National Australia Bank

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Monthly Business Survey

June 2013

Business conditions and capacity utilisation slump to a four year low. Confidence a little better but still below trend. Conditions very bad in retail, mining and manufacturing, despite low interest rates and falling AUD, though signs a little better for exports. Plenty of spare capacity with little indication of being utilised in the near term; forward orders and employment still very poor.

- The June survey paints a worrying picture of the Australian economy; business conditions slumped in June to their lowest level since May 2009. Weaker trading conditions and profitability combined with still poor employment conditions drove business conditions lower, with each of these indicators remaining well below average levels. Conditions deteriorated heavily in mining, retail and manufacturing (despite a tumbling AUD). Weak forward indicators – including forward orders, stocks, capacity utilisation and employment conditions – remain concerning and suggest little improvement in near-term demand.
- Business confidence lifted marginally in June, but remained lacklustre. The falling AUD appears to have done little to lift spirits, with concerns about global economic conditions likely to be weighing. Overall weakness in domestic economy also likely to be worrying firms. Federal government reshuffle occurred during the final days of survey period, but the survey provides little indication about how sentiment may have been affected.
- Overall, the survey implies underlying demand growth and GDP (6-monthly annualised) of around 2½% in the June quarter. Our wholesale leading indicator suggests a modest improvement in near-term activity, at best.
- Labour costs growth softened in June, consistent with still weak employment conditions. Prices fell for a second consecutive month (but retail rose), while costs grew modestly.

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

- Equity and currency market volatility reflects uncertainties over the pace at which the Fed might alter US monetary policy, Chinese authorities might clamp down on shadow banking and the potential impact of the Bank of Japan's move to greater monetary easing. Recent industrial and trade data plus business survey readings show slightly better activity outcomes in big advanced economies but growth in India and Brazil remains disappointing and there are growing concerns that China might be unable to manage a smooth transition to slower more consumer-led economic growth. After two years of growth of around 3%, we still expect global growth to move back to trend in 2014.
- Domestic weakness implied by this survey, along with softness in China, a weaker terms of trade and financial market volatility, encourages us to bring our next expected rate cut forward to August (previously November), assuming no downside surprises from unemployment or inflation. We expect the bias to easing to continue beyond August. Our inflation forecasts are unchanged at 2.4% in mid-2013 and 2.5% in mid-2014, well within the RBA target band. We have left GDP growth unchanged at 2.3% in 2013 and 2.8% in 2014 but with greater downside risk to the outlook. The unemployment rate is still expected to exceed 6% by the end of this year.

Key monthly business statistics*

	Apr 2013	May 2013	**Jun 2013**		Apr 2013	May 2013	**Jun 2013**
		Net balance				*Net balance*	
Business confidence	-1	-1	**0**	Employment	-8	-6	**-6**
Business conditions	-6	-4	**-8**	Forward orders	-6	-6	**-5**
Trading	-3	-1	**-7**	Stocks	-3	-1	**-5**
Profitability	-7	-5	**-8**	Exports	-3	-3	**-1**
		% change at quarterly rate				*% change at quarterly rate*	
Labour costs	0.8	0.9	**0.5**	Retail prices	0.1	-0.2	**0.3**
Purchase costs	0.4	0.5	**0.3**			*Per cent*	
Final products prices	0.2	-0.1	**-0.2**	Capacity utilisation rate	79.5	79.5	**79.3**

* All data seasonally adjusted and subject to revision. Cost and prices data are monthly percentage changes expressed at a quarterly rate. Fieldwork for this survey was conducted from 24 to 28 June, covering over 400 firms across the non-farm business sector.

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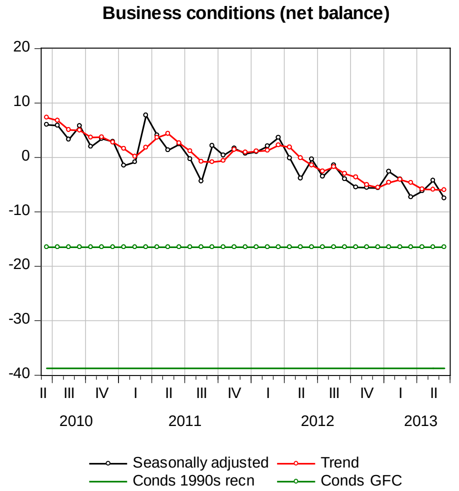
Next release:
13 August 2013 (July monthly)

Analysis

Business conditions slumped to -8 points in June, from -4 points in May, which was the weakest reading since May 2009. This more than reversed the tentative signs of improvement in April and May. Most concerning in June was the collapse in retail, mining and manufacturing conditions, with retail activity deteriorating to its weakest level in the history of the monthly survey (since 1997). All of this weakness has come about despite relatively easy monetary policy settings and the recent depreciation of the Australian dollar, which should be helping to improve Australia's competitiveness. While industry activity readings were heavily skewed to the downside, conditions in finance/ business/ property bucked the trend, lifting to their highest level in two years. Overall, the outlook for near-term activity remains worrisome, with forward orders, stocks, employment conditions and capacity utilisation all remaining well below historical average levels.

