

The travelling economist: Queensland

Economic research note

31 August 2011

- Queensland is a perfect example of the ‘multi-speed’ Australian economy.
- There is a large restructuring process underway to transition the Queensland economy from residential construction in the south east to coal and gas developments in the middle and north of the state.
- This is a painful process for some regions, currently exacerbated by the impacts of natural disasters and the higher Australian dollar on the tourism sector.
- Over time this restructuring process should benefit the whole of Queensland through higher economic activity levels, job creation and income growth.
- One key advantage for Queensland will be its historical resilience to challenging economic cycles, and the culture and pride in its State.
- This should hold Queensland in good standing to return to one of the fastest growing states in the Australian economy and reap the benefits this brings.



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Queensland overview

This Travelling Economist has been fortunate enough to spend considerable time in various parts of Queensland in recent months, visiting Cairns, Townsville, Brisbane and the Gold Coast. Queensland is a great example of the ‘multi speed’ national economy, with some parts of the local economy going through some tough times (e.g. tourism and construction -especially in the flood impacted areas), while other sectors are gearing up for a significant increase in mining and gas activity that will likely bring with it much greater wealth and prosperity in the future.

A closer look at the Queensland economy is useful as a guide to the broader Australian economy. What was also interesting from the visits though is how the culture of a particular region is also vital in analysing the outlook for the economy and its ability to restructure and benefit from the enormous potential growth over the next decade.

The economy

The global financial crisis was not kind to the Queensland economy, with a significant downturn in the economy in 2009, with the contraction in state final demand reaching 4.3% for the 12 months to September 2009 (versus +1% for Australia wide). This compares to an average growth rate of 7.7% between 2004 and 2007 and a peak rate of 12.9% in June 2009.

There is no doubt that the Queensland economy is very cyclical in its nature, and many Queenslanders are accustomed to this, others are not, herein lies a challenge. The Queensland government forecasts growth to recover to around 5% per year in 2011-2012, but then accelerate to 5.25% per year in 2012-2013 then ease back to 4% after that.¹

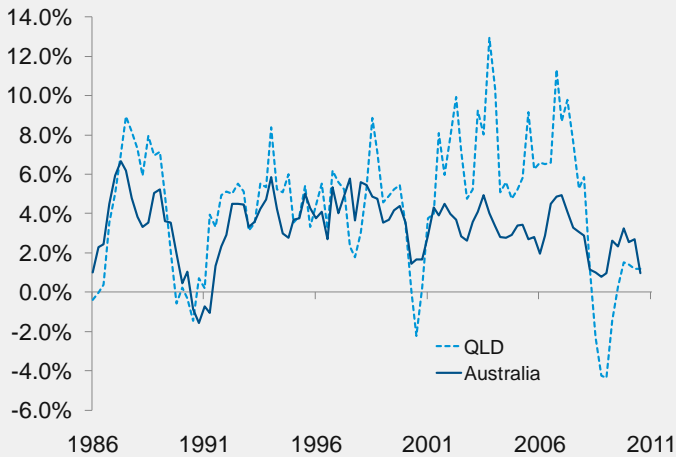
¹ As detailed in 2011/12 Queensland Budget

The opportunity, therefore, looks to exist for Queensland to continue to record annual economic growth rates well above the national average as one of Australia's 'resources states'. Queensland produced 25% of Australians resources, compared to almost 50% in WA, but only 12% in NSW.

Going forward though, the nature and composition of growth will continue to change and currently this is bringing painful structural adjustments to many parts of Queensland.

For south east Queensland in particular, the changing structure is bringing enormous challenges given the downturn in the construction sector, weak house prices and headwinds for small businesses. An opportunity though does exist to leverage off the mining and gas led activity as well as important infrastructure projects.

