WALGA Economic Briefing

March 2022

Overview

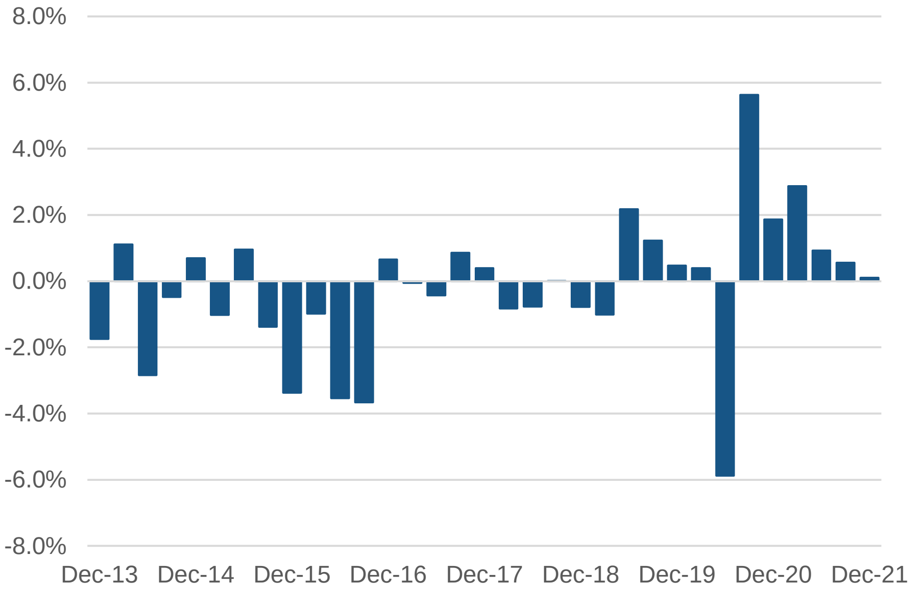
- **Australian GDP bounced back to 3.4% growth in the December quarter** after falling 1.9% in the September quarter as household spending in NSW, Victoria and the ACT recovered from their Delta COVID-19 lockdowns. Despite the much higher case numbers arising from Omicron, it is expected that the national economic impact in the current quarter will be far less severe as border restrictions ease.
- **In WA, domestic demand was flat**, increasing 0.1% in the December quarter. Whilst household spending (+1.5%) and Government spending (+1.0%) increased, it was offset by reductions in business investment (-2.8%) and Government investment (-4.1%) both which fell from high levels in the previous quarter. State Final Demand (SFD) remains well above pre-pandemic levels, having grown 6.3% in the last two years, similar to QLD and SA and well above NSW and Victoria who experienced more severe lockdowns. However SFD growth is slowing as labour and supply constraints take hold.
- The **Perth Consumer Price Index (CPI) increased 1.44% for the December quarter** driven by increases in housing costs, petrol prices and domestic travel costs. Annualised this is 5.66% for the year to December 2021, the first time Perth CPI has been above 5% since 2001. This is above the Australian CPI of 1.3% for the quarter and 3.5% for the year. The Reserve Bank of Australia's preferred measure of underlying inflation excludes larger price rises and falls and is 2.6%, in the middle of the RBA's target range of 2-3%. The RBA continues to leave the cash rate target at 0.1%
- **The labour market in WA remains tight although the unemployment rate increased to 4.1% in February,** compared to 8.5% at the height of the pandemic and 5.4% in February 2020 before the impact of the pandemic. Underemployment fell slightly to 6.8%. The labour force participation rate, which measures the proportion of people aged fifteen years and older who are employed or seeking work, rose to a record 70.0% which indicates that there is little spare capacity in the labour market within WA. The opening of the State and International borders is expected to provide some relief to hiring businesses, although it is expected that this will not be immediate. Without access to the necessary skills, businesses may miss opportunities to expand.
- **COVID-19 is now spreading in all regions of Western Australia** with the peak for case numbers expected to be later in March with hospitalisations lagging around a week. Whilst there will be an economic impact from the Omicron wave, the magnitude of this remains to be seen and will depend on the when the peak is reached and how long restrictions are enforced.

