Box A

Insights from Liaison

This Box highlights key messages collected by teams based in Adelaide, Brisbane, Melbourne, Perth and Sydney during discussions with around 200 businesses, industry bodies, government agencies and community organisations over the period from the beginning of November 2023 to the end of January 2024.

In recent liaison discussions, firms have generally reported a clear slowing in demand over the past 12 months, though some have indicated that they are in a better position than they had previously expected. Demand conditions in most industries are generally expected to stabilise over coming months. The moderation in demand is making it more difficult for firms to increase prices. Together with continued reports of upward pressure on the costs of labour and other inputs, this is weighing on profit margins, and firms are widely reporting an increased focus on reducing costs where possible. Consistent with this, there has been a clear softening in firms' employment intentions and expected wages growth over the next 12 months.

Consumer spending remains subdued and is increasingly price-sensitive.

Discussions with contacts suggest that household consumption has been fairly flat over recent months after growth eased through most of 2023. Contacts report that consumers remain more budget-conscious in their spending than earlier in this cycle, particularly for more discretionary consumption.

Over recent months, retailers continued to report lower sales volumes than a year earlier, despite extensive promotions during the Black Friday, Christmas and Boxing Day sales. Contacts note that consumers are concentrating their spending during these and other promotional periods as they search for bargains. Retailers generally expect current conditions to persist over coming months and that consumers will remain budget-conscious.

Domestic leisure travel spending remains elevated but below the post-pandemic highs seen in 2022; this decline over the past year has been more pronounced in Queensland and the Northern Territory. In recent months, some contacts have noted a trend towards shorter holidays closer to home as travellers try to keep household costs down.

Household demand for assistance from community services organisations remains very strong, driven by constrained housing availability and affordability, as well as broader cost-of-living pressures. Contacts in this sector continue to see requests from people who have not previously sought assistance, including wage earners and those with mortgages.

International student numbers have largely recovered to pre-pandemic levels, with slower growth expected over the next 12 months.

Further growth in new international student university enrolments is anticipated for the upcoming academic year, but at a slower pace than seen over the past two years. A number of contacts in the tertiary education sector have flagged concerns around the availability of suitable student accommodation. While not currently a binding constraint on further enrolment growth, demand for accommodation is nevertheless very strong and increasing. Several contacts have also noted that recent and pending changes to student visa policy settings could affect the outlook for international enrolments.

International tourism has picked up over the past year but remains below pre-pandemic levels. International visitor arrivals are expected to reach pre-pandemic levels later in 2024, supported by a strong recovery in Chinese demand.

Home building is expected to slow over 2024 as builders work through the backlog of construction work.

Contacts in the detached housing industry generally report that they are still busy as backlogs continue to be worked through. While builders' margins are improving and supply chains have largely normalised, firms continue to report some challenges in sourcing contractors and labour, particularly for finishing trades. Builders and civil contractors also regularly note competition from non-residential construction activity in sourcing materials and labour, which is maintaining upwards pressure on costs.

Overall, contacts in this industry are expecting less activity in the coming year due to slower land and building contract sales in 2023. Regional variation in the outlook across housing industry contacts became more apparent over the second half of 2023, as the effects of pandemic-related policy measures faded and other demand drivers (such as population flows and relative affordability) increased in importance.

For higher density residential developments, contacts are still reporting an unfavourable commercial environment for new projects due to elevated costs for land, financing and construction, as well as constrained purchasing capacity by prospective owners. Looking ahead, some contacts suggest that apartment building activity could pick up relatively quickly in some markets once construction costs stabilise, given the strong underlying demand for housing.

Infrastructure construction activity remains strong and capacity remains stretched.

Contacts working in the infrastructure sector note that capacity to deliver the large amount of current and prospective projects remains stretched. A few firms supplying this sector have recently reported some easing in demand conditions, consistent with some delays and reductions in government spending. Private sector resource and energy sector investment intentions remain solid, but some firms note concerns around adding pressure to an already capacity-constrained industry, as well as noting uncertainty around the timing of expenditures given ongoing regulatory and approvals processes.

