

Construction

MAY 2005

Outlook

STRONG INFRASTRUCTURE AND RESOURCES INVESTMENT UNDERPINS SOLID GROWTH PROSPECTS FOR CONSTRUCTION INDUSTRY

Consistent with a strong project pipeline, the nation's leading construction companies are forecasting that growth in engineering and non-residential building activity will continue at solid levels over the next two years. The latest Australian Industry Group Construction Outlook Survey reveals that total construction turnover (current dollars) is expected to rise by 9.6% in 2005 followed by a further 9.2% rise in 2006. Nevertheless, the actual dollar value of work is likely to be diminished by rising raw materials and labour costs while many firms are expecting on-going difficulties in sourcing equipment, materials and labour inputs.

Results from the survey show that prospects over the next two years are particularly strong in engineering infrastructure with growth to be driven by an upturn in Government infrastructure spending and a further strong phase of private sector transport investment. This includes the substantial volume of work still to be undertaken on toll road construction and continued work on various major rail projects. Other key infrastructure sectors to benefit from the upturn include electricity genera-

tion and supply (reflecting a tightening of capacity across most states); telecommunications, sewerage, drainage and water supply and; "other" civil projects where activity is expected to be underpinned by port upgrades, bridge projects and airport developments.

Resource-based construction covering mining and resource related industrial construction is also set to maintain solid expansion through to 2006, consistent with strong global (notably Chinese) demand and high commodity prices. Within the heavy industrial sector, strongest growth is expected in large-scale oil and gas projects and "other industrial plants" including large alumina and other downstream processing plants.

The outlook for non-residential building (commercial construction) remains positive, in line with the continued strength in retail building and the increased investment expected in industrial buildings and health infrastructure. Following a rise of 7.2% in 2005, the total non-residential building market is expected to post growth of more than 10% in both 2005 (10.1%) and 2006 (13.1%).

KEY FINDINGS:

- The value of total construction turnover (current dollars) increased by 8.5% in 2004 to build on the surge in activity which has occurred since mid-2001.
- The industry is poised for a continuation of strong growth over the next two years with turnover forecast to increase by 9.6% in 2005 followed by a further 9.2% rise in 2006.
- Engineering and infrastructure construction will remain a key driver of growth reflecting continued high levels of work done on road and rail projects combined with solid growth in the utilities sector (electricity infrastructure, water supply and sewerage), telecommunications and "other" civil projects.
- After moderating in 2004, non-residential building (commercial construction) is forecast to record another strong growth phase of 10.1% in 2005 and 13.1% in 2006. Private sector building activity is expected to underwrite most of this growth, based on anticipated increases in the construction of factories, retail

- premises and health related buildings.
- Consistent with buoyant resources investment, mining sector work is set to expand strongly in 2005 (18.8%), and 2006 (11.0%) underpinned by key mining projects in gold, coal, nickel and iron ore. Robust heavy industrial resource construction is also predicted with turnover in this area forecast to increase by 11.3% in 2005 and a further 8.6% in 2006.
- Due to excessive construction in recent years, which has led to oversupply conditions, revenue from the apartment building activity fell by 6.3% in 2004. A further downturn is predicted for this sector in 2005 (3.4%) and 2006 (14.6%).
- Total employment increased by 9.2% in the twelve months to February 2005 due mainly to strong growth in on-site workers and sub-contract tradesmen. The forecast is for growth of 4.5% between February and December 2005, followed by a further increase of 4.0% in the first six months of 2006.

- The average level of industrial/construction capacity used in February/March 2005 was 86.4%, down slightly from a year ago (87.2%), although still well above the most recent low point of 74.9% recorded in February 2001.
- The overseas business of construction firms grew by 12.7% in 2004 with exports as a proportion of industry revenue rising to an historic high of 14.8% in the last year as compared to 3% in the mid 1990's. The outlook is for stable conditions in 2005, followed by modest growth in 2006.
- The recruitment of qualified labour including professional/supervisory staff) was reported to be the dominant supply constraint on the industry. In total, 71% of firms reported either major (33.3%) or moderate (38.1%) difficulty with respect to this factor in February/March 2005. This was closely followed by the sourcing of sub-contractors (26.2% major difficulty and 42.9% moderate difficulty).

