National Australia Bank

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Quarterly Business Survey — September quarter 2013

Businesses become more confident in the September quarter. This fundamentally appears to be driven by political factors – albeit the lower AUD and rates, together with stronger asset markets would have helped. But these factors have not yet boosted business conditions, which tracked lower to the weakest level in four years. Forward indicators remain subdued. Capex expectations also weak, especially in mining. Prices growth implies soft underlying inflation in Q3.

- Business confidence lifted to its highest level in two years, despite business conditions slipping into even deeper negative territory in the September quarter.
- Better sentiment was felt across most industries and states. Fundamentally, it appears to reflect a reaction to the political change associated with the federal election in September. Better Chinese data may have also helped trade-exposed firms. Also helping are lower rates and the currency. However, a special question shows that the lower AUD is squeezing wholesale and retail margins (see p4).
- Business conditions deteriorated to their lowest level in more than four years. The Survey points to six-month annualised GDP growth in the September quarter of around 2¾% (ie. below trend). While forward orders and capacity utilisation lifted a little in the quarter, they remain at subdued levels, and combined with even weaker employment conditions and stocks, suggest little improvement in near-term demand.
- At the industry level, business conditions weakened to a 14½ year low in mining. Weak conditions were also sustained in manufacturing, retail, wholesale, transport & utilities and construction. Personal services continued to outperform all other industries, while property services also performed strongly, possibly helped by better housing market activity. Conditions were especially weak in WA, Queensland and SA, where the mining slowdown continues to gain momentum.
- Business investment intentions (next 12 months) weakened marginally, pointing to only investment modest growth over the year ahead. Near and longer term employment expectations also remain soft, consistent with NAB's view for rising unemployment over the next year. Lack of demand is expected to be the largest constraint on profitability (next 12 months) while tax & government policy remain important.
- Product prices inflation lifted a touch in the quarter, recording annualised inflation of just 0.4% (0.1% in the quarter), after no growth in prices in the first half of 2013. Retail price inflation was a touch stronger in the quarter, but still suggests little upside to Q3 underlying CPI. Labour and purchase costs growth remain modest, and when combined with soft price inflation, resulted in increased pressure on margins.

Implications for NAB forecasts:

- No change to latest Global and Australian Forecasts (released 8 October).

Key quarterly business statistics**

	2013q1	2013q2	**2013q3**		2013q1	2013q2	**2013q3**
		Net balance				*Net balance*	
Business confidence	2	-1	**3**	Trading	-2	-5	**-5**
Business conditions				Profitability	-7	-7	**-8**
Current	-4	-6	**-7**	Employment	-4	-6	**-8**
Next 3 months	5	2	**1**	Forward orders	-9	-7	**-5**
Next 12 months	17	13	**16**	Stocks	-3	-1	**-3**
Capex plans (next 12)	13	15	**14**	Exports	-1	-3	**0**
		% change				*% change*	
Labour costs	0.5	0.5	**0.3**	Retail prices	0.0	0.0	**0.2**
Purchase costs	0.4	0.3	**0.5**			*Per cent*	
Final products prices	0.0	0.0	**0.1**	Capacity utilisation rate	80.4	79.6	**79.8**

** All data seasonally adjusted, except purchase costs and exports. Fieldwork for this Survey was conducted from 26 August to 11 September 2013, covering over 900 firms across the non-farm business sector.

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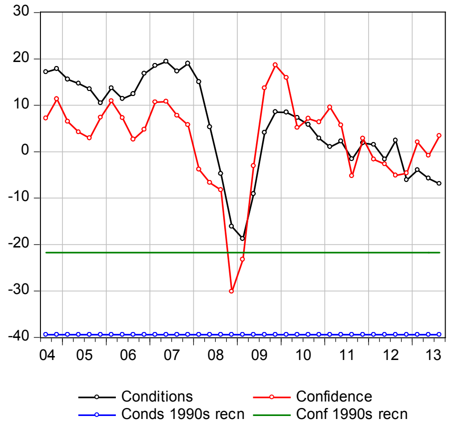
Next release:
12 November 2013 (October Monthly)

Analysis

The business environment remained difficult in Q3, as highlighted by the still poor level of **business conditions**, which edged down from -6 in the June quarter to -7 points. However, businesses became more confident, with the **business confidence** index lifting from -1 point to +3 points. The improvement in business confidence may reflect a number of factors, including the recent improvement in the housing market, the weaker AUD, better consumer sentiment and lower interest rates. Fundamentally, however, it appears to reflect a reaction to the political change, with the survey conducted in the period before and after the Federal election. At +3 points, business confidence is very close to the series long-run average of +4 points since 1989. Confidence readings in the quarterly business survey were broadly consistent with the monthly survey readings, which have shown steady improvement during Q3.

Confidence up but activity still poor



Confidence = excluding normal seasonal changes, how do you expect the business conditions facing your industry in the next 3 months to change?

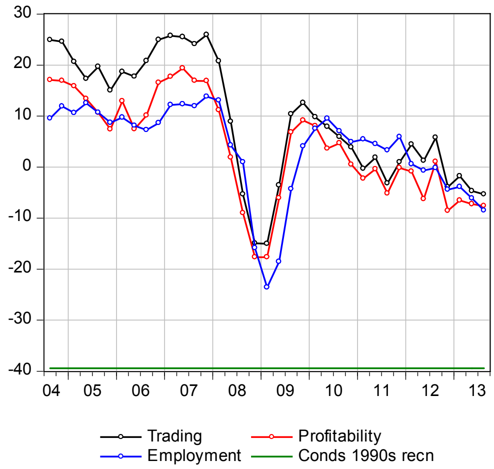
Conditions = average of the indexes of trading conditions, profitability and employment.

