National Australia Bank

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Monthly Business Survey

March 2014

Business conditions lifted slightly in March, but remained at relatively subdued levels, weighing on business optimism. Confidence still positive but softened to its lowest post-election level to be below long-run trend. Sales fell slightly in March and employment, though better, still points to soft labour market conditions. Most industries saw some improvement in conditions, especially mining, but transport and "bellwether" wholesale weakened significantly. Near-term outlook still soft according to forward indicators. Inflation outlook well contained due to limited upstream pressures, and retail prices fell. Economic growth forecasts unchanged with unemployment still expected to rise to 6½% by late 2014 and one more rate cut probable in late 2014.

- Business confidence was pared back in the month to its lowest post-election level, which is also below its long-run average. It appears as though firms are responding to the ongoing sluggishness in business activity, which has not quite reflected the exuberance of firms in past months. The stubbornly high AUD, uncertainty over the global economy and the potential for significant 'belt tightening' in the upcoming budget, could all have contributed as well. Mining continues to be the least confident industry.
- Business conditions rose only slightly in the month and are still pointing to a sluggish recovery in business activity. Nevertheless, most industries recorded an improvement in business conditions in the month, with the exception of transport & utilities and wholesale. Conditions facing wholesalers deteriorated heavily in March and are by far the weakest of all the industries covered in the survey – a concern given its characteristics as a bellwether industry. Recreation & personal services continue to enjoy the highest level of business conditions. Sales eased in the month, while forward orders and employment both remain soft
- Our wholesale leading indicator suggests much weaker underlying conditions, pointing to further below trend economic growth in the first quarter of 2014 of around 2½% and continuing weakness into Q2.
- Inflation pressures softened again in the month due to lower input cost pressures. In particular, purchase cost inflation eased in the month, resulting in a sharp fall in retail prices. Soft labour costs growth is consistent with increasing slack in the labour market.

Implications for NAB forecasts (See latest Global and Australian Forecasts):

- Global economy growing around trend with advanced economies providing more of global output expansion as China slows. Inflation low in big advanced economies, underpinning low interest rates, but price pressures in many emerging economies (excluding China). Forecasts broadly unchanged with global growth 3.5% in 2014 and 3.8% in 2015.
- Australian forecasts unchanged with rate cut still expected in late 2014 and unemployment to edge up, peaking at 6½% in late 2014. Dwelling investment and exports likely to strengthen, but expect tight Budget to add to mining headwinds. GDP to grow at 2.7% in 2013/14 and 3.0% in 2014/15.

Key monthly business statistics*

	Jan 2014	Feb 2014	**March 2014**		Jan 2014	Feb 2014	**March 2014**
	Net balance				*Net balance*		
Business confidence	9	7	**4**	Employment	2	-7	**-1**
Business conditions	5	0	**1**	Forward orders	6	1	**2**
Trading	8	4	**3**	Stocks	0	-1	**-1**
Profitability	3	1	**1**	Exports	2	1	**2**
	% change at quarterly rate				*% change at quarterly rate*		
Labour costs	1.0	0.6	**0.7**	Retail prices	0.5	0.3	**-0.3**
Purchase costs	1.1	0.8	**0.5**		*Per cent*		
Final products prices	0.6	0.3	**0.2**	Capacity utilisation rate	80.6	80.5	**80.2**

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

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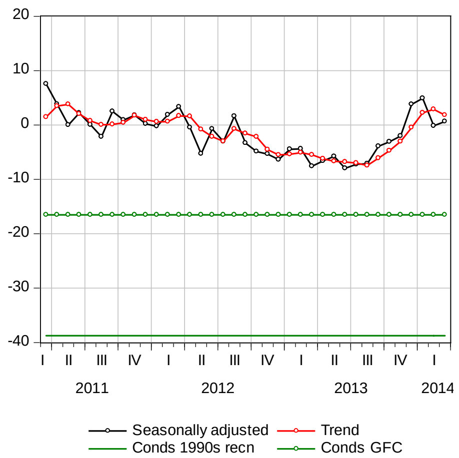
Next release:
17 April 2014 (March quarterly)
13 May 2014 (April monthly)