Overview

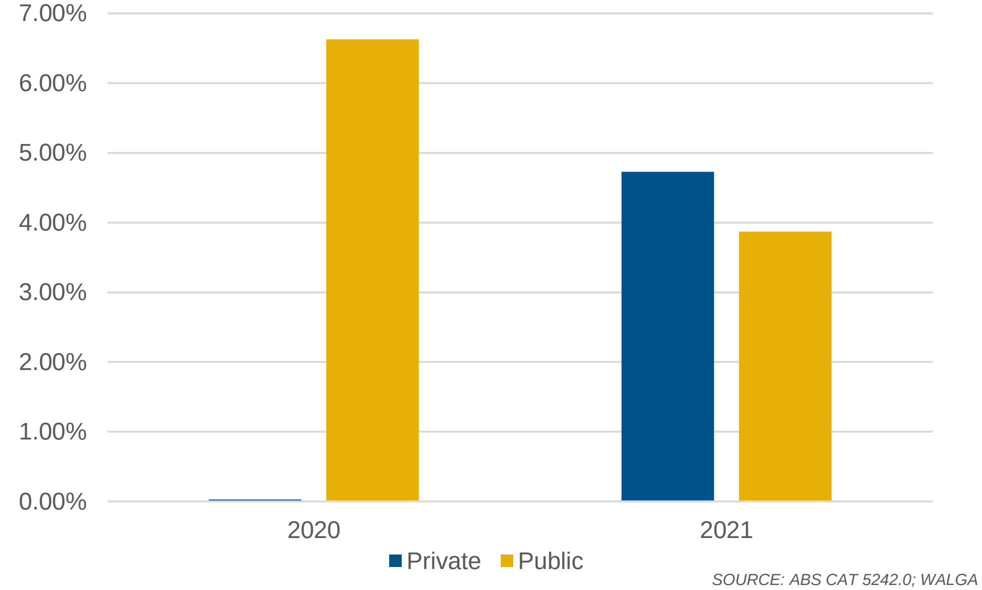
- **Costs for Local Governments continue to rise at a fast pace**. In particular construction costs are increasing at a speed similar to that experienced during the mining boom.
- WALGA forecasts the **Local Government Cost Index (LGCI) to increase 5.7% in 2021-22** as supply constraints in materials and labour continue to place upwards pressure on prices. Demand too remains high as Government stimulus continues to wash through the economy.
- The rate of growth in Local Government costs is expected to slow to **2.5% in 2022-23 and 2.2% in 2023-24** although this is dependent on how quickly the supply constraints are resolved, the impact that opening the borders has on labour supply and the influence of global pressures such as the Russian invasion of Ukraine and its inflationary impact on oil prices, transportation and the cost of goods.
- 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**.
- **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.

WA's domestic economic growth slowing

WA State Final Demand, Quarterly % Change



Private v Public Contribution to State Final Demand, Annual % Change



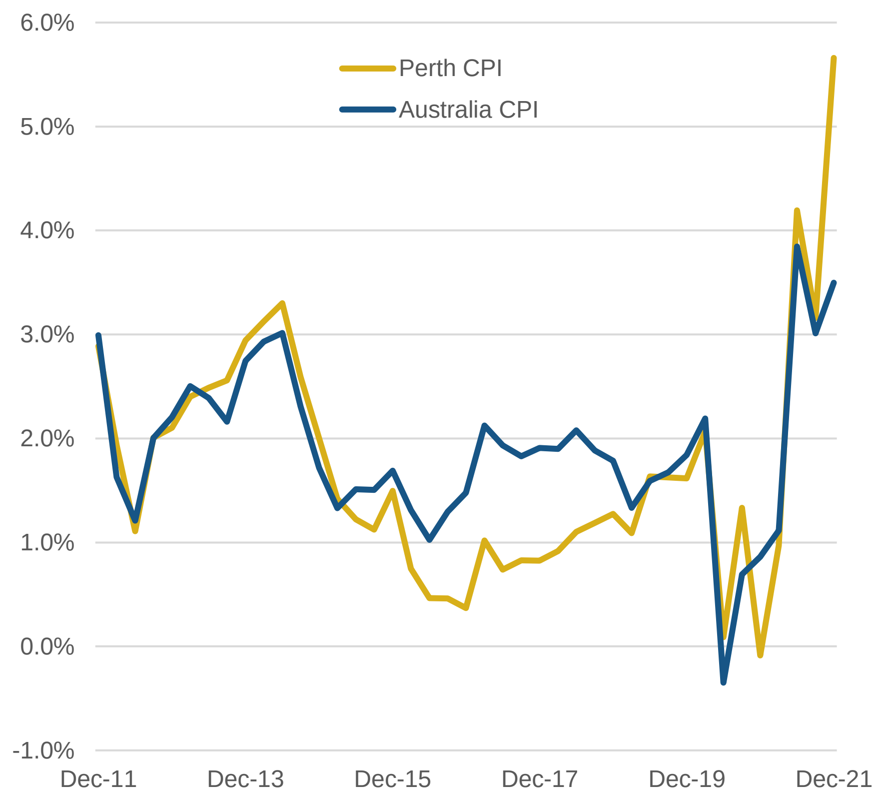
SOURCE: ABS CAT 5242.0; WALGA

- Recent quarters have seen a slowing in WA's domestic economy measured by State Final Demand (SFD).
- As Government stimulus continues to ease, it has been steady growth in household consumption of goods and services that has kept SFD from contracting.
- In 2020, private sector growth was flat and the public sector drove the growth in the domestic economy. This dynamic shifted in 2021 as the private sector grew faster thanks to a recovery in household consumption and a surge in housing construction and additions. At the same time, Government stimulus switched from providing direct support for individuals and businesses to infrastructure and investment.
- As the impact of Government stimulus fades and expenditure on dwellings eases, it will be business investment that will drive economic growth. To invest, firms will need to be confident that they can access the labour and materials needed to grow their business.

