

# **WALGA Economic Briefing**

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*June 2021*



# Overview

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- The **WA economy has continued its recovery from the COVID-19 pandemic**, with domestic economic growth accelerating in the first quarter of 2021. The labour market also remains strong, although the conclusion of Job Keeper did result in some job losses in April.
- While Government stimulus spending continues to play a significant role in driving economic growth, business investment has ramped up over the past quarter and other partial indicators of economic activity have improved. This suggest that **private sector activity is strengthening**, - which will be essential to the sustained recovery in the WA economy.
- The **housing market is experiencing a high level of activity**, on the back of historically low interest rates; people returning from overseas due to Covid-19; and State and Federal Covid-19 economic stimulus measures, (such as building grants.) While this will see residential construction remain strong until at least late next year, there is a risk that housing activity will drop off in 2023. Re-opening international borders may help to address this issue as a pick up in migration drives demand for rental housing and encourages investors into the market.
- **There are emerging capacity constraints due to strong construction activity**, (particularly in relation to labour and materials), which will add to costs in the near term.

# Overview

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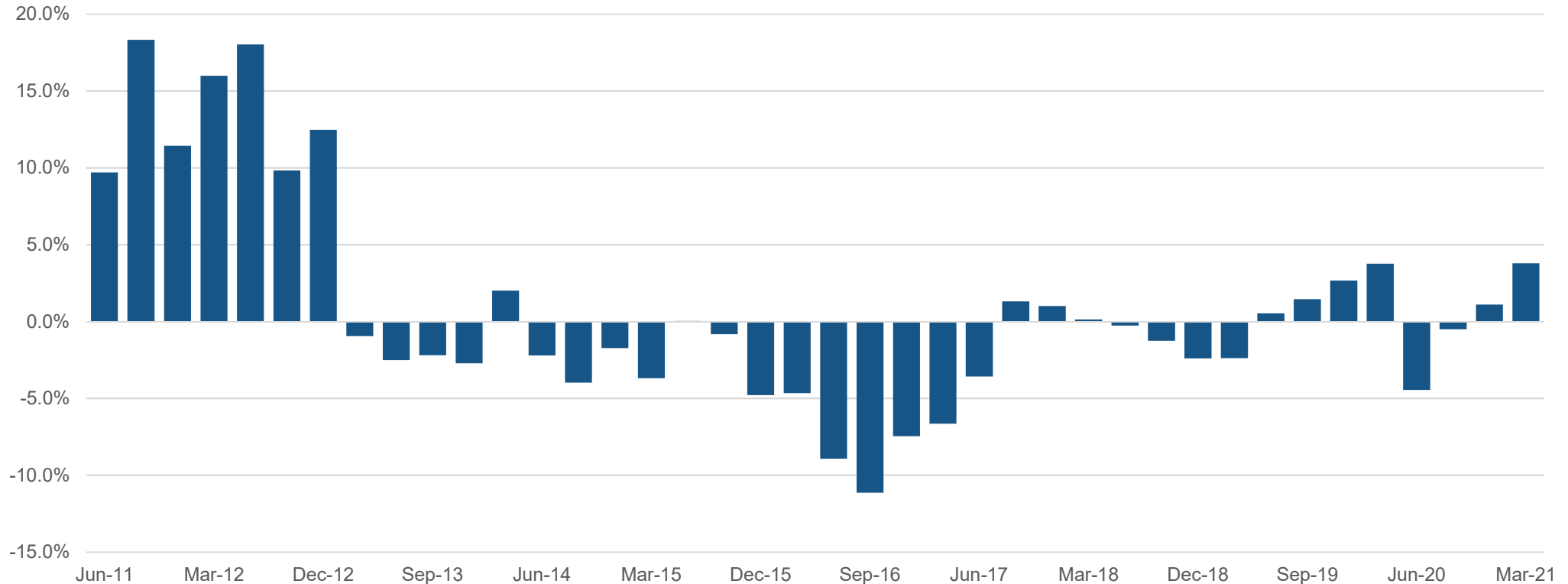


- While increases in the LGCI in the March quarter were modest due to the backward-looking nature of the data, **the index is expected to rise in coming years due to strengthening economic activity and capacity constraints in the construction sector.**
- WALGA's latest base case forecasts indicate that the **LGCI is expected to grow by 3.2% in 2021-22, and 2.8% in 2022-23**, driven by higher construction costs for roads and bridges, non-road infrastructure and non-residential buildings.
- It should be noted that there are significant challenges with forecasting in the current economic environment, and so **the LGCI should be used with caution.**
- Based on recent responses to tenders and requests for quotation, Local Governments indicate that they are facing significantly higher costs, particularly in relation to construction. As higher costs are reflected in official data, this will see the index revised upwards.
- **It is important that Local Governments take into account their own local issues and experiences when considering cost pressures.** It would also be prudent for Local Governments to prepare for multiple scenarios for cost increases coming years.

