



**GOVERNMENT OF
WESTERN AUSTRALIA**

Fair Work Commission

2017-18 Annual Wage Review

Submission of the Government of Western Australia

DATE: 13 March 2018

Western Australian Government

Submission to Fair Work Commission Annual Wage Review 2017-18

Introduction

1. The Western Australian Government welcomes the opportunity to make this submission to the Expert Panel of the Fair Work Commission (**the Panel**) for the 2017-18 Annual Wage Review (**AWR**).
2. In carrying out its functions, the Panel is required to ‘establish and maintain a safety net of fair minimum wages’ taking into account the statutory criteria (the ‘minimum wages objective’) in section 284 of the *Fair Work Act 2009* (**the Act**), including:
 - (a) the performance and competitiveness of the national economy, including productivity, business competitiveness and viability, inflation and employment growth; and
 - (b) promoting social inclusion through increased workforce participation; and
 - (c) relative living standards and the needs of the low paid; and
 - (d) the principle of equal remuneration for work of equal or comparable value; and
 - (e) providing a comprehensive range of fair minimum wages to junior employees, employees to whom training arrangements apply and employees with a disability.
3. In adjusting rates of pay in awards, the Panel must also have regard to the ‘modern awards objective’, which requires that it ensure that modern awards, together with the National Employment Standards, provide a fair and relevant minimum safety net of terms and conditions, taking into account a variety of factors outlined in section 134 of the Act.
4. This submission includes information pertaining to Western Australia’s economy and labour market to assist the Panel in its deliberations, as well as broader observations on various criteria that are relevant to the National Wage Order.

Overview

5. The Western Australian Government supports a fair, meaningful and sustainable wage increase being granted by the Panel for the National Minimum Wage (**NMW**) and modern award wages in this year’s AWR.

6. The Western Australian Government contends that the needs of low paid and vulnerable workers should feature prominently in the Panel's deliberations, and that social and equity considerations should be given at least equal weighting with economic and business objectives.
7. For much of its history Australia has prided itself on maintaining a fair and just workplace culture, where a strong safety net of employment protections has underpinned our social fabric. In recent years rising inequality and growing wealth differentials have challenged this ideal, creating an environment where some of the most vulnerable in our community are falling behind.
8. Stagnant wages growth and the rising cost of many non-discretionary expenses have combined to place added stress on many workers and households. While the national AWR cannot address all of the issues associated with social and economic inequality, it can help to ensure the lowest paid are afforded dignity and security in the workplace, and are fairly rewarded for their efforts.
9. In last year's AWR Decision the Panel observed that "*...research suggests that the Panel's past assessment of what constitutes a 'modest' increase may have been overly cautious, in terms of its assessed disemployment effects.*"¹
10. The Western Australian Government notes that in recent years many of the predicted negative outcomes associated with meaningful wage increases have failed to materialise, and many jurisdictions have in fact experienced positive employment growth following robust minimum wage increases.²
11. In 2017 the Panel awarded a robust 3.3 per cent increase to minimum and award wages - a quantum that was criticised by a variety of stakeholders as being unsustainable. However, far from having adverse effects:
 - (a) unemployment in Australia has fallen to the lowest level in five years,³ and
 - (b) total employment has grown by 3.3 per cent in the year to January 2018.⁴
12. The Western Australian Government submits that the Panel should not give credence to predictions by some that the level of Australia's minimum and award wages is damaging the employment prospects of those seeking work.
13. By awarding a fair, meaningful and sustainable increase in wages the Panel will enhance the financial resilience of low paid employees, whilst still ensuring business competitiveness and viability.

¹ Fair Work Commission (2017), *Annual Wage Review 2016-17*, at [14].

² Chapter 6 of the Panel's decision in last year's Annual Wage Review contains a useful overview of international minimum wage setting developments, including recent literature on the relationship between wages and employment growth.

³ Australian Bureau of Statistics (ABS) (2018), *Labour Force, Australia, January 2018*, catalogue 6202.0 (seasonally adjusted data).

⁴ *Ibid.*

Western Australian economy and labour market

14. While the Act requires that the Panel consider the state of the national economy in its AWR deliberations each year, the national economy itself is comprised of many geographic regions and associated labour markets, and it is appropriate consideration be given to prevailing conditions in particular States and Territories.
15. The Western Australian Department of Treasury (**WA Treasury**) has provided an overview of the State's economy, which is included at **Attachment A**. The overview provides detailed information on economic developments and labour market trends.
16. Economic conditions in Western Australia are currently improving, as evidenced by a variety of indicators. Total State output, as measured by Gross State Product, is expected to rebound from a decline of 2.7 per cent in 2016-17 to an expansion of 2.5 per cent in 2017-18.⁵ Employment growth has also improved, and after falling by 0.5 per cent in 2015-16 and 0.8 per cent in 2016-17, employment increased by 1.7 per cent in the year to January 2018.⁶
17. As discussed further in **Attachment A**, a number of other indicators point to improving conditions, including a lift in internet job vacancies, an improvement in consumer sentiment and business confidence.
18. Domestic economic activity (as measured by State Final Demand) is still expected to contract (by 2.0 per cent) in 2017-18, for the fifth consecutive year. However, State Final Demand is expected to return to positive growth, with WA Treasury forecasting growth of 0.75 per cent in 2018-19 and 3.25 per cent in 2019-20.⁷
19. Western Australia's unemployment rate averaged 5.9 percent in 2017, down from an average of 6.1 percent in 2016.⁸
20. The Wage Price Index (**WPI**) for Western Australia increased by 1.4 per cent in the year to December 2017, with private sector wage growth increasing by just 1.2 per cent.⁹ WA Treasury estimates that WPI will increase by 1.5 per cent in annual average terms in 2017-18.¹⁰
21. More detailed information on the state of the Western Australian economy is included in **Attachment A**.

⁵ Department of Treasury (2017), *2017-18 Government Mid-Year Financial Projections Statement*, p.43.

