

The Australian Industry Group
NATIONAL CEO SURVEY:
Business prospects in 2013: Australia's gap year?



Principal contact person for this report:

Julie Toth
Chief Economist
THE AUSTRALIAN INDUSTRY GROUP
Direct Tel: (03) 9867 0124
Julie.Toth@aigroup.asn.au

This report was produced with financial support from the Government of Australia's Productivity, Education and Training (PET) Fund.

© THE AUSTRALIAN INDUSTRY GROUP, 2013

The copyright in this work is owned by the publisher, The Australian Industry Group, 51 Walker Street, North Sydney NSW 2060. All rights reserved. No part of this work covered by copyright may be reproduced or copied in any form or by any means (graphic, electronic or mechanical) without the written permission of the publisher.

ISBN 978-1-921768-44-6

Australian Industry Group

National CEO Survey

Business prospects in 2013:
Australia's gap year?

Key messages

Business prospects in 2013: Australia's gap year?



The Australian economy is going through significant change, with multiple, long-term forces restructuring our economy (such as global growth shifts and our own demographic changes), and ongoing challenges in our immediate outlook (such as the high Australian dollar and our relatively high business cost base). Recent drivers of growth are waning, with capital investment by the mining industry due to peak soon and federal and state government investment already past its post-GFC peak. But other potential growth drivers – most notably commercial and residential investment – are yet to show signs of a meaningful pickup. The global outlook also remains challenging, with only Asia generating any real growth in demand. As a result, in 2013, we are likely to see a gap in Australia's economic momentum. Outside of the supply chains feeding the mining industry's huge investment surge, this slow patch is already more than apparent to Australian businesses. It is also apparent to the Reserve Bank of Australia (RBA), which recently cut its growth expectations for the domestic economy in 2013 by $\frac{1}{4}$ of a percentage point to below the trend rate of 3 per cent per annum. The 2013 growth gap anticipated in this report makes further cash rate cuts by the RBA a real possibility – particularly if the consolidation of the Federal Budget position continues.


Our National CEO Survey this year indicates that on average, Australia's CEOs are expecting a tougher trading year in 2013 than they experienced in 2012. These expectations were recorded before the latest season of flood and fire was unleashed, and before the announcement of the federal election. The concerns of our CEOs for the Australian economy in 2013 can be grouped around three key themes:

- slowing demand across the economy;
- the high value of the Australian dollar and the challenge of global competition; and,
- rising business costs.

Adding to the sombre mood in many locations, 2013 opened with floods in the north and fires in the south, in an eerily similar pattern to 2011. By early February, the Federal Government had allocated \$76 million in emergency aid, and insurers had received an estimated 65,000 claims, worth \$674 million for fire and flood. Queensland has again been hit hard, with 53,700 insurance claims worth \$555 million already lodged this year. These events will have ramifications for the economy nationally; the disasters of 2011 were enough to shave $\frac{1}{2}$ a percentage point off national GDP growth in Q1 2011. A similar, but thankfully smaller, hit to the economy is likely this time around. Such is the nature of the Australian environment, especially in our northern zones.

2013 is also an election year, with a federal election announced for 14 September. As is often the case, pre-election uncertainty may see a reluctance to commit to longer-term business plans and especially longer term investment.

The challenge for Australian business leaders and policy-makers in 2013 is: ***How can we make the most of this 'gap year'? As with students taking a gap-year before the next big phase of their lives, how can we best prepare for the next change in gear?*** At a policy level, this lull provides an opportunity to re-focus our economic priorities and re-balance our cost base in preparation for the next phase of growth. It will be crucial in this policy process that we look past this election year to the longer-term growth path ahead. At a business level, our CEOs nationwide are working on their business models, their markets, their customer needs and their costs. Australian businesses have shown their resilience and adaptability over and over again in recent years. They are set to do so again in 2013.

A handwritten signature in black ink, reading 'Innes Willox', with a horizontal line underneath.

Innes Willox

Chief Executive
Australian Industry Group

Executive Summary

Business prospects in 2013

This report is based on information collected in our annual survey of Chief Executive Officers (CEOs) from approximately 350 businesses across Australia. These businesses are based in all states of Australia and are spread across all major non-farm private-sector industries. Together, these businesses employed around 34,000 people and had a collective annual turnover of \$14.3 billion in 2012 (see Appendix for sample details).

Economy-wide prospects

Australia's CEOs expect their general business conditions will be weaker in 2013 than they were in 2012. **Just over half of all CEOs (52%) expect general business conditions to deteriorate in 2013, relative to 2012 and around a third expect no change.** Just 16% of CEOs expect conditions to improve in 2013. Deteriorating conditions are expected in 2013 by more than half of CEOs in each of manufacturing (56%) and construction (52%). In services, 42% of CEOs expect a deterioration, while in mining, 47% expect conditions to deteriorate. The highest proportion of optimists is in services (23%) and the lowest is in mining (9%). 14% of construction and manufacturing CEOs expect their general conditions to improve in 2013. This will come on top of a tough year for most businesses in 2012. Indeed, 58% of all CEOs said 2012 had brought worse business conditions than 2011, while 15% said it was better (another 27% reported no change in 2012).

Across all industries, Australian CEOs told us that in 2013 they expect:

- **Flat sales revenue**
 - Sales revenue (annual turnover) will improve for 39% of businesses, but decline for 40% of businesses. 21% expect sales revenue growth to be flat, relative to a year ago.
- **Lower levels of employment**
 - Employment will expand in a quarter of businesses, but more than a third (37%) plan to reduce employment and 38% plan no change to their employment numbers.
- **Reduced capital investment**
 - Capital investment expenditure will rise for a quarter of businesses, but decline for 31% of businesses and remain unchanged for 44% of businesses.
- **Slightly higher spending on research and development (R&D)**
 - R&D spending will increase for 21% of businesses, decline for 17% and remain unchanged for 61%. This suggests many businesses place a high priority on innovation and staying ahead of their market, even when they are seeking to reign in costs elsewhere in their business.
- **Static export incomes**
 - Export income is expected to rise for 18% of businesses, decline for 16% and remain unchanged for 65%. This reflects the high Australian dollar and lack of growth in export volumes since 2011.
- **Increased use of imported inputs**
 - Imported inputs will increase in 30% of businesses and reduce in 11%. 58% of businesses will not change the value of inputs they import. This may reflect an acceptance among CEOs that the Australian dollar is likely to stay higher for longer into 2013 (see discussion below).
- **Input cost increases, especially for energy**
 - Input costs will rise for half of all businesses, but 8% are expecting their input prices to fall.
 - 82% of CEOs expect the prices they pay for energy will rise further in 2013.
- **Rising unit labour costs that will not be fully offset by improved productivity**
 - 44% of CEOs expect their unit labour costs to increase in 2013, relative to 2012. 13% of CEOs expect them to go down.
 - On labour productivity, one third of CEOs (33%) are expecting to see an improvement in 2013. Of more concern, 13% say they expect labour productivity in their own business to fall in 2013, relative to 2012 and over half (54%) expect no improvement.

These views are largely in line with forecasts for decelerating growth in 2013 from the RBA and from most private-sector economists. Indeed, the RBA recently cut its growth expectations for national GDP in 2013 by $\frac{1}{4}$ of a percentage point. It now expects GDP to grow by 2 to 3% in 2013 (previously $2\frac{1}{4}$ to $3\frac{1}{4}\%$), compared with $3\frac{1}{2}\%$ annual growth in 2012 and Australia's long-term average (or 'trend') GDP growth rate of 3% p.a. Resources investment is now widely expected to peak sometime in 2013-14 (earlier than previously anticipated), and state and federal government investment and operational spending is being cut. The economy is now awaiting an upturn from other growth drivers, primarily business investment, commercial and residential construction. In the meantime, a gap in the drivers of national growth is opening up for all to see.

Table 1: RBA forecasts for the Australian economy (as of Feb 2013)

	2011-12	2012	2013 (f)	2014 (f)
All GDP (% p.a.)	3.7	3.5 (est.)	2 - 3	$2\frac{1}{2}$–$3\frac{1}{2}$
CPI headline (% p.a.)	1.2	2.2	2–3	2–3
AUD/USD (average)	1.03	1.04	1.03	1.03

Source: RBA, *Statement of Monetary Policy*, Feb 2013.

Industry prospects

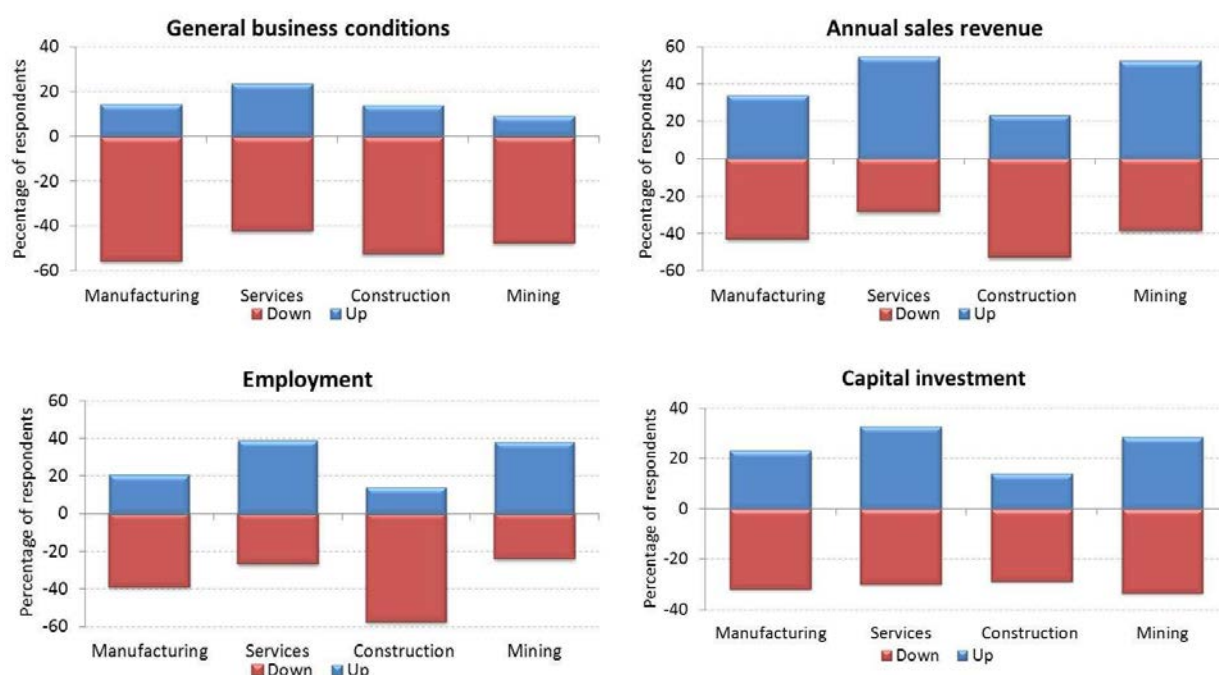
Mining and mining services CEOs are currently the least likely of any major industry group to expect their general business conditions to improve in 2013, relative to 2012 (9% expect conditions to improve). This may reflect the recent run of extremely good years that they are coming from. Even so, over half (52%) are expecting their sales revenue to increase in 2013, and over a third (38%) plan to increase their workforce even further. Over a quarter (28%) are still planning to increase their capital expenditure from here, but a third (33%) appear to have already peaked and are planning to reduce investment expenditure in 2013. The top five growth concerns among mining CEOs for 2013 are: customer demand (28% of CEOs), government regulation (20%), skill shortages (17%), the high AUD (13%) and wage pressures (7%).

Manufacturing CEOs are clearly resigned to another tough year in 2013, with 56% expecting business conditions to deteriorate further (and 14% expecting an improvement). A third (34%) remain optimistic about their ability to grow their sales revenues, but 43% expect their revenue to decline. Reflecting this outlook, 39% anticipate they will need to reduce their workforce, but this is partly offset by a fifth (21%) who plan to increase their employment numbers. With regard to investment, a similar portion are planning cuts in 2013 (32%), while 23% plan to increase their capital investment spending. The top five growth concerns among manufacturing CEOs for 2013 are: customer demand (26% of CEOs), imports competition (16%), the high AUD (12%), higher energy costs (9%) and wage pressures (9%).

Construction CEOs are expecting a year of contraction in 2013, as they await an upturn in demand for residential and commercial buildings. Some will also be affected by the reduction in federal and state investment and maintenance spending. 52% expect business conditions to deteriorate, versus 14% expecting an improvement. A higher proportion (24%) expect their sales revenue to increase, but only 14% plan to increase their workforce or their capital investment spending. 57% plan to reduce their employment numbers in 2013, the largest proportion of our four major industry groups.

Services CEOs are, on average, more upbeat than those in other sectors, but even for this group, less than a quarter (23%) expect business conditions to improve in 2013, with 42% expecting a deterioration. In their own business, the majority (55%) are looking for growth in their sales revenue, but over a quarter (28%) fear a fall. 40% plan to grow their workforce, but a quarter (27%) will be reducing it. A third (33%) will increase their capital investment as part of their growth strategy in 2013, but 30% will be cutting back on this spending also. Unlike the CEOs in other industry groups, the top five growth concerns among services CEOs for 2013 are primarily local rather than global: customer demand (22% of CEOs), wage pressures (15%), government regulation (14%), skill shortages (11%) and higher energy costs (9%).

Chart 1: CEO's expectations for 2013, by major industry group



Outlook theme 1: slowing demand across the economy

In all major industry groups, the factor most often cited as an expected growth inhibitor in 2013 was “lack of customer demand”, with well over a quarter of all CEOs nominating customer demand as one of their top three ‘growth inhibitors’ for 2013. In manufacturing, 26% of CEOs expected lack of demand to dampen their growth, while 28% of mining CEOs and 27% of construction CEOs expected customer demand to be problematic. Among CEOs in the services industries, a slightly lower proportion (22%) expected weak customer demand to impede their growth.

