NAB Quarterly Business Survey

by NAB Group Economics

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June Quarter 2016

National Australia Bank

Key Points:

- The NAB Quarterly Business Survey provides valuable insight into Australian business, and offers a more in-depth probe into the conditions facing Australian business than the monthly survey, and also provides extra information about how firms perceive the outlook for their respective industries.
- **Business conditions remained elevated in the June quarter, driven by strong trading conditions and profits, while confidence moderated a little.** This outcome is consistent with observations from the NAB Monthly Business Survey, although confidence appeared to improve again in the month of June. The impact on labour demand from very strong trading conditions has been relatively muted to date, although there has been a steady rise from the lows of 2013. Improvements in business conditions are looking a little more broad-based across industries, having previously been largely confined to services and construction (see p11-12 for details), although both the monthly and quarterly surveys are starting to point to weakness in retail.
- **Leading indicators were again positive in Q2 2016, although some appear to have lost momentum**. Forward orders remain positive, despite easing slightly, while expectations for business conditions in 3 and 12 months time showed a similar trend. An increase in capacity utilisation could support future investment and labour demand (at least for non-mining sectors). Indeed, **capex plans for the next 12 months strengthened, while near-term employment intentions improved and longer-term employment intentions remained relatively solid.** However, firms are still suggesting that the availability of labour is not a major constraint on output at the moment, consistent with subdued labour cost measures.
- Most firms in the Survey (more than two thirds) indicate that they comfortable with the current level of the AUD – the Survey was conducted while the AUD was averaging less than $US 0.73. Wholesalers are showing the most discomfort with the AUD, reflecting a degree of import reliance (which is similar for retail). In contrast, manufacturing has the second highest discomfort, but is falling, as AUD depreciation helps competitiveness.
- **Product price inflation was even more subdued in Q2**, at an annualised rate of 0.6% (0.1% in the quarter), **which could flag another weak CPI ahead of the August RBA rate meeting**. Both subdued purchase and labour costs are acting to contain product price inflation, although firms are still hinting at margin compression. Retail inflation was steady, while wholesale inflation picked up modestly.

Table 1: Key quarterly business statistics*

	2015q4	2016q1	**2016q2**		2015q4	2016q1	**2016q2**
	Net balance				*Net balance*		
Business confidence	5	4	**2**	Trading	18	14	**17**
Business conditions				Profitability	12	11	**13**
Current	11	10	**11**	Employment	3	3	**2**
Next 3 months	14	16	**15**	Forward orders	4	3	**2**
Next 12 months	24	26	**22**	Stocks	4	6	**4**
Capex plans (next 12)	22	24	**25**	Exports	2	1	**1**
	% change						
Labour costs	0.3	0.4	**0.4**	Retail prices	0.5	0.2	**0.2**
Purchase costs	0.4	0.3	**0.3**				
Final products prices	0.2	0.2	**0.1**	Capacity utilisation rate	81.1	81.7	**82.0**

** All data seasonally adjusted, except purchase costs and exports. Fieldwork for this Survey was conducted from 23 May to 9 Jun 2016, covering over 910 firms across the non-farm business sector.

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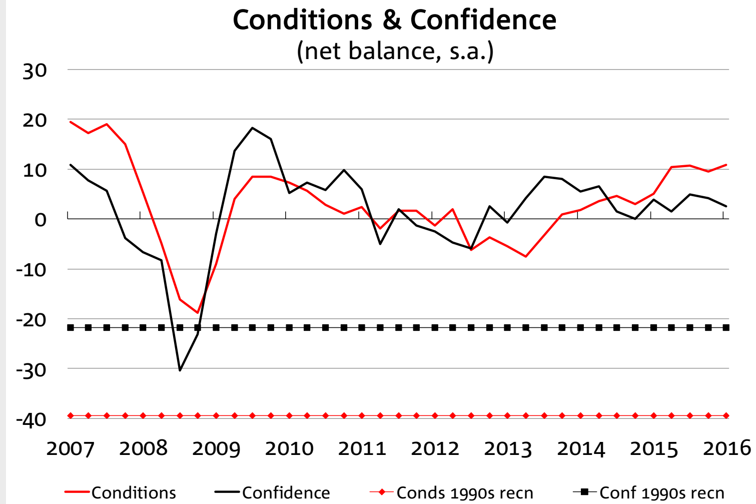
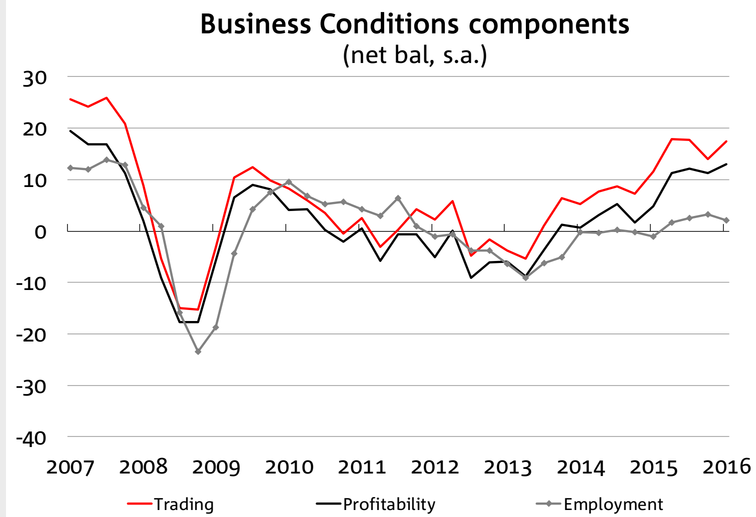
Business conditions & confidence

- Business **conditions** rose modestly in the June quarter (up 1 point, to +11), which is equal to the post-GFC high for the series and well above the long-run average (+1). This indicates that the non-mining recovery witnessed in recent quarters has continued, supported by record low interest rates and a somewhat more favourable AUD. In terms of the components, employment conditions have been relatively slow to ramp-up, but have seen a notable improvement over recent years. However, employment demand appeared to ease slightly in Q2 2016 (see p6 for more details on labour market conditions in the Survey). The trading and profitability components have been the biggest drivers of higher business conditions, with both improving further in the quarter from already elevated levels.
- The Survey is continuing to give tentative signs that the non-mining economic recovery is becoming a little more broad-based, which bodes well for the longevity of the improvement. There remains a significant amount of variation across industries, but the spread between the best and worst performing industries has narrowed in each quarter over the past year. Even industries expected to be adversely affected by AUD depreciation (such as wholesale), or those that take longer to capitalise on the benefits (e.g. manufacturing), have shown notable improvement. Nevertheless, services based industries tend to be the best performers (chart on p13).
- Despite the strength in business conditions, firms' **confidence** eased a little further in Q2, although the index remains at a positive level – a relatively good outcome given the prevailing uncertainty in the global economy and financial markets. Similar to business conditions, confidence varied across industries, with less than half showing an improvement from last quarter. Confidence remains highest in construction (+11), consistent with the elevated residential construction pipeline, followed by retail and personal services (both +5) – an encouraging sign for future consumption (although the June monthly survey suggested that retailers have come under renewed pressure). Interestingly, in the last 6 months, firms indicated that government policy and regulatory compliance costs are of growing significance to confidence going forward – more so than rate cuts or currency movements.
- **Forward orders** were a little softer in the quarter, but remained in positive territory, suggesting reasonable momentum for business in the near term. Orders are highest in construction (+11) and wholesale (+6), while orders are lowest in mining (-10), followed by retail (-1), despite relatively good confidence for the latter.

