

OUTLOOK

Will we bottle it?



inflation



Outlook is the Chamber of Commerce and Industry of Western Australia's biannual analysis of the WA economy. All growth rates cited in *Outlook* are calculated in terms of annual average growth, comparing four quarters of data to the previous four quarters of data, unless otherwise stated.

Editor: Sam Collins, Senior Economist.



Economic outlook

Economic Forecast for Western Australia

Forecasts ^{1,2}	2021-22 Actual	2022-23 Forecast	2023-24 Forecast	2024-25 Forecast
Economic Activity				
Household Consumption	5.6%	3.0%	0.75%	2.25%
Dwelling Investment	2.3%	-1.75%	8.0%	-1.25%
Business Investment	4.0%	4.0%	9.0%	2.5%
State Final Demand	5.6%	3.5%	2.75%	2.0%
Exports	-3.2%	6.5%	1.5%	0.5%
Imports	0.2%	10.5%	6.0%	2.0%
Gross State Product	3.1%	4.5%	1.75%	1.25%
Labour Market and Prices				
Unemployment	3.75%	3.5%	4.0%	4.0%
Inflation	6.0%	6.5%	3.75%	2.75%
Wages	2.2%	3.75%	3.5%	3.5%

Footnotes:

¹ Actual outcomes are as reported in the 2021-22 State Accounts, updated with the latest State Final Demand and Balance of Payments data.

² Forecasts for economic activity are produced in terms of annual average growth, comparing four quarters of data to the previous four quarters of data.

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Outlook at a glance

The world economy teeters on a knife-edge.

Global interest rates are increasing at their fastest pace in history in response to sky-rocketing inflation, while at the same time legacy stimulus measures continue to bolster economies.

Western Australia is one of the most trade-exposed economies in the world; its businesses cannot hide from these global factors. Indeed, CCIWA's latest *Business Confidence* survey reveals 75 per cent of local businesses see rising operating costs hurting their ability to do business over the next 12 months. Meanwhile, labour shortages continue to bite, with nearly four out of five businesses still struggling to fill a vacancy. Together, these factors make for a tough business environment.

In terms of further downside risk, the Russia-Ukraine conflict has room to escalate, which would further disrupt food security, energy prices and supply chains throughout the global economy. US and Chinese relations also remain frosty, and any escalation of tensions would have ramifications for us.

There are signs, however, that many of the issues ailing the global economy are set to abate.

The reopening of China following extensive lockdowns should support global growth in the near term, as demand and supply capacity in the country pick up. Barring any new lockdowns or major COVID outbreaks, the relaxation of restrictions should also see a further easing of supply chains for one of the world's key global

trading hubs. On balance, we expect China's reopening to put downward pressure on inflation.

And while the US Federal Reserve has recently indicated it may increase the pace of interest rate increases, it is undeniably the case that inflation rates are coming down across the world. Global commodity prices, including key energy benchmarks, have also fallen from their recent highs in 2022, feeding expectations that inflation will ease over the year. It is also important to recognise that despite the rapid pace of interest rate increases, key economies such as the United States remain resilient.

Supply chain issues more broadly are easing. The cost of shipping freight through China is now near pre-COVID levels after increasing almost seven-fold throughout the height of the pandemic, while the New York Federal Reserve's global supply chain pressure index has dropped to its lowest reading since November 2020. On the home front, our latest *Business Confidence* survey has also found the number of businesses viewing supply chain disruptions as a barrier to doing business has fallen to its lowest value in nine months. While still a key issue to navigate, cooling demand over 2023 should see supply chain disruptions ease further.

Now the fundamental question is whether economies and central banks can engineer a so-called 'soft landing', whereby interest rates increase enough to cool inflation, but don't pull the rug from under the global economy.

The evidence outlined above and throughout this report suggests they can.

Against this backdrop, Western Australia's economic fundamentals remain as solid as ever. Our domestic economy is now 12 per cent bigger than what it was pre-COVID and the number of Western Australians in full-time work continues to grow. Both the household and business sectors have driven this performance, with WA's strong jobs market stimulating consumer spending while the strength of the resources sector has propelled business investment.

Looking forward, the drive to decarbonise the world will continue to underpin commodity prices, generating wealth for Western Australians.

We cannot, however, rest on our laurels. Western Australia has a unique opportunity to capitalise on the rapid shifts occurring in the global economy, including changes in energy markets, shifting patterns of global trade, and advancements in technology. To attract the investment needed to grow and diversify our economy, a suite of policy measures is needed, including a greater trade and investment presence in the United States and a more competitive payroll tax regime. If we lay these policy foundations now, we can help to ensure future generations of Western Australians prosper in a changing world.

The following section details some of the key factors impacting Western Australia's immediate economic outlook.

China's reopening a welcome development for the global outlook

One of the more significant shifts to the global economy in recent months is China's relaxation of its zero-COVID policy. With one of the strictest lockdown regimes still ensuing at the time, the reversal of these measures in November last year surprised the world.

Despite the reopening initially weighing heavily on China's economy following a wave of infections, things appear to be turning. Both mobility data and economic activity have picked up in early 2023, following weak readings in December.

This has brought forward the expected recovery of consumption and supply capacity in China and removed some of the downside risk associated with the global outlook.