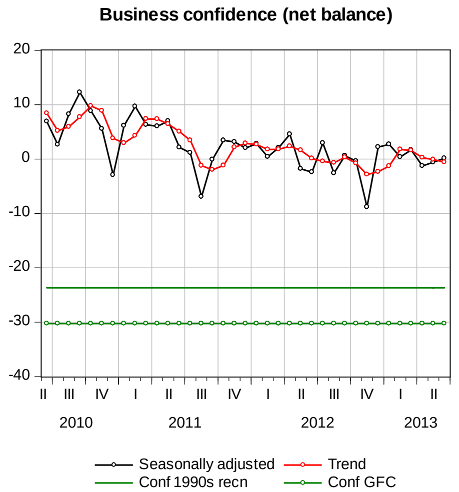
Business confidence improved only marginally in June, up 1 to zero points; this reading implies that the number of optimistic and pessimistic firms was broadly similar in the month. Mining became by far the most pessimistic in June – consistent with the slowing in mining investment and further declines in commodity prices during the month – while the consumer dependent wholesale and retail industries also appear downcast. Elsewhere, confidence levels were marginally positive, where firms may be looking forward to the benefits of a lower Australian dollar. This survey was conducted during the week that Kevin Rudd was re-elected as Prime Minister, though it is difficult to gauge from the responses how this affected business confidence, if at all. Internationally, it is possible that the expectation for the US Federal Reserve to begin tapering its asset purchasing program before the end of this year, which has raised expectations for the Fed funds rate to be lifted sooner, may be concerning Australian firms. Furthermore, the outlook for the Chinese economy appears to have become more worrying over recent months, which may be weighing (especially) on exporting firms.

Conditions fall to lowest level since May 2009



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

Confidence still lacklustre



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

Business conditions by industry. Business conditions deteriorated markedly in retail (down 17 to -28 points), mining (down 15 to -28 points) and manufacturing (down 13 to -27 points). The slump in retail activity is consistent with very poor forward orders in the previous month; while June is traditionally a seasonally strong month for retailers, this year's mid-year sales appear to have been underwhelming. While manufacturing conditions were very poor, confidence in this industry improved in June, which may reflect the expectation for a lower exchange rate to eventually strengthen international demand for Australian manufacturing exports and alleviate pressure from imports. The weakness in mining conditions can be explained by the slowing in mining investment and softening global commodities demand. In contrast, business conditions improved solidly in finance/ business/ property (up 12 to +12 points), possibly helped by relatively low borrowing rates as well as recent improvements in housing demand. Overall, conditions in the consumer dependent sectors (recreation & personal services to a lesser extent) remained poor in June. Until consumers' reluctance to borrow and spend on discretionary items eases it is unlikely that we will see a sustained improvement in consumption growth.

Analysis (cont.)

Business conditions by state. In June, trend conditions were broadly unchanged across states. Across the mainland states, activity was weakest in SA (-12 points), where fiscal consolidation appears to be weighing more heavily than in some of the other states. Trend conditions were also especially poor in WA, NSW (both -7) and Queensland (-6), likely reflecting the current weakness in mining activity. Business conditions were relatively less subdued for Victorian firms, trending at -4 index points, though seasonally adjusted conditions deteriorated heavily in the month implying some downside to future trend readings. The recent weakness in (seasonally adjusted) Victorian activity is consistent with reports of significant job cuts in some key Victorian industries.

Business confidence by industry. The pessimism that has crept into the mining sector since mid last year has become very apparent and persistent, with this industry remaining by far the most pessimistic overall. Confidence faltered modestly in wholesale and retail, with these sectors relatively downbeat in June. It is possible that the weakness in activity in these consumer dependent industries has weighed on expectations for the month ahead. Elsewhere, industries generally reported slight positive confidence readings; manufacturing confidence lifted notably, which may mean that the Australian dollar depreciation represents positive news. Confidence levels were weakest in mining (-21), wholesale (-9) and retail (-5), while they were least subdued in recreation & personal services (+3) and transport & utilities (+2).

Business confidence by state. Trend business confidence was little changed across the mainland states in June – softening a little in WA and Victoria, but otherwise remaining unchanged. The overall level of confidence was broadly similar across the states, ranging from +2 in Queensland – the only mainland state to report a positive reading – and -4 points in Victoria.