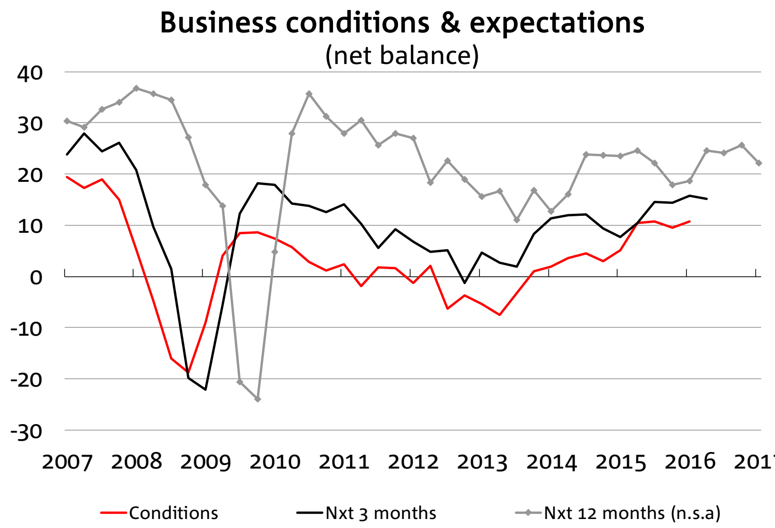




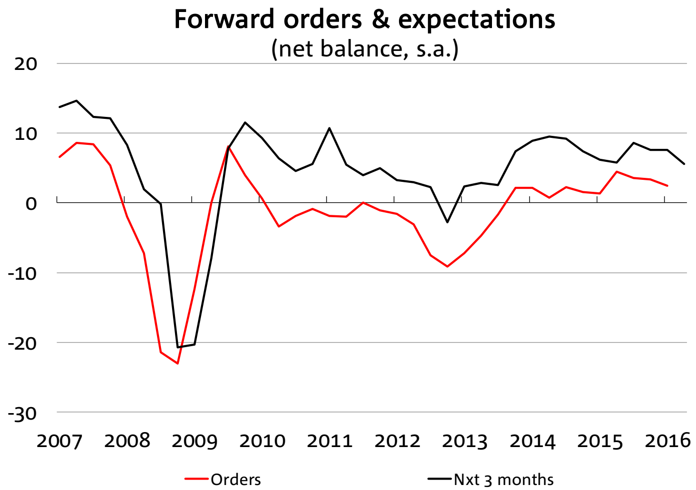
Other leading indicators

- In the quarterly survey, firms provide responses regarding their expectations for business activity going forward. Despite better current conditions, expectations for activity in both the near term (3 months) and longer term (12 months) weakened in Q2 – although not enough to reverse the notable improvements over recent years. Overall, leading indicators from the Survey tend to point to ongoing resilience in non-mining industries, which will help to partially offset the significant headwinds coming from the mining sector as investment in major projects grinds to a halt.
- Expectations for forward orders (3 months ahead) were also a little softer in Q2, but still at reasonable levels – albeit well down from post-GFC highs. Near-term expectations for profitability also eased, but from quite an elevated level.
- Stocks can be another indicator of near-term activity. The stocks index has improved steadily in response to strengthening trading conditions and positive orders, but dropped back slightly this quarter. Relatively subdued confidence levels may also account for firms tentative outlook for re-stocking (3 months ahead), although the index remains positive. Cost pressures might be contributing, given the lower AUD, but the Survey suggests these have remain relatively muted (albeit varied by industry, see p8).

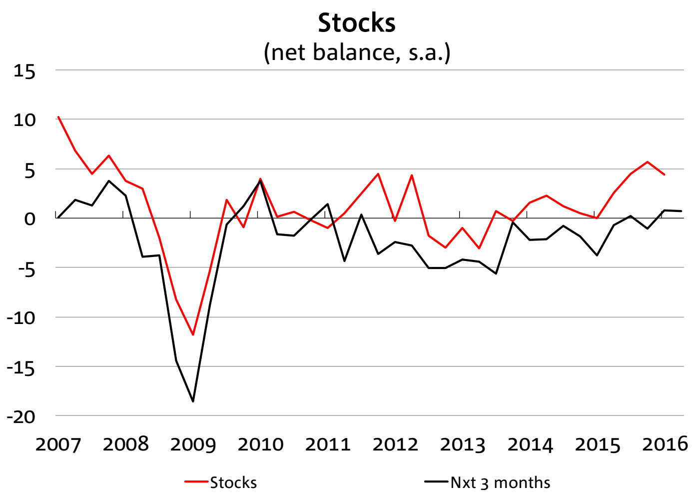
Expectations for 'own business' conditions eased



Orders are positive, but easing from already muted levels



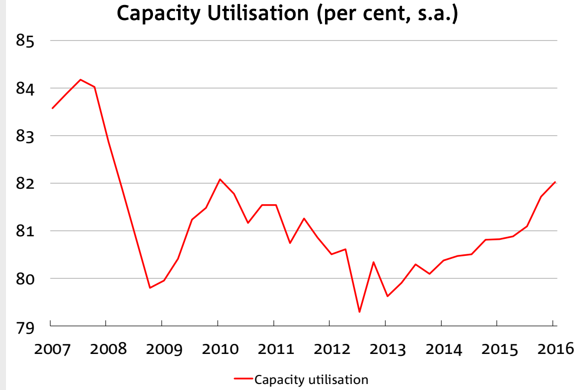
Firms tentatively re-stocking in response to stronger sales



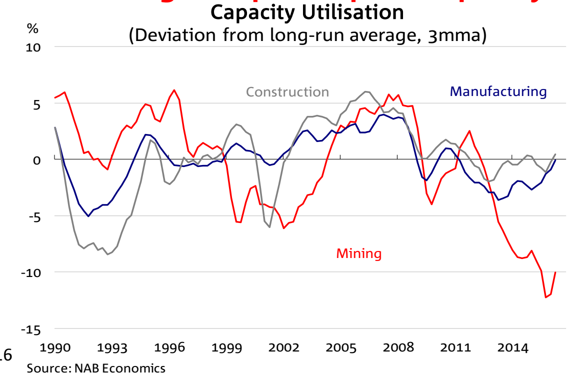
Business investment indicators

- Capacity utilisation rose even higher in Q2, up to 82%, which is above long-run average levels (80.6%) and its highest level since 2010. This is a continuation of the steadily improving trend in utilisation rates over recent years, and coincides with a degree of tightening in the labour market. However, evidence of pass-through to investment decisions has been mixed, although capex spending measures within the Survey itself have been quite solid – which includes spending intentions (see below). Manufacturing, wholesale and mining are showing the lowest capacity utilisation rates.
- According to the capital expenditure measure included in the NAB Survey, business investment activity has lifted from the lows of recent years, despite dipping from a multi year high last quarter. Mining saw a surprise jump this quarter, but that is likely to be temporary given expectations for further large declines as major projects reach completion. The capex index is positive for all industries, and was especially strong in transport (+18) and wholesale (+13).
- When asked about their future capex plans, firms in the NAB Survey remain more upbeat than the ABS Capex Survey, although this partly reflects differences in the industry mix across the two surveys, with the ABS survey not including key services industries such as health, education and some community services. The NAB capex index for the next 12 months suggests investment growth should already be stronger and holding at relatively elevated levels. However, mining firms are under-represented in our survey's investment measures. Interestingly, the recent RBA rate cut did not appear to lower firms **required rates of return** for new investment, suggesting uncertainty over the outlook may still impede future capital spending.

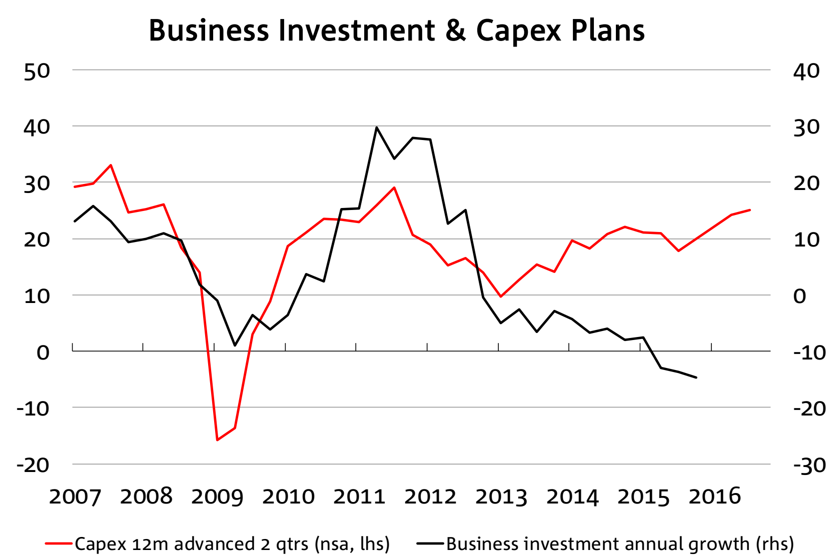
Tighter capacity utilisation a positive for labour and capital demand



