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ANZ States and Territories Economic Update

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Inside

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Mark Rodrigues
Senior Economist, Australia

The big picture

Australia's economic prospects remain favourable

The Australian economy is booming, with strong growth in employment and wages supporting household spending; high commodity prices continuing to buoy corporate profitability; and a massive public infrastructure program across most states supplementing a private business investment boom already in full swing. But the picture has become more clouded lately, with the world's largest economy threatening to slip into recession and end the global economic party.

The global outlook has deteriorated, but Asia is likely to remain strong…

The global outlook is evolving on an almost daily basis, making it difficult to be too definitive at the current juncture. However, the most likely scenario still remains a 'soft landing' in the US economy. That is, a significant slowdown in economic activity, to be sure, but something short of outright recession. Under such circumstances, Asia, and China in particular, will be able to grow at a more moderate, but still strong pace, under the weight of its own domestic demand and exports to increasingly diverse partners in the rest of Asia and Europe.

…supporting resource commodity prices

And it's China, more than any other single nation that matters most for Australia, particularly with respect to resource commodity prices. On this front, we expect further gains in commodity prices in 2008, particularly with respect to bulk commodities, where further double-digit price gains are likely.

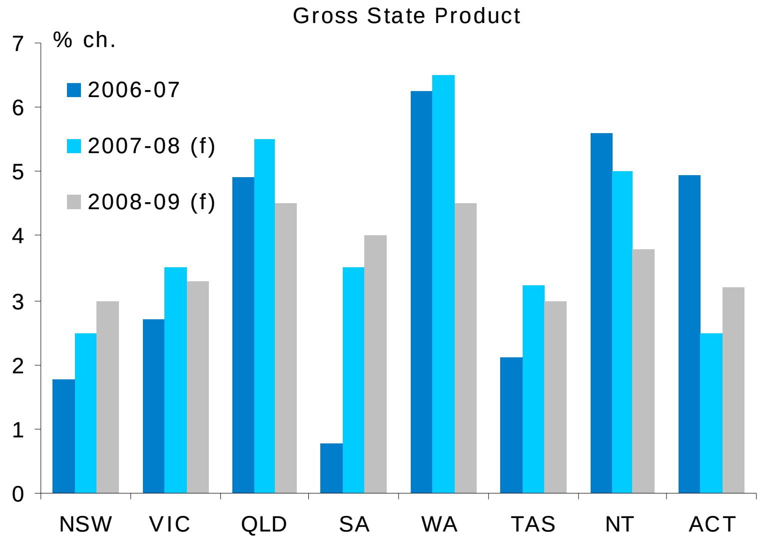
Resource-rich states will again dominate, but the gap will narrow

All of this means that the resource-rich regions of Western Australia, Queensland and the Northern Territory will continue to dominate the domestic growth scene, although the gap with the rest of the field will narrow. South Australia and Tasmania are likely to be the big improvers this year, thanks in large part to their increasing exposure to the resources boom. New South Wales now looks to be past the worst of its economic woes, while Victoria is set for another workmanlike year. Only in the Australian Capital Territory has the outlook deteriorated, although this seems largely related to the political cycle.

Domestic inflation poses the main threat to Australia's economic expansion

The key risk for the Australian economy does not originate offshore, but rather, is well and truly home grown: inflation. It is becoming increasingly difficult to escape the conclusion that the RBA has fallen 'behind the curve' and we now have a full blown inflation problem on our hands. Core inflation is already sitting at the top of the central bank's 2-3% target band and is likely to have breached it in the final quarter of 2007. The outlook doesn't look pretty either, with price pressures evident across a number of household staples including food, petrol, rents and utilities. With demand powering ahead at a rate in excess of the economy's sustainable rate of growth, it is difficult to see what forces will bring inflation back to within the RBA's comfort zone. RBA interest rate deliberations in the year ahead are going to have to balance the *threat* associated with slower growth in the US and global economies with the *reality* of rampant inflation. For an inflation-targeting central bank, that's a no-brainer.

Resource-rich states continue to dominate, but disparities will narrow



Sources: Australian Bureau of Statistics and Economics@ANZ

New South Wales: on the rise (slowly)

Mark Rodrigues, Senior Economist, Australia

There are signs that New South Wales, the nation's economic giant, is beginning to awake from its long slumber. After four years of disappointing economic outcomes, with growth mired around or below 2% per annum, the state is expected to grow by 2½% in 2007-08. To be sure, this would still place it at the bottom end of the national economic growth table. But after years of sub-par growth, such an outcome would represent a significant lift in economic activity that comparatively, will feel like a boom.

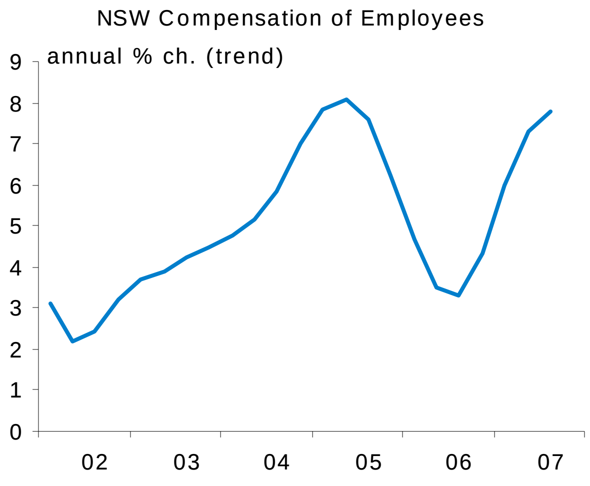
Households lead the resurgence

The most recent data confirm that the economic recovery is already in train, with state final demand up an impressive 5% over the year to the September quarter 2007, significantly stronger than the paltry rate of just 0.4% recorded a year earlier.

Underpinning the turnaround has been an appreciable lift in consumer spending. Household consumption increased by 4.5% over the year to the September quarter and partial data suggest that strong demand continued through to the end of the year, with nominal retail spending up 8.5% in the year to November, the strongest annual growth since late 2001.

The lift in consumer spending has occurred against a backdrop of very strong growth in household incomes as the state's labour market tightens. Employment grew at a healthy pace of 2.1% over the year to November while the unemployment rate was 4.8%, up slightly from the low of 4.6% reached in the months prior, but nonetheless on a downward trend from rates in excess of 5% a year earlier. Meanwhile, wages continue to grow at an elevated pace of around 4% per annum. Overall, total compensation of New South Wales's employees increased by 8% over the year to the September quarter, up from a growth rate of 3.6% a year prior.

Strong growth in employment and wages is spurring growth in household incomes



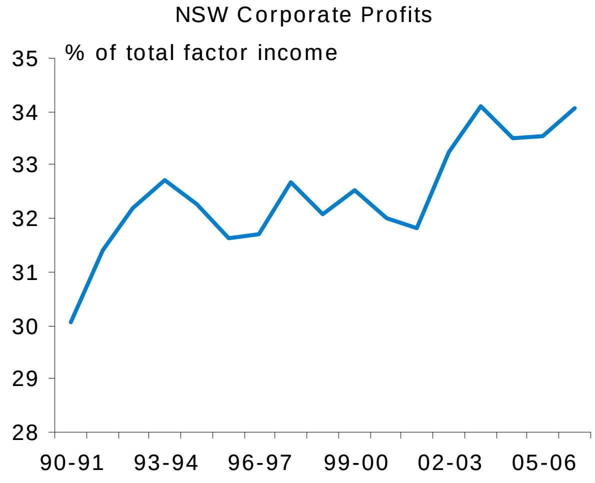
Source: Australian Bureau of Statistics

The state's labour market may yet tighten further with leading indicators pointing to an acceleration in labour demand in the months ahead. According to the *ANZ Job Advertisements* series, newspaper advertisements in New South Wales grew by 7.7% in December, one of the strongest rates of growth in the country. Meanwhile, ABS data on job vacancies in the state increased by a similarly strong 7.4% in the three months to November, and 16.4% over the year.