The **forward orders** index edged marginally higher in June – up 1 to -5 index points – and remained 4 points below the series long-run average since 1989. In levels terms, orders were especially weak in mining (-28), manufacturing (-20) and wholesale (-12), while they were strongest (and positive) in construction (+10). **Capacity utilisation** fell back in June, to 79.3%, which is the lowest outcome in four years. The fall was largely driven by an increase in mining and transport & utilities spare capacity, which was partly offset by increased capacity utilisation in construction. Utilised capacity was lowest in manufacturing (73.4%) and mining (75.3%) – consistent with very poor employment conditions in these industries. The **stocks** index – also a good indicator of current demand – fell back sharply, from -1 point in May to -5 points in June. Given a sharp deterioration in trading activity in the month, the fall in the stocks index implies that the unwinding of stocks was involuntary.

The **capital expenditure** index was unchanged at -3 index points in June. While mining capex reported a significant turnaround in the month – up 44 to -1 index point – the trend in mining capex remains fairly subdued, at -18 points. The weakness in trend mining capex is consistent with official data and anecdotal reports that mining investment is beginning to slow. Capital expenditure also improved solidly in construction (up 9) and manufacturing (up 6), but the level of capex for these industries remained in negative territory. In levels terms, the capex index (seasonally adjusted) was lowest in manufacturing (-9) and wholesale (-6), while it was highest in recreation & personal services and transport & utilities (both +3). Uncertainty associated with the forthcoming Federal election may be a negative for capex plans.

Analysis (cont.)

Based on forward orders, the survey implies 6-monthly annualised demand growth was around 2¼% in Q1 2013, much higher than the actual level of -0.2%. If we assume average monthly forward orders for the three months to June, the survey implies 6-monthly annualised demand growth will be around 2½% in Q2 2013. That is, a little stronger than Q1 growth but still below trend.

Similarly, based on average business conditions for Q1 2013, the survey implies 6-month annualised GDP growth (excluding mining) of around 3-3¼% in Q1 2013, somewhat higher than actual growth of 2¼%. If we assume average monthly business conditions for the three months to June, the implied growth rate would be around 2¼-½% in Q2 2013.

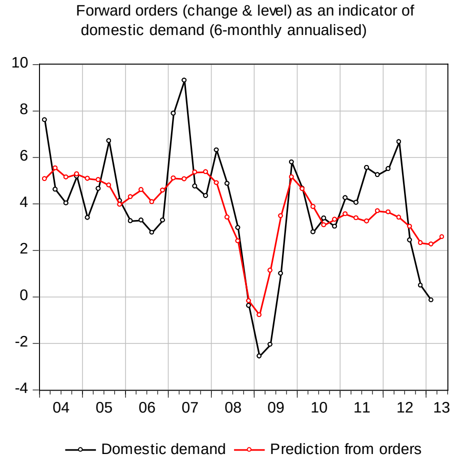
Elsewhere in the survey, cash flow (not seasonally adjusted) was strongest in finance/ business/ property and recreation & personal services, and weakest in mining and manufacturing.

Labour costs growth (a wages bill measure) softened to 0.5% in June, from 0.9% in May (at a quarterly rate). With employment conditions still very negative, the softening in labour costs growth does not necessarily imply a weakening in wage pressures. However, labour market conditions have been subdued for quite some time – employment conditions have been negative for 14 consecutive months – and when combined with a low level of capacity utilisation, the softness in labour costs growth implies wage pressures are limited. Labour costs growth was strongest in finance/ business/ property (1.2%, quarterly), while labour costs fell by 2.4% in mining.

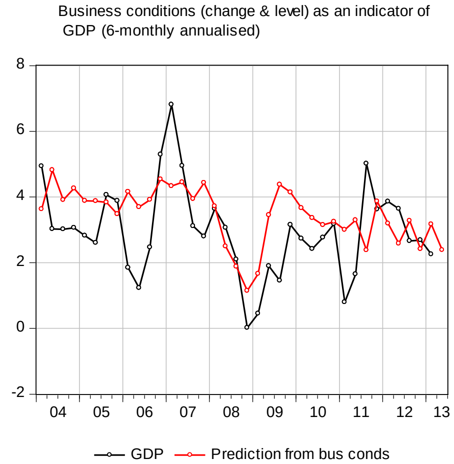
Final product prices fell again in June, down 0.2% following a fall of 0.1% in the previous month (at a quarterly rate). The instance of deflation is consistent with particularly poor trading activity in June, as well substantial spare capacity. The weakness in product prices was largely driven by continued declines in the mining sector, where prices fell by 3.3%, after falling by 2.2% in the previous month (at a quarterly rate) – which is consistent with recent commodity price declines. Price inflation was only present for transport & utilities (0.4%) and retail (0.3%), while the price deflation was most apparent in mining (-3.3%) and manufacturing (-0.6%).

Purchase cost growth softened to 0.3% in June, from 0.5% in May (at a quarterly rate). The softening in purchase costs growth was largely driven by weaker growth in recreation & personal services (down 0.6 ppts to 0.2%) and transport & utilities (down 0.5% to 0%). This was partly offset by a slight pick up in manufacturing, mining and retail cost pressures. Overall, growth in purchase costs was strongest in wholesale (1.1%) and softest in transport & utilities (zero growth) and construction (0.1%).