# The WA economy continues to gather momentum...



*State Final Demand, WA, Annual % Change*



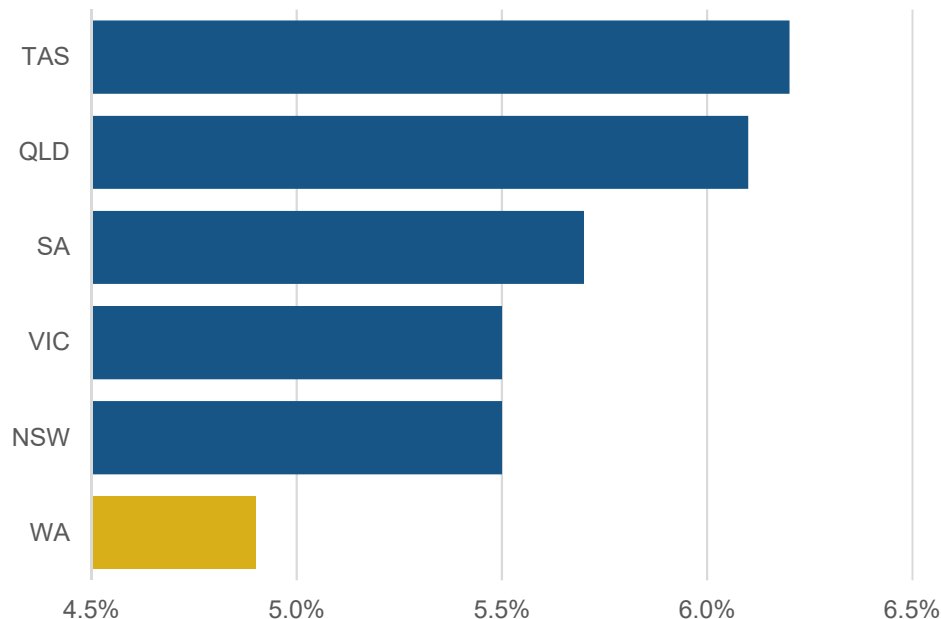
SOURCE: ABS CAT 5242.0

- The latest quarterly State Accounts figures show that the WA economy expanded by 3% during the March quarter of 2021, to stand 3.8% higher than a year ago.
- In a positive sign that private sector activity is starting to pick up, business investment was a significant driver of growth, up by 7.6% over the year.
- Stimulus spending also continued to support activity, with strong increases in dwelling investment (up 9.6% over the year) and Government spending (up 7.9%).

