National Australia Bank

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Monthly Business Survey

September 2013

Animal spirits lift again. Confidence surges to its highest level in 3½ years. Business conditions, however, still subdued – with employment poor. Signs of better conditions in finance/ business/ property and construction. Forward indicators – including orders, stocks and capacity utilisation – point to future improvement. But our wholesale leading indicator less certain. Firms manage to increase prices modestly but margins still under pressure. Forecasts unchanged except cash rate cut delayed to February.

- Business confidence was boosted again in September, with the index rising to its highest level since March 2010, to be 17 points higher than its most recent trough in July. The federal election result appears to have helped confidence further but the gains were uneven. Low borrowing rates, rising consumer sentiment and a lower dollar may have also helped – especially in recreation & personal services and retail. Also better news from China probably helped sentiment in mining. Transport & utilities sentiment however has weakened. By region sentiment rose sharply in WA, Victoria and NSW.
- Business conditions were moderately up in September but, at -4 points, remained relatively low. Finance/ business/ property and construction showed big gains possibly in line with the housing market. Activity remained worryingly weak in mining and manufacturing, while conditions in transport & utilities have recently turned down to very poor levels. Finance/ business/ property and recreation & personal services were the best performing sectors in the month. Some hope for better activity to come, with orders, stocks and capacity utilisation rising to fresh highs for the year. Nonetheless, employment conditions remain subdued, painting a soft outlook for the labour market.
- The survey implies underlying demand growth (6-monthly annualised) of around 2¾-3% in Q3 and GDP growth of around 2½%. Our wholesale leading indicator implies no improvement in near-term activity.
- Labour and purchase costs growth continued to soften in September. While prices rose modestly in September (as did retail prices), when combined with relatively stronger cost pressures, margins have probably tightened.

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

- Although an upturn is still underway, the pace of industrial growth and business sentiment in some big advanced economies has stopped improving. Emerging market trends have been mixed with China showing signs of stabilising, India remaining weak and a very modest improvement across emerging Asia and Latin America. Global growth still expected to be 3% this year and 3½% in 2014 and 2015. US political uncertainties over its government shut-down and debt ceiling are not assumed to have a marked impact on US GDP growth.
- GDP forecasts unchanged this month: growth to soften to 2.3% in 2013 before gradually rising to 2.5% in 2014 and 2.9% in 2015. Unemployment to exceed 6% by end 2013 and reach 6¾% by end 2014. Consistent with this soft outlook, core CPI to edge down to 2.2% by end 2013, lifting modestly to 2.5% by end 2014. RBA appears less dovish on the back of better confidence and improving asset prices. But AUD still elevated and labour market continues to weaken. We still see a need for another 25 bp rate cut – probably in Feb (was Nov).

Key monthly business statistics*

	Jul 2013	Aug 2013	**Sep 2013**		Jul 2013	Aug 2013	**Sep 2013**
	Net balance				*Net balance*		
Business confidence	-5	4	**12**	Employment	-6	-9	**-6**
Business conditions	-7	-7	**-4**	Forward orders	-6	-5	**1**
Trading	-5	-6	**-3**	Stocks	-6	-3	**4**
Profitability	-11	-9	**-4**	Exports	-2	0	**-1**
	% change at quarterly rate				*% change at quarterly rate*		
Labour costs	1.4	0.6	**0.5**	Retail prices	0.2	0.1	**0.3**
Purchase costs	1.2	0.7	**0.6**		*Per cent*		
Final products prices	-0.1	0.1	**0.4**	Capacity utilisation rate	79.9	80.1	**80.3**

* 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 30 September, covering over 400 firms across the non-farm business sector.

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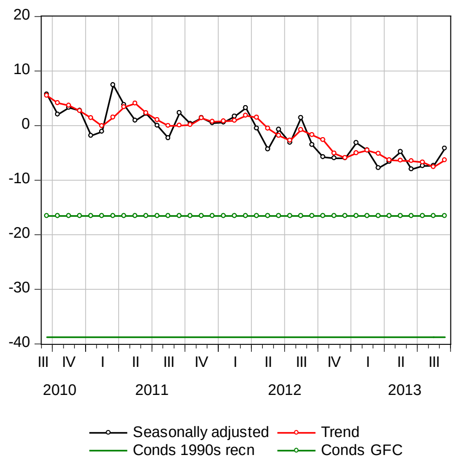
Next releases:
17 October 2013 (September quarterly)
12 November 2013 (October monthly)

Analysis

Business conditions improved modestly in September, with the index lifting to its highest level since January this year. The **business conditions** index was moderately better in the month, rising 3 points to -4 points, though the negative outcome still implies a reasonably subdued level of activity. The lift in conditions was largely driven by improvements in finance/ business/ property and construction, which appear to have benefited from better sentiment in the housing market – especially accelerating house price increases. Against that conditions weakened again in transport & utilities. While a majority of industries continued to report negative activity readings, forward indicators, including forward orders, stocks and capacity utilisation, generally strengthened in the month, suggesting near-term activity may improve. But with employment conditions still subdued, labour market conditions may remain challenging over the months ahead.

