Local Government

Economic Briefing

February 2020

As Local Governments prepare their annual budgets, it is important that these are underpinned by realistic assumptions about future revenue streams and spending requirements.

The economic and policy environment can provide insights into any potential impacts on key sources of revenue and likely changes in demand for services. It can also help to identify risks that may prevent the projected budget outcome from being achieved.

This update provides a snapshot of the key economic trends in the coming year that are relevant to Local Government's budget and strategic planning activities.

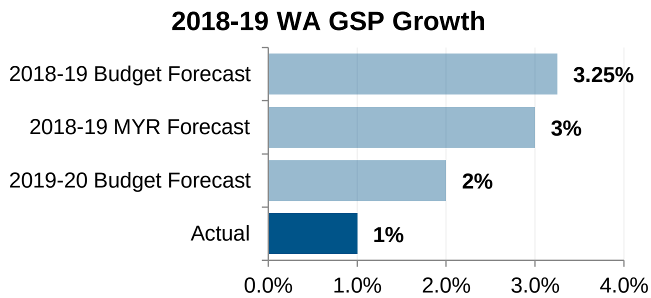
WA ECONOMIC UPDATE

Eight years after the peak of the resources investment boom, lacklustre demand continues to plague economic activity across the State.

When the 2018-19 Budget was handed down in May 2018, the Treasurer expected the WA economy to grow by 3.25% in the 2018-19 financial year. This forecast was revised down to 3% in December 2018, and then to 2% in May 2019.

Even with the downward revisions, the WA economy still failed to meet expectations. When official figures were released in November 2019, domestic economic growth for 2018-19 ended up coming in at just 1% (see Figure One).

Figure One



The worse than expected growth figures were predominately due to a spluttering domestic economy. State Final Demand, which is a measure of output in the economy excluding net exports, fell by 1% in 2018-19. This was much worse than the original forecast decline of 0.25%.

Driving the lack of activity in the domestic economy in particular was anaemic household spending. At Budget time, household consumption was forecast to grow by 2.25% in 2018-19, while dwelling investment was forecast to increase by 4.75%. Both of these indicators fell well short of expectations, with household consumption increasing by just 1% and dwelling investment actually falling by 3.6% in 2018-19.

The reluctance of households to spend money is affirmed by data reported in the Chamber of Commerce and Industry's Consumer Confidence Survey. Since the start of 2019, the short term confidence index reported in the survey has fallen by 5.3% and is now at its lowest level since September 2017.

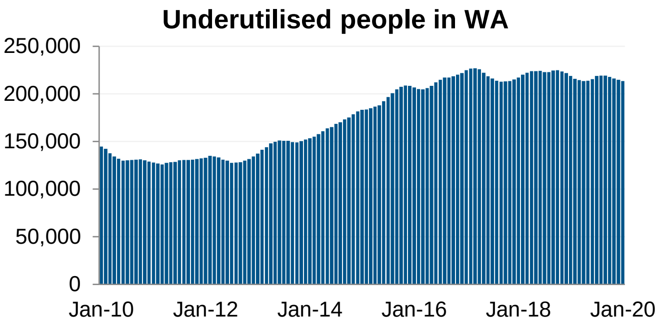
Another significant detractor from domestic economic activity in 2018-19 was lower than expected levels of State Government investment in infrastructure. Overall, expenditure in the State Government's Asset Investment Program was close to $1.3 billion less than originally planned in 2018-19 – totalling $5 billion rather than the originally estimated $6.2 billion.

In its Annual Report on State Finances, the State Government noted that the infrastructure underspend spanned across almost all of its Agencies and was generally due to project delays and timing issues.

The last major component of the domestic economy, business investment, also detracted from growth in 2018-19, falling by 7.6%. This was, however, better that the State Government's forecast fall of 14% when the 2018-19 Budget was first handed down. The better than expected result was primarily due to a one-off spike in machinery and equipment investments made by the mining sector in the June quarter of 2019.

