Quarterly ASX 300 Business Survey

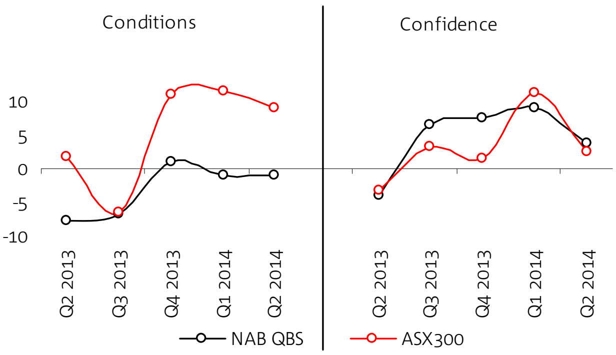
by NAB Group Economics June 2014

Embargoed until: 11.30am Tuesday 29 July 2014

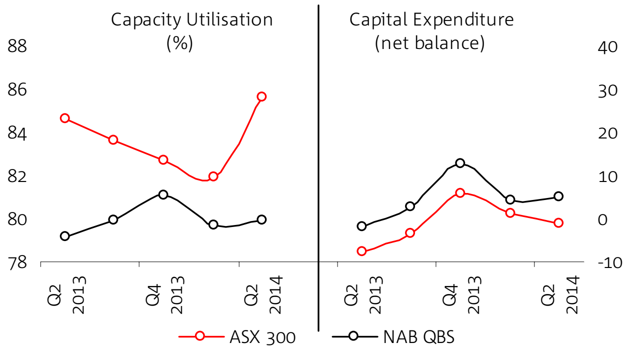
National Australia Bank

Business confidence among Australia's largest firms dropped significantly – from a position of above average confidence relative to the broader economy to marginally below. Businesses are reacting to the subdued domestic demand outlook and the increased uncertainty that followed the Commonwealth Budget in May (the collapse in consumer confidence demonstrates this sentiment even more starkly). Conditions amongst ASX 300 weakened marginally but remained at relatively high levels – especially relative to the broader economic conditions. Trading conditions and profitability remain at very strong levels but – possibly reflecting weaker confidence – employment fell significantly. Capex declined as business investment dipped into negative territory for larger firms. However, firms overall plan to invest more in the coming twelve months.

Business conditions & confidence (net balance,nsa)



Capacity utilisation and capital expenditure



- In sync with the broader economy, business confidence for ASX 300 edged down. For larger firms, confidence deteriorated sharply from +11 points in the March quarter to a final reading of +3 points. Confidence in the broader economy (as in the QBS) dipped to +4 points (from +9 previously).
- Business conditions also weakened for ASX 300, but they remain at strong levels, decelerating to +9 (from +12 previously). In contrast business conditions for QBS were unchanged at -1 points.
- Trading conditions and profitability remain at high levels but were not translated into better labour market outcomes – with employment in large firms falling 6 points to -4 index points. Weak labour market outcomes are expected to continue with little improvement in business conditions expected over the coming year.
- Recent proposed tax and public expenditure changes in the May Federal Budget have raised concerns, adding onto the constraints on profitability, in an environment where sales margins continued to narrow.
- Capital expenditure dipped back into negative territory for ASX 300, with mining and recreational services contributing largely. Capex for the broader economy ticked upwards.
- Firms benefited from easing inflationary cost pressures and increased forward orders - but are passing savings on to consumers, with the final product price edging marginally downwards. Stock levels are stabilising.

Key quarterly business statistics**

	ASX 300 Q1 2014	ASX 300 Q2 2014	NAB QBS Q2 2014
		Net balance	
Business confidence	11	3	4
Business conditions			
- Current	12	9	-1
- Next 3 months	11	14	10
- Next 12 months	35	27	24
Capex plans (next 12)	15	23	21
		% change	
Labour costs	0.28	0.21	0.24
Purchase costs	0.15	0.09	0.27
Final product prices	0.30	0.17	0.10

	ASX 300 Q1 2014	ASX 300 Q2 2014	NAB QBS Q2 2014
		Net balance	
Trading	18	15	1
Profitability	14	15	-3
Employment	2	-4	-1
Forward orders	7	10	2
Stocks	7	10	0
Export sales	7	5	2
		% change	
Retail prices	0.31	0.25	-0.01
		Per cent	
Capacity utilisation	81.9	85.6	79.9

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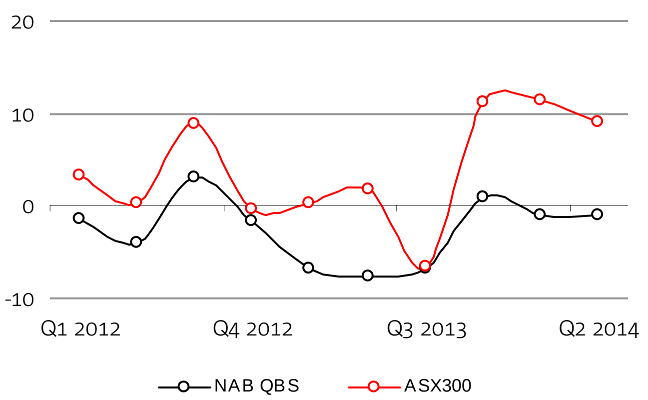
** All data non-seasonally adjusted. Cost and prices data are percentage changes expressed at a quarterly rate. All other data are net balance indexes, except capacity utilisation, which is an average rate, expressed as a percentage. Fieldwork for this Survey was conducted from 26 May to 12 June