⁶ Australian Bureau of Statistics (ABS) (2018), *Labour Force, Australia, January 2018*, catalogue 6202.0 (seasonally adjusted data). Data is expressed in annual average terms.

⁷ Department of Treasury (2017), *2017-18 Government Mid-Year Financial Projections Statement*, p.43.

⁸ Australian Bureau of Statistics (ABS) (2018), *Labour Force, Australia, December 2017*, catalogue 6202.0 (seasonally adjusted data).

⁹ Australian Bureau of Statistics (ABS) (2018), *Wage Price Index, Australia, December 2017*, catalogue 6345.0 (original data). Wages growth is expressed in annual average terms.

¹⁰ Department of Treasury (2017), *2017-18 Government Mid-Year Financial Projections Statement*, p.43.

Coverage of the national industrial relations system in WA

22. Unlike the other Australian States, Western Australia has not referred its industrial relations powers to the Commonwealth in relation to private sector employers and employees. Subsequently, those employing authorities that are not “constitutional corporations” for the purposes of section 51(xx) of the Australian Constitution generally fall within the State industrial relations jurisdiction.¹¹
23. As a non-referring State, a larger proportion of the workforce remains subject to the State industrial relations system than in other jurisdictions. Notwithstanding, a sizable proportion of Western Australian employers and employees are covered by the national industrial relations system, and the AWR therefore has a material impact on businesses and employees within the State.
24. Analysis conducted by the Western Australian Department of Mines, Industry Regulation and Safety (**DMIRS**) estimates that between 64 and 78 per cent of State’s workforce are subject to the national industrial relations jurisdiction.¹² Estimates of employee coverage vary depending on the methodology used.
25. DMIRS has also produced an estimate of employer coverage for the Western Australian private sector, using data obtained from the Australian Taxation Office (**ATO**).
26. This section outlines the current estimates of jurisdictional coverage of the national industrial relations system in Western Australia.

Employee coverage

27. Two main data sources are available to measure jurisdictional coverage of Western Australian employees. These are:
 - (a) identification of coverage based on reported pay setting methods; and
 - (b) collection of employer information by the type of legal organisation.

Pay setting methods

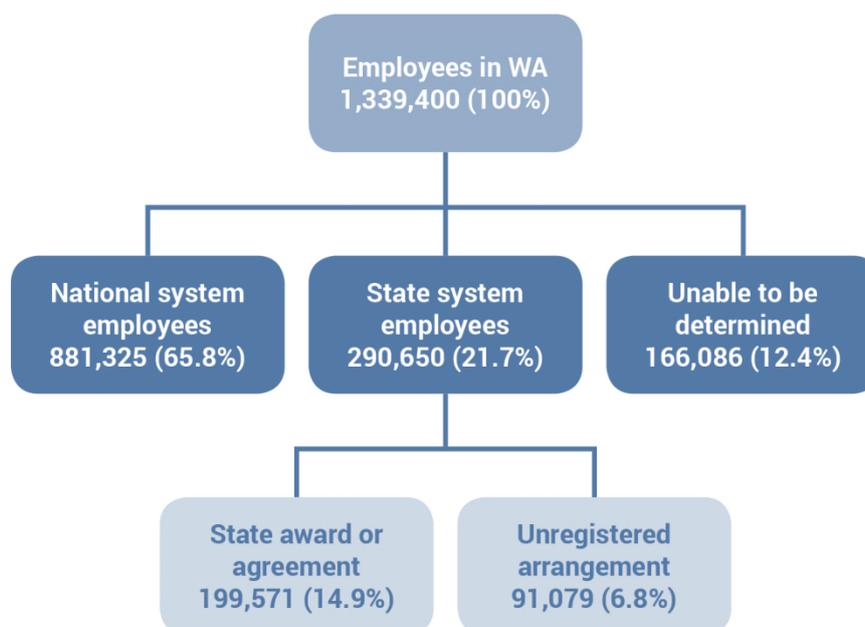
28. Data on pay setting methods is sourced from the Australian Bureau of Statistics (**ABS**) *Employee, Earnings and Hours (EEH)* survey. The ABS classifies pay setting methods according to the workplace relations instrument that is principally used to determine wage rates, including awards, collective agreements and individual arrangements.

¹¹ For the purposes of Section 51(xx) of the Australian Constitution, a “constitutional corporation” refers to “foreign corporations, and trading or financial corporations formed within the limits of the Commonwealth”. Local governments may be deemed trading corporations, depending on the level of their trading activities.

¹² Australian Bureau of Statistics (ABS) (2011), *Employee Earnings and Hours, Australia, May 2010*, catalogue 6306.0, unpublished data; and *Labour Force, Australia, December 2017*, catalogue 6202.0, Table 8 (trend data series). The 2010 data disaggregating pay setting methods has been applied against current labour force data in order to provide up-to-date estimates of employee numbers in each jurisdiction. The EEH data obtained in 2010 is no longer produced by the ABS; however, it is unlikely that jurisdiction coverage has changed significantly since then.

29. As can be seen in Figure 1 below, it is estimated that at least **65.8 per cent of employees** are covered by the national industrial relations system according to pay setting methods, while at least 21.7 per cent are covered by the State system.
30. It should be noted that the status of 12.4 per cent of employees was unable to be accurately determined, due to the ABS being unable to identify the pay setting method reported by survey respondents.

