National Australia Bank

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Monthly Business Survey

April 2013

Business conditions remain very difficult and confidence stumbles after showing signs of recovery earlier this year. Despite less negativity in retail & manufacturing, activity still very poor and labour market showing new signs of weakness. Also no sign of upward momentum – with forward orders, capacity utilisation and employment all very subdued and weaker. Tomorrow's Budget to show lower growth forecasts and a fiscal position still retarding growth. We still expect one more cut (November) but could come earlier.

- The business environment remained difficult in April, with business conditions improving only marginally, after slumping to the lowest level in almost four years in March. There were only modest improvements in trading conditions and profitability, mostly offset by worse employment conditions – the weakest in four years. Implied job losses were most prevalent in manufacturing, wholesale and now recreation & personal services sectors, (where labour cost pressures were highest). Persistent weakness in forward indicators of demand, combined with tight fiscal policy settings, imply little improvement in near-term activity – indeed suggest modest weakening.
- Business confidence was shaken in April, after showing signs of improvement earlier this year. The stumble may reflect business concern over weaker than anticipated growth in the US, China and Euro-zone, and falling commodity prices, which paint an uncertain picture for the near-term global demand outlook. This is consistent with a slump in mining confidence, now the lowest since the global financial crisis, with confidence also slipping across most other industries. That said, continued weakness at home also not helping – especially as forward indicators weaken.
- Overall, the survey implies underlying demand growth (6-monthly annualised) of around 2½% in the June quarter. Our wholesale leading indicator suggests no near-term improvement in already weak activity levels.
- Labour costs grew a little less strongly; given weak employment, this suggests wage pressure is resilient. Price inflation was very subdued, consistent with still poor trading conditions. Combined with modest costs growth, the survey implies further pressure on margins, especially in retail.

Implications for NAB forecasts (Updated forecasts will be released in our Budget report, to be released tomorrow):

- That said going into the Budget, we expect GDP growth locally at around 2¼% in 2013 (2.7% fiscal 12/13) and 3% in 2014 (2.6% fiscal 13/14). Core inflation is expected to be 2¼% by year end and 2.5% by end 2014. Unemployment is expected to be around 6% by end 2013 and remain around that level in 2014. We still see another rate cut by late 2013 (November) but further deterioration in the labour market could see earlier action and possibly more than one cut. We expect fiscal surpluses will be hard to achieve in the forecasting period – a very moderate surplus by 2014/15 would involve the fiscal stance detracting from growth in each of the next two years by around ½ point (cf 1½% in 12/13). Global GDP growth unchanged at 3¼% but risks to the downside are building.

Key monthly business statistics*

	Feb 2013	Mar 2013	**Apr 2013**		Feb 2013	Mar 2013	**Apr 2013**
		Net balance				*Net balance*	
Business confidence	1	2	**-2**	Employment	-4	-6	**-9**
Business conditions	-4	-7	**-6**	Forward orders	-11	-5	**-6**
Trading	-1	-5	**-3**	Stocks	-4	0	**-2**
Profitability	-7	-9	**-6**	Exports	-1	-1	**-3**
		% change at quarterly rate				*% change at quarterly rate*	
Labour costs	0.8	0.8	**0.7**	Retail prices	0.0	-0.4	**0.1**
Purchase costs	0.5	0.5	**0.4**			*Per cent*	
Final products prices	0.1	-0.2	**0.1**	Capacity utilisation rate	79.9	79.9	**79.6**

* 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 23 to 30 April, covering over 400 firms across the non-farm business sector.

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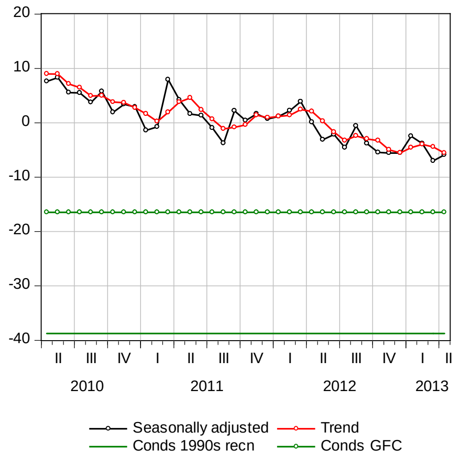
Next release:
11 June 2013 (May monthly)

Analysis

Business conditions improved only marginally to -6 points in April, after falling to the lowest level since May 2009 in the previous month (-7). Business conditions strengthened markedly in mining, where they rose to their highest level in eight months, as well as retail and manufacturing, although the latter two sectors remain deeply in negative territory. Activity also remained very weak in wholesale. While it appears that households have become somewhat more upbeat in response to lower borrowing rates and improved equity and house prices, that has not yet translated into better business conditions. Overall, the survey provides little indication of any improvement in near-term business activity, with employment conditions, forwards orders and capacity utilisation all weaker from already very subdued levels.

