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SPECIAL REPORT

Risks to WA

BN FEATURE

Key takeaways

- China grapples with trade dispute, debt problems, potential flow-on to WA
- Likelihood of global monetary tightening subsiding
- Projects to push up costs, need skills (page 20)
- Election, tax hikes and house price falls (page 22)
- Positives still outweigh risks

Risks to WA

- Chinese debt and US trade dispute
- Wrong monetary policy settings
- Skills shortages
- Increasing construction costs as public, private projects compete
- Election brings big tax hikes
- House prices continue to drop

CHINA

2018 GDP growth
6.6%

2019 projection
6.2%

Debt/GDP
300%

WA

Iron ore price projection
$US64/t in Dec 2020

Major projects on BNiQ
$95bn likely or under way

2018FY iron ore exports
$61.7bn
826 million tonnes

FINANCIAL MARKETS

US Fed Funds rate
Up 1% in 2018 to 2.5%

ASX 200
down 6.8% in 2018

Dow Jones
down 5.6% in 2018

All eyes on China amid slowing global trade

Trade battles, high Chinese debt and slowing global growth are among the biggest threats to the WA economy.

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5-PAGE FEATURE

A RECENT speech by Chinese President Xi Jinping, in which he referenced the possibility of an economic slowdown, shows that concerns about the long-term sustainability of China's growth run right to the top.

The Asian powerhouse has appeared recession-proof for at least four decades, particularly in the past 15 years, and this success has flowed to Western Australia.

The signs are pointing to a bumpier road ahead, however.

China's GDP growth was 6.6 per cent in 2018, the lowest annual level since 1990, while car sales fell 6 per cent to 22.7 million units, the first drop in two decades.

A big challenge will be Chinese negotiations with the US to resolve a trade war that started last year, and may escalate in the months ahead.

But that is not the only issue.

China's debt-to-GDP ratio is roughly 300 per cent, according to the Institute for International Finance, with a good portion of that believed to be debt between government entities, such as public corporations and public banks.

That prompted Mr Xi to warn bureaucrats from across the country to prepare for economic problems, including over-indebted businesses.

The International Monetary Fund recently projected Chinese GDP growth of 6.2 per cent this year, while world growth would be 3.5 per cent, lower than other recent projections.

Risk was on the downside, however.

"Despite fiscal stimulus that offsets some of the impact of higher US tariffs, China's economy will slow due to the combined influence of needed financial regulatory tightening and trade tensions with the US," the report said.

There would still be some way to go for trade negotiations, the IMF predicted, putting trade and investment under threat globally.

"A second source of systemic financial stability risk is a deeper-than-envisaged slowdown in China, with negative implications for trading partners and global commodity prices," the report said.

"China's economy slowed in 2018 mainly due to financial regulatory tightening to rein-in

6.2%
IMF PROJECTION OF CHINESE GROWTH

shadow banking activity and off-budget local government investment, and as a result of the widening trade dispute with the US, which intensified the slowdown toward the end of the year.

"Further deceleration is projected for 2019."

Outside of China, there were clear signals in 2018 that the decade of monetary easing worldwide since the GFC would be unwound, with the US federal funds rate up 1 percentage point in 2018 to 2.5 per cent.

Recently, however, the US Federal Reserve has reportedly become more cautious, possibly

> **When Trump starts a trade war that tariffs Chinese steel, he's tariffing WA iron ore**
>
> –Jeffrey Wilson

holding off further rate hikes for some months.

Those worries about China and monetary tightening contributed to much bloodshed on equity markets in 2018, with the Dow Jones 5.6 per cent lower, and the ASX 200 falling 6.8 per cent.

Iron ore

The most pertinent number for WA is probably iron ore futures, which predict a $US10 per tonne drop in the commodity's price from time of writing until December 2020, to be around $US64/t.

If realised, that would take about $760 million per year out of the WA state budget.

Nonetheless, projections for WA are generally optimistic, with $95 billion of major projects that are either likely or under way, according to the BNiQ Search Engine.

