Key themes from the Treasury Business Liaison Programme — October 2007

As part of Treasury's Business Liaison Programme, Treasury officials met with around 60 businesses, and some industry and government organisations, in Sydney, Melbourne, Brisbane, Perth, Rockhampton and Gladstone in October 2007.[1] This summary also draws on meetings held in May and July-August 2007, when Treasury officials met with firms in Sydney, Melbourne, Newcastle, Cootamundra, Wagga Wagga and Young. Collectively the firms interviewed employ over 500,000 Australians.

Most retailers expect sales to remain solid, although there is wariness about the prospective impact of higher interest rates. The strongest part of the economy continues to be the mining sector and associated construction activity. Manufacturers and tourist operators are concerned about the effect of the appreciation of the Australian dollar. Companies indicate that the labour market is tight and there are shortages of workers with key skills, but they anticipate this will lead to only a modest rise in wage growth. They also suggest that the appreciation of the dollar, and competitive pressures, are limiting the impact of strong demand on inflation.

Treasury greatly appreciates the commitment of time and effort 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 in the liaison programme, 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.

Retail sales

Retailers report a continuation of solid trading conditions which they anticipate will continue. They are generally surprised that interest rate rises have had a relatively muted impact on sales thus far, and that defaults on goods purchased on credit remain low. However, there are concerns that a 'tipping point' could be reached if interest rate increases continue.[3] Discount retailers comment that tax cuts provided a fillip to sales in July.

Retailers note that high petrol prices are affecting the pattern of sales at convenience stores. Consumers have a limit to the amount they wish to spend at petrol stations and respond to higher prices by making more trips to stations and buying less in the associated convenience stores.

Many retailers were expecting weaker sales during the election campaign. Some attribute this to uncertainty in general leading to deferral of large purchases. Others felt that the election was a distraction for families making decisions on purchases. There was general agreement that elections disrupt advertising campaigns, even if only by cluttering up letterboxes, although a few retailers regarded this 'election campaign effect' as an 'urban myth'.

Continuing the pattern of recent quarters, national retailers speak of particularly strong sales growth in Western Australia, the Northern Territory and south-east Queensland, reflecting the mining boom and strong population growth. In Perth sales of luxury goods are especially strong. Retailers also note that sales growth in Victoria is stronger than in New South Wales, although NSW sales are picking up. There are still some concerns expressed about western Sydney, where falling house prices and a more cautious approach by lenders appear to be constraining spending. This is also an area where higher interest rates (and prospectively higher petrol prices) have a strong impact. Some stores in rural areas are still suffering the adverse impact of drought on their sales.

Contacts remark that only a small proportion of purchases are made over the Internet but such purchases are growing rapidly. It is suggested that the exchange rate appreciation is encouraging purchases from Internet retailers overseas.

3 The liaison meetings were held before the Reserve Bank increased interest rates in November, but this was widely anticipated by contacts.

Manufacturing

Manufacturers describe facing more difficulty in exporting due to the appreciation of the Australian dollar, although widespread use of hedging instruments is delaying this impact.

However, some manufacturers argue that they are more resilient to exchange rate pressures than previously. Moreover, they view the high dollar as an opportunity to import more capital equipment while its $A price is low.

Manufacturers of processed food tell of being constrained by the drought limiting supplies from farms. This is particularly a problem for manufacturers who stress their products are 'fresh' or 'Australian made'.

In October, contacts were not reporting any marked impact from the problems in the subprime market in the US on either the cost or availability of credit.

Housing

Marked divergences remain in the housing market across the country. House prices in some mining areas are rising rapidly, and approaching those in capital cities. On the other hand, contacts refer to weak demand for larger homes, falling house prices, and little interest in land purchases in western Sydney. House construction in New South Wales in general is reported as quite weak. Estate agents suggest that high petrol prices are making areas with poor public transport less attractive. The housing market remains strong in Queensland. While the rate of price growth appears to have softened in Perth, sales remain strong and rents continue to rise. One response to higher home prices has been developers putting smaller blocks on the market.

Contacts describe the demand by investors as having been lacklustre in 2007. They attribute this to low yields and a slowing in price growth and the incentives for investors to direct funds into superannuation. However, as rental yields are now rising, and some of the temporary superannuation concessions are no longer available, some estate agents and builders think investor interest in housing is reviving.

Some contacts believe that the housing industry would struggle to expand its level of activity were demand to pick up, owing to widespread skills shortages. The skills shortages are attributed to a short-sighted neglect of apprenticeships over recent years. As a consequence, completion times could stretch out were demand to increase appreciably.

Tourism

Tourism operators tell of difficulties arising from the strong Australian dollar. In particular, the Japanese market is being affected, with the dollar appreciating by 23 per cent against the yen during the course of 2006-07. Tourism operators refer to some structural features of the Japanese market as exacerbating this problem. Japanese tourists make unusually heavy use of travel agents who only adjust the price of holiday packages once a year. When the costs of Australian accommodation rise due to exchange rate changes, the travel agents redirect tourists to other destinations until the annual repricing.

The strong Australian dollar is also adding to a tendency for Australian holidaymakers to favour overseas travel over traditional coastal resorts.

Business investment

With business activity strong, a number of firms are planning to increase capital expenditure. Ironically, while some investment projects are designed to reduce the need for workers, a shortage of skilled workers is often stated as a reason why some projects are being deferred. Another problem is a shortage of well-located land.

Mining companies tell of embarking on new projects to expand capacity (despite viewing current commodity prices as unsustainable). Most mining companies continue to note difficulties in obtaining certain equipment, such as large tyres.