WHAT IS THE CONSTRUCTION OUTLOOK REPORT?

The Australian Industry Group survey was conducted in March/April 2005 in association with the Australian Constructors Association, the peak industry body representing the nation's major construction contractors. The survey covered the responses of 100 companies employing almost 41,000 persons with combined turnover of \$12.2 billion or approximately 25% of total industry activity.

SPONSOR STATEMENT

The Australian Constructors Association 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.

PRINCIPAL ACTIVITIES OF RESPONDENTS

Respondents to the survey included the key market leaders and covered the full spectrum of construction activity. The four primary construction activities identified by respondents were as follows:

- 1) Building Construction (43.8% of total turnover)
- 2) Civil Engineering construction (23.5%)
- 3) Contract mining (9.9%)
- 4) Building and construction materials- fabrication/erection (6.3%)

TURNOVER IN 2004

The value of total construction turnover rose by 8.5% (current dollars) in 2004, sustaining the solid upward trend of the previous three years. The upturn was supported by a broad base of activity, with infrastructure construction the major driver of growth. Within the infrastructure market, the level of work done on roads and freeways increased by 40.7% (reflecting significant private sector toll road construction), while solid growth also occurred in rail projects (12.9%), pipelines (16.3%), electrical power generation and supply (22.0%) and sewerage, drainage and water storage (18.7%). The value of the heavy industrial construction market increased by 7.3% in 2004 with activity dominated by solid growth in the oil and gas sector (12.8%) - principally large scale projects in Western Australia and Northern Territory. The non-residential building sector continued to expand in 2004 with a 7.2% rise generated in construction revenue following a 10% rise in the previous year. This moderation reflects a lower growth contribution in 2004 from private sector building work. With prices of major minerals and energy commodities remaining robust in response to continuing world growth (particularly Chinese), revenue from mining sector work increased by a solid 15.4% in 2004. Revenue from overseas projects (which accounted for 15% of total industry revenue in 2004) was another key contributor to growth, rising by 12.7% to maintain the upward trend of the past five years.

