QUEENSLAND
FUTURES INSTITUTE

QLD POLICY LEADERS' FORUM

QUEENSLAND'S ECONOMIC OUTLOOK

13 SEPTEMBER 2023

QLD Policy Leaders' Forum

QUEENSLAND'S ECONOMIC OUTLOOK

Wednesday 13 September 2023
7:30am – 9:00am
Customs House,
399 Queen St, Brisbane

PANELISTS:

MICHAEL ANTHONISZ
Chief Economist
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SIMON LEWIS
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Australian Retirement Trust

RICHARD YETSENGA
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ANZ

MODERATOR
JO MASTERS
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Barrenjoey

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Snapshot

The key theme from the 2023 Queensland Futures Institute's – Queensland's Economic Outlook – was the current macroeconomic challenges we are facing within Australia and globally. The Panel outlined the pathway forward for Australia and the Queensland economy, as the Reserve Bank of Australia manages inflation over the next 12 months. The discussion also highlighted opportunities around several economic drivers – including Queensland's population growth, productivity and strong trade relationships – which will bolster economic activity going forward.

Summary of Panel Comments

- We are seeing a moderation of many global inflationary drivers – including deglobalisation and supply chain disruptions – as we come out of a challenging few years since Covid.
- We will likely see a moderating of the interest rate increases we have seen in the past 12-18 months – with interest rates expected to remain stable over the next 12 months - as the Reserve Bank of Australia (RBA) manages inflation.
- However, we will continue to see a number of larger, structural drivers of inflation which will create challenges in returning to the bottom half of the target inflation band of 2-3%, which could reflect a new economic paradigm for Australia. These drivers include Queensland's population growth, saturation of technology industry developments, and international developments such as the Inflation Reduction Act.
- It will remain important for Queensland to focus on its economic strengths, delivering economic opportunities throughout the climate and energy transition and prudently deploying capital. It will also be critical to monitor productivity and wages relative to other states.

Comments from Panel

Jo Masters

- The economic environment across Queensland and Australia remains complex after a challenging few years, both from a cyclical and a structural perspective.

Michael Anthonisz

- From the recent state budget, the outlook for Queensland holds several opportunities and risks for the state over the years ahead. Queensland Treasury has forecasted Queensland's Gross State Product to accelerate over the next few years, from 2% this year to 3% in each of the next two financial years.
- This reflects the normalisation of interest rates. That is, as interest rates come down, they will no longer weigh on household spending as much as they currently do. Additionally, we may potentially see tax cuts at the federal level and the unwinding of supply chain disruptions which have weighed on housing construction and the state's export sector.
- This is a cautiously optimistic forecast of the next few years from Queensland Treasury. It also indicates growth rates which are slightly above the average since the Global Financial Crisis, and roughly in line with the national average.
- There will also be a number of opportunities to bolster this growth, the most significant of which is our trade relationship with India. India is currently Queensland's second largest trading partner and it doesn't require a huge leap in imagination to see it becoming the largest in the coming years. This opportunity is significant for Queensland given India's geographical proximity, its favourable demographic underpinnings, and the scale of the industrialisation and urbanisation that is currently underway.
- A key strength for Queensland in recent decades has been our population story. Over the past 40 years, Queensland's share of the national population has increased from 15% to 20%. Our share of the national economy also increased from 15% to 20% over the past 30 years, indicating the correlation between our relative population, performance, and economic outperformance.
- This relationship will likely continue, as there are no constraints which would structurally change this dynamic. However, the Commonwealth Government's National Centre for Population projects that over the next decade, Queensland's share of the national population will flatline, rather than continue to increase. If this eventuates, then we need other things to fall our way in order to continue to grow our share of the national economic pie. These may include higher commodity prices or finding ways to be more productive than other states. These sorts of outcomes are inherently uncertain however, a key challenge going forward will therefore be the planning required if the tailwind of population growth ceases.

