National Australia Bank

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Monthly Business Survey

March 2013

Business conditions fall to weakest level in almost four years but confidence steady. Previous surge in activity in consumer sectors – retail & manufacturing – unwinds, with signs lower interest rates need more time to fully work through economy. Businesses seemingly unfazed by events in Cyprus or political leadership scuffles at home – at least no more than usual. Forward indicators still poor, not boding well for near-term demand.

- The business environment remained challenging in March, with business conditions deteriorating to the lowest level since May 2009. The slump in activity reflects a weakening in trading and employment conditions, while profitability was unchanged at a subdued level. While forward orders improved, they remained weak, with the outlook for near-term demand not helped by still low levels of capacity utilisation and capital expenditure. Heavy falls in manufacturing and retail business conditions indicate we are yet to see the upswing in consumer demand that policy makers are searching for; instead, it seems that either lower interest rates need more time, or more stimulus (eg. RBA rate cuts) may be needed to set the economy back on a steady growth path.
- Business confidence was resilient in March, lifting marginally despite reignited worries about a European crisis and political uncertainty at home. It is possible that relatively higher equity prices and lower borrowing rates are keeping firms somewhat optimistic. However, the mood has deteriorated sharply in mining, with confidence falling to its weakest level in four years. This was offset by better confidence in interest sensitive sectors.
- Overall, the survey implies underlying demand growth (6-monthly annualised) of around 2¼% in the March quarter. Our wholesale leading indicator suggests little near-term improvement in already weak activity levels.
- Labour costs growth was unchanged at a below-average rate, held down by subdued employment conditions. Overall wage cost pressures appear well contained at present. Price deflation was apparent in March, with the poor outcome consistent with the weakness in trading conditions. Combined with modest costs growth, the survey implies further pressure on margins, especially in retail.

Implications for NAB forecasts (See latest Global and Australian Forecasts report also released today):

- Global forecasts little changed. The latest bout of Euro-zone instability has taken a toll on global equity markets and we remain to see the impact of the changes in Japanese monetary policy. While business surveys in the advanced economies show a lift in sentiment, the reality is Europe is likely to be in recession until late 2013. USA is reasonable and only China is showing signs of accelerated growth. Overall we still expect growth to pick up in the latter half of this year, before strengthening to an above-trend 3.9% in 2014 as recessions end in Europe, Japan reflates and the big emerging market economies pick up speed.
- GDP forecasts broadly unchanged – we have lifted Q1 consumption (strong retail data) and softened outlook for investment (lower commodity prices). We see GDP of 2.4% in 2013 (was 2.3%), lifting to 3.0% in 2014 (was 3.1%). While there are signs the Australian economy is strengthening, falling commodity prices and high AUD still weighing on activity. We see unemployment rising to around 5¾% by late 2013. With inflationary pressures well contained, there is thus scope for two more rate cuts by year-end (possibly June & November). Timing is still fluid with higher house prices a possible delay factor but the unemployment path will be the key variable.

Key monthly business statistics*

	Jan 2013	Feb 2013	**Mar 2013**		Jan 2013	Feb 2013	**Mar 2013**
	Net balance				*Net balance*		
Business confidence	3	1	**2**	Employment	-6	-3	**-5**
Business conditions	-2	-3	**-7**	Forward orders	-5	-11	**-5**
Trading	0	0	**-4**	Stocks	-2	-4	**0**
Profitability	-3	-6	**-6**	Exports	-2	-1	**0**
	% change at quarterly rate				*% change at quarterly rate*		
Labour costs	0.3	0.8	**0.8**	Retail prices	-0.2	0.0	**-0.4**
Purchase costs	0.3	0.5	**0.5**		*Per cent*		
Final products prices	0.0	0.1	**-0.2**	Capacity utilisation rate	79.4	79.9	**79.9**

* 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 22 to 28 March, covering over 400 firms across the non-farm business sector.

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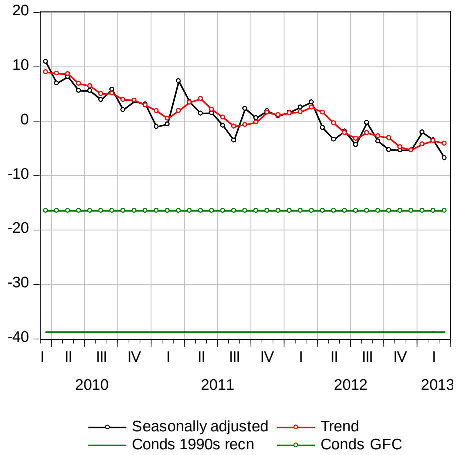
Next release:
13 May 2013 (April monthly)

Analysis

Business conditions fell from -3 to -7 index points in March – the weakest outcome since May 2009 – providing further evidence that the domestic demand environment is still challenging. The pull back in conditions in March was particularly marked in the consumer dependent sectors as well as mining, where activity has turned down sharply since mid-2012. However, activity in construction has recovered from very poor levels. While lower borrowing rates and the recent upturn in equity prices appear to be working to gradually strengthen activity in the retail, wholesale and manufacturing sectors, this survey implies that these effects may need longer to fully work through the economy, or perhaps more stimulus may be necessary for 'normal' activity to resume (ie. more RBA rate cuts). Overall, the survey indicates little intention by business to expand operations, with capex and forward orders still weak, and capacity utilisation and demand for finance at very low levels.

