ATTACHMENT A

2018 State Wage Case – Economic Outlook[1,2]

1. Overview

The Western Australian economy is forecast to grow by 2.5% in 2017-18, after contracting by 2.7% in 2016-17 (as measured by Gross State Product, GSP)[3]. Growth in GSP is expected to accelerate to 3.25% in 2018-19, as continued strength in exports growth combines with increased household consumption and dwelling investment.

Western Australia's domestic economy (State Final Demand, SFD) is forecast to contract by -0.25% in both 2017-18 and 2018-19. This would result in the domestic economy contracting for six consecutive years. The domestic economy is then expected to resume growing in 2019-20 and beyond at 3.75% per annum, which is in line with the long-run average growth rate of 3.9%.

The changes in domestic economic activity in recent years largely align with the trends in business investment, with the recent annual declines in SFD occurring in years in which business investment declined. This extended slowdown in the domestic economy follows a sustained period of very strong growth, which was supported by very high levels of business investment. Investment has been tapering from a peak of $80.5 billion in 2012-13, and the decline is expected to continue in 2017-18 and 2018-19 as a number of very large resource projects are progressively completed. From 2019-20 business investment is expected to resume growing, supported by backfill investment by large iron ore and liquefied natural gas (LNG) producers.

The declines in business investment have been accompanied by weak growth in household consumption, as consumers have been cautious with their discretionary spending. Household spending grew at an average annual rate of 1.1% per annum between 2013-14 and 2016-17. Growth in consumer spending is expected to remain below its long-run average of 4% per annum across the forecast period, constrained by modest wage and population growth. After two consecutive annual declines, dwelling investment is expected to increase by 4.75% in 2018-19, before increasing to 5.75% in 2019-20.

Importantly, the completion of resource projects is supporting a robust expansion in exports (especially in LNG), which is expected to be the main driver of economic growth in 2018-19, given the on-going weakness in the domestic economy.

The weakness in the domestic economy in recent years has affected the State's labour market, with employment declining and the unemployment rate increasing in 2015-16 and 2016-17. However, employment growth has since recovered, with annual average growth in employment increasing to 2.2% in March 2018, largely underpinned by full-time hiring (which contributed 1.9 percentage points to overall growth after it detracted from growth in the last two financial years). The unemployment rate has also eased from 6.2% in 2016-17 to 5.9% in the year to March 2018, and is forecast to fall to 5.75% and remain steady at this rate in 2018-19.

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1 The forecasts for Western Australia's economic aggregates in this attachment are those published in the 2018-19 Budget released on 10 May 2018.

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.

Consistent with overall economic and labour market conditions (especially relative to other States), Western Australia's population growth eased from a recent peak of 3.1% in 2012-13 to 0.7% in 2015-16 and 2016-17, largely as a result of a decline in the number of overseas migrants moving to the State. There has also been a turnaround in net interstate migration, from a period of strong migration to Western Australia from other States, to migration from Western Australia to other States. Reflecting these trends, population growth is expected to remain subdued in 2017-18 and 2018-19 before lifting towards the long-term average over the forecast period.

Inflation in Perth has been subdued recently, reflected in the Perth Consumer Price Index (CPI) increasing by an annual average of 0.8% in the March quarter 2018. This represents a small increase relative to the annual average growth of 0.6% in the March quarter 2017, which was the weakest annual average growth over a year to the March quarter since 1998. The moderate increase over the past year primarily reflects higher automotive fuel prices as well as reduced drag from housing costs. In the 2018-19 Budget, Perth's CPI is forecast to grow by 1.5% in 2018-19, before returning to the middle of the Reserve Bank of Australia's 2-3% target band in 2020-21.

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

	2016-17	**2017-18**	**2018-19**	**2019-20**	**2020-21**	**2021-22**
	Actual	Estimated Actual	Budget Estimate	Forward Estimate	Forward Estimate	Forward Estimate
State Final Demand	-7.2	-0.25	-0.25	3.75	3.75	3.75
Gross State Product	-2.7	2.5	3.25	3.75	3.0	3.0
Employment	-0.9	2.25	1.5	2.0	2.25	2.25
Unemployment rate [(a)]	6.2	5.75	5.75	5.5	5.25	5.0
Consumer Price Index	0.6	1.0	1.5	2.0	2.5	2.5
Wage Price Index	1.4	1.5	1.75	2.75	3.0	3.25
Population	0.7	1.0	1.2	1.5	1.8	2.0

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

Source: 2018-19 Budget

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

2. Global Outlook

The global economy is experiencing largely positive trends with a synchronised cyclical upswing gaining momentum in many parts of the world over the past year, particularly among many advanced economies. This is creating a relatively favourable external environment, which has been broadly supportive of commodity prices. In its April 2018 World Economic Outlook, the International Monetary Fund (IMF) is projecting that the global economy will expand by 3.8% in 2017, up from 3.2% in 2016. Global growth is forecast to increase to 3.9% in 2018 and 2019 before trending down to 3.7% by 2023.

Risks to the outlook are largely balanced, with current growth momentum providing some upside risks over the short-term, while disputes among key economies over trade, possible increases in global interest rates and excessive leverage in China pose ongoing downside risks.

Notwithstanding this positive momentum, long-term trends in key parts of the globe, including China and some of the advanced economies, remain unfavourable. While the short-term outlook for China is relatively robust (in April 2018 the IMF estimated growth of 6.9% in 2017 and 6.6% in 2018), it is likely that China's cyclical rebound peaked in 2017 and will lose some momentum heading into 2018-19 as the property construction cycle slows and macroeconomic policies become less accommodative now that the five yearly leadership re-shuffle is complete and Presidential term limits have been removed. This is consistent with trends in a 'secondary indicator'[4] of Chinese economic activity, comprising consumption trends for various commodities and services, which show a recent peak in growth of secondary activity in 2017.

The IMF has estimated that economic growth in advanced economies increased from 1.7% in 2016 to 2.3% in 2017. Growth is then projected to rise further to 2.5% in 2018 before trending back to 1.5% by 2023, influenced to varying extents by ageing populations which are expected to result in lower labour force participation. In the United States the short- to medium-term outlook has gained support from significant tax cuts passed under the *Tax Cuts and Jobs Act 2017*, which may lead to further tightening in the labour market. However, the tax cuts are also likely to substantially increase Government debt, with the US Congressional Budget Office projecting that debt will increase by almost $US1.5 trillion over 10 years.

Table 2 – IMF Global Economic Forecasts

Annual GDP Growth, %

			IMF Projections	
	2016	**2017**	**2018**	**2019**
World	3.2	3.8	3.9	3.9
Advanced Economies	1.7	2.3	2.5	2.2
United States	1.5	2.3	2.9	2.7
Euro Area	1.8	2.3	2.4	2.0
Japan	0.9	1.7	1.2	0.9
Other Advanced Economies	2.1	2.5	2.4	2.3
Emerging market and developing economies	4.4	4.8	4.9	5.1
China	6.7	6.9	6.6	6.4

Source: IMF World Outlook, April 2018

2.1 Global commodity markets

Prices for most of Western Australia's key commodity exports were generally higher in 2017 relative to 2016 in line with an improvement in global economic conditions. These prices were largely maintained in early 2018. However, the iron ore price fell sharply to around $US63 per tonne in March 2018. The iron ore price stabilised in April following a sharp drawdown in steel inventories, reducing concerns of excess steel production, as well as a more conciliatory tone on trade between the US and China. The 2018-19 Budget assumes that the iron ore price will average around $US60-63 per tonne out to 2021-22.

