

Jemena Gas Networks (NSW) Ltd - Initial response to the draft decision

Appendix 3b.7

Macromonitor: Forecasts of Readymixed concrete costs – A report prepared for CEG – March 2010

19 March 2010



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Forecasts of Readymixed Concrete Costs

New South Wales

Report prepared for CEG March 2010

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Contact:

Nigel Hatcher
Director

Macromonitor Pty Ltd

02 8819 2791

nigelhatcher@macromonitor.com.au

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1. Introduction

The objective of this report is to provide well researched forecasts of readymixed concrete cost increases which are expected to be experienced by gas network operators in New South Wales.

We aim to provide the historical data which we believe to be the best available indicators of these costs. We also provide annual forecasts of these data series out to 2014/15, along with a clear explanation of the forecasts.

The forecasts in this report are in nominal terms. These reflect nominal wage and other cost pressures in the construction and construction materials sectors, which Macromonitor specialises in analysing. In order to derive forecasts of real changes in costs one must adopt a forecast of CPI inflation. This will require one to take a view of changes in all prices for consumer goods across all sectors (including exchange rates and the price of imports of finished goods). Macromonitor does not hold itself out to be an expert in developing such forecasts.

2. Readymixed Concrete Costs

Macromonitor regularly forecasts movements in the cost of concrete, as part of its forecasting report 'Australian Construction Cost Trends' and for inclusion in numerous tailored forecasting reports for clients in the cement and concrete, general construction and related industries.

There are three primary data series measuring the cost of readymixed (or premixed) concrete. These three data series are:

- **Price Indexes of Materials Used in House Building – Readymixed Concrete**, from the ABS publication, *Producer Prices Indexes, Australia*, catalogue Number 6427.0
- **Price Indexes of Articles Produced by Manufacturing Industries – Concrete Slurry Manufacturing**, from the ABS publication, *Producer Prices Indexes, Australia*, catalogue Number 6427.0
- **Price Indexes of Materials Used in Building other than House Building – Readymixed Concrete**, from the ABS publication, *Producer Prices Indexes, Australia*, catalogue Number 6427.0 – discontinued in June 2004, but projected forward using the other two measures

Chart 1 below presents each of these series on the same chart, illustrating the similarity between movements in each of the three series.

