NAB Monthly Business Survey

by NAB Group Economics

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May 2016

National Australia Bank

Key Points:

- **This month's NAB Business Survey remains true to the narrative of an ongoing recovery in the non-mining sectors of the economy, building on the already solid growth seen in the recent National Accounts.** Business conditions remained at an elevated level in May (at +10 index points), which is an above average result and close to post-GFC highs. Services are continuing to lead the way, which now includes distributional services such as retail, while manufacturing has pulled back and mining (and related sectors) still look weak. The elevated level of business conditions (unchanged from last month) was due to a notable improvement in trading (sales) and profitability, which offset a disappointing moderation in employment demand, which is back to subdued levels – consistent with more moderate employment growth in recent months.
- **Despite steady business conditions and an interest rate cut by the RBA (unanticipated by many), confidence dropped back further below the series average in May.** Uncertainty over the upcoming election may have contributed to the result, but since the deterioration was confined to a subset of industries (mainly manufacturing and transport), other factors appear to be at play. **Other forward indicators from the Survey are reasonably good, with forward orders remaining in positive territory and spare capacity declining**. The capital expenditure index improved, as did stocks, while there were moderate signs of a pick-up in inflation – a welcome development given global concerns about deflationary pressures.
- The National Accounts for Q1 confirmed the strong signal on non-mining activity evident in the NAB Business Survey. Similarly, the Survey points to further improvement going into Q2, with signs that growth is becoming more broad-based – although evidence of this is mixed. Despite the improvement, headwinds from the mining sector remain significant, keeping domestic demand subdued, while inflation has been uncomfortably low (below the RBA's target band). These trends justify the highly accommodative setting for monetary policy, particularly as uncertainty over US Fed rate hikes threaten to renew upward pressure on the AUD – given the lower AUD has been instrumental to the non-mining recovery. Encouragingly, survey indicators of inflation picked-up a little this month, which will be a welcome sign for the RBA. Financial markets have priced in another 25bp cut by November, but barring a very weak CPI result in late July, positive activity trends are likely to keep the RBA on hold for an extended period.

Table 1: Key monthly business statistics*

	Mar 2016	Apr 2016	**May 2016**		Mar 2016	Apr 2016	**May 2016**
	Net balance				*Net balance*		
Business confidence	6	5	**3**	Employment	4	4	**1**
Business conditions	12	10	**10**	Forward orders	-1	2	**2**
Trading	17	15	**20**	Stocks	2	3	**4**
Profitability	14	9	**12**	Exports	0	0	**1**
	% change at quarterly rate				*% change at quarterly rate*		
Labour costs	0.8	0.6	**0.6**	Retail prices	0.5	0.3	**0.5**
Purchase costs	0.5	0.3	**0.7**		*Per cent*		
Final products prices	0.1	0.1	**0.3**	Capacity utilisation rate	82.0	81.4	**82.0**

* 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 27 May, covering around 530 firms across the non-farm business sector.

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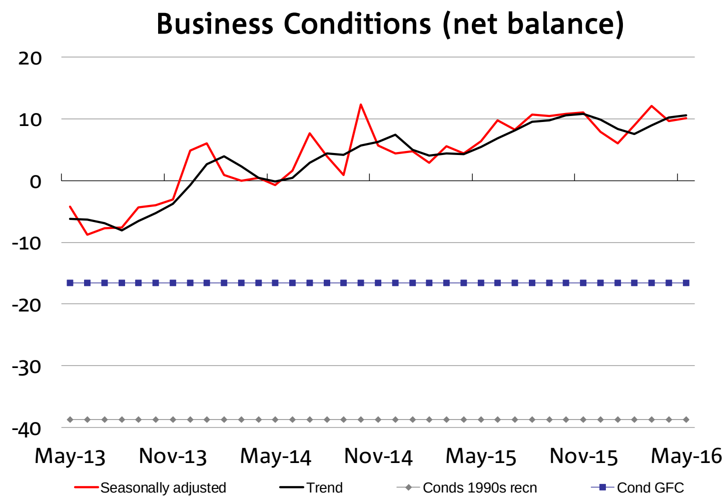
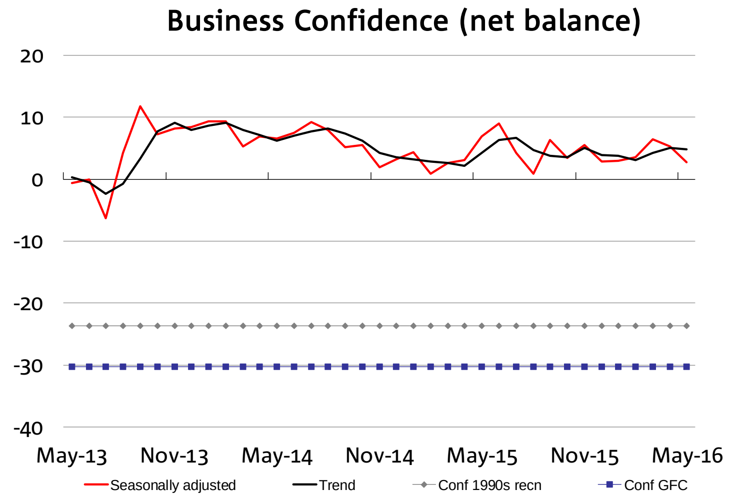
Analysis

