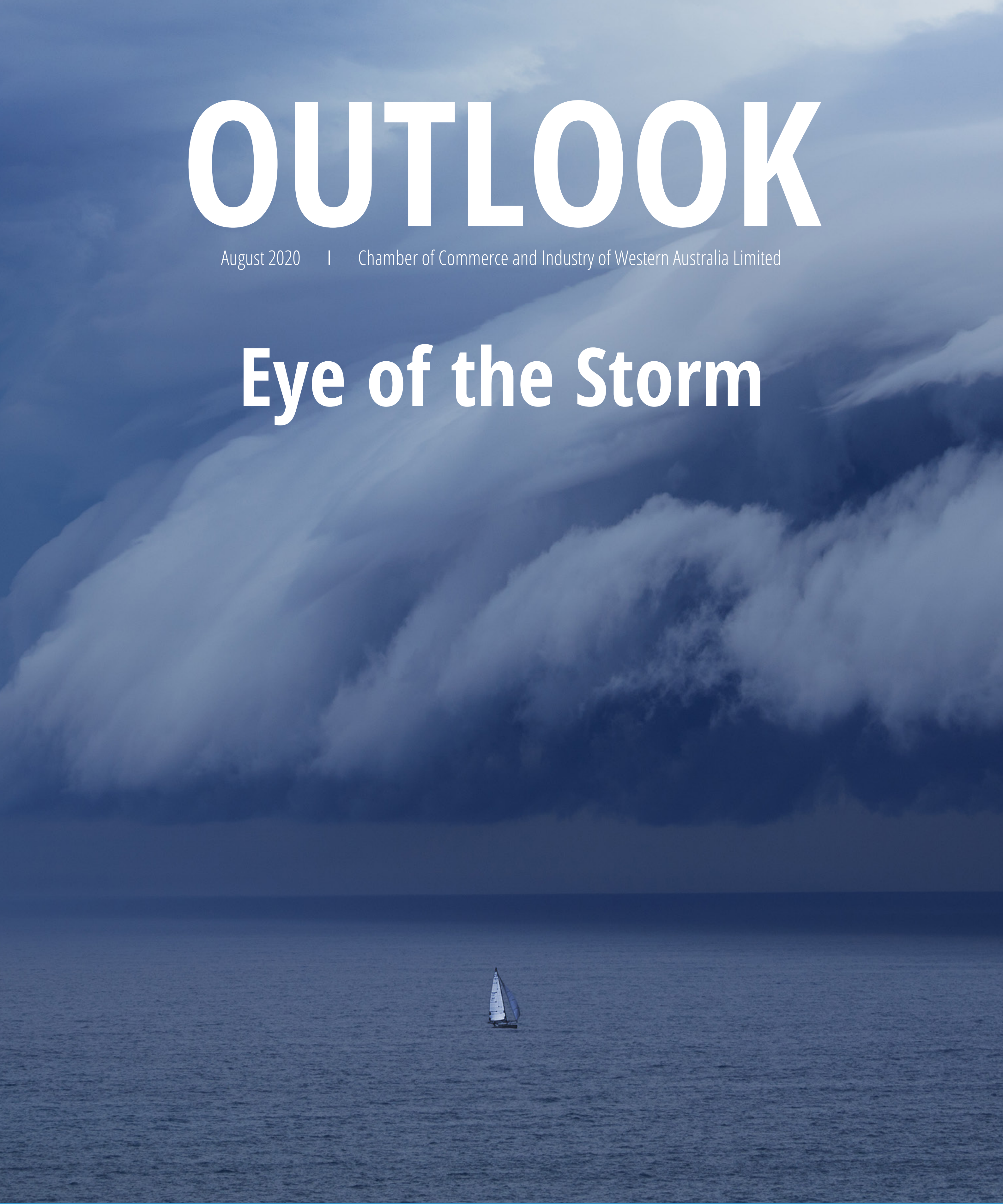
OUTLOOK

August 2020 | Chamber of Commerce and Industry of Western Australia Limited

Eye of the Storm



About Outlook

Outlook is the Chamber of Commerce and Industry of Western Australia's (CCIWA) biannual analysis of the WA economy. All growth rates cited in Outlook are calculated in terms of year-on-year growth, comparing four quarters of data to the previous four quarters of data, unless otherwise stated. The editor of Outlook is Daniel Norrie, Senior Economist.

