ATTACHMENT A

2019 State Wage Case – Economic Outlook[1,2]

1. Overview

The Western Australian economy is forecast to grow by 2% in 2018-19, after growing by 1.9% in 2017-18, and its first contraction on record of 1.8% in 2016-17. Current economic conditions have been impacted by an ongoing tightening in access to credit in response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) as well as declining house prices, both nationally and at a State level. These factors have moderated growth in household spending and dwelling investment, at a time when business investment continues to decline as construction work on the last remaining LNG projects is completed.

Growth in the State's economy, as measured by Gross State Product (GSP)[3], is expected to pick up to 3.5% in 2019-20 underpinned by the first substantial lift in business investment in seven years, reflecting the commencement of work on a number of new resource and infrastructure projects and a ramp-up in work on existing projects. GSP growth is forecast at 3% per annum in 2020-21 and beyond, with the domestic economy becoming the major driver of growth and export volumes stabilising as iron ore and LNG projects operate at output capacity.

Many of the factors underpinning growth in the domestic economy in 2019-20 are expected to sustain growth over the Budget period. Household spending is expected to progressively increase over the forecast period due to a consolidation in consumer confidence, a lift in population growth and a strengthening in labour market conditions. Combined with continued growth in business and dwelling investment, this is expected to support ongoing growth in the overall economy.

The State's domestic economy, as measured by State Final Demand (SFD), is projected to contract by 1% in 2018-19, mainly reflecting declines in business and dwelling investment. A pick-up in growth in household consumption and a return to growth in business investment are expected to result in SFD growth rebounding to 3% in 2019-20. SFD growth is then expected to stabilise at 3.5% from 2020-21 onwards, supported by growth across all major sectors of the domestic economy, particularly household consumption, dwelling investment and business investment. Nonetheless, the size of the domestic economy by the end of the forecast period is still projected to be about $6 billion lower than its peak in 2012-13.

Construction of new and replacement iron ore projects and new lithium projects are expected to contribute to employment growth of 1.75% (or 23,500 jobs) in 2019-20. In addition, Government investment in major road and rail infrastructure projects will support improvements in the labour market.

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1 The forecasts for Western Australia's economic aggregates in this attachment are those published in the Western Australia State Budget 2019-20, released on 9 May 2019.

2 Data for historical levels of activity and historical growth rates are based on data published by the Australian Bureau of Statistics, unless otherwise stated.

3 GSP is the most complete measure of Western Australia's economic activity, as it includes domestic activity and net external demand for Western Australia's goods and services.

After moderating for several years, population growth in Western Australia has picked up slightly (reaching 0.8% in annual average terms in the September quarter 2018) from a trough in the March quarter 2017 (at 0.6%, the lowest rate of growth since the Second World War). Net overseas migration also appears to have turned, and is increasing at its strongest rate since 2012. The outflow of migrants from Western Australia is also slowing, with net interstate migration expected to turn positive from 2021-22.

Population growth is expected to remain subdued at 1% in 2018-19 and 1.3% in 2019-20, with natural increase being the primary driver of growth until 2019-20. Population growth is projected to gradually lift over the forward estimates period to 1.7% by 2022-23 (in line with average growth over the past 28 years), as Western Australia's share of national net overseas migration gradually returns to its long run average and net interstate migration recovers, consistent with improvements in the domestic economy.

Table 1 – Major Economic Aggregates, Annual Growth (%)

	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
	Actual	Estimated Actual	Budget Estimate	Forward Estimate	Forward Estimate	Forward Estimate
State Final Demand	1.0	-1.0	3.0	3.5	3.5	3.5
Gross State Product	1.9	2.0	3.5	3.0	3.0	3.0
Employment	2.2	1.0	1.75	2.0	2.0	2.25
Unemployment rate [a]	6.1	6.25	6.0	5.75	5.5	5.25
Consumer Price Index	0.9	1.25	1.75	2.25	2.5	2.5
Wage Price Index	1.5	1.75	2.25	2.75	3.0	3.25
Population	0.8	1.0	1.3	1.5	1.6	1.7

(a) Data expressed as annual average during the financial year.

Source: Western Australia State Budget 2019-20

A table providing more detailed forecasts is provided at the end of this Attachment.

2. Global Outlook

Global economic conditions started to weaken late in 2018, particularly in advanced economies. Weakness was concentrated in manufacturing and so the downturn was particularly evident in major manufacturing nations such as Japan and Germany. Notwithstanding this, commodity prices remained relatively elevated, supported in large part by resilient construction activity in China and ongoing demand growth in populous nations in South and South East Asia, such as India and Vietnam. The International Monetary Fund (IMF) is projecting that the global economy will expand by 3.3% in 2019, down from 3.6% in 2018[4]. Growth is then forecast to rebound to 3.6% by 2020 and remain broadly stable across the remainder of the forecast period.

Risks to the global economic outlook are more heavily weighted to the downside. The recent softening of growth in advanced economies represents some downside risk in the short term. However, risks to commodities demand are considered more balanced, due to policy stimulus in China and positive outlooks for the populous nations in South and South East Asia.

4 *World Economic Outlook Update*, April 2019.

Economic growth in major advanced economies became less synchronised throughout 2018. The Euro area and Japan also slowed significantly while growth in the United States (US), supported by fiscal stimulus, remained relatively buoyant over the year. Risks to growth are weighted to the downside as momentum remains weak in the Euro area and Japan, and risks are emerging in the US. According to IMF projections, economic growth in advanced economies will decrease from 2.2% in 2018 to 1.8% in 2019 and continue to trend down to 1.6% by 2022. Growth is initially expected to slow as a result of the unwinding of the cyclical upswing before structural factors, such as ageing populations, become the source of slower growth.

Table 2 – IMF Global Economic Forecasts

Annual GDP Growth, %

			IMF Projections	
	2017	**2018**	**2019**	**2020**
World	3.8	3.6	3.3	3.6
Advanced Economies	2.4	2.2	1.8	1.7
United States	2.2	2.9	2.3	1.9
Euro Area	2.4	1.8	1.3	1.5
Japan	1.9	0.8	1.0	0.5
Other Advanced Economies	2.9	2.6	2.2	2.5
Emerging market and developing economies	4.8	4.5	4.4	4.8
China	6.8	6.6	6.3	6.1

Source: IMF World Outlook, April 2019

2.1 Global commodity markets

Demand for commodities has been stronger than expected over the past year. In Australian dollar terms, prices for the commodities most relevant to Western Australia were higher in 2018-19 than in 2017-18, with increases in iron ore, gold, oil, LNG and alumina partially offset by declines in copper and zinc. As a result, the commodity price index has continued to rise, but still remains well below the extraordinarily high levels that were seen during the mining investment boom. Strong commodity prices in 2018-19 to date have supported mining revenue. A stronger US dollar relative to the Australian dollar has further increased mining revenue.

