.9	1.8	0.7	2.0	1.2	1.0
Private housing investment	Constant price ($m)	3,846	4,104	4,359	4,143	4,054	4,365
	% change	-3.4	6.7	6.2	-5.0	-2.2	7.7
Private commercial construction	Constant price ($m)	3,052	3,619	3,730	3,514	3,215	3,128
	% change	-1.8	18.6	3.1	-5.8	-8.5	-2.7
Private equipment investment	Constant price ($m)	4,580	5,218	5,588	5,492	5,381	5,400
	% change	-11.6	13.9	7.1	-1.7	-2.0	0.4
International exports	Constant price ($m)	9,415	8,778	8,925	9,850	10,798	11,971
	% change	14.5	-6.8	1.7	10.4	9.6	10.9
International imports	Constant price ($m)	7,301	8,271	9,213	9,450	9,979	10,693
	% change	11.0	13.3	11.4	2.6	5.6	7.2
Industrial production	Constant price ($m)	13,189	13,603	13,680	13,972	14,244	14,492
	% change	0.9	3.1	0.6	2.1	1.9	1.7
Retail turnover	Constant price ($m)	15,985	16,096	15,843	16,402	16,643	16,840
	% change	6.1	0.7	-1.6	3.5	1.5	1.2
International tourist arrivals	Persons ('000s)	169	162	166	176	191	207
	% change	-0.5	-4.1	2.2	6.2	8.1	8.7
Total population	Persons ('000s)	1,594	1,610	1,624	1,638	1,651	1,663
	% change	1.0	1.0	0.9	0.8	0.8	0.7
Population aged 15 and over	Persons ('000s)	1,307	1,323	1,338	1,352	1,365	1,377
	% change	1.3	1.2	1.1	1.1	1.0	0.9
Employment ('000s)	Persons ('000s)	773	786	800	809	811	816
	% change	2.1	1.7	1.8	1.1	0.2	0.7
Unemployment	Persons ('000s)	39	43	46	45	47	48
Unemployment rate	%	4.8	5.2	5.4	5.2	5.5	5.6
Consumer Price Index	1989-90 = 100	164.4	171.9	176.6	180.9	185.9	190.3
	% change	3.3	4.6	2.7	2.5	2.7	2.4
Average Weekly Earnings	$	802.83	842.70	882.08	915.23	951.30	995.25
	% change	3.7	5.0	4.7	3.8	3.9	4.6
Labour Price Index	Level	116.88	122.03	128.13	133.28	138.73	145.25
	% change	4.7	4.4	5.0	4.0	4.1	4.7
Base year for real data is 2005-06							

Commercial approvals have been rising, reaching record levels of late, suggesting activity is set to lift over the coming year. Work underway includes a $250 million upgrade to AAMI Stadium, due for completion in 2011, plus a redevelopment at the University of Adelaide. The Flinders Medical Centre redevelopment is costing of $150 million, while the Queen Elizabeth and Royal Adelaide Hospitals are also receiving upgrades. A new State Aquatic Centre is underway at Marion and is due to be completed in 2009, while a redevelopment of the Lyell McEwin Health Service is still ongoing. The Adelaide Showground is receiving a $42 million upgrade, while the Makris Group is refurbishing the Hallett Cove shopping centre at a cost of $40 million. The Samaras Group is constructing a 10-storey office complex in Adelaide at a cost of $30 million, while the Adelaide City Council is finalising construction on a $25 million redevelopment of Victoria Square. Projects in planning are led by the proposed $1.7 billion Marjorie Jackson-Nelson Hospital in Adelaide and a $180 million, 17-storey office tower on Franklin Street adjacent to Victoria Square.

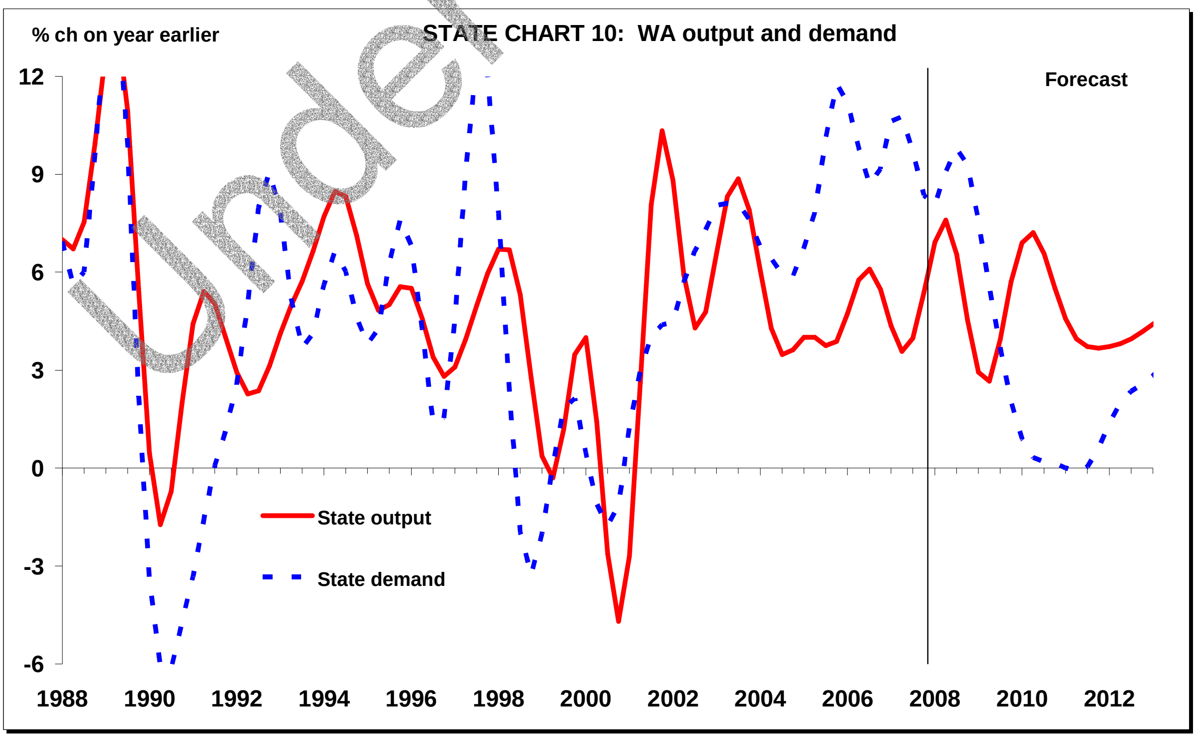
Western Australia

The eyes of the world are on the meltdown in financial markets. But it isn't financial markets that West Australia need fear, it is commodity markets. Our long held mantra (that the State is fine while China is fine) remains true in spades (let alone in diamonds, gold, iron ore and gas). This financial year WA will earn more than $30 billion in exports of iron ore alone – a sixth of the income of the entire WA economy. Indeed, those dollars are still climbing and the State is still booming as it plays an increasingly desperate game of catch up to the stunning burst of industrialisation underway in China and other emerging economies.

