National Australia Bank

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Quarterly Business Survey

September quarter 2012

Business conditions improve in the quarter but still soft. However, Monthly survey results suggest conditions weakened towards the end of the quarter. Forward indicators remain very weak. Confidence up a touch but still at downbeat levels – especially mining. Medium-term expectations lacklustre and capex lower. Price pressures low, implying soft near-term core inflation.

- Business conditions improved modestly in the September quarter though were unable to recover the sharp fall in the previous quarter. Official ABS data point to relatively soft activity in the September quarter, following a fairly robust first half of the year; our survey implies a slowing in annualised domestic demand growth to around 3% (six-monthly). Measures of future near-term demand remained at very subdued levels, pointing to further slowing in activity in the December quarter.
- While still reasonably poor, business conditions in some of the consumer dependent and housing related industries improved in the quarter, suggesting lower borrowing rates may be beginning to help. While the mining sector remains a big part of Australia's growth story, it appears that a slowing in global commodities demand and prices are now impacting on mining activity and confidence. Conditions improved across each of the mainland states; conditions were strongest in WA and NSW, while they were weakest in Victoria and Queensland.
- Business confidence improved marginally in the quarter, but remained at downbeat levels. It appears that global uncertainties (especially on the mining outlook), the persistently high AUD, weak forward orders and the impact of fiscal consolidation (State and Federal) are weighing on firms future expectations.
- Business investment intentions (next 12 months) weakened a touch, consistent with our expectation for a softening in business investment growth over the year ahead. Near-term and long-term employment expectations remained lacklustre and consistent with our expectation for little near-term employment growth. Lack of demand is expected to be the most significant factor impacting on profitability over the year ahead, while concerns about interest rates, wages, capital capacity and suitable labour were low.
- Product price inflation remained weak, recording annualised growth of just 0.7%. Retail price inflation was practically flat (implying Q3 core CPI of around 0.5%) – suggesting that the indirect effects of the carbon tax are yet to flow through. Labour and purchase costs growth was within 'normal' ranges.

Implications for NAB forecasts:

- Little change to latest Global and Australian Forecasts (released 9 October) for activity, though the unemployment rate has been lifted slightly following a jump in September. 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 quarterly business statistics**

	2012q1	2012q2	**2012q3**		2012q1	2012q2	**2012q3**
		Net balance				*Net balance*	
Business confidence	-1	-3	**-2**	Trading	5	1	**6**
Business conditions				Profitability	0	-5	**0**
Current	3	-2	**1**	Employment	1	-1	**-1**
Next 3 months	8	5	**5**	Forward orders	-1	-2	**-2**
Next 12 months	19	16	**17**	Stocks	3	0	**6**
Capex plans (next 12)	15	17	**14**	Exports	-3	-1	**-1**
		% change				*% change*	
Labour costs	0.6	0.5	**0.6**	Retail prices	0.1	0.0	**0.1**
Purchase costs	0.4	0.4	**0.4**			*Per cent*	
Final products prices	0.1	0.1	**0.2**	Capacity utilisation rate	80.9	80.4	**80.7**

** All data seasonally adjusted, except purchase costs and exports. Cost and prices data are 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 27 August to 12 September 2012, covering over 900 firms across the non-farm business sector.

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Next release:
13 November 2012 (October Monthly)

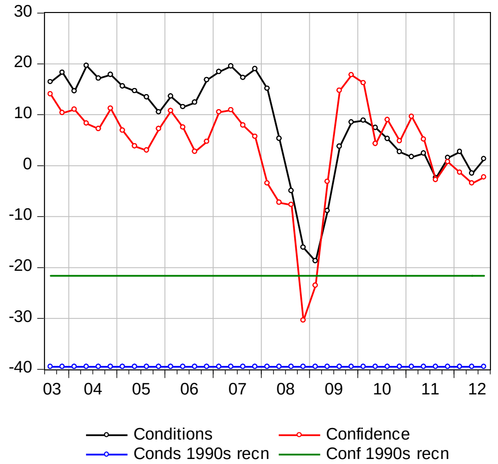
Analysis

Business confidence improved marginally in the September quarter, but remains at downbeat levels – also the “improvement” did not fully unwind the deterioration in confidence reported in the previous quarter. At the time the survey was conducted, global commodity prices were in sharp decline and fear that Australia’s mining investment boom was coming to an end had intensified. Global growth was also weakening. While Australia’s mining investment boom remains far from over it is clearly moving into a new phase. The survey was also taken amidst hints of further policy easing by the US Fed and the ECB announcing details of a bond rescue plan. Locally, worries about the high AUD, weakening new orders and fiscal tightening, combined to weigh on sentiment.

Overall confidence readings in the quarterly business survey were a little more subdued than monthly readings; this may come down to timing, as the latest monthly survey was conducted after the recent partial recovery in commodity prices.

Conditions strengthen but still poor

Confidence & conditions (net balance., s.a.)



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.

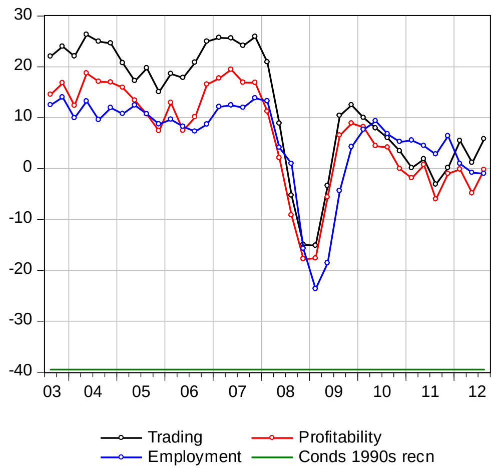
Business conditions improved moderately in the September quarter. While official data report that the economy grew robustly in H1 2012, more recent activity data suggest growth is likely to have softened in the September quarter.

