NAB Monthly Business Survey

by NAB Group Economics

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March 2016

National Australia Bank

Key Points:

- This NAB Business Survey revealed **a significant improvement in both business conditions and confidence**, suggesting the domestic business environment not only remains favourable but appears to be strengthening further. In March, business conditions jumped to +12 points, its equal highest value since early 2008, **reflecting above-average conditions in most industries**. Service industries remain the best performers, although construction also closed the gap in March, manufacturing is looking more upbeat, and transport appears to be responding positively to lower fuel prices – in contrast, mining conditions remain extremely weak and retail was disappointing. **All three components of conditions (trading, profits and employment) improved during the month**, with the employment index particularly encouraging (the highest read since mid-2011), and indicative of on going labour market strength.
- **Capacity utilisation increased notably this month (and is now comfortably above long run averages), pointing to further improvement in the underlying health of the economy**. This was in conjunction with a jump in business confidence (back to long-run average levels), helping provide some reassurance that the strength in business conditions can be sustained. However, less encouragingly, **forward orders dipped back into marginal negative territory** – mainly due to lower mining, construction and retail orders. The capital expenditure index also softened (although remained positive) – mainly mining related. Across industries, positive business confidence is broad based, with only the mining sector reporting negative confidence.
- The very strong outcome in this month's NAB Business Survey provides strong evidence that the non-mining recovery has not been derailed by the financial market volatility and escalation in global economic concerns earlier in the year. While the service sector is still a major driver of the recovery, this survey suggests that the improvements may be becoming more broad-based across the economy – particularly in construction and manufacturing. This is an especially good result in the context of a downbeat global economic outlook. Low interest rates and a more competitive currency (even given recent strength) are expected to remain key drivers domestically. Consequently, our outlook for the economy remains unchanged – and with the non-mining recovery expected to progress further, monetary policy is likely to remain on hold for an extended period. However, recent statements from the RBA reinforced the point that if the non mining sector were to show any signs of weakening, lower inflation and AUD strength has increased the RBA's willingness to cut rates.

Table 1: Key monthly business statistics*

	Jan 2016	Feb 2016	**Mar 2016**		Jan 2016	Feb 2016	**Mar 2016**
		Net balance				*Net balance*	
Business confidence	3	3	**6**	Employment	-1	1	**5**
Business conditions	6	8	**12**	Forward orders	1	3	**-1**
Trading	10	12	**18**	Stocks	-1	11	**2**
Profitability	6	11	**14**	Exports	0	2	**0**
		% change at quarterly rate				*% change at quarterly rate*	
Labour costs	0.6	0.7	**0.7**	Retail prices	0.4	0.3	**0.4**
Purchase costs	0.6	0.5	**0.5**			*Per cent*	
Final products prices	0.2	0.2	**0.1**	Capacity utilisation rate	81.0	81.5	**82.1**

* 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 23 to 31 Mar, covering over 400 firms across the non-farm business sector.

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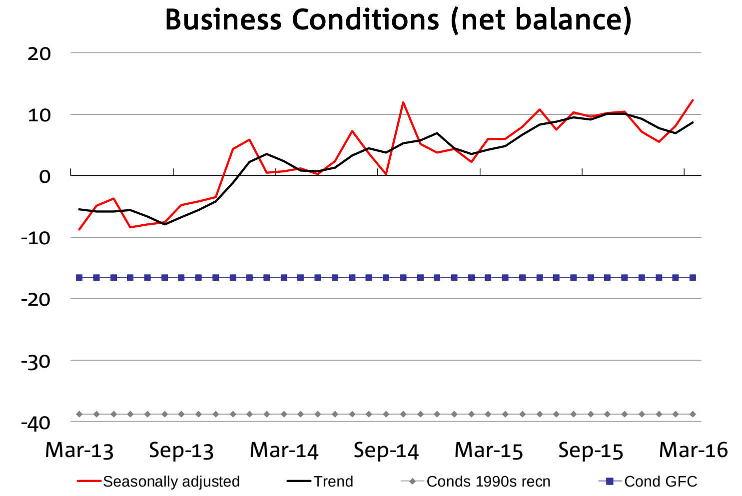
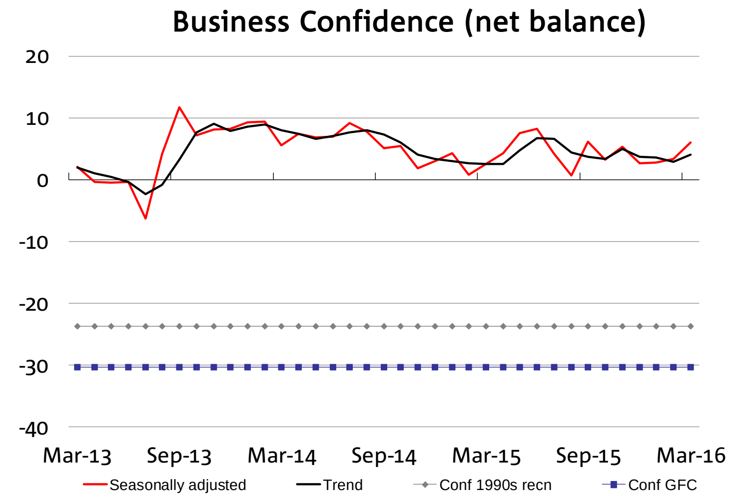
Analysis

