

Outlook

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SOLID CONSTRUCTION PIPELINE TO LIFT COSTS AND TEST CAPACITY

Major construction value
2017: +5.2% p.a.

Major construction value
2018(e): +9.3% p.a.

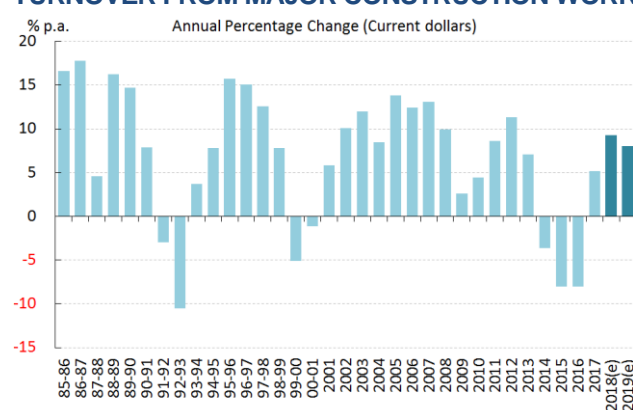
Major construction value
2019(e): +8.0%

Major construction jobs
Year to Feb 18: +4.3%

KEY FINDINGS

- Australia's leading construction companies are forecasting a continued solid uplift in major non-residential project work over the course of 2018 and 2019. Growth will be led by a strong pipeline of non-mining infrastructure in line with the significant growth impetus from public sector spending on transport infrastructure projects. However, the actual value of growth is likely to be tempered by rising cost pressures, particularly escalating energy input costs and supplier price hikes related to the relative strength in commodity prices. There is also widespread reporting of difficulties in recruiting skilled labour and sourcing materials in the volumes required for major projects.
- The latest **Australian Industry Group/Australian Constructors Association Construction Outlook survey** indicates that after recovering by 5.2% in 2017 (current prices), the total value of non-residential construction work is forecast to rise by 9.3% in 2018 and a further 8.0% in 2019.
- Engineering construction** will remain a key driver of growth with total turnover rising by 8.4% in 2018 and 12.6% in 2019. This reflects continued high levels of work done on major road and rail projects, led by various big-ticket projects across the eastern states. Solid support is also expected from telecommunications infrastructure (in line with NBN-related investment network upgrades) and "other" civil projects, including, bridges, tunnels and the construction of Sydney's second airport at Badgerys Creek.
- While the mining investment downturn remains a drag on industry conditions, its negative impact is diminishing with a marked slowdown in the rate of decline in **resource-related construction** expected in 2018 followed by a modest anticipated upturn in 2019.
- Commercial building activity** (including offices, retail buildings and industrial premises) is poised to experience stronger conditions over the next two years. With more projects starting to receive the go ahead, the total value of commercial work is expected to recover from a 2.9% decline in 2017 to growth of 7.8% in 2018 and 5.8% in 2019.
- The outlook also points to a continuation of strong growth in the **multi-level apartments** sector during 2018 (+14.8%) supported by projects either still underway or in the pipeline. However, the value of work is set to turn down sharply in 2019 (-16.6%).
- Higher workloads and increasing investment demand will also lead to further workforce expansion, with **total employment** expected to rise by around 2.9% in 2018 and by a further 2.7% over the first half of 2019 (after a rise of 4.3% in the year to February 2018).

TURNOVER FROM MAJOR CONSTRUCTION WORK



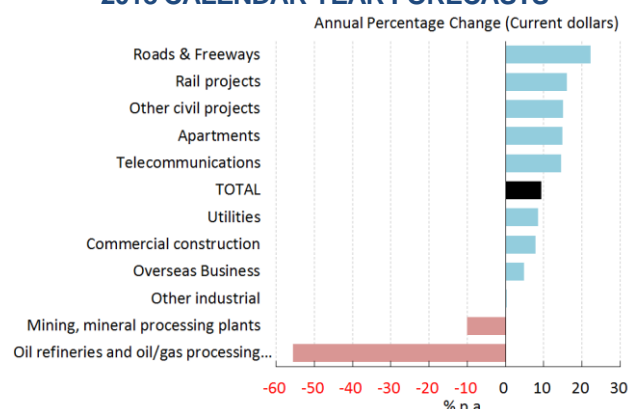
TURNOVER FROM MAJOR CONSTRUCTION WORK: OUTLOOK – CALENDAR YEARS

	2017	2018(e)	2019(e)
SECTOR	% p.a.	% p.a.	% p.a.
Engineering	8.5	8.4	12.6
Commercial construction	-2.9	7.8	5.8
Multi-level Apartments	13.6	14.8	-16.6
Overseas business	5.4	4.9	3.9
Total major construction	5.2	9.3	8.0

