

## Key themes from the Treasury Business Liaison Program — April 2004

The following article is a summary of findings from the Treasury Business Liaison Program conducted in April 2004.<sup>1</sup>

The general view of businesses on the outlook for the economy over the coming year was positive, as was the outlook for their own business. The most optimistic views on the outlook were held by participants in the construction, retail and mining sectors.

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

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

## Overview

The April business liaison round comprised meetings in Sydney and Melbourne with businesses and industry associations from a range of sectors.

Overall, business liaison continues to present an upbeat view about both the economic outlook and prospects for individual businesses.

The most optimistic sectors were construction, retail and mining. The tone of meetings with participants from the manufacturing sector was also positive, with sales volumes and profits generally remaining healthy. Participants in the agricultural sector provided a mixed outlook depending on the type of product and the region of production.

Most industries reported that cost pressures were under control and that profitability was sound or strong. However, a number of contacts noted that the cost of meeting regulatory requirements, such as workers compensation insurance and financial reporting standards, was rising significantly.

In general, wage pressures were reported as manageable in most industries. However, as in previous rounds, there were indications of skill shortages in specific occupations, and this was putting some pressure on wages in certain occupational groups.

Most industries reported that product markets remain highly competitive. As a result, the majority of businesses were reducing costs through actions such as improving logistics, outsourcing non-core operations and sourcing imported products directly from manufacturers.

## General business conditions and outlook

Consistent with previous liaison rounds, most participants reported solid business conditions and had positive expectations about both the economic outlook and their own businesses prospects. Furthermore, a high proportion of contacts expressed the view that their own business would continue to perform strongly even if the domestic economy slowed in the year ahead.

- Supporting this upbeat perspective, contacts in the business services sector indicated that there had been no growth in work relating to business failures and bankruptcies.

Retailers reported that consumer demand continued to grow at a strong rate. High sales volumes meant that businesses were recording strong profitability despite a high

level of competition making trading conditions 'tough'. Further information on the retail sector is included below.

Participants from the mining and metal processing sectors were also optimistic, noting that international demand for most commodities continued to be strong (especially from China) and international prices remained high. The outlook was also positive, with several contacts in the process of negotiating long-term supply contracts, which would typically lead to further investment to increase capacity. However, it was reported that a reduction in exploration activity could pose a constraint to increasing capacity in the future.

In the petroleum industry, it was noted that strong competition in refining and retail operations meant that profitability was very tight. However, upstream oil and gas mining operations remained rewarding.

Transport contacts reported strong business activity and were optimistic about the future. Also, the hotel and accommodation sector continued to pick up, supported by an increase in the number of inbound tourists and strong domestic travel (driven largely by low airfares).

Meetings with businesses in the manufacturing sector indicated that sales volumes and profits generally remain healthy. Employment agency contacts also reported that employment vacancies have been strong in the manufacturing sector.

Participants in the business liaison program from the pharmaceutical and health industry generally reported steady growth. However, a number of contacts noted that they were uncertain about the outlook as it was dependent on future policy decisions – both the direction of the Pharmaceutical Benefits Scheme in Australia and the health policy of overseas governments.

The views of agricultural sector contacts varied reflecting the fact that recovery from the drought is uneven. For example, while those in grain production indicated that output had rebounded, contacts in other products – such as oilseeds – noted that their growing regions were almost entirely still in drought. Likewise, some downstream agricultural sectors – such as rural transport – reported strong activity, while other downstream sectors noted that demand for their products was yet to return to pre-drought levels.

Entertainment services were reportedly performing strongly, although the outlook is uncertain for this sector as it depends on non-economic factors (such as the quality of new films and recording artists).

The majority of participants in the business liaison program reported that overall they were not facing significant cost pressures. However, some contacts noted that insurance costs (including workers compensation insurance) continue to be an issue, reflecting either continued increases in premiums or the fact that costs have stabilised but remain at high levels. It was also reported that freight costs had risen markedly over the past year.

## Retail

Retail industry participants reported strong turnover and good profitability on the back of ongoing growth in consumer demand. Consistent with this, contacts managing retail shopping centres also reported strong business over the past year, although they are anticipating a slowdown in the near future. Media contacts also reported strong advertising activity.