Data service IbisWorld said last month that a return to the boom conditions in WA prior to 2011-12 may be on the way, citing new iron ore projects under construction and likely LNG developments.

However, IbisWorld senior industry analyst Jason Aravanis warned that rising LNG production from Qatar and the US might threaten that investment, while China's problems were a definite threat.

"Should the global economy enter a downturn in response to the significant tariffs introduced in 2018, the Australian economy is likely to be hit hard," Mr Aravanis said.

PerthUSAsia Centre director of research Jeffrey Wilson agreed the trade war would flow on to WA.

"That's a trade dispute against WA iron ore," Dr Wilson said.

"Their steel is our iron ore … when Trump starts a trade war that tariffs Chinese steel, he's tariffing WA iron ore.

"At the moment the trade dispute hasn't had a big impact on that because it's still at a standoff point … and the Chinese system lurches on because of the state banking system underpinning it.

"The cost for the Chinese heavy industry because of the trade dispute is basically being absorbed by the taxpayer through the financial system; that's probably not sustainable."

WA exported $61.7 billion of iron ore in the 2018 financial year, mostly to China.

The 826 million tonnes shipped from WA accounted for about 57 per cent of global seaborne iron ore exports.

Whether there's a negotiated solution to the trade battle or not, Dr Wilson said the Chinese growth model of heavy industry exports would not be able to continue.

WA may not be hit too hard, with advantages in quality compared to other jurisdictions, he said, although the state should not expect a high level of growth in iron ore exports in the near future.

Diversity

That meant a need to look to other sectors to drive growth, and some fresh thinking about how that might be generated.

One example was in tourism, which Dr Wilson said should be approached in a coordinated way with international education, because families often visited their children while they were studying in Australia.

Low growth in international student numbers was linked to poor showings in tourism data, so he suggested the two be marketed together in a way that was appealing to the Asian market.

WA could also export its technological developments in agribusiness and natural resources, Dr Wilson said, but this would require a strategy focused on supporting small and medium enterprises, rather than mass scale exporters.

SHIFT: Jeffrey Wilson says China will need to rethink its growth model regardless of the outcome of the trade dispute with the US. **Photo: Gabriel Oliveira**

Optimism

Deloitte Access Economics partner Matt Judkins told *Business News* there was plenty of cause for optimism in WA, although problems in China would be one of the biggest economic risks.

"China would be near the top of the agenda of things to watch out for," Mr Judkins said.

"More broadly … we've had some pretty coordinated growth around the world (in recent years), and that dynamic is now changing.

"One of the big changes is a slowing Chinese economy."

The chance of a massive contraction that reduced demand for WA iron ore was relatively low, he said, although not impossible.

"The risk that there's a severe contraction, there'd have to be a trigger for that, a reasonably catastrophic trigger," Mr Judkins said.

A full-blown trade war or a major deleveraging would both be potential causes, but an advantage for WA would be that the state's producers were very low on the cash-cost curve for iron ore, making it less likely volume would be reduced, he said.

"At some point in time, relying on debt-fuelled growth is not a sustainable position to be in. If they continue to grow, and they are able to continue to have that growth without a reliance on increasing debt, then they grow themselves out of the problem," Mr Judkins said.

"The issue is how reliant that growth rate is at the moment on fiscal stimulus.

"That's both the formal debt and also with the shadow banking system; it certainly is a concern to economists around the world how much of this debt is hidden."

The other pertinent question for China would be changing its growth model away from capital goods manufacturing to consumption, he said.

Monetary matters

As the risk of a China slowdown has increased, another risk appears to be fading.

Mr Judkins said monetary tightening had been withdrawn in the US in recent months as inflation expectations had remained subdued.

Overall, he was positive.

"There's a lot to be optimistic about," Mr Judkins said.

"While there are certainly globally some issues on the horizon, WA is a little countercyclical relative to our east coast cousins.

> **The issue is how reliant (China's) growth rate is at the moment on fiscal stimulus**
>
> –Matt Judkins

"We've taken a fair amount of medicine over the last five or six years, which is always good in terms of positioning the economy for the next upturn."