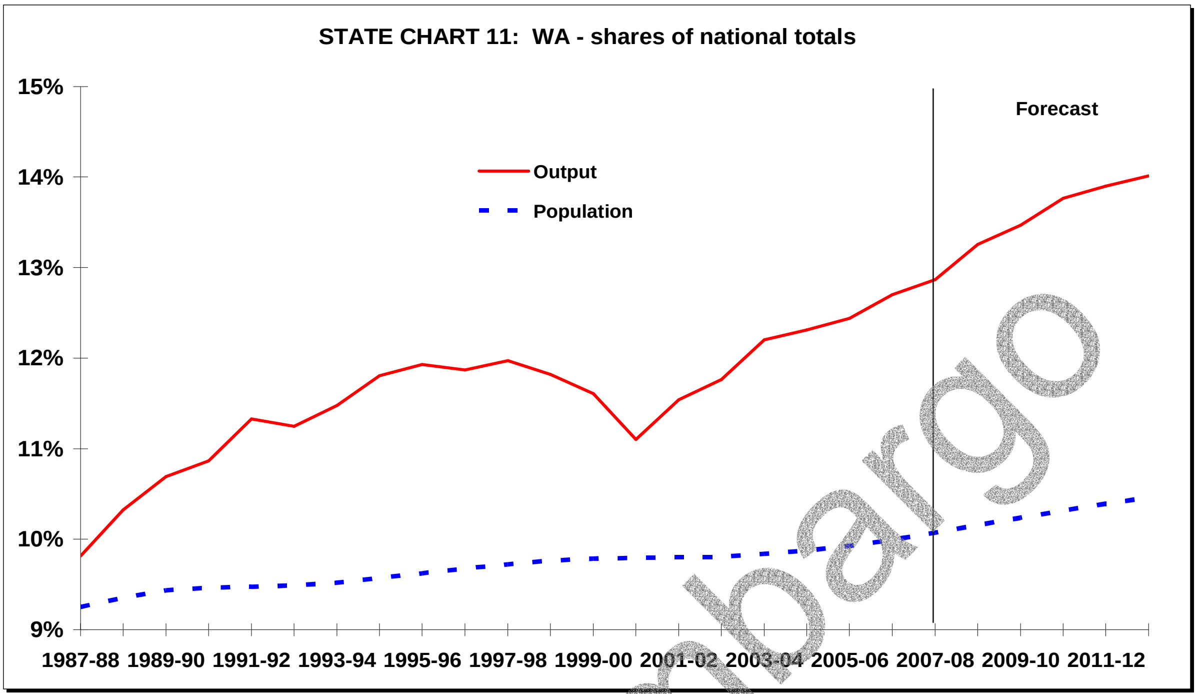
The State's economy took a nasty hit with disruptions to gas supplies, but that was mostly a temporary challenge. As State Chart 10 shows, we estimate growth is still accelerating rather than slowing down. That is because ever larger dollars are getting spent to bring the State's mineral riches to market, and as the earlier spending on mining and related infrastructure is coming on stream as higher volumes of export sales in everything from iron ore to LNG. In turn, the still booming economy is underwriting an impressive jump in wages as employers scramble to attract the labour necessary to boost corporate output. And, although population growth is rising, it is just not enough. Australians are notoriously hard to shift from east to west, so WA is reliant on the latest increase in skilled migration targets to meet its manpower demands. Unemployment is incredibly low, and employment growth remains more restrained by a lack of workers than by a lack of jobs, leaving the unemployment rate incredibly low.

Good early rain suggests the State will see rather better wheat crops this year than last year. Small businesses remain remarkably confident, and we can't help but be the same.

It is true that job vacancies are dropping off their highs, and that the domestic wing of the economy has lost altitude. Approvals for housing and commercial construction are tailing off and housing prices remain stalled. In turn, those developments are weighing on retail, though sales are still growing faster than the national average, with signs of recovery evident of late.



The new Government might rearrange spending priorities between Perth and the regions, but the royalty revenues flowing into State coffers are continuing to underpin a pretty solid share of national public sector capex outlays. Moreover, a range of Federal State initiatives are aiming to break down some of the barriers to trade and job flows across State borders. The more successful these policies from the Council of Australian Governments (COAG) become in transport, infrastructure and regulatory reduction, then the better the outlook for this State.



However, as we stress elsewhere in *Business Outlook*, the risks for China are rising, meaning that the risks to State incomes are also rising. Both China and India have already seen their growth slow, and expectations continue to slide. The economies of the rich nations continue to look ever sicker and the chances of contagions to emerging economies continue to rise.

As we've said before, if China cools enough, WA might get not merely a cold, but flirt with Asian flu. Today's commodity prices can't last. Whether they are brought to heel sooner rather than later remains to be seen. But the risk of a shakeout in Western Australia's economy continues to rise. That is unlikely to become evident in the next 12 months, but the leading indicator will continue to be industrial commodity prices, particularly iron ore prices.

Forward indicators for the pace of **housing** construction in Western Australia remain modest, even though the State's population growth is the fastest seen in Australia (and indeed, the fastest seen in Western Australia itself in over two decades). Yet housing starts lifted of late, a development which was always on the cards given that rental costs are going through the roof. The fundamentals of great population growth and a lack of vacant homes for rent means that housing construction has to lift soon, with the rapid run-up in rents seen of late a necessary part of the process in tempting investors back into residential construction markets.

Construction work yet to be done in WA continues to scale to previously unheard of highs, and Access Economics' *Investment Monitor* suggests that this magnificent run has further to go. As we often note, we doubt all the projects jostling for position in the construction pipeline can or will go ahead, but even just a portion of them going ahead will keep the State ticking over for some time yet. After all, the pipeline of **engineering construction** work is massive, and looks set to continue for some time. Projects are led by the $11.2 billion Pluto LNG project, which has been underway for a year and is due to be completed by end-2010. Other gas projects underway include the $2.5 billion 'fifth train' on the North West Shelf

LNG development and the $1.6 billion Angel gas field project nearby. A $750 million development is underway at the Black Tip gas field in the Joseph Bonaparte Gulf, while Santos' $800 million Devil Creek project at the Reindeer gas field is also underway. Others include Newmont's $2 billion Boddington gold mine development, set to be commissioned after delays and cost overruns, while the fourth stage of BHP Billiton's Rapid Growth iron ore project in the Pilbara is also underway. Rio Tinto is spending $1.7 billion on the third stage of the Argyle diamond mine development near Kununurra, while $1.5 billion is being spent on an expansion of the Worsley alumina refinery at Collie, south of Perth. Rio Tinto is also finalising construction on a $990 million upgrade to the Cape Lambert Port, which is due for completion by end-2008.