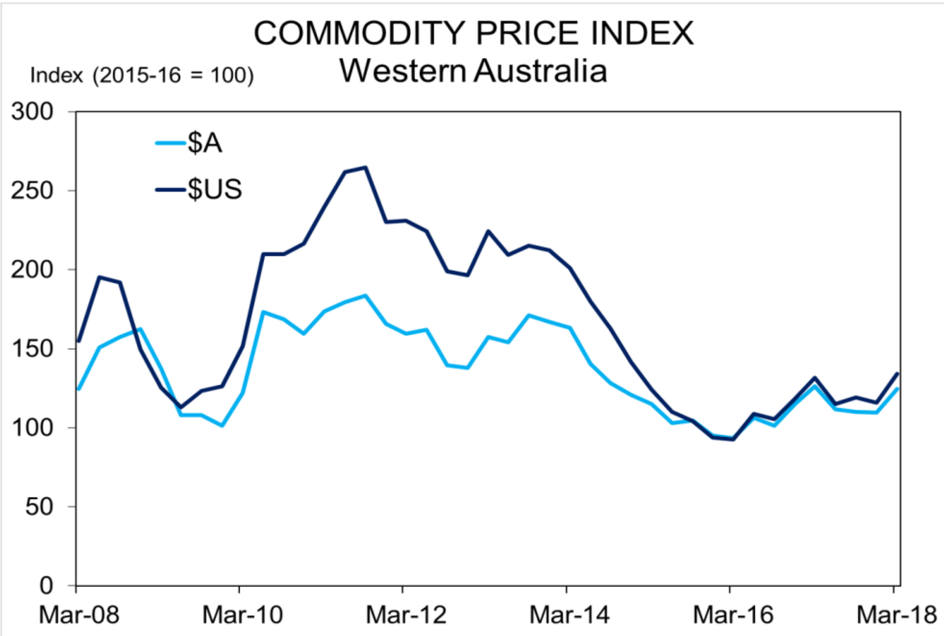
[4] The secondary indicator is a composite index of: rail freight volumes; electricity production; port throughput and a construction materials index, which is comprised of finished steel, plate glass and cement.

In contrast to iron ore, after a substantial increase of almost 25% between 2016-17 and 2017-18, the oil price is forecast to lift further in 2018-19 before declining moderately over the remaining forward estimates period. The oil price appears likely to remain volatile over the medium-term due to ongoing risks, such as the continued tensions surrounding the conflict in Syria and rhetoric around global trade disputes. The oil price affects the Western Australian economy in several ways. Most obviously it is a key determinant of investment and export income in the LNG industry because most LNG prices are linked to the oil price. In addition, the oil price impacts mining costs, in particular shipping, and is an important driver of domestic inflation through its effect on automotive fuel.

The gold price trended upwards over the 18 months to March 2018 as moderating expectations of interest rate rises in the US weakened the US dollar. Further modest increases in the gold price are projected across the forward estimates period. The gradual improvement in the gold market between 2014 and 2017 resulted in gold producers employing almost 6,000 more full-time equivalent (FTE) mine site employees. This growth was more than offset by weakness in the iron ore mining industry, with mine site employment falling by around 13,350 FTEs.

Despite a moderate increase since the March quarter 2016, 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



3. National Economic Outlook

The Australian economy (as measured by Gross Domestic Product, GDP) is expected to grow by 2.75% in 2017-18, after expanding by 2.1% in 2016-17. As such, growth is expected to remain slightly below the historical average of 3.0% per annum.

As detailed in the 2018-19 Budget, the Commonwealth Treasury expects growth of the Australian economy to accelerate to 3% in 2018-19 (see Table 3) and stabilise at that rate for the remainder of the forecast and projections period. The Budget notes that the Australian economy continues to transition from the investment phase of the mining boom to broader-based growth with the transition expected to conclude by the end of the forecast period.

As the drag from the unwinding of the mining investment boom recedes, growth is expected to flow from increased exports, household consumption, and non-mining business investment. Further near-term support is expected to come from the largely positive global outlook, across both advanced and emerging economies.

The Commonwealth expects that the pace of growth will be sufficient to lower the unemployment rate over the next few years. The Budget projects a gradual lowering of the unemployment rate from 5.6% in 2016-17 down to 5% by 2021-22. In 2017, the labour market strengthened substantially, resulting in the largest increase in employment ever recorded in Australia in a calendar year. This growth flowed from a variety of industries, with around three-quarters of the growth in full-time employment.

Table 3 – Major Economic Parameters, Australia

Annual Growth, %[(a)]

	Outcomes	Forecasts			Projections	
	2016-17	**2017-18**	**2018-19**	**2019-20**	**2020-21**	**2021-22**
Real GDP	2.1	2.75	3.0	3.0	3.0	3.0
Employment	1.9	2.75	1.5	1.5	1.25	1.25
Unemployment rate	5.6	5.5	5.25	5.25	5.25	5.0
Consumer Price Index	1.9	2.0	2.25	2.5	2.5	2.5
Wage Price Index	1.9	2.25	2.75	3.25	3.5	3.5

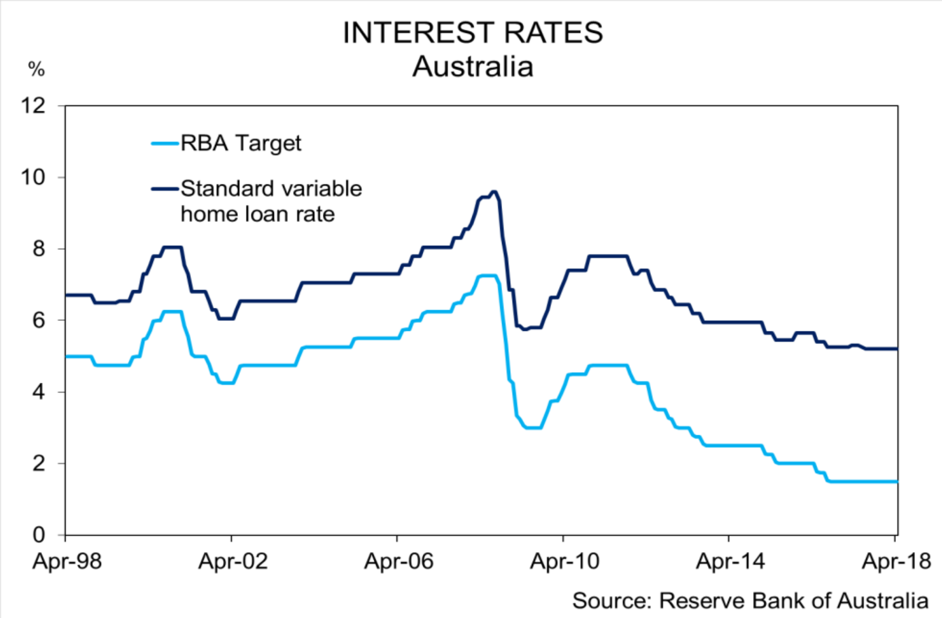
(a) Year average growth unless otherwise stated. From 2016–17 to 2019–20, employment and the wage price index are through-the-year growth to the June quarter. The unemployment rate is the rate for the June quarter. The consumer price index is through-the-year growth to the June quarter.

Source: 2018-19 Budget Commonwealth Treasury.

While wage growth and consumer prices have been somewhat subdued, which may be attributable to spare capacity in the labour market, the Commonwealth Treasury is expecting wage growth to strengthen as excess capacity in the labour market is unwound. In turn, the Budget forecasts that growth in consumer prices will return to the middle of the Reserve Bank of Australia's (RBA) inflation target range by 2019-20.

