

2016 State Wage Case – Economic Outlook^{1,2}

1. Overview

Following very strong growth of 6.7% over the three years to 2013-14, growth in the Western Australian economy (as measured by Gross State Product, GSP) slowed to 3.5% in 2014-15. Growth in GSP is expected to ease further to 1.5% in 2015-16, as strong contributions from the external sector are moderated by a weak domestic economy (as measured by State Final Demand, SFD).

SFD contracted by 3.5% in 2014-15, mainly due to a 12.3% fall in business investment. Domestic activity is forecast to decline further in each year out to 2017-18, marking an extended period of weakness in the State's domestic economy.

The subdued outlook for SFD primarily reflects a further tapering of business investment from unprecedented levels after peaking at \$76.5 billion in 2012-13. Business investment is projected to decline over the entire forecast period due to the ongoing completion of construction on major resource projects and because lower commodity prices (particularly iron ore and oil) have reduced the probability of major new resource projects emerging. Substantial declines in key commodity prices have also reduced revenue for mineral and energy producers in the State, leading to cost cutting, which has in time resulted in lower growth in household incomes.

Consistent with this, household consumption grew by only 1.1% in 2014-15, the weakest rate of growth since 2008-09. Consumer spending growth is expected to remain below its long-run average across the forecast period, constrained by subdued wages growth and more moderate increases in the State's population. These factors are also likely to impact dwelling investment, which is projected to contract in 2016-17 and 2017-18.

Conversely, a robust expansion in exports (especially in LNG) is expected to support economic growth over the coming years, as large resource projects increase their output. However, sustained weakness in the domestic economy is expected to contain GSP growth to below-trend rates over the next few years (notwithstanding a strengthening to 3% by 2018-19).

The weaker domestic economy has flowed through to softer labour market conditions in the State, as reflected in a rising unemployment rate, a decline in full-time employment and a further slowing of wage growth to its weakest pace on record. In line with the outlook for SFD, employment growth is expected to remain moderate over the forecast period (especially as resource projects transition to the less labour-intensive production phase), while the unemployment rate is expected to peak at 6.5% in 2015-16. Furthermore, wage growth is likely to remain subdued, consistent with businesses' efforts to reduce costs.

¹ The forecasts for Western Australia's economic aggregates in this attachment are those published in the 2015-16 Mid-Year Financial Projections Statement, released on 18 December 2015.

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.

In line with softer labour market and more modest economic conditions (especially relative to other States), Western Australia's population growth has eased from a peak of 3.5% in 2012-13 to 1.4% in 2014-15, largely driven by a fall in the number of overseas migrants moving to the State. Growth of 1.5% is expected to continue in 2015-16, before modestly increasing across the forecast period.

Inflation in Perth has been weak over the first part of 2015-16. The Perth Consumer Price Index (CPI) declined by 0.6% in the March quarter 2016, and grew by 1.1% in annual average terms, the weakest rate of growth recorded since 1998. This was mainly due to falling automotive fuel prices project home prices and declining rents. The 2015-16 Mid-year Review forecast is for CPI to grow by 1.5% in 2015-16, returning to the middle of the Reserve Bank of Australia's 2-3% target band by 2017-18.

Table 1.1: Major Economic Aggregates, Annual Growth (%) ^(a)

	2014-15 Actual	2015-16 Mid-year Revision	2016-17 Forward Estimate	2017-18 Forward Estimate	2018-19 Forward Estimate
State Final Demand (SFD)	-3.5	-2.25	-2.5	-0.5	1.25
Gross State Product (GSP)	3.5	1.5	2.0	2.75	3.0
Employment	1.5	1.25	1.25	1.5	1.5
Unemployment rate ^(b)	5.4	6.5	6.5	6.25	5.75
Consumer Price Index (CPI)	1.8	1.5	2.0	2.5	2.5
Wage Price Index (WPI)	2.2	2.0	2.25	2.5	2.75
Population ^(c)	1.5	1.5	1.6	1.7	1.9

(a) Annual average growth unless otherwise stated.

(b) Average rate over the year.

(c) Population in 2014-15 is an estimated actual.

Source: 2015-16 Mid-year Financial Projections Statement.

2. Global Outlook

According to the International Monetary Fund (IMF), the global recovery has weakened amid financial turbulence, softened economic activity in advanced economies and ongoing stresses in large emerging market economies³.

The IMF has revised down its global growth expectations for 2016 to a modest 3.2%, compared to 4.3% growth in the decade to 2008⁴. Growth prospects in emerging markets and developing economies account for the majority of projected world growth in 2016. Notwithstanding this, prospects across countries remain uneven and generally weaker than over the past two decades. The IMF expects a pickup in global growth to 3.5% in 2017.

³ Broadly, an emerging market can be distinguished from a developing economy as a country experiencing rapid growth and industrialisation. Examples include China, India, Russia and Mexico.

⁴ April 2016 *World Economic Outlook*, International Monetary Fund

Table 2.1 IMF global growth forecasts

Annual growth (%)

	2014	2015	IMF Projections	
			2016	2017
World Output	3.4	3.1	3.2	3.5
Advanced Economies	1.8	1.9	1.9	2.0
- United States	2.4	2.4	2.4	2.5
- Euro Area	0.9	1.6	1.5	1.6
- United Kingdom	2.9	2.2	1.9	2.2
- Japan	0.0	0.5	0.5	-0.1
Developing Economies	4.6	4.0	4.1	4.6
- China	7.3	6.9	6.5	6.2

Source: IMF World Economic Outlook, April 2016

Growth in China, Western Australia's largest export market (accounting for 52.9% of merchandise exports in the year to February 2016), is expected to moderate, as authorities attempt to move towards more sustainable sources of growth and decrease the economy's reliance on investment. However, growth remains slightly stronger than previously forecast. As a result, the IMF has revised up its growth forecast for China to 6.5% in 2016 and 6.2% in 2017. Growth in Japan, the State's next largest export market, is projected to be very modest at only 0.5% in 2016, with slightly negative growth forecast in 2017 (-0.1%).

The IMF's assessment is that risks to the outlook remain tilted to the downside. Key downside risks include that China's slowdown may be sharper than expected (with spillover effects that will directly affect Western Australia), and that the risk of depreciating currencies in emerging markets could worsen corporate balance sheets and reduce capital inflows in those economies. Additionally, they note the risk of stagnation and low inflation in advanced economies, as well as geopolitical risks. A key upside risk is a boost to global demand as a result of lower oil prices.