- **Business conditions increased strongly again in March**, with gains in the past two months more than offsetting the previous declines. The rise has lifted the index to +12 index points (previously +8), which is its **equal highest level since 2008**, and is well above the series long-run average of +5. With this result, the long-running upward trend in business conditions has resumed, suggesting the non-mining recovery is becoming more entrenched, brushing aside the challenges faced from offshore. The **improvement in conditions was also experienced across all components** (sales, profits and employment). The rise in **employment conditions** put the index back on its strong upward trend, to be more consistent with solid employment growth outcomes in the official labour statistics.
- In addition to the overall strength in business conditions, **improvements are also looking relatively more broad based across the industries.** Conditions in both transport (up 18) and manufacturing (up 16) bounced back strongly from negative levels last month. Construction (up 5) and wholesale (up 4) also improved. Following this, construction conditions are again on par with the service industries, which had been consistently outperforming. In contrast, both the mining and retail industries recorded a deterioration in conditions, with the latter being the most concerning given the importance of consumption to the non-mining recovery. Overall, conditions are now above-average in all industries other than mining and retail, although in trend terms the service industries are still the best performers.
- **Business confidence reciprocated the jump in conditions**, doubling to +6 in March, while some pull-back in the concerns evident in global financial markets early in the year likely provided support as well. This is an encouraging result given that positive confidence levels will be crucial to the outlook for non-mining investment. Additionally, while there does remain some noticeable variation in confidence across industries, the spread between the best and worst outcomes narrowed in the month.
- **Confidence is neutral-to-positive for all industries outside of mining,** with most recording an improvement in the month. The largest gains occurred in wholesale (up 10), followed by recreation & personal services (up 6). In contrast, transport & utilities posted a notable decline (down 12), unwinding large gains last month that coincided with falls in the petrol price. In trend terms, however, transport/utility firms remain the most confident, followed by construction. In contrast, mining confidence is lowest and is expected to remain weak.
- Business conditions fell notably in Queensland (down 10) and were marginally lower in NSW (down 1). However, big gains in WA (up 13) and SA (up 8) meant **conditions were positive in all states in March.** This suggests a sharp turnaround in the mining states, but trend conditions in WA and SA remain weak (both at -7). Of the mainland states, trend conditions are best in NSW (+13) and Vic (+12). In terms of confidence, NSW and Vic are high, but firms in Qld are most confident, while confidence remained negative in WA (despite improving).

Conditions jump to multi-year high



Confidence lift despite global headwinds

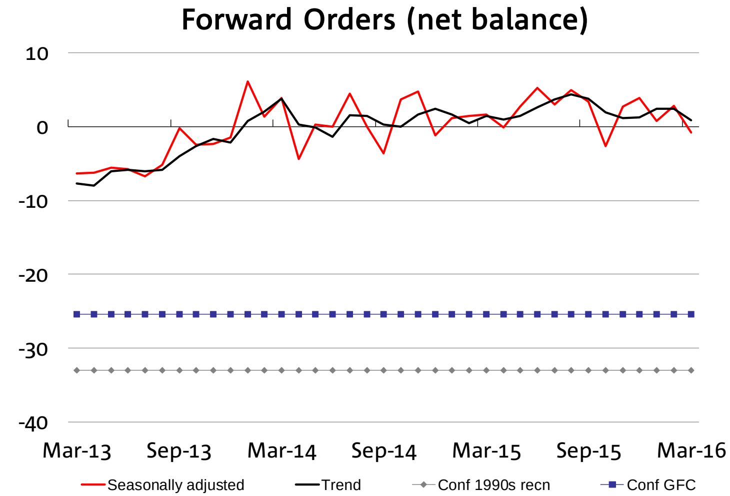


Excluding normal seasonal changes, how do you expect the business conditions facing your industry in the next month to change?

