

WA ECONOMIC OUTLOOK

Wednesday, 30 November 2011

Summary:

- Western Australia is the fourth largest economy in Australia. It comprises almost a 15% share of Australia's economy and has a population of 2.3 million. Western Australia is well known for its mining activity, which is the largest industry in the state, and its services sector.
- Turning to the pace of economic growth, the Western Australian economy has been an engine of growth for the Australian economy over the past two years. State final demand rose 1.0% in the June quarter, placing it in the middle of the pack among the states, in terms of quarterly growth. However, the annual rate of growth rose by 6.6%, which although a very robust growth rate, was actually below the 6.8% long-run average.
- The biggest driver of growth in the Western Australian economy, much like the Australian economy, is private business investment. Business investment in Western Australia is strong and is benefiting from its growing mining sector, including mining services. Business investment rose by 12.7% in the year to the June quarter in Western Australia, down from 16.9% in the year to the March quarter. It is faster than the annual growth of 10.5% recorded for Australia in the year to the June quarter.
- Business investment intentions in Australia for the next two years are very strong, with much of this centred on the resources industry in Western Australia. The increase in mining investment is led by LNG, with the Gorgon project, the Wheatstone development, the Prelude project and the North Rankin redevelopment either underway or having just been approved. There are further projects undergoing assessment or in the decision phase. Iron ore projects also feature, as do several gold projects.
- Export growth has eased in Western Australia over the past year, although this follows very strong growth in the previous two years. Western Australia's exports account for more than 35 per cent of Australia's exports. Western Australia's major exports include iron-ore, gold, crude petroleum, natural gas, wheat and copper ores and concentrates.
- Western Australian retail sales are outperforming the national average, having risen 8.0% in the year to September, with consumer's more upbeat likely due to the mining boom and very low unemployment rate. Further, the fall in the population growth rate has now ended.
- Jobs growth in Western Australia has slowed from much stronger growth in recent years, although the unemployment rate remains low, at 4.2%, compared to the national average at 5.2%. Western Australians are also taking home larger pay packets, most likely due to rising earnings in the mining and construction industries.
- Housing conditions in Western Australia continue to soften. Perth house prices have fallen more sharply than the national average over the past year, although this was from strong peaks due to robust growth over the past 10 years. The RBA's interest rate cut from early November will provide some relief, although interest rates are still likely to bite.
- The mining boom has driven up house prices and rents in Western Australia, so that housing affordability remains an issue, despite a recent softening in house prices.
- The downside risks for the Western Australian economy in the near term include the potential for global growth risks to impact Asia, and China in particular, from the growing European sovereign debt crisis. The RBA is closely monitoring this situation and if Asia shows the impact from the downside risks to global economic growth, it is likely to result in lower interest rates from the RBA.
- St George forecasts Western Australian economic growth will strengthen further in the current financial year, to 7.50% average growth in state final demand for 2011-12, easing to 5.50% in 2012-13.

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Overview

Western Australia is the fourth largest economy in Australia and comprises a 14.6% share of Australia's gross domestic product (GDP). The mining industry is the largest and fastest growing sector in Western Australia and Western Australia's economy at the moment is dominated by mining, including mining services.

The increase in Western Australia's mining sector in recent years reflects growing demand for its natural resources from China and other Asian economies. Last year, 40 per cent of Western Australia's goods exports were destined for China, followed by Japan (17.7%), the Republic of Korea (9.0%) and India (7.0%). The only non-Asian goods export destination in the top five for Western Australia was the UK, which took less than six per cent of Western Australia's goods exports, indicating how import the Asian region is for Western Australia's economy.

