Economics@ANZ

States and Territories Economic Update

Differences in state economic performance will narrow in 2007-08

18 May 2007

Inside:

Authors:

Tony Pearson
Head of Australian Economics
+61 3 9273 5083
Tony.Pearson@anz.com

Mark Rodrigues
Senior Economist, Australia
+61 3 9273 6286
Mark.Rodrigues@anz.com

Riki Polygenis
Senior Economist (acting), Australia
+61 3 9273 4060
Riki.Polygenis@anz.com

Amber Rabinov
Economist, Australia
+61 3 9273 4853
Amber.Rabinov@anz.com

Our Vision:

For Economics@ANZ to be the most respected, sought-after and commercially valued source of economics research and information on Australia, New Zealand, the Pacific and Asia.

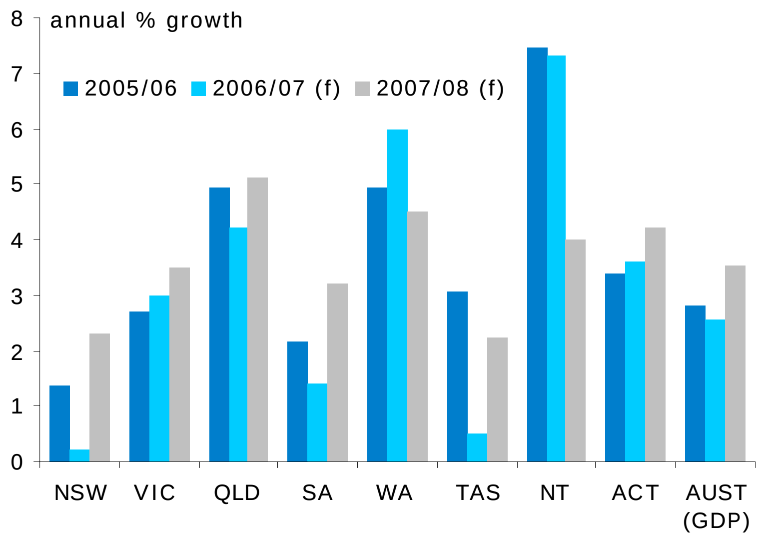
Overview

The Australian economy entered 2007 with considerable momentum. Retail spending was strong supported by solid growth in household incomes, positive wealth effects from higher asset prices and a rebound in consumer confidence. Household demand for finance reaccelerated, suggesting a waning impact from the three interest rate increases in 2006, and the unemployment rate returned to the lowest level in over 30 years. At the same time, business conditions and profitability remain buoyant, supported by continued strength in commodity prices. These positives were partly offset by the severe drought which has reduced rural incomes to the lowest level in over ten years, and the rise of the A$, to a 16-year high in April, which has tempered incomes of exporters and made life more difficult for import competing industries. Nevertheless, in aggregate, domestic demand appeared to strengthen in the first quarter of 2007, after ending 2006 on a strong note.

This positive economic environment is expected to continue through 2007 and 2008. Global economic conditions are expected to remain supportive, and growth in Australia's key commodity export markets will remain robust. Commodity prices are expected to ease by about 15% by the end of 2008, but this will be offset by increased export volumes helping maintain the superior economic performance of the commodity rich states of Western Australia, the Northern Territory and Queensland.

Further out, these relativities may begin to change. There are now good prospects for a rebound in dwelling investment from late 2007, as housing markets begin to respond to the growing deficiency of dwellings built in recent years. This rebound will be most intense in NSW, adding to growth in employment and spending in that state. It may also be associated with some renewed upward movement in dwelling prices which will add to household wealth and consumption. But even then, these improved growth prospects in the medium term will only help to narrow the growth differential with the resource rich states, rather than close it.

State and territory GSP



Source: Australian Bureau of Statistics and Economics@ANZ

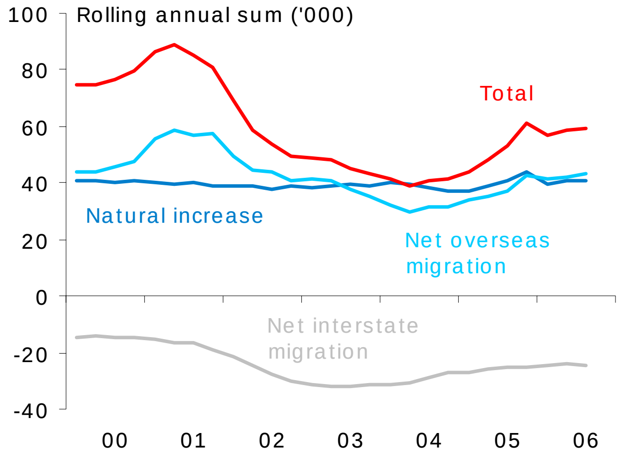
New South Wales

Recent data paint a brighter picture of the New South Wales economy. State final demand rose by 1.4% in the December quarter 2006, the strongest quarterly increase for two years. This reflected a solid rise in household consumption, a small rise in business investment after three quarters of decline, an increase in dwelling investment and a very large increase in public sector investment. Less volatile trend data suggest the low point for the economy was in mid 2006, with an improved (albeit still tepid) performance in the second half of the year.

One factor behind this better performance is a slight lift in population growth. The annual rate of population growth broadly halved between 2001 and 2004 to around 0.6%, but by the September quarter 2006, had reaccelerated to around 0.9%.

The key driver of the turnaround in NSW population growth has been increased overseas migration, a consequence of the Commonwealth Government's increased immigration program. On the downside, there is still a high flow of interstate emigration, i.e. people leaving NSW to move to other states and territories. Most recent data show this exodus has diminished slightly, but NSW is still losing 24,000 people a year to other regions within Australia.

Sources of NSW population growth



Source: Australian Bureau of Statistics

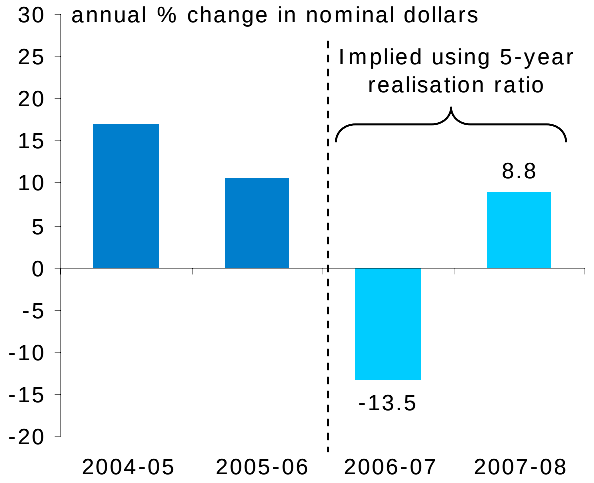
For the past three years the chief source of weakness in the NSW economy has been the collapse in dwelling investment. The downturn in this sector has been milder but more protracted than the slump in 2000-01. Trend data suggest the downturn was most severe in 2004 and might now be near its trough. However, it is premature to declare the commencement of the upturn. Dwelling construction approvals in March 2007 totalled 2,498 in trend terms, the lowest number since data were first collected in July 1984. Moreover, the three interest rate increases last year would not yet have fully impacted on this sector, and it is likely approvals – and therefore construction – will weaken further in the short term.

