NAB Monthly Business Survey

by NAB Group Economics

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June 2016

National Australia Bank

Key Points:

- This month's NAB Business Survey was undertaken right amidst the heightened uncertainty around the Brexit referendum, and ahead of the Australian Federal election. Despite the disruptive nature of these events (evident in the financial market volatility following the Brexit vote), it was encouraging to see that **business confidence continued to see support from consistently above average conditions in non-mining sectors**. In fact, **business confidence jumped in June to +6 index points**, which is consistent with long-run confidence levels. While there is potential for the unsettled post-election political environment to have an impact on confidence, this month's outcome suggests that **firms remain more focused on economic conditions**. In that respect, it was reassuring to also see **an improvement in some of the leading indicators, including forward orders and capex** – although capacity utilisation did ease back a little.
- **Business conditions lifted from their already elevated level in June, to +12 index points** (from +10), which is around its highest since the GFC. **Services remain the best performers, although retail pulled back considerably** – consistent with a large drop in retail prices, which could reflect an escalation of competitive pressures in the sector. That is a surprising contrast to wholesale – sometimes considered a bellwether for the economy – which has been consistently improving of late. The rise in business conditions was due to **a notable improvement in employment demand, although profitability also rose**, while trading conditions were unchanged at very elevated levels. **Employment conditions are now back above long-run average levels**, suggesting solid near-term employment growth. **Inflation measures in the Survey were broadly steady**, although a drop in retail prices may have implications for CPI.
- The overall narrative of the Survey has not changed, even in light of recent disruptions. The results point to further improvement in the non-mining economy in Q2, with growth potentially becoming more broad-based – although evidence is mixed. This will help counterbalance some of the mining sector headwinds to domestic demand, but is unlikely to be fully offsetting. While the RBA should be reasonably comfortable with the present state of economic conditions, they would also welcome the resilience of business confidence and business conditions in the wake of recent events that cloud the outlook. However, the view on inflation is arguably more important at this juncture, and the Survey is not suggesting any meaningful turnaround in near-term inflation pressures. These trends justify the highly accommodative setting for monetary policy, but while the August RBA meeting (post Q2 CPI) is likely to be 'live', current information suggest rates will remain on hold (although it is likely to be a close call).

Table 1: Key monthly business statistics*

	Apr 2016	May 2016	**Jun 2016**		Apr 2016	May 2016	**Jun 2016**
	Net balance				*Net balance*		
Business confidence	6	3	**6**	Employment	5	1	**4**
Business conditions	10	10	**12**	Forward orders	2	2	**4**
Trading	15	18	**18**	Stocks	2	4	**1**
Profitability	9	11	**12**	Exports	0	1	**2**
	% change at quarterly rate				*% change at quarterly rate*		
Labour costs	0.7	0.7	**0.8**	Retail prices	0.3	0.5	**-0.2**
Purchase costs	0.2	0.7	**0.8**		*Per cent*		
Final products prices	0.2	0.3	**0.3**	Capacity utilisation rate	81.3	81.9	**81.3**

* 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 to 30 June, covering around 400 firms across the non-farm business sector.

Contents

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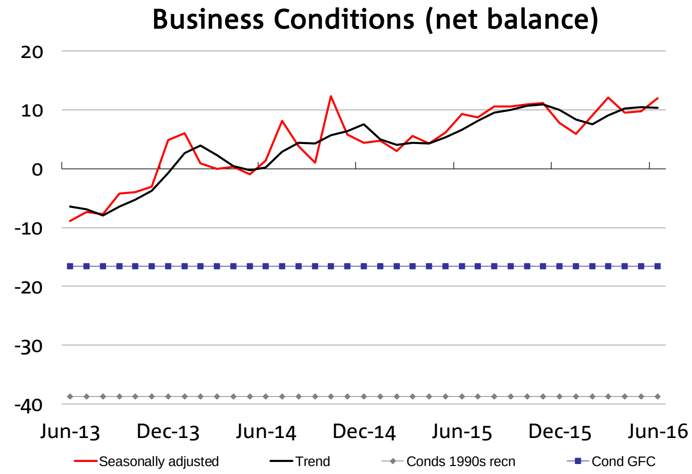
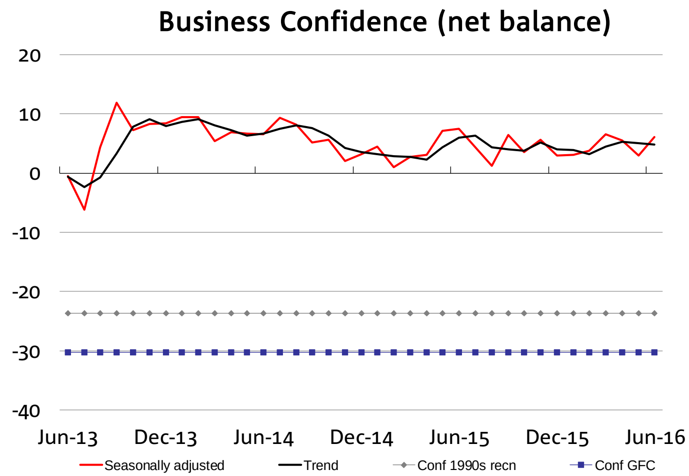
Analysis

