AUSTRALIAN CHAMBER OF COMMERCE AND INDUSTRY

THE Westpac GROUP

ACCI–Westpac
Survey of Industrial Trends

Australian Chamber of Commerce and Industry & Westpac Banking Corporation

211th report June quarter 2014 (survey conducted 13 May to 9 June 2014)

- The ACCI-Westpac Survey of Industrial Trends, the longest running business survey in Australia, dating from 1966, provides a timely update on the manufacturing sector and insights into economy wide trends.
- The Westpac-ACCI Actual Composite was steady in the June quarter, at 51.0 following 50.9 in March.
- This is the third consecutive reading above 50, the first such run of expansionary readings since 2011. The manufacturing sector is benefitting from a strengthening of consumer spending, an upturn in housing construction and a lift in exports. Output increased a fraction in the quarter, supported by an increase in new orders and a rise in exports.
- Nevertheless, while conditions have improved on a year ago, the strength of this upturn has proven to be relatively modest over the first half of 2014. The overall tone of the June quarter survey is underwhelming. This highlights that while record low interest rates are a significant tailwind for growth, a number of headwinds persist.
- Expectations have been scaled back, with the Expected Composite Index edging below 50, to 49.6, for the first time since September 2011. While expectations for new orders are positive, they have been pared back, with a net 3% of respondents anticipating a rise in orders in the coming three months, down from a net 26% in the March survey.
- Profits are expected to weaken over the year ahead, with a net 4% anticipating a decline, little changed from a net –5% in the March survey. Investment intentions are tentative, with a net 2% expecting to lift plant and equipment spending over the coming year.
- The survey provides some useful insights into the tone of the economy wide labour market. The Labour Market Composite index, while weakening in the June quarter, remains stronger than a year ago and points to a further improvement in economy wide jobs growth, albeit a modest one. In addition, the 'labour market tightness' question suggests that the nation's unemployment rate may have peaked.
- The ACCI-Westpac survey also provides a guide to the outlook for wages growth in the manufacturing sector. The most recent two surveys have been striking, pointing to a deceleration in wages growth on par with the 2009 downturn. This adds to the evidence that incomes in Australia are currently under pressure. Weakness in household incomes is constraining the upturn in household demand, with flow-on effects for the manufacturing sector.

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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 211th consecutive survey was closed on 9 June 2014.
A total of **352** 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 August/September 2014.

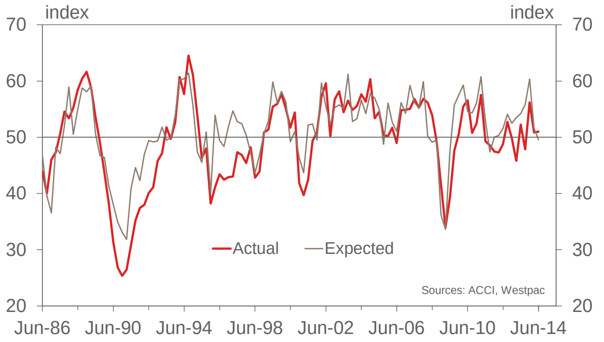
Key survey results

Westpac–ACCI composites, seasonally adjusted

	Q1 2014	Q2 2014
Actual – composite index	50.9	51.0
Expected – composite index	51.6	49.6

- The Westpac-ACCI Actual Composite index was steady in the June quarter, printing at 51.0 following a 50.9 reading in the March quarter.
- This is the third consecutive reading above 50, the first run of consecutive expansionary readings for the manufacturing sector since 2011.
- A strengthening of consumer spending, an upturn in housing construction and a lift in export orders are providing a boost to manufacturing.
- Although, the improvement is relatively modest, as the economy remains constrained by a number of persistent headwinds. Indeed, expectations in the June quarter slipped below 50, the first time since September 2011.