Annual GDP growth



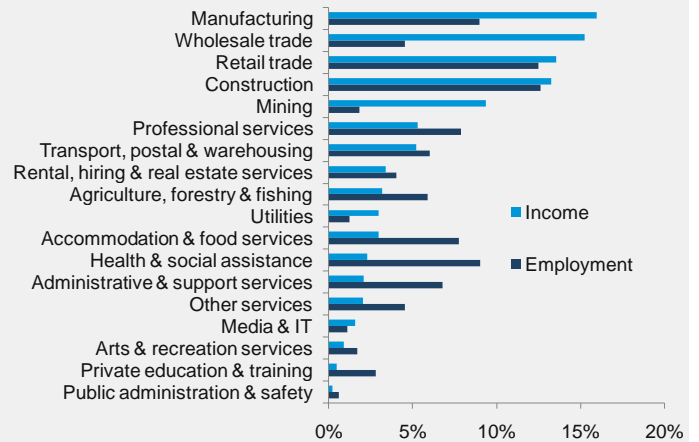
Source: ABS. Data to 31 March 2011

The Queensland economy is very diverse, with significant agriculture, mining and gas assets as well as having exposure to the domestic services sector (especially tourism and some finance) and in recent times a large construction industry.

While significant upside potential in growth and employment can be seen in mining, gas and agriculture, the Queensland economy currently remains highly leveraged to the domestic economy, particularly manufacturing, tourism, construction and consumer spending, helping to explain the weakness since 2009.

As the table below shows, there remains significant employment in construction, retail trade and services such as education and health care. Mining currently makes up just 2% of employment, but 9% of income generated in the economy. Future employment growth will likely also come from the ancillary services attached to mining and gas works and the construction that goes in to the start up phase of major projects.

Structure of Queensland economy (%)



Source: ABS.

Drilling down even further, what is more interesting is the diverse economic structure of particular regions and towns and future economic growth potential.

Impact of the floods

The floods in late 2010 and early 2011, as well as Cyclone Yasi, were a devastating blow to the people of Queensland, confidence and the broader economy. The natural disasters occurred at a time when a high Australian dollar, relatively high interest rates and weak construction sector were already causing the Queensland economy growth issues. The natural disasters are estimated to reduce economic growth in Queensland by 2.25 percentage points in 2010-11. In terms of the economy; coal, agriculture and tourism exports are expected to be \$A7bn lower.

Significantly, an expected 27 million tonnes of coal are anticipated to be cut from exports and recovery is taking longer than originally anticipated due to water and environmental issues. The Reserve Bank of Australia (RBA) recently suggested that only two-thirds of the recovery in coal production has occurred to date and it is not until 2012 that full production is expected to resume.

Sugar, horticultural and other crops were also all damaged from the weather events and a strong Australian dollar has also compounded weaker tourism volumes due to the bad weather. Depending on the crop, recovery of volumes may not occur till 2012 and as most consumers are aware, the price impact on fruit has been extreme. For example, banana prices have risen 400% and supply and quality have been low.

The severe flooding and Cyclone Yasi is estimated to have made 3,000 dwellings non-liveable. And more than 50,000 dwellings are damaged and in need of repair. Rebuild activity and resumption of normal coal exports should exert a mild expansionary force on the Queensland economy over the rest of 2011 and into 2012.

Townsville

This was my first visit to Townsville and I was surprised by the mix of the town, between commercial, residential as well as being at the doorstep to the Whitsundays and the tourism heart of Queensland. This was especially in contrast to Cairns, which has a decidedly tropical and leisurely feel, despite having a number of key commercial industries.

Having visited both Cairns and Townsville I was struck by how many people commented in Cairns on how lucky Townsville was because they had the large army base, university and government sector. This traditionally has made the Townsville economy less cyclical, and its people less accustomed to downturns. However, the overall weakness of the Townsville economy was evident through discussions with numerous people and how quiet the restaurants and hotels were. The general mood was far from optimistic.

This mood was in complete contrast to Cairns, where the population was more upbeat, despite the Cairns economy being in a weaker position with a much higher exposure to the Australian dollar and the tourism sector.

