National Australia Bank

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Monthly Business Survey

October 2013

Firms reassess their confidence on the outlook as business conditions undershoot again. Capacity utilisation falls sharply – especially in manufacturing, construction, mining and retail – despite low interest rates and improved housing and equity markets. Other forward indicators deteriorate, paring back earlier gains and implying a continuing soft outlook for domestic demand. Price inflation outpaced by costs growth suggesting margins still tightening. Rate cut still expected in 2014 but – given RBA comfort with current settings – delayed till mid 2014. Unemployment key to how many cut(s) required.

- Business confidence fell back significantly in October, partly unwinding the sharp improvement reported in the prior two months. Businesses may have reassessed their expectations about future activity in the changed political environment given the continued weakness in actual business conditions. Nonetheless, overall confidence remains relatively higher than the well below-average levels over the previous three years. That is, despite the reversal of the previous gain in confidence, low interest rates and improving asset market may still be helping. Transport & utilities and finance/ business/ property were especially confident, while wholesale was relatively pessimistic. Confidence levels were very similar across states, though lower in Victoria.
- Business conditions were unchanged at a lacklustre -4 points in October, though outcomes were somewhat varied across industries. Conditions in mining improved significantly, consistent with higher commodity prices, but they remained subdued overall. Elsewhere, conditions remained positive in recreation & personal services and finance/ business/ property but these industries reported a marked step down in activity compared to recent outcomes. Forward indicators do not paint a favourable picture for the outlook, with capacity utilisation falling to a four year low and the level of forward orders, capex and stocks also declining. While employment conditions lifted to a one year high, the index remained negative implying further jobs shedding.
- The survey implies underlying demand growth (6-monthly annualised) of around 2¾% in Q3 and GDP growth of around 2½%. Our wholesale as a leading indicator implies only a slight improvement in near-term activity.
- Labour costs growth continued to soften, consistent with the slack in the labour market, while purchase costs growth lifted a touch. Overall prices growth softened modestly in October, and when combined with relatively stronger cost pressures, this outcome suggests margins continued to tighten.

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

- Global growth expected to rise from 2.9% in 2013 to 3.5% next year. The national accounts and business surveys show a quickening pace of growth in the big advanced economies with the UK and Japan the standout performers. The emerging economies present a mixed picture with solid outcomes in China, a disappointing record and outlook for activity in India and only moderate growth across Latin America and East Asia.
- Australian GDP growth to soften to 2.3% in 2013, rising to 2.4% in 2014 and 2.9% in 2015. Unemployment to nudge 6% by end 2013 and reach 6½% by end 2014. Given the soft outlook, core CPI expected to edge down to 2.3% by end 2013 and 2.4% by end 2014. Rising asset price trends and higher confidence likely to see RBA wait to see how labour market trends play out before cutting again in May (previous cut expected in February).

Key monthly business statistics*

	Aug 2013	Sep 2013	**Oct 2013**		Aug 2013	Sep 2013	**Oct 2013**
	Net balance				*Net balance*		
Business confidence	4	12	**5**	Employment	-9	-6	**-3**
Business conditions	-8	-4	**-4**	Forward orders	-5	0	**-2**
Trading	-6	-3	**-2**	Stocks	-3	4	**0**
Profitability	-9	-4	**-6**	Exports	0	-1	**0**
	% change at quarterly rate				*% change at quarterly rate*		
Labour costs	0.7	0.6	**0.5**	Retail prices	0.1	0.3	**0.4**
Purchase costs	0.8	0.7	**0.8**		*Per cent*		
Final products prices	0.2	0.4	**0.2**	Capacity utilisation rate	80.0	80.2	**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 25 to 31 October, covering over 400 firms across the non-farm business sector.

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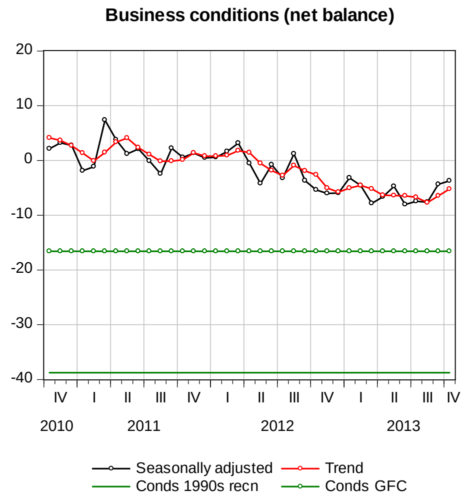
Next release:
10 December 2013 (November monthly)