Despite the high level of activity, however, almost all contacts noted that a high level of competition continues to exist in the retail sector. Contacts highlighted this increasing competition as evident in retailers holding a greater number of sales than was previously the case. A number of businesses indicated that this was being led by the larger retailers and was having a flow-on effect through the entire sector.

To remain competitive, most businesses were working to reduce their costs. At a general level this has involved improving transport and logistics operations, outsourcing non-core functions and improving inventory management. In some sectors – notably hardware – retailers had also moved to import more of their products as well as to import directly from manufacturers – rather than using import wholesalers. Some contacts expected the strong competition to result in further consolidation of retail outlets, particularly once consumer demand started to ease.

Participants also raised a number of specific retail challenges. For example, some retailers cited the continuation of warm days through autumn as having a negative effect on business. In particular, clothing retailers were not able to sell winter stock and demand had fallen for indoor recreation activities. A number of businesses also noted that they were facing continued competition for consumer's disposable income from the sale of mobile phones. In particular, they suggested that the contract nature of phone agreements saw an ongoing transfer of expenditure from areas such as fashion to the communication sector.

## Construction

Participants in the business liaison program from the construction sector expected activity to hold up for at least the next 12 months and were anticipating a shift from residential to non-residential construction after this time.

- One contact noted that that demand was exceeding their normal supply capacity and that they were using higher cost options to meet the excess demand. This was reducing their margins, although overall profits remained very strong.

It was noted that cost pressures remain in the sector and that skill shortages continue to exist. This shortage of skilled labour, particularly in regional areas, was flowing through to wage pressures.

Contacts reported that there remains a high level of competition in the sector as firms seek to increase market share. These competitive pressures led a number of contacts to suggest that the consolidation in the construction sector would continue to take place.

Related to the construction sector, it was reported that continued strong growth in the do-it-yourself (DIY) segment of the market continued. It was suggested that this trend would continue for a further 10 years.

## Employment and wages

Employment agency contacts reported strong business especially in Western Australia and Queensland where large resource projects are raising employment. Other sectors reported as driving employment growth were business services, tourism, retail and construction.

This high level of employment was supported by contacts in most sectors of the economy reporting stable or slightly increasing employment intentions. The main exception was in the manufacturing sector where although employment agencies reported strong activity, a number of manufacturers indicated they would be looking to reduce their workforce over the next 2 years — in some cases by a considerable amount.

In general, most participants were not having difficulty attracting good quality labour. However, some businesses continue to report a shortage of skilled tradespeople, including in particular apprentices and trainees, as well as a shortage of nurses and other essential services staff. Employment agencies who participated in the liaison meetings also reported a continuing trend towards casual and part-time employment.

Aside from the specific cases noted above, contacts typically reported that no significant wage pressures had emerged. However, the overall expected level of wage negotiation outcomes was slightly higher than reported in February — with these higher expectations being especially evident in the manufacturing sector in Melbourne. Participants also reported that it was becoming harder to find productivity offsets as part of wage bargaining processes.

## Regulation and infrastructure

Over the course of the April liaison round, a number of participants raised concerns relating to government regulation and also infrastructure.

The most common issue raised was the difficulty for nation-wide companies in dealing with varying regulations and legislation across states. In particular, the need to deal with several sets of occupational health and safety legislation, and multiple workers compensation insurance schemes was adding significantly to costs.

- Related to this, several contacts noted that the cost of workers compensation insurance had risen considerably (especially in NSW) in recent years.

Financial sector contacts also noted that although they recognised the benefits of the improved regulation, the cost of meeting financial sector requirements had increased 3 to 4 times over the past 5 years. They also suggested that overlap between Australian Competition and Consumer Commission (ACCC), Australian Prudential Regulation Authority (APRA) and Australian Securities and Investments Commission (ASIC) was placing additional burdens on their business from a reporting perspective.

Some business liaison participants also reported that transport infrastructure was creating bottlenecks in some areas. The most notable of these was the rail and road infrastructure feeding certain ports which was restricting the flow of goods to the docks and resulting in ships standing idle outside certain ports. Some participants in the program noted that state-owned railway monopolies meant that there was often no alternative approach to getting product to ports. Contacts also raised restrictions on the number and size of ships able to access certain ports — in particular the Port of Melbourne — as an issue.