But, capital intensive sectors showing adequate spare capacity



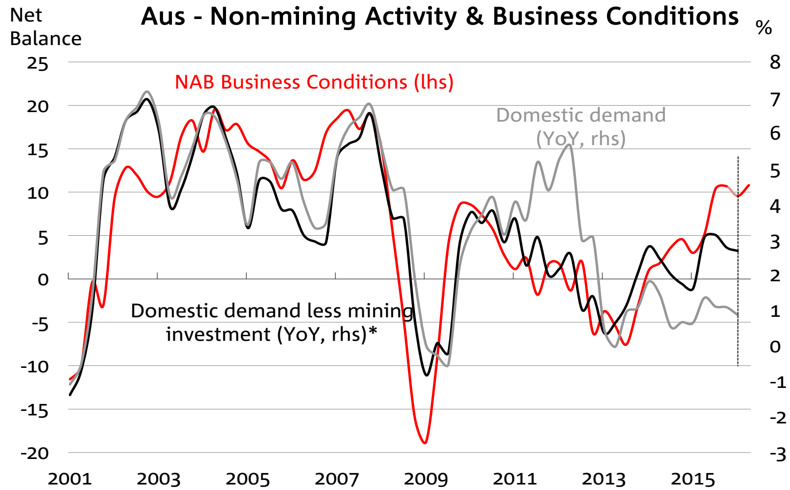
Capex intentions suggests a bigger lift in non-mining investment



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

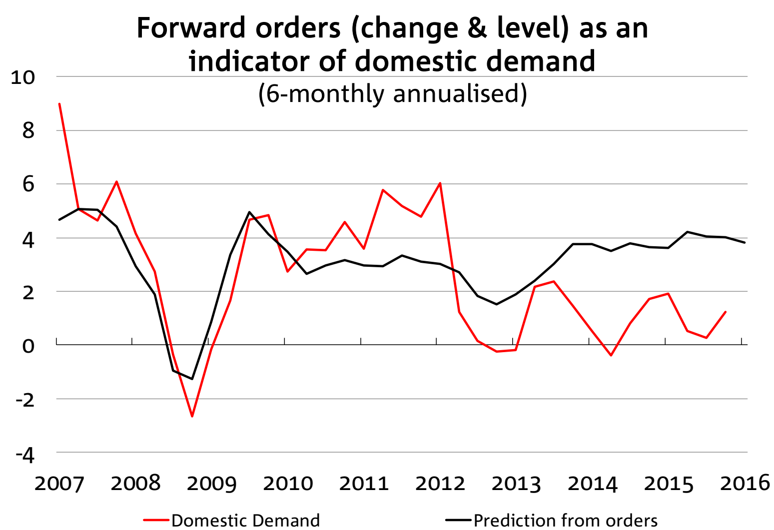
- Recent National Accounts have confirmed a ramping up of growth in the non-mining sectors of the economy long predicted by the NAB Survey – counter to very weak growth in total domestic demand. If this relationship holds, business condition suggest growth in non-mining demand should hold up at relatively elevated levels in Q2, although momentum in the Survey did actually rise a touch in the quarter.
- Our model of 6-monthly annualised demand growth, using forward orders as a predictor, has continued to suggest stronger growth than the National Accounts, although the predictions have been losing momentum of late. This could suggest another subdued result for domestic demand in Q2. However, better results for intermediate industries such as wholesale and transport could suggest an element of upside risk to the growth outlook.
- In contrast, our business conditions model under-predicted GDP growth marginally in Q1. Based on robust business conditions in recent quarters, our model implies steady-to-rising GDP growth for Q2.

Conditions have closer correlation with non-mining demand

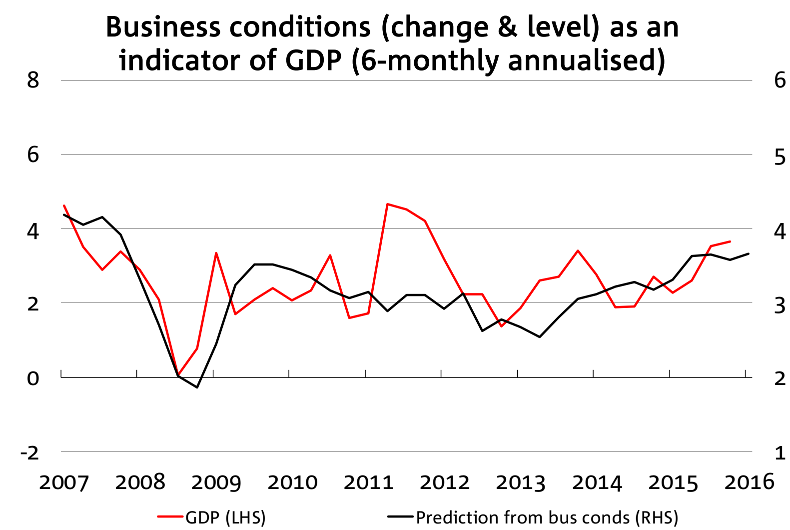


* NAB estimate.

Domestic demand prediction from orders is moderating



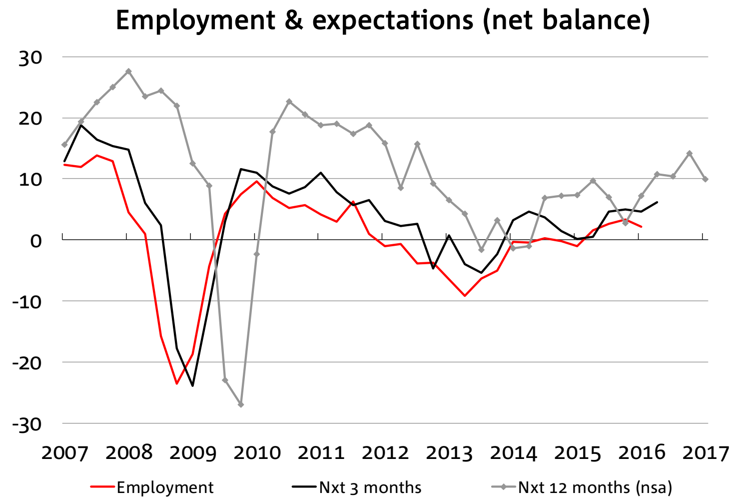
Conditions point to steady GDP growth



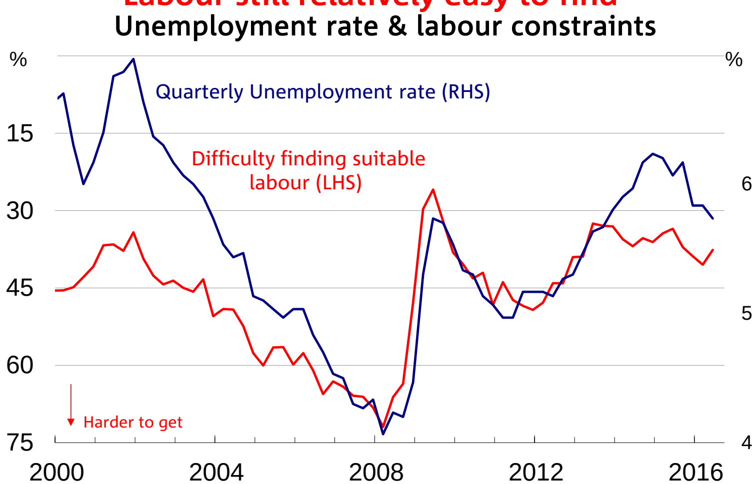
Labour Market

- The employment index lost a little ground in Q2 (down 1 to +2 index points), suggesting slightly softer rates of employment growth – although the long-run trend continues to show considerable improvement in the labour market to date. Average hours worked were also steady at 40 hours in the quarter.
- Near-term employment expectations improved to +6 index points, which is above its long-run average level. In contrast, longer-term expectations took a step back, having hit a multi year high in the previous quarter. These outcomes are consistent with our view that unemployment will remain elevated, but will gradually improve. While current employment conditions suggest jobs growth of about 15k per month – enough to keep the unemployment rate stable – the 12 month expectation is more consistent with jobs growth closer to 17k per month over the next 6 months – which would see the unemployment rate ease.
- Firms had been starting to report greater difficulty in finding suitable labour from around mid 2015. That was to be expected given falls in the unemployment rate and population growth, although big shifts in worker migration post the mining investment boom may be helping alleviate the strain – indeed, the proportion of firms' having difficulty finding labour (as a constraint on output) eased back slightly this quarter.

