STATE HANDBOOK: WESTERN AUSTRALIA

MARCH 2017

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KEY POINTS

CHART 1: STATE GSP GROWTH FORECASTS

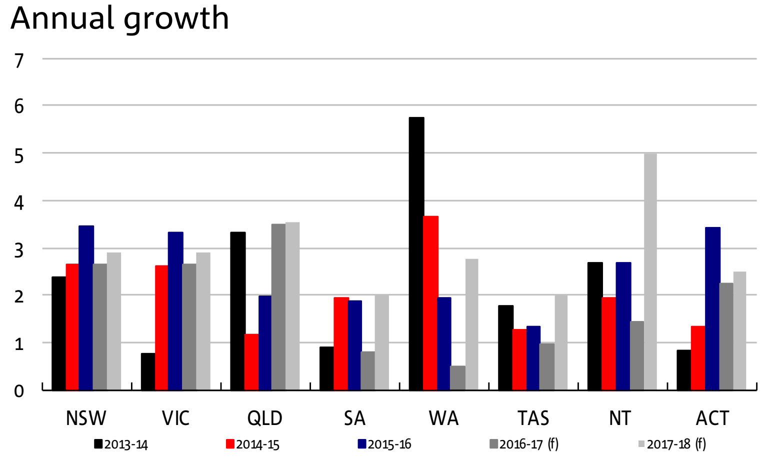
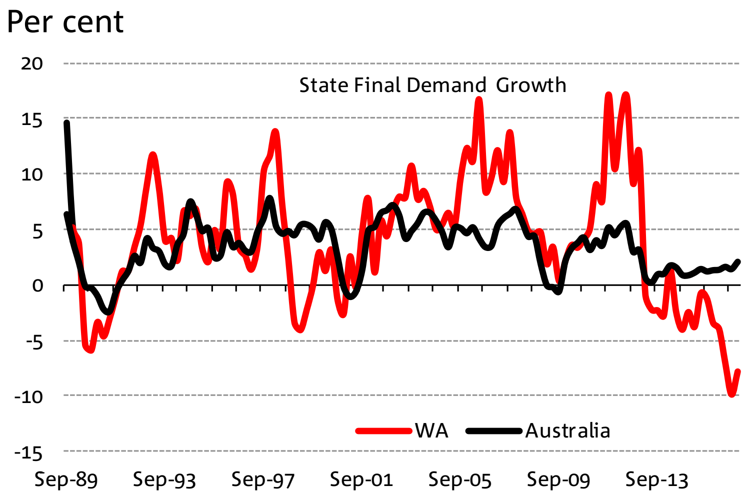


CHART 2: STATE FINAL DEMAND GROWTH



Source: ABS and NAB Group Economics

- The mining cycle continues to dominate economic trends in WA, although the unexpected partial rebound in commodity prices since last year adds to the uncertainty around the outlook. The most recent state National Accounts indicated that WA experienced fairly modest growth of just 1.9% in 2015-16, despite seeing a very strong contribution from net export volumes. Meanwhile, state final demand in WA was down almost 9% over the year to H2 2016. Additionally, more timely partial indicators suggest that conditions in WA remain quite challenging, although there have been some signs that the worst of the downturn may be behind us. Overall, **we expect real GSP growth in WA to remain subdued at just ½% in 2016-17, down from rates of over 5% p.a. in past years (2011-12 through 2013-14). A ramping-up in LNG exports will make a very large contribution to growth thereafter (Charts 1 & 2).**
- While the partial rebound in commodity prices last year will provide some assistance to the economy, and particularly government finances, NAB's assessment is that the overall impact on the economy will be fairly minimal and temporary. Iron ore prices are expected to drop back to mid US$60s per tonne by end 2018 as Chinese demand pulls back in a well-supplied market. Additionally, ample capacity and a desire to pay down debt suggests that much of the windfall to mining revenues will not find its way back into the local economy.
- Business investment has been one of the primary drivers of weakness in domestic demand as construction rates wind down on major mining projects. The mining investment downturn is now well progressed, but more falls can still be expected as the handful of remaining LNG projects finish up. Non-mining sectors have yet to step in to fill the void, and forward indicators of investment suggest that is unlikely to happen any time soon. Business conditions are still extremely weak in WA, with the weakness relatively broad-based across the economy.
- The local housing market is still feeling the strain from economic headwinds, with property prices falling again in 2016, although there have been signs that the market may soon stabilise. However, with more adjustment still to come in the labour market, property prices are expected to underperform again in 2017. Similarly, dwelling investment will remain weak.
- Despite the negative wealth effects, some of the consumer trends have been a little more encouraging, including a lift in consumer sentiment and tentative signs of a positive shift in spending behaviours. But a weak labour market and softer population growth pose a significant constraint on consumption. The situation is not expected to improve, with **the unemployment rate expected to stay around current levels before seeing only a gradual improvement.**
- **Higher commodity prices contributed to a near-term improvement in the State Governments financial positions according to the recent mid-year update.** Higher royalty income will more than offset other drags on revenue in the near-term, but revisions to GST relativities worsen the position further out – halving the previously projected surplus for 2019-20. There is, however, some upside risk in the out years given our view of iron ore prices.

National Australia Bank

IN FOCUS:

Commodity price surge will provide only temporary relief for WA

Bulk commodity prices saw a surprise rally in 2016, with iron ore prices almost doubling (Chart 3). While prices are still well down on previous peaks, any changes can potentially have significant implications for the WA economy – iron ore prices have previously had a positive correlation with WA SFD (Chart 4). The impact on royalty revenue is also significant to Government finances (see slide 10).

But what flow on effects will there be the WA economy this time around? Certainly, there are some encouraging signs emerging with reports that previously shuttered operations are being reopened. Also, based on estimates of the states iron ore export volumes, if recent price gains are sustained they would add almost US$40b per year to mining revenues (relative to if prices returned to their previous low).

However, we are not yet convinced that there will be a lasting positive impact on the WA economy. In particular, our assessment of market fundamentals suggest that current prices are likely to be unsustainable (see Minerals & Energy Outlook) – which is broadly in line with the consensus view of analysts. Our forecast is for prices to head lower over the next two years as Chinese steel production declines and iron ore producers utilise their capacity (Chart 3). The iron ore spot price is expected to hit US$75/t in late 2017, before ebbing to US$65/t by end 2018.

Additionally, if current prices are viewed as unsustainable, producers are unlikely to utilise revenue windfalls to invest in new capacity – a major source of domestic demand and employment growth in the previous cycle. If this were to change, an early indication would come from mining exploration spending. However, available data suggests that expenditure on iron ore exploration has remained quite low (Chart 5). Capacity utilisation rates in the mining sector have also remained quite low, albeit rising recently, providing yet another disincentive to mining investment.

Finally, many mining firms have expressed an intention to use any windfall to help reduce levels of debt accumulated over the course of the mining investment boom. Given the high degree of foreign capital used in the sector a significant share of profits will likely find its way overseas (not contributing to the domestic economy).