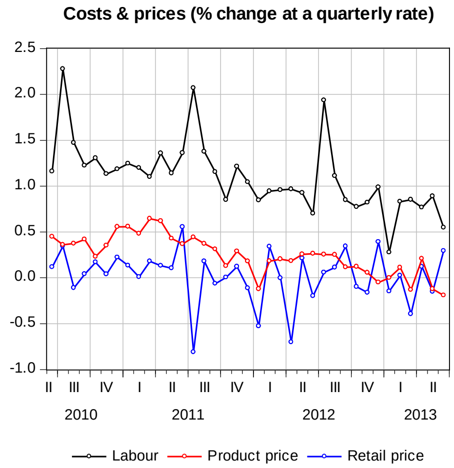
Demand growth to remain below trend in Q2



GDP (ex coal) growth to remain close to current (low) levels in mid 2013



Prices fall further – modest cost growth implies tighter margins



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

Current business conditions

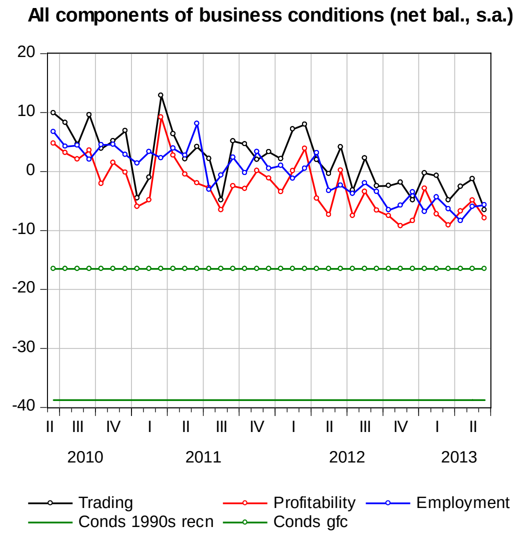
The business conditions index pared back previous gains in June – down 4 points to -8 index points – falling to the lowest level since May 2009. While also very weak, trend conditions were unchanged in June, at -6 index points, which is 6 points below the series average since 1989 (a period which encompassed the early 1990s recession). The overall weakness in conditions implies that the domestic economic environment remains challenging.

Trading, profitability and employment

The sharp fall in June business conditions reflected deteriorations in trading and profitability, while employment conditions were unchanged.

The sharp decline in **trading** activity in June was largely driven by retail (down 18), mining and manufacturing (both down 8). Finance/ business/ property was the only sector to report better trading conditions in the month (up 4). In levels terms, trading conditions were very subdued in retail (-34), manufacturing (-23) and mining (-16), while they were strongest in finance/ business/ property (+11) and recreation & personal services (+4).

Trading & profits sink, employment steady at still subdued level

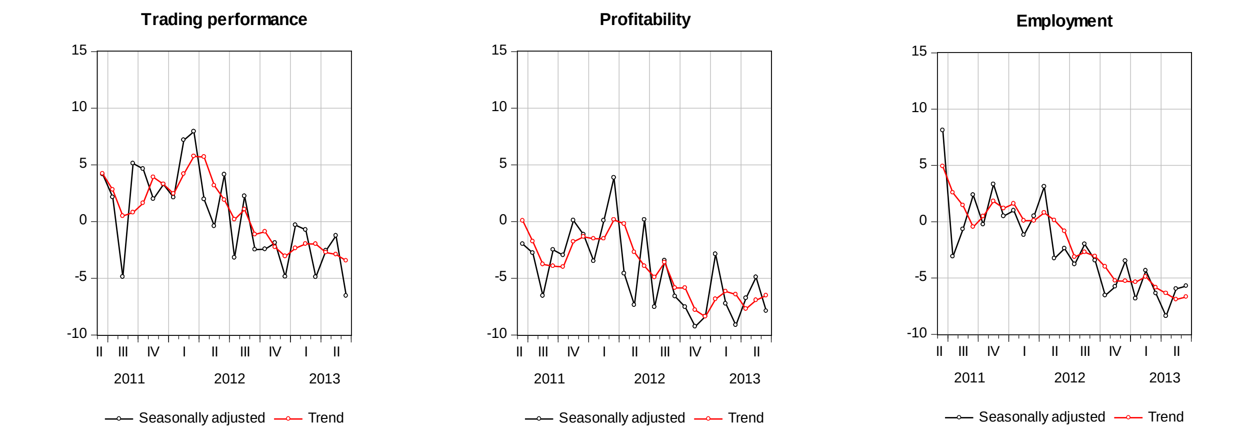


Net balance of respondents who regard last month's trading / profitability / employment performance as good.