Chamber of Commerce and Industry WA

Outlook at a glance

Western Australia is in a unique economic situation. Our economy has been buffeted by the winds of COVID-19. Yet for parts of the economy at present, conditions are relatively calm due to enormous levels of fiscal stimulus. With significant headwinds on the horizon however, we are very much in the Eye of the Storm.

Like economies all over the world, Western Australia has copped a belting

COVID-19 has rocked the WA economy. Enforced shutdowns of economic and social activity at home and abroad have thrown consumer markets into turmoil. At the same time, disruptions to global trade and international and interstate border closures have disrupted supply chains and workforces.

A vicious circle has ensued; business closures, job losses and fewer hours worked have reduced incomes and spending, which have in turn further weakened the business sector.

Reflecting this, the heaviest blows so far have been inflicted on service-based businesses that rely on human interaction and travel, particularly those in the retail, accommodation, hospitality and transport services sectors.

For many Western Australian businesses, the upshot has been the agonising decisions to reduce employment and hours worked, and ultimately for some — closing their doors forever.

All of this comes at a time when the WA economy has been struggling to find its feet, particularly outside the mining sector, where investment has contracted in six of the past seven years.

Stimulus measures are currently propping up the economy

The Australian and WA economies are being propped up by an unprecedented amount of government fiscal support. JobKeeper, business cash flow payments, and apprenticeship and trainee payments are currently helping to keep many businesses afloat. The JobSeeker supplement payment, other direct payments, and the early release of superannuation are supporting household spending.

Banks are lending support through loan deferrals, new lending programs and the SME Loan Guarantee. Insolvency and bankruptcy proceedings are also

currently on hold. On top of all this, the quadrupling of government support for new home builders has triggered a rush to secure land and lay a slab.

The sum total of this support has been extraordinarily effective in propping up the economy at an aggregate level. Retail spending by many measures is actually higher than it was at the same time last year. And business insolvencies are relatively low.

Yet sadly for many businesses, this support has not been enough to keep the doors open.

The WA business community is fighting back

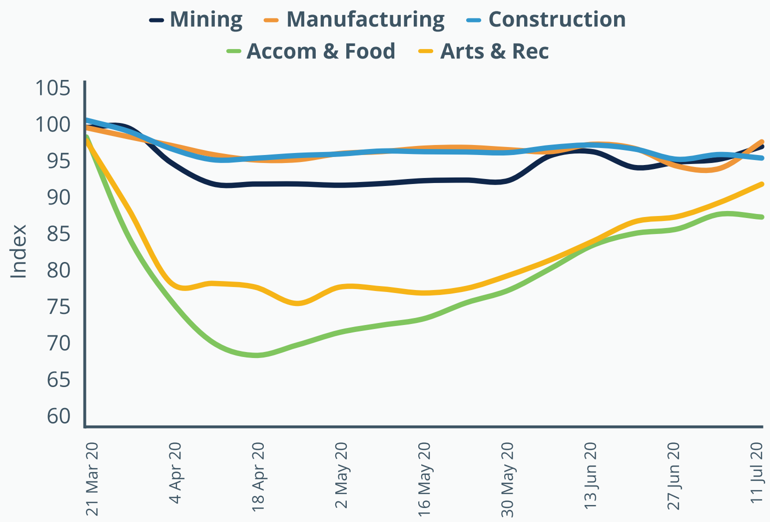
Another factor supporting the economy through this period is the fighting spirit of WA businesses.

Around 85 per cent of WA businesses have sought to adapt or change their operations in the face of COVID-19.