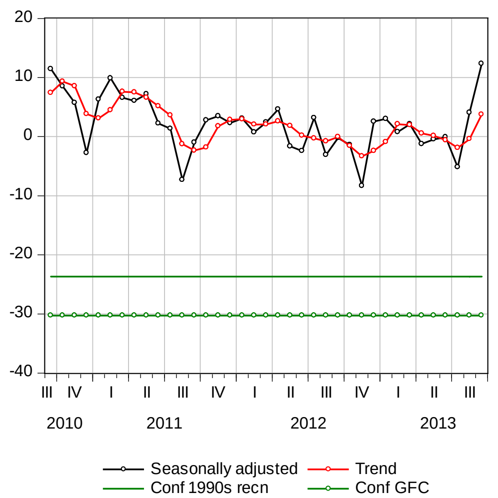
Businesses became much more confident in September, consolidating a sharp improvement in sentiment in the previous month. The **business confidence** index rose by 8 points to +12 index points, to be 17 points above the recent July trough and the highest level since March 2010. This is the largest two-monthly gain in confidence since May-June 2009 (during the immediate aftermath of the GFC). The recent turnaround in business confidence may reflect a number of factors, including recent strengthening in asset price growth, better consumer sentiment, the moderate improvement in business conditions and a lift in forward looking indicators. Fundamentally, however, it appears to reflect a reaction to the political change. Recreation & personal services and retail became much more confident in the month – possibly aided by rising house and equity prices – as did mining. Transport & utilities was the only industry to report (slightly) weaker confidence, consistent with very weak orders and falling capacity utilisation in this sector.

Conditions improve moderately



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

Confidence gets another leg up



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

Business conditions by industry. Conditions in finance/ business/ property lifted strongly in September (up 15 to +12 points), possibly reflecting the recent strengthening in demand for housing finance and improved sentiment in the residential property market. Construction conditions also rose sharply (up 10). The only industries to report weaker conditions in the month were transport & utilities (down 4) and recreation & personal services (down 2); transport conditions have turned down sharply over recent months, a worrying development given that this industry is often viewed as a bellwether of future demand. Overall conditions were strongest in finance/ business/ property (+12), followed by recreation & personal services (+10), despite falling a touch. All other industries reported negative activity readings in September, with conditions remaining especially weak in mining (-25) – largely reflecting very weak trading activity – manufacturing (-18), transport & utilities (-16), retail (-15) and wholesale (-12).

Analysis (cont.)

Business conditions by state. Business conditions surged into positive territory in WA (up 20), which appears to reflect broad-based improvements across most WA industries. Conditions in WA are now at their highest level since July 2012, before the decline in minerals and energy prices. Elsewhere, conditions were modestly better in SA (up 3), while they were marginally weaker in Queensland (down 1) and unchanged in Victoria and NSW. Consistent with the sharp lift in WA activity, conditions in that state were strongest overall (+11); given the volatility in seasonally adjusted state readings, the trend conditions index, which rose to -4 points, may provide a better indication of actual activity in this state. Elsewhere, conditions were very weak in NSW, Queensland (both -9) and SA (-6), and moderate in Victoria (-2).

Business confidence by industry. Business confidence turned positive for all industries in September; this is the first time in more than 2½ years that all firms have reported positive confidence readings. Recreation & personal services (up 15), mining and retail firms (both up 11) became much more optimistic in the month, while transport & utilities (down 2) was the only industry to report weaker sentiment, consistent with poor activity readings here. Overall, confidence was most positive in recreation & personal services (+15) and retail (+13), which may be looking forward to stronger household spending in response to a recent uplift in consumer sentiment. Confidence was also relatively strong in finance/ business/ property and construction (both +12), which may be looking towards stronger housing activity following recent house price rises. The least optimistic industries were wholesale (+1) and transport & utilities (+2), consistent with weak indicators of future demand (forward orders) for these industries.

