The CONUS Quarterly

Vol. VI - Issue 3 - Sept. 2014

CONUS

Business Consultancy Services

climate friendly business

in this issue……

Editor's Note

As well as the second quarter GDP data and commentary this issue contains an in-depth look at some of the main economic metrics for our own region.

We are starting to see real improvements in Far North Queensland with unemployment down, building approvals up and the tourism industry benefiting from the upsurge in arrivals from China (although there are still factors that are worrying). This is being reflected in an increase in investment opportunities being considered and the slow but steady rise in property values. However, as we make clear, population growth outside of the metropolitan areas of Cairns and Townsville is likely to remain a drag on growth in other regions.

If there are other topics which you would like to see addressed in future issues of The CONUS Quarterly, please do not hesitate to let us know.

In the meantime, stay up-to-date with all the latest economic news, with a particular slant to Queensland and FNQ issues, by checking out our Economics Blog.

Conus Business Consultancy Services

PO Box 441

Mission Beach

QLD 4852

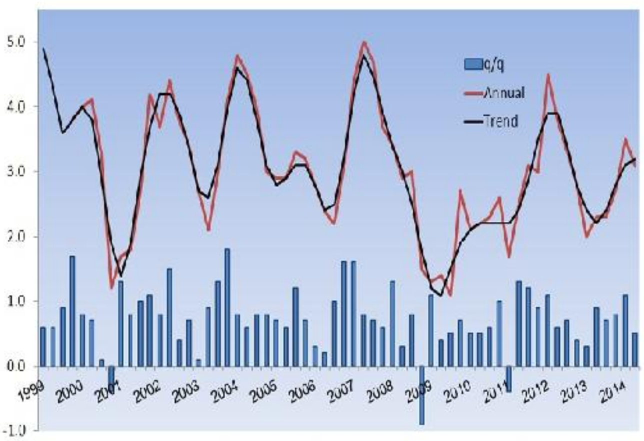
www.conus.com.au Ruth: 0419 697901 Pete: 0439 490088

2nd Quarter Australian GDP

As we suggested last quarter, after the strong +1.1% GDP growth in Q1, this quarter was unlikely to see growth sustained at those levels. And so we have seen. Second quarter GDP grew at 0.5%, for an annual increase of 3.1%. Growth therefore remains at just below long-tern trend levels.

Some of the data previously released for the quarter had pointed towards the possibility of a weaker print, so these numbers will probably be seen as rather stronger than they might otherwise have been. After a weak showing in Q1 (when they subtracted 0.6ppts from growth) it was inventories which led the way this quarter, contributing 0.9ppts. Net exports subtracted 0.9ppts after a very strong Q1, while household consumption (the largest component in GDP) rose by 0.5% q/q to contribute 0.3ppt to growth (exactly the same rate as in Q1).

GDP



Source: Australian Bureau of Statistics

With the household savings rate fairly stable at 9.4% for the past three quarters there is little sign of any significant loosening of household purse-strings. Sentiment, which appears to have suffered somewhat from the fall-out of the federal budget machinations, looks unlikely to see any major rebound any time soon.

Given that household consumption accounts for well over half of all demand, if we are to see growth return to trend then we will need to see some return to strength in the household sector.

Despite CPI rising to 3% in Q2 the Gross National Expenditure Implied Price Deflator fell to just 2%, reflecting the fact that a component of price rises (such as they are) are now coming from the import side of the economy on the back of the slight A$ weakness. This is a significant turn-around from 2 years ago when CPI was running at 1% *below* the Gross National Expenditure IPD as the A$ went from strength to strength, kept import prices low and subtracted from CPI.

While price pressures within the domestic economy remain muted, if we were to see the A$ weaker significantly further (as the RBA have made it clear they would like to see), then we can expect to see import price rises having even more of an impact on CPI.

Queensland has broken its run of negative growth quarters posting a 0.4% increase to State Final Demand; although this still equates to a 0.4% fall over the year. As the chart below makes clear, growth in Queensland has been muted (at best) for the past two years. However, we should also bear in mind that State Final Demand takes no account of exports from the state; a factor which for a major exported such as Queensland is a significant one.