There is, however, light at the end of the tunnel. Dwelling completions are running well behind demographic requirements. Economics@ANZ estimates that NSW currently needs to build 45,000 dwellings a year, but completions have been running below requirements since 2001 and in 2007 completions are projected to be only 29,000. This shortfall is sowing the seeds for recovery, with a tightening in rental vacancy rates and rising rents. This demographic pressure is expected to prompt a strong adjustment in construction, beginning in late 2007 and swelling through 2008. This in turn will sow the seeds of a significant lift in employment growth, spending and overall economic activity.

Sydney remains the weakest residential market of the capital cities, and the sobering news is that the downward trend in house prices since end 2003 may still have some way to run. Prices of established houses fell by another 0.4% in the March quarter, taking the cumulative decline from the peak in the December quarter 2003 to 8%.

The weakness in dwelling investment was accompanied by a sharp fall in business investment in 2006. It is not just that the rate of growth that has eased; in real terms, business investment actually fell and approached the severity of the slump in 2000-01. Having said that, there are grounds for hope that this sector has turned the corner. As noted above, business investment increased, albeit modestly, in the December quarter, and the latest survey of business capital spending intentions points to a 9% lift in business investment in nominal terms in NSW in 2007-08.

CAPEX survey suggests NSW business investment will rebound in 2007-08

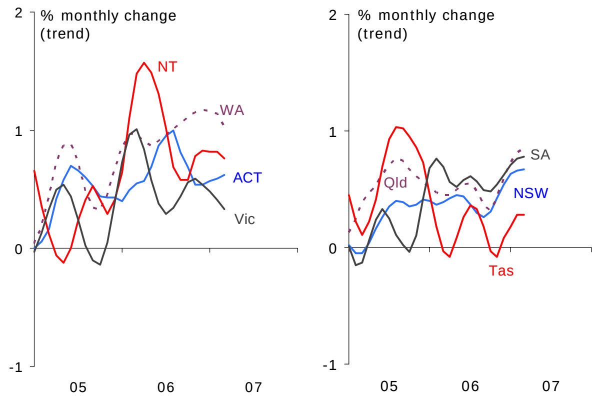


Sources: Australian Bureau of Statistics and Economics@ANZ

Households have been doing their bit to keep the NSW economy afloat, with growth in retail spending accelerating in the first three months of 2007 to a trend rate in excess of 0.6% per month, about double the pace of the September quarter 2006. This was despite the dragging impacts of higher interest rates, and reflected in part the slight lift in population growth as well as more general buoyancy in household disposable income.

Acceleration in spending by NSW households

Retail Sales

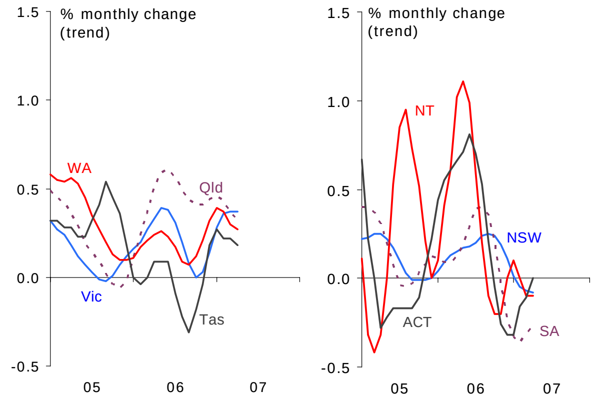


Source: Australian Bureau of Statistics

Recent soft economic outcomes in NSW are reflected in its labour market. Trend employment actually fell in February, March and April, at a time when trend employment growth for Australia as a whole was strong, led by Victoria, Queensland and WA. The unemployment rate has been stable for some months at 5.1%, but is still only where it was in the middle of 2005.

NSW employment growth has weakened

Employment Growth



Source: Australian Bureau of Statistics

In the half yearly budget review the Government revised down its forecasts of gross state product (GSP) growth in 2006-07 to 1½% from 2½% at budget time. This now looks optimistic; the performance over the first two quarters of the year points to growth of only 0.2%. Prospects are better for 2007-08, with a rebound in dwelling investment and recovery in rural production lifting growth to 2¼%. Over the medium term, the Government expects growth to return to around 3¼%pa.

NSW Budget

The NSW budgetary position will deteriorate in 2006-07, although the mid-year update (released in December 2006) suggests not by as much as expected at budget time. Nevertheless, NSW is the only state to project an operating deficit in 2006-07. The general government budget result for 2006-07 is now expected to be a deficit of $497mn, which is an improvement of $199mn on the budget estimate. This change reflects increased projected investment income due to the strongly performing equity markets and a reduction in expenses flowing from workers compensation and tort law reforms. This improvement has been balanced by a slight worsening in the fiscal position in 2008-09 and 2009-10, although the budget is still expected to return to sustained surplus by 2007-08. The 2007-08 state budget is due for release on Tuesday 19 June. NSW retains its AAA rating.

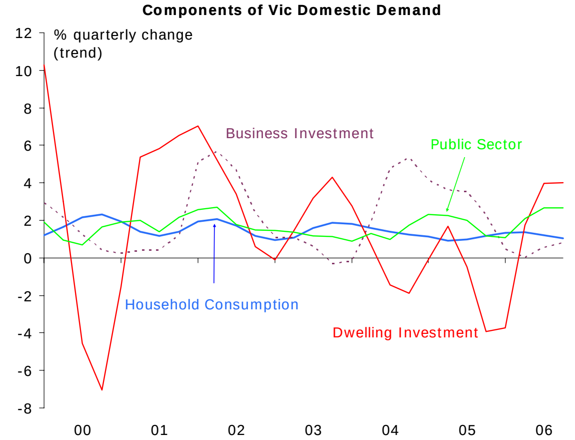
Victoria

Victoria's economic performance remains robust, particularly given its low exposure to the resources boom. State final demand in the December quarter 2006 rose by 0.9%, and followed two quarters of similarly solid growth. The December quarter result reflected a firm rise in household spending (0.9%), a sharp increase in public sector investment (25.7%), partly offset by small falls in dwelling and business investment.

Trend data provide a clearer picture of the recent strength of the Victorian economy. Household spending remains solid although has eased slightly; business investment is bouncing from its lows; and investment in dwellings has recovered strongly from a soft spot in late 2005 and early 2006. Spending by the public sector is also contributing solidly to growth.