- **Business conditions increased from the already elevated level in June**, confirming that the non-mining economy improved further in Q2. The index increased 2 points, to **+12 index points** in the month, which is **around its highest since the GFC and well above the series long-run average** of +5. The improvement in conditions were also seen in 7 of the 8 industry groupings included in the Survey, which is an encouraging sign that growth is becoming more broad-based. In terms of the components that make up conditions, the improvement was driven by a noticeable improvement in employment conditions – which is well above the long-run average of +1.2 – and a milder increase in the already elevated profitability index. Trading conditions were unchanged in the month, but the index is highest of the three components.
- As mentioned above, **most industry groupings in the Survey improved this month**, suggesting the non-mining recovery is becoming more broad-based. The biggest gains occurred in mining (up 25 to +15) as well as transport and personal services (both up 7 to +20 and +22). **Retail was the only industry to see a deterioration** (down 13 to -7), which also makes it the only industry reporting negative conditions (albeit not in trend terms). The deterioration in retail coincides with big declines in retail price growth, with a big impact on its profitability index, which might reflect an escalation of pre-existing competitive pressures in the industry – limiting their ability to pass on greater currency pass-through from wholesalers. In trend level terms, **service industries continue to lead the way**, while mining and construction remained in negative territory (see p7 for trend charts).
- **Strong business conditions appear to have cushioned firms' confidence from some high profile external shocks (for now)**. The surprise resolution to the Brexit vote (and the volatile market reaction) occurred during the period that the Survey was undertaken. Despite that, **confidence actually increased notably**, back to around long-run levels; **the confidence index rose 3 points to +6 index points in June**. It is encouraging that firms have remained confident, particularly as we enter a period of political uncertainty.
- **Confidence increased for most industries, and is positive (or neutral) for all of them – although mining and wholesale remain negative in trend terms (see p7)**. The largest gains occurred in finance/ property/ business (FPB) services (up 10 to +13), followed by mining (up 6 to 0). In contrast, construction (down 7 to +10) and retail (down 1 to +4) were the only industries to post declines. In trend terms, construction (+13) and FPB services (+6) were the most confident. In contrast, mining confidence was still the lowest (-4) and is expected to remain weak (see p7).
- There were some large fluctuations in the results by state. In trend terms, however, conditions improved modestly in NSW (up 2 to +21) and SA (up 1 to +7). This was offset by declines in the other states, the largest being Tas (down 6 to +27) and WA (down 3 to -8). Conditions remained positive in all states excluding WA – **NSW being the best performing mainland state**. On confidence, Qld and WA jumped in the month and were modestly higher in trend terms. The trends in other states were flat to lower, although NSW was most confident along with Queensland, while WA is still least confident (see p8).

Conditions lift from elevated level



Confidence higher, despite uncertainty



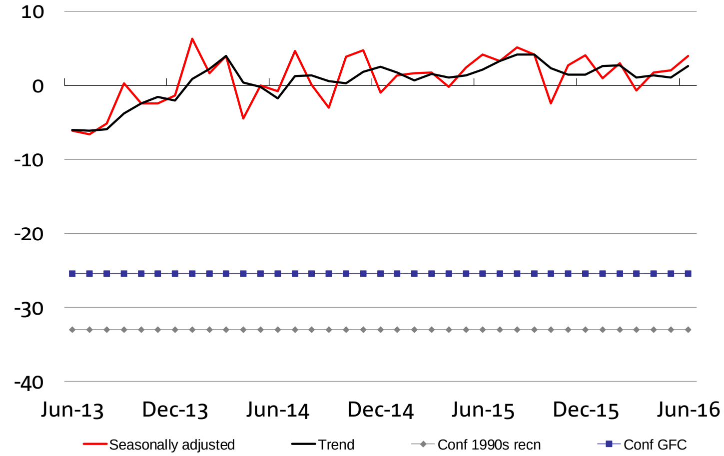
Excluding normal seasonal changes, how do you expect the business conditions facing your industry in the next month to change?

