

AUSTRALIAN Performance of Construction Index



Media Contact: Tony Melville, Australian Industry Group. 0419 190 347

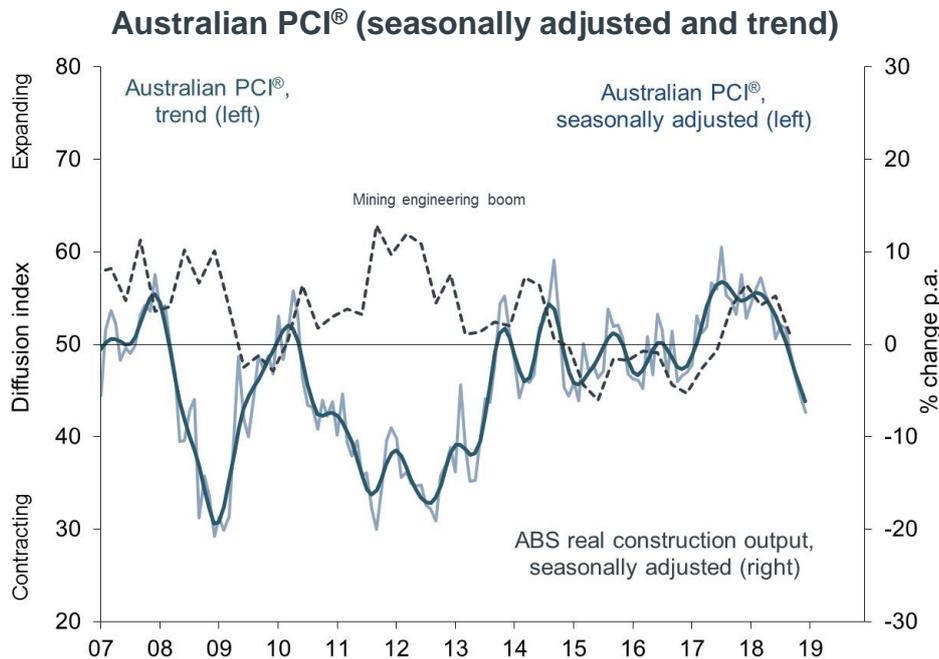
CONSTRUCTION ENDS 2018 IN THE RED AMID WEAKER DEMAND

The Australian Industry Group/Housing Industry Association Australian Performance of Construction Index (**Australian PCI®**) registered 42.6 points (seasonally adjusted) in December. This was down by 1.9 points from November, indicating that the construction industry on aggregate fell more sharply in the final month of 2018 and at the steepest rate in 5½ years.

December also marked the fourth consecutive month of contracting conditions in the **Australian PCI®** with overall falls in activity and new orders becoming more entrenched.

All four sectors of the **Australian PCI®** contracted in December. Weighing heavily on overall industry conditions was a further weakening in the house and apartment building sectors where rates of decline in activity were the most marked in six years. Commercial construction remained subdued while engineering construction drifted into mild negative territory as survey respondents closed out 2018 with fewer new tender wins.

House building respondents to the **Australian PCI®** commented on slower market activity due to tighter lending conditions, falling house prices and generally increased caution by prospective buyers at the close of 2018. Apartment builders indicated that activity continued to be driven lower by soft investor demand, project completions and over supplied markets.



AUSTRALIAN PCI®
42.6
 ↓ 1.9 POINTS
 (seasonally adjusted)

ACTIVITY
35.7
 ↓ 5.9 POINTS
 (seasonally adjusted)

NEW ORDERS
41.0
 ↓ 4.8 POINTS
 (seasonally adjusted)

EMPLOYMENT
49.4
 ↑ 5.1 POINTS
 (seasonally adjusted)

HOUSE BUILDING ACTIVITY
35.4
 ↓ 2.6 POINTS
 (trend)

APARTMENT ACTIVITY
26.3
 ↓ 2.7 POINTS
 (trend)

ENGINEERING ACTIVITY
48.3
 ↓ -2.6 POINTS
 (trend)

COMMERCIAL ACTIVITY
45.0
 ↓ 0.9 POINTS
 (trend)

Australian PCI® summary

Construction sectors: Apartment building (26.3 points trend) was the weakest performing sector, declining for a ninth consecutive month and at the sharpest rate since mid-2012. House building (35.4 points trend) also fell further into negative territory with the sector's rate of contraction the most marked in just over six years. Across the major project areas, commercial construction (45.0 points trend) recorded a fifth month of decline amid a further overall fall in demand for commercial projects. Engineering construction (48.3 points trend) was also weaker in December, falling into mild contraction for the first time in 22 months.