Victoria is firing on all cylinders

Components of Vic Domestic Demand

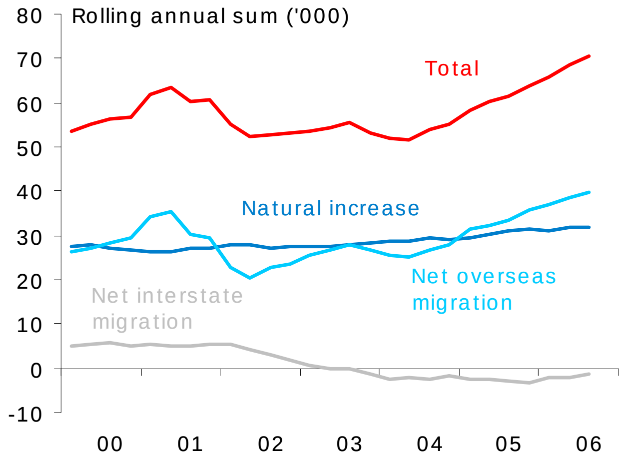


Source: Australian Bureau of Statistics

Underpinning Victoria's relatively strong economic performance is a rate of population increase that is high for a non-resources state. Victoria's population growth has been above 1%pa through this decade, and by September 2006 had accelerated to just over 1.4%pa. The surge has reflected increased international immigration and a slight lift in births. Interstate migration has switched from a small positive early in the decade to a small negative now, but to put that in perspective, Victoria only loses about 2,000 people a year to other states, compared to the annual haemorrhage from NSW of 24,000. In net terms Victorians mostly choose to remain in Victoria!

Population growth is helping to satisfy increasing demand for labour. This has been reflected in a marked pick up in trend employment growth to 3.0%pa in April 2007, from 1.2% in early 2006. This has driven Victoria's unemployment rate down to 4.8%, down from 5.4% at the start of 2006, and Victoria now boasts the lowest unemployment rate of the non-resource states. The strong labour market has also encouraged more people into the labour force, with the participation rate rising to 65.2%, the highest level since July 1990. Together with solid wages growth (3.5% over the year to December), labour market strength is underpinning rapid growth in household incomes.

Victorian population boosted by stronger immigration



Source: Australian Bureau of Statistics

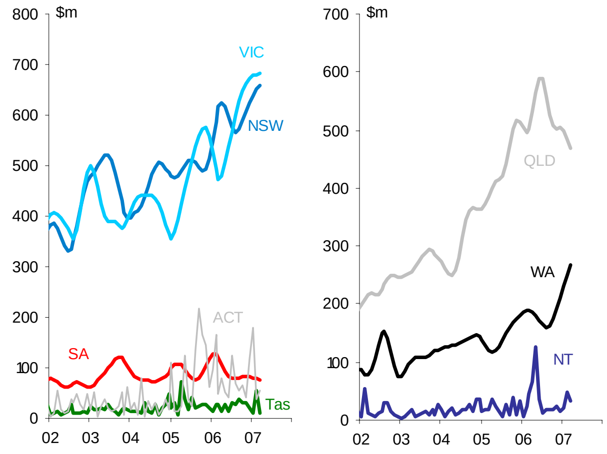
Rapidly growing household incomes have helped sustain household demand for finance in the face of the three rate hikes in 2006. Housing loan approvals (excluding refinancing) rebounded by almost 8% in the three months to March, reflecting a 9% increase in owner-occupier approvals and a 5% rise in approvals for investors.

Against this backdrop, house prices in Melbourne are increasing, albeit gently. In the March quarter 2007, prices of established houses rose another 1.7%, taking annual growth to 7.4%. The cumulative increase in prices since the end of the housing boom on the east coast in the latter part of 2003 is now 12.5%. This is not a heroic pace of increase relative to Perth and Darwin, but is a much better performance than Sydney.

The recent improvement in house price growth is not likely to prompt an immediate pick up in dwelling construction. Although dwelling investment bounced back in the June and September quarters of 2006, recent movements in dwelling construction approvals suggest this upturn may have been short-lived. Dwelling approvals fell consistently in trend terms in the second half of 2006, and while have stabilised in February and March 2007, remain at the lowest level since early 2001. This points to renewed softness in Victorian dwelling construction in the first half of 2007. Later in the year, dwelling approvals should lift as demographic pressures start to build and as confidence returns following a period of stability in interest rates in 2007.

On the other hand, a dramatic pick up in non-dwelling building approvals and high levels of work yet to be done augur well for business investment in coming years. In fact, the value of Victorian non-dwelling building approvals is now higher than in all other states and territories.

Non-dwelling building approvals



Source: Australian Bureau of Statistics

The Victorian Government expects economic growth to accelerate to 3.25% in 2007-08 from 2.75% in 2006-07. This looks a little pessimistic and appears to be based on quite conservative labour force assumptions, with the unemployment rate assumed to increase back up to 5.0% and employment growth slowing considerably to 1.25% in 2007-08. We expect economic growth in Victoria to be higher at 3.0% in 2006-07 and 3.5% in 2007-08.

Victorian Budget

In its 2007-08 Budget, the Victorian Government implemented a number of tax cuts and spending initiatives, while still maintaining a sound fiscal position. The operating surplus in 2007-08 is projected at $324mn, about half the surplus of $622bn in 2006-07. Between 2008-09 and 2010-11, the surplus is projected to average $424mn.

In 2007-08, revenue and grants received are expected to increase by 2.8% to $34.3bn. Within this, total taxation revenue is projected to increase by just 1.0%, with the Budget implementing further reductions in land tax and Workcover premiums and a fall in the effective motor vehicle rate. Meanwhile, expenses are projected to rise by 3.7% to $33.9bn. Major spending initiatives in the Budget include significant funding boosts for education (including a school rebuilding program), health, public housing, public transport and roads. Altogether, Victoria has committed a further $13bn to infrastructure investment in the next four years, following the over $16bn already spent since 2000-01.

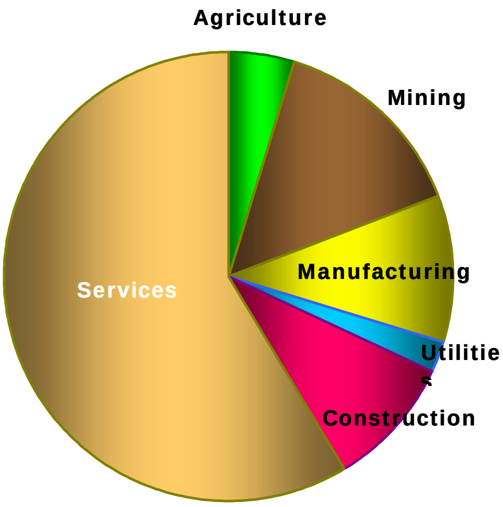
As a result of the Budget's record infrastructure spending, general government net debt will increase from $3bn now (1.2% of GSP) to $8.8bn in June 2011 (2.9% of GSP). Notwithstanding the increase, net debt will remain substantially below the levels seen in the mid-1990s. Victoria's AAA credit rating is not threatened by the higher debt according to a Standard and Poor's statement.