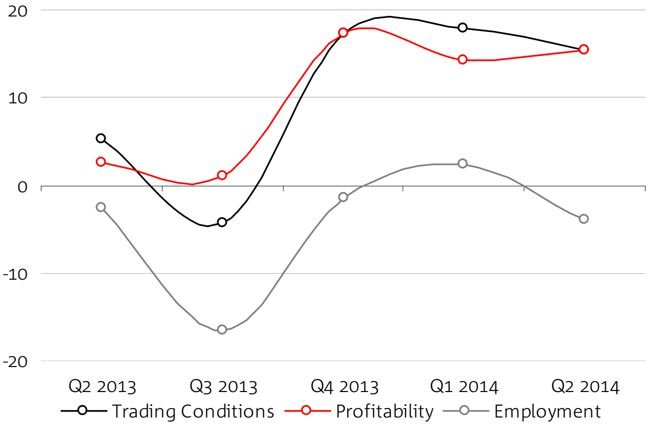
Analysis

Conditions amongst larger firms dipped in the June quarter. The broader economy remained unchanged

Business conditions (net balance, nsa)



Business conditions components (net balance, nsa)



Business conditions for ASX 300 eased in the June quarter of 2014, recording a final reading of +9 points, down from +12 previously. Conditions are particularly weak in construction, recording a reading of -33 points. Despite the modest decrease, conditions have improved from a year earlier.

Meanwhile, for the broader economy, the NAB measure of business conditions remained unchanged at -1 points, with business components trending downwards. Conditions in mining remained the worst at -22 points (from -20) with better conditions felt in finance/ banking/ property.

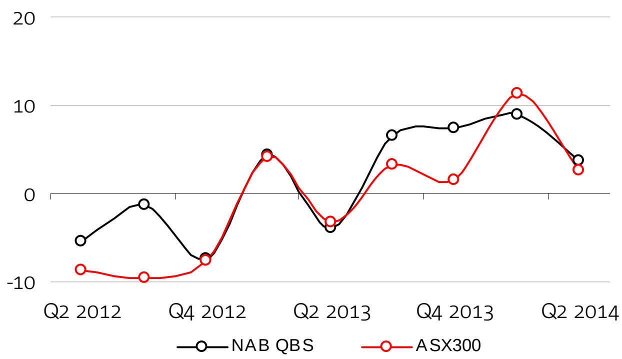
The dip in business conditions for larger firms resulted from a marginal softening in sales, but more importantly a significant deterioration in employment. Trading conditions edged down 3 points to +15 points as the AUD remained at elevated levels. Construction was most adversely affected at -25 points. All other industries reported positive readings.

Profitability gained +1 point to +15 points, as firms benefited from easing costs of production, although final product inflation also eased. Employment remained subdued as it contracted into negative territory to -4 points, from +2 in the previous quarter – this was consistent with expectations of jobless growth.

For larger firms, trading and profitability continue to be positive, however employment demand deteriorated.

Confidence reverted back to lower levels for ASX300

Business confidence (net balance, nsa)



Business confidence for ASX 300 reverted back to levels of late 2013, recording a reading of +3 points - a significant reduction from the +11 March quarter reading. It could well be that the ASX 300 companies are more sensitive to the collapse in consumer sentiment that followed the tough Federal Budget. ASX 300 companies, in the main, would also have not benefited from the reduction of the corporate tax rate contained in the Budget.

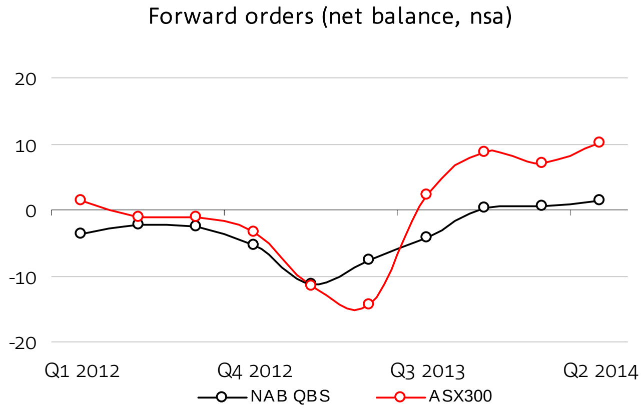
That said the QBS measure of confidence also trended downwards to +4 points (from +9 previously) - although firms are still quite positive relative to consumers.

net balance	Conditions – current	Conditions – next 3 months	Conditions – next 12 months	Confidence – next 3 months
ASX 300	9	14	27	3
NAB QBS	-1	10	24	4

net balance	Trading Conditions	Profitability	Employment	Sales margins	Forward orders	Stocks
ASX 300	15	15	-4	-6	10	10
NAB QBS	1	-3	-1	-13	2	0