The hydrogen economy, remote sensing and automation, and integrating storage with renewable energy were among the industries Deloitte recently highlighted as global opportunities, and areas in which WA has a comparative advantage.

"One of the greatest risks we have as a state is that we don't do enough to position ourselves around some of those opportunities … (that) we're too complacent," Mr Judkins said.

Project pick-up puts pressure on skills

Western Australia may not be ready with the workforce and skills needed for the next boom.

> When the crunch came, all these experienced people … we got rid of the cream
>
> – Partha Dav

EXPERIENCE: Partha Dev says there is a lot of talent ready to return to the oil and gas industry. **Photo: Gabriel Oliveira**

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AS far as problems go, high demand for skilled workers is probably a good one to have.

It's a sign Western Australia is finally lifting out of the stagnation that has beset the economy for years.

But it could well mean the $95 billion of resources, infrastructure and building projects in the pipeline, according to BNiQ Search Engine, face familiar cost pressures.

Recent work by recruitment business Hays predicted construction and engineering skills shortages will intensify dramatically in the next six months in response to public transport program Metronet and mining projects.

"Within civil construction, demand will be high this half for candidates with a rail background who can work on the Metronet project," the briefing said.

Project engineers, civil construction project managers, civil engineers and contract administrators were among the jobs in high demand.

"Demand has also started to rise for mechanical engineers and site managers with commercial construction backgrounds to work on hotel, apartment, large-scale shopping centres and mixed-use building projects," the briefing said.

Staffing group Manpower predicted an uptick in labour demand in WA, publishing an employment index pointing to positive hiring intentions.

"The strongest hiring pace in more than four years is anticipated in the first quarter of 2019," Manpower's report said.

That was two percentage points higher than the same time in 2017.

December data from the federal government's Labour Market Information Portal found 15,900 job vacancies in WA, up 4.4 per cent year on year in trend terms.

Vacancies were higher in a range of fields, with positions available for electrical engineering draftspersons and technicians, ICT managers, engineering managers and environmental scientists all having large increases (see graphic).

Some of the roles with a high volume of vacancies included electricians, 38 per cent higher at 279 positions, metal fitters and machinists (up 19 per cent to 539 spots), and drillers, miners and shot firers (11 per cent higher at 261).

Chamber of Minerals and Energy WA chief executive Paul Everingham said there would likely be skills shortages by the end of the year or early next year, although not as acute as during the previous boom.

Mr Everingham said resource expansion projects in the pipeline were already putting a lot of demand for skills into the market.

But there were differences in approach this time.

"Looking at the way iron ore and oil and gas companies, commodity houses, have done workforce planning, mine planning, reservoir planning, there's been a massive amount of lessons learned from the last boom," he said.

"The companies have been working with Tafes, universities, job providers, labour hire groups, contractors … to really get much more factual information about demand into the system so that providers are ready.

"You're already seeing the benefit of that.

$14bn

TRANSPORT SPENDING ANNUALLY IN 2024 - BIS OXFORD

"There's been no huge wage breakout with the announcement of (major) iron ore expansions."

He said he was very optimistic about WA's position.

Competition

Civil Contractors Federation WA chief executive Andy Graham said there was competition for workers from the resources sector, land developers and government projects.

An additional issue was strong demand from the east coast coinciding with the upswing in WA.

Mr Graham said BIS Oxford research showed about $6 billion was being spent nationally on transport projects in 2012.

By 2024, it would be about $14 billion, he said.

"If it's a skilled job in the construction industry, we're either facing a shortage now, or we're going to be," Mr Graham said.

"It's only going to get worse.

"This time, there's more competition for WA in the national infrastructure market.

"Construction managers, civil engineers, these are fairly mobile occupations, and they're in high demand in New South Wales and Victoria.

"The scale of their infrastructure activity just dwarfs WA."

Rail in particular was quite a highly skilled, niche capability, he said.

"There will be pressure on specialist rail track laying equipment and also experienced workers," Mr Graham said.

