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Government of Western Australia

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CONTENTS

| | |
|---|-----------|
| EXECUTIVE SUMMARY | 2 |
| 1. THE ECONOMY | 4 |
| OVERVIEW | 4 |
| HOUSEHOLD CONSUMPTION | 7 |
| DWELLING INVESTMENT | 13 |
| BUSINESS INVESTMENT | 19 |
| EXTERNAL CONDITIONS | 24 |
| LABOUR MARKET | 37 |
| PRICES, INCOMES AND INTEREST RATES | 46 |
| INTERNATIONAL CONDITIONS..... | 51 |
| 2. THE 2004-05 STATE ACCOUNTS | 56 |
| 3. 2005-06 GOVERNMENT MID-YEAR FINANCIAL PROJECTIONS STATEMENT | 63 |
| 4. PRESSURES, RISKS AND UNCERTAINTIES AFFECTING WESTERN AUSTRALIA'S ECONOMIC OUTLOOK | 68 |
| APPENDIX 1 WESTERN AUSTRALIAN EXPORTS BY COMMODITY | 81 |
| APPENDIX 1 WESTERN AUSTRALIAN EXPORTS BY DESTINATION..... | 82 |
| GLOSSARY..... | 83 |

EXECUTIVE SUMMARY

Recent data point to strong economic activity in Western Australia, with the domestic economy growing by 2.1% in the September quarter 2005 and by 6.3% in annual average terms in the year to September.

Household consumption grew by 0.8% in the September quarter 2005. High levels of consumer sentiment, steady and relatively low interest rates, healthy income flows, population and employment growth and wealth effects from strong property prices are all supporting growth in consumption. Household consumption is expected to continue expanding at a moderate pace in the near term.

Dwelling activity is robust, with investment increasing by 1.5% during the September quarter 2005 and by 6.0% over the year. Housing market indicators point to high levels of activity in both the established market and new dwelling construction.

Most of the expansion in the domestic economy in the September quarter 2005 was due to an increase in business investment, as construction work commenced recently on a number of major resource-related projects. High commodity prices and strong external demand for the State's key resources have created a favourable resource investment environment which was reflected in strong investment levels both over the year to September 2005 and in the previous three years.

Demand from China has been particularly strong (and is likely to be sustained for some time), while the economic recovery under way in Japan is also likely to boost export demand.

Western Australia's robust economic conditions are also reflected in the labour market. Employment growth is strong, with annual average growth at its highest level, and the three-month average unemployment level at its lowest level, since the current data series began in 1978.

This edition of the Economic Summary has three feature articles:

- The first discusses the 2004-05 State Accounts data for Western Australia, and in particular the unexpectedly low GSP growth of 2.7% for the year;*

- *The second provides an overview of the Western Australian Government's recently released Mid-Year Financial Projections Statement (which updates the fiscal and economic forecasts and other related information from the 2005-06 Budget released in May 2005).*
- *The third provides a brief outline of potential risks facing the Western Australian economic outlook, and some scenarios of possible economic shocks.*

1. THE ECONOMY

OVERVIEW

- *State Final Demand increased by 2.1% in the September quarter 2005 and by 6.3% over the year. The robust expansion in activity in the State continues to underpin jobs growth and low rates of unemployment.*
- *The Western Australian economy is still showing considerable strength across a range of indicators with the outlook, at least in the shorter term, stronger than what was expected at the time of the 2005-06 Budget handed down in May.*

Western Australia's State Final Demand grew by 6.3% over the year to September, underpinned by strong household consumption and business investment. These factors also underpinned growth in the domestic economy of 2.1% in the September quarter, its strongest growth rate since June 2004.

State Final Demand

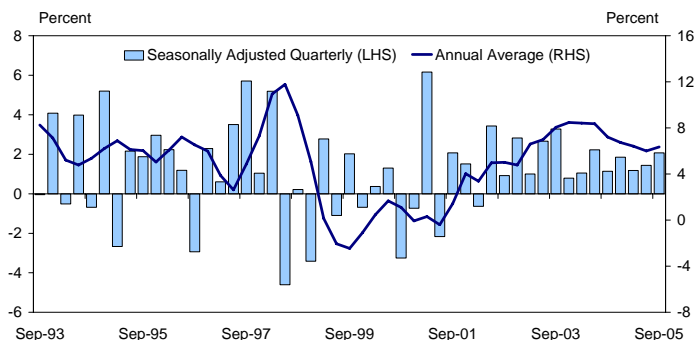
Real Growth (%)

September quarter 2005

| | qtr | yr* |
|-------------|------------|------------|
| NSW | -0.8 | 3.1 |
| Vic | 0.3 | 3.9 |
| Qld | 1.9 | 4.4 |
| WA | 2.1 | 6.3 |
| SA | -0.1 | 3.4 |
| Tas | 3.2 | 7.0 |
| Aust | 0.2 | 4.0 |

* In annual average terms.

DOMESTIC DEMAND GROWTH
Western Australia



Household consumption increased by 0.8% in the September quarter 2005, following growth of 1.4% in the June quarter. Most components of household consumption contributed to the increase, with food, rent and other dwelling services, purchases of motor vehicles and 'other' goods and services the main contributors to growth. Increases in most areas were partially offset by declines in spending on clothing and footwear, hotels, cafés and restaurants and the operation of motor vehicles (this decline in volume terms possibly reflecting consumers' responses to higher petrol prices). These declines detracted only 0.10 percentage points from State Final Demand growth.

Western Australia's **residential building investment** has expanded in each quarter since June 2004, increasing by 1.5% in September 2005. In annual average terms, growth strengthened to 6.0% in the year to September, the highest rate of growth of all States. Housing market indicators such as building approvals point to continuing high levels of activity in both the established market and new dwelling construction.

Business investment grew by 17.8% in the September quarter 2005, contributing 3.2 percentage points to growth in the domestic economy. Less volatile annual data show that, over the year to September 2005, business investment increased by 10.0%, underpinned by non-dwelling construction (up 13.0%) and machinery and equipment (up 11.2%). Surveys of business confidence indicate that the outlook for business investment in Western Australia remains positive.

Western Australia's **net merchandise exports** fell 2.0% (in real terms) over the September quarter 2005, with merchandise exports and imports falling 2.7% and 3.7% respectively. Despite the falls in exports and imports during the quarter, net merchandise exports rose by 0.3% over the year.

Labour market conditions are strong in Western Australia, but there are signs of moderation in employment growth and the participation rate. Western Australia's employment growth moderated in the three months to November 2005 – partly because the previously high rates of growth were probably unsustainable, and also due to ongoing tight labour market supply. Employment growth was 5.4% over the year to November 2005, unchanged from growth in the year to October.

The *Mid-Year Financial Projections Statement* (released on 21 December 2005) shows that growth in the Western Australian property market, household spending, and employment are all proving to be more resilient than had been expected. As a result, State Final Demand is forecast to increase by 5.75% in 2005-06, up from the 2.25% forecasted in the May State Budget.

Gross State Product growth is expected to strengthen to 5.0% in 2005-06, a slight revision upwards from the 2005-06 budget-time forecast of 4.5%. This improved outlook mainly reflects the buoyancy of domestic economic conditions.

HOUSEHOLD CONSUMPTION

- *Positive underlying fundamentals supported household consumption during the September quarter 2005, including healthy employment and wages growth, strong gains in house prices and the stability of interest rates. These factors more than offset any dampening effect of high fuel prices.*
- *During the September quarter 2005, consumption increased by 0.8%. Growth in consumption is fairly robust, although it has moderated over the year. In annual average terms, household consumption increased by 5.3% (and was above the 3.5% growth recorded nationally).*
- *The relatively strong annual growth in retail sales and new motor vehicle sales suggests that consumption growth is likely to remain robust in the near term.*

Recent Conditions

Household consumption increased by 0.8% in the September quarter 2005, following growth of 1.4% in the June quarter. Household consumption, along with business investment, was a major contributor to the growth in activity in the State and national economy during in the September quarter (0.4 and 0.3 percentage points respectively).

In annual average terms, household consumption grew by 5.3% in the year to September, the second fastest rate of growth of all States (after Tasmania, at 5.8%). While the State's annual average household consumption growth has moderated somewhat from the peak of 8.4% growth in December 2004, it has been above the national rate of growth for over three years (or fourteen consecutive quarters).

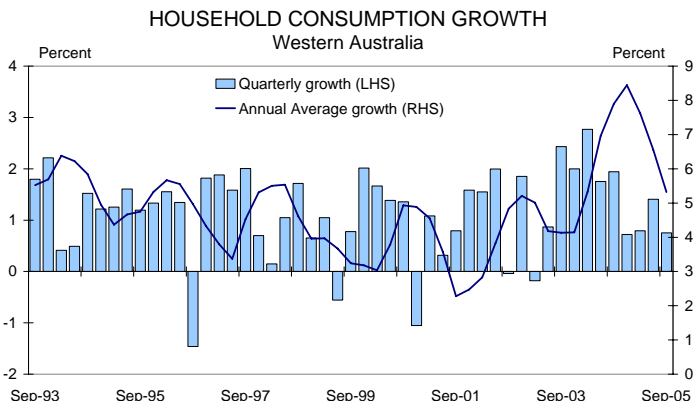
Household Consumption

Real Growth (%)

Period to Sept 2005

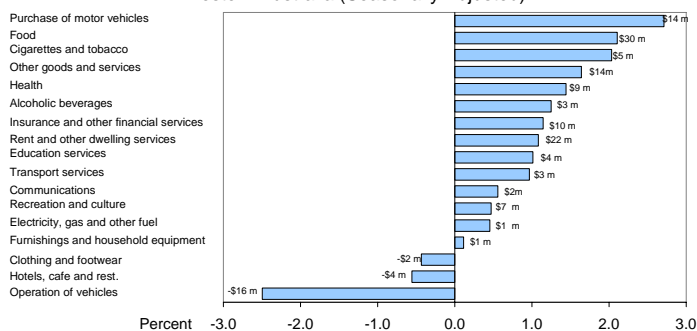
| | <i>qtr</i> | <i>yr*</i> |
|-------------|------------|------------|
| NSW | 0.3 | 2.7 |
| Vic | 0.5 | 3.6 |
| Qld | 0.8 | 4.1 |
| WA | 0.8 | 5.3 |
| SA | 0.7 | 3.1 |
| Tas | 3.1 | 5.8 |
| Aust | 0.6 | 3.5 |

* In annual average terms



Growth in spending in the September quarter was strongest in the areas of motor vehicle purchases, (up 2.7%), food (up 2.1%), cigarettes and tobacco (up 2.0%) and 'other' goods and services (including expenditures on personal care and insurance) (up 1.6%). Increases in these areas were partially offset by reduced spending on hotels, cafes and restaurants (down 0.6%) and operation of vehicles (down 2.5%).

CHANGE IN HOUSEHOLD EXPENDITURE BY TYPE
September Quarter 2005 from June Quarter 2005
Western Australia (Seasonally Adjusted)



Retail Spending

Although retail turnover growth has been decelerating in recent months, it remains quite strong in three monthly and annual average terms (retail sales represent about 40% of household consumption).

Real retail turnover rose by 1.1% in the September quarter, however more recent data (only available in nominal terms) indicate that turnover rose by 1.4% in the three months to October 2005, slightly below the long-term average rate of growth. In annual average terms, nominal retail turnover growth remains strong, and at 5.6%, has been higher than the rate of growth nationally since September 2004.

Retail Turnover

Nominal Growth (%)

Period to October
2005

| | <i>qtr*</i> | <i>yr*</i> |
|-------------|-------------|------------|
| NSW | -0.1 | 2.1 |
| Vic | -0.1 | 3.0 |
| Qld | 2.4 | 3.0 |
| WA | 1.4 | 5.6 |
| SA | 0.2 | 1.7 |
| Tas | 3.1 | 5.1 |
| Aust | 0.7 | 2.9 |

* In annual average terms.



In annual average terms, growth in expenditure on recreational items (such as books, sport, toys and games and leisure equipment) was the strongest of all sectors over the year (albeit, 'recreation' is a small sector and likely to be subject to a degree of volatility). Spending in other sectors including household goods retailing (which includes furniture, appliance and music retailing), and clothing and soft goods retailing also grew strongly during the quarter. This increase in 'discretionary' spending during the quarter is perhaps a reflection of broader favourable economic conditions and a high level of consumer confidence.



However, growth in annual average terms is below its most recent peak of 9.6% in September 2002, and also lower than its long-term average rate of growth. This is likely to be in part a reflection of concerns about a possible rise in interest rates and an expectation that high fuel prices may start to flow through into higher prices for goods and services.

New Motor Vehicle Sales

New motor vehicle sales increased by 7.6% in the three months to October 2005 and by 10.2% in annual average terms (the highest across all States).

Growth in the sale of 'other vehicles' (which includes panel vans and utilities) and 'sports utilities' (which includes four wheel drives) outpaced the sale of passenger motor vehicles over the period.

New Motor Vehicle Sales

Growth (%)

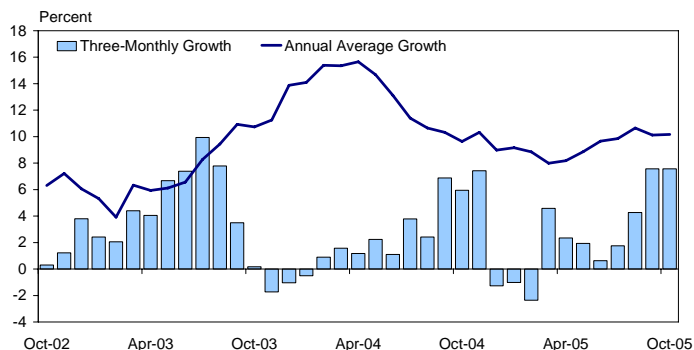
Period to October
2005

| | qtr | yr* |
|-------------|------------|-------------|
| NSW | -0.1 | 0.7 |
| Vic | -0.3 | 4.0 |
| Qld | -1.6 | 8.5 |
| WA | 7.6 | 10.2 |
| SA | -0.3 | 0.9 |
| Tas | 3.3 | 8.7 |
| Aust | 0.4 | 4.4 |

* In annual average

terms.

NEW MOTOR VEHICLE SALES
Western Australia



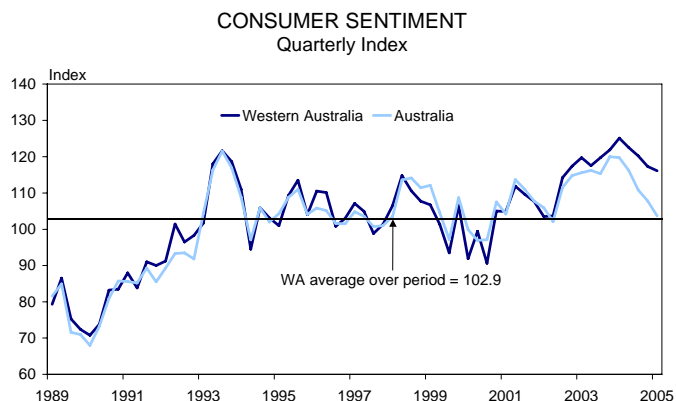
In annual average terms, growth in new motor vehicle sales has moderated from the 15.7% peak in the year to April 2004, to 10.2% in the year to October 2005. However, growth is still more than double the long-term annual average rate of 4.3% per annum.

Outlook

Household consumption is expected to continue expanding at a moderate pace in the near term.

The following chart shows that, while consumer sentiment remains high in Western Australia, it has eased from the high a year ago. This is also the case nationally, with the Westpac-Melbourne Institute noting that "the petrol "story" has run its course" and that "other factors are now affecting the consumer". According to the Westpac-Melbourne Institute the "most obvious explanation for the surprising fall in confidence is that consumers are now focusing more on interest rates"¹.

¹ Source: Westpac-Melbourne Institute, *Index of Consumer Sentiment*, 14 December 2005



Source: DataStream

Although consumer sentiment in Western Australia is now 7.2% below its level a year ago, the index still remains higher than the long-term average.

A recent speech by the Governor of the Reserve Bank of Australia noted that many central banks around the world (with the exception of Japan) had begun to tighten, or were currently tightening, interest rates in an effort to gradually return rates back to “normality”². Market analysts had earlier interpreted the Reserve Bank’s November *Statement on Monetary Policy* as having upside risks to interest rates.

Western Australia’s household consumption is expected to remain reasonably robust, underpinned by high levels of consumer sentiment, steady and relatively low interest rates, wages growth, population and employment growth and the flow on wealth effects from strong property prices.

However, uncertainty about interest rates and future movements in petrol prices could act to dampen sentiment and spending growth.

² Source: Macfarlane I, Australian Business Economists, Annual Forecasting Conference Dinner, Sydney - 13 December 2005

DWELLING INVESTMENT

- Dwelling investment in Western Australia grew by 1.5% in the September quarter 2005, underpinned by positive housing market fundamentals and a large backlog of work still under way.
- Indicators such as building approvals and loan approvals point to a high level of new dwelling construction activity and robust demand for established houses continuing in the near term.
- Dwelling investment is expected to grow by 4.75% in 2005-06, followed by an increase of 4.0% in 2006-07.