Analysis

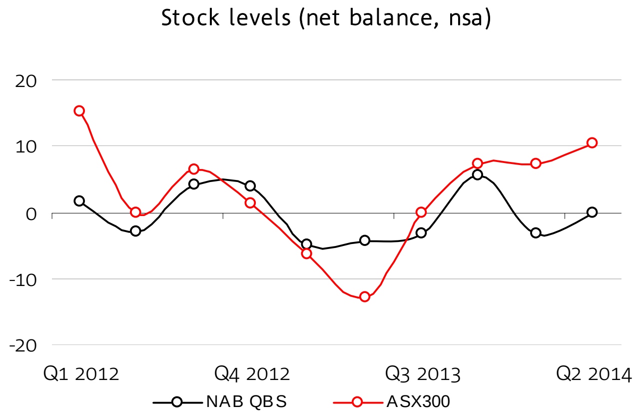
Forward orders for ASX 300 is at a series high



The majority of industries in ASX 300 benefited from increased forward orders, with the index rising to +10 points (from +7 previously). The index is now at a series high and sits somewhat at odds with ASX 300 employment and confidence readings. It could well be the ASX 300 companies don't expect these improved orders will be maintained. Interestingly the strongest orders were in retail.

In tandem, forward orders for the broader economy also gained some momentum, increasing slightly to +2 points (from +1 previously) – the best performers were transport services and finance/ banking/ property. The trend is expected to continue for larger firms in the next quarter and remain softer for the overall economy.

Stock levels are stabilising for ASX & QBS

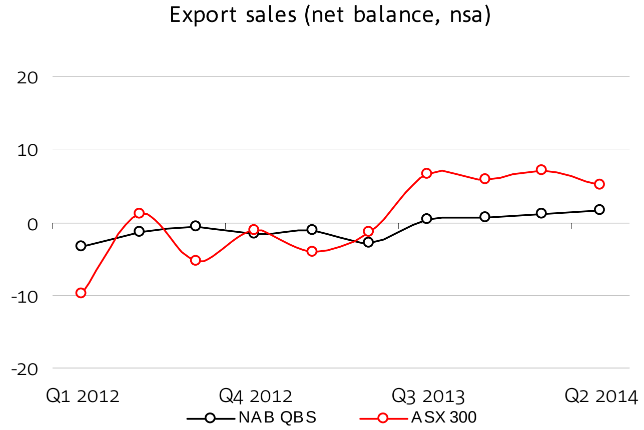


The stock index improved for ASX 300, increasing to +10 points from +7 points. The marginal increase has been supported by stronger profitability and easing cost pressures, and indicates that larger firms may be stocking ahead of stronger domestic demand.

For the overall economy, the index lifted to a zero reading (from -3 previously), with the majority of industries posting negative readings.

Looking ahead, stock levels amongst larger firms should continue increasing, in comparison to the broader economy where the index looks to remain soft.

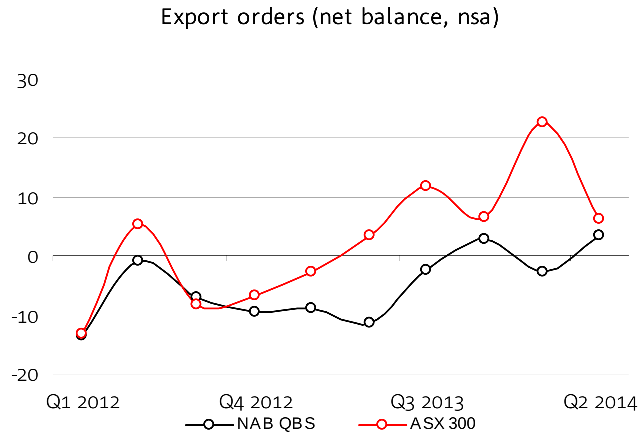
Export sales softened as the AUD remained high



The higher AUD saw export sales for ASX 300 soften marginally in the June quarter, from +7 to +5. Despite the slight decrease, the index remains at elevated levels. Manufacturing and wholesale gained at +22 and +14 points respectively (from a zero reading and +13 in the March quarter).

For the broader economy, demand for exports was stronger, with export sales ticking upwards to +2 points from +1 previously. Exports for larger firms are expected to pick up in the near term, in particular for mining, manufacturing and transport services.

ASX 300 export orders came down from its recent high

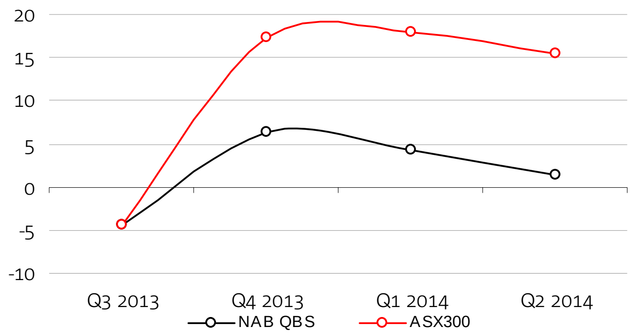


In contrast, export orders for larger firms trended downwards from a March quarter hike, recording a final reading of +6 points (from +23 previously) - the stubbornly high AUD has been less accommodative to domestic firms, as export demand slowed. Although experiencing a sharp decline, export orders remain slightly higher compared to this time last year, with manufacturing holding the fort. For the next three months, export orders are expected to continue a downward trend.