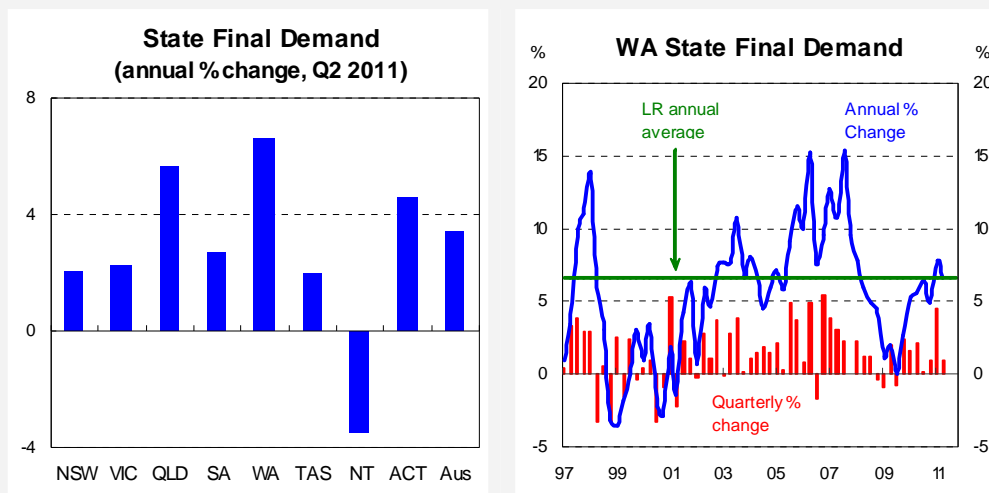
After mining, the next largest sector is the construction sector, also reflecting increased capital expenditure as the mining sector continues to expand, looking to bring on new production in the mining industry.

Percentage Shares of the Economy*		
Industries	Australia	WA
Mining	8.6	30.6
Construction	7.3	9.8
Manufacturing	8.6	6.4
Professional, scientific and technical services	6.4	5.0
Transport, postal and warehousing	5.0	4.6
Health care and social assistance	5.7	4.4
Financial and insurance services	10.2	4.3
Retail trade	4.2	3.3
Wholesale trade	4.4	3.3
Public administration and safety	2.4	2.9
Education and training	4.1	2.7
Rental, hiring and real estate services	2.6	2.6
Agriculture, forestry and fishing	2.5	2.4
Administrative and support services	2.4	2.1
Electricity, gas, water and waste services	2.0	1.7
Information media and telecommunications	3.1	1.5
Other services	1.5	1.3
Accommodation and food services	2.1	1.1
Arts and recreation services	0.8	0.5

* For Australia, using GDP and for NSW, using GSP; Source: ABS, St. George

Economic Growth

Western Australia experienced strong growth in the June quarter, as measured by State final demand. State final demand jumped by solid 1.0% in Western Australia in the June quarter, following a 4.5% increase in the previous quarter. The June quarter growth in Western Australia put it in the middle of the pack in terms of quarterly growth, compared to the other states and territories, however, in annual terms, Western Australia's growth remains very strong at 6.6%. This is in line with Western Australia's 5-year average growth rate.



The annual growth rate of 6.6% (in State Final Demand) is well above the domestic final demand reading of 3.4% for the national economy, but in line with the average growth rate in State Final Demand of 6.6% over the past five years.

Note that ideally, gross state product (GSP) would be used to assess broad economic growth, which includes inventories and net exports, but the data isn't available quarterly (only annually).

The significant growth driver for Western Australia and the wider Australian economy remains private business investment (discussed below). Nationally, slower population growth, relatively high interest rates and cautiousness by households are having a dampening impact on housing and consumption. Some sectors are also being weighed down by the high Australian dollar. Given the size of its mining sector and the current mining boom, however, Western Australia has largely escaped this downside. However, escalating worries from abroad are adding to downside risks to economic activity for Western Australia and Australia.

The Western Australian Treasury expects robust economic growth in 2011-12 and 2012-13 of 4.5% and 4.0%, respectively, in Gross State Product, which compares to the average pace of growth witnessed over the last five years of 4.5%.

Business Investment

The mining boom and strong terms of trade in Australia are expected to lead to an increase in private business investment over the coming year. Nationally, businesses raised capital expenditure by 11.9% in 2010-11 and it is estimated they intend to increase spending by approximately 32% in 2011-12 (according to the most recent survey from the ABS).