	Quarterly					*Monthly*				
	2011q3	2011q4	2012q1	2012q2	**2012q3**	2012m05	2012m06	2012m07	2012m08	2012m09
Confidence	-3	1	-1	-3	**-2**	-2	-3	3	-3	0
Conditions	-2	2	3	-2	**1**	-4	-1	-4	0	-3

The **business conditions** index improved in the September quarter (up 3 to +1 index point), to be in line with the long-run average of the series (since 1989). The pick up in activity in the quarter reflected solid improvements in trading conditions and profitability – unwinding similar sized falls in the previous month – while employment conditions were unchanged at relatively poor levels. Much of the improvement in activity occurred in the consumer dependent sectors – which appear to have benefited from the residual impacts of carbon tax compensation payments – as well as construction, which is likely to be benefiting from an improving property market. RBA rate cuts over the past 12 months may also be having an impact. The quarterly survey result is somewhat stronger than recent monthly surveys – suggesting a deterioration in conditions through the quarter.

Activity measures generally improve

Business conditions components (net bal., s.a.)



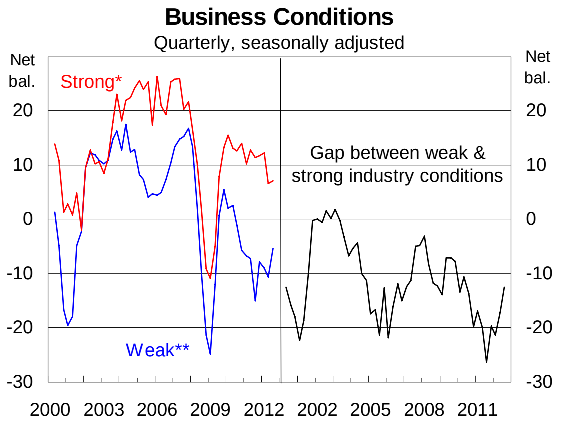
Net balance of respondents who regard last 3 months’ trading / profitability / employment performance as good.

	Quarterly					*Monthly*				
	2011q3	2011q4	2012q1	2012q2	**2012q3**	2012m05	2012m06	2012m07	2012m08	2012m09
Trading	-3	0	5	1	**6**	0	3	-3	3	-3
Profitability	-6	-1	0	-5	**0**	-6	-1	-7	-2	-5
Employment	3	6	1	-1	**-1**	-4	-4	-2	-1	-2

Analysis (cont.)

As demonstrated in the monthly business survey releases, quarterly data confirm that variation in business conditions has widened significantly since late 2009. The disparity across sector performances can be observed by comparing business conditions of the (currently) strongest performing sectors (mining, transport & utilities, recreation & personal services and finance/ business/ property) with conditions of the weakest performing sectors (retail, manufacturing, construction and wholesale). The gap between the strongest and weakest performing industries has narrowed over recent quarters but remains large.

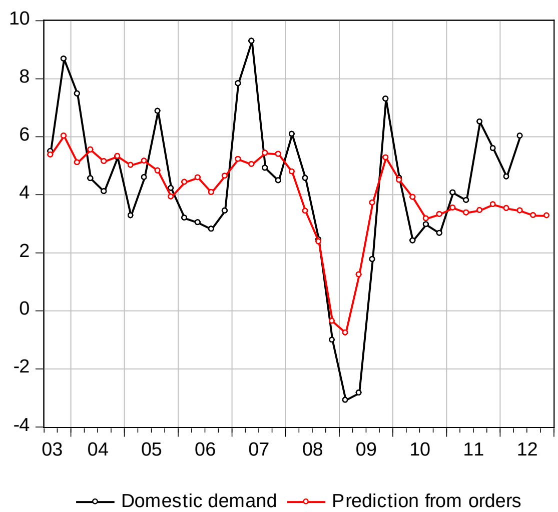
Disparity between sectors narrows



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

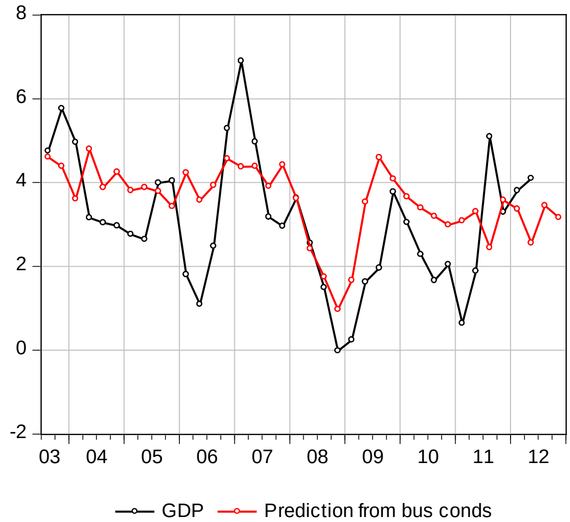
Demand growth to be noticeably weaker

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



GDP growth to slow (to around trend)