Whether it is a restaurant shifting to a home delivery model, a gym providing live classes online, a manufacturer pivoting to produce medical equipment, or a farming business seeking to diversify their international markets.

Around a third of WA businesses have taken on extra credit funding to support their continued operations, with the majority taking on that extra credit just to cover their overheads or pay their staff wages.

Chart 1: Job Market Dynamics Across Industries



Source: ABS, CCIWA

The WA business community clearly has its back to the wall but is fighting back.

Yet there are significant risks on the horizon

The challenges, however, will only get more difficult.

A key source of uncertainty in the short-term is what happens when government support measures expire. The clock is ticking, with key measures like JobKeeper and the JobSeeker supplement being significantly pared back at the end of September before – on the current schedule – coming to an end in early 2021. By this time the additional spending from early superannuation withdrawals would have been exhausted. At this point, the economy may weaken further, with the risks greatest for service-based sectors like retail and hospitality.

At the same time, a slowdown in the global economy will continue to weigh on parts of the industrial sector. Total world trade has fallen significantly since the beginning of the pandemic. Sectors exposed to global value chains like manufacturing are concerned about the delayed impacts of the crisis and their forward pipeline of work. Even mining is not immune from these global forces, with reduced world growth and trade flowing through to reduced demand for some commodities.

Reflecting this, the pipeline of investment in WA has contracted. Businesses of all sizes are deferring investment decisions in the uncertain climate, from SMEs to large corporates. For the latter, the most notable and significant are the delays to large LNG projects in the north of the state.

To top it all off, population growth will slow to its lowest level since 1916. In part this will be driven by net international migration falling by more than 85 per cent across 2019-20 and 2020-21. A slowdown in population growth will dampen consumer markets and reduce the availability of skilled workers, and in particular will weigh heavily on the housing and construction sectors.

The building of additional homes amid lower population growth may reduce house prices further. This creates its own risk for income and consumption, with lower housing prices reducing household wealth and spending.

The WA economy needs to brace itself for further blows

So what does all this mean for the short-term outlook for the WA economy?

The current financial year is expected to be extremely difficult, with the domestic economy forecast to contract by 1.9 per cent. However, growth in exports and a significant decline in imports should see the overall economy shrink by just 0.2 per cent.

As explained in the sections that follow, the main drags on the economy in 2020-21 will be significant falls in consumption and business investment. At the same time, a short-term boost in dwelling construction on the back of government stimulus measures will support the economy.

But we don't have to accept our economic fate

Whichever way you look at it, CCIWA's forecasts for the WA economy paint a grim picture.

We do not, however, have to accept our economic fate.

If we take the opportunity to build a more competitive business environment, we can return to growth sooner. If business investment were to increase by just one percentage point in each of the next three years, the WA economy would be around $1.5 billion larger, approximately $1,400 per household. This highlights the importance of formulating policies now to make it more attractive to invest in WA. The most effective way to achieve that is to create a more competitive tax environment.

Business investment will be supported by major projects already in the pipeline, particularly in sectors that have seen resilience in commodity prices

Section 1: Economic Outlook

Economic forecasts for Western Australia

Forecasts	2018-19 Actual	2019-20 Forecast	2020-21 Forecast	2021-22 Forecast	2022-23 Forecast
Economic Activity					
Household Consumption	1.0%	0.5%	-3.0%	1.0%	1.5%
Dwelling Investment	-3.8%	-10.0%	5.0%	-6.0%	-4.0%
Business Investment	-7.1%	3.0%	-4.5%	2.0%	5.0%
State Final Demand	-0.8%	1.1%	-1.9%	0.8%	2.1%
Exports	1.4%	2.0%	1.0%	1.5%	1.0%
Imports	-6.1%	-5.0%	-5.0%	3.5%	7.5%
Gross State Product	1.0%	2.7%	-0.2%	0.9%	1.0%
Labour Market					
Unemployment	5.8%	8.7%	11.0%	9.0%	7.0%
Inflation	1.3%	1.3%	0.5%	1.0%	1.5%
Wages	1.6%	1.0%	0.5%	1.0%	1.5%

Notes:

1 Actual outcomes are as reported in the 2018-19 State Accounts, updated with the latest State Final Demand and Balance of Payments data.