Analysis

Business conditions were unchanged at -4 points in October, which was a better outcome compared to the very subdued level of activity experienced for most of this year; the conditions index has averaged just -6 points since January. While overall conditions were unchanged, there were marked differences across industries in the month. Business conditions strengthened considerably in mining, transport & utilities and wholesale, with these improvements largely offset by notable declines in finance/ business/ property, construction and recreation & personal services. The current business environment remains extremely challenging for export orientated and consumer dependent sectors, with manufacturing, mining, construction and retail firms all reporting subdued activity readings. After showing a glimmer of hope in recent surveys, forward indicators were poor, with forward orders, stocks and capacity utilisation paring back earlier gains. Nonetheless, employment conditions posted another modest rise, to -3 index points – the least subdued outcome since September 2012. Even so, the employment conditions index remains negative suggesting jobs shedding continued in the month.

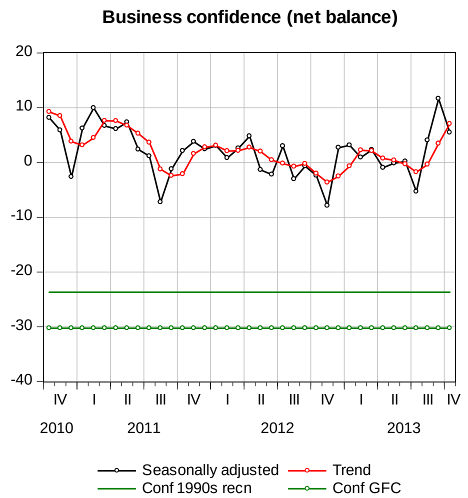
After surging to a 3½ year high in September, the **business confidence** index fell back significantly in October, to +5 index points. While the index pared back earlier (election) gains, it remained elevated relative to recent history and was in line with the series long-run average since 1989. The pull back in confidence suggests businesses may have reassessed their expectations for the outlook given the continued weakness in actual conditions. Nonetheless, the relatively elevated level of business confidence (compared to early 2013 readings) suggests businesses may still be feeling buoyed by positive housing price trends and low borrowing rates. This is consistent with relatively strong confidence reported in finance/ business/ property and construction firms. Wholesale was the only firm to report negative confidence, with the still high AUD possibly weighing.

Conditions remain lacklustre



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

Confidence falls back on weak conditions



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 mining improved strongly in October (up 13), consistent with rising commodity prices in the month, which were supported by heightened expectations that the US Federal Reserve will postpone tapering its $85 billion monthly debt buying program until early next year. Conditions also lifted solidly in transport & utilities (up 11); it is unclear whether this was associated with the audit of around 100 fuel tankers of one Victorian based firm, which put additional pressure on alternative transport services. Conditions in wholesale also improved (up 9) – an industry that tends to be a bellwether of future demand – which may indicate some improvement in future conditions. Elsewhere, conditions were modestly better in retail and manufacturing, while they weakened notably in finance/ business/ property (down 10), construction (down 6) and recreation & personal services (down 5). Despite activity softening in the month, overall conditions were strongest in recreation & personal services (+5) and finance/ business/ property (+2) and weakest in manufacturing (-15), construction (-13), mining (-12) and retail (-11).

Analysis (cont.)

Business conditions by state. Business conditions deteriorated heavily in SA, with this state experiencing the weakest activity overall (down 10 to -16 points), while conditions in WA also weakened, paring back earlier gains (down 8). The remaining mainland states reported modestly better activity readings in October – conditions in NSW rose by 4 points, Victoria improved by 3 points and conditions in Queensland lifted 2 points. Despite a deterioration in conditions in WA, conditions in this state were the strongest of the mainland states (+2). Victoria was the next best performing state (+1), while activity was weakest in SA (-16), Queensland (-7) and NSW (-6).

Business confidence by industry. Transport & utilities was the only industry to report improved confidence in October (up 13), consistent with better activity in this industry, In contrast, confidence fell back sharply in recreation & personal services (down 10), manufacturing (down 6) and wholesale (down 5), with the last two industries possibly worried about the higher AUD. Confidence softened a touch across the remaining industries, with the exception of finance/ business/ property, where it was unchanged. Overall, confidence was most positive in transport & utilities (+14), finance/ business/ property (+12), construction (+9) and retail (+8). It is possible that the consumer dependent and property related industries are looking forward to continued improvement in housing market activity, which should help to support better consumer spending. Wholesale was the only industry to report negative confidence (-4), while confidence was also relatively soft in manufacturing (+2), mining (+3) and recreation & personal services (+4). Consistent with the lack of optimism in these industries, forward orders in these industries were relatively subdued.