Westpac-ACCI composite indexes
Actual & expected, sa

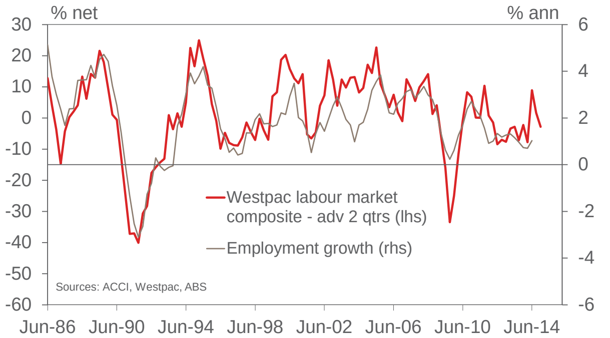


Westpac–ACCI labour market composite

	Q1 2014	Q2 2014
Net balance	1.7	–2.8

- The Labour Market Composite index weakened for a second quarter, following a particularly sharp jump at the end of last year.
- The index declined to –2.8 from 1.7. That is still above readings over the two year period to September 2013, when the index averaged –6.
- The Labour Market Composite has proven itself to be a reliable indicator of total jobs growth across the Australian economy as a whole. This highlights the key linkages between manufacturing and the household sector.
- The index correctly foreshadowed an improvement in jobs growth over recent months, off a weak base. This latest update points to a continuation of this uptrend in jobs in the months ahead, albeit a modest one.

Jobs growth, modest improvement

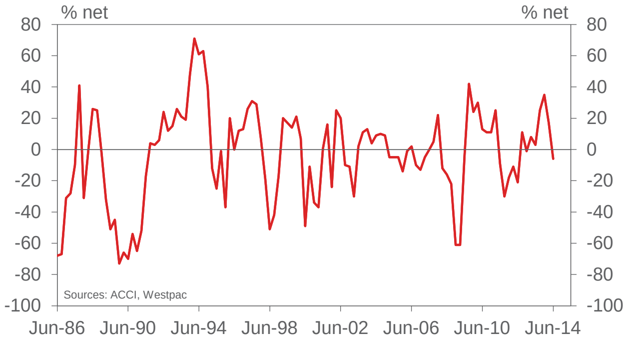


General business situation

	Q1 2014	Q2 2014
Net balance	17	–6

- Respondent's views on the general business environment over the coming six months have deteriorated. The mood has turned from one of optimism to one of mild caution.
- A net 6% of firms expect conditions to weaken. That is a turnaround from a net 17% anticipating a strengthening of conditions. The detail reveals that, relative to the historic norm, it is not that there are more firms with a negative outlook than normal, but rather a lack of firms looking for an improvement.
- It may be that firms are underwhelmed by the extent of the current upturn, which is mild relative to the cycle of 2009/10, and may also be concerned about its durability.

General business situation
Next six months

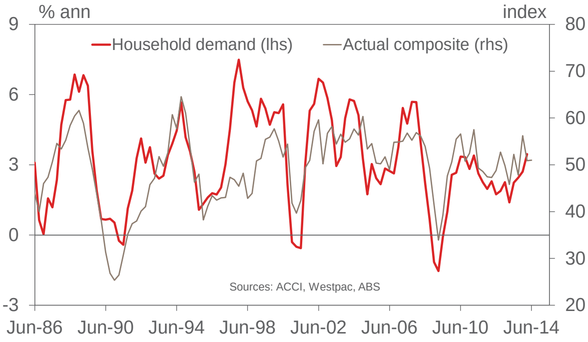


The business cycle & economic outlook

Westpac–ACCI survey & the business cycle

- The Westpac-ACCI Actual Composite has a solid track record of predicting near-term domestic demand growth, including identifying turning points in the cycle.
- In particular, the Composite tracks movements in household demand, highlighting the key linkages between the consumer, housing construction and manufacturing.
- The Q1 GDP report confirmed that overall household demand strengthened over the past year, with annual growth lifting to an around trend 3.5%. There was a burst of housing construction work in the opening months of this year, signalling the start of a strong upswing in 2014. However, official data reports that consumption growth moderated following a solid finish to 2013.

