Box A

Insights from Liaison

This Box summarises information collected by five teams based in Adelaide, Brisbane, Melbourne, Perth and Sydney during discussions with around 250 businesses, industry bodies, government agencies and community organisations over the period from the beginning of August to the end of October. 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 Bank's liaison contacts continued to report strong demand for goods and services over the past three months. Conditions in the labour market remain very tight and wages growth has picked up further. Most firms continue to operate at or very close to full capacity and investment intentions remain at or above average levels for most industries; cost increases and ongoing input shortages present a risk to their plans. However, there are signs that firms are starting to see turning points in a range of economic conditions. While retail demand remains elevated, it seems to have plateaued in real terms and sales of new homes have declined. Hiring intentions have eased from very high levels and wages growth is expected to pick up further in coming quarters. A small but growing number of goods-related firms have reported an easing in their non-labour cost pressures recently. While most firms intend to increase prices further in coming months, these increases are generally expected to be smaller than those of late.

Household sector

Consumption remains buoyant but growth has slowed recently

Retail contacts generally described conditions as remaining buoyant but with some slowing in growth in nominal sales in recent months. A few contacts observed that some customers appear to be buying cheaper brands or shopping around more than they were earlier in the year. Sales at cafes & restaurants outside of CBDs were reported to be back around pre-pandemic levels. The recent increase in nominal retail sales appears to be mainly driven by price increases rather than higher volumes (see below).

Many tourism contacts reported that spending on domestic tourism has recovered to be at or above pre-pandemic levels, largely driven by leisure travel. Some contacts noted that business travel has been slower to recover. Domestic demand for university education continues to be low, in part because strong labour demand is encouraging more participation in the labour market.

Firms expressed mixed views around the outlook for household spending. Hospitality sector contacts were generally optimistic. While some retailers noted concerns that low consumer sentiment could translate into reduced spending on durable goods, other retailers suggested that favourable labour market conditions should continue to support demand for at least the next three to six months. Tourism contacts conveyed concerns that Australians may start to travel overseas in greater numbers before international tourism picks up sufficiently to make up the shortfall in the domestic sector.

Higher cost of living has lifted demand for community services

Community service providers reported an increase in demand for financial assistance due to higher cost-of-living pressures. Those seeking assistance are primarily households that rent, although there has been a pick-up in recent home buyers contacting community service providers. Affected households were said to have reduced their consumption of fuel, utilities, food and medicines, and in some cases sought financing to cover their expenses. The sector's capacity to meet higher demand for services is being constrained by funding limitations and labour shortages, with the sector also experiencing high turnover rates and a lower level of volunteers relative to before the pandemic.

Business sector

Investment intentions remain at or above average

Most firms reported that finance remains readily available, which has supported ongoing plans for investment; however, financing conditions have been more difficult in the construction and fossil fuel-exposed industries for some time. Various supply constraints and uncertainty about costs for delivering projects are a concern for firms and these issues have made project feasibility estimation more difficult. In this context, some firms noted downside risks to the outlook for the volume of their investment.

Investment intentions in the transport & storage and wholesale & retail trade industries have declined from a high level over recent months. Investment plans among mining and mining-associated firms vary – some miners plan to increase their capital expenditure over the coming year, while others plan to prioritise sustaining investment rather than investment that supports expanding production.

Housing construction continues to face headwinds from a range of supply-side factors

Residential construction work remains at a high level, with many builders and developers reporting a substantial pipeline of construction activity still to be worked through. Challenges to obtaining tradespeople in a timely fashion persist and contacts noted that availability of labour remains a significant constraint on the ability to get work done. Bad weather on the east coast of Australia has also disrupted construction activity. Some firms reported that construction materials had become somewhat easier to obtain in recent months, but overall obtaining materials remains more difficult and expensive than was the case pre-pandemic.

Sales of new homes for construction have fallen alongside rising interest rates and the reduction in fiscal support for home building. As a result, the outlook for residential construction firms' output is expected to be lower from mid-2023, once the existing order book is worked through.

The outlook for exports is mixed

The number of international students and other visitor arrivals has continued to recover in recent months, and international student commencements have picked up at a faster pace than expected by some contacts. However, contacts remain concerned that the outlook for global economic conditions may hinder the recovery in international tourism. Bulk commodity exports have been affected by planned and unplanned maintenance over recent months. The third La Niña event on the east coast is also seen as a risk to the outlook for production and export volumes for commodities.

Employment intentions remain very strong but appear to have eased a little

Hiring intentions remain elevated but are not quite as high as they were a few months ago. Based on firms spoken to in liaison, the share of firms that intend to increase headcount over coming months declined from around 70 per cent a few months ago to around 55 per cent in October. However, very few firms plan to reduce headcount. Hiring intentions in the quarter were strongest in the business services and transport & storage industries.

Difficulties obtaining appropriate candidates continue to be widespread across location, industry and occupations. Some of the positions noted to be difficult to fill were those in information technology, human resources, accounting, construction-related trades and in the rural sector. Some noted that labour availability had improved a little recently; however, for many firms – including those whose staff work in close proximity, such as manufacturers – illness-related absenteeism remained a challenge.

Costs and prices

Private sector wages growth has continued to pick up

Firms reported that year-ended growth in base wages had increased to be a little above 3½ per cent, although with a wide range of outcomes across firms and industries.[1] This compares with an average increase of around 3 per cent reported by firms in the three months prior. The increase over recent months reflects firms' responses to strong labour demand, the award wage increases announced by the Fair Work Commission and higher inflation outcomes.

