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New decade, same story?

Queensland Business Outlook

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New decade, same story?

Entering a new decade can hold a lot of promise. *What will be different to the last? How fast will things change? How will society and technologies evolve in ways we can't imagine?* It tends to bring a sense of endless opportunity.

And while you feel this sense entering a new decade and starting 2020, there is an equal sense of trepidation… this new decade seems to be beginning the same way as the last decade ended – shrouded in **uncertainty**.

Global growth is towards the lower end of the range seen since the beginning of the last decade. Growth is not dire, just disappointing. But this disappointment is widespread: most of the world has felt the weaker growth in the past two years and recovery still seems some way off.

Despite trade talks, **trade tensions** are entrenched, and the uncertainty is having a toxic impact on confidence and investment. The undermining and weakening of global economic institutions, pose serious medium-term challenges for economic growth. And for a small open economy and middling foreign power like Australia, we stand to lose when global, rules-based, institutions break down.

Signs point toward global indicators not getting considerably worse in the near term. But then again, **geopolitical tensions** climbed in much of the world all through 2019 and there's a high chance that one or more of the landmines that are littering the global landscape will go off in 2020. The rise in nationalism and nationalistic regimes can undermine the hard earned gains in globalisation which have benefited economies like ours.

While at home, the **Queensland economy** has been ambling along. Some things are going well; some are not; our economy is neither spectacular nor in dire straits. In such an economy, treading water and complacency can creep in. But a dose of confidence, vision, and incentives will go far.

The Mid-Year Fiscal and Economic Review released at the end of last year downgraded economic growth but continued to project surpluses of $2.1 billion over the forward estimates.

The bottom line is this – the surpluses, while projected, are fragile and the impacts to Queensland's economy from the Coronavirus could further weaken this position. The Future Fund will need to deliver over the medium term, the revenue base needs attention, and spending still needs to be worked over carefully to minimise waste and maximise returns. A big ask in an election year, but an imperative, nonetheless.

But dominating all this, has been the **cruel summer** we've experienced. Queensland, like our east coast neighbours in NSW and Victoria, has been battling the drought and natural disasters for some time now. More than a decade ago the then Access Economics warned that Australia was at risk of "suffering the slings and arrows of outrageous climate change". The past summer may have finally underlined that in red.

Queensland's economy has always ebbed and flowed with the climate – from our natural resources, to our natural wonders drawing in tourists.

This relationship has driven domestic economic growth and shared prosperity across the regions – but this **relationship now also leads to tension.**

Our economy depends on the demands of the world and still earns big bucks from fossil fuels. Yet domestically, our landscape and our industries are significantly exposed to the impacts of climate change.

This is the rub of it all: we might be a small emitter (in absolute terms; large in per capita terms) relative to the rest of the world, but we are more vulnerable. So we can't afford to wait or not act.

Our economy, like the climate, can be seasonal and have trends. But this summer's bushfire crisis and increasingly extreme weather does not appear to be a normal season. And it is climate change that risks making this the trend.

This 'new normal' can quickly become an economic lose-lose.

Economic policy settings will increasingly find it difficult to juggle the immediate costs of natural disasters, the shifting demands of markets and industry and the need to establish a truly sustainable growth path – one that can both benefit from, and mitigate the risks of, the major trends of a warming world.

Business gets this – because business understands risks (and opportunity). As global business leaders met at Davos for the World Economic forum, Deloitte's Industry 4.0 Global Readiness Report survey, of more than 2000 global executives, found nine of 10 business leaders say they expect climate change to have a negative impact on their organisations.

But there is **optimism at home.** In the same survey, 41% of Australian businesses want to use new technologies to counteract the effects of climate change and positively impact society.

So as economies and business look towards the future, there is a recognition that **decisions made in the next 2-3 years are the ones that will shape the next 10-20.**

And these decisions need to be the right ones, the ones we collectively haven't made before.

The decisions that will set up economies, businesses and communities for sustainable and inclusive economic growth paths – paths that can also accommodate increased productivity, innovation, competition and high-value adding jobs.

