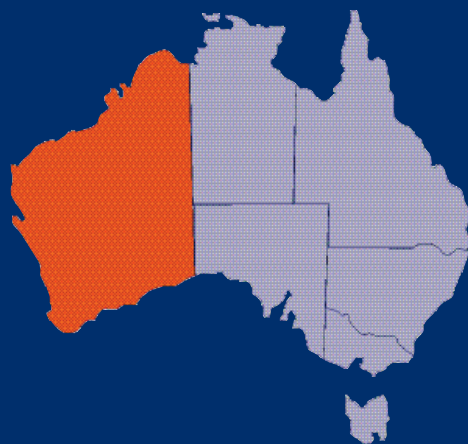




# WESTERN AUSTRALIAN ECONOMIC SUMMARY

Winter 2005



Department of Treasury and Finance  
Government of Western Australia



Department of Treasury and Finance  
Government of Western Australia

Western Australian  
**E c o n o m i c**  
**S u m m a r y**

**WINTER 2005**

Released 21 October 2005

---



---

**CONTENTS**

---

<b>EXECUTIVE SUMMARY .....</b>	<b>2</b>
<b>1. THE ECONOMY .....</b>	<b>4</b>
OVERVIEW .....	4
HOUSEHOLD CONSUMPTION .....	6
DWELLING INVESTMENT.....	12
BUSINESS INVESTMENT .....	19
EXTERNAL CONDITIONS .....	26
LABOUR MARKET.....	42
PRICES, INCOMES AND INTEREST RATES.....	51
INTERNATIONAL CONDITIONS.....	57
<b>2. 2004-05 GOVERNMENT FINANCIAL RESULTS     REPORT .....</b>	<b>64</b>
<b>3. COMPETITION IN WESTERN AUSTRALIA'S FOOD     MARKET .....</b>	<b>70</b>
<b>APPENDIX 1 WESTERN AUSTRALIAN EXPORTS BY     COMMODITY .....</b>	<b>79</b>
<b>APPENDIX 2 WESTERN AUSTRALIAN EXPORTS BY     DESTINATION .....</b>	<b>80</b>
<b>GLOSSARY .....</b>	<b>81</b>

## EXECUTIVE SUMMARY

Western Australian domestic demand continues to perform well, growing by 1.4% in the June quarter and by 5.5% over 2004-05. This was largely underpinned by consumption and public investment.

Household consumption in Western Australia continued to show considerable resilience in the June quarter and over 2004-05. In trend terms, household consumption grew for the seventeenth consecutive quarter (up by 1.0% in the June quarter) with the robust labour market, rising property prices and positive news about the Western Australian economy continuing to underpin consumption expenditures.

Conditions in Western Australia's housing sector also remain healthy, with strong activity in both the established market and new dwelling construction. The large build up of work on builders' books and solid demand for housing finance, point to sustained activity in 2005-06.

Business investment in Western Australia continues to benefit from resource-related activity. Following double-digit growth in 2003-04, the pace of growth in business investment moderated in 2004-05 following the completion of construction of some of the State's large-scale resource projects. Nonetheless, the overall outlook for business investment in Western Australia remains positive.

Demand from Western Australia's key export partners remains strong. The rapid expansion of economic activity in China seen over recent years shows no sign of immediate slackening, with exports to China (particularly iron ore) continuing to exhibit remarkable increases. Growth in Western Australia's imports has also strengthened as investment activity in the resource sector and consumer spending remains buoyant.

Importantly, the State's strong performance has translated into jobs growth. Employment strengthened by 5.1% over the year to August 2005, with the State's participation rate remaining strong and the unemployment rate at record lows.

The global expansion continues to provide a favourable backdrop for the Western Australian economy.

This edition of the *Economic Summary* contains two feature articles:

- The first feature article provides an overview of the State's public sector financial results for 2004-05; and
- The second discusses competition in the Western Australian grocery market.

## 1. THE ECONOMY

### OVERVIEW

- The Western Australian domestic economy grew by 1.4% in the June quarter 2005 and by 5.5% over 2004-05, underpinned, in both instances, by growth in household consumption and public investment.
- Continued strong economic growth has contributed to positive labour market outcomes. Over the three months to August 2005, employment grew by 1.0% and the unemployment rate declined to average 4.7%.

The Western Australian domestic economy grew by 5.5% in 2004-05, underpinned by household consumption and public investment.

The State's domestic economy grew strongly in the June quarter, with growth of 1.4% driven mainly by household consumption and public investment.

### State Final Demand

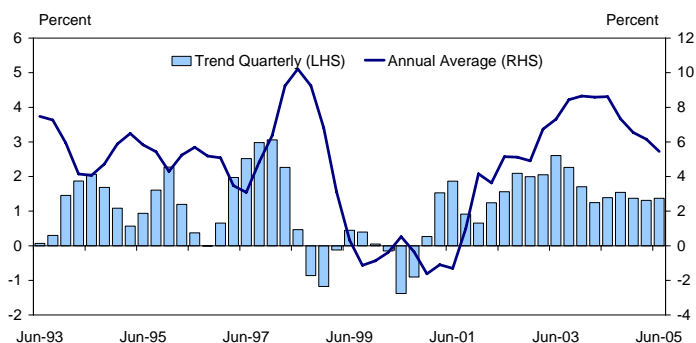
Real Growth (%)

Period to June 2005

	qtr*	yr
NSW	0.8	3.1
Vic	0.9	4.1
Qld	0.8	6.1
<b>WA</b>	<b>1.4</b>	<b>5.5</b>
SA	0.9	3.8
Tas	0.3	5.8
<b>Aust</b>	<b>1.0</b>	<b>4.2</b>

\* In trend terms.

DOMESTIC DEMAND GROWTH  
Western Australia



**Household consumption** grew by 1.0% over the June quarter with partial indicators suggesting consumption will remain strong in the near term (despite annual average growth moderating from a high of 7.6% in the September quarter 2004, to 5.8% currently).

**Public investment** in Western Australia grew by 7.6% in the June quarter and by 18.4% over 2004-05. Growth over these periods was underpinned by investment by the State Government's public corporations.

**Business investment** continues to benefit from resource-related activity, with latest data showing growth of 3.6% over 2004-05. Surveys of business confidence indicate that the outlook for business investment in Western Australia remains positive.

Western Australia's **housing sector** grew for the fifth consecutive quarter to be 2.4% higher in June (with the rate of growth the fastest of all States). In annual average terms, growth strengthened to 6.4% in 2004-05, with partial indicators pointing to continuing high levels of activity in both the established market and in new dwelling construction.

Western Australia's **net merchandise exports** improved greatly over the three months to July 2005, increasing by 27.7% (or \$1.6 billion) in nominal terms when compared with the same period a year later. Growth in exports was underpinned by iron ore and petroleum exports. In real terms, net exports increased by 1.6% in the June quarter and declined by 2.4% over 2004-05.

The Western Australian **labour market** strengthened over the year to August 2005, with employment growing by a robust 5.1% and the unemployment rate falling to an average of 4.7%. Business surveys suggest that labour market prospects in Western Australia remain positive, with any moderation in the market likely to be more attributable to labour supply constraints (such as shortages in skilled labour) rather than low labour demand.



---

## HOUSEHOLD CONSUMPTION

---

- *Household consumption remains resilient in Western Australia, with consumer spending increasing by 1.0% in trend terms in the June quarter 2005. This is the fourth consecutive quarter that consumption growth in Western Australia was the highest of all States.*
- *In annual average terms, private consumption remained strong in Western Australia, growing by 5.8% over 2004-05. Growth appears to be supported by wealth effects (flowing from increases in house prices and equities), high consumer sentiment levels and strong employment growth.*
- *Recent trends in partial indicators of consumption point to relatively strong growth in retail sales in the near term (despite annual average growth continuing to moderate) and steady growth in sales of new motor vehicles.*

### **Recent Conditions**

Consumer spending in Western Australia continued to show considerable resilience in the June quarter 2005 and over 2004-05. This likely reflects the robust labour market, wealth effects associated with rising property prices and ongoing positive news about the Western Australian economy more generally.

In trend terms, household consumption grew for the seventeenth consecutive quarter (up by 1.0% in the June quarter following a 1.1% increase in the March quarter). While growth in household consumption eased slightly in the June quarter, the pace of household consumption growth appears to be stabilising after several quarters of moderation.

In annual average terms, household consumption grew by 5.8% in 2004-05. While this is lower than growth of 7.3% in 2003-04, the moderation in growth in annual average terms is not surprising as growth in 2003-04 was the highest on record.

**Household Consumption**

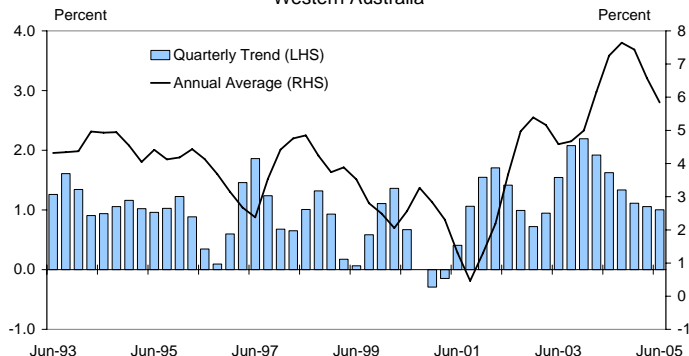
Real Growth (%)

Period to June 2005

	qtr*	yr
NSW	0.3	2.7
Vic	0.7	4.2
Qld	0.7	5.3
<b>WA</b>	<b>1.0</b>	<b>5.8</b>
SA	0.4	3.1
Tas	0.5	4.7
<b>Aust</b>	<b>0.6</b>	<b>3.9</b>

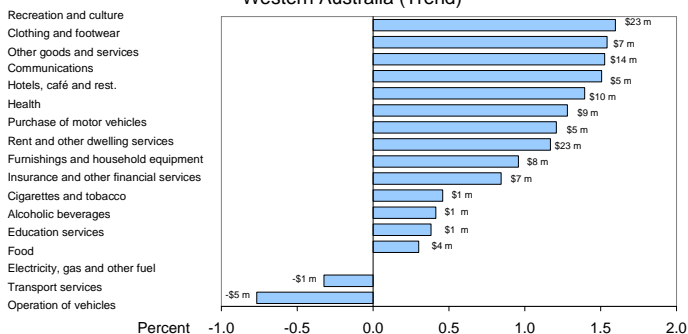
\* In trend terms

HOUSEHOLD CONSUMPTION GROWTH  
Western Australia



Growth in spending in the June quarter was strongest in the areas of recreation and culture (up 1.6%), clothing and footwear (up 1.5%), 'other' goods and services (including expenditures on personal care and insurance) (up 1.5%) and communication (also up 1.5%). Increases in these areas were partially offset by reduced spending on transport services (down 0.3%) and operation of vehicles (down 0.8%).

CHANGE IN HOUSEHOLD EXPENDITURE BY TYPE  
June Quarter 2005 from March Quarter 2005  
Western Australia (Trend)



Retail Spending

Recent trends in partial indicators of private consumption (i.e. retail turnover and new motor vehicle sales) suggest that the level of consumer spending in Western Australia remains resilient.

Real retail turnover rose by 0.6% in trend terms in the June quarter. More recent (nominal) data indicate that retail turnover rose by 2.7% in the three months to July 2005, the strongest pace of growth since February 2002.

**Retail Turnover**

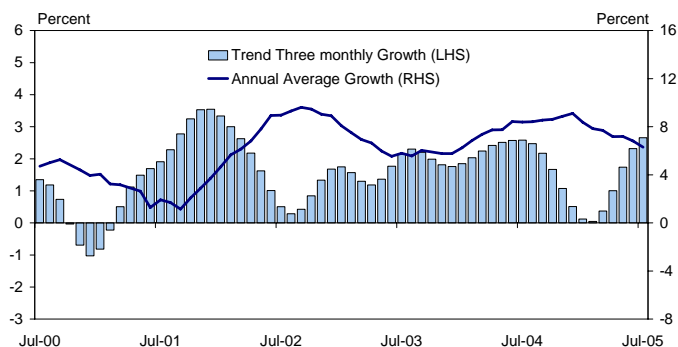
Nominal Growth (%)

Period to July 2005

	qtr*	yr
NSW	0.6	2.5
Vic	1.7	3.9
Qld	1.6	3.7
<b>WA</b>	<b>2.7</b>	<b>6.3</b>
SA	0.4	2.5
Tas	0.4	4.6
<b>Aust</b>	<b>1.3</b>	<b>3.5</b>

\* In trend terms.

RETAIL TURNOVER  
Western Australia



Growth in spending was mixed across different segments of the retail industry in the three months to July 2005, although broad trends are apparent for some industry groups.

In the three months to July, growth was highest in hospitality and service goods retailing (up 4.2%) followed by growth in food retailing (up 3.9%), while 'other' retailing declined (by 2.6%).

RETAIL SALES GROWTH BY INDUSTRY\*  
THREE MONTHS TO JULY 2005  
Western Australia



\* Nominal data. A breakdown by State and industry is not available in real terms.

Although retail turnover grew significantly in the three months to July, growth in annual average terms has moderated over the past six months in Western Australia. Notwithstanding this, growth in turnover of 6.3% over the year to July 2005 is around the long-term average rate of growth for the State.

In annual average terms, growth remains strong across most industry groups. Since late 2003, household goods retailing has typically had the highest rate of growth of all industry groups (likely reflecting the strengthening of housing market activity in Western Australia), however more recently, the growth in recreational goods retailing has been the strongest of all industry groups.

#### New Motor Vehicle Sales

Monthly data for August indicate that the number of new motor vehicles sold in Western Australia is at an historical high (indeed, the number of new car sales recorded in August 2005 is around 48% higher than sales of new motor vehicles four years earlier). In August, around 8,400 new motor vehicles were sold in Western Australia (around 96,700 over the year to August).

Latest trend three-monthly data show that growth in new motor vehicle sales in Western Australia rose in the three months to August 2005, increasing by 3.1% after rising by 4.8% in the three months to August 2004. Strong growth in 'other vehicles' (which includes utilities, panel vans, cab chassis, etc.) continues to drive total new motor vehicle sales growth.

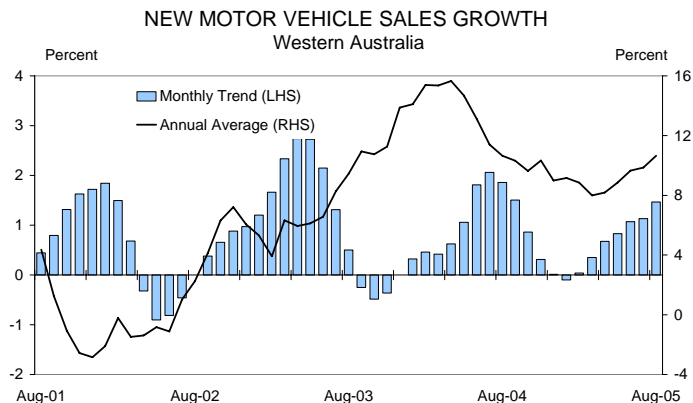
## New Motor Vehicle Sales

Nominal Growth (%)

Period to August  
2005

	<i>qtr*</i>	<i>yr</i>
NSW	-2.4	1.4
Vic	0.3	4.9
Qld	1.1	9.3
<b>WA</b>	<b>3.1</b>	<b>10.6</b>
SA	-3.1	1.6
Tas	-3.1	10.0
<b>Aust</b>	<b>-0.4</b>	<b>5.1</b>

\* In trend terms.

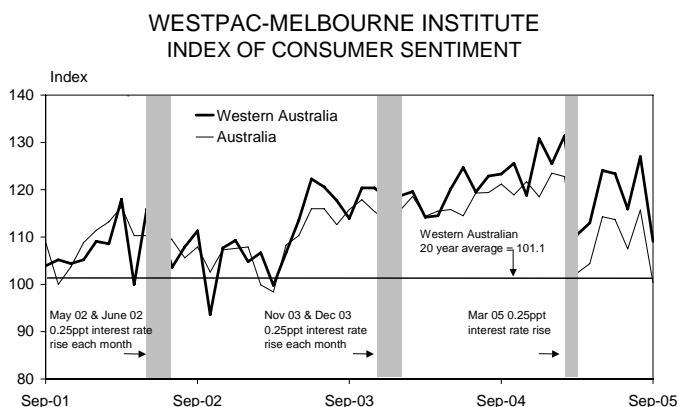


In annual average terms, growth in new motor vehicle sales has moderated from the 15.7% peak in the year to April 2004. While growth in sales eased to 10.6% in annual average terms in the year to August 2005, growth is still more than double the long term annual average growth rate of around 4.2% per annum.