Business is booming, supporting jobs growth and investment

The strength of labour demand is closely associated with improved conditions in New South Wales's business sector in recent years. State corporate profits increased by 7.7% in 2006-07, the strongest since the final year of the state's last housing boom in 2003-04. As a result, the corporate share of income has crept up in recent years, to 34.1% in 2006-07. This compares with a share of between 32 and 33% over much of the 1990s.

Business has been good for corporate NSW



Source: Australian Bureau of Statistics and Economics@ANZ

In addition to expanding their labour force, cashed up businesses are also beginning to invest. Over the year to the September quarter, business investment increased 15%. This compares with a decline of almost 9% a year earlier.

While most components of business investment have increased significantly over the past year, growth has largely been underpinned by a sharp acceleration in non-dwelling construction. Within this, new engineering construction has increased 23.9% over the past year while new non-residential building is up almost 20%.

Further increases in non-dwelling construction are likely in the year ahead with a significant pipeline of work still to be done, equivalent to more than two quarter's work at the current pace of $3.7bn a quarter.

Not out of the woods yet...

While economic prospects for New South Wales have improved, the outlook is not without its fair share of challenges.

Of most immediate concern is the condition of the state's housing market. New residential building fell by 2.1% over the year to the September quarter and is down almost 40% from the peak in the last building boom in late 2002. Leading indicators of housing activity suggest that conditions will remain sluggish well into 2008, with residential building approvals up only 2.6% over the year to November 2007.

The 'glass half full' take on this is that the market appears to be nearing a trough, with the worst of the outright falls in activity now past. The 'glass half empty' interpretation is that while the market may be stabilising, there seems little hope of a significant upswing in the near future, with interest rate rises in August and November 2007 and the prospect of more to come in early 2008, likely to weigh on building industry sentiment in the short term.

Whatever spin you put on these figures, the reality is that there simply aren't enough dwellings being built in New South Wales. For example, around 30,000 new dwellings were built in the state in 2007, compared with underlying demand of nearly 45,000. We estimate that the current shortage of housing stock equates to over eighteen months of production, and by the end of 2008, this shortfall will grow to over two years production.

Tightening conditions in the housing market have already pushed the residential vacancy rate to a 19-year low of 1.4% in September and seen growth in the price of rental accommodation accelerate, to 4.9% over the year to September for established rents and 24% in advertised rents. Given the outlook for construction, further tightening in the market seems inevitable, although this should eventually set the scene for a housing revival as the investment proposition improves.

A second area of concern is the state's rural sector. 2007-08 is shaping up to be just as weak, if not weaker, than the drought-afflicted 2006-07 harvest. ABARE is forecasting winter crop production to be just 2.78Mt this year, down 9% on 2006-07 and just one-quarter of pre-drought production levels. Summer crop production is forecast to increase by about 10% this year but remain less than 40% of pre-drought levels.

Recent drenching rains across most of the state's agricultural land have raised hopes that the forecasts for the summer crop might be bettered, while irrigators are already starting to benefit from increases in seasonal water allocations. That said, these rains represent only temporary relief, and more will be needed in the months ahead to ensure a successful planting season for the next winter crop and secure reasonable water allocations for the 2007-08 season.

Economic data – New South Wales

Monthly data (% change)	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07
Retail sales	1.3	1.6	0.8	0.8	0.4	0.8
Private building approvals	1.8	0.2	-3.9	6.2	-9.0	58.8
Employment	0.1	-0.1	0.2	0.4	0.1	0.2
Unemployment rate, %	4.7	4.7	4.7	4.6	4.6	4.8
Quarterly data (% change)	**Jun-06**	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**
Household consumption	0.2	0.3	2.0	1.3	0.0	1.2
Private investment	-0.3	-5.5	2.9	2.9	6.0	-1.4
Public demand	0.1	3.0	0.4	-0.6	0.0	2.0
State final demand	0.1	-0.3	1.8	1.2	1.1	0.8
Population, ann. % ch.	0.1	0.3	0.3	0.3	0.2	n.a.
Median house price – Sydney, $'000s	478.5	479.0	481.0	480.0	496.2	503.8
Annual data (% change)	**03-04**	**04-05**	**05-06**	**06-07**	**07-08 (f)**	**08-09 (f)**
Gross state product	2.1	1.8	2.1	1.8	2.5	3.0
Employment	1.2	1.4	1.7	1.8	2.0	2.0
Consumer prices – Sydney	2.2	2.5	3.0	2.7	2.6	3.0

Sources: Australian Bureau of Statistics and Economics@ANZ

Victoria: Momentum building

Riki Polygenis, Economist, Australia

The Victorian economy was the strongest performer of the non-resource intensive states and territories in 2006-07. Victorian economic growth rose by 2.7%, only a little below the national average of 3.2%. And the good news is that economic momentum is building, with growth in 2007-08 anticipated to pick up to 3.3%. In particular, the outlook for household spending and business and government investment is positive, although the outlook is looking more uncertain for home building, rural production and merchandise exports.

Household fundamentals favourable

Household consumption was the largest contributor to growth in 2006-07, rising by 3.2% in real terms and adding 1.9ppts to Victoria's economic growth. More recent data suggest this trend continued into the second half of 2007; real household consumption rose by 1.2% in the September quarter and retail sales increased by 0.7% in nominal terms in both October and November. Consumer spending is being supported by rapid growth in household disposable incomes, which rose by 7.7% in 2006-07 in nominal terms, faster than the increase in the national average of 7.4%. The underlying drivers of household income growth will persist over the coming year, including rapid employment, solid wages growth and further increases in tax cuts. This will support Victorian consumer spending in the face of cost of living pressures such as higher interest rates and higher prices for petrol, rents, food and electricity.

Investment to continue at high levels

The outlook for both government and business investment is also positive. Business investment rose by 3.2% in 2006-07 with a sharp rise in non-residential building and a modest increase in machinery and equipment investment offsetting a fall in engineering construction. Government spending eased by 13.3% in 2006-07 although these data were distorted by the privatisation of Telstra and we expect strong growth over the next two years as the state government's ambitious infrastructure program ramps up.

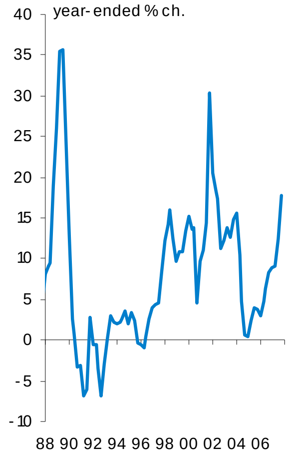
Non-residential building will continue to expand rapidly, with a large array of investment projects in the retail and office space underway such as new office towers by ANZ and AXA Pacific at Docklands and Westfield's redevelopment of the Doncaster shopping centre. There are also a number of engineering projects under construction, such as the Eastlink Motorway, the Geelong Bypass, BHP Billiton's Kipper gas development at Orbost and the expansion of Anzon Australia's Manta and Gummy offshore gas fields.

Housing affordability to deteriorate further

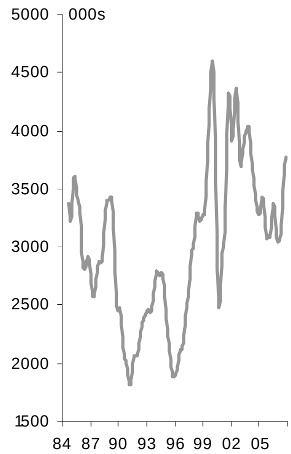
While rapid population growth has positive economic benefits in terms of easing labour shortages and increasing demand for goods and services, it also provides challenges. In particular, it is adding to pressures in the housing market where the supply of housing is already running short of demand. This has manifested itself in rising house prices and rents. House prices in Melbourne rose by 17.8% over the year to September according to the ABS and falling rental vacancy rates have prompted annual growth in average rents to increase to 4.7% from just 2.2% a year earlier. Newly advertised rents are rising more quickly, with Residex figures showing a 27% rise over the year to September.