The weakening in **profitability** in June was reasonably broadly based across most industries. Profitability sank in mining (down 27), while it also fell markedly in transport & utilities (down 10), manufacturing, retail (both down 9) and wholesale (down 8). In contrast, profitability improved strongly in finance/ business/ property (up 16) and was marginally better in construction (up 1), albeit still weak. Profitability was weakest in mining (-38, the weakest outcome in a decade), manufacturing and retail (both -25), while it was strongest (and positive) in finance/ business/ property (+14) and recreation & personal services (+1).

While **employment conditions** were unchanged in June, conditions remained varied across industries. Employment conditions weakened notably in retail (down 16) and manufacturing (down 15), while they strengthened considerably in transport & utilities (up 13), construction (up 9) and finance/ business/ property (up 8). Overall employment conditions were weakest in mining (-27), manufacturing (-26), retail (-16) and wholesale (-12), while they were least subdued in transport & utilities (+8) and finance/ business/ property (+2). The generally weak employment conditions reported here are broadly consistent with other indicators of labour market activity.

Business conditions components (net balance)



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

Current business conditions (cont.)

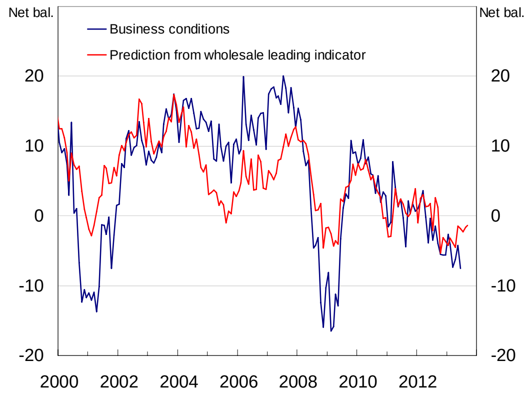
Wholesale: Signalling continued softness in the domestic economy?

The weakness in wholesaling that has persisted for the best part of 3½ years has continued into 2013. While conditions have been volatile in recent months, trend business conditions in wholesaling ticked up in June, to -10 points, but remained very poor overall.

Based on historical relationships, wholesale conditions appear to be a reasonably good predictor of overall business conditions – certainly there is strong statistical evidence of a leading relationship (Granger causality). Our analysis suggests that if seasonally adjusted wholesale conditions in June (-9) were to continue though to Q3 2013, overall business conditions could be expected to remain poor, averaging just -2 index points. That, in turn, is suggestive of an economy still running below trend and with little upward momentum in the growth rate.

Wholesale activity points to modestly better overall conditions

Wholesale as a leading indicator of business conditions



Indicator = f(business conditions_wsl, business conditions_wsl(-1 to -4), ar(1), ar(3))

Forward orders

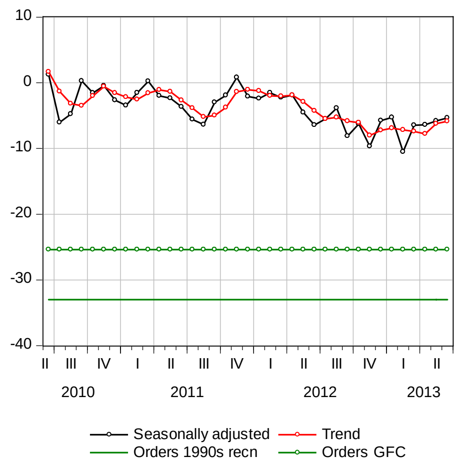
The forward orders index rose only marginally in June, up 1 point to -5 index points, to remain below the series long-run average of -1 point since 1989. This measure of future demand implies that activity will remain poor through the middle of this year.

Forward orders deteriorated heavily in wholesale (down 9) and manufacturing (down 8) in June, with these falls broadly offset by improvements in retail (up 13) and construction (up 8). The improvement in construction orders has been fairly marked over recent months; looking through the volatility, trend orders have lifted by 12 points in the past two months. Orders were most subdued in mining (-28), manufacturing (-20) and wholesale (-12), while they were strongest (and positive) in construction (+10).

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

New orders still weak, but stabilising

Forward orders (net balance)



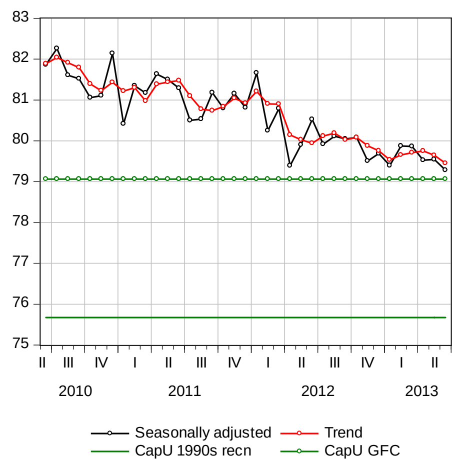
Capacity utilisation

In June, capacity utilisation eased to 79.3% from an already low 79.5% in the previous month, with this month's outcome almost 1 ppt below the series long-run average (of 80.4% since 1989). Capacity utilisation fell heavily in mining (down 3.4 ppts to 75.3%, the lowest outcome since October 2002), followed by transport & utilities (down 1.5 ppts to 81.0%). Partly offsetting these falls was a solid rise in utilised capacity of construction (up 1.7 ppts to 81.4%). In levels terms, capacity utilisation was highest in finance/ business/ property (82.0%), construction (81.4%) and recreation & personal services (81.3%), and lowest in manufacturing (73.4%) and mining (75.3%).

