ACCI–Westpac
Survey of Industrial Trends

Australian Chamber of Commerce and Industry & Westpac Banking Corporation

209th report December quarter 2013 (survey conducted 4 November to 2 December 2013)

- The ACCI–Westpac Survey of Industrial Trends, the longest running business survey in Australia, dating back to 1966, reports that economic conditions in the manufacturing sector improved significantly in the three months to December.
- The Westpac–ACCI Actual Composite rose to 56.2 in the December quarter from 47.8 three months ago. At its current level, the Actual Composite points to moderate growth in the sector; however, we caution that this is only the third expansionary reading in the past two years.
- Arguably, the release of pent-up demand following the election has brought about this noteable improvement in conditions. The weaker Australian dollar and an emerging uptrend in housing investment activity have also been supportive.
- The improvement in the Actual Composite in the December quarter was primarily driven by a sharp increase in the output (from 0% to +20%) and new order (from –4% to +32%) net balances, with flow-on consequences for overtime and employment. On employment, manufacturers look to have put an end to the job shedding that has been a key finding of this survey over the past two years.
- From the responses received for exports, it seems that the majority of the demand impulse has been domestic. Only 8% of all respondents reported an increase in exports in the December quarter, while just 7% expect an improvement in the coming three months. This suggests the still historically-high level of the Australian dollar remains a significant impediment for Australian manufacturers.
- Nonetheless, with the Expected Composite rising to 60.3 in the December quarter, Australian manufacturers clearly anticipate a further improvement in conditions in early 2014 driven by domestic demand. This expectation is likely built upon the jump in business confidence witnessed after the election as well as an improvement in production costs and selling prices.
- Capacity utilisation in the manufacturing sector improved in the December quarter. While the improvement in activity is certainly a step in the right direction, given the degree of uncertainty over the outlook, firms remain reluctant to increase capacity through investment or hiring. Persistent gains for output will arguably be necessary to see a shift in this firmly entrenched attitude towards expansion.

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The Survey of Industrial Trends produced by the Australian Chamber of Commerce and Industry & Westpac Banking Corporation is a quarterly publication.

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Net response or "balance" is calculated by the proportion of "ups" less "downs" on individual questions, thereby yielding the net balance. A positive balance indicates a net upward or improving trend and a minus balance a net downward or deteriorating trend.

The 209th consecutive survey was closed on 2 December 2013. A total of **289** responses were received, and provided a reasonable cross-section of Australian manufacturing in respect of industry groups and size of operation. The next survey will be conducted over February/March 2014.

Key survey results

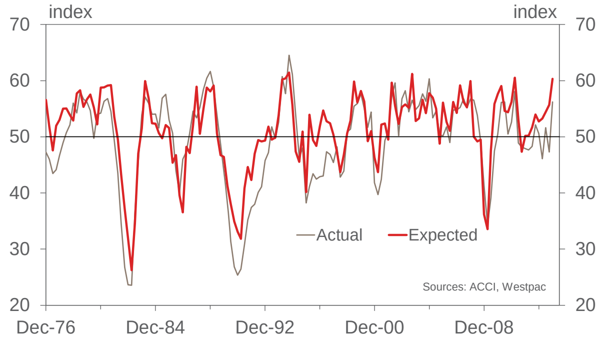
Westpac–ACCI composites, seasonally adjusted

	Q3 2013	Q4 2013
Actual – composite index	47.8	56.2
Expected – composite index	55.8	60.3

- The Westpac–ACCI Actual Composite jumped from 47.8 to 56.2 in the December quarter. A reading above 50 signals expansion in the manufacturing sector.
- Coming on the heels of the September Federal election and the marked decline in the Australian Dollar in mid-2013, a material pick-up in the Westpac–ACCI Actual Composite was to be expected in the current quarter. This improvement is also consistent with the above-50 reading of the Expected Composite three months ago.
- The Expected Composite rose further in the December quarter to 60.3; this points to confidence amongst respondents that the reported improvement will be sustained – despite an absence of domestic momentum.

