

OUTLOOK

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

WESTERN AUSTRALIA'S TURNING POINT



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

Western Australia is at a turning point. After a year of negative economic growth, we are forecasting a return back to the black in 2017-18.

Business and consumer confidence are both at a four-year high, over 15,000 full-time jobs have been created in the past twelve months, exports are growing at 5 per cent per year, business investment increased by 5 per cent in the year to September 2017, and wages are growing at 1.3 per cent. However, dwelling investment has declined by a further 10 per cent and households are only consuming 0.8 per cent more than they were a year ago.¹

While some sectors of the WA economy are expected to take longer to return to positive growth than others, overall, the Chamber of Commerce and Industry of Western Australia (CCI) is optimistic about the future. We forecast that the whole state economy will grow by 0.9 per cent this year, and will continue to improve, albeit slow and steady.

The key indicators we expect to improve in 2018 include: slightly stronger wages growth spurring on household consumption; business investment continuing to moderate and reach the bottom of its fall from the peak; and strong resource exports continuing to set record volumes as new operations come online. Looking further ahead, a return to positive growth in business investment in WA is likely to be supported by the current level of planned

investment in resource projects, including further export infrastructure.

At a glance, we predict that we are 95 per cent of the way down the business investment cliff, which means the sharpest decline in investment is behind us. We expect exports to grow by around 6 per cent this year as more LNG and iron ore is shipped abroad and commodity prices rally slightly higher than last year.

The flexibility in the labour market has continued to take the sting out of the end of the resources investment boom. Substantial 'spare capacity' in the labour market emerged as businesses reduced their investment in WA. Many of the employees in

the resources sector that were attracted to WA through high wages have now returned to other states where there is currently a surge in major infrastructure projects.

As a result, WA's population growth has slowed down but it is still growing. The good news is that this has helped keep the unemployment rate lower than it otherwise could have been, and the amount of unused potential in the labour market is coming down. The participation rate is also increasing again as more people are returning to the workforce. The WA unemployment rate is currently tracking close to the national average. CCIWA anticipates the unemployment rate to average around 5.8 per cent over 2017-18.

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%	-15%	3%	5%
State Final Demand	-7.2%	-2.5%	2.4%	2.6%
Exports ³	6.7%	6%	5%	4%
Imports ³	-3.7%	-0.5%	2%	4%
Gross State Product	-2.7%	0.9%	3%	3%
Labour Market				
Unemployment Rate	6.2%	5.8%	5.6%	5.5%
Inflation	0.6%	1.3%	2.0%	2.3%
Wages	1.4%	1.7%	2.4%	2.8%

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.

¹ Calculated in terms of through-the-year growth, comparing the latest quarter of data to the same quarter in the previous year.



BUSINESS AND CONSUMER CONFIDENCE ARE BOTH AT A FOUR-YEAR HIGH.

ECONOMIC GROWTH

	State Final Demand	Gross State Product
2016-17 Actual	-7.2%	-2.7%
2017-18 Forecast	-2.5%	0.9%
2018-19 Forecast	2.4%	3%
2019-20 Forecast	2.6%	3%

Headlines were made late last year when the annual ABS State Accounts data revealed that WA's economy (GSP) had contracted by 2.7 per cent over the 2016-17 financial year.

Overall, CCI anticipates that the economy will grow by 0.9 per cent in 2017-18. As business investment and dwelling investment begin to recover over the forecast horizon and exports maintain at a strong level, we forecast the economy to grow by around 3 per cent in 2018-19 and 2.7 per cent in 2019-20.

The quarterly domestic data underlying the headline contraction in the economy across 2016-17 tells a slightly more positive story. Business investment fell by 17 per cent in the first quarter of last financial year, then remained fairly flat over the next three quarters. Consistent with this moderation, the *WA Super – CCI Survey of Business Confidence* reported business confidence at a four-year high in the December quarter 2017. Encouragingly, over half of the mining industry businesses surveyed reported that they expect their capital expenditure to increase in the next quarter.