Longer-term employment expectations step back

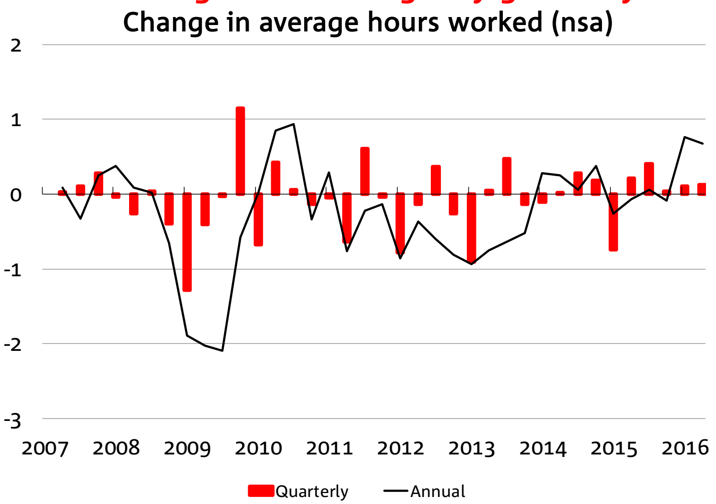


Labour still relatively easy to find



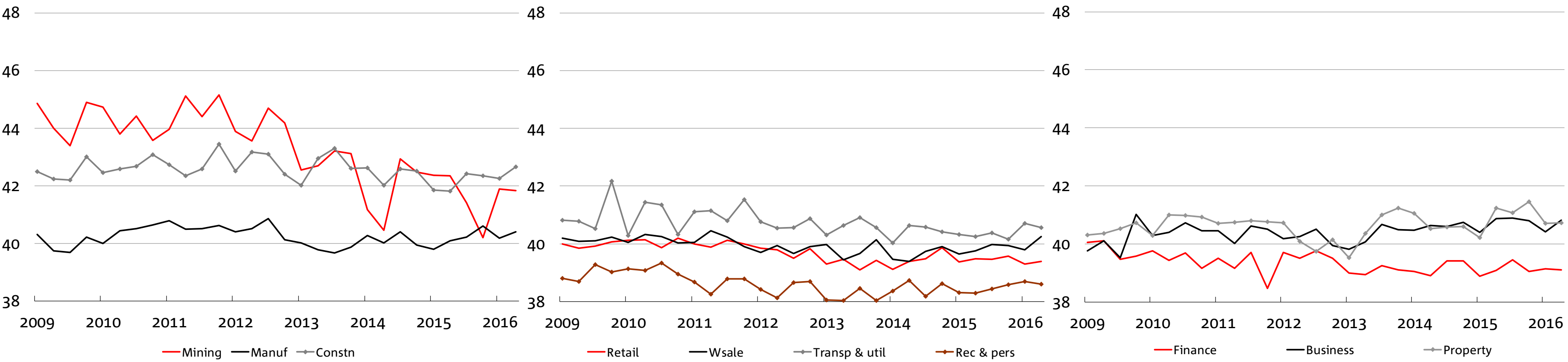
Sources: ABS; NAB

Average hours rising only gradually



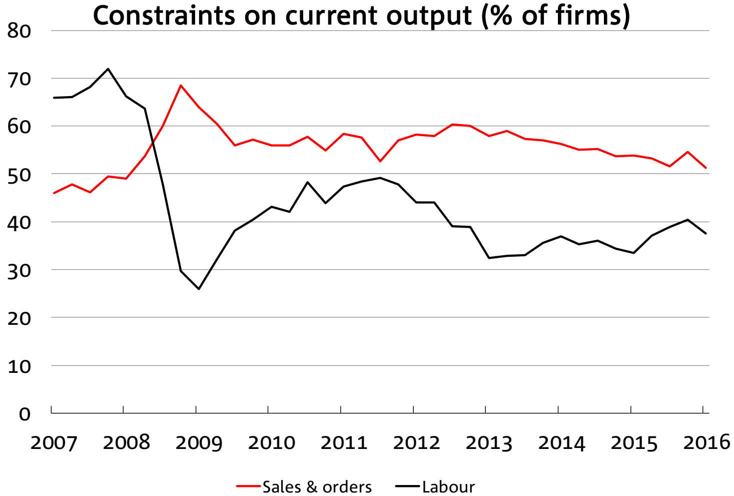
Labour Market (cont.)

Average weekly hours worked by industry (nsa)

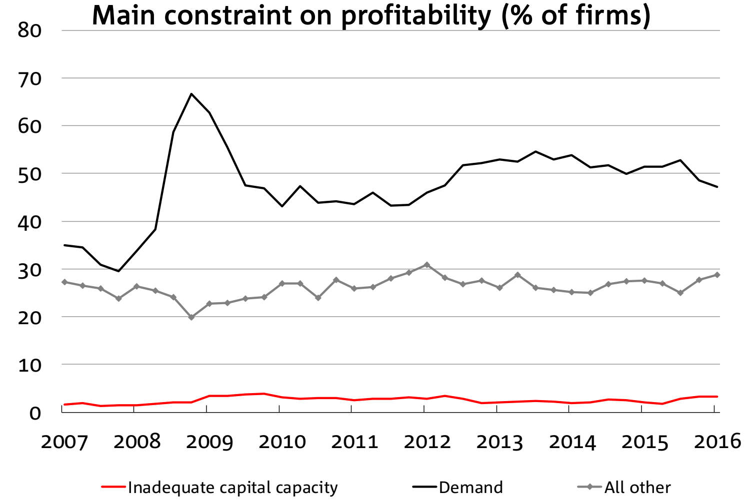


Major constraints on firm output and profits

Constraints on current output (% of firms)



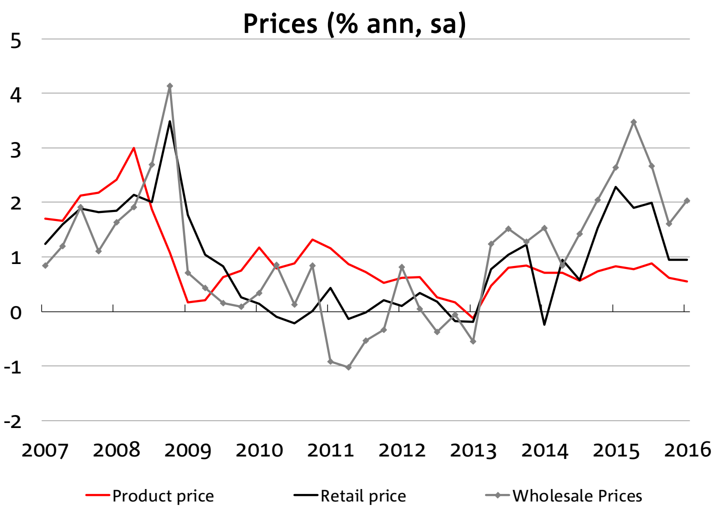
Main constraint on profitability (% of firms)



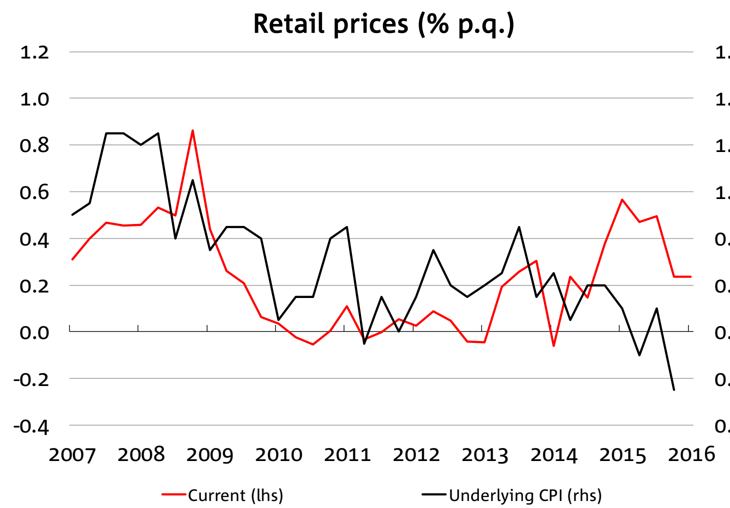
Inflation pressures

- A lot of focus has shifted back to the inflation outlook, given the role it played in the RBA interest rate cut back in May – since indicators of real activity continued to look reasonably solid. Similarly, the inflation outcome for Q2 is likely to heavily influence the RBA's decision whether or not to cut rates again in August. The broad picture on inflation provided by the Business Survey suggests price pressures have remained quite muted. Inflation pressures emanating from the wholesale sector have even wound back a little in recent quarters, having previously shown signs of responding to cost pressures as the AUD depreciated. Despite relative strength in wholesale prices, the retail price index has been relatively more muted, suggesting that either competitive pressures or subdued demand are stifling their ability to pass on higher costs to consumers at this stage.
- Growth in final product prices was slightly more subdued at a 0.6% annualised and 0.1% quarterly rate. Purchase cost inflation was broadly unchanged in Q2, as was labour cost inflation (at 0.3% and 0.4% respectively at a quarterly rate). Mining price inflation accelerated the most in the quarter (up 0.3 ppts), consistent with recent improvements in commodity prices, but suggest relatively flat prices overall. Retail and wholesale price inflation was relatively steady in the quarter, but is suggesting lesser pass-through of higher cost pressures due to AUD depreciation. Looking forward, inflation expectations for the next 3 months point to a continuation of subdued price pressures, with final price inflation expected to be at around an annualised rate of 0.6% (0.5% for retail inflation).
- Firms' have been reporting very weak profit margins (albeit improving) in the Survey for quite some time, which is consistent with the fact that labour and purchase costs have consistently outstripped growth in final product prices. Even for wholesale, where there has been some evidence of pass through from higher costs, the outcome for margins remain poor, suggesting a tepid demand environment – reflected in weak retail margins as well. Personal services is the only industry reporting a positive margins index.