2 Forecasts for economic activity are produced in terms of year-on-year growth, comparing four quarters of data to the previous four quarters of data.

3 For 2018-19, unemployment and inflation references present the most recent data available for June (the most recent data point).

Economic Growth

	Economic Activity	
Forecasts	**State Final Demand**	**Gross State Product**
2018-19 Actual	-0.8%	1.0%
2019-20 Forecast	1.1%	2.7%
2020-21 Forecast	-1.9%	-0.2%
2021-22 Forecast	0.8%	0.9%
2022-23 Forecast	2.1%	1.0%

Despite the economic mayhem unfolding, Australia's strong export sector and consumption driven by government stimulus will see State Final Demand and Gross State Product grow in 2019-20.

The full impacts of COVID-19 will be felt in the current financial year. Falls in income and employment will reduce consumption, and while some dwelling investment activity driven by State and Federal Government incentives will support the economy, the net result will be a domestic economic contraction in 2020-21. Once the export sector is accounted for however, the overall economy is only expected to marginally contract.

Business investment will be supported by major projects already in the pipeline, particularly in sectors that have seen resilience in commodity prices, such as iron ore. However, SMEs are less willing to invest and LNG projects have been deferred due to low oil prices. As such, the overall pipeline of investment will contract.

In the short-term, exports have continued to remain strong as new domestic supply has been brought online and WA has benefited from high prices for iron ore due to supply difficulties in Brazil and strong demand from China. Notably, with Western Australia's mining export capacity now much larger off the back of the mining investment boom, even modest growth in exports can have large impacts on the Gross State Product.

However, slowing global growth and world trade will likely reduce demand for some commodities. The ongoing closure of international borders will also continue to dampen spending.

Household Consumption

	Economic Activity
Forecasts	**Household Consumption**
2018-19 Actual	1.0%
2019-20 Forecast	0.5%
2020-21 Forecast	-3.0%
2021-22 Forecast	1.0%
2022-23 Forecast	1.5%

Household consumption and retail spending have been on a wild ride through the pandemic, spiking on the back of panic buying, then falling through the hard lockdown, before growing again on the back of record government stimulus.

Despite the damage inflicted on business revenue, hours worked and jobs, some spending categories have recorded the largest increases since the mining boom. For example, record amounts have been spent on food deliveries, gym equipment, homewares, D.I.Y. projects and caravans. This has been assisted by the temporary doubling of unemployment benefits and superannuation withdrawals.

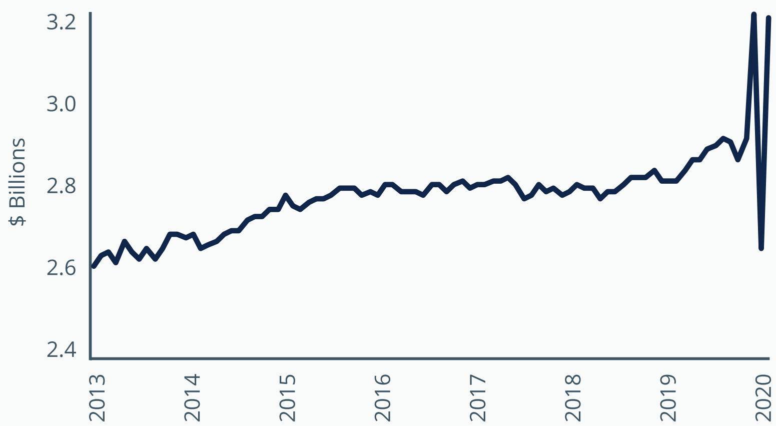
At the same time, households have significantly reduced spending on transport services, discretionary retail like clothing and footwear, and instore purchases in cafes and restaurants.

