National Australia Bank

STATE HANDBOOK: WESTERN AUSTRALIA

OCTOBER 2017

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KEY POINTS:

Some tentative signs of improvement, but challenging conditions remain

CHART 1: STATE GSP GROWTH FORECASTS

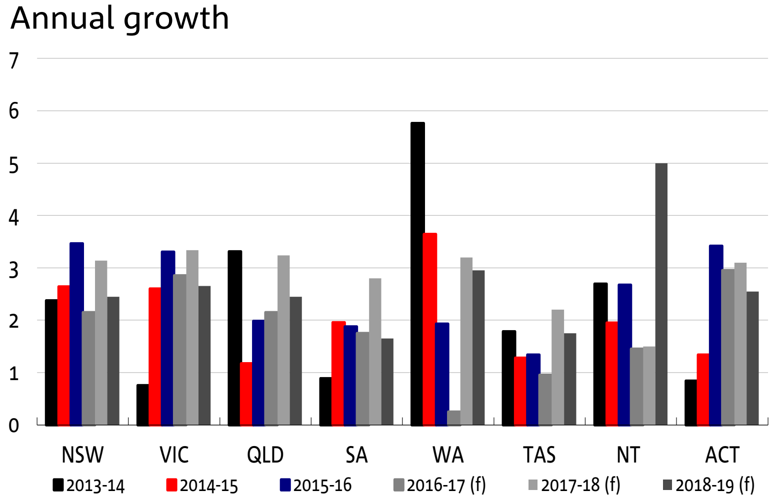
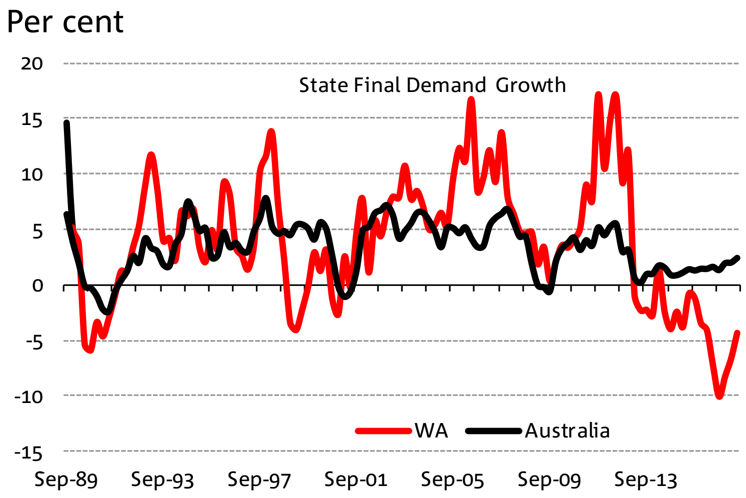


CHART 2: STATE FINAL DEMAND GROWTH



Source: ABS and NAB Group Economics

- The headwinds from the mining sector continue to be felt across the state, although there are some encouraging signs that the worst of the pain has passed. The most recent National Accounts showed that state final demand in WA continued to contract, but at a much slower pace than at the same time last year (Chart 2). Similarly, most of the timely indicators of the economy signal that conditions remain extremely challenging, but many appear to be stabilising (at subdued levels). Despite that though, it will likely take quite some time before the economy can rebound. Overall, **we expect real GSP growth in WA to have remained subdued at just ¼% in 2016-17, down from 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 (Chart 1), with growth of 3.2% and 3% forecast in 2017-18 and 2018-19 respectively.**
- The lumpy nature of mining projects has resulted in quite a volatile profile for business investment. Following another large decline in Q2 2017, business investment was down nearly 20% over the year in real terms, while further declines are to be expected as major mining works reach completion. That said, the pace of decline seems to have slowed and reads from leading indicators such as mineral and energy exploration activity have actually improved. Nonetheless, we believe that overall market and business conditions within the mining industry are likely to keep new major projects at bay. Meanwhile, there have been some tentative signs of improvement for non-mining investment. Business conditions in WA have clearly lifted (albeit still negative), while non-residential building approvals have seen some encouraging trends.
- The WA housing market remains under pressure, reflected in ongoing declines in prices. However, similar to elsewhere in the economy, conditions are slowly expected to stabilise – the apparent halt to the pull-back in population growth is a good start. However, with the market still well oversupplied and the labour market staying soft, a turnaround is still some way off. These conditions will also cap on dwelling investment.
- Consumer spending growth has picked up a little in recent quarters, but remains very anaemic in annual terms, weighed down by negative wealth effects and falling wages. Labour market conditions do appear to be improving, but we expect it will take a while to generate any notable wages pressure. **The unemployment rate is expected to stay around current levels before seeing only a gradual improvement.** NAB's consumer surveys also suggest that households in WA remain very cautious with their spending patterns, although Q2 2017 did show some propensity to spend a little more on items such as home improvements and eating out than they did a year ago.
- **The most recent state Budget reported a deterioration in the fiscal position** going forward, in large part reflecting a weak outlook for iron ore prices. The state's asset investment program will rise modestly this year, but contract from 2019-20.

IN FOCUS:

The end of the mining headwind may be around the corner

The final stages of the mining boom have had big implications for most parts of the WA economy. The direct impact in terms of capital expenditure has been particularly large, although indications do suggest that the worst of the headwinds may now be behind us. According to the ABS Private Capital Expenditure Survey, quarterly mining capital expenditure has fallen more than 60% from its mid-2012 highs, while the pipeline of mining project (using both WA and NT due to data constraints) has fallen back to pre-2010 levels as major projects are completed (Chart 3). However, spending does appear to have stabilised somewhat in recent quarters, while leading Indicators such as mineral and energy exploration activity have actually improved. That said, we believe that overall market and business conditions within the mining industry are likely to keep new major projects at bay for some time yet. Also, since major works are still under construction, we expect to see a little more downward adjustment to mining capex in coming quarters.

In terms of the labour market, the drag from mining employment has not been quite as sever as previously thought. To date, a little more than 30k jobs have been lost in the mining sector since its peak in 2012, but that level has remain fairly constant for some time (Chart 4). Similarly, after an notable loss in construction jobs between mid-2015 and late 2016, the lost ground has been largely recovered (albeit not completely). That said, there is a risk that the rising trend will be disrupted once major mining projects are completed

Finally, we are also seeing signs that the unwinding of WA's population boom has largely stabilised, although at very low levels of population growth. Housing supply was far too slow in responding to the previous boom (Chart 5), and the sharp pull back in population has had some severe consequences for the state's property market, reflected in ongoing declines in prices. The market pushed into oversupplied territory, with rental vacancy rates moving above 7%. The ratio of residential building approvals to population growth has been tracking well above long-run average levels, but with population stabilising and approvals coming off, the ratio is gradually returning to more normal levels – suggesting market conditions may eventually start to improve, but is likely to take time, while a lift in residential construction is still a way off.