### Outlook

Data on trends in retail turnover and new motor vehicle sales are only available up to July and August respectively. Since late August there has been a considerable increase in petrol prices which appears to have had a significant impact on consumer sentiment. Reflecting this, the Westpac-Melbourne Institute of Consumer Sentiment fell by 14.1% in Western Australia in September.

The chart below shows the fall in consumer sentiment for Western Australia and for Australia during September (which was attributed by the Westpac-Melbourne Institute to higher petrol prices). Specifically, the fall in sentiment (down 14.1% for Western Australia and 13.3% nationally) was largely a result of increases in transportation fuel prices and impacts from hurricane Katrina (which had occurred during the survey's reference period). This compares with slightly larger declines in consumer sentiment in March (down 15.9% in Western Australia and 16.6% nationally) due to weaker than expected economic data and the first increase in official interest rates in 15 months. Although consumer sentiment in Western Australia is now 11.5% below its level a year ago, the index remains higher than the long term (20 year) average.



While there is inevitably uncertainty about future movements in petrol prices and their impact on consumer sentiment, the underlying drivers of household confidence remain robust. In particular, house prices in Perth continue to grow at a healthy pace, interest rates remain low, employment and wage growth are strong and the unemployment rate is at record lows.

The extent to which the decline in consumer sentiment impacts on household consumption and economic activity more broadly will depend on how long petrol prices remain relatively high and the way in which consumers respond to higher fuel prices. Consumer sentiment fell following the latest interest rate rise, but rebounded subsequently when expectations of a further rate rise eased.

## DWELLING INVESTMENT

- Dwelling investment in Western Australia grew by 2.4% in the June quarter 2005, and defied national trends to grow by 6.4% in 2004-05.
- Partial indicators point to continued high levels of activity in both the established market and in new dwelling construction.
- Dwelling investment is expected to remain at high levels in 2005-06, underpinned by continued high levels of construction activity and strong growth in housing finance and house prices.

### Recent Conditions

Dwelling investment in Western Australia is growing at a faster pace than we had previously expected, and significantly faster than in most other States. In the June quarter 2005, dwelling investment in Western Australia rose by 2.4%, the second fastest rate of growth after South Australia. Over 2004-05, Western Australia and South Australia were the only States in which dwelling investment rose (up 6.4% and 0.5% respectively).

### Dwelling Investment

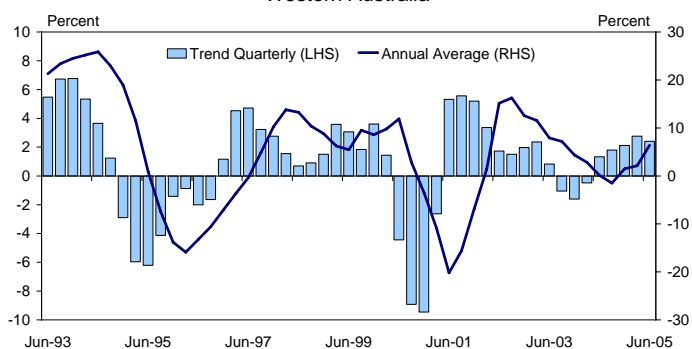
Real Growth (%)

Period to June 2005

	qtr*	yr
NSW	-1.5	-11.7
Vic	0.0	-4.0
Qld	0.3	-0.2
<b>WA</b>	<b>2.4</b>	<b>6.4</b>
SA	3.8	0.5
Tas	-2.8	-11.5
<b>Aust</b>	<b>0.6</b>	<b>-4.3</b>

\* In trend terms.

DWELLING INVESTMENT  
Western Australia



The strong growth in Western Australia reflects stronger activity in the dwelling construction sector (supported by a backlog of work and a continuing inflow of new work) and the established market (through the ownership transfer costs component).

### *Partial Indicators*

Partial indicators of dwelling investment, and housing activity more broadly, generally point to continued high levels of activity in both the established market and new dwelling construction.

#### New Dwelling Construction

The new dwelling construction<sup>1</sup> component of dwelling investment grew by 4.9% in the June quarter 2005, following an increase of 4.5% in the March quarter. Overall, new dwelling construction has grown for seven consecutive quarters, and rose by 7.9% in 2004-05.

Recent growth trends in partial indicators of dwelling investment continue to provide mixed signals about growth in dwelling investment. In particular:

- dwelling commencements and housing finance commitments have grown in three monthly terms; and
- building approvals declined (albeit only slightly) in the past three months.

Notwithstanding the recent decline in approvals, the number of approvals remains high. Further, work on builders' books remains very high. Together, these indicators suggest that construction activity will likely remain strong for at least another 12 months.

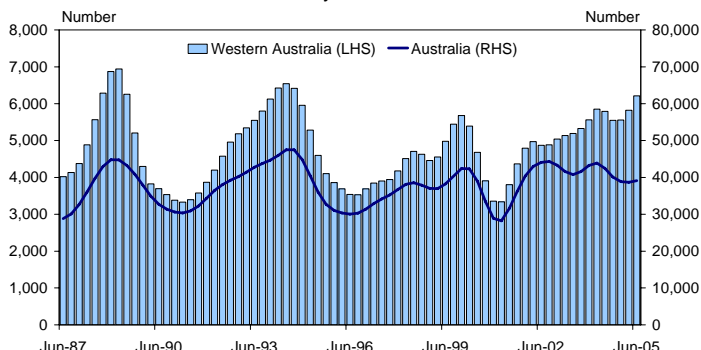
Dwelling commencements increased by a very strong 6.7% in the June quarter 2005. Although the number of dwelling commencements had moderated in previous quarters, dwelling commencements remain at high levels (refer to following chart).

---

<sup>1</sup> According to the ABS, investment in new and used dwellings comprises the value of acquisitions of new and existing dwellings less the value of disposals of existing dwellings, and the value of dwellings created by the conversion of existing non-dwelling buildings into dwellings. This is used as a measure of new construction activity.

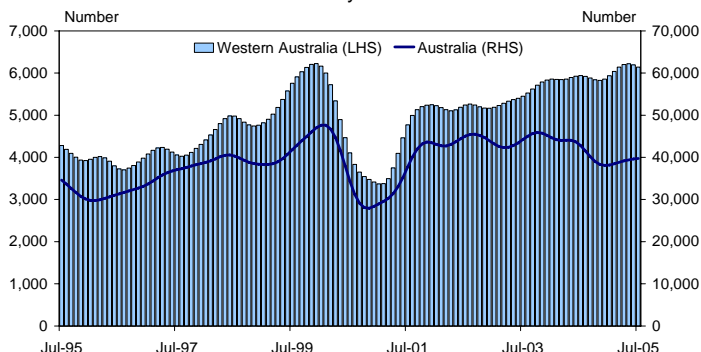


DWELLING COMMENCEMENTS  
Quarterly Trend Levels



Building approvals data indicate that demand for new construction in Western Australia may be steady at high levels. The number of building approvals declined by 1.0% in the three months to July 2005. Notwithstanding the recent decline in three monthly growth, the level of building approvals remains close to the highest level in the past 10 years.

BUILDING APPROVALS  
Three Monthly Trend Levels



Building approvals data are consistent with other data suggesting that Western Australia's housing cycle is more robust than in other States. In particular, Western Australia was the only State to record growth over the year (albeit only of 0.7%), with building approvals nationally declining by 12.2% over the same period.

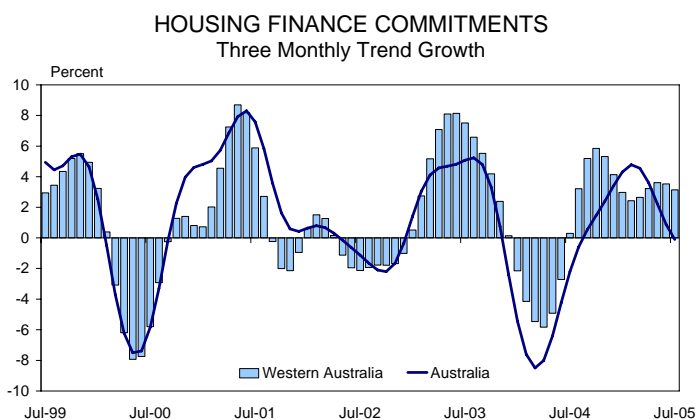
Housing finance for construction and the purchase of newly erected dwellings is consistent with high levels of activity, with the number of commitments 12.6% higher in the three months to July 2005 than the same period in 2004.

#### Established Market

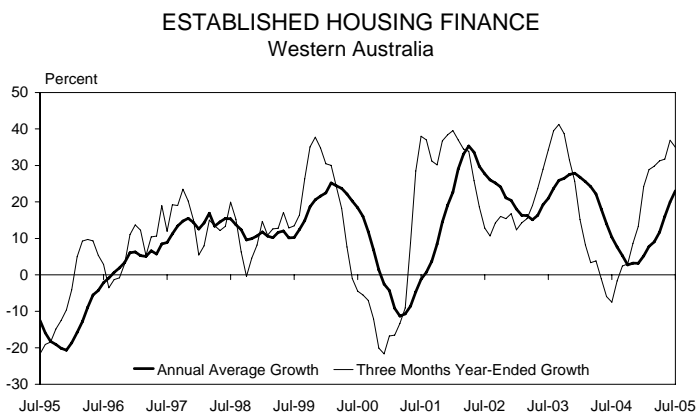
Dwelling investment captures trends in the established market through ownership transfer costs, which grew by 0.7% in the June quarter. Combined with growth in the previous three quarters, ownership transfer costs increased by 3.0% over 2004-05.

The established market remains robust in Western Australia with strong growth in the number and value of housing finance commitments and in house prices.

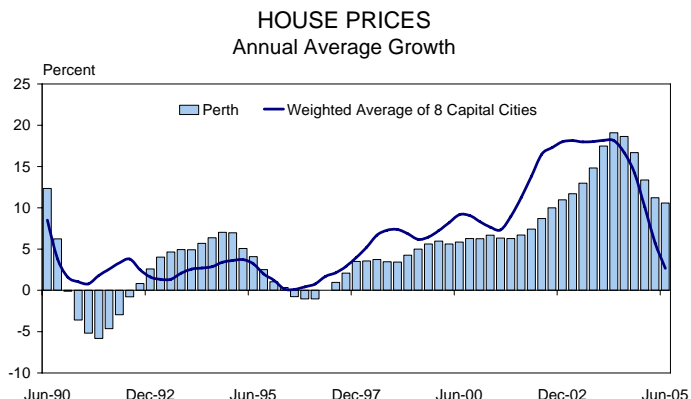
Established finance data reveal that the level of activity in the established market continues to grow strongly. The number of housing finance commitments for owner-occupiers grew by 3.1% in the three months to July 2005. Of this, the number of finance commitments for established houses (excluding refinancing) was 25.7% higher in the three months to July 2005 than in the same period of 2004.



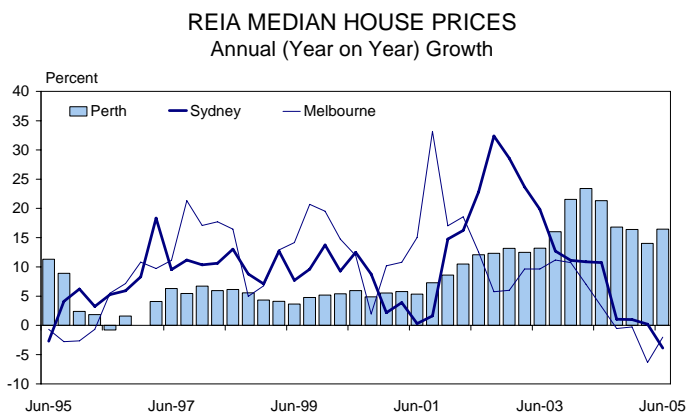
The total value of housing finance for established houses (excluding refinancing), including both owner-occupiers and investors, was 35.0% higher in the three months to July 2005 than a year earlier. Although three monthly year-ended data show that growth may have peaked in July 2005, the relationship between year-ended and annual average growth (whereby turning points in year-ended growth tend to lead turning points in annual average growth), suggests that annual growth is expected to remain positive through 2005-06 (refer to following chart).



Trends in the prices of established houses are also consistent with a robust established housing market. Established house price index data from the ABS reveal that growth in established house prices in Perth continues to outstrip growth in house prices in other State capital cities. Growth in Perth house prices (up 10.6%) was the strongest of all the State capitals in 2004-05, and stronger than the growth in the weighted average of the eight capital cities (refer to following chart).



Similarly, median house price data released by the Real Estate Institute of Australia (REIA) for the June quarter 2005 reveal that the median house price for Perth continues to grow at a strong pace (up 16.5% on the June quarter 2004 to \$297,000) in contrast to recent national trends.



Trends in Perth house prices appear to have lagged price trends in other States, with growth in Perth having peaked well after peaks nationally and in the large State capitals. While growth in house prices in Perth have moderated in line with earlier moderations in the larger State capitals, both the ABS and REIA show a steadying in growth in the most recent quarters (as opposed to the declines in some other capitals).

Composition-adjusted house price data from the RBA corroborates ABS data that Perth property prices continued to rise at a solid rate. In its August Statement on Monetary Policy, the RBA noted that over the 18 months to June, Perth property prices rose by 19% but remained flat at a national level.

House prices in Western Australia are more affordable than in other States. In this regard, data from the REIA indicate that the ratio of median family income to average loan repayments is higher in Western Australia than in other States.

### *Outlook*

Dwelling investment is expected to remain at high levels in 2005-06. The partial indicators of dwelling investment for new construction point to continued high levels of construction activity, in addition to the large build up of work on builders' books that should sustain activity. At the same time, however, tight supply conditions, including for labour, materials and land, have the potential to constrain growth.

The established market is also expected to remain strong, with the housing finance data suggesting demand remains robust. This likely reflects the low price of houses in Perth relative to other States, together with stronger underlying fundamentals (such as population growth and the economic outlook).

---

## BUSINESS INVESTMENT

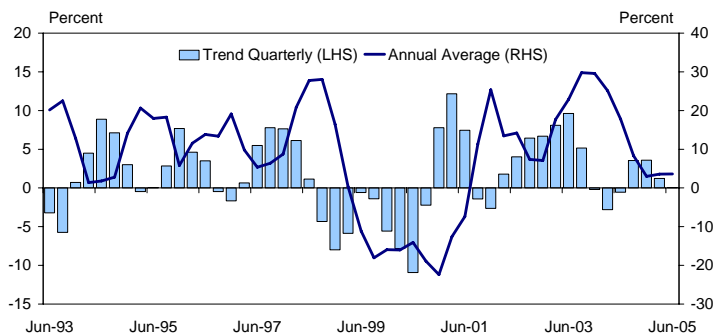
---

- *Business investment in Western Australia continues to benefit from resource-related activity and healthy business conditions and expectations.*
- *Business investment grew by 3.6% in an annual average terms in 2004-05. Annual business investment levels for the same period totalled \$15.6 billion (at almost \$4 billion per quarter).*
- *With work on a number of large resource-related projects being completed over the course of 2004 (including the fourth LNG train for the North West Shelf), growth in business investment in annual average terms has moderated from the double-digit growth experienced over 2003-04.*
- *Despite this, activity related to the construction phases of other new and continuing mining projects, together with business investment across a broad range of other industries, has helped maintain activity at historically high levels.*
- *The short-term outlook for business conditions in Western Australia is broadly positive, with expectations that business investment will grow at a sustainable rate.*

### **Recent Conditions**

June quarter data show that growth in business investment has moderated over 2005, with trend growth in the quarter only marginally positive and less than 1%. From the low in late 2000, trend business investment exhibited about three years of generally continuous growth, which has been followed by two years of more moderate movements.

**BUSINESS INVESTMENT GROWTH**  
Western Australia



The following chart of business investment levels assists in interpreting the quarterly and annual growth figures. While growth figures have exhibited typical volatility, total investment levels are still high. The slowing of growth shows a consolidation of business investment over the last three quarters at just under \$4 billion.