Queensland

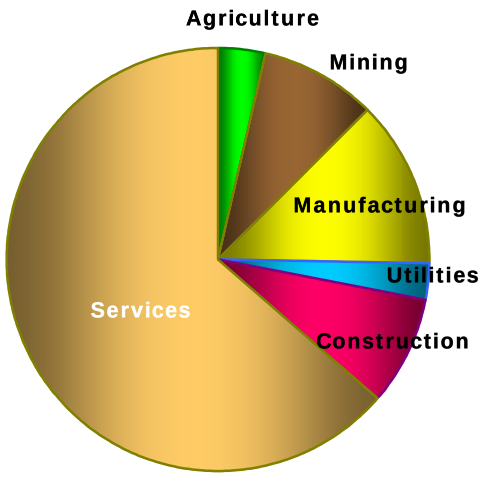
Queensland continues to cruise at the high end of the nation's 'two-speed' economic divide. GSP increased by 4.9% in 2005-06 – on par with the other boom state of WA and well above the national average of 2.9%. All indications are that this robust economic momentum continued into 2006-07, with state final demand up 6.7% over the year to the December quarter 2006. Growth has been broadly based, with household consumption, dwelling and business investment and public demand all contributing strongly to growth over the past year.

Queensland's strong economic performance is underpinned by two fundamental drivers. First, like WA and the NT, it is benefiting from a relatively high exposure to mining and the current resource commodity price boom. Mining accounts for almost 15% of Queensland's economy, compared with 9% for the Australian economy more broadly. And this likely understates the state's overall exposure to the mining sector, with much of its services, manufacturing and construction industries engaged in mining-dependent activities.

Composition of the Queensland economy, 2005-06



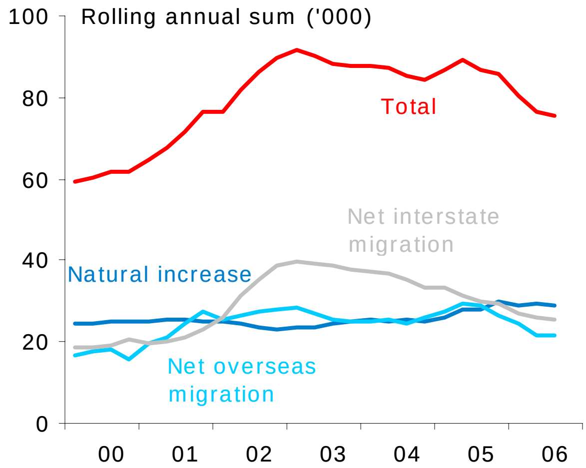
Composition of the Australian economy, 2005-06



Source: Australian Bureau of Statistics

Second, population growth in Queensland has consistently, over a long period of time, been faster than other states (although it has recently been overtaken by WA), resulting in stronger demand in that economy. Over the year to the September quarter 2006, Queensland's population grew by 1.9%, to tip the scales at just over four million people. This compares with a national rate of 1.3% over the same period. In addition to natural increase (the excess of births over deaths) and net overseas migration, which are an important source of population growth for all states and territories, Queensland also sources a significant amount of its population growth from interstate, particularly NSW. Over the year to the September quarter 2006, net interstate migration to Queensland was 25,276 persons.

Sources of Queensland population growth



Source: Australian Bureau of Statistics

Queensland's residential construction industry is faring better than counterparts elsewhere in the south-eastern seaboard. In trend terms, there were 3,350 new dwelling approvals in March 2007, 8.1% higher than a year ago. Notwithstanding this, strong population growth and soft market sentiment following last year's rate rises means that supply is struggling to keep up with underlying demand. The current approvals level translates to an annual completion rate of around 37,000 dwellings, somewhat below our estimate of underlying demand of 41,000 dwellings per annum.

Rental vacancy rates have already begun to tighten, and are now at 1.7% - the lowest level since the late 1980s. Against this backdrop house prices have begun to rebound, increasing by 2.9% in the March quarter alone, to be 10.2% higher over the year. Conditions in the Queensland housing market are likely to tighten further over the coming year, with underlying demand continuing to accelerate and the prospect of another interest rate hike likely to weigh on market sentiment in the near term.

The dividends of recent stronger economic growth are most clearly visible in the state's labour market. Employment growth accelerated to a stunning 5.8% over the year to April 2006, up from 1.4% a year earlier. As a result, the unemployment rate now stands at 3.4% - the lowest on record and well below the national rate of 4.4%.

Improved labour market outcomes bode well for the Queensland economy going forward. Stronger employment growth has boosted household disposable incomes with compensation of employees up 11.7% over the year to the December quarter 2006. This, in turn, will have a feedback effect to household consumption and demand in the economy more broadly. Overall, we expect the economy to continue to track at around recent rates of between 4¼% and 5% for the next few years.

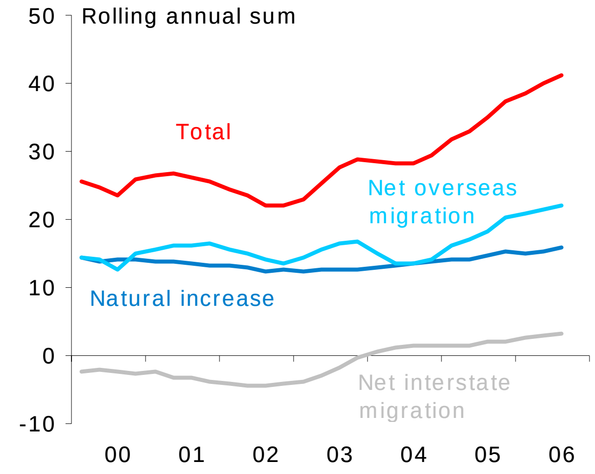
The next update on the Queensland economy will be available with the release of the government's 2007-08 budget on Tuesday 5 June 2007.

Western Australia

Everyone wants to live in Western Australia. Population growth over the year to September 2006 was just over 2%, the fastest population growth of any of the states and territories. This has reflected increased international immigration, as part of the Commonwealth Government's effort to ease labour market constraints, and has also been the result of increased migration from other states, with over 3,000 people in net terms heading west each year.

The big attraction – other than the lifestyle – is jobs. WA has the lowest unemployment rate – 2.7% in March – which has been achieved despite the strong growth in the labour force, indicating an ongoing very strong demand for labour. Feedback from employers suggests that finding and retaining suitable labour is now a significant constraint on the operation and expansion of business.

Sources of WA population growth



Source: Australian Bureau of Statistics

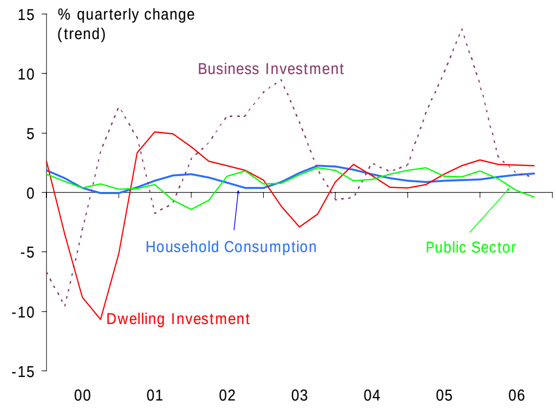
Growth in WA has been driven by all components of domestic demand, with solid investment in dwellings, household consumption and business investment.

Household consumption remains supported by strong employment growth, the highest pace of wages growth in the country, and strong wealth gains from equities and residential housing.