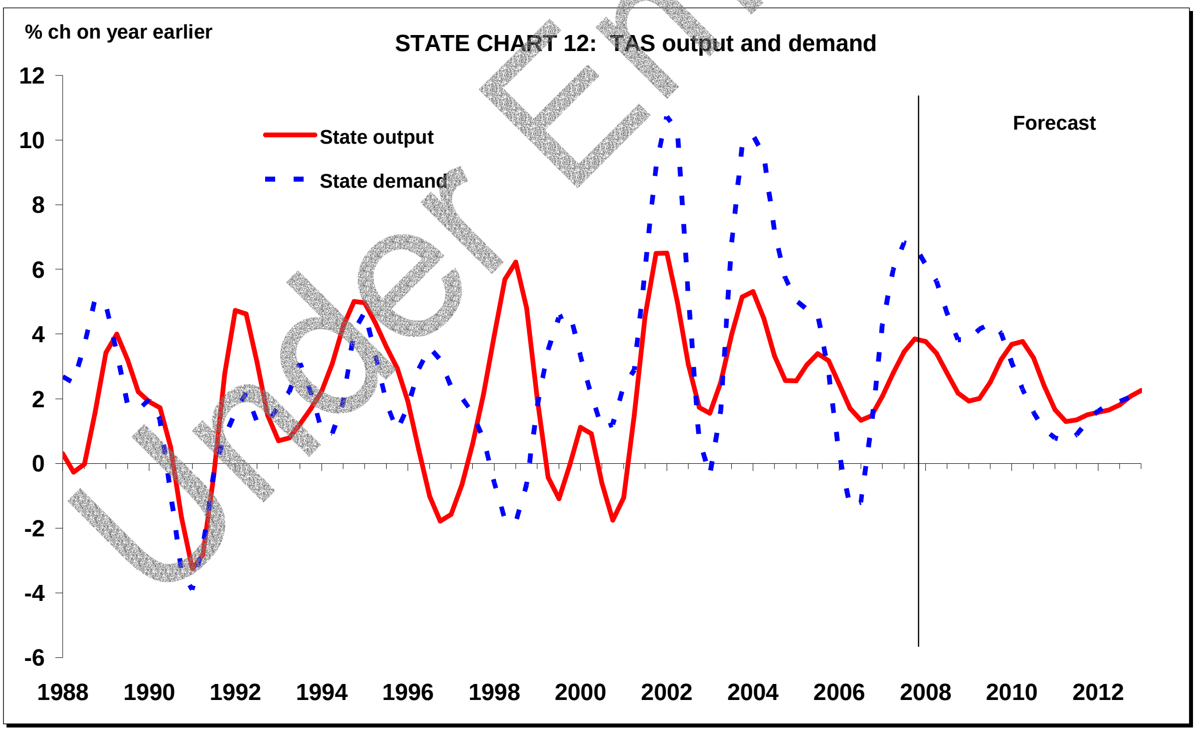
In other sectors, the new Perth to Bunbury highway is under construction at a cost of $700 million, while a number of gas-fired power station projects are underway near Collie and Neerabup. Meanwhile, projects in the pipeline include the massive Gorgon LNG project on Barrow Island. The cost of this project has again been revised upward to $20 billion, and it has been granted environmental approval. Among the bibs and bobs, the $5 billion North Rankin LNG redevelopment has approval, while Gindalbie Gold's $1.7 billion development of the Karara iron ore mine is set to begin in early 2009.

State table 5		**Forecasts**					
		2007-08	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**2012-13**
WESTERN AUSTRALIA							
Gross State product	Constant price ($m)	133,337	140,267	147,213	155,906	161,776	168,393
	% change	5.0	5.2	5.0	5.9	3.8	4.1
Western Australia as a share of Australian output %		12.9	13.3	13.5	13.8	13.9	14.0
Nominal gross State product	$m	155,522	176,931	185,971	200,591	213,854	225,320
	% change	10.4	13.8	5.1	7.9	6.6	5.4
Real final demand	Constant price ($m)	126,995	138,554	142,626	142,918	143,565	147,058
	% change	9.3	9.1	2.9	0.2	0.5	2.4
Private consumption	Constant price ($m)	58,312	60,003	62,899	66,156	68,666	70,827
	% change	5.3	2.9	4.8	5.2	3.8	3.1
Private housing investment	Constant price ($m)	9,120	9,256	9,439	9,127	9,112	9,916
	% change	10.0	1.5	2.0	-3.3	-0.2	8.8
Private commercial construction	Constant price ($m)	17,995	23,308	21,750	19,387	17,343	16,521
	% change	18.4	29.5	-6.7	-10.9	-10.5	-4.7
Private equipment investment	Constant price ($m)	14,215	17,154	17,828	16,933	16,449	16,524
	% change	23.3	20.7	3.9	-5.0	-2.9	0.5
International exports	Constant price ($m)	56,678	59,874	65,743	74,194	83,600	94,056
	% change	3.3	5.6	9.8	12.9	12.7	12.5
International imports	Constant price ($m)	24,274	28,686	32,376	33,524	35,768	38,751
	% change	13.2	18.2	12.9	3.5	6.7	8.3
Industrial production	Constant price ($m)	52,052	55,426	58,138	61,340	63,852	66,219
	% change	6.7	6.5	4.9	5.5	4.1	3.7
Retail turnover	Constant price ($m)	24,564	24,753	25,651	27,548	28,827	29,867
	% change	3.2	0.8	3.6	7.4	4.6	3.6
International tourist arrivals	Persons ('000s)	549	557	575	606	651	701
	% change	5.0	1.5	3.2	5.5	7.4	7.7
Total population	Persons ('000s)	2,138	2,188	2,237	2,287	2,335	2,382
	% change	2.4	2.3	2.3	2.2	2.1	2.0
Population aged 15 and over	Persons ('000s)	1,717	1,761	1,805	1,847	1,889	1,929
	% change	2.6	2.6	2.5	2.4	2.2	2.1
Employment ('000s)	Persons ('000s)	1,124	1,149	1,187	1,221	1,237	1,264
	% change	3.3	2.2	3.3	2.8	1.3	2.1
Unemployment	Persons ('000s)	38	43	45	45	48	51
Unemployment rate	%	3.2	3.6	3.7	3.6	3.7	3.9
Consumer Price Index	1989-90 = 100	161.7	169.6	174.6	179.2	184.3	188.7
	% change	3.6	4.9	2.9	2.7	2.8	2.4
Average Weekly Earnings	$	970.55	1,033.15	1,089.90	1,135.58	1,184.95	1,243.13
	% change	9.3	6.4	5.5	4.2	4.3	4.9
Labour Price Index	Level	120.65	127.05	133.95	139.60	145.60	152.68
	% change	5.8	5.3	5.4	4.2	4.3	4.9
Base year for real data is 2005-06							

Commercial activity is solid, but lacks the strength of engineering. That said, approvals lifted more than 70% in 2007-08 led by office and retail facilities, suggesting that construction may get a boost in the near future. Ground works have begun on the new Fiona Stanley Tertiary Hospital development in Perth, with the $1.8 billion project due for completion in 2013. Meanwhile, a $1 billion long term upgrade to the Jandakot Airport is underway, as is a $425 million retail and commercial facility at Raine Square in Perth. A new $335 million indoor sport and entertainment complex is underway in Perth, due for completion in 2010, while upgrades to the Princes Margaret and Joondalup Hospitals are ongoing. The $100 million 'Bishop's See' office redevelopment on St Georges Terrace in Perth is almost complete.