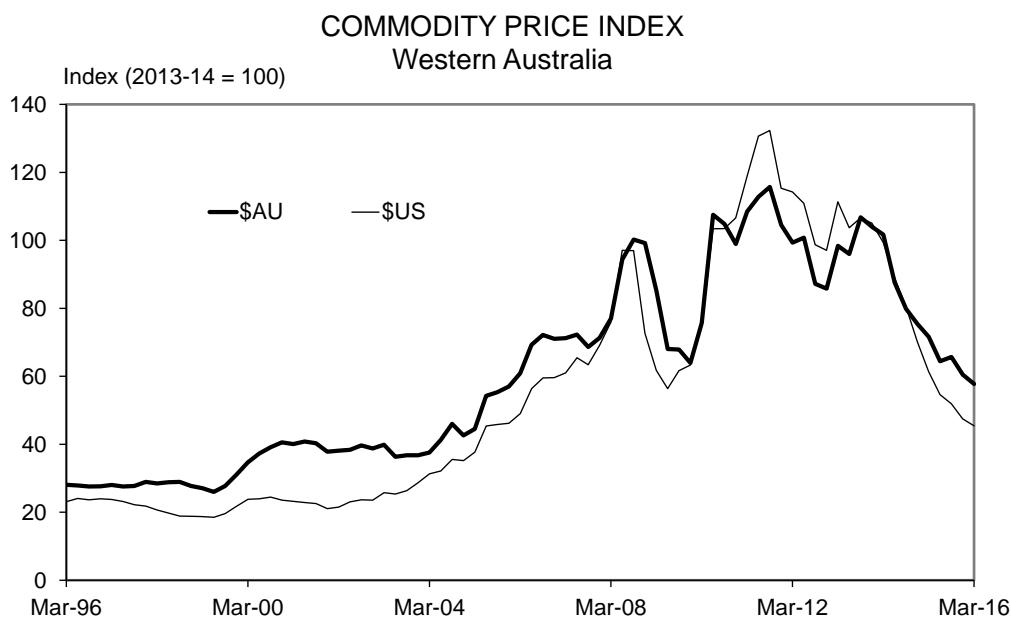
Global commodity markets

Prices for a number of the State's key commodity exports declined considerably in 2015, reflected in a sizeable fall in the Western Australian Commodity Price Index⁵ (see graph below).

Most notably, iron ore and oil prices both fell by approximately 40% in 2015, while the gold price dropped by almost 10% over the same period. These downward price movements reflected substantial expansions of low-cost supply, particularly for iron ore, as well as softer economic conditions in key markets.

Notwithstanding the increase in the iron ore spot price to-date in 2016, prices for the State's key commodities are expected to remain low, compared with recent years, in the near term, but to lift gradually as demand and supply rebalance over time.

⁵ A weighted index of prices for iron ore, gold, oil, LNG, copper, nickel, zinc and alumina.



Source: Department of Treasury

3. National Economic Outlook

The Australian economy (as measured by Gross Domestic Product) grew by 2.5% in 2015, strengthening slightly from 2.2% growth in 2014-15. Despite this, growth remains below the historical average of 3.2%.

As detailed in the 2016-17 Federal Budget, the Commonwealth Treasury expects the Australian economy to grow by 2.5% per annum in 2015-16 and 2016-17, before strengthening to 3% growth from 2017-18. The Budget notes that the transition to broader-based growth in the Australian economy is underway. Economic growth in the next few years is underpinned by historically low interest rates keeping borrowing costs for business and households low and a lower exchange rate supporting export growth.

Table 3.1: Major Economic Aggregates, Australia

Annual Growth (%) ^(a)

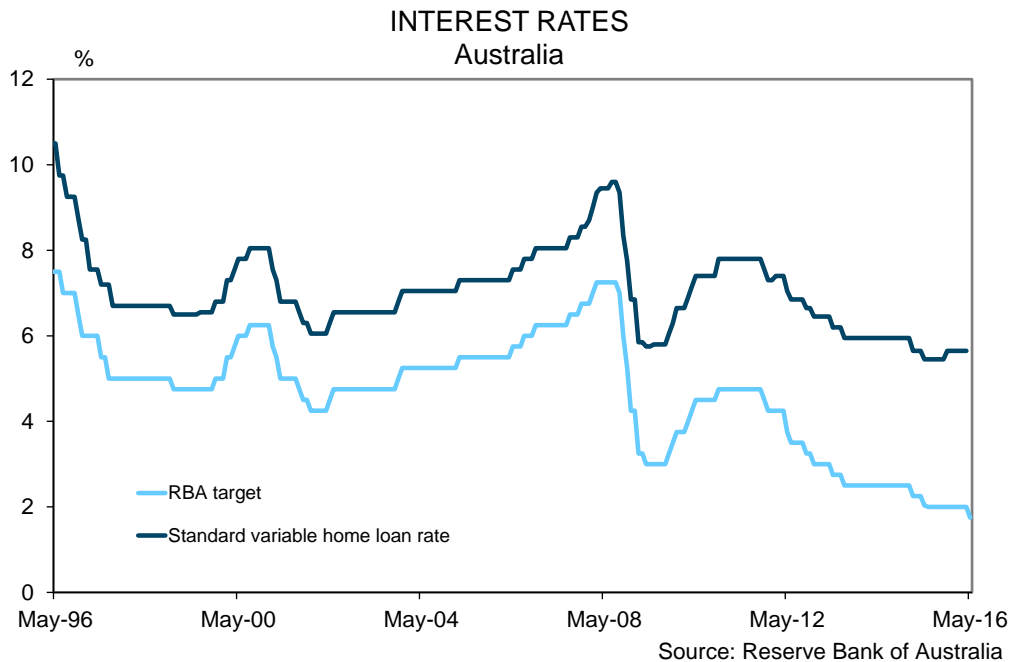
	Actual	Forecasts		Projections		
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Real GDP	2.2	2.5	2.5	3.0	3.0	3.0
Employment	1.6	2.0	1.75	1.75	1.25	1.5
Unemployment rate ^(a)	6.1	5.75	5.5	5.5	5.5	5.5
Consumer Price Index	1.5	1.25	2.0	2.25	2.5	2.5

(a) Year average unless otherwise stated. From 2014-15 to 2017-18, employment is 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 to the June quarter.

Source: 2016-17 Budget, Commonwealth Treasury

According to Commonwealth Treasury, the transition to broader-based growth is evident in the national labour market, where a shift towards more labour-intensive service industries is underpinning strong employment growth, supported by modest wage growth. Labour market conditions at the national level have improved over the past year. In the year to March 2016, employment increased by 2.1% (up from 1.2% in 2014-15), while the unemployment rate fell to 6% (from 6.2% in 2014-15). Commonwealth Treasury projects the unemployment rate to decline further to 5.75% in 2015-16, and to 5.5% from 2016-17.

After holding the cash rate at 2% for twelve months, the Reserve Bank of Australia (RBA) reduced the cash rate to a record low of 1.75% in May. The May rate cut was passed on in full to the standard variable home loan rate by three of the four major banks.⁶ In announcing its May 2016 decision, the RBA highlighted lower than expected inflationary pressure (reported in the March 2016 CPI data) as its primary reason for the rate cut.