Over the past 20 years, growth in household consumption has relied heavily on population growth. Tight travel bans and restrictions on cross-border mobility will mean that population growth and international tourism will no longer buttress State economies. Indeed, the Commonwealth Government has forecast net overseas migration for Australia to fall from 232,00 in 2018-19, to around 31,000 in 2020-21.

As government support payments are withdrawn, more people will need to reduce their spending to manage their finances. Households are also more reluctant to make large purchases – as seen in the results of the latest *WA Super-CCIWA Consumer Confidence Survey*. This will weigh on consumption in 2020-21 and 2021-22.

Some banks are offering to defer loans further, which could help some people to manage their finances and reduce the likelihood of an increased supply of properties up for sale, which would put downward pressure on house prices. Significant falls in house prices and wealth would further detract from consumption growth, and are key risks to the outlook.

Chart 2: Retail Turnover Nominal, Monthly



Source: ABS, CCIWA

Spending on major projects increased total business investment by around $700 million in the first quarter of 2020. Much of this involved spending on new iron ore projects

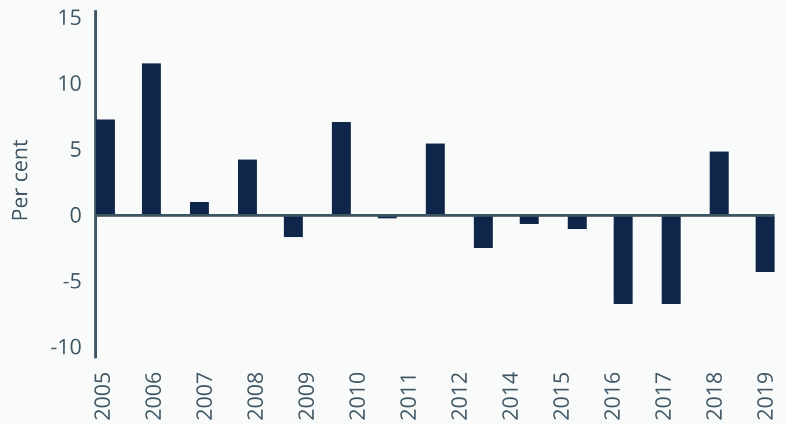
Business Investment

	Economic Activity
Forecasts	Business Investment
2018-19 Actual	-7.1%
2019-20 Forecast	3.0%
2020-21 Forecast	-4.5%
2021-22 Forecast	2.0%
2022-23 Forecast	5.0%

Spending on major projects increased total business investment by around $700 million in the first quarter of 2020. Much of this involved spending on new iron ore projects and maintenance expenditure. However, supply chain disruptions due to COVID-19 have delayed some planned capital investments in the June quarter.

In the current uncertain environment, many business owners are more cautious in committing to investments. The continuation of difficult conditions and restrictions will make it more difficult for some entrepreneurs and businesses to commit to large-scale investments.

Chart 3: Non-mining Business Investment Annual Percentage Change, Chain Volume



Source: ABS, CCIWA

CCIWA has been warning of the difficult conditions faced by SMEs in Australia for some time, with low growth in revenue, high growth in costs and flat profit levels.

At a national level, Commonwealth Treasury expects non-mining investment to contract by around 19.5 per cent in 2020-21.

Business investment in WA will continue to be supported by spending on major projects.

However, some LNG projects have been deferred due to low oil prices, reducing business investment in WA by up to $1 billion per annum. The viability of some projects may be further undermined by increased competition and reduced global growth prospects. Investment outside the mining sector has been weak for some time, falling in six of the past seven years (chart).

Dwelling Investment

Forecasts	Economic Activity: Dwelling Investment
2018-19 Actual	-3.8%
2019-20 Forecast	-10.0%
2020-21 Forecast	5.0%
2021-22 Forecast	-6.0%
2022-23 Forecast	-4.0%

Despite some positive signs, dwelling investment has continued to fall in 2019-20. New home sales and loan commitments took a battering across March and April, before record inquiries and contracts were signed in June on the back of a large increase in subsidies for new home builds.