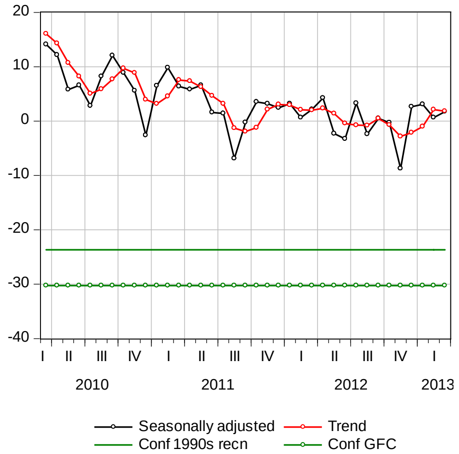
Business confidence improved only marginally in March – up 1 to +2 index points – and remained below the series long-run average level (of +5 points since 1989). While there was little variation in sentiment across most industries in March, a severe lack of confidence is persisting in mining, with the index deteriorating to -25 points. This was the weakest outcome since Feb 2009, likely reflecting concern about weaker commodity prices and the approaching end to the mining investment phase. In aggregate, the announcement of the unprecedented levy to be imposed on Cyprus bank deposits in order to secure bailout funding from the European Union and the potential consequences of such a move on other already fragile euro-zone economies appears to have caused little concern for Australian firms. There is also little evidence that political leadership uncertainty at home has shaken sentiment (most of the survey period fell after the federal government leadership ballot), though general uncertainty about the state of politics may already be factored into the below-average level of confidence. More broadly, confidence has held up reasonably well over recent months, possibly helped by lower interest rates and improving financial and equity markets.

Conditions deteriorate to weakest level in almost four years



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

Confidence steadies



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

Business conditions by industry. The weakness in overall activity in March largely reflected very poor business conditions in manufacturing (-33 points) and retail (-21), after showing recent signs of improvement. Business conditions in these industries deteriorated heavily in March due largely to poor trading conditions and profitability, despite product prices declining for both industries in the month. There has also been a clear weakening in mining conditions over the past six or so months, likely in response to lower commodity prices. In contrast, conditions strengthened modestly in construction, albeit activity is still subdued at -7 points, suggesting lower borrowing costs may be having an effect. While conditions in services – finance/ business/ property, recreation & personal services and transport & utilities – have clearly softened over the past year, they continue to outperform all other industries. Overall, the snap back in activity in the consumer dependent sectors and general softness elsewhere suggests the economy may require more stimulus via either monetary or fiscal policy to regain its growth momentum.

Analysis (cont.)

Business conditions by state. Conditions deteriorated considerably in WA in March – down 15 to -13 points, the weakest outcome since May 2009 – possibly a sign that the weakness in mining activity is spreading to other industries, particularly mining-services industries. Elsewhere, conditions deteriorated modestly in Victoria (down 6 to -7 points), while activity was modestly better in NSW, Queensland and SA, albeit still subdued. Conditions in Tasmania have been surprisingly resilient of late, and are now stronger than in any other state; trend conditions edged up 1 point to -1 index point in March, though care should be taken when interpreting data for Tasmania due to small sample size.

Business confidence by industry. Mining confidence was shattered in March, falling to -25 points – its weakest reading in four years. The general shift in focus of mining companies towards cost cutting, which has led to the scaling back of capacity, coupled with the general softening in commodity prices has softened the outlook for mining activity. Mining employment conditions have also been scaled back over recent months, providing further evidence that mining investment is approaching its peak. Changes in confidence elsewhere were somewhat mixed in March; confidence improved solidly in wholesale (up 8 to -1 point), construction and recreation & personal services (both up 5 points), while it deteriorated notably in finance/ business/ property (down 7 to +4 points), more than unwinding a solid pick up in the previous month. With the exception of mining, confidence levels were fairly similar across industries, ranging from -1 point for wholesale, to +5 points for construction, with the latter industry possibly optimistic about the outlook for dwellings investment due to an improving housing market.

Business confidence by state. Confidence levels were little changed across the mainland states in March. WA, Queensland and SA became a touch more optimistic in the month, while sentiment weakened a little in NSW and Victoria. The slight reduction in confidence in NSW and Victoria may in part reflect some unwinding of consumer activity, which contributes more to growth in these states than elsewhere. Confidence was broadly similar across the mainland states, ranging from -1 point in NSW to +4 points in WA. Consistent with a solid improvement in (seasonally adjusted) conditions, Tasmanian confidence also strengthened considerably in the month. In trend terms, confidence in Tasmania was unchanged at +7 points (on a small sample).

