

MAJOR CONSTRUCTION ON ROAD TO RECOVERY

Major construction value
2016: -8.0% p.a.

Major construction value
2017(e): +4.3% p.a.

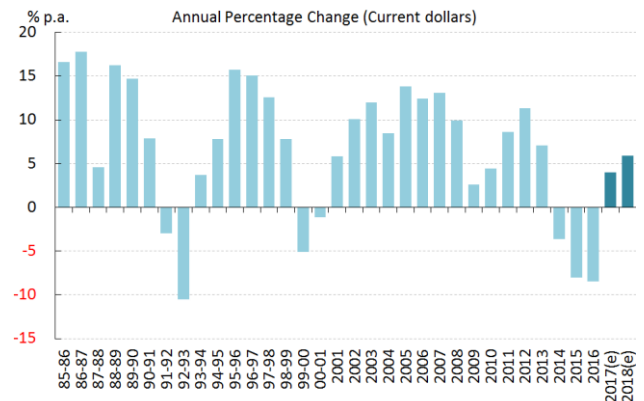
Major construction value
2018(e): +6.4%

Major construction jobs
Year to Feb 17: -1.2%

KEY FINDINGS

- After three years of declining major project work, the nation's leading construction companies are forecasting a recovery in engineering and non-residential building activity in calendar years 2017 and 2018. This is on the back of an upturn in non-mining infrastructure construction, as major new road and rail projects gather pace. Commercial building (including offices, retail buildings and industrial premises) is also set improve over the next two years boosted by higher levels of private sector investment.
- Added to this, the growth outlook for multi-level apartments remains strongly positive in 2017 as construction companies continue to work through a solid backlog of work. However, the pace of growth will moderate in 2018 reflecting the imminent peak in activity in the current apartment building cycle.
- The latest **Australian Industry Group/Australian Constructors Association Construction Outlook survey** indicates that after dropping sharply by 8.0% in 2016 (current prices), the total value of major project work is forecast to rise by 4.3% in 2017 followed by a stronger lift of 6.4% in 2018.
- Employment in non-residential construction** is also forecast to recover somewhat in 2017 and over the first half of 2018 in response to expanding infrastructure-related work. Rises in employment will be mainly driven higher workforce requirements for on-site and sub-contracted tradesmen.
- Highlighting the renewed impetus from non-mining infrastructure projects, the value of **engineering construction** is expected to increase by 2.9% in 2017 and a further 6.8% in 2018, following a steep 16.5% downturn in 2016. Despite a further winding down in mining-related construction, conditions will be boosted by the emerging phase of strong public sector spending on transport infrastructure projects. Growth prospects are also solid for telecommunications infrastructure in line with rising NBN-related investment.
- After struggling in recent years, **commercial construction** is forecast to gain some momentum. The total value of commercial work is expected to recover from flat conditions in 2016 to increase by 1.6% in 2017 and a further 5.6% in 2018. This increase reflects a marked pick-up over both years in private building activity (+4.8% in 2017 and +15.2% in 2018) with support flowing from project categories such as wholesale/retailing, accommodation and recreation building.
- For **multi-level apartments**, an increase in turnover of 22.9% is expected in 2017, coming on top of growth of 15.5% in 2016. Further ahead, slower pace of growth is expected in 2018 (+6.8%) due to likely excess supply and an easing in price growth.

TURNOVER FROM MAJOR CONSTRUCTION WORK



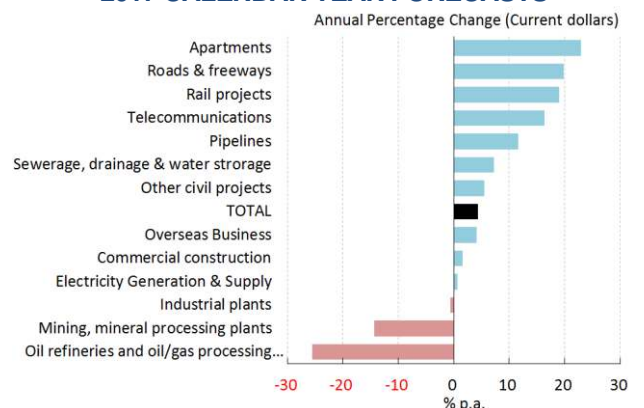
TURNOVER FROM MAJOR CONSTRUCTION WORK: OUTLOOK – CALENDAR YEARS

	2016	2017(e)	2018(e)
SECTOR	% p.a.	% p.a.	% p.a.
Engineering	-16.5	2.9	6.8
Commercial construction	0.3	1.6	5.6
Multi-level Apartments	15.5	22.9	6.8
Overseas business	5.3	4.1	4.5
Total major construction	-8.0	4.3	6.4