CHART 3: MINING INVESTMENT PIPELINE

$ billion, $ million

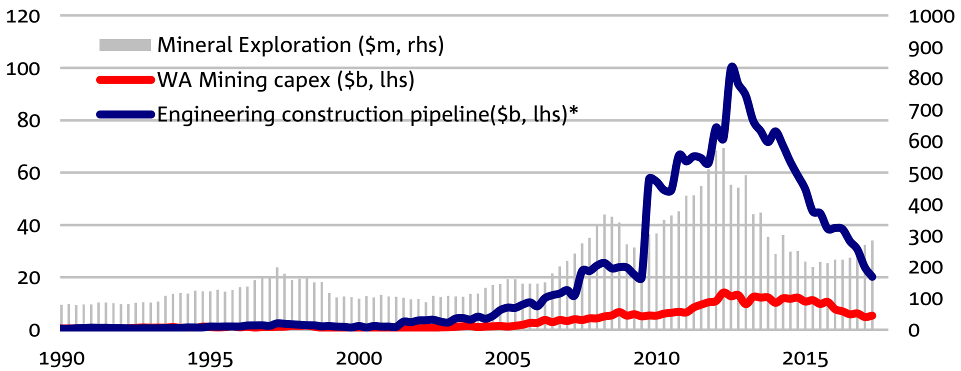


CHART 4: LABOUR MARKET STABILISING

Employment since mining peak (Sep 2012) and job vacancies in WA, Thousands

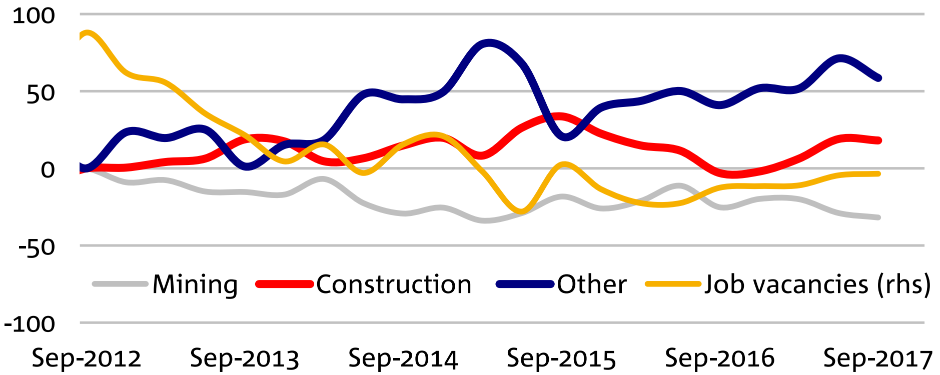
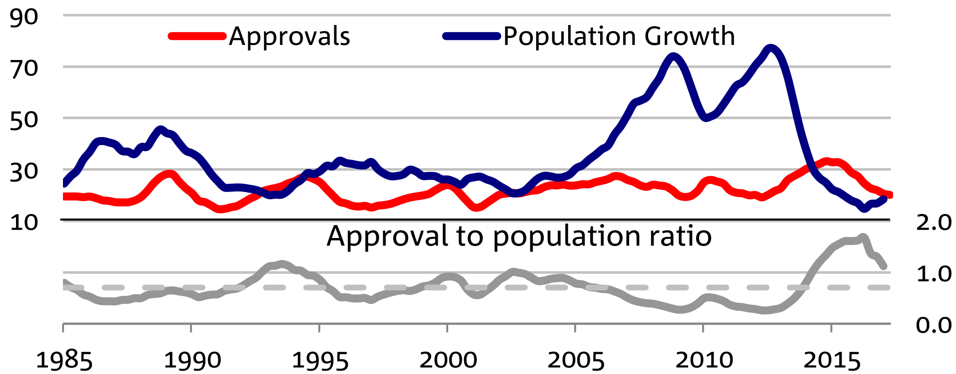


CHART 5: HOUSING SUPPLY STILL CORRECTING

Thousands; ratio



*Due to missing ABS data, the pipeline reflects both WA and NT

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

CONSUMER SPENDING:

Spending is likely to remain soft in the near-term, but will gradually improve

Significant economic headwinds from the mining sector have had a clear impact on consumer spending in WA. Real consumption has picked up modestly to 0.5% q/q in Q2 2017, but is only up 1.1% over the year. Price pressures meant that nominal growth has been even more anaemic, rising just 0.6% over the year, although growth does appear to be stabilising (Chart 6). Population and labour market conditions remain weak, but appear to be stabilising, although we will need to see a significant turn-around to stem the decline in aggregate wages. The property market is also not helping household wealth, although the pace of decline has eased (Chart 7).

CHART 6: NOMINAL COMPENSATION OF EMPLOYEES AND HOUSEHOLD CONSUMPTION GROWTH

Year-on-year percentage growth

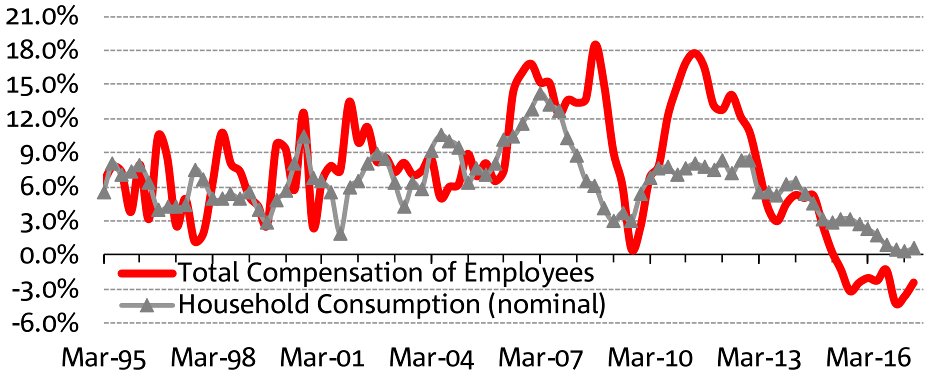
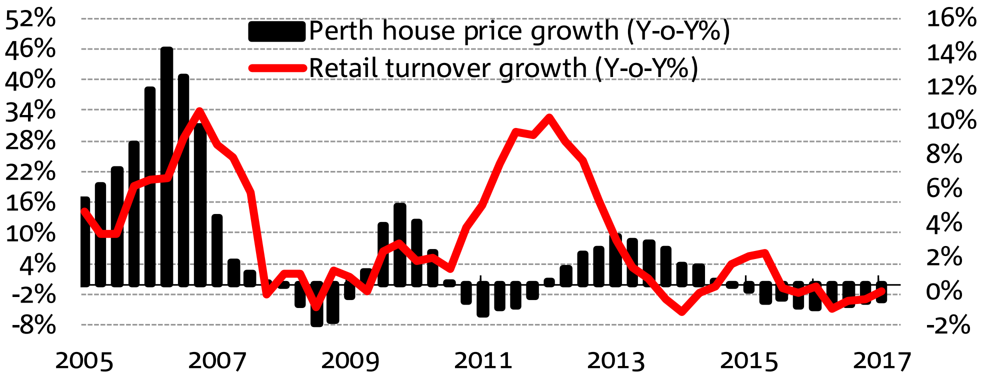


CHART 7: RETAIL TURNOVER AND HOUSE PRICE GROWTH

Year-on-year percentage growth



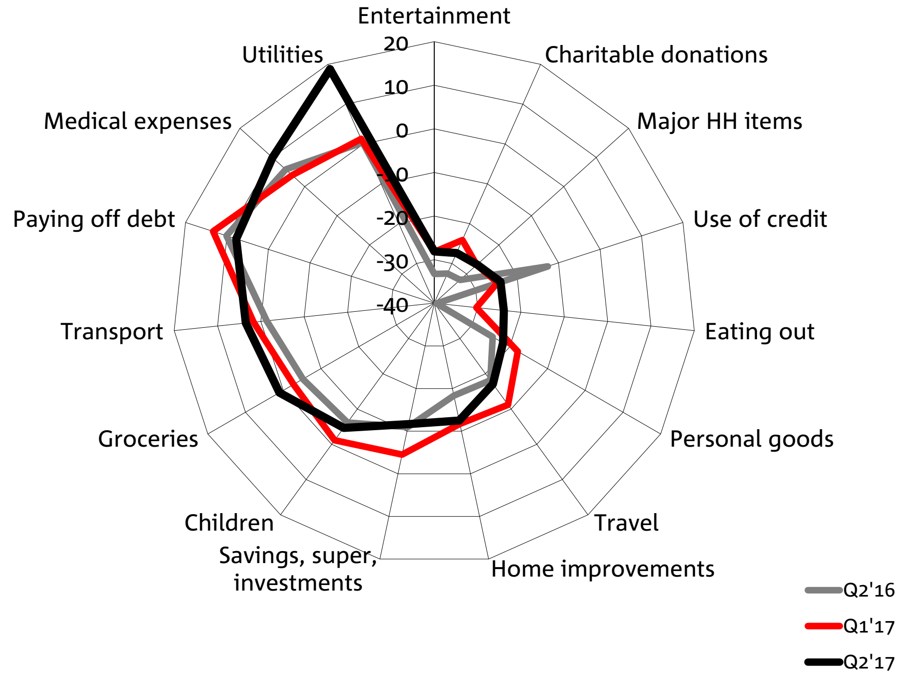
Source: ABS, NAB Group Economics

A number of indicators suggest that the worst of the (post-mining boom) labour market adjustment may now be behind us – although there is still some adjustment to come. Additionally, property prices are forecast to fall further but should begin to bottom out as the labour market and population begin to stabilise. Consequently, consumption can be expected to remain fairly subdued in the near term, but we should start to see more signs of improvement in the medium-term.

The Q2 2017 NAB Consumer Behaviours Survey showed a dip in consumer sentiment, although (perhaps surprisingly) WA still has the least anxious consumers relative to other mainland states. While economic conditions appear to be stabilising somewhat, such a (relatively) low level of anxiety is difficult to reconcile with very poor economic performance in WA generally. Still, spending behaviours largely reflect a cautious consumer, with a focus on reducing debt and spending on essentials – including a big pick-up in utilities (a trend seen across other states) following recent price hikes. That said, consumers have shown some propensity to spend a little more on items such as home improvements and eating out than they did a year ago (Chart 8).

CHART 8: NAB CONSUMER ANXIETY SURVEY - CONSUMER SPENDING PREFERENCES

Changes in Consumer Spending Preferences (net balance)



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NAB CUSTOMER SPENDING BEHAVIOURS:

Spending growth is very mixed across regions in 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 Mariginiup 6078 (11.6%), Trigg 6029 (10.6%), Singleton 6175 (10.1%) and Mosman Park 6012 (9.3%). In Regional WA, spending was fastest in Picton 6229 (57.6%), Denham 6537 (47.8%), Woodanilling 6316 (33.9%) and Wyalkatchem 6485 (29.8%).