Meanwhile, export orders for the broader economy lifted out of negative territory, increasing to +3 (from -3 points), with stronger gains in construction.

Trading conditions weakened but still robust

Trading conditions (net balance, nsa)

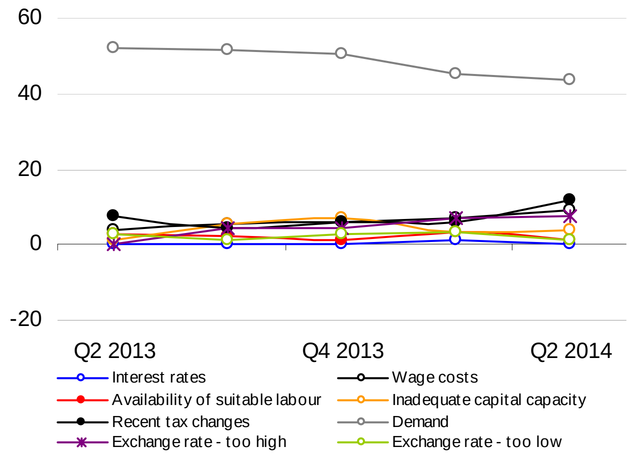


In line with the broader economy, trading conditions for ASX 300 firms weakened a touch in the June quarter, but fundamentally remained robust – especially compared to the broader economy. Trading conditions for the ASX 300 were +15 points in June (+18 points previously). For larger firms, (albeit improving quarter on quarter), construction reported the weakest conditions at -25 points (-33 previously) – no doubt reflecting slowing construction activity in the mining sector.

For QBS, trading conditions dipped to +1 from +4 in the March quarter. Half of the industries were in negative territory – with mining and retail performing the worst (-29 and -20 respectively). Finance/ banking/ property reported a stronger reading of +15 (from +9 previously). The weakened trend is expected to continue into the next quarter for the broader economy but strengthen for larger firms.

Demand remains the predominant constraint on profitability

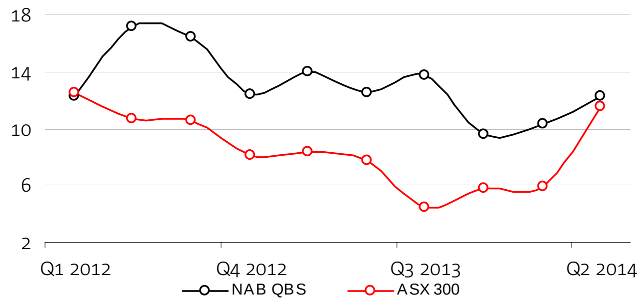
Constraints on profitability (% of firms) – ASX 300



For the ASX 300 there was little fundamental change in the expected restraints on profitability – with demand the key restraint at 44% (previously 45%). The notable exception to the above was question on recent Government tax changes, increasing from 6% to 12% in the June quarter.

Proposed Federal Budget tax changes raising constraints

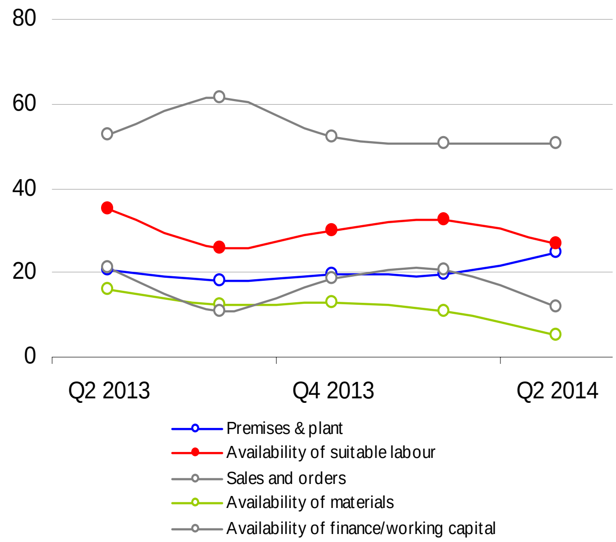
Constraints on profitability (% of firms)
Government changes