The point was made to me that Cairns was used to an economic cycle, with a number of comments to the tune of the current downturn will end and an upswing will occur, patience was the key. Culture and confidence should not be underestimated when considering the outlook for a town or region.

The Australian Defence Force represents 10% of the Townsville economy and with a new battalion expected this year, population growth should continue to be a key driver of growth in the region. Townsville is also home to the largest government sector in Queensland outside Brisbane and helps to support the local economy and services sector. The large James Cook University, home to around 18,000 students also helps anchor the local economy. These industries help remove the economic cycle from Townsville.

Townsville is also fortunate given it is in a handy location with port capacity, making it a transport and logistics hub for the mineral and agricultural industries of greater North Queensland. The Port of Townsville is Queensland's third largest multi-cargo port, servicing the sugar industry as well as bulk copper, lead, zinc and fertilisers.

The Townsville Enterprise Development Status Report has identified \$A20bn projects since March 2011 with \$A13 bn already underway in Townsville and surrounding areas. This excludes any work in the Bowen Basin.

The recent downturn in the Queensland economy and weather related issues have definitely had an impact on the region. This can be seen in the unemployment rate for the region, currently 6.7%. The average unemployment rate for the two years to October 2010 was 4.2%, well below the Queensland and Australian average of 5.2% and 5.3% respectively.

The outlook for Townsville is bright given exposure to agriculture and mining and the skills of its people. One important driver for the area though will be a rebuild of confidence and the continuing exposure to non-cyclical economic activity.

Cairns

In contrast to Townsville, Cairns appears more comfortable riding an economic cycle, albeit conditions are still painful. The strong Australian dollar has hurt the region with lower international and domestic tourists. Just walking around the streets, there were a large number of empty shops that were 'for sale' or 'for lease', or both! One source puts the total number of vacant premises at 100, the highest since 1997 when a large amount of new supply came on to the market.

The Cairns economy has clearly suffered in recent years, with reports that 400 businesses in Cairns had closed over the last two years, most are small businesses. The unemployment rate has risen and is near 13%, compared to the 5% national level.

Tourism volumes have fallen sharply, with anecdotal reports placing it around a 25% fall. This can be seen in the occupancy rate for accommodation, at only 45.2% for the March quarter 2011 compared to 66.9% for the Gold Coast, 81.8% for Brisbane and 64.3% for Townsville. It can also be seen at room rates, with only \$A140 a night required for a stay in 5 star accommodation.

Cairns airport saw a sharp fall in international passenger numbers in 2008/09 by 25% and 2009/10 by 20%. In 2010/11, international passenger numbers increased by 20% with expectations this has been driven by fly-in/fly-out workers to Port Moresby and its gold mines with daily flights, rather than higher tourism. Domestic passenger numbers have been less volatile, rising 1.9% in 2008/09, falling 0.7% in 2009/10 and rebounding 6.3% in 2010/11. See chart below of the trend in passenger numbers.

Cairns Airport Passenger numbers



Source: Cairns airport

There were numerous comments that Cairns is too linked to the tourism sector and an alternative industry was needed to help the economy through the economic cycle. This is especially important given the heavy reliance of tourists from Japan and Europe, where weak economic growth could further deter tourists. Going forward more specific marketing to new markets, especially the growth engine of the global economy, emerging Asia would help the Cairns tourist industry.

There are growing calls for government departments to move to Cairns (similar to Townsville), although this may not happen. One alternative solution would be to make Cairns a hub for mining workers, given the high skill level of citizens, and good airport infrastructure and proximity to the Bowen Basin.

