ECONOMIC BRIEFING

SEPTEMBER 2023

WALGA

OVERVIEW

The rapid increase in costs faced by Local Governments in recent times has now peaked, but growth rates are still above the long-term average.

While the slowing rates of inflation across Australia will come as welcome news, the focus is now shifting to the emerging challenges resulting from the global economy and its implications for WA and the Local Government sector.

The **global economy** is forecast to slow in coming years. Inflation is slowing across the globe, but significant risks are present as wages grow and the ongoing threat of escalating conflict remains.

The biggest threat to the trade-exposed WA economy is coming from China, whose economy is suffering from slower-than-expected growth stemming from weak consumer demand and challenges in the property sector.

Conditions in the **WA economy** are expected to moderate in coming years in line with recent efforts to reduce inflation, capacity constraints in the resource sector, and global economic uncertainty, particularly in China. Interest rate hikes are already impacting the domestic economy, as reflected in indicators of retail sales, housing activity, and business and consumer confidence. There is mounting speculation that the Reserve Bank of Australia's tightening cycle may have reached an end, with inflation starting to trend downwards.

While private sector spending is slowing, Government investment is continuing to support the domestic economy in the short term as work continues on major infrastructure projects.

The WA economy is well placed to withstand a global economic slowdown due to its strong pipeline of construction activity and significant capacity for Government stimulus, however in an uncertain economic climate, significant risks to the forecast remain.

The **Local Government Cost Index (LGCI)** has continued to ease in recent months, recording its lowest quarterly increase since March 2021. However, the overall figures mask some components of the index that are trending upwards. Employee costs, insurance costs and machinery and equipment are all placing upward pressure on the index.

Growth in **construction costs** have continued to ease in recent months, driven by falling fuel prices and easing global supply-chain pressures. Non-residential building costs have slowed at a faster rate than road and bridge costs which have remained above the long-term average due to continued strong increases in the cost of some materials. While the base case is for construction costs to continue to moderate and then settle at a higher level, risks to the forecast remain. A slowdown in the global economy may see prices ease, however a strong pipeline of construction in WA suggests the competition for labour and materials will remain strong in the near term.

Wage pressures in WA accelerated in the June quarter of 2023, growing at the fastest annual rate since December 2012. Official data is expected to show further increases in coming months, as pay increases at the end of the financial year and increases to minimum wages and award rates of pay come into effect. While wages are increasing, these benefits are not yet being felt by households given that the rate of growth is slower than the CPI across the nation. However, the June quarter of 2023 marked a tipping point where wages growth kept pace with inflation in WA suggesting that real wages growth is not far away.

Insurance costs have been increasing across all categories over the past year. While insurance costs are increasing, to date LGIS has insulated the sector against some of the rapid increases experienced across the globe. To discuss insurance coverage and pricing, WA Local Governments can contact LGIS directly.

NOTE

The significant challenges of forecasting in the current economic environment, mean **the LGCI should be used with caution**. The LGCI will be subject to revisions in coming months, as the impact of major economic shocks such as the pandemic, war in Ukraine, and the impact of recent rate rises become clearer. An increase in wage pressures may also see the index revised higher.

It is important that Local Governments take into account their own local issues and experiences when considering cost pressures. It would also be prudent for Local Governments to prepare for multiple scenarios for cost increases in coming years.

GLOBAL IMPACTS ON THE WA ECONOMY

KEY POINTS:

- **The global economy is forecast to slow in coming years**
- **Inflation is falling across the globe, but significant risks are present as wages grow and the ongoing threat of escalating conflict remains**
- **The biggest threat to the trade-exposed WA economy is coming from China.**

Many of the economic challenges faced by WA in recent years have stemmed from global issues: the COVID-19 pandemic, rising inflation and its impact on the cost of living, supply-chain issues, and economic shocks from the invasion of Ukraine. As an open economy, Australia is impacted by the global economy through trade policies, the value of the Australian dollar and the demand for our exports.

In its July World Economic Outlook update[1], the International Monetary Fund (IMF) projected global economic growth to fall from 3.5% in 2022 to 3.0% in the current calendar year and remain at this historically weak level through 2024. Linked to this is slow growth in global trade, which is forecast to be 2.0% in 2023, well below the 4.9% average in the first twenty years of this century. This is due to subdued demand from the fight against inflation, the shift towards domestic services and rising trade barriers.

The IMF reports easing, but still historically high, inflation in most countries. Globally, energy and food costs have fallen from their peaks in 2022 as supply chains normalise and demand weakens. In the USA, where the fight against inflation is broadly accepted to be around six months ahead of Australia, headline inflation has fallen from a peak of 9.1% in June 2022 to 3.3% in the year to July. Inflation in the Euro Area has been slower to fall, currently at 5.3%, while the UK is lagging at 6.8%. As interest rate rises across the globe take effect and inflation falls, the focus turns to ensuring the economy has a 'soft landing' where the impact of rate rises cools the economy enough to subdue demand and drag down inflation, while avoiding mass unemployment and recession.

However, it is premature to declare inflation beaten. Tight labour markets around the world are resulting in wages growth. Although modest wages growth is expected in this environment, rapid wages growth can be inflationary, and lead to a 'wage-price spiral', particularly if it is not accompanied by productivity growth. The IMF reports that this is not yet evident in Australia and comparable countries. Other risks to inflation include: an escalation of the war in Ukraine or other conflicts impacting the price of food and commodities, an increase in profit margins as input costs fall, or a further drop in the Australian dollar which would increase the cost of imported goods.

While inflation is the key issue in developed economies, the opposite is true in WA's key trading partner, China. The Chinese economy has recently slid into deflation with the CPI falling by 0.3% over the year to July 2023, largely because of weaker consumer confidence and changes in spending patterns, particularly among younger people where unemployment is an increasing concern.[2]

Economic growth in China has eased to 0.8% in the June quarter after a strong initial recovery from the pandemic. Of particular concern are the challenges facing the property sector, which has contributed more than 20% of China's GDP in recent years, as well as being a major driver of record exports for WA. Property prices in China have dropped sharply, after years of investment in building up supply which is now outstripping demand, and major property developers are struggling to meet payments as sales deteriorate.

In response to the slowdown in activity, the Chinese Government has announced stimulus measures to reach their 2023 GDP growth target of 5%, however their impact is yet to be seen. Recently, it slashed stamp duty on securities trading for the first time in 15 years, unlocking capital markets and boosting investor confidence.[3] China has also reduced interest rates twice this year. It is expected that more will need to be done by the Chinese Government to stimulate consumer spending to reach its economic growth targets.