The target cash rate set by the RBA has remained at the record low of 1.5% since the cash rate was lowered by 0.25 percentage points (pp) in August 2016. The unprecedented period of a low and unchanged target rate has produced a similar period of stability in standard lending rates (see Chart 2).

Chart 2 – Interest Rates



4. Western Australia's Economic Outlook

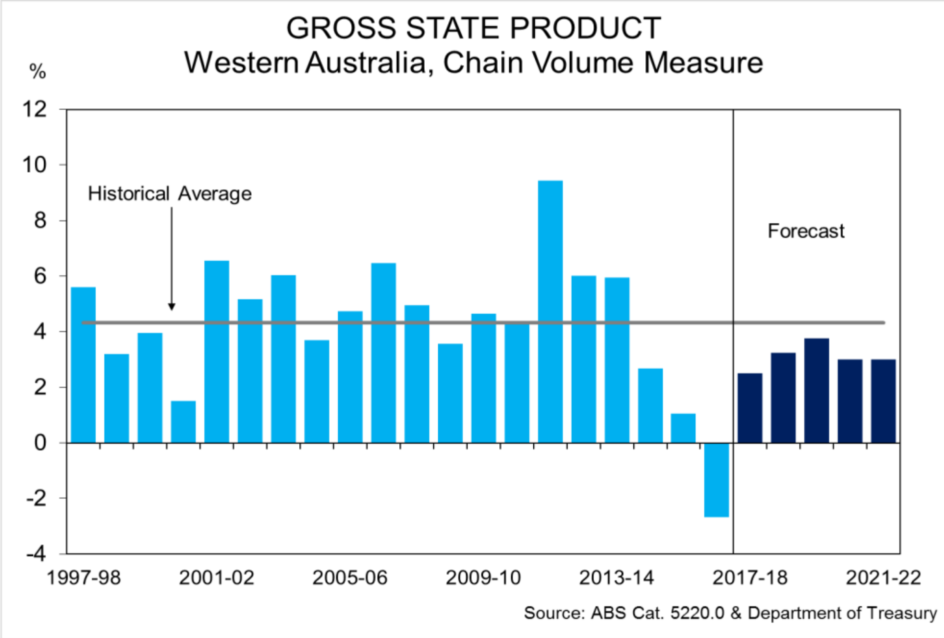
Western Australia's GSP contracted by 2.7% in 2016-17 following growth of 1.0% in 2015-16. This fall was largely attributable to a substantial contraction in the domestic economy (as measured by SFD) of 7.2% in 2016-17, flowing from even larger falls in business and dwelling investment.

Importantly, the contraction in domestic demand appears to have moderated over 2017-18 and is now projected to decline by only 0.25% in 2017-18 and 2018-19, before returning to growth of 3.75% in 2019-20. If these forecasts eventuate then Western Australia's domestic economy will have contracted for six consecutive years.

The State will therefore need to rely on strong growth in net exports (forecast growth of 10.0% and 12.5% in 2017-18 and 2018-19 respectively) as the economy continues its transition from the construction phase to the production phase of the mining boom.

Growth in exports is expected to be the largest contributor to economic growth of 2.5% in 2017-18 and 3.25% in 2018-19 (see Chart 3). By 2019-20 all the components of the State's domestic economy are expected to return to growth, which combined with a moderate expansion in net exports, is forecast to support GSP growth of 3.75%. GSP growth is then projected to moderate to 3.0% per annum in both 2020-21 and 2021-22. Notably, all of these rates are below Western Australia's long-term average annual growth rate of 4.3%.

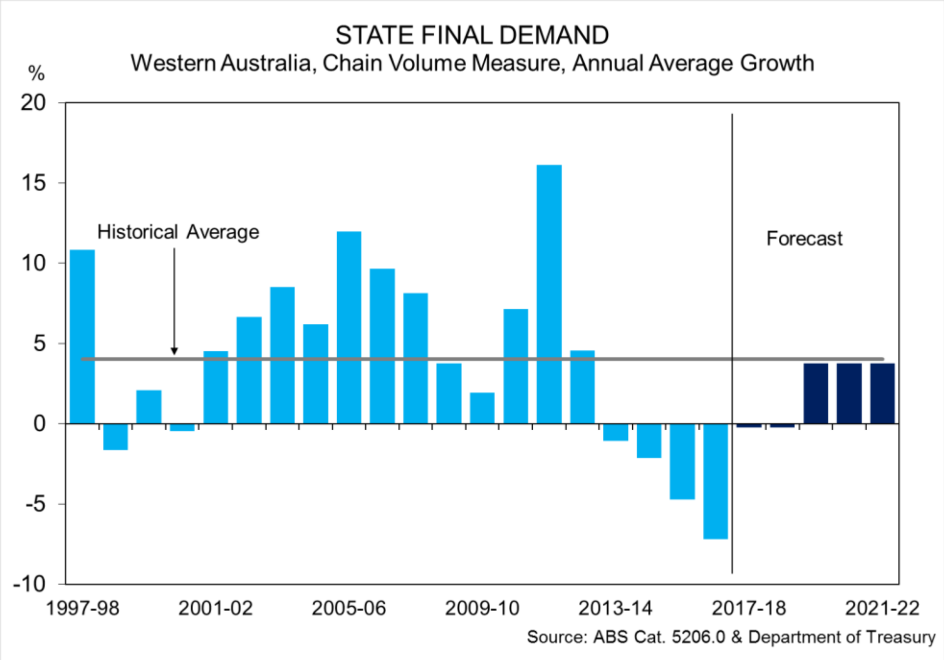
Chart 3 – Gross State Product



Domestic Economy

As noted above, 2017-18 is expected to be the fifth consecutive year of Western Australia's domestic economy contracting. The forecast decline in domestic activity of -0.25% in 2017-18 follows falls of 7.2% (2016-17), 4.7% (2015-16), 2.2% (2014-15), and 1.1% (2013-14). These declines follow a recent peak in growth of 16.1% in 2011-12, and compare with a historical average growth rate of 3.9% per annum (see Chart 4).

Chart 4 – State Final Demand



In contrast to the weakness in Western Australia's domestic economy, domestic demand nationally has increased in recent years (1.9% in 2016 and 2.9% in 2017), reflecting that key components of domestic demand have grown at a stronger pace at the national level over 2017 (see Table 4). In particular, business investment expanded at the national level despite a substantial decline for Western Australia.

Business investment is expected to decline further in 2017-18 and 2018-19, Western Australia's SFD is forecast to contract in both years, before returning to healthy growth of 3.75% per annum in each of the remaining outyears to 2021-22 (see Chart 4).

