

## WA Economic Outlook

### Summary

- **The glow from the mining investment boom is waning as large mining projects are completed, with little in the way of investment to take their place. This has weighed heavily on domestic demand in WA. We expect growth in Western Australia to weaken next year, as mining investment declines further.**
- **Increased mining production is providing a boost to WA's economy through exports growth. Export volumes will continue to support growth, although the positive impact of this will be somewhat mitigated by the decline in bulk commodity prices. Demand from China for key WA commodities remains a major determinant of WA's fortunes.**
- **Additionally, the flow on to the rest of the economy, from strong exports growth is more tepid. Where mining investment provided a strong boost to jobs and consumption, exports growth is less labour intensive.**
- **The pace of jobs growth in WA has failed to keep pace with population growth. As a result WA's unemployment rate was rose to 6.4% in October, surpassing the national unemployment rate. The record low in the WA unemployment rate of 2.3% in October 2008 seems like a distant memory.**
- **Household consumption growth remains subdued reflecting slower growth in incomes in WA and less employment certainty than has been the case in recent years.**
- **The housing market in Western Australia is in retreat, following a period of very strong growth in recent years. Dwelling prices fell in the year to October. This reflected a slowdown in the pace of population growth against a backdrop of increased housing supply.**

## 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

Western Australia has been a powerhouse of the Australian economy in recent 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 3.5% in 2014-15, following growth of 5.6% in 2013-14. After the Northern Territory, growth in WA was the strongest of all the States and territories in 2014-15. The outlook for WA in 2015-16 is still positive but the pace of growth is likely to slow towards 2.00% (see page 9 for further details regarding our forecasts). This indicates that economic growth in WA remains sturdy, being driven by exports as new mines move from the construction phase into the production phase. This growth will be negated to some extent by softness in commodity prices.

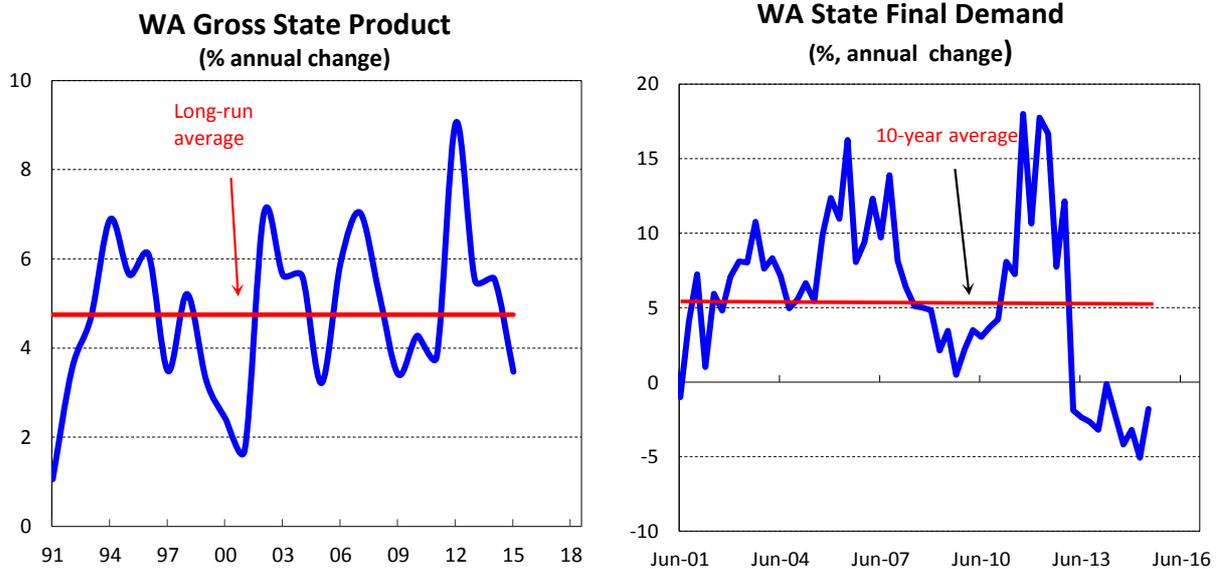
The impact on the traded sector will be two-fold. There will be a lift in exports, due to the increase in resource production capacity. At the same time, demand for capital imports should ease as mining projects are completed. This trend is already starting to play out: in 2014-15 exports jumped 8.3%, while imports slipped 0.8%.

