The Australian Industry Group

NATIONAL CEO SURVEY
Business Prospects for 2019

Leadership needed as economy softens

January 2019

ABOUT Ai GROUP

The Australian Industry Group (Ai Group) is a peak employer association which together with partner organisations, represents the interests of 60,000 businesses employing more than 1 million Australians.

Ai Group members are from a broad range of industry sectors including manufacturing; engineering; construction; food and beverage processing; transport and logistics; information and technology; telecommunications; labour hire; and defence.

Ai Group is a leading advocate for government policies that are in the best interests of business and the community.

With more than 250 staff in offices across Australia, we are recognised leaders in policy research and advocacy in areas such as workplace relations, education and training, energy, trade, taxation and regulation.

We promote industry development, employment and stronger Australian communities.

www.aigroup.com.au

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LEADERSHIP NEEDED AS ECONOMY SOFTENS

Ai Group's 2019 Business Prospects survey reads like a report card comment for a weak student: "*Could do better*". In this election year, the serious challenge for Australia is that to do better we have to lift our ambitions and not settle for good enough, which currently seems to be the case. We need more decisive action from Canberra in a range of areas including workplace relations; energy policy and delivering a better trained and more fit for purpose workforce.

The Business Prospects report finds that Australian Chief Executive Officers (CEOs) expect further growth in the year ahead, but for the slowing of activity that began late last year to continue in 2019 due to a mix of local and global factors.

The report identifies key risks for businesses inside Australia including: uncertainties surrounding the Federal election; concerns over the workings and direction of our workplace relations arrangements; the threat of rising barriers to global trade; the impacts of the housing market downturn; consumer caution; high energy prices; and the continuation of drought conditions in many parts of the country.

Expectations for 2019 point to moderate lifts in production, sales and employment and for a modest pick-up in inflation and wages. The 2019 slowdown is anticipated to see activity drift downwards rather than fall precipitously.

This outlook is far from inspiring. While a healthy proportion of the anticipated slowing can be attributed to global factors including heightened trade tensions, geopolitical risks, the slowing of the European recovery and an easing of industrial activity in China, there are a range of factors that are well within our own control that are not attracting the policy attention they deserve.

Rather than simply drift with the international tide, Australia should be proactively building on our relative strengths to lift our economic potential and our domestic living standards. Key policy areas ripe for action include:

- developing the skills of the current and future workforce;
- developing a stable, effective and bipartisan approach to energy policy to secure the investment needed to reduce price pressures and uncertainties over supply;
- removing the administrative obstructions that are preventing the approval of the enterprise bargaining agreements that were once the foundation of strong productivity and sustainable wages growth;
- investing in developing the domestic business capabilities needed to build more world-class enterprises invested in trade, innovation and high-performance workplaces; and
- committing to improving the effectiveness, fairness and competitiveness of our national taxation arrangements.

Words like modest, soft and flat should be ringing alarm bells for policy makers. The coming election is a real opportunity for our political leaders to lay out an agenda for the future which focuses on strong growth and targeted investments that will deliver long-term benefits to our community.

Innes Willox

Innes Willox

Chief Executive, Australian Industry Group

KEY FINDINGS

2018

CEOs viewed 2018 as a year of two distinct halves. The first half of the year saw a welcome acceleration in business-output, sales, employment and investment in response to improving global and local conditions. The second half of 2018 saw some of the shine come off as the pace of improvement eased and as the global and domestic outlook become more uncertain.

Notwithstanding the relative health of the US economy, global growth decelerated over the course of 2018 under the weight of heightened trade tensions, geopolitical risks, the slowing of the European recovery and an easing of industrial activity in China.

For the year as a whole, Australia's growth looked relatively resilient and more broad-based than in the past, with a greater range of locations and industries growing their output and employment in 2018. This was supported by strong export earnings, high levels of public sector spending and investment (e.g. for large long-term programs such as the National Disability Insurance Scheme and urban transport infrastructure expansion and renewal) and relatively robust population growth. As the year wore on however these positive factors were countered somewhat by ongoing weakness in consumer spending and business investment, long-term weakness in productivity growth and, more recently, by a shift downwards in residential property prices and residential and commercial construction activity.

While 2018 was a better year for many Australian businesses, it was not the stellar year for which they had hoped. One third of CEOs said their general business conditions improved in 2018 versus one quarter who saw a deterioration, relative to the previous year. For many businesses, higher input costs - and especially higher energy costs - ate into margins in 2018, detracting from the benefits of the increases in output and turnover they were able to generate, and reducing their ability to invest. Thus, this year's annual Ai Group survey of Australian CEOs indicates that although 57% of CEOs reported an increase in turnover in 2018, non-mining profits were flat with only 41% of businesses surveyed improving their profit margins and 39% reporting a fall in margins in 2018.

2019

CEOs expect 2019 to be a touch slower for Australian businesses than was experienced in 2018. This reflects the very recent deceleration that is evident across local and global indicators in recent months plus the increasing range of risks on the horizon. This moderation in the outlook is apparent in the economic forecasts as well as in business leaders' expectations, plans and strategies.

Heading into 2019, Ai Group's annual CEO survey reveals fewer business leaders are feeling optimistic about their general business conditions in 2019 than was the case one year ago. Indeed, on a net balance basis (optimists minus pessimists), fewer CEOs expect an improvement in business conditions in 2019 than in any year since 2015. This largely reflects their experiences in 2018 and especially the second half of the year.

In this year's Ai Group CEO survey of Business Prospects:

- General business conditions are expected to be better in 2019 for one third of CEOs, which is a lower proportion than had expected an improvement for 2018 (42%) but similar to the proportions of CEOs who had expected better business conditions for 2017 (33%).
- One quarter of CEOs expect their business conditions to deteriorate in 2019, which is the highest such proportion since 2014 (35% of CEOs surveyed at the end of 2014 had expected worse conditions for 2015). On a 'net balance' basis (optimists minus pessimists), 7% of CEOs expect better conditions in 2019, which is the lowest such net balance number since 2015.

- Business turnover is expected to increase for 58% of businesses in 2019, with 24% expecting no change from 2018 levels and 18% expecting a decline in sales in 2019. Although the majority of CEOs expect their total turnover to grow in 2019, most (72%) expect no growth in their export revenue. This suggests that much of the turnover growth will be sought within Australian domestic markets rather than offshore in 2019.

- Profit margins are expected to grow in 46% of businesses in 2019 and fall in 24% of businesses (giving a net balance of +22%), suggesting that businesses are less optimistic about profit margins for 2019 than they were for 2018.

- The majority of CEOs expect prices to rise for both their inputs (63% of CEOs) and their outputs (52% of CEOs). On the selling side, a higher proportion of businesses plan to implement price rises for their own goods and services in 2019 than in any of the preceding six years. Just 10% of businesses plan to cut their selling prices in 2019, which is a lower proportion than had planned to cut prices in the past six years. This suggests a mild pickup in inflation is likely.

- On the input costs side, a higher proportion of businesses expect their input costs to rise in 2019 (63%) than in any of the previous six years, but there is also a higher proportion (6%) who expect their input prices to fall in 2019. This increase in input price volatility adds an additional layer of uncertainty to business planning that may not have been present previously.

- This concern about input price changes relates largely (but not solely) to energy pricing. Over two-thirds of CEOs (68%) expect their energy input costs to rise further in 2019. This will be on top of energy price increases reported by 63% of businesses in 2018. Higher energy prices and reliability of energy supply have become key risks for Australian business across an increasing range of industries and locations.

- Employment (headcount) is expected to increase for 42% of businesses in 2019, with 40% expecting no change and 18% expecting to reduce their business headcount. On a net balance basis, employment expectations are lower than for 2018 but are higher than in previous years. This suggests slower aggregate employment growth is likely in Australia's private-sector in 2019 than was experienced in 2018 or 2017, but higher than in previous years.

- Most CEOs plan to maintain or increase their spending on various types of business investment in 2019. A majority (57%) of CEOs expect to spend more on technology, while 39% also expect to spend more on staff training, 33% expect to spend more on physical capital (buildings, plant and equipment) and 23% expect to spend more on R&D. Very few CEOs intend to spend less on investment in 2019 than they did in 2018, with lower proportions of businesses planning to cut back on various types of investment in 2019 than in the previous six years. The strong focus on investing in technology is a long-term trend, with expectations of spending on new technologies rising at a faster pace than other forms of investment since 2013.

- When asked which factors would provide the biggest inhibitors to business in 2019, 31% of CEOs identified a 'lack of customer demand' as their most significant constraint, down from 45% of CEOs who said the same for 2018 (and down from most previous years, since 2013). Labour market concerns feature prominently for businesses in 2019. The second most pressing concern for CEOs is skill shortages, with 21% of businesses nominating this as their top concern. This is up from 17% of leaders that identified skill shortages as an impediment for 2018 and triple the proportion in 2017 (7%). A further 7% of CEOs said the flexibility of industrial relations is their top concern in 2019, up from 4% in 2018.

- In response to these challenges, 30% of CEOs plan to concentrate on improving sales of current products and services to their customers in 2019, down from 34% who ranked this as their top planning priority in 2018. Around 23% of CEOs will focus on introducing new products to the market in 2019 down from 40% in 2018 and 33% in 2017. This switch in focus from 'new' to 'existing' products and services suggests that those who introduced new products and services in recent years, will now progress from the development phase to focus on consolidating their markets.

1. Australian Economy and Business Conditions in 2018

2018 was a year of two distinct halves for the Australian economy. The first half of 2018 saw a mild but welcome acceleration in activity, employment, business incomes and investment, in response to improving global and local conditions. In early 2018 commodity prices recovered but the Australian dollar stayed low, supporting growth in exports; population growth supported residential development and major infrastructure projects; output increased across all industries except agriculture; and a solid run of employment growth pushed participation up and unemployment down, including in regional locations and among older Australians and Australian youth.

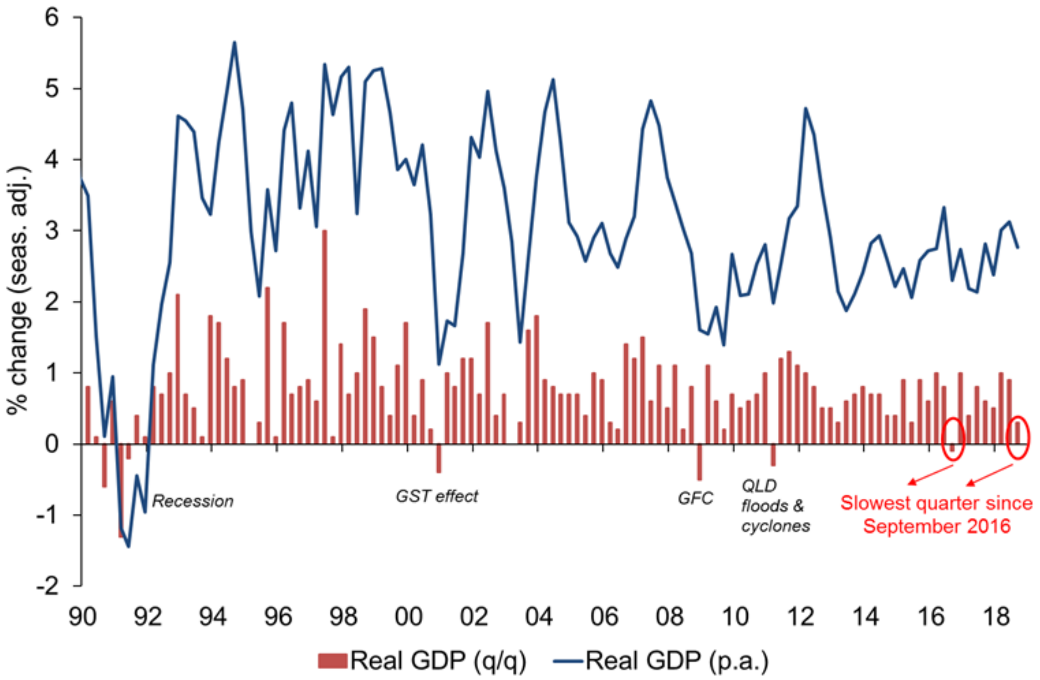
Agriculture and other industries in many regional locations however, were adversely affected by protracted drought conditions through New South Wales and Queensland. Towards the end of 2018 global conditions decelerated under the weight of heightened trade tensions and geopolitical risk; locally the beginnings of a downturn in residential property markets spread across east coast metropolitan areas. These trends and emerging risks during the latter half of 2018 were evident across key data and information sources including the Australian Bureau of Statistics (ABS) regular economic indicators (gross domestic product, business investment, employment growth), Ai Group's monthly business surveys and the Ai Group annual CEO Business Prospects survey for 2018-19.

1.1 Australian economy in 2018

The Australian economy performed relatively well on many but not all major economic indicators in 2018.

2018 marked 27 years since Australia last experienced a recession (1991), setting a modern record among OECD countries. Australia's real GDP grew at around its long-term average in the first half of 2018 (3.1% p.a. to June 2018) but then slowed in the second half, to 2.8% p.a. to September 2018 (Chart 1.1). On the expenditure (demand) side of the economy, growth in 2018 was mainly driven by net exports, government spending and government investment. An early boost to demand from the residential construction boom had faded by mid-year, supplanted by major infrastructure projects. Household spending was the weak link throughout 2018, constrained by slow income growth and high housing debt.

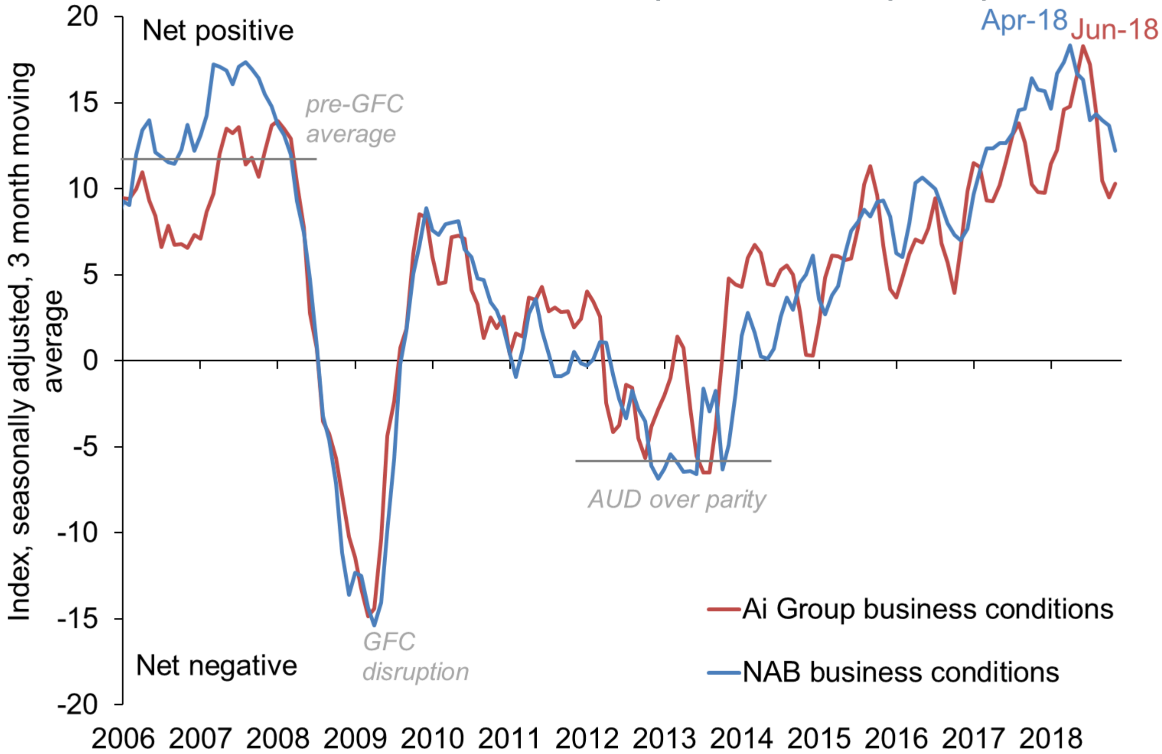
CHART 1.1 Real GDP growth, annual and quarterly rates since the last recession, 1990 to Q3 2018



Source: ABS, *National Accounts,* Sep 2018.

The two-speed nature of 2018 is more evident in the monthly surveys of private-sector business conditions conducted by Ai Group and the National Australia Bank (NAB). Both data series clearly show business conditions (reflecting a composite of sales, profitability, forward orders and employment) improving through 2017 and into early 2018. Both series also show a peak during Q2 of 2018, with decelerating – but not yet net-negative – conditions through Q3 and Q4 of 2018 (Chart 1.2).

CHART 1.2 Australian business conditions: Ai Group and NAB monthly surveys, to Nov 2018



Sources: Ai Group Australian PMI, Australian PSI and Australian PCI; NAB Monthly Business Survey, to Nov 2018.

All industries except agriculture grew their output in the year to June 2018, but industrial sectors lost some ground in the second half of the calendar year. Growth was strongest in 2018 in healthcare (reflecting growth in the National Disability Insurance Scheme and other public-sector programs) and in services industries linked to real estate and/or large infrastructure projects. Output stumbled in Q3 however, across all of the industrial-related sectors including construction, manufacturing, mining, utilities, agriculture, transport and telecommunications. Agricultural output was clearly affected by drought in 2018 (down by 1.6% q/q and 7.9% p.a. in Q3), due to reduced grains and other crops (see Chart 1.3).

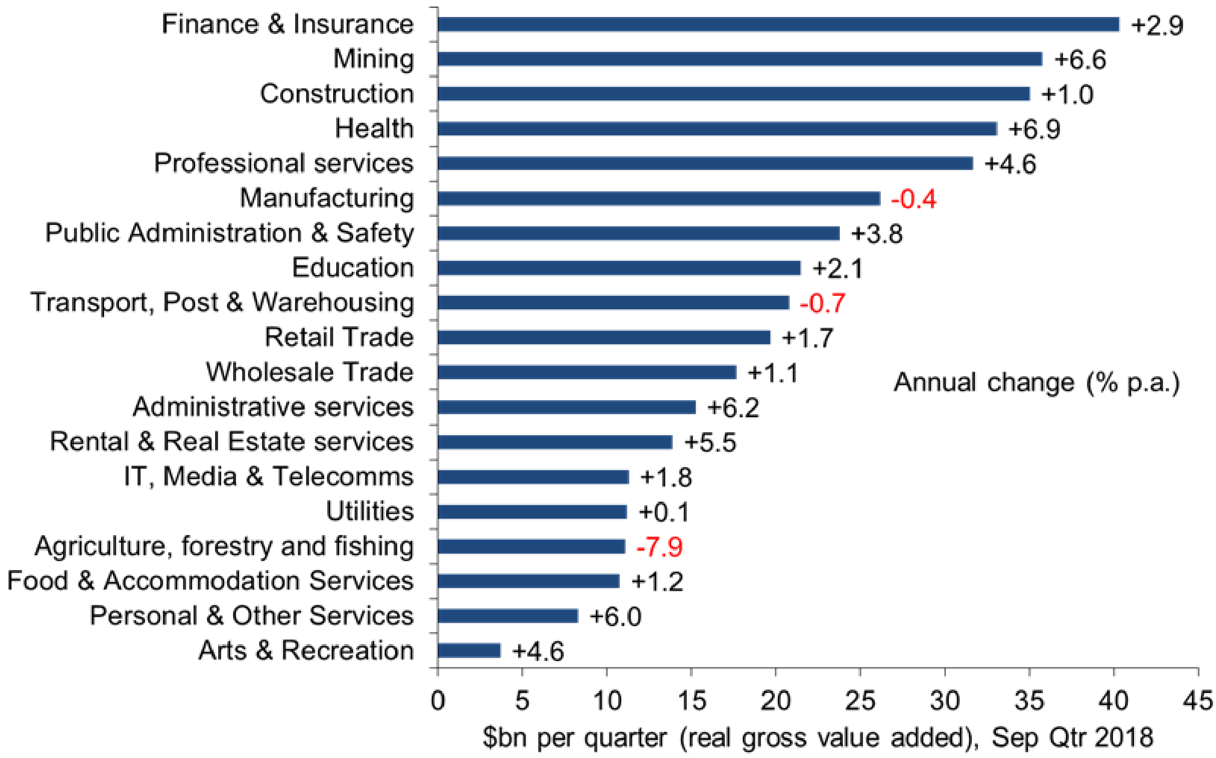
Some states performed better than others in 2018. Population growth, housing demand and government infrastructure projects all supported stronger activity in the populous eastern states. New South Wales and Victoria enjoyed stronger jobs growth and lower unemployment rates than other states throughout 2018. A recovery in global commodity prices benefited Western Australia and, to a lesser extent, Queensland.