**Business Investment**

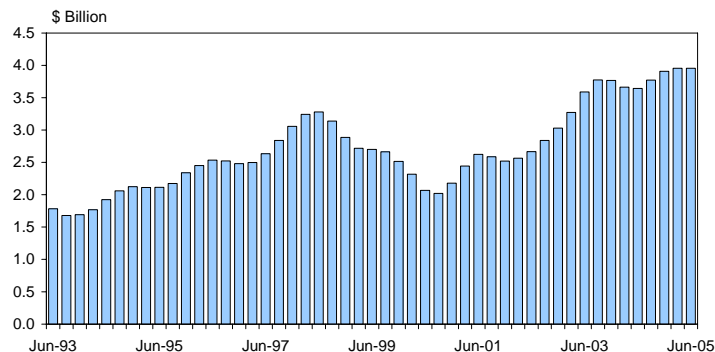
Real Growth (%)

June Qtr 2005

	qtr*	yr
NSW	4.8	16.9
Vic	2.8	12.1
Qld	1.0	14.5
<b>WA</b>	<b>0.1</b>	<b>3.6</b>
SA	0.6	9.4
Tas	1.3	30.3
<b>Aust</b>	<b>3.0</b>	<b>12.3</b>

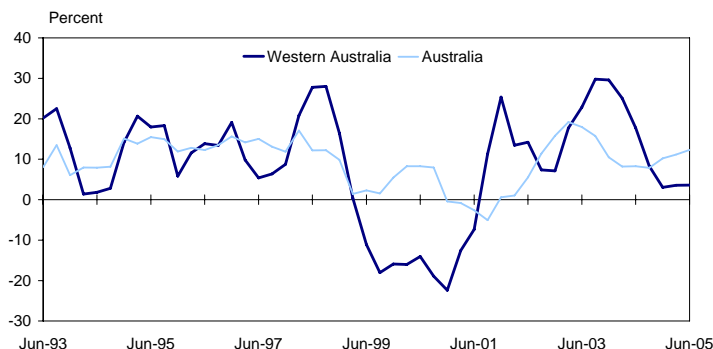
\* In trend terms.

**TREND BUSINESS INVESTMENT**  
Western Australia



In annual average terms business investment for 2004-05 grew by 3.6%, which was lower than the growth nationally.

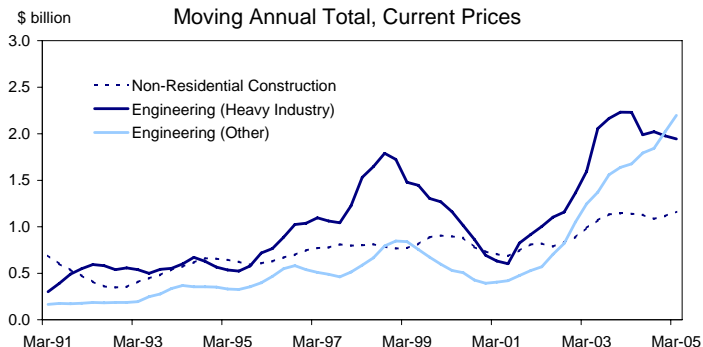
**BUSINESS INVESTMENT GROWTH**  
Annual Average Growth



For Western Australia, the pattern of quarterly growth over the past year partly reflects the completion of construction on a number of major investment projects over the first half of 2004 (including the \$2.4 billion 4th LNG train of the North West Shelf Project<sup>2</sup>).

The extended phase of business investment (particularly in infrastructure) has expanded the State’s productive capacity at a time when the resource and commodity sectors are experiencing high prices. This investment in infrastructure appears under the ‘Engineering (other)’ category in the following chart and includes roads, bridges, railways, harbours, electricity generation and transmission and water storage and supply.

**ENGINEERING & NON-RESIDENTIAL CONSTRUCTION**  
Moving Annual Total, Current Prices



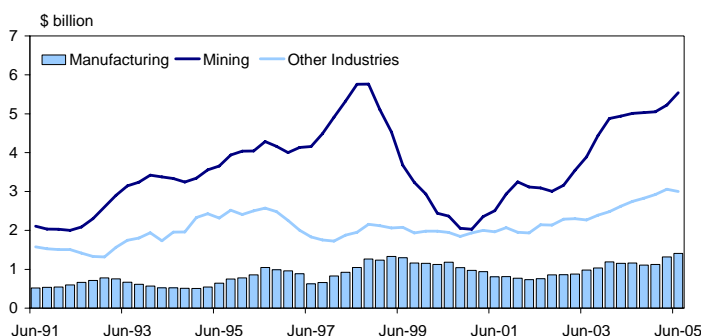
<sup>2</sup> \$2.4 billion total inclusive of \$1.6 billion LNG plant and related \$800 million second gas trunk line.



Although the Australian dollar is hovering around levels not seen for a decade, the global resources boom (particularly for iron ore and petroleum commodities) has allowed businesses to enjoy increasing profitability. Expectations are that demand from Western Australia's major commodity trading partners will remain strong.

Examination of capital expenditure by industry shows that investment in the mining industry has grown steadily over the past few years. Following several quarters where investment in the mining sector eased (with 'other industries' exhibiting stronger growth) in the March and June 2005 quarters, capital expenditure by mining companies climbed again.

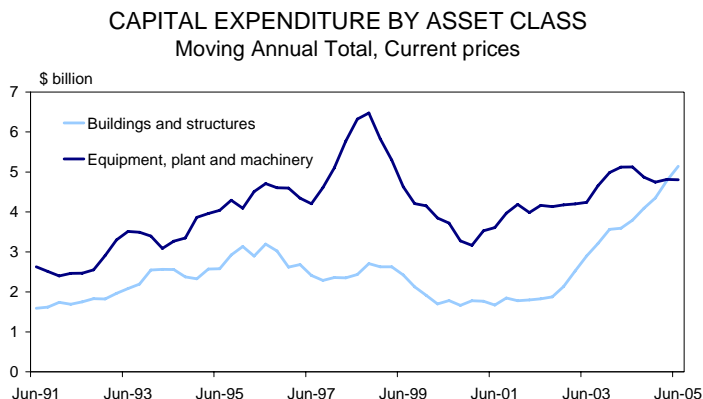
WA CAPITAL EXPENDITURE BY INDUSTRY  
Moving Annual Total, Current prices



Western Australia continues to have numerous major projects under construction (or commencing soon), across a number of key commodity markets including, oil and gas, iron ore, alumina and nickel<sup>3</sup>. This investment will not only assist in boosting the on going productive development of the State, it is expected to result in capacity utilisation returning to more normal levels (the later 'Capacity Utilisation' chart shows a decline over recent quarters).

<sup>3</sup> Refer to either the *Autumn Economic Summary* or *Access Economics' Investment Monitor* for further detail of current projects.

Data on businesses' capital expenditure patterns by asset class (in current prices) show that over the year to the June quarter 2005, expenditure on buildings and structures grew by a strong 35.6%. The infrastructure expenditure discussed earlier (on roads, ports, power, etc) falls into the 'Building and structures' category of the next chart. Over the same period, the 'Equipment, plant and machinery' category recorded a fall of 6.2%.



Notwithstanding this, aggregate annual levels of investment in both categories are quite strong (at approximately \$4.8 billion for equipment, plant and machinery and \$5.1 billion for buildings and structures). The chart above illustrates the historically high level for buildings and structures.

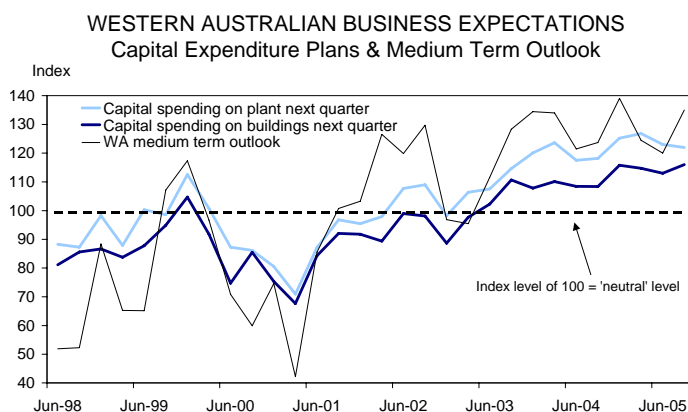
### **Outlook**

Overall the outlook for business investment in Western Australia is positive, with key contributing factors being:

- favourable global economic conditions;
- high commodity prices and continued strong demand for key commodities, such as iron ore, gold and petroleum/LNG;
- improved infrastructure (public and private);
- high levels of consumer sentiment; and
- increasing corporate profits.

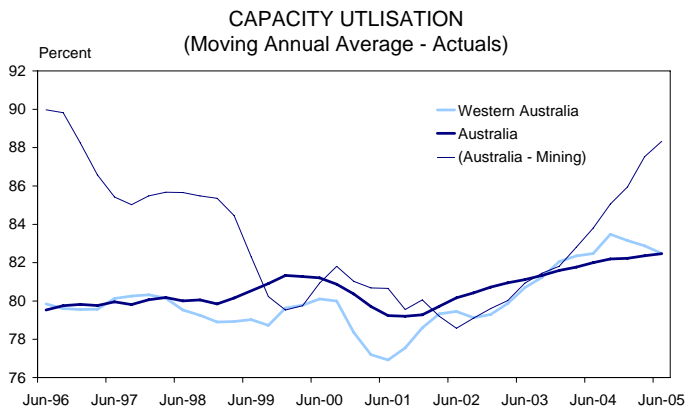
Most business surveys continue to report optimistic business sentiment, though there is some concern about the impact of rising oil prices and labour shortages.

The September quarter 2005 Chamber of Commerce and Industry of Western Australia-BankWest *Survey of Business Expectations* indicates that Western Australian businesses' confidence in general economic conditions over the medium term has risen<sup>4</sup>. The indexes on capital spending point to an increase in building and structure investment in the December quarter, and an easing (but still positive) movement in investment in plant.



Trends in capacity utilisation provide an indication of how much 'spare' capacity business is operating with. Investment tends to grow when capacity utilisation is high, as businesses need to expand if they are to increase output. According to the NAB's *Quarterly Business Survey* Western Australia's capacity utilisation rate remains above its long term average (of just under 80%), at a rate of 81.4% for the June quarter 2005, and at an average annual rate of 82.5% over the year to June 2005.

<sup>4</sup> Indices are based on a net balance approach, with no weighting applied to the firm size of respondents.



Capacity utilisation continues to remain at high levels, and while data are not available for particular sectors at a State level, the national figures for the mining sector show capacity utilisation increasing for this sector.

Western Australian business investment is expected to be sustained at a high level in 2005-06, supported by the first full year of construction on projects such as the fifth LNG train, the Ravensthorpe nickel mine (and associated infrastructure) and the Enfield oil field development.

---

## EXTERNAL CONDITIONS

---

- *Increasing export capacity as a result of numerous resource sector developments finally appears to be reflected in recent data from the ABS. Meanwhile, strength in the domestic economy continues to drive solid growth in imports.*
- *Real exports strengthened, to increase by 3.8% over 2004-05, largely driven by strong growth of 3.3% in the June quarter 2005.*
- *Real imports grew by 15.7% over 2004-05, supported by a 13.6% increase over the June quarter 2005.*
- *More recent nominal trade data indicate Western Australia's exports continue to strengthen in value and volume terms, reflecting healthy economic conditions both domestically and globally.*

### ***Net Exports***

Western Australia's net merchandise trade surplus continues to expand as the volume of the State's exports also increases. Over the three months to July 2005, the trade surplus widened by 27.7% (or \$1.6 billion) in nominal terms<sup>5</sup> when compared to same period a year earlier. Nationally, the trade deficit improved, by \$2.4 billion over the same period, to be in its healthiest position since the three months to August 2002.

In real terms<sup>1</sup>, net exports fell by 2.7% over the June quarter 2005, following two consecutive quarters of increase. Net exports were 2.4% lower over 2004-05 than over 2003-04 in annual average terms, reflecting the most recent and September quarter 2004 falls.

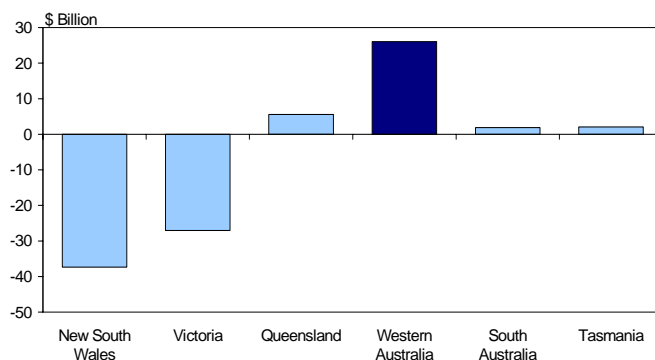
---

<sup>5</sup> Trade data are based on two main sources, both from the ABS. Nominal data on trade values are not adjusted for price effects, although they provides a more timely indication of international trade patterns. Real data (based on ABS' National Accounts chain volume series) lags a few months behind nominal data (in terms of its availability) but provides a better indication of international trade patterns that are not affected by changes in the prices of traded goods.

Latest forecasts in the 2005-06 Budget was for the net export sector to make a modest contribution to growth (increasing by 2.0%) over 2004-05, primarily associated with weaker than anticipated growth in exports combined with stronger than anticipated growth in imports. In 2005-06, however, net exports are expected to strengthen and be a major driver of the economy, growing by a healthy 9.75%.

Western Australia's nominal merchandise trade surplus of \$26.0 billion is the State's largest on record, and compares to a national deficit of \$21.1 billion over the year to July 2005.

MERCHANDISE TRADE BALANCE  
Year to August 2005 Total



### *Exports*

In seasonally adjusted terms, real merchandise exports grew by 3.3% over the June quarter 2005, following two quarters of growth. Real merchandise exports also grew strongly in trend terms during the June quarter (up by 2.6%), which was the highest rate of growth of all States. Despite this, exports grew by a moderate, yet strengthening 3.8% over 2004-05. The gradual increase in exports largely reflects the ramp-up in production from the 4th LNG train on the North West Shelf, which was commissioned in late 2004 and continued expansion of several iron ore mines.

## Exports

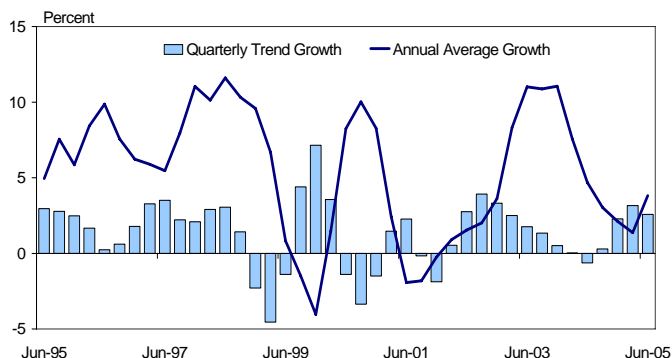
### Real Growth (%)

#### Period to June 2005

	qtr*	yr
NSW	1.5	4.2
Vic	0.8	-0.9
Qld	2.2	6.3
<b>WA</b>	<b>2.6</b>	<b>3.8</b>
SA	0.9	-1.3
Tas	0.0	2.2
<b>Aust</b>	<b>1.7</b>	<b>2.9</b>

\* In trend terms.

### REAL MERCHANDISE EXPORTS Western Australia



The nominal value of Western Australia's merchandise exports grew by 27.4% in the three months to August 2005, compared with the corresponding period a year earlier. This increase was driven by a healthy increase in \$A commodity prices in year-earlier terms (see below) as well as higher volumes. Nationally, the nominal value of merchandise exports increased by 15.3% over the same period.

Reflecting the State's strengthening exports sector, Western Australia accounts for a record 32.2% of Australia's merchandise exports.

### Items Exported

Iron ore exports continue to rise as capacity gradually comes on line in the State's North West. Iron ore exports have been fuelled by sustained demand from China and the subsequent record 71.5% contract price for iron ore, resulting in significant expenditure in the industry. Over the three months to August 2005, the nominal value of iron ore sales rose by \$1.3 billion (or 79.6%) compared to the three months to August 2004. The volume of iron ore exports, which increased by 11.6% over the period also drove, although to a lesser extent, the overall increase in export earnings.

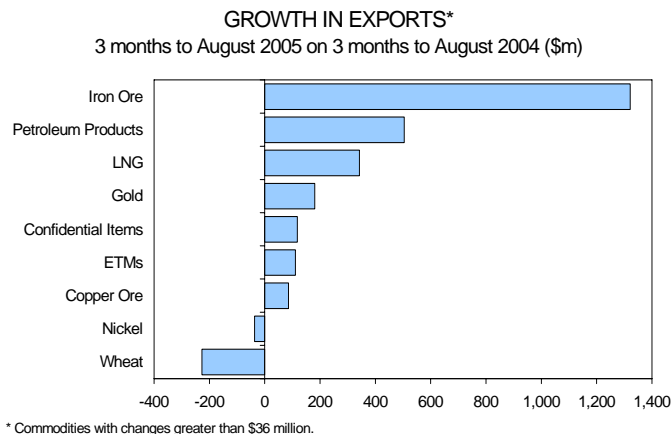
The increase in exports earnings largely reflects the latest contractual agreements with Japanese steel mills, which came into effect on 1 April this year for the Japanese financial year (1 April 2005 to 31 March 2006). For iron ore delivered to Japanese steel mills for this current Japanese financial year, prices are some 71.5% higher than the previous year's price (or around 58% higher for Australian producers, taking currency changes into account).