Business confidence by state. Confidence fell back across all states across October, which is consistent with the idea that all firms may have reassessed just how much the change in government will improve the outlook for their firms given actual activity has failed to show signs of improvement. Confidence fell back sharply in Victoria (down 10) and WA (down 9). Despite the general pull back, confidence remained positive for all mainland states; Victoria was the least optimistic (+2), while confidence elsewhere was broadly similar, ranging between +6 and +7 points.

The **forward orders** index fell by 2 points to -2 index points, partly offsetting a solid improvement in September. The deterioration in orders was largely driven by mining and wholesale, which was partly offset by better orders in transport & utilities. Consistent with this, the forward orders index was highest in transport & utilities (+8), followed by finance/ business/ property (+4), while it was weakest in wholesale (-11) and mining (-8). **Capacity utilisation** fell to the lowest level since June 2009 in October (down 0.9 ppts to 79.3%), further highlighting the significant amount of slack in the economy. This month's outcome largely reflected significant declines in manufacturing, construction and retail, while more capacity was utilised in transport & utilities and wholesale. In levels terms, capacity utilisation was extremely low in manufacturing (70.7%; the lowest outcome ever reported for this industry in the monthly survey) and mining (72.9%; the lowest level in eleven years), while it was highest in wholesale (82.3%), recreation & personal services (82.0%), finance/ business/ property (81.9%) and transport & utilities (81.4%). The **stocks** index – also a good indicator of current demand – fell by 4 points to a net balance of zero, consistent with the still poor level of trading conditions. Furthermore, the fall in forward orders may have prompted firms to limit the amount of inventory accumulation in the face of a soft demand outlook.

The **capital expenditure** index fell by 5 points to -2 index points – the lowest reading since June this year. The capex index fell across all industries, with the exception of manufacturing and finance/ business/ property, where it was unchanged. Mining reported the heaviest decline – down 28 to -17 points – although this outcome followed an even larger increase in the previous month; in trend terms, mining capex fell modestly to -9 points. The capex index also fell considerably in retail (down 12) and transport & utilities (down 8). In levels terms, capex was highest in finance/ business/ property (+6) and retail (+1), while it was lowest in mining (-17) and construction (-12).

Analysis (cont.)

Forward orders implied stronger 6-monthly annualised demand growth for Q2 2013 than the 0.4% outcome in the Q2 national accounts. Based on forward orders, the survey implies 6-monthly annualised demand growth was around 2¾% in Q3. If we assume the October trend forward orders outcome is continued into Q4, the implied demand growth would strengthen to around 3¼%. But this relationship has been over-predicting demand and does not reflect our forecast outlook. Based on average business conditions for June quarter, the survey implies 6-month annualised GDP growth (excluding mining) of around 2½% in Q2, somewhat higher than actual growth of 2.3%. Based on Q3 business conditions from the Quarterly Survey, the survey implies GDP growth of around 2½% in Q3. Assuming October trend business conditions continue into Q4, implied growth would lift to around 2¾-3%.

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

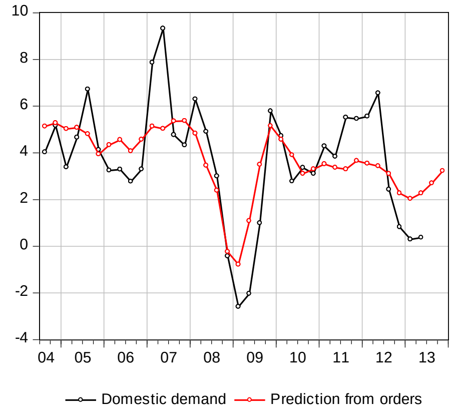
Labour costs growth (a wages bill measure) softened to 0.5% in October (quarterly). The pull back in growth reflected softer labour cost pressures in finance/ business/ property and mining (growth 0.2 ppts softer in both industries), which were partly offset by modest increases in manufacturing, construction and retail labour costs growth (all 0.4 ppts higher). Labour costs growth was strongest in recreation & personal services (0.9%), transport & utilities (0.8%) and finance/ business/ property (0.7%), and softest in mining, manufacturing and retail (all 0.2%).

