2 October 2024

ECONOMY RUNNING AT TWO SPEEDS BULLETIN

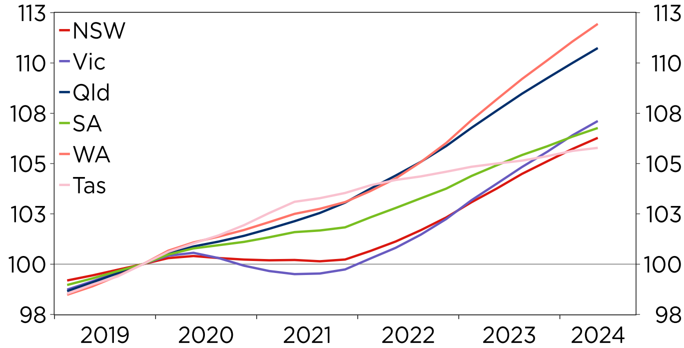
Activities diverge but prices remained merged

Key points

- On key metrics, including growth in demand and labour market conditions, WA is clearly outperforming. Qld is a distant second, but we expect this gap to narrow going forward.
- Differences in population growth is a key reason the economy is running at two speeds, with the mining states remaining resilient while some of the other states stall.
- The difference is particularly stark when it comes to dwelling prices: since 2019, prices in Perth (+78%) and Brisbane (+73%) have increased by almost twice as much as Sydney (+44%) and four times as much as Melbourne (+19%).
- Despite this, inflation rates (except for housing) are similar across states.

Working age population

Index: Dec 2019 = 100



Source: ABS, Macrobond, Westpac Economics

- While there are several possible reasons for this apparent conundrum, such as supply responding to stronger demand including through interstate migration, it does suggest that inflationary pressures are mostly national and therefore having the one national tool to deal with inflation is appropriate.

Mining states remain resilient while other states stall

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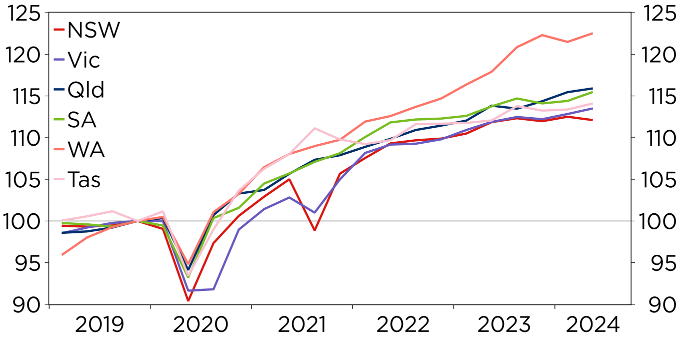
The Australian economy has slowed noticeably in recent times, but the picture can vary widely under the surface, at state level. Looking at growth in state demand, retail trade, labour market conditions and fiscal outcomes WA is clearly outperforming. On these metrics, Queensland is a distant second, but we expect this gap to narrow going forward as the Queensland Government's cost of living measures kick in and the "Queensland's Big Build" infrastructure program gathers momentum.

Why have both these mining-based states outperformed? Population! Population growth in the mining states has outpaced growth elsewhere. Over the period Q4 2019 to Q2 2024, working age population has grown 12% in WA and just over 11% in Qld, or at an annualised pace of around 2.5% in both states. Victoria comes in at a distant third, up 7% over the same period, or growing at an annualised pace of 1.5%.

State domestic demand

Index: Dec 2019 = 100



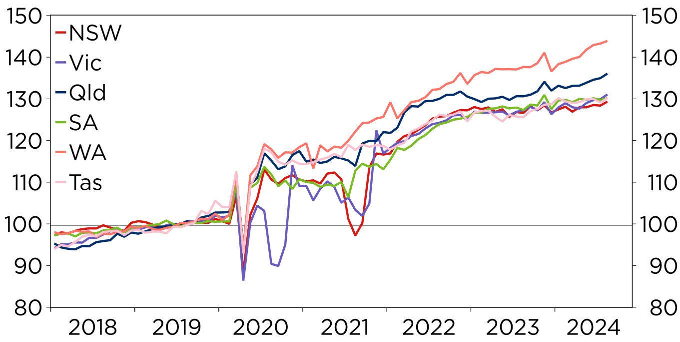
Source: ABS, Macrobond, Westpac Economics

In the case of WA, stronger population growth has combined with stronger per-capita demand. This has been spread across a broad base with retail trade, consumption, dwelling construction, business investment and public demand all showing solid growth. In per capita terms, private spending has been softer in Qld, with public spending continuing to support activity. Public spending per capita has been strong in Tas and Vic, up 21% and 19% (or 4.2% and 3.9% in annualised terms), respectively since Q4 2019. WA is up 15% (or 3.1% in annualised terms) over the same period.

