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An illion Report on the Australian Construction Sector

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I Overview

The construction sector is weakening under pressure from the early stages of what appears to be a sharp downturn in housing construction and signs of a topping out in non-residential construction activity.

There is no question that things are deteriorating in the sector, which appears to be confirmed by share market investors who, since the middle of 2018, have been selling construction shares.

The level of public sector infrastructure spending has been strong, but near-term growth may slow as some projects reach completion. Important for the sector will be any new projects in the wake of the Federal election and whether the State and Territory Governments commit to new projects proposed by the Commonwealth Government.

As projects come to an end, there is currently not a lot of evidence to suggest that State and Territories are adding new projects to the sector in the short-term.

Context – a sector under stress



Australian construction is currently in a sharp downturn, with dwelling construction the main concern.



Over the remainder of 2019, activity is likely to weaken further.



With interest rate cuts and non-residential construction expected to edge higher over the medium term, 2020 could see a bottoming in this cycle.



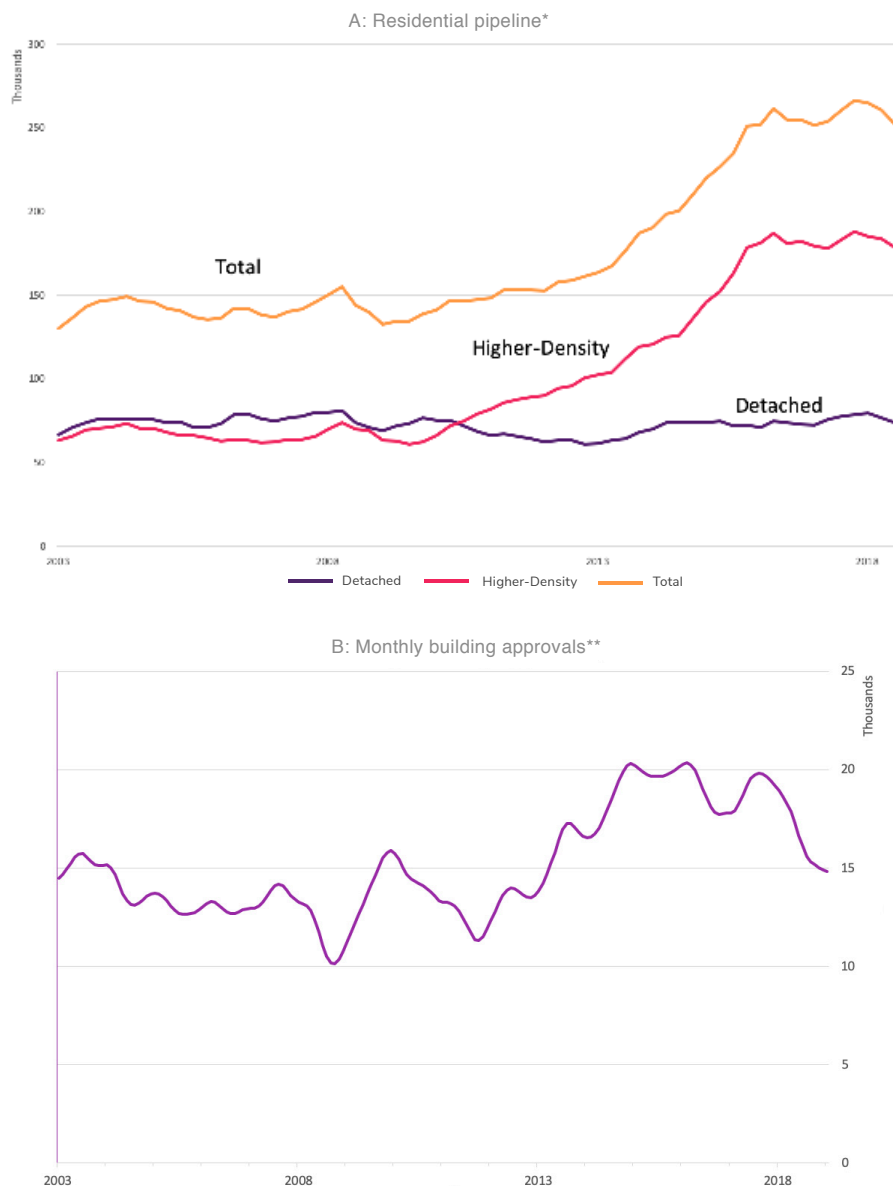
A risk is a fall-off in public sector infrastructure spending as projects are completed by the State and Territory Governments. Early announcements following several State and Territory budget announcements have not suggested any significant additional expenditure at this point.

