OUTLOOK

June 2018 | Chamber of Commerce and Industry of Western Australia (Inc)

WA HOUSEHOLDS DINING OUT ON RENEWED OPTIMISM

ABOUT OUTLOOK

Outlook is CCIWA's biannual analysis of the Western Australian economy. All growth rates cited in **Outlook** are calculated in terms of year-on-year growth, comparing four quarters of data to the previous four quarters of data, unless otherwise stated. The editor of **Outlook** is Nathan Viles, Senior Economist.

Chamber of Commerce and Industry WA

OUTLOOK AT A GLANCE

The good news in this edition of *Outlook* is that 2017-18 is looking to have been a better year than expected. The central forecast for growth in the domestic economy (SFD) in 2017-18 is a decline of just -0.4 per cent, revised up from -2.5 per cent. Likewise, the central forecast for economic growth (GSP) this year is now 1.3 per cent, previously just 0.9 per cent. We are cautiously optimistic that the official figures at year's end could even outperform our forecast for household consumption and business investment.

The reason for this more positive outlook comes from a string of positive economic data in 2018 so far (with the exception of the labour market – more on that below). In particular, household consumption and business investment have found renewed strength this year and will likely contribute more to economic growth than looked possible late last year.

Sentiment is picking up too. Businesses and households are as confident in the economy as they have been since the resources investment boom. Cost-of-living pressures and household budget constraints still remain, but discretionary spending is showing signs of life again. For example, expenditure on hotels, cafes and restaurants grew 3.2 per cent in the year to March 2018, while consumption in recreation and culture grew by 1.2 per cent.

The downside in recent economic data is in the labour market. Since this financial year began, the unemployment rate has been as low as 5.3 per cent in July 2017 and as high as 6.9 per cent in March 2018. Given this significant rise, we have revised our forecast for the average unemployment rate in 2017-18 up from 5.8 per cent to 6.1 per cent. As there is perhaps more spare capacity in the labour market than we previously thought, a forecast for slightly weaker wages growth and inflation than in our previous edition of Outlook is looking more appropriate.

ECONOMIC FORECASTS FOR WESTERN AUSTRALIA (PER CENT)

Forecasts[1]	2016-17[2] Actual	2017-18 Forecast	2018-19 Forecast	2019-20 Forecast
Economic Activity				
Housing Consumption	0.5%	1.0%	1.5%	2.0%
Dwelling Investment	-19.8%	-10%	2%	5%
Business Investment	-28.6%	-5%	3%	5%
State Final Demand	-7.2%	-0.4%	2.2%	2.9%
Exports[3]	6.7%	6%	5%	4%
Imports[3]	-3.7%	-0.5%	2%	4%
Gross State Product	-2.7%	1.3%	3%	3%
Labour Market				
Unemployment Rate	6.2%	6.1%	6.0%	5.8%
Inflation	0.6%	0.9%	1.6%	1.9%
Wages	1.4%	1.5%	1.9%	2.3%

Footnotes:

1 Forecasts are produced in terms of year-on-year growth, comparing four quarters of data to the previous four quarters of data.

2 Actual outcomes as reported in the 2016-17 State Accounts (ABS Cat. 5220.0).

3 Exports and imports figures are for goods and services trade measured on a Balance of Payments basis.

ECONOMIC GROWTH

	State Final Demand	Gross State Product
2016-17 Actual	-7.2%	-2.7%
2017-18 Forecast	-0.4%	1.3%
2018-19 Forecast	2.2%	3%
2019-20 Forecast	2.9%	3%

The Western Australian economy has continued on its path of gradual recovery in the first half of 2018. Since the last edition of Outlook (February 2018), our forecasts for business investment and economic growth have been revised up.

We track economic growth in each of its components and how they interact with the rest of the economy. Growth in the domestic economy (i.e. State Final Demand) has been negative for the past four and a half years, in most part due to the winding down of the resources investment boom. The level of business investment peaked at $85 billion in 2012 but has since fallen to around $38 billion per year. The upside in recent economic data is that business investment has stopped falling, for now.