OUTLOOK 2018

- For the 2018 calendar year, the value of turnover from **all major construction work** is expected to rise at a rate of 9.3%, following a 5.2% increase in 2017. Despite a further fall in mining-related engineering construction, a solid pipeline of publicly funded infrastructure investment is expected to drive stronger activity over the year.
- Engineering construction** is expected to rise by 8.4% in 2018, underpinned by a strong lift in the value of **non-mining infrastructure construction work** (17.1%). Both road (+22.3%) and rail (+16.0%) projects will continue to expand from a high base. Other strong areas of growth include "other" civil projects (+15.1%) and telecommunications infrastructure (+14.6%).
- Resources-related engineering construction** is expected to continue to decline in 2018. Weakness will be concentrated in the oil and gas processing sector (-55.6%) as the remaining major LNG projects under construction largely move through to completion by the end of 2018. However, a slower fall is predicted in turnover derived from mining projects (-10.1%) in 2018 after a 20.4% decline in 2017 consistent with the approaching end of the mining investment wind down.
- Commercial construction** is expected to rebound by 7.8% in 2018 (after contracting in 2017) supported by stronger private and public-sector investment.

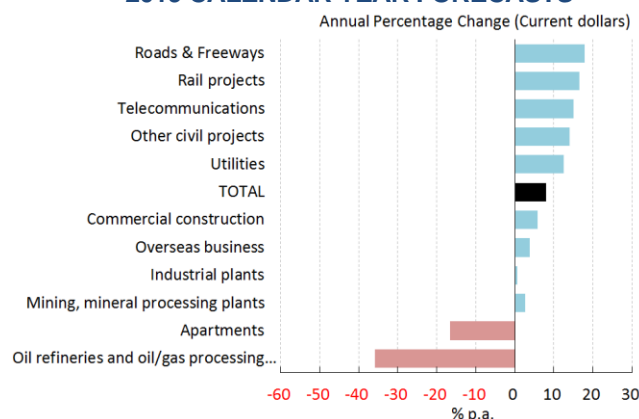
2018 CALENDAR YEAR FORECASTS



OUTLOOK 2019

- Turnover from **all major construction work** is forecast to continue to expand at a healthy rate of 8.0% in the 2019 calendar year reflecting further upside to public sector infrastructure works and additional gains in commercial construction.
- Engineering construction** growth will lift to a higher level of 12.6%. This again reflects solid growth contributions from road (+17.9%) and rail projects (+16.6%), backed by telecommunications (+14.8%) and in other civil projects (+13.8%). Utilities construction (+12.5%) is expected to continue to receive a boost from investment in new pipeline infrastructure for gas supply, wind and solar projects, electrical sub-station upgrades and the construction of water treatment facilities.
- Resources-related engineering construction** is set to continue to decline with weakness centred on the oil and gas processing sector (-35.8%). However, the mining investment downturn is likely to have run its course with a slight upturn in mining-related construction expected to emerge in 2019 (+2.7%).
- Commercial construction** is projected to continue to expand in 2019, albeit at a slower pace of 5.8%. Private sector building activity is expected to rise by 6.9% while investment in education and health building projects is set to underpin a 5.0% growth outlook for public sector building activity.