Around one-quarter of firms reported wages growth over the past year of more than 5 per cent. This is in contrast to the years leading up to the pandemic when very few firms reported wages growth above 5 per cent. The strongest reported wages outcomes at an industry level continued to be among firms in the construction and business services industries (Graph A.1). Wage freezes and wage declines have become rare over the past year.

Many firms continued to report the use of non-base wage measures to attract and retain staff but have found that larger base wage increases have also been needed.

Liaison contacts across a wide range of industries indicated that they expect a further pick-up in wages growth in coming quarters. Around two-thirds of firms over the past three months expect wages growth of between 3–5 per cent and around 10 per cent of firms expect growth of more than 5 per cent. Around one in four contacts expect wages to grow more slowly over the coming year than over the previous 12 months. Most of these contacts are at firms that had wages growth of more than 5 per cent over the past year, and around half still expect wages growth at their firm to be above its historical average over the next year.

Other cost pressures remain elevated but have started to ease

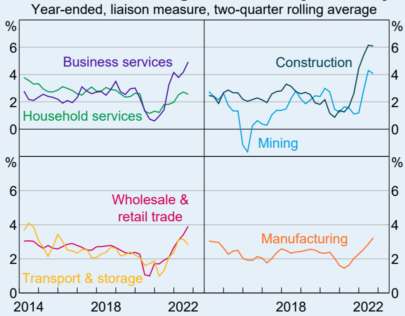
While non-labour cost pressures remain elevated, some contacts noted that the prices of materials and freight had stabilised or even declined a little recently. Retail contacts reported that wholesalers continued to seek to renegotiate higher prices for their goods, and that higher input costs remained a challenge for manufacturers. Construction firms reported further large increases in subcontractor rates recently, but also that the rate of increase for the cost of materials had slowed following some improvement in supply chains.

Firms are highly uncertain about how their non-labour costs will evolve over the coming year. On the one hand, goods-related firms said global demand could weaken, which should reduce upwards pressure on costs. On the other hand, most firms do not expect

Graph A.1

Private Sector Wages Growth by Industry

Year-ended, liaison measure, two-quarter rolling average



Sources: ABS; RBA

shipping times and reliability, or the availability of materials, to fully normalise for several quarters yet and some reported that the recent AUD/USD depreciation, if sustained, will add to the cost of imported goods. Energy costs are expected to increase further in the period ahead as higher wholesale electricity and gas prices continue to be passed through to end-users' energy prices. Firms also remain concerned about the prospect of supply chain issues persisting.

Previous cost increases are still being passed through to prices

Price increases have remained widespread over recent months. Home builders continued to report that they had increased their prices for new sales. Higher costs from wage increases had also been passed through to prices paid by customers at cafés and restaurants, where labour is a comparatively large share of costs. Most other retailers also reported that they had increased prices in the three months to October.

Many firms currently expect to increase prices further over coming months, including in the professional services and construction industries and at cafes & restaurants. By contrast, some other retailers reported they had reduced the size of price increases planned for coming months relative to a few months ago, while others reported increased discounting.

The key messages from the Bank's liaison program on prices and wages have been in line with those from the latest earnings reports and related investor conference calls by listed Australian companies in their six-monthly reporting season (Graph A.2).[2]

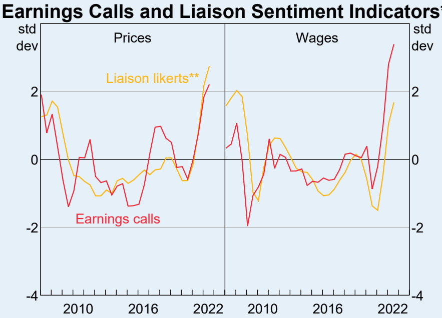
Recent flooding is expected to increase food prices over coming months

Recent flooding in south-eastern Australia has been disastrous for many households and businesses. Contacts expect significant personal losses to property and motor vehicles in affected areas, and there has been an increase in demand for financial assistance and counselling from rural households.

The full extent of crop and livestock losses is still being assessed and damages continue to increase as water progresses along river systems. The areas flooded in New South Wales, Tasmania and Victoria in October together account for a non-trivial proportion of agricultural output. Affected products include broadacre crops, fruits & vegetables and dairy. Contacts have noted that there has been significant disruption and damage, but that not all agricultural production in affected areas has been entirely destroyed. These supply shocks to fresh food will push up prices for some goods at retailers; however, liaison contacts expect the inflationary impact of the latest floods to be smaller than those earlier in the year in Queensland and northern New South Wales.

Graph A.2

Earnings Calls and Liaison Sentiment Indicators*



* Each series standardised to measure the number of standard deviations away the series is from its mean value; updated to end of August.

** 13-month centred moving average of monthly average scores across firms.

Sources: RBA; Reuters

Some firms stated that very strong farming output in South Australia and Western Australia this year should partially offset potential lower production on the east coast. However, firms across several industries – including commodity exporters, utilities producers and construction firms – have expressed concern about further supply shocks that could arise from the third consecutive La Niña event on their production and economy-wide costs and prices.

Endnotes

[1] Liaison estimates are the trimmed mean of firms' reported wages growth, rescaled to have the same mean as the private Wage Price Index.

[2] This indictor measures the frequency with which a topic is mentioned in earnings calls from Australian-listed companies, which take place following the release of financial results.