

Thursday, 2 July 2020

WA Economic Outlook

- Western Australia is poised to outperform the national economy under the spectre of COVID-19, although it is not immune from the pandemic.
- Western Australia took the honours for the best performing State as measured by final demand in the March quarter 2020. State final demand rose 0.9% in the quarter, reversing a 0.1% decline in the December 2019 quarter. On a year ago, final demand was 3.4% firmer and at its strongest in over 7 years.
- The factors suggesting this relative outperformance will continue include WA's comparatively low exposure to key industries hit hardest by the virus – tourism, foreign students and international migration – and external factors supporting iron ore prices and incomes. Moreover, WA has had a relatively good outcome containing COVID-19.
- The hangover from the mining downturn has faded. The turnaround in fortunes in the mining sector has come at an opportune time for Western Australia. COVID-19 is less likely to derail the fortunes of mining-sector companies.
- However, WA's outlook depends heavily on Chinese economic policy, which is a key driver of demand for commodities.
- Stimulus measures from the WA government that top up the Federal government's housing stimulus package will help give support to Perth's languishing residential property market.
- Dwelling prices fell by 1.1% in June in Perth, according to the latest data from CoreLogic. Perth and Melbourne recorded the deepest fall of all capital cities in June. Perth also had the worst outcome of all capital cities when comparing housing prices to a year ago.
- WA will not avoid the recession facing other States and the country. Household consumption is critical to the outlook and it was lacklustre in WA before the COVID-19 pandemic. Consumption will continue to be sluggish, as unemployment rises and uncertainty continues.

National Economic Outlook

The COVID-19 pandemic has cast a large shadow on the domestic and global economy. A sharp contraction in economic activity is expected this year. It reflects restrictions, including distancing, to prevent the spread of the virus and the impact of caution and uncertainty among consumers and businesses. The loss of tourism and migration flows due to international border restrictions are also key factors hurting economic activity. We expect the Australian economy to contract 4.0% this year with the deepest contraction expected for the June quarter of this year. A recession over the first half of this year is a virtual certainty. Household services have been hit particularly hard, but all industries have been impacted. Nonetheless, Australia's relative success in containing the virus has meant that restrictions are being lifted sooner than anticipated earlier this year.

Economic activity is expected to recover in the second half of this year, although the economy is likely to stay in the slow lane for some time.

The lingering threat of COVID-19, however, has led to more long-lasting changes in behaviour among consumers and businesses, suggesting an uneven recovery. Social distancing measures remain in place, limiting the ability for many businesses to return to normal operating conditions. Economic activity is unlikely to recover fully to pre-pandemic levels for some time. There is also a risk of restrictions being re-imposed if new infections continue to rise, which would threaten the nascent recovery.

Significant stimulus measures from the Government and the Reserve Bank (RBA) have helped cushion the impact from the virus and associated restrictions. However, there is a major concern around some key support measures expiring at the end of September, including JobKeeper. There is a risk that these support measures are withdrawn at a time when economic activity has not fully recovered and when unemployment is still rising.

West Australian State Economic Outlook

Western Australia is poised to outperform the national economy under the spectre of COVID-19. The eastern States are relatively more exposed to the sectors most impacted by the global pandemic, including tourism, household services and international migration. Additionally, the iron ore price has remained elevated, which would support incomes in Western Australia.

The outperformance of Western Australia compared with the rest of Australia invokes comparisons with the global financial crisis (GFC). The relative strength of the mining sector will undoubtedly support growth; however, the State is not immune from national and global trends. Western Australia has been relatively successful in containing COVID-19, but the economy will not escape the current crisis unscathed. Measures to contain the spread of the virus have significantly impacted consumption. Domestic demand has fallen dramatically. Chinese stimulatory policies are unlikely to be as widespread or focussed on construction as what occurred in 2009.

Western Australia's economic cycle is highly dependent on the price cycle of commodity prices. The most recent available data suggest that Western Australia was recovering from the unwinding of a mining investment boom and momentum was shifting towards an upturn before COVID-19 gripped the economic outlook.

Economic activity by State and territory is principally provided by **Gross State Product (GSP)**. GSP is the closest measure to gross domestic product (GDP). GSP showed Western Australia grew by 1.0% in the financial year 2018-19, down from 2.5% in 2017-18 and below the long-run average of 4.2%.

State final demand is published more frequently (i.e. quarterly), but it excludes the trade sector. Western Australia took the honours for the best performing State as measured by final demand in the March quarter 2020. **State final demand** rose 0.9% in the quarter, reversing a 0.1% decline in the December 2019 quarter. On a year ago, State final demand was 3.4% stronger, also the strongest pace in just over 7 years.

