Key themes from Treasury's Business Liaison Program

As part of Treasury's Business Liaison Program, staff held discussions with around 25 businesses in Sydney, Melbourne, Brisbane, Perth and Adelaide during May 2009.[1] Treasury greatly appreciates the commitment of time and effort by the organisations that participate in the program.[2]

In general, the retail sector experienced quite strong conditions in the March quarter and into April, buoyed by the impact of interest rates, Government stimulus payments and petrol prices on household incomes. Pockets of the residential property sector also experienced robust conditions on the back of lower interest rates and the First Home Owners Boost.

Outcomes in the mining sector were better than expected earlier in 2009, and a number of firms reported their optimism that robust demand from developing markets would return. Contacts in the manufacturing and construction sectors generally reported in much weaker terms, with difficult conditions anticipated to continue.[3]

1 A detailed explanation of the Treasury Business Liaison Program is provided in the Treasury *Economic Roundup*, Spring 2001.

2 This summary reflects the views and opinions of participants in the liaison program, which are not necessarily shared by Treasury. While Treasury's evaluation of the economic outlook is informed by findings from business liaison, a much wider range of information and data are utilised to ensure a rigorous assessment of the Australian economy.

3 This liaison round focused on the construction, manufacturing, resources and retail sectors. Additional meetings were held with representatives from the financial and transport sectors and the general themes arising are reported. The program encompasses the full range of sectors and Treasury aims to meet with a broad cross-section of the business community over time. Companies are invited to register their interest in participating.

Trading conditions

Lower interest rates and the Economic Security Strategy were reported as having helped to keep retail sales reasonably buoyant through the March quarter. With payments under the Nation Building and Jobs Plan beginning to flow in late March, some retailers also noticed an impact on sales in April and expected similar results in May. In any case, retail sales remained stronger than expected, and were tracking moderately higher than in the corresponding period last year. The strength in sales appeared to be more broadly based than in the previous liaison round, where the impact had been found to be more concentrated among supermarkets and value-based retailers.

The First Home Owners Boost was continuing to have a strong impact on that market segment, with first home buyers representing a much larger share of the market than usual. There were signs that this had begun to translate into building activity, and several contacts anticipated a relatively busy second half of 2009.

A broader recovery in residential construction, driven by lower interest rates, was expected to gather strength in 2009-10, with demand returning among owner-occupiers. Prospects for a recovery in medium- to high-density residential construction and the investor market more generally, while also improving, were considered to be heavily finance-dependent.

Private non-residential construction activity began to contract sharply as completed projects were not being replaced by new projects. There was a broad-based weakness across offices, retail, warehouses and storage, factories and hotels. A number of contacts reported a change in their business focus toward public sector projects which should help to fill the gap in private activity in the short to medium term. Once again, there were widespread concerns about the prospects for an early recovery in the sector given the anticipated economic downturn and difficulties in accessing finance.

Manufacturing contacts offered mixed reports, with those operating in the food and beverage sector or supplying lower value retailers generally enjoying relatively benign conditions considering the weakness in the economy. Those engaged in the production of consumer durables and business plant and equipment were less sanguine. Among the latter group, several contacts believed the bottom of the current economic cycle may have been reached, even if there was little prospect of a resumption of strong growth in the near term.

A number of mining sector contacts reported 'cautious optimism' about a recovery on the basis that the March quarter had been better than expected in terms of export volumes, particularly for those exporters targeting the Chinese market. The fiscal stimulus being applied by Chinese authorities was considered to be producing the intended outcomes.

Business credit

Concerns about the availability of finance were once again most widespread in the property sector. Contacts agreed that the combination of market conditions and tighter lending practices was to blame for a lack of available credit and excessive borrowing costs in the commercial property market.

A thin volume of sales of commercial properties and an overhang of unsold property on the market were leading to considerable uncertainty about property values, which was also contributing to lending becoming more restricted. More conservative valuations of residential property were also reported as contributing to a tightening of credit for the investor market.

Elsewhere, lower demand for business credit was clearly linked to firms scaling back on planned capital expenditure, with many expansion projects and discretionary spending being deferred where possible, pending a clearer view of market conditions.

Investment plans

While the retail sector was experiencing relatively good trading conditions and low vacancy rates, broader weakness in the commercial property sector and the unfavourable employment outlook were factors weighing against planned expansions. Retailers were also targeting lower inventories as a capital management strategy, with flow-on effects for warehousing space. However, projects that had been planned and financed before the current downturn were not at risk, and a number of firms reported that their longer term expansion strategies remained intact.

Once again there were few examples of major energy and minerals expansion projects having been cancelled, although delays caused by financing concerns or anticipated weak demand for commodities had become more common. On balance, the flow of news in relation to prospective energy and mineral investment was positive.

Employment and skills

Reports of planned job cuts were less prevalent than in past months, with the outlook relatively steady among those firms contacted, subject to the economic outlook holding up. Contractors and staff engaged for expansion projects were particularly vulnerable to job loss, but the firms contacted were generally attempting to retain skilled staff and preferred to vary their hours of engagement.

There were several reports of firms adding staff in the retail sector, where employers had also noticed application numbers rising, and in relation to construction of public sector projects.

Prices and wages

Retail sector contacts reported that the rate of price increases had slowed over the course of 2009, and was probably tracking at less than 4 per cent. While the exchange rate depreciation was having an impact on the cost of imported items, competition was considered to be squeezing retail margins and reducing the extent of pass-through to consumers.

Wage pressures were reported to have eased considerably. There were numerous reports of white collar salaries having been temporarily frozen. Collective negotiations were typically aiming at wage increases of somewhere between 2.5 and 4 per cent, although in certain sectors that were more exposed to the downturn, lower outcomes were being pursued in order to support employment outcomes.

Within the construction sector there were varying reports. Several organisations involved in resource-sector construction projects in remote areas noted that recent wage claims had remained high. However, elsewhere in the non-residential building sector, claims had weakened considerably.