Table 4 – Components of Economic Growth (Seasonally Adjusted)

Annual Average Growth to December 2017, %

	Western Australia (%)	Australia (%)
Household consumption expenditure	1.3	2.7
Business Investment	-10.6	2.6
Dwelling Investment	-18	-2.4
Government Consumption	2.0	3.6
Government Investment	8.4	10.5
State/Domestic Final Demand	-1.8	2.9
International exports of goods [(a)]	3.5	3.8
International imports of goods [(a)]	N/A	7.6
Gross Product	N/A	2.3

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

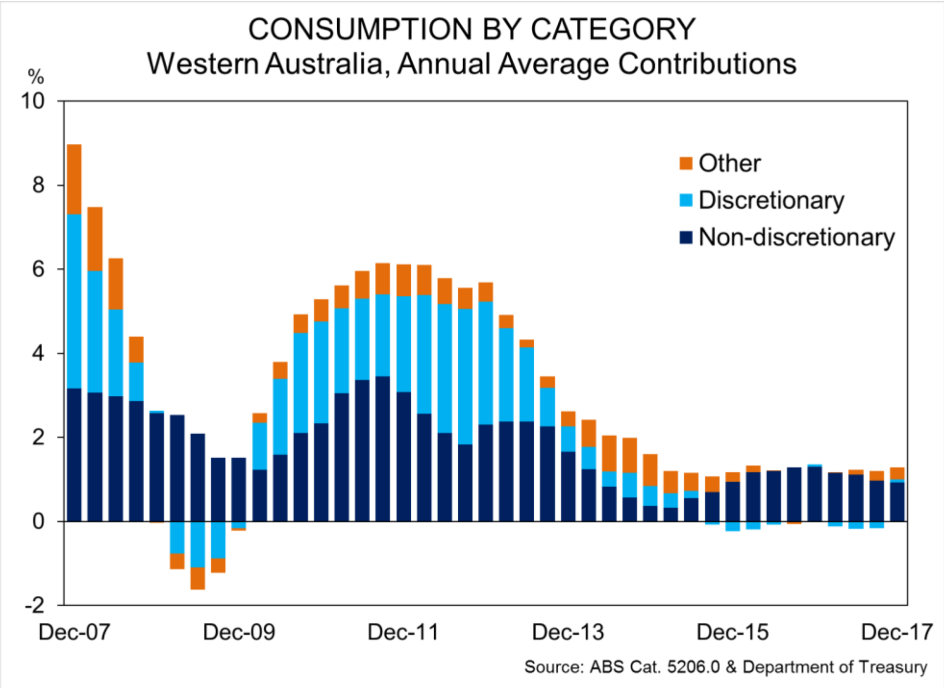
A more detailed analysis of the individual components of GSP is contained in the remainder of this section.

4.1 Consumer Spending

Household consumption expanded by a modest 1.3% in 2017, slightly lower than growth of 1.4% in 2016. Growth in 2017 was underpinned by non-discretionary and 'other' spending[5], which contributed 0.9 and 0.3 pp to growth respectively, while discretionary spending contributed only 0.1 pp in 2017 (see Chart 5). 'Rent and other dwelling services' and 'Health' made the largest contributions to growth (0.35 pp each), while 'electricity, gas and other fuel' and 'Furnishings and household equipment' were the largest detractors (accounting for -0.17 and -0.13 pp respectively).

Modest growth in household consumption (particularly discretionary spending) is consistent with weak labour market conditions, low wage growth and subdued population growth. Notwithstanding this, growth in household consumption is expected to lift from 1.75% in 2017-18 to 3.5% in 2021-22 as labour market conditions improve. However, growth is expected to remain below the historical average of 4.0% per annum, partly reflecting that population growth is expected to remain below the long-run trend.

Chart 5 – Consumption by Category



4.2 Housing Market

Dwelling investment declined by 18.0% in 2017, following a 14.3% decline in 2016. This reflects substantial falls in expenditure for both 'new and used' dwelling investment (-19.6%) and 'alterations and additions' (-14.7%). The decline in 'new and used' investment was slightly deeper than expected, reflecting a continued moderation in construction activity, following a record level of dwelling completions in 2015-16 and a marginal deterioration in the short-term outlook for investors[6].

[5] 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. Other spending includes: insurance and other financial services; other goods and services and net expenditure interstate.

[6] The limited prospect of substantial capital gain over the forecast period, the probability of rising interest rates, the potential for tighter lending criteria and out of cycle rate increases for investor loans in December 2017, the outlook for investors remains relativity subdued.

This trend is expected to reverse in 2018-19 with growth in total dwelling investment of 4.75% forecast in the 2018-19 State Budget. This pick up is consistent with leading indicators, such as building approvals for complete dwellings (with the rate of decline slowing to -10.1% in March 2018, from -17.5% in 2016-17) and the value of housing construction finance (grew by an annual average of 3.1% in February 2018).

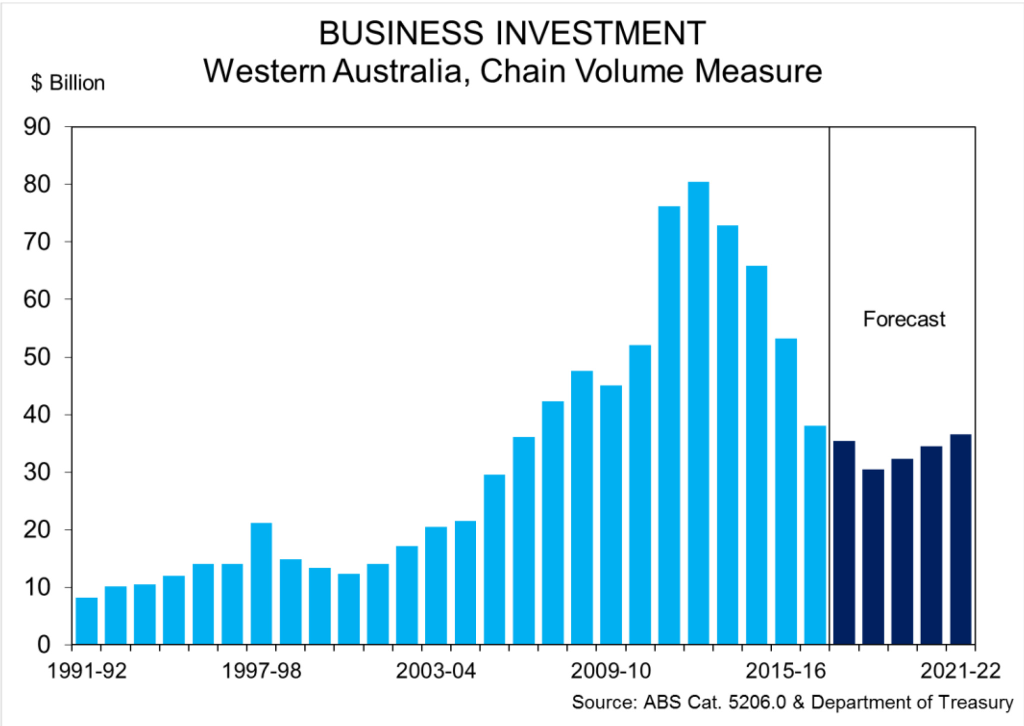
Dwelling investment is expected to grow by 5.75% in 2019-20, before slowing to 2.25% by 2021-22. This transition will return dwelling investment towards the long-term average growth rate of 2.0% per annum.

4.3 Business Investment

Following a lengthy period of strong growth, business investment has fallen substantially from its peak of $80.5 billion in 2012-13 to $38.1 billion in 2016-17, as major projects have been progressively completed. Investment fell by 28.5% in 2016-17, with a decline of 7.0% expected in 2017-18 and an additional 14.0% contraction forecast in 2018-19 (see graph below). The declines in these years reflect the absence of major new resource project commitments and the winding-down of construction on large LNG projects.

Business investment is expected to resume growing in 2019-20 and is forecast to grow by an average of 6.3% per annum over the years 2019-20 to 2021-22, above the long-run average growth rate of 4.7%. These rates of growth are expected to be supported by sustaining capital spending to maintain production and optimise capacity at existing iron ore and LNG facilities. Investment as a share of GSP is expected to fall from a peak of 37.1% in 2011-12 to around 13.3% over the forecast period, which is similar to the average share of GSP experienced prior to the recent mining investment boom.

Chart 6 – Business Investment



International Trade

4.4 Merchandise Exports

Western Australia's merchandise exports are estimated to increase by 5.5% in 2017-18 and 7.5% in 2018-19. The pick-up in growth in 2018-19 reflects a ramp up of LNG exports as well as increases in gold, iron ore and lithium exports.

