# NAB Monthly Business Survey

by NAB Group Economics

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July 2016

National Australia Bank

## Key Points:

- **Business sentiment has shown great resilience to external shocks in the July NAB Monthly Business Survey**, with firms choosing to remain focussed on the positive trends within their own business. Despite the cacophony of events – including Brexit and the recent Federal election – that have posed a risk to market sentiment in the past month or so, **firms are continuing to report positive levels of business confidence (albeit a little below average levels)**. The **business confidence index eased slightly to +4 index points in July** (from +5), which is modestly below the long-term average of +6. The resilience of business confidence appears to stem largely from the fact that firms are still experiencing very elevated levels of business conditions – noting that the Survey was also conducted prior to the RBA recent decision to cut the cash rate 25bps.
- **Business conditions dropped back as well in July, to +8 index points (from +11), but this is still quite an elevated level that sits well above the long run average of +5.** The contribution from major industries suggest a relatively mixed bag, with service sectors continuing to be the best performers. Signs of a broadening recovery in recent months have again become more obscure following sharp deteriorations in transport and wholesale – although a recovery in retail conditions was encouraging. While trading conditions and profitability have been the main driver of elevated business conditions, both of these contributed to the deterioration during the month. **Encouragingly, the employment component managed to hold onto the gains seen in June, suggesting ongoing employment growth.** Inflation measures in the Survey generally stayed soft, although there was a surprise spike in retail prices.
- For a while now, the NAB Business Survey has provided a relatively consistent message on the health of the Australian economy. It continues to show a steady recovery in non-mining activity, with the services sectors clearly leading the way. **But while the Survey points to a reasonably upbeat outlook for the near to medium-term, longer term risks are becoming increasingly apparent, particularly going into 2018 as resource exports start to level off and dwelling construction turns negative.** These headwinds may require additional policy action to support growth, especially if the RBA hopes to see inflation return to be within its target band. Both global and domestic disinflationary pressures are expected to keep CPI inflation below the target band for an extended period, while structural shifts in the economy and modest economic growth may keep the labour market under pressure. To stabilise the unemployment rate (at around 5 ½%) we expect the RBA will feel the need to provide further medium term support through two more 25bp cuts in May and August 2017 (to a new low of 1%). And thereafter raises the prospect of the RBA considering the use of non conventional monetary policy measures.

**Table 1: Key monthly business statistics***

| | May 2016 | Jun 2016 | **Jul 2016** | | May 2016 | Jun 2016 | **Jul 2016** |
|---|---|---|---|---|---|---|---|
| | *Net balance* | | | | *Net balance* | | |
| Business confidence | 3 | 5 | **4** | Employment | 1 | 4 | **4** |
| Business conditions | 10 | 11 | **8** | Forward orders | 2 | 4 | **2** |
| Trading | 18 | 17 | **16** | Stocks | 4 | 1 | **2** |
| Profitability | 12 | 12 | **7** | Exports | 1 | 2 | **3** |
| | *% change at quarterly rate* | | | | *% change at quarterly rate* | | |
| Labour costs | 0.7 | 0.9 | **0.7** | Retail prices | 0.5 | -0.2 | **0.8** |
| Purchase costs | 0.6 | 0.7 | **0.3** | | *Per cent* | | |
| Final products prices | 0.3 | 0.3 | **0.3** | Capacity utilisation rate | 81.9 | 81.2 | **81.5** |

* 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 25 to 29 July, covering around 400 firms across the non-farm business sector.

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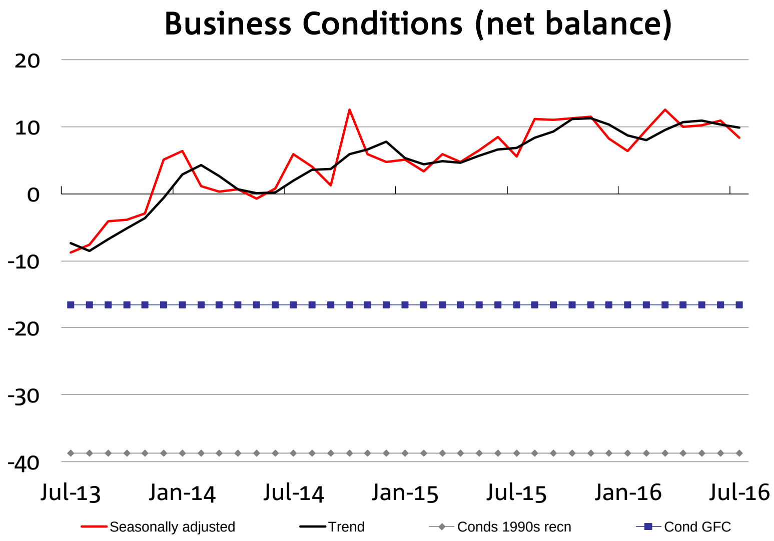
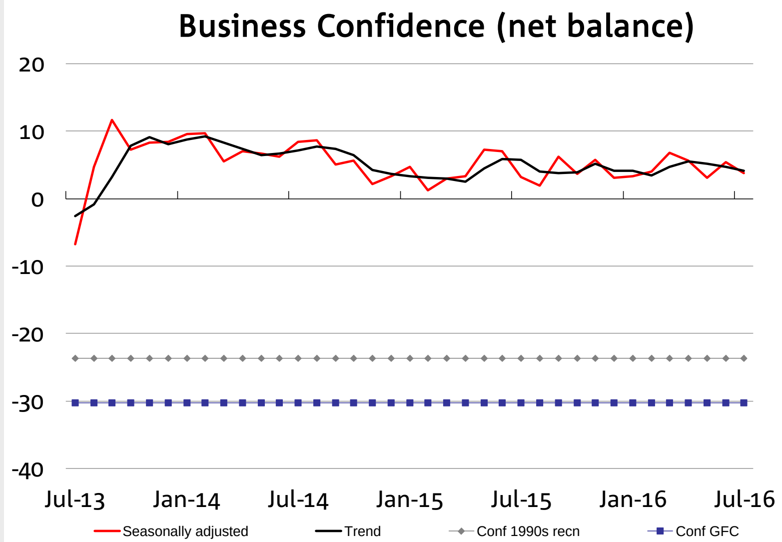
# Analysis