Purchase cost growth increased a touch to 0.8 ppts in October (at a quarterly rate), entirely unwinding a tick down in growth in the previous month. While the exchange rate lifted throughout most of October, it is possible that part of the increase in purchase costs pressures reflected the lagged effect of previous AUD depreciations. Purchase cost growth was strongest in manufacturing (1.5%, at a quarterly rate), retail (0.9%) and recreation & personal services (0.8%), while purchase costs fell marginally in mining (-0.1%) and growth was soft in transport & utilities (0.3%) and construction (0.4%).

Final product price growth softened a touch in October, partly unwinding a moderate increase in the previous month. While at 0.2% (quarterly rate), price inflation remains slightly more elevated than average growth over the previous two years (of 0.1%), it remains relatively soft compared to the series average of 0.5%, suggesting inflationary pressures remain well contained at present. Across industries, price deflation was very apparent in mining (-1.2%) and construction (-0.7%), while prices increased most strongly in wholesale (0.8%) possibly reflecting previous AUD depreciations, followed by transport & utilities and finance/ business/ property (both 0.5%).

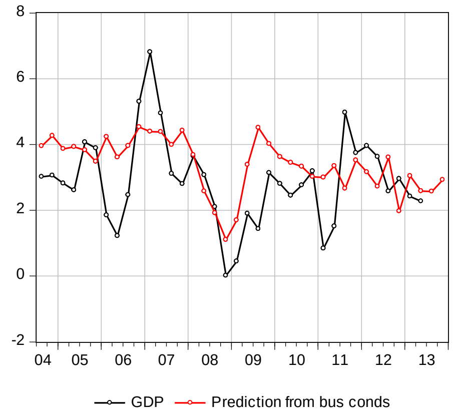
Demand growth to stay below trend

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



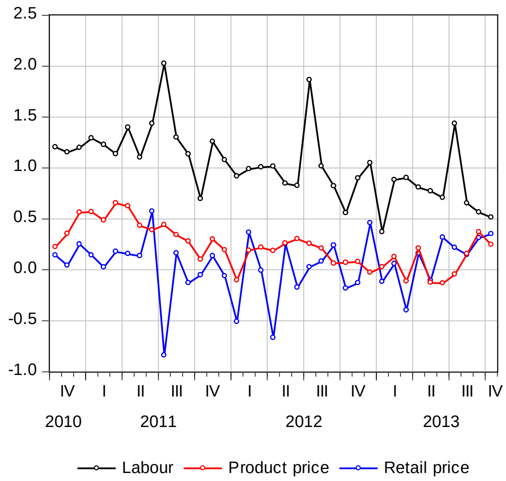
GDP growth to remain soft in Q4

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



Prices growth softens and still outpaced by rising costs

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 was unchanged at -4 points in October – a lacklustre outcome providing further evidence that the domestic demand environment remains difficult. 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.

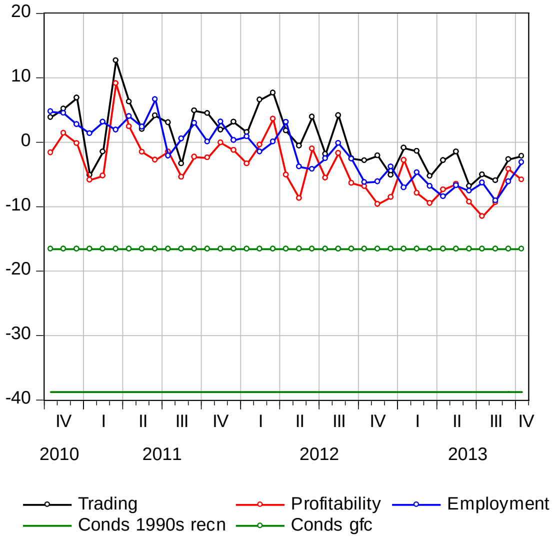
Trading, profitability and employment

The business conditions outcome in October reflected better employment and trading conditions, which were entirely offset by a deterioration in profitability. Consistent with the overall weakness in conditions, each of these components remained below average levels.

Trading conditions improved significantly in transport & utilities (up 21), mining (up 14) and wholesale (up 13), while they deteriorated considerably in finance/ business/ property (down 14), and were moderately weaker in construction and recreation & personal services (both down 5). In levels terms, trading was very poor in mining (-22), manufacturing (-17) and retail (-14), while it was much better in recreation & personal services (+9) and transport & utilities (+6).

