National Australia Bank

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Monthly Business Survey

September 2012

Business confidence recovers modestly but still downbeat – especially mining. Business conditions disappoint – with struggling retail and wholesale falling significantly. Forward orders noticeably weaker and capacity utilization trending down - indicative of weakening demand. Labour market softish and marginally down. Forecasts edged down and, if inflation remains subdued, door opens for Nov rate cut – with risk of another in 2013.

- Business conditions slipped in September, to be well below long-run average levels. This appears to be related to the impact of the high AUD, tighter fiscal (both state and federal) policy and weaker commodity prices on the back of global (and Chinese) economic uncertainties.
- Businesses were slightly more upbeat in September, though levels of overall business confidence remain down beat – particularly in mining and manufacturing. Announcements of further policy stimulus in major international economies and speculation of more RBA rate cuts may have helped.
- The softening in activity was driven by broad-based declines in trading conditions, profitability and, to a lesser extent, employment conditions. Conditions deteriorated heavily in wholesale, retail and transport & utilities, and improved modestly in construction. Conditions fell back heavily in Victoria and SA.
- As well as much weaker activity readings (business conditions, stocks and capacity utilisation) in the month, indicators of future demand such as forward orders fell heavily in September. Capital expenditure also continued to weaken and credit demand softened. Overall, the survey implies that underlying demand and GDP growth will be around 2¾-3% in Q3 2012 – slightly below trend. But if the September monthly readings were repeated in coming months, the slowdown implied would be much more pronounced.
- Labour costs growth eased in September, to be close to 'normal'. Product prices growth was again subdued, while purchase costs pressures softened modestly. Retail prices growth increased a touch, but remains low.

Implications for NAB forecasts (See latest Global & Australian forecasts report also released today):

- Conditions appear to have stabilised in the big advanced economies, while trade and industrial indicators still point to a broad-based slowing in the emerging economies. Central bank policy stimulus in the US, Euro-zone and Japan has lifted sentiment in financial and commodity markets and reduced fears of Euro-zone collapse and further slowing in the US. Global growth expected to rise from 3% in 2012 to a still sub-trend 3¼% in 2013.
- The Australian economy is passing through a soft patch. GDP forecasts slightly weaker, especially in out years: 3.3% in 2012 (was 3.4%), 2.5% in 2013 (was 2.8%) and 3.2% in 2014 (was 3.6%). Key drivers of slower activity include: falling income growth from weaker commodity prices, a high AUD and fiscal tightening (both at the federal and state levels). Core CPI expected to stay within RBA target range; 2.4% in 2012 and 2.9% in 2013. We expect to see one more RBA rate cut in November, provided core inflation remains subdued (a CPI of 0.7% or lower), with the possibility of another in early 2013. RBA to run accommodative policy in 2013 (3% or lower) to help offset changing nature of mining boom. But will be sensitive to asset prices and fiscal indiscipline.

Key monthly business statistics*

	Jul 2012	Aug 2012	**Sep 2012**		Jul 2012	Aug 2012	**Sep 2012**
	Net balance				*Net balance*		
Business confidence	3	-3	**0**	Employment	-2	-1	**-2**
Business conditions	-4	0	**-3**	Forward orders	-4	-2	**-7**
Trading	-3	3	**-3**	Stocks	0	6	**-1**
Profitability	-7	-2	**-5**	Exports	-3	-2	**-2**
	% change at quarterly rate				*% change at quarterly rate*		
Labour costs	1.9	0.9	**0.7**	Retail prices	0.1	0.1	**0.3**
Purchase costs	1.2	0.7	**0.4**		*Per cent*		
Final products prices	0.2	0.2	**0.1**	Capacity utilisation rate	79.9	80.1	**80.1**

* All data seasonally adjusted and subject to revision. Cost and prices data are monthly percentage changes expressed at a quarterly rate. All other data are net balance indexes, except capacity utilisation, which is an average rate, expressed as a percentage. Fieldwork for this survey was conducted from 18 of September to 1 October 2012, covering around 400 firms across the non-farm business sector.

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Next releases:
18 October 2012 (September quarterly)
13 November 2012 (October monthly)

Analysis

Business conditions fell back in September – down 3 points to -3 index points – with the economy apparently weakening to below trend growth. The pull back in business conditions was led by particularly heavy declines in wholesale, retail and transport & utilities. In contrast, conditions improved in construction and recreation & personal services. While mining conditions were unchanged in September, they failed to claw back a sharp decline in August. In addition to the general deterioration in business conditions, forward indicators of demand (especially forward orders and stocks) fell significantly in September, while confidence remains low.

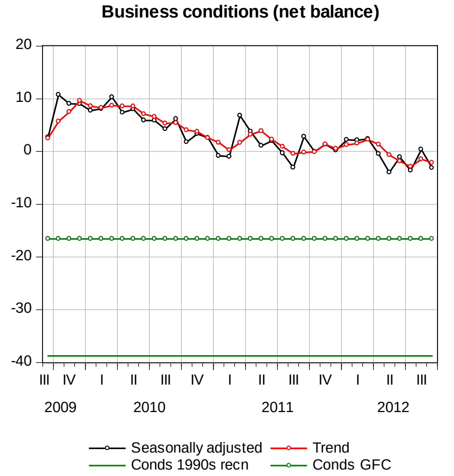
The business conditions index is now 8 points below its medium-term average (since 1997 for the Monthly Survey) of +5 index points. Over the time period of the full Quarterly Survey (1989), conditions are 4 points below the long-run average (of +1 point).