The **forward orders** index rebounded in March – up 6 points to -5 index points – after recording its weakest outcome since May 2009 in the previous month. Orders strengthened across all industries in the month, with the exception of finance/ business/ property, where they were a touch weaker. The strongest improvements in orders occurred in mining, retail, manufacturing and transport & utilities. Despite the broad-based improvement in new orders in the month, not a single industry reported positive orders; orders were weakest in construction, wholesale (both -8 points), manufacturing and finance/ business/ property (both -4). **Capacity utilisation** was unchanged at a low 79.9% in March – a level not too dissimilar to levels reported at the bottom of the GFC. Capacity utilisation was very low in manufacturing and mining – where it fell heavily – while it continued to hold up relatively well in recreation & personal services and finance/ business/ property. The **stocks** index – also a good indicator of current demand – improved modestly in March, though the level, at zero points, implies little change in inventories.

The **capital expenditure** index improved slightly in March – up 1 to zero points – but remained below the series long-run average level of +5 points since 2002. Much of the recent moderation in the capex index reflects a softening in mining capex – consistent with anecdotal evidence that mining firms are reducing capacity and scaling back projects – though mining capex did spike up in March after an even bigger decline in the previous month. The capex index was highest in retail (+19), construction (+9) and mining (+8), while it was lowest in manufacturing (-9), wholesale and finance/ business/ property (both -4).

Analysis (cont.)

Based on forward orders, the survey implies 6-monthly annualised demand growth was around 2¼% in Q4 2012, higher than the actual level of 0.6%. The survey predicts a similar level of growth (2¼%) for Q1 2013 demand growth. If we assume forward orders for March are continued into the June quarter, the survey implies 6-monthly annualised demand growth will strengthen to around 2¾% in Q2 2013.

Similarly, based on average business conditions for Q4 2012, the survey implies 6-monthly annualised GDP growth (excluding mining) was around 2¼% in Q4 2012, slightly below actual growth of 2.5%, while growth is expected to pick up to 3¼% in Q1 2013. But if business conditions for March are continued into the June quarter, the implied growth rate would fall to around 2¼% in Q2 2013.

Elsewhere in the survey, cash flow (not seasonally adjusted) was strongest in recreation & personal services and weakest in manufacturing.

Labour costs growth (a wages bill measure) was unchanged at 0.8% in March (at a quarterly rate). When combined with a deterioration in employment conditions, this outcome implies a slight pick up in wage pressures in the month. However, the overall pace of labour costs growth remains below the series long-run average (of 1.1% since 1997), suggesting overall wages growth remains modest at best.

By industry, labour costs growth was strongest in transport & utilities (1.8%; at a quarterly rate) – consistent with relatively stronger employment conditions in this industry – while costs growth was softest in wholesale (0.2%), manufacturing and construction (both 0.4%).

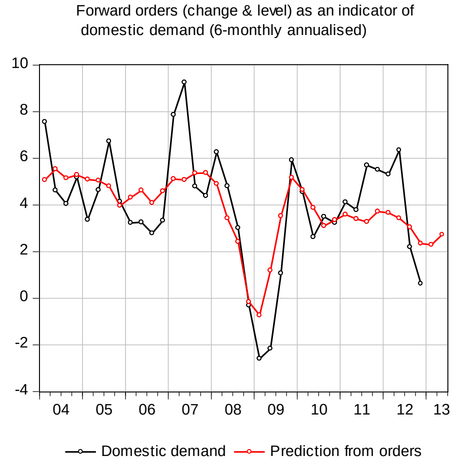
Final product prices fell by 0.2% in March (at a quarterly rate). The weakness in prices is consistent with weak trading conditions in March, particularly in the retail sector, were very poor trading appears to have contributed to a 0.4% decline in retail prices.

Price deflation eased modestly in mining, while inflation softened most noticeably in retail, recreation & personal services and finance/ business/ property. Growth in prices was strongest in transport & utilities (0.7% at a quarterly rate) and recreation & personal services (0.1%), while prices fell notably in mining (-0.9%), retail (-0.4%) and construction (-0.3%).

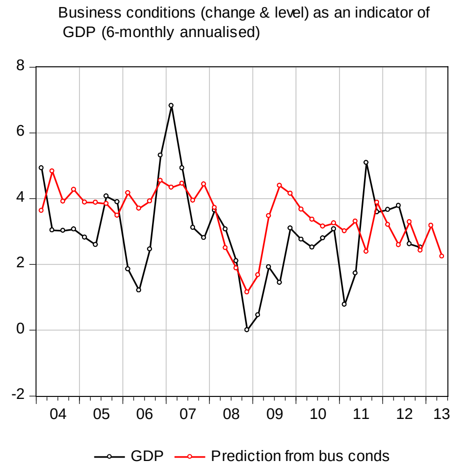
Purchase cost growth was unchanged in March at 0.5% (at a quarterly rate). This outcome reflected solid increases in the cost inflation in manufacturing (up 0.9 ppts) and wholesale (up 0.4 ppts), which were broadly offset by a reduction in finance/ business/ property and retail (both down 0.5 ppts). Overall, growth in purchase costs was strongest in manufacturing (1.3%) and weakest in retail (-0.2%).