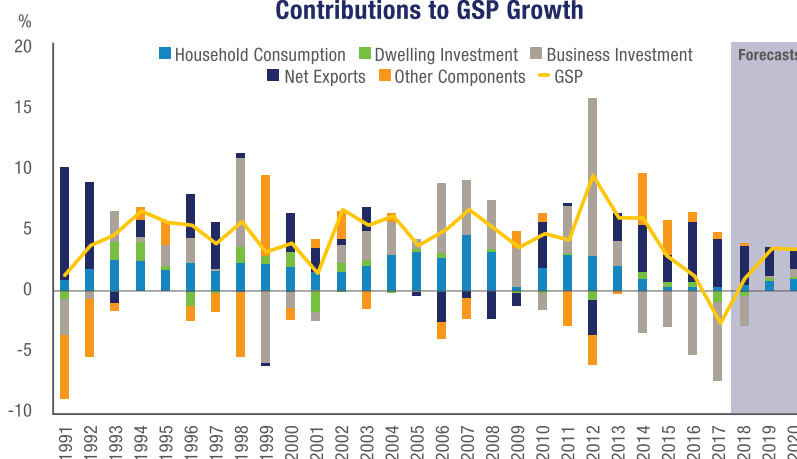
While export volumes set new records last financial year, imports of goods and services held up stronger than expected given the relatively low AUD/USD exchange rate, only declining by 3.7 per cent in 2016-17 after declining by 11.1 per cent in 2015-16.

Figure 1 shows how each of these components of the WA economy contributed to overall growth. Each coloured bar represents a different component of the economy and its contribution to economic growth (positive or negative), and the Gross State Product (GSP) line is the sum of the coloured bars representing overall economic growth. Household consumption and net exports in 2016-17 still contributed to positive growth but not as much as in previous years. Business investment and dwelling investment were the major components weighing down on growth

last financial year. Looking ahead, our forecasts for the next three financial years have business investment and dwelling investment detracting less from economic growth than in recent years and household consumption with a larger positive contribution to growth.

By industry, the biggest contributions made to economic growth in 2016-17 came from mining (adding 0.5 percentage points to GSP), financial and insurance services (adding 0.4 percentage points to GSP), and health care and social assistance (adding 0.3 percentage points to GSP). The industries which contracted the most in 2016-17 were public administration and safety (-0.3 percentage points from GSP), professional, scientific and technical services (-0.7 percentage points from GSP), and construction (-2.8 percentage points from GSP).

Figure 1 **WHAT WILL DRIVE GROWTH IN THE WESTERN AUSTRALIAN ECONOMY?**
Contributions to GSP Growth



Source: CCIWA, ABS

Notes: 'Other Components' includes government expenditure and investment, ownership transfer costs, the ABS Balancing item and statistical discrepancy.

CCIWA FORECASTS THAT WE ARE 95 PER CENT OF THE WAY DOWN THE BUSINESS INVESTMENT CLIFF.

HOUSEHOLD CONSUMPTION

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

Household consumption is the largest component of the domestic economy. Even a small difference in how fast consumption grows can have a significant impact on economic growth. Households only consumed 0.5 per cent more in 2016-17 than they did in the year prior. This is particularly low given that the average increase in the years since the peak of the resources investment boom has been 1.5 per cent. While the growth was still positive, it was not the strong pillar of growth as it has been in previous years.

The latest *CCI Survey of Consumer Confidence* for the December quarter 2017 reported that only 27 per cent of consumers anticipate that the WA economy will worsen over the next 12-months, however 70 per cent identified living costs as the most important factor influencing their confidence. Like business confidence, the headline index for consumer confidence is currently at a four-year high which provides some optimism for household consumption in 2017-18. A stable political environment, subdued interest rates, and minimal inflationary pressures have contributed to this boost in consumer confidence, with WA consumers remaining cautious about slow wages growth, high household debt and a weak property market.

BUSINESS INVESTMENT

	Business Investment
2016-17 Actual	-28.6%
2017-18 Forecast	-15%
2018-19 Forecast	3%
2019-20 Forecast	5%

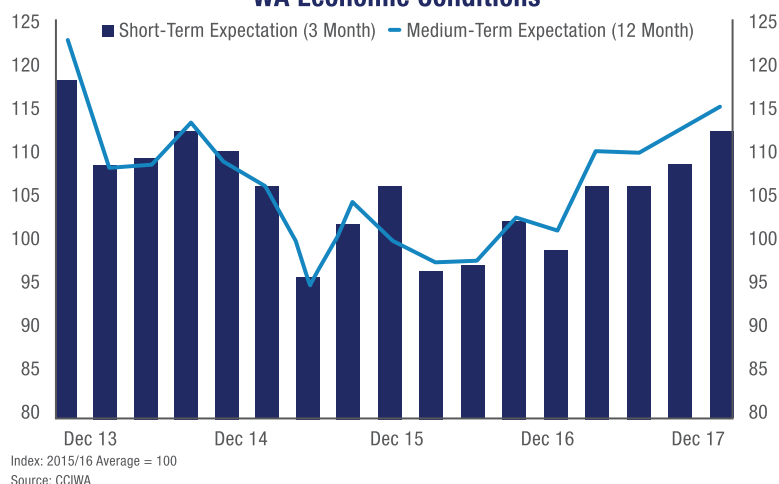
Looking back at the profile of business investment in WA illustrates the story of the resources investment boom in our economic history. Investment levels increased from around \$20 billion in 2005 to \$80 billion in 2012. The decline from this peak back to a more 'normal' level over the past few years is the main driver influencing the labour market and industries associated with mining.