An economic slowdown in China will impact WA both indirectly, through slowing economic growth, and directly as China is WA's largest trading partner. More than half of the State's goods exports, worth $135 billion, are sent to China. The biggest risk to WA is a reduction in the demand for our key export commodities. This may be exacerbated by a depreciation in the Australian dollar if there is a flight to less risky currencies as the Australian dollar is seen to be too closely tied to commodity prices. However, this may be mitigated by Australian exports becoming more attractive as they are cheaper relative to their competitors. A fall in the Australian dollar could be inflationary as imported items into Australia become more expensive.

While there are risks to the outlook for China, it is expected that the Chinese Government will respond with further stimulus to boost activity. This has previously contributed to record surpluses to the WA Treasury and more recently to the first Commonwealth surplus in fifteen years in 2022-23. Conservative iron ore price forecasts will act as a buffer for the WA budget. This provides the WA Government with the capacity to stimulate the local economy if needed.

While iron ore prices have fallen from their highs, they remain well above the WA Treasury's forecast of $US 74 per tonne (see chart). If this remains the case, Treasury can expect another year of strong royalties revenue. At a national level, the RBA has room to cut interest rates in response to any major global slowdown.

Despite these risks, the base case is for continued growth in Western Australia. If the global economy maintains its low but steady growth and inflation is slowed without a major economic downturn, WA is well placed to continue to benefit from its strong export economy. Australia's economy is closely tied to the global economy, particularly China. This is also true for Western Australia and those regions with a strong export economy. WALGA will be closely watching the global economy to forecast the impact on jobs and investment in local communities.

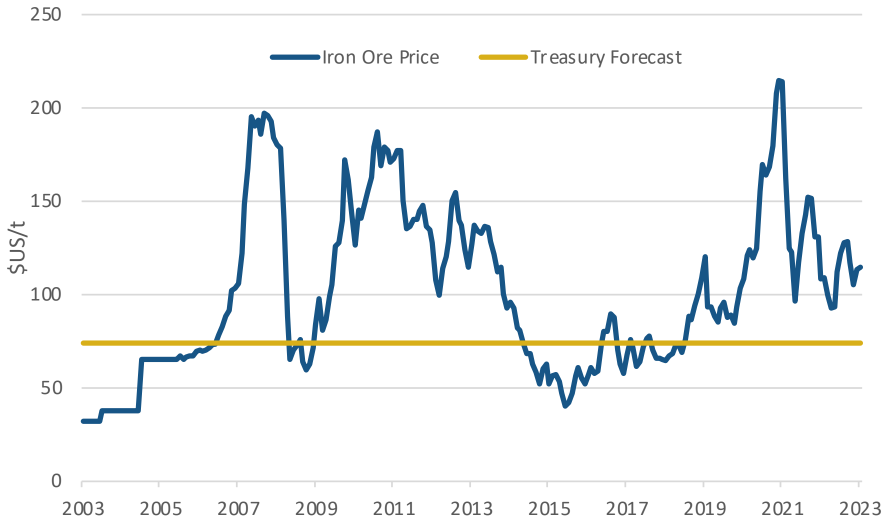
[1] IMF World Economic Outlook July 2023

[2] Hale, T., Xueqiao. W, and Li, G., August 2023, "Why the world is worried China's Millennials are giving up shopping," Australian Financial Review.

[3] Courier Mail, August 2023, 'Near-perfect storm': How China's economic crisis could devastate Australia

Iron Ore Price v 2023-24 WA Treasury Forecast, $US/tonne

SOURCE: WORLD BANK; GOVERNMENT OF WESTERN AUSTRALIA



WA ECONOMIC OUTLOOK

KEY POINTS:

- **Conditions in the WA economy are expected to moderate in coming years in line with recent efforts to reduce inflation, capacity constraints in the resource sector, and global economic uncertainty particularly in China**
- **Interest rate hikes are impacting the domestic economy as reflected in indicators of retail sales, housing activity, and business and consumer confidence**
- **While private sector spending is slowing, Government investment is continuing to support the domestic economy in the short term as work continues on major infrastructure projects**
- **There is mounting speculation that the Reserve Bank of Australia's tightening cycle may have reached an end, with inflation starting to trend downwards**
- **The WA economy is well placed to withstand a global economic slowdown, however in an uncertain economic climate, there remain significant risks to the forecast.**

After recording the highest rate of economic growth in almost a decade in 2022-23, conditions in the WA economy are expected to moderate in coming years. This is in line with recent efforts to cool inflation, with capacity being reached at some of the state's key resource producers, and global economic uncertainty, particularly in China. WA Treasury's forecast predicts growth in the WA economy will slow to 2.25% in 2023-24 and 1.75% in 2024-25.

In recent months, it has become apparent that interest rate rises are starting to have their desired impact by slowing retail spending, albeit at a slower rate than expected. Retail trade is a key indicator of the strength of the household sector, accounting for one-third of consumer spending.

Australian retail sales increased 2.1% in the year to July 2023, well down on the double-digit rates of growth recorded during 2022. In WA, retail sales also slowed to growth of 3.6% over the year, down from growth rates in excess of 10% in mid-2022. However, total retail sales consider both the quantity of goods sold as well as the price, which can be distorted by rising prices. When considering only the volume of retail turnover, the impact of recent rate hikes is even more stark, with Australian retail trade down 1.4% in the year to June. In WA, retail volumes have remained above the nation's for three consecutive quarters but still grew just 0.7% in 2022-23 (see chart).

While retail sales are slowing, Australians are being buffered to some extent from the cost-of-living rises due to the accumulation of savings. During the pandemic Australians built up savings at an unprecedented rate from a combination of Government stimulus, changed spending patterns, and restricted spending opportunities. AMP estimates total savings to be $253 billion with just 7% of this spent to March 2023. It is forecast that at current rates, this safety net will not be expended until late 2024, providing a significant savings buffer for some households that will assist with cost-of-living pressures.

At the same time, households that fixed their mortgages during the period of historically low interest rates, have seen their discretionary budgets squeezed as home loan payments jump to the higher variable rate. The RBA forecasts that 65% of fixed-rate loans that were outstanding in early 2022 will have expired by the end of 2023[4]. This equates to 1.5 million loan facilities that are now attracting a higher interest rate. A further 20%, or 450,000, mortgages will roll-off fixed interest rates in 2024.