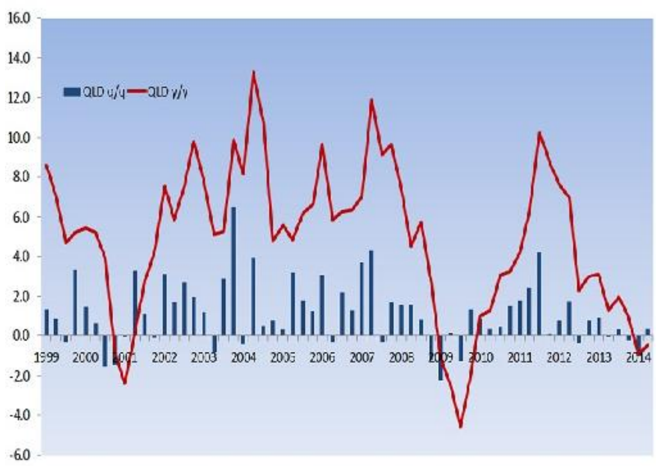
Victoria was the main driver of domestic growth with its State Final Demand up 1.2% q/q adding 0.3ppts to GDP growth.

Growth in QLD all came from public sector investment which was up 7.5%. The private sector was flat with both consumption and investment virtually static. Public sector consumption fell 0.1%.

When we consider the make-up of Queensland's State Final Demand we see that household consumption accounts for about 53%, private investment another 25% with public consumption at just 16% and public investment making up the remaining 6%. Therefore the private sector contributes fully 78% of demand, with the public sector at 22%. It is obvious therefore that, even with growth in the public sector, meaningful growth for the state must come from the private sector.

Queensland is currently struggling with a decline in mining investment which has pulled down private investment by 7.5% over the course of the last year while household consumption is up just 1.9%. Increased public sector investment (up 7.8% over the year) is no match for the rebalancing of private sector investment that we need to see both in Queensland and the nation as a whole.

QLD Final State Demand



Source: Australian Bureau of Statistics

The Far North Queensland Review

Now that we have access to the bulk of economic data for the financial year 2013-14 we thought we would take a look at some of the main indicators for the FNQ region.

We'll start with **population.** The latest available population data is for the end of 2013. If we first consider the data for the Local Government Areas in the region, we see..

LGA	2003 pop	2013 pop	% change
Cairns	130,808	168,618	+28.9
Tablelands	40,809	46,175	+13.1
Cassowary Coast	29,438	28,694	-2.5
Hinchinbrook	12,004	11,700	-2.5
Townsville	147,964	189,238	+27.9

Over the same 10 year period population in Australia has grown by 17.6% to 23,319,385 while in Queensland we have seen 23.8% growth to 4,690,910.

As we can see, the growth in both Cairns and Townsville has been impressive (and well above both national and state levels), with Cairns very slowly closing the population gap with Townsville. However, the two coastal shires of the Cassowary Coast and Hinchinbrook have both seen declines over the decade. Clearly the impacts of 2 major tropical cyclones in the space of five years have played a part in these declines.

We can also consider population by the broader SA4 regions. These are the same areas for which the monthly regional labour market statistics are reported. The SA4 of "Cairns" covers Cairns itself, Port Douglas, Daintree, Tablelands and the Cassowary Coast. Growth over the decade here has been 21.4% to now stand at 240,184.

The Townsville region (SA4) covers Townsville, Charters Towers, Ayr and Ingham. Here we have seen 21.9% growth since 2003 with population now sitting at 233,907.

We can see the impact of the non-metropolitan areas dragging growth in the broader areas down to below that seen at state level.

The Queensland Government also produce regular updates on projected populations as of the middle of the year. In their most recent projection they saw Queensland's population increasing to 7,095,177 in 2036 which would mean a 51.3% increase from the end of 2013 over those 23 years.

The projections for the SA4 areas sees Cairns increase to 346,269 (+44.2%) and Townsville to 361,098 (+54.4%).

The relevant projections for our LGAs are in the next table..

Note: Cairns includes Douglas; Tablelands includes Mareeba.

