Key themes from Treasury's Business Liaison Program

As part of Treasury's Business Liaison Program, staff met with around 25 organisations in Sydney, Melbourne, Brisbane and Perth during November 2009.[1] Treasury greatly appreciates the commitment of time and effort by the organisations that participate in the program.[2]

Businesses generally reported improved conditions in the September quarter and increasing optimism about the sustainability of a recovery. However, given the degree of spare capacity in the economy, the weakness in business investment (particularly outside the resources sector) looks set to continue. Labour market conditions have strengthened in line with an improving economy. Wage and price pressures remain subdued.

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

2 This summary reflects the views and opinions of participants in the liaison program, which are not necessarily shared by Treasury. 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. Treasury aims to meet with a broad cross-section of the business community over time. Companies are invited to register their interest in participating.

Trading conditions

With stimulus payments to households having their peak impact in the June quarter, previous liaison had revealed a concern that retail sales would weaken over the second half of 2009. Through-the-year growth in sales had slowed in the September quarter, with conditions stabilising since then. Historically low interest rates, improving economic conditions, rebounding asset prices and the strength of the currency were identified as supporting consumer confidence and demand. With the December quarter always the strongest in seasonal terms, contacts were hopeful the generally favourable trading environment would continue through the Christmas period.

Mining sector contacts had weathered the downturn better than expected, and were reporting improvements in traditional export markets for mineral and energy commodities. Some had compensated for the weak demand in contract markets such as Japan, Korea and Europe by redirecting volumes to China with spot market sales. With a recovery in traditional markets, there was less spare capacity to satisfy Chinese demand and capacity expansions might be brought forward as a result. While the currency appreciation had offset much of the recent recovery in global commodity prices, export volumes were clearly strengthening.

Transport sector contacts also saw emerging signs of a recovery with international passenger and container movements now higher than a year ago at major airports and ports. In contrast, domestic passenger and container volumes were largely flat compared to a year ago. Additional capacity from new entrants combined with aggressive fare discounting had supported international passenger volumes, particularly in the outbound market; whereas the domestic business travel market remained subdued for most of 2009.

Domestic manufacturing sector activity was apparently not particularly strong. This pattern could reflect a degree of import substitution in response to the strength of the currency. Recent private sector surveys indicate that while the domestic manufacturing sector is now expanding, businesses remain cautious about the durability of demand and are yet to rebuild inventories to a significant degree.

The construction sector continued to receive strong support from fiscal stimulus and record public sector capital expenditure programs. However, significant variations were evident across the sector with the greatest weakness in new office and retail developments. Although the flow of new developments remains subdued, there were signs of improvement in the commercial property market with the volume of transactions picking up off a very low base and asset prices and yields stabilising, although vacancies may not yet have peaked.

The housing market was being supported by first home buyer activity, and more recently existing home owners seeking to upgrade. Investor activity remained subdued, and residential developers continued to face difficulty in getting medium-density and high-density projects off the ground.

Business credit and investment

The cost and conditions attached to bank credit were again raised as a concern, though outside of the commercial property and residential property development sectors, there were fewer indications of credit supply being constrained. Higher margins and more restrictive lending conditions had supported the trend of larger corporations accessing capital markets directly, where possible. Smaller to medium-sized firms appeared generally able to access bank credit, but could be deferring expenditure and continuing their deleveraging until economic and financial conditions become more favorable.

With the exception of the resources sector, contacts reported that planned expansions would remain on hold until the significant existing spare capacity had been absorbed. As such, many expected general weakness in capital expenditure for perhaps another 12 to 18 months. That said, the deferral of discretionary maintenance during the downturn had led to a backlog of work in some sectors, to the point that a resumption of usual maintenance programs was now expected, given improved confidence and underlying conditions.

Capacity issues

The impact of the Government's stimulus packages on the building construction sector was explored again during this liaison round. Contacts advised that there were few signs of public spending leading to capacity constraints or cost pressures in the relevant sectors. Indeed, with very little other work occurring, public expenditure was seen to be helping to fill a large gap in private building activity.

Exports of coal and liquefied natural gas (LNG)

Several contacts reported their optimism regarding the expansion of the New South Wales coal export supply chain, following the long-term agreements concluded in recent months. Expectations were that the export capacity of the supply chain could now be expanded relatively quickly, with the first increment coming on line in the first half of 2010. Additional expansion projects could see capacity grow much more significantly over coming years.

The outlook for Australia's LNG exports in coming years is also very positive, with potential large-scale investment extending well into the next decade. Contacts commented that although the global recession had weakened demand, the outlook for Australian LNG projects looked quite positive on balance. The extent of the supply response from other countries will likely determine the viability of several prospective projects, such that not all of the slated projects would proceed. A factor that could support development of the sector is the desire of buyers to diversify their sources of energy supply.

Employment and skills

Contacts suggested that the outlook for employment had improved a little, with the finance, sales and marketing and construction sectors showing signs of growth. Small to medium-sized employers had been the first to begin hiring from around the middle of the year, and the signs were that larger companies were beginning to add staff. Demand for specialist skills, particularly engineers with mining sector experience and skilled construction staff, has remained strong.

Prices and wages

The strength of the Australian dollar and favourable seasonal conditions were driving down the price of fresh produce, and this was being passed through to customers. Retailers anticipated the currency appreciation would also be passed through into 2010 as the effects flowed through the supply chain.

Wage pressures remained subdued, with the strongest growth in the mining sector. In most other sectors wages were generally tracking below inflation. Wage and salary freezes were still in force across a number of firms.

The extent of spare capacity in the economy was also serving to moderate input price pressures throughout the supply chain, and contacts expected this to continue on the basis that the full effect of the currency appreciation was yet to be passed through.