Household consumption is likely to be impacted by a reduced capacity for discretionary spending as mortgage payments rise.

Housing activity has also slowed in line with the increase in interest rates and the end to COVID-19-related incentives. Housing finance approvals have been falling in annual terms since October 2021, dropping a further 10.7% over the year to June 2023. The number of owner-occupier housing finance approvals (excluding refinancing) is now below the long-term average.

Similarly, dwelling approvals have also gone backwards for 22 of the last 23 months in annual terms, falling a further 12.5% over the year to July 2023.

These forward indicators of housing construction activity suggests that dwelling investment is likely to act as a drag on growth in the future. This is broadly consistent with Treasury's estimates which show that after a period of expansion of 6.5% through 2023-24, dwelling investment is forecast to fall 7.75% in 2024-25 as the increase in interest rates impacts building activity.

However, the contraction in dwelling investment is expected to be short-lived, given that there remains pent-up demand for housing. The Real Estate Institute of Australia estimates the vacancy rate to be 0.9% in Perth, well below its estimate of a balanced market

[4] *Reserve Bank of Australia, March 2023, 'Fixed-rate Housing Loans: Monetary Policy Transmission and Financial Stability Risks*

WA ECONOMIC OUTLOOK

of 2.5% to 3.5% where there are neither too many nor too few rental properties. This housing pressure is replicated across the major regional cities. Advertised rents in Perth increased 13.4% in the 12 months to June 2023, above the national figure of 9.7%. While vacancies are low, it is expected that rents will continue to rise.

Rising interest rates are also impacting the business community, with Roy Morgan reporting business confidence to be 7.8% lower than a year ago in Australia. However, WA businesses are more optimistic than their national counterparts, with confidence over 25 points above the national average and up 6.4% in the year to July. CCIWA's Business Confidence Survey also reflects the impact of the recent rate hikes on the business community, with long-term confidence in the WA economy hovering at levels seen during the COVID-19 pandemic. The cost of doing business is the main detractor, along with the skilled labour shortages and rising employee costs. Businesses are also reporting that weak consumer demand is an issue due to the impact of interest rate rises on spending.

Lower business confidence has not yet translated into reduced business investment though, with total new capital expenditure growing at 10.8% in Australia in the 12 months to June 2023. In WA, the increase was 6.3% in the year to June due to the slower rate of growth of capital investment in the mining sector. Despite this, capital expenditure in the mining sector is now at its highest level since December 2016.

Government investment is continuing to support the domestic economy in the short-term as work continues on major infrastructure projects. Government investment is forecast to increase 6.25% in 2022-23 and 13% in 2023-24 according to estimates in the May budget off the back of increased spending on health infrastructure and METRONET projects.

This investment is flowing through the economy with engineering work done by the public sector up 11% over the year to March 2023. Public sector engineering construction work done has been growing at double-digit rates in annual terms for the last ten quarters, reflecting the record asset investment program that is under way. Significant increases have been seen in the bridges, railways and harbours category (up 40.3% over the year to March 2023) due to the large investment in Metronet.

Strong investment by the public sector has meant that the construction sector is competitive and has led to supply constraints and increased costs for Local Governments (see construction section).

With interest rate rises clearly starting to take effect, there is mounting speculation that the Reserve Bank of Australia's tightening cycle may have reached an end.

This speculation is supported by data that shows that inflation is now trending downwards.

The Trimmed Mean, which is the RBA's preferred measure of underlying inflation, has slowed to 5.9% from its recent high of 6.9% in December 2022, though remains well above the target band of 2% to 3%.

While goods inflation has eased (growing by 5.8% over the year to June 2023, down from a recent peak of 9.6%), the cost of services continues to accelerate, rising by 6.3% over the year to June 2023. This is the largest increase in annual terms since March 2001. This will be a critical issue for the RBA to monitor. The continued high level of services inflation suggests that rising domestic costs remain an issue on the back of increases in wages, utilities, rents and insurance. This is reflected in the CPI for non-tradables, which remains high at 6.9% over the year to June 2023. By contrast, the CPI for tradables slowed to 4.4% over the year to June 2023 – the lowest annual increase since June 2021 – as global supply chains pressures have eased.

In WA, headline inflation in has fallen faster than anticipated to sit at 4.9% in the year to June, compared to 6.0% for Australia. The slowdown has largely been underpinned by transport as fuel prices have returned to more normal levels. The transport CPI grew by just 0.9% over the year to June 2023, compared to the recent peak of 15.5% over the year to March 2022.

Western Australians have also benefited from statewide policies on energy prices with utilities pricing staying flat over the past twelve months (+0.1%), while nationally they have been a key driver of inflation increasing 13.9% in the year to June.

There are, however, other categories that continue to record stronger growth. Western Australians' preference for international holidays after a long hiatus has led to international holiday travel and accommodation prices increasing 8.4%, while the domestic equivalent decreased 5.8%. Other drivers of inflation in WA were takeaway and fast foods (+3.6%), rents (+2.7%), and other financial services (+1.9%).

Monthly CPI data suggests the fall in prices is set to continue as the RBA held interest rates steady in September for the third consecutive month. This pause enables the RBA to assess the impact of the 400 basis point rise since May last year. The RBA continues to target a gradual slowing of the economy to bring inflation back into the target range of 2% to 3% by 2025 while also preserving most of the gains made in employment figures and maintaining modest economic growth.

WA's economy has been resilient in recent years despite the challenging economic climate. Treasury and the RBA's base case is for modest growth in the coming years with easing inflation and a small rise in unemployment. Local Governments are likely to see some pockets of their communities struggling with rises in the cost of living. However, the long-term prospects for the WA economy remain positive as a robust pipeline of private and public investment is rolled out in the coming years.

