

State Economic Report

Friday, 7 November 2014



WA Economic Outlook

Summary

- Until the end of 2014, Western Australia had been a powerhouse of the Australian economy for several years. Since the end of 2014, the growth drivers of the economy have shifted away from mining investment and this shift has been felt acutely in WA.
- We expect growth in Western Australia to weaken in coming years, as mining investment starts to decline more significantly. Export volumes will support growth, although the positive impact of this will be somewhat mitigated by recent declines in bulk commodity prices.
- After being a key 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 faster decline in mining investment next year.
- 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.
- Western Australia's labour market has been resilient, despite the headwinds within the mining sector. Job growth in Western Australia was the strongest across all States in the year to October, lifting 40.3k, although this pace is still a slowdown on previous years.
- Household spending has been dampened by a weakening jobs market, as demand for labour-intensive mining investment wanes.
- The housing market is one of the bright spots in the Australian economy and in Western Australia property prices have had a decent run-up, although they peaked towards the end of 2013.

Economic Growth

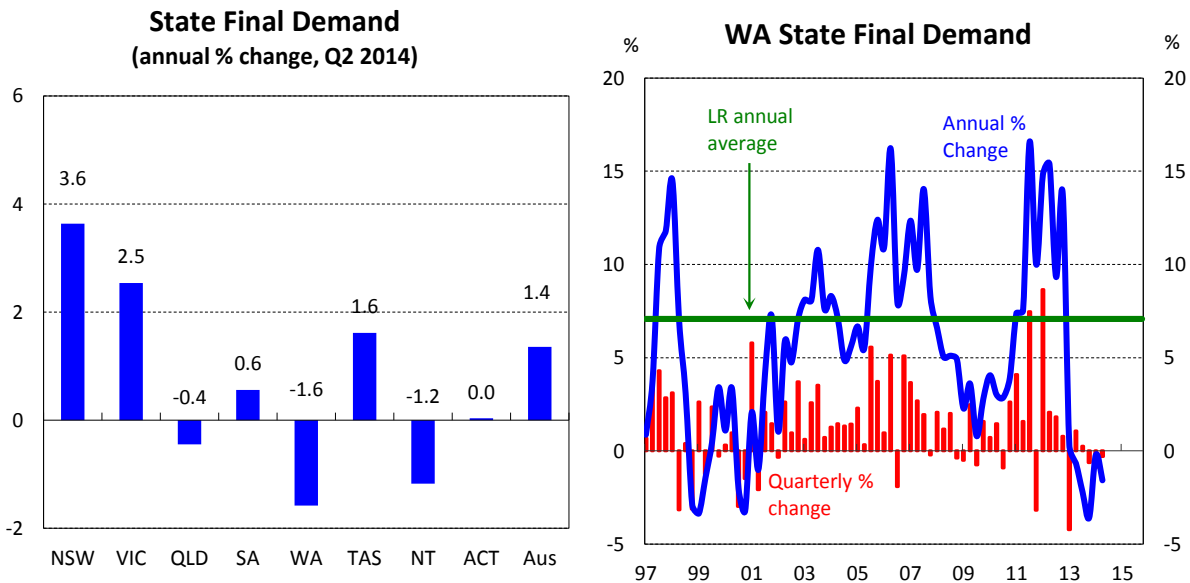
Percentage Shares of the Economy*		
Industries	WA	Australia
Mining	38.1	11.2
Construction	13.3	8.8
Professional, scientific and technical services	5.6	7.7
Manufacturing	5.2	7.9
Transport, postal and warehousing	4.9	5.6
Health care and social assistance	4.5	7.4
Retail trade	3.6	5.3
Wholesale trade	3.2	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

Western Australia was been a powerhouse of the Australian economy for several years until the end of 2014. As one of the big beneficiaries of the rapid expansion of the Chinese economy as well as other Asian economies, gross state product (GSP) grew by a solid 5.1% in 2012-13, following growth of 7.3% in 2011-12.