Lithium exports are forecast to grow substantially over the entire forecast period (from 2017-18 to 2021-22), providing support to export growth, albeit from a low base.

Exports are forecast to grow by 3.5% in 2019-20. While iron ore volumes are still expected to increase in 2019-20, as the iron ore majors reach full capacity, the contribution to total export growth from iron ore exports will moderate. Similarly, the contribution to export growth from LNG will ease as major LNG projects reach full capacity. As a result, growth in exports is forecast to slow to 2.0% and 1.5% in 2020-21 and 2021-22 respectively.

4.5 Merchandise Imports

Merchandise imports are expected to decline in 2017-18 (-3.5%) and 2018-19 (-2.75%), in line with continuing falls in business investment (as fewer imports of large capital goods are required for the construction of major projects). If these falls eventuate it will mean the State's merchandise imports would have fallen for four consecutive years (-13.1% in 2015-16 and -0.4% in 2016-17). In 2017-18 and 2018-19, a decline in imports of large capital goods is likely to outweigh a moderate pick-up in demand for imported consumer goods (in line with subdued growth for household consumption).

5. The Labour Market

Conditions in Western Australia's labour market have improved over the past year, with a turnaround in employment growth and a reduction in spare capacity in the workforce. Important labour force statistics for the Western Australian economy are summarised in Table 5.

Table 5 – Population and Labour Force Forecasts

Western Australia

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Annual Level						
Total population ('000)	2,572	2,597	2,627	2,666	2,713	2,768
Working age population (15-64) ('000)	1,717	1,719	1,727	1,742	1,764	1,793
Employment ('000)	1,306	1,336	1,356	1,383	1,414	1,446
Unemployment ('000)	86	81	83	80	78	76
Unemployment rate (%)	6.2	5.75	5.75	5.5	5.25	5.0
Participation rate [(a)] (%)	67.3	68.1	68.4	68.6	68.8	68.7
Annual growth (%)						
Total population	0.7	1.0	1.2	1.5	1.8	2.0
Working age population (15-64)	0.0	0.1	0.4	0.9	1.3	1.7
Employment	-0.9	2.25	1.5	2.0	2.25	2.25

(a) Based on the population aged 15 years and over.
Source: ABS and Department of Treasury

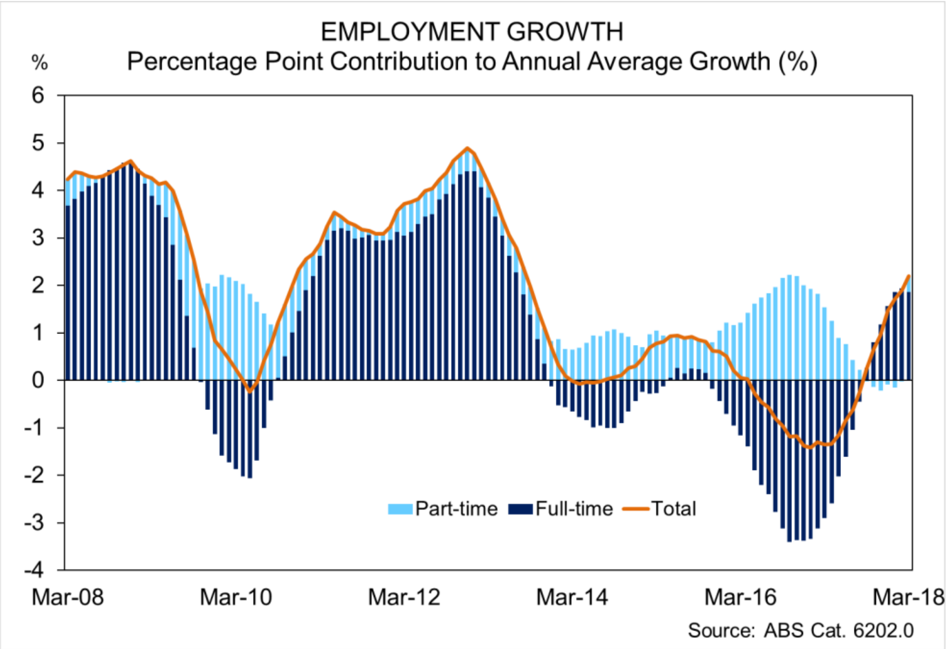
5.1 Employment

Employment is forecast to grow by 2.25% in 2017-18 after declining by 0.9% in 2016-17.

Annual average growth increased to 2.2% in March 2018 (see Chart 7), largely underpinned by full-time hiring, which contributed 1.9 pp to overall growth (after it detracted from growth in the last two financial years). Over this period, full-time hiring increased by 24,215 persons, with a portion of this increase attributable to the hook-up and commissioning of a number of floating LNG platforms in the second half of 2017 generating a number of new jobs.

Employment growth over the forward estimates period is expected to be broadly in line with the 27-year average of 2.1%. Despite this, employment growth is forecast to ease to 1.5% in 2018-19, with the winding down of labour-intensive construction on major LNG projects expected to dampen employment growth relative to 2017-18. The expected moderation in employment growth in 2018-19 is consistent with trends in 3-month year ended growth (which tends to lead annual average growth), which peaked at 3.0% in December 2017 and has subsequently fallen to 2.1% in March 2018.

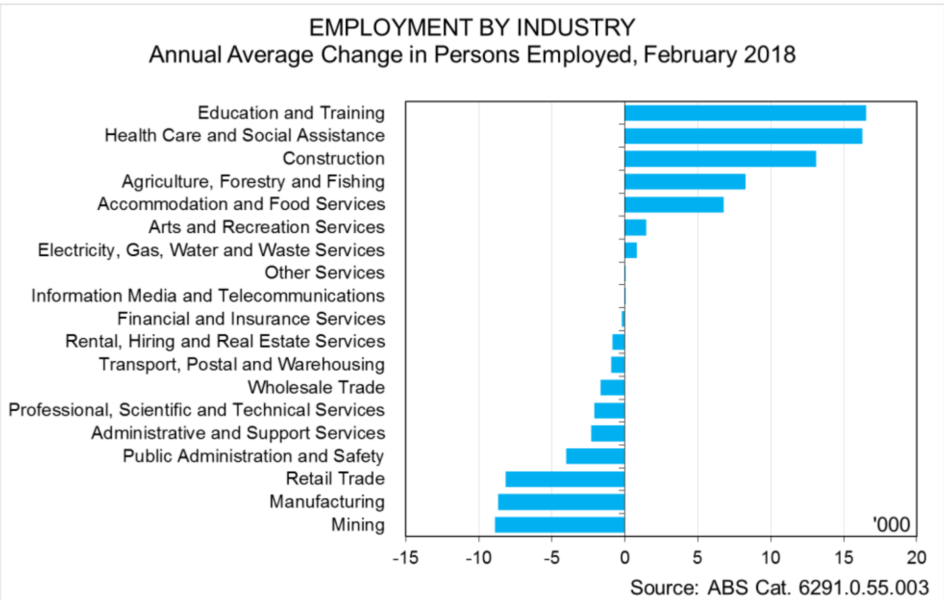
Chart 7 – Employment Growth



At an industry level, the State's industries with the strongest growth are clustered in the services sectors (such as Education and Training, Health Care and Social Assistance, and Accommodation and Food), as well as Construction, and Agriculture, Forestry and Fishing. 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 Mining, Manufacturing, and Retail Trade. Employment declined to a lesser extent in Public Administration and Safety, Administrative and Support Services, and Professional, Scientific and Technical Support Services.