Other activity indicators

- The near-term outlook appears to have improved a little according to some of the Survey's leading indicators. The **forward orders** index rose further into positive territory, having softened earlier in the year. At +4 index points, the index was above the long-run average of zero points, which suggests good near-term prospects for activity – more consistent with business conditions. Orders were flat-to-higher for most industries in the month, which fits into the narrative of a broadening non-mining recovery.
- Most industries saw flat-to-higher forward orders in June, although mining (down 9) and FPB services (down 4) were the main exceptions – mining was also the only industry to see a negative orders index this month. **The rise in orders was most pronounced in manufacturing (up 8)**, followed by a more moderate increase in transport & utilities orders (up 5). Orders also rose in construction, wholesale and personal services (all up 3). Manufacturing appeared slow to capitalise on increased competitiveness following AUD depreciation. Yet, even with significant structural headwinds, the trend improvement in manufacturing conditions since late 2015, and this month's jump in orders, suggest things may be turning around for the industry – although profitability remains under pressure, and trading conditions pulled back somewhat in June. **Trend orders remained strongest in manufacturing (+9), while mining is weakest (-2).**
- NAB's measure of **capacity utilisation** pulled back this month, although the trend still remains quite positive – rising steadily since mid-2013. Utilisation rates fell to 81.3% (from 81.9%), although this is still slightly above the long-run average of 81%. The increase seems inconsistent with elevated levels of trading conditions, although both capex and employment rose notably in the month (adding to capacity). Most industries saw a deterioration, but wholesale increased significantly in June, up 4.4 ppts. Despite the improvements mentioned above, manufacturing saw the biggest fall in capacity utilisation (down 4.4 ppts), although the industry did see reasonably big increases in capex and employment, and some pull back in demand. Utilisation rates are now above average levels in only a handful of industries (see Chart).
- The capital expenditure index improved again in the month, recovering the ground lost in previous months to be well above the long-run average. At +9 index points, the capex indicator looks to be more upbeat on investment than reads from 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 (+16 points) and construction was lowest (-2 points), which may reflect the impact of rapidly falling mining investment.
- Elsewhere in the survey, **cash flow** (not seasonally adjusted) was the strongest in mining, which is a little surprising but could stem from relatively stable commodity prices and possible efficiency gains. Cash flows were weakest in retail.

Sales orders rose again

Forward Orders (net balance)

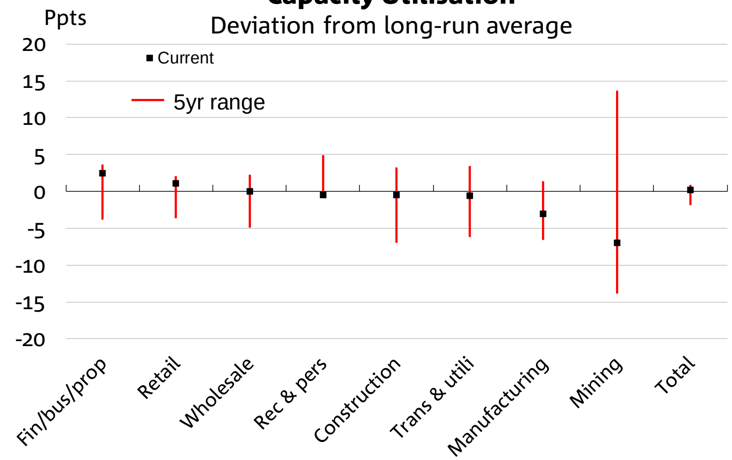


Net balance of respondents with more orders from customers last month.

Capacity utilisation by industry

Capacity Utilisation

Deviation from long-run average



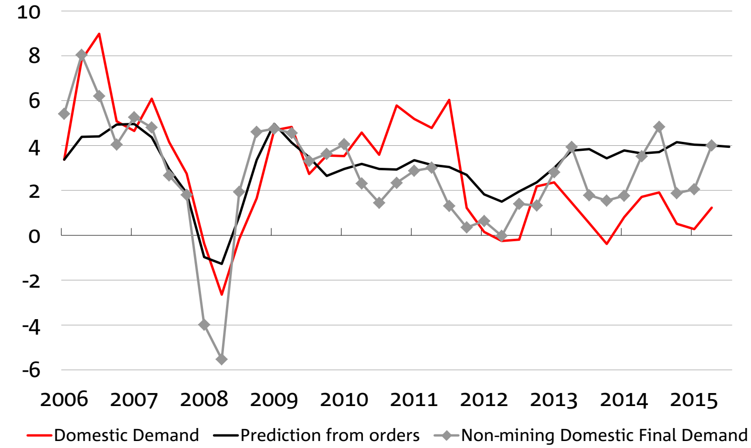
Source: NAB Economics

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

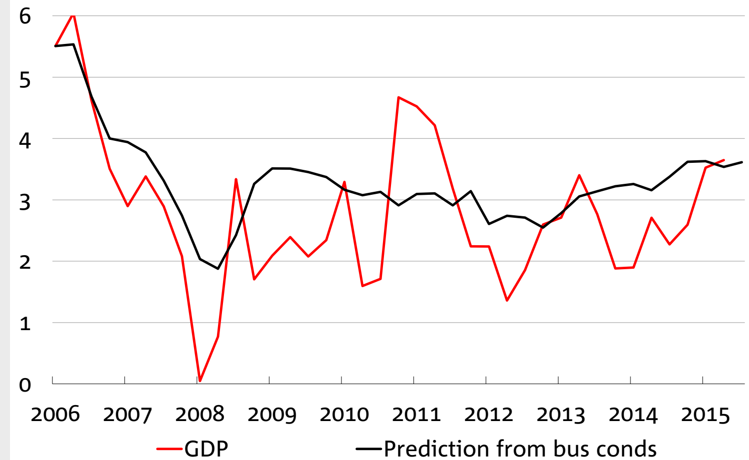
Implications for forecasts For more information see latest Global & Australian Forecasts