The shift from the mining investment boom to the mining production boom has been in the changing size of some industries in WA. The mining industry was 36.6% of WA's economy in 2014-15, up from 32.2% in the previous year. The construction industry, however, fell from 13.7% in 2013-14 to 12.5% in 2014-15.

While export growth is solid, the domestic economic picture in WA is less reassuring. The glow from the mining investment boom is waning as large mining projects are completed, with little

in the way of investment to take their place. There is evidence of the economy slowing in the State final demand figures. State final demand does not include the traded sector, which is a large component of WA's economy.

State final demand in Western Australia fell by 1.8% in the year to June 2015, a sharp deterioration from the 18.0% annual growth recorded in the September quarter 2011. State final demand in Western Australia has experienced its tenth consecutive quarter of annual contraction. The slowdown in growth of State final demand has been led by declines in business investment, although household consumption has become lacklustre, likely reflecting weaker income growth, softer job prospects and slower population growth.



Western Australia's economic growth is highly dependent upon the outlook for China and the global economy. On this front, there are some risks to the outlook. Some of the pessimism around China is overdone and we expect economic growth in China to remain relatively firm over the next year, with growth of around 6-7%. 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. The volumes of bulk commodity exports from Western Australia should continue to strengthen, however, and the weaker Australian dollar will support the value of commodity exports (which are priced in US dollars).

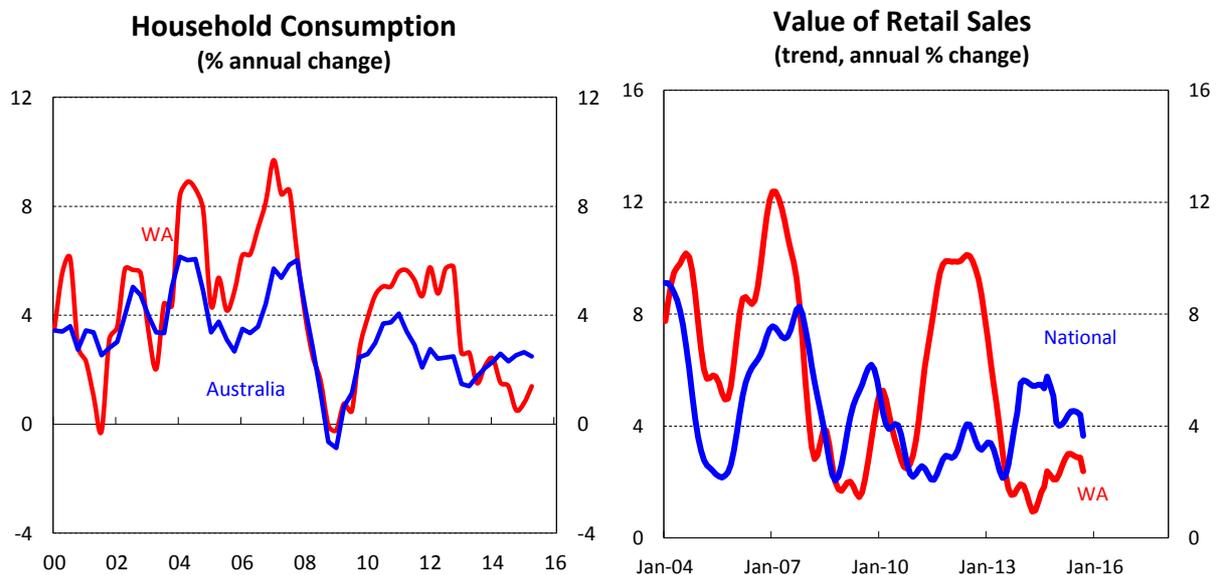
**Consumer Spending**

Household consumption growth remains subdued. After annual growth hit a recent peak of 5.8% in the year to the December quarter 2012, annual growth in household consumption weakened to 0.5% in the year to the December quarter 2014. The most recent data shows household consumption lifted a little to 1.4% in the year to the June quarter 2015. This remains well below the long-term average of 4.0% and lower than the national average of 2.5% in the year to the June quarter. Household spending in WA has been dampened by weakening income growth as the slowdown in mining investment weighs on economic activity. Spending on cigarettes and tobacco fell 13.8% in the year to June, while spending on vehicle purchases fell

9.7% and spending at hotels, cafes and restaurants was down 4.1%. Spending on communications rose 7.3% over the year to June, and spending on health rose 5.9% over that period.