With regards to non-infrastructure business investment, firms report ongoing expenditure on a broad range of projects including those relating to digitisation and automation, technology, fitouts and refurbishments. Some firms have reported slowing their investment plans, however, citing concerns over input and financing costs.

Firms are finding it more challenging to increase prices, while overall cost pressures remain elevated.

As growth of demand has slowed, an increasing number of firms along domestic supply chains have noted that their customers have become less willing to accept cost increases being passed through to prices, and contacts generally expect to make smaller average price increases over the year ahead than over the past 12 months.

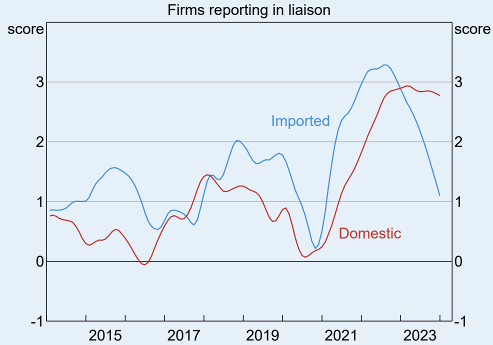
For firms sourcing imported goods, supply chains have largely normalised and shipping costs remain lower than in the peak of the pandemic, which has slowed price increases for downstream customers (Graph A.1). Most liaison contacts have reported only limited supply chain problems associated with either domestic port disputes or the recent disruptions in international shipping routes, although some firms have experienced delays in recent weeks.

Firms otherwise generally note that overall input cost growth remains elevated, which is intensifying their focus on cost discipline. Key non-labour cost drivers that have been called out by contacts include logistics, fuel, utilities, insurance and professional services fees. Some – typically larger – firms have reported being able to push back on increases from upstream suppliers, but other firms are experiencing a long tail of cost increases that is challenging to absorb or offset. Overall, though, firms report that growth in non-labour input costs has been gradually easing, with further easing expected over the next 12 months.

Graph A.1

Indicators of Non-labour Costs*

Firms reporting in liaison



* Over the past 12 months; smoothed with a 13-month Henderson trend; a score of 0 indicates a firm has reported no change in average non-labour input costs, while a score of 2 indicates a firm has reported around-average increases.

Source: RBA.

Firms are managing labour costs more tightly, which is feeding through to a moderation in their employment intentions and wage expectations.

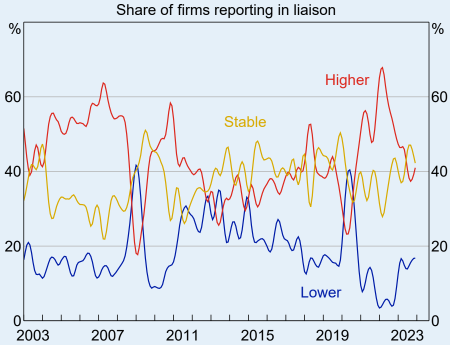
Firms continue to report strong growth in labour costs over the past couple of years. As part of controlling this, and in response to slowing demand, fewer firms are looking to expand headcount over the next 12 months, and employment intentions have declined to around longer run levels after peaking in 2022 (Graph A.2). Firms report that voluntary staff turnover rates have continued to decline and that labour availability has improved in recent months, though contacts across a broad range of industries note that finding suitable labour generally remains more difficult than prior to the pandemic.

Higher labour costs also reflect ongoing strong wages growth, which liaison suggests averaged a little above 4 per cent for the private sector over the year to the December quarter. Firms continue to note that wages growth for staff on individual agreements has been slowing but that this is being offset by a pick-up in award and collective agreement wages. The majority of contacts are anticipating slower wages growth over the next 12 months, with average expected year-ended growth currently around 3½ per cent. This slowing reflects expectations of lower inflation and award rate outcomes in the coming 12 months, as well as an increased need to reduce business costs and a slowing labour market.

Graph A.2

Employment Intentions*

Share of firms reporting in liaison



* Over the next 12 months; smoothed with a 13-month Henderson trend.

Source: RBA.