I Dwelling construction

Dwelling investment reached a peak towards the middle of 2018. This marked the end of a record boom in new dwelling approvals and construction, with the main area of strength evident in higher-density housing. It should be noted that these types of dwellings are generally smaller than detached houses and use considerably less materials in their construction, meaning the boost to activity was muted. (Figure 1)

To date, the decline in actual activity in the dwelling sector has been mild. Dwellings approved and commenced in the past year are in the pipeline of construction activity and still need to be completed. That said, the forward indicators of new or additional residential building (mainly the ABS building approvals data (Figure 1B), has turned down sharply over the first-half of 2019. This suggests additional dwelling construction will fall sharply in the second half of 2019 and through 2020. A pick up in actual dwelling construction activity is unlikely before 2021 given the new supply of dwellings that are hitting the market.

Figure 1 A & B: Residential building activity



* Includes dwellings approved but not yet commenced and private dwellings under construction

** Trend measure

Sources: ABS; RBA

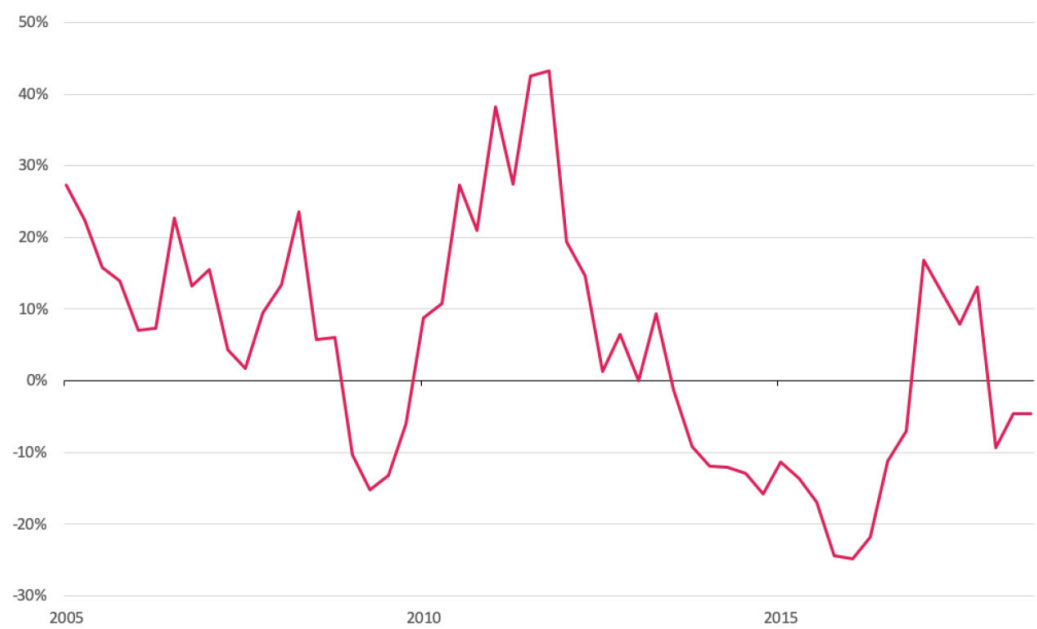
Private sector non-residential construction & public sector infrastructure

While non-residential construction activity outside the mining sector had been growing solidly in 2016, 2017 and into the first half of 2018, growth has now slowed.

The completion of a number of large scale projects and a clear moderation in the value of non-residential building approvals suggests ongoing moderate growth in non-residential construction over the next 12 to 18 months. (Figure 2).