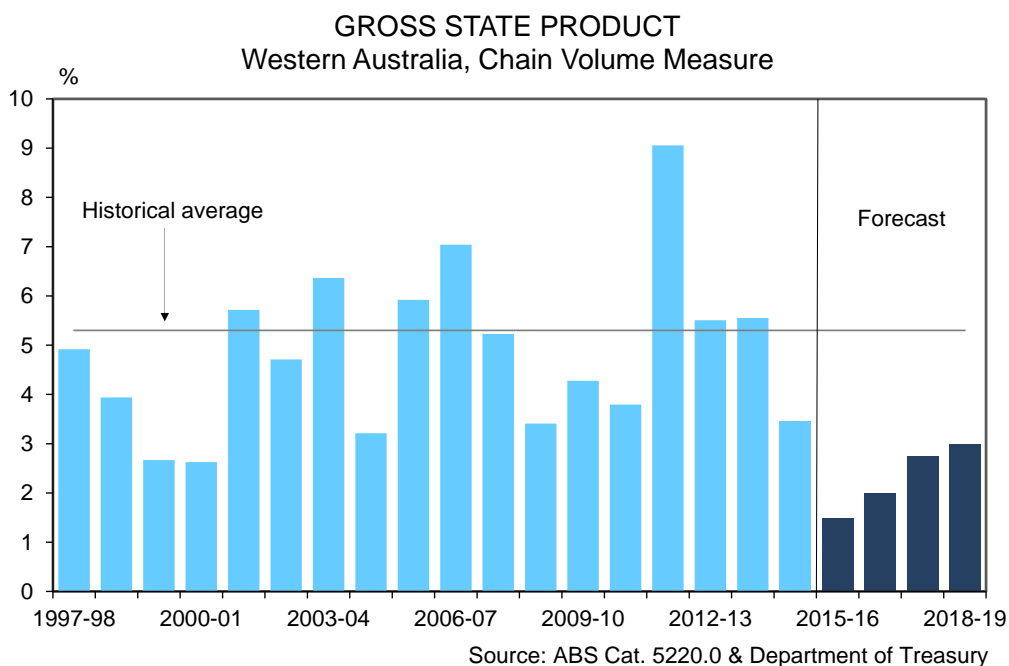
4. Western Australia’s Economic Outlook

The Western Australian economy (as measured by GSP⁷) grew by 3.5% in 2014-2015, down from 5.6% growth in 2013-14 but still above national economic growth of 2.3%. The latest data released by the Australian Bureau of Statistics (ABS) in March 2016 shows that the domestic economy (as measured by State Final Demand) contracted by 3.4% in 2015, and this was partially offset by strong growth in the State’s merchandise exports (6.1%).

Economic growth is expected to slow further in the immediate term to 1.5% in 2015-16, modestly increasing to 2% growth in 2016-17. Steady growth in exports (especially in the LNG sector) is expected to be moderated by a further tapering of business investment from unprecedented levels (as detailed in Section 4.1). Growth is forecast to increase modestly in the remaining years of the forecast period as the rate of decline in business investment eases (see graph below).

⁶ ANZ reduced its home loan rates by 0.19 of a percentage point. ‘Banks pass on Reserve Bank of Australia’s interest rate cut’, *Sydney Morning Herald*, 3 May 2016.

⁷ Gross State Product is a more complete measure of Western Australia’s economic activity, as it includes domestic activity and net external demand for Western Australia’s goods.



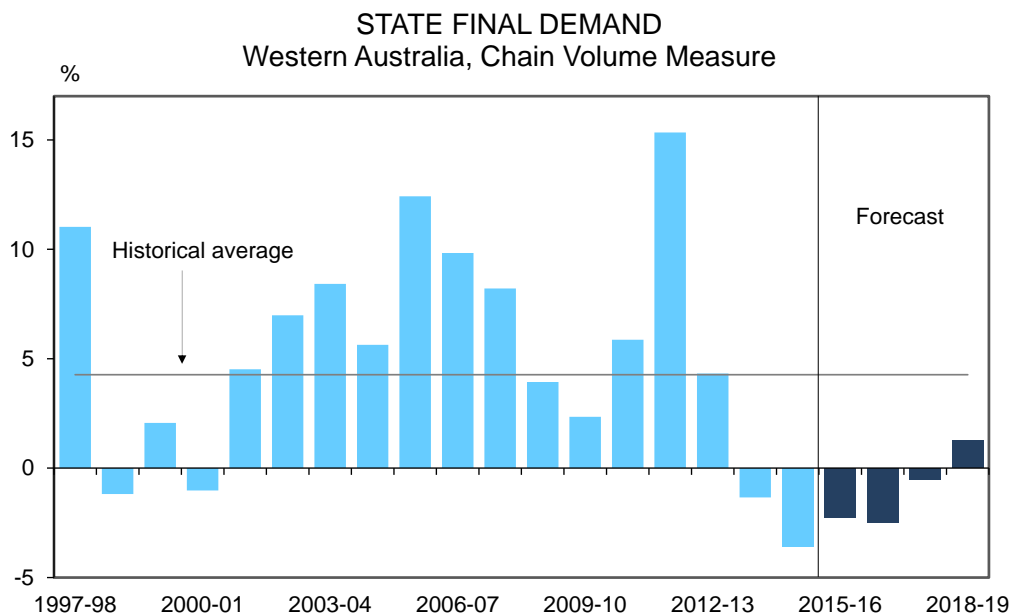
The latest data indicates that activity in Western Australia's domestic economy declined by 3.4% in 2015, following falls of 2.4% and 1.5% over the previous two calendar years. These declines are well below the recent peak of 15.3% growth in 2011-12 and the historical average of 4.7% (see chart below).

The recent fall in SFD compares to 1% growth in the national domestic economy over 2015, as measured by Domestic Final Demand. This reflects that key components of domestic demand grew at a stronger pace at the national level over 2015 (see table below). In the case of business and public investment, the declines were less severe at the national level than for the State.

COMPONENTS OF ECONOMIC GROWTH – SEASONALLY ADJUSTED DATA		
ANNUAL AVERAGE GROWTH TO DECEMBER 2015		
	Western Australia (%)	Australia (%)
Household consumption expenditure	1.5	2.8
Business investment	-14.3	-8.8
Dwelling investment	9.1	9.5
Government consumption	2.6	2.8
Government investment	-10.9	-3.4
State / Domestic Final Demand	-3.4	1.0
International exports of goods*	6.1	6.1
International imports of goods*	n.a	1.0

* Figures for Australia are for trade in both merchandise and services, while figures for Western Australia are for merchandise trade only.

With additional falls in business investment expected over the coming years, Western Australia's SFD growth is forecast to contract each year to 2017-18, before returning to moderate growth of 1.25% in 2018-19 (see chart below).



Source: ABS Cat. 5206.0 & Department of Treasury

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

4.1 Domestic Economy

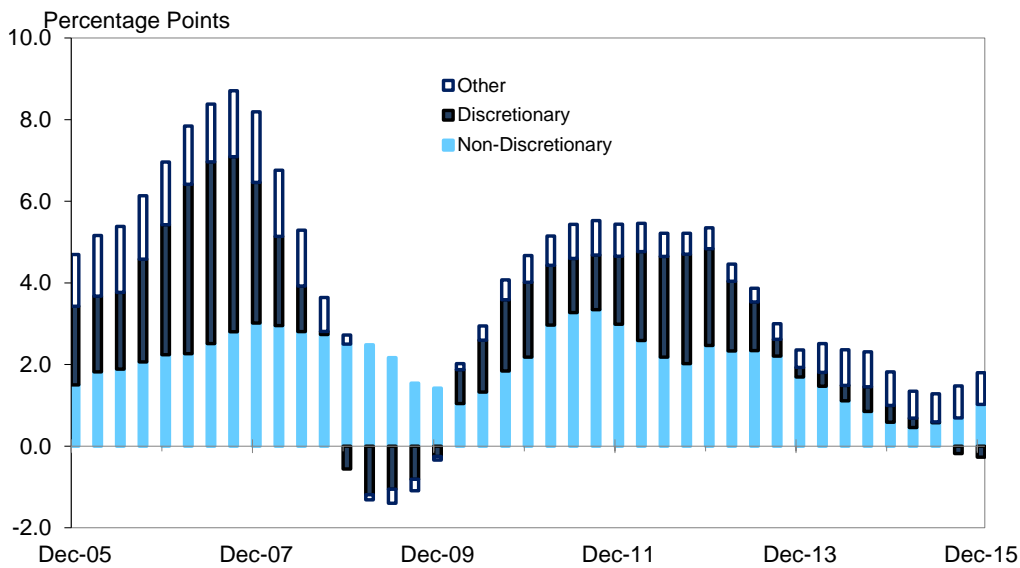
Consumer Spending

Household consumption grew by a modest 1.5% in 2015, easing from 1.8% growth in 2014. This was primarily due to a slowdown in discretionary expenditure⁸, which detracted 0.3 percentage points from household spending growth in 2015 (see chart below). Growth in non-discretionary spending was stronger by comparison (contributing one percentage point to growth), underpinned by increased spending on rents and health services.