# The labour market remains firm, though roles have been lost as Job Keeper ends



*Unemployment Rate, WA, April 2021*



*Monthly Hours Worked, WA, Millions*



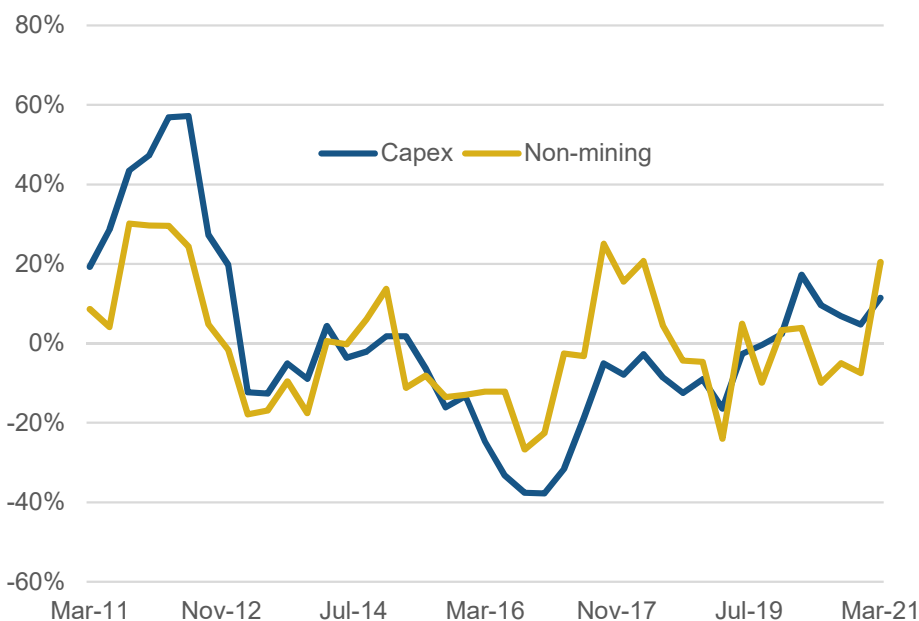
SOURCE: ABS CAT 6202

- WA's unemployment rate is the lowest of all States, standing at 4.9% in April 2021, and down from its COVID-19 induced peak of 8.7% in June 2020.
- However, the end of Job Keeper was reflected in the April figures, with employment falling by 14,400 during the month, and the participation rate dropping to 68% as people exited the labour force.
- Despite this, employment is still 6% higher than a year ago, with 79,000 jobs created in the past year, and 109,800 new jobs since the COVID-19 induced low in May 2020.
- There is now less spare capacity in the labour market. Monthly hours worked are up by 12.7% compared to the same time a year ago. The labour force underutilisation rate has dropped back to 12% from a peak of 20.3% in April 2020.

# There are signs that private sector activity is starting to pick up



*Private New Capital Expenditure, WA, Annual % Change*



*Retail turnover, WA, Annual % Change*



SOURCE: ABS CAT 5625.15

- The resumption of private sector spending will be critical to the sustained recovery in the WA economy.
- Investment among WA businesses has started to increase in recent months, with capital expenditure up by 11.5% over the year to March 2021 – the sixth consecutive quarter of annual increase. Investment is not just being driven by the resources sector, with non-mining capital expenditure up by 20% over the year to March 2021.
- Household spending activity remains strong as consumers have spent on lifestyle goods and redirected travel spending to local activities. Retail turnover is up by 7.8% over the year to March 2021.

# Housing market activity continues to take off, driven by Government incentives



*Private Building Approvals, WA*



SOURCE: ABS CAT 8731

*Number of housing commencements, WA, Annual % Change*



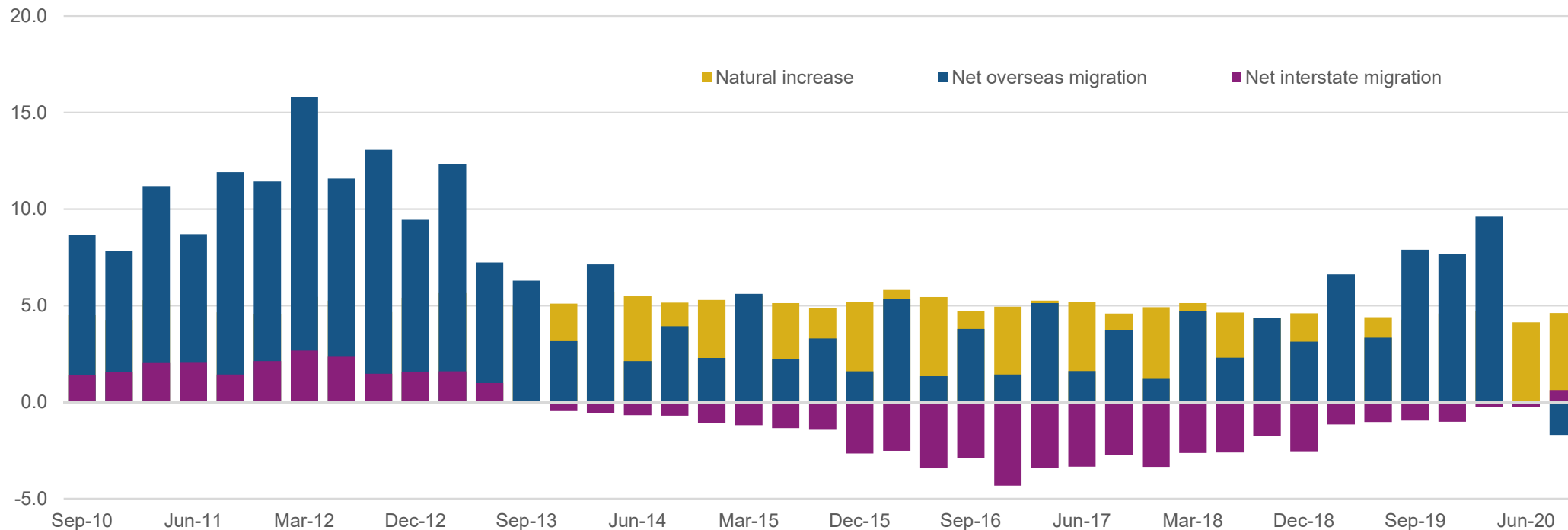
SOURCE: ABS CAT 8752

- Activity in the state's housing market has ramped up, on the back of historically low interest rates; the State and Federal COVID-19 economic stimulus policies; and people returning from overseas due to COVID-19.
- There is a significant amount of work in the pipeline that will sustain residential construction activity in the short term.

