**National Australia Bank**

**Embargoed until: 11.30am Tuesday 12 February 2013**

# Monthly Business Survey — January 2013

**Business confidence hangs on to gains made last month on reduced global fears. Business conditions improve a touch but are still poor. Signs that previously stronger industries are being dragged down by weakness elsewhere. Capacity utilisation now lowest since 2001 and forward orders remain weak. Floods in north-east Australia do not appear to have had major impacts on activity. GDP forecasts unchanged – rate cuts still coming but marginally delayed.**

- Business confidence was broadly steady in January, after recovering strongly in December from very poor levels. That recovery mainly reflects external factors, including the rally in global equity markets and generally better activity in China, as well as recent RBA cuts. However confidence remains below long-run average levels.
- In January, business conditions improved somewhat but the net balance statistic remained negative – implying continuing below-trend growth. While profitability and trading conditions posted solid gains in the month, employment conditions weakened considerably. Forward orders were little changed at poor levels suggesting little upward momentum. A similar story is told by our wholesale based leading indicator (see page 3). Capacity utilisation fell further and is now at its lowest level since 2001. Also credit demand remains near record lows.
- Business conditions were generally better across interest sensitive industries in January, but fell heavily in mining. That, however, returns mining to levels reported in the Quarterly Business Survey for December (and hence it is hard to separate out any impact of the Queensland floods). Recent surveys have highlighted the gradual deterioration in conditions in recreation & personal services and transport & utilities (previous non-mining strong performers). This trend continued in January. It may well be that continuing weakness elsewhere is now spreading.
- Overall, the survey implies underlying demand growth in the March quarter of around 2¾% – a slight improvement on expectations for the December quarter but still below trend.
- Labour costs growth softened significantly in January – in line with a sharp deterioration in employment conditions – suggesting that wage pressures are unlikely to fuel near-term prices growth. Consistent with this, final product price inflation was flat and purchase costs growth eased to a subdued level. Retail prices declined implying further discounting in response to still very poor conditions in this industry.

**Implications for NAB forecasts** (See latest Global and Australian Forecasts released on 29 January 2013):

- Little change to latest global and Australian forecasts for activity. However, we remain more bearish than the RBA on the near-term outlook; we see GDP growth of 2.0% over 2013 (RBA 2-3%) and 3.1% over 2014 (RBA 2¼-3¼%).
- We still see the need for the RBA to cut by 75 bps this year – but have marginally delayed the timing. RBA appears now focused on non-mining recovery and business investment. With the labour market still holding up and the RBA still looking for the impact of past cuts, we have delayed the next cut to May (but capex data critical). We have tentatively put additional rate cuts in June and November.

**Key monthly business statistics***

| | Nov 2012 | Dec 2012 | **Jan 2013** | | Nov 2012 | Dec 2012 | **Jan 2013** |
|---|---|---|---|---|---|---|---|
| | *Net balance* | | | | *Net balance* | | |
| Business confidence | -9 | 2 | **3** | Employment | -5 | -3 | **-7** |
| Business conditions | -5 | -5 | **-2** | Forward orders | -10 | -5 | **-4** |
| Trading | -2 | -5 | **1** | Stocks | -4 | -2 | **-2** |
| Profitability | -9 | -8 | **-1** | Exports | -3 | -4 | **-2** |
| | *% change at quarterly rate* | | | | *% change at quarterly rate* | | |
| Labour costs | 0.7 | 0.9 | **0.4** | Retail prices | -0.2 | 0.4 | **-0.2** |
| Purchase costs | 0.6 | 0.4 | **0.2** | | *Per cent* | | |
| Final products prices | 0.1 | 0.0 | **0.0** | Capacity utilisation rate | 79.5 | 79.6 | **79.0** |

* 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 25 January to 4 February, covering over 400 firms across the non-farm business sector.

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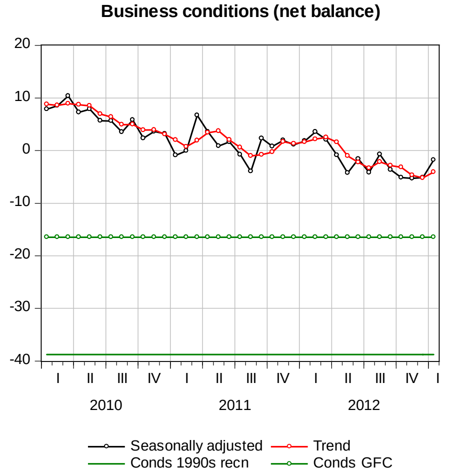
Next release:
12 March 2013 (February monthly)

# Analysis

**Business conditions** improved modestly in January – up 3 to -2 points – though they remained well below the series average (of +5 points since 1997), implying a continuation of weak business activity in the New Year. Nonetheless, wholesale and manufacturing conditions improved notably. Conditions in mining deteriorated very sharply in January but really only returns business conditions reported in the broader Quarterly Business Survey for Q4 2012. As such it is hard to estimate the impact of the recent flooding in Queensland and NSW. Early reports indicate that mining flood damage has been largely confined to the rail network supplying Gladstone, rather than the mines and ports, suggesting interruptions will only be temporary. Conditions also deteriorated in recreation & personal services and transport & utilities; it appears that conditions in these industries, which have generally outperformed since mid 2009, are beginning to soften due to persistently weak (and in some cases, recessed) conditions in other industries. Forward indicators of demand remain poor implying little improvement in near-term activity.