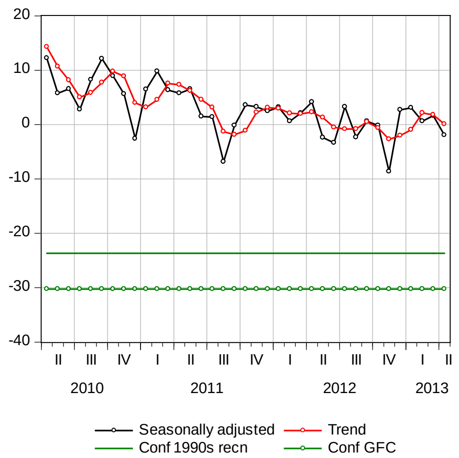
Business confidence slipped back in April – down 4 to -2 index points – to be well below the series long-run average level (of +5 points since 1989). Mining confidence fell heavily for a second consecutive month in April, to -39 points, which was the weakest outcome in over four years. Weak mining sentiment probably reflects concern over the outlook for commodities demand, with GDP outcomes in major economies coming in below expectations in the March quarter, as well as concern about the impact of the approaching peak in mining investment. Elsewhere, confidence was broadly similar at modestly below-average levels. It is possible that uncertainty over the potential implications of tomorrow's Budget announcement and the upcoming election is keeping firms on edge. Despite the deterioration in the month, overall confidence remains better than it was throughout much of 2012, possibly helped by lower interest rates and improving financial and equity markets.

Conditions improve a touch but still very difficult



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

Confidence falls back



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

Business conditions by industry. Despite only a minor tick up in overall activity in April, conditions improved markedly in mining (up 17 to +4 points), retail (up 15 to -8 points) and manufacturing (up 14 to -21 points). While the improvement in mining activity is a little surprising given the extent of falls in commodity prices over April, it is possible that the impact of earlier floods and cyclones has now subsided, providing some relief to miners. Transport & utilities and finance/ business/ property were the only industries to report a (moderate) deterioration in activity in the month – both down 4 points – with activity in the latter falling to its lowest level since June 2009. While parts of the property segment are probably benefiting from an improved housing market, it is possible that finance firms' margins have deteriorated in the low interest rate environment. Overall activity in the consumer dependent sectors (with the exception of recreation & personal services) remained poor in April, indicating the need for further stimulus to be injected into the economy, either through monetary policy settings (and we have seen another rate cut on 7 May) or via fiscal easing, in order for the economy to regain its growth momentum.

Analysis (cont.)

Business conditions by state. Trend conditions deteriorated heavily in SA in April – down 7 points to -10 index points. The weakness in SA business activity may partly reflect the vast amount of uncertainty surrounding a number of future maritime defence projects, which has already had a real impact on jobs; consistent with this, our survey highlighted a significant deterioration in SA employment conditions in April. Trend conditions also deteriorated modestly in NSW (-9 points), which could partly reflect weakness in finance/ business/ property conditions, which makes up a relatively larger share of the NSW economy compared to other states. Elsewhere, trend business conditions were broadly unchanged across the mainland states, with conditions ranging from -5 points in WA and Queensland, to -3 points in Victoria.

Business confidence by industry. Confidence deteriorated across most industries in April, with a particularly heavy decline reported in mining (down 14 to -39 points) – the lowest reading since February 2009. This outcome followed a heavy fall in the previous month, with mining firms clearly shaken by recent commodity price declines as well as the general uncertainty surrounding the repercussions of mining transitioning from the investment phase to the exports phase, especially given the soft near-term global demand outlook. Confidence also deteriorated notably in construction, with a soft outlook for non-residential investment likely to be weighing here, while it was modestly weaker in finance/ business/ property. Retail and wholesale were the only industries to report a slight improvement in sentiment in April, with these industries possibly still looking to benefit from previous (and future) interest rate cuts. With the exception of mining, confidence levels were fairly similar across industries, ranging from -4 points in construction to zero points in recreation & personal services.

Business confidence by state. Consistent with a very sharp deterioration in mining confidence in April, trend business confidence in WA deteriorated considerably (down 4 to +1 point). Trend confidence also weakened slightly in SA, Victoria, NSW and Queensland. The level of business confidence was very similar across the mainland states, ranging from -1 point in Victoria to +1 point in WA.

