



Australian construction
cost trends **2016**

EXTRACT

September 2016

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Over the past three or four years, construction activity has weakened nationally, largely due to the end of the resources boom, but also as a result of a large decline in road construction since 2012. Activity has remained stronger in New South Wales and Victoria, however, largely due to the boom in residential building. Chart 3 shows wages growth has slowed, reflecting the downturn in construction activity nationally.

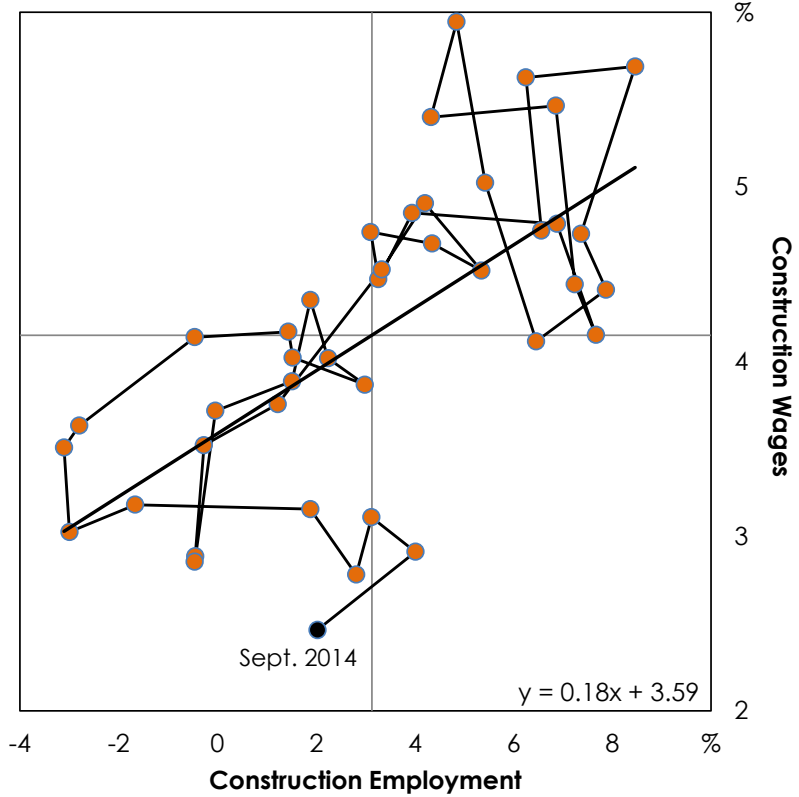
We expect wages growth to edge marginally higher during the remainder of 2016, reaching just above 2% (in wage price index terms) in the year to December 2016, before climbing to 2.6% in the year to December 2017. This represents a return to more normal rates of wages growth, and is expected to be accompanied by a slight rise in price and wage inflation generally in the economy.

Over the decade to June 2026, average annual wage inflation is forecast to be 3.2% in wage price index terms.

Data and forecasts (as at June) for each industry are tabled on the following page.

Chart 4 Construction Employment and Wages

Annual percentage change



Source: ABS ; Macromonitor

Growth in concrete prices in the year to the June 2016 (the latest data) was reasonably strong in New South Wales, Victoria and Queensland also – as these three states have the strongest economies and have benefitted from a large upturn in residential building (in particular apartments).

Nationally, readymixed concrete prices increased by just 1.8% over the year to June 2016. Slightly more rapid price increases are expected in 2016/17, at 2.7%. We are seeing the major materials companies aiming to improve margins and raise prices for cement and concrete. We have seen ‘out of cycle’ price increases by Holcim and the ‘pricing culture’ program announce by Boral. Price increases by cement and concrete companies generally take effect in April. This year, all of the major supplies announced increases.