Inflation on the rise, impacting all sectors

- Headline inflation in Australia rose 1.3% in the December quarter and 3.5% year-on-year. Major contributors to CPI in the December quarter include the cost of new homes and housing rents, petrol prices, and discretionary goods like clothing and footwear. Woolworths have reported shelf price increases of 2-3% in the last month.
- Headline Perth CPI increased 1.4% for the quarter and 5.7% for the year after a dip in the corresponding quarter in 2020. This is the first time Perth CPI has risen above 5% since 2001.
- The Reserve Bank's preferred measure of underlying inflation which excludes large price rises and falls increased 2.6%, the highest result since 2014 and comfortably inside the RBA's target range of 2-3%.The RBA expects this to rise to 3.25% in coming quarters, before dropping to 2.75% in 2023.
- During the pandemic, Government stimulus and low interest rates have increased demand within the economy. At the same time, the economy has experienced supply issues from disruptions in global trade and closed borders. It is expected that increased demand and supply challenges will normalise in the medium-term. How long this takes will dictate the inflationary impact and the timing of any future interest rate rises.

Perth CPI vs Australia CPI, Annual % Change

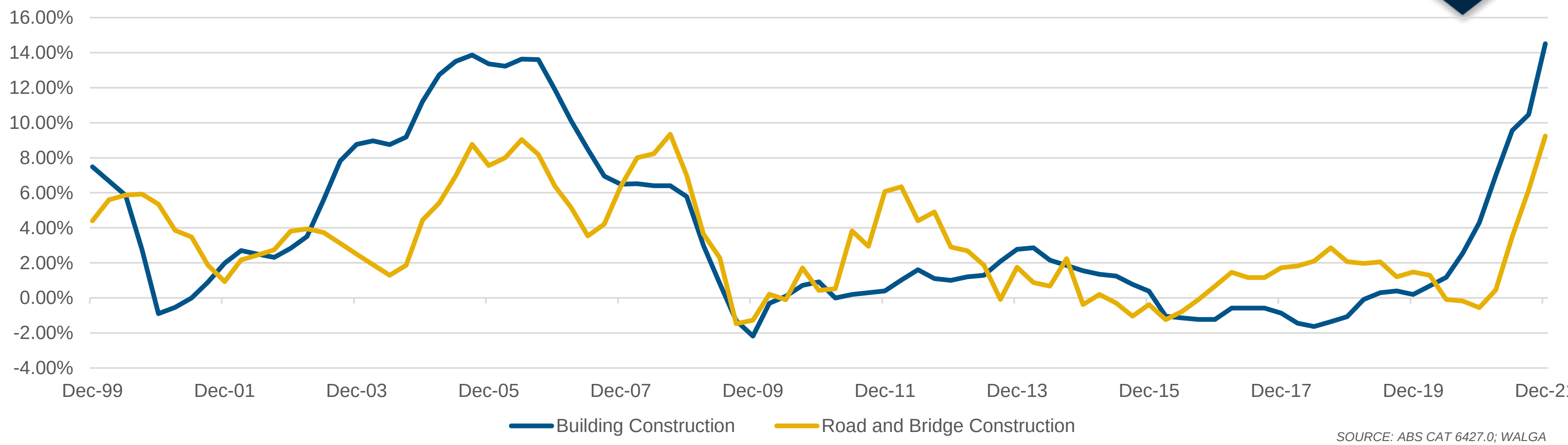


SOURCE: ABS CAT 6401.0; WALGA

Interest rates at record lows, but may rise

- Whilst the Reserve Bank of Australia has not yet increased the cash rate, it has changed its messaging to suggest that increases could be considered this year, with the markets and major banks expecting multiple rate rises in 2022. The likelihood of this has increased with the Russian invasion of Ukraine likely to force prices higher.
- Whilst interest rates are likely to rise in the medium-term, the RBA does not expect there to be multiple increases in quick succession and rates are likely to remain low by historic standards.
- There are still times when borrowing can be appropriate to fill gaps in outlays and available funds or to fund investment. Local Governments should consider their individual circumstances when considering debt funding.
- This may be particularly relevant for Local Governments seeking to cover the cost increases in infrastructure projects.
- There will also be impacts for cash based investments such as term deposits as low returns in recent years will likely increase in-line with the cash rate.