Employment & trading conditions pick up but profits deteriorate

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

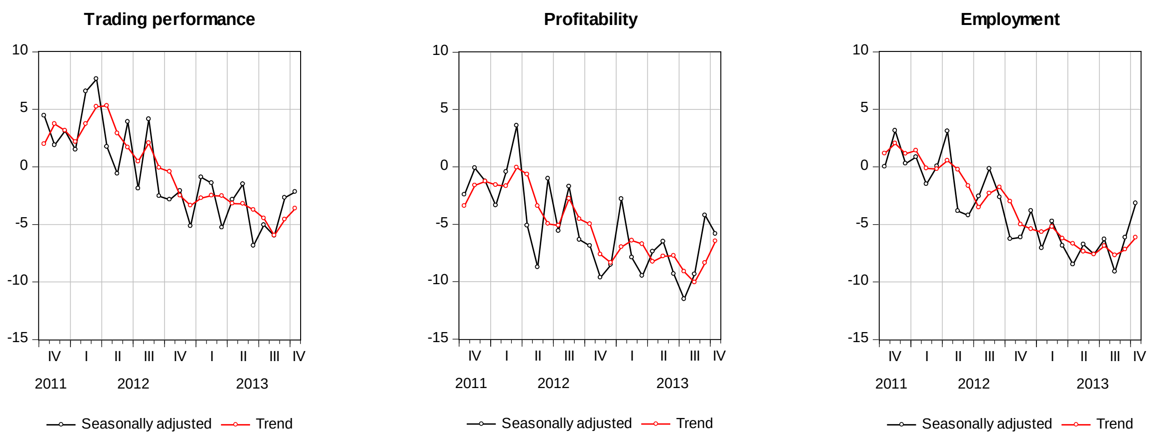


Net balance of respondents who regard last month's trading / profitability / employment performance as good.

The improvement in **employment conditions** – where the overall index rose to the least subdued level since September 2012 – largely reflected a sharp turnaround in mining employment (up 20), while employment conditions also strengthened solidly in transport & utilities (up 6) and finance/ business/ property (up 4). Wholesale was the only industry to report weaker employment conditions in the month (down 4). In levels terms, employment conditions were weakest in construction (-12), manufacturing and transport & utilities (-11), while they were strongest (and positive) in mining (+6), recreation & personal services and finance/ business/ property (both +2).

Profitability ticked down in October, only partly unwinding a notable rise in September. The pull back in profitability was entirely driven by a deterioration in finance/ business/ property (down 18), construction (down 15) and recreation & personal services (down 10). In contrast, profitability strengthened considerably in wholesale (up 21), transport & utilities (up 13) and retail (up 10), which was broadly consistent with improved trading activity for these industries in the month. Profitability was extremely weak in mining (-21), construction (-20), manufacturing (-18) and retail (-13), while it was least subdued in recreation & personal services (+4) and finance/ business/ property (+1).

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.)

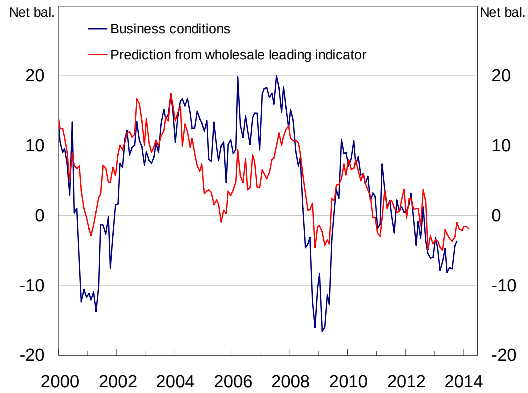
Wholesale: Signalling continued softness in the domestic economy?

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 trend conditions remained subdued, at -10 points in October.

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 trend conditions in October (-10) were to continue over the remainder of this year, overall business conditions could be expected to remain poor, averaging -2 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

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

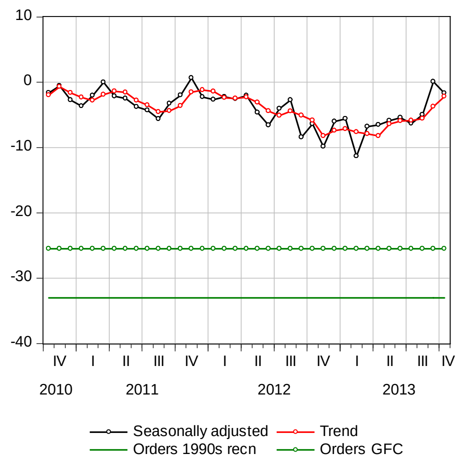
The forward orders index declined 2 points to -2 points in October, after rising to a two year high in September. At -2 points, the index is now marginally below the series long-run average of zero points since 1989. Nonetheless, the index is higher than the index average of the past two years (-5 points).