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

Plenty of spare capacity

Capacity utilisation (per cent)



Current business conditions (cont.)

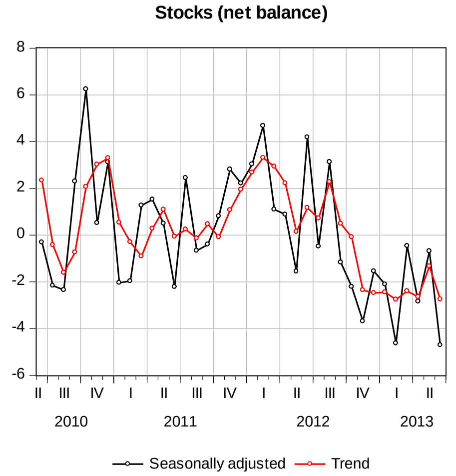
Stocks

The stocks index fell by 4 points to -5 points in June, more than offsetting a pick up in May. In trend terms, the index fell by 2 points to -3 index points, to remain below the series long-run average of +1 point since 1989.

The stocks index fell significantly in mining (down 13), transport & utilities (down 12) and retail (down 11); construction (up 12) and recreation & personal services (up 2) were the only industries to report an increase. When combined with the deterioration in trading activity, the fall in stocks appears to have been voluntary. In levels terms, stock indices were lowest in mining (-27) and wholesale (-11), while the index was highest (and positive) in construction (+3).

Net balance of respondents with a rise in stocks last month

Voluntary de-stocking begins

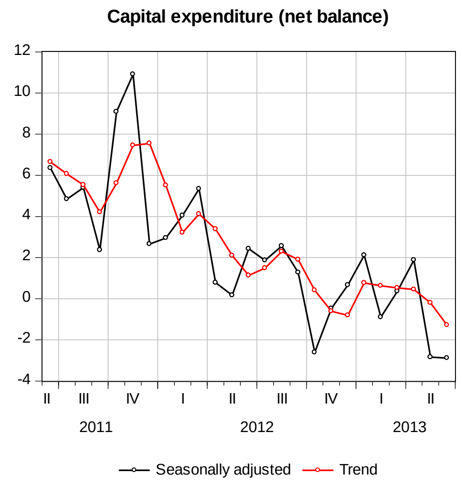


Capital expenditure

The capex index remained at -3 index points – the equal lowest outcome in almost four years. This outcome came despite a sharp pick-up in mining capex (up 44 to -1 point); looking through the volatility, trend mining capex eased modestly to -18 points in June. In the non-resource sector, the capex index lifted in construction (up 9) and manufacturing (up 6), while it declined notably in finance/ business /property (down 6) and retail (down 4). In levels terms, capex was lowest in manufacturing (-9) and wholesale (-6), while it was highest in transport & utilities and recreation & personal services (both +3).

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

Capex remains close to 4 year low



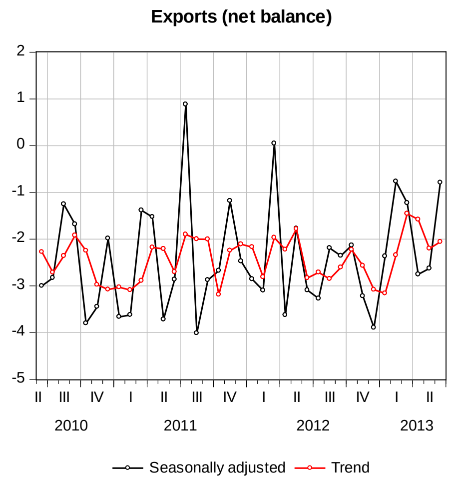
Exports

The exports index, which represents export conditions for the economy as a whole, lifted modestly to -1 point in June, from -3 points in May. The rise in exports was broadly based across industries in the month, with manufacturing the only exception (down 2 points). The most notable improvements were in finance/ business/ property (up 7), construction and wholesale (both up 5). It appears that the recent depreciation in the Australian dollar may be helping to strengthen Australia's international competitiveness. The exports index was highest in construction (+4) and finance/ business/ property (+3), and lowest in manufacturing (-11) and mining (-2).