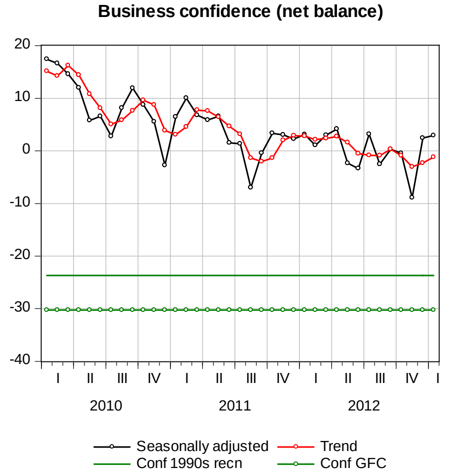
**Business confidence** improved marginally in January – up 1 point to +3 index points – after recovering strongly in December. Nonetheless, the overall level of confidence is soft when compared to history (long-run average for this series of +5 points since 1989). While in aggregate, it appears that recent flooding in the north-eastern states has had little impact on sentiment. Interestingly, most industries reported a deterioration in confidence in January, but sharp improvements in mining and wholesale confidence were sufficient to lift the overall level. More broadly, with domestic activity apparently still lacklustre in early 2013, improved sentiment over the past two months is likely to have been driven by external factors, including the rally in global equity markets and generally better activity indicators in China as well as prospects of new stimulus in Japan.

## Conditions better but still trending below average




*Average of the indexes of trading conditions, profitability and employment.*

## Confidence holds up in New Year




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

**Business conditions by industry.** Business conditions rebounded strongly in wholesale in January, more than unwinding a sharp deterioration in December. Nonetheless, overall conditions remain challenging for this industry. The performance of manufacturing and finance/ business/ property also improved in January, with the latter probably benefiting from generally improved borrowing conditions and the recent rally in equity prices. In contrast, mining conditions deteriorated sharply in January; albeit it is hard to determine if this reflects a return to recent fundamental downward trends or an impact from flooding in Queensland and NSW. Conditions also weakened notably in recreation & personal services and transport & utilities, though these industries continued to outperform the majority of industries. According to the survey, mining was the worst performing industry in January.

**Business conditions by state.** Conditions deteriorated moderately in Queensland and NSW – it is possible that activity has been negatively impacted by recent flooding in isolated regions within these states, though it is too soon to see the full extent of flood impacts on business in the January survey. While some businesses will be badly affected as a result, the overall impact of the most recent floods on economic activity will be far less severe than it was in the summer of 2010-11. Conditions improved very sharply in SA and WA in January, more than offsetting heavy declines in December. The range of business conditions across the mainland states narrowed in January, with indices ranging from -5 in NSW to zero points in WA.

# Analysis (cont.)

**Business confidence by industry.** Confidence improved significantly in mining and wholesale in January, but softened in all other industries leaving the overall level of confidence up marginally. Nonetheless, when combined with a considerable strengthening in confidence in nearly all industries in December, the overall level of confidence remains much better than its recent lows in November 2012. Confidence readings are also much less diverse across industries, ranging from a low of -3 points in wholesale, and a high of +7 points in finance/ property/ business. Confidence in wholesale and manufacturing – the two least optimistic industries – is likely to be weighed down by the weakness in consumer dependent sectors like retail, which tends to be a bellwether for demand for these industries. In contrast, confidence in finance/ property / business – the most optimistic industry – is likely to be supported by better financial market conditions and the general outlook for lower borrowing costs.

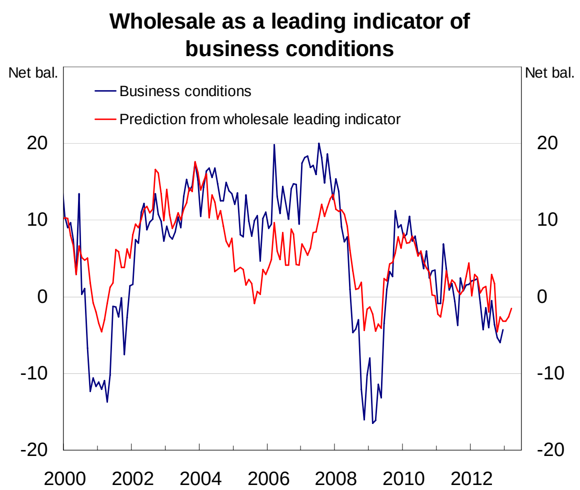
**Business confidence by state.** Confidence strengthened modestly in Victoria and SA, but it appears that recent flooding may have weighed on sentiment in Queensland. Confidence also softened in WA, though it remained strong relative to the other states, with a reading of +10 index points. Confidence was broadly similar across all other states, ranging from +1 in both Queensland and Tasmania (the latter on a small sample) to +3 in SA.

### Wholesale: Signalling continued softness in the domestic economy?

The weakness in wholesaling that has persisted for the best part of three and a half years has been accentuated over recent months. While conditions did recover solidly in January, trend business conditions in wholesaling remained very poor, at just -12 points.

Based on historical relationships, wholesale conditions appear to be a reasonably good forward indicator of overall business conditions – certainly there is strong statistical evidence of a leading relationship (Granger causality). Our analysis suggests that if the January reading for wholesale conditions (-8) were to continue though the remainder of Q1 2013, overall business conditions could be expected to remain poor, averaging just -3 index points over the quarter. That, in turn, is suggestive of an economy still running well below trend.