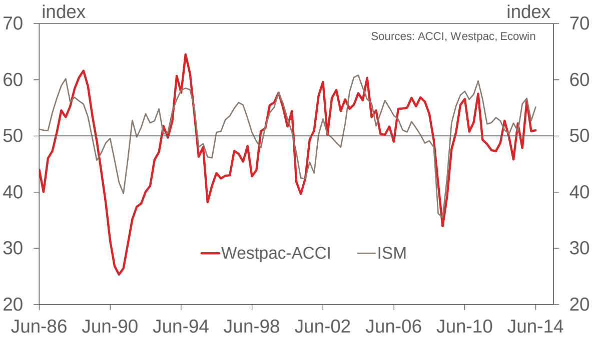
Manufacturing & the business cycle
Westpac-ACCI composite index & household demand



Australian & US manufacturing surveys

- The US and Australian manufacturing cycles have historically been highly synchronised, particularly at major turning points.
- Both the US and Australian manufacturing sectors ended the 2013 year on a relatively positive note. The US ISM averaged 56.7 while the Westpac-ACCI Composite was 56.2 for the quarter.
- In the June quarter 2014, the ISM is so far averaging a tick over 55, a clear notch above conditions here.
- The larger manufacturers surveyed by ISM are benefitting from their global exposure and market position. In Australia, a number of local factors are weighing on the sector, notably: a high currency, which has appreciated against the USD by 5% so far this year; a downturn in mining investment; and a tightening of fiscal policy.

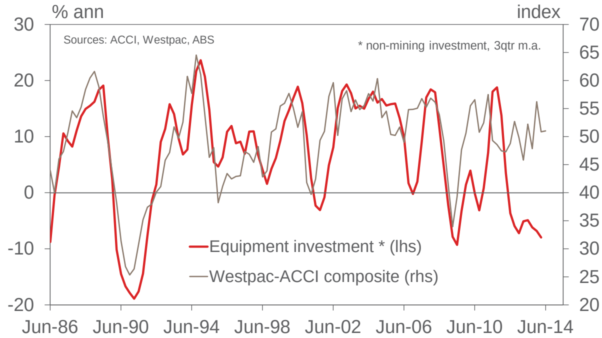
Australian & US manufacturing surveys
Westpac-ACCI & ISM composite indexes



Westpac–ACCI survey & business investment

- The Westpac-ACCI Composite historically has provided a broad guide to equipment investment. However, recently such spending by the non-mining sectors has been much weaker than predicted by the Composite.
- An atypical mix of growth, with consumers taking more of a back seat in recent years; greater than usual uncertainty, domestically and globally; and significant structural change in response to the high Australian dollar have all played a part in weaker investment outcomes.
- Looking ahead, it could be thought that the mildly more positive tone of the survey over the past three quarters offer the prospect of an improvement in investment trends. However, with expectations taking a step back in the June quarter, there may be a near-term reluctance by firms to commit to major new investment expenditure.

Activity & capital investment
Westpac-ACCI composite & equipment investment



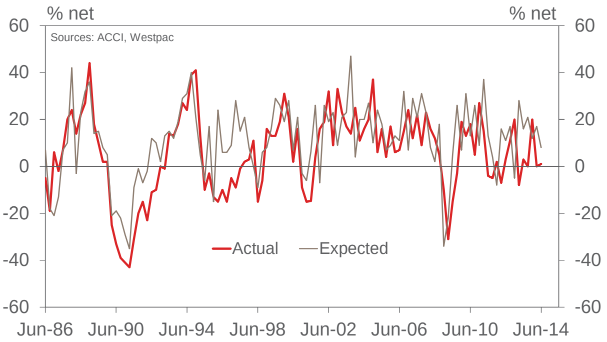
Activity & orders

Output

	Q1 2014	Q2 2014
Actual – net balance	0	1
Expected – net balance	17	8

- In 2014, output has consolidated following a particularly sharp burst in the final quarter of 2013.
- A net balance of 1% of respondents recorded an increase in output in the current quarter. This result, which is in line with the historic average for June quarters, is all but unchanged from a net balance of 0% in the March quarter.
- Expectations have moderated somewhat. A net 8% anticipate a rise in output in the next three months, down from a net 17% in the previous survey. This shift reflects fewer anticipating an improvement, with the number expecting a deterioration unchanged from the previous survey.