Meanwhile, other components of the economy have helped counteract the weight of falling business investment. Household consumption is approaching $110 billion per year, which is over 50 per cent of domestic economy activity. Hence, small changes in household consumption can have a substantial effect on the headline economic growth figures. A contributing factor to the -2.7 per cent contraction in the WA economy in 2016-17 was weak household consumption growth, which was unexpected at just 0.5 per cent. More recently though, growth in household spending has been tracking at 1.5 per cent, and we are cautiously optimistic that our forecast of 1.0 per cent for 2017-18 will be realised when the official State Accounts data is released in late 2018.

Strong exports have also contributed to reviving WA's economic growth. Our exports of goods and services now contributes over $120 billion per year to the economy. Goods sent overseas now accounts for 95 per cent of the value of our exports, which largely reflects the volume of iron ore and LNG now being produced. Our forecast of 6 per cent growth in exports in 2017-18 is on track.

HOUSEHOLD CONSUMPTION

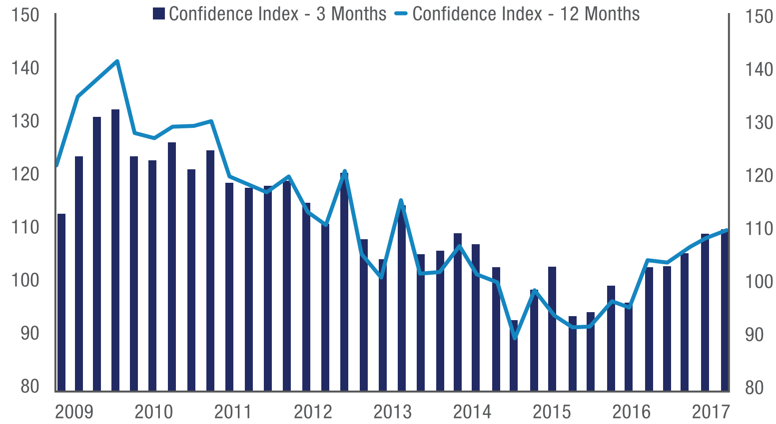
	Household Consumption
2016-17 Actual	0.5%
2017-18 Forecast	1.0%
2018-19 Forecast	1.5%
2019-20 Forecast	2.0%

There are signs of a strengthening household sector after a year of reserved spending in 2016-17. While consumption only grew by 0.5 per cent in 2016-17, the latest data has consumption growing at a rate of 1.5 per cent in the year to March.

While some cost-of-living pressures still remain, aggregate spending on electricity and gas is down 10.4 per cent in the year to March 2018. Another positive development is that discretionary spending in some areas is beginning to re-emerge. For example, expenditure on hotels, cafes and restaurants grew 3.2 per cent in the year to March 2018, while consumption in recreation and culture grew by 1.2 per cent. Major household purchases are still yet to show signs of improvement, with purchases of new vehicles down 2.4 per cent in annual terms.

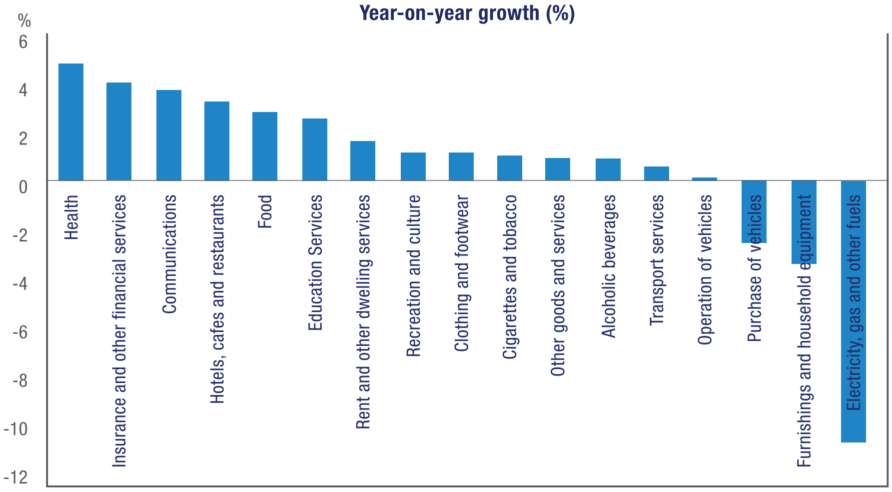
The latest edition of the *CCIWA Consumer Confidence Survey* shows consumer confidence is at a four-year high. While this strength in confidence is coming off a low base, it is broad based with optimism growing in job prospects and personal finances (both at two-year highs). However, this optimism is likely to take a little longer to materialise into transactions, as more than two-thirds of surveyed consumers (68 per cent) report that they are unlikely to make a major household purchase in the next three months.