Business confidence improved moderately in September – up 3 to zero points – partially recovering a heavy fall in August. While overall sentiment remains fairly downbeat, announcements of further policy stimulus in major international economies over the past month, which have supported equity and commodity prices more recently, appear to have helped alleviate some of the pessimism harnessed by businesses. Furthermore, increased speculation about possible RBA rate cuts – one of which subsequently eventuated in October – may have helped to assist confidence higher. Abstracting from month-to-month movements, underlying confidence appears tied to general worries about the high AUD, fiscal tightening and falling commodity prices on concerns about global (and especially Chinese) growth. Confidence is now 6 points below the long-run average level (of +6 points), and has been subdued relative to average for more than a year.

Business conditions by industry. Movements in business conditions were fairly mixed across industries in the month; conditions fell heavily in wholesale, retail and transport & utilities, while they improved modestly in construction and recreation & personal services. While mining conditions were unchanged in September that follows a particularly sharp deterioration in the previous month.

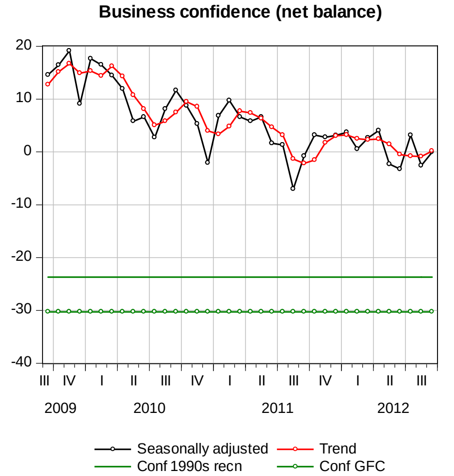
Consistent with the recent softening in mining conditions, the gap between the mining (WA and Queensland) and non-mining (Tasmania, Victoria, NSW and SA) states has narrowed more recently (see Graph). It appears increasingly unlikely that conditions in the mining states will achieve levels recorded in the lead up to the GFC. As we saw during the GFC, mining states were hit harder than non-mining states, meaning these states may be more vulnerable to weakening commodity prices in the current period.

Conditions pare back previous gains



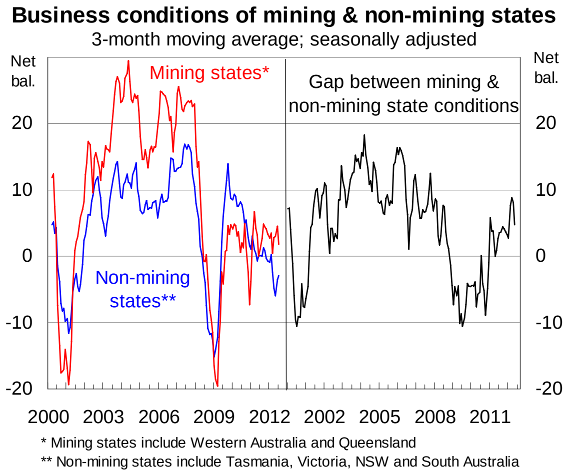
Average of the indexes of trading conditions, profitability and employment.

Confidence up but still downbeat



Excluding normal seasonal changes, how do you expect the business conditions facing your industry in the next month to change?

Activity slowing in mining states



Analysis (cont.)

Business conditions by state. Conditions deteriorated across all of the mainland states in September, with the exception of WA, where they improved marginally (albeit following a large decline last month). Conditions remained fairly subdued across most of the states; Victoria (especially) and SA were the worst performing states. Trend conditions were little changed across most states, with the exception of WA, where they weakened considerably, reflecting the impact of weaker commodity prices on mining activity in recent months.

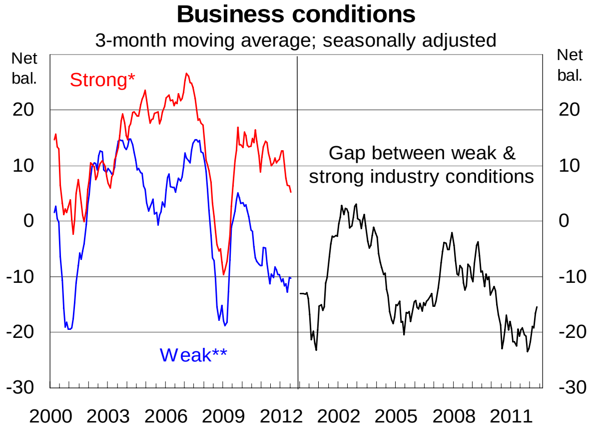
Business confidence by industry. Confidence improved across most industries in September. The exception to the modestly improving trend was retail and transport & utilities, where cautiousness of consumers appears to be having an impact. The most significant improvement in confidence was in construction (up 16 to +4 points), which may in part reflect the recent improvement in property prices in turn related to past and prospective rate cuts by the RBA. Confidence also improved moderately in manufacturing and mining, though these two industries remain the most pessimistic overall.