Price growth still muted, retail inflation steady



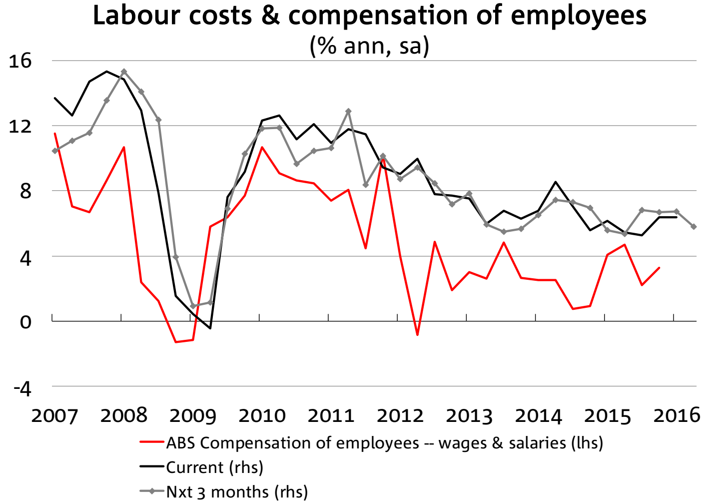
Retail price growth suggest limited upside to ABS core CPI measure



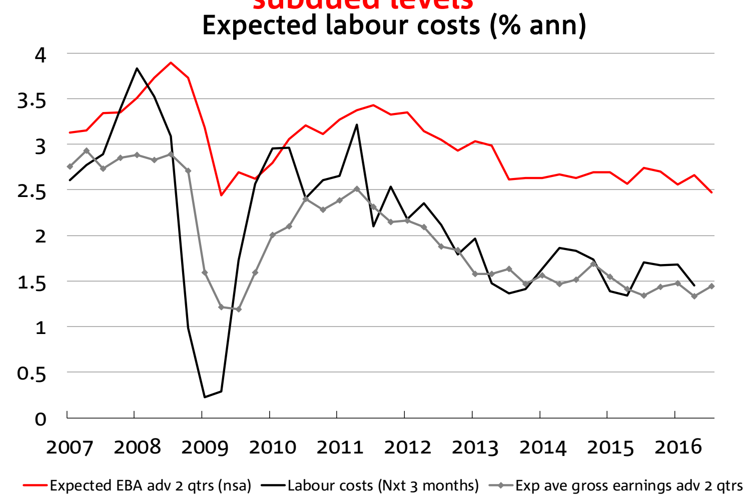
Labour costs (details) and expectations for AUD, rates and inflation

- Annualised growth in labour costs remained steady at 1.6% in the quarter, which is below the series average of around 2.9% since 1989. Wage cost pressures have remained relatively subdued despite positive (albeit moderating) employment conditions and a published unemployment rate that has gradually trended downwards. Still, labour cost expectations (next 3 months) suggest these wage trends are set to continue in the near term, easing further in the quarter. Wage increases under EBAs are expected to average just 2.5% over the next year, or 1.6% after allowing for productivity offsets.
- On average, businesses revised down their expectation for short-term interest rates and are now pricing in almost a 50% probability of a 25bp cut – less than what is priced in by financial markets. NAB Economics agree that the August RBA rate meeting will be a 'line ball' decision that will largely hinge on the outlook for inflation and the currency. Exchange rate expectations in the Survey (6-months-ahead) rose to US$0.72, which was below the rate at the time the Survey was taken.
- Medium-term inflation expectations remained soft, with 72% of respondents expecting inflation to remain below 3% (more than the previous quarter), slightly more than a fifth (22%) are expecting inflation of 3-4% (down from last quarter). Around 3% of firms believe inflation is a serious problem (up from last quarter), while 34% believe it is a minor problem (up from Q1).

Wage pressures tick up, but remain contained



Labour cost expectations holding at subdued levels

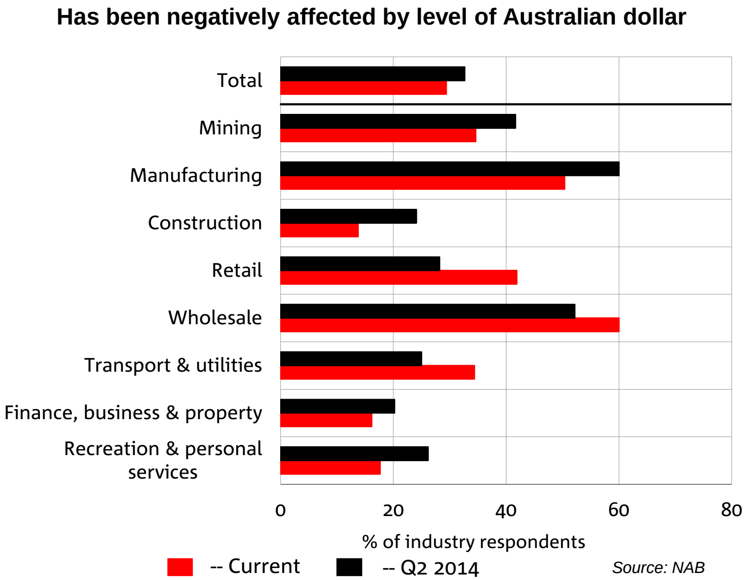


	Mining	Manuf	Const	Retail	Wsale	Trans	Rec. & pers.	Fin. prop. & bus.	Aust.
Expected EBA growth	1.5	2.4	2.4	2.2	2.3	2.6	2.9	1.9	2.5
Productivity offset	1.6	1.1	0.8	0.9	0.8	0.7	0.9	0.6	0.9
Net EBA growth	-0.1	1.3	1.5	1.3	1.5	1.8	2.0	1.3	1.6

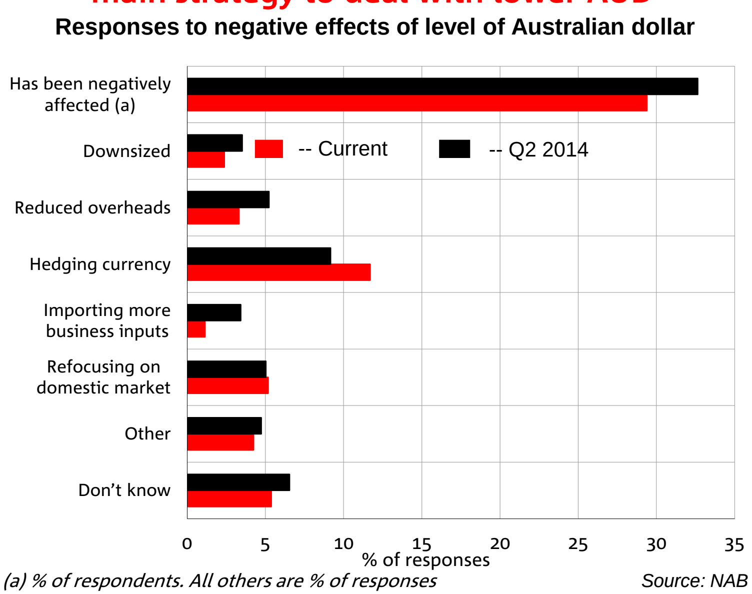
Business & the AUD

- In NAB's Quarterly Business Survey, we have asked businesses how they have been affected by the level of the Australian dollar, and what strategies they have been using to mitigate the negative impacts. The interviews for this question were conducted between 23 May and 9 June, when the exchange rate averaged $US 0.728 and 61.6 on a TWI basis. These levels are largely consist with those seen during the March survey period, although there was a noticeable appreciation in the AUD while the Survey was in the field. The AUD has subsequently appreciated much further (currently around $US 0.75), but this is still slightly below the levels seen during the comparable survey from last year ($US 0.77).
- According to the survey, less than 30% of non-farm businesses reported an adverse impact from the AUD. This is lower than Q1 2016 and is still well down on levels seen in mid-2014 – prior to the steady depreciation of the AUD. The magnitude of the improvement since mid-2014 seems relatively small, which is likely to be underestimating the true benefits of the depreciation for the economy. The main reason for this is the notable disparity in currency effects across industries, although most have improved – including personal and business services, which have made a major contribution to the non-mining recovery.
- Unsurprisingly, industries where there are clearly direct benefits from AUD depreciation such as mining (since commodities tend to be priced in USD, while much of the cost is incurred in AUD) have reported more favourably on the AUD. Trade competing industries such as manufacturing have also improved, but strangely it is the construction industry which has reported the biggest improvement since mid-2014 – possibly reflecting strong ties between non-residential construction and the mining sector. Offsets have largely come from a deterioration in retail, wholesale and transport, which can tend to be highly reliant on imports – even more so following an extended period of AUD strength.
- In terms of how businesses are responding to the negative effects, hedging remains the most common strategy. Additionally, as the AUD has depreciated, firms appear to have become even more focussed on areas like hedging and import substitution, as opposed to greater cost cutting (e.g. downsizing) – although this can vary considerably by industry. Recreation & personal services has the highest share of firms that are uncertain about what strategies to employ to manage currency risk.

