Trends

DECEMBER 2015
A bulletin of economic developments in South Australia

Premium food for thought

Opportunities for South Australia in the Asian dining boom

Inside this issue

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Chief Executive's Foreword

Food for the future

Welcome to the latest edition of BankSA's economic bulletin, *Trends*, compiled in conjunction with Deloitte Access Economics.

In this edition we examine the current state of the food sector in South Australia, future opportunities locally and globally, and some of the challenges the industry must overcome to make the most of opportunities.

Cyclical drivers are currently favouring South Australia's food sector, and this *Trends* report shows the longer term outlook is also positive.

With continued population growth, there will be growing demand for food from the domestic market, and demand for more health and premium foods as incomes rise and consumer preferences shift.

The opportunities in selling to Asia's rising middle class are enormous, and they have been enhanced by recent Free Trade Agreements. South Australia's meat producers and aquaculture industry are particularly well placed to tap into the rising demand for protein as incomes rise in this region.

However, while South Australia is positioned to capitalise on our well-earned reputation for quality produce, food producers cannot rest on their laurels.

This report highlights that a 'dining boom' for South Australia is by no means guaranteed. With access to these new emerging markets comes strong competition. There will need to be an expansion of the industry for the opportunities to be fully seized, while costs will need to be kept down, efficiencies realised and productivity increased.

As this edition mentions, and as previous issues of BankSA *Trends* have detailed, the South Australian economy is facing challenges. The cessation of the manufacturing operations of Holden will see the end of car manufacturing in this State, while defence manufacturing is slowing.

Unemployment is also on the rise, with the latest figures showing it is now the highest in the country.

Despite these challenges though, which can often be exaggerated, there are some positives to focus on.

We currently have the combination of lower interest rates and lower exchange rates delivering a powerful stimulus.

In addition, this State has opportunities ripe for the taking that will help to underpin our economic future. The potential of our premium food sector is one of these.

Not only is the food industry currently important to the South Australian economy, its future is exceptionally bright. This is an industry where businesses will be well positioned to take advantage of the downward shift in the Australian dollar and – longer term – sell into Asia's emerging middle class, while also maximising opportunities domestically.

That's why firms such as McKinsey and Deloitte have nominated agribusiness as one of the key drivers of growth opportunity for the Australian economy in coming decades. Of all the sectors in the Australian economy, agribusiness is seen as the sector with the strongest combination of being able to play to Australia's competitive advantages as well as producing what the world increasingly wants.

The South Australian Government has nominated the export of premium food and wine as one of its top 10 economic priorities. As a result, a number of initiatives are being put in place to support the industry's growth and to increase the international exports of food and wine from South Australia.

Accounting for just over 5% of the State's output in 2013-14, agriculture alone is our sixth largest industry. Moreover, the food industry as a whole is larger than agriculture's contribution to the economy because it also encompasses the manufacturing of food and beverage products.

Data from the 2011 Census shows that employment in food and beverage product manufacturing in South Australia accounted for around 19,500 workers, or about 25% of the total manufacturing workforce in South Australia. When we add employment in primary production – agriculture – of around 27,500 workers, a total of roughly 47,000 workers are employed in South Australia's food industry, comprising about 6.5% of the State's total workforce.

In comparison, data shows that direct employment in car and car parts manufacturing is around 6,500 jobs, while in defence manufacturing is around 5,200, indicating the food sector employs four times the number of those in car and defence manufacturing.

South Australia's international exports of food and beverage have recorded strong growth in recent years, and amounted to $5 billion in 2014-15.

There will also be future opportunities in the Australian domestic market and in emerging markets. According to the South Australian Government's Department of Primary Industries and Regions SA, interstate sales of food products from South Australia amounted to around $2.3 billion in 2013-14. In addition, the sale of food through retailers, restaurants and the like in South Australia was around $10 billion in 2013-14.

Looking to the future, Australia's and South Australia's population will grow, meaning increased food demands. Over the next decade there may be an additional 3.7 million mouths to feed in Australia, including 162,000 extra in South Australia.

While a growing Australian market presents an opportunity for food producers in South Australia, it is the global opportunities that may be the greatest.

Our abundance of agricultural land and our proximity to emerging Asian markets puts the food sector at the top of the list of industries where Australia has a comparative advantage. We know that a vision for Australia as the 'food bowl of Asia' has been on the horizon for at least two decades. Even so, with emerging Asia set to grow substantially over the years ahead, there will be plenty of opportunities for Australia to deliver more food to this region. Additionally, the size of the global middle class could increase from 1.8 billion people to 3.2 billion by 2020, and to 4.9 billion by 2030.

Almost all of this growth (85%) comes from Asia, and in terms of sheer numbers, is driven by China and India.

According to the Federal Government, Asia is expected to account for 71% of the growth in global food demand up to 2050. China is set to account for the largest share of that growth and already, export data indicates that South Australian producers are making significant inroads.

This *Trends* report asks where the greatest growth opportunities lie within the sector. Importantly, this analysis also goes beyond identifying the future global demand to consider the competitive advantages of Australian producers compared to our overseas counterparts.

South Australia has many opportunities for the taking however this does not mean that there won't be challenges, but with strong opportunities for the local sector, there are plenty of rewards to be realised for South Australia.

N. C. Reade.

Nick Reade
Chief Executive, BankSA

47,000
People are employed in South Australia's food industry.

$5 billion
SA's international exports of food and beverages in 2014-15.

3.7 million
Predicted population growth in Australia over the next decade.

The opportunities in selling to Asia's rising middle class are enormous, and they have been enhanced by recent Free Trade Agreements.

Premium food for thought

"Agriculture is our wisest pursuit, because it will in the end contribute most to real wealth, good morals, and happiness." - Thomas Jefferson

"If you tickle the earth with a hoe, she laughs with a harvest." - Douglas Jerrold

"To most people, this is just dirt. To a farmer, it is potential." - Doe Zantamata

South Australia's economy is facing headwinds. As previous issues of BankSA *Trends* have detailed, the cessation of the manufacturing operations of Holden will spell the death knell for car manufacturing in this State, while defence manufacturing faces a 'Valley of Death' as work dries up.

As a result, unemployment in this State has already risen, with the latest data indicating that it is now the highest in the nation.

Yet BankSA *Trends* has also been a consistent voice in arguing that these challenges are easy to overstate: and may not be as bad as some people think. While there are genuine reasons to be concerned for the short term outlook, there are important positives as well.

Two of the reasons for that view of South Australia's economy are tied up with the shift in the State's cyclical drivers that is now underway. The combination of lower interest rates and lower exchange rates is now delivering a powerful stimulus.

You can now see some of the benefits of that interest rate stimulus in better outcomes through the retailers' tills and in more housing construction activity for builders. That will help the State transition to a new future.

So too will the lower Australian dollar – arguably the biggest positive for this State. And as it takes up to two years between the exchange rate moving and the maximum benefit for the State's economy, the latest falls in the currency already imply a pipeline of good economic news for South Australia.

In addition, this State has numerous opportunities for the taking which will help to underpin our economic future. One of the headliners is the potential for one of South Australia's long standing niche industries – premium food.

Not only is the food industry already of real importance to the South Australian economy, its future is exceptionally bright. This is an industry where businesses will be well positioned to not only take advantage of the downward shift in the Australian dollar but – longer term – to sell into the rise of Asia's emerging middle class. And that's not all, with some lucrative opportunities at home too.

Therefore, this issue of BankSA *Trends* takes a detailed look at:

- The current state of the food sector in South Australia;
- The future opportunities that will be present locally;
- The future opportunities in selling to the world; and
- Some of the challenges the industry will need to overcome to seize those opportunities.

Agribusiness is a future growth industry for Australia

When economists try to identify the industries of the future, they fall back on asking two related questions – *what will the world want* and *what are we good at doing?*

Those sound simple, but they have profound implications.

We already know one thing that will be required in the future – more and better food.

History is very clear: as nations see their incomes rise, so too does their consumption of food. And, more importantly still, the quality of the food in demand lifts as well.

Both scientists and economists have therefore long since noted that protein intake rises alongside income – but faster than it.

And that's not the end of the story. Yes, the world will want more and better food. But it is also true that Australia is good at producing that. A rarity among rich nations, we are one of the world's major food bowls, producing much more than we eat here in Australia.

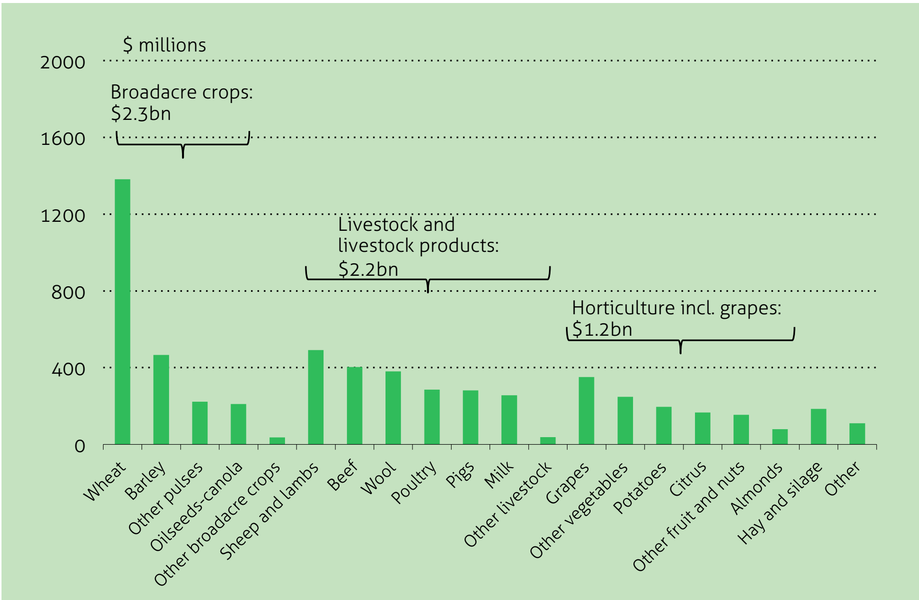
That's why the likes of McKinsey and Deloitte have nominated agribusiness as one of the key drivers of growth opportunities for the Australian economy over coming decades. Of all the sectors in the Australian economy, agribusiness is seen as the sector with the strongest combination of playing most to Australia's competitive advantages (we are good at it), as well as being a sector producing what the world increasingly wants (it will be in demand).

But it isn't just the economists recognising the potential – governments have done the same. The South Australian Government has nominated premium food and wine produced

CHART 1.1
AUSTRALIA'S FUTURE WAVES OF GROWTH 2013-33

Source: Deloitte Access Economics

CHART 1.2
THE VALUE OF SOUTH AUSTRALIA'S AGRICULTURAL PRODUCTION IN 2013-14

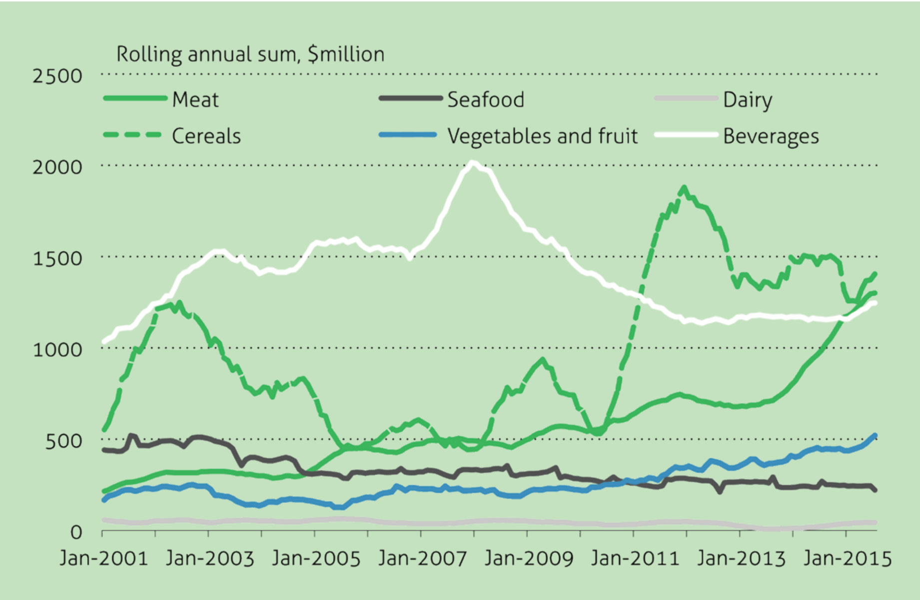


Source: Australian Bureau of Statistics

CHART 1.3
VALUE OF FINISHED FOODS IN SOUTH AUSTRALIA

Source: Primary Industries and Regions SA

CHART 1.4
SOUTH AUSTRALIA'S FOOD AND BEVERAGE EXPORTS



Source: Australian Bureau of Statistics

in this State and exported to the world as one of the top 10 economic priorities for South Australia.

That means a number of initiatives are being put in place to further support the industry's growth and to increase the international exports of food and wine from South Australia.

South Australia's premium food industry is already a success story

Before we delve into the future potential of the industry, let's take a closer look at its current state. As many of us are already aware, South Australia's food industry has long been a success story, with products such as wine from the Barossa Valley famous on the world stage.

Accounting for just over 5% of the State's output in 2013-14, agriculture alone is the sixth largest industry in the State. This share has remained broadly unchanged since the early 1990s.

Moreover, the food industry as a whole is larger than agriculture's contribution to the State's economy, because it also encompasses the manufacturing of food and beverage products (which is classified under the manufacturing industry).

