Tuesday, 21 July 2015

# WA Economic Outlook


**Summary**

- **For several years prior to the end of 2014, Western Australia had been in the 'fast lane' of Australia's 'two speed' economy. Since the end of 2014, the growth drivers of the Australian economy have shifted away from mining investment. This shift has been acutely felt in WA.**

- **We expect growth in Western Australia to weaken in coming years, as mining investment declines further. Export volumes will support growth, although the positive impact of this will be somewhat mitigated by the decline in bulk commodity prices.**

- **After being a key driver of growth in Western Australia, business investment is now detracting from growth. Intention surveys and the pipeline of minerals and resource projects point to a faster decline in mining investment in the year ahead.**

- **The pace of the decline in mining investment in coming years and the impact on Western Australia's growth is highly dependent upon the outlook for China, the global economy and commodity prices.**

- **Household consumption growth continues to grow at a pace below par as the transition to the less labour-intensive mining production phase continues to dampen job prospects. However, ongoing low interest rates should continue to provide support for consumer spending.**

- **Job growth has moderated from earlier years. Despite 30.9k jobs added in the year to June 2015, Western Australia's unemployment rate has risen to 5.8%. However, Western Australia's unemployment rate remains one of the lowest among all States, although the gap has closed in recent months.**

- **The housing market in Western Australia has reached the end of its upswing. Dwelling prices fell in the year to June as population growth slowed against a backdrop of increased housing supply.**

## Economic Growth

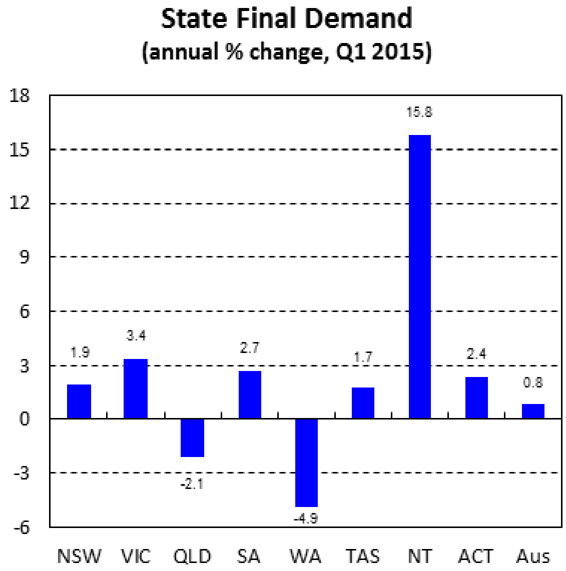
| Percentage Shares of the Economy* | | |
|---|---|---|
| **Industries** | **WA** | **Australia** |
| Mining | 32.2 | 9.6 |
| Construction | 14.7 | 9.4 |
| Manufacturing | 5.2 | 7.5 |
| Transport, postal and warehousing | 5.2 | 5.6 |
| Health care and social assistance | 5.0 | 7.6 |
| Professional, scientific and technical services | 5.0 | 7.5 |
| Retail trade | 3.8 | 5.3 |
| Financial and insurance services | 3.6 | 9.9 |
| Public administration and safety | 3.3 | 6.3 |
| Education and training | 3.3 | 5.4 |
| Administrative and support services | 3.3 | 3.3 |
| Agriculture, forestry and fishing | 2.9 | 2.7 |
| Wholesale trade | 2.8 | 4.6 |
| Electricity, gas, water and waste services | 2.5 | 3.2 |
| Rental, hiring and real estate services | 2.2 | 3.2 |
| Accommodation and food services | 1.6 | 2.7 |
| Information media and telecommunications | 1.5 | 3.3 |
| Other services | 1.5 | 2.1 |
| Arts and recreation services | 0.4 | 0.9 |

