

# State Economic Report

Monday, 3<sup>rd</sup> March 2014



## WA Economic Outlook

### Summary

- Western Australia has been a powerhouse of growth for the Australian economy for several years. However, the growth drivers of Australia are shifting away from mining investment and Western Australia is seeing the impact.
- Underscoring the turnaround in fortunes for WA, annual growth in State final demand in WA slowed from a peak of 16.8% in the year to the September quarter 2011 to -2.2% in the year to the September quarter 2013.
- We expect growth in Western Australia to weaken in coming years as mining investment starts to decline more significantly. There should however, be support to growth from exports and dwelling investment.
- After being a formidable driver of growth in Western Australia, business investment has started to detract from growth. Intention surveys and the pipeline of mineral and resource projects point to a gradual decline in mining investment this year, but this decline accelerating in following years. There remains a risk of a much sharper decline in WA mining investment as mega projects approach completion in 2015-16.
- The slowdown in mining investment activity has impacted negatively on retail sales growth in WA, although more recently there have been signs of gradual improvement. This slight uptick in retail spending provides a positive sign that lower interest rates are providing support to the WA economy.
- As the transition from mining investment to mining production takes hold, Western Australia's capacity for exports will be greatly increased. Iron ore, gold and LNG export volumes are set for strong growth in coming years. According to BREE, Australian export revenues in resources are expected to increase 17% in 2013-14, supported by solid growth in export volumes and a weaker Australian dollar.
- Dwelling prices in Western Australia have recovered and have hit a record high. The lift in dwelling prices is supportive of stronger growth in residential construction, which should help mitigate the impact of slower mining investment. An undersupply of housing, healthy population growth and a lengthy period of low interest rates should continue to support house prices and dwelling investment in Western Australia.

Percentage Shares of the Economy*		
Industries	WA	Australia
Mining	38.1	11.2
Construction	13.3	8.8
Professional, scientific and technical services	5.6	7.7
Manufacturing	5.2	7.9
Transport, postal and warehousing	4.9	5.6
Health care and social assistance	4.5	7.4
Retail trade	3.6	5.3
Wholesale trade	3.2	4.9
Financial and insurance services	3.2	9.3
Public administration and safety	3.1	6.0
Education and training	3.0	5.3
Administrative and support services	2.6	3.4
Electricity, gas, water and waste services	2.3	2.9
Rental, hiring and real estate services	1.9	3.0
Other services	1.5	2.0
Accommodation and food services	1.4	2.7
Information media and telecommunications	1.3	3.1
Agriculture, forestry and fishing	1.1	2.4
Arts and recreation services	0.5	0.9

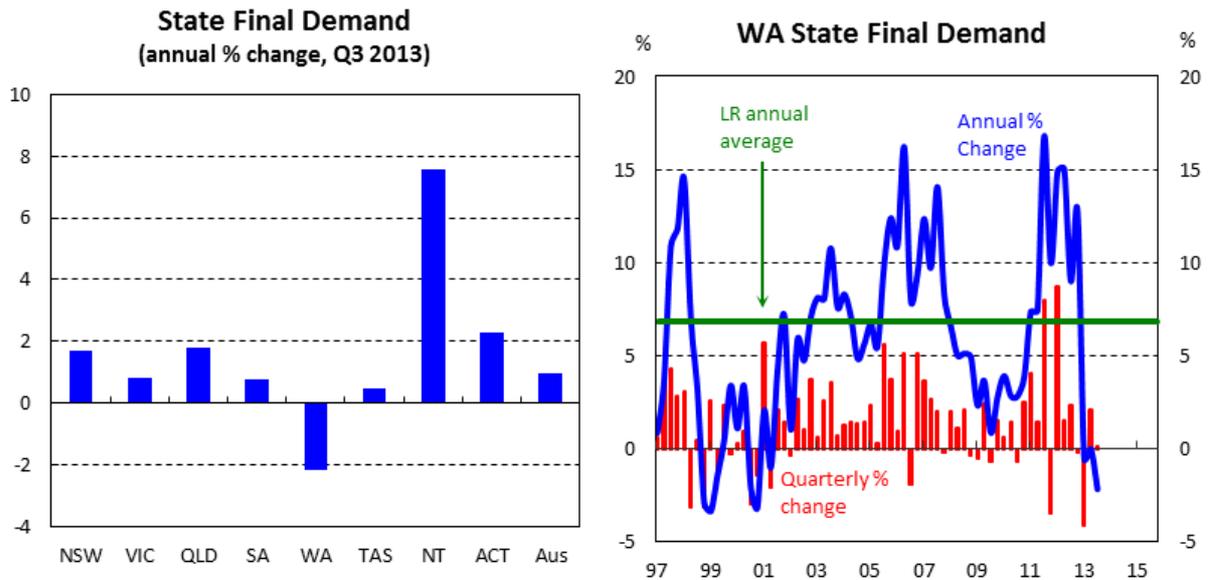
\* Share of gross value added less ownership of dwellings 2012-13; Source: ABS, St. George