# Whether borders open will determine whether the housing boom is prolonged



Population Change, WA, '000s



SOURCE: ABS CAT 3101.0

- Residential construction is forecast to remain strong until at least late next year, with the Housing Industry Association (HIA) indicating that WA is having its strongest year for detached house starts since 2014, with 20,845 detached starts expected this financial year.
- However, the HIA has cautioned that there is a risk of a 30% slump in activity in 2023, as stimulus spending expires and lower population growth weighs on future construction activity. Already, the value of owner occupier housing finance approvals in WA has fallen 17% in the last month.
- Re-opening international borders may help to address this issue to the extent that overseas migration drives demand for rental housing and encourages investors into the market.



# Strong construction activity is seeing capacity constraints emerge in some areas



- In conjunction with strong growth in residential construction, engineering construction activity has also ramped up. The value of engineering construction activity work done in WA has recorded double-digit annual increases in the past four quarters.
- With a high level of activity occurring across a range of construction sectors, there are now signs of emerging capacity constraints.
- There have been growing reports of skilled labour shortages, particularly with border closures that have limited the ability to access overseas workers.
- In addition, reports indicate constraints on building materials and supplies, such as timber and steel.

*Job vacancies, WA  
Public and Private, '000s*



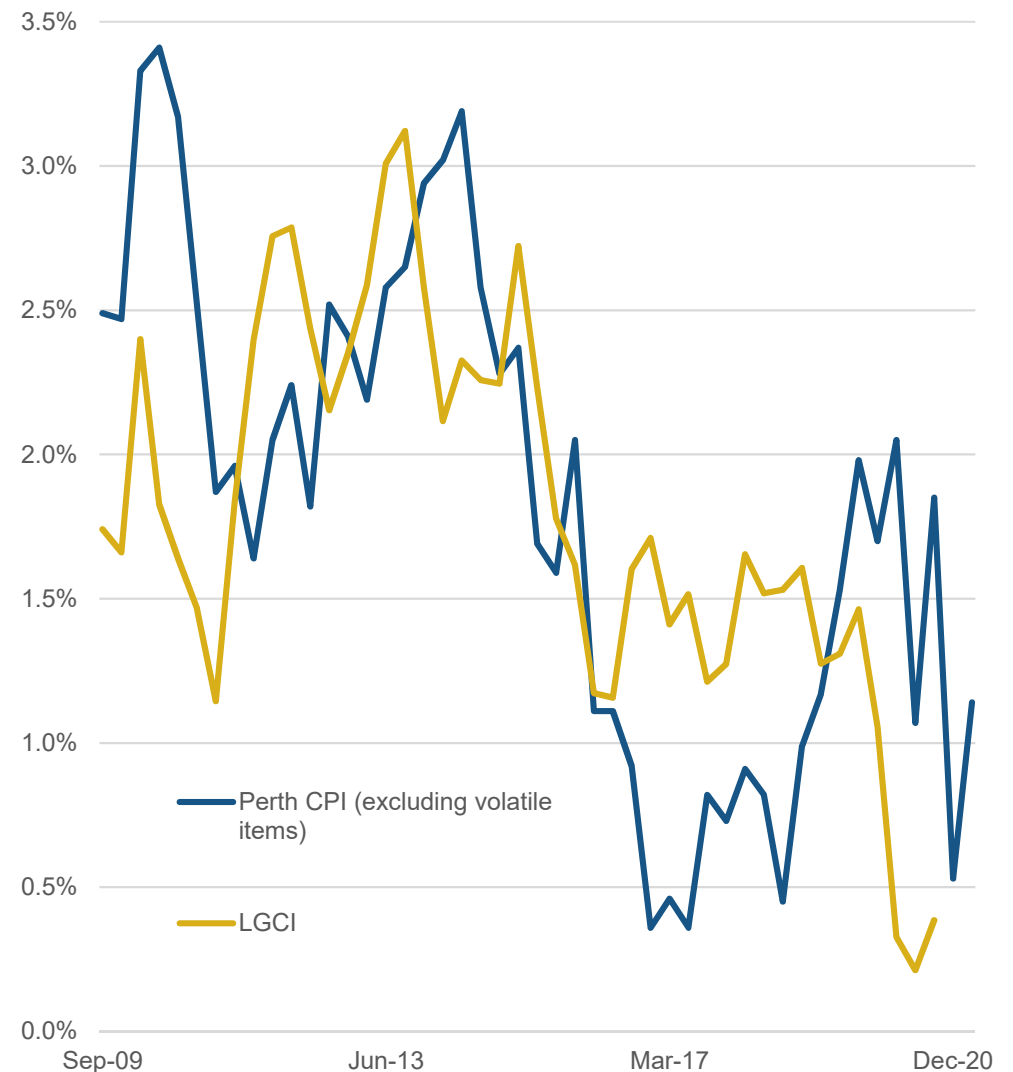
SOURCE: ABS CAT 6354.0

# The increase in activity will mean that cost pressures are expected to increase...



- While increases in the LGCI in the March quarter were modest due to the backward-looking nature of the data, the index is expected to increase in coming years.
- In March 2021, the index grew by just 0.4% in the quarter, and 0.4% compared to a year ago.
- Falls in the cost of materials and contracts (down 1.5%) and only modest growth in wages (0.9%) have placed downward pressure on the index during the past quarter.
- However, the index is expected to pick up in coming years, driven by higher construction costs for roads and bridges, buildings and other infrastructure.
- WALGA's latest forecasts show that the LGCI is expected to grow by 3.2% in 2021-22, and 2.8% in 2022-23.

*LGCI vs Perth CPI, Annual % Change*



# LGCI Components – Forecast % Change



Component	2019-20	2020-21(f)	2021-22(f)	2022-23(f)
Employee costs	1.7	1.8	2.0	2.0
Materials and contracts	1.9	5.3	4.2	2.4
Non-residential building	-0.1	4.4	3.6	2.9
Machinery and Equipment	2.1	0.9	3.0	2.5
Non-road infrastructure	0.0	4.3	3.7	3.0
Road and bridge construction	0.0	3.6	4.2	3.3
Utilities	0.5	1.0	3.1	3.0