Data from the 2011 Census showed that employment in food and beverage product manufacturing in South Australia accounted for around 19,500 workers, or about 25% of the total manufacturing workforce in South Australia. When we add in employment in primary production – agriculture – of around a further 27,500 workers, we find that a total of roughly 47,000 workers are employed in South Australia's food industry.

That's a big number in anyone's language and it comprises roughly 6.5% of the State's total workforce.

Indeed, a bit of perspective is also handy here. Census data shows that the direct employment in car and car parts manufacturing is around 6,500 jobs, while that in defence manufacturing is around 5,200 (of which around 1,650 are in naval shipbuilding).

Those numbers are significant, which is why there's been much attention of late due to the current pressures on those two industries. Yet, there are clearly many more jobs involved in food production, which is a sector with brighter prospects.

You get the picture: a sector which employs four times the number of those in car and defence manufacturing has great potential, but rarely hits the headlines.

No surprise there, of course. Bad news sells – so good news tends not to be news.

So let's take a deeper dive. The biggest employers by area of specialisation in food production are sheep, beef cattle and grain farming, wine making, fruit and nut tree growing, bakery products, and meat and meat products manufacturing.

As Chart 1.2 (page 5) shows, when it comes to the dollars involved in primary production, South Australia holds quite a diversified portfolio. The total value of agricultural commodities produced in South Australia was $5.9 billion in 2013-14.

The value of crops produced amounted to around $2.3 billion, led by wheat, while the value of livestock production amounted to around $2.2 billion, with sheep, lamb and beef areas of strength.

Horticulture production makes the third largest contribution at around $1.2 billion, with South Australia a leading producer of grapes and potatoes, and almond production increasing of late.

Dairy and seafood make smaller but still significant contributions to primary food production in the State.

In addition, Chart 1.3 (left) shows the value of finished foods in South Australia – this includes post-farm value-adding activities such as packing, processing and food manufacturing. The value of finished foods has increased strongly of late, driven in part by growing meat processing activities so as to meet strong export demand.

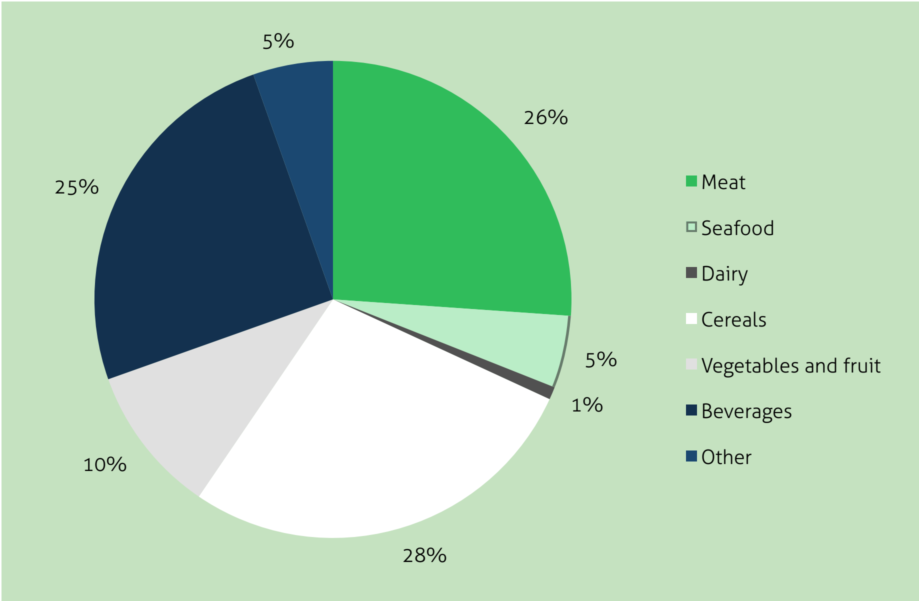
That chart is worth a closer look. Yes, in a State that often only hears of doom and gloom, the value of food production has been growing fast.

Indeed, as Chart 1.4 (left) shows, South Australia's international exports of food and beverages have recorded strong growth in recent years, and amounted to a hefty $5.0 billion in 2014-15. Chart 1.5 (right) shows the distribution of that total across the various commodities in 2014-15.

But there have been widely divergent trends across the different food and beverage commodities:

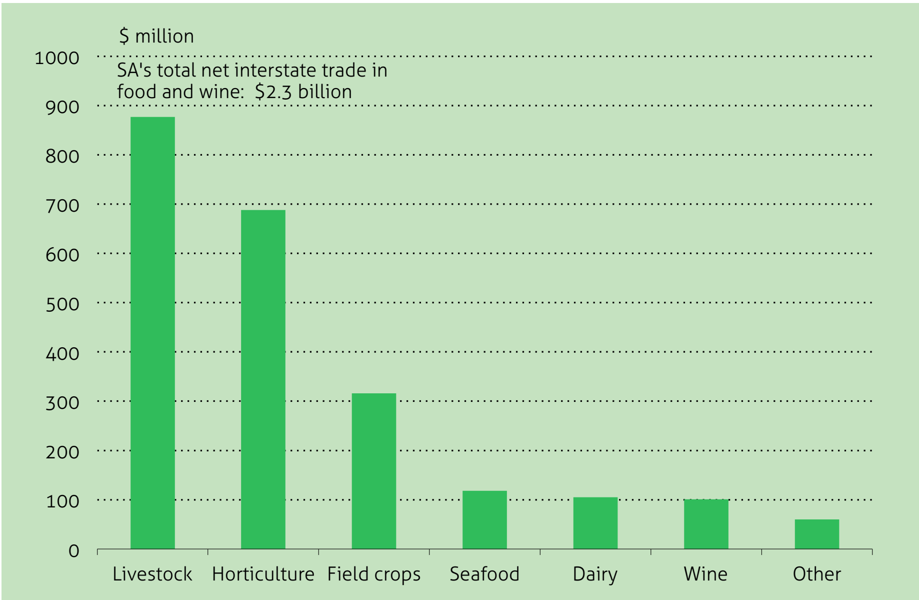
- **Meat** exports have more than doubled over the past five years, and have recorded a compound annual growth rate of 11% over the past decade. There has been strong growth in meat exports to China in recent years – the 'protein effect' noted earlier.
- **Cereal** exports have similarly recorded strong growth over time, although that was driven by a big lift in 2011, and exports in recent years have yet to exceed that earlier peak. Cereal production can be particularly volatile due to the influence of seasonal conditions, and was affected by drought during the early to mid-2000s.
- **Vegetable and fruit** exports have similarly recorded strong growth over the past decade, although like cereals were affected during the earlier drought years.
- **Beverages** exports including wine have experienced a long downward trend since peaking in 2007. In fact, 2007 marked the high point of an extended run of good export growth in beverages, and recent years have seen the level of exports remaining at similar levels to a decade ago. Considering the importance of wine to South Australia's food and beverage exports, that is a disappointing outcome.

CHART 1.5
SHARE OF SOUTH AUSTRALIA'S FOOD AND BEVERAGE EXPORTS IN 2014-15



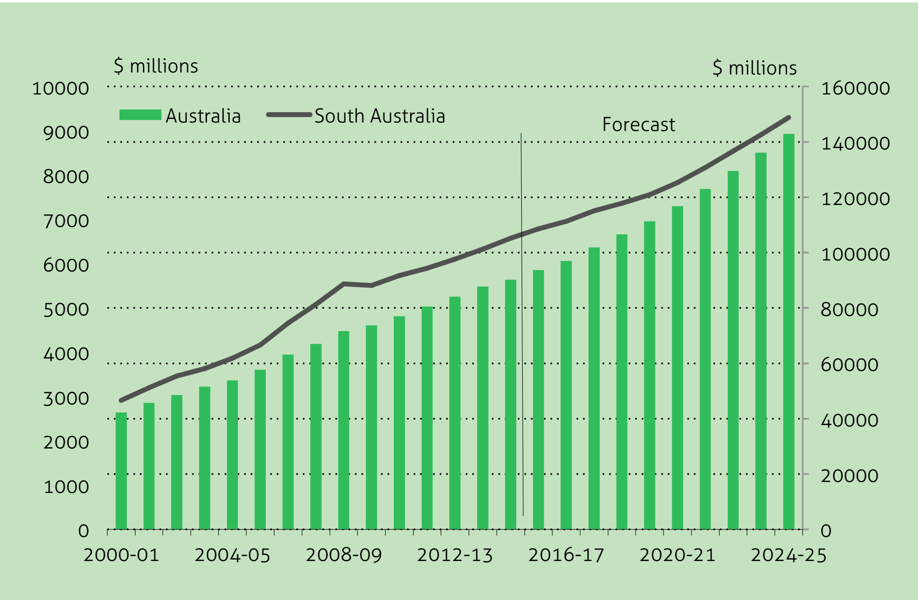
Source: Australian Bureau of Statistics

CHART 1.6
SOUTH AUSTRALIA'S NET INTERSTATE TRADE IN FOOD AND WINE IN 2013-14



Source: Primary Industries and Regions SA

CHART 1.7
HOUSEHOLD FOOD CONSUMPTION OVER NEXT DECADE



Source: Australian Bureau of Statistics, Deloitte Access Economics

- **Seafood** exports have been in a long term, slow decline. Over the past decade, they have fallen at a compound annual rate of around 2.6%.

It's worthwhile noting that these figures are in nominal terms, and therefore include the influences of both the volume of production and prices (with the latter also influenced by movements in the Australian dollar).

For example, the poor performance of wine exports can be partly traced to grape prices. Farm gate grape prices were as high as $1,000 per tonne in 2001-02, but that was followed by a long period of decline. The price of grapes almost halved to a low of almost $500 per tonne by 2010-11, and has since recovered slightly but only to around $600 per tonne.

That isn't a surprise: the global financial crisis hit markets for our wine hard, and then a soaring Australian dollar hit them even harder still. But now markets such as the United States and the United Kingdom are recovering, while the Australian dollar is falling – meaning that the vicious cycle of recent years is turning back into a virtuous cycle.

In short, what these divergent trends reveal is that being a farmer in this State has been a tough gig for many in the industry – despite some farmers and the industry as a whole doing reasonably well. Not only did the weather often play havoc with the farming business, but the rise of the Australian dollar in recent years took another slice out of farmers' incomes.

There will be future opportunities in the Australian domestic market

The good news is that there will be opportunities for future growth in this industry. That is certainly true in selling to emerging markets (which we will look at in detail shortly), but also in selling to the domestic market.

Let's begin by getting an understanding of the current sales to the domestic market.
As Chart 1.6 (page 7) shows, interstate sales of food products from South Australia amounted to around $2.3 billion in 2013-14, according to the SA Government's Department of Primary Industries and Regions SA. In addition, there is the local market in South Australia. The same source indicates that there were sales of food through retailers, restaurants and the like in South Australia of around $10 billion in 2013-14. Note, that figure is higher than the raw value of agricultural commodities

produced because it also covers the services of food manufacturers, wholesalers and retailers – demonstrating that the local market is a large and important source of demand for South Australia.

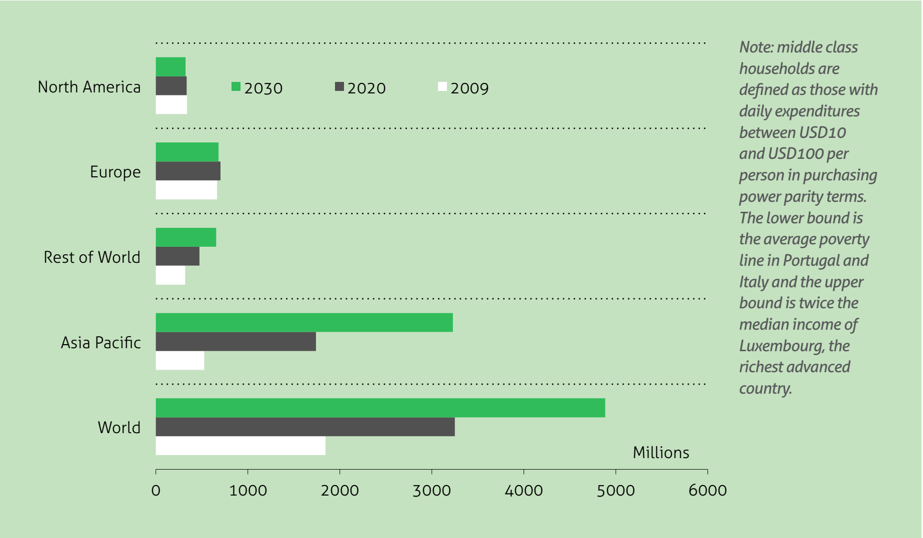
How might this domestic market grow in the future? Australia and South Australia's population will grow over time, and that will mean demand for food. The latest data from the ABS indicates that Australia's population growth was 1.4% over the past year, while South Australia's population grew by 0.8%. Over the next decade there might be an additional 3.7 million mouths to feed in Australia, including 162,000 extra mouths to feed in South Australia.

Of course, there is more to this story than raw population numbers because we will also have higher incomes over time. Although household spending on food tends to rise with incomes, it doesn't rise proportionally – in Australia, we tend to spend more on things like overseas holidays and private school fees than on food as our incomes rise. This is in contrast to poor, developing countries who tend to spend more on food as their incomes rise. In fact, as the boxed text (right) notes, Australia's problem as a nation is more one of obesity rather than not having enough to eat.