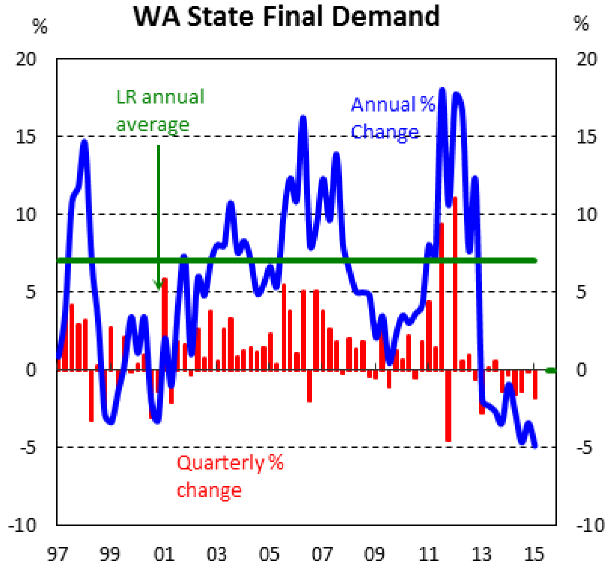
** Share of gross value added less ownership of dwellings 2013-14; Source: ABS, St.George*

Western Australia has been a powerhouse of the Australian economy for several years. As one of the major beneficiaries of the rapid expansion of the Chinese economy, as well as other Asian economies, gross state product (GSP) grew by a solid 5.5% in 2013-14. By 2014-15 this pace had slowed to an estimated 3.00%. The outlook for 2015-16 is still positive but the pace of growth is likely to slow towards 2.50%. (see page 9 for further details regarding our forecasts).

Slowing mining investment is weighing heavily on the economy as a number of large-scale mining projects move towards completion. There is evidence of the economy slowing in the State final demand figures. State final demand in Western Australia fell by 4.9% in the year to March, a sharp deterioration from the 17.7% annual growth recorded in the March quarter three years prior. State final demand in Western Australia is now into its ninth consecutive quarter of annual contraction. The slowdown in growth of State final demand has been led by declines in business investment, although growth in household consumption has also slowed, likely reflecting weaker income growth and softer job prospects.

The fall in State final demand points to tougher times for Western Australia. However, it fails to provide the whole picture of the Western Australian economy. State final demand data ignores the traded sector, which is a large component of the State's economy. As the mining boom transitions from the investment phase to the export phase, export volumes should strengthen, although the positive impact on the economy will be reduced by recent declines in commodity prices.



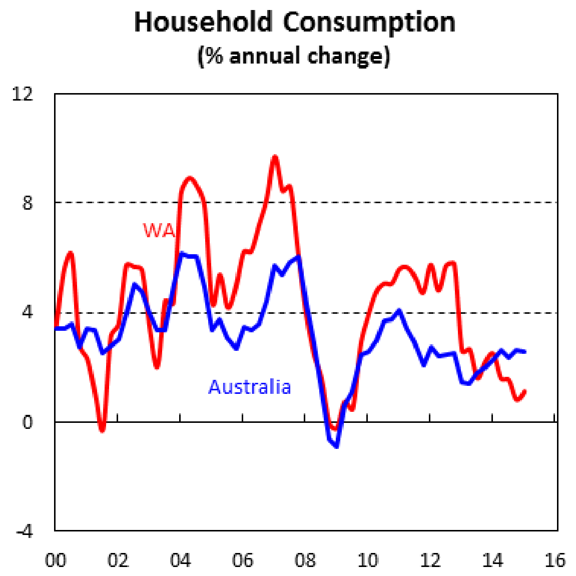

The slowdown in mining investment is set to weigh on growth in Western Australia in coming years. However, there should be strong contributions to growth from net exports. Demand for capital imports should ease, while greater production capacity should boost export volumes. There are also growing signs that low interest rates and rising property prices are boosting residential investment. This is expected to assist in offsetting the gap in growth left by slowing mining investment.