Construction prices and wages: Input price inflation in the **Australian PCI®** remained elevated in December. The input prices index fell by 1.1 points to 72.0 points, indicating that cost pressures eased slightly during the month but remained significant. The selling prices sub-index in the **Australian PCI®** decreased by 6.5 points to 40.6 points in December, highlighting the strong competition between builders which is pushing down construction selling prices. The ongoing gap between these price series in the **Australian PCI®** demonstrates that profit margins remain tight for many businesses in the construction industry.

Construction activity: Across the overall construction industry, activity (35.7 points) contracted for a third consecutive month in December and at its sharpest rate in 5½ years. This was associated with a continued drop in new orders (41.0 points) and a reduction in deliveries from suppliers (48.4 points). However, labour market conditions moved closer to stabilisation with the employment sub-index increasing by 5.1 points to 49.4 points, indicating a broadly unchanged level of total construction employment.

Construction highlights: Across the residential construction sectors, the influence of declining activity after recent peaks and the downtrend in approvals is having an increasingly negative impact on overall industry conditions. Commercial construction is also detracting from industry-wide performance. While conditions have weakened in the engineering construction sector in the closing months of 2018, a solid pipeline of public infrastructure works including transport, wind and solar projects and pipelines is likely to underpin more robust conditions for this sector in 2019.

Construction concerns: Respondents are continuing to indicate significant cost pressures in the delivery of building projects due to elevated energy prices and price hikes related to the strength in commodity prices. Reports are also rising about difficulties in filling skilled vacancies as well as sourcing building materials in the volumes required for major projects.

| AUSTRALIAN PCI® KEY NUMBERS | Index this month | Change from last month | 12-month average | | Index this month | Change from last month | 12-month average |
|-----------------------------|------------------|------------------------|------------------|----------------------------|------------------|------------------------|------------------|
| <i>Seasonally adjusted</i> | | | | <i>trend</i> | | | |
| Australian PCI® | 42.6 | -1.9 | 51.2 | Australian PCI® | 43.9 | -1.4 | 51.2 |
| Activity | 35.7 | -5.9 | 50.0 | House building | 35.4 | -2.6 | 48.7 |
| Employment | 49.4 | 5.1 | 51.7 | Apartments | 26.3 | -2.7 | 41.0 |
| New Orders | 41.0 | -4.8 | 50.9 | Commercial construction | 45.0 | -0.9 | 52.9 |
| Supplier Deliveries | 48.4 | 0.5 | 53.4 | Engineering construction | 48.3 | -2.6 | 54.3 |
| Input Prices | 72.0 | -1.1 | 76.1 | <i>Seasonally adjusted</i> | | | % |
| Selling Prices | 40.6 | -6.5 | 51.9 | Capacity Utilisation (%) | 74.5 | 0.2 | 77.3 |
| Average Wages | 60.9 | -0.7 | 62.9 | | | ppt | % |

Results above 50 points indicate expansion. All indexes for sectors in the Australia PCI® are reported in trend terms (Henderson 13-month filter).

| CONSTRUCTION REPORT CARD: Latest ABS data | Level | change q/q | change y/y | Share of total, % |
|--|-------|------------|------------|--------------------------------|
| <i>Latest ABS data, seasonally adjusted</i> | | | | |
| Nom. value of residential building approvals, \$bn, year to Nov 2018 | 76.6 | - | -0.8 | 63.8% of building approvals |
| Nom. value of non-residential building approvals, \$bn, year to Nov 2018 | 43.5 | - | -8.3 | 36.2% of building approvals |
| Real value of building work done, \$bn, year to Sep 2018 | 119.0 | -1.5 | 4.5 | 56.7% of all construction done |
| Real value of engineering work done, \$bn, year to Sep 2018 | 94.0 | -4.5 | -7.9 | 43.3% of all construction done |
| Real value of all construction work done, \$bn, year to Sep 2018 | 213.9 | -2.8 | -1.4 | - |
| Real value-added output, \$bn, year to September 2018 | 141.2 | -2.2 | 4.2 | 7.6% of total GDP |
| Number of employed persons, '000, November 2018 | 1,166 | -9.0 | -5.7 | 9.2% of employed persons |

ABS data sources: *National Accounts; Business Indicators; Labour Force Quarterly Detail; Building Approvals; Construction Work Done.*

For more detail about the Ai Group Australian PCI® visit: www.aigroup.com.au/policy-and-research/economics/

House building activity

The volume of new house building work done fell by 3.2% q/q but rose by 7.4% p.a. to \$9.2bn in the September quarter of 2018 (seasonally adjusted and inflation-adjusted), accounting for 17.3% of all construction work done.