### *Wholesale weakness a worry*




*Indicator = f(business conditions_wsl, business conditions_wsl(-1 to -4), ar(1), ar(3))*

The **forward orders** index was marginally better in January – up 1 to -4 index points – though remained weak overall, pointing to further softness in trading activity. The pick up in orders largely reflected a sharp rebound in wholesale orders, aided by soft rises in recreation & personal services and finance/ business/ property orders. Orders eased back in all other industries. Another sign that domestic demand is poised to remain soft in the near term is the low level of **capacity utilisation** that has persisted for much of the past year. In January, the level of utilised capacity fell to 79.0% – marginally below the lowest level recorded during the GFC and the lowest overall level since July 2001. Utilised capacity was particularly low in manufacturing and below the national average in retail, consistent with the particularly poor level of activity in these industries. In contrast, utilised capacity held up reasonably well in transport & utilities. The **stocks** index – also a good indicator of current demand – was unchanged at a below average -2 points in January, providing little indication of an expected improvement in near-term demand. Nonetheless, when combined with a general improvement in trading conditions in the month, the stocks index implies that businesses are maintaining inventory levels, rather than allowing them to decline.

The **capital expenditure** index ticked up in January – up 1 point to +2 index points – though remained below the long-run average level of +5 points. The capital expenditure index remained highest in mining (+19), followed by retail (+11) and recreation & personal services (+9), while it was softest in manufacturing (-18), construction (-12) and wholesale (-6).

# Analysis (cont.)

Based on forward orders for the December quarter, the survey implies 6-monthly annualised demand growth was a subdued 2¼% in the December quarter. If we assume monthly forward orders for January continue at a similar level through the remainder of the March quarter, the survey implies growth will strengthen to around 2¾% in the March quarter.

Similarly, business conditions for the December quarter imply 6-monthly annualised GDP growth of just 2% in the December quarter. Assuming January business conditions persist through the remainder of the March quarter, the survey implies GDP growth will pick up to around 3¼% in the March quarter.

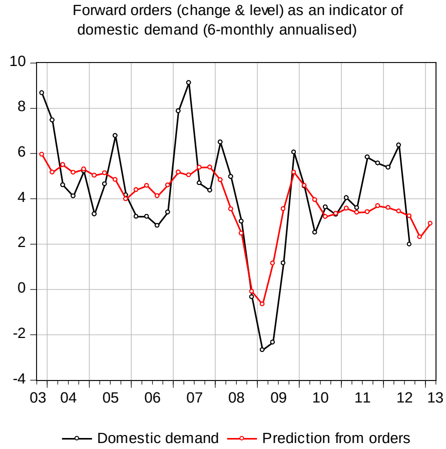
Elsewhere in the survey, cash flow (not seasonally adjusted) was strongest in recreation & personal services and finance/ business/ property, and weakest in mining.

**Labour costs** growth (a wages bill measure) softened markedly in January, down 0.5 ppts to 0.4% (at a quarterly rate). The softness in labour costs growth is consistent with a sharp pull back in employment conditions. At 0.4%, labour costs growth is below the series long-run average level (of 1.1% since 1989); suggesting wage pressures are unlikely to fuel near-term prices growth. The softening in costs growth was very apparent in construction and recreation & personal services, while finance/ property/ business was the only industry to report a strengthening in growth. Overall, labour costs growth was strongest in finance/ business/ property (1.6%; quarterly rate) and transport & utilities (1.1%) in January, and weakest in construction (-0.5%) – consistent with a very sharp drop in employment conditions – and recreation & personal services (-0.2%)

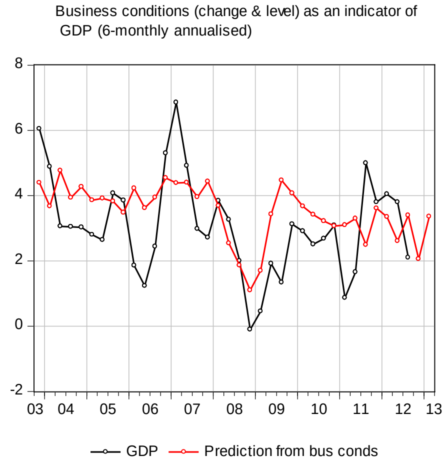
No **price inflation** was recorded for a second consecutive month in January. The softness in inflation implied by this survey is consistent with official ABS inflation data. Overall, the lack of price pressure implied by the survey is in line with soft activity in the economy (as highlighted in official retail sales, labour force, building activity data etc). Prices fell modestly in retail in January – consistent with very poor trading in this industry – while it was marginally softer in mining. In contrast, price growth strengthened in wholesale and recreation & personal services. Price deflation was most rapid in mining (-0.9%), while inflation was strongest in recreation & personal services (+0.6%).

**Purchase cost** pressures softened in January (down 0.2 ppts to 0.2%; at a quarterly rate). The weakening in purchase costs growth reflected a softening in mining and recreation & personal services costs growth, which was partly offset by stronger finance/ business/ property and construction costs growth. Purchase costs growth was strongest in construction and transport & utilities (both 0.7%; quarterly rate) and weakest in manufacturing (-0.2%) and mining (-0.1%).

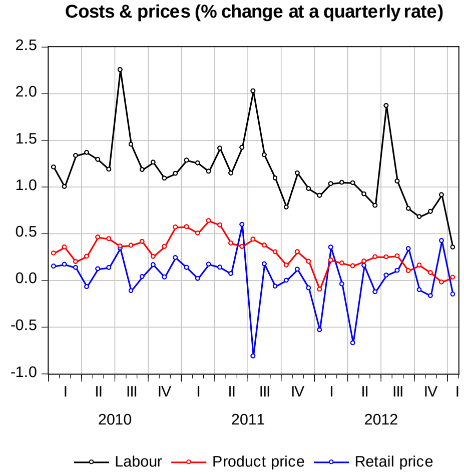
## *Demand growth to improve in Q3 but remain soft*




## *GDP (ex coal) growth to weaken in Q4, before ticking up in early 2013*




## *Labour cost pressures fall sharply – in line with weakness in employment*




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

# Current business conditions

The business conditions index strengthened modestly in January – up 3 to -2 index points. In trend terms, conditions improved a touch to -4 index points – a still below-average outcome (of +5 points since 1997; or +1 point since 1989).