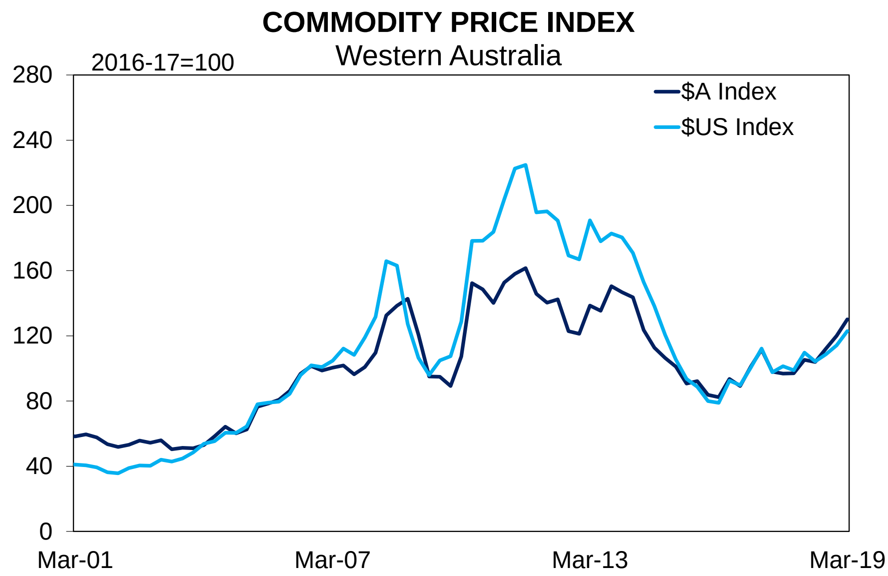
After trading at $US66.2 per tonne (at the 3 December 2018 cut-off date for the Mid-year Review), the 62%Fe benchmark iron ore price increased to around $US75 per tonne by late January 2019. This increase came on the back of a more positive demand outlook resulting from a de-escalation in the US-China trade dispute and increasing fiscal stimulus in China. The iron ore price has since increased further following the collapse of a tailings dam at Vale’s Córrego do Feijão mine on 25 January 2019. The dam collapse has reduced Vale’s production and tightened global supply, shifting the iron ore market from a small surplus position immediately prior to the collapse to a deficit in 2019. The tightness in the iron ore market makes the price more susceptible to short-term supply impacts, such as the recent Cyclone Veronica, exacerbating volatility.

Western Australian lithium-spodumene concentrate export volumes are expected to rise from around 1.2Mt in 2017-18 to 1.9Mt in 2018-19, and further increased to 4.6Mt by 2022-23. Increasing production is being driven by growing demand for electric vehicle batteries. A number of the Western Australian lithium producers are progressing plans to move further up the lithium battery value chain by constructing plants to process concentrate to lithium hydroxide. While lithium prices have eased in 2018-19 with additional supply entering the market, lithium is expected to provide an increasing contribution to the value of Western Australia’s mineral production as export volumes rise, supported by strong growth in global demand.

The oil market is important for Western Australia as it is a major cost input for business and a significant source of export income, largely through the link between oil and LNG prices. The significance of oil to Western Australia's economy is likely to grow as LNG, a cleaner alternative to coal, increases in popularity, especially in China where imports have increased by around 40% for two consecutive years. Oil prices have been extremely volatile so far in 2018-19, with Brent crude trading as low as about $US50/barrel and as high as nearly $US90/barrel, as the market balance swung from deficit to surplus.

Despite increases over 2018 and early 2019, prices for Western Australia's key commodities are expected to remain low compared to levels reached during the mining investment boom (see Chart 1).

Chart 1 – Commodity Price Index[5]



Source: Refinitiv and Treasury

3. National Economic Outlook

The Australian economy (as measured by Gross Domestic Product, GDP) is expected to grow by 2.25% in 2018-19, after expanding by 2.8% in 2017-18. As such, short term growth is expected to remain below the historical average of 3.0% per annum.

As detailed in the 2019-20 Budget and Pre-election Economic and Fiscal Outlook, the Commonwealth Treasury expects growth of the Australian economy to accelerate to 2.75% in 2019-20 (see Table 3) and stabilise at that rate in 2020-21, before strengthening to 3.0% per annum over the remainder of the budget period. The Commonwealth Budget notes some factors impacting the national economy, including that internationally, there has been some loss of momentum in key economies including in the Euro area. On the domestic front, tighter credit conditions and a decline in house prices have affected household consumption and dwelling investment.

[5] The Commodity Price Index is weighted index of prices of iron ore, gold, oil, LNG, copper, nickel, zinc, alumina and lithium.

Dwelling investment has been weak in 2018-19, and is expected to be a drag on growth in both 2019-20 and 2020-21. Growth in household consumption is forecast to moderate from 2.8% in 2017-18 to 2.25% in 2018-19. Consumption of discretionary items including spending on items that relate to housing market conditions, such as household furnishings and motor vehicles, softened in the second half of 2018. The forecast for consumption growth has been downgraded (by 0.25 percentage points (pp) since the 2018-19 Mid-Year Economic and Fiscal Outlook) to 2.25% in 2018-19. However, household consumption growth is forecast to pick up to 2.75% in 2019-20 and 3.0% in 2020-21, underpinned by continued growth in employment and increasing wage growth, and supported by continued low interest rates and personal income tax relief.

Employment growth nationally has been above its long-run average rate for almost two years and the participation rate is also high relative to historical standards. The Commonwealth expects the current strength in the labour market to continue, with solid growth in output expected to support employment growth at 1.75% in 2019-20 and 2020-21, and the unemployment rate expected to remain at 5% across the budget period.

Table 3 – Major Economic Parameters, Australia

Annual Growth, %(a)

	Outcomes	Forecasts			Projections	
	2017-18	**2018-19**	**2019-20**	**2020-21**	**2021-22**	**2022-23**
Real GDP	**2.8**	2.25	2.75	2.75	3.0	3.0
Employment	**2.7**	2.0	1.75	1.75	1.5	1.5
Unemployment rate	**5.4**	5.0	5.0	5.0	5.0	5.0
Consumer Price Index	**2.1**	1.5	2.25	2.5	2.5	2.5
Wage Price Index	**2.1**	2.5	2.75	3.25	3.5	3.5