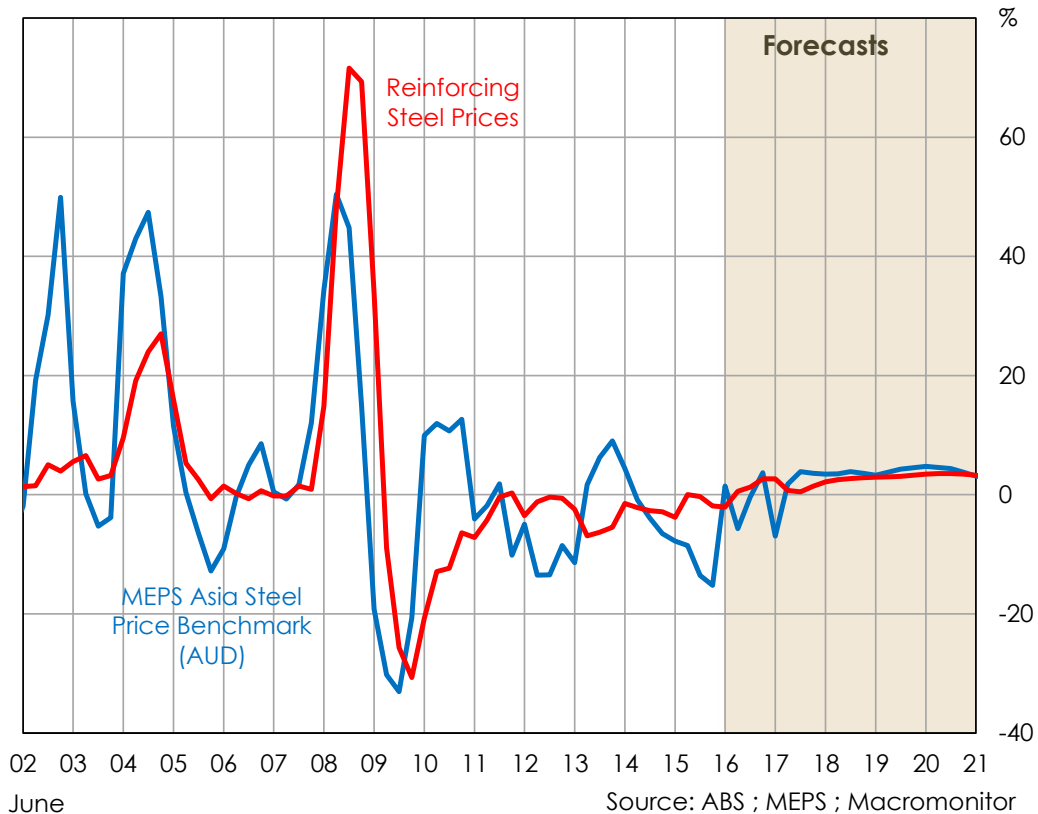
We expect an easing of price growth in 2017/18 as the residential market turns down. The rate of price increase should then accelerate modestly over the following few years, to 3% per year or higher in 2018/19, 2019/20 and 2020/21.

2.2.2 Reinforcing Steel

The measure we use for reinforcing steel is obtained again from the ABS’ producer price index publication (6427.0). As with the readymixed concrete price index, it represents changes in the price of reinforcing steel used as an input to the house construction industry. As the chart shows below, reinforcing steel costs are influenced primarily by world steel prices, the USD/AUD exchange rate, plus labour and other costs.