Limited refining capacity combined with strong underlying market fundamentals (including continuous growth in global crude oil consumption) has seen pressure on the oil price maintained. In addition, supply disruptions have increased the risk premium placed on the global oil price.

Stronger customer demand and increasing capacity (the Mutineer-Exeter oil development came on-line at the end of March) has seen the volume of the State's petroleum exports grow by 14.7% in volume terms over the three months to August 2005, when compared to the same period a year earlier. The nominal value of petroleum exports increased by \$504.2 million (or 40.8%) over the same period.

The Australian Bureau of Agricultural and Resource Economics (ABARE) estimates LNG production from the North West Shelf project increased by 9.3% in the June quarter 2005. Nominal trade data also show that LNG was a sound contributor to growth in exports in value terms over the three months to August 2005. Over the period, the value of LNG exports increased strongly as a result of LNG price increases, by \$342.7 million or 53.6%, when compared to the three months to July 2004.



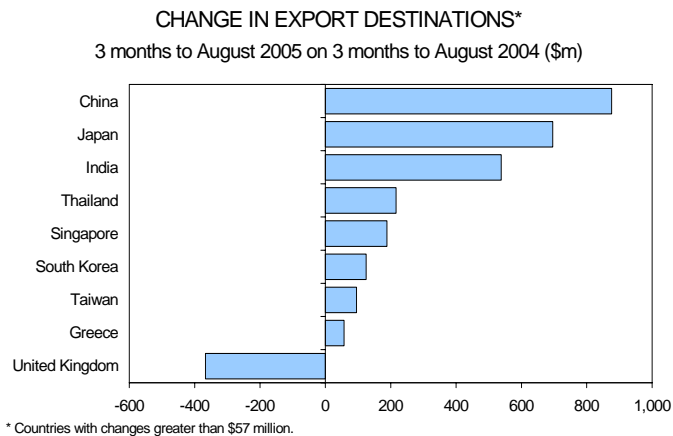


The value of gold exports reversed a previous downward trend to record an increase of \$180.7 million (or 14.8%) over the three months to July 2005. The increase in gold exports is thought to reflect the State's refining operations, which is also evidenced in the value of gold imported (mostly for re-export).

Partly offsetting these gains was a large decline in the value of wheat exports. In the three months to August 2005, the export of wheat fell by \$227.4 million (or 32.4%). This was largely due to a fall in the volume of wheat exports, which were 38.6% lower than the three months to August 2004.

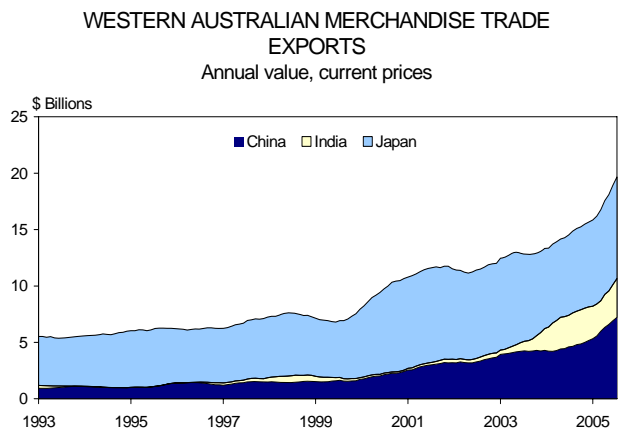
### Export Markets

Western Australia's resource exports to China, Japan and India continue to exhibit remarkable strength. Exports to these three countries alone accounted for 24.0 percentage points (or over 85%) of the 27.4% increase in exports over the three months to August 2005, when compared with the same period a year ago.



Consistent with the experience over the first half of 2005, exports to China grew by the largest amount in absolute terms. Over the three months to August 2005, exports to China rose by \$876.0 million (or 66.4%) in nominal terms compared to the same period a year earlier.

The February 2005 negotiated iron ore price increase, which came into effect on 1 April, is partly responsible for some of this growth. Indeed, iron ore exports to China increased by \$859.9 million, more than doubling over the period. In volume terms too, iron ore exports increased by a very strong 44% over the period, as increasing production and incremental capacity from iron ore companies come on line to service Chinese (and other global) demand.



As economic activity in Japan recovers, exports to Japan (in nominal terms) have made a significant contribution to the growth in Western Australia's exports. Exports to Japan increased by \$698.0 million (or 34.9%) in the three months to August 2005, when compared to the same period a year earlier. In contrast to China, the increase was purely price driven. The value of iron ore exports rose strongly, by \$309.7 million (or 57.9%) over the period. Meanwhile, iron ore exports to Japan fell marginally, by 7.2% in volume terms over the same period.

The export to Japan of confidential items (which include alumina and LNG) recorded a healthy increase in nominal value terms over the three months to August 2005, up \$188.8 million (or 21.4%). Similarly, petroleum exports increased by \$106.1 million over the period.

Over the three months to August 2005, exports to India more than doubled, rising by \$538.2 million when compared to the same period a year earlier. The primary driver of this growth was gold, which was up \$534.1 million. This largely reflects strength in gold jewellery demand in India, as strong economic growth and expectations of a healthy monsoon season increase gold jewellery demand.

In contrast, exports to the United Kingdom declined significantly. Over the three months to July 2005, exports to the United Kingdom fell by \$364.7 million (or 58.9%). This decline is largely the result of reduced gold exports, which fell by \$444.2 million over the period.

### *Imports*

In seasonally adjusted terms, real imports rose by a massive 13.6% in the June quarter 2005 and by 15.7% in annual average terms. The following chart illustrates that growth in imports moderated in annual average terms up until mid-2004, in line with the consolidation of business investment. However, growth in imports has since strengthened as activity in the resource sector and household sector remains buoyant.

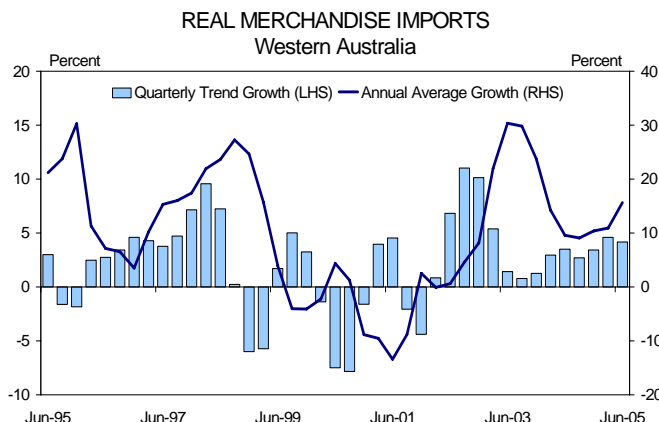
**Imports**

*Real Growth (%)*

*Period to June 2005*

	<i>qtr*</i>	<i>yr</i>
NSW	2.4	14.4
Vic	1.6	10.5
Qld	2.0	15.6
<b>WA</b>	<b>4.2</b>	<b>15.7</b>
SA	-0.3	8.8
Tas	-0.7	-11.5
<b>Aust</b>	<b>1.9</b>	<b>13.8</b>

\* *In trend terms.*

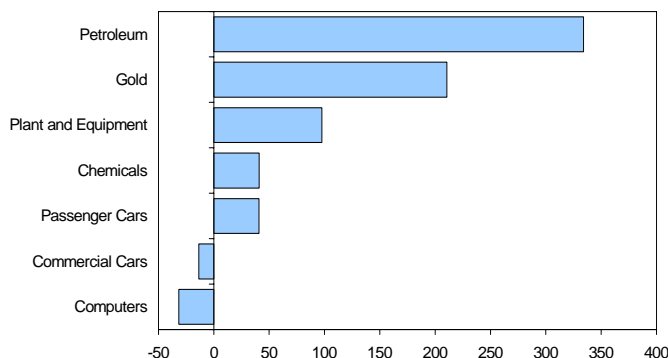


More recent nominal trade data indicate that merchandise imports continue to grow at a solid pace. Over the three months to August 2005, the nominal value of merchandise imports into Western Australia increased by 23.0% (or \$732.0 million) compared to the same period a year earlier.

Not surprisingly given the price of oil, petroleum imports made the largest contribution (almost half) to import growth over the period. Over the three months to August 2005, the value of petroleum imports was 74.3% (or \$334.1 million) higher than the same period a year earlier, and contributed 10.5 percentage points to the overall growth rate in imports of 23.0%. In volume terms, petroleum imports increased by 31.8% over the period.

**GROWTH IN COMMODITY IMPORTS\***

3 months to August 2005 on 3 months to August 2004 (\$m)



\* Commodities with changes of \$13 million or more

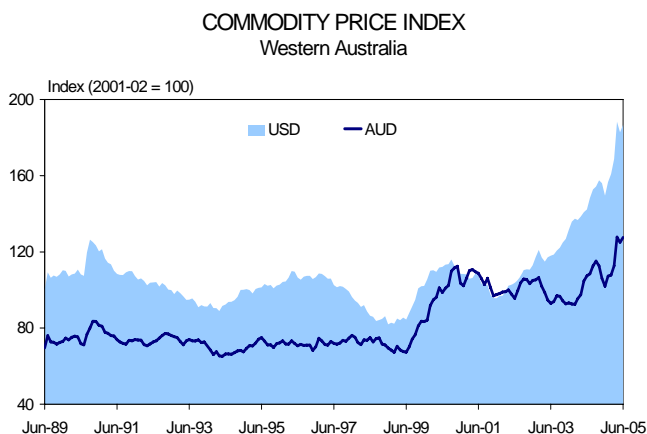
Reflecting the State's gold refining activities, imports of gold increased strongly over the three months to August 2005, up by \$210.7 million (or 46.3%) compared to a year earlier. This is the strongest growth since mid-2003, when the merger of Australian Gold Refineries and Johnson Matthey in the latter half of 2002, transferred gold refining operations from Victoria to Western Australia.

### *Commodity Price Index<sup>6</sup>*

The fixed weight index of transaction prices of Western Australia's major minerals and energy commodities (in both \$US and \$A terms) has reached historical highs. The Western Australian \$US commodity price index rose by 14.7% in the June quarter 2005, to be 32.3% higher than the same period a year earlier.

Iron ore was the major contributor to the rise in the index (accounting for 12.6 percentage points of the total 32.3% increase), with the iron ore contract price (negotiated in February 2005) with Japanese steel mills coming into effect from April 1, the first day of the June quarter 2005.

A spike in oil prices resulted in petroleum making a strong contribution to the increase in the commodity price index (11.6 percentage points). All other non-rural commodities made comparably modest contributions, with nickel (3.5 percentage points) and alumina (1.8 percentage points) accounting for most of the growth.



<sup>6</sup> The Western Australian commodity price index, which is compiled by the Department of Treasury and Finance, is based on a 'basket' of commodity exports, weighted according to the relative value of total commodity production in Western Australia.

In Australian dollar terms, the index strengthened by 16.0% in the June quarter 2005, and was up by 22.8% on the same period a year earlier. The stronger growth in \$A terms over the June quarter 2005 reflects a 2.2% depreciation of the \$A/\$US in the June quarter 2005, while the \$A appreciated by 8.1% against the \$US between the June quarter 2005 and June quarter 2004.

### GROWTH IN COMMODITY PRICES (%)

June quarter 2005 on June quarter 2004

	\$US terms	\$A terms
Nickel	30.8	21.5
Petroleum	45.7	35.2
Alumina	14.5	6.3
Iron Ore	71.5	59.3
Wheat	-8.7	-15.2
Gold	8.6	0.9
LNG	11.4	3.4
Wool	-1.4	-8.4
<b>Total</b>	<b>32.3</b>	<b>22.8</b>

#### Resource Prices

Fuelled by robust steel demand in China, largely in the car and construction industries, Western Australia's iron ore producers have enjoyed healthy price increases (contract prices for iron ore increased by 71.5% on 1 April 2005 from April 2004 levels). In \$A terms, this translates into a 59.3% increase in the iron ore price. As a result, many producers in the State's iron rich Pilbara region are responding to stronger demand and higher prices by investing in expanded capacity.

Most analysts initially expected prices to stay the same, or even retreat, in 2006 and beyond, as supply was increased to meet demand. However, a number of leading analysts have revised upward their forecasts for the next round of contract price negotiations with Japanese steel mills. Most expect modest price growth of between 5% and 10% as tight market conditions prevail.

Notwithstanding an increase in China's domestic iron ore output, growth in demand for iron ore is expected to be increasingly met by imports. China's iron ore imports are forecast to rise by 50 million tonnes by year-end, and by a similar amount in 2006. So strong is China's demand for iron ore that an increasing amount of iron ore imports are reportedly being met by spot tonnages supplied by India. The premium paid on these shipments would have resulted in a higher average price for iron ore imported into China.

As new export capacity comes online in Western Australia and Brazil, any moderation in Chinese iron ore demand should result in a falling market share for the higher priced spot shipments of India. Reflecting this, iron ore exports from Western Australia (and also Brazil) are expected to continue to rise, supporting further price growth into 2006. According to ABARE, the volume of iron ore exported from Australia (and hence Western Australia, given that virtually all of the nation's iron ore is produced in the State) is expected to rise by 17%, and by 60% in value terms in 2005-06.

Increasing global oil consumption, driven mainly by strong growth in oil consumption in the United States and China, has placed some pressure on prices. In addition, supply-side constraints, and in particular spare refining capacity have resulted in a tightening in oil markets. Over the June quarter 2005, the tapis<sup>7</sup> oil price averaged \$US55 per barrel, the highest three-monthly nominal price on record. Comparing the June quarter 2005 with the same period a year earlier, the tapis price was 45.7% higher in \$US terms (35.2% in \$A terms).

---

<sup>7</sup> The Malaysian 'tapis' oil price is one of the major international benchmarks that typically applies to crude oil (with others being West Texas Intermediate, North Sea Brent and Mideast Dubai, for example). The Tapis oil price is commonly used to reference crude oil produced by Australia and other countries in the Asian region.



Recent events such as hurricane Katrina which damaged the port of New Orleans and a number of refineries, as well as hurricane Rita, which hit the oil and gas producing region of the Gulf of Mexico damaging a number of refineries, has raised concerns over potential fuel supply shortages. As refining capacity is already thought to be strained, the near term outlook is for the oil price to remain high, with any potential supply disruptions resulting in upward pressure on oil prices.

ABARE expects the benchmark West Texas Intermediate oil price to be \$US58 a barrel over the remainder of 2005-06. This is up from an initial forecast of \$US45.5 a barrel earlier in the year. Furthermore, these forecasts are presented under the assumption of no further significant supply-side disruptions to oil production. Meanwhile, some other commentators have suggested the peak in the oil price is yet to be seen.

Over the longer term, ABARE notes the distinct possibility that world oil prices could remain relatively high for a number of years. Even so, ABARE expects prices to decline, albeit moderately, over the period to 2010.

Gold prices increased by 8.6% over the June quarter 2005 when compared to the same period a year earlier. Taking into account currency fluctuations, in Australian dollar terms, the gold price was 0.9% higher over the same period.

The safe-haven status of gold, coupled with concerns over inflation stemming from current and forecast high oil prices, is expected to increase demand for gold in the near term. In addition, the world consumption of gold is expected to increase on the back of strong jewellery demand from India, China and the Middle-East as incomes in these markets grow. Together with an expected lesser increase in production and central bank sales, ABARE predicts the world gold price to rise by 5% over 2005.

Looking further forward, ABARE forecasts the world gold price to fall by around 4% in 2006. This reflects that the US dollar is assumed to remain relatively unchanged as the US Federal Reserve continues to increase short-term interest rates to a more neutral level and offset other concerns regarding the United States large twin deficits. Nevertheless, the value of Australia's gold exports are expected to increase by 2% in 2005-06, largely supported by higher export volumes. Gold production in Western Australia should grow strongly, with the ramp-up of production at the Telfer Deeps gold mine and a number of other smaller operations.

Base metal prices have shown remarkable strength recently. After showing signs of moderating earlier in the year, both nickel and alumina prices have subsequently turned up.

The \$US spot price for nickel was 30.8% higher in the June quarter 2005 than in the June quarter 2004, supported by strong growth in stainless steel production and the time taken to bring on additional supply.