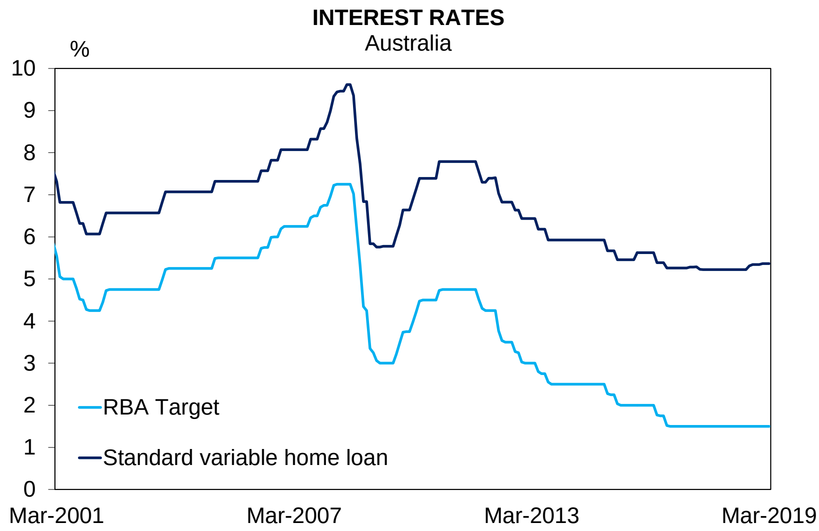
(a) Year average growth unless otherwise stated. From 2017-18 to 2020-21, employment and the wage price index are through-the-year growth to the June quarter. The unemployment rate is the rate for the June quarter. The consumer price index is through-the-year growth to the June quarter.

Source: Commonwealth Treasury 2019-20 Budget

The Commonwealth is expecting wage growth to pick up to 2.75% in 2019-20 and 3.25% in 2020-21 as economic growth strengthens and spare capacity in the labour market continues to be reduced. Nationally, growth in the Wage Price Index was 2.3% (through the year to the December quarter 2018). The response of wages in Australia to improving labour market conditions has been slower and more muted than in past cycles. This is similar to the experience in other advanced economies. The Commonwealth attributes this, at least in part, to lower inflation expectations and spare capacity in the labour market as indicated by broader measures of labour underutilisation. This in turn reflects, at least in part, that strong employment growth has also drawn people into the labour market who were not previously looking for work. Slower wage growth, in Australia’s case, also reflects adjustments associated with the unwinding of the terms of trade boom.

The RBA target cash rate has remained at the record low of 1.5% since the cash rate was lowered by 0.25 pp in August 2016. Despite this, access to credit has tightened in response to the findings of the Royal Commission. The tightening in access to credit has been compounded by small out of cycle increases in mortgage rates (see Chart 2).

Chart 2 – Interest Rates



Source: Reserve Bank of Australia

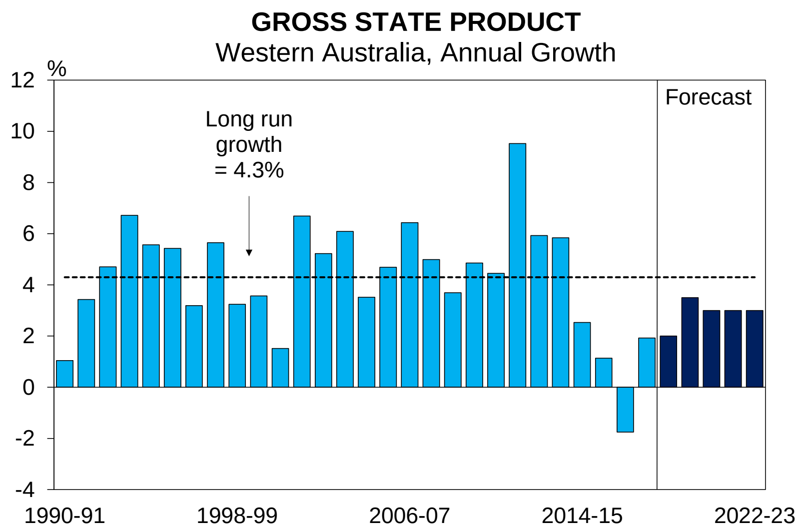
4. Western Australia's Economic Outlook

The deterioration in the short-term economic outlook for the State since the 2018-19 Budget has coincided with weakness at both the global and national levels over the second half of 2018. Global growth has been revised down by the International Monetary Fund, and a tightening in access to credit across Australia, coupled with declining house prices, has impacted household consumption and dwelling investment.

In 2018-19, the Western Australian economy is forecast to grow by 2.0%, up slightly from 1.9% in 2017-18. In 2019-20, both the domestic economy, particularly business investment and household consumption, as well as net exports are expected to contribute to GSP growth of 3.5%.

From 2020-21, GSP is expected to grow by 3% per annum. The domestic economy is expected to be the key driver of GSP growth. Over the same period, net exports are also expected to contribute to GSP growth, but by less than the domestic economy, and at a lower rate than in recent years, reflecting that the mining investment outlook is geared towards maintaining, rather than increasing, output capacity in key commodities.

Chart 3 – Gross State Product



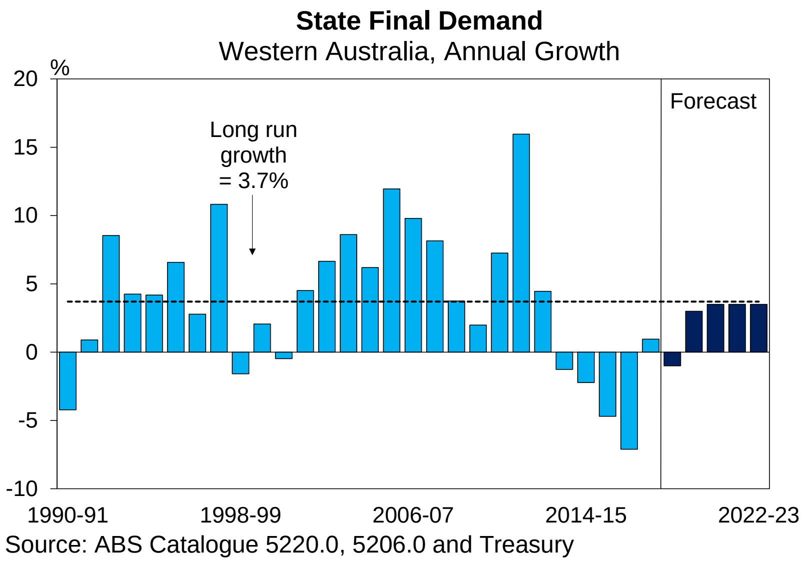
Source: ABS Catalogue 5220.0, 5206.0 and Treasury

Domestic Economy

SFD is expected to decline by 1% in 2018-19, reflecting declines in dwelling investment and business investment partially offset by weak growth in household consumption as well as growth in government consumption and investment. Household spending on housing and consumer goods and services has been affected by the tightening of credit availability through 2018 which has impacted both the State and national economies. Spending has also been impacted by a weaker outlook for wealth as a result of declining house prices.

SFD is projected to grow by 3% in 2019-20, before stabilising at 3.5% per annum (slightly below the long run growth rate), underpinned by a lift in growth of household spending and business investment.