Figure 1: Number and proportion of employees by pay setting methods, WA ¹³



Type of legal organisation

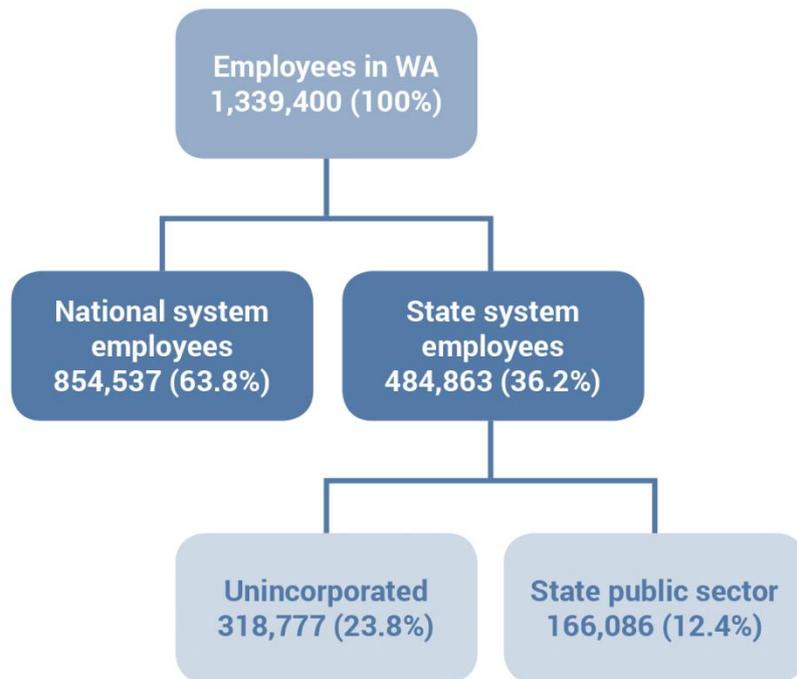
31. The EEH survey classifies all employing businesses according to the ABS Economic Units Model, which includes the type of legal organisation (**TOLO**). The TOLO is used to classify businesses according to the legal setup that best describes their structure. For example, the three broad types of TOLO are incorporated private sector entities, unincorporated private sector entities and public sector entities.¹⁴
32. As per Figure 2 below, the proportion of **national system employees** by TOLO is estimated to be **63.8 per cent** (854,537 employees). It should be noted that the small proportion of local government authorities that are operating in the State system has not been included in this estimate.¹⁵

¹³ Figures for individual components may not sum to the total due to rounding.

¹⁴ Australian Bureau of Statistics (ABS) (2013), *Standard Economic Sector Classifications of Australia (SESCA), 2008* (Version 1.1).

¹⁵ The Western Australian Local Government Association recently advised that 17 local government entities (out of a total of 148 in Western Australia) are operating in the State industrial relations system. The remainder are operating in the federal jurisdiction.

Figure 2: Number and proportion of employees by type of legal organisation, WA

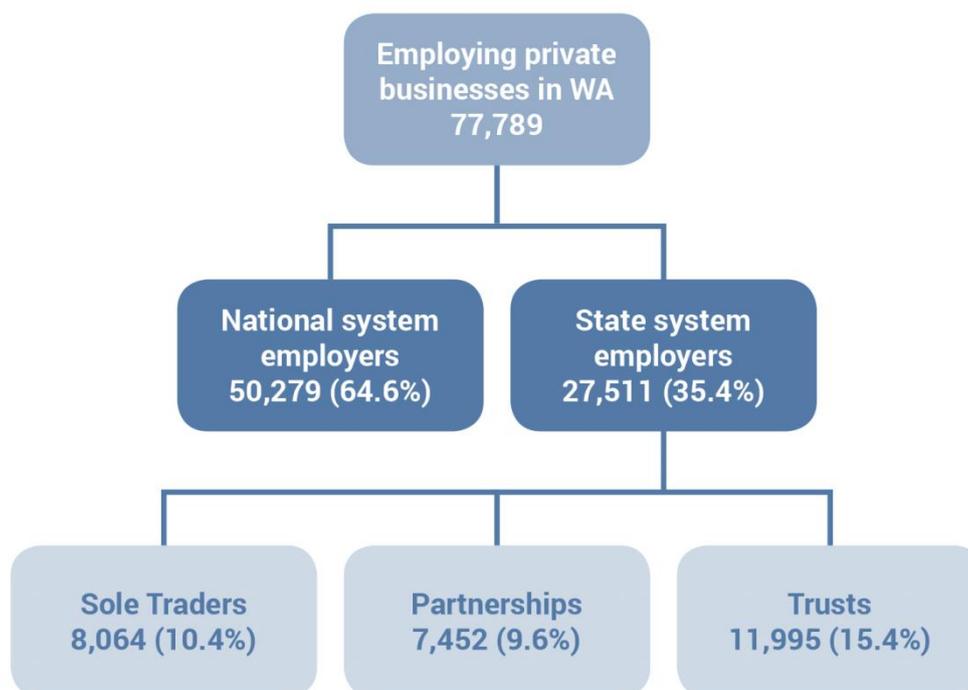


Employers

33. Based on unpublished administrative data from the ATO, it is estimated that a minimum of **64.6 per cent of private sector employers** in Western Australia are covered by the national industrial relations system. This analysis is based on business entity type and makes the following assumptions:
- all sole traders (individuals) are considered unincorporated, and therefore subject to the State, rather than national, industrial relations system.
 - the vast majority (86.8 per cent) of all partnership businesses (both employing and non-employing) are partnerships between individuals, rather than between incorporated entities, while 13.2 per cent are partnerships where one or more partner is an incorporated entity. It has therefore been assumed that **13.2 per cent** of employing partnerships in Western Australia are subject to the national industrial relations jurisdiction.
 - based on data from the Australian Business Register (**ABR**), 54.4 per cent of all trust businesses (employing and non-employing) have an individual as a trustee, while 45.6 per cent of trusts have an incorporated entity as a trustee. It is therefore assumed that **45.6 per cent** of employing trust businesses are in the national industrial relations system.¹⁶
34. Figure 3 below illustrates by entity type the estimated proportion and number of **private sector employers** covered by the State industrial relations system.

¹⁶ Trust business structures are highly complex and can include fixed, hybrid or public trusts of varying types.