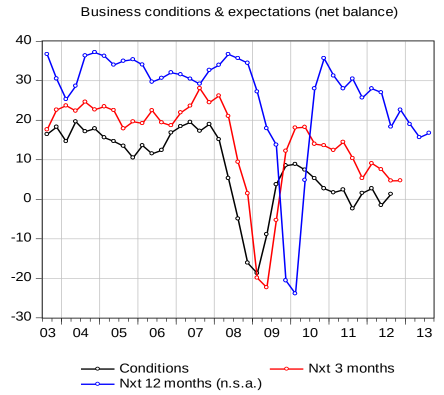
Business conditions (change & level) as an indicator of GDP (6-monthly annualised)



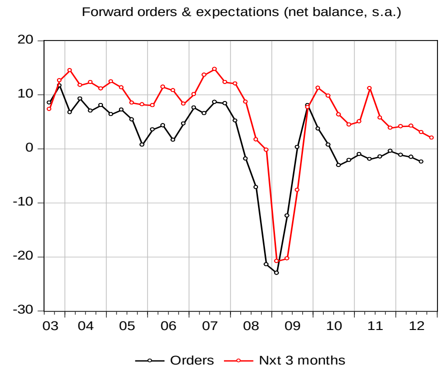
Based on average forward orders in the September quarter, we estimate that 6-monthly annualised demand growth was around 3¼% in the September quarter. If we assume the September quarter forward orders outcome is continued into the December quarter, the survey implies 6-monthly annualised demand growth will remain close to 3%. Similarly, based on historical relationships, the business conditions index implies that 6-monthly annualised GDP growth would be around 3½% (annualised) in the September quarter. But if September quarter business conditions are maintained into the December quarter, the implied growth rate would ease to around 3-3¼%. As noted above it appears that the growth momentum has weakened further during the quarter (with Monthly readings significantly weaker than the Quarterly).

Analysis (cont.)

Expectations still subdued



Orders expected to remain weak

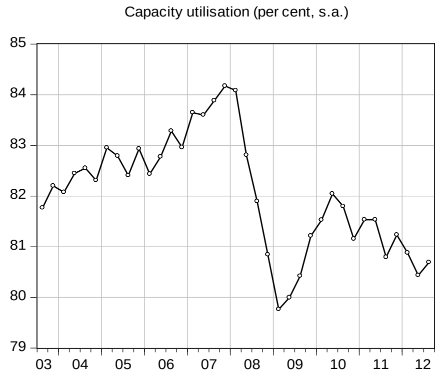


Consistent with actual conditions, short and long-term expectations for business conditions improved a little in the September quarter though remained well below levels reported in late 2009. Expectations for forward orders were marginally softer, and still subdued, largely reflecting weakness in current forward orders for manufacturing. Overall, expectations for both conditions and orders remain well above GFC levels – but are much weaker than the pre GFC boom readings.

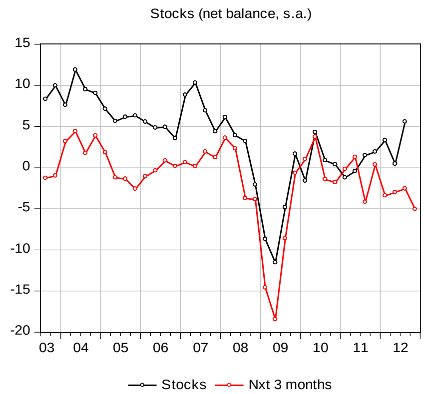
	Quarterly [(a)]					*Monthly*				
	2012q2	2012q3	2012q4	2013q2	2013q3	2012m05	2012m06	2012m07	2012m08	2012m09
Conditions	-2	**1**				-4	-1	-4	0	-3
Conds. next 3m	8	5	**5**							
Conds. nxt 12m	27	18	23	16	**17**					
Orders	-2	**-2**				-5	-7	-4	-2	-7
Orders next 3m	4	3	**2**							

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

Utilised capacity to remain low



Stocks up but rebuilding set to stall



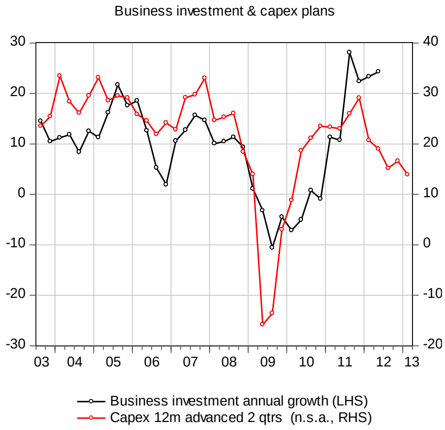
Capacity utilisation picked up a little in the September quarter, though the path for capacity utilisation remains down. The level of utilised capacity is only around 1 ppt higher than it was immediately following the GFC. Nonetheless, the current rate, at 80.7%, is a touch above the series long-run average (80.6% since 1989). Expectations for stocks (over the next three months) weakened to the lowest level since mid-2009, suggesting near-term inventory rebuilding will remain soft. To the extent that the stocks series tends to move pro cyclically – as it does – this also signals a weakening in the growth momentum.

	Quarterly [(a)]					*Monthly*				
	2011q4	2012q1	2012q2	2012q3	2012q4	2012m05	2012m06	2012m07	2012m08	2012m09
Capacity utilis.	81.2	80.9	80.4	**80.7**		79.9	80.6	79.9	80.1	80.1
Stocks current	2	3	0	**6**		-1	3	0	6	-1
Stocks next 3m	0	-3	-3	-3	**-5**					

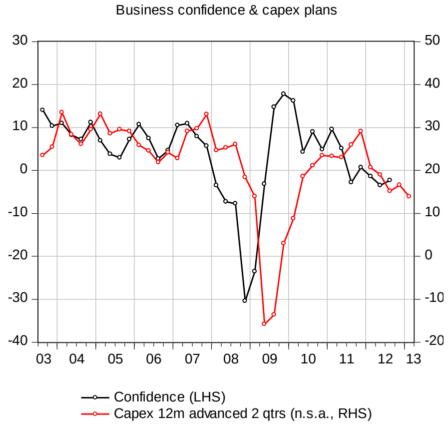
(a) Quarter to which expectation applies. All data are seasonally adjusted.

