Submission to the Fair Work Commission

National Annual Minimum Wage Review

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Introduction

The residential building industry is one of Australia's most dynamic, innovative and efficient service industries and is a key driver of the Australian economy.

The aggregate contribution from the industry to the Australian economy was over $114 billion per annum in 2023, with over one million workers in the construction industry, of which tens of thousands are small businesses reliant on the industry for their livelihood.

The residential building industry is one of the most important sectors of the Australian economy providing housing for millions of Australians. A home is often the greatest source of wealth and savings for many families. The industry contributes to the economy in a number of ways providing hundreds of thousands of Australians with jobs, generating billions of dollars of economic output each year and stimulating spending on housing services.

The residential building industry ranges from single dwelling construction to multi-unit apartment buildings, and encompasses the home renovations market. The industry has important linkages with other sectors, such as manufacturing and retailing, so its impacts on the economy go well beyond the direct contribution of construction activities.

HIA submits that for its 2024-2025 Annual Wage Review, the Expert Panel should consider the following specific issues confronting the residential building industry:

- The industry's economic performance, including productivity, viability, inflation and employment growth, particularly in light of the economic downturn;
- Policy settings that may adversely impact the Federal Government's commitment to build 1.2 million homes over the next 5 years;
- Cost of living pressures that demand a need to support the supply of housing. Only when the supply of housing meets underlying demand can the issue of housing affordability be addressed. The provision of housing is critical to maintaining adequate living standards, a key factor amongst the Expert Panels considerations during an Annual Wage Review.

Performance and competitiveness of the national economy

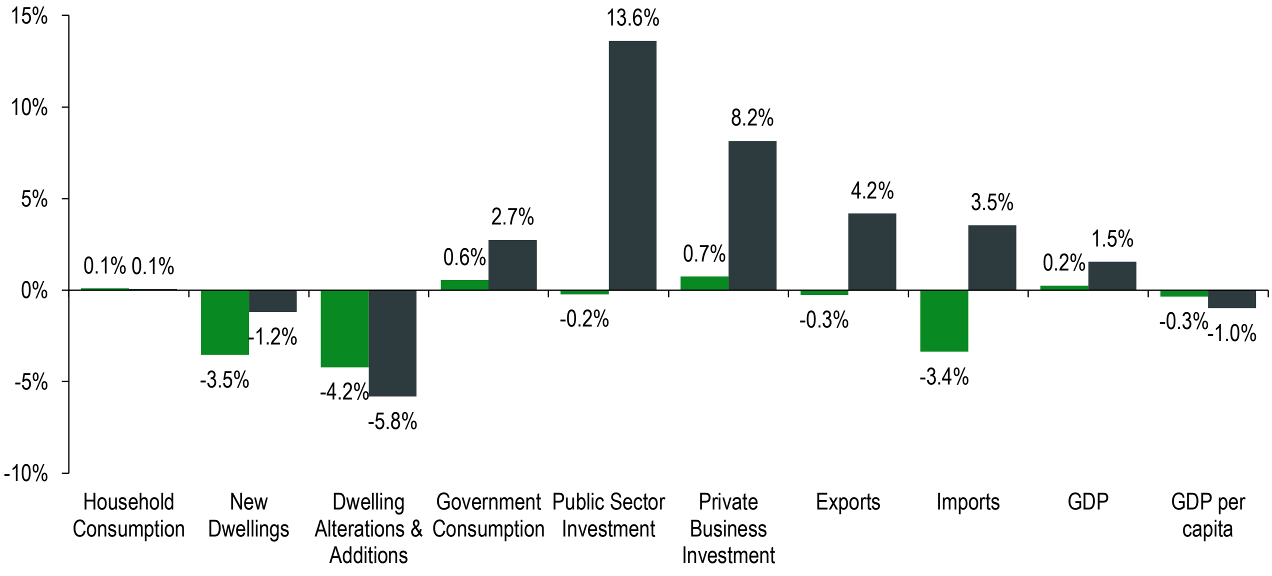
Background on economic conditions

The rise in the cash rate since May 2022 has caused a slowdown, but not a decline in economic activity, with its effects adversely affecting some sectors more than others.

The long lags in this cycle make it appear that the RBA's tightening policy is taking longer to affect the Australian economy. As a result, economic indicators such as GDP and unemployment have not materially turned, despite almost two years of higher interest rates. While interest rates have slowed activity and adversely affected consumer confidence it is expected that the impact of these changes will be reflective in the economic indicators throughout the remainder of 2024.