Figure 3: Proportion and number of private sector employers, WA¹⁷



35. It should be noted the above data only provides an estimate of jurisdictional coverage for Western Australian **employers** in the **private sector**. These figures exclude public sector employers.
36. It could be expected that the proportion of private sector **employers** subject to the national industrial relations system will be lower than the proportion of private sector **employees**, as the unincorporated employers remaining in the State jurisdiction will generally have less employees on average than those in the national system.

Who is impacted by the Annual Wage Review?

Employees covered by awards

37. Available data indicates that award-reliance in Australia has increased in recent years, reversing a long-term trend away from awards being the central tenet of the wage fixing system.
38. As at May 2016, some 2.3 million Australian employees were paid entirely in accordance with an award, with the vast majority of them being paid in accordance with a national modern award.¹⁸
39. Many award-reliant employees are solely dependent on increases determined in the AWR to meet changes in their everyday living costs, and it is vital that fair and meaningful adjustments to pay rates are granted on a regular basis to ensure the needs of the low paid are adequately safeguarded.

¹⁷ Figures for individual components may not sum to the total due to rounding.

¹⁸ Australian Bureau of Statistics (ABS) (2017), *Employee Earnings and Hours, Australia, May 2016*, catalogue 6306.0, Datacube 5, Table 4.

40. While award reliance in Western Australia is lower than the national average, it has increased in recent years, in line with growing award reliance throughout the country.
41. In Western Australia, award reliance increased from 14.6 per cent of all non-managerial employees in 2014, to 16.4 per cent in 2016. Nationally, award reliance rose from 20.4 per cent in 2014, to 24.5 per cent in 2016.¹⁹
42. Employees in industries known to be award-reliant constitute a significant proportion of Western Australia's workforce, as shown in Table 1 below.

Table 1: Employment and award reliance by industry - WA and Australia, November Quarter 2017

Industry	WA: Proportion of Workforce ²⁰	Australia: Proportion of Workforce ²⁰	Australia: Proportion of employees paid by award ²¹
Accommodation and Food Services	7.4%	7.2%	42.7%
Administrative and Support Services	3.1%	3.3%	42.1%
Retail Trade	9.9%	10.6%	34.5%
Other Services	4.2%	4.3%	34.3%
Health Care and Social Assistance	12.1%	13.3%	28.8%
Rental, Hiring and Real Estate Services	1.6%	1.8%	27.2%
Arts and Recreation Services	2.0%	2.0%	26.2%
Education and Training	9.3%	8.4%	26.0%
Construction	10.5%	9.3%	19.7%
Public Administration and Safety	5.7%	5.9%	18.1%
Manufacturing	5.2%	7.0%	17.7%
Wholesale Trade	2.6%	2.9%	16.8%
Transport, Postal and Warehousing	4.6%	5.2%	13.4%
Professional, Scientific and Technical Services	7.1%	8.2%	9.3%
Electricity, Gas, Water and Waste Services	1.3%	1.1%	6.5%
Information, Media and Telecommunications	1.3%	1.7%	5.5%
Financial and Insurance Services	2.2%	3.4%	N/A*
Mining	6.6%	1.7%	N/A*
Agriculture, Forestry and Fishing	3.2%	2.6%	N/A [†]
All industries	100.0%	100.0%	24.5%

[†] N/A: Enterprises primarily engaged in agriculture, forestry and fishing are outside the scope of the ABS *Employee, Earnings and Hours* survey from which this data is drawn.* Not available for publication, but included in totals where applicable, unless otherwise indicated.

¹⁹ Australian Bureau of Statistics (ABS) (2015), *Employee Earnings and Hours, Australia, May 2014*, catalogue 6306.0, Datacube 5, Table 5; and ABS (2017), *Employee Earnings and Hours, Australia, May 2016*, catalogue 6306.0, Datacube 5, Table 5. In some State industrial relations jurisdictions awards perform the function of collective agreements, which can have the effect of elevating the number of 'award only' employees. This is particularly relevant for the New South Wales public sector, where the ABS has re-coded a number of collective agreements to awards between 2014 and 2016.

²⁰ Australian Bureau of Statistics (ABS) (2017), *Labour Force, Australia, Detailed Quarterly, November 2017*, catalogue 6291.0.55.003, Time Series, Table 5 (original data).

²¹ Australian Bureau of Statistics (ABS) (2017), *Employee Earnings and Hours, Australia, May 2016*, catalogue 6306.0, Datacube 5, Table 4.

43. The AWR therefore plays a vital role in maintaining a fair and relevant safety net for many low paid employees in both Western Australia and nationally, and by granting a fair and meaningful wage increase the Panel can directly assist many award-reliant workers in the State.
44. While award reliance has been increasing throughout Australia, penalty rates in two of the most award-reliant industries - retail and hospitality - are being reduced.
45. The Western Australian Government notes that further impending cuts to Sunday penalty rates in the hospitality, fast food, retail and pharmacy awards are due to take effect from July 2018. While cuts to Sunday penalties in affected awards started being phased in from 1 July 2017, the smaller reductions in the first year were able to be largely offset by the 3.3 per cent increase in base award wages granted in last year's National Wage Order.
46. In 2018, several awards will experience larger reductions in penalty rates, not all of which can be ameliorated by any general increase to award wages granted by the Panel. Many award-reliant workers in the retail and hospitality industries therefore face a looming reduction in their take home pay, and the Western Australian Government contends this is a contextual factor that should be taken into consideration in determining wage outcomes in this year's AWR.

Employees covered by enterprise agreements

47. At the same time as award reliance has been increasing, collective bargaining has declined in the federal jurisdiction, with both the number and proportion of Australian workers subject to enterprise agreements diminishing.
48. According to the Commonwealth Department of Jobs and Small Business, 30.2 per cent of all Australian employees were covered by a federal enterprise agreement in 2016, down from 32.6 per cent in 2014.²² Notwithstanding this reduction, more than 3 million Australian employees still have their wages determined by a federal collective agreement.
49. Modern national awards play a critical role in underpinning the enterprise bargaining system. Awards perform a dual role in establishing the benchmark for agreement registration, through the Better Off Overall Test (**BOOT**), as well as setting a floor through which wages cannot fall below during the life of an agreement.²³
50. Any increases the panel determines for national modern awards will therefore have flow on implications for employees subject to federal enterprise agreements. While this effect will be indirect in many cases, some enterprise agreements peg future wage increases to national minimum wage orders, and as such, some employees will be directly impacted by the Panel's decision in this year's AWR. This reinforces the essential role that Australia's national award system continues to play, and highlights the importance of a strong award safety net being maintained for national system employees.

