

## **Key themes from the Treasury Business Liaison Program — February and April 2005**

Treasury met with around 100 companies and organisations in Sydney, Melbourne, Brisbane, Canberra and Emerald in its Business Liaison Program in February and April 2005.<sup>1</sup>

Businesses reported that Australia's economic conditions remain buoyant, although sales have slowed since the latter part of 2004. This accords with the findings of most surveys of business sentiment. Businesses reported strong profits, with firms continuing to increase their productivity.

Queensland and Western Australia remain the states with the strongest demand, reflecting population growth and strength in the resources sector.

Firms and farmers reported increased skills shortages in a number of areas and increased difficulties in retaining and recruiting unskilled labour in remote areas. This is putting upward pressure on labour costs for some occupations, but the more flexible labour market means this has not spread across the economy.

Businesses noted that inflationary pressures remain well-contained. Strong global competition and innovation continue to drive down the prices of many internationally traded goods.

Treasury greatly appreciates the commitment of time and effort made by the Australian businesses and industry associations that participate in the Business Liaison Program.<sup>2</sup>

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- 1 A detailed explanation of the Treasury Business Liaison Program is provided in the Australian Government Treasury Economic Roundup, Spring 2001.
  - 2 This summary of business conditions reported in liaison meetings reflects the views and opinions of participants. It is provided for the information of readers. Treasury's evaluation of the economic outlook is informed by findings from business liaison and a wide range of information and data to ensure a rigorous assessment of the Australian economy.

## Retail trade

Retailers reported that sales had slowed from late 2004. A number of factors were mentioned as contributing to the slowdown. One temporary factor noted was the generous response of Australians to the tsunami appeals, which reduced the money available for discretionary spending. Some contacts also suggested that the tsunami may have led to a disinclination towards spending on luxury goods. The increase in interest rates in early March — the first rise in over a year — and some weaker than anticipated economic news around the same time were also cited as factors depressing consumer sentiment.

Some retailers thought consumers were moderating spending to rein in debt. This was thought likely in an environment where house prices are no longer adding significantly to wealth. Higher petrol prices have also reduced money available for other spending. And the high visibility of petrol prices may increase their impact on spending decisions. The slower pace of home sales and construction is reducing demand for durable goods. Finally, weather conditions have been mild in most of Australia, reducing demand for seasonal clothing, and for products such as air conditioners.

Some retailers suggested customers were becoming more price-sensitive. They were delaying expenditure until stores offered 'sales', and were requiring larger discounts to increase their purchases. A number of retailers said they were only maintaining sales volumes by cutting prices. The strongest sales growth was seen in consumer electronics such as digital cameras, DVD players and plasma and LCD television screens, where prices are dropping and new features are being introduced.

## Production and investment

### Manufacturing

Only a few manufacturers, mostly supplying the construction industry, reported running out of capacity or an urgent need to invest more in equipment. Any capacity problems appeared to relate more to distribution than production.

### Construction

Construction activity was tending to moderate in most areas. However, the downturn in housing construction was expected to continue to be very mild by historical standards. There were some pockets where activity had dropped off more substantially, such as inner city developments targeted at investors.

## Agriculture

In many parts of Australia the rural sector has not fully recovered from the 2002-03 drought, with low levels of water in rivers and dams, low sub-soil moisture and reduced flocks and herds. Despite these difficulties, many contacts reported that the price of rural land has risen significantly, which has made it easier for farmers to borrow. Contacts noted a long-run tendency towards consolidation of properties which allows economies of scale and diversification benefits.

Australia's beef exports to Japan are particularly strong at present with the United States temporarily out of the market. This has led to increased slaughtering in Australia and has therefore slowed the rebuilding of herds. In the medium term, South American beef producers were viewed as increasingly strong competitors. Contacts noted that grain prices were historically low, reflecting high world inventories.

Rural employment fell markedly during the drought and has not fully recovered. Partly this is due to the lingering effects of the drought on herd and flock sizes. But it also reflects difficulties in farmers attracting workers. Former farm workers have moved to the cities, or to work for mining companies, and casual workers have become harder to find. Contacts noted that some fruit had not been harvested due to a lack of available labour.

## Tourism and education

Businesses in the tourism industry indicated that more Australians were taking overseas holidays in place of domestic travel. They attributed this to the appreciation of the dollar, and an easing in international tensions and terrorism concerns. Higher petrol prices may also be discouraging domestic holiday travel. The high Australian dollar was also adversely affecting foreign tourism into Australia.

## Employment

The majority of the companies interviewed expected to maintain employment around current levels. In a few cases it was noted that automation to improve efficiency would reduce employment. However, in strongly growing sectors such as mining, employment was expected to increase. Retailers expanding their outlets were also expecting to hire additional staff. The finance industry, which had seen very strong growth since the 1980s, was not expecting to increase employment, other than in compliance areas.

There were increasing numbers of firms reporting difficulty in retaining or hiring staff with particular skills. Among occupations mentioned as having particular shortages were accountants, engineers, some IT areas, tilers, electricians, professionals in the

construction industry and truck drivers. There was also increasing competition for good sales and marketing people, exacerbated by less interest being shown by young people in retailing as a career.

Some firms seeking staff had not received suitable responses from advertising in the usual channels. Some of these firms had switched to other forms of recruitment such as bonuses for staff referring new starters or hiring overseas.

The increased investment in the mining sector has increased the demand for labour and the markedly higher prices recently negotiated for iron ore and coal exports have increased the capacity of mining companies to pay higher wages. Accordingly, the mining sector is attracting workers such as truck drivers and cooks away from other sectors. Particularly hard hit have been farmers in areas close to mines.

## Labour costs

Unsurprisingly, firms noted upward pressure on labour costs for occupations where labour is in short supply. For some specialised occupations, salaries were rising sharply while in other sectors wage growth was muted. Some managers reported that younger workers were placing less emphasis on salaries but were demanding improved conditions, such as childcare, more flexible working times, job-sharing or more ready access to leave without pay and secondments.

## Costs, prices and profits

The rise in global oil prices is gradually permeating through the economy. For example, contacts reported higher prices for plastics and foam rubber and higher freight charges. Steel, aluminium and tin prices were also considerably higher. Farmers were paying more for fertiliser.

A number of retailers reported large rises in rents, particularly for prime sites in shopping malls. While expenditure on accounting services had increased, insurance premia had fallen. Some firms had responded to the slowing in sales by cutting back on advertising expenditure while a minority had responded by increasing it.

Some firms were able to pass on cost increases, but many contacts said competitive market conditions would not allow this. In most cases productivity increases, cheaper costs for imports, and sometimes higher volumes, were allowing profits to be maintained with only modest price rises.

## Accounting standards

Australian equivalents to International Financial Reporting Standards (IFRS) replaced existing Australian Accounting Standards for financial reporting periods beginning on or after 1 January 2005. Many multinational companies in Australia already operate under international standards so have been little affected. Other large companies have had some work to do but found it manageable. Medium-sized companies raised some concerns about IFRS. In some cases firms reported a need to increase accounting resources. Companies which raise funds in the United States reported that meeting the new requirements of the Sarbanes-Oxley Act was far more onerous than the IFRS.

## Environmental regulations

Most contacts accepted the need to better manage the use of scarce resources such as water and to cut down on packaging. However, some firms and farmers expressed concern that environmental regulations were unduly hampering their operations or involved high compliance costs. There was a perception that these restrictions had become more stringent, and the differences in rules between states added further to complexity and costs.