Growth in business investment slowed through 2006 signalling that the strongest phase of the mining investment boom is over. Nevertheless, forward estimates of engineering work yet to be done suggest there is a significant amount of work still in the pipeline (over three years work at the current pace), which points to a continued high level of business investment for the next few years. In addition, the value of non-residential building approvals was up 28% in trend terms over the three months to February, and there remains a significant volume of private sector projects (mainly in mining) at the 'under active consideration' stage, although not all will proceed.

Business investment is slowing in WA

Components of WA Domestic Demand



Source: Australian Bureau of Statistics

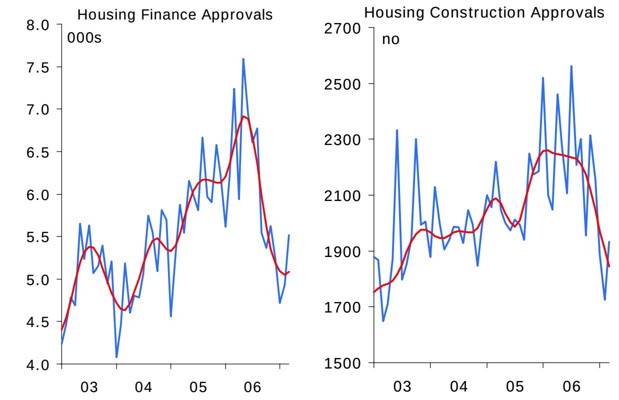
The housing sector has been very buoyant in recent years, driven generally by the increased economic prosperity and specifically by the acceleration in population growth – all those extra people have to live somewhere. This has proved a boon for the housing market, with strong gains in house prices (up 37% over the year to December 2006) and solid growth in construction of dwellings. On a more sombre note, in recent quarters there have been signs that this sector is running out of steam:

- the rate of house price growth has progressively cooled since mid 2006;
- the flow of housing finance approvals has turned down since mid 2006 with the value of owner-occupier housing finance approvals excluding refinancing in February 2007 was 25% below the May 2006 peak; and
- the number of approvals to construct new dwellings has fallen sharply, with approvals in February 2007 a third lower than the July 2006 peak.

It has been suggested these developments reflect a flight of first home buyers from the market as housing affordability has plummeted. The recent state budget delivered significant measures to address this issue, including a doubling of the stamp duty exemption threshold for first home buyers to $500,000 from $250,000. It will be some months before any post budget rebound becomes apparent.

Signs of a downturn in the WA housing market

WA Housing

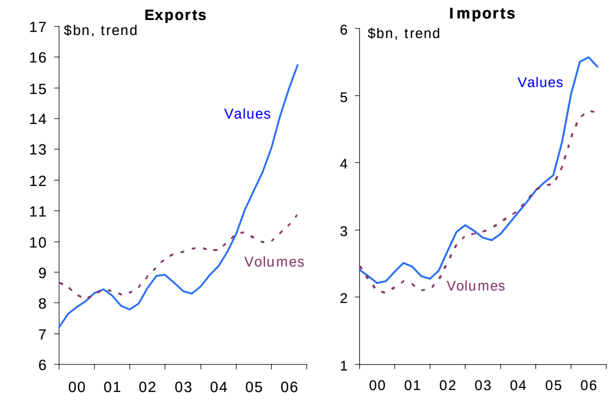


Source: Australian Bureau of Statistics

Export growth remains strong, although values have increased much more quickly than volumes, reflecting the stellar price performance of iron ore and gold, the two biggest exports of the state. Export volumes are expected to rise more quickly in coming years as new infrastructure and mines come on stream. Import volumes have also increased rapidly in response to strong household consumption and business investment.

Strong lift in both exports and imports

WA trade



Source: Australian Bureau of Statistics

The continued strong price performance of iron ore and gold continues to deliver strong income flows to the WA economy. Between January 2001 and April 2007 the price of gold in US$ has increased 2.6 times, with the price of iron ore almost tripling. The price of gold rose 8% in the first four months of 2007 alone, with the price of iron ore up 5% in the spot market over the same period. And the price gains may not be over yet; futures markets suggest a little further upside in the gold price and there are hints of a further increase in iron ore contract prices in the current round of price negotiations. A continuation of high prices for commodities relevant to WA will help to support business investment, employment and income flows.

Western Australian Budget

The Western Australian budgetary position continues to be buoyed by massive revenues from the commodity boom. This has allowed the government to fund rising recurrent costs and to lower taxes while still maintaining a considerable operating surplus throughout the forecast period. The surplus for 2006-07 is expected to be $1.857bn, easing to $1.453bn in 2007-08 and further declining to $0.848bn by 2010-11.

A key feature of the 2007-08 Budget was tax relief worth $2.1bn over the next four years. The residential sector was a big winner. First home purchasers will no longer pay stamp duty when purchasing properties up to $500,000 (previously $250,000), with the exemption phasing out at $600,000. There was also a lift in the land tax exemption to $250,000 from $150,000. The market will be watching to see if this provides a new spark to residential property.

The budget surplus will be allocated to fund some but not all of an expanded capital works program. Part of the 2006-07 surplus will be used to fund the $1.09bn Fiona Stanley hospital with the remaining $750mn allocated to develop new water sources and a range of other infrastructure projects. Revenues will not be sufficient to fully fund the capital works program and so the net debt position of the public sector as a whole is projected to rise over the four years from 2007-08, roughly doubling from $4.2bn at end 2006-07 to $8.2bn at end 2010-11. This is not expected to impact on the AAA credit rating as the net debt to revenue ratio for the whole non-financial public sector will remain comfortably below the government mandated maximum of 47%, with a ratio of 38% projected for 2010-2011.

The economy is expected to remain very strong. The Treasury forecasts GSP to lift to 6% in 2006-07 from 4.9% in 2005-06, supported by continued strong household consumption and business investment, and with a big lift in export volumes. Growth is then expected to ease to 4.5% in 2007-08 as the consequence of a slight easing in growth of consumption and investment, and a small fall in dwelling investment.

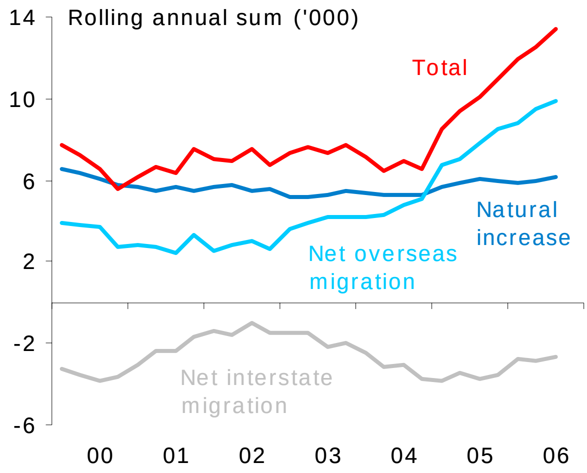
South Australia

South Australia's economic performance has been less than spectacular, with growth in GSP of just 2.2% in 2005-06 – the lowest of any state or territory with the exception of NSW.