Westpac-ACCI composite indexes

Actual & expected, sa

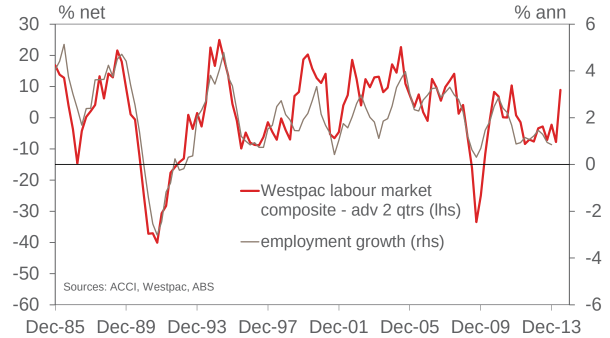


Westpac–ACCI labour market composite

	Q3 2013	Q4 2013
Net balance	–7.8	8.9

- The Labour Market Composite also improved sharply in the December quarter, rising from –7.8 to 8.9. Historically, this indicator has given a reliable guide to economy-wide job creation with a two-quarter lead.
- Prior to the December quarter, the Composite had been pointing to job growth around 1%, implying a continuation of the subdued employment trend seen over the six months to October. The December quarter outcome instead points to a material strengthening in job growth.
- That being said, the report's labour market detail gives cause to doubt that such an improvement will occur. The actual and expected net balances for employment remain marginally below zero, suggesting an end to firing but not significant hiring. Also, while we did see a sharp jump in overtime, respondents expect this to be a one-off.

Jobs growth remains subdued



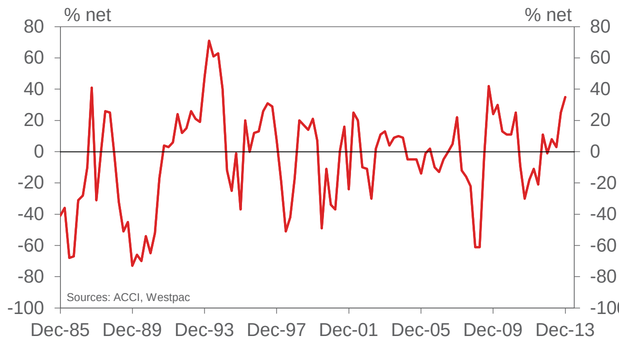
General business situation

	Q3 2013	Q4 2013
Net balance	25	35

- There was a further improvement in respondents' views on the general business environment over the coming six months. A net 35% of firms expect conditions to improve. The greater optimism on display came about primarily due to less respondents being concerned with downside risks – 8% of respondents now expect conditions to deteriorate compared to 19% three months ago.
- As previously discussed, this improvement has likely come about owing to optimism following September's Federal election as well as the maintenance of a much lower Australian dollar after mid-2013's depreciation. Arguably the improvement in house prices and dwelling approvals have also been supportive of confidence.

General business situation

Next six months



Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

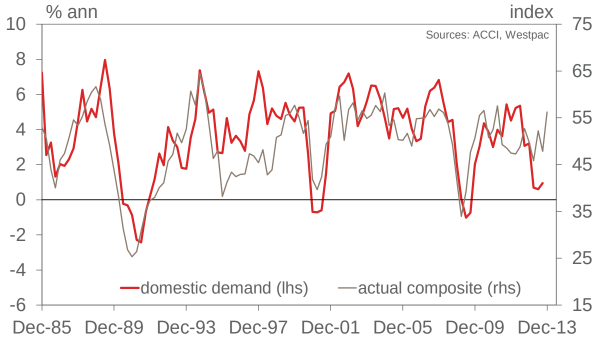
The business cycle & economic outlook

Westpac–ACCI survey & the business cycle

- The Westpac–ACCI Actual Composite has a solid track record of predicting near-term final demand growth, including identifying turning points in the cycle.
- However, over the past two years, the two activity measures have taken different paths as growth in domestic demand became more dependent on mining investment. Following a period of outperformance, domestic demand growth has fallen back to just 0.9%yr, a stark contrast to June quarter 2012's 5.4%yr.
- The Q3 GDP report points to a distinct lack of momentum in the economy as the mining investment boom crests and other sectors remain reticent to invest and spend. In light of this trend, we anticipate conditions in the manufacturing sector and the broader economy will remain subdued through 2014.

