Construction Outlook

October 2014

AUSTRALIAN INDUSTRY GROUP

AUSTRALIAN CONSTRUCTORS ASSOCIATION

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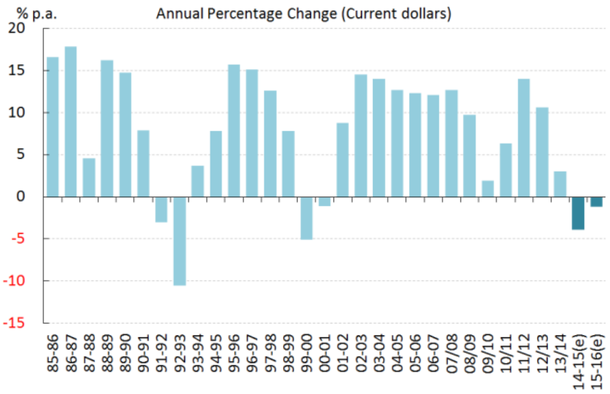
CONSTRUCTION SECTOR AWAITS INFRASTRUCTURE LIFT

Major construction value	Major construction value	Major construction value	Major construction jobs
2013-14: +3.0% p.a.	2014-15: -3.9% p.a.	2015-16: -1.2%	Year to Jun 15: -1.7%

KEY FINDINGS

- The **nation's leading construction companies** are forecasting a fall in total non-residential building work in 2014/15 and 2015/16 as declining investment levels put pressure on resource-related project activity. Both mining and heavy industrial construction are forecast to weaken markedly.
- Nevertheless, overall levels of activity will be supported over the next two years by continued growth in telecommunications investment, an upturn in the commercial construction sector and growth in apartment building. Federal and State Government infrastructure plans (particularly for road and rail) will, if realised, also help fill the void left by reduced mining-related construction.
- The latest **Australian Industry Group/Australian Constructors Association Construction Outlook survey** reveals that after growth of 3.0% in 2013/14 (current prices), the total value of engineering and commercial construction work is expected to fall by 3.9% in 2014/15, followed by a slower decline of 1.2% in 2015/16.
- Total employment is forecast to turn down through the year to June 2015 in response to weaker resource-related construction and the completion of various major projects. Reductions in employment will fall more heavily on numbers of on-site employees.
- **Engineering construction** is expected to experience falls of 7.5% in 2014/15, and 3.4% in 2015/16 due to reduced work levels in a range of major project categories. The key driver of the downturn will be mining construction. Other notable declines are forecast in the heavy industrial resource based sectors, including oil and gas processing which is forecast to fall heavily in 2015/16. In addition, a further winding back in utilities investment is expected to drive steep declines over the next two years in electricity generation and water supply projects. It is anticipated that declines in these project categories will be most pronounced in 2015/16.
- Encouragingly, the **commercial construction** sector is forecast to recover, expanding by a solid 6.1% in 2014/15 and consolidating with a further gain of 3.2% in 2015/16. This largely reflects sustained growth forecast over both years in private building activity (including offices, retail premises and recreation building).
- The **apartment building** sector is set to maintain solid growth, with a forecast rise of 11.1% in 2014/15 after lifting by 16.4% in 2013/14. The sector's pace of growth is expected to moderate to a 6.3% rate in 2015/16.

TURNOVER FROM CONSTRUCTION WORK



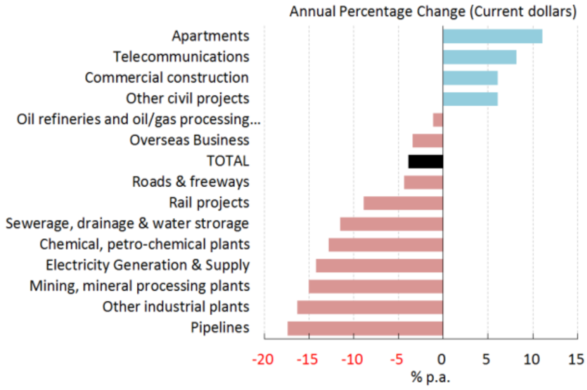
TURNOVER FROM CONSTRUCTION WORK: OUTLOOK AT A GLANCE