The weakness in spending on vehicle purchases is reflected in WA motor vehicle sales, which peaked in late 2012 and have since been on a downward trend. WA motor vehicle sales fell 8.6% in the year to October. In the year to October, the weakness in WA motor vehicle sales has been in the ‘other vehicles’ category which includes light trucks (-20.4%), followed by the passenger vehicles category (-19.2%). This reflects the impact of the slowdown in the mining investment boom on ‘other vehicles’ and slowing consumer demand for passenger vehicles.

More recent data indicates that household consumption continues to grow at a pace below par. Retail sales, which comprise a proportion of consumer spending, grew at an annual pace of 2.5% in the year to September. This annual growth is below both the long-run average of 5.4% and national growth of 3.7% in September, and is likely to remain subdued for some time as a result of soft income growth.



Consumers in WA have been feeling pessimistic over the past year, although sentiment lifted in November. According to the Westpac – Melbourne Institute, consumer sentiment in Western Australia was at 104.7 in November, up from 94.8 in October. This reading is now above the 100 ‘neutral’ level, indicating more consumers are optimistic than pessimistic. However, the sharp fall in commodity prices and a rising unemployment rate remain key uncertainties for WA consumers.

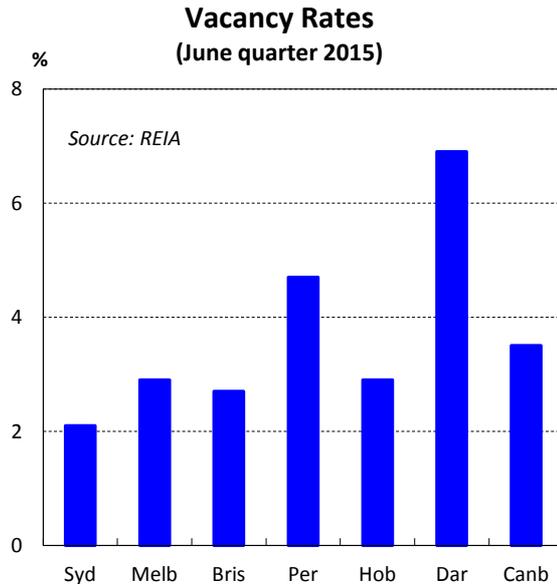
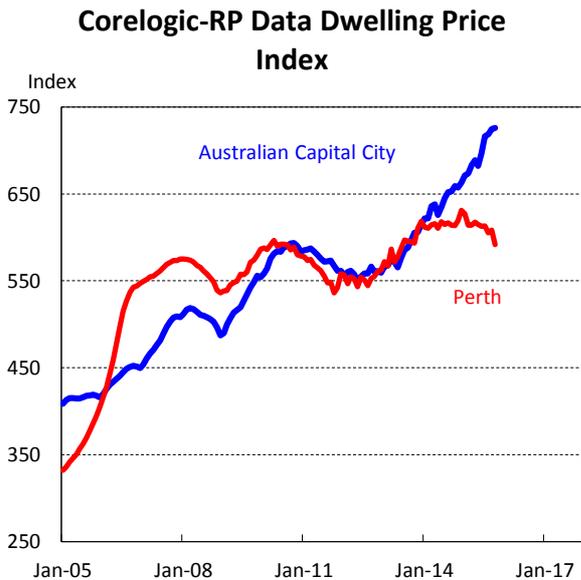
The transition in the resources sector from the investment to the production phase will continue to dampen consumer appetites, with the job outlook now less rosy. Additionally, the slowing housing market in WA is likely to continue to weigh on demand for housing-related goods. However, ongoing low interest rates should provide some support for consumer spending.

### Housing

The housing market has supported WA economic activity in recent years. The tide is turning,

however, with recent data indicating that housing market activity in Western Australia is slowing. While dwelling investment is likely to continue to support growth in the short-term, dwelling prices are already reflecting the drop in demand.

According to RP Data Core-Logic, Perth residential property prices have retreated. Perth dwelling prices have fallen by 3.6% in the year to October, down from a peak in annual growth of 9.9% in the year to December 2013. This decline is in contrast to other capital cities, with the Australian capital-city-average dwelling price up 10.1% over the past year. Perth unit prices declined 2.6% in the year to October, while house prices fell 3.7% 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 4.4% in the year to the June quarter, to \$340 per week. For two-bedroom “other dwellings”, rents slumped 9.1% in the year to the June quarter, to \$400 per week. Among capital cities, Perth had the largest decline in rents for two-bedroom “other dwellings” over the June quarter, and the second largest decline for three-bedroom houses, behind Darwin.