Other activity indicators

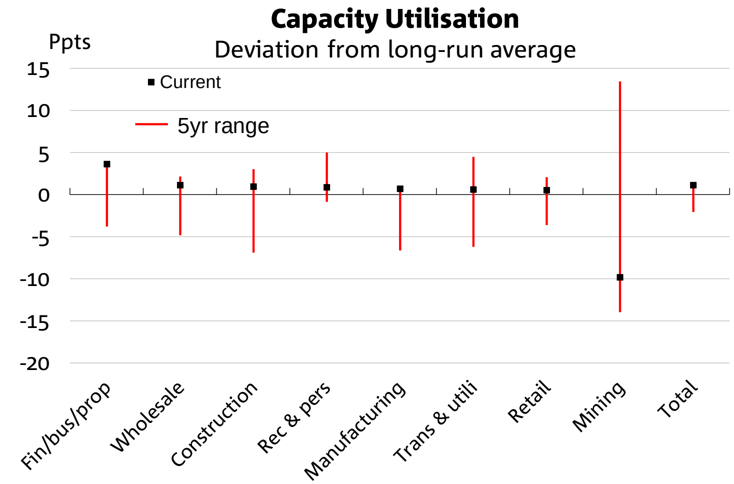
- Leading indicators were mixed in March. The **forward orders** index lost ground, dipping back into negative territory for the first time in 5 months. At -1 index point (down from +3), the index is just below the long-run average, which in contrast to business conditions **suggests some caution on near-term prospects** – that said significant contributions to the decline came from a limited number of sectors – notably mining, construction and retail.
- **The fall in orders was especially sharp in construction (down 24)**, following a similar sized jump last month. This may be a reflection of the pull back in new projects approved, but the pipeline of residential construction remains large. At the same time, engineering activity is expected to remain weak, while other non-residential approvals have stayed tepid despite a lift in business credit. Orders also fell a lot in mining (down 20), followed by retail (down 11). In contrast, manufacturing saw the biggest rise in orders (up 9), while wholesale was the only other industry to improve (up 3). In trend terms, orders are once again weakest in mining at -17 index points, followed by wholesale (-12). Elsewhere, trend orders are now strongest in manufacturing (+12), which could suggest that a more competitive AUD is finally starting to have a positive impact on the industry, while construction is next highest.
- NAB's measure of **capacity utilisation picked up further in the month** (to 82.1% from 81.5% and a long-run average of 81%), supported by the strength in trading activity (and lack of new investment). This a significant increase that sees spare capacity shrink to its lowest levels in the post-GFC period. Outcomes were better for a majority of industries, and importantly, capacity utilisation is now above average (albeit only slightly in many cases) for all industries but mining. The improvement was largest in transport (up 3.5 ppts), followed by finance/ property/ business services (up 1.9 ppts). In contrast, construction (down 2 ppts) and mining (down 1.1 ppts) had the biggest pull backs.
- Despite an increase in trading conditions and capacity utilisation, the capital expenditure index deteriorated noticeably in the month, down 6 points, although it remains positive at +4 index points (slightly below the series average of +5). Although this points to more modest growth in non-mining investment (as non-mining sectors have a larger weighting in the survey), it is a better result than ABS Capex Survey expectations would suggest (pointing to a contraction in investment spending). In trend terms, capex in recreation/personal services is the highest (+14 points) and mining is unsurprisingly the lowest (-26 points) – the only industry with a negative index (trend).
- Elsewhere in the survey, **cash flow** (not seasonally adjusted) was the strongest in recreation & personal services, and the weakest in retail – suggesting retailers are facing problems with AUD pass-through.

Sales orders surprisingly soft



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

Capacity utilisation by industry



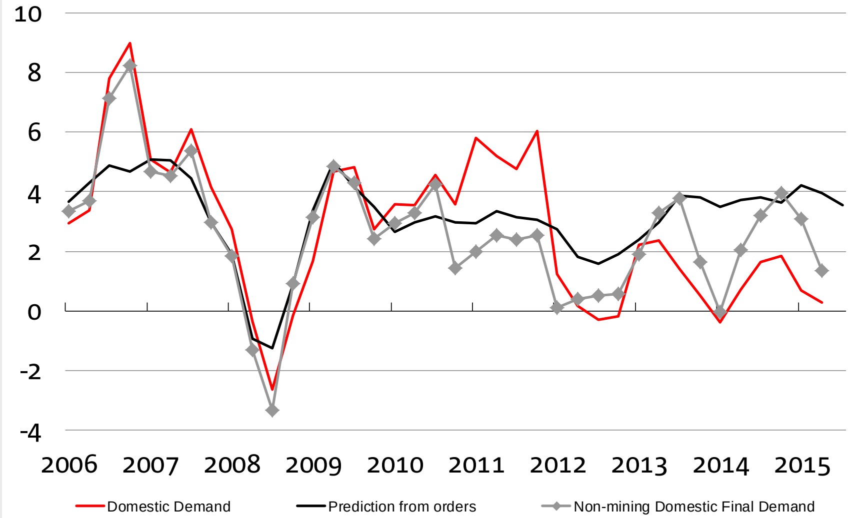
Source: NAB Economics

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

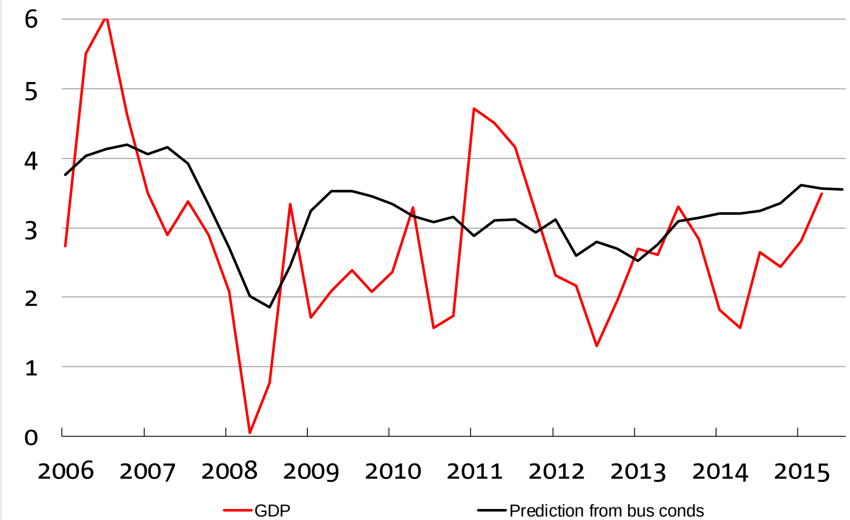
Implications for forecasts For more information see latest Global & Australian Forecasts