Impact of lower AUD varies considerably across industries



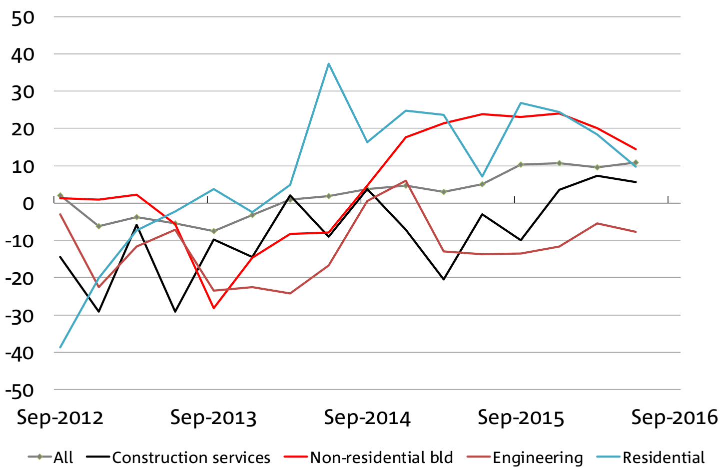
Hedging and import substitution are main strategy to deal with lower AUD



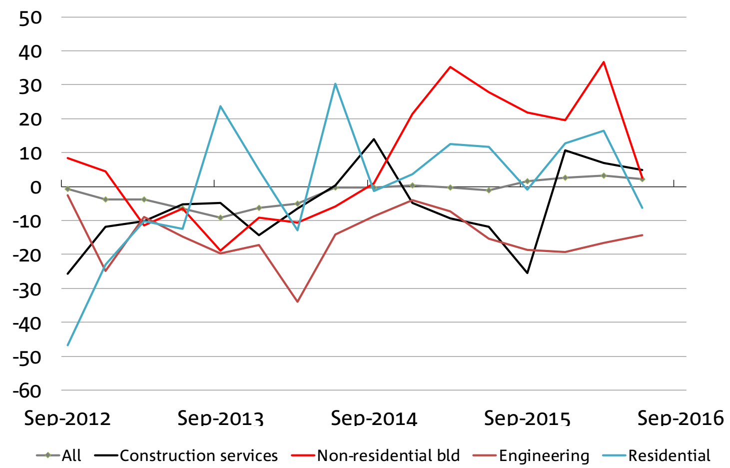
Some Industry Details: Construction

- Business conditions in residential and non-residential construction remain elevated, but have started to moderate of late – suggesting a shift in fundamentals in the property market. Confidence has also softened considerable for residential construction, consistent with concerns of a looming oversupply, particularly in the apartment market. Conditions have stayed extremely weak in engineering, reflecting the ongoing mining investment downturn – capacity utilisation in engineering construction is much weaker than other construction sectors.

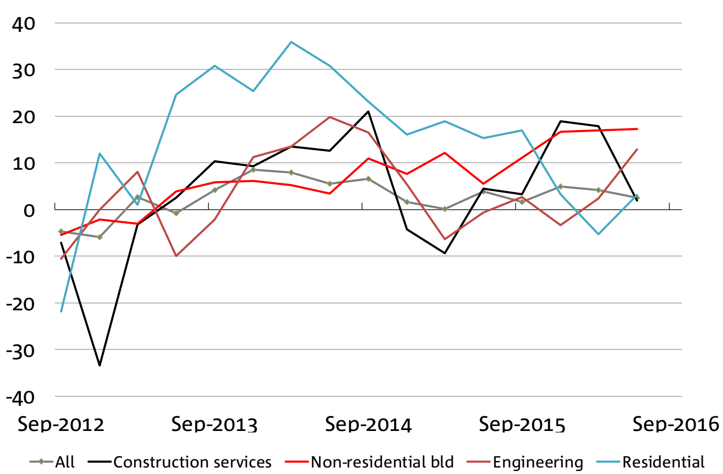
Business conditions by industry



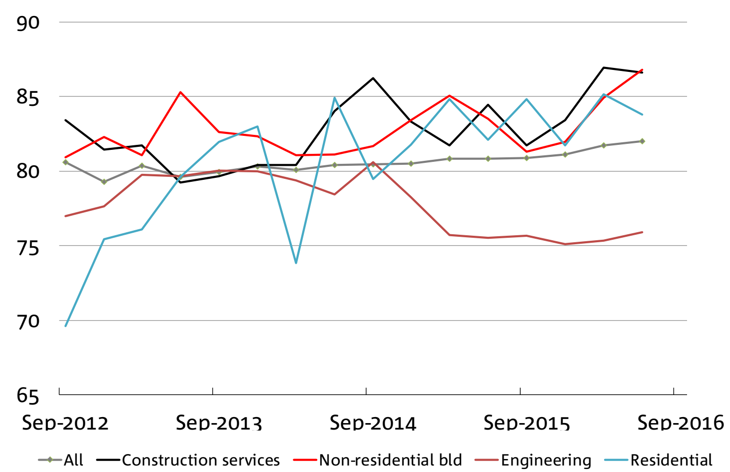
Business confidence by industry



Employment conditions by industry



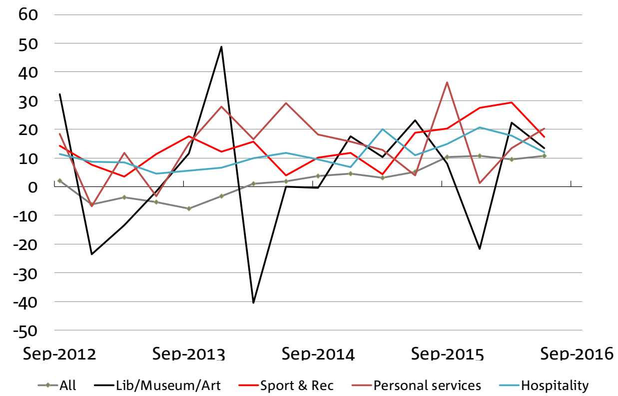
Capacity utilisation by industry

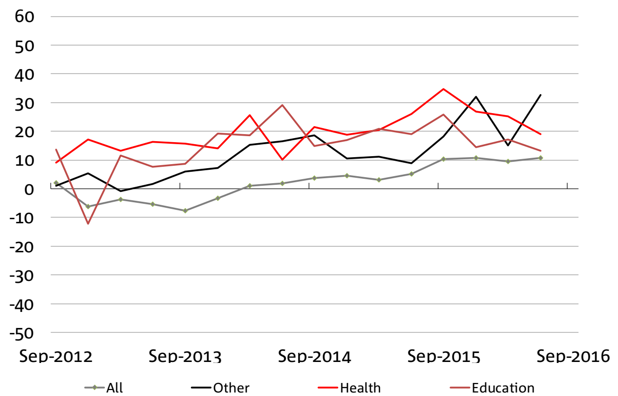


Some Industry Details: Personal & Recreational Services

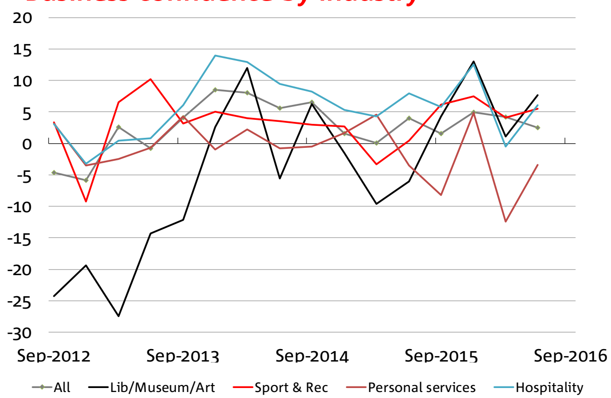
- The non-mining recovery appears to have broadened a little, but services remain a stand out – particularly recreation & personal services, which has consistently been the best performer of the major industry groups in the survey.
- Breaking the industry down into its various sub-industries suggests that all are performing reasonably well, although libraries/ museums/ art has been volatile, while sport & recreation, hospitality, health and education have all lost some momentum since last year. In contrast, personal services and other services have shown signs of improvement lately.
- Confidence appeared to have bounced back in most sub-industries in Q2, although personal services remain quite weak.
- Health (and to some extent education) have been a major source of employment growth in Australia over recent years. While employment conditions in these sectors remain positive, they have eased back recently.