## Economic Growth

Western Australia has been a powerhouse of the Australian economy for several years. As one of the big beneficiaries of the rapid expansion of the Chinese economy, gross State product (GSP) grew by a solid 5.1% in 2012-13, following growth of 7.3% in 2011-12.

The State, however, is starting to feel the impact of slowing mining investment as a number of large-scale mining projects approach completion. This slowdown is evident in more recent economic indicators, such as State final demand. State final demand in Western Australia fell 2.2% in the year to the September quarter, a far cry from the 16.8% annual growth recorded in the September quarter 2011. Unsurprisingly, a sharp decline in business investment was the major driver for the weakness in final demand. However, growth in household consumption has also slowed significantly, likely reflecting weaker income growth and softer job prospects.

The fall in State final demand points to tougher times for Western Australia, but State final demand data ignores the traded sector, which is a large component of Western Australia's economy. As the mining boom transitions from the investment phase to the export phase, stronger exports and production capacity will contribute more significantly to Western Australia's growth. Export volumes in goods grew 5.7% in the year to the September quarter, well outpacing the 5.8% decline in import volumes in goods over the same period.



The slowdown in mining investment is set to weigh on growth in Western Australia, after being a major driver of growth for several years. However, there should be further 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 are boosting consumption, and residential investment is expected to assist in offsetting the gap in growth left by slowing mining investment.

On balance, we expect growth to slow from 5.1% in 2012-13 to 3.5% in 2013-14 (see page 9 for further details on our forecasts).

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 and the global economy. There remains significant uncertainty regarding growth in China as its authorities seek to rebalance growth away from investment to consumption. A number of hurdles remain, which will need to be addressed by policy reform. Nonetheless, an improving outlook for advanced economies including Europe and the US will be supportive of global growth and the prices of commodities. Commodity prices, which have fallen from their peaks in 2011, are still expected to continue to drift lower this year, reflecting a large increase in global supply. That said, a weaker Australian dollar is boosting the values of commodity exports, which are denominated in US\$ terms.

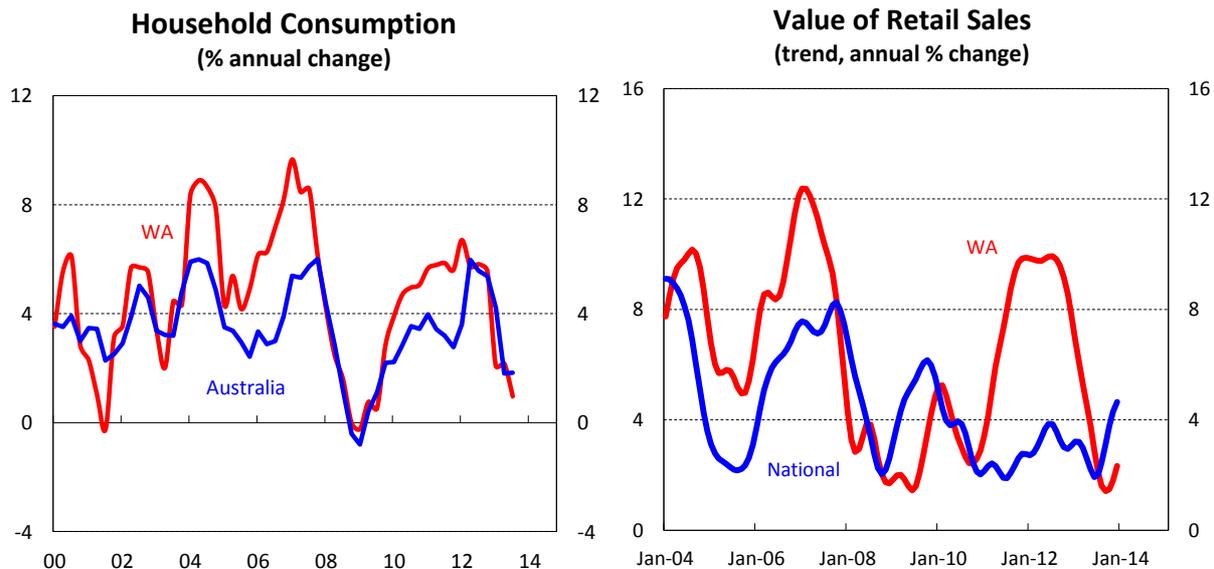
The longer-term outlook for Western Australia is still promising. Export growth should strengthen further as the capacity for commodity production increases, including iron ore, gold and LNG.