Greater consumer conservatism is consistent with subdued wages growth (see Section 6), a rising unemployment rate, and weaker consumer confidence. With softer labour market conditions and slower population growth expected to persist over the near term, household consumption is projected to grow by only 1.5% in 2015-16 and 2% in 2016-17 before gradually strengthening to 3% by 2018-19. However, growth is expected to remain below the historical average of 4.1% per annum.

⁸ Discretionary items include: cigarettes and tobacco; alcoholic beverages; clothing and footwear; furnishings and household equipment; purchase of vehicles; communications; recreation and culture; and hotels, cafes and restaurants. Non-discretionary items include: food; rent and other dwelling services; electricity, gas and other fuel; health; operation of vehicles; transport services; and education services.

CONSUMPTION BY MAJOR CATEGORY^(a)
 Western Australia, Annual Contributions to Consumption Growth



Source: ABS Cat. 5206.0

Housing Market

Dwelling investment grew by 9.1% over 2015, increasing from a 3.9% rise in 2014-15. This was supported by continuing growth in new dwelling investment, which increased by 8.6% in 2015, as well as growth in alterations and additions (10.3%).

Going forward, growth in new dwelling construction is expected to ease in line with moderating growth in leading indicators (such as building approvals) and a soft outlook for key drivers of new housing demand (such as population and employment growth). As such, total dwelling investment is projected to grow by 2.25% in 2015-16, supported by spending on the current large number of dwellings under construction. Dwelling investment is then forecast to decline in the following two years. This reflects falls in new dwelling construction, which is expected to be partially offset by expenditure on alterations and additions.

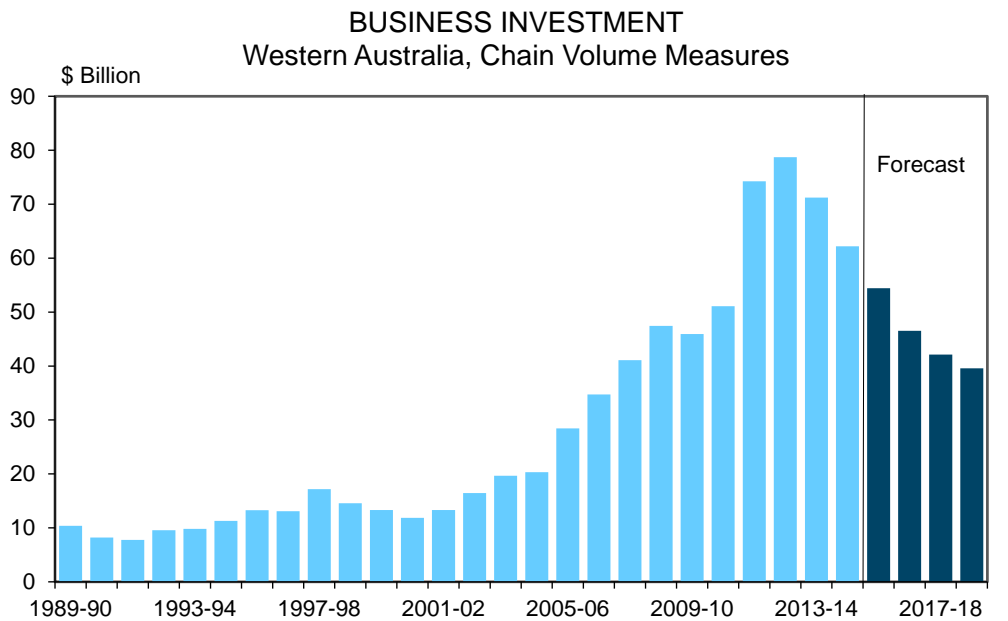
Business Investment

Following a lengthy period of strong growth (including a 45.3% increase in 2011-12), business investment has fallen substantially from its peak of \$78.7 billion in 2012-13 as construction in the resource sector eases. Further declines in business investment are expected over the budget period, including projected falls of 12.5% in 2015-16 and 14.5% in 2016-17 (see graph below).

The declines in business investment reflect the absence of major new resource project commitments and the wind down of construction on large LNG projects. It also reflects the expectation that falls in commodity prices (notwithstanding recent volatility) will reduce the probability of major new resource investment projects emerging.

The rate of decline is expected to moderate over the remainder of the forecast period, with investment anticipated to fall to around 13% of GSP by 2018-19. While this is below the long-run average share of GSP (around 16%), it remains above the long-term share for the period up to 2004-05 of around 11%.

Despite the downward trend, business investment in Western Australia is expected to total \$39.8 billion in 2018-19, which is just below the level recorded in 2007-08.



Source: ABS Cat. 5206.0 & Department of Treasury

4.2 International Trade

Exports

Western Australia’s merchandise exports grew by 8.6% in 2014-15, supported by stronger than expected growth in iron ore exports, offset by lower than anticipated LNG exports (due to an unplanned shutdown) and gold exports (due to lower than projected re-exports⁹).

Growth in merchandise exports is forecast to moderate to 4.25% in 2015-16, as the rate of increase in iron ore production slows. Export growth is then expected to be modestly stronger in 2016-17 and 2017-18 (5.75% and 5.25% respectively), driven by LNG production (largely from the Gorgon, Wheatstone and Prelude projects), before easing to 4.25% growth in 2018-19. While large increases in iron ore production have underpinned export growth in recent years, LNG is expected to be the largest contributor to growth from 2016-17 onwards.

Imports

Merchandise imports are expected to decline over the entire forecast period, in line with falls in business investment (with businesses expected to import fewer large capital goods), and weaker growth in consumer spending (which reduces growth in consumer imports). The declines in imports are projected to become smaller towards 2018-19 as, as private consumption strengthens and the declines in business investment moderate.

5. The Labour Market

Conditions in Western Australia’s labour market worsened over the past year, with employment growth continuing to moderate and the unemployment rate drifting higher. Despite this, Western Australia’s annual unemployment rate of 6% in March 2016 is equal second lowest amongst the States and equivalent to the national rate.

⁹ Gold re-exports refer to gold that is imported, then processed and subsequently re-exported.

Key labour force statistics for the Western Australian economy are summarised in the following table.