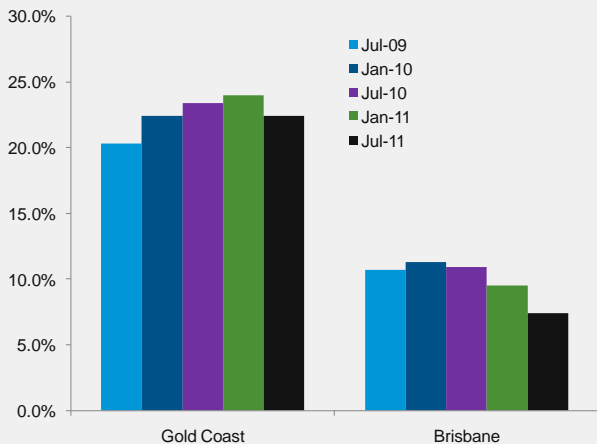
While Cairns has its challenge to reengineer its economy to benefit from the resources boom at its doorstep, the resilience and optimism of its people holds it in good stead.

Brisbane

Brisbane should be one of the main beneficiaries of the resources boom to its north. During one of my many visits to Brisbane, I was told of rising demand for office space from mining and gas companies, with one company leasing 9 floors of office space to house almost 500 new staff, including engineers. The chart below shows the improvements in office vacancy rates for Brisbane and compares it to the Gold Coast which has a massive oversupply of commercial property.

The Brisbane vacancy rate peaked at 11.3% in January 2010 and has since fallen to 7.4%. This compares to 22.4% in the Gold Coast, 7.8% in Perth, 7.3% in Adelaide, 5.8% in Melbourne and 9.3% in Sydney.

Office vacancy rates (%)



Source: Australian Property Council

Part of the improvement in office vacancy rates have come from a slowdown in construction in Brisbane. Compared to recent years, there are fewer cranes dotted around the city, with the largest project now on the horizon, the Infinity Tower, which will rise 77 stories high and contain 545 residential apartments.

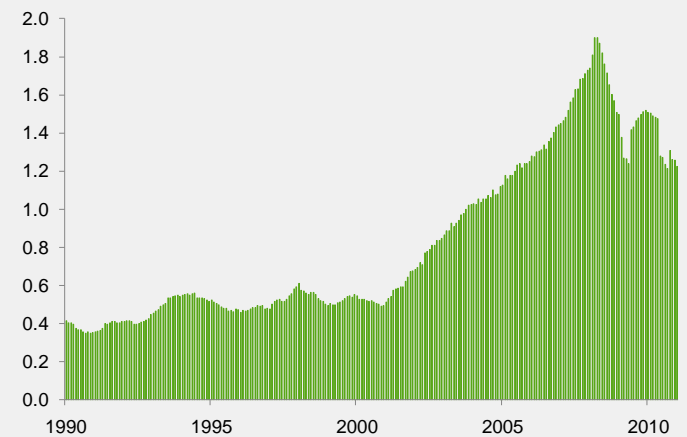
Head offices are one way the rest of Australia will benefit from the mining and gas boom. New office space requires a new café, dry cleaner and other ancillary services and employment creation occurs beyond mining and gas. One Australian company chairman has suggested that for every one mining job created in the Australian economy, another six to seven other workers are employed. Brisbane is a great example of this, with the unemployment rate currently 3.9% versus the balance of Queensland at 6.3%.

Gold Coast

The Gold Coast has been one of the hardest hit areas in Australia post the GFC. Much of this has been due to the downturn in the property market and higher interest rates, as well as lower tourist volumes. In the August company earnings season, many companies referenced specifically how tough the region has been in terms of lower tourism volumes, lower volumes for real estate agents and rising bad loans on homes. The unemployment rate in the region stands at 6.7%

South East Queensland went through a very large property boom, both residential and commercial from 2003 to 2008, boosting the local economy. See chart below of value of building approvals for Queensland below. Easy access to financing and strong interstate migration saw strong demand for property and there was a very rapid and large response. In retrospect overbuilding is likely to have occurred. This can be seen in the office vacancy rates, currently at 22.4%. Over the first half of 2011 there was a withdrawal of office space of 1,166sq, but more supply to come including 5,746sqm in 2012 and more mooted, this is likely to have rental implications. For the many small businesses, better leasing deals could be a small upside from the downturn.