Business confidence by state. Changes in confidence were fairly mixed across states; confidence picked up solidly in Queensland and NSW, while it deteriorated heavily in SA and WA. Sentiment in the mining states (WA and Queensland) has softened notably over the past six months or so, suggesting the weakened outlook for global commodity demand is negatively impacting sentiment in these regions. In levels terms, confidence in the mainland states was strongest in NSW and WA, and weakest in SA and Victoria. Confidence improved solidly in Tasmania, though care should be taken when interpreting these data due to small sample size.

Variation in business conditions across sectors has become quite pronounced since late 2009, although the gap has started to narrow over recent months. This can be observed by comparing trend conditions of the recently strongest performing sectors (mining, transport & utilities, recreation & personal services and finance/ business/ property) with trend conditions of the weakest performing sectors (retail, manufacturing, construction and wholesale).

The persistent divergence in industry conditions indicates that the Australian economy is undergoing a structural transformation towards mining and service-based industries, and away from traditional manufacturing and discretionary retailing.

Economy remaking itself



* Strong industries include mining, transport & utilities, recreation & personal services and finance/business/property
** Weak industries include retail, manufacturing, construction and wholesale

The **forward orders** index deteriorated heavily in September – down 5 to -7 index points. While a similar reading of -7 was reported (after rounding) in June this year, the current reading (in raw terms) is the weakest since May 2009. The deterioration in orders was apparent across all industries, with the exception of finance/ business/ property, where they were unchanged. Particularly large falls in orders were reported in manufacturing – where the impact the high AUD continues to erode competitiveness – and in construction, mining and wholesale. Consistent with the fall in orders, the **stocks** index also fell solidly in September (down 7 to -1 point), suggesting restocking may have stalled. The stock series has in the past tended to move pro-cyclically and as such adds weight to the general weak tone of the survey. **Capacity utilisation** was unchanged at a slightly below-average 80.1% in the month but continues to move down in trend terms. In September significant increases in utilised capacity were reported in recreation & personal services and construction, offset by falls in transport & utilities, finance/ business/ property and retail. Overall, capacity utilisation was highest in recreation & personal services and wholesale, while it was lowest in manufacturing, construction and retail.

Capital expenditure edged down 2 points to +1 index point in September, implying a softening in business investment activity. In levels terms, capital expenditure was highest in transport & utilities (+18), mining (+9), finance/ business/ property and recreation & personal services (both +8), while it was lowest (and negative) in construction (-16) and manufacturing (-11).

Analysis (cont.)

Based on forward orders for the June quarter, the survey implies 6-monthly annualised demand growth was around 3½% in the June quarter, below the actual recorded level of 4%. Taking average monthly forward orders for the September quarter, the survey implies 6-monthly annualised demand growth will slow to around 2¾-3% in the September quarter.

Similarly, based on average business conditions for the June quarter, the survey implies 6-monthly annualised GDP growth (ex mining) was around 2½-2¾% (6-monthly annualised) in the June quarter, below actual growth of 4.1%. But if we take average monthly business conditions for the September quarter, the implied growth rate would be around 2¾-3% in the September quarter.

In both demand and GDP terms the implied slowing – if the September month readings are repeated in coming months – is much sharper (to 2¼% in Q4).

Elsewhere in the survey, **cash flow** (not seasonally adjusted) was strongest in mining, recreation & personal services and transport & utilities, and weakest in retail and wholesale.

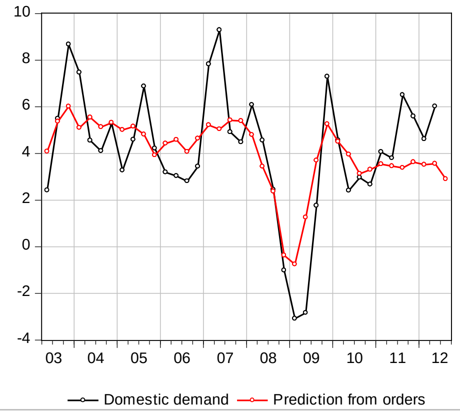
Labour costs growth (a wages bill measure) fell further in September, following a heavy fall in August. Labour costs growth (at a quarterly rate) eased from 0.9% in August to 0.7% in September. The pull back in cost pressures was consistent with a softening in employment conditions in the month. Overall, labour costs growth (at a quarterly rate) remained strongest in mining (1.3%), followed by finance/ business/ property, and weakest in transport & utilities (-0.4%).

Price inflation fell to its lowest level since January (down 0.1 ppts to 0.1%; at a quarterly rate). Weakening domestic demand may have prompted firms to cut prices, while the high AUD would have also helped. The softening in prices was very apparent in manufacturing, transport & utilities and recreation & personal services. That was somewhat surprising given the expected impacts of carbon pricing in utilities especially, though prices in this industry did rise sharply in July. No doubt indirect effects of carbon pricing are still filtering through the economy. This month, prices growth was strongest in mining, retail and recreation & personal services (all 0.3%; at a quarterly rate), while it was weakest in manufacturing and construction (both -0.4%).