- Global share markets have regained much of their early 2016 losses, financial market volatility has subsided and both commodity prices and the Chinese currency have stabilised – helping to reduce the risk of a renewed downturn in global economic activity. However the backdrop to these market movements remains one of very sluggish sub-trend growth, inflation that is below target in major economies, difficulty in increasing revenue as margins are sacrificed to win modest volume gains, slow wage growth cramping spending increases, high levels of debt and central banks that have used up much of their policy ammunition. Despite the many risks, we still think global growth will muddle through 2016 at around the 3% rate seen last year but it could be a bumpy ride with plenty of further scope for volatility, reflecting the numerous triggers for further bouts of market jitters.
- On Australia, in light of recent indicators (including the Business Survey) our real GDP forecasts are broadly unchanged at 2.7% in 2016 and 3.0% in 2017, before easing to 2.5% in 2018 as the large contribution from net exports dissipates. The unemployment rate is forecast to fall to 5.6% by end-16, ease a touch further to 5.5% by end-17 before ticking up in 2018. While recent AUD appreciation presents a downside risk to economic activity, we doubt whether this move higher will be sustained and expect the downward trend to resume as the year progresses. Meanwhile, we retain our view that the RBA will remain on hold through 2016, although this will depend on the path of the currency, inflation and whether the labour market continues to improve as anticipated. Lower than target inflation in conjunction with an AUD above 80 US cents and any evidence of a faltering non mining recovery would quickly see further rate cut(s).
- **Our model of 6-monthly annualised demand growth, using forward orders as a predictor, has been suggesting stronger growth than the National Accounts.** This divergence is partly explained by the greater representation of non-mining sectors in the business survey – headline growth in the National Accounts had masked recent improvements in non-mining domestic demand, although some of the momentum has begun to wane. Applying trend forward orders for March to our model suggests solid (but moderating) domestic demand growth for Q1 2016.
- Similarly, business conditions have over-predicted GDP growth, although the gap has begun to close more recently. **Based on strong business conditions in Q1, our model implies steady (solid) GDP growth for Q1 2016.**

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



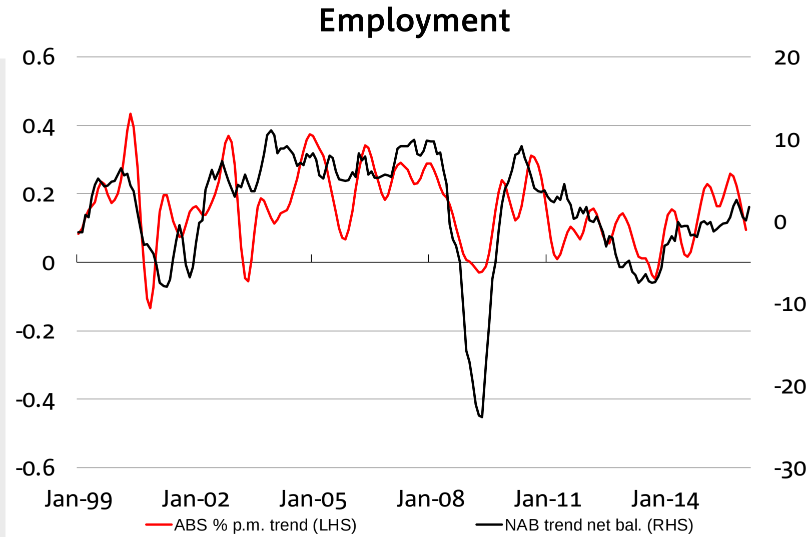
Business conditions (change & level) as an indicator of GDP (6-monthly annualised)