Manufacturing & the business cycle

Westpac-ACCI composite index & domestic demand

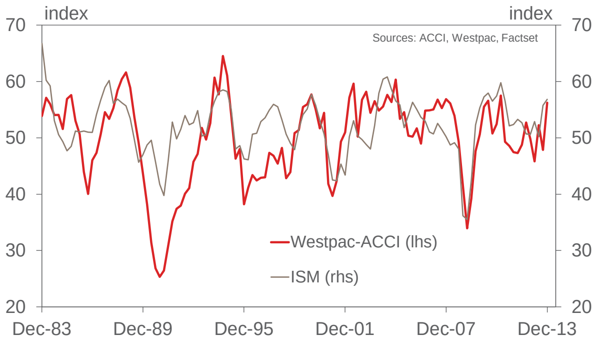


Australian & US manufacturing surveys

- The US and Australian manufacturing cycles have historically been highly synchronised.
- Both indexes rebounded sharply in the second half of 2009, had a choppy 2010, then lost momentum in 2011.
- Through 2013, the ISM has averaged 53.6. Broadly speaking, this points to moderately expansionary conditions in the US manufacturing sector. US end demand growth remains, at best, around trend, but the larger manufacturers surveyed by ISM are arguably benefiting from their global exposure and market position.
- In Australia, the Westpac–ACCI Actual Composite averaged 50.5 through 2013, indicating the sector largely marked time. The high Australian dollar and uncertainty ahead of the election clearly weighed in early 2013; soft momentum in non-mining remains a challenge.

Australian & US manufacturing surveys

Westpac-ACCI & ISM composite indexes

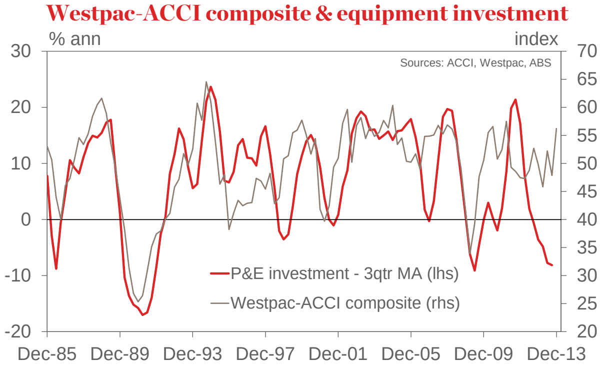


Westpac–ACCI survey & business investment

- Mining's contribution to total business investment has grown significantly in recent years due to the boom in the LNG sector and additional resource expansion projects.
- However, in the year to the September quarter, new machinery and equipment investment declined by 9.7%; contrast this to the 2.4%yr decline to September 2012 and the 29.5%yr gain to September 2011. This deterioration in activity has largely been due to the cresting of the mining boom and associated reductions in spending.
- That being said, there is little in the way of evidence to suggest non-mining sectors will pick up the slack as mining investment activity declines. Specifically, despite improving in the September quarter, CAPEX plans for manufacturing still point to a 10% decline in 2013/14, while a modest 4% rise is anticipated for services.

Activity & capital investment

Westpac-ACCI composite & equipment investment



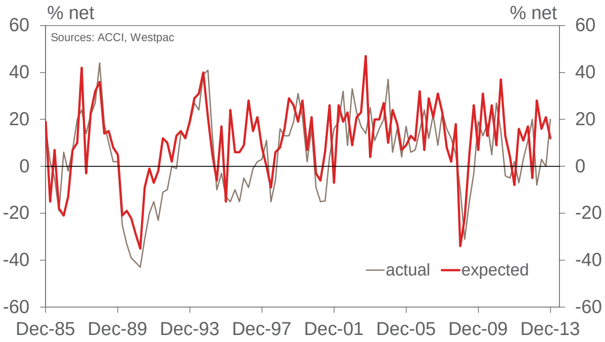
Activity & orders

Output

	Q3 2013	Q4 2013
Actual – net balance	0	20
Expected – net balance	21	12

- Output reportedly surged in the December quarter, with a net 20% of respondents reporting an increase. The improvement from a net balance of 0% in the September quarter came about owing to a 14ppt rise in the number of respondents reporting an increase (38% from 24%). 44% of firms reported no change in the quarter. It it typical for an improvement to be reported in the December quarter, arguably owing to greater demand before year-end.
- Respondents continue to expect a further improvement in the next three months, with a net 12% of respondents anticipating their output will rise. The December result compares to a net balance of 21% three months ago, indicating a more moderate gain is expected hence.

Output growth
Actual & expected

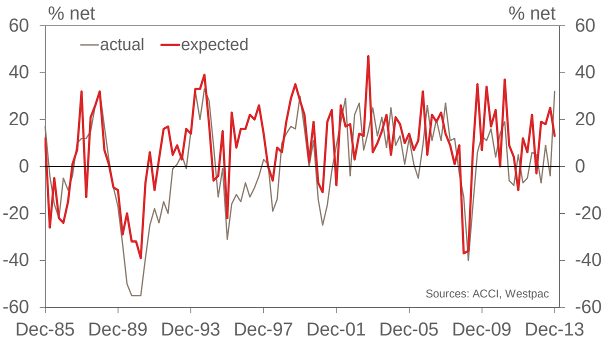


New orders

	Q3 2013	Q4 2013
Actual – net balance	–4	32
Expected – net balance	25	13

- New orders also improved significantly in the December quarter. A net 32% of firms reported that new orders had increased; that compares to a –4% outcome three months ago. In gross terms, twice as many respondents reported an increase in the quarter (45%). As for output, the normal seasonal pattern sees an increase in orders ahead of year-end. It is also likely that we are seeing some pent-up demand from before the election.
- A further increase in orders is expected to be seen in the first three months of 2014. However, a net balance of 13% in the December quarter compared to 25% three months ago indicates this subsequent rise will be of a lesser magnitude. Prospects for orders in 2014 may depend on the Australian dollar and housing market activity.