The divergence in conditions and confidence measures has widened since the start of this year, suggesting businesses are optimistic but continue to be disappointed by lacklustre conditions. Business conditions, at -7 index points, have been in negative territory for one year, and the quarterly index was close to the average of the range of monthly data.

	Quarterly					*Monthly*				
	2012q3	2012q4	2013q1	2013q2	**2013q3**	2013m05	2013m06	2013m07	2013m08	2013m09
Confidence	-5	-5	2	-1	**3**	0	0	-5	4	12
Conditions	2	-6	-4	-6	**-7**	-5	-8	-7	-7	-4

The slight deterioration in **business conditions** in the September quarter reflected weaker employment conditions and profitability, while trading conditions were unchanged at a relatively low level. The conditions index fell very sharply in transport & utilities – a worrying sign as this sector tends to be a bellwether of demand – while it also weakened significantly in wholesale and mining. There were moderate improvements in activity in manufacturing and recreation & personal services. In levels terms, conditions were weakest in mining – where softening Chinese demand and falling commodity prices appear to be impacting activity – followed by manufacturing, retail, wholesale, transport & utilities and construction, where conditions ranged from -15 to -18 points. The weakness in this last group of industries suggests that lower borrowing costs and a falling AUD are yet to support actual activity.

Activity measures trend lower and remain poor relative to history



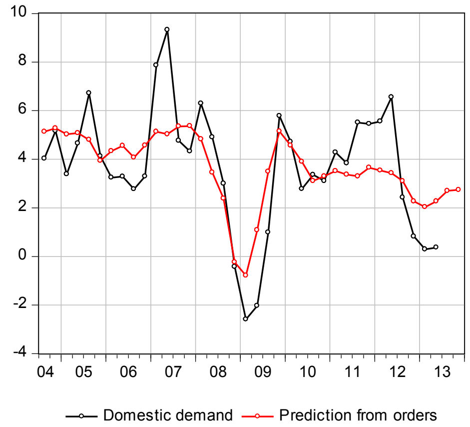
Net balance of respondents who regard last 3 months' trading / profitability / employment performance as good.

	Quarterly					*Monthly*				
	2012q3	2012q4	2013q1	2013q2	**2013q3**	2013m05	2013m06	2013m07	2013m08	2013m09
Trading	6	-4	-2	-5	**-5**	-2	-7	-5	-6	-3
Profitability	1	-9	-7	-7	**-8**	-6	-9	-11	-9	-4
Employment	0	-4	-4	-6	**-8**	-7	-7	-6	-9	-6

Analysis (cont.)

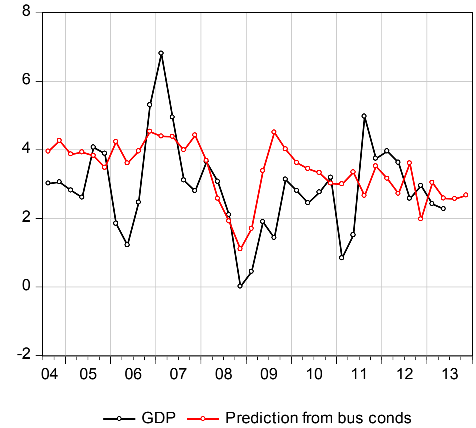
Demand growth to remain soft

Forward orders (change & level) as an indicator of domestic demand (6-monthly annualised)



GDP growth to remain sub-par

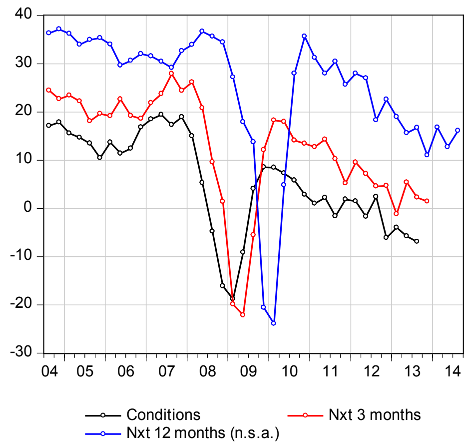
Business conditions (change & level) as an indicator of GDP (6-monthly annualised)



Based on forward orders in Q3, the survey implies that 6-monthly annualised demand growth remained modest at around 2¾% in Q3. If we assume forward orders for Q3 are continued into Q4, the survey implies 6-monthly annualised demand growth will remain close to this level. Similarly, based on business conditions in Q3, the survey implies that 6-monthly annualised GDP growth was a below-trend 2½% in Q3. If Q3 business conditions are maintained into Q4, the implied growth rate would be a marginally higher 2½-2¾%. That is, still below trend.

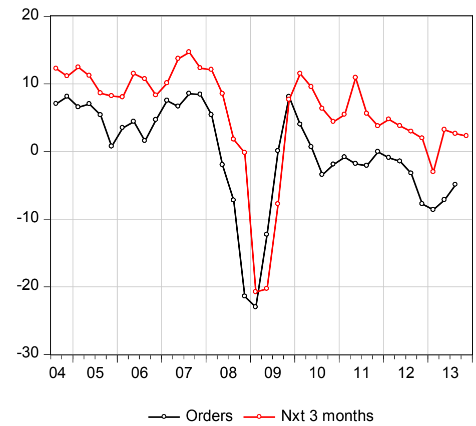
Longer term expectations improve

Business conditions & expectations (net balance)



Orders rising but still very poor

Forward orders & expectations (net balance, s.a.)



