National Australia Bank

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Monthly Business Survey

April 2014

Business conditions more subdued in April but confidence up marginally – shrugging off 'tough budget' rhetoric. Sales eased slightly, employment slightly better but still soft, profits weaker. Conditions remain volatile and mixed across industries: 'bellwether' sectors (wholesale, transport) still soft with near term conditions likely to remain sluggish – forward orders fell sharply. Inflation pressures relatively muted, but retail prices accelerated. Tomorrow's Budget to show lower growth outlook with fiscal headwinds. We now expect Q1 GDP to be stronger (mainly net exports) and unemployment to peak marginally lower, prompting us to drop our call for a rate cut in November (subject to Budget). Rate rises not till late 2015.

- Business confidence lifted slightly in April, returning to long-run average levels after hitting a post-election low last month. The rise in confidence was a little surprising given negative rhetoric about a 'tough budget.' Other leading indicators in the survey still soft and seemingly not the source of better sentiment. Broader macro indicators are looking a little more positive – including the labour market – and may be helping confidence, which is highest in finance/ property/ business and retail.
- Business conditions dipped slightly in the month, continuing to point to a sluggish recovery in business activity. Conditions varied significantly across industries: looking through the monthly volatility, wholesale and mining continue to face the biggest challenges. Wholesale conditions improved strongly but remain at soft levels – a concern for this bellwether industry. Recreation & personal services remain strongest in trend and actual terms. Forward orders fell sharply, employment remains soft, sales eased (still positive) and profits fell (now negative).
- Our wholesale leading indicator suggests much weaker underlying conditions, pointing to further below trend economic growth in the first quarter of 2014, remaining soft into Q2 (at around 2¾%).
- Inflation pressures remain generally soft again in the month due to lower labour cost pressures. However, purchase costs picked up slightly, while retail prices strengthened.

Implications for NAB forecasts (provisional: updated forecasts in our Budget report tomorrow night):

- Going into the Budget, we now expect GDP growth at 2.9% in 2013/14 (was 2.7%) and 3.1% in 2014/15 (was 3.0%). That fundamentally reflects a stronger net exports contribution in Q1. GNE in the next two financial years remains at a very subdued 1%. Underlying CPI 2.7% through 2013/14 (was 2.9%) and 2.3% through 2014/15 (was 2.2%). Unemployment is now expected to reach 6¼% by end 2014 (was 6½%). That, plus the RBA's reluctance to cut further, underpins our rate call change. We see the Commonwealth budget in structural deficit for some years with fiscal restraint imposing headwinds for several years — the extent of restraint may require post-Budget adjustments to our forecasts. We are currently expecting a fiscal contraction of around ½% per annum over the next 4 years. Global GDP growth unchanged at 3.5% in 2014 and 3.8% in 2015.

Key monthly business statistics*

	Feb 2014	Mar 2014	**Apr 2014**		Feb 2014	Mar 2014	**Apr 2014**
		Net balance				*Net balance*	
Business confidence	7	4	**6**	Employment	-7	-1	**0**
Business conditions	0	1	**0**	Forward orders	1	2	**-6**
Trading	4	4	**3**	Stocks	-1	-1	**0**
Profitability	1	1	**-2**	Exports	1	2	**1**
		% change at quarterly rate				*% change at quarterly rate*	
Labour costs	0.6	0.7	**0.6**	Retail prices	0.3	-0.3	**0.1**
Purchase costs	0.8	0.5	**0.6**			*Per cent*	
Final products prices	0.3	0.3	**0.2**	Capacity utilisation rate	80.5	80.2	**80.4**

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

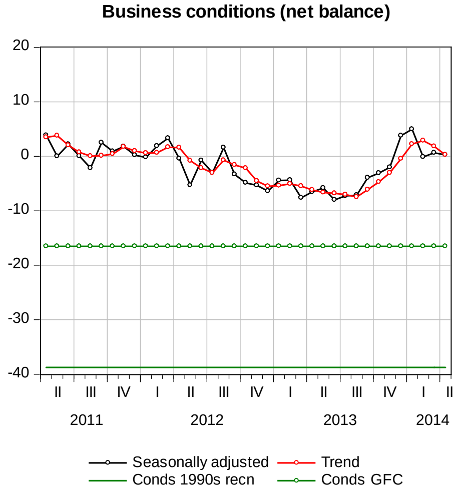
For more information contact:
Alan Oster, Chief Economist
(03) 8634 2927 Mobile 0414 444 652

Next release:
10 June 2014 (April monthly)