New orders
Actual & expected

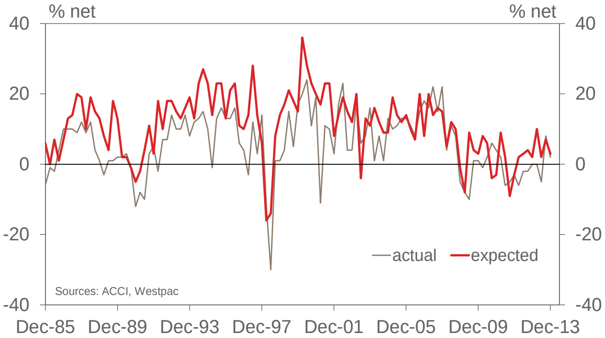


Exports

	Q3 2013	Q4 2013
Actual – net balance	8	2
Expected – net balance	7	3

- Surprisingly, despite the currency remaining near its 2013 lows during the past three months, the number of respondents reporting an increase in export orders fell from 8% to 2% in net terms. This is a surprising result that highlights the still-high level of the Australian dollar and the fickle nature of foreign demand at present.
- Looking forward, the Australian dollar remains a pressing concern. We note that export expectations for the coming three months are also modest, with just 3% of recipients anticipating a rise.

Export deliveries
Actual & expected



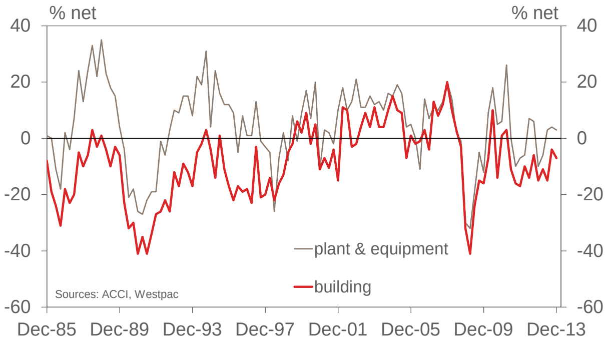
Investment & profitability

Investment intentions

	Q3 2013	Q4 2013
Plant & Equipment – net balance	4	3
Building – net balance	–4	–7

- The plant & equipment investment plans of Australian manufacturers were broadly unchanged in the December quarter: a net 3% reported that they planned to increase expenditure in this area over the coming twelve months compared to 4% three months ago.
- For buildings, there was a modest deterioration in investment intentions: a net 7% of respondents now expect to reduce their spending on buildings over the coming twelve months versus 4% last quarter.
- Despite improved confidence, the latest CAPEX survey also continued to point to a decline in investment activity amongst manufacturers in 2013/14, circa 10%. Buildings will be impacted more than equipment as manufacturers do not see a need to expand capacity.

Investment intentions
Next twelve months

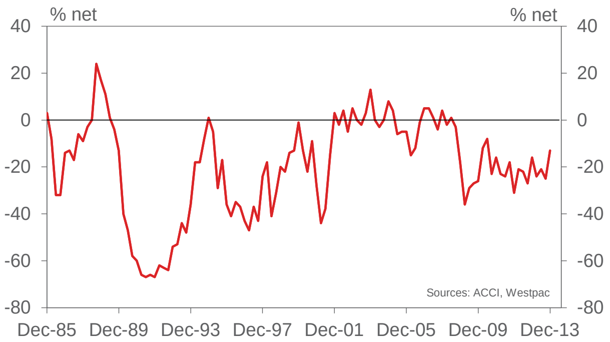


Capacity utilisation

	Q3 2013	Q4 2013
Net balance	–25	–13

- Stronger output and new orders during the past three months saw capacity utilisation improve materially. A net 13% of respondents still reported capacity utilisation as being below average in the December quarter. However, the historic average of this series is around –19%; so capacity utilisation in the sector has arguably been a little above average of late.
- To spark greater investment in the sector, this level of capacity utilisation will have to be bettered not merely sustained. This is because there is a great deal of uncertainty over the outlook; this necessitates a strong justification for capacity expansion.