House building contracted for a fifth consecutive month in December. The sector's activity sub-index decreased by 2.6 points to 35.4 points (trend), indicating a sharper rate of decline relative to November. It was also the softest reading on housing activity since October 2012 and was associated with a fifth month of contraction in new orders. The house building activity index is currently tracking at a level which is 13.3 points below its 12-month average.

House building new orders

The total number of private house approvals fell to 9,505 in November 2018 (trend).

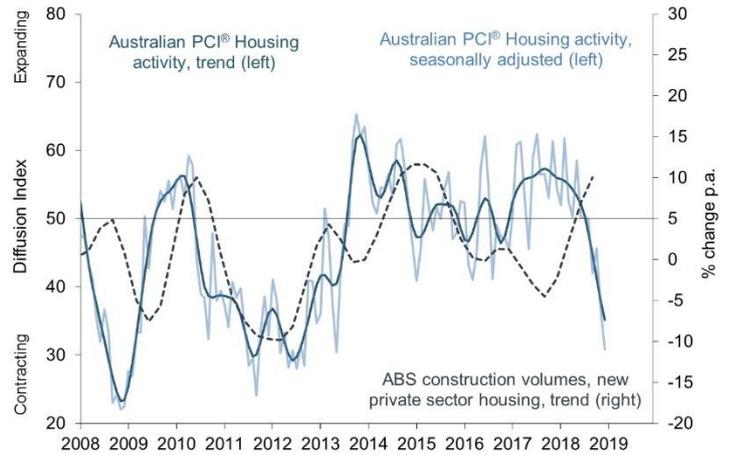
New orders in the house building sector continued to contract in December, and at slightly sharper rate. The sub-index drifted lower by 1.0 point to 42.7 points, placing it below the critical 50-points no change threshold for five consecutive months. It points to a continuation of a softening in housing demand conditions in coming months and follows the 0.24% m/m fall (-6.34% p.a.) in private sector house approvals in November (ABS, trend data).

Apartments activity

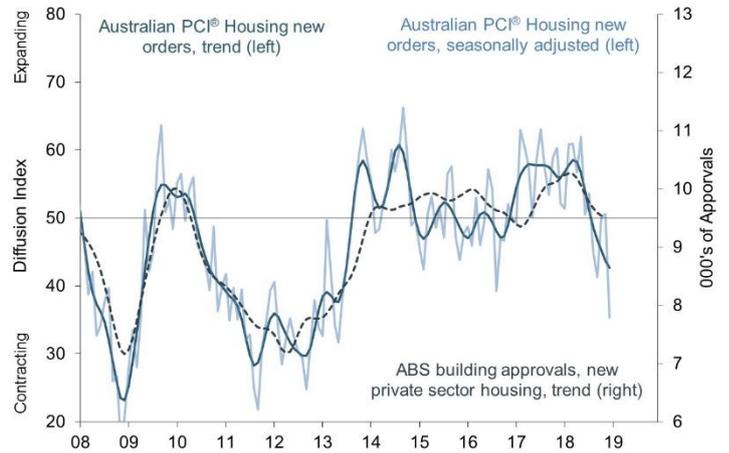
The volume of new multi-unit dwelling building work done fell by 0.1% q/q but increased by 1.9% p.a. to \$8.1bn in the September quarter of 2018 (seasonally adjusted and inflation-adjusted), accounting for 15.3% of all construction work done.

Apartment building activity declined for a tenth month in December, and at a steeper rate. The sector's sub-index registered 26.3 points in November, a fall of 2.7 points from the previous month and the most subdued reading since contracting at the same sharp rate in August 2012. The apartment sector has now experienced steady or declining activity in 15 of the past 16 months following a weakening in new orders extending over the second half of 2017 and through 2018.