Business investment in Western Australia is strong and is benefiting from its strong and growing mining sector. Business investment rose by 12.7% over the year to the June quarter in Western Australia, down from growth of 16.9% in the previous quarter, but still showing a

robust rate of growth.

Much like the national trend, a big driver of strong business investment has been driven by engineering construction. The pipeline for engineering construction is high nationally and particularly in Western Australia, largely reflecting strong infrastructure demand from the resource sector. However, in the June quarter construction engineering slipped 2.3%, after rising 11.4% in the March quarter. This saw the annual rate fall to 8.1% in the year to June, from 33.4% in the year to March.

Despite slower growth in construction engineering at the moment, there is a huge amount of work in the pipeline in Western Australia and supply shortages are likely to become problematic. The projects in the pipeline will be competing for workers, in the face of slowing population growth, as well as materials.

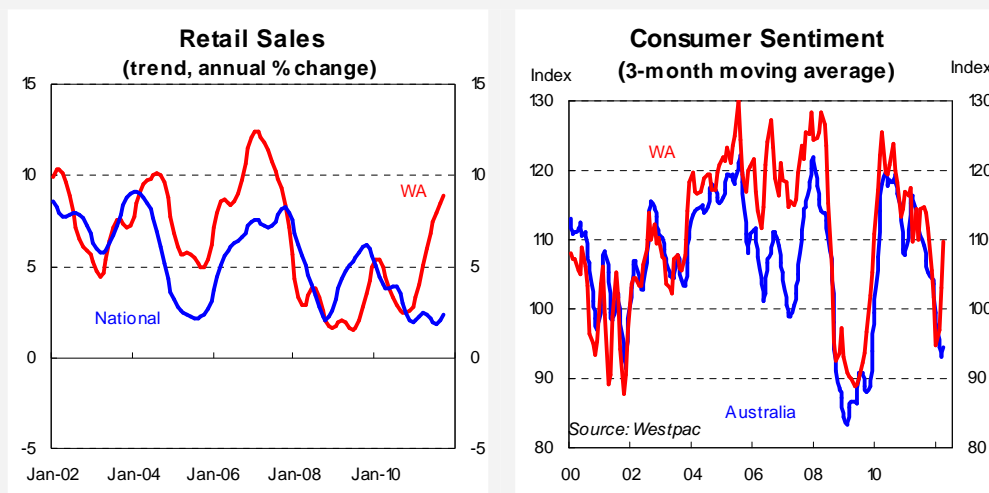
The volume of projects in Western Australia are being led by the \$43 billion Gorgon LNG project, work on BHP Billiton's Rapid Growth iron ore project and the North Rankin LNG development, worth \$5 billion.

Exports

Increased potential for mineral production is a large positive for the Western Australian outlook. While commodity prices have softened recently due to the downside risks for the global economy, they remain at high levels and should support export income.

Export volumes fell 0.7% in Western Australia in the June quarter, and are down 2.3% over the year to the June quarter. The major exports from Western Australia in 2010 included iron ore and concentrates, gold, crude petroleum, natural gas and wheat. With increased LNG projects underway in Western Australia, natural gas will become an increasingly important export for Western Australia. The strong Australian dollar is weighing on some exports from Australia, particularly in the manufacturing and tourism industries, however, strong demand from China and Asia more broadly means commodity exports have remained robust. Over the medium to longer term, we can expect the Australian dollar to trade higher than historically has been the case, as it receives underlying support from Australia's attractive interest rates, Australia's rising terms of trade, Australia's strong links to the Asian region and Australia's relatively robust economic fundamentals. In the near term, however, the AUD will be subject to the nervousness in financial markets due to the deepening European sovereign debt crisis.