Capacity utilisation

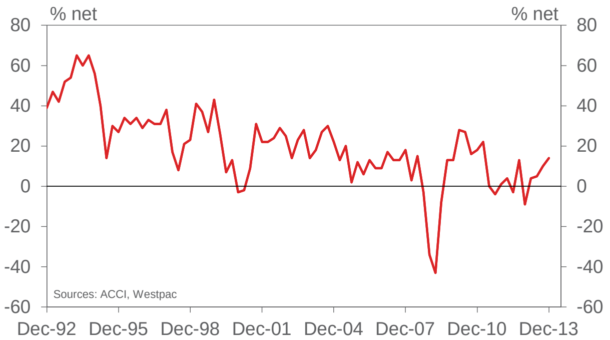


Profit expectations

	Q3 2013	Q4 2013
Net balance	10	14

- For the fourth quarter in a row, we have seen a rise in manufacturers' profit expectations for the coming twelve months. A net 14% of respondents now anticipate their profitability will improve. That being said, it is worth remembering that the historic average for this series is 21%, so profit expectations remain below average.
- There are likely a number of factors at play in this improvement; chief among them is likely to be the weaker Australian dollar – a revenue booster – and more moderate price growth for a key input of production, labour. The uptick in demand has also likely given respondents reason to expect greater pricing power.

Profit expectations
Next twelve months



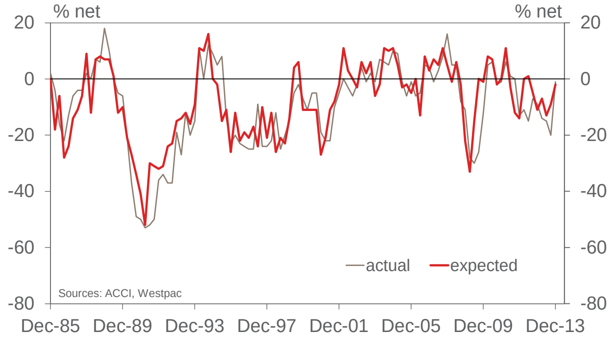
The labour market

Numbers employed

	Q3 2013	Q4 2013
Actual – net balance	–20	–1
Expected – net balance	–9	–2

- The best conclusion to draw from firms' employment responses is that manufacturers look to have halted job shedding. A net 1% of respondents reported reducing their headcount in the past three months compared to 20% in the September quarter. However, only 15% of all respondents reported increasing their headcount in the quarter, pointing to a very subdued pace of hiring.
- Looking forward to the beginning of 2014, only 8% of all respondents expect to increase their staff numbers in the coming quarter. This is little changed from the outcomes of the three proceeding quarters of 6%. There is little expectation that staff numbers will be reduced significantly either, with only 10% reporting plans to fire.

Numbers employed
Actual & expected

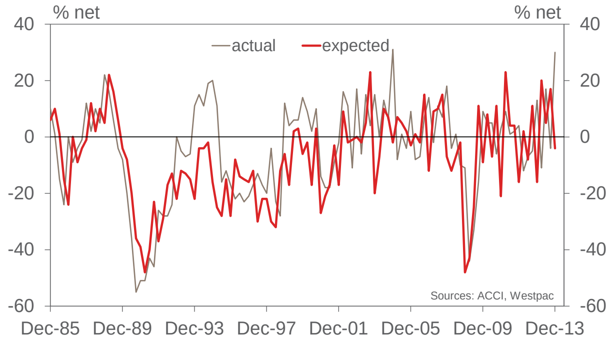


Overtime worked

	Q3 2013	Q4 2013
Actual – net balance	–4	30
Expected – net balance	17	–4

- Actual overtime jumped in the December quarter. A net 30% of respondents reported an increase in overtime. Of all respondents, 44% reported increasing hours.
- The decline in the expected overtime net balance series to –4% (from 17%) in the December quarter alludes to the jump in actual overtime being a seasonal one-off rather than the beginning of an uptrend in labour utilisation.
- Taken together, the employment and overtime series continue to point to manufacturers focusing on efficiency instead of capacity expansion. As for investment, a pronounced, persistent rise in activity would be needed to see a sustained rise in employment and hours worked.