Australia's GDP grew by 0.2 per cent in the December Quarter 2023, to be 1.5 per cent larger than it was in the previous year. GDP on a per-person basis, however, has been in decline for three quarters, which marks a per-capita recession. As the overall economy continues to grow, each individual is experiencing a decline in personal wealth.

Components of GDP Growth, December Quarter 2023



Source: ABS

The resilience of the national economy has been driven by strong population growth and government expenditure. As highlighted in the above graph, Public-Sector investment within the December quarter was the largest growth area. The rise in the population offsets the decreased spending of each household, as they contend with cost-of-living pressures amid rising prices and higher interest rates. This is evident in the decline in the savings rate from its high levels during the pandemic and the weak retail trade result in December 2023.

There are no immediate signs yet that the RBA would cut rates soon, given that inflation remains above its target. While inflation has not endured at the high levels seen in 2022, there is a possibility that getting it within the 2-3 per cent band will take longer. This could mean that higher interest rates could persist.

The residential building industry

The effects of a tighter monetary policy environment disproportionately and immediately impact the residential building industry. Higher interest rates have a primary outcome of increasing the cost of borrowing but also a second-order impact of depressing market confidence.

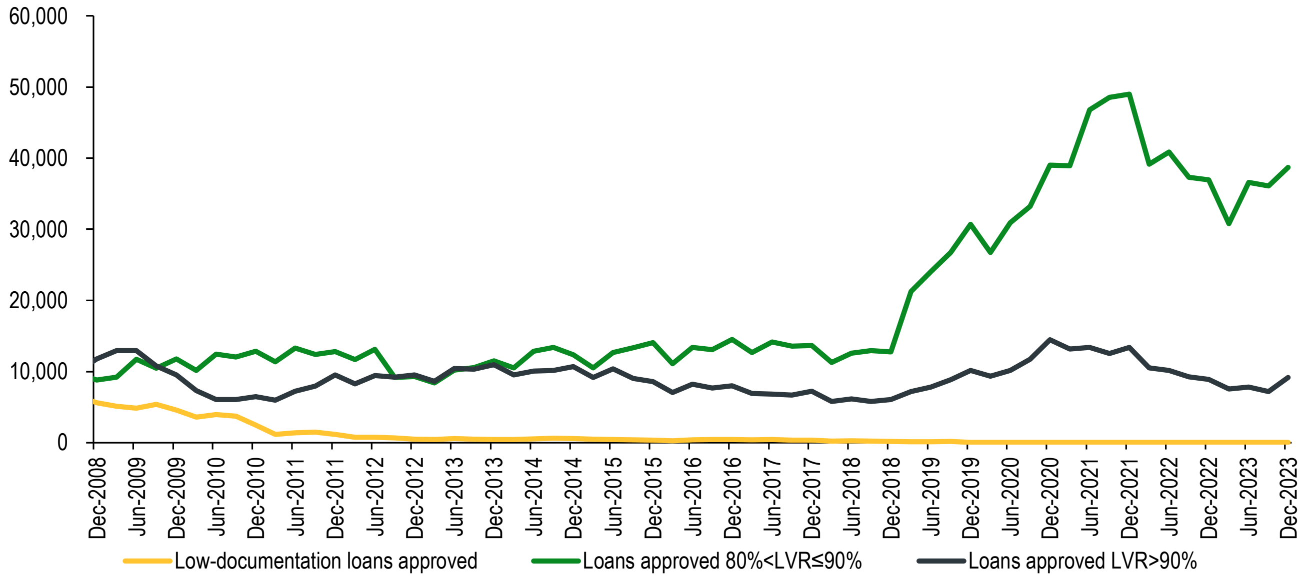
Compounding higher interest rates are macroprudential regulations, which have restricted greater access to home lending. The prudential regulation agency, APRA, maintained the three per cent mortgage serviceability buffer in December 2023, deeming it appropriate amid an uncertain economic outlook.

The cost of an ‘unquestionably strong’ banking system and tightened prudential standards is a restrictive lending environment, which has greater adverse effects on lending to first home buyers compared to someone who already owns a home.

While these settings were largely obscured by declining interest rates in the past decade, particularly during the zero-interest rate period, the effects of these would have been more obvious in recent years which saw a sudden rise in borrowing costs.