Output growth
Actual & expected

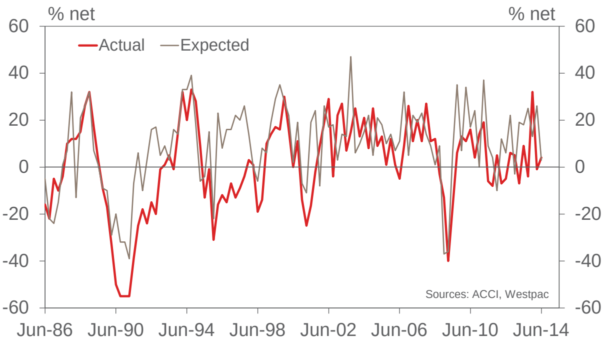


New orders

	Q1 2014	Q2 2014
Actual – net balance	–1	4
Expected – net balance	26	3

- New orders moved ahead in the June quarter, recording a modest improvement.
- A net 4% of respondents reported an increase in orders. That is an uptick from a net –1% in the opening three months of the year. Recall that a consolidation of orders in early 2014 was to be expected, following a +32% reading for the final three months of 2013, the strongest result since 1994.
- Expectations, while still positive, have been pared back. A net 3% anticipate a rise in new orders in the coming three months, down from a net 26% in March. Once again, this reflects fewer anticipating an improvement rather than many more expecting a deterioration.

New orders
Actual & expected

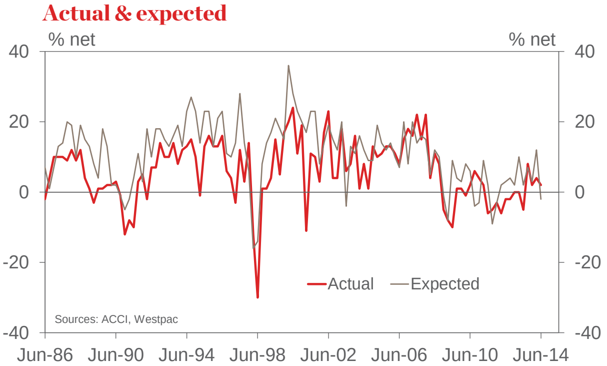


Exports

	Q1 2014	Q2 2014
Actual – net balance	4	2
Expected – net balance	12	–2

- Just as new orders advanced in the June quarter, export deliveries increased in the period. Again, the movement was relatively modest.
- A net 2% of respondents reported a rise in exports, the fourth consecutive positive quarter. Although, the reading is a tick down from a net +4% in the March quarter.
- Once again, expectations have weakened. A net 2% expect exports to decline in the coming three months, the first negative reading since the end of 2011. The Australian dollar has moved higher in recent months, adding to the challenges faced by locally based exporters.

Export deliveries
Actual & expected



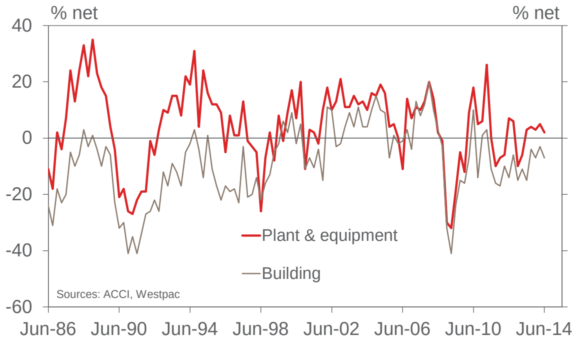
Investment & profitability

Investment intentions

	Q1 2014	Q2 2014
Plant & Equipment – net balance	5	2
Building – net balance	–3	–7

- Respondent's plant and equipment investment plans are positive, but only just. Intentions have softened a little from three months ago.
- A net 2% plan to increase spending on plant and equipment during the next twelve months, down from +5% in March and below the historic average of +5%.
- A net 7% of respondents intend on reducing spending on buildings & structures, representing a slight deterioration on three months ago but still a material improvement from a year ago, when the reading was –15%.
- With firms moderating their expectations in the June quarter, it is not surprising that they are more tentative about their investment plans.