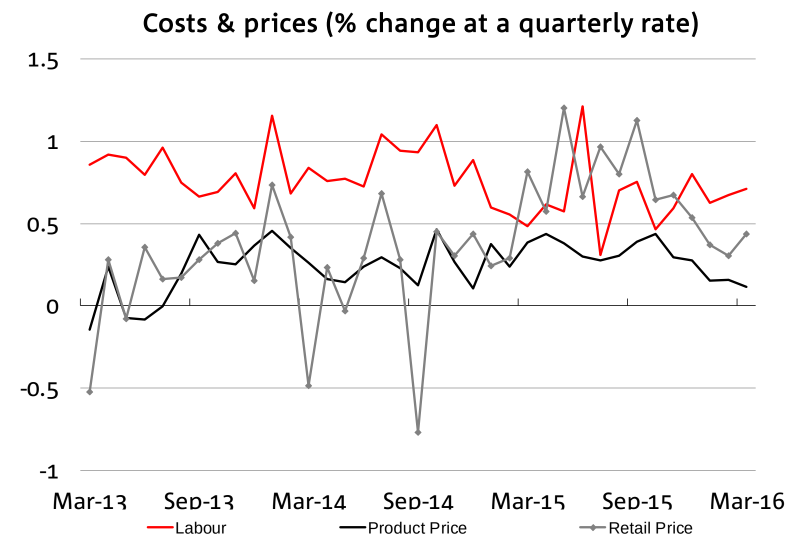
Costs, prices & labour

- The **NAB Survey's employment index recovered further in March** (to +5, from +1), putting the index back on its previous long-running positive trend, and bringing it more into line with previous solid employment growth outcomes seen in the official ABS statistics. This outcome points to annual job creation of around 220k (almost 19k per month) in coming months, which compares to a trend increase of 11.3k in February according to the ABS. The rise in employment conditions was particularly pronounced in manufacturing (up 18), and even more surprising, mining (up 13) – although the latter index remains negative. The rise in manufacturing employment demand is consistent with better trading conditions and higher capacity utilisation. In contrast, construction and retail were the only industries to record a deterioration (both down 9). In trend terms, the employment index is still very negative for mining (-17 points), followed by wholesale (-6 points). Recreation and personal services are also surprisingly weak (-1) given the industries' previous contribution to employment growth. The strongest employment demand (trend) is in finance/ property/ business services (+9), followed by construction (+2).
- Labour cost growth (a wage bill measure) held steady in the month, but still suggests relatively contained wage pressures – at 0.7% (a quarterly rate). Restrained labour cost growth is consistent with the currently improving – albeit elevated – rate of unemployment, subdued inflation expectations, an apparent shift in labour toward lower average income sectors, and a reduction in previously high incomes seen in industries such as mining. Labour cost pressures were highest in manufacturing (1.5%), but still falling in mining (-1.8%).
- Growth in purchase costs were also unchanged at 0.5% in March (at a quarterly rate). This is below the long-run average and is quite weak relative to the history of the series. More subdued growth in purchase costs is a little surprising given the pressure from currency depreciation – although subdued inflation pressures have been a common theme globally. Growth in purchase costs decelerated the most in wholesale (down 0.4 ppts), but rose the most in construction (up 0.8 ppts). Purchase cost pressures are now highest in construction (0.9%, quarterly rate), consistent with reports of higher cost pressures associated with the residential construction boom.
- Final product prices growth eased marginally in March to a quarterly rate of just 0.1%. Final prices growth was, however, mixed across industries, with the greatest slow-down occurring in manufacturing (down 0.8 ppts), while construction experienced the largest pick-up (0.3 ppts higher). Mining prices are still falling (down 1%, quarterly rate), while manufacturing and transport prices are also down. Prices are flat to rising elsewhere, with price growth highest in wholesale (0.5%). Growth in retail prices (0.4%, quarterly rate) was consistent with a CPI below the RBA's target inflation band.

Employment up, resuming positive trend



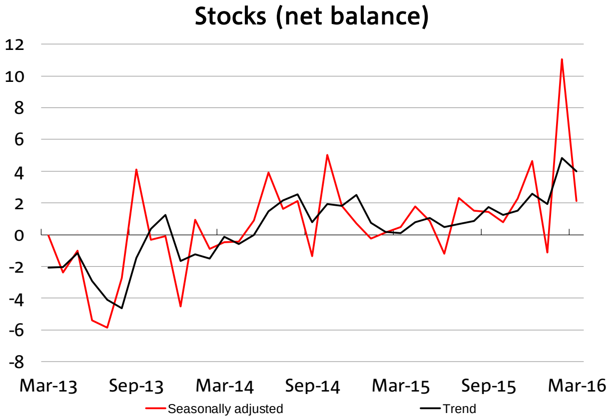
Price pressures remain subdued



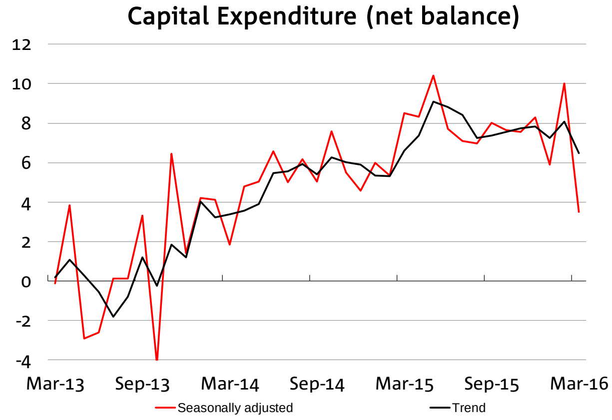
Based on respondent estimates of changes in labour costs and product prices. Retail prices are based on retail sector product price estimates.