- Business conditions remain quite elevated despite easing back in the month of July, suggesting the near-term outlook for the non-mining economy remains positive. The index decreased by 3 points, to **+8 index points** in the month, which is **around is still above the series long-run average** of +5. But while conditions remain elevated, the deterioration has eroded many of the recent signs that the non-mining recovery was broadening beyond the long outperforming services sectors. In terms of the components that make up conditions, trading conditions and profitability are largely underlying elevated business conditions, but both deteriorated in the month. In contrast, employment conditions – while at a lower level – held on to last months gains.
- **Signs of a broadening recovery in recent months have again become more obscure following sharp deteriorations in transport and wholesale (both down 18 points) – although a recovery in retail conditions (up 12) was encouraging.** Other than retail, construction and personal services were the only industries to see a (modest) improvement (both up 1). **The largest deterioration was seen in mining** (down 70), while finance/ property/ business (FPB) services also weakened (down 3). In trend terms, mining is the only industry to report negative business conditions in July (-14), but conditions in most other industries are relatively subdued – especially in retail and wholesale (both at +1). Personal services and FPB services are the main standouts, with trend conditions at 20 and 15 index points respectively.
- **Business confidence continues to show resilience despite the number of external factors (Brexit, Federal election and more), which had threatened to derail it.** Despite easing in July, the business confidence index remains positive (down 1 point to +4 index points), although this is modestly below the series long run average.
- **None of the industries in the Survey reported negative business confidence in July,** although half of them did report lower confidence levels than in June. Surprisingly, the largest improvement in trend terms was in mining (up 8), despite a sharp decline in business conditions. Wholesale was the only other industry to improve (up 2), again despite a sharp fall in conditions. In contrast, construction, retail, transport and FPB services all saw confidence ease by 1 point. In trend terms, construction (+12) was the most confident, followed by personal services and FPB services (both +5). In contrast, transport is now weakest (0) following the surprise jump in mining.
- There were some large fluctuations in the results by state. In trend terms, however, conditions softened in **NSW (down 5 to +16), although it is still the strongest mainland state, while Queensland improved the most of the mainland states (up 4 to +7).** Conditions remain positive in all states excluding WA. On confidence, Qld weakened in seasonally adjusted terms, but movements were relatively mild across all the states in trend terms. NSW was most confident along with Queensland, while WA is still least confident in trend terms (see p8).

## Conditions ease, but still elevated




## Confidence positive, despite uncertainty

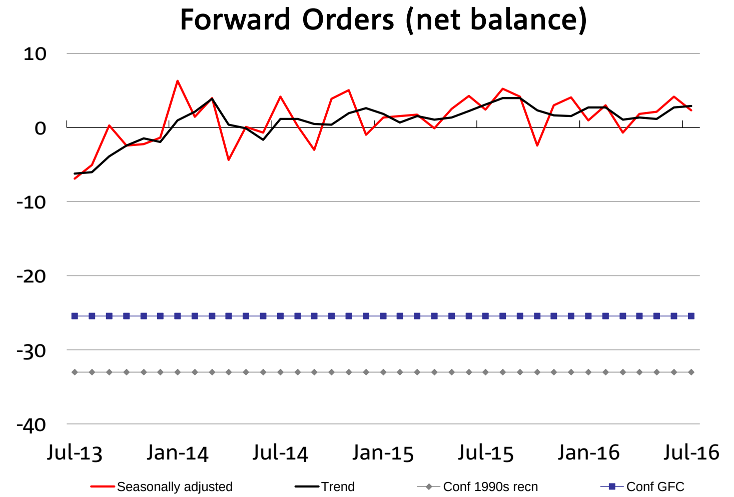



Excluding normal seasonal changes, how do you expect the business conditions facing your industry in the next month to change?