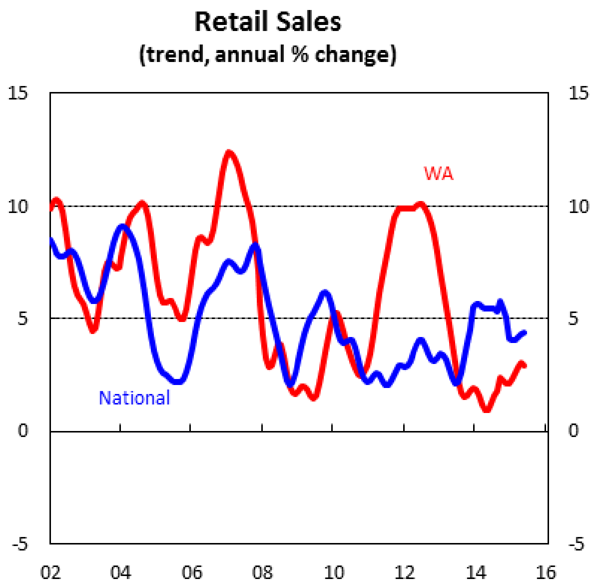
Western Australia's economic growth is highly dependent upon the outlook for China and the global economy. A more promising development for the Western Australian outlook is signs that Chinese economic growth is stabilising. While some risks exist for the outlook, we expect that economic growth in China is likely to remain relatively firm. Additionally, an improving outlook for the US will be supportive of global growth and the prices of commodities. Commodity prices, which have fallen from their peaks in 2011, seem unlikely to rebound much over the near term, due to a global boom in supply. That said, the volumes of bulk commodity exports from Western Australia should continue to strengthen. Additionally, the weaker Australian dollar should assist in boosting the value of commodity exports, which are denominated in US-dollars.

**Consumer Spending**

Household consumption growth has softened considerably in recent years. After annual growth hit a peak of 5.8% in the year to the December quarter 2012, annual growth in household consumption weakened to 1.1% in the year to the March quarter 2015. Household spending has been dampened by weakening income growth as the slowdown in mining investment weighs on economic activity.

More recent data indicates that household consumption continues to grow at a pace below par. Retail sales, which comprise a large proportion of consumer spending, grew at an annual pace of 3.2% in the year to May. Annual growth is below both the long-run average of 5.5% and national growth of 4.7% in May, and is likely to remain subdued for some time as a result of soft income growth.




Other areas of consumer spending also show weakness. The sales of motor vehicles fell 13.9% in the year to May. Motor vehicle sales peaked in late 2012.

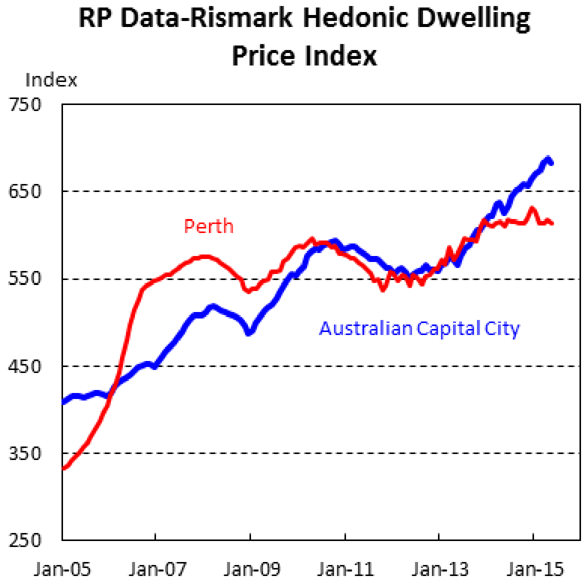
Over the near-term, there is limited prospect of a meaningful pick-up in consumer spending given that consumers remain pessimistic. According to the Westpac – Melbourne Institute, consumer sentiment in Western Australia has deteriorated in recent months. In June, the Consumer Sentiment Index fell to 84.8, down from 98.8 in April. Since this reading is well below the 100 'neutral' level, it indicates that currently more consumers are pessimistic than optimistic, by a significant margin. The sharp fall in commodity prices is keeping consumers downbeat and they remain uncertain about WA's future.

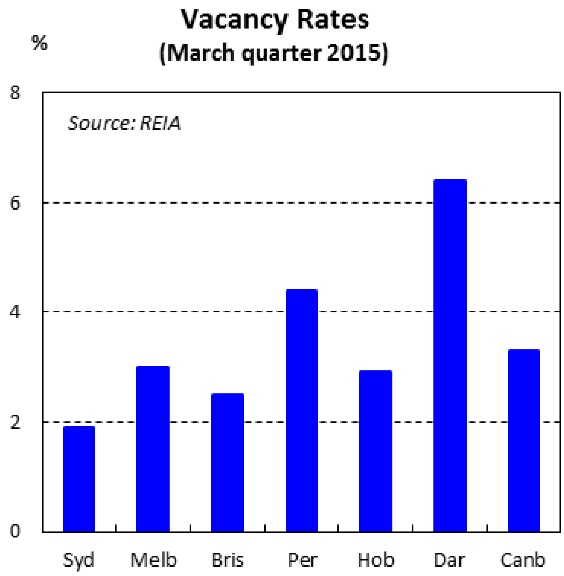
The transition in the resources sector from the investment to the production phase will continue to dampen job prospects and could weigh on consumption growth. The production phase is less labour intensive. However, ongoing low interest rates should provide some support for consumer spending.