National income is influenced by more than just output volumes; the terms of trade are also a key factor. As of September 2018, recovering commodity prices had lifted Australia's terms of trade by 2.7% p.a. This helped push up real gross domestic income (GDI) by more than just output alone; real GDI rose by 0.4% q/q and 3.4% p.a., compared to 0.3% q/q and 2.8% p.a. for real GDP.

Nominal income growth was spread across all categories of income, including employees, financial corporations (banks, building societies, superannuation funds and related entities), non-financial private corporations and dwellings owned by individuals in 2018. The share of total income derived from each type of income remained relatively stable over the year, at 52% for employees, 20% for private-sector non-financial corporations, 7% for private-sector financial corporations, 10% to small businesses and self-employed individuals and 8% in rents earned from dwellings owned by individuals.

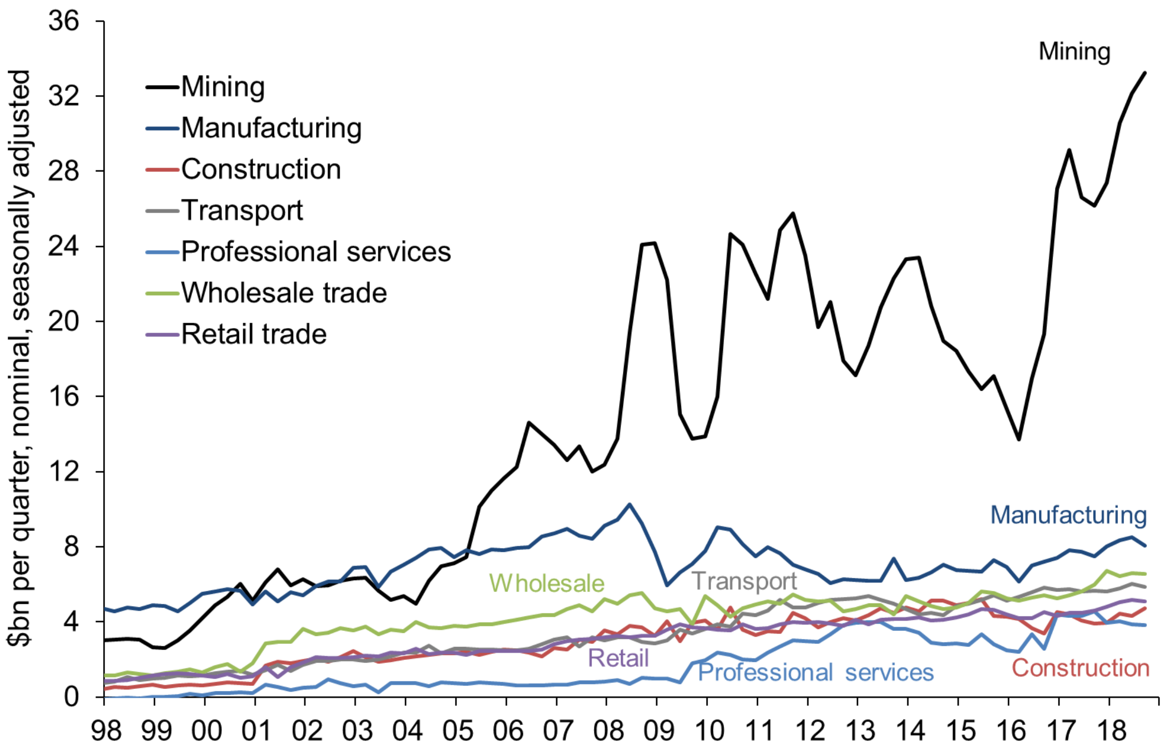
That said, **income growth is extremely uneven across major industries**, with most of the growth in aggregate company profits accruing to the mining sector. Nominal gross operating profits (GOP) in mining grew by 27% in the year to Q3 2018, accounting for 64% of all increase in profits and rising to 37% of all GOP earned in that year. Nominal GOP in the non-mining sectors grew by a modest 1.0% q/q and 6.8% p.a. in Q3. In contrast, nominal GOP in manufacturing fell by 5.1% q/q to $8.1 billion in Q3 2018, well below the industry's high point of $10.1bn it reached just before the GFC in June 2008 (see Chart 1.4).

CHART 1.3 Real output size and growth, by industry, Q3 2018



Source: ABS, *National Accounts,* Sep 2018.

CHART 1.4 Nominal aggregate company profits in industrial & related sectors, to Q3 2018



Source: ABS, *Business Indicators*, Sep 2018.

Productivity growth remained weak and patchy in 2018 and within the current 'productivity cycle'. Across all of the industries for which productivity estimates are available, labour productivity fell by 1.3% in 2017-18 and multifactor productivity fell by 0.3%, on a quality-adjusted hours worked basis. Over the latest (incomplete) productivity cycle since the previous peak in 2011-12, labour productivity growth has averaged 1.0% p.a. and multifactor productivity has averaged 0.3% p.a. (Chart 1.5).

Reflecting this weakness in recent productivity growth, GDP growth per capita fell by 0.1% in Q3 2018 (to be up by just 1.2% p.a.) and gross value-added output per hour worked dropped by 0.1%, to be up by just 0.6% over the year to Q3. This failure to generate meaningful productivity growth has weighed on real incomes over an extended period and continues to do so. It implies a greater reliance on export prices, population growth and labour participation as drivers of Australia's output and income growth.

CHART 1.5 Productivity growth, all selected industries*, 1988-89 to 2017-18

* Quality-adjusted hours worked basis, for all industries for which estimates are available. Source: ABS, *Estimates of Industry Multifactor Productivity*, Dec 2018.

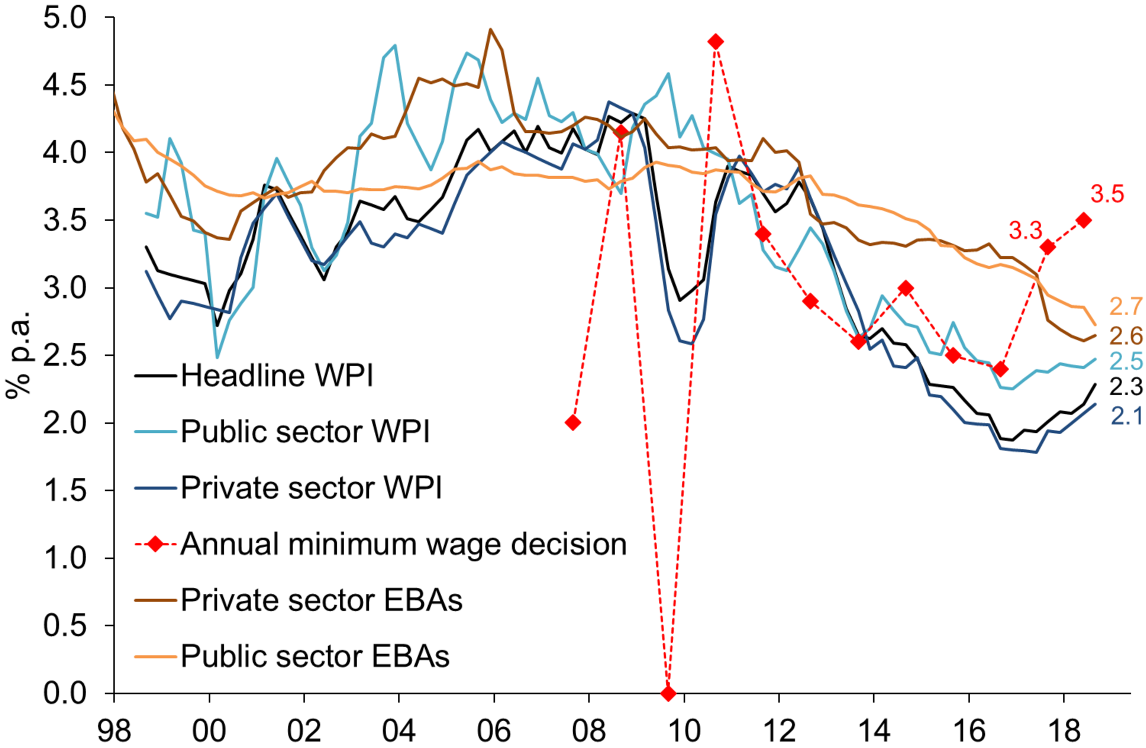
The labour market tightened somewhat in 2018. Full-time employment has grown for two years, with an average increase of 21,600 jobs per month (trend). Part-time employment accounted for 31.5% of the workforce in November 2018, down from a record high in 2016. In trend terms, the national unemployment rate fell to 5.1% by November 2018, its lowest level since June 2011. Most positively, the youth unemployment rate (for those aged 15-24 years) fell to 11.4% as of November 2018, from a recent peak of 14.1% in November 2014. This is near the lowest youth unemployment rate since the GFC began in 2008. The underemployment rate (that is, the proportion of the labour force who are working but willing and available to work more hours) remains relatively elevated by historical standards at 8.4% in November. This indicates a greater degree of 'spare capacity' in the labour market than is evident from the unemployment rate alone. This spare capacity continues to weigh on wage growth, albeit more lightly than in recent years.

Stronger employment growth is attracting more people into the labour market and pushing up the national **participation rate** (those that are working or looking for work). As of November, Australia's participation rate was at a record high 65.68%, just above the previous record of 65.64% in December 2010 (trend). A strong rise in female participation has more than offset a long-term fall in male participation. This has occurred despite the long-term ageing of our population, which more typically sees participation rates decline.

Wage growth accelerated in 2018, from record slow rates in 2016 and 2017. The ABS Wage Price Index (WPI) for the September quarter (Q3) of 2018 grew by 0.6% q/q and 2.3% p.a. This was its fastest annual growth rate since Q3 2015. The ABS noted that "*September quarter wages growth was mainly influenced by increases to the national minimum wage* [3.5% in 2018], *regularly scheduled enterprise agreement increases, modern awards and salary reviews timed to coincide with the financial year*."

All wage-setting methods contributed to wage growth over the year to Q3 2018, suggesting wage growth has lifted from its slowest point in this cycle after reaching a recent low of 1.9% p.a. in 2016. Public sector wages grew by 0.6% q/q and 2.5% p.a. in Q3 2018 and have been stronger than wage increases in the private-sector since 2014. Private-sector wages excluding bonuses, grew by 0.5% q/q and 2.1% p.a., their fastest annual growth rate since Q2 2015 (Chart 1.6). Private-sector wages including bonuses rose by 2.7% p.a. in Q3, which suggests that more firms are now paying higher bonuses instead of raising base rates. Some businesses might be doing this in order to retain flexibility and reward stronger performances.

CHART 1.6 Australian wage growth indicators, 1998 to 2018



Sources: ABS, *Wage Price Index*, Sep 2018; Fair Work Commission; Department of Jobs and Small Business, *Trends in Federal Enterprise Bargaining*, June 2018.

Inflation remained weak in 2018, with the headline consumer price index (CPI) slowing to 1.9% p.a. in the September quarter of 2018 (Q3), just below the Reserve Bank of Australia's (RBA) target band of 2 to 3% over the cycle. Underlying inflation was slightly lower, easing to its slowest rate since early 2017, at 1.8% p.a., but up from its lowest point in 2016. This deceleration in 2018 reflected modest price rises for housing-related costs such as utilities, rents, property rates and charges, as well as price falls for out-of-pocket childcare services expenses, communications and household equipment and services. On the upside, weak national inflation means that relatively weak wages growth is still enough to generate (very modest) real income growth.

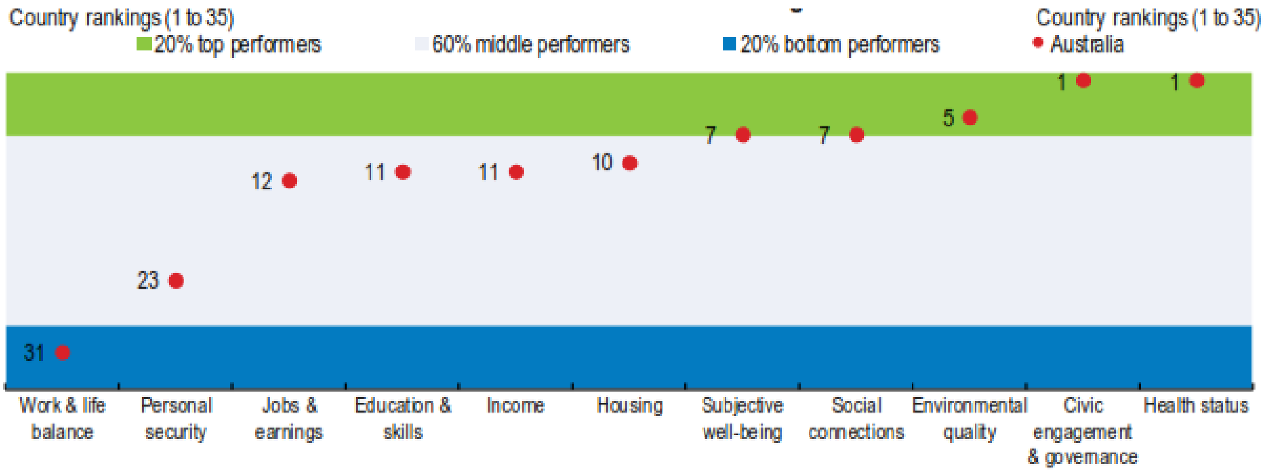
Inflation is not quite so benign however, for all businesses. Input costs are, on average, rising more strongly than output prices for producers of Australian goods and services. Price growth in preliminary (+5.2% p.a.) and intermediate (4.7% p.a.) producer inputs outpaced price growth in producer outputs (+2.1% p.a.) in Q3 of 2018. This 'growth gap' between price rises for final products versus preliminary and intermediate inputs indicates that business margins were further compressed in Q3 2018.

In response to this mixed picture – and more particularly, in response to the glacial pace of change in prices and wages - the RBA left the cash rate on hold at a record low of 1.50% for all of 2018, where it had been since August 2016 (a record length of time with no movement).

Despite this mixed scorecard of economic factors, the OECD was strongly positive in its latest assessment of Australia's economic, personal and community well-being (Chart 1.7). In December 2018[1] it concluded:

> *"Australia's long span of positive output growth continues, demonstrating the economy's resilience to shocks. The labour market has been equally resilient, with rising employment and labour-force participation. Life is good, with high levels of well being, including health, and education.*
>
> *… During the global financial crisis, comparatively limited exposure, but also good economic management, saw output growth hold up well. Also, the economy's adjustment in the wake of the commodity super-cycle has been reasonably smooth. This good macroeconomic performance has strengthened the country's standing in terms of GDP per capita.*
>
> *…scores are favourable on many other indicators of well-being. Australia scores particularly well in health status, ranking first among OECD countries with life expectancy of 82.5 years compared with an OECD average of 80.1 years and a high score in self-reported health. It also scores well in terms of air pollution, ranking 5th in the OECD, subjective well being and social connections (both 7th place in the rankings). Immigration has played a fundamental role in the demographic, economic and cultural development of Australia, and continues to do so with broadly successful integration."*

CHART 1.7 Australia's ranking on OECD indicators of national well-being, 2018



Source: OECD 2018, *OECD Economic Surveys: Australia*. December 2018.

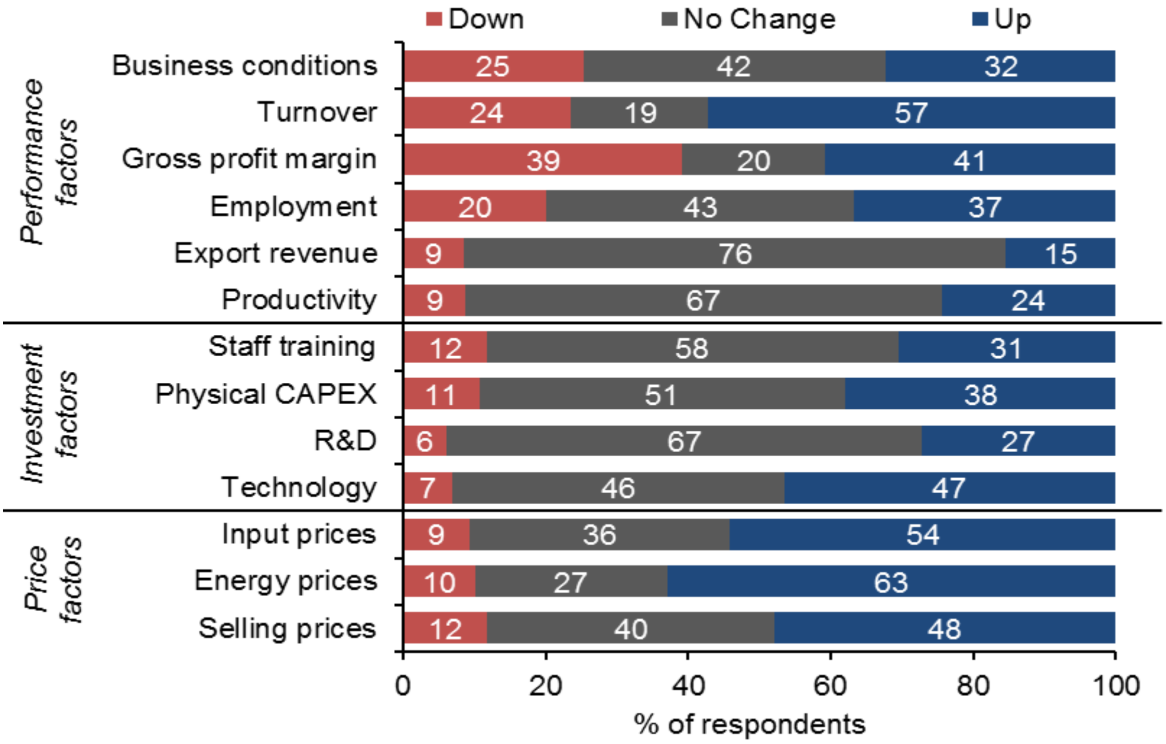
[1] Organisation for Economic Cooperation and Development, *OECD Economic Surveys, Australia*, December 2018, pp 9-14.

1.2 Business conditions in 2018

In line with improving local economic conditions in 2018, Australian CEOs participating in this year's Ai Group survey reported a broadly positive year. In 2018, a greater proportion of Australian CEOs reported improved performance and higher spending on investment (see Chart 1.8). More than half of respondents noted higher turnover in 2018 (57%) but only 41% of respondents reported improving profit margins, with almost the same amount reporting falling profit margins (39%). This can be at least partially explained by a high proportion of respondents reporting increased inputs costs, especially for energy. Market prices for gas and electricity increased to record highs in 2017, before easing slightly in 2018. Most businesses commit to energy contracts of more than one year, and market price increases take time to filter through, so many businesses may find themselves negotiating energy contracts that are substantially higher than their previous contract. Rising energy price costs are proving difficult to pass on as price increases to customers and are squeezing margins across a wide range of industries.

On the spending side, almost half of respondents increased their spending on new technology in 2018 (47%). In other areas of business investment, most businesses did not alter their spending on staff training, physical capital expenditure or research and development (R&D) in 2018, relative to one year earlier.