Slowing mining investment, however, has weighed heavily on the momentum of growth in the State, as a number of large-scale mining projects move towards completion. There is evidence of economic slowing in the State final demand figures. State final demand in Western Australia fell by 1.6% in the year to June, a sharp deterioration from the 16.6% annual growth recorded in the September quarter 2011. 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. 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, export volumes should strengthen, although the positive impact on economic growth will be somewhat mitigated by recent declines in commodity prices.



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 and rising in property prices are boosting residential investment. This is expected to assist in offsetting the gap in growth left by slowing mining investment.

On balance, we expect growth to slow from an estimated 5.5% in 2013-14 to 2.7% in 2014-15 (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. The outlook for economic growth in China has clouded this year. A number of hurdles remain, which will need to be addressed by policy reform, however, 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, are expected to continue to drift lower this year. This weakness in commodity prices reflects easing demand from China and the advanced economies. 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-dollar terms.

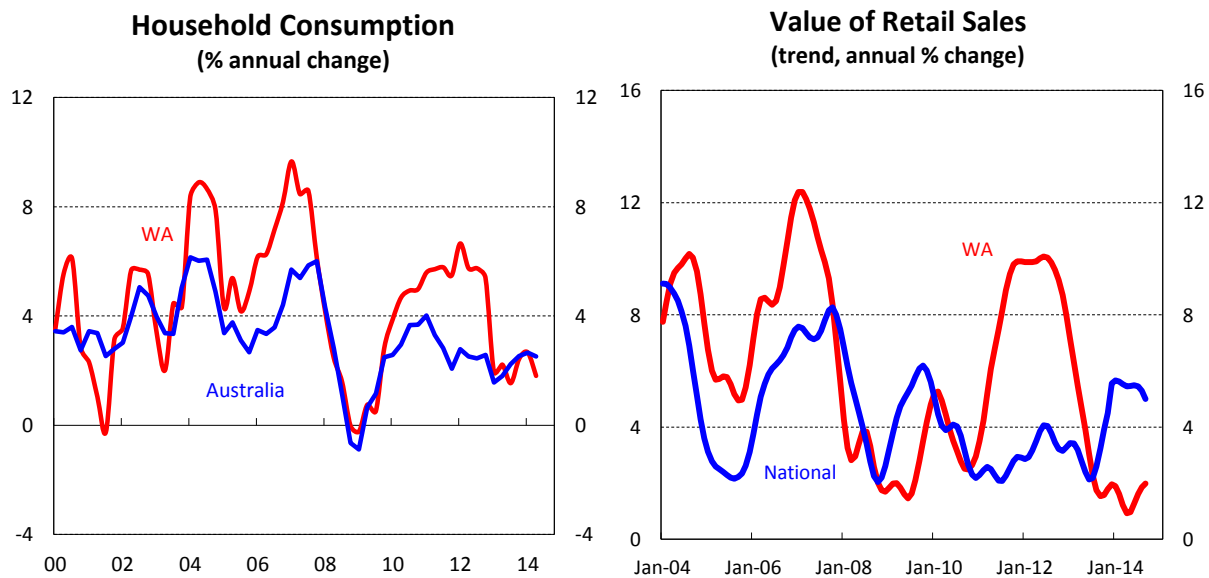
The longer-term outlook for Western Australia is more challenging. Export growth should strengthen further as the capacity for commodity production increases, however, decreased mining investment will continue to negatively impact on economic activity.

Consumer Spending

Household consumption growth has softened considerably in recent years. After annual growth hit a peak of 6.7% in the year to the March quarter 2012, annual growth in household

consumption weakened to 1.8% in the year to the June quarter 2014. Household spending has been dampened by a weakening jobs market as demand for labour-intensive mining investment wanes.

More recent data indicates that household consumption may have picked up modestly in WA. Retail sales, which comprise a large proportion of consumer spending, grew at an annual pace of 3.3% in the year to September, the strongest rate since mid-2013. While growth was below the long-run average of 5.8% and national growth of 5.7% in September, the improvement suggests that low interest rates are providing some underlying support for consumer spending.



Other areas of consumer spending, however, continue to show some weakness. The sales of motor vehicles fell 3.5% in the year to September. Motor vehicle sales peaked in late 2012.