At the same time, Chinese authorities have announced new policy measures focusing on economic growth, with some of these looking to buoy the flailing property sector. At the Central Economic Working Conference in December 2022, top government officials pledged to focus on boosting consumption and the broader economy, setting the GDP growth target for 2023 at 'around 5 per cent'.

Earlier in November, China's Central Bank and banking regulator jointly issued a 16-point set of internal directives to promote the 'stable and healthy development' of the property sector which would assist in providing a soft landing. This follows years of property market instability with the introduction of the 'three red lines' policy in 2020 and has led to expectations of higher steel production, which is good news for WA's iron ore exporters.

There remains the risk that infection numbers continue to surge which would dampen economic activity and disrupt supply chains, particularly as there are concerns over the efficacy of China's vaccinations. However, the reopening of China should be seen as a positive development for the global economy, with the risk of some potential setbacks along the way.

Consumer spending will slow as the cost of living continues to rise...

The outlook for household consumption remains uncertain, as forces compete to tip consumption growth in both directions.

On the one hand, the savings buffers built up through the pandemic, combined with WA's tight labour market and strong outlook for wages should help maintain a solid level of baseline consumption. These factors have helped consumption remain more resilient than anticipated over the past six months. The extent to which households are willing to dip into their savings to maintain their current levels of consumption will also be an important factor in the outlook for consumption.

On the other hand, the rising cost of living and surging interest rates will force households to tighten their belts over the next year. Our latest *Consumer Confidence* survey has found that households are already cutting back spending, with more than four in five (84%) mortgage holders pulling back on consumption.

Household spending has continued to remain robust over the past six months despite this pickup in headwinds. However, if the current level of consumption does not begin to moderate as expected, then financial stress is likely to be heightened further.

This is particularly the case for households that were unable to build a savings buffer throughout the pandemic.

On balance, we expect growth in consumption to slow to 3.0% this year, before falling further to 0.75% in 2023-24 as the higher cost of living weighs on household budgets.

...But business investment is set to shore up the State's economy

While the slowdown in consumer spending will dampen the Western Australian economy, our strong business investment pipeline will help drive economic growth over the coming years.

We expect business investment to pick up further this year, primarily underpinned by big ticket items such as Woodside's Scarborough and Pluto 2 extension projects, along with a raft of newly announced projects in the resources and agricultural sectors. This, along with increasing investment in the growing critical minerals sectors from the sustainable energy transition, should support economic growth in the coming years.

At the same time, non-mining investment is likely to soften as rising cost pressures and labour shortages continue to weigh on project feasibility.

The reopening of China and policy support in the property sector has lifted expectations for steel demand, which will provide a source of support for iron ore exports. With iron ore majors expecting to operate close to capacity, this should help maintain solid baseline investment levels.

WA's jobs market remains tight, although there are signs it's easing

Western Australia's job market remains one of the strongest in the country, with the third lowest unemployment rate of all states.

Despite the unemployment rate increasing since the lows recorded in April 2022, WA's robust investment pipeline and the State Government's Asset Investment program is expected to support continued demand for WA-based workers. However, in a sign that labour shortages have eased slightly, the number of job vacancies in the state is declining despite remaining near record high levels.

The increase in overseas migration into Western Australia since the removal of border restrictions will also help ease labour shortages, however this won't be a quick fix. Delays in visa processing and the global demand for talent will weigh on the migration pipeline in the short term. As a result, we expect the unemployment rate to average 3.5 per cent this financial year.

One effect of this strong demand for workers is the flow on effect to wages. Our latest *Business Confidence* survey found labour shortages continues to be the biggest barrier to business, while three in five (60%) WA businesses have increased their base wages to attract and retain workers.

Reflecting this, we expect wages to grow 3.75 per cent this financial year, before moderating slightly in the following years.

Inflation remains high, but looks to have peaked

Consumers and businesses alike have been crushed by rising prices over the past 12 months. Our latest *Consumer Confidence* survey revealed nearly half (46%) of Western Australians have needed to dip into their savings to cover the higher cost of living so far, while our *Business Confidence* survey shows rising costs continue to eviscerate the profits of WA's SMEs.

There are signs, however, that inflation may have peaked. Rising interest rates finally look to be slowing consumer spending, while many of the supply chain issues that have hobbled our economy also appear to be easing.

Reflecting this, we expect inflation to peak in 2022-23 before easing gradually over the next two years, returning to the RBA's target band in 2024-25.



Western Australia's job market remains one of the strongest in the country, with the third lowest unemployment rate of all states.

We expect growth to be underpinned primarily by large-scale business investment, the State Government’s Asset Investment program and a strong pipeline of residential construction, although risks are tilted to the downside.

Economic growth

The Western Australian economy has remained resilient in the face of strong headwinds. Robust household consumption, solid activity in the resources sector and a strong jobs market have continued to fuel economic momentum over the past 6 months.