# Other activity indicators

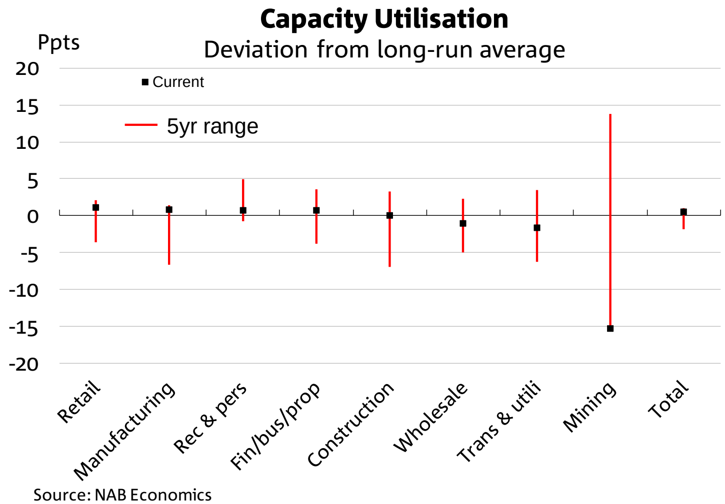
- The near-term outlook continues to look reasonably good according to some of the Survey's leading indicators. The **forward orders** index eased a little, but has remained in positive territory for 8 of the past 9 months. At +2 index points, the index was above the long-run average of zero points, which suggests good near-term prospects for activity – consistent with solid levels of business conditions**.** Orders were lower for most industries in the month, but were only negative in mining and retail.
- Most industries saw a decline in forward orders in July, although construction (up 7) and FPB services (up 1) were exceptions. **The fall in orders was most pronounced in mining (down 11)**, followed by manufacturing (down 9) and retail (down 6). Nonetheless, orders are still positive in most industries, outside of mining and retail. **Trend orders are currently strongest in construction (at +7), consistent with the record high pipeline of residential projects and still elevated levels of residential approvals.** After construction, manufacturing has the next highest trend orders (at +6, despite dropping back in the month), suggesting that the lagged effect from previous currency depreciation is helping the industry – despite significant structural headwinds. In contrast, orders remain weakest for mining firms in trend terms (-7).
- NAB's measure of **capacity utilisation** partially recovered from last months drop, helping to support the long running positive trend – rising steadily since mid-2013. Utilisation rates rose to 81.5% (from 81.2%), which is a little above the long-run average of 81%. The increase is consistent with elevated levels of trading conditions, although both capex and employment remained positive in the month (adding to capacity). Only half of the industries saw an improvement, with manufacturing rising the most in July, up 3.8 ppts. In contrast, mining capacity utilisation fell the most (down 8.1 ppts), consistent with the sharp deterioration in trading conditions, and appears to have had a noticeable effect on capex (down 24 points) and employment (down 36 points). Utilisation rates are now above long-term average levels for a little more than half of the industries (see Chart).
- The capital expenditure index eased modestly in the month, but is still above the long-run average for the series. At +8 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 – which is the only industry to have a negative capex index in the NAB Survey this month (-2). In trend terms, capex in transport/utilities was the highest (+18 points) and construction was lowest (-1 points), which may reflect the impact of rapidly falling mining investment/engineering construction.
- Elsewhere in the survey, **cash flow** (not seasonally adjusted) was the strongest in trasport & utilities, which is a little surprising given the deterioration in business conditions for the industry. In contrast, cash flows were weakest in mining, but have been volatile.

## Sales orders still positive




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

## Capacity utilisation by industry

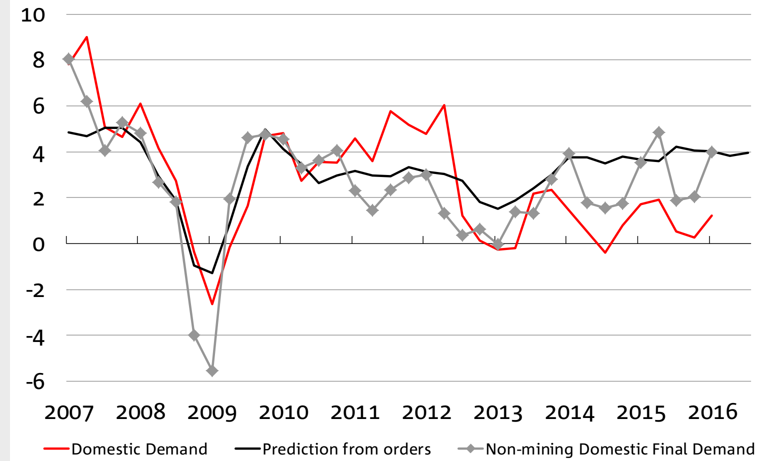



Full capacity is the maximum desirable level of output using existing capital equipment.