Analysis

Business conditions eased slightly in April (down 1 to 0 index points), staying below the long-run average of the series (+5 since 1997) and pointing to ongoing sluggishness in domestic demand – despite recent improvements in pockets of the economy. Looking through some of the recent volatility, trend business conditions have improved since the middle of last year as lower interest rates and AUD helped to support activity, but have given up some of these gains recently. Sales eased back in the month but remain the most positive of the components. In contrast, forward orders deteriorated significantly to quite weak levels. The employment component lifted slightly, but is still consistent with only modest employment growth in the near term – somewhat inconsistent with headline labour market statistics, although full-time employment growth remains sluggish (having been flat over the past 12 months). Services sectors have been the major standout performers, although the biggest improvement this month came from wholesale (off a very low base, but conditions in the industry have been volatile and are still weak in trend terms). The largest deteriorations were recorded in mining and retail, down 30 points and 17 points respectively, while construction was the only other industry to record a fall, down 6 points. Near-term indicators are signalling additional weakness in coming months, with forward orders deteriorating and firms reluctant to re-stock. Capacity utilisation improved, but remains below long-run average levels.

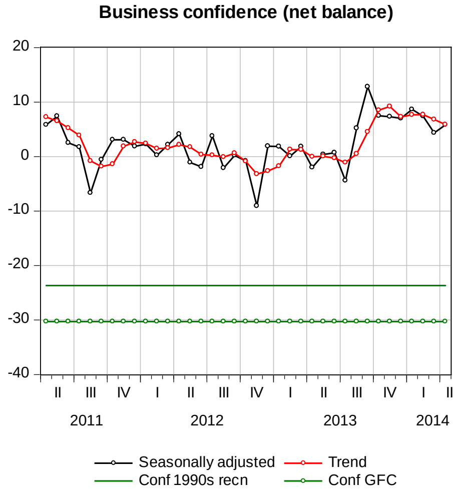
Conditions stabilise at low level



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

Business confidence lifted in April from its weakest since the election. Confidence rose by 2 points to +6 index points. Higher confidence comes as somewhat of a surprise given the negative rhetoric over the upcoming 'tough budget' and the persistently low level of business conditions. Despite the improvement in confidence, the trend has fallen from last year's highs. Soft forward orders and headwinds from business investment and a soft labour market suggest this trend may continue over coming months. Bright spots remain in services, construction, and retail. Confidence is still positive for most industries, but mining is still quite negative – significant given its importance to the Australian economy – and wholesale again turned negative.

Confidence lift, but still off peaks



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

Business conditions by industry. The moderate fall in conditions was driven by large declines in just a handful of industries, the largest of which has been in the mining industry (down 30) – coinciding with declines in iron ore prices late in the month and persistently soft coal prices. Retail (down 17) and construction (down 6) were the only other industries to record falls in conditions in the month, although the level of conditions remains soft in a number of additional industries. In particular, wholesale conditions remain very soft (at -6 points), despite recording the largest improvement in the month (up 19 points), pointing to ongoing weakness in the broader economy. The next best improvement came from manufacturing and finance/ property/ business (both up 6). 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 (+14 index points), followed by finance/ property/ business services (+8 index points). Conditions are negative in all other industries. Mining is the lowest (-26 index points), followed by retail and construction (-18 and -12 respectively) – both of which are yet to consistently sustain positive conditions despite low interest rates and high interest rate sensitivity. This suggests other negative factors, particularly the soft labour market and receding mining investment boom, are still more than offsetting accommodative monetary policy.

Analysis (cont.)

Business conditions by state. Business conditions were again mixed across the states, with the two largest states giving back some of the gains associated with the buoyant residential markets of previous months. NSW and Victoria were the only mainland states to record declines (down 2 points and 3 points respectively). Elsewhere, conditions were up strongly. Western Australia improved the most (up 7) to have the highest conditions of the mainland states (+6), while South Australia also improved strongly (up 6) to be the second highest (+4) – surprising considering SA's trend unemployment rate in April was the worst of the mainland states. Despite some improvement, a strengthening residential property market, and some relief from drought conditions, Queensland remains the worst performing state (-3).

Business confidence by industry. Total business confidence was up 2 points in the month, but outcomes were very mixed across the industries. The largest rise was in mining (up 14 points), following a sharp contraction in the previous month. Finance/ property/ business services also recorded a solid increase (up 8), while retail was the only other industry to record an improvement (up 5). These two industries now share the highest confidence index (+12), suggesting that at the time of the survey retailers were unconcerned about the potential impact the Federal government's 'belt tightening' is likely to have on discretionary income/spending. In contrast, confidence fell heavily for wholesale (down 8), while construction and manufacturing recorded more moderate declines (down 2 and 1 point respectively) – possibly a reflection of softening engineering construction demand and a persistently high AUD. However, despite easing in the month confidence remains elevated for construction, assisted by the run-up in residential building approvals over the past 6-9 months (spurred by low interest rates and rising property prices). On balance, confidence is generally positive across most industries, but mining and wholesale are the main exceptions (-6 and -3 points respectively), which is consistent with lower commodity prices and a reduced investment pipeline, as well as sluggish domestic demand growth.