CHART 3: IRON ORE PRICE & FORECASTS

US$ per tonne

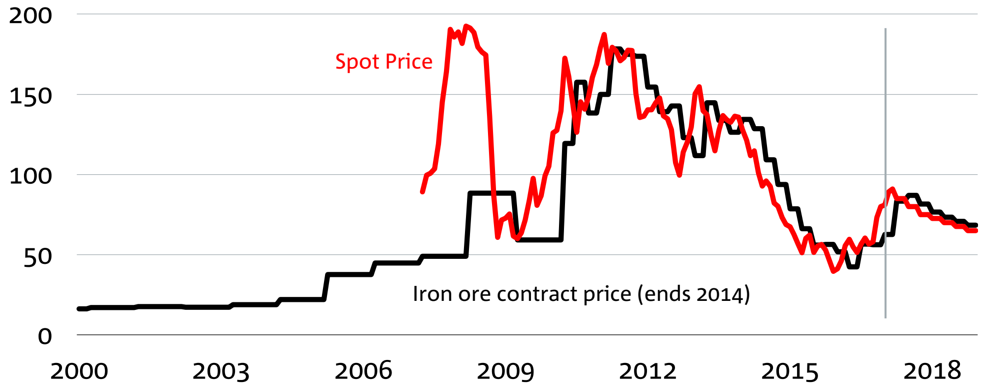


CHART 4: STATE FINAL DEMAND & IRON ORE PRICES

Year-ended Growth; US$ per tonne

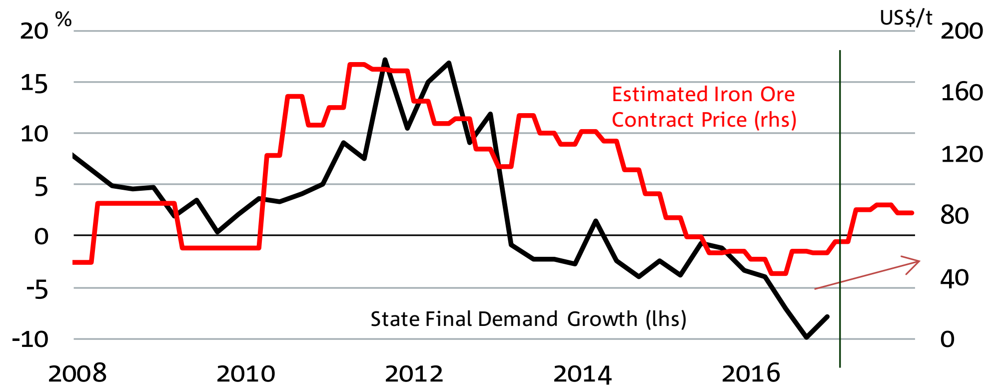
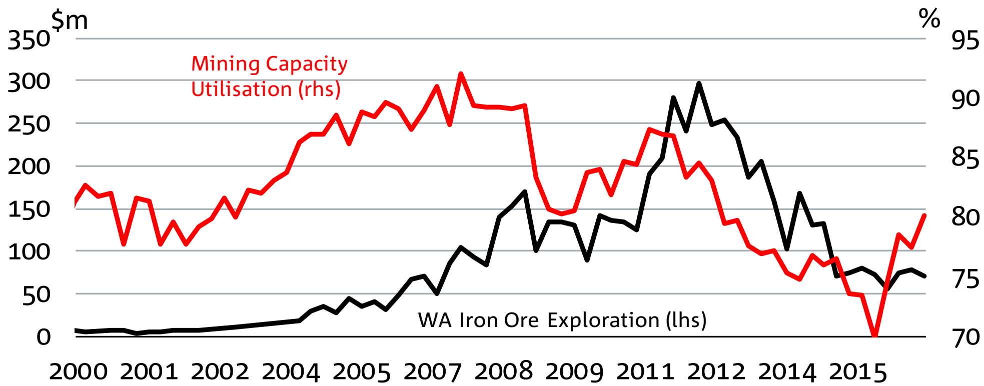


CHART 5: MINING CAPACITY UTILISATION RATE & EXPLORATION

Per cent, $ million



Source: ABS, Bloomberg, NAB Business Survey, NAB Group Economics

CONSUMER SPENDING:

Wealth effects are still a drag, but consumers appear less anxious

While growth in household consumption has stayed subdued in WA, rising just 1.9% over the year to Q3 2016, momentum did seem to improve over 2016 – following a very weak outcome in late 2015. That said, nominal growth has continued to weaken given the effect of competition and the low demand environment on prices. Population and labour market trends in WA remain quite poor (but stabilising), which is limiting wage growth and aggregate consumer demand. The property market is also doing no favours, having a negative impact on household wealth (Chart 7).

The full extent of the labour market adjustment (post-mining boom) is yet to fully play out, and while recent commodity price gains may help to cushion some of the impact, the effect is expected to be temporary and not fully offsetting. Additionally, property prices are forecast to record further (albeit more moderate) declines this year, while population growth will stay weak – a reflection of the deteriorating labour market. Consequently, consumption can be expected to remain very subdued for a while yet.

The Q4 2016 NAB Consumer Anxiety Survey showed a lift in consumer sentiment and (perhaps surprisingly) had close to the least anxious consumers relative to other states (behind Tasmania). That seems at odds with some of the negative economic trends, although recent signs of stabilisation and higher commodity prices may be helping sentiment. Spending behaviours still largely reflect what you would expect from cautious households – with a focus on reducing debt and spending on essentials – but there have been signs of more positive behaviour of late (Chart 8).

CHART 6: NOMINAL COMPENSATION OF EMPLOYEES AND HOUSEHOLD CONSUMPTION GROWTH

Year-on-year percentage growth

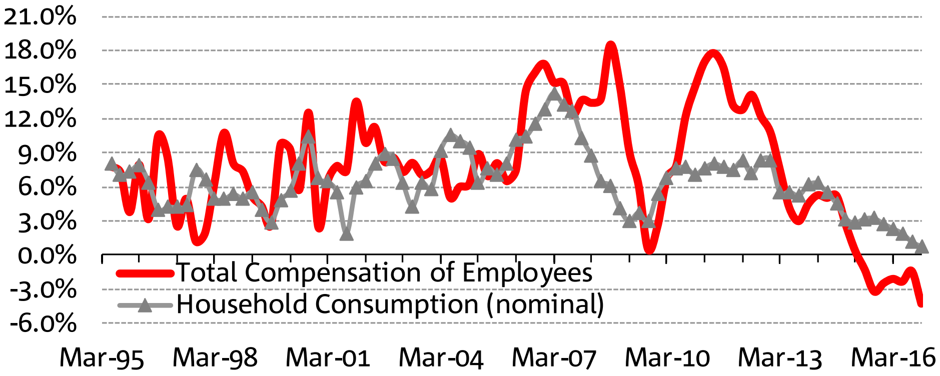


CHART 7: RETAIL TURNOVER AND HOUSE PRICE GROWTH

Year-on-year percentage growth

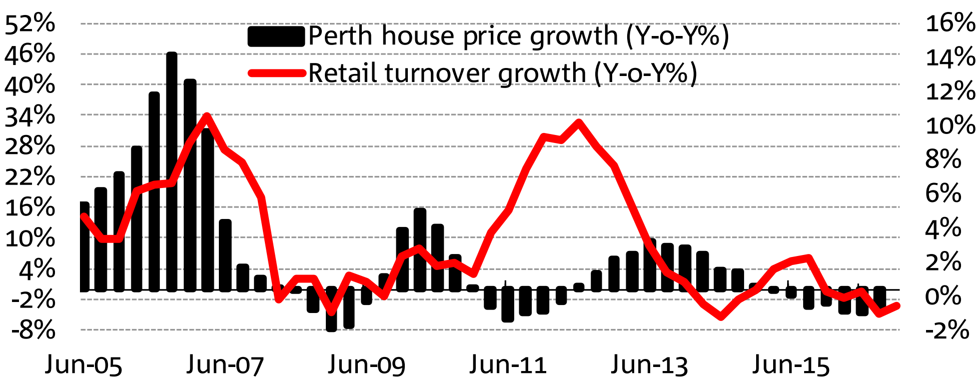
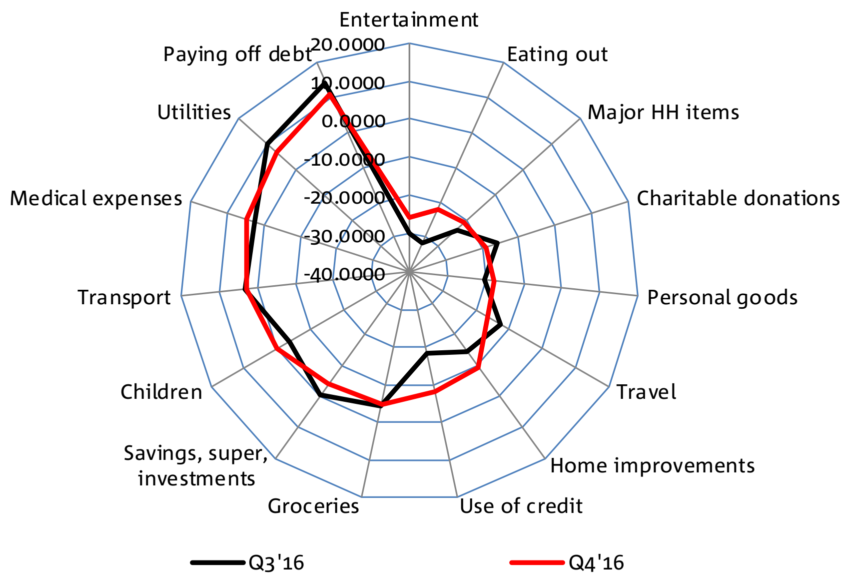


CHART 8: NAB CONSUMER ANXIETY SURVEY - CONSUMER SPENDING PREFERENCES

Changes in Consumer Spending Preferences (net balance)



Source: ABS, NAB Group Economics

NAB CUSTOMER SPENDING BEHAVIOURS:

Spending growth in regional areas stronger than in metropolitan WA

NAB's customer transaction data allows for a more granular look at spending behaviours across regions in WA.