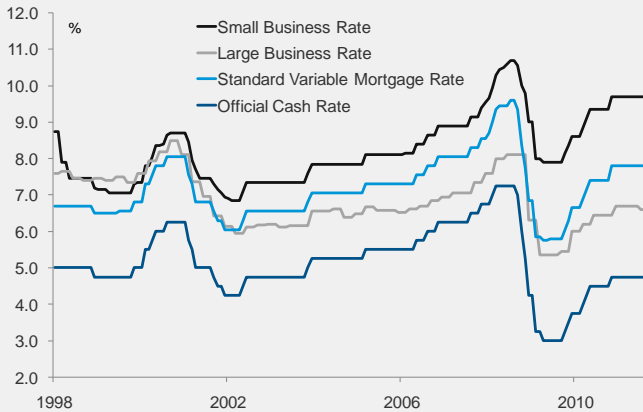
Value of building approvals – Queensland (\$Abn)



Source: ABS. Data to 30 June 2011

The Gold Coast has traditionally been a small business economy with around 85% of businesses employing less than four people and only 1.5% of businesses employing more than 50 people. SMEs have found it harder to attract financing in recent times at a reasonable rate as the chart below shows:

Standard lending rates (%)



Source: RBA. Data to August 2011

This has been exacerbated by local lenders who have found funding markets challenging given the high concentration to loans in Queensland and softer lending practices. There is little appetite to fund property developments (let alone low demand for new projects) which has taken a key source of growth for the region away. There has also been evidence that lenders are reluctant to extend credit to SMEs where the loan is backed by residential property.

In the recent earnings season there have been some signs of possible improvements to lending in Queensland, outside of the subdued nature of the Queensland housing mortgage market. There is growing optimism about the rebuild and impact on economic activity, as well as signs the appetite is slowly improving for investors and financiers and some pick up in appetite for building purchases.

The Gold Coast regions would benefit from new stimulus measures to help compensate for the property market, which is unlikely to improve in the near term given vacancy rates, as well as lower tourism volumes.

Population growth should continue to be a positive driver of growth, as should infrastructure development. One major project is the \$A949m Rapid Transit light rail system. The aim is to provide 40km of light rail system, initially from Griffith University to Broadbeach South, before linking to Helensvale and Coolangatta via the Gold Coast Airport over time. Passenger services are due to start in 2014 and should improve road congestion in the area and enhancing productivity.

Infrastructure investment will be key for economic growth in the Gold Coast region in the medium term. Population growth is set to continue, but in the face of challenging property market and tourism conditions and competition for labour from coal and gas regions, a more diverse economy will be highly beneficial.

Opportunities

Resources: One of the biggest sources of opportunity for growth in Queensland is the resources sector. This will be driven by significant capital spending and export receipts, especially to Asia, and the employment opportunities, population growth and consumer demand that comes with this. A separate note will be released on the outlook for the coal and gas sector in Queensland.

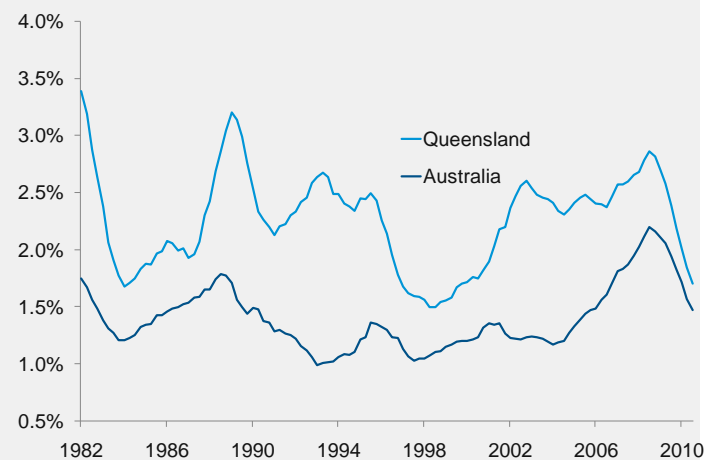
Queensland has the challenge, but more importantly the opportunity to benefit from the mining and gas boom underway in the state. As this research report details, the benefits flow to the rest of the state, particularly Brisbane and the services sector. This will help the Queensland economy rebalance away from tourism and property development, but use its key skill set over coming years.