Business confidence by state. Confidence remains positive in all mainland states, despite a notable fall in the month for NSW (down 4). Once again, it was surprising to see South Australian firms report such a strong improvement in confidence (up 7), which was the strongest increase in the month and means that South Australia has the highest confidence index of the mainland states (+11). Next highest is Queensland (+9), followed by Victoria (+5) then NSW (+4). Firms are least confident in WA (+1).

The **forward orders** index dropped dramatically in the month (down 8 to -6 points), unwinding most of the gains seen since early 2013. Monthly movements in the index can often be volatile, but even looking through the volatility the trend measure also points to soft sales activity in coming months (at -1 index point). By industry there were some significant deteriorations, particularly in construction (down 27), wholesale (down 24) and recreation & personal services (down 17), all of which recorded strong increases last month. Retail was the only other industry to record a decline (down 13). In contrast, manufacturing recorded the largest increase in the month (up 7) with the remaining industries recording relatively moderate rises. Orders are now negative for all industries excluding finance/ property/ business (+7). Looking through the monthly volatility, orders are still negative in several industries, with mining currently the worst (-17), while construction (+6), finance/ property/ business (+5) and recreation & personal services (+2) are positive.

Capacity utilisation rose slightly in March (from 80.2% to 80.4%), which is well up on last year's lows. Current readings for capacity utilisation are still below the long-run averages for most industries, excluding recreation & personal services and construction, although the degree of slack varies across industries. Mining capacity utilisation is farthest below long-run averages following a sharp fall in the month, while transport is the next worst – low utilisation gives very little impetus for capex spending. In the month, the sharp fall in utilisation rates for mining (down 5.2 ppts) was offset by more moderate rises in most other industries (except fin/ prop/ bus, which was down 0.2 ppts). Utilisation rates remain the lowest in manufacturing (75.3%), while construction and recreation & personal services are highest at 83.1% and 82.7% respectively.

The **stocks** index – also a good indicator of current demand – rose slightly to a net balance of 0, indicating that firms are still reluctant to restock – although the index has been volatile. De-stocking is most apparent in wholesale and construction (-9 and -7 points in trend terms).

The **capital expenditure** index rose by 2 points to +3 index points, although the trend is slightly lower. Although positive, the index is yet to indicate enough impetus in capital spending to counter the current contraction in mining investment. As expected, last month's lift in mining capex was more than unwound (down 16) to -12 index points – the weakest of all the industries. Transport also recorded a large drop (down 10), while construction also fell (down 3). In levels terms, capex was highest in rec & pers services (+13) and finance/ property/ business (+7). Capex is muted across most of the other industries, but wholesale and construction are especially weak in trend terms (at -5 and -9 index points respectively).

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 3½%. The quarterly survey implies growth of 3¼% in Q1. If we apply trend forward orders for April to our model for Q2, it suggests that demand growth will strengthen further to around 3½% – well above our forecast.

Based on business conditions for the December quarter, the survey implied 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 quarter survey and the April monthly survey, our model again implies GDP growth of around 3% in Q1 and Q2, a little below our forecast. Applying business conditions for the quarter derived from our 'wholesale leading indicator' (see below) implies slightly weaker GDP growth in Q2 at 2¾%.

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

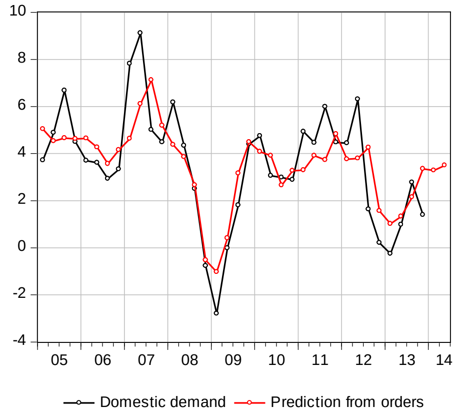
Labour costs growth (a wages bill measure) eased slightly in April, with wage pressures continuing to be subdued relative to previous years. The rise in April reflected higher labour cost pressures in a handful of industries; services industries continue to record the largest pressures. Retail (up 0.4 ppts), wholesale (up 0.3 ppts), transport & utilities (up 0.5 ppts) and fin/ prop/ bus (up 0.2 ppts) all showed an acceleration in labour cost growth. Labour cost inflation is highest for fin/ prop/ business (1.2%) and softest in mining (-0.3%).

Purchase cost growth rose (up 0.1 ppts) to 0.6% in April (at a quarterly rate), and has trended lower in recent months – possibly a reflection of strength in the AUD. Purchase costs accelerated across a majority of industries, with the largest occurring in transport & utilities (up 0.8 ppts) and retail (up 0.7 ppts). Purchase costs growth was strongest in wholesale (1.6%, at a quarterly rate) and manufacturing (1.4%), while purchase costs pressures remain weakest for construction (-0.3%) and mining (-0.1%).