The deterioration in orders reflected sharp falls in mining (down 10) and wholesale (down 9) orders, while recreation & personal services (down 5) and manufacturing (down 4) also reported modest declines. Partly offsetting these falls was a sharp increase in transport & utilities orders (up 15). Orders were strongest (and positive) in transport & utilities (+8) and finance/ business/ property (+4), and weakest in wholesale (-11) and mining (-8).

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

New orders fall from two year high

Forward orders (net balance)



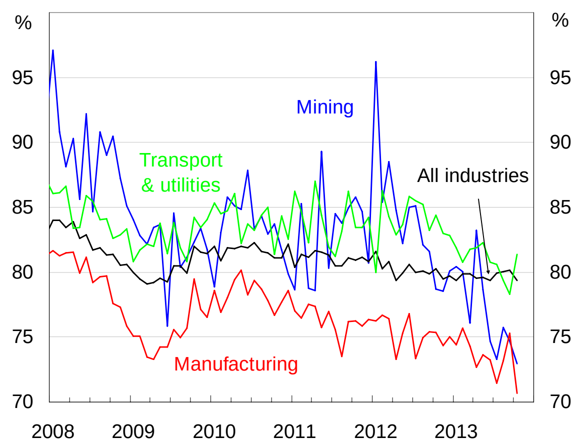
Capacity utilisation

Capacity utilisation fell sharply in October – down 0.9 ppts to 79.3%. At this level capacity utilisation is almost 3.0 ppts below the monthly survey average of 81.1% (since 1997), and 2.1 ppts below the long-run average of 80.4% (since 1989). This month's outcome reflected very sharp falls in manufacturing (down 4.6 ppts), construction (down 3.9 ppts) and retail (down 3.8 ppts), which were partly offset by increases in transport & utilities (up 3.0 ppts) and wholesale (up 1.1 ppts). Manufacturing capacity utilisation fell to the lowest level in the history of the survey (70.7%), while it fell to an eleven year low in mining (72.9%). Utilised capacity was highest in wholesale (82.3%) and recreation & personal services (82.0%).