CONSUMER CONFIDENCE
WA Economic Conditions



Index100 = : 2016/17 Average
Source: CCIWA

COMPONENTS OF HOUSEHOLD CONSUMPTION
Year-on-year growth (%)



Sources: CCIWA, ABS

CCIWA EXPECTS THAT 2017-18 WILL BE THE LAST YEAR THAT BUSINESS INVESTMENT WILL FALL

BUSINESS INVESTMENT

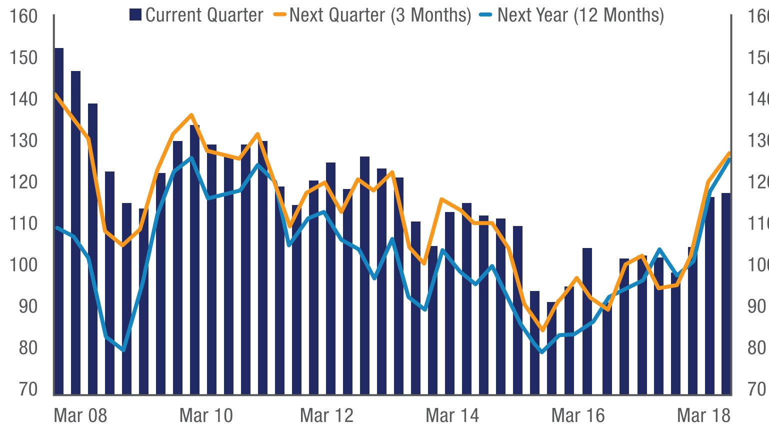
	Business Investment
2016-17 Actual	-28.6%
2017-18 Forecast	-5%
2018-19 Forecast	3%
2019-20 Forecast	5%

The level of business investment in Western Australia has remained relatively flat for almost two years now at about $9.5 billion per quarter. CCIWA expects that 2017-18 will be the last year that business investment will fall, in year-on-year growth terms. We have revised up our forecast for business investment from 15 per cent fall in 2017-18 to -5 per cent given the strength of recent economic data.

The fall in business investment has been largely due to a fall in non-dwelling construction, but this component is now being offset somewhat by positive growth in machinery and equipment and cultivated biological resources. Intellectual property products (around $1 billion per quarter) are also trending towards positive growth once more.

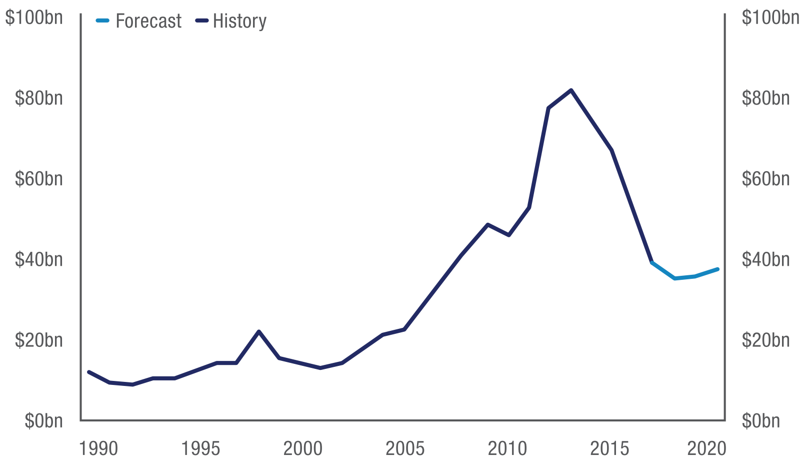
The latest edition of the *WA Super – CCIWA Survey of Business Confidence* shows business confidence at its highest level since 2011. This growing optimism in the business community appears to be widespread, with similar highs found in various other state and national surveys. In Western Australia, mining businesses continue to be the most optimistic about business conditions. Around 50 per cent of mining businesses expect to increase capital expenditure in the last quarter of 2017-18, in contrast to just 21 per cent of manufacturing businesses.