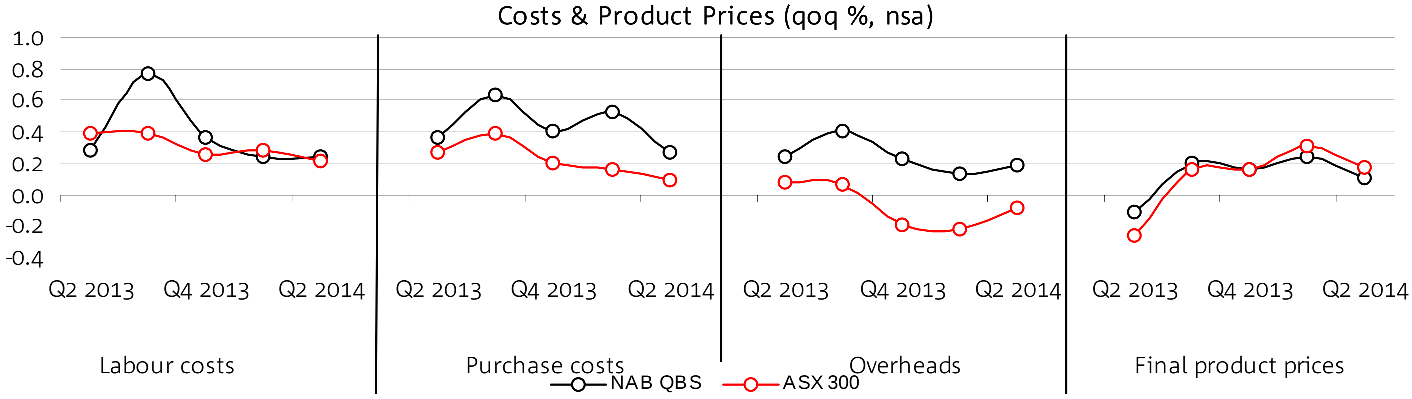
As shown by the chart above ASX 300 respondents fear that tax (and presumably other Budgetary) changes will have a serious impact on future potential profitability. While still only 12% of respondents that represents a doubling of ASX 300 firms concerned about this.

Sales and orders are the key constraint on output

Constraints on output (% of firms) – ASX 300



At the margin, firms surveyed in ASX 300 became less concerned about the availability of suitable labour as a constraint on output, decreasing to 27% of respondents (from 33% previously). This is consistent with the noticeable increase in capacity utilisation in the June quarter (see page 6). Larger firms also reported that the availability of finance/working capital and materials are posing less of a constraint, decreasing to 12% and 5% (from 21% and 11% for the latter). Meanwhile, ASX 300 firms reported that premises and plant are becoming a greater constraint on output, increasing from 19% of respondents to 25%.



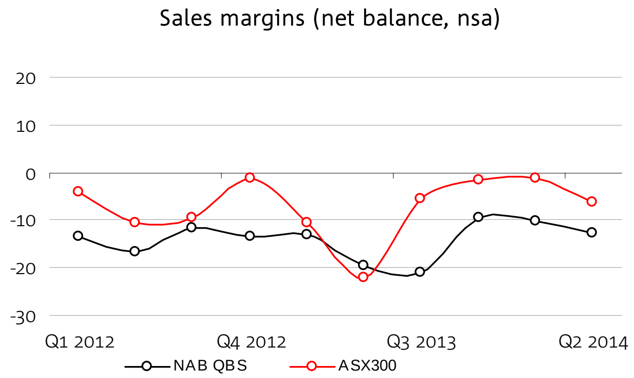
Firms experience reduced inflationary cost pressures

ASX 300 firms benefited from diminished cost pressures during the June quarter, with the majority of cost inflation measures easing back. Labour costs edged downwards for industries (except finance/ banking/ property and mining) from 0.3% to 0.2%. Construction benefited the most, with costs easing to -0.3%. Purchase costs edged up 0.2% while the decline in overheads was slightly less at -0.1%. Final product inflation eased to 0.2% (from 0.3%).

For the broader economy, purchase costs and final product prices eased downwards to 0.3% and 0.1% respectively (from 0.5% and 0.2% in the March quarter). Overheads ticked marginally upwards from 0.1% to 0.2% and labour costs remained unchanged (at a subdued 0.2%).

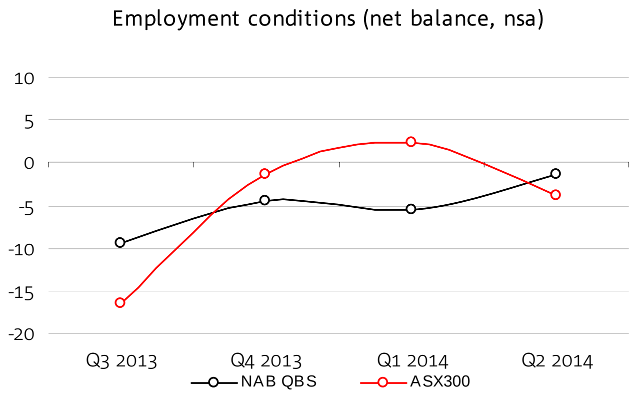
The trend is expected to continue in the near term; however firms should expect a modest rise in labour costs, in particular for recreational services for ASX 300 and QBS.

Sales margins dipped for ASX 300 and QBS



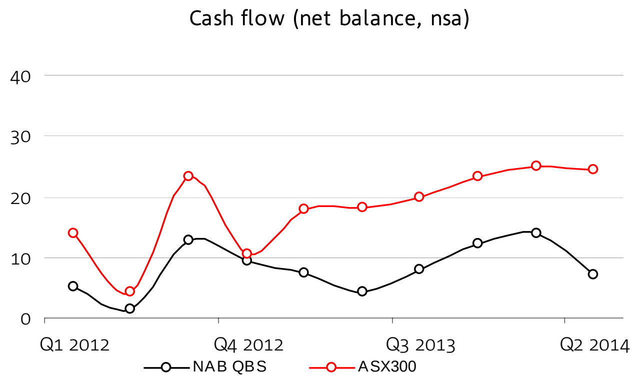
Sales margins narrowed for ASX 300 firms, dipping to -6 points (from -1 points previously). The QBS measure of sales margins also narrowed, decreasing further to -13 points from -10 points previously, with all industries recording negative readings.