By postcode, customer spending growth in the Perth metro region was fastest in Trigg 6029 (20.2%), North Fremantle 6159 (15.9%) and Mosman Park 6012 (9.6%). In Regional WA, spending was fastest in Dampier 6713 (38.3%), Gnowangerup 6335 (36.0%), Burekup 6227 (34.7%), Port Hedland 6706 (34.4%) and Moora 6510 (31.4%).

Spending was fastest for Accommodation, Cafes, Pubs & Restaurants in both the Perth metro area (8.9%) and in Regional WA (11.8%).

CHART 9: GREATER PERTH METRO AREA

Year-ended growth to Q4 2016

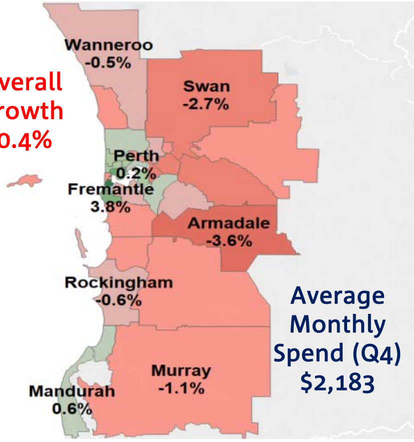


CHART 11: REGIONAL WA (EX METRO)

Year-ended growth to Q4 2016

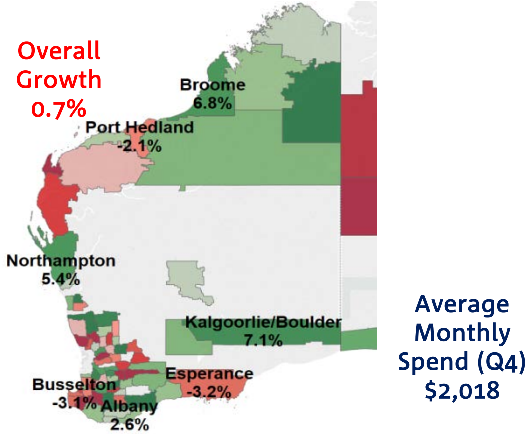


CHART 10: TOP 20 FASTEST GROWING SUBURBS FOR SPENDING

Metro

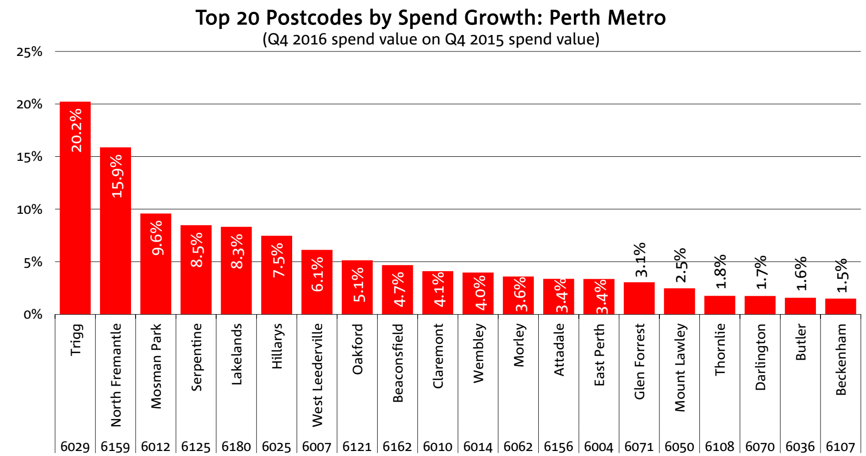
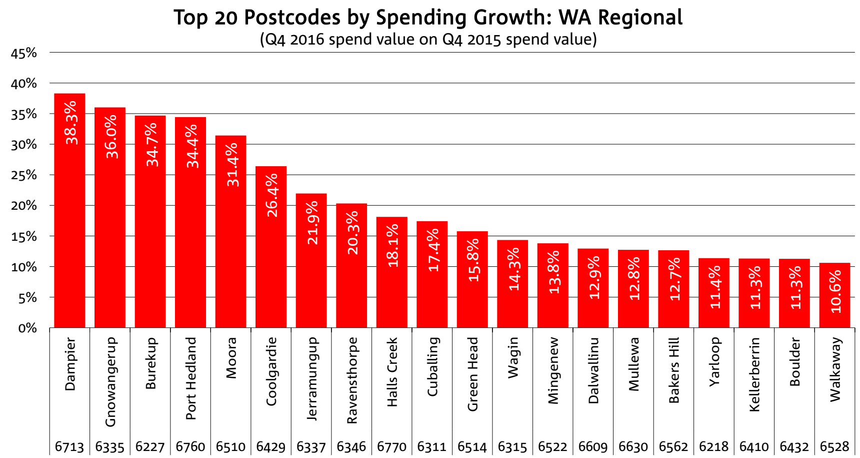


CHART 12: TOP 20 FASTEST GROWING SUBURBS FOR SPENDING

Regional NSW



Source: ABS, NAB Group Economics

BUSINESS CONDITIONS:

Most industries continue to report weak conditions, while spare capacity is elevated

The post-boom downturn in mining investment continues to play out across WA, contributing to very weak business conditions that are having a negative impact on most industries and sectors of the economy in one way or another.

Consistent with what you would expect at this stage in an investment boom/bust cycle, the NAB Business Survey is showing relatively elevated rates of spare capacity for firms in WA – capacity utilisation is below the national average (Chart 10). Similarly, business conditions are negative and have been the lowest of all the Australian states for a number of months (Chart 15).

Investment intentions from the NAB Survey have been trending lower, although they have been surprising resilient given the headwinds from the mining sector – perhaps reflecting the survey's emphasis on non-mining industries (Chart 12). Nevertheless, intentions remain below the historical average, albeit not as weak as suggested by the ABS Capex Survey (slide 7, Chart 19).

Most industry groupings are showing quite soft business conditions, although confidence appears somewhat more mixed. Manufacturing appears to be the best performer, which is unusually given the structure headwinds facing the sector (Chart 16).