- **Business conditions held steady at very good levels in May, suggesting the positive non-mining momentum has continued into Q2.** The index was unchanged at +10 index points in May, which was still well above the series long-run average of +5, while trend conditions have remained above average levels for more than a year. Additionally, even though conditions were unchanged in the month, most industries recorded an improvement. In terms of the components, trading conditions (sales) and profitability both improved notably in the month, but was offset by a disappointing deterioration in employment demand – which is back at fairly subdued levels, consistent with slower employment growth of late.
- Evidence of a broader-based non-mining recovery has been mixed in the Survey, but **most industries did record an improvement in business conditions in May**. The biggest gains occurred in mining (up 14) and transport (up 5), but construction, retail, wholesale and personal services all saw an increase as well. This was offset be a decline in conditions for manufacturing (down 5) and finance/ property/ business services (FPB) (down 4). In level terms, service industries continue to lead the way, which now included distributional services such as retail, while mining and construction remained in negative territory – and were the only two industries with below average business conditions (see p7 for trend charts).
- **Despite solid business conditions and anticipated support from the RBA rate cut in May, business confidence appears to have weakened in the month,** pushing the index further below average levels. The confidence index eased 2 points to +3 index points in May, which is its lowest level since August 2015. Uncertainty over the upcoming election may have contributed to the fall, but a non-uniform result across industries suggests other factors are at play. Nevertheless, it is encouraging that confidence has remained above zero continuously since mid-2003.
- **Confidence was positive (or neutral) for most industries outside of mining and transport,** although changes in confidence over May varied notably. The largest gains occurred in construction and wholesale (both up 6), followed by mining (up 2). In contrast, manufacturing (down 11) and transport (down 7) posted notable declines – a possible reflection of growing costs as oil and petrol prices continue to gain momentum. In trend terms, construction (+12), manufacturing (+6) and personal services (+6) firms were the most confident. In contrast, mining confidence was still the lowest (-5) and is expected to remain weak (see p7).
- There was a great deal of volatility across states this month. In trend terms, however, conditions improved markedly in Vic (up 5) and SA (up 4). This was partially offset by declines in Qld (down 2) and WA (down 1), but conditions remained positive in all states excluding WA – NSW being the best performing mainland state. On confidence, SA jumped in the month – coinciding with the Government's submarine announcement – but there was only a modest gain in trend terms, while the trends in other states were flat to lower – NSW was most confident, followed closely by the other states, excluding WA (see p8).

Conditions steady at solid level



Confidence dips further below average

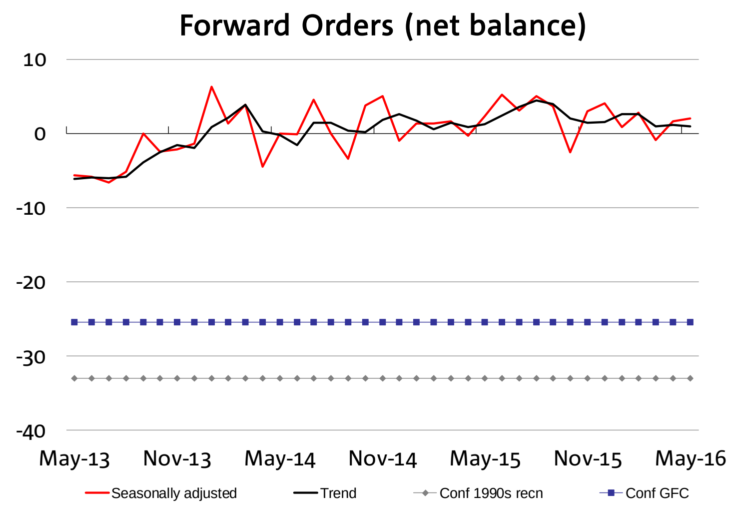


Excluding normal seasonal changes, how do you expect the business conditions facing your industry in the next month to change?

