

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

The following article provides a summary of findings from the Treasury Business Liaison Program conducted in November 2004.<sup>1</sup> In this round of business liaison, Treasury held meetings with a range of companies in Sydney and Melbourne as well as visiting the Mildura area.

Businesses continued to be positive about Australia's economic conditions and the prospects for sustained economic growth. Profitability remained strong, with cost pressures under control and most firms having experienced high volumes of turnover. Employment intentions remained robust while wage pressures were moderate.

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 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. 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.

## Overview

The companies Treasury met in the November 2004 business liaison round were positive about the Australian economy and the prospects for sustained economic growth. This outlook was consistent with the buoyant expectations reported in most business surveys in the lead-up to this liaison round.

In particular, business surveys were suggesting that firms were becoming increasingly confident about their own business outlook. Treasury's discussions with companies confirmed this outlook, with most firms noting that they were experiencing strong sales volumes and good profitability. Consistent with this, firms with involvement across multiple sectors of the Australian economy, such as transport and media companies, also reported high levels of activity and revenue.

The retail and mining sectors continued to perform very strongly and to support growth in other sectors of the economy. Companies also noted that, as a whole, construction activity remained relatively robust, despite an easing in medium-density dwelling and office construction.

Businesses operating in service sectors of the economy provided mixed reports. Some firms, such as those operating in the finance, insurance and tourism-related industries, reported strong business activity. However, firms providing gaming and related services had seen a slowing of activity.

Most manufacturers reported sound business performance, although a number noted that they continue to face intense competition from 'low-cost' countries, especially in the production of generic or mass-market items (such as clothing).

Sales reported by farm machinery businesses suggest that overall farm activity is relatively sound. However, crop production is still patchy with some areas and some crops still struggling as a result of low water storage levels. Agricultural sector contacts reported that cattle herd rebuilding was taking place following the drought but that high meat prices were slowing the pace of restocking by holding up slaughter rates.

Firms generally reported stable to increasing employment intentions. Most companies were able to fill vacant positions with good-quality staff. However, as in past liaison rounds, some firms noted difficulties in filling certain positions. Wage pressures were largely under control, with recent wage outcomes not differing significantly from those agreed in previous wage negotiations.

Companies typically reported that their investment intentions were broadly similar to their current levels of investment. A number of firms indicated that the objective of their investment was to increase efficiency, with a particular emphasis on improving distribution networks, rather than to increase production per se.

## Retail

In the lead up to the November business liaison round retail indicators suggested relatively weak growth in the value of sales. However, most retailers met during the liaison round indicated that their sales had remained strong. In some cases this reflected ongoing growth in sales. In other cases it reflected stable but high levels of sales.

Consistent with reported strong consumer demand, a significant number of retailers were planning a net increase in the number of stores they operate. In most cases companies planned to expand at roughly the same rate as in recent years. This trend towards expansion should produce continued investment and employment growth in the retail sector.

The recent record high levels of motor vehicle sales were reflected in positive comments from car manufacturers and importers. These firms saw the combination of new products and competitive pricing (in part reflecting the strength of the Australian dollar and the lowering of tariffs) as driving the strong demand for motor vehicles. Companies did not believe that higher petrol prices had dampened demand for motor vehicles, nor did they expect this to occur in the foreseeable future.

Some retailers noticed a change in the pattern of sales coinciding with the federal election, although businesses provided mixed reports. Some firms, such as those in the restaurant and consumer durables industries, noted that activity slowed in the two weeks prior to the election. Other firms thought sales slowed only in the week before the election but then didn't return for at least a week after the election. But, a number of retailers didn't notice any change in sales at all.

## Construction

Over the course of 2004, economic indicators suggested that growth in the construction sector — and in particular housing construction — was easing. However, firms in both the residential and commercial construction segments of the market remained positive about their prospects for growth.

Most construction companies noted that although there was less work currently available on medium-density dwellings, there was still some work in the pipeline.

Some firms also suggested that the rate of decline in medium-density dwelling work was slower than earlier in the year and a number of companies referred to new projects currently in the concept stage. Companies also indicated that investment in new detached dwellings was still performing solidly, especially in Queensland.

Firms reported that the construction of retail and commercial buildings was still strong. In particular, companies considered construction work in the aviation and hotel sectors to be 'booming'. However, office building work had slowed, reflecting the high vacancy rates for existing offices. A number of companies also cited engineering construction as generating very good growth, driven largely by work in the mining sector.

## State economic conditions

A consistent theme from companies operating across a number of states was that activity was particularly strong in Western Australia and Queensland. This strength included retail, building and farm activity. In part, firms saw this as driven by the strength of the resources sector, as well as by solid rates of population growth.

In contrast, companies reported that Victoria was their weakest performing state, although the forthcoming Commonwealth Games were considered to be supporting infrastructure investment in Melbourne. Business activity in NSW was generally reported as solid.

## Employment and wages

More often than not, firms indicated that they were still able to recruit labour when required and that the quality of this labour was adequate. However, given strong employment growth recorded in the three months to November, some companies reported difficulties in attracting and retaining high-quality staff. In particular, shortages were reported in the areas of skilled tradespeople and finance and accounting professionals. Companies operating in regional areas also noted that they continue to face difficulties in filling positions.

Consistent with the *Mid-Year Economic and Fiscal Outlook 2004-05* (MYEFO) forecast for unemployment to remain low, most companies reported stable or growing demand for labour. In particular, the mining and retail sectors indicated strong employment intentions, reflecting their expectations of continued demand for their products. Both firms and employment agencies noted that companies were looking to increase the flexibility of their workforce to allow them to meet peak demands without locking in a given payroll size.

As has been the case in previous liaison rounds, there was little evidence of the strong labour market leading to a generalised increase in wages pressure. In most cases, firms were negotiating wage outcomes similar to previous increases. A number of companies also indicated that they thought employees were giving considerable attention to lifestyle and other opportunities – not just wages – when negotiating employment contracts.

Nonetheless, certain industries – and again most notably the construction sector – reported some wage competition as firms tried to attract employees with skills that were in relatively short supply.

## Costs and prices

From the beginning of 2004 to the start of this business liaison round, Australian dollar oil prices increased by over 40 per cent. Most firms reported that the higher cost of oil was being passed through to users in the form of higher input costs – including transport, resin and packaging costs. Logically, those companies with a heavy reliance on oil-based inputs were facing the greatest cost pressure. However, the majority of firms reported that although high oil prices were starting to have an impact on profitability, it was not of significant concern at present.

Some individual firms raised specific cost pressures they were facing, but in general companies saw increases in overall costs as affordable. In addition, most firms reported the falling cost of imported inputs as a positive factor.

In contrast, firms noted that pricing pressures were squeezing profit margins. Companies saw this as the result of intense competition and indicated that they were continually seeking cost savings to compete on price. In particular, a number of firms were looking to source more products directly from low-cost countries (most notably China) to improve their competitiveness. Other firms noted that they were refining their products to meet the needs of their more profitable clients rather than trying continually to undercut their competitors' prices. Although this was reducing output for these firms, it was leading to a stronger profit position.

## 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. The adoption of IFRS represents a significant change in accounting policy for many businesses, notably those in the financial services industry and those with significant intangible assets.

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In general, most companies indicated they were making a smooth transition to the new standards as the necessary changes were relatively small. Accordingly, a number of companies had already implemented, or were well on the way to implementing, the IFRS.