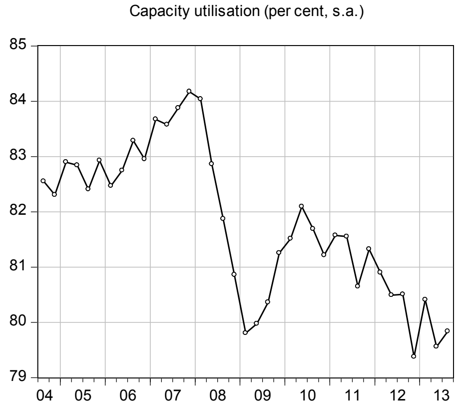
Expectations for conditions over the next three months ticked down, in line with the deterioration in actual conditions. However, longer term expectations (next 12 months) improved. There is a slight definitional difference around expected conditions and confidence; expected conditions refer to expectations around a firms' individual performance, while confidence refers to expectations about the industry in which the firm operates. While near-term confidence has lifted, it appears that firms do not expect activity in their business to lift in the near term. Forward orders were stronger – up 2 points – but at -5 points, the index remained subdued implying little improvement in near-term demand. Near-term expectations for orders softened marginally in the quarter, pointing to little likelihood of a strengthening in activity over the remainder of this year.

	Quarterly [(a)]					*Monthly*				
	2013q2	2013q3	2013q4	2014q2	2014q3	2013m05	2013m06	2013m07	2013m08	2013m09
Conditions	-6	**-7**				-5	-8	-7	-7	-4
Conds. next 3m	5	2	**1**							
Conds. nxt 12m	16	17	11	13	**16**					
Orders	-7	**-5**				-6	-5	-6	-5	1
Orders next 3m	3	3	**2**							

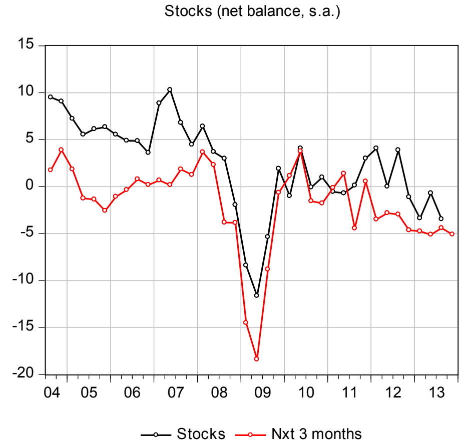
(a) Quarter to which expectation applies. Business conditions next 12 months not seasonally adjusted.

Analysis (cont.)

Plenty of slack in the market



Stocks fall back, consistent with weaker expected trading conditions



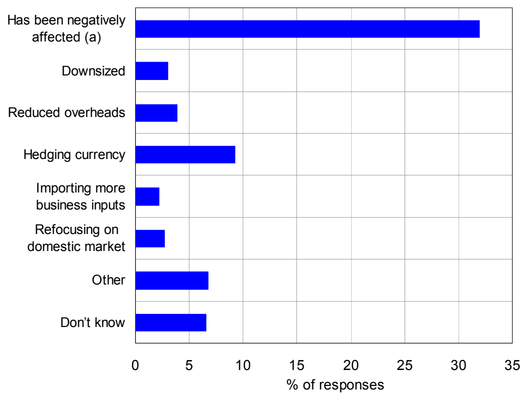
Capacity utilisation improved a touch in the September quarter (up 0.2 ppts), partly unwinding a considerable fall in the June quarter. The current rate, at 79.8%, is 0.8 ppts below the series long-run average, and in line with post-GFC lows. The level of slack in the market implied by the low level of utilised capacity is consistent with the apparent softness in domestic demand. The stocks index fell back in the September quarter, entirely unwinding a pick up in the June quarter; this outcome is consistent with firms positioning their businesses for still soft trading activity in the December quarter. Expectations for stocks (over the next three months) were a little softer and, at -5 points, point to further voluntary de-stocking.

	Quarterly [(a)]					*Monthly*				
	2012q4	2013q1	2013q2	2013q3	**2013q4**	2013m05	2013m06	2013m07	2013m08	2013m09
Capacity utilis.	79.4	80.4	79.6	**79.8**		79.6	79.3	79.9	80.1	80.3
Stocks current	-1	-3	-1	**-3**		-1	-6	-6	-3	4
Stocks next 3m	-5	-5	-5	-4	**-5**					

(a) Quarter to which expectation applies. All data are seasonally adjusted.

AUD hedging a common strategy

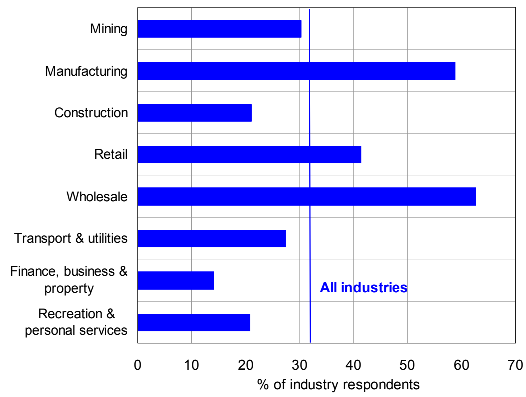
Responses to negative effects of level of Australian dollar