SECTOR	2013-14 % p.a.	2014-15 % p.a.	2015-16 % p.a.
Engineering	2.1	-7.5	-3.4
Commercial construction	2.0	6.1	3.2
Apartments	16.4	11.1	6.3
Overseas business	2.0	-3.0	3.0
Total construction	3.0	-3.9	-1.2

OUTLOOK 2014-15

- Growth in total turnover from construction work is forecast to decline by 3.9% (current dollars) in 2014/15, after more than a decade of sustained growth.
- The total value of infrastructure work is expected to contract by 4.4% over the next year. With the completion of some major road projects and weaker mining-related rail investment revenue from transport construction is expected to decline by 6.6% during the year. Current cut-backs in investment in power and water infrastructure are reflected in solid declines of between 11% and 14% in electricity generation and supply and sewerage, drainage and water supply projects.
- More positively for infrastructure construction, the telecommunications sector will continue its growth phase (8.2%) due mainly to NBN network investment. In addition, a rise of 6.1% is forecast in other civil projects, reflecting port expansions and terminal developments to cater for expanding volumes of resource exports.
- Consistent with falling mining investment, the value of mining sector work is expected to contract by 15.0% following a sustained period of strong growth. A decline of 5.4% is also forecast in heavy industrial resource-based construction. However, a small (1.1%) reduction in work generated from oil and gas processing projects suggests that this sector will continue to hold-up in 2014/15, despite edging below peak levels.
- The value of commercial construction work is expected to strengthen with projected growth of 6.1% in line with a range of large projects in the pipeline and major developments underway.

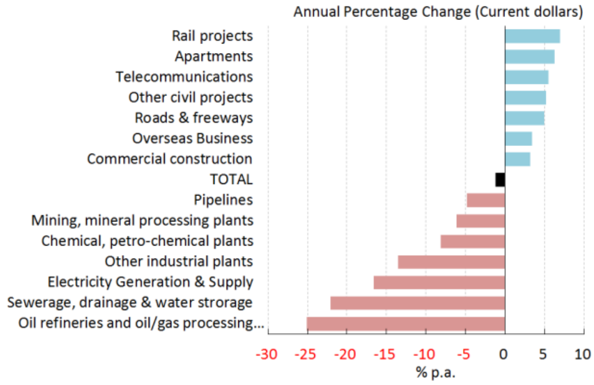
2014-15 FORECASTS



OUTLOOK 2015-16

- The total value of construction turnover is forecast to decline at a slower rate of 1.2% in 2015/16.
- The value of infrastructure work, however, is expected to record overall growth of 5.0% during the year. This largely reflects the positive influences of a lift in revenue from road and rail construction (6.0%), continued growth in telecommunications infrastructure work (5.5%) and a further increase in revenue from other civil projects (5.2%). Growth in these more dominant infrastructure categories will offset the declines anticipated in electricity, generation & supply (-19.6%), sewerage, drainage & water supply (-16.6%) and pipelines (-4.8%).
- The oil and gas processing sector will be a major drag on industry activity in 2015/16 with the value of work set to fall by 25.1% over the year as current projects move to completion.
- Turnover from commercial construction is projected to maintain growth, although at a slower rate of 3.2%. Private sector building activity is expected to underpin the sector's overall expansion with a forecast increase of 7.1% through the year. In contrast, public building activity is expected to decline by 2.4% as public funding allocations wind back.