LGA	2013 pop	2036 pop	% change
Cairns	168,618	259,800	+54.1
Tablelands	46,175	58,013	+25.6
Cassowary	28,694	31,476	+9.7
Hinchinbrook	11,700	11,351	-3.0
Townsville	189,238	314,362	+66.1

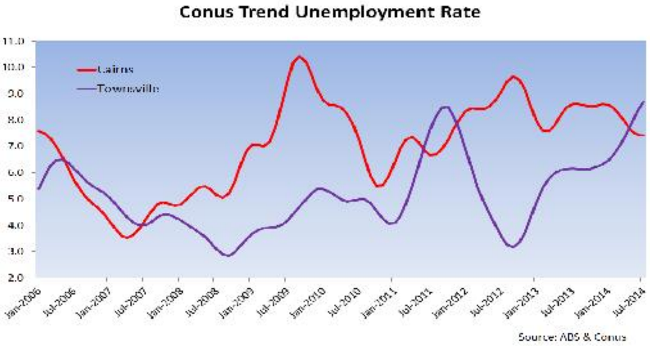
Again we see the metropolitan areas forecast to grow strongly (particularly Townsville) while the more rural areas see growth well below the state average. It will be difficult for local governments to meet the growing expectations of their rate-payers (whilst at the same time keeping rate rises to reasonable levels) unless we can see more reliable population growth in the rural regions.

Unemployment in the region has been a hot topic for some years. The latest available data from the ABS is for July 2014.

The Dept of Employment also produce quarterly data for what they call Small Areas; unfortunately this data for the first quarter of 2014 is yet to be released and the data for the final quarter of 2013 relates to old ABS statistical areas (and old pre-amalgamation councils) which makes using that data useless for comparison.

As at July 2014 the seasonally adjusted unemployment rate in Australia stood at 6.4% and was 6.8% in Queensland.

When considering the more local data the ABS produce monthly statistics for the SA4 regions but this data is presented in its original, unadjusted form. As such it can be highly volatile. In order to make some sense of this raw data we have developed the Conus Trend series for the unemployment rate, and number employed for all the various SA4 areas in Queensland. Using this Conus Trend data we get a much clearer picture of the current state of unemployment in the region. The graph below plots the Conus Trend unemployment rate for both Cairns and Townsville. In Cairns in July Conus Trend unemployment was 7.4%, in Townsville 8.7%.



The Far North Queensland Review cont..

Even when looking at a Trend series we can still see a good deal of volatility, nevertheless the trend does give us some idea of what is going on in the medium to long term.

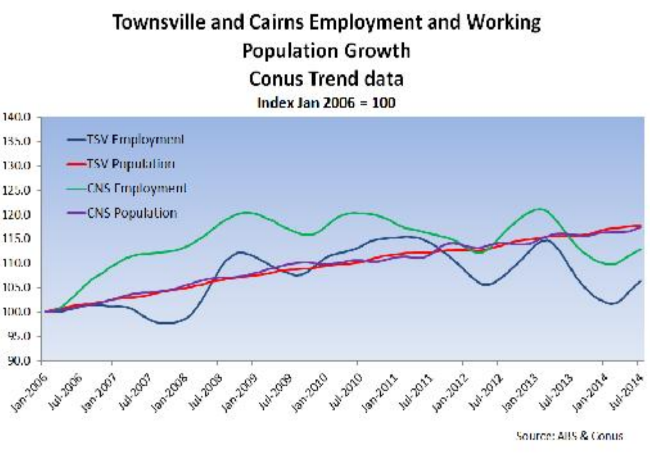
However, the headline unemployment rate does not tell us the whole picture when it come to the labour market. The Participation Rate has an enormous role to play and changes in that rate have been impacting significantly on the unemployment rate in the region (indeed, at state and national level too) for some time.

To recap; the Participation Rate (PR) measures the proportion of those of working age who are either in jobs or counted as unemployed (the labour force). If the PR falls (say, because fewer people are bothering to look for work) then, all other things being equal, the unemployment rate will fall; and vice versa.