These expectations correlate closely with the latest trends in other forward indicators of demand in the economy - such as forward orders, business credit approvals, non-mining investment expectations, building approvals and job vacancies - all of which are relatively weak at present, at least in the non-mining sectors of the economy and in all states except Western Australia. This is, to some extent, the continuation of a pre-existing pattern; Australia's economy has been running at multiple speeds for some time, across geographies and across industries. The twist to emerge in 2013 is that even the better-performing sectors (such as mining and services) are now feeling the pinch. And those that have been slow for some time are yet to pick up. Crucially for many businesses, the all-important construction cycle is yet to turn upwards, with both commercial and residential construction activity remaining at historically low levels. Rising pent-up demand means a substantial upturn is expected eventually, but the timing remains unclear. This has major flow-on effects to a large number of businesses in other industries, up and down the construction supply chain.

Outlook theme 2: ongoing strength of the Australian dollar and international competition

The second key theme to emerge among our CEOs for 2013 is their expectation of a negative impact from the global economic environment. Around a quarter expect their business growth in 2013 to be inhibited by ‘competition from imports’ and/or a ‘high or variable exchange rate’. Unsurprisingly, these international competitive pressures are still being felt most keenly by manufacturers, with 16% expecting growth to be inhibited by imports competition and 12% expecting their growth to be inhibited by the high dollar. Perhaps less obviously, import competition has also become a key concern for many construction CEOs (20%), as imported components and construction services increase their penetration in Australia. Few construction CEOs however, thought the high dollar will be an issue for their business in 2013 (4%). Among services CEOs, local cost pressures (see below) were of greater concern than international pressures, with just 8% nominating ‘competition from imports’ and 6% nominating a high dollar as a potential growth inhibitor. CEOs

in mining and mining services businesses had the lowest level of concern about import competition (listed as a top 3 concern by just 2% of mining CEOs), although 13% said the high dollar is an inhibitor for their growth plans in 2013.

Two years ago¹, we identified the USD/AUD exchange rates at which Australian CEOs believed their own exported goods and services, and those competing against imports, would become uncompetitive. They indicated that, at an exchange rate of parity against the USD, 93% of manufacturing exports would become uncompetitive, as would 87% of services exports and 82% of construction exports (see table 1 below). With regard to their ability to compete against imported goods and services in the Australian market, most businesses said they would become uncompetitive at an even lower USD/AUD trading range, including all CEOs in the services and construction sectors. Just 3.6% of manufacturing CEOs said they could compete against imported goods when Australian dollar was trading above parity with the US dollar.

Table 2: Proportion of businesses who can remain competitive at each USD/AUD trading range (2011)

Level	Competitive in export markets			Competitive against imports		
AUD/USD:	Manufacturing	Services	Construction	Manufacturing	Services	Construction
0.5-0.6	4.7	3.3	0.0	9.3	3.6	0.0
0.61-0.7	2.3	6.7	0.0	17.1	10.7	16.7
0.71-0.8	25.6	6.7	18.2	28.6	28.6	41.7
0.81-0.9	32.6	53.3	45.5	25.7	39.3	33.3
0.91- 1.00	27.9	16.7	18.2	15.7	17.9	8.3
1.01-1.10	5.8	13.3	9.1	2.9	0.0	0.0
1.11-1.20	1.2	0.0	9.1	0.7	0.0	0.0
Total %	100	100	100	100	100	100

Source: Ai Group CEO Survey: Business Prospects 2011.

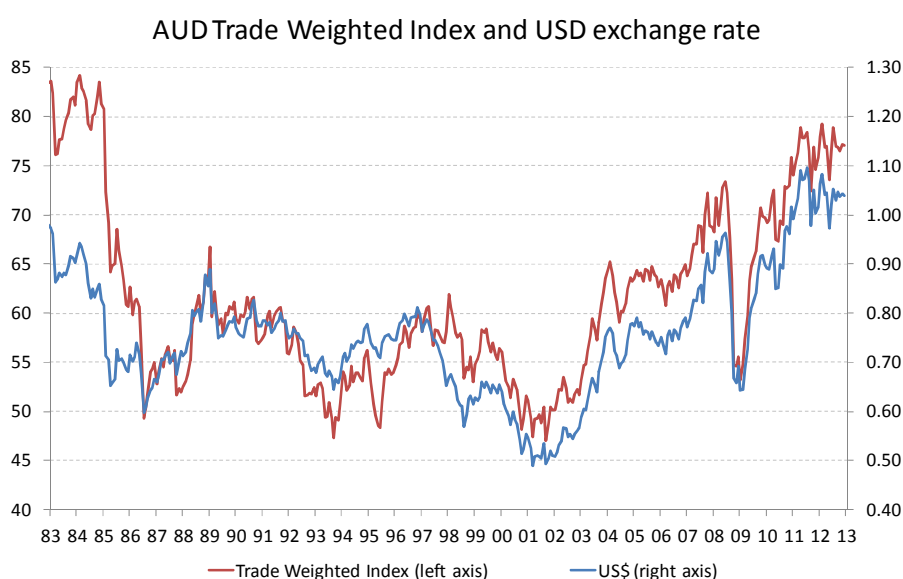
In the two years since we published that Report, the dollar has ended each month above parity against the USD in all but two months (September 2011 and May 2012). This is the longest period in which the dollar has remained at such elevated levels against the USD (and against other major currencies), since it was first floated in 1983 (see chart 2). The reasons for the sustained strength of the Australian dollar are complex and, in many respects, lie outside Australia. Traditionally, our dollar has tracked closely to two key indicators: (1) Australian export commodity prices and (2) the difference between interest rates paid in Australia versus those available in the US and other key markets. Lately however, the Australian dollar has remained stubbornly elevated, despite falls in commodity prices (and in Australia's terms of trade), and in the interest rate differential. Indeed, the RBA has now cut the cash rate six times since November 2011, to the current rate of 3.00%. On each occasion, the dollar reacted with only a temporary lull, only to bounce up again relatively quickly. As noted by the RBA recently, "*the exchange rate remains higher than might have been expected, given the observed decline in export prices and the weaker global outlook*"².

Instead of these long-term local influences, the Australian dollar is now being supported by international market conditions including: investor sentiment that favours 'commodity' countries and currencies; growing private investor inflows into Australian government bonds (over three quarters of which are now being purchased by offshore investors) and other 'safe haven', AAA-rated, positive-yield investments; increasing interest in the Australian dollar as an alternative 'reserve status' currency by foreign central banks; zero cash rate settings in almost all major developed economies; and ongoing weakness in the US economy, relative to the (still reasonably robust) Australian economy. With the dollar continuing to punch above its weight in international financial markets and among sovereign banks, exchange rates above 1.02 to 1.05 USD seem set to continue well into 2013. Indicative of these currency expectations, the RBA is currently basing its forecasts on the expectation that the dollar will trade around 1.03 USD throughout 2013 and 2014.

¹ Ai Group Feb 2011, *National CEO Survey: Business Prospects in 2011*.

² RBA, *Statement by Glenn Stevens, Governor: Monetary Policy Decision*, 4 Dec 2012.

Chart 2: AUD has consistently traded above parity against the USD since early 2011



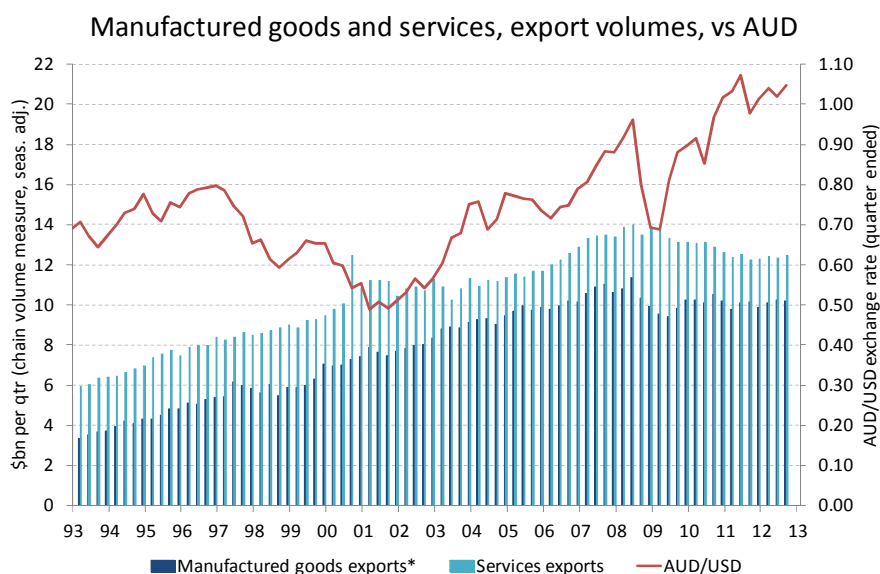
Source: RBA, AUD end of month values, Table F11.

This sustained strength in the AUD has had major ramifications for Australian businesses. The effects of the high AUD flow through the entire economy and include benefits (lower prices for imported consumer goods and business inputs) as well as challenges (lower AUD earnings for all exporters). The effects for local businesses are most visible in Australia's export volumes for goods and services other than rural and resources export goods (see chart 3). In volume terms, exports of both manufactured goods and all services enjoyed a very long run of solid growth that peaked in 2008, immediately prior to the onset of the Global Financial Crisis (GFC). In the decade to March 2008, exports of both manufactured goods and services grew at an annual average rate of 5% by volume. Manufactured goods exports dropped sharply in 2008 (down 16% in the year to March 2009), and then made a partial recovery in 2009. Services exports contracted over a longer period (down 11% in the three years to March 2011).

Export volumes for services, and to a lesser extent manufactured goods, continued to drift down through 2011 and 2012 (see chart 3). The failure to continue 2009's promising recovery has coincided with a sharp AUD appreciation, followed by an extended period of trading in excess of one USD. Other global factors also contributed to this poor export performance, including ongoing weakness in the US and Japanese economies and 2011's natural disasters in Queensland and Japan. Indeed, given the number and strength of these headwinds, it is a credit to Australia's non-mining exporters that their volumes did not fall by more than they did. But while some of these recent headwinds were one-offs or are improving, the high AUD remains a significant challenge to all exporters and import-competing businesses, and therefore a foremost concern for many Australian CEOs in 2013.

In this year's survey, 6.1% (net balance) of manufacturing businesses reported that their export income had declined in 2012, relative to 2011, and by an average of 33%. This balance included a small number (12% of manufacturing firms) who reported an increase in export earnings in 2012, but the overall trend remains downward. For 2013, a more positive 1% (net balance) expect their export earnings to improve, including 18% of firms who expect an improvement (versus 17% who are expecting a further decline). Among services CEOs the reported declines in export incomes were less drastic, with 3.5% (net balance) reporting a decline in export earnings in 2012, relative to 2011 (by an average of 29% reduction), but 5.3% (net balance) of services sector CEOs expecting an improvement in their export earnings in 2013.

Chart 3: Export volumes of manufactured goods and services peaked in 2008 and have not recovered



* Manufactured goods volumes includes machinery, transport equipment, sugar, beverages and all other manufactured goods.

Source: ABS, *Balance of Payments*, cat. no. 5302 (tables 6 and 11); RBA, *exchange rates*, Table F11.

Outlook theme 3: rising local business costs

The third area of concern to emerge from this year's CEO survey is various aspects of local business costs. This is not unexpected, particularly for businesses operating in an international context, since Australia has become a relatively more expensive country in which to do business, in a relatively short space of time, as indicated by a number of recent international business comparisons and reported single-business examples.³

As noted above, services businesses felt local costs would impede their growth in 2013 to a greater degree than businesses in other major industry groups, but businesses across a range of industry sectors expressed concern about rising costs for energy and labour:

- Higher energy costs were expected to be an impediment to growth for 9% of manufacturers, 9% of services businesses, 6% of miners and 4% of construction firms. This will come on top of large price rises for electricity, gas and other energy inputs in 2012 due to the introduction carbon tax in 2012 as well as other cost pressures in the energy sector.
- Wage pressures are expected by 15% of services businesses (10% of whom are expecting skill shortages), 11% of construction firms and 9% of manufacturers (8% of whom are expecting to be affected by skill shortages). Curiously, only 6% of miners expect wage pressures to impede on their business, even though 17% of these CEOs expect skill shortages. This possibly reflects a greater ability by miners to meet high wage claims and/or they have already factored such rises into their business plans. Also indicative of their greater capacity to pay, just 2% of miners nominated 'flexibility of industrial relations' as a potential growth inhibitor for 2013, compared with 9% of construction firms, 7% of services firms and 4% of manufacturing firms.

Rising non-wage input costs (other than energy) were of concern for just 4% of manufacturers, 3% of services, 2% of construction firms and was not nominated as an issue by mining CEOs. This probably reflects recent falls in commodity prices that have flowed through into reduced price pressures for many basic inputs.

Business regulation, including its costs, also featured prominently as a potential inhibitor of growth in 2013. It was noted as a growth blocker by 20% of miners, 14% of services businesses and 9% of manufacturers and construction firms.

³ See for example: Economist Intelligence Unit, *Survey of international manufacturing labour costs*; AHRI *Global workplace performance survey*; WEF *Global Competitiveness Report 2012-13*; IKEA (various media).

Business responses: growth strategies for 2013

This year's CEO Survey results clearly demonstrate that Australian CEOs are keenly aware of the challenging business environment they face in 2013. Among other growth strategies, they plan to focus on their existing products and customers, as well as developing new ones, in order to address these challenges:

- Around a quarter of CEOs in each of manufacturing and services planned to focus on improving sales for their current range of product, as did 18% of construction firms and 30% of mining firms
- New products or services were planned by 20% of manufacturing, 19% of services, 18% of construction businesses and 15% of miners.
- A focus on building new Australian customers is included in the strategy for 18% of services and construction firms, 15% of manufacturers and 15% of miners.
- A focus on building new export markets was less prominent, with 10% of miners, 5% of manufacturers and services and 2% of construction firms planning to do so in 2013.

As noted above, a significant proportion of CEOs signalled that they intend to reduce their workforces in 2013. In addition, a general reduction in business operating costs is planned in 2013, as part of the overall 'business growth strategy', by 20% of construction businesses, 10% of manufacturing and services businesses and 7% of miners (see table 3).

On the other hand however, many businesses were planning to give increased attention and resources to investing in: their current business; advertising and marketing, new technologies; and market development. Increased investment in the current business is planned by 12% of miners and 9% of services businesses, with smaller proportions of manufacturers and construction firms able to plan for an increase in investment in their current business in 2013 (see table 3).