ABARE is expecting prices over the remainder of 2005 to be maintained 9% higher than in 2004. While it is expected that growth in nickel demand is forecast to moderate over the rest of the year, weak growth in nickel supply is expected to maintain prices at a high level.

Notwithstanding any supply disruptions, nickel prices are expected to decline by 8% in 2006 as world nickel production expands and exceeds consumption. As a result, Australian export returns are forecast to fall slightly in 2005-06, despite an expected 7% increase in mine production. The commissioning of Western Australia's Maggie Hays (LionOre) and Flying Fox (Western Areas) mines in 2005 and 2006 respectively is predicted to drive this increase. In addition, latest reports are that the Ravensthorpe Nickel development is on track to commence production by mid-2007.

In contrast to ABARE's forecast nickel price moderation, numerous industry representatives believe supply from new mines will be constrained, and enough to keep prices high. BHP expects the nickel market will remain 'balanced to tight in the medium to long term' with predictions of oversupply being exaggerated.

A limited availability of alumina in spot markets, coupled with strong alumina demand from China has resulted in sustained price growth. Over the past two years, the alumina price has grown by 39.3% while the June quarter 2005 price was 5.9% higher than the previous quarter. ABARE attributes much of the price strength in 2005 to production difficulties at a number of Australian and African refineries.

Alumina prices are anticipated to fall by 13% in 2006 as demand for alumina eases and new global refining capacity comes on line.

ABARE has forecast Australia's export earnings to rise marginally in 2005-06, even though a price fall has been forecast on the back of increased export volumes. For Western Australia, the expansion of Pinjarra's alumina refinery is to be completed by year-end, with the Worsely refinery expansion expected soon after in early 2006.

#### Rural Prices

Wheat prices were 8.7% lower in \$US terms in the June quarter 2005 than the same period a year earlier. When taking the appreciation of the \$A into account, wheat prices were around 15.2% lower in \$A terms over the same period.

World wheat prices are estimated by ABARE to rise by around 3% in 2005-06, with world supplies of wheat expected to be lower and wheat demand expected to remain unchanged. However, there exists the possibility of stronger wheat prices if wheat exports from the United States were disrupted following damage to the port of New Orleans, the largest wheat exporting port in the United States. The return on Australian wheat is expected to be 3.5% higher over 2005-06 at around \$A205 a tonne.

The outlook for Australia's wheat industry has improved following above-average rainfall across much of Australia's wheat belt. Even so, the nation's wheat production is forecast to be around 3% lower in 2005-06 than a year earlier.

Even though the seasonal outlook for the agricultural industry has improved in recent months, ABARE anticipates the wool price to follow a downward trend. Given generally poorer conditions previously forecast, Australia's wool production is expected to fall in 2005-06 by 1%. Changing consumer preferences away from woollen apparel is expected to see demand for wool weaken further in the short term. In the June quarter 2005, the wool price fell by 1.4% in \$US terms and by a more substantial 8.4% in Australian dollar terms, compared to the same period a year earlier.

The Australian eastern market indicator (the benchmark for wool prices in Australia) is forecast by ABARE to fall by around 3.8% in 2005-06.

---

## LABOUR MARKET

---

- *Conditions in the Western Australian labour market remain very strong, with almost 50,000 additional employed persons over the year to August 2005.*
- *The State's labour force participation rate continues to break records – Western Australia's participation rate reached 68.2% for the three months to August 2005.*
- *Despite strong labour force participation, unemployment has remained historically low, with the unemployment rate edging 0.1 percentage points lower to average 4.7% for the three months to August 2005.*
- *While employment prospects in Western Australia remain sound, difficulties faced by firms in filling skilled positions may be starting to have a moderating impact on employment growth and labour demand.*

### **Employment**

Employment in Western Australia grew by 1.0% in the three months to August 2005, moderating from the 2.2% growth recorded for the three months to May 2005. Despite slower growth over the three months, this rate of growth was the equal strongest (with Tasmania) of all the States in three monthly terms. Employment growth also moderated in trend terms, down from 1.8% in the three months to May to 1.3% over the three months to August.

In annual average terms, employment in Western Australia grew a very strong 5.1% over the year to August 2005. This is more than double the State's ten-year annual average growth rate (of 2.2%) and represents the highest annual average growth rate recorded for the State since the twelve months to August 1989. Employment growth in Western Australia compares favourably to the national employment growth of 3.3% over the same period. The Western Australian employment growth translates into 49,900 additional employed persons over the year to August and accounts for approximately 16% of national employment growth.

**Employment**

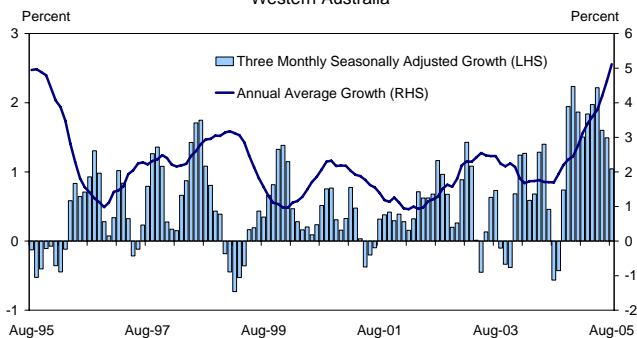
Growth (%)

Period to August 2005

	qtr*	yr
NSW	0.7	1.6
Vic	0.4	3.3
Qld	0.8	5.7
<b>WA</b>	<b>1.0</b>	<b>5.1</b>
SA	0.4	2.4
Tas	1.0	2.9
<b>Aust</b>	<b>0.8</b>	<b>3.3</b>

\* In seasonally adjusted terms

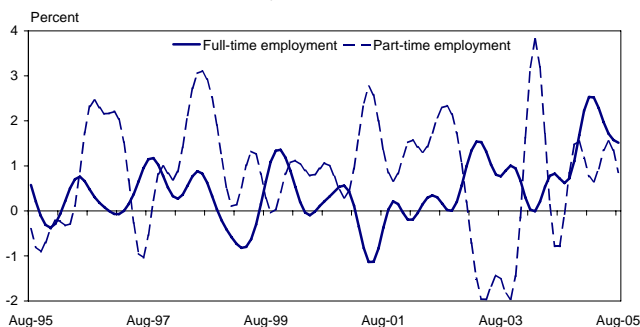
EMPLOYMENT GROWTH  
Western Australia



**Employment by Type and by Industry**

Growth eased in both full-time and part-time employment over the three months to August 2005. Full-time employment grew 1.3% (or 9,500 persons) to an average of 754,300 persons and part-time employment grew only 0.4% (or 1,400 persons) to an average of 303,000 persons. There was also an easing in trend terms, with full-time employment growing 1.5% (down from 2.0% in the three months to May) and part-time employment growing 0.9% (down from 1.4%) over the three months to August 2005.

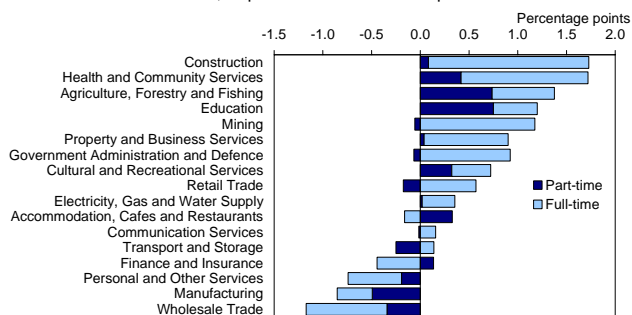
EMPLOYMENT GROWTH BY TYPE  
Three Monthly Trend, Western Australia



Despite the easing in growth over the three months to August, in annual average terms, full-time and part-time employment growth were both very strong over the twelve months to August 2005. Full-time employment grew an impressive 5.3% and part-time employment grew 4.6%. The growth in full-time employment is the highest annual average growth in full-time employment for Western Australia in almost twenty years.

On an industry basis, employment over the year to August 2005 was 7.5% higher than in the year to August 2004. The industries that contributed the most to employment growth were construction (up 20.1%), health and community services (up 18.6%) and agriculture, forestry and fishing (up 30.8%). Employment growth in these, and a number of other industries, over the quarter was more than sufficient to offset some detractors from growth, including the wholesale trade (down 22.3%), manufacturing (down 8.5%) and personal and other services (down 15.4%) industries.

CONTRIBUTION TO EMPLOYMENT GROWTH  
Western Australia, September Qtr 2005 on September Qtr 2004



In annual average terms, the strongest contributors to employment growth over the year to August 2005 were construction (up 15.9%), health and community services (up 8.4%) and property and business services (up 7.0%). The industries for which employment contracted over the year were wholesale trade (down 11.8%), finance and insurance (down 7.0%) and transport (down 3.2%).

### *Unemployment Rate*

Over the three months to August 2005, Western Australia's unemployment rate remained near record lows, falling 0.1 percentage points to an average of

4.7%. Nationally, the three monthly unemployment rate also fell 0.2 percentage points to 5.0%. In trend terms, Western Australia’s unemployment rate was also 4.7% for the three months to August (down from 4.8% for the previous three months).

In annual average terms, Western Australia’s unemployment rate was at a record equalling low of 4.7% for the year to August 2005, down from 5.5% recorded for the year to August 2004. This continued to be the lowest unemployment rate of all the States and remains considerably lower than the national rate of 5.1% over the same period.

Western Australia’s unemployment rate has remained near record low levels despite a continuation of strong labour supply. The growth in the Western Australian labour force over the twelve months to August 2005 (of 4.2%) was surpassed by employment growth (of 5.1%) over the same period, helping ensure Western Australia’s unemployment rates remained low. The average number of unemployed persons over the year to August 2005 was down to 50,500 persons – approximately 6,700 lower than for August 2004.

**Unemployment Rate**

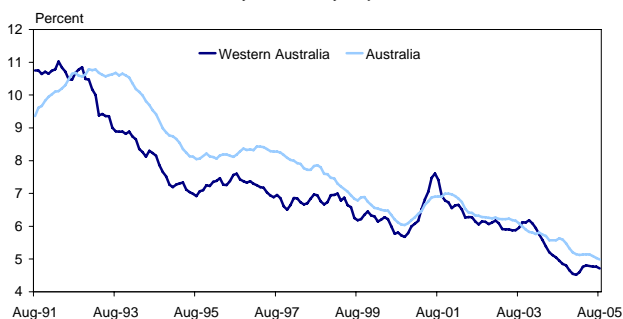
Average rates (%)

Period to August 2005

	<i>qtr*</i>	<i>yr</i>
NSW	4.9	5.2
Vic	5.3	5.5
Qld	5.0	4.9
<b>WA</b>	<b>4.7</b>	<b>4.7</b>
SA	4.8	5.2
Tas	5.8	5.9
<b>Aust</b>	<b>5.0</b>	<b>5.1</b>

\* In seasonally adjusted terms

UNEMPLOYMENT RATE  
Three Monthly Seasonally Adjusted Growth





### Youth Unemployment Rate

The youth employment market was also strong over the twelve months to August 2005, with Western Australia's youth unemployment rate<sup>8</sup> falling 4.5 percentage points to 15.2%. Nationally, the youth unemployment rate fell a more modest 1.4 percentage points to 19.9% over the same period.

### Participation Rate

Western Australia's unemployment rate has remained low despite the State's participation rate continuing to set new records. The State's participation rate for the three months to August 2005 was 68.2% – 0.4 percentage points higher than the three months to May 2005. This is the highest participation rate for Western Australia since the monthly Labour Force data began in 1978, and is higher than all other States. The chart below shows that Western Australia's participation rate remains substantially above the national rate, which was 64.7% for the three months to August 2005 (up 0.2 percentage points from the three months to May 2005).

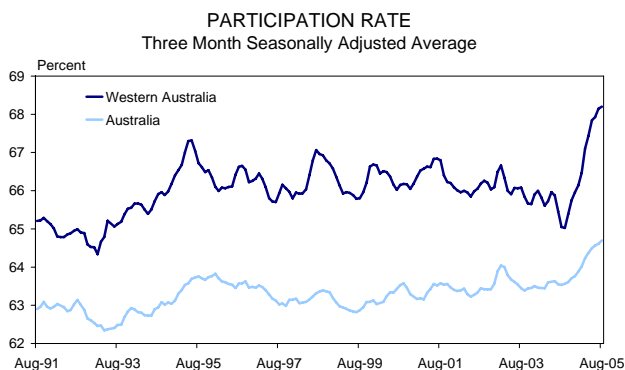
### Participation Rate

Average rates (%)

Period to August 2005

	qtr*	yr
NSW	62.9	62.6
Vic	64.5	64.3
Qld	66.8	66.1
<b>WA</b>	<b>68.2</b>	<b>67.1</b>
SA	62.0	61.8
Tas	59.9	59.4
<b>Aust</b>	<b>64.7</b>	<b>64.2</b>

\* In seasonally adjusted terms

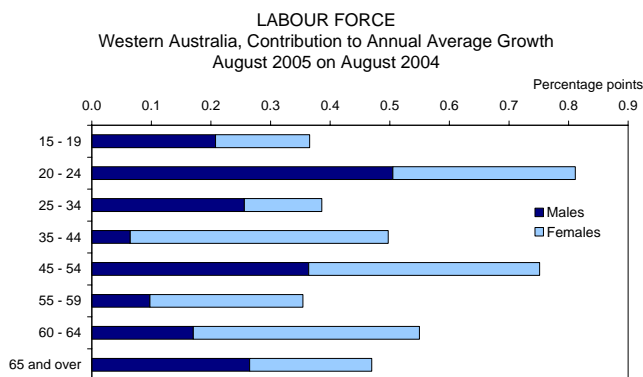


In trend terms, Western Australia's participation rate was 68.3% over the three months to August 2005, up from 67.7% for the three months to May 2005.

<sup>8</sup> The youth unemployment rate is defined as persons aged 15 to 19 years seeking full-time employment as a share of the 15-19 year labour force. Western Australia's youth unemployment rate, like the other Australian jurisdictions, is typically volatile and hence annual average rates are the preferred measure.

In annual average terms, Western Australia's participation rate rose a strong 1.5 percentage points to 67.1% over the year to August 2005. Nationally, the participation rate increased 0.7 percentage points to 64.2% over the same period.

The continued strength in the Western Australian labour force participation is a reflection of the strong economic conditions in Western Australia. The 20-24 year age bracket was the strongest contributor to labour force growth (up 7.5% in annual average terms) over the year to August whilst those aged 65 and over had the strongest growth (up 28.6% in annual average terms - however this group represents only 2.0% of the Western Australian labour force).



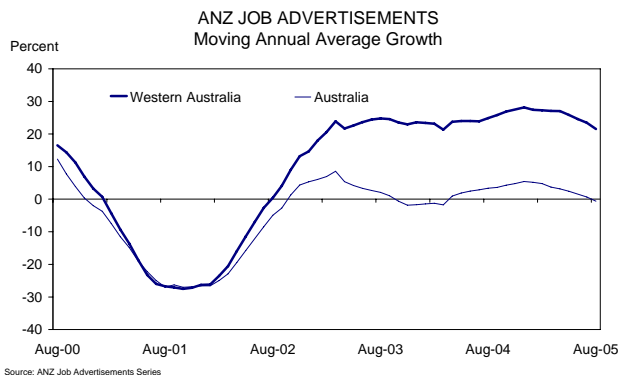
The 4.2% increase in the Western Australian labour force translates to approximately 43,200 persons.

### *Short-term outlook*

Labour demand in Western Australia remains strong according to various business surveys as well as data on job advertisements and skilled vacancies. However, there are signs that labour demand may be moderating somewhat, likely reflecting the difficulty faced by firms in filling skilled positions.

There was a slight fall (of -0.2%) in the number of newspaper job advertisements in Western Australia for the three months to August 2005, according to the ANZ Bank

Newspaper Job Advertisement series<sup>9</sup>. However, in annual average terms, newspaper job advertisements remained strong with growth of 21.5% over the year to August 2005. As the chart below demonstrates, this growth continues to moderate from the high of 28.2% recorded over 2004.



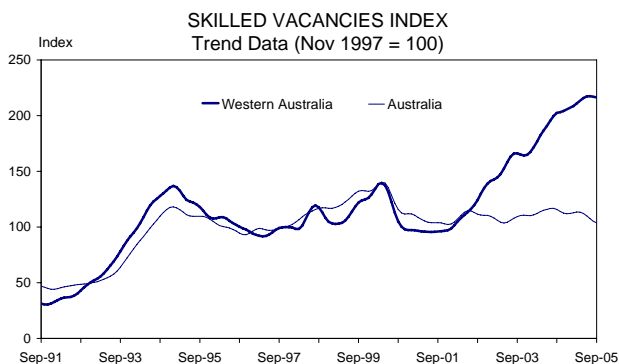
Other surveys such as the Manpower *Employment Outlook Survey* showed that Western Australian employers anticipate a period of active hiring in the December quarter, with a net balance employment outlook of 32%<sup>10</sup>. Similarly the Chamber of Commerce and Industry Western Australia BankWest *Survey of Business Expectations* is reporting that Western Australian employers remain positive about the future, with the recruitment expectations index at 127 (slightly up from 126 for the same time last year but down from 129 and 131 for the September and June quarters respectively). In particular, active hiring is expected to take place in the services and manufacturing sectors over the December quarter, as temporary and part-time positions for the pre-Christmas sales are filled.