**Housing**

As one of the bright spots in the Australian economy, the housing market previously helped to support activity in Western Australia. Recent data, however, suggests that the upswing in the housing market in Western Australia is ending, coinciding with the slowdown in mining investment. According to RP Data Core-Logic, Perth residential property prices have stalled, after annual growth peaked in December 2013. Dwelling prices are 0.9% lower in June compared to a year ago. This small decline is in contrast with other major capital cities and the Australian capital-city-average, which grew 9.8% in the year to June. Perth unit prices declined 3.9% in the year to June, while house prices fell 0.6% over the same period.

Data from the Australian Bureau of Statistics (ABS) tells a similar story. Perth residential property prices saw moderate quarterly growth for ten consecutive quarters from late 2011 through to mid-2013, before coming to a standstill in the June quarter last year. Growth has since been sluggish – in the March quarter 2015, residential property prices slipped 0.1%. In the year to the March quarter, Perth residential property prices fell 0.3%. The average price rise among the capital cities in the year to the March quarter was 6.9%.




- **Rental Markets**

Demand for rental accommodation in Perth has ebbed, 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 6.4% in the year to the March quarter. For two-bedroom "other dwellings", rents fell 4.5% in the year to the March quarter. Among capital cities, Perth had the largest decline in rents for two-bedroom "other dwellings" over the March quarter, and the second largest decline for three-bedroom houses, behind Darwin.

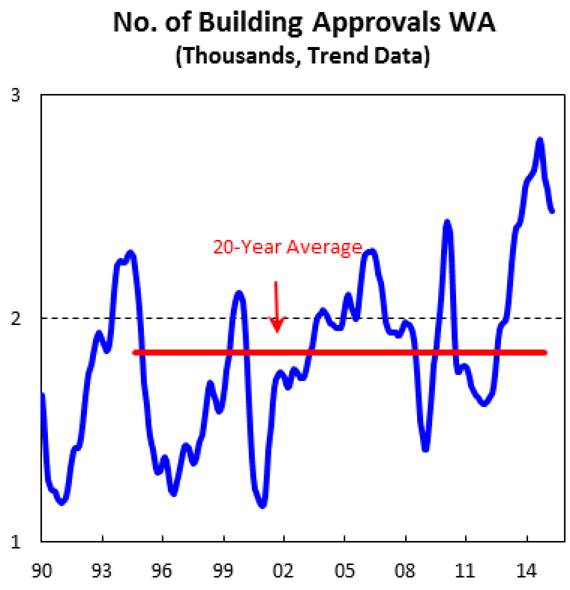
Vacancy rates in Perth have crept higher in recent years to 4.4% in the March quarter. This compares to a cyclical low in the rental vacancy rate of 1.8% in September 2012. The climb in the rental vacancy rate over the past two and a half years indicates the Perth rental market has loosened and indicates an over supply of rental properties. Vacancy rates at 3.0% are considered the benchmark for a balanced rental market. This lift in vacancy rates suggests that rents will moderate further.