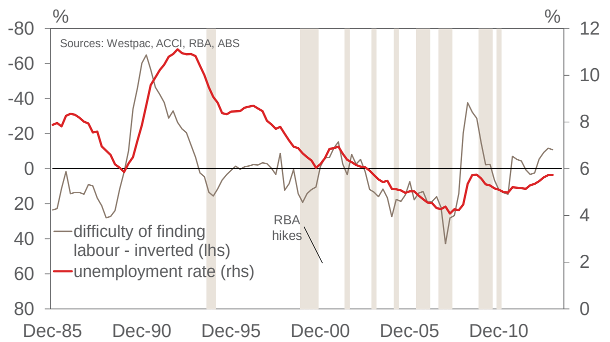
Overtime worked
Actual & expected



Labour market tightness

- The net balance of respondents reporting labour as 'harder to get' rose from –13% to –9% in the December quarter.
- In gross terms, just 2% of respondents reported labour as being harder to get; that is the weakest reading since the wake of the GFC, and is also well below the long-run average of 14%. 87% of firms reported that their ability to access suitable labour was unchanged.
- This result is consistent with the modest uptrend apparent in the unemployment rate over the past year, driven by lacklustre employment growth throughout the economy.
- Westpac–Melbourne Institute unemployment expectations remain some 14% above their long-run average, indicating a further deterioration in unemployment is likely.

Difficulty of finding labour



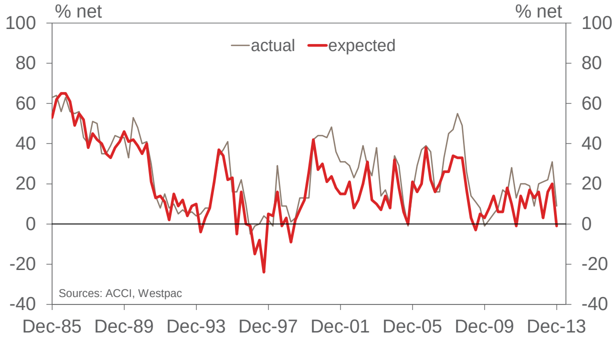
Prices & inflation

Average unit costs

	Q3 2013	Q4 2013
Actual – net balance	31	9
Expected – net balance	20	–1

- Input cost pressures look to have abated somewhat over the past three months, with the net balance declining from 31% three months ago to 9% in December. 21% of all firms reported an increase this quarter, while 67% reported no change.
- Cost pressures are expected to continue to abate as we move into 2014; the net balance fell from 20% to –1% in the December quarter, the first negative reading in a little over two years. Cost pressures have been a persistent burden for Australian manufacturers over the past two years (indeed the past decade); a moderation in these pressures will be of significant benefit to the industry.

Average unit costs
Actual & expected

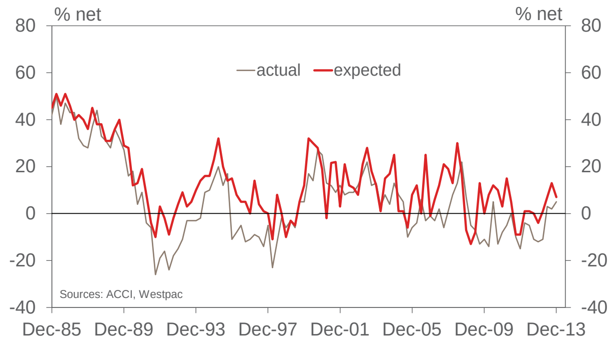


Average selling prices

	Q3 2013	Q4 2013
Actual – net balance	2	5
Expected – net balance	13	7

- On balance, 5% of firms reported being able to increase their selling prices last quarter. This is the third quarter in a row where we have seen an (albeit marginal) improvement in selling prices following four years of persistent price cuts. Australian manufacturers' pricing power remains abnormally weak, with the net balance well below the long-run average of 20%.
- Respondents expect a further (again modest) improvement early in 2014, with a net 7% expecting to increase their selling prices.
- Together with more limited unit cost pressures and more moderate wage growth, higher selling prices will help to improve their profitability and financial health.