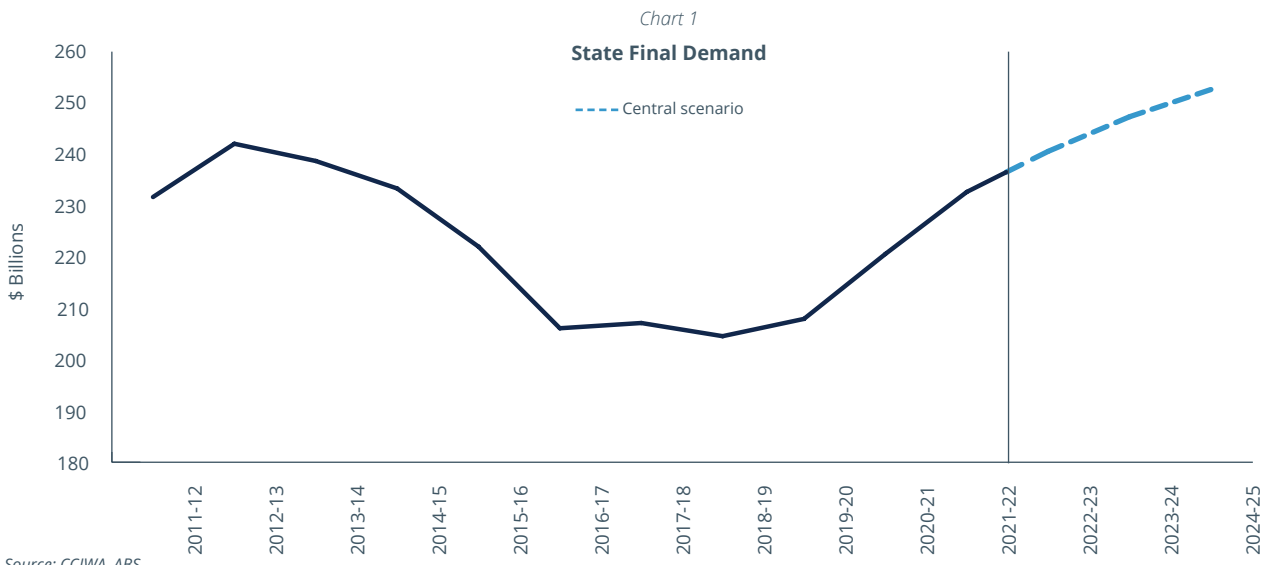
Looking ahead, the outlook for WA’s economy remains largely positive despite the well documented challenges ahead. We expect growth to be underpinned primarily by large-scale business investment, the State Government’s Asset Investment program and a strong pipeline of residential construction, although risks are tilted to the downside.

While headwinds have further intensified over the past six months, we consider a steep fall in economic activity

	2021-22	2022-23	2023-24	2024-25
Forecasts	Actual	Forecast	Forecast	Forecast
State Final Demand	5.6%	3.5%	2.75%	2.0%
Gross State Product	3.1%	4.5%	1.75%	1.25%

is unlikely. We expect domestic economic growth to slow to 3.5 per cent this financial year, as household consumption softens on the back of rising inflation and interest rates but remaining more resilient than initially anticipated. Ongoing labour shortages and elevated input costs have also softened the outlook for non-mining investment.

Growth in the overall economy (Gross State Product) is expected to pick up to 4.5 per cent this financial year, primarily due to the rebound in both goods and services exports following subdued readings in 2021-22.



Source: CCIWA, ABS

Household spending

The current financial year looks to be a tale of two halves for household spending. Western Australian household consumption has remained extremely resilient to start 2022-23, despite headwinds both here and abroad. Underpinning this has been high savings buffers built up over the pandemic, a labour market that continues to remain extremely tight and a pick-up in income growth helping boost spending levels.