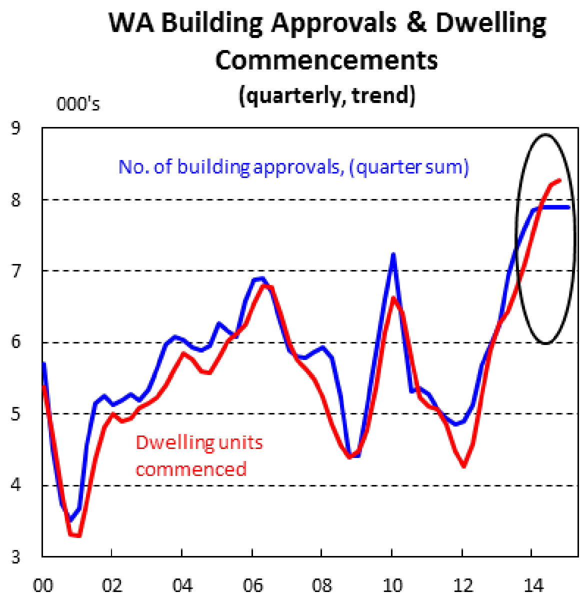
- **Dwelling Investment**

Dwelling investment in Western Australia has grown modestly, lifting 7.4% in the year to the March quarter. Growth in dwelling investment will provide some welcome support while mining investment is softening. Its strength has been driven by new dwelling investment, currently in its eighth consecutive quarter of positive annual growth, seven of which have been double-digit. Alterations and additions work in Western Australia has been more subdued, experiencing negative annual growth for 13 consecutive quarters.

Building approvals are pointing to a decline in housing construction in Western Australia over the near-term. In the year to May, building approvals fell 6.0% (in trend terms). Annual growth has been on a general downward trend since January. However, the level of building approvals remains high by historical comparison. The number of building approvals has exceeded their long-run average for over two years, suggesting that residential building will remain elevated.

A dwelling shortage developed in WA as population growth exceeded residential construction. As population growth has fallen in recent months, and given the supply pipeline of residential construction, this dwelling shortage should narrow.



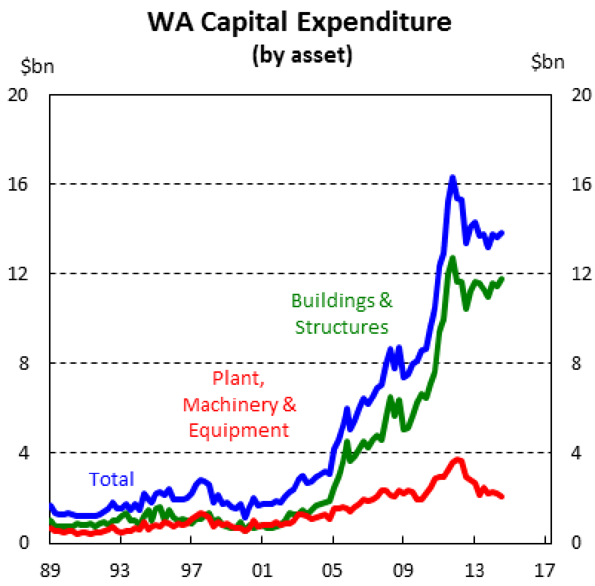



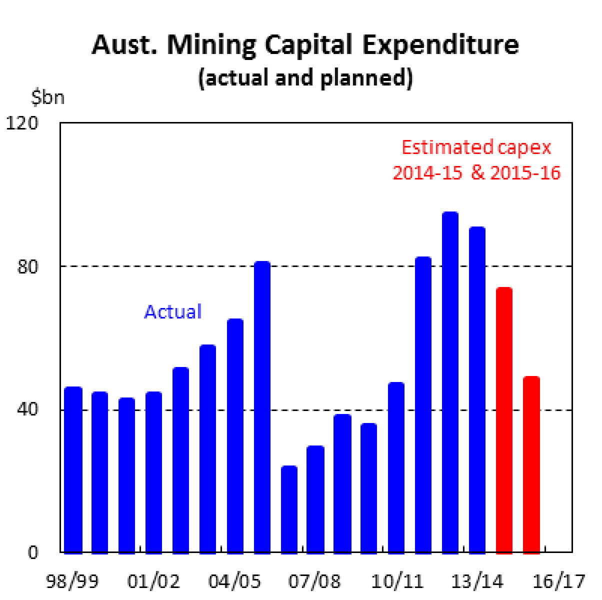

- **Outlook**

As the labour-intensive phase of the mining boom fades there will be implications for the labour market and population flows, which will impact the Western Australian housing market.

Population growth in Western Australia has slowed from the highs seen in 2012 and early 2013. However, the annual growth rate in Western Australia was the second strongest State, after Victoria, at 1.6% in the year to the December quarter 2014 (the latest available data).