CHART 13: NAB BUSINESS SURVEY – CAPACITY UTILISATION

Per cent of full capacity

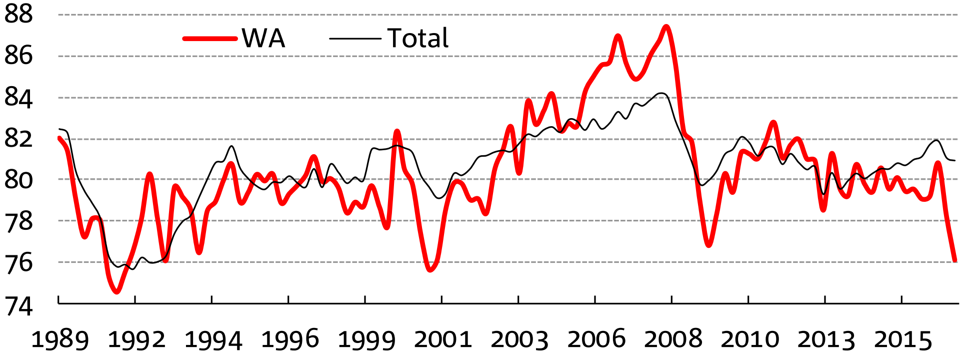


CHART 14: NAB SURVEY CAPEX EXPECTATIONS & PRIVATE BUSINESS INVESTMENT GROWTH

Net balance; Per cent growth

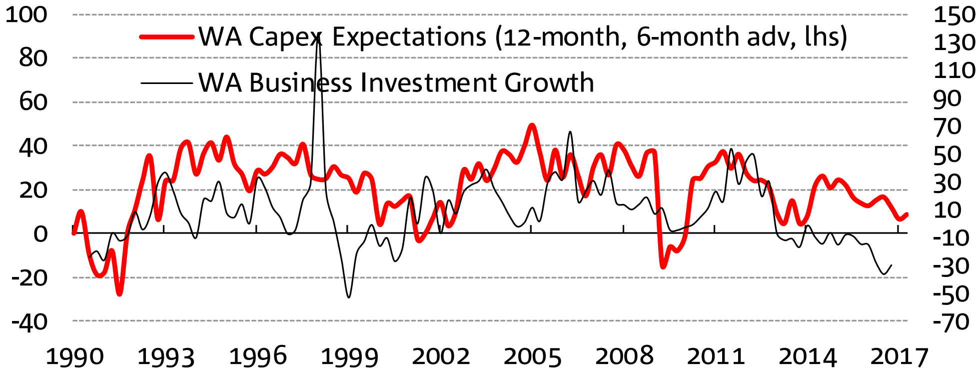


CHART 15: SPREAD IN NAB BUSINESS CONDITIONS

Net balance

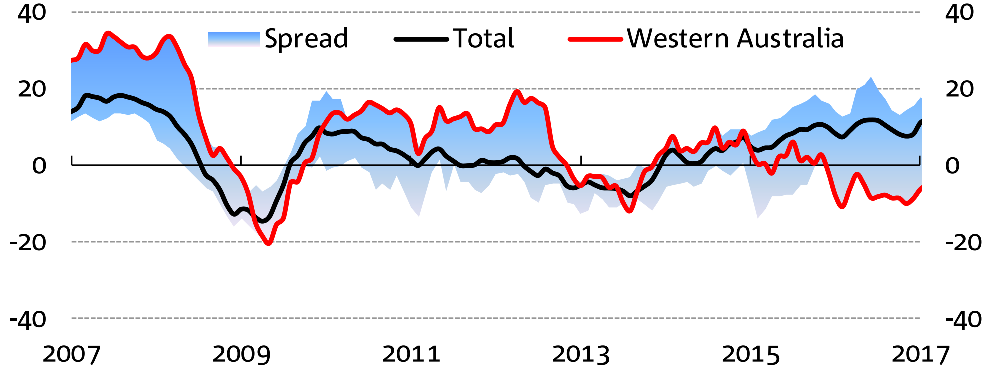
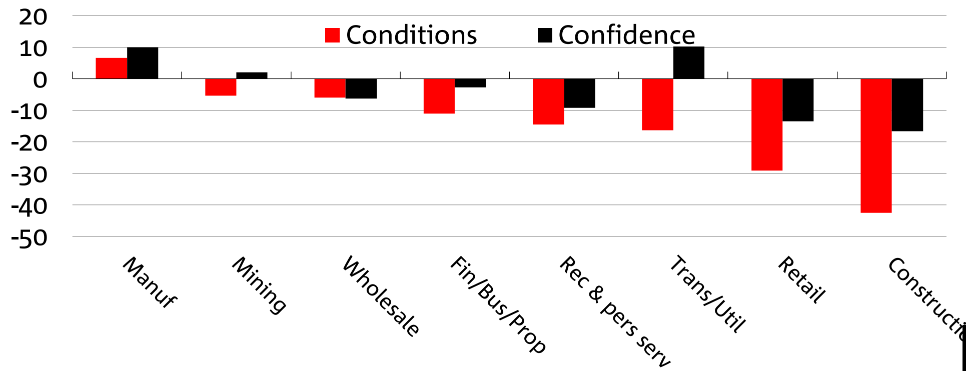


CHART 16: WA BUSINESS CONDITIONS & CONFIDENCE BY INDUSTRY

Net balance, Q3 2016



Source: ABS, NAB Group Economics

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INVESTMENT:

Investment outlook remains weak, especially in the mining and office segments

There continued to be large falls in WA's business investment as more major mining investment projects approach completion. Private business investment dropped 30% over 2016, despite a small rise in Q4. However, it is not only mining investment that has been subdued, with the ABS Capex Survey suggesting investment by 'other selected industries' has been flat to falling since mid-2012 (Chart 19).

More recently though, building approvals have been pointing to an improvement in some segments (although approvals tend to be lumpy) (Chart 17). There is, however, still quite significant slack in the office sector (Chart 18).

Similarly, the NAB Commercial Property Survey for Q4 2016 shows that office property conditions remain extremely weak, as is industrial property (Chart 20).

Expected capital expenditure (capex) by businesses (according to the ABS survey) suggests that mining investment in WA will continue to contract over the next 12 months, but at a slower pace (Chart 19).

Non-mining investment is considerably smaller and the ABS Survey provides no indication that a pick up is underway to help offset declines in mining.

CHART 17: NON-RESIDENTIAL BUILDING APPROVALS

Million dollars

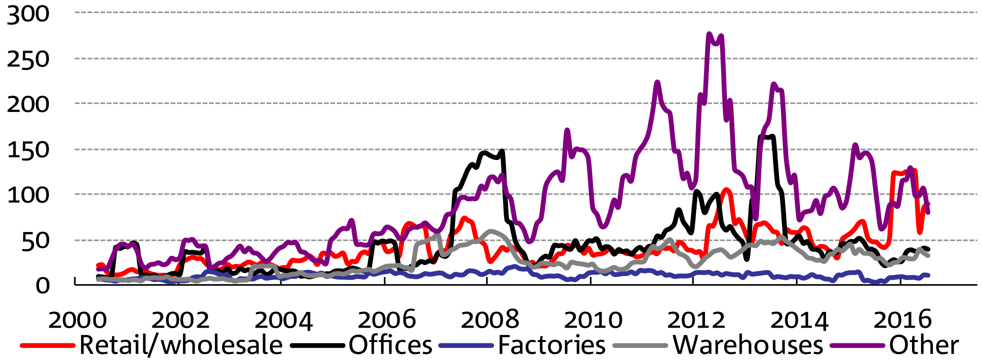


CHART 19: WA CAPITAL EXPENDITURE & EXPECTATIONS

Actual & expected based on previous realisation ratio ($billion)

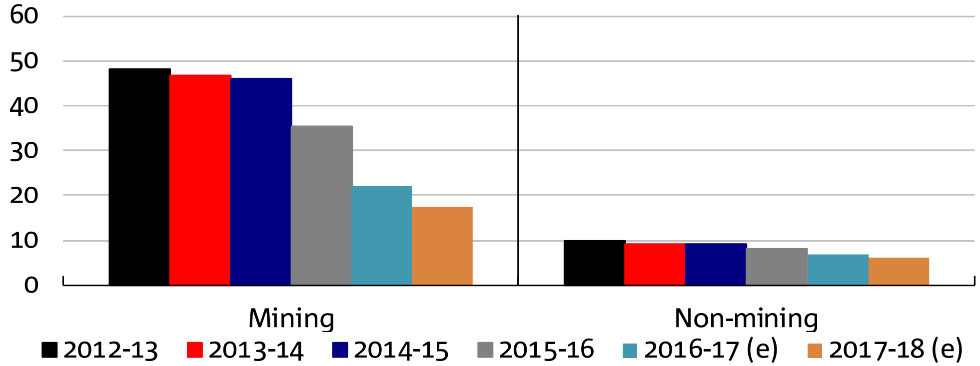


CHART 18: WA OFFICE MARKET CONDITIONS

Million dollars; Per cent of capacity

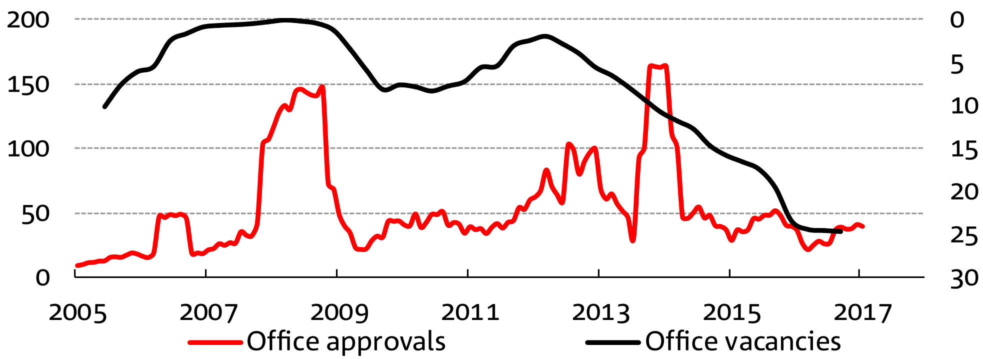
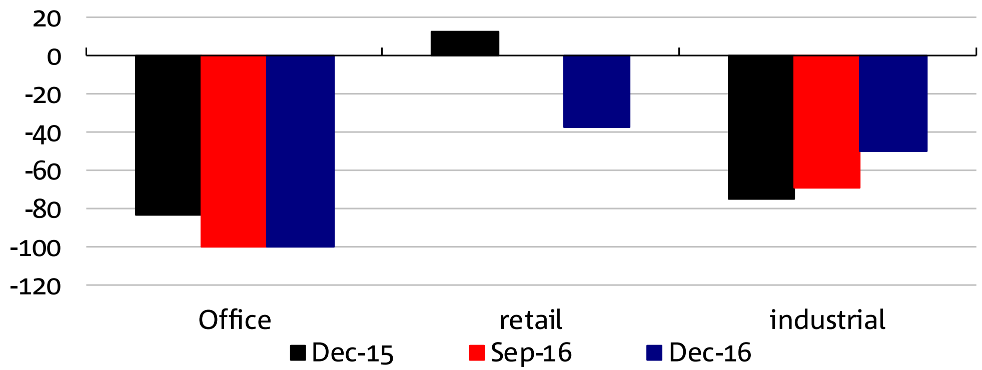