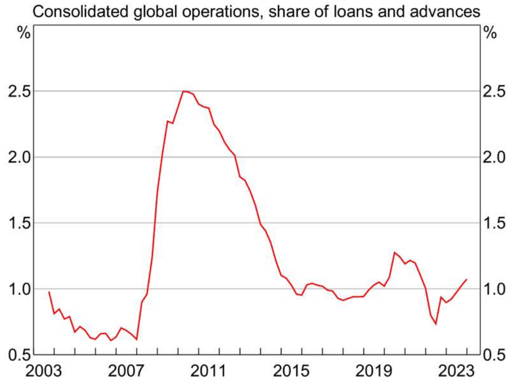
Residential Lending to Households

Source: APRA Quarterly ADI Property



Banks' Non-performing Loans

Consolidated global operations, share of loans and advances

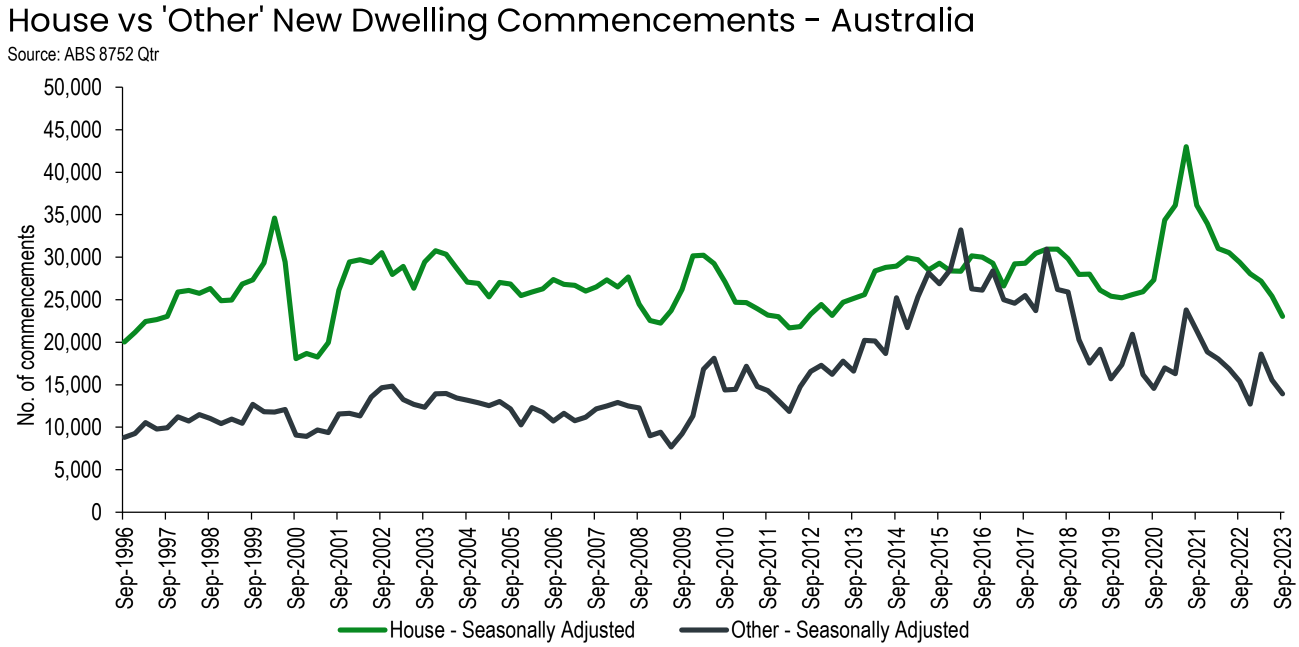


Source: APRA.

Not only are higher interest rates gatekeeping new home lending, but consumers are also likely to respond to higher interest rates by holding off big-ticket spending, such as buying a new home.

This is evident in the decline in the leading indicators of home building activity months after the rise in the cash rate. The results of HIA's new home sales survey remain very weak in February 2024. ABS data on loans for new homes reached record lows in 2023, while residential building approvals recorded their decade lows.

As a result, the volume of dwelling commencements declined to its weakest level in the September Quarter 2023. This is expected to recover modestly in subsequent quarters amid an increase in the number of approved projects that have yet to commence. The low result of the most recent quarter brought commencements in the year to September 2023 to 165,600, which is 15.0 per cent lower than in the previous year.