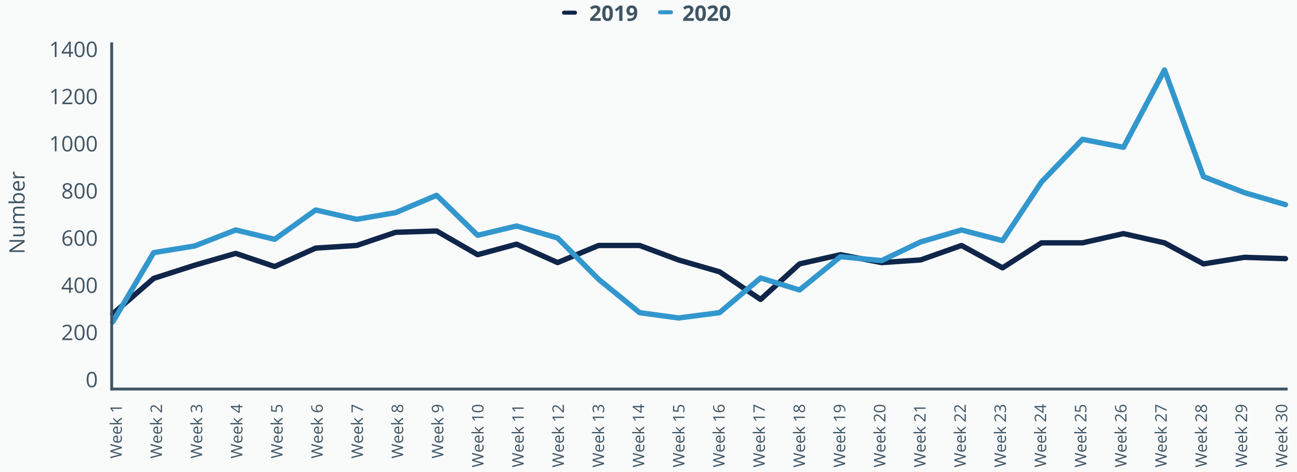
Several factors are having conflicting effects on construction activity in the short and medium-term.

Government subsidies are encouraging first-home buyers to make financial commitments to new builds this financial year. This is bringing forward demand and resulting in increased land sales – which is expected to provide some support to dwelling investment.

On the other hand, falls in employment and income are reducing the ability and willingness of people to make large financial commitments. This, combined with expectations of falls in property prices may reduce demand for some property types.

Over the longer term, ongoing border closures and lower levels of population growth will be a significant drag on house prices and new home construction.

Chart 4: Property Transactions in Perth



Source: REIWA, CCIWA

> Weakness in international container trade has not harmed WA's commodity exports, which have been supported by high demand for Australian iron ore

International Trade

	Economic Activity	
Forecasts	**Exports**	**Imports**
2018-19 Actual	1.4%	-6.1%
2019-20 Forecast	2.0%	-5.0%
2020-21 Forecast	1.0%	-5.0%
2021-22 Forecast	1.5%	3.5%
2022-23 Forecast	1.0%	7.5%

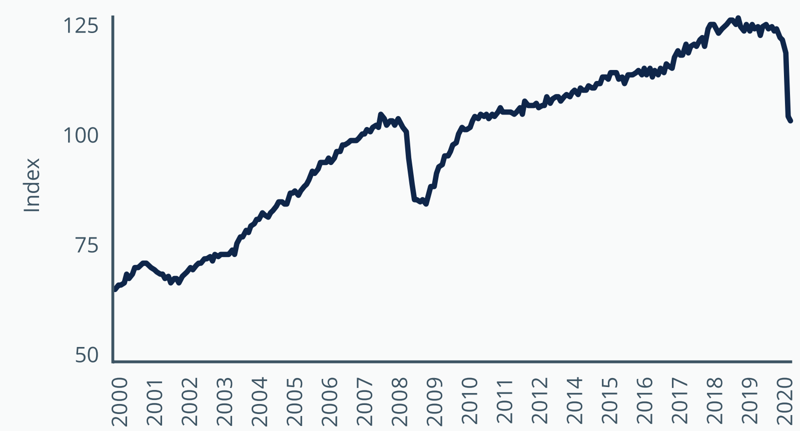
The volume of international trade has fallen significantly. This has been driven by supply chain disruptions and reduced global consumer spending.