We expect dwelling prices in WA to continue to soften this year due to a slowdown in population growth against a backdrop of an increased supply of housing. However, we do not expect dwelling prices to fall sharply. Instead, we expect housing prices to remain close to their peak given ongoing strong population growth, high average incomes in WA and low interest rates.




**Business Investment**

A slowdown in mining investment is increasingly weighing on business spending in Western Australia. Business investment declined 18.0% in the year to the March quarter, and is set to continue this decline in coming years. Capital expenditure rose marginally (0.3%) in the year to the March quarter. However, it has fallen 15.3% from its peak in June 2012.

According to the Bureau of Resource and Energy Economics (BREE), the number of “committed” projects has fallen. In April, the number of “committed” projects fell to 16, valued at $114.1bn. 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 16 committed resources and energy related projects, seven are associated with LNG, gas and oil and valued at $100.9bn. A further three, valued at $11.4bn, are associated with iron ore. In the six months to April, four projects valued at $1.8bn reached the committed stage. The list includes the Eastern Goldfields pipeline expansion ($140mn), the Nova Bollinger nickel project ($443mn), the Persephone gas field ($1.2bn), and the Thunderbox gold project ($65mn).

Major projects worth $112bn are scheduled for completion before 2017, and the pipeline has little of significance to offer in replacement. Of note, the Coniston Oil Field Project worth $500 million and BHP Billiton’s Western Australian Iron Ore optimisation project worth $2.6 billion were both completed in the last six months.

Falling commodity prices are increasingly weighing on the feasibility of new projects, despite the lower Australian dollar. Export earnings nation-wide from resource and energy commodities are estimated to have fallen 11% in 2014-15 to $174bn, predominantly influenced by a 27% decline in the value of iron ore exports. Iron ore export volumes, along with LNG, are expected to increase as the industry continues to transition into the production phase. In 2015-16, the value of Australia’s exports from resource and energy commodities is forecast to improve slightly to $178bn as energy export values rise. This should correspond with solid export growth in Western Australia in coming years.

The Commonwealth Department of Industry and Science report on Resources and Energy Major Projects lists 39 potential projects in Western Australia with a combined value of $55.3 billion. 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. Exploration expenditure also fell 11% in the year to the March quarter as reduced profits led to cost cutting measures.

Despite the decline of new projects in the pipeline, there remains a relatively high level of investment. Major LNG projects, including the $61bn Gorgon project, the $29bn Wheatstone project and the $12bn Prelude project will support activity over the near term. The $10bn Roy Hill iron-ore project is currently leading the way in iron ore, however, it is scheduled for completion late this year. Nonetheless, the recent fall in commodity prices and limited scope for a recovery suggests that new projects are less likely to get the go ahead. Moreover, Western Australian investment is likely to decline sharply over the coming year when LNG mega-projects approach completion.

Non-residential construction was generally supported by the lift in resources investment, reflecting demand for accommodation camps and operations buildings in mine-related areas. Unfortunately, this means that the downbeat outlook for resource investment will translate into weaker activity in commercial construction. However, there remain some notable projects underway, including the $3bn Perth City Link urban renewal project and the $1.6bn Elizabeth Quay development. Construction of the Perth Stadium is also expected to continue until the end of 2017, costing over $1.5bn. Also, the $1.2bn construction of a new Perth Children's Hospital is due to be completed by the end of the year. Furthermore, in the 2015-16 State Budget, $400mn of infrastructure investment in utilities, roads and transport was announced.

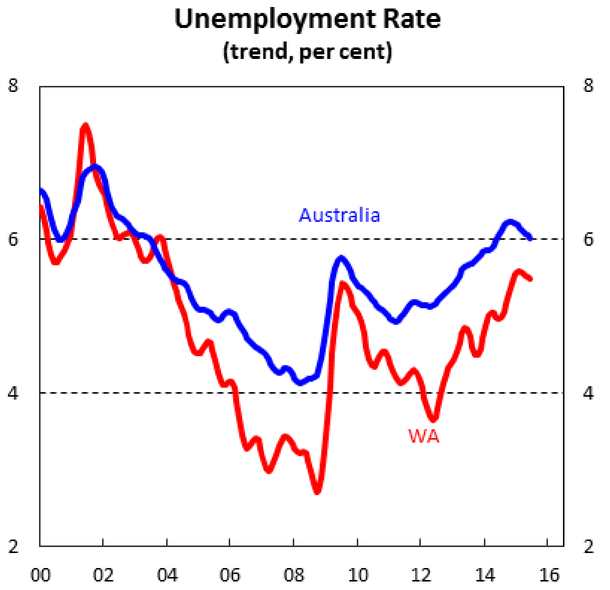
The outlook for commercial construction is fairly bleak, with little to offer in the way of offsetting the decline in engineering construction. However, low interest rates and the weaker Australian dollar are providing welcome support and could encourage investment outside of mining over time.