The profile of business investment over the next few years is looking more stable. While there are less large-scale projects on the horizon than were typical during the boom, there is more than enough small investment potential to sustain the forecast levels of business investment going

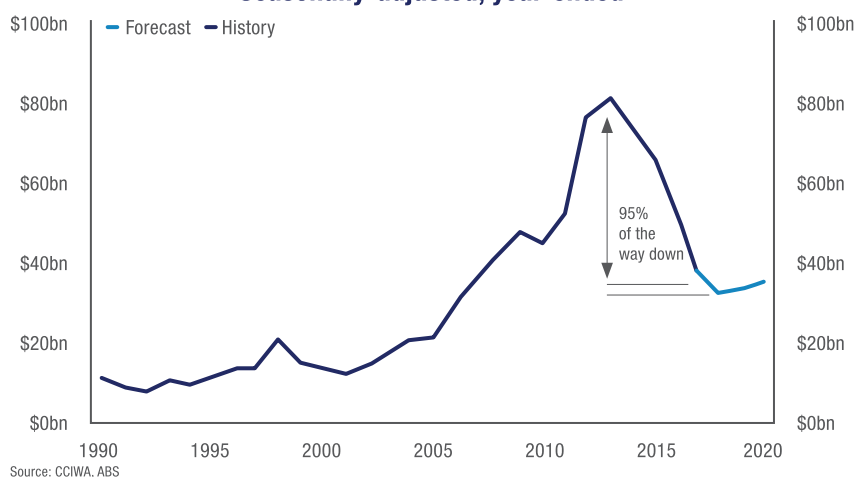
forward. CCI anticipates that the turning point in business investment will occur in the next financial year. Overall, our forecast is for a further 15 per cent decline in business investment this year, followed by 3 per cent and 5 per cent growth in 2018-19 and 2019-20, respectively.

Our outlook is informed by results from the latest *WA Super-CCI Survey of Business Confidence* which reported that the majority of WA businesses (62%) are anticipating no changes to their investment levels over the next quarter. Businesses in the mining industries remain bullish however, with over half (53%) reporting that they expect to increase capital expenditure.

CONSUMER CONFIDENCE WA Economic Conditions



WA BUSINESS INVESTMENT Seasonally-adjusted, year-ended





DWELLING INVESTMENT

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

Dwelling investment declined by around 20 per cent in 2016-17, which was the first decline in annual figures since the peak of the resources investment boom. The outlook for dwelling investment over the next few years is reflective of three different factors playing out. First, population growth is gradually coming out of its trough after growing at 0.5 per cent per year. While net interstate migration is still negative, which means that more people are leaving WA than arriving from other states, the natural increase in population and overseas migration are currently supporting an increasing population. This will slowly help soak up some of the excess housing supply that is taking some time to clear.

Second, residential property prices are still declining in Perth, albeit at a marginally slower pace than in recent history. As higher population growth helps clear some of the excess housing supply in the market, prices should begin to stabilise and find a new equilibrium. We expect stable prices to precede a return to positive growth in dwelling investment.

Lastly, low interest rates are continuing to support a favourable environment for dwelling investment. The ASX RBA Rate Indicator, which shows market expectations of a change in the official cash rate,

suggests that a rise is more likely than further cuts. However, the rise is forecast to be slow and gradual, with only a 25 basis point rise expected in the next 12 months.

In consideration of these factors, our forecast for dwelling investment is a further 10 per cent decline this financial year before returning to positive growth next financial year.