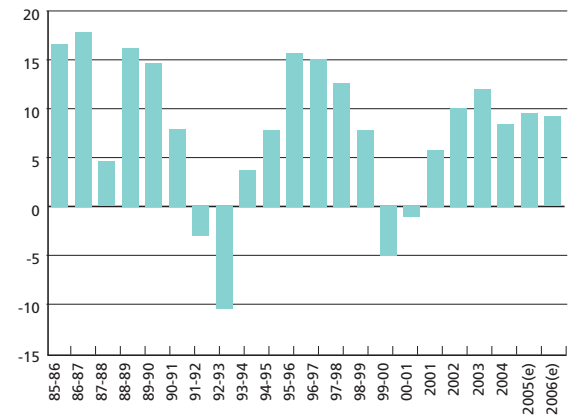
OUTLOOK FOR 2005

The outlook is for continued solid expansion in construction activity in 2005 with forecast growth of 9.6%. Infrastructure projects and resource-based construction, covering mining and resource related construction will be the key areas sustaining the upturn. Within the infrastructure market, revenue from road projects is expected to continue to increase from a high base with growth of 29.3% forecast. This is consistent with a continuation of strong private sector involvement in roads investment and a lift in government road spending as the Federal Government's AusLink program gets underway. Further solid growth is also expected in electricity generation and supply (28.8%), and "sewerage, drainage and water supply (20.3%), in line with the \$30 billion of projects currently earmarked for the utilities sector. The transmission and telecommunications sector is expected to record some pick-up in growth to 8.4% consistent with investment plans for 3G mobile networks and wireless broadband networks. The mining sector is forecast to record stronger growth of 18.8% in 2005 reflecting continued strong world growth and mineral demand, while investment plans in heavy industrial and resource-based construction are expected to remain firm with a forecast rise in turnover of 11.3%. Activity in the heavy industrial sector will be led by oil and gas processing projects (9.4%) and the "other" industrial plants category (13.0%) - incorporating alumina, nickel refining, brown coal projects and other downstream processing plants. The upturn in non-residential building sector is expected to strengthen, with a forecast rise of 10.1%. Both private and public sector building activity is expected to exhibit firm growth.

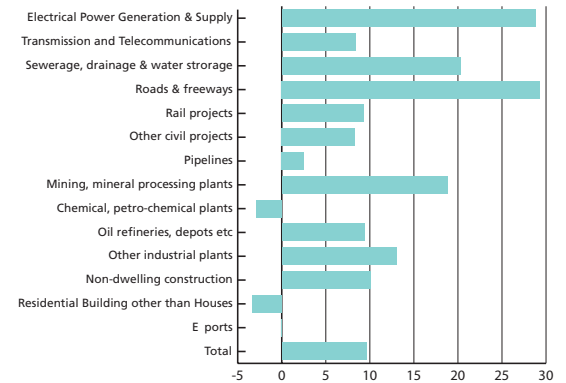
OUTLOOK FOR 2006

Further ahead, prospects are for construction activity to record growth of 9.2% (current dollars) in 2006 with the sizeable infrastructure sector underpinning growth prospects. For infrastructure construction, growth will again be led by road construction (33.4%) with several large-scale projects set to soon begin, while the Geelong Bypass is currently progressing through the planning stage. Other key infrastructure growth areas include electricity generation and supply (18.2%) and rail projects (11.8%). Prospects for the mining sector indicate that despite a moderation in growth, activity will be maintained at a high level in 2006. This is consistent with the high value of projects either committed or undergoing feasibility with petroleum, coal and iron ore projects dominant. Further growth will also be recorded in heavy industrial construction, with annual increases of approximately 9% expected for work undertaken on other industrial plants (9.2%) and oil and gas projects (8.7%).

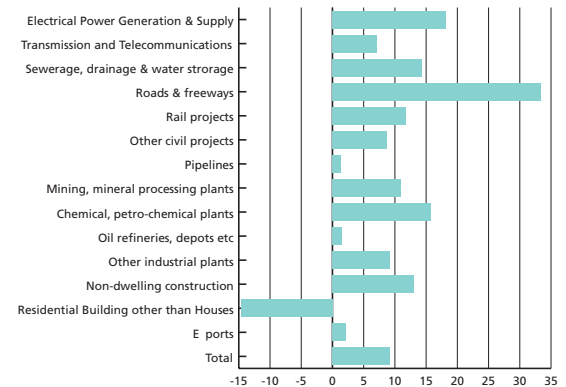
TURNOVER IN 2004



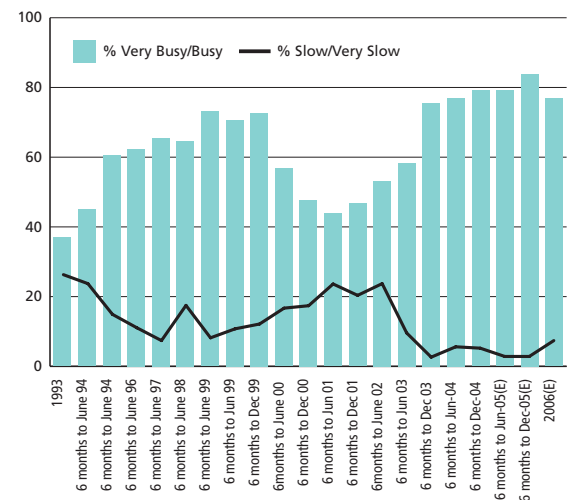
OUTLOOK FOR 2005



OUTLOOK FOR 2006



LEVELS OF ACTIVITY



Non-residential construction is set to maintain solid growth of 13.1% in 2006 on the back of prior strength in domestic demand and employment growth. However, as key projects are completed this is likely to be a peak year of activity.