Comments from Panel

Simon Lewis

- Australian consumers have been surprisingly resilient to the recent economic challenges. As interest rates have risen by 400 basis points over the last 12-18 months, consumer confidence has declined. However, at an individual level, people have been finding ways through this period, for example, by using cash saved over Covid. Since we are only 60% through the fixed rate cliff, we will see this start to reduce even further, particularly by the first quarter of next year.
- Most current mortgage borrowers have qualified for a mortgage at an interest rate of at least 5.5%. So, while the cost-of-living shock has been considerable, the actual shock we should be wary of is the difference between this amount and perhaps 6% that people are now paying on their variable rate mortgages.
- Investors are cautiously optimistic in the current conditions. There are a number of concerns and challenges – including around rental reforms currently underway and the possibility of impending drought and the potential impacts on our communities is another cause for concern in the near future.

Richard Yetsenga

- The balance sheet of the Australian household sector has never been this strong. We have handled higher rates quite well because our net asset position is the best we have ever seen. While this has slightly deteriorated with the decline in house prices relative to the peaks of 24 months ago, we expect the household sector to continue in pretty good shape.
- As we undertake the climate transition, Australia is one of the few economies which not only was a beneficiary through the export side of a fossil fuel driven global energy system, but also has the minerals required to deal with the transition. This creates a massive opportunity in the coming years, which will require the right policy settings to achieve. But we are also delivering into these challenges with a very strong labour market. Unemployment is at 50-year lows and female participation is at the highest level we've ever seen.
- One of Queensland's strengths has been our demographic story. This is closely linked with housing affordability, which will remain a challenge to sustain.
- Finally, Queensland's strong trade position and relationship with China is another area of opportunity and challenge in the coming years. China's slowing regional activity may persist in the next couple of decades, relative to previous decades. While it is still an $18 trillion economy, we will start to transition the export sector to diversify trade partners. Additionally, we will need to deal with the trade cycle and the global transition from fossil fuel towards different forms of energy.

Comments from Panel

Anthony Rose

- Australian Retirement Trust manages about $260 billion of the retirement savings of over 2.2 million members, around 70% of which is based here in Queensland given our heritage in QSuper and Sunsuper (prior to the merger to form Australian Retirement Trust). Of over 3,000 employees, 2,500 are Brisbane-based. We are also the largest custodian of superannuation funds for women in the country.
- Looking at the macroeconomic environment, we have recently seen an abatement in the supply chain issues that have persisted over the recent years. While inflation seems to have stabilised and moderated, central banks are now looking at wage inflation and how this may later impact the rate cycle. However, we have recently seen a slight increase in unemployment in the US to 3.8% - last at this level in February 2022. This is a possible sign of easing inflationary pressures.
- Equity markets are currently optimistic on the global economic outlook, but there are a number of drivers which should be considered around this. Firstly, there is a broad push post-Covid towards de-globalisation, particularly given the current geopolitical environment. This is reflected in a strong focus on building business resiliency and redundancy, identifying the concentration risks in end-to-end business models, and diversifying away from these risks. This will be a multi-decade journey, shifting the allocation of capital and how our end-to-end systems function.
- Secondly, there is significant movement around the Unites States' Inflation Reduction Act (IRA). This is effectively a series of tax reforms, driving the decarbonisation of the U.S. economy and putting USD$800 billion into related initiatives. This money is starting to have real impacts, flowing through to the balance sheets of the industries that are driving decarbonisation. The employment and economic activity this drives will be significant.
- Comparing the IRA to other macroeconomic policies, this reform may actually contribute to the stability of the US market, as it could be argued that this is similar to the quantitative easing of the GFC and the spending through Covid measures.