Purchase cost pressures eased further in September - to 0.4% in September (at a quarterly rate) from 0.7% previously. Once again the high AUD probably played an important role here. Construction was the only industry to report an increase in purchase costs inflation in the month. The most notable softening in costs growth was in retail and mining. Purchase costs growth was strongest in recreation & personal services (1.1%, at a quarterly rate), and weakest in mining (0.1%) and retail (0.2%).

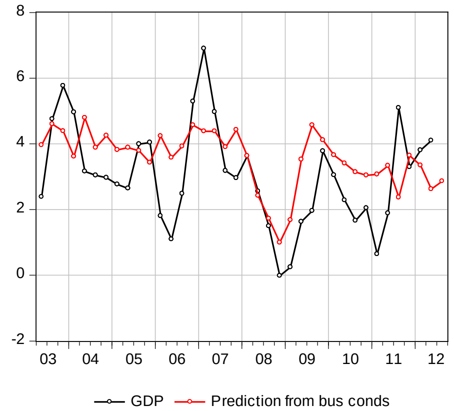
Demand growth to soften further

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



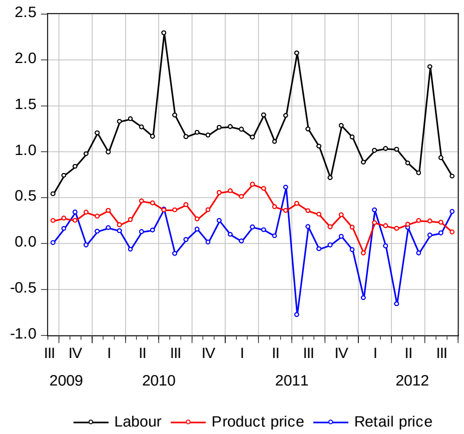
GDP (ex coal) growth to weaken in Q3, partly unwinding H1 strength

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



Labour cost pressures fairly minimal

Costs & prices (% change at a quarterly rate)



Based on respondent estimates of changes in labour costs and product. Retail prices are based on retail sector product price estimates.

Current business conditions

The business conditions index fell back in September – down 3 to -3 index points – partly unwinding a modest pick up in August. Consistent with the deterioration in monthly activity, trend conditions also softened – down 1 to -2 index points, a little below the series long-run average (of +1 point).

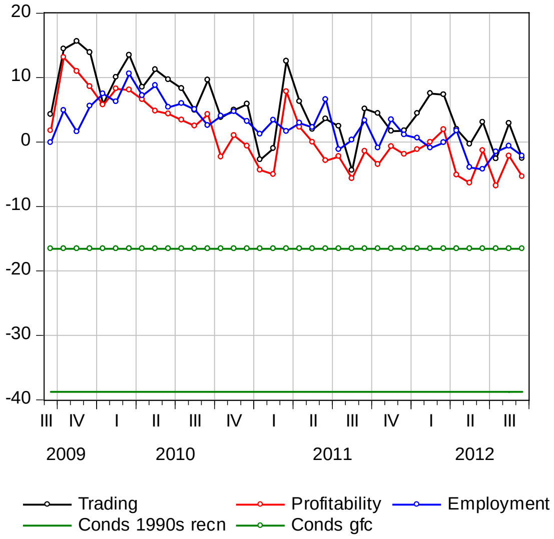
Trading, profitability and employment

The paring back of activity in the month largely reflected a sharp deterioration in trading conditions, as well as weakening profitability and employment conditions.

Profitability deteriorated very sharply in retail in September (down 21 to -29 points), which is consistent with a significant weakening in retail trading conditions. Profitability in transport & utilities and mining deteriorated sharply (both down 10 points). In contrast, profitability in construction rose solidly (up 12 to -8 points), and while the negative net balance implies profitability continued to decline, this industry may be benefiting from stabilising property markets. In trend terms, profitability was strongest in transport & utilities (+13), and weakest in construction (-20) and retail (-18).