[1] *IMF World Economic Outlook July 2023*

[2] *Hale, T., Xueqiao. W, and Li, G., August 2023, "Why the world is worried China's Millennials are giving up shopping," Australian Financial Review.*

[3] *Courier Mail, August 2023, 'Near-perfect storm': How China's economic crisis could devastate Australia*

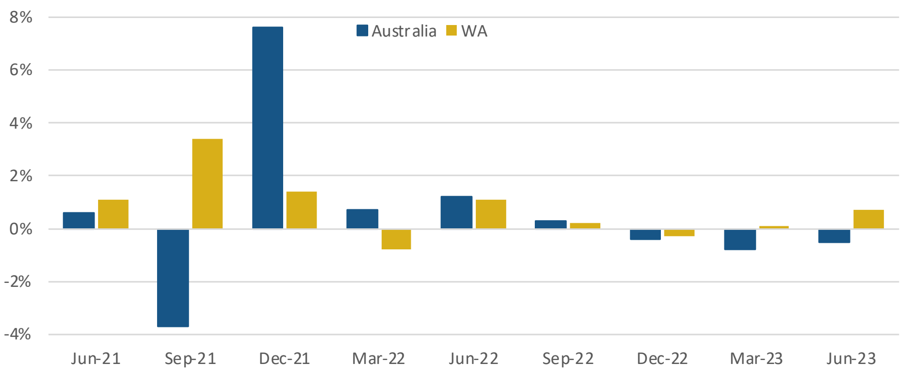
Economic forecasts as per last EB

Economic Forecasts	2020-21 %	2021-22 %	2022-23 %	2023-24 %	2024-25 %	2026-27 %
Gross State Product	3.1	4.25	2.25	1.75	2.0	1.5
Household Consumption	5.6	3.25	1.5	2.25	2.5	2.5
Business Investment	4.0	3.0	6.75	5.25	4.25	0.75
Dwelling Investment	2.3	-1.75	6.5	-7.75	7.75	2.0
Good Exports	-3.1	6.0	2.0	1.75	1.5	0.75
Good Imports	-2.0	4.25	2.75	2.75	2.5	1.5
Employment Growth	5.8	1.75	1.0	1.25	1.25	1.5
Unemployment Rate	3.7	3.5	4.0	4.25	4.5	4.5
Participation Rate	69.4	69.1	68.7	68.4	68.2	68.0

SOURCE: WA TREASURY

Retail Volumes, Australia v WA, Quarterly % Change

SOURCE: ABS; WALGA



LOCAL GOVERNMENT COST INDEX

KEY POINTS:

- **The LGCI has continued to ease in recent months, recording its lowest quarterly increase since March 2021**
- **The overall figures mask some components of the index that are trending upwards**
- **Employee costs, insurance costs and machinery and equipment are all placing upward pressure on the index**
- **Construction costs have continued to moderate following double-digit rates of growth in 2021-22**
- **WALGA continues to encourage Local Governments to prepare for multiple scenarios through their budgeting process and to be adaptable to changing economic conditions.**

The Local Government Cost Index (LGCI) has continued to slow in the June quarter of 2023, rising by just 0.6%, the lowest quarterly increase since March 2021. In annual terms, the LGCI increased 4.4%, down from 6.4% in the previous year. LGCI growth is expected to continue to moderate, increasing 3.9% in 2023-24. This is above the WA Treasury's forecast rise in the Consumer Price Index of 3.5%. On the face of it, the slowdown in the index is positive news for Local Governments that have experienced sharp increases in their cost base in recent years. However, the overall figures mask some components of the index that are trending upwards.

Employee costs increased 4.2% in 2022-23, a significant increase from the 2.7% rise in 2021-22 due to the increasingly competitive labour market (see labour market section). Employee costs are forecast to rise 4.25% in 2023-24. It is expected that employee costs will continue to grow faster than in recent years as organisations compete for skilled workers in a tight labour market. It will be important for Local Governments to monitor trends in wages, given that employee costs represent around one-third of the sector's cost base.

Insurance costs have also been on the rise across the economy, up by 12.4% in 2022-23 on the back of the increased incidence of natural disasters, supply chain pressure and the high-inflation environment. It is expected that insurance costs will grow 6.5% in 2023-24, however significant challenges are ongoing (see insurance section).

Machinery and equipment costs also remained high, increasing by 12.2% in 2021-22 and 11.5% in 2022-23 on the back of supply chain constraints. These issues have largely been resolved and growth is expected to moderate to 4.6% in 2023-24.

While new cost pressures are emerging, construction costs are keeping a lid on the index having moderated in 2022-23 following double-digit rates of growth in 2021-22. Significantly, non-residential building costs have increased by just 1.0%. Growth in materials and contract costs also decreased from 5.7% in 2021-22 to 4.3% in 2022-23. This trend is expected to continue through 2023-24 with growth of 3.4%.

However, road and bridge construction costs remain above the long-term average, up 3.8%, while non-road infrastructure was up 3.6%. Construction cost growth is expected to continue to be modest in the coming years, settling at this higher level. Increasingly the cost of labour in the construction sector is expected to drive growth as issues around the supply of materials normalise (see construction section).

Persistent inflation continues to be a risk to Local Government bottom lines as price rises impact budgets through the cost of materials, contracts, furniture, utilities and construction projects. International and domestic factors influencing costs are explored in the domestic and international sections of this Economic Briefing. While inflation has peaked, it is still well above the Reserve Bank of Australia's inflation target of 2% to 3% (see domestic economy section). WALGA will continue to monitor the economic data and update the LGCI as further information is obtained. Both the Commonwealth and State treasuries will next update their forecasts in December for their mid-year economic and fiscal reviews.

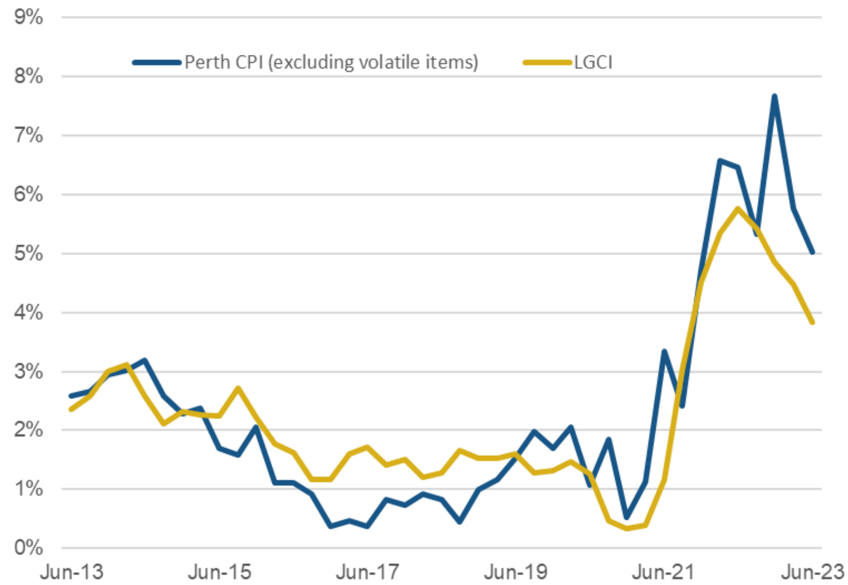
WALGA continues to encourage Local Governments to prepare for multiple scenarios through their budgeting process and to be adaptable to changing economic conditions. The Local Government Cost Index uses statewide data and regional variances will impact each Local Government. Liaising with suppliers to understand the local economic conditions and constraints will enable Local Governments to effectively plan the timing of their projects.