CHART 1.8 BUSINESS INDICATORS IN 2018: PERFORMANCE, INVESTMENT AND PRICING



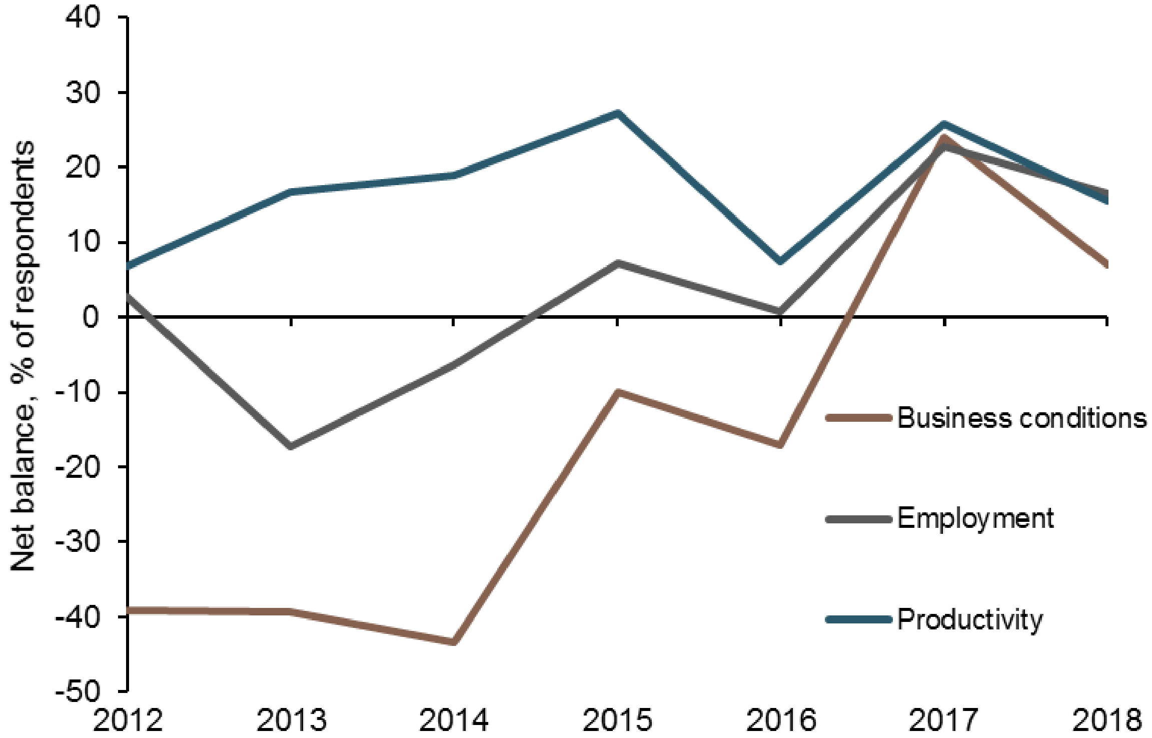
Conditions in 2018: Business Performance Indicators

Looking at the performance indicators over time, 2018 appears to have been good year for more businesses, but not quite as good as in 2017 (see Charts 1.9 and 1.10). The 'net balance' of businesses reporting an improvement in turnover was about the same as in 2017 (+34%), but the 'net balance' fell across other key indicators in 2018 compared to 2017, including profit margins (+2%), business conditions (+7%), employment (+17%) and labour productivity (+16%). Export revenue was the only indicator to show an improvement (see chapter 4).

Regarding employment, 37% of CEOs reported employing more people in 2018 than they had in 2017, but 20% reported falling employment in their businesses, giving a 'net balance' of +17%. This 'net balance' is slightly below the record high in 2017 of +23%, which also coincided with an Australian record for calendar year employment growth, at 412,000 jobs added nationally. Employment growth averaged 22,900 per month in 2018 (up 2.3% p.a. to November). Although weaker than in 2017 (34,400 per month and up 3.4% p.a. to Dec), 2018 was still a relatively strong year for jobs growth by recent Australian standards.

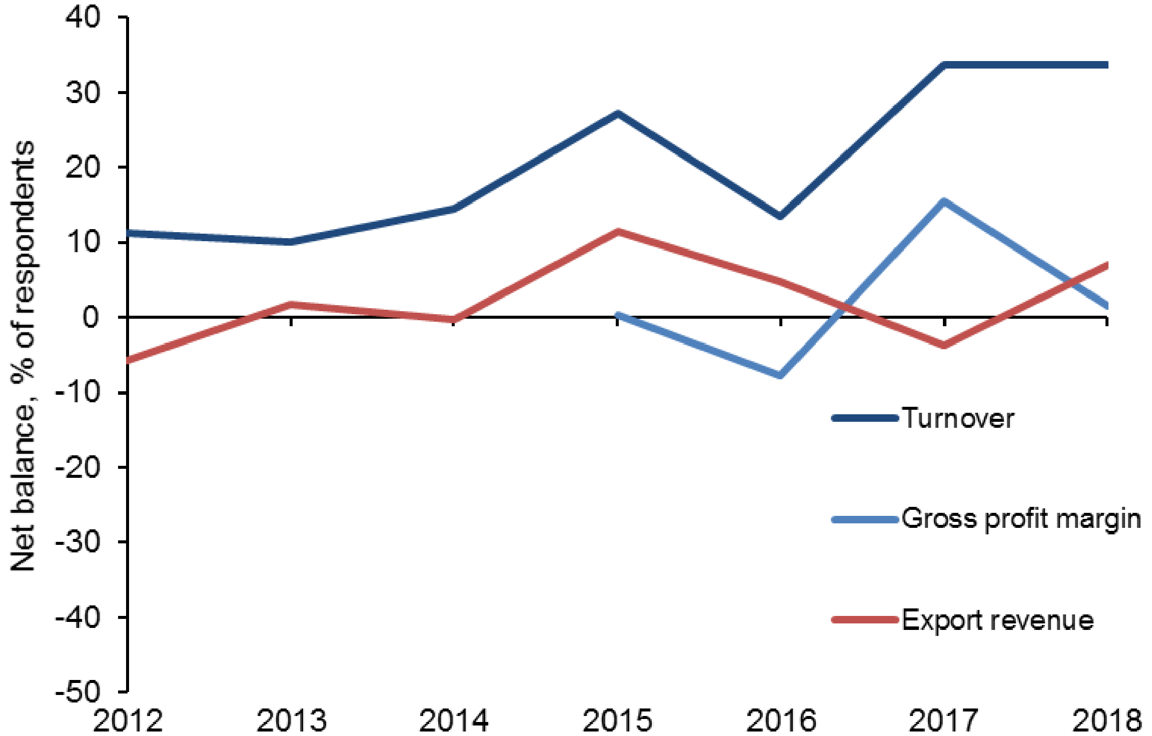
Consistent with national productivity performance (as estimated by the ABS and reported in section 1.1 above), labour productivity improved for fewer businesses in 2018 than it had in 2017, with the 'net balance' of labour productivity improvement falling from +26% in 2017 to +16% in 2018 (Chart 1.9).

CHART 1.9 BUSINESS PERFORMANCE INDICATORS, 2012-2018



'Net balance' is the proportion of all survey respondents that reported an improvement minus the proportion that reported a deterioration in each indicator. Aggregate results include respondents from all surveyed industries and are weighted by ABS estimates of output from each industry

CHART 1.10 BUSINESS PERFORMANCE INDICATORS, 2012-2018



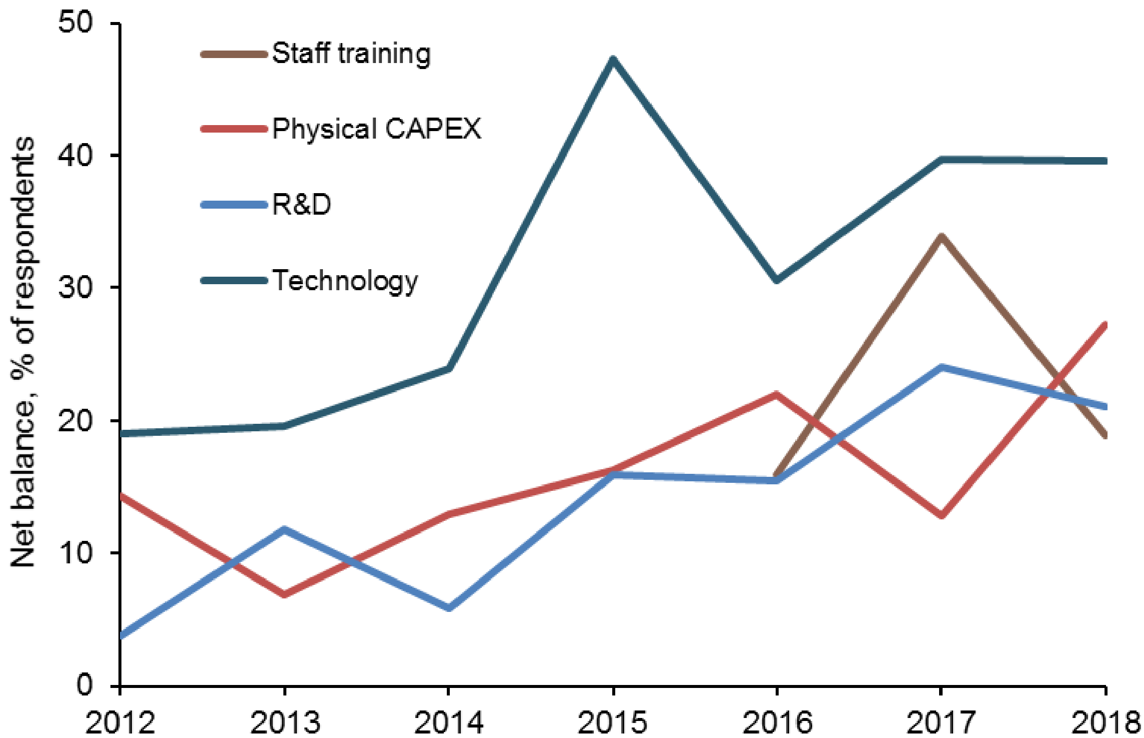
'Net balance' is the proportion of all survey respondents that reported an improvement minus the proportion that reported a deterioration in each indicator. Aggregate results include respondents from all surveyed industries and are weighted by ABS estimates of output from each industry

Conditions in 2018: Business Investment Indicators

Ai Group's annual CEO survey has indicated an upward trend in annual spending on technology, R&D and physical CAPEX since at least 2012 (see Chart 1.11). A greater proportion of CEOs have reported growth in spending on technology than other investment options consistently since 2012. Looking back at previous surveys, it is clear that this focus on investing in technology has increased over time. This suggests the nature of investment in the Australian economy is changing, with a greater focus on information technology and a shift towards increased investment in the services industries.

Looking at just 2018 however, the only investment indicator to improve in net terms was spending on physical CAPEX such as buildings and equipment. Capacity utilisation in Ai Group's monthly performance indices across the manufacturing, services and construction sectors were consistently above their long-run averages in 2018. This suggests that an increasing number of businesses in these sectors have low spare capacity and need to invest further to meet future growth requirements. Increased spending on physical CAPEX, such as buildings and equipment, was stronger than originally forecast by the RBA in 2017. Net spending on R&D was only slightly weaker than in 2017 (+24% in 2017 vs +21% in 2018), however like previous years, more than two-thirds of businesses indicated they would not change their level of R&D investment. Spending on staff training has only been included as a question since 2016 but this indicator appears to have pulled back in 2018 after jumping in 2017.

CHART 1.11 BUSINESS INVESTMENT INDICATORS, 2012-2018

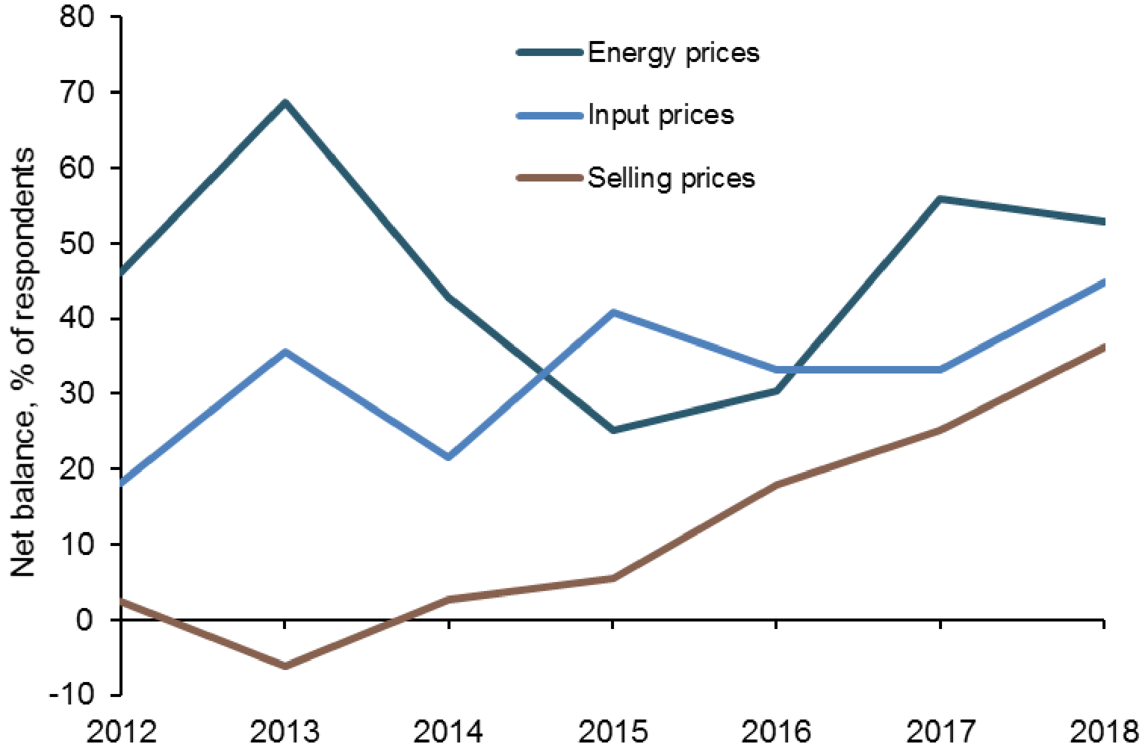


'Net balance' is the proportion of all survey respondents that reported an improvement minus the proportion that reported a deterioration in each indicator. Aggregate results include respondents from all surveyed industries and are weighted by ABS estimates of output from each industry

Conditions in 2018: Business Pricing Indicators

As discussed above, market prices for gas and electricity increased to extraordinary levels in 2017, before recovering in 2018. These price decreases were not experienced by those participating in the survey, as businesses commit to energy contracts of more than one year, and market price changes take time to eventuate. Therefore, many businesses are negotiating new energy contracts at rates far above what they have paid in the past. Consistent with rising energy costs and increasing costs of some raw materials in 2018, more CEOs reported rising input prices. There was an improvement in selling prices in 2018 with 48% of respondents noting an increase in their selling prices and only 12% noting falling selling prices (net balance of +36%).

CHART 1.12 BUSINESS PRICING INDICATORS, 2012-2018



'Net balance' is the proportion of all survey respondents that reported an improvement minus the proportion that reported a deterioration in each indicator. Aggregate results include respondents from all surveyed industries and are weighted by ABS estimates of output from each industry

Industry Conditions in 2018

Australian **manufacturing** CEOs reported a better year in 2018 than in the previous six years. Australian manufacturing experienced a strong year despite high energy prices and growing skills shortages. For the second year in the survey's history, more manufacturing CEOs reported that business conditions improved instead of deteriorated (53% reported improving conditions while 19% reported deteriorating conditions). Manufacturing accounted for 5.8% of GDP (value-added output) and 8.3% of employment in 2018 (most recent data).

While still positive, **services** businesses reported a moderation in conditions in 2018 compared to 2017. Results across services industries were mixed with a divergence in results between the business-oriented sectors and consumer-oriented sectors as shown in Ai Group's **Australian PSI®**. In 2018, 55% of CEOs reported an improvement in business conditions compared to 20% who reported a decline in business conditions.

As with the manufacturing sector, **construction and mining businesses** reported a better year in 2018 than in the previous six years. More than two-thirds of construction and mining CEOs reported improving turnover and profit margins in 2018. Record numbers of new homes being built and high levels of infrastructure activity lead to strong improvement in employment and turnover for the construction sector. Rising global commodity prices and a rebound in the mining sector improved profit margins for mining businesses (and those servicing miners) in 2018 compared to 2017. Levels of construction activity remain respectable by historical standards with infrastructure work accounting for a significant proportion of total activity. However, house building respondents to the **Australian PCI®** reported 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 also indicated that activity continued to be driven lower by soft investor demand, project completions and over supplied markets.

2. Australian Economy and Business Outlook in 2019

After a stronger period of activity during 2017-18, the Australian economy looked to be slowing again by the end of 2018. Reflecting this deceleration, the latest expectations for growth in 2019 remain cautiously positive but are slightly slower than was experienced in 2018. The risk profile has risen, locally (see below) and globally (see chapter 4).

This moderation in the outlook is apparent in economic forecasts as well as in business leaders' expectations, plans and strategies. Compared to one year earlier, fewer CEOs are expecting an improvement in general business conditions in 2019 and more are expecting a deterioration in conditions. Fewer businesses are expecting growth in turnover, employment, profit margins and in most types of investment in 2019, but more businesses are expecting increases in their input prices and energy costs.

2.1 Australian economic outlook in 2019

GDP grew by 2.8% p.a. to Q3 2018 and looks to have decelerated through 2018 (see chapter 1 above). In its latest quarterly *Statement on Monetary Policy* (published in November 2018, before the latest GDP estimates for Q3 2018 had been released), the RBA slightly upgraded its forecasts for GDP growth to 3.5% for the end of 2018. This seems optimistic given the latest data for 2018 to date, despite quarterly volatility and recent revisions to the published estimates. The RBA expects GDP growth to then moderate to 3.25% in 2018-19 and 3.0% by the end of 2020, as production volumes of new resource commodities (mainly LNG exports) come on stream, stabilise and then cease to contribute to growth, albeit at a new, significantly higher levels of production (see Table 2.1).

As of the end of 2018, the federal Treasury was feeling more circumspect than the RBA about headline GDP growth rates for Australia in 2019, as was the OECD. Treasury forecasts GDP growth of 2.75% in 2018-19 and 3.0% in 2019-20 (and the OECD forecasts 3.0% for the 2019 calendar year), significantly slower than the RBA's forecast of 3.25% in both years (Table 2.1). Both central government agencies expect growth of around 3.0% in 2020 and beyond, which is around the long-run average for Australian GDP growth, but rather faster than our average annual growth rate of 2.7% achieved since 2010 (or 2.9% since 2000).

During 2019, the RBA and Treasury expect GDP growth to be supported by **large-scale public spending programs** that are already under way, particularly for infrastructure projects and the implementation of the National Disability Insurance Scheme (NDIS). They also expect better **non-mining business investment**, after many years of weak spending. This should help to counter falls in residential investment and building activity after the recent boom of 2018, when construction of new apartments hit an all-time peak.

Strong jobs growth in 2018 may moderate in 2019, but it is still likely to push the unemployment rate lower than the recent rate of 5.1% recorded in November 2018. Indeed, unemployment is well on track to fall below the RBA and Treasury's expectation of 5.0% by the end of 2018-19. It had already outperformed the OECDs' estimate of 5.4% by December 2018. This recent tightening in the labour market is already feeding through into **wages growth**, which bottomed out during 2018 and is now accelerating gently. Ongoing long-term weakness in productivity growth (see chapter 1) plus slow background inflation however, means nominal wages growth seems unlikely to accelerate from the current rate of around 2.3% p.a. (WPI, Q3 2018) to reach official expectations of 3.0% in 2019-20 and 3.5% in 2020-21.

A cautious mood among households (stemming from slow wages growth, high household debt and falling house prices in Sydney, Melbourne and some other cities and regions), means that the key uncertainty in the local economy for 2019 is the outlook for discretionary household spending. Treasury hopes that household spending growth will pick-up to 3.0% by 2020 as the labour market tightens and household incomes rise more strongly, but the OECD is expecting growth in real household spending to slow to just 2.0% over the next two years (in line with its less positive assessment of the labour market).

More positively, exports of services and manufactured goods are expected to keep growing in 2019 and beyond, supported by solid trading-partner growth (mainly in Asia) and the depreciation of the exchange rate since the start of 2018. Globally, growth has slowed in some economies but is expected to remain above trend in major advanced economies (see chapter 4). The risks of trade disruption and protectionism are increasing however, which could slow global GDP, trade, business confidence and investment. In its latest assessment of the "resilient" Australian economy, the OECD identifies three key risks for 2019:

- **Disruptions to the local housing market** and residential construction sector, led by falling residential dwelling prices in Melbourne and Sydney. The OECD says "*The housing market poses macroeconomic risks. Australia's housing market is a source of vulnerabilities due to elevated prices and related household debt. House prices have fallen, although only gradually since late last year; the current trajectory would suggest a soft landing, but some risk of a hard landing remains*";

- **Disruptions to export markets** due to rebalancing policies inside China (see chapter 4). The OECD says "*Australia's concentration of exports in commodities is a key element in Australia's risk profile. Most critical are developments in demand and prices for iron ore and coal, particularly the impact of China's economy on these. China is also of growing importance for Australia's trade in services, notably in tourism*"; and

- **Disruptions to export markets** due to an escalation of international trade disputes (see chapter 4). The OECD says "*the impacts on Australia of higher US tariffs on imports from China and Mexico are probably not large but a widespread increase in tariffs globally could have substantial impact*".[2]

Drought conditions are exerting additional, short-term drag on output growth in Australia during 2018-19. The **Federal election** to be held during 2019, may also temporarily weaken business and consumer sentiment and delay some spending.

