

Key themes from Treasury's Business Liaison Program

Introduction

As part of Treasury's Business Liaison Program, staff met with around 25 businesses and a number of industry and government organisations in Sydney, Melbourne, Perth and Adelaide during February 2009. Additional teleconferences were conducted with retail sector contacts during December 2008 and January 2009.¹

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

In general, trading conditions deteriorated significantly over the latter part of 2008 as global financial market conditions and associated uncertainty translated into weaker confidence and activity.³

Impact of the Economic Security Strategy

A positive impact from the Economic Security Strategy (ESS) was particularly evident among retailers of mid-value to lower value products. Supermarkets, retailers of lower value household items and hardware/home improvement businesses reported a significant spike in December sales. In contrast, retailers of higher end products and consumer durables reported weaker trading conditions. The consumer mood was summarised as being one of 'staying at home' and 'fleeing to value'.

Contacts felt that together with lower interest rates and lower petrol prices, the fiscal stimulus had helped to keep consumer confidence higher than it otherwise would be. There were also reports of improved trading conditions being sustained into January and early February, though several contacts considered the effects were beginning to fade.

According to a number of residential construction companies, real estate and lending firms, the First Home Owners Boost was having a strong impact on that market segment. What started as an initial surge in inquiries has begun to translate into loans

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.

3 This report focuses in more detail on the retail, construction and resources sectors. Additional meetings were held with representatives from the financial, manufacturing and rural sectors and the general themes arising are also reported. The program encompasses the full range of sectors and Treasury aims to meet with a broad cross-section of the business community over time. Companies are invited to register their interest in participating.

and approvals should follow. Beyond the first home buyers segment, indications are that the residential property remains very weak, reflecting both the legacy of higher interest rates and poor consumer sentiment.

Business credit

Access to credit and high borrowing costs remain a central concern for some businesses. In the commercial property sector, the supply of finance has been significantly constrained. More generally, the slowing growth in business lending also reflects weaker demand for credit as broader economic conditions translate into increased spare capacity and less investment. Some firms considered that they were being pressured by lenders to reduce their debt levels through a tightening of lending standards and higher borrowing costs. Concerns about cash flows and not being able to access credit are encouraging many firms to undertake cost-cutting programs in order to strengthen their cash reserves.

Sectoral activity

Looking beyond the impact of the ESS, underlying conditions in the retail sector remain subdued, with overall sales tracking flat to negative in the current financial year. However, this overall assessment masks shifts that are occurring in the composition of retail expenditure which some firms considered to have good opportunities for gaining market share. The additional stimulus of the *Nation Building and Jobs Plan* was more of a prospective than actual consideration in this liaison round, given the timing of its passage in mid-February. A relatively weak demand for consumer credit was evident as households consolidate their financial position.

As noted previously, the commercial property sector is particularly weak, and is experiencing credit constraints. Contacts report an overhang of unsold retail and office space is depressing prices and vacancy rates are also rising, compounding this effect. Increased public investment was expected to assist building and construction firms endure an otherwise difficult period.

The weakening global economy continues to depress output and prices in the Australian resources sector. Most companies were surprised at the pace of the turnaround and have sought to bunker down while the current storm subsides. The composition of the sector is changing as tighter financial market conditions have forced a number of resources companies to find new investment partners as a means of easing capital constraints. Most firms were cautiously optimistic of a recovery in late 2009 and into 2010, particularly given the strong economic stimulus being applied globally.

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Those manufacturers contacted were also significantly exposed to prevailing global conditions, even though domestic conditions were comparatively robust.

Relatively speaking the rural sector appears to be reporting more robust trading conditions and confidence in the medium-term outlook than other sectors, although property prices have been depressed by global conditions.

Investment plans

Insofar as the majority of business investment relates to building and machinery and equipment, there is mounting evidence that a significant contraction is underway. Businesses continue to report delays in their discretionary capital expenditure with a clear trend towards reducing it from previous high levels. Several businesses reported expansion plans have been curtailed and refurbishment projects delayed pending more favourable conditions.

Major projects in the resources sector continue to provide a pocket of relative strength in business investment. Among the large projects already underway, Treasury liaison has revealed relatively minor examples of delays and cancellations. Those changes in plans that have been publicly announced relate to weakness in global demand and prices and some difficulties in obtaining external finance. There remains significant work in the investment pipeline that has already been committed and financed to underpin a continued contribution to growth from engineering construction. It would appear that prospective weakness in this area may be more in the medium term than the short-term, depending on the global economic recovery.

Employment and skills

Trends such as reduced operating hours and laying off staff have become apparent in past months, in contrast to earlier liaison rounds where firms had been aiming to keep employment levels relatively steady. The clear trend in the retail sector was toward engagement of casual staff, underlying a strategy of retaining flexibility in terms of trading hours and hours worked.

In the construction and resources sectors, employment intentions were more varied. In relation to major projects, given the momentum in activity and long project lives, firms were generally continuing to hire. That said, several firms reported actual and planned workforce reductions in light of diminishing operating conditions and scaled-back expansion plans.

While skills shortages had reduced considerably, a number of firms reported continued tightness in parts of the skilled labour market, and others expect tightness to re-emerge when growth resumes.

Prices and wages

The prices of business inputs are being affected by opposing forces. On the one hand slowing economic activity and easing capacity constraints are lowering costs. On the other hand, the significant currency depreciation has offset much of this effect for imported capital goods and consumer items.

Consumer prices are expected to be subject to similar forces, albeit with some delay. Retailers considered the currency effects were still to flow through to final prices, though tough trading conditions and competition for retail market share bode well for consumers.

Wage pressures were reported to have eased considerably.

Regional variations

The economic slowdown is affecting all regions, but the benefit of the resource-driven boom continues to be felt in Western Australia. Contacts report residual strength of the Western Australian economy on the back of major projects and despite strong net migration, skilled workers remain in strong demand. There are tentative signs the New South Wales economy has resumed growing, driven by retail trade and dwellings, albeit off a low base of activity.