The **forward orders** index edged lower in April – down 1 to -6 index points – after rebounding in the previous month from a very subdued level in February. The index fell sharply in construction, mining and manufacturing, while orders rose considerably in transport & utilities. Overall, orders were especially weak in construction (-22), manufacturing (-15), mining (-14) and wholesale (-11), while transport & utilities was the only industry to report a positive outcome (+9). **Capacity utilisation** eased to 79.6% in April – a level not too dissimilar to levels reported at the bottom of the GFC – after hovering close to 80% for the previous two months. The drop in utilised capacity was largely driven by recreation & personal services and manufacturing, where declines of 3.6 ppts and 1.6 ppts were recorded. At 72.7%, capacity utilisation in the manufacturing sector was close to the lowest outcome in the history of the survey. In contrast, utilised capacity rose very sharply in mining – up 6.2 ppts – which could reflect some relief following previous flood and cyclone impacts. The **stocks** index – also a good indicator of current demand – fell back in April, partly unwinding a rise in the previous month; the level, at -2 points, implies a slight fall in inventories in the month, possible reflecting improved trading activity.

The **capital expenditure** index edged up 1 point to +2 index points in April, though remained at a reasonably low level relative to recent history. The improvement in the month was driven by manufacturing, recreation & personal services and finance/ business/ property. However, heavy declines were reported in retail (no doubt reflecting the string of weak outcomes for conditions and confidence) and mining (possibly a precursor of the end of the mining investment boom). The capex index was lowest in wholesale (-8) and mining (-5; where capex readings prior to this survey had been among the highest of all industries since 2010). The highest capex readings were in transport & utilities and recreation & personal services (both +6). Uncertainty associated with the forthcoming Federal election may also be a negative for capex plans in the non-mining sector.

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 April are continued into the June quarter, the survey implies 6-monthly annualised demand growth will be around 2½% in Q2 2013.

Similarly, based on average business conditions for Q4 2012, the survey implies 6-monthly annualised GDP growth (excluding mining) of 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 April are continued into the June quarter, the implied growth rate would fall to around 2¼-2½% in Q2 2013.

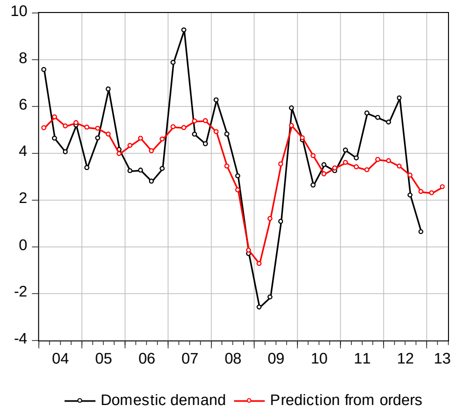
Elsewhere in the survey, cash flow (not seasonally adjusted) was strongest in transport & utilities and recreation & personal services, and weakest in manufacturing and wholesale.

Labour costs growth (a wages bill measure) softened to 0.7% in April, from 0.8% in March (at a quarterly rate). Combined with the deterioration in employment conditions, this outcome suggests wage pressures remained fairly resilient. However, the overall pace of labour costs growth remains below the series long-run average (of 1.0% since 1989).

Labour costs growth was strongest in wholesale (1.7% at a quarterly rate); but mining labour costs fell (-0.4%).

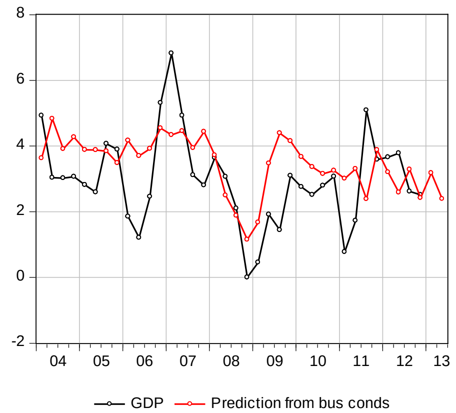
Demand growth to lift marginally in Q2

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



GDP (ex coal) growth to weaken in mid 2013

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



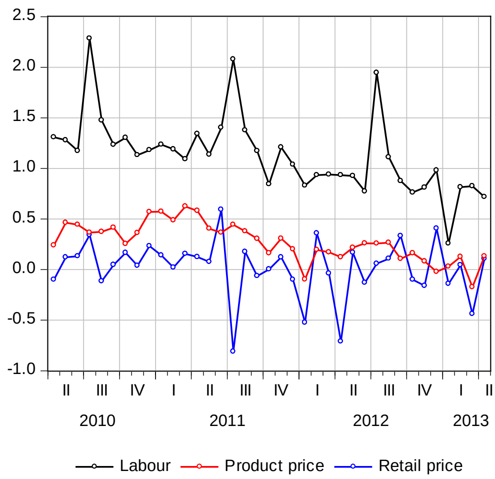
Final product prices rose marginally in April, up 0.1% (at a quarterly rate), after having fallen by 0.2% in the previous month, though remained subdued overall. Part of the pick up in prices was driven by the retail sector, with a solid turnaround in trading activity contributing to a 0.5 ppt turnaround in prices growth.