TABLE 2.1 AUSTRALIAN ECONOMY: LATEST ANNUAL GROWTH RATES AND FORECASTS

RBA SoMP (Nov 2018)	2016-17 e	2017-18 e	2018-19 f	2019-20 f	2020 f	
GDP, % change p.a., year end	1.8	3.1	3.25	3.25	3.0	
Unemployment rate, %, year end	5.6	5.4	5.0	4.75	4.75	
Inflation (CPI), % change p.a., year end	1.9	2.1	2.0	2.25	2.25	
Treasury MYEFO (Dec 2018)	**2016-17 e**	**2017-18 e**	**2018-19 f**	**2019-20 f**	**2020-21 p**	**2021-22 p**
GDP, % change p.a., year average	2.1	2.8	2.75	3.0	3.0	3.0
Household consumption, % p.a., yr ave.	2.6	2.8	2.5	3.0		
Dwelling investment, % p.a., yr ave.	2.8	0.1	1.0	-4.0		
Business investment, % p.a., yr ave.	-4.0	6.0	1.0	5.0		
Employment growth, % p.a., year end	1.9	2.7	1.75	1.75	1.5	1.5
Unemployment rate, %, year end	5.6	5.4	5.0	5.0	5.0	5.0
Inflation (CPI), % change p.a., year end	1.9	2.1	2.0	2.25	2.5	2.5
Wages (WPI), % change p.a., year end	1.9	2.1	2.5	3.0	3.5	3.5
Terms of trade, % change p.a., yr end	14.4	1.9	1.25	-6.0		
OECD (Dec 2018), calendar years	**2016 e**	**2017 e**	**2018 f**	**2019 f**		
GDP, % change p.a., year end	2.6	2.2	2.9	3.0		
Household consumption, % p.a., yr end	2.9	2.7	2.0	2.0		
Dwelling investment, % p.a., year end	8.7	-2.2	-2.1	-2.2		
Business investment, % p.a., year end	-9.5	2.6	3.8	5.3		
Employment growth, % p.a., year end	1.7	2.3	2.0	1.8		
Unemployment rate, %, year end	5.7	5.6	5.4	5.3		
Inflation (CPI), % change p.a., year end	1.3	2.0	2.1	2.3		

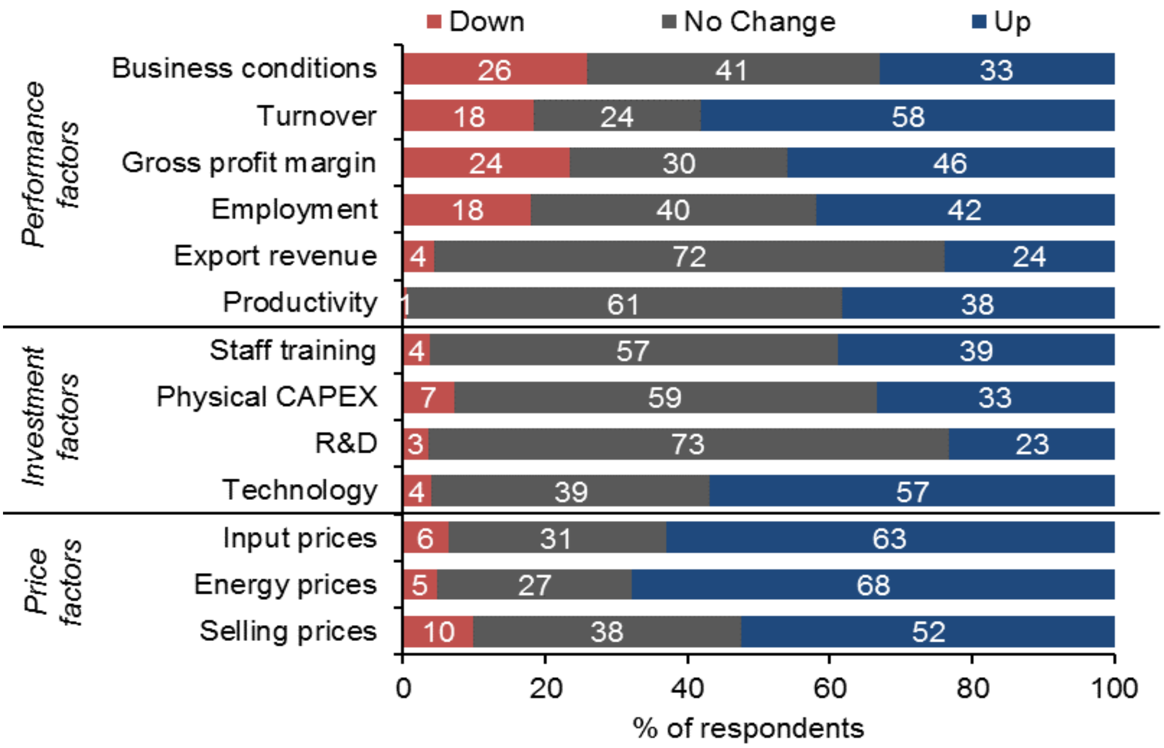
e = estimates, at December 2018. f = forecast p = projection. Sources: ABS various data; RBA Nov 2018 *Statement on Monetary Policy*; Australian Treasury, *Mid-Year Economic and Financial Outlook,* 2018; OECD *Economic Surveys of Australia,* 2018.

[2] Organisation for Economic Cooperation and Development, *Economic Survey of Australia*, 2018

2.2 Business expectations in 2019

Business expectations for 2019 are generally positive, although less positive than the expectations they had a year ago for the 2018 year. 2019 expectations are broadly similar to initial expectations for 2016 and 2017. For 2019, one third of CEOs expect better general business conditions and a further 41% expect no change in 2019. Around one quarter expect a deterioration in general business conditions. The single biggest caveat to this mildly positive outlook for most businesses is concern about rising input costs and especially rising energy costs in 2019; 63% of CEOs expect their input prices to rise and 68% expect their energy input costs to rise in 2019. These rises are denting an otherwise positive outlook for sales and margins. Nevertheless (and possibly in response), the great majority of CEOs plan to maintain or grow their employment and investment in 2019, albeit in fewer numbers than one year earlier.

CHART 2.1 EXPECTED CHANGE IN BUSINESS INDICATORS, 2019



Expectations for 2019: Performance Indicators

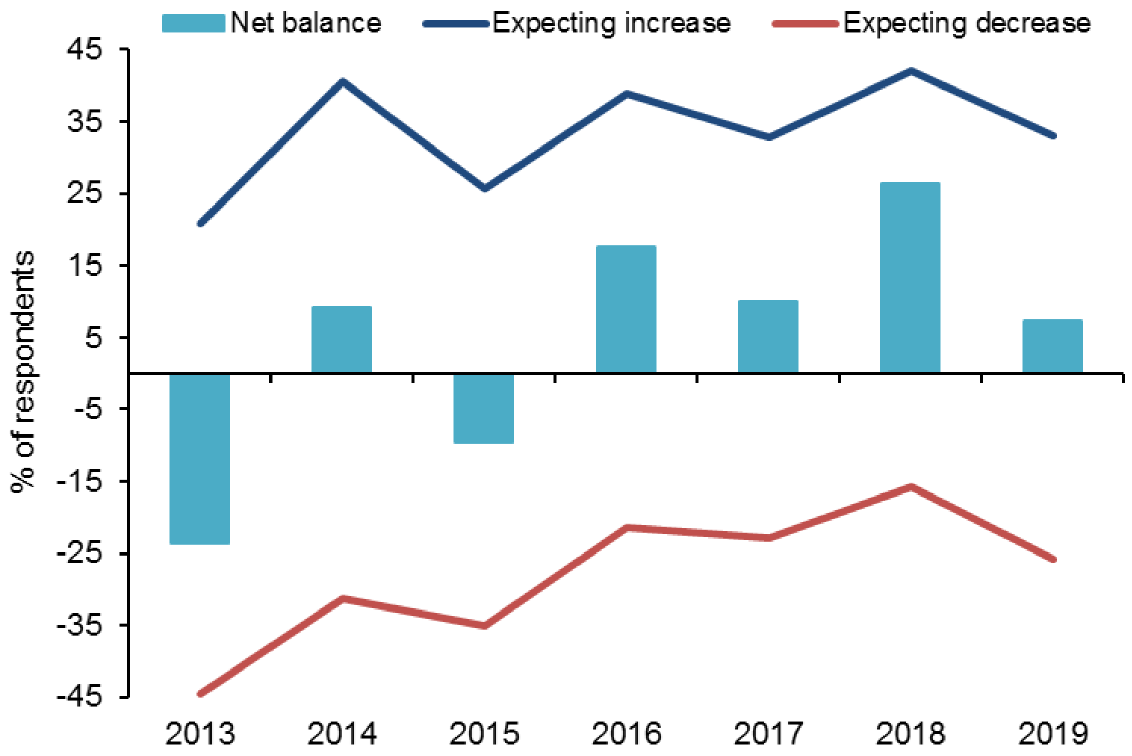
General business conditions are expected to be mildly positive in 2019, but not as strong as expected one year earlier for 2018. One third of businesses expect an improvement, which is lower than the proportion that had expected an improvement for 2018 (42%). One quarter of respondents expect their business conditions to deteriorate in 2019, which is the highest proportion expecting worse business conditions since 2014 (35% expected of CEOs surveyed at the end of 2014 had expected worse conditions for 2015). The remainder of CEOs expect no change to conditions for 2019. This produces a 'net balance' of 7% of CEOs expecting better conditions for 2019, which is the lowest such number since 2015 (see Chart 2.2).

CEOs are generally expecting improving conditions, turnover and profits in 2019 but are not as optimistic as they were for 2018. In 'net balance' terms, businesses are less optimistic about their own conditions, turnover and profits.

Business turnover (sales) is expected to increase for 58% of businesses in 2019, with 24% expecting no change from 2018 levels and 18% expecting a decline in sales in 2019. Although the majority of CEOs expect their total turnover to grow in 2018, most expect no growth in their own export revenue. This suggests that much of the turnover growth will be sought within Australian domestic markets rather than offshore in 2019. Profit margins are expected to grow in 46% of businesses in 2019 and fall in 24% of businesses (giving a net balance of +22%). This lower expectation of margin growth, despite higher turnover, appears to be related to rising input prices.

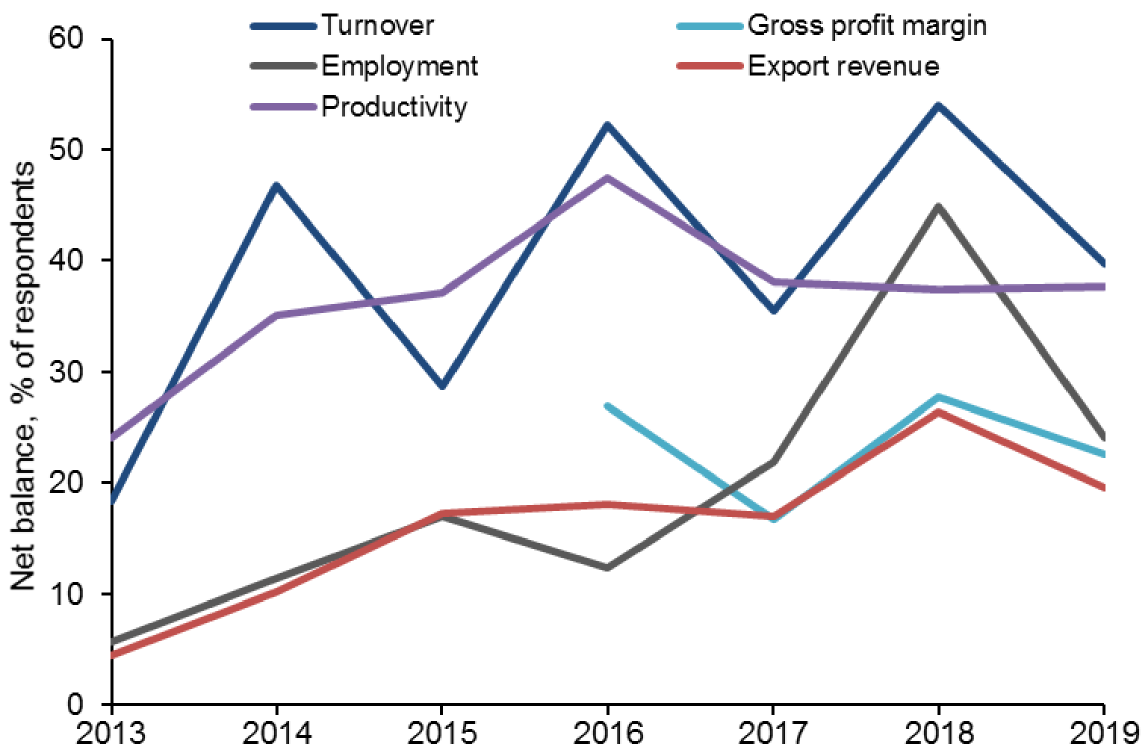
Employment (headcount) is expected to increase in 42% of businesses in 2018, with 40% expecting no change and 18% expecting falling employment. In net terms, employment expectations are lower than last year but higher than in previous years (see Chart 2.3). Most CEOs anticipate no change in labour productivity in their businesses (61%) and 38% expect labour productivity to improve. This 'net balance' (+37%) is about the same as expectations in 2017 and 2018.

CHART 2.2 EXPECTED BUSINESS CONDITIONS*, 2013-2019



** 'Net balance' is the proportion of all survey respondents that improved minus the proportion that deteriorated. Aggregate results include respondents from all surveyed industries and are weighted by ABS estimates of output from each industry.*

CHART 2.3 EXPECTED BUSINESS PERFORMANCE INDICATORS*, 2013-2019



** 'Net balance' is the proportion of all survey respondents that improved minus the proportion that deteriorated. Aggregate results include respondents from all surveyed industries and are weighted by ABS estimates of output from each industry.*

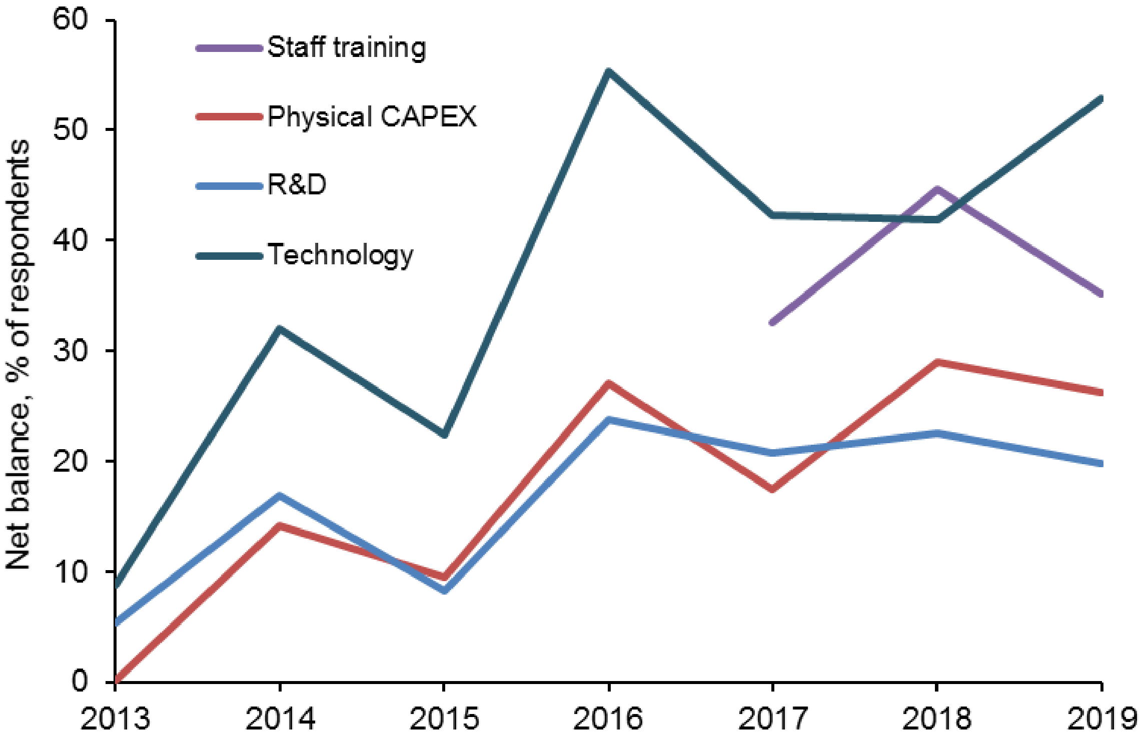
Expectations for 2019: Business Investment Indicators

The survey results indicate that most CEOs plan to maintain or increase their spending on various types of business investment in 2019. The proportions of businesses planning to reduce various types of investment are similar to results seen in 2018 but are much lower than from 2013 to 2017.

The majority of Australian CEOs plan to maintain the same level of spending on staff training, physical CAPEX and R&D in 2019 as they did in 2018. Under half (39%) plan to increase spending on staff training, 33% expect to spend more on physical CAPEX and 23% foresee increased expenditure on R&D. Very few CEOs plan to reduce business investment in 2019.

Expectations of spending on new technologies has risen at a faster pace than other forms of investment since 2013. This suggests that the nature of Australia's investment environment will continue to change in 2019; with a greater focus on investment in new technologies. In 'net' terms, investment spending on new technologies was the only investment indicator to rise (+42% in 2018 vs +53% in 2019).

CHART 2.4 EXPECTED BUSINESS INVESTMENT INDICATORS*, 2013-2019

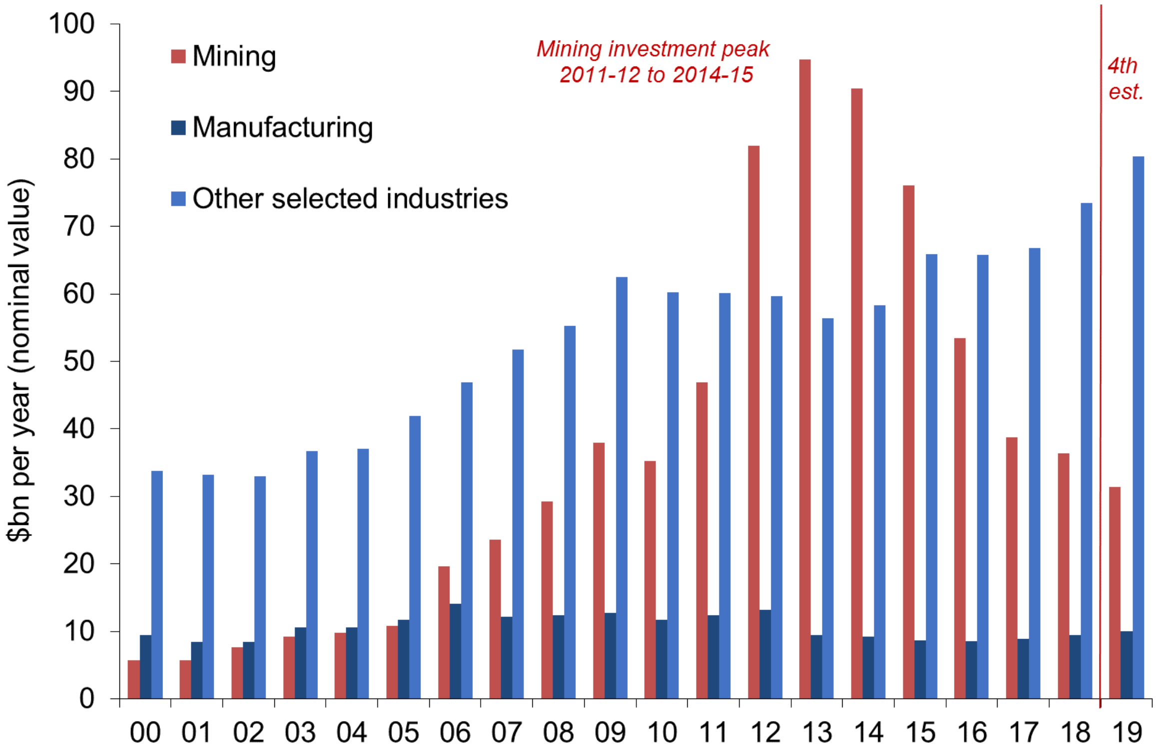


** 'Net balance' is the proportion of all survey respondents that improved minus the proportion that deteriorated. Aggregate results include respondents from all surveyed industries and are weighted by ABS estimates of output from each industry.*

These expectations for business investment are in line with the latest estimates of non-mining business investment collected by the ABS. As of Q3 2018, the ABS's fourth estimate of annual Private New Capital Expenditure and Expected Expenditure (CAPEX) for 2018-19 indicated total CAPEX is anticipated to fall by 2.1% from the previous year, due to a 14% fall in mining CAPEX. Mining CAPEX accounted for 29% of all CAPEX in 2018, down from a peak of 59.4% at the height of the mining investment super-cycle (see Chart 2.5).