Chart 6
Steel and Reinforcing Steel Prices

Annual percentage change



2.5 EQUIPMENT COSTS

2.5.1 New Equipment

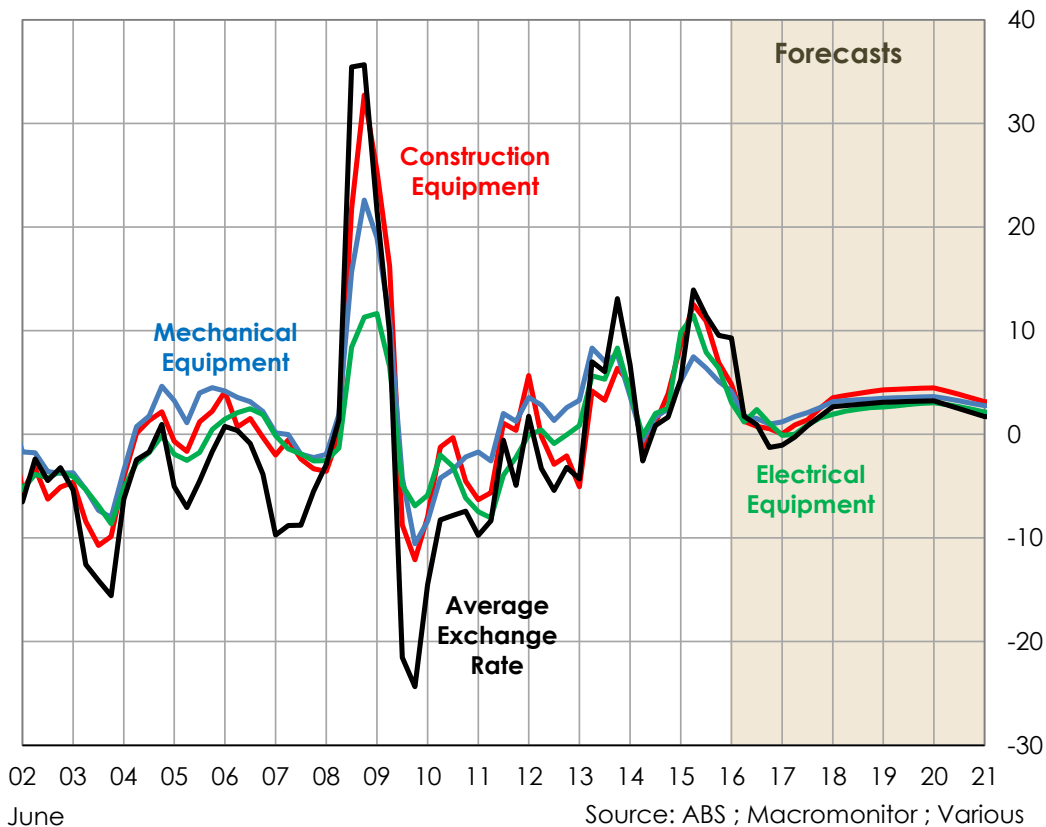
Equipment costs in this report are broken down separately into four categories: construction equipment; electrical equipment; mine mobile equipment; and mechanical equipment. Construction equipment features in our cost estimates for all sectors other than electricity, gas pipelines and water. The other three categories feature only in our calculations for the mining sector.

The basic concept behind these indexes is that some equipment items are imported, while others are produced domestically. We obtain indexes for both imported and domestic equipment costs and weight them together appropriately to represent general cost escalation for that category. The domestic price index data is obtained from the ABS producer price index catalogue (6427.0), and the imported price data is obtained from their international trade price index catalogue (6457.0). The indexes used are as follows:

Changes in mine mobile equipment prices are described as a weighted average of the price changes of mining and construction machinery (domestic 35%), and machinery specialized for particular industries (imported 65%). Domestic mechanical equipment costs can be broken down further into the costs of mining and construction machinery, lifting and material handling equipment, and pump and compressor manufacturing. Imported price growth (50%) is estimated with the index for general industrial machinery and equipment, n.e.s., and machine parts, n.e.s.