Investment intentions
Next twelve months

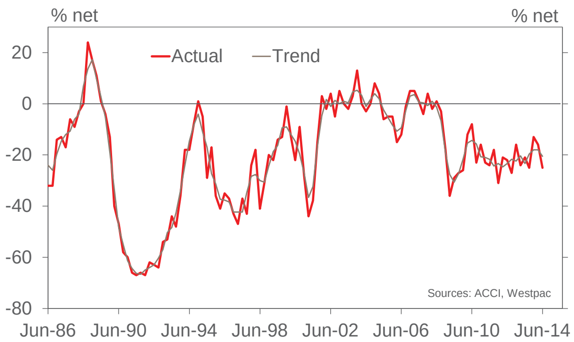


Capacity utilisation

	Q1 2014	Q2 2014
Net balance	–16	–25

- Capacity utilisation levels have taken one step forward, on a flood of new orders in late 2013, and then one step back, with growth in new orders relatively modest so far in 2014.
- A net 25% of respondents reported capacity utilisation as below average, down from –16% in the March quarter.
- The latest update is in line with levels prevailing throughout much of 2013 and is a touch below the average for this series, since the 1990s, of –22%. This recent slippage in capacity utilisation highlights the modest nature, to date, of this upturn.

Capacity utilisation

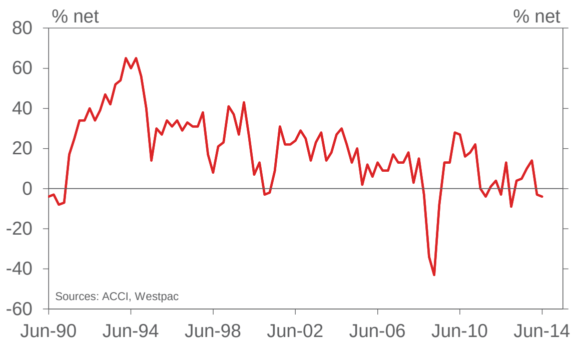


Profit expectations

	Q1 2014	Q2 2014
Net balance	–3	–4

- Profit expectations moved broadly sideways at a mildly negative reading.
- A net 4% of respondents anticipate that their profitability will decline over the coming year. This is a below average reading, with weakness centred on a lack of firms expecting an improvement.
- Concerns that new orders may rise at a relatively modest pace in the period ahead could well be the main factor weighing on profit expectations.
- There is the usual challenge of rising costs, but this factor is no more intense at present than is the norm.

Profit expectations
Next twelve months



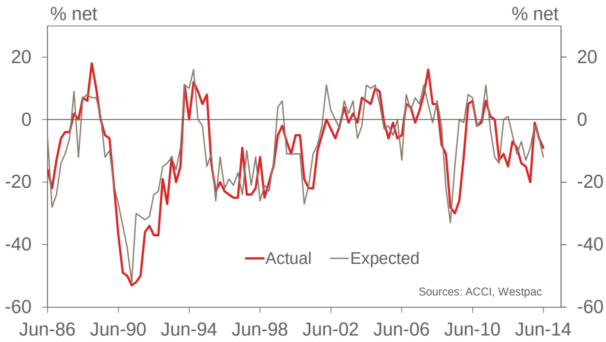
The labour market

Numbers employed

	Q1 2014	Q2 2014
Actual – net balance	–6	–9
Expected – net balance	–6	–12

- A net 9% of respondents reported reducing their headcount in the past three months.
- While that represents a tick down from the start of the year, it still represents a marked improvement from the soggy conditions prevailing throughout much of 2013.
- This profile for actual employment is broadly consistent with recent trends in orders and output - an improvement over the past year is apparent, but the upturn to date has been relatively modest.
- Looking ahead, a net 12% of respondents expect to reduce their staff numbers. This weaker than average reading reflects the cautious mood of firms at present.

Numbers employed
Actual & expected

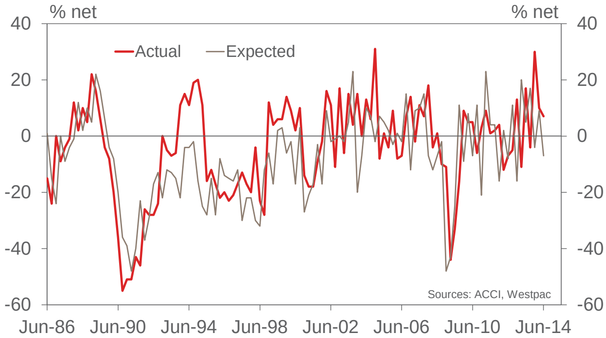


Overtime worked

	Q1 2014	Q2 2014
Actual – net balance	10	7
Expected – net balance	9	–7

- Firms continue to utilise overtime as the swing factor, in the first instance, to respond to variations in new order flows.
- With new orders up in the quarter and export deliveries rising, albeit modestly, overtime increased.
- A net 7% of respondents reported an increase in overtime in the past three months. This was the third consecutive quarter of rising overtime.
- Expectations softened, to be more in line with the historic norm. A net 7% of firms expect to reduce overtime in the coming three months.