- Brexit, the latest in a series of shocks to global financial markets, leads us to shave our global growth forecasts by 10 to 20 bps in 2016 and 2017. The UK economy should fall into a technical recession and the impact via lower UK and Euro-zone growth drives around three quarters of our downward global forecast revision for 2016 and almost half for 2017. Annual global growth should average around 3% over the forecast horizon, a lacklustre performance that falls well below its long run trend. China, India and the US remain key drivers of growth with softer conditions across Japan and the rest of East Asia, Latin America and Western Europe. With little evidence of inflation pressures, central banks can keep interest rates very low by historical standards. The global trading environment for Australian business looks set to remain subdued but, while disappointing, the degree of global softness should not be exaggerated – this is a long flat period for growth as the global economy recovers from the GFC, it is definitely not a recession.
- In Australia, economic growth continues to be supported by LNG and services exports, as well as solid activity more broadly through the non-mining economy. The divergence between mining sectors and geographies is increasingly stark however, while measures of national income are weak amidst declines in the terms of trade. Consistently above-average business conditions in non-mining appear to be supporting business confidence (despite Brexit), which is encouraging as we enter a period of political uncertainty. Brexit is expected to have limited direct economic effect on Australia given Australian goods trade has re-oriented to Asia, although services trade and investment flows are larger. Our real GDP forecasts have been revised slightly to 2.9% for both 2016 and 2017 and to 2.5% in 2018, given slight downgrades to trading partners' growth and slight upgrades to our AUD forecasts. The unemployment rate eases to just above 5½% in coming quarters, then holds steady before drifting up to 5.8% in 2018. Meanwhile, low wages growth and weak commodity prices are a testing combination for government revenue and are consistent with a subdued inflation outlook. Our central case remains for the RBA to hold, although we acknowledge that this is data dependant and the central bank is clearly keeping its options open.
- 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 June trend orders to our model suggests steady 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)



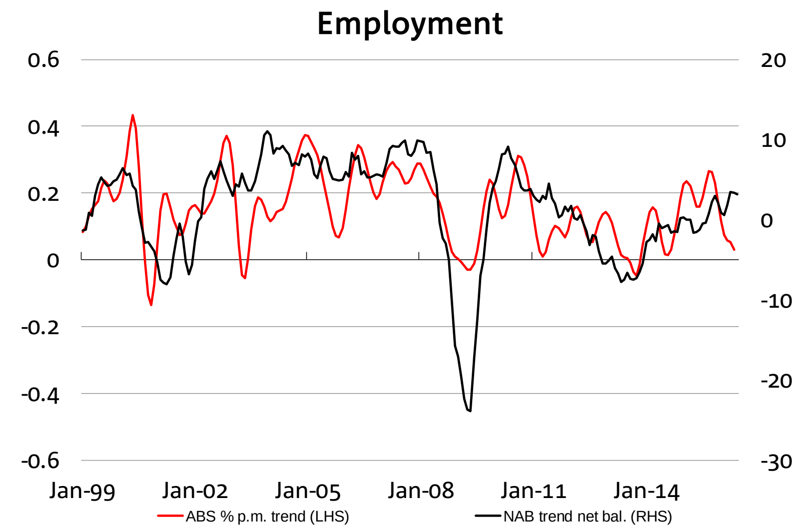
Business conditions (change & level) as an indicator of GDP (6-monthly annualised)