Business confidence by state. Consistent with the broad-based increase in confidence across industries, confidence lifted across all of the mainland states in September, expect in SA, where it fell marginally. WA (up 17), Victoria (up 10) and NSW (up 9) all received a significant boost, while confidence lifted modestly in Queensland. In levels terms, confidence was strongest in WA (+16), Victoria and NSW (+12), while it was softest (albeit still reasonably strong) in SA (+8) and Queensland (+9).

The **forward orders** index rose by 6 points to +1 index point in September, which is its highest level since November 2011. The pick up was almost entirely driven by mining and manufacturing. In levels terms, orders were strongest in mining (+5), though this followed an especially weak outcome in the previous month, followed by recreation & personal services (+3), finance/ business/ property (+2) and manufacturing (+1). **Capacity utilisation** was a touch better, though remained well below the average level over the history of the monthly survey (of 81.1% since 1997). This month's outcome largely reflected increases in utilised capacity in retail and manufacturing, which were partly offset by heavy falls in transport & utilities and mining. In levels terms, capacity utilisation was very low in mining (74.7%) and manufacturing (75.0%), while it was highest in construction (83.4%) and finance/ business/ property (82.9%). The **stocks** index – also a good indicator of current demand – lifted sharply in the month (up 7 to +4 points). The increase in the stocks index is consistent with a rise in trading activity and forward indicators of demand, suggesting firms may be preparing themselves for a pick up in trading activity.

The **capital expenditure** index rose by 3 points to +3 index points in September, which was the highest reading for a year. The capex index rebounded in mining (up 32 to +11 points); given recent volatility in this series it is perhaps better to look at trend mining capex, which lifted 4 points to -5 index points. Capex also rose significantly in transport & utilities (up 12) and retail (up 11), while it fell back in recreation & personal services (down 6). In levels terms, capex was highest in retail (+13) and mining (+11) and lowest in construction (-5) and manufacturing (-3).

Analysis (cont.)

Based on forward orders, the survey implies 6-monthly annualised demand growth was around 2¼% in Q2 2013, much higher than the actual rate of 0.4%. If we assume average monthly forward orders for the three months to September, the survey implies 6-monthly annualised demand growth of around 2¾-3% in Q3 2013. That is, better than growth in Q2 but still below trend.

Based on average business conditions for Q2 2013, the survey implies 6-month annualised GDP growth (excluding mining) of around 2¾% in Q2, which is modestly higher than the actual rate of 2.3%. Assuming average monthly business conditions for the three months to September, implied growth would soften compared with Q2 to be around 2½%.

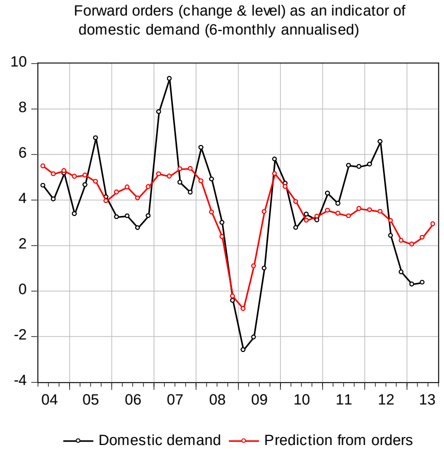
Elsewhere in the survey, cash flow (not seasonally adjusted) was strongest in recreation & personal services and finance/ business/ property, and weakest in manufacturing and retail.

Labour costs growth (a wages bill measure) softened marginally in September to 0.5% (at a quarterly rate), consolidating a pull back in growth in August. The softening in labour costs growth was most apparent for manufacturing (down 1.1 ppts) and retailers (down 0.9 ppts). In contrast, labour costs growth picked up sharply in mining (up 1.0 ppts). Labour costs growth was strongest in finance/ business/ property, recreation & personal services (both 0.9%) and transport & utilities (0.8%), while labour costs fell in manufacturing (-0.4%), retail (-0.2%) and construction (-0.1%).

