

Box B

Insights from Liaison

This Box summarises information collected by five teams based in Adelaide, Brisbane, Melbourne, Perth and Sydney during discussions with around 230 businesses, industry bodies, government agencies and community organisations over the period from the beginning of May to early August 2023. Further information on the Reserve Bank's liaison program is provided in the September 2022 *Bulletin* article 'The Reserve Bank's Liaison Program Turns 21'.

The slowing in growth in private sector economic activity has been evident in information collected through the liaison program over recent months. Firms report that household consumption and demand for new residential construction have been subdued. Employment intentions have eased over the past six months, as has growth in most firms' costs and prices. Current and expected wages growth have been stable, though wage pressures remain higher than for many years. Contacts expect household spending and demand for residential investment to remain subdued over the next 12 months.

Household sector

Household consumer demand has softened

Sentiment of retailers in the Bank's liaison program has continued to deteriorate over recent months alongside declines in sales volumes. While most retailers have recorded modest declines in sales, a small number of household goods and clothing retailers have reported large falls in recent months. Firms report that low consumer confidence and cost-of-living pressures, including from

higher interest rates, have led to more cautious spending. This has included households, particularly those on lower incomes, trading down to cheaper products and reducing basket sizes. Sales volumes at some retailers that target value-conscious shoppers have been relatively resilient, while other similar stores have reported large declines in their sales.

Spending on services has held up more than that for goods over recent quarters, though spending growth on some discretionary household services has slowed in recent months. Sales growth at hospitality venues has moderated slightly. Domestic tourism demand has declined, driven by reduced spending on leisure travel. The decline in tourism demand has been larger in some regional areas than capital cities, partly reflecting households substituting back towards overseas travel. Spending on discretionary services, such as major events, remains elevated. In the higher education sector, growth in domestic student numbers has been weak; contacts attribute this to the tight labour market, with many potential students choosing to work rather than pursue university study, and to pent-up demand for travel and gap years.

Firms expect household spending to decline further over coming months. Most retailers expect sales volumes to remain subdued, particularly for non-essential items. Domestic tourism contacts generally expect demand to weaken further in response to higher interest rates and other cost-of-living pressures. Universities see the outlook for the higher education sector as highly uncertain, and dependent on how the job market evolves over the next 12 months.

Community services organisations are providing more assistance

In discussions with the Bank, community services organisations have continued to emphasise an increase in calls for their services over the past six months, including for housing assistance, financial counselling services, mental health services, domestic violence services and food support. They attribute this largely to increases in basic living costs – for example, on housing, energy and food – which constitute a larger share of spending for people on lower incomes. Contacts have said that the shortage of affordable housing and the higher cost of living are causing an increase in homelessness. People with jobs are now also seeking food support assistance more often than in the recent past and higher interest rates have contributed to an increase in demand for services from people with a mortgage. Community organisations report ongoing difficulties in their operating environment due to staffing challenges, reflecting the tight labour market, higher costs and concerns about funding levels.

Business sector

Residential construction activity is expected to decline

Challenges in the delivery of new housing have persisted over recent months. Shortages of trade labour continue particularly around the latter stages of construction, such as for tilers and painters. The elevated number of construction firm insolvencies is also contributing to delays because alternative arrangements need to be made for project completions. These delays mean some residential construction firms still have a backlog of work to be completed, which may push out the decline in aggregate residential investment. Completion times improved modestly over the quarter, and a return to more normal build times is anticipated in 2024.

Firms expect that residential construction activity will start to decline from the latter part of this year due to very low sales of new homes over recent quarters feeding through to a lower level of work to be done. A scaling back of projects in some cases is also expected to contribute to this decline. Leading indicators of activity appear to have stabilised at low levels, partly supported by a modest increase in new detached home sales and increased investor demand in Western Australia and Queensland. Over the medium term, a number of contacts are more optimistic, supported by strong population growth. However, the current lack of a supply response amid strong underlying demand from the increase in population is expected to lead to ongoing tightness in rental markets for the period ahead.