In the meantime, a failure to comprehensively mitigate climate change and prepare economies for a warming world suggests this 'new normal' may continue to drag on economies until decision makers set the course to realise the opportunities.

2020 is a big wake up call to **policy makers.** Climate change is all about risk and all about transition – but transition has the unforgiving parameter of time. As the transition window closes, the costs of transition increases. For governments, there are questions of how to facilitate this transition; how to ensure energy systems are reliable and meet demands; how to help communities and workers adapt and cope with change.

All these could bring new demands on budgets alongside risks from falls in some revenue and risks around budget financing. And the ratings agencies are all watching.

And as the new decade starts the same the way the past one ended, there remains unbridled hope that it will end differently, for the better.

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Queensland economic outlook

The same Australian story...

For some time, the **Australian economy has been battling the dual demons of drought and housing-related negatives,** including cautious buyers and a downturn in housing construction.

And in 2019, the economy added a third threat: cratered confidence among consumers and business. **Crumbling confidence** has a few causes – and this summer's devastating bushfires doesn't help. It's probably fair to say that our confidence is probably worse than the economy itself - but this risk is becoming a self-fulfilling prophecy.

But there are **some positives,** cuts to taxes and to interest rates, as well as a lower Australian dollar and a rebound in housing prices are all boosters.

But what of the Sunshine state?

Things are bigger in Queensland: the Big Pineapple, the Big Mango and the Big Crab. And because of its **exposure to global commodities, it also tends to have bigger business cycles** than most other States.

Luckily, **Queensland has a larger and more diversified economy** than the likes of WA and the NT – both have done it tough in recent years. That degree of diversification has helped to clip the peaks and troughs of Queensland's business cycles.

But the economic diversity of the State hasn't helped much lately. **Housing construction** activity has been sliding (partly in response to the earlier glut of apartment building), and so has **business investment** (a lot of the latter slide is still due to the tailing away in work on big LNG projects, the timing of which was determined long ago).

The **international story may get more challenging from here.** Coal prices are already well down on their peaks, and China has reason to start switching its stimulus efforts from construction (great for our big exports) to consumers (a harder sell). So we need to play a smarter game.

On top of this, the Novel Coronavirus could have a material short-term economic impact on Australia. As such, sustained further weakening in confidence or financial market instability are risks to keep a watching brief on.

And how are the State coffers?

No surprises here – the economy is taking a toll on Federal and State finances. Wobbly wage growth plus falling housing construction hurts State GST monies. So, it is good the State is keeping up its infrastructure spending. This is a good story for Queensland but we must keep on our game – roll the infrastructure out in a timely and effective way, boosting jobs and local business along the way.

But there are red flags. As economies around the world look to mitigate their risk and exposure to a warming world, this can lead to divestment and economic shocks for emission's intensive states like Queensland. In November 2019, Sweden's central bank shared it had sold off their Queensland, Western Australia and Alberta (Canada) bonds because of their emissions intensive economic activity. This had little real effect on Queensland (the Swede's didn't hold much of our bonds on issue) but they have branded us in the global marketplace. And others are watching.

The upshot of all this: natural disasters and trend shifts in climate change impacts will have long-term impacts on the **budget bottom line... which we will hear about earlier than usual this year.** The 2020-21 Queensland Budget will be tabled in State Parliament on Tuesday 28 April 2020.

But there is always good news in Queensland...

While construction slid backwards, the State Government is providing a solid pipeline of public infrastructure. #BNE2025 will ensure that public infrastructure investment is contributing positively to the State's outlook, with large projects such as the Brisbane Metro, Cross River Rail and Queen's Wharf upgrade stretching out over the next five years.

At the same time the backdrop of falling interest rates, high net interstate migration and the easing of lending restrictions are encouraging signs for future **residential property demand** in the Sunshine State.