Overtime worked
Actual & expected

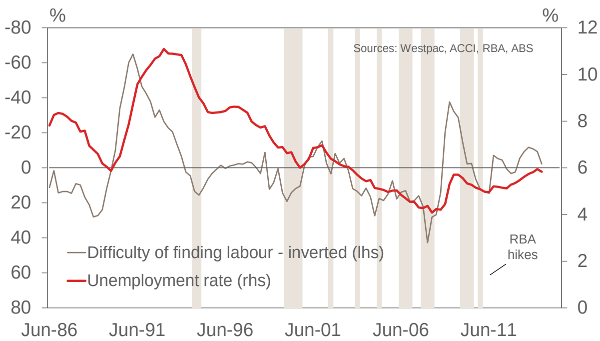


Difficulty of finding labour

	Q1 2014	Q2 2014
Net balance	–9	–2

- The ACCI survey of manufacturing provides insights into the tone of the overall labour market. Respondents' views on the difficulty of finding labour track movements in the unemployment rate for the Australian economy.
- Over the past two quarters, respondents have found labour a little less readily available. A net 2% of respondents reported labour as easier to find, down from 9% last quarter and from over 10% at the end of 2013.
- This suggests the unemployment rate will tick lower in the near term. Consistent with this, the unemployment rate has edged down to 5.8% from 6.0% at the start of 2014.

Labour markets tightness



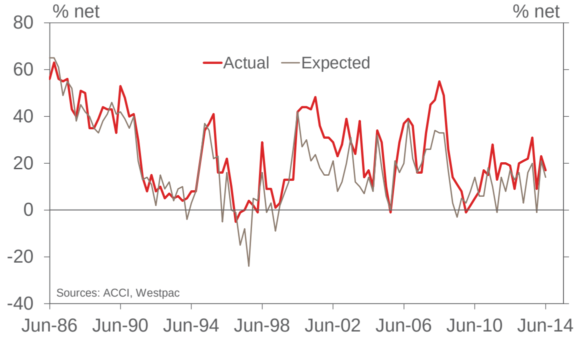
Prices & inflation

Average unit costs

	Q1 2014	Q2 2014
Actual – net balance	23	17
Expected – net balance	21	14

- Input cost pressures eased a little in the June quarter.
- A net 17% of respondents reported a rise in unit costs. This is a moderation from +23% in the March quarter, bringing the reading more into line with the historic norm.
- Imported inputs became cheaper, with the Australian dollar appreciating in the June quarter. The currency rose by 3½% against the US dollar and on a TWI basis.
- In addition, wages growth is subdued
- Expectations around unit costs have eased, to be in line with the historic average, at +14%.

Average unit costs
Actual & expected

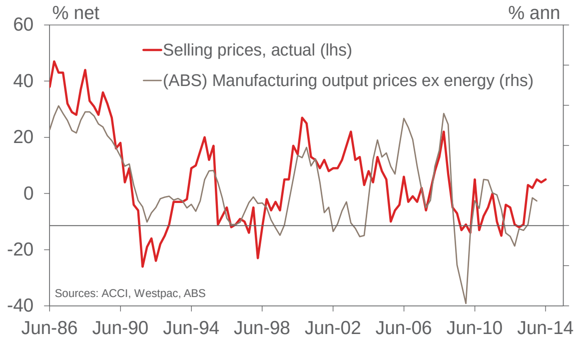


Average selling prices

	Q1 2014	Q2 2014
Actual – net balance	4	5
Expected – net balance	19	4

- Manufacturing selling prices have increased of late, as evident from this survey and from official ABS data.
- A net 5% of respondents reported being able to increase their selling prices last quarter, in line with +4% last period. This is the fifth consecutive quarter of rising prices, albeit only mildly positive.
- In recent quarters, upstream price pressures flowing from a weakening Australian dollar during 2013 were passing through the pricing chain.
- There may also be an element of margin repair, at a time of improved sales. This follows a very difficult four year period, from 2009 to 2013, when selling prices and margins were under considerable pressure.