Table 5.1: Population and Labour Force forecasts
Western Australia

	2014-15 ^(a)	2015-16	2016-17	2017-18	2018-19
Annual level					
Total population ('000)	2,582	2,621	2,662	2,709	2,761
Working age population (15-64) ('000)	1,751	1,764	1,778	1,795	1,817
Employment ('000)	1,349	1,366	1,383	1,404	1,425
Unemployment ('000)	77.2	95.0	96.1	93.6	86.9
Unemployment rate (%)	5.4	6.5	6.5	6.25	5.75
Participation rate ^(b) (%)	68.5	69.1	69.0	68.9	68.4
Annual growth (%)					
Total population	1.5	1.5	1.6	1.7	1.9
Working age population (15-64)	1.0	0.7	0.8	0.9	1.2
Employment	1.5	1.25	1.25	1.5	1.5

(a) Actuals at the time of MYR cut-off

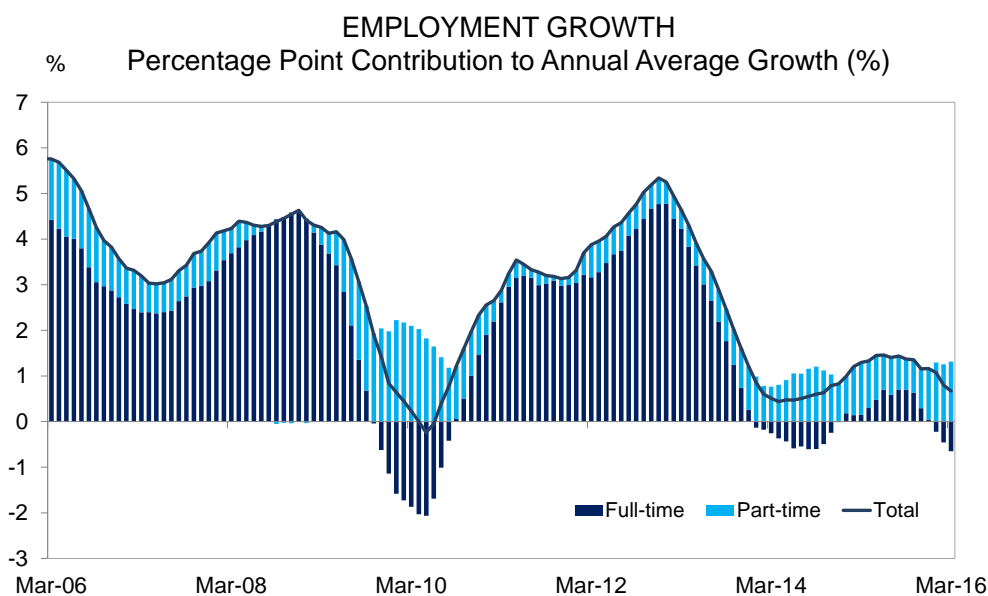
(b) Based on the population aged 15 years and over.

Source: ABS and Department of Treasury

More detail on the labour market is outlined as follows.

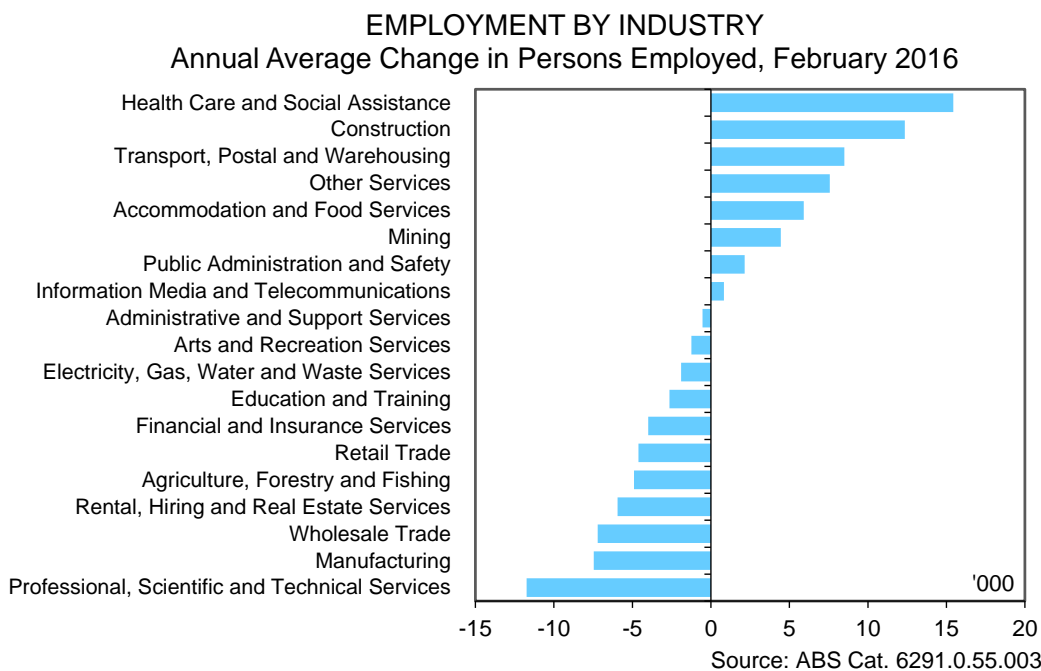
5.1 Employment

Employment grew by just 0.7% in annual average terms to March 2016, slowing from 1.4% growth in 2014-15. Growth is being entirely underpinned by part-time employment, which increased by a robust 4.5% in the year to March (see chart below). Conversely, full-time hiring declined by 0.9%, indicating that the underlying labour market conditions remain soft.



Source: ABS Cat. 6202.0

The chart below shows that employment growth is being driven by a diverse range of industries, led by healthcare and construction (with the latter coinciding with high levels of activity in the residential housing sector). Notwithstanding this, employment has declined across a number of industries, suggesting that the softening in the State's economy has also impacted industries outside of the resource sector.



Outlook

Leading indicators of labour demand (such as internet job vacancies) point to continued moderate employment growth, while the upcoming completion of a number of large resource projects is expected to result in a slowdown in hiring in the mining industry.

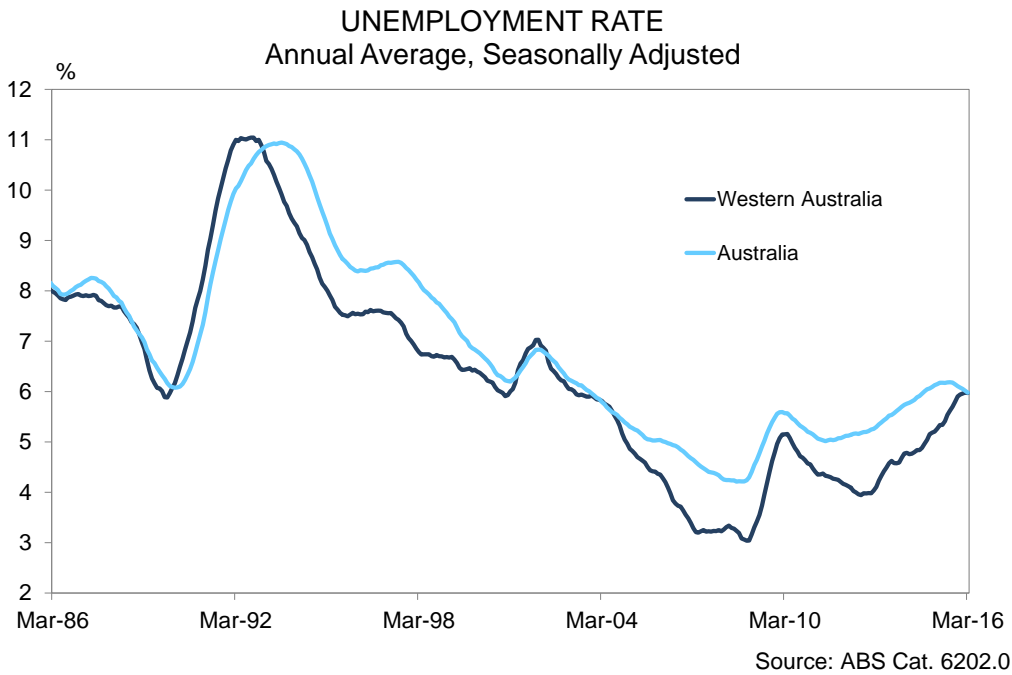
Consequently, growth in employment is expected to remain subdued at 1.25% in 2015-16 and 2016-17 as the domestic economy contracts further, before lifting slightly to 1.5% per annum out to 2018-19. These rates of growth are well below the historical average of 2.6%.