Analysis (cont.)

Capex plans softening

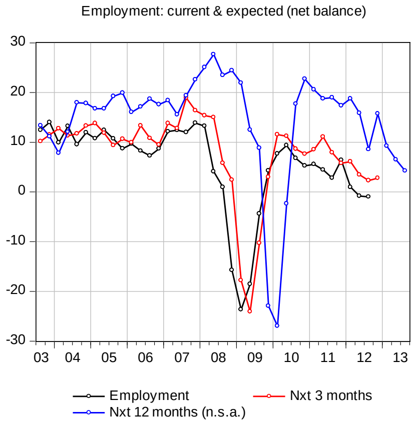


…largely reflecting deteriorating sentiment (in mining)

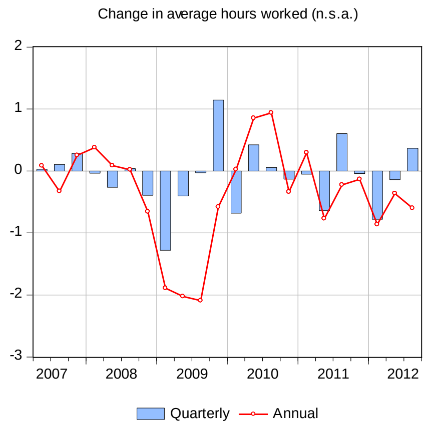


Official ABS data showed another slight rise in already exceptionally high business investment growth in the June quarter 2012. In contrast the NAB survey measure of business capital expenditure points to a softening in business investment growth – at least in the next 6 -12 months. Largely this appears to lower confidence feeding into capital expenditure intentions – and especially lower confidence in mining. This would also be broadly consistent with NAB's view that the mining investment boom will peak in late 2013 / mid 2014, with the effects of the softening in business investment activity to largely be offset by a strengthening in exports. Non-mining investment may be somewhat restricted over the year ahead, reflecting a pull back in public sector investment as well as potential resource restraints as the allocation of resources is directed into mining.

Near-term employment growth still soft and softening?



Average hours rise a touch



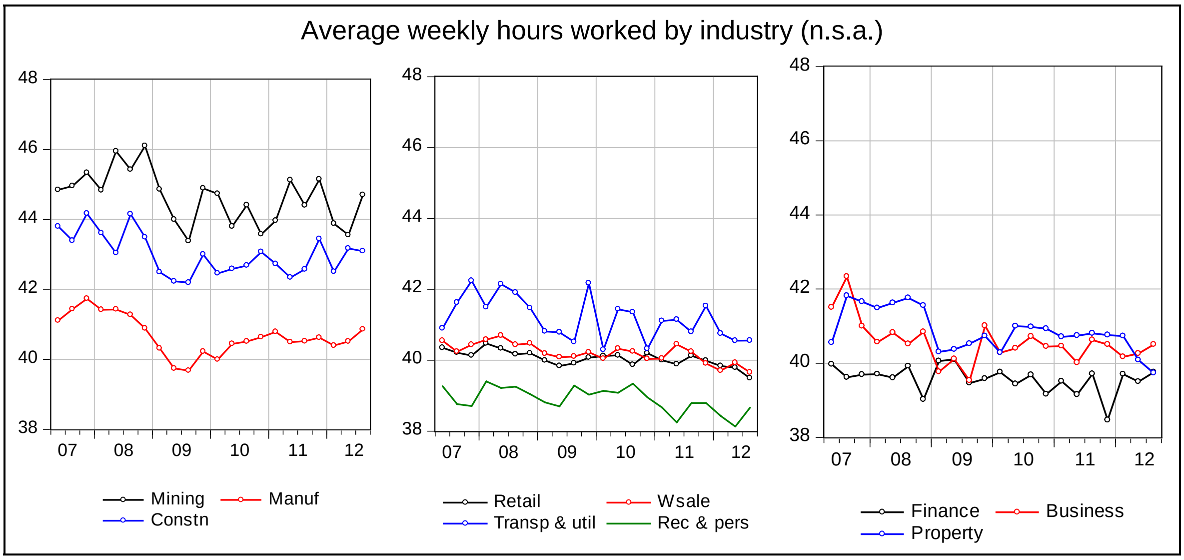
The employment index was unchanged at a subdued -1 index points in the September quarter (in line with the long-run average and still well above GFC levels). Employment expectations point to still soft conditions in the December quarter; near-term employment expectations were marginally high, though remained relatively poor overall.

Looking further ahead, expectations (12 months ahead) deteriorated for the third consecutive quarter and remain well below levels recorded in the lead-up to the GFC.

While average hours worked increased marginally in the month – up from 40.0 hours per week to 40.1 hours per week – they remained below average levels recorded over 2011. The overall story implies that employers have chosen to cut back employee hours over the past year rather than reduce heads – the risk being that a further deterioration in business conditions could well see a sharper round of job shedding in coming quarters. By industry, average hours worked is highest in mining (consistent with high capacity production utilisation of mine production), followed by construction (including mining). Against that the lowest hours worked are in recreation & personal services – which may reflect a higher resort to casual / part-time workers in these industries – and retail / wholesale (presumably due to cyclical factors).