The volume of imports to WA has also fallen, driven by large falls in imports of most goods, including vehicles, retail goods, machinery and equipment, and fuel.

Weakness in international container trade has not harmed WA's commodity exports, which have been supported by high demand for Australian iron ore, in part due to ongoing supply difficulties in Brazil. Miners, ports and shippers are expected to continue to increase WA's export volumes, however capacity constraints will place a ceiling on the extent to which export volumes can increase.

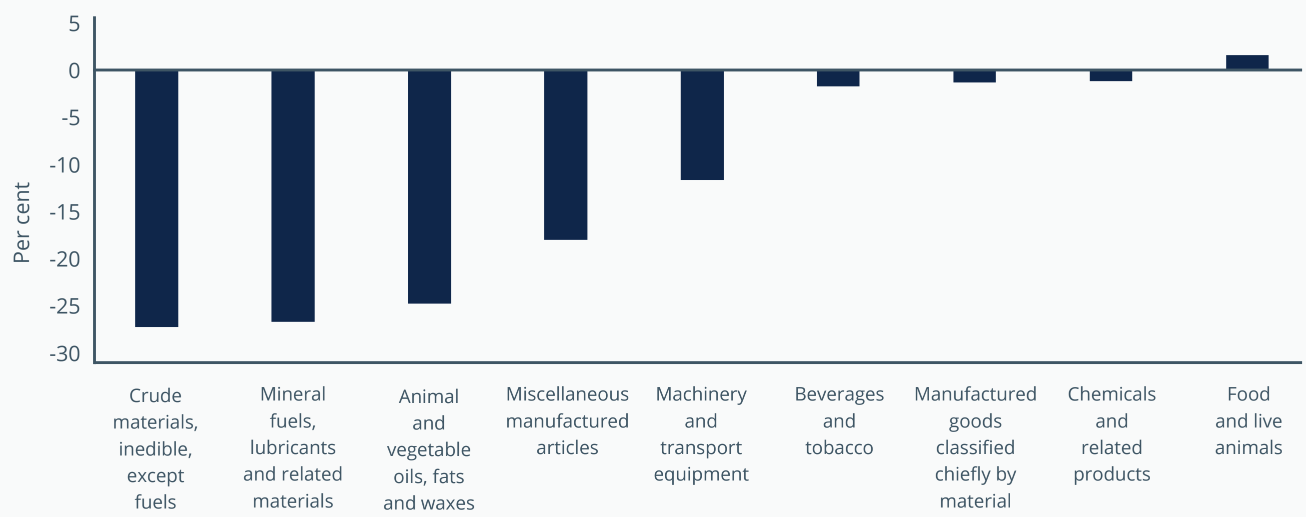
With Western Australia's mining export capacity now much larger off the back of the mining investment boom, even modest growth in exports can have large impacts on economic activity.

Chart 5: World Trade Balance Index Volume, S/A, 2010=100



Source: Eikon, CCIWA

Chart 6: Imports by Classification Annual Percentage Change, May 2020, Nominal



Source: ABS, CCIWA

> Businesses directly affected by restrictions and supported the most by JobKeeper include hospitality, retail, hair and beauty, tourism and accommodation businesses

Unemployment

	Economic Activity
Forecasts	**Unemployment**
2018-19 Actual	5.8%
2019-20 Forecast	8.7%
2020-21 Forecast	11.0%
2021-22 Forecast	9.0%
2022-23 Forecast	7.0%

Many businesses have sought to keep their employees in work during the COVID-19 pandemic. This effort has been aided by wage subsidies that have kept the unemployment rate lower than it would have been and efforts to reduce hours rather than staffing levels.