Garnett Hollier

- Brighter Super are a $31 billion asset owner based here in Queensland since 1965.
- Inflation is at the forefront of investment decisions we take, given its impacts on purchasing power for our fund members. We returned 10.62% for our members last year and remain focused on the economic environment ahead. There are headwinds around the uncertainty of inflation, interest rates or potentially a recession, which we must respond to appropriately through the allocation of our assets.
- To do this, we believe in the strength of the Queensland economy, having about a billion dollars in unlisted infrastructure and property here. We allocate to earn best risk adjusted return globally. So having a fifth of our global infrastructure allocation in Queensland and about a quarter of our global property allocation in Queensland indicates our high conviction relative to other opportunities.
- We are also well positioned to do more in Queensland. It's a key part of our strategy to build a tangible connection between our assets, our members and the communities that they live and work in. We recently acquired Suncorp Superannuation Fund, which has provided a liquidity injection of $6 billion. As we fully integrate these portfolios over time, we will continue looking for opportunities to deploy these funds into Queensland.

Panel Questions

What is the outlook for the US and the global economy more broadly, and how does that flow to the economy?

Anthony Rose

- Our currency is an important indicator. We've seen a reduction in the value of the Australian dollar through a combination of relative strength in the US dollar and a view around the implications for Australia of a slowing China. Economic forecasts into 2024 are placing between the Australian dollar back higher at or above $0.70-0.75. How this plays out will impact domestic inflation as a more prolonged lower dollar will flow through into inflation, given import costs being brought into our economy.
- In parallel, wage inflation - which generally lags behind headline inflation – is progressively coming through in enterprise agreements. If the RBA can return inflation to a manageable level, this will afford a sustainable premium (e.g., 100 basis points) on wage inflation.

What is the outlook for China, and what is the impact on Queensland via resources, tourism or education?

Richard Yetsenga

- There is a record of fast-growing economies experiencing a sharp slowing in growth before never returning to the previous fast growth regime – this has happened in the U.S. and Japan, where each successive decade has typically seen slower growth than the decade before.
- China's GDP per capita is now approaching $15,000 p.a., which places it as a middle-income economy. It therefore has quite a different growth story from developing economies such as India and Vietnam. Additionally, China's high level of debt is around 297% of GDP – a similar level to advanced economies. This is reflected both at the country level and the household debt level.
- Debt is not necessarily a problem if growth metrics are able to support this. Traditionally, China's key growth metric has been its population. But China's population is now falling. Given how unlikely it is for this trend to reverse, it can be assumed that China may grow at low single digits in coming years. Despite this slow growth, it is still an $18 trillion giant – behind the U.S. at $22 trillion and in front of Japan at $5 trillion.
- Opportunities in China will likely look different going forward – we will see less early-stage infrastructure, more late stage renewable energy, less early education and more aged care.

Panel Questions

Where is Australia's economy headed? When will we see rate cuts? Will we see a recession?

Michael Anthonisz

- We consider that the RBA has reached its peak rate for this cycle. Our analysis has considered different policy rules, historical experience, model-based estimates and scenario analysis.
- We also consider that the pause could last between 6-18 months, though we anticipate it will be 14 months with rates possibly starting to be cut in August of next year and then declining by about 130 basis points over the following eight months.
- Our analysis also considered whether Australia would have a slow down or a recession and what the next economic phase would look like. Our modelling indicates a 50- 60% probability of a recession in the next 12 months and an 80% probability in the next two years. However, one must be careful in over-interpreting these estimates given the small sample of recessions in Australia. That said, the estimates are useful in conveying the idea that there is a material risk of economic slowdown in the period ahead.
- There are a number of factors why we might not see a recession eventuate. This includes strong household balance sheets, firms possibly trying to 'hoard labour' even as demand weakens, population growth, interest rate settings that are only modestly restrictive, scope for additional fiscal and monetary policy to support the economy in a slowdown if required as well as tax cuts and lower inflation which should both support real household disposable income.