Even so, spending on food may be expected to rise somewhat more than pure population growth would suggest due to the income effect, with people spending on higher quality premium food and beverage products as well as on other product features such as convenience or type of production (conventional versus organic, for example) as incomes rise. Indeed, there has been a strong tendency for Australians to spend more on eating out over the years. Given Australia's strong immigration rate (around half or more of those additional mouths are likely to be new migrants to Australia), religious and cultural considerations may be another important factor in considering future food demand.

And there is additional potential for premium food here. The scarcest commodity we have in a rich nation such as Australia is our time, and so we are increasingly buying partly prepared food rather than cooking it from scratch. That means more of the 'manufacturing phase' of our food production is actually occurring in factories rather than family kitchens.

CHART 1.8
THE RISE OF THE GLOBAL MIDDLE CLASS



Source: Homi Kharas (2010), 'The Emerging Middle Class In Developing Countries', OECD Development Centre Working Paper 285.

The obesity epidemic and the rise of healthy eating

Along with many other developed nations, Australia has an obesity problem. In 2011-12, nearly two-thirds of Australian adults were estimated to be overweight or obese, and obesity in Australia has more than doubled in the past two decades.

That makes Australia one of the fattest nations in the world and comes with a substantial public health cost.

To tackle the obesity problem, the Australian Government has been enacting initiatives to influence our behaviour around food choices. To date, these include such things as the Australian Dietary Guidelines which recommends more fruits and vegetables and limiting consumption of saturated fats, added salt and sugar, and alcohol.

Some overseas governments have gone further. For example, Denmark introduced a fat tax in 2011 and later abolished it, while Mexico – the world's fattest country – has enacted a 10% 'soda tax'. There has recently been a call from the Heart Foundation and others for a similar tax and other related regulatory measures in Australia.

Independently, there is a trend towards healthy eating. The food industry has made some efforts to increase healthy food choices. For example, McDonald's offers the choice of a salad instead of fries in its Australian restaurants.

An analysis of the latest ABS Household Expenditure for 2009-10 may be illustrative of these income effects. Expenditure on certain types of food tends to go up as a proportion of the total food budget more than others as household incomes rise. For example:

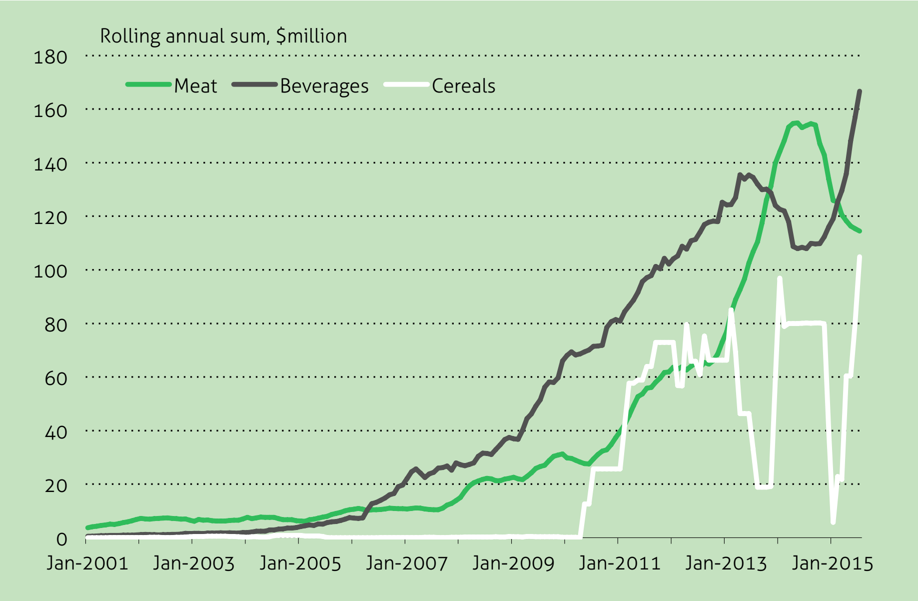
- Spending on chicken goes up as incomes rise, but expenditure on pork as a proportion of the total food budget goes down with income.
- Spending on cheese, spices and herbs and fresh berries tends to rise with higher incomes.
- Finally, spending on fresh fish and seafood as a proportion of the total food budget is highest for high income households.

There has also been significant growth in demand for organic produce. According to the Victorian Government, the domestic organic food industry was worth around $300 million in 2012, and consumer demand is estimated to be growing at over 20% per year.

Overall, and as Chart 1.7 shows (left), Australian households may spend around $53 billion more on food in a decade, with South Australian households spending about $2.7 billion more.

That will mean more demand for the food staples like wheat, potatoes and meat due to the higher number of mouths to feed. But it is also likely to mean some additional demand for premium food products as incomes rise.

CHART 1.9
SELECTED SOUTH AUSTRALIAN FOOD AND BEVERAGE EXPORTS TO CHINA



Source: Australian Bureau of Statistics

The future opportunities in selling to the rest of the world may be the most lucrative of all

While a growing Australian market presents an opportunity for food producers in South Australia, it is the opportunities that lie beyond our shores that have caught the eye of many analysts in recent years.

The reasons are obvious. Australia's abundance of agricultural land and our proximity to emerging Asian markets puts the food sector at the top of the list of industries where Australia has a comparative advantage.

This isn't a new development. A vision for Australia as a 'supermarket to Asia' or the 'food bowl of Asia' has been expressed by various commentators for at least two decades. That is a big task and may in reality be too ambitious: less than 1% of Asia's current food demand can currently be met by Australia's agricultural producers after meeting our own food demand. Even so, with emerging Asia set to grow substantially over the years ahead, there will be plenty of opportunities for Australia to deliver more food to Asia.

After all, the market is a growing one. As Chart 1.8 (page 9) shows, the size of the global middle class could increase from 1.8 billion people to 3.2 billion by 2020 and to 4.9 billion by 2030.

Almost all of this growth (85%) comes from Asia, and in terms of sheer numbers is driven by China and India. China already has a middle class of more than 150 million people, but that is relatively small as a proportion of its total population at only around 12%, and is set to grow significantly. India may also see a dramatic expansion of its middle class from around 5-10% today. In fact, the OECD estimates that between 2015 and 2025, half the population of India will surpass the $US10 per day threshold and enter the middle class.

In turn, this growth in the global middle class will have enormous implications for global food demand. Most fundamentally, in developing countries people eat more food once income rises above poverty levels (that is, kilojoule intake increases). They also change the composition of their food intake from primarily staple carbohydrates to more premium food, including protein. This will power a dietary shift from grains and cereals towards meat, dairy, fruit and vegetables, and refined sugars.

Premium or bulk?

Yet while premium food is sexy and the opportunities for it are obvious, it may not be the biggest opportunity on South Australia's plate. The best news is likely to lie in what South Australia already does in bulk.

According to projections made by ABARES (the Federal Government's 'food forecaster'), Asia is expected to account for 71% of the growth in global food demand up to 2050. China is set to account for the largest share of that growth (around 60% of additional food demand from Asia is expected to come out of China). This is estimated to increase the value of Australia's agrifood exports by 142% between 2007 and 2050.

Already, export data is indicating that South Australian producers are making significant inroads. South Australian agricultural exports to China were minimal in 2005, but have grown in leaps and bounds in recent years.

The Free Trade Agreements with Japan, Korea and China

Australia has recently concluded negotiations on Free Trade Agreements with Japan, Korea and China which will reduce import tariffs on many of Australia's agricultural exports to these countries over the next two decades.

Japan–Australia Economic Partnership Agreement: Australia will have preferential tariff access to Japan for its exports of beef, cheese, wine, horticulture, seafood, vegetable oils, livestock, pork, honey, wheat and feed barley. Australia's largest agricultural export to Japan is beef.

Korea–Australia Free Trade Agreement: Tariffs will be eliminated on a wide range of agricultural commodities, including beef, wheat, sugar, wine and seafood. Beef, cheese, malting barley and malt exporters are particularly likely to benefit.

China–Australia Free Trade Agreement: China's import tariffs on many Australian agricultural exports including dairy products, beef, sheep meat, hides and skins, livestock, seafood, wine and horticulture will be removed over periods of up to 11 years. Most of these products will be tariff free within four years.

Source: ABARES 2015, Agricultural commodities, March quarter 2015, vol. 5, no. 1, Australian Bureau of Agricultural and Resource Economics and Sciences, Canberra

Chart 1.9 (left) indicates South Australian exports of meat to China have increased their value by more than 15 times over the past decade. South Australian exports of beverages (essentially wine) have similarly recorded average annual growth of around 40% over the past decade.

Or, in other words, the world will want it.

But remember what South Australia has in particular abundance. Sure we have some great agricultural land, some of which ranks with the best in the world.

But we have even more poor dry soils. And that is exactly where agri-scientists expect the biggest advances in food production to come from in the decades ahead. Indeed, it has been true for some years now that new technologies (including new strains of crops) have coaxed relatively greater increases in food production out of the world's poorest and driest soils.

So although there is – correctly – much focus on the premium market, nor should we forget the potential for the likes of wheat production to rise substantially in the decades ahead.

Where do the greatest growth opportunities lie?

This optimism over the prospects of Australian agribusiness raises a further question – where, within the sector, do the greatest growth opportunities lie?

In a recent publication, Deloitte Access Economics identified the 'fantastic five' of Australian agriculture as beef, lamb, aquaculture, dairy and oilseeds. Importantly, this analysis went beyond identifying the future global demand for food to also consider the competitive advantages of Australian producers compared to our overseas competitors.

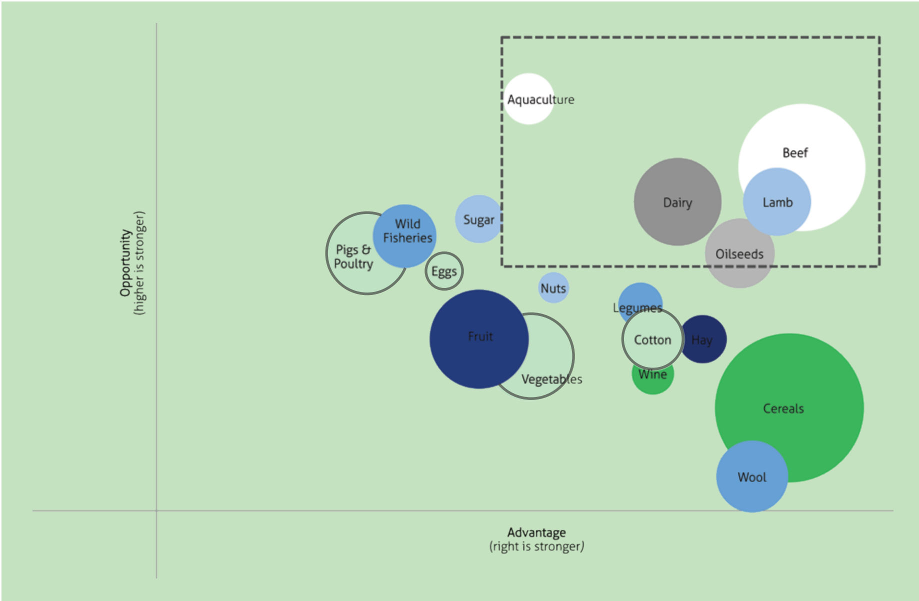
Chart 1.10 (right) shows the strength of demand drivers on the vertical axis. As we have noted, this includes the impact of population growth and the rise of the global middle class on food demand, as well as other relevant factors. For example, ethical considerations are increasing (such as animal welfare), while other considerations include food safety, food security, and health consciousness.

The competitive advantage of Australian producers is shown on the horizontal axis. Australia's key competitive advantages are:

- our large area of arable land;
- relatively low land use conflicts (with urban and industrial expansion);
- high biosecurity status;
- relative ease of doing business;
- technological readiness;
- high education levels;
- an innovative culture; and
- close proximity to export markets.

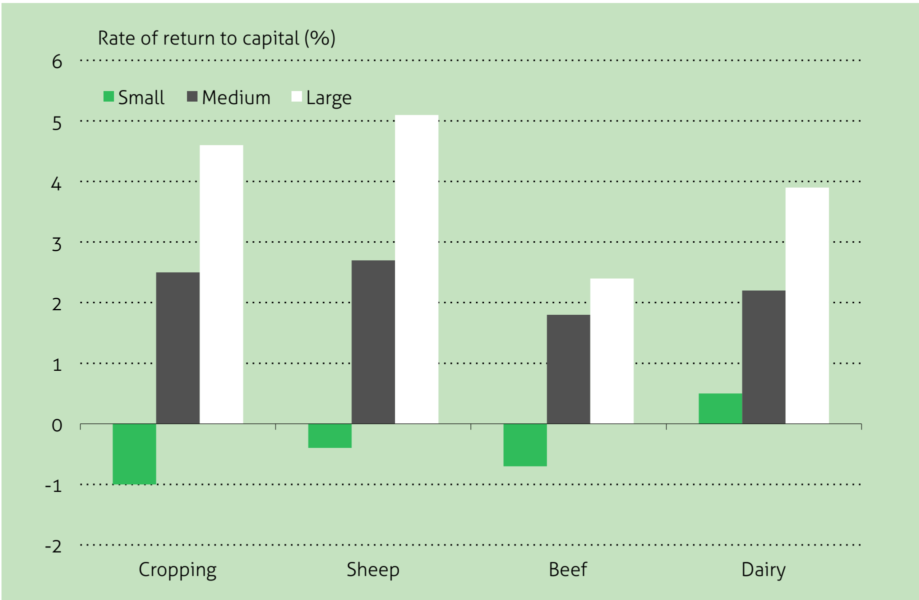
That's an impressive list. In addition, trade

CHART 1.10
THE NEXT OPPORTUNITIES IN AGRIBUSINESS



Source: Deloitte Access Economics, 'Where are the growth opportunities in Australian agriculture?', The Agribusiness Bulletin.