Tasmania

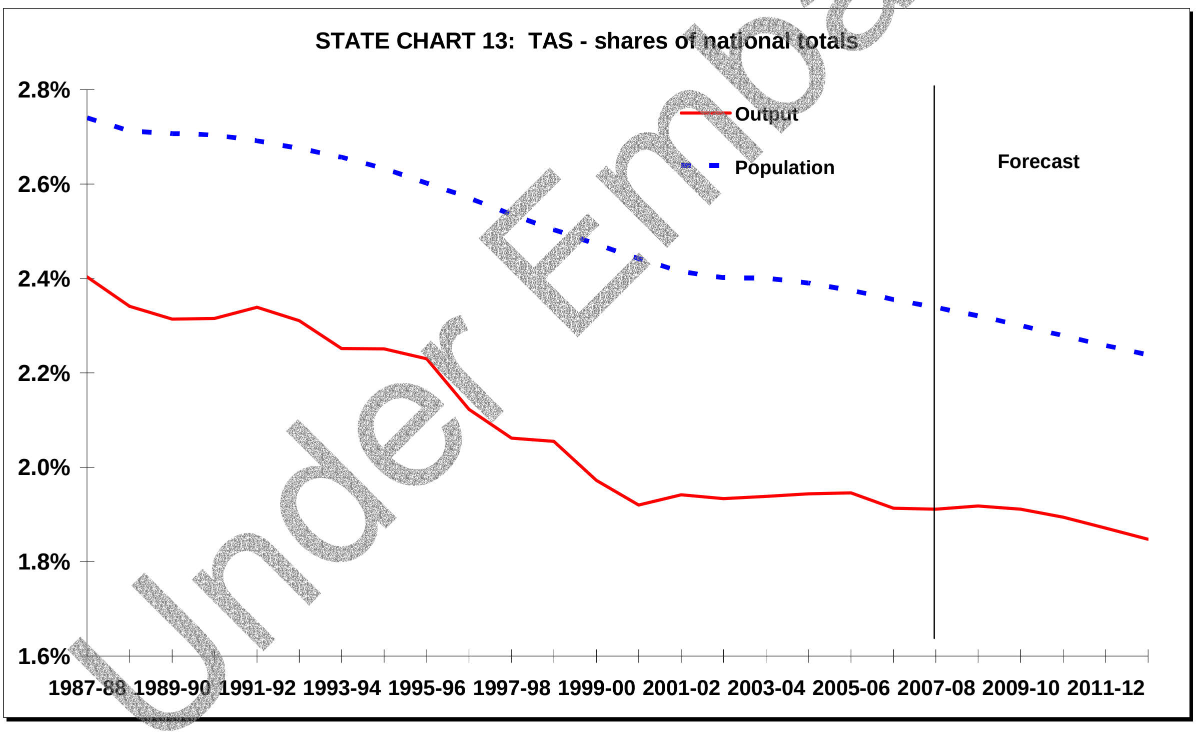
It looks as if the pulp mill is now less than likely to go ahead, raising growth challenges for a small State lacking economies of scale. However, and as State Chart 12 shows, growth is currently sitting pretty. As in SA, the biggest national negative for demand has been high interest rates, and the smaller debts of Tasmanian families and businesses means that negative bulks less large in Tasmania than it does in most other States. As a result, housing construction solid, with healthy trends in the forward indicators for construction. That has kept housing as a growth driver for the State's economy across a time when others have seen housing construction weighing heavily again them. (But it means housing construction is less likely to be a particularly strong growth driver in the period ahead, as the State lacks the pent up demand for housing evident in most other markets. That is why Hobart's vacancy rates are the highest in the nation, albeit hardly at heady highs given that they are 2%.)



Moreover, and unlike South Australia, news on the supply front is just as good as that on the demand front. Population growth is rising, there has been a substantial recovery in capex to a new record, unemployment has dropped to national rates thanks to great job gains and, unlike most of the rest of Australia, job vacancies are actually rising rather than falling. The lack of pent up demand for housing is partly why the growth in residential rents in Hobart is falling at a time when they are bounding ahead nationally. And relatively lower inflation in retail prices means that the punters are seeing their dollars stretch further than elsewhere, a factor underpinning growth in retail sales at a reasonably solid rate. That combination has left small businesses positively perky, with confidence readings the highest in the nation.

There are some short term negatives, most notably so on the farm front. Whereas the rest of Australia can look forward to a substantial rural recovery in 2008-09, Tassie's big dry has not yet broken, suggesting a bad year down on the farm for the State.

Can it last? There is good news for the State in the fall in the $A, which takes pressure off its manufacturers and adds to opportunities for exporters. Yet although business investment has indeed jumped back up, commercial approvals have dropped back of late, and the trials of Gunns are a reminder that past performance is no guarantee of future performance on business investment spending in Tasmania. Moreover, this is a State lacking ticks in the boxes against each and every one of Federal Treasury's 3P's framework. *Population* growth might be lifting, but it is only a little over half that seen nationally. *Participation* may have improved as well, but it remains the lowest in the nation. And the same is true for *productivity*, with output per worker in Tasmania lower than in any other State. We suspect that the outlook in the short term will stay more than benign. For the longer term, it is rather harder to see such benign outcomes continuing. If the supply side falls prey to some of the risks noted above, that will continue the longer term trends that underpin State Chart 13.



Tasmanian **housing** construction continues to gather strength – as does its South Australian counterpart. The common linkage is that both States have seen housing activity less affected by interest rates than has been true in the 'big mortgage' markets of Sydney, Melbourne, Perth, Brisbane and Canberra. A further boost comes from the recent increase in population growth. However, and as is also true of South Australia, the better things are now, the less they can be expected to recover alongside the rest of Australia as mortgage interest rates continue to swing down over the next year or so.

Engineering construction started 2008 solidly, though the State is losing out relative to the mainland. The $230 million Tamar power project is the biggest project under construction. It involves the construction of a 200 megawatt power station in northern Tasmania and is due to be completed in 2009. Other projects include an upgrade to the East Tamar Highway.