Prices fell heavily in mining (down 3% at a quarterly rate), which is consistent with heavy declines in commodity prices in the month, particularly for the industrial commodities. Price deflation was also recorded in wholesale and manufacturing, while price inflation was highest in transport & utilities (0.6%) and recreation & personal services (0.5%) – the two top performing industries.

Purchase cost growth eased to 0.4% (at a quarterly rate) in April, largely driven by weaker growth in manufacturing (down 1.2 ppts), wholesale (down 0.5 ppts) and mining (down 0.4 ppts). This was partly offset by a solid rise in retail cost pressures (up 1.0 ppts). Overall, growth in purchase costs was strongest in retail and recreation & personal services (both 0.9%), while costs fell in mining (-0.2%).

Labour costs soften marginally; price growth improves but still subdued

Costs & prices (% change at a quarterly rate)



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

Current business conditions

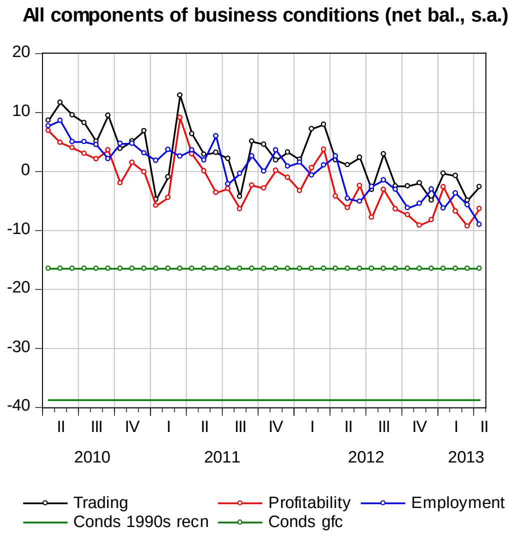
The business conditions index improved only marginally in April – up 1 point to -6 index points. Despite the slight tick up in activity in the month, trend business conditions weakened to -6 index points. That is 11 points below the series average since 1997, implying that the level of activity implied by the survey remains extremely difficult.

Trading, profitability and employment

The April business conditions outcome reflected an improvement in trading conditions and profitability, which was almost entirely offset by deterioration in employment conditions.

The improvement in **trading conditions** was led by the retail (up 26) and mining (up 22) – consistent with a solid increase in capacity utilisation in these sectors – and to a lesser extent manufacturing (up 14). In contrast, trading activity deteriorated heavily in transport & utilities (down 14). In levels terms, trading conditions were most subdued in manufacturing (-22), with the impact of the high AUD still evident, and wholesale (-10) – possibly reflecting still weak forward orders in retail. The strongest conditions were reported in recreation & personal services (+16) and mining (+6).

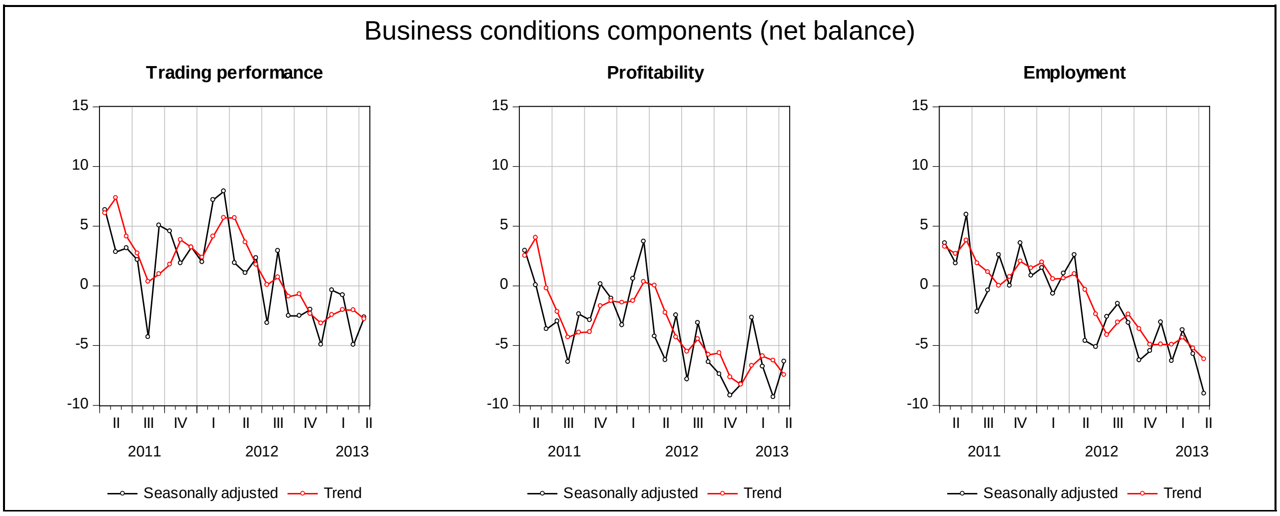
Trading & profitability improve, at the expense of employment



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

The modest improvement in **profitability** in April reflected much better profitability in retail (up 24), manufacturing (up 21) and mining (up 15). However, these improvements in profitability were partly offset by significant deteriorations in finance/ business/ property (down 8), transport & utilities and wholesale (both down 7). While manufacturing profitability posted a remarkable turnaround in the month, this outcome followed the weakest outcome in the history of the series, and the overall level of profitability, at -24 points, is still very poor. Profitability in wholesale (-26) was also very subdued in April, while it was strongest in recreation & personal services (+13) and transport & utilities (+1).