CHART 1.11
RATE OF RETURN TO CAPITAL ON AUSTRALIAN FARMS BY FARM SIZE



Source: ABARES

barriers (such as the removal of tariffs under Free Trade Agreements – see the box on page 10 for details) are also contributing further to Australia's competitiveness.

But this isn't all one way traffic. We have our burdens to bear as well. Our competitive disadvantages include:

- the regulatory burden here in Australia;
- a lack of rainfall;
- water availability and water reliability;
- low soil fertility;
- an aged farm workforce; and
- our high labour costs.

These factors have different implications for different parts of Australian agriculture.

Beef, lamb and dairy

The three livestock sectors of beef, lamb and dairy are thought to be best positioned to capitalise on the high demand for protein as a result of higher incomes in Asia. Other factors in our favour include the premium quality attributes of Australian meat and dairy, Australia's reputation for safety and security of supply, and the growing concern for animal welfare (which should favour Australian livestock overall compared to other countries due to relatively higher numbers of free range livestock).

On the supply side, we have lower barriers to entry, and we have plenty of marginal land for increased red meat production to occur.

Aquaculture

South Australia already has an international reputation for high quality and sustainable seafood, and is home to the most diverse range of aquaculture in Australia. Currently the State's aquaculture industry produces southern bluefin tuna and pacific oysters among other seafood, with almost all of the tuna exported to Japan.

And South Australia's aquaculture industry is positioned very favourably for the future. The factors driving this outlook include the higher demand for protein as incomes rise, the health benefits of fish (for health conscious consumers, particularly domestically), and the fact that aquaculture is a sustainable alternative to decreasing wild fish stocks. Fish is also a relatively efficient source of protein to produce compared to other animal proteins.

In addition, we have plenty of land and/or ocean area for expansion of aquaculture, while our soil fertility and rainfall problems are less relevant here.

On the downside, aquaculture's regulatory burden is considered higher on average than other agriculture sectors.

Oilseeds

The relatively bright outlook for oilseeds is linked to strong global demand for both food products (from higher incomes) and biofuels (as alternative to fossil fuel sources). There are other advantages too, including the perception of being more sustainable relative to tropical oils such as palm oil, and the perception of being more healthy than animal-based or tropical oils.

South Australia is a producer of canola, although the value of canola production is small relative to commodities such as wheat. Australia has competitive advantages here due to our large land area for cropping and our biosecurity status. Our high labour cost environment is also less of a factor because oilseeds production tends to be highly mechanised.

The future challenge: realising economies of scale, raising productivity and profitability

While the opportunities for the food sector in selling to both the domestic and overseas markets are enormous, there are certainly challenges ahead in order for farmers to be able to seize those opportunities. Moreover, trying to seize those opportunities will be pointless if there is no profit in it for farmers.

Chart 1.11 (page 11) shows a measure of profitability – the rate of return to capital – for farms of different size in Australia. This is striking because it's very clear that the larger the operation, the higher the profitability has tended to be. In broad terms, that's a fact that has consistently been true across all sectors of farming. That said, it's notable that the difference between medium and large size beef farms is much less than for other sectors.

What that says is that 'family sized' farms have struggled, while 'corporate sized' farms have done better.

Is it possible for small farms to match it with the bigger players in terms of profitability?

In fact, even if we concentrate on the top 25% of small farms by profitability and compare them to the average large farm, the profitability of the best performing small farms typically only barely matches the profitability of the average large farm.

So it is possible for 'small to be beautiful', but there remains a large number of underperforming small farms. The lower average profitability of the smaller farms is being driven by lower average productivity (in other words, using inputs such as land, labour and capital less efficiently to produce the same amount of output).

An indication of the industry's structure is illustrative. Small farms account for around 70% of Australian broadacre and dairy farms but only around 20% of the total value of sales of broadacre and dairy farms. Large farms account for 10% of broadacre and dairy farms but account for around 49% of total sales.

It is not surprising that the data shows that the high performing farms – which tend to be large farms – have also accounted for most new investment. That suggests they may also be better positioned than smaller farms to be able to keep lifting productivity, sales and production over time.

So it appears that the process of structural adjustment towards larger average farm size will need to continue, along with the adoption of larger scale production technologies to exploit economies of scale. That said, the process may not be straightforward, with some small farms located close to population centres where land values are high and perhaps not as suited to expansion.

There will also need to be additional investment beyond the farm gate to raise productivity. This includes investment in areas such as roads, irrigation systems and dams, as well as in areas such as storage facilities.

There are some other big challenges for the sector too. The age of Australia's farmers is a particular issue, with the farming sector having a much older than average age profile. Compared to the average Australian business, farmers are under-represented in workers aged up to 44, and over-represented above that age. Farmers are more than six times more likely to be aged over 65 than workers in the Australian workforce as a whole.

In addition the sector faces greater environmental constraints with pressures for water to be diverted from agriculture to environmental use. Climate change may also exacerbate some of these challenges.

Some final words

South Australia is a State with a farm sector half as big again as its mining sector. In fact, that ratio of farm-to-mining sectoral size favours South Australia more than any other State except Tasmania, and is a reason why the series of falls in the Australian dollar in the last couple of years points to more positives than you might otherwise initially recognise.

Cyclical drivers are now favouring the sector, and the longer term outlook is bright too. With continued strong population growth, there will be growing demand for food from the domestic market. In addition to staples there is likely to be demand for more health and premium foods as incomes rise and consumer preferences shift.

The opportunities in selling to Asia's rising middle class are enormous, and they have been enhanced by recent Free Trade Agreements.

South Australia's meat producers and aquaculture industry are particularly well placed to tap into the rising demand for protein as incomes rise in Asia, and capitalise on our well-earned reputation for quality produce.

However, this does not mean that food producers can rest on their laurels. A 'dining boom' for South Australia is by no means guaranteed. Along with access to these new emerging markets also comes stiffer competition. There will need to be an expansion of the industry for the opportunities to be fully seized, costs will need to be kept down, efficiencies realised and productivity increased.

That is a challenging task, but with such big opportunities for the sector, the rewards are there for South Australians to take.

China's slowdown

China has been an enormous global success story in recent decades – but some of its success has happened a little too fast, and the resultant need to transition from construction to consumers as an economic driver is sending shockwaves through the world.

Given that China is important to Australia, that is creating some shockwaves a little closer to home as well.

Chart 1 (right) shows that China has been by far Australia's biggest trading partner for several years. Indeed, China's share of Australian trade dwarfs the matching peak share achieved in the late 1970s, and you have to go back to the pre-World War Two era to find a time when Australia had greater reliance on any other single nation for trade purpose – in that case, the United Kingdom.

So, to make the obvious point, if China sneezes, then Australia has a problem.

And now to ask the obvious questions: is China sneezing, could it be catching a cold, or have its recent woes been nothing more than a passing fever?

The answers there will tell you a lot about where Australia's own economy heads next.

This is, of course, a different sort of China conversation. For some years the China story was one of boom. But now China is in a difficult transition period as it moves towards a consumer based economy and away from a rapidly industrialising economy based on construction activity. This transition is not an easy one, and it has brought with it an economic slowdown for China with repercussions for Australia.

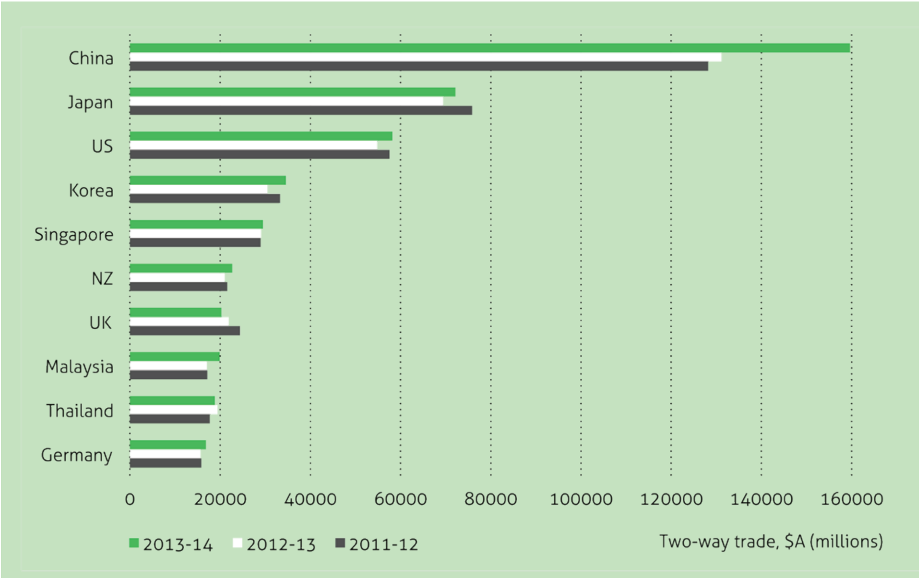
So what has caused China's recent slowdown?

China's stunning reliance on construction and construction-related spending as a share of its economy helped it rocket through an industrialisation phase that took many other nations much longer to achieve.

But it has overdone it: China has built too much, and borrowed too much to do so.

Chart 2 (page 15) shows business investment (capital spending by corporates, much of it on construction) as a share of the economy across 200 nations. China – the only nation named in the chart – is a remarkable outlier.

CHART 1
AUSTRALIA'S MAJOR TRADING PARTNERS ($A, MILLIONS)



It is spending a fortune on construction, but in many cases the things being built are already in over-supply. China's transition is required because it has already 'built too much' - too many steel mills, iron ore mines, shopping centres and apartments.

But the problems are rather wider than just that. In both Japan and Korea, nations whose growth also accelerated thanks to a long period of over-reliance on over-construction, the final phase of that infrastructure growth was characterised by a credit bubble that saw debt grow by an extra 30% of annual national income (in the late 1980s in Japan and the mid-1990s in Korea). That surge of debt proved to be the last throw of the dice before an extended period of difficulties.

Such run ups in debt aren't that unusual. In years past each of the US, UK and Australia came a cropper after a debt binge, though the common denominator was the liberalisation of financial markets, followed by a phase in which people borrowed because they could, which led to the price of assets such as housing and shares going up, which then encouraged more borrowing... and so it went.

The difference is that the last seven years saw China add the equivalent of 100% of annual national income to its stock of credit. That surge in debt, to place it in its proper perspective, equals the size of the US commercial banking system. And each extra dollar of debt is boosting China's economy by less than the one before it, a classic sign of a lack of sustainability.

Given the massive size of the construction sector, the transition now underway to a consumer based economy is an ongoing challenge.

To be clear, that change is proceeding in a remarkably orderly manner: China may be slowing, but to date its slowdown hasn't been a hectic one.

Chart 3 (page 15) shows the resultant gentle downward glidepath in both industrial production and wider economic growth in recent years.

What next? What's the worst that could happen?

It is worth teasing out the worst that could happen. And yes, were these risks to all eventuate, it would be a real worry. In particular, two things may yet get worse than expected in China:

- Businesses may cut construction spending – new buildings (not just apartments, but roads, factories and shops) are losing money. Chinese construction may therefore slow more than analysts expect, leading to rising unemployment and panic at senior government levels.
- Consumers may cut spending – as apartment prices start to head back down and share prices do the same, Chinese families may opt to save rather than spend (meaning that the necessary transition from construction to consumers stalls, further slowing the economy).

A bigger than expected downturn in China would hit hard. World commodity prices would plunge further, and that would further cut into the incentive to build 'the next mine', meaning the current falls in engineering project works in Australia accelerate.

There would be offsets, including:

- The Reserve Bank setting cash rates to zero and potentially starting to 'print money';
- The Australian dollar falling sharply; and
- The Federal Government wheeling out stimulus spending.

Even so, however, Australian unemployment would jump, and a recession – the first in a quarter of a century – would loom as likely.

What's most likely to happen?

However, speaking of 'what's likely', the above scenario isn't.

It is a plausible risk, yet the consensus view among forecasters is that China's slowdown continues, but not at an overly problematic pace for either the world or Australia.

The overall assessment is that – their clumsy sharemarket policy interventions aside – the authorities have done pretty well at managing China's massive economic transition to date away from infrastructure and towards retail therapy.

Recent measures have seen the authorities embark on renewed stimulus, adopting a mix of new tax breaks (and stays of execution for old tax breaks), issuing a direction to the banks (many of whom are state-owned) to fund more infrastructure, and the re-opening of a window that had recently slammed shut, with local governments once more able to borrow (issue bonds) to finance their infrastructure investment.