The least popular type of growth strategies are those involving mergers and acquisitions or increased 'offshoring' (see table 3). This seems to be in line with international business trends of late, which have seen growth strategies built around extensive supply chain acquisitions or complex international production links fall out of favour, with a return to 'home base' or to a smaller number of established location bases.

Table 3: Proportion of businesses planning to use each type of growth strategy in 2013*

% of businesses planning to utilise each strategy	Mining	Manufacturing	Services	Construction
Improving sales of current products/services	30	24	23	18
Introducing new products/services	15	19	19	18
Developing new domestic markets	15	15	18	18
Downsizing / reducing operational costs	7	10	10	20
Investing in current business	12	7	9	2
Increasing advertising / marketing	0	6	6	4
Developing new overseas markets	10	4	5	2
Increasing investment in new technologies	7	4	4	2
Increasing offshore sourcing of inputs	0	3	2	6
Partnering with another business	2	2	3	8
Acquiring another business	0	1	1	2

* Proportion of businesses in each industry group who nominated each type of strategy in their top 3 ranking.

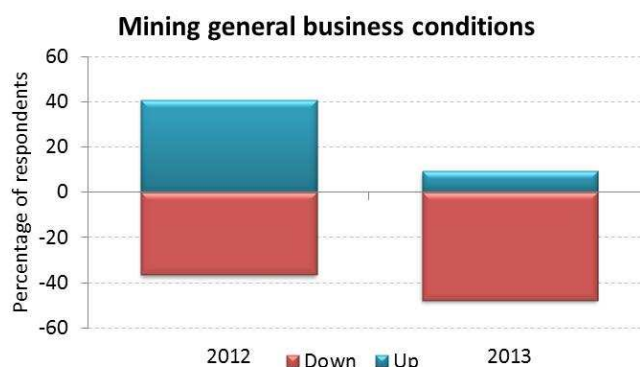
Mining and mining services sector

Mining business conditions expected to worsen, new growth strategies planned for 2013

Mining general business conditions

- The majority of mining CEOs in this survey were in mining services firms rather than mining extraction. Reflecting this, most of the customers of this group in 2012 were other miners, other mining services and construction firms.
- 41% of mining and mining services CEOs said business conditions in their sector were better in 2012 than in the previous year, against 36 % who said it was worse, giving a net balance of 5% giving a positive view of general business conditions in 2012 (relative to 2011).
- This group of CEOs expect general business conditions in their sector to moderate in 2013, with 47% expecting worse conditions and only 10% expecting business conditions to improve, giving a net balance of 37% of mining CEOs expecting a deterioration in 2013.

Mining CEOs expect business conditions to worsen in 2013

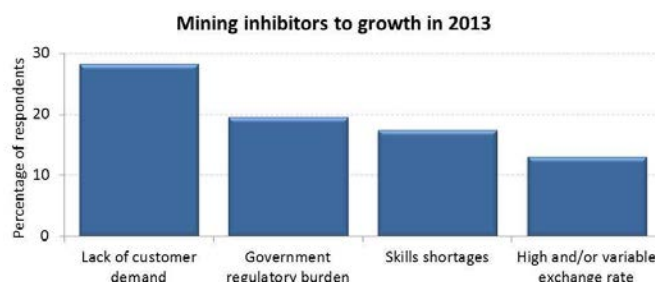


Mining inhibitors to growth in 2013

Mining and mining services CEOs expect the following factors will inhibit their business growth in 2013.

- A lack of customer demand is expected to inhibit growth in the mining sector in 2013 with 28% of CEOs naming it as one of the top three factors.
- Government regulatory burden was the second most common inhibitor expected by mining and mining services, mentioned by 20% of respondents.
- Skills shortages (17%) and the high and/or variable exchange rate (13%) were the third and fourth factors most frequently expected by mining CEOs.

Mining sector expects lack of customer demand and government regulatory burden to inhibit growth in 2013



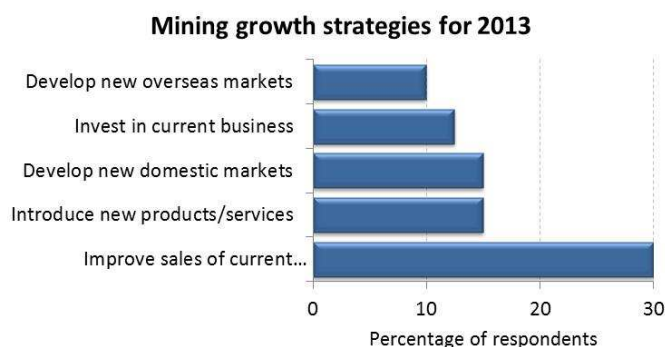
Mining growth strategies for 2013

In response to this outlook, mining and mining services CEOs will mainly focus on sales-oriented strategies to grow their businesses in 2013:

- 30% plan to improve sales of their current products and services
- 15% intend to introduce new products and services
- 15% will focus on developing new domestic markets and
- 12% will invest in their current business.

Developing overseas markets, downsizing and reducing operational costs and increasing investment in current business were other noted but less popular strategies for achieving better growth in 2013.

Mining CEOs will focus on improving sales of current products and services as their preferred growth strategy

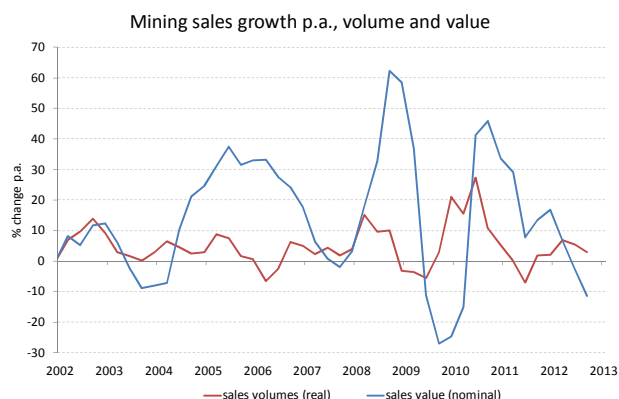


Mining sales and employment will continue to rise, but export earnings are under pressure

Mining sales (annual turnover)

- The nominal value of mining sector sales declined in late 2012 for the first time since 2009, due to falling commodity prices in 2012 (see 'mining selling prices' below).
- The volume of mining output sold expanded through 2012, as the industry recovered from the interruptions of 2011's floods in Queensland (which mainly affected black coal production). The rate of expansion in mining sales volumes in 2012 was very close to the industry's recent average of 5% p.a. (average for 2002 to 2012).
- Mining sector CEOs told us on balance their average turnover went up by 31% in 2012.
- For 2013, 52% of mining CEOs expect their turnover will go up while 38% expect it to decline, giving a net balance of 14% expecting their sales revenues to improve in 2013.

Nominal value of mining sales is falling even as volumes rise

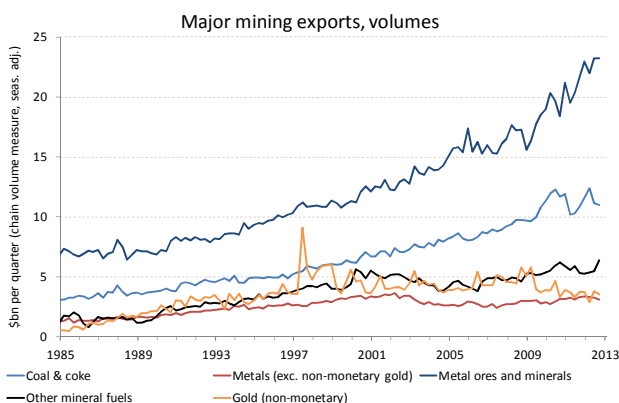


ABS, *Business Indicators, Australia*, Cat. No. 5676.0 (seasonally adjusted data).

Mining export income

- Mining sector export income has been boosted dramatically over the past decade, primarily by large price increases. For many commodities, prices are now down from their all-time peaks, but remain elevated by historical standards. Export volumes have increased more slowly, as capacity expands in key sectors such as coal and iron ore (ABS data). Exports of mining services have also grown, as demand increases from other resource-rich countries who are similarly working to expand their capacity at present.
- The majority (62%) of mining sector CEOs told us their export earnings remained steady in 2012, relative to 2011. 24% of mining CEOs reported that their export income declined by an average 30%, while for 14%, their export income rose an average 46%.
- For 2013, just under half (45%) of mining CEOs expect their export earnings will remain steady while 27% expect export earnings to go up and 23% expect it to decline.

Export volumes will grow, but earnings likely to fall in 2013

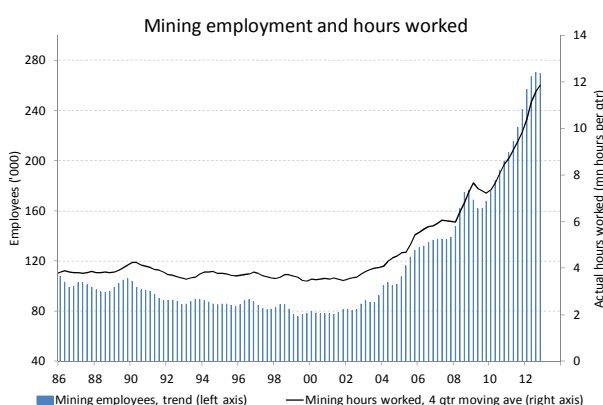


ABS, *Balance of Payments*, Cat. No. 5302.0 (seasonally adjusted data).

Mining employment

- Direct employment in mining and mining services has soared over the past five years, from around 100k at the end of 2004 to 270k by the end of 2012. Many more are employed in related industries through contracting and supply chain links (e.g. in mining-related construction, finance and engineering services).
- 40% of mining CEOs told us their employee numbers went up (by an average of 29%) in 2012. A further 36% had no change in employment levels in 2012.
- In 2013, 38% of Mining CEOs expect their employee numbers will go up while 23% expect it to decline, giving a net balance of 15% of mining businesses who expect their employment numbers to grow in 2013.

Mining employment has soared over the past five years and will keep growing in 2013, albeit at a slower pace



ABS, *Labour Force Australia, Detailed Quarterly*, Cat. No. 6291.0.55.003 (trend data).

Mining sector spending on capital investment and R&D is likely to peak in 2013

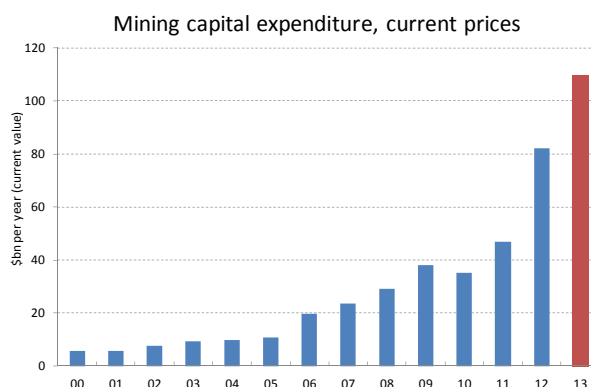
Mining capital investment

- The latest ABS estimates of private sector capital expenditure (CAPEX) indicate the total value of CAPEX by the mining sector rose by 40% in the year to September 2012 (actual nominal spending).
- Nationally, mining businesses plan a further increase in their CAPEX in 2012-13 of 33.3% (nominal value of the fourth estimate of 2012-13 CAPEX, unadjusted by realization ratios). Applying a realization ratio to this expected growth rate however (based on the actual amount of last year's equivalent estimate that was later realized in practice), brings this growth rate down to an expected increase of 17% p.a. in mining CAPEX in 2012-13. Significantly (and unusually in the national CAPEX data of late), this latest (fourth) estimate of mining CAPEX for 2012-13 was 8% lower than the previous (third) estimate, indicating that mining companies are already revising down their CAPEX plans as they move through 2012-13.
- In line with these national data, mining sector CEOs in this year's survey told us their spending on physical capital either stayed the same or went up - by an average of 55% - in 2012. None of these respondents recorded a decrease in capital investment in 2012.
- In 2013 however, mining CEOs investment intentions indicate this spending may be reaching a peak. 29% of mining CEOs expect their spending on physical capital will go up in 2013 (relative to 2012) while 33% expect their physical investment budget to decline.

Mining research and development

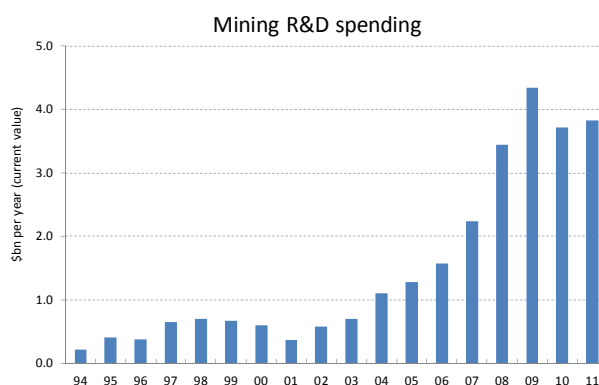
- The value of research and experimental development spending in the mining sector rose by 2.9% in 2010-11 after declining by 14.5% in 2009-10, from an all-time peak of around \$4.2bn (ABS data). This indicates that the developmental (or experimental) stage of investment, in this current mining investment cycle, peaked some time ago.
- Mining sector CEOs told us their spending on R&D remained steady in 2012 relative to 2011, with 73% of respondents stating there was no change relative to 2011.
- For 2013, 24% of mining CEOs expect their spending on R&D will go up while 19% expect it to decline, giving a net balance of 5% planning to increase their spending on this important area of investment in 2013.

Mining investment has more than doubled in two years and is expected peak in 2013 or 2014



ABS, private new capital expenditure, Cat. No. 5625.0 (seasonally adjusted data).

Mining R&D spending is low relative to the industry's CAPEX



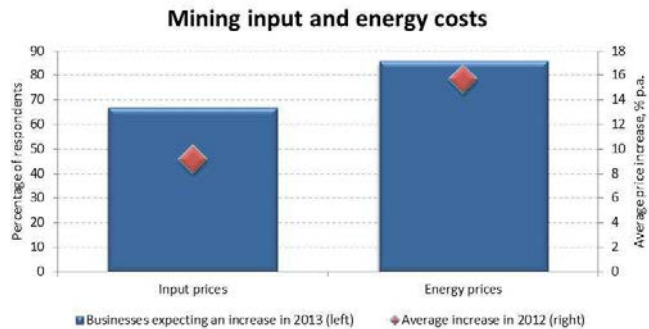
ABS, Research and Experimental Development, Businesses, Australia, 2008-09, 2010-11, Cat. No. 8104.0 (original data).