Chart 4 – State Final Demand



In contrast to the current weakness in Western Australia's domestic economy, domestic demand nationally has increased in recent years (2.9% in 2017 and 3.0% in 2018), reflecting that key components of domestic demand have grown at a stronger pace (see Table 4). In particular, business investment expanded at the national level despite a decline for Western Australia.

Table 4 – Components of Economic Growth (Seasonally Adjusted)

Annual Average Growth to December 2018, %

	Western Australia (%)	Australia (%)
Household consumption expenditure	1.1	2.6
Business Investment	-6.2	3.9
Dwelling Investment	4.3	4.4
Government Consumption	1.6	4.8
Government Investment	-6.5	1.1
State/Domestic Final Demand	-0.5	3.0
International exports[(a)]	5.8	5.0
International imports[(a)]	N/A	4.1
Gross Product	N/A	2.8

(a) Exports/imports refers to merchandise (goods) and services exports/imports.

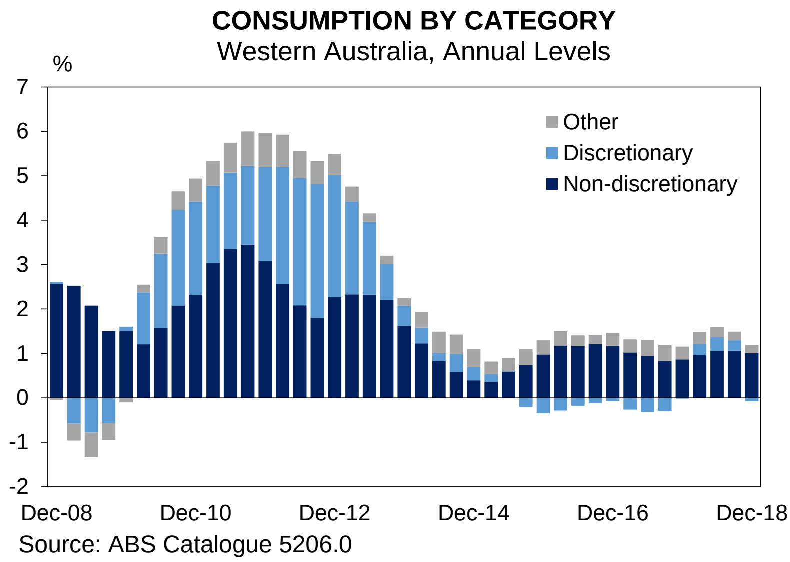
Source: ABS Catalogue 5206.0

A more detailed analysis of the individual components of GSP is contained in the remainder of this section.

4.1 Consumer Spending

Household consumption is expected to grow by just 0.75% in 2018-19, after increasing by 1.6% in 2017-18. This moderation in growth reflects a softer outlook for wealth (proxied by house prices), modest growth in wages and a recent slowdown in employment growth. Recent improvements in consumer sentiment have not yet translated into higher spending, as households have maintained a high savings rate and continue to restrain spending on non-essential goods. A gradual recovery in household income and wealth, together with a steady increase in population growth over the forecast horizon, is expected to support a modest increase in consumption growth to 1.75% in 2019-20 and 3.5% by 2022-23.

Chart 5 – Consumption by Category



4.2 Dwelling Investment

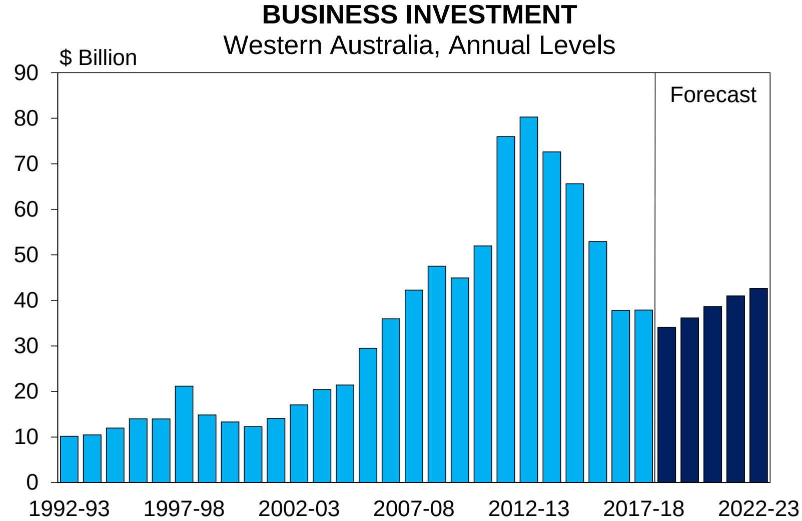
Dwelling investment is expected to weaken in the short term, reflecting the tightening of credit across Australia in response to the Royal Commission. This is flowing through to the residential construction market through declining housing finance and building approvals. Reflecting the trends in these leading indicators, dwelling investment is expected to decline by 1.75% in 2018-19 and by a further 2.75% in 2019-20.

Dwelling investment is expected to resume growing from 2020-21 onwards, reflecting that a tighter rental market and limited additions to stock in recent years have constrained supply, while stronger labour market conditions and population growth provide a base for a lift in demand for new housing.

4.3 Business Investment

Business investment is expected to decline by 10% in 2018-19 due to the completion of construction work on the last major LNG projects. Investment is then expected to increase, growing by 6% in 2019-20. The lift in investment will be primarily supported by iron ore projects that are intended to replace production at existing mines, and new lithium projects. Investment is expected to continue its growth trajectory over the remainder of the forecast period, underpinned by spending required to maintain recent increases in Western Australia's output levels in the iron ore and oil and gas sectors. In dollar terms, business investment is expected to increase to $43 billion by 2022-23, $8.5 billion above the 2018-19 level.

Chart 6 – Business Investment



Source: ABS Catalogue 5206.0 and Treasury

International Trade

4.4 Merchandise Exports

Merchandise exports are forecast to grow by 4% in 2019-20 as the remaining LNG projects ramp up shipments and as lithium and gold production increase. This follows anticipated growth of 4.25% in 2018-19, underpinned by LNG and gold exports.

Growth in exports is expected to ease from 2020-21, as the current batch of investment projects (which flow through to exports with a lag) are predominantly intended to maintain, rather than increase, output of key commodities. Nonetheless, from 2017-18 to 2022-23, Western Australia's merchandise exports are forecast to increase from around $130 billion to $150 billion (in real terms), with the majority of exports comprising iron ore and LNG.

4.5 Merchandise Imports

Merchandise imports are forecast to decline in 2018-19 as fewer imports of large capital goods are required for the construction of major projects, and consumer goods imports fall in response to weak household spending. Imports are expected to increase over 2019-20 to 2022-23, consistent with a projected lift in both business investment and household consumption.

5. The Labour Market

Conditions in Western Australia's labour market have softened over the past year, in line with broader economic conditions. Key labour force statistics for the Western Australian economy are summarised in Table 5.