There are a number of risks to this outlook, in particular the possibility of a broader downturn in the economy and a slump in inbound tourism, which would see development of hotels and other resorts scaled back.

Figure 2: Private non-dwelling construction YoY growth rates



Source: ABS

The latest illion Business Expectations survey revealed a sharp slump in actual activity even though expected activity was relatively firm (Figure 3). It remains the case that expectations in the construction sector remain more positive than the actual performance. The illion expectations results fit with the ABS business investment intentions data noted in figure 1 above.

It appears the optimistic tone of the construction sector, as opposed to the actual performance, is linked to the prospect of further interest rate reductions which are designed to support overall economic activity.

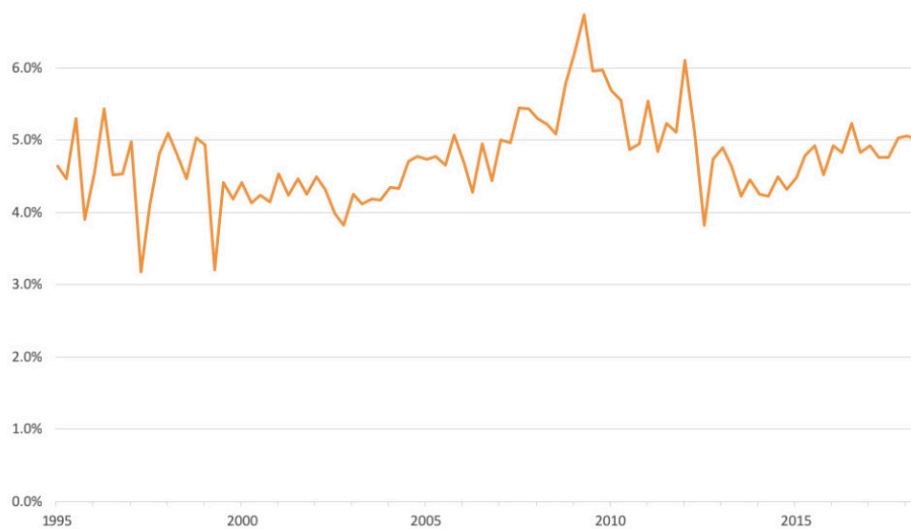
Figure 3: Construction: illion Business Survey Actual and Expected Activity



Public sector infrastructure spending, particularly at the State Government level on urban transport projects, grew at a steady pace from 2015 (Figure 4). Further growth will require new projects to be approved to replace the fall off in activity as existing projects are completed.

The outlook for infrastructure spending is something of 'a moving feast' and is difficult to pin-point however. The Commonwealth Government has spoken of higher spending, although it must be noted that this is spread out over the next decade, rather than occurring in the very near-term. Recent State and Territory budgets have hinted at a range of new projects, but more information will be needed to be confident that the construction sector will benefit from additional projects.

Figure 4: Government investment - per cent of nominal GDP



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Expectations in the construction sector are more positive than actual performance.”

| The outlook

The near-term outlook for construction remains somewhat fragile, with the dwelling cycle set to weaken and growth in private sector non-residential construction subdued. With the Reserve Bank of Australia poised to deliver a series of interest rate cuts to fresh record lows, there will be some support for private sector residential and non-residential construction activity. The effect is likely to remain moderate, but it is a small positive.

According to forecasts from Treasury, the RBA and illion, the three sub-sectors of construction have a varied outlook (Table 1).

After no growth in 2018-19, and a sharp 10% slump in 2019-20, residential construction is forecast to contract by a further 3% in 2020-21. It is clearly the aspect of the construction sector. After that residential construction should be supported over the longer run by ongoing favorable demographics, particularly strong population growth.

Despite growing uncertainty in the business sector, private sector non-residential construction is forecast to grow by around 5% in both 2019-20 and 2020-21. Public sector infrastructure is forecast to grow, albeit at a markedly slower pace.