Australia's trade links to the Asian region have become increasingly important over the past decade. This is particularly true of Western Australia, which exports the commodities so desired by the Asian region, and is reflected in the destinations of Western Australia's exports. The major destinations for Western Australia's goods exports are China (40.2% in 2010), Japan (17.7%), South Korea (9.0%) and India (7.0%). Western Australia's exports account for around 45 per cent of national merchandise exports, underlying the states' importance to Australia's economic growth.



Consumer Spending

Western Australia has outperformed the national economy in retail sales. A broad measure of consumer spending is household final consumption expenditure contained in the national accounts. It confirms that household consumption in Western Australia is currently robust. In the year to the June quarter, household consumption in Western Australia rose by 5.1%, its strongest growth rate in a year. This compares to growth of 3.2% seen Australia-wide and growth in Western Australian household consumption of 4.7% on average over the past ten years.

Areas of strength in household consumption in Western Australia over the past year include transport services, hotels, cafes and restaurants, alcoholic beverages and furnishings and household equipment. Some of these are discretionary areas of spending, reflecting that Western Australian households are less cautious than households in some of Australia's other states, reflecting the flow through of the mining boom to incomes in the state.

A notable weak spot in Western Australian household consumption was evident in vehicle sales, but this is largely due to supply-chain disruptions in Japan after its natural disasters. This disruption is now easing.

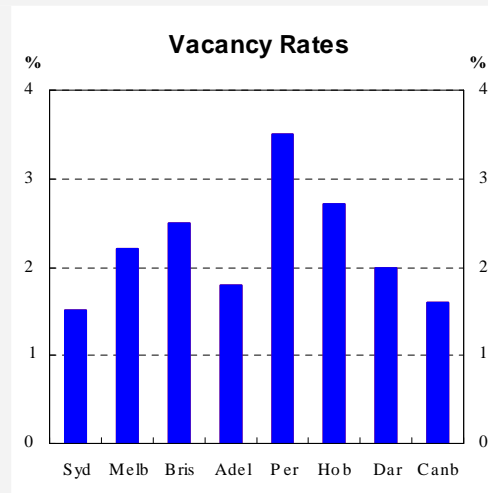
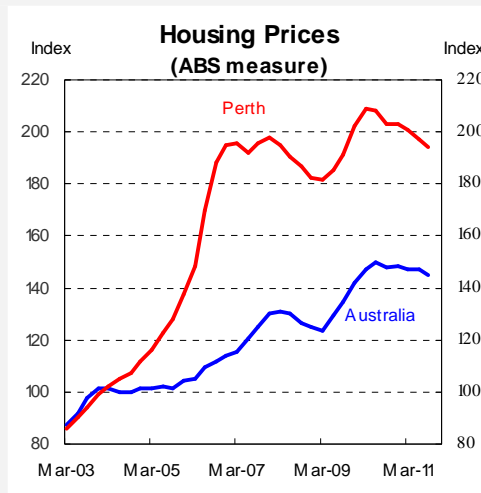
Retail spending is a large component of overall household consumption. Retailing is a weak spot in the economy nationally but this is not reflected in Western Australian retail spending. Retailing in Western Australia jumped 7.8% in the year to September, making it the strongest growth state for retail sales. This also compares favourably to long-run average growth of 6.5% in Western Australian retail sales.

The Westpac-Melbourne Institute measure of consumer sentiment for Western Australia has risen sharply over the past five months. Consumer sentiment for Western Australia jumped 19.4% in the five months to November, although consumer sentiment in Western Australia eased in November, likely reflecting ongoing volatility in financial markets and growing concerns about global growth. Sentiment, however, remains well above 100 in Western Australia (at 110), indicating optimistic consumers in the state outweigh pessimists. It is also well above the overall national sentiment reading of 103.4, indicating that Western Australian consumers are more optimistic than the national average.