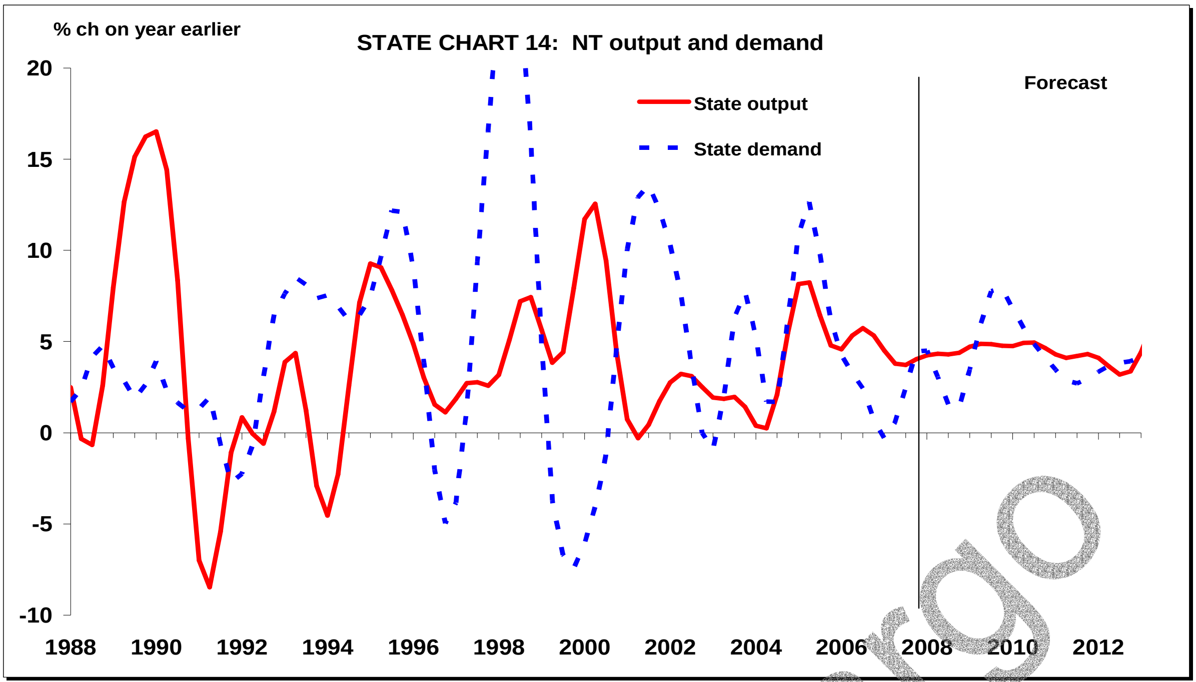
Recently announced plans to spend $2 billion constructing a 500km pipe from Tasmania to Victoria and South Australia are under consideration. The pipeline would allow Tasmania to sell water to mainland Australia. While the project is in the very early planning phases, it would be a massive boon to the State if it goes ahead.

Commercial work is set to lift, with approvals jumping by more than 25% in 2007-08. The Royal Hobart Hospital is receiving a $50 million upgrade including new operating theatres and a new emergency department, while 'The Hazards' luxury resort is under construction at Coles Bay at a cost of $40 million. The historic Tasmanian Museum and Gallery is receiving a $30 million redevelopment in Hobart, while plans have been approved for an eco-tourism development including a five-star hotel and golf course at Musselroe Bay.

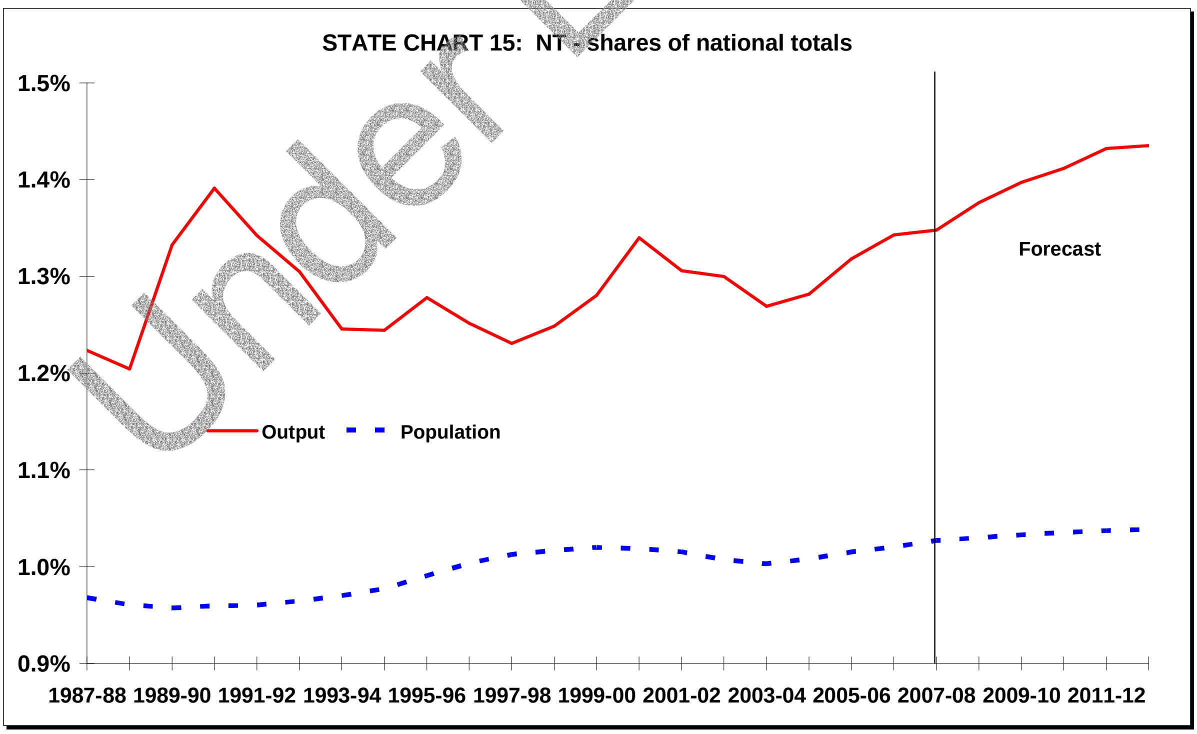
State table 6		**Forecasts**					
		2007-08	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**2012-13**
TASMANIA							
Gross State product	Constant price ($m)	19,806	20,293	20,885	21,456	21,771	22,197
	% change	3.6	2.5	2.9	2.7	1.5	2.0
Tasmania as a share of Australian output %		1.9	1.9	1.9	1.9	1.9	1.8
Nominal gross State product	$m	22,417	23,969	24,907	26,196	27,449	28,673
	% change	5.7	6.9	3.9	5.2	4.8	4.5
Real final demand	Constant price ($m)	21,614	22,525	23,448	23,769	24,049	24,530
	% change	6.7	4.2	4.1	1.4	1.2	2.0
Private consumption	Constant price ($m)	12,363	12,587	12,832	13,188	13,401	13,563
	% change	4.6	1.8	1.9	2.8	1.6	1.2
Private housing investment	Constant price ($m)	1,296	1,349	1,450	1,388	1,359	1,452
	% change	8.9	4.1	7.5	-4.3	-2.1	6.9
Private commercial construction	Constant price ($m)	838	880	966	889	833	829
	% change	19.5	5.0	9.9	-8.0	-6.3	-0.5
Private equipment investment	Constant price ($m)	1,391	1,616	1,699	1,574	1,559	1,541
	% change	31.5	16.2	5.2	-7.4	-0.9	-1.2
International exports	Constant price ($m)	3,166	3,278	3,548	3,879	4,245	4,680
	% change	2.4	3.5	8.2	9.3	9.4	10.2
International imports	Constant price ($m)	655	875	956	959	990	1,040
	% change	10.6	33.5	9.3	0.3	3.3	5.0
Industrial production	Constant price ($m)	4,108	4,168	4,308	4,375	4,411	4,428
	% change	1.6	1.5	3.4	1.6	0.8	0.4
Retail turnover	Constant price ($m)	4,905	4,934	5,166	5,355	5,425	5,496
	% change	3.8	0.6	4.7	3.7	1.3	1.3
International tourist arrivals	Persons ('000s)	45	48	52	56	61	67
	% change	-4.2	6.2	7.7	7.4	9.2	9.7
Total population	Persons ('000s)	496	500	503	505	507	510
	% change	0.8	0.7	0.6	0.5	0.5	0.4
Population aged 15 and over	Persons ('000s)	400	404	407	410	412	415
	% change	1.0	1.0	0.8	0.7	0.6	0.6
Employment ('000s)	Persons ('000s)	231	237	242	246	249	252
	% change	3.1	2.6	2.1	1.9	0.9	1.4
Unemployment	Persons ('000s)	12	13	15	14	14	14
Unemployment rate	%	5.0	5.3	5.9	5.5	5.5	5.3
Consumer Price Index	1989-90 = 100	160.3	167.3	172.0	176.2	181.1	185.3
	% change	3.0	4.3	2.8	2.5	2.7	2.3
Average Weekly Earnings	$	770.08	804.88	844.70	875.58	909.43	949.55
	% change	4.1	4.5	4.9	3.7	3.9	4.4
Labour Price Index	Level	117.48	122.85	129.15	134.25	139.68	146.10
	% change	3.9	4.6	5.1	3.9	4.0	4.6
Base year for real data is 2005-06							