Employment weakens in ASX companies



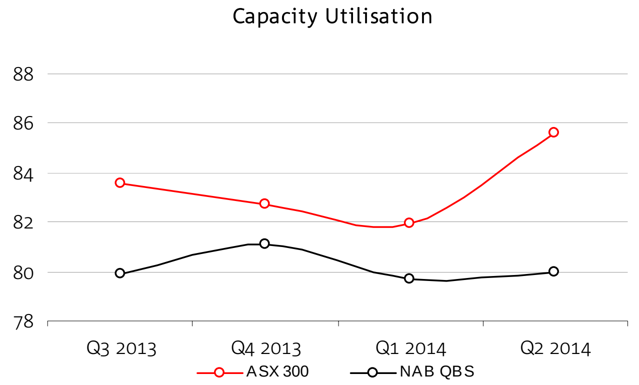
Employment for larger firms eroded to -4 points (from +2 points previously) but improved for the broader economy adding +4 points to a final reading of -1 point (from -5 in q1 2014). The labour market is expected to weaken further in the near term - particularly in (mining related) construction for larger firms.

Cash flow remains stronger for ASX 300



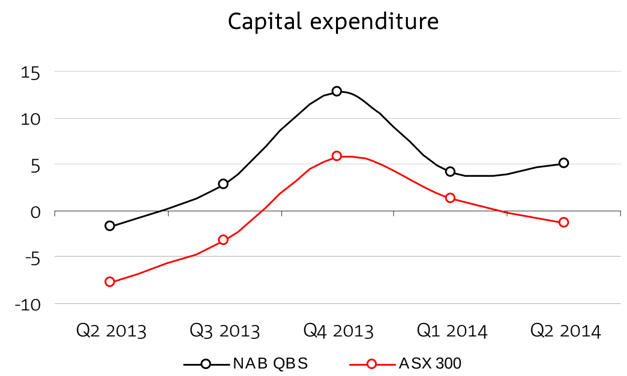
Cash flow for larger firms softened a touch to +24 points (down from +25 points previously), but remains relatively strong. For the broader economy, cash flow weakened to 7 points (from +14 previously).

Capacity utilisation strengthened for larger firms

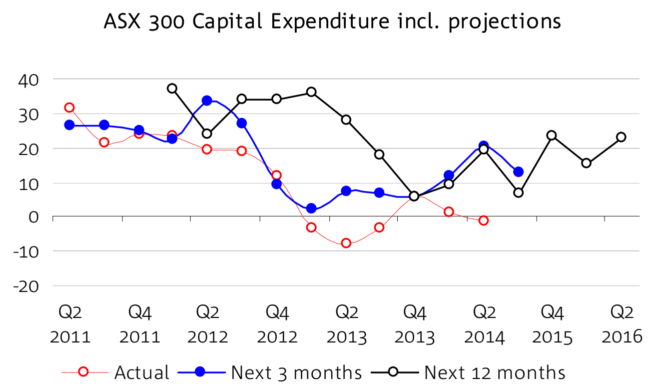


Capacity utilisation increased during the June quarter to 86% (from 82% previously) for ASX 300 firms. Gains were seen across most industries, with just utilities declining. For the QBS measure of capacity utilisation, the index remained unchanged for the broader economy at 80%.

Capex remains subdued for larger firms, but expanded for the broader economy

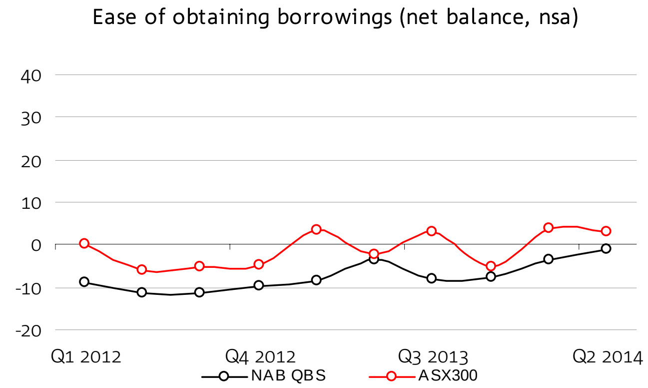


Business investment for larger firms deteriorated, as capital expenditure (capex) dipped further to -1 points (from +1 point previously). For the broader economy, business investment increased slightly, adding 1 point to a final reading of +5 points for the June quarter (see page 8).

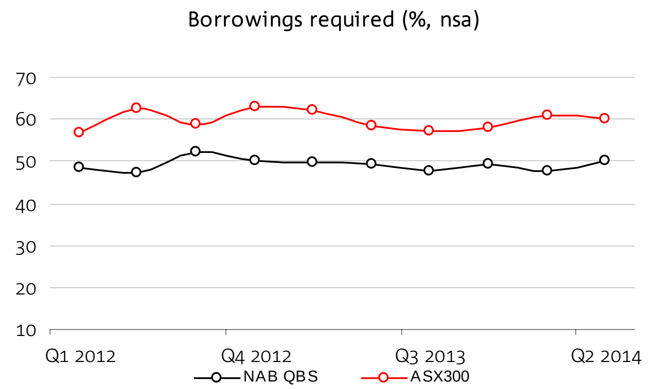


For the short term, capex for ASX 300 firms is expected to ease a touch, however planned business investment for the next twelve months is rising moderately.