Recent Conditions

Western Australia's housing market continues to defy the national trend, growing by 6.0% over the year to the September quarter 2005, compared with a decline of 5.3% nationally. Dwelling investment increased by 1.5% in the September quarter.

Strong consumer confidence, employment and earnings, and positive net migration underpin activity in Western Australia's housing sector. Capacity constraints have led to a large backlog of work that is likely to support the high levels of activity for some time, and are reflected in labour and materials shortages.

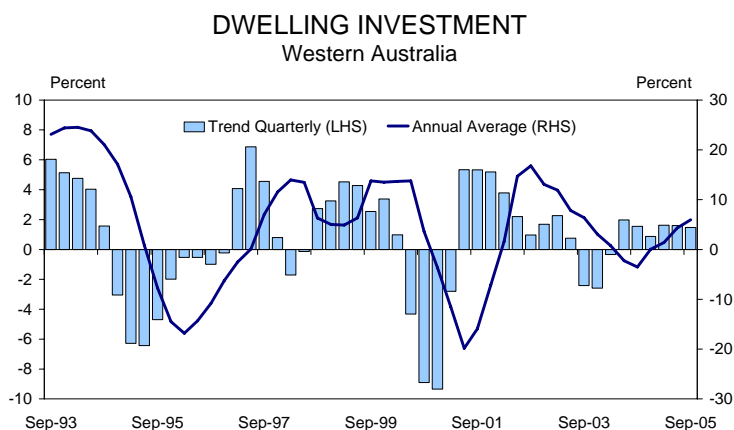
Dwelling Investment

Real Growth (%)

Period to September 2005

| | qtr* | yr |
|-------------|------------|-------------|
| NSW | -1.0 | -14.0 |
| Vic | 2.2 | -4.5 |
| Qld | 0.9 | -1.4 |
| WA | 1.5 | 6.0 |
| SA | 2.5 | 3.6 |
| Tas | -0.7 | -8.5 |
| Aust | 0.8 | -5.3 |

* In trend terms.



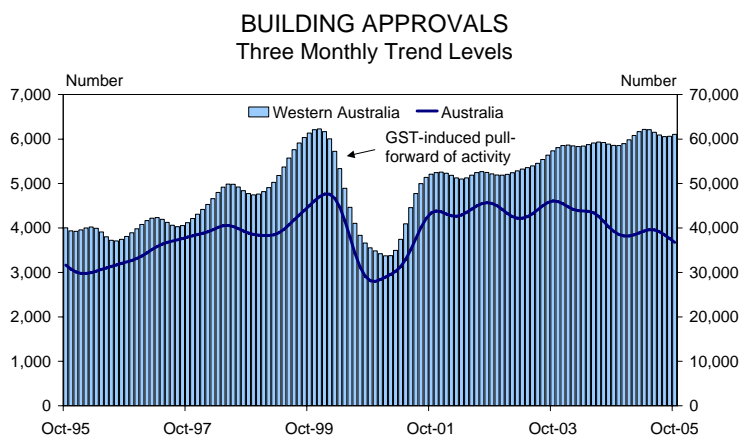
Housing Indicators

Most indicators of housing activity in Western Australia point to continued strong demand for dwellings in both the construction and established markets.

New Dwelling Construction

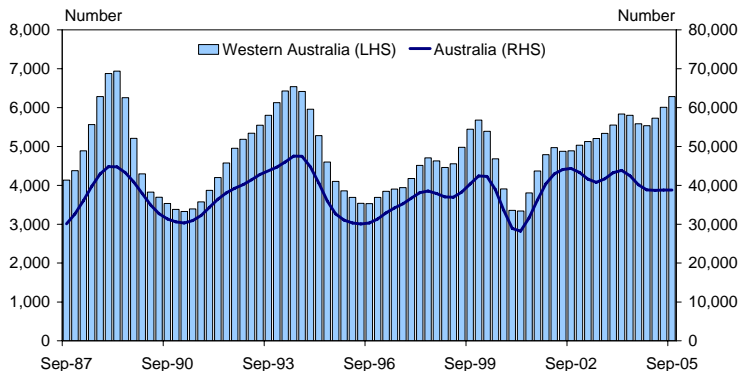
New dwelling construction increased by 3.8% over the September quarter 2005 to be 7.5% higher over the year, and was largely responsible for the increase in dwelling investment over the quarter.

Building approvals increased by 0.3% in the three months to October 2005, after declining by 2.0% in the three months to July. The moderation in the level of approvals is the result of declines in multi-dwelling approvals, which were 30.3% lower (in original terms) in the three months to October when compared with the same period of the previous year. However, approvals for new houses (which comprise approximately 80% of total approvals) increased by 14.5% over the same period, and total building approvals remain at historically high levels.



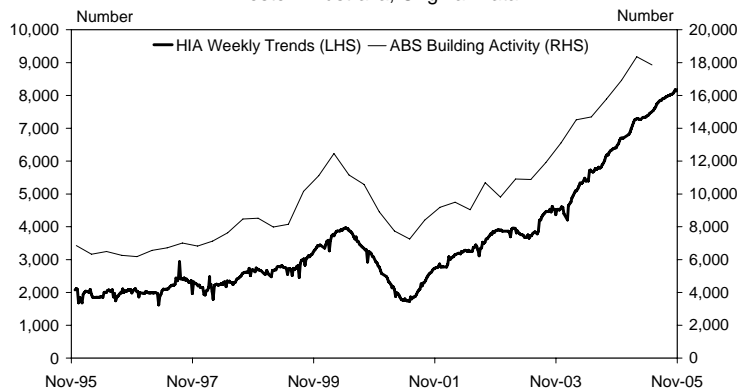
Dwelling commencements grew by 4.6% in the September quarter 2005, and are high by historical standards. Similar to building approvals, the data show that the number of commencements for new houses remained strong (up 18.0%, in original terms, in the September quarter 2005 compared to the same period of the previous year), while multi-dwelling commencements moderated (down 17.0% in the same period).

DWELLING COMMENCEMENTS
Quarterly Trend Levels



The number of dwellings under construction was 21.5% higher in the June quarter 2005 than in the same period of the previous year, and increased by 27.1% over 2004-05. This is consistent with more recent Housing Industry Association *Weekly Trends* data,³ which show a continuation of the trend to the end of November, with the number of dwellings under construction currently at a record high (see following chart).

DWELLINGS UNDER CONSTRUCTION
Western Australia, Original Data

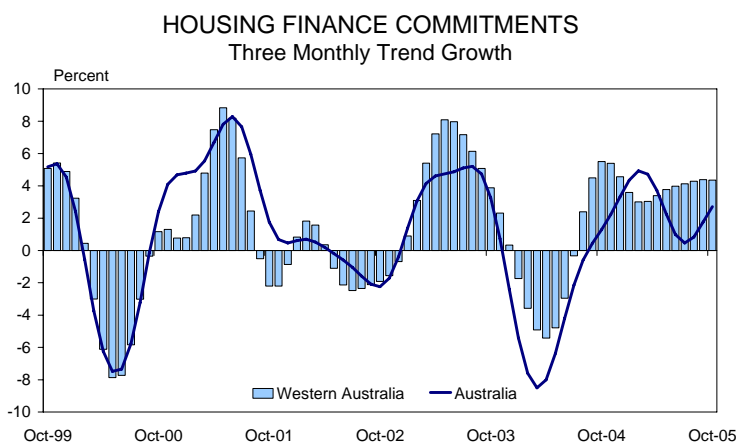


³ The *Weekly Trends* data from the HIA comprises a representative sample of 47% of all dwelling units.

Established Market

Ownership transfer costs,⁴ increased by 0.4% in the September quarter 2005, and were 6.8% higher over the year.

Robust demand for established houses in Western Australia is reflected in strong growth in the total number of owner occupied housing finance commitments, which increased by 4.4% in the three months to October 2005 and by 12.8% over the year. Owner occupied finance commitments for established houses only (excluding refinancing), comprise approximately 60% of the total number of owner occupied housing commitments. These increased by 14.4% in the three months to October 2005 compared to the same period of the previous year, and by 18.5% higher over the year to October.

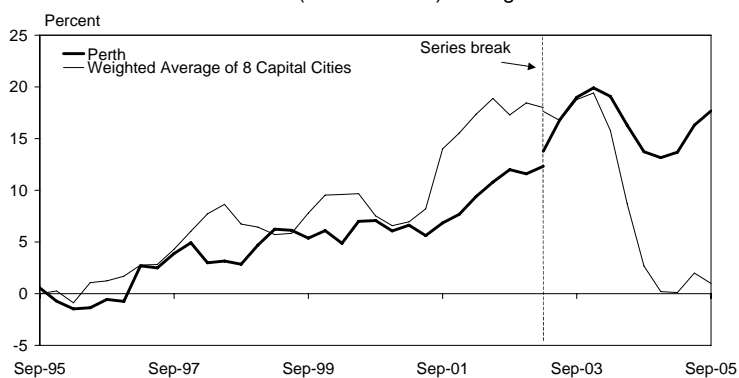


Growth in the total value of housing commitments in Western Australia was even stronger. The nominal total value of finance commitments (including both owner occupiers and investors, but excluding refinancing) for established houses was 34.3% higher in the three months to October 2005 when compared with the same period of the previous year, and 31.4% higher over the year to October.

⁴ Ownership transfer costs are an indicator of activity in the dwellings market. Costs include legal/conveyancing fees, real estate agent/auctioneer fees, and government taxes/charges (such as stamp duty), and cover newly built and established dwellings, other buildings and structures and unoccupied land.

In addition to robust demand for established houses, the growth in the value of housing commitments reflects strong increases in the prices of established houses. The ABS established house price index for Perth was 17.7% higher in the September quarter 2005 than in the same period of the previous year. This is consistent with data from the Real Estate Institute of Western Australia, which indicate that the median house price for Perth rose by 21.7% to \$308,000 through the year to the September quarter.⁵

ABS ESTABLISHED HOUSE PRICE INDEX
Annual (Year on Year) Change



According to the latest Real Estate Institute of Australia home loan affordability index, even though affordability in Western Australia has deteriorated (down 5.3% in the September quarter compared to the same period of the previous year) house prices remain more affordable than in other States.⁶

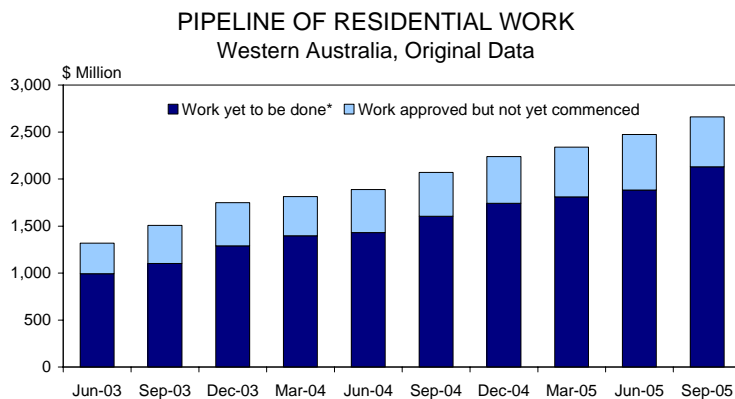
⁵ Real Estate Institute of Western Australia, *The REIWA Market Update*, September quarter 2005

⁶ Real Estate Institute of Australia, *Home loan affordability report*, September quarter 2005

Outlook

Further house price growth is likely over the remainder of 2005-06. The market appears to have considerable momentum, and demand for established houses is strong. However, while the prospect of further house price growth may drive growth in dwelling investment (to the extent that it encourages people to enter the market), higher house prices may also act as a deterrent for others entering the market (particularly for those hoping to buy their first home).

The substantial amount of residential construction work still in the pipeline (see following chart) is expected to continue to support activity over the next two years. Furthermore, a robust established housing market, along with high incomes, low unemployment, low interest rates and strong population growth, should continue to drive growth in the components of dwelling investment in 2005-06 and 2006-07.



* The difference between the anticipated completion value of a project, and the estimated value of work already done up to the end of the reference period for jobs that have commenced.

Forecasts contained in the Western Australian Government's recently released *Mid-Year Financial Projections Statement* are for dwelling investment to grow by 4.75% in 2005-06, followed by an increase of 4.0% in 2006-07.

BUSINESS INVESTMENT

- *Business investment in Western Australia is at historical highs. Activity in the near term is likely to be sustained by the significant number of resource-related projects already under way, and the expectation of further capacity expansions in key mineral / energy developments over the next year or so.*
- *Strong trend growth of 4.2% in business investment over the September quarter 2005 primarily resulted from the commencement of construction work on a number of major resource-related projects, which is also reflected in the annual average growth rate of 10.0% for the year to the September quarter.*
- *Capacity constraints in respect to labour and some key input materials (such as steel) are affecting some major resource-related projects. However, overall project viability is supported by strong commodity prices, which are a positive counter to the higher costs brought by such constraints.*
- *Ongoing firm prices and demand for Western Australian commodities will support business investment activity in the near term. Even though cost pressures are expected to remain, at least in the short term, the construction phases of the major resource projects already under way is forecast to provide a strong basis for impetus behind income flows and employment levels in Western Australia.*
- *Business investment in Western Australia is forecast to grow by 6.5% in 2005-06, followed by similarly strong growth of 6.0% in 2006-07.*

Recent Conditions

Strong growth in global demand for many of Western Australia's key resource commodities has induced a commensurately strong investment response. The commencement of several major new resource-related projects⁷ have led business investment in the State to grow by an annual average rate of 12.9% over the past five years.

⁷ This also includes the supporting infrastructure associated with such projects; for example, port and railway expansions (which are particularly important for capacity expansions for bulk commodities, such as iron ore).

Business investment in Western Australia grew by 4.2% over the September quarter in trend terms, and by 10.0% (in annual average terms) for the year to the September quarter 2005. As shown by the following chart, trend levels of business investment are at historical highs.

Business Investment

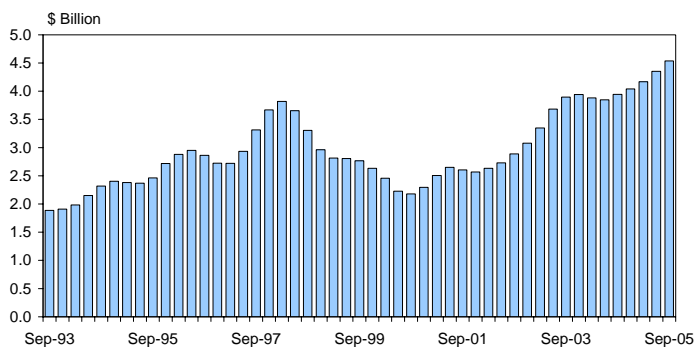
Real Growth (%)

September 2005

| | qtr* | yr |
|-------------|------------|-------------|
| NSW | 2.9 | 19.8 |
| Vic | 2.7 | 14.6 |
| Qld | 3.1 | 9.7 |
| WA | 4.2 | 10.0 |
| SA | 2.2 | 4.3 |
| Tas | 3.7 | 27.9 |
| Aust | 3.1 | 13.9 |

* In trend terms.

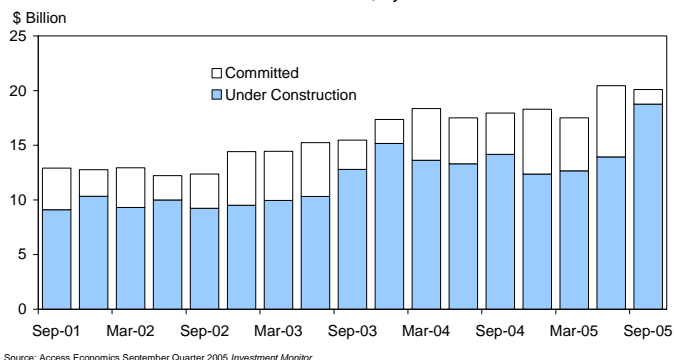
BUSINESS INVESTMENT - TREND LEVELS
Western Australia



Western Australia has several major resource-related projects under construction, covering a number of key commodity markets (primarily oil and gas, iron ore, alumina and nickel). A number of these have only recently (in the last half year or so) commenced their construction phases, including:

- BHP Billiton's \$2.3 billion Ravensthorpe nickel project;
- the North West Shelf Consortium's \$2.0 billion 5th LNG train;
- Woodside's \$1.5 billion Enfield, Vincent & Laverda oil & gas project; and
- BHP Billiton's \$750 million 'Rapid Growth 2' iron ore expansion.