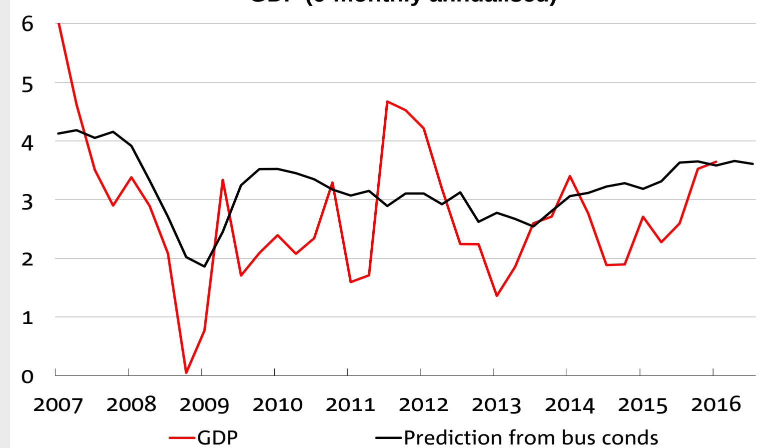
# Implications for forecasts For more information see latest Global & Australian Forecasts

- Brexit has had less impact on the global economy than many feared. Financial markets are generally either back to pre-referendum levels or even stronger, and the direct economic fall-out looks like being largely restricted to a UK recession and modest spill-over to European trading partners. Having dodged yet another bullet, the global economic upturn continues along at its sub-trend pace with only a few inconclusive signs that things are finally about to get better. We have marked down our US forecasts in the wake of disappointing second quarter data but East Asia is doing slightly better and the outcome is 2016 forecast global growth stays at 2.8%. Inflation generally remains sub-target, central banks have used up much of their policy ammunition (although very unorthodox measures like "helicopter money" remain) and the structural factors that have weighed on global growth remain. China and India are driving more than half of global growth, the former by returning to time-honoured pump priming measures that pile up debt and the latter by printing statistics that many view as erring on the side of optimism in measuring GDP.
- Australian economic growth is expected to remain resilient at 2.9% in 2016 and 2017, despite significant variation across industries and states. **However the risks to the outlook going into 2018 are becoming increasingly apparent, as LNG exports flatten off at a high level and the dwelling construction cycle turns down.** Against these headwinds, the economy may require additional policy action to support growth, especially if the RBA hopes to see inflation return to within its 2-3% target band. Both global and domestic disinflationary pressures are expected to keep CPI inflation below the target band for an extended period, while structural shifts in the economy and modest economic growth risk upward pressure on the unemployment rate. **We now expect the RBA will need to provide further support through two more 25bp cuts in May and August 2017 (to a new low of 1%)**, which should be enough to stabilise the unemployment rate at just over 5½% and prevent economic growth from dropping below our forecast of 2.6% in 2018. Monetary policy deliberations may then turn to the possible use of non-conventional policy measures if the outlook deteriorates further.
- 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 Q2 and July trend orders to our model suggests steady domestic demand growth for the next 6 months.
- 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 the next 6 months.**

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



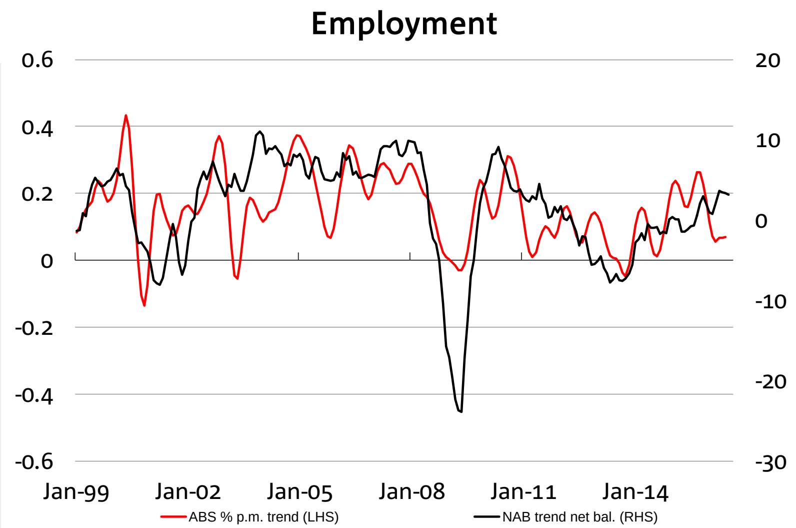

Business conditions (change & level) as an indicator of GDP (6-monthly annualised)