Production and exports continue to be constrained by capacity in rail and ports and considerable investment is continuing in these areas. A number of contacts mention they would like to make more use of rail transport (and note it is environmentally preferable) but links between major centres were inadequate as there has been insufficient investment over many years.

Employment

Most firms indicate plans to increase employment over the coming year, although many say they would expand employment more if there were more workers available.

Businesses operating nationally highlight shortages of managers, engineers, electricians, geologists, truck drivers, IT staff and chefs (among others) in Western Australia. However, with Perth property prices now the second highest in the country, they say it is very hard to entice eastern state workers to move there. For this reason, many mining companies report increasing use of ‘fly-in-fly-out’ arrangements to run their remote mines.

There are also skills shortages and increased labour turnover in other States. As well as those occupations noted above, there are shortages of accountants, store managers and logistics experts, and specialists such as radiologists. In some places there are shortages of low-skilled workers such as delivery drivers.

Contacts suggested that a shortage of workers in child care is being heightened by 'welfare to work' provisions increasing the demand for childcare. Farmers near mining areas face particular difficulty in retaining workers. And once labour leaves the farm, it is difficult to coax back. Some firms have concerns about the ageing workforces in some trades such as bricklaying. Mining companies are making extensive use of '457' visas, but some smaller employers claim the scheme is too complicated for them to use.

Many companies refer to shortages of apprentices, and a lack of experienced workers to mentor them. Some apprentices are abandoning their training to take well-paid unskilled jobs at the mines. A number of contacts express dissatisfaction with TAFE training, which is often characterised as lacking vibrancy, operating in overcrowded and rundown campuses with poorly paid staff, often retired tradespeople unfamiliar with current techniques and unable to connect with young students.

Wages and other costs

Notwithstanding the tight labour market, there continues to be no generalised surge in wages**,** although there has been a slight rise in the growth rate. Three-year agreements are common, which spreads out the impact of labour shortages on wages. However, some companies report a tendency to promote people faster than their experience would normally warrant. Some are improving the non-wage component of packages such as salary sacrificing for superannuation, cars or notebook computers. Some firms are also finding that they need to offer more flexible working hours to retain and attract staff. Some have responded by improving working conditions, such as by air conditioning offices.

Other costs are generally contained. Firms comment that the world prices of some manufactured goods have stopped dropping as China removes export subsidies. However the Australian dollar costs of imported inputs and capital equipment are being kept down by the appreciation of the Australian dollar. The prices of mining equipment have increased markedly.

Contacts described how the drought has led to some sharp rises in electricity prices (as most electricity plants rely on fresh water for cooling). In the medium term, they noted, emissions trading may result in further increases but trials of meters offering and displaying off-peak prices may lead to a more efficient use of electricity. A number of companies refer to the impact of higher water prices, which are expected to rise further. Many contacts with operations in Perth refer to significant rises in rents.

A commonly mentioned problem is inconsistent regulations and licensing requirements across the States. This unnecessarily drives up business costs.

Some food prices, notably of dairy products, have risen considerably, partly attributable to the drought. This effect could extend for some time as, for example, dairy production will take at least two years to return to pre-drought levels, given the need to rebuild herds. Moreover contacts warn that price rises are not solely due to the Australian drought. Global prices of food have increased as farmland is increasingly used for growing crops used to produce biofuels, demand increases in Asia and subsidies are removed, while there are no longer large stockpiles of rural produce in Europe to buffer price movements.

Prices

Underlying inflationary pressures are rising, although the exchange rate appreciation is containing import prices. Companies suggest that competitive pressures are limiting price increases. This is compressing margins, although profits generally remain strong.

New car prices are static despite cars having more features, while used car prices are falling.

Inflationary pressures are stronger in Perth than in other capital cities, reflecting the mining boom's impact on demand and the property market in particular.

Regional areas

Drought conditions continue to have a serious impact on farmers, although rains have brought relief to some. The recent drought is viewed as worse than 2002-03 by some agriculturalists and their suppliers as it has proved more prolonged.

The May business liaison round included meetings in Cootamundra, Wagga Wagga and Young. Wagga Wagga is developing as a services centre, aided by Charles Sturt University and the defence industry, a diversification which reduces the impact of droughts on the town. This has been reinforced by several companies moving to the region from major city centres, reflecting the lower costs of doing business. However, some companies in the region are reporting labour shortages.

Water allocations are regarded as a crucial challenge for the Riverina and wine and fruit growers. Abattoirs' business surged as farmers sought to cut stock levels during the drought but has since dropped away after the mid-2007 rains.

The July business liaison round included meetings in Newcastle. Its port, the world's largest for coal exports, remains a key issue. The number of ships off Newcastle had peaked at 78 after severe storms along the NSW coast disrupted shipping and rail operations. There were around 40 in the queue in November. However, this queue understates the excess demand as quotas are still in force.

The largest employers in Newcastle now include the hospital and the university, rather than being dominated by mining-related businesses.

The October round included meetings in Rockhampton and Gladstone. The strength of the mining sector is underpinning strong growth in these towns. Large capital expenditures are being undertaken to expand the capacity of Gladstone's port and the aluminium smelter. Rockhampton continues to be a centre for the beef industry but significant employment also comes from Central Queensland University and regional offices of government departments. Rents and house prices have increased in recent years and there are shortages of both temporary and permanent accommodation. Contacts report that this has pushed the poorest and least skilled people out to small towns and declining villages with poor transport and health care.

Carbon pricing and trading

Many companies support a prompt introduction of an emissions trading/carbon pricing scheme to reduce uncertainty about the regime to be adopted. There still appear to be a number of companies that have given little thought to the implications of carbon pricing, apparently assuming widespread 'grandfathering' or protection of existing producers, or that they can pass on cost increases with minimal effect on demand.