OUTLOOK 2017

- For the full 2017 calendar year, the value of turnover from **all major construction work** is expected to recover by 4.3%, following an 8.0% reduction in 2016. Notwithstanding the wind-down of mining-related engineering construction, a bigger pipeline of publicly funded infrastructure investment is expected to support overall activity in the industry.
- Engineering construction** is expected to rise by 2.9% through the year following a steep decline of 16.5% in 2016. This reflects a lift in the value of **infrastructure-related** engineering work (13.4%), driven by strong growth in road (+19.8%) and rail (+19.0%) projects. Solid support is also expected from telecommunications infrastructure (+16.1%) while relatively firm conditions in sewerage, drainage and water supply projects (+7.2%) reflects population growth and new property developments.
- In contrast, the value of work in the oil and gas processing sector is set to fall sharply again in 2017 (down by 25.5% after declining by 39.0% in 2016) with many of the major LNG projects either complete or in the advanced stages of construction. However, the drag from reduced mining investment (other than oil and gas) is moderating with a slower fall predicted in turnover derived mining projects (-14.3%) in 2017 after a 25.6% fall in 2016.
- The **commercial construction sector** is expected to record a mild recovery of 1.6% in 2017 (after broadly stable conditions in 2016) supported by stronger private sector building activity.

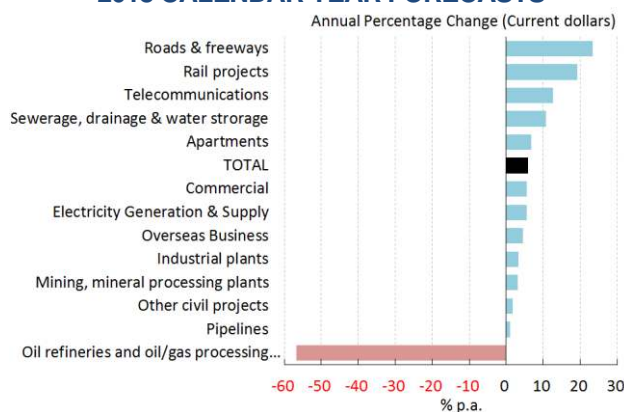
2017 CALENDAR YEAR FORECASTS



OUTLOOK 2018

- Turnover from **all major construction work** is forecast to grow at a faster pace of 6.4% in the 2018 calendar year as a higher level of publicly-funded infrastructure projects move through the development pipeline to the commencement stage.
- Engineering construction** is expected gain momentum, lifting by 6.8% with work generated from **infrastructure-related engineering** remaining the major driver of growth. This again reflects solid growth contributions from road (+23.3%) and rail projects (+19.2%) led by a large investment pipeline across the eastern states. Conditions are also expected to remain robust in telecommunications construction (+12.7%) due to the continued roll-out of the NBN, and in the sewerage, drainage and water supply sector (+10.7%).
- Resources-related engineering construction** is expected to continue to decline in 2018. Weakness will be concentrated in the oil and gas processing (primarily LNG) sector (-56.8%) while mining-related construction is expected to emerge from its downturn to record mild growth of 3.1%.
- Commercial construction** is poised to build further momentum in 2018 driven by a faster pace of growth in private sector building activity (+15.2%). However, work generated from public sector building activity is expected to turn down (-1.6%) due to a softer project pipeline and the near-completion of several large hospital projects.