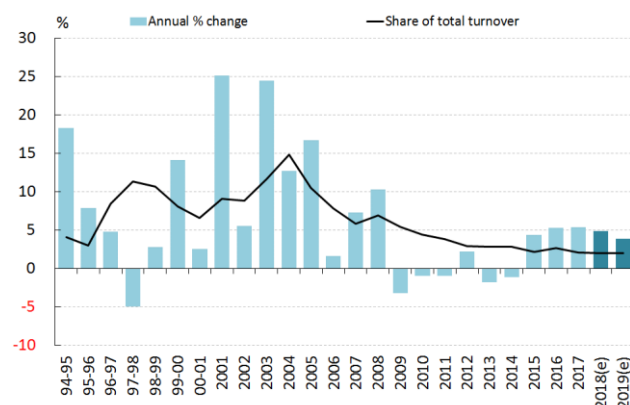
2019 CALENDAR YEAR FORECASTS



OVERSEAS BUSINESS

- The **overseas business of the major construction sector** accounted for approximately 2.0% of all major construction revenue in 2017, well below the peak of 14.8% thirteen years ago in 2004.
- Revenue from overseas business increased by 5.4% in 2017 (in nominal Australian dollars). The relatively low trading range for the Australian dollar in 2017 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 3.8% p.a. in 2016.
- The outlook indicates further growth over the next two years, with revenue from overseas business expected to rise by 4.9% in 2018 followed by a further increase of 3.9% in 2019.

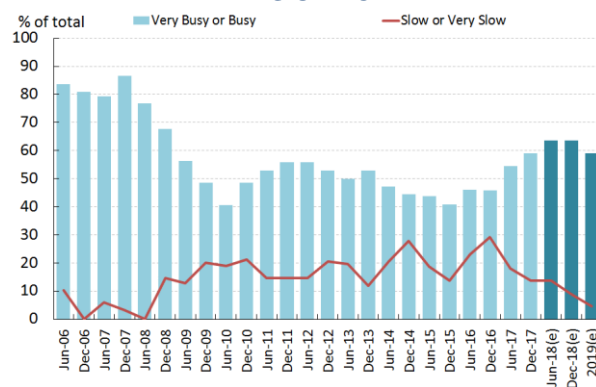
OVERSEAS BUSINESS



LEVELS OF ACTIVITY

- In line with the upturn in infrastructure project work, **levels of activity strengthened over the second half of 2017**. In total, 59.1% of respondents reported very busy or busy activity levels during the six months to December 2017, up from 54.6% in the previous six-month period. This was the **highest activity reading by survey respondents in nine years**.
- Over the first half of 2018, activity is expected to gain further ground, with 63.6% of businesses anticipating 'very busy' or 'busy' conditions as more projects move through the development pipeline into construction.
- Activity levels are expected to be sustained at this higher level through the second half of 2018. Thereafter, activity is expected to remain solid through 2019, although conditions are likely to moderate with the proportion anticipating very busy/busy activity levels easing back to 59.1%.
- The average level of industrial and construction capacity in use was 85.7% in March 2018, an increase of 4.7 percentage points from 81.0% a year earlier. It was also 6.8 percentage points above the most recent low level of 78.9% in February 2015.