Outside of mining, CAPEX is expected to grow by around 9% p.a. (in nominal dollars), including a rise of 6% among manufacturing businesses and 9.3% among other selected industries. Manufacturing accounted for 8.3% of total CAPEX in 2018, down from around 20% in the early 2000s and a record high of 27% during the last recession of 1991. CAPEX by selected industries outside mining and manufacturing was back up to 62.5% of total CAPEX in 2018, after falling to an all-time low of 34% during the mining super-cycle. In 2019 it will rise further in absolute terms and as a share of CAPEX, as mining recedes.

CHART 2.5 PRIVATE BUSINESS CAPITAL EXPENDITURE (CAPEX), ACTUAL ANNUAL VALUE 2000 TO 2017-18 AND EXPECTED ANNUAL VALUE* IN 2018-19



* five-year average realisation ratio applied. Source: ABS, *Private New Capital Expenditure and Expected Expenditure*, Sep 2018

Expectations for 2019: Business Pricing Indicators

The majority of Australian CEOs expect prices to rise for both their inputs (63% of CEOs) and their outputs (52% of CEOs) in 2019. Indeed, a higher proportion of businesses plan to implement price rises for their own goods and services in 2019 than in any of the preceding six years. Just 10% of businesses plan to cut their selling prices in 2019, which is a lower proportion than had planned to cut prices from 2013 to 2017 (see Chart 2.6).

At the same time, more businesses are expecting price pressure on the input side in 2019. A higher proportion of businesses expect their input costs to rise in 2019 (63%) than in any of the previous six years, but there is also a higher proportion (6%) who expect their input prices to fall in 2019. As a result, a smaller proportion of businesses (31%) expect their input costs to remain unchanged in 2019, compared to CEOs' pricing expectations for the previous six years (2013-18). This increase in input price pressure adds an additional layer of uncertainty to business planning, that may not have been present previously.

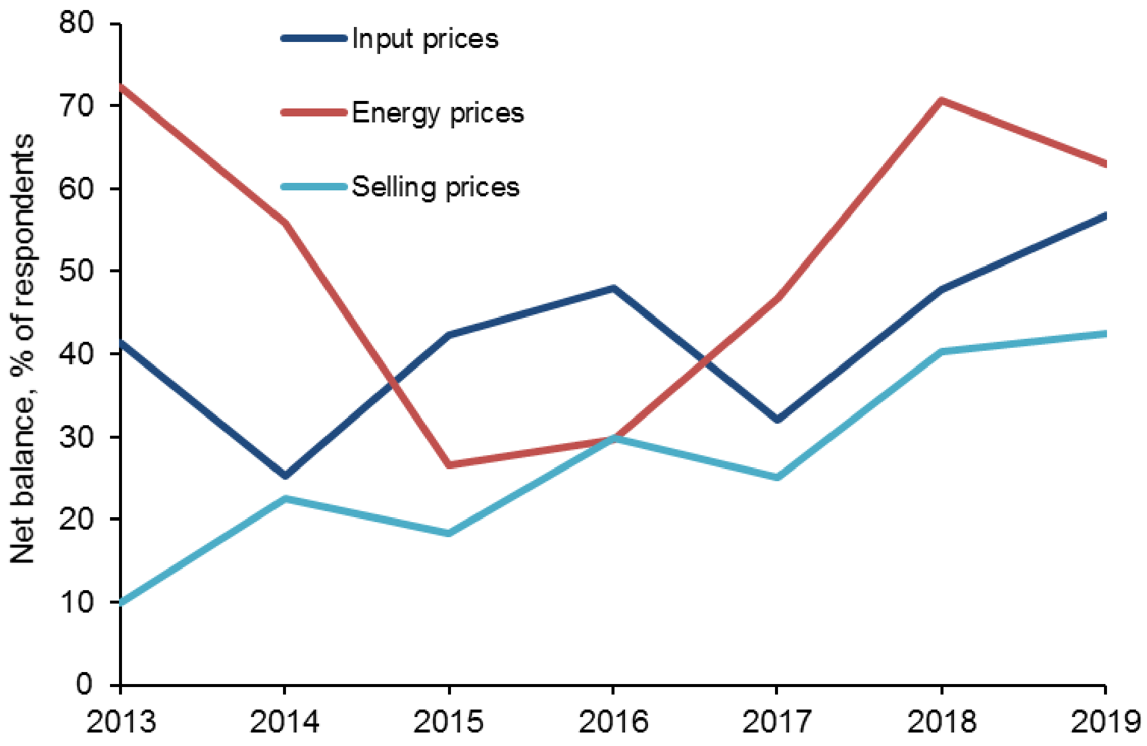
This concern about input price changes largely (but not solely) relates to energy pricing. Over two-thirds of CEOs (68%) expect energy input costs for their business to rise further in 2019 (see Charts 2.6 and 2.7). This comes on top of reported energy price increases for 63% of businesses in 2018. Rising energy prices (and reliability of energy supply) are becoming a key risk for an increasing number of Australian businesses, and across an increasing range of industries.

At the start of 2017, 50% of businesses expected their energy prices to increase, while at the end of 2017 64% reported experiencing higher energy prices. Energy costs were expected to rise further in 2018, with almost three quarter of CEOs (71%) expecting energy costs for their business to increase; at the end of 2018, 63% of CEOs reported higher energy prices. In 2019, 68% of CEOs expect further increases to energy prices, 5% expect lower energy prices (+63% net balance) and 27% expect no change in energy prices[3].

[3] Australian Industry Group, *Eastern Australian Energy Prices- From Worse to Bad*, 2018.

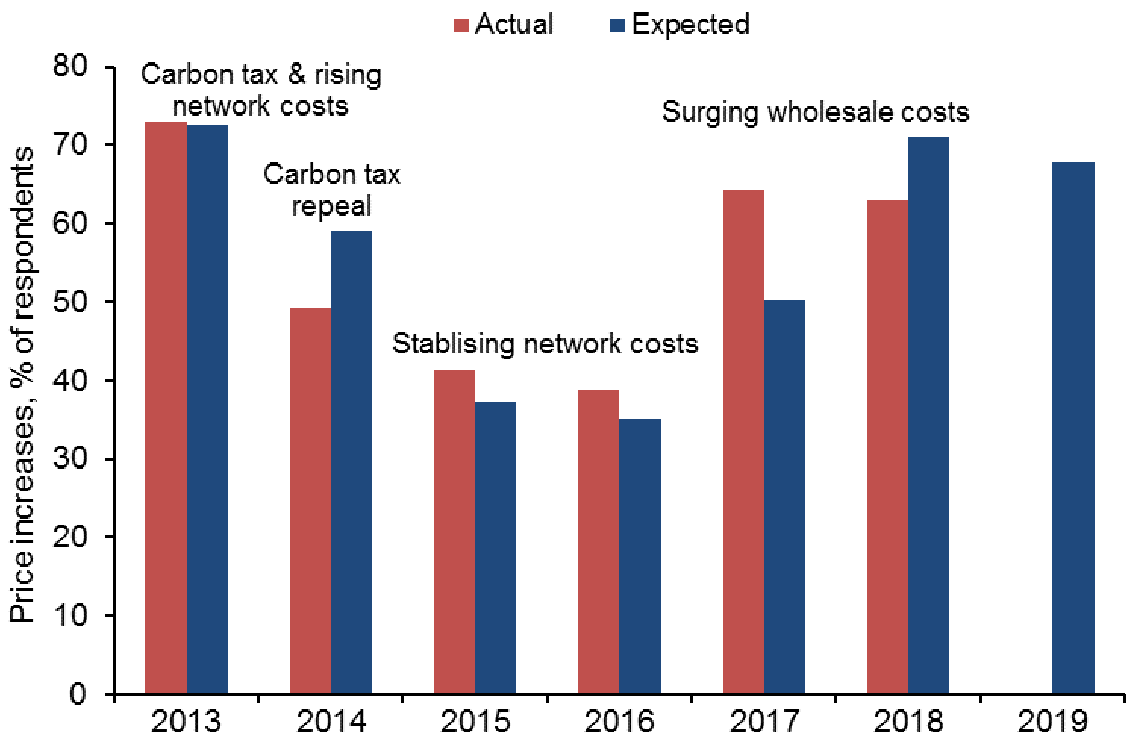
These significant input cost increases help to account for the more subdued expectations for profit margins than for turnover in 2019, with 58% of CEOs expecting their turnover to improve in 2019 but only 46% expecting their profit margins to improve.

CHART 2.6 EXPECTED BUSINESS PRICING INDICATORS*, 2013-2019



** 'Net balance' is the proportion of all survey respondents that improved minus the proportion that deteriorated. Aggregate results include respondents from all surveyed industries and are weighted by ABS estimates of output from each industry.*

CHART 2.7 ENERGY PRICE INCREASES, ACTUAL VS EXPECTED*, 2013 TO 2019



Industry Expectations in 2019

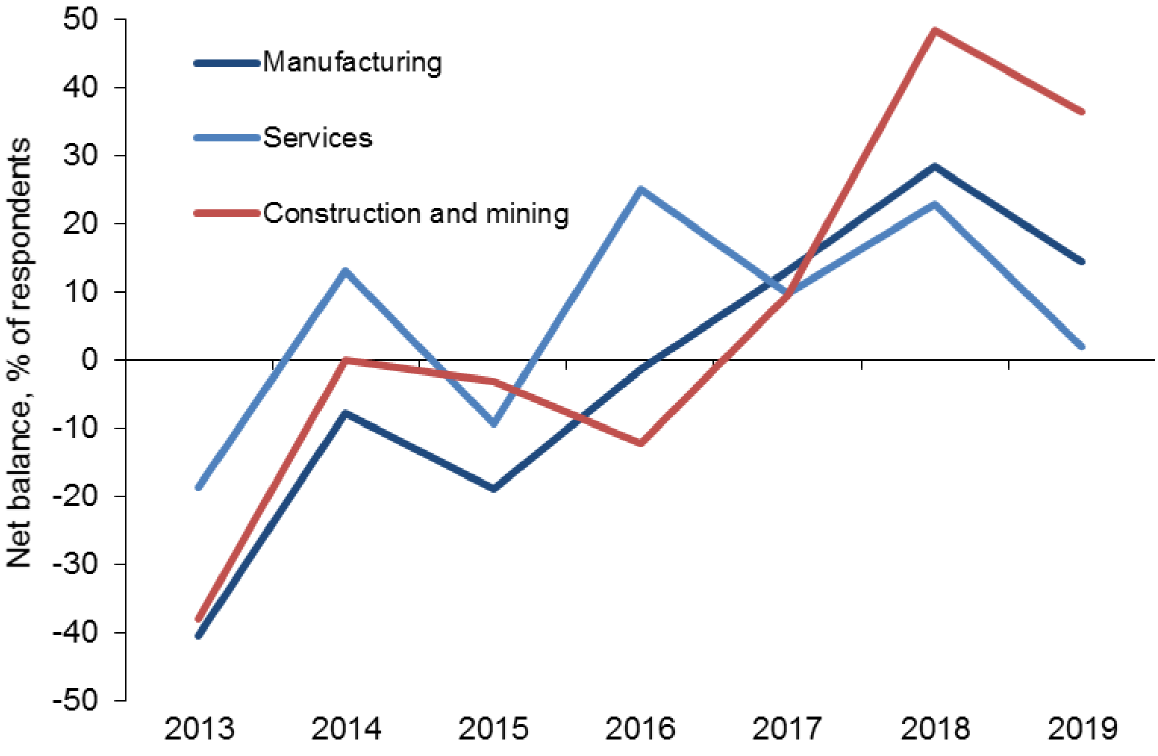
This year's Ai Group CEO Survey of Business Prospects included responses from all major non-farm private-sector industries and all states of Australia.

Manufacturers are positive about 2019, with 57% of CEOs expecting an increase in turnover compared to 17% of CEOs expecting a decrease in turnover (+40% net balance). Gross profit margin is expected to improve for 45% of CEOs while 21% expect their gross profit margin to shrink (+24% net balance). The lower proportion of margin growth relative to expectations of sales growth is related to anticipation of rising input prices. Manufacturing CEOs expect energy prices to escalate in 2019 with 65% anticipating increases following increases already experienced in 2018.

Services businesses are also optimistic about 2019, expecting a continuation of the improved business conditions experienced in 2018. 57% of CEOs expect general business conditions to improve, while 20% expect a deterioration (+37% net balance). Energy prices remain a concern across the services industry with 70% of CEOs expecting their energy prices to increase.

As with the manufacturing and services industries, **construction and mining businesses** are optimistic about 2019 although rising energy prices and input costs remain a concern. Almost 64% of construction and mining CEOs expect their sales turnover to increase in 2019 and 55% expect an improvement in business conditions. Energy price increases are expected to moderate in 2019, with 53% of construction and mining CEOs expecting energy prices to rise and 6% expecting a fall in prices from current levels.

CHART 2.8 INDUSTRY EXPECTATIONS FOR GENERAL BUSINESS CONDITIONS, 2013 TO 2019



3. Opportunities and Challenges for Business in 2019

Opportunities and challenges for Australian businesses can arise offshore and onshore, from external and internal influences. When asked which factors would provide the biggest challenge to business in 2019, 31% of CEOs identified a 'lack of customer demand' as their most significant constraint, down from 45% of CEOs who said the same in 2018 (and down from most previous years, since 2013, see Chart 3.1).

Labour market concerns feature prominently for businesses in 2019. The second most pressing concern for CEOs in 2019 is skill shortages with 21% of businesses nominating this as their top concern. This is up from 17% of leaders that identified skill shortages as an impediment for 2018 and triple the proportion in 2017 (7%). These concerns reflect rising demand for labour seen in 2017 and 2018, as was indicated across a range of data sources including the monthly ABS Labour Force surveys and Ai Group's Australian PMI®, PSI® and PCI®.

As reported in Ai Group's 2018 publication on workforce skill needs[4], it is apparent that skills for both current and future-oriented occupations are not meeting demand. Three quarters of respondents reported skills shortages, most often in the technician and trades worker category and for the first time in that workforce development survey, skills shortages were reported for those involved in business automation, big data and artificial intelligence solutions.

As noted above, almost half of businesses (42%) in this year's CEO survey plan to increase employment in their business in 2019 (see Chapter 2), so concerns about skill shortages are expected to worsen as recruitment activity steps up during 2019. A further 7.5% of CEOs said the flexibility of industrial relations is their top concern in 2019, up from 4% in 2018. Despite these widespread (and growing) concerns about skill shortages and industrial relations flexibilities, only 5% of CEOs ranked wage pressures as their greatest inhibitor in 2019, similar to 2018 but well down from 12% of CEOs in 2017.

Competition from imports and online sources (14%) increased as a constraint for 2019 compared to 2018 (11%) but was well down from the recent peak in 2017 when it was a primary inhibitor for 28% of responding businesses.

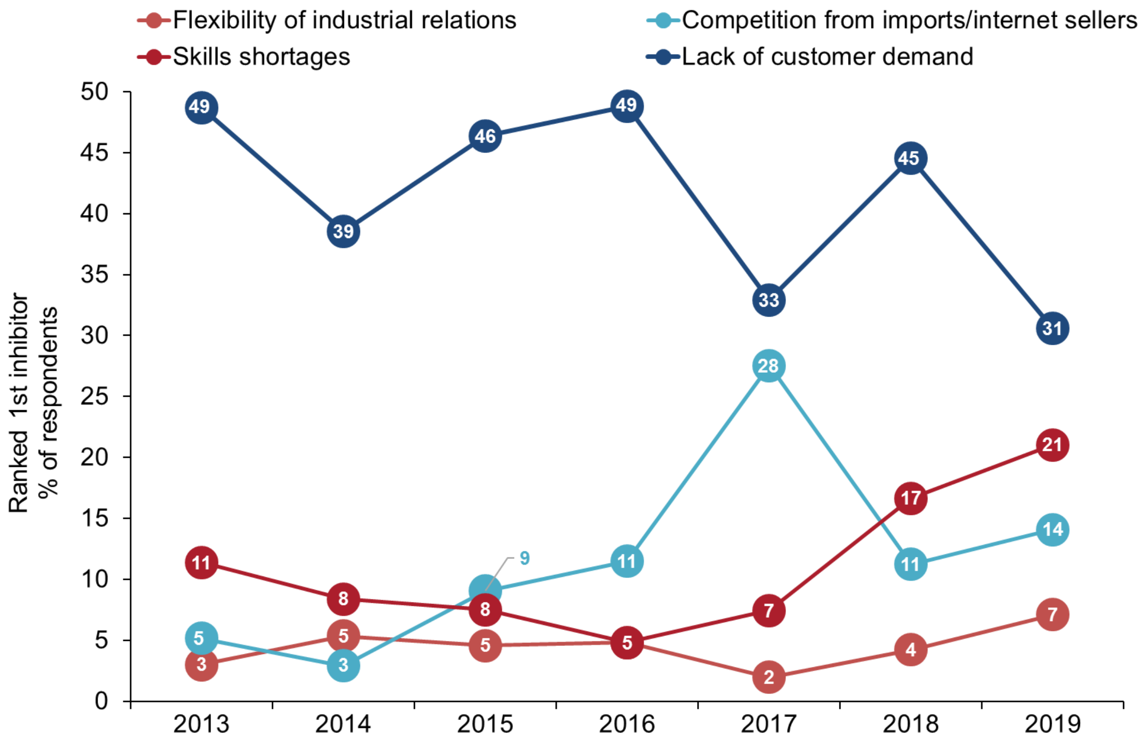
Flexibility of industrial relations was a primary inhibitor for 7% of CEOs, up from 4% in 2018 and 2% in 2017. Government regulations were also a primary constraint for around 7% of CEOs, down slightly from the past couple of years.

Following the recent peak of the Australian dollar in January 2018, concerns about high and/or variable exchange rates were the main issue for 4% of businesses, which was slightly up from 2018 (3%). This was much lower than the 10% of businesses that had nominated this in 2015, when the trading range for the Australian dollar had been much higher (see chapter 4 below).

Other constraining factors for business in 2019 included: rising input costs due to higher energy prices (the most commonly listed 'other' factor); uncertainty about international trade; drought conditions and access to funding for operational and/or investment purposes.

[4] Australian Industry Group, *Skilling: A national imperative,* 2018.

CHART 3.1 EXPECTED INHIBITORS TO BUSINESS GROWTH*, 2013 TO 2019



* Percentage of respondents who ranked each factor first in each year, out of a list of possible inhibitors.

4. Global Competitiveness of Australia's Business Environment in 2019

The Australian economy is performing relatively well in 2018-19, across a number of key indicators. Despite ongoing concerns across a range of issues, overall Australian businesses are relatively optimistic about their local outlook (see chapters 1 and 2). Globally however, the business environment became more volatile in 2018, with a particularly significant rise in the risks related to global trade.

The two largest trade protagonists – the USA and China – are directly connected to Australia through long-standing and significant trade, investment, technological and political relationships. In addition, uncertainties about the outcome of 'Brexit', ongoing conflict in the Middle East, international responses to climate change, and other current global issues, are contributing to rising volatility and uncertainty in 2019. These events are disrupting an otherwise promising period of slow improvement in global growth.

The competitiveness of Australian businesses and the Australian business environment helps to determine how well businesses will be able to respond to future disruptions. A lower Australian dollar helps to support the competitiveness of Australian goods and services, but other factors are also at play. Australia's business environment is internationally competitive with regard to financial and economic stability and the general health status and education attainment of the workforce. Australia's international competitiveness could be improved by focussing on infrastructure (energy, transport and ICT), innovation, workforce flexibility and future skills.

This year's Business Prospects survey of CEOs indicates that around 44% of businesses undertook some direct exports in 2018. Of these, 16% of businesses increased their annual export revenue, from their 2017 levels, and 9% experienced a decrease. On the imports side, 44% of CEOs said they directly imported at least some of their inputs in 2018. This was down slightly from 50% in 2017 but the longer-term trend since 2012 is towards an increase.

4.1 Global outlook, challenges and risks in 2019

2018 saw an improvement in economic growth rates in most but not all larger advanced economies. The risks are growing that 2019 may see global growth rates flatten out or even decelerate, due to:

- trade tensions and negotiations between the world's largest and most influential economies including the USA, China, the UK and the eurozone, which are already disrupting trade and investment;
- ongoing regional conflicts in the middle east (and increasingly, in former USSR countries), which have the potential to further disrupt trade flows and to affect oil prices and other key commodity prices;
- slower growth in the US as the benefits of temporary stimulus measures wane. Growth rates in US employment, incomes and investment strengthened in 2018 but appear to have already peaked; and
- slower growth in China as its Government seeks to rebalance the economy, contain financial risks and support non-financial national goals such as pollution containment and urban consolidation. In November 2018, the RBA reported that Chinese authorities had eased fiscal policy in some areas, to avoid a material slowing in growth, while responding to financial stability risks. In the very long-term, growth in China is expected to slow, reflecting structural factors such as a declining working-age population.