Analysis

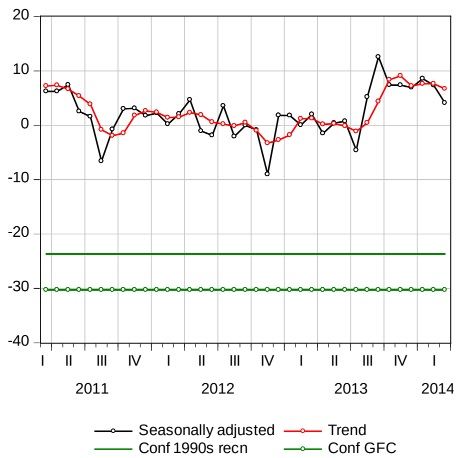
Business conditions rose modestly in the month, but remain well below the near 3 year highs recorded recently. This outcome is consistent with expectations of a relatively modest recovery in business activity and a return to trend growth in the economy. Looking through some of the volatility in late 2013/early 2014, trend business conditions have improved since mid last year as lower interest rates and AUD helped to support activity, but have given up some of these gains recently. The employment component of the survey continues to support our expectation of a relatively jobless recovery – somewhat contrary to the strong employment growth recorded in February – which is likely to weigh on the consumer sensitive sectors of the economy. Despite further pullback in confidence, business conditions still lag well behind confidence, rising 1 point to +1 index point in the month – below the long run average of the series (+5 since 1997). Services sectors have been the major standout performers, but the biggest improvement this month came from mining. The largest deteriorations were recorded in wholesale and transport & utilities, both down 10 points, while finance/ property/ business was the only other industry to record a fall, down 1 point. Near-term indicators suggest little improvement over coming months, with forward orders still soft, while firms continue to de-stock. Capacity utilisation suggests there is still significant slack in the economy.

Conditions stabilise at low level



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

Confidence eased further



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

Business confidence eased off again in the month to be below long-run trend and its weakest level post election. Confidence declined by 3 points to +4 index points. Despite showing resilience in previous months, confidence appears to be gradually responding to volatile (and presently weak) business conditions. Soft forward orders and headwinds from weak business investment and a deteriorating labour market also suggest that this trend may continue over coming months. There are, however, a handful of bright spots emerging, particularly in services, construction, and (surprisingly) retail. Confidence is now positive for most industries, including wholesale (a bellwether industry), although mining is still deeply negative – significant given the importance of mining to the Australian economy.

Business conditions by industry. The moderate rise in conditions was driven by improvements across a number of industries, although mining recorded the largest improvement (up 14 points) – somewhat at odds with softer commodity prices and poor levels of confidence for the industry. Manufacturing (up 2 points), construction (up 2 points) and retail (up 1 point) also improved in the month, although the level of conditions still remains soft, particularly for manufacturing and construction. Wholesale and transport & utilities both recorded the largest fall in conditions (both down 10 points), while finance/ property/ business recorded a modest fall (down 1 point) as well. Conditions are still highest in some of the services sectors – with consumers more prepared to spend on services (especially those considered non discretionary). Recreation & personal services are highest (+12 index points), followed by mining (+5 index points), and finance/ property/ business services (+1 index points). Conditions remain very poor and deteriorating in wholesale (-25 index points), which points to ongoing weakness in the broader economy. Transport & utilities and manufacturing are also very weak (-10 and -7 index points respectively).

Analysis (cont.)

Business conditions by state. Business conditions were mixed across the mainland states in the month. NSW and Victoria were the only states to record an increase (up 4 points and 3 points respectively), while conditions in WA remained unchanged. Queensland and South Australia both recorded weaker conditions. Business conditions in Queensland continue to be the weakest of the mainland states, dropping 2 points to -5 index points in March; drought conditions, retail headwinds and flow-on effects from the softer mining sector, kept it the worst performing state. Following a sharp deterioration in conditions in SA, NSW is now the best performing state followed by Victoria – a reflection of improving construction activity and higher industry concentration in services.

Business confidence by industry. Total business confidence was down 3 points in the month, with a number of industries recording a decline. The largest falls were in mining (down 12 points) and finance/ property/ business (down 11 points). Other industries to record a decline included wholesale (down 3), manufacturing (down 2), retail and recreation & personal services (both down 1 point). The retail sector appears to have lost some steam following the strongest holiday trading period for a number of years. Soft labour market conditions – and muted wages growth – are likely to be an ongoing headwind to the industry, particularly for discretionary spending. In contrast, transport & utilities and construction were the only industries to record a (modest) increase in business confidence (up 3 points and 2 points respectively). The improvement in construction is a reflection of the low interest rate environment, which has fed into higher real estate transactions and strong increases in property prices (particularly in NSW and Victoria). On balance, confidence remains positive in most industries, but mining is the main exception and is extremely downbeat (-21 index points), which is consistent with lower commodity prices and the transitional phase of the mining boom that is underway.