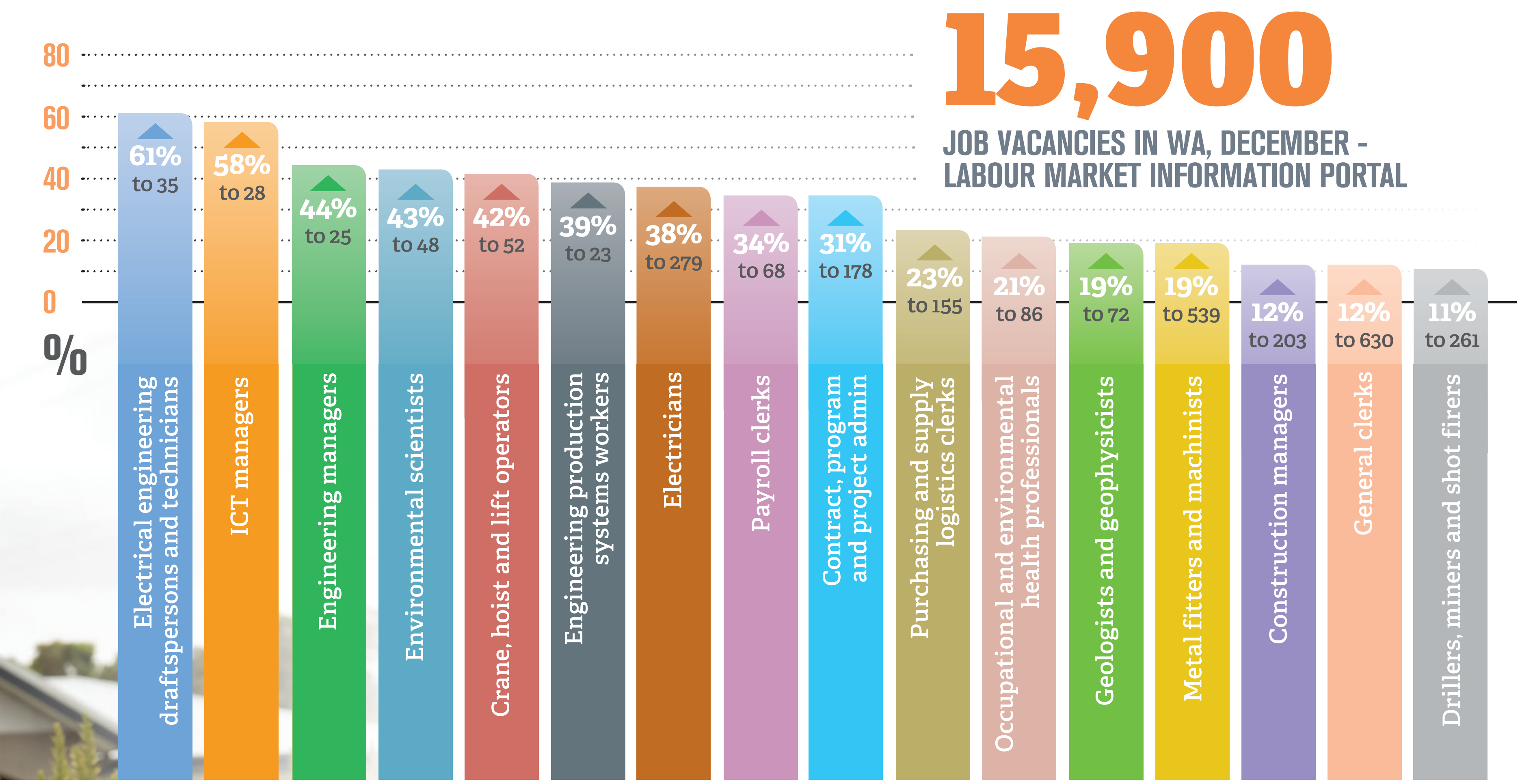
There were shortages in other parts of the market too, particularly apprentices.

The familiar issue for apprenticeships was the time lag between supply and demand to match skills, he said.