According to the Curtin Business School-CCI survey, consumer sentiment in Western Australia improved in the September quarter, for the second consecutive quarter. However, consumer sentiment in WA remains subdued. The twelve-month index rose from 87 in the June quarter to 92 in the September quarter, although it remains below the 100 'neutral' level, suggesting consumers remain somewhat pessimistic.

The Westpac – Melbourne Institute index of consumer sentiment for Western Australia has weakened over the past year to a reading of 100.8 in October. However, this reading is just above 100 indicating that more consumers are optimistic than pessimistic, by a small margin.

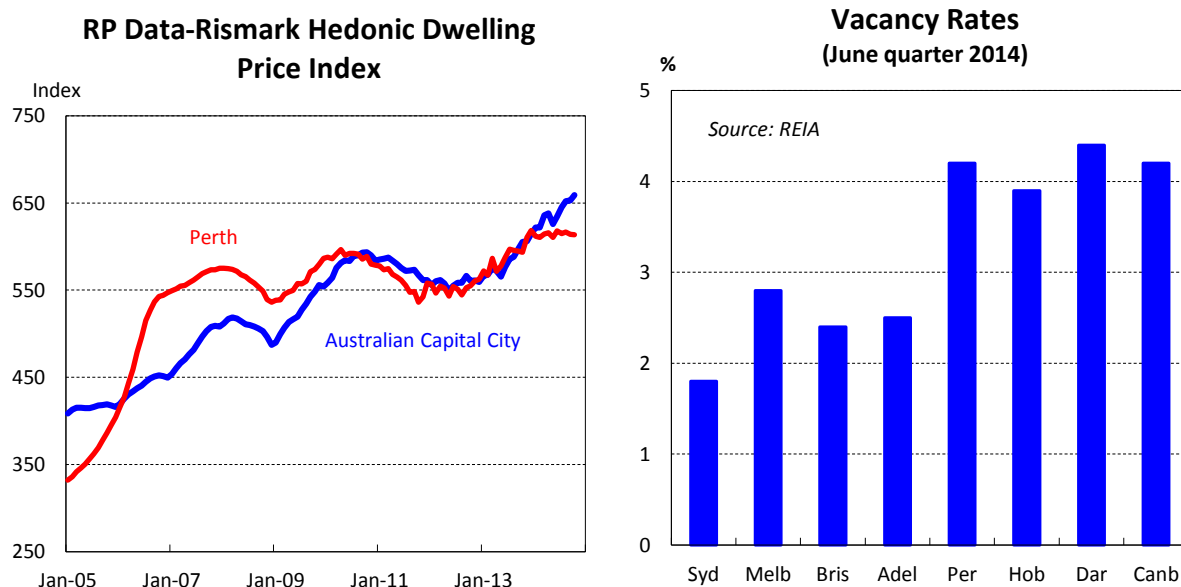
Ongoing low interest rates should continue to provide some support for consumer spending. However, this is against a backdrop of mining transitioning from the investment to the production phase, which is less labour intensive. Hence, job prospects could remain subdued in Western Australia and could act to dampen consumption growth. An improvement in the labour market is likely required for consumer sentiment and spending to pick up convincingly.

Housing

The housing market is one of the bright spots in the Australian economy and has helped support activity in Western Australia. Perth residential property prices have had a decent run-

up although they probably peaked in December 2013, according to RP Data CoreLogic. Dwelling price growth in Perth has slowed significantly, after very strong gains through 2006-07. However, house prices are still 3.4% higher in October on a year ago. This modest growth has now been eclipsed by other major capital cities and the Australian capital-city-average, which grew 8.9% in the year to October. Perth unit price growth rose 1.7% in the year to October, while house price growth rose 3.5% in the year to October.

Data from the Australian Bureau of Statistics (ABS) tells a similar story. Perth residential property prices increased for ten consecutive quarters before declining 0.2% in the June quarter. Perth residential property prices rose 3.6% in the year to the June quarter. The average price rise among the capital cities was 10.1%.