Other activity indicators

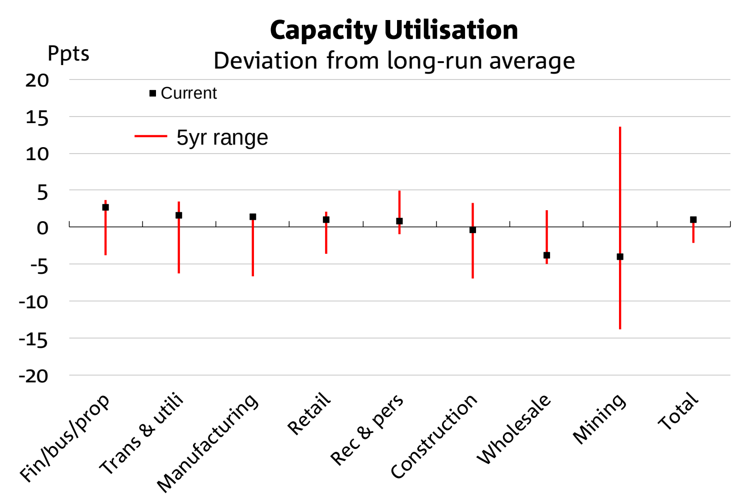
- The Survey's indicators of the near-term outlook were somewhat mixed, but generally encouraging. The **forward orders** index held steady in positive territory, having softened earlier in the year. At +2 index points, the index was above the long-run average, which was more consistent with business conditions and **suggests good near-term prospects for activity.** Although orders were unchanged, most industries improved in the month, offset by a sharp pull back in manufacturing and construction – although the latter seems inconsistent with a renewed pick up in residential building approvals in April (although these tend to be volatile, particularly for apartments).
- **The rise in orders was most pronounced in mining and wholesale (both up 8)**, followed by a more moderate increase in transport & utilities orders (up 6). Orders also rose in retail (up 3), followed by personal services (up 2) and FPB (up 1). In contrast, only manufacturing (down 10) and construction (down 7) had a fall in orders. Construction orders had been expected to weaken given the large number of residential projects already in the pipeline, although building approvals have been volatile. In trend terms, orders were still weakest in mining at -11 index points, followed by wholesale (-4). Elsewhere, trend orders remained strongest in manufacturing (+11), which could suggest that a more competitive AUD was having a positive impact on demand, albeit with a less positive impact on profitability, while construction was the next highest.
- NAB's measure of **capacity utilisation recovered from last month's decline, to resume the clear upward trend evident since mid-2013.** Utilisation rates rose to 82% (from 81.4%), which is above the long-run average of 81%. The increase was consistent with the ramping up of trading conditions, and relatively subdued rates of capital investment. Outcomes were mixed across industries, but transport & utilities increased the most in May, up 4.3 ppts, followed by mining (up 2.1 ppts) – although mining still has the lowest utilisation rates in trend terms. Wholesale saw the biggest fall in capacity utilisation (down 2 ppts), despite better trading conditions. Utilisation rates are near, or above, average levels for most industries, with mining and wholesale the main exceptions.
- The capital expenditure index improved marginally in the month, suggesting firms are starting to respond to falls in spare capacity. At +6 index points, the capex indicator is perhaps more upbeat that recent reads on investment form the ABS Capex survey and the National Accounts – partly a reflection of differing weights in the NAB survey, which puts less emphasis on mining. In trend terms, capex in transport/utilities was the highest (+15 points) and mining was unsurprisingly the lowest (-19 points).
- Elsewhere in the survey, **cash flow** (not seasonally adjusted) was the strongest in transport & utilities, and the weakest in mining – although an improvement from last month suggests that more stability in commodity prices has helped.

Sales orders moderately positive



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

Capacity utilisation by industry



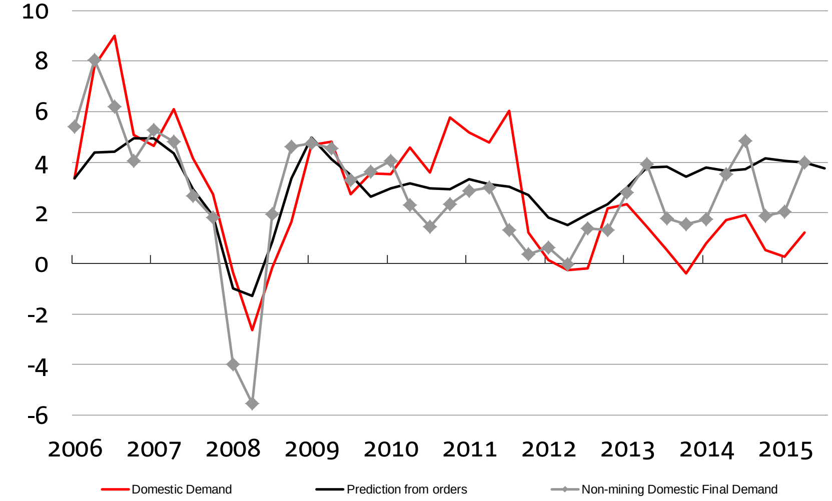
Source: NAB Economics

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

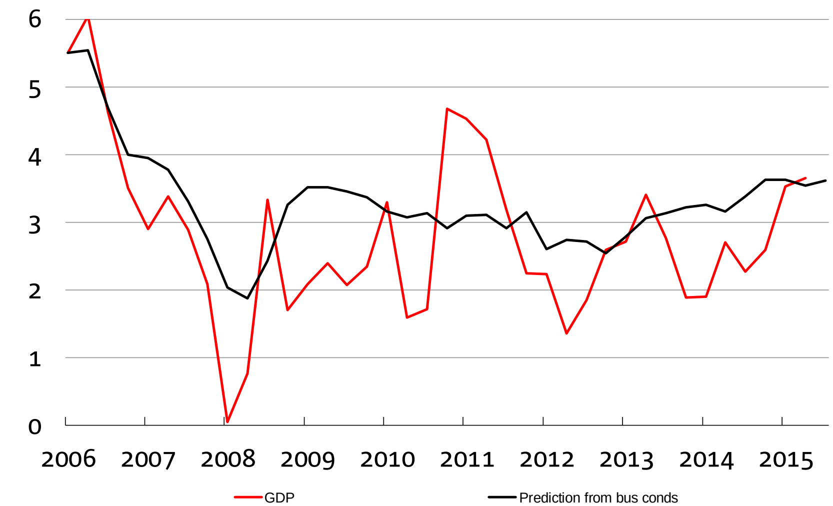
Implications for forecasts For more information see latest Global & Australian Forecasts