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

Capacity usage low in manuf. & mining

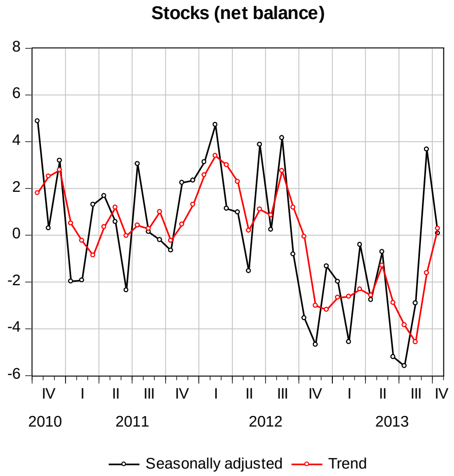
Capacity Utilisation



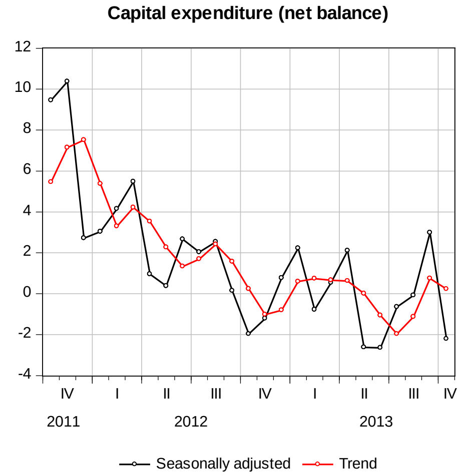
Source: NAB

More details on business activity

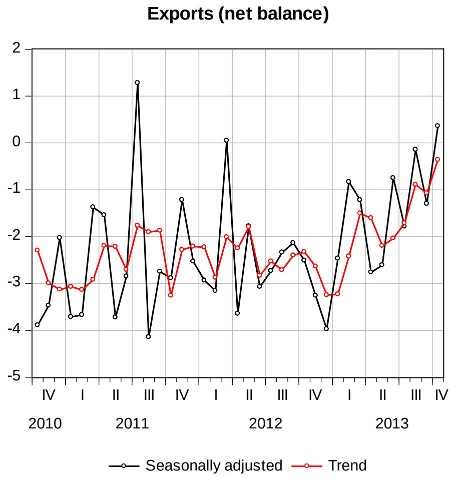
Weaker orders trigger de-stocking



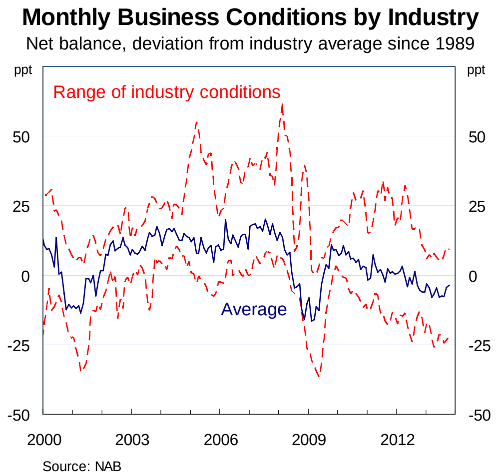
Capex falls, especially in mining



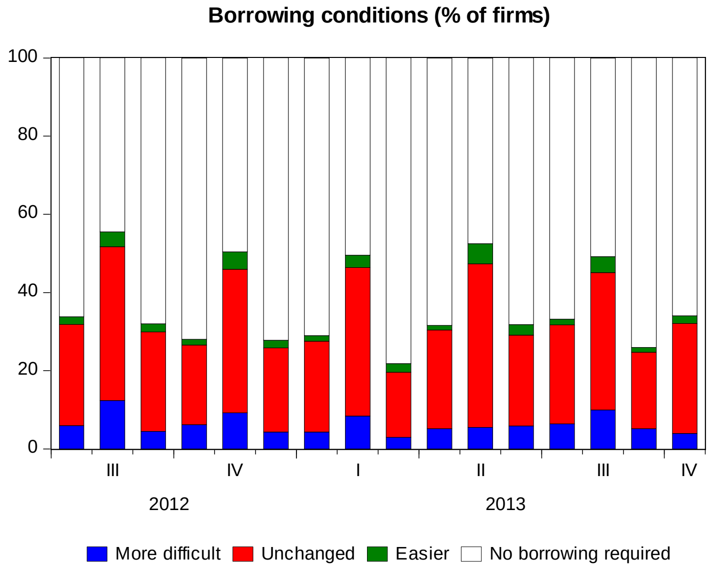
Exports continue to strengthen



Range of industry conditions still wide

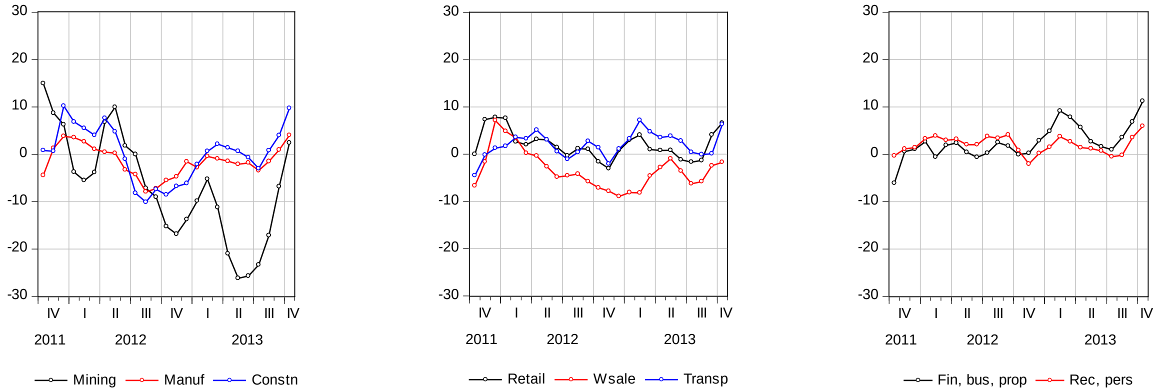