Mining input costs continue to rise, but selling prices likely to match them

Mining input and energy costs

- In 2012, mining sector CEOs estimated that on average 23% of their inputs were imported (sourced offshore). 27% of CEOs reported they had increased their imported inputs in 2012.
- Input costs remained largely flat in 2012 with 59% of respondents stating that there was no change, while 27% reported an increase.
- Mining CEOs estimated that their energy input costs increased by an average of 16% in 2012.
- For 2013 however, 67% of businesses are expecting an increase in input prices and 86% are expecting their energy costs to rise.

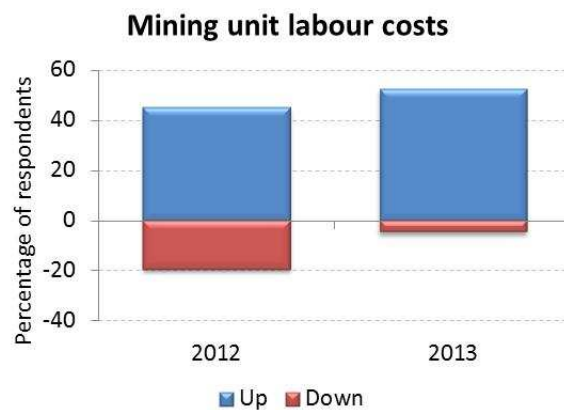
More cost increases expected for energy and other inputs



Mining unit labour costs

- Mining sector CEOs told us their unit labour costs (labour cost per unit produced) went up in 2012. 45% of businesses reporting an increase and 19% reporting a decrease, giving a net balance of 25% of mining CEOs reporting an increase in their unit labour costs in 2012.
- For 2013, 53% of mining CEOs expect their unit labour costs will go up while only 5% expect it to decline, giving a net balance of 47% of mining CEOs who expect their unit labour costs to rise further in 2013.

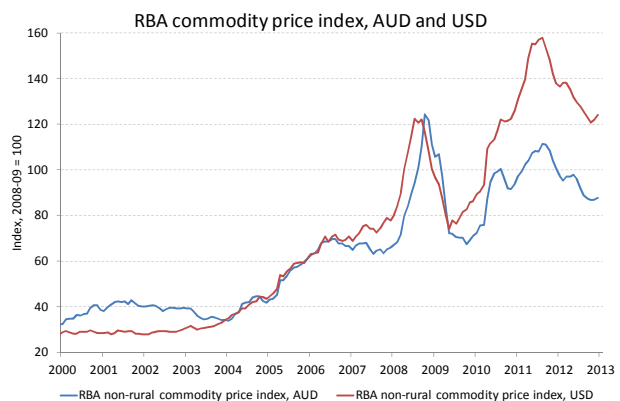
Miners expect their unit labour costs to rise further in 2013



Mining selling prices

- The latest RBA commodity price index shows that non-rural commodities declined by 13% in 2012 in AUD terms, and by 10% in USD. Commodity prices are now 29% below their August 2008 peak, in AUD (and 21% below the August 2011 peak in USD). The large gap between the AUD and USD price indexes illustrates the effect the high AUD is having on AUD export incomes, even for the miners.
- These price indexes represent the average spot price per month. The actual prices paid to Australian miners are generally set far in advance, in long-term contract arrangements that are mostly negotiated offshore and in USD.
- Reflecting these typical contracting arrangements, mining sector CEOs told us their selling prices remained flat in 2012, with 60% reporting no change in their selling prices.
- In 2013, 38% of mining CEOs expect their selling prices will go up and 48% think they will remain steady, but 14% expect their selling prices to decline in 2013.

Mining product prices have declined from recent peaks but remain elevated by long-run historical standards



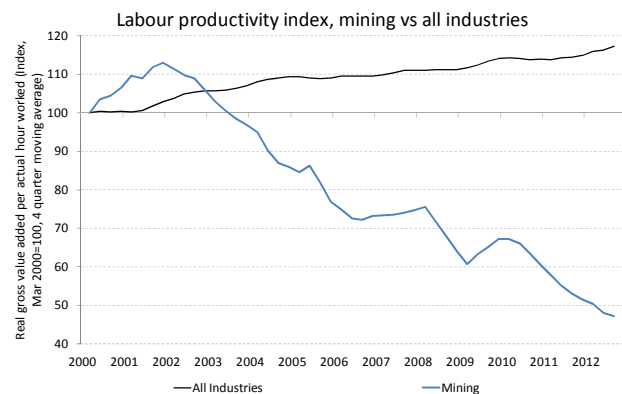
RBA, Index of Commodity Prices, Table G5.

Mining labour productivity to be boosted by skills, processes and investment in 2013

Mining labour productivity

- Official calculations of labour productivity (volume of output per hour worked) for the national mining industry from ABS data[#] continue to show labour productivity declining dramatically. This reflects the current stage in the mining investment cycle, which is seeing the whole industry investing heavily in capital and labour, well ahead of any return in terms of increased volumes of output.
- Against this industry-wide cyclical trend, mining sector CEOs told us their labour productivity remained the same (50%) or went up (36%) in 2012. Another 14% said it had declined in 2012.
- For 2013, 48% of mining CEOs expect their labour productivity will go up while 19% expect it to decline further, giving a net balance of 29% of CEOs in this sector expecting an improvement. A further third of mining CEOs expect no change in labour productivity in their business in 2013.

Labour productivity may fall further in mining in 2013, ahead of current expansion in capacity and output



Calculated from ABS, *National Accounts*, Cat. No. 5206.0 and ABS, *Labour Force Australia, Detailed Quarterly*, Cat. No. 6291.0.55.003 (original data).

Mining labour productivity: inhibitors and contributors

In this year's survey, mining and mining services CEOs who said their labour productivity had *improved* in 2012 listed the following three factors as contributing to that improvement:

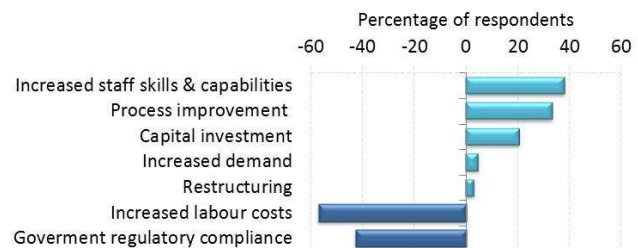
- An increase in staff skills, capabilities and productivity (38%)
- Improvements to processes (33%) and
- Productivity increases as a result of capital investment (21%).

Mining and mining services CEOs who said their labour productivity had *declined* in 2012 listed the following two factors as the major inhibitors:

- Increased labour costs (57%) and
- Complying with government regulations (43%).

Mining labour productivity: top 3 inhibitors and top 3 contributors to change in 2012

Mining labour productivity: contributors and inhibitors



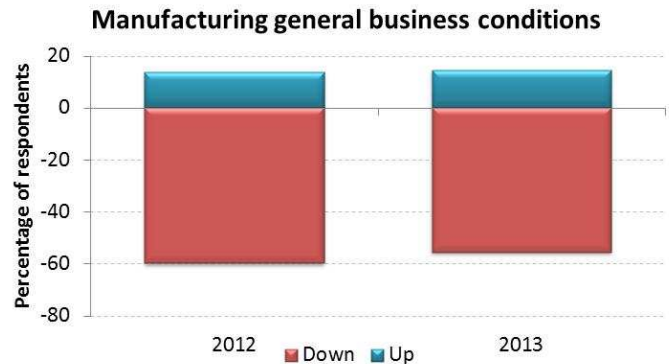
Manufacturing Sector

Manufacturing business conditions remain tough in 2013, new growth strategies planned

Manufacturing general business conditions

- The manufacturing CEOs in this year's CEO Survey came from a broad range of sectors and locations. The top 3 industries in which their customers were based in 2012 were construction, other manufacturers and services.
- Manufacturing CEOs said business conditions in their sector had worsened in 2012. 60% of this group reported business conditions in 2012 being worse than 2011, while 14% said they had improved, giving a net balance of 46% indicating a decline in conditions in 2012.
- For 2013, 56% of manufacturing expect business conditions to be worse than in 2012, while 14% expect an improvement and 30% expect no change. In net balance terms, 41% expect conditions to deteriorate in 2013.

Manufacturers remain pessimistic about general business conditions for 2013, much as they did in 2012

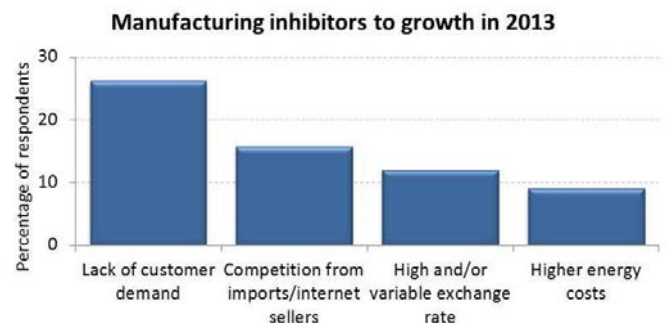


Manufacturing inhibitors to growth in 2013

Manufacturing CEOs expect the following factors will continue to inhibit their business growth in 2013.

- A lack of customer demand, with 26% naming it as one of their top three factors.
- Competition from imports and internet sellers, with 16% of respondents considering it a major factor.
- The high and/or variable exchange rate (12%) and higher energy costs (9%) were also expected to contribute to curbing growth for large proportions of manufacturing firms in 2013.

Manufacturers expect customer demand, import competition and the AUD to inhibit their growth in 2013

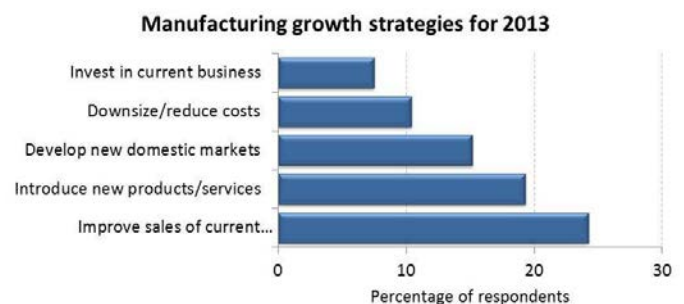


Manufacturing growth strategies for 2013

In response to this outlook, manufacturing CEOs expect to pursue the following growth strategies in their businesses in 2013.

- For 24% of respondents improving sales of current products and services is a high priority.
- 19% of respondents plan to introduce new products and services.
- For 15%, developing new domestic markets was one of their top three strategies for growth over the coming year.
- Reducing costs or downsizing their business will be part of the strategy for 10% of firms.

Manufacturers will focus on their current products and some will introduce some new ones in 2013



Manufacturing sales, export earnings and employment continue to face serious challenges

Manufacturing sales (annual turnover)

- Manufacturing sales declined in both nominal value and volume terms through 2012. Indeed, manufacturing sales volumes have grown in only two quarters since 2008 (ABS data, annual percentage changes). This trend has seen sales volumes for the sector fall by a total of 13.4% between September 2008 and September 2012. Nominal sales revenue has fallen by 12.3% over the same period.
- Almost as many manufacturing CEOs reported their annual turnover increased in 2012 (40%) relative to 2011, as those that reported a decrease (44%). The balance, 16% reported no change in sales. For those that saw an increase in sales in 2012, the average increase was 18% p.a., while those who experienced a decrease averaged a fall of 18% p.a.
- In 2013, 34% of manufacturing CEOs expect their turnover will go up, while 43% expect it to decline. 23% expect no change, giving a net balance of 9% expecting sales to fall.

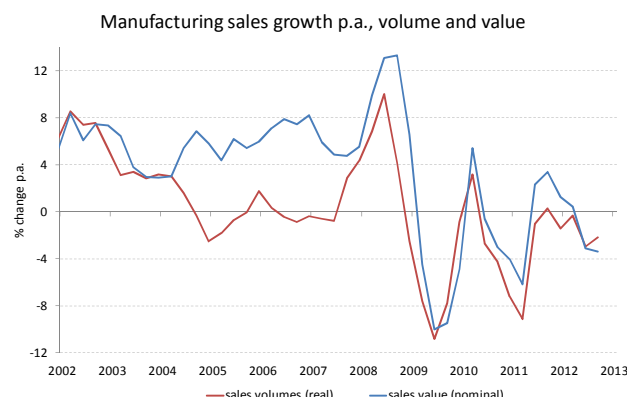
Manufacturing export income

- Manufacturing export income has been vulnerable for several years now, with both the value of earnings and the volume of goods being exported both failing to recover the large falls experienced in 2009 (ABS data).
- Among the manufacturing CEOs in this year's survey, export income represented an average of 47% of their total sales turnover in 2012.
- Manufacturing sector CEOs told us their export earnings remained steady in 2012, with 70% experiencing no change. 12% had managed to grow their export earnings in 2012 (by an average of 41%), while 18% had experienced a further decline in their export income (by an average of 33% p.a.) in 2012, relative to their export earnings in 2011.
- In 2013, 18% of manufacturing CEOs expect their export earnings will go up, while 17% expect it to decline further. 65% expect no change in their export earnings, giving a net balance of just 1% of manufacturing firms expecting growth in their export earnings in 2013.