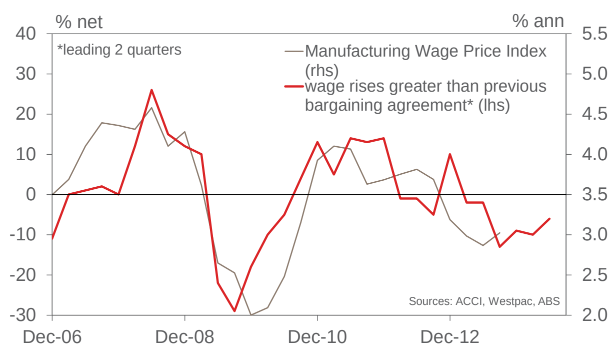
Average selling prices
Actual & expected



Manufacturing wages

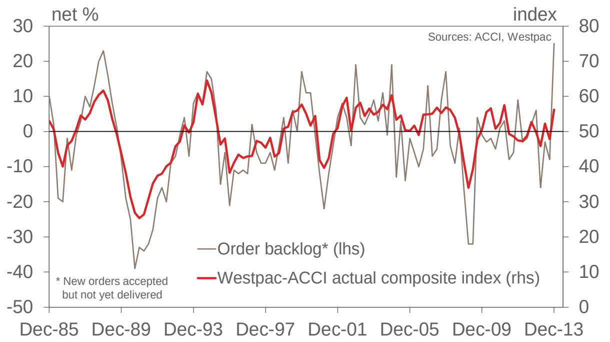
- A net 6% of respondents expect their next wage deal to deliver wage growth below the last. Of all the firms who took part in the survey, only 5% expect a higher rate of wage growth.
- Overall, it is best to characterise the recent trend in this series as being indicative of a moderation in wage growth. On this point, 84% of respondents anticipate no change in the pace of wage growth, with the new agreement to be in line with the last.
- This indicator has a strong track record of predicting the ABS' Wage Price Index measure of manufacturing wages. The outcomes of the past year for our own measure and that of the ABS point to a deceleration in wage growth not a collapse. This would be consistent with ongoing soft labour market conditions.

Manufacturing wage growth pressures



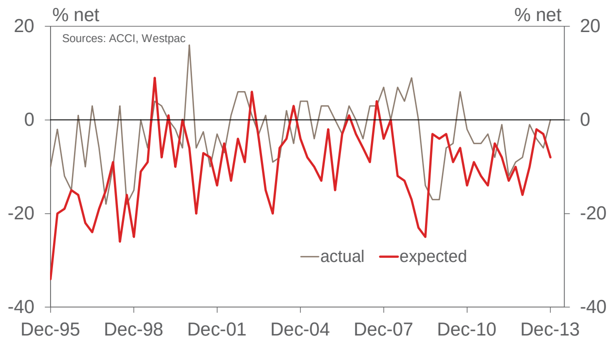
Other results

Order backlog & Actual conditions

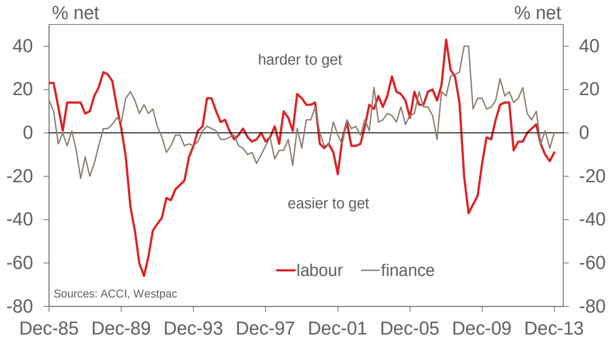


Stocks of finished goods

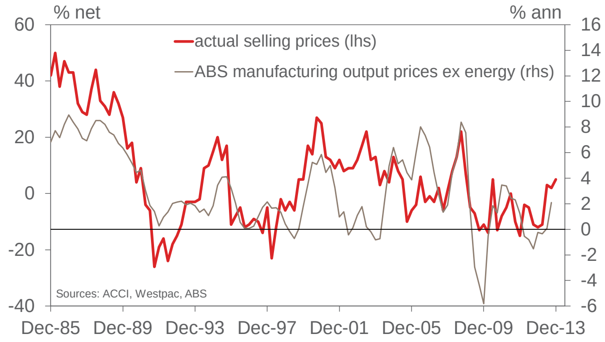
Actual & expected



Availability of labour & finance

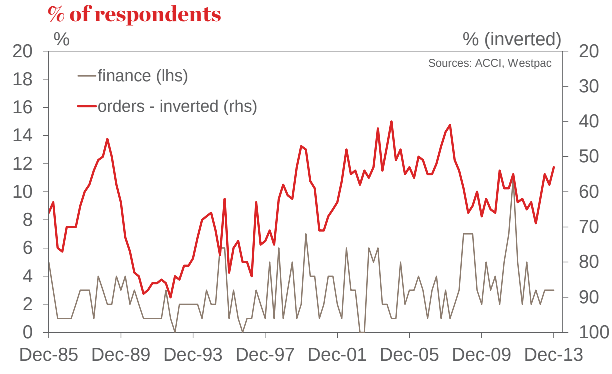


Manufacturing upstream price pressures



Key factor limiting production

% of respondents



Factors limiting production

	Q2 2013	Q3 2013	Q4 2013
Orders (%)	55	58	53
Capacity (%)	9	8	10
Labour (%)	1	2	4
Finance (%)	3	3	3
Materials (%)	1	1	3
None (%)	7	9	9
Other (%)	24	19	18

Summary of results

1. Do you consider that the general business situation in Australia will improve, remain the same, or deteriorate in the next six months?