Northern Territory

We'd feared the pocket rocket of Australia's economy, the Northern Territory, would hit an air pocket as a gap between mega-projects saw the Territory take a breather. Additional challenges arose from the fast fade in housing construction, the difficult social issues surrounding Federal intervention into indigenous affairs, and the potential for the Territory to get caught up in some of the factors slowing the Australian economy as a whole.



In practice, the Territory's economy remains very healthy. It is true **housing** commitments and approvals turned down in the Territory earlier than elsewhere, and that they remain weak. In fact they remain far too weak given the Territory's burgeoning population growth, a combination which has left the housing construction sector as more of a drag on growth in the Territory's economy than evident in most other jurisdictions. Approvals suggest that there is worse to come despite rental accommodation vacancy rates which are next to non-existent (the lowest in Australia), leaving residential rents rising rapidly as a result.



Yet, the Territory's economy has navigated some tricky shoals and it is in still relatively good shape. Population growth is still accelerating; unemployment is back near record lows. And although the level of job vacancies is easing alongside the pace of job growth, both of these are still very robust against national yardsticks. Moreover, the combination of good population and employment growth and solid news on the wage front means that retail spending growth has barely hiccupped in recent times, leaving the Northern Territory vying with South Australia for the fastest growth rate in retail spending in the nation.

Moreover, even if the completion of big projects such as Alcan's expansion of its Gove Refinery have left something of a hole in the pace of business investment in the Northern Territory, the latter remains more than robust nonetheless.

State table 7			**Forecasts**				
		2007-08	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**2012-13**
NORTHERN TERRITORY							
Gross State product	Constant price ($m)	13,967	14,563	15,267	15,988	16,665	17,248
	% change	4.1	4.3	4.8	4.7	4.2	3.5
Northern Territory as a share of Australian output %		1.3	1.4	1.4	1.4	1.4	1.4
Nominal gross State product	$m	16,258	18,270	19,224	20,403	21,807	22,883
	% change	11.4	12.4	5.2	6.1	6.9	4.9
Real final demand	Constant price ($m)	14,878	15,123	16,253	16,977	17,479	18,157
	% change	3.4	1.6	7.5	4.5	3.0	3.9
Private consumption	Constant price ($m)	6,222	6,604	7,076	7,583	7,983	8,348
	% change	4.4	6.1	7.1	7.2	5.3	4.6
Private housing investment	Constant price ($m)	496	474	558	556	554	632
	% change	-8.8	-4.4	17.7	-0.3	-0.3	13.9
Private commercial construction	Constant price ($m)	1,327	1,323	1,645	1,629	1,525	1,444
	% change	-26.2	-0.3	24.3	-1.0	-6.4	-5.3
Private equipment investment	Constant price ($m)	1,221	926	909	928	957	1,002
	% change	74.9	-24.2	-1.8	2.1	3.1	4.7
International exports	Constant price ($m)	3,596	4,229	4,891	5,469	6,106	6,729
	% change	-8.2	17.6	15.7	11.8	11.6	10.2
International imports	Constant price ($m)	2,249	2,890	3,259	3,385	3,603	3,884
	% change	-21.9	28.5	12.8	3.9	6.4	7.8
Industrial production	Constant price ($m)	4,210	4,280	4,401	4,515	4,630	4,750
	% change	1.1	1.7	2.8	2.6	2.5	2.6
Retail turnover	Constant price ($m)	2,367	2,385	2,438	2,593	2,706	2,838
	% change	7.3	0.8	2.2	6.4	4.4	4.9
International tourist arrivals	Persons ('000s)	87	67	80	88	98	110
	% change	-8.2	-23.1	18.7	10.3	11.5	12.6
Total population	Persons ('000s)	218	222	226	230	233	237
	% change	2.2	1.8	1.8	1.7	1.5	1.5
Population aged 15 and over	Persons ('000s)	166	170	173	177	180	183
	% change	2.7	2.2	2.1	2.0	1.8	1.7
Employment ('000s)	Persons ('000s)	109	112	115	118	121	124
	% change	5.7	2.8	2.9	2.8	2.0	2.5
Unemployment	Persons ('000s)	5	4	5	5	5	6
Unemployment rate	%	4.5	3.8	4.2	4.1	4.3	4.5
Consumer Price Index	1989-90 = 100	158.3	165.2	170.0	174.4	179.4	183.5
	% change	3.5	4.4	2.9	2.6	2.9	2.3
Average Weekly Earnings	$	904.68	956.28	1,008.95	1,050.93	1,096.68	1,146.28
	% change	6.1	5.7	5.5	4.2	4.4	4.5
Labour Price Index	Level	116.78	122.98	129.65	135.13	140.93	147.48
	% change	3.9	5.3	5.4	4.2	4.3	4.6
Base year for real data is 2005-06							

There's a lot of work around, as befits a resource rich mineral province at a time when emerging economy growth remains strong. Indeed, there is talk of a second LNG plant in Darwin, bringing raw materials from the Browse Basin onshore for processing. The plant in question is even bigger than Darwin's current LNG operation, and the latter had a big impact on the Territory. That points to the potential for single large projects to have a notable impact on the pace of growth in the Territory's economy. Moreover, even if business investment spending is off its peaks as a share of the Territory's economy, the NT still ranks second only to Western Australia on that measure of future potential growth. Add in continuing gains in government spending in response to the Federal intervention to indigenous affairs, and that leaves the Northern Territory's outlook reasonably robust not merely in the next year, but also in the next five.