LGCI Forecasts

Economic Forecasts	Weighting	2021-22 (a)	2022-23 (a)	2023-24 (f)	2024-25 (f)	2025-26 (f)
Employee costs	35%	2.7	4.2	4.25	3.75	3.25
Materials and contracts	28%	5.7	4.3	3.4	2.1	1.4
Furniture	1%	7.5	5.8	1.4	1.3	1.3
Non-residential building	5%	14.4	1.0	3.7	1.1	1.8
Machinery and Equipment	5%	12.2	11.5	4.6	2.4	2.3
Non-road infrastructure	9%	12.1	3.6	3.6	1.6	2.2
Road and bridge construction	10%	12.0	3.8	4.5	2.0	2.5
Utilities	3%	1.4	2.5	2.5	2.5	2.5
Insurance	1%	7.0	12.4	6.5	4.1	3.9
Other	3%	5.9	6.2	3.5	2.8	2.5
LGCI	**100%**	**6.4**	**4.4**	**3.9**	**2.6**	**2.4**

LGCI vs CPI (excluding volatile items), Annual % Change

SOURCE: ABS; WALGA



CONSTRUCTION COSTS

KEY POINTS:

- **Growth in construction costs has continued to ease in recent months, driven by falling fuel prices and easing global supply chain pressures**
- **Non-residential building costs have slowed at a faster rate than road and bridge costs, which have remained above the long-term average due to continued strong increases in the cost of some materials**
- **While the base case is for construction costs to continue to moderate and then settle at a higher level, risks to the forecast remain. A slowdown in the global economy may see prices ease, however, a strong pipeline of construction in WA is suggests that the competition for labour and materials will remain strong in the near term.**

As forecast in previous Economic Briefings, growth in construction costs has continued to slow in recent months, as fuel prices fall and global supply chain pressures ease. This is welcome news after a period of double-digit price hikes weighed on Local Government's budgets over the past year.

The biggest slowdown has been in WA's non-residential building costs, which grew by just 1.0% over the year to June 2023. This follows a 14.4% over the same period in the previous year. The price of materials, which make up 53% of the index, slowed to 8.9% overall, down from the double-digit rates of growth recorded over the past year. While at the aggregate level materials costs have slowed, there were stark differences across material types. Strong increases were still recorded in relation to bricks and tiles (+29%), sand and aggregate (+25%), and electrical items (+14%). By contrast, there were mild price decreases for steel products (-3%) and structural steel (-2%).

It is expected that steel, copper and other metal prices will ease, while significant increases are still expected in concrete, cement and electrical items. Overall, Macromonitor forecasts the cost of construction materials to grow by just 1.4% in 2023-24 and 0.9% in 2024-25.

Road and bridge project costs have also eased, albeit to a lesser extent, rising by 3.8% over the year to June 2023 following a 12.0% hike over the year to June 2022. Growth in road and bridge costs has remained above the long-term average as a result of stubbornly high prices in 2022-23 for quarry products (+25%), concrete pipes and culverts (+18%), ready mixed concrete (+9%), asphalt (+9%) and bitumen (+6%), which together contribute more than 40% of the total cost of road and bridge projects.

Road and bridge costs are expected to pick up slightly to 4.5% in 2023-24, on the back of an increase in services costs (up 4.8%) and equipment costs (up 1.6%). However, the cost of road and bridge materials is expected to continue to moderate. By 2024-25, growth in road and bridge construction costs are forecast to slow to 2.0%.

Non-road infrastructure is expected to follow a similar trend, with moderate cost increases of 3.6% in 2023-24 and 1.6% in 2024-25, following the rapid increase of 12.1% in 2021-22 and 3.6% in 2023-24.

For all three construction indices, a major contributor to the slowdown in costs has been the drop in the fuel price in 2022-23 compared to the year earlier. While directly, fuel costs are a small proportion of total construction costs (around 2-5% depending on the project), the 28% drop in fuel prices over the last year has indirectly contributed to the easing in construction costs through its use as an input to the production and transport of construction materials.

Easing supply chain pressures have also contributed to the slowdown in construction prices. This is reflected in the Federal Reserve Bank of New York's Global Supply Chain Pressure Index (GSCPI), which measures constraints and shifts in the supply chain through transportation and manufacturing data. In 2020 and 2021, the GSCPI rose rapidly as COVID wreaked havoc on global supply chains. These pressures eased through 2022 and became negative in 2023 as supply chain disruptions are now below their historical averages. The easing of global supply chain pressures has contributed to the slowdown in the growth of material costs, although domestic and regional constraints still apply and shifts in global trading relationships may see this trend reverse.

While there has been positive news in terms of the cost of construction materials, construction labour costs are growing at the fastest rate in a decade (+5%) as organisations compete for skills in a competitive labour market. It is expected that construction wages will grow above the national

Wage Price Index for the next two years with growth forecast at 5.0% in 2023-24 and 4.4% in 2024-25. As labour costs contribute between a quarter and a third of total construction costs on average, this growth in wages will continue to place upwards pressure on project costs for Local Governments.

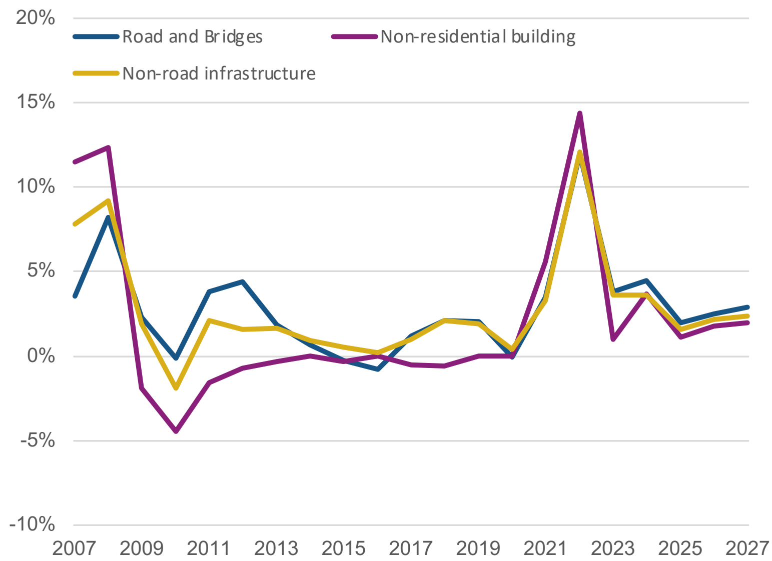
The construction sector is expected to remain competitive in the coming years as ongoing labour supply constraints and elevated levels of public investment drive economic activity. According to Deloitte Access Economics Investment Monitor, engineering work done in WA increased 15% over the year to March 2023 while commercial work done increased by 20% in the same year. $50 billion worth of projects are currently under construction with more than $100 billion of further projects in the pipeline.

