Tuesday, 28 June 2016

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WA Economic Outlook

Summary

- **Employment levels in Western Australia are at an all-time high of almost 1.4 million. The State has grown, in fits and starts, over the past thirty years. While the glow from the mining investment boom is fading rapidly, export volumes are up. Some sectors of the economy are struggling but others remain firm. The outlook is difficult but not dour. Another tough year ahead is expected but the economy should expand courtesy of the export sector.**

- **Cycles in commodity prices play a significant role in the West Australian economy. The changing shape of the Chinese economy, as well as global supply responses to the surge in demand for resources from China, has put significant downward pressure on iron ore and energy prices. Weaker commodity prices have placed strains on government finances and reduced the likelihood of new projects getting off the ground.**

- **A slowdown in mining investment is continuing to weigh on business investment in Western Australia. Although mining investment has already slowed substantially, there is further weakness in business investment on the horizon for WA.**

- **The 2016-17 Budget for WA was handed down in mid-May. The projected deficit, at $3.9bn for 2016-17, is set to be the largest ever seen in WA. Revenue is forecast to decline by 3.1% or $810mn, the third consecutive year in which revenue has fallen. In order to reduce its debts, the WA government is looking to undertake asset sales valued at around $16bn.**

- **With weak growth in wages, slower population growth, and a softer outlook for the economy, consumer spending is expected to remain subdued during 2016-17.**

- **Population growth in WA has slowed from 88,000 per year in 2012 to 31,000 in 2015.**

- **The tide has well and truly turned in the Western Australian residential property market. Prices are down, building approvals are down and construction activity is set to slow from the current relatively high levels.**

- **Economic Growth**

Percentage Shares of the Economy*		
Industries	**WA**	**Australia**
Mining	36.6	9.6
Construction	12.5	9.4
Manufacturing	5.3	7.5
Transport, postal and warehousing	5.2	5.6
Health care and social assistance	5.0	7.6
Professional, scientific and technical services	4.6	7.5
Retail trade	3.4	5.3
Financial and insurance services	4.2	9.9
Public administration and safety	3.0	6.3
Education and training	3.2	5.4
Administrative and support services	3.0	3.3
Agriculture, forestry and fishing	2.0	2.7
Wholesale trade	2.9	4.6
Electricity, gas, water and waste services	2.5	3.2
Rental, hiring and real estate services	1.9	3.2
Accommodation and food services	1.5	2.7
Information media and telecommunications	1.4	3.3
Other services	1.3	2.1
Arts and recreation services	0.4	0.9

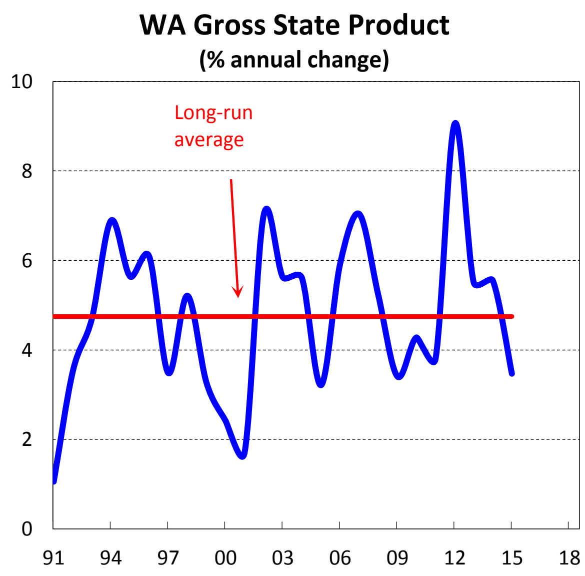
** Share of gross value added less ownership of dwellings 2014-15; Source: ABS, St.George*