INTERNATIONAL TRADE

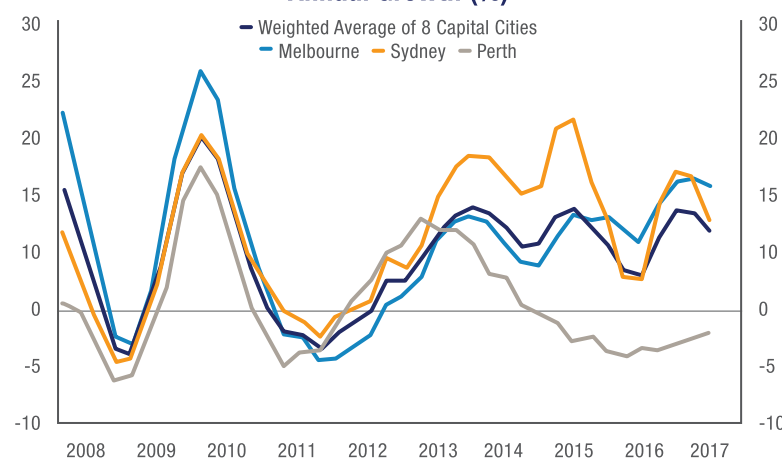
	Exports	Imports
2016-17 Actual	6.7%	-3.7%
2017-18 Forecast	6%	-0.5%
2018-19 Forecast	5%	2%
2019-20 Forecast	4%	4%

Exports contributed close to \$118 billion to the WA economy in 2016-17, which is just over 50 per cent of GSP. Strong exports are being supported by several large resource projects coming online and

reaching capacity. The iron ore spot price has also gained a little this financial year so far which will support strong export growth again in 2017-18. New LNG capacity is also expected to come online in the near future. On current indicators, CCI anticipates export growth of around 6 per cent in 2017-18 and around 5 per cent in 2018-19.

Imports declined by 3.7 per cent in 2016-17, driven almost entirely by a decline in imported services. While there is less reliance on imported goods to service construction in the mining sector, imports are expected to strengthen in line with higher growth in wages and household consumption. An appreciation in the AUD/USD exchange rate would also contribute to imports growth. Overall, CCI anticipates a 0.5 per cent decline in imports this financial year in line with weaker household consumption growth, before 2 per cent and 4 per cent growth in 2018-19 and 2019-20, respectively.

RESIDENTIAL PROPERTY PRICE INDEX Annual Growth (%)



Source: CCIWA, ABS



UNEMPLOYMENT

	Unemployment Rate
2016-17 Actual	6.2%
2017-18 Forecast	5.8%
2018-19 Forecast	5.6%
2019-20 Forecast	5.5%

Flexibility in the labour market has taken some of the sting out of the adjustment that has taken place in the economy. Over the past two years, as full-time jobs were in decline, part-time jobs were being created. Although this contributed to an increase in the underutilisation rate, it allowed flexibility in working arrangements and may have prevented an even larger contraction in household consumption and the broader economy.

Over the past 12 months, full-time job creation has returned to positive territory again with over 15,000 new full time jobs. While early indicators of labour market conditions improving were met with some scepticism, we find the latest figures consistent with spare capacity finally being put to productive use in the economy. In support of this, the underutilisation rate has begun to drop and the youth unemployment rate is now at 13.5 per cent.

CCI expects labour market conditions to continue to improve as population growth gathers some strength and the economy returns to positive growth. In 2017-18 the unemployment rate is anticipated to average around 5.8 per cent. Looking

further ahead, we forecast unemployment of 5.6 per cent and 5.5 per cent in 2018-19 and 2019-20, respectively.

Our forecast is informed by the latest *WA Super-CCI Survey of Business Confidence* which reported improvements in business sentiment around employment, with 80 per cent of WA businesses identifying that they expect to increase or keep their staff levels stable over the coming quarter (December 2017 edition).

WAGES AND INFLATION

	Inflation	Wages
2016-17 Actual	0.6%	1.4%
2017-18 Forecast	1.3%	1.7%
2018-19 Forecast	2.0%	2.4%
2019-20 Forecast	2.3%	2.8%

In line with a declining underutilisation rate and a rising participation rate so far in 2017-18, the outlook for wage and inflation pressures is strengthening. While wages growth has been stubbornly low for some time now in advanced economies around the world, there are some signs emerging of a more 'normal' response in wages growth to the decline in the unemployment rate. There are few other sources of price inflation pressure in WA at the moment besides an eventual increase in wages. Inflation in Perth last year came in at just 0.6 per cent. After wages growth of 1.4 per cent last financial year, CCI forecasts slightly higher wages growth of 1.7 per cent this financial year before increasing to 2.4 per cent growth in 2018-19. Perth inflation is expected to rise in line with wages growth, with 1.3 per cent this financial year and 2.0 per cent in 2018-19.

WA FULL-TIME & PART-TIME JOB CREATION 12 Month Rolling Difference

