New South Wales

State Economic Download.

April 2024

Boldly backing business

Contents.

A note from our Chief Economic Advisor.

Signs of a gradual recovery in 2024.

The economic slowdown of 2023 is increasingly looking like it is turning into a recovery in 2024, at least for some states and industries across Australia. We are seeing the first hints of a two-speed economy emerging, with Queensland and Western Australia looking much better in 2024, while New South Wales and Victoria remain soft.

Australia's economy should register better economic growth over the first half of 2024 than experienced through the final six months of 2023. The Judo Bank Purchasing Managers Index (PMI) has seen a big improvement in key indicators such as output, new orders and employment. The recovery is primarily occurring in the service sector recovery. The Judo Bank Australian Manufacturing PMI remains soft in early 2024, stuck in the slow lane as it was for much of the last year.

Along the eastern seaboard, the state PMIs highlight a divergence in performance between regions. Queensland has seen a significant bounce-back in business activity since late 2023, Victoria has had a more modest recovery, and New South Wales remains near the cyclical lows of last year.

Queensland business activity is strong. If sustained over the next six months, it will be consistent with economic momentum rising back above the long-term rate of growth. New South Wales business activity, by contrast, is weak. The key PMI activity indicators for the state remain above levels historically associated with recession, but the soft landing continues in 2024.

South Australia and Western Australia have also seen an improvement in business activity in the first three months of 2024, consistent with our State Economic Performance Indicator, which has these two states plus Queensland at the top of the State Economic Performance League Table.

The source of economic weakness in 2023 was consumer belt tightening, a response to cost-of-living pressures, a rising income tax burden and tighter monetary policy. However, there are some tentative signs of better consumer spending across most states in early 2024. The upcoming big tax cuts, set to commence on 1 July, could potentially boost consumer spending.

The emerging economic recovery is tentative, and from a national perspective, we should not be expecting a return to the strong growth rates experienced in 2021 and 2022. Australia simply does not have the capacity to facilitate strong economic growth over the next three years.

Inflation pressures eased to around 3.5% in early 2024, although the domestic element of inflation is running above 4.0%. The significant disinflationary impact on overall inflation is coming out of the global goods markets, where price inflation has fallen back to zero.

The jury is still out on what's next for Australian inflation. The consensus among economists, and the hope of the Reserve Bank of Australia (RBA), is further moderation of price pressures. But if international developments are any guide, inflation will likely be 'sticky' going forward due to elevated domestic services inflation.

The worst of the pandemic inflation is now behind us, and you could argue that the original pandemic-induced inflation 'shock' has turned into a disinflation impulse within the global economy. Underlying inflation globally, however, risks becoming entrenched due to a self-reinforcing cycle of cost pressures and rising prices.

Domestic inflation and the ongoing resilience of demand in economies across the globe is happening despite tighter monetary policy and the political, economic and financial uncertainty plaguing the world in 2024.

This highlights that the Australian economy's underlying fundamentals remain solid, with strong employment growth and multigenerational lows in unemployment, a historically unique and positive feature. We are seeing an investment boom, led by a surge in infrastructure spending and solid building activity across most state economies.

Australia's economy is proving resilient once again. However, this resilience raises the risk that interest rates are not high enough to ensure inflation returns to the RBA's target sustainably. Australia's interest rate, at 4.35%, is below the rate seen in similar economies. As major economies deal with the 'higher-for-longer' risk for inflation and interest rates, there is a real possibility that the RBA may have to take our interest rates a little higher to get the job done.

Warren Hogan
Judo Bank Chief Economic Advisor

Section 1

Global and national.

Global economy
Bouncing back in 2024?

Key takeaways

- The world economy is on the mend after a soft landing in 2023, and the US is leading the way.
- Inflation is still too high, which could keep interest rates higher for longer, and even see some central banks increase interest rates.

The US economy is streaking ahead of the rest of the world, supported by massive government support in the form of the Inflation Reduction Act. Despite its name, the act is adding demand to the economy and making it hard to get inflation down to the Federal Reserve's 2.0% target rate.

The global economy continues to show signs of a revival in 2024 after the slowdown of 2023. Leading indicators of economic activity have been rising since late 2023. Recent data confirms that the 2023 slowdown in economic activity worldwide was moderate, a classic soft landing.

Even for those economies experiencing a technical recession, it was more-or-less a recession in name only. The financial distress and job losses usually associated with a recession have not materialised in the current cycle.

Distress has emerged in parts of the financial system, business community and household sector. The distress, however, is isolated to vulnerable pockets and has not derailed the broader economy in most countries.

The demand for labour is holding up in most economies, while unemployment remains near multigenerational lows. This is a hallmark of the current global economy, which is likely related to the significant demographic shift we have seen over the past decade – the retirement of baby boomers.

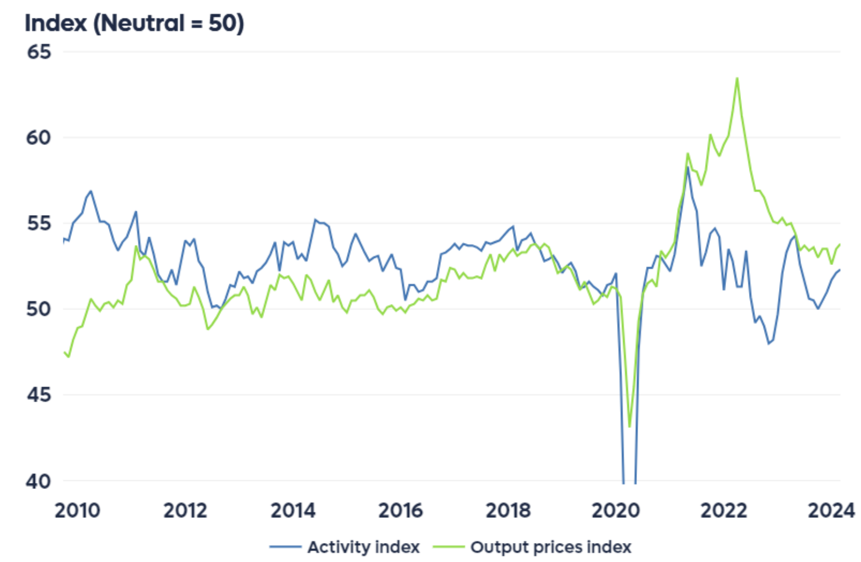
While baby boomers have stopped working, they have not stopped spending. Indeed, many have saved for decades for this precise moment in life, to enjoy retirement with more free time to focus on special interests and travel.

Further progress on inflation has been made over the last six months, although almost all of the lower inflation is due to weakness in goods prices. Services inflation, which is mostly a domestic phenomenon, remains elevated above central bank target rates in most major economies.

The global cost-of-living crisis is easing, but it is far from over. The so-called 'last mile' of disinflation is proving more challenging to achieve than the initial fall from inflation rates, from about 8.0% to around 4.0%. To get inflation back to the Federal Reserve's target of 2.0% will require patience.

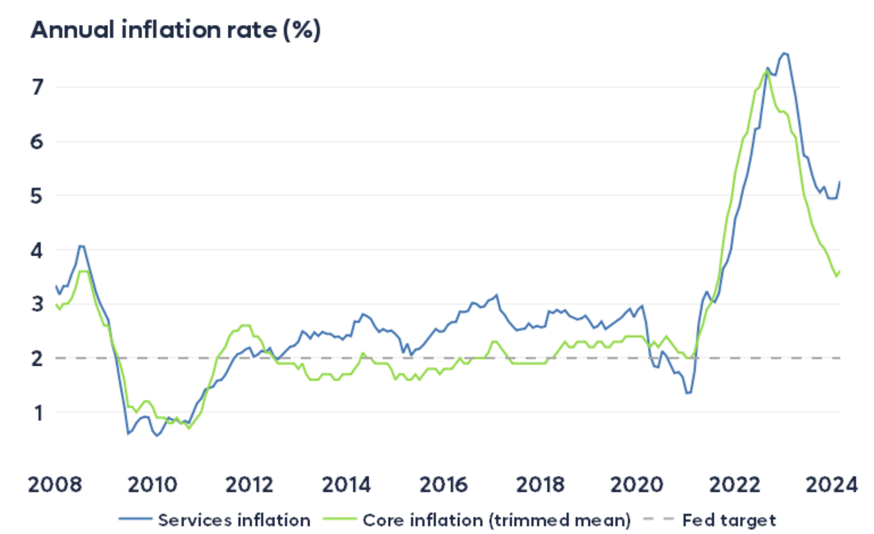
This may result in interest rates remaining higher for longer, and in some economies there is a possibility that policy may need to be tightened a little further.

S&P Global PMI – Activity and output prices



Source: S&P Global, Judo Bank

US inflation – Services and core (trimmed mean)



Source: FRED, Judo Bank

judobank

Global markets

While markets are performing well, investors seeking safe havens.

Key takeaways

- Financial markets are performing well in 2024, with the underlying consensus that the US Federal Reserve will commence a moderate cutting cycle this year.
- Sticky inflation may put upward pressure on interest rates and create volatility in many asset markets.

Bitcoin and gold have hit record highs in 2024 despite rising interest rates and a strong US dollar, as investors seek safe havens from potential market volatility.

Asset markets have experienced strong trading conditions in 2024 thus far, with many markets worldwide setting record high prices. Whether we look at public equity markets, segments of the commercial property market or residential property in Australia, investors are happy to buy up assets despite higher interest rates, political uncertainty and concerns about the outlook for economic activity.

A common theme across asset markets is earnings yields, which inflationary pressures have supported. Whether it is rising rents in Australia's housing market supporting local rental yields, or higher earnings across corporate America, asset prices have continued to perform well despite higher interest rates because an inflationary economy is boosting underlying earnings.

Asset markets are starting to feel pressure from rising long-term interest rates. The US 10-year Treasury yield increased from about 4.0% at the start of 2024 to nearly 4.5% in April. The US interest rate is a benchmark for global asset prices and the interest rates of other countries.