²² Department of Jobs and Small Business, *Trends in Federal Enterprise Bargaining*, September quarter 2017, www.jobs.gov.au/trends-federal-enterprise-bargaining.

²³ Pursuant to section 206 of *Fair Work Act 2009* base wages in enterprise agreements cannot fall below the base rates of pay in any federal award that is applicable to the employee.

Employees covered by individual arrangements

51. While the National Wage Order does not directly affect many employees working under individual arrangements, some common law contracts of employment may contain provisions linking future wage increases to the movements in the NMW or modern award wages. Additionally, contracts of employment that provide for wage rates only marginally above award minima may be impacted by any decision the Panel makes in this year's AWR.
52. As the Panel noted in last year's AWR "...*minimum wage increases may influence bargained outcomes and pay set by individual arrangements, depending upon the circumstances in each industry sector including the degree to which the bargained or over-award rates exceed the minimum award rates.*"²⁴

Further considerations

Promoting social inclusion through increased workforce participation

53. One of the criteria the Panel is required to have regard to in meeting the "minimum wages objective" is promoting social inclusion through increased workforce participation.
54. The Western Australian Government notes that there has been an increase in labour force participation in the last 12 months, both in Western Australia and Australia.
55. The participation rate in Western Australia averaged 67.9 per cent over the year to January 2018, slightly up from an average of 67.4 per cent in the year to January 2017. Across Australia, the participation rate averaged 65.2 per cent in the year to January 2018, up from an average of 64.8 per cent in the year to January 2017.²⁵ This is particularly encouraging given Australia's aging population is expected to put downward pressure on the participation rate over time.
56. While workforce participation is influenced by a variety of factors, there is no doubt that fair and meaningful increases to minimum and award wages help to encourage people into the labour force, particularly those with a marginal attachment to work.
57. At the same time as labour force participation has been increasing, employment itself has grown strongly. As outlined earlier in this submission, total employment increased by 3.3 per cent across Australia in the 12 months to January 2018, the strongest rate of growth in a number of years.
58. The fact that workforce participation has risen following a robust increase to minimum and award wages in last year's AWR should give the Panel confidence that fair and meaningful pay increases can play a role in positively promoting social inclusion.

²⁴ Fair Work Commission (2017), *Annual Wage Review 2016-17*, at [628].

²⁵ Australian Bureau of Statistics (ABS) (2018), *Labour Force, Australia, January 2018*, catalogue 6202.0 (seasonally adjusted data).

Equal remuneration and the gender pay gap

59. A critical consideration in maintaining fair minimum wages is the need to promote equal remuneration for men and women. As noted by the FWC in the 2016-17 AWR Decision the gender pay gap is a relevant consideration as it is an element of the requirement to establish a safety net that is fair and relevant.²⁶
60. The Western Australian Government concurs with the FWC's observation that reducing the gender pay gap is also a factor in promoting social inclusion through workforce participation, as this can have a positive effect on female participation in the workforce.²⁷
61. As can be seen from the table below, Western Australia continues to have the largest gender pay gap in Australia, as measured by Average Weekly Ordinary Time Earnings (**AWOTE**). The State's gender pay gap was 22.5 per cent in November 2017, compared with 15.4 per cent nationally.²⁸

Table 2: Gender Pay Gap – by State / Territory – November Quarter 2017

State / Territory	Male AWOTE	Female AWOTE	Gender Pay Gap
NSW	\$1682.20	\$1441.80	14.3%
VIC	\$1586.90	\$1394.80	12.1%
QLD	\$1639.80	\$1337.90	18.4%
SA	\$1494.40	\$1336.90	10.5%
WA	\$1883.00	\$1458.50	22.5%
TAS	\$1405.30	\$1254.80	10.7%
NT	\$1802.10	\$1436.30	20.3%
ACT	\$1904.90	\$1664.70	12.6%
AUS	\$1665.00	\$1409.40	15.4%

62. Women are more likely to be paid in accordance with awards than their male counterparts, at both lower and higher award classifications. In May 2016, 28.9 per cent of female non-managerial employees in Australia were paid in accordance with an award, compared to 19.6 per cent of male non-managerial employees.²⁹

²⁶ Fair Work Commission (2017), *Annual Wage Review 2016-17*, at [643].

²⁷ Ibid.

²⁸ Australian Bureau of Statistics (ABS) (2018), *Average Weekly Earnings, Australia, November 2017*, catalogue 6302.0, Time Series Spreadsheets 12A – 12H. Data is expressed as full time average weekly ordinary time earnings (seasonally adjusted).

²⁹ Australian Bureau of Statistics (ABS) (2017), *Employee Earnings and Hours, Australia, May 2016*, catalogue 6306.0, Datacube 5, Table 2.

63. The causes of the gender pay gap include many social, historical and labour market factors. While many of the factors that have created the gender pay gap cannot be addressed through the National Wage Order, regular increases in minimum and award wages can nonetheless play an important role in helping to reduce gender pay inequality, particularly as the AWR directly affects a larger proportion of female employees.

Conclusion

64. Aggregate labour market conditions in Australia have continued to improve over the past year, underpinned by strong growth in employment and labour market participation, along with a reduction in the unemployment rate.
65. The Western Australian Government recognises the important role that minimum and award wages play in modern Australian workplaces, particularly in maintaining a strong safety net for vulnerable employees.
66. The Western Australian Government encourages the Panel to award a fair, meaningful and sustainable wage increase that will help to protect the living standards of the low paid, and encourage their participation in the workforce. Any increase should balance economic and social objectives in accordance with the objects of the Act.