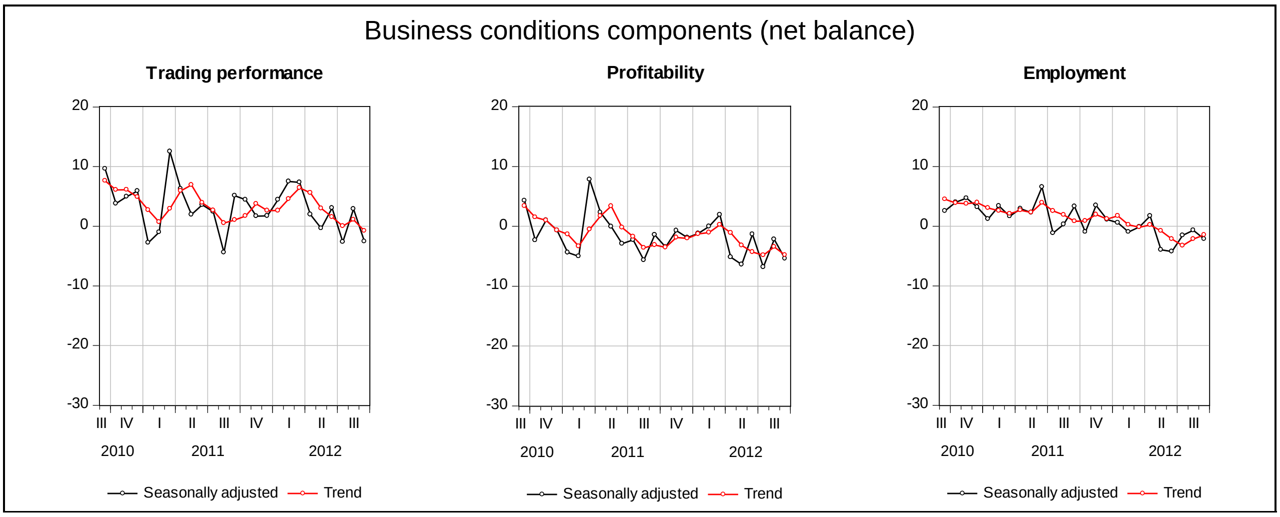
Broad-based weakening in trading, profitability & employment

All components of business conditions (net bal., s.a.)



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

Employment conditions deteriorated heavily in mining (down 19 to +2), as this industry (and associated service sectors) respond to sharply softer commodity prices (iron ore and coal) over recent months. Nonetheless, overall mining employment conditions remain in positive territory, suggesting mining employment is continuing to expand, albeit at a much slower pace. Employment conditions also deteriorated sharply in wholesale (down 14), while they improved modestly in construction and finance/ business/ property (both up 3). In trend terms, employment conditions remained strongest in mining (+17) and transport & utilities (+9), while they were again weakest in construction (-8) and manufacturing (-7).



Net balance of respondents reporting trading performance / profitability / employment as good or very good (rather than poor or very poor).

Current business conditions (cont.)

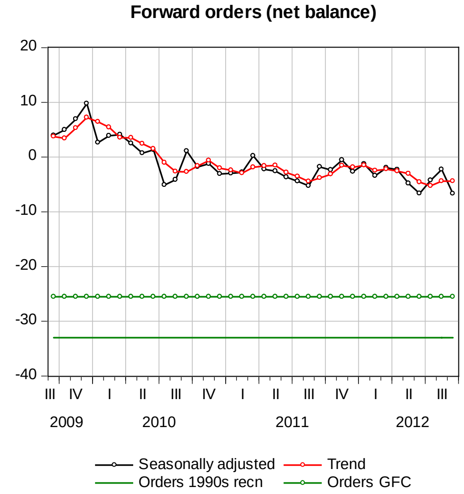
Forward orders

In September, the forward orders index – an indicator of domestic demand – fell to its weakest outcome since June (down 5 to -7 index points). The forward orders index has not fallen below -7 index points since May 2009.

The very weak outcome in September reflects very weak orders in manufacturing and construction: -18 and -13 index points respectively. In trend terms, orders in manufacturing and construction were -13 and -11 index points respectively. In contrast, orders were least subdued (albeit still soft) in finance/ business/ property (+1) and transport & utilities (zero).

Net balance of respondents with more orders from customers last month.

New demand falls to weakest level in over three years

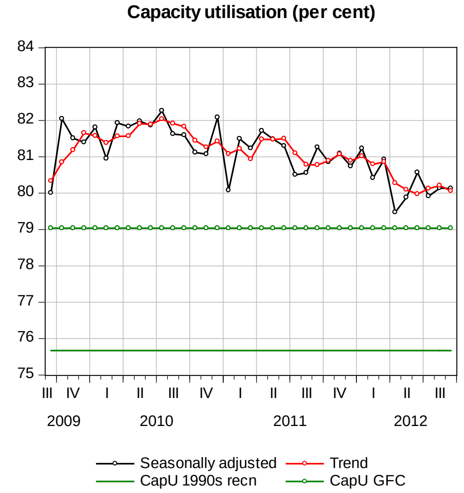


Capacity utilisation

Capacity utilisation was unchanged at 80.1% in September, a relatively low level when compared to outcomes in the post-GFC period. In the month, utilised capacity fell significantly in transport & utilities (down 4.4 ppts to 81.1% – the lowest reading in three years), as well as finance/ business/ property (down 1.4 ppts) and retail (down 1.1 ppts). In contrast, capacity utilisation picked up solidly in recreation & personal services (up 3.6 ppts) and construction (up 3.3 ppts). While mining continues to report relatively high levels of capacity use (as per the nature of this industry) nevertheless the trend rate of usage continues to reduce sharply (down 1.1% in the month). In levels terms, capacity utilisation was highest in recreation & personal services (83.7%) and wholesale (82.3%), while it was lowest in manufacturing (75.5%), construction (78.8%) and retail (79.8%).