Construction costs increasing at rates not seen since the mining boom



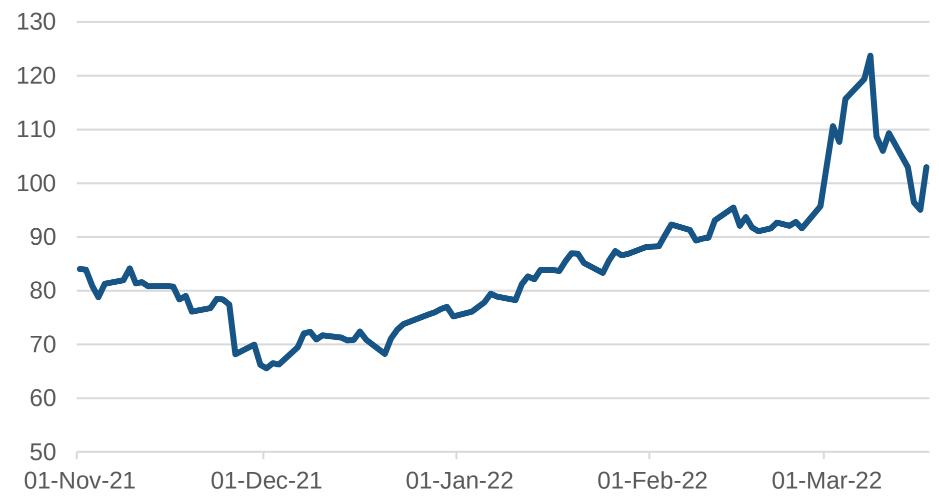
SOURCE: ABS CAT 6427.0; WALGA

- Construction has been the fastest growing sector for Local Government costs in recent quarters.
- After a decade of little growth, Building Construction costs as measured by the Producer Price Index have increased 14.5% in WA in the last year, including more than 5% in the December quarter alone.
- Similarly Road and Bridge Construction costs grew more than 9% in the last year and more than 3% in the December quarter.
- The construction sector has been hit particularly hard by constraints in the supply of materials and fierce competition for trade services and labour, which has been exacerbated by the closed borders and record levels of Government stimulus spending in response to the COVID-19 pandemic. The opening of the State's borders is expected to ease some of the pressures in coming years
- However, pressures will still exist from global factors such as shipping constraints and oil price inflation, which are expected to keep prices elevated in the short term.
- **Construction costs are particularly susceptible to local pressures and supply constraints. Given the lack of data available at a regional level, it is recommended that Local Governments consult their local suppliers to understand the specific issues for their region**.

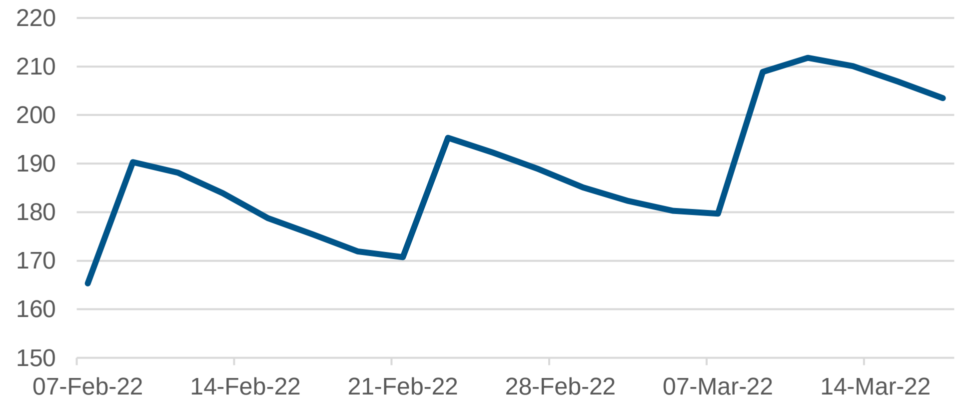
The Russian invasion of Ukraine adds to global inflation

- As in Australia, inflation across the globe has been on the rise as a result of elevated demand and global supply issues.
- It was expected that as Australia's international and state borders normalised, some of these inflationary pressures would ease.
- However the Russian invasion of Ukraine has changed the expected trajectory of inflation in the short-term.
- Most critically, Russia is a major energy supplier, accounting for 11% of global oil and 17% of global gas production.
- As global oil prices rise, Australians will not just notice this at the bowser, increased costs will flow through to food prices, aviation, transportation and the cost of goods. Higher global volatility may also drive down the Australian Dollar, putting additional upwards pressure on prices for imports.
- Russia is also a major supplier of commodities with price shocks already being experienced in nickel, copper, palladium and zinc.
- Whilst consumers will see further price inflation, the Australian economy will also see positive impacts in the short-term as Australia benefits on balance from higher commodity prices where it competes with Russia and Ukraine such as wheat and gas.