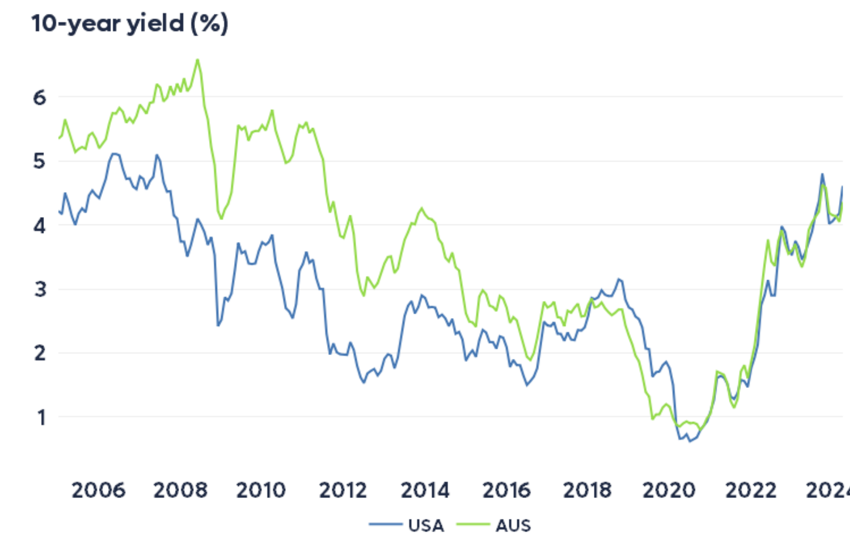
Rising long-term interest rates put downward pressure on asset prices. As a rule of thumb, for every 1.0% increase in rates, asset prices should fall about 10.0%. However, if underlying earnings are rising, then asset prices can withstand higher rates.

It is becoming clear that the new normal for US interest rates is around 4.0%. While both short- and long-term rates will fluctuate around this level, 4.0% is a good starting point for considering what other interest rates and asset values should be in the post-pandemic world.

Commodity markets are diverging, with some – including coal, gas and many agricultural products – returning to pre-pandemic levels. Oil is moving higher in 2024, thanks to uncertainty in the Middle East and solid global demand. Gold is surging to record highs as investors seek protection against inflation and geopolitical uncertainty.

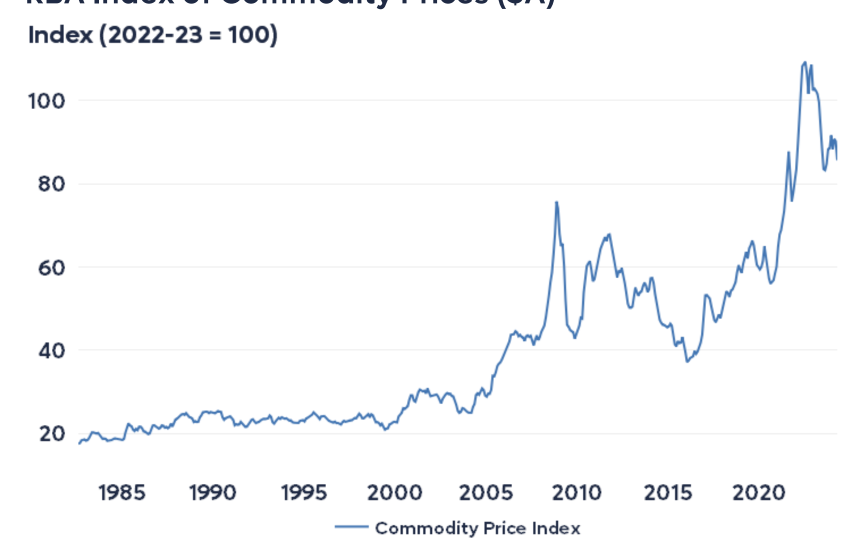
The RBA Index of Commodity Prices summarises the overall commodity picture and what it means for our economy. Although commodity prices are 20.0% below 2022 peaks, they are just above the average levels seen since the start of the pandemic and almost 40.0% above pre-pandemic averages.

Government 10-year Treasury yields – Australia and US



Source: FRED, RBA, Judo Bank

RBA Index of Commodity Prices ($A)



Source: RBA, Judo Bank

judobank

Australian economy
Not a normal cycle.

Key takeaways

- The RBA's 'narrow path' is getting narrower as the economy starts 2024 on a stronger footing.
- The RBA has no room for upside surprises on its inflation projections, which could be threatened by a sharper bounce-back in consumer spending in the first half of 2024.

Over the past 40 years, inflation-adjusted consumer spending has stalled four times. In each episode, business investment contracted by an average of 16.0%. But in 2023, business investment in plant, machinery and equipment increased by 7.4%.

The slowdown in the Australian economy over the last 18 months has primarily resulted from consumer belt tightening. Despite rising gross household incomes, inflation has undermined disposable incomes, and surging income tax payments have torn a hole in many Australians' spending capacity.

Higher mortgage rates have been painful for many, but the number of Australian households driven into financial distress due to higher debt service is relatively small. A quick look at the major banks' results shows that distress is only just back to what was once considered normal.

In a typical economic slowdown, higher interest rates also impact business profits, investment and, ultimately, hiring. Most Australian businesses are in good financial health. Chronic labour shortages mean the demand for labour continues to outstrip the number of available workers, and overall employment is still expanding.

No economy experiences a severe economic downturn when employment is growing.

Australia appears to be following the path of the US. Early signs of stronger business conditions in 2024 suggest a cyclical recovery in economic activity is afoot following the soft landing in 2023.

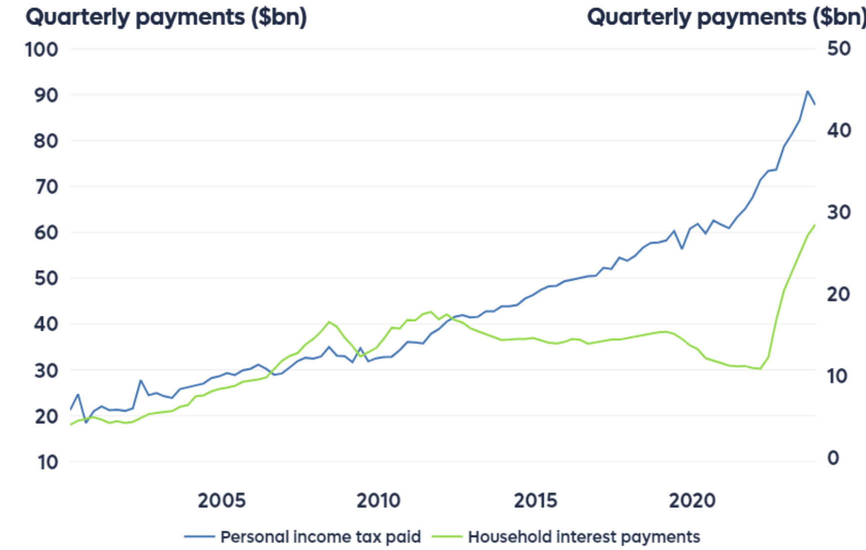
This is excellent news, but it comes with a sting in its tail. A more robust economy means inflation might persist for longer. This could mean higher interest rates to ensure inflation returns to the RBA's target range of 2.0% to 3.0%.

The RBA's narrow path, driving the expectation that Australian interest rates will be cut in the next 12 months, requires economic activity to remain subdued throughout 2024 for inflation to return to target on a sustainable basis.

Buoyant commodity markets, rising asset values and low unemployment do not suggest a weak economy. The main stress in the economy is the impact of rising prices on everyday Australians' living standards. The policy priority should be to remove this pressure by getting inflation below 3.0%.

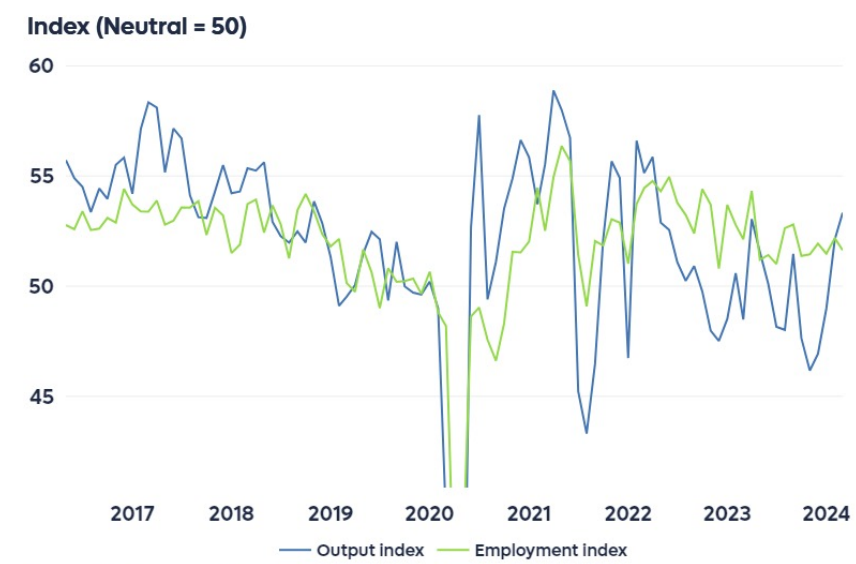
History shows that the only way to control inflation is to set interest rates to the right levels. At 4.35%, the RBA cash rate might not yet be high enough to ensure price stability.

Household interest and personal income tax payments



Source: ABS, Judo Bank

Australian S&P PMI – Output and employment



Source: S&P Global, Judo Bank

Australian consumers

Drove the slowdown in 2023, but worst is likely behind them.

Key takeaways

- Consumers nationwide took a hit in 2023, tightening their belts and pulling back on discretionary spending.
- Despite this slowdown in spending activity, consumption levels appear to have stabilised heading into 2024, with inflation-adjusted per capita sales still above pre-pandemic levels in each state.
- While household savings and real disposable incomes improved through to the end of 2023, whether this will convert to an improvement in consumption levels in the first half of 2024 is unknown.

Consumer belt tightening drove the overall slowdown in economic activity in 2023, with business activity and investment holding up. What happens next with consumer spending could determine the next phase of the Australian economy.

The Australian household sector has borne the brunt of the economic slowdown since 2022. Inflation, a rising tax burden and higher interest rates have squeezed household disposable incomes.

We saw the first signs of an easing of these pressures on household incomes in the final three months of 2023. The effects of higher interest rates are starting to wane as the last of the fixed-rate mortgages roll off.

