Key themes from the Treasury Business Liaison Programme — April to July 2006

As part of Treasury's Business Liaison Programme, Treasury officials met with around 70 businesses and organisations in Sydney, Melbourne, Brisbane, Adelaide and Perth from April to July 2006.[1] Officials also spent two days meeting with businesses on the Gold and Sunshine Coasts and two days meeting with businesses in Tamworth.

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

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

2 This summary reflects the views and opinions of participants. 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.

Business conditions

Business conditions were generally good across Australia, but there were noticeable variations across sectors and among States. For example, retailers reported reasonable conditions, but manufacturers reported varying conditions depending on their line of business.

Manufacturers supplying products to the mining and construction sectors described strong conditions. These businesses were running at high capacity utilisation rates and some were importing products to make up for their production shortfall. However, manufacturers of goods such as clothing, homewares and automotive parts reported tough conditions and were struggling to compete with imported goods from Asia. Manufacturers of food products noted that they were facing reasonable conditions.

Both retailers and manufacturers reported a divergence in conditions among the States. Most were experiencing strong conditions in Western Australia, solid conditions in Queensland, average conditions in Victoria and South Australia and flat conditions in New South Wales. Businesses on the Gold and Sunshine Coasts were generally performing well, with these areas continuing to grow strongly.

The favourable conditions in Western Australia were reported as largely the result of strength in the mining sector. Mining businesses described very favourable conditions, notwithstanding cyclone activity in the first quarter of this year. This strength was flowing through to other sectors, particularly the construction sector. Businesses in the construction sector commented that non-residential and engineering construction was strong, with the degree of the strength varying across States.

The strength in the construction sector has offset the slowing in residential activity that has occurred in most States. Businesses reported that the property market in New South Wales was still broadly flat, although businesses in Tamworth noted that their local market was still strong. Conditions held up a little better than businesses expected in Queensland. There were reports of a patchy housing market in the south-east Queensland region, with the first home owner segment showing solid performance, while other segments were a little flatter. Residential construction had not slowed in Western Australia and capacity constraints were resulting in longer lead times for building.

In the services sector, businesses providing services to the mining industry were performing well, while logistics service providers were facing tight conditions largely due to high fuel costs and a highly competitive environment. Companies involved with the infrastructure sector in Victoria and South Australia were benefiting from increased capital spending by these State governments.

Businesses in the tertiary education sector felt that conditions were steady, although the international student market appears to be maturing. They also reported increased competition in the education sector, with more students attending university in their own countries and some countries increasing their competition for international students. Businesses involved in communication and media services also reported increasing competition from Asia.

For businesses involved in tourism, the number of Australians travelling overseas was higher, which was detracting from domestic tourism. High petrol prices were also having some effect on the domestic tourism market, with some evidence in Queensland that domestic tourists were not travelling as far by car for holidays.

In terms of rural conditions, businesses in Tamworth commented that they were grateful for the recent rainfall in the region, but that follow-up rain was required. The winter crop in the region was fully sown, with the area planted similar to last year. Follow up rain is not only required for the current yield on the winter crop but also for preparation of the incoming summer crop. In Victoria, it was reported that conditions in certain parts of the State remain dry.

Business investment

Overall business investment levels were fairly steady, with those businesses benefiting from the strength in the mining sector undertaking more investment. It was also evident that some businesses in south-east Queensland were undertaking significant investment relative to their size, with a number of them in a growth phase.

Retailers reported they were undertaking sufficient investment to maintain existing operating levels. Some manufacturers told us that it was difficult for them to justify increased investment in the sector, given the increased competition from Asia. However, those manufacturers involved in supplying products to the mining sector were increasing investment levels to lift their output capacity. Other types of businesses benefiting from the strength of the mining sector, such as construction and maritime services, were also undertaking greater amounts of investment.

Mining companies reported undertaking significant amounts of investment in both current operations and new projects. There were also reports of a large amount of exploration expenditure being undertaken in the resources sector. For mining investment, businesses reported that the challenge was undertaking large projects with skill shortages and increased construction costs. Some mining companies were also having difficulty getting certain capital equipment, with tyres being a particular issue. The lags are long in this industry, with investment still in its ramp-up stage.

Employment

Employment levels were expected to remain reasonably steady overall, with the general theme of divergences in strength in sectors and States reflected in the reports from businesses.

Businesses in the mining sector continued to report tight employment conditions in some areas and noted that it was increasingly difficult to retain staff in some occupations, including engineers, seismic interpreters, tradespeople and geologists. In Queensland and Western Australia, there were reports that staff with transferable skills, such as truck drivers and tradespeople, were being attracted to the mining sector. There were also reports that labour in rural Victoria was moving to the resources sector. Businesses in the mining sector noted that sourcing employees from overseas was not an easy option, with competition also coming from other countries.

Some businesses have established in-house training and training colleges in response to their skills requirements. Businesses in Tamworth noted that, where they can, they try to hold on to labour during dry weather conditions in order to maintain their skill base.

There were some pressures noted for professionals in legal areas, finance, information technology and accountancy.

Wages, other costs and prices

The pattern of wage pressures reported by businesses was consistent with broader indicators of labour market strength. The mining sector in particular reported strong wage growth compared to other industries. Wage pressures across a number of skilled occupation groups were particularly evident in Western Australia, a situation that has been emerging for some time.

Moreover, high levels of activity in parts of the construction sector were leading to relatively strong wage growth, with non-residential and engineering construction activity outside the mining sector also remaining very high.

In most other parts of the economy, businesses reported more moderate wage pressures.

Non-wage business costs were also showing strength. Not surprisingly, a large proportion of businesses mentioned that high fuel prices were having an impact on their costs. Businesses in the transport and logistics sector reported a relatively greater impact from high fuel prices, as did retailers and other businesses providing delivery services. High fuel costs were also affecting the rural sector, both directly and indirectly with a flow-through to higher fertiliser costs.

Costs in the construction industry were reported to be remaining high, reflecting strong demand for construction materials. This was affecting the cost of new building and engineering construction projects. High steel costs remained an important factor for many businesses in the construction sector.

Increases in raw material costs were also affecting some businesses. The costs of aluminium, steel, tin and plastic were mentioned by some businesses as increasing their packaging costs. Increases in the cost of some agricultural commodities, such as sugar and milk, were also mentioned as important for some businesses.

Some businesses were benefiting from continued falling prices for a number of imported goods. Wholesalers and retailers reported falling costs for imported goods, as did manufacturing businesses that use imported inputs. However, some businesses reported that the cost of imported machinery and equipment was rising.

Businesses across a number of sectors reported continuing strong competitive pressures in the economy. This was constraining their ability to pass on increases in input costs. An exception was for fuel-related increases in transport costs, which were being passed on to final consumers in some cases. Some retailers also reported using promotional activities to increase sales volumes to offset falling profit margins.