Vacancy rates in Perth have crept higher in recent years to 4.7% in the June 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. Vacancy rates at this elevated level suggest that rents will moderate further.

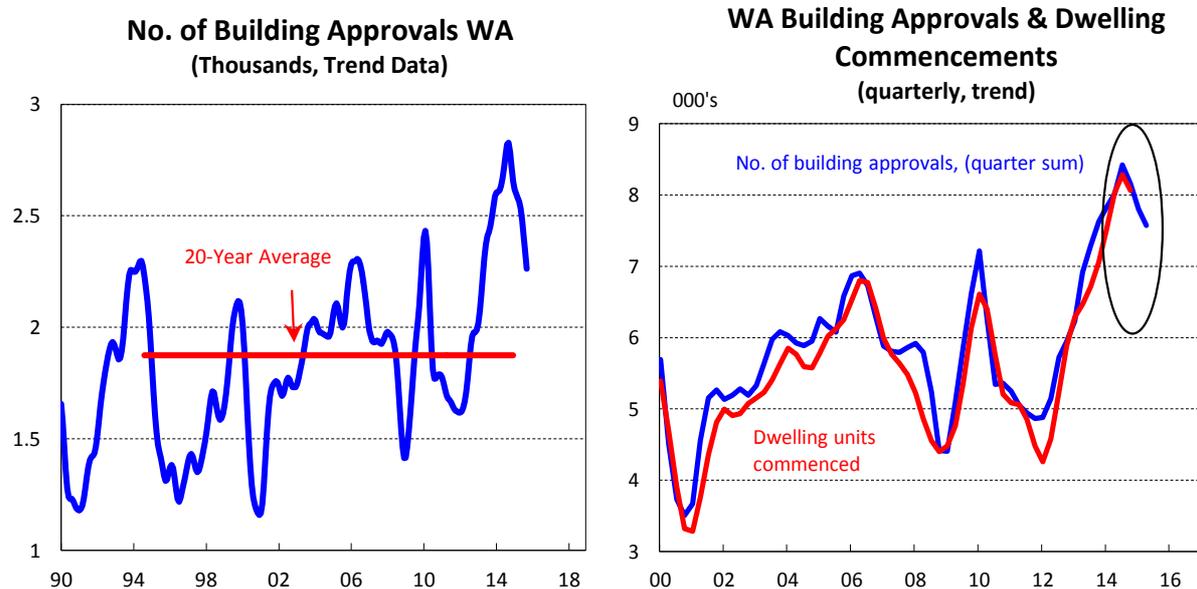
**- Dwelling Investment**

Dwelling investment in Western Australia has grown solidly, lifting 8.1% in the year to the June quarter. Growth in dwelling investment will provide some welcome support while mining investment is softening, although it is unlikely to be able to fully compensate for the downturn in mining investment. The strength in dwelling investment has been concentrated in new dwelling, up 10.8% in the year to the June quarter. Alterations and additions work in Western

Australia has been more subdued, but rose 2.3% in the year to the June quarter, the first positive annual growth rate in fourteen quarters.

Building approvals are pointing to a decline in housing construction in Western Australia over the medium-term. In the year to September, building approvals fell 20.0% (in trend terms). Annual growth has been on a general downward trend since February. However, the level of building approvals remains above its long-term average. The number of building approvals has exceeded their long-run average for two-and-a-half years, suggesting that residential construction will remain elevated in the near-term.