### Consumer Spending

Household consumption growth has softened considerably in recent times. After annual growth hit a peak of 6.7% in the year to the March quarter 2012, annual growth in household consumption weakened to 1.0% in the year to the September quarter 2012, a four-year low.

Household spending has been dampened by a weakening jobs market as demand for labour-intensive mining investment wanes.

More recent data, however, spell out better news for consumer spending. Retail sales, which comprise a large proportion of consumer spending, have improved gradually. After reaching a low point of just 0.3% annual growth in October 2013, a weakening trend has reversed with annual growth in retail spending lifting to 3.0% in the year to December. While this latest pickup holds some promise, the annual growth rate of 3.0% in December is still substantially below WA's long run average of 6.4%. Retail spending growth in WA was dwarfed by the national average growth rate of 5.7% in the year to December.



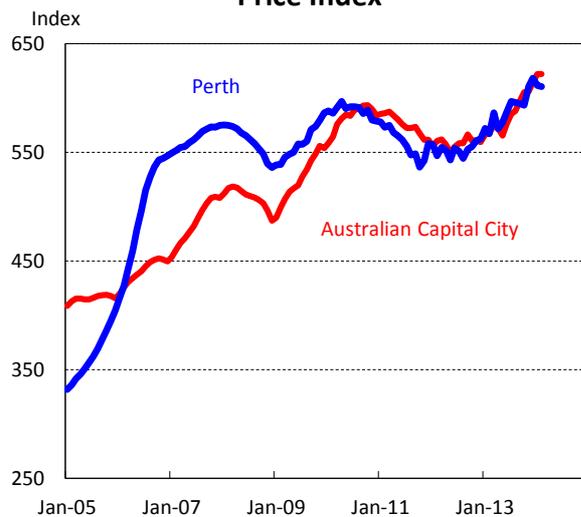
Other areas of consumer spending continue to show some weakness. The sales of motor vehicles fell 9.0% in the year to December. Sales have yet to recover from a peak in late 2012.

According to a Curtin Business School survey, consumer sentiment in Western Australia picked up in the December quarter following bouts of weakness in June and September. The outlook for the next three months is positive with the index rising from 74 to 104 where 100 is a neutral outlook. The twelve month index rose from 81 to 122 suggesting a significant degree of consumer confidence.

In contrast, the Westpac – Melbourne Institute index of consumer sentiment for Western Australia has weakened to 94.5 in February, below the 100 mark, signaling that pessimists outweigh optimists. It was the first time the index has fallen below 100 since November 2012.

A lengthy period of low interest rates and rising house prices, which are driving an increase in household wealth should provide further support in consumer spending, and will help mitigate the impact of slower mining investment. However, as the mining boom continues to transition from the investment phase to the production phase, job prospects are expected to weaken, and could dampen consumption growth. A further pick-up in both consumer sentiment and consumer spending may require ongoing improvement in the labour market and a good news flow regarding employment and project development.