"At a trade level … there's an extreme shortage of heavy duty plant mechanics and mechanical fitters, both of these are support skills to keep the machines running," he said.

"And we're seeing very high wage demands."

IN DEMAND - SELECTED PROFESSIONS WITH RISING VACANCIES



Source: Labour Market Information Portal

He acknowledged capacity and capability issues for public projects would translate into higher costs for taxpayers.

But there were some positives in all this, Mr Graham said, with relief on the way for contractors after years of being squeezed.

"When there's more activity out there, contractors think 'maybe I can put a reasonable bid in there and make some money'," he said.

Losing the cream

Rosen Engineering head of structural engineering Partha Dev said problems were broader than just shortages in trades.

One of the issues in the previous boom had been that too many projects were run simultaneously, particularly in oil and gas, Mr Dev said.

That meant many people had been fast tracked into project management without suitable experience in the industry, often from other sectors.

"If you're not a good domestic cricket player, Sheffield Shield, you really can't play test matches," he said.

Since then, many good people had been lost in the recent downturn.

"I've seen people of my experience or more, in the last few years, they've been forced to either drive Ubers, or they've … prematurely retired from the industry," Mr Dev said.

"When the crunch came, all these experienced people … we got rid of the cream.

"(And) every graduate that came out (of university) was either without a job or without a role model."

That had been demoralising for many, he said, and many young people either did not pursue engineering or headed into other parts of the industry.

Mr Dev, who is also playing a role in the upcoming Australasian Oil & Gas Exhibition & Conference in Perth, said industry professional bodies had taken the lead in trying to re-engage experienced people to mentor the next generation, getting in early ahead of the next surge of projects.

Although projects around the world would often go over budget, Australia was probably well above the industry average, and was notorious for it, he said.

There were other issues that could be resolved to help ease cost pressures, Mr Dev said.

"A global problem that's even more prevalent in Australian projects, (is) bespoke requirements," he said.

"I've been on both sides as an operator and a service provider.

"Operators have all wanted to be unique to each other and they are paying the price for it

"There's inconsistency, differences in specifications for equipment, the service providers had to reinvent every time."

Mr Dev said organisations such as Engineers Australia were working to resolve these problems through encouraging standardisation.

That meant participating in international standards bodies, and equally, ensuring that requirements for the unique environment of the state's north west, compared with the North Sea or Gulf of Mexico, were factored in.

> **If it's a skilled job in the construction industry, we're either facing a shortage now, or we're going to be** – Andy Graham

Rules

Mr Everingham highlighted two other issues the state would need to grapple with to keep costs competitive for projects.

Regulatory 'creep' was one major problem.

"In my six months in the job (it's) been the single concern most raised with me," Mr Everingham said.

"(It's) not just the time it takes to get mining and environmental and related approvals, (it's) also duplication."

An example was the Labor opposition's plan for a federal Environmental Protection Authority.

"Every state has an EPA, what's a federal one supposed to do?" he said.

It may not in itself discourage projects, but it added to headwinds.

"Finance costs are going up, interest rates in the United States are rising, all financial institution costs are going up, and then there's trade uncertainty … add on to that regulatory uncertainty, long approval timelines," Mr Everingham said.

"You can paint a scenario that could see certain projects, particularly greenfields, struggling to get finance and get over the line."

Then there was the issue of stability and certainty in royalty regimes.

"Sudden rapid changes or increases can do significant short to medium-term damage to project viability," he said.

Recently proposed controversial regulatory changes to another primary industry, the Western Rock Lobster fishery, have served as an example.

"More than a dozen of my members have said 'wow, they didn't see that coming' to the rock lobster industry, it makes you realise you've got to be alert," Mr Everingham said.

"Foreign investors, they'll just look at other jurisdictions … they have that many different countries and regions they can invest in."

Business, investors count down to key poll

Elections always bring uncertainty for business, but in 2019 the difference between the major parties is among the starkest in decades.