Analysis (cont.)

Average hours in mining the highest; Lowest hours in recreation & personal services and retail



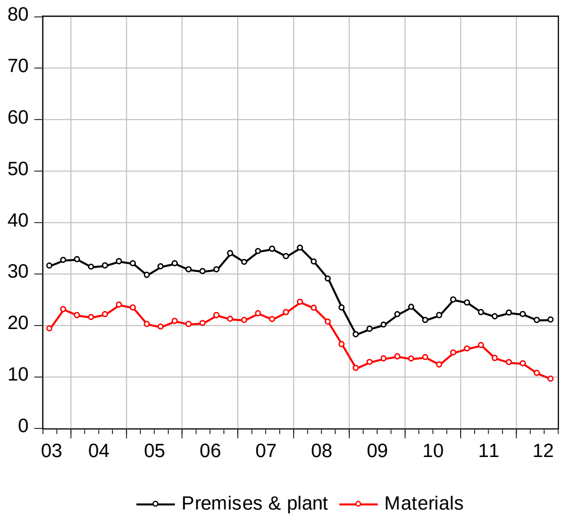
	Quarterly [(a)]					*Monthly*				
	2012q2	2012q3	2012q4	2013q2	2013q3	2012m05	2012m06	2012m07	2012m08	2012m09
Empl current	-1	**-1**				-4	-4	-2	-1	-2
Empl next 3m	3	2	**3**							
Empl nxt 12m	16	9	16	6	**4**					

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

Sales remain the most significant constraint on output

Constraints on current output (% of firms)

Constraints on current output (% of firms)



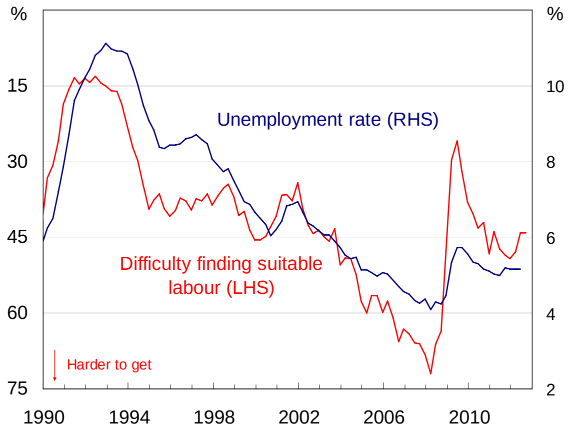
While broadly unchanged in the quarter, sales remained the most constraining factor on output, with almost two-thirds of firms reporting lack of sales and orders as their number one constraint. Labour also remained fairly constraining – indicative of a still reasonably strong labour market. That said, the proportion of firms reporting difficulty in obtaining suitable labour (as a constraint) has edged down – broadly consistent with a softening in the labour market. In contrast, materials became even less of a constraint on output and remained the least constraining factor overall. Premises & plant was also perceived a reasonably small constraint in the quarter.

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 difficult for firms to obtain suitable labour in the face of improving labour market conditions and the recommencement of hiring. Nonetheless, it is now much easier for firms to obtain suitable labour than it was prior to the GFC, suggesting there is still some slack in the labour market at present.

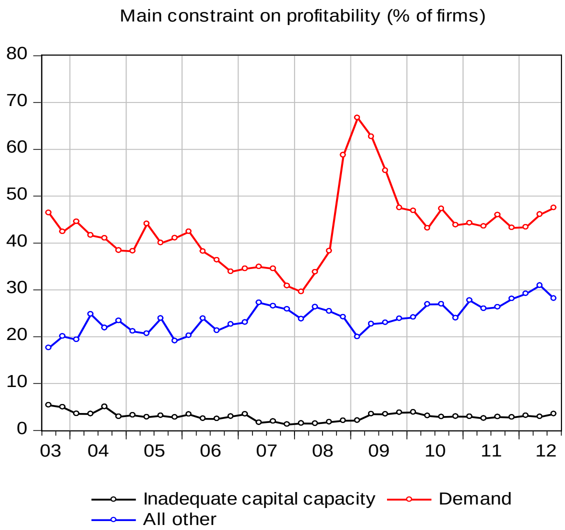
Labour relatively easy to find

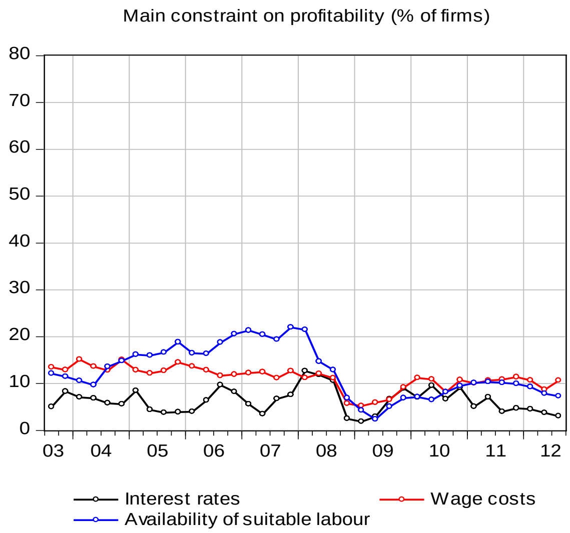
Unemployment rate & labour constraints



Sources: ABS; NAB

Demand constraining profitability





Demand remains the most significant constraint on firms' profitability over the next 12 months, and it is now expected to be more of a constraint than in any quarter since December quarter 2009. 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 and inadequate capital capacity as a relatively minor constraints on future profitability. Wage costs increased in importance in the September quarter. Within 'all other', tax & government policy remains elevated.