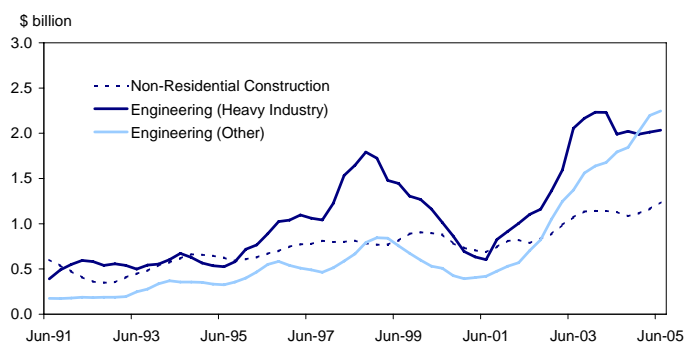
MAJOR INVESTMENT PROJECTS
Western Australia, by status



Consistent with this (and as shown by the chart above), Access Economics’ data on Western Australia’s current and potential major investment projects shows a number of very large projects shifting in status from the ‘committed’ category to the ‘under construction’ category for the September quarter 2005.

These projects have in turn induced the development of support infrastructure, such as port upgrades, rail lines, electricity-related projects and gas pipelines. The following chart shows growth in the value of private sector work done in engineering construction (by the categories of ‘heavy industry’ and ‘other’⁸) and non-residential construction.

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



⁸ ‘Other’ predominantly includes infrastructure such as roads, highways, bridges, railways, harbours, electricity generation and transmission, pipelines, telecommunications, water storage and supply, and sewerage and drainage).

Outlook

Overall the outlook for business investment in Western Australia in the short term remains positive. Key factors supporting investment include favourable global economic conditions (including continued strong demand for the State's key commodities, and strong rates of global growth), and healthy profit levels.

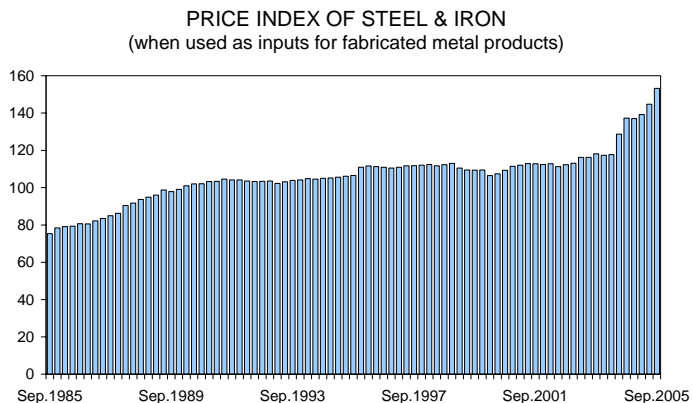
The large number of major resource-related projects already under way together with those in prospect underpins the expected expansion of business investment in 2005-06 and 2006-07. This in turn is forecast to support positive growth in the State's overall output, exports and employment growth, particularly given the significant employment and income flows that are typically associated with the construction phases of such projects.

However, skilled labour shortages and higher materials costs remain a constraint on the construction of major projects, and are likely to remain acute in the near term given the large number of projects expected over the next year or so.

The latest Hudson Employment Expectations report (for October - December) noted that "not one of the resource organisations surveyed in Western Australia or Queensland indicated they would decrease permanent employment levels over the next three months". The report also showed that 61.4% of those employers in Western Australia's resources sector surveyed indicated that they intended to increase permanent employment levels over the next three months (an increase of 12.1 percentage points on the last survey)⁹.

Higher costs for key input materials used in construction also represent a constraint (a situation exacerbated by the coincidental timing of the current resources boom and the State's strong housing market). In particular, the price of steel has risen considerably over the last year or so, as shown by ABS data on the price of steel and iron (when used as inputs for the fabrication of metals products - see following chart).

⁹ Source: Hudson *Employment Expectations*, Oct-Dec 2005



However, while a number of projects have faced higher costs than originally expected (for example, the Ravensthorpe nickel project has seen costs associated with its construction phase increase by around a third), historically strong commodity prices have helped maintain project viability for most major resource-related projects.

To some extent, proponents of major resource-related projects have also been able to mitigate higher construction costs. For example, a larger amount of the engineering work and pre-fabricated content for the North West Shelf Consortium's 5th LNG train is being sourced from overseas (relative to what was done for the similarly designed 4th LNG train).

At the same time however, higher costs are likely to be causing a certain degree of 'crowding out' of investment in some of the more marginal business investment projects, particularly for those that are not necessarily resource-related, and where costs have increased without any commensurate increase in expected profitability.

The current favourable resource investment conditions are unlikely to last indefinitely. Extra global supply is expected to come on-stream for a number of key commodities over the next few years, leading to moderation in commodity prices. But for the shorter term, conditions look very favourable. Forecasts in the Western Australian Government's 2005-06 *Mid-Year Financial Projections Statement* are for business investment to grow by 6.5% in 2005-06, followed by a further increase of 6.0% in 2006-07.

EXTERNAL CONDITIONS

- *Recent trade data indicate that Western Australia's exports are strengthening in value and volume terms, reflecting healthy economic conditions both domestically and globally. This follows a period of relatively weak export response to strong global demand. The recent pick-up in exports may reflect expansion in the State's export capacity created by the resource-driven investment boom of the past three years.*
- *Strength in the domestic economy is driving solid growth in imports.*

Net Exports

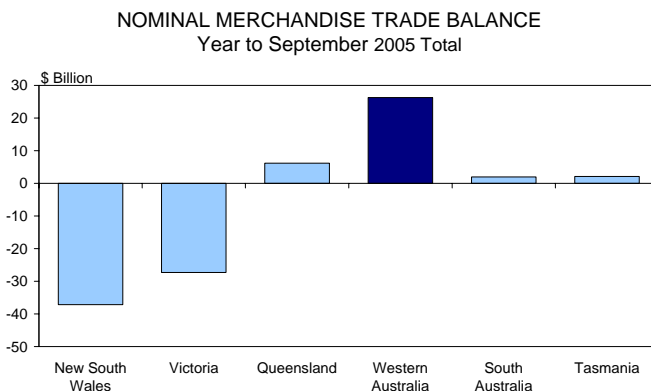
Over the three months to October 2005, Western Australia's trade surplus rose by 25.4% (or \$1.5 billion) in value terms¹⁰ when compared to same period a year earlier. Nationally, the trade deficit improved by \$1.8 billion over the same period.

Western Australia's merchandise trade surplus of \$26.8 billion over the year to October 2005 was the State's largest on record. This contrasts with a national deficit of \$19.2 billion over the same period, although this was the smallest deficit since the year to July 2003.

In real terms, net exports fell by 2.0% over the September quarter 2005 (latest data available), following a fall of 3.6% in the previous quarter. Notwithstanding these falls, however, net exports were 0.3% higher in annual average terms over the year to September 2005.

The 2005-06 *Mid-Year Financial Projections Statement* forecasts the net exports to increase by 3.0% in real terms over 2005–06. While exports are expected to grow strongly (despite coming off an historically high base), it is anticipated that continued strong demand for imports would offset this to some degree.

¹⁰ Trade data are available from two main sources, both from the ABS. Nominal or current price data on trade values in dollars of the day are available monthly. Real, or chain volume, data (based on ABS' National Accounts chain volume series) are published quarterly with a somewhat longer lag, and abstract from the effects of price movements on the value of exports and imports.



Exports

In trend terms, real merchandise exports were flat over the September quarter 2005, following four consecutive quarters of growth. Strong growth in previous quarters, however, meant that over the year to September, real exports grew by 5.3%. The *Mid-Year Financial Projections Statement* forecasts growth of 6.25% over 2005-06 with exports expected to accelerate as the year continues and further capacity expansions come on-line.

The strong annual increase in volumes is predominantly a result of the increase in iron ore exports, a result of capacity expansions that have occurred across the industry to take advantage of the strong demand from China. While the effect of the increase in production from the 4th LNG train on the North West Shelf, which was commissioned in late 2004, is beginning to wash through it also still had some impact on most recent growth data.

Exports

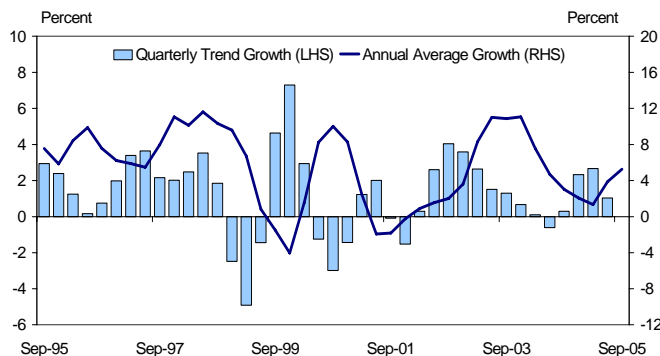
Real Growth (%)

Period to Sept 2005

| | qtr* | yr |
|-------------|------------|------------|
| NSW | 0.3 | 2.9 |
| Vic | 1.5 | -3.8 |
| Qld | 1.6 | 5.6 |
| WA | 0.0 | 5.3 |
| SA | 2.6 | 0.2 |
| Tas | 0.0 | 9.6 |
| Aust | 0.7 | 2.6 |

* In trend terms.

REAL MERCHANDISE EXPORTS Western Australia



The nominal value of Western Australia's merchandise exports grew by 18.8% in the three months to October 2005, compared with the corresponding period a year earlier. While still strong, this reflects a slight easing in export growth from previous months. The increase was driven predominantly by strong gains in \$A commodity prices in year-earlier terms (see below) and, to a lesser extent, higher volumes. Nationally, the nominal value of merchandise exports increased by 14.3% over the same period.

Items Exported

Iron ore exports continue to dominate the State's trade profile, a result of higher prices and increased capacity. Demand from China continues to fuel demand and so producers have experienced increased bargaining power as price makers, negotiating record price increases in recent rounds. China's market for Western Australian-produced iron ore is now over one and a half times that of Japan, although contract negotiations with Japan traditionally set international prices.

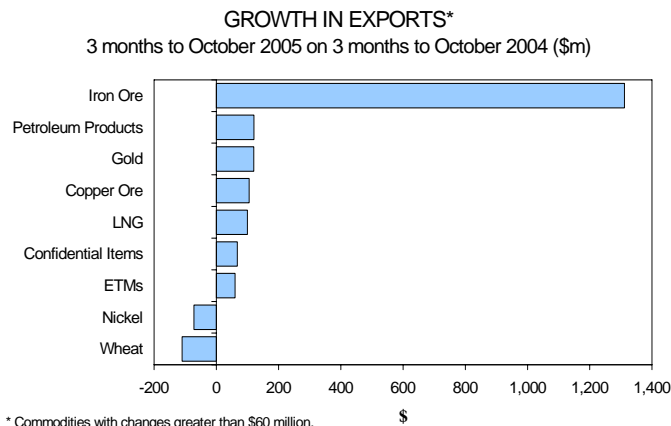
Over the three months to October 2005, the nominal value of iron ore sales rose by \$1.3 billion (or 77.0%) compared to the three months to October 2004. While the volume of iron ore exported also increased (up by 7.7%) it has been higher prices that have been the main driver of the overall increase in export earnings.

To a far lesser extent, increases in the value of petroleum, gold, copper ore and LNG exports also supported growth.

The value of petroleum exports increased by 8.6% (or \$120.8 million) over the three months to October 2005 compared to the same period a year earlier. This is a very subdued increase compared to recent months and is caused by an actual fall in the volume of petroleum exports. This is thought to be a result of a combination of factors, including declining oil reserves as well as a disruption to the North West Shelf 4th LNG train supplies (due to repairs), which may have affected supplies of condensate.

The value of gold exports recorded an increase of \$12.3 million (or 9.2%) over the three months to October 2005. Since the move of gold refining operations to Western Australia (which has also seen an increase in gold imported for re-export), the value and volumes of gold exported has fluctuated and this is expected to continue.

While the value of LNG exports increased by 12.8% over the three months to October 2005 (volume figures are not published by the ABS), this is a subdued result compared to previous months. A slight drop in export values in recent months (which occurred despite increases in LNG prices) is thought to be a result of the shut down of the North West Shelf 4th LNG train for repairs for over a month around September. However, with the North West Shelf 4th LNG train having now been in production for over a year, the strong growth figures of previous months are beginning to dissipate, with the effect of the commissioning of the 4th train beginning to wash through the data.

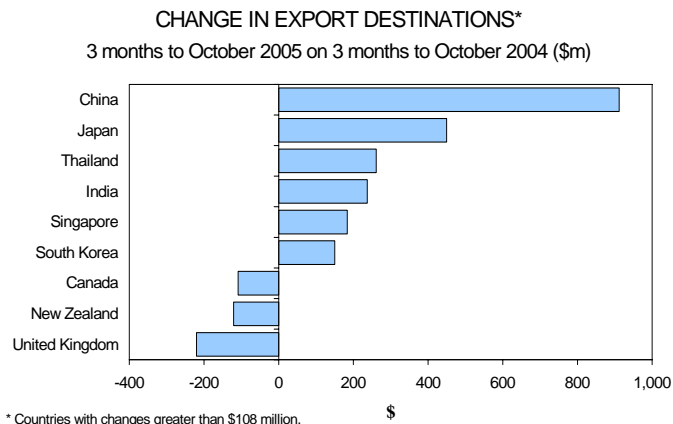


Only partly detracting from these gains was a decline in the value of wheat exports. In the three months to October 2005, the export of wheat fell by \$110.0 million (or 21.4%), predominantly the result of a fall in the volume of wheat exports (which fell by 14.2%).

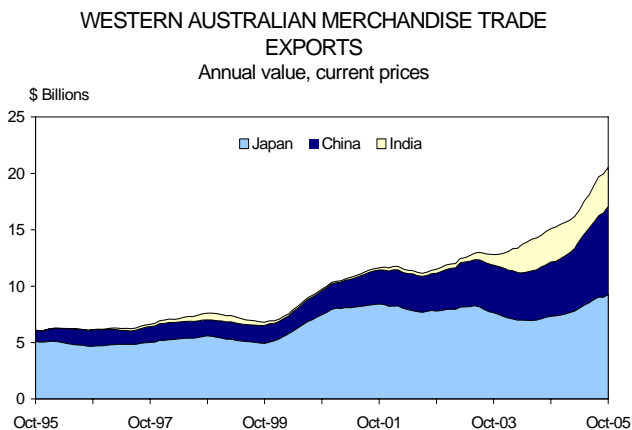
Export Markets

Western Australia's trade relationship with the Asian powerhouses continues to drive the State's export boom with exports to China, Japan and India continuing to dominate the State's export growth profile. In the three months to October 2005, exports to these three nations accounted for over 51.1% of the total value of the States' exports, compared to only 35.0% five years ago.

While Japan remains the State's largest export market, this is beginning to be challenged by Western Australia's increasing trade with China. In the three months to October 2005, Japan accounted for 22.3% of the State's total exports, which compares to 18.9% for China. Five years ago however, Japan accounted for 26.4% of total exports compared to just 7.6% for China.



Unsurprisingly, growth in the value of exports to China continues to outstrip that of any other country. Over the three months to October 2005, exports to China rose by a massive \$911.7 million (or 66.5%) in nominal terms compared to the same period a year earlier, contributing over half (9.9 percentage points) to the State’s overall 18.8% rate of growth. This strong growth was almost entirely driven by increases in iron ore exports, which were up by \$824.2 million over the period.



Exports to Japan increased by \$449.6 million (or 21.8%) in the three months to October 2005 when compared to the same period a year earlier, contributing 4.9% to overall growth in exports. While the increase was again mostly driven by a rise in the value of iron ore exports (with the higher contract prices largely responsible for this jump), petroleum and gold exports also contributed to growth.

Exports to Thailand, now Australia's fifth largest export market, almost doubled over the three months to October 2005 compared to the same period last year. Exports grew by \$261.1 million, with gold (up \$164.2 million) and petroleum (up \$96.2 million) the main contributors to this growth.

Increases in the State's exports to these countries were only partially offset by a fall in the value of exports to the United Kingdom. Over the three months to October 2005, exports to the United Kingdom fell by \$220.0 million (or 34.0%). Because the United Kingdom is a significant market for gold, the shift of gold refining to Western Australia has increased the United Kingdom's trade profile, with any significant swings in export values usually a result of shifts in the value and volume gold exports. Over the three months to October 2005, gold exports to the United Kingdom fell by \$273.5 million compared to the same period a year earlier.

Imports

In seasonally adjusted terms, real imports rose by 3.0% in the September quarter 2005, following growth of 4.1% in the June quarter 2005. The most recent *Mid-Year Financial Projections Statement* forecasts growth of 11.25% in imports over 2005-06, based on continued strong domestic demand and strong business investment (which usually generates high levels of capital imports). While this most recent fall is in contrast to expectations of high growth over 2005-06, annual average growth over the year to September 2005 remains strong at 14.2%. The following chart also shows that imports are still trending upwards, with this increase expected to accelerate in upcoming quarters.