Crude Oil WTI, US Dollars per Barrel



Perth Average ULP Price, Cents per Litre



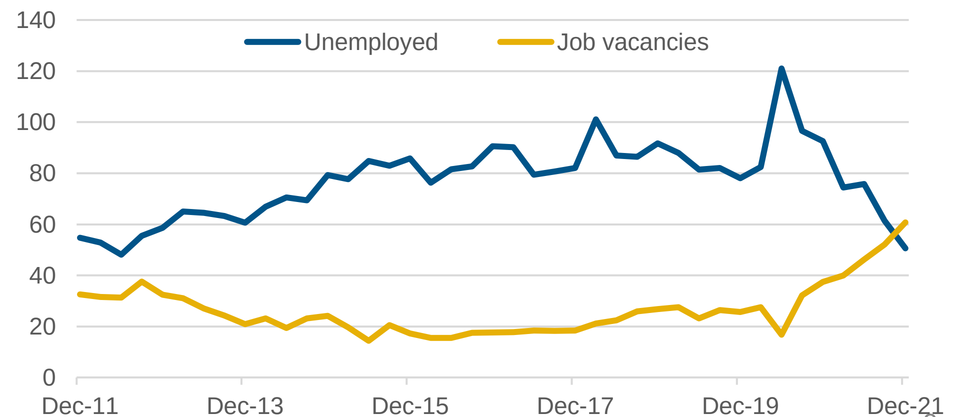
Labour constraints persist…

- There is little spare capacity within the WA labour market, as demonstrated by the number of job vacancies now exceeding the number of unemployed persons in WA, a phenomenon that was not seen even at the height of the mining boom.
- In February, WA's unemployment rate rose slightly to 4.1% as more people entered the labour market to drive the participation rate up to 70.0% for the first time in history.
- Monthly hours worked in WA are well back above pre-pandemic levels.
- The great hope for businesses is that the reopening of the state and international borders will bring in workers, but this will not be an immediate solution to the State's labour force needs.
- An example is the Working Holiday Makers (WHM) program.
    - 34,000 offshore WHMs have been granted visas in the last four months, with 5,600 already in Australia.
    - WHMs fill critical labour gaps with 60% working for at least half their trip, the most common occupations being farm hand, food service and construction. One third of WHM jobs were located outside of the major centres
    - WHMs spent $2.6 billion in Australia in 2019, staying on average for 5 months according to Austrade