Table 5 – Population and Labour Force Forecasts

Western Australia

	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Annual Level						
Total population ('000)	2,587	2,614	2,647	2,686	2,730	2,777
Working age population (15-64) ('000)	1,713	1,720	1,732	1,750	1,773	1,799
Employment ('000)	1,332	1,345	1,369	1,396	1,424	1,456
Unemployment ('000)	86	90	87	85	83	81
Unemployment rate (%)	6.1	6.25	6.0	5.75	5.5	5.25
Participation rate [(a)] (%)	68.3	68.4	68.6	68.7	68.7	68.7
Annual growth (%)						
Total population	0.8	1.0	1.3	1.5	1.6	1.7
Working age population (15-64)	0.0	0.4	0.7	1.0	1.3	1.5
Employment	2.2	1.0	1.75	2.0	2.0	2.25

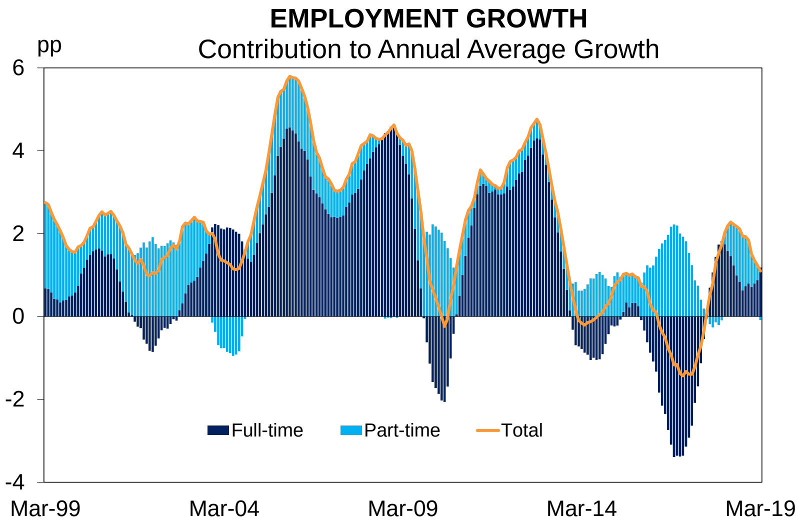
(a) Based on the population aged 15 years and over.

Source: ABS and Department of Treasury

5.1 Employment

Employment is forecast to grow by 1% in 2018-19 after growing by 2.2% in 2017-18. Annual average employment growth moderated slightly to 1.1% in March 2019 (see Chart 7), supported by full-time hiring, which contributed 1.2 pp to overall growth (offset by a decline of 0.1 pp in part-time employment). Since March 2018, an estimated 37,785 people found full-time employment in the State. This was partially offset by a contraction in part-time employment by around 29,370 people. Hiring has been led by the resources sector and related industries, while employment in other industries (including construction) has contracted.

Chart 7 – Employment Growth

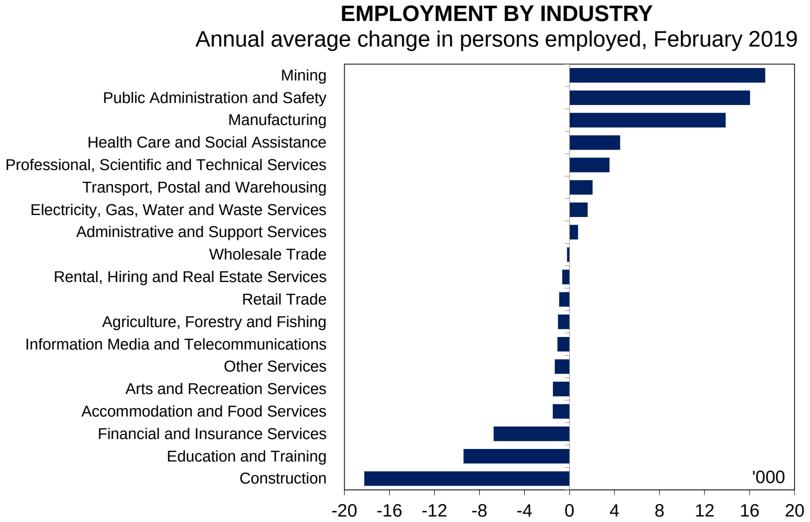


Source: ABS Catalogue 6202.0

At an industry level, the State's industries with the strongest employment growth are clustered in resource related sectors (Mining and Manufacturing), as well as Public Administration and Safety (see Chart 8). Health Care and Social Assistance, particularly aged care, appears likely to be an area of growing labour demand over the long-term.

Contributions to employment from these industries have been partly offset by declines in Construction, Education and Training and Financial and Insurance Services. Employment declined to a lesser extent in Accommodation and Food Services and Arts and Recreation Services.

Chart 8 – Employment by Industry



Source: ABS Catalogue 6291.0.55.003

Outlook

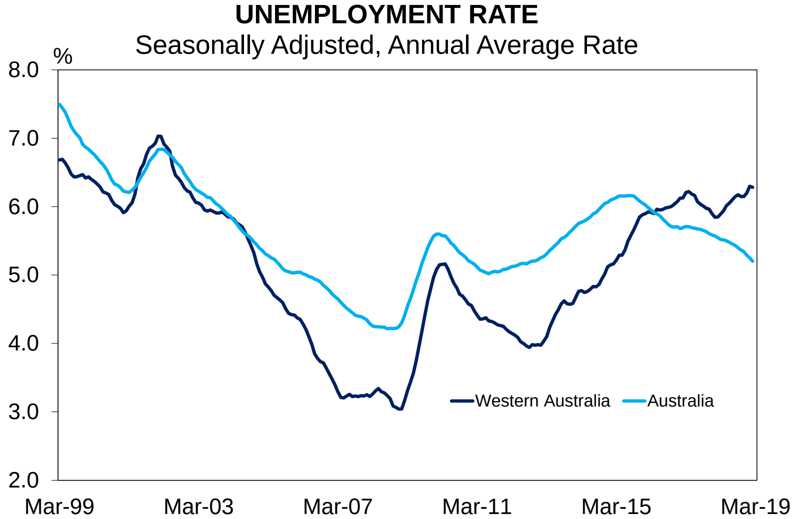
Employment growth over the forward estimates period is expected to be broadly in line with the 28-year average of 2.1%. Employment is expected to grow by 1.75% (or 23,500 additional jobs) in 2019-20, following growth of 1% (or 13,300 jobs) in 2018-19. The increased pace of employment growth in 2019-20 will be supported by the construction of new and replacement iron ore projects, new lithium projects and major road and rail infrastructure projects. Increasing employment in the healthcare and social assistance sector is also expected to contribute to growth, in line with national trends.

Overall, employment growth is expected to continue over the Budget period, supported by a range of industries. While the end of the labour-intensive construction phase of major LNG projects is expected to moderate employment growth in 2018-19, growth is then projected to strengthen to 2.25% by 2022-23, corresponding to a recovery in the domestic economy and a return to growth in business investment.