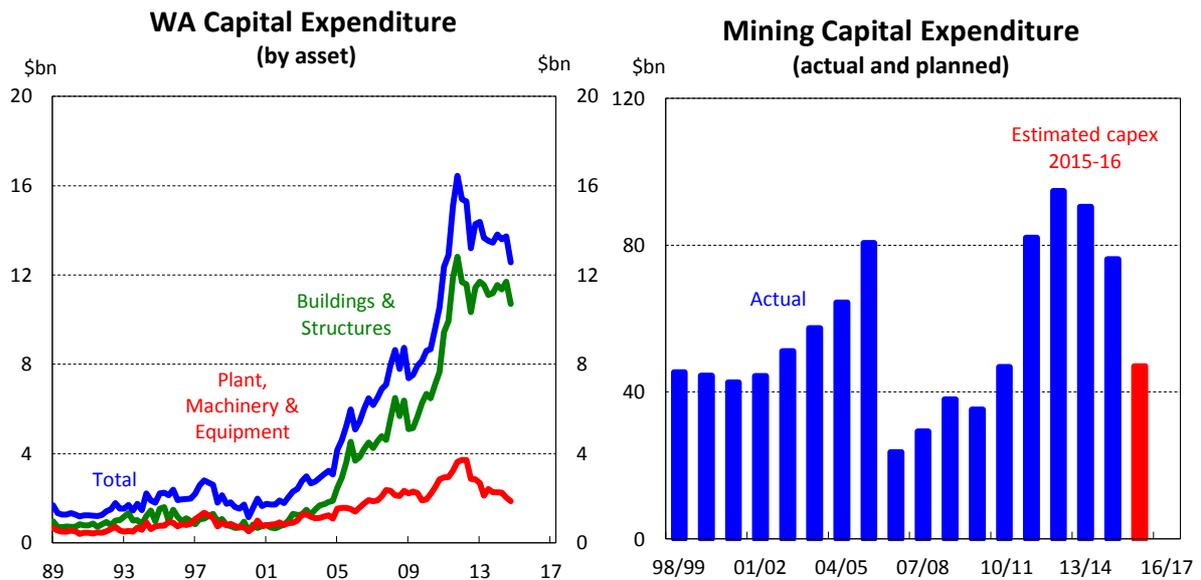
A dwelling shortage has developed in WA in recent years as population growth exceeded residential construction. WA has the largest housing shortage by State, after NSW. As the pace of WA's population growth has fallen in recent quarters, and given the supply pipeline of residential construction, this dwelling shortage should narrow sharply in 2016.



#### - 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, however, we do not expect dwelling prices to fall sharply. Instead, we expect housing prices to ease slowly from their peak given ongoing support from high average incomes in WA and low interest rates.



### Business Investment

A slowdown in mining investment is increasingly weighing on business investment in Western Australia and the outlook for business investment is weak compared to recent years. Business investment declined 9.9% in the year to the June quarter, and is expected to decline further in coming years. Capital expenditure by businesses peaked in June 2012 and has slumped 23.5% 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. 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).

Putting WA in a wider context, the downturn in the mining investment boom has seen the number of projects at the completed stage nationally rise in number, and in dollar value. In the six months to April (the latest available data), projects at the completed stage nationally rose to 13 projects, with a value of \$7.8bn, up from eight projects worth \$1.2bn in October 2014. Western Australia is bearing the brunt of the downturn in mining investment, with eight of the 13 projects of the completed stage in WA, including BHP Billiton’s Western Australian Iron Ore optimisation project worth \$2.1bn and the Coniston oil field project worth \$500mn.

While there are still a significant number of resource projects underway, the pipeline of new projects will not be sufficient to compensate for those projects which have reached completion. Additionally, falling commodity prices are weighing on the feasibility of new projects. The oil price (for West Texas Intermediate) has declined 43% over the past year, taking down the price

of LNG with it. The iron ore price has also fallen over the past year, shedding 37% of its value. Therefore the value of resource related investment is expected to decline further in coming years.

The Department of Industry, Innovation 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 34% in the year to the June quarter in WA 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 will support projects in the near-term, although their completion is on the horizon. The \$61bn Gorgon project is expected to make its first shipment before year-end and the \$29bn Wheatstone project is due for completion in 2016. The \$10bn Roy Hill iron-ore project is currently leading the way in iron ore, however, it is scheduled for completion late this year.

As a result of the slowdown in new resource projects, engineering construction has declined in 10 out of the last 14 quarters. The weakness in engineering construction is likely to continue.

Non-residential construction was supported by the boom in mining investment. On the flip-side, as the mining investment boom continues to unwind, this will translate into weaker activity in commercial construction. 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. Also, the \$1.2bn construction of a new Perth Children's Hospital is due to be completed early next year.