There are different dynamics playing across different home building segments. A trough in detached commencements is expected in 2023/24 to 96,250, down 12.6 per cent compared to the previous year and down by almost a third of its peak in 2020/21. The trough in multi-units may have already been reached in 2022/23, which produced an 11-year low 63,100 commencements. Although recent quarters have been weak for multi-units, there is an expectation that it would pick up in succeeding quarters to produce 72,010 commencements in 2023/24.

These declines in new home building driven by the rise in the cash rate presents another dilemma. There is an increase in housing demand amid strong population growth. This is evident in the very low vacancy rates across Australia. As the volume of new homes entering the market shrinks amid greater demand for homes, housing affordability will only continue to deteriorate as a consequence.

Wages and inflation

Recent inflation figures are trending in the right direction thanks to easing supply constraints, growing at 4.1 per cent in the year to December 2023. This is down from the 7.8 per cent recorded in the year to December 2022 and progresses closer to the RBA's 2-3 per cent target band.

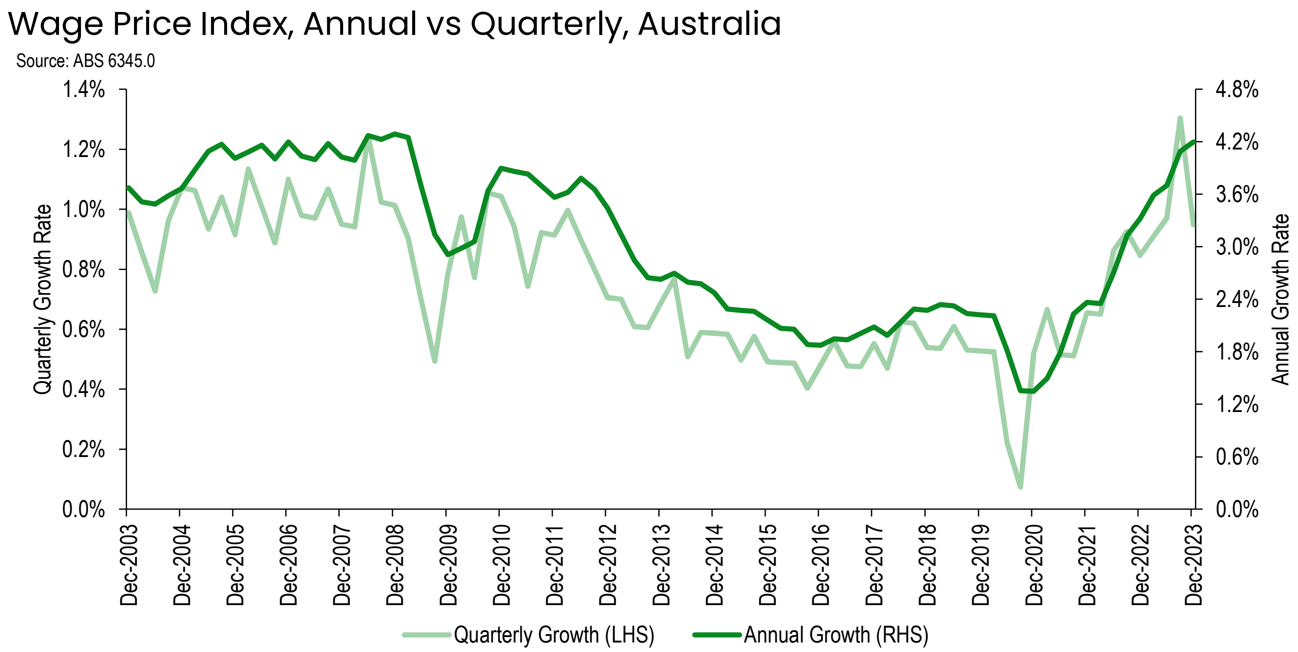
The RBA's *Statement of Monetary Policy* in February 2024 indicated while that goods price inflation in Australia and overseas was weaker than expected, services inflation remained high (but in line with expectations).

There are concerns that the stickiness of prices and wages will make it more challenging to get inflation precisely to target sooner rather than later. Amid tight labour market conditions, wages grew by 4.2 per cent in the year to December 2023, the strongest annual increase in 15 years.