BUSINESS CONFIDENCE
Current, 3 and 12 month expectations



Index100 = : 2016/17 Average
Source: CCIWA

WA BUSINESS INVESTMENT



Source: CCIWA, ABS

DWELLING INVESTMENT

	Dwelling Investment
2016-17 Actual	-19.8%
2017-18 Forecast	-10%
2018-19 Forecast	2%
2019-20 Forecast	5%

The housing market is tracking as expected, with a very gradual pick up in population growth and the Perth Residential Property Price Index finally approaching the bottom of its fall. The latest REIWA Market Update shows median house prices rising in some pockets of Perth including Claremont, Swan View, and the North-East and South-East Metro areas.

Monetary policy continues to take an accomodative stance, and recent commentary from regulators suggests that there is little appetite for further macroprudential controls at this time. The ASX RBA Rate Indicator, which is inferred from trading data, shows that the market is still only expecting one 25 basis point rise in the next twelve months.

The *WA Housing Industry Forecasting Group* – of which CCIWA is a member – has held steady with its forecast of 19,500 commencements for the 2017-18 financial year in its April 2018 market update. We are also keeping our forecast for the value of dwelling investment in 2017-18 the same as last edition of Outlook – dwelling investment is on track to record just a 10 per cent decline (in contrast to -20 per cent last year). Our expectation is still that a recovery in dwelling investment will lag the other components of the domestic economy (household consumption and business investment), but positive growth could return as early as 2018-19.

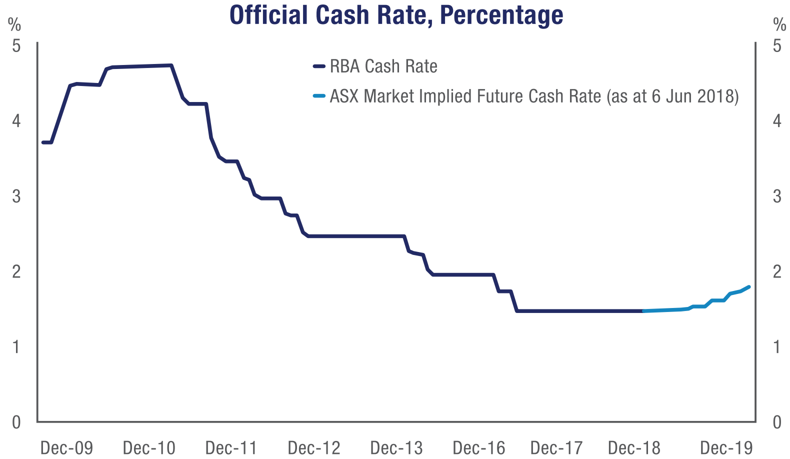
INTERNATIONAL TRADE

	Exports	Imports
2016-17 Actual	6.7%	-3.7%
2017-18 Forecast	6%	-0.5%
2018-19 Forecast	5%	2%
2019-20 Forecast	4%	4%

Exports are still playing a major role in Western Australia's economic recovery, now contributing just over $120 billion annually. It is the single largest component of our economy and has helped offset the decline in business investment. However, it is worth noting that a dollar in exports will not flow through to job creation to the same degree as a dollar in business investment. Around 95 per cent of the value of exports is now attributable to trading goods, particularly bulk commodities such as iron ore and LNG. Services provided to overseas buyers may only be a small component of our trade, but still accounts for $1.5 billion every quarter.

We have kept our forecast for export growth at 6 per cent for 2017-18. The forecast profile still reflects slightly smaller growth in 2018-19 and 2019-20; however, the contribution that this growth will make to the economy is still significant. There is less regular data available on imports, so our imports forecasts should be interpreted with a wider margin of error. Nonetheless, as conditions in consumer confidence and household finances continue to improve, gradual growth in imports should be expected.