5.2 Unemployment and participation

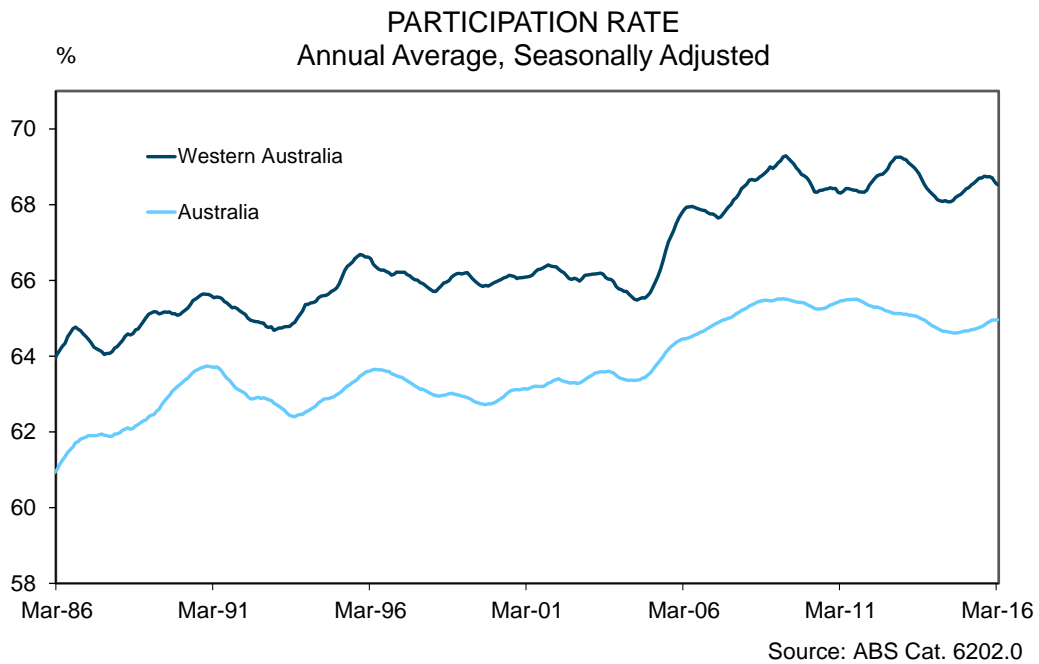
Western Australia's unemployment rate has fallen back slightly over recent months, largely due to a fall in the level of workforce participation (rather than an improvement in underlying labour market conditions). Notwithstanding this, the annual average rate lifted from 5.4% in 2014-15 to 6% over the year to March 2016 - its equal highest rate in almost 13 years.

Consequently, Western Australia's unemployment rate is now in line with the national equivalent (6%, see chart below), as labour market conditions improve modestly at the national level. This follows a period where the State's unemployment rate was consistently below the national rate.

Furthermore, Western Australia's unemployment rate has slipped to the equal second lowest of all States, overtaken by New South Wales (5.6%).



Western Australia’s monthly participation rate has trended down over recent months, falling to 68.1% in March 2016 (compared to a recent high of 69% in October 2015). Despite this, the participation rate remains the highest of all States and is well above the national equivalent (see the following chart)



Outlook

The unemployment rate is expected to increase to 6.5% in 2015-16 and remain at this rate in 2016-17 as economic conditions remain weak, before falling to 5.75% by the end of the forecast period as labour demand moderately improves.

The participation rate is projected to average 69.1% in 2015-16 before gradually easing to 68.4% by 2018-19 as workers become discouraged (consistent with subdued employment growth) and as a greater number of persons reach retirement age.

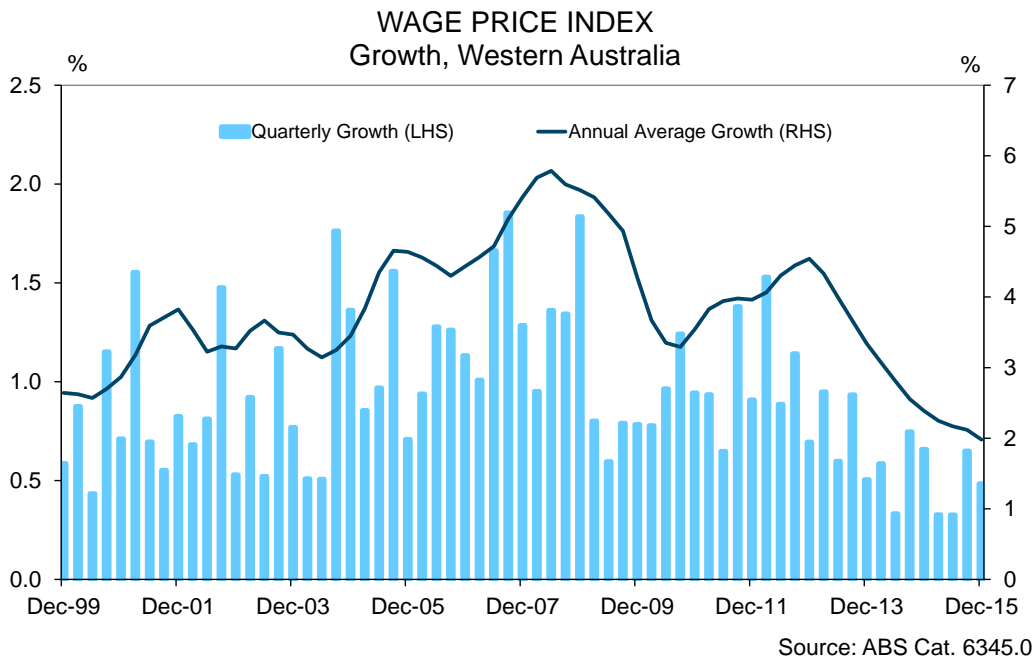
6. Wages

6.1 Wage Price Index

Wage growth in Western Australia remained subdued in 2015, falling to a new record low. This is consistent with continued increasing spare capacity in the labour market and ongoing efforts by businesses to reduce costs and improve efficiency.

Of the various wage price indicators published by the ABS, the Wage Price Index (WPI) is generally viewed as the preferred measure of underlying wages 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 0.5% in the December quarter 2015, following growth of 0.6% in the September quarter of 2015, both below decade average quarterly growth of 0.9%. Consequently, annual growth moderated to just 2% in 2015, the slowest growth on record (since 1998-99, see chart below).