CHART 20: NAB COMMERCIAL PROPERTY INDEX - WA

Per cent of responses



Source: ABS, JLL, NAB Group Economics

LABOUR MARKET:

Employment holding up better than expected, but probably not for long

The labour market appears to be holding up a little better than expected, but the unemployment rate has continued to deteriorate (Chart 21). While slower population growth is assisting the unemployment rate, employment has also not deteriorated as much as expected, with only 2,500 jobs lost over the year to January.

Despite that, major mining (LNG) projects are getting close to completion, meaning that a large adjustment to the labour market can still be expected. Given the subdued labour market and outlook, wages growth will remain weak for quite a while yet (Chart 22).

Over the past year, retail saw the biggest increase in employment, followed by the mining industry (Chart 23). The latter is a little surprising given the large contraction in mining investment, however this may reflect an increase in the labour-intensiveness of projects in the final stages (or simply volatility in the data) – mining investment is expected to fall further, which will likely see declines in mining employment going forward.

CHART 21: UNEMPLOYMENT RATE BY REGION

Per cent, nsa

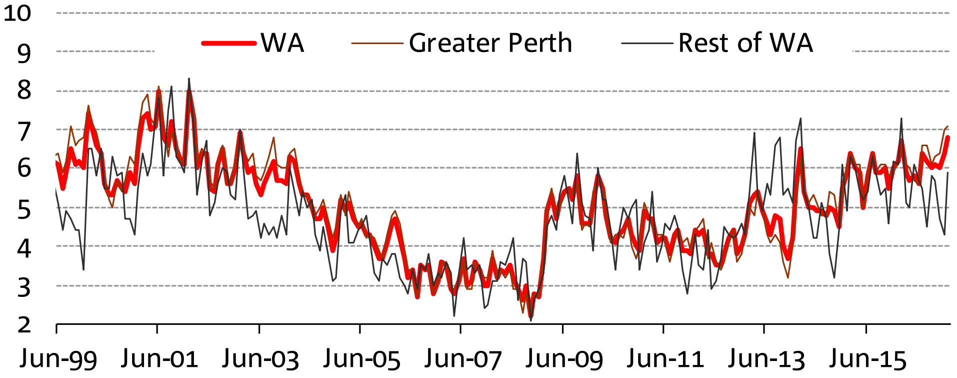


CHART 22: UNEMPLOYMENT RATE & NAB CAPACITY UTILISATION RATE

Per cent

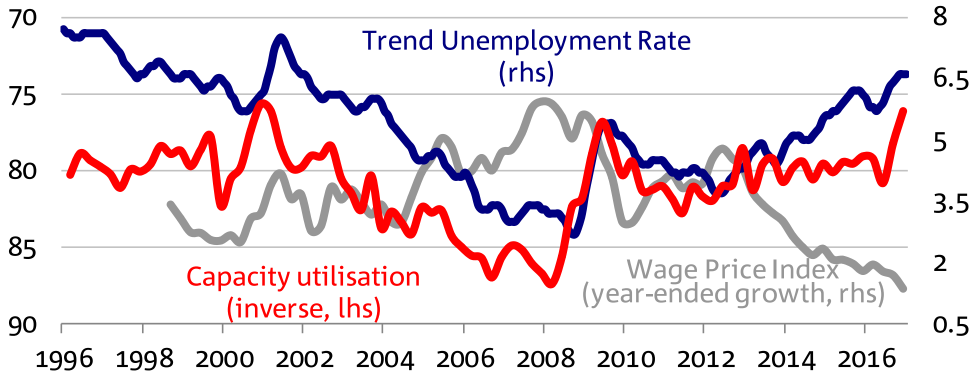
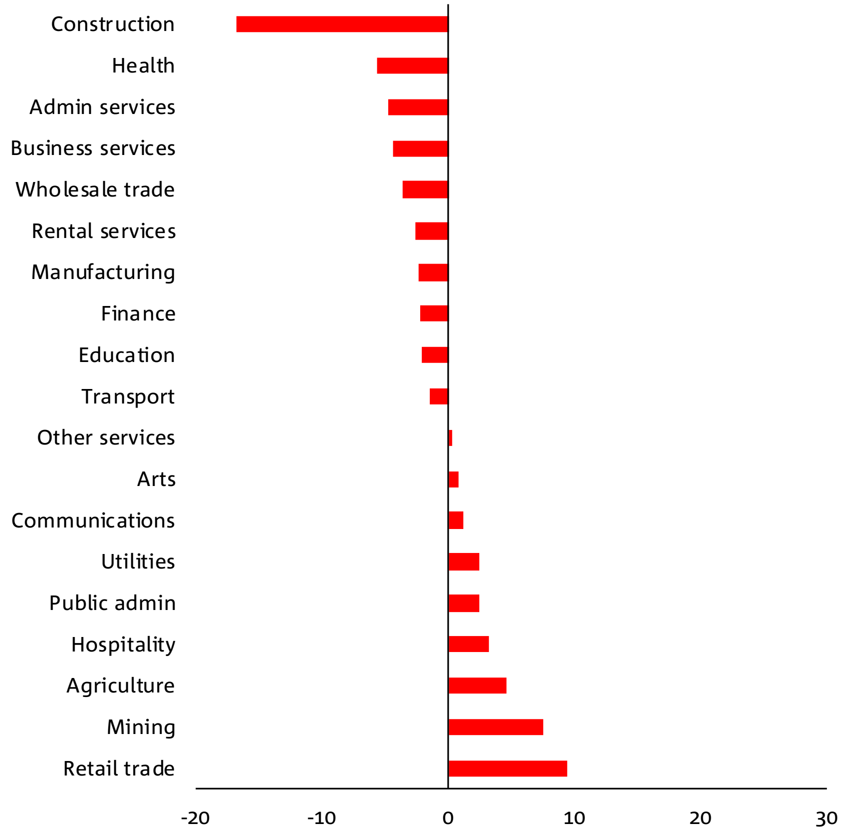


CHART 23: CHANGE IN EMPLOYMENT BY INDUSTRY, WA

Last 12 months, thousands



Source: ABS, NAB Group Economics

DEMOGRAPHICS:

Population growth has dropped below the national average.

A sharp pull-back in overseas migration and a reversal of interstate migration flows has seen WA's population growth drop significantly in recent years (although is still positive). While the net interstate outflows are still picking up, overseas migration appears to have stabilised, helping to stem the strain on total population (Chart 24).

Nevertheless, population growth in WA has now dipped below the national average, having previously led the way for more than a decade (Chart 25). Timely estimates of civilian working age population also show growth below the national average.

Population trends are consistent with observations from the labour market. While job gains in WA have slowed from the levels seen in previous years, it appears as though most of the losses over the past year were mainly jobs held by full-time Australian born workers. The flow of jobs has been somewhat mixed for other regions, but most regions saw a net gain in jobs over the same period (albeit mostly in part-time positions) – southern & eastern Europe being the main exception (Chart 26).