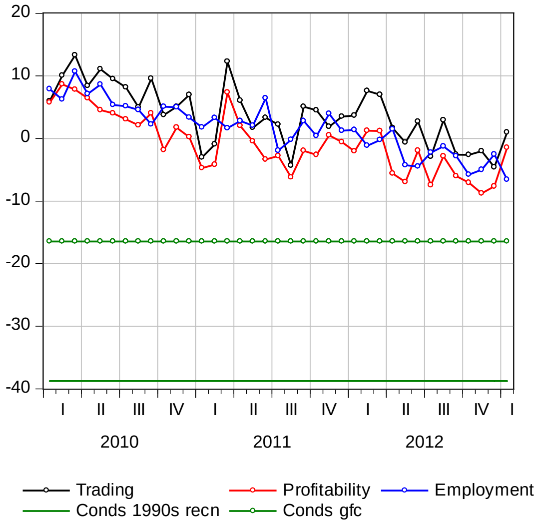
## Trading, profitability and employment

The modest pick up in activity in January reflected very solid improvements in profitability and trading conditions, which were partly offset by a solid deterioration in employment conditions.

The strengthening in **profitability** was apparent across the majority of industries in January; profits strengthened considerably in wholesale (up 16) and manufacturing (up 15), more than offsetting declines in the previous month, while they were modestly better in finance/ business/ property (up 5) and construction (up 4). However, profitability in mining appears to have faltered, reporting a 12 points decline to -8 points in the month (the lowest level since January 2011). In level terms, profitability was least subdued in transport & utilities (+4), wholesale and recreation & personal services (both +2), while it was weakest in retail (-16), manufacturing and construction (both -9).

***Profitability and trading up sharply, but employment weakens notably***

**All components of business conditions (net bal., s.a.)**

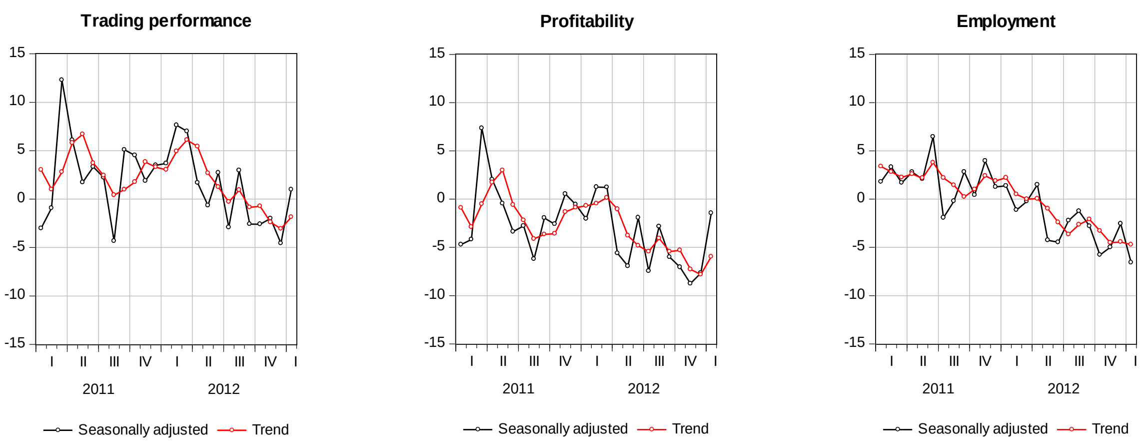



*Net balance of respondents who regard last month's trading / profitability / employment performance as good.*

The pick up in **trading conditions** in January reflected a very sharp uplift in wholesale conditions (up 26 to -10 points) – almost entirely offsetting a deterioration in the previous month – as well as a solid improvement in trading performance in construction (up 11). However, these gains were partly offset by a collapse in mining conditions (down 34) and to a lesser extent, recreation & personal services (down 11). In levels terms, trading conditions were strongest in transport & utilities (+9) and recreation & personal services (+8) while they were weakest in mining (-19, its lowest level since March 2009), retail (-13), manufacturing and wholesale (both -10).

**Employment conditions** deteriorated in all industries in January, with the exception of finance/ business/ property and manufacturing, where they improved a touch. The most significant declines in employment conditions occurred in construction (down 22), mining (down 16) and recreation & personal services (down 15). In levels terms, employment conditions were weakest in construction (-22), mining (-20), recreation & personal services (-14) and wholesale (-12), while they were least subdued in finance/ business/ property (+3) and transport & utilities (zero). The general weakness in industry employment conditions in survey provides little indication of a near-term improvement in the labour market.