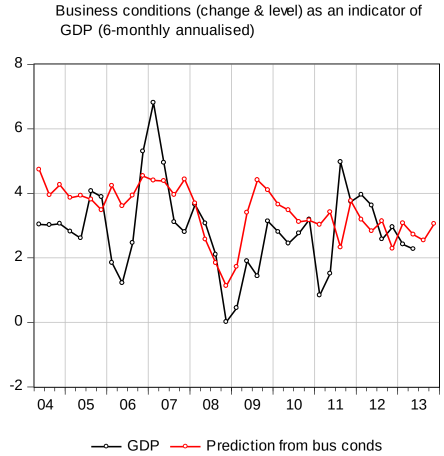
Purchase cost growth ticked down marginally to 0.6 ppts in September (at a quarterly rate), after a sharp fall in August. With the exchange rate remaining reasonably range bound over September, there is little evidence at the aggregate level that the AUD affected import prices in the month. However, there is some evidence that import price rises are having an impact at the industry level, with purchase costs growth relatively elevated in construction (1.4%), wholesale (1.3%) and manufacturing (1.1%). Furthermore, when combined with relatively softer final product prices growth, margins in these industries still appear to be under pressure. Elsewhere, purchase costs fell in mining (-1.4%, quarterly), while growth was relatively subdued in transport & utilities (0.3%) and retail (0.5%).

Final product prices rose by the highest rate since April 2011, up 0.4% in the month (at a quarterly rate). Nonetheless, price increases are still struggling to stay ahead of purchase cost rises, suggesting margins continue to be squeezed. Inflation was highest in wholesale and recreation & personal services (both 0.7%), while deflation was apparent in mining (-2.1%) and transport & utilities (-0.5%). Retail prices edged higher (0.3% at a quarterly rate).

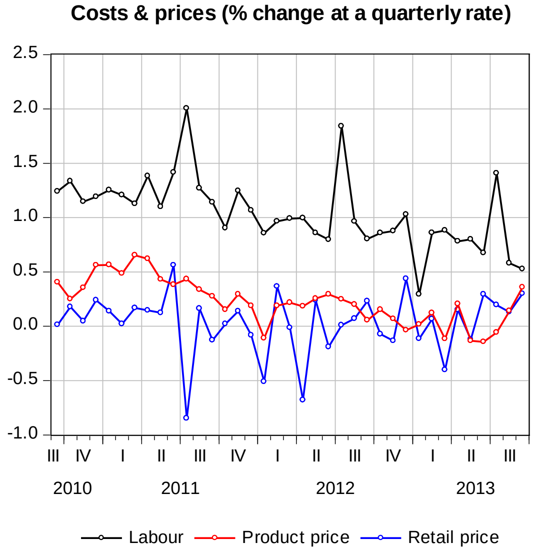
Demand growth to stay below trend



Little sign of a near-term recovery in GDP growth



Prices growth strengthens but margins still being squeezed



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 rose modestly in September though a still negative reading of -4 points implies that domestic activity continued to increase at below trend rates. This outcome remained below the series long-run average of zero points since 1989, and well-below the monthly survey average of +5 points since 1997. The persistent weakness in business conditions highlights the inherent weakness in demand.

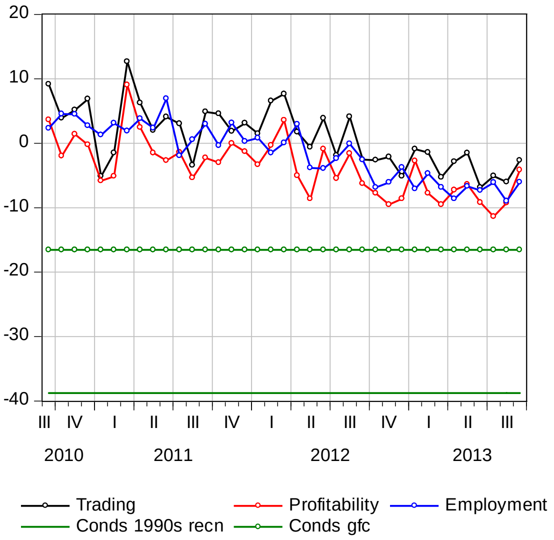
Trading, profitability and employment

The increase in business conditions in September reflected broad-based improvements in profitability, trading and employment conditions, though each of these components remained in negative territory.

Trading conditions strengthened notably in finance/ business/ property (up 18), construction (up 15) and retail (up 8), while it deteriorated very sharply in mining (down 22), and was notably softer in recreation & personal services (down 9), partly offsetting a rise in August. In levels terms, trading was extremely poor in mining (-40) followed by manufacturing (-20), retail (-16) and transport (-15), while in stark contrast it was strongest in finance/ business/ property (+19) and recreation & personal services (+14).