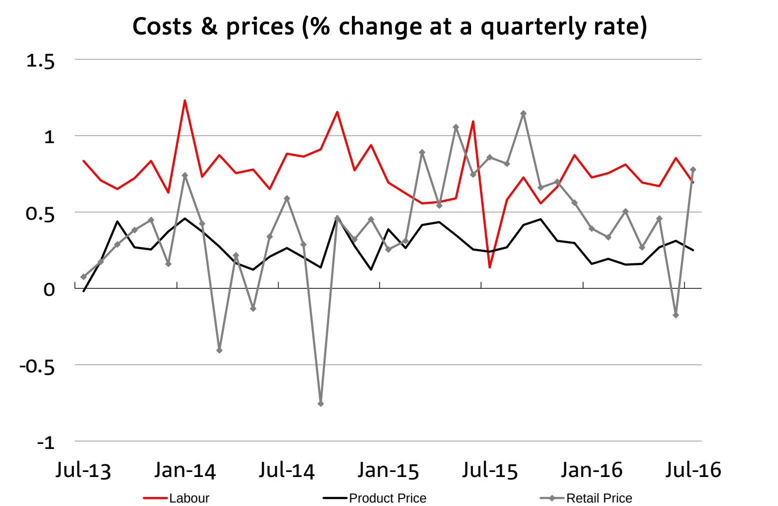
# Costs, prices & labour

- **Employment conditions held on to the gains recorded last month**, suggesting further employment growth in the near term. The employment index was unchanged at +4 index point, which is above the long-run average for the series. Recent outcomes hint at an annual job creation rate of around 212k (around 18k per month) in coming months, which should be sufficient to lower the unemployment rate further, with all else unchanged, although this compares to a trend increase of just 8.3k in June according to the ABS.
- Despite the solid result, more than **half of the industry groupings in the Survey recorded weaker employment conditions** this month. The biggest deterioration was in mining (down 36) – more than offsetting a sharp increase last month – and manufacturing (down 9). In contrast, employment conditions improved the most in construction (up 19), followed by wholesale (up 8). In trend terms, the employment index was still most negative for mining (-14 points), followed by wholesale (-4 points). The strongest employment demand (trend) was in retail and FPB services (both +8).
- **Labour cost growth (a wage bill measure) eased back slightly in the month, indicating that wage pressures remain relatively contained** at 0.7% (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 (at 1.5%), but still falling in mining (-0.4%).
- **Growth in purchase costs was down in the month as well, to 0.3% (at a quarterly rate, from 0.7%).** This outcome was well below the long-run average, suggesting pass-through from currency depreciation remains elusive. Subdued inflation pressures have been a common theme globally, but higher purchase costs had been expected to some degree given anticipated currency effects. Growth in purchase costs decelerated the most in wholesale (down 1.8 ppts), followed by mining (down 1 ppts). Construction was the only industry to see an increase (up 0.7%), which might reflect tighter capacity resulting from the residential construction boom. Overall, purchase cost pressures were highest in construction (0.7%), but softest in mining (-1%).
- **Final product prices growth in June was unchanged at just 0.3% (a quarterly rate), although retail price growth spiked up to 0.8%** – above the upper bound of the RBA's inflation target – which is counter to recent trends and may simply reflect volatility. Elsewhere, changes in final prices growth were quite mixed across industries, although most recorded increasing prices. Mining prices fell 1.4%, while price growth was highest in manufacturing (0.9%) – suggesting some pass through of higher labour costs. Final prices inflation is not keeping pace with the rise in input costs, which may have contributed to the drop in profitability this month.

## Employment maintained recent gains




## Price pressures still subdued

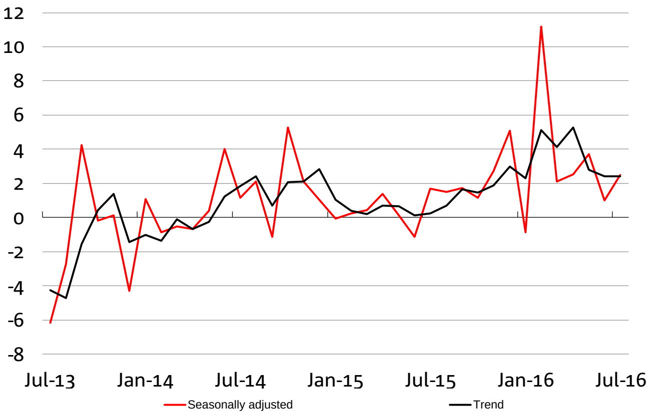



Based on respondent estimates of changes in labour costs and product prices. Retail prices are based on retail sector product price estimates.

# More details on business activity

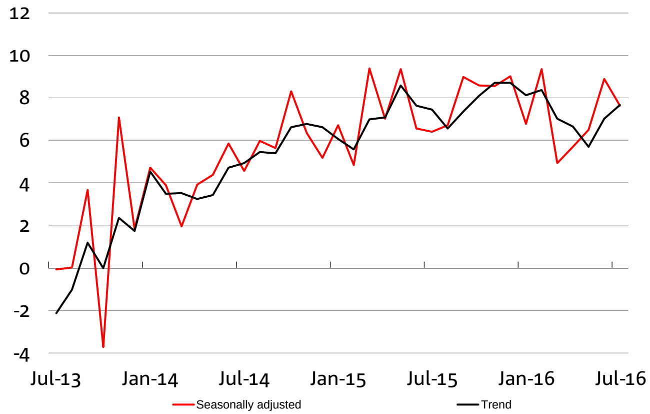
## Firms re-stocking, but at a modest pace