The WA state economy enjoyed a moment of outperformance in Q1 ahead of the COVID-19 shock. Three factors suggest this relative outperformance will continue: 1) WA's comparatively low exposure to key sectors hit hardest by the virus – tourism, foreign students and international migration; 2) external factors supporting iron ore prices and incomes; and 3) a relatively good outcome containing COVID-19 locally. Despite this, the state will still succumb to the forces driving

the wider Australian economy into recession in the first half of 2020. And there are also significant areas of fragility: household finances in particular will come under more pressure as yet another lurch lower in the long running correction in Perth house prices combines with persistent real wage declines. Indeed, even a shallow recession compared to the major eastern states will be a stern test for households in the west – many of whom are still only just recovering from WA's most recent recession.

Growth drivers were mixed heading into the health crisis. The recovery in the State was largely driven by investment in the March quarter. **Private business investment** rose 7.4%, boosted by a pick up in mining sector activity. **Final consumption by households** fell 1.0%, reflecting the impact of COVID-19 on household spending. Spending had been on weak footing following the multi-year unwinding of the mining boom, which resulted in falling incomes and weak labour market outcomes. **Dwelling investment** (including new and alterations & additions) fell 4.6% over the quarter.

Additional data from the **private capital expenditure** survey (CAPEX) suggest that the hangover from the mining downturn has faded. Investment plans for the mining sector in the 2019-20 financial year were up 10.9% compared with the same estimate a year ago in March.

The turnaround in fortunes in the mining sector has come at an opportune time for Western Australia. COVID-19 is less likely to derail the fortunes of mining sector companies. Highlighting this point, the fifth edition of the Australian Bureau of Statistics (ABS)'s survey measuring the impact of COVID-19 on businesses showed that mining companies were the least likely to report a reduction in revenue compared with the same period a year ago. The survey, conducted between June 10 and June 17, revealed 31% of mining companies reporting a reduction in revenue compared with a year ago, while 66% of companies reported a decline in revenue across all industries.

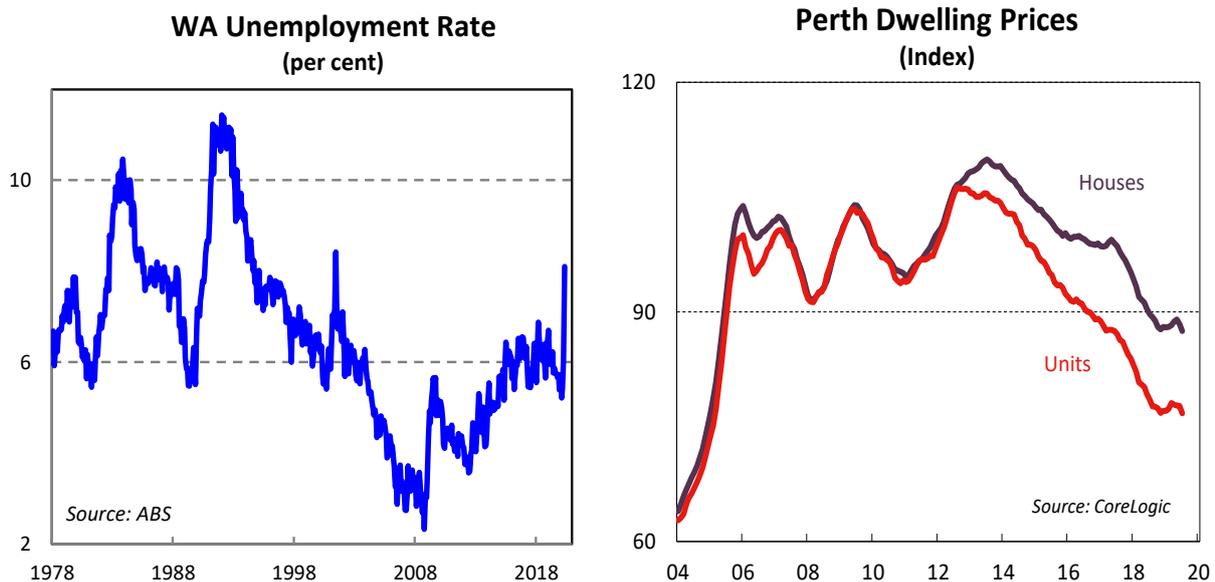
While most commodity prices have fallen sharply due to a fall in demand triggered by COVID-19, iron ore prices have remained resilient. Supply issues have plagued the other major player in the iron ore market, Brazil. A combination of natural disasters and a reduction in capacity due to COVID-19 has halted supply in several mines in South America. This has had the effect of boosting prices and supporting export volumes from Australia.