Monthly Hours Worked, WA, Millions

SOURCE: ABS CAT 6202.0; WALGA

Job Vacancies vs Unemployed Persons, WA Public and Private, '000s

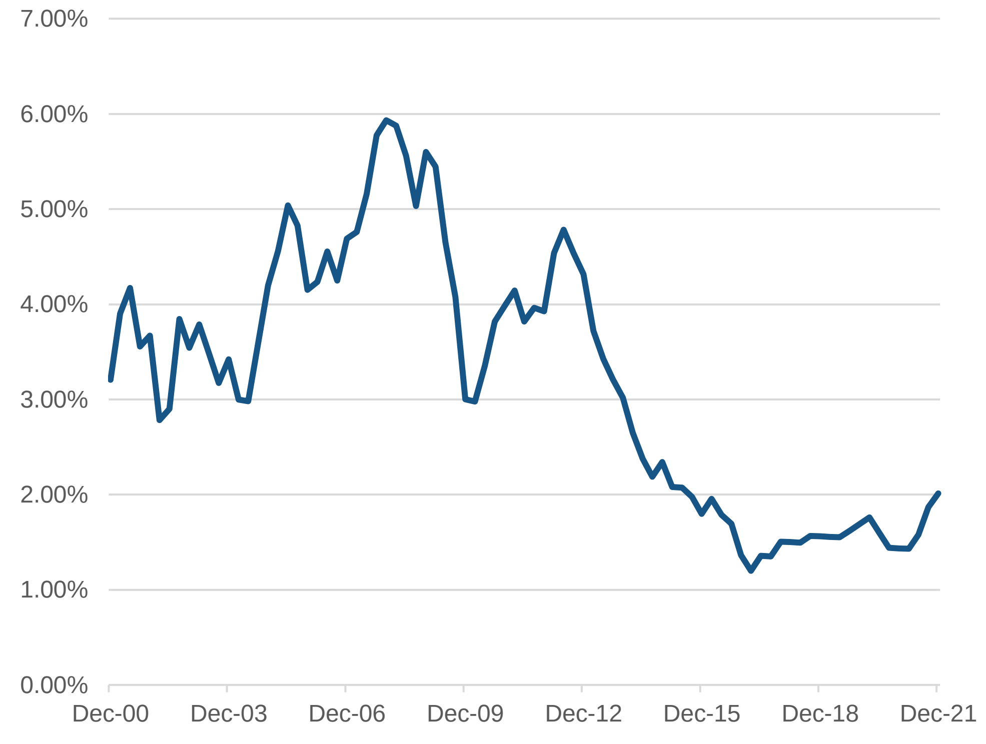


SOURCE: ABS CAT 6202.0 & 6354.0; WALGA

… but this is not yet leading to wages growth

- Although the labour market is strong, wage prices have been slow to react.
- In WA the Wage Price Index is up 2.0% for the year to December, the lowest of the states despite the strongest labour market.
- Price freezes in the public sector have kept wage growth at 1.4%, while the private sector is growing at 2.1% in annual terms
- Despite these tepid figures, this was the first time since 2015 that wage growth has hit 2%.
- Wages are a lagging indicator as it takes time to for wage rises to increase through the enterprise bargaining process and in the public sector.
- The State Government has now unfrozen wages announcing that public sector employees will receive a 2.5% increase per annum with a further increase subject to negotiated reforms.
- The WA Treasury anticipates wages growth of 2.75% in 2022-23.
- With CPI increasing faster than wages, employees are seeing their wages decrease in real terms. This is expected to place pressure on wages going forward and may see forecasts revised upwards.
- Without an increase in real wages, this will act as a brake on the WA economy as household consumption accounts for close to a third of Gross State Product.

Wage Price Index, WA, Annual % Change

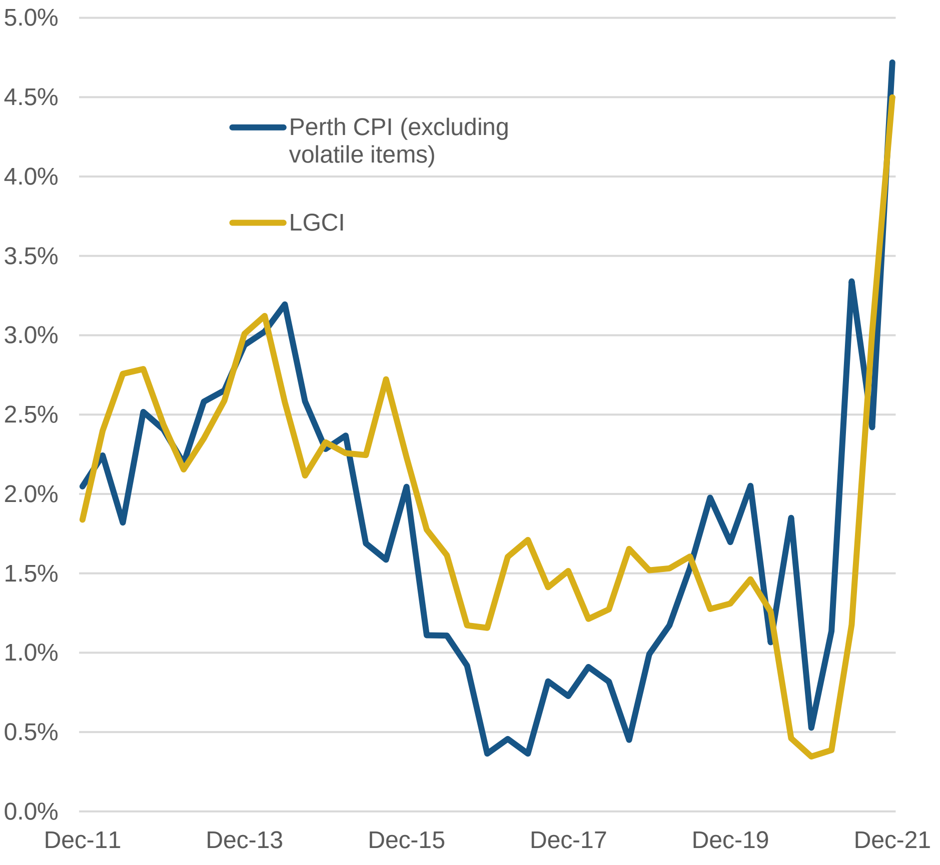


SOURCE: ABS CAT 6345.0; WALGA

Local Government costs rising at record speed

- **Inflationary pressures are now starting to flow through to the Local Government Cost Index (LGCI),** which has climbed rapidly as the increase in costs that had been experienced across the State has become reflected in official data.
- **The LGCI grew 1.7% for the quarter** to reach 4.5% annualised growth, the highest since 2008. This annual increase of the LGCI is in-line with the Perth CPI (excluding volatile items) annual growth of 4.72%.
- This increase was driven by **big jumps in Building Construction costs** of 5.3% for the quarter (14.5% year-on-year), and **Road and Bridge Construction** up 3.3% for the quarter (9.2% year-on-year).
- **Large increases** are also being experienced in Materials and Contracts, Furniture, Machinery and Equipment and Insurance costs.
- These sectors are experiencing **strong demand** driven by low interest rates and large Government stimulus programs. At the same time, firms are competing for a **limited supply** of materials and labour, driving up prices.
- In Western Australia, global shipping and supply chain issues have been compounded in recent months by the **closure of the freight rail link** to the East Coast and the border closures.
- On top of the high growth in 2021-22, it is expected that **Local Government costs will increase a further 2.5% in 2022-23 and 2.2% in 2023-24**.