- Despite the ups and downs of global financial markets in the first five months of the year, the underlying picture remains one of steady sub-trend growth and sub-target inflation. Neither the business surveys nor the monthly partial data on industrial output and exports show evidence of an imminent acceleration in growth but the rise in commodity markets off their recent lows and the wealth effects of higher share prices could support activity later this year. Despite the many risks, we still think global growth will muddle through 2016 at around the 3% rate seen last year but there are plenty of economic vulnerabilities that could spark further rounds of market volatility.
- In Australia, real GDP growth picked up to 3.1% y/y in Q1 and is expected to remain at around the 3% mark for the remainder of 2016 and 2017 before easing back to 2½% in 2018. While net exports are providing the largest contribution to growth (1.1ppt in Q1 alone) in real terms, our estimates also suggest non-mining activity is outperforming the aggregate economy. The ongoing above-average level of business conditions is also consistent with the rotation towards non-mining industries and states (with non mining GDP now growing at a rate around 3¾%). The unemployment rate is forecast to fall to around 5½% by late 2016 before ticking up to around 5¾% in 2018. Meanwhile, the weaker terms of trade and low wages growth will continue to challenge national income and government revenue. Low inflation will remain a feature (despite some early evidence of stronger price pressures in this month's business survey) but we are not persuaded at this stage that further monetary policy easing will be forthcoming. A cut would first require another very low core CPI reading, a sharply higher AUD (to say above 80c USD) and/or signs of weakness in the non mining economy.
- Our model of 6-monthly annualised domestic demand growth, using forward orders as a predictor, had been suggesting stronger growth than the National Accounts. **However, the Q1 result appears to have bridged that gap, especially when looking at it in non-mining terms.** The National Accounts provided clear evidence of a lift in many non-mining sectors of the economy, consistent with the signal evident in the NAB Survey for some time. Applying May orders to our model suggests solid (but moderating) domestic demand growth for Q2 2016.
- Similarly, business conditions have previously over-predicted GDP growth, but the gap has closed more recently. **Based on strong business conditions of late, our model implies steady (solid) GDP growth for Q2 2016.**

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



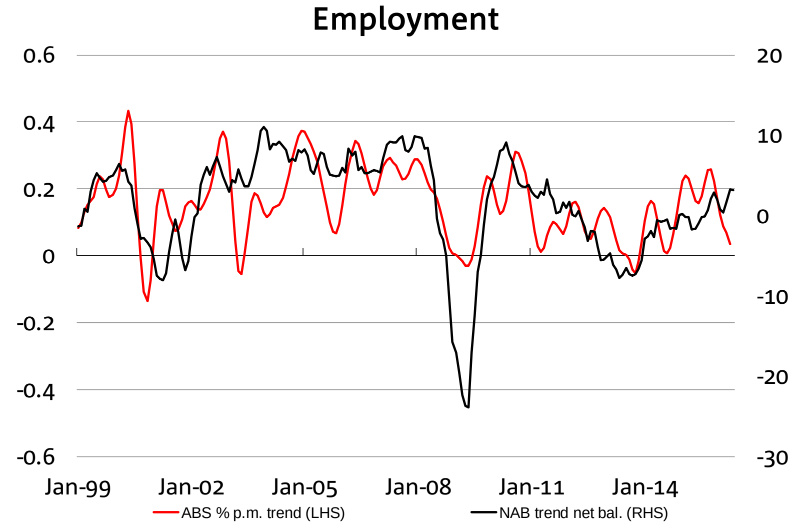
Business conditions (change & level) as an indicator of GDP (6-monthly annualised)