Hence, the RBA has not and would not be likely to respond to this until it is certain that inflation is fully contained and labour market conditions ease. Wage growth is expected to only remain robust in the near-term, with a moderation thereafter expected, contingent on an improvement in productivity outcomes.

HIA remains concerned about the risk of a price-wage spiral similar to the 1970s and 1980s. Getting inflation to target quickly will be crucial in ensuring it does not become entrenched in inflation expectations. This will require prudent economic decisions, from responsible fiscal policy settings to appropriate monetary policy settings.

Wage decisions also have implications for interest rate decisions by the RBA and may complicate the RBA's attempts to rein in inflation. Higher inflation can require higher interest rates for longer, with negative consequences for household finances, businesses in home building and other industries, and for housing affordability.



Workforce participation and apprenticeships

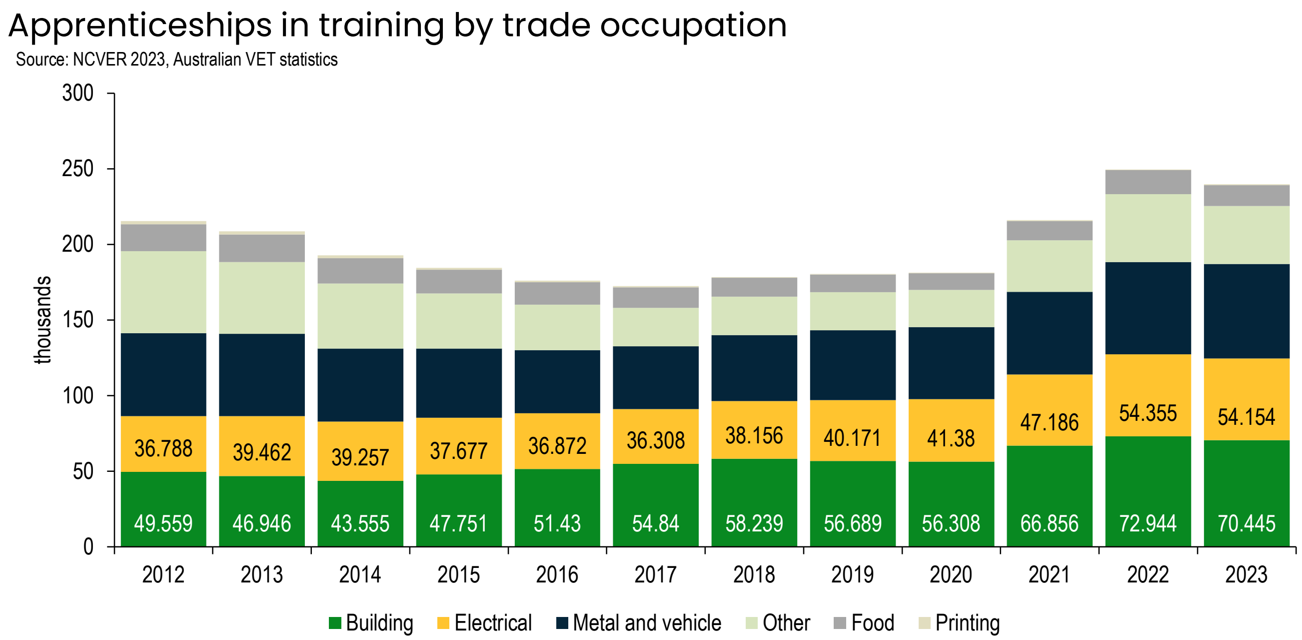
The decline in the volume of work entering the pipeline noted above will be an important issue for the discussion on wages in the industry. Any minimum wage increase should consider the pipeline of works and the outlook for the industry, to ensure that businesses could continue to employ their workers.

Worker retention in the industry is crucial, as businesses need to be able to access the skilled trades they need. This is particularly important when home building picks up and in order to meet the Federal Government's stated objective of building 1.2 million homes over the next five years.

Labour shortages have continued to beleaguer the industry but was particularly the case during the pandemic when there was little to no access to overseas skilled tradespeople. A common entry point and training ground for the industry is apprenticeships. Businesses are able to employ and enhance the skills of entrants looking to participate in the construction workforce.

The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) published a report in May 2023 called *Apprentices and Trainees Employed by Small Businesses*. It found that small businesses (with less than 20 employees) employed 167,328 apprentices and trainees, which is 42 per cent of the total number.