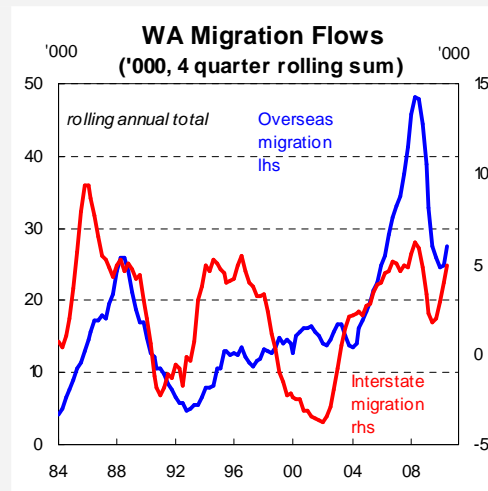
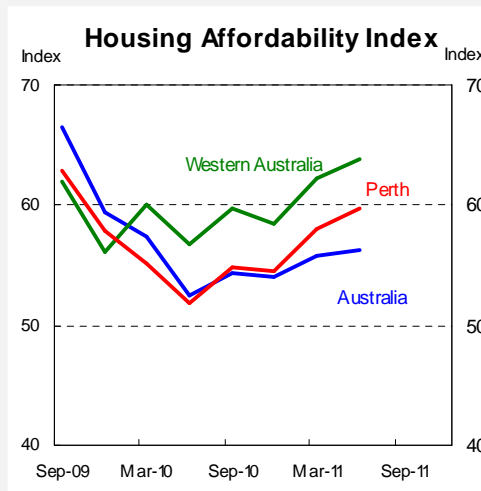
Housing

House prices have moderated in Australia and in Western Australia over the course of this

year. According to the Australian Bureau of Statistics (ABS), Western Australian house price growth has slowed significantly from a recent peak of 14.9% growth in the year to the March quarter 2010 to be down 4.2% in the year to the September of 2011. It compares with a decline of 2.2% across Australia. The Perth property market saw very strong growth through the early 2000s, with the growth rate topping 45% in 2006, so while the current decline in prices is greater than the national capital city average, it is coming off very strong growth cycles over the past ten years.



Other house price data also indicates that house price growth remains subdued. RP Data-Rismark dwelling prices fell 5.1% in the year to September, compared to a decline of 3.4% nationally. Relatively high interest rates and the end of the boost to the first-home-owners' grant (FHOG) are also weighing on demand as is low housing affordability. However, November's interest rate cut will provide a modest boost and the degree of contraction in housing prices already appears to be easing.



Population growth is comprised of changes in the birth rate, changes in overseas arrivals and

changes in interstate migration. The population growth rate in Western Australia fell sharply in the wake of the GFC, but began to recover late last year.

We expect house prices to continue to soften over the next twelve months both across Australia and in Western Australia, as homebuyers remain on the sidelines. Low unemployment and strong growth in household incomes is giving support to the housing market but ongoing turmoil in the global economy, low housing affordability and household caution will encourage homebuyers to stay on the sidelines.

The expected continuing softening in house prices will flow through to the residential construction market. This will be particularly noticeable in Western Australia where residential construction is likely to be “crowded out” by engineering construction due the mining industry.

We expect that a weaker trend of dwelling investment is likely to continue. Leading indicators of residential dwelling investment suggest building activity will ease. Building approvals in Western Australia have fallen 0.8% over the year to September, an improvement from last year, which saw annual declines in excess of 30 per cent. However, the number of building approvals in the state remains more than 10 per cent below the long term average and we are unlikely to see a convincing pick up in residential building in Western Australia in the near term.

According to BIS Shrapnel, Perth’s dwelling stock remains slightly undersupplied. Despite this, Perth’s residential rental vacancy rate is the highest of all the capital cities. Vacancy rates lower than 3.0% indicate strong demand for rental accommodation or a shortage of rental accommodation. A rate below 2% indicates the rental market is super tight. Vacancy rates in Perth are at 3.5%, which tends to reflect an oversupply of rental accommodation.

Non-residential Construction

Non-residential building has been lacklustre nationally and in Western Australia as the stimulus from the Building the Education Revolution (BER) program fades and as the effects of the global financial crisis linger.