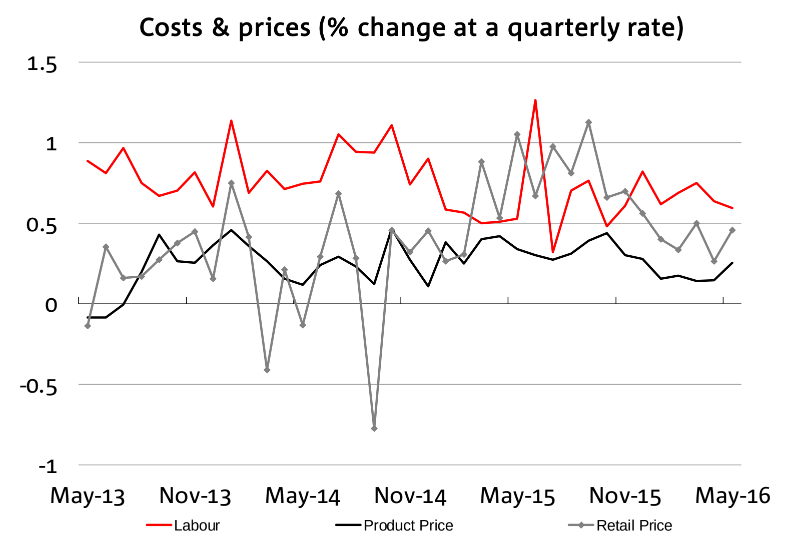
Costs, prices & labour

- Despite higher trading conditions, there was **a disappointing moderation in the Survey's employment index** this month. The employment index eased back to just +1 index point in May, although this was still in line with the long-run average, while the trend managed to hold its ground. A moderation in the index is, however, broadly consistent with the slowdown seen in official labour market statistics of late – following previously solid growth in employment. This outcome hints at an annual job creation rate of around 185k (close to 15k per month) in coming months, which compares to a trend increase of just 4.1k in March according to the ABS.
- Only **half of the industry groupings in the Survey recorded a weakening in employment conditions** this month. The worst decline was in manufacturing (down 28), followed by construction (down 4), FPB (down 3) and wholesale (down 1). These more than offset increases in most other industries, led by mining (up 15) and transport (up 9). In trend terms, the employment index was still very negative for mining (-22 points), followed by construction (-7 points). The strongest employment demand (trend) was in FPB services (+11).
- **Labour cost growth (a wage bill measure) was steady in the month**, suggesting wage pressures remain relatively contained – at 0.6% (a quarterly rate). Restrained labour cost growth is consistent with the currently elevated – albeit improving – rate of unemployment, subdued inflation expectations, and other shifts in the composition of employment. Labour cost pressures were highest in manufacturing, transport and personal services (all 0.8%), but still falling in mining (-0.6%).
- **Growth in purchase costs were up in the month to 0.7% (at a quarterly rate, from 0.3%).** However, this outcome was still below the long-run average. Higher purchase costs are to be expected given the pressure from currency depreciation – although subdued inflation pressures have been a common theme globally. Growth in purchase costs accelerated the most in wholesale (up 1.6 ppts), followed by retail (up 0.9 ppts) – both of which tend to have a high import component. Overall, purchase cost pressures were also highest in these industries, but softest in mining (-0.5%).
- **Final product prices growth in May lifted slightly to 0.3% (a quarterly rate), with retail price growth rising to 0.5% (quarterly rate), which is more consistent with the lower bound of the RBA's inflation target**. Elsewhere, final prices growth picked up in most industries, although transport and personal services were the main exceptions (both down 0.1 ppts). Construction and transport prices fell (-0.6% and -0.2%) despite strong residential building activity, while price growth was highest in wholesale (1.3%). Although final product price growth rose this month, it was less than purchase cost, suggesting there is still limited scope for pass through which is also working to constrain wages.

Employment maintained recent gains



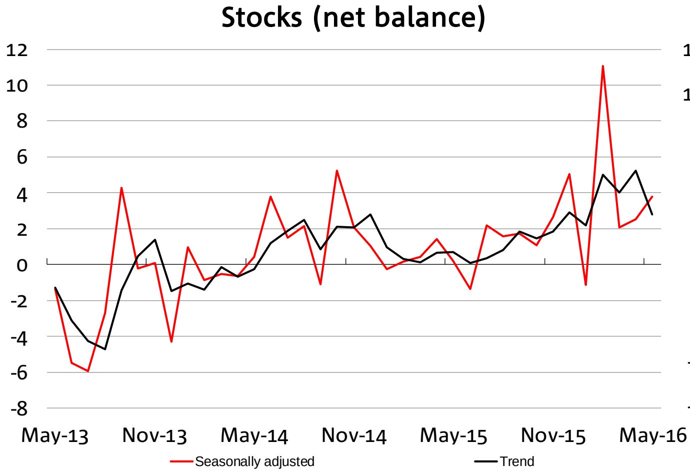
Price pressures more subdued



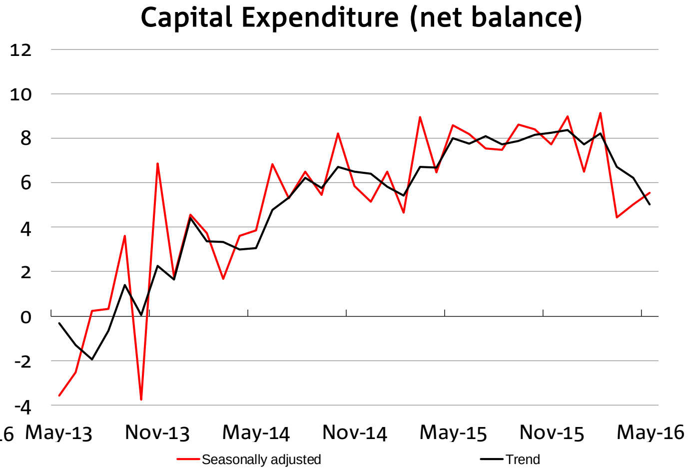
Based on respondent estimates of changes in labour costs and product prices. Retail prices are based on retail sector product price estimates.