The deterioration in **employment conditions** in April was almost entirely driven by weakness in recreation & personal services (down 12) and construction (down 6), partially offset by solid improvements in transport & utilities (up 7) and mining (up 6). Overall employment conditions were weakest in manufacturing (-16), wholesale (-13) and recreation & personal services (-12); labour costs growth was also strongest in these industries, suggesting high wages growth may be partly responsible for the increased attrition in these businesses. In contrast, employment conditions were strongest (and positive) in transport & utilities (+11). The generally weak employment conditions reported here are broadly consistent with other market base indicators of labour market activity.



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

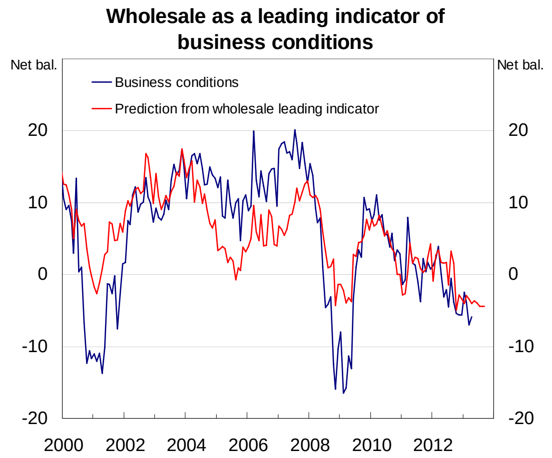
Current business conditions (cont.)

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 April, at just -13 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 April (-15) were to continue though to Q3 2013, overall business conditions could be expected to remain poor, averaging just -4 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 still a concern



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

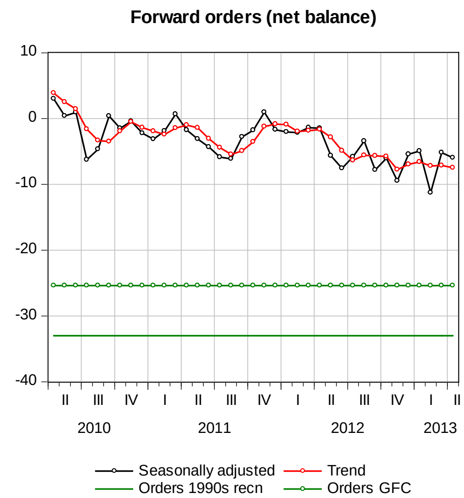
Forward orders

The forward orders index fell slightly in April, after having rebounded from its lowest level since May 2009 in the previous month. At -6 index points, the index is still well below the series long-run average of -1 points (since 1989), providing little indication of a near-term resurgence in domestic demand.

The tick down in forward orders was driven by weakness in construction (down 13), mining (down 10), and manufacturing (down 9) orders, partly offset by a solid improvement in transport & utilities orders (up 9). Orders were strongest (and positive) in transport & utilities (+9), while they were very subdued in construction (-22), manufacturing (-15), mining (-14) and wholesale (-11).

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

New orders still weak

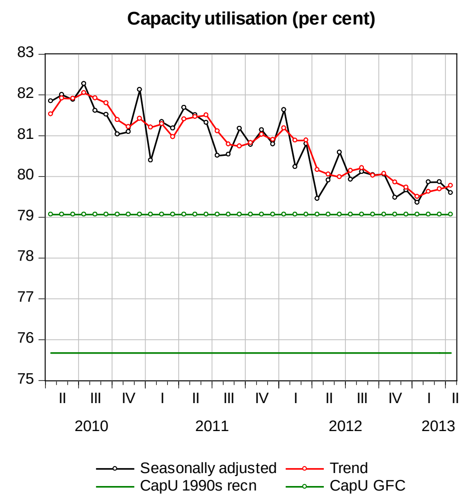


Capacity utilisation

In April, capacity utilisation softened to 79.6%, from 79.9% in March, to be modestly below the series long-run average of 80.4% since 1989. Capacity utilisation rebounded sharply in mining (up 6.2 ppts to 82.5%), more than offsetting a big decline in the previous month, while it also picked up in retail (up 1.7 ppts) and finance/ business/ property (up 1.2 ppts). In contrast, significant falls were reported in recreation & personal services (down 3.6 ppts) and manufacturing (down 1.7 ppts). In levels terms, capacity utilisation was highest in recreation & personal services (83.4%) and mining (82.5%), while it was lowest in manufacturing (72.7%) – near the lowest outcome in the history of the survey – and wholesale (78.2%).