Credit conditions ticked down a touch



Credit conditions ticked downwards in the June quarter, but are fundamentally not much changed, at +3 points (from +4 previously). Although this indicates that credit became less readily available quarter on quarter, the index is stronger than this time last year and somewhat above credit conditions in the broader economy.



Overall, credit demand is marginally higher for ASX 300 firms, despite weakening slightly in the June quarter to 60% of respondents reporting the need for credit (compared to 61% previously).

In contrast to the broader economy, the QBS index for credit demand increased from 47% to 50% firms. The majority of industries reported an increase in credit demand – mining and retail were the exceptions, decreasing to 58% and 51% for the latter (down from 62% and 57% previously).

Industry analysis

Conditions for ASX 300 firms diverged across industries.

On a level basis (albeit improving slightly quarter on quarter) construction (CON) reported the worst conditions with a reading of -33 index points (from a previous reading of -56 index points). Conditions in wholesale (WHL) worsened markedly falling to -14 index points (from +21).

In contrast, recreational and personal services (REC), retail (RET) and finance/ banking/ property (FBP) recorded the strongest business conditions, at +42, +30 and +18 respectively. Among the stronger sectors, the level of business conditions was broadly unchanged.

Generally larger firms reported better business conditions in each industry relative to their counterparts in the broader economy (as reported in the QBS). The contrast in ASX 300 firms was most marked in retail and recreational and personal services. Against that ASX firms in construction reported significantly poorer outcomes.

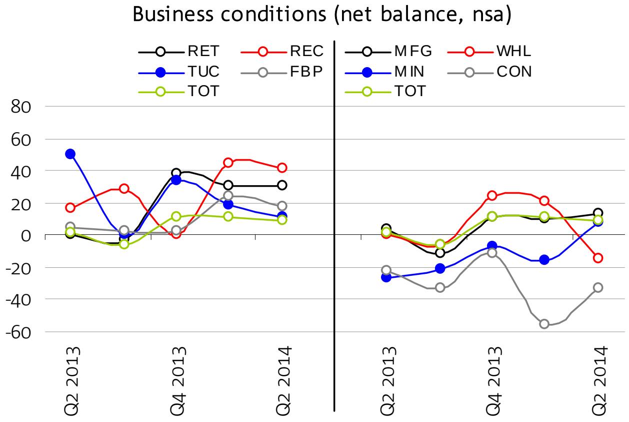
For the next quarter, conditions for larger firms (with the notable exception of wholesaling) appear to be stabilising or improving (construction and mining).

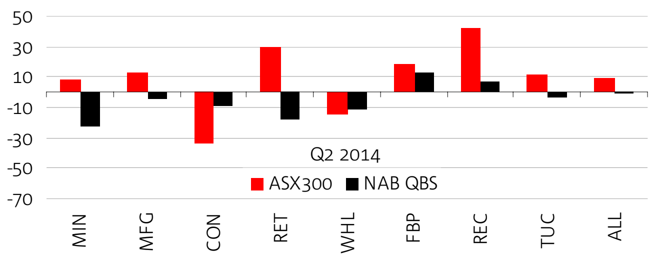
The decline in **business confidence** for ASX 300 was driven by the deterioration in manufacturing (MFG), retail (RET) and mining (MIN). The elevated AUD may have adversely affected confidence in manufacturing (MFG), while soft commodity prices likely weighed on e mining (MIN) confidence.

The most positive (and improving) confidence reading was in recreational and personal services (REC), while construction confidence (now around zero) continued to improve from previously poor readings.

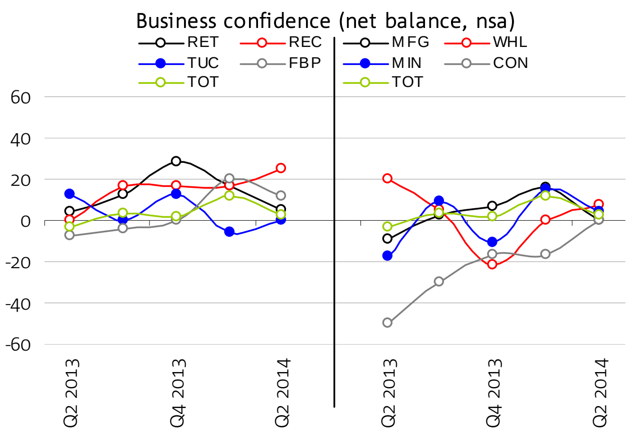
Relative to the broader economy (as per the QBS) confidence in ASX 300 firms is much stronger in the recreational and personal services sector, and also more positive in finance, wholesale and retailing. But confidence is relatively weaker in ASX 300 construction firms than construction firms more generally.

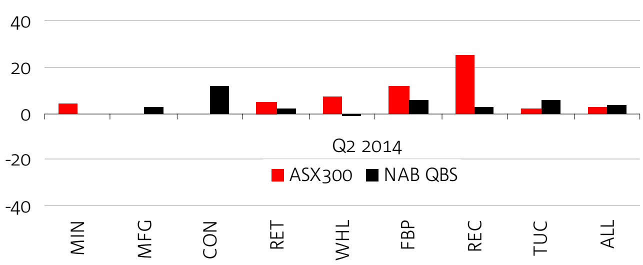
Business conditions (net balance, nsa)





Business confidence (net balance, nsa)





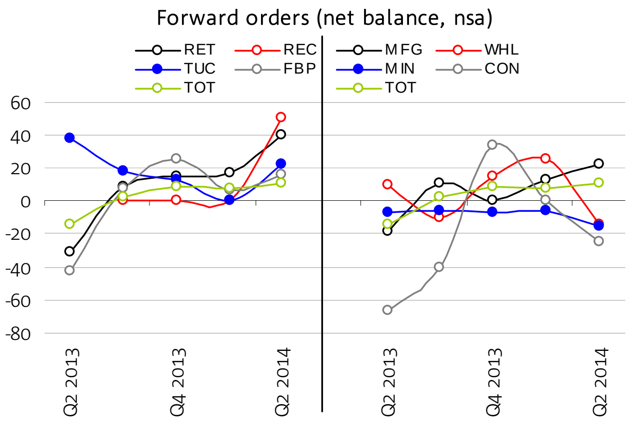
Forward orders ticked upwards for both ASX 300 firms and the broader economy. The increase in ASX orders was however more marked. ASX 300 reported a forward orders reading of +10 points (up from +7) and QBS reported +2 points (from +1 point).

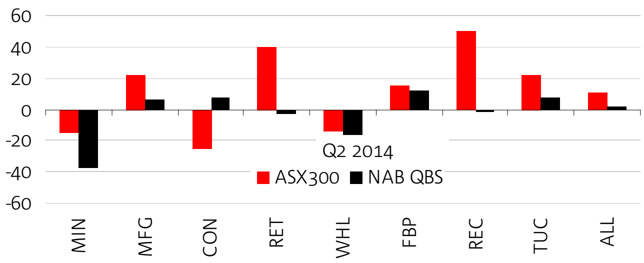
That more marked increase was driven by a particularly strong increase in recreational and personal services (REC), and stronger improvements in retail and manufacturing. On the other hand ASX 300 orders were sharply lower in wholesaling.

Relative to the broader economy, orders in ASX 300 firms are much stronger in recreational and personal services, retail, transport and to a lesser extent manufacturing. Against that, mining orders are relatively stronger (albeit still negative) in ASX 300 miners.

For the next quarter, forward orders are expected to ease across the board, as firms expect the dollar to remain elevated and sales margins continue to narrow.

Forward orders increased marginally for both surveys





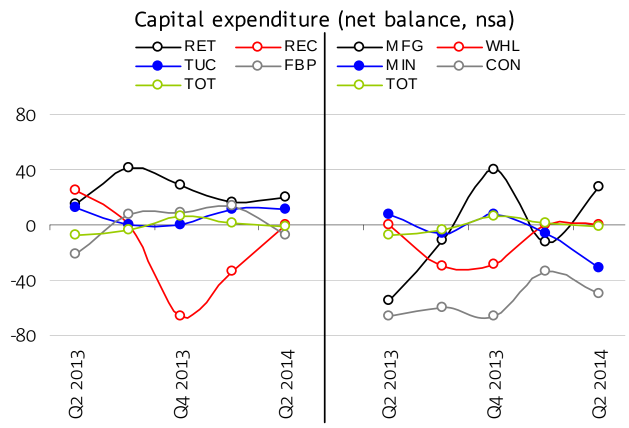
Business investment for ASX 300 remained sluggish in the second quarter of 2014, as **capital expenditure** (capex) slipped back into negative territory to -1 points (from +1 previously).

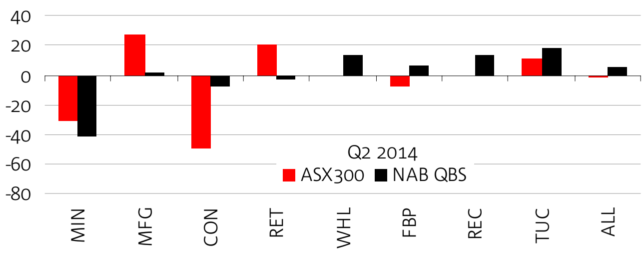
For ASX 300 firms, finance/ banking/ property (FBP), mining (MIN) and construction (CON) slumped to -8, -33 and -50 index points respectively (down from 13, -6 and -33 in the March quarter). Planned investment in the short term is to remain subdued.

On a brighter note, capex for ASX manufacturing (MFG) bounced back, adding 40 index points quarter on quarter to a final reading of +28 index points. Retail (RET) also improved to +20 points (from +17 in the March quarter).

Capital expenditure for the broader economy was broadly unchanged (+5 up from +4 previously). The main area of weakness in the broader economy (relative to ASX 300 firms) is mining – where the broader economy reading has deteriorated for seven consecutive quarters and is now at its survey low of -42.

Capital expenditure dipped back into negative territory for larger firms





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