Shortages of housing are expected to intensify over the next year. While dwelling approvals have rebounded strongly, the threat of further interest rate rises is likely to delay the recovery in residential building activity further, and we do not expect a significant rebound until 2008-09. Meanwhile, with the demand for housing continuing to grow, housing affordability will continue to deteriorate and rental vacancy rates will fall further.

House prices



Dwelling approvals



Source: Australian Bureau of Statistics

Another tough year for the rural sector…

Another aspect of the economic outlook that has deteriorated is that for the rural sector. Last year's drought will continue to weigh on 2007-08 winter crop production, which is expected to increase but remain well below average. In addition, while some of south-western Victoria has received good rainfall in recent months, the latest weather outlook from the Bureau of Meteorology suggests the probability of average rainfall in the three months to March is below 50%. Dairy production is also likely to struggle in the face of reduced water allocations in irrigation districts and higher feed prices.

…and merchandise exports

Victoria's international exports may also struggle over the coming year. Merchandise export volumes increased by just 2.4% in 2006-07, and the weaker rural outlook combined with the high level of the exchange rate and the weaker outlook for the global economy, mean that little improvement is forecast in 2007-08. The only bright spot is services exports, which grew by 8.3% in 2006-07 and should continue to grow apace provided that demand in key export markets such as China and India holds up.

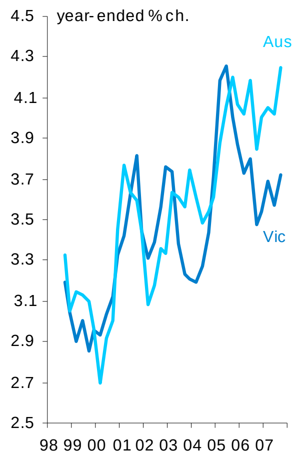
Further employment growth ahead

Victoria's strong economic performance has maintained demand for labour at a high level and has led Victorian employment growth to outperform other non-resource states. Annual growth in employment was 2.9% in November, with full-time employment growth even faster at 3.1% (trend).

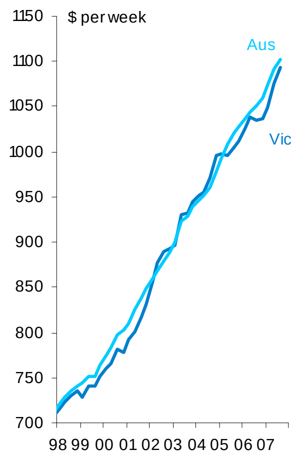
Strong demand for labour has led the unemployment rate down to 4.5% in November from 4.8% a year earlier (trend). But it has also been met by increasing labour supply. Net overseas migration totalled 47,153 in 2006-07, an increase of 19.2% from that in 2005-06. Together with an increase in births, this has resulted in population growth in Victoria rising to 1.5%, in line with the national average. This is the fastest rate of population growth in the state since 1990. Higher labour force participation has also boosted labour supply. The participation rate, or the share of the working age population working or actively looking for work, rose to 65.0% in November from 64.4% a year earlier. The increase in participation has been most pronounced for females, with female participation rising to 57.7% from 56.9%.

The rapid growth in labour supply has helped keep wages under control despite further labour market tightening. According to the wage price index (WPI), wages in Victoria grew by 3.7% in the year to the September quarter. Victorian wages growth has been well below the national average since mid 2005 when Victorian wages growth peaked at 4.3%. Data on average weekly ordinary full-time earnings (AWOTE) on the other hand, show a slightly different picture. Unlike the WPI, AWOTE incorporates compositional change in the workforce, such as shifts in the distribution of employees across occupations and industries. It is also affected by factors such as higher rates of promotion role changes. This measure suggests that average ordinary full-time earnings in Victoria are starting to catch up to the national average. In the three months to August, the average full-time employee in Victoria earned $1092.7 per week, just below the national average of $1103.6 (trend).

Wage Price Index



AWOTE



Source: ABS

Fiscal outlook improves

Thanks to higher economic and population growth, Victoria's fiscal position is looking stronger than at the time of the 2007-08 Budget in May 2007. The estimated operating surplus for 2007-08 has been revised upwards to $842mn from $324mn and the average for the forward estimates period between 2008-09 and 2010-11 has been revised to $823mn from $424mn. Despite the improved fiscal outlook, the Victorian government will still need to increase debt levels to fund a record $3.9bn per year of infrastructure spending until 2010-11. Victoria's net debt is projected to increase to 2.7% of GSP by June 2011 (revised down from 2.9% of GSP at the time of the 2007-08 Budget).

Economic data – Victoria

Monthly data (% change)	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07
Retail sales	1.7	0.2	1.0	0.6	0.7	0.7
Private building approvals	3.4	16.6	-0.8	5.5	-0.1	-10.8
Employment	-0.2	0.5	0.2	0.0	0.1	0.5
Unemployment rate, %	4.6	4.4	4.7	4.2	4.3	4.9
Quarterly data (% change)	**Jun-06**	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**
Household consumption	0.7	0.4	1.0	1.1	0.5	1.2
Private investment	-0.2	3.5	-2.8	3.6	1.5	2.6
Public demand	1.9	-1.2	2.3	-4.0	2.1	-0.9
State final demand	0.7	0.8	0.4	0.6	1.0	1.1
Population, ann. % ch.	0.3	0.4	0.3	0.4	0.3	n.a.
Median house price – Melbourne, $'000s	320.5	326.3	334.5	340.0	360.1	384.3
Annual data (% change)	**03-04**	**04-05**	**05-06**	**06-07**	**07-08 (f)**	**08-09 (f)**
Gross state product	4.4	2.4	2.5	2.7	3.5	3.3
Employment	1.7	3.1	1.7	2.7	2.8	2.0
Consumer prices – Melbourne	2.3	2.0	3.1	2.6	3.1	2.8

Sources: Australian Bureau of Statistics and Economics@ANZ

Queensland: Firing on all cylinders

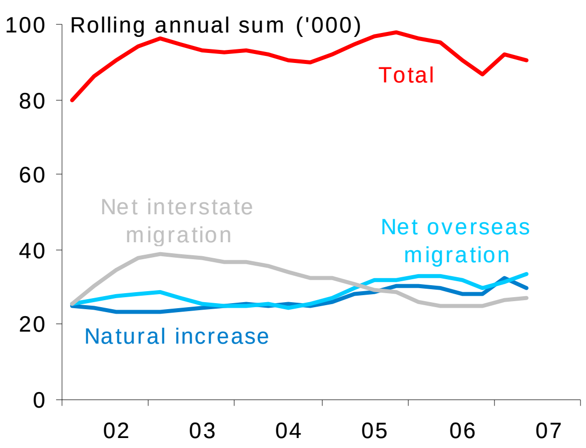
Mark Rodrigues, Senior Economist, Australia

To state the obvious, Queensland's economy is booming. Economic growth is forecast to accelerate to 5.5% in 2007-08. Not bad considering the economy grew by a stellar 4.9% in 2006-07. The major hurdle to continued economic sunshine up north is the state's capacity to adequately meet the demands of its expanding population and make good on a massive infrastructure investment program.

Heading for the sunshine, jobs and cheap(er) houses

At a fundamental level, Queensland's strong economic performance has been leveraged off a high rate of population growth. Over the year to the June quarter 2007, the state's population increased by 2.2% - the fastest of any state or territory – to currently stand at almost 4.2mn people. Population growth is being driven in broadly equally measures by natural increase, international immigration, and interstate immigration, but it is the strong net inflow from other states and territories that sets it apart from the pack. Over the past year, Queensland has attracted a net inflow of 27,000 people from other states and territories, significantly better than the next best performer, Western Australia, which attracted a net interstate inflow of 4,400 people last year.

Everyone wants to live in Queensland!



