

## TREASURY MINISTERIAL SUBMISSION

2 April 2019

PDR No. MS19-000701

Treasurer

cc: Assistant Treasurer, Assistant Minister for Treasury and Finance

**BUSINESS LIAISON – FEBRUARY AND MARCH 2019****TIMING:** For information.**KEY POINTS**

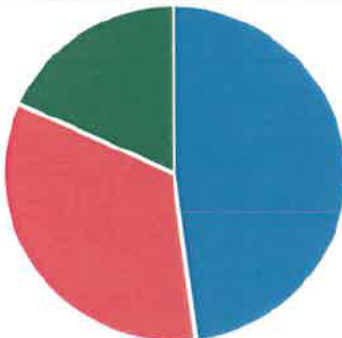
- From 1 February to 15 March, the Macroeconomic Conditions Division discussed current and expected economic conditions with contacts across Australia as part of the Business Liaison Program. Most of these contacts were businesses, in addition to several industry associations s 47E(d)
- Contacts reported:
  - a subdued near-term outlook for residential property, with demand and supply pressures weighing on prices and investment, but contacts are confident that underlying demand will result in a rebound in the medium term;
  - good underlying fundamentals for business investment, but increased uncertainty;
  - a weaker outlook for employment growth, but ongoing skill shortages in technology and specialised mining roles;
  - an expectation s 47E(d) of a gradual lift in wages, but minimal real wage growth expected by firms;
  - weaker consumption and a fall in consumer sentiment, s 47E(d)
  - continued subdued inflation, with grocery deflation only partly offset by higher power prices;
  - heightened uncertainty about the global outlook, but ongoing strength in tourism and education exports;
  - elevated iron ore prices s 47E(d) and
  - price pressures for farming and food manufacturing inputs from the drought.
- An overview of Treasury's business liaison program is provided at Attachment A. Key themes from this round are summarised at Attachment B.

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Angelia Grant  
Division Head  
Macroeconomic Conditions Division  
Ext: 02 6263 3153

Contact Officer: s 22  
Ext: s 22

**ATTACHMENT A – TREASURY’S BUSINESS LIAISON PROGRAM**

<b>TREASURY BUSINESS LIAISON PROGRAM</b>			
<b>February to March 2019</b>			
<b>1. Participation</b>			
Total number of businesses	§ 47E(d)	Days of liaison	22
<b>2. Geographical coverage</b>			
§ 47E(d)			
<b>3. Sector Coverage</b>			
§ 47E(d)			
<b>4. Cultivating and maintaining business contacts</b>			
■ Regularly visited businesses	§ 47E(d)		
■ Newly established contacts	§ 47E(d)		
■ Reconnected with businesses not seen in over 2 years	§ 47E(d)		

ATTACHMENT B – KEY THEMES

Residential property

- Contacts were generally pessimistic about the near-term outlook for residential property. s 47E(d) expectations for peak-to-trough price decreases in Sydney and Melbourne ranged between 10 and 20 per cent, with the largest price declines foreshadowed in the most expensive postcodes. s 47E(d)

*Dwelling demand*

- Businesses attributed weakness in demand to credit tightening, housing price declines and negative sentiment. There was a general consensus that demand had dropped off in recent months, especially in the new dwelling market where prices have not fallen with the established housing market.
  - Credit constraints, which many business contacts believed had recently become more acute, have made it more difficult for buyers to finalise purchases, particularly for the most expensive dwellings.
  - Buyers are confused about market conditions and are taking a ‘wait and see’ approach. Business contacts argued that media coverage of the housing market has also weakened sentiment to purchase. s 47E(d)
  - The decline in housing prices has seen buyers move towards the established dwelling market to take advantage of discounting.
  - s 47E(d) suggested that government should provide solutions that support more affordable new dwellings, which would in turn support the supply of new dwelling investment.
- Despite recent weakness, underlying strength in demand remains. Demand for student housing is increasing, and business contacts argued that the likely lack of high-density projects in the near future could lead to undersupply in as little as three years and put upward pressure on prices. s 47E(d)

*Dwelling investment*

s 47E(d)

s 47E(d)