LEVELS OF ACTIVITY

The survey confirms the strength in levels of construction activity. In the six months to December 2004, 79.1% of firms reported operating at busy or very busy activity levels, a rise from 76.9% in the previous six months period and the highest reading in the past twelve years. Activity levels are forecast to remain at robust levels over 2005 and into 2006. Firms anticipate that current operating conditions will continue to prevail over the first six months of 2005, with a lift in activity expected during the second half of the year, by which time 83.8% expect to be experiencing either busy or very busy activity levels. Thereafter, activity is expected to remain solid, although conditions will ease (to be slightly below current levels) with busy/very busy activity projected by 76.8% of firms during 2006. The survey also found that the average level of industrial/construction capacity in use was at 86.4% in February/March 2005 to be only slightly below the reading of a year ago (87.2%). Of significance, current capacity utilisation is 12 percentage points higher than the most recent low point of 74.9% recorded in February 2001.

EMPLOYMENT

Buoyant activity levels and strong investment demand has continued to drive employment growth. In the year to February 2005, total employment rose by 9.2% with strongest growth in on-site employees (+11.1%) and sub-contract tradesmen (+8.4%). This rise follows an increase of 10.4% during the previous 12 months and is the second highest annual rate of jobs growth recorded since the survey's inception in 1983. Sustained growth in work levels through 2005 will promote further job gains, albeit at a more moderate rate. Total employment is expected to increase by 4.5% over the period February to December 2005. Employment increases are expected to be more prevalent among employees principally engaged on-site (+10.2%). Over the first half of 2006, total employment is forecast to rise by a further 4.0%. Increases are forecast in all employment categories: on-site (+6.0%), off-site (+3.5%) and sub-contract labour (+2.8%).

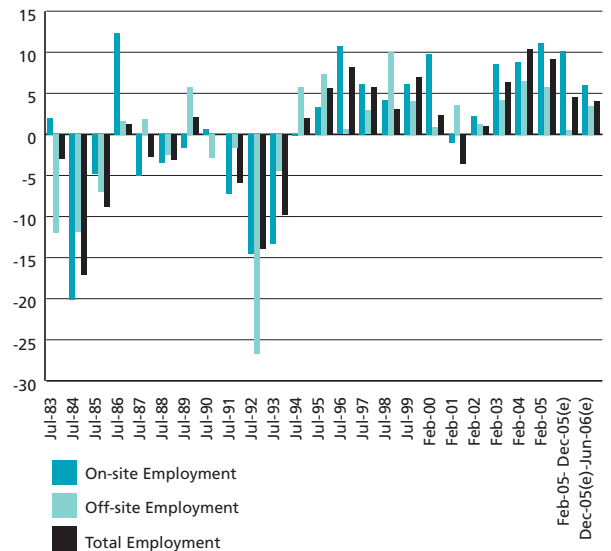
SUPPLY CONSTRAINTS

The recruitment of qualified labour (including professional and supervisory staff) remains the dominant supply constraint impacting on the industry. In total, 33.3% of firms reported major difficulty and 38.1% moderate difficulty in the recruitment of qualified labour. This was closely followed by the sourcing of sub-contractors (26.2% major difficulty and 42.9% moderate difficulty). Other dominant constraints were the sourcing of building materials (28.6% major difficulty and 31.0% moderate difficulty) and hiring and/or purchasing plant and equipment (7.1% major difficulty and 21.4% moderate difficulty). Over the next six months to August 2005, the recruitment of qualified labour and the sourcing of sub-contractors are seen as becoming greater supply constraints for firms as compared to their current experience with almost three quarters of all firms (73.8%) reporting that each factor is expected to pose either major or moderate difficulty. A slightly lower, but still high, proportion of firms (compared to currently) expect difficulty in the sourcing of building materials (28.6% major and 28.5% moderate). The degree of difficulty in hiring and/or purchasing plant and equipment is expected to remain unchanged on current levels.