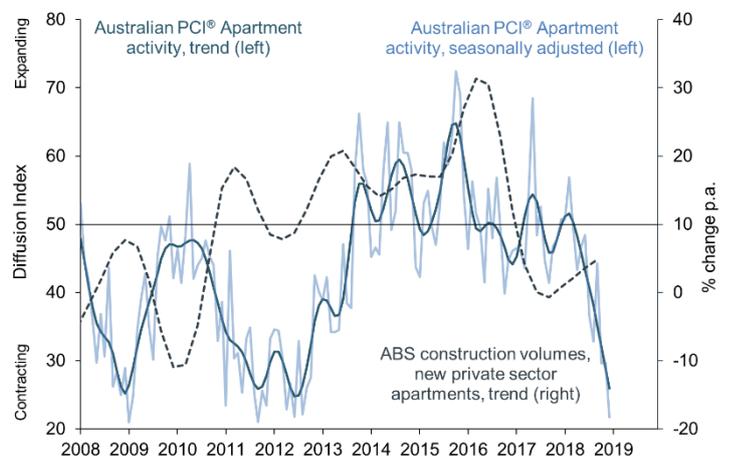
House building activity and ABS construction volumes



House building new orders and ABS building approvals



Apartments activity and ABS construction volumes



Australian PCI® sectors

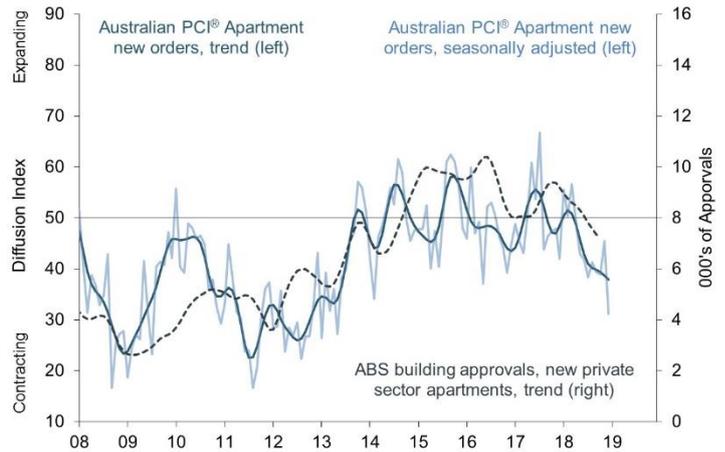
Apartment new orders

The total number of private 'other dwellings' approvals (apartments, flats and townhouses) fell to 6,484 in November 2018 (trend).

In the apartment building sector, new orders contracted for a ninth month with the sector's sub-index registering 38.3 points in December. This was a decrease of 0.7 points from November, signalling a slightly steeper pace of contraction.

Similarly, ABS data shows that apartment ('other dwellings') fell 5.0% m/m in November to be down sharply by -31.2% p.a. over the year to November.

Apartments new orders and ABS building approvals



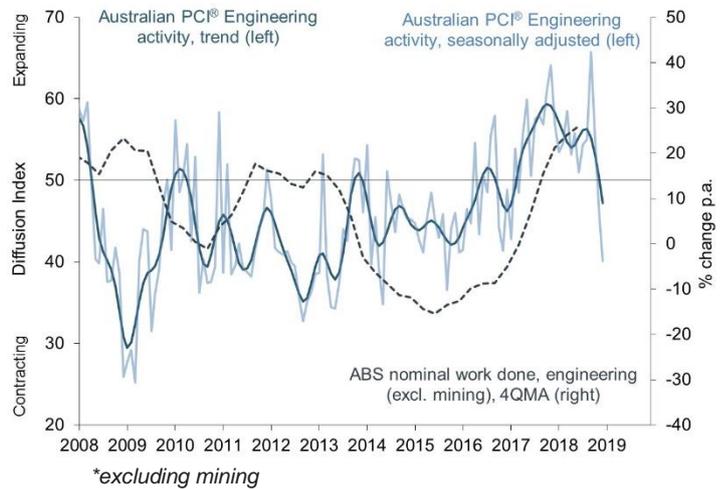
Engineering construction activity

The volume of engineering construction work done fell by 4.5% q/q and by 34.4% p.a. to \$23.0bn in the September quarter of 2018 (seasonally adjusted and inflation-adjusted), accounting for 43.3% of all construction work done.

Engineering construction activity lost ground in December, falling into negative territory for the first time in 22 months.

The sector's activity sub-index decreased by 2.6 points to 48.3 points. This coincided with reports from some respondents of an easing in new tendering opportunities towards the end of 2018.