Income tax paid by households fell in the December quarter of 2023 for the first time since the March quarter of 2021. While it is unclear how the tax take will evolve over the first six months of 2024, what is clear is that we will see a significant boost to household income from 1 July when the Stage 3 tax cuts kick in. The tax cuts are worth about $6bn a quarter. With the current tax take at about $90bn a quarter, household incomes will be boosted by at least 5.0%.

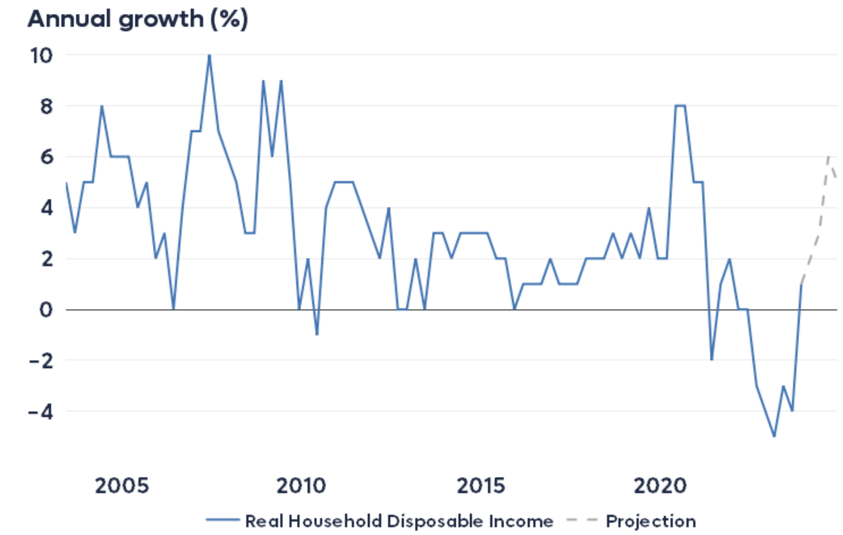
As household disposable income starts to grow, the question is what impact will this have on consumption and the economy? The swing factor in this calculation is the household saving rate, which moved off 15-year lows late last year, rising from 1.9% to 3.2%.

Our analysis suggests the households' desired savings rate is about 9.0% in early 2024, much higher than the rate seen over the past year. If consumers decide to save the extra income rather than spend it, consumer spending may remain tepid in 2024. This is the central case, with consumption growth expected to remain at around 1.7% in 2024.

Despite the lower savings rate in 2023, Households have accumulated excess savings since the pandemic. We expect some excess savings remain and will be used to support spending, keeping actual savings below the desired rate.

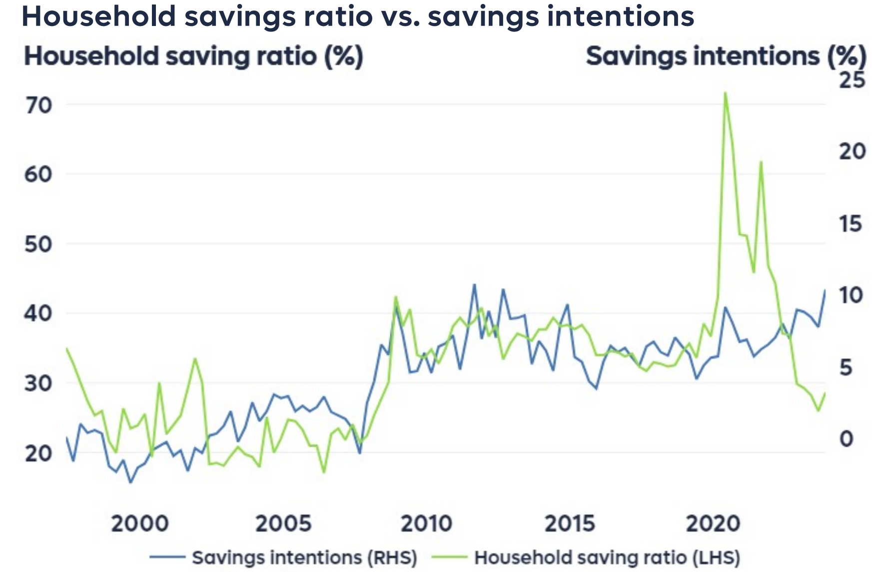
This suggests that the worst of the consumer adjustment to higher interest rates is behind us. What is not clear is how much of a recovery in spending is coming. Population growth remains strong, and so does employment in early 2024. So far in 2024, we have seen a recovery in essential spending while discretionary spending remains soft.

Growth in real household disposable income



Source: ABS, Judo Bank

Household savings ratio vs. savings intentions



Source: ABS, WMI, Judo Bank

Australian businesses

Early signs of improved conditions in 2024.

Key takeaways

- There are tentative signs of a recovery for Australian business in 2024.
- While business insolvencies have been climbing, this pick-up is to be expected after an extended period of low insolvency rates.

If demand remains soft across the economy, eventually businesses will pull back on investing and hiring. This must happen for the economy to stay on the RBA's narrow path.

Business activity appears to be recovering in 2024 from the low point of late 2023. The Judo Bank PMIs, which provide a timely insight into business conditions, suggest the manufacturing sector remains soft while conditions have improved across service industries.

The Australian service sector accounts for over 80.0% of business activity, while manufacturing has fallen to about 7.0% of output. The rapid improvement in key activity indicators in the Judo Bank Services PMI suggests a cyclical economic recovery is underway. However, without a recovery in consumer data, it is too early to be confident of this view.

The services output index was above the neutral 50 mark in February and March and experienced the most significant four-month increase in the survey's history (outside pandemic lockdown periods). This is a clear signal of stronger business conditions in 2024 and could reflect a loosening of Australian consumers' purse strings.

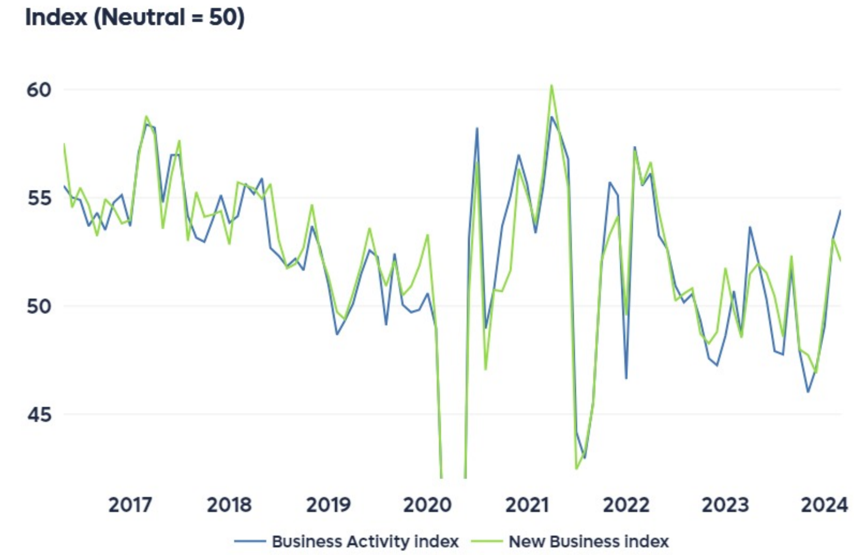
Business profits remain under pressure as cost pressures become increasingly difficult to pass on to final prices in a slower economy. While this has tempered investment and hiring intentions, it has not reversed investment plans. The Australian Bureau of Statistics (ABS) capital expenditure survey for 2024–25 points to a 10.0% increase in Australian businesses' capex plans.

Construction activity remains elevated, with dwellings under construction, non-residential construction and infrastructure spending all at high levels. While down from 2023 highs, investment pipelines remain elevated, highlighting the high levels of construction spending that will take place across the Australian economy well into 2025.

Business insolvencies are rising despite the relatively healthy state of business balance sheets across the Australian economy. First-time insolvencies are running at an annual rate of about 10,000 in the 2023–24 financial year, with a clear upward trend in the monthly data to February. This is the highest number of insolvencies in almost a decade, when ASIC's data hit a high point.

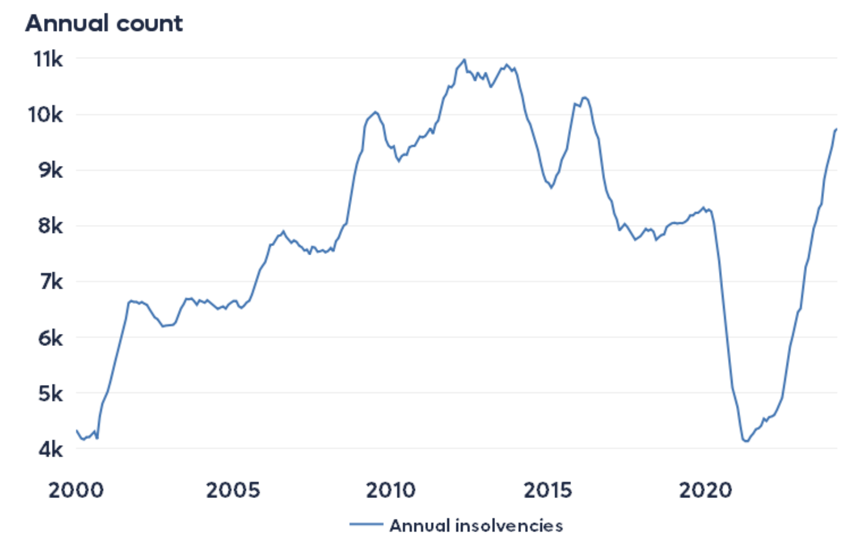
If we see a surge in insolvencies over a short period, it will create risks for the economy. If the insolvency process plays out over several years, the implications for the broader economy will be limited. Indeed, an economy free of the 'zombie' businesses accumulated after the pandemic will go a long way to reducing labour shortages, as failing industries release people to seek work in industries looking for more staff.

Australian services S&P PMI – Activity and new business



Source: S&P Global, Judo Bank

Annual first-time business insolvencies



Source: ASIC, Judo Bank

Inflation and interest rates

The job might not be done at a 4.35% cash rate.

Key takeaways

- The war on inflation is far from over, with underlying domestic inflation pressures still above the RBA's target of 2.0% to 3.0%.
- Until inflation is sustainably back to target, the economy must remain 'soft' to stay on the RBA's narrow path.