Added to that, **Queensland still has one of the fastest growing job markets in the country.** More people are entering the labour force than ever before. That's a great outcome. **But because people's willingness to work has improved faster than the number of jobs, unemployment has shifted higher (to the highest rate in the country).** But don't let that get you down. In the long run, this improvement in the State's participation rate will pay dividends.

Queensland's coffers

Update on 2019-20 Mid-Year Fiscal and Economic Review

Released late last year, the 2019-20 Mid-Year Fiscal and Economic Review (MYFER) reported an estimated **$151 million General Government sector net operating surplus in 2019-20,** which was a $38 million reduction from the estimated surplus at budget.

The bottom line is this – the surpluses, while projected, are fragile; the Future Fund needs to deliver over the medium term, the revenue base needs attention over the medium term, spending still needs to be worked over carefully to minimise waste and maximise returns. A big ask in an election year, but an imperative, nonetheless.

Despite weakened global and domestic conditions resulting in significant reductions in forecast GST revenue and coal royalties, MYFER forecasts that the Government will deliver $2.1 billion in surpluses over the forward estimates.

In acknowledgement of the challenging economic environment, Treasury expects economic growth in Queensland to be 2.5% in 2019-20, down from the 3% originally forecast at budget.

Despite this, Queensland jobs growth has strengthened over the first four months of the financial year, with MYFER reporting that employment growth in 2019-20 is expected to improve from the budget forecast to 1.5%. Economic forecasts for 2020-21 are largely unchanged since the Budget.

MYFER is also showing the impact of the drought. Ongoing drought conditions has led to a **weakened outlook for agriculture exports** since the Budget, as crop production forecasts remain lower than annual averages over the last decade.

The impact of trade pressures has intensified since budget, reducing spot prices for metallurgical coal and **reducing spot thermal coal prices by around 10%** since budget. In contrast, LNG export prices have increased, with the value of LNG exports outstripping thermal coal exports over 2019. Further, metal exports are expected to grow further in 2019-20, mainly due to an **increase in aluminium production.**

The outlook for **Queensland export services remains largely unchanged** since the time of the budget, however, MYFER cautions that the sector it is not immune from a downturn, should the weakness in the global economy intensify.

Despite global trade tensions, uncertainty and ongoing drought, MYFER expects strong **population growth, low interest rates and the low Australian dollar** will help mitigate some of the negative impacts on the state's economy.