Spending was fastest for Arts & Recreation services in both the Perth metro area (42.7%) and in Regional WA (39.3%).

CHART 9: GREATER PERTH METRO AREA

Year-ended growth to Q2 2017

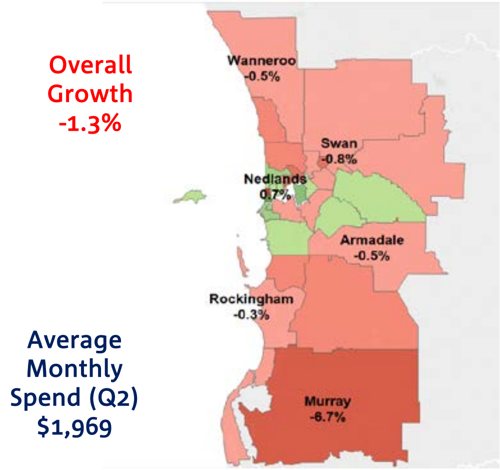


CHART 11: REGIONAL WA (EX METRO)

Year-ended growth to Q2 2017

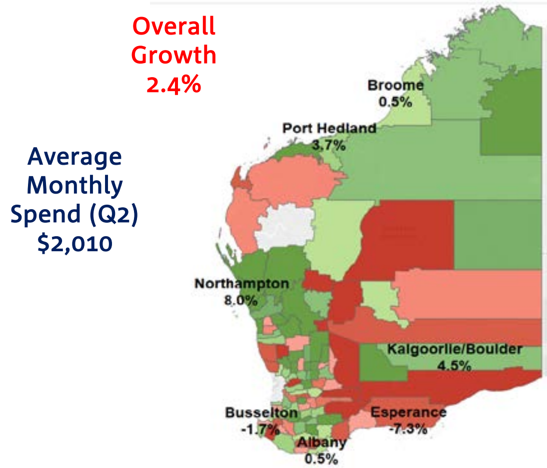


CHART 10: TOP 20 FASTEST GROWING SUBURBS FOR SPENDING

Metro; Q2 2017 spend value on Q2 2016 spend value

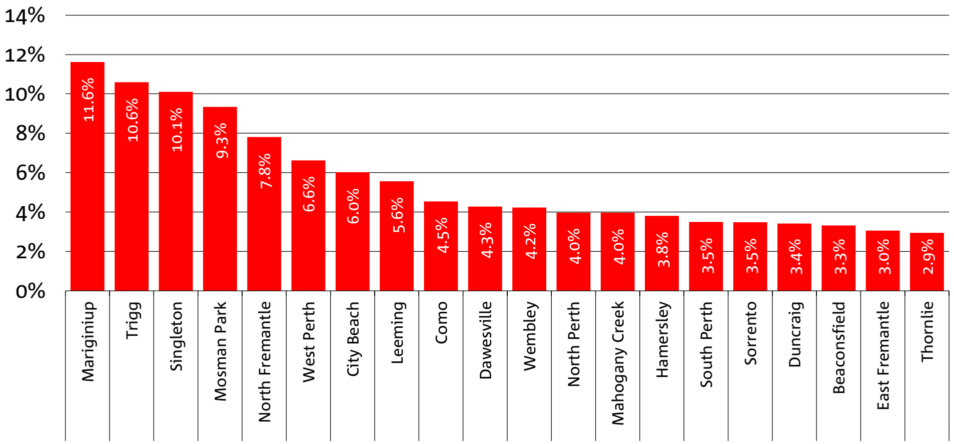
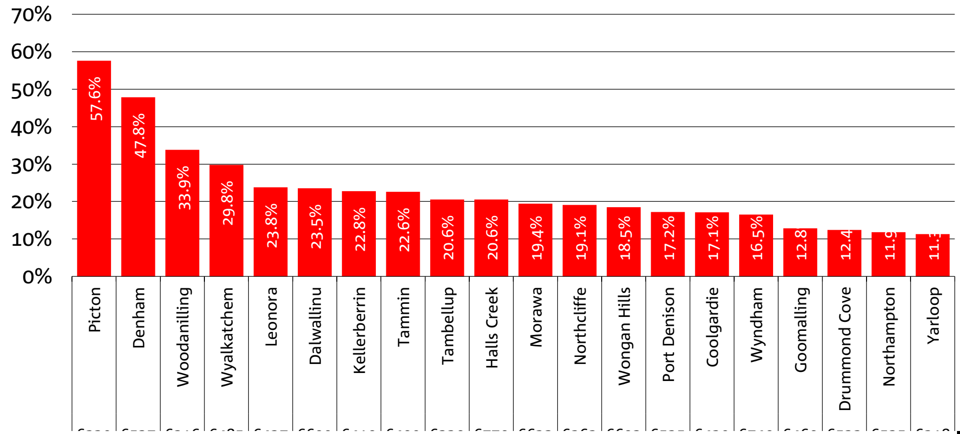


CHART 12: TOP 20 FASTEST GROWING SUBURBS FOR SPENDING

Regional; Q2 2017 spend value on Q2 2016 spend value



Source: ABS, NAB Group Economics

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BUSINESS CONDITIONS:

A clear improvement in the non-mining business sector, but will it continue?

In the past couple of years, WA has consistently seen the worst business conditions of all the states. That is not surprising given the significant headwinds created by lower commodity prices and the mining investment downturn. More recently, business conditions have remained very subdued relative to the other states, but there has been a clear improvement from the 2015-16 lows (Chart 15).

Similarly, the NAB Business Survey is still showing fairly elevated rates of spare capacity for firms in WA, consistent with continued falls in business investment – capacity utilisation is well below the national average (Charts 13 & 14). Capacity utilisation has begun to tick up, but more progress is needed.

CHART 13: NAB BUSINESS SURVEY – CAPACITY UTILISATION

Per cent of full capacity

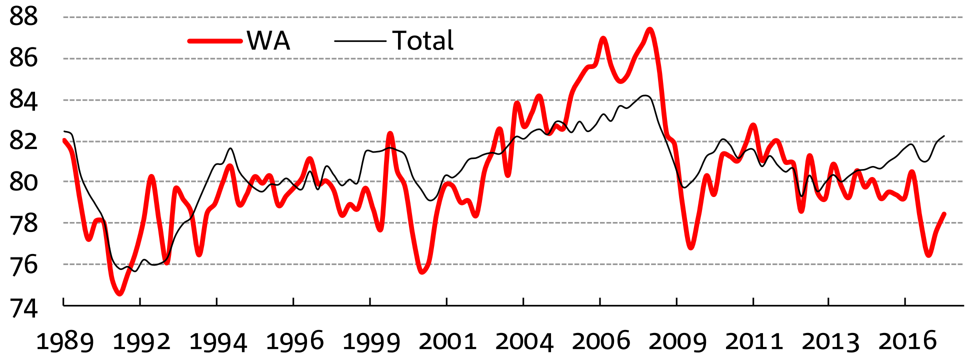
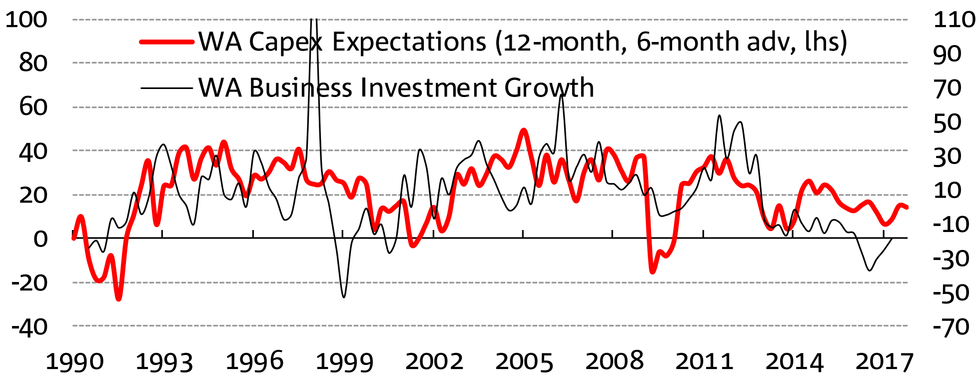


CHART 14: NAB SURVEY CAPEX EXPECTATIONS & PRIVATE BUSINESS INVESTMENT GROWTH

Net balance; Per cent growth



Source: ABS, NAB Group Economics

Investment intentions from the NAB Survey have lifted a little this year, but nowhere near enough to offset the long-running downward trend – remaining well below long-run averages (Chart 14). Nonetheless, the index is loosely pointing to fairly flat investment for next year, which is somewhat consistent with reads from the ABS Capex Survey, which is showing much more modest declines than recent years for FY18 (slide 7, chart 20).

There is a notable variation in business conditions across the WA economy, signalling a patchy recovery lead by segments of the non-mining sector – although confidence is actually positive in all industries outside of retail (chart 16).