Profits, employment & trading pick-up but overall activity still poor

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

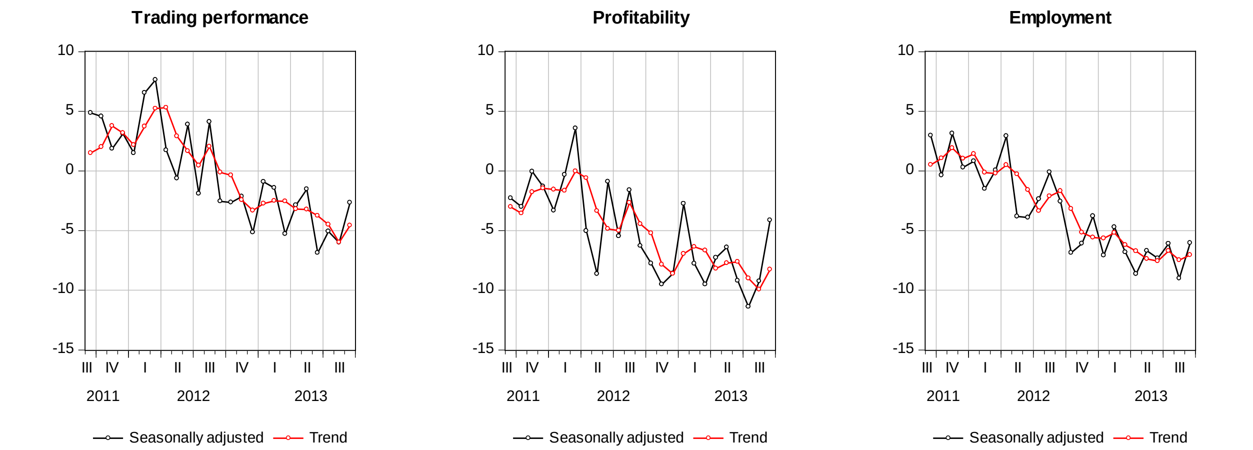


Net balance of respondents who regard last month's trading / profitability / employment performance as good.

The improvement in **employment conditions** in September almost entirely reflected better wholesale (up 15) and mining (up 9) conditions, though conditions in the latter remain very poor, in line with the slowing in labour-intensive mining investment activity. Elsewhere, employment conditions were modestly weaker in transport & utilities (down 4 to -16 implying considerable labour shedding)) and construction (down 2). In levels terms, employment conditions were least subdued in recreation & personal services (+1), wholesale and finance/ business/ property (both -2), while they were very poor in transport & utilities (-16), mining (-14), manufacturing (-13) and construction (-11).

A notable rise in **profitability** entirely reflected improvements in finance/ business/ property (up 22) and construction (up 17) – these industries may have benefited from an improved housing market – and mining (up 12). In contrast, profitability slumped in transport & utilities (down 9), consistent with very poor trading here, while it was mildly softer in recreation & personal services (down 3), partly unwinding a sharp rise in August. Profitability was weakest in wholesale (-23), mining, retail (both -22), manufacturing and transport & utilities (both -19), while it was strongest in finance/ business/ property (+20) and recreation & personal services (+14).

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).

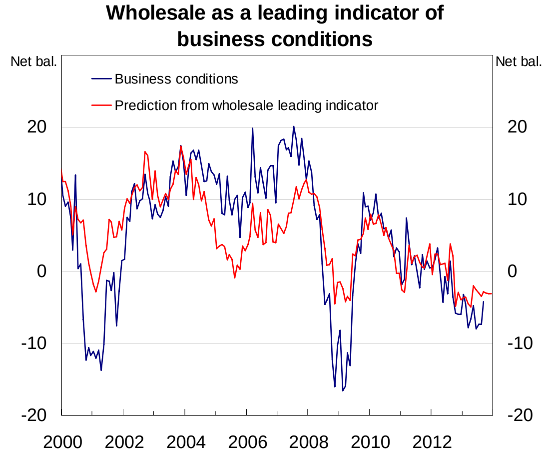
Current business conditions (cont.)

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, wholesale conditions remained subdued, at -12 points in September.

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 September (-12) were to continue over the remainder of this year, overall business conditions could be expected to remain poor, averaging -3 index points towards the end of this year. That in turn suggests an economy still running well below trend and with little upward momentum in growth.

Wholesale activity points to continued weak conditions



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

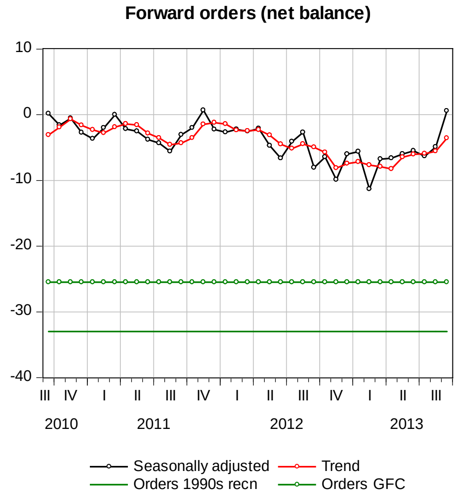
Forward orders

The forward orders index jumped to a two year high in September – up 6 to +1 point. At +1 point, the index is now marginally above the series average of zero points since 1989, and points to the prospect of a pick up in near-term demand.