Business conditions components (net balance)




*Net balance of respondents reporting trading performance / profitability / employment as good or very good (rather than poor or very poor).*

# Current business conditions (cont.)

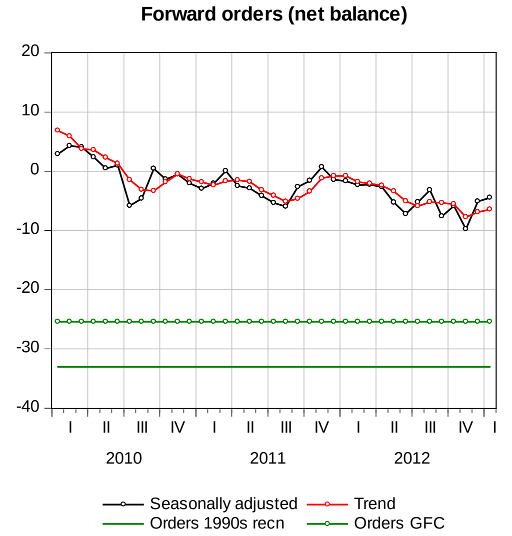
## Forward orders

While the forward orders index improved a touch in January, it remained at a relatively poor level overall and continues to provide little suggestion of a pick up in near-term demand. The index – at -4 points – remains below the series average (of zero points since 1997).

The slight up tick in orders in January reflected a sharp recovery in wholesale orders (up 26 points), after falling to the lowest level in the history of the survey in the previous month. Orders also strengthened a little in recreation & personal services and finance/ business/ property, while they deteriorated everywhere else. The sharpest deterioration was reported in mining (down 11 points), which may partly reflect some impact from recent floods, as well as the recent rise in commodities prices (in particular, iron ore), and the impact on stock levels caused by the timing of Chinese New Year. In levels terms, orders were weakest in manufacturing (-14), mining (-13) and retail (-10), while they were least subdued (and positive) in construction and recreation & personal services (both +1).

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

### *New orders edge higher but still poor*

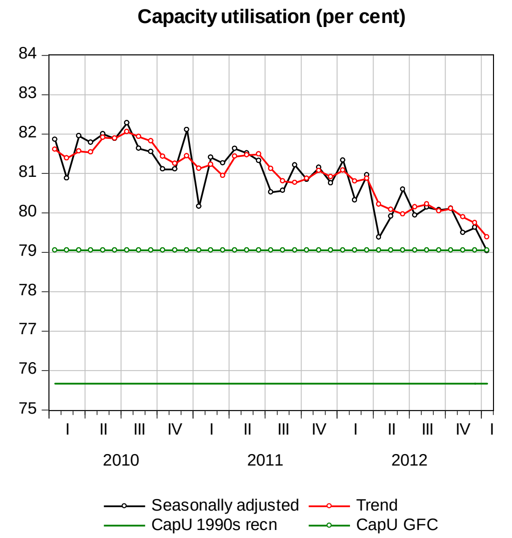



## Capacity utilisation

In January, capacity utilisation fell to its lowest level since July 2001 – down 0.6 ppts to 79.0%. This outcome was marginally below the level recorded during the GFC (of 79.1%), putting into perspective just how loose capacity pressures are at present. In the month, utilised capacity fell significantly in recreation & personal services (down 2.1 ppts) and manufacturing (0.5 ppts). Capacity utilisation actually lifted in all other industries in the month, with to most notable rises in construction (up 2.1 ppts) and wholesale (up 0.9 ppts). In levels terms, capacity utilisation was highest in transport & utilities (83.2%) and finance/ property/ business (81.5%), and lowest in manufacturing (74.4%) and retail (78.4%).

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

### *Capacity utilisation falls to lowest level since July 2001*



# Current business conditions (cont.)

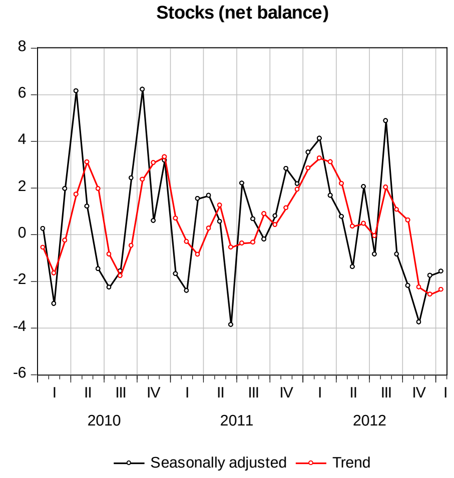
## Stocks

The stocks index was unchanged at -2 index points in January, holding onto a modest rise in the previous month. In trend terms, stocks improved slightly.

Stocks increased significantly in mining in January (up 34 points); the build up of mining stocks was probably involuntary as the impacts of flooding would have limited the volume of commodities that could be delivered. In contrast, the stocks index declined solidly in construction (down 11) and wholesale (down 8). In levels terms, the stocks index was highest in mining (+7), and lowest in wholesale (-14), construction (-7) and transport & utilities (-6).

*Net balance of respondents with a rise in stocks last month*

## *Implied inventory level remains low*

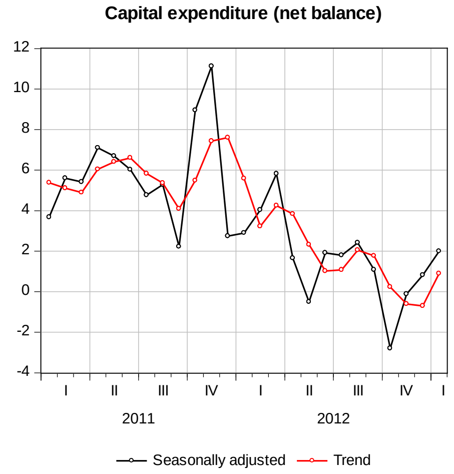



## Capital expenditure

The capex index climbed a little higher in January – up 1 point to +2 index points – though it remained relatively low compared to history. While retail and wholesale capex rose solidly in the month, this was broadly offset by a heavy decline in manufacturing capex. In levels terms, capex was highest in mining (+19), retail (+11) and recreation & personal services (+9), while it was lowest in manufacturing (-18), construction (-12) and wholesale (-6).