Imports

Real Growth (%)
Period to Sept 2005

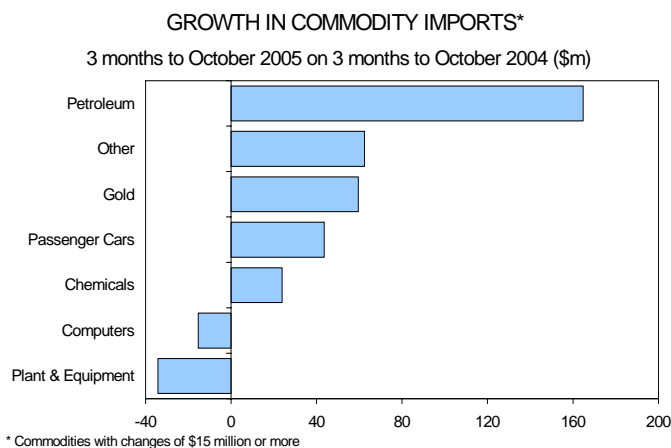
| | <i>qtr*</i> | <i>yr</i> |
|-------------|-------------|-------------|
| NSW | 1.8 | 12.2 |
| Vic | 2.1 | 8.1 |
| Qld | 0.5 | 13.3 |
| WA | 3.0 | 14.2 |
| SA | 2.5 | 10.0 |
| Tas | 0.0 | -10.5 |
| Aust | 1.7 | 11.6 |

* *In trend terms*



Recent trade data indicate that the value of merchandise imports continues to grow at a solid pace. Over the three months to October 2005, the nominal value of merchandise imports into Western Australia increased by 8.7% (or \$300 million) compared to the same period a year earlier. In annual average terms, growth was 19.2% over the 12 months to October 2005.

Petroleum imports made the largest contribution to import growth (4.8 percentage points) over the period. Over the three months to October 2005, the value of petroleum imports was 28.7% (or \$164.7 million) higher than in the same period a year earlier. This was entirely due to higher prices, as the volume of petroleum imports fell by 7.5%.

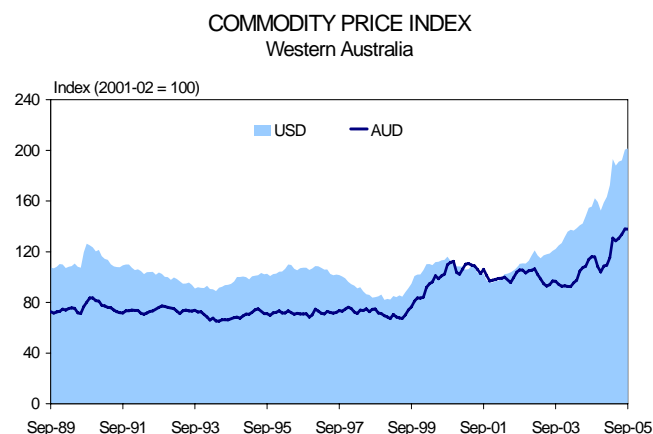


The value of imports of plant and equipment fell by 3.4% (or \$34.2 million). Due to the lumpy nature of business investment, the import of plant and equipment is volatile. Despite the drop in September, imports are likely to increase in the near term, driven by strong domestic investment and, to a lesser degree, consumer demand.

Commodity Price Index¹¹

The September quarter 2005 saw a consolidation of commodity prices at very high levels. The Western Australian commodity price index grew by 3.8% over the quarter in \$US terms, and by 5.0% in \$A terms. Compared to the same period a year earlier, commodity prices were 30% and 21% higher in \$US and \$A terms respectively.

The strength of commodity prices has made an important contribution to economic activity in Western Australia over the past few years. Not only have higher prices created an additional incentive for businesses to invest, they have also provided a boost to real incomes. So while the ABS measure of GSP growth for 2004-05 was quite soft (at 2.7%), Gross State Income (which adjusts GSP for changes in the terms of trade), grew by 6.4% in 2004-05.¹²



¹¹ 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.

¹² The article on page 56 discusses the 2004-05 state accounts, and compares Gross State Product and Gross State Income.

Much of the rise in the commodity price index over the past year is due to increases in the price of crude oil and iron ore. Together, these two commodities accounted for over three-quarters of rise in the commodity price index in the year to September 2005.

GROWTH IN COMMODITY PRICES

September quarter 2005 on September quarter 2004

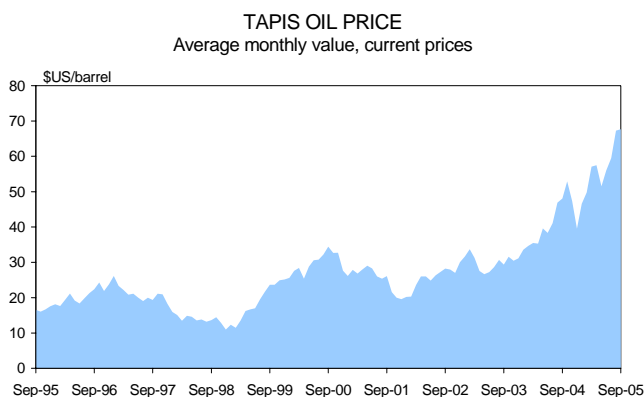
| | \$US terms | \$A terms |
|--------------|------------|------------|
| Iron Ore | 72% | 60% |
| Crude Oil | 43% | 33% |
| LNG | 23% | 15% |
| Alumina | 11% | 3% |
| Gold | 9% | 2% |
| Wheat | 4% | -3% |
| Nickel | 4% | -3% |
| Wool | -4% | -10% |
| Total | 30% | 21% |

Resource Prices

In early 2005, the world's major **iron ore** producers secured a record 71.5% increase in \$US prices due to very strong demand in the Chinese market. The price of iron ore has now more than doubled since 2002-03. This has elicited a large investment response, with domestic producers having committed to a series of major capacity expansions in recent years.

While increases in domestic and international production of iron ore may place some downward pressure on prices over the medium to longer term, continued strength in demand from China may support another solid price increase in 2006-07. The Australian Bureau of Agricultural and Resource Economics (ABARE) forecasts that imports of iron ore from China will grow by around 16% in 2006, and also that iron ore prices will increase by 11.5% in the 2006-07 Japanese fiscal year.

Conditions in the world **oil** market remain very tight. Growth in international consumption means that global production of oil is now only marginally ahead of demand, and as a consequence, markets have become particularly sensitive to disruptions in supply. The damage occasioned by hurricanes Katrina and Rita on refining capacity in the United States triggered a large spike in prices in late August 2005. The tapis¹³ oil price rose by 18% over the September quarter 2005, to be 43% higher than the same period a year earlier (although the price has slipped slightly lower more recently).



ABARE forecasts that the price of oil will ease slightly in 2006, with growth in world production expected to just offset higher consumption. The Bureau notes, however, that the short-term outlook for the price of oil is still very uncertain. Solid consumption growth and relatively low spare capacity means that prices could rise significantly if large and unexpected disruptions were to occur.

The price of **gold** averaged \$US456/oz in the September quarter 2005, a 9% increase compared to same period a year earlier. More recently, gold prices reached a peak of \$US537/oz in mid-December 2005, before retreating to just above \$US500/oz shortly thereafter.

¹³ The tapis oil price is the benchmark oil price in the Asian region.

The recent strength in the gold price has been attributed to a combination of heightened investor activity and fundamental factors. Investment demand for gold has increased amid concerns that higher fuel prices could add to global inflationary pressures. At the same time, growth in world mine production has been constrained by a decline in output from South Africa, while fabrication demand (industrial use in electronics, jewellery etc) from India, the Middle East and China has increased strongly.

Looking ahead, ABARE forecasts that the price of gold will average \$US475/oz in 2006, a 7% increase from 2005. Continued growth in gold fabrication, a decline in central bank sales and the possibility of higher fuel costs (and hence higher inflation) are the major factors underpinning this forecast.

Base metal prices remain very firm in historical terms. Although the \$US spot price of **nickel** fell by 11% in the September quarter 2005, the average price was still 4% higher than the same period a year earlier, and more than twice the average price level recorded in 2002. Similarly, unit export returns for **alumina** are currently around 11% higher than a year earlier (in \$US terms), taking the cumulative increase since 2002 to more than 50%. Much of the increase in prices for these commodities over this period can be linked to the substantial rise in Chinese demand.

ABARE forecasts that alumina prices will continue to grow in 2006 (up 8%), with increases in world production unlikely to offset continued growth in demand from China. In contrast, rising nickel production is expected to outpace growth in nickel demand, leading to a 7% fall in prices over 2006.

Rural Prices

Rural commodity prices are quite subdued. The price of **wool** has been particularly weak, having declined steadily since peaking in 2002. In the September quarter 2005, the eastern market indicator for wool was 11% lower (in \$A terms), compared to the corresponding period a year earlier. More recently, the eastern market indicator for wool has fallen to 650 cents per kilogram, the lowest level in six years.

The decline in the price of wool over the past few years reflects subdued international demand and strong competition from cotton and synthetic fibres. With these trends unlikely to change in the near term, prices are likely to remain weak for the remainder of 2005-06.

Although the price of wheat has also been quite soft in recent times, the outlook is more positive. A decline in production by the world's major exporting nations, coupled with a small increase in world consumption, is likely to underpin modest price increases. ABARE forecasts that the benchmark price for wheat (US hard red winter, free on board, Gulf ports) will be 4.5% higher in 2005-06.

LABOUR MARKET

- *Employment growth in Western Australia appears to be moderating – growing only 0.6% over the three months to November 2005.*
- *Nonetheless, the State's labour market remains tight, with the unemployment rate falling 0.4 percentage points to average 4.0% over the three months to November 2005 (its lowest level since the 1970s).*
- *The participation fell 0.4 percentage points to 67.7% over the three months to November 2005, but remains near historically high levels.*
- *Business surveys indicate continuing strong labour demand, but the tight labour supply currently being experienced may dampen the extent to which demand translates into employment growth.*

Employment

Western Australia's employment growth moderated over the three months to November 2005, growing by 0.6%. This followed higher growth recorded over the three months to August 2005 (of 1.0%) and the three months to November 2004 (of 2.1%).

This earlier strong growth meant that, in annual average terms, employment growth in Western Australia over the year to November 2005 was 5.4%, the highest rate of growth since 1989. However, the annual rate of growth is no longer accelerating, but has levelled off (see following chart). The recent deceleration of employment growth is most likely attributable to continuing tight labour market supply rather than softening labour demand.

Western Australia's employment growth compares favourably to the national annual average employment growth rate of 3.3% over the year to November 2005, with Western Australia contributing 17% of the national employment growth over the year. In numerical terms, the State's employment over the year to November 2005 grew by 53,000 persons.

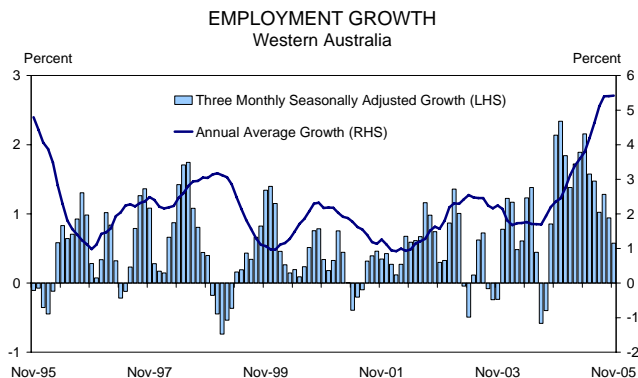
Employment

Growth (%)

Period to November 2005

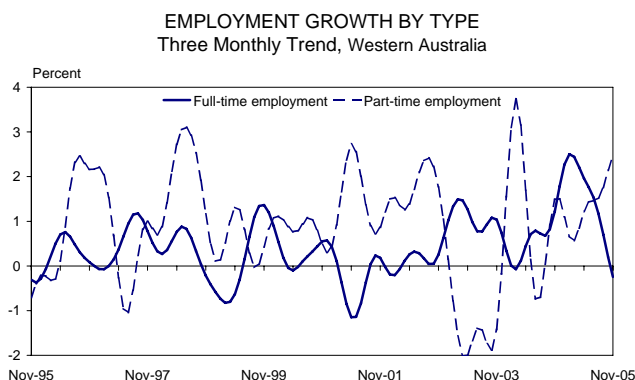
| | qtr* | yr |
|-------------|-------------|------------|
| NSW | -0.3 | 1.8 |
| Vic | -0.2 | 3.1 |
| Qld | 0.0 | 5.2 |
| WA | 0.6 | 5.4 |
| SA | -0.1 | 2.7 |
| Tas | 1.0 | 3.0 |
| Aust | -0.2 | 3.3 |

* In seasonally adjusted terms



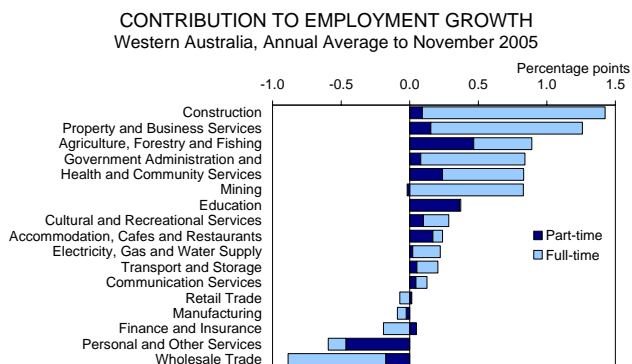
Employment by Type and by Industry

Full-time employment fell by 0.9% or 6,800 persons to an average of 738,000 persons over the three months to November 2005, but this was more than offset by part-time employment growth of 4.2% (or 12,900 persons) to an average of 316,000 over the period. In trend terms, full-time employment fell by 0.2% while part-time employment grew by 2.5% over the three months to November 2005.



Although full-time employment fell over the three months to November, in annual average terms, Western Australia's full-time employment grew by 6.0% in the year to November 2005. This was the highest full-time employment growth for Western Australia since monthly labour force data began in 1978. Part-time employment growth was also strong over the year to November (up 4.1%).

In annual average terms, the strongest contributors to employment growth over the year to November 2005 were construction (up 16.7%), property and business services (up 11.1%) and agriculture, forestry and fishing (up 19.3%). The industries for which employment contracted over the year were wholesale trade (down 17.2%), personal and other services (down 12.5%) and finance and insurance (down 5.2%).



Unemployment Rate

Western Australia’s unemployment rate averaged 4.0% over the three months to November 2005 – the lowest three monthly unemployment rate recorded for the State since monthly labour force data began in 1978. This compares to a three-monthly unemployment rate of 5.1% nationally.

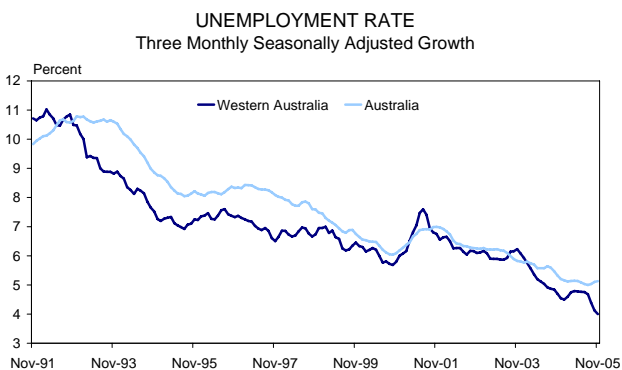
Unemployment Rate

Average rates (%)

Period to November 2005

| | qtr* | yr |
|-------------|------------|------------|
| NSW | 5.3 | 5.2 |
| Vic | 5.5 | 5.5 |
| Qld | 4.8 | 4.8 |
| WA | 4.0 | 4.5 |
| SA | 5.0 | 5.1 |
| Tas | 6.9 | 6.1 |
| Aust | 5.1 | 5.1 |

* In seasonally adjusted terms



In annual average terms, Western Australia's unemployment rate also reached a record low (of 4.5%) over the year to November 2005. This was also considerably lower than the national annual average unemployment rate of 5.1%, with Western Australia continuing to have the lowest annual average unemployment rate of all the States.

Western Australia's record low unemployment rate was underpinned by a slight contraction in the State's labour force participation rate in recent months and by employment growth of 5.4% (in annual average terms) that exceeded labour force growth of 4.7%. The average number of unemployed persons over the year to November 2005 was 49,100 persons – approximately 4,300 lower than for the year to November 2004.

Youth Unemployment Rate

Western Australia's youth unemployment rate¹⁴ continued to fall over the year to November 2005, down 2.2 percentage points to 16.2%. Nationally the youth unemployment rate fell 0.8 percentage points to 20.3% over the same period.

Participation Rate

Western Australia's participation rate¹⁵ has edged down lately, but averaged over the year to November, stood at 67.5% (its highest on record for an 12-month period). As shown in the following chart, Western Australia's participation rate remains considerably higher than the national rate of 64.4%.

¹⁴ 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 on a monthly basis with large standard errors, and hence annual average rates are the preferred measure.