Stocks (net balance)



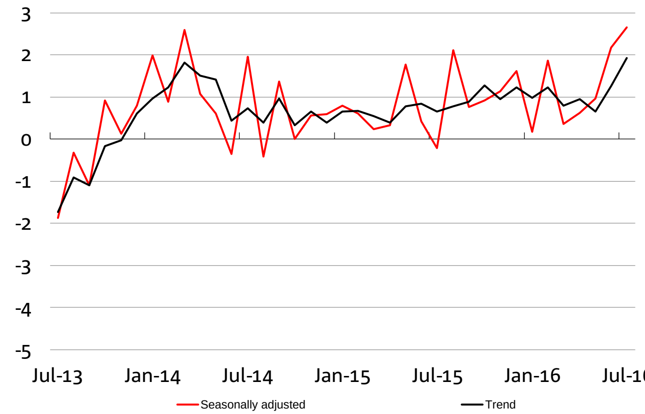

## Capex holding up

Capital Expenditure (net balance)




## Exports on the rise

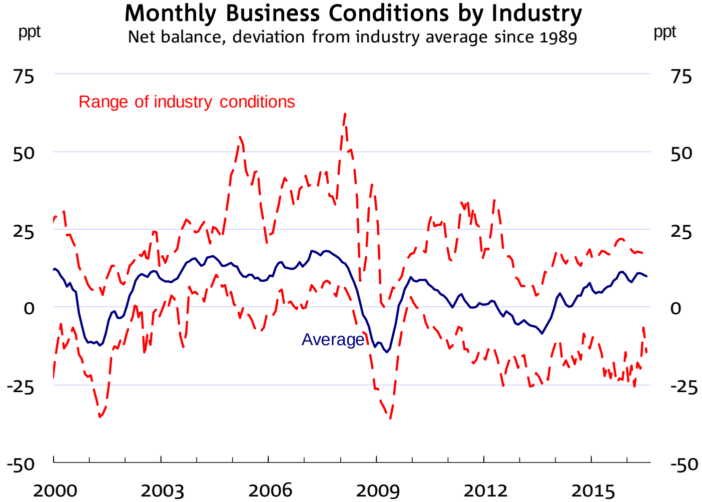
Exports (net balance)




## Range of conditions widened following a big deterioration in wholesale and transport

Monthly Business Conditions by Industry

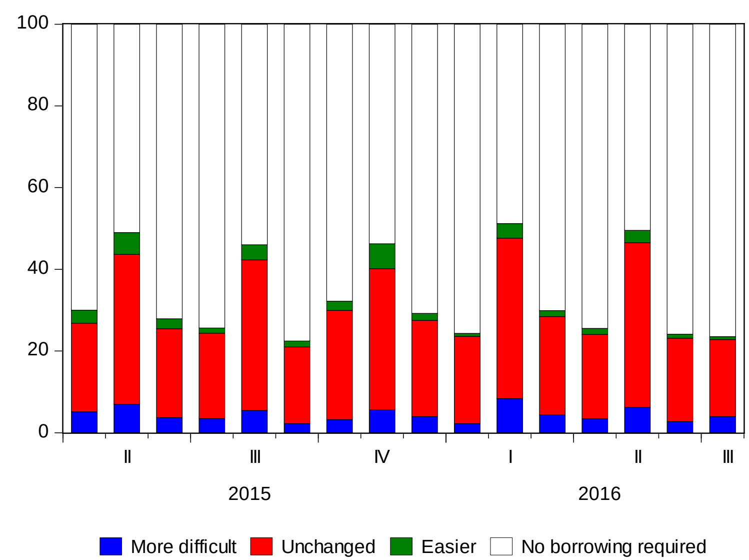
Net balance, deviation from industry average since 1989




Source: NAB

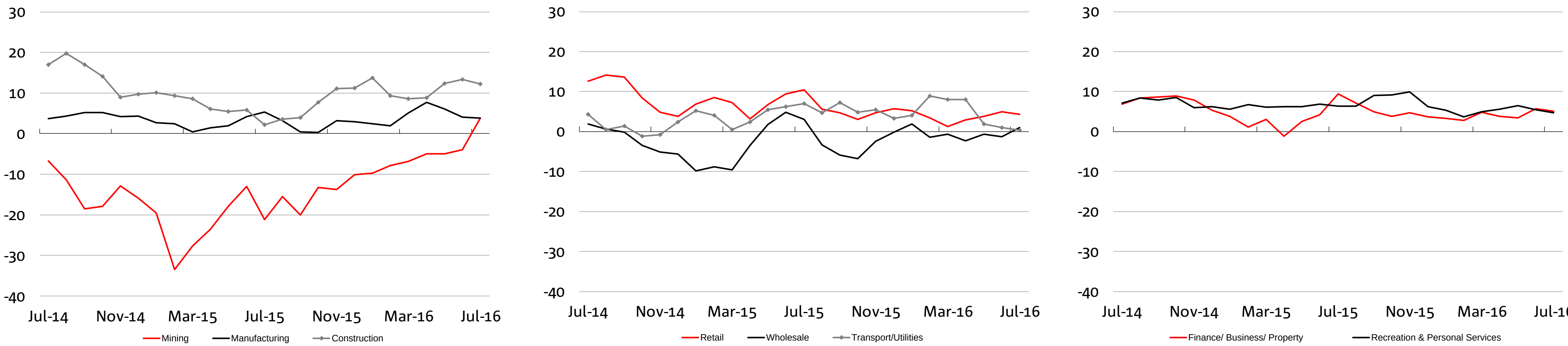
## Borrowing conditions deteriorated in the past 3 months, and demand for credit fell