More details on business activity

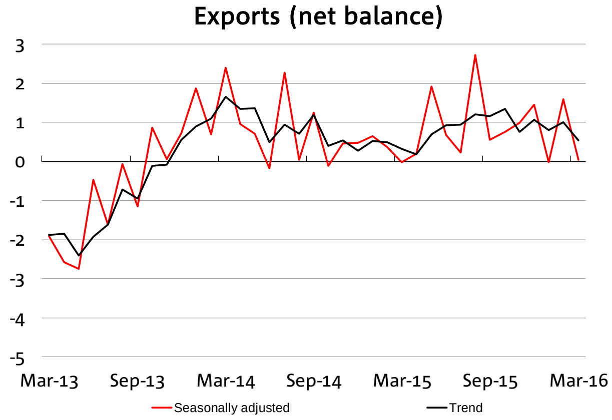
Firms re-stocking, but at a slower pace



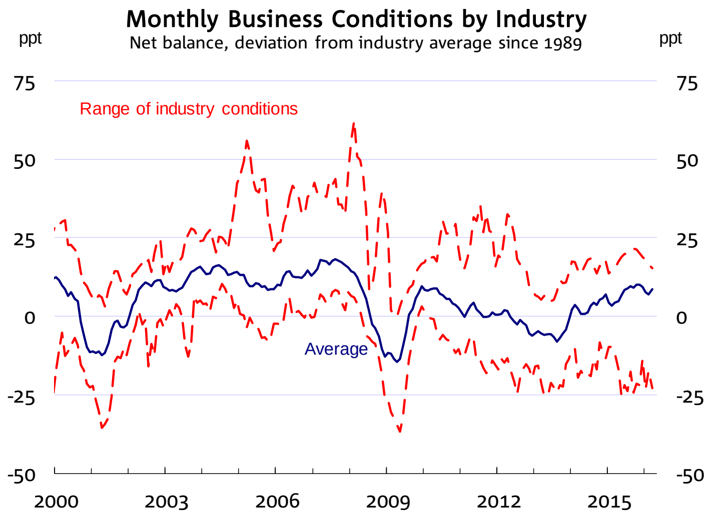
Capex positive, but slowing



Exports looking subdued

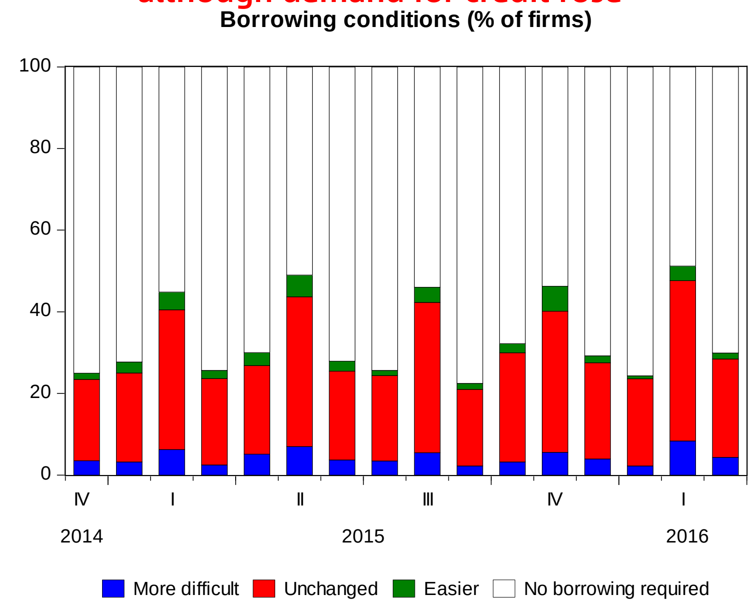


Range of conditions widens as mining sinks again



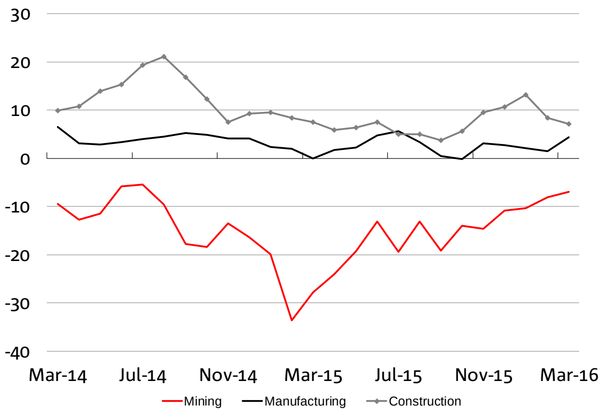
Source: NAB

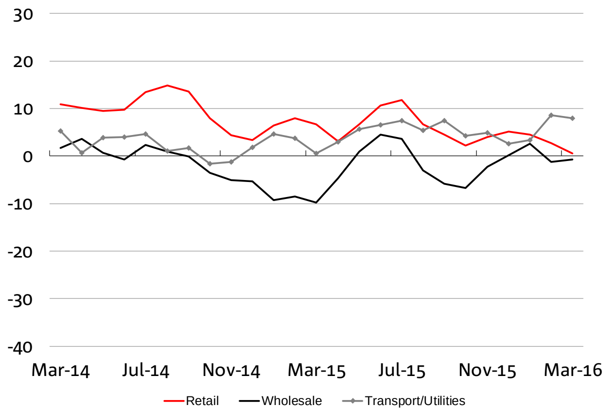
Borrowing conditions deteriorate in past 3 months, although demand for credit rose