¹⁵ The participation rate is defined as the ratio of the labour force to the total working age population

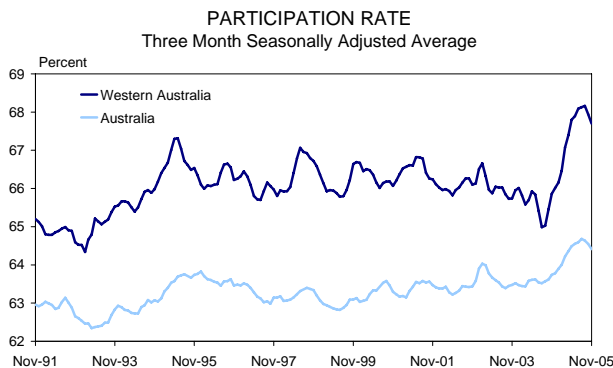
Participation Rate

Average rates (%)

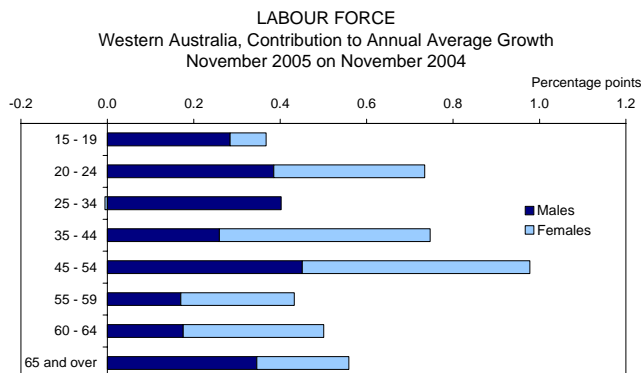
Period to November 2005

| | <i>qtr*</i> | <i>yr</i> |
|-------------|-------------|-------------|
| NSW | 62.8 | 62.8 |
| Vic | 64.3 | 64.4 |
| Qld | 66.3 | 66.3 |
| WA | 67.7 | 67.5 |
| SA | 61.9 | 61.9 |
| Tas | 61.1 | 59.9 |
| Aust | 64.4 | 64.4 |

** In seasonally adjusted terms*



Over the year to November 2005 the age group that contributed the most to the 4.7% growth in Western Australia’s labour force was the 45-54 year age group (up by 4.4%). The 65 and over age group experienced the highest growth over the year (up 33.1%) (however this group only represents around 2% of the Western Australian labour force).



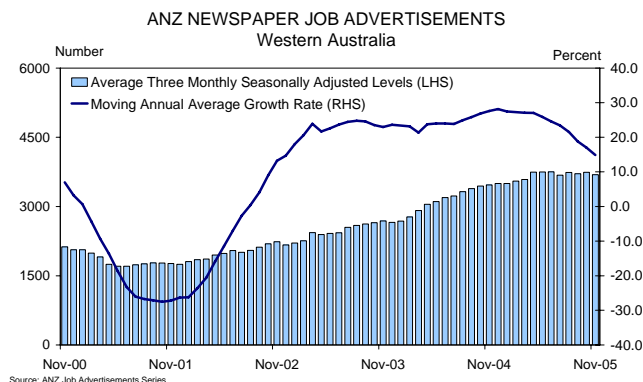
The 4.7% increase in the Western Australian labour force translates to approximately 48,900 persons.

Short-term outlook

Business surveys and well as job advertisements and skilled vacancies data indicate that labour demand in Western Australia remains strong.

Despite a contraction of 1.4% in newspaper job advertisements in the State over the three months to November 2005, the level of newspaper jobs advertisements remains near a record high, according to the ANZ Bank

Newspaper Job Advertisements Series¹⁶. In annual average terms, newspaper job advertisements remained strong, with growth of 14.9% over the year to November 2005. As the chart below indicates, however, it is moderating from the high of 28.2% recorded over 2004.

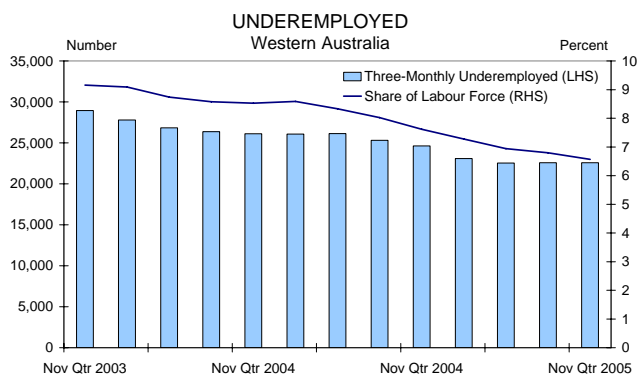


To some degree, the drop-off from the past high rates of growth is to be expected. Newspaper job advertisements are at historically high levels, making it hard to sustain the current strong growth rates.

Other employment outlook surveys are also reporting strong recruitment expectations for Western Australia in the coming quarters (see below).

¹⁶ The ANZ Bank has 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. [While the ANZ publish an Internet job advertisement series at a national level, data are not available at a State level].

The extent to which strong labour demand will translate into employment growth will depend on labour supply, which remains tight in Western Australia. The pool of underemployed¹⁷ and unemployed persons is small. Furthermore, to the extent that Western Australia's historical high participation rates already indicate a large "encouraged worker" effect¹⁸, there might be less likelihood for rises in participation going forward. These conditions are likely to present difficulties for employers when they are seeking to recruit labour, and in particular skilled labour.

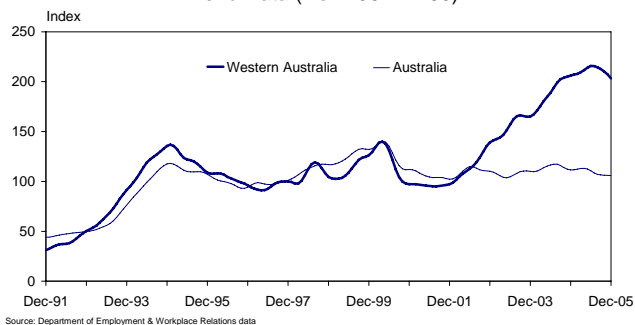


The Department of Employment and Workplace Relations' *Skilled Vacancies Index* indicates the extent of skilled labour shortages. The index for Western Australia is falling from its record high recorded in mid-2005, but remains significantly higher than the national level. The average index for Western Australia over the December quarter 2005 was 3.5% lower than the September quarter, and 0.9% higher than for the December quarter 2004.

¹⁷ Underemployment refers to employed persons who want, and are available for, more hours of work than they currently have.

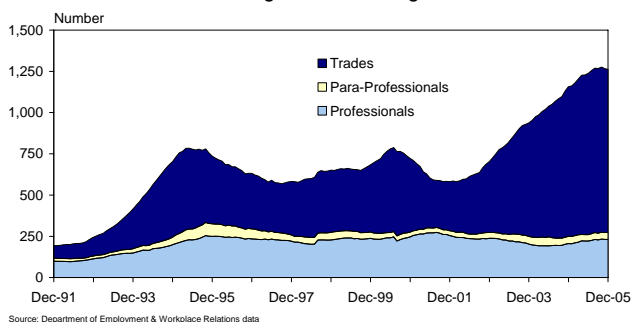
¹⁸ When labour market conditions are weak, with poor employment growth and high unemployment, the participation rate tends to drop – a phenomenon known as the "discouraged worker" effect, as people without jobs give up looking for them (and thereby count as unemployed). Western Australia's current tight labour market seems to be giving rise to an opposite "encouraged worker" effect, as people are attracted into the labour market by abundant job opportunities, giving rise to Western Australia's record participation rate in 2005.

SKILLED VACANCIES INDEX
Trend Data (Nov 1997 = 100)



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

JOB VACANCIES
Moving Annual Average



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 December 2005 reported that 66% of respondents considered labour availability to be 'scarce', slightly higher than the September quarter 2005 (63%) and substantially higher than the December quarter 2004 (51%).¹⁹

¹⁹ Source: CCIWA/BankWest *Business Expectations*, December 2005

In line with expected strong labour demand and tight labour supply, the forecasts contained in the latest *Mid-Year Financial Projections Statement* are for employment to grow by 3.75% and the unemployment rate to fall to 4.5% in 2005-06.

PRICES, INCOMES AND INTEREST RATES

- Perth consumer prices increased by 1.0% over the September quarter 2005, largely reflecting increases in petrol prices and costs associated with building new houses.
- The CPI for Perth increased by 4.1% through the year to the September quarter, with automotive fuel and building costs for new houses the largest contributors to growth.
- Wages and earnings continued to grow strongly in the September quarter, consistent with Western Australia's tight labour market conditions.
- 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

Perth's Consumer Price Index (CPI) increased by 1.0% in the September quarter 2005, following a rise of 1.3% in the June quarter. Automotive fuel and house purchases were the two major contributors to the CPI growth in the quarter, contributing 0.50 and 0.33 percentage points respectively. Growth in these two items accounted for 0.83 percentage points of the total increase in consumer prices in Perth, compared to 0.54 percentage points nationally.

Consumer Price Index

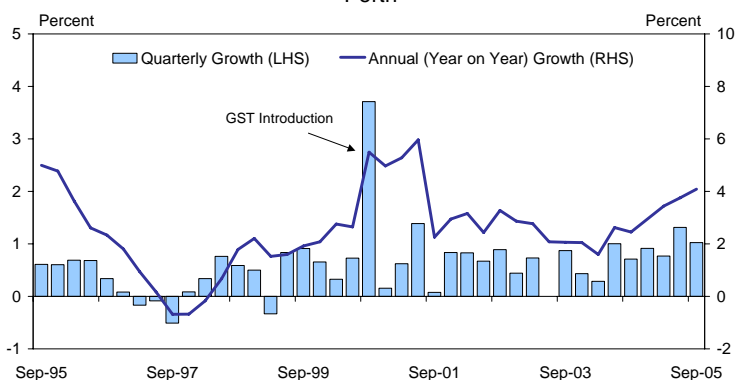
Growth (%)

Period to September 2005

| | qtr | yr* |
|------------------|------------|------------|
| Sydney | 1.0 | 2.9 |
| Melbourne | 1.2 | 3.1 |
| Brisbane | 0.6 | 2.8 |
| Perth | 1.0 | 4.1 |
| Adelaide | 1.1 | 3.0 |
| Hobart | 0.9 | 3.5 |
| Australia | 0.9 | 3.0 |

* Past quarter on same period a year earlier.

CONSUMER PRICE INDEX
Perth



The contribution from house purchases²⁰ is at a high level for Perth, and much higher than its contribution nationally. This is the most significant contributor to Perth's higher inflation - the CPI for Perth increased by 4.1% through the year to the September quarter, with the CPI nationally growing by 3.0% over the same period.

Although the CPI growth for Perth was quite strong over the past year, prices growth has been similar to the national average over the longer term. Over the past five years, Perth's CPI has increased by 14.9%, compared to 14.4% nationally. This partly reflects the fact that Perth's housing cycle has, to a certain degree, lagged behind that of other jurisdictions (in a sense, there has been an element of 'catch-up' in Perth prices over recent quarters).

It is expected that demand in the housing market will continue to generate some house price growth for the remainder of 2005-06, keeping Western Australia ahead of the national average in the short term. The forecasts in the *Mid-Year Financial Projections Statement* are for the CPI to increase by 4.0% in 2005-06, moderating to 3.0% in 2006-07.

Incomes

Wages and earnings continued to grow strongly in the September quarter 2005, consistent with the tight labour market conditions across Western Australia. The Wage Price Index (WPI) grew by 1.6% in the September quarter, while average weekly earnings rose by 1.2% and average weekly ordinary time earnings increased by 1.4%.

²⁰ House purchases incorporate construction costs for new houses and major improvements to existing homes and fixed appliances (such as ducted heating and hot water systems).

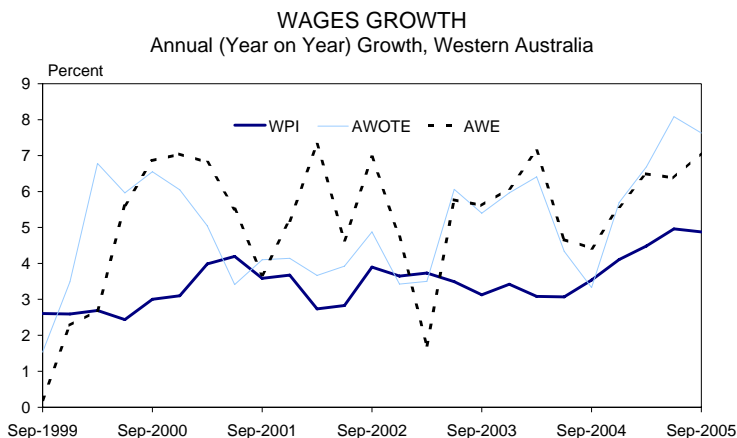
Wage Price Index

Growth (%)

September quarter 2005

| | qtr | yr* |
|-------------|------------|------------|
| NSW | 1.4 | 4.2 |
| Vic | 1.1 | 4.0 |
| Qld | 1.5 | 4.1 |
| WA | 1.6 | 4.9 |
| SA | 1.2 | 3.8 |
| Tas | 1.4 | 4.3 |
| Aust | 1.4 | 4.2 |

* Past quarter on same period
a year earlier



The WPI is the preferred measure of wages growth to changes in average earnings. Similar to the CPI, it is an index measuring the cost of a 'fixed basket' of jobs, and is designed to measure changes in wages over time for a fixed quantity and quality of labour input. Unlike the average weekly earnings measures, the WPI is designed to measure wage changes rather than levels. As such, it is not subject to the influence of compositional change (unlike average weekly earnings data).

The WPI for Western Australia grew by 4.9% through the year to the September quarter, recording the strongest annual growth of all the States. The WPI grew more moderately at a national level, increasing by 1.4% in the September quarter and by 4.2% through the year. Wages growth by industry at the national level²¹ over the September quarter was strongest in health and community services (up 1.9%), cultural and recreational services (up 1.9%) and transport and storage (up 1.8%).

Average weekly ordinary time earnings in Western Australia increased by 0.5% in August, to \$1,037.00 per week. This represents an increase of 7.6% when compared with the same period of the previous year. At a national level, ordinary time earnings increased by 6.3% through the year to August (to \$1,022.00 per week).

²¹ State-based wage by industry data are not available.

Average Weekly Earnings²² in Western Australia grew by 1.2% to \$801.90 in the three months to August. This represents an increase of 7.1% when compared with the same period of the previous year. At a national level, Average Weekly Earnings increased by 6.1% through the year.

Average weekly earnings are influenced not just by movements in wage rates, but also by changes in the composition of employment, so growth in mining industry employment may be inflating average weekly earnings data, as this has the highest average earnings by sector.

According to the December 2005 CCIWA-BankWest *Business Expectations* survey, 47% of respondents reported higher labour costs compared to just 2% who reported lower costs.²³ Furthermore, around 63% of respondents identified wage costs as one of their top three areas of concern, with 66% of respondents identifying labour shortages as one of their top three areas of concern.²⁴

Forecasts in the Western Australian Government's recently released *Mid-Year Financial Projections Statement* are for the WPI to increase by 4.5% in 2005-06, underpinned by ongoing tight labour market conditions, before easing to 3.5% in 2006-07.

Although substantial across-the-board increases in wages have not occurred in Western Australia, wages growth in some industries has been relatively strong. To the extent that strong wages growth would represent a significant increase in businesses' input costs (particularly for industries such as construction), wages growth remains a risk to the State's future economic growth. If wages growth was to accelerate, it could make Western Australia a relatively less attractive location for business investment, and also result in some projects at the margin becoming commercially unviable.

²² Unlike AWOTE, AWE includes payments such as overtime and bonuses, in addition to the earnings of part-time, casual and junior employees.

²³ Source: CCIWA/BankWest, *Business Expectations*, December quarter 2005

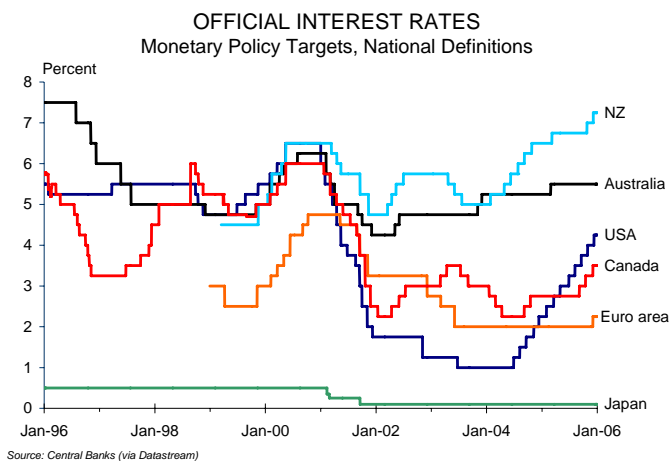
²⁴ Ibid

Interest Rates

The cash rate has remained unchanged at 5.50% since the Reserve Bank of Australia (RBA) increased interest rates by 25 basis points in March 2005.