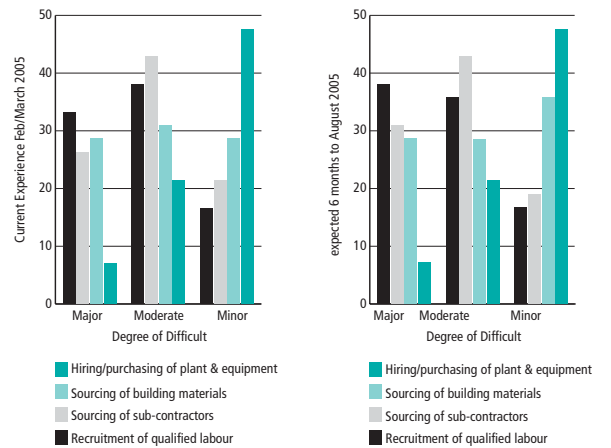
INPUT COSTS

During the six months to February 2005, a substantial majority of firms cited increases in construction materials and labour costs. For 81% of firms, either major or moderate increases were reported for direct labour costs, while 78.6% and 64.3% respectively cited major or moderate increases for prices of construction materials and sub-contractor rates. Over the six to August 2005, expectations indicate that firms anticipate little respite with respect to the degree of increases in labour costs (81.0% major or moderate increase) and sub-contractor rates (59.5% major or moderate increase). The degree of increase expected for construction materials is expected to ease, albeit slightly, with 76.2% expecting major or moderate increases.

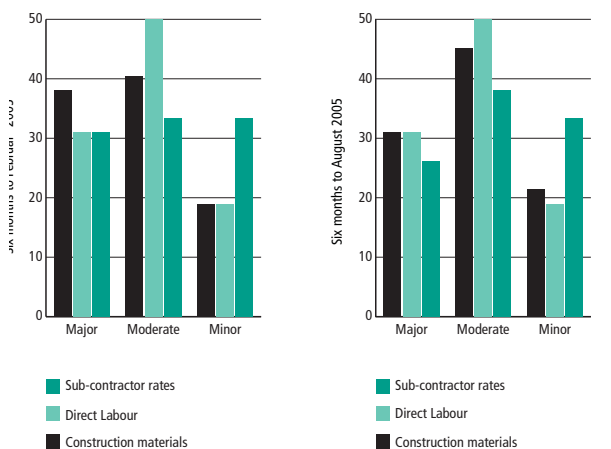
EMPLOYMENT



SUPPLY CONSTRAINTS



INPUT COSTS



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GROUP



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VALUE OF TURNOVER IN CONSTRUCTION WORK