5.2 Unemployment and participation

The unemployment rate increased to an annual average rate of 6.2% in the year to March 2019 (see Chart 9), from 5.9% in March 2018, remaining above the national rate of 5.2%. Western Australia's unemployment rate has remained above the national average since April 2016. While Western Australia's rate is similar to Queensland's (6.1%), both New South Wales and Victoria have experienced relatively lower rates of unemployment in recent years to reach 4.5% and 4.8% respectively in annual average terms to March 2019.

Chart 9 – Unemployment Rate



Source: ABS Catalogue 6202.0

Demographic data shows that unemployment in the State is mixed across age groups, being far more prevalent amongst younger cohorts. The unemployment rate in the year to March 2019 was 18.9% for 15-19 year olds and 11.4% for 20-24 year olds. This may reflect the nature of available jobs, or firms having a preference for skilled labour given the current spare capacity in the labour market.

Western Australia's underemployment rate (the proportion of persons who are currently employed but would like to work more hours) declined slightly to 9.4% in annual average terms to March 2019, from a record high of 9.9% in November 2017. This indicates that there is still a large number of workers that would prefer to work more hours, and also indicates that the degree of spare capacity in the labour market is higher than the unemployment rate suggests.

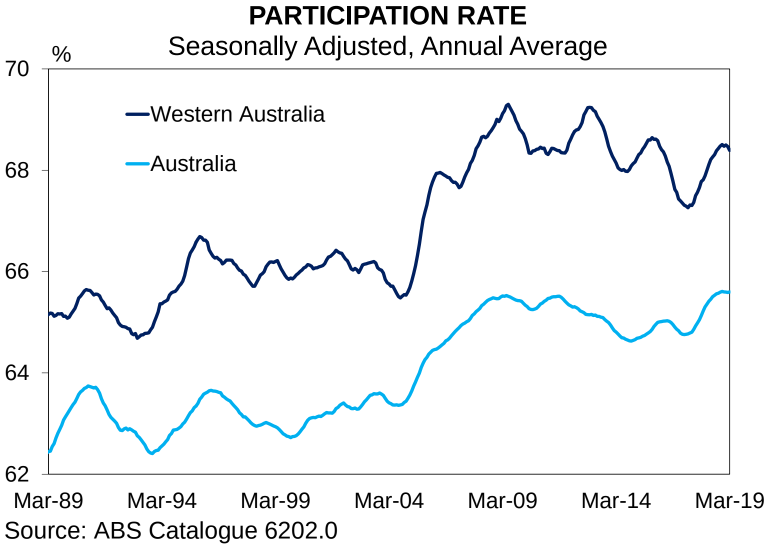
The participation rate is expected to rise to 68.4% in 2018-19, from a recent low of 67.3% in 2016-17. The average participation rate in the first nine months of 2018-19 is higher relative to the same period a year earlier for males; however, the female participation rate was stable compared to a year earlier[6]. Indeed, female participation in annual average terms reached a record high 62.5% in November 2018. In March 2019, people aged 65 years and over made up 18.1% of the working age population in WA[7], the largest share on record (though lower than 19.5% at the national level). The participation rate for this age cohort was 14.9% in the year to March 2019, compared to 10.9% a decade earlier.

Western Australia's participation rate (at annual average rate of 68.4%) has remained the highest of all States (2.7 pp higher than the second highest rate of 65.7% in both Victoria and Queensland) and 2.8 pp above the national equivalent of 65.6% in the year to March 2019.

[6] In the first nine months of 2018-19, the male participation rate averaged 74.7%, compared to 74.3% at the same time the previous year, while the female rate averaged 62.1% (stable from 62.1% at the same time the previous year).

[7] Australian Bureau of Statistics (ABS) (2019), *Labour Force, Australia, March 2019*, Catalogue 6202.0.

Chart 10 – Participation Rate



Outlook

The unemployment rate is forecast to fall from 6.25% in 2018-19 to 6% in 2019-20. Underlying spare capacity in the labour market and increased workforce participation have resulted in the unemployment rate remaining slightly higher for longer than previously expected in 2018-19. In line with the expected strengthening in employment growth over the forward estimates period, the unemployment rate is forecast to gradually fall to 5.25% by 2022-23.

The State's participation rate is expected to rise to 68.6% in 2019-20 from 68.4% in 2018-19. As employment prospects improve, more people are anticipated to join the workforce. From 2020-21 to 2022-23, the participation rate is forecast to stay at 68.7%, above the decade average of 68.4%, as the domestic economy and population growth strengthen.

6. Wages

6.1 Wage Price Index

After increasing at a record low rate (in a financial year) of 1.4% in 2016-17, Wage Price Index (WPI) growth in Western Australia remained subdued at 1.5% in 2017-18, reflecting ongoing spare capacity in the labour market.

Of the various wage indicators published by the Australian Bureau of Statistics, the WPI is generally viewed as the preferred measure of underlying wage growth. This is because the WPI is designed to measure wage changes for a fixed quantity and quality of labour, and thus abstracts from changes in average hours worked and other compositional changes in the labour market.

The State's WPI grew by 0.3% in the December quarter 2018, after increasing by 0.6% in the September quarter of 2018, both below decade-average quarterly growth of 0.7%. The WPI grew by just 1.5% 2018, which is the second lowest calendar year WPI increase on record, just above 1.4% growth in 2017.

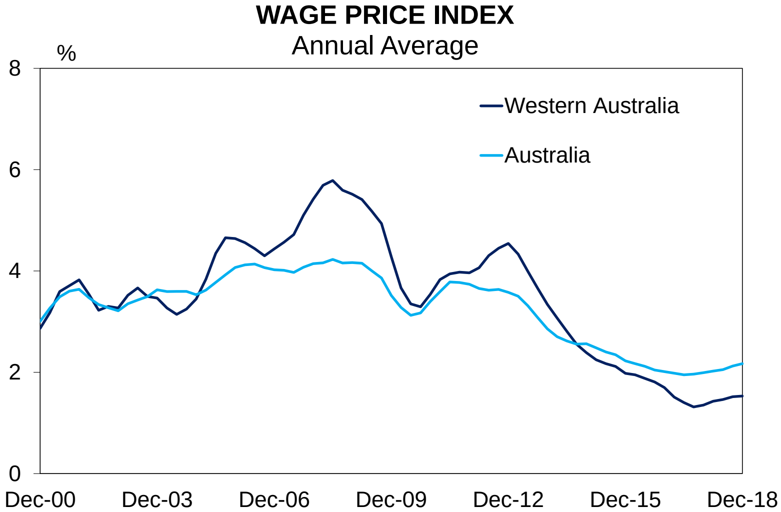
The slow annual growth in total WPI is reflected in historically subdued private sector wage changes, with the private sector WPI increasing by 1.6% in 2018, up from 1.2% in 2017. These rates are a sharp contrast with the recent peak of 4.6% growth in 2012 and the record high of 6.2% in 2007-08. Public sector wage growth was comparatively weaker in 2018, with growth of 1.4%. This was the lowest growth rate on record, down from 1.8% in 2017 and significantly lower than the recent peak of 4.3% in 2012.