Manufacturing employment

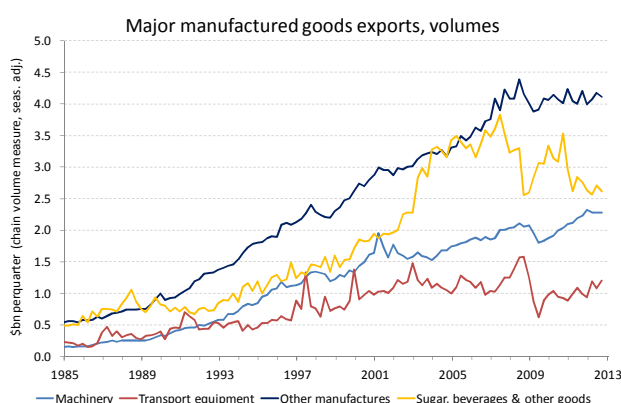
- Manufacturing employment declined sharply between 2008 and 2011, losing a total of 120k employees (ABS data). This corresponds with the period in which manufacturers were facing rapid declines in their export earnings and volumes (see above). Employment levels stabilised in 2012, with the return of 21k jobs in the year to November 2012. Total hours worked shows a similar pattern, albeit with a sharper fall that lasted into 2012, as work hours continued to be cut back.
- Manufacturing CEOs told us that in 2012, 30% of businesses reduced their employee numbers (by an average of 17%), while 24% increased their headcount (by an average of 17%). 46% of businesses held their employment numbers steady.
- In 2013, 21% of manufacturing CEOs expect to increase their employee numbers, while 39% will cut employment and 40% will not change their numbers, giving a net balance of 18% of manufacturing businesses planning to cut employment in 2013.

Manufacturing sales are declining in volume and value



ABS, *Business Indicators, Australia*, Cat. No. 5676.0 (seasonally adjusted data).

Manufacturing exports difficult to grow in value or volume, due to high AUD and depressed non-Asian export markets



ABS, *Balance of Payments*, Cat. No. 5302.0 (seasonally adjusted data).

Manufacturing employment stabilised in 2012, but will decline again in 2013, if sales continue to decline



ABS, *Labour Force Australia, Detailed Quarterly*, Cat. No. 6291.0.55.003 (trend data).

Manufacturing spending on capital investment and R&D under pressure

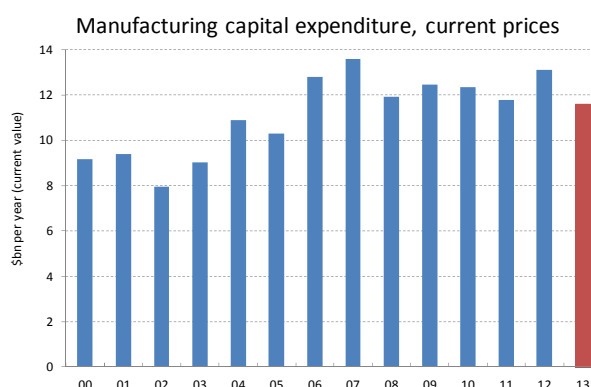
Manufacturing capital investment

- ABS estimates indicate that the nominal value of CAPEX by businesses in the manufacturing sector recovered by 11.1% in 2011-12, after shrinking in each of the preceding two years. In the September quarter of 2012 however, manufacturing CAPEX took another sharp fall, to be 26% lower than a year earlier.
- Based on the latest ABS CAPEX survey (estimate four, in November 2012), national manufacturing CAPEX is expected to fall by 11.5% in 2012-13, in unadjusted nominal terms. Applying the previous year's realization ratio however, takes the expected fall in manufacturing CAPEX in 2012-13 to 17.7% p.a.. Of most concern, the size of this fall has increased with each estimate over the past year, indicating that manufacturing firms were progressively increasing the size of the cuts to their CAPEX plans, as 2012 progressed.
- These national data mirror the CAPEX decisions of manufacturing CEOs in our survey. 28% told us their spending on physical capital went up in 2012 (by an average of 54% in 2012), 19% told us their spending was cut in 2012 (by an average of 49% p.a.) and 53% reported no change in their investment spending.
- For 2013, 23% of manufacturing CEOs expect their spending on physical capital will go up while 32% expect it to decline and 45% plan no change, giving a net balance of 8.4% of businesses expecting to cut their capital investment budget in 2013.

Manufacturing research and development

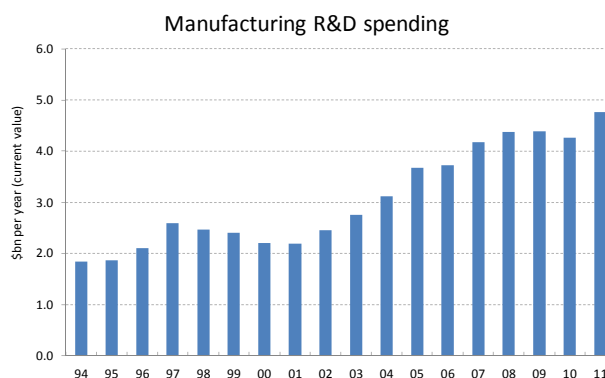
- The value of research and experimental development spending in the manufacturing sector rose 11.7% in 2010-11 to an all-time high of around \$4.8bn, after declining by 2.9% in 2009-10 (ABS data). In nominal dollar terms (and as a proportion of its total investment budget), the manufacturing industry still tends to spend more on R&D than do other industries. This indicates the extent of the effort being put into innovation and adaptation by the manufacturing sector, even during this recent extremely challenging trading period.
- Most manufacturing sector CEOs told us their spending on R&D remained steady in 2012, with 60% experiencing no change. More positively, 30% had increased their R&D spending in 2012 (by an average of 18% p.a.), but another 10% had decreased their R&D spending (by an average of 57%) in 2012.
- Levels of R&D investment are expected to remain steady in 2013 for 63% of manufacturing CEOs, while 20% expect their spending on R&D will go up and 17% expect it to decline in 2013. This gives a (weakly positive) net balance of 3% of manufacturing businesses who are planning to increase their R&D budget in 2013.

Manufacturing investment is expected to contract in 2013, as further savings are sought



ABS, private new capital expenditure, Cat. No. 5625.0 (seasonally adjusted data).

Manufacturing R&D steady, may even grow slightly in 2013



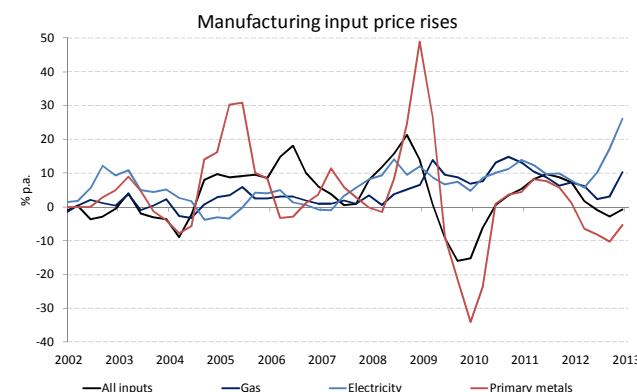
ABS, Research and Experimental Development, Businesses, Australia, 2008-09, 2010-11, Cat. No. 8104.0 (original data).

Manufacturing input costs are mixed, selling prices move lower

Manufacturing input and energy costs

- ABS producer price index data (PPI) shows that in the year to December 2012, input prices for all manufacturers fell by 0.7% from a year earlier.
- These price falls were not experienced universally. Half of the manufacturing CEOs in our CEO Survey reported their input prices had increased in 2012 (by 13.4% on average) and 41% reported no change in their input prices. 9% of businesses reported a price fall, by an average of 7.6% p.a.
- In 2012, Manufacturing sector CEOs in our Survey estimated that on average, 24% of their inputs were imported (sourced offshore). 24% of manufacturing businesses increased their imported inputs in 2012.
- Electricity prices for manufacturers increased by 26% p.a. and gas prices increased by 10% p.a. in 2012 (ABS data). This reflected the introduction of the carbon tax from 1 July 2012 plus energy network and generation cost increases. Among the manufacturing CEOs in our CEO survey, 75% reported a big increase in electricity prices in 2012 (up by an average of 17% p.a.).
- For 2013, 50% of manufacturing CEOs are expecting their input prices to rise, and 86% are expecting a further increase in their energy prices.

Manufacturers hit by big price rises for energy in 2012, offset by price falls for metal inputs

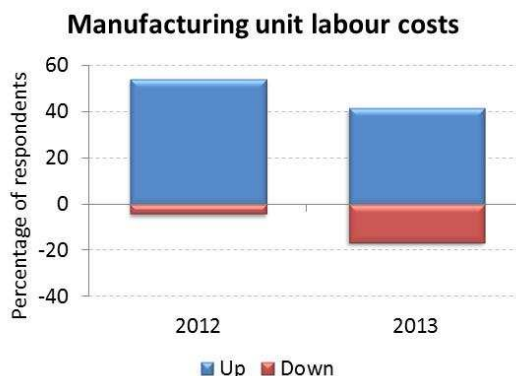


ABS, Producer Price Index, Cat. No. 6427.0 (seasonally adjusted data).

Manufacturing unit labour costs

- 54% of manufacturing CEOs told us their unit labour costs (labour cost per unit produced) went up in 2012 (by an average of 6% p.a.) and 40% said it did not change. Just 4% of manufacturing businesses had been able to lower their unit labour costs in 2012 (by an average of 10% p.a.).
- In 2013, 42% of manufacturing CEOs expect to see no change in their unit labour costs. 41% of Manufacturing CEOs expect their unit labour costs will go up again, while 17% expect it to decline, giving a net balance of 24% of manufacturing businesses expecting their unit labour costs to increase in 2013.

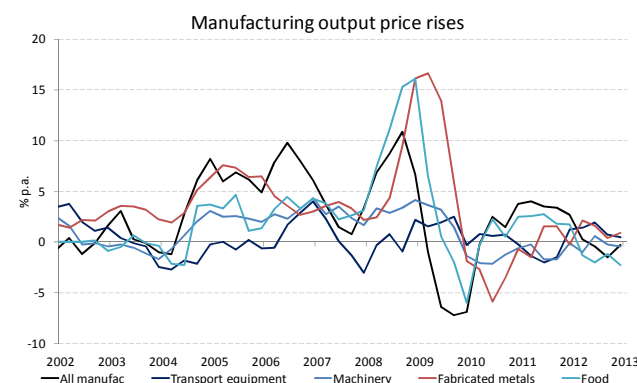
Unit labour costs increased for manufacturers in 2012



Manufacturing selling prices

- The latest ABS PPI data shows that output (selling) prices for all manufacturing firms fell by an average of 0.3% p.a. in the year to December 2012. Price changes in 2012 ranged from -5.7% p.a. in primary metals and -2.3% p.a. in food manufacturing, to +2.3% p.a. in chemicals and +2.0% p.a. in non-metallic minerals (mainly building materials).
- This range of pricing is evident in our CEO Survey, with 21% of manufacturing CEOs decreasing their selling prices in 2012 (by an average of 9% p.a.) but 34% increasing prices (by an average of 7% p.a.).
- For 2013, 39% of manufacturers do not expect to change their selling prices. 28% plan to put prices up, while 33% expect to lower their selling prices.

Manufacturers under pressure to lower selling prices



ABS, Producer Price Index, Cat. No. 6427.0 (seasonally adjusted data).

Manufacturing labour productivity to improve in 2013 in some firms, but decline in others

Manufacturing labour productivity

- Labour productivity (volume of output per hour worked) for the manufacturing sector showed sporadic improvement in 2011 and 2012. This was achieved in a difficult period of decline in both output volumes and employment (hours worked), mainly because employment declined to a greater degree than did output (thus 'boosting' productivity).
- For most manufacturers (65% of CEOs), labour productivity was steady in 2012. 18% of manufacturing businesses were able to improve their labour productivity in 2012 (by an average of 9%), while the same proportion saw their labour productivity worsen (by an average of 8%).
- In 2013, 24% of Manufacturing CEOs expect their labour productivity will go up, but 44% expect it to decline and 32% expect no change at all in 2013.

Manufacturing labour productivity: inhibitors and contributors

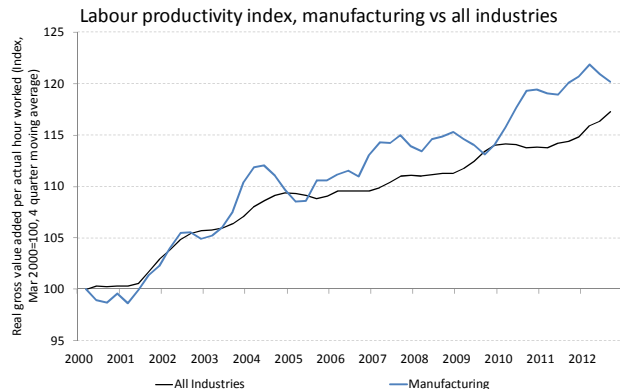
In this year's survey, manufacturing CEOs who said their labour productivity had *improved* in 2012 listed the following 3 factors as contributing to that improvement :

- Increased staff skills, capabilities and productivity (38%)
- Process improvements (33%) and
- Capital investment (21%).

Manufacturing CEOs who said their labour productivity had *declined* in 2012 listed the following 3 factors as contributing to that decline:

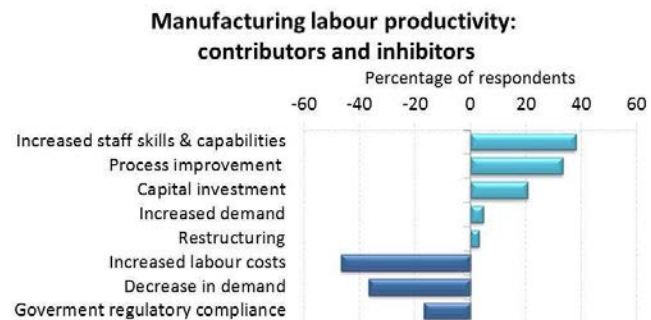
- Increased labour costs (47%)
- A decrease in customer demand (37%) and
- Complying with government regulations (17%).

Labour productivity growth will continue sporadically



Calculated from ABS, *National Accounts*, Cat. No. 5206.0 and ABS, *Labour Force Australia, Detailed Quarterly*, Cat. No. 6291.0.55.003 (original data).