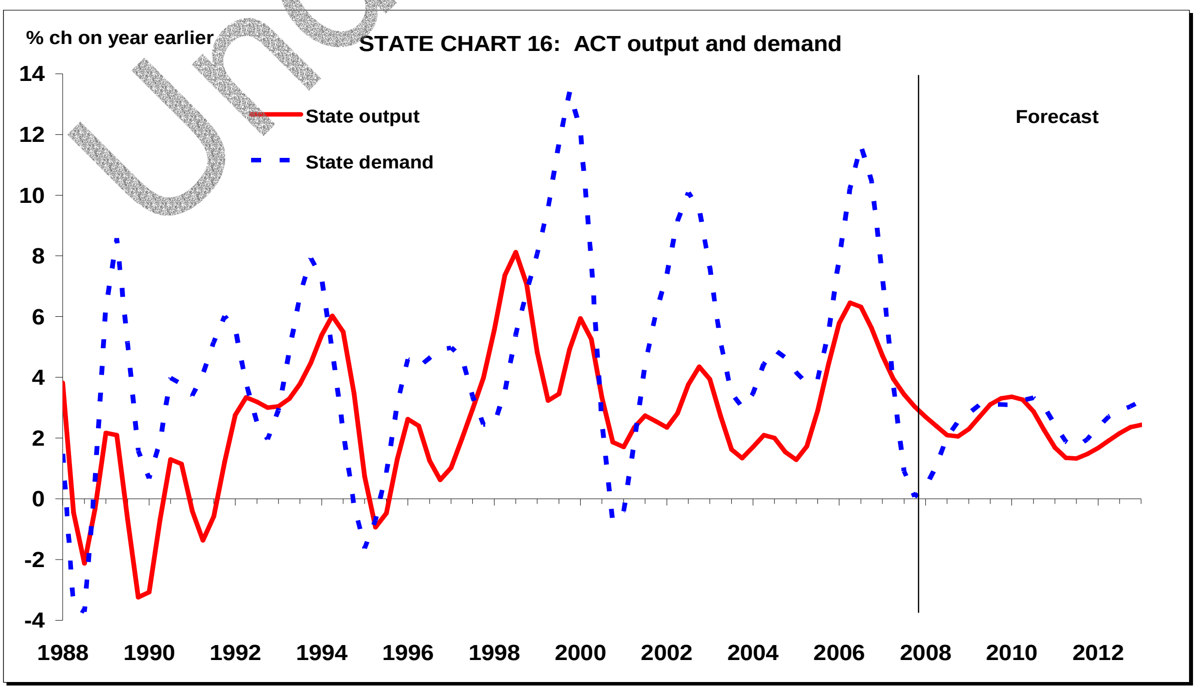
That said, the Territory faces risks from more slowdown materialising in emerging economies. As is true of some other parts of Australia, the Northern Territory is a leveraged bet on global growth. If emerging markets sail through the volatility in financial markets evident of late, then that would be particularly good news for the Territory.

Engineering work has been disappointing given its potential, though commencements jumped in early 2008 to their highest since late 2004 and, as noted above, LNG prospects shimmer on the horizon. Projects underway include the $170 million Bonaparte gas pipeline which will eventually extend from Wadeye to the Amadeus Basin, while an upgrade of an existing manganese ore processing plant is underway at the Groote Eylandt mine, also costing $170 million. Arafura Resources plans to spend $1.1 billion on the Nolans Bore uranium project north of Alice Springs, with feasibility studies underway, while Dow Pacific is considering a $3 billion chemical factory in Darwin. A feasibility study is also underway on a $1 billion Nexus Energy plan to undertake the Crux gas project in the Timor Sea.

Commercial work underway is led by the Darwin Waterfront development. While some components of this $900 million project are complete (including a new 1,500 seat convention centre), construction is scheduled through to 2015. Darwin's new $90 million Chinatown development is also underway, as is a $35 million expansion of the Tiwi Gardens Aged Care facility in north Darwin, with the latter set to be completed shortly. An upgrade to the Darwin casino was recently completed, while a site is being determined for the construction of a new $300 million jail in Darwin.

Australian Capital Territory

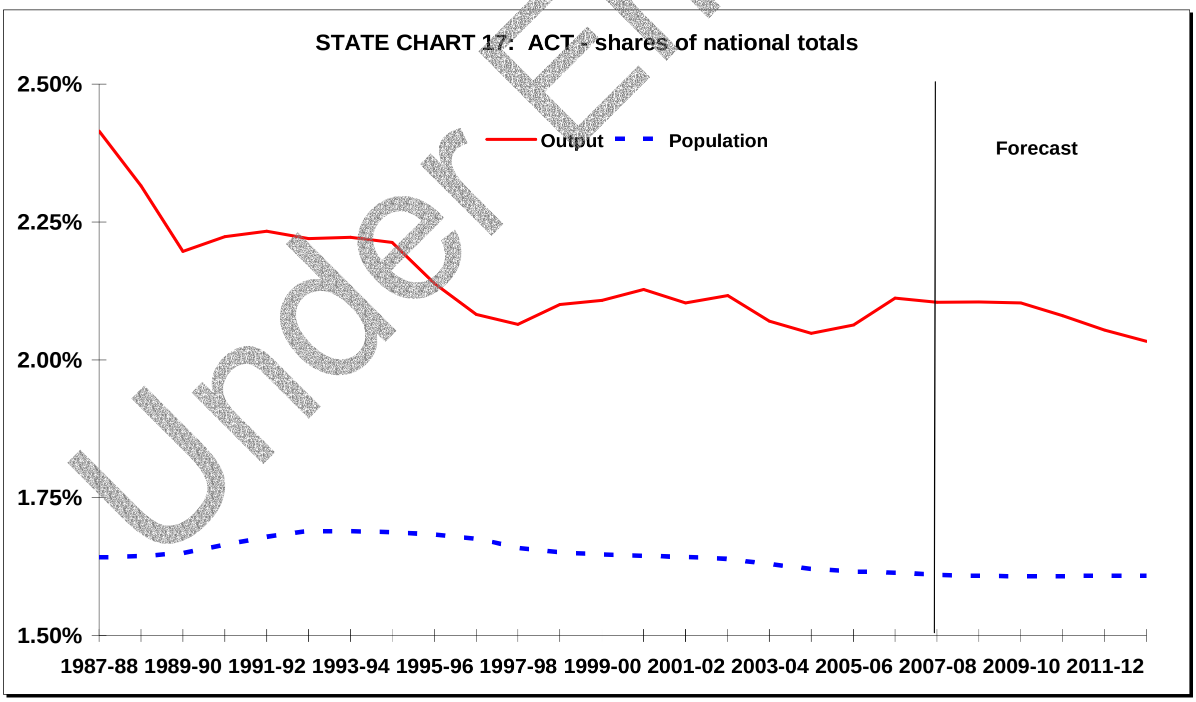
The ACT has been slowing for a while now, its big mortgage belt smarting under the weight of higher interest rates, and its commercial construction sector having completed some of the bigger jobs around town. In addition, although the new Federal Government wielded a particularly blunt axe in May's Budget, that was still enough to take some of the momentum out of job growth and local spending. The upshot is that most demand indicators are signalling at least amber, weaker than their longer term trends. That is true in each of retail sales, government spending, car sales, the pace at which businesses are constructing new commercial space and engineering works, and the pace of housing starts.