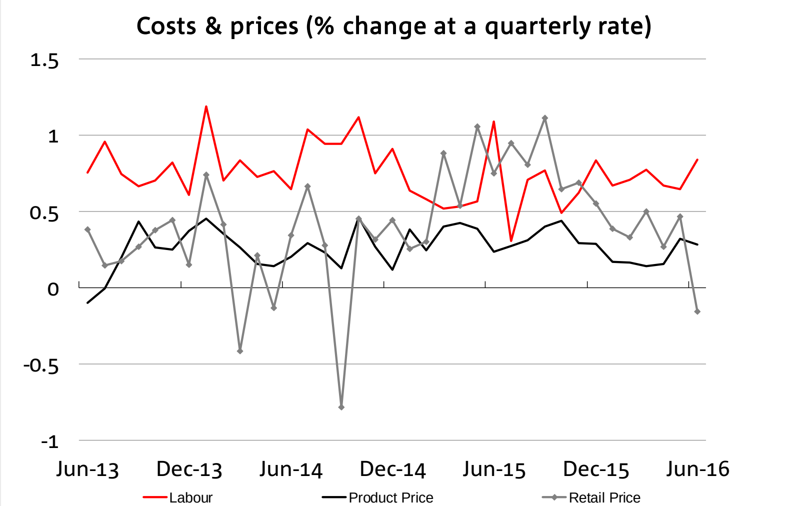
Costs, prices & labour

- **Employment conditions picked up in June**, following a disappointing result last month. The employment index rose to +4 index point (from +1), which is above the long-run average for the series. Trend employment conditions are higher than they were 12 months ago, despite a considerable moderation in official ABS employment of recent months. This outcome hints at an annual job creation rate of around 212k (around 18k per month) in coming months, which would be more than sufficient to lower the unemployment rate further, although this compares to a trend increase of just 3.7k in May according to the ABS.
- Despite the solid result, only **half of the industry groupings in the Survey recorded stronger employment conditions** this month. The biggest improvement was in mining (up 27) and manufacturing (up 24), although mining continues to look very weak in trend terms. In contrast, employment conditions deteriorated the most in transport (down 6), followed by wholesale (down 4). In trend terms, the employment index was still most negative for mining (-16 points), followed by construction (-8 points). The strongest employment demand (trend) was in FPB services (+9).
- **Labour cost growth (a wage bill measure) picked up slightly in the month. While this bears watching, wage pressures are relatively contained** at 0.8% (a quarterly rate). Restrained labour cost growth is consistent with the currently elevated – albeit gradually improving – rate of unemployment, subdued inflation expectations, and other shifts in the composition of employment. Labour cost pressures were highest in manufacturing and FPB services (both 1.2%), but still falling in mining (-1.2%).
- **Growth in purchase costs were only up modestly in the month as well, to 0.8% (at a quarterly rate, from 0.7%).** However, this outcome was still below the long-run average. Subdued inflation pressures have been a common theme globally, but higher purchase costs are to be expected to some degree given the pressure from currency depreciation. Growth in purchase costs accelerated the most in transport (up 0.8 ppts), followed by mining (up 0.5 ppts) – both of which tend to be sensitive to higher energy costs. Overall, purchase cost pressures were highest in wholesale (1.8%), but softest in mining and construction (both 0%).
- **Final product prices growth in June was unchanged at just 0.3% (a quarterly rate), although retail price growth plummeted to -0.2% – well below the lower bound of the RBA's inflation target**. Elsewhere, changes in final prices growth were quite mixed across industries. Mining, retail and transport prices all fell (-0.4%, -0.2% and -0.2% respectively), while price growth was highest in wholesale (1.4%) – suggesting we may be starting to see some currency effects. However, purchase costs continue to grow at a much faster pace than final product prices, suggesting that competitive pressures is still limiting the amount of pass through that is possible, and keeping pressure on wages.

Employment maintained recent gains



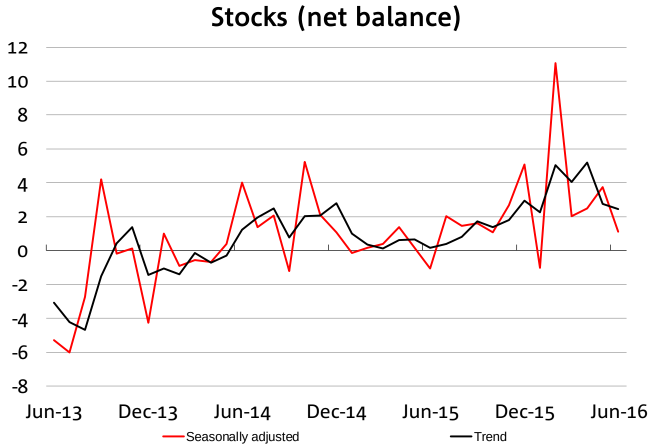
Price pressures still subdued



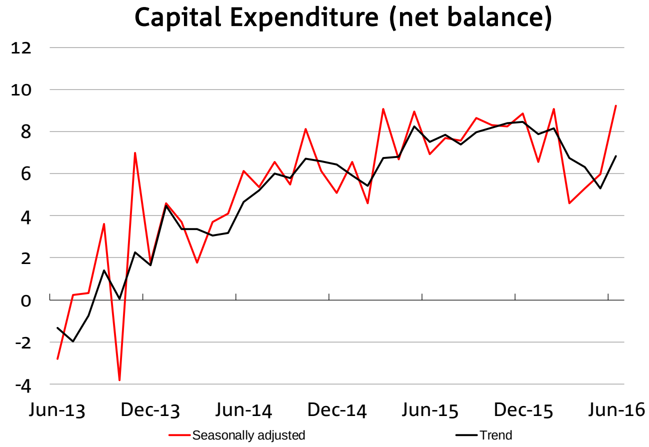
Based on respondent estimates of changes in labour costs and product prices. Retail prices are based on retail sector product price estimates.