The divergence between mining and the non-mining states continues to grow and if anything has accelerated over the past 12 months. Working age population grew 3.6% over the year to the June quarter in WA and 2.9%yr in Qld, above the national average of 2.7%. The August retail trade outcomes showed turnover grew 4.5%yr in WA and 4.2%yr in Qld, both well above the national average of 3.1%yr.

Retail trade by state

Index: 2019=100

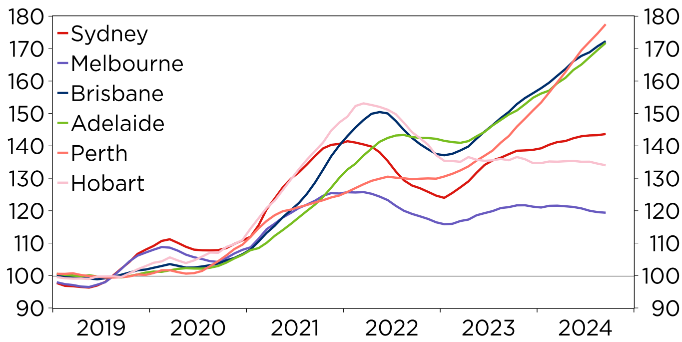


Source: ABS, Macrobond, Westpac Economics

And there's a similar story when it comes to dwelling prices, with prices in the mining states continuing to grow more strongly than the national average. In Perth, dwelling prices are almost 80% above 2019 levels; prices in Brisbane are 72% above 2019 levels; while in Sydney prices are 40% higher. This compares to the national average of around 48% above 2019 levels.

Dwelling prices by capital cities

Index: 2019 = 100



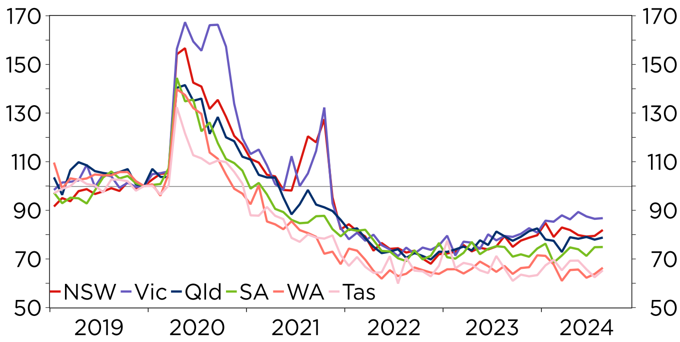
Source: CoreLogic Australia, Macrobond, Westpac Economics

State domestic demand is only part of the growth picture as it excludes net exports and interstate trade. Net export performances have differed somewhat across states – a hidden support in Vic but more of a drag in WA as growth in mining output has slowed. Labour market conditions provide a good sense check on how the state economies are performing more broadly, including this aspect of activity.

WA's strong performance is also visible in the labour market with the underutilisation rate (those unemployed and employed workers looking for more hours to work) still well down on pre pandemic levels – by around 5.4ppts compared with the average over 2019. Qld comes in third with the underutilisation rate 3.6ppts below pre-pandemic levels. Labour market conditions have softened the most in NSW and Vic – with the underutilisation rate still around 1.9ppts lower than 2019 levels.

Underutilisation rate by state

Index: Dec 2019 = 100

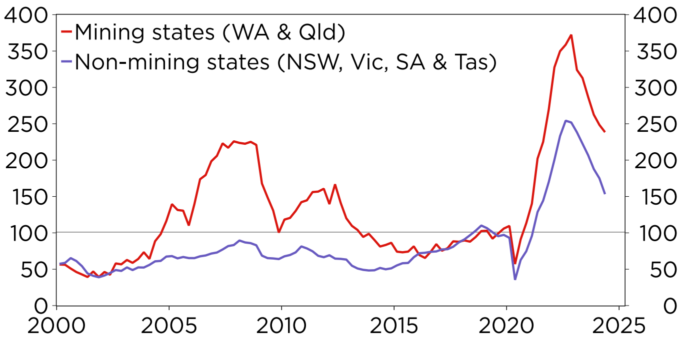


Source: ABS, Macrobond, Westpac Economics

In addition, unmet labour demand (or vacancies) continues to remain elevated in the mining states compared with the non-mining states. Indeed, the vacancy to unemployment ratio, which provides a gauge of any imbalance in the labour market, remains above the level recorded during the mining investment boom of the 2000s in the mining states, and has come down more gradually than in the non-mining states.