(a) % of respondents. All others are % of responses *Source: NAB*

Wholesale & manuf. most affected

Has been negatively affected by level of Australian dollar

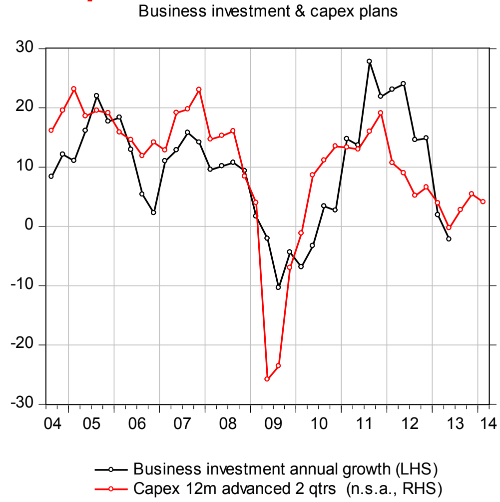


Source: NAB

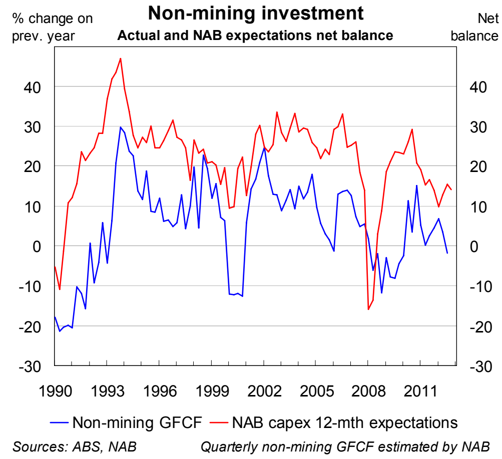
The recent depreciation of the dollar has not been all good news for Australian business. While a weaker dollar has helped raise returns in export markets and blunted some import competition it has also raised input costs for some domestic industries that are in no position to pass them on. Despite the recent depreciation, 32% of non-farm businesses reported an adverse impact from the AUD, with wholesale, manufacturing, retail and mining most affected. Hedging is the most common strategy used by affected firms, especially in wholesale and manufacturing. Downsizing and reducing overheads have also been important responses in mining, manufacturing and wholesale. These results are derived from a special question in the Q3 Survey in collaboration with the Commonwealth Department of Industry. The special question will be included in several future Quarterly surveys (see Business & the Dollar for more details).

Analysis (cont.)

Capex intentions still weak…

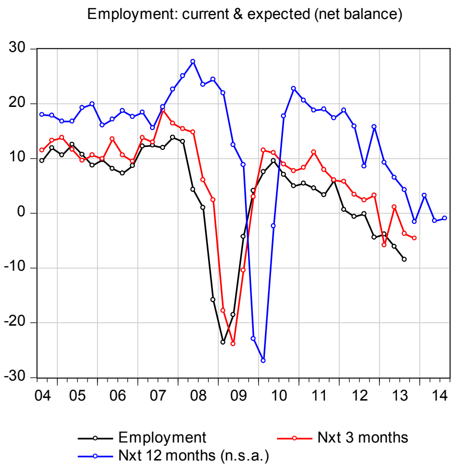


…especially in mining

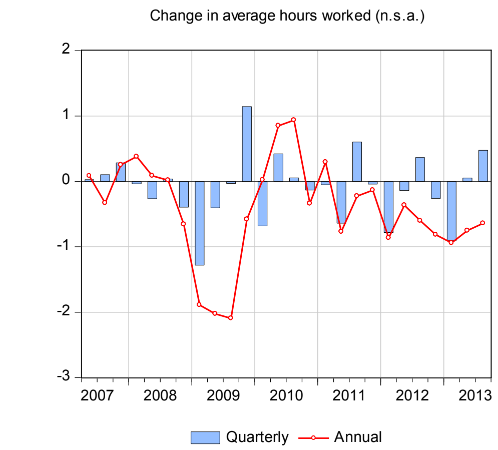


The NAB survey measure of business capital expenditure suggests business investment growth may lift modestly in the next six to 12 months. However, caution should be exercised when interpreting capex data as mining respondents are under represented in our survey, meaning the degree of slowing in mining investment is unlikely to be fully captured. Indeed, the mining capex index remained very poor at -24 points and 12-month-ahead expectations were also poor at -6 points, suggesting no expected strengthening in mining investment. Capex intentions across the non-resources sector generally softened, with retail and recreation & personal services the only exceptions. More broadly, any increase in non-mining investment is unlikely to fully offset the rapid slowing in mining investment over the year ahead.

Near-term employment expectations still poor



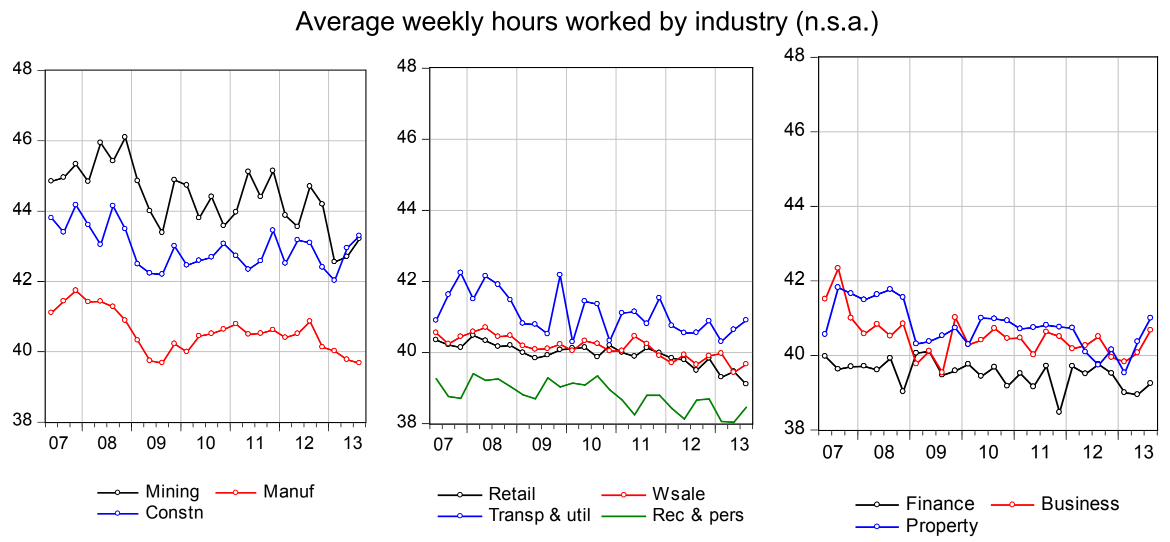
Average hours pick up – employers trading heads for hours?



