Key themes from Treasury's Business Liaison program

Overview

As part of its quarterly Business Liaison Program, Treasury met with 34 businesses and organisations in four capital cities and via teleconference in May. Treasury greatly appreciates the commitment of time and effort made by the businesses and industry associations that participate in this program.

Liaison discussions confirmed that, behind the strong medium term outlook, growth in different parts of the economy remains uneven. On the one hand, mining investment is ramping up, driven by the high prices Australian companies are receiving for their resources exports in response to strong demand from China. On the other hand, the non-mining economy is weaker, with household demand remaining subdued and the construction sector still to see a significant pick-up in growth following the global financial crisis. Some contacts also reported that the high dollar is affecting the overall outlook for their business, despite reducing the cost of imported inputs.

The pace of recovery from the floods earlier in the year is also slower than expected for some parts of the mining sector, although this is not expected to delay the broader upturn in the second half of this year. Coal production in Queensland is yet to fully recover, with some expectations of production delays into 2011-12.

Activity

Resources investment and production continue to drive overall economic growth. Contacts expect growth in China to continue to drive demand and support continued strength in the mining sector.

That being said, activity is yet to fully recover from the floods and cyclonic activity in January and February. Some firms are still removing water from their mines, and some infrastructure has not yet returned to full capacity. Contacts suggested that it could take until the second half of 2011 to pump excess water out of all mines and return to full production.

Contacts reported that conditions are broadly subdued across the rest of the economy. Activity in the manufacturing and tourism sectors continues to be weaker due to the appreciation of the Australian dollar and the residual impact of the natural disasters. Residential and non-residential construction also remains soft and the short-term growth outlook is generally flat. Non-residential construction activity has slowed in recent months as the pipeline of education projects lessens. Contacts also noted that land availability for residential construction remains a constraint.

Activity in the household sector continues to be dampened by more cautious spending behaviour, as evidenced by high household saving and slower household credit growth. Consumer spending has been weak in recent months, particularly in the retail sector, due to ongoing consumer concerns about interest rate increases and cost-of-living pressures. Contacts noted that signs of an upturn in spending are yet to emerge and are not expected in the immediate future.

Employment and wages

Overall, firms are reporting continued tightness in the labour market. The situation is particularly acute in the mining and related industries in Western Australia and Queensland, with increased turnover and some firms experiencing difficulty in recruiting and retaining skilled labour.

A number of firms in the mining sector have reviewed remuneration packages, or changed rosters, in an attempt to retain workers. Firms are increasingly utilising fly-in-fly-out arrangements from other states as another measure to attract and retain skilled staff.

Although the predominant view is that skills shortages are not yet as acute as during the last mining boom, shortages in the resources and related construction sectors are expected to drive wage pressures in the near term, with wage agreements awarding pay increases in excess of 5 per cent in some specialised professions. Elsewhere, firms are generally providing pay increases of around 3 to 5 per cent.

Costs and prices

Contacts reported mixed effects from the appreciation of the Australian dollar. While most are continuing to benefit from cheaper imported materials, trade-exposed firms, particularly in the manufacturing sector, are under increased pressure from overseas competitors.

The inflationary effect of the floods and cyclones on fresh produce prices is waning, but still significant. Overall, the prices of fresh produce are expected to remain elevated for the next few months.

Financing and investment

Mining investment remains strong, and demand for Australia's resources is driving a surge in expected investment. However, concerns are starting to emerge about the capacity of existing infrastructure and the availability of skilled labour to support the rapid expansion in volumes, particularly if there is slippage in planned infrastructure projects.

Overall, credit conditions continued to improve this round, consistent with the general trend since the global financial crisis. Concerns about credit were mainly reported by the construction sector, with contacts continuing to cite stringent lending criteria and interest rate concerns as factors influencing the recovery.