Manufacturing upstream price pressures

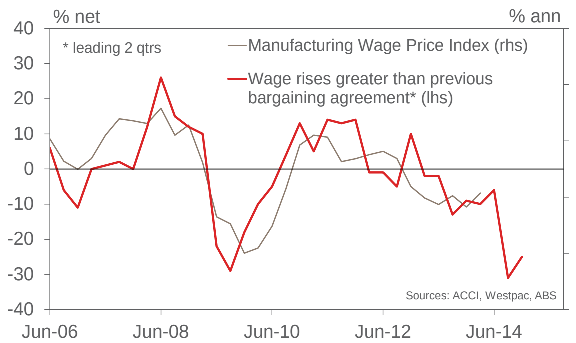


Manufacturing wages

	Q1 2014	Q2 2014
Net balance	–31	–25

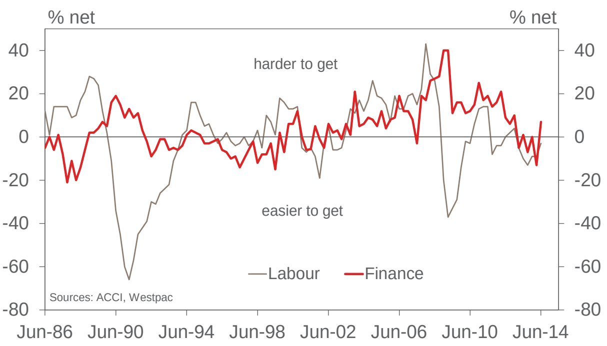
- The survey provides a guide to the outlook for manufacturing sector wages growth. Strikingly, the most recent two surveys point to a deceleration in wages growth on par with the 2009 downturn.
- A net 25% of respondents expect their next wage deal to deliver wage growth below the last, a deterioration from –9% a year ago. The March result of –31% was the weakest in the history of this series, back to 1997.
- Incomes are under pressure in Australia at present as the terms of trade decline, world growth is lacklustre and given the still high currency. Weakness in household incomes is constraining the upturn in household demand, with flow-on effects for the manufacturing sector.

Manufacturing wage growth pressures

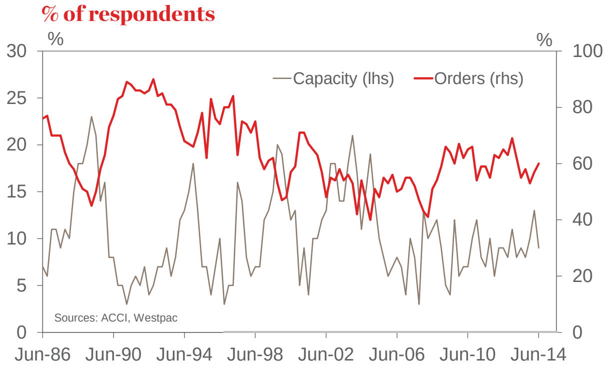


Other results

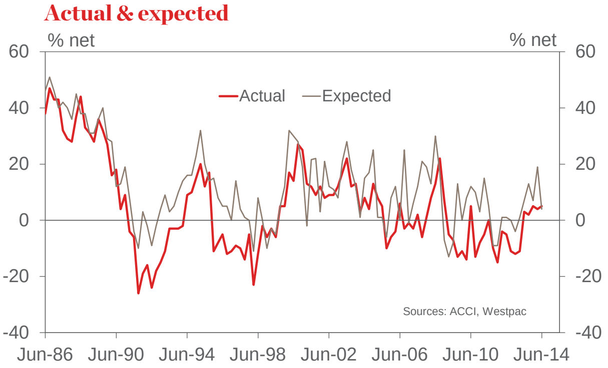
Availability of labour & finance



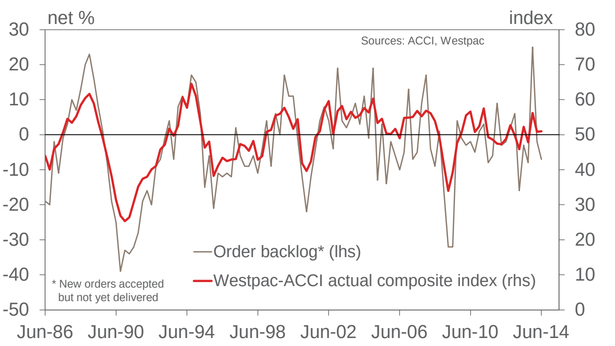
Key factor limiting production
% of respondents