CHART 15: SPREAD IN NAB BUSINESS CONDITIONS

Net balance

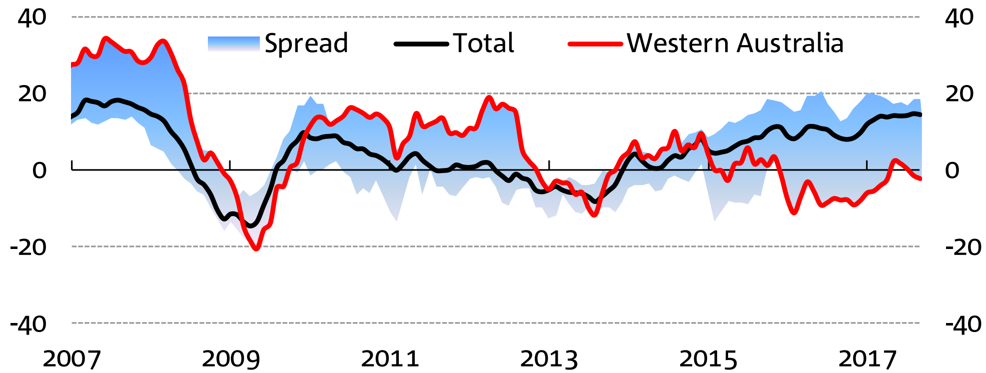
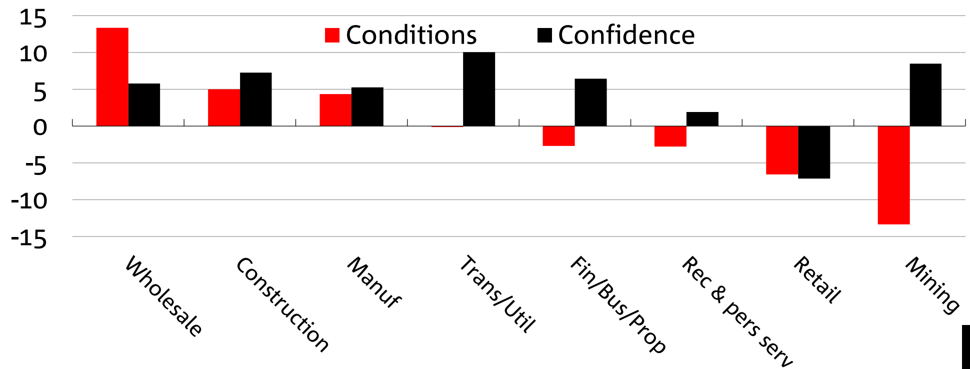


CHART 16: WA BUSINESS CONDITIONS & CONFIDENCE BY INDUSTRY

Net balance, Q2 2017



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INVESTMENT:

Worst of the investment 'cliff' may be behind us, although outlook is still clouded

Business investment in WA has been lumpy, but is still in sharp decline in annual growth terms (down 19% y/y in Q2 2017). The result is likely driven by a deterioration in mining investment, with the ABS Capex Survey showing a 24% y/y decline in (nominal) mining investment for WA – although, non-mining investment was also down modestly over the year according to the survey.

There are signs that we may have seen the worst of it though, with timely leading indicators such as private non-residential building approvals showing a bit of an upward trend (although approvals tend to be lumpy). That said, despite a slight uptick in office approvals recently, there is still significant slack in the sector that is likely to limit new investment in that sector (Chart 17 & 18).

Similarly, the NAB Commercial Property Survey for Q4 2016 shows that office property conditions remain extremely weak, as is industrial property (Chart 20). Retail is not quite as weak, although that is surprising given poor conditions and confidence in the industry generally.

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 points to flat-to-slightly lower expenditure, giving no indication of an offset to mining.

CHART 17: NON-RESIDENTIAL BUILDING APPROVALS

Million dollars

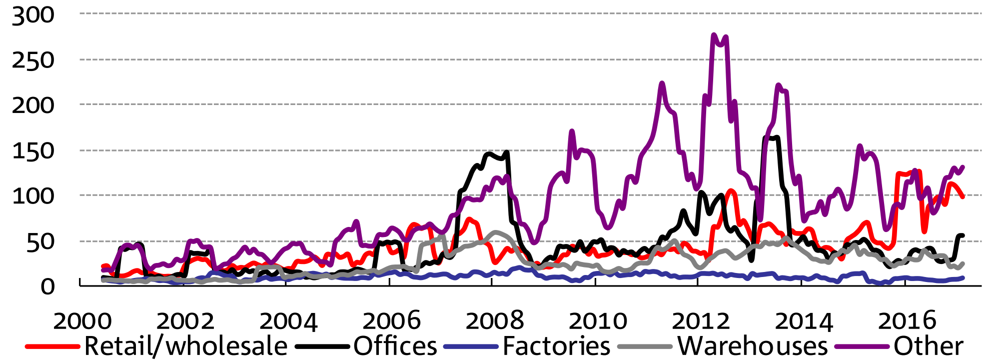


CHART 18: WA OFFICE MARKET CONDITIONS

Million dollars; Per cent of capacity

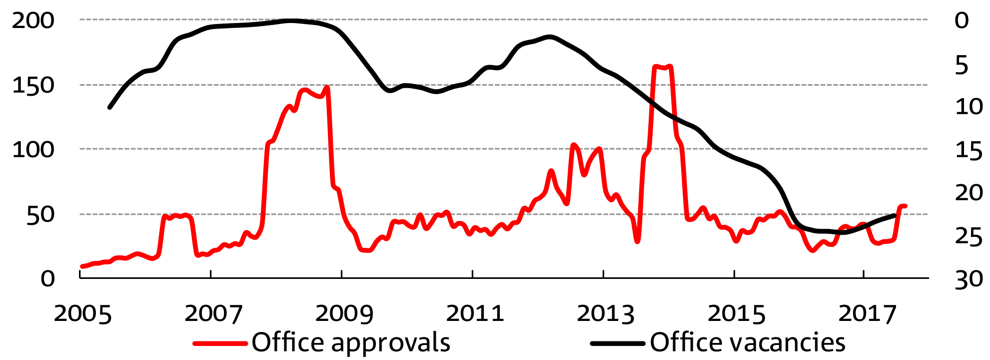


CHART 19: WA CAPITAL EXPENDITURE & EXPECTATIONS

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

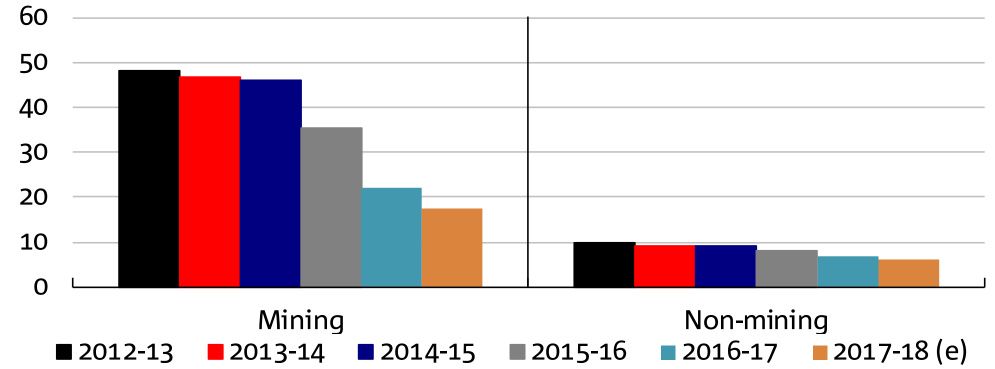
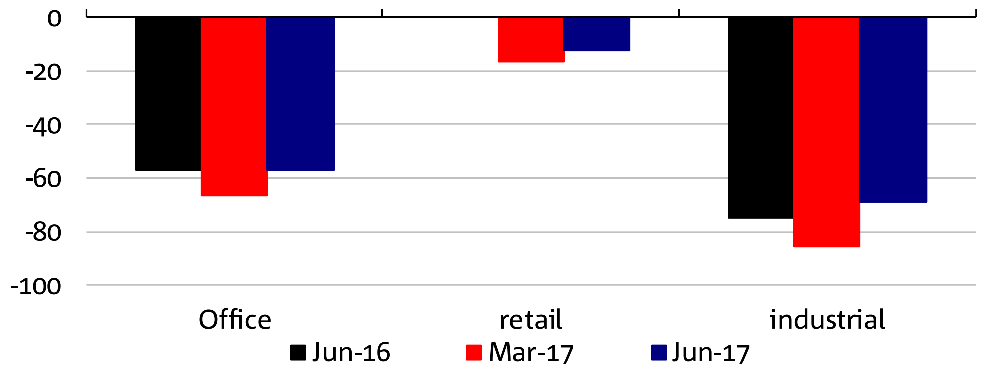


CHART 20: NAB COMMERCIAL PROPERTY INDEX - WA

Per cent of responses



Source: ABS, JLL, NAB Group Economics

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LABOUR MARKET:

WA's labour market may have turned a corner, but expect a delay in higher wages

The labour market looks to have turned a corner and should see further improvement as the headwinds from falling mining investment fade away. Better employment growth (32.8k jobs created in the year to August), relatively muted population growth and a lower participation rate have helped lower the unemployment rate from its recent highs (Chart 21). That said, the underemployment rate in WA remains close to record highs at 9.6%.