The exporters' sales index, which represents export conditions for exporting industries, also lifted, to -4 points, from -11 points in May.

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

Lower $ appears to be helping exports



Current business conditions (cont.)

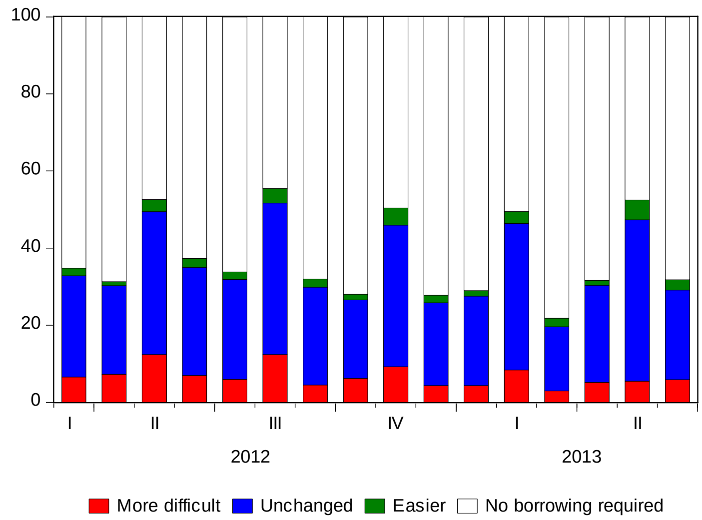
Credit availability

Borrowing conditions tightened moderately in June, suggesting that finance became more difficult for businesses to access in the month.

The net borrowing index (easier minus harder) fell from zero points to -3 points in June. This outcome entirely reflected a decline in the proportion of firms finding borrowing easier, while the proportion of firms finding borrowing more difficult to obtain was unchanged. Overall, around one third of firms required borrowing in June.

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

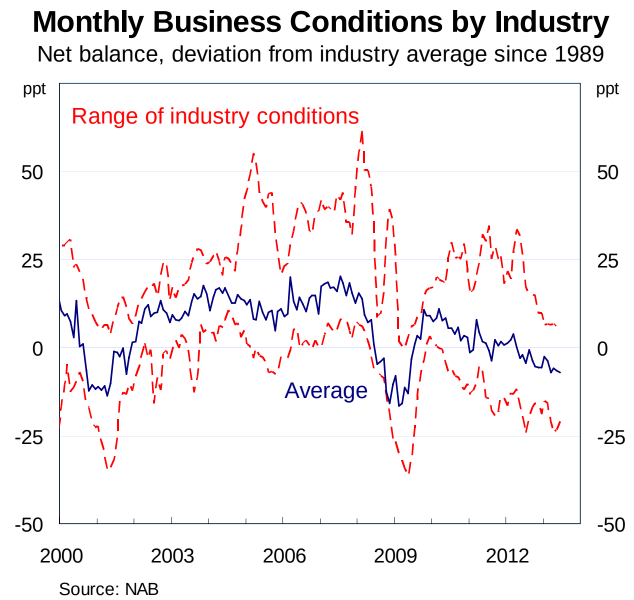
Borrowing conditions tighten



The variation in business conditions across industry has been quite pronounced since late 2009, largely reflecting the relative strength of mining and service related industries compared to the weaker consumer dependent and trade based industries following the GFC. However, the range of industry conditions has narrowed notably over the past year or so. This can be observed by comparing the difference between the best performing and worst performing industries each month.

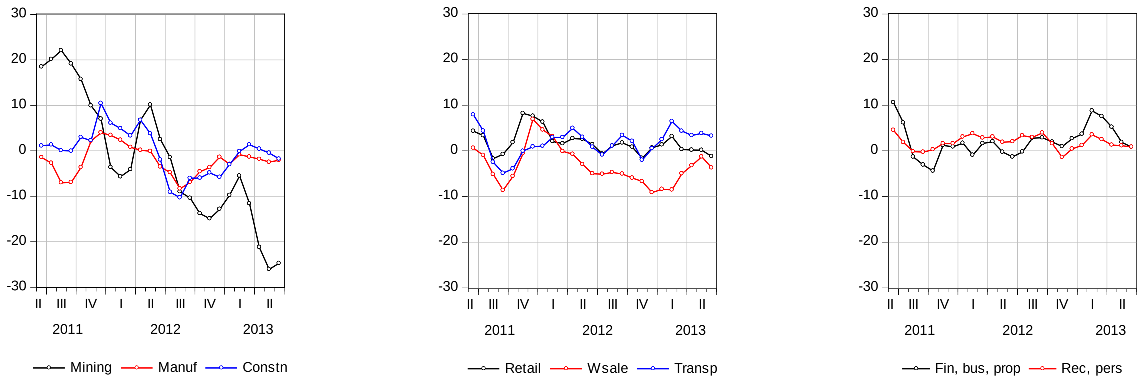
While the variation in conditions across industries has narrowed more recently, it largely reflects a weakening in conditions of the previously stronger performing industries – including mining, services and transport firms – suggesting weakness elsewhere may be spreading.