Close to half of these apprentices and trainees were employed in the construction industry, engaged mainly in electrical, carpentry, and plumbing services. The largest share of trades apprentices in training as of 30 June 2023 were in the building industry (29.4 per cent), followed by metal and vehicle (26.0 per cent) and electrical (22.6 per cent).

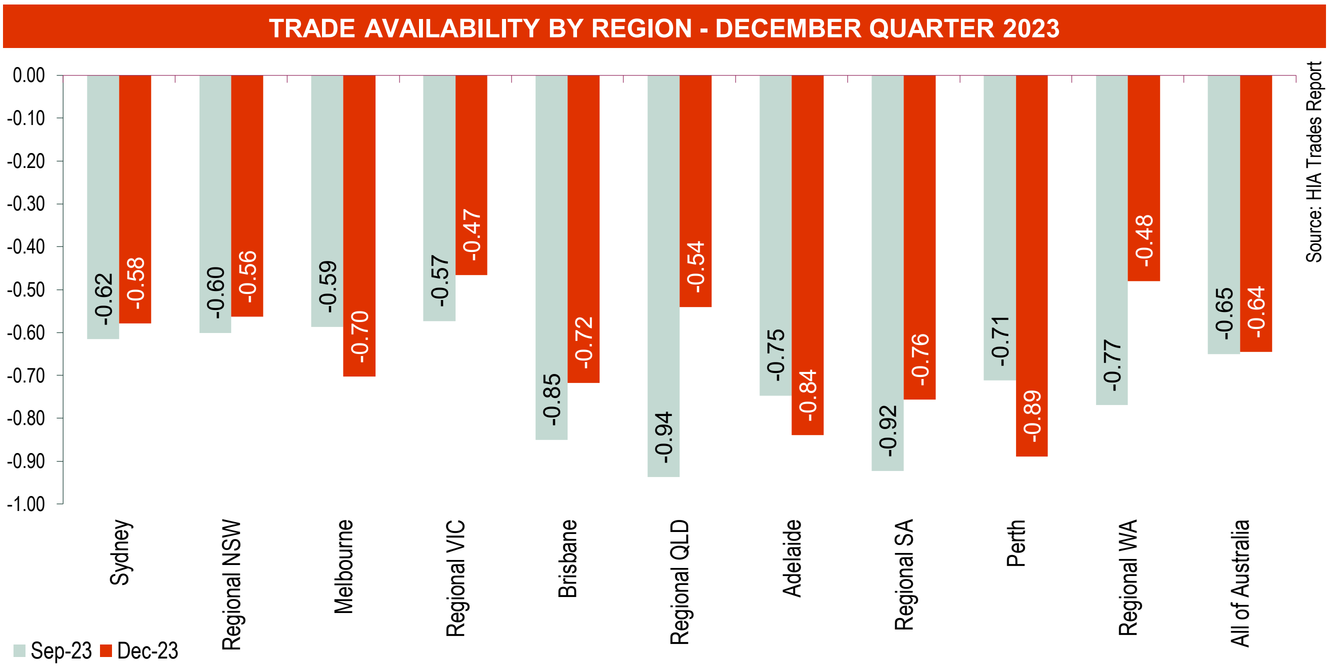


A review of minimum wage increases must also factor in the costs of training carried out by employers. Small businesses in the industry with a turnover of less than $500,000 employ a large proportion of apprentices. Any minimum wage increase should take into consideration the financial viability of these businesses in being able to hire apprentices. The cost of not being able to satisfy the labour needed is an inability to increase capacity and fill substantial skills shortages.

HIA's Trades Report tracks availability across different trades and regions. The pandemic brought about acute shortages of skilled labour, and the HIA Trades Availability Index recorded its worst in the June Quarter 2022. Since then, trades availability, or lack thereof, has eased from these acute levels but not enough to make it easy to find skilled trades.

This persistent shortage leaves the price of skilled trades in the December Quarter 2023 up by 5.0 per cent compared to the previous year, with some trades (i.e. plastering) recording more acute shortages and consequently, price increases.

Across regions, Perth recorded the worst trades availability in the most recent quarter, with a reading of -0.89. This is followed by Adelaide (-0.84), Regional SA (-0.76) and Brisbane (-0.72). As it stands, there is no capital city or regional area that has recorded a positive reading, which is the demarcation of trades being easily available.