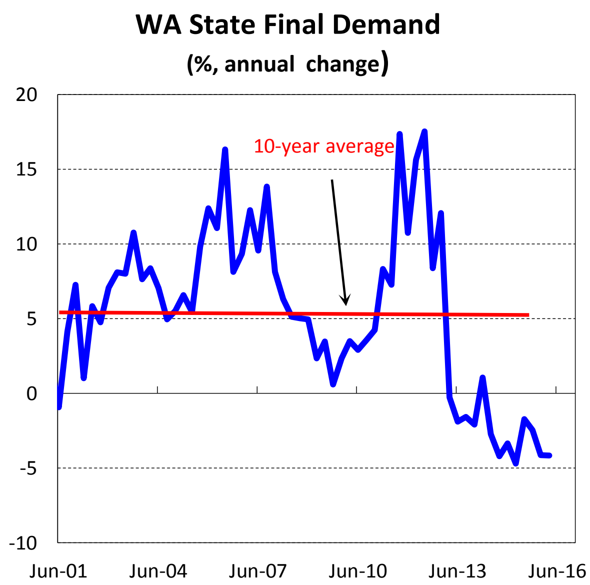
During the resources boom, Western Australia was one of the powerhouses of the Australian economy. As one of the major beneficiaries of the rapid expansion of the Chinese and other Asian economies, its economy grew; it saw rapid population growth, rising wages and low unemployment. In 2011-12 its economy grew 9.1%. This was followed by two years of growth in excess of 5.0%. There were good times for the economy.

The pace growth in Western Australia eased in 2014-15 as Gross State Product grew 3.5%. Estimates for 2015-16 suggest growth of just 1.4% and forecasts for 2016-17 are close to 2.0%. The boom has passed. The economy is now larger but growing at a very modest pace. Growth is based on exports rather than domestic demand.

The changing fortunes of Western Australia are best seen in its State Final Demand statistics. State final demand measures economic growth but does not include net exports. For the past 20 years, annual State final demand has growth at an average of 4.9%. During the recent boom years of 2011 and 2012, State final Demand was growing at around 12%. Over 2014 and 2015, average annual growth has been -2.8%.

State final demand in Western Australia has fallen for the past 8 quarters; hence the perception that activity is shrinking. What must be kept in mind, however, is that some sectors of the economy are more impacted than others by the slowdown in the construction phase of the resources boom.





Western Australia's economic growth is highly dependent upon the outlook for the global economy and in particular China and the Asian region. On this front, there are some risks. Global economic activity is still trying to find traction following the GFC and China is in transition – moving away from dependence on heavy industry, investment and exports and towards growth in services and consumer spending.

It seems likely that the anticipated direction of the Chinese economy will not lead to the same growth in demand that might have been seen in earlier years, however we expect that demand will remain firm. While the pace of Chinese growth has slowed, it remains robust. There are risks to Chinese growth given its high levels of debt and these risks will need to be carefully monitored over the next two years.

Cycles in commodity prices play a significant role in the West Australian economy. The changing shape of the Chinese economy, as well as global supply responses to the surge in demand for resources from China, has put significant downward pressure on iron ore and energy prices. Weaker commodity prices have placed strains on government finances and reduced the likelihood of new projects getting off the ground.

Despite a pick-up in commodity prices in early 2016, we doubt that commodity prices will see significant recovery over the next year or two. For commodity prices to move significantly higher would require a re-acceleration of the Chinese economy and the closure of many higher cost producers. At this stage only the closure of high cost producers seems likely. As such, a rapid pick-up in activity seems unlikely in Western Australia. There is likely to be growth but at a very modest pace.

Consumer Spending

Household consumption growth has eased since the heady days of 2003 to 2007 during which annual consumption growth averaged 6.6%. Another burst of solid consumption growth occurred from 2010 to 2012 with average annual growth of 5.3%. Since then, the pace has slowed with growth in private consumption running a 2.2% in the year to the March quarter 2016. Growth has slowed but it is off a much larger base.