DECISION: Scott Morrison and Bill Shorten have argued that this election will be critical in shaping the country's economic future. **Photos: Gabriel Oliveira**

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VOTERS could make one of the most significant choices in a generation when they head to the polls for a federal election in a few months, and businesses and investors could be vulnerable to any poor policy decisions.

It will be particularly critical for Western Australia, with the state's economic recovery still in its infancy, and property prices falling.

The battlelines will largely be drawn around taxation and emissions reduction, with the Labor opposition proposing a series of tax increases and changes that will cost an estimated $200 billion over the next 10 years.

The most controversial are the abolition of negative gearing for new home purchases, cutting capital gains tax concessions and abolition of refunds on franking credits.

The coalition is fighting on a platform of lower taxes, with an income tax cut flagged for the April budget, following a $134 billion income tax reduction package legislated in 2018.

A major discussion point is how the proposed tax changes will affect the property market, after house prices in WA fell about 4 per cent in 2018.

In 2016, the Grattan Institute estimated similar changes would reduce house prices by about 2 per cent, while more recent analysis by Cadence Economics for the Master Builders Association predicted it would reduce construction activity by about $858 million over five years.

Another 2016 report, by BIS Shrapnel, estimated limited changes to negative gearing would reduce house prices by about 1.6 per cent.

Any reduction in prices would likely flow through to consumer sentiment and impact on spending and borrowing.

Property Council of Australia WA chief executive Sandra Brewer told *Business News* the timing was wrong to change policy settings in property because the sector was recovering.

"The last thing we need in the property industry will be uncertainty," Ms Brewer said.

"That means it's difficult for people to make decisions about buying their next home or for investors to invest in property.

"When the property market is just recovering in WA and with the eastern seaboard experiencing declines, now's not the time to be trying untried policy settings."

She said the changes to capital gains tax would likely have a bigger impact than those to negative gearing.

However, shadow small business minister Madeleine King told *Business News* analysis showed Labor's policies would cause only a modest reduction in house prices.

"The most generous tax concessions in the developed world mean wealthier investors get a subsidy from the government while first home buyers get locked out of home ownership," Ms King said.

Confidence

A survey of 251 retail investors by data firm Listcorp found that 54 per cent felt a Labor victory would be the most likely factor to contribute negatively to share market returns in 2019.

Only 4 per cent picked a coalition victory as most likely to hit returns.

In response, Ms King said instability under the current Liberal government created negative investor sentiment.

$200bn
ESTIMATE OF LABOR'S PLANNED TAX INCREASES

Prime Minister Scott Morrison has made concerns about economic risk under Labor the centrepiece of his strategy, arguing last week a change of government would make the economy weaker.

"You can't tax the economy to success.

"If you tax it harder and higher you will make it weaker."

The government's argument is that increasing taxes will slow an economy already at risk from global headwinds, while Labor has countered that their tax changes will encourage spending by middle and low income earners.

The other major battleground will be emissions policy.

In something of an ironic twist, Labor has said it may well implement the National Energy Guarantee framework developed by past energy minister, now Treasurer, Josh Frydenberg.

That policy incorporates an emissions reduction target and a reserve capacity target.

The key difference on this front will be the level of the target, with the coalition retaining the 28 per cent on 2005 levels picked by former prime minister Tony Abbott. Labor hopes to hit a 45 per cent reduction.

The latter will most likely mean the speedy closure of some coal-fired generation in WA, with a recent report by the Australian Energy Market Operator suggesting older units would be shut as early as 2021.

BNiQ SEARCH Sandra Brewer

*There are **10** results from our index of **97,480** articles, **9,729** companies and **35,750** people*

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BNiQ SEARCH *Risks to WA*

*There are **2,961** results from our index of **97,523** articles, **9,729** companies and **35,753** people..*

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04 Feb 2019 by AAP

insurance broker in WA, according to BNiQ data, with 96 brokers. That puts it just ahead of local firm EBM ... – the 2015 purchase of CKA Risk Solutions. A much bigger change is looming, with global players Marsh ... & McLennan and Jardine Lloyd Thompson looking to finalise their $US5.6 billion merger in coming ...

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