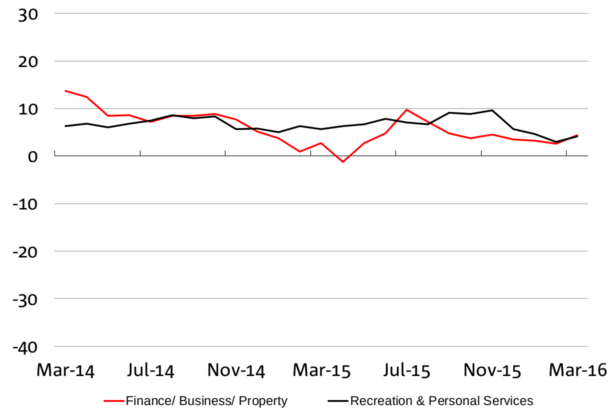


More details on industries

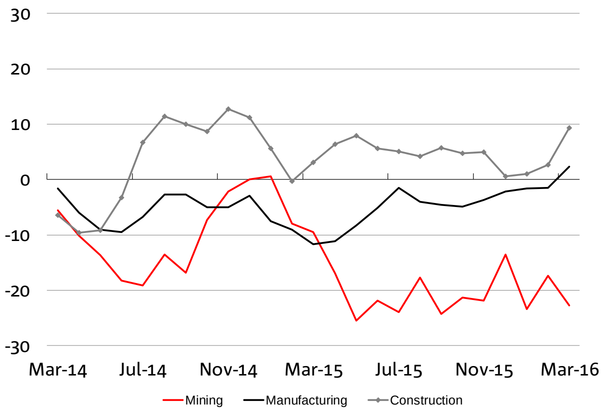
Business confidence by industry (net balance): 3-month moving average