Business confidence by state. Confidence remains positive (or neutral) in all mainland states, despite falls in the month for all states except NSW (up 2); WA (down 9), Victoria (down 6), Queensland (down 5) and SA (down 2). Despite the weak business conditions facing Queensland firms, the state is reporting the second highest degree of confidence of the mainland states in levels terms (+4 index points), behind NSW (+8 index points). Firms are least confident in WA (0).

The **forward orders** index rose slightly in the month, but is still well down on the January peak and is pointing to very little impetus for conditions to improve over the coming months. By industry, solid increases were recorded in construction (up 20 points), wholesale (up 14 points) and personal & recreation services (up 12 points). Manufacturing (down 19 points) recorded the largest decline. Unsurprisingly, forward orders were highest in construction (+21 index points), reflecting the significant ramping up of building approvals since late last year. Mining is still the weakest despite the improvement in the month, while manufacturing is almost as soft (-11). **Capacity utilisation** eased slightly in March (from 80.5% to 80.2%), although this is still well up on last years lows. Current readings for capacity utilisation are still below the long run averages for all industries except recreation & personal services, although the degree of slack varies across industries. Transport & utilities capacity utilisation is furthest below long run averages, followed by manufacturing and mining – both of which are major drivers of business capex and suggest very little impetus for additional spending.

In the month, capacity utilisation fell for transport & utilities (down 2 ppts), manufacturing (down 0.8 ppts), wholesale (down 0.5 ppts), retail (down 0.4 ppts), recreation & personal services (down 0.4 ppts) and finance/ property/ business services (down 0.2 ppts). These were only partly offset by increases in mining (up 5.1 ppts) as well as construction (up 1.2 ppts). Following the months decline, utilisation in manufacturing is just 75%, the weakest across the industries, while transport & utilities has the largest deviation below long-run average. Utilisation is highest in finance/ property/ business (83%).

The **stocks** index – also a good indicator of current demand – remained unchanged at a net balance of -1, indicating that the de-stocking cycle continued in the month – although the index has been volatile. Wholesale recorded the most notable change, down 14 points to -21 index points.

The **capital expenditure** index fell by 2 points to +1 index points, although this is not as much of a decline as recent falls in business investment might suggest. A surprising increase in capex by the mining sector (up 8), as well as more moderate increases in other sectors, was more than offset by declines in manufacturing (down 11), retail (down 6) and finance/ property/ business services (down 5). In levels terms, capital expenditure was highest in recreation & personal services (+12) and mining (+9), followed by transport & utilities (+7). Capex is muted across most of the other industries, but wholesale and construction are especially weak (at -8 and -6 index points respectively). The capex series is quite volatile and under represents mining investment, but overall remains at relatively subdued levels.

Analysis (cont.)

Our model of 6-monthly annualised demand growth, using forward orders as a predictor, has been suggesting stronger growth in recent quarters than the national accounts, although following recent revisions, actual growth overshot the model in Q3 2013. In Q4, actual growth dropped to 1.4%, compared to the model's prediction of 3¼%. If we apply trend forward orders for March to our model for Q1, it still implies that demand growth will strengthen to around 3½% – well above our forecast.

Based on business conditions for the December quarter, the survey implies 6-month annualised GDP growth of around 3% in Q4, close to the actual growth rate in the national accounts. Based on business conditions from the March survey, our model implies GDP growth will be around 3% in Q1, also a little above our forecast. However, applying business conditions for the quarter derived from our 'wholesale leading indicator' (see below) implies weaker growth in Q1 at 2½% – in line with our forecast.

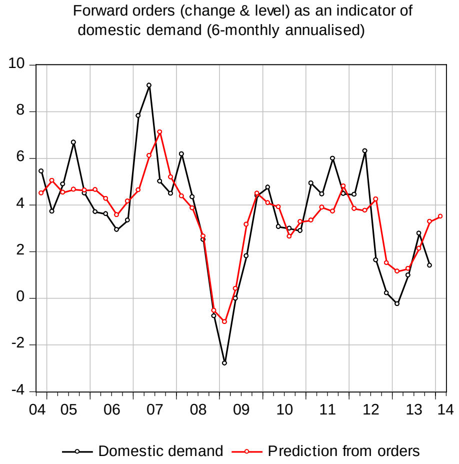
Elsewhere in the survey, cash flow (not seasonally adjusted) was strongest in recreation & personal services, and weakest in construction and retail.