Constraints on output (% of firms)*	2011q3	2012q2	2012q3
Sales & orders	57.0	58.2	**57.9**
Labour	47.9	44.1	**44.1**
Premises & plant	22.1	21.0	**21.1**
Materials	12.5	10.7	**9.6**

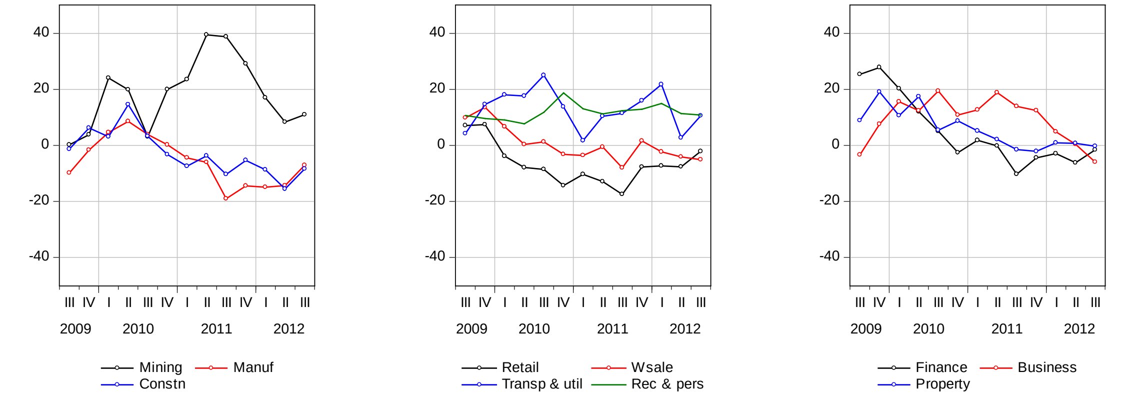
Main constraints on profitability (% of firms)*	2011q3	2012q2	2012q3
Interest rates	4.5	3.7	**3.0**
Wage costs	10.7	8.7	**10.6**
Labour	9.2	7.8	**7.3**
Capital	3.1	2.9	**3.5**
Demand	43.3	46.0	**47.4**
All other	29.2	30.9	**28.1**

* *not s.a.*

Industry and state analysis

Business conditions: recreation, transport & mining strongest

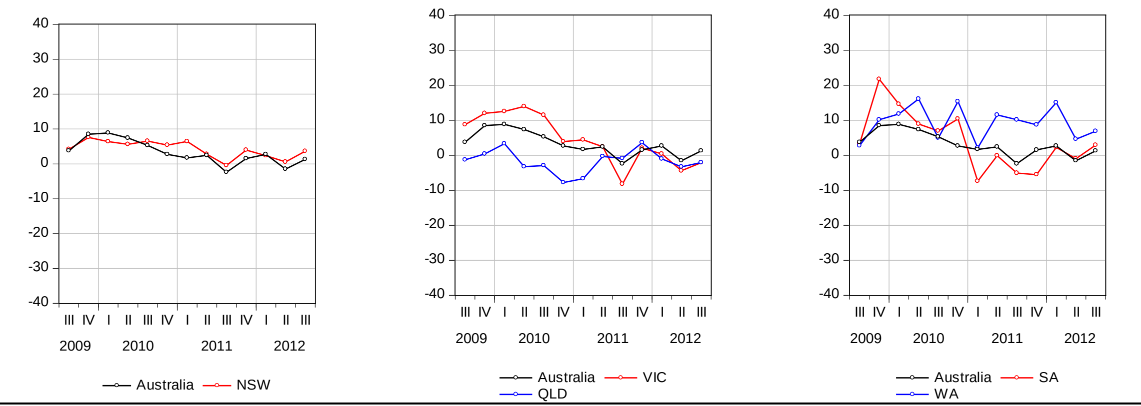
Business conditions (s.a., net balance)



Business conditions improved across most industries in the quarter. The two exceptions being, business services and wholesale – with the former reporting the more significant falls. The most notable improvements in conditions were in transport & utilities, manufacturing, construction and retail – with these sectors starting to benefit from the impact of lower borrowing costs. Furthermore, it is likely that some benefit from government carbon tax compensation payments made to households in May and June boosted activity in the consumer dependant sectors at the beginning of the September quarter. Interestingly, mining conditions improved in the quarter, despite falling commodity prices. According to the survey, mining trading conditions deteriorated heavily but this was more than offset by a solid improvement in employment conditions. In the September quarter, conditions were strongest in recreation & personal services, transport & utilities and mining, but weakest in construction, manufacturing and business services.