Other costs	1.3	1.5	1.75	1.75
<b>LGCI</b>	<b>1.3</b>	<b>3.3</b>	<b>3.2</b>	<b>2.8</b>

# New State Government tariffs will also come into effect from 1 July 2021



- New electricity tariffs take effect from 1 July 2021. The changes in tariffs typically used by Local Governments differ from the 1.75% increase in household and small business tariffs announced in the media.
- Changes in the most common **Synergy** tariffs are:

Tariff	Description	% Change
L1	Business Plan	1.75
L3	Business Plan Fifty	(3.45)
R1	Business Time of Use	1.75
R3	Business Time of Use Fifty	(0.91)
UMS	Unmetered Supply	2.27
Z	Street Lights	3.03

- The increase in street light tariffs is greater than the 2.3% foreshadowed in the 2020-21 State Budget. The increase in the cost of unmetered supply is in line with the long term tariff glide path. The increases in business tariffs are less than the 3.7% (2.1% for time of use tariffs) increase indicated in the 2020-21 State Budget.

# New State Government tariffs will also come into effect from 1 July 2021

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For areas served by **Horizon Power**:

- The L2 tariff (Small Business) will increase 1.75%, in line with the increase in prices for households. The L4 tariff (Medium – Large Business) will be reduced by 3.45%.
- Z (Street light) tariffs will increase by 5.9% on average, although there is some variation across different types of lights. This is a large increase, but less than the 9.2% increase forecast for 2021-22 at this time last year. WALGA has been advised that the lower increase is due to:
  - Lower network charges as a result of a different valuation methodology for the Pilbara network; and
  - Lower gas costs.

# Data volatility means that the LGCI forecasts should be used with caution

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- The significant challenges of forecasting in the current economic environment, mean **the LGCI should be used with caution.**
- The LGCI is a guide for economy-wide cost pressures, and **doesn't take into account local or regional issues** which may impact costs for individual Local Governments.
- Local Governments have reported significantly higher costs, particularly in relation to construction. KW2  
As these become reflected in official data, index could be revised higher.
- **It is important that Local Governments take into account their own local issues and experiences when considering cost pressures.** It will also be prudent for Local Governments to prepare for multiple scenarios for cost increases coming years.
- Downside risks also exist, particularly if another wave of COVID-19 hits WA and causes extended periods of lock down.
- WALGA will continue to monitor cost pressures and provide updates to the forecasts as more information becomes available.



# Questions

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