- Rental Markets

Demand for rental accommodation in Perth has ebbed, and rents for both houses and other dwellings in Perth have declined over the past year. Median weekly rents for three-bedroom houses fell 2.1% in the June quarter and are down 4.2% in the year to the June quarter. For two-bedroom “other dwellings”, rents were up 1.1% in the June quarter, but fell 3.3% in the year to the June quarter. Among the capital cities, Perth had the largest decline in rents over the June quarter, aside from Canberra, which had more sizeable falls.

Vacancy rates in Perth increased 0.8 percentage points over the year to the June quarter, to 4.2%. 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 years indicates the Perth rental market has become looser and there may be a slight over supply of rental properties in Perth now. Vacancy rates at 3.0% are considered the benchmark for a balanced rental market. This continued lift in vacancy rates suggests that growth in rents will likely moderate further.

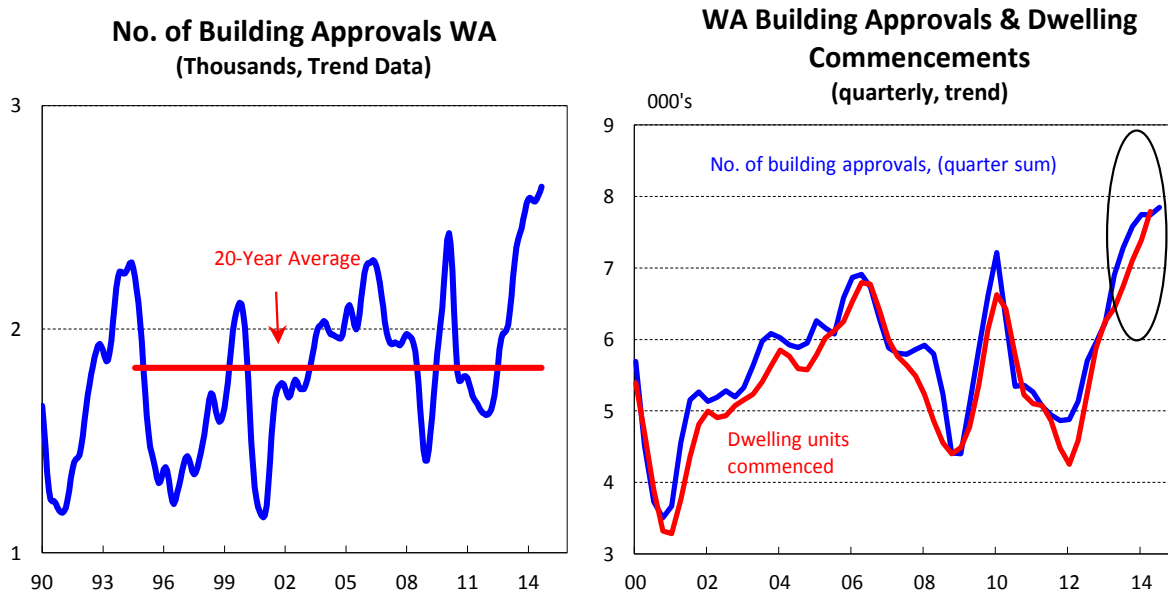
- Dwelling Investment

Dwelling investment has strengthened in Western Australia and is providing some welcome support to growth while mining investment is softening. For the year to the June quarter,

dwelling investment in WA grew 15.6%, the fifth consecutive quarter of double-digit annual growth. This strength in dwelling investment has been driven by new dwelling investment, while alterations and additions work has been more subdued.

Building approvals are pointing to further strength in housing construction in Western Australia. Annual growth in building approvals has come off its highs, growing at 7.5% in the year to September (in trend terms). It follows annual growth in excess of 20% through 2013 and early 2014. However, the level of building approvals remains high on a historical comparison. The number of building approvals has exceeded their long-run average for over a year, so it remains supportive of residential building.

A dwelling shortage developed in WA as population growth exceeded residential construction. This dwelling shortage should narrow as the supply of new housing lifts, given the supply pipeline of residential construction.