	Proportion of Percentage Change			
	2004 Turnover	2004 on 2003	2005(E) on 2004	2006 (E) on 2005(E)
INFRASTRUCTURE				
Utilities				
Electrical Power Generation & Supply	1.0	22.00	28.8	18.2
Sewerage, drainage and water storage	1.4	18.7	20.3	14.3
Sub-total	2.4	20	23.9	16.0
Transport Infrastructure				
Roads and freeways	7.9	40.7	29.3	33.4
Rail projects	7.9	12.9	9.3	11.8
Sub-total	15.8	25.2	19.2	23.5
Transmission and telecommunications				
Other civil projects	4.8	6.7	8.3	8.8
Pipelines	1.1	16.3	2.5	1.3
Sub-total Infrastructure	27.0	18.4	15.8	17.9
Mining Mineral Processing etc				
Industrial Construction	11.6	15.4	18.8	11.0
Industrial Construction				
Chemical, petro-chemical plants etc	0.4	5.9	-2.9	15.8
Oil refineries and gas processing facilities	1.4	12.8	9.4	8.7
Other industrial plants	4.9	6.0	13.0	9.2
Sub-total Industrial Construction	6.7	7.3	11.3	8.6
Non Dwelling Construction				
- Private Sector	20.9	5.2	9.9	15.8
- Public Sector	4.8	17.2	11	1.5
Sub-total Non-Dwelling Construction	25.7	7.2	10.1	13.1
Residential Building other than Houses "Apartments"	11.9	-6.3	-3.4	-14.6
Export Business	14.8	12.7	-0.1	2.2
Other	2.3	-30.7	9.3	0
TOTAL	100.0	8.5	9.6	9.2

EMPLOYMENT

	Week Beginning 14 February 2005 Compared with a year earlier	Expected December 2005 Compared with 14 February 2005	Expected Jun-06 Compared with Exp. Dec-05
On-site employees	11.1	10.2	6.0
Off-site employees	5.8	0.5	3.5
Sub-contract labour	8.4	1.5	2.8
TOTAL	9.2	4.5	4.0

LEVEL OF ACTIVITY (% OF COMPANIES)

	Very Busy %	Busy %	Moderate %	Slow %	Very Slow %
Six months to December 2003	46.9	28.6	22.4	2.1	0.0
Six months to June 2004	35.9	41.0	12.8	7.7	2.6
Six months to December 2004	37.2	41.9	16.2	4.7	0.0
Expected					
Six months to June 2005	32.6	46.5	18.6	2.3	0.0
Six months to December 2005	32.6	51.2	14.0	2.3	0.0
During 2006	25.6	51.2	16.3	6.9	0.0

CONTACTS

Heather Ridout
Chief Executive, Ai Group
work 02 9466 5503
mobile 0419 257 361

Jim Barrett
Secretary, ACA
work 02 9466 5522
mobile 0418 119 887

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AUSTRALIAN CONSTRUCTORS ASSOCIATION

 **AUSTRALIAN
INDUSTRY
GROUP**

CONTACT DETAILS

SYDNEY

51 Walker Street,
North Sydney
NSW 2060
PO Box 289
North Sydney
NSW 2059
Tel: 02 9466 5566
Fax: 02 9466 5599

CANBERRA

44 Sydney Avenue
Forrest ACT 2603
PO Box 4986
Kingston ACT 2604
Tel: 02 6233 0700
Fax: 02 6233 0799

MELBOURNE

20 Queens Road
Melbourne VIC 3004
PO Box 7622
Melbourne VIC 8004
Tel: 03 9867 0111
Fax: 03 9867 0199

BRISBANE

202 Boundary Street
Spring Hill QLD 4004
PO Box 128
Spring Hill QLD 4004
Tel: 07 3244 1777
Fax: 07 3244 1799

ALBURY/WODONGA

Tel: 02 6021 5722
Fax: 02 6021 5117

BALLARAT

Tel: 03 5331 7688
Fax: 03 5332 3858

BENDIGO

Tel: 03 5443 4810
Fax: 03 5443 9785

GEELONG

Tel: 03 5222 3144
Fax: 03 5221 2914

NEWCASTLE

Tel: 02 4929 7899
Fax: 02 4929 3429

WESTERN SYDNEY

Tel: 02 9687 6700
Fax: 02 9687 6755

WOLLONGONG

Tel: 02 4228 7266
Fax: 02 4228 1898

AFFILIATE

ADELAIDE
Tel: 08 8300 0133
Fax: 08 8300 0134

AFFILIATE

PERTH
Tel: 08 9365 7555
Fax: 08 9365 7550

For all your workplace
related questions, please
call BIZassist@infoline
Tel: 1300 78 38 44

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