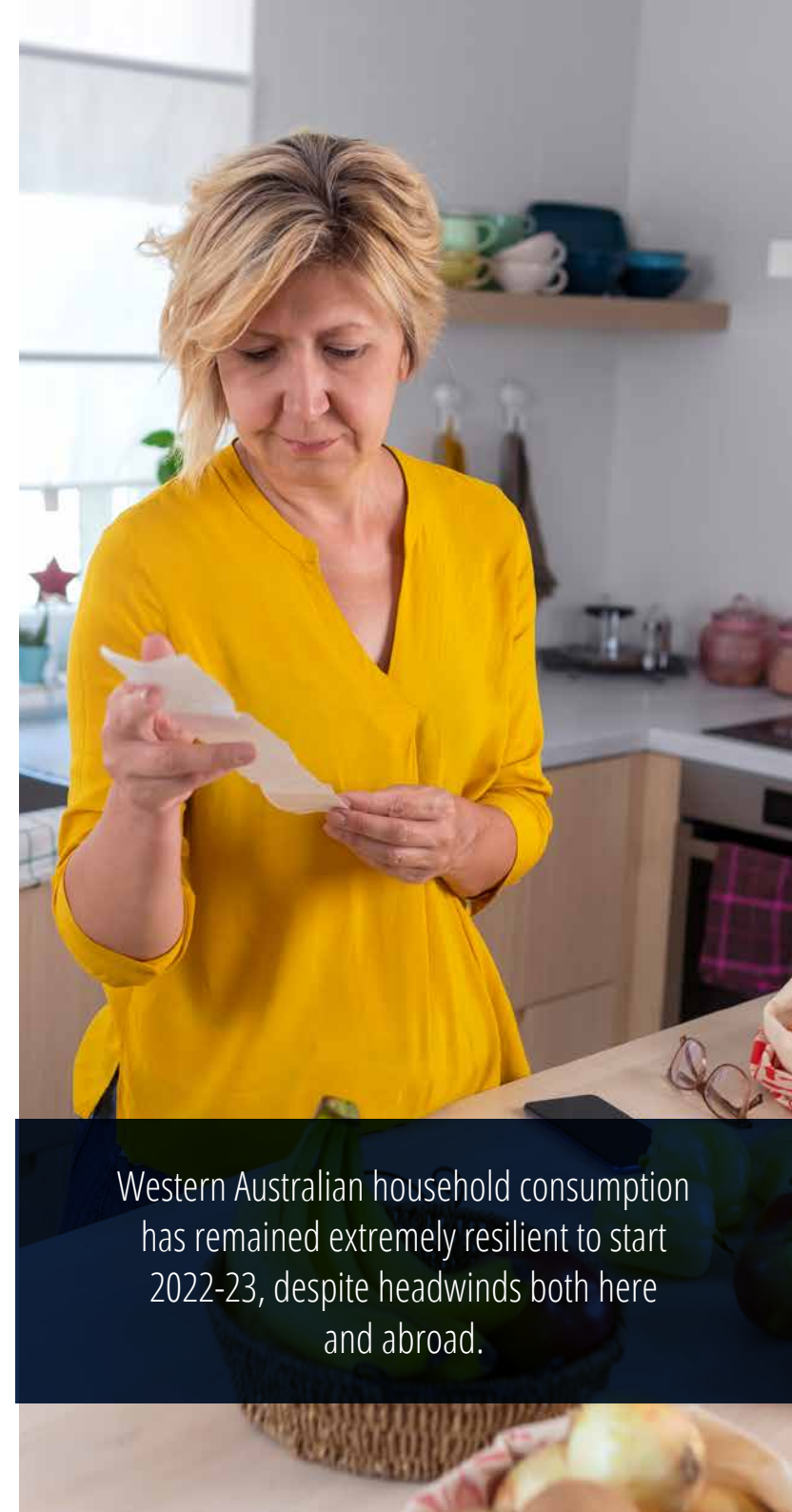
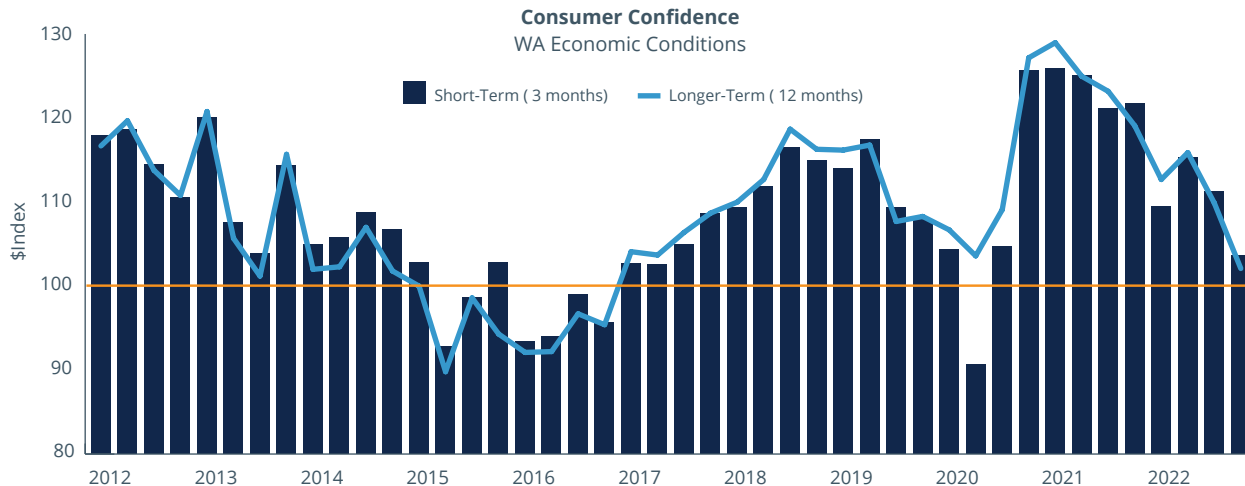
Looking ahead though is a different story, with early signs that consumption is set to ease. Rising interest rates and inflationary pressures will force households to tighten their belts, especially for the large number of fixed mortgage holders needing to refinance throughout the year.

	2021-22	2022-23	2023-24	2024-25
Forecasts	Actual	Forecast	Forecast	Forecast
Household Consumption	5.6%	3.0%	0.75%	2.25%

Indeed, CCIWA's latest *Consumer Confidence* survey found consumer confidence for the next 12 months is the lowest it has been since December 2016 (Chart 2), with around half of households already cutting back spending in recreation (54%), cafes and restaurants (54%) and consumer goods (52%). Additionally, retail trade volumes declined marginally over the December quarter, indicating spending has started to slow.

There are risks to this outlook in both directions. High savings buffers, low unemployment rates and a pick-up in wages growth may help maintain stronger than expected baseline consumption levels. On the other hand, additional increases to the cash rate, higher and more persistent inflationary pressures, and softer net migration levels may weigh further on spending. On balance, we expect consumption to grow by 3.0 per cent in 2022-23, before slowing further to 0.75 per cent in 2023-24.

Chart 2



Western Australian household consumption has remained extremely resilient to start 2022-23, despite headwinds both here and abroad.