In its last major assessment of the global economy for 2018, Australia's RBA[5] noted that trade tensions are the single biggest risk for 2019. It said that the global outlook remains broadly positive, but that current trade tensions between major economies run the risk of escalating and/or spreading to involve other countries. The effect of these tensions on business investment decisions in affected countries and globally are a separate but related concern, any cancelled or delayed investment will also weigh on future growth.

For these and other reasons, by late 2018 the RBA had marked down its expectations for growth among Australia's trade partners in 2019 and 2020. In addition to a slower outlook for China, Australia will face slower growth in Japan (partly due to consumption tax increases in 2019) and stable growth rates at best throughout Southeast Asian economies that are trade-exposed to a slower China. More positively, growth appears to be accelerating in New Zealand and India, which are also major trade partners for Australia.

Similarly, the OECD[6] downgraded its outlook for the global economy due to slower trade growth. In December 2018, the OECD said global growth had already peaked and is set to weaken over the next two years. The OECD is now forecasting "a soft landing", with global output growth projected to slow from 3.7% in 2018 to 3.5% in 2019 and 2020 (see Table 4.1). Growth in the OECD countries is set to slow gradually from 2.4% p.a. in 2018 to 1.9% in 2020. This is partly because of an expected slowing of growth in the United States in the coming two years, as the short-term benefits of recent tax cuts wear off and trade tensions with China start to bite. The OECD says the risk of a harder landing has risen since mid-2018 due to:

- escalating trade tensions and the fragmentation of multilateral rules-based trade systems (e.g. WTO);
- financial market instability and tightening financial conditions (e.g. rising interest rates); and
- China slowing more than expected as authorities try to balance high growth and financial stability.

TABLE 4.1 OECD GROWTH FORECASTS, SELECTED ECONOMIES, NOVEMBER 2018

Real GDP, % change p.a.	2017e	2018f	2019f	2020f
World output	**3.6**	**3.7**	**3.5**	**3.5**
OECD countries	2.1	2.5	2.4	2.1
US	2.2	2.9	2.7	2.1
Euro area	2.5	1.9	1.8	1.6
Japan	1.7	0.9	1.0	0.7
Australia	**2.2**	**3.1**	**2.9**	**2.6**
Non-OECD countries	4.6	4.7	4.7	4.7
China	6.9	6.6	6.3	6.0
India	6.7	7.5	7.3	7.4
World trade volumes, % change p.a.	**5.2**	**3.9**	**3.7**	**3.7**

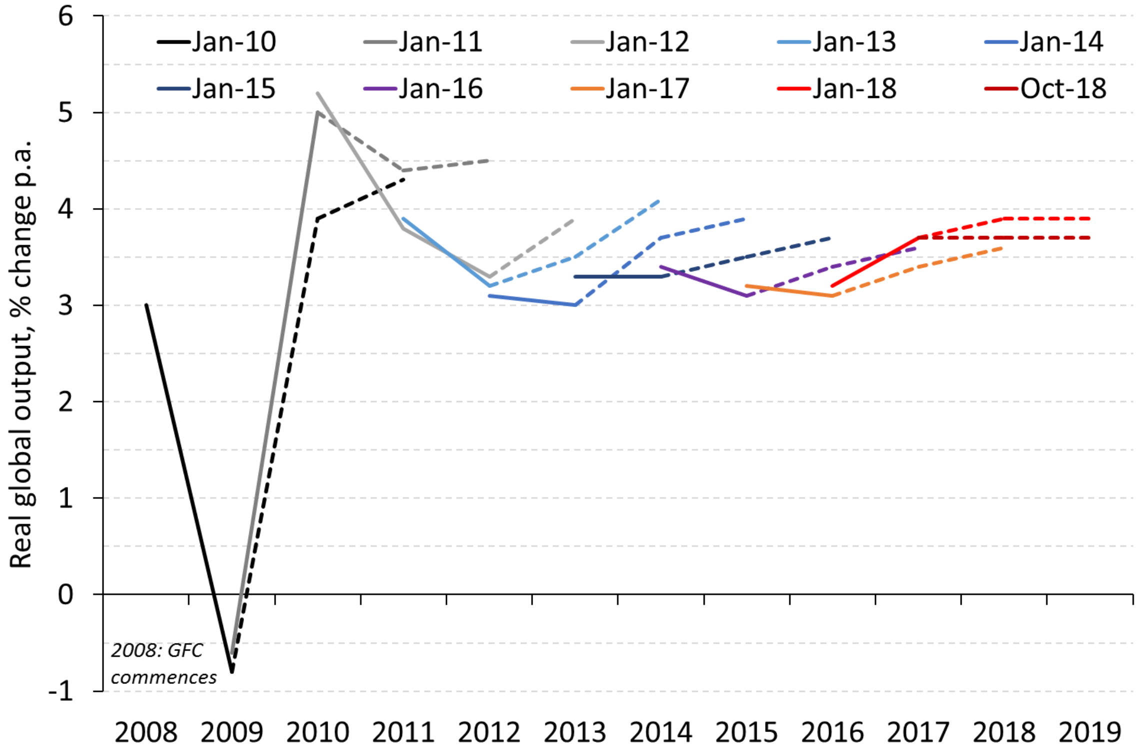
e = estimate, f = forecast. Source: OECD *Economic Outlook*, November 2018.

The International Monetary Fund (IMF) had already downgraded its global growth outlook in October 2018[7], for similar reasons, as it has in almost every update over the past decade. Indeed, the pattern among all of the international economics agencies since the disruptions of the GFC has been to over-estimate the growth outlook and subsequently revise it down (see Chart 4.1). This reflects a very protracted period of slow growth for many advanced economies since the GFC commenced in 2008.

In a detailed analysis attached to its latest *World Economic Outlook*, the IMF sought to explain the slow recovery path that has emerged since the GFC. The IMF says the GFC reduced long-term potential global growth by reducing fertility rates, migration, trade and income equality in the countries that were most directly affected by it. Specific policies have affected outcomes in individual countries. More positively for Australia, the IMF says countries such as Australia that were in "*better fiscal shape, with better regulated and supervised banks, and flexible exchange rates generally suffered less [long-term] damage*."

[5] Reserve Bank of Australia, *Statement on Monetary Policy*, pp. 5-15, November 2018.
[6] Organisation for Economic Cooperation and Development, *Economic Outlook*, November 2018.
[7] International Monetary Fund, *World Economic Outlook,* October 2018.

CHART 4.1 GLOBAL GDP: ACTUAL ANNUAL GROWTH AND IMF FORECASTS*



* Solid lines = actual, Dotted lines = forecasts.
Sources: IMF October 2018, *World Economic Outlook,* and earlier editions.

Businesses that operate globally are, however, interested in a rather broader range of risk factors than the growth outlook, trade and macroeconomic risks. The WEF's annual survey of CEOs in 140 countries about future risks to their business indicates that in 2018[8], concerns about the effects and ramifications of high or stubborn unemployment and underemployment topped their list. Of the 34 countries that ranked unemployment as their top concern in 2018 however, 22 were in Sub-Saharan Africa. Of more relevance to advanced economies such as Australia, the WEF notes that 14 of the 19 countries that ranked 'cyber attacks' as their top concern in 2018 were in Europe and North America. Globally, concern about cyber-attacks jumped from 8th place in 2017 to 5th place in 2018.

There is also a broad range of concerns across regions of the world and individual countries which reflect their local state of play in 2018. In Europe, the top three concerns for business were cyber-attacks, asset bubbles and a possible failure of national governance. Concerns about unemployment ranked as the fifth most pressing concern in Europe, despite pockets of high unemployment remaining in some countries and regions of the eurozone. In North America, the top three business concerns are cyber-attacks, data fraud and extreme weather events. Concerns about energy prices ranked fifth in North America while 'failure of climate change adaptation' ranked tenth and unemployment did not feature as a concern in the US at all. In the middle east, the top three concerns are energy price shocks, unemployment and terrorist attacks.

In the East Asian region that includes Australia and its largest trade partners, 'cyber-attack' was the number one concern about doing business in 2018, followed by disruption due to unemployment (see Table 4.2). Concerns about asset prices, energy prices and data fraud rounded out the top 5 concerns in this region. In Australia, the risk of disruption to business due to energy prices was (uniquely) the top concern in 2018, followed by cyber-attacks and asset bubbles. Risks arising from a failure of regional and global governance (e.g. trade agreements and governance) and critical infrastructure also scored highly among Australian executives participating in this WEF opinion survey.

These risks to global growth and stability mean that many Australian businesses that wish to export or contribute to global supply chains may need to work harder to maintain their global connections and competitiveness in 2019. The WEF global risks list highlights the risks that are top of mind to business.

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[8] World Economic Forum, *Regional risks for doing business 2018,* 2018.

TABLE 4.2 TOP 10 RISKS TO "DOING BUSINESS IN YOUR COUNTRY" IN 2018*: GLOBAL, ASIAN REGION AND AUSTRALIA

Rank	Global	East Asia & Pacific	Australia
1	**Unemployment & underemployment**	**Cyber attacks**	**Energy price shock**
2	Failure of national governance	Unemployment & underemployment	Cyber attack
3	Energy price shock	Asset bubble	Asset bubble
4	Fiscal crises	Energy price shock	Failure of regional and global governance
5	Cyber attacks	Data fraud or theft	Failure of critical infrastructure
6	Profound social instability	Failure of national governance	Fiscal crises
7	Failure of financial mechanism or institution	Failure of regional and global governance	
8	Failure of critical infrastructure	Fiscal crises	
9	Failure of regional and global governance	Failure of critical infrastructure	
10	Terrorist attacks	Man-made environmental catastrophes	

* respondents to WEF's Executive Opinion Survey were asked to select "the five risks that you believe to be of most concern to doing business in your country within the next ten years" from a core list of 30 global risks.
Source: WEF November 2018, *Regional Risks for Doing Business 2018*.

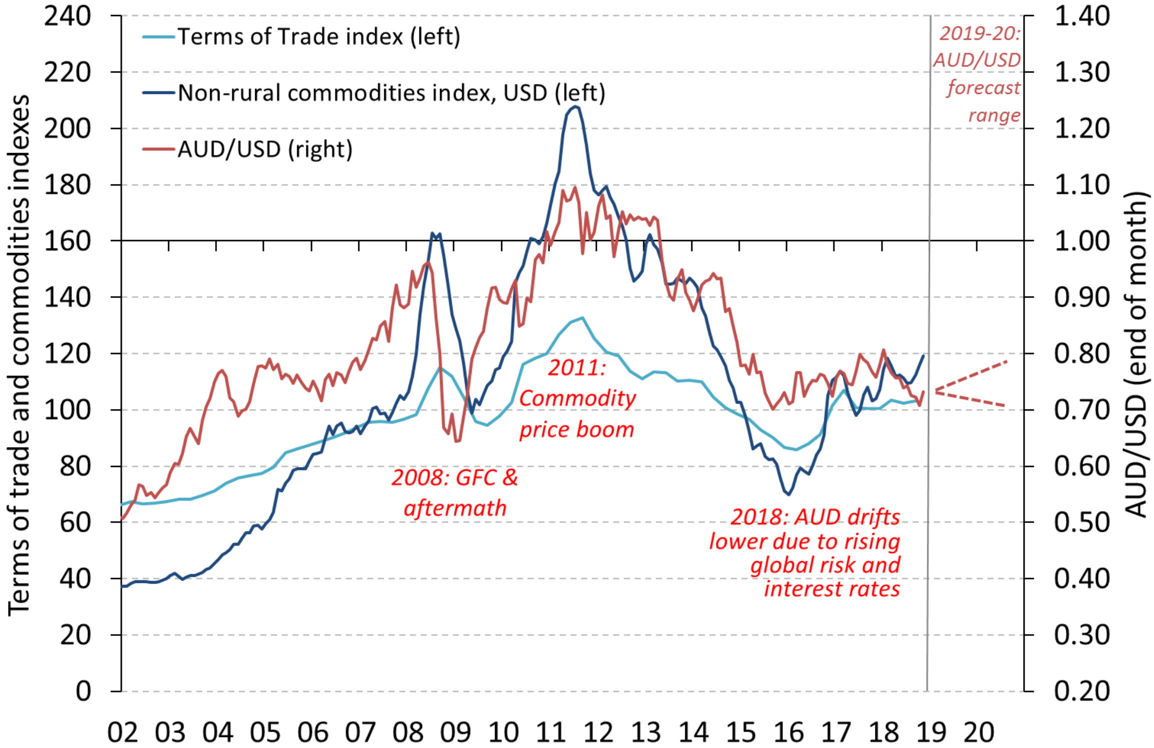
4.2 Australian dollar and Australian global competitiveness in 2019

Australia's global competitiveness received a boost through 2018 from a sustained drop in the trading range for the Australian dollar to values below its long-run average of around 75 US cents (see Chart 4.2). This drop was influenced by external factors including lower global commodity prices, rising perceptions of global risk as well as rising US interest rates and bond returns relative to Australia's during 2018. In 2019, recovering commodity prices could push the Australian dollar higher once more, but this upward influence is likely to be countered by higher global interest rates and financial market risk perceptions, which have historically pushed the Australian dollar lower against the US dollar and other currencies.

Looking past the effects of movements in the dollar, the World Economic Forum (WEF) ranked Australia as the 14th most competitive business environment in 2018 in its (revised) annual *Global Competitiveness Report*, up one place since 2017. Australia scored 78.9 points out of a possible 100 points in 2018, up slightly from 78.2 points in 2017. This suggests a modest improvement in Australia's absolute competitive performance (the score) as well as its relative performance (the rank). In the WEF's 12 'pillars' of performance, Australia shared top spot with 31 other countries for 'macroeconomic stability' and obtained a near perfect score for public health. Australia also obtained high scores for the size and stability of the national financial system and for national workforce skills (based on average education attainment, literacy rates and other metrics). Compared to 2017, the WEF results for 2018 indicate Australia's performance deteriorated most notably in infrastructure (transport, communications and energy). This was balanced out by improvements in ICT adoption, product markets and innovation capability (Chart 4.3).

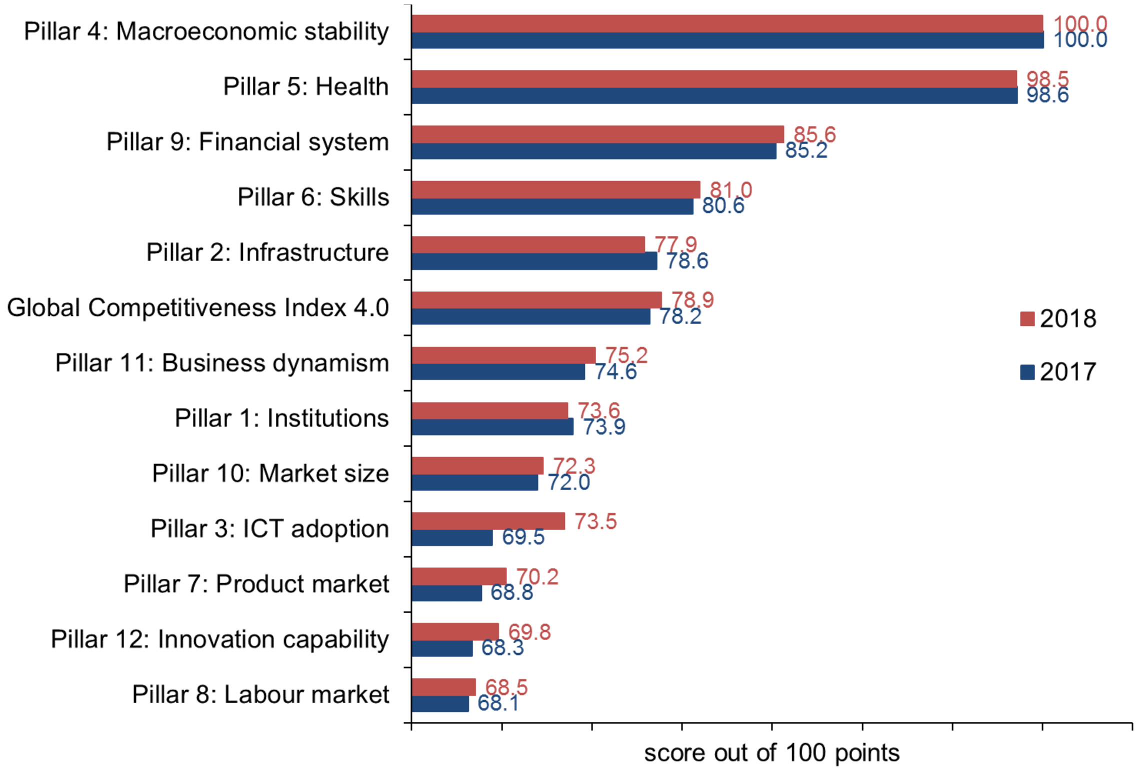
Australia's lowest scores are in the pillars for 'labour market' and 'innovation capability'. Australia's innovation capability score is almost 20 points below that of best-ranking Germany, and Australia is ranked 18th for this 'innovation' pillar. Looking at the individual indicators that make up the 'innovation' pillar, Australia performs well with regard to research and development (78.8 points) but performs relatively poorly on the softer dimensions of the innovation ecosystem including 'interacting and diversity' (60.8 points) and 'entrepreneurial culture' (61.6 points) indexes. Relatively poor labour market scores and rankings for Australia in the WEF global competitiveness index, reflect Australia's continued use of centralised wage-setting arrangements through national minimum wage setting and industry awards. These tend to get lower scores than enterprise and individual agreements, due to their lack of flexibility for workers and businesses. Australia also scores relatively poorly in the labour market pillar due to lower gender diversity and larger wage gaps.

CHART 4.2 AUSTRALIAN DOLLAR, NON-FARM COMMODITY PRICES AND TERMS OF TRADE



Sources: RBA, end of month exchange rates, to end of Nov 2018; RBA, end of month commodity price indexes, to end of Nov 2018; ABS, *National Accounts*, to Sep 2018.

CHART 4.3 AUSTRALIA'S COMPETITIVENESS IN 2017 AND 2018: THE WEF INDEX & 12 'PILLARS'



Source: WEF October 2018, *Global Competitiveness Report 2018*.

Australia's ranking of the 14th most competitive economy in 2018 means Australia continues to lag behind Canada (12th), Japan (5th), the UK (8th), the US (1st) and Singapore (2nd) but ahead of New Zealand (18th). Australia's largest trade partner, China, was ranked the 28th most competitive economy.

In 2018 the WEF's Top Ten economies continue to be dominated by advanced open economies including the US, Singapore, the UK, Japan, Germany and Hong Kong, as well as smaller northern European economies such as Switzerland, The Netherlands and Sweden (see Table 4.3). These economies are not the cheapest locations of production globally. Instead, they share key competitive characteristics such as:

- very open and competitive trade access and facilities (including large and efficient ports);
- advanced manufacturing sectors and/or advanced manufacturing design and distribution;
- strong promotion of innovation, ICT, R&D and new technologies;
- very high education participation and education quality outcomes; and
- strong and stable financial, legal and political systems.