LGCI vs Perth CPI, Annual % Change



SOURCE: ABS CAT 6401.0; WALGA

LGCI Components – Forecast % Change

Component	2020-21(a)	2021-22(f)	2022-23(f)	2023-24(f)
Employee costs	1.5	2.50	2.75	2.75
Materials and contracts	-0.9	6.7	2.3	1.4
Furniture	-0.1	5.7	1.8	1.7
Non-residential building	5.6	11.7	3.1	2.6
Machinery and Equipment	-0.5	5.7	1.1	1.0
Non-road infrastructure	5.2	11.1	3.1	2.6
Road and bridge construction	3.5	8.9	2.9	2.6
Utilities	0.0	1.4	1.4	1.4
Insurance	2.2	6.0	2.9	2.9
Other costs	2.9	3.8	2.8	2.3
LGCI	**1.4**	**5.7**	**2.5**	**2.2**

SOURCE: WALGA
(a) Actual figures
(f) Forecast figures

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

- 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. This is particularly relevant in a inflationary environment where prices are changing regularly.

- In recent months, Local Governments have reported **significantly higher costs**, particularly in relation to construction. These increases continue to be reflected in the backwards looking datasets and as prices rise, the LGCI will be revised upwards.

- **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.

- WALGA will continue to **monitor cost pressures** and provide updates to the forecasts as more information becomes available.

Treasury forecasts WA's economy to continue growing but at a slower rate

	2020-21 %	2021-22 %	2022-23 %	2023-24 %	2024-25 %
Gross State Product	2.6	3.5	1.0	1.25	1.5
Household Consumption	2.6	2.75	2.25	3.0	2.5
Business Investment	4.6	8.5	8.0	1.25	0.75
Dwelling Investment	2.4	23.5	-16.25	-1.75	6.75
Exports	0.6	1.75	1.0	0.5	0.25
Imports	4.7	3.25	3.0	1.75	1.5
Employment Growth	1.8	3.75	1.25	1.25	1.25
Unemployment Rate	6.1	4.25	4.25	4.0	4.0
Participation Rate	68.0	68.6	68.6	68.3	68.1

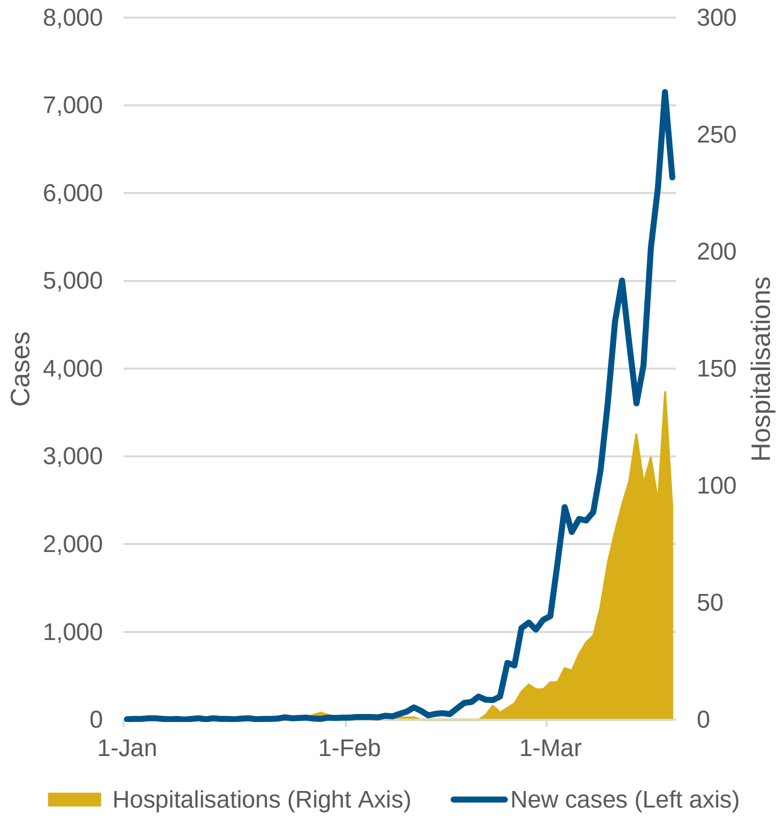
- In their mid-year review released in December, Treasury upgraded their labour market measures of employment growth, the participation rate and the unemployment rate as the jobs market surges ahead of expectation
- Economic growth is expected to continue but at a slower rate over the next three years as Government stimulus is eased and the housing construction boom slows.
- Business Investment projections for 2021-22 were lowered, reflecting challenges with supply chains and skills constraints, but were increased for 2022-23 as investment is delayed, not abandoned.