*Net balance of respondents with an increase in capital expenditure last month.*

## *Capex up a touch but still low overall*



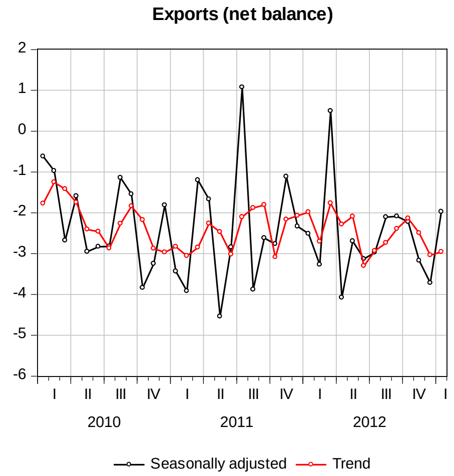

## Exports

The exports index, which represents export conditions for the economy as a whole, lifted 2 points to -2 index points in January. The improvement was driven by a rebound in wholesale exports, after declining very sharply in December, as well as a solid improvement in manufacturing exports. However, these were partly offset by a sharp deterioration in mining exports – not unexpected given the impact of the floods on mining conditions in January. In levels terms, the exports index was lowest in mining (-6), manufacturing and wholesale (both -5), and highest in finance/ business/ property (+1).

The exporters' sales index, which represents export conditions for exporting industries, also rose in the month – up 10 to -10 points.

*Net balance of respondents with an increase in export sales last month.*

## *Exports improve – largely reflecting bounce back in wholesale*



# Current business conditions (cont.)

## Credit availability

Borrowing conditions weakened marginally in January, though remained much better than conditions reported in mid 2012, when borrowing costs were relatively higher. Despite borrowing conditions remaining relatively easy in the month, overall demand for credit remained around record levels.

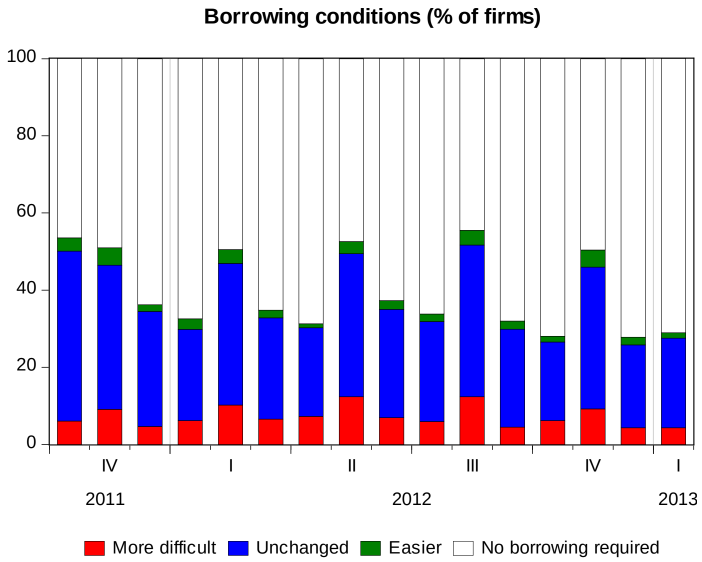
The net borrowing index (easier minus harder) eased 1 point to -3 index points in January. This outcome reflected a slight reduction in the proportion of firms finding borrowing easier, while the proportion of firms finding borrowing more difficult was unchanged. The proportion of businesses requiring finance was marginally higher at 29% (up from 28% in December); the low level of demand for credit is consistent with the low level of business investment implied by the survey (ex. mining), suggesting firms remain cautious.

*In terms of the borrowings required for your business in the last month, has it been …*

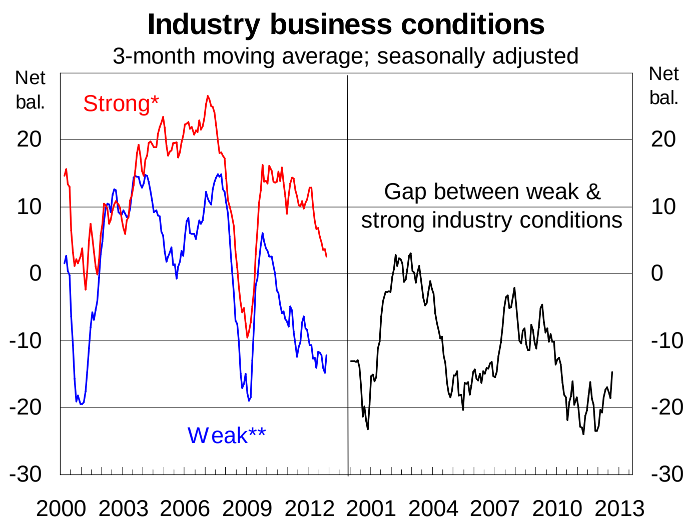
Variation in business conditions across sectors has remained quite pronounced since late 2009, although the gap has narrowed notably over the past nine or so months. This can be observed by comparing trend conditions of the recently strongest performing sectors (mining, transport & utilities, recreation & personal services and finance/ business/ property) with trend conditions of the weakest performing sectors (retail, manufacturing, construction and wholesale).