Domestic inflation remains uncomfortably high in Australia. A pick-up in domestic economic activity before inflation returns to target will increase the risk of further rate hikes.

The first battle in the war on inflation is over. The original pandemic inflation shock to global goods markets and associated supply chains is now receding. Global goods inflation has been close to zero in early 2024, and has been responsible for getting inflation in most countries under 4.0% over the past six months.

The main battle is reducing domestically generated inflation. Across most economies, that battle is far from won. US service inflation has hovered around 5.0% over the past six months, despite the overall Consumer Price Index (CPI) falling below 4.0%. In Australia, various measures of domestic services inflation are running at 4.0% to 5.0%.

At this stage, there appears to be little risk that inflation will start rising again. The threat of the so-called wage-price spiral is not apparent. However, central banks need inflation to get all the way down to their targets, an inflation rate of 2.0% for most global central banks. The RBA will be happy if Australia's inflation comes down to 2.5%.

Currently, domestic inflation in most economies is sticky, showing how little spare capacity is available globally.

We have achieved full employment in Australia, with the unemployment rate below 4.0%. In many industries, there are still difficulties in accessing inputs for production. The Australian construction industry is particularly stretched.

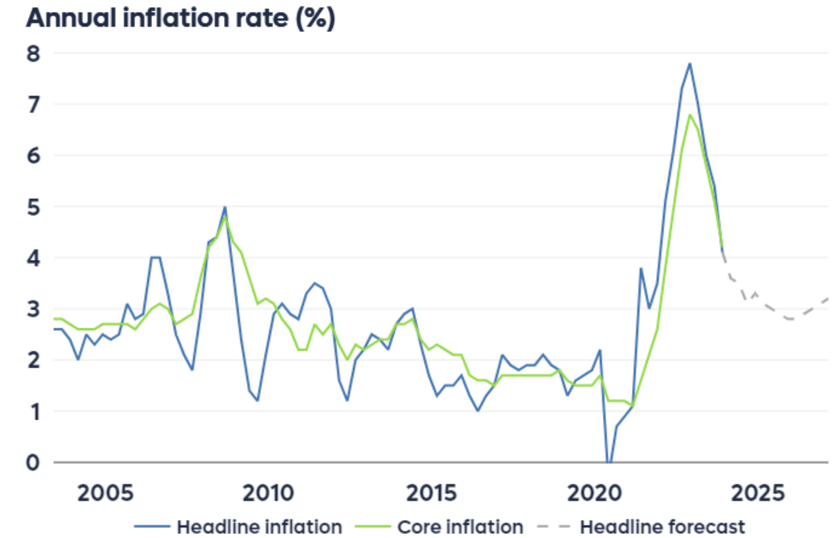
As global markets have retracted their expectations of rate cuts, long-term interest rates have been on the rise, reflecting the necessity for interest rates to be sustained at higher levels for an extended period. This trend makes it increasingly improbable for global interest rates to decrease significantly this year.

This poses a real problem for the RBA as they never got interest rates up to the global level of around 5.0%. The RBA has been relying on a high proportion of variable rate mortgages, creating enough pressure in the economy to maintain a soft landing and get inflation back to target.

The longer global interest rates remain above 5.0%, the more likely the RBA is to finish tightening monetary policy and raise the Australian cash rate to 5.0% from 4.35%.

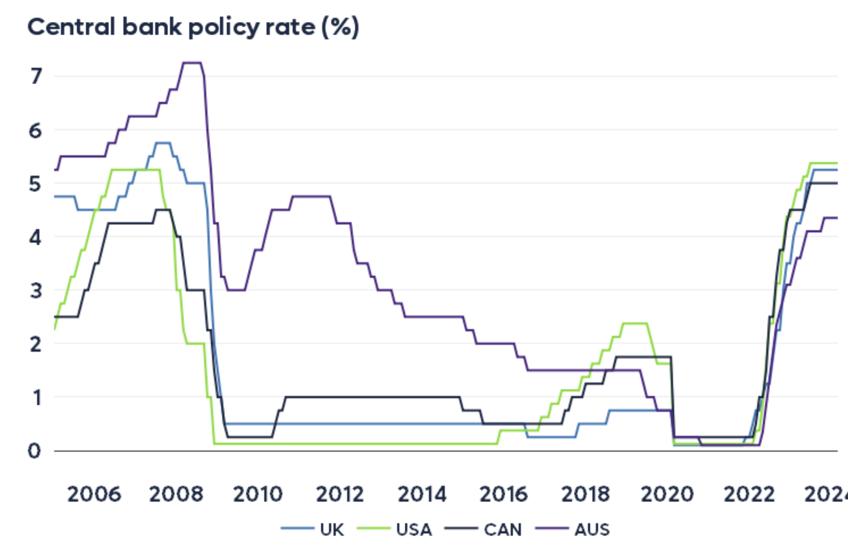
The RBA board will not hike again unless they absolutely have to. This means they will be late and may need to hike more because they are late. At the very least, we should not rule out another two or three rate hikes before the cycle is over.

Domestic inflation pressures



Source: ABS, Judo Bank

Central bank policy rates – Australia, US, UK and Canada



Source: RBA, FRED, BOE, BOC, Judo Bank

The SME economy.

Leading the way in 2024.

Key takeaways

- **The recovery in Australian business activity in 2024 has been almost entirely the result of an improvement in the SME sector.**
- **The emerging SME economic recovery will be uneven across states and industries, with Queensland and Western Australia leading the way in 2024.**

The SME sector is leading the recovery in business activity across Australia in 2024. A lift in SME activity has been responsible for just about all the recovery in the Judo Bank PMI key activity indicators.

This partly reflects that SMEs were a soft spot in the economy throughout 2023. Despite the relative health of the Australian business sector, the operating environment has been challenging for the past four years. Even in recovery, businesses have had to deal with rising costs, tight labour markets, and grumpy consumers bearing the brunt of this inflation with cost-of-living pressures.

The SME sector tends to have less scale and flexibility to deal with these challenges, making the strong recovery in 2024 even more impressive. Sentiment lifted significantly over the summer break as the economy stabilised, financial markets improved, and expectations grew that we had seen the last of the RBA's rate hikes.

The jump in SME activity could reflect better consumer spending. The official statistics point to only a small improvement in retail spending in 2024; however, businesses might be confident that the worst of the consumer spending adjustment is behind us.

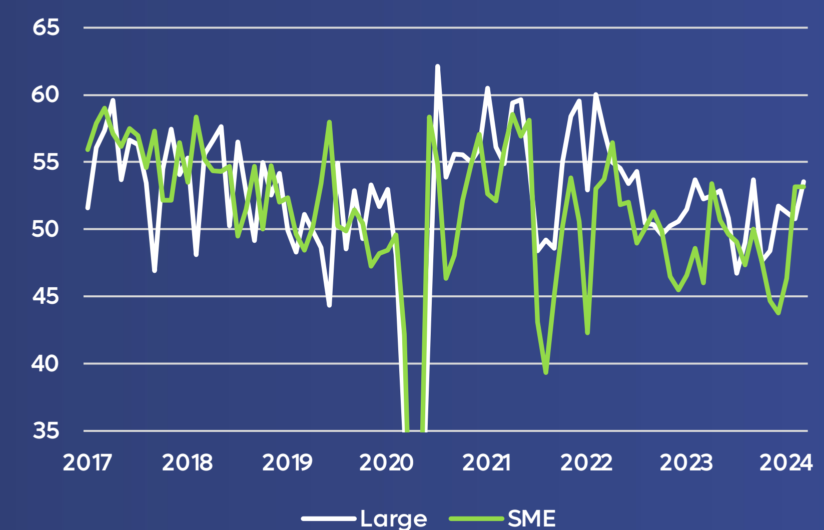
The recovery in Australian economic and business conditions has not been even across the states. The evidence from 2024 thus far points to a strong recovery in Queensland, Western Australia and South Australia, while Victoria and New South Wales remain soft. This geographic dispersion of economic conditions will also be relevant for the SME sector.

There is also clear evidence that business failures are rising, many of which would be classified as SMEs. But we should keep these numbers in perspective. Australia has about 2.6m businesses, 90.0% of which are SMEs. ASIC data shows that first-time insolvencies are running at an annualised rate of around 10,000.

The broad numbers are consistent with what we are seeing in relative state economic performance, with a net increase of 11,031 in the number of businesses in Queensland in 2022–23 compared to a net decrease of 7,606 in Victoria over the same period.

We expect SMEs in Victoria and New South Wales to continue to experience challenging operating conditions in 2024. However, the outlook is bright for state economies in recovery, particularly for the high-growth states of Western Australia and Queensland.

Judo Bank S&P output PMI – Large vs. SME
Index (neutral = 50)



Source: S&P Global, Judo Bank

Judo Bank S&P output PMI – NSW, Victoria and Queensland
Index (neutral = 50)

Source: S&P Global, Judo Bank

SME activity readings for February and March suggest consumption is beginning to bounce back in 2024.

Section 2

New South Wales.

The tightest consumer belts across the nation.

Judo Office | Sydney

New South Wales.

The tightest consumer belts across the nation.

Despite high levels of construction activity across the state, business sentiment remains weak. The Judo Bank New South Wales PMI, at 45.8, has remained near cyclical lows in early 2024, at 45.8. This is in contrast to other states, which have seen rapid improvement in early 2024.

New South Wales consumers are struggling more than those in the rest of the country. Sentiment is still very weak in early 2024 and consumption is barely growing.

The New South Wales housing market is the most expensive in the nation on just about every metric. Dwelling sale prices are almost 50.0% higher than the national average. Housing is incredibly expensive compared to household incomes, with rental costs continuing to rise rapidly.

Higher house prices mean bigger mortgages, which leave New South Wales residents particularly vulnerable to higher interest rates. On a positive note, rising house prices over the past 15 months should exert a bigger wealth effect, although it appears wealth-related spending is being directed out of the state.

It is hard to see economic growth in New South Wales bounding ahead over the year, particularly if the RBA is forced to raise rates again due to strong growth elsewhere. By the same token, it is also hard to see a major downturn in the state's economic activity. The construction pipeline is large, employment levels are high, and the state government is motivated to increase the supply of new dwellings in the face of strong population growth.