More details on business activity

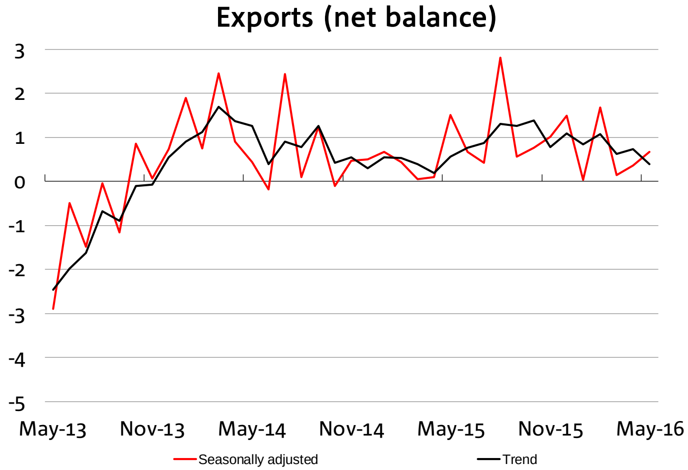
Firms re-stocking, but at a modest pace



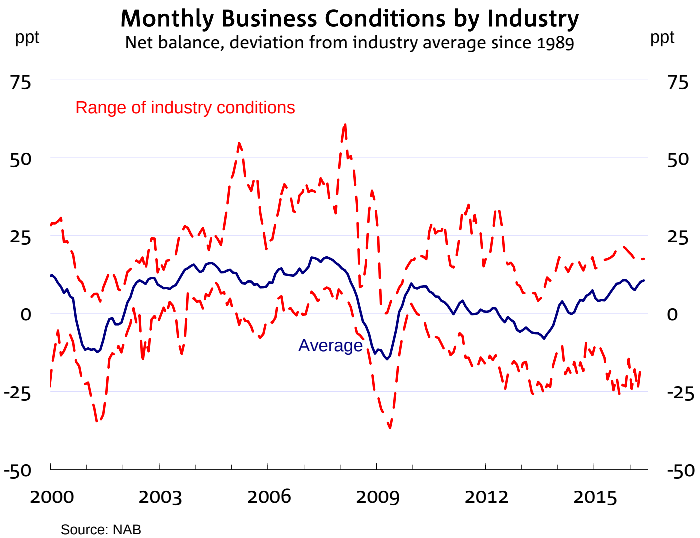
Capex positive, but has lost momentum



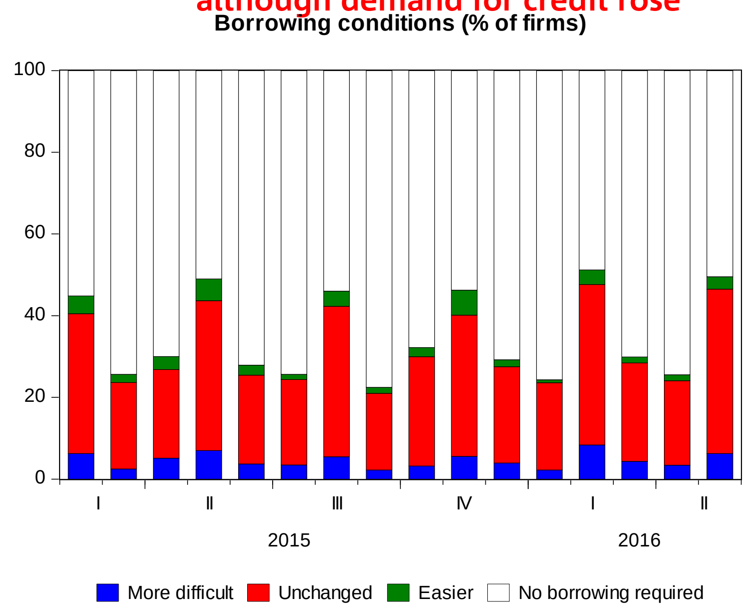
Exports looking subdued



Range of conditions widen as minig falls and fin/ prop/ bus lift

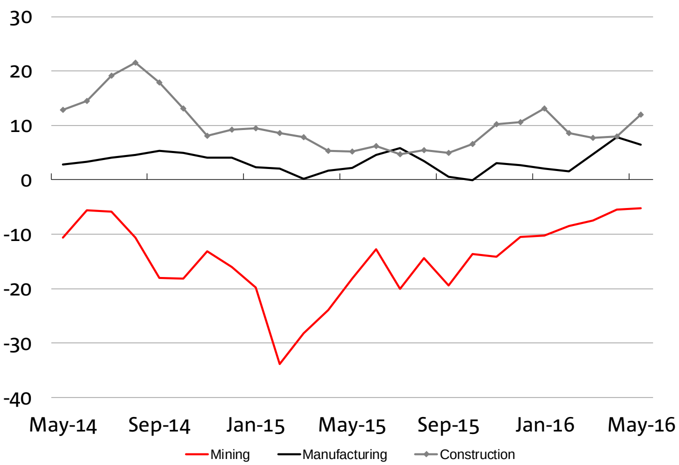


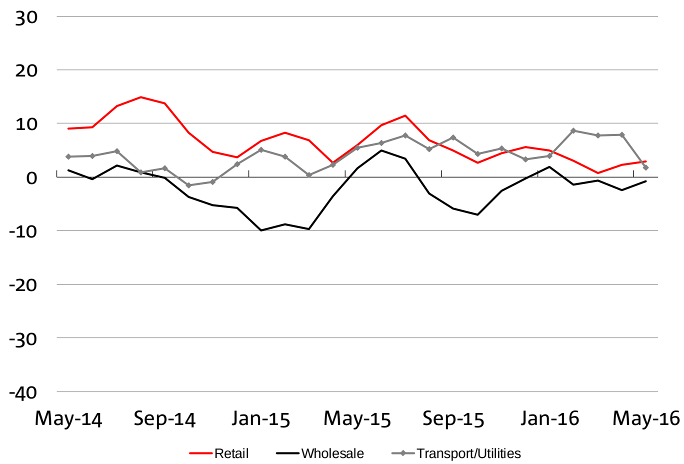
Borrowing conditions deteriorated in past 3 months, although demand for credit rose