In its November 2005 *Statement of Monetary Policy*, the RBA adopted what market commentators have described as a “mild tightening bias”. The Statement said that inflation is likely to be close to the top of its 2-3% target band for some time, and that “policy will need to be responsive to any sign that demand and inflation pressures are stronger than currently expected.”²⁵

In a speech on 13 December 2005, the RBA Governor, Ian Macfarlane, pointed out that although world interest rates are low by historical standards, Australia had not reduced interest rates to the extent that they had been reduced by the United States, Japan and the euro area.²⁶ He noted that “what we are seeing now around the world is a gradual return to normality in interest rates”, but that “we in Australia can make some claim to being the first in this process”.²⁷



²⁵ Ibid

²⁶ Macfarlane, I, Australian Business Economists Annual Forecasting Conference Dinner, 13 December 2005

²⁷ Ibid

INTERNATIONAL CONDITIONS

- *World GDP growth remains strong, driven by momentum in the buoyant Chinese and US economies.*
- *The growth in world GDP is now much more broadly based, with developing countries contributing to growth, and signs are emerging that the Japanese economy has been able to maintain its recovery.*
- *Although uncertainty in the global oil price outlook is still affecting the rate of expansion in some countries, overall activity in the economies of most of Western Australia's key trading partners remains healthy.*

The world economy has withstood a steady rise in oil prices over the past 18 months. Many commentators expect fuel prices to remain high in the near term, but their impact on world growth is likely to remain small. Although world growth is likely to moderate in 2006, it is still expected to continue to expand at a reasonable pace.

Overall global GDP growth remains robust, with the Organisation for Economic Cooperation and Development (OECD) expecting economic activity to increase by 2.7% in 2005 and by 2.1% in 2006. The OECD notes that "one important and reassuring feature of the present situation is that virtually all countries have maintained price stability in the face of the oil price shock, without compromising activity".²⁸

In an encouraging sign, the OECD also noted that world growth has been broadening across regions over the past few months. It remarked that world growth, "is already quite strong in North America and most of Asia, (and) now looks well established in Japan with continental Europe progressively recovering from its latest bout of weakness".

Forecasts of world GDP growth in 2005 and 2006 from Consensus Forecasts (which surveys over 240 financial and economic forecasters) are slightly more upbeat than forecasts from the OECD, with Consensus expecting growth of 3.1% in each year.

²⁸ Source: OECD, *Economic Outlook*, December 2005

Although world growth is broadening, the United States of America (USA) and China continue to drive much of the pace of global expansion. Importantly for Western Australia, activity in China is exerting considerable impetus on the activity in most of its neighbouring countries (many of which are key trading partners).

Economic growth in China continues unabated, with recent government announcements forecasting GDP to increase by 9.3% in 2005. Furthermore, commentary from Goldman Sachs indicates that by the end of 2006, the Chinese economy will be about half the size of the Japanese economy, shifting the balance of power in the region away from Japan.²⁹ However, while China's economy is growing rapidly, it continues to have a relatively low GDP per capita, with around 212 million rural Chinese living on the equivalent of US\$1 dollar a day³⁰. Poverty is concentrated especially in the large rural population and the western provinces.

Many forecasters (including the OECD and IMF) expect the Chinese economy to continue to expand by at least 7-9% per year in the medium term. As a result of the predicted high rates of growth across most sectors (including agriculture), the standard of living of many Chinese is likely to improve in the coming years. The future prospects for China remain bright and, as an indication of its growing economic prosperity, the World Food Program recently announced that it would end its 26-year food aid assistance to China at the end of 2005.

²⁹ Source: Avery, N. *China's economy larger than thought*, at www.bloomberg.com

³⁰ Source: Xiaohua, S. *Chinese NGO's to get state funds to help poor*, at www.asianewsnet.net

Economic conditions in the USA remain positive, which is continuing to ensure that activity expands steadily elsewhere in the world. The OECD notes that activity in the USA continues to grow, underpinned by robust productivity growth, buoyant house prices, and fiscal and monetary stimulus. Despite damaging hurricanes and large increases in oil prices, the economy is anticipated to "maintain a relatively smooth trajectory" in the near term.³¹ Accordingly, the OECD expects the USA's GDP to increase by 3.6% in 2005 and by 3.5% in 2006.

The Open Market Committee of the US Federal Reserve raised interest rates in each meeting it held during 2005. Interest rates were recently raised by 25 basis points on 13 December, marking the thirteenth consecutive tightening by the bank. Many market commentators expect further tightening in coming months, with median expectations of rates to reach 4.75% by the end of 2005-06.

The recent rise in US interest rates has acted to contain growth in consumer prices. In a recent statement the Federal Reserve noted that "core inflation has stayed relatively low in recent months and longer-term inflation expectations remain contained". Most recent estimates of consumer price growth indicate that prices have grown by 3.8% over 2005 (compared with 3.7% a year earlier).

Signs have recently emerged that growth in the Japanese economy is likely to be sustained (albeit at a modest pace), after initial concerns about whether the recovery would last. In a recent report, the Japanese government noted that corporate earnings had improved and major corporations had gradually increased investment (particularly in plant and equipment).³² A similar level of optimism has also been reflected in business sentiment, which in December, rose to its highest level in a year.

Japanese consumers are also becoming more optimistic. Recent surveys of consumer confidence show that 50% of Japanese consumers surveyed believe prices are likely to rise over the 2006, one of the highest proportions in recent survey periods.

³¹ Source: OECD, *Economic Outlook No 78: United States*, December 2005

³² Source: Japanese Cabinet Office, *Economic Report*, December 2005

The current expansion in Japan is the longest in eight years, fuelled by consumer and capital spending. This has prompted many commentators to suggest that the end to seven years of deflation is near, and that the Bank of Japan may consider raising interest rates (which have been close to zero percent since March 2001). However, the Bank of Japan's policy of "quantitative easing" is likely to continue in future until inflation is high enough to make the risk of renewed deflation negligible.

The OECD forecasts that Japan's economy will expand by 2.4% in 2005, followed by growth of 2.0% in 2006.

There are signs that activity is gradually strengthening in South Korea. Private consumption is now recovering from a protracted adjustment, following the collapse of the household credit bubble in 2002, and export growth has picked up. Given the promising outlook, the Bank of Korea expects that economic growth will accelerate to 5% in 2006, the fastest rate of growth in four years. Similarly, the OECD forecasts that GDP in South Korea will increase by 5.1% in 2006 following an expected 3.9% increase in 2005.

Exports will continue to play a leading role in the growth of the South Korean economy, in addition to renewed support from private consumption. The Bank of Korea recently raised interest rates to 3.75% in an effort to control emerging cost pressures against the backdrop of strengthening economic activity.

Both business and consumer confidence are high despite the recent interest rate rise. Latest data (for November 2005) from the Federation of Korean Industries indicate that South Korean business confidence is at its highest level in more than three years, while measures of consumer confidence also remain strong (with most consumers planning to increase spending over the coming year).³³

³³ Source: Federation of Korean Industries, Business Survey Index, November 2005

The recovery in the Euro area is also gaining momentum. A recent report by the European Commission noted that leading indicators pointed to solid growth in the Euro-zone in the last few months of 2005, with expectations that growth will remain strong into 2006.³⁴ Growth in the region is becoming increasingly broadly based, with consumption increasing gradually, and business investment and exports continuing to improve (however, there are cost pressures from oil prices and booming credit growth). Considering these risks, and given signs of faster forecasted growth in the region, the European Central Bank raised interest rates in December (to 2.25%) for the first time in five years (see the official interest rate chart in the proceeding chapter).

Our outlook for growth in most Association of South East Asian Nations trading partners is positive, with growth in Singapore, Indonesia, Malaysia and Thailand in particular, expected to remain healthy, despite the possibility that high oil prices may act to soften activity in the region.

³⁴ Source: European Commission, *Quarterly Report on the Euro Area*, December 2005

2. THE 2004-05 STATE ACCOUNTS

Western Australia's real Gross State Product rose by just 2.7% in 2004-05, according to the annual State Accounts released in November 2005. This was much lower growth than had been predicted by private and government forecasters (including the Department of Treasury and Finance), and seemed at odds with other data indicating that economic activity in the State was very robust.

This article examines the reasons for this unexpectedly weak growth in 2004-05, and concludes that Western Australia's economic conditions were stronger than this growth rate suggests.

It also argues that, at a time when the State's terms of trade are changing rapidly due to changing commodity prices, growth in real Gross State Income may provide a better gauge of changes in the State's purchasing power than real Gross State Product.

Overview of the 2004-05 State Accounts

Western Australia's real Gross State Product (GSP) increased by just 2.7% in 2004-05, according to estimates released by the Australian Bureau of Statistics in November 2005.

This seemed at odds with the strong economic activity suggested by most indicators at the time³⁵. For example, the labour market was showing signs of overheating, with the unemployment rate averaging 4.7% for the year (its lowest since 1976-77), and employment increasing by 4.2% (the strongest growth since 1994-95).

Also, Western Australia's house prices and residential construction activity were still rising, in contrast with cyclical downswing in some Eastern States' housing markets.

³⁵ See the 2005-06 Government Mid-Year Financial Projections Statement feature article in this Summary for a fuller description of recent economic trends.

Business investment was strong, in large part because the resource sector was expanding capacity in response to high commodity prices and strong international demand for minerals and energy.

These favourable international conditions were also generating rapid increases in export values (although the volume of exports was slower to respond – see below).

Table 1: Western Australia's Economic Growth

| | <u>Annual % Change</u> | | | | <i>Period</i> |
|---|------------------------|----------------|----------------|----------------|------------------------------|
| | <i>2001-02</i> | <i>2002-03</i> | <i>2003-04</i> | <i>2004-05</i> | <i>Average⁽¹⁾</i> |
| Growth in GSP Components, Chain Volume (Real) Measures | | | | | |
| <i>Private</i> | | | | | |
| Consumption | 3.2 | 3.6 | 6.4 | 6.1 | 4.8 |
| Business investment | 12.9 | 22.3 | 21.0 | 2.7 | 14.5 |
| Dwelling investment | 14.7 | 7.9 | -2.3 | 6.4 | 6.5 |
| <i>Public</i> | | | | | |
| Public Consumption | 1.6 | 2.6 | 3.7 | 4.0 | 2.9 |
| Public investment | -9.8 | 2.3 | 13.5 | 24.2 | 6.8 |
| State Final Demand | 4.6 | 6.7 | 8.0 | 5.8 | 6.3 |
| <i>External Sector</i> | | | | | |
| International exports | 1.5 | 9.8 | 4.3 | 3.4 | 4.7 |
| International imports | 1.1 | 22.5 | 10.7 | 15.1 | 12.1 |
| Net Exports | 1.8 | 3.3 | 0.4 | -4.5 | 0.2 |
| Balancing item | -4.5 | 7.9 | -3.6 | 10.3 | 2.3 |
| Gross State Product | 5.6 | 5.6 | 8.1 | 2.7 | 5.5 |
| Gross State Income | 3.5 | 6.4 | 9.0 | 6.4 | 6.3 |
| Growth in Implicit Price Deflators and Terms of Trade | | | | | |
| Private Consumption | 2.8 | 2.3 | 1.2 | 2.3 | 2.1 |
| Dwelling investment | 0.6 | 5.2 | 11.5 | 10.5 | 6.9 |
| State Final Demand | 2.5 | 1.9 | 1.3 | 3.1 | 2.2 |
| International exports | -3.5 | -0.4 | -6.5 | 12.9 | 0.4 |
| International imports | 0.4 | -2.7 | -9.4 | 3.8 | -2.1 |
| Gross State Product | 0.4 | 2.0 | -0.1 | 6.4 | 2.1 |
| Terms of Trade ⁽²⁾ | -3.9 | 2.5 | 3.2 | 8.7 | 2.5 |
| Nominal⁽³⁾ Gross State Product | | | | | |
| | 6.0 | 7.6 | 8.0 | 9.3 | 7.7 |

(1) annual average % change in the 4 years to 2004-05

(2) ratio of export prices to import prices

(3) in current prices, i.e. not adjusted for price changes

The GSP growth rate of 2.7% was also less than public and private forecasters had predicted. For example, the Department of Treasury and Finance's forecasts published in the May 2005 Budget Papers predicted real GSP growth of 5.25% in 2004-05.

Private sector forecasters' more recent predictions (released in the September quarter) ranged from 3.8% forecast by Econtech³⁶, to 4.5% forecast by the Chamber of Commerce and Industry of Western Australia³⁷, and 4.6% by Access Economics³⁸.

The domestic demand component of the state accounts showed very strong growth, consistent both with forecasters' expectations and with other indicators of economic activity. Growth in real domestic demand was estimated at 5.8% in 2004-05, following 8.0% growth in 2003-04.

Domestic demand growth was underpinned by household expenditure and public investment in 2004-05, and all key components of domestic demand grew (private consumption, housing investment, business investment and government spending).

Two factors - net exports and the "balancing item" - acted to drag down overall GSP growth during the year compared to relatively strong growth in the domestic economy.

The net merchandise trade balance contracted in volume terms for the first time since 1992-93, as export growth of 3.4% was more than offset by import growth of 15.1%.

This export weakness was surprising. Global demand for the State's export commodities is strong, as the State's record commodity prices demonstrate.

Furthermore, some expansion of productive capacity in the export sector should have resulted from the strong growth of business investment, which has risen at an average rate of 14.5% a year in the past four years.

³⁶ Source: Econtech, *State and Industry Outlook*, July 2005

³⁷ Source: CCIWA, *Economic Compass*, September 2005

³⁸ Source: Access Economics, *Business Outlook*, September 2005

It should be noted, however, that the real GSP data measure only changes in volumes, and so do not reflect the effect on export values of the 12.9% increase in average export prices over the year. In current prices, the value of the State's exports increased by 16.7% over 2004-05, and its trade surplus rose by \$3.3 billion (14.9%).

Because it excludes these price effects, real GSP growth is not the best measure of changes in the State's real purchasing power when its terms of trading are changing rapidly (see analysis below).

Data Quality of the Gross State Product Estimates

Besides net exports, the other key component of the state accounts to detract from GSP growth over the year was the "balancing item". This term comprises mainly net interstate trade and changes in inventories, but also includes a large "statistical discrepancy" which reflects measurement differences between the different methods used by the Australian Bureau of Statistics to estimate GSP.

The size of the balancing item serves as a reminder that the Bureau calls its GSP data "experimental". Because there are no data collections available on some of the components of expenditure on GSP, it uses estimating techniques to approximate the missing information. Furthermore, the quality of some of the data on components for which estimates are available is not particularly good. Partly for these reasons, GSP estimates can be revised substantially between publications.

Export Prices and the Terms of Trade

Because it measures growth in the **volume** of outputs, real GSP growth does not directly reflect the increase in the value of those outputs arising from changes in prices.

It may show some indirect effects of price changes – for example, if the level of investment or volume of exports increases in response to higher export prices, any increase in the value of output caused by the higher prices themselves does not count towards real GSP growth.

Adjusting for price changes is appropriate when considering changes in real purchasing power. Real living standards are determined by the quantity of goods and services a community has at its disposal, not by changes in the notional value of those goods and services resulting from price changes.

However, when states and countries trade, they have access to goods and services other than those they produce themselves – they can exchange their output for the produce of other states and countries.

Furthermore, when a state or country's export prices are rising faster than its import prices – that is, when its terms of trade³⁹ are increasing – it can exchange a given volume of its exports for a larger volume of imports. So the quantity of goods and services that it has at its disposal will increase by more than the quantity of goods and services it produces. In these circumstances, growth in the volume of output – that is, in real gross State or domestic product – will be less than growth in real purchasing power.

To capture this effect, the Australian Bureau of Statistics produces a terms-of-trade-adjusted measure of the purchasing power of economic output called real Gross State Income⁴⁰. This is calculated by adjusting the value of the State's exports by its terms of trade, to reflect the value imports that it can obtain in exchange for its exports.

For most states and at most times, the differences between growth in Gross State Income and Gross State Product will not be very large. Their terms of trade do not usually change sharply over short time periods (although occasionally they do). Furthermore, exports represent only about 17% of Australia's Gross Domestic Product (and less than 13% of GSP, on average, in the States other than Western Australia). So for most States, an increase in the volume of imports that can be exchanged for their exports does not generate a large increase in overall purchasing power.

Western Australia is different, for two reasons.

³⁹ The terms of trade is the ratio of export prices to import prices

⁴⁰ or Gross National Income, at national level.

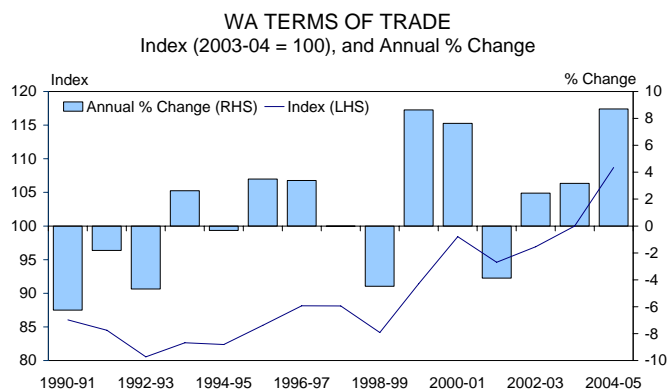
Firstly, it is much more export reliant than the rest of Australia, with the value of merchandise exports equivalent to 43% of Western Australia's GSP.