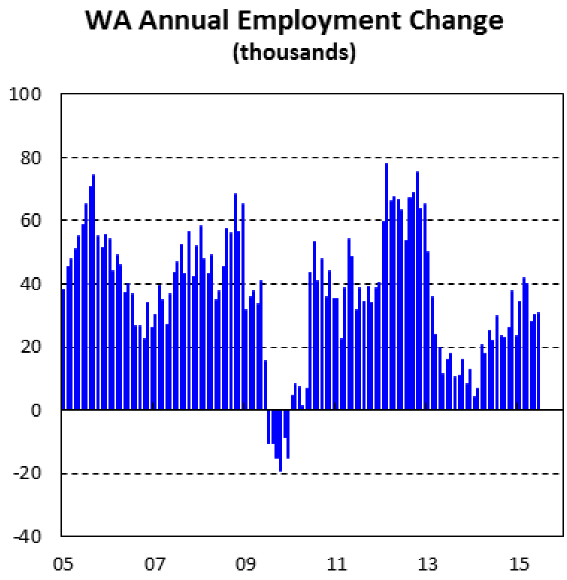
**Labour Market**

Western Australia's labour market has been resilient, despite the headwinds within the mining sector. Job growth in Western Australia was the third strongest across all States in the year to June, lifting 30.9k. Job growth has moderated from earlier years, resulting in a lift in Western Australia's unemployment rate. The unemployment rate lifted from a cyclical low of 3.5% in June 2012 to 5.8% in June 2015. However, Western Australia's unemployment rate remains one of the lowest among all States, although the gap has closed in recent months.

Softer labour market conditions are reflecting job losses in the mining industry, which lost 5.1k in the year to May. To put this into perspective, 26.6k jobs have been lost in the industry since the peak in the August quarter 2012. Slow retail sales growth corresponded with job losses in retail trade, which was down 20k in May compared with a year earlier. Health care and social assistance (31.6k), construction (22.1k) and other services (15.1k) were industries with the largest job gains over the year to May. However, other industries with job losses over the year included rental, hiring and real estate services (-7.9k).

Unfortunately, the resilience in WA's labour market is unlikely to last. Job prospects are becoming less promising, as more projects approach completion.




### WA State Budget 2015-16

The 2015-16 WA Budget was handed down on 4th May. A decline in royalties from iron ore combined with a decline in its share of GST put severe pressure on revenue. Acknowledging these difficulties, the Federal Government provided WA with $500 million to assist with infrastructure projects. A deficit of $2.7 billion is expected for 2015-16 with a return to surplus estimated in 2017-18.

### St.George Banking Group Forecasts

| Economic Indicators, % Change | 2013-14 | 2014-15 (e) | 2015-16 (f) | 2016-17 (f) | 2017-18(f) |
|---|---|---|---|---|---|
| Gross State product | 5.50 | 3.00 | 2.50 | 3.50 | 3.20 |
| State Final Demand | -2.20 | -3.20 | -2.50 | 0.40 | 1.70 |
| Employment | 1.10 | 2.30 | 1.40 | 1.90 | 2.00 |
| Unemployment Rate | 4.80 | 5.40 | 6.00 | 6.00 | 5.70 |
| Perth CPI | 3.00 | 2.40 | 2.30 | 2.40 | 2.40 |
| Wage Price Index | 2.80 | 2.20 | 2.00 | 2.00 | 2.30 |

*Source: St.George Banking Group*

The Western Australian Treasury expects growth of 2.00% in 2015-16, slowing from estimated growth of 3.25% in 2014-15. Our forecast for growth in 2015-16 is slightly firmer at 2.50%, although our expectations for 2014-15 are a touch weaker at 3.00%. 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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