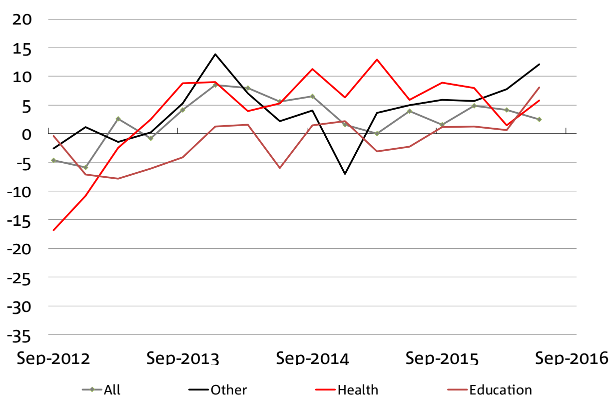
Business conditions by industry



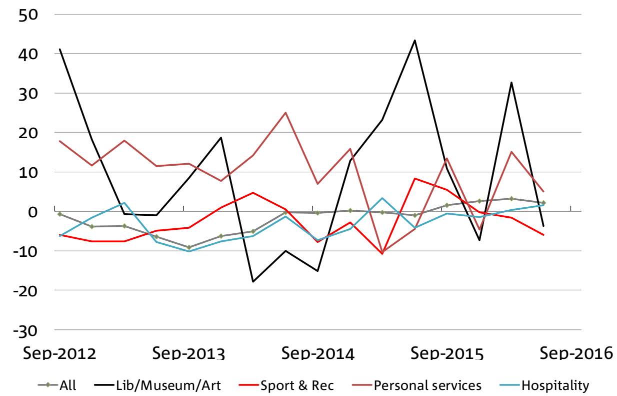


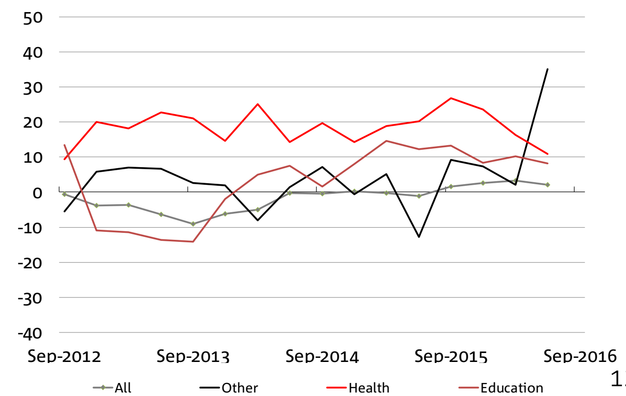
Business confidence by industry





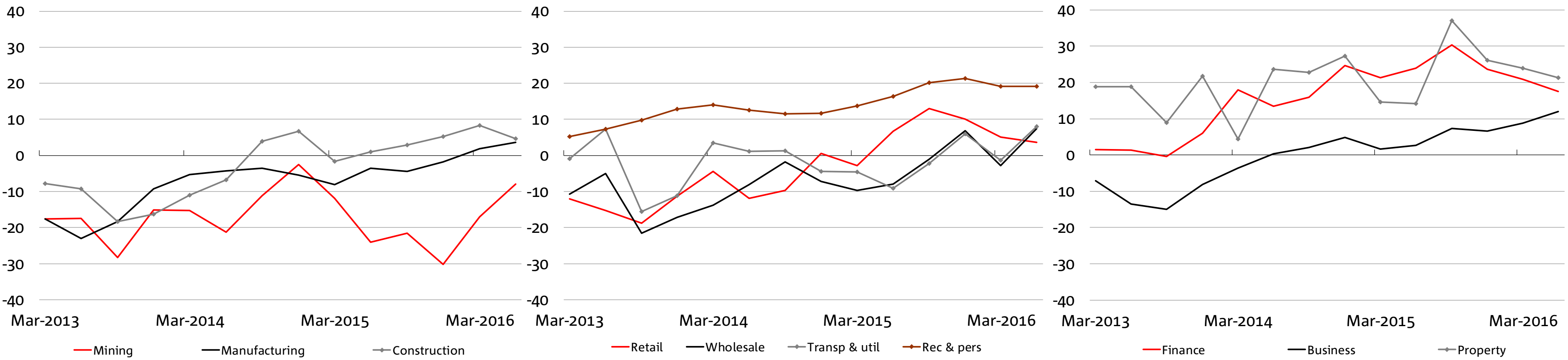
Employment conditions by industry



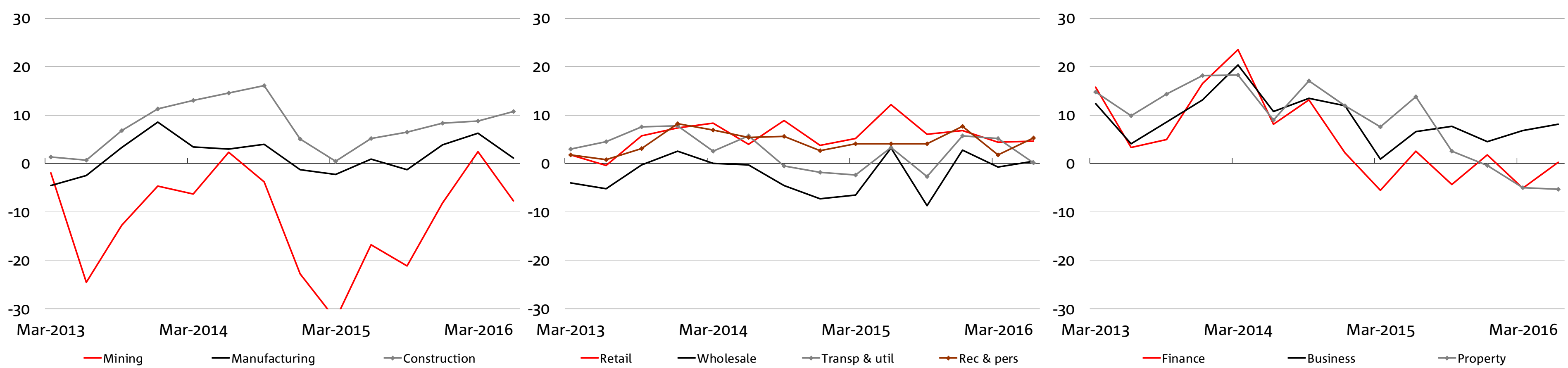


More details on industries

Business conditions by industry (net balance)

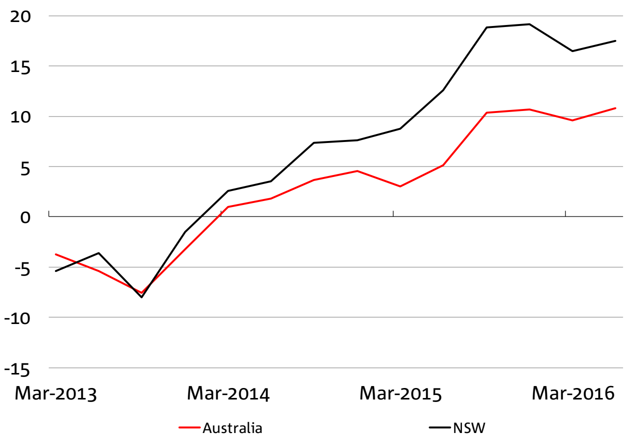


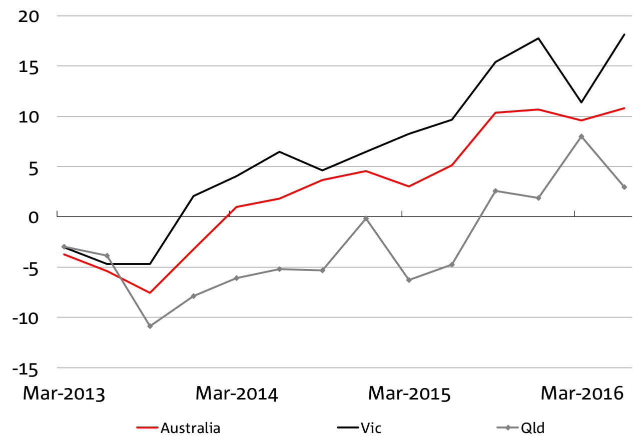
Business confidence by industry (net balance)