There is tentative evidence that the economy is on the mend, however. State final demand increased by a respectable 0.6% in the December quarter 2006 to be 2.5% higher over the year. And more recent partial data confirm that the economy commenced 2007 with considerable momentum, with retail sales up by 1.8%, 1.4% and 0.7%, respectively, in the first three months of 2007, to be running at an annual rate of 8.9%.

Signs of an improvement in South Australia's economic fortunes coincide with an acceleration in population growth, albeit from a very low base. Population increased by 0.9% over the year to the September quarter 2006, up from 0.7% a year earlier and a trough of 0.4% in 2004, driven by an increase in net overseas migration. Net interstate migration remains a drag on overall population growth.

Sources of South Australian population growth



Source: Australian Bureau of Statistics

Recent signs of improvement in economic conditions, if sustained, should flow through to the labour market. The lagged effect of slower growth earlier in 2006 has seen employment growth ease since the middle of 2006, in stark contrast to the rest of the country, to be just 0.6% over the year to April 2007. The current unemployment rate of just 5.3% and participation rate of 62.0% falls well short of national benchmarks, and leaves plenty of scope to meet labour demand as the economy picks up.

Notwithstanding the recent improvement, soft population growth will continue to weigh on South Australia's residential construction industry. Underlying demand is now just 8,800 dwellings per annum, and is likely to fall further in coming years. While building approvals have fallen by 4.3% over the past year (to March 2007), the current level translates to around 9,900 dwelling completions a year, pointing to a modest excess supply emerging in coming years.

While economic growth in South Australia should continue to improve, it will remain hampered by low population growth and exposure to a couple of key industries undergoing structural adjustment, including automotive manufacturing, fisheries and wine. That said, South Australia stands to benefit from a massive increase in capital expenditure on defence in coming years and, government policy permitting, a potential expansion of uranium supply capacity. On balance, we expect economic growth to accelerate from a low of around 1½% this year to 3¼% in 2007-08.

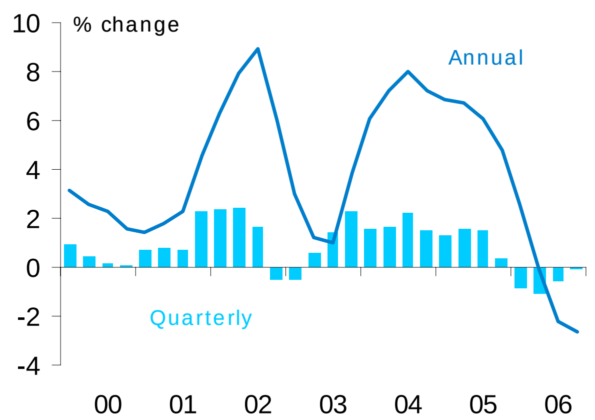
The next update on the South Australian economy will be available with the release of the government's 2007-08 Budget on Thursday 7 June 2007.

Tasmania

Annual growth in the Tasmanian economy averaged 3.7% between 2001-02 and 2005-06, 0.4ppts faster than the national average. However, in recent quarters Tasmanian economic growth has begun to lag behind that of other states. This is not surprising given the effect of the resources boom, if anything, is more likely to have been negative than positive for the state. In particular, manufacturing and agriculture (which account for a greater proportion of economic activity than in any other state) have been adversely affected by the strong A$ (largely induced by high resource commodity prices) and with respect to agriculture, also by both drought and frosts.

Softness in economic activity reflects declines in both public and private investment spending. Note that given the small size of the Tasmanian economy, the economic data tend to be quite choppy. As GSP data are only released on an annual basis, we can construct GSP estimates, calculated as state final demand plus international exports less international imports. Care should be taken when using these estimates as they exclude interstate trade (for which we do not have data). Although only partial, these estimates help to provide a good indication of how the economy is tracking. In trend terms, these estimates show that the Tasmanian economy shrank in every quarter during 2006, and is likely due to the aforementioned drop in investment as well as the significant slowing in population growth since the beginning of 2004.

Estimated trend Tasmanian GSP has been weak

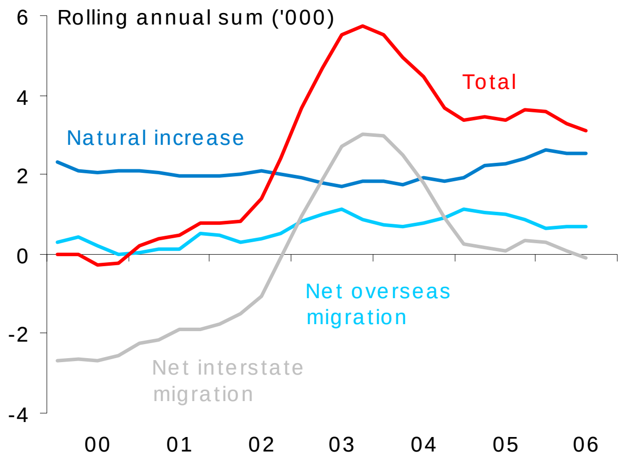


Source: Australian Bureau of Statistics, Economics@ANZ

A remarkable improvement has been made in the labour market in recent years: the unemployment rate has halved from a peak of 10.9% in October 1997 to 5.4% in April 2007 (in trend terms), with 0.8ppts of the fall occurring in the last six months alone. After stalling in 2006, there are tentative signs that employment growth is picking up again in 2007. However, the participation rate has dropped 0.4ppts in trend terms over the same time period and has now fallen 1.2ppts from its recent peak in December 2005.

Population growth in the Apple Isle has slowed over the past three years as the positive inflows from other states have come to an end. In the mid 2000s, people were drawn to Tasmania by lower living costs. However, the growing population drove up demand for housing, and consequently house prices and construction activity and costs. House prices in Hobart have doubled since the end of 2002, and after slowing in 2005 and 2006, have once again picked up to annual rates of just over 10%.

Sources of Tasmanian population growth



Source: Australian Bureau of Statistics

Conditions for retailers have been tough of late, with real retail sales actually falling by 0.5% over the year to the March quarter. In annual average terms, real retail sales have grown by around half of the national average (2.1% versus 4%). This is despite the above-mentioned fact (that Tasmanian real GSP has grown faster than the national aggregate over the past five years).

Tasmanian Budget

The Tasmanian budget update (published in February 2007) revised down the general government net operating balance for 2006-07, with a deficit of $111mn now expected (originally forecast to be $90mn). Although revenues have been revised up by 2.1% since the 2006-07 Budget, expenses are expected to be 2.6% greater than initial estimates. The net operating balance is then expected to improve to deficits of $81mn and $12mn in 2007-08 and 2008-09 respectively. The net debt situation has further improved to -$286mn (i.e. total assets are greater than total liabilities). Forecasts improve further in the out years. Although the general government sector remains debt free, there is still much debt in the public non-financial corporations sector, estimated in the budget update at $1683mn for 2006-07. The 2007-08 Budget is due to be handed down on Thursday 7 June 2007.

Tasmania retains its AA+ credit rating from Standard & Poor's. Moody's upgraded its rating of Tasmania to Aaa (the agency's top rating) from Aa1 in December 2006.