Despite being on a better path, it will likely take time before lower labour market slack translates into higher wage pressures – something that is taken longer than expected in other states with much tighter labour markets (chart 22).

Over the past year, agriculture actually saw the largest increase in employment, coinciding with a near-record grain harvest, followed up by the service based industries of education, finance and hospitality (chart 23). In contrast, construction, transport and mining were the biggest drag on jobs growth, consistent with what you would expect from the current phase of the mining cycle.

CHART 21: UNEMPLOYMENT RATE BY REGION

Per cent, nsa

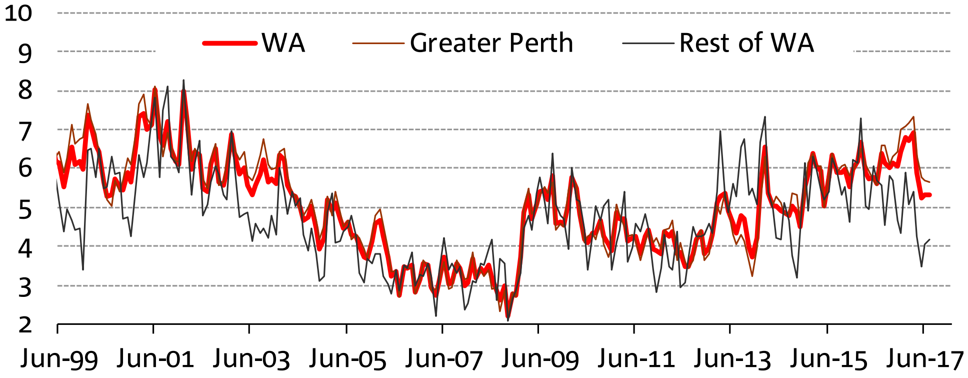
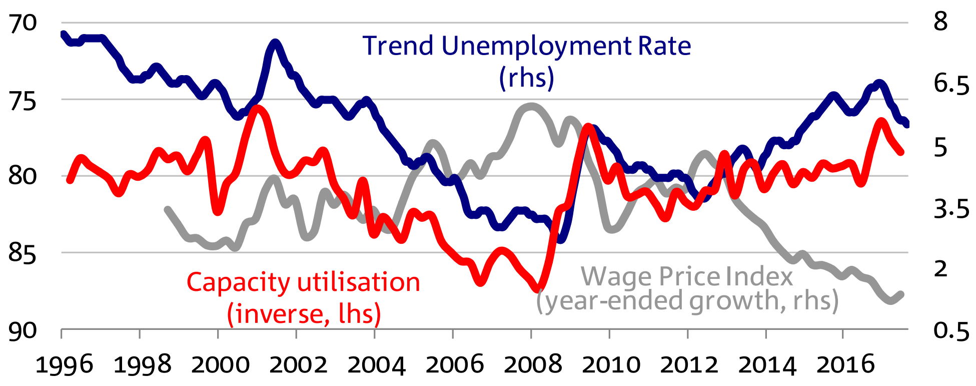


CHART 22: UNEMPLOYMENT RATE & NAB CAPACITY UTILISATION RATE

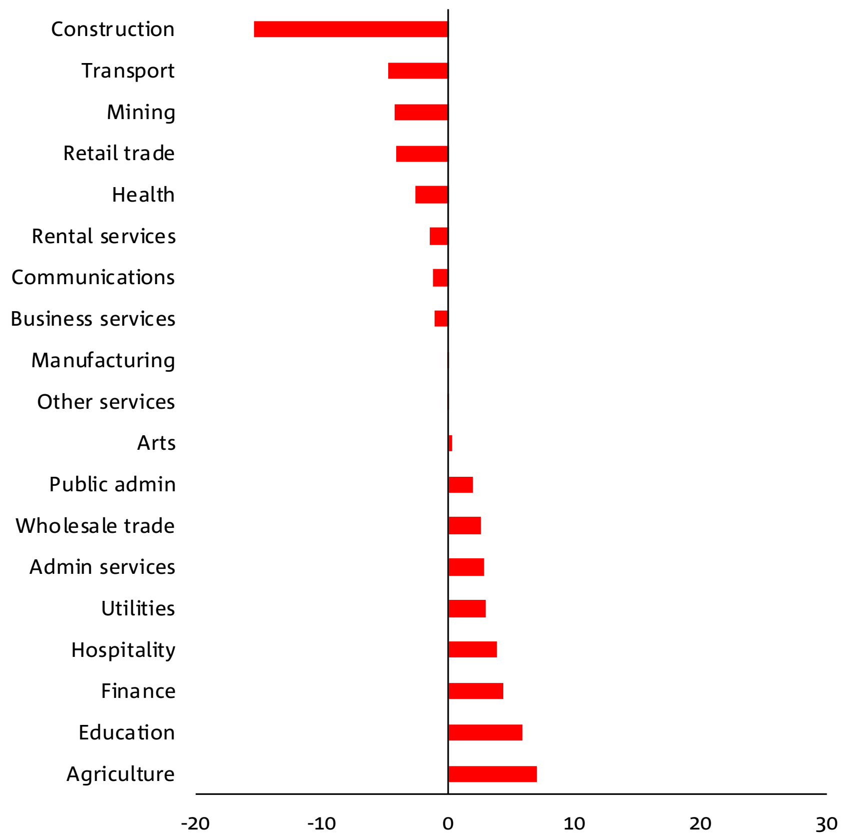
Per cent



Source: ABS, NAB Group Economics

CHART 23: CHANGE IN EMPLOYMENT BY INDUSTRY, WA

Last 12 months, thousands



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 dipped well 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.

Interstate outflows appear to have picked-up further, despite the fact that Australian born workers have seen a solid rise in full-time employment, more than offsetting a modest decline in part-time work (Chart 26). The situation for workers born elsewhere is more mixed, with north-west Europeans seeing most of the jobs growth, while New Zealand and south & central Asian workers had some of the biggest falls. In net terms though, foreign born workers gained nearly 20k jobs over the past year (mainly full-time), which may help to explain the stabilisation of net overseas migration.

CHART 24: WA POPULATION GROWTH

Thousands, over the year

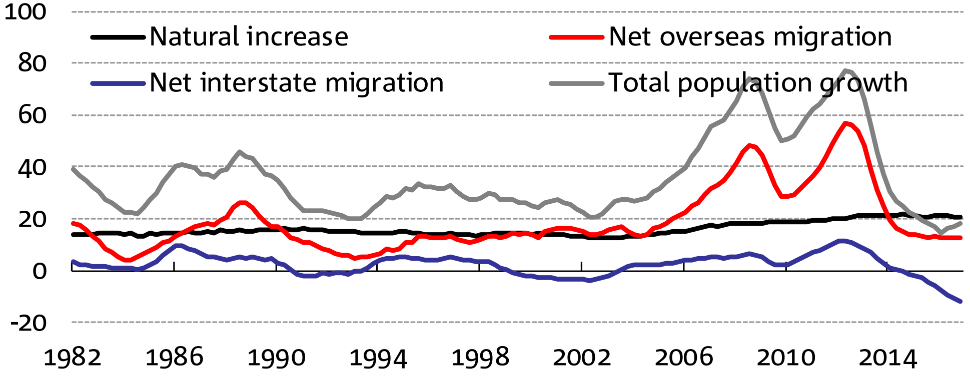
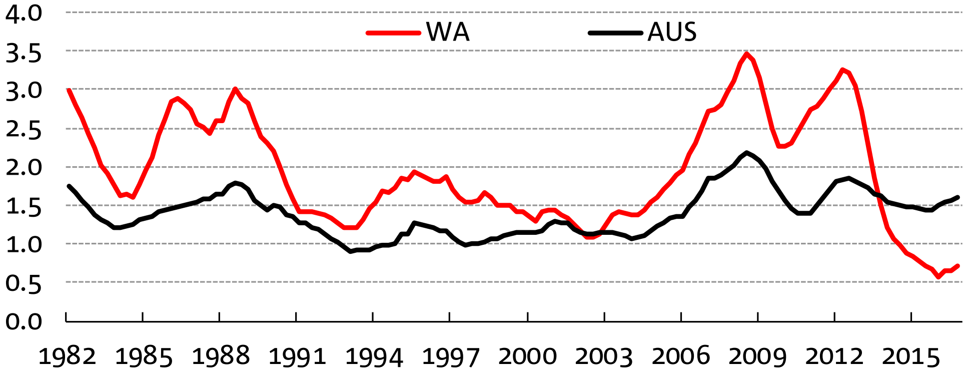