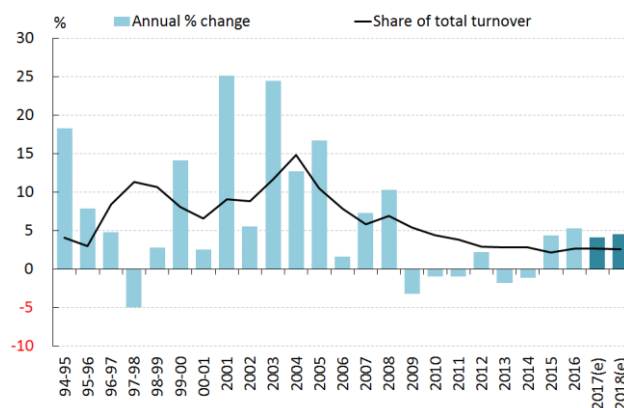
2018 CALENDAR YEAR FORECASTS



OVERSEAS BUSINESS

- The overseas business of the major construction sector accounted for approximately 3.0% of all major construction revenue in 2016, well below the peak of 14.8% twelve years ago in 2004.
- Revenue from overseas business increased by 5.3% in 2016 (in nominal Australian dollars). The lower Australian dollar is likely to have had a positive influence on this, by raising the local currency value of overseas generated revenue. This growth follows an increase in overseas revenue of 4.4% p.a. in 2015.
- The outlook indicates further growth over the next two years, with revenue from overseas business expected to rise by 4.1% in 2017 followed by a further increase of 4.5% in 2018.

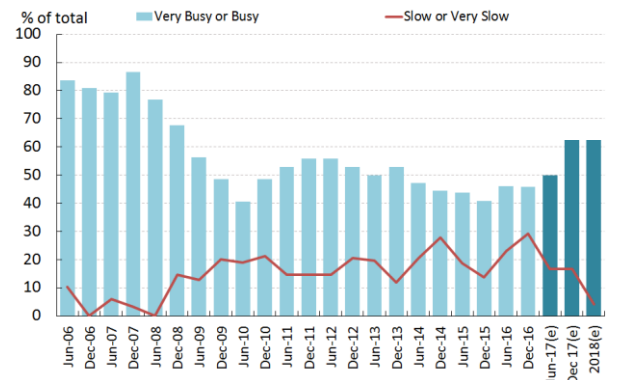
OVERSEAS BUSINESS



LEVELS OF ACTIVITY

- Levels of activity in the second half of 2016 were consistent with the further winding down in capital expenditure on major resource projects. Less than one-half (45.8%) of respondents reported very busy or busy activity levels during the six months to December 2017, slightly down from 46.1% in the previous six-month period. Although this was an improvement from the recent low of 40.9% in December 2015, it was below results in 2011 and 2012 and the more robust levels of 2006 and 2007.
- Over the first half of 2017, activity is expected to gain some ground, with 50.0% of businesses anticipating 'very busy' or 'busy' conditions consistent with the projected lift in infrastructure construction over this period.
- However, a more distinct improvement in activity levels is expected over the second half of 2017 (62.5% of respondents expect 'very busy' or 'busy' levels of activity) with this proportion holding steady during the calendar year 2018.
- The average level of industrial and construction capacity in use was 81.0% in March 2017, a fall of 3.3 percentage points from 84.3% a year earlier. It was also well below the peak of approximately 93% recorded during the mining investment boom in early 2008.

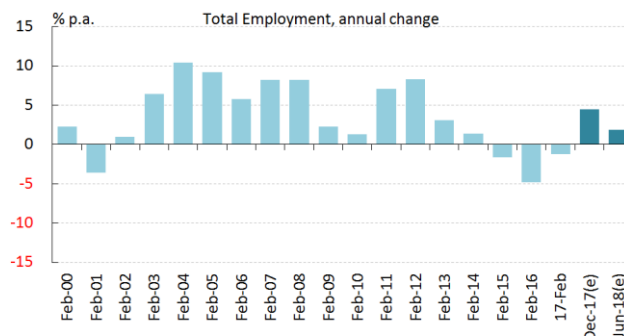
LEVELS OF ACTIVITY



EMPLOYMENT

- Labour market results from the survey reveal that major construction employment is expected to recover through 2017 and the first half of 2018.
- Reflecting weakness across key project areas in 2016, employment in major construction fell by 1.2% in the year to February 2017, following a decline of 4.8% during the previous 12 months. Across the industry, falls in employment were concentrated among sub-contract tradesmen (-2.0%) and employees principally engaged on-site (-0.8%) as cut backs in resources investment continued to reduce on-site workforce requirements.
- However, total employment is expected to return to growth over the remainder of 2017 (+4.5%) in response to the job-creating influence of rising infrastructure work. Over this period, businesses intend to engage higher numbers of sub-contract tradesmen (+6.3%) and on-site employees (+3.5%). Off-site employment is expected to record slower growth of 1.4%.
- Thereafter, in the six months to June 2018, total employment is expected to register a further increase of 1.9%. Over this period the expansion of the workforce will again be more centred on higher numbers of on-site employees (+2.1%) and subcontract tradesmen (+2.1%), while off-site employment will lift at a modest rate of 0.5%