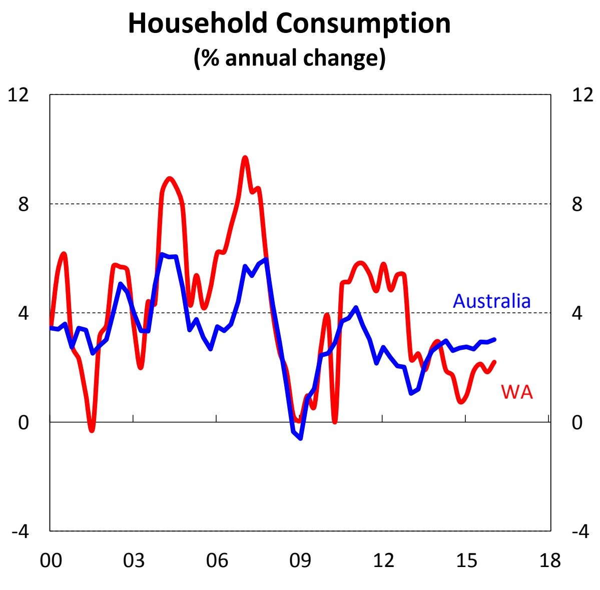
The weakest areas of consumption over the past year have been in cigarettes and tobacco (-10.8%), vehicle purchases (-11.8%) and alcoholic beverages (-2.1%). Spending has been stronger in health (5.7%), communications (6.3%) and education (5.1%).

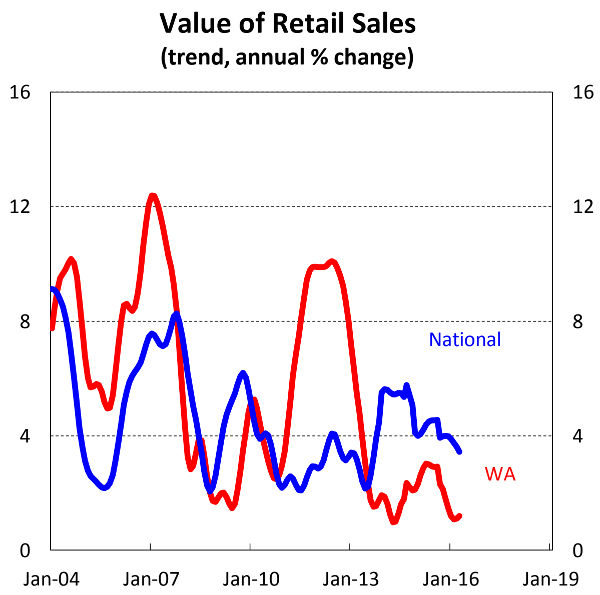
The decline in consumer spending is also reflected in the number of WA motor vehicle sales. Sales of passenger vehicles were running at around 5,000 per month in late 2012. More recently, in the first four months of 2016, sales are down to 3,300 per month. Sales of sports utility vehicles remained broadly stable over the same time period, at close to 3,300 per month, while sales of 'other vehicles' such as commercial vans and trucks has declined from 3,000 to 2,000 per month.

With population growth in WA having slowed from 88,000 per year in 2012 to 33,000 in late 2015, it is difficult to see vehicle sales growth picking up over the next few years.

Retail sales data to April shows spending up 2.0% on a year earlier. This is well down on the 10 year average of 5.2%. As with motor vehicle sales, retail spending has suffered from slower population growth and the slowdown in the resource construction boom.

Solid activity in the building sector has seen expansion over the year in the sales of retail goods associated with housing such as furniture, floor coverings and textile goods (7.9%), electrical and electronic goods (6.2%) as well as building and gardening supplies (6.6%). The weaker sectors over the year to April have been liquor (-7.4%), specialized foods (-4.2%) and cafes, restaurants & catering services (-4.0%).