Brazil's supply issues could be sorted out in the medium term, which will put downward pressure on the price of iron ore. However, a robust economic recovery in China, as well as the potential for further stimulus measures, should place a floor under prices over the next year.

A key risk for the trade outlook is the deteriorating diplomatic relations between Australia and China. If continued, increasing trade tensions with China could have negative implications for Australian exports more broadly. Australia faces less competition in the iron ore market in comparison to other commodities, suggesting that iron ore is less likely to be the subject of trade barriers.

Lacklustre **household consumption** was present before the COVID-19 pandemic. Lockdown measures have been a reset button for consumption across the States, and Western Australia is not immune. The unprecedented stimulus measures unleashed by fiscal and monetary authorities will support a recovery once the pandemic subsides, although some fiscal stimulus measures are only temporary. However, Western Australia is in a better position than most States. A recovery in the mining sector will support incomes. The relatively low level of transmission of COVID-19 across the State will also support consumption through a reduced requirement for movement restrictions.

Labour market outcomes have been less severe than experienced nationally. Total hours worked picked up by 2.1% May after a 10.8% plunge in April in Western Australia, suggesting that activity was beginning to return to normal faster than the national rate. Total hours worked fell 0.7% in May, Australia wide. The sharp fall in lost work in April highlights the impact of social-distancing measures. The unemployment rate rose to 8.1% in May, up from 5.2% in February and the highest of all States. However, at 65.0%, the participation rate was also the highest of all States, suggesting that there have been fewer discouraged workers who have dropped out of the workforce. The national unemployment rate was 7.1% in May and the participation rate across Australia collapsed to a near 20-year low of 62.9%.



Perth **dwelling prices** fell in June by 1.1%, as uncertainty regarding the impact of COVID-19 weighed on housing demand. It followed a 0.6% decline in dwelling prices over May. Perth and Melbourne dwelling prices fell the most in June across the capital cities. Prior to May, prices had risen in five out of six months, suggesting that dwelling prices were forming a base. Perth unit prices fell by 1.4% in June while house prices declined 1.2%. Across WA, dwelling prices fell by 1.2% in June and 3.1% on a year ago.

Sales volumes in WA were also significantly down amid social-distancing measures.

In year-on-year terms, dwelling prices were 2.5% lower in June, which is the same rate of contraction as April and still a much better result than the contraction of 9.1% recorded in June of 2019 when dwelling prices were at a trough in Perth.

Ultra-loose monetary policy will provide support to house prices once the economic recovery sets in. House prices have fallen to levels more in line with underlying housing demand over recent years. Better fortunes for Western Australia's economy suggest that it is poised to outperform the eastern States, which have been more reliant on overseas migration for housing demand.

Earlier this month, the WA government released a \$444 million housing stimulus package and building bonus. First-home buyers in WA could receive almost \$70,000 in government grants if they build a new home. West Australians could receive up to \$45,000 in grants for building a home, with the state government also providing a \$20,000 bonus for new residential builds on top of the \$25,000 already offered by the Federal government's HomeBuilder scheme. First-home buyers would also be eligible for the existing \$10,000 first-home owner grant and stamp-duty concessions, meaning some WA first-home buyers could qualify for up to a \$69,440 benefit. These packages will provide a boost to the WA housing sector. These packages will also help bring

forward construction activity in WA, which has a shorter pipeline of work than many other states.

A sustained pick up in prices will be required before dwelling investment returns. **Building approvals** fell by 8.9% in May, ending a three-month streak of consecutive monthly. Approvals remain at a low level by historical standards.

The health emergency has prompted stronger public spending earlier in the year. Public spending was robust in the first quarter, with public final demand rising 1.2%. The elevated iron ore price has been a boon for State government finances, which will facilitate greater public investment into infrastructure and support the recovery after the impending downturn.

Outlook & Indicators to Watch

It is clear the COVID-19 pandemic will weigh on a recovery in Western Australia. However, the fundamentals driving the recovery will remain. Key to Western Australia's relative economic success reflects some external factors: the mining sector is relatively well placed and the export market for iron ore has been resilient.

This outlook depends heavily on Chinese economic policy, which is a key driver of demand for commodities. Consumer spending prospects will be driven by the easing of containment measures and the profile of new COVID-19 cases. Labour market developments will also have an important bearing on consumption going forward.

A key indicator to watch will be the labour market, in particular the change in employment and hours worked. International developments, particularly Chinese economic growth and stimulus policies will also have a material impact on the outlook.

There is also the possibility of a domestic tourism renaissance. Domestic tourism levels will be worth watching over the coming months while international borders remain closed. International tourism may not return in any meaningful way until the middle of next year at the earliest. The success of Western Australia containing COVID-19 and Australia's success more broadly could see a pick up in domestic tourism.

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