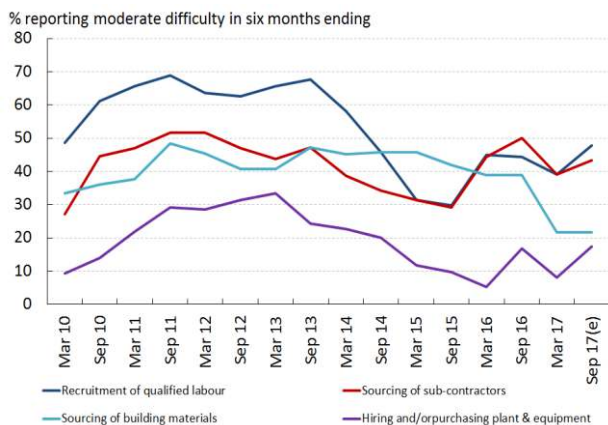
EMPLOYMENT



SUPPLY CONSTRAINTS

- **Skill labour shortages** are a still a concern for a relatively high number of construction businesses with 39.1% of respondents reporting either 'major' or 'moderate' difficulty in recruiting skilled labour in the six months to March 2017, down slightly from a relatively elevated 40.0% in the previous six months. Sourcing sub-contractors also remained a key concern in the six months to March 2017, with 39.1% also citing 'major' or 'moderate' difficulty, although this was down from 44.4% in the previous six months.
- With the projected lift in workforce demand as major infrastructure works come on stream, labour sourcing difficulties are expected to become more widespread. Over the six months to September 2017, a higher number of businesses expect difficulty with recruiting skilled labour (47.8% expect major or moderate difficulty) and sourcing sub-contractors (43.4% expect major or moderate difficulty).
- Sourcing **building materials** was of less concern for the industry in the six months to March 2017, with 21.7% of respondents reporting 'major' or 'moderate' difficulty, down from 38.9% six months earlier.
- A lower proportion of businesses (8.7%) also reported 'major' or 'moderate' difficulty with **hiring and purchasing equipment** as compared with six months earlier (16.7%).
- However, looking ahead, more businesses expect major or moderate difficulties with hiring and purchasing equipment (17.4%) over the six months to September 2017. The same proportion expect difficulties with sourcing building materials (21.7%) compared with the previous six months.