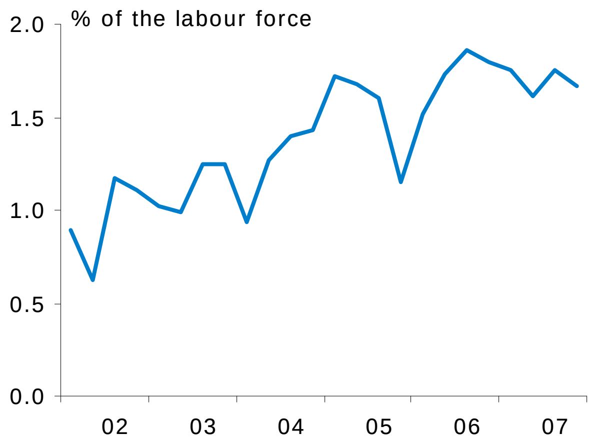
Sources: Australian Bureau of Statistics and Economics@ANZ

The reasons why people relocate states are complex and varied and may reflect non-economic factors such as climate and family considerations. That said, economic considerations explain at least some of the movement, and on this front, it is not difficult to see why everyone wants to live in Queensland.

A key attraction of the Sunshine State is the relatively affordable cost of housing. With a median house price of $387,000 as at the September quarter 2007, Brisbane prices are around three-quarters that of Sydney's. That said, the gap is closing, with Brisbane's median house price up more than 18% in the past year, the strongest growth of any capital city in the country.

Perhaps more importantly, however, the state economy is strong, which means jobs, and lots of them. Over the past year, employment has grown by 3.6%, a full one percentage point above the national rate. As a result, the unemployment rate has fallen to 3.8% as at November 2007, up slightly from rates of 3.4% earlier in the year, but nonetheless still near generational lows. The labour market looks set to remain tight with job vacancies, an indicator of labour demand, hovering near historic highs.

Labour demand remains strong in Qld



Sources: Australian Bureau of Statistics and Economics@ANZ

Not surprisingly against this backdrop, wage claims have accelerated. Over the year to the September quarter, wages in Queensland grew by 4.5%, among the highest rates in the nation, and up from rates closer to 4% a couple of years earlier.

'tis the season to spend...

Tight labour market conditions are proving a boon for households. In 2006-07, gross household disposable incomes in the state grew by 10.1%, largely reflecting very strong growth in employee compensation and further income tax cuts.

Strong growth in incomes and wealth (associated with increases in house prices) is fuelling consumer confidence and ultimately, spending. Over the year to the September quarter, household consumption increased by 4.6% in real terms. And partial data suggest that this momentum carried into the important Christmas trading period, with nominal retail sales up 0.6% in November and a staggering 11.2% over the year. Amongst the strongest performers in recent months have been retailers of discretionary goods such as recreational goods, hospitality and services, and household goods retailers.

In contrast to other states (with the exception of South Australia), Queensland's residential construction industry is faring rather well. Dwelling investment increased by 8% over the year to the September quarter 2007 and in trend terms, building approvals are running at a 13-year high. Despite this, the industry is still struggling to keep pace with underlying demand. We estimate that there is already a housing shortage equivalent to 6½ months production. This shortfall is expected to grow to 8½ months production in 2008 as interest rate rises cap any significant acceleration in home building.

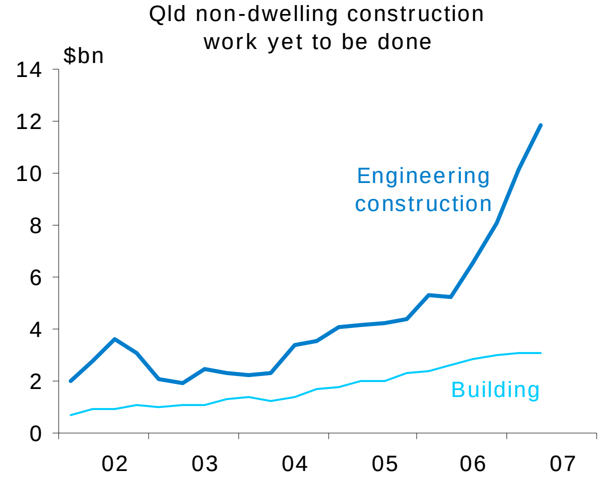
...and invest

Outside of housing, the construction industry is booming, spurred on by strong demand, high levels of capacity use and a massive public infrastructure investment program. Private business investment increased by 16% in 2006-07, driven by strong gains in engineering construction (up 32%), machinery and equipment investment (up 13.5%) and non-residential building (up 12.3%). Meanwhile, public investment increased by a massive 24% last year.

Investment looks set to be a major driver of growth for some time yet, with the pipeline of non-residential construction work yet to be done rising sharply in recent years. Engineering construction work yet to be done, for example, has more than doubled in the past year alone, reflecting a more than twelve-fold increase in water-related projects, a more than eight-fold increase in bridges, railways and harbours, and a doubling of road-related work. Non-residential building work yet to be done has also increased significantly, albeit more modestly, and currently stands at a record level of over $3bn.

While Queensland's economic outlook remains very bright indeed, capacity constraints loom as a cloud on the horizon, threatening the state's capacity to meet burgeoning demand for goods and services.

The pipeline of work to be done will sustain the construction industry for years to come



Source: Australian Bureau of Statistics

The labour market remains the epicentre of concerns. Despite very strong growth in its labour force, the unemployment rate remains near historic lows. There are now only a little over two unemployed people for each job vacancy in the state, down from over six just a few years ago. Meanwhile, the investment boom occurring in both Queensland and elsewhere around the country has intensified competition for already scarce skills.

There is no quick fix for such entrenched labour shortages. Temporary employment programs may help at the margin, as will the lucrative packages being offered by some employers to lure students, employees from other states and from other professions. But in the end, the only real solution will require significant investment in education, skills and training, and this will take time. It seems likely that Queensland's investment boom will continue, but over time and over budget.

Economic data – Queensland

Monthly data (% change)	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07
Retail sales	2.5	1.4	0.4	0.9	0.1	0.6
Private building approvals	11.1	-7.1	4.2	0.8	9.6	-8.0
Employment	0.2	-0.2	0.4	0.5	0.2	0.4
Unemployment rate, %	3.5	3.7	3.6	3.8	3.8	3.8
Quarterly data (% change)	**Jun-06**	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**
Household consumption	0.8	0.6	0.9	1.9	0.6	1.1
Private investment	-0.1	2.4	1.5	9.3	0.4	-2.3
Public demand	-1.1	6.7	0.5	-2.4	11.0	0.7
State final demand	0.2	2.3	1.0	2.8	2.7	0.1
Population, ann. % ch.	0.5	0.5	0.5	0.7	0.5	n.a.
Median house price – Brisbane, $'000s	322.4	327.6	336.0	350.0	372.1	386.9
Annual data (% change)	**03-04**	**04-05**	**05-06**	**06-07**	**07-08 (f)**	**08-09 (f)**
Gross state product	6.4	4.6	3.6	4.9	5.5	4.5
Employment	3.3	5.2	3.5	4.6	3.3	2.8
Consumer prices – Brisbane	2.9	2.6	3.1	3.3	3.6	3.0

Sources: Australian Bureau of Statistics and Economics@ANZ

Western Australia: The good times roll on

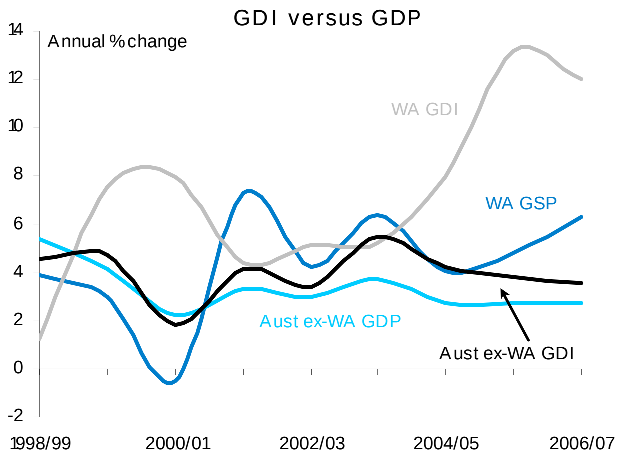
Alex Joiner, Economist, Australia

Economic prosperity continues in Western Australia, which recorded 6.3% annual growth in gross state product in 2006-07. This is the fastest rate of growth of all states and territories and almost twice the national average of 3.2%. Outperforming growth rates have resulted from the exposure of the WA economy to the ongoing commodity price boom.