There has been a trend over recent years for the PR to fall across the country as the demographic bulge of baby boomers reach the age at which many of them remove themselves from the labour force. This (among other things) has meant that the unemployment rate has stayed lower than might otherwise have been the case. In Cairns we have seen a recent sharp decline in PR which has certainly assisted in pushing the unemployment rate lower. A similar trend had been seen in Townsville, but in recent months has been sharply reversed as PR there has moved higher. This is one of the reasons that Townsville has seen headline unemployment rates above 10% for the past 2 months.

One way of trying to see through these “PR effects” is to consider the ratio of those employed against the working age population. This measure doesn’t consider PR, since we are not looking at the size of the labour force at all. The graph below (which uses an index for both employed and working population of 100 at Jan ‘06) plots the Conus Trend for employed and working age populations in both Cairns and Townsville.

What we see is that over the past 8 1/2 years the working

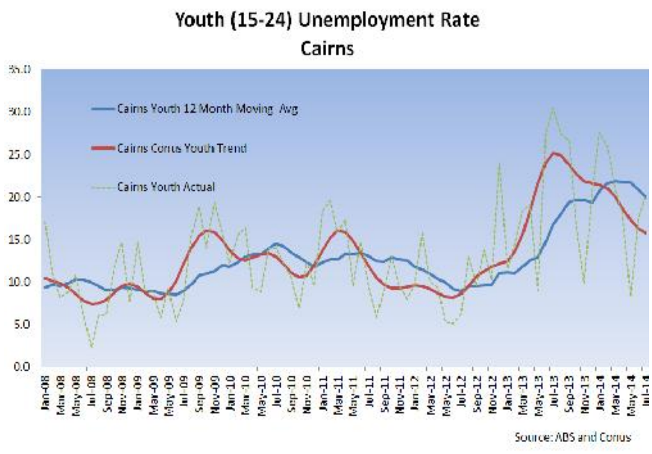


age populations in both Cairns and Townsville have grown at about the same rate (both are up almost 18%). However, employment growth in both over the period has failed to keep pace with that population growth. In Cairns employment has grown by 13% while in Townsville it is up by only 6.5%.

In Cairns we saw robust employment growth in the years through the end of 2008 but despite this solid employment growth the Trend unemployment rate by Dec ‘08 stood at 8.8% (this at a time when unemployment at the national level was just 4.6%). The reason for this apparent paradox was the PR; it was at 73.4; 8 pts higher than nationally. As employment growth began to flat line in Cairns through ‘09 and ‘10 we saw Trend unemployment rates peak above 12% because the PR remained stubbornly high, well above 70. As we moved through ‘11 and ‘12 we eventually saw the PR fall so that, despite negative employment growth, the Trend unemployment rate actually started to fall. Finally in ‘13 and ‘14 we saw employment return to growth and with such a low PR the Trend unemployment rate has fallen quite sharply.

If employment growth continues to improve in Cairns we would expect to see some improvement in the PR and this would act to moderate further declines in the Trend unemployment rate.

We’re also seeing some encouraging signs when it comes to the level of youth unemployment in the region. From some frightening highs above 25% in the middle of last year Trend youth unemployment has steadily fallen to currently sit at just below 16%. The data set used for this series is very small so we would caution against reading too much into absolute figures. However, it does appear that



the trend has improved; even if it remains far too high.

Tourism is clearly an important component to consider when we look at the region’s economy. We are yet to get all the tourism data for the first half of this year (the National Visitors Survey is due for release tomorrow), but the picture is clearly a broadly positive one. As the next chart shows, Aussies continue to leave the country in record numbers but we can also see that international arrivals have been trending higher almost continually since the middle of 2009.

Over the past 12 months international arrivals are up just

The Far North Queensland Review cont..

under 8%. Obviously an important driver in that growth has been the Chinese market. In the year to June 2014 Australia welcomed almost 708,500 Chinese arrivals, an increase of 10.5% from the previous year.