The shortage is also evident across all trades, with ceramic tiling (-1.04) recording the worst availability, immediately followed by bricklaying (-1.03). The other difficult-to-source trades include carpentry (-0.84), roofing (-0.81), and plastering (-0.79). This suggests that finishing trades are increasingly in short supply, as the large volume of homes commenced during the pandemic reach completion.

Other factors

A vast majority of employers in the industry are small businesses. These employers have been hit the hardest by the changing economic conditions and rely heavily on award rates of pay and terms and conditions. They operate in a very competitive market where costs are tightly controlled, and profit margins are low. These employers are highly sensitive to economic conditions affecting them, including the effects of employment regulation and wage increases.

Whilst measured increases to household income may help alleviate some affordability stresses, ongoing labour input costs and supply chain issues in the construction of housing, without any link to productivity improvements, will impact project costs. This in turn affects housing affordability. Increases in wages inherently place added cost pressures on businesses making them less likely to grow, invest or take on additional employees. This can also create demand side implications including tightening the supply of existing skilled trades and reducing the entry of new apprentices to the industry placing further pressure on existing businesses to meet demand.

In addition to the demand side implications of the economy, there has been an abundance of commentary recently on the number of building and trade insolvencies increasing[1]. Unfortunately, construction companies have featured heavily on the list of recent insolvencies and this trend is expected to continue in the short to medium term.

[1] Australian Financial Review April 18 2023 ' Construction Insolvencies march Towards Decade High'
https://www.afr.com/property/commercial/construction-insolvencies-march-towards-a-decade-high-20230418-p5d1b7

Australia's construction sector has long been sensitive to the impacts of insolvency and broader cash-flow issues. Late payments and bad debts are two of the main triggers for insolvency, a situation currently exacerbated by inflation, supply chain issues, increasing materials costs and labour shortages. More recently, cash flow pressures from 2022 are being compounded by volatility in sales volumes and other business factors.

A more recent development is that the transfer of the cash flow problems down the supply chain to contractors will see that part of the market hit insolvencies and will be another direct challenge for builders to manage throughout 2024.

As a result, it is going to take the industry some time to recovery from the pandemic driven impacts and HIA don't expect insolvencies in the industry to return to pre-pandemic levels until 2025.

Approach to minimum wage increase in recent years

In recent years, the Expert Panel has taken a more nuanced approach to the implementation of the minimum increase in light of the COVID-19 pandemic and other factors.

This included a staggered approach in 2021 and a delay to the commencement of increases for certain modern awards in 2022. That review also saw a noticeable increase in the quantum of the minimum wage rise when the Expert Panel awarded a $40 a week increase for employees earning below $869.60 per week, whilst those earning above that amount received a 4.6 per cent increase to their wages. In 2023 this level of increase continued when the minimum wage rose by a further 5.75 per cent.

The cumulative effect of significant increases year on year should not be underestimated.

While HIA strongly submits that a cautious approach be taken, if an increase is to be awarded, HIA would encourage the Expert Panel to, once again, take a more nuanced and conservative approach to any increase.

Conclusion

It is important that minimum wage policy settings as determined by the Expert Panel encourage both investment and employment.

The impacts of prices increases, delays and material and labour shortages are continuing to adversely affect the day to day financial circumstances of many in the residential building industry, including the many small businesses that operate in the sector.

Finally, the current conditions affecting apprentice employment deserves special consideration. Wage increases undoubtedly affect the capacity of businesses, particularly small business, to sustain the continued employment of apprentices to obtain completion status, leading to the eventual heightening of skills shortages in industry. We also understand that a number of important government apprentice financial support packages are due to end, without any indications of what will replace them.

Further to this, HIA asks the Panel to be mindful of any erosive effect a minimum wage increase at this time could have on the residential building industry, especially at a time where government stimulus for wages has lapsed and there has been significant labour cost increases over the last 12 months and labour shortages remain the worst on record.

The cumulative impact of minimum wage increases, inflation issues, the ongoing tightening of builder margins, the ongoing market conditions arising from the pandemic and its flow on impacts, combined with the precarious global circumstances suggest the economy has limited capacity to manage a significant wage increase.

Employers in the residential building industry are unlikely to be able to sustain further increases of the magnitude awarded in previous years.

In light of the current landscape, HIA strongly submits that the Expert Panel takes a conservative approach in this year's minimum wage review.