CHART 25: WA POPULATION GROWTH

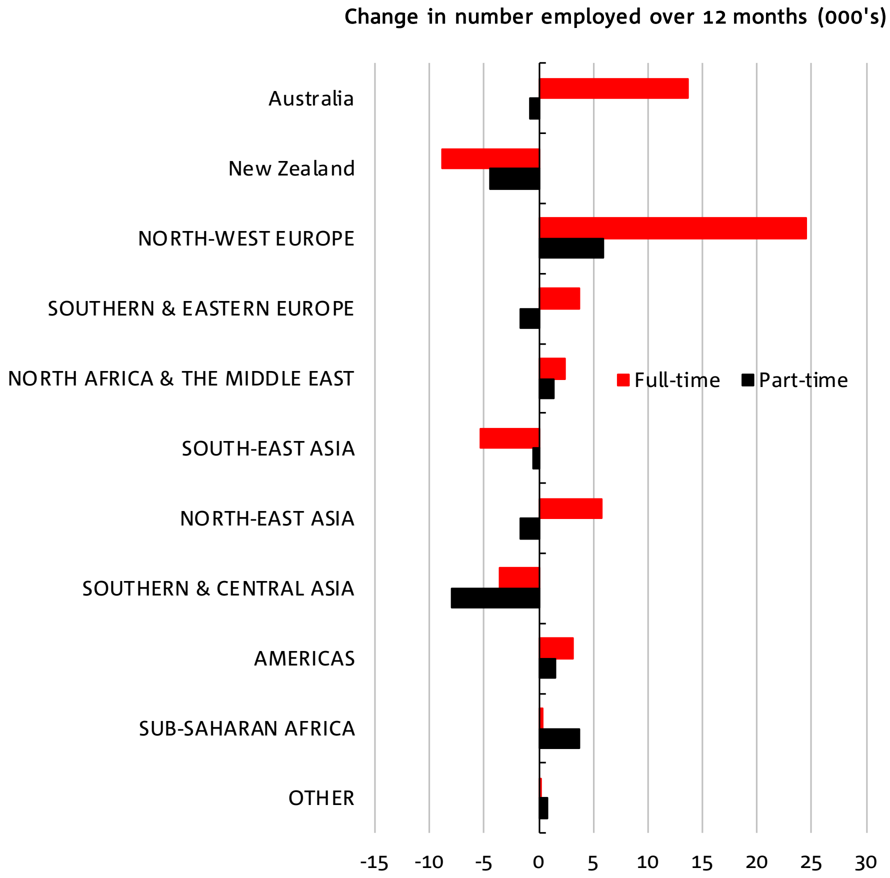
Year-ended growth



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 is slowly coming in to sight.

Unfavourable population and labour market trends continue to play out on the local housing market. The supply situation has generally not helped market conditions in recent years, as a slow response to stronger demand during the mining boom saw supply enter the market after demand conditions had turned. That pushed the market into 'oversupplied' territory from around 2014-15. Perth property prices are 2.8% lower over the past year, and are down 10.8% from their peak. Prices have been falling across most property types and regions (Charts 29 & 30).

Regional prices have seen a similar trend (Chart 29), although regions within close proximity of mining operations tended to perform particularly poorly – albeit showing some signs of stabilising in some areas more recently.

In terms of the timing for a recovery, the NAB Property Survey suggests a return to positive price growth within the next two years (Chart 28), which is still a while off. NAB expects Perth house prices to remain soft in 2017; forecast to fall 3% in 2017 (apartment prices down 1.9%), but to gradually recover from 2018. Encouragingly, housing finance data suggests that policy initiatives have encouraged more first home buyers into the market (currently 27.5% of commitments, from <20% in early 2016).

The sharp deterioration in market conditions saw the dwelling construction cycle peaked in late 2015, while private dwelling investment has declined by over a quarter in just the past year. Steady declines in both approvals and commencements suggest that is unlikely to turn around any time soon (Chart 29).

CHART 27: WA RESIDENTIAL APPROVALS & COMMENCEMENTS

Per cent

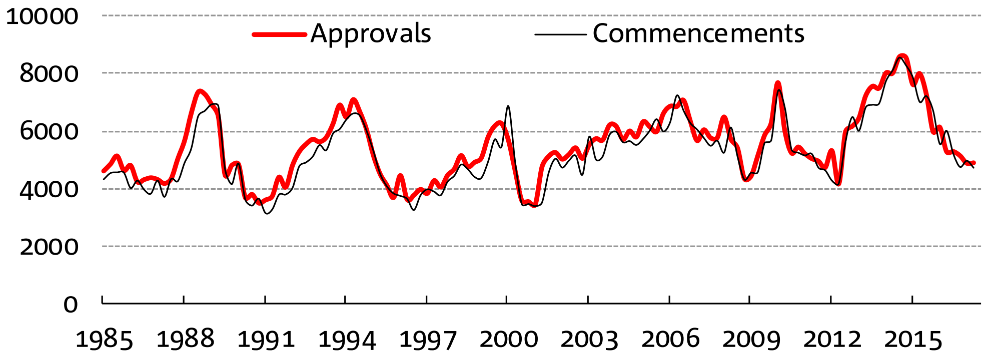


CHART 29: WA RESIDENTIAL PROPERTY PRICE GROWTH

Per cent

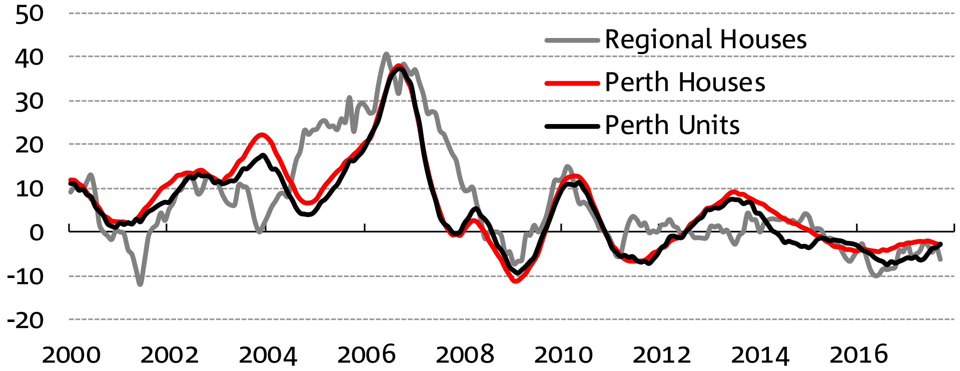


CHART 28: NAB SURVEY – HOUSE PRICE EXPECTATIONS

Per cent

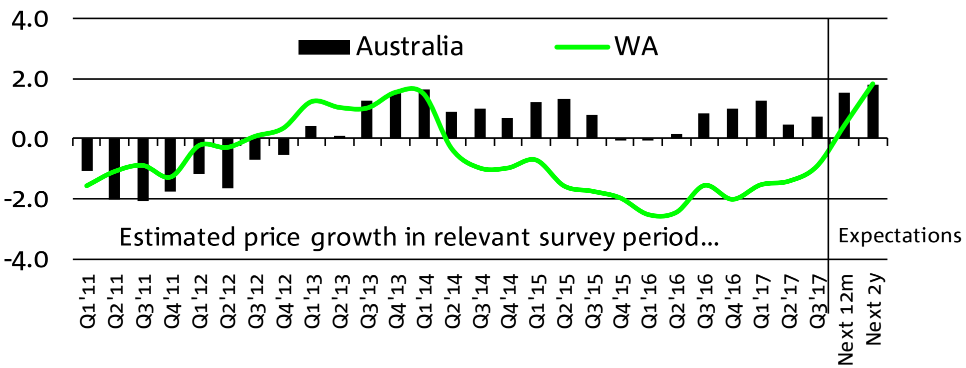
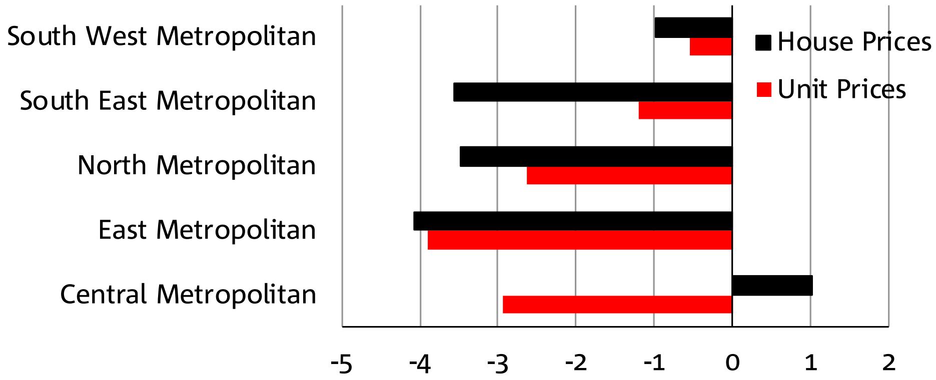