Chart 1
Price Indexes of Readymixed Concrete

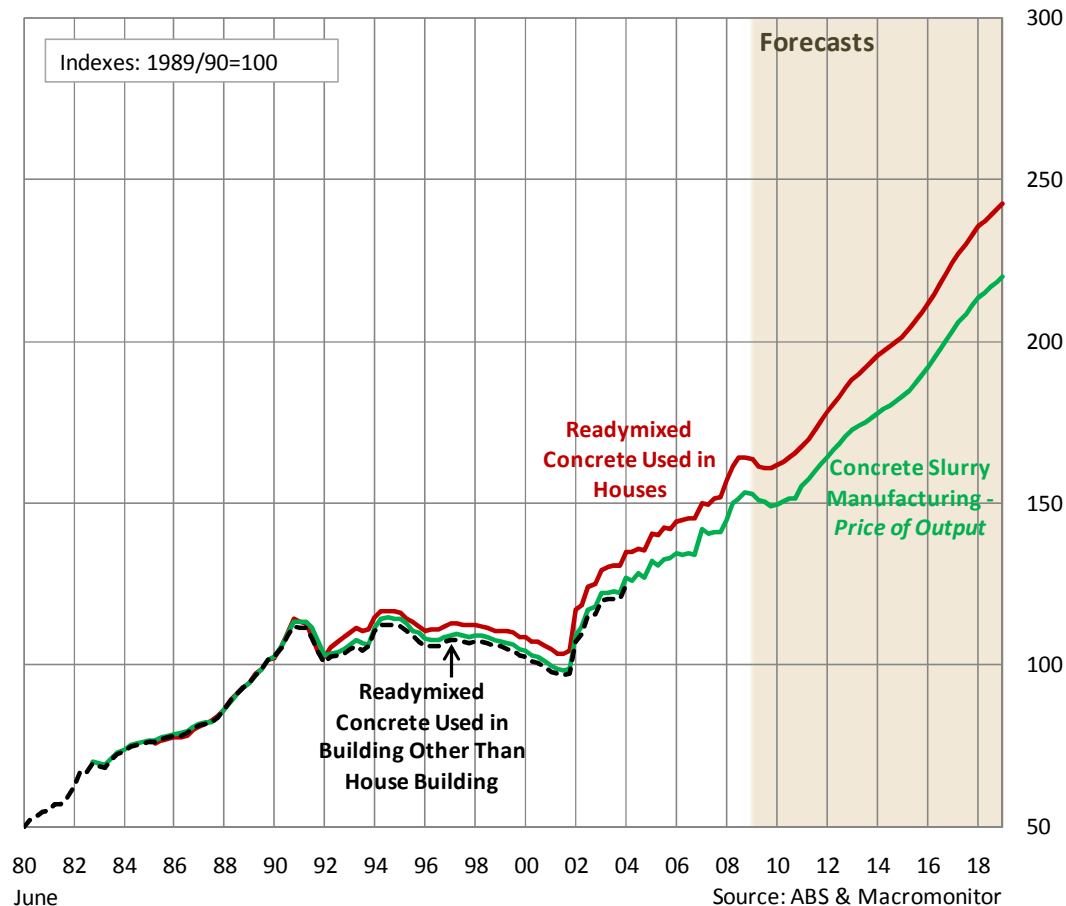


Chart 2 and Table 1 below describe the same data as Chart 1, but report the annual percentage change in the indexes rather than the actual index numbers. As is made clear in Chart 2 and Table 1, these three indexes have moved in near 'lock-step' over the entire period for which data are available.