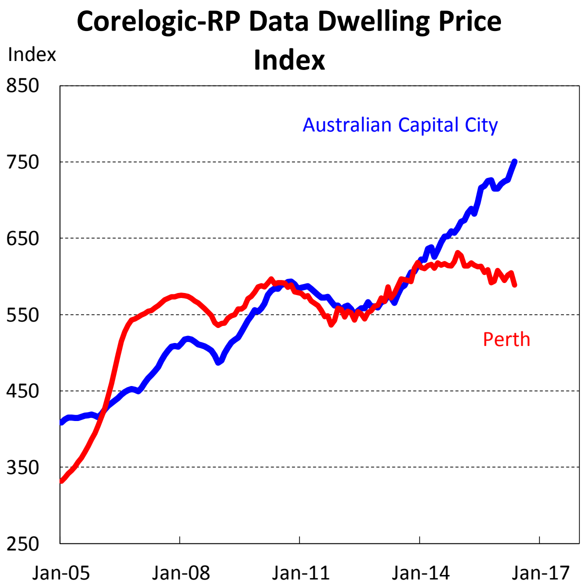
Consumers in WA have been feeling pessimistic over the past year and a half. According to the Westpac – Melbourne Institute, consumer sentiment in Western Australia had risen above 100 only once between December 2014 and May 2016. The June reading of 101.6 was well above the 82.2 recorded at the height of the GFC and the highest since 104.7 was reported in November 2015.

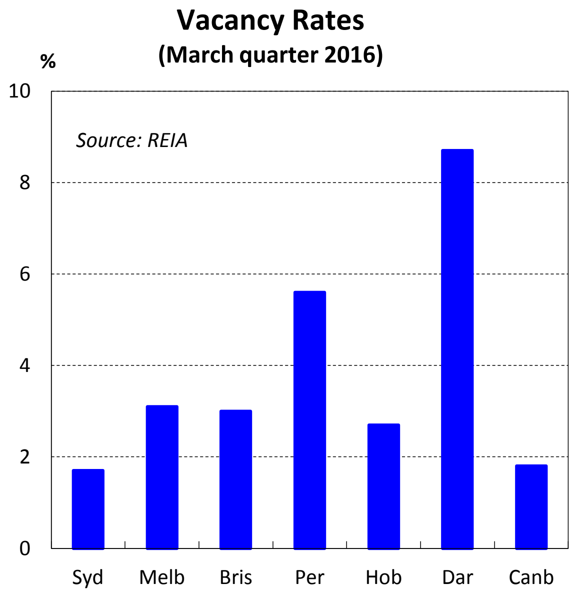
With slower population growth, weak growth in wages and a softer outlook for the economy, consumer spending is expected to remain subdued during 2016-17.

Housing

The tide has well and truly turned in the Western Australian residential property market. Prices are down, building approvals are down and construction activity is set to slow.

According to RP Data Core-Logic, Perth residential property prices have been falling on an annualized basis since mid-2015. Perth dwelling prices have fallen by 4.2% in the year to May, down from a peak in annual growth of 9.9% in the year to December 2013. The Australian capital-city average dwelling price is up 10.1% over the same period. Perth unit prices declined 4.6% in the year to May, while house prices fell 4.2% over the same period.





- **Rental Markets**

Demand for rental accommodation in Perth has softened, and rents for both houses and other dwellings in Perth have declined over the last two years. Median weekly rents for three-bedroom houses were down 2.4% in the year to the March quarter, to $400 per week. For two-bedroom “other dwellings”, rents slumped 9.5% in the year to the March quarter, to $380 per week. Among capital cities, Perth had the second largest decline in rents for two-bedroom “other dwellings” over the year to the March quarter. The Northern Territory has seen a 13.4% decline in rents over that period. The decline in rents for three-bedroom houses at -2.4% was the largest decline among the capital cities.