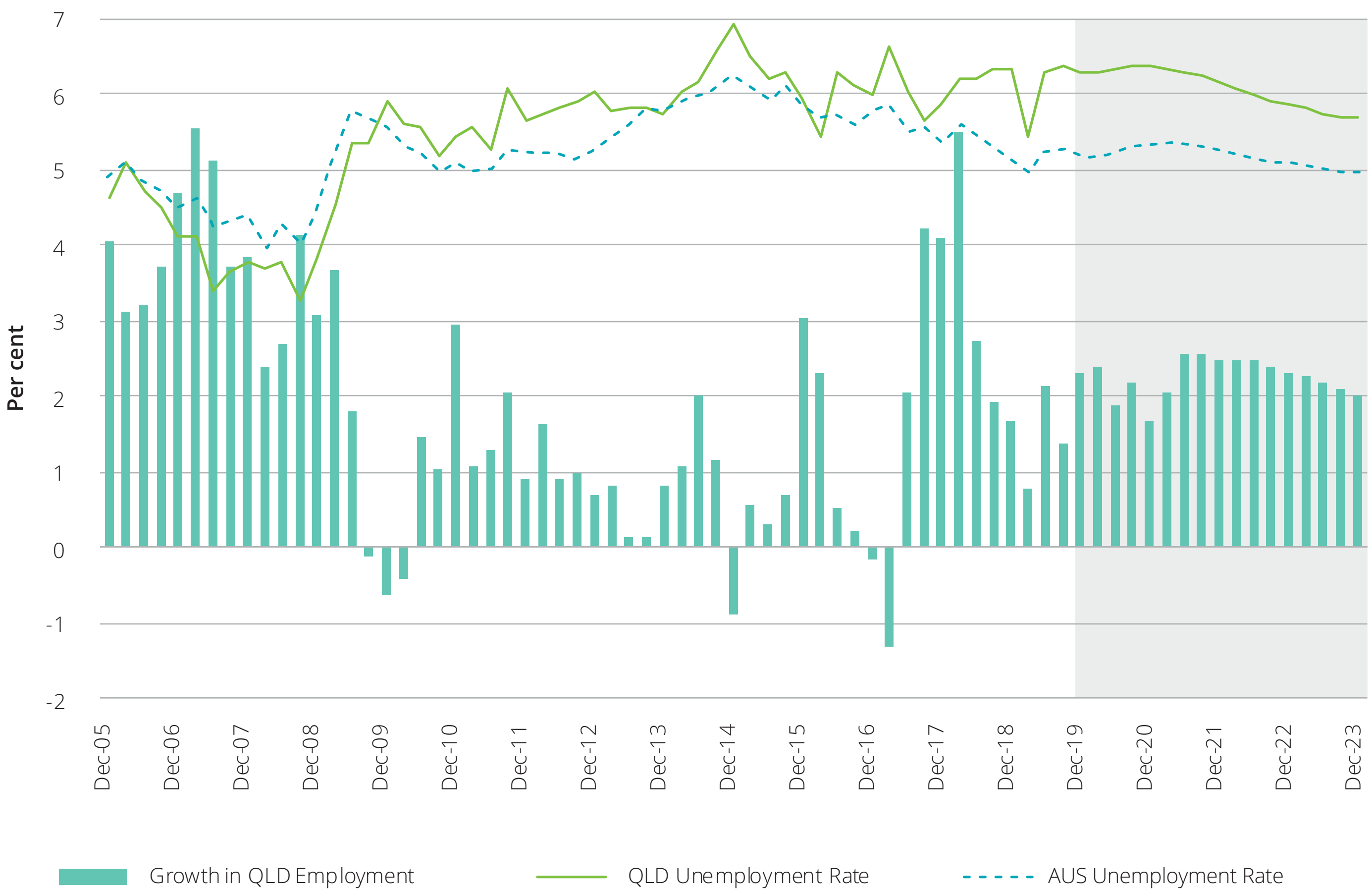
Snapshot: Economic outlook

Population growth is the fuel that drives the Queensland job market. Over the year to December 2019, over 57,000 jobs were added to the Queensland economy. Despite this solid employment growth, the number of Queenslanders entering the job market is growing faster than the number of jobs – this has led to the Queensland unemployment rate shifting higher.

Over the forecast period, economic growth will likely intensify demand for labour and help to absorb spare capacity in the labour market and ease the unemployment rate.

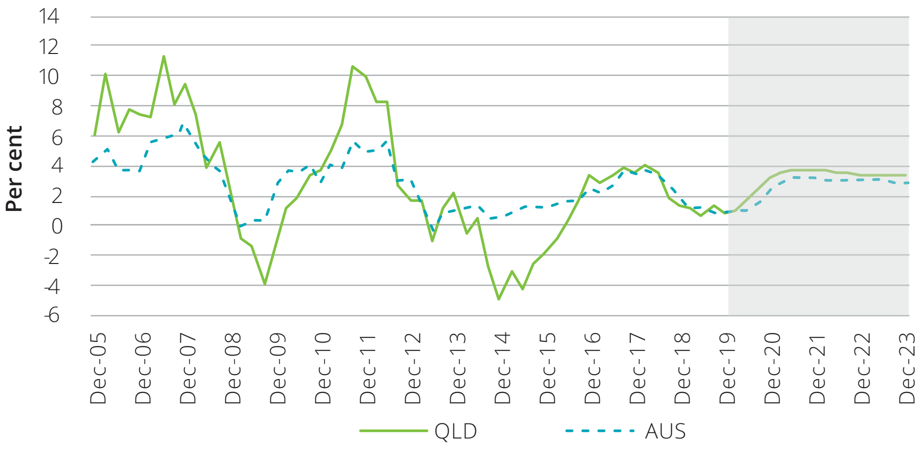
Over this period, the Queensland unemployment rate is expected to remain above the national average, meaning the focus should remain on jobs, jobs, and jobs. So more work to do here.