**RP Data-Rismark Hedonic Dwelling Price Index**



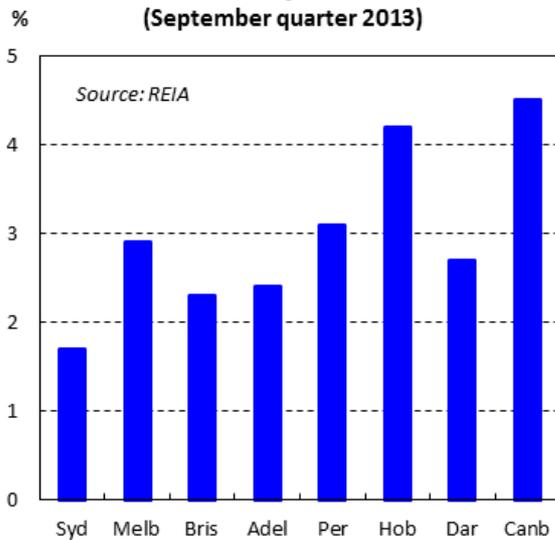
**Housing**

The housing market is one of the bright spots in the Australian economy, and in Western Australia, it is assisting in filling some of the gap in growth left by fading mining investment.

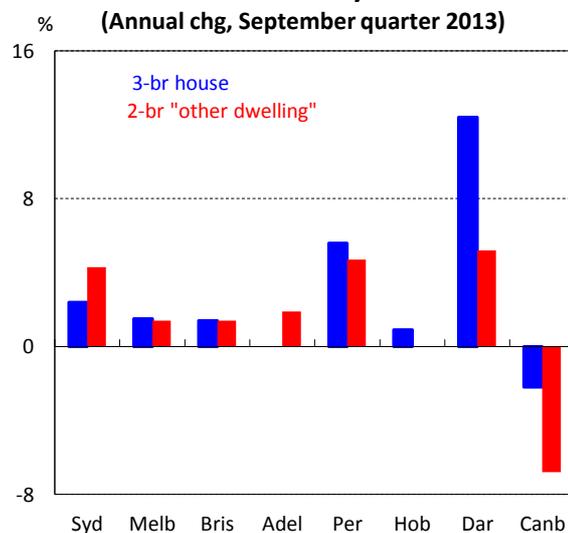
According to RP Data-Rismark, Perth dwelling prices hit a record high in December 2013. For the year to February, dwelling prices grew a healthy 7.6%, although annual growth has softened from a peak of 9.9% in the year to December. Growth in Perth dwelling prices was the third strongest behind Sydney and Melbourne. In the year to February, unit price growth of 13.1% in Perth outpaced house price growth of 7.2%.

Data from the Australian Bureau of Statistics (ABS) tells a similar story. Perth residential property prices have increased for nine consecutive quarters and in the year to the December quarter, they rose 8.7%. On this measure, Perth had the second highest growth among the State capitals, and was surpassed only by Sydney where house prices rose 13.8%. The average price rise among the capital cities was 9.3%.

**Vacancy Rates (September quarter 2013)**



**Median Weekly Rents (Annual chg, September quarter 2013)**



**- Rental Markets**

There has been strong demand for rental property in Perth, and residential rents continue to witness solid growth. Median weekly rents for a three-bedroom house grew 5.6% in the year to the September quarter and for a two-bedroom “other dwelling”, rents grew 4.7% over the same period. Growth in rents is the second strongest among capital cities, second behind Darwin.