ATTACHMENT A

State Economic Conditions

SUMMARY

The Western Australian economy (as measured by Gross State Product, GSP) contracted by 2.7% in 2016-17. Economic activity was heavily impacted by a large fall in construction spending on the State's major LNG projects, which contributed to a 28.6% decline in business investment.

However, a number of indicators of improving conditions have been emerging in the second half of 2017 (consistent with expectations at the State Budget). Western Australia's labour market has been stronger than expected, coinciding with a lift in business confidence and advertised job vacancies.

Total State output is expected to rebound, and expand by 2.5% in 2017-18, underpinned by a strong increase in export volumes. This is expected to be accompanied by a smaller 'drag' on growth from falling business investment (as the State's large LNG projects move into their final stages of construction and commissioning).

The expected decline in investment will weaken domestic economic activity (as measured by State Final Demand (SFD)) in 2017-18, which is estimated to contract (by 2.0%) for the fifth year in a row. However, SFD is projected to grow albeit modestly (0.75%) in 2018-19. This is despite one last projected decline in business investment, which is more than offset by increases in household spending in consumption goods, dwelling investment, and government expenditure.

While improvements in overall conditions are projected to continue, the economy is forecast to grow at an average rate of around 3.0% per annum over the forecast period, down from an average of around 4.3% per annum since 1989-90, with the drivers of growth becoming more diversified by 2020-21. By this time, all key components of the State's economy are projected to grow, along with employment and wages, but at rates below or around long run average levels.

Notwithstanding the above, there are a number of potential risks that may impact the State's economic outlook over the next few years.

Given current weakness in household income and cautious spending behaviour, along with moderate population growth, there may be some downside risk to the outlook for household consumption. As consumption constitutes a large share of the State's economy, even slightly weaker than expected household spending may have a noticeable impact on the economic growth projections.

The timing and magnitude of the tapering in capital expenditure on Western Australia's large LNG projects remains the key risk to the domestic economic outlook and labour demand. In particular, potential delays to the start-up and subsequent ramp-up of the LNG projects (which are complex in nature) means that merchandise export growth could be lower than forecast.

Substantial spare capacity has also built up in the State's housing market creating the risk that potential rises in the cash rate (and increases in home loan rates independent of changes to the official rate) could moderate the expected recovery in both dwelling investment and house prices. This may flow through to lower household consumption as mortgage repayments increase.

Global risks relevant to Western Australia mainly relate to conditions in China, which is by far the State's most important trading partner and an increasingly important source of foreign investment.

The Chinese economic rebound over the past two years has been supported by policy stimulus, both monetary and fiscal, and this implies a higher debt trajectory and diminished fiscal capacity to respond to crisis. These factors are likely to increase the possibility of a sharp slowdown, which the IMF note could be triggered by a domestic financial shock or an increase in capital outflows, prompted by the normalisation of monetary policy in the US.

Commodity prices have been supported by a relatively broad based pick-up in global economic activity, underpinned by improved conditions in advanced economies and a cyclical rebound in China. Notwithstanding this, the recovery is fragile and risks to the outlook remain relatively elevated.

The combination of growing global supply and a potential cyclical slowdown in Chinese steel demand presents risks to the State's benchmark iron ore price over the coming year. However, recent increases in iron ore costs, largely due to higher oil prices increasing the cost of transporting iron ore, as well as high discounts for low grade ore, may act to moderate declines in the benchmark 62% price. Producers of lower grade ore and those shipping long distances are expected to come under pressure to cease operations at a higher benchmark price than previously.

The outlook for the oil price has improved, reflecting a number of factors including political instability and supply disruptions in the middle-east, expectations of continued output restrictions from key exporters, and relatively strong economic growth trends. Oil is the world's primary transport fuel. Therefore, higher oil prices have increased costs in many industries that have significant transport costs, such as bulk and agricultural commodities. Higher oil prices may help to reflate many economies which have been at risk of deflation over recent years.

Further details on key parts of the State's economy follow.

NATIONAL ACCOUNTS DATA

The latest estimate of GSP (released by the Australian Bureau of Statistics (ABS) in November 2017) shows that Western Australia's economy declined by 2.7% in 2016-17, the first decline since the series commenced in 1989-90. This is in contrast to national Gross Domestic Product growth of 2% in 2016-17 and is the second consecutive year (since 2001-02) that national economic growth exceeded the State's economic growth.

The GSP declined in 2016-17, as strong exports growth was not sufficient to offset declining investment levels as major projects gradually progressed to completion. The composition of growth illustrates the economy's transition from investment-led to export-driven growth, which is expected to continue until 2018-19 as construction on the State's large resource projects is completed.

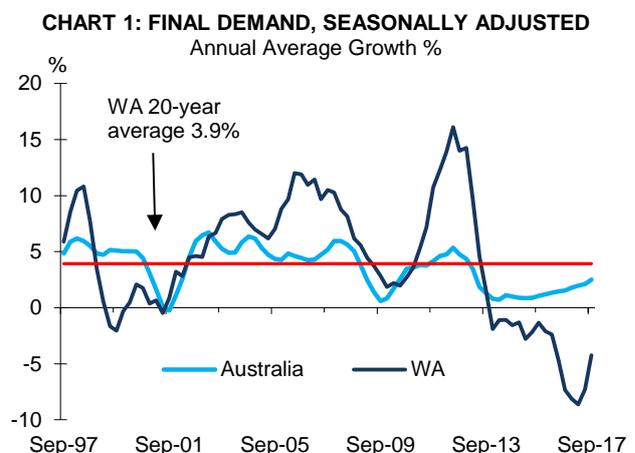
Abstracting from net exports, domestic economic activity moderated sharply in 2016-17, with SFD falling by 7.2%, the largest annual fall on record. The contraction was primarily due to a 28.6% fall in business investment in 2016-17, which detracted 6.4 percentage points from annual SFD growth. The annual rate of decline has softened in the September quarter 2017, with SFD and business investment falling by 4.2% and 17.9% respectively.