Infrastructure spending has risks both ways, with some projects coming to an end and some potential for a lift in the number of large-scale projects which could provide a significant boost to the construction sector. These need to be announced and committed to for the current cautious optimism to come to fruition.

Table 1: Construction forecasts - percentage growth in real terms*

	Residential	Private non-res	Public including Infrastructure
2018 -19	0.0	-5.0	6.0
2019 - 20	-10.0	4.5	3.0
2020 - 21	-3.0	5.0	2.0

*Using data and forecasts from ABS, RBA, Treasury and illion.

| The illion solution

Due to the significant uncertainty and risks in the construction sector, there is a high likelihood of increased insolvencies. As such, it is critical for those exposed to the construction sector to take appropriate risk management precautions.

When a client, supplier, or business partner gets into financial difficulty, this may cause delays, disruptions, financial loss and reputational damage. With the right forward-looking approach, the risk of these negative outcomes can be significantly reduced.

illion is a highly credentialled provider of data, analytics and software, and has been relied on by Australia's banks, governments and companies across the spectrum for many decades.

Businesses in the sector routinely perform credit or financial assessments and/or risk monitoring, and illion has the best commercial dataset in the market to compare all the options quickly and efficiently in order for a business to make informed decisions to ensure it has a robust end-to-end risk management process.

In one instance, illion is assisting a large civil works contractor that won a tender for a substantial public works contract. The firm has thousands of subcontractors that they use routinely to complete work of this nature, and illion is undertaking credit and financial assessments ongoing monitoring for the duration of the project.

In another instance, one of Australia's largest commercial builders is using illion to conduct forward-looking financial viability & financial capacity assessments on their larger subcontractors. These financial assessments are conducted by illion's team of chartered accountants, who provide a professional opinion based on an independent, rigorous assessment of financial statements, work in progress reports, bank facilities, and independent credit checking. Testing of the work in progress reports has ensured a better understanding of the amount of work that each sub-contractor was taking on as this can be as problematic as having an insufficient amount of work.

Client benefits

Risk of Failure Report

- The Risk of Failure Report helps understand the long-term financial viability of a company. Knowing the risk of a potential customer or supplier experiencing severe financial stress or failure allows for clear decisions when extending credit to customers.

Risk of Late Payments

- Understanding how a company or business has paid other creditors provides clear insight into their payment behaviour. This helps to predict their payment reliability so our customers can prepare, manage and reduce the risk of late or non-payment.

Portfolio Insights

- illion's Portfolio Insight provides clear visibility on how suppliers are performing. Using powerful analytics that merge your accounts receivable data with the most predictive late payment score from Australia and New Zealand's largest commercial database, Portfolio Insight gives valuable insights every day about suppliers.

Financial Viability Reports

- These reports provide a professional opinion and specific recommendations, and are delivered by illion's team of Chartered Accountants. The assessments are based on financial statements, work in progress reports, and bank facilities and are tested against Australia's deepest commercial credit data, sourced from Australia's largest institutions.

illion's team boasts:

- Over 130 years of experience across our specialised credit decisioning experts.
- Proven and highly flexible origination, bureau, Credit Reporting and decisioning solutions.
- Comprehensive reporting transition programs, including bureau hubs and Credit Reporting Portal.

Our engagement process

Initiation: Arrange a meeting now with our illion representative of our construction sector team to hear how we can give you the edge: rukan.zaman@illion.com.au

About illion

illion is the leading independent provider of trusted data and analytics products and services in Australasia, with the company's consumer and commercial registries representing a core element of the region's financial infrastructure.

We leverage consumer and commercial credit registries, which comprise data on over 24 million individuals and over 2 million commercial entities, to provide end-to-end customer management solutions to clients in the construction sector, financial services, telecommunications, utilities and government sectors.

illion boasts one of the largest and most extensive consumer bureaux, and is a key element in Comprehensive Credit Reporting compliance. With wide-ranging data from public, private and proprietary sources, along with cutting-edge matching algorithms and analytics, illion is a valuable source for data exchange.

Trusted Insights. Responsible Decisions.

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