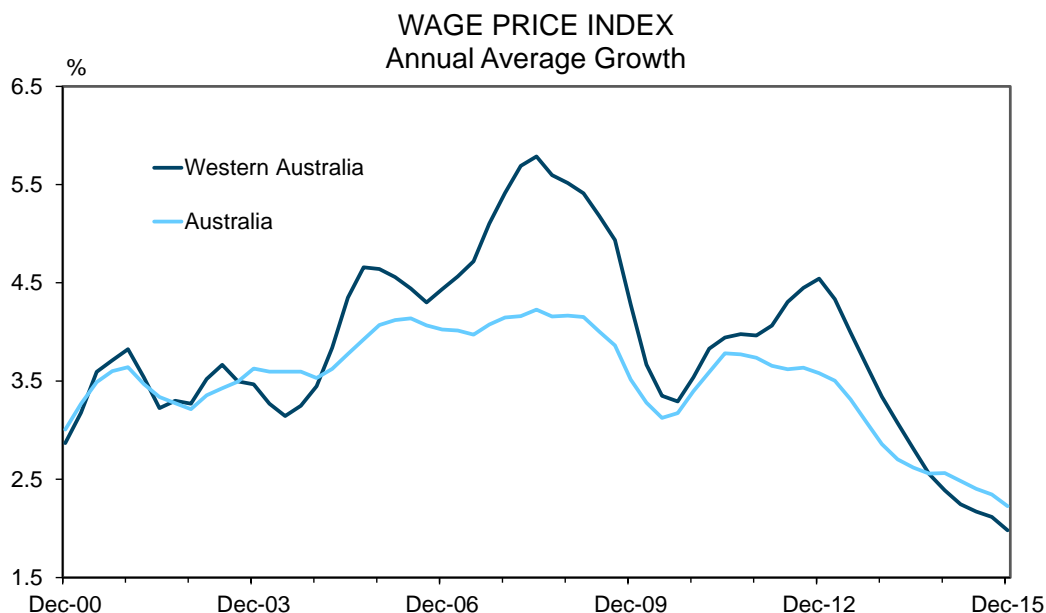
The slowing of annual wage growth was largely due to a significant moderation in private sector wages, which grew by just 1.7% in 2015 (also the weakest on record), following 2.2% growth in 2014. As well as being comparatively stronger, public sector wage growth was fairly steady over the same period, with growth of 3.2% in 2015 moderating only slightly from 3.3% growth in 2014.

National comparison

Annual wage growth has also moderated at the national level, easing from 2.4% in 2014 to 2.2% in 2015. However, the slowdown has been more pronounced in Western Australia, with current growth of 2% substantially lower than the recent peak of 4.5% in 2012. As a result, annual average growth in the State's WPI remained below national growth for the fifth consecutive quarter. Prior to the December quarter 2014, the State's WPI growth had not fallen below the national average since 2004 (see chart below).

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 when business investment was surging). However the slowdown in domestic economic activity in the State over the past two years has resulted in a corresponding moderation in wage growth, bringing it more in line with the rest of Australia. In fact, Western Australia currently has the second lowest wages growth amongst all jurisdictions, behind only the Australian Capital Territory.

Wage growth in Western Australia is expected to be more closely aligned with growth at the national level over the coming few years, in line with more subdued economic conditions in the State.



Source: ABS Cat. 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 2% in 2015-16, before increasing modestly to 2.25% in 2016-17, both well below the historical average of 3.8% per annum. WPI growth is projected to gradually increase over the following few years as domestic economic conditions moderately improve.

7. Inflation

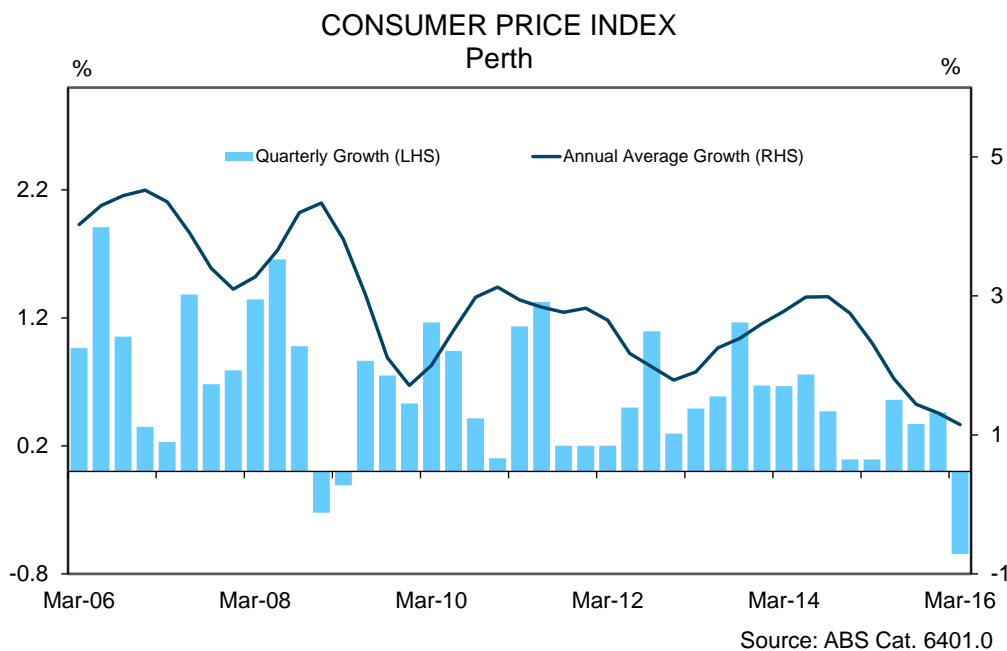
Inflation in Perth (as measured by growth in the Consumer Price Index, CPI) has eased so far in 2015-16 (see chart below), consistent with trends at the national level. CPI for Perth declined for the first time since 2009, decreasing by 0.6% in the March quarter 2016. This followed moderate quarterly growth of 0.5% in December 2015 and 0.4% in September 2015.

The deflation recorded in the March quarter was primarily the result of a decline in the housing component of CPI (as a result of lower project home costs and lower rents) which detracted 0.3 percentage points (pp) from quarterly growth, and a fall in transport costs, as a result of persistently lower fuel prices, which detracted 0.2 pp from inflation in March.

The decrease in CPI in the March quarter 2016, meant that annual average growth in the Perth CPI eased to 1.1%, the weakest annual growth recorded since 1998. Annual growth was primarily supported by price rises for alcohol and tobacco (6.8% growth), as well as non-discretionary items such as health (4.2%) and education (4.1%).

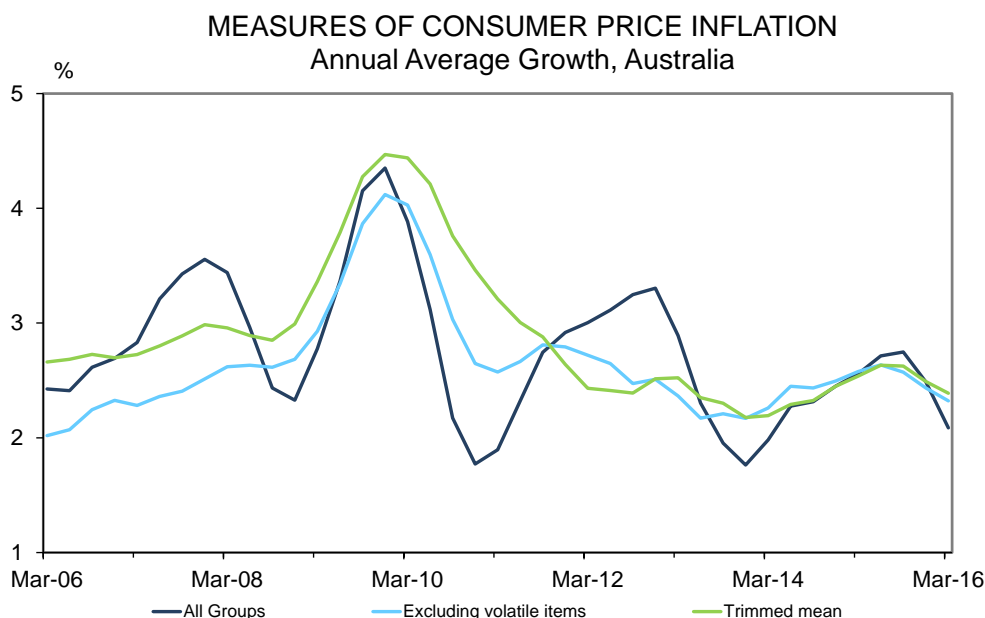
These price rises were partially dampened by falls in the price of transport (-1.6%, primarily driven by automotive fuel prices, which decreased by 9.6%) and communication (-5%). It is worth noting that while housing has been a strong contributor to CPI growth in recent years, growth in housing costs was particularly subdued at 0.7% in the year to March 2016, moderated by declining rental prices (-2.3%).