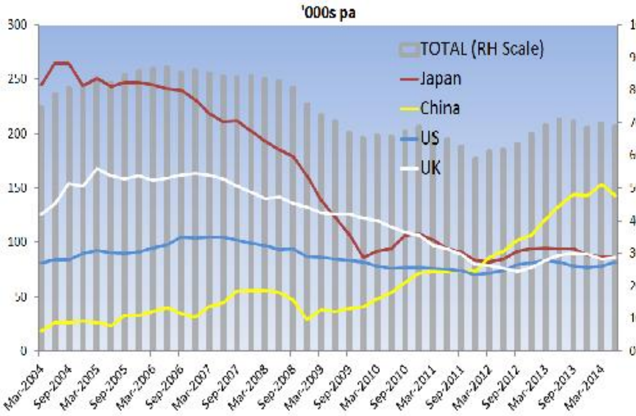
Travel Trends

Source: Australian Bureau of Statistics, RBA & Tourism Research Australia

In TNQ the Chinese growth has slowed somewhat and is rather less spectacular. In the 12 months to June 2014 there were a total of 143,000 Chinese visitors to the region (up 6.7% on the year) and they now account for 21% of all our international visitors. As the chart below makes clear, while this growth in Chinese visitor numbers has been dramatic, they remain well below the levels of Japanese visitors that the region saw during '05 and '06. Indeed Chinese numbers are only now approaching the levels seen for UK visitors in '05; there is clearly still ample scope for further increase. When we consider the chart as a whole it is clear that the overriding regional trend in the past decade has been the sharp decline in numbers from Japan and the UK being only partly replaced by Chinese growth.

International Visitors to TNQ

'000s pa



Source: Tourism Research Australia

What is also clear is that, since having reached a peak of 868,000 in June 2006, international visitors to TNQ have fallen (despite some improvements in 2011/12). International visitors to the region are down over 20% since 2006; at the same time international visitors to Australia as a whole are **up** 22% over the same period. International visitor numbers to Queensland have also fallen over that time and are down 4%; largely due to the collapse of numbers coming to TNQ.

Clearly Queensland, and TNQ in particular, has suffered very badly over the past 8 years in spite of the surge in Chinese numbers. This is a worrying trend that has only recently appeared to be reversed as Chinese arrivals have picked up. In 2006 Queensland accounted for almost 43% of all international visitors with TNQ picking up over 17%. The latest data for June 2014 shows those figures to have fallen to 33.6% and 11.2% respectively.

For many years we have been highlighting this disturbing trend while the tourism industry attempted to spin the data to declare things were much better. The TNQ industry needs to seriously address where it has gone wrong; what has allowed itself to have fallen so far behind the pack? Tourism operators and their industry bodies (most notably TTNQ) need to realise that the world tourism market has changed; relying on the old formula of sun, sand, reef and a low Aussie dollar are simply not good enough in the 21st century. International travellers have become far more sophisticated and demanding; and TNQ has been too slow to react.

The high Aussie dollar has been a reality for many years now and there is little sign that there is likely to be any significant reversal of that position, even if we do see (as we expect) the A$ weaken somewhat in coming months. Other regions of Australia have managed to adapt to the increased expense for visitors of a high Aussie dollar and the numbers coming to the country have never been higher.

TNQ's share of the domestic market has remained fairly stable at just over 2% for the past decade or so. However, as the first tourism chart shows, the doemstic market suffered badly after the GFC and is now only 6% higher than it was back in June 2006, and is only marginally ahead of the situation a full decade ago. Continued growth in the domestic market will certainly help the industry in TNQ but it will not fully recover until it can reverse the catastrophic declines in international visitor market share seen in the past 8 years.

The Chinese market will obviously be crucial to that recovery. However, as our second tourism chart demonstrates, we should not lose sight of the fact that not so long ago even the UK market was more significant than the Chinese are now. Other major markets such as the US and New Zealand have been unimpressive performers recently and clearly have scope for growth.