The persistent divergence in industry conditions indicates that the Australian economy is undergoing a structural transformation towards mining and service-based industries, and away from traditional manufacturing and discretionary retailing. However, the recent weakening in mining conditions and the softened outlook for investment may restrain the pace of this restructuring.

### *Demand for credit remains low despite relatively easy borrowing conditions*




### *Economy undergoing structural transformation*




* Strong industries include mining, transport & utilities, recreation & personal services and finance/business/property

** Weak industries include retail, manufacturing, construction and wholesale

# Industry sectors

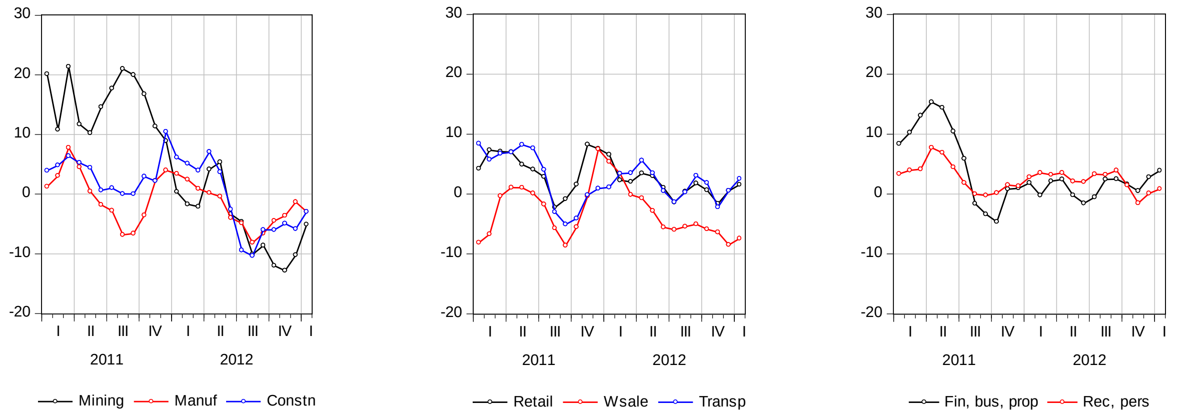
## Business confidence

***Business confidence up strongly in mining and wholesale, but retail and transport more pessimistic***

While the overall level of confidence was little changed in January, there were some marked variations across industries. Confidence improved sharply in mining (up 10 to +6 points), possibly reflecting the anticipated bounce back from the impact of recent flooding on mining activity, and wholesale (up 8). Confidence deteriorated across all other industries, with the most notable declines in retail (down 5 to +2 points) and transport & utilities (down 4 to +6 points). The difference in confidence readings across industries narrowed in January, ranging from a low of -3 points for wholesale and +7 points for finance/ business/ property.

Business confidence by industry (net balance)

3-month moving average



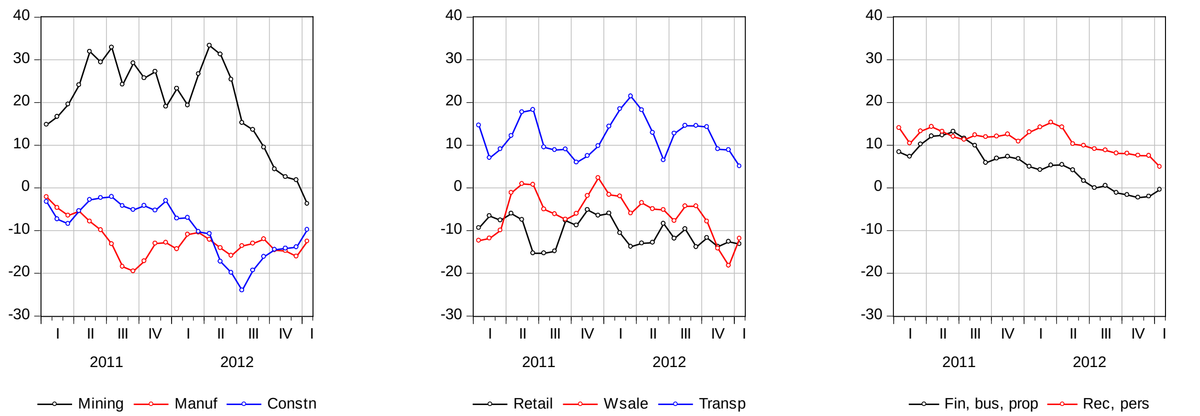

## Business conditions

***Conditions weakest in mining, retail and manufacturing***

Business conditions improved across a majority of industries in January, with the most notable improvements in wholesale (up to -8 points, following a particularly sharp deterioration in December) and manufacturing (up 5). One notable change in activity occurred in mining, where conditions faltered (down 15 to -13 points), while an element of this may reflect the immediate impact of the floods on operations, it could equally be data volatility with mining activity back to levels reported in the December quarter 2012. That said, early reports suggest that the key impact of recent flooding was largely confined to the rail network supplying Gladstone, rather than the mines and ports. That suggests that supply disruptions are unlikely to last for long. This is consistent with the pick up in mining confidence in the month. Overall, conditions were least subdued in transport & utilities (+4) and finance/ business/ property (+2), while they were weakest in mining (-13), retail (-12) and manufacturing (-10).