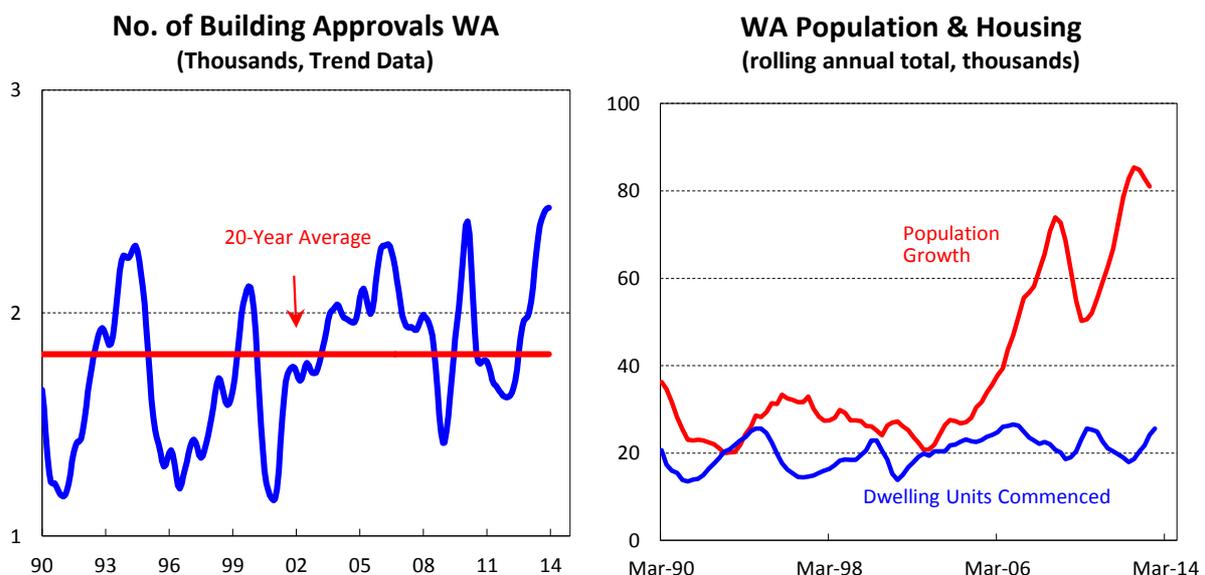
However, there is growing evidence that rental markets are loosening. Vacancy rates in Perth increased 1.3 percentage points over the year to 3.1% in the September quarter, and point to a more balanced rental market (vacancy rates at 3.0% are considered the benchmark for a balanced rental market). This lift in vacancy rates suggests that growth in rents will likely moderate.

#### - Dwelling Investment

Dwelling investment has strengthened notably in Western Australia, and is providing some welcome support to growth while mining investment is softening. For the year to the September quarter, dwelling investment in WA grew 10.4%, the second consecutive quarter of double-digit annual growth.

Building approvals are pointing to further strength in housing construction in Western Australia. The number of building approvals has exceeded their long-run average for over a year. Annual growth in building approvals was a solid 29.1% in the year to December.

Despite the pickup in residential construction, a dwelling shortage is expected to exist given strong population growth.



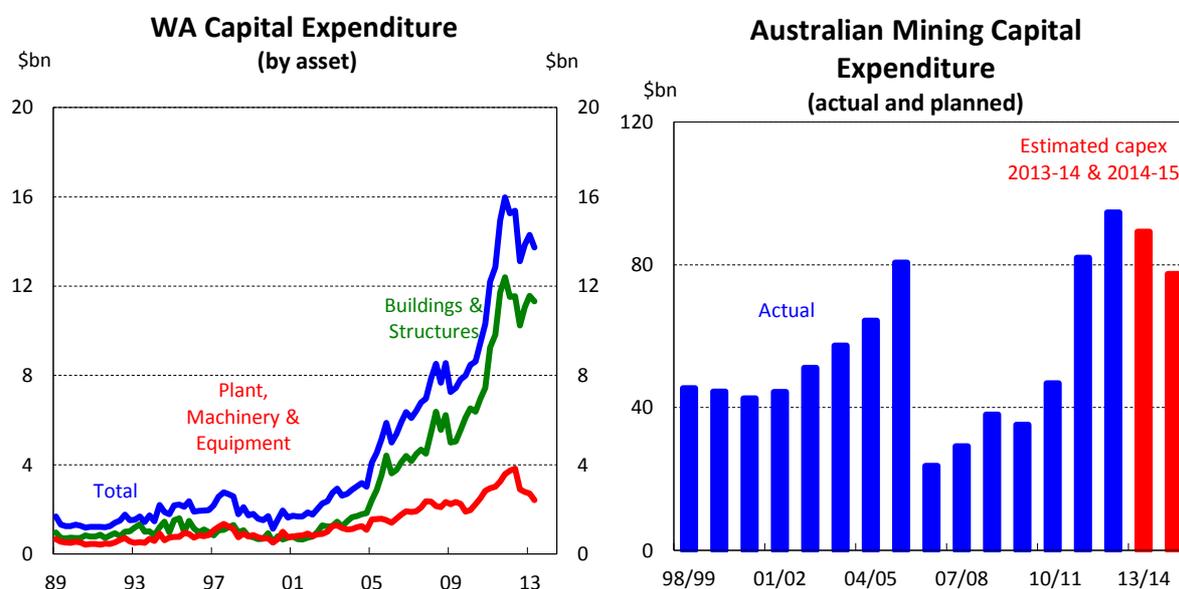
#### - Outlook

Low interest rates, relatively high incomes and strong population growth have been supportive of housing demand in Perth and Western Australia.