Final product price growth decelerated modestly in April (down 0.1 ppts), a relevant factor in the RBA's deliberations. At 0.2% (quarterly rate), final price inflation has now decelerated for three months in a row from a peak of 0.6% in January, reducing scope for margin repair. It is below the series average of 0.5%. Across industries, the mining sector is experiencing the most price deflation (-0.5%), while prices growth is highest in wholesale (0.7%) and manufacturing (0.4%).

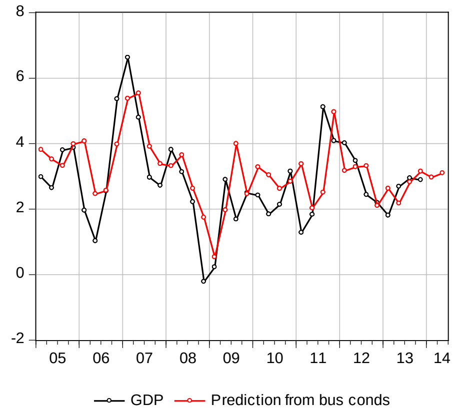
Implies solid demand growth

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



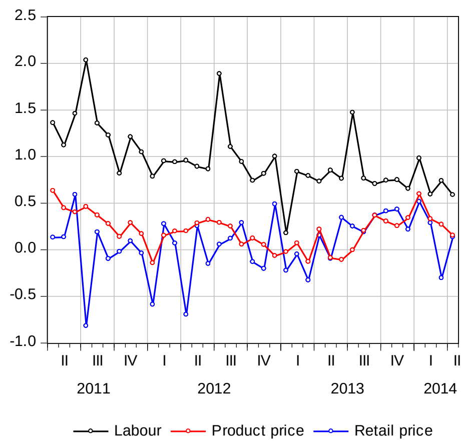
GDP growth remaining slightly below trend in Q1 & Q2

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



Prices growth still easing, partly assisted by softer labour costs

Costs & prices (% change at a quarterly rate)

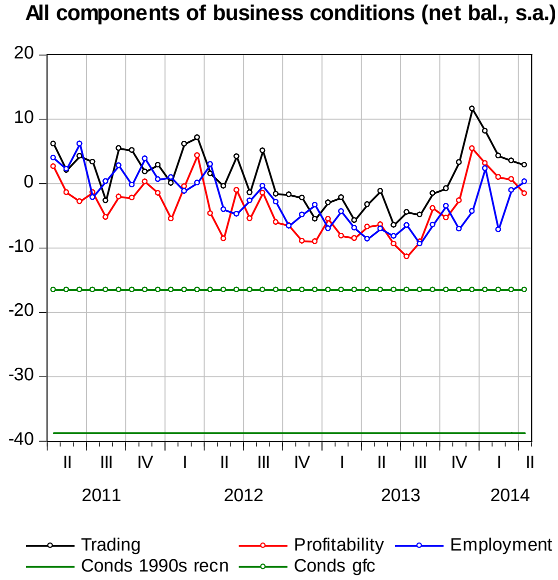


Based on respondent estimates of changes in labour costs and product. Retail prices are based on retail sector product price estimates.

Current business conditions

The business conditions index eased slightly in March (down 1) to 0 points, still well below the recent peak (+5 index points in January). In contrast, confidence rose for the first time in three months, again widening 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 outlook for a deteriorating labour market and sub-trend growth.

Trading and profits down; employment up, but still soft



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

Trading, profitability and employment

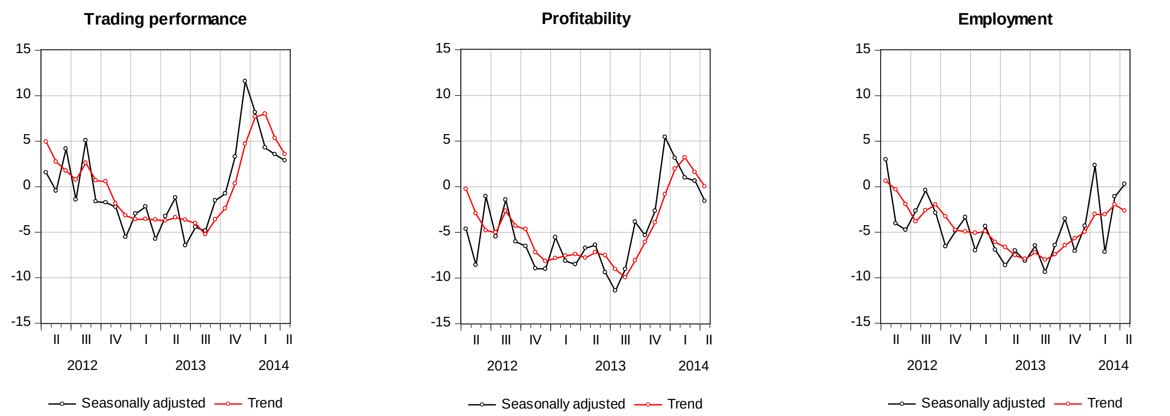
The fall in business conditions reflected a drop in trading and profitability (although the former is still positive). Employment recorded another increase, but the index remained low in April, consistent with a soft labour market (the index has been particularly volatile in recent months). In contrast, the trend improvement in trading conditions and profitability appears to have reversed.