The employment index continued along its downward path in the September quarter, falling to a four year low of -8 index points and remaining below the long-run average of zero points since 1989. Near-term employment expectations were also weak relative to average expectations throughout the post-GFC period. While official September monthly labour market data suggest improving conditions, part of this is likely to reflect the impact of the election. Other measures of labour activity remain poor. Average hours worked increased notably from 39.7 hours in the June quarter to 39.9 hours in the September quarter, suggesting that employers are trying to reduce costs by having their existing employees work longer hours. By industry, average hours worked were again highest in construction and mining, while they were lowest in recreation & personal services and retail, likely reflecting a greater reliance on casual and part-time workers in these two sector.

Analysis (cont.)

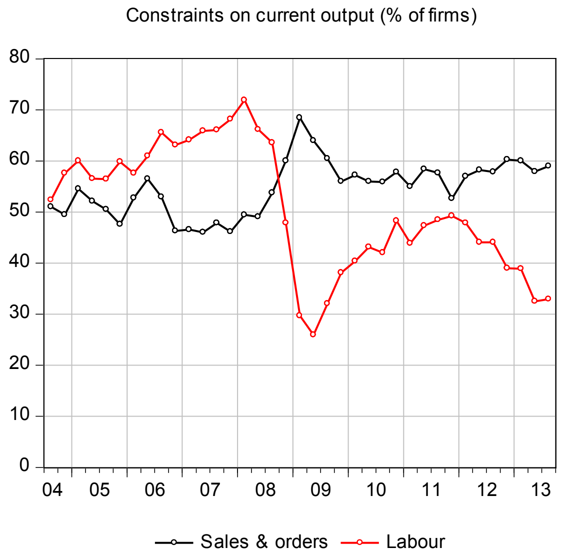
Average hours highest in mining and construction; much lower in recreation & personal services & retail, probably reflecting part-timers

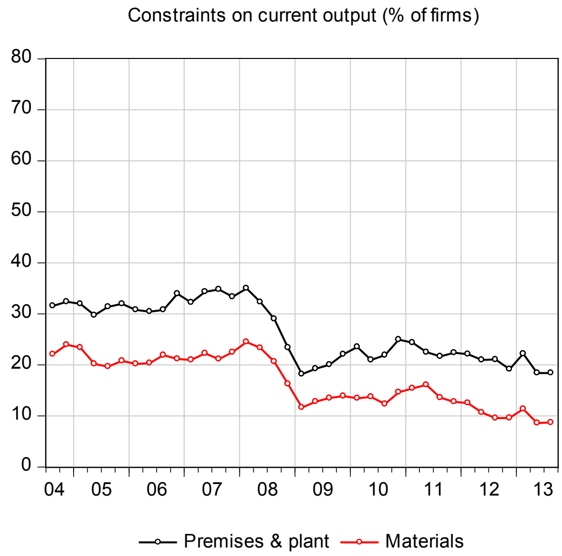


	Quarterly [a]					Monthly				
	2013q2	2013q3	2013q4	2014q2	2014q3	2013m05	2013m06	2013m07	2013m08	2013m09
Empl current	-6	**-8**				-7	-7	-6	-9	-6
Empl next 3m	1	-4	**-5**							
Empl nxt 12m	6	4	-2	-1	**-1**					

(a) Quarter to which expectation applies. Employment conditions next 12 months not seasonally adjusted.

Output much less constrained by labour availability relative to 2 years ago





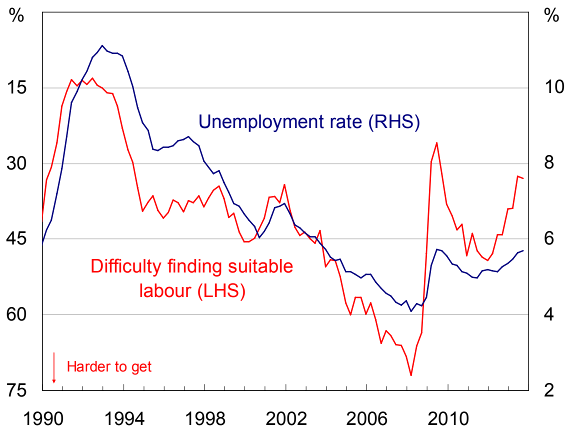
Sales remained the most constraining factor on output in the September quarter, with around 60% of firms reporting lack of sales and orders as their number one constraint. This outcome remains consistent with the poor level of trading conditions and forward orders reported in this survey. The survey continues to showcase the lack of tightness in the labour market, with just one-third of firms reporting difficulty in finding suitable labour as a primary constraint on their business' output. This is much lower than the peak in the lead up to the GFC, where the availability of suitable labour was a concern for more than 70% of firms. Premises & plant and materials continued to be viewed as fairly minor constraints on output in the September quarter. These factors also remain significantly less constraining than they were in the lead up to the GFC, when capacity utilisation was fairly tight (especially compared to the current level).

Analysis (cont.)

The Survey measure of labour as a constraint on output (reversed) has historically moved quite closely with the unemployment rate. Just prior to the GFC in late 2008, over 70 per cent of firms reported that labour was a significant factor constraining output. The unemployment rate rose rapidly following the GFC and, consistent with this, firms were reporting significantly less difficulty finding access to suitable labour (less than 30 per cent of firms reported it as a constraint on output at the end of 2009). After the unemployment rate peaked in late 2009, it became increasingly more difficult for firms to obtain suitable labour in the face of improving labour market conditions and the recommencement of hiring. More recently, the ease of finding suitable labour has improved suggesting labour market conditions are likely to continue to deteriorate.