Borrowing conditions (% of firms)

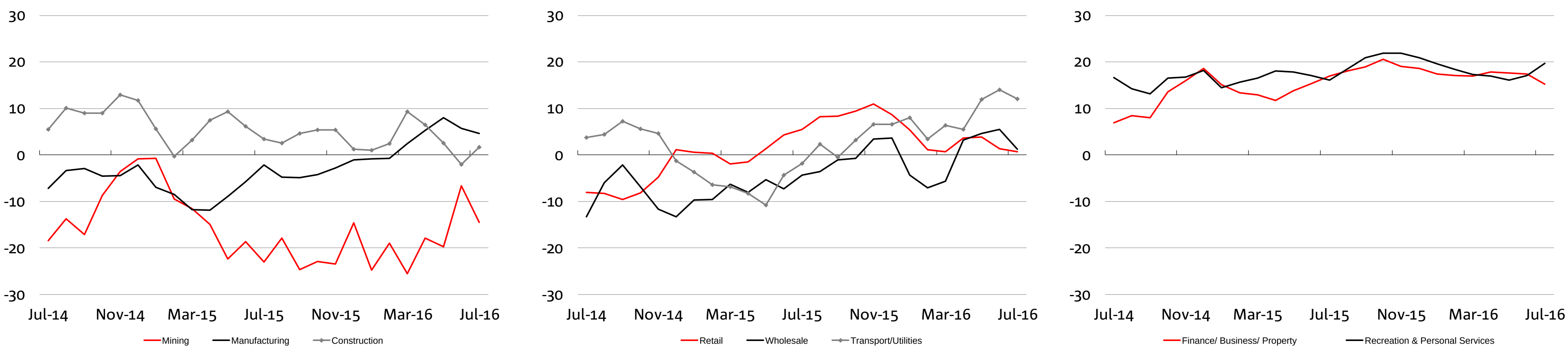


# More details on industries

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

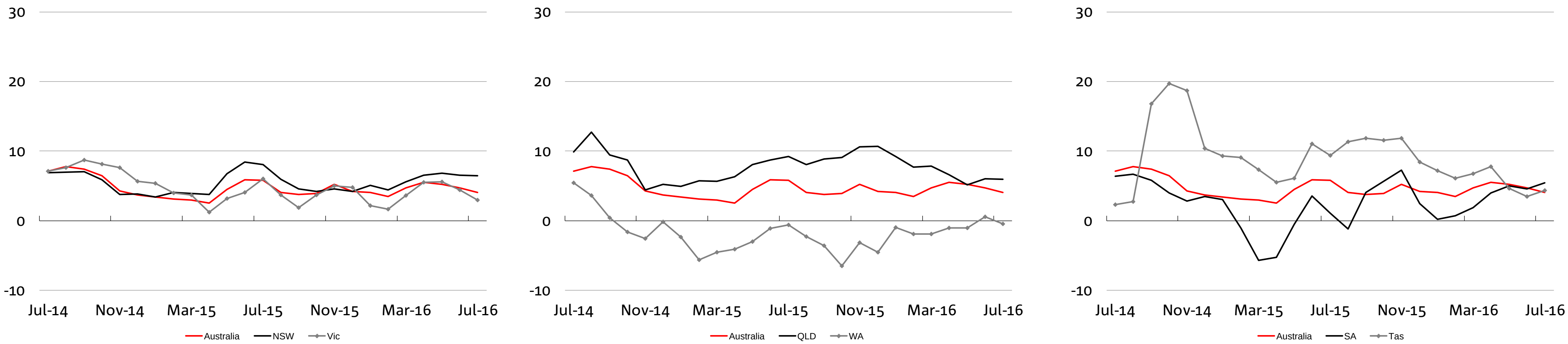



## Business conditions by industry (net balance): 3-month moving average

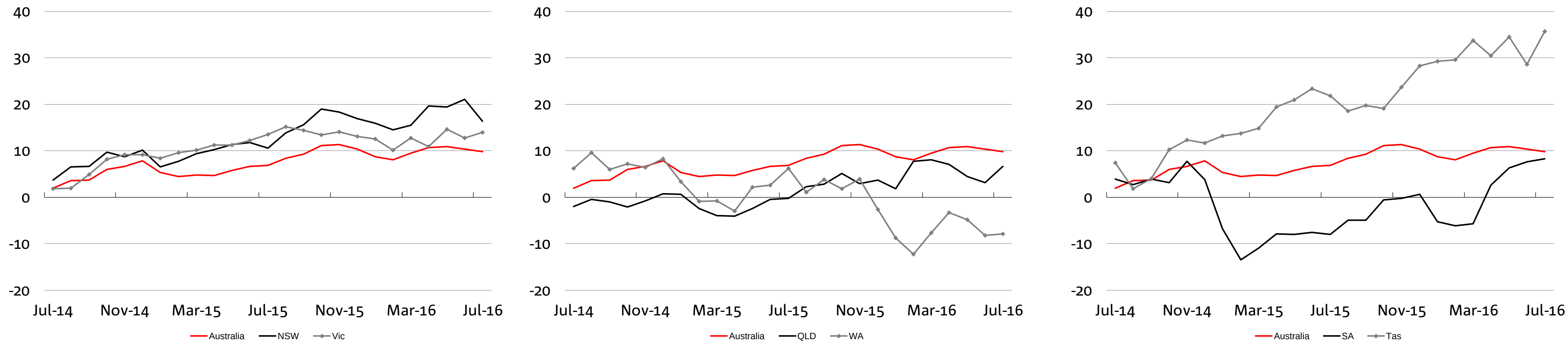


# More details on states

## 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)

| **Jul-2016** | Mining | Manuf | Constn | Retail | Wsale | Tran. & utils | Rec. & pers. | Fin. prop. & bus. | Australia |
|---|---|---|---|---|---|---|---|---|---|
| Labour costs: current | -0.4 | 1.5 | 0.9 | 0.3 | 0.5 | 0.7 | 0.6 | 0.6 | 0.7 |
| Labour costs: previous | -1.3 | 1.0 | 0.7 | 0.5 | 0.8 | 0.4 | 0.8 | 1.1 | 0.9 |
| Labour costs: change | 0.9 | 0.5 | 0.2 | -0.2 | -0.3 | 0.3 | -0.2 | -0.5 | -0.2 |
| | | | | | | | | | |
| Prices (final): current | -1.4 | 0.9 | 0.7 | 0.8 | 0.5 | 0.7 | 0.2 | -0.2 | 0.3 |
| Prices (final): previous | -0.4 | 0.2 | 0.0 | -0.2 | 1.3 | -0.2 | 0.3 | 0.6 | 0.3 |
| Prices (final): change | -1.0 | 0.7 | 0.7 | 1.0 | -0.8 | 0.9 | -0.1 | -0.8 | 0.0 |
| | | | | | | | | | |
| Purchase costs: current | -1.0 | 0.6 | 0.7 | 0.4 | 0.0 | 0.4 | 0.5 | 0.0 | 0.3 |