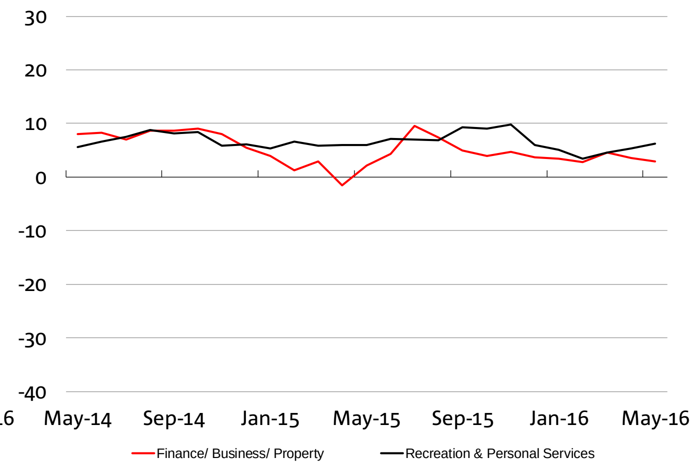


More details on industries

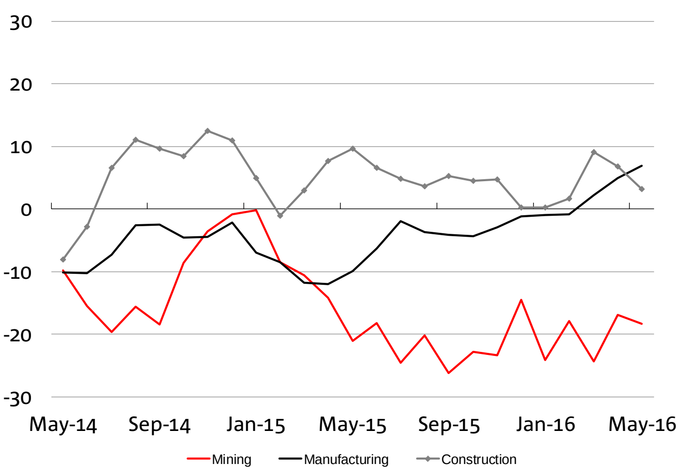
Business confidence by industry (net balance): 3-month moving average