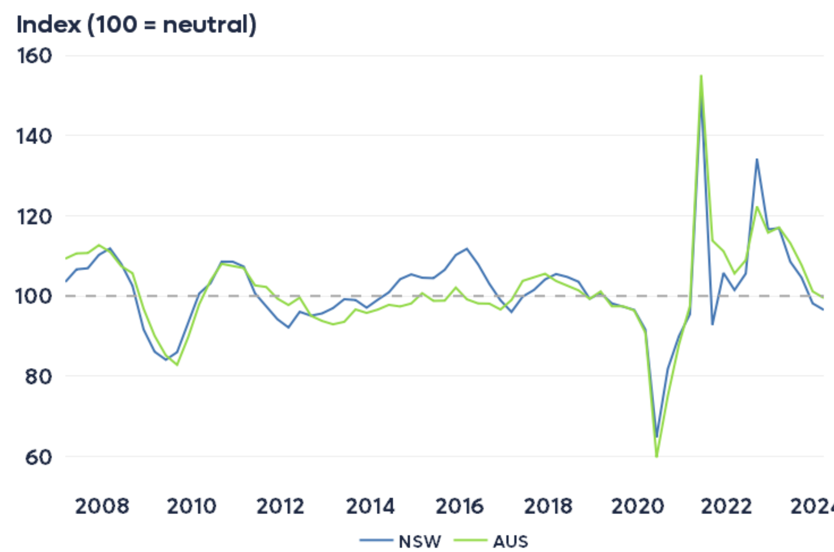
1.3%
Fall in real retail sales through second half of 2023

1.6
Number of unemployed persons to job vacancies

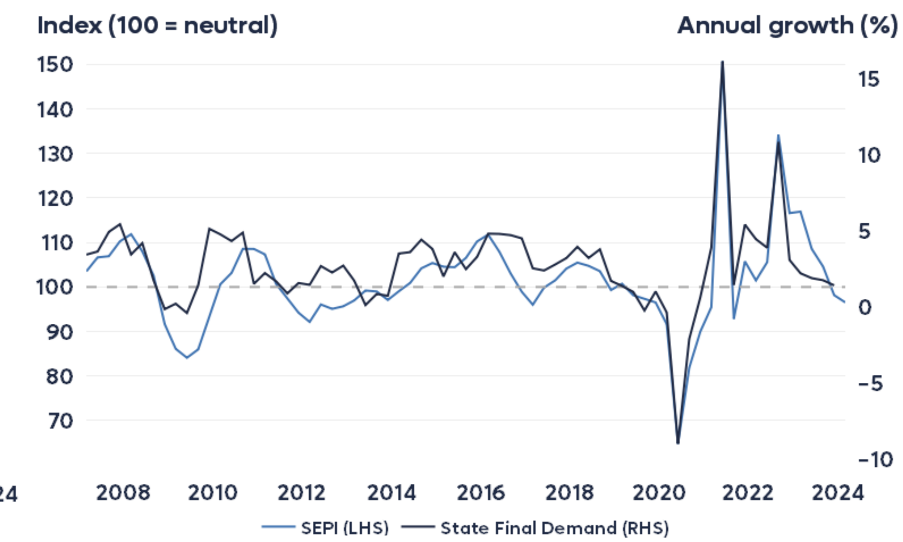
28.5%
Average sale price premium of Sydney dwellings over national capital city average

New South Wales
The labour market is easing to pre-pandemic levels quicker than any other state

New South Wales State Economic Performance Indicator (SEPI)



Source: ABS, Jobs & Skills Australia, Judo Bank



Source: ABS, Jobs & Skills Australia, Judo Bank

New South Wales' SEPI score, measuring economic momentum, was the lowest among all states through March 2024, at 96.5.

Despite slowing through 2023, inflation-adjusted retail sales per capita in New South Wales are still 3.9% above 2019 levels.

Households.

After a tough end to 2023, consumers to bounce back in 2024.

Key takeaways

- Consumer sentiment has picked up over the past six months, driven by increased optimism about family finances in the year ahead and improving clarity about the economic outlook.
- Retail sales, however, continued to ease at the end of 2023, albeit at a slower rate than earlier in the year. Despite the fall, New South Wales residents are still, on average, consuming more than in 2019.
- Early activity readings suggest sales are bouncing back in 2024 and we expect this to continue as inflation eases, tax cuts commence and housing prices continue to rise.

New South Wales consumers have ushered in 2024 in a less pessimistic mood.

The period between December and March has witnessed an upswing in consumer sentiment, rising from a low of 82.8 in the September 2023 quarter to a promising 86.2 in the March 2024 quarter. This improvement in sentiment can be attributed to the improved perception of family finances and a more positive economic outlook for the next 12 months. The Melbourne Institute's Expectations Index – a key indicator of economic outlook and expected family finances – has nearly returned to pre-pandemic levels after a dip in mid-2023.

Despite consumer sentiment improving throughout New South Wales, consumers continued to 'tighten their belts' at the end of 2023, albeit at a slower rate than in the first half of 2023. We estimate that over the last six months of 2023 real consumer sales fell by 1.3% per capita but remain 3.7% above the average level through 2019. That is, despite the softening through 2023, retail consumption for the average New South Wales resident remains above their consumption levels leading into the pandemic. However, this tracks behind the national average of 4.0%, driven by more robust consumption levels in Queensland (4.7%) and Western Australia (7.1%).

While New South Wales consumers have felt the impact of higher interest rates due to household leverage and rising mortgage repayments, the worst of the consumer slowdown seems to be over. The six-month annualised sales growth – which is a more current indicator of sales trends – has been on an upward trajectory since mid-2023. It reached a high of 2.7% in February 2024 – the highest growth rate in a year.

This growth has been primarily driven by an increase in goods retailing, which saw a 3.1% rise in six-month annualised terms up to February. New South Wales consumers pulled back more significantly on eating out through the final months of 2023, with a six-month annualised decline of 6.5% in December before recovering to 0.6% in February. The positive reading for February – the first positive reading since May last year – further suggests a bounce-back among New South Wales consumers in early 2024.

With inflation continuing to ease gradually through the first half of 2024, household balance sheets improving with rising house prices, and Stage 3 tax cuts on the way, we expect consumer activity in New South Wales will see further recovery throughout 2024.

Retail trade – nominal vs. real

Index (100 = Dec' 2019 Expenditure)

Source: ABS 8501.0, Judo Bank

Retail trade – goods and hospitality

Index (100 = Dec' 2019 Expenditure)

Source: ABS 8501.0, Judo Bank

judobank

Business

New South Wales businesses hit harder than any Australian state.

Key takeaways

- Business activity and margin pressure readings for New South Wales have suggested a higher contraction in business activity over the past six months than the national average.
- Consequently, New South Wales businesses have pulled back on hiring more than others across the nation, with job advertisements on a falling trajectory.
- While the start of the year has been weak, business conditions are anticipated to improve as New South Wales consumers bounce back in mid- to late-2024.

Business activity took a harder hit through the end of 2023 and the start of 2024 than in the rest of the nation. Judo Bank New South Wales Activity PMI fell to 43.6 in the December quarter of 2023, well below the neutral 50 level and the lowest reading in the series history outside of the pandemic. While improving slightly through the March quarter, the index remains in contraction territory, suggesting businesses, on average, continued to see a slowdown in activity in the early months of 2024. This contrasts with the national index reading of 51.5, suggesting improved national business conditions through the March quarter.

Margin pressure continues to negatively impact New South Wales businesses more than those in other states. New South Wales businesses are facing worse cost pressures and are finding it more difficult than other states to pass these costs onto consumers, likely driven by comparatively weaker household budgets. The Judo Bank Margin Pressure Index for New South Wales was 53.7 (Australia 51.8) in the March quarter of 2024, with readings above 50 suggesting margin pressure is worse than pre-pandemic.

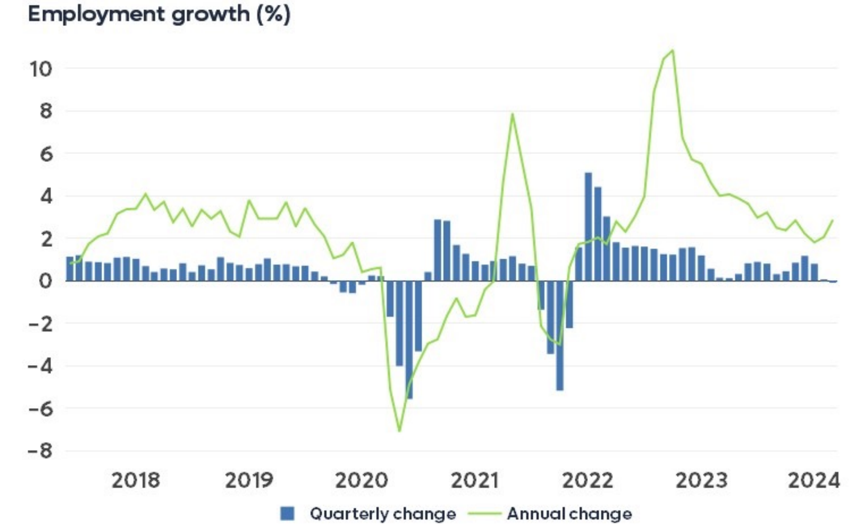
With activity weakening and increased pressure on business profitability, the state's labour market eased by more than the national average over the second half of 2023.

Annual employment growth in New South Wales has slowed from the late 2022 peak of 10.9% to 2.9% in March, compared to the national average of 2.4%. Nationally, employment growth has been propped up by a notable increase in part-time employment that has been underway since mid-2023. The increase has been a lot less substantial in New South Wales, driving the overall weak employment growth figures. In the year to February, part-time employment growth in New South Wales reached 4.9% – less than the national rate of 5.9%.

In line with the weak employment growth seen in New South Wales, the number of job advertisements has fallen more sharply in the state – down 10.5% over the past six months compared to 7.8% nationwide. The number of New South Wales job ads in March was 21.2% above the 2019 average. While this still indicates labour tightness, it is lower than the national figure of 44.8% and individual state figures. The fall in job ads corresponds with an increase in the state's unemployment rate to around 4.5% by mid-year, in line with the RBA's predictions.