Engineering construction activity and ABS work done*

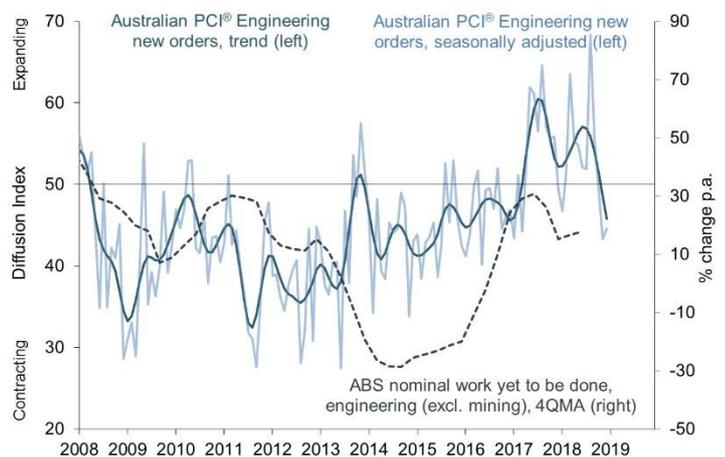


Engineering new orders

In engineering construction, new orders remained in negative territory. The sector's new orders sub-index declined by 2.8 points to 45.7 points in the month. This was the sector's second consecutive month of contracting new orders, although it follows 20 consecutive months of rising new orders largely driven by solid public-sector infrastructure investment.

This is consistent with ABS data showing that engineering work in the pipeline (excluding mining related projects) was valued at \$40.7 billion in the June quarter of 2018 (nominal, unadjusted data). While this is below the record high of \$46.4 billion in Q3 2012, it remains relatively large and is set to underpin strength in engineering construction activity as we move through 2019.

Engineering construction new orders and ABS work yet to be done (excluding mining)



Commercial construction activity

The volume of non-residential building work done declined by 1.5% q/q in the September quarter of 2018, but was 4.3% higher over the year (seasonally adjusted and inflation-adjusted), accounting for 19.7% of all construction work done.

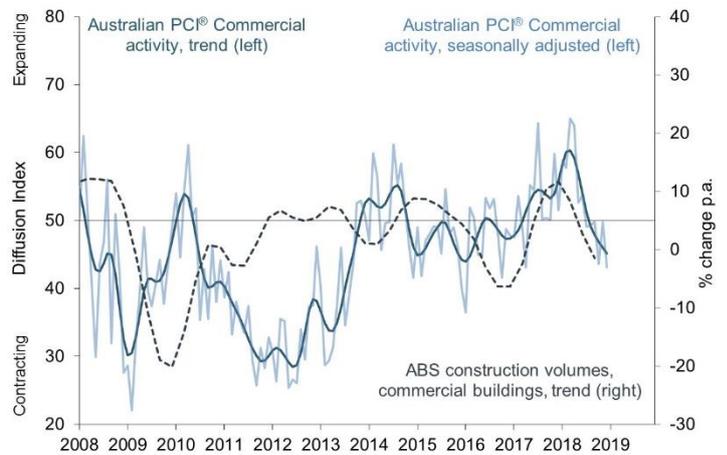
Commercial construction remained in negative territory in December with the sector's sub-index declining by 0.9 points to 45.0 points (trend). This was indicative of contracting commercial construction conditions for a fifth consecutive month. Despite the overall decline, conditions across the sector are mixed with respondents indicating opportunities in key commercial and social building categories as the main positives, including hotels, education, health buildings and industrial buildings.

Commercial new orders

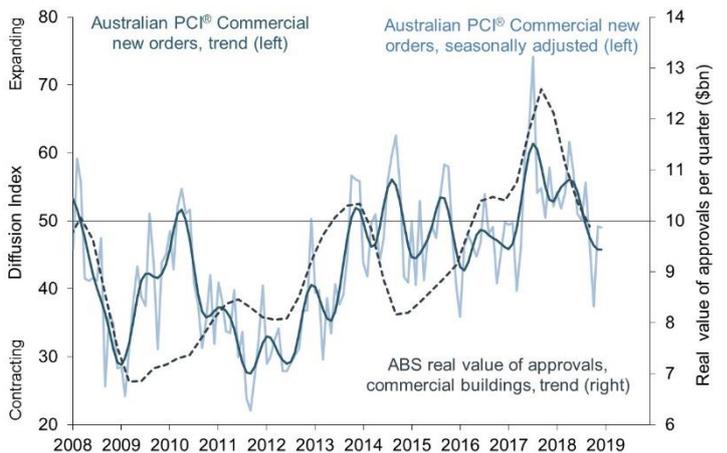
The real value of non-residential building approvals increased by 1.5% q/q but was down by 16.8% p.a. to \$10.1bn in the September quarter 2018 (seasonally adjusted).

December's drop in commercial construction activity coincided with a fifth month of contraction in new orders. However, the pace of decline in December was unchanged with the new orders sub-index steady at 45.8 points (trend) in the month. The drop seen in new orders over much of the second half of 2018, follows a 16 months period of sustained growth in new orders. This is consistent with a pipeline of work that is still relatively healthy in key project areas (including hotels, offices, education and industrial buildings). This and the demands of a growing population are likely to be enough to support a relatively firm level of activity moving into 2019.