Commodities boom fuelling incomes

As of November, in terms of value, WA produced over a third of Australia's merchandise exports. The strength of international trade has added not only directly to the economic growth bottom line, but indirectly through almost all sectors of the economy. On top of adding to GSP growth, the improvements in the state's terms of trade have delivered just under 12% growth in gross state domestic income in 2006-07. This is compared with an average of 3.5% growth in gross domestic income in the rest of the country. As a result since 1999-00, terms of trade gains have been on average worth $10,990 to each Western Australian, over three times the Australian average of $3,252.

Terms of trade boosts state incomes



Source: Australian Bureau of Statistics

This boost in the incomes of both businesses and individuals has seen the state economy firing on all cylinders. Business investment expanded a massive 22.2% in 2006-07 and contributed 4.5% to the GSP growth result. This rapid expansion of business investment is expected to continue, driven ever higher by the mining sector which is scrambling to add to production capacity to take advantage of elevated commodity prices and strong global demand.

Household consumption also grew rapidly in the year, expanding 5.5% and contributing 2.4ppts to the GSP growth. This rate of consumption growth has been underpinned by a significant jump in household disposable incomes. Tax cuts, a tight labour market and the exposure of much of the corporate sector to the commodity boom saw disposable income grow by 10.1% in the year to 2006-07, well above the national average of 7.4%.

Strong prospects driving population growth

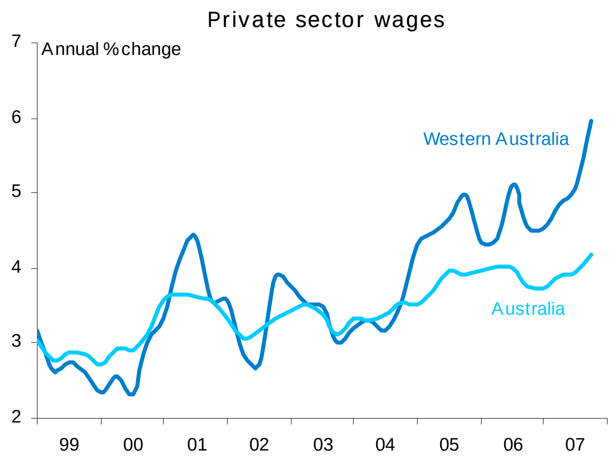
With all this in mind, it is no wonder that the state is experiencing a population boom. The promise of strong employment prospects and a relatively high income has seen the WA population expand at just over 2¼% per annum in the year to June 2007, the fastest pace in 17 years. However, unlike Queensland (the only other state in which population growth also exceeds 2%) it is net overseas migration that is driving the increase, rather than net interstate migration. In the year to June, four times as many people entered WA from inward overseas migration than from other Australian states.

Despite this strong rise in population, labour market conditions remain relatively tight. Partial indicators have come off slightly in recent months, yet demand for labour remains very strong in the face of limited supply. The supply-side constraints on the labour market have seen the participation rate level off above 68%, yet this figure remains well in excess of the national average.

Labour market remains tight…

Unemployment also remains below what is seen in other states. The unemployment reached a low of 2.8% in April last year, the lowest level since 1974. However, this rate has edged up into the mid-3% range late in 2007 with labour force growth outstripping employment growth as people flock to WA to find employment. This continued inflow of people should alleviate a labour shortage that has constrained business expansion across many sectors. With employment growth picking up in 2007-08 this should see the unemployment rate ease marginally to around 3-3¼%.

Wages take off



Source: Australian Bureau of Statistics

Such a low level of unemployment will continue to fuel wages growth. Unsurprisingly, wages in WA have been growing at the fastest rate in the country, expanding 5.7% in the year to September

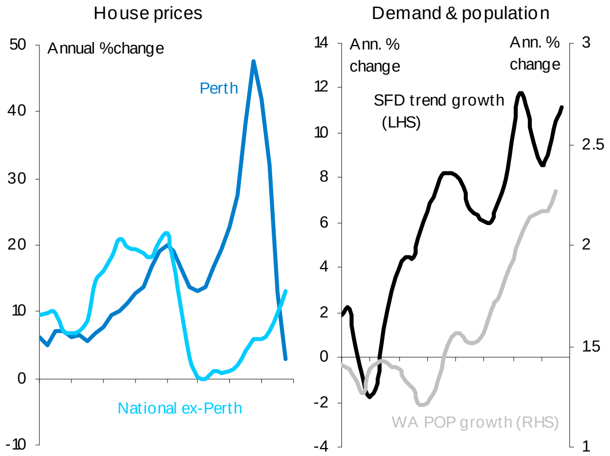
2007. Average weekly ordinary time earnings (AWOTE) in WA reached $1,184 in September, the highest of any state and second only to the ACT.

...as does the housing market

This ongoing strength of population and wages growth has led to the housing market being amongst the tightest in the country. Further, the robust economic environment should maintain a floor under the WA property market and, despite widespread doomsday commentary, will avert a significant correction.

House price growth slowed to just 2.8% through the year to September, yet this was not entirely unexpected given there was almost 50% annual growth in prices last year. In the wake of recent interest rate hikes, combined with a doubling of median house prices since late 2003, housing affordability has clearly become an issue and this will continue to cap house prices in coming quarters.

Strong economy fuelling population growth



Source: Australian Bureau of Statistics

Despite this, housing approvals and commencements have continued to fall from the peaks reached in late 2005 as interest rates have climbed. Consequently, demand for housing will remain robust in what will continue to be a tight market. With affordability putting home purchase out of the reach of many, rental vacancy rates have fallen to 20-year lows. Ongoing tightness in the rental market has seen rents skyrocket with increases in advertised rents in excess of 35% in the year to September (Residex). A chronic shortage of housing going forward combined with strong economic growth will provide continued support for house prices and rents in coming years.

Prosperity to continue

Going forward, the WA economy is expected to remain very strong. This is despite base metal prices most likely reaching cyclical peaks. It is anticipated very strong increases in bulk commodities prices throughout 2008 should ensure further improvements in WA's terms of trade, which will continue to provide external economic stimulus. The WA Treasury forecasts GSP growth of 7.0% in 2007-08. This result is expected to be driven by strong business investment of over 15% in the year, underpinned going forward by significant build-up of engineering construction work yet to be done. In addition, with income growth anticipated to remain solid, household consumption growth of just under 5% should also contribute significantly to economic expansion going in the year ahead. We do not disagree with the sentiment of these forecasts, although expect slightly weaker growth of 6.5%.