<sup>9</sup> The ANZ Bank has recently cautioned that newspaper job advertisements are likely becoming a somewhat less useful indicator of labour demand due to the growing use of Internet job advertisements.

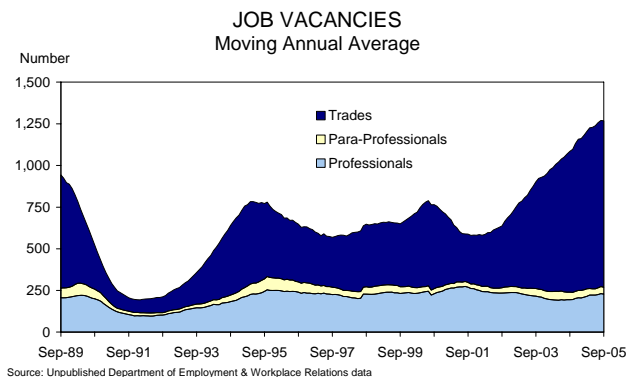
<sup>10</sup> The net balance employment outlook is calculated by subtracting the number of surveyed respondents who expect a decrease in employment in the coming quarter from the number of surveyed respondents who expect an increase.

Although labour demand indicators remaining strong, they do appear to be moderating slightly from their respective highs. This may be a reflection of the difficulties many employers are facing in trying to recruit skilled workers.

The Skilled Vacancies Index for Western Australia, produced by the Department of Employment and Workplace Relations, remains at record highs (continuing to be over double the national index). There may be signs of a softening in the index with the average index for Western Australia over the September quarter 2005 up only 0.7% from the June quarter 2005. Despite this, the index was 8.9% higher than for the September quarter 2004.



As shown in the chart below, skill shortages remain particularly acute in the trades. Vacancies data indicates that the trade industries most heavily impacted by the skills shortages are construction, metal trades and electrical and electronics trades.



Source: Unpublished Department of Employment & Workplace Relations data

Business surveys also indicate labour shortages, with many businesses continuing to report difficulties in finding available labour. The Chamber of Commerce and Industry Western Australia BankWest *Survey of Business Expectations* for September 2005 reported that 63% of respondents considered labour availability to be 'scarce', similar to the June quarter 2005 (62%) and substantially higher than the September quarter 2004 (44%).

The 2005-06 Budget forecast are for employment growth of 2.0% during the year with a corresponding unemployment rate of 4.75%.

**PRICES, INCOMES AND INTEREST RATES**

- Perth consumer prices increased by 1.3% over the June quarter 2005, largely driven by price increases in housing, transportation, food and household furnishing, supplies and services.
- In annual average terms, the CPI for Perth grew by 3.2% in 2004-05, with rising housing costs the major contributor to price pressures.
- Latest wages data indicate that wages grew strongly over 2004-05.
- The Reserve Bank of Australia has left interest rates unchanged since it increased rates by 25 basis points to 5.50% in its March 2005 meeting.

**Prices**

Growth in Perth’s consumer prices accelerated during the June quarter, with the Consumer Price Index (CPI) for Perth increasing by a strong 1.3% (following a 0.8% rise in the March quarter 2005).

In annual terms, prices growth is also strengthening, with prices in Perth growing by 3.8% in year ended terms (or 3.2% higher in annual average terms). This annual average result is higher than the Western Australian 2005-06 Budget forecast of 2.75% growth estimated for 2004-05.

**Consumer Price Index**

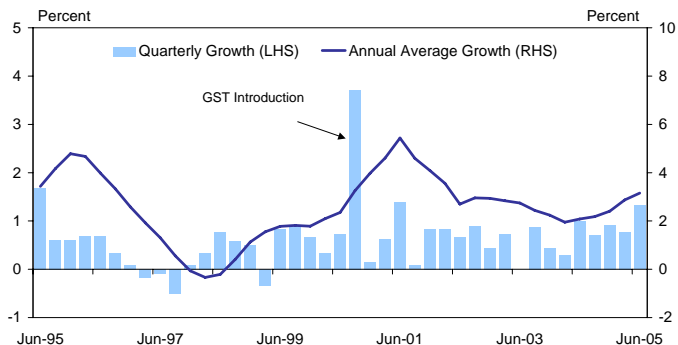
Growth (%)

Period to June 2005

	qtr	yr*
Sydney	0.5	2.5
Melbourne	0.3	2.0
Brisbane	0.5	2.6
<b>Perth</b>	<b>1.3</b>	<b>3.2</b>
Adelaide	0.6	2.3
Hobart	0.5	3.2
<b>Australia</b>	<b>0.6</b>	<b>2.4</b>

\* In annual average terms

CONSUMER PRICE INDEX  
Perth



The major factors underpinning price growth in 2004-05 were housing, transportation, food and household furnishings. Nationally, growth moderated, with the CPI rising by 0.6% in the June quarter, slightly lower than the 0.7% growth recorded in the March quarter 2005. The national inflation outcome for the June quarter was slightly below the median market forecast of 0.8%.

In its August *Statement on Monetary Policy*, the Reserve Bank of Australia (RBA) noted that underlying inflation is likely to increase gradually from its current level over the next year or so. This is partly as a result of fading exchange rate effects which have been holding the inflation rate down during the past couple of years. While an anticipated easing in domestic demand should help moderate domestic price pressures in the medium term, the RBA noted that further tightness in the labour market may act to increase general price pressures.

### Incomes

Over the June quarter 2005, the growth in wages and earnings remained strong. Growth in the Wage Price Index (WPI) and the Average Weekly Ordinary Time Earnings (AWOTE) measures has consistently exceeded the respective long-term quarterly growth rates over the last few quarters. Reflecting this, growth in annual average terms was higher in 2004-05 than in 2003-04. WPI grew by 4.3% in 2004-05, the fastest rate of growth on record. At the same time, growth in AWOTE of 6.0% in 2004-05 was the fastest rate of growth in a financial year since 1995-96.

### Wage Price Index

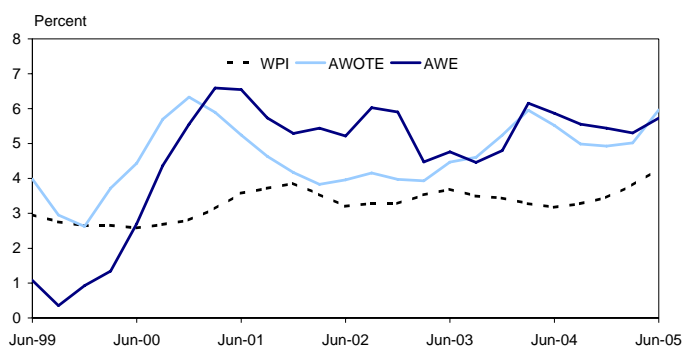
Growth (%)

Period to June 2005

	<i>qtr</i>	<i>yr*</i>
NSW	0.8	3.5
Vic	0.8	3.9
Qld	0.7	3.8
<b>WA</b>	<b>1.0</b>	<b>4.3</b>
SA	0.5	3.5
Tas	0.9	4.1
<b>Aust</b>	<b>0.7</b>	<b>3.8</b>

\* Annual average growth.

WAGES GROWTH  
Annual Average Growth, Western Australia



The WPI is the preferred measure of wages pressures as it is less susceptible to compositional change than earnings measures (i.e. AWOTE and AWE). The Western Australian WPI grew by 1.0% in the June quarter 2005, following growth of 0.9% in the March quarter. This was the fourth consecutive quarter that the WPI has grown faster than its long-term quarterly average growth rate (of 0.8%). Furthermore, this was the strongest rate of quarterly growth of all the States.

Growth in the WPI in Western Australia in the June quarter was underpinned by strong growth in the public sector WPI, which increased by 1.7%. The growth in the public sector WPI was driven by the impact of the Western Australian Public Service General Agreement, which, although arbitrated in February, was outside the reporting period for the March quarter and was included in the June quarter. The arbitrated Public Service General Agreement provided for salary increases of 3.8% in 2004 and 3.6% in 2005.

The national WPI rose by 0.7% in the June quarter, after growing by 1.1% in the previous quarter. Western Australia was the only State to experience faster growth in the June quarter than in the March quarter.

Over 2004-05, the Western Australian WPI grew by 4.3% in annual average terms and was 5.0% higher in the June quarter 2005 than in the June quarter 2004. These constitute the fastest rates of growth since the ABS commenced compiling the series in September 1997. Nationally, the WPI grew by 3.8% in annual average terms, and was 4.1% in year ended terms.



At a national level<sup>11</sup>, growth in the WPI over the June quarter 2005 was strongest in finance and insurance (up 1.5%), mining (up 1.4%) and cultural and recreational services (up 1.3%). Over 2004-05, WPI growth was strongest in education (up 5.3%), construction (up 5.1%) and electricity, gas and water supply (up 4.3%). A similar experience occurred in year-ended terms, with WPI growth strongest in education, construction and government administration and defence. The ABS notes<sup>12</sup> "there appears to be strong demand for skilled labour in both construction and mining with a number of respondents to the survey reporting they are paying additional wage increases to retain quality staff".

This is consistent with anecdotal evidence that the resource boom, and significant investment in resource projects, has resulted in resource companies offering significant wage increases to attract and retain staff. This has been exacerbated by the shortage of skilled labour evident in Western Australia.

AWOTE, which is subject to the influences of change in industry composition of the workforce, increased by 2.2% in the June quarter in Western Australia to be \$1,034.00 per week.

As with the WPI index, AWOTE has grown quite strongly over the last three quarters, with growth in the June quarter the third consecutive quarter that growth has exceeded 2.0%. The last occasion where this occurred was between the June and December quarters of 1990. In trend terms, growth in AWOTE has accelerated over the last six quarters, with trend growth of 0.7% in March quarter 2004 increasing to growth of 2.4% in the June quarter 2004.

Nationally, growth in AWOTE over the June quarter also moderated to be 1.5%, after increasing by 1.8% in the March quarter.

---

<sup>11</sup> State-based wage by industry data is not available.

<sup>12</sup> ABS catalogue 6345.0, June quarter 2005, p. 5

Over 2004-05, AWOTE in Western Australia grew by 6.0%, the fastest rate of financial year growth since 1995-96. Nationally, AWOTE grew by 4.6% over this same period.

Industry data on AWOTE show a slightly different pattern of growth than WPI data. Over 2004-05, earnings growth was strongest in transport and storage (up 9.3%), cultural and recreational services (up 8.3%) and construction (up 6.3%). Earnings growth in the construction sector was also the second fastest in year-ended terms.

AWE in Western Australia grew by a more moderate 0.2% in the June quarter to be \$786.40 per week. This follows strong growth of 2.3% in the March quarter. This measure includes payments such as overtime and bonuses in addition to part-time, casual and junior employees.

Over 2004-05, AWE in Western Australia grew by 5.7%, down slightly from growth of 5.9% in 2003-04. Nationally, AWE also moderated, up by 4.3%, after growing by 4.8% in the previous financial year.

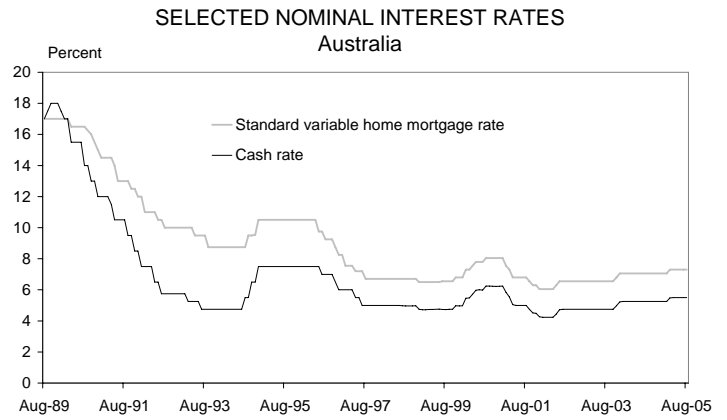
The CCIWA-BankWest *Survey of Business Expectations*, which covers businesses employing approximately 42,600 people, notes that Western Australian businesses have experienced an increase in total unit labour costs, average wages and other labour costs in the September quarter, but are expecting these indicators to decline in the December quarter.

### ***Interest Rates***

The cash rate has remained unchanged at 5.50% since the RBA increased interest rates by 25 basis points in March 2005.

In recent months, the RBA's Board has assessed that the medium-term inflation risks were not as strong as they had been earlier in the year, and as a result, the Board has decided to hold the cash rate unchanged (pending any further information on prices that might prompt a reassessment of the inflation outlook).

Even with the March 2005 increase in the cash rate, interest rates in Australia remain relatively low by historical standards.



Source: Reserve Bank of Australia

---

## INTERNATIONAL CONDITIONS

---

- *The economic and social costs of hurricane Katrina are still being quantified although most forecasters have begun to revise down short-term estimates of economic growth in the US, and indeed for the world economy, as a result of the event.*
- *Despite the devastation caused by hurricane Katrina, the US economy is still expected to grow by 3.5% this year and remain a key driver of world economic growth.*
- *Activity continues to remain strong in China, with the IMF forecasting activity to remain buoyant for several years. Chinese authorities are however still intent on influencing growth in some areas of the economy, most notably restricting investment in real estate while encouraging investment in other areas such as in the energy sector.*
- *While growth prospects for many of Western Australia's trading partners remain relatively upbeat, rising oil prices continue to appear to be a constraint on activity in many countries.*

World GDP growth is expected to remain strong and above long-term averages for the remainder of 2005 and for 2006<sup>13</sup>. The International Monetary Fund (IMF) has indicated that while it will retain its 4.3% world growth forecast for 2005, it had cut its 2006 growth forecast from 4.4% to 4.3% as activity next year is dampened by high oil prices exacerbated by the aftermath of hurricane Katrina. The IMF also indicated that the effects of hurricane Katrina would only have a short-term overall impact on the United States (US) and for other world economies.

Elsewhere, China continues to be a major driver of the pace of world growth with activity in the world's fastest growing major economy likely to be sustained at recent record high rates of growth for several years. While growth prospects are strong for China, there are signs that activity in other major Asian economies is steadily improving. Encouraging remarks from central banks in Japan and South Korea point to the beginning of a recovery phase in both nations - a promising sign for Western Australian exporters.

---

<sup>13</sup> Source: IMF, *World Economic Outlook*, September 2005

Before hurricane Katrina devastated much of the US south coast on 28 August, economic activity in the US was strengthening. Real growth in GDP was around 3.7% over 2004-05 and industrial output was reaching capacity levels. While there is a strong relief response to the natural disaster from the US government to minimise disruptions and displacements in the affected areas, some short term effects from hurricane Katrina - considered to be the costliest natural disaster in US history - are expected.

It is still somewhat early to quantify the broad economic impacts from the hurricane, however the Congressional Budget Office (CBO) has quoted initial estimates of some social and economic costs. The CBO has estimated that the event may cost the economy around 400,000 jobs and reduce economic growth by a percentage point in the second half of the year. Although rattled by the devastation caused by hurricane Katrina, the US economy is resilient and is expected to bounce back from what many commentators expect will be a temporary rough patch. Accordingly, the US economy is still expected to continue to be a major driver of world growth and is expected to grow by 3.5% in 2005 and by 3.3% in 2006.

Damage from the hurricane to oil and natural gas extraction facilities in the Gulf of Mexico has added to price pressures in oil and petroleum markets. The Gulf of Mexico provides about a tenth of all crude oil consumed in America and almost half of the petrol produced in the US comes from refineries in the States along the Gulf's shores. Though pipelines recommenced operations shortly after the hurricane, three weeks on, 40% of the region's natural gas production, and almost 60% of oil output was still shut down.

Concerns about the possibility of future oil price rises and the aftermath of the hurricane itself were thought to be main contributors to a significant fall in US consumer confidence (which fell to its lowest level in thirteen years during September). In other sectors of the economy, data is weak for retail trade and industrial production which were both significantly below market expectations and show modest growth during August.