The increase largely reflected better mining (up 24) and manufacturing (up 13) orders, which may have benefited from better international competitiveness due to the recent AUD tumble. Weaker orders were reported in transport & utilities (down 1). Orders were highest in mining (+5) and recreation & personal services (+3), and weakest in transport & utilities (-7), retail (-4) and wholesale (-2).

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

New orders rise to two year high

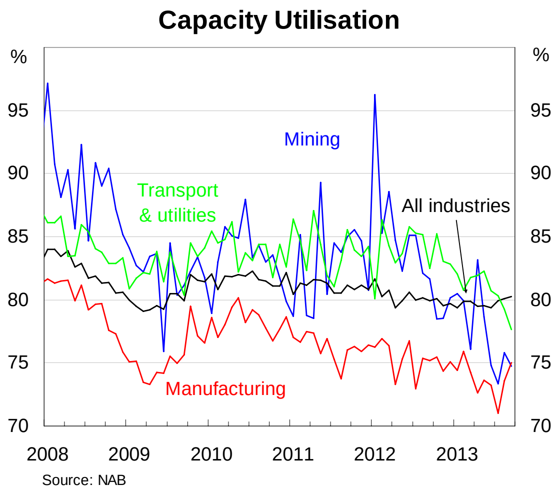


Capacity utilisation

Capacity utilisation rose for a third consecutive month in September, up 0.2 ppts to 80.3%, to be a touch below the long-run average of 80.4% since 1989 (but still below the monthly average of 81.1% since 1997). This month's outcome primarily reflected solid rises in retail (up 3.3 ppts), manufacturing (up 1.4 ppts), construction (up 0.8 ppts) and recreation & personal services (up 0.7 ppts). Falls in capacity utilisation for transport & utilities (down 1.7 ppts) and mining (down 1.1 ppts) provided a partial offset to these gains. Capacity utilisation was highest in construction (83.4%) and finance/ business/ property (82.9%), while it was lowest in mining (74.7%), manufacturing (75.0%) and now transport & utilities (77.6%).

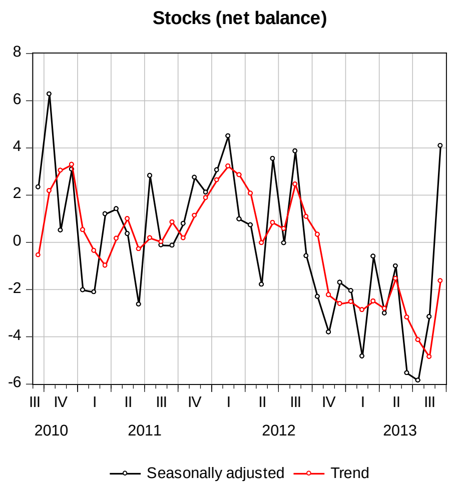
Full capacity is the maximum desirable level of output using existing capital equipment.