Commercial construction activity and ABS work done



Commercial construction new orders and ABS commercial building approvals



Australian PCI[®] prices and wages

Input prices

The **Australian PCI[®]** input prices sub-index remained elevated at 72.0 points in December. This was a decrease of 1.1 points from November, indicating that cost pressures in construction and building projects eased slightly during the month.

Cost pressures remain high on wide industry basis due to robust demand for construction materials, elevated energy input costs and supplier price hikes related to strength in commodity prices. Demand for engineering-related construction materials is especially strong, due to rising infrastructure activity. Prices for materials used in heavy and civil construction were up by 3.4% p.a. in the September quarter of 2018, the strongest increase since 2012 (+4.0% p.a.) (ABS).

Selling prices

The ABS construction industry's output price index (PPI) rose by 1.2% q/q and 2.4% p.a. in the September quarter of 2018.

Selling prices continued to contract in December, and at a steeper rate. The selling prices sub-index in the **Australian PCI[®]** decreased by 6.5 points to 40.6 points in December. This indicates that pressures on businesses in raising prices persists on a broad industry basis due to a highly competitive quoting and tendering pricing environment.

The ongoing gap between these price series in the **Australian PCI[®]** demonstrates that profit margins remain tight for businesses in the construction industry. This is consistent with reports of a strong competition in securing work across the construction industry.

Average wages

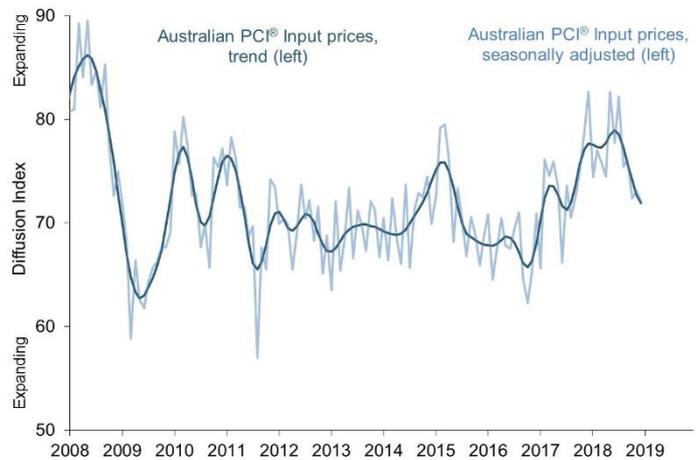
The ABS wage index for private sector construction rose by 0.5% q/q and 2.0% p.a. in the June quarter of 2018.

Growth in wages continued in December, albeit at a marginally slower rate, with the wages sub-index decreasing by 0.7 points to 60.9 points.

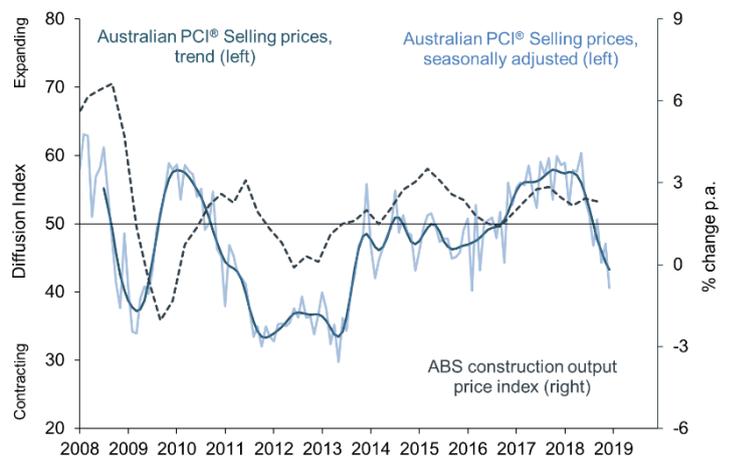
Despite this easing, construction wages are currently increasing at a pace that is only slightly below the 12-month average of 62.9 points.

This indicates that overall wages growth remains relatively high due to an elevated level of publicly-funded projects underway and in the pipeline which is increasing skill shortages in occupations central to infrastructure activity.