Chart 8 – Employment by Industry



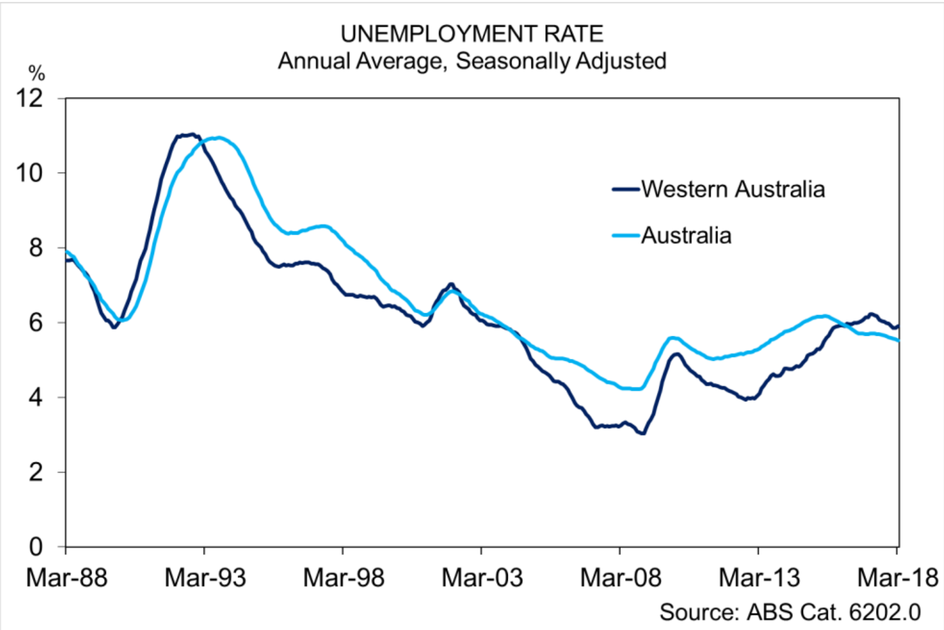
Outlook
Overall, employment growth is expected to continue over the Budget period, supported by a range of industries and consistent with lead indicators of labour demand (such as internet job advertisements). While the end of the labour-intensive construction phase of major LNG projects is expected to moderate employment growth in 2018-19, growth is then projected to strengthen to 2.25% by 2021-22, corresponding to a recovery in the domestic economy and a return to growth in business investment.

5.2 Unemployment and participation

As a result of the return to growth in employment in 2017-18, the unemployment rate is forecast to fall to 5.75% in 2017-18 and to remain steady at this rate in 2018-19, down from a recent peak of 6.2% in 2016-17.

The unemployment rate fell to an annual average rate of 5.9% in the year to March 2018 (see Chart 9), remaining above the national rate of 5.5%. Western Australia's unemployment rate has remained above the national average since April 2016. However, Western Australia's rate is similar to other states, excluding New South Wales, with unemployment rates in the range of 5.8% (Victoria) and 6.2% (South Australia). New South Wales' relatively low unemployment rate of 4.8% is holding down the national average.

Chart 9 – Unemployment Rate



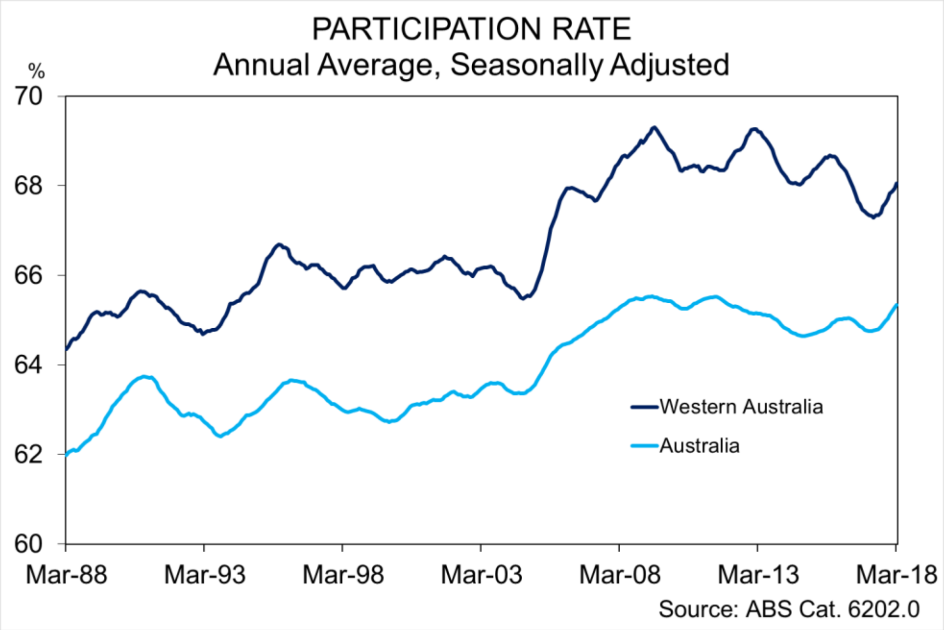
Demographic data shows that unemployment in the State is mixed across age groups, being far more prevalent amongst younger cohorts. The unemployment rate in the year to March 2018 was 20.3% for 15-19 year olds and 9.9% for 20-24 year olds. This is consistent with declining employment for those age demographics, and may reflect the nature of available jobs, or firms having a preference for skilled labour given the current slack in the labour market.

Accompanying the fall in the unemployment rate, Western Australia's underemployment rate (the proportion of persons who are currently employed but would like to work more hours) declined to 8.8% in the three months to February 2018, from a record high of 10.6% a year earlier. This indicates that there are 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 68.1% in 2017-18, from a decadal low of 67.3% in 2016-17. The average participation rate in the first nine months of 2017-18 is higher relative to the same period a year earlier for both males and females[7]. Indeed, female participation in trend terms reached a record high 62.7% in March 2018. This likely reflects strong employment growth in female dominated industries, such as Education and Training, and Health Care and Social Assistance.

Western Australia's participation rate has remained the highest of all States (2.1 pp higher than the second highest Victoria) and 2.7 pp above the national equivalent of 65.3% in the year to March 2018.

Chart 10 – Participation Rate



Outlook

The State's unemployment rate is expected to remain stable at an average of 5.75% in 2017-18 and 2018-19 as employment growth tracks labour force growth. The unemployment rate is then projected to gradually ease towards a 5.0% unemployment rate in 2021-22.

The participation rate is forecast to increase to 68.4% in 2018-19 as improved confidence and rising demand for labour encourage workers to return to the labour force, or join for the first time. Over the remaining forecast period, the participation rate is expected to rise further to an average of 68.7% per annum, remaining above Western Australia's long-term average of 67.0%.

7 In the first nine months of 2017-18, the male participation rate averaged 74.3%, compared to 73.4% at this time last year, while the female rate averaged 62.1% (up from 61.2%).

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 is expected to remain subdued at 1.5% in 2017-18, reflecting ongoing spare capacity in the labour market, low inflation expectations and the dampening effect from the State Government's public sector wages policy. Subsequently, WPI growth is forecast to lift in line with improving labour market conditions and a recovery in the domestic economy, but is expected to remain below the historical average rate of growth of 3.5%.

Of the various wage price 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 2017, after increasing by 0.6% in the September quarter of 2017, both below decade-average quarterly growth of 0.8%. These results contributed to the lowest calendar year WPI increase on record of just 1.4% growth in 2017.