Chart 2
Price Indexes of Readymixed Concrete
 Annual % Change

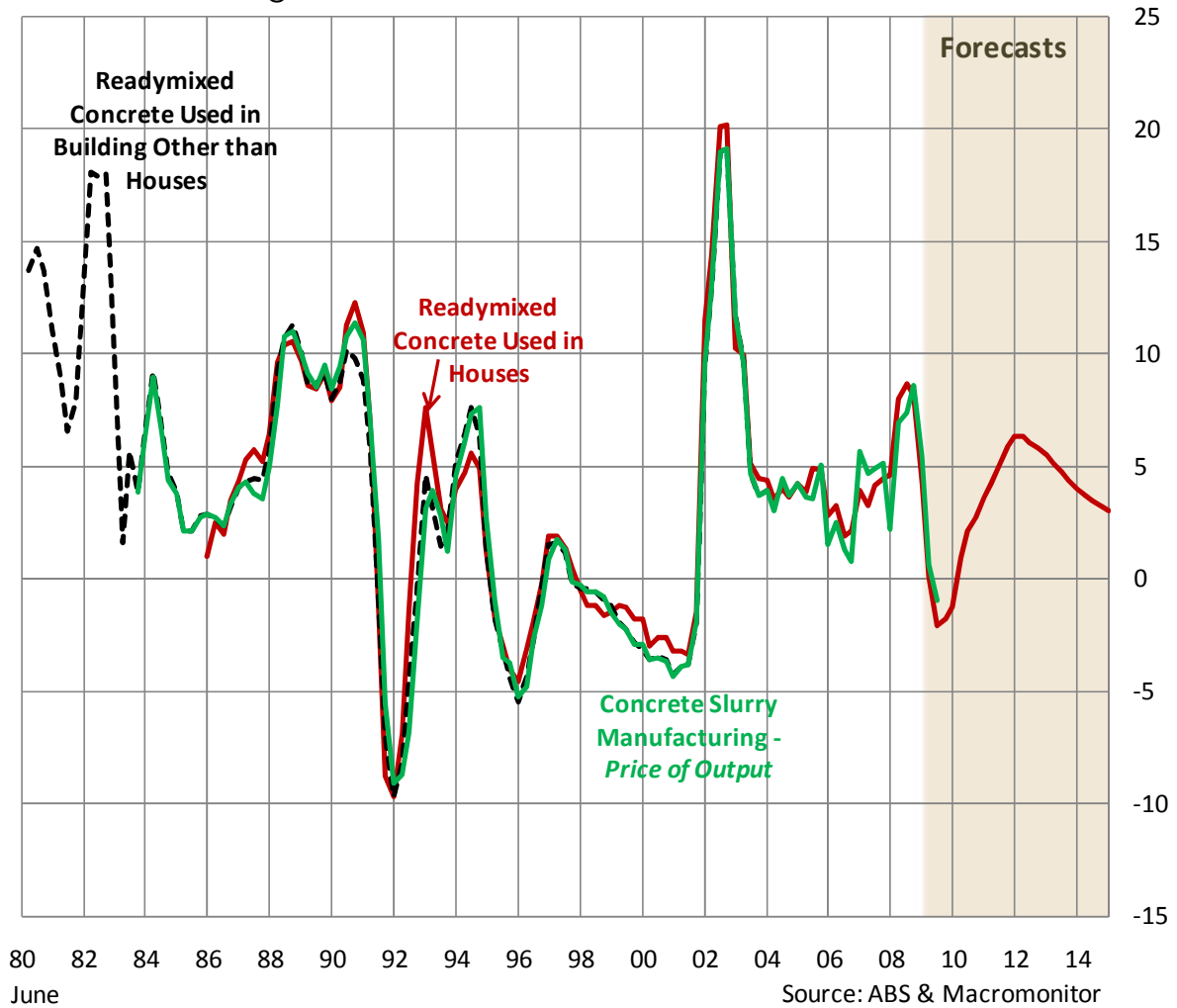


Table 1
Readymixed Concrete Price Index

Index: 1989/90=100

	Readymixed Concrete Used in Houses	Annual % Change	Readymixed Concrete Used in Building Other Than Houses	Annual % Change	Concrete Slurry Manufacturing - Price of Output	Annual % Change
1990	102.2		102.3		102.6	
1991	113.4	11.0	111.3	8.8	113.5	10.6
1992	102.4	-9.7	100.5	-9.7	103.2	-9.1
1993	110.2	7.6	105.1	4.6	106.4	3.1
1994	114.6	4.0	110.6	5.2	111.3	4.6
1995	116.0	1.2	112.0	1.3	114.3	2.7
1996	110.7	-4.6	105.9	-5.4	108.3	-5.2
1997	112.8	1.9	107.5	1.5	109.2	0.8
1998	112.2	-0.5	107.0	-0.5	108.9	-0.3
1999	110.5	-1.5	105.7	-1.2	107.3	-1.5
2000	108.5	-1.8	102.4	-3.1	104.2	-2.9
2001	105.0	-3.2	98.0	-4.3	99.7	-4.3
2002	117.1	11.5	107.4	9.6	109.3	9.6
2003	129.1	10.2	120.0	11.7	122.1	11.7
2004	134.8	4.4	124.7	3.9	126.9	3.9
2005	140.5	4.2	<i>n.a.</i>		132.3	4.3
2006	144.4	2.8	<i>n.a.</i>		134.3	1.5
2007	150.1	3.9	<i>n.a.</i>		141.9	5.7
2008	157.0	4.6	<i>n.a.</i>		145.0	2.2
2009	163.7	4.3	<i>n.a.</i>		152.9	5.4
Forecast						
2010	161.7	-1.2	<i>n.f.</i>		<i>n.f.</i>	
2011	167.6	3.6	<i>n.f.</i>		<i>n.f.</i>	
2012	178.2	6.3	<i>n.f.</i>		<i>n.f.</i>	
2013	188.0	5.5	<i>n.f.</i>		<i>n.f.</i>	
2014	195.5	4.0	<i>n.f.</i>		<i>n.f.</i>	
2015	201.4	3.0	<i>n.f.</i>		<i>n.f.</i>	
Average Annual Growth Rates						
1999-2004	4.1		3.4		3.4	
2004-2009	4.0		<i>n.a.</i>		3.8	
Forecasts						
2009-2015	3.5		<i>n.f.</i>		<i>n.f.</i>	