The increase in costs growth combined with a fall in prices implies margins continue to be squeezed.

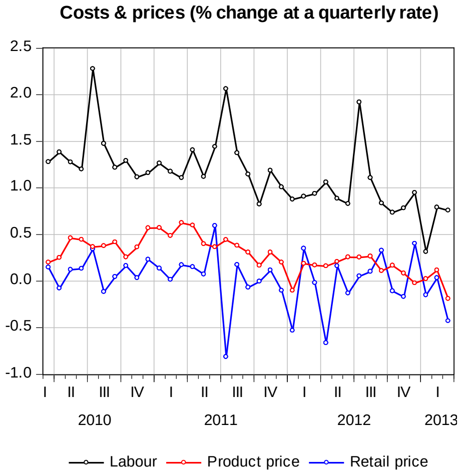
Demand growth to strengthen marginally in Q2



GDP (ex coal) growth to weaken in mid 2013



Labour costs growth still below-average, held down by weak employ.



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

Current business conditions

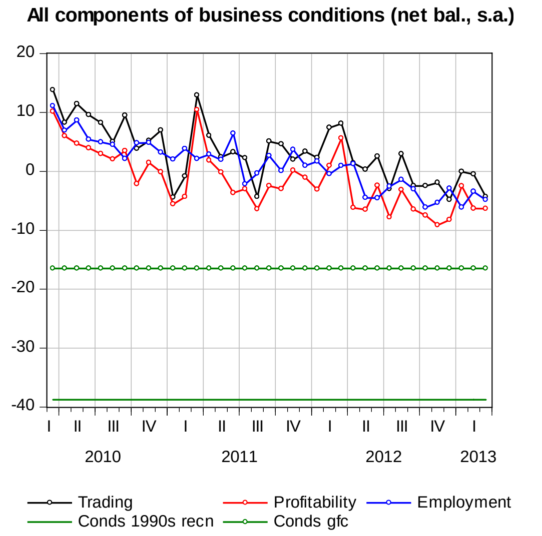
The business conditions index recoiled in March – down 4 to -7 index points. In trend terms, conditions were unchanged at -4 index points; at 9 points below the series average since 1997, the strength in activity implied by the survey remains lacklustre.

Trading, profitability and employment

The pull back in activity in March was driven by a moderation in trading and employment conditions, while profitability was unchanged at a very poor level.

The deterioration in trading conditions was broadly based across industries; the only exceptions were transport & utilities (up 20 points), where conditions rebounded sharply following a heavy decline in the previous month, and construction (up 2), where conditions are likely to have been aided by stronger investment activity in response to a slowly improving property sector. Trading conditions weakened significantly in manufacturing (down 23), retail (down 22) and mining (down 19), while conditions deteriorated modestly across all other industries.

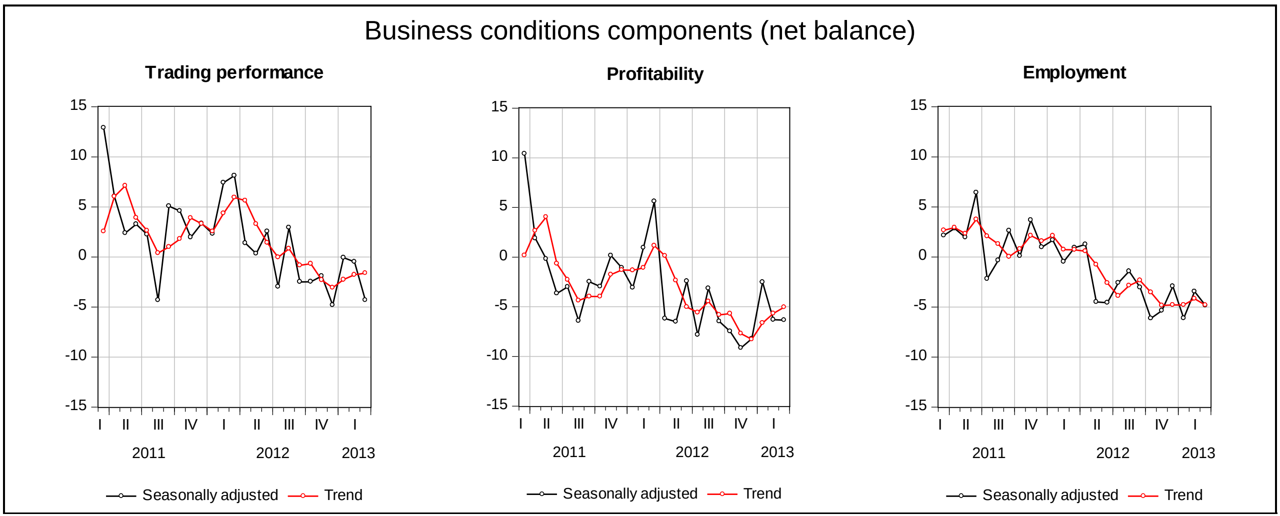
Trading & employment weaken. Profits unchanged but still weak.