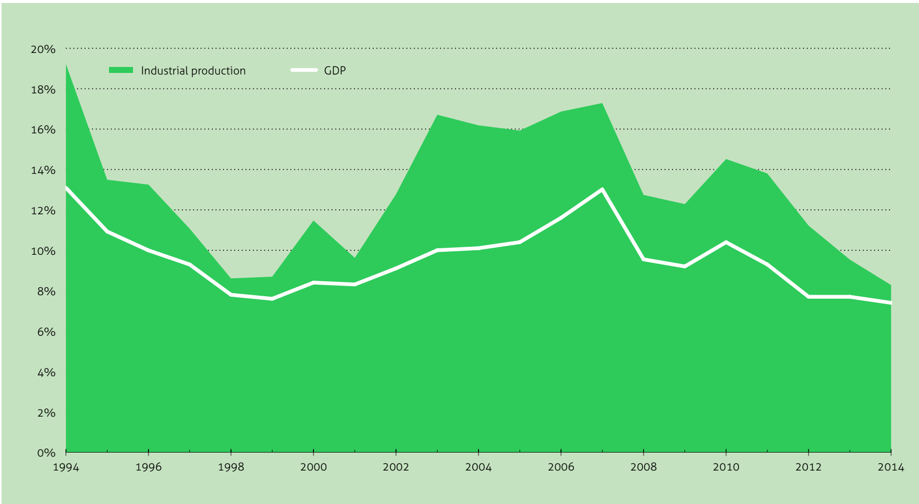
It's worth putting into perspective the magnitude of the slowdown. Remember that Chinese growth has slowed really sharply since 2007, and to date that slowdown hasn't put a banana skin under either Australia or global growth.

For decades we all were impressed by China's double-digit growth. But the new normal is no longer so exuberant. China is expected to grow less rapidly than previously expected – but grow it will, with a consensus forecast of 6.5% growth in 2015, down from average growth of around 8% in recent years.

That's rather less than before. But it certainly isn't the end of the world.

CHART 2
INVESTMENT SPENDING AS A SHARE OF DIFFERENT ECONOMIES (%)

CHART 3
GDP AND INDUSTRIAL PRODUCTION GROWTH IN CHINA (ANNUAL CHANGE)



SA's jobs challenge

South Australia's job market is under pressure. Job gains have been weak while unemployment has ratcheted up as the State's economy continues to transition away from manufacturing to services industries related employment.

Employment

In the past five years employment has grown nationally by an annual average of 1.3%, versus a bare 0.1% for South Australia – and the past year has been no better for South Australia.

This relatively poor performance for the State has not always been the case. Chart 1 (right) shows that, in the middle part of the past decade, South Australia actually outperformed Australia as a whole on trend employment growth.

But it didn't last. This article looks at some of the drivers.

Jobs to population ratio

South Australia's economy is not producing enough ongoing job opportunities relative to its population. This is clear from the jobs to population ratio (the number of employed people as a share of the adult population).

Chart 2 (right) shows that ratio has been trending downwards since late 2010 for both South Australia and nationally. However, the gap between the national ratio and the South Australian ratio has widened – an indicator that the local economy is under more stress than its national cousin.

Full-time employment

One of the drivers of that relatively poor employment performance in South Australia in recent years has been full-time employment. In trend terms, growth in full-time employment in South Australia has been much more volatile than nationally.

In brief, the news hasn't been good – and much of the pain has been in manufacturing.

Employment by industry

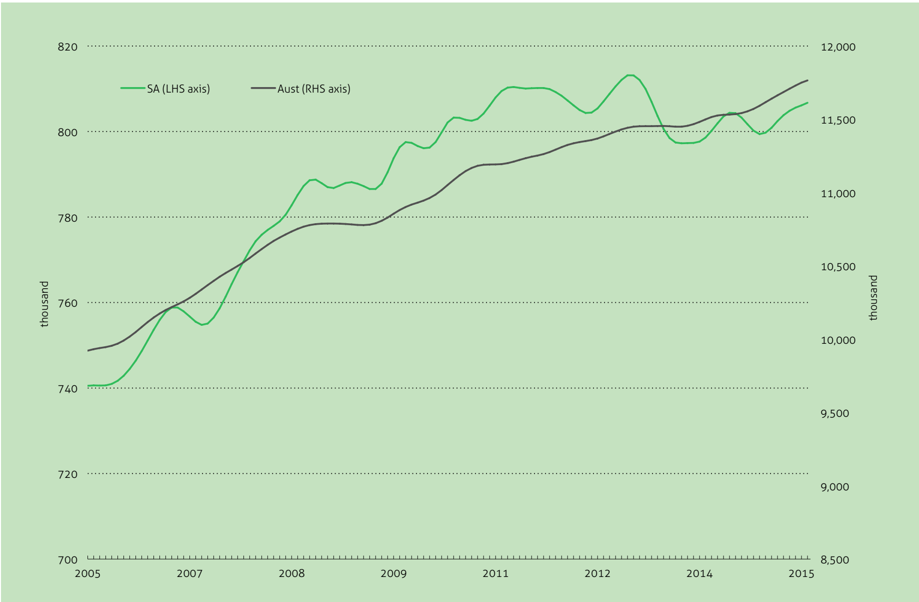
Chart 3 (page 17) shows the change in employment numbers by industry since 2005-06.

You can see the pain in manufacturing. Years of strength in the Australian dollar led to closures, shutdowns and cutbacks – with some more known to be in the pipeline.

At the same time, the east coast has snapped up some local jobs – which helps to explain part of the pain in wholesaling and in IT.

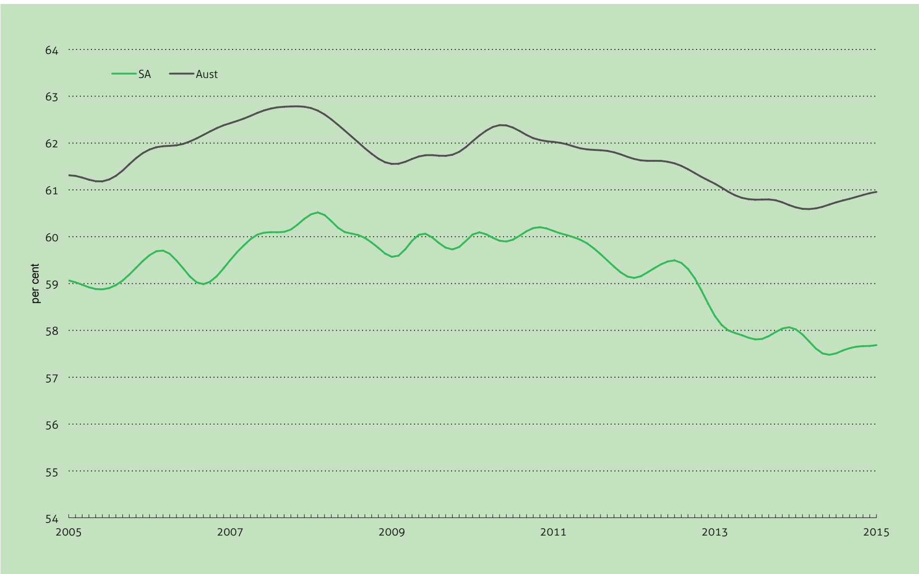
Yet there are good news stories as well. All over Australia the health and social services sector has been a key driver of job gains. Given that this State's population is a little older than average, it has been a standout contributor here.

CHART 1
JOBS IN SOUTH AUSTRALIA AND NATIONALLY



Source: Australian Bureau of Statistics

CHART 2
JOBS TO POPULATION RATIOS, SOUTH AUSTRALIA AND NATIONAL



Source: Australian Bureau of Statistics

And not all service sector jobs have headed east, with the professional services sector – which covers the likes of accountants and lawyers – another strong local contributor, with education another good news story.

This pattern reflects the structural change occurring in the South Australian and Australian economies away from manufacturing, with that pain accelerated by the strength of the Australian dollar over recent years.

But that cycle is swinging. The fall in the Australian dollar of late will help the job outlook in some sectors and help reduce unemployment in parts of manufacturing and farming.

Unemployment

The unemployment rate has moved up over the past year at a faster pace in South Australia, whereas it has flat-lined nationally (as seen in Chart 4 right).

Underutilisation rate

One last indictor is worth noting here. In a broad sense, labour underutilisation picks up the extent to which the desire to work is not being fully met.

This measure includes people who are not working but want to work as well as those who are working but want to work more.

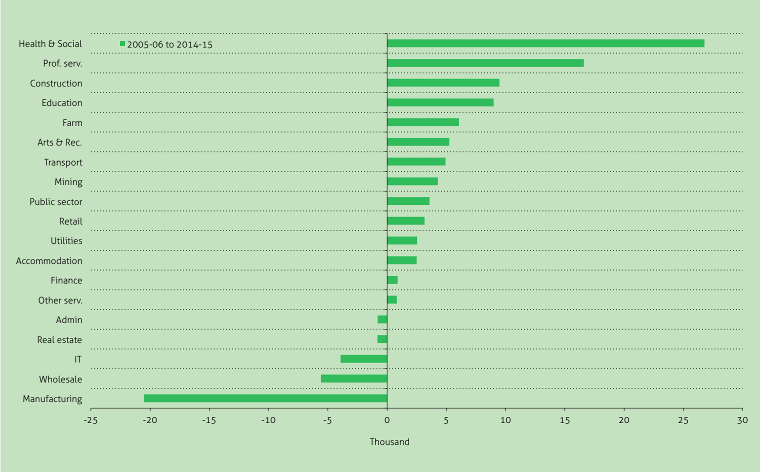
Chart 5 (right) shows how the underutilisation rate for South Australia and nationally has moved over the past decade. For the most part, the two have closely followed each other, although since 2011 the upward trend for South Australia has been more pronounced than nationally.

To sum up, South Australia's job market lost momentum a couple of years ago. And although recent job gains are solid enough, that hasn't stopped unemployment from edging over 8%, or the wider measure of underutilisation also dragging its feet.

But it is easy to be overly negative here. Although there are further known job losses in the pipeline from the likes of car manufacturing and the 'Valley of Death' in defence manufacturing, a number of sectors have been recording stellar growth.

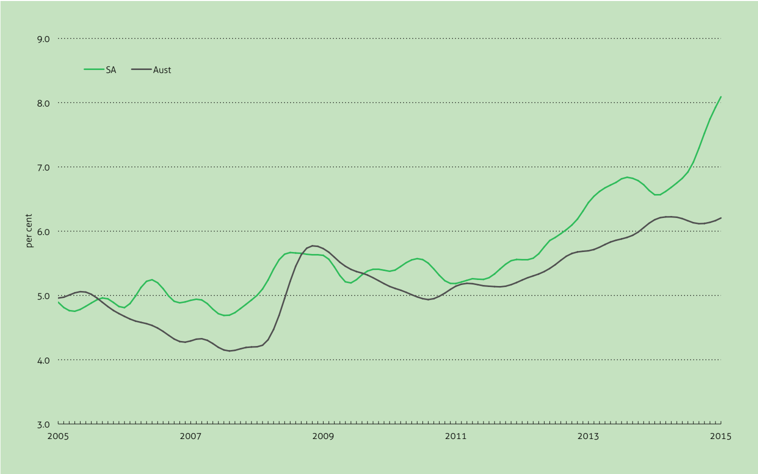
At the moment it is the service sectors which stand out there, though the falls in Australian interest and exchange rates in the last couple of years have also improved the outlook for a number of sectors outside services as well.

CHART 3
EMPLOYMENT CHANGES BY INDUSTRY, SOUTH AUSTRALIA



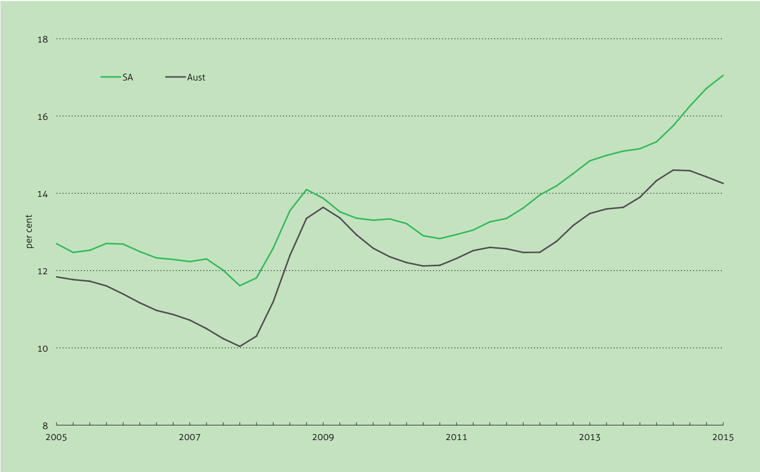
Source: Australian Bureau of Statistics

CHART 4
UNEMPLOYMENT RATES, SOUTH AUSTRALIA AND NATIONAL



Source: Australian Bureau of Statistics

CHART 5
LABOUR UNDERUTILISATION RATES, SOUTH AUSTRALIA AND NATIONAL



Source: Australian Bureau of Statistics

Since
2012
RETURNS FOR LOCAL WHEAT FARMERS HAVE BEEN STABLE

2015-16
US DEMAND FOR BEEF IS SET TO FALL

BankSA Rural Price Index

Dollar driven recovery

The BankSA *Rural Price Index* informs the State's farmers and farm industries how prices are faring for South Australia's farm products, rather than merely how prices are faring across Australia as a whole. The index aggregates price movements across 17 products which make up more than 80% of South Australia's farm output.

There are three groups of products – grains (such as wheat and barley), livestock and related products (dominated by wool, milk and beef), and horticulture (dominated by grapes).

The index shows prices in Australian dollars (thereby reflecting the prices received by South Australian farmers), as well as in terms of the prices paid by foreign buyers (that is, prices in foreign currency).

Local prices remain solid

A simple summary of the last decade is that China and other emerging economies boomed, but then subsequently slowed.

The effect of that on commodity markets has been massive, because the boom phase pushed up prices and convinced people to produce more, while the subsequent slowdown has eaten into demand growth. The resultant tsunami of supply hitting modest demand gains has seen commodity prices take something of a tumble.

The bad news for farmers is that they've been caught up in this boom and bust cycle. For everything from wheat through to milk, prices on world markets rose to considerable heights, but have subsequently slid back again.