Economic data – Western Australia

Monthly data (% change)	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07
Retail sales	0.9	0.2	0.7	1.0	-1.0	1.9
Private building approvals	9.7	-19.5	2.7	16.8	-12.0	13.5
Employment	0.5	0.8	0.2	-0.1	0.1	-0.3
Unemployment rate, %	3.8	3.3	3.2	3.5	3.6	3.4
Quarterly data (% change)	**Jun-06**	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**
Household consumption	1.0	1.4	1.7	1.7	0.7	1.8
Private investment	10.9	-9.0	9.1	8.9	8.0	-0.3
Public demand	1.9	2.1	-0.2	1.5	0.5	-2.3
State final demand	4.4	-2.0	3.8	4.1	3.3	0.3
Population, ann. % ch.	0.4	0.5	0.5	0.7	0.5	n.a.
Median house price – Perth, $'000s	402.8	447.4	462.6	465.0	454.8	459.8
Annual data (% change)	**03-04**	**04-05**	**05-06**	**06-07**	**07-08 (f)**	**08-09 (f)**
Gross state product	6.4	4.0	4.8	6.3	6.5	4.5
Employment	1.3	4.2	4.9	2.5	3.0	2.0
Consumer prices – Perth	2.1	3.2	4.3	3.9	3.3	2.8

Sources: Australian Bureau of Statistics and Economics@ANZ

South Australia: On the cusp of revitalisation

Mark Rodrigues, Senior Economist, Australia

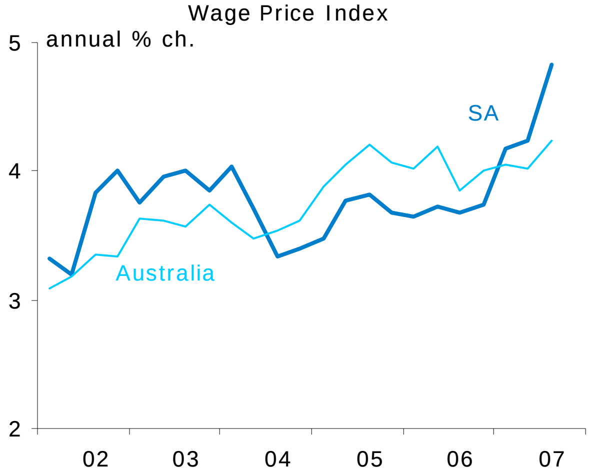
South Australia's economy is on the cusp of revitalisation, spurred on by income and activity associated with its mining industry. If it follows the template provided by Western Australia, Queensland and the Northern Territory, which are now at more mature phases of their own mining booms, then we can expect the benefits to broaden well beyond the initial investment-related expenditure. Employment and wages growth will accelerate, flowing through to household spending, and consumer and house price inflation. At the same time, population growth will pick up, nourishing a self-reinforcing cycle. Overall, economic growth is forecast to accelerate to 3.5% in 2007-08, from a paltry 0.8% in 2006-07.

The boom hasn't begun yet, but there are signs it's just around the corner

But before we get too excited, we should note that the state is only at the very start of what is likely to be a number of years of strong economic outcomes. In fact, the latest data on state demand are anything but inspiring: state final demand actually fell by 0.2% in the September quarter 2007 and was up by only 1.3% on an annual basis.

But there are early signs of better days to come, particularly from the consumer sector. Retail sales have increased strongly in recent months, to be up 8% in the year to November 2007. The willingness of consumers to spend money more freely no doubt reflects improved conditions in the state's labour market. Wages growth has accelerated to 4.8% over the year to September, up over one percentage point from 3.7% a year earlier, and second only to Western Australian wages growth.

South Australian wages have accelerated sharply over the past year



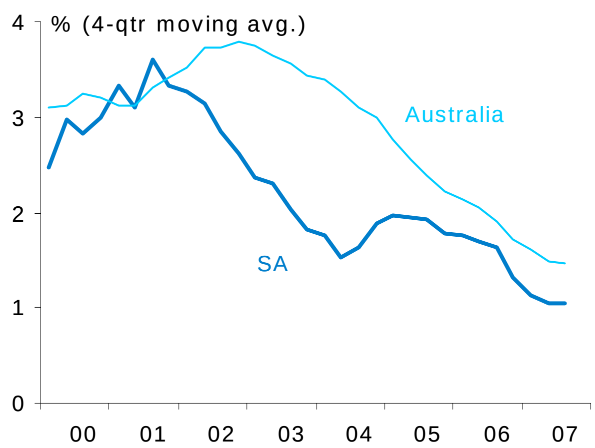
Source: Australian Bureau of Statistics

Employment growth is also starting to accelerate. Jobs growth was 2.1% over the year to November, up from a recent low of just 0.2% in July. Not surprisingly, the unemployment rate has begun to creep lower, and now stands at 4.8%, down from an average of 5% over the course of 2007. While tight by South Australia's historical standards, current unemployment rates of 3.4% in Western Australia and 3.8% in Queensland provide some indication of how much further the unemployment rate might fall as activity in the state accelerates.

Another sure sign of consumer confidence in the prospects for the state is the strength of the local housing market. Adelaide's median house price increased by more than 5% in both the June and September quarters of last year to be 16.2% higher over the year. This was one of the strongest rates of house price growth in the country over the past year, alongside Brisbane and Melbourne.

The residential construction industry has already begun to respond. Investment in new dwellings increased by 12.7% in the September quarter alone, and by a staggering 21% over the past year. And prospects for the year ahead look promising too, with the November 2007 level of building approvals some 32% higher than a year earlier. That said, the acceleration in residential building activity is only just keeping pace with the rise in underlying demand. The industry is struggling to eat into the significant stock of pent-up demand for new housing stock, which we estimate to be equivalent to a little over one year of production. As a result, we do not see much relief from the tight housing market conditions that have seen residential vacancy rates in Adelaide plummet to 1.1% (the lowest of all the state capitals), and advertised rents surge 22% over the year to September.

Adelaide's housing market remains historically tight



Sources: Real Estate Institute of Australia and Economics@ANZ

The seeds of revival are being sown by South Australia's miners

The seeds of South Australia's anticipated economic revival are being sown in its mining industry. High commodity prices are finally beginning to spur activity in the local industry, with mineral exploration expenditure surging 80% in 2006-07 and some large mining projects – notably Oxiania's

$775mn gold and copper mine at Prominent Hill – nearing completion. But above and beyond anything else, the state's hopes are riding on the planned expansion at BHP Billiton's Olympic Dam copper and uranium mine. The project is still in its feasibility study stage, but the numbers coming out are pretty spectacular: the expansion is estimated to cost $6.3bn and will lift copper production to 500,000 tonnes per year from a current capacity of 200,000 tonnes.

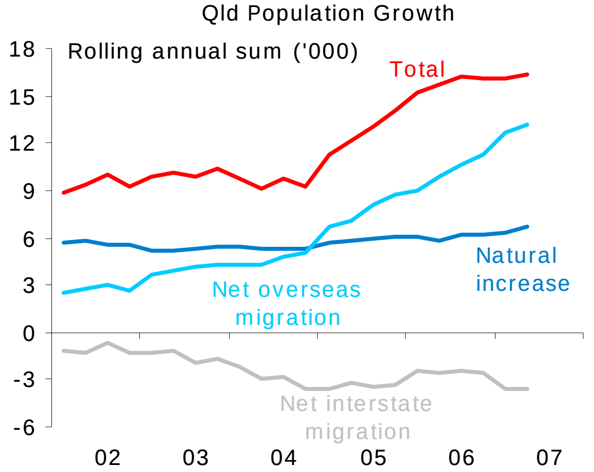
Business investment in the state has eased from recent peaks, but is likely to pick up again over the course of 2008 and beyond as the Olympic Dam expansion project moves from the feasibility stage to construction. The stock of engineering construction work yet to be done was some 87% higher in the June quarter 2007 than a year earlier, reflecting large increases in outstanding work in heavy industry and electricity generation, transmission, distribution and pipelines. Perhaps more anecdotally, Adelaide now has cranes on its skyline, a site not seen in many years!

Some challenges ahead

The South Australian economic outlook is not without its difficulties. In the rural sector, drought continues to affect outcomes. ABARE again downgraded its forecast for winter crop production in the state to just 4.55Mt in 2007-08. This is just 60% of the pre-drought level of 7.39Mt in 2005-06. Recent above-average rainfall in the state has improved soil moisture levels and seasonal water allocations for state's irrigators. But significantly more rain will be needed in coming months to secure the normal post-drought recovery in 2008-09.