Labour relatively easy to find; consistent with rising unemployment

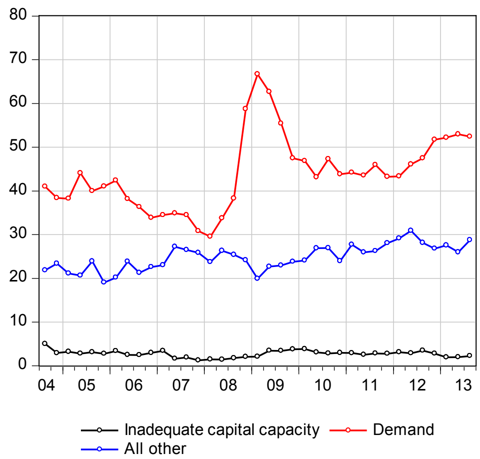
Unemployment rate & labour constraints



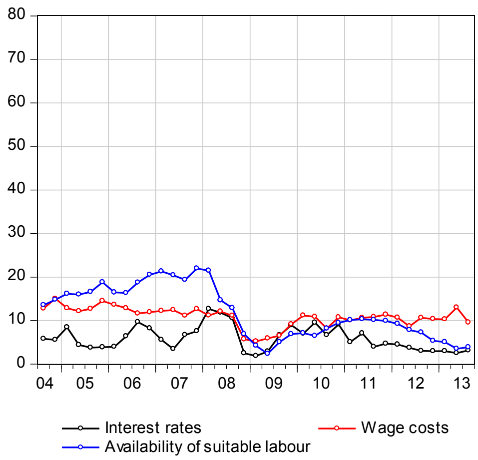
Sources: ABS; NAB

Demand expected to constrain profitability over next year

Main constraint on profitability (% of firms)



Main constraint on profitability (% of firms)



Profitability is expected to be most constrained by a lack of demand over the next 12 months, with over 50% of respondents reporting demand as a major constraint on future profitability. Around 30% of firms also reported 'all other' factors as relatively constraining in the quarter; almost half of this category represented concern about tax & government policy on future profitability, which became more concerning compared to in the previous quarters. A slightly higher proportion of firms (3% in total) also reported the most concern about the exchange rate being too low, while a slightly smaller proportion (2%) were worried about the exchange being too high. Consistent with historically low borrowing rates as well as the relatively low rate of capacity utilisation in the economy at present, respondents view interest rates, inadequate capital capacity and the availability of suitable labour as relatively minor constraints on future profitability. The proportion of firms reporting wage costs as a constraining factor also softened, which is consistent with our expectation for labour market conditions to soften over the year ahead.

Constraints on output (% of firms)*	2012q3	2013q2	2013q3
Sales & orders	60.0	57.9	**59.0**
Labour	38.9	32.5	**32.9**
Premises & plant	22.2	18.4	**18.4**
Materials	11.4	8.6	**8.7**

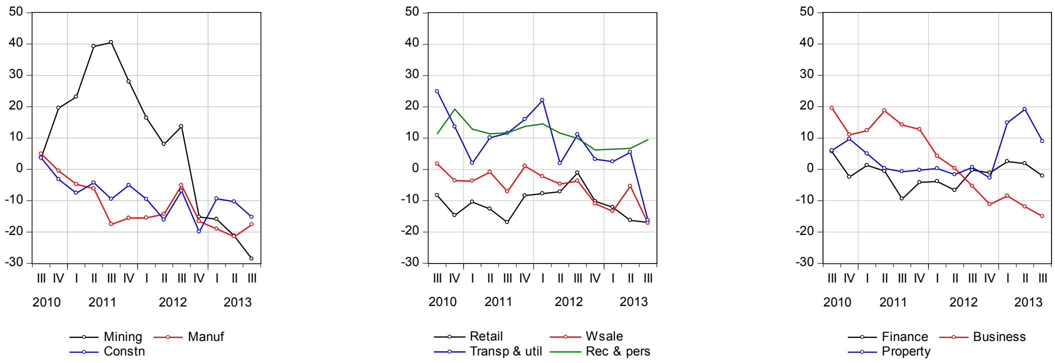
Main constraints on profitability (% of firms)*	2012q3	2013q2	2013q3
Interest rates	3.0	2.5	**3.1**
Wage costs	10.3	13.0	**9.6**
Labour	5.0	3.5	**3.9**
Capital	1.9	2.0	**2.3**
Demand	52.2	53.0	**52.4**
All other	27.5	26.0	**28.7**

** not s.a.*

Industry and state analysis

Business conditions: mining very weak, personal services outperform

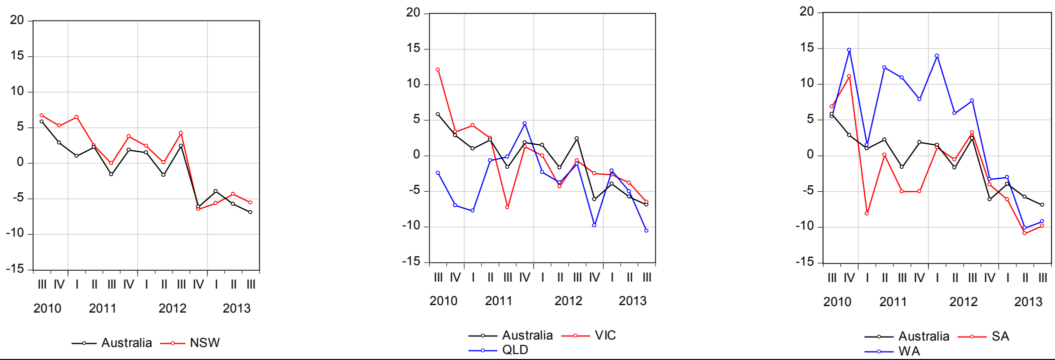
Business conditions (s.a., net balance)