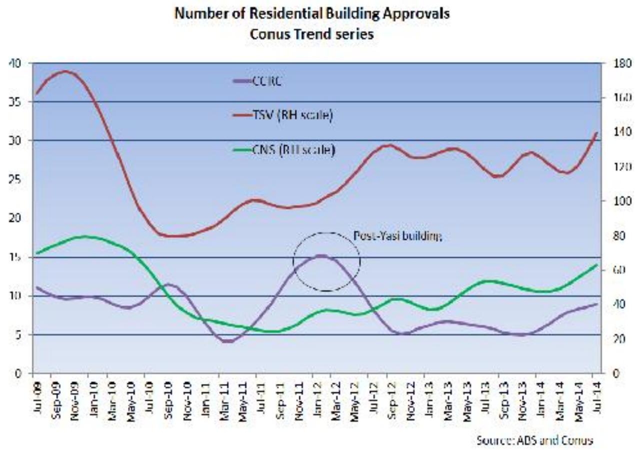
Undoubtedly one of the reasons the region did so badly after 2006 was its over-reliance on Japan; let's hope that lesson has been learnt and that our regional industry doesn't put all its eggs in one *Made In China* basket.

Finally, we shall take a look at **building approvals** in the region. The state of our construction industry will always be a good indicator of the growth of the broader regional economy. As our population grows and requires more houses, so our economy will grow. After a period of weakness Master Builders Queensland note in their June quarter Industry Conditions survey that business confidence remains positive.

The Far North Queensland Review cont..

Unfortunately, as is the case with the regional employment data, the ABS only produce the building approvals data for the Local Government Areas as an unadjusted series. This can be highly volatile, as one might imagine, so we have developed the Conus Trend series for building approvals in Cairns (which also includes the new Douglas Shire), the Cassowary Coast and Townsville Local Government Areas.

What becomes clear immediately is the dramatic decline in building approvals that the Far North witnessed in the aftermath of the GFC. Approvals in both Townsville and Cairns fell sharply and have yet to fully recover in either region.



However, we can see that approvals in Cairns started a slow but steady rally in the final quarter of 2011 and have been gradually moving higher since. As at July 2014 Conus Trend approvals in Cairns stood at 63, which is some 70% higher than where they were 2 years ago. Even with that improvement Trend building approvals remain 21% below the highs seen in late 2009.

Recent news of a large potential development in the CBD, which would include a number of units, could see this data improving sharply in the next few quarters. In addition the potential impact of the Aquis Resort on the construction industry in the region cannot be overstated.

The post-GFC decline seen in Townsville was equally dramatic but, unlike in Cairns, the recovery from the bottom happened relatively quickly. Having seen quite strong recovery in 2010-2012 approvals in Townsville have virtually flat-lined since the middle of 2012 (although the most recent data does indicate some upward trend again emerging).

Trend approvals in Townsville in July 2014 are only 9% higher than they were two years ago; and they remain 20% below their 2009 peak.

Building approvals in the Cassowary Coast have been weak for some time (not surprising perhaps, when we consider the evidence of population declines noted above). The impact of Tropical Cyclone Yasi can be clearly seen in the data with the Trend approvals series showing a sharp move up through the latter half of 2011 as post-Yasi rebuilds and repairs took place.

However, since then the story has been one of low, and fairly stable, approvals. The most recent data has seen positive signs of recovery with Trend approvals moving steadily higher throughout 2014.

Within the CCRC region the majority of the approvals this year have come in the Tully area (which includes Cardwell and Mission Beach as well as Tully itself). Of the 88 approvals in the CCRC region during the 2013-14 year 46 were in the Tully area. That trend has continued into the new financial year with 5 of the 7 approvals in July 2014 coming from the Tully area.

While a gradual improvement in sentiment within the CCRC may well help to lift economic activity, and another few seasons without a significant cyclone would certainly assist in the tourism recovery, we do not expect to see a sharp uplift in building activity until such time as we get meaningful population growth.

If the Queensland Government projections are proved to be accurate then population growth of less than 10% in the space of 23 years will likely see building approvals remain very subdued in the Cassowary Coast for the foreseeable future. Nevertheless there is a real chance that the burgeoning recovery being seen to our north will have spill-over impacts into our own area. More Chinese tourists give the CCRC operators an opportunity to tap into a new (for them) market; real estate price rises in Cairns will eventually be felt further south as a growing city population start to look further afield for value.

A State Government that is truly committed to development in the regions could also have massive positive impacts; interesting times await for Far North Queensland.