Range of industry conditions continues to narrow

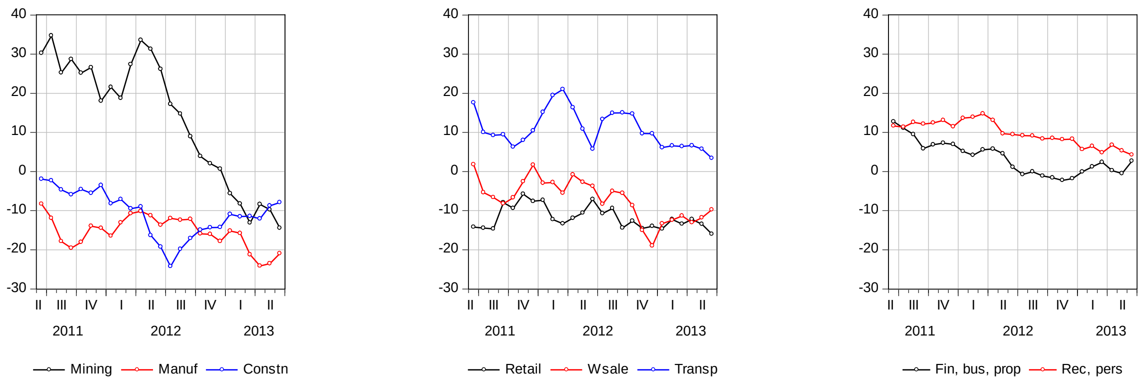


Industry sectors and states

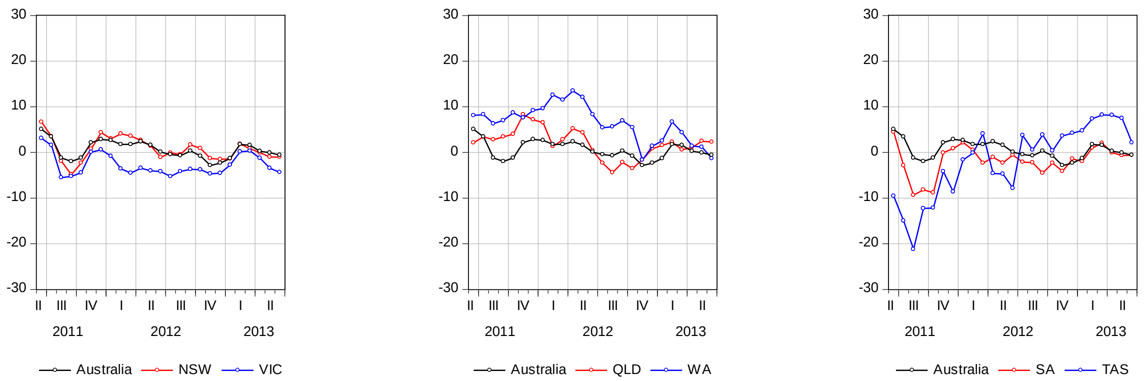
Business confidence by industry (net balance): 3-month moving average



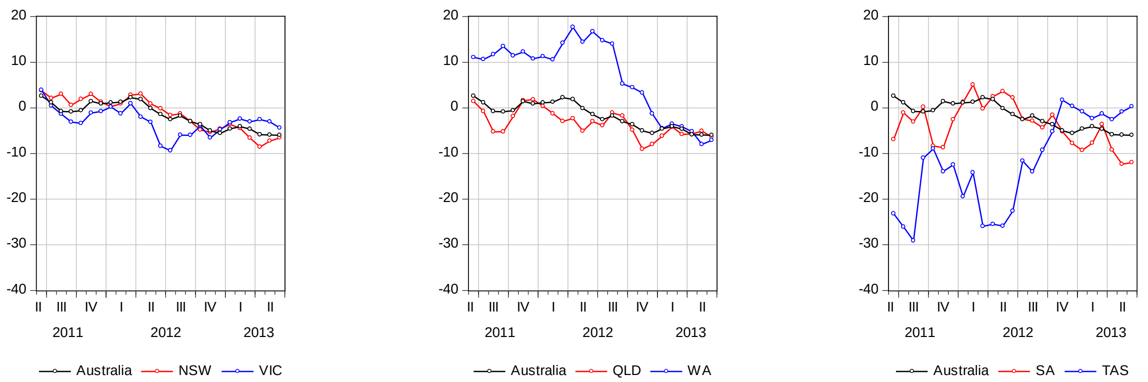
Business conditions by industry (net balance): 3-month moving average



Business confidence by state (net balance): 3-month moving average



Business conditions by state (net balance): 3-month moving average



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Wellington	+800 64 642 222	+800 64 644 464
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