Full capacity is the maximum desirable level of output using existing capital equipment.

Capacity utilisation remains low



Current business conditions (cont.)

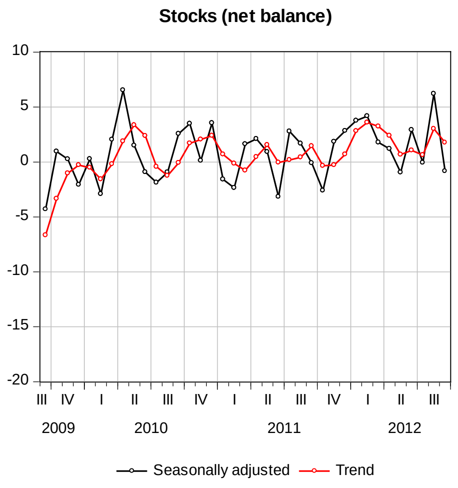
Stocks

The stocks index pared back solid gains amassed in the previous month; the index fell from +6 to -1 in September, to be a little below its long-run average (of +1 point since 1989). It appears that stock rebuilding may have ended in response to weakened trading conditions.

The fall in the stocks index was driven by sharp declines in mining (down 18), wholesale (down 16) and retail (down 15) stocks, partly offset by a solid pick up in construction (up 11). In trend terms, the stocks index was highest in wholesale (+13) and lowest in construction (-7).

Net balance of respondents with an increase in stocks last month

Stock rebuilding stalls

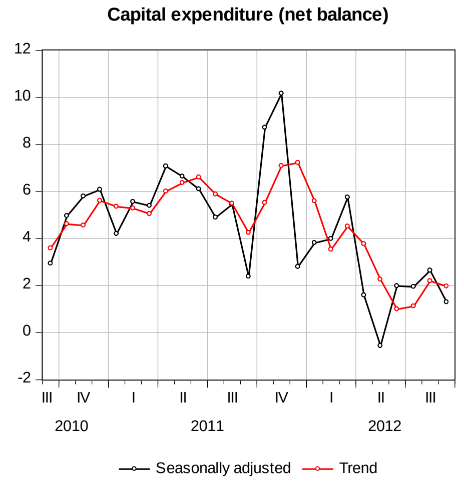


Capital expenditure

Capital expenditure weakened a little in September; down 2 points to +1 point, which remained fairly low relative to outcomes over the previous year. The capex index fell considerably in wholesale and construction (both down 10), while it picked up solidly in transport & utilities (up 14) and finance/ business/ property (up 10). In levels terms, the capex index was highest in transport & utilities (+18) and mining (+9), and lowest in construction (-16) and manufacturing (-11).

Net balance of respondents with an increase in capital expenditure last month.

Capex points suggests a pull back in investment



Exports

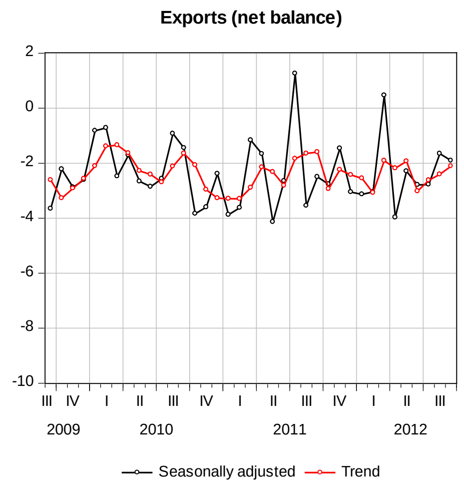
The exports index, which represents export conditions for the economy as a whole, was unchanged at a reasonably low -2 index points in September.

By industry, the exports index rose notably in wholesale (up 7), while it deteriorated modestly in transport & utilities (down 4), mining, recreation & personal services and construction (all down 3). Exports were strongest in mining (+4) and weakest in manufacturing (-9).

The exporters' sales index, which represents export conditions for exporting industries, was marginally weaker in the month, falling from -7 to -8 index points.

Net balance of respondents with an increase in export sales last month.

Exports remain soft overall



Current business conditions (cont.)

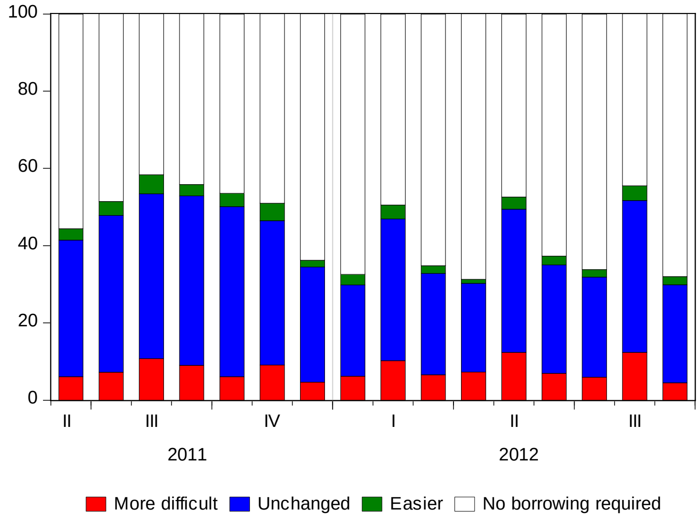
Credit availability

Firms reported that borrowing conditions were much easier in September, although demand for credit did fall considerably, despite generally lower borrowing costs following recent RBA rate cuts.