Anthony Rose

- There is an open question around what neutral, non-inflationary rates should be. Under the previous Australian economic paradigm of 4-4.5% before this extended easing cycle, where we also saw China exporting deflation and the RBA consistently delivering inflation below its 2-3% inflation target range.
- But in the current environment, it's not clear where the non-inflationary rate will land. The quicker the RBA can address inflation, the sooner we can moderate wage growth such that it does not feed back into the inflation cycle. The longer we remain above target inflation, the higher the risk is that wage inflation impacts could flow into the broader economy.

Will this cycle see the cash rate and yields remain higher for longer than we've historically seen? What is the impact on investors of this dynamic?

Simon Lewis

- From a portfolio management perspective, we see the current risk-free rate at 4%, which provides an alternative investment (e.g. cash), compared to commercial property or other alternative asset classes. As superannuation funds grow, they may consider unlisted asset classes. There is certainly a role to play for super funds in supporting the infrastructure required by Queensland moving forward.
- The transition to the carbon economy is a real opportunity for Queensland. It is likely this, and the activities in the US, that will have an effect on this. The RBA will continue to need to manage inflation, but we may see interest rates lowered in the second half of 2024.

Panel Questions

Queensland has a strong fiscal position compared to other states. We saw new infrastructure projects announced in the Queensland Budget, around the Olympics and the energy transition. Where are the opportunities for investors around this?

Garnett Hollier

- As we approach Olympics 2032, we're seeing economic activity and opportunities emerge – the current levels of construction, planning and other development this requires is being supported by private sector and by the Queensland Government, which is spending $89 billion over 4 years under the FY24 budget on significant development. This includes the Queensland Energy and Jobs Plan, the Olympic infrastructure, and other capital works programs.
- To take advantage of these developments, we need to translate these themes into investment ideas. When we were first awarded the Olympics, it was estimated that the economic benefits would be $4.6 billion. We need to be able to tell the thematic story around tourism and trade that the Olympics will bring in order to create investable opportunities around them.
- While we are overweight in Queensland, we are not overweight across all sectors. For example, we are underweight airports but overweight airports in Queensland. This includes investments in airports across the Queensland coast. In taking this investment position, we have taken of view on tourism in Cairns, in Townsville, Mackay, Sunshine Coast, and the Gold Coast.
- In addition to this, we also own the land of Village Roadshow on the Gold Coast, which speaks to the tourism thematic that we invest in. While there is a challenging environment in property development, these investments and other investments in infrastructure in Brisbane are some of the key opportunities that we've taken advantage of in the lead up to the Olympics.

Are inflation and interest rates destined to be higher in the future?

Michael Anthonisz

- In the next couple of years, we will likely see inflation continue to moderate as pent-up demand for services eases and higher interest rates bite. However, the path lower may not be a linear one.
- On a longer time horizon, inflation will likely be higher on average than we've seen in the past. This is impacted by a number of drivers, including the energy transition, climate variability, and deglobalisation. All of these factors are inherently inflationary, and we will likely see medium to long-term inflation settle in the top half of the RBA target inflation band.
- In the near-term interest rates will likely remain steady but they could trend higher over time. This reflects an increase in the investment required to boost national security, undertake the energy transition and respond to climate change. AI and robotics will also facilitate an expansion in economic activity as they become increasingly adopted by businesses. These drivers all indicate higher equilibrium interest rates of the long-term.
- It is possible that AI and robotics will result in a concentration of productivity within dominant technology firms which would have a depressing influence on equilibrium interest rates. As could adverse demographics and elevated uncertainty. However, the trends discussed earlier all indicate higher inflation and interest rates on average than we've seen in the past.