Labour costs growth (a wages bill measure) lifted slightly in March, but wage pressures continue to be relatively subdued relative to previous years. The rise in March reflected higher labour cost pressures in most industries; mining and services industries recorded the largest increases (each up 0.4 ppts). Transport & utilities (down 0.7 ppts) and wholesale (down 0.5 ppts) were the only industries to record softer labour cost growth. Labour cost inflation is highest for rec & personal services (1.4%) and softest in mining and wholesale (-0.1%).

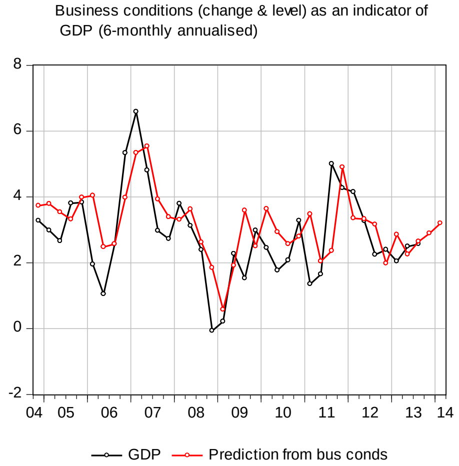
Purchase cost growth eased (down 0.3 ppts) to 0.5% in March (at a quarterly rate), its softest rate in over a year – possibly reflecting recent strength in the AUD. Purchase costs fell across most industries, with the largest falls in transport & utilities (down 1.3 ppts) and retail (down 0.9 ppts). Purchase costs growth was strongest in wholesale (1.4%, at a quarterly rate) and manufacturing (1%), while purchase costs pressures remain weakest for mining (-1%), transport & utilities (-0.5%) and construction (-0.4%).

Final product price growth softened modestly in March (down 0.3 ppts), suggesting that consumer price are unlikely to be a pressing consideration for the RBA in the near term. The deceleration in final price inflation last month unwound all of the upward momentum in prices seen over 2013, which had helped to stem the deterioration in margins. At 0.2% (quarterly rate), price inflation is below the series average of 0.5%. Across industries, the mining sector is continuing to experience price deflation (-0.5%), while prices growth ranges from -0.3% (retail) to 1% (wholesale) for the other industries.

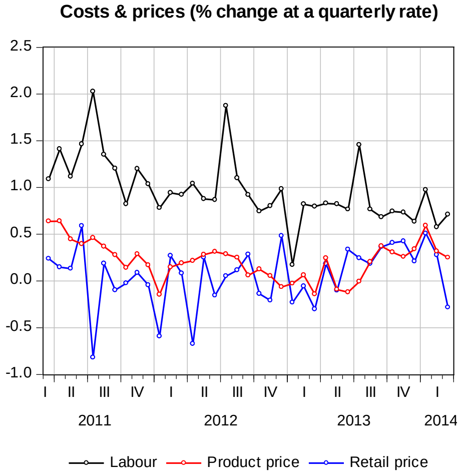
Implies demand growth a little above trend



GDP growth to rise to trend Q1



Prices growth sharply lower, partly assisted by softer purchasing costs



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

Current business conditions

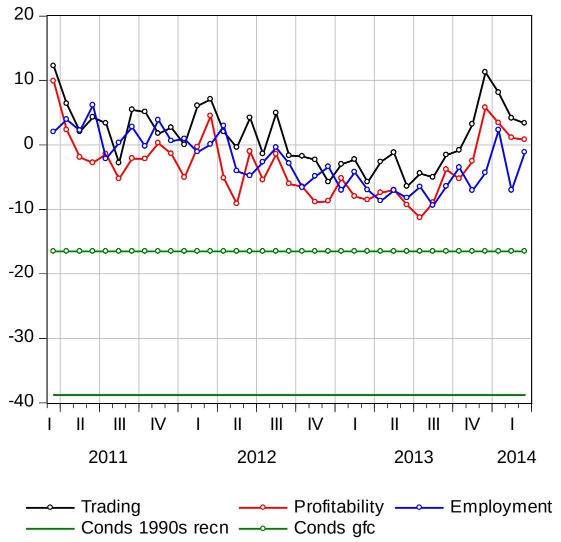
The business conditions index rose slightly in March (up 1) to +1 point, but is still well below the recent peak (+5 index points in January). In response to the much more moderate level of business activity, confidence fell again in the month helping to reduce the divergence seen since the Federal election late last year. Although there have been pockets of improvement in the economy, a more broad based pick up is needed to sustain current confidence levels. Current conditions suggest that domestic demand growth is at or below trend; the long run average for conditions is zero since 1989 (+5 for just the monthly series since 1997). Current conditions are consistent with our view for a deteriorating labour market and sub-trend growth.