The net borrowing index (easier minus harder) rose from -9 index points to -2 index points – the best outcome since April 2011. This month's outcome reflected a reduction in the proportion of firms finding borrowing more difficult to obtain, which was slightly offset by a fall in the proportion of respondents finding finance easier to obtain. The proportion of businesses requiring finance fell from 56% to 32%, implying a significant step down in demand for credit. However, demand for credit was unusually strong in the previous month, compared to recent outcomes.

In terms of the borrowings required for your business in the last month, has it been …

Demand for credit falls back but credit conditions much easier



Industry sectors

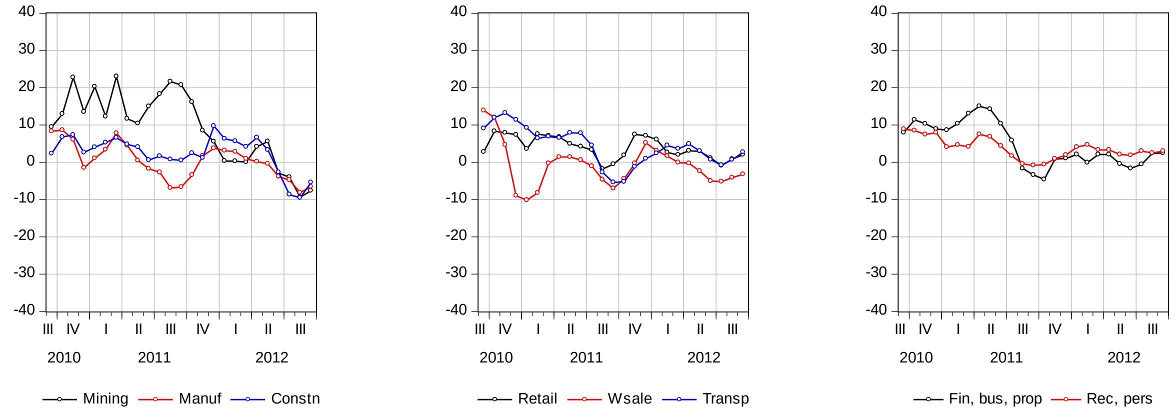
Business confidence

Confidence generally improves across industries

Business confidence improved across most industries in September. The exceptions were confidence readings in retail and transport & utilities, where it weakened moderately. Construction confidence rose significantly in the month; with the index up 16 points to +4 points probably on the back of lower and prospective further reductions in interest rates and some stabilisation in property prices. Sentiment also improved solidly in manufacturing, finance/ business/ property and mining. Lower rates and the prospect of some weakening in the AUD would have helped confidence in manufacturing. Some modest increase in commodity prices off their recent bottoms may have also helped stabilise mining confidence, while recent actions by the ECB and the FED would have helped lower fears in finance. In trend terms, confidence was strongest in finance/ business/ property, recreation & personal services and transport & utilities (all +3), while it was weakest in mining (-8) and manufacturing (-7).

Business confidence by industry (net balance)

3-month moving average



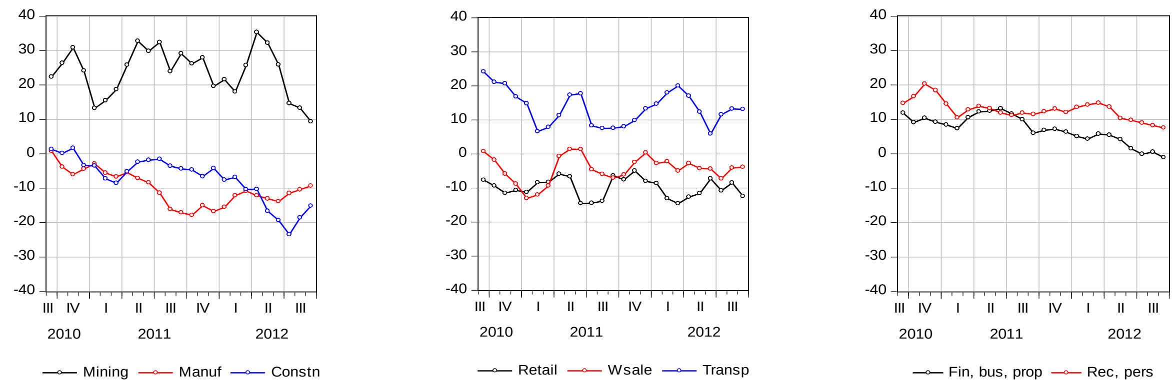
Business conditions

Mining conditions still soft; retail very weak

Industry conditions either weakened or were unchanged in September, with the exception of construction (up 6) and finance/ business/ property (up 2). While mining conditions were unchanged in the month, they have come down significantly from highs recorded in April this year. The relative weakness in mining activity of late has reflected the weakened outlook for global commodities demand and concerns about global (and especially Chinese) growth. That said conditions weakened most notably in interest sensitive sectors and those most exposed to consumer and business sentiment. Thus the largest falls in conditions in the month were in wholesale (down 13), retail (down 10) and transport & utilities (down 7). Seasonally adjusted conditions, in level terms were strongest in transport & utilities (+9), recreation & personal services (+8) and mining (+5), but were weakest in retail (-16), manufacturing (-9) and construction (-8).