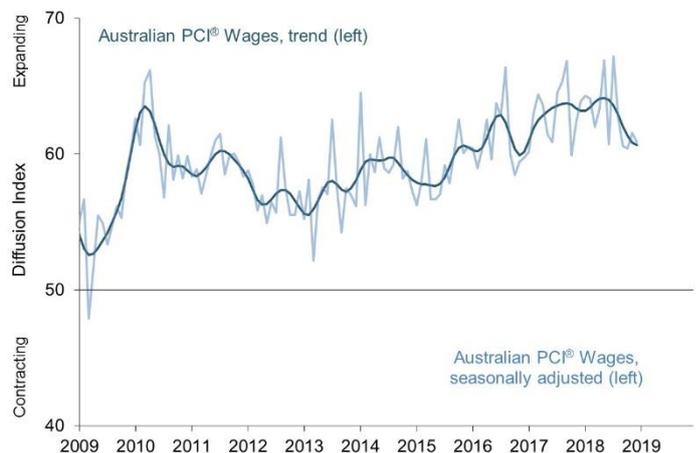
Input prices



Selling prices and ABS construction industry output prices



Average wages



Australian PCI® activity

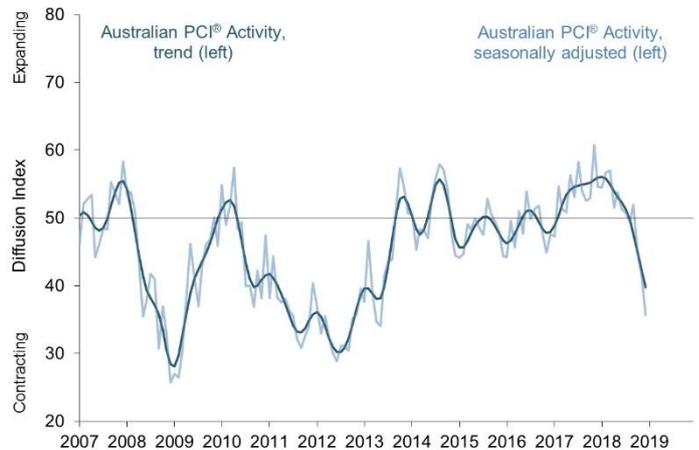
Activity

The activity sub-index in the **Australian PCI®** registered 35.7 points in December.

This was down by 5.9 points from the previous month, signalling a steeper rate of contraction in total construction activity. It also marked the sharpest rate of decline since May 2013.

Overall levels of activity were weighed down by a drift back into negative territory for engineering construction, combined with sharper falls in housing, apartment and commercial construction work.

Activity



Employment

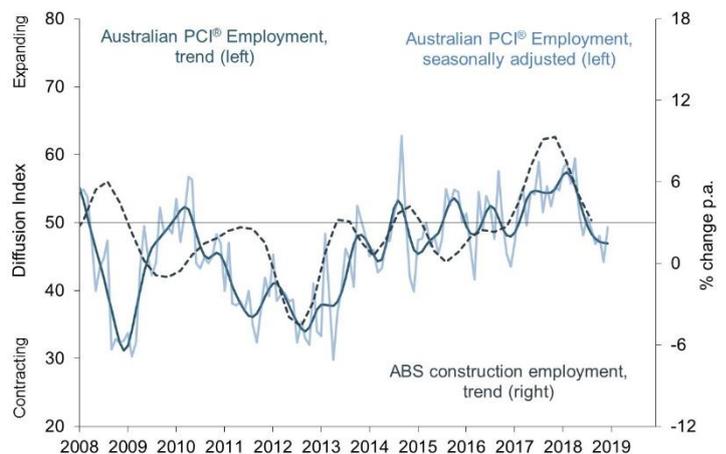
The construction sector employed 1,166,900 people in November 2018 (9.2% of total employment).

Construction employment continued to decline in December, although at a slower rate.

The employment sub-index within the **Australian PCI®** increased by 5.1 points to 49.4 points.

This marked a fifth consecutive month of contraction in employment and the sixth decline in the past seven months consistent with the more subdued readings on activity from mid-2018. It points to a general reluctance by businesses to increase their workforce capacity amid the continuation of soft demand at an aggregate level.