MONETARY POLICY
Official Cash Rate, Percentage



Source: ASX, CCIWA, RBA

UNEMPLOYMENT

	Unemployment Rate
2016-17 Actual	6.2%
2017-18 Forecast	6.1%
2018-19 Forecast	6.0%
2019-20 Forecast	5.8%

The headline unemployment rate increased sharply over the first quarter of 2018, recording a 16-year high of 6.9 per cent in March. While some volatility in the unemployment rate data should be expected, the underlying trend rate is now above 6 per cent and rising. Our view is that the recent change in labour market conditions is likely too great to simply be measurement error in the Australian Bureau of Statistics survey – there's real changes occurring to the degree of 'spare capacity' in our workforce. However, despite increasing spare capacity in the labour market, the economy continues to expand.

A contributing factor to the rise in the unemployment rate is a rise in the participation rate, which is currently at 68.5 per cent and trending upwards. More people have returned to actively looking for work, which immediately increases the size of the 'unemployed' pool. There are several possible reasons why these people have returned to job searching, including a return from study or parental leave, and increased optimism in their ability to find a job.

Part-time job creation has acted as a 'shock absorber' in the Western Australian economy over the past three years, helping to soften the blow when full-time job creation has been in decline. While this has helped keep the unemployment rate lower than it otherwise would have been, there was a slow build up of workers who were being underutilised. However, this trend is now in decline. The proportion of underutilised part-time workers – that is, part-time workers who would prefer to work more hours – has declined from 33 per cent to 28 per cent over the past year and a half.

WAGES AND INFLATION

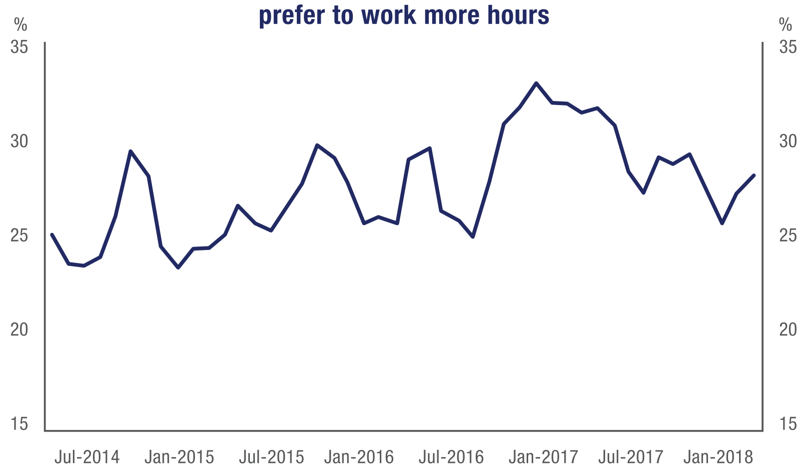
	Inflation	Wages
2016-17 Actual	0.6%	1.4%
2017-18 Forecast	0.9%	1.5%
2018-19 Forecast	1.6%	1.9%
2019-20 Forecast	1.9%	2.3%

The labour market, inflation and wages growth are fundamentally linked. When the demand for skilled labour grew during the resources investment boom, the prevailing wage level in the market increased to attract workers to the State. That has more or less unwound itself now and some CCIWA members are starting to identify skills shortage risks in key industries like construction and mining.

Given the rise in the unemployment rate over the first quarter of 2018, we have revised our forecast profile for inflation and wages down slightly. The degree of spare capacity in the labour market is most likely expanding again, increasing the competition for jobs and placing less pressure on wages growth. However, we still expect wages growth and inflation to pick up gradually over the forecast horizon.

Inflation pressure is building from market prices in alcohol and tobacco, health, transport, education and insurance and financial services. However, food and non-alcoholic beverages, clothing and footwear, and communication market prices continue to drop.

UNDEREMPLOYMENT
Proportion of part-time workers who would prefer to work more hours



Source: CCIWA, ABS