Business conditions by industry (net balance)

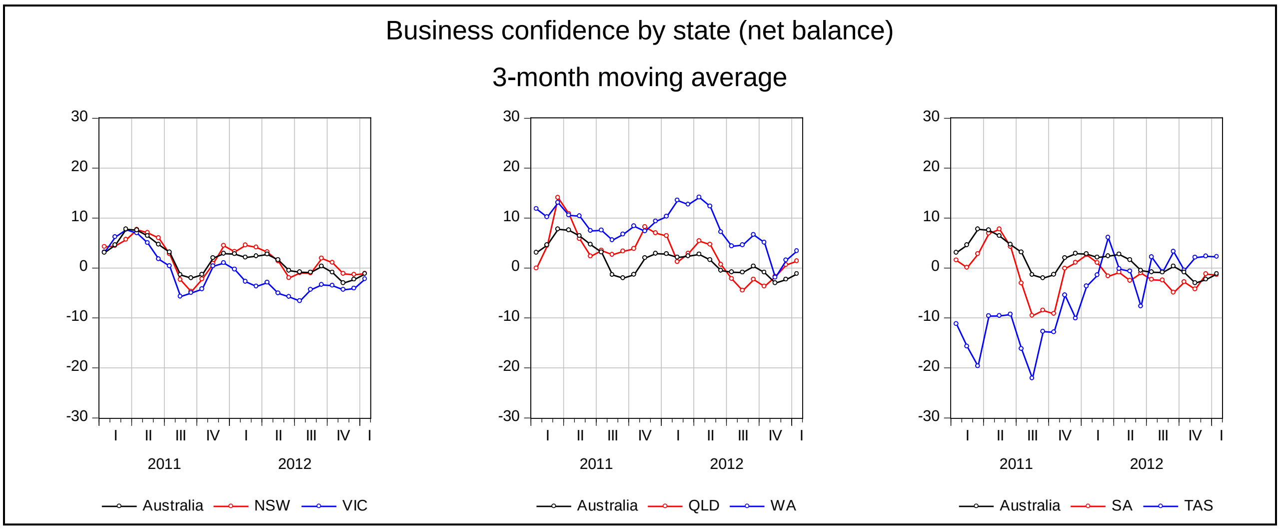
3-month moving average



# States

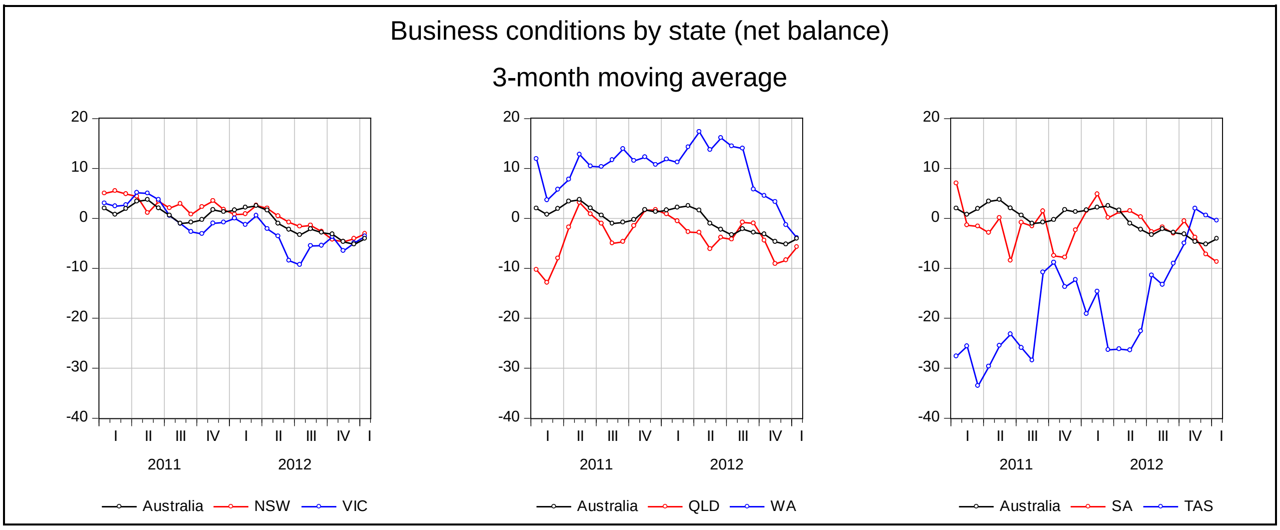
## Business confidence *Confidence mixed across states but overall levels similar*

Business confidence fell back in Queensland in January - somewhat surprising as expectations in mining improved on views of short term recovery. That said, broader economy effects from renewed flooding may have played some role in depressing sentiment. Confidence also ticked down in WA and NSW, while it was modestly better in Victoria and SA. More generally, trend confidence levels either improved or were unchanged across the states in January, a positive outcome which is likely to in part reflect the general improvement in external conditions (e.g. global equity markets, commodity markets, the outlook for growth in the US, China and Japan etc.). Confidence in January was strongest in WA (+10), while it was lower but broadly similar across the other mainland states - ranging from +1 point for Queensland to +3 points for SA. Trend confidence was unchanged at +2 index points in Tasmania, only slightly below the national trend (care should be taken when interpreting these data due to small sample size).




## Business conditions *Conditions poor across states; NSW & QLD very weak*

Business conditions were mixed across the states in January. Conditions improved sharply in SA (up 14) and WA (up 11), broadly offsetting sharp declines in the previous month, while they were modestly weaker in NSW and Queensland. Looking through the volatility, trend business conditions softened in WA and SA, while they were a little stronger in Queensland, Victoria and NSW. In levels terms, conditions of the mainland states were least subdued in WA (zero), while they were weakest in NSW (-5), Queensland (-4) and SA (-3). In Tasmania, trend conditions were marginally softer in January (down 1 to zero points); though they were better than the trend national average (of -4 points).



# Macroeconomic, Industry & Markets Research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