Vacancy rates in Perth have crept higher in recent years and in the March quarter 2016 stood at 5.6%. This compares to a cyclical low in the rental vacancy rate of 1.8% in September 2012. The climb in the rental vacancy rate over the past three and a half years suggests that there is an excess supply of rental properties in Perth. Vacancy rates at 3.0% are considered the benchmark for a balanced rental market. Vacancy rates at this elevated level combined with softer population growth suggests that rents will moderate further.

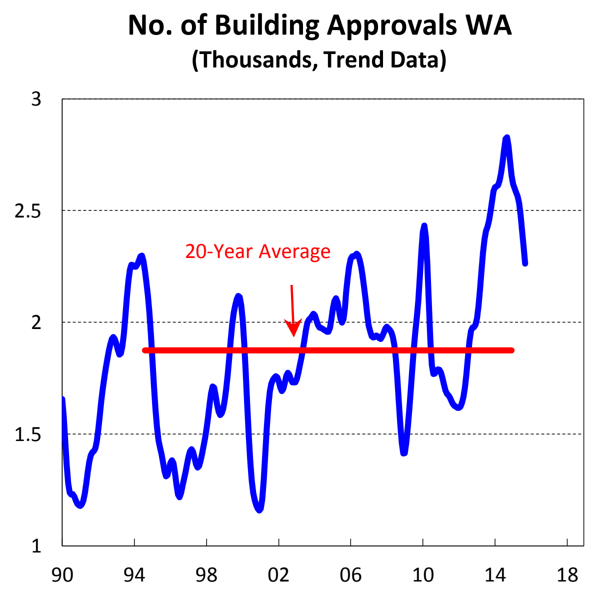
- **Dwelling Investment**

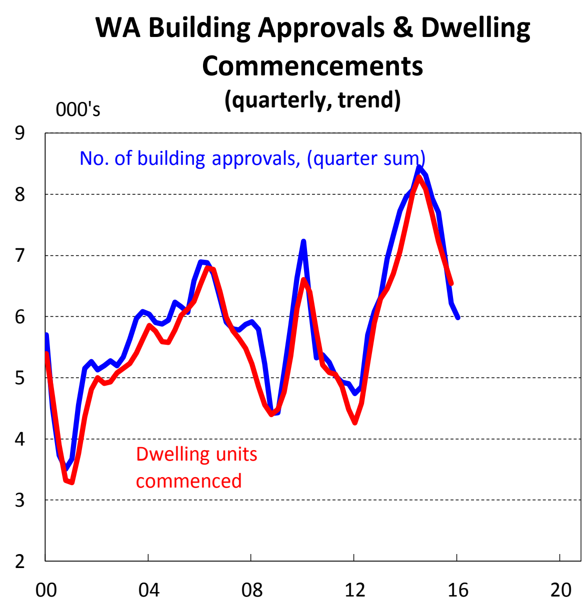
Dwelling investment in Western Australia grew a solid 7.0% in the year to the March quarter. However, the pace of growth appears to have peaked at 11.5% annual growth in the year to the September quarter 2015.

The number of dwelling units commenced peaked at 8401 in the September quarter 2014 and has fallen to 6421 in the December quarter 2015. The number of dwelling units constructed in Western Australia during 2015 was 28,232. This was down on the 32,098 constructed in 2014. Given that population growth in WA in 2015 was slowing, there are concerns regarding an oversupply of dwellings and units in particular in the not too distant future.

In light of rising vacancy rates, falling rents, falling prices and slower population growth, residential building approvals in WA have turned down. In the year to April 2016 approvals were down 23.6% having now fallen for nineteen consecutive months.

Building approvals are pointing to a further decline in housing construction in Western Australia over the medium-term. While the current pace of construction is at above average levels, this seems likely to change over the next twelve months.