Business investment

Difficult operating conditions have continued to challenge businesses over the back half of 2022. While supply chain disruptions have eased somewhat over the past 6 months, rising operating costs and labour shortages have persisted, delaying some investment spending and weighing on new project feasibility. Indeed, CCIWA's latest *Business Confidence* survey revealed a record difference between short- and long-term business confidence, reflecting uncertainty surrounding the macroeconomic conditions over the next year.

Despite this uncertainty, WA's business investment pipeline remains strong, and investment is set to accelerate as construction continues to ramp up on major LNG projects – namely Woodside's Scarborough and Pluto 2 extension. A raft of other newly announced projects, including Rio Tinto's Western Range iron ore project, OZ Minerals' West Musgrave Copper/Nickel project and CBH's Network Infrastructure and Assets project, has increased this pipeline over the forecast years.

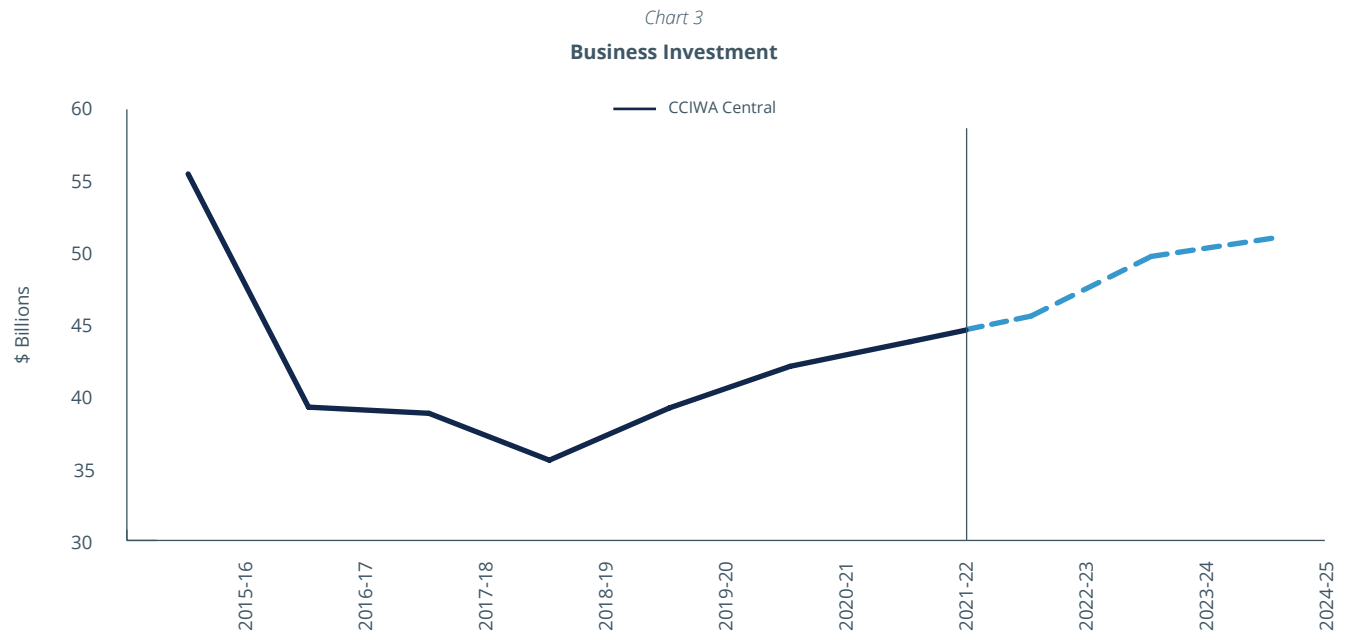
Additionally, WA's iron ore majors expect to sustain strong levels of production over the coming year, following solid results in the December quarter, which will help support robust baseline levels of capital expenditure. The ramp-up of new iron ore projects, including Rio Tinto's Gudai-Darri mine and BHP's South Flank, will also assist in boosting production levels.

Over the longer-term, the global acceleration toward decarbonisation and associated uptake of electric vehicles is expected to support growth in WA's critical and battery minerals sectors.

As such, we expect business investment to grow 4.0 per cent this financial year and 9.0 per cent in 2023-24, before moderating in 2024-25.

Key risks to the outlook include higher than expected inflation and prolonged labour shortages.

Forecasts	2021-22 Actual	2022-23 Forecast	2023-24 Forecast	2024-25 Forecast
Business Investment	4.0%	4.0%	9.0%	2.5%



Source: CCIWA, ABS

Dwelling Investment

WA's enormous construction pipeline has continued to blow out over the past six months. Accommodative borrowing conditions, combined with generous government support payments, triggered a surge in the number of housing builds being approved and under construction throughout 2021 and 2022 (Chart 4).