Northern Territory

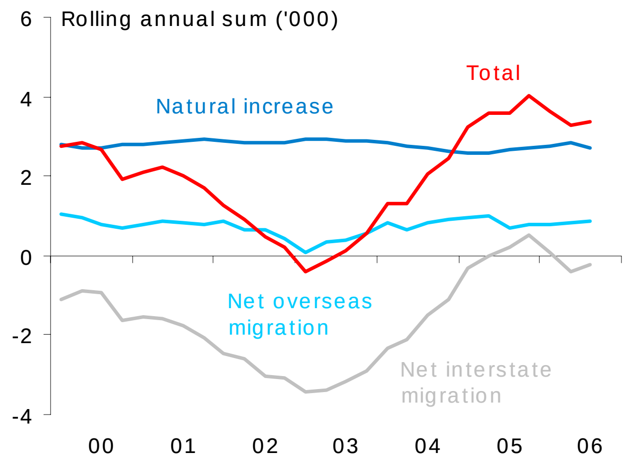
The Northern Territory is Australia's smallest economy, accounting for just 1¼% of total GDP in 2005-06. Dominated by the mining and energy sectors, resource-based projects generate large swings in income and investment streams, and result in quite volatile economic growth for the Territory. Consequently, state final demand data are very choppy, with business investment streams in both the private and public sector especially volatile.

For instance, the 2007-08 Budget highlights that peak production of liquefied natural gas, gas condensate and liquid petroleum gas at the Bayu-Undan fields, and increased alumina production from Alcan are expected to be the major drivers of strong growth in 2006-07. The completion of a number of major projects is likely to result in softer business investment. However, in line with recent strength in resident population and employment, strong growth is likely to be achieved in other industries.

The public sector in the NT is also large relative to those in the other states, with general government consumption and investment accounting for 31.9% of state final demand in 2006 (in volume terms).

The NT has experienced a population boost over the past few years, with people migrating from interstate (and Northern Territorians remaining at home) to take advantage of the abundance of jobs resulting from the resources boom. The NT population continued to grow solidly 2006 and has expanded by over 5% since the beginning of the mining boom in 2003. Although employment has slowed over the past number of months, growth over the past year has averaged 5.3%. This has driven the unemployment rate down to an average of 3.3% over the past six months in trend terms, down from a recent peak of 7.7% in September 2004.

Sources of NT population growth



Source: Australian Bureau of Statistics

Thanks in large part to the mining boom and in line with solid population and employment growth, retail sales have also grown strongly. In real terms, retail sales increased 6.2% in 2006 (10.2% through the year to March 2007) and have grown by a staggering 25.7% since the end of 2002. Over the past six months alone, nominal through the year growth has averaged a bumper 12.8%.

Like their counterparts in Perth, Darwin property owners have gained additional benefits from the mining boom. Since the end of 2002, house prices have soared 89%, with annual rates of growth close to 20% achieved in 2005 and 2006. However, as one of the few regions of Australia not experiencing a housing shortage, house prices are expected to decelerate in 2007, with finance and building approvals data trending downwards since mid 2006.

We expect the NT economy to continue to boom in 2006-07, with growth of around 7¼% likely easing to 4% in 2007-08.

Northern Territory Budget

The 2007-08 budget estimates an improved operating result of $31mn in 2006-07, as compared to the $17mn estimate that was published in the 2006-07 budget. The favourable revision is largely due to increased revenue related to mining royalties and stamp duty on conveyances, and the revised timing of capital payments, largely related to the Darwin Waterfront. However, some offset has been provided by increased superannuation expenses and a one-off reduction in dividends.

Going forward, the net operating surplus is expected to deteriorate slightly to $29mn in 2007-08 and then further to $8mn in 2008-09 before improving to $15mn and $38mn in 2009-10 and 2010-11 respectively. Net debt is forecast to remain largely unchanged at $1.2bn between 2006-07 and 2008-09, with some inroads to reduce net debt to around $1.1bn being made in the out years.

Moody's upgraded the Northern Territory's credit rating to Aa1 from Aa2 in December 2006.

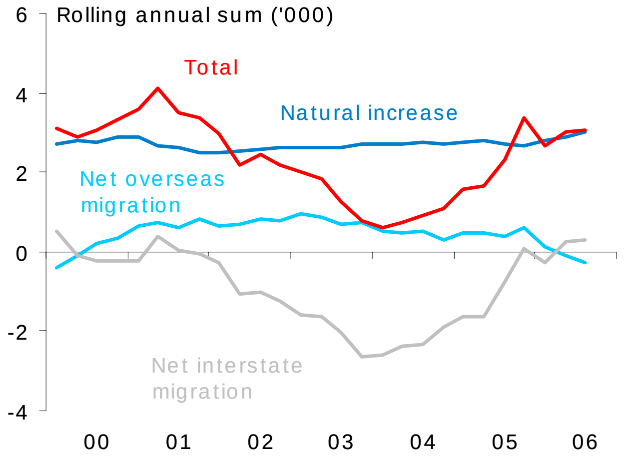
Australian Capital Territory

Growth in the Australian Capital Territory economy picked up in 2005-06, with GSP increasing by 3.4% after growth of 2% in 2004-05.

The ACT is not exposed to the mining industry, but is dominated by business and the government sector. Being the seat of the Federal government, the government sector is larger than the private sector: in 2006, public sector consumption and investment accounted for 56.1% of state final demand in volume terms.

Population growth in the ACT lifted in 2006 due to positive net interstate migration and an up tick in the rate of natural increase (births). However, the annual rate of growth, at 0.9%, is still below the total for Australia of 1.3%.

Sources of ACT population growth



Source: Australian Bureau of Statistics

The ACT has the second lowest unemployment rate in the country after WA. In trend terms, the unemployment rate dipped to a low of 2.8% in mid 2006 and has since ticked back up to 3.4%. Employment growth has been strong, hitting 5.6% in annual terms in October 2006, although growth has weakened in recent months, with the annual rate now tracking at 1.7%. We expect employment to grow by around 4.2% in 2006-07, easing to 2.5% in 2007-08.

Retail sales grew above the annual average rate for Australia in 2006. Nominal through the year growth has averaged around 8.9% over the past six months (the comparative figure for Australia is 6.8%).

House prices in Canberra have also been tracking quite strongly of late, posting growth of 9% through the year to the March quarter 2007. House prices have bounced back solidly from the small annual price declines recorded in 2004 and 2005.

Overall, we expect ACT GSP to grow by 3.7% in 2006-07, improving to 4.2% in 2007-08. Inflation in Canberra will likely continue to track below the national weighted average over the next financial year.

ACT Budget Update 2006-07

The ACT budget update (released in December 2006) estimates a revised $42.5mn operating deficit in 2006-07, a vast improvement on the $80.3mn deficit originally estimated in the 2006-07 budget. This improvement is mainly due to strong commercial conveyance returns over the past six months, improved GST revenue returns, and increased interest revenue as a result of the three interest rate rises in 2006.