Panel Questions

Richard Yetsenga

- The RBA has had a difficult time returning the economy to the 2-3% inflation target, given extra inflation pressures we've discussed. There are several reasons that indicate we might therefore see an additional policy response. Firstly, we underplayed the shift in prudential standards globally after the GFC to tighten lending standards – which meant households had to demonstrate stronger credit metrics to their institution to get loans. This had a tightening impact on the global economy, including in Australia, following the GFC. This has meant that this is the first interest rate hiking cycle that Australia has had where more than 90% of mortgages have been assessed with a 300-basis point interest rate buffer. This has meant interest rates have impacted mortgages much later in the cycle.
- Secondly, the deflationary pressure of the technological advancements around the semiconductor industry has likely ended. Taking a very long-term view and considering historical impacts of technological advancements – for example, in the UK - GDP per capita increased fivefold, and the price level went up 55x in the last century. Technology is initially deflationary or disruptive, but as the sector itself becomes large and draws in substantial resources, it starts contributing to higher living standards and contributes to demand, productivity and consumption. The global technology industry has certainly now reached saturation, meaning although it may continue to be disruptive, it is unlikely to remain deflationary.
- Lastly, demographics significant role in the growth of the economy, moving forward. As we see a reduction in the working population and an increase in youth and retired, we see greater inflationary pressures as there are more consumers and less producers. We have seen population growth over the past couple of decades of about 25,000 people a year, but this will increase in coming decades to 65,000 people a year. This will contribute to economic growth and inflation.

How does interest rate uncertainty impact the investment decision process?

Simon Lewis

- There's a lot to be positive about – with significant levels of resilience in the community and a well-supported, well-funded business community. With high levels of superannuation funds per capita, we have significant funds to be deployed into growth opportunities across Queensland in the next 10 years.

Anthony Rose

- Net zero targets will play a significant role in the growth of the economy moving forward. Considering the large infrastructure requirements, there will be significant opportunities that will drive economic activity - including in energy generation.
- Also, there are significant opportunities in responding to the physical risks of climate change – in building resilience across various parts of the economy, including within biodiversity, as well as in the property market. A small historical analogy: In the depressed residential property market across Australia in the early 1990s, there was one market that saw a boom in construction activity. This was in Newcastle following the earthquake – which contributed significant momentum and house price inflation in that market.
- When these drivers are considered together, it is very likely that they will continue to contribute towards economic growth and inflation moving forward.

Audience Questions

How do we ensure productivity growth in Queensland?

Jo Masters

- There's no shortage of ideas in Australia about how to boost productivity. We recently had the productivity commission report exploring opportunities around this, but it is critical to determine which of these opportunities are the most politically feasible.
- One of the largest challenges around this is the ability of Commonwealth and State Governments to come together across election cycles to take advantage of these opportunities.

Given the national conversation around housing, is there a role for super funds to be invested more directly into the housing market?

Anthony Rose

- ART is currently collaborating with QIC to explore proposed opportunities in community housing. This is currently in the early stage of investigation. In relation to super funds' role in housing, over time, we'd expect several alternative investment models will emerge which may support these opportunities. These will eventually help to identify the best scalable versions which attribute risk and return to those that can best deal with the risk profile of the opportunity.
- While our risk appetite may be more appropriate than that of government to fund elements of these models, we will continue to allocate capital only where the risk/return equation is in the best interests of our members. We will likely find a number of ways in which we can respond to this need.

Garnett Hollier

- A key objective as an institutional investor is that we must work to deliver outcomes in the best financial interest of our members. We are in a competitive marketplace in property and are also constrained by fee and liquidity requirements as well as APRA performance benchmarking. If we were to enter this space, we would need to structure our investment to navigate these constraints.

Richard Yetsenga

- The housing sector is not suffering from a lack of capital. Therefore, the high prices are coming through from the supply chain – in the cost of providing the building. For other products, such as solar panels, you benefit from a learning rate which decreases the cost per unit as you produce more. For housing, we see the opposite happen – more expensive build costs as the supply chain is constrained.
- Therefore, addressing the problem around housing is likely less of a question around capital and more of a question around utilisation. This is not just a supply-side issue, and clearing more land - which is contributing to Australia being the only advanced economy on a list of 24 deforestation hotspots around the world – is not solving this issue. So, it is clear that the housing issue needs to be reconsidered.

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