Vacancy to unemployment by state

Index: 2019 = 100



Source: ABS, Macrobond, Westpac Economics

It is becoming clearer that weak demand conditions are spilling over into the labour market, with softening occurring at a faster pace in NSW and Vic, approaching 2019 conditions where the economy was operating below full employment and wages growth was subdued.

Inflation outcomes remained in sync

If demand is more resilient in the mining states and we're at "capacity" then we should expect to see inflation remain elevated in these states.

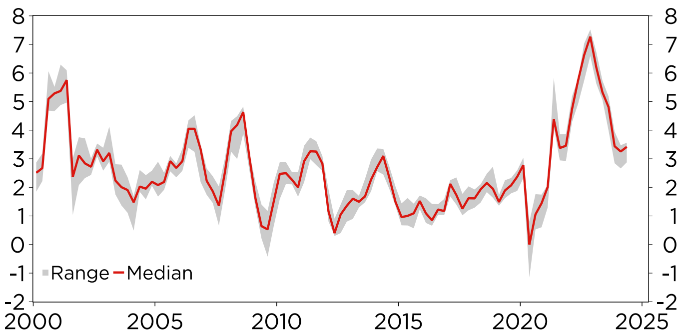
Remarkably, inflation rates are quite similar across states, both currently and during previous episodes where state variations have been more extreme. A notable exception here is around housing, which includes the cost of purchasing newly built dwellings and rents. Indeed, one of the difficulties in comparing inflation outcomes across states at the moment is accounting for how policy differences, particularly related to electricity rebates, are directly impacting the CPI.

We have done this by generating our own measure of underlying inflation (both trimmed mean and weighted median), and by looking at the evolution of inflation when we exclude the CPI group most significantly impacted by cost-of-living measures, i.e. housing.

Headline inflation excluding housing shows differences across states are still minor and, if anything, have converged more recently - the lowest is running at 2.8%yr and the median at 3.4%yr – Perth is at 3.3%yr (all state CPI measures are based on capital city prices).

Headline inflation excluding housing

Year-ended % change. Range across states.

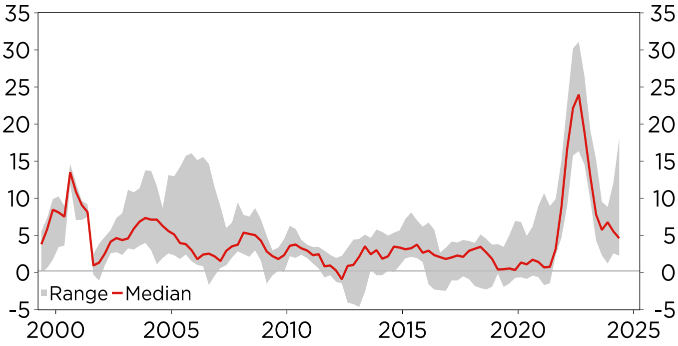


Source: ABS, Macrobond, Westpac Economics

However, the picture changes when you look at housing and construction costs. Here the spread between states is at its largest on record. In those states with strong population, we have seen home building costs reaccelerate – running at close to 20%yr in Perth.

New dwelling purchases (CPI component)

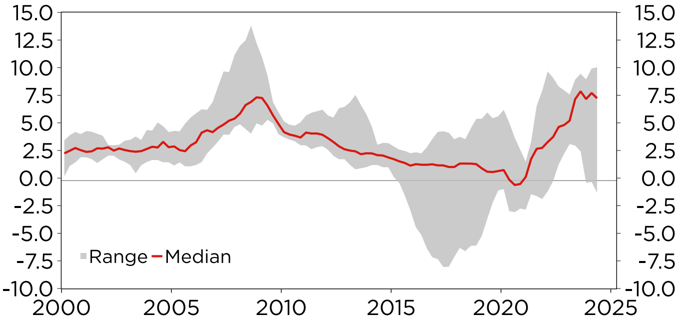
Year-ended % change. Range across states.



Rental growth is also strong in WA and Qld but is negative in Hobart, reflecting the large differences in population growth.

Housing rents

Year-ended % change. Range across states.



What's behind this conundrum?

Why are conditions diverging but underlying inflationary pressures converging?