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

Spare capacity on the rise



Current business conditions (cont.)

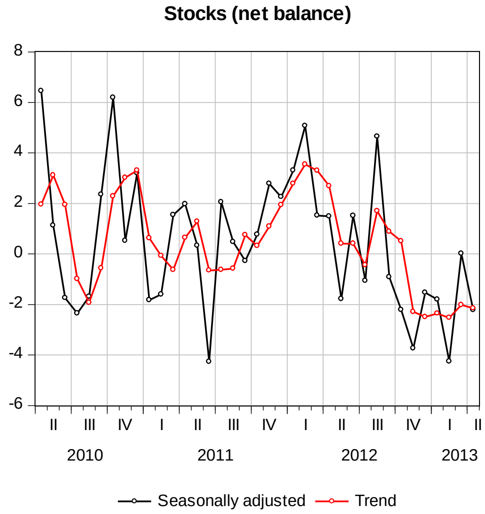
Stocks

The stocks index fell back in April – down 2 to -2 index points – partly unwinding a solid rise in March. In trend terms, the 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 fell significantly in mining (down 14 to -18 points) and wholesale (down 12), while construction and finance/ business/ property were the only industries to report a (modest) rise (both up 2). Part of the run down in stocks implied by the survey may have been involuntary, given the modest improvement in trading activity in the month. The stocks index was highest in retail and finance/ business/ property (both +3), while it was by far the lowest in mining (-18).

Net balance of respondents with a rise in stocks last month

De-stocking activity resumes

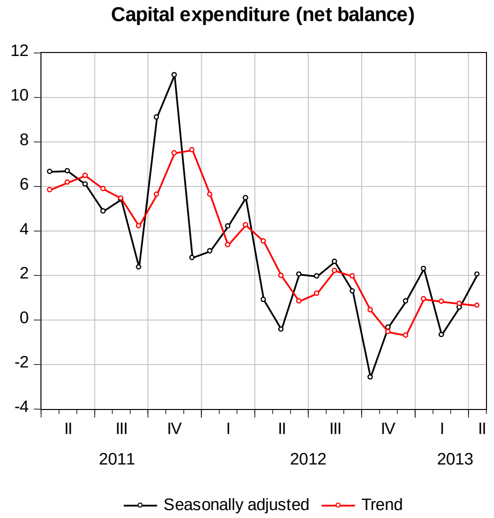


Capital expenditure

The capex index lifted again in April – up 1 to +2 index points. Overall, this level remains relatively low compared to recent history, with the general softness largely reflecting the sharp downturn in mining capex reported over the past year or so. In fact, mining capex reported a sharp deterioration in April, down 12 to -5 points. Capital expenditure fell considerably in retail (down 18 to +1), while it lifted notably in manufacturing (up 9), finance/ business/ property (up 8) and recreation & personal services (up 6). In levels terms, capital expenditure was highest in recreation & personal services and transport & utilities (both +6), while it was lowest in wholesale (-8) and mining (-5).

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

Capex improves but falls back in mining



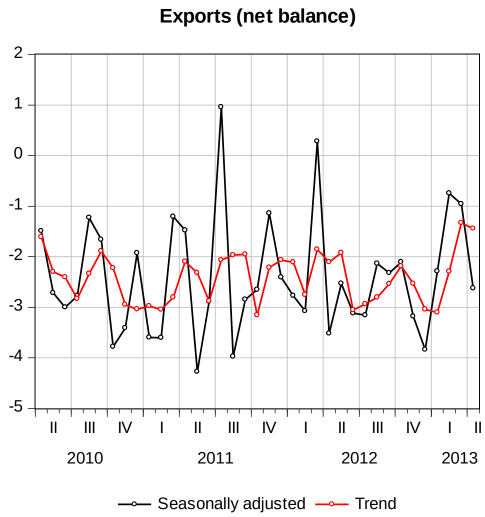
Exports

The exports index, which represents export conditions for the economy as a whole, fell in April – down 2 points to -3 index points. By industry, exports deteriorated moderately in mining (down 4), manufacturing and recreation & personal services (both down 3), while it lifted in transport & utilities (up 8) and wholesale (up 3). In levels terms, the exports index was highest (and positive) in wholesale (+3) and transport & utilities (+1), while it was lowest in manufacturing (-8) and mining (-4), the two largest trade-based industries.

The exporters' sales index, which represents export conditions for exporting industries, also weakened, with the index falling to -10 points, from -5 points in March.