At a more fundamental level, and as we have noted previously, South Australia will need to address longer term issues around its low rate of population growth if it is to permanently lift its rate of economic growth. While population growth has picked up marginally in recent years, reflecting higher rates of international migration, at around 1% per annum, the state maintains the second slowest rate of population growth in the nation. To address this problem, the government will need to come to grips with why it consistently loses more of its citizens to other states and territories than it lures from them. There is some hope on this front over the next few years, with the strengthening economy and the flow of jobs from the coming resources boom in the state likely to attract people in greater numbers than before.

South Australia continues to lose its citizens to other states and territories



Source: Australian Bureau of Statistics

Economic data –South Australia

Monthly data (% change)	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07
Retail sales	1.7	0.2	0.8	0.8	1.1	0.4
Private building approvals	0.2	-0.6	5.1	34.8	-19.1	26.0
Employment	-0.1	-0.3	1.6	-0.2	0.4	0.8
Unemployment rate, %	4.9	4.9	4.7	4.7	5.4	4.8
Quarterly data (% change)	**Jun-06**	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**
Household consumption	1.1	0.3	0.0	1.3	0.5	1.2
Private investment	-2.2	3.2	-2.1	5.6	0.7	-5.8
Public demand	-0.1	2.7	1.7	-3.5	0.5	1.4
State final demand	0.2	1.4	-0.1	1.1	0.5	-0.2
Population, ann. % ch.	0.2	0.3	0.2	0.4	0.2	n.a.
Median house price – Adelaide, $'000s	285.2	287.0	294.7	300.0	317.0	333.3
Annual data (% change)	**03-04**	**04-05**	**05-06**	**06-07**	**07-08 (f)**	**08-09 (f)**
Gross state product	4.3	1.2	2.4	0.8	3.5	4.0
Employment	1.9	1.4	2.0	1.7	3.0	2.3
Consumer prices – Adelaide	3.0	2.3	3.2	2.6	2.8	2.9

Sources: Australian Bureau of Statistics and Economics@ANZ

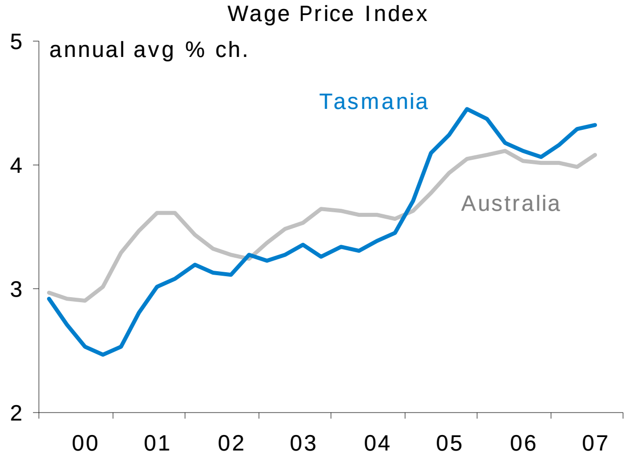
Tasmania: The 'other' mining boom state

Julie Toth, Senior Economist, Industry

Tasmania's economy grew by 2.1% in 2006-07, weaker than the big mining boom states to the north and west, but better than NSW or South Australia. Annual state final demand was buoyed by private investment, with household consumption growing more slowly but still making a positive contribution. In contrast, data for September 2007 shows private investment falling off but household consumption accelerating a touch.

Mining and related activity continues to rocket along. Several tin and nickel processing projects (together worth over $100mn) are underway at Mt Bischoff, Renison and Avesbury in the north-west, and exploration expenditure is at record levels, with $41.5mn spent on mineral and petroleum exploration in 2006-07 (up 68% from 2005-06), plus another $14mn in September 2007 alone.

Tasmanian wages are rising faster than average



Source: Australian Bureau of Statistics

As on the mainland, Tasmanian agriculture remains drought affected, with below-average rainfall state-wide through late 2007. The northeast and central midlands regions are officially drought-declared for assistance purposes. All other regions were declared eligible for interim assistance from September 2007. Forecasts for the first quarter of 2008 indicate only a 50-50 chance of above average rainfall at best.

Tasmanian building and construction remains relatively flat, with virtually no growth in the last six months in building or engineering construction work done, in work yet to be done, or in residential dwelling approvals. In heavy infrastructure construction, the state's electricity transmission company, Transend, recently announced plans to spend $100mn on transmission lines at Risdon Vale.

Despite these flat spots, Tasmania's labour market is performing well, with employment growth rates tracking above the national average through late 2007. The State's wage price index has grown faster than the national index in every quarter since March 2005 (on an annual average basis), pushed higher by wage rises in mining and utilities. Tasmania's relatively high unemployment rate improved in November 2007 but it remains second only to the Northern Territory. Tasmania's older demography means its participation rate (61%) is consistently lower than the national rate (currently 65.3%).

Although employment and wages are up, Tasmanian retail trade and new car sales growth have been weaker than elsewhere. Monthly retail trade growth was flat or negative through late 2007. Annual new vehicle sales in 2007 were up only 3.3% from 2006, against a national increase in vehicle sales of 9.1%.

In 2007-08 we expect Tasmania's economic growth to accelerate appreciably, to 3.3%, with employment growth of 2.3%. Local inflation is expected to stay below the national average, at around 2.4% — good news for Tasmanian households and businesses alike.

Economic data –Tasmania

Monthly data (% change)	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07
Retail sales	1.4	0.0	1.2	-1.5	-0.2	0.6
Private building approvals	-13.3	-6.1	6.5	10.1	-8.4	2.2
Employment	-1.0	1.1	-0.1	0.9	-0.3	0.6
Unemployment rate, %	5.3	4.9	5.4	4.9	5.7	5.2
Quarterly data (% change)	**Jun-06**	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**
Household consumption	1.1	0.2	2.7	1.1	0.2	1.7
Private investment	-4.4	-9.9	2.3	6.0	5.2	-2.2
Public demand	0.1	-12.5	11.3	-1.2	2.5	0.7
State final demand	-0.2	-4.8	4.7	1.3	1.6	0.8
Population, ann. % ch.	0.1	0.1	0.2	0.2	0.1	n.a.
Median house price – Hobart, $'000s	262.7	268.0	272.4	280.0	287.8	299.0
Annual data (% change)	**03-04**	**04-05**	**05-06**	**06-07**	**07-08 (f)**	**08-09 (f)**
Gross state product	4.7	3.2	2.8	2.1	3.3	3.0
Employment	4.5	2.7	3.2	0.8	2.8	1.8
Consumer prices – Hobart	2.5	3.2	3.2	2.5	2.7	2.6

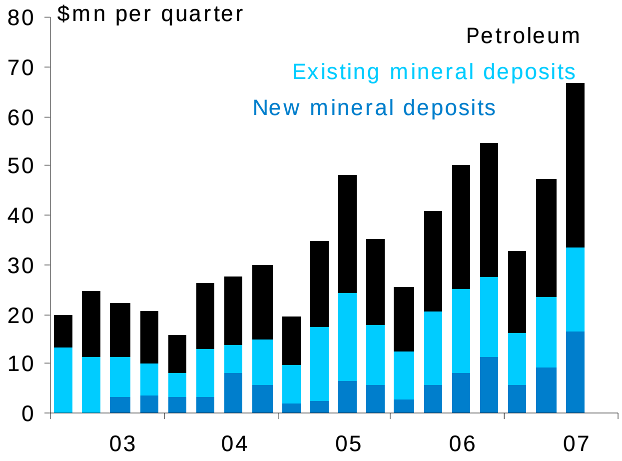
Sources: Australian Bureau of Statistics and Economics@ANZ

Northern Territory: Past the peak but still powering ahead

Julie Toth, Senior Economist, Industry

The Northern Territory's economy grew by 5.6% in 2006-07, second only to the other mining giant, Western Australia. There are signs, though, that outside the dominant mining sector, the Territory's growth momentum is now easing. Household consumption kept growing strongly to September 2007, but private investment contracted in the last two quarters and employment growth has stalled.