With the domestic economy only just out of recession, it comes as no surprise that there is a significant amount of spare capacity in the State's labour market. Although the unemployment rate has a five in front of it, just above 210,000 people are considered to be underutilised – meaning that they are either unemployed or wanting to work more hours than they currently do. This is just shy of the all-time high 227,000 Western Australians who were reported to be underemployed at the start of 2017 (see Figure Two).

Figure Two



Spare labour capacity means that there isn't any significant pressure on WA wages. Annual wages growth was 1.6% in 2018-19, which is well below the 4.8% recorded in June 2012 when the State was crying out for more workers at the height of the resources investment boom.

With there being fewer employment opportunities across the State, population growth remains subdued (1.1% in 2018-19). More people continue to move interstate from WA, rather than move from interstate to here, with net interstate migration recorded at -6,500 people in 2018-19. This marked the sixth consecutive financial year of negative interstate migration in WA. Although net overseas migration totalled 15,900 in 2018-19, it was still well short of the 50,800 figure recorded at the height of the boom in 2011-12.

With restrained population growth, demand for Perth property continued to be lacklustre in 2018-19. Over the financial year, Perth property prices fell by 3.9%. On average, property prices are now the same as they were in 2007.

On the global front, the year-long trade and technology dispute between the USA and China and the continued Brexit debate led to global growth being lower than expected in 2019. The impact of these global issues on the WA economy was mostly gentle, with iron ore exports in particular not impacted.

A global shock that will have an impact, however, on the WA economy is the coronavirus outbreak originating from mainland China. The sector's that are likely to be impacted most are tourism and education due to the travel ban imposed by Commonwealth Government. Also, like was the case with the SARS outbreak in 2003, Chinese output will probably slow, resulting in reduced demand for WA's iron ore until the virus is contained.

Despite the current challenging circumstances facing the domestic economy, the near and medium term prospects are still bright.

WA Gross State Product (GSP) is forecast to increase by 3% in 2019-20 followed by an average increase of 2.7% per annum between 2020-21 and 2022-23. For the first time in a long time, growth is expected to be driven by domestic expenditure rather than exports, with:

- household spending forecast to increase by 1.25% in 2019-20 followed by an average increase of 2.7% per annum between 2020-21 and 2022-23;
- dwelling investment forecast to first decline in 2019-20 by 7%, but then rebound and grow by an average of 5.4% per annum between 2020-21 and 2022-23; and
- business investment forecast to increase by an average of 5.75% per annum over the four year forward estimates period (2019-20 to 2022-23).

The improved prospects for the domestic economy are once again on the back of increased activity in the resources sector. A combination of increased prices, a lower exchange rate and better profit expectations has led to WA mineral exploration expenditure recently reaching a seven year high ($456 million in the September quarter).

In addition, a number of resources companies are about to make significant investments, including:

- Rio Tinto's investment of $3.5 billion for the Koodaideri mine and rail;
- Rio Tinto's investment of $1 billion for the Western Turner Syncline Phase 2 mine project;
- Fortescue's investment of $3.7 billion for the Iron Bridge project; and
- Fortescue's investment of $1.7 billion for the Eliwana Mine and Railway project

Also, the Scarborough and Browse LNG projects are expected to reach final investment decisions over the coming years.

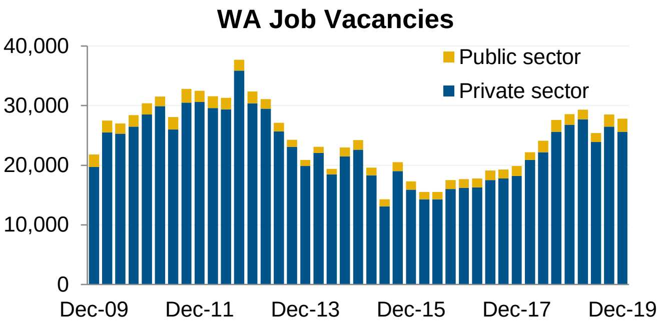
The collective impact of these investments on the economy will be much less significant than the resources sector investments that took place during the 2000s and early 2010s. This is due to some of the projects being focussed on replacing existing retiring production capacity, instead of creating new production capacity. Where this is the case, the workforce impact will predominately be during the construction phase of projects, rather than the ongoing operational phase.