Net balance	Improve	Same	Deteriorate
35%	43%	49%	8%

2. At what level of capacity utilisation are you working?

Net balance	Above Normal	Normal	Below Normal
–13 %	14%	59%	27%

3. What single factor is most limiting your ability to increase production?

None	9%	Orders	53%
Material	3%	Finance	3%
Labour	4%	Capacity	10%
Other	18%		

4. Do you find it is now harder, easier, or the same as it was three months ago to get:

		Net balance	Harder	Same	Easier
(a)	labour?	–9%	2%	87%	11%
(b)	finance?	0%	4%	92%	4%

5. Do you expect your company's capital expenditure during the next twelve month to be greater, the same, or less than the past year:

		Net balance	Greater	Same	Less
(a)	on buildings?	–7%	11%	71%	18%
(b)	on plant & machinery?	3%	19%	65%	16%

Excluding normal seasonal changes, what has been your company's experience over the past three months & what changes do you expect during the next three months in respect of:

		Change in position in the last 3 months				*Expected change during the next 3 months*			
		Net balance	Improve	Same	Down	Net balance	Improve	Same	Down
6.	Numbers employed	–1%	15%	69%	16%	–2%	8%	82%	10%
7.	Overtime worked	30%	44%	42%	14%	–4%	13%	70%	17%
8.	All new orders received	32%	45%	42%	13%	13%	23%	67%	10%
9.	Orders accepted but not yet delivered	25%	31%	63%	6%	–1%	9%	81%	10%
10.	Output	20%	38%	44%	18%	12%	24%	64%	12%
11.	Average costs per unit of output	9%	21%	67%	12%	–1%	8%	83%	9%
12.	Average selling prices	5%	13%	79%	8%	7%	11%	85%	4%
13.	Export deliveries	2%	8%	86%	6%	3%	7%	89%	4%
14.	Stock of raw materials	6%	16%	74%	10%	–6%	6%	82%	12%
15.	Stocks of finished goods	0%	13%	74%	13%	–8%	8%	76%	16%

Summary of results

16. Over the next twelve months do you expect your firm's profitability to:

(a) Improve?	29%
(b) Remain unchanged?	56%
(c) Decline?	15%
Net balance	14%

17. Do you expect your firm's next wage enterprise deal will produce annual rises which vis-a-vis the previous deal are:

(a) Greater?	5%
(b) Same?	84%
(c) Less?	11%
Net balance	-6%

A. Industry profile of survey:

	(% of respondents)
Food, beverages, tobacco	13
Textiles, fabrics, floor coverings, felt, canvas, rope	4
Clothing, footwear	7
Wood, wood products, furniture	5
Paper, paper products, printing	9
Chemicals, paints, pharmaceuticals, soaps, cosmetics petroleum & coal products	7
Non-metallic mineral products: glass, pottery, cement bricks	5
Basic metal products: processing, smelting, refining, pipes & tubes	3
Fabricated metal products: structural & sheet metal, coating & finishing, wire, springs, hand tools	15
Transport equipment: motor vehicles & parts, excluding repairs, rail, ships, aircraft, including repairs	4
Other machinery & equipment: electrical, industrial scientific, photographic	13
Miscellaneous: including manufacturers of leather, plastic & rubber, sporting equipment, jewellery	15

B. How many employees are covered by this return?

1-100	**101-200**	**201-1000**	**Over 1000**
55%	16%	21%	8%

C. In which state is the main production to which this return relates?

WA	**SA**	**VIC**	**NSW/ACT**	**QLD**	**TAS**
11%	11%	23%	36%	14%	5%

The Westpac-ACCI Composite Indices

The Westpac-ACCI actual and expected composite indices are weighted averages of the various activity measures in the survey. The weights are as follows: employment 20%; new orders 30%; output 25%; orders accepted but not delivered 15%; overtime 10%.

The labour demand indicator is a weighted average of current and expected labour indicators from the Westpac-ACCI survey. The indicator is expressed as a detrended net balance. Approximate weights are as follows: employment 40%; expected employment 20%; overtime 30%; and expected overtime 10%.

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