The State Government is seeking to address the issue of a constrained construction labour force, budgeting $47.6 million in 2023-24 to increase local training, boost apprenticeships and attract more skilled workers from overseas with visa subsidies and sponsorships.

While the most likely scenario is for construction costs to settle at a higher level, risks to the forecast remain on both sides. The slowdown in the global economy will be a key factor to watch, with weaker activity in China expected to ease demand for Australian commodities. Conversely a major infrastructure stimulus program could see demand and prices increase (see global section). Any depreciation in the Australian dollar is expected to drive fuel and imported goods prices higher. Local Governments can mitigate these risks by working with suppliers to understand the exposure to price fluctuations and to plan accordingly.

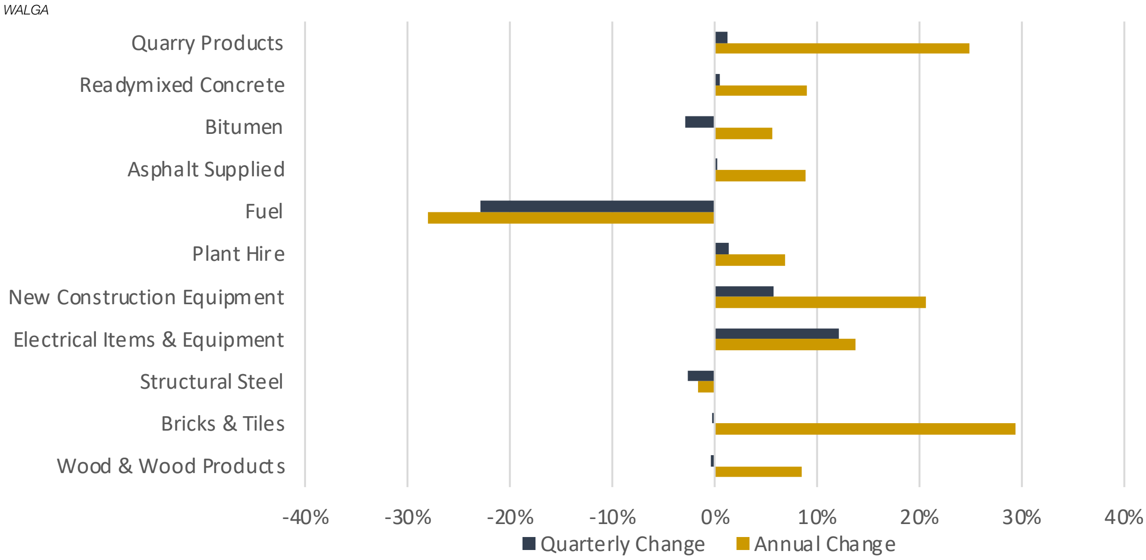
Construction Cost Indexes, WA, Annual % Change

SOURCE: ABS; MACROMONITOR; WALGA



Selected Components of Construction Costs, WA, Quarterly v Annual % Change

SOURCE: ABS; MACROMONITOR; WALGA



LABOUR MARKET AND WAGES

KEY POINTS:

- **Wage pressures in WA accelerated in the June quarter of 2023, growing at the fastest annual rate since December 2012**
- **Official data is expected to show further increases in coming months, as pay increases at the end of the financial year and increases to minimum wages and award rates of pay come into effect**
- **Although wages are increasing, these benefits are not yet being felt by households given that the rate of growth is slower than the national CPI. However, June quarter of 2023 marked a tipping point where wages growth kept pace with inflation in WA suggesting that real wages growth is not far away.**

Despite a strong increase in migration from overseas and interstate, labour shortages remain an ongoing challenge for WA employers. Wage pressures in WA have continued to build in the June quarter of 2023. This will be a key challenge for Local Governments in the future, given that one third of the sector's cost base is comprised of employee costs.

The Wage Price Index in WA grew by 0.8% in the June quarter and 4.2% for the year. This was the highest rate of growth since December 2012, and outpaced national wages growth of 0.6% during the quarter and 3.6% over the year. It was also above Treasury's estimate of 3.75% for 2022-23 in May's budget. If this trend continues it is likely that the forecast for wages will be revised upwards in December's Mid-Year Financial Projections Statement.

Rising rates of growth in wages are expected to continue in coming months, as the September quarter typically shows the largest increase due to pay increases at the end of the financial year and increases to minimum wages and award rates of pay coming into effect. Treasury forecasts wages growth to peak in 2023-24 at 4.0% before falling to 3.75% in 2024-25 and 3.25% in 2025-26.

The rise in wages acknowledges the ongoing competition for workers in the State's tight labour market. This is reflected in the persistently low unemployment rate in WA, which stood at 3.4% in July 2023. The unemployment rate in WA has now been below 4% for 21 of the last 22 months. The unemployment rate across the nation is also low, sitting at 3.7% in July.

Tight labour conditions are also reflected in the number of job vacancies in WA, which remain well above historic averages. Some 55,900 jobs were available in June. By way of comparison, during the mining boom, job vacancies peaked at 37,600 in September 2012, and typically averaged between 25,000 and 35,000 job vacancies at any given time.

While there are a large number of jobs available in WA, employment growth in WA has been modest. Some 22,100 jobs were created in the year to July 2023 (up 1.5%), growing slower than the national employment growth of 2.8%. The relatively modest rate of employment growth combined with the high rate of job vacancies suggests that there is a challenge to match jobs available with appropriately skilled workers.