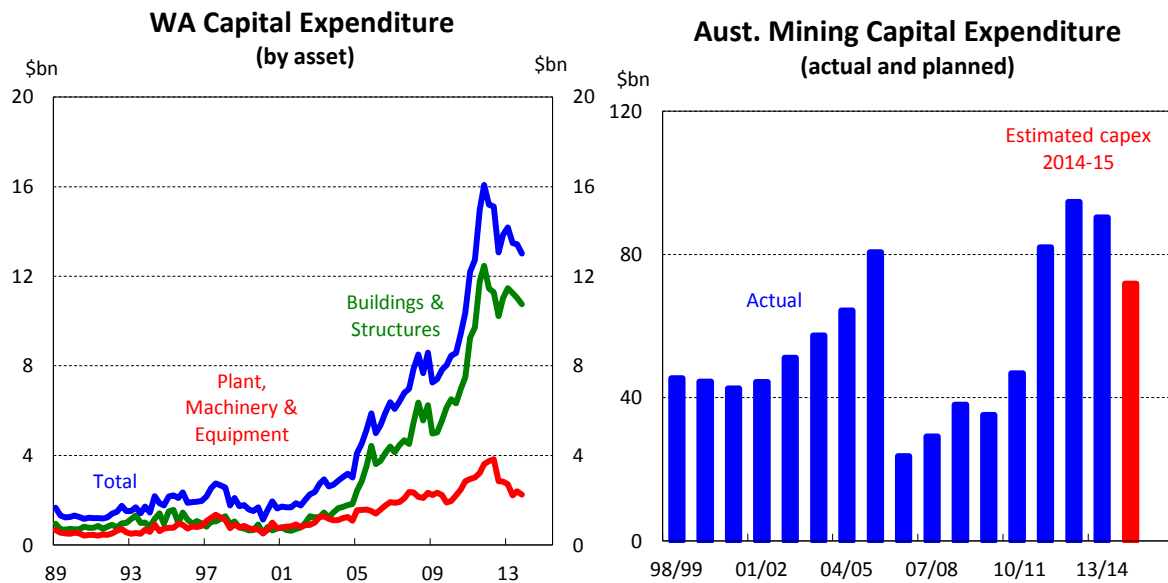


- Outlook

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, although the annual growth rate in Western Australia remains stronger than any other State or territory in the country at 2.5% in the year to the March quarter 2014 (which is 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 don't expect dwelling prices to fall sharply. Instead, we expect housing prices to remain close to their peak given ongoing strong population growth and high average incomes in WA.



Business Investment

A slowdown in mining investment is increasingly weighing on business spending in Western Australia. Business investment declined 10.5% in the year to the June quarter, and is set to decline further in coming years.

According to the Bureau of Resource and Energy Economics (BREE), the number of “committed” projects has continued to fall. In April, it fell to 18 and was worth a value of \$115.7bn. 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 24 committed projects in October 2013.

Of the 18 committed resources and energy related projects, nine are associated with LNG, gas and oil and valued at \$100.5bn. A further five, valued at \$11.9bn, are associated with iron ore and two, valued at \$2.4bn, involve infrastructure (ports and railways).

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 are supporting activity over the next few years. Meanwhile, the \$10bn Roy Hill iron-ore project is leading the way in iron ore. Nonetheless, the recent fall in iron ore prices and limited scope for a recovery suggested that new projects are less likely to get the go ahead. There is also the risk of a sharper decline in WA investment in 2015-16 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 bleaker outlook for resource investment will translate into weaker activity in commercial construction.