Financial conditions among construction firms continue to be tighter than firms report in most other industries. Finance is less

readily available, and the cost of funds has risen in line with higher interest rates. Some contacts are concerned that a high number of insolvencies in the industry will persist over the period ahead and further dampen confidence in the sector.

Business investment intentions have softened recently

Many contacts continue to report that their investment levels have been elevated over recent quarters and that further investment is planned in the near term. Liaison suggests that resources investment will increase a little over coming years, driven by bulk commodity projects and supported by investment in battery minerals. The level of non-mining investment is being supported by a broad range of projects across renewable energy, transport, storage and infrastructure construction. Many firms also have digitisation and automation projects underway or planned.

Most firms report that finance remains readily available, though the cost of debt has increased in line with cash rate rises. That said, some smaller businesses are reducing their investment intentions because of higher interest payments and deteriorating business conditions. Further, over recent months firms have generally reported that a range of factors, including a slowing economy, have led to an easing in their investment plans for the next 12 months (Graph B.1).

Firms also report a number of risks to the timely delivery of their investment plans. Securing labour is still a challenge for construction and engineering projects and related delays are common. Major electricity transmission projects, and associated renewable energy generation projects, are at

risk of being pushed out because of difficulties in securing land access. Commencement of some new office projects have been delayed because vacancy rates are elevated in many major cities and office values have declined. Firms have also noted that lower valuations for offices are expected, which may weigh on financing and new project commencements.

Exports are expected to grow over the period ahead

Services exports have recovered further. International student commencements increased in the first half of the year and have reached their pre-pandemic levels at several universities. Demand from students from South Asia has been a strong driver of the recovery, and universities expect student commencements to grow further in the second half of 2023. However, contacts have flagged that the tight rental market may constrain increases in student numbers going forward, particularly in Brisbane and Sydney.

Sales at international tourism operators have grown over recent months as overseas visitors have returned; however, sales

Graph B.1



generally remain below pre-pandemic levels. International flight capacity is still regarded as a constraint on a full recovery of overseas visitors and the recovery in Chinese tourist numbers continues to be slower than the broader recovery in inbound tourism demand.

Commodity exports are generally expected to rise. In addition to an expected modest increase in bulk commodity exports, investments in productive capacity for battery-related minerals will boost exports of non-bulk mining commodities in the period ahead. On the agricultural side, contacts expect livestock supply and, in turn, exports to increase a little further over coming years. By contrast, non-livestock rural exports are expected to decline over the next 12 months, from very high levels, as drier weather conditions lead to lower crop production.

Hiring intentions are little changed, and labour availability has improved

Hiring intentions for most liaison contacts have remained broadly steady over the past few months (Graph B.2). Most firms are still looking to either increase or maintain headcount over the year ahead, and labour demand for household services firms remains resilient. Intentions have weakened for firms exposed to the residential construction sector, consistent with expectations for a decline in construction activity. A number of firms in the wholesale and retail sector have also reported lower hiring intentions; some have already reduced employee hours over recent months in response to declining demand and an increased focus on cost control.

Hiring new labour has become a little easier for most firms in recent months, and staff turnover rates have generally declined.

However, both labour availability and turnover remain more challenging for firms than prior to the pandemic, and some continue to report little improvement in conditions. For those firms reporting an improvement in hiring conditions, several linked this to an increasing availability of both skilled and unskilled foreign workers, consistent with the increase in migrants.

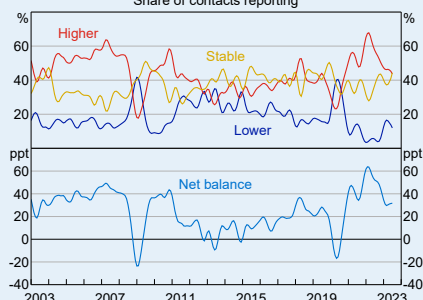
Costs and prices

Private sector wages growth is still tracking around 4 per cent

Firms reported that year-ended growth in private sector wages was around 4 per cent in the June quarter, similar to the March and December quarters. Around 60 per cent of firms reported wages growth of between 3 per cent and 5 per cent, and one-quarter of firms reported wages growth above 5 per cent (down from around one-third of firms in late 2022) (Graph B.3). Overall, reported wages growth over recent months remains above pre-pandemic growth rates in all industries; the range of observations across firms is broadly similar to that seen in the mid-2000s.