In year-ended terms, Perth's CPI grew by only 0.7% in the year to March, which is below 1.3% growth nationally¹⁰.



¹⁰ 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.

As shown in the following chart, underlying measures of national inflation have eased slightly less than the headline indicator, mainly because they do not include fuel prices (which have fallen sharply over recent quarters). Excluding volatile items (mainly food and automotive fuel), the national CPI grew by 0.2% in the March quarter (compared to 0.2% decline in the overall measure). Likewise, the RBA's 'trimmed mean' (which excludes the 15% of items with both the smallest and largest price changes) increased by 0.2% in the March quarter. Both alternative measures of CPI were still subdued, but relatively more robust at 2% in annual average terms, the lower bound of the RBA's target band.



Outlook

Perth's CPI growth is expected to remain subdued at 1.5% in 2015-16 and 2% in 2016-17. Inflation over this period is expected to be supported by a 12.5% increase in the Commonwealth's tobacco excise in September 2015 and September 2016, as well as a lagged effect of the depreciation of the Australian dollar against the US dollar since 2013 (which increases the domestic price of imports). It is anticipated that these pressures will be moderated by weak growth in household spending, which limits retailers' capacity to raise prices, as well as modest wage growth and moderating housing costs (including declining rents and an absence of price pressure from project home costs). Falling automotive fuel prices have also resulted in weak inflationary pressure thus far in 2015-16.

Over the following two years, CPI growth is forecast to increase by 2.5% per annum, in line with the middle of the RBA's target band of 2-3%.

The forecast for Perth CPI growth in 2015-16 is higher than the RBA's May 2016¹¹ forecast for national inflation. In year-ended terms, the RBA expects headline CPI inflation to be 1.0% in 2015-16, with underlying inflation at 1.25%. The forecast for 2016-17 is broadly consistent with the RBA's forecasts for headline CPI to fall between 1.5% and 2.5% in year-ended terms in 2016-17. The RBA cites weak price pressure from subdued wages growth and heightened retail competition as having a moderating effect on price pressure from increased import prices due to exchange rate depreciation since 2013. A further increase to the tobacco excise later in 2016 is expected to add 0.25 percentage points to the headline inflation rate.

¹¹ Reserve Bank of Australia, *Statement on Monetary Policy*, May 2016.

8. Risks to the economic outlook

Notwithstanding the above, there are a number of potential risks that may impact the State's economic outlook over the next few years. The magnitude of these risks is largely weighed on the downside.

8.1 Global risks

Global risks mainly relate to emerging market economies (in particular, China), and their demand for the State's commodities. Over-capacity in **China's** heavy industries, such as construction and manufacturing, pose a significant risk given they are major consumers of steel. As the Chinese economy rebalances, these sectors are likely to become less important to growth in China, flowing through to lower demand for iron ore and a weaker iron ore price (all else equal). This could translate into lower profits for the State's mineral producers, potentially leading to further cost cutting (which may adversely affect household incomes).

In addition, a rapid increase in private debt accumulation in China poses a risk to the financial system, while efforts by the Chinese leadership to combat corruption within the country may translate into lower development in the short-term (due to increased uncertainty), but would benefit the economy in the long run.

However these risks must be balanced against continued urbanisation and increasing incomes in China, which are expected to support housing demand and economic growth over the longer term.

Another key global risk is the raising of interest rates in the **United States**, as this increases the cost of servicing US dollar debt and could be a catalyst for capital flows out of emerging markets and into US dollar assets (thus limiting funds available for investment in these countries).

8.2 Domestic risks

The outlook for **business investment** is potentially the largest domestic risk for the State's economy. While large declines are forecast over the near-term, the balance of risks is probably on the downside, reflecting the lack of large scale new resource projects on the horizon, and given that the forecasts assume some additional prospective and/or currently unidentified major project investment will be realised over the upcoming period.

There is also a risk that **dwelling investment** may decline more strongly than forecast. This reflects a number of potential factors including lower than expected population, house price and/or employment growth, and an over-supply in the housing market (reflecting the large volumes of new homes currently under construction).

In terms of the **labour market**, there is a risk that conditions may be weaker than expected if activity outside of the resource sector fails to compensate for more subdued hiring in the resource sector. This could flow through to softer WPI growth, which may trough at a lower rate than expected, and a further fall in migration into Western Australia (which would result in more moderate population growth).

2015-16 GOVERNMENT MID-YEAR FINANCIAL PROJECTIONS STATEMENT FORECASTS
COMPONENTS OF GROSS STATE PRODUCT

Western Australia

	2014-15	2015-16	2015-16	2016-17	2017-18	2018-19
	Actual %	Budget Estimate %	Mid-year Revision %	Forward Estimate %	Forward Estimate %	Forward Estimate %
Demand and Output ^(a)						
- Household consumption	1.1	2.75	1.5	2.0	2.5	3.0
- Dwelling investment	4.1	2.0	2.25	-3.75	-2.0	2.5
- Business investment	-12.3	-12.0	-12.5	-14.5	-9.5	-6.0
- Government consumption	2.7	3.75	4.0	3.5	3.25	3.25
- Government investment	-13.5	2.0	5.25	0.75	0.5	-0.5
State Final Demand (SFD)	-3.5	-1.25	-2.25	-2.5	-0.5	1.25
- Merchandise exports	8.7	4.75	4.25	5.75	5.25	4.25
- Merchandise imports	0.8	-3.75	-5.0	-5.0	-2.25	-0.5
Net exports ^(b)	13.2	8.5	8.75	10.25	8.0	5.75
Gross State Product (GSP) ^(c)	3.5	2.0	1.5	2.0	2.75	3.0
Labour market						
Population ^(d)	1.5	2.0	1.5	1.6	1.7	1.9
Employment	1.5	1.75	1.25	1.25	1.5	1.5
Unemployment rate ^(e)	5.4	6.25	6.5	6.5	6.25	5.75
Participation rate ^(e)	68.5	69.2	69.1	69.0	68.9	68.4
Prices						
Consumer Price Index (CPI)	1.8	2.25	1.5	2.0	2.5	2.5
Wage Price Index (WPI)	2.2	2.75	2.0	2.25	2.5	2.75
SFD deflator	1.8	1.9	1.7	1.8	1.8	1.9
GSP deflator	-10.0	-3.7	-11.4	0.4	4.2	3.1
Median house price	1.8	1.4	-3.5	-0.5	1.3	2.7
Other key parameters						
Exchange rate \$US/\$A (cents)	83.6	75.9	71.8	70.7	70.0	69.4
Iron ore price (\$US/tonne) cost and freight inclusive (CFR)	71.1	47.5	46.0	42.5	46.3	50.2
Crude oil price (\$US/barrel)	73.5	64.2	46.7	52.1	56.3	58.9

(a) Based on 2014-15 State Accounts data, released 20 November 2015 (ABS Catalogue 5220.0).

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

(c) Forecasts for ownership transfer costs, international trade in services, balancing item components, and the statistical discrepancy of the State Accounts are not separately reported.

(d) Estimated actual for 2014-15.

(e) Data expressed in terms of the annual average during the financial year.