Capacity usage falling in transport

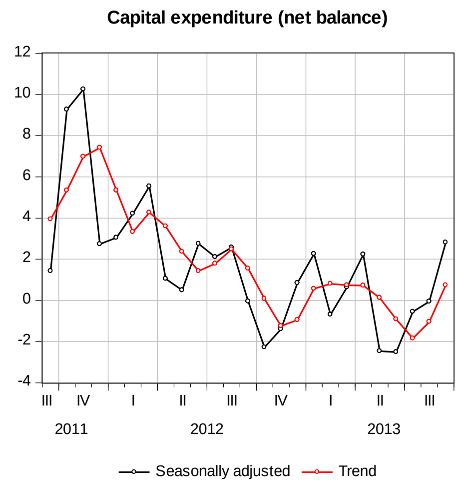


More details on business activity

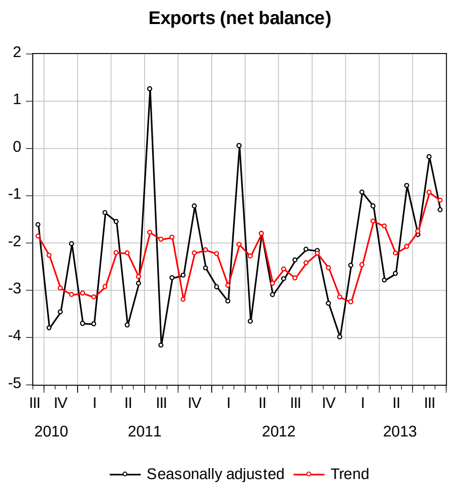
Better orders trigger re-stocking



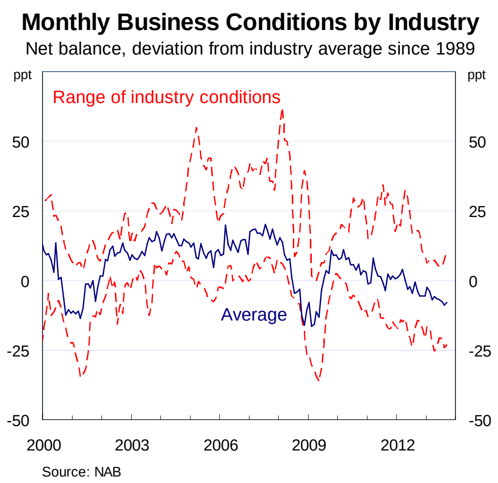
Capex rises again but remains low



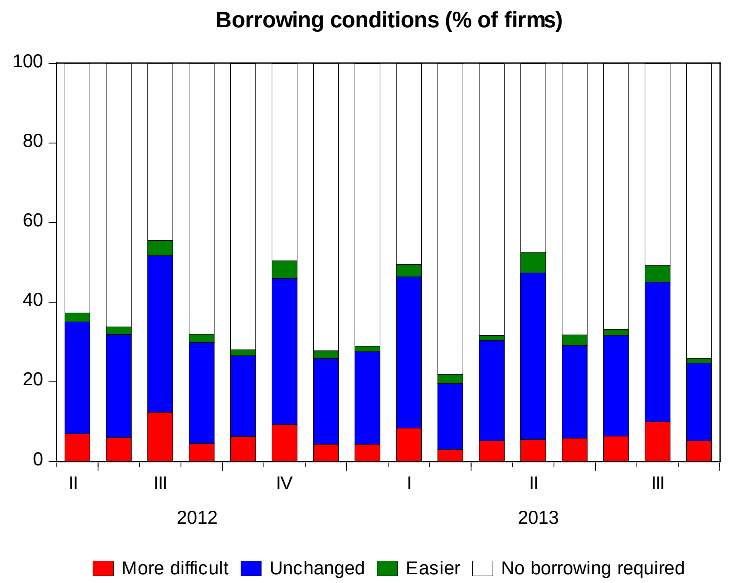
Exports fall on slight AUD recovery



Range of industry conditions still wide

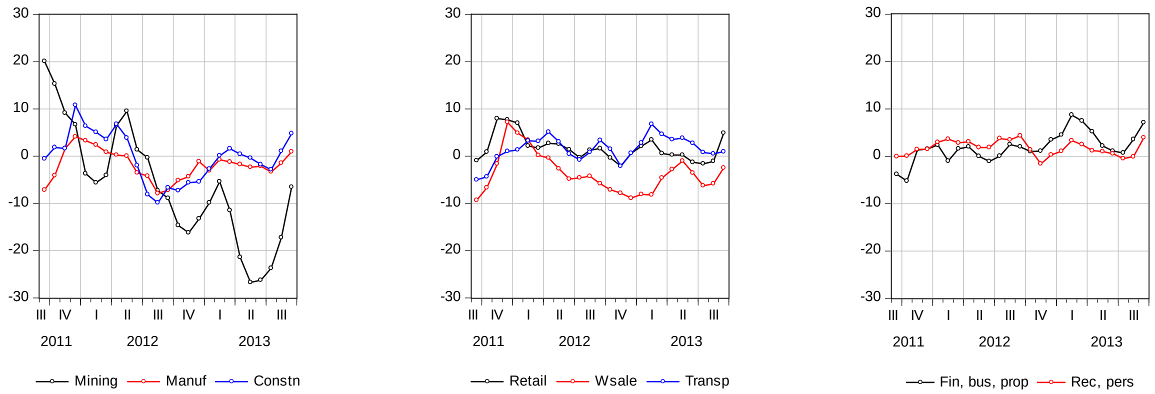


Borrowing conditions ease a touch but demand for credit still low