Employment and ABS construction industry employment

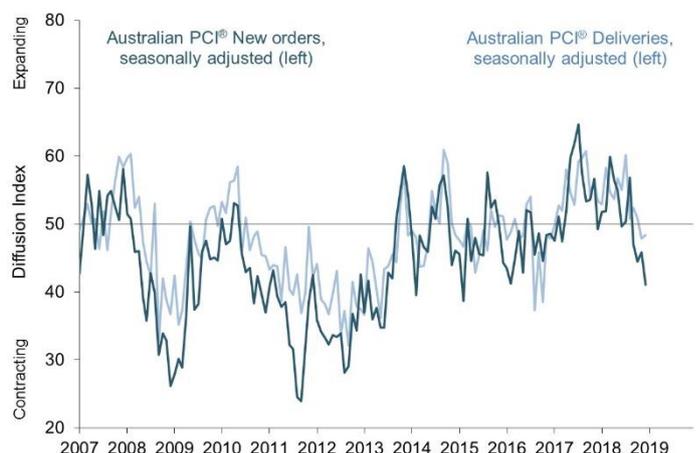


New orders and supplier deliveries

The new orders index in the **Australian PCI®** registered 41.0 points in December. This was a decrease of 4.8 points from November and the lowest new orders result (and therefore the steepest rate of decline) in just under four years.

This further decline in new orders is of concern as the industry looks for growth opportunities at the start of 2019.

New orders and supplier deliveries



Australian PCI® activity

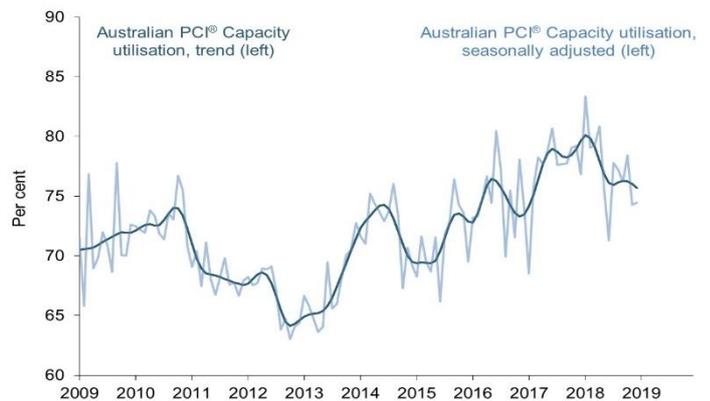
For more information about the Ai Group Australian PCI® visit:

Capacity utilisation

The rate of capacity utilisation stood at 74.5% across the construction industry in December, up marginally by 0.2 points from November.

This is just 2.8 points below the indicator's 12-month average of 77.3 points. This suggests that further investment in people, machinery and equipment will be needed of the industry is to meet any significant growth in demand in the future.

Capacity utilisation



www.aigroup.com.au/policy-and-research/economics/

Australian PCI®: data definitions

The Australian PCI classifies each business according to their single main activity, using the industry data codes and definitions set out in the ANZSIC 2006. These classifications are comparable with all ABS data that use these same codes. For manufacturing in the Australian PCI, the definitions of the 4 sectors are:

1. House building (ANZSIC code 4111 "House construction"). Businesses involved in the construction, repair and renovation of houses (a detached dwelling predominantly used for long term purposes and consisting of one dwelling unit), or in organizing or managing these activities as the prime contractor.
2. Apartment building (ANZSIC code 4112 "Residential building construction n.e.c. (units)". This covers buildings other than a house primarily used for long-term residential purposes (or has attached to it) more than one dwelling unit such as blocks of flats, home units, attached townhouses, semi-detached houses, maisonettes, duplexes, apartment buildings etc.
3. Engineering construction. (ANZSIC code 4121 "Road and bridge construction" and ANZSIC code 4122 "Non-building construction"). Businesses involved in the construction of engineering projects or infrastructure. This includes transport projects, telecommunications facilities, bridges, water and gas supply systems, pipelines, sports complexes, heavy industry constructions and other large-scale construction projects that do not generally involve the construction of buildings.
4. Commercial construction (ANZSIC code 4111 "Non-residential building construction"). Involves the construction of non-residential buildings such as offices, industrial premises, hotels, hospitals, aged care facilities, education buildings, entertainment and recreation developments, and in carrying out alterations, additions, renovation, and in organizing or managing these activities.

What is the Australian PCI®? The Australian Industry Group Australian Performance of Construction Index (Australian PCI®) is a national composite index based on the diffusion indices for activity, new orders, deliveries, inventories and employment with varying weights. An Australian PCI® reading above 50 points indicates that manufacturing is generally expanding; below 50, that it is declining. The distance from 50 indicates the strength of the expansion or decline. Australian PCI® results are based on responses from a national sample of construction businesses that includes all states and all sectors. The Australian PCI® uses the ANZSIC industry classifications for construction sectors and sector weights derived from ABS industry output data. Seasonal adjustment and trend calculations follow ABS methodology. For further economic analysis and information from the Australian Industry Group, visit <http://www.aigroup.com.au/policy-and-research/economics/economicindicators/>.

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