Borrowing conditions ease a touch and demand for credit increases a touch

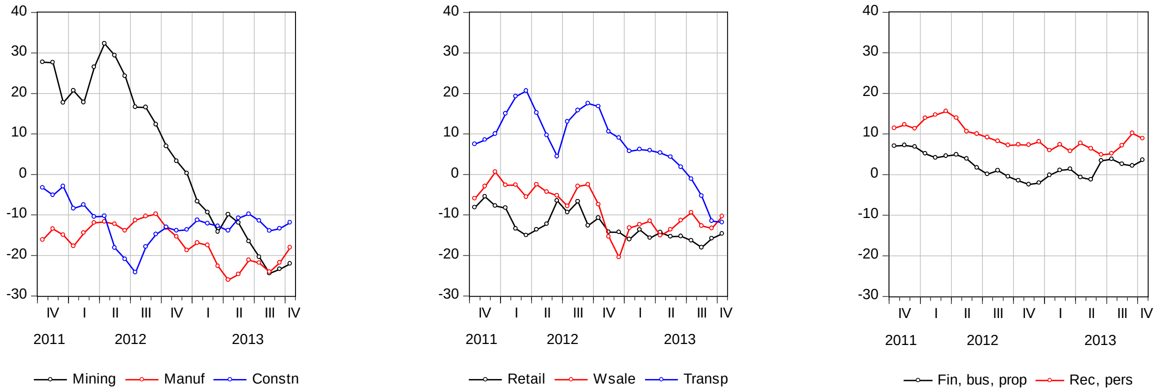


Industry sectors and states

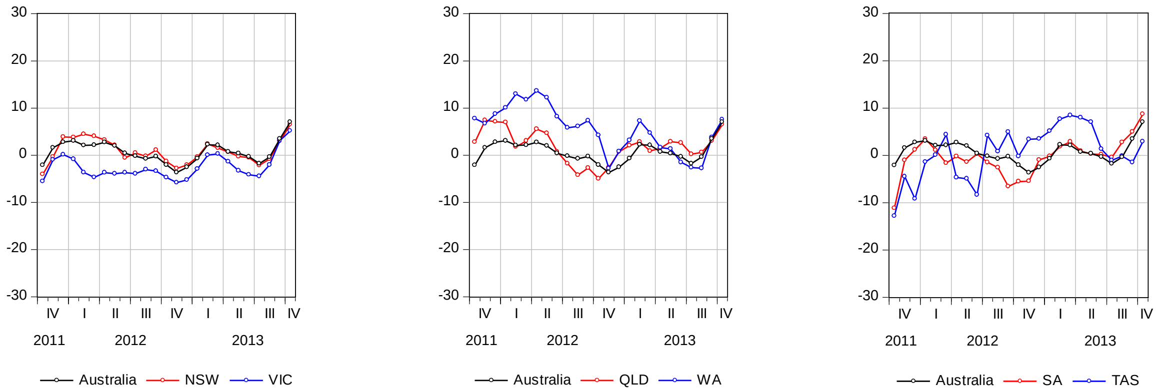
Business confidence by industry (net balance): 3-month moving average



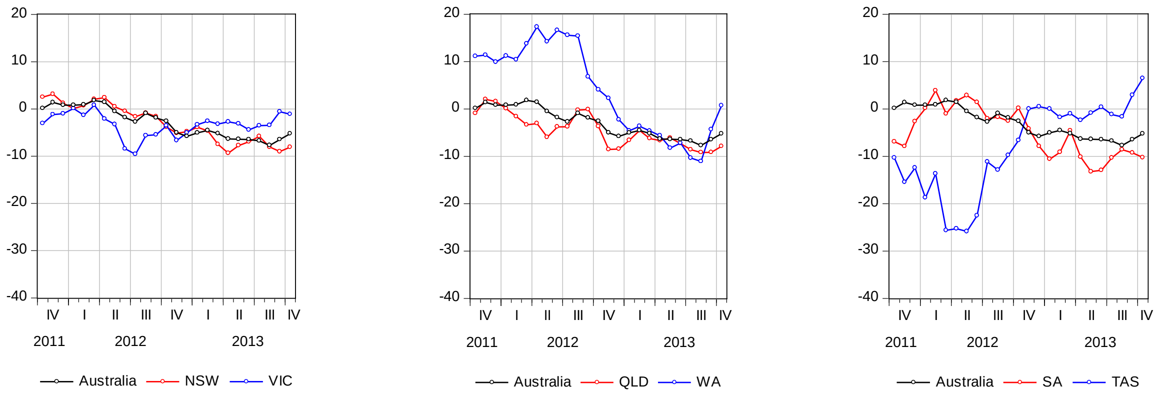
Business conditions by industry (net balance): 3-month moving average



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



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



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New York	+1 800 125 602	+1877 377 5480
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