- s 47E(d) expected dwelling investment to be weak or negative in the near term once the current pipeline of work is complete. There is a high degree of uncertainty around how quickly this will materialise. Weakness in dwelling investment is supported by survey data on forward orders being particularly soft, especially for apartments, as well the recent falls in approvals.
- Investment prospects for residential property are low relative to commercial and public projects that use similar resources. Business contacts noted that in an environment of falling prices and increasing input costs, the investment yield from residential property is low. s 47E(d)

s 47E(d)

- Investment intentions for high-density projects are constrained by pre-sale financing options. Chinese capital controls have seen demand for high-density projects decline and domestic buyers have not picked up the slack.

s 47E(d)

#### *Regional variation*

- s 47E(d) also pointed to regional variation in the outlook for residential property.
  - Prices in Hobart have remained strong, driven by demand from tourists and international students.
  - Housing investment in Perth remains weak, as house prices continue to fall in the longest downswing on record, driven by soft migration trends and changing consumer preferences to not move as often.
  - The housing market in Queensland has been less affected by the recent price cycle than NSW and Victoria. The market has been able to absorb the large quantity of high-density housing that came online.
  - Dwelling approvals in South Australia are at their lowest levels ever, but prices have not fallen to the extent as in Sydney and Melbourne.

**Business investment**

- The underlying fundamentals for investment are good, though contacts noted that uncertainty has increased over the past few months and has softened expectations for the outlook.
  - Trade was noted as a contributor to uncertainty in the investment outlook, largely related to the current USA-China-EU tensions, with Brexit less of a concern. Businesses are looking for clarity and, even if a deal between China and the US were to eventuate, overarching tensions and continued uncertainty between China and the USA will not fully allay nerves.
  - s 47E(d) [REDACTED] noted that the outlook for weaker household consumption growth is expected to flow through to weaker business investment.
- Foreign investment in tourism is stronger and more stable than it was 10 years ago, and more so when compared with mining or agriculture. s 47E(d) [REDACTED]
  - Pockets of investor strength over the past five years in the tourism sector have been noted after long periods of insignificant investment. The current investment pipeline is significant and broad-based and includes accommodation, airport works, cruise terminal works, sporting and transport infrastructure.

*Commodities investment*

- There is a slowdown in new mines being developed, reflecting: lower commodity prices a few years ago; a shift in emphasis to maintain the current, larger capital stock; and an inability to expand existing projects. s 47E(d) [REDACTED]

s 47E(d) [REDACTED]

### **Labour market and wages**

- In general, businesses were not reporting substantial changes in actual or planned staffing levels. However, a few businesses noted that if anything over the next few years they wanted to increase efficiency and reduce staffing levels.
- s 47E(d) expect employment growth to slow. Contacts suggested that the fall in job advertisements indicates that strength in employment growth is coming off in a number of industries. There was disagreement about whether employment growth would be strong enough to hold the unemployment rate down.
  - Job losses were expected in residential construction as investment slows; these could be absorbed by a pick-up in mining.
  - The National Disability Insurance Scheme was cited by business contacts as a major source of employment growth.
  - Confidence in the labour market appears weaker, while churn – a proxy for sentiment – had slowed.
- Business contacts reported skills shortages for IT and autonomous technology jobs, specialised mining jobs and mechanics. There is significant competition for staff with skills in sales, but firms reported that they are still able to fill vacancies.
  - Increased automation is leading some firms to cut employment, while adding technical jobs at higher pay-points. Some firms have begun running ‘dark warehouses’ – where machines but no human staff work.
- While s 47E(d) expected a pick-up in wage growth, they expected it to be gradual. Most firms did not report offering wages growth substantially stronger than inflation.
  - s 47E(d) argued that underemployment remains high, and together with weak inflation expectations is contributing to low wage growth.
- Farmers are concerned about the quality of the regional workforce. Farmers typically require semi-skilled labour, given that employees are required to work more with technology and machinery. While the pay is good, there is a growing proportion of labour that is imported, which could be affected by changes to visa arrangements.
- Employers are offering greater flexibility to staff (sometimes instead of wage rises), although there are some jobs that do not lend themselves to greater flexibility.
- Tasmanian-based firms reported difficulties with matching mainland wages, and some were suffering skill shortages as a result. In addition to lower wages, high costs of living in Hobart (such as expensive rents) and a shortage of rental properties made competing for labour more difficult. There is also a shortage of sufficiently skilled staff in the hospitality sector, ranging from chefs to housekeeping staff.