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

Employment conditions (in trend terms) softened modestly in transport & utilities in March (down 3 points), manufacturing, finance/ business/ property and wholesale (all down 2 points). Not a single industry reported a strengthening in trend employment conditions in March, while only one industry – transport & utilities – reported positive conditions (+5). In contrast, trend employment conditions were very subdued in manufacturing (-15), wholesale (-13), construction (-12) and mining (-11). The generally weak employment conditions reported here are consistent with other forward indicators and are somewhat at odds with the upward trend in official ABS employment data.

While **profitability** was unchanged in aggregate, a couple of industries reported very heavy declines in March. Profitability weakened considerably in manufacturing (down 24 to -43 points) and retail (20 points to -33 points). The reading for manufacturing was the weakest outcome in the history of the series (since 1997), putting into perspective just how much strain manufacturers are under as a result of the still high AUD and import competition. Profitability improved solidly in mining (up 10), albeit remained subdued, and transport & utilities (up 9), while it was marginally better in finance/ business/ property. In levels terms, profitability was most subdued in manufacturing (-43), retail (-33), wholesale (-17) and mining (-15), while it was strongest in transport & utilities (+7), finance/ business/ property (+4) and recreation & personal services (+3).



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

Current business conditions (cont.)

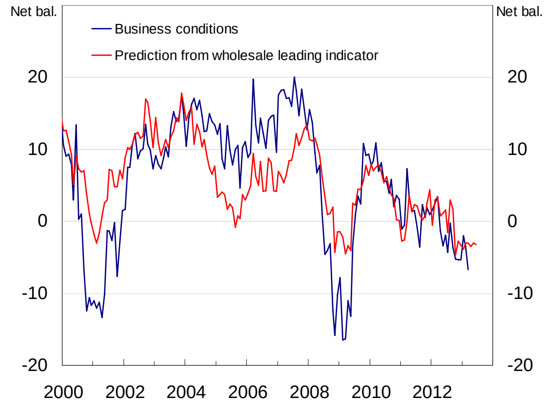
Wholesale: Signalling continued softness in the domestic economy?

The weakness in wholesaling that has persisted for the best part of 3½ years has continued into 2013. While conditions have been volatile in recent months, trend business conditions in wholesaling remained very poor in March, at just -10 points.

Based on historical relationships, wholesale conditions appear to be a reasonably good predictor of overall business conditions – certainly there is strong statistical evidence of a leading relationship (Granger causality). Our analysis suggests that if wholesale conditions in March (-13) were to continue though the remainder of H1 2013, overall business conditions could be expected to remain poor (but improving), averaging just -3 index points over the next quarter. That, in turn, is suggestive of an economy still running below trend and with little upward momentum in the growth rate.

Wholesale weakness a worry

Wholesale as a leading indicator of business conditions



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

Forward orders

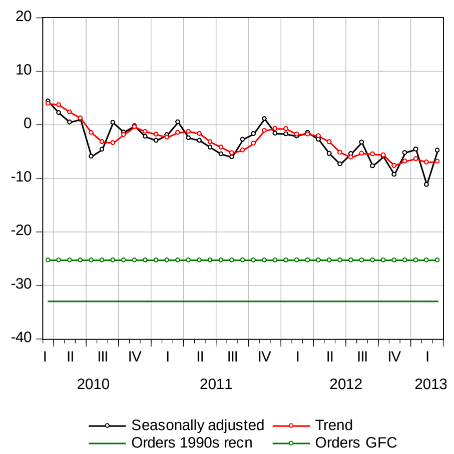
The forward orders index rebounded in March, after slumping to its lowest level since May 2009 in February. At -5 index points, the index remains well below the series long-run average of zero points (since 1997), providing little indication of a near-term strengthening in domestic demand.

The improvement in forward orders was broadly based, with finance/ business/ property (where orders eased slightly) the only industry to buck the trend. Orders strengthened most in mining (up 14), retail (up 13) and manufacturing (up 12). In levels terms, orders were most subdued in construction, wholesale (both -8), manufacturing and finance/ business/ property (both -4). No industry reported positive orders in March.

