

## **Key themes from Treasury's Business Liaison Program**

## Overview

As part of its quarterly Business Liaison Program, Treasury met with 53 businesses and organisations in November, in five capital cities and by teleconference. Treasury greatly appreciates the commitment of time and effort made by the businesses and organisations that participate in the program.

Liaison discussions confirm strong activity in the resources sector supported by robust demand from emerging Asia, particularly China. As demand is being driven by the longer-term needs of these economies, the deterioration in global conditions and recent falls in non-rural commodity prices are not expected to have a significant impact on activity or investment. However, weak conditions persist in some industries outside of the resources sectors. Weak demand continues to constrain growth in retail and construction, and the high exchange rate is maintaining pressure on the manufacturing sector notwithstanding the recent modest depreciation.

Labour market conditions in the mining sector remain tight, with strong wages growth for skilled labour in some occupations. On the other hand, wage pressures are easing across the majority of the non-mining sectors of the economy where most workers are employed.

## Activity

Activity in the mining sector is buoyant, driven by growth in the emerging economies of Asia, which so far remains intact despite the weakness in advanced countries and global financial volatility. The recent drop in iron ore prices is not expected to have a significant impact on activity as contacts attribute it to seasonality, additional supply from South America and large stockpiles of iron ore in China, which are factors unrelated to the longer-term dynamics driving demand for Australia's resources. However, the slower-than-expected recovery from the adverse weather events in early 2011 will continue to have some impact on coal production over the coming months.

Economic activity remains uneven across the rest of the economy. Conditions in the manufacturing sector are mixed, with firms servicing the mining sector outperforming businesses in the non-mining sectors. However, most manufacturers continue to cite the high exchange rate as having a negative impact on their business, notwithstanding recent falls in the Australian dollar.

Retail sector contacts report a sluggish start to the Christmas sales period with soft consumer spending on discretionary items, although spending on non-discretionary items remains solid. This weakness is affecting transport activity with little product moving on the east coast. Consumer sentiment remains below its long-run average despite a recent pickup, in part reflecting continuing volatility in global financial markets and uncertainty about how this could impact on Australia. After slow sales

growth in September and October, retailers are now looking to November's interest rate cut to boost sales in the coming months. Those contacts that are experiencing growth attribute this to gains in market share through the opening of new stores.

Contacts report that conditions in the commercial property sector remain weak. Discussions confirm that conditions in the residential construction sector also remain subdued, consistent with the softening housing market. In Victoria, residential construction activity is likely to moderate further from recent elevated levels, while the outlook for the Queensland market remains pessimistic. However, the New South Wales detached housing market is starting to recover from the record low levels of recent years.

### Employment and wages

Hiring intentions continue to vary across sectors with strong intentions in mining and a more subdued outlook for the non-mining sectors. Firms in the mining and mining-related sectors of the economy report high levels of turnover with skilled labour able to move between firms with ease. Businesses report that the strong competition for labour means that potential recruits are placing significant value on non-pecuniary factors such as conditions, quality of work and firm reputation.

Contacts suggest that strong growth in wages and other forms of remuneration on offer in the mining sector are now starting to attract labour from non-mining firms, with those in Western Australia and Queensland reporting more difficulty in recruitment than non-mining firms in other states.

Strong wages growth in the mining and mining-related sectors of the economy, where shortages of skilled labour are being felt most acutely, is expected to continue in the near term. By contrast, contacts in the non-resources-related sectors report that wage pressures are easing across the majority of the non-mining sectors of the economy.

### Costs and prices

Contacts report that the outlook for prices is generally benign, although some firms expect the recent modest depreciation in the Australian dollar to put upward pressure on the price of imported goods in the near term. Retail contacts expect this to place additional pressures on margins with firms having little scope to increase prices given weak consumer demand.

### Financing and investment

Mining-related investment remains strong despite the recent volatility in global commodity prices as investment plans are being made over long time horizons. However, capacity constraints are emerging due to shortages in some specialised skills and delays in the completion of infrastructure to support further investment.

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An uncertain outlook for construction sector activity means some firms are limiting their expansion plans to alterations or additions that are absolutely necessary. Access to credit remains an issue in the non-residential construction sector with banks imposing more restrictive conditions on lending, leading to projects being delayed or scaled back.