Yet the key for commodity producers doesn't solely lie in the prices applicable in world markets. We're Australians, and much revenue (and some costs) are therefore felt through the filter of the Australian dollar.

That's important, because although the likes of wheat and milk prices have taken their lumps over the last year and more, by and large the price falls have been bigger and nastier for the likes of coal, iron ore, and oil and gas than has been true for farm products.

That's no big surprise, with demand swings for industrial inputs tending to be rather more marked than the demand swings affecting those in the 'paddock to plate' part of world commodity markets.

And with industrial commodity prices having taken the bigger beating, there's no particular surprise that the Australian dollar has moved sharply down from its earlier peaks.

As a rule of thumb, every cent that the dollar drops against the US dollar adds some $400 million to annual farm revenue (more than 1%) across Australia – with South Australia taking around 15% of that, or $60 million.

The returns available to South Australian farmers have therefore been down to a tug-of-war between the bad news in world prices on the one hand, and the good news from a depreciating Australian dollar on the other hand.

As Chart R1 (right) makes clear, that divergence between world prices and Australian prices for South Australian farmers has seen the latter do better recently: although world prices are still falling, the Australian dollar has been falling faster.

That has allowed prices in Australian dollars for the output of South Australian farmers to begin to rise for the first time since 2011.

Rural prices are more important for South Australia than is true for farmers in general across the nation. Chart R2 (page 20) shows agriculture as a share of each State and Territory's economy, with South Australia's farmers accounting for more than twice the share of this economy than is true on average in Australia, and ranking only behind Tasmania.

As usual, there are a large number of other swings and roundabouts in play. The lower Australian dollar brings a range of benefits on the revenue side of farm accounts, but is rather less kind to the cost equation – much farm equipment is imported, and is amid an upswing in price as suppliers increasingly pass through the currency falls of recent times. Even so, that's an offset against what is an overall plus for the farm sector as a whole.

Additionally, the good news on interest rates that has been evident for a while has been another powerful positive against a number of negatives, including some dramas on the world price front, and the usual trials and tribulations around everything from regulations to rainfall.

Differing performances across categories

Yet, as always, the devil is in the detail. Chart R3 (page 20) looks at movements for the three key commodity groups within the broader agricultural sector, with the table showing recent growth rates across a range of measures.

The most volatile of these sectors is the 'crops and grains' component. Sharp price rises usually reflect shortages due to the onset of drought conditions (globally and/or in Australia), while the sharp downward price movements reflect the relative ease of transporting the produce from bumper crops between markets.

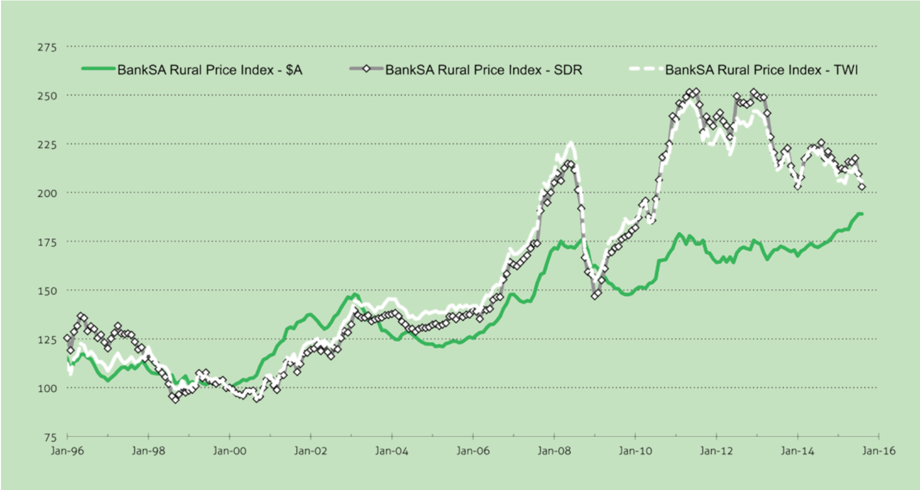
The recent winter growing season in South Australia saw below average yields across the board. Overall production of wheat and barley production rose to above average levels although this reflected gains in planted area. Planted area, production and yields for canola all fell, reflecting poor returns.

Wheat prices in Australian dollar terms have been stable over recent years, with the falling Australian dollar offsetting US dollar price falls. Northern hemisphere production is expected to be roughly unchanged over 2015-16 as production falls due to dry conditions in Europe

BankSA Rural Price Index

Index base : January 2000 = 100	Level	August 2015 % change since Mar 2015	Aug 2014	Aug 2013
AUSTRALIAN DOLLAR INDEX				
Grains	196.5	-0.3%	+7.1%	-3.2%
Livestock and Livestock Product	212.8	+9.4%	+14.3%	+22.3%
Livestock Only	*218.6*	*+8.6%*	*+13.0%*	*+23.1%*
Horticulture	124.8	-2.1%	-2.8%	+0.5%
TOTAL ($A Based)	**189.0**	**+4.4%**	**+9.3%**	**+9.6%**
SDR INDEX				
Grains	211.0	-8.4%	-11.8%	-16.7%
Livestock and Livestock Product	228.5	+0.5%	-5.9%	+5.3%
Horticulture	134.0	-10.1%	-20.0%	-13.5%
TOTAL (SDR Based)	**203.0**	**-4.1%**	**-10.0%**	**-5.6%**
TOTAL (TWI Based)	**205.6**	**+0.4%**	**-7.4%**	**-3.5%**

CHART R1
BANKSA RURAL PRICE INDEX – JANUARY 2000 = 100



and Canada are more than offset by increased production elsewhere.

The upshot is that returns to local farmers have held fairly steady since 2012, and are expected to continue to do so as the balancing act between the falling Australian dollar and falling US dollar wheat prices remains in play over the year ahead.

The situation is similar for barley. Rising Australian production will only partially offset falls in production from the northern hemisphere. Global prices are expected to be stable as both consumption and production fall in 2015-16. However, any falls in world prices would be offset by an easing in the Australian dollar and rising production, thereby lifting returns to local farmers.

The largest contributor to South Australia's agriculture sector – livestock and livestock products – tends to see less volatility in its prices than does the crop component. After peaking during the drought conditions of 2010 and 2011, prices for sheep fell sharply in 2012 before recovering in 2014 and 2015. Sheep prices have moderated somewhat, but remain at a high level. Wool prices have seen small gains in the past year, while beef prices have risen steadily over the same period.

CHART R2
AGRICULTURE - SHARE OF STATE ECONOMY (%)

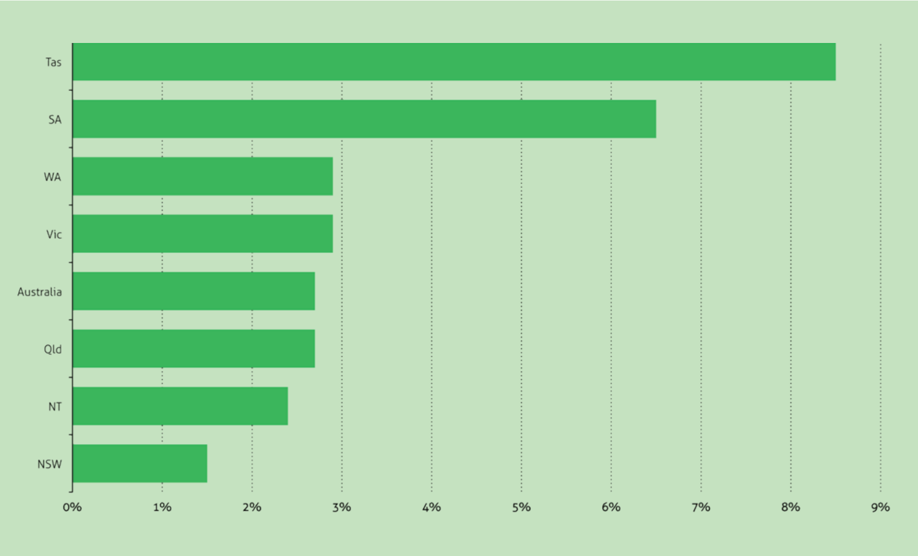
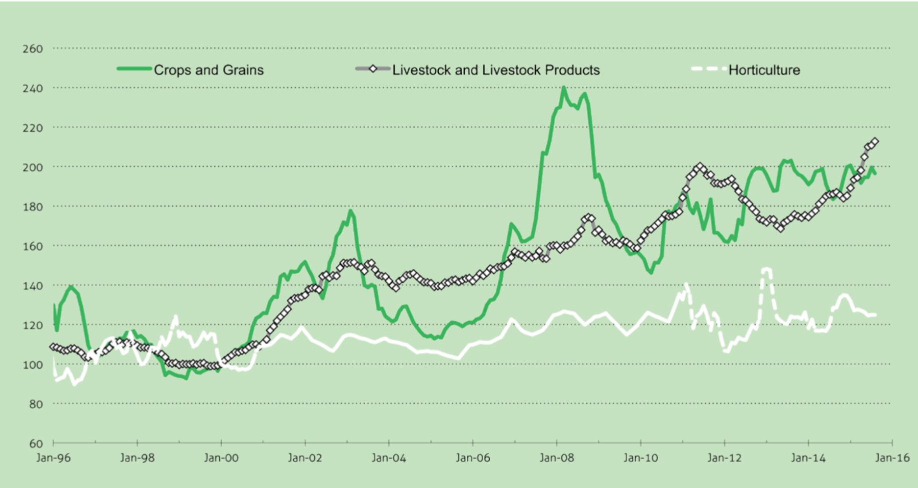


CHART R3
COMPONENTS OF THE BANKSA RURAL PRICE INDEX



Looking ahead, prices are expected to rise over the next year as production falls while Australian export demand remains solid. Flock rebuilding in Victoria and South Australia will see lamb, mutton and wool production fall, along with lower live export volumes. Increased prices and the weakening Australian currency will limit the fall in farm incomes as volumes fall.

The recent devaluation of the Chinese yuan against the US dollar has helped to increase US demand for Chinese textiles and this, in turn, has boosted demand for Australian wool, although this effect is small. More significantly, the Australian dollar has still fallen relative to the Chinese currency over the past two years, which has made Australian wool more attractive to Chinese wool importers.

US demand for beef is set to fall in 2015-16, albeit from high levels, as US production increases. This will put downward pressure on prices and export values, particularly for older cattle. Tariff reductions in Japan and Korea as a result of new Free Trade Agreements and a depreciating currency are expected to make Australian beef more competitive in these markets.

However, Australian beef producers are likely to face greater competition in the Chinese market from South America and New Zealand. The latter will see tariff reductions from early 2016 as their trade agreements with China take effect.

The final (and smallest) component of the index – horticulture – has seen the slowest increase in prices across the past couple of decades.

South Australia is the largest Australian producer of potatoes, and while potato prices have fluctuated over the past two years, they are around the same level as early 2013.

Both onion and tomato prices are at the same level they were a year ago, however tomato prices have been extremely volatile since 2011.

Overall though, horticulture prices are generally close to the levels seen since 2007, but the horticulture price index saw two major spikes – in early 2011, and late 2012 to early 2013.

As is the case for 'hard' or mining commodities, the outlook for export volumes of 'soft' or dining commodities are increasingly dependent on China.

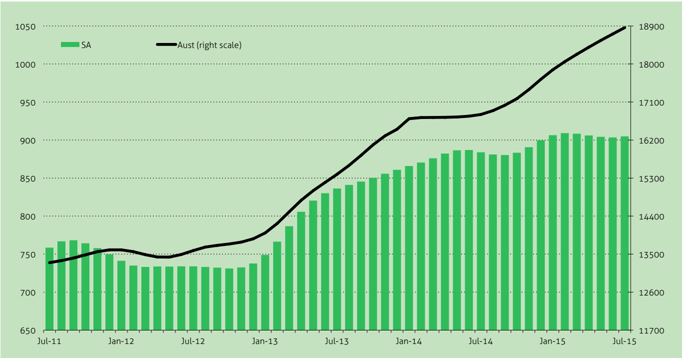
Chinese demand for all types of Australian agricultural produce is likely to improve over the longer term as the Chinese economy shifts from investment-led growth to a more balanced consumption-led growth path.

Although they come with obvious potential as well, there is often a 'spaghetti bowl' of rules and regulations accompanying new Free Trade Agreements.

However, with an increasing amount of global trade being subject to these regional and bilateral agreements, international relations and trade negotiations will become increasingly important to the international competitiveness of South Australia's farmers.