Manufacturing labour productivity: top 3 inhibitors and top 3 contributors to change in 2012



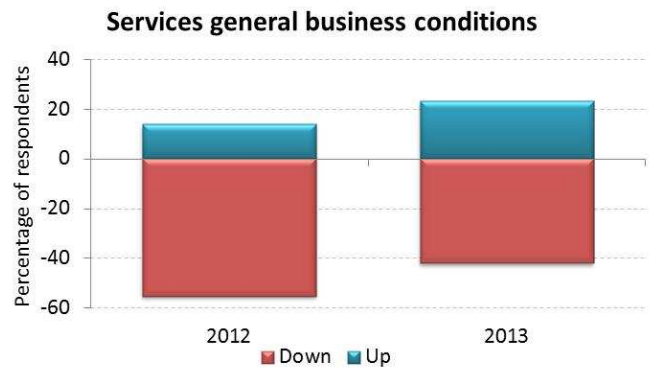
Services Sector

Services business conditions expected to ease marginally, new growth strategies are planned

Services general business conditions

- The services businesses in this year's CEO Survey came from almost every services sector. They mainly sold their services to other businesses, located in the mining, manufacturing and construction sectors, although some also sold their services to households rather than other businesses.
- Services CEOs said business conditions in their sector deteriorated in 2012 relative to 2011. 55% said conditions worsened in 2012 and 31% reported no change. 14% said 2012 was better than 2011.
- Services CEOs were more likely to be optimistic about 2013 than they were about 2012. 23% expect better general business conditions and 34% expect no change. Nearly half however, 42%, are expecting general business conditions to worsen in 2013.

Services sector more optimistic for 2013 than in 2012

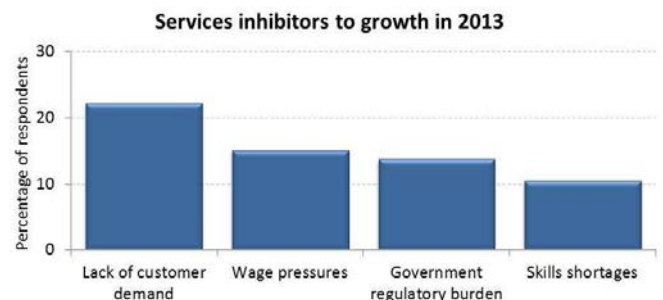


Services inhibitors to growth in 2013

Services CEOs expect the following factors will inhibit their business growth in 2013.

- 22% of CEOs expect a lack of customer demand to inhibit their growth in 2013.
- Wage pressures was the second most common inhibitor, expected by 15% of CEOs and
- Complying with government regulations is expected to inhibit growth by 14% of services CEOs.

Services CEOs are concerned about customer demand, wage pressures and government regulation in 2013

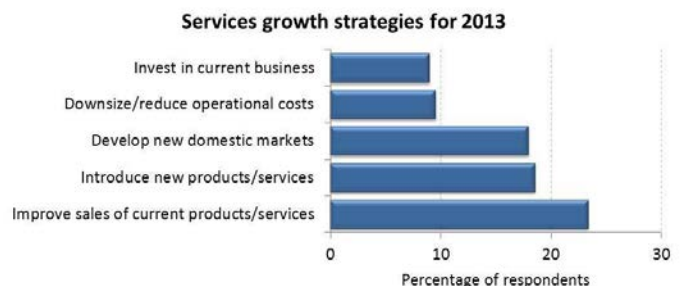


Services growth strategies for 2013

In response to this outlook, services CEOs expect to pursue the following growth strategies in their businesses in 2013.

- 23% of respondents will focus on improving sales of current products and services.
- For 19% of respondents introducing new products and services is key and
- 18% of responding CEOs plan to develop new domestic markets.

Services CEOs will focus on current product ranges and will consider introducing some new ones in 2013

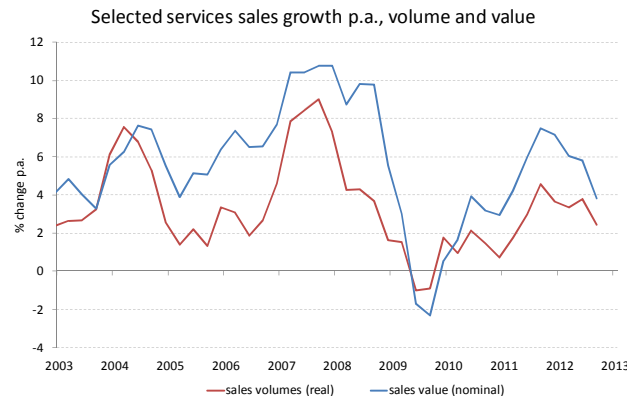


Services output, export earnings and employment will continue to rise modestly

Services sales (annual turnover)

- Services sales have consistently risen more strongly in nominal (value) terms than they have in volume terms over the past three years (ABS data). This reflects the greater degree of price inflation present in this sector, relative to other sectors of the economy. Over the past decade (2002-12), services sales have grown by an average of 5.6% p.a. in both real (volume) and nominal (value) terms, with contraction recorded only in 2009.
- Sales performance was relatively mixed in 2012 as reported by services CEOs in this year's survey. 40% of services CEOs told us their turnover went up in 2012 (by an average of 15%) compared to the previous year, but 29% reported a decline in sales (by an average of 19% p.a.). For 31% of services businesses, turnover remained steady.
- For 2013, 55% of services CEOs expect their turnover will grow, but 28% expect their sales to decline and 17% expect to see no growth in 2013.

Services sales volumes will continue to grow modestly

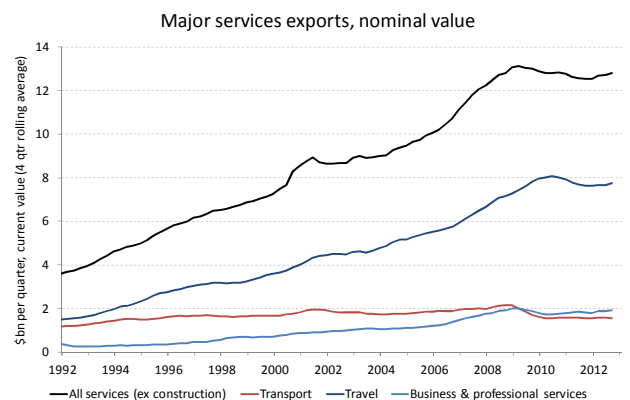


ABS, *Business Indicators, Australia*, Cat. No. 5676.0 (seasonally adjusted data).

Services export income

- Services export income has been vulnerable for several years now, with both the value of earnings and the volume of goods being exported failing to grow since around 2009 (ABS data).
- Among the services CEOs in this year's survey, export income represented an average of just 2% of their turnover. Unlike the other industries included in this Survey, the very low level of export income reported in this survey indicates a heavy domestic focus for most services businesses in this Survey.
- In line with the national exports data, services sector CEOs told us their export growth was flat in 2012, with 79% reporting no change over the year. 9% of CEOs reported that they had achieved growth in their export earnings in 2012 (by an average of 26% p.a.), while another 12% had seen their export income fall in 2012 (by an average of 29% p.a.).
- In 2013, 19% of services CEOs expect their export earnings will grow, while 14% expect it to decline. The large majority (67%) expect to see no change in their export earnings in 2013.

Service export earnings suffering the weight of high AUD and post-GFC global slump

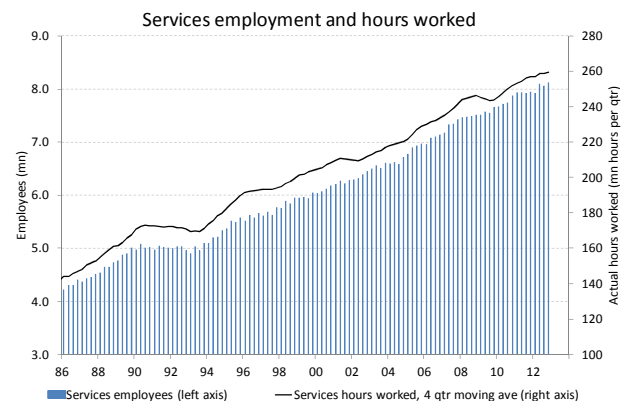


ABS, *International Trade in Goods & Services*, Cat. No. 5368.0.

Services employment

- Services employment (not including public administration services) settled at around 8.1 million in 2012, after stepping up slightly from 2011 (2% growth in the year to May 2012). Services (ex. public admin.) account for around 70% of total employment, with health and welfare services (12%) followed by retail trade (11%) accounting for the largest shares. Professional services and education each account for another 8% of the workforce.
- A quarter of services CEOs told us their employee numbers went up (by an average of 16% p.a.) in 2012 and over half (52%) remained steady in 2012. 23% however, had needed to cut staff numbers in 2012, by an average of 10% p.a.
- In 2013, 39% of Services CEOs expect their employee numbers will go up while 27% expect it to decline, giving a net balance of 12% of services businesses who plan to increase their employment in 2013.

Services employment was stable in 2012 and will remain so in 2013, as market sector enter a holding pattern



ABS, *Labour Force Australia, Detailed Quarterly*, Cat. No. 6291.0.55.003 (original data, excluding public administration and safety services).

Services spending on capital investment and R&D likely to remain lacklustre in 2013

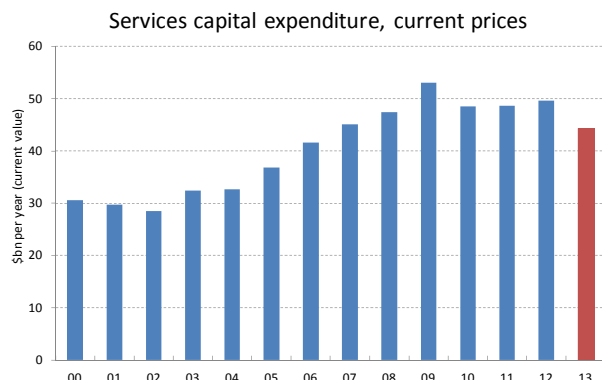
Services capital investment

- The latest ABS capital expenditure (CAPEX) data indicate total CAPEX by businesses in the services sector increased slightly in 2011-12, but then fell by 4% in the September quarter of 2012, relative to a year earlier.
- Across the services sector, the latest ABS CAPEX estimate (the fourth estimate) of spending in 2012-13 suggests a fall of 11% p.a. in nominal, unadjusted terms. When a one year realization ratio is applied, these latest estimates suggest falls in CAPEX in 2012-13 in the order of 12 to 16% p.a. for transport and storage, utilities, retail trade and professional services. Financial services is looking to increase its CAPEX in 2012-13 by 11% while the IT sector is looking to increase its spending by 6%.
- This range of experiences and expectations regarding CAPEX spending across the services sector is reflected in this year's CEO Survey results. 45% of services CEOs reported their spending on physical capital did not change in 2012, relative to 2011. But 34% had increased their spending in 2012 (by an average of 60% p.a.) and 21% had decreased their spending in 2012 (by an average of 48%). These large fluctuations underscore the large, one-off (or 'lumpy') nature of these types of investments.
- In 2013, 33% of services CEOs expect their spending on physical capital will go up while 30% expect it to decline.

Services research and development

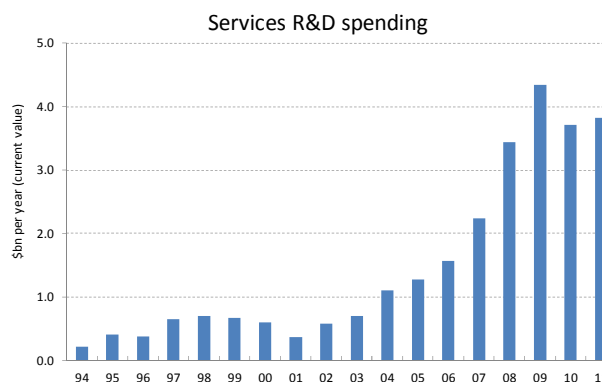
- Research and experimental development spending in the services sector rose by 5.2 % in 2011, after falling by 3.1% in 2010. (ABS, 2013). Spending in this sector reached an all-time peak in 2009, at around \$4.2bn.
- Services sector CEOs told us their spending on R&D remained steady in 2012 with 67% of respondents reporting no change in investment levels. 18% of businesses had increased their R&D spending in 2012 (by an average of 34% p.a.) but 15% decreased their spending (by an average of 27% p.a.).
- In 2013, more fluctuation is expected, with 54% of services CEOs planning no change in their R&D budget, but 26% expect to spend more and 20% expecting to spend less on R&D in 2013.

Services* investment is expected to shrink markedly in 2013



- Selected services in the CAPEX survey include private sector utilities, construction, wholesale and retail trade, transport, IT, telecomms, finance, real estate, professional and other services. ABS, *private new capital expenditure*, Cat. No. 5625.0 (seasonally adjusted data).

Services R&D expenditure is yet to recover in strength



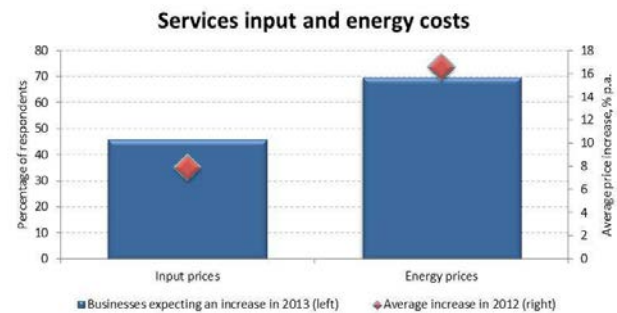
ABS, *Research and Experimental Development, Businesses, Australia*, 2008-09, 2010-11, Cat. No. 8104.0 (original data).

Services input costs, labour costs and selling prices continue to move upwards

Services input and energy costs

- In 2012, services sector CEOs estimated that on average, 45% of their inputs were imported (sourced offshore). 17% of services businesses had increased their use of imported inputs (by an average of 8% p.a.), while 9% had decreased their imports in 2012 (by an average of 9% p.a.).
- Services CEOs told us that in 2012, 32% faced increases in their input costs (up by an average of 8% p.a.), while 15% had a decrease in costs (by an average of 12%) and 53% had been no change.
- Energy costs for services businesses increased for 52% of businesses in 2012 (by an average of 17% p.a.). 11% said their energy costs declined in 2012 and 36% said their energy costs were unchanged, despite the introduction of the carbon tax from 1 July 2012.
- Services CEOs are mainly expecting their input prices to stay flat or go up in 2013. 48% of services CEOs expect no change in all input prices and 30% expect no change in their energy prices, while 46% expect all inputs to increase and 70% expect their energy prices to increase. Just 7% hope to see their input costs go down in 2013.