There was a further backtrack in **trading conditions**, driven mainly by mining (down 26), retail (down 13), and construction (down 11). In contrast, wholesale recorded a solid improvement (up 25) and manufacturing also rose (up 9). In trend levels terms, trading is strongest in recreation & personal services (+18) and weakest in transport & utilities (-10).

The rise in **employment conditions** in April, rising 1 point to 0 index points, was a continuation of the trend improvement seen since mid last year. Nevertheless, this level is still consistent with elevated levels of unemployment and the transition to less labour-intensive mining operations (yet to be offset by labour demand elsewhere). Unsurprisingly, there was a very sharp deterioration in mining (down 51), which was more than offset by increases in fin/ prop/ bus (up 18), trans & util (up 8) and wholesale (up 6). Employment is mixed across industries in trend levels terms; wholesale is weakest at -18 index points, followed by mining (-12 points). Fin/ prop/ bus (+4) and rec & pers services (+3 points) are strongest in trend terms.

Consistent with the dip in trading conditions and product prices, **profitability** also dropped (down 3 to -2 index points). The falls came from retail (down 21) and construction (down 4). All other industries saw an improvement. In levels terms, profitability remains soft across a number of industries, but rec & pers services has outperformed (+18). Abstracting from volatility, wholesale is weakest (-19).

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).

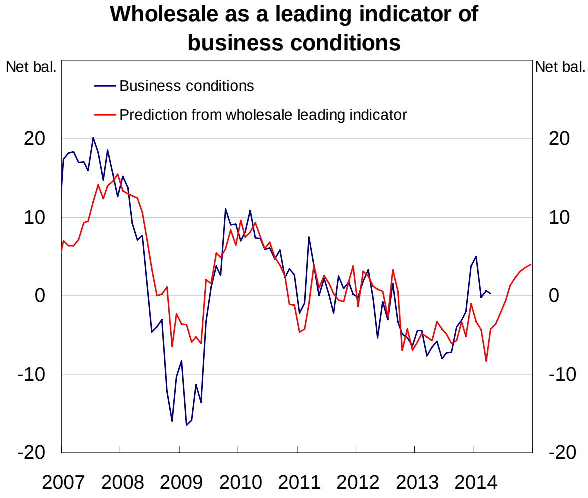
Current business conditions (cont.)

Wholesale: Better, but still signal softer domestic economy than conditions

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 -16 points in April.

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 since late last year as conditions improved – this spread, while still wide, started to close in April. Nevertheless, our analysis suggests that if wholesale conditions revert to trend over coming months, overall business conditions could be expected to remain soft, averaging -3 index points for the remainder of Q2. That in turn suggests an economy still running well below trend.

Wholesale activity points to much weaker conditions



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

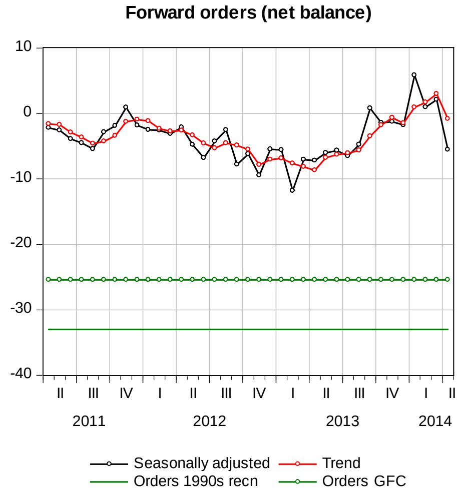
Forward orders

The forward orders index dropped sharply (down 8 points) in April. At -6 points, the index is now well below the series long-run average of zero points since 1989, suggesting a temporary stalling in the recovery; trend orders are also soft at -1 index point.

The sharp fall in orders reflected declines in construction (down 27), wholesale (down 24), rec & pers services (down 17) and retail (down 13). This was only partly offset by a rise in manufacturing (up 7), mining (up 3), transport & utilities (up 2) and fin/ prop/ bus (up 1). Orders remain very weak in trend terms for mining (-17 points), followed by retail (-4) then wholesale (-3). The trend orders index is currently strongest for construction (+6).

