Key themes from Treasury's Business Liaison Program

Overview

As part of its quarterly Business Liaison Program, Treasury met with businesses and organisations during February. Meetings took place across five capital cities and via teleconference. Treasury greatly appreciates the commitment of time and effort by the organisations that participate in this program.

There were some promising key messages from business liaison with early signs that, whilst global economic conditions remain challenging, the uncertainty around the global outlook was starting to abate. However, with competitive pressures evident across all sectors of the economy, businesses were looking to improve the profitability of their operations by cutting costs.

Activity and Prices

There were some signs of cautious optimism following the flows of positive news around the international outlook, although businesses across all industries noted that profits margins had contracted in 2012. To support margins, business reported an increased focus on improving productivity across their operations and closely examining their cost structures. This had included a close examination of wages and salaries, supplier costs and investment plans.

Miners suggested that this summer's adverse weather events had less of an impact on activity than in previous seasons. While commodity prices (in particular for iron ore and coal) had stabilised in recent months, with strong growth in global supply coming on line, there was an expectation that, aside from cyclical volatility, there will be continued downward pressure on prices in coming years. As a result, contacts largely expected that growth in export income is likely to be driven by an increase in volumes rather than prices.

In terms of investment projects, reports suggested that good progress was being made and that, in the main, projects were on schedule. While volume of work was slowing in the coal and iron ore sectors, both miners and contacts in the construction sector noted that there remained a solid pipeline of work yet to be done on LNG projects.

There were mixed reports from trade exposed sectors. Manufacturers continued to suggest that the high Australian dollar was having a significant impact on their businesses. Consistent with previous rounds, manufacturers also reported a focus on the breadth of their activities, in some cases suggesting that operations could be scaled back and focused on the design and distribution elements of their businesses.

On the other hand, there were some positive signs coming from parts of the tourism industry with some contacts suggesting that the impact of the high Australian dollar may be starting to wane. In particular, there was a sense that domestic travellers may be refocusing on Australian destinations having now taken an advantage of favourable exchange rates and gone on an overseas holiday.

In the retail sector, there were mixed views around the Christmas period, with some contacts suggesting that sales had been strong while others considered that they had fallen below expectations. Consistent with previous rounds, margin compression continued to be a key challenge in some parts of the retail sector. While costs such as rents are increasing in excess of CPI, strong competition continues to make it difficult for retailers to increase their prices in a meaningful way.

In residential construction, there was a strong view that the fundamentals in the sector were supportive of a strong period of growth. Despite this, it was generally noted that these fundamentals had yet to translate into a groundswell of activity. Potential purchasers continue to take a cautious approach and both developers and banks noted an increase in the time taken between enquiries for new loans or house and land packages and contracts being signed.

In non residential construction, conditions were reported as remaining weak, with activity being supported by several large projects rather any strength in underlying demand for commercial property, in particular offices and retail.

Employment and wages

Overall, contacts reported modest hiring intentions, emphasising that both uncertain demand and the need to cut costs would have an impact on hiring decisions. Some businesses also noted that, with employment prospects being a key concern for households, this could hinder consumer confidence in the near term.

On labour costs, miners reported continued growth in wages but noted that this had eased in recent months. While discussions made some mention of negotiations with workers on non¬ wage conditions, there were noticeably fewer reports of this than there had been in previous rounds.

Outside of mining, there were varying reports of wage pressures. Firms in sectors such as manufacturing and retail suggested that, in a climate where they were unable to put up prices, wage pressures remained strong, while others mentioned that there had been a noticeable easing of wage pressures.