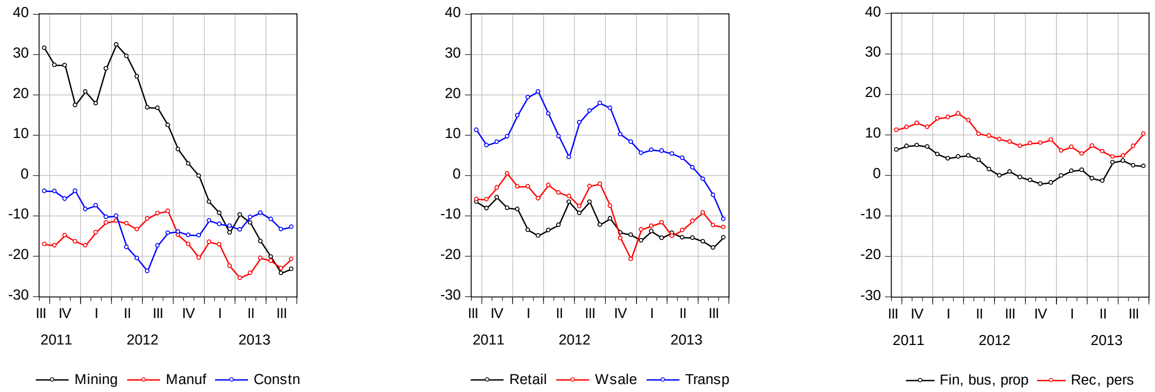


Industry sectors and states

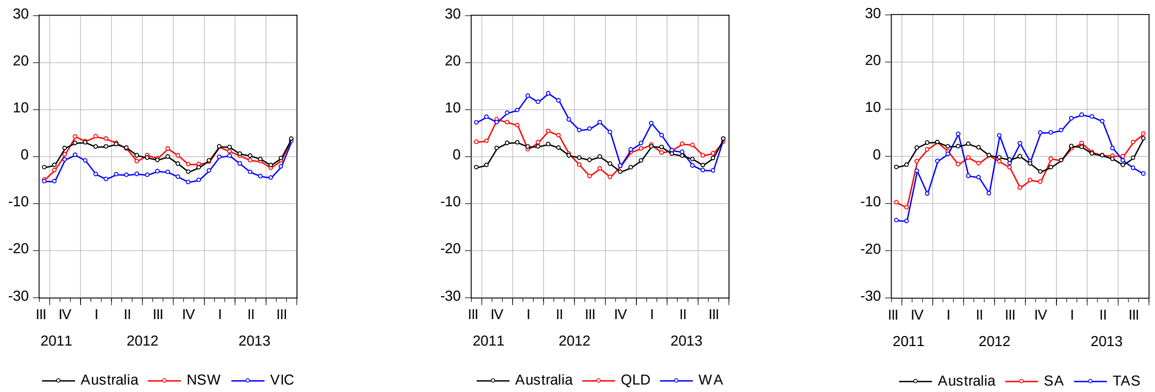
Business confidence by industry (net balance): 3-month moving average



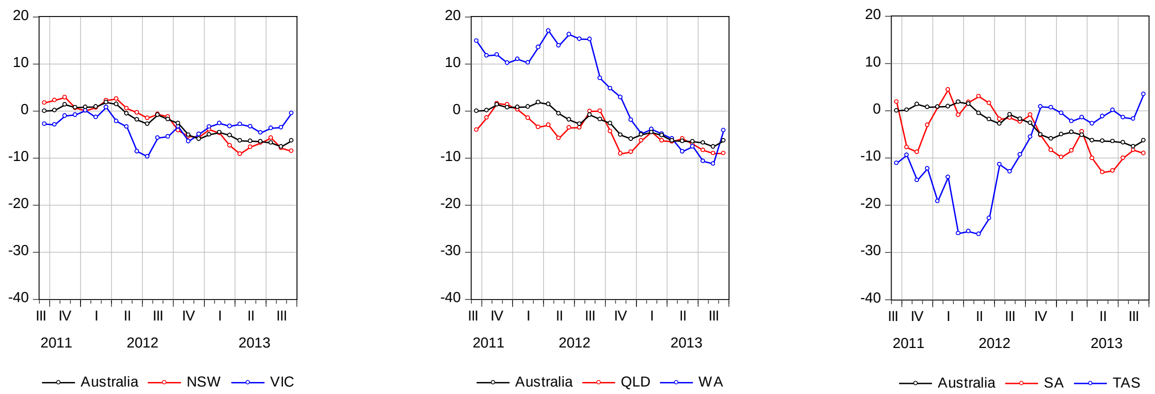
Business conditions by industry (net balance): 3-month moving average



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



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



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