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

Exports deteriorate



Current business conditions (cont.)

Credit availability

Borrowing conditions deteriorated in April, suggesting that lending became more difficult for businesses to access in the month.

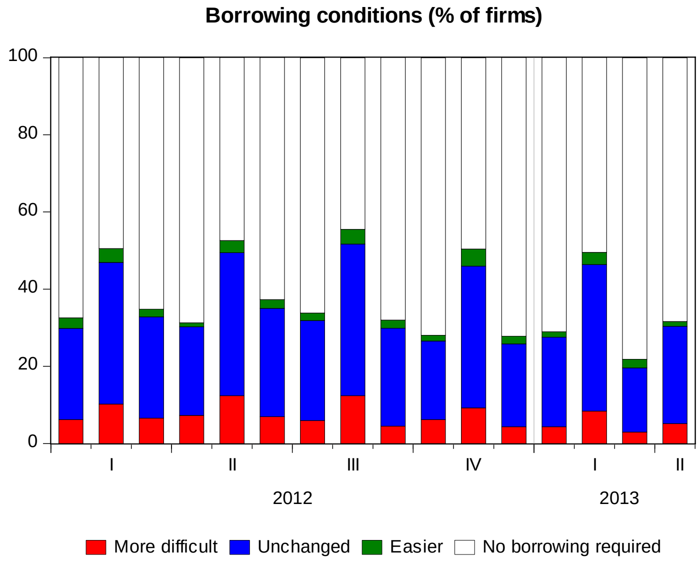
The net borrowing index (easier minus harder) declined from -1 point in March, to -4 points in April. This outcome reflected a solid increase in the proportion of firms finding borrowing more difficult, which was compounded by a slight fall in the proportion of firms finding credit easier to obtain. Overall demand for credit lifted in the month, but remained reasonably soft overall, with just 32% of firms requiring finance in April.

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

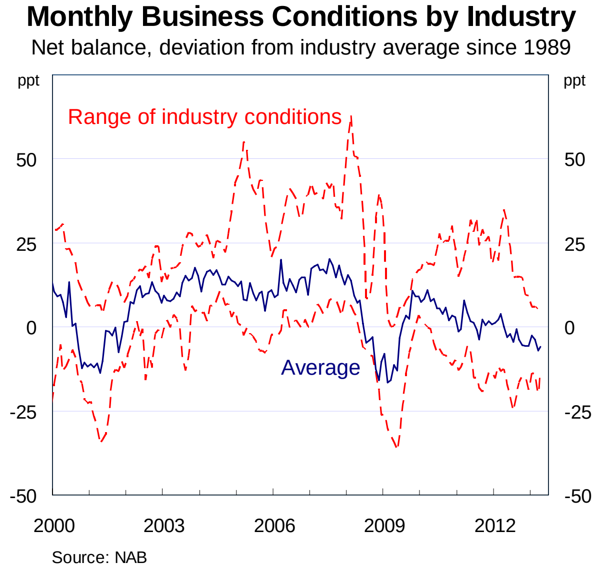
The variation in business conditions across industry has been quite pronounced since late 2009, largely reflecting the relative strength of mining and service related industries compared to the weaker consumer dependant and trade based industries following the GFC. However, the range of industry conditions 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.