More details on business activity

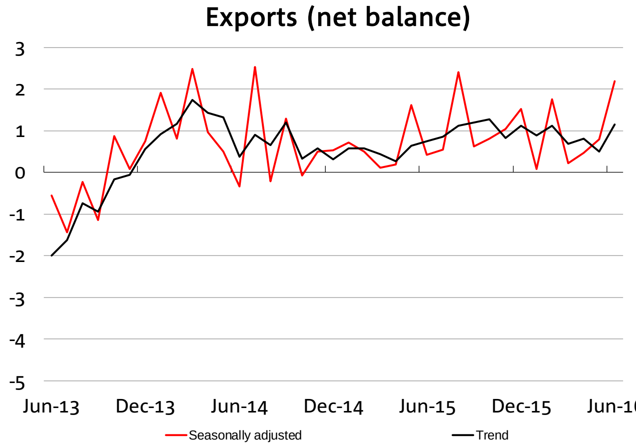
Firms re-stocking, but at a modest pace



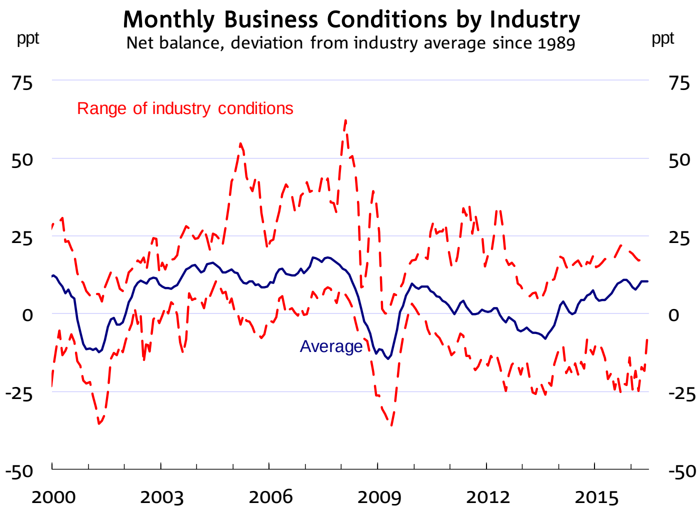
Capex regains lost momentum



Exports on the rise

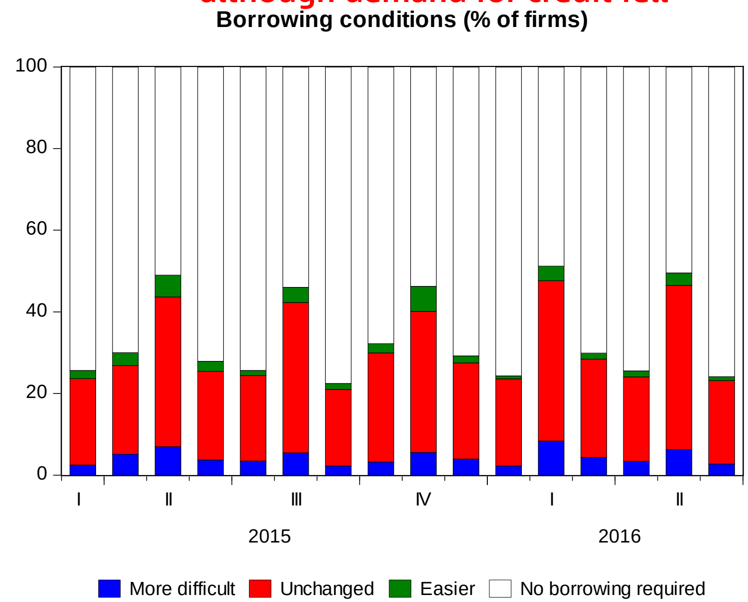


Range of conditions narrow as mining lifts and recovery becomes more broad based



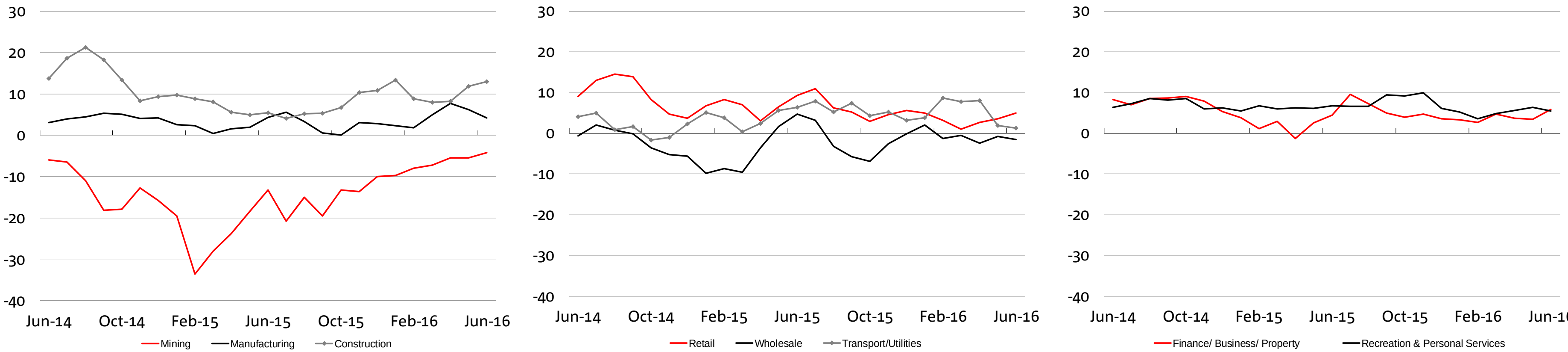