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

Sales orders drop sharply

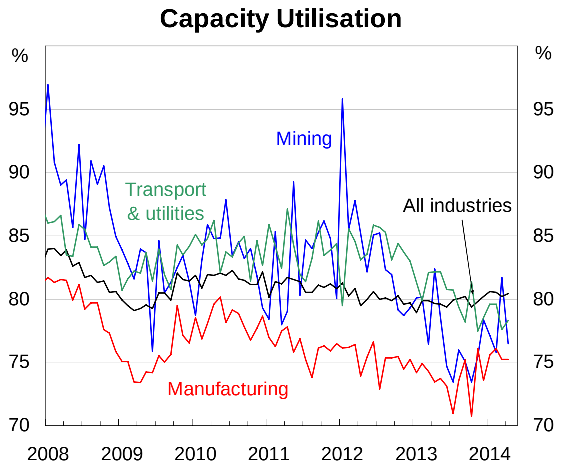


Capacity utilisation

Capacity utilisation was up in April (80.4% from 80.2%), lifting from a 3-month low. Utilisation has been below the monthly survey average of 81.1% (since 1997) since 2012, but is in line with the long-run average of 80.4% (since 1989). In the month, a sharp fall in utilisation rates for mining (down 5.2 ppts) was offset by more moderate rises in most other industries (except fin/ prop/ bus, which was down 0.2 ppts). Utilisation rates remain the lowest in manufacturing (75.3%), while construction and recreation & personal services are highest at 83.1% and 82.7% respectively.

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

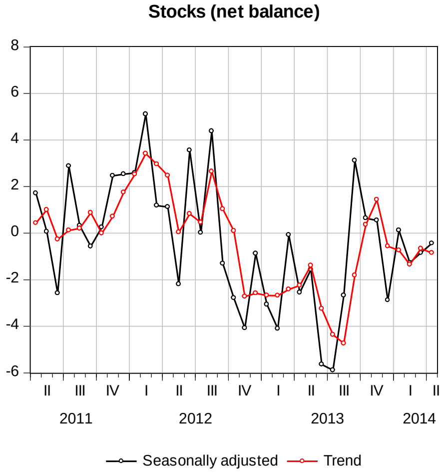
Capacity usage varies across industry



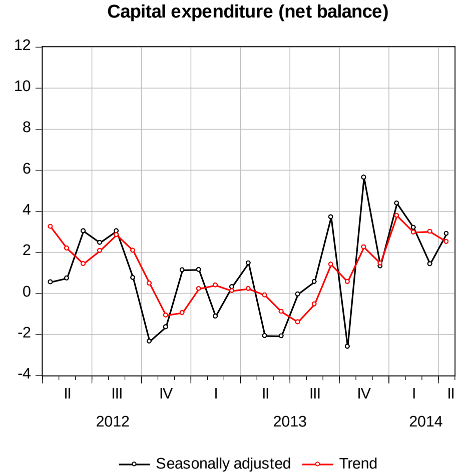
Source: NAB

More details on business activity

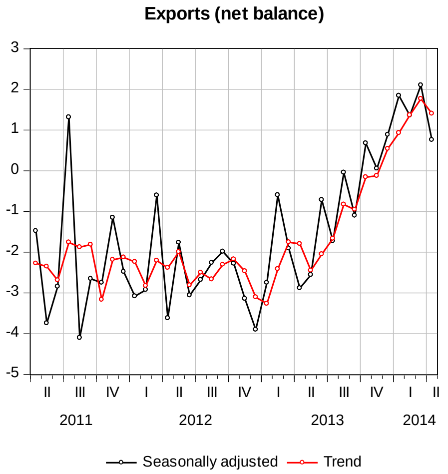
Firms still reluctant to re-stock. Reflecting a cautious outlook



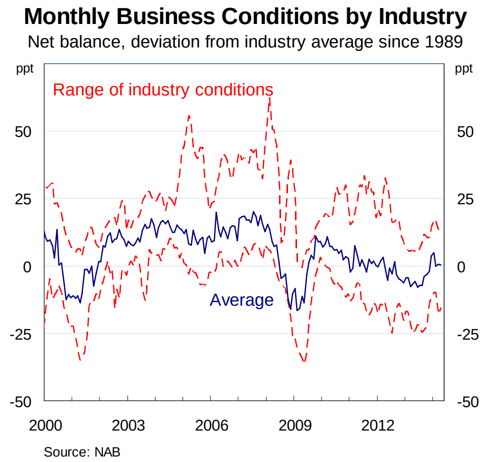
Capex positive, but the trend is lower; more needed to offset mining