In lieu of a pool of suitably skilled unemployed people to hire from, Australia has sought to attract workers from overseas, with 387,000 moving to Australia from other countries in 2022. As highlighted in the previous Economic Briefing, WA was the state with the fastest growing population in 2022, however this increase in workers from interstate (+14,000) and overseas (+38,000) has not yet been sufficient to ease the pressure on the labour market.

Although wages are increasing, these benefits are not yet being felt by households given that the rate of growth is slower than the CPI. This means that workers are not seeing the benefits of real wages growth. The Bankwest Curtin Economic Centre[5] reports real wages in Australia to be 5% lower than they were before the pandemic and the lowest it has been in a decade. Over the last twelve months, WA has had the slowest decline in real wages of the States at -0.7%. This is due to WA having the lowest level of inflation and the highest level of wages growth in the nation.

There are, however, signs that this is turning around. Wages growth matched inflation in the June quarter. Consequently, WA was the only state in Australia where real wages did not decline over the past quarter. As inflation is forecast to continue its decline, real wages growth is expected in the coming months providing some relief for household budgets.

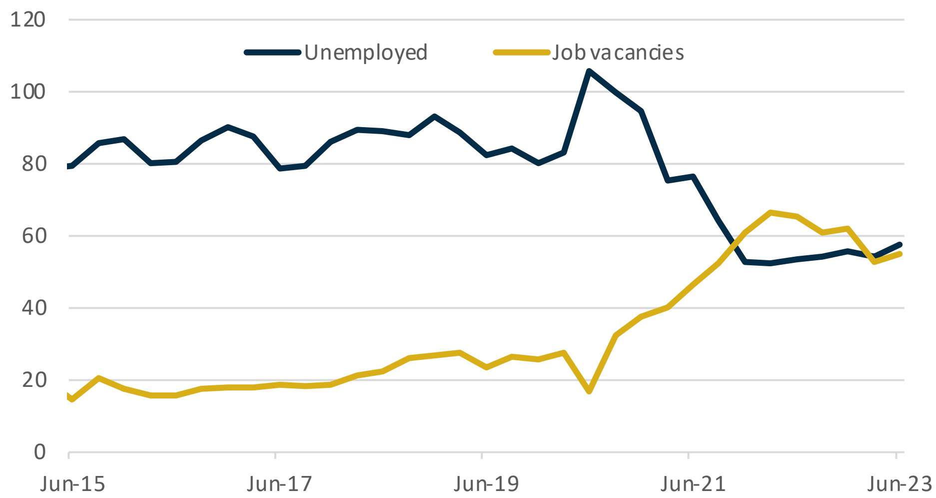
[5] *Bankwest Curtin Economic Centre Monthly Labour Market Update – July 2023*

The growth in the Wage Price Index is also reflected in the half-yearly release of Average Weekly Earnings (AWE) data. Western Australia saw growth in AWE of 5.3% in the year to June 2023, well above the national average of 3.9%. In dollar terms, the AWE in WA is $2,039, which is $201 more than the Australian figure of $1,838. This is largely driven by the sizeable proportion of WA's workforce employed by the mining sector, which is the highest paying industry at $2,854.

Feedback from WALGA's Employee Relations Team suggests there continues to be pressure on the sector for wages to rise in 2023, with Unions reportedly seeking pay increases in the order of 7% to 8% as part of industrial agreement negotiations. As reported previously, informal feedback from Local Governments suggests that wage increases provided to employees this year are ranging from 3% to 6%.

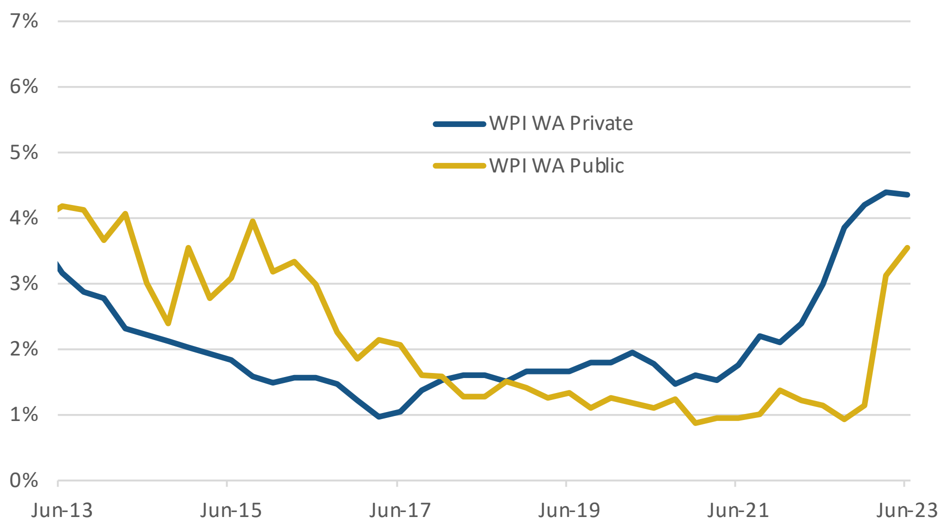
Job Vacancies v Unemployed Persons, WA Public and Private, '000s

SOURCE: ABS, WALGA



Wage Price Index Private vs Public, WA, Annual % Change

SOURCE: ABS, WALGA



INSURANCE AND RISK FINANCING

KEY POINTS:

- **Insurance costs have been increasing across most categories over the past year**
- **While insurance costs are increasing, to date the mutual (LGIS) has insulated the sector against the coverage and pricing changes witnessed in the traditional insurance market**
- **To discuss protection offered by the mutual and pricing, WA Local Governments can contact LGIS directly.**

While insurance is an essential tool for managing risk, the rising cost of insurance has been an issue affecting households, businesses and Governments across the globe in recent times. Many of the factors creating pressures for the economy such as rising inflation and supply chain pressures are also leading to challenges in the insurance market.

Globally, insurance costs across all categories have increased for twenty-three consecutive quarters, peaking at an unprecedented 22% increase in the fourth quarter of 2020 before slowing to a still rapid increase of 17% in the 12 months to June 2023[6].

All Western Australian Local Governments are members of LGIS. This mutual indemnity scheme is designed to take advantage of economies of scale to provide tailored insurance protection for all Local Governments.

In the Pacific region, LGIS highlights that all insurance classes are under pressure. Property insurance costs increased 8% in the first quarter of 2023, with the East Coast floods of 2022 and 2023 significantly impacting costs. Catastrophic weather events are a key focus for underwriters.