CHART 24: WA POPULATION GROWTH

Thousands, over the year

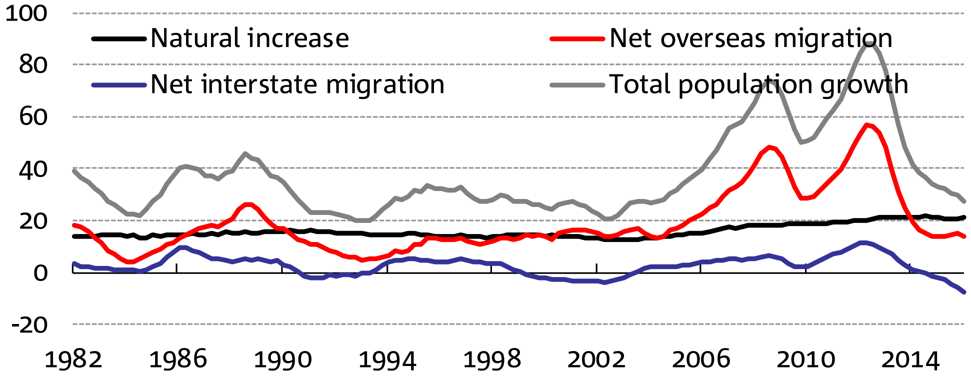
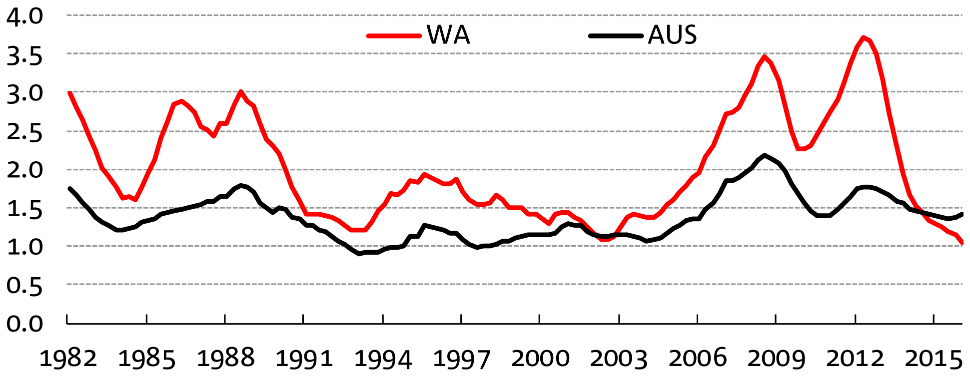


CHART 25: WA POPULATION GROWTH

Year-ended growth



Sources: ABS; NAB Economics

CHART 26: WA EMPLOYMENT BY COUNTRY OF BIRTH

Thousands, over the year

HOUSING MARKET:

Housing market still very weak, but the trough may be in sight.

Market conditions remain tough in WA, but there are some signs that the downturn could soon reach its trough. For now though, slower population growth, a weak labour market and a less than favourable supply environment have taken a toll on the WA housing market. Perth property prices have been the consistent worst performing relative to other capital cities, with prices falling 4.2% over 2016.

Regional prices have tended to perform even worse than the capital city, reflecting the influence of the mining sector (Chart 29). The areas within closer proximity of mining operations (such as the Pilbara) have been hit particularly hard. The impact on dwelling construction has been very apparent, falling in each of the five quarters to Q4 2016 – dropping more than 20% over 2016.

Both commencements and approvals have fallen steadily from their past peaks (Chart 27), suggesting dwelling investment will remain subdued.

On a more positive note, the NAB Property Survey suggests a moderate improvement in price performance over coming years, although fundamentals may not support this view (Chart 28). NAB expects Perth house prices to continue with a trend decline in 2017; forecast to fall 2.7% in 2017 (apartment prices down 3.8%). This years increase in the states FHOG is also not expected to provide much boost given soft fundamentals.

Prices have been falling across most property types and regions (Charts 29 & 30). For the metro area, house prices in the east have fallen the most.

CHART 27: WA RESIDENTIAL APPROVALS & COMMENCEMENTS

Per cent

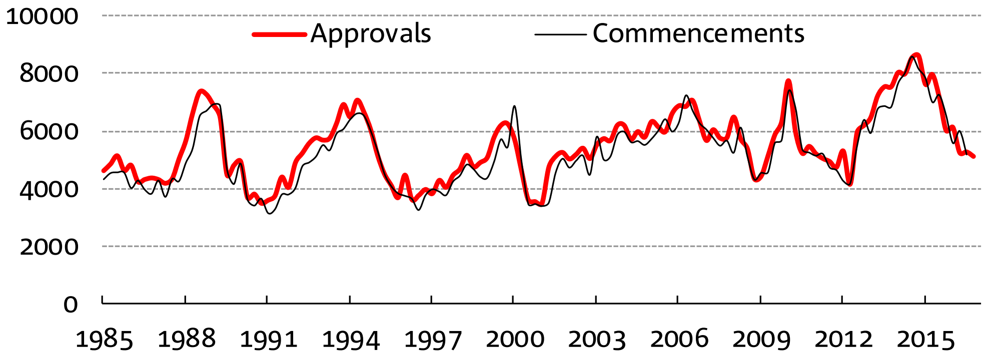


CHART 29: WA RESIDENTIAL PROPERTY PRICE GROWTH

Per cent

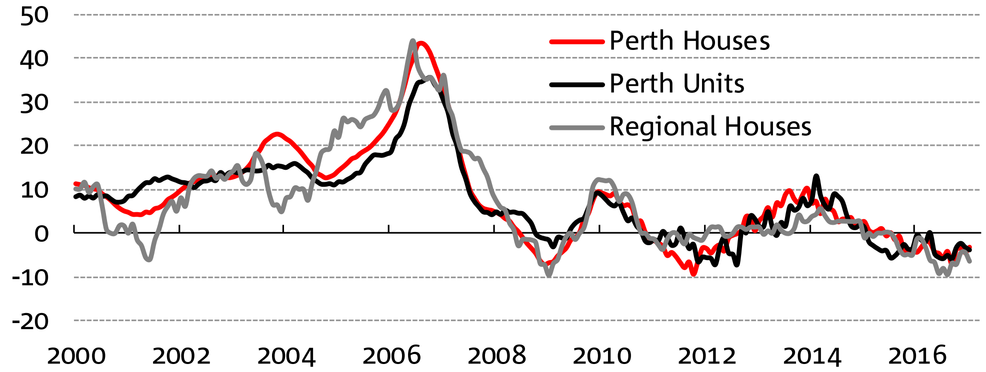


CHART 28: NAB SURVEY – HOUSE PRICE EXPECTATIONS

Per cent

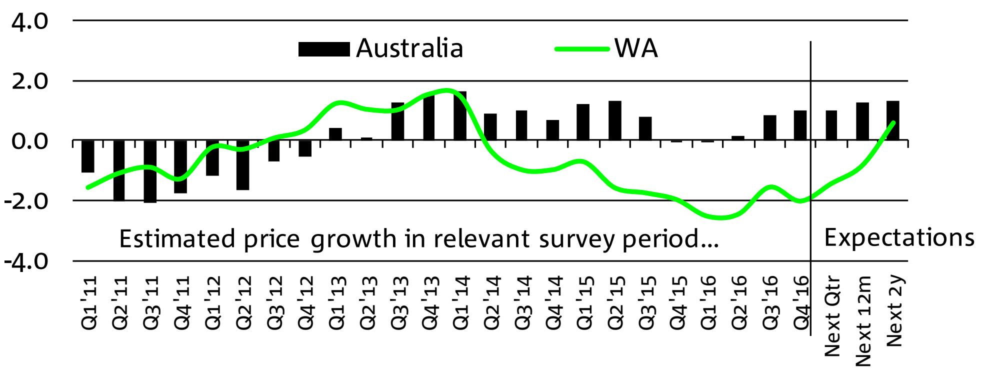
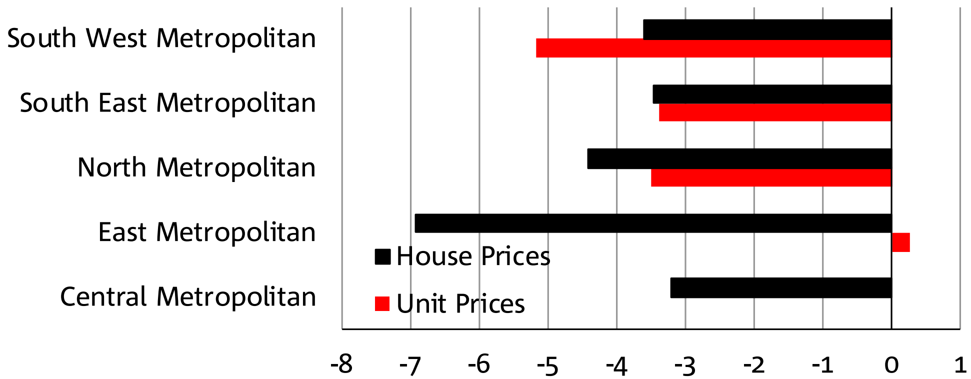


CHART 30: PERTH - MEDIAN PROPERTY PRICE GROWTH

Year to Q3 2016



Source: ABS; CoreLogic; NAB Economics

FISCAL POSITION:

Deteriorating further on weaker economy and commodity prices

The most recent mid-year state Budget update for 2016-17 showed that the fiscal position has improved largely as a result of iron ore prices, offsetting a number of negative factors – including weaker payrolls tax and transfer duty revenues, as well as delays in Commonwealth infrastructure funding.