Trading, profitability and employment

The rise in business conditions reflected a pick-up in employment (still at soft levels). Both trading and profitability eased again. The employment component has been volatile, but the trend appears to be one of gradual improvement (or lesser deterioration), although still consistent with a soft labour market. In contrast, the trend improvement in trading conditions and profitability appears to have reversed.

Trading and profits down; employment up, but still soft

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



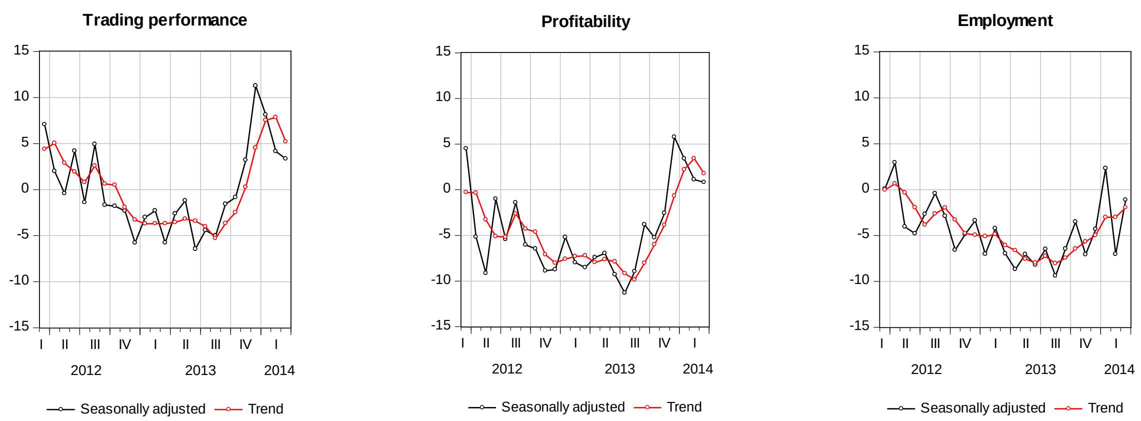
Net balance of respondents who regard last month's trading / profitability / employment performance as good.

There was a further backtrack in **trading conditions**, driven by transport & utilities (down 17), wholesale (down 8), construction and retail (both down 5) and recreation & personal services (down 2). In contrast, mining recorded an improvement (up 15). In levels terms, trading is strongest in recreation & personal services (+17) and weakest in wholesale (-20).

The rise in **employment conditions** in February, rising 6 points to -1 index points, was a continuation of the trend improvement seen since mid last year. Nevertheless, this level is still consistent with rising levels of unemployment and the transition to less labour-intensive mining operations (yet to be offset by labour demand elsewhere). Surprisingly, the improvement was driven by a large jump in mining (up 35) and smaller increases against most other industries. Fine/ prop/ bus was the only industry to record a (slight) decline, down 1. Employment is mixed across industries; wholesale remains weakest at -17 index points, while mining (+16 points) and rec & pers services (+5 points) are now strongest.

Consistent with the dip in trading conditions, **profitability** also dropped slightly, but was flat after rounding (at +1 points). Largest falls came from wholesale (down 22) and trans & util (down 20). Manufacturing recorded the biggest gain (up 7). In levels terms, profitability remains soft across a number of industries, but Rec & pers services has outperformed (+14), while wholesale is very poor (-33).

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).

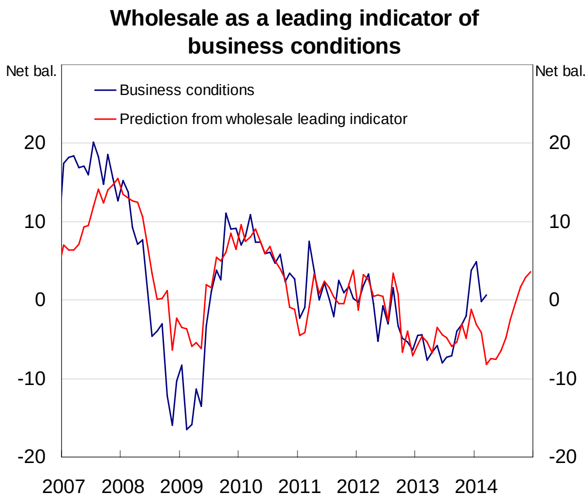
Current business conditions (cont.)

Wholesale: Signalling softer domestic economy than conditions suggest

The weakness in wholesaling that has persisted for the best part of 3½ years continued into 2014. While conditions have been volatile in recent months, wholesale trend conditions remained weak, at -18 points in March.