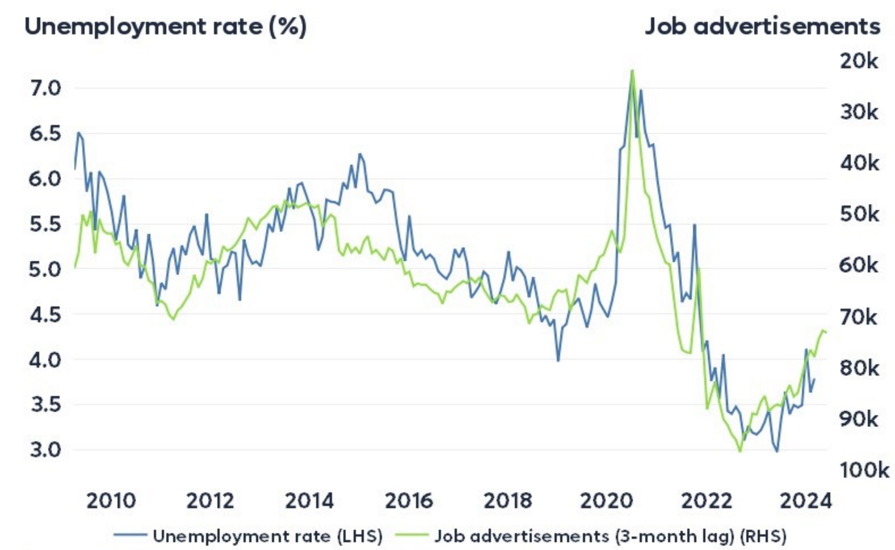
Employment growth is expected to stabilise over the first half of 2024 in line with the six-month annualised trend. Improvements in consumer balance sheets, labour supply and inflation throughout the year are expected to correspond with improved activity levels for New South Wales businesses and thus put a floor under hiring intentions.

Employment growth – annually and quarterly



Source: ABS 6202.0, Judo Bank

Unemployment rate vs. job advertisements



Source: ABS 6202.0, Jobs & Skills Australia (3/24), Judo Bank

Managing Director Comments

"Despite tight trading conditions, businesses have remained resilient. There are green shoots emerging with a marked increase in activity and investment spending."

- Gordon Moy

Government and construction

The infrastructure boom is showing signs of peaking.

Key takeaways

- The infrastructure and construction pipeline stood at $70bn in late 2023, just below the record highs of earlier in the year. Infrastructure work to be done makes up almost 50% of the construction pipeline in New South Wales.
- NSW Government finances have deteriorated by almost $2bn in the past year as rising expenses and flat revenues take the government's deficit to almost $10bn in 2023–24.

The New South Wales infrastructure and construction boom showed signs of reaching a peak in 2023 although the current pipeline of work across all major sectors remains at near historically high levels. Widespread evidence of capacity constraints in the construction sector suggests that the future flow of work will remain elevated despite a year of weakening building approvals.

The total construction pipeline in New South Wales stood at $70bn at the end of 2023, growing almost threefold in a decade. Inflation may explain some of the increase in construction costs and total spend, but the reality is that the New South Wales Government has embarked on one of the biggest infrastructure expansions in the state's history. Infrastructure investment is needed given the high rates of population growth we have sustained over the past 20 years.

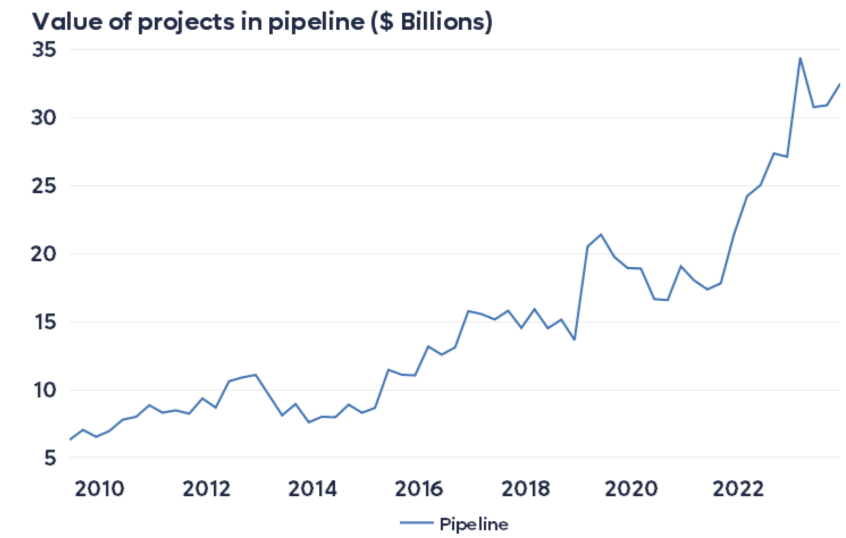
The infrastructure pipeline makes up almost half of the total New South Wales construction pipeline, at a value of $32.5bn. The infrastructure build across regional New South Wales and Sydney has been unprecedented in the past 50 years. There is still $32bn of infrastructure work to be done according to the ABS. The residential and non-residential pipelines are also near the record high level of the past two years. New building approvals for both residential and non-residential construction are falling but with $37bn of work yet to be done, activity is unlikely to weaken substantially in the next 12–18 months.

New South Wales Government finances have deteriorated since the 2023–24 budget, with the budget update revealing a $1.7bn increase in the predicted deficit for 2023–24, to $9.6bn, and a $3.7bn deterioration over the forecast horizon to 2026–27. The upward revision in operating expenses has primarily been driven by increased interest expenses, while lower government revenues are due to lower GST payments, cuts to federal infrastructure funding and a weak investment fund performance.

In November last year, the Australian Government, under recommendations from the Infrastructure Investment Program Strategic Review, made cuts to infrastructure funding promises to the states. For New South Wales, this has resulted in the withdrawal of Australian Government funding for 17 infrastructure projects, with an estimated loss of $3.2bn in project funding.

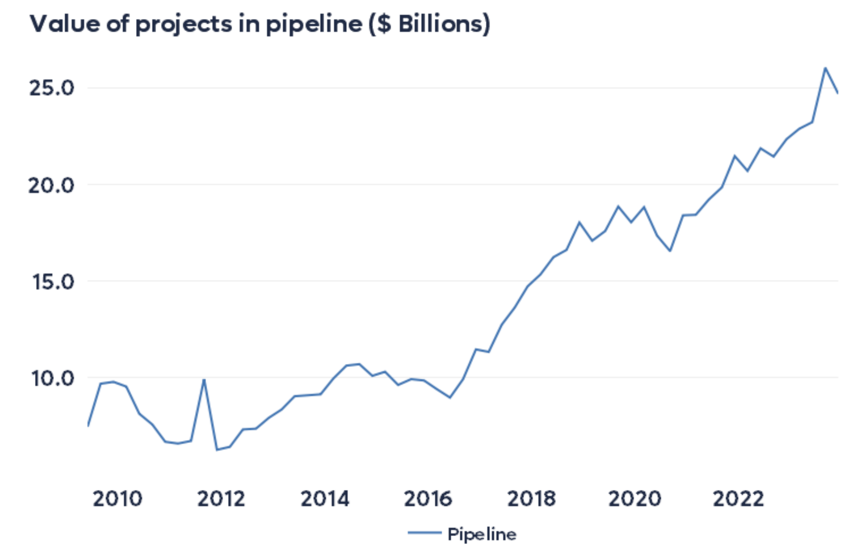
The Minns government is concerned federal funding going forward will not be sufficient for the state's infrastructure needs. Australian Government funding cuts and rising debt servicing costs will likely result in less infrastructure spending in New South Wales over the years ahead, despite the high levels of net overseas migration and strong population growth in regional areas.

Infrastructure construction pipeline



Source: ABS 8762.0, Judo Bank

Non-residential construction pipeline



Source: ABS 8752.0, Judo Bank

The total construction pipeline in New South Wales was $70bn at the end of 2023, having grown almost threefold in a decade.

Can property prices keep climbing in New South Wales?

Key takeaways

- **Housing affordability continues to worsen in New South Wales relative to the rest of the nation, with Sydney dwelling prices and rents increasing to almost 50.0% higher than the national capital city average.**
- **Despite government initiatives, housing stress through 2024 is likely to continue given ongoing high levels of overseas migration and capacity constraints in the construction industry.**

The housing affordability crisis in Australia is a pressing issue, particularly in New South Wales. Despite house prices not growing as rapidly as in other states like South Australia and Western Australia, the disparity between dwelling prices in Sydney and the national capital city average is a staggering 35.0% higher than it was before the pandemic. This is a significant jump, especially considering that wages in New South Wales are up 12.0% in line with the nation, over the same period.

The price difference is more notable when looking at detached dwellings, at 440k in March this year. This makes houses in Sydney 47.0% more expensive than the national capital city average, with the price difference increasing by 50.0% since 2019. Units have seen affordability worsen slightly, with the difference increasing to 152k from 141k pre-pandemic. This also extends to regional New South Wales, where dwelling prices now resemble those in Melbourne and Brisbane.

A similar issue of relative affordability is playing out in the rental market. While rents have grown at the same rate as in other states, the differential between those in Sydney and Australia's capital city average has increased by 50.0% since the start of the pandemic.

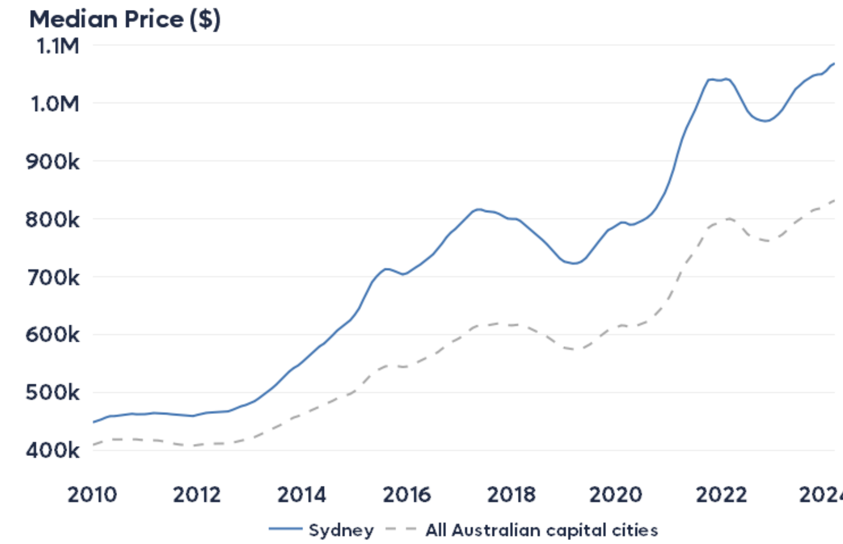
With ongoing supply and demand imbalances projected through 2024, house price and rental price growth are expected to continue.