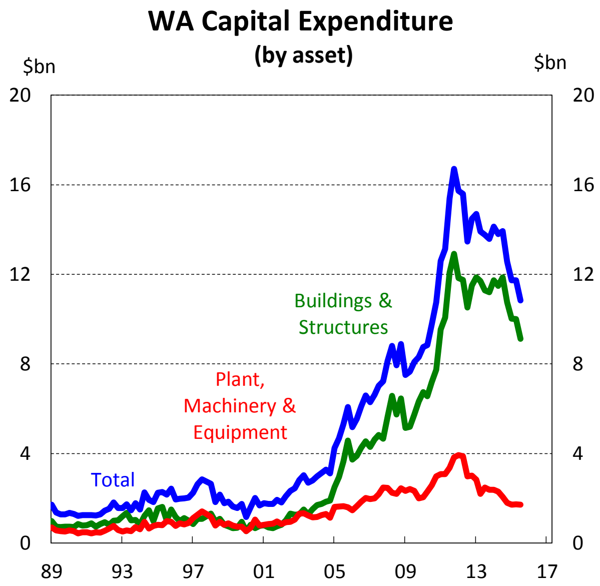


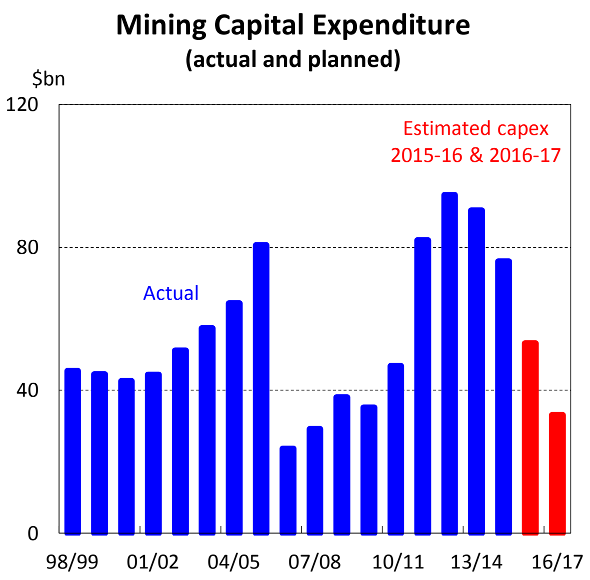


- **Outlook**

The labour-intensive investment phase of the mining boom continues to fade and this is weighing on the labour market and population flows in Western Australia. These factors will continue to impact the demand for Western Australian housing, while new housing supply continues to come on line.

We expect dwelling prices in WA to continue to soften this year, with greater weakness in unit prices given the rapid growth in supply. We do not expect house prices to fall sharply given ongoing support from high average incomes in WA and low interest rates.





Business Investment

A slowdown in mining investment is continuing to weigh on business investment in Western Australia. Although mining investment has already slowed substantially, there is further weakness in business investment on the horizon for WA.

Business investment declined 4.6% in the March quarter. It has fallen in 12 out of the last 14 quarters. For the year to the March quarter, business investment in WA is down 17.5%, the sharpest pace of decline since the December quarter 2000. Capital expenditure by businesses peaked in June 2012 and has slumped 35.1% since then.

According to the Department of Industry, Innovation and Science report on resources and energy major projects, the number of projects at the "committed" stage has fallen further but the value has risen. In October 2015, the number of "committed" projects fell to 15, valued at $123.1bn. These are projects which have received the final go ahead from the owner and are either currently under construction or preparing to commence construction. This was down from the 20 committed projects in October 2014 worth $115.8bn.

Of the 15 committed resources and energy related projects, six are associated with LNG, gas and oil and valued at $109.7bn. A further three, valued at $11.4bn, are associated with iron ore.

Putting WA in a wider context, the downturn in the mining investment boom has seen some large projects reach completion Australia-wide. In the six months to October 2015, 7 projects reached the completed stage nationally, with a value of almost $25bn, according to the latest data. More recently, the $61bn Gorgon LNG project and the $29bn Wheatstone LNG project in WA reached completion.