Also, the increasing uptake of autonomous operations means that even when new production capacity is expected to come on line, the on-the-ground economic impact will be more subdued than before.

In addition to the private sector, the State Government will also support the domestic economy over the coming years through spending on infrastructure projects, such as METRONET. Over the forward estimates, State Government infrastructure spending is expected to grow by an average of 5.6% per annum.

Although 2020-21, not 2019-20, is expected to be the year that WA's economic recovery takes full swing, a pickup in activity is already evident through job vacancy data. The number of vacancies reported in the State's public sector are up 83% since the start of 2016, while they are up 79% in the State's private sector over the same period (See Figure Three).

Figure Three



Over the next 12 months, increased demand for labour is expected to lead to increased interstate and overseas migration. In this regard, the WA Government expects population growth to increase to 1.3% in 2019-20 from 1.1% in 2018-19. After that, population growth is expected to increase at an average rate of 1.6% per annum between 2020-21 and 2022-23.

Improved economic conditions over the next few years will help boost the State Government's Budget bottom line and pay off the State's record levels of debt. Within this context, a cash surplus of close to $2 billion is expected in 2019-20, and cash surpluses of between $500 million and $1 billion are expected each year after that in the forward estimates.

All in all, net debt is expected to reduce to $34.6 billion by June 2023 after peaking at $37.5 billion during June 2019. Even with net debt reducing by close to $3 billion over the next few years, interest repayments on debt are still expected to be close to $1.7 billion per year over the forward estimates period.

For the Local Government sector, the expected improvement in the economy will bring some relief in the form of fewer late payments; an increase in fees and charges revenue; and an increase in the rates base for communities where population growth results in an increased number of dwellings.

As a cautionary note, however, Local Governments should prepare for higher wages and prices over the coming years as the WA economy emerges out of its post-boom funk. In this regard, the State Government expects wages to grow by 2% in 2019-20 and at an average of 2.5% per annum between 2020-21 and 2022-23. Perth CPI is expected to increase by 1.75% in 2019-20 and then at an average of 2.2% per annum between 2020-21 and 2022-23. On the back of these forecasts, WALGA is expecting the Local Government Cost Index to increase by:

- 1.6% in 2019-20;
- 1.8% in 2020-21;
- 2.7%in 2021-22; and
- 3.2% in 2022-23.

In addition to the LGCI, the below table shows economic forecasts for WA (in annual % change terms) that Local Governments should appropriately consider as they construct their budgets for the coming year.

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	2018-19 Actual	2019-20 Forecast	2020-21 Forecast	2021-22 Forecast	2022-23 Forecast
Gross State Product	1%	3%	2.5%	2.75%	2.75%
State Final Demand	-1%	2.25%	3.25%	3.5%	3.5%
Unemployment Rate	6.1%	5.75%	5.75%	5.5%	5.25%
Population Growth	1.1%	1.3%	1.5%	1.6%	1.7%
State Budget Cash Position	-$715m	$1,961m	$560m	$866m	$968m
WA Local Government Cost Index	1.7%	1.6%	1.8%	2.7%	3.2%
WA Wages	1.6%	2.0%	2.25%	2.5%	2.75%
WA Consumer Price Index	1.3%	1.75%	2.0%	2.25%	2.25%
Road and bridge construction prices	2.1%	1.4%	0.6%	0.8%	1.3%
Non-residential building construction	0.0%	0.7%	1.6%	1.6%	1.6%
Machinery and equipment prices	1.9%	0.5%	1.1%	1.1%	1.1%
Electricity and street lighting prices	5.8%	5.9%	5.9%	5.9%	5.9%