However, signs of life were seen in Q3, with non-residential building growing 3.1% for the quarter, nationally, following on from four consecutive quarters of declines. In Western Australia, non-residential building was stronger, rising almost 20% in Q3, to be up 14% for the year. The recovery seen in non-residential construction is expected to continue this financial year.

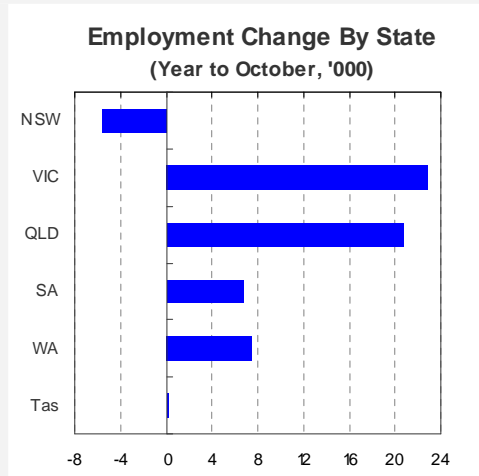
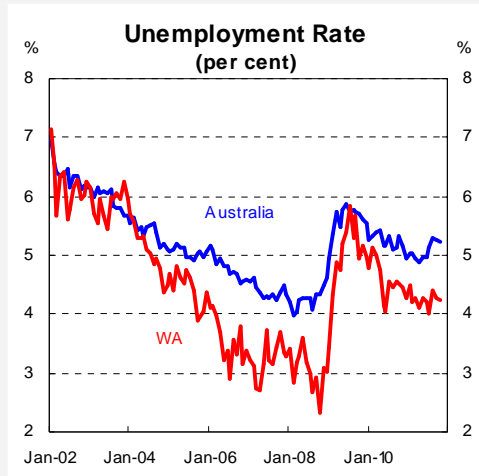
Labour Market

The Western Australian labour market has softened in line with the trend nationally. Annual employment growth was 1.0% in October in Western Australia, compared to 1.1% nationally and a cyclical peak of 5.1% in July last year. However, Western Australia has added a net 7.4k jobs so far this year, the third most amongst all the States, behind Victoria and Queensland.

Despite the weaker growth in jobs, the unemployment rate in Western Australia at 4.2% remains very low, pointing to a very tight labour market in the state. This is below the 10-year average of 4.6% for Western Australia, and well below the national average unemployment rate of 5.2%. It suggests wage pressures are likely an issue in some parts of the WA economy. The low unemployment rate, despite lacklustre jobs growth reflects a decrease in the workforce participation rate (which includes those working and those looking for work), to 67.7% in October, from a peak of 69.8 in December 2008, before the GFC had begun to impact resource projects in Western Australia.

Leading indicators of employment – namely job advertisements – continue to point to a moderate pace of jobs growth. Further, there has been an encouraging bounce in business confidence and conditions in September, suggesting firms are less pessimistic about the

outlook.



Despite the dominance of the mining sector in Western Australia, it is not the largest employer. That honour goes to the construction industry, the recent strength of which certainly also reflects the growth of the resources sector. The construction industry employs 13.0% of the Western Australian labour market, while the mining industry employs 10.2%. Employment in the construction and mining industries has increased sharply (by 68.7% and almost 226%, respectively) over the past ten years. This compares to a total 33% increase in the number of people employed in Western Australia (including the construction and mining industries).