The slow annual growth in total WPI is largely due to historically subdued private sector wage changes, with the private sector WPI increasing by just 1.2% in 2017, down from 1.4% in 2016. 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. While public sector wage growth was comparatively stronger, with growth of 1.8% in 2017, this was also the lowest growth rate on record, down from 2.6% in 2016 and the recent peak of 4.3% in 2012.

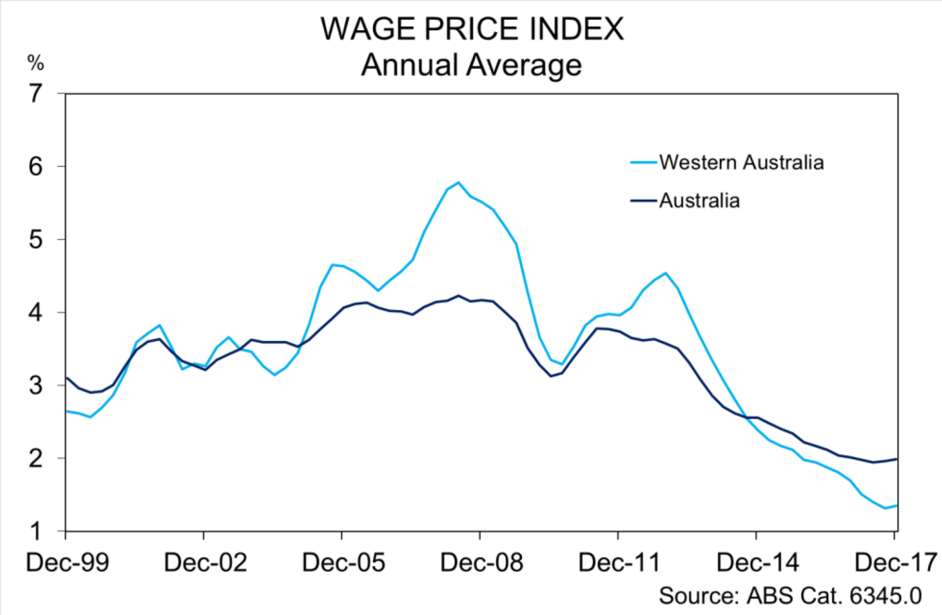
National comparison

Annual wage growth at the national level has also been at historically low rates, but remained steady at 2.0% in 2017, unchanged from 2.0% in 2016. 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 currently has the lowest annual average wage growth across all the States.

While growth rates are 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 2021-22.

Chart 11 – Wage Price Index



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 1.5% in 2017-18, before increasing modestly to 1.75% in 2018-19, both well below the historical average of 3.5% per annum. WPI growth is then projected to gradually increase to 3.25% by the end of the Budget forecast period (2021-22) as domestic economic conditions, such as business investment and private consumption, improve.

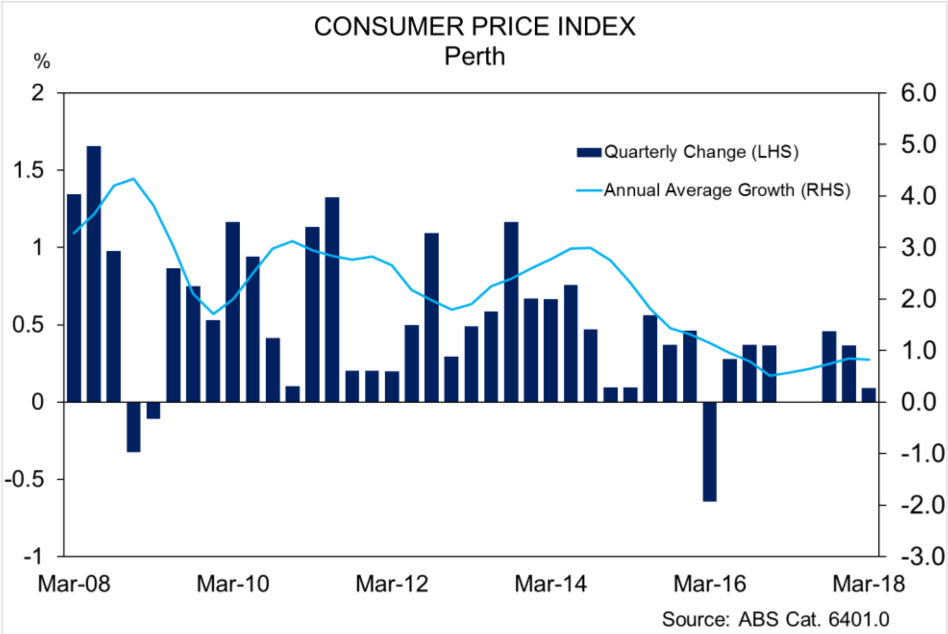
7. Inflation

Prices in Perth remained almost unchanged in the March quarter 2018, with the CPI increasing by only 0.1% (see Chart 12). This mainly reflects that increases in the prices of health related goods and services, education services and automotive fuel were offset by substantial housing price declines, primarily for rent and new dwelling purchases.

Perth's CPI increased by 0.8% in annual average terms to March 2018, up from 0.6% growth in the same period a year earlier. The annual increase was largely underpinned by a rise 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 fell slightly from 1.0% in the March quarter 2017 to 0.9% in the March quarter 2018[8].

[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.

Chart 12 – Consumer Price Index



The national CPI increased by 0.4% in the March quarter 2018, down slightly from the December quarter 2017 result of 0.6%. The main contributors at the national level were ‘housing’ and 'transport' and ‘health’, while the major detractors from growth were ‘clothing and footwear’ and ‘recreation and culture’ (specifically audio, visual and computing equipment and services, and international holiday travel and accommodation).

In annual average terms, the national CPI increased by 1.9% in the March quarter 2018, which was more than a percentage point above inflation in Perth (0.8%), largely reflecting continued divergence in housing market conditions. This gap between Perth’s inflation and the national rate is the largest negative gap (i.e. Perth’s annual CPI growth being lower than nationally) since 1992. The gap has remained steady for the past year.

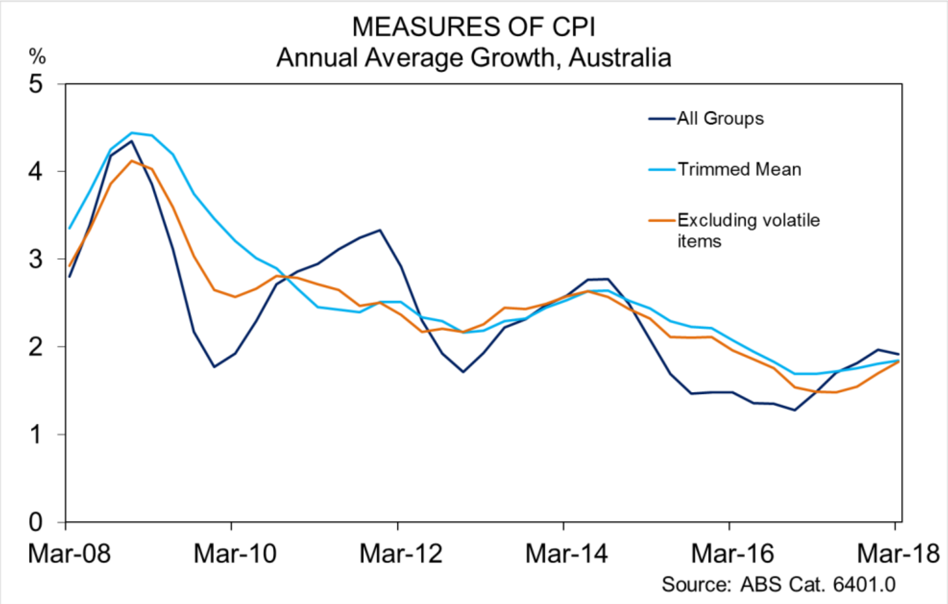
Growth in underlying measures of inflation nationally may differ to the headline indicator (see Chart 13). Excluding volatile items (mainly food and automotive fuel), the national CPI grew by 1.8% in annual average terms in March 2018 (compared to 1.9% growth in the overall measure). The ‘trimmed mean’ measure (which excludes the 15% of items with both the smallest and largest price changes) also increased by 1.8% in annual average terms to March 2018.

