Key themes from Treasury’s Business Liaison program

Overview

As part of its quarterly Business Liaison Program, Treasury met with 51 businesses and organisations in eight capital cities and regional centres in February, and held teleconferences with a further three businesses in early March. Treasury greatly appreciates the commitment of time and effort made by the businesses and industry associations that participate in this program.[1]

Overall, liaison contacts pointed to continued strength in the economy underpinned by the mining sector, with strong external demand for resources exports and a range of major mining investment projects underway and in the pipeline. Elsewhere the economy is patchy, with weakness in manufacturing, retail trade and residential construction. The floods and cyclone in January and February have had a substantial impact on rural and non-rural production and have caused significant damage to infrastructure.

Activity

A focus of the round was the economic impact of the floods and Cyclone Yasi in January and February 2011. Several states were affected, but Queensland bore the brunt of the economic impact.

The key economic impact has been through the effects on coal production and exports. The floods halted production in mines and cut key transport infrastructure. Contacts suggested that the loss of coal production is estimated to be between 20 million and 30 million tonnes. Although weather conditions have normalised, mines are still affected by flooding: some mines are still flooded and face logistical and regulatory hurdles (because of the water salinity) in pumping out the water. While the greatest impact will have been in the March quarter, effects appear likely to extend into the June quarter. Lower coal exports have been partly offset through higher prices, which have increased sharply in response to the temporary supply constraints. Notwithstanding the immediate problems, prospects for the industry are strong, with businesses looking to expand production through increased investment.

The floods have led to a significant loss of agricultural production in some states, with both the volume and quality of output suffering. That said, contacts noted that, floods aside, the rains have been good for the sector overall, and are encouraging a positive outlook. Rising prices for crops and livestock are restoring optimism, and are leading some farmers to increase their overall expenditure and rebuild their stocks.

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

The floods and cyclone have also had an adverse effect on the tourism industry, reducing numbers during the crisis but also affecting near-term prospects. Contacts noted that the tourism industry was already labouring under a range of problems: aging infrastructure, a high cost structure, increasing competition from the Asian region and the high dollar, and that slower growth is likely to persist for some time.

Contacts reported that the elevated exchange rate is also placing competitive pressure on other firms in the tradeables sector that are not benefiting from the mining boom. In some cases this is creating an uncertain outlook.

Contacts confirmed that households appear to be more cautious with their money, with retail sales subdued and residential construction weak. Contacts also mentioned that interest rate rises and banks' tighter financing requirements are affecting buyer confidence.

Contacts suggested that there are tentative signs that the commercial property sector is starting to recover, and gaining strength in some parts of Australia, particularly inner-city commercial developments. However, it remains very weak in some areas, particularly in Queensland.

Employment and wages

The expectation is that the labour market will approach capacity in the next two years, with strong employment growth and low unemployment.

There is increased demand for some specialised skills, particularly in Western Australia and Queensland, and this is expected to flow through to other states' labour markets. Skills shortages within the resources sector and in some other sectors, notably construction, may start to drive wage pressures, with some employers saying they are willing to pay a premium to attract skills. This may see pressures emerge in other sectors as labour migrates to higher-paying firms. Other businesses in the sector are already reporting increased competition for labour, and some firms in the weaker sectors are reporting a reduction in staff numbers.

Firms are taking various approaches to bridge the overall skills gap. Some are importing labour, including from overseas branches of multinationals, and also importing plant and equipment to reduce the need for domestic construction. Other firms are shifting to less labour-intensive production.

To date, wage agreements are generally providing increases of around 3 to 5 per cent, with larger rises being experienced in some specialised professions and trades.

Costs and prices

Costs and price pressures remain contained, although contacts are experiencing increased fuel and utility costs, attributing the latter to increased network charges and capital expenditure. Margins were being squeezed for those contacts with limited scope to pass costs through to consumers.

Contacts reported that the higher dollar is reducing the cost of imported inputs, although the reductions are sometimes slow to feed through.

Retail discounting prevailed through Christmas and into the New Year in response to weaker demand. Increased consumer caution and the wet weather are thought to be partly behind the weakness as are interest rates, although the cash rate had remained steady since the last liaison round.

The outlook for commodity prices remains robust, underpinned by expectations of ongoing strong demand from China and India. Recent disruptions to coal supply associated with adverse weather events in Queensland have resulted in a spike in coal prices, which are expected to unwind as supply comes back online. Contacts remain fairly bullish on iron ore prices, noting that ongoing global demand pressures will underpin prices in the medium term. More broadly, contacts anticipate that commodity prices will ease off gradually over the medium term, rather than falling sharply.

Financing and Investment

Credit conditions remain tight for some borrowers, particularly medium-sized businesses, although conditions have improved significantly since the difficult conditions during the global financial crisis.

The robust outlook for mining continues to underpin a pipeline of strong mining investment, which will boost production. Along with infrastructure and port expansions, this will help the sector to meet demand, reducing some of the costly delays at ports and terminals which are currently hampering the industry.