Annual dwelling approvals eased notably through 2023, down 17.4%. Ongoing labour shortages and a high level of construction in other sectors are continuing to limit the industry's ability to keep up with demand for new dwellings. This is reflected in the average number of approved dwellings that have not yet commenced, growing 5.0% to 14,700 in 2023. Given these dynamics, we expect close to 45,000 dwelling completions through 2024 – down on recent years and well below the peak number of completions of 73,000 in 2018.

On the demand side, net overseas migration reached a historic high in September 2023, with an annual read of 186,000 persons. Data on overseas arrivals and departures suggests this historically high level of overseas migration – close to double the level seen in 2019 – will likely continue through recent December and March quarters.

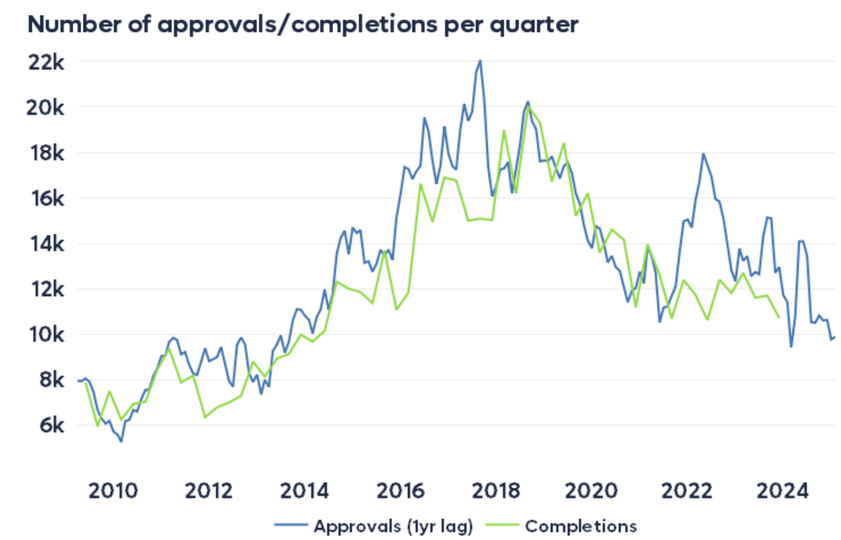
The Minns government has put forward a comprehensive plan to address the housing affordability crisis. Its proposals include rezoning of land near transport infrastructure for medium-density housing and streamlining the development process to accelerate construction. While these measures are expected to improve affordability over the long term, the combination of high migration rates and ongoing labour shortages in the construction industry means that immediate relief is unlikely in 2024. In this environment, we expect to see further increases in New South Wales dwelling prices in 2024.

Median capital city dwelling price – NSW and Australia



Source: REA Proptrack, Judo Bank

Residential building approvals and completions



Source: ABS 8752.0, Judo Bank

The disparity between dwelling prices in Sydney and the national capital city is 35.0% above 2019 levels.

Section 3

Q1 2024 comparisons and forecasts.

Review of the business and economic conditions of the six states.

Pictured: Judo customer

Rene Ratilainen
Broadbeach Waters Pharmacy

judobank

Queensland: Strongest performing state economy.

Queensland replaced South Australia in the top spot on Judo Bank's State Economic Performance League Table in early 2024.

The New South Wales economy is languishing at the bottom of the rankings, with weak growth performance over the past year and few signs of a recovery in early 2024.

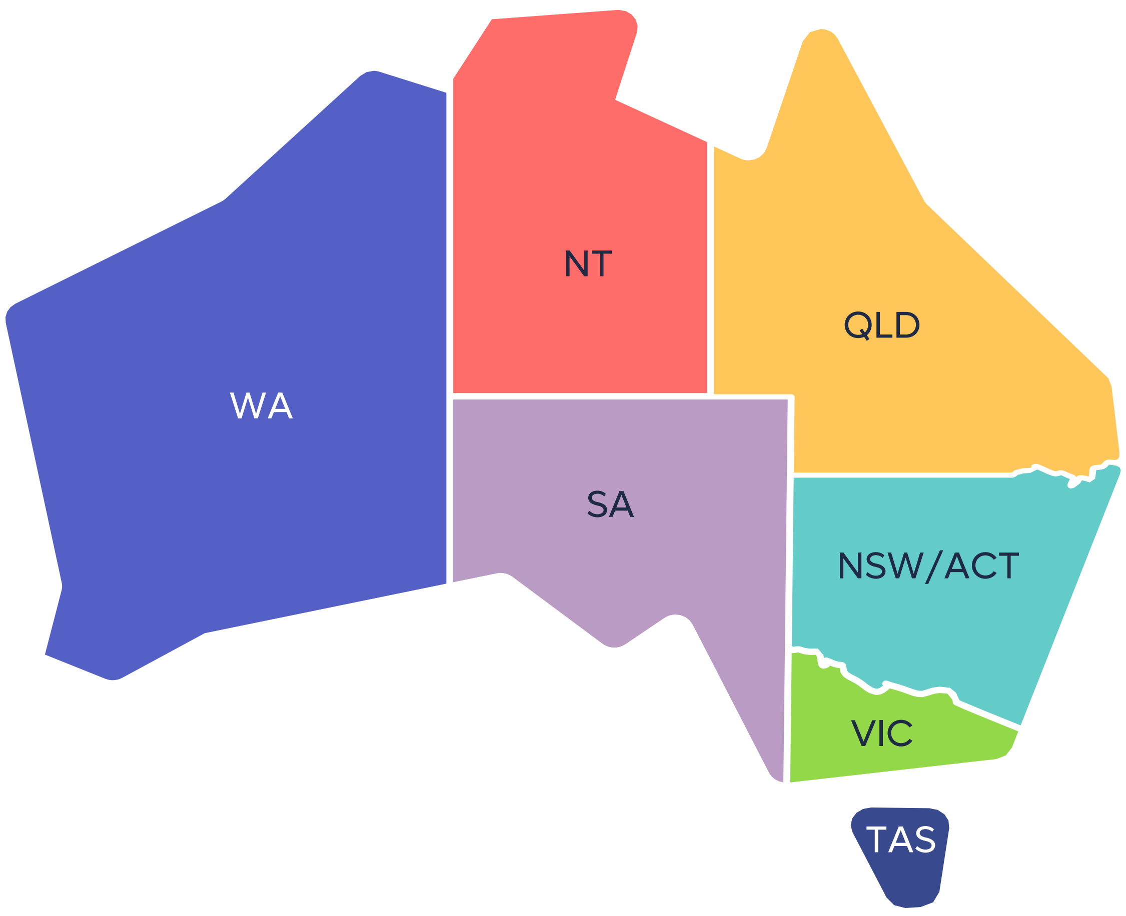
Victoria is hanging in there in the fourth spot, but activity is still below trend. It is becoming increasingly clear that Queensland and Western Australia will be the growth engines of the Australian economy in 2024.

The Western Australian economy has finally recalibrated itself with the national economic cycle after 20 years of de-synchronisation stemming from the once-in-a-hundred-year mining investment boom.

Western Australia is now reaping the economic benefits of its expanded mining capacity. Despite the global economic slowdown of 2023, the state is experiencing high income growth driven by strong export markets.

Queensland's potential to outpace all states over the next three to five years cannot be ignored. Not only is Queensland at the start of a massive infrastructure journey, but the 2032 Olympics will provide a significant lift to the state if the next Queensland Government puts together a credible plan to deliver world-class facilities.

Tasmania remains in a lacklustre position as flat population dynamics inhibit growth in economic activity. The fundamentals of the state are solid, and a strong wave of investment in recent years should be the foundation for future growth in industrial capacity.



State Economic Performance League Table (March 2024)

1. Queensland	**102.1**
2. Western Australia	100.4
3. South Australia	99.1
4. Victoria	99.0
5. Tasmania	98.3
6. New South Wales	96.5

102.1
Queensland
Leading the nation out of a soft landing.

100.4
Western Australia
The most resilient state through the consumer-led slowdown.

99.1
South Australia
Ongoing tightness in the labour market as national labour demand eases.

99.0
Victoria
Signs of positive activity heading into 2024, but debt woes remain.

98.3
Tasmania
Population woes continue.

96.5
New South Wales
The tightest consumer belts across the nation.

State economic performance.

Queensland scores highest SEPI through March quarter 2024

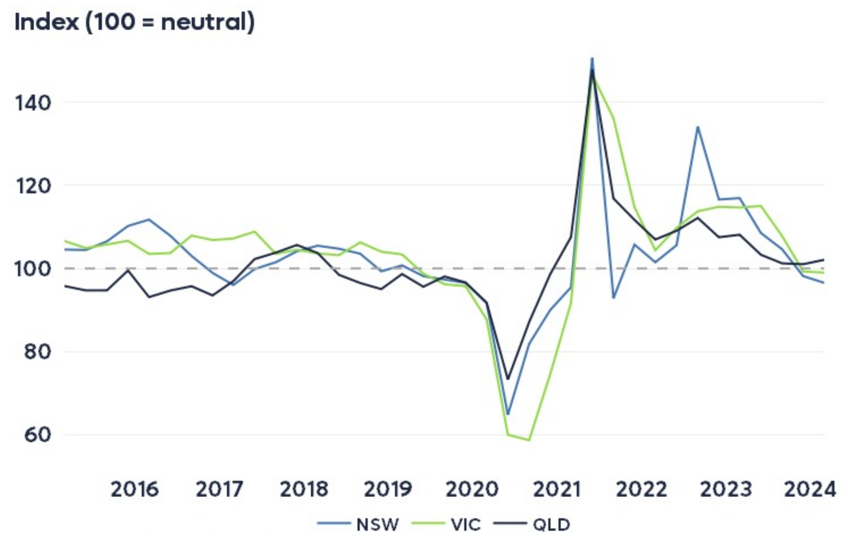
- **Queensland ranked highest in economic momentum through the start of 2024, driven predominantly by growth in hours worked across the economy.**
- **All states outside Queensland and Western Australia appear to be growing below long-term trend, driven by a combination of squeezed household budgets in New South Wales and Victoria, and increased difficulty in sourcing labour in South Australia and Tasmania.**

Over the March quarter, Queensland's SEPI was ranked the highest at 102.1, followed by Western Australia at 100.4. The combination of elevated job advertisements and resilient hours worked growth drove Queensland's differing performance from the other states through the March quarter.