Outlook

In the 2018-19 Budget, Perth’s CPI is forecast to increase by 1.0% in 2017-18, before rising further to 1.5% in 2018-19 as housing market conditions improve and excess rental properties are absorbed. Inflation is then expected to lift to 2.0% in 2019-20 and 2.5% (the mid-point of the RBA’s target range) in both 2020-21 and 2021-22. These changes broadly align with anticipated improvements in domestic economic activity and wage growth. Over the next few years inflation is expected to be supported by further increases in the Commonwealth’s tobacco excise of 12.5% per annum. This is expected to add around 0.3 pp to inflation in 2018-19, 2019-20 and 2020-21.

The forecast for Perth CPI growth in 2018-19 (1.5%) is lower than the Commonwealth’s 2018-19 Budget forecast for national inflation (2.25%). The difference between national and Perth CPI forecasts largely reflects differences in the rate of change in housing costs (which have been declining in Western Australia but increasing nationally). The forecast for Perth CPI growth in 2019-20 (2.0%) remains below the Commonwealth’s forecast for national CPI of 2.5% (in year-ended terms).

Chart 13 – Measures of Consumer Price Index



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 appears relatively evenly weighted.

8.1 Global risks

There is a significant chance that recent positive momentum in major economies, such as the Euro area and the US, will result in stronger than expected economic growth over the next year or so. This growth may become more durable if it leads to increased investment and productivity growth and would have a positive impact on our major trading partners which export to these major developed economies.

China is by far the most important trading partner for Western Australia, accounting for more than 50% of the State's merchandise exports. Therefore changes in the country's domestic economy can have a major impact on the State's economic outlook.

There is a risk that recent economic growth momentum in China, which directly impacts royalty income from the sale of iron ore, will last longer than anticipated. However, risks to demand over the medium- to long-term are on the downside, reflecting China's rapid debt accumulation, particularly since the GFC, and unfavourable demographics. Rapid accumulations of debt and capital investment increase the risk of a significant financial disturbance and, historically, have been associated with misallocations of resources, which can reduce economic growth potential over subsequent years. Transitioning towards a more sustainable rate of debt accumulation will likely constrain growth over the medium-term.

Persistent global trade imbalances over recent years in combination with relatively poor growth in large pockets of the globe, particularly since the GFC, have led to a rise in popularity of trade protectionism. This culminated in a series of tariff announcements from the US President and some retaliatory announcements from the Chinese Government. To date, these measures have been relatively modest compared to the size of the US and Chinese economies, and any adverse impact on US demand for Chinese imports may be offset by the favourable impact of US tax cuts. Notwithstanding this, further escalation of trade disputes poses a risk to global trade, potentially impacting demand for commodities exported by Western Australia.

US interest rates have a large impact on interest rates throughout the globe as the US dollar is the de facto global reserve currency, underpinning a large proportion of global trade and financial flows. Increases in US interest rates have preceded financial crises in emerging markets over recent decades and the last two recessions in Australia. Therefore, any further significant increases in US interest rates pose risks to the State's major trading partners and to the Australian economy more generally.

8.2 Domestic risks

The timing and magnitude of the tapering in capital expenditure on the large LNG projects currently under construction in Western Australia remains the key risk to the domestic economic outlook. In particular, a sharper than expected fall in business investment could translate into weaker than anticipated economic growth. Furthermore, the business investment outlook hinges on a number of prospective projects being realised over the forecast period, and also the expectation that projects not yet identified will emerge.

The outlook for population growth creates a general element of uncertainty for domestic demand. For example, if overseas migration to Western Australia remains at current levels, rather than lifting as anticipated, growth in consumer spending and dwelling investment would be lower than forecast.

In addition, while growth in annual average employment strengthened to March 2018, the increase in employment since mid-2017 has been modest. If this continues, employment may be weaker than forecast in the near-term, which may flow through to a higher than projected unemployment rate.

There is also a risk that dwelling investment and house prices may decline more strongly than forecast if population growth and labour market conditions are weaker than anticipated. In addition, any potential tightening of residential lending criteria would put downward pressure on demand.

WESTERN AUSTRALIAN STATE BUDGET 2018-19 BUDGET STATEMENT FORECASTS
COMPONENTS OF GROSS STATE PROUCT

Western Australia

	2016-17 Actual (%)	2017-18 Estimated Actual (%)	2018-19 Budget Estimate (%)	2019-20 Forward Estimate (%)	2020-21 Forward Estimate (%)	2021-22 Forward Estimate (%)
Demand and output [(a)]						
- Household consumption	1.1	1.75	2.25	3.25	3.5	3.5
- Dwelling investment	-22.5	-6.25	4.75	5.75	3.25	2.25
- Business investment	-28.5	-7.0	-14.0	6.0	7.0	6.0
- Government consumption	1.9	2.0	1.75	2.0	1.5	2.25
- Government investment	7.8	3.5	6.0	5.25	1.5	-1.0
State Final Demand (SFD)	-7.2	-0.25	-0.25	3.75	3.75	3.75
- Merchandise exports	7.3	5.5	7.5	3.5	2.0	1.5
- Merchandise imports	-0.4	-3.5	-2.75	2.5	3.0	2.75
Net exports [(b)]	14.6	10.0	12.5	4.0	1.75	1.25
Gross State Product (GSP)	-2.7	2.5	3.25	3.75	3.0	3.0
Labour market						
Employment	-0.9	2.25	1.5	2.0	2.25	2.25
Unemployment rate [(c)]	6.2	5.75	5.75	5.5	5.25	5.0
Participation rate [(c)]	67.3	68.1	68.4	68.6	68.8	68.7
Population						
Population	0.7	1.0	1.2	1.5	1.8	2.0
Working age population (15-64)	0.0	0.1	0.4	0.9	1.3	1.7
Prices						
Consumer Price Index (CPI)	0.6	1.0	1.5	2.0	2.5	2.5
Wage Price Index (WPI)	1.4	1.5	1.75	2.75	3.0	3.25
SFD deflator	-0.3	1.2	1.7	1.9	2.3	2.3
GSP deflator	6.2	3.1	-0.4	0.0	1.4	1.9
Median house price	-3.1	-0.1	1.4	1.8	3.2	2.6
Other key parameters [(c)]						
Exchange rate $US/$A (cents)	75.4	77.8	77.0	77.2	77.4	77.4
Iron ore price ($US/tonne) CFR [(d)]	68.8	68.3	61.9	60.8	62.1	63.4
Crude oil price ($US/barrel)	49.7	62.1	66.0	62.2	59.4	57.7

(a) Based on the 2016-17 annual State Accounts data, updated with the latest State Final Demand data for the December quarter 2017.

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

(c) Data expressed as annual average during the financial year

(d) The cost and freight (CFR) price is the spot price for ore with a 62% (Fe) content delivered to north China. Royalty estimates are based on a benchmark free on board (FOB) price, which is the CFR price minus a moisture adjusted freight assumption.