Population: One of the key contributors to growth over many years for the Queensland economy was its strong population growth. This was closely related to the strength of the employment market and from 2002 to 2008 the strength of the property market. The total population of Queensland is just short of 4.6m people, around 20% of Australia's 22.5m people.

Through 2002 and 2008, the Queensland population grew at an annual rate of around 2.5% per year, well above the national average of 1.5%, as people came to Queensland for lifestyle reasons and its faster pace of economic growth.

In 2010/11 and 2011/12, however, the population growth rate looks set to slow to just 1.5%, much closer to the national average, with a sharp fall in interstate migration. Much of this sharp fall is likely attributed to the depressed nature of the housing market and lower employment prospects. A positive aspect of this would be less demand on already low spare capacity and infrastructure in south east Queensland.

Annual population growth (%)



Source: ABS. Data to 31 December 2010.

Going forward, it is likely that population growth will reaccelerate in Queensland. It would also be expected that resource exposed regions like Mackay and Townsville would attract a higher growth rate than south east Queensland. This has implications for improvements in property prices in the south and also implications for property prices in the north, where there is anecdotal evidence of extreme rental prices and house prices in towns like Moranbah.

Culture and sport

What has impressed me about travelling around Queensland has been how each town and region has such local pride and a sense of culture. For many towns this centres around the local sports team or the State representatives. There is constant discussion about the need for a new sports stadium and how this would add to the town and the spirit and attract economic activity.

Townsville is a good example with the Australian Rugby League Team, the North Queensland Cowboys based in the town. It is often discussed that fans drive 10 hours or so to see the team play on the weekend and then drive home. There is now talk of a new stadium being built in the centre of Townsville to replace Dairy Farmers Stadium, which is currently out of the centre of Townsville and reports it could use an expansion and refresh. This would fit with the Premier's vision of Townsville to be the second capital of Queensland and help stimulate economic activity and attract new teams and fans to the town.

Challenges

Tourism: The strong Australian dollar has certainly hurt the Queensland tourism sector. The traditional market for visitors has been Europe and Japan, with these economies facing their own economic woes, contributing to lower volumes.

Perhaps a tourism strategy more focused on attracting the growing middle-classes from near-by Asia (ie. China and India) would be a worthwhile development to compliment the natural beauty and the infrastructure assets already in place.

Restructure of the economy: The changing structure of the Australian economy is one of the most discussed topics in the current macroeconomic landscape. Queensland will bear a significant brunt of these changes, but has the advantage of significant coal and gas assets to benefit from in higher activity levels, job creation and income growth.

However the growth in mining and gas sectors will likely occur at the same time that property construction and prices will continue to be weak in south east Queensland. House price growth in this corridor could remain restrained, with lower demand from weaker population growth and this could continue to hold back consumer spending and confidence until this structural change is well understood.

Financing: A fast growing population and demand for infrastructure development will require financing for large scale projects and this could be a key challenge for Queensland. The Queensland government remains challenged in its fiscal stance as it focuses on regaining its AAA credit rating (currently rated AA) and returning the budget back to surplus (currently forecast by the Queensland government to occur in 2015/16).

Debt levels are expected to continue to accelerate to 2015 (with net government debt expected to peak at 3% of Gross State Product in 2015, or \$A10.2bn), limiting the ability to finance new infrastructure projects on the government balance sheet. Alternative sources will need to be found, focussing on private public private partnerships, or further asset sales by the government to make room to finance new projects.

Measures in the recent budget were focussed on temporary support for tourism and the housing sector. This included \$A10,000 Queensland Building Boost grant available to all new house purchases between 1 August 2011 and 31 January 2012. There is also focus on Events Queensland to attract new events and conferences to the region. Other focuses continue to be on healthcare given the ageing and growing population.

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