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

New orders recover but still weak

Forward orders (net balance)



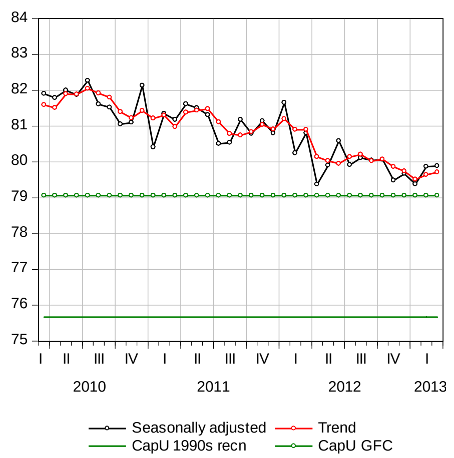
Capacity utilisation

In March, capacity utilisation was unchanged at 79.9% – below the series long-run average of 81.1% since 1997. Capacity utilisation fell very sharply in mining (down 4.3 ppts to 75.7%), which is consistent with a sharp deterioration in employment and trading conditions in this industry, followed by retail (down 1.8 ppts) and wholesale (down 1.6 ppts), while it rose solidly in recreation & personal services (up 2.2 ppts). In levels terms, capacity utilisation was highest in recreation & personal services (83.4%) and finance/ business/ property (82.0%), and lowest in manufacturing (74.7%) and mining (75.7%) – the lowest mining outcome since November 2002.

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

Capacity utilisation still very low

Capacity utilisation (per cent)



Current business conditions (cont.)

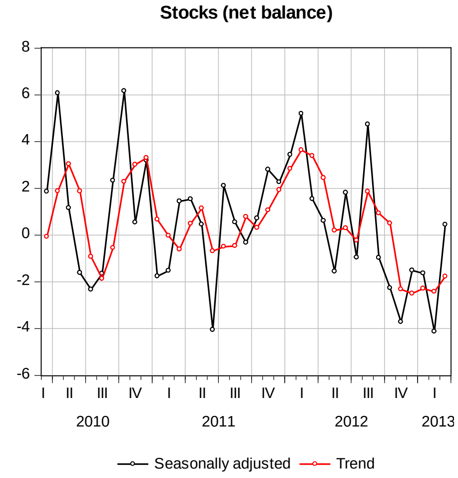
Stocks

The stocks index jumped to its highest level in six months in March, up 4 to zero points. In trend terms, the stocks index was unchanged at -2 index points, to remain 4 points below the series long-run average of +2 points (since 1997).

The stocks index rose significantly in mining (up 15 to -2 points), though the negative read still implied a fall in inventories, followed by transport & utilities and manufacturing. The pick up in stocks reported by these industries may have been involuntary, given the weakness in trading – transport & utilities is the exception, where trading was robust. Recreation & personal services was the only industry to report a (marginal) decline. The stocks index was highest in retail (+8) and wholesale (+7), and lowest in construction (-8).

Net balance of respondents with a rise in stocks last month

Unwinding of stocks comes to an end

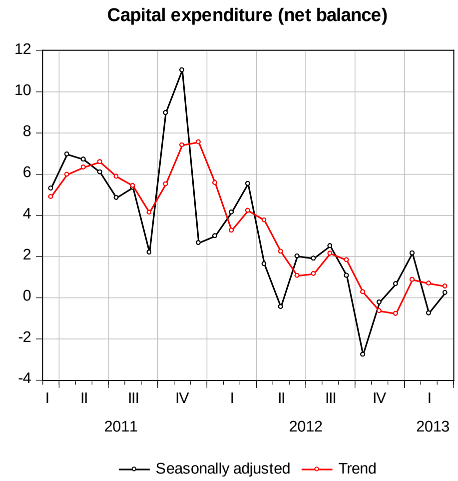


Capital expenditure

The capex index rose marginally in March – up 1 to zero points. A noteworthy rise was the increase in construction capex (up 19 to +9 points), which may indicate the expectation for activity to expand in this industry as the housing market strengthens. Capital expenditure also rose considerably in retail (up 18), mining and transport & utilities (both up 10). While mining capex picked up solidly in the month, this only partly unwound a very sharp contraction in the previous month. Capital expenditure, in levels terms, was highest in retail (+19) – perhaps reflecting investment in online infrastructure – and construction (+9), while it was lowest in manufacturing (-9), wholesale and finance/ business/ property (both -4).

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

Capex still low, but mining spikes up



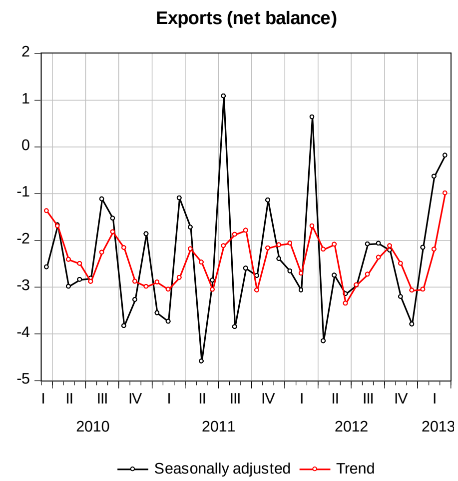
Exports

The exports index, which represents export conditions for the economy as a whole, rose to a one year high in March – up 1 to zero points – but there were variations across industries. The exports index rose modestly in manufacturing and mining, while it fell moderately in construction and transport & utilities. In levels terms, the exports index was lowest in transport & utilities (-7) and manufacturing (-3), while it was highest in mining and finance/ business/ property (both +1).