Employment growth (QLD) and unemployment rate (QLD,AUS)



Source: Deloitte Access Economics

Real Final Demand Constant price annual % change



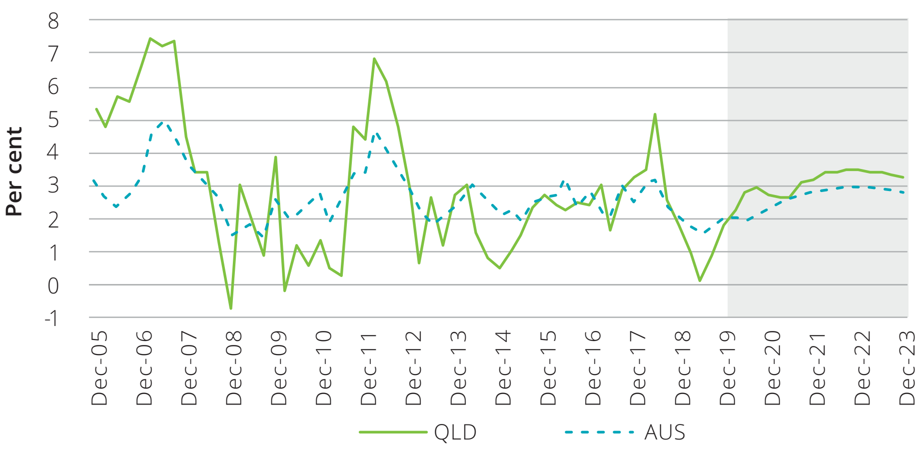
Source: Deloitte Access Economics

Queensland's State Final Demand grew by 0.8% over the quarter to December 2019. Over the forecast period to December 2023, Queensland's demand is expected to **track above the national average, growing at 3.2%.**

This performance is expected to be underpinned by **sustained growth in private consumption and investment,** with an uplift in engineering construction and housing investment.

This is good, but we need to counter crumbling confidence and global uncertainty.

Gross State Product Constant price annual % change



Source: Deloitte Access Economics

Queensland's industrial commodity exports have held up reasonably well in recent times, which has helped to **offset some of the weakness in the domestic economy,** with the State's surging earnings from LNG, minerals and coking coal exports providing a welcome boost locally. The export-strength-but-domestic-weakness has been characterising Queensland's economy for some time.

Queensland's Gross State Product grew by 1.8% over the quarter to December 2019. Over the forecast period to 2023, Queensland be will remain above the national average, growing at 3.1%. If this rate of growth sustains over the next four years, **Queensland will outperform its southern counterparts** – Victoria and New South Wales.

All dried up

The impact of drought continues to be felt across Australia's agricultural sector.

For the **first time in Australia in 63 years, farm production has fallen for 3 consecutive years.**[1]

Current seasonal conditions are remarkable in their extent and severity when compared with previous major droughts. In October 2019 vegetation cover across New South Wales, Queensland, the Northern Territory and Western Australia was noticeably lower than in October 2007, during the last major widespread drought.

For Queensland, as growth in industrial commodity exports drops away, **more than two-thirds of Queensland is in drought.**[2]

This is punishing for farmers – and the communities around them – with Queensland seeing the largest percentage fall in agricultural output of any State or Territory last financial year, stifling rural exports.