While there are still a significant number of resource projects underway, the pipeline of new projects will not be sufficient to compensate for those resource projects which have reached completion. Late last year, falling commodity prices were weighing on the feasibility of resource projects. Commodity prices, however, have increased since then, with the RBA's commodity price index (in Australian dollar terms) up 8.4% from its December low. The oil price (for West Texas Intermediate) has jumped 83.1% from its February low, taking up the price of LNG with it.

The iron ore price is lower than a year ago, but has risen 33.3% from its December low. The stabilisation of commodity prices removes an important impediment for the feasibility of new resource projects, but won't be enough to put a significant dent in the decline in resource related investment expected in coming years.

The Department of Industry, Innovation and Science report on Resources and Energy Major Projects lists 40 potential projects in Western Australia with a combined value of $92.9 billion. Six of these projects are LNG, gas or oil projects worth a combined $67.9bn. However, these potential projects are not guaranteed to get the go-ahead. Subdued market conditions may result in a number of these projects being cancelled.

As a result of the slowdown in new resource projects, engineering construction has declined in 11 out of the last 15 quarters in WA. The value of engineering construction work in WA has declined 24.4% from the peak reached in March 2012. The weakness in engineering construction is likely to continue. Despite falling over the past four years, engineering construction in the State remains almost 250% above the average level in 2005, before the recent resource investment boom. While it may not be reasonable to assume engineering construction could return to this level, the numbers suggest engineering construction in WA has further to fall.

Non-residential construction was supported by the boom in mining investment. As mining investment continues to slide, the outlook for commercial construction is discouraging. There are however, some projects underway, including the $3bn Perth City Link urban renewal project. Construction of the Perth Stadium is also expected to continue until the end of 2017, costing over $1.5bn.

The outlook for commercial construction is fairly bleak, offering little to cushion the decline in engineering construction. The dollar value of these commercial construction projects currently underway pales in comparison to the size of the LNG projects which have reached completion over the past year and those which are still to finish construction. However, low interest rates and the weaker Australian dollar are providing welcome support and could encourage investment outside of mining over time.

Labour Market

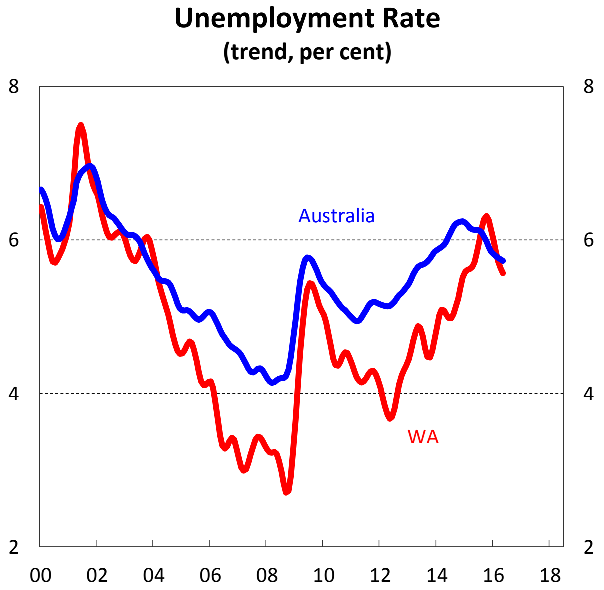
Over the past ten years, the Western Australian economy has seen the creation of 281.8k jobs, an increase of 26.2% for total employment of 1.356 million. Over the past year, the pace of job growth has declined. In the year to May, 3.6k jobs were created compared to the ten year average of 29.6k.