However, the IMF has indicated that it does not expect a lasting economic impact in the US as a direct result of hurricane Katrina. While the US Federal Reserve has slightly revised down its forecasts of economic activity, rebuilding, once underway, should help energise overall economic activity and the labour market, although this may not have an appreciable effect on the US economy until 2006.

The US Federal Reserve raised interest rates to 3.75% in its September meeting, the eleventh increase in a row. According to the Federal Reserve, "output appeared poised to continue growing at a good pace before the tragic toll of hurricane Katrina". The Federal Reserve also noted that while these unfortunate developments have increased uncertainty about near term economic performance, they "do not pose a more persistent threat".

The recent re-election of the Japanese prime minister, Junichiro Koizumi, has been interpreted by some market commentators as a vote of confidence in the future of the Japanese economy. A range of economic indicators in Japan support the view that the long-awaited Japanese recovery was underway even before the general election was held.

The Japanese economy yielded positive economic news on multiple fronts during the second quarter of 2005, including improvements in employment, land prices, consumer and business confidence as well as consumer spending.

In particular, unemployment in Japan is at its lowest level in seven years with rising wages (which increased 1.1% over 2004-05) having a positive effect on consumer and business confidence. Market expectations are that consumer and capital spending will underpin the economic recovery - the first time since 1991 that a recovery is being fuelled by consumer and capital spending, and not from exports and the public sector.

The governor of the Bank of Japan noted that prospects are good for the country's "battle against deflation". Indeed there have been some preliminary signs that prices have risen in some sectors of the Japanese economy, most notably in the prices for clothing goods and for property in some major cities, including for Tokyo.

Healthy corporate profits and low levels of corporate debt continue to provide encouraging conditions for business investment in Japan, with interest rates close to zero percent. However high oil and materials prices are likely to continue to moderate corporate profit growth in the near term.

Another factor that bodes well for Japan is continuing efforts by the Japanese government to create a positive environment for restructuring, reform and for foreign investment, with one of the most publicised reforms in the lead-up to the Japanese election involving a proposal to privatise the postal system. Progress on this reform is continuing with other reforms, including taxation reforms, changes to the Anti-Monopoly Act and new policies designed to encourage mergers, joint ventures and takeovers well-received by foreign governments, including by Australia, industry associations and investors.

A recent report from the OECD on the Chinese economy, noted that China's average annual growth rate of 9.5% over the past two decades seems likely to continue, extending one of the fastest sustained economic transformations in the world over the past five decades.

The private sector has been the driver of much of that growth and has overtaken the state sector to become the main engine of China's economic boom and the source of most exports and new jobs created. Given that around half of national income is generated in the private sector, many market commentators are now questioning whether the rise of the private sector will undermine the power of China's communist regime.

In any event, economic activity in China is remarkably buoyant and Chinese authorities remain keen to boost household consumption to reduce the economy's reliance on investment and exports.

Although rising incomes are underpinning consumption growth, China's underdeveloped welfare system, the fear of job losses due to continued restructuring of state-owned firms and the still-low levels of rural incomes mean household savings are still quite high.

The Chinese government continues to try to cut back on soaring spending on construction and other capital, warning that excess investment in redundant and ultimately unprofitable projects is straining the country's energy and other resources and could threaten the financial system.

While trying to restrain spending on real estate and some construction projects, the government has been encouraging investments in coal, oil and natural gas and electricity generation as the country grapples with severe energy shortages. Despite the efforts of authorities to rebalance growth in the economy, investment continues to remain at high levels (up 32.1% in the year to August).

Growth in South Korea is expected to steady at around 4% in 2005 (below the government's target growth rate of 5%) and policymakers across a range of ministries in South Korea are in continual discussions of ways to strengthen the sluggish economy. To this end, the South Korean government has planned to introduce countermeasures against population ageing (South Korea has the fastest ageing society of all OPEC nations) and low birth rates (which have fallen to their lowest level in 35 years) while making efforts to improve the quality of human resources and investment environment.

Recent economic data suggest that the South Korean economy is heading into a low growth stage with core elements for economic growth, labour supply and capital spending, floundering. Although the South Korean economy is still emerging from an extended slump in consumer spending, inflation is at a five-year low (up 2.0% in the year to August) and the Bank of Korea has indicated that if the economy continues to expand as expected, it will review monetary policy settings.



The won's appreciation over recent months (which helped to insulate the South Korean economy against rising oil price rises) has shown signs of moderating. South Korea is the world's fourth largest buyer of crude oil, and the country's producers have started to pass costs on to consumers (which may act to dampen the recovery in household consumption and place upward pressure on general prices).

The UK economy continues to recover and is expected to grow by 2.6% in 2005. The pace of growth in the economy continues to be constrained by rising oil prices, slowing consumer spending and faltering industrial production.

The Bank of England trimmed its benchmark rate by 25 basis points in early August to help revive UK's economy, which grew at its slowest annual rate in more than three years in the June quarter. The Bank of England left rates unchanged at 4.5% in its September meeting as soaring oil prices drove inflation to an eight-year high, with most investors not expecting any rate reductions for the remainder of this year.

Record oil prices are continuing to threaten economic activity in the European Union (EU). Recent remarks by the European Central Bank warn that rises in oil prices could lead to higher wage and price demands and, as a result, could raise the inflation rate in the euro-zone (which at 1.3% in the year to August, is still low by historical levels).

The OECD expects GDP growth in the EU to be 1.3% in 2005 (revised up from a forecast of 1.2% in May), as consumption and employment are improving. However the EU still faces considerable competition from China in many markets and for its part, the EU has recently experienced first hand the effects of China's economic strength with the 25-nation bloc recently engaged in difficult talks with Chinese officials over Chinese exports (particularly for textiles) to the EU.

The outlook for growth in most Association of South East Asian Nations (ASEAN) trading partners remains positive for the remainder of 2005, with growth in Singapore, Indonesia, Malaysia and Thailand in particular, expected to remain healthy, despite the expectation that high oil prices will continue to moderate growth.

## 2. 2004-05 GOVERNMENT FINANCIAL RESULTS REPORT

This article summarises the major features and financial aggregates presented in the 2004-05 *Government Financial Results Report* (Results Report), released on 21 September 2005.

The Results Report is a statutory requirement of the *Government Financial Responsibility Act 2000*, and is in the same format as the State's budget presentations, enabling comparisons to be made between the financial projections contained in the original budget, in this case, the 2004-05 Budget presented on 6 May 2004.

### *Financial Results*

The State recorded its strongest financial results on record in 2004-05, with the highest operating surplus and lowest net debt outcomes ever recorded. The key financial aggregates are summarised in the following table.

#### KEY BUDGET AGGREGATES Western Australia

	2003-04		2004-05		Variation on Budget (c) - (a)
	Actual	Budget Estimate (a)	Estimated Outturn (b)	Actual (c)	
<b>GENERAL GOVERNMENT</b>					
Revenue (\$m)	12,753	12,719	13,789	14,222	1,503
Expenses (\$m)	11,954	12,477	13,158	12,982	506
<b>Net Operating Balance (\$m)</b>	<b>799</b>	<b>243</b>	<b>631</b>	<b>1,240</b>	<b>997</b>
<b>TOTAL NON-FINANCIAL PUBLIC SECTOR</b>					
Net Debt to Revenue Ratio (%)	28.4	39.6	32.5	25.2	-14.4
<b>TOTAL PUBLIC SECTOR</b>					
Net Debt at 30 June (\$m)	4,194	5,930	5,167	4,001 <sup>(1)</sup>	-1,929
Capital Works Program (\$m)	3,285	3,917	4,514	4,136 <sup>(1)</sup>	219

(1) Preliminary outcome for the Capital Works Program. The final audited outcome will be published in the 2005-06 mid-year review.

A general government operating surplus<sup>14</sup> of \$1,240 million was recorded for 2004-05, compared with the original budget estimate of \$243 million. This outcome is \$441 million higher than the \$799 million surplus achieved in 2003-04.

The better than expected surplus in 2004-05 largely reflects the revenue impact of strong growth in the Western Australian economy (particularly the property market), higher than forecast GST grants, and higher than expected prices and volumes for key commodities such as oil and iron ore.

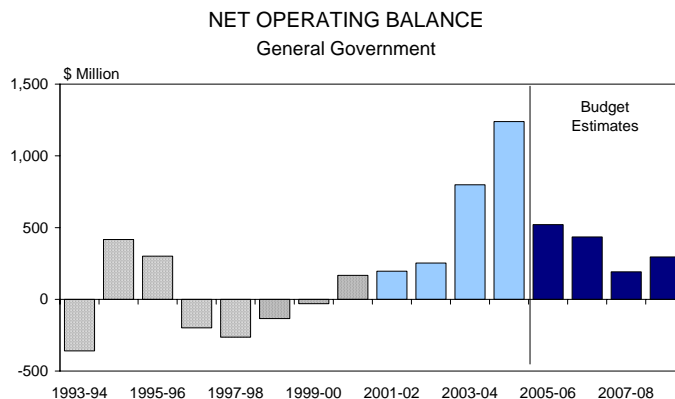
Relative to the original budget, revenue was \$1,503 million higher than expected, and incorporated an extension of the 2004-05 Budget tax relief measures with further reform announced in October 2004.

Expenses were \$506 million higher than originally budgeted, with \$468 million (or 93%) attributable to policy decisions taken by the Government throughout the year. Importantly, many of these expense initiatives were of a one-off nature or had short-term financial impacts and do not represent permanent increases in base spending into the forward estimates.

The operating surplus recorded for 2004-05 is the fourth consecutive budget surplus for the current Government (see chart below). These positive surplus outcomes have been largely applied to reducing public sector debt and investing in essential social and economic infrastructure.

---

<sup>14</sup> Western Australia's headline budget measure is the general government net operating balance, which measures the difference between revenue earned in a financial year (from taxes, royalties, Commonwealth grants, etc.) and expenses incurred in that year (on salaries, grants to the community, etc.).



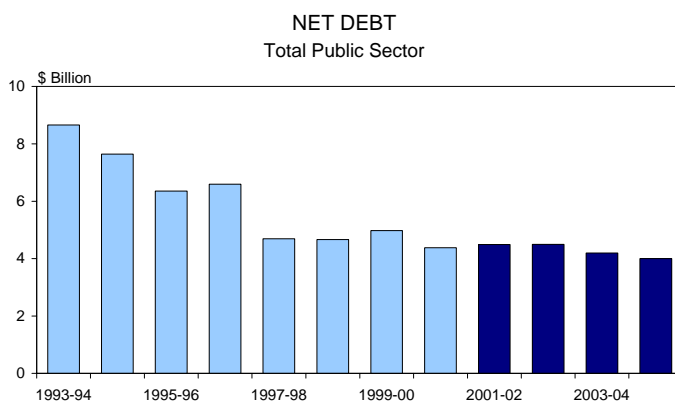
The public sector's Capital Works Program totalled an estimated \$4.1 billion in 2004-05<sup>15</sup>, up from the original budget estimate of \$3.9 billion, and the 2003-04 Capital Works Program (\$3.3 billion). Projects completed or in progress during the year included:

- investment in regional (Geraldton and Moora) and outer metropolitan (Swan Districts and Rockingham/Kwinana) hospitals, upgrades to emergency departments, the purchase of Kaleeya and Galliers private hospitals to increase public sector bed capacity, and the purchase of new medical equipment;
- construction of new and replacement primary schools as well as refurbishment and upgrades of existing schools and TAFE college infrastructure;
- law and order-related projects, such as the Albany Justice Complex, additional prisoner accommodation, improvements to Court security, and work on a number of new police facilities including District Police Complexes in Albany and Broome;
- improvements in the quality and reliability of electricity supply in both regional and metropolitan areas, with new transmission works, capacity enhancement and the replacement of ageing assets within the distribution network;

<sup>15</sup> Preliminary outcome for the Capital Works Program. The final outcome will be published in the 2005-06 mid-year review

- completion of the Northern Suburbs Railway extension and progress on the infrastructure works for the Southern Suburbs Railway, including underground works in the Perth central business district and bridge and road works along the Kwinana Freeway;
- capacity-related works at various regional ports and the construction of the North Quay Rail Loop and Rail Terminal at Fremantle;
- road construction and maintenance, including the extension of Roe Highway to Kwinana Freeway, Tonkin Highway to Thomas Road, the Mitchell Freeway to Burns Beach Road and the construction of the Geraldton Southern Transport Corridor; and
- the ongoing Infill Sewerage Program, the Kalgoorlie Pipeline, securing water supply to Perth and country areas, work on the Burrup Peninsula to serve new industrial developments, the Kwinana wastewater re-use plant, and initial work on the Perth Seawater Desalination Project.

A consequence of the larger than expected operating surplus outlined earlier is that new borrowings to fund the Capital Works Program were minimised through the year. As such, total public sector net debt at 30 June 2005, at \$4.0 billion, was at a record low. Around \$870 million in new debt was used in support of the Capital Works Program, accounting for approximately 21% of the program's funding in 2004-05.



The Government applied \$562 million of the 2004-05 surplus to the repayment of borrowings following the stronger outcomes for 2004-05, with \$318 million in outstanding rail freight borrowings, and \$244 million in centrally held debt repaid during August and September 2005. Together with the \$481 million in early debt retirement made following the 2003-04 result, over \$1.0 billion worth of debt has been repaid from surplus funds over the past year, with around \$70 million in interest costs saved annually as a result, increasing budget flexibility.

Remaining surplus funds have been allocated to the recently announced \$890 million increase in health infrastructure spending plans over the medium term.

### *Financial Targets*

The Government's financial targets as expressed in the 2004-05 Budget<sup>16</sup> were to:

- maintain or increase the net worth of the total public sector;
- achieve an operating surplus for the general government sector;
- maintain Western Australia's tax competitiveness, as measured by interstate taxation revenue per capita ranking; and
- retain Western Australia's triple-A credit rating, represented by the following two specific targets:
  - maintain the net debt to revenue ratio for the total non-financial public sector at or below 47%; and
  - ensure that real per capita expenses for the general government sector do not increase.

The financial results for 2004-05 are consistent with the financial targets presented in the 2004-05 Budget, with the exception of the real per capita general government expenses target.

---

<sup>16</sup> In the 2005-06 Budget, the targets were subject to minor technical amendments to make them more useful tools for measure of government policy. Further details are available in the 2005-06 Budget Papers.

In 2004-05, expenses grew by 8.6%, mainly reflecting Government policy decisions through the year (as noted above). These decisions were taken in the context of the higher capacity afforded by the stronger than expected revenue outcome, and in many cases were for one-off or short-term initiatives.

These outcomes were noted by Standard and Poor's in its 4 October 2005 confirmation of the State's triple-A credit rating assessment.

Full details of the State's financial results for 2004-05, including detailed supporting commentary, can be found online at [www.dtf.wa.gov.au](http://www.dtf.wa.gov.au).



### 3. COMPETITION IN WESTERN AUSTRALIA'S FOOD MARKET

Competition policy promotes free and fair trade for the benefit of consumers, business and the community. Its application to the food industry is an issue of particular importance, as the derived benefits impact directly upon all of society. Conversely the damage can be excessive if businesses engage in anti-competitive practices or misuse their market power. Consequently, the issue of competition in the production and marketing of foodstuffs is an emotive subject with widely expressed views and anecdotes.

The issue of increased presence in the Western Australian grocery market of major grocery retail chains was raised in the Western Australian Parliament in June 2005. Concerns regarding this matter lead to the Economics and Industry Standing Committee's 'Inquiry into the Production and Marketing of Foodstuffs'.

This article provides an overview of issues considered in the Department of Treasury and Finance's submission to this Parliamentary inquiry.

#### *Competition in the Grocery Retail Sector*

The Western Australian grocery market is characterised by a relatively small market and large distances. The outcome is that increased economies of scale enable retailers to deliver grocery items to consumers in a more efficient manner. This can lead to a high level of concentration in the grocery retail market which, if operating in the context of a competitive environment, can be beneficial to the economy as cost savings in logistics and inventory investment are passed on to consumers. This will be the case unless market power exists and is misused.

Market power relates to the power held by a firm to affect product prices and subdue competitors. *The Trade Practices Act 1974 (TPA)* does not prevent firms from acquiring market power, however section 46 of the TPA does seek to prevent exploitation of market power to the detriment of competition in the market.