Chart 10
Equipment Prices and Exchange Rates

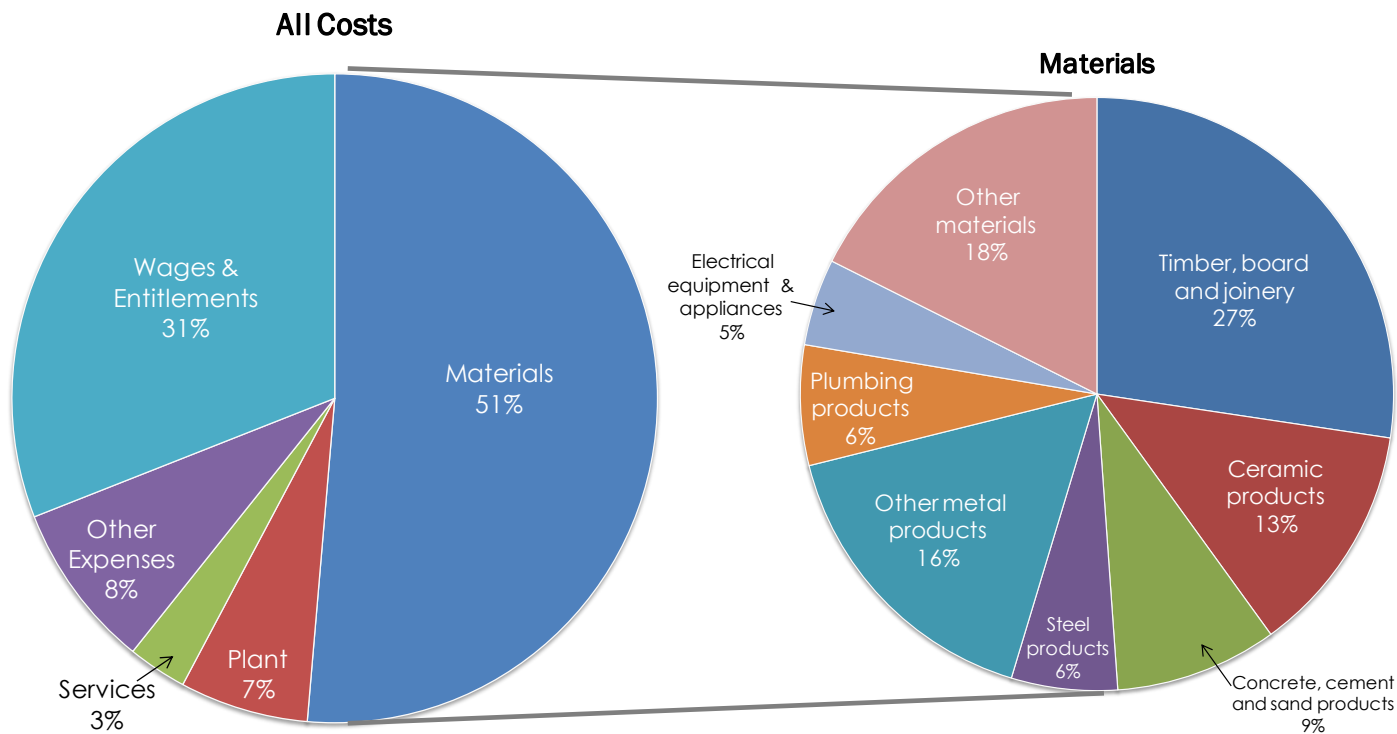
Annual percentage change



3.2 BREAKDOWN OF COSTS

Overall costs of residential building can be broken down roughly according to Chart 16.

Chart 17
Estimated Breakdown of Residential Building Costs



Source: ABS & Macromonitor

The overall price charged by a builder for the construction of a residential building must ultimately be split between costs and profits. The portion of the price which goes to cover costs is shared amongst the various cost components represented in Chart 16. Much of the price of the building goes to either the suppliers of materials or to wages of building workers. A smaller share goes to cover other costs, including plant hire, fuel and services. What is left is the profit to the builder. If we include corporate overheads (admin costs, corporate services, interest, depreciation etc.) in the calculation of costs, then what is left over is the net profit to the builder, if we don't include overheads then it is the operating profit.

The quoted price for a residential building is largely determined by the costs which are expected to be incurred (or typically incurred) to construct the building, plus a profit mark-up.

That said, the rate of change over time in the price charged by builders for a building, can be quite different from the rate of change in the various costs components, with the difference reflected in changes in the profit margin. During a downturn in demand, builders might be happy to accept a lower margin, that is, raise their prices by less than the rate of increase in their costs, in order to maintain a workload. Similarly, in an upturn, builders might feel able to increase their prices more strongly than their costs are increasing.