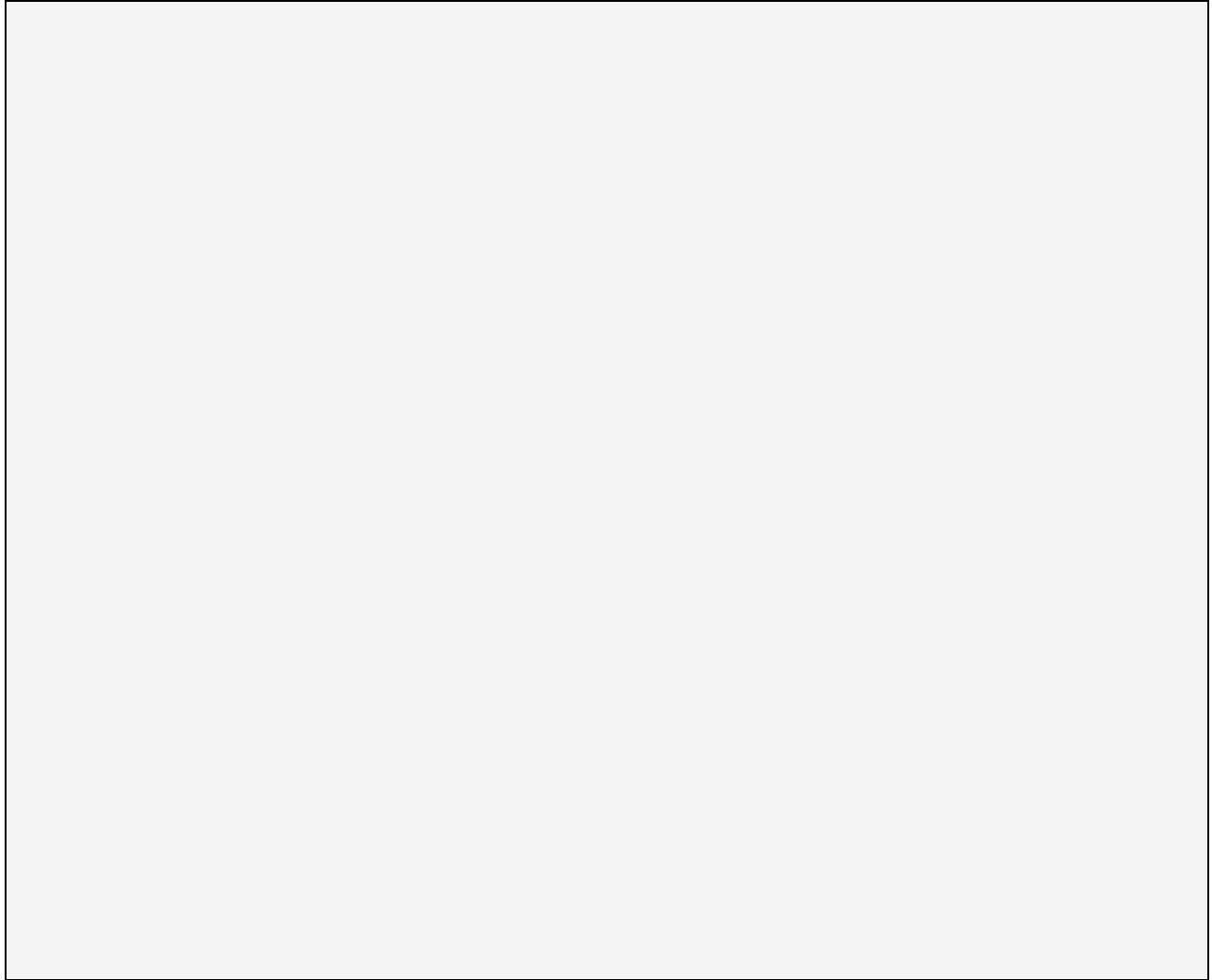
St.George Banking Group Forecasts

Economic Indicators, % Change				
	2009-10	2010-11	2011-12 (f)	2012-13 (f)
State Final Demand	3.40	6.50	7.50	5.00
Employment	0.30	3.20	2.80	3.00
Unemployment Rate	5.00	4.40	4.40	4.30
Perth CPI	2.50	2.80	2.40	2.30
Wage Price Index	3.40	4.00	4.40	4.60

Source: St.George Banking Group

Western Australian Treasury expect gross state product to expand by 4.5% this financial year and 4.0% in 2012-13, after growth of 4.0% last financial year. As noted above, the more regular but narrower measure of economic activity is state final demand. On this measure, we expect state final demand to grow by 7.50% next financial year, after growing 6.50% last financial year.

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