Key themes from Treasury's Business Liaison Program

Overview

As part of its quarterly Business Liaison Program, Treasury met with 27 businesses and organisations in August. The meetings took place in four capital cities as well as in regional areas and via teleconference. Treasury greatly appreciates the commitment of time and effort made by the businesses and industry associations that participate in this program.

Since the last round, the divergent outlook for the mining and non mining parts of the economy has become more pronounced, driven by increasing weakness in the 'goods' sectors, notably manufacturing and retail.

Contacts report that prospects for the mining and related sectors remain strong, and that the recent global turbulence is not expected to affect investment plans. By contrast, the 'goods' part of the economy is struggling under the weight of soft demand, partly due to the impact of the high exchange rate, and is increasingly vulnerable to the impact of the uncertain global outlook on business and consumer confidence. Soft demand also continues to dampen activity in the residential and non residential construction sectors.

Consistent with the patchiness across the economy, a more mixed outlook for employment emerged this round. Competition for skilled labour is driving more flexible conditions in the mining and related sectors, along with strong wages growth. However, softer employment growth is now evident in the retail and manufacturing sectors.

Activity

Liaison discussions confirm that activity in the resources sector remains robust, with strong demand for Australia's key non rural bulk commodities. Production rates for iron ore and thermal coal in New South Wales have fully recovered after the adverse weather events earlier in 2011. However, some Queensland coal mines are still struggling with high water levels. General indications are that coal operations in Queensland will continue to be affected throughout the rest of 2011, although this is not expected to affect the broader recovery in the sector.

In the retail sector, the general sentiment is pessimistic, with already weak sales and confidence dipping in response to the recent global volatility. Contacts report that store closures have increased and, that a few high profile retailers are downsizing their operations and closing less profitable outlets.

Contacts report varying conditions in the manufacturing sector, with firms servicing the mining sector, and those less exposed to the high exchange rate and faltering global conditions, better placed than others. However other, non mining trade exposed firms, are increasingly uncertain about their prospects.

Contacts report that conditions in the broader construction sector are weak, with growth slowing in the residential and non residential construction sectors. The outlook for private non residential construction remains weak with the slowdown in employment growth leading to less demand for new office space, although public construction continues to support the services related areas of the sector. Hospital construction is supporting activity in regional Australia, as is education construction, notwithstanding the wind down of the Building the Education Revolution spending. Contacts also note that public funding for construction has reversed the negative outcomes induced by the natural disasters earlier in the year.

Despite some positive pockets of activity in the residential sector in Victoria, the outlook for residential construction activity is broadly flat.

Employment and wages

Overall, the outlook for employment is mixed. While mining employment remains strong, contacts in the manufacturing, retail and finance sectors report a reduction in their hiring intentions.

The labour market in the mining and related sectors remains tight. Some contacts report acute labour shortages, and the need to look overseas for skilled labour. Some firms also report the need to compete in ways that do not involve wages, such as a shift towards more flexible rosters.

Some contacts in the manufacturing and retail sectors report that they have already reduced staffing levels, and that this is expected to continue in light of the global uncertainty and overall softer outlook. While the exchange rate appreciation has helped dampen some input costs, contacts are concerned about the prospect of increased labour costs in coming years.

With regard to wages, overall skills shortages in the resource and construction sectors are expected to drive wage pressures, with wage agreements above 4 per cent and, for more experienced employees, above 6 per cent. Elsewhere, firms are generally providing increases of around 3 to 4 per cent.

In the retail sector, some contacts are seeking to reduce costs through wage freezes for senior staff.

Costs and prices

Contacts indicate that demand for Australia's key non rural bulk commodities is expected to remain strong for the foreseeable future, helping to support continued high prices. There is also expected to be continued short term support for metallurgical coal prices, with tight supply as dewatering drags on for longer than originally expected.

Financing and investment

Contacts report that the boom in mining investment continues on the back of continued strength in commodity prices, notwithstanding some investment delays and cost overruns arising from regulatory requirements. Further, investment intentions appear resilient to the recent global uncertainty with the large players driving the strength in investment. For junior and mid tier miners, financing and post GFC caution are holding back final investment decisions for some projects, although there is an abundance of feasibility studies.

Contractors supporting mining and oil and gas operations are optimistic about the strong pipeline of work which is expected to come their way over coming years with some indicating that the full benefits are yet to be felt.

The general pessimism in the retail sector is impacting investment, with cuts in capital expenditure reported by some in the retail sector, including delays to planned expansions. High volume, low cost outlets appear to be defying the general trend, with planned expansions on track.

Contacts in the non residential construction sector cite increasing retail vacancies as delaying plans for retail construction while anticipated reductions in white collar employment across industries could translate into additional spare capacity and a weaker outlook for office construction.