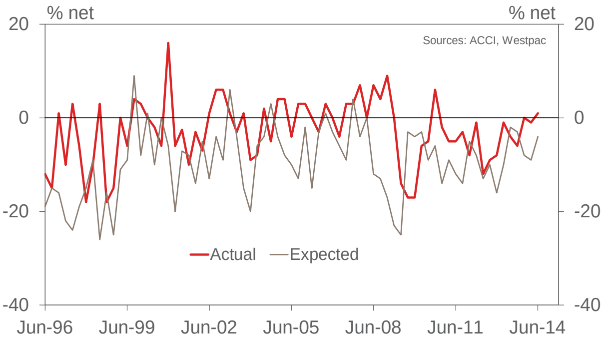
Average selling prices
Actual & expected



Order backlog & actual conditions



Stocks of finished goods
Actual & expected



Factors limiting production

	Q4 2013	Q1 2014	Q2 2014
Orders (%)	53	57	60
Capacity (%)	10	13	9
Labour (%)	4	3	2
Finance (%)	3	4	5
Materials (%)	3	3	4
None (%)	9	4	3
Other (%)	18	16	17

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
-6%	19%	56%	25%

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

Net balance	Above Normal	Normal	Below Normal
–25%	6%	63%	31%

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

None	3%	Orders	60%
Material	4%	Finance	5%
Labour	2%	Capacity	9%
Other	17%		

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?	–3%	5%	87%	8%
(b)	finance?	7%	12%	83%	5%

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?	2%	20%	62%	18%

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	–9%	10%	71%	19%	–12%	6%	76%	18%
7.	Overtime worked	7%	25%	57%	18%	–7%	15%	63%	22%
8.	All new orders received	4%	29%	46%	25%	3%	21%	61%	18%
9.	Orders accepted but not yet delivered	–7%	14%	65%	21%	–7%	12%	69%	19%
10.	Output	1%	25%	51%	24%	8%	24%	60%	16%
11.	Average costs per unit of output	17%	25%	67%	8%	14%	19%	76%	5%
12.	Average selling prices	5%	12%	81%	7%	4%	12%	80%	8%
13.	Export deliveries	2%	7%	88%	5%	–2%	5%	88%	7%
14.	Stock of raw materials	–1%	13%	73%	14%	–8%	8%	76%	16%
15.	Stocks of finished goods	1%	13%	75%	12%	–4%	10%	76%	14%

Summary of results

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

(a) Improve?	20%
(b) Remain unchanged?	56%
(c) Decline?	24%
Net balance	-4%

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?	6%
(b) Same?	63%
(c) Less?	31%
Net balance	-25%

A. Industry profile of survey:

	(% of respondents)
Food, beverages, tobacco	15
Textiles, fabrics, floor coverings, felt, canvas, rope	5
Clothing, footwear	7
Wood, wood products, furniture	5
Paper, paper products, printing	9
Chemicals, paints, pharmaceuticals, soaps, cosmetics petroleum & coal products	11
Non-metallic mineral products: glass, pottery, cement bricks	7
Basic metal products: processing, smelting, refining, pipes & tubes	2
Fabricated metal products: structural & sheet metal, coating & finishing, wire, springs, hand tools	10
Transport equipment: motor vehicles & parts, excluding repairs, rail, ships, aircraft, including repairs	5
Other machinery & equipment: electrical, industrial scientific, photographic	12
Miscellaneous: including manufacturers of leather, plastic & rubber, sporting equipment, jewellery	12

B. How many employees are covered by this return?

1-100	101-200	201-1000	Over 1000
56%	15%	17%	12%

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

WA	SA	VIC	NSW/ACT	QLD	TAS
9%	11%	24%	39%	13%	4%

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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