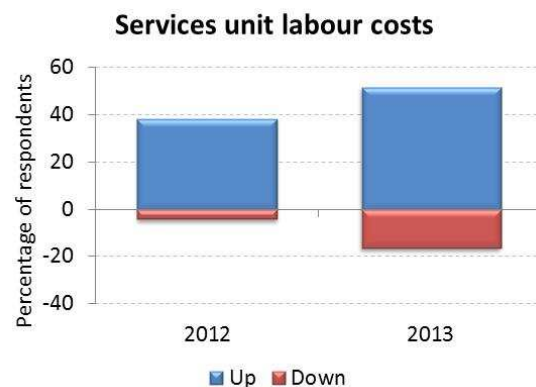
Further price rises expected for energy and other inputs



Services unit labour costs

- Labour cost increases continue to be an issue for services businesses. 38% of services CEOs reported their unit labour costs went up in 2012, by an average of 7% p.a. Another 10% managed to reduce their unit labour costs in 2012 (by an average of 6%), while 52% reported no change.
- In 2013, 52% of Services CEOs expect their unit labour costs will go up again, while 17% expect their unit labour costs to decline.

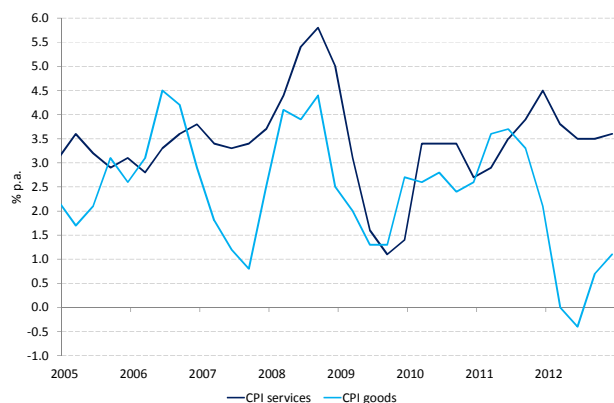
Services CEOs expect unit labour costs to rise in 2013



Services selling prices

- The latest ABS Consumer Price Index (CPI) data shows that retail selling prices for services continue to outstrip those for goods, by a large margin. In 2012, retail selling prices for services typically went up by 3 ½ to 4 %, while those for goods declined during the middle of 2012. This largely reflects the high labour content (and labour costs) for services.
- 26% of services sector CEOs told us their selling prices went up (by an average of 7% p.a.%) in 2012, while for 53% prices remained steady. 21% of services CEOs reported they had been able to reduce their selling prices in 2012, by an average of 9% p.a.
- In 2013, 32% of services CEOs expect to increase their selling prices, while 29% expect to lower their prices. 39% will not change their prices in 2013.

Services selling prices continue to rise strongly



ABS, Consumer Price Index, Cat. No. 6401.0 (seasonally adjusted data).

Labour productivity performance will be a focus for the services sector in 2013

Services labour productivity

- Labour productivity growth (volume of output per hour worked) for the services sector as a whole* has tracked slightly higher than the Australian all-industries average over the past decade (2002-12). However, this masks large differences between services sectors. The best gains in labour productivity have generally been in sectors with greater ability to adopt and benefit from new technologies, such as finance, IT and telecoms, but also in wholesaling and more recently, transport. The large, labour-intensive sectors such as retail, health, education and professional services have achieved about average labour productivity growth.
- 15% of services sector CEOs told us their labour productivity went up (by an average 10%) in 2012, while for 73% it remained steady.
- In 2013, 26% of Services CEOs expect their labour productivity will improve, while 42% expect it to decline.

Services labour productivity: inhibitors and contributors

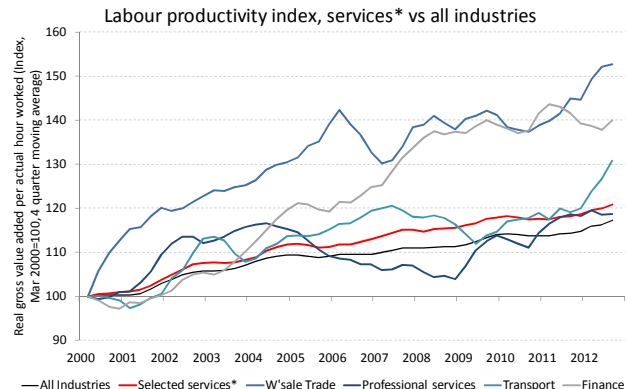
In this year's survey, services CEOs who said their labour productivity had *improved* in 2012 listed the following 3 factors as contributing to that improvement:

- 60% attributed an increase in productivity to increased staff skills, capabilities and productivity
- 32% of respondents listed process improvements as one of the top three factors and
- 9% reported the flow on from capital investment as a factor in improving labour productivity.

Services CEOs who said their labour productivity had *declined* in 2012 listed the following 3 factors as contributing to that decline:

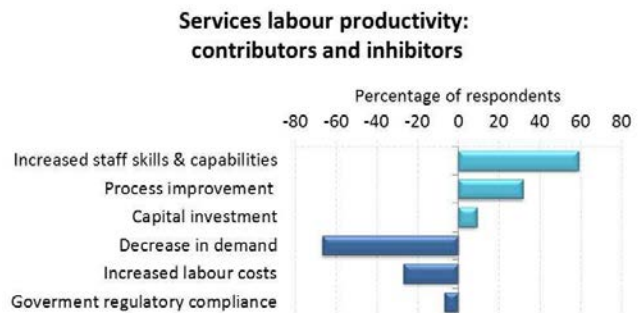
- A decrease in customer demand was the most reported factor in inhibiting productivity for 67% of respondents.
- Increased labour costs were named by 27% of respondents and
- Complying with government regulations inhibited labour productivity for 7% of services businesses.

Mixed labour productivity performance across services



* Selected services includes all services industries except public administration and utilities. Calculated from ABS, *National Accounts*, Cat. No. 5206.0 and ABS, *Labour Force Australia, Detailed Quarterly*, Cat. No. 6291.0.55.003 (original data).

Services labour productivity: top 3 inhibitors and top 3 contributors to change in 2012



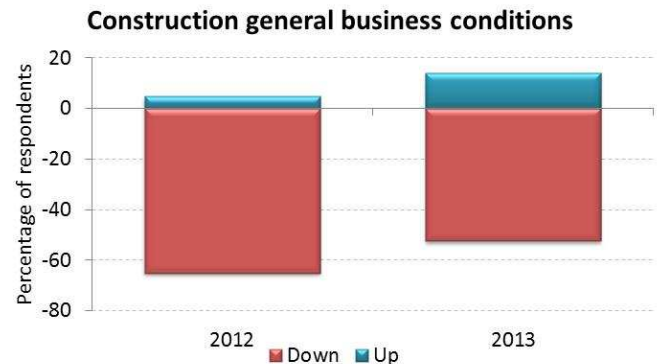
Construction Sector

Construction business conditions expected to remain tough, new growth strategies planned

Construction general business conditions

- Construction businesses sell their services to a wide range of other industries and to households. In 2012, our construction CEOs reported selling mainly to the mining industry, as well as to manufacturing, government, education, health and retail customers.
- 65% of construction CEOs said business conditions in their sector deteriorated in 2012 compared to 2011. Just 5% said 2012 was a better year than 2011.
- 52% of respondents expect general business conditions in the construction sector to worsen in 2013, while 14% expect it to be better than in 2012.

General business conditions will worsen in 2013, after a tough year for many in 2012

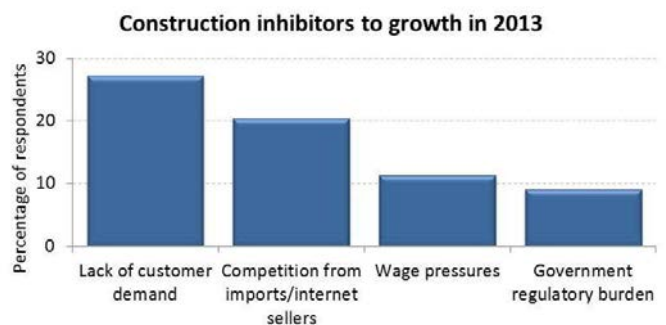


Construction inhibitors to growth in 2013

Construction CEOs expect the following factors will inhibit their business growth in 2013.

- 27% expect a lack of customer demand to be one of the top three factors to inhibit growth in 2013.
- Competition from imports and internet sellers was listed as a factor by 21% of respondents.
- Wage pressures were the third most reported factor with 11% expecting it to inhibit growth in 2013.

Construction sector fears lack of customer demand and imports competition will inhibit growth in 2013

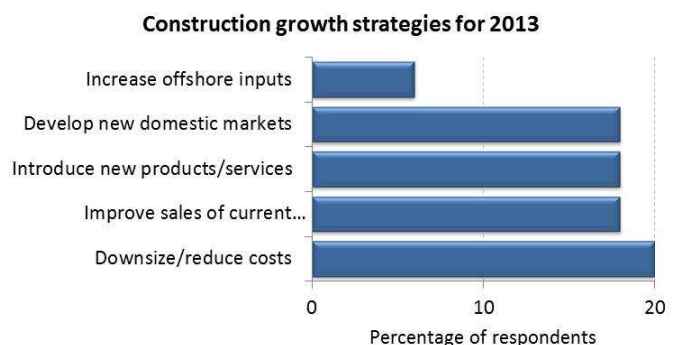


Construction growth strategies for 2013

In response to this outlook, construction CEOs expect to pursue the following cost-oriented growth strategies in their businesses in 2013.

- Downsizing/reducing operational costs is favoured by 20% of construction respondents.
- Improving sales of current product and services is an intended strategy for 18% of respondents as is
- Introducing new products and services (18%) and developing new domestic markets (18%).

Construction CEOs will downsize and chase sales in 2013

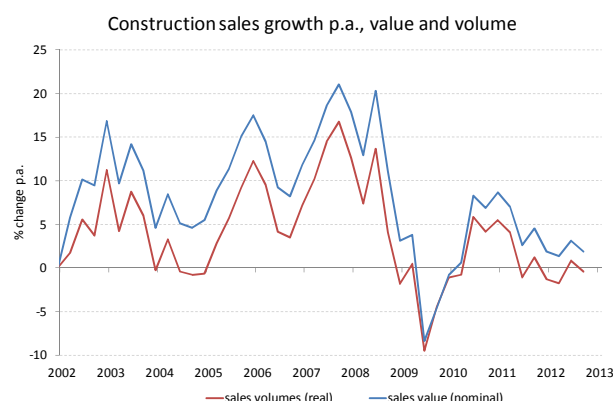


Construction output, export earnings and employment await the next cyclical upturn to begin

Construction sales (annual turnover)

- After recovering modestly in 2010, sales growth for the construction sector has been decelerating through 2011 and 2012 in both nominal (value) and real (volume) terms (ABS data). Through 2011 and 2012, aggregate national sales volumes have contracted over several quarters.
- This sales performance reflects the trend evident in Ai Group's monthly Performance of Construction index, which has indicated industry contraction for the last two years. It is due to a cyclical downturn in both residential and commercial construction activity that has been only partially offset by a surge in large engineering projects.
- 40% of construction sector CEOs told us their turnover went up in 2012 (by an average of 27% p.a.), while 36% said it went down (by an average 30% p.a.) in 2012.
- In 2013, 24% of construction CEOs expect their turnover will go up, while 52% expect it to decline.

Construction sales volumes are contracting, sales values holding up better due to price increases in some sectors

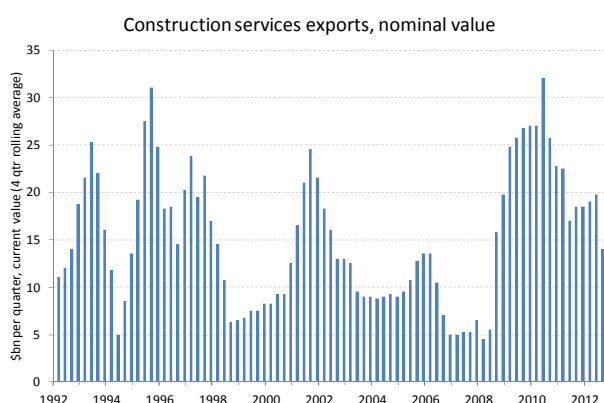


ABS, *Business Indicators, Australia*, Cat. No. 5676.0 (seasonally adjusted data).

Construction export income

- Construction sector export income is relatively negligible compared with other industries, at less than \$2bn per quarter in 2012. Like other services industries, it has been declining (in nominal value terms) since 2010 (ABS data).
- None of the construction CEOs that responded to this survey reported any export earnings in 2012.
- None of the construction CEOs that responded to this survey reported that they expect to earn any income from exports in 2012.

Construction export earnings show weight of high AUD and slowing global demand in 2012

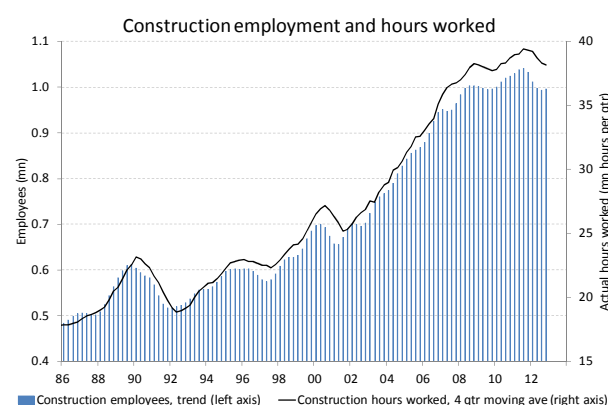


ABS, *International Trade in Goods & Services*, Cat. No. 5368.0.

Construction employment

- Construction has shed around 50k workers since peaking at 1.04 million in late 2011, a fall of 5% (ABS data). This reflects a sharp downturn in activity in national commercial and residential construction, with the less labour-intensive engineering construction sector picking up some but not all of the construction workforce. Others have moved into mining or may have dropped out of the labour market. Construction employment numbers tend to adjust faster to changing conditions than in some other industries, due to the fixed term contract arrangements that are prevalent throughout the industry.
- Construction CEOs told us their employee numbers went down (30%) or remained steady (48%) in 2012.
- In 2013, 57% of construction CEOs expect to further reduce their workforce, in line with the decline in general conditions and sales activity. 14% of construction CEOs expect their employee numbers will go up in 2013.

Construction employment will keep tracking the decline in residential and commercial building activity in 2013



ABS, *Labour Force Australia, Detailed Quarterly*, Cat. No. 6291.0.55.003 (trend data).