The exporters' sales index, which represents export conditions for exporting industries, fell marginally to -3 index points.

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

Exports improve again



Current business conditions (cont.)

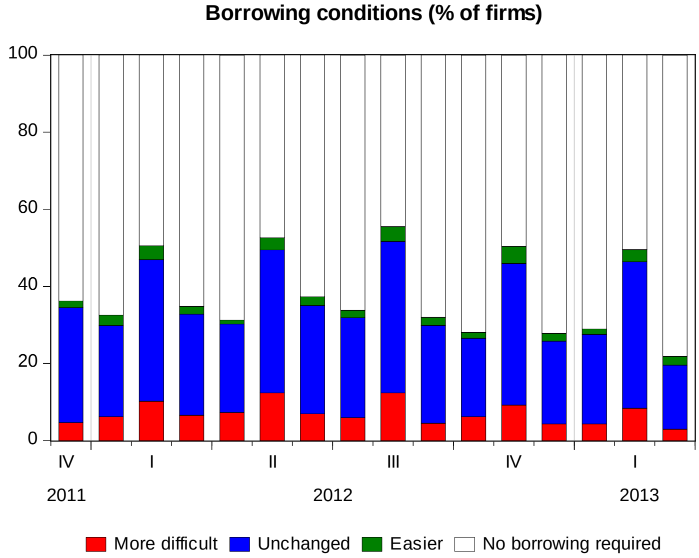
Credit availability

Borrowing conditions improved considerably in March, suggesting that lending institutions may be looking to provide businesses with easier access to credit in the currently soft demand environment.

The net borrowing index (easier minus harder) eased to -1 point in March, up from -5 index points in February. This outcome reflected a solid reduction in the proportion of firms finding borrowing more difficult, which was partly offset by a slight fall in the proportion of firms finding credit easier to obtain. However, overall demand for credit was extremely weak, with just 22% of respondents requiring finance in March, the weakest level of credit demand ever recorded in this survey (ie. since November 2008).

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

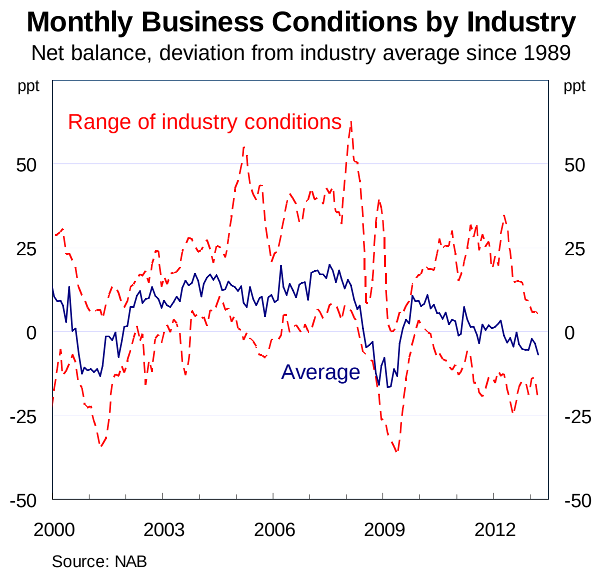
Demand for credit falls to lowest level in (short) history, despite easier conditions



The variation in business conditions across industry has remained quite pronounced since late 2009, largely reflecting the relative strength of mining and service related industries compared to the weaker consumer dependant and trade based industries following the GFC. However, the range of industry conditions has narrowed notably over the past year or so. This can be observed by comparing the difference between the best performing and worst performing industries each month.

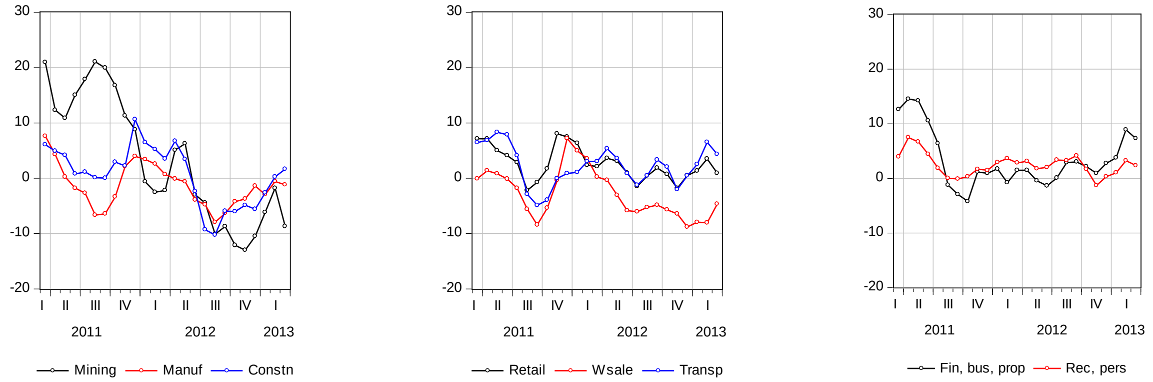
While the variation in conditions across industries has narrowed more recently, it largely reflects a weakening in conditions of the previously stronger performing industries – including mining, services and transport firms – suggesting weakness elsewhere may be spreading.