By the end of the forward estimates, however, the impact of higher iron ore prices are more than offset by lower GST grants, reflecting a reduction in Western Australia's GST relativity. The anticipated operating deficit for 2016-17 was revised down by more than $500m, to $3.4b, with the balance expected to return to modest surplus by 2019-20 (albeit roughly half the surplus expected at the time of Budget).

Revenue estimates for 2016-17 have been revised up $832m, largely in response to higher commodity prices, but also with the assistance from a lower AUD and some upward revision to commodity sales volumes. For the period 2017-18 to 2019-20, royalty revenue was revised up by $2.4 billion to reflect higher iron ore prices. However, the Budget iron ore price assumption is around $US5-15 per tonne lower than NAB's forecast in the out years (page 3)– Budget sensitivities suggest at least a $365m-$1.1b boost to royalties revenue per annum if NAB forecasts are correct (although the associated positive pressure on the AUD will provide some offset).

Infrastructure spending is expected to make a positive contribution to the economy in the next two years - more than half the contribution is to come from public corporations, while a total of $22.3 billion to be invested between 2016-17 and 2019-20 under the state's Asset Investment Program. Nonetheless, public infrastructure investment over the forward period was revised down $522m relative to Budget (with the biggest cut coming from the Public Transport Authority.

Excluding the impact of potential new asset sales, total public sector net debt is now forecast to be $483 million lower at $39.7 billion by 30 June 2020, down from $40.2 billion forecast at Budget-time.

CHART 31: WA NET OPERATING BALANCE & ROYALTY INCOME

Per cent of GSP

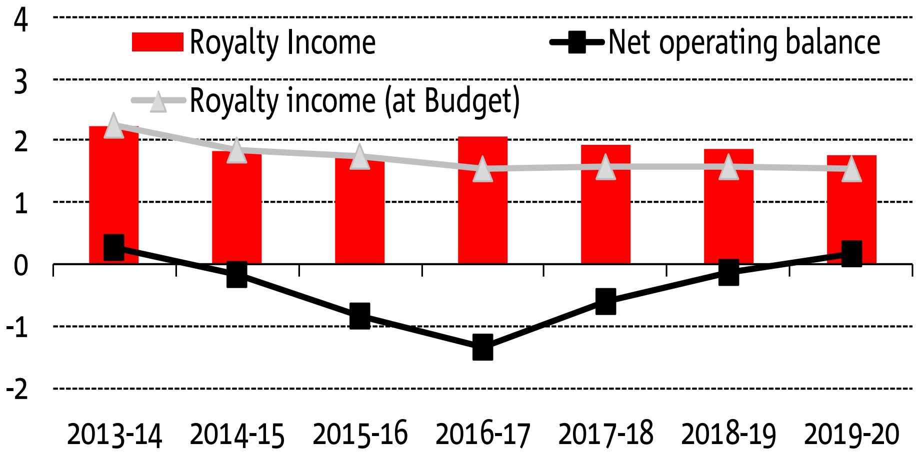
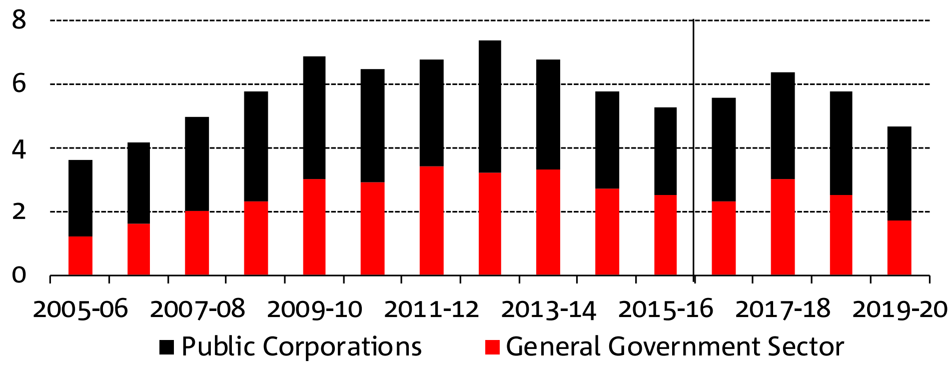


CHART 32: WA ASSET INVESTMENT PROGRAM

$ billion



Source:: WA State Budget; NAB Economics

SEMI GOVERNMENT AND CREDIT OUTLOOK: WESTERN AUSTRALIA

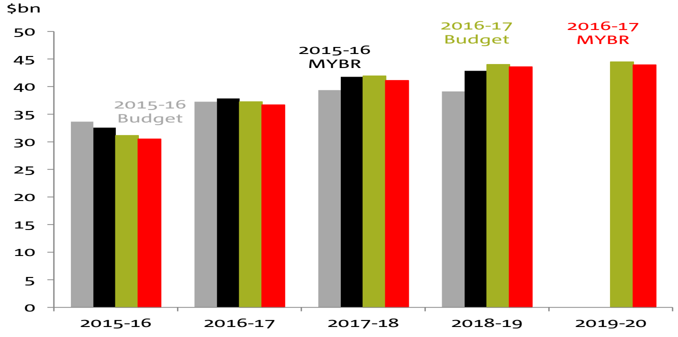
Higher iron ore price reduces prospect of rating downgrade

Capex at the broader state level (NFPS) is expected to be fairly steady at around $5-6bn pa. Ongoing fiscal deficits will keep net debt rising throughout the forecast period, from $36.7bn to $43.9bn by 2019-20. Proposed asset sales, such as Western Power, are not included in forecasts and if the Labor party wins at the upcoming election Western Power is unlikely to be sold. The PFPS showed a $1.1bn deterioration in debt over four years. Most of the deterioration reflects the roll-out of NDIS scheme.

WA's rating outlook remains negative but recent gains in commodity prices have reduced the chances of a rating downgrade.

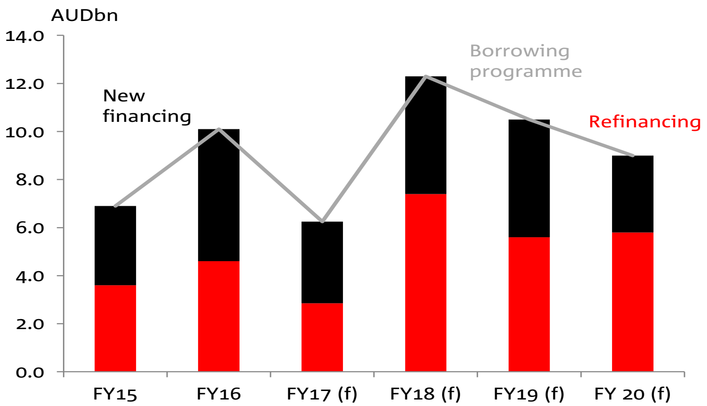
Following the MYBR, WATC's funding program for FY17 was revised lower to $6bn from $7.15bn. As at the end of February WA was 100% through its 2016-17 funding program.