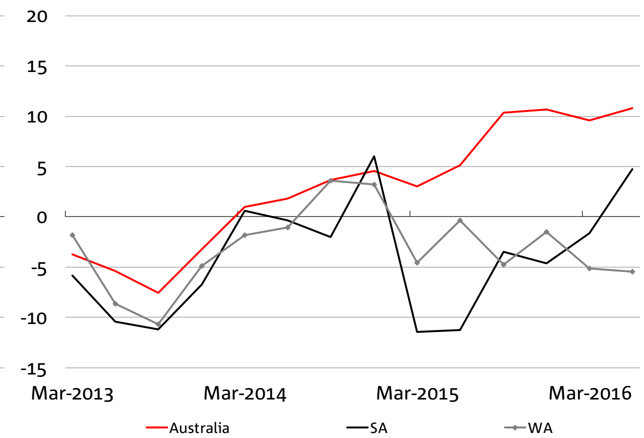


More details on states

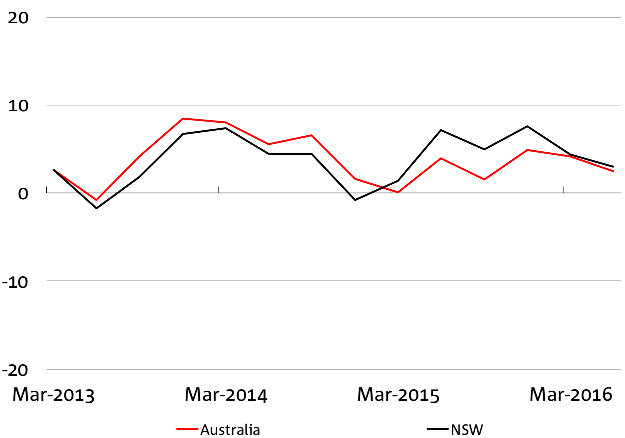
Business conditions by state (net balance)

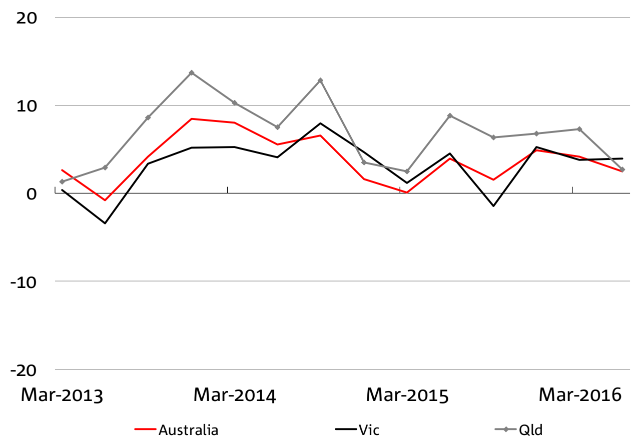


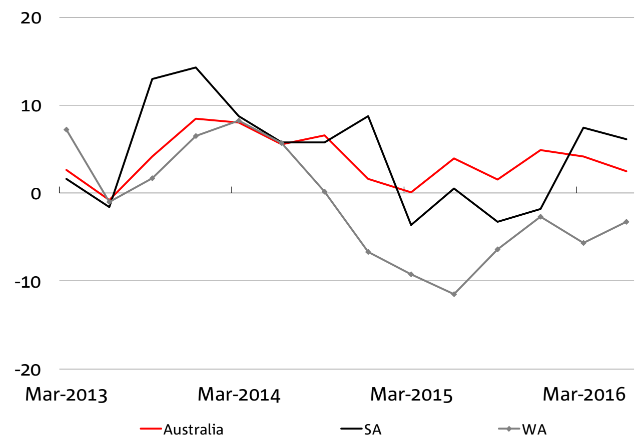




Business confidence by state (net balance)







Data appendix

	Quarterly					*Monthly*				
	2015q2	2015q3	2015q4	2016q1	**2016q2**	2016m02	2016m03	**2016m04**	**2016m05**	**2016m06**
Confidence	4	2	5	4	**2**	4	7	6	3	6
Conditions	5	10	11	10	**11**	9	12	10	10	12

	Quarterly					*Monthly*				
	2015q2	2015q3	2015q4	2016q1	**2016q2**	2016m02	2016m03	**2016m04**	**2016m05**	**2016m06**
Trading	12	18	18	14	**17**	14	18	15	18	18
Profitability	5	11	12	11	**13**	12	14	9	11	12
Employment	-1	2	3	3	**2**	1	5	5	1	4

	Quarterly [(a)]					*Monthly*				
	2016q1	2016q2	2016q3	2017q1	2017q2	2016m02	2016m03	**2016m04**	**2016m05**	**2016m06**
Conditions	10	**11**				9	12	10	10	12
Conds. next 3m	14	16	**15**							
Conds. nxt 12m	18	19	25	26	**22**					
Orders	3	**2**				3	-1	2	2	4
Orders next 3m	8	8	**6**							

(a) Quarter to which expectation applies. Business conditions next 12 months not seasonally adjusted.

	Quarterly [(a)]					*Monthly*				
	2015q3	2015q4	2016q1	2016q2	**2016q3**	2016m02	2016m03	**2016m04**	**2016m05**	**2016m06**
Capacity utilis.	80.9	81.1	81.7	**82.0**		81.5	82.0	81.3	81.9	81.3
Stocks current	3	4	6	**4**		11	2	2	4	1
Stocks next 3m	-1	0	-1	1	**1**					

(a) Quarter to which expectation applies. All data are seasonally adjusted.

Constraints on output (% of firms)*	2015q2	2016q1	2016q2
Sales & orders	51.5	54.6	**51.2**
Labour	38.8	40.5	**37.6**
Premises & plant	20.1	21.9	**21.1**
Materials	9.3	9.7	**8.3**

Main constraints on profitability (% of firms)*	2015q2	2016q1	2016q2
Interest rates	2.4	2.3	**2.6**
Wage costs	9.8	10.1	**11.2**
Labour	7.2	8.1	**7.0**
Capital	2.8	3.3	**3.2**
Demand	52.7	48.6	**47.1**
All other	24.9	27.7	**28.8**

** not s.a.*

Data appendix (cont.)

	Quarterly [(a)] 2016q1	2016q2	2016q3	2017q1	2017q2	*Monthly* 2016m02	2016m03	**2016m04**	**2016m05**	**2016m06**
Empl current	3	**2**				1	5	5	1	4
Empl next 3m	5	5	**6**							
Empl nxt 12m	3	7	11	14	**10**					

(a) Quarter to which expectation applies. Employment conditions next 12 months not seasonally adjusted.

	Mining	Manuf	Const	Retail	Wsale	Trans	Rec. & pers.	Fin. prop. & bus.	Aust.
Expected EBA growth	1.5	2.4	2.4	2.2	2.3	2.6	2.9	1.9	2.5
Productivity offset	1.6	1.1	0.8	0.9	0.8	0.7	0.9	0.6	0.9
Net EBA growth	-0.1	1.3	1.5	1.3	1.5	1.8	2.0	1.3	1.6

State Tables

	Quarterly 2015q2	2015q3	2015q4	2016q1	**2016q2**	*Monthly* 2016m02	2016m03	**2016m04**	**2016m05**	**2016m06**
Business conditions										
NSW	13	19	19	16	**18**	15	16	26	15	22
VIC	10	15	18	11	**18**	9	19	5	21	12
QLD	-5	3	2	8	**3**	15	5	1	7	2
SA	-11	-3	-5	-2	**5**	-4	4	7	7	8
WA	0	-5	-2	-5	**-5**	-8	7	-9	-12	-3

	Quarterly 2015q2	2015q3	2015q4	2016q1	**2016q2**	*Monthly* 2016m02	2016m03	**2016m04**	**2016m05**	**2016m06**
Business confidence										
NSW	7	5	8	4	**3**	4	7	7	5	7
VIC	5	-1	5	4	**4**	3	6	7	3	3
QLD	9	6	7	7	**3**	7	9	3	3	13
SA	1	-3	-2	7	**6**	4	7	1	7	6
WA	-11	-6	-3	-6	**-3**	-5	-2	4	-4	3

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