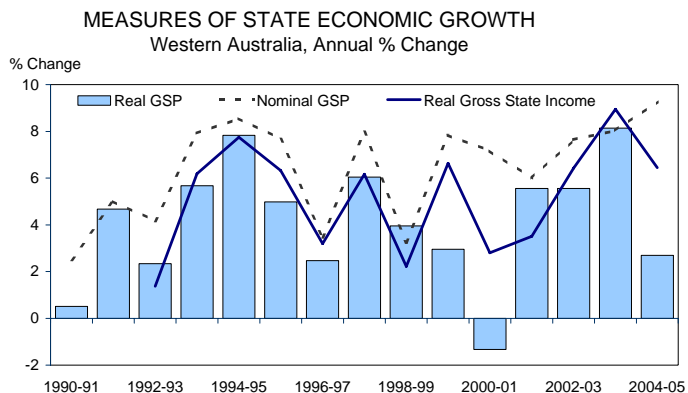
Secondly, Western Australia's exports are predominantly commodities, whose prices tend to be more volatile than other goods and services. This means that its export prices and terms of trade are more likely to change markedly from one year to the next than if it exported mainly services or manufactured goods.

These factors mean that Western Australia can experience a marked divergence between its economic growth as measured by Gross State Income and growth measured by the more familiar benchmark of Gross State Product when its export prices are moving rapidly.

Because of the global commodity price boom, 2004-05 was such a year. Western Australia enjoyed an 8.7% increase in its terms of trade, generated by a 12.9% rise in its export prices (see following chart).

As a result, in 2004-05 Western Australia's real Gross State Income rose by 6.4%, well ahead of the national average, and second only to Queensland of the Australian States.





It is worth noting that nominal GSP, which is not adjusted for price effects, rose by 9.3% in 2004-05 - even more rapidly than real Gross State Income. The difference between this and the real GSP growth rate of 2.7% was due to price changes, with the GSP price deflator rising by 6.4% during the year. This was also mainly an effect of export prices - the price deflator for domestic demand rose by 3.1%.

In years when Western Australia's terms of trade are not changing sharply, the rate of growth in GSP is fairly close to growth in its real Gross State Income. In these circumstances the more familiar real GSP measure provides as good a benchmark as any of overall growth in the economy - bearing in mind, of course, the measurement problems which mean that both indicators are subject to fairly wide measurement errors, and should be treated as experimental.

However, in years when Western Australia's terms of trade are changing sharply, growth in Gross State Income provides a better measure of the change in overall purchasing power than real GSP. So in 2004-05, the 6.4% increase in the state's real Gross State Income is a better indicator of economic conditions than the 2.7% growth in its real GSP.

3. 2005-06 GOVERNMENT MID-YEAR FINANCIAL PROJECTIONS STATEMENT

The 2005-06 *Government Mid-year Financial Projections Statement* (mid-year review) was released on 22 December 2005 and outlined developments and changes in the State's financial and economic outlook since the 2005-06 Budget (presented on 26 May 2005).

The revised projections are consistent with meeting all of the Government's financial targets except for the expense growth target in 2005-06 (due to changes in spending expectations in the priority service delivery areas of health, education and training, and law and order, and various post-budget policy decisions detailed in Appendix 3 of the mid-year review).

Compliance with Financial Targets

| | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
|--|---------|---------|---------|---------|
| FINANCIAL TARGET | | | | |
| Real net worth maintained or increased ^(a) | Yes | Yes | Yes | Yes |
| General government net operating surplus | Yes | Yes | Yes | Yes |
| Triple-A credit rating maintained via: | | | | |
| - net debt as a share of revenue at or below 47% ^(b) | Yes | Yes | Yes | Yes |
| - no increase in real per capita own-purpose general government expenses | No | Yes | Yes | Yes |
| Tax competitiveness maintained ^(c) | Yes | Yes | Yes | Yes |
| (a) Total public sector. | | | | |
| (b) Total non-financial public sector. | | | | |
| (c) Tax revenue as a share of gross State product to be below other States' average. | | | | |

Financial Projections

The revised financial outlook reflects continuing general government operating surpluses over the forward estimates period, lower than budgeted net debt levels (as a result of the better than expected outcome for 2004-05 and stronger surpluses across the projection period) and continued strong infrastructure spending across the forward estimates.

A general government net operating surplus of \$1,302 million is now in prospect in 2005-06, a substantial upward revision from the estimated surplus of \$521 million at budget time, due mainly to a stronger outlook for revenue.

Movements between the budget and mid-year review projections in the revenue estimates for 2005-06 include:

- increases in projected taxation revenue (up \$674 million, or 16.9%), reflecting continued strength in the property and labour markets (flowing through to higher collections of stamp duties on conveyances and mortgages, and payroll tax) and the continued strength of motor vehicle sales (impacting motor vehicle tax collections);
- an upward revision to Commonwealth grants and subsidies revenue (up \$165 million, or 2.4%), due mainly to projected increases in North West Shelf petroleum royalties (from higher than budgeted oil prices) and increased grants for roads and schools;
- increases in projected mining royalties (up \$103 million, or 9.0%), reflecting higher commodity prices, particularly for iron ore;
- higher expectations for "Other" revenue (up \$80 million, or 28.7%) due largely to the impact of land resumption as part of the Perry Lakes redevelopment project, and additional industry grants to the Department of Agriculture;
- stronger public corporations revenue (up \$61 million, or 8.6%), reflecting more favourable profitability forecasts, particularly for the Water Corporation; and
- higher agency goods and services revenue (up \$55 million, or 5.8%) for a range of cost recovery activities carried out by the sector.

Partly offsetting the stronger revenue projections, expenses are expected to increase relative to the budget estimates for 2005-06, reflecting:

- policy decisions taken by the Government since the Budget estimates were finalised, such as measures to address identified skills shortages, additional resources for the Office of the Director of Public Prosecutions, implementation of the Outcomes and Standards Education curriculum, enhancing counter-terrorism capabilities, streamlining resource project approval processes, and increasing student safety on school buses;
- spending carried over from 2004-05 due to timing issues; and
- cost and demand driven increases in spending across various areas including patient health service provision, road works and the impact of enterprise bargaining agreement increases in various sectors.

Operating surpluses in the outyears are expected to be on average \$378 million higher than estimated at the time of the 2005-06 Budget, reflecting the flow-on impact of continued strength in the revenue estimates discussed above, partially offset by projected increases in expenses.

General Government Sector Operating Statement

| | 2005-06 Estimate \$m | 2006-07 Estimate \$m | 2007-08 Estimate \$m | 2008-09 Estimate \$m |
|------------------------------|----------------------------|----------------------------|----------------------------|----------------------------|
| MID-YEAR REVIEW | | | | |
| Revenue | 15,357 | 15,338 | 15,608 | 16,009 |
| Expenses | 14,056 | 14,597 | 14,929 | 15,363 |
| Net Operating Balance | 1,302 | 731 | 678 | 646 |
| 2005-06 BUDGET | | | | |
| Revenue | 14,218 | 14,520 | 14,861 | 13,268 |
| Expenses | 13,697 | 14,085 | 14,669 | 14,973 |
| Net Operating Balance | 521 | 435 | 192 | 295 |
| VARIANCE | | | | |
| Revenue | 1,139 | 808 | 747 | 741 |
| Expenses | 359 | 512 | 260 | 389 |
| Net Operating Balance | 780 | 296 | 487 | 351 |

Note: Columns may not add due to rounding.

The impact of the stronger revenue outlook, combined with the better than expected net debt outcome for 2004-05 (reported in the 2004-05 *Government Financial Results Report*), is reflected in a downward revision in the total non-financial public sector net debt to revenue ratio, which is projected to remain comfortably below the Government's target upper limit of 47% across the entire forward estimates period. The ratio is forecast to reach an expected maximum of 39.9% in 2008-09, down from a peak of 43.4% at the time of the 2005-06 Budget.

Ratio projections at these levels indicate that growth in net debt remains affordable and does not place an undue burden on State finances. This has allowed the Government to maintain high levels of infrastructure spending. In this regard, the mid-year review projections show that the public sector is forecast to spend \$18.2 billion on capital works over the four years to 2008-09, up from an estimated \$15.8 billion at budget time. The increase in capital spending includes projects in the health sector, investment in new sporting, community and industry projects and provision for cost increases across the public sector's existing capital projects.

Economic Outlook

In addition to the Government of Western Australia's financial projections and financial strategy, the 2005-06 *Government Mid-Year Financial Projections Statement* also includes an outlook for the State's economy.

The forecast for Gross State Product has been revised upwards from a budget time forecast of 4.5% in 2005-06 to 5.0%, reflecting the buoyancy of domestic economic conditions. This still represents strong economic growth and follows growth of 2.7% in 2004-05.

The outlook for the domestic economy as measured by State Final Demand remains relatively robust and is forecast to grow by 5.75% in 2005-06, up from 2.25% at budget time, underpinned by our expectations of a stronger domestic economy.

The following table outlines the revised mid-year review economic forecasts.

| Major Economic Aggregates | | | | | |
|----------------------------------|-------------------|-----------------------|---------------------|---------------------|---------------------|
| | Western Australia | | | | |
| | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
| | Actual | Mid-Year Revision | Forward Estimate | Forward Estimate | Forward Estimate |
| | % | % | % | % | % |
| Real Gross State Product Growth | 2.7 | 5.0 (4.5) | 3.5 (4.25) | 4.5 (4.5) | 4.5 (4.5) |
| State Final Demand Growth | 5.8 | 5.75 (2.25) | 3.0 (3.25) | 4.0 (4.0) | 4.0 (4.0) |
| Employment Growth | 4.2 | 3.75 (2.0) | 2.25 (2.0) | 2.25 (2.25) | 2.25 (2.25) |
| Unemployment Rate | 4.7 | 4.5 (4.75) | 4.75 (4.75) | 4.75 (4.75) | 4.75 (4.75) |
| Wage Price Index Growth | 4.3 | 4.5 (3.75) | 3.5 (3.25) | 3.5 (3.25) | 3.0 (3.0) |
| Average Weekly Earnings Growth | 5.7 | 5.5 (4.75) | 4.0 (3.5) | 4.0 (3.5) | 3.5 (3.5) |
| Consumer Price Index Growth | 3.2 | 4.0 (2.5) | 3.0 (2.5) | 2.5 (2.5) | 2.5 (2.5) |
| Implicit Price Deflator Growth | 6.4 | 2.75 (2.25) | 2.25 (2.25) | 2.25 (2.25) | 2.25 (2.25) |

Note: Figures in brackets represent the Department of Treasury and Finance's 2005-06 Budget estimates.

4. PRESSURES, RISKS AND UNCERTAINTIES AFFECTING WESTERN AUSTRALIA'S ECONOMIC OUTLOOK

The Western Australian economy is enjoying very favourable conditions, and most forecasters expect these conditions to continue over the next few years. Recently-updated forecasts from the Department of Treasury and Finance (DTF) predict that the economy will grow by more than 4% a year to 2008-09 (see previous feature article).

Risk and Uncertainty

These forecasts are based on what the DTF believes to be reasonable assumptions about the factors affecting the growth prospects of the Western Australian economy and on long term trends.

However, consistent with economic forecasting conventions, the DTF's forecasts do not attempt to capture the possible effects on the Western Australian economy of risks⁴¹ such as droughts. We know that the State will be affected by drought periodically, but cannot predict the timing or severity of the next one. Similarly, forecasts cannot encompass all uncertainties⁴¹. So economic forecasts make no allowance, for example, for the possible effects of an avian flu pandemic.

As well as risks and uncertainties, some factors are highly likely to affect the State's growth path, but the nature of their effects is hard to predict. The ageing population, for example, will have many social and economic consequences, but at best we can make informed guesses as to what they might be.

While these events cannot be anticipated precisely, and do not properly belong in short-term economic forecasts, it is still possible, and of interest, to explore their potential effects on the Western Australian economy.

⁴¹ Here, "risk" is defined as an event whose probability of occurring and likely outcomes are in principle predictable, such as drought. "Uncertainty" describes events whose likelihood and possible outcomes cannot be predicted.

This article considers some of the pressures, risks and uncertainties that may affect Western Australia's growth, but which are not captured in the DTF's economic forecasts.

This first part of the article sketches the nature and consequences of economic shocks using recent examples, while the second outlines the DTF's views on which risks have the greatest potential to affect the short-term economic outlook for Western Australia.

The third, final section looks at some possible scenarios that may unfold in the Western Australian economy in the medium and longer term. The examples chosen are illustrative and speculative, and should not be taken to suggest that the DTF believes they are likely to happen.

Nature and Consequences of Economic Shocks

Most economic shocks produce second-round effects that flow from their initial impacts on the economy. These chains of cause and effect can be traced out as possible scenarios that could affect the economy.

In some cases, these secondary effects act to offset or to mitigate the initial impacts. For example, strong labour demand can lead to wages growth that induces an increase in labour supply, either through an increase in the labour force participation rate of the existing population, or by inducing interstate and overseas migration.

Conversely, some events may have knock-on effects that magnify or reinforce their initial impact. An example could be an unrestrained wage/price spiral, where strong growth in prices leads to higher wages claims, which raises input costs, which in turn places pressure on prices to rise higher, etc.

The duration of the effects of economic shocks varies. Some events have a very large initial impact, but their economic consequences fade fairly quickly, such as the September 11 terrorist attacks in the USA, or the SARS virus. Others take longer to unfold, and their consequences take longer to unwind, such as the Asian economic crisis in 1997-98, or the geopolitical uncertainty in the Middle East and its continuing effects on oil prices.

Finally, while we can be fairly sure that some economic phenomena will not persist, the timing and nature of their reversal can be hard to foretell.

For example, forecasters may believe that rising household debt or a perceived housing or stock market bubble to be unsustainable, and incorporate the reversal of such imbalances into their predictions. But turning points in markets such as these are determined by human behaviour that is hard to predict, and may be driven by factors other than a calculated assessment of market conditions. So it can be hard to forecast when a market adjustment will take place, or whether it will take the form of a gradual and gentle correction or an abrupt readjustment.

Current Risks to Growth

This section focuses on those risks whose probability of occurring or potential severity could feasibly cause economic growth to deviate significantly from the growth forecasts contained in the latest Mid Year Financial Projections Statement (see previous feature article).

International Conditions

Economic activity in the United States of America, Japan and more recently China, is driving global growth. While economic conditions in the USA and China are buoyant, the recovery in the Japanese economy is still tentative, and there are some external vulnerabilities to the economic outlook for Western Australia.

A major risk to global markets is a slowdown in the economies of the USA, Japan and/or China. While the short to medium term outlook remains reasonably positive for these economies, any shock to these environments would affect Western Australia's prospects.

In particular, any deceleration of China's economic growth from the remarkable expansion of the past three decades (from 1980 to 2005 China's real economic growth averaged 9.5% a year) would affect Western Australia's trading environment both directly and indirectly. China is a key driver of growth in many of the State's other trading partners, as well as an important market in its own right.

China's growth has also been particularly beneficial to Western Australia because its import demand complements the State's strength in resources export.

While the USA's economic growth seems fairly robust, the sustainability of its large fiscal current account deficits remains a source of global economic uncertainty.

Japan is still Western Australia's largest export market, although it looks likely that China will overtake it in the near future. Japan's economy is still struggling to achieve sustained strong growth, and is also reliant on trade with China as a key source of the improved growth of the past three years.

Risks to global growth from continued high oil prices could also have a detrimental effect on Western Australia's economy. So far, the global (and State and national) economies have survived the high oil prices of the past few years remarkably well, with little discernable effect on economic growth. But this does not mean that any further sharp oil price rises could be contained so easily. If prices rise much further, both economic growth and inflation could be adversely affected.

Unpredictable external shocks, such as geo-political events or the outbreak of disease (e.g. uncontained avian flu or other viral infections) also present additional risks that could adversely affect the economic growth rates of the State's key trading partners, perhaps significantly.

Commodity Prices

Commodity prices are closely linked to international economic conditions, typically rising and falling as global demand growth accelerates or slows. However, commodity prices tend to be more volatile than the prices of other goods and services, with marked swings over the course of the economic cycle.

This means that the economic cycles of commodity-focussed economies such as Western Australia are subject to greater-than-average variability.

Western Australia is enjoying a particularly strong upswing in its commodity prices at present, and this has led to increased business investment, exports, income flows and employment; all of which have boosted economic activity in the State. Higher commodity prices are not entirely positive for growth, however, as they have also led to higher business and consumer costs (particularly in key areas such as crude oil and steel).

In the short to medium term, Commodity prices could surprise on the upside or downside, with subsequent flow-on for Western Australia's economic growth

Prices could remain higher than expected if global growth and commodity demand (particularly from China) remain strong. Alternatively, there is a downside risk if such demand softens considerably, and/or the expected increase in global commodity supply comes online quicker than expected.

In the long term, the historical trend has been for commodity prices to fall relative to the prices of services and manufactured goods. If this trend eventually resumes, then Western Australia may face a period of transition away from the unusually high prices enjoyed in the past three years.

The historical tendency of the Australian dollar to rise when commodity prices rise and vice versa can dampen the revenue/profit impact of fluctuations in commodity prices⁴². If the dollar declines at tail end of the current resources boom, it would also act to soften the effect on Australian dollar export revenues of any decline in international commodity prices.

Even if this mitigates some of the effect on export revenues, however, it is likely that there would be other negative economic effects. Business investment, in particular, could drop off quite sharply if commodity prices fall.