However, as the large-scale mining projects in the State approach completion, there will be implications for the housing market, as the labour-intensive phase of the mining boom fades. Weaker labour demand has already resulted in rising unemployment, and is beginning to affect migration flows. Population growth in Western Australia has slowed, although the annual growth rate in Western Australia remains stronger than any other State or territory in the country at 3.3% in the year to the June quarter.

The ongoing strong inflow of new residents will help underpin further gains in dwelling prices.

Additionally, although wage growth in WA has slowed significantly, incomes in WA are among the highest in the country. We expect further modest gains in dwelling prices this year given interest rates are expected to remain low for an extended period, although the shifts within the mining sector suggests that Perth dwelling prices could underperform other capital cities. The upswing in residential construction, however, should provide a solid contribution to Western Australian growth.



## Business Investment

Business investment was a significant driver of economic growth in Western Australia until recent quarters. After annual growth in business investment peaked at 50.9% in the year to the September quarter 2011, business investment has slowed and declined 9.4% in the year to the September quarter 2013.

As one of the biggest winners of the mining investment boom, Western Australia is one of the more vulnerable States to a decline in mining investment. The recent completion of major projects including Woodside's \$5bn North Rankin LNG project, the \$1.2bn expansion of BS4 Pilbara mine and the lack of new major projects point to a further decline in mining investment.

According to the Bureau of Resource and Energy Economics (BREE), there remain 24 projects worth an estimated \$121.8bn at the "committed stage" in Western Australia, as of October 2013. 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 is down from 28 projects at the "committed stage" in Western Australia reported in April last year.

Of the 24 committed resources and energy related projects, nine are associated with LNG, gas and oil and valued at \$98.5bn. A further eight, valued at \$17.2bn are associated with iron ore and four, valued at \$4.5bn, involve infrastructure (ports and railways).

Despite the decline in committed projects, there remain significant mega projects driving activity, particularly in LNG. These include the \$54bn Gorgon project, the \$29bn Wheatstone project and the \$12bn Prelude project, and should keep activity at a high level in coming years.

According to the ABS, mining investment across Australia is expected to decline gradually in 2013-14 and to a larger extent in 2014-15. Nonetheless, there is a risk of a sharper decline in WA investment in 2015-16 when these mega-projects approach completion.

Among other areas of business investment, non-residential construction activity witnessed strong growth in 2011-12, supported by demand for accommodation camps and operations buildings in mine-related areas. While the outlook for commercial construction is weakening in step with a decline in mining investment, lower interest rates and a weaker Australian dollar are beginning support other areas of the economy. Non-residential approvals in Western Australia are pointing to a healthy level of activity in the near-term. There remain some notable projects underway, including the \$5.6bn Perth City Link urban renewal project and the \$1.6bn Elizabeth Quay development. Healthcare is being led by the \$2bn Fiona Stanley teaching hospital. For this year, non-residential commencements are being led by the AFL Stadium worth \$700mn and work beginning on Crown Towers Perth.

