

Key themes from the Treasury Business Liaison Programme — November 2006 and February 2007

As part of Treasury's Business Liaison Programme, Treasury officials met with around ninety businesses, collectively employing over half a million Australians, in Sydney, Melbourne, Perth, Bendigo, Ballarat and Mandurah and some industry organisations in Canberra in November 2006 and February 2007.¹

Retailers are generally optimistic about economic conditions. The mining sector, and hence the Western Australian economy, continues to be a source of strength. The drought is having a serious impact on farmers, pushing up food prices, and retailers report that sales in regional centres have been affected. The labour market remains tight but companies are not reporting accelerating wages.

Treasury greatly appreciates the commitment of time and effort made by the businesses, industry associations and government agencies that participate in the programme.²

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

2 This summary reflects the views and opinions of participants. 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.

Retail sales

Retailers report mixed conditions in the latter part of 2006 and early 2007. The easing in petrol prices, and continued strong growth in employment, is helping maintain growth in sales volumes. While some stores noted a significant impact on sales from the interest rate increases in August and November of 2006, others reported an apparent lack of any impact. Sales of large discretionary items such as whitegoods and outdoor furniture seemed most affected, particularly in the outer suburban 'mortgage belt'. Purchases of luxury food items and entertainment have also been cut back. Unusually mild temperatures in December hurt sales of some products. A number of retailers noted an increasing swing towards healthier foods.

Continuing the pattern of recent quarters, retailers spoke of particularly strong sales growth in Western Australia and south-east Queensland, reflecting the strength in the mining sector and strong population growth. Their sales continue to be weakest in New South Wales, but are improving in Victoria.

In the November meetings, sales in rural towns seemed relatively unaffected by the drought but by February, retailers were experiencing an impact.

Manufacturing and construction

Manufacturers supplying products to the mining and construction sectors continue to enjoy very strong conditions. Some food producers tell of drought conditions limiting their access to raw materials, and this is flowing on to packaging companies. The breaking of the drought would quickly restore supplies of grains and vegetables to manufacturers of food products but manufacturers of meat products anticipate being more affected in the longer term given the culling of cattle herds.

A change in customer preferences away from larger cars, which manufacturers largely attributed to high petrol prices, is leading to a reduction in Australian vehicle production.

A few manufacturers say they are increasing exports. (For example, sales of Australian wine to Scandinavia are rising.) Some Australian subsidiaries of international manufacturers explain that both exports and imports are rising as global production is being rationalised with countries specialising in particular lines. Even when manufacturing in Australia was not being increased, some Australian subsidiaries report they are winning a large share of design work from their foreign parent.

A succession of new large infrastructure projects is said to be underpinning the construction sector, although activity in NSW and Victoria is slowing. Some retailers plan to build new stores, especially in areas such as south-east Queensland where

population is expanding. Some companies are commissioning new buildings combining warehouses, small factories and head offices. Dry conditions are allowing construction projects to be finished quicker.

Housing

The housing sector remains soft, with industry contacts expecting investment in the residential market to remain weak. Builders note a drop in traffic through display homes since the interest rate rises, suggesting further weakness ahead. Industry sources opined that house prices are at best rising modestly in the eastern states, and falling in outer suburban areas. By contrast, house prices had been booming in Perth and Darwin during 2006, to levels some financiers thought unsustainable.

Education

Exporters of education services say they are expanding their business, with India a growing market. While overseas students might prefer to study in the United Kingdom or United States, Australia is seen as offering better value with lower tuition fees and living costs. There is also increasing overseas interest in vocational training in Australia.

Among domestic students, universities report an increasing interest in studying accounting and finance but only a modest increase in students taking engineering courses.

Business investment

Wholesalers and retailers are investing in better information technology to lift their efficiency.

Mining companies are embarking on new projects to expand capacity. Most mining companies continue to report difficulties in obtaining certain equipment, such as large tyres, although a few think the problem is easing. Changing practices are making tyres and equipment last longer and suppliers are gradually catching up with the backlog of orders.

Employment

Businesses differ in their employment intentions, but overall planned increases exceed cuts. In many cases, business leaders suggest that the need for increased labour due to market growth is offsetting any reduction from productivity improvements.

A lack of skilled labour is reported as constraining increases in output by some companies. Skill shortages are particularly viewed as a problem by the mining sector, or companies with workers such as engineers and electricians whose skills are readily transferable to the mining sector.

Project managers and good mid-level managers are regarded as hard to find in many industries. Financial professionals, such as the more analytical accountants, are also scarce. There is a shortage of nurses. In Western Australia, employers are also finding difficulty in hiring unskilled labour. In the eastern states, there are also certain types of unskilled workers in short supply, such as salespeople in affluent suburbs and fruit pickers.

Wages and other costs

Outside the mining sector, few firms report accelerating wages, even when they were facing difficulties in hiring and retaining staff. Some are offering retention bonuses to staff who stay for a number of years, and some report increasing expenditure on training. Employers in Western Australia say the high house prices there are making it harder to attract staff and putting pressure on them to pay rental allowances. Some companies describe providing better facilities and accommodation for mining workers, but many firms are not facing any pressure to improve these forms of remuneration.

Retailers report large rises in rents, especially in shopping malls, while manufacturers are bracing for price increases of rural products as a result of the drought.

Prices

Compared to a year ago, more businesses seem able to pass on price rises. Retailers appear to be expanding margins, helped by falling prices for imported goods. They comment that competition is driving down prices for fashion clothing and furniture.

Vegetable and cereal prices are rising due to the drought. While retailers in November had expected increased slaughterings to depress domestic meat prices markedly (albeit temporarily), it appears that higher global meat prices resulted in the price fall being only marginal.

Regional areas

Drought conditions are having a serious impact on farmers. In addition, Victorian fruit crops were affected by frosts in late 2006. At the November meetings, contacts were not reporting much knock-on impact in regional towns, but by February this impact

was notable. Retailers commented that sales in some coastal areas were weak, reflecting the weakness in local tourism.

The February business liaison round included meetings in Ballarat and Bendigo. As had been observed in other regional cities, there is a long-term trend for activity there to strengthen at the expense of surrounding small towns and villages. Rural shoppers were preferring to do all their shopping and other business in one trip.

Ballarat and Bendigo both benefit from having diverse economic bases, which means they are less affected by the closure of some manufacturing operations. Higher petrol prices are reducing visits by day-tripper tourists. As noted above, retail sales to farmers, and indirectly to residents, are being adversely affected by the drought. In the medium term, concerns about water restrictions are seen as eroding some of the lifestyle attractions of the towns. This is exacerbating the skill shortages that are evident there despite unemployment rates above the national average. More residents are commuting to jobs in Melbourne due to improved transport links and regional cities offering more affordable housing.