TABLE 4.3 WEF GLOBAL COMPETITIVENESS INDEX 2018: THE TOP 20

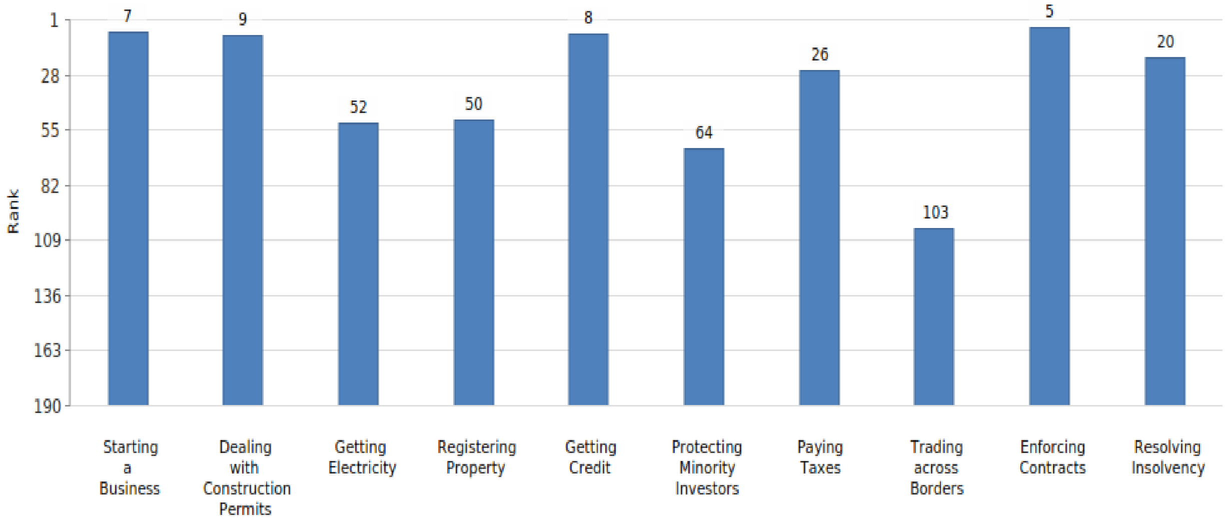
Country	2018		Movement since 2017	
	Rank (out of 140 countries)	Score (out of 100 points)	Change in Rank	Change in Score
United States	1	85.6	-	0.8
Singapore	2	83.5	-	0.5
Germany	3	82.8	-	0.2
Switzerland	4	82.6	-	0.2
Japan	5	82.5	-3	0.9
Netherlands	6	82.4	1	0.2
Hong Kong SAR	7	82.3	-	0.3
United Kingdom	8	82.0	2	-0.1
Sweden	9	81.7	-	0.1
Denmark	10	80.6	-1	0.7
Finland	11	80.3	-1	0.5
Canada	12	79.9	2	-0.1
Taiwan, China	13	79.3	-	0.1
Australia	**14**	**78.9**	**1**	**0.7**
Korea, Rep.	15	78.8	-2	0.8
Norway	16	78.2	2	-0.8
France	17	78.0	-1	0.6
New Zealand	18	77.5	2	-0.6
Luxembourg	19	76.6	-3	0.6
Israel	20	76.6	-	0.4

Source: WEF October 2018, *Global Competitiveness Report 2018*.

Australia ranked lower in the World Bank's *Doing Business Index* for 2019 than in these latest WEF results. Based on a (narrower base) of 10 topics that measure the effects of comparable business regulations, the World Bank ranked Australia as the 18th best place to do business out of 190 economies, well below New Zealand (1st) and the US (8th) but above Canada (22nd) and above the OECD average.

Across the 10 topics in the World Bank Index, Australia ranked best in 2019 for legal and financial regulatory processes such as enforcing contracts (5th best), access to credit for business (8th), and registering a new business (7th). Like the WEF report, the quality of infrastructure – in this case new electricity connections for business – was judged to be relatively poor. Cross-border trade arrangements was the lowest-ranked area of business regulation for Australian business.

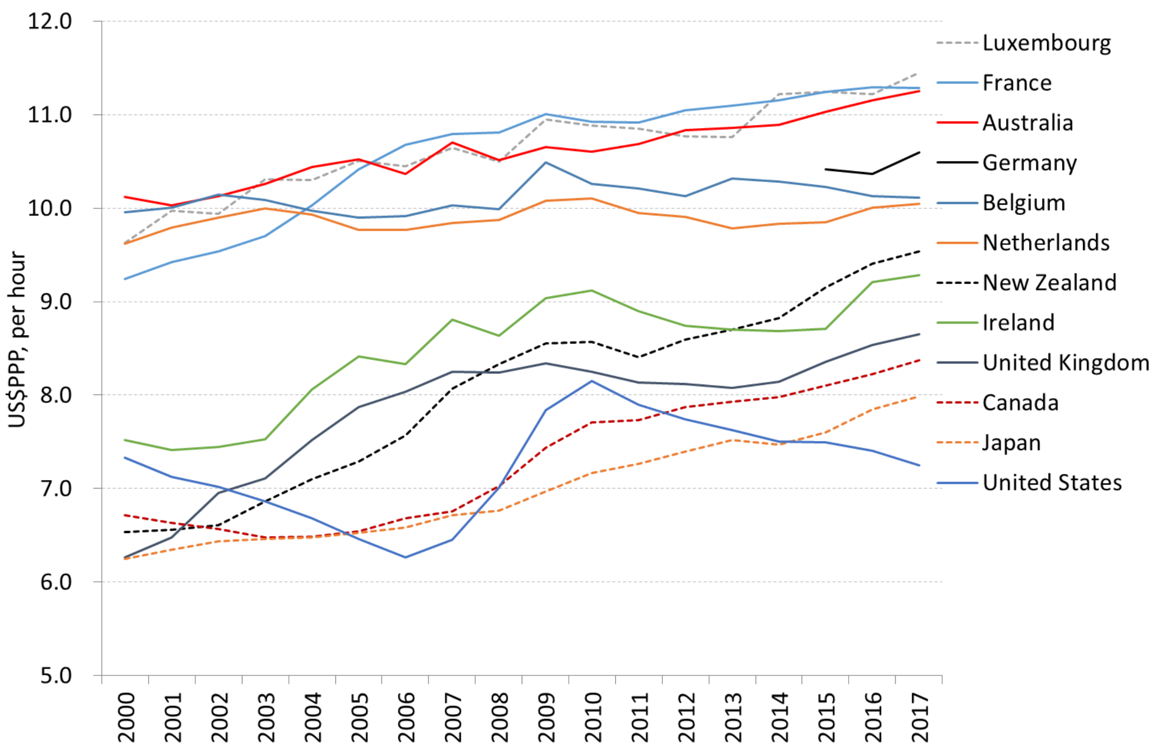
CHART 4.4 AUSTRALIA'S COMPETITIVENESS IN 2019: WORLD BANK 'DOING BUSINESS' TOPICS



Source: World Bank 2018, *Doing Business 2019: Australia*.

Neither the WEF nor World Bank reports compare direct business costs or labour costs across countries as part of their assessment of 'competitiveness'. Cost comparisons can change markedly over time due to fluctuations in exchange rates, purchasing power and relative living costs across countries. To try to address this, the OECD compares wage rates using 'purchasing power parity' (PPP) rates instead of current or average exchange rates. This method shows that Australia continues to track at the highest end of global labour costs. As of 2017, Australia's minimum wage was the second highest globally, among countries that have a national minimum wage. It was equal second with France and behind only the tiny principality of Luxembourg (see Chart 4.5). Since then, Australia's minimum wage has risen by a further 3.5% (on 1 July 2018) so it may have moved back into the top spot globally, as it was in the early 2000s.

CHART 4.5 REAL MINIMUM WAGES, 2017 CONSTANT DOLLARS, USD PPP



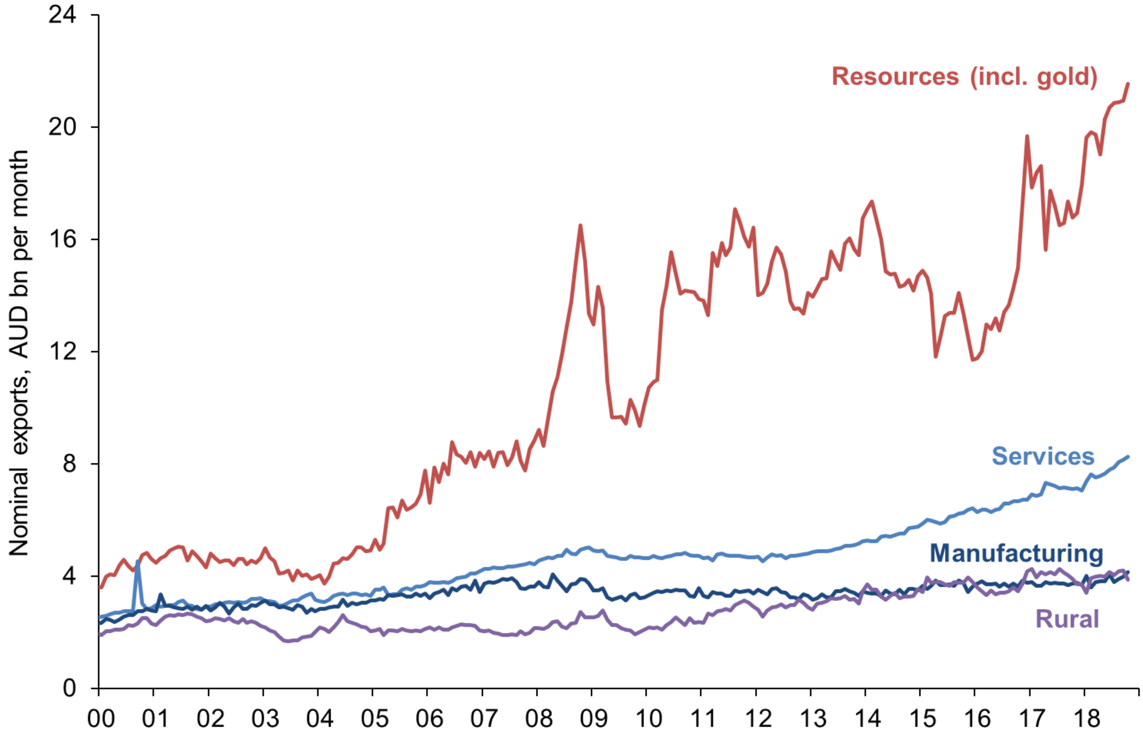
Source: OECD Employment and Labour Market Statistics database, www.oecd-ilibrary.org/

4.3 Recent trends in Australian trade

One of the more positive developments in 2018 has been the depreciation of the Australian dollar and small improvements in other aspects of Australia's competitiveness (see above). The benefits of this can be seen in Australia's trade balance, which has been positive in most months of 2017 and all months of 2018 (to October 2018). This marks a significant break from the past when trade deficits were the norm.

Better earnings from resources exports (mainly iron ore, coal and more recently, LNG) due to higher prices and growing volumes (as new capacity has come on stream) have undoubtedly been a key factor in generating these trade surpluses, but solid improvements in export revenue have also been evident for services and manufactured goods during this recent expansion period (Chart 4.6). Over the year to October 2018 (latest data available), total nominal export revenue was up by 20%, with growth in all categories except for rural exports (down by 2.3% p.a. due to drought in 2017 and 2018). Nominal export revenue for resources was up by 28.7% p.a. to October and accounted for 56% of the total value of exports for 2018 to date. Although somewhat overshadowed by this success, manufacturing export revenue rose by 10.7% (to 11% of the total) and services exports rose by 16.4% (to 21% of the total) over the same period.

CHART 4.6 EXPORT REVENUE BY MAJOR INDUSTRIES, $BN PER MONTH, TO OCT 2018



Source: ABS, *International Trade in Goods and Services*, Oct 2018.

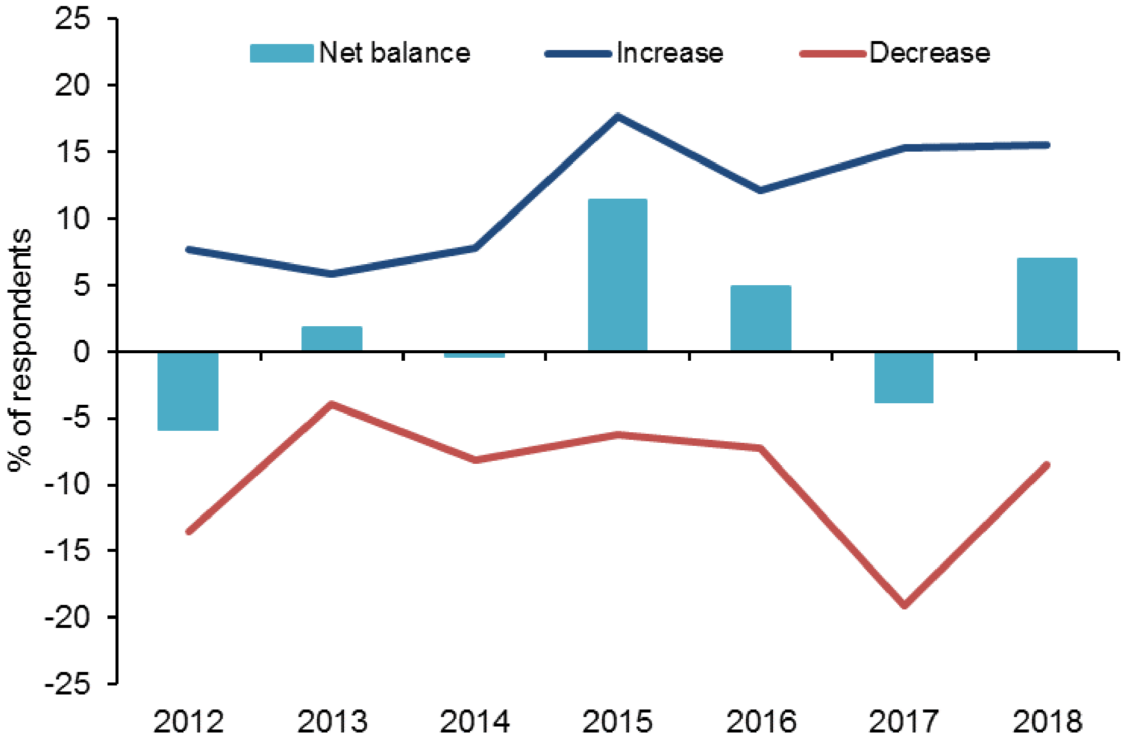
Australia's export composition reflects the country's dominant mix of mining and services industries. In 2017 (the latest available year of detailed data), Australia's top five goods and services exports were: Iron ore & concentrates ($63.1 billion); Coal ($57.1 billion); Education-related travel services – which includes foreign student expenditure on tuition fees and living expenses in Australia – ($30.3 billion); Natural gas ($25.6 billion) and Personal travel (excluding education) services – which includes short term visitors' expenditure in Australia, mainly for holiday purposes – ($21.3 billion). In 2017, the value of exports of unprocessed primary products increased by 22.8% to $171.2 billion and processed primary products rose by 23.4% to $61.8 billion. Exports of manufactured goods rose by 2.7% to $44.8 billion, with simply transformed manufactured exports (excluding nickel) rising by 8.2% to $14.3 billion and elaborately transformed manufactured exports up by 0.4% to $30.5 billion.

In this year's CEO Business Prospects survey, 111 of 252 respondents (44%) reported some direct export sales in 2018. This is above the average for this annual survey (36% of all respondents since 2013). The majority of exporting businesses in all years have been in manufacturing rather than construction or the services industries. For those with export revenue in 2018, sales abroad accounted for an average of around 20% of total business revenue in 2018 (ranging from 2% to 100% of total revenue for individual businesses), which is a touch below the average of 21% of revenue for all exporting respondents since 2013.

In 2018, 15% of CEOs reported an increase in annual export revenue, from their 2017 levels, which was about the same proportion as had reported an increase in 2017 (see Chart 4.7). For those reporting an increase in exports in 2018, the average size of the increase was 27%, which was just above the average annual increase of 25% for all respondents with rising exports since 2013.

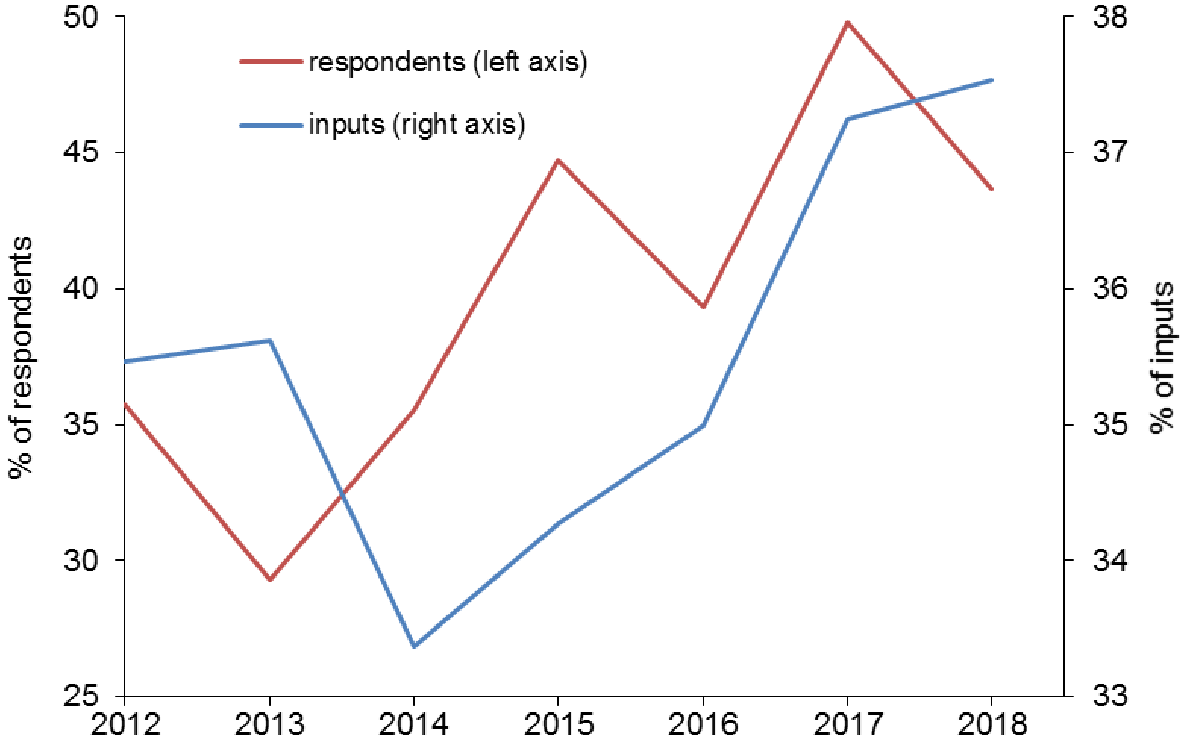
At the same time, 9% of CEOs reported a decrease in annual export revenue in 2018 compared to 2017, which was a big improvement from 19% reporting a decrease one year earlier. For those reporting a decrease in exports in 2018, the average size of the decrease was 15%, which was just above the average annual decrease of 17% for all respondents with falling exports since 2013. The remainder of all respondents reported either no export earnings or no change in their export earnings from year to year.

CHART 4.7 SHARE OF BUSINESSES REPORTING A CHANGE IN ANNUAL EXPORT REVENUE



On the imports side, 44% of CEOs said they directly imported at least some of their inputs in 2018. This was down slightly from 50% in 2017 but the longer-term trend since 2012 is towards an increase (see Chart 4.8). For those businesses that import at least some of their inputs, an average of 38% of the total value of inputs was imported in 2018, which was largely unchanged from 2017 (37%). As with the proportion of respondents, the proportion of inputs that are imported appears to have been rising since 2012, notwithstanding a sudden dip in 2014 (Chart 4.8).

CHART 4.8 IMPORTED INPUTS: SHARE OF RESPONDENTS AND SHARE OF INPUTS



Regarding the location of trade, Australia's major trade partners in 2018 are (in order of magnitude) China, Japan, the US and South-East Asia. DFAT analysis of Australian trade in 2017 (latest data available)[9] indicates that China was Australia's largest individual two-way goods and services trading partner in 2017, accounting for 24% ($183.4 billion) of total trade. China was Australia's largest export destination (valued at $116.0 billion) as well as the largest source country for imports (valued at $67.4 billion). Japan was Australia's second largest trade partner, accounting for 9.4% ($71.9 billion) followed by the US, which accounted for 9% ($68.5 billion). Reflecting Australia's geographic location, APEC members accounted for 73.8% of Australia's total trade in 2017 and ASEAN members accounted for 13.7% of trade. EU members together accounted for 13.2%. Oceania countries (mainly the Pacific Island nations) accounted for just 4.9% of Australian two-way trade because they are close but relatively small.

These direct trade relationships tend to understate the importance of the US, EU and UK to Australian trade and prosperity however, because these countries are often the final destination of the goods and services to which Australia contributes, through increasingly complex global supply chains. In particular, the United States market is more important to Australian businesses than these headline trade statistics might suggest. Research by the Department of Industry, Innovation and Science shows that although North America (United States, Canada and Mexico) accounted for only 4.3% of Australia's gross direct exports in 2014, 9.0% of Australia's value-added exports are eventually consumed there (that is, direct plus indirect exports. See Table 4.4). This implies that demand from North America is 1.69 times more important to the Australian economy than conventional trade statistics suggest. It indicates that the North American market gets more Australian input than from direct exports alone, with additional 'value-added exports' making their way to America via increasingly complex international supply chains. A similar pattern is observed for 'value-added exports' to the EU and to a lesser extent, the UK.

[9] Department of Foreign Affairs and Trade (DFAT), *Composition of Trade 2017*, July 2018.