Demand for credit lifts, but borrowing conditions more difficult

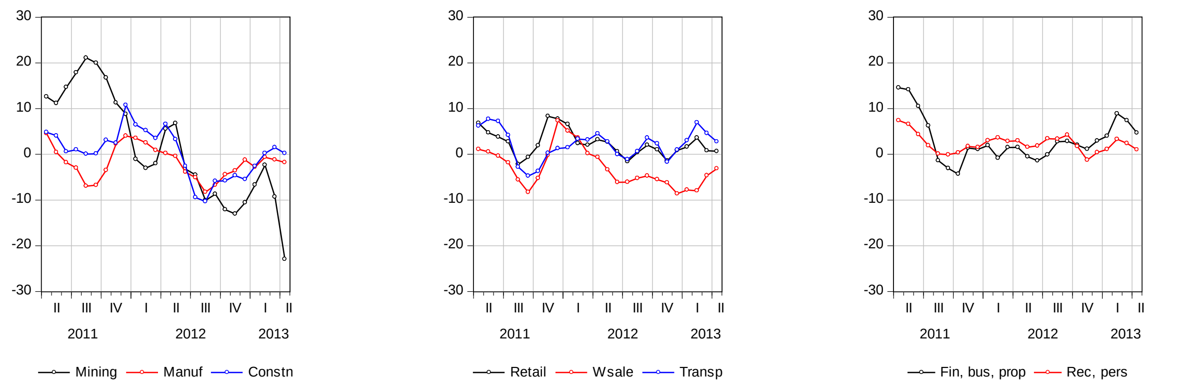


Industry conditions converging to low levels

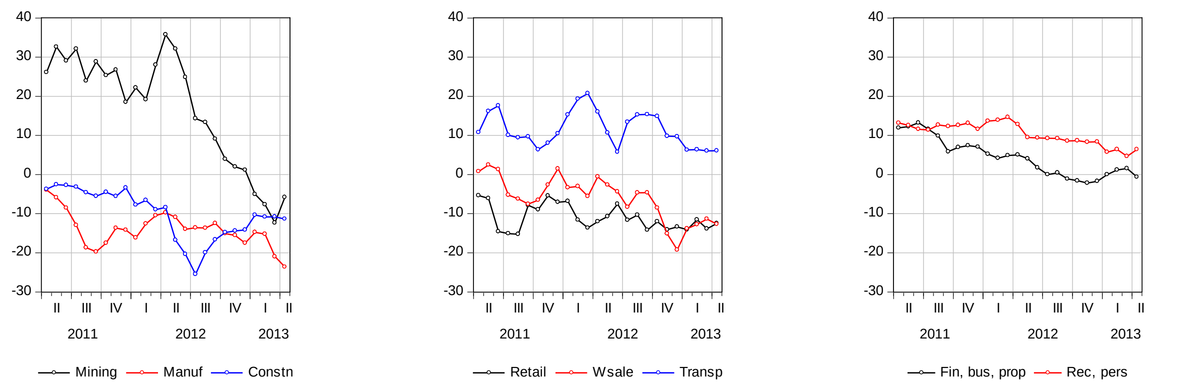


Industry sectors and states

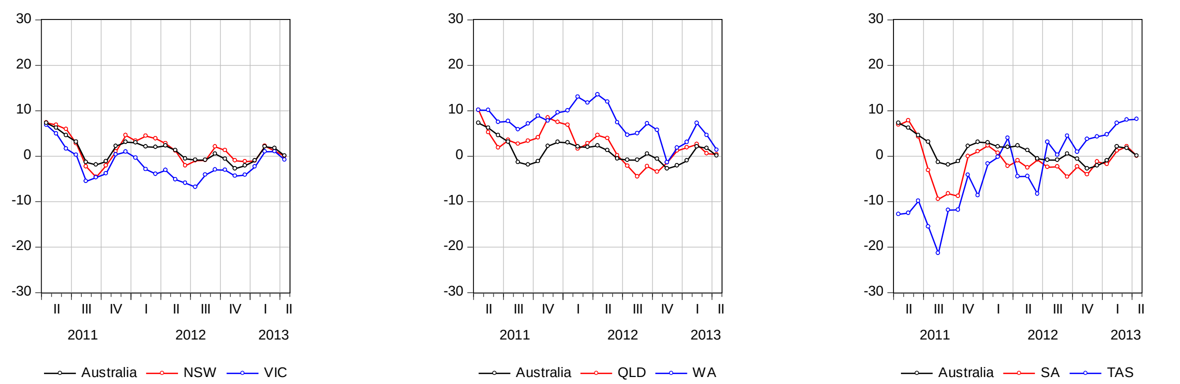
Business confidence by industry (net balance): 3-month moving average



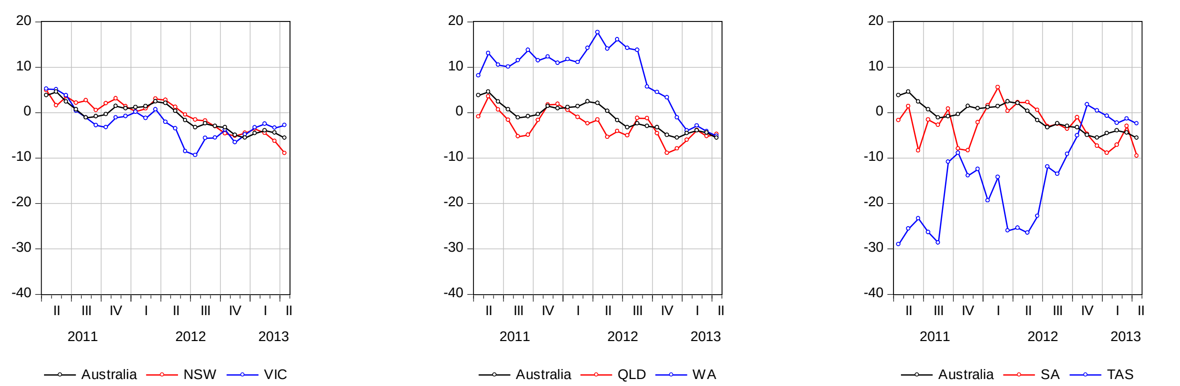
Business conditions by industry (net balance): 3-month moving average



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



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



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