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). However, there has been a noticeable divergence in recent months as business conditions improved. Our analysis suggests that if wholesale conditions revert to trend over coming months, overall business conditions could be expected to remain soft, averaging -5 index points in the next 6-months. That in turn suggests an economy still running well below trend.

Wholesale activity points to much weaker (GFC level) conditions



Indicator = f(business conditions_wsl, business conditions_wsl(-1 to -4), const.)

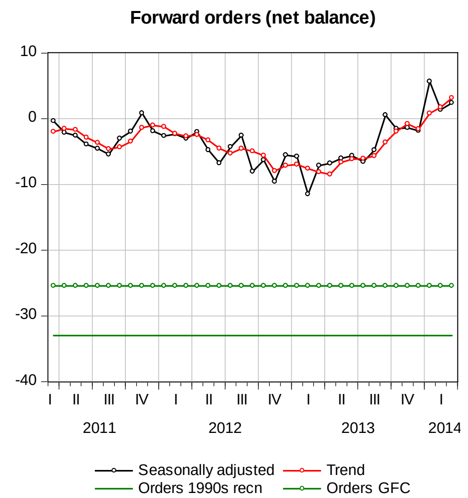
Forward orders

The forward orders index rose slightly (up 1 point) in March. At +2 points, the index is now slightly above the series long-run average of zero points since 1989, but still suggests only a moderate recovery.

The rise in orders reflected increases in construction (up 20), wholesale (up 14), recreation & personal services (up 12), mining (up 7) and fin/ prop/ bus (up 4). This was only partly offset by a decline in manufacturing (down 19), retail and transport & utilities (both down 7). Orders remain very weak for mining (-15 points), followed by manufacturing (-11) and trans & util (-5). The orders index is currently strongest for construction (+21).

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

Trend orders close to 4-year high

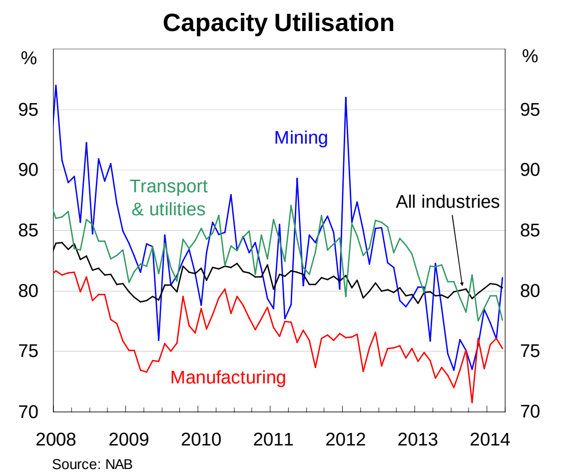


Capacity utilisation

Capacity utilisation was down in March (80.2% from 80.5%), dipping to a 3-month low. Utilisation has been below the monthly survey average of 81.1% (since 1997) since 2012 and is also marginally under the long-run average of 80.4% (since 1989). This month's outcome reflected a fall across most industries, particularly transport & utilities (down 2), which has more than offset a solid pick up in mining (up 5.1 ppts), and a more moderate rise in construction (up 1.2 ppts). Manufacturing capacity utilisation remains very low (75%). Utilised capacity was highest in finance/ property/ business (83%).

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

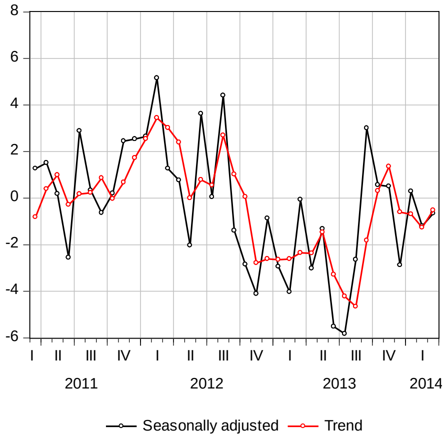
Capacity usage varies across industry



More details on business activity

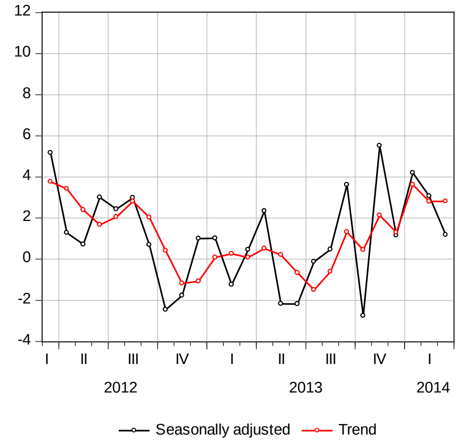
Firms continue to de-stock. Reflects soft orders?