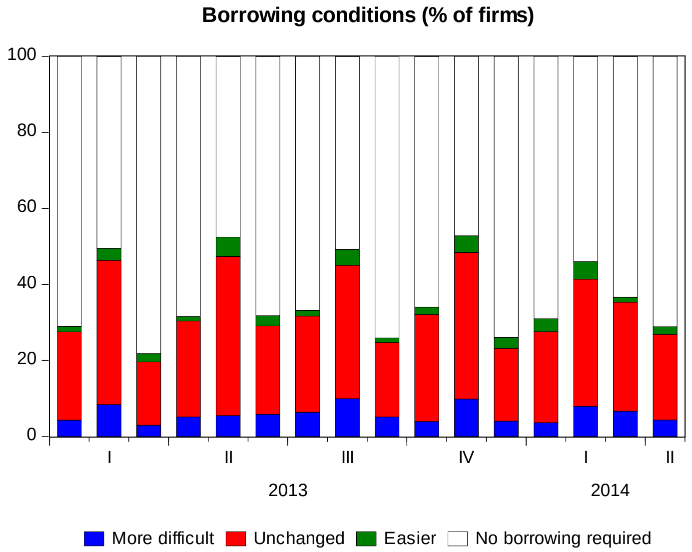
Exports dropped from post-GFC high



Range of conditions narrowed slightly

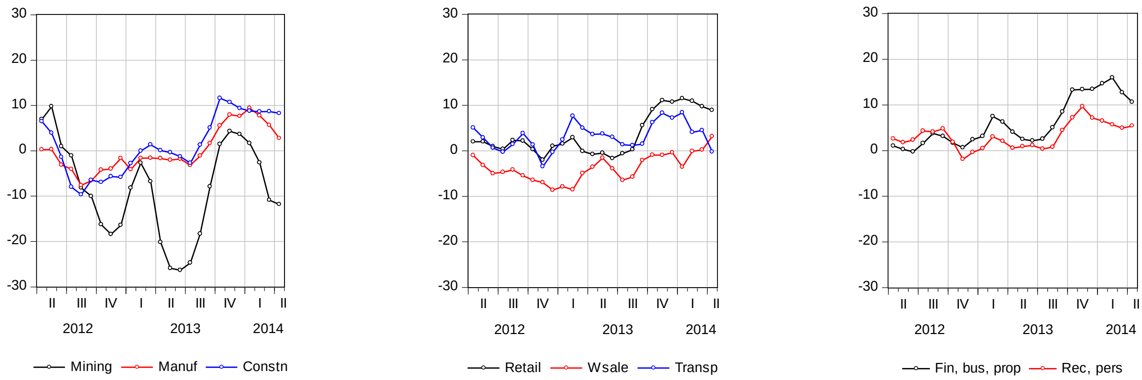


Decline in borrowing conditions in last 3 months and demand for credit eased

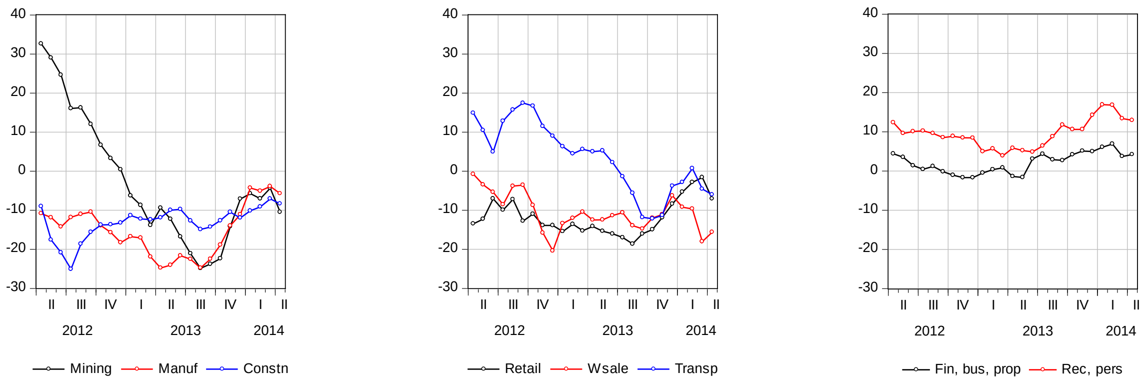


Industry sectors and states

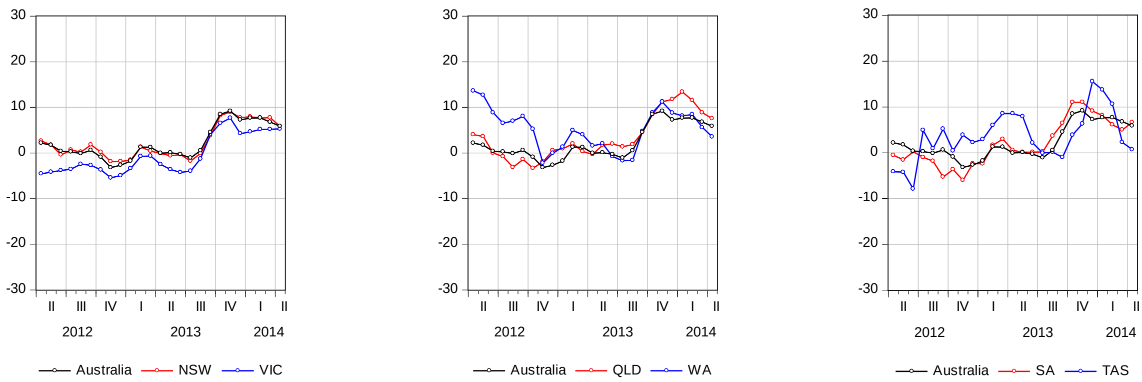
Business confidence by industry (net balance): 3-month moving average



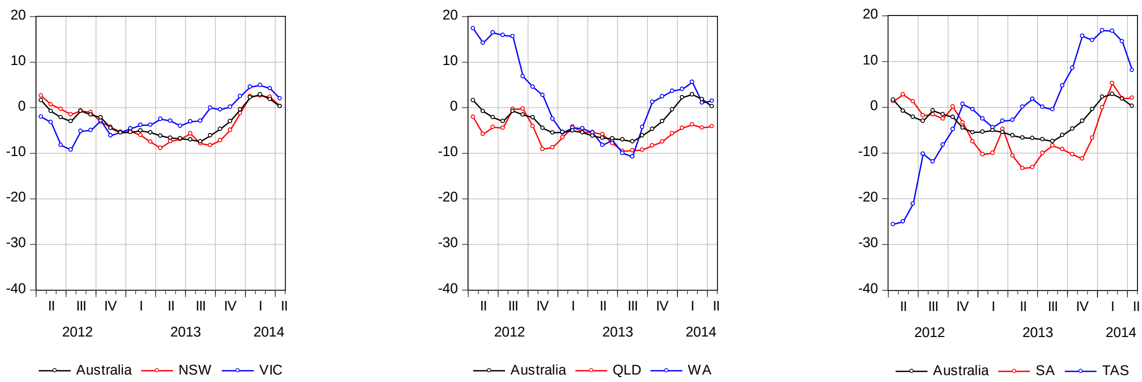
Business conditions by industry (net balance): 3-month moving average



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



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



Macroeconomic, Industry & Markets Research

Australia

Alan Oster	Group Chief Economist	+(61 3) 8634 2927
Jacqui Brand	Personal Assistant	+(61 3) 8634 2181
Rob Brooker	Head of Australian Economics & Commodities	+(61 3) 8634 1663
James Glenn	Senior Economist – Australia & Commodities	+(61 3) 9208 8129
Vyanne Lai	Economist – Agribusiness	+(61 3) 8634 0198
Karla Bulauan	Economist – Australia & Commodities	+(61 3) 8641 4028
Dean Pearson	Head of Industry Analysis	+(61 3) 8634 2331
Robert De Iure	Senior Economist – Property	+(61 3) 8634 4611