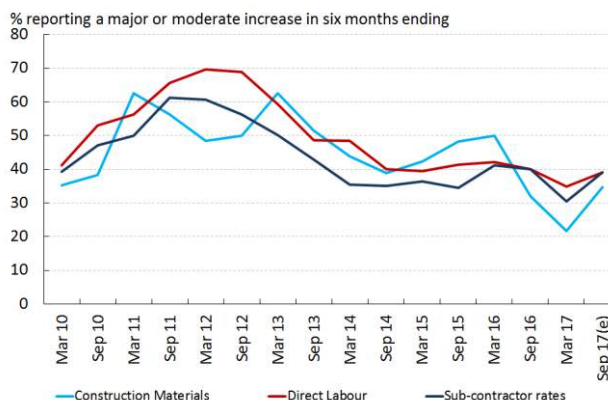
SUPPLY CONSTRAINTS: LABOUR AND CAPITAL



INPUT COSTS

- **Labour costs** are expected to become a greater source of pressure for the construction of infrastructure and building projects in 2017. Upward pressures on direct labour costs are expected to be exerted as large infrastructure projects increasingly move from the planning pipeline into the construction phase and contractors compete for the same pool of skilled labour.
- Over the six months to March 2017, 34.8% of respondents reported 'major' or 'moderate' increases in direct labour rates while 30.4% also reported 'major' or 'moderate' increases for sub-contractor labour rates. These proportions were down from 40.0% reporting 'major' or 'moderate' rises for both direct labour and sub-contractor rates six months earlier.
- However, over the six months to September 2017, the survey points to heightening cost pressures with the proportion of businesses expecting 'major' or 'moderate' increases in direct labour costs rising to 39.0%. In addition, more businesses (39.0%) expect 'major' or 'moderate' pressure on sub-contractor rates in the six months to September 2017, than in the six months to March 2017.
- Reports of increases in **construction material costs** have eased off to some extent in recent months, with 21.7% of businesses reporting 'major' or 'moderate' increases in the cost of materials in the six months to March 2017. This compares with 32.0% citing 'major' or 'moderate' increases six months earlier. The continuing decline in mining investment activity appears to have taken some of the heat out of demand for and therefore the cost of construction materials.
- Looking ahead, the impact of stronger demand requirements, particularly in the expanding infrastructure sector, is expected to result in increased cost pressures on material costs. A more widespread number of businesses (34.7%) expect 'major' or 'moderate' rises in the cost of construction materials in the six months to September 2017 than in the six months to March 2017.

INPUT COSTS



Value of turnover in construction work	Share of turnover, 2016	2016	2017(e)	2018(e)
	% of total	% change p.a.	% change p.a.	% change p.a.
Engineering Construction*	51.2	-16.5	2.9	6.8
(A) Infrastructure	31.3	-9.9	13.4	13.8
Utilities Infrastructure	3.3	-2.6	6.0	9.8
- Electricity generation and gas supply	0.6	-17.2	0.7	5.5
- Sewerage, drainage and water storage	2.7	1.2	7.2	10.7
Transport infrastructure	15.2	-6.9	19.5	21.5
- Roads and freeways	8.6	-7.5	19.8	23.3
- Rail projects	6.7	-6.2	19.0	19.2
Telecommunications infrastructure	3.1	16.3	16.1	12.7
Other civil projects	9.6	-21.6	5.5	1.8
Pipelines	0.1	26.0	11.6	1.0
(B) Mining & mineral processing construction	11.5	-25.6	-14.3	3.1
(C) Heavy Industrial construction	8.4	-23.9	-12.1	-20.3
Oil refineries and gas processing facilities	4.0	-39.0	-25.5	-56.8
Industrial plants	4.4	-3.6	-0.6	3.3
Commercial construction	36.0	0.3	1.6	5.6
Private sector	15.0	-6.9	4.8	15.2
Public sector	21.0	6.2	0.6	-1.6
Multi-Apartment Complexes	9.0	15.5	22.9	6.8
Overseas Business	2.7	5.3	4.1	4.5
Other	1.0	2.1	0.0	9.4
Total value of turnover in construction work	100.0	-8.0	4.3	6.4

* Infrastructure, Mining and Industrial Construction

Outlook

Employment	Share of employment, Feb 2017 % of total	Feb 16– Feb 17 % change	Exp. Feb 17 – Dec 17 % change	Exp. Dec 17 – Jun 18 % change
On-site employees	45.7	-0.8	3.5	2.1
Off-site employees	10.8	0.6	1.4	0.5
Sub-contract labour	43.5	-2.0	6.3	2.1
Total employment	100.0	-1.2	4.5	1.9

Level of activity	Very busy % of companies	Busy % of companies	Moderate % of companies	Slow % of companies	Very slow % of companies
Six months to June 2016, actual	19.2	26.9	30.8	15.4	7.7
Six months to Dec 2016, actual	12.5	33.3	25.0	16.7	12.5
Six months to June 2017, expected	8.3	41.7	33.3	4.2	12.5
Six months to Dec 2017, expected	16.7	45.8	20.8	16.7	0.0
Expected 2018 (calendar year)	12.5	50.0	33.3	4.2	3.8

WHAT IS THE CONSTRUCTION OUTLOOK REPORT?

The Australian Industry Group Construction Outlook survey was conducted in March/April in conjunction with the Australian Constructors Association (ACA), the peak industry body representing the nation's major construction contractors. The survey covered the responses of 100 companies employing 50,000 persons with combined turnover of around \$21 billion.

SPONSOR STATEMENT

The Australian Constructors Association (ACA) is delighted to be associated with the Australian Industry Group as the major sponsor of one of the most authoritative surveys of Australian construction activity. The survey, which is conducted on a bi-annual basis, provides an excellent barometer on the state of the engineering and non-residential building sectors – on a national and key market basis. We look forward to our continuing association with the survey and its development as the most credible source of information on construction industry activity.

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