n.a. Not available

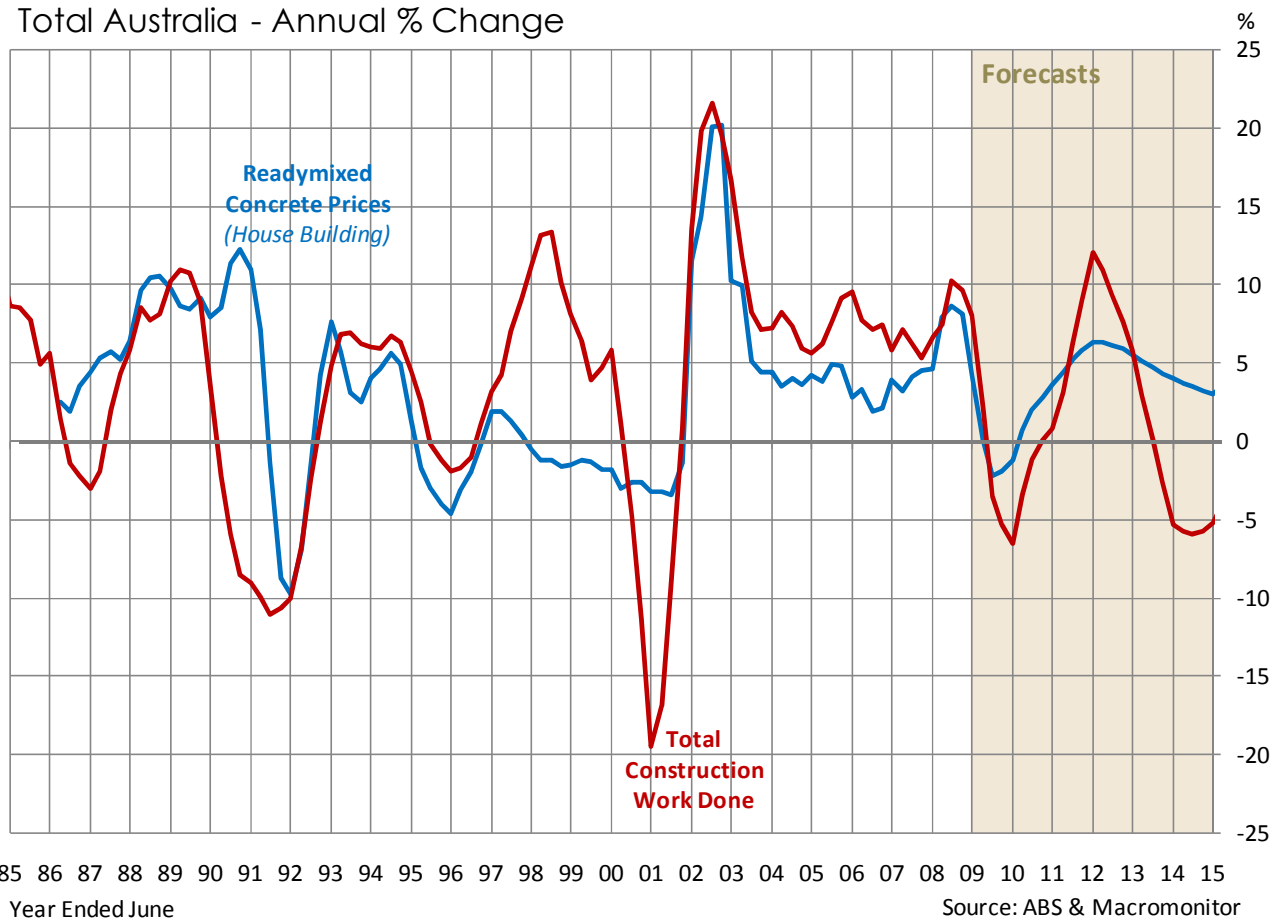
n.f. Not Forecast

Source: ABS & Macromonitor

Table 2 on the following page contains historical data and our forecasts of readymixed concrete costs. This table contains data from the series: *Price Indexes of Materials Used in House Building – Readymixed Concrete*, but any of the three series could be used, because their movements are so similar over time.