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**

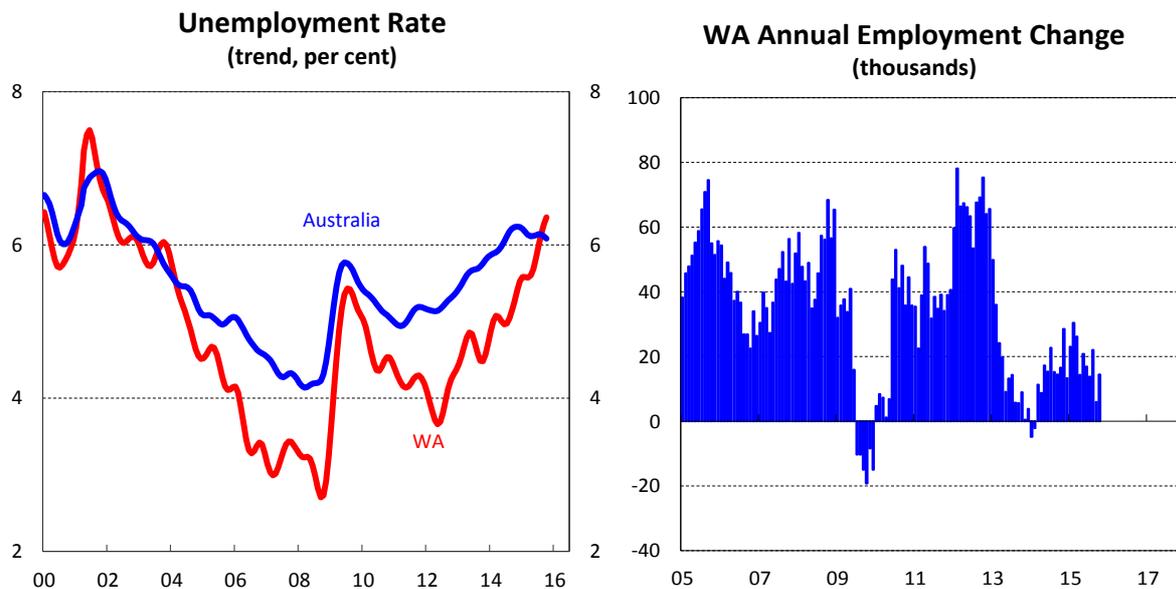
Western Australia's labour market has softened in comparison to the national picture, which has improved. In the year to October, 14.4k new jobs were added to Western Australia's economy, which is not sufficient to absorb population growth in the State. This makes up only a small proportion of the 315k jobs added nationally over the past year, with the bulk of these occurring in the Eastern States. Employment in WA has grown a subdued 1.1% over the year to October, well below the national average of 2.7%. The peak of 6.4% in employment growth in February 2012 seems like a distant memory now for WA.

WA's population increased by 35,348 in the year to the March quarter (a 1.4% increase). This is down on WA population growth of above 3% in 2012. In the year to the March quarter, the population increase was driven by overseas migration and natural increase. Meanwhile more Western Australians left WA for other States over the past year, which is the first time this has happened since 2002, reflecting diminished job prospects in WA.

WA's unemployment rate was at 6.4% in October. WA's unemployment rate has slowly lifted since the GFC; back in October 2008 it hit a record low of 2.3%. The unemployment rate in WA

rose above the national average (which now sits at 5.9%) in October. It was the first time the WA unemployment rate was this far above the national unemployment rate since November 2003.

The slowdown in mining investment and slower growth in incomes in WA have weighed on jobs in the professional, scientific & technical field, which fell 24.2k in the year to August. Slowing consumer spending has weighed on jobs in retail trade, which have declined 25.5k in the year to August. The strongest performing sector for job growth was healthcare & social assistance (19.9k), followed by construction (19.6k) in the year to August. Jobs in the mining industry have been in decline since November 2012, although that decline appears to have stabilised in recent quarters. Mining jobs lifted by 11.5k in the year to August, after falling in annual terms for the previous five consecutive quarters.



### WA State Budget 2015-16

The 2015-16 WA Budget was handed down on 4<sup>th</sup> 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	5.60	3.50	2.00	3.50	3.20
State Final Demand	-2.00	-3.60	-2.50	-0.40	2.00
Employment	0.50	1.50	1.40	1.90	2.00
Unemployment Rate	4.80	5.40	6.20	6.30	6.00
Perth CPI	3.00	1.80	2.30	2.50	2.50
Wage Price Index	2.80	2.20	2.20	2.50	2.80

Source: St. George Banking Group July 2015

The Western Australian Treasury expects growth of 3.50% in 2016-17, slowing from expected growth of 2.0% in 2015-16. Our forecast for growth in 2015-16 and 2016-17 is in line with these forecasts. Export volumes are expected to remain solid while a lower Australian dollar and low interest rates will support other areas of WA's economy.

## Contact Listing

**Chief Economist**

Hans Kunnen

[kunnenh@stgeorge.com.au](mailto:kunnenh@stgeorge.com.au)

(02) 8254 8322

**Senior Economist**

Josephine Horton

[hortonj@stgeorge.com.au](mailto:hortonj@stgeorge.com.au)

(02) 8253 6696

**Senior Economist**

Janu Chan

[chanj@stgeorge.com.au](mailto:chanj@stgeorge.com.au)

(02) 8253 0898

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