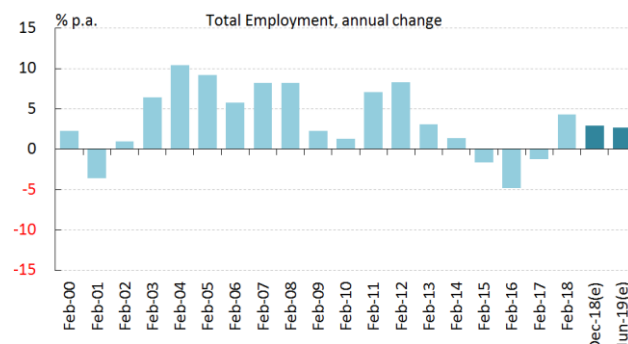
LEVELS OF ACTIVITY



EMPLOYMENT

- Labour market results from the survey reveal that **major construction employment is expected to recover through 2018 and the first half of 2019**.
- Reflecting renewed strength across key project areas, employment in major construction increased by 4.3% in the year to February 2018, following a decline of 1.2% during the previous 12 months. Across the industry, rises in employment were concentrated among sub-contract tradesmen (+6.9%) and employees principally engaged on-site (+1.6%) with the higher volume of total work placing the strongest demand on on-site workforce resources.
- The expected lift in activity levels in the year ahead will underwrite continued job gains on an aggregate industry basis. Over the period February to December 2018, total employment is expected to rise by a further 2.9% due the hiring of higher numbers of sub-contract tradesmen (+4.8%) and on-site employees (+2.0%). These rises will outweigh a fall in off-site employment of 3.3%.
- Thereafter, in the six months to June 2019, total employment is expected to register a further increase of 2.7%. Over this period the expansion of the workforce will again be highest among subcontract tradesmen (+2.9%) and on-site employees (+2.7%). The jobs upturn is also expected to extend to off-site employment with an increase of 1.7% expected in the first half of next year.

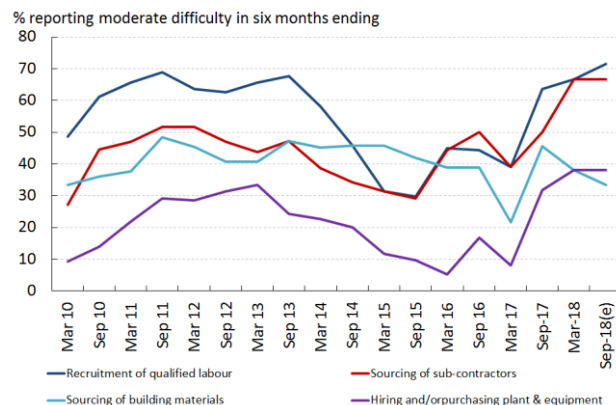
EMPLOYMENT



SUPPLY CONSTRAINTS

- Businesses are reporting **worsening labour shortages** while **pressures in the procurement of building materials and equipment** is widespread. The demand for labour has continued to increase due to the lift in infrastructure work and the scale of the projects in the pipeline. In total, a high 66.7% of respondents, up from 63.6% six months ago, reported either 'major' or 'moderate' difficulty in recruiting **skilled labour** in the six months to March 2018. **Sourcing sub-contractors** has also become a greater concern in the six months to March 2018, with 66.7% citing 'major' or 'moderate' difficulty, an increase from 50.0% in the previous six months.
- With the projected lift in workforce demand as more major infrastructure works come on stream, skilled labour sourcing difficulties are expected to become more prevalent. Over the six months to September 2018, a higher number of businesses expect difficulty with recruiting skilled labour (71.4% expect major or moderate difficulty). An unchanged (but high) 66.7% expect major or moderate difficulty in sourcing sub-contractors.
- Sourcing **building materials** is a key concern for the industry with 38.1% of respondents reporting 'major' or 'moderate' difficulty in the six months to March 2018, although this was lower than the 45.5% reported six months earlier.
- However, a higher proportion of businesses (38.1%) reported 'major' or 'moderate' difficulty with **hiring and purchasing equipment** as compared with six months earlier (31.8%).
- Businesses expect little respite from supply constraints for capital inputs over the coming months. Businesses anticipating major/moderate difficulties remains unchanged with respect to the purchasing/hiring of equipment (38.1%). A slightly lower proportion of businesses expect major/moderate difficulties in the sourcing of building materials (33.3%).