CHART 30: PERTH - MEDIAN PROPERTY PRICE GROWTH

Year to Q2 2017



Source: ABS; CoreLogic; NAB Economics

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FISCAL POSITION:

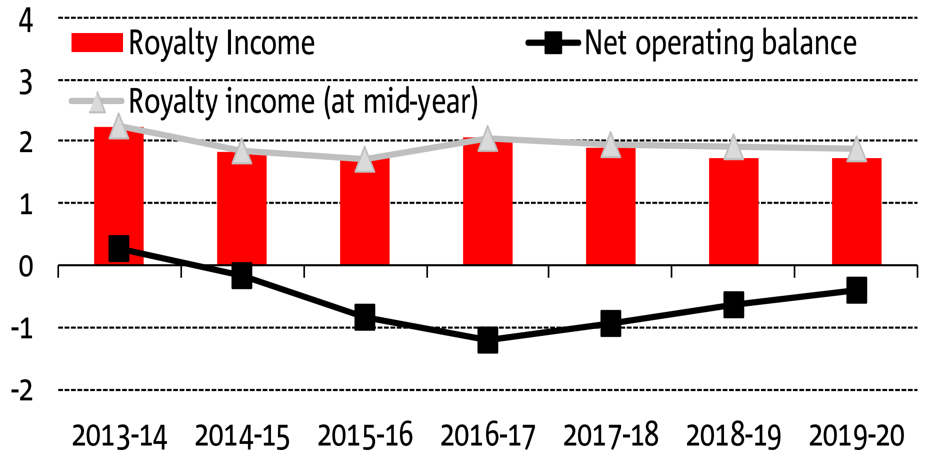
Weaker iron ore prices and USD weighing on the budget position

The Budget for 2017-18 revealed a significant deterioration in the Budget position, prompting actions to try and rein in spending. Since the Pre-election Financial Position Statement, the operating deficit for the three years to 2019-20 has deteriorated by a total of $2.2b, primarily driven by much weaker revenue projections – spending has been revised down with the help of the Budget repair measures. That said, the Budget still anticipates a return to surplus, although not occurring until 2020-21.

Excluding new revenue measures, the Budget estimates that revenue would have been written down by $5.1b in the three years to 2019-20, mainly resulting from lower Commonwealth grants and royalty revenue – although lower taxation revenue is also significant (Chart 33). Weaker expectations for royalty revenues reflects a downward revision to iron ore prices and a stronger than expected USD. Their current iron ore price forecast has prices easing to the high US$50s per tonne over the forecast horizon. That is slightly lower than NAB's forecast for the spot price to stabilise at around US$60, and suggests some modest upside risk to the forecast.

CHART 31: WA NET OPERATING BALANCE & ROYALTY INCOME

Per cent of GSP



Source:: WA State Budget; NAB Economics

Infrastructure spending is expected to make a modestly positive contribution to the economy next year – driven by an increase in spend by general government (although public corporations fill the gap the following year), while a total of $21.9b is to be invested between 2017-18 and 2020-21 under the state's Asset Investment Program. Relative to the PFPS, infrastructure spending has decreased by $164 million over the period 2016-17 to 2019-20.

CHART 32: WA ASSET INVESTMENT PROGRAM

$ billion

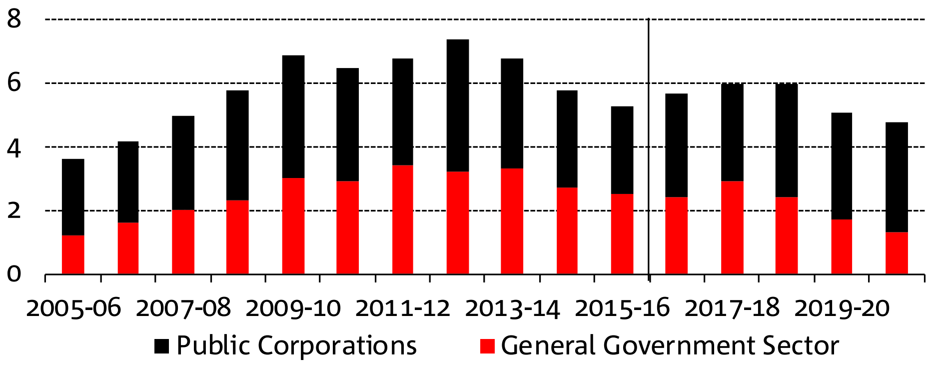
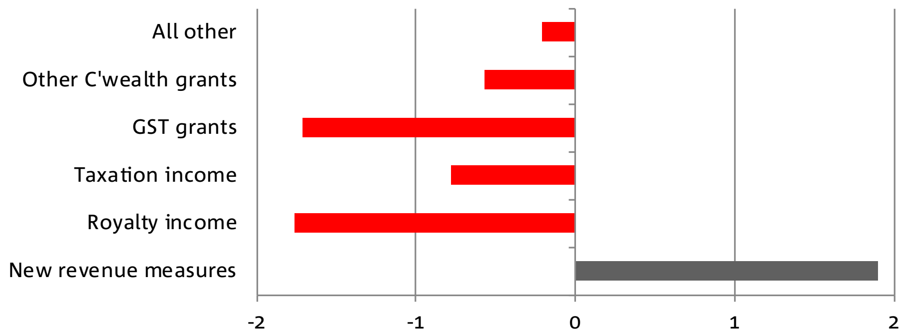


CHART 33: COMPOSITION OF REVENUE CHANGES

Change since PFPS, $ billions



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SEMI GOVERNMENT AND CREDIT OUTLOOK: WESTERN AUSTRALIA

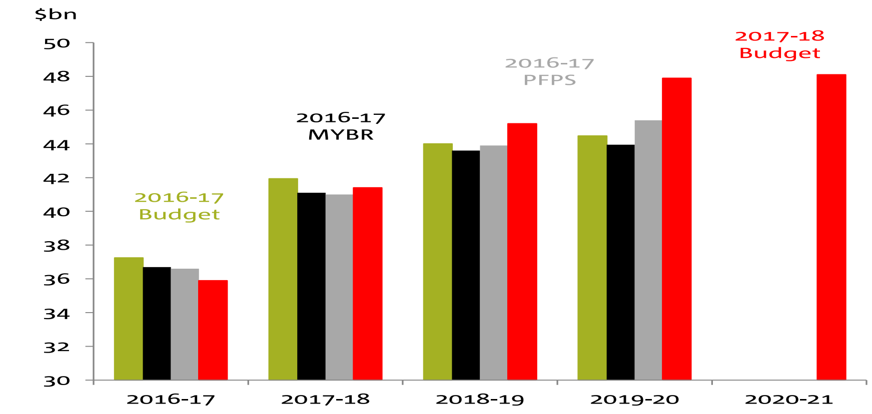
Significant debt growth

WA expects to reach a general government surplus by 2020-21, which implies a significant turnaround from a $3bn deficit in 2016-17. Total state net debt is forecast to grow from $41bn in 2016-17 to $48bn by 2020-21.

WATC projects a total borrowing program of around $6bn ($8bn including Jul-17 maturity) for 2017-18. WATC has been active FYTD and net issuance is around $2bn, including a large tap of the Oct-26 line.

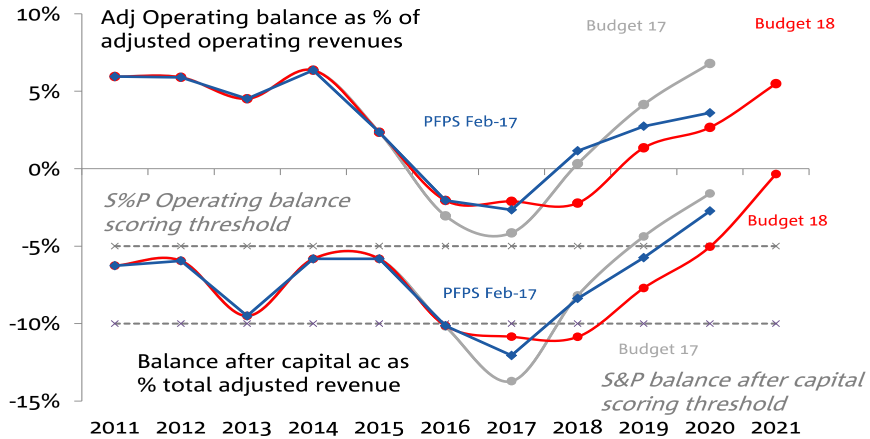
WA is rated Aa2/stable from Moody's and AA+/negative from S&P. Our estimate of S&P's budget performance metrics shows further deterioration, which suggests ratings pressure will remain in place.