Construction businesses' ability to investment in capital and R&D will remain weak in 2013

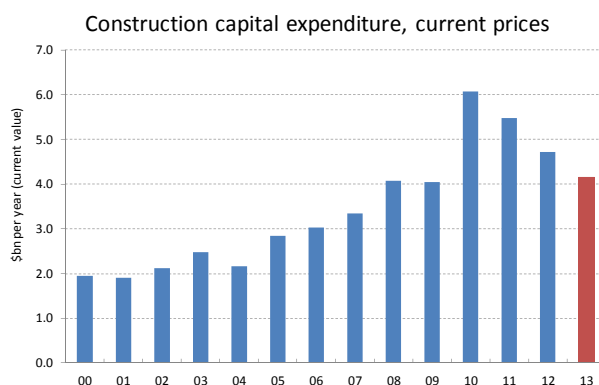
Construction capital investment

- ABS capital expenditure data (CAPEX) shows CAPEX by the construction industry peaked in 2010 and has since been declining. Construction CAPEX fell by 9.8% in 2010-11 and another 14% in 2011-12.
- The latest CAPEX estimate for construction spending in 2012-13 (estimate four) suggests a further fall in CAPEX in 2012-13 of 11.9% p.a., in nominal unadjusted terms. These estimates can change rapidly however, as conditions unfold. And once realization ratios are applied, the latest estimate for construction might actually imply an increase in investment in 2012-13, even though earlier estimates were pointing to another fall in investment spending in 2012-13.
- 23% of construction sector CEOs told us their spending on physical capital went up in 2012 (by an average of 12% p.a.) compared with a year earlier, while 27% reported a decrease (by an average of 86% p.a.). 50% of construction CEOs reported no change in 2012.
- In 2013, 14% of construction CEOs expect their spending on physical capital will go up, while 29% expect it to decline. 57% expect their investment budget will remain unchanged in 2013.

Construction research and development

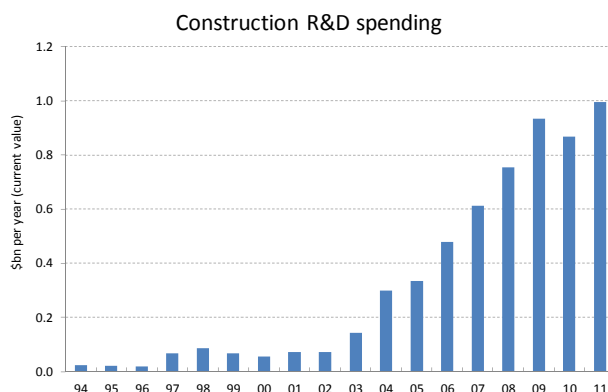
- The value of research and experimental development spending in the construction sector rose by 14.6% in 2011, after declining by 7.1% in 2010 (ABS data). The total amount spent by the industry is around \$1bn.
- Construction sector CEOs told us their spending on R&D remained steady in 2012 with 71% experiencing no change on the previous year.
- In 2013, 15% of construction CEOs expect their spending on R&D will go up while 20% expect it to decline, and 65% anticipate it will remain steady.

Construction sector investment jumped in 2010, gearing up for new mining activity; it is likely to drop again in 2013



ABS, private new capital expenditure, Cat. No. 5625.0 (seasonally adjusted data).

Construction R&D expenditure will stay restrained in 2013



Construction inputs, energy costs and selling prices set to rise further in 2013

Construction input and energy costs

- Construction input costs are directly affected by changes in commodity pricing, particularly for steel, cement and timber products.
- In 2012, Construction sector CEOs estimated that on average 16% of their inputs were imported (sourced offshore). The share of imports for individual businesses ranged from 0% to 60%.
- 44% of construction CEOs reported a rise in input costs in 2012, with an average increase of 10%.
- 62% of construction CEOs reported their energy costs increased in 2012, by an average of 25%. A third saw no change in their energy costs and 5% reported that their energy costs fell in 2012.
- For 2013, 47% of construction CEOs expect their total input costs to rise, and 70% expect their energy costs to rise. 41% are expecting no change in their input costs while 30% expect no change in their energy costs.

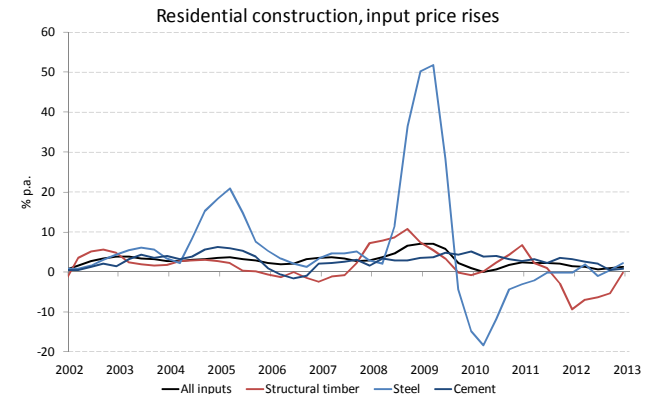
Construction unit labour costs

- 50% of construction sector CEOs told us their unit labour costs (labour cost per unit produced) went up in 2012, by an average of 5% p.a. Another 24% however, were able to reduce their unit labour costs in 2012, by an average of 5% p.a.
- In 2013, 37% of construction CEOs expect their unit labour costs will go up, while 16% expect it to decline. The remainder expect no change in their unit labour costs in 2013.

Construction selling prices

- The latest ABS producer price index (PPI) data shows that selling price rises in the construction sector moderated in most segments of the market through 2011 and 2012, reflecting the fall in activity and demand. The one exception is road and bridge construction, for which price increases continued to run at around 4 to 5 % p.a. until the end of 2012. For non-residential buildings and for residences other than houses (flats and units), construction prices declined toward the end of 2012.
- These national data are in line with this year's CEO Survey, with 47% of construction sector CEOs reporting a reduction in their selling prices (down by an average of 13% p.a.) in 2012. 37% of construction businesses did not change their prices in 2012, while 16% put their prices up in 2012 (up by an average of 7% p.a.).
- For 2013, 41% of construction businesses will not change their selling prices, but 31% expect to put their selling prices up and 28% will lower them.

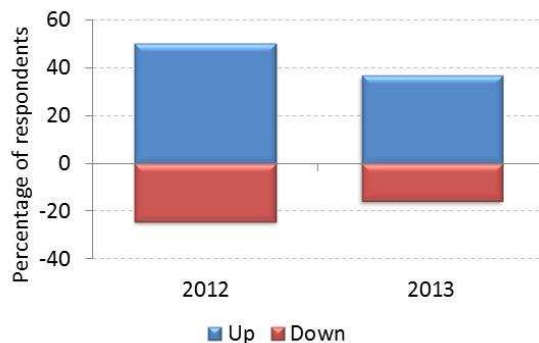
Construction cost increases for steel have moderated



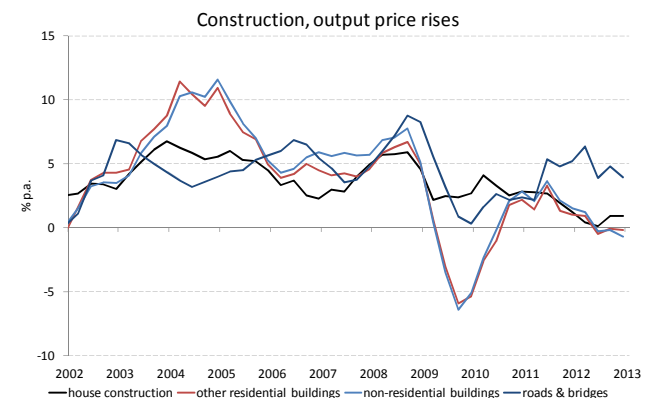
ABS, Producer Price Index, Cat. No. 6427.0 (seasonally adjusted data).

Unit labour costs to decelerate in construction in 2013

Construction unit labour costs



Construction pricing mirrors the market; falling residential, flat non-residential and rising engineering output prices



Construction labour productivity is likely stall in 2013, as activity and employment fall

Construction labour productivity

- Labour productivity growth (volume of output per hour worked) in the construction sector surged ahead of the all industry average in 2012. The industry is shedding employees due to the shift from (labour-intensive) residential and commercial construction to less labour-intensive large-scale engineering and infrastructure projects, resulting in an uptick in aggregate labour productivity.
- 76% of construction sector CEOs told us their labour productivity remained steady while 24% reported an increase; none of the CEOs reported a decline in their labour productivity in 2012.
- In 2013, 25% of construction CEOs expect their labour productivity will go up, while 43% expect it to decline.

Labour productivity in construction is picking up, due to cycle switch from residential to engineering activity



Calculated from ABS, *National Accounts*, Cat. No. 5206.0 and ABS, *Labour Force Australia, Detailed Quarterly*, Cat. No. 6291.0.55.003 (original data).

Construction labour productivity: inhibitors and contributors

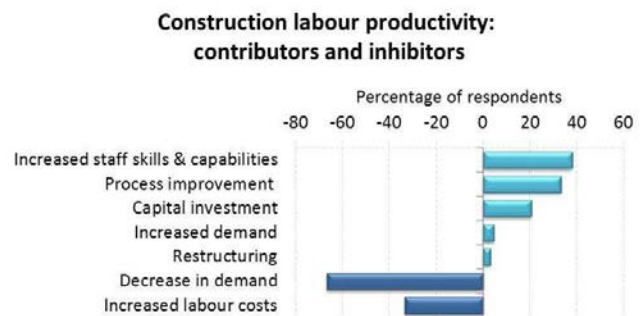
In this year's survey, Construction CEOs who said their labour productivity had *improved* in 2012 listed the following three factors as contributing to that improvement :

- For 38% increased staff skills, capabilities and productivity contributed to an increase in labour productivity.
- 33% noted process improvements and
- 20% named capital investment as one of the three major contributing factors.

Construction CEOs who said their labour productivity had *declined* in 2012 noted only two major factors contributing to that decline:

- A decrease in customer demand (66%) and
- Increased labour costs (33%).

Construction labour productivity: top 3 inhibitors and top 3 contributors to change in 2012



Appendix

About the National CEO Survey: Business Prospects in 2013

In order to identify the prospects for businesses in 2013, the Australian Industry Group undertook a comprehensive survey of Australian business CEOs in December 2012. Responses were received from the CEOs of approximately 350 businesses across Australia. Together, these businesses employed around 34,000 people (just under 100 on average) and had a collective annual turnover of \$14.3 billion in 2012.

All Australian States and private-sector industries are represented in this year's CEO survey (see tables below). The manufacturing sector contributed the highest proportion of respondents (68%). Manufacturing's share of this sample is far higher than its share of national production (around 8%). Victoria was somewhat over-represented in the sample, relative to other states. The data in this report have been presented in their original form and are not been adjusted or weighted to match the current industry representation in the broader economy (e.g. as indicated in the ABS national accounts or labour force data). The higher proportion of manufacturers and Victorian businesses in the sample therefore means that the general findings reflect the higher number of responses from these types of businesses. The analysis of the results for each of the four broad industry groups and for each state, however, is not affected by this over-sampling in manufacturing.

CEO Survey: Business Prospects 2013			ABS data (2011-12)
State	Number of respondents	% of respondents	GSP as % of GDP
NSW	89	25.1	30.7
Vic	142	40.0	22.2
Qld	34	9.9	19.3
WA	56	15.8	16.3
SA	25	7.0	6.3
Tas	7	2.0	1.7
ACT	1	0.3	2.2
NT	0	0.0	1.2
Not available	1	0.3	0.0
Total	355	100	100

CEO Survey: Business Prospects 2013			ABS data (2011-12)
Industry	Number of respondents	% of respondents	% of all industry output
Mining and mining services	22	6.2	11.8
<i>food & beverage manufac.</i>	21	5.9	1.5
<i>textiles, clothing & footwear</i>	13	3.7	0.4
<i>paper, pulp, printing & publishing</i>	8	2.3	0.3
<i>petroleum, coal and chemicals</i>	19	5.4	1.2
<i>non-metallic minerals manufac.</i>	6	1.7	0.3
<i>metals manufacturing</i>	115	32.4	1.5
<i>transport & equipment manufac.</i>	39	11.0	1.5
<i>wood, furniture & other manufac.</i>	20	5.6	0.5
Manufacturing	227	67.9	8.4
Construction	23	6.5	8.6
Services *	72	19.5	63.0
Other / not available	0	0	2.5
Total	355	100	94.3

* **the services sectors** represented in this sample include: utilities (electricity, gas and water); IT, communications and media services; transport, post and storage services; wholesale trade; retail trade; finance and insurance; real estate and property services; professional services; administrative services; health and welfare services; education; hospitality (food and accommodation services); arts and recreation services; and personal and other services. Excludes public administration and safety (about 5% of output).



Ai GROUP METROPOLITAN OFFICES: 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 **ADELAIDE** 45 Greenhill Road, Wayville SA 5034. Tel: 08 8394 0000 Fax: 08 8394 0099 **REGIONAL OFFICES: ALBURY/WODONGA** 560 David Street Albury NSW 2640. PO Box 1183 Albury NSW 2640. Tel 02 6041 0600 Fax 02 6021 5117 **BALLARAT** 1021 Sturt Street Ballarat VIC 3350. PO Box 640 Ballarat VIC 3353. Tel 03 5331 7688 Fax 03 5332 3858 **BENDIGO** 87 Wills Street Bendigo VIC 3550. Tel 03 5440 3900 Fax 03 5444 5940 Newcastle Suite 1 "Nautilus" 265 Wharf Road Newcastle 2300. PO Box 811 **NEWCASTLE** NSW 2300 Tel: 02 4925 8300 Fax: 02 4929 3429 **WOLLONGONG** Level 1, 166 Keira Street Wollongong NSW 2500. PO Box 891 Wollongong East NSW 2520. Tel 02 4228 7266 Fax 02 4228 1898 **AFFILIATE: PERTH CHAMBER OF COMMERCE & INDUSTRY WESTERN AUSTRALIA** 180 Hay Street East Perth WA 6004. PO Box 6209 East Perth WA 6892. Tel 08 9365 7555 Fax 08 9365 7550 www.aigroup.com.au