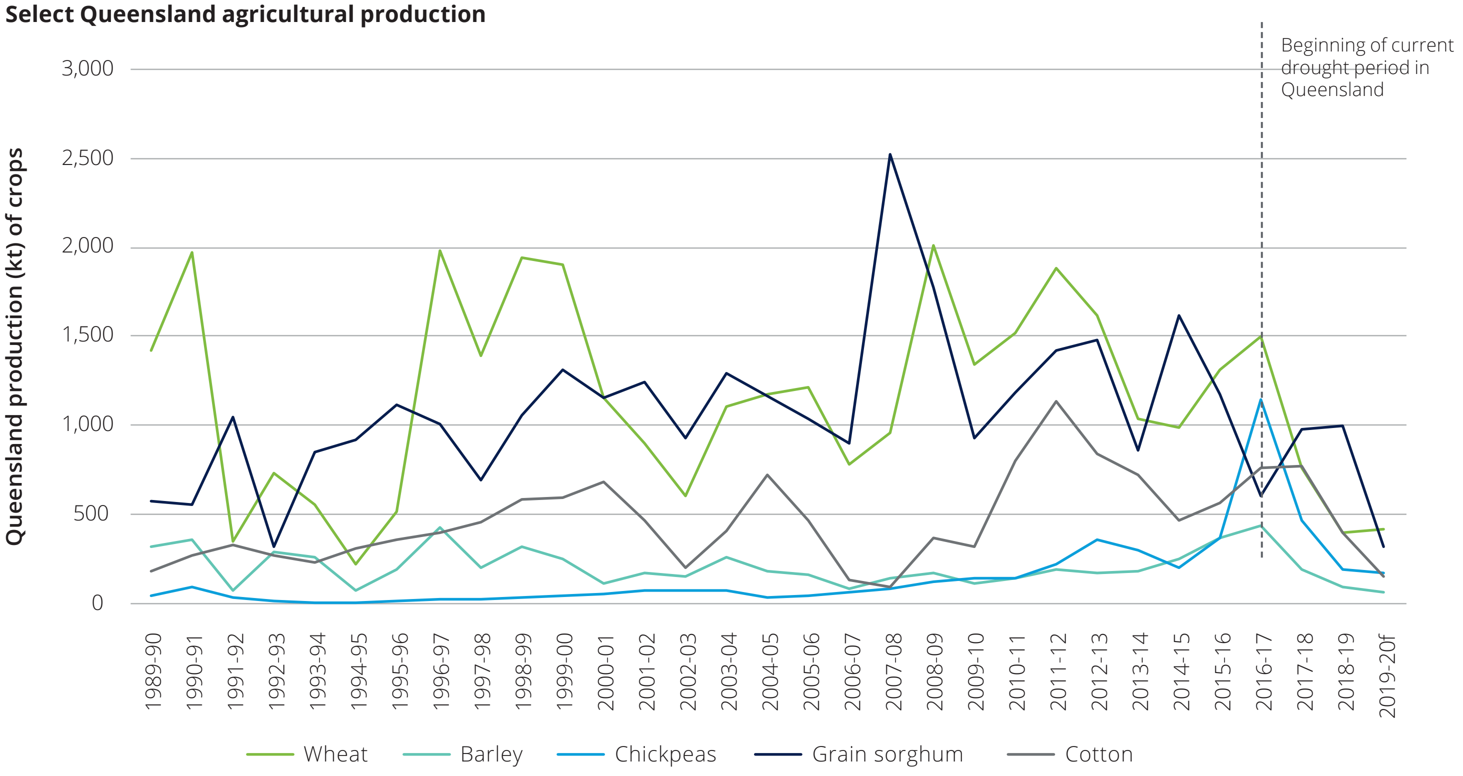
Added to that, devastating fires have ravaged the State that has already incurred more than its share of climate-related costs and heartache.

There is little sign of the drought breaking… And it's worth remembering that even after the drought breaks, there will be a delay before farmers are able to build back up; many have had to sell livestock, while anecdotal evidence has suggested some have already packed-up and moved.

The lower $A will offer some support to farmers, making our exports relatively cheaper and encouraging farmers to respond to global demand.

But the $A won't break the drought, and until it does break, farmers can't sell what they don't have.

Select Queensland agricultural production



Source: ABARES; ABS; Pulse Australia; Cotton Australia

[1] ABARES, December Quarter 2019
[2] ABARES, December Quarter 2019

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