EXPENDITURE COMPONENTS OF GROWTH IN DOMESTIC DEMAND
September 2017, Seasonally Adjusted

	<u>Western Australia (%)</u>		<u>Australia (%)</u>	
	Quarter	Year	Quarter	Year
Private Consumption	0.1	0.7	0.1	2.4
Business Investment	4.8	-17.9	8.6	-2.1
Dwelling Investment	3.7	-19.8	-1.0	0.6
Government Consumption	-1.6	1.1	0.2	3.2
Government Investment	2.0	6.9	-7.5	15.9
Final Demand	0.9	-4.2	0.6	2.5
Exports	2.0	7.8	1.9	5.7
Imports	n.a.	n.a.	1.9	6.5
Gross Domestic Product	n.a	n.a	0.6	2.2

It is important to note that SFD is not a comprehensive measure of the State's economic growth, as it does not include the external trade sector. For a State such as Western Australia, the external trade sector is an important driver of income and therefore growth. Given the State's strong international trade linkages, GSP is a better measure of overall economic activity (as it also includes the State's external trade sector).

Notwithstanding this, trends in domestic demand tend to have a strong influence on labour market conditions, particularly as the investment phase of activity tends to be more labour intensive than the production phase.



CONSUMER PRICE INDEX

Current Inflation Trends

Perth's CPI grew by 0.4% in the December quarter 2017, primarily due to increases in 'automotive fuel' and 'tobacco'. Apart from these increases, price pressures in the broader economy remain subdued, particularly in 'housing' (the largest component of Perth's CPI).

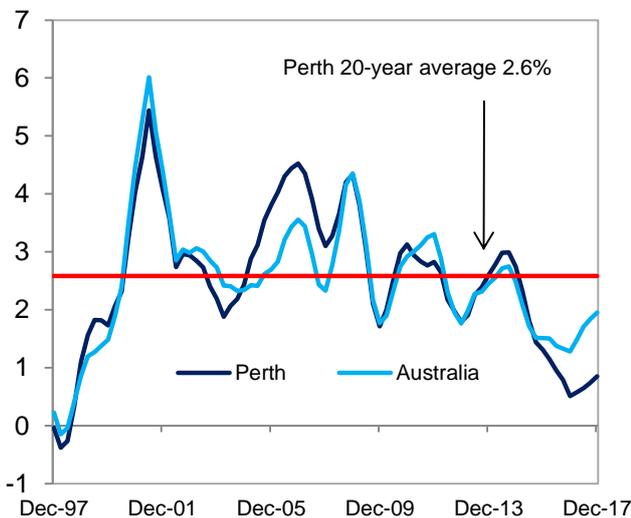
Perth's annual inflation rate has started to increase after a sharp fall over 2016, as higher prices for alcohol and tobacco, healthcare, and insurance and financial services and transport costs were partially offset by falls in housing. Perth's CPI increased by 0.9% in 2017, compared to 0.5% growth in 2016. This is the highest annual growth rate since June 2016, but remains well below the 20-year average growth rate of 2.6% per annum (Chart 2).

Inflation in Perth remains below the national rate of 1.9% (Chart 2), reflecting weaker domestic economic conditions in Western Australia. The drivers of recent price movements have been broadly similar at the State and national level and across all capital cities, with the exception that housing (e.g. rent) costs have fallen substantially in Perth relative to other capitals.

Inflation Outlook

The subdued inflationary environment largely reflects persistent weakness in the housing-related expenditure categories.

CHART 2: CONSUMER PRICE INDEX
Annual Average Growth %



Rents have now contracted for 11 of the past 13 quarters (with the two exceptions showing no change in rents over the quarter), while the price of project homes has contracted in six out of the past nine quarters. This is consistent with falls in both the median house price and an elevated vacancy rate (of 6.9% in the September quarter 2017).

Moreover, prices of 'quality adjusted telecommunications related goods and services' have been trending down for some time, reflecting improvements in products and services without a corresponding increase in the headline price.

Growth in the Perth CPI is expected to lift from 1% in 2017-18 to 2% in 2019-20 and 2.5% in 2020-21, supported by a recovery in general economic conditions, including a return to more robust rates of growth in SFD. The Reserve Bank of Australia expects national inflation to lift to 2.25% over 2018 to 2020.

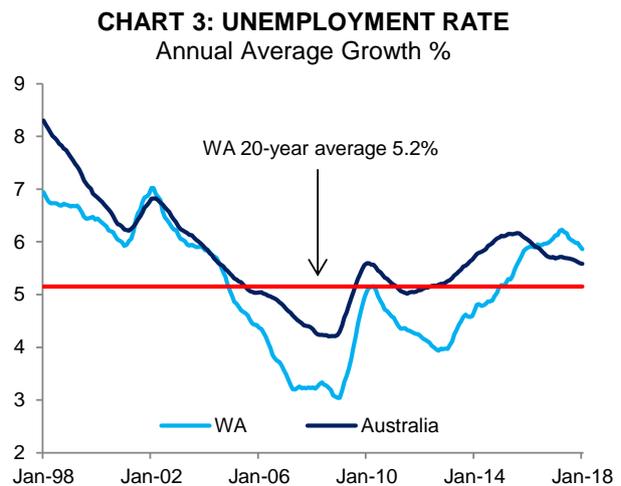
LABOUR MARKET

Western Australia's labour market has been stronger than expected since the Budget and Mid-year Review. Employment grew by 1.7% in January 2018, recovering strongly from a 0.9% fall in 2016-17. This turnaround in annual terms was fuelled by full-time hiring.

Growth in full-time employment (2.7% or over 23,500 persons in the year to January 2018) was slightly offset by the decline in part-time employment, which fell by 0.4% (or over 1,700 persons) over the same period. Lead indicators of labour demand, such as advertised job vacancies and business confidence, suggest that hiring will continue at a robust pace over the near term.