TABLE 4.4 REGIONAL SHARES OF AUSTRALIAN EXPORTS, 2014

Region	Gross exports (%)	Value-added exports (%)	Difference (percentage points)	VAX ratio*
North America	4.3	9.0	4.7	1.69
United Kingdom	1.3	1.8	0.5	1.14
European Union (EU)	2.1	4.6	2.5	1.75
Non-Euro EU	0.9	1.4	0.5	1.23
South Korea & Taiwan	9.6	5.9	-3.7	0.49
Japan	16.2	14.5	-1.7	0.72
China	26.9	25.3	-1.6	0.75
Rest of World	38.8	37.5	-1.3	0.77
Total	100.0	100.0	0.0	0.8

* VAX = 'value-added exports ratio'. A VAX ratio of less than one occurs when value-added exports are less than gross exports.
Source: World Input-Output Database (2016) Input-Output Tables; Department of Industry Innovation and Science (2017).

4.4 Australian business expectations for trade in 2019

A lower Australian dollar tends to work in the favour of exporters but is not necessarily favourable to businesses that import inputs or to those that trade extensively as part of global supply chains.

Looking ahead, business expectations for export growth in 2019 are less favourable than they were one year earlier (possibly reflecting recent movements in the dollar and/or global demand), but more CEOs are optimistic about their export prospects in 2019 than was the case two to five years ago. This year, 24% of CEOs in this year's Business Prospects survey indicated they expect to increase their annual export revenue to increase in 2019. This is a lower proportion than had expected an increase for 2018 but is up on previous years. 4% of CEOs said they expect their export revenue to decline in 2019, while the remainder (the majority) expected no change (including just over half of all respondents who indicated they were not directly exporting in 2018) (see Chart 4.9).

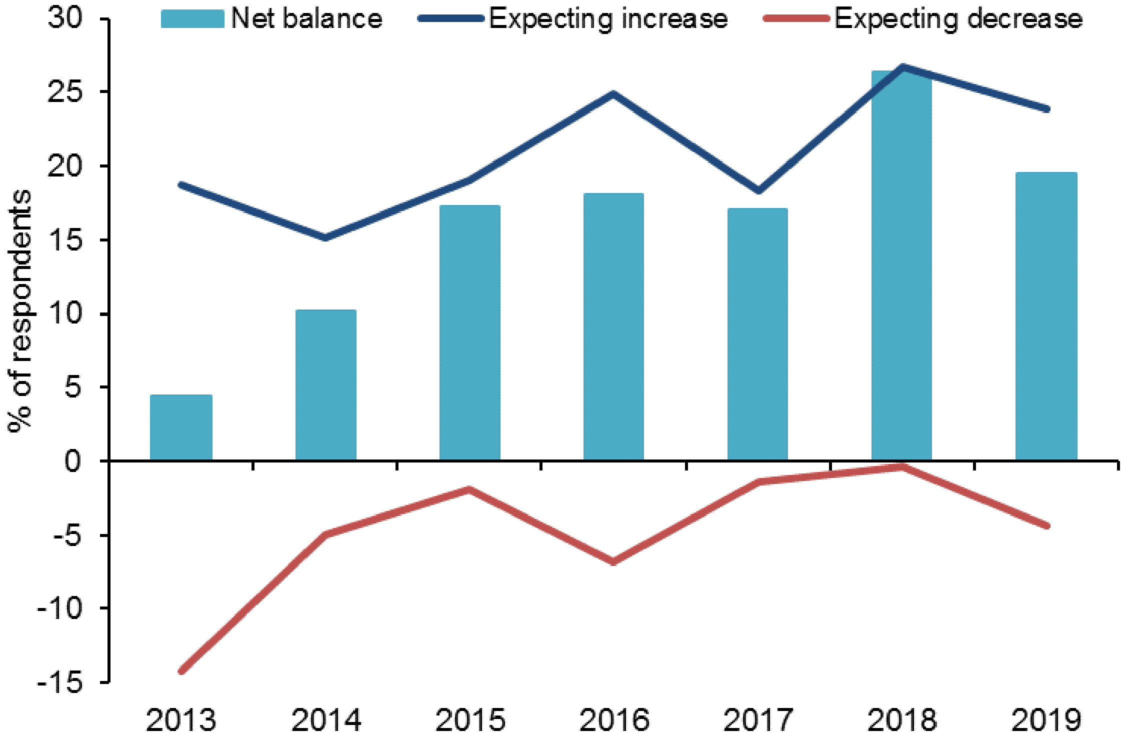
Regarding the likely success of Australian export promotions, plans and expansions in 2019, Austrade's annual Australian International Business Survey (conducted by Austrade, EFIC and the Export Council of Australia)[10] found that despite growing risks from trade tensions, the expectations of Australian businesses for their international markets in 2019 and 2020 is mostly positive, with 66% of Austrade's respondents expecting the next two years to be better than the last two years and only 5% expecting the next two years to be worse than the last two years. Only 2% cited US political instability as a reason to target new or different markets while 4% cited global trade factors such as Brexit and the US-China trade concerns. The most common reasons for changing target markets were to expand into new markets and because of increased interest in the products or services offered.

Despite clear escalations in trade tensions and negative sentiment toward trade emanating from the US, this year's Austrade survey indicated that the US remains the top market that Australian businesses are considering in the next two years, with 20% ranking it as their top priority, closely followed by China (19%), the UK (18%) and Indonesia (15%).

Of concern in the global race to win digital sales however, this year's Austrade survey revealed that many Australian businesses that operate internationally are lagging behind in their use of online sales channels to reach overseas customers, with only one third of exporters planning to increase their use of online sales and mobile and digital technologies. Among respondents who are engaged in other international activities beyond trade and investment (e.g. cooperative R&D activity or deeper supply chain involvement), 70% deemed intellectual property-related activities as essential or very important to generating overseas revenue.

[10] Austrade, *Australia's International Business Survey 2018*, Oct 2018.

CHART 4.9 BUSINESS EXPECTATIONS FOR ANNUAL EXPORT REVENUE, 2013 TO 2019

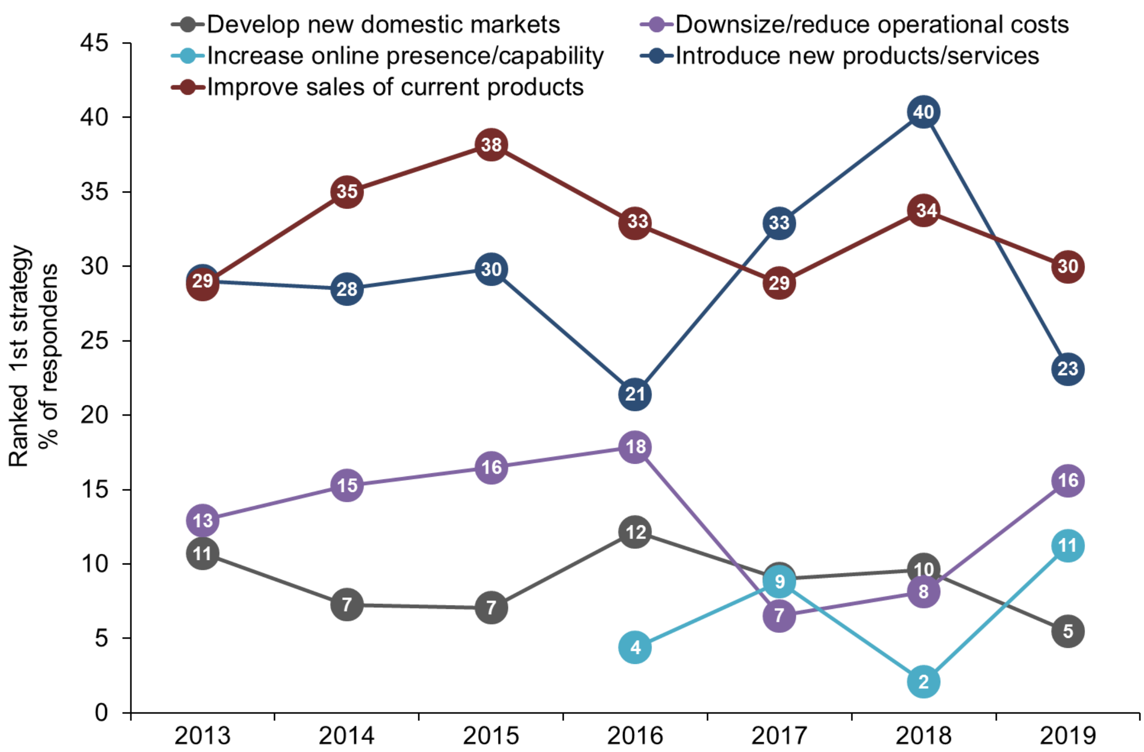


5. Planning and Strategy for Australian Businesses in 2019

Business plans and strategies often need to be adjusted in response to changing business conditions. In this year's survey, 46% of CEOs said they had revised their 'business model, plan or strategy' at some point during 2018 in response to variations in the business environment (down from 56% in 2017). Around 9% of CEOs said they didn't have a plan or strategy in 2018, up from 6% in 2017 but well down from previous years of the same survey (15% in 2016, 10% in 2015 and 12% in 2014). This suggests a concerning pause in the proportion of businesses developing the formal plans and strategies that are required to shape their business growth.

In 2019, Australian CEOs plan to concentrate on improving sales of current products and services to their customers. This strategy was the most popular priority for 2019 with 30% of CEOs ranking it their first choice, but the proportion of respondents listing this as their primary strategy has fallen from 2018 (34% of respondents) and is around similar levels to 2017 (see Chart 5.1).

CHART 5.1 TOP STRATEGIES FOR BUSINESS GROWTH, 2013 TO 2019



* Percentage of respondents who ranked each factor first in each year, out of a list of possible strategies.

Introducing new products to the market is a primary strategy for growth in 2019 for 23% of businesses. It was the principal approach for more respondents in 2018 (40%) and 2017 (33%) but has since dropped back as the main approach for business improvement. We may be starting to see a cyclical process emerging across the time series as businesses alternate their focus from developing to consolidating sales of existing products and services.

Downsizing or reducing operational costs is a priority for more businesses in 2019 than it has been in the past two years (16%). After a decline in cost reduction as a primary growth strategy in 2018 (8%) and 2017 (7%), it has crept back up to similar levels as 2016 (18%) and 2015 (16%).

Increasing online presence or capability is the primary growth strategy for 11% of Australian businesses in 2019. This factor has only been one of the most common strategies since 2016, where 4% of respondents considered it their priority, it rose in 2017, before falling back in 2018. Although there has been substantial growth in online presence (all responding large businesses have a website for example) there is room for further growth in small to medium enterprises and some sectors of industry have more capacity to increase their online capabilities in the future.

The same proportion of businesses plan to develop new markets within Australia, as plan to work on developing new export markets (5% each of responding CEOs).

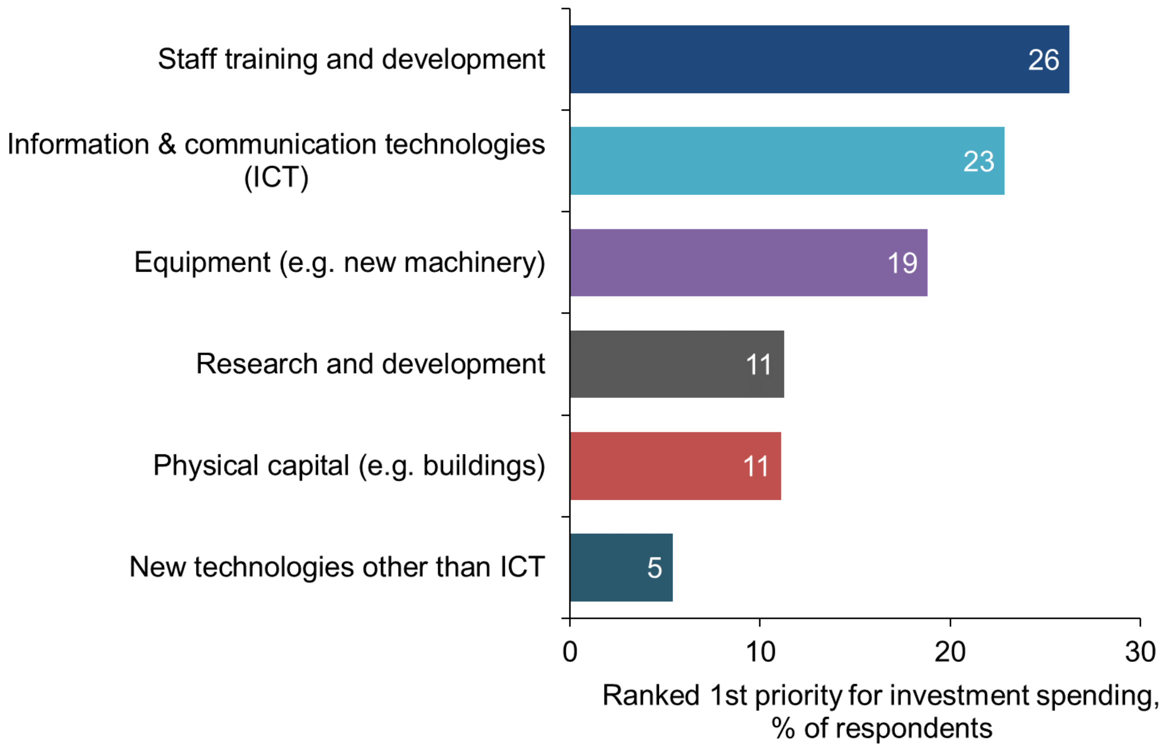
Few CEOs rank advertising and marketing as their top business strategy in 2019 (4% although this is slightly higher than in previous years) with most choosing to focus their efforts on selling existing products and services instead.

5.1 Business investment priorities for 2019

In 2019 half of businesses (49%) plan to concentrate their investment spending on either staff training & development or information & communication technologies (Chart 5.2). When asked what their highest priorities were for business investment spending in 2019, just over a quarter (26%) of CEOs stated that improving employee capability was their focus for investment. Just under a quarter (23%) of respondents said their first priority was information and communication technologies (ICT). These two factors are likely linked as the introduction of new technology generally necessitates an upgrade of employee skills.

The third most important area for investment spending for Australian CEOs is new equipment with 19% of respondents planning to prioritise this area of investment in 2019. Research & development and physical capital expenditure were each important to 11% of CEOs reporting on their investment intentions, while just five per cent of businesses plan to focus on new technologies other than ICT.

CHART 5.2 INVESTMENT PRIORITIES FOR BUSINESS*, 2019



* Percentage of respondents who ranked each category first, out of a list of possible types of business investment spending.

APPENDIX: CEO BUSINESS PROSPECTS SURVEY 2019 PARTICIPANTS AND QUESTIONNAIRE

Responses were received from the CEOs of 252 private-sector businesses across Australia in October and November 2018. Together, these businesses employed around 87,000 people (357 people each on average) and had an aggregate annual turnover of around $72 billion in 2018.

All Australian states and all major non-farm private-sector industries are represented in this year's CEO survey. The manufacturing sector contributed the highest proportion of respondents (65%). Manufacturing's share of this sample is higher than its share of national production (5.8%). Victoria was somewhat over-represented in the sample, relative to other states.

The data presented in the summary section of this report were weighted by industry (based on ABS estimates of their value-added contribution to GDP in 2017-18) in order to adjust for these characteristics of the sample.

The services sectors represented in this year's sample include: 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 services.

	CEO Survey: Business Prospects 2019		ABS data (2017-18)
Industry	Number of respondents	% of respondents	Value-added output, % of GDP
Manufacturing	164	65.1	5.8
Services	55	21.8	53.5
Construction and mining services	33	13.1	8.2
Total	252	100.0	67.5

**only includes construction value-added output. ** These industries do not sum to GDP due to the exclusion of utilities (2.4% of GDP), public administration and safety services (5.5%), agriculture (2.4%), mining other than mining services (5.8% of GDP), ownership of dwellings (8.7% of GDP) and other additional statistical items that are included in GDP.*

CEO Survey of Business Prospects 2019 Questionnaire

1. Business name:

2. Postcode:

3. In which industry does your business mainly operate? *Please tick one box only, for your main activity*

☐ Mining and/or mining services (e.g. exploration, mining engineering or mining processing)

☐ Manufacturing (e.g. making food, beverages, chemicals, equipment, building materials, metals, textiles, furniture)

☐ Construction (e.g. engineering, infrastructure, commercial, residential construction or contracting)

☐ Services (e.g. retail, wholesale, transport, professions, real estate, IT, media, health, education, cafes, hotels)

☐ Other industry (please specify): ____________________

4. What was your approximate annual turnover in 2018? $ ____________

5. How many fulltime equivalent (FTE) people did you employ in 2018? _____ FTE people

6. By what percentage did the following factors change in your business in 2018, compared to 2017?

Please complete one box only for each of:	Down *(write in %)*	No change *(tick if applicable)*	Up *(write in %)*
Annual turnover	________ %	☐	________ %
Gross profit margin	________ %	☐	________ %
Number of employees	________ %	☐	________ %
Spending on staff training & development	________ %	☐	________ %
Spending on physical capital (e.g. buildings)	________ %	☐	________ %
Spending on research & development	________ %	☐	________ %
Spending on new technology	________ %	☐	________ %
Export income	________ %	☐	________ %
Input prices	________ %	☐	________ %
Energy prices (inputs)	________ %	☐	________ %
Selling prices	________ %	☐	________ %
Labour productivity (output per hour worked)	________ %	☐	________ %
General business conditions in your sector	☐ Worse	☐ No change	☐ Better

7. Did you change any parts of your business model, plan or strategies in 2018 due to business conditions?

☐ Yes ☐ No ☐ we don't have a formal business model, plan or strategy

If yes, what did you change in 2018? ____________________

8. If exporting, what was the total value of exports for your business in 2018? $ ____________

9. Approximately what percentage of all your inputs (by value) were imported in 2018? ______%

10. IF your business was EXPORTING in 2018 or planning to export in 2019, at what AUD/USD exchange rate do your exports become uncompetitive with products from other countries? _________US cents

11. IF your business was competing with IMPORTS in the Australian market in 2018 or expecting to compete against imports in 2019, at what AUD/USD exchange rate do your products become uncompetitive with imported products from other countries? _________US cents

12. How did your business use the internet in 2018? *Please tick all uses that are applicable to your business*

☐ Business website	☐ Ordering / buying from suppliers	☐ Online applications (e.g. payroll)
☐ Advertising / marketing	☐ Data storage and / or analysis	☐ No internet used in the business
☐ Orders / sales from customers	☐ Other:	

13. Did your business experience any internet security problems in 2018?			
☐ Yes	☐ No	☐ Don't know	☐ Not applicable to my business
If yes, please briefly describe your internet security problem(s) and your response to it? ____________________			

14. Did your business invest in any internet security measures in 2018?			
☐ Yes	☐ No	☐ Don't know	☐ Not applicable to my business
If yes, please briefly describe your internet security investment? ____________________			

15. Did your business use any internet security assistance or advice from Government in 2018?			
☐ Yes	☐ No	☐ Don't know	☐ Not applicable to my business
If yes, please briefly describe the Government assistance or advice on internet security used by your business? ____________________			

16. Do you expect the following factors to change in your business in 2019, compared to 2018?

Please tick one box only for each of:	Down	No change	Up
Annual turnover	☐	☐	☐
Gross profit margin	☐	☐	☐
Number of employees	☐	☐	☐
Spending on staff training & development	☐	☐	☐
Spending on physical capital (e.g. buildings)	☐	☐	☐
Spending on research & development	☐	☐	☐
Spending on new technology	☐	☐	☐
Export income	☐	☐	☐
Input prices	☐	☐	☐
Energy prices (inputs)	☐	☐	☐
Selling prices	☐	☐	☐
Labour productivity (output per hour worked)	☐	☐	☐
General business conditions in your sector	☐	☐	☐

17. What factors do you expect will inhibit your business growth in 2019?
Please rank all factors that will inhibit your business in 2019, starting with 1 as your most important inhibiting factor

Lack of customer demand	______	Government regulatory burden	______
High and/or variable exchange rate	______	Competition from imports / internet sellers	______
Flexibility of industrial relations	______	Wage pressures or high wage costs	______
Skills shortages	______	Other (please specify): ________________	______

18. What key growth strategies do you plan to implement in your business during 2019?
Please rank all relevant strategies for 2019, starting with 1 as your most important strategy

Introduce new products/services	______	Downsize / reduce operational costs	______
Improve sales of current products/services	______	Increase online presence / capability	______
Develop new domestic markets	______	Increase advertising / marketing	______
Develop new overseas markets	______	Other (please specify):________________	______

19. What are your highest priorities for your business investment spending in 2019? *Please rank all types of investment that you are considering for 2019, starting with 1 as your most important area of investment*

Staff training and development	__________	Research and development	____________
Physical capital (e.g. buildings)	__________	Information and communication technologies (ICT)	____
Equipment (e.g. new machinery)	__________	New technologies other than ICT	____________
Other (please specify): ________________________________			

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