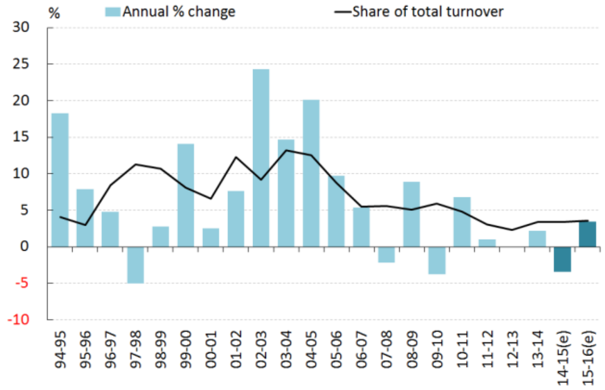
2015-16 FORECASTS



OVERSEAS BUSINESS

- The overseas business of construction businesses accounted for just 3.4% of all construction revenue in 2013/14, a share which is well below the plus 10% peak years of 2002/03 to 2004/05
- Revenue from overseas business increased by only 2.2% in 2013/14 reflecting a relatively subdued uptake of off-shore projects among respondents. This follows stable levels of revenue in the previous year. The strong Australian dollar is likely to have impacted negatively on the local currency value of overseas generated revenue.
- Revenue from overseas business is expected to fall by 3.4% in 2014/15 followed by a projected 3.4% increase in 2015/16.

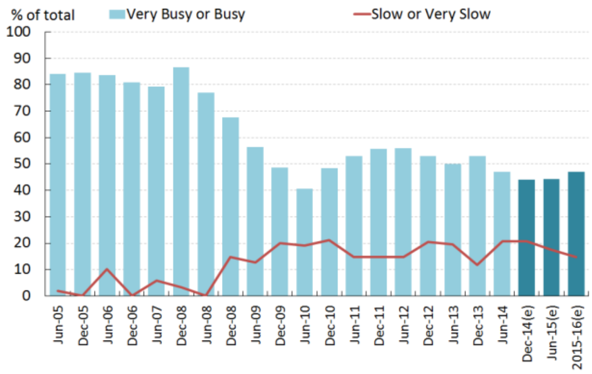
OVERSEAS BUSINESS



LEVELS OF ACTIVITY

- Weaker resources and infrastructure project work led to a moderation in activity levels during the second half of 2014. Less than one in every two respondents (47.1%) reported operating at busy or very busy levels of activity during the six months to June 2014, down from 52.9% in the previous six months period.
- During the second half of 2014 a further easing in activity is expected. Over this period, the proportion of businesses anticipating busy or very busy activity falls to 44.1% with this proportion holding broadly steady during the first six months of 2015. Thereafter, during the financial year 2015/16 activity is expected to show some improvement (47.1% very busy/busy) with the impact of reduced resource related construction moderated by higher activity in commercial construction and key infrastructure sectors.
- The average level of industrial/construction capacity in use was 82.8% in August 2014, a fall of 2.1 percentage points from the reading (82.1%) from the level six months earlier.
- The current level of capacity utilisation is in line with the average level recorded over the past five years, although it remains well down on the peak levels of approximately 90.0% recorded in late 2007 and early 2008 prior to the strong hit to construction demand from the Global Financial Crisis