NT mining exploration spending at record highs



Source: Australian Bureau of Statistics

Mining and related activity continues to underpin the Territory's economy. Mineral and petroleum exploration is particularly significant at present, with exploration expenditure rising to record levels in 2007. Investment in mining capacity is also running hot, with nine advanced infrastructure projects underway, worth a total of $1.26bn, plus another 13 less advanced projects in train. Current major infrastructure projects include the offshore Blacktip gas platform and linked Bonaparte gas pipeline, a liquid helium plant near Darwin and expansion of processing capacity at Ranger.

Outside mining, the real value of engineering construction in the Territory fell in each quarter of 2007, while building construction was volatile from quarter to quarter. Building work yet to be done, or approved but not yet commenced, increased each quarter, indicating a construction backlog is building up due to labour shortages or other reasons.

The Territory's labour market is small, uniquely specialised and quite volatile. Employment grew 5.5% in 2006-07, the highest annual growth anywhere in Australia. Since June 2007 however, the monthly increases in employment have decelerated, with no growth at all in November (although November employment was still 6.1% higher than a year earlier). With a relatively young and mobile population, the Territory has the highest labour force participation rate in the country by far, at 73.8%, compared with a national rate of 65.2%. But as of November 2007, it had the highest unemployment rate also, at 5.4% (trend).

This slowing in employment growth is not yet evident in consumer spending, with retail trade and new car sales still growing strongly. Retail trade climbed steadily through 2007, to be up 10.6% from 2006 by November (seasonally adjusted). New car sales increased by 7.2% in 2007 — slower than the national increase of 9.1% but nevertheless solid.

Overall, we expect the Territory's economy to grow by 5.0% in 2007-08. This will be its slowest annual growth rate in four years, but it still represents a very strong performance — only Western Australia and Queensland are expected to grow faster in 2007-08. After phenomenal growth in 2006-07, employment in the Territory is already slowing and will halve to 2.3% growth in 2007-08. The remoteness of Darwin and lack of local food production will again see local inflation running well above the national average in 2007-08.

Economic data –Northern Territory

Monthly data (% change)	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07
Retail sales	1.6	0.4	0.4	0.6	0.7	1.6
Private building approvals (trend)	1.9	-0.9	-2.8	1.0	-1.0	-24.0
Employment (trend)	1.0	1.0	0.8	0.5	0.3	0.0
Unemployment rate, % (trend)	4.5	4.5	4.6	4.8	5.1	5.4
Quarterly data (% change)	**Jun-06**	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**
Household consumption	0.0	1.2	0.5	2.4	2.2	2.9
Private investment	-4.6	13.1	-20.1	9.9	-8.6	-0.8
Public demand	1.7	0.0	1.9	-0.2	-2.8	4.4
State final demand	-0.7	3.9	-5.0	3.3	-2.2	2.5
Population, ann. % ch.	0.5	0.6	0.3	0.6	0.5	n.a.
Median house price – Darwin, $'000s	355.9	360.6	378.1	389.5	387.8	407.7
Annual data (% change)	**03-04**	**04-05**	**05-06**	**06-07**	**07-08 (f)**	**08-09 (f)**
Gross state product	2.0	5.5	5.5	5.6	5.0	3.8
Employment	-2.9	-1.2	2.9	5.5	5.0	2.3
Consumer prices – Darwin	1.4	2.2	3.4	4.4	3.9	2.9

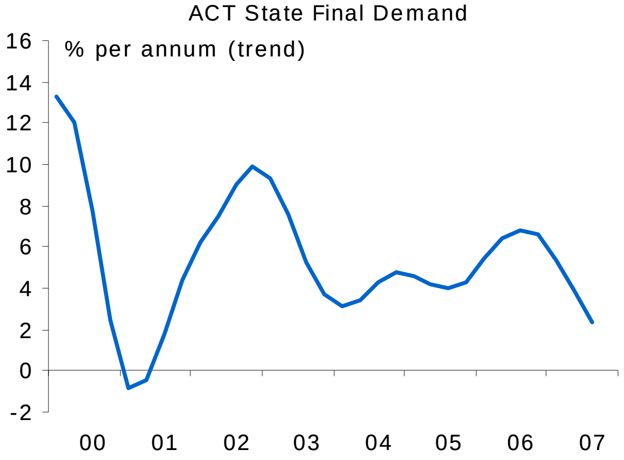
Sources: Australian Bureau of Statistics and Economics@ANZ

Australian Capital Territory: Signs of slowing

Wain Yuen, Economist, Industry

Following strong growth of 5.0% in 2006-07, the ACT economy now appears to be slowing. According to the latest data, state final demand declined by 1.9% in the September quarter 2007, reflecting softer consumption growth and the greatest decline in private business investment since June 2004.

The ACT's economy is slowing



Source: Australian Bureau of Statistics

Other indicators depict a similar story. For example, retail sales declined by 0.3% in November 2007, remaining only 2.8% higher than a year ago. This is the ACT's weakest result since April 2005 and stands in marked contrast to the national scene which saw retailers enjoy a bumper lead up to the Christmas season.

It may be that the Federal election kept ACT residents away from the shops in November, but other factors are likely to play a less transient role. Higher petrol prices and higher interest rates have curtailed the ability of consumers to spend.

In addition, employment growth remains subdued. Since October 2006, the monthly trend growth in employment has been either flat or negative. Arguably, the ACT's labour market has hit supply constraints with the unemployment rate at just 2.7%, the lowest in Australia, and the participation rate at 72.1%, significantly above the Australian average of 65.2%. Yet there are some signs that labour demand is slowing with the *ANZ Job Advertisement* series showing that the number of ACT newspaper job ads fell by 0.4% in December. It may be that the new Federal Government's announced savings measures are keeping a lid on hiring activity in Commonwealth Departments.

At the same time, private business investment continues to fall following the phenomenal growth rates in 2005-06 associated with the development of new government office buildings.

On a brighter note, population growth continues to accelerate, rising to 1.7% in the year to June 2007. Until recently, ample employment opportunities have lured people to the ACT, with net interstate migration at its highest level since March 1993. However, the new government's savings announcements represent a risk to the continuation of this trend.

Faster population growth is putting further pressure on an already stretched housing market. We estimate that underlying demand for housing is already running well ahead of supply, generating higher prices and rents. House prices increased by 11.2% in the year to September, and rental vacancy rates have fallen below 2%. As a result, rental price growth is likely to pick up from the already solid 15% rise seen in the year to September. These conditions should prompt a lift in dwelling construction, with building approvals increasing by 32.1% in trend terms over the year to November.

Economic data –Australian Capital Territory

Monthly data (% change)	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07
Retail sales	0.6	-1.6	2.1	-0.4	0.4	-0.3
Private building approvals (trend)	0.9	-4.3	-8.2	-10.9	-9.4	28.8
Employment (trend)	0.0	0.0	0.0	0.0	-0.1	-0.1
Unemployment rate, % (trend)	2.9	2.8	2.7	2.6	2.6	2.7
Quarterly data (% change)	**Jun-06**	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**
Household consumption	1.5	0.9	1.2	1.8	0.1	0.1
Private investment	19.8	-2.3	-1.2	1.1	-1.8	-4.0
Public demand	3.3	1.4	1.7	-1.3	4.2	-2.7
State final demand	4.4	0.8	1.2	0.0	2.2	-1.9
Population, ann. % ch.	0.3	0.3	0.4	0.5	0.5	n.a.
Median house price – Canberra, $'000s	405.4	416.7	423.6	430.0	445.9	463.3
Annual data (% change)	**03-04**	**04-05**	**05-06**	**06-07**	**07-08 (f)**	**08-09 (f)**
Gross state product	1.8	2.4	3.4	5.0	2.5	3.2
Employment	0.1	2.1	1.2	3.8	0.0	1.3
Consumer prices – Canberra	2.6	2.3	3.6	2.9	3.2	2.8

Sources: Australian Bureau of Statistics and Economics@ANZ

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