Industry conditions converging to low levels

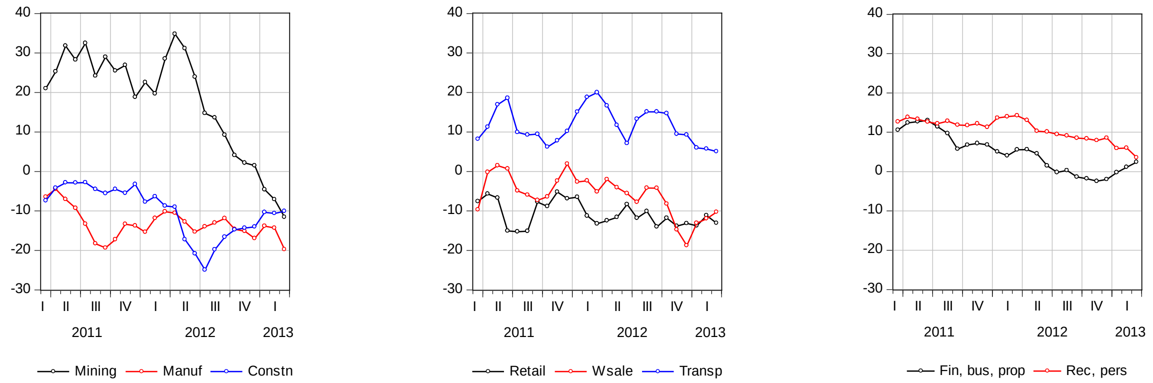


Industry sectors and states

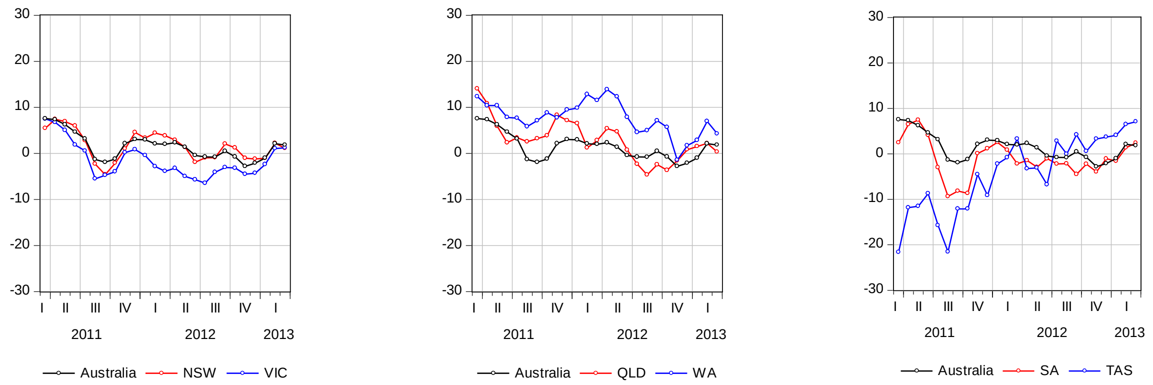
Business confidence by industry (net balance): 3-month moving average



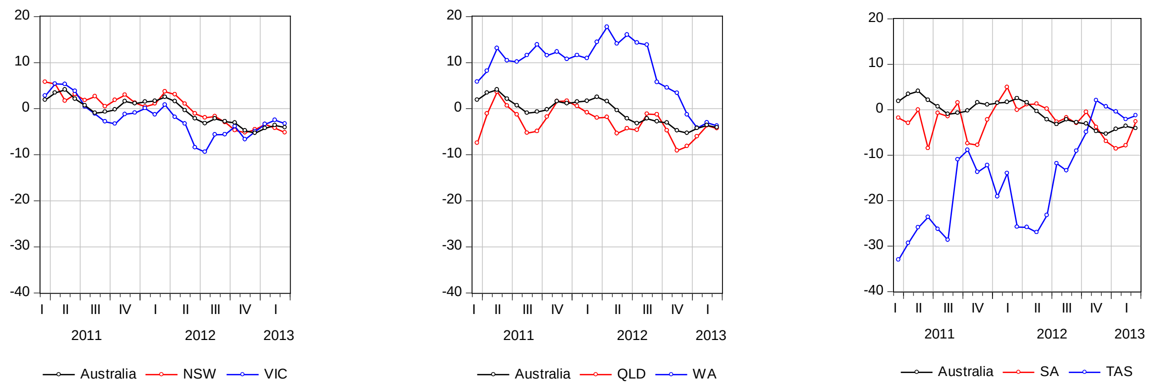
Business conditions by industry (net balance): 3-month moving average



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



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



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