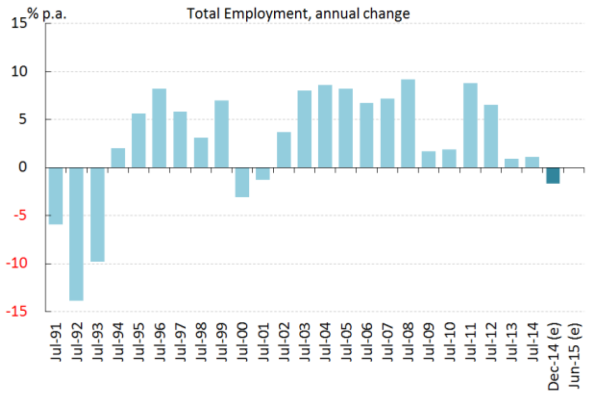
LEVELS OF ACTIVITY



EMPLOYMENT

- Total employment expanded by 1.1% in the year to July 2014, following a 0.9% increase during the previous 12 months. Across the industry, the number of on-site and sub-contract tradesmen increased by 1.2% and 1.9% respectively, while the number of off-site employees declined by 2.8% over this period.
- With overall project demand weakening, a downturn in employment is forecast over the remainder of 2014. Total employment is forecast to fall by 1.7% between July and December 2014. Reduced investment demand and the completion of various major projects will see reductions in employment concentrated on employees principally engaged on-site (-1.5%) and sub-contract tradesmen (-2.1%). Off-site employment is expected to be broadly unchanged over this period.
- Thereafter to June 2015, total employment is expected to remain unchanged. Slight increases in off-site employees (0.6%) and sub-contract tradesmen (0.9%) are forecast to be offset by a further fall in on-site employees (-1.0%).

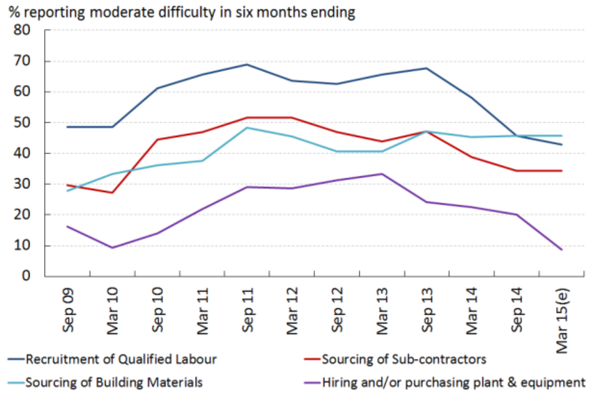
EMPLOYMENT



SUPPLY CONSTRAINTS

- Reflecting weaker labour demand and the winding back in mining-related construction, labour supply constraints have moderated in recent months. Although a sizable 45.7% of respondents reported either major or moderate difficulty in the recruitment of skilled labour in the six months to September 2014, this was down from 58.1% in the previous six months period. The sourcing of sub-contractors was also a less dominant supply constraint in the six months to September 2014 with 34.3% citing major or moderate difficulty (down from 38.7%).
- For capital supplies, sourcing difficulties were broadly unchanged from the previous reporting period. In total, 45.7% of respondents reported major or moderate difficulty in the sourcing of building materials (45.2% six months ago). In addition, 20.0% of businesses reported major or moderate difficulty in the hiring and purchasing of equipment (22.6% six months ago).
- Over the six months to March 2015, the degree of difficulty in the recruitment of skilled labour (42.9% major or moderate), sub-contractors (34.3%) and the sourcing of building materials (45.7%) is generally expected to remain steady. However, difficulties in the hiring and purchasing of equipment (8.6%) are expected to be less widespread.