- Unemployment is high in Queensland due to labour-saving technology in the agriculture sector and advanced manufacturing requiring less labour per dollar of investment. Services has been a strong growth area, but in part-time jobs.

### Consumption

- s 47E(d) noted a fall in consumer sentiment. s 47E(d) did not believe that recent weakness in consumption growth reflected wealth effects from falling house prices, and pointed instead to subdued income growth, high levels of debt and credit tightening. While these may not all be new factors, the low level of the saving rate may mean that they may now be constraining spending. s 47E(d) expected continued weakness in consumption over the next year and some retail firms have reduced their expansion plans. A lift in consumption was seen as dependent on the outlook for incomes.
  - Weak sentiment was attributed to uncertainty about future government policy (both state and federal) and falling house prices.

s 47E(d)

- Firms highlighted several structural shifts in consumer preferences:
  - Consumers may want to see and touch a product in person but then buy it online for a cheaper price.
  - There is an ongoing shift towards healthier food and beverages, s 47E(d)
  - Customers of food delivery platforms are less price-conscious and are willing to pay more than they would previously. While the entrance of these platforms into the food delivery market has increased competition, s 47E(d)
- Several firms suggested that the introduction of a ban on plastic bags meant customers reduced their consumption to an amount that they could instead carry, and delayed purchases of heavier groceries.

### Prices

- Grocery prices continue to contribute to subdued inflation.

s 47E(d)

s 47E(d)

- The drought has contributed to higher prices in some products, such as lamb. Consumers have been switching to cheaper alternatives.

s 47E(d)

### **International and trade**

- s 47E(d) saw a slowing in global economic activity, including in China. Firms cited international risks including trade tensions and a slowing in Chinese economic growth.

s 47E(d)

- Beyond affecting sentiment, both s 47E(d) did not expect a significant impact from trade tensions on Australia.

s 47E(d)

- Tourism is a boom industry in Tasmania.
  - The number of cruise ships stopping in Hobart has nearly doubled over the past four years, increasing the number of passengers from around 100,000 in 2015-16 to 180,000 in 2018-19. While there has been a slight decrease in the number of ships over the past year, there has been a switch to more exclusive ships with higher-spending passengers.
  - Tourism is also putting pressure on infrastructure in more remote tourist locations. There are challenges for sewerage, roads and other infrastructure which together with increased traffic and reduced parking availability is starting to impact amenity for the community.



- Queensland continues to see strong growth in tourism, notwithstanding extreme weather events (see below). Demand is being driven by increasing global affluence and a domestic trend towards spending on experiences rather than objects.
  - Visitor growth numbers from China continue to grow at double-digit rates.

s 47E(d)

**Commodities**

- Iron ore prices have been high after the Vale mining disaster. s 47E(d)

s 47E(d)

- The MYEFO assumption of metallurgical coal prices going to US\$120 per tonne was now seen as too low s 47E(d).
  - There have been setbacks for alternative supply to Queensland’s high-quality metallurgical coal.
- There will continue to be a premium for high-quality Australian thermal coal.

s 47E(d)

**Drought and Townsville floods**

- Drought is contributing to price pressure for farming and food manufacturing input costs. It is difficult to pass the rising costs on to retailers because of their focus on low prices.
  - Regional businesses along the Murray are really struggling.
  - South Australia is predicted to have its smallest crop in 10 years.
  - Some Queensland industries are operating at a loss because of high costs for feed, water and power.
  - Western Australia received significant winter rain and limited frost, and recorded their second biggest value (and largest volume) crop yield.
  
- The Townsville floods have been devastating to the beef industry, but other agriculture had fared reasonably well.
  - The flood came following long periods of drought so most of the losses were breeding stock. However, there were some suggestions that farmers were culling their herds anyway due to the drought. The impact on sugar cane yields will not be known until harvest.
  - Tourism is unlikely to be significantly affected, as Townsville is not on the main tourist track, and the flood occurred in the offseason. However, there is damage to local infrastructure and continued extreme weather events including the 2018 cyclone and reef bleaching have put off domestic visitors. s 47E(d)