As ever, Canberra's population growth is super-sensitive to the state of its economy, and population growth in recent times has therefore rapidly gone from above the national average to back below it as the well-publicised easing in job prospects saw fewer arrivals and more departures than usual. Interestingly, the latest twist in the population tale comes thanks to international migrants. You'd have thought that global warming was making Canberra an increasingly pleasant place to stay, but migration trends have turned against it for now.

With most of the big engines of growth idling, the ACT lacks much of the short term growth drivers. That said, there's a second wind in commercial building approvals afoot, and that bids fair to add some moral fibre to the ACT outlook. Indeed, some recovery in the pace of business investment is clearly necessary – private sector spending on construction and on plant and equipment such as the computer software and hardware levelled off in the ACT a while ago whereas it has been making big strides in most of the nation. As a share of its economy, business investment spending in the ACT is now the lowest in the nation. (And when you're worse off than NSW, you know you're in trouble). Job growth has moderated, and falls in ANZ job ads suggest moderation will continue. Moreover, the IMF's report card on Australia has urged a renewed round of government spending cutbacks on the Feds. If that advice is followed, then the ACT will stay in the slow lane for a while further yet.

In practice, we suspect the ACT may soon begin a slow recovery. Not only are commercial construction approvals rising again, but the inevitable turn of the electoral cycle makes it less likely that the Feds will be stropping their razor next year. Indeed, even the cutbacks announced in May's Budget are being ameliorated by the passing of time as a series of Sir Humphreys convince their new Ministers of the dire results of those cutbacks being enforced.



Population growth may be easing back, but **housing** starts have now fallen so far that you can name the families getting new homes built. In part that is because the tail end of the earlier surge in apartment developments is still trickling steadily onto the Canberra housing market, and in part it is because housing prices have now stalled after their strength through 2007. Although much depends on the pace of job growth in the Federal public service, that suggests that, even with a degree of population pressure easing, the next big move for this sector should be a substantial recovery in housing activity through the course of 2009 and into 2010.

State table 8		Forecasts					
		2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
AUSTRALIAN CAPITAL TERRITORY							
Gross State product	Constant price ($m)	21,807	22,271	22,983	23,558	23,900	24,436
	% change	3.3	2.1	3.2	2.5	1.5	2.2
Australian Capital Territory as a share	of Australian output %	2.1	2.1	2.1	2.1	2.1	2.0
Nominal gross State product	$m	24,060	25,702	26,679	28,097	29,790	31,529
	% change	10.5	6.8	3.8	5.3	6.0	5.8
Real final demand	Constant price ($m)	35,521	36,329	37,443	38,591	39,348	40,517
	% change	0.7	2.3	3.1	3.1	2.0	3.0
Private consumption	Constant price ($m)	11,552	11,647	11,859	12,255	12,561	12,825
	% change	2.7	0.8	1.8	3.3	2.5	2.1
Private housing investment	Constant price ($m)	876	860	994	1,048	1,097	1,195
	% change	-5.6	-1.8	15.5	5.5	4.6	9.0
Private commercial construction	Constant price ($m)	1,221	1,333	1,378	1,322	1,226	1,181
	% change	-8.7	9.1	3.4	-4.1	-7.2	-3.7
Private equipment investment	Constant price ($m)	729	729	884	982	963	965
	% change	-15.9	0.0	21.3	11.0	-1.9	0.2
International exports	Constant price ($m)	4	0	0	0	0	0
	% change	-	-	-	-	-	-
International imports	Constant price ($m)	14	8	8	8	8	8
	% change	-	-	-	-	-	-
Industrial production	Constant price ($m)	818	838	863	886	902	908
	% change	0.3	2.5	3.0	2.6	1.8	0.7
Retail turnover	Constant price ($m)	4,370	4,420	4,460	4,603	4,669	4,781
	% change	0.8	1.1	0.9	3.2	1.4	2.4
International tourist arrivals	Persons ('000s)	45	47	48	50	54	58
	% change	1.3	4.5	1.4	4.9	6.8	7.1
Total population	Persons ('000s)	342	346	351	356	361	366
	% change	1.3	1.4	1.4	1.4	1.4	1.4
Population aged 15 and over	Persons ('000s)	278	282	287	291	295	299
	% change	1.4	1.4	1.5	1.5	1.4	1.3
Employment ('000s)	Persons ('000s)	190	193	195	198	205	208
	% change	0.8	1.8	1.0	1.4	3.6	1.7
Unemployment	Persons ('000s)	5	6	7	7	8	9
Unemployment rate	%	2.6	3.0	3.5	3.5	3.8	4.0
Consumer Price Index	1989-90 = 100	162.0	169.9	174.6	179.3	185.1	190.3
	% change	3.6	4.9	2.8	2.7	3.2	2.8
Average Weekly Earnings	$	1,062.18	1,118.40	1,174.40	1,218.58	1,266.73	1,324.58
	% change	1.5	5.3	5.0	3.8	4.0	4.6
Labour Price Index	Level	117.73	122.83	129.18	134.38	139.85	146.43
	% change	4.1	4.3	5.2	4.0	4.1	4.7
Base year for real data is 2005-06							

Engineering activity in the ACT dipped back after the Gungahlin Drive Extension (finally) finished, though some major projects are underway. An upgrade to the Canberra Airport includes a runway extension, a new passenger terminal and upgrades to the carpark and to surrounding roads. Meanwhile the Cotter Dam is being expanded significantly in a $145 million project to secure Canberra's water supplies. Planned works include a $155 million pipeline from the Murrumbidgee River to the Googong Dam, along with a proposal to construct a gas-fired power station in Canberra's south.

Commercial construction has been strong in Canberra, though activity may have already peaked. Approvals fell notably in 2007-08 and a number of major projects have completed recently. Work underway includes Doma Group's 'Realm' project in Barton which includes a five-star hotel along with commercial and office components (such as Access Economics' new Canberra office), while a number of office developments are underway in the city. A new headquarters for the Federal Attorney-General's Department is under construction at a cost of $100 million, while the National Gallery of Australia is receiving a major upgrade and a new National Portrait Gallery building is under construction at a cost of $90 million. Elsewhere, further upgrades are taking place at the Australian Institute of Sport, while a new school is being constructed in West Belconnen at a cost of $45 million.