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 to support other areas of the economy. Non-residential approvals in Western Australia are pointing to a healthy

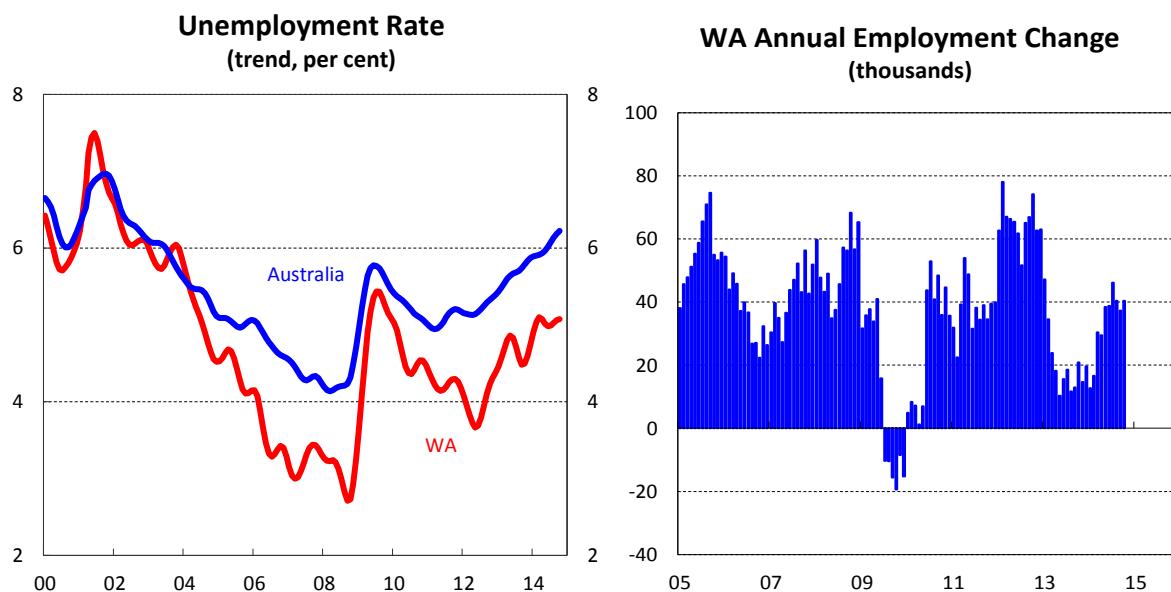
level of activity in the near-term. There remain some notable projects underway, including the \$5.6bn Perth City Link urban renewal project and the \$2.6bn Elizabeth Quay development. For this year, non-residential commencements are being led by the AFL Stadium worth over \$800mn and work beginning on Crown Towers Perth.

Labour Market

Western Australia's labour market has been resilient, despite the headwinds within the mining sector. Job growth in Western Australia was the strongest across all States in the year to October, lifting 40.3k. However, job growth has slowed from earlier years, and resulted in a lift in Western Australia's unemployment rate. The unemployment rate lifted from a cyclical low of 3.5% in June 2012 to 5.2% in October 2014.

Softer labour market conditions are reflecting job losses in the mining industry, which lost 11.7k in the year to August. However, low interest rates are providing support to job growth in other areas of the economy. Retail trade (23.3k) and rental, hiring & real estate industries (9.2k) more than offset the job losses in the mining industry. Other industries that added jobs were in professional, scientific & technical services (22.4k) and healthcare & social assistance (16.5k).

While Western Australia's unemployment rate remains the lowest among all States, the gap is closing. In the near-term, job growth should be supported by the high level of construction activity underway. However, job prospects are becoming less promising, as more projects approach completion.



St.George Banking Group Forecasts

Economic Indicators, % Change					
	2012-13	2013-14 (f)	2014-15 (f)	2015-16 (f)	2016-17 (f)
Gross State product	5.10	5.50	2.70	4.00	5.50
State Final Demand	5.00	-1.90	-0.50	0.80	1.50
Employment	3.50	1.70	2.00	2.00	2.00
Unemployment Rate	4.40	4.80	5.30	5.40	5.40
Perth CPI	2.30	3.00	2.40	2.50	2.60
Wage Price Index	4.00	2.80	2.50	3.00	4.00

Source: St. George Banking Group

The Western Australian Treasury expects growth of 2.75% in 2014-15, slowing from estimated growth of 3.75% in 2013-14. Our forecast for growth in 2014-15 is similar at 2.70%, although our expectations for 2013-14 are significantly higher at 5.50%. Export volumes are expected to remain solid and low interest rates will support other areas of WA's economy.

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