Brien McDonald	Economist – Industry Analysis & Risk Metrics	+(61 3) 8634 3837
Amy Li	Economist – Industry Analysis	+(61 3) 8634 1563
Tom Taylor	Head of International Economics	+(61 3) 8634 1883
Tony Kelly	Senior Economist – International	+(61 3) 9208 5049
Gerard Burg	Senior Economist – Asia	+(61 3) 8634 2788
John Sharma	Economist – Sovereign Risk	+(61 3) 8634 4514

Global Markets Research

Peter Jolly	Global Head of Research	+(61 2) 9237 1406
Spiros Papadopoulos	Senior Economist – Markets	+(61 3) 8641 0978
David de Garis	Senior Economist – Markets	+(61 3) 8641 3045

New Zealand

Stephen Toplis	Head of Research, NZ	+(64 4) 474 6905
Craig Ebert	Senior Economist, NZ	+(64 4) 474 6799
Doug Steel	Senior Economist, NZ	+(64 4) 474 6923

London

Nick Parsons	Head of Research, UK/Europe & Global Head of FX Strategy	+(44 20) 7710 2993
Tom Vosa	Head of Market Economics – UK/Europe	+(44 20) 7710 1573
Gavin Friend	Markets Strategist – UK/Europe	+(44 20) 7710 2155

	Foreign Exchange	Fixed Interest/Derivatives
Sydney	+800 9295 1100	+(61 2) 9295 1166
Melbourne	+800 842 3301	+(61 3) 9277 3321
Wellington	+800 64 642 222	+800 64 644 464
London	+800 747 4615	+(44 20) 7796 4761
New York	+1 800 125 602	+1877 377 5480
Singapore	+(65) 338 0019	+(65) 338 1789