Business conditions weakened across all industries in Q3, except for manufacturing and recreation & personal services, where they improved modestly. Conditions weakened heavily in transport & utilities (down 21) – a bellwether of demand – and wholesale (down 12). Mining business conditions continued to deteriorate (down 8), with the index falling to the lowest level in 14½ years, to be around 70 points below the most recent peak in Q3 2011. The deterioration in mining over recent years has coincided with the slowing in Chinese growth, weighing on commodities prices, as well as the slowing in mining investment. There was marked variation in conditions within finance/ business/ property; activity was strongest in property services, while business services were at the other end of the spectrum reporting very weak activity. Conditions were weakest in mining (-29), followed by manufacturing, retail, wholesale, transport & utilities and construction, all ranging from -15 to -18 points. More favourable conditions were reported in recreation & personal services (+9) and finance/ business/ property (zero).

Business conditions: Very weak in mining states, VIC & NSW holding up

Business conditions (s.a., net balance)

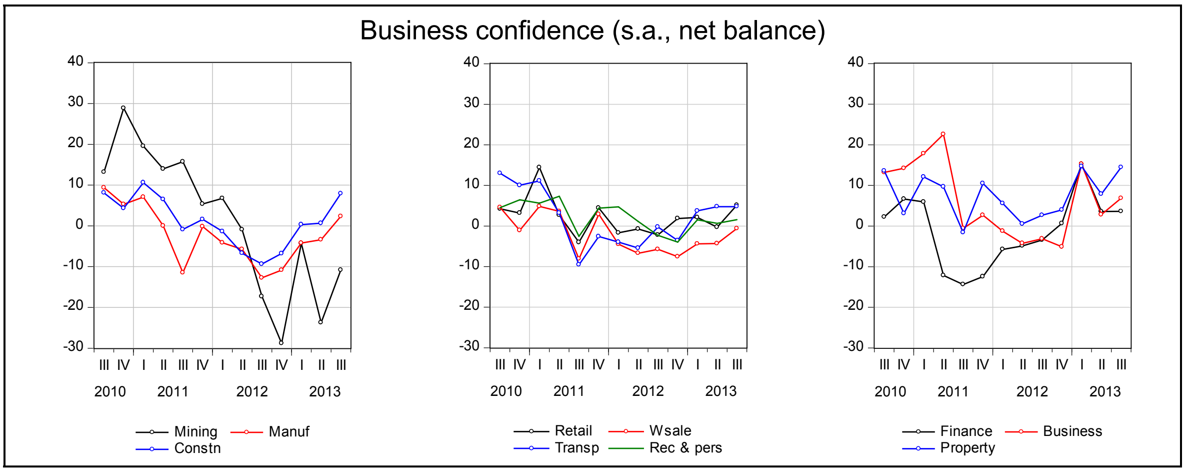


Business conditions weakened notably in Queensland in Q3 (down 6), with this state reporting the weakest activity outcome since the post-GFC trough in Q1 2009. The poor level of conditions in Queensland (-11) is now very similar to levels in SA and WA (-10 and -9 respectively), with businesses in these states likely to have been impacted by the slowing in mining investment activity. Business conditions also softened in Victoria (down 2 to -6 points), and to a lesser extent NSW (also down 2 to -6 points); conditions are holding up better in these states relative to elsewhere, probably helped by their more diversified industry structure and stronger migration. Tasmanian conditions improved (up 5) and, at -5 points, were the least subdued overall.

	Quarterly					*Monthly*				
	2012q3	2012q4	2013q1	2013q2	2013q3	2013m05	2013m06	2013m07	2013m08	2013m09
Business conditions										
NSW	4	-6	-6	-4	**-6**	-2	-7	-8	-9	-9
VIC	-1	-2	-3	-4	**-6**	-3	-11	3	-2	-2
QLD	-1	-10	-2	-5	**-11**	-6	-9	-10	-8	-9
SA	3	-4	-6	-11	**-10**	-14	-4	-13	-9	-6
WA	8	-3	-3	-10	**-9**	-7	-11	-14	-9	11

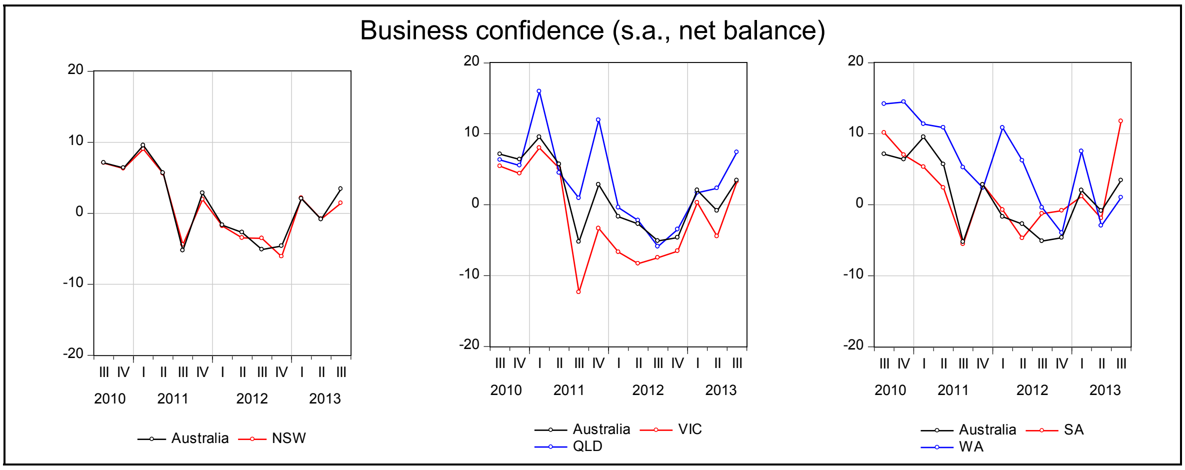
Industry and state analysis (cont.)