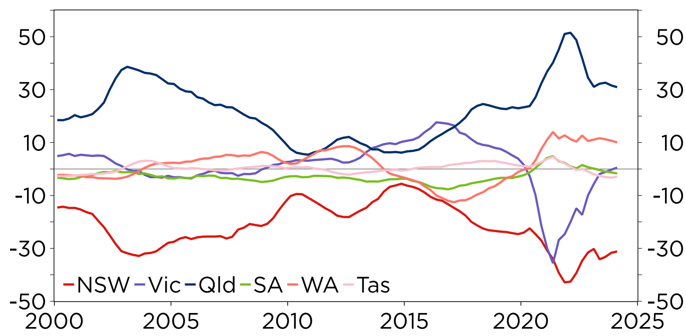
One explanation could be that conditions have not diverged by enough or for long enough to really drive a difference in inflation rates. The inflation divergence may be something that is still emerging.

Another factor is that some of the drivers of strong demand, including interstate migration, bring additional supply capacity as well, at least for labour. Outside the housing sector (since people can't bring a house with them when they move), the net effect on pricing pressures is therefore likely to be small. We saw a similar pattern emerge during the mining investment boom where strong conditions in WA led to a population boost and non-housing inflation rates did not differ much.

Another possible explanation is that changes in prices and wages are mainly set at the national level, with less consideration for local supply and demand conditions.

Net interstate migration

Rolling Annual Sum, 000's



Businesses with a national footprint operating across state lines would hesitate to adopt significantly different pricing policies across different geographies. It would be hard to make it stick in a world of online commerce, and they could risk being labelled price gougers. Note that this does not preclude significant differences in price levels for things bought locally such as restaurant meals. Fuel prices are perhaps the best example – the price of oil tends to impact changes in the price of petrol at the bowser in similar ways across states and territories, even though levels may differ.

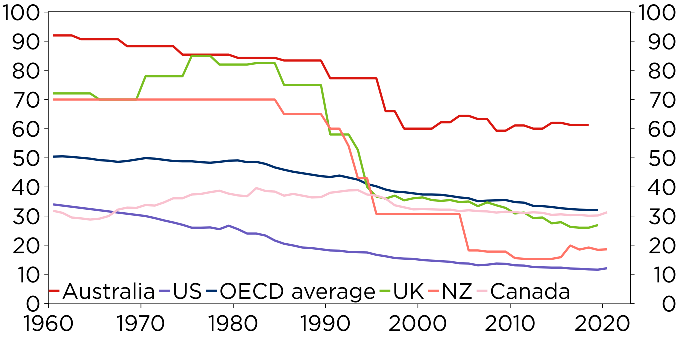
And, where Australia differs from other G7 and OECD countries, is that wage setting is more likely to be collective – awards or EBAs. Workers on individual arrangements are also often covered by awards or EBAs as a baseline or minimum standard. These agreements can apply across state borders, equalising wages growth irrespective of local conditions. In the US, around 10% of the workforce is on collective agreements – this is more than 60% of the workforce in Australia.

If prices and wages are mostly set nationally, the implications could be quite profound. Regionally specific demand shocks would affect volumes and activity more than prices. And the supply response from interstate migration would take time and bring with it even more demand.

Having just one national-level instrument to deal with inflation pressures – monetary policy – makes sense when the inflation pressures themselves are mostly national. But it does speak to the need for other arms of policy to deal with regional differences in demand and activity.

Collective bargaining agreements

% share of the workforce



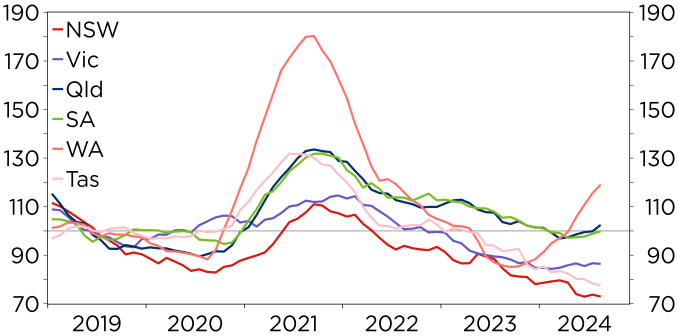
Source: OECD, Macrobond, Westpac Economics

What about housing?

This still leaves the housing problem. More people generate the need for more buildings, infrastructure and homes. Growing demand for housing has pushed up the price of dwellings (new and existing) and rents. Except for WA where approvals have started to increase due to higher dwelling prices and rising rents, this has not (yet) brought forth a supply response because of capacity constraints, and because the resulting higher construction costs have damaged confidence that individual construction projects will complete on budget. The solution to this long-standing problem requires input from all levels of governments.

Dwellings approvals by state

Index: 2019 = 100



Source: ABS, Macrobond, Westpac Economics

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