CHART 33: WA NON-FINANCIAL PUBLIC SECTOR NET DEBT



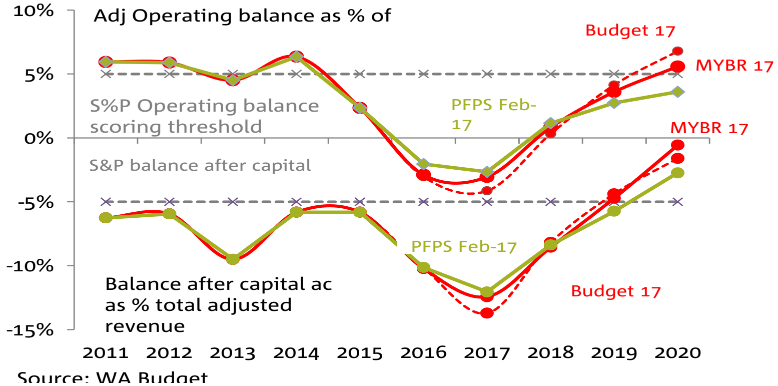
Source: WA budget paper

CHART 34: WATC BORROWING PROGRAM



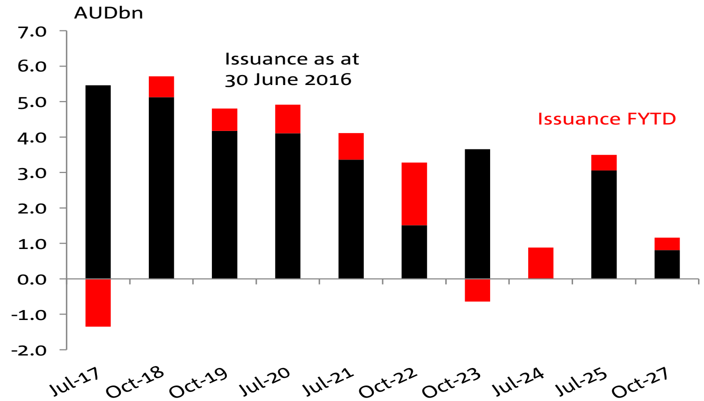
Source: WATC

CHART 35: S&P CREDIT METRIC: BUDGET PERFORMANCE METRICS



Source: WA budget paper, NAB

CHART 36: WATC TERM BONDS OUTSTANDING



Source: WATC

EXTERNAL TRADE:

Economic growth to be driven by net exports until around 2018-19

The once-in-a-generation mining boom has driven growth in mining and related industries including construction, bolstering their share of total economic output. However, a weak outlook for both mining investment and residential construction could unwind some of this share.

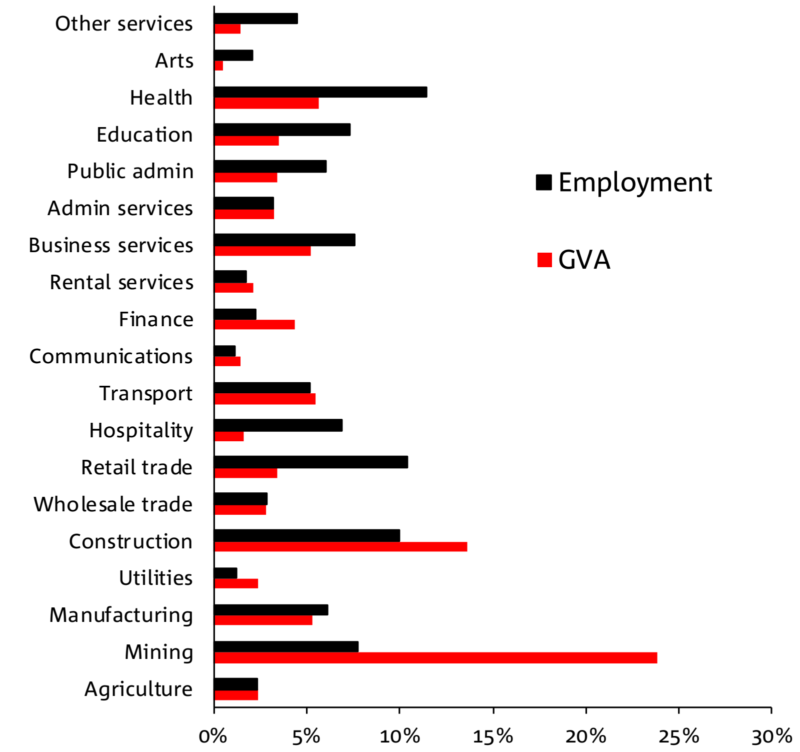
In contrast, the composition of employment is much more diverse, reflecting the relatively higher labour intensity of other industries.

Goods export volumes in WA continue to expand rapidly, supported by rising production of commodities. The trend is likely to continue as iron ore and LNG production ramps up towards full capacity in the coming year or so. In particular, LNG will quickly increase in importance to the WA economy as production capacity more than doubles. These trends will see more strong net exports contributions to GSP growth going forward, following on from a very impressive 4.8 ppts in 2015-16.

In the near term, a partial recovery in commodity prices is having an impact on incomes and nominal growth – nominal net merchandise exports have been picking up again (Chart 38). However, NAB's assessment is that the 2016 rallies in commodity prices are largely driven by temporary factors and will reapproach their previous lows going forward. Iron ore prices are expected to return to the low US$50's per tonne (CFR, spot) in 2018 – below state government assumptions in the out years.

CHART 37: COMPOSITION OF EMPLOYMENT & GVA

Percentage share



Source: ABS, NAB Economics

CHART 38: WA NET TRADE

Million dollars, 3mma

TOP EXPORT DESTINATIONS, WA

Billion dollars, 12-month average

		Value of exports ($m)
1	China	51250
2	Japan	13832
3	EU	9762
4	ASEAN	8511
5	UK	7485
6	HK	6681
7	Korea	6042
8	Singapore	2277
9	Taiwan	1584
10	Germany	1334
11	India	1318
12	US	1197
13	New Zealand	329

		Value of imports ($m)
1	ASEAN	7269
2	EU	4112
3	China	4059
4	Japan	3674
5	US	2877
6	Singapore	1603
7	Korea	1295
8	Germany	890
9	UK	842
10	New Zealand	814
11	Taiwan	269
12	HK	179

FORECASTS BY STATE AND TERRITORY:

WA growth rebounding moderately in 2017-18

NAB's economic forecasts by state and territory are below. For a summary of the outlook by state, please see the States Handbook – Overview which contains links to the detailed handbook for each state and territory.

REAL GROSS STATE PRODUCT AND UNEMPLOYMENT RATE FORECASTS

Annual average

NAB growth and unemployment rate forecasts for the states								
	Gross State Product YoY				Unemployment Rate			
	14-15	15-16	16-17f	17-18f	14-15	15-16	16-17f	17-18f
NSW	2.6	3.5	2.7	2.9	5.9	5.4	5.1	5.3
VIC	2.6	3.3	2.7	2.9	6.4	5.9	5.7	5.7
QLD	1.2	2.0	3.5	3.5	6.5	6.2	6.2	5.8
SA	2.0	1.9	0.8	2.0	6.9	7.3	7.0	7.0
WA	3.6	1.9	0.5	2.8	5.4	6.0	6.5	6.3
TAS	1.3	1.3	1.0	2.0	6.9	6.5	6.5	6.5
NT	2.0	2.7	1.5	5.0	4.2	4.2	4.0	4.8
ACT	1.3	3.4	2.3	2.5	4.5	4.5	4.3	4.3
Australia	**2.4**	**2.7**	**2.1**	**3.0**	**6.2**	**5.9**	**5.7**	**5.7**

HEDONIC HOUSE PRICE FORECASTS*

Through the year growth to Q4

	2013	2014	2015	2016	2017
Sydney	15.2	13.4	11.5	16.7	4.5
Melbourne	8.5	8.4	11.7	15.1	5.6
Brisbane	5.3	5.2	4.3	4.0	1.7
Adelaide	3.0	4.5	-0.3	4.5	1.5
Perth	10.2	2.1	-3.8	-4.4	-2.7
Hobart	2.9	3.3	-1.6	11.7	3.5
Cap City Avg	9.9	8.4	7.8	11.6	3.4

Source: ABS, CoreLogicNAB Economics

HEDONIC UNIT/APARTMENT PRICE FORECASTS *

Through the year growth to Q4

	2013	2014	2015	2016	2017
Sydney	11.6	8.3	11.3	9.6	1.0
Melbourne	8.7	1.1	6.9	1.7	-2.7
Brisbane	3.5	1.2	1.8	-0.2	-1.8
Adelaide	0.6	2.5	1.4	1.1	0.7
Perth	6.3	1.9	-3.5	-3.2	-3.8
Hobart	-5.1	5.9	8.6	6.7	0.6
Cap City Avg	9.0	5.1	7.9	5.9	-0.8

SOURCE: CoreLogic, NAB Economics

National Australia Bank