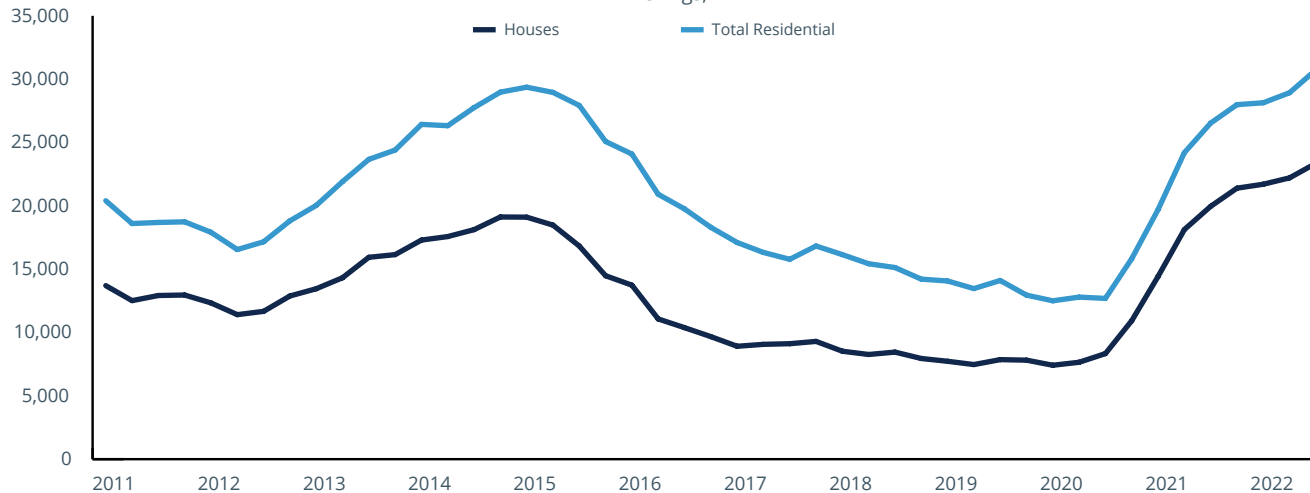
However, labour shortages, rapid cost escalation and rising interest rates have created significant challenges for both prospective homeowners and construction businesses over the past 12 months. This has led to an increase in reports of contract cancellations, while construction businesses have seen a sharp decline in profits, stifling the ability for many to bid for new work and in some cases leading to insolvency.

Reflecting this, the greenfield development pipeline remains weak. Lack of certainty around the cost and interest rate outlook has seen risk margins blow out and the feasibility of new projects compromised. As such, we expect few major residential developments to commence in the next 12 months.

Looking ahead, we expect dwelling investment to fall -1.75 per cent in 2022-23 as many of the issues plaguing the construction sector continue to bite, before accelerating to 8.0 per cent in 2023-24 as these issues begin to ease and much of the existing pipeline is completed.

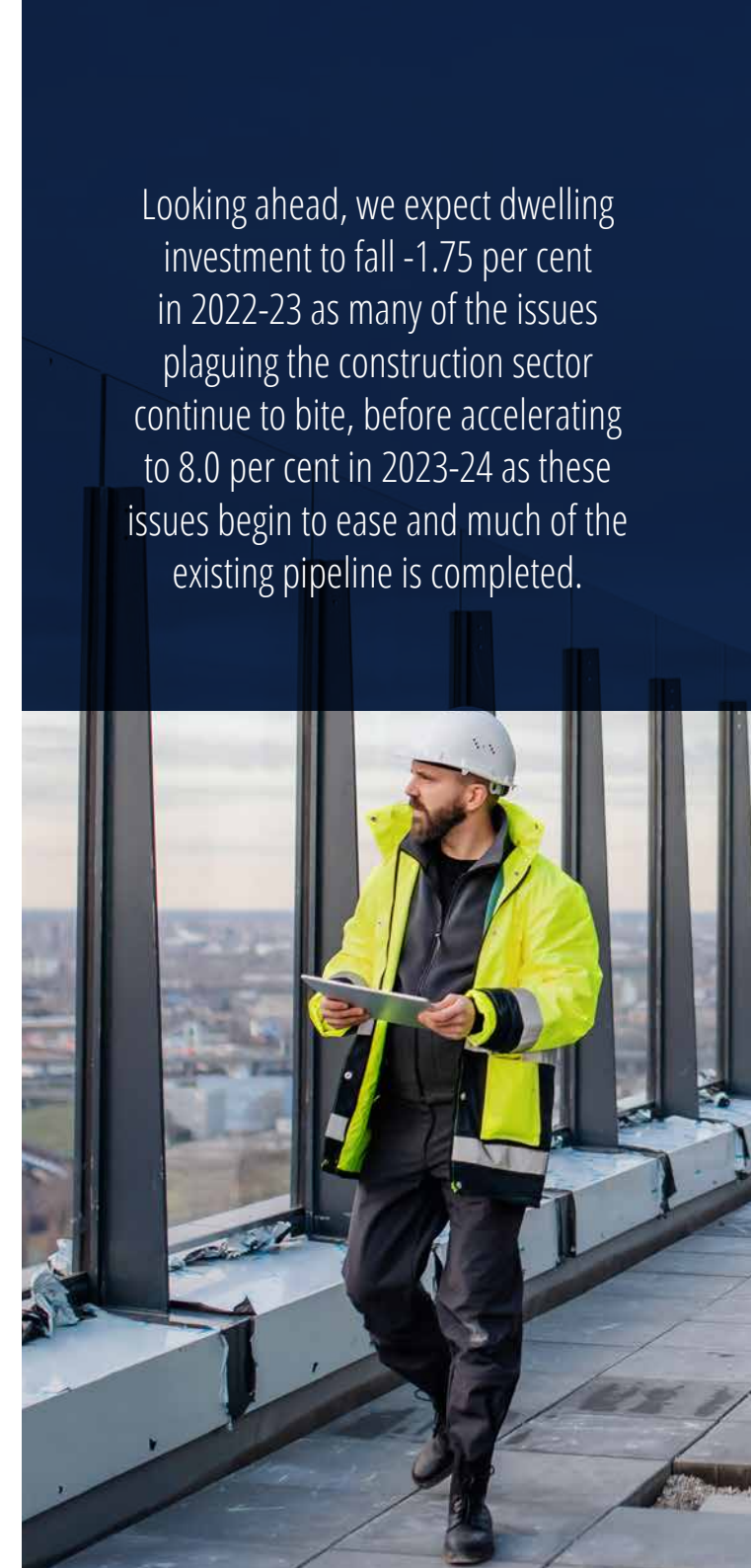
	2021-22	2022-23	2023-24	2024-25
Forecasts	Actual	Forecast	Forecast	Forecast
Dwelling Investment	2.3%	-1.75%	8.0%	-1.25%