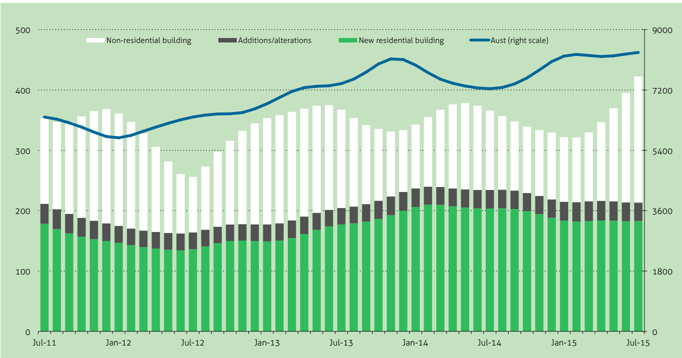
Statistics

CHART 1
SECURED HOUSING FINANCE COMMITMENTS - TREND ($M)



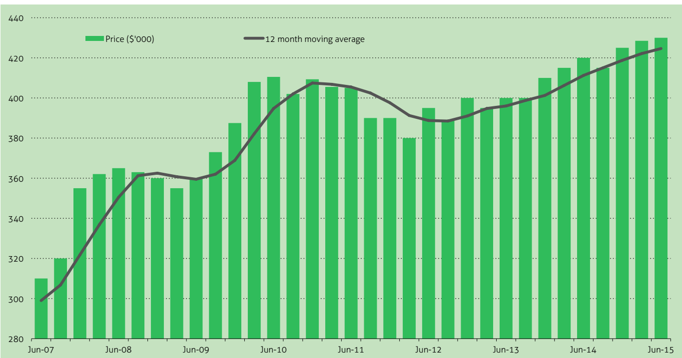
National housing finance commitments continue to rise on the back of record low interest rates and strong investor interest in the Sydney and Melbourne property markets. South Australian housing finance commitments have also risen since the current easing cycle in interest rates commenced, but that rise has been more measured. Latest data suggest a levelling off in housing finance commitments in South Australia in recent months, in contrast to the strong rise still being seen nationally. The latter is still a focus for the Reserve Bank given the overheating concerns surrounding Sydney and Melbourne housing prices, although that is less of a problem for Adelaide.

CHART 2
BUILDING APPROVALS - TREND ($M)



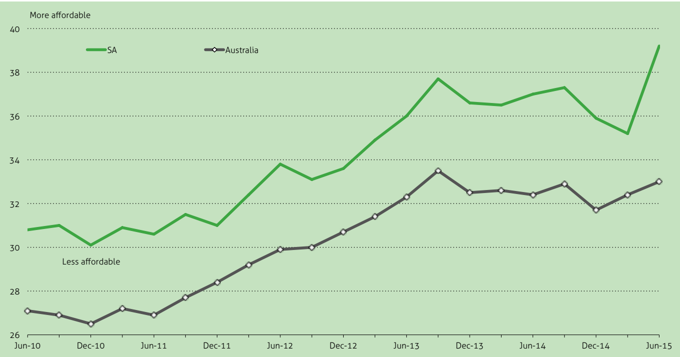
The value of new house building approvals in South Australia has been trending slowly downwards over the past year. That said, residential building approvals are coming down from a higher level following an earlier run-up on the back of low interest rates. On the other hand, the value of non-residential building approvals in South Australia – such as shopping malls and offices – has strengthened in recent months. The latter has helped to drive a rise in overall building approvals across all sectors in South Australia over the past year. Nationally, overall building approvals have risen notably, with residential building approvals particularly strong.

CHART 3
MEDIAN PRICE OF HOUSES SOLD ($'000)



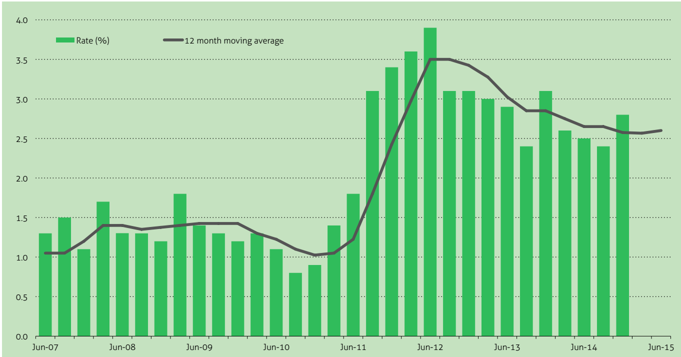
Adelaide's house prices have recorded a moderate rise over the past year, increasing at about the same rate of growth as seen across much of the past three years. Low mortgage interest rates continue to provide support to the market. In contrast to the moderate rises being seen in Adelaide, much larger increases in house prices are being seen in Sydney and Melbourne. That has resulted in the median Sydney house price recently surpassing $1 million on some estimates, whereas the median Adelaide house price is now at around $430,000.

CHART 4
HOME LOAN AFFORDABILITY - INDICATOR STATISTIC



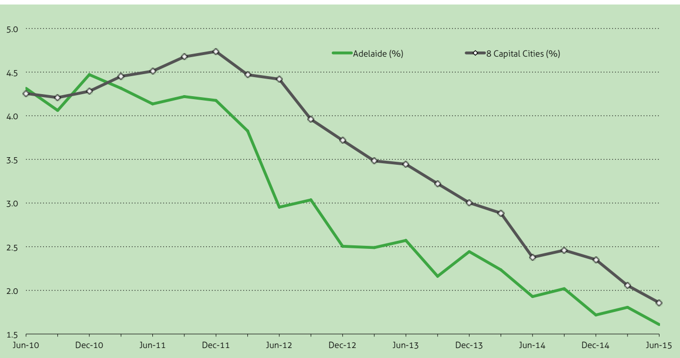
Given the more moderate trends in house prices in Adelaide, it is not surprising that housing affordability in South Australia remains much better than the national average. Affordability in South Australia appears to have improved in the latest data, with two further interest rate cuts by the Reserve Bank earlier this year helping to improve the effective purchasing power of this State's residents in recent months. In contrast, strong rises in Sydney and Melbourne house prices appears to have cancelled out much of the effect of lower interest rates on affordability on the national stage.

CHART 5
RENTAL ACCOMMODATION VACANCY RATE



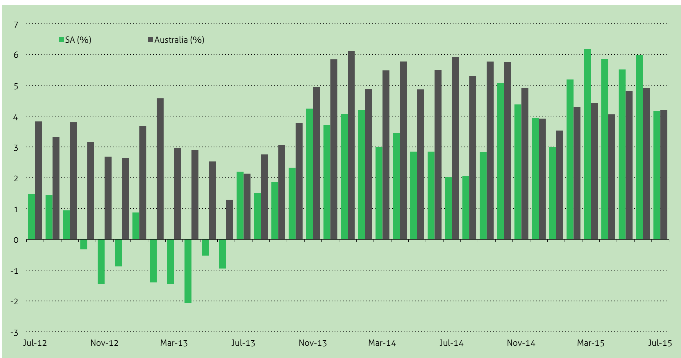
The rental accommodation vacancy rate in Adelaide has generally been trending downwards since early 2012. Although the latest data indicated a slight upward movement in the vacancy rate, the broader trend is indicative of a gradual tightening in the rental market. That said, vacancy rates are not yet showing signs of returning to their lows of 2010. Even so, a tighter rental market should help boost demand for home ownership in the State.

CHART 6
INDEX OF DWELLING RENTS - % CHANGE ON PREVIOUS YEAR



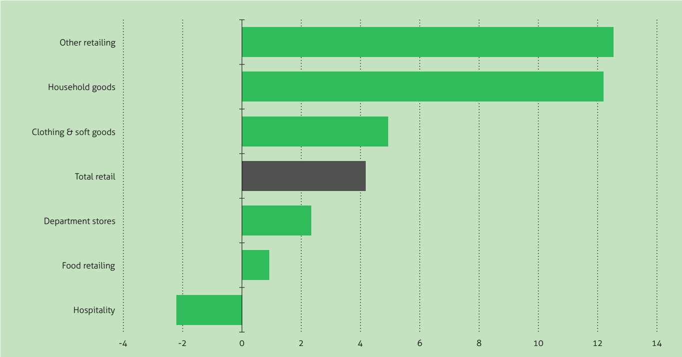
Growth in dwelling rents has continued to ease in recent months in Adelaide and is currently the lowest in well over a decade. A similar easing in the rate of growth of dwelling rents is being seen nationally, although the rate of growth in dwelling rents remains a notch higher nationally than in Adelaide. Subdued wage growth, modest job gains and a lack of much by way of broader inflationary pressures are key factors supporting that weaker growth in housing rents.

CHART 7
RETAIL TRADE - % CHANGE OVER PREVIOUS YEAR - SEASONALLY ADJUSTED SERIES



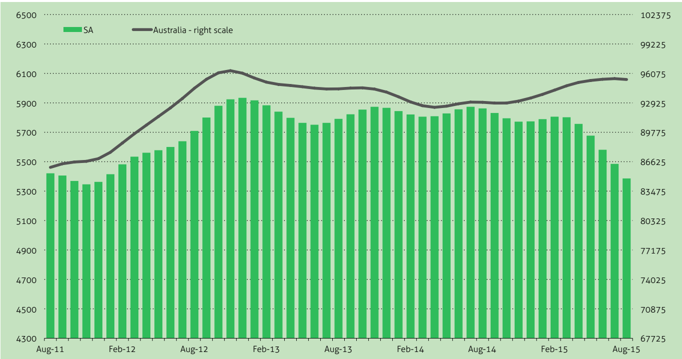
Growth in retail turnover in South Australia has enjoyed a good run in recent months, having exceeded the national average for much of the first half of 2015. Lower petrol prices along with low interest rates – including the cuts to interest rates earlier this year – are two powerful factors that have been supporting stronger retail outcomes. In addition, new small business tax incentives were announced in May's Federal Budget which may have resulted in some additional spending at retailers in recent months. Looking ahead, wage growth remains weak in South Australia (as well as nationally), and that may weigh on the outlook.

CHART 8
RETAIL TRADE - % CHANGE OVER PREVIOUS YEAR - SEASONALLY ADJUSTED SERIES



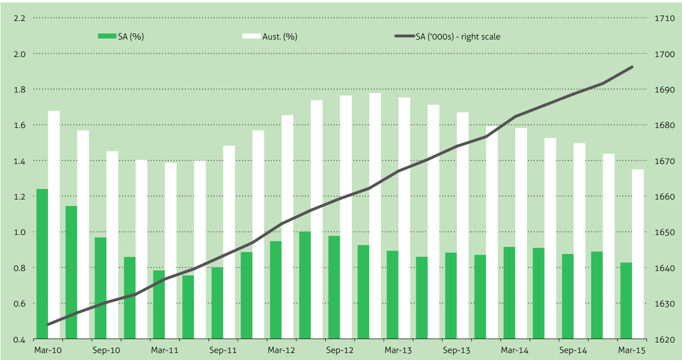
Most categories of discretionary retailing continue to perform strongly on the back of low interest rates. Locally, the catch-all category 'Other retailing' has seen the strongest sales increase over the past year, with household goods retailing only just behind. The latter sector may have been assisted by the small business tax incentives in May's Federal Budget. At the other end of the scale, food and hospitality retailers recorded soft outcomes in the latest data.

CHART 9
NEW MOTOR VEHICLE REGISTRATIONS - SEASONALLY ADJUSTED



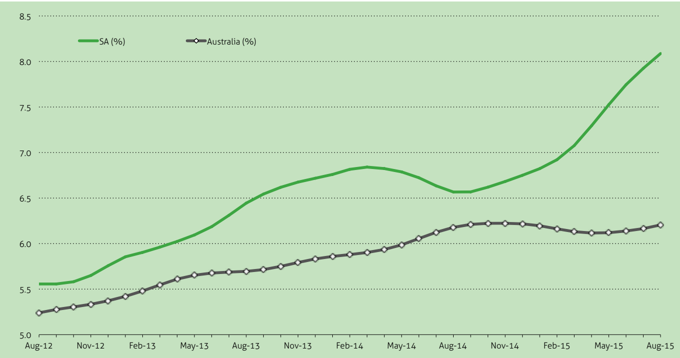
The number of car sales in South Australia has fallen quite sharply in recent months. That is in contrast to the small rise being seen nationally. Recent falls in the value of the Australian dollar are placing upward pressure on the cost of imported cars, and that is not helping. Although retail spending has been performing quite well, the weakness in car sales may be an indication that some families in South Australia are not feeling comfortable enough with their circumstances to make such a large purchase amid a rising rate of unemployment.

CHART 10
POPULATION TRENDS - % CHANGE ON PREVIOUS YEAR AND LOCAL LEVEL ('000S)



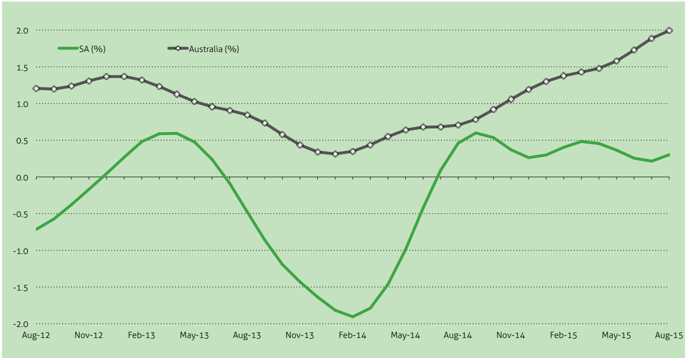
Australia's population growth has continued to ease, driven by lower net overseas migration. The slowdown in Australia's population growth has been concentrated in the mining jurisdictions of Western Australia, Queensland and the Northern Territory. In contrast, South Australia's population growth has remained relatively steady of late, although it still remains notably lower than the matching national population growth rate.

CHART 11
TREND UNEMPLOYMENT RATE (%)



The upward trend in South Australia's unemployment rate has continued in recent months. The State's unemployment rate of around 8% is now the highest in the nation. With expected closures in local manufacturing industries still to come, unemployment levels may be under pressure for some time further, but recent falls in the Australian dollar and low interest rates will help other sectors to support local employment levels.