Businesses directly affected by restrictions and supported the most by JobKeeper include hospitality, retail, hair and beauty, tourism and accommodation businesses.

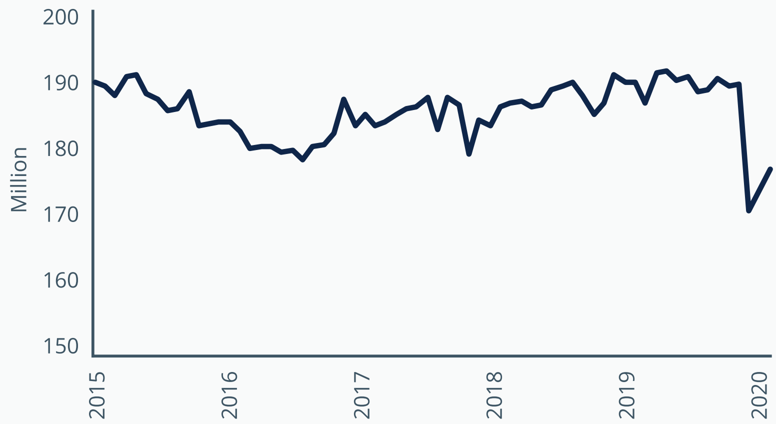
Weekly payroll jobs have showed some signs of recovery, particularly in WA, supported by the reopening of the WA economy. However, the unemployment rate will continue to increase as government support measures are wound back and more people look for work.

Ultimately, continued elevation in the unemployment rate will limit increases in wages and inflation.

Wages and Inflation

	Economic Activity	
Forecasts	**Inflation**	**Wages**
2018-19 Actual	1.3%	1.6%
2019-20 Forecast	1.3%	1.0%
2020-21 Forecast	0.5%	0.5%
2021-22 Forecast	1.0%	1.0%
2022-23 Forecast	1.5%	1.5%

Chart 7: Monthly Hours Worked Millions, Seasonally Adjusted



Source: ABS, CCIWA

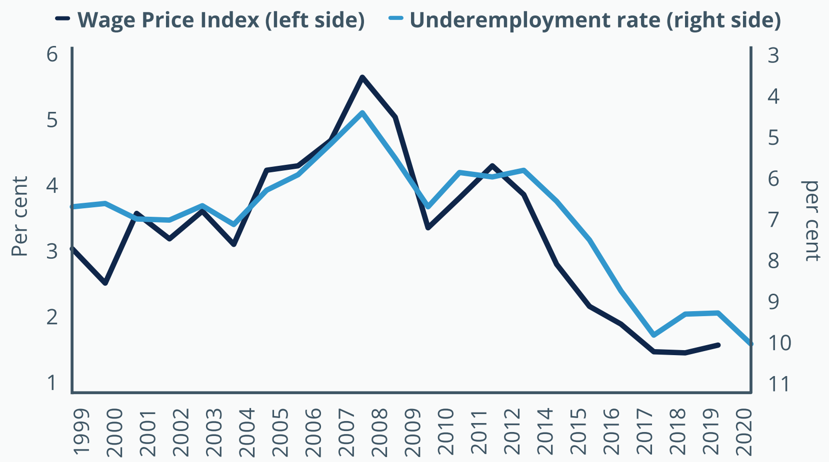
COVID-19 and government restrictions have reduced available work, meaning businesses have had to reduce staff hours. Only a small number of businesses have negotiated arrangements to reduce the hourly rate of pay to employees.

Falls in business revenue and business investment will restrict businesses from hiring more workers and increasing wages.

That said, in some sectors there will continue to be areas of skills shortages putting upward pressure on wages, as businesses compete to attract workers. However, this wage pressure is not expected to spread to other parts of the labour market.

Inflation will remain low due to falls in oil prices, increased unemployment and increased competition among businesses to retain customers.

Chart 8: Average Wage Growth (Annual Growth) and the Average Underemployment Rate (Inverted)



Source: ABS, CCIWA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