⁴² Although it is also worth noting that this relationship appeared to break down in the early 2000s, at least temporarily.

Beside the risk to global growth that higher crude oil prices represent, they also remain a risk to growth for Western Australia specifically.

While it appears that the impact of high oil prices on the State's overall economic growth has to this stage been moderate, high oil prices for a sustained period of time could be expected to place upward pressure on prices, interest rates and costs, and reduce profitability and production (particularly in energy-intensive industries).

Notwithstanding this, if higher crude oil prices are sustained (and similarly LNG prices), this would also benefit the Western Australian economy, given it is a large net exporter of energy.

Housing

Factors that affect the housing market in the short to medium term include affordability, interest rates, consumer and investor sentiment, capacity constraints in the construction industry, land availability, employment growth and labour mobility induced by skill shortages, population growth and growth in households' disposable incomes.

Housing demand not only feeds into residential building activity, it can create secondary demand in the retail sector for household goods such as furnishings.

Because the housing construction industry is now operating at capacity, completion times have lengthened and there is a large backlog of work yet to be done. This suggests that strong investment levels will continue in the short term at least (for further information, see the "Dwelling Investment" chapter in this publication, page 13).

However, the current strong levels of building activity and rapid increases in house prices will ease as the housing cycle peaks, although the timing and severity of any correction cannot be predicted with certainty.

Interest Rates

Interest rate rises have a negative impact on the housing sector and household balance sheets, and can also affect business costs and cash flow (especially in the small business sector). Business investment may also be affected by rising interest rates, as borrowing capital at market rates could increase the cost of an investment. Rising interest rates may also affect the timing of projects and could result in their postponement or cancellation. However, Western Australia's business investment in the key resource sector is driven more by international demand and commodity prices than domestic interest rates⁴³. Unless rates rise dramatically, their effects are more likely to be felt in the household and small business sector.

There are mixed opinions on the interest rate outlook for 2006. Some analysis indicates that the balance of risks to interest rates from rising inflation expectations "appears skewed to the upside at present"⁴⁴. While the RBA notes that US bond yields typically have a strong influence on domestic monetary policy settings, it also says that spreads between Australian and US 10-year bonds remain well below their average for the past few years and the Australian yield curve remains "unusually flat". While private sector commentators anticipate an interest rate tightening in 2005-06, the magnitude of any rate increase is likely to be small given the increased sensitivity of the household sector to interest rates resulting from high household debt

Capacity Constraints and Inflation

With demand for labour forecast to remain strong, labour supply side constraints also represent a potential risk to the economic outlook. Labour supply constraints (particularly for skilled labour) may lead to project delays, deferrals, or the inability of businesses to take on additional work.

⁴³ Refer to *Business Investment in Western Australia* (January 2006), Economic Research Paper, available at www.dtf.wa.gov.au

⁴⁴ Source: ANZ *Economic Outlook*, December Quarter 2005

Similarly, business input costs could be driven higher by continued strong demand for certain commodities and/or materials, thereby reducing the commercial viability of projects. This could remain an issue for overall building and engineering construction costs (as it already has in the case of inputs such as steel) and for industries such as transportation (if fuel costs remain high).

Labour supply constraints also have the potential to place generalised upward pressure on wages. To date, there is little evidence of across-the-board acceleration in wage increases, although wages growth in some industries, occupations and locations has been relatively strong. If wages growth was to accelerate it could make Western Australia a relatively less attractive location for business investment.

Speculative Scenarios

While the preceding section sketches some plausible risks to Western Australia's short to medium-term economic outlook, this final section ranges over less likely events and into the longer term to trace some possible future issues for the State's economic development.

International Trade

Western Australia is far more reliant on exports than the rest of Australia, and its largest industry, mining, is almost entirely focussed on overseas markets. International trade therefore has more importance for the economic future of Western Australia than the other states. Trade can be influenced both by international events and by factors affecting the State's competitiveness and its productive capacity in the export sector.

As discussed above, international economic conditions and global commodity prices are key risks to Western Australia's trade.

Policy decisions at the national and international levels also affect Western Australia's trading environment. Bilateral and multilateral agreements on issues such as trade and investment, border security and greenhouse gases affect exporters' market access and competitiveness.

As well as directly affecting export and import levels, such influences can also flow on to shape other economic conditions such as business investment, employment, wages growth and inflation.

One negative scenario for Western Australia's medium term export growth would arise if the world moved towards greater trade protectionism, perhaps if the World Trade Organisation's Doha round of trade negotiations foundered on the contentious issue of agricultural trade liberalisation. This could slow or reverse the decades-long trend towards integration of the world's economies that has led growth in global trade to consistently outstrip growth in production.

Western Australia's agricultural exporters would probably feel the most immediate effects of such a rise in protectionism, but its most important consequences could be indirect. For example, it is unlikely that China will impose significant tariffs on Western Australia's iron ore exports, as this would not be in its economic interests. But if the USA were to impose higher tariffs on Chinese manufactured goods, it would affect China's demand for Western Australian iron ore.

The Labour Market and the Ageing Population

The labour and skills shortages currently affecting Western Australia comprise a key short-term risk discussed in the previous section.

Over the medium and longer term, factors that will affect the Western Australian labour market include the ageing population, rates of labour force participation, whether current skills shortages persist, the extent to which interstate and overseas migration affect the State's labour supply, training, and technology shocks that bring about productivity improvements.

The ageing population will be a key driver of labour market trends. While a greater proportion of the working age population will be reaching the normal retirement age over the next few decades, their involvement in the State's future labour force is still unclear.

If there is an increasing propensity for older workers to continue working past the traditional retirement age, then the labour force participation rate will not decline by as much as current projections suggest, and the productive capacity of the economy will be higher than it would have otherwise been.

This scenario is plausible – older people are fitter, more active and more long-lived than ever before, and may choose to continue working longer. Or, they may be forced to, either by economic necessity (many may not have enough superannuation savings to provide a comfortable income for a prolonged retirement), or by government policy (e.g. tighter restrictions on access to superannuation savings for early retirees).

It is also likely that demand for older workers will increase if employers find it increasingly hard to find other recruits.

The alternative scenario of a declining participation rate among older workers is also plausible, however.

Although older people may be capable of working beyond normal retirement age, this does not mean that they will want to.

Compulsory superannuation means that most workers have at least some retirement savings, which will allow some at least to retire on quite comfortable incomes.

Even if labour force participation is higher among older workers in future than at present, it is not plausible that over-60s will have the same participation rate as the 15-to-60 age group. So overall labour force participation will almost inevitably decline as an increasing proportion of the population reaches normal retirement age. This will result in deceleration in the rate of productivity growth and of sustainable economic growth over the longer term.

The effect of the ageing population on the labour market will be influenced by government policies affecting the level and accessibility of superannuation savings, pension levels and entitlements, as well as broader influences such as superannuation funds returns and employers' attitudes to older workers.

Housing and Interest Rates

The interest rate outlook and the short-term risks posed by Western Australia's strong housing market are discussed above.

In the medium to longer term, market conditions may be influenced by demographic trends affecting the rate of household formation, the historically high level of housing debt relative to household income, and government policies influencing affordability and investment returns.

Interest rates can also affect the market for new and established homes. Higher interest rates affect consumer confidence and housing affordability, and increase the likelihood of mortgage defaults.

For the past decade or so Australia's official interest rate has been relatively low and stable by historical standards, reflecting the fact that inflation has been subdued. The most likely medium term trend for interest rates is continuation of historically low rates and modest adjustments as part of the Reserve Bank of Australia's normal management of the economic cycle.

However, history shows that episodes of much higher inflation and interest rates are possible, whether resulting from an international price shock (such as the rise in oil prices in the 1970s) or from domestic pressures such as a wage/price spiral. Such an event could see interest rates raised sharply, which would add significantly to the household sector's debt servicing costs⁴⁵.

⁴⁵ According to the Reserve Bank of Australia, housing debt is now equivalent to about 120% of households' disposable income Australia-wide, compared to 33% in 1989-90, when mortgage interest rates peaked at 17%. The standard bank housing loan rate is currently 7.25%, and it has been below 10% since May 1996.

Household Consumption

Household consumption is not just important as a contributor to economic growth⁴⁶; it is also an indication of the relative wellbeing of consumers. Indeed, many economists prefer real household consumption to Gross State or Domestic Product as their key benchmark for economic performance (or at least, consumer welfare).

Interest rates, petrol prices, inflationary pressures, the stock market, house prices, consumer sentiment, net migration flows, wages, changes to taxation, and employment opportunities can all affect trends in household consumption.

Some of these factors act not just as influences on household consumption; they may in turn be influenced by the household sector, providing positive or negative reinforcement of initial effects.

For example, a strong labour market provides growth in employment opportunities and real wages that boosts households' disposable incomes and confidence, which can provide an impetus for growth in household consumption. This potentially adds to labour demand, reinforcing the growth spiral.

Other reinforcing effects might arise if strong consumer demand generates growth in house prices. This can generate a 'wealth effect' where owner-occupied households draw down against the extra equity built up in their home to finance additional consumer purchases. Similar wealth effects may also result from strong returns to consumers on other assets (for example, from equity markets).

⁴⁶ Household consumption accounts for around half of Western Australia's overall economy, and has been an important driver of the State's recent strong economic growth.

However, such consumer booms are often eventually self-limiting. Higher wages may place pressure on business input costs, adding to inflation and dampening labour demand. House price booms are often followed by corrections, sometimes in the form of busts. Overheated domestic demand and housing markets may also prompt the Reserve Bank of Australia to raise interest rates, also moderating consumer demand.

Concluding Comments

This article does not contain predictions of what the DTF believes will happen to the Western Australian economy, or even of what it thinks is likely to happen. Rather, it traces some of the risks and uncertainties that could cause Western Australia's growth path to deviate from the extremely favourable conditions forecast in the short to medium term, and also to sketch out some hypothetical scenarios of factors that could influence its growth path in the longer term.

APPENDIX 1.

WESTERN AUSTRALIAN EXPORTS BY COMMODITY

| | Nov-04 | Dec-04 | Jan-05 | Feb-05 | Mar-05 | Apr-05 | May-05 | Jun-05 | Jul-05 | Aug-05 | Sep-05 | Oct-05 |
|------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| | \$ Million | | | | | | | | | | | |
| Gold | 503.8 | 536.4 | 533.2 | 443.8 | 365.0 | 431.0 | 651.0 | 340.8 | 501.3 | 559.5 | 403.1 | 471.4 |
| Iron Ore | 526.7 | 601.3 | 585.6 | 491.5 | 631.6 | 892.3 | 984.8 | 991.4 | 1,022.7 | 987.9 | 948.3 | 1077.7 |
| ETMs | 176.3 | 154.9 | 128.7 | 144.8 | 165.3 | 285.0 | 198.7 | 211.9 | 159.7 | 236.6 | 155.6 | 172.0 |
| Wheat | 165.9 | 148.8 | 148.3 | 159.6 | 129.1 | 99.9 | 72.3 | 115.3 | 121.7 | 113.5 | 148.9 | 142.3 |
| Petroleum | 512.3 | 348.5 | 454.4 | 371.8 | 551.5 | 540.4 | 525.8 | 493.3 | 678.5 | 591.7 | 507.6 | 423.4 |
| LNG | 304.0 | 307.7 | 278.5 | 209.0 | 271.6 | 292.3 | 308.8 | 268.4 | 382.8 | 340.1 | 249.6 | 284.3 |
| Nickel | 133.3 | 96.1 | 114.7 | 90.6 | 124.3 | 116.2 | 57.2 | 82.6 | 94.8 | 74.4 | 43.8 | 151.8 |
| Wool | 40.6 | 44.4 | 19.8 | 40.2 | 47.8 | 40.2 | 54.6 | 38.3 | 34.3 | 29.1 | 32.6 | 35.0 |
| Crustaceans | 6.8 | 49.4 | 36.5 | 25.8 | 36.5 | 49.4 | 44.1 | 37.5 | 30.5 | 13.9 | 9.9 | 12.2 |
| Live Animals | 26.7 | 40.0 | 40.3 | 23.6 | 23.4 | 29.2 | 19.3 | 19.8 | 22.9 | 47.2 | 46.6 | 37.7 |
| Confidential Items | 528.9 | 653.4 | 561.8 | 722.0 | 623.3 | 663.7 | 621.8 | 649.8 | 584.3 | 645.6 | 515.2 | 622.5 |
| All Commodities | 3,110.0 | 3,257.0 | 3,098.0 | 2,949.0 | 3,198.0 | 3,719.0 | 3,837.0 | 3,473.0 | 3,896.0 | 3,866.0 | 3,330.0 | 3,743.0 |

Source: Australian Bureau of Statistics, unpublished data.

APPENDIX 2.

WESTERN AUSTRALIAN EXPORTS BY DESTINATION

| | Nov-04 | Dec-04 | Jan-05 | Feb-05 | Mar-05 | Apr-05 | May-05 | Jun-05 | Jul-05 | Aug-05 | Sep-05 | Oct-05 |
|-------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| | \$ Million | | | | | | | | | | | |
| Singapore | 101.0 | 107.0 | 97.0 | 123.0 | 156.4 | 95.4 | 171.0 | 141.0 | 198.2 | 142.1 | 176.7 | 207.7 |
| Indonesia | 40.8 | 75.4 | 142.2 | 87.8 | 109.6 | 77.0 | 119.4 | 138.5 | 101.4 | 127.6 | 154.2 | 66.8 |
| Malaysia | 22.2 | 26.7 | 59.7 | 12.1 | 26.0 | 21.1 | 19.8 | 41.3 | 26.9 | 25.1 | 20.1 | 28.9 |
| Thailand | 157.0 | 241.0 | 243.0 | 265.6 | 161.5 | 99.3 | 106.0 | 116.0 | 65.2 | 239.6 | 186.9 | 97.7 |
| Philippines | 10.4 | 4.6 | 4.5 | 9.0 | 5.2 | 9.2 | 5.5 | 5.5 | 3.5 | 6.2 | 27.3 | 5.8 |
| South East Asia | 331.4 | 454.7 | 546.4 | 497.5 | 458.8 | 302.0 | 421.7 | 442.3 | 395.2 | 540.6 | 565.1 | 406.9 |
| South Korea | 262.0 | 254.0 | 259.0 | 147.1 | 224.3 | 366.3 | 336.0 | 208.0 | 460.6 | 291.3 | 258.9 | 386.8 |
| China | 451.0 | 560.0 | 443.0 | 445.2 | 667.6 | 777.2 | 745.0 | 716.0 | 738.6 | 758.5 | 691.5 | 831.7 |
| Taiwan | 55.0 | 113.0 | 65.0 | 73.1 | 130.5 | 182.5 | 80.0 | 95.0 | 93.7 | 103.5 | 107.7 | 106.7 |
| Hong Kong | 12.0 | 18.0 | 27.0 | 17.7 | 21.8 | 14.4 | 17.0 | 13.0 | 18.8 | 11.9 | 25.3 | 13.0 |
| North East Asia | 882.0 | 1,073.0 | 972.0 | 876.0 | 1,075.0 | 1,256.0 | 1,204.0 | 1,053.0 | 1,289.0 | 1,301.0 | 1,163.0 | 1,330.0 |
| Japan | 591.0 | 685.0 | 672.0 | 612.0 | 699.5 | 828.5 | 872.0 | 816.0 | 968.5 | 922.4 | 717.0 | 874.2 |
| United States | 238.0 | 136.0 | 52.0 | 89.9 | 83.6 | 115.1 | 120.0 | 200.0 | 64.1 | 105.1 | 50.5 | 111.8 |
| United Kingdom | 118.0 | 64.0 | 36.0 | 67.8 | 63.8 | 85.6 | 69.0 | 72.0 | 86.4 | 96.9 | 145.4 | 184.7 |
| Germany | 6.0 | 7.0 | 7.0 | 5.8 | 8.4 | 6.2 | 10.0 | 4.0 | 4.2 | 6.9 | 19.8 | 6.9 |
| Canada | 113.0 | 79.0 | 34.3 | 96.0 | 77.6 | 79.8 | 33.8 | 92.6 | 103.3 | 6.0 | 35.0 | 62.8 |
| France | 25.7 | 12.3 | 20.6 | 16.2 | 5.1 | 25.9 | 19.0 | 20.5 | 15.1 | 13.4 | 12.4 | 21.8 |
| Italy | 15.6 | 9.5 | 20.7 | 33.7 | 12.8 | 17.7 | 30.3 | 17.5 | 22.7 | 8.9 | 25.4 | 18.7 |
| Group of Seven | 1,107.3 | 992.8 | 842.5 | 921.9 | 950.4 | 1,158.4 | 1,154.0 | 1,222.5 | 1,265.1 | 1,159.3 | 1,004.8 | 1,281.3 |
| All Destinations | 3,110.0 | 3,257.0 | 3,098.0 | 2,949.0 | 3,198.0 | 3,719.0 | 3,837.0 | 3,473.0 | 3,896.0 | 3,866.0 | 3,330.0 | 3,743.0 |

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.