### **Labour Market**

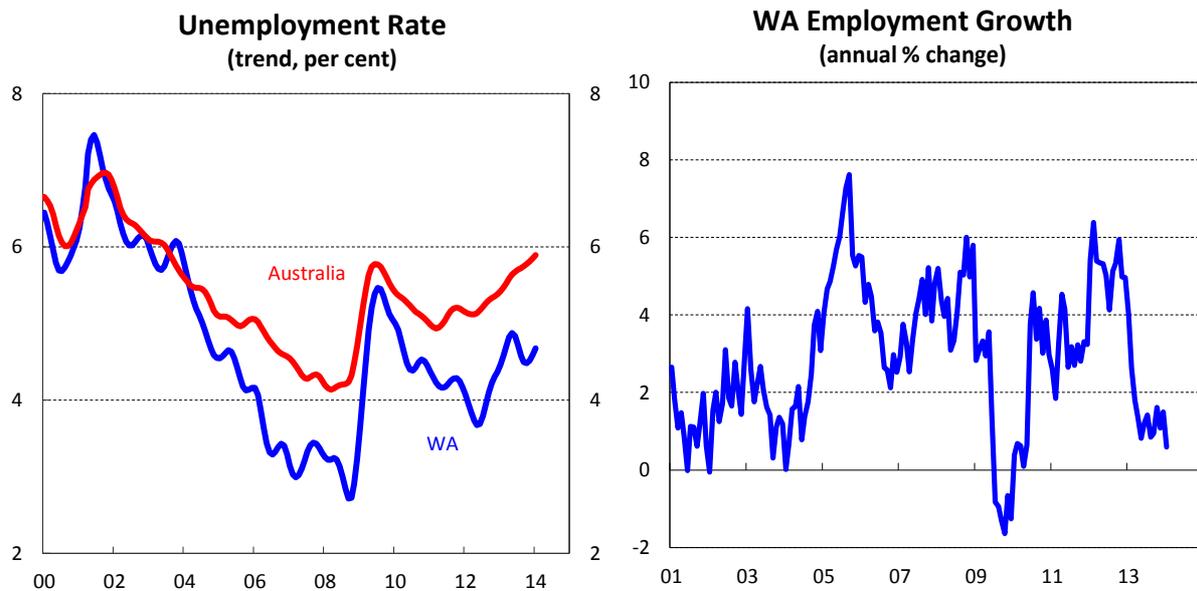
Conditions in the Western Australian labour market have softened, reflecting the impact of weaker domestic demand in the State. Over the year to January, Western Australia added 8.0k new jobs, which was the lowest annual job gain since May 2010.

A breakdown by industry revealed that employment in mining is weakening. The industry lost 2.6k jobs in the year to November, well down on the 28.1k jobs added in the year to May 2012. However, in the year to November, most jobs in WA were lost in agriculture, forestry and fishing (-12.9k), administration and support (-9.2k) and retail (-7.2k). Adding jobs over the same period were construction (16.5k), transport, postal and warehousing (16.2k) and accommodation and food services (10.0k).

The slowdown in job creation in Western Australia is reflected in its rising unemployment rate. In January, WA's unemployment rate hit 5.1%, the highest in a nearly three years. Despite lifting over the past 1½ years, WA's unemployment rate remains the lowest across States, although that gap is likely to close.

The acid test for the Western Australian labour market (and the economy as a whole) will come when the current phase of mega-project construction ends. Liquid natural gas (LNG) projects such as Gorgon, Wheatstone and Prelude are all scheduled to be complete within the next few years. The Roy Hill iron ore project has the potential to create new jobs and expansion of existing mines cannot be ruled out and there are also a number of ongoing urban renewal and hospital projects underway in Perth.

On balance, we expect the unemployment rate to rise further, as job prospects within mining weaken. Employment gains are unlikely to keep pace with WA's strong population growth.



### St.George Banking Group Forecasts

Economic Indicators, % Change				
	2012-13	2013-14 (f)	2014-15 (f)	2015-16 (f)
Gross State product	5.10	3.50	2.30	2.90
State Final Demand	7.00	-0.60	0.10	0.80
Employment	3.50	1.30	1.40	1.70
Unemployment Rate	4.50	4.80	5.30	5.30
Perth CPI	2.20	2.80	2.40	2.50
Wage Price Index	4.00	2.90	2.80	2.80

Source: St. George Banking Group

The Western Australian Treasury expects growth of 3.25% in 2013-14, slowing from growth of 5.1% in 2012-13. Our forecast for growth in 2013-14 is marginally higher at 3.5%, as weaker business investment is partially offset by strong contributions to growth from net exports and dwelling investment. We expect growth to soften further in 2014-15 and 2015-16 as mining investment declines more sharply, although export volumes are expected to remain solid and low interest rates will support other areas of WA's economy, including dwelling investment and consumption. These will provide some means to bridge the gap as investment slows.

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