Source: NAB

Borrowing conditions improved in past 3 months, although demand for credit fell

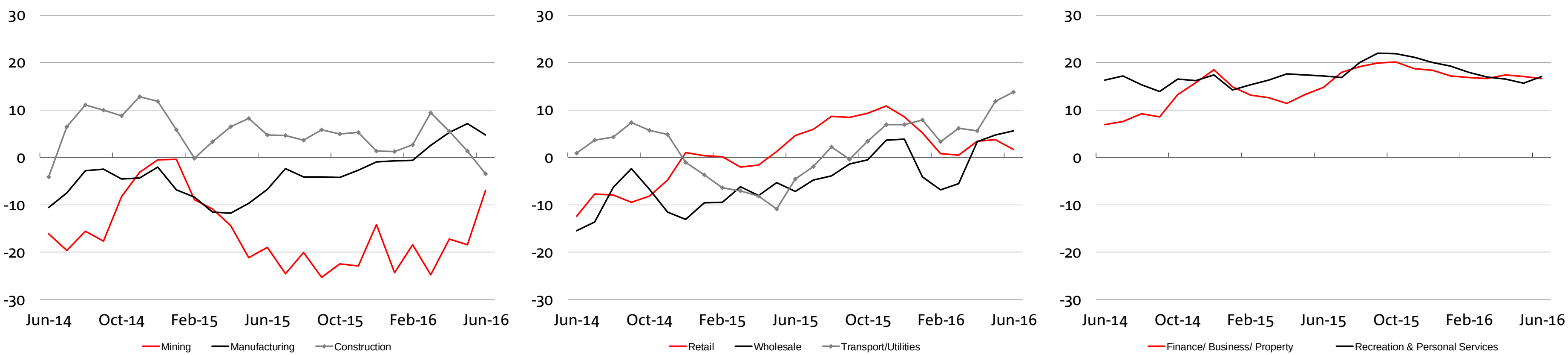


More details on industries

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

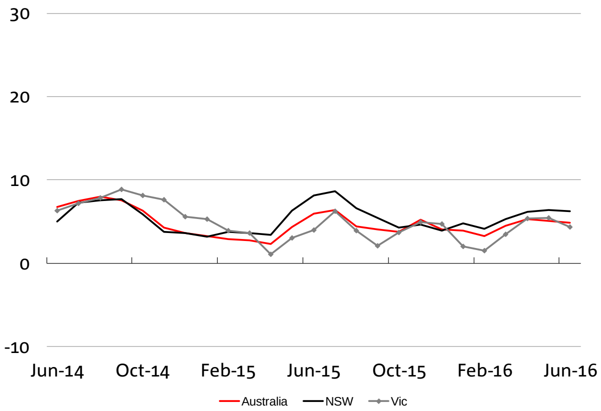


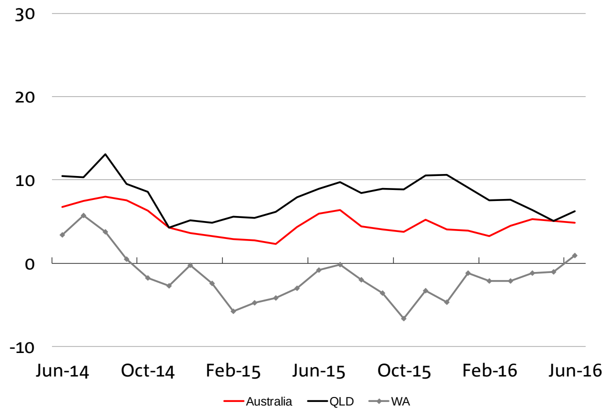
Business conditions by industry (net balance): 3-month moving average