CHART 34: WA NON-FINANCIAL PUBLIC SECTOR NET DEBT



Source: WA State Budgets

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



Source: WA Budget papers, NAB, S&P

WATC BORROWING PROGRAM

WATC Issuance outlook ($bn)	2017-18	2018-19	2019-20	2020-21
New Money	3.4	4.6	3.7	2.9
Maturities	5.3	6.6	7.2	6.9
Total	8.7	11.2	10.9	9.8

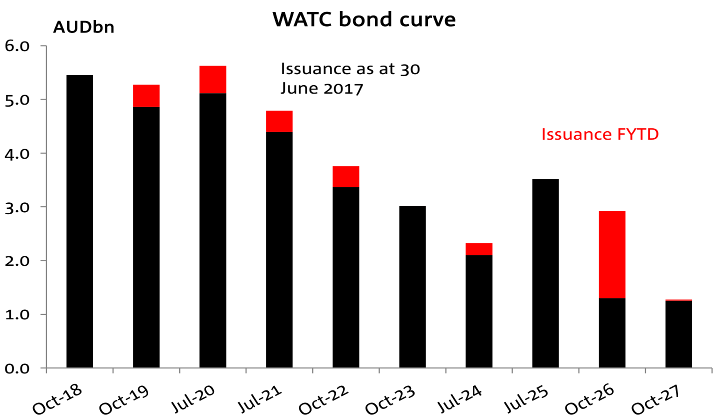
Source: WATC, Budgets, NAB

**Reflects new money estimates from WATC post-September Budget*

**Estimates are full year for FY 2017-18*

Source: WATC

CHART 36: WATC TERM BONDS OUTSTANDING



Source: WATC, NAB

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EXTERNAL TRADE:

Net exports will continue making major contributions to growth for now

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, that is expected to shift again given the weak outlook for both mining investment and residential construction. In contrast, the composition of employment is much more diverse, reflecting the relatively higher labour intensity of other industries.

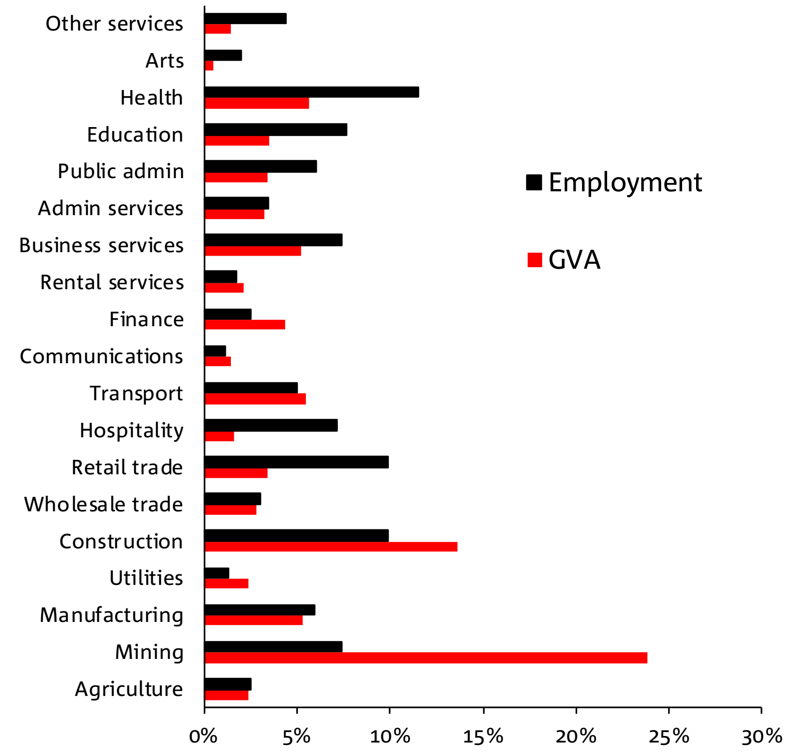
Goods export volumes in WA have seen solid, albeit volatile, growth in the past year. The upward trend is likely to continue as iron ore and LNG production ramps up towards full capacity in the coming year or so. In particular, LNG will quickly increase in importance to the WA economy as production capacity rapidly expands.

There is some offset coming from the imports side, given the large import component of major mining projects, although timely data is fairly limited due to confidentiality reasons. Merchandise trade data shows a sudden spike in imports for WA in July was behind a sudden deterioration in the trade balance (Chart 38). That likely relates to the import of an LNG terminal, and was only temporary.

These trends will see more solid net exports contributions to GSP growth over the next 1-2 years, although the contribution is expected to ease from 2017-18. The outlook for commodity prices will also be important for the nominal trade balance. NAB expects iron ore prices to stabilise at around US$60's per tonne (CFR, spot)going forward – slightly above state government assumptions in the out years.

CHART 37: COMPOSITION OF EMPLOYMENT & GVA

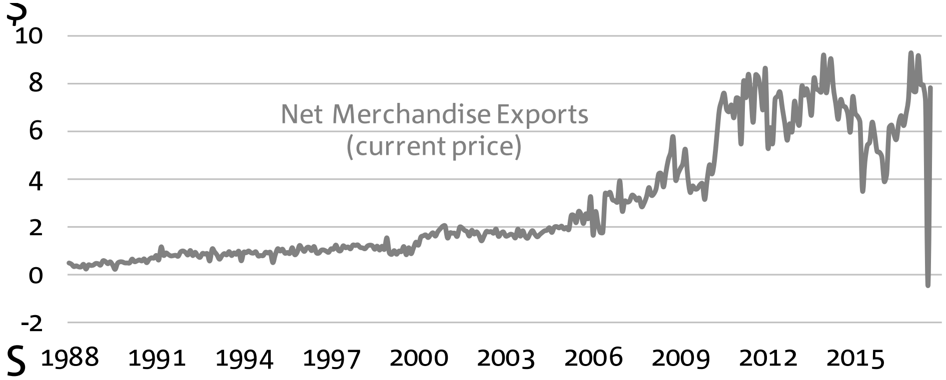
Percentage share



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	60205
2	Japan	15721
3	ASEAN	9889
4	HK	9583
5	EU	7175
6	Korea	6538
7	UK	4602
8	Singapore	2630
9	Taiwan	1893
10	India	1806
11	Germany	1548
12	US	1180
13	New Zealand	262

		Value of imports ($m)
1	ASEAN	6799
2	Japan	4182
3	China	4086
4	EU	3803
5	US	2855
6	Singapore	1777
7	Germany	921
8	New Zealand	766
9	UK	738
10	Korea	598
11	Taiwan	288
12	HK	144

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FORECASTS BY STATE AND TERRITORY

Exports to support GSP growth, while unemployment sees only gradual improvement

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			
	15-16	16-17f	17-18f	18-19f	15-16	16-17	17-18f	18-19f
NSW	3.5	2.2	3.1	2.5	5.4	5.0	4.7	4.7
VIC	3.3	2.9	3.3	2.7	6.0	5.9	5.8	5.4
QLD	2.0	2.2	3.2	2.5	6.2	6.2	6.0	5.9
SA	1.9	1.8	2.7	1.7	7.3	6.7	6.5	6.5
WA	1.9	0.3	3.2	3.0	6.0	6.2	6.2	5.9
TAS	1.3	1.0	2.2	1.8	6.5	6.1	6.0	6.0
NT	2.7	1.5	1.5	5.0	4.2	3.5	4.0	4.2
ACT	3.4	3.0	3.1	2.6	4.5	3.8	4.8	4.8
Australia	**2.7**	**2.0**	**3.2**	**2.5**	**5.9**	**5.7**	**5.4**	**5.3**

HEDONIC HOUSE PRICE FORECASTS*

Through the year growth to Q4

	2015	2016	2017f	2018f	2019f
Sydney	15.5	10.7	5.1	3.7	3.0
Melbourne	15.8	9.5	8.6	5.5	3.4
Brisbane	6.9	2.7	3.1	1.9	1.2
Adelaide	3.8	3.8	3.4	1.7	1.7
Perth	-4.2	-2.9	-3.0	0.7	1.2
Hobart	7.0	9.6	10.0	4.9	1.7
Cap City Avg	11.2	7.3	4.6	3.4	2.5

HEDONIC UNIT/APARTMENT PRICE FORECASTS *

Through the year growth to Q4

	2015	2016	2017f	2018f	2019f
Sydney	13.1	5.8	5.9	0.5	0.6
Melbourne	7.5	4.7	6.4	1.2	-2.4
Brisbane	1.1	-3.0	-1.1	-1.8	-1.2
Adelaide	2.4	0.6	0.5	0.5	0.5
Perth	-2.8	-6.3	-1.9	0.4	0.7
Hobart	1.1	6.4	5.7	2.4	0.6
Cap City Avg	8.2	3.5	4.7	0.5	-0.3

Source: ABS, CoreLogic, NAB Economics

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