Business conditions: WA strongest; Tas weakest

Business conditions (s.a., net balance)

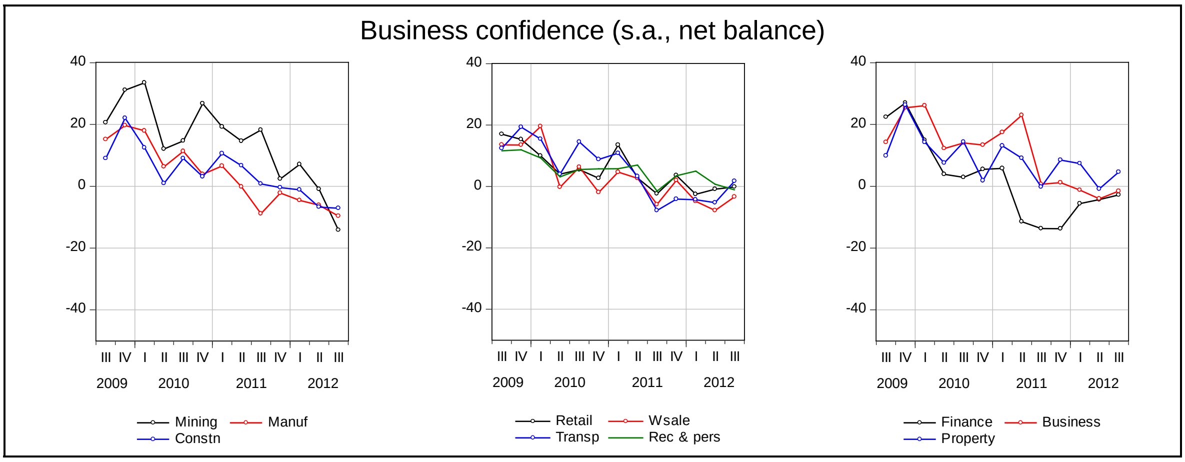


Business conditions improved across all mainland states in the September quarter, with the most significant improvement in SA, followed by NSW, Victoria and WA. Overall conditions remained the strongest in WA – implying the recent softening in commodity prices is yet to have an impact on the state's overall economy – followed by NSW and SA. The weakest conditions are reported in Victoria and Queensland. Conditions in Tasmania picked up solidly but remained poor (on a small sample).

	Quarterly					*Monthly*				
	2011q3	2011q4	2012q1	2012q2	2012q3	2012m05	2012m06	2012m07	2012m08	2012m09
Business conditions										
NSW	0	4	2	1	**4**	-3	1	-2	-1	-2
VIC	-8	2	0	-4	**-2**	-7	-10	-11	5	-9
QLD	-1	4	-1	-3	**-2**	-8	-1	-1	1	-2
SA	-5	-6	2	-1	**3**	1	-3	-5	4	-6
WA	10	9	15	5	**7**	3	28	12	2	3

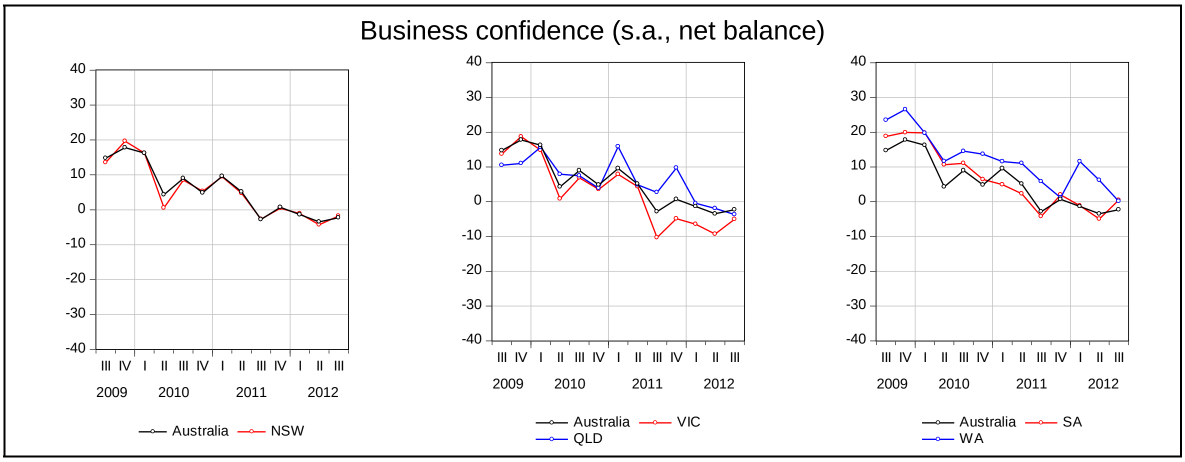
Industry and state analysis (cont.)

Business confidence: mining now least optimistic; property strongest



Changes in business confidence were mixed in the September quarter, though sentiment was generally downbeat for all industries – especially mining, which has gone from being one of the most optimistic industries to the most pessimistic on the back of weaker commodity prices and concerns about Chinese growth. While not as significant as the decline in mining confidence, sentiment also eased in manufacturing and recreation & personal services in the quarter. In contrast, confidence improved solidly in transport & utilities and wholesale. In levels terms, confidence was highest (and positive) in transport & utilities, followed by retail, while it was weakest in mining, manufacturing and construction.