Liability costs jumped by 10% in the same quarter due to increases in the magnitude of claims and material inflation. The cost of cyber insurance rose 25% in the March quarter of 2023 due to the increased frequency and severity of ransomware losses.

WorkCare (workers' compensation) costs are also on the rise due to an increase in the average cost per claim. Drivers of this increase include: the sector's ageing workforce, increasing hospital costs, prolonged time off work, and increasing surgeries.

Households are also feeling the impact of increasing costs through their housing, contents and motor vehicle insurance. In Perth, insurance for consumers increased 12.4% in the year to June. This cost-of-living hit was felt across the country with Australian insurance costs growing at 14%. This is the fastest rise in insurance costs since the introduction of the GST.

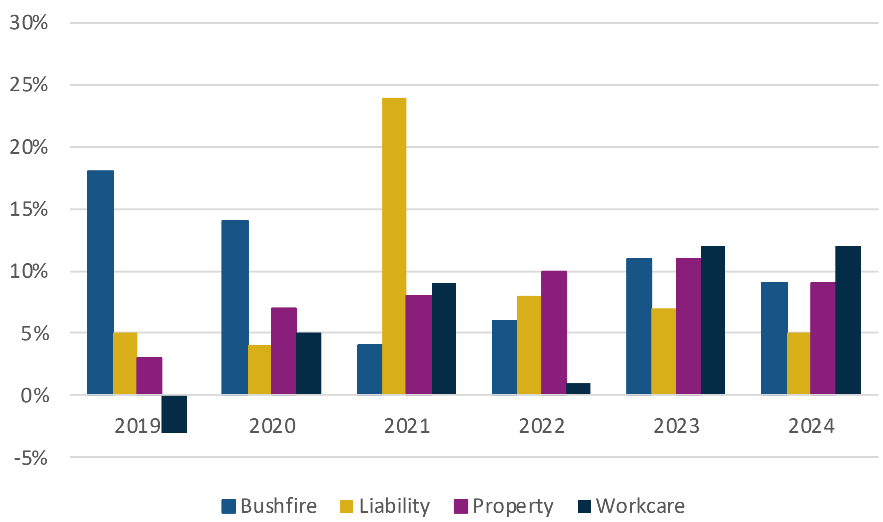
Although the costs to Local Governments are increasing, to date LGIS has insulated the sector against some of the rapid increases experienced across the globe.

To discuss protection and pricing, WA Local Governments can speak to their LGIS member services contact or find out more at https://www.lgiswa.com.au.

[6] *Marsh Global Insurance Market Index Q2 2023*

LGIS Insurance Components, Annual % Change

SOURCE: LGIS

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QUESTIONS

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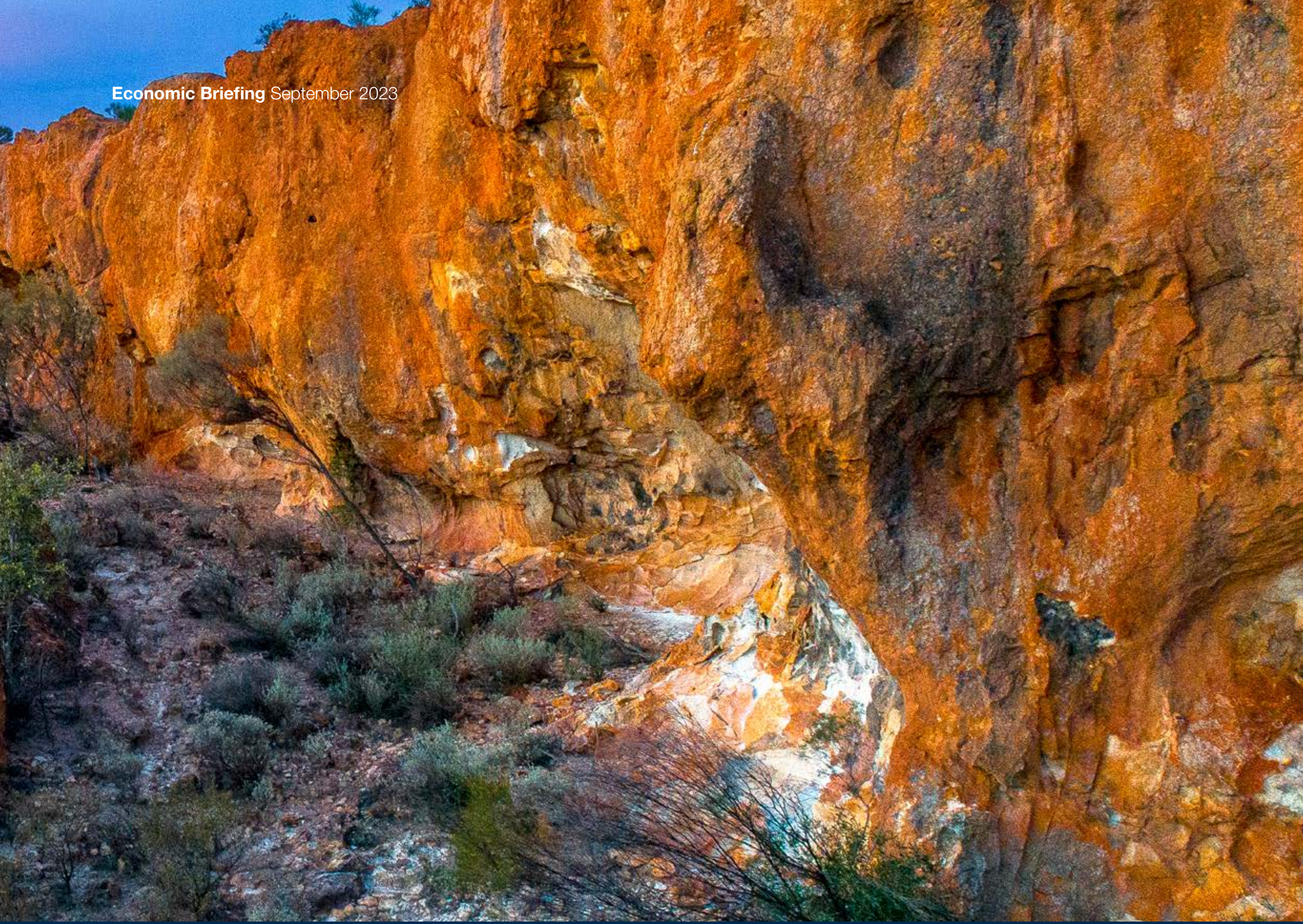

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