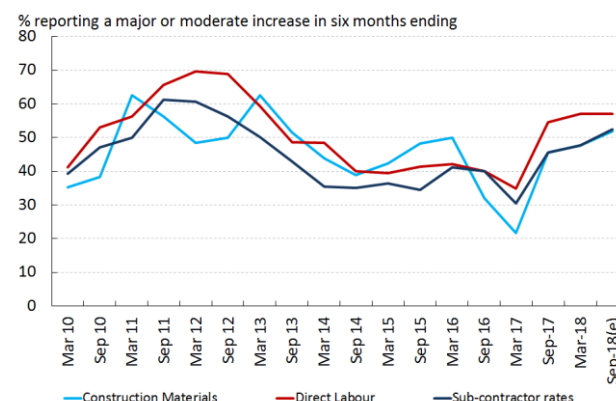
SUPPLY CONSTRAINTS: LABOUR AND CAPITAL



LABOUR AND CONSTRUCTION MATERIAL COSTS

- Labour costs** pressures are increasing in the construction of infrastructure and building projects with heightened pressures expected to be exerted in 2018. This reflects contractors competing for the same pool of skilled labour as major projects are ramped up.
- Over the six months to March 2018, 57.1% of respondents reported 'major' or 'moderate' increases in direct labour rates while 47.6% also reported 'major' or 'moderate' increases for sub-contractor labour rates. These proportions were up from 54.5% and 45.5% respectively reporting 'major' or 'moderate' rises six months earlier.
- The survey points to these cost pressures being sustained over the six months to March 2018. The proportion of businesses expecting 'major' or 'moderate' increases in direct labour costs remains unchanged at 57.1% while more businesses (52.3%) expect 'major' or 'moderate' pressure on sub-contractor rates in the six months to March 2018, than in the six months to September 2018.
- Reports of increases in **construction material costs** have also become more widespread with 47.6% of businesses reporting 'major' or 'moderate' increases in the cost of materials in the six months to March 2018. This compares with 45.5% citing 'major' or 'moderate' increases six months earlier. Higher commodity prices and a lift in demand requirements due to the continuing rise in infrastructure investment activity has pushed construction material costs higher.
- Looking ahead, the impact of stronger demand requirements, particularly in the strongly expanding infrastructure sector, is expected to result in increased cost pressures on material costs. A higher number of businesses (52.3%) expect 'major' or 'moderate' rises in the cost of construction materials over the six months to September 2018.

INPUT COSTS



Value of turnover in construction work	Share of turnover, 2017	2017	2018(e)	2019(e)
	% of total	% change p.a.	% change p.a.	% change p.a.
Engineering Construction*	57.9	8.5	8.4	12.6
(A) Infrastructure (non-mining)	44.6	21.5	17.1	13.8
Utilities (<i>electricity generation, pipelines, water storage</i>)	5.1	14.6	8.6	12.5
Transport	28.7	23.3	18.9	17.2
Roads and freeways	13.4	25.9	22.3	17.9
Rail projects	15.2	21.2	16.0	16.6
Telecommunications	3.0	5.6	14.6	14.8
Other civil projects (<i>eg. tunnels, airports, sports facilities</i>)	7.8	27.1	15.1	13.8
(B) Mining & mineral processing construction	9.2	-20.4	-10.1	2.7
(C) Heavy Industrial construction	5.8	-13.0	-26.5	-10.0
Oil refineries and gas processing facilities	2.8	-25.7	-55.6	-35.8
Industrial plants	3.0	-3.4	0.3	0.6
Commercial construction	28.2	-2.9	7.8	5.8
Private sector	11.8	4.2	8.9	6.9
Public sector	16.4	-7.5	7.0	5.0
Multi-Apartment Complexes	8.6	13.6	14.8	-16.6
Overseas Business	2.1	5.4	4.9	3.9
Other	1.5	14.7	28.5	25.0
Total value of turnover in construction work	100.0	5.2	9.3	8.0

* Infrastructure, Mining and Industrial Construction

Outlook

Employment	Share of employment, Feb 2018 % of total	Feb 17 – Feb 18 % change	Exp. Feb 18 – Dec 18 % change	Exp. Dec 18– Jun 19 % change
On-site employees	30.4	1.6	2.0	2.7
Off-site employees	13.4	0.4	-3.3	1.7
Sub-contract labour	56.2	6.9	4.8	2.9
Total employment	100.0	4.3	2.9	2.7

Level of activity	Very busy % of companies	Busy % of companies	Moderate % of companies	Slow % of companies	Very slow % of companies
Six months to June 2017, actual	18.2	36.4	27.3	4.5	13.6
Six months to Dec 2017, actual	36.4	22.7	27.3	9.1	4.5
Six months to Jun 2018, expected	31.8	31.8	22.7	4.5	9.1
Six months to Dec 2018, expected	22.7	40.9	27.3	4.5	4.5
Expected 2019 (calendar year)	27.3	31.8	36.4	0.0	4.5

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 major construction companies responding to the survey employed a total of 43,000 persons with combined turnover of around \$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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