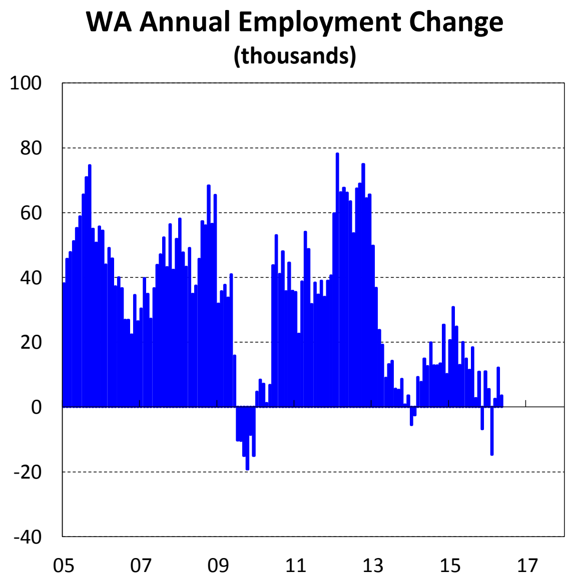
From a low of 3.5% in June 2012, Western Australia's unemployment rate rose to 6.5% in November 2015. The rise coincided with the slump in iron ore prices, a squeeze on the profitability of industries associated with the mining sector and ongoing population growth.

Since November 2015, Western Australia's unemployment rate has declined despite very weak growth in jobs. As at May 2016, WA's unemployment rate stood at 5.7%. The unemployment rate fell because of a decline in the participation rate from 69.4% in November 2015 to 68.1% in May 2016. There is now a lower proportion of the population looking for work. In this case, the lower unemployment rate reflects discouraged workers rather than a strengthening of the labour market.

The recent decline in the unemployment rate has also been assisted by a decline in population growth. In the year to December 2015, WA's population grew by 28,232. This is well down on the growth of 87,914 seen in the year to December 2012. Overseas migration to WA has fallen from 56.3k in 2012 to 14.6k in 2015. Similarly, during 2012, WA attracted 10.8k interstate migrants. By 2015, it lost 4.3k to interstate migration. With fewer jobs on offer, fewer people are attracted to WA.

Over the year to May 2016, job outcomes have varied across industries. Job growth occurred in mining (18.2k), retailing (16.0k), information, media & telecommunications (4.0k) and accommodation & food services (9.6k). Losses were seen in construction (-14.4k), professional, scientific & technical (-11.5k), transport, postal & warehousing (-7.4k) and education & training (-8.3k).





WA State Budget 2016-17

The 2016-17 Budget for WA was handed down in mid-May. The projected deficit, at $3.9bn for 2016-17, is set to be the largest ever seen in WA. Revenue is forecast to decline by 3.1% or $810mn, the third consecutive year in which revenue has fallen. Sharply lower iron ore royalties sits behind the deficit as does WA's low share of GST revenue. Given the lag in adjusting the GST sharing formula, WA will receive a 'GST top-up' of $490mn from the Federal Government in addition to the $500mn it received in 2015-16.

In order to reduce its debts, the WA government is looking to undertake asset sales valued at around $16bn. Assets in the sale program now include Western Power and Horizon Power's Pilbara distribution infrastructure.

St.George Banking Group Forecasts

Economic Indicators, % Change					
	2013-14	**2014-15**	**2015-16 (e)**	**2016-17 (f)**	**2017-18(f)**
Gross State product	5.60	3.50	1.10	2.50	3.10
State Final Demand	-2.20	-3.60	-4.00	-3.50	0.50
Employment	0.50	1.50	0.10	0.30	0.80
Unemployment Rate	4.80	5.40	6.20	6.30	6.10
Perth CPI	3.00	1.80	1.40	2.00	2.50
Wage Price Index	2.80	2.20	1.80	1.80	2.20

The Western Australian Treasury expects growth of 1.25% in 2016-17, marginally up from an estimated 1.0% growth in 2015-16. Our expectation for growth in 2015-16 and 2016-17 are similar although we have forecast slightly firmer growth in and 2017-18. Export volumes are expected to remain solid while a lower Australian dollar and low interest rates will support other areas of WA's economy.

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