Graph B.2

Employment Intentions* Share of contacts reporting



* Over the year ahead, smoothed with a 13-month Henderson trend.
Source: RBA.

For the past 12 months, firms' expectations for year-ahead wages growth have been steady at around 4 per cent. Wages growth is expected to moderate somewhat over coming quarters for workers covered by individual agreements, but to be similar or a little stronger for other workers. This year's Fair Work Commission decision for award wages was higher than some firms anticipated, but few expect it to have a larger spillover effect on wage bargaining outcomes than in prior years. Around one-quarter of firms expect wages growth to slow over the year ahead, with these firms noting drivers such as lower staff turnover, less competition for labour, slowing business conditions and cost control.

The pace of overall input cost increases continues to ease

Many firms have reported a further slowing in the pace of input cost increases over the past few months. The cost of imported goods is declining as availability of products

improves. International freight rates have declined to be closer to pre-pandemic levels (and in some cases are lower), alongside slowing global demand and increased freight capacity. However, cost increases from domestic inputs have remained high – particularly energy, labour (discussed above), transport and insurance – and these increases are partially offsetting the lower costs of imported goods.

Firms on the east coast are still reporting large increases in energy costs where prices are variable or contracts have been renewed. Some contacts have been less exposed to rising energy prices because of pre-existing long-term contracts or because they have rooftop solar power. Several firms expect energy costs to increase further in the period ahead as contracts are renewed. The price of default electricity offers for small businesses on the east coast increased by around 15–30 per cent on 1 July 2023 (and by 21–25 per cent for households).

Overall, firms still expect growth in their aggregate costs to ease further over coming months but note ongoing domestic cost pressures.

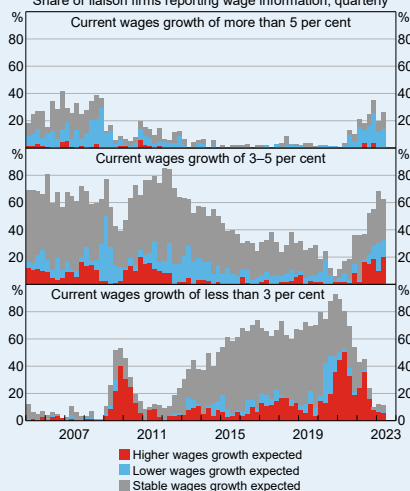
Price pressures persist, but firms are increasingly cautious about raising prices

More firms expect price growth to slow, rather than accelerate, over the next 12 months (Graph B.4). Firms have noted in recent months that ongoing labour cost increases are placing upward pressure on prices. Most goods-related firms intend to increase prices in response to costs growth, but typically expect these to be smaller than over the past 12 months. This reflects the overall easing in the rate of cost increases as well as firms being cautious about the detrimental effects that large price rises

Graph B.3

Current Wages Growth and Expectations

Share of liaison firms reporting wage information, quarterly



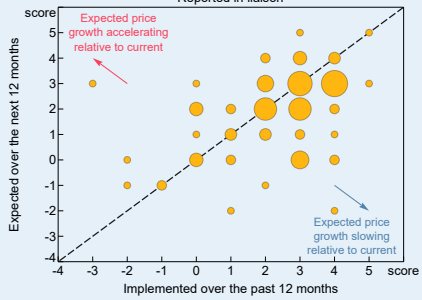
Source: RBA.

might have on demand. Some retailers have been discounting in response to a decline in demand or to clear excess inventory, while others have noted rising competition – both of these factors are expected to weigh on price increases over the next 12 months. ✖

Graph B.4

Firms' Price Changes*

Reported in liaison



* Compares quantitative scores assigned by staff based on the extent of change in the key economic variables firms expressed in meetings over the past three months; dot size is proportional to the number of firms recording that combination of current and expected price outcomes.

Source: RBA.