Stocks (net balance)



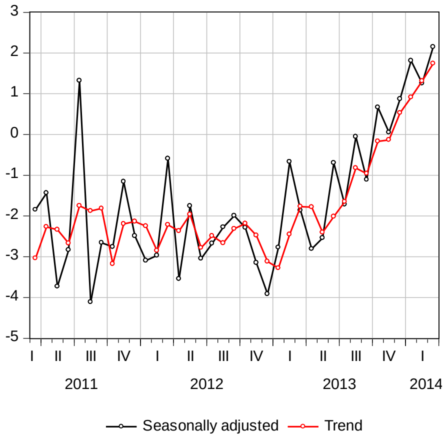
Capex positive, but easing; varies across industries

Capital expenditure (net balance)



Exports reach a new post-GFC high

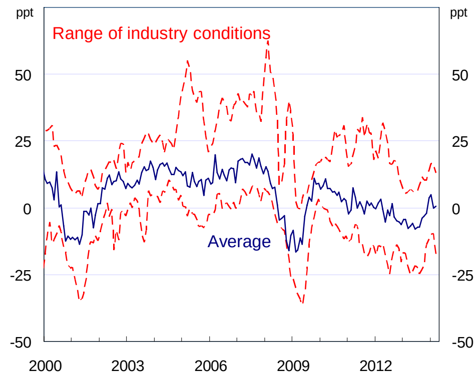
Exports (net balance)



Range of conditions widened

Monthly Business Conditions by Industry

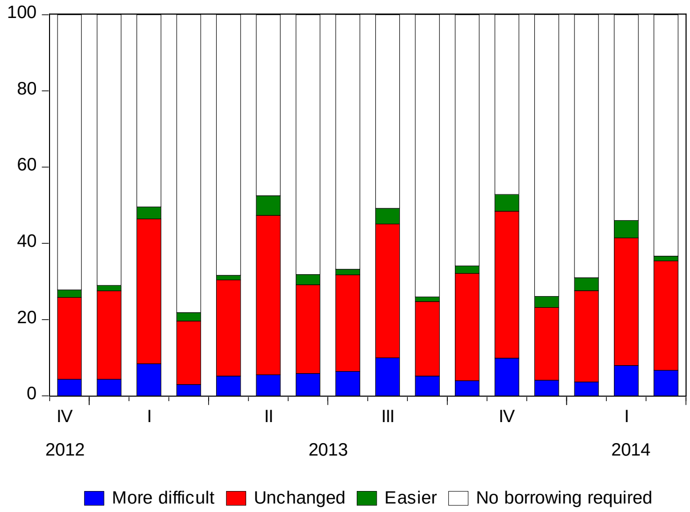
Net balance, deviation from industry average since 1989



Source: NAB

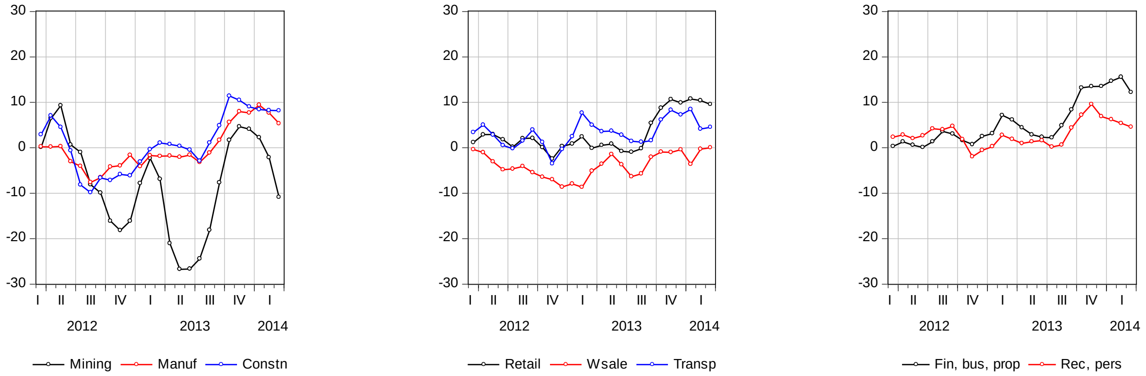
Decline in borrowing conditions in last 3 months, but demand for credit rose