Omicron is spreading across WA

- To date, case numbers and hospitalisations have developed in-line with WA Health modelling and the health system has coped with the impact.
- The economic impact of the Omicron wave will depend on the length of the outbreak and the level of restrictions.
- Case numbers are on the rise again in other states with further waves possible in WA.

Region	Active Cases (18 March)	New Cases (18 March)
Metropolitan	28,545	5,271
Goldfields	433	86
Great Southern	276	64
Kimberley	305	65
Mid West	344	76
Pilbara	603	157
South West	800	123
Wheatbelt	352	75

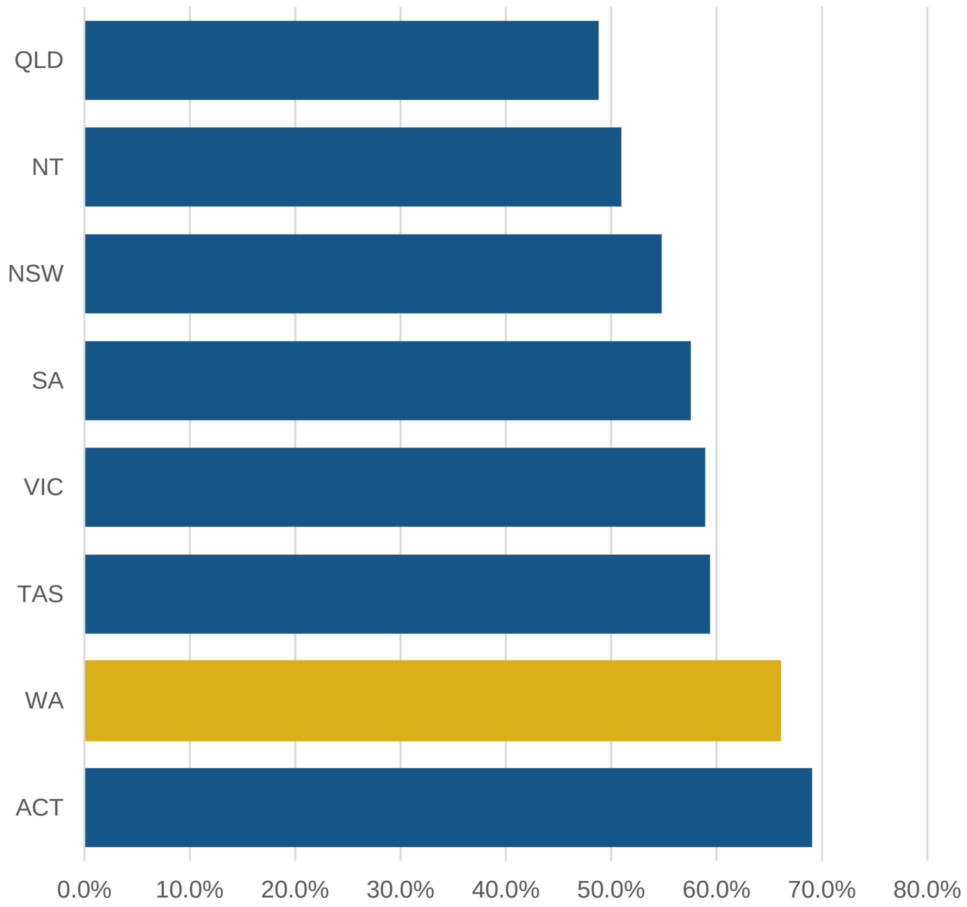
WA COVID-19 daily cases vs current hospitalisations



SOURCE: WA Health; WALGA

After a slow start, WA is a leader in 2nd and 3rd dose vaccination rates

Third dose vaccination %, Age 12+



- Vaccination remains the best protection against hospitalisation. NSW Health found that unvaccinated people were more than five times more likely to be hospitalised and nearly eight times more likely to be in ICU.
- WA now leads the mainland states for second dose rates with >95% of people aged 12+ double-dosed.
- Booster rates continue to rise with 66% of Western Australians aged 12+ boosted, ahead of the national rate of 57%.
- All Regions in WA have 16+ double-dose rates above 95% with the exception of Outback (north) where West Pilbara is at 61%, East Pilbara at 64% and the Kimberley at 82%.
- Data is not currently released by the WA Government for hospitalisation rates at Regional or Local Government level. With COVID-19 now spreading through the community the focus will shift from vaccinations to the impact on health service provision.

SOURCE: Commonwealth of Australia Department of Health, ABC

Questions

If you have any question on the contents of this report, please direct them to the WALGA Economics team:

- Daniel Thomson – dthomson@walga.asn.au or (08) 9213 2015
- Dana Mason – dmason@walga.asn.au or (08) 9213 2020