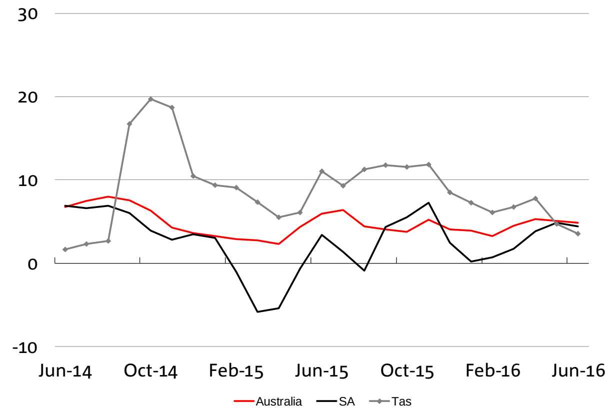


More details on states

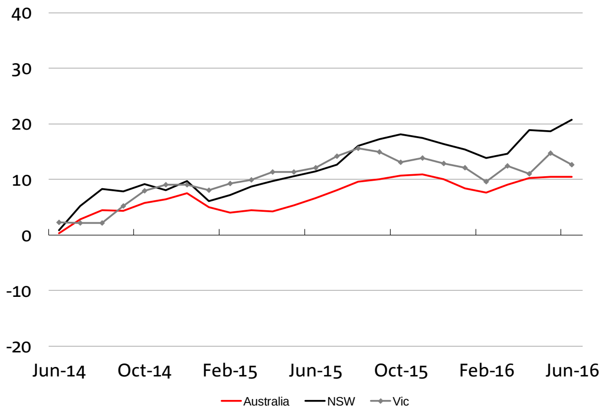
Business confidence by state (net balance): 3-month moving average

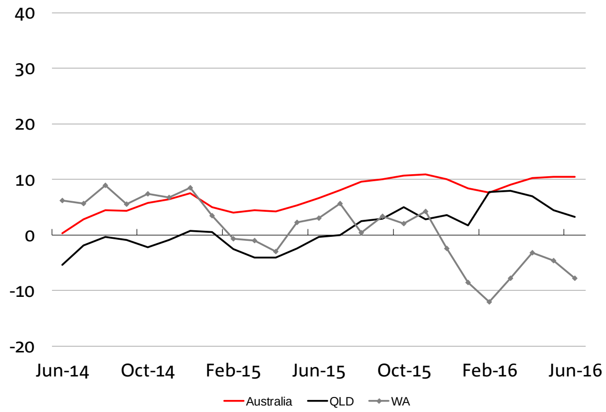


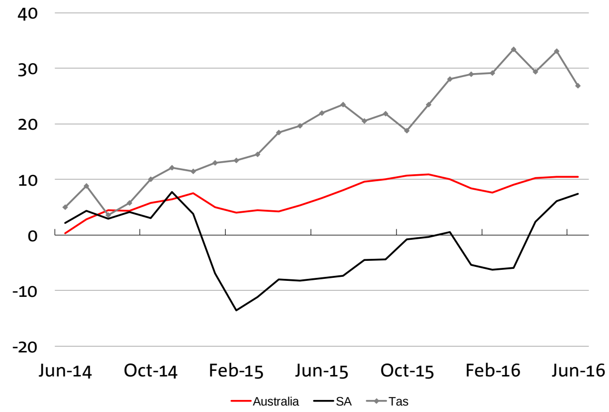




Business conditions by state (net balance): 3-month moving average







Data appendix

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

Jun-2016	Mining	Manuf	Constn	Retail	Wsale	Tran. & utils	Rec. & pers.	Fin. prop. & bus.	Australia
Labour costs: current	-1.2	1.2	0.7	0.6	0.6	0.4	0.9	1.2	0.8
Labour costs: previous	-0.7	0.8	0.3	0.4	0.6	0.8	0.8	0.7	0.7
Labour costs: change	-0.5	0.4	0.4	0.2	0.0	-0.4	0.1	0.5	0.1
Prices (final): current	-0.4	0.2	0.0	-0.2	1.4	-0.2	0.3	0.6	0.3
Prices (final): previous	1.0	0.4	-0.6	0.5	1.2	-0.2	0.3	0.2	0.3
Prices (final): change	-1.4	-0.2	0.6	-0.7	0.2	0.0	0.0	0.4	0.0
Purchase costs: current	0.0	0.7	0.0	0.7	1.8	1.3	0.6	0.3	0.8
Purchase costs: previous	-0.5	1.0	-0.3	1.1	1.6	0.5	0.6	0.3	0.7
Purchase costs: change	0.5	-0.3	0.3	-0.4	0.2	0.8	0.0	0.0	0.1

Key state business statistics for the month

Jun-2016	Monthly Business Survey Data: By State						
	NSW	**VIC**	**Qld**	**SA**	**WA**	**Tasmania**	**Australia**
Bus. conf.: current	7	3	13	6	3	6	6
Bus. conf.: previous	5	3	3	7	-4	3	3
Bus. conf.: change	2	0	10	-1	7	3	3
Bus. conf: current - Trend	6	4	6	4	1	4	5
Bus. conf: previous Trend	6	5	5	5	-1	5	5
Bus. conf.: change -Trend	0	-1	1	-1	2	-1	0
Bus. conds: current	22	12	2	8	-3	26	12
Bus. conds: previous	15	21	7	7	-12	39	10
Bus. conds: change	7	-9	-5	1	9	-13	2
Bus. conds: current -Trend	21	13	3	7	-8	27	10
Bus. conds: previous -Trend	19	15	4	6	-5	33	10
Bus. conds: change -Trend	2	-2	-1	1	-3	-6	0

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