In the retail grocery market many small retailers maintain that if they are not protected from competition imposed by the major retailers, a market oligopoly will result. To date these claims have not been demonstrated in any independent rigorous analysis of the relevant markets. However, the Whitehall Associates (2004) report on 'Price Determination in the Australian Food Industry,' found that:

*"There is a highly competitive and contested retail food market in Australia...the intense competition for market share between the grocery retail majors, and between majors and independents and over 30,000 specialty food businesses is a major benefit to Australian consumers in terms of price, convenience, range and choice."*

The Whitehall Report also noted that a highly competitive retail sector has resulted in a low margin grocery sector. For major retailers in the Australian market earnings margins average only 3-4 per cent after coverage of the costs of doing business, which is estimated by major retailers in Australia to be approximately 23 per cent of product prices. Target product margins are therefore in the order of 26-27 per cent across the retail product range, but tend to be higher for fresh produce. The existence of low earnings margins and the absence of super-normal profits are likely to indicate that the market is operating efficiently.

The Dawson Review released by the Commonwealth Treasurer in April 2003 noted complaints against market dominance are often not about reduced competition, but about the structure of the market that competition has produced. Although high market shares may be associated with market dominance, it is not necessarily the case that market concentration is evidence of market dominance. Concentrated markets can be highly competitive and, importantly, competition policy should be about protecting the competitive process not any particular market structure or category of business.

It is estimated that Woolworths and industry number two, Coles-Myer, have a combined share of about 77 per cent of the Australia-wide retail grocery market. Metcash with its Independent Grocers Association (IGA) network make up the balance. By world standards this is relatively concentrated, for example the five largest food retailers account for 80 per cent of total retail food sales in France, 64 per cent in the United Kingdom, 62 per cent in Germany, 58 per cent in Spain and only 32 per cent in the United States.

Whether a market can be determined to be over concentrated is dependent upon the specifics of each market. In Australia the geographic distribution of the population may warrant a higher level of concentration in order to achieve economies of scale. When compared to the United States, the retail grocery market in Australia experiences higher costs of doing business and lower earnings margins. This is likely to be due to higher transport costs in Australia, as well as the dispersion of the market resulting in higher overheads relative to turnover. Cost savings that can be achieved through economies of scale will be passed on to consumers if there is effective competition in the market. Increased market concentration may therefore reflect realization of efficiency gains.

Again it needs to be recognised that higher concentration in the food retail market does not necessarily inhibit competition and action taken to alter the market structure may reduce competition and impact adversely upon consumers.

### *Competition in Food Production and Wholesaling Sectors*

Deregulation of many of the grower industries in Australia has changed the nature of the relationships between producers, processors and retailers. Open competition is replacing market controls. Primary producers are now often required to undertake the task of negotiating their own selling price and other terms of trade, instead of observing a set market price. At the same time, primary producers in many industries are facing increasing consolidation in upstream markets. This situation raises the issue of 'buyer power,' which occurs when a firm or group of firms obtains from producers and suppliers more favourable terms in purchasing supplies than those that would be expected under normal competitive conditions.

If the concentrated market position of the major food retail chains provides them with buyer power, possible risks include:

- suppliers charging higher prices to other buyers to subsidise the lower prices to the two major supermarket chains;
- raised barriers to entry in the retail sector reducing the likelihood of new entrants;
- independent grocery retailers exiting the industry due to an inability to compete on a price level, thereby pushing the independent sector below the critical mass needed to sustain a viable competitive force; and
- reduced vigour of the competitive process in the retail sector and a higher likelihood of parallel conduct or tacit collusion involving those remaining in the industry.

However, the Whitehall Report found that although a high level of industry concentration in the food retail sector provides retail chains with more bargaining power in supply negotiations, there was no evidence of an abuse of market power to the detriment of food product suppliers.

The Australian Competition and Consumer Commission's (ACCC) (2002) report to the Senate on 'Prices Paid for Wholesale Groceries by Major Retail Chains and Independent Wholesalers' also found that suppliers in the Australian grocery industry do not favour any single buyer and that the market does not appear to exhibit anti-competitive conduct. Although major retailers may obtain better wholesale prices more often than the independent wholesalers, they generally do not receive better terms. Price discounts are related to volumes, settlement terms, wastage and promotion of a suppliers' product at the retail outlet. This indicates the market at work with suppliers varying their deals where they achieved best performance for the terms paid, whether the buyers were independent wholesalers or major chain retailers.

### ***The Trade Practices Act's Mechanisms to Restrict Market Dominance***

The objective of the TPA is to enhance the welfare of Australians through the promotion of competition and fair-trading and provisions for consumer protection. The competition laws are contained in Part IV of the TPA. Specifically, section 46 of the TPA prohibits corporations with a substantial degree of market power from taking advantage of that power and section 50 provides that a merger or acquisition is illegal if it is likely to have the effect of substantially lessening competition in the market. Part VII provides for the authorisation of otherwise prohibited conduct, such as collective bargaining, when that conduct is justified in the public interest.

The importance of the TPA is in protecting the competitive process, not in protecting competitors (large or small) against competitive behaviour. Appropriately the TPA is not concerned with the size of a firm per se, but it is concerned with any exploitation of market power that may be derived from a firm's size or position in the market.

The possibility of buyer power being exploited in the food wholesale market is more likely to occur in industries where major retail chains are purchasing from smaller market participants. However, section 51AC of the TPA makes it illegal for a firm to act in an unconscionable manner when acquiring goods or services from a small business. When determining whether a purchaser has acted in an unconscionable manner a court may have regard to:

- the relative strengths of the bargaining positions of the acquirer and the supplier;
- whether the supplier was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the acquirer;
- whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the small business supplier; and
- the amount for which, and the circumstances in which, the small business supplier could have supplied identical or equivalent goods or services to a person other than the acquirer.

Therefore the legislation provides a mechanism to prevent large retail chains from exploiting their buyer power against small business producers and suppliers.

Smaller producers can also strengthen their market position by engaging in collective bargaining, if it can be demonstrated that such an arrangement is in the public interest. The TPA allows the ACCC to grant immunity on public benefit grounds from the application of most competition provisions of the TPA, including those relating to collective bargaining. These countervailing power and unconscionable conduct provisions of the TPA, serve to prevent the exploitation of buyer power by major retail chains.

The Prime Minister initiated on 15 October 2001 a review of the competition provisions of the TPA. The findings of this review (known as the Dawson Review) were published in April 2003. Following the Commonwealth's consideration and endorsement of a number of the review recommendations, the Trade Practices Legislation Amendment Bill (No. 1) 2005 was passed by the House of Representatives on 10 March 2005. While the Bill dealt with a range of matters, those targeted for special attention were collective bargaining and third-line forcing amendments, as well as changes to merger authorisation procedures.

As part of the Commonwealth's continued legislative review process the Senate Economics References Committee published in March 2004 its 'Inquiry into the Effectiveness of the TPA in Protecting Small Business.' According to the Committee, the Act should:

*"protect businesses (large or small) against anticompetitive conduct, and it should not be amended to protect competitors against competitive conduct."*

The recommendations of this inquiry led to the drafting of the Trade Practices Legislation Amendment (Small Business Protection) Bill 2005. Proposed amendments to the TPA broadened the scope of section 46 (which prevents the misuse of market power) such that:

- a corporation with substantial market power need not take advantage of that power in the same market as that in which the substantial market power accrued, in order to breach section 46;
- for the purposes of determining the degree of power that a corporation has in a market the court may have regard to any market power that results from actual or proposed contracts, arrangements or understandings the corporation may have with other parties as well as covenants and proposed covenants by which the corporation is bound or benefits from;
- in considering whether or not a corporation has misused market power the court may have regard to:
  - whether the corporation was selling relevant goods or services at a price that was below cost;

- whether a corporation has a reasonable prospect or expectation of recoupment (of losses it suffered by selling the relevant goods or services at a price that was below cost).

By making it easier to establish whether a misuse of market power has occurred, the proposed changes to the TPA will strengthen protections against anti-competitive conduct.

### ***The Role of the ACCC in Restricting Market Dominance.***

The ACCC is the body responsible for administering the TPA. Under the TPA the ACCC reviews mergers and acquisitions of all sizes and in all sectors of the economy to determine whether they would likely result in a breach of section 50, which prohibits mergers and acquisitions that are likely to substantially lessen competition. Section 155 of the TPA empowers the ACCC to compel parties to provide documents and other evidence relevant to investigations into possible contraventions of the Act.

Following the outcome of an investigation, if the ACCC forms a view that no breach is likely to result from a merger or acquisition the ACCC gives the parties informal clearance. In the event the parties proceed with an undertaking that has been opposed, the ACCC would commence proceedings in the Federal Court of Australia seeking orders to prevent the merger or acquisition.

### ***Conclusion***

It must be recognised that increased market concentration does not in itself establish the existence of anti-competitive conduct. Reaping economies of scale is an effective business strategy, which generally provides benefits to consumers through lower prices and stimulates the economy. Of greater risk perhaps, is that concern over market concentration leads to pressure for specific interests to act in a manner that lessens competition to the detriment of Western Australian consumers and the local economy.

Available evidence suggests that:

- the retail grocery market in Western Australia is not subject to misuse of market power by major food retail chains; and



- the wholesale grocery market in Western Australia is operating under effective competition, and producers and suppliers are not subject to unconscionable conducted by major buyers.

If a problem of market power was to develop suitable means are available to address the issue as:

- through the TPA the ACCC has the power to assess and prohibit market power misuse;
- the TPA has recently been strengthened to further ensure that the competitive process is protected;
- countervailing market power can be sanctioned by the ACCC; and
- the ACCC continues to monitor the impact mergers and acquisitions will have on effective competition in the market.

Nonetheless, it is important to ensure that increased concentration in the food industry does not prevent the operation of effective competition, and the potential for misuse of market power by major retail chains continues to be monitored through existing mechanisms.

## APPENDIX 1.

## WESTERN AUSTRALIAN EXPORTS BY COMMODITY

	Sep-04	Oct-04	Nov-04	Dec-04	Jan-05	Feb-05	Mar-05	Apr-05	May-05	Jun-05	Jul-05	Aug-05
	\$ Million											
Gold	506.3	448.7	503.8	536.4	533.2	443.8	365.0	431.0	651.0	340.8	501.3	559.5
Iron Ore	559.2	555.2	526.7	601.3	585.6	488.0	620.7	895.0	984.8	986.3	1,021.3	971.3
ETMs	172.2	188.5	176.3	154.9	128.7	144.8	165.3	285.9	198.7	212.0	161.1	236.9
Wheat	184.8	140.1	165.9	148.8	148.3	159.8	129.1	99.9	72.3	115.3	121.7	112.9
Petroleum	472.7	504.7	512.3	348.5	454.4	372.5	528.7	540.4	525.8	493.5	678.4	567.2
LNG	256.8	292.3	304.0	307.7	278.5	217.5	276.8	294.3	308.8	268.4	340.7	335.0
Nickel	84.9	116.1	133.3	96.1	114.7	87.9	125.5	120.6	57.2	82.6	94.1	74.5
Wool	47.1	47.1	40.6	44.4	19.8	40.2	47.8	40.2	54.6	38.3	34.5	29.1
Crustaceans	7.2	7.5	6.8	49.4	36.5	25.8	36.5	49.4	44.1	37.5	30.5	13.9
Live Animals	38.0	46.6	26.7	40.0	40.3	23.6	23.4	29.2	19.3	19.8	22.9	47.1
Confidential Items	564.8	574.2	528.9	653.4	561.8	712.4	615.7	659.8	621.8	649.7	595.1	667.2
<b>All Commodities</b>	<b>3,127.0</b>	<b>3,141.0</b>	<b>3,110.0</b>	<b>3,257.0</b>	<b>3,098.0</b>	<b>2,943.0</b>	<b>3,185.0</b>	<b>3,722.0</b>	<b>3,824.0</b>	<b>3,463.0</b>	<b>3,856.0</b>	<b>3,842.0</b>

Source: Australian Bureau of Statistics, unpublished data.

## APPENDIX 2.

## WESTERN AUSTRALIAN EXPORTS BY DESTINATION

	Sep-04	Oct-04	Nov-04	Dec-04	Jan-05	Feb-05	Mar-05	Apr-05	May-05	Jun-05	Jul-05	Aug-05
	\$ Million											
Singapore	149.0	94.0	101.0	107.0	97.0	123.0	156.0	95.0	171.0	141.0	198.2	142.0
Indonesia	107.1	109.4	40.8	75.4	142.2	87.8	114.3	76.4	119.4	138.5	101.4	118.8
Malaysia	27.0	34.3	22.2	26.7	59.7	12.1	26.1	21.1	19.8	41.3	26.9	25.1
Thailand	68.0	162.0	157.0	241.0	243.0	265.6	161.0	99.0	106.0	116.0	65.2	231.0
Philippines	5.3	10.3	10.4	4.6	4.5	9.0	5.2	9.2	5.5	5.5	3.5	6.2
<b>South East Asia</b>	<b>356.4</b>	<b>410.0</b>	<b>331.4</b>	<b>454.7</b>	<b>546.4</b>	<b>497.5</b>	<b>462.6</b>	<b>300.7</b>	<b>421.7</b>	<b>442.3</b>	<b>395.2</b>	<b>523.1</b>
South Korea	253.0	276.0	262.0	254.0	259.0	147.1	224.0	366.0	336.0	208.0	460.6	290.0
China	437.0	490.0	451.0	560.0	443.0	445.2	668.0	777.0	744.0	714.0	736.0	745.0
Taiwan	91.0	71.0	55.0	113.0	65.0	73.1	131.0	182.0	80.0	96.0	92.1	100.0
Hong Kong	18.0	38.0	12.0	18.0	27.0	17.7	22.0	14.0	17.0	13.0	18.8	12.0
<b>North East Asia</b>	<b>776.0</b>	<b>966.0</b>	<b>882.0</b>	<b>1,073.0</b>	<b>972.0</b>	<b>876.0</b>	<b>1,075.0</b>	<b>1,256.0</b>	<b>1,203.0</b>	<b>1,051.0</b>	<b>1,281.0</b>	<b>1,278.0</b>
Japan	728.0	627.0	591.0	685.0	672.0	612.0	699.0	828.0	872.0	814.0	965.0	920.0
United States	129.0	147.0	238.0	136.0	52.0	89.9	84.0	115.0	120.0	200.0	64.1	106.0
United Kingdom	212.0	236.0	118.0	64.0	36.0	67.8	64.0	84.0	69.0	72.0	85.3	97.0
Germany	18.0	10.0	6.0	7.0	7.0	5.8	8.0	6.0	10.0	4.0	4.2	7.0
Canada	93.1	29.6	113.0	79.0	34.3	96.0	79.2	80.9	33.8	92.6	102.9	6.0
France	7.1	19.4	25.7	12.3	20.6	16.2	5.1	25.9	19.0	20.5	15.1	13.4
Italy	28.3	18.3	15.6	9.5	20.7	33.7	12.8	17.7	30.3	17.5	22.7	8.9
<b>Group of Seven</b>	<b>1,215.6</b>	<b>1,087.3</b>	<b>1,107.3</b>	<b>992.8</b>	<b>842.5</b>	<b>921.9</b>	<b>952.1</b>	<b>1,157.5</b>	<b>1,154.0</b>	<b>1,220.5</b>	<b>1,258.7</b>	<b>1,158.3</b>
<b>All Destinations</b>	<b>3,127.0</b>	<b>3,141.0</b>	<b>3,110.0</b>	<b>3,257.0</b>	<b>3,098.0</b>	<b>2,949.0</b>	<b>3,199.0</b>	<b>3,719.0</b>	<b>3,836.0</b>	<b>3,467.0</b>	<b>3,890.0</b>	<b>3,842.0</b>

Source: Australian Bureau of Statistics, unpublished data.

---

## GLOSSARY

---

**Consumer Price Index:** An index of the price of a basket of goods purchased by the average household for consumption. It is a subset of the GSP deflator.

**Dwelling Investment:** This consists of three components, which are new dwelling investment, alterations and additions and ownership transfer costs.

**Gross State Product (GSP):** The total output of an economy. It includes expenditure in Western Australia on State final demand plus net expenditures (i.e. exports less imports) from interstate and overseas.

**GSP Deflator:** An index of economy-wide prices. It is the broadest measure of prices in an economy.

**Labour Force:** The number of people of working age who are either employed or actively seeking a job.

**Net Exports:** The value of exports minus the value of imports.

**Nominal Exports:** The value of exports at current world prices and in Australian dollar terms. Changes in nominal exports are a measure of the change in value, which incorporates changes in both export prices and volumes.

**Participation Rate:** The ratio of the labour force to the total working age population.

**Real Exports:** The value of exports adjusted for movements in commodity prices and the exchange rate. As such, changes in real exports only measure changes in the volume of exports.

**State Final Demand (SFD):** The total value of expenditure in Western Australia on private consumption, housing (new housing and alterations and additions), business investment and public consumption and investment. State final demand does not include net expenditure in Western Australia from interstate or overseas.