Borrowing conditions (% of firms)

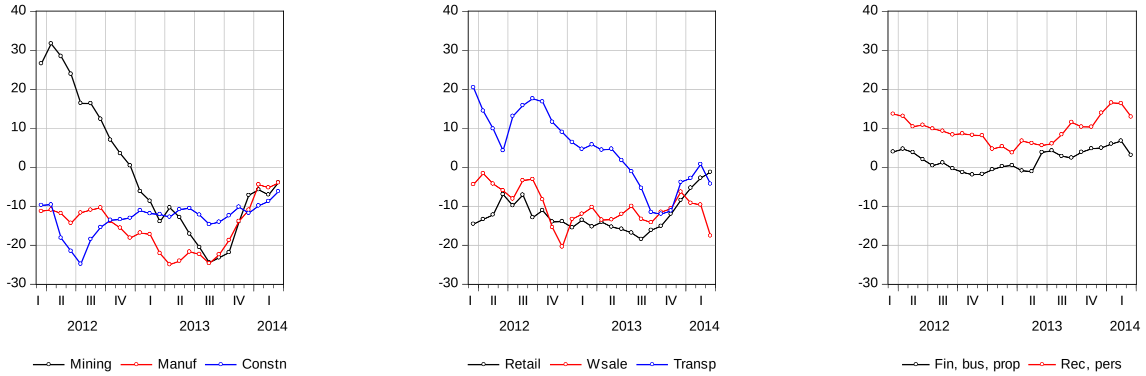


Industry sectors and states

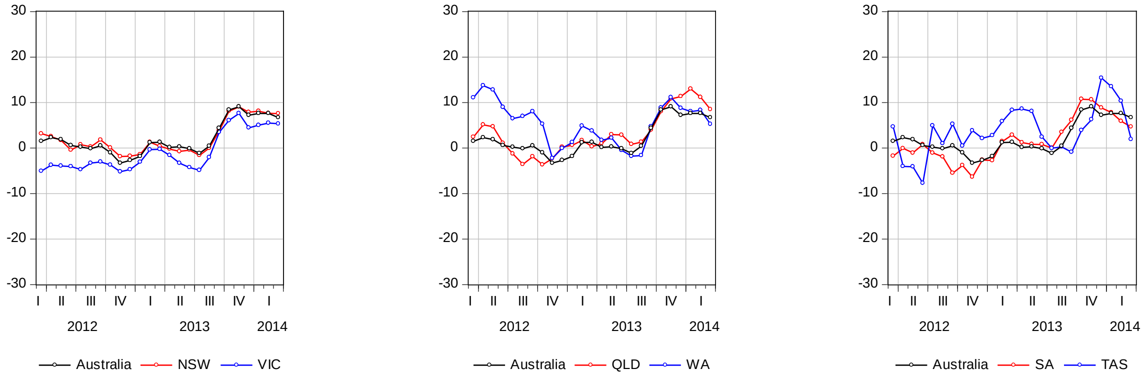
Business confidence by industry (net balance): 3-month moving average



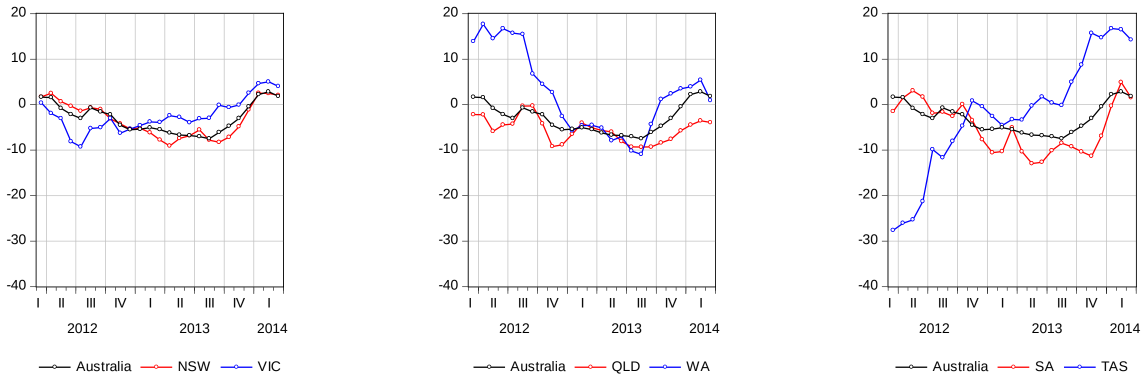
Business conditions by industry (net balance): 3-month moving average



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



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



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