Business confidence: mining still poor; property & construction optimistic



Almost all industries were more confident in the September quarter compared to in the previous quarter. Mining became much more confident (index up 13) but the lift in confidence was insufficient to offset an even larger sized fall in the June quarter and, at -11, mining remained the least optimistic industry overall. Nonetheless, this industry may be looking forward to better export volumes towards the end of the year as a result of the lower AUD. Confidence also increased solidly in construction, manufacturing and retail, and was modestly better in finance/ business/ property (reflecting a lift in property and business services) and wholesale, while it was unchanged in transport & utilities. Overall, construction (+8) and finance/ business/ property (+7) were the most confident industries, possibly in response to improving housing market trends.

Business confidence: up everywhere, possibly helped by federal election

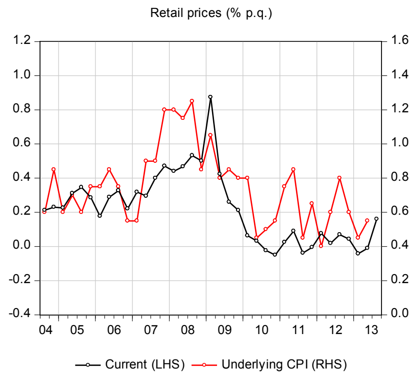


Business confidence strengthened across all mainland states in the September quarter, perhaps suggesting the federal election was received favourably by businesses across all states. SA became the most confident state in the quarter (up 14 to +12 points), while confidence also lifted notably in Victoria (up 7) and Queensland (up 5). Confidence was also a little better in WA (up 4) and NSW (up 2). In levels terms, confidence was highest in SA, followed by Queensland (+7) and Victoria (+3), while it was softest in NSW and WA (both +1). Confidence lifted moderately in Tasmania, where it was a little above the national average (up 5 to +6).

	Quarterly					*Monthly*				
	2012q3	2012q4	2013q1	2013q2	2013q3	2013m05	2013m06	2013m07	2013m08	2013m09
Business confidence										
NSW	-4	-6	2	-1	**1**	-2	-1	-4	3	12
VIC	-7	-7	0	-4	**3**	-5	-4	-5	2	12
QLD	-6	-3	2	2	**7**	4	1	-4	5	9
SA	-1	-1	1	-2	**12**	0	3	-3	9	8
WA	0	-4	8	-3	**1**	-1	-4	-4	-1	16

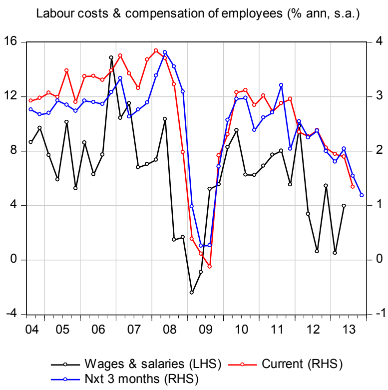
Inflation and costs

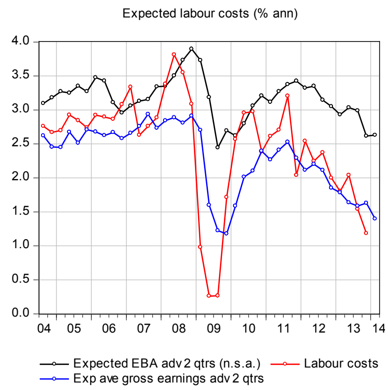
Price growth lifts a touch; little implied upside to Q3 underlying CPI



Consistent with a modest improvement in trading conditions in the September quarter, final product prices growth was a touch firmer, at 0.1% (no growth in the previous two quarters). Prices growth lifted in most industries in the quarter, with the exception of transport & utilities, where it declined marginally, and recreation & personal services and finance/ business/ property, where growth was unchanged from the previous quarter. Prices growth was strongest in recreation & personal services, wholesale (both 0.3% in the quarter), and retail (0.2%), while consistent with softening commodity prices, final product prices fell notably in mining (down 0.9%). Despite the slight up tick in overall prices, labour and purchase costs growth continued to outpace price inflation, causing margins to tighten further; the lower AUD may have placed additional pressure on margins for importing firms. Still subdued price inflation indicated by the survey suggests little upwards pressure on the underlying CPI in the September quarter.

Labour cost pressures remain subdued; consistent with soft labour market





Quarterly annualised **labour costs** growth eased to 1.2% in the quarter, from 1.5% previously, which remains well below the series average of 3.0% since 1989. The relatively subdued pace of growth is consistent with still weak employment conditions, which indicate continued shedding of jobs in the quarter. Given the weakness in domestic demand, wage pressures remain fairly benign, with wage increases under EBAs expected to average just 2.6% over the next year, or 1.7% after allowing for productivity offsets.

On average, businesses expect short-term interest rates to fall by a further 8 bps (after an expected fall of 16 bps in the June quarter). Given that the RBA has lowered the cash rate by a further 25 bps since the September quarter survey was conducted, the expectation for further cash rate cuts suggests that businesses believe the economy requires more support via lower interest rates than they did in the previous survey. Exchange rate expectations (6-months-ahead) fell to US$0.89 in the September quarter, from US$0.95 in the June quarter.

Medium-term inflation expectations remained soft, with 56% of respondents expecting inflation to remain below 3% (down from 57% in the previous quarter) and 37% expecting inflation of 3-4% (was 36%). Only 2% of firms believe inflation is a serious problem (3% previously), while 27% believe it is a minor problem (25% previously).

House prices are expected to rise by 2.4% over the next 12 months, up from 1.4% previously.

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