National comparison
Annual wage growth at the national level has also been at historically low rates, but strengthened slightly in 2018 to 2.2%, up from 2.0% in 2017. Annual growth in the national WPI has exceeded Western Australia's growth rate in every quarter since September 2014. Prior to the September quarter 2014, the State's WPI growth had not fallen below the national average since 2004 (see Chart 11).

Historically, growth in Western Australia's WPI has exceeded the national equivalent during periods of stronger economic conditions in the State relative to national (especially prior to and following the Global Financial Crisis (GFC) when business investment was surging). The slowdown in the State's domestic economy starting in 2013-14 has resulted in a corresponding moderation in wage growth, to the point that Western Australia has had the lowest annual average wage growth across all the States since the March quarter 2015.

While the rate of growth in the WPI is expected to lift over the medium-term both in Western Australia and nationally, wage growth in Western Australia is expected to remain below national rates of growth over the period to 2022-23.

Chart 11 – Wage Price Index



Source: ABS Catalogue 6345.0

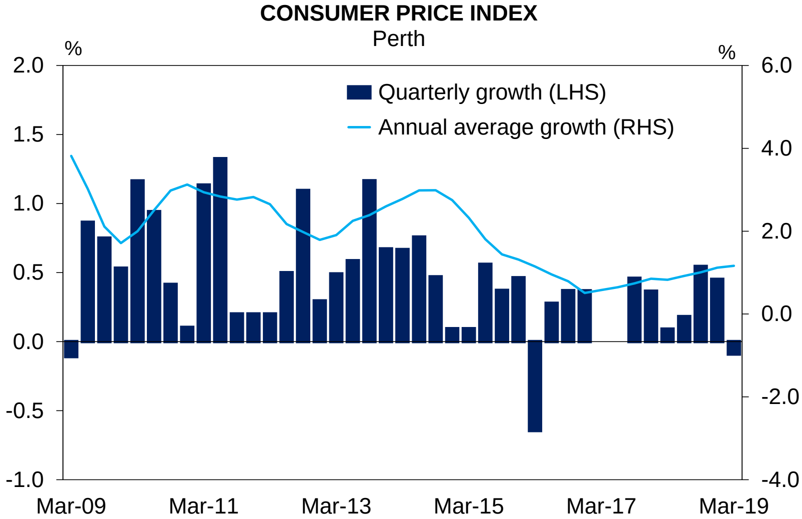
Outlook
With labour market and domestic economic conditions expected to remain soft over the near-term, the State's WPI is forecast to grow by 1.75% in 2018-19, before increasing modestly to 2.25% in 2019-20, both well below the historical average of 3.4% per annum. WPI growth is then projected to gradually increase to 3.25% by the end of the Budget forecast period (2022-23) in line with improving labour market conditions and a recovery in the economy.

7. Inflation

Prices in Perth declined slightly in the March quarter 2019, with the Perth Consumer Price Index (CPI) contracting by 0.1% (see Chart 12). This mainly reflects declines in ‘automotive fuel’ and ‘recreation and culture’ which were partially offset by rises ‘fruit and vegetables’, ‘health’ and ‘education’.

Perth’s CPI increased by 1.2% in annual average terms to March 2019, up from 0.8% growth in the same period a year earlier. The annual increase was largely supported by increases in 'alcohol and tobacco', ‘transport’ and ‘health’. The largest detractor from annual growth was ‘housing', consistent with continued falls in rents and project home prices. In year-ended terms, Perth’s inflation increased slightly from 0.9% in the March quarter 2018 to 1.1% in the March quarter 2019[8].

Chart 12 – Consumer Price Index



Source: ABS Catalogue 6401.0

The national CPI was unchanged in the March quarter 2019, down from growth in the December quarter 2018 of 0.5%. The main detractors to quarterly growth at the national level were ‘recreation and culture’, ‘transport’, ‘clothing and footwear’ and ‘furnishings, household equipment and services’. These declines were offset by rises in ‘food and non-alcoholic beverages’, ‘education’ and ‘health’. In annual average terms, the national CPI increased by 1.8% in the March quarter 2019.

Growth in underlying measures of inflation nationally may differ to the headline indicator (see Chart 13). Excluding volatile items (mainly food and automotive fuel), the national CPI grew by 1.5% in annual average terms in March 2019 (compared to 1.8% growth in the overall measure). The ‘trimmed mean’ measure (which excludes the 15% of items with both the smallest and largest price changes) increased by 1.7% in annual average terms to March 2019.

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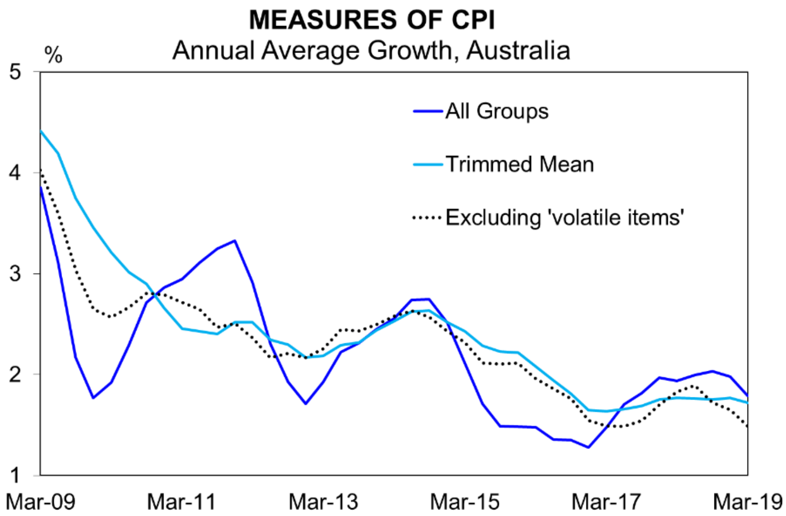
8 There are two ways in which annual changes in the Australian CPI (weighted average of eight capital cities) are commonly measured, year-ended growth and annual average growth. Year-ended growth (also referred to as “through the year” growth) compares the CPI for one quarter with the CPI for the same quarter a year earlier, while annual average growth compares the average of the CPI for four successive quarters with its average in the same four quarters of the previous year. Treasury’s preferred measure is annual average growth because it is less volatile than year-ended growth.

Outlook

Based on the most recent Budget outlook, Perth's CPI is expected to lift to 1.75% in 2019-20, supported by an expected recovery in the rental market and scheduled increases to health insurance premiums and the Commonwealth's tobacco excise. A gradual rise in inflation over this period is also consistent with the expected strengthening in the domestic economy.