In line with the improvements in employment, the State's annual unemployment rate fell from 6.2% in 2016-17 to 5.9% in the year to January 2018.

Western Australia's annual unemployment rate remains above the national equivalent (5.6% in January), as it has done since May 2016, which was the first time in over 15 years that Western Australia's rate exceeded the national rate (Chart 3).



Despite this, there are a number of indicators that suggest the degree of spare capacity in the labour market may be higher than the unemployment rate indicates. This includes the underemployment rate, which averaged 9.2% in November 2017. This is lower than a record high of 10.4% in February 2017 (but much higher than its recent low of 5.4% in August 2012) and implies that there is a large portion of employed persons who would like to work more hours. When combined with the unemployment rate, the rate of underutilisation in the State rose to 15.5% in November 2017, slightly lower than the peak of 16.1% in February 2017 (the highest rate in over 24 years).

In addition, there are a record number of persons in Western Australia looking for work who were not officially classed as 'unemployed' by the ABS as they did not meet the official criteria (i.e. they were either passively looking for work or not immediately available to start). Consistent with the stronger job prospects, the State's participation rate increased to 67.9% in the year to January 2018, up from 67.4% in 2016-17, and remains the highest of all States and well above the national rate (65.2%).

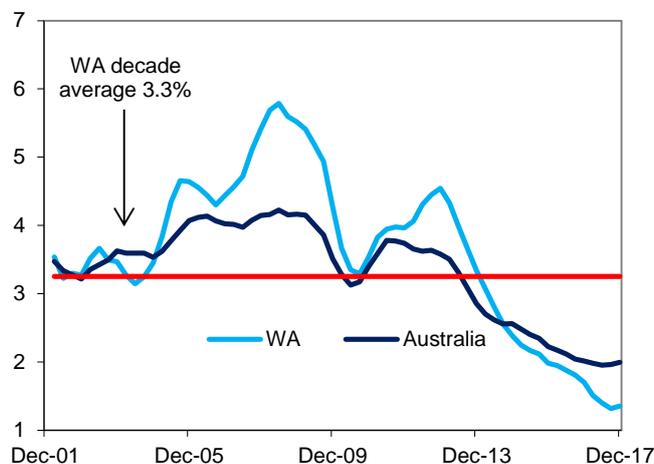
Labour force outlook

Lead indicators of labour demand, such as advertised job vacancies and business confidence, suggest that hiring will continue at a robust pace over the near term. As such, employment is projected to increase by 2% in 2017-18. Growth is expected to moderate slightly to 1.5% in 2018-19, consistent with the end of the labour-intensive construction phase on major LNG projects, before strengthening to 2.25% by 2020-21 (supported by a lift in population growth and a return to growth in the domestic economy).

WAGES

Wage growth in Western Australia has slowed to record lows as spare capacity in the labour market builds and businesses continue to cut costs.

CHART 4: WAGE PRICE INDEX
Annual Average Growth %



The State's Wage Price Index (WPI) increased by just 0.3% in the December quarter 2017. This follows 0.6% growth in the September 2017 quarter, and is well below the decade average quarterly growth of 0.8%.

Annual average WPI growth picked up slightly to 1.4% in 2017, from 1.3% in September 2017 (the lowest annual growth rate on record). This compares to 1.7% WPI growth during 2016 and is the lowest result of all jurisdictions.

While national wages growth in 2017 is near record lows at 2%, it remains above growth in Western Australia (Chart 4).

Consistent with declines in nominal wage growth, real wages growth moderated to 0.5% in 2017, compared to 1.2% in 2016 and 0.8% in 2016-17. This also reflects a slight increase in the Perth CPI over this period (as outlined in the CPI section above).

The slowing of nominal wage growth in Western Australia continues to be led by the private sector, where growth reached a record low of 1.2% in 2017. As has been the case for some time, public sector wage growth remained more robust by comparison (at 1.8%). Since the March quarter 2017, annual average growth has moved below the national rate which has been stable at around 2.4% in the last six quarters.

Earnings

Seasonally adjusted total average weekly earnings (AWE) in Western Australia increased by 0.7% in 2017¹, to reach \$1,332.50. In dollar terms, AWE in Western Australia was the highest of all the states, behind only the NT (\$1,443.50) and the ACT (\$1,394.3). However, annual average growth was the lowest of all jurisdictions, at 0.7% in 2017, following a decline of 0.7% in 2016. This compares to a 2.9% recent growth peak in the year to May 2015.

Average weekly full-time earnings (AWOTE) increased by 1.6% in 2017 to reach \$1,743 (behind only the ACT at \$1,801). This measure of average wages is not impacted by the compositional changes between full-time and part-time employment.

¹ The frequency of the AWE series changed from quarterly to biannual in 2012, with the November 2012 issue the first produced on a biannual basis. AWE data will now be produced twice a year relating to the May and November reference periods.

In a State like Western Australia, growth in the various average weekly earnings measures tends to be more volatile than growth in the WPI. The greater volatility in part reflects changes in the composition of the State's workforce², which affects average earnings data, but not the WPI (as the latter only measures wage movements in a basket of jobs of a fixed quantity and quality).

Given the volatility and compositional issues associated with earnings measures, the WPI is a preferred measure of underlying wage growth.

Wages outlook

Wage growth is expected to remain subdued at 1.5% in 2017-18, consistent with high levels of spare capacity in the labour market (notwithstanding a slight improvement over the past six months). From 2018-19 to 2020-21, WPI growth is projected to gradually increase as economic activity strengthens and the labour market tightens. Nevertheless, growth is expected to remain significantly lower than the 18-year historical average growth of 3.5% per annum.

² For example, the mining industry has a large impact on the State's earnings measures (as earnings tend to be high in this sector). One reason that earnings for the mining industry are higher than the average for all industries is that workers in the mining industry tend to work longer hours and receive allowances for shift work and for often working in isolated locations.