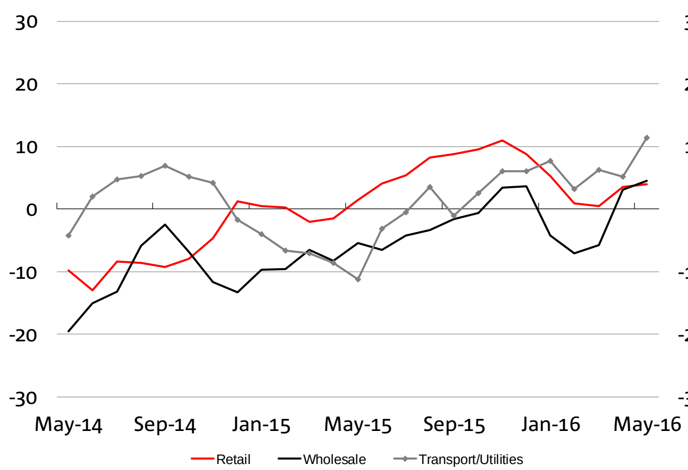


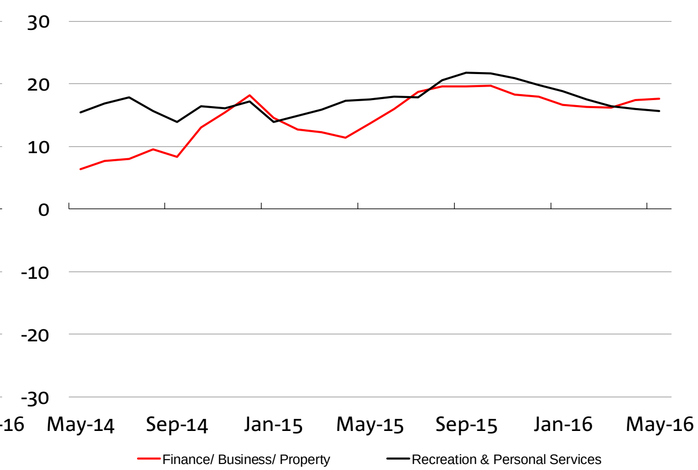




Business conditions by industry (net balance): 3-month moving average

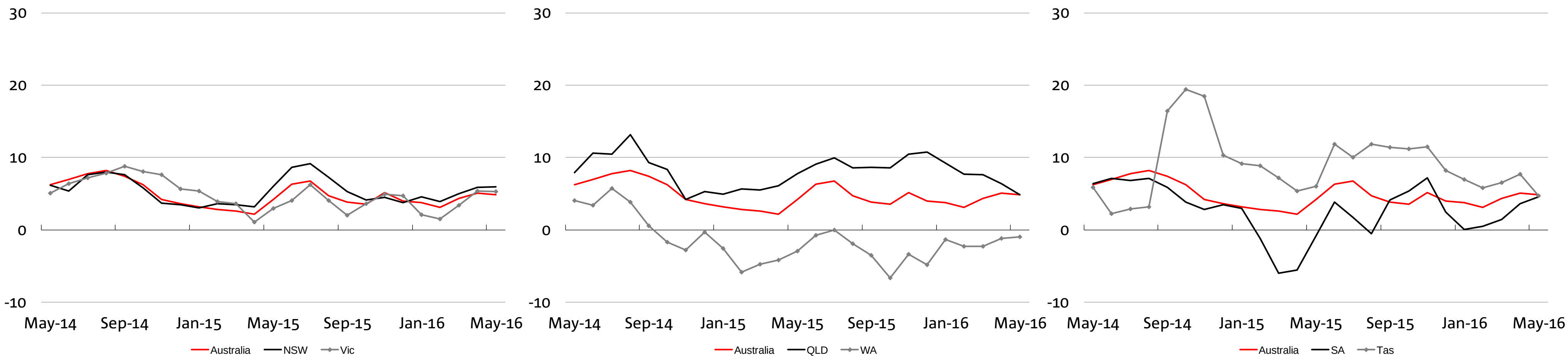




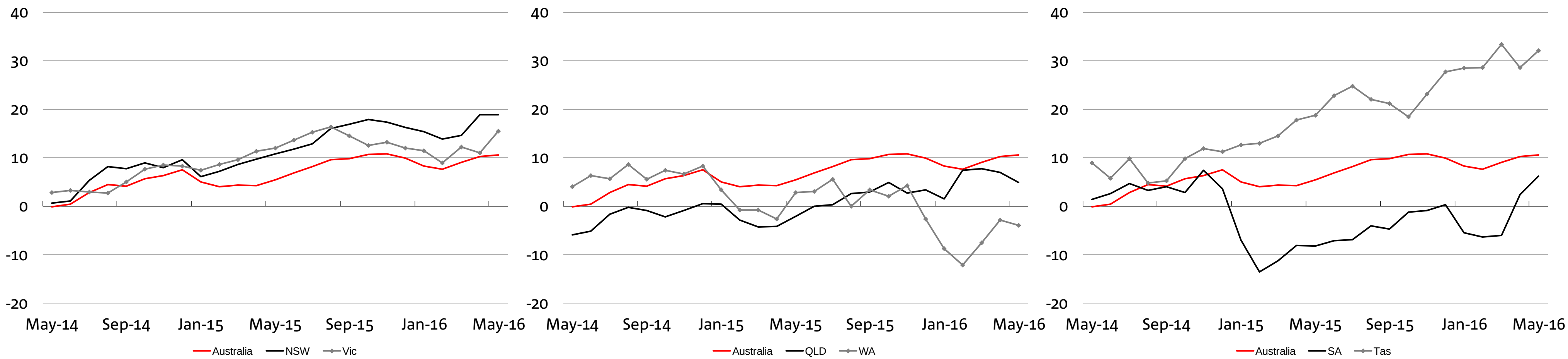


More details on states

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)

May-2016	Mining	Manuf	Constn	Retail	Wsale	Tran. & utils	Rec. & pers.	Fin. prop. & bus.	Australia
Labour costs: current	-0.6	0.8	0.2	0.4	0.6	0.8	0.8	0.7	0.6
Labour costs: previous	-2.0	0.5	0.5	0.2	1.1	1.1	1.0	0.8	0.6
Labour costs: change	1.4	0.3	-0.3	0.2	-0.5	-0.3	-0.2	-0.1	0.0
Prices (final): current	0.9	0.4	-0.6	0.5	1.3	-0.2	0.3	0.1	0.3
Prices (final): previous	0.6	0.2	-0.6	0.3	0.3	-0.1	0.4	-0.4	0.1
Prices (final): change	0.3	0.2	0.0	0.2	1.0	-0.1	-0.1	0.5	0.2
Purchase costs: current	-0.5	0.9	-0.3	1.3	1.5	0.4	0.7	0.2	0.7
Purchase costs: previous	-0.2	0.4	0.0	0.4	-0.1	0.4	0.3	0.1	0.3
Purchase costs: change	-0.3	0.5	-0.3	0.9	1.6	0.0	0.4	0.1	0.4

Key state business statistics for the month

May-2016	Monthly Business Survey Data: By State					
	NSW	**VIC**	**Qld**	**SA**	**WA**	**Tasmania**	**Australia**
Bus. conf.: current	4	3	3	7	-4	3	3
Bus. conf.: previous	7	7	3	0	4	2	5
Bus. conf.: change	-3	-4	0	7	-8	1	-2
Bus. conf: current - Trend	6	5	5	5	-1	5	5
Bus. conf: previous Trend	6	5	6	4	-1	8	5
Bus. conf.: change -Trend	0	0	-1	1	0	-3	0
Bus. conds: current	15	22	9	7	-11	37	10
Bus. conds: previous	26	6	1	7	-8	14	10
Bus. conds: change	-11	16	8	0	-3	23	0
Bus. conds: current -Trend	19	16	5	6	-4	32	11
Bus. conds: previous -Trend	19	11	7	2	-3	29	10
Bus. conds: change -Trend	0	5	-2	4	-1	3	1

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