Over the remainder of the forecast period, Perth's CPI growth is expected to increase towards the mid-point of the Reserve Bank of Australia's target range, reaching 2.25% in 2020-21 and stabilising at 2.5% from 2021-22, consistent with expectations of stronger domestic demand and improving labour market conditions.

Chart 13 – Measures of Consumer Price Index



Source: ABS Catalogue 6401.0

8. Risks to the economic outlook

There remains considerable uncertainty with the growth outlook for specific sectors of the State's economy.

8.1 Global risks

In the second half of 2018 there was a slowing in economic growth in a number of the major advanced countries. There is a risk that this slowing gathers momentum in 2019 which would negatively impact demand for commodities, particularly if there are negative spill overs for China. These risks could be magnified if trade disputes between major trading partners are not resolved.

Relatively strong economic growth in the US economy over the past two years supported further declines in the unemployment rate which has stabilised slightly below 4%. This supported wage growth which accelerated from around 2.5% at the beginning of 2018 to around 3.5% at the end of 2018. However, the US economy is showing signs of slowing, with quarterly growth rates declining from an annualised 4.2% in June 2018 to 2.2% in December 2018. The IMF projects that annual growth in the US will be 2.3% in 2019, and it expects US growth to continue to slow out to 2023 (1.6%).

Economic activity in the Euro area weakened significantly over the course of 2018. Manufacturing activity was a key source of weakness, which had a significant impact on Germany, the Euro area's largest economy. The outlook for the Euro area has also been clouded by ongoing uncertainty regarding the United Kingdom's plans to exit the European Union. The IMF estimates that Euro area GDP growth was around 1.8% in 2018, down from 2.4% in 2017. It forecasts that growth will continue to moderate to 1.4% by 2022, as many key economies are facing significant demographic challenges.

China is by far Western Australia's most important trading partner, accounting for around 50% of the State's merchandise exports. Therefore, changes in China's domestic economy can have a major impact on the State's economic outlook. There are tentative signs that a progressive easing of macroeconomic policy settings through 2018 may be succeeding in stabilising economic growth. Indeed, there is an upside risk that over the short term these measures could be more effective than anticipated at stimulating economic growth.

However, China has been increasing its capital stock at a very rapid rate over recent decades and there is a risk that over the long term the need for additional physical capital may decline faster than anticipated, which would adversely impact demand for construction raw materials, such as iron ore. For example, in 2009 China had around 1,200 km of high speed rail in operation. By January 2019, China had around 30,000 km of high speed rail in operation and the government announced plans to construct an additional 3,000 km in 2019. At some point, China will have met its high speed network needs.

Notwithstanding the longer-term easing in the need for new capital, the Chinese government is looking to facilitate the development of markets in emerging economies, for example through the Belt and Road Initiative, which may help mitigate the impact of the eventual decline in China's own demand for construction raw materials.

8.2 Domestic risks

The business investment outlook depends on the magnitude and timing of a number of resource sector projects. Significant changes to the timing of these projects would impact the business investment growth projections. Risks in the external trade sector mainly relate to uncertainties regarding the timing of commissioning and ramp-up of complex LNG projects, which could translate into either higher or lower merchandise export volumes than forecast.

The pace of growth in the domestic economy in the near term is dependent on the pipeline of large-scale resource and infrastructure projects. Changes to the timing of these projects may lead to employment being stronger or weaker than forecast.

Further, the forecast recovery in dwelling investment and the established residential property market could be moderated by weaker than expected increases in population and income growth, while there continues to be uncertainty regarding the ongoing impact of the Royal Commission.

Household consumption has been weak as households have maintained high levels of saving in Western Australia since the GFC. Increased spending over the forecast period is dependent on progressive increases in income and wealth (proxied by house prices) providing households with confidence to spend. There is a risk that consumers may further delay spending decisions until wages growth has been sustained and growth in disposable incomes is considered to be permanent.

Population growth underpins the expansion of the State economy and will continue to do so over the forecast period. A lower rate of migration to Western Australia from overseas and interstate could also have a material impact on forecasts for household consumption and dwelling investment.

WESTERN AUSTRALIAN STATE BUDGET 2019-20 BUDGET STATEMENT FORECASTS COMPONENTS OF GROSS STATE PROUCT

Western Australia

	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
	Actual	Estimated Actual	Budget Estimate	Forward Estimate	Forward Estimate	Forward Estimate
	(%)	(%)	(%)	(%)	(%)	(%)
Demand and output [(a)]						
- Household Consumption	1.6	0.75	1.75	2.75	3.25	3.5
- Dwelling Investment	-2.5	-1.75	-2.75	6.25	7.5	4.0
- Business Investment	0.2	-10.0	6.0	7.0	6.0	4.0
- Government Consumption	1.7	2.75	1.75	1.0	1.5	2.75
- Government Investment	-1.8	3.0	10.5	2.0	-1.0	1.0
State Final Demand (SFD)	1.0	-1.0	3.0	3.5	3.5	3.5
- Merchandise Exports	4.9	4.25	4.0	2.0	1.75	1.75
- Merchandise Imports	-4.8	-4.0	2.5	3.0	3.0	2.5
Net Exports [(b)]	8.5	8.0	4.5	1.75	1.5	1.75
Gross State Product (GSP) [(c)]	1.9	2.0	3.5	3.0	3.0	3.0
Labour market						
Employment	2.2	1.0	1.75	2.0	2.0	2.25
Unemployment Rate [(d)]	6.1	6.25	6.0	5.75	5.5	5.25
Participation Rate [(d)]	68.3	68.4	68.6	68.7	68.7	68.7
Population						
Population	0.8	1.0	1.3	1.5	1.6	1.7
Working Age Population (15-64)	0.0	0.4	0.7	1.0	1.3	1.5
Prices						
Consumer Price Index (CPI)	0.9	1.25	1.75	2.25	2.5	2.5
Wage Price Index (WPI)	1.5	1.75	2.25	2.75	3.0	3.25
Perth Median House Price	-1.1	-2.2	1.1	1.8	3.0	3.6
Other key parameters [(c)]						
Exchange Rate $US/$A (cents)	77.5	71.8	71.4	71.8	72.1	72.3
Iron Ore Price ($US per tonne) cost and freight inclusive (CFR)	68.8	76.5	73.5	65.6	63.7	63.7
Crude Oil Price ($US/barrel)	63.7	68.5	67.1	64.5	62.4	61.0

(a) Based on the 2017-18 annual State Accounts data, updated with the latest State Final Demand data for the December quarter 2018.

(b) Net exports refer to international trade in both goods and services.

(c) Forecasts for ownership transfer costs, international trade in services and the balancing item are not separately reported.

(d) Data expressed as annual average during the financial year.