CHART 12
EMPLOYMENT - % CHANGE ON PREVIOUS YEAR - TREND SERIES

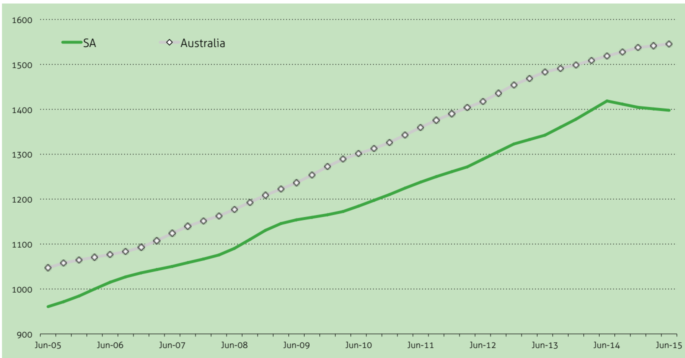


Rising unemployment is being driven by modest employment growth in South Australia. While widespread job losses are not currently being seen, job growth has simply been too weak to bring the unemployment rate down. In contrast, job growth at the national level has shown a considerable improvement in recent months, a development that has helped to keep the national unemployment rate broadly steady. Even so, there remain signs of weakness in the national labour market, with the number of hours worked not rising as fast as the number of jobs.

CHART 13
ROOM OCCUPANCY RATE - TREND SERIES

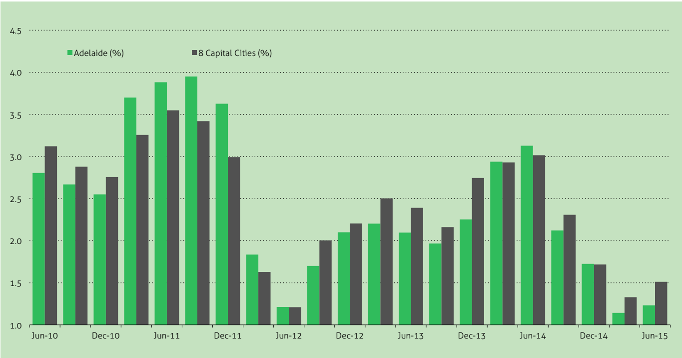
South Australia's room occupancy rates edged upwards through the course of 2013-14. The large fall in the Australian dollar in recent months along with lower oil prices are very favourable developments for the Australian tourism industry. Latest data indicates that the number of international visitors to Australia has increased strongly over 2014-15, but a small decline was recorded in South Australia. There continues to be strong growth in tourists from Asia, led by China and India.

CHART 14
TOTAL AVERAGE WEEKLY EARNINGS ($) - PERSONS IN FULL-TIME EMPLOYMENT



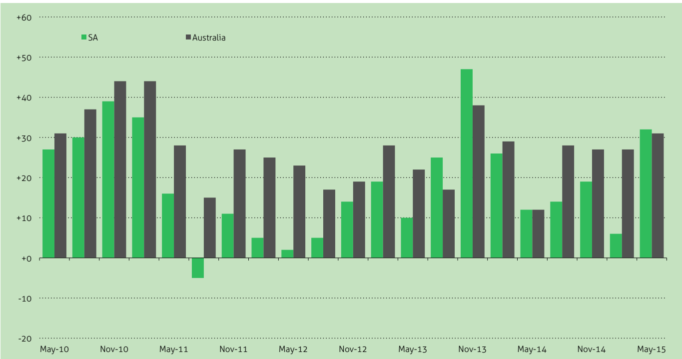
A key indicator of current pressures on the State – as well as the mix of industries shrinking and growing – the latest data indicates that wages have stopped rising in South Australia since mid-2014. In contrast, growth in wages at the national level – albeit more modest wage growth than seen in previous years – has meant that the wage gap to the national average has been widening at a solid clip.

CHART 15
CONSUMER PRICE INDEX, ALL GROUPS - % CHANGE ON PREVIOUS YEAR



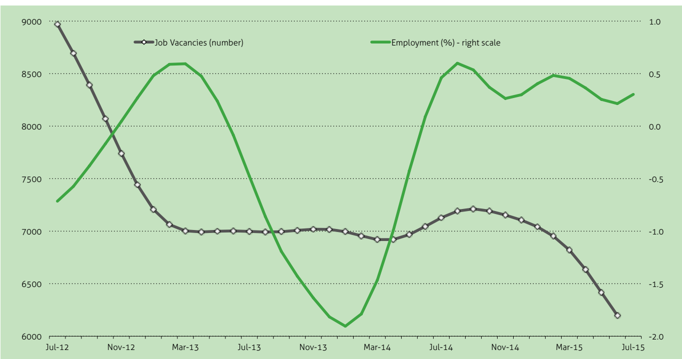
There's little evidence of inflationary pressures in consumer prices either in Adelaide or in Australia more widely. As Chart 15 shows, trends in the CPI in Adelaide pretty much match those in Australia. There have been big factors driving down pricing pressures in recent times, including relatively modest economic conditions, record low rates of wage growth, and falling world oil prices. With this State's growth lower than Australia, it's no surprise that our inflation rate is lower too.

CHART 16
SMALL BUSINESS CONFIDENCE - NET BALANCE



There was good news in the most recent reading for small business confidence in the State. Confidence bounced back up to essentially be up at national levels for the first time since 2013. In part that reflects weakening trends in the mining exposed States on the one hand, as well as better news locally.

CHART 17
EMPLOYMENT GROWTH & JOB VACANCIES



Job growth in the State has been relatively steady at modest rates since early 2014. However, that came after a considerable earlier phase of weakness, and there is the potential for further pressure on local job markets. The job vacancies data put together by the Federal Department of Employment appears to have commenced another downturn.

CHART 18
SHARE OF NATIONAL OUTPUT AND POPULATION (%)

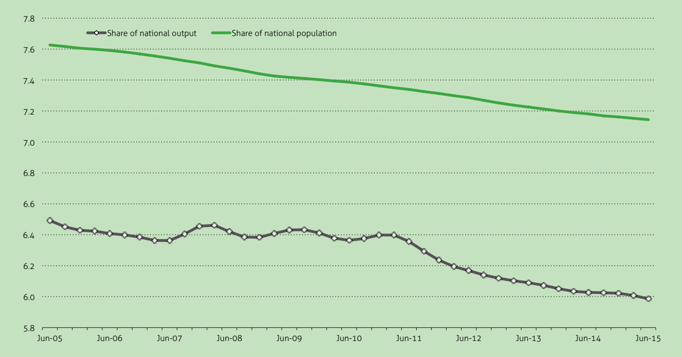
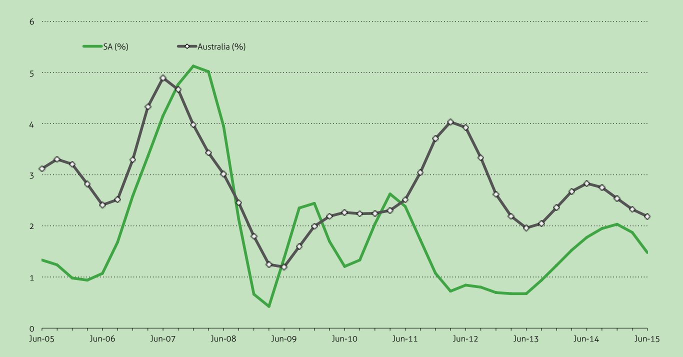


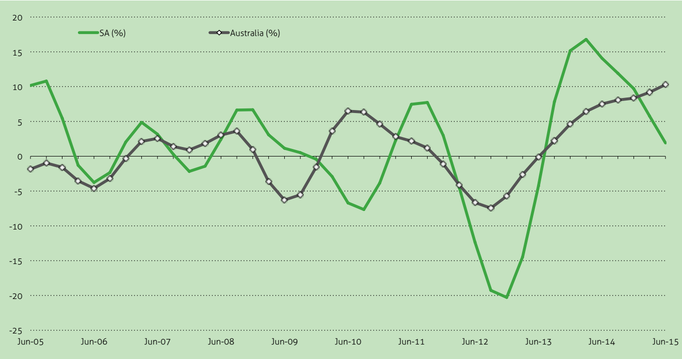
Chart 18 maps this State's share of Australia's economy and population. Although both have been trending downwards over time, it is worth noting that since 2011, South Australia's share of Australia's economy has held up better than the matching share of population. That's an unsung positive result – it means that this State has had relative success in the productivity of its workers in recent years.

CHART 19
OUTPUT - % CHANGE ON PREVIOUS YEAR



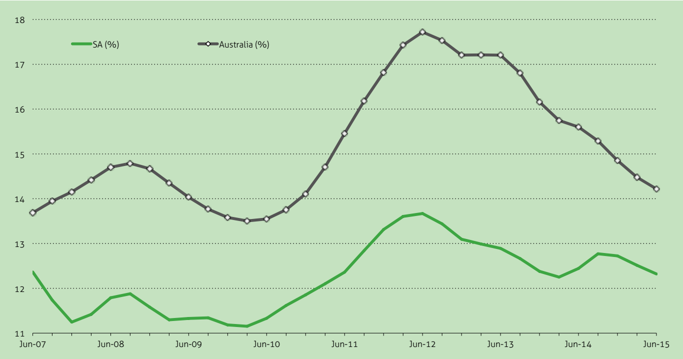
Both South Australia and Australia are seeing weakening business cycles at present. However, the gap between the national and State outcomes is explained by South Australia's more modest population growth. Allowing for the latter, local and national performance is pretty much lineball.

CHART 20
DWELLING INVESTMENT - % CHANGE ON PREVIOUS YEAR



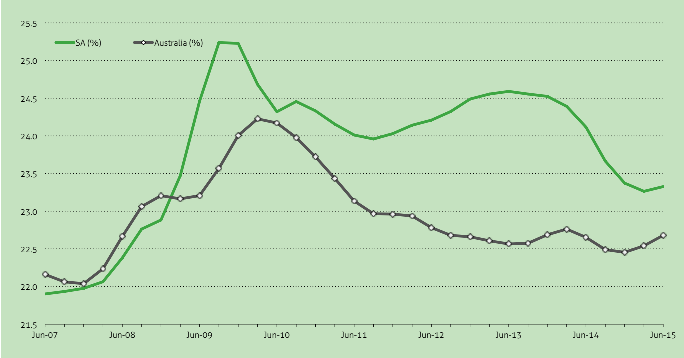
Partly thanks to ongoing strength in both Victoria and New South Wales, the national growth rate in spending on building new homes and renovating old ones continues to march higher. In contrast, although construction in South Australia hit a more marked peak in early 2014, it has now entered a more moderate phase, while low interest rates continue to provide important support.

CHART 21
BUSINESS INVESTMENT - % OF OUTPUT



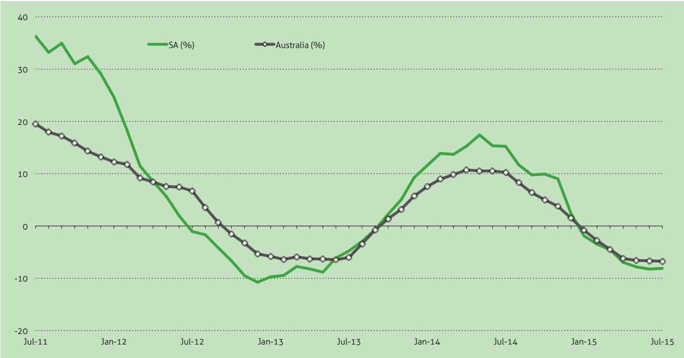
A key side-effect of the rise of emerging Asia in recent years was the remarkable impact it had on capital spending by businesses here in Australia. But much of that was in mining, and South Australia's relatively small mining sector means that it didn't see the same run up in capex as was true at the national level. Equally, having not risen as high in the first place, this State is better protected amid the downswing in engineering construction currently being felt in the likes of Western Australia and Queensland.

CHART 22
PUBLIC SECTOR OUTPUT - % OF TOTAL CONSUMPTION AND INVESTMENT



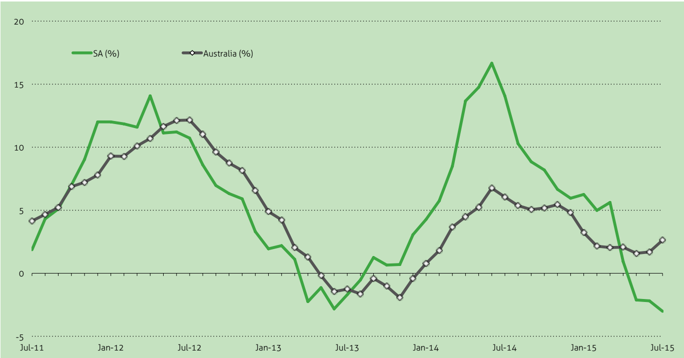
The public sector in Australia grew in response to the global financial crisis, and some of that boost has been maintained through to the present. That lingering increase in the public sector's size was more evident for longer here in South Australia than nationally, though the gap has closed somewhat over the past two years.

CHART 23
MERCHANDISE EXPORTS - % CHANGE LAST TWELVE MONTHS TO PREVIOUS



South Australia's export cycle has closely tracked its national equivalent. But it wasn't meant to be that way: the big investment in mining in other States was expected to generate better news for their exports. In practice, falling world prices for the likes of coal, iron ore and gas has kept this State's export cycle in close contact with that of the nation. Looking ahead, the fall in the Australian dollar against the US dollar and the British pound has considerable potential to assist some important niches among this State's export sectors.

CHART 24
MERCHANDISE IMPORTS - % CHANGE LAST TWELVE MONTHS TO PREVIOUS



The current weakness in merchandise imports into South Australia – this State is buying less from the world than it was a year ago – partly reflects the present weakness in economic conditions in the State. However, it is also a catch up from the earlier period of strength that saw a marked cyclical high in 2012.

Trends December 2015

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