| Purchase costs: previous | 0.0 | 0.7 | 0.0 | 0.6 | 1.8 | 1.3 | 0.6 | 0.2 | 0.7 |
| Purchase costs: change | -1.0 | -0.1 | 0.7 | -0.2 | -1.8 | -0.9 | -0.1 | -0.2 | -0.4 |

## Key state business statistics for the month

| **Jul-2016** | **Monthly Business Survey Data: By State** | | | | | | |
|---|---|---|---|---|---|---|---|
| | **NSW** | **VIC** | **Qld** | **SA** | **WA** | **Tasmania** | **Australia** |
| Bus. conf.: current | 7 | 3 | 3 | 3 | 1 | 5 | 4 |
| Bus. conf.: previous | 6 | 3 | 12 | 6 | 3 | 6 | 5 |
| Bus. conf.: change | 1 | 0 | -9 | -3 | -2 | -1 | -1 |
| | | | | | | | |
| Bus. conf: current - Trend | 6 | 3 | 6 | 5 | 0 | 4 | 4 |
| Bus. conf: previous Trend | 7 | 4 | 6 | 5 | 1 | 3 | 5 |
| Bus. conf.: change -Trend | -1 | -1 | 0 | 0 | -1 | 1 | -1 |
| | | | | | | | |
| Bus. conds: current | 12 | 8 | 11 | 9 | -9 | 40 | 8 |
| Bus. conds: previous | 21 | 13 | 2 | 9 | -3 | 26 | 11 |
| Bus. conds: change | -9 | -5 | 9 | 0 | -6 | 14 | -3 |
| | | | | | | | |
| Bus. conds: current -Trend | 16 | 14 | 7 | 8 | -8 | 36 | 10 |
| Bus. conds: previous -Trend | 21 | 13 | 3 | 8 | -8 | 29 | 10 |
| Bus. conds: change -Trend | -5 | 1 | 4 | 0 | 0 | 7 | 0 |

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