Business conditions by industry (net balance)

3-month moving average



States

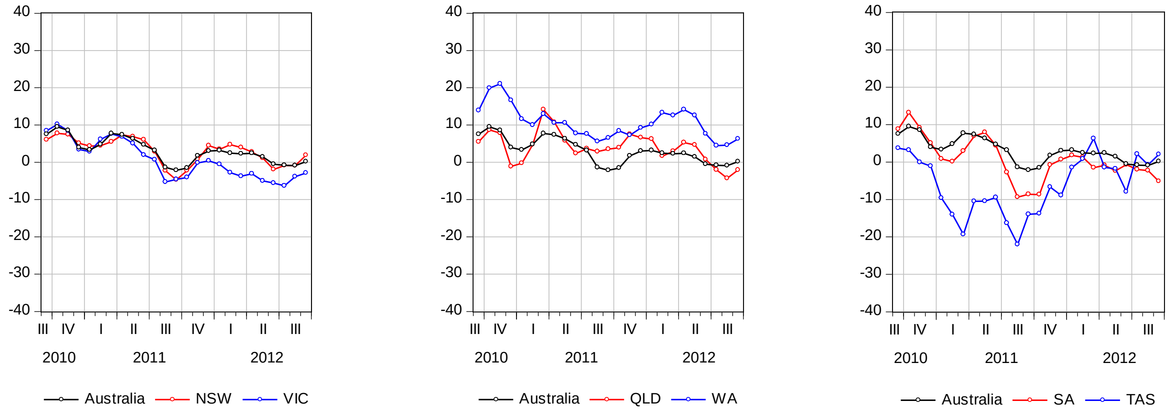
Business confidence

Confidence still strongest in WA, despite softening; Sentiment in Queensland and NSW rebounds

Movements in business confidence were varied across the states in September; confidence improved solidly in Queensland and NSW, and was a little better in Victoria, while it deteriorated notably in SA and WA. Previously WA confidence held up surprisingly well, but this month's data suggest the downgraded outlook to global minerals and energy demand is beginning to weigh on sentiment in Australia's largest mining state. Nonetheless, trend confidence in the mainland states remained strongest in WA (+6), while it was weakest in SA (-5), Victoria (-3) and Queensland (-2). Trend confidence was a little better in Tasmania (up 3 to +2 points), although care should be taken when interpreting data for this state given the relatively small number of respondents.

Business confidence by state (net balance)

3-month moving average



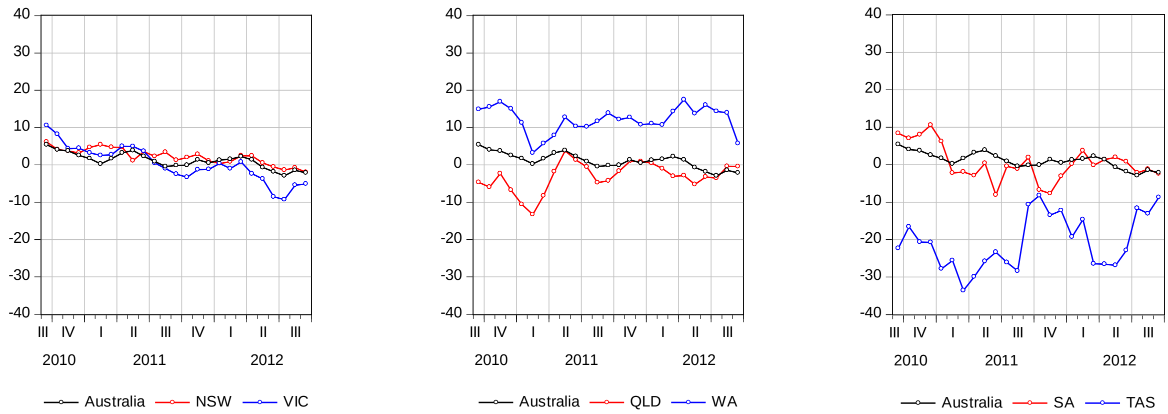
Business conditions

Conditions in Tasmania very poor; WA continues to outpace all other states

Business conditions deteriorated heavily in Victoria and SA in the month, with activity in these states the weakest of all of the states, according to the survey. Conditions also weakened a touch in Queensland and NSW, while they were marginally better in WA. Of the mainland states, trend conditions were weakest in Victoria (-5), SA and NSW (both -2), while they were strongest in WA (+6). Trend conditions in Tasmania improved modestly in September, though they remained very subdued (up 4 to -9 points; on a small sample).

Business conditions by state (net balance)

3-month moving average



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