The budget balance outlook over the next four years is bright, with the territory expected to enter into surplus by 2008-09 and improve again in 2009-10.The 2007-08 budget is due to be handed down on Tuesday 5 June 2007.

The ACT retains its AAA credit rating from Standard & Poor's.

Gross State Product, employment and inflation projections

		2004-05	2005-06	2006-07 (f)	2007-08 (f)
NSW	GSP (real % change)	0.8	1.4	0.2	2.3
	Employment (% change)	1.3	1.6	1.6	1.5
	CPI (Sydney, % pa)	2.5	3.0	2.6	2.2
VIC	GSP (real % change)	2.4	2.7	3.0	3.5
	Employment (% change)	3.3	1.7	2.6	1.6
	CPI (Melbourne, % pa)	2.0	3.1	2.5	2.3
QLD	GSP (real % change)	4.8	4.9	4.2	5.1
	Employment (% change)	5.6	2.9	4.8	3.3
	CPI (Brisbane, % pa)	2.6	3.1	3.2	2.5
SA	GSP (real % change)	1.2	2.2	1.4	3.2
	Employment (% change)	1.9	1.7	1.6	1.6
	CPI (Adelaide, % pa)	2.3	3.2	2.5	1.4
WA	GSP (real % change)	4.7	4.9	6.0	4.5
	Employment (% change)	4.2	4.4	2.3	2.0
	CPI (Perth, % pa)	3.2	4.3	3.8	3.1
NT	GSP (real % change)	6.0	7.5	7.3	4.0
	Employment (% change)	-2.0	3.9	4.9	2.3
	CPI (Darwin, % pa)	2.2	3.4	4.3	3.4
ACT	GSP (real % change)	2.0	3.4	3.6	4.2
	Employment (% change)	1.9	1.4	4.2	2.5
	CPI (Canberra, % pa)	2.3	3.6	2.8	2.1
TAS	GSP (real % change)	4.1	3.0	0.4	2.3
	Employment (% change)	2.9	3.3	0.4	1.0
	CPI (Hobart, % pa)	3.2	3.2	2.4	1.9
AUST	**GSP (real % change)**	**2.7**	**2.8**	**2.6**	**3.5**
	Employment (% change)	**3.0**	**2.2**	**2.6**	**2.0**
	CPI (capital cities, % pa)	**2.4**	**3.2**	**2.8**	**2.3**

Sources: Australian Bureau of Statistics; forecasts by Economics@ANZ.

ANZ Research

Economics@ANZ

Saul Eslake	**Fiona Allen**			
Chief Economist	Business Manager			
+61 3 9273 6251	+61 3 9273 6224			
Saul.Eslake@anz.com	Fiona.Allen@anz.com			
Tony Pearson	**Mark Rodrigues**	**Riki Polygenis**	**Wain Yuen**	**Amber Rabinov**
Head of Australian Economics	Senior Economist, Australia	Senior Economist, Australia (Acting)	Economist, Industry	Economist, Australia
+61 3 9273 5083	+61 3 9273 6286	+61 3 9273 4060	+61 3 9273 6295	+61 3 9273 4853
Tony.Pearson@anz.com	Mark.Rodrigues@anz.com	Riki.Polygenis@anz.com	Wain.Yuen@anz.com	Amber.Rabinov@anz.com
Amy Auster	**Katie Dean**	**Jasmine Robinson**	**Dr. Alex Joiner**	
Head of International Economics	Senior Economist, International	Senior Economist, International	Economist, International	
+61 3 9273 5417	+61 3 9273 5466	+61 3 9273 6289	+61 3 9273 6123	
Amy.Auster@anz.com	Katie.Dean@anz.com	Jasmine.Robinson@anz.com	Alex.Joiner@anz.com	
Paul Braddick	**Ange Montalti**			
Head of Financial System Analysis	Senior Economist, Financial System Analysis			
+61 3 9273 5987	+61 3 9273 6288			
Paul.Braddick@anz.com	Ange.Montalti@anz.com			
Warren Hogan	**Cherelle Murphy**			
Head of Markets Research	Economist, Markets			
+61 2 9227 1562	+61 3 9273 1995			
Warren.Hogan@anz.com	Cherelle.Murphy@anz.com			

ANZ Investment Bank

Warren Hogan	**Sally Auld**	**Tony Morriss**	**David Croy**	**Cherelle Murphy**
Head of Markets Research	Senior Interest Rate Strategist	Senior Currency Strategist	Strategist	Economist, Markets
+61 2 9227 1562	+61 2 9227 1809	+61 2 9226 6757	+44 20 7378 2070	+61 3 9273 1995
Warren.Hogan@anz.com	Sally.Auld@anz.com	Anthony.Morriss@anz.com	croyd@anz.com	Cherelle.Murphy@anz.com
Patricia Gacis				
Fixed Income Analyst				
+61 2 9227 1272				
Patricia.Gacis@anz.com				
Sarah Percy-Dove	**John Manning**	**Bradley Bugg**		
Head of Credit Research	Senior Credit Analyst	Senior Credit Analyst		
+61 2 9227 1142	+61 2 9227 1493	+61 2 9227 1693		
Sarah.Percy-Dove@anz.com	John.Manning@anz.com	Bradley.Bugg@anz.com		

Research & Information Services

Mary Yaxley	**Marilla Rough**	**Manesha Jayasuriya**
Head of Research & Information Services	Senior Information Officer	Information Officer
+61 3 9273 6265	+61 3 9273 6263	+61 3 9273 4121
Mary.Yaxley@anz.com	Marilla.Rough@anz.com	Manesha.Jayasuriya@anz.com

ANZ New Zealand

Cameron Bagrie	**Khoon Goh**	**Philip Borkin**	**Sean Comber**	**Steve Edwards**
Chief Economist	Senior Economist	Economist	Economist	Economist
+64 4 802 2212	+64 4 802 2357	+64 4 802 2199	+64 4 802 2286	+64 4 802 2217
bagriec@anz.com	gohk@anz.com	borkinp@anz.com	combers@anz.com	edwards1@anz.com
Kevin Wilson				
Rural Economist				
+64 4 802 2361				
Wilsonk1@anz.com				

Important Notice

Australia and New Zealand Banking Group Limited is represented in:

AUSTRALIA by:

Australia and New Zealand Banking Group Limited ABN 11 005 357 522

10th Floor 100 Queen Street, Melbourne 3000, Australia

Telephone +61 3 9273 6224 Fax +61 3 9273 5711

UNITED KINGDOM by:

Australia and New Zealand Banking Group Limited

ABN 11 005 357 522

Minerva House, PO Box 7, Montague Close, London, SE1 9DH, United Kingdom

Telephone +44 20 7378 2121 Fax +44 20 7378 2378

UNITED STATES OF AMERICA by:

ANZ Securities, Inc. (Member of NASD and SIPC)

6th Floor 1177 Avenue of the Americas

New York, NY 10036, United States of America

Tel: +1 212 801 9160 Fax: +1 212 801 9163

NEW ZEALAND by:

ANZ National Bank Limited

Level 7, 1-9 Victoria Street, Wellington, New Zealand

Telephone +64 4 802 2000