Most state indexes are close to 100, suggesting that activity across the nation is no longer expanding at elevated post-pandemic levels, and that we have begun to see a reversion in momentum to levels more reflective of long-term averages through the back half of 2023.

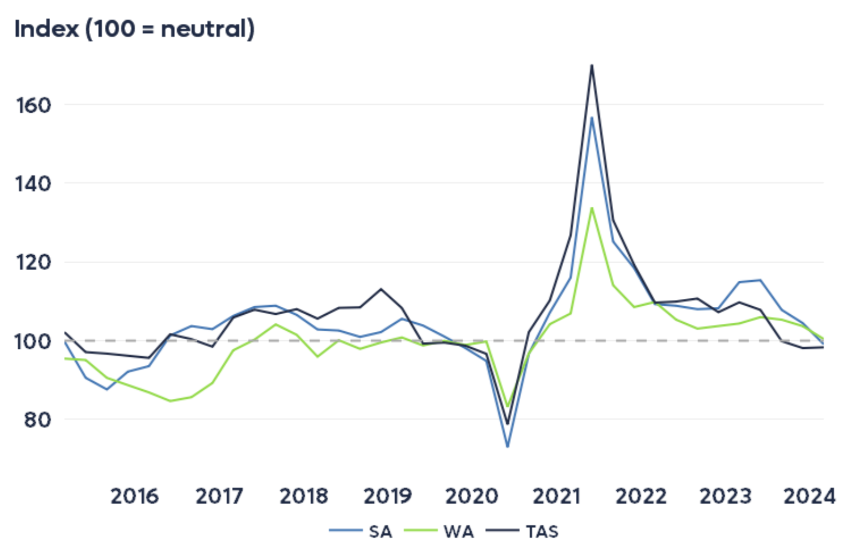
New South Wales SEPI has taken the most notable fall, driven primarily by weak household consumption levels and a pronounced slowing of growth in hours worked relative to long-term averages. Consumers and households in New South Wales have been hit harder by the slowdown and interest rate rises compared to other states.

SEPI – Larger states



Source: ABS, Jobs & Skills Australia, Judo Bank

SEPI – Smaller states



Source: ABS, Jobs & Skills Australia, Judo Bank

State Economic League Table Q1 2024

State Economic Performance Indicator	
1. Queensland	102.1
2. Western Australia	100.4
3. South Australia	99.1
4. Victoria	99.0
5. Tasmania	98.3
6. New South Wales	96.5

The March quarter reading is an estimate based on the data available at the time of publication. All readings are subject to future revisions that normally occur with time series data.

Judo Bank's SEPI combines the growth rates of a range of economic variables and reflects whether a state economy is expanding or contracting relative to historical trends.

At 100, the indicator is at a neutral level. Above 100 indicates the economy is growing above the long-run average rate, while below 100 indicates economic activity is growing slower than average.

Workforce comparison.

- **With activity levels easing through the back half of 2023, labour demand across most states has begun its transition towards pre-pandemic levels.**
- **South Australian and Tasmanian businesses continue to face extraordinarily tight labour markets, limiting employment growth.**
- **New South Wales has seen the sharpest easing of labour markets, with job vacancies now only 20.0% above 2019 levels.**

Labour markets began to ease in the second half of 2023 and early 2024, with national unemployment rising from its low point of 3.5% in June 2023 to 3.8% in March 2024.

Despite this easing, labour markets across Australia remain extraordinarily tight by historical measures. Excluding February 2008, the ABS has no record of the national unemployment rate falling below 4.0%, a reality we have faced for almost two years.

While the labour market tightness has been a blessing in achieving the RBA's soft landing, it has caused hiring to become the most significant issue facing businesses. Difficulty finding suitable labour and meeting wage demands has been a key issue for businesses across all states.

The level of labour market tightness across states has been uneven. With the consumer segment slowing down more sharply in New South Wales, employment growth has slowed in the state by a greater degree than the national average. South Australia and Tasmania too have experienced weak employment growth, but for the opposite reason. As these states have seen labour markets plateau or become somewhat tighter, the inability to source labour has inhibited businesses' hiring ability.

Workforce statistics across the states

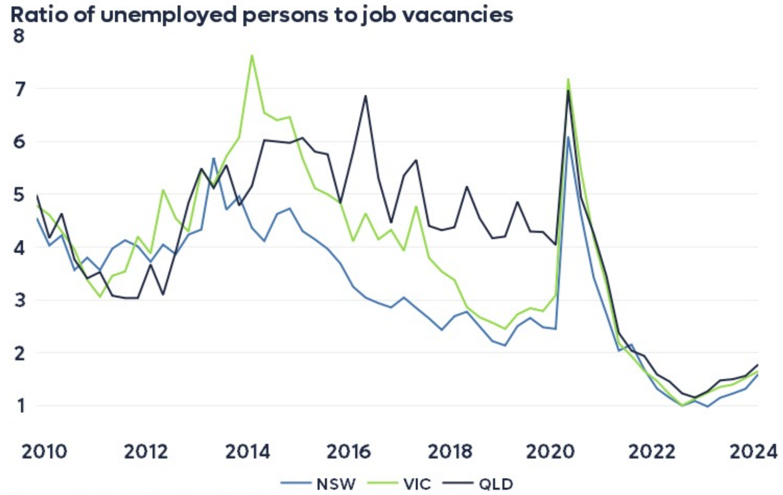
	NSW	Vic	Qld	SA	WA	Tas
Labour market tightness ratio (unemployed/vacancies)	1.6	1.6	1.8	1.4	1.4	1.8
Labour underutilisation	10.0%	10.9%	10.8%	10.5%	9.9%	11.8%
Unemployment rate	3.8%	4.1%	4.1%	3.9%	3.4%	3.8%
Employment-to-population ratio	63.6	64.6	63.9	60.3	66.6	58.7
Annual wage growth	4.3%	3.7%	4.8%	4.0%	4.7%	4.3%
Average weekly wage	$1,891	$1,858	$1,845	$1,735	$2,108	$1,670

Source: ABS (19/04/2024)

While labour market tightness is easing across the eastern states, South Australia and Tasmania have seen little alleviation of labour shortages.

Labour market tightness – Eastern states

Ratio of unemployed persons to job vacancies



Source: ABS 6202.0, ABS 6354.0, Judo Bank

Labour market tightness – Other states

Ratio of unemployed persons to job vacancies

Source: ABS 6202.0, ABS 6354.0, Judo Bank

Forecast tables.

The consensus among economists and the expectation of the RBA is for the economy to remain in a soft landing through the first half of 2024. A soft landing is essentially a slowdown in economic activity that takes growth below its long-run trend but remains positive. A recession is defined as a contraction in economic activity lasting at least six months.

The tentative signs of a recovery in some state economies suggest that the soft landing might be behind us, and we have entered a new phase of economic expansion, a cyclical recovery in activity.

While great news, the problem for Australia and the world is that inflation remains above central bank targets. It is our assessment that economic activity must remain below trend throughout 2024 to ensure inflation continues to fall towards 2.5% by 2025. We find ourselves in an unusual situation where good news on the economy could be bad news for interest rates. The RBA has done less than other central banks in raising interest rates over the last two years.

The prospect of global interest rate reductions in 2024 has faded in recent months. A higher-for-longer global interest rate environment raises the risk that the RBA might be forced to resume its tightening cycle later in the year to bring rates into line with those of other nations.

The consumer is key. The consumer belt tightening phase must be extended well into 2024 if the economy is to remain on the RBA's narrow path.

State government real gross state product forecasts (year average)

	NSW	Vic	Qld	WA	SA	Tas
2021–22	1.80	5.60	4.40	3.10	5.10	4.30
2022–23	3.70	2.60	2.30	3.50	3.80	1.10
2023–24f	1.50 (1.25)	1.50	3.00	1.75 (2.25)	1.25 (1.00)	1.50 (2.00)
2024–25f	1.25	2.50	3.00	2.00 (1.75)	1.50 (1.75)	2.00 (2.25)
2025–26f	2.00	2.75	2.75	2.00	1.75 (2.00)	2.50

Source: State and Federal Government 2023–24 budgets
*Australian figures reflect real GDP growth, e=estimated, f=forecast, original projections in parenthesis

National and international forecast table (year on year)

	June 23	June 24	June 25	June 26
Economic activity				
Gross domestic product (real GDP)	2.1	1.4	2.2	3.0
RBA		*1.3*	*2.1*	*2.4*
Unemployment rate (quarterly, %)	3.6	4.5	4.5	4.3
RBA		*4.2*	*4.4*	*4.4*
Consumption (real)	1.2	0.9	2.1	2.7
RBA		*0.8*	*2.4*	*2.6*
Business investment (real)	10.6	3.7	5.0	8.0
RBA		*1.2*	*1.6*	*2.2*
Inflation				
Consumer price index	6.0	3.5	3.0	2.9
RBA		*3.3*	*3.1*	*2.6*
Wage price index	3.6	4.2	4.0	3.3
RBA		*4.1*	*3.6*	*3.2*
Financial				
RBA cash rate (end quarter, %)	4.10	4.35	3.50	3.50
3-year government bond yield	4.00	3.75	3.50	4.00
10-year government bond yield	3.92	4.50	4.00	4.25
US federal funds rate	5.25	5.50	4.50	4.25
US 10-year interest rate	3.75	4.50	4.00	4.25
USD/AUD	0.67	0.64	0.70	0.72

Source: ABS, RBA, Judo Bank

Thank you.

Warren Hogan
Chief Economic Advisor
M 0414 498 675
E warren.hogan@judo.bank

Matthew De Pasquale
Economist
M 0417 731 106
E matthew.depasquale@judo.bank

Casey Van Liessum
General Manager – Corporate Affairs
M 0403 119 671
E casey.vanliessum@judo.bank

Disclaimer