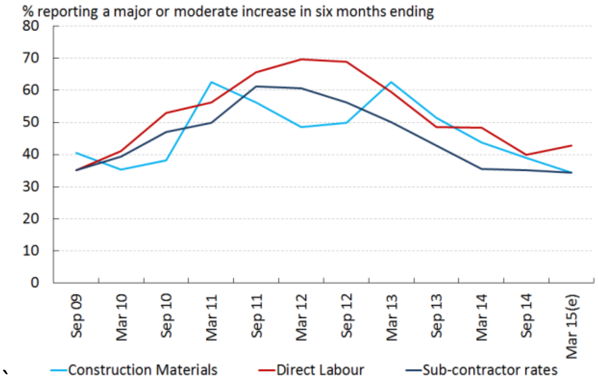
SUPPLY CONSTRAINTS: LABOUR AND CAPITAL



INPUT COSTS

- The survey results indicate that labour and construction material costs remain a source of pressure on total costs for infrastructure and building projects. This is despite a moderation in input cost inflation in the six months to September (relative to the previous six months period). During the six months to September 2014, 38.9% of businesses cited major or moderate increases in material costs, down from 43.8% citing this level of difficulty six months ago. Contributing to this moderation was the impact of the strong Australian dollar which reduced local currency costs of imported materials.
- Reflecting an easing in skill shortages, 40.0% of respondents reported major or moderate increases in direct labour costs, down from 48.4% in the six months to March 2014. For subcontractor rates, 35.1% reported major or moderate increases (compared to 35.5%).
- Labour cost pressures are expected to be sustained at broadly unchanged levels in coming months. Over the six months to March 2015, the proportion of businesses anticipating major or moderate increases is forecast to rise slightly to 42.9% for direct labour and fall slightly to 34.3% for sub-contractor rates. Price pressures on construction materials is expected to show a further easing with 34.3% anticipating major or moderate increases.

INPUT COSTS



Value of turnover in construction work	Share of turnover, 2013-14 % of total	2013-14 % change p.a.	2014-15 (f) % change p.a.	2015-16(f) % change p.a.
Engineering Construction*	**72.7**	2.1	-7.5	-3.4
Infrastructure	**42.1**	0.9	-4.4	5.0
Utilities Infrastructure	**5.0**	-4.9	-12.8	-19.6
Electricity generation and gas supply	**2.3**	0.9	-14.2	-16.6
Sewerage, drainage and water storage	**2.6**	-9.4	-11.5	-22.1
Transport infrastructure	**22.4**	0.7	-6.6	6.0
Roads and freeways	**11.4**	2.4	-4.4	5.0
Rail projects	**11.0**	-1.1	-8.9	7.0
Telecommunications infrastructure	**3.0**	6.0	8.2	5.5
Other civil projects	**8.5**	0.5	6.1	5.2
Pipelines	**3.2**	-13.4	-17.4	-4.8
Mining & mineral processing	**19.8**	3.6	-15.0	-6.1
Heavy Industrial construction	**10.9**	12.4	-5.4	-20.8
Chemical, petrochemical plants etc	**2.0**	-3.7	-12.8	-8.1
Oil refineries and gas processing facilities	**7.4**	22.9	-1.1	-25.1
Other industrial plants	**1.5**	-5.7	-16.3	-13.5
Commercial construction	**19.2**	2.0	6.1	3.2
Private sector	**11.2**	1.4	8.2	7.1
Public sector	**8.0**	2.8	3.3	-2.4
Apartments	**4.2**	16.4	11.1	6.3
Overseas Business	**3.4**	2.2	-3.4	3.4
Other	**0.4**	17.0	-5.0	11.8
Total value of turnover in construction work	**100.0**	**3.0**	**-3.9**	**-1.2**

* Infrastructure, Mining and Industrial Construction

Employment	Share of employment, Jul 14 % of total	July 13 – Jul 14 % change	Exp. Jul 14 – Dec 14 % change	Exp. Dec 14 – Jun 15 % change	Exp. Jul 14 – Jun 15 % change
On-site employees	**49.1**	1.2	-1.5	-1.0	-2.5
Off-site employees	**10.6**	-2.8	-0.5	0.6	0.1
Sub-contract labour	**40.3**	1.9	-2.1	0.9	-1.2
Total employment	**100.0**	**1.1**	**-1.7**	**0.0**	**-1.7**

Level of activity	Very busy % of companies	Busy % of companies	Moderate % of companies	Slow % of companies	Very slow % of companies
Six months to Dec 2013	**29.4**	**23.5**	35.3	11.8	0.0
Six months to Jun 2014	**11.8**	**35.3**	32.4	14.7	5.8
Six months to Dec 2014	**8.8**	**35.3**	35.3	17.7	2.9
Six months to Jun 2015	**11.8**	**32.4**	38.2	14.7	2.9
2015-16 (year)	**14.7**	**32.4**	**38.2**	**11.8**	**2.9**

WHAT IS THE CONSTRUCTION OUTLOOK REPORT?
The Australian Industry Group Construction Outlook survey was conducted in August/ September 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 approximately 70,000 persons with combined turnover of almost $25 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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