Chart 4
Residential Construction on the Pipeline
Dwellings, WA



Source: CCIWA, ABS

Looking ahead, we expect dwelling investment to fall -1.75 per cent in 2022-23 as many of the issues plaguing the construction sector continue to bite, before accelerating to 8.0 per cent in 2023-24 as these issues begin to ease and much of the existing pipeline is completed.



International Trade

WA's exporters experienced mixed results last financial year. A bumper harvest combined with a lack of supply from agricultural heavyweights, Russia and Ukraine, saw the agricultural sector performing strongly. However, seasonal weather disruptions in Q1 2022 dampened iron ore export volumes, dragging down total exports. The lack of international travel also weighed on WA's exports, although momentum in service exports growth picked up significantly in Q2 2022 following the reopening of WA's borders.

Export volumes are expected to recover throughout the rest of this year before stabilising into 2023-24. While challenges in China's property sector poses a key risk to this outlook, the relaxation of restrictions in China coupled with newly announced policy support both generally and in the property sector point towards ongoing demand for WA's iron ore over the coming year. Given this, we believe China will remain a source of stability for WA's resources sector over the next 12 months.

All up, we expect exports to grow 6.5 per cent in 2022-23 as iron ore exports pick up slightly and international students and foreign tourists return to WA.

	2021-22	2022-23	2023-24	2024-25
Forecasts	Actual	Forecast	Forecast	Forecast
Exports	-3.2%	6.5%	1.5%	0.5%
Imports	0.2%	10.5%	6.0%	2.0%

Imports of goods are expected to rise this year on the back of the anticipated pick up in business investment and strong conditions in the agricultural sector. The return of international travel will boost imports of services as many Western Australians look to jet off for their first overseas holiday in over two years. Given this, we expect imports to grow by 10.5 per cent this financial year.

All up, we expect exports to grow 6.5 per cent in 2022-23 as iron ore exports pick up slightly and international students and foreign tourists return to WA.



Unemployment

Western Australia’s jobs market remains red hot. Our unemployment rate was 3.6 per cent in January – the third lowest in the nation - and we remain the only state with more job vacancies than unemployed people.

This continues to be good news for job-hunters, but not so much for local businesses struggling to find staff. Our December quarter *Business Confidence Survey* revealed four in five (79%) WA businesses are still struggling to fill a skilled occupation (Chart 5).

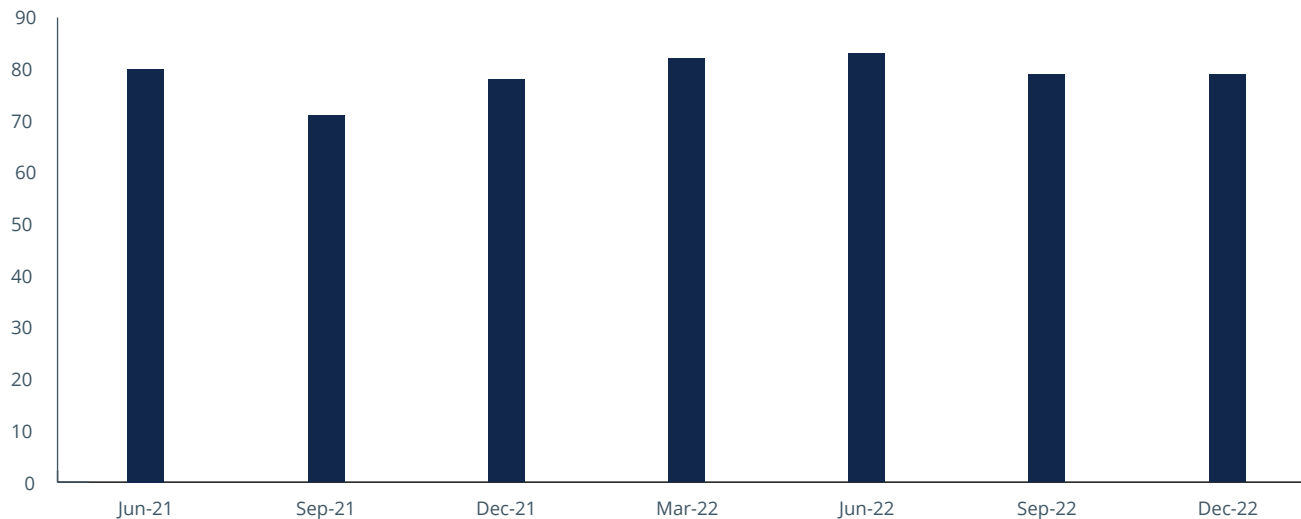
While the reopening of international borders will begin to alleviate some of the pressure, visa processing

	2021-22	2022-23	2023-24	2024-25
Forecasts	Actual	Forecast	Forecast	Forecast
Unemployment	3.75%	3.5%	4.0%	4.0%

delays and strong global competition for skilled workers are expected to weigh on WA’s inbound migration pipeline.