The determinants of concrete prices are a combination of trends in cost inputs (prices of cement, other raw materials, fuel and labour) and trends in the demand for concrete. Demand for concrete, in turn, is driven by cycles in construction activity. Chart 3 below illustrates the relationship which often exists between changes in the volume of construction activity and changes in the price of concrete.

Chart 3
Concrete Costs and Construction Work Done
 Total Australia - Annual % Change



The Construction Work Done historical figures in the above table are sourced from the Australian Bureau of Statistics (ABS On-Line Data Series, Catalogue number 8782.0.65.001 'Construction Activity: Chain Volume Measures, Australia'). The forecasts are sourced from Macromonitor's regularly updated reports on the outlook for Australia's construction sector (i.e. these forecasts are not prepared specifically for the purpose of this report and can be found the reports which comprise Macromonitor's 'Australian Construction Outlook' series).

Table 2
Readymixed Concrete Price Index

	Index As At June	
	89/90=100	Ann. % Ch
1990	102.2	
1991	113.4	11.0
1992	102.4	-9.7
1993	110.2	7.6
1994	114.6	4.0
1995	116.0	1.2
1996	110.7	-4.6
1997	112.8	1.9
1998	112.2	-0.5
1999	110.5	-1.5
2000	108.5	-1.8
2001	105.0	-3.2
2002	117.1	11.5
2003	129.1	10.2
2004	134.8	4.4
2005	140.5	4.2
2006	144.4	2.8
2007	150.1	3.9
2008	157.0	4.6
2009	163.7	4.3
Forecasts		
2010	161.7	-1.2
2011	167.6	3.6
2012	178.2	6.3
2013	188.0	5.5
2014	195.5	4.0
2015	201.4	3.0
Average Annual Growth Rates		
1999-2004	4.1	
2004-2009	4.0	
Forecasts		
2009-2015	3.5	

Source: ABS & Macromonitor

The forecast relationship between concrete prices and construction work done reflects both the historical statistical relationship between these indices and Macromonitor's expert understanding of future developments in the construction and concrete sectors of the economy. That is, the forecasts are not a crude simplistic extrapolation from past statistical correlations.

Concrete prices are currently experiencing slight falls, following a number of years of quite strong growth, as a result of falls in building and construction activity. The global financial crisis, and associated lack of financing availability in Australia, has triggered a sharp downturn in many parts of the building and construction sector. Concrete prices have responded, with a lag, by starting to edge down.

Major concrete suppliers announced two sets of price increases in 2008; one price increase effective from around the August to November 2008 period and the other effective from April 2009. The first of these announced increases was of a magnitude of around 8% on average while the second was around 5% to 6%. That amounts to a total planned increase through 2008 and 2009 of around 13% to 14%.

These announced increases however, have been ignored by suppliers, as adjustments are made to the weak state of product demand. Prices are now actually being cut rather than increased.

In past construction sector downturns we have seen significant price discounting by suppliers, which is observable in the negative growth in prices during 1992, 1996 and 2001. This time around however, we are not expecting quite the same degree of downward pressure on prices. However, we do expect to see negative growth in prices during 2009 and 2010.

Data for the March, June and September quarters of 2009 show national readymixed concrete prices in decline, by a total of close to 2%. We expect a total decline in readymixed concrete prices of 2.2% during calendar 2009 (December 2009 over December 2008).

In the short term, the combination of falling input costs and a weaker construction sector is expected to continue to drive down the rate of concrete price growth. We are forecasting a decline in national readymixed concrete prices of 1.2% in 2009/10 (as shown in Table 2).

Beyond 2009/10, we expect a return to positive rates of price growth, reflecting a tentative upturn in construction sector activity, led by house building. We are forecasting average annual growth in national concrete prices of 4.5% over the five years from 2009/10 to 2014/15 inclusive.