Business confidence: no positive readings; WA & SA least pessimistic, Victoria & Queensland weakest

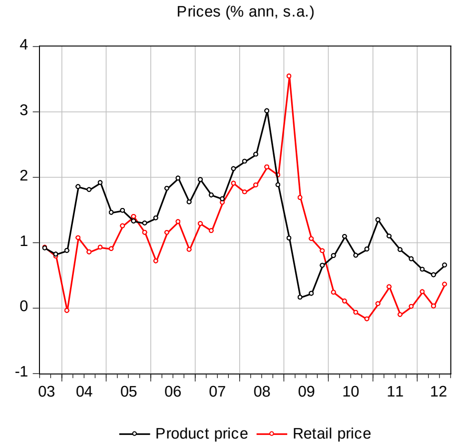


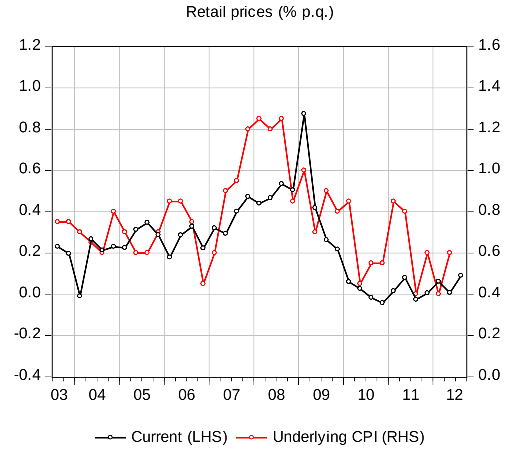
Business confidence levels picked up in most mainland states in the September quarter – with the exception of WA and Queensland – following broad-based declines in the previous quarter. The fall in WA sentiment was fairly heavy and consistent with the sharp decline in mining confidence in the quarter. The largest improvement in confidence was in SA, followed by Victoria and NSW. While no state reported positive sentiment in the quarter, SA and WA were the least pessimistic, while Victoria and Queensland were the most pessimistic. Business confidence in Tasmania deteriorated modestly and remained the most pessimistic of all states.

	Quarterly					*Monthly*				
	2011q3	2011q4	2012q1	2012q2	2012q3	2012m05	2012m06	2012m07	2012m08	2012m09
Business confidence										
NSW	-3	0	-1	-4	**-2**	-2	-5	4	-2	3
VIC	-10	-5	-6	-9	**-5**	-12	-4	-3	-4	-2
QLD	3	10	0	-2	**-4**	-2	-7	3	-9	0
SA	-4	2	-1	-5	**0**	-2	-1	-3	-3	-10
WA	6	1	12	6	**0**	8	-4	9	8	1

Inflation and costs

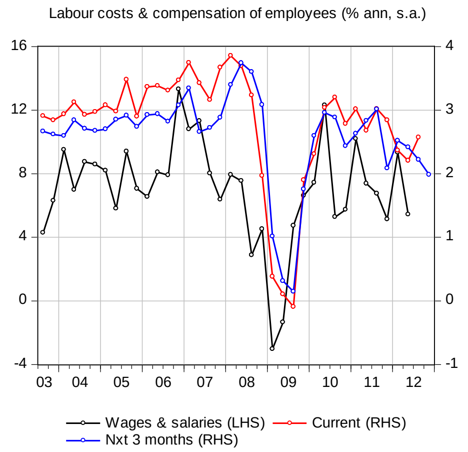
Price pressures remain benign: retail prices point to soft Q3 core inflation

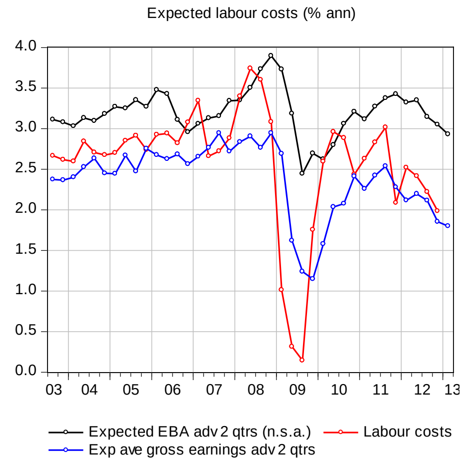




Product price inflation ticked up a little in the September quarter – up 0.1 ppt to 0.2% (at a quarterly rate). Interestingly, there appears to be little evidence to suggest that prices have been substantially impacted by carbon pricing, which was introduced by the government on 1st July 2012. In particular, prices growth in transport & utilities – the industry most likely to feel the initial brunt of the tax burden – was unchanged at 0.4% in the quarter, although this was the (equal) highest rate of growth reported by any industry. Retail prices increased marginally (up 0.1 ppts to 0.1%); the trend in the quarterly NAB retail price series is broadly consistent with official underlying inflation data, and points to another soft inflation outcome in the September quarter.

Labour costs pressures remain fairly 'normal'





Quarterly annualised **labour costs** growth rose to 2.6% in the September quarter, from 2.2% in the June quarter. There are two factors that influence labour costs – changes in employment and changes in wages; given the softness in recent employment conditions, the rise in labour costs growth implies that wage pressures may have increased in the quarter. Wage increases under EBAs are expected to average 2.9% over the next year – down from 3.1% in the previous quarter – or 2% after allowing for productivity offsets.

On average, businesses expect short-term interest rates to decline by 13 bps (down 36 points in the June quarter). Note, the interviewing for the September quarter survey was conducted prior to the RBA's decision to lower the cash rate by 25 bps in October, implying the October rate cut was not fully anticipated. Exchange rate expectations (6-months-ahead) rose sharply, from $0.98 US in the June quarter to $1.06 US in the September quarter. The increase in the expected exchange rate is consistent with the higher level of the AUD during the quarter.

Medium-term inflation expectations remained reasonably relaxed, with 48% of respondents expecting inflation to remain below 3% (44% in the previous quarter) and 44% expecting inflation of 3-4% (47% last quarter). Only 3% of respondents now believe inflation is a serious problem (4% last quarter), while 28% believe it is a minor problem (30% last quarter).

Expected house price inflation for the coming year was revised down to -0.1% (-0.8% previously).

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