These factors, combined with strong demand for WA-based workers, will sustain ongoing tightness in WA’s jobs market. As such, we expect the unemployment rate to average 3.5 per cent this financial year, before drifting up to 4.0 per cent in 2023-24 as the economy begins to slow.

Chart 5
% of respondents struggling to fill a position



Source: CCIWA



Our unemployment rate was 3.6 per cent in January – the third lowest in the nation - and we remain the only state with more job vacancies than unemployed people.

Wages and inflation

Inflation outlook

Inflation is the most pressing challenge facing the world economy.

This episode of high inflation was initially driven by supply side developments, with acute supply chain disruptions resulting from COVID, along with Russia's invasion of Ukraine. More recently, demand-side factors have become more prominent, with robust domestic demand due to the bounce back from COVID and the enormous amount of policy stimulus during the pandemic.

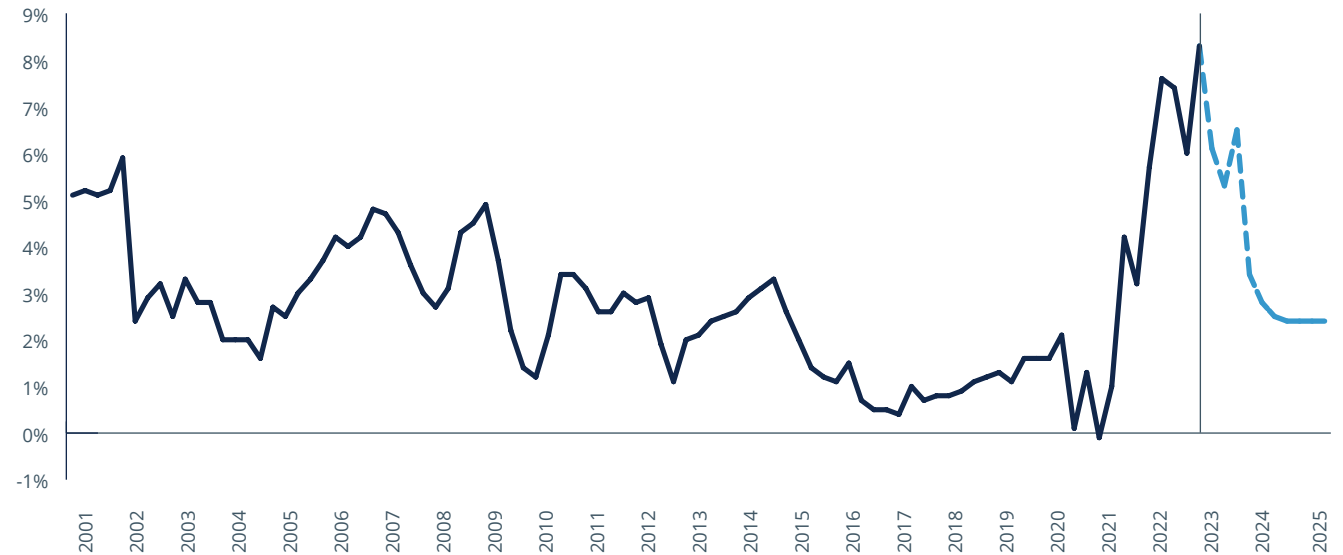
Both factors have seen inflation skyrocket – in Western Australia, inflation recently reached 8.3 per cent year-on-year in December 2022 (although this result was partially driven by the impact of the State Government's electricity subsidy).

In good news, inflation appears to have peaked. Some global supply chain issues have eased, with the cost of freight shipping from China now 20 per cent of what it was at its peak in January 2022. Rising interest rates globally will also cool demand, further taking some heat out of the economy.

As such, we expect headline Perth CPI to hit 6.5 per cent this financial year in annual average terms, before gradually returning to the RBA's target inflation rate in 2024-25.

	2021-22	2022-23	2023-24	2024-25
Forecasts	Actual	Forecast	Forecast	Forecast
Inflation	6.0%	6.5%	3.75%	2.75%
Wages	2.2%	3.75%	3.5%	3.5%

Chart 6
WA CPI Inflation Rate



Source: CCIWA, ABS

Key risks include stronger than expected consumer demand throughout 2023 and further supply chain disruptions following China's reopening from COVID-19 restrictions.

Wage outlook

The tight labour market has applied sharp upward pressure to labour costs throughout the entire WA economy.

WA businesses have turned to raising base wages to attract and retain staff, with our December quarter

Business Confidence Survey revealing three in five (60%) WA businesses are lifting base wages to combat skills shortages, while 81 per cent indicated they have experienced an increase in their labour costs.

With sustained tightness in WA's labour market expected, we anticipate base wage pressures to rise further over the forecast horizon. We expect the headline Wage Price Index to hit 3.75 per cent this financial year in annual average terms, before easing to 3.5 per cent in 2023-24 as the labour market cools slightly.



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