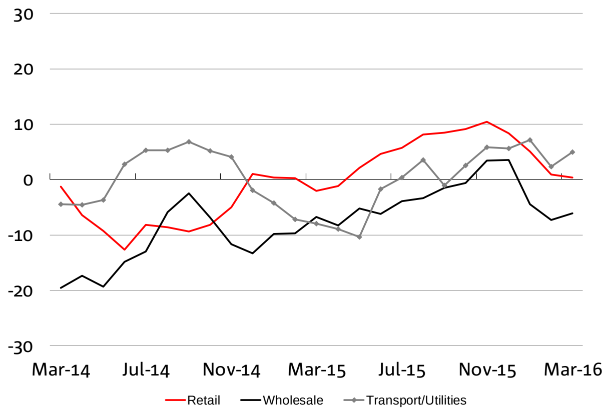


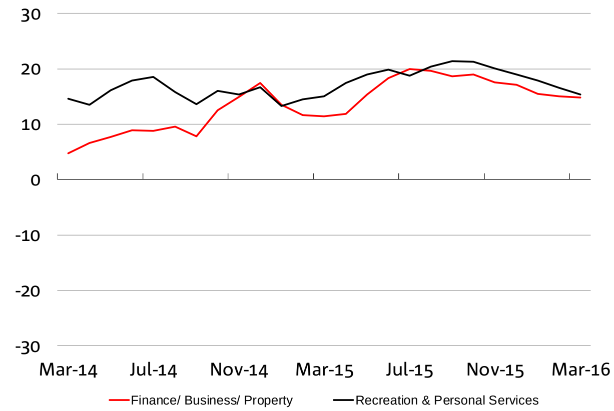




Business conditions by industry (net balance): 3-month moving average

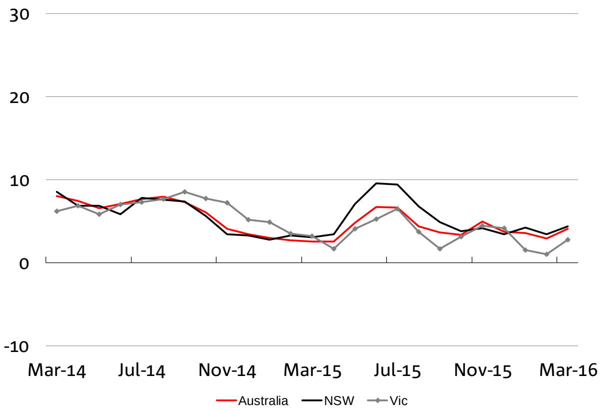


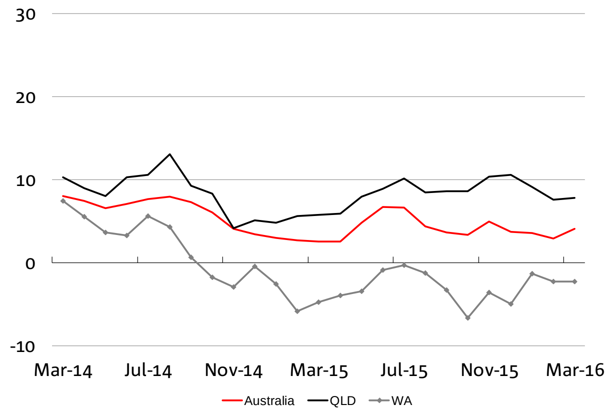


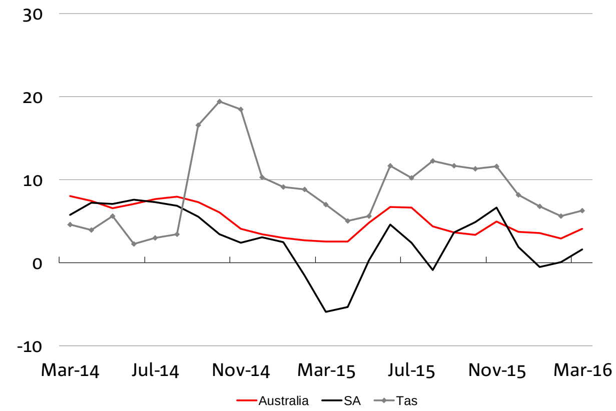


More details on states

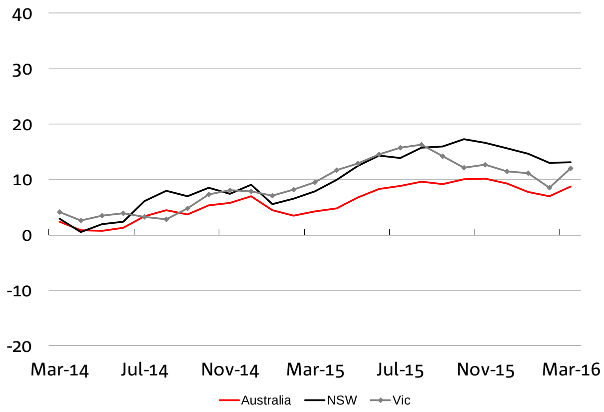
Business confidence by state (net balance): 3-month moving average

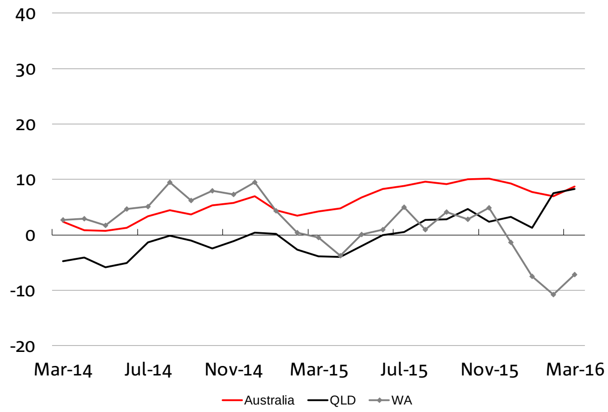


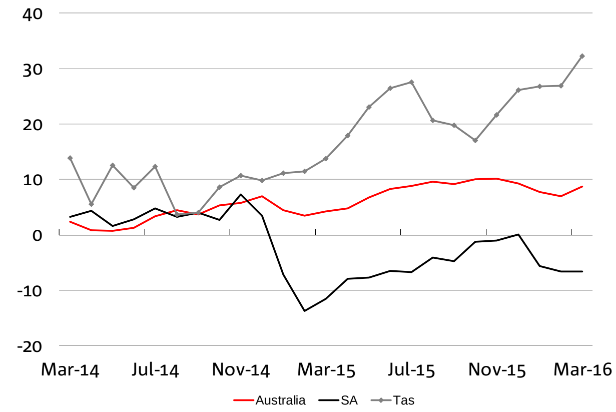




Business conditions by state (net balance): 3-month moving average







Data appendix

Prices & costs by industry (% change at a quarterly rate)

Mar-2016	Mining	Manuf	Constn	Retail	Wsale	Tran. & utils	Rec. & pers.	Fin. prop. & bus.	Australia
Labour costs: current	-1.8	1.5	0.5	0.5	0.8	0.3	0.9	0.7	0.7
Labour costs: previous	-0.6	0.7	0.4	0.3	0.2	0.3	1.0	1.1	0.7
Labour costs: change	-1.2	0.8	0.1	0.2	0.6	0.0	-0.1	-0.4	0.0
Prices (final): current	-1.0	-0.5	0.0	0.4	0.5	-0.3	0.3	0.4	0.1
Prices (final): previous	-0.5	0.3	-0.3	0.3	0.5	0.0	0.1	0.2	0.2
Prices (final): change	-0.5	-0.8	0.3	0.1	0.0	-0.3	0.2	0.2	-0.1
Purchase costs: current	0.1	0.3	0.9	0.5	0.7	0.2	0.5	0.1	0.5
Purchase costs: previous	-0.3	0.6	0.1	0.6	1.1	0.3	0.6	0.3	0.5
Purchase costs: change	0.4	-0.3	0.8	-0.1	-0.4	-0.1	-0.1	-0.2	0.0

Key state business statistics for the month

Monthly Business Survey Data: By State

Mar-2016	NSW	VIC	Qld	SA	WA	Tasmania	Australia
Bus. conf.: current	6	5	10	8	-3	9	6
Bus. conf.: previous	4	3	7	4	-5	12	3
Bus. conf.: change	2	2	3	4	2	-3	3
Bus. conf: current - Trend	4	3	8	2	-2	6	4
Bus. conf: previous Trend	3	1	8	0	-2	6	3
Bus. conf.: change -Trend	1	2	0	2	0	0	1
Bus. conds: current	13	19	6	3	7	45	12
Bus. conds: previous	14	8	16	-5	-6	26	8
Bus. conds: change	-1	11	-10	8	13	19	4
Bus. conds: current -Trend